Competition policy and "too big" banks in the European Union and the United States

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This article examines the role of antitrust and competition policy in regulation of large banks made fragile by the financial meltdowns of 2007–09. We compare crisis-related regulation in the European Union and the United States and find that in the European Union, competition policy experts played a key role in applying crisis-related financial regulation, but in the United States they did not. Consequentially, the European Union avoided making banks bigger as a side effect of making weak banks stronger. In the United States, bank consolidation was encouraged. We argue that in the United States, policies to preserve competition should be given a more significant role and made part of an on-going plan that will apply even in a time of crisis. At minimum, the Antitrust Division of the Justice Department should be promptly consulted by the prudential regulators of financial institutions on all matters likely to substantially affect the structure of the financial services industry, including market power issues.

KEY WORDS: *antitrust, competition policy, concentration, consolidation, financial services industry, bank mergers*

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I. INTRODUCTION

In this article, we examine the role of antitrust and competition policy in the regulation of large banks made fragile by the major financial meltdowns of 2007–09. Our view is that bank regulation issues and competition policies are and should be intertwined, even in times of financial crisis, when preserving banking stability is particularly crucial. We agree with Federal Reserve Board Chair Ben Bernanke's observation that "[h]aving institutions that are too big to fail also creates competitive inequities that may prevent our most productive and innovative firms from prospering . . . . [F]irms that do not make the grade should exit, freeing up resources for other uses."[1]

First we look at the approach to regulation during the financial crisis in the European Union (EU) and then in the United States. To summarize our thesis: In Brussels, competition policy experts played a key role in revising financial regulation in response to the global crisis; in the United States they did not. A stronger focus on competition policy in the EU seems to have avoided making banks bigger as a side effect of a regulatory goal of making weak banks stronger. In the United States, on the other hand, bank consolidation was actually encouraged by the government.

Comparison of EU and United States financial regulation stories during the meltdowns brings us to consider the value of competition policy as an aspect of the regulation of large financial institutions. Ben Bernanke's comment implies, and we agree, that competition is a good thing in banking during good times and bad, although we appreciate that the need for banking stability may require some flexibility in competition policy in a time of financial crisis. Competition policy and its coordination with financial regulation should be part of an on-going plan, not subject to impromptu radical adjustment on the fly in a time of crisis. In a time of crisis, competition policy should be compromised as little as practically possible, consistent with preserving stability.

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[1] Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys., Keynote Address at the Independent Community Bankers of America Nat'l Convention: Preserving a Central Role for Community Banking (Mar. 20, 2010), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20100320a.htm.

We believe that the United States can learn from the European experience that competition policy should be given a more significant role in the preparation for and protection against future financial crises. Because banking regulation issues and competition policies are intertwined, we believe that, at minimum, the Antitrust Division of the U.S. Department of Justice (the Antitrust Division) should be promptly consulted by the prudential regulators of financial institutions on all matters that are likely to substantially affect the structure of the financial services industry, including the economic implications of the undue concentration of economic power, broadly understood.[2]

II. COMPETITION POLICY IN THE BANKING CRISIS: A COMPARISON OF THE EUROPEAN COMMISSION AND THE UNITED STATES

A. Europe: Competition policy as part of the solution

Overleveraged positions in complex and overpriced financial products made European financial institutions vulnerable to corrections in asset markets, deteriorating loan performance, and disturbances in wholesale funding markets. The speculative bubble burst in 2007, resulting in a crisis and the effective shutdown of the interbank market. Risk premiums on interbank loans soared. Banks faced a serious liquidity problem. By 2008, the bankruptcy of Lehman Brothers and other fears of company meltdowns led to panic in stock markets. Market valuations of financial institutions collapsed, and investors rushed to such comparatively safe investment alternatives as sovereign bonds.[3]

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[2] We understand that our view is at odds, respectfully, with the views of some eminent antitrust experts, such as Lawrence White, who hold that too-big-to-fail is only about size and interconnectedness, but not about competition and market power. *See* Lawrence J. White, *Financial Regulation and the Current Crisis: A Guide for the Antitrust Community* (June 11, 2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1426188.

[3] EUROPEAN COMM'N, ECONOMIC CRISIS IN EUROPE: CAUSES, CONSEQUENCES AND RESPONSES (2009), http://ec.europa.eu/economy_finance/publications/publication15887_en.pdf. *See also* Iftekhar Hason & Matej Marinč, *Should Competition Policy in Banking Be Amended during Crises? Lessons from the EU*, EUR. J.L. & ECON. (forthcoming), *available at* http://papers.ssrn.com/sol3/papers.cfm ?abstract_id=2212468.

An EU report explains that the "crisis began to feed onto itself, with banks forced to restrain credit, economic activity plummeting, loan books deteriorating, banks cutting down credit . . . . Confidence of both consumers and businesses fell to unprecedented lows."[4]

At this critical juncture, then–EU Competition Commissioner Neelie Kroes stepped in to play a critical role. In 2008 and 2009, as the financial crisis hit Europe, she vigorously championed competition policy as a vital element of the solution to the crisis. Kroes observed that "[i]n the midst of massive government intervention, we need to make sure that we do not—along the way—also lose the level playing field and the future dynamism that comes from competition."[5] Kroes warned that "[g]iving up on competition was the surest way to waste state aid funds and hurt consumers as they began to hurt from job losses, home foreclosures, and the general economic malaise"[6] resulting from the crisis.

The central role played by the Competition Directorate in the financial crisis was an incident of preexisting State Aid jurisdiction rather than the result of ad hoc planning to address the financial crisis. State Aid jurisdiction was something that Commissioner Kroes, and her successor as the Commissioner with the European Commission's competition portfolio, Joaquin Almunia, happened to have in their toolkit and which fortuitously placed them at the center of the crisis. It is a tool we do not have in the United States.

The Treaty under which the European Commission operates makes it the responsibility of the Competition Authority to take

[4] *Id.* at 8.

[5] Neelie Kroes, Comm'r for Competition Policy, European Union, Address before Bundeskartellamt Conference on "Dominant Companies": The Interface Between Regulation and Competition Law (Apr. 28, 2009), *available at* http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CCwQFjAA&url=http%3A%2F%2Feuropa.eu%2Frapid%2Fpress-release_SPEECH-09-202_en.pdf&ei=3jUrUoS2BLa14APKpICIDw&usg=AFQjCNGo66RSnkoFdJDZKFjx1tScvGDv6Q&sig2=2Yy_oWu0irQ7vLVpcr96qg&bvm=bv.51773540,d.dmg&cad=rja.

[6] Neelie Kroes, *Competition Policy and the Crisis–The Commission's Approach to Banking and Beyond*, Competition Policy Newsl. 2010-1, *available at* http://ec.europa.eu/competition/publications/cpn/2010_1_1.pdf.

action against the policies of individual Member States that would give special advantage to local companies, including banks. Any sort of bailout of a bank by a Member State might require the approval of the Competition Directorate and the full College of Commissioners, thus putting the critical initiatives relating to the banking crisis into the Competition Authority, subject to approval by the majority of all commissioners. As Commissioner Almunia told an audience in Washington, DC, "State Aid is the area of competition policy the European Commission uses to make sure that competition in the internal market is not distorted by government action."[7]

The Competition Directorate in fact was geared up even before the financial crisis with lawyers and economists whose expertise and purpose is the handling of State Aid plans of the Member States in ways that minimize disruption of competition. The origin of this administrative structure lies in the desire to create a single market for Europe, which would be undermined if individual Member States could promote their own national champions.[8] When the financial crisis came along, the State Aid staff was expanded to deal with it.

Commissioner Kroes has emphasized that the advantages gained by beneficiaries of State Aid in the context of rescue operations during the financial crisis could enable recipient banks to obtain market power, which would allow them to raise prices and restrict output.[9] Thus, unrestricted bailout measures would cause additional harm to

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[7] Joaquin Almunia, Vice President, Eur. Comm'n, Lewis Bernstein Mem'l Lecture (Mar. 30, 2012), *available at* http://www.montesquieu-institute.eu/9353000/1/j9vvhfxcd6p0lcl/viy8tjhl2nze?ctx=vg9wikc5q2yt&v=1&start_tab0=43.

[8] IOANNIS KOKKORIS & RODRIGO OLIVARES-CAMINAL, ANTITRUST LAW AMIDST FINANCIAL CRISIS 349–70 (2010).

[9] In 2007, Commissioner Kroes stated that the potential negative effects of State Aid required asking, "[D]oes the aid reinforce market power? Does it distort the dynamic incentives of competitors? Does it support inefficient companies?" *See* Neelie Kroes, Eur. Comm'r for Competition Policy, Speech at the Joint EStALI/ESMT Conference: The Law and Economics of State Aid Control—A Commission Perspective (Oct. 8, 2007), *available at* http://europa.eu/rapid/press-release_SPEECH-07-601_en.htm.

consumers and further deepen the recession. Firm competition-based restrictions on State Aid were deemed necessary.

But what role did competition policy actually play in Europe's response to the crisis? Commissioner Almunia reported in 2012 that the EU, when faced with the financial crisis,

> introduced an emergency State aid regime which—with minor changes—still specifies the conditions under which EU governments can use public resources to rescue their banks . . . . Three main goals guide our work; safeguarding financial stability, preserving the integrity of the internal market, and ensuring that the beneficiaries of aid return to long-term viability. For instance, we have asked some banks to move away from unsustainable business models based on excessive leverage and the over-reliance on short-term wholesale funding. In other cases, we have required a downsizing and the simplification of banking structures. Finally, when it was clear that the viability of a bank could not be restored, we proceeded to its orderly resolution.[10]

In the EU practice, as Almunia explains it, competition policy has a central seat at the decision making table: "To all intents, the competition authority of the European Commission has been acting as a crisis-management and resolution authority at EU level, addressing both the emergency situation and the structural problems that had been affecting many European banks well before the crisis."[11]

Almunia summed up concerning State Aid control: "[U]sing State [A]id control, we ensure the restructuring or the orderly resolution of the banks that receive taxpayers' money. We require that they profoundly change their business models so that, in the long run, they can return to operate without more public bail-outs . . . . It is our responsibility to make sure that companies genuinely compete rather than collude and that the markets are transparent, contestable, and open to innovation."[12]

An American Antitrust Institute (AAI) working paper by Jonathan DeVito describes, among other things, how, as a means of preventing inefficient banks from crowding the market to the detriment of

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[10] Almunia, *supra* note 7.

[11] *Id.*

[12] *Id.*

healthy competitors, the Commission required unsound banks to undergo restructuring, including reduction in size or divestment, as a condition of receiving government support.[13]

It is difficult to evaluate with precision how well the EU has succeeded in protecting competition while dealing with the financial crisis.[14] It is important to note, for instance, that there is a distinction between EU policies established and executed in Brussels and the policies or actions of Member States that may not have met the thresholds for community concern. The EU has been criticized for giving too much deference to national authorities that wished to protect local banking interests.[15]

Despite the nearness of time and complexities of evaluation, there are strong indications that EU-level coordination of competition policy and systemic risk regulation had measurable positive benefits in Europe, particularly in avoiding increases in firm size and market consolidation. Gert-Jan Koopman, Deputy Director General for State Aid in the EC Competition Directorate, reports that across the EU as a whole, banking markets do not seem to have become much more concentrated as a result of the EU State Aid regime. Aided banks have not seen their overall share in the market increase.[16]

Criticisms that have been made about the EU level of coordination of competition policy and systemic risk regulation do not appear to undermine Koopman's points about benefits. Some of the reported criticisms, which we note but do not evaluate here, are that in prac-

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[13] Jonathan M. DeVito, *The Role of Competition Policy and Competition Enforcers in the EU Response to the Financial Crisis: Applying the State Aid Rules of the TFEU to Bank Bailouts in Order to Limit Distortions of Competition in the Financial Sector* (AAI Working Paper No. 11-01, 2011), *available at* http://www.antitrustinstitute.org/~antitrust/content/aai-working-paper-no-11-01-role-competition-policy-and-competition-enforcers-eu-response-fin.

[14] For a balanced and detailed assessment of this issue, see Hasan & Marinč, *supra* note 3.

[15] *See id*. (discussing problematic national responses).

[16] Gert-Jan Koopman, *Stability and Competition in EU Banking during the Financial Crisis: The Role of State Aid and Control,* 7 Competition Pol'y Int'l 8 (2011), *available at* http://ec.europa.eu/competition/speeches/text/koopman_cpi_7_2_en.pdf.

tice, the EU did not do all it could to protect banking competition, giving too much weight to the perceived need to stabilize banks with financial aid.[17] Another criticism is that disabling conduct requirements were imposed on aided banks.[18]

The key point remains. It is simply that in Europe systemic regulation and competition policy effectively worked in tandem, and firm size and competitiveness issues were not put into an analytical silo segregated from systemic risk regulation. There is no indication that coordination of regulation with competition policy did harm in Europe, and there are strong indications that it went a long way toward protecting competition in the face of crisis, avoiding unnecessary market consolidation while preserving regulatory goals of good bank performance.

B. *Meanwhile in the United States: Consolidation as a response to the financial crisis*

For a variety of reasons, circumstances in the United States did not lead to a State Aid provision lodged in a competition agency. The U.S. Constitution included an interstate commerce clause over a hundred years before there was a felt need for a federal antitrust statute. Both the interstate commerce clause and its court-created inverse, the "dormant commerce clause,"[19] place some limits on what a state can

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17 Walter W. Eubanks, Cong. Research Serv., The European Union's Response to the 2007-2009 Financial Crisis (2010), *available at* http://www.fas.org/sgp/crs/row/R41367.pdf ("[F]inancial services providers were recapitalized with taxpayer money, a tax subsidy. One of the important consequences is that such tax subsidy created competitive distortion among financial services providers within the European member countries and in the international banking community overall. Yet, the European Commission has continued to extend permission to member countries' governments to continue the subsidies to the financial services industry.").

18 Emily Adler, James Kavanagh & Alexander Ugryumov, *State Aid to Banks in the Financial Crisis: The Past and the Future,* 1 J. Euro. Competition L. & Prac. 66, 69 (2010).

19 Kexin Li, *The Dormant Commerce Clause, Anticompetitive State Regulation, Competition, and Consumers* (AAI Working Paper No. 13-01, 2013), *available at* http://www.antitrustinstitute.org/~antitrust/content/aai-working-paper-no-13-01-dormant-commerce-clause-anticompetitive-state-regulation-competit.

do that would impede interstate commerce. The United States has had a single currency and a Federal Reserve Board for many years. Under these circumstances, legislators did not perceive an urgent need to worry about the competitive effect of subsidies to favored local enterprises, and it apparently never occurred to anyone to create a State Aid jurisdiction, restricting states' rights, not to mention placing it under the antitrust authorities.[20]

Unlike the European Union, where the competition authority enforces State Aid and has a central position in determining what rules and conditions would apply to governmental bailouts of troubled financial institutions, in the United States the central bank (the Federal Reserve Board) and the economic ministry (the Treasury Department) are the dominant players. We have found no evidence that the Antitrust Division had a significant role when the Federal Reserve Board, the Treasury, and other U.S. agencies made crisis-time decisions to encourage the acquisition of weakened financial institutions by stronger ones. It is clear, to be sure, that during this period the Antitrust Division followed statutory procedures and conducted standard reviews of several horizontal bank mergers before quickly approving them.

Treasury officials facilitated the sale of Bear Stearns to JPMorgan Chase, and may have actively imposed the sale of Merrill Lynch to Bank of America. To prevent the macroeconomic fallout from the insolvency of Countrywide, the largest mortgage lender, the Federal Reserve enabled Bank of America's acquisition of Countrywide by relaxing normal capital requirements. The Federal Deposit Insurance Corporation (FDIC) acted in a similar way when it seized Washington Mutual, pursuant to its authority under the Federal Deposit Insurance Act, and sold it to JPMorgan.[21]

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[20] An unfortunate consequence of a lack of restriction is that the American states often vie with each other in a "race to the bottom" to provide subsidies and regulatory incentives to attract corporations. Moreover, the state action doctrine makes it relatively easy for state legislatures to immunize businesses from the federal antitrust laws.

[21] A number of excellent books and articles discuss the crisis in the United States and the response of government agencies. *See, e.g.*, Nat'l Comm'n on the Causes of the Fin. & Econ. Crisis, The Financial & Economic Crisis

The approval by the Federal Reserve Board and other prudential (nonantitrust) regulatory agencies of acquisitions by JP Morgan, Bank of America, and Wells Fargo has substantially increased consolidation in the financial services industry. The *Wall Street Journal* reported that the four biggest U.S. banks by assets—J.P. Morgan, Bank of America, Citigroup, and Wells Fargo—have more than $7 trillion in assets, up more than fifty percent since the end of 2007.[22] "Those gains," said the *Journal*, "came in large part through such crisis-era acquisitions as J.P. Morgan's takeover of failed Washington Mutual Inc., Bank of America's acquisition of mortgage lender Countrywide Financial Corp. and Wells Fargo's purchase of Wachovia Corp."[23] Economist Simon Johnson observed in late 2012 that the "Big Six"—JPMorgan, Bank of America, Citigroup, Wells Fargo, Goldman Sachs, and Morgan Stanley—now have combined assets amounting to sixty percent of gross domestic product.[24] This is a measure of "aggregate concentration" that should be frightening, although when we discuss the relative inactivity of the American antitrust authorities we will see that aggregate concentration is a concept that is virtually ignored by antitrust analysts.

One might ask: Where was the Antitrust Division while the Federal Reserve Board, the Treasury, and other U.S. agencies were approving mergers that greatly increased industry consolidation? As Kevin Kim's working paper for the American Antitrust Institute doc-

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in the United States (2011); Andrew Ross Sorkin, Too Big to Fail (2009); Don Allen Resnikoff, *Resnikoff on 13 Bankers by Johnson & Kwak*, http://www.antitrustinstitute.org/~antitrust/content/book-review-resnikoff-13-bankers-johnson-and-kwak (reviewing Simon Johnson & James Kwak, 13 Bankers: The Wall Street Takeover and the Next Financial Meltdown (2010)). *See also* Kevin Kim, *Competition Policy in the Financial Crisis* (AAI Working Paper No. 12-07, 2012), *available at* http://www.antitrustinstitute.org/~antitrust/content/aai-working-paper-no-12-07-competition-policy-financial-crisis.

[22] Dennis Berman, *Big-Bank Pioneer Now Seeks Breakup*, Wall St. J., July 26, 2012, http://online.wsj.com/article/SB10000872396390444840104577549441815973130.html#articleTabs%3Darticle.

[23] *Id.*

[24] Simon Johnson, *Big Banks are Hazardous to U.S. Financial Health*, Bloomberg.com, Sept. 2, 2013, http://www.bloomberg.com/news/2012-09-02/big-banks-are-hazardous-to-u-s-financial-health.html.

uments, government antitrust enforcers did not utilize the antitrust laws to stop any of these acquisitions, presumably because the enforcers concluded, usually under the pressure of limited time and an air of national emergency, that the narrow requirements of the antitrust laws were satisfied.[25]

The Department of Justice shares merger review jurisdiction with the Federal Reserve, the FDIC, the Office of Thrift Supervision, or the Office of the Comptroller of the Currency, depending on which agency has jurisdiction over the relevant category of banking institution. The Federal Reserve has been the most important of these agencies because of its jurisdiction over mergers involving bank holding companies. In the financial crisis, most of the large bank mergers involved bank holding companies, such as Bank of America, JPMorgan Chase, and Wells Fargo, and thus were subject to review by both the Federal Reserve and the Department of Justice.

The procedure relevant to interagency collaboration is that the acquiring bank first files an application with the Federal Reserve (or one of the other regulatory agencies, as applicable), which will then pass the application on to the Antitrust Division for review. The Federal Reserve or other regulatory agency then reviews the application concurrently with the Antitrust Division.

The analytical approaches of the Antitrust Division are somewhat different from the approaches of the Federal Reserve Board and the other regulatory agencies,[26] but the differences have certainly not obstructed the recent U.S. government tendency to facilitate nationwide consolidation in banking. The Antitrust Division has enabled consolidation through its focus on narrowly defined geographic and product markets at the expense of the broader original spirit of the antitrust laws.

There is, then, a question of why a broader competition policy concern was not advocated by the Antitrust Division with respect to the massive conglomerations. A brief review of antitrust and competition policy in the United States will help us answer that question.

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[25] Kim, *supra* note 21, at 8.

[26] *See* Carl Felsenfeld, *The Antitrust Aspects of Bank Mergers*, 13 Fordham J. Corp. & Fin. L. 507–15 (2008).

III. A BRIEF REVIEW OF ANTITRUST AND COMPETITION POLICY IN THE UNITED STATES

While U.S. antitrust law has roots in a late 1800s and early 1900s "big is bad" political perspective on the newly emerging megacompanies of the day, antitrust law has evolved so that company size does not in itself raise an antitrust problem. For a dominant firm to be found liable for monopolization, anticompetitive or predatory conduct must be established, in addition to possession of monopoly power in a "relevant antitrust market." In the absence of a particularized antitrust problem (such as reduced competition in small business loans within a particularly identified metropolitan area), antitrust laws as currently applied don't stretch to address bank consolidations that simply increase bank size, and also do not address the related too-big-to-fail issue of implied special government support for large banks. Instead, modern Justice Department practice and court decisions generally follow agency-drafted Horizontal Merger Guidelines, which focus narrowly on competitive effects in particular product and geographic markets.

When a financial institution of one sort (such as a commercial bank) acquires one of another sort (such as a brokerage), the transaction is considered conglomerate rather than horizontal or vertical, although there may be secondary horizontal or vertical aspects. Conglomerate mergers were the target of government antitrust enforcement as late as the 1960s, and the subject of major court decisions,[27] but conglomerate mergers are no longer recognized antitrust problems. When an antitrust analyst studies particular markets, it is possible to identify the companies that compete within a given product and geographic market, to calculate market shares for each company (usually but not always based on sales volume), and to show various measures of market concentration. On the other hand, when companies within an industry, such as financial services, engage in a variety of narrowly defined markets, it is more difficult to obtain a generally accepted measure of concentration that takes into account the industry-level similarities of the firms. For example, how would one compare the market share of a commercial bank that owns an insurance

[27] *See, e.g.*, FTC v. Consol. Foods Corp., 380 U.S. 592 (1965), and FTC v. Procter & Gamble Co., 386 U.S. 568 (1967).

company with that of a commercial bank that owns an investment bank and a brokerage? One answer is to assign a broad category definition—financial services institution—that recognizes the overall similarities and to calculate the total revenues of all financial services institutions as a percentage of some national measure, such as gross domestic product.

This measure of aggregate concentration is what the *Wall Street Journal* used in describing the banking sector. It is one reasonable way to compare the distribution of economic assets over time and it may have great political significance. It is an approach with a case law heritage that includes the U.S. Supreme Court's *Philadelphia National Bank* case,[28] which found that a cluster of products and services denoted by the term "commercial banking" constitutes a distinct antitrust product market. But the cluster market doctrine is to a great extent a vestige of the past, and aggregate concentration does not play a significant role today in the enforcement of the antitrust laws.

It is useful at this point to distinguish between antitrust, which is encapsulated in the Sherman Act, the Clayton Act, and the FTC Act, and competition policy more generally. Antitrust is a subset of competition policy. Competition policy, as the term is used in the United States, relates to all of the various governmental laws and regulations that can affect competition, including banking and other sectoral regulations. Competition policy encompasses issues of firm size, including too-big-to-fail banking issues, drawing on the expertise of antitrust lawyers and economists as well as sectoral specialists.

Competition policy often comes into play when an agency has a "public interest" objective as one of its statutory functions. Antitrust agencies typically carry out a competition policy function when they engage in competition advocacy before other agencies of government or Congress. This is an important, well-recognized, albeit discretionary, function of the Antitrust Division, as explained in the Antitrust Division Manual published in 2012.[29]

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[28] United States v. Phila. Nat'l Bank, 374 U.S. 321 (1963).

[29] U.S. DEP'T OF JUSTICE ANTITRUST DIVISION MANUAL, COMPETITION ADVOCACY, *available at* http://www.justice.gov/atr/public/divisionmanual/chapter5.pdf.

The Federal Trade Commission also engages in competition advocacy.[30]

The merger enforcement policies of the Antitrust Division have narrowed in a way that focuses almost exclusively on predicted near-term competitive effects (most often relating to price increases) in narrowly defined product and geographic markets. This restricted focus has supported the short shrift that the Federal Reserve Board and other U.S. regulatory agencies give to concerns about bank size and industry consolidation. Yet, this analytical framework in mergers should not reduce the Antitrust Division's role of advocating for a more comprehensive competition policy that applies its accumulated expertise in market structure, firm behavior, and industry dynamics. It is the potential of applying competition advocacy to the problems of aggregate concentration in our financial institutions to which we now turn.

IV. COMPETITION POLICY AND ISSUES OF FIRM SIZE

We will offer concrete suggestions on bringing competition policy to bear on regulation of financial institutions, but we start with a discussion of issues relating to large firm size that should fit within the ambit of competition policy. We do so with an awareness that competition policy and regulation intertwine and affect one another in subtle and complex ways, so much so that we suggest the need for a conference of antitrust and financial regulators to develop agreement on guidelines for coordination of competition policy and regulation in crisis situations. The skewing effect on competition caused by government support of too-big-to-fail banks is but one example of the ways in which regulation affects competition. Deposit insurance and Federal Reserve Board lending policies will affect the ability of particular banks to compete, as will regulatory requirements that impose managerial standards or capital requirements.

Following is a brief list of some relevant too-big issues that are within the ambit of prudential regulation, but which we think should be considered as also being within the ambit of competition policy.

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30 *See* FED. TRADE COMM'N, ADVOCACY FILINGS BY DATE, http://www.ftc.gov/opp/advocacydate.shtm.

- *Large financial firms are able to charge artificially high prices in particular markets*

  This is a microeconomic concept that requires identifying specific product and geographic markets and then determining the nature of competition within them. The antitrust laws prohibit firms from increasing their market power in specific markets through mergers and acquisitions. This is the area, previously described, in which the U.S. government's antitrust resources are focused.

- *Large financial firms are too big to fail*

  This critique implies that the domino-like consequences of a financial institution's failure would be so expansive and disruptive that governments will do whatever is necessary, including the provision of massive amounts of taxpayer money, in order to keep a failing megabank in business. And the investment community's assumption that failure is unthinkable for the largest institutions apparently reduces the perceived risk of lending to them, resulting in lower interest rates and a competitive advantage over rivals.[31] The problem involves systemic risk, which may be contained and reduced by downsizing, or raising reserve requirements. The legislative proposals of Senators Brown and Vitter to increase reserve requirements respond to this critique.[32] Federal Reserve Governor Daniel K. Tarullo supports a similar approach.[33]

- *Large financial firms are too interconnected with the economy*

  This is the problem of systemic risk expressed in terms of connectedness rather than size. Interconnectedness often seems to be linked to great risk taking. Remedies might include downsizing by hiving off noncore assets. A Glass-Steagall type of silo approach could separate functions like commercial and investment banking.[34] Closer regulation of risk taking is another relevant remedy.

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[31] Michael Kling, *Independent Community Bankers: U.S. Must End Too Big to Fail,* MONEY NEWS.COM, May 24, 2013, *available at* http://www.moneynews.com/FinanceNews/ICBA-banks-too-big-to-fail-Brown-Vitter/2013/05/24/id/506290.

[32] Peter Eavis, *A New Fed Thought for "Too Big to Fail" Banks: Shrink Them*, N.Y. TIMES, May 4, 2013, at B5 (discussing both the Brown-Vitter proposal and proposals by Federal Reserve Board Governor Tarullo).

[33] Daniel K. Tarullo, Bd. of Governors, Fed. Reserve Sys., *Evaluating Progress in Regulatory Reforms to Promote Financial Stability*, May 3, 2012, *available at* http://www.federalreserve.gov/newsevents/speech/tarullo20130503a.pdf.

[34] Floyd Norris, *Bank Rules that Serve Two Masters,* N.Y TIMES, Oct. 14, 2011, at B1.

- *Large financial firms are often too big to jail*

  Some regulators, including Attorney General Eric Holder and Lanny Breuer, former Assistant Attorney General for the Criminal Division of the Department of Justice, have expressed concerns that strong enforcement actions against certain very large financial institutions could cause the failure of the institution—a consequence so dire as to discourage vigorous criminal enforcement.[35] Remedies for "too big to jail" could include downsizing of financial institutions by regulators and fashioning penalties that are severe s without bringing down the company itself.

- *Aggregate concentration and great economic power provide large firms with economic advantages not captured by microeconomic analysis of whether market power exercised in antitrust markets causes elevated prices*

  Although we observe that a small number of financial institutions control a very high percentage of the U.S. national banking market, this does not necessarily imply that there is a high level of concentration in disaggregated product markets such as markets for residential mortgages in particular geographic areas. Aggregate concentration, although once believed to be important,[36] today (as we have explained) plays no role at all in antitrust enforcement. Aggregate concentration was once thought to be a useful indicator of economic power—the ability to influence the national economy through conduct with economic effects other than high prices in particular markets.[37] A remedy for too much aggregate or economic

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[35] *See, e.g.*, Danielle Douglas, *Attorney General Says Big Banks' Size Inhibits Prosecution*, WASH. POST, Mar. 7, 2013, http://articles.washingtonpost.com/2013-03-06/business/37500594_1_criminal-charges-hsbc-case-swiss-bank; Sen. Bernie Sanders, *Too Big to Jail?*, HUFFINGTON POST.COM, Mar. 28, 2013), http://www.huffingtonpost.com/rep-bernie-sanders/too-big-to-jail_b_2973641.html; Randall W. Forsyth, *Too Big to Jail*, BARRONS.COM, Mar. 9, 2013, http://online.barrons.com/article/SB50001424052748704836204578340381145471280.html#articleTabs_article%3D1; Danielle Douglas, *Lanny Breuer, Justice Department Criminal Division Chief is Stepping Down*, WASH. POST, Jan. 23, 2013, http://www.washingtonpost.com/business/economy/doj-criminal-division-chief-stepping-down/2013/01/23/e4331e32-64e0-11e2-b84d-21c7b65985ee_story.html.

[36] F.M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE (1990).

[37] WALTER ADAMS & JAMES W. BROCK, THE BIGNESS COMPLEX: INDUSTRY, LABOR AND GOVERNMENT IN THE AMERICAN ECONOMY (2d ed. 2004).

power is reduction of economic power through downsizing of the largest institutions. A forward-looking remedy would be to legislate limits on firm size, thereby directly reintroducing the world of conglomeration to competition policy.

- *"Resolution" (a bankruptcy-like proceeding) is much more difficult for large failed financial institutions than for small ones*

  As Federal Reserve Board Governor Jerome Powell said in a recent speech, "[t]oday's global financial institutions are of staggering size and complexity."[38] Powell initially believed that "an attempt to resolve one of these firms . . . could trigger or accelerate a run on the failed institution that could quickly spread and destabilize the whole system."[39] Powell subsequently developed a more optimistic view of resolution possibilities based on the FDIC's approach, but the insight remains that big financial institutions are more difficult to resolve than smaller ones.

- *Large financial firms command too much political power*

  Large economic power may shade over into political power. Examples could include political contributions, the ability to employ lobbyists and public relations agents on a large scale, and domination over trade associations through the payment of large fees and the provision of dedicated staffing. Remedies can include downsizing but might more directly relate to rules on political behavior, such as limitations of campaign financing.

- *Large institutions are often too big to manage*

  As organizations grow larger, they grow more complex, raising the probabilities of internal communication failures, loss of control over agents, and an inability of top management to see and comprehend all it needs to.[40] Remedies might include restructuring toward less complexity, or downsizing.

Several observations can be drawn from this brief survey of complaints about the concentration of financial services institutions. Encouraging a larger number of players of smaller size would seem to

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[38] Jerome H Powell, Bd. of Governors, Fed. Reserve Sys., *Ending "Too Big to Fail,"* Mar. 4, 2013, *available at* http://www.federalreserve.gov/newsevents/speech/powell20130304a.htm.

[39] *Id.*

[40] THOMAS H. STANTON, WHY SOME FIRMS THRIVE WHILE OTHERS FAIL, GOVERNANCE AND MANAGEMENT LESSONS FROM THE CRISIS (2012).

be, in general, a positive step. But because the size problem is not a single problem but a nettle of problems, it will take a variety of approaches to create an effective remedy.

For competition policy, the most important remedial concern is maintaining a level playing field where government does not provide artificial and competitively unhealthy assistance to large but financially weak companies. But the other concerns listed here are relevant to regulation and competition policy issues. For large financial institutions, concerns about the degree of systemic risk associated with size and interconnections are particularly important.

Other concerns include whether large banks should be required to downsize, based on the argument, vigorously disputed by some, that economies of scale for particular banking markets are exhausted at a rather small size, as argued by Andrew G. Haldane.[41]

Finally, antitrust law as currently theorized and practiced plays a minor role focused on narrowly defined antitrust markets, but we think the role of traditional antitrust could be expanded and refocused in the future to be more effective, particularly where markets have become more concentrated and firms more complex.[42]

Meanwhile, competition policy can play a major role in developing remedies because of its broader scope.

V. LOOKING TO THE FUTURE

A financial crisis of the magnitude of 2007–09 is something that governments should constantly strive to avoid, of course, but governments should also become better prepared to handle similar crises in the future. The main argument of this article is that nations—including the United States—should learn from the Euro-

41 Andrew G. Haldane, Exec. Dir., Financial Stability and Member, Fin. Policy Comm., Address to Inst. Econ. Affairs' 22nd Annual Series, The 2012 Beesley Lectures: On Being the Right Size (Oct. 25, 2012), *available at* http://www.bankofengland.co.uk/publications/Documents/speeches/2012/speech615.pdf.

42 How the role of traditional antitrust could be expanded and refocused in the future so as to be more effective is an important and interesting topic, but outside of the scope of this article.

pean experience that competition policy must be assigned a seat at the decision-making table. Competition policy and prudential regulation are intertwined, and coordination between them must be improved in a way that hasn't yet happened in the United States. As we've suggested, a conference of antitrust and financial regulators to develop forward-looking agreement on guidelines for coordination during times of financial crisis would be a sensible first step. In the next crisis, will the priority be on fostering further concentration or on maintaining as much competition as is compatible with quickly resolving the crisis?

We have several concrete proposals addressed to provisions of the Dodd-Frank Act that already touch on competition policy issues. These Dodd-Frank provisions now apparently operate without significant input from the Antitrust Division or the FTC, agencies with relevant expertise.

For example, section 165 of Dodd-Frank "requires that the Federal Reserve establish a special set of prudential requirements for bank holding companies with more than $50 billion in assets."[43] The special set of prudential requirements applies to bank holding companies and other designated nonbank entities. On April 11, 2012, the Financial Stability Oversight Council, a group of officials operating under Treasury supervision, published a final rule stating how nonbank financial institutions in addition to bank holding companies are to be identified as systemically important. Financial institutions that are designated as systemically important will be supervised by the Federal Reserve Board in the same manner that it supervises bank holding companies with $50 billion or more in assets. The supervision applies "enhanced prudential standards," which are more rigorous than standards used for entities not designated as systemically important.

The Financial Stability Oversight Council was established pursuant to the Dodd-Frank Act to provide recommendations concerning stability issues. The statute does not provide that the Antitrust Division or other competition policy experts be included on the

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[43] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 165. The section is titled *Enhanced Supervision and Prudential Standard for Nonbank Financial Companies Supervised by the Board of Governors and Certain Bank Holding Companies*.

Council. Voting agencies on the Council are the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission, the FDIC, the Federal Housing Finance Agency, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Securities and Exchange Commission, the Treasury Department, and the Consumer Financial Protection Bureau, along with an independent appointed member with insurance expertise. There are also five nonvoting advisor participants: the Office of Financial Research, the Federal Insurance Office, a state insurance commissioner designated by the state insurance commissioners, a state banking supervisor designated by the state banking supervisors, and a state securities commissioner designated by the state securities commissioners.

Because so many of the issues that will be considered by the Council have competition policy implications, the Antitrust Division should be included as a voting member.

The Dodd-Frank Act contains additional significant provisions relevant to bank size and competition issues, and they too should be better applied, or perhaps modified, so that competition considerations are given greater weight and competition policy input from Antitrust Division people is encouraged.

Section 622 of Dodd-Frank contains a financial sector concentration limit, although Federal Reserve Board Governor Tarullo complains that it is based on a "somewhat awkward and potentially shifting metric" that he believes should be improved. "There is, then, a case to be made for specifying an upper bound" on size, Tarullo has said.[44] The role for competition policy input is obvious.

Section 121 of the Dodd-Frank Act, titled Mitigation of Risks to Financial Stability, grants regulators "very broad scope for dealing with a large bank holding company or designated nonbank financial company that 'poses a grave threat to the financial stability of the United States,'" including power to (1) limit the ability of the

[44] Daniel K. Tarullo, Bd. of Governors, Fed. Reserve Sys., Distinguished Jurist Lecture, University of Pennsylvania Law School: Financial Stability (Oct. 10, 2012), *available at* http://www.federalreserve.gov/newsevents/speech/tarullo20121010a.htm.

company to merge with, acquire, consolidate with, or otherwise become affiliated with another company; (2) restrict the ability of the company to offer a financial product or products; and (3) require the company to terminate one or more activities. Again, competition policy input from the Antitrust Division is obviously relevant.

More broadly, we suggest that Dodd-Frank be amended to specify that the Antitrust Division will be promptly consulted on all matters that are likely substantially to affect the structure of the financial services industry or any part thereof. And the Antitrust Division, in this context, should be required to consider the economic implications, *including the undue concentration of economic power broadly understood*, in any such matter. While these objectives can in theory be accomplished without new legislation, recent experience unfortunately gives little reason to expect any change without a shove from Congress.

The Antitrust Division is relevant for several reasons. It is independent; that is, unlike the sectoral regulators, it has no statutory responsibility for the well-being of the banking industry. It can be an advocate for policies that protect competition in the broadest sense. Its attorneys and economists have particular expertise in such areas as the relationship between competition and regulation; the comparison of various remedies in terms of their impact on markets; and the structuring and enforcement of divestitures and behavioral conditions.

Our basic recommendation of an enhanced role for competition advocacy does not require that the Antitrust Division be given any sort of veto on policies adopted by the executive branch during a crisis. Similarly, it is not necessary that the Division be able unilaterally to slow down the decision process in a crisis. Our basic point is simply that competition advocacy should be formally recognized and entitled to timely and full information and an opportunity to provide expert opinion when decisions are being made. It is not even necessary that the Division be given an enhanced role in financial rule making or antitrust enforcement in the financial institutions arena, although we hope this will occur.

Our comparison of the role of competition policy during the financial crisis in the EU and the United States demonstrates the importance of a government determining in advance whether it will use the next crisis to maintain competition, enhance competition, or promote consolidation.