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It's Time to Let Banks (Even Big Ones) Compete

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Executive Summary

One would have thought that by now all of the artificial barriers that prevent banks and other financial service firms from competing would have been removed. In the 1990s, Congress enacted two sweeping financial deregulation bills, the Riegle-Neal Interstate Banking and Branching Act of 1994 that finally treated banks like other firms in the economy and let them operate nationwide, and the Gramm-Leach-Bliley Act, which permitted banks to affiliate with a broad range of other financial service firms.

The 1994 Act contained one seemingly minor restriction, however: fearing that interstate authority would lead banks to engage excessively in mergers, Congress put caps on the share of domestic deposits that any banking organization could hold: 10 percent nationwide, 30 percent in any individual state (subject to modification by individual states). These numbers were chosen arbitrarily – the national cap in particular has no rationale in antitrust law or economics – but, at the time, they also seemed relatively innocuous, since no depository institution then had deposits that put it even close to either cap.

That is no longer true today. Several banks have domestic deposits that are nearly at or close to the nationwide cap. This essay argues that now that the caps are binding, or nearly so, they are also counterproductive. They artificially encourage U.S. banking organizations to expand into non-banking businesses and abroad, while giving foreign banks an artificial advantage in bidding for U.S. banks. Furthermore, by limiting the ability of banks to compete and expand, the caps are detrimental to the interests of the consumers they presumably were designed to protect.

Congress can correct this situation, ideally by removing both caps, and subject depository institution mergers to the same legal standards that have long applied to mergers among firms in other industries. As fallback measures, Congress could repeal just the national cap and/or could change the way the nationwide cap is calculated, to make it less inimical to the interest of consumers.

It's Time to Let Banks (Even Big Ones) Compete

Robert E. Litan

1. Text

The last two decades have seen a revolution in the financial services industry -- banking in particular -- unleashed in large part by major federal legislative changes.

In 1989 and 1991, after a rash of failures of banks and savings and loans, Congress toughened capital standards for depository institutions, or requirements that these institutions back a set percentage of their deposits with shareholders' money. Bank and thrift failures have fallen dramatically since then.

In 1994, Congress took a similarly bold step and, for the first time in the nation's history, put banks on the same footing with other companies by allowing them to operate in multiple states – that is, to set up "branches" in other states that did not affirmatively "opt out" of this interstate system. Up to that time, banking organizations could operate in multiple states only through "holding companies" that owned separately chartered banks, each with its own boards of directors and officers and various regulatory limitations, in each state. Interstate branching dispensed with the need for this cumbersome structure and allowed a single bank to operate throughout the country (subject to states opting out of the system).

In 1999, Congress went even further, and after a nearly two decade-long debate, allowed banks and financial companies to own each other through a new "financial holding company" authorized by the Gramm-Leach-Bliley Act (GLBA).[1] The results of GLBA, however, have been relatively disappointing, since only a handful of major companies have taken full advantage of the Act's permissions, and the one "poster child" for the Act – Citigroup – actually has retrenched somewhat in recent years, selling off parts of its insurance underwriting business.

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[1] GLBA amended the Bank Holding Company Act, which granted bank holding companies limited abilities to move into other financial businesses, and effectively repealed the Glass-Steagall Act of 1933, which had separated commercial and investment banking, but whose restrictions had been somewhat relaxed through regulation in the late 1980s and 1990s by the Federal Reserve Board. The GLBA also permitted the new financial conglomerates to own insurance underwriters and agents.

Nonetheless, in combination, the foregoing legislative changes have led to sweeping changes in the financial services industry, banking in particular. Many more banks are operating in multiple states, and some are allied with other financial activities, (although for political reasons, banking organizations are still being stopped from providing real estate brokerage services, a natural financially-related activity where banking organizations could provide helpful competition).[2] It would seem, therefore, that not much remains to be done on the public policy front to permit financial service companies the same or similar degree of competitive freedom that non-financial enterprises enjoy.

This is mostly right, but not entirely. The Riegle-Neal Act, while broadly enabling interstate branching, also prohibits any interstate merger in which the resulting banking organization (including a bank and its affiliates) would control more than 10 percent of the nationwide deposits of "insured depository institutions" (insured banks and savings and loans, and insured U.S. branches of foreign banks), or more than 30 percent of such deposits in any particular state (although the states are permitted to set higher or lower statewide caps). These arbitrary restrictions on bank expansion were inserted into the Act to assuage concerns at the time that, without the deposit caps, some banks could eventually dominate the U.S. banking market – despite the fact that the antitrust laws would continue to apply and the long record of the Justice Department's Antitrust Division and the federal banking agencies in challenging bank mergers up to that time that, like mergers in any other industry, threatened competition.

This essay argues that if the caps were ever justified they are not now, and in fact, are generating perverse results. Ideally, the caps – the nationwide cap in particular – should be removed. The antitrust laws, and the agencies that enforce them, are fully adequate to address any concerns about undue banking concentration. Should Congress not go this far, the essay outlines alternatives that would ease the current restrictions, thereby reducing their counter-productive impacts and enhancing competition in banking and financial markets.

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[2] See Robert Hahn, Robert E. Litan, and Jesse Gurman, 2005. "Paying Less for Real Estate Brokerage: What Can Make It Happen?" AEI-Brookings Joint Center Working Paper, 05-11, June.

2. The Deposit Caps: Background

The notion that the federal government should cap deposit shares of banks was first placed on the Congressional agenda in 1991, when Congress was considering the Federal Deposit Insurance Corporation Improvement Act ("FDICIA"). Ultimately, Congress enacted FDICIA – which clarified capital standards for banks – but without any caps (which passed the Senate but not the House). The same national (10 percent) and state-specific caps (30 percent) that were considered in 1991 again surfaced three years later when Congress was considering the removal of the long-standing restrictions on interstate branching. This time, the caps were included in the final Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, and were defined only on the basis of a bank's percentage of national insured deposits, excluding such functional equivalents of bank deposits as money market fund balances and credit union deposit accounts.

An obvious question is why Congress believed that specific caps were necessary. After all, in 1994, the national banking market was hardly concentrated. As shown in Table 1, the largest bank holding company in the United States then had less than 4 percent of national deposits held in banks and thrift institutions.

Table 1
Top Nationwide Domestic Deposit Shares, Bank Holding Companies
June, 1994

Organization	Deposits (Billions)	Percentage
BankAmerica	118	3.7
NationsBank	85	2.7
Chemical Bank	70	2.2
Banc One	61	1.9
Citicorp	55	1.8
First Union	51	1.6
First Interstate	47	1.5
Keycorp	44	1.4
Wells Fargo	41	1.3
Chase Manhattan	37	1.2

Source: FDIC Summary of Deposits

Of course, it is difficult to look into the minds of "Congress" – a body of 535 elected officials – for what it intended in any piece of legislation. Courts typically look to the language of the Committee reports on particular pieces of legislation, as well as floor statements of bill sponsors, for clues. In this particular case, there is little to go on. The Senate Committee Report in connection with FDICIA, where the concentration issue was earlier considered, says simply that "relaxing historical restrictions on interstate banking is not intended to allow large banks to acquire *undue financial power* nationwide or in individual states."[3] [italics added]. A similar broadly defined concern about financial power must explain why, since the 1994 Act was enacted and as of year-end 2005, 13 states had enacted lower statewide caps than 30 percent, while 6 had set higher caps, as shown in Table 2 (All of the rest of the states had either adopted the 30 percent cap in Riegle-Neal or defaulted to it).

[3] *Comprehensive Deposit Insurance Reform and Taxpayer Protection of 1991*, Report of the Committee on Banking, Housing, and Urban Affairs, United States Senate (Washington, D.C. : U.S. Government Printing Office), p. 72. It was also well known at the time, of course, that smaller banks and state banking supervisors had opposed interstate branching. See Edward J. Kane, 1996. "De Jure Interstate Banking: Why Only Now?" *Journal of Money, Credit and Banking*, Vol. 28, No. 2, May, pp. 141-61.

Table 2
State Deposit Cap Laws Different From The 30 Percent Cap

	Cap Level
Increased Cap	
Hawaii	None
Idaho	None
Michigan	None
Utah	None
Alaska	50%
New Mexico	40%
Lowered Cap	
Arkansas	25%
Mississippi	25%
West Virginia	25%
North Dakota	25%
Colorado	25%
Montana	22%
Oklahoma	20%
Texas	20%
Ohio	20%
Iowa	15%
Kansas	15%
Kentucky	15%
Nebraska	14%
Missouri	13%

Source: Compiled from data provided by the American Bankers Association

But what is “undue financial power”? The conventional answer would be that power is “undue” when a firm has the ability to affect price or output, or in other words, what is known in the antitrust world as “market power.” Yet the most used antitrust test for market power -- the joint merger guidelines of the Justice Department and the Federal Trade Commission, which have been in place since the early 1980s -- implies market share thresholds that would be well above the 10 percent nationwide deposit market share cap. In particular, the joint guidelines define a market as “highly concentrated” – and thus having firms that are most likely to be able to exercise some power over price or output –

only where the sum of the squared deposit shares of firms in the market is over 1800.[4] The lowest firm-specific market share to which this definition corresponds is roughly 20 percent, or double the 10 percent nationwide deposit share limit in Riegle-Neal.[5]

An even more fundamental problem with nationwide or statewide deposit caps exists, however. As already noted, the antitrust laws already prohibit banking organizations from merging where the effect would be to substantially lessen competition in any relevant banking market (or to create a monopoly in any such market). What is a "relevant banking market"? Courts and the agencies consistently looked to *local areas* – cities and towns where banks compete – and not to the state or national level. This reflects a fundamental reality that for most customers, whether placing deposits or seeking loans, banking is like politics: all the action is local. Furthermore, it is at the local level where banking markets historically have been much more concentrated than at the state or national levels, and accordingly, in many instances in the past where banks have applied to merge, the Justice Department and/or the banking agencies have required the acquiring bank to divest certain offices to ensure that competition will not be threatened by the merger.[6]

In contrast, those banking customers who look to national banks tend to have many more choices, where banking is not only less concentrated than in local markets, but also many borrowers in particular have alternatives to banks for funds. Smaller companies can turn to finance companies or insurers for loans. Larger, public companies have been increasingly turning to the securities markets to raise capital rather than banks.

So what could justify Congress picking on the banking industry in particular (broadly defined to include thrift institutions) and placing market share limits on mergers that are more strict than for any other industry in the U.S. economy? This question seems especially salient given the possibility that banks with a broader national presence (one

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[4] This definition and the calculation that goes with it is referred to as the "Herfindahl-Hirschman Index."

[5] For example, suppose the nationwide banking market consists of just five banks, each with a 20 percent share. The square of 20 percent is 400, which multiplied by 5 would equal 2000, or a figure just above the HHI threshold of 1800.

[6] See, e.g. Dean F. Amel, 1997. "Antitrust Policy in Banking: Current Status and Future Prospects," *Proceedings of the 33rd Annual Conference on Bank Structure and Competition* (Chicago: Federal Reserve Bank of Chicago). In this regard, it is noteworthy that the Riegle-Neal Act does not seem to permit banks involved in a merger that would otherwise violate the 10 percent deposit market share cap to avoid exceeding the ceiling by arranging, as part of the merger, for appropriate divestitures.

that would likely require them to exceed the 10 percent deposit market share cap in the Rielge-Neal Act) may improve consumer welfare by enabling their deposit and lending customers to have the convenience of using the same bank, whenever they move, temporarily or permanently, and to firms that establish new locations within the country.

Below I outline and then analyze several concerns that have been discussed from time to time over the years, including the period when Riegle-Neal was considered. I conclude that these concerns today are without basis, and that even if one or more had some justification, they should be balanced against the offsetting costs and counter-productive impacts that the current deposit market share caps are having.

3. Analyzing Possible Rationales for the Deposit Market Share Caps

To go beyond the antitrust laws, and to impose tighter merger restrictions for banks than for any other type of firm in the U.S. economy, policy makers should have more than broadly stated concerns or fears of "undue concentration" because, in principle, such vaguely worded concerns could be voiced about other industries. So, why single out banks? I can think of three possible reasons.

To prevent concentration of undue political power

One possible reason is that depository institutions in a highly concentrated market may wield an undue amount of political power, and thus caps could be a way of preventing this problem from arising. There is some history relevant to this concern. Neither the federal or state governments, after all, allowed banks to branch across state lines for roughly 200 years, which at least implicitly suggests that policy makers at all levels have long feared the power of large banks. Indeed, in 1836, Congress did not renew the charter for the Second National Bank of the United States (there was a First National Bank as its predecessor) out of concern that too much power would be concentrated in a single federal bank, to the detriment of rural interests. In the early 20th century, the federal government created the Federal Reserve System largely because policy makers were uncomfortable relying on one bank – and one individual, J.P. Morgan – to rescue the banking system when troubled. While this action relates to a concern

about “systemic risk” that is taken up shortly, it also appears to have been motivated by the concern that a single bank could have too much influence on national policy.

If there ever was a real basis for this concern – and it is not clear that there was – there is no basis for it now. As a threshold matter, the banking industry as a whole no longer is the largest financial industry, measured by asset size, in the United States. At roughly $6 trillion in total deposits, the industry is now overmatched by the mutual fund industry, which has approximately $9 trillion in assets.

Perhaps more fundamentally, the evidence is mixed, at best, as to whether large organizations, in any industry, wield an undue amount of political power. For one thing, large companies typically have opposition from other large companies on public policy issues, and thus no single company can count on having its views swallowed whole. The financial industry itself provides a good example: large banking organizations for years wanted to engage in other financial businesses, but were strongly opposed by large securities and insurance firms. Only after nearly two decades did Congress finally allow firms from each of the industries to own each other, when it passed GLBA. The continuing battles over telecommunications reform -- which yielded an unwieldy Congressional compromise in 1996 and which continue to this day -- provide another example: ten years ago, the large regional Bell Operating Companies were on opposite sides from the long-distance providers and from the cable industry, whereas today it is the large remaining telecommunications companies fighting it out with such high-tech giants as Microsoft, Google and Amazon over the right pricing regime for the Internet of the future.

Second, industries populated by many small firms or organizations made up of many individuals often have as much, if not more, political heft than large organizations. For example, organizations such as the National Rifle Association, the AARP, and the teachers’ unions, have legendary political clout in Washington, arguably much more than any single bank or firm in an another industry.

Third, America has an almost a mystical attachment to its small banks, and totally apart from pure antitrust notions, there may be an emotional fear that if existing large banking organizations were permitted to grow larger – even if their acquisitions and size and behavior were consistent with the antitrust laws – small banks will disappear. While

understandable, this fear is misplaced. Since Riegle-Neal and subsequently Gramm-Leach-Bliley, many thousands of small banks (those with assets below $1 billion, or even below $100 million) continue to thrive. Indeed, the banking authorities have been receiving applications for *new bank charters* in the hundreds each year even as the industry has been consolidating at the top since these two acts were passed. This is because many Americans choose to "bank" with small banks and credit unions (which offer essentially the same services as banks and which have been growing, on average, since 1994) because they like the personal touch and feel of being able to walk into a bank lobby where the employees have been there for years and know them by name. Small banks would continue to be there to service this segment of the American population even if deposit share caps were removed, and replaced by the antitrust laws.

There are examples from other industries where this is so. The insurance industry is unconcentrated, yet has a few nationwide large firms, competing alongside many local and regional competitors. Likewise, even many small corner grocery stores or specialty shops continue to exist throughout the country, despite the growth of the large-scale chains and "big-box" retailers. There is no reason to think that banking would be any different, if as is true for other industries, concentration through mergers (and abuse of dominant power, if any) is policed by the antitrust enforcement agencies (as indeed the banking industry has been even with the caps in place).

To prevent systemic risk:

A second possible reason for imposing a deposit market share cap on banks is to prevent some banks from growing so large that their failure could threaten the financial system, and in turn, the economy as a whole. The intellectual rationale for this alleged second reason might be found in a famous essay -- "Are Banks Special?" -- written in the early 1980's by E. Gerald Corrigan, then President of the Federal Reserve Bank of Minneapolis and later President of the Federal Reserve Bank of New York.[7] One of the answers that Corrigan supplied to his own question is that banks have a special role in the economy not only because they are important sources of finance, but also because they

[7] Corrigan, Gerald, 1982. "Are Banks Special?", *Annual Report*, Federal Reserve Bank of Minneapolis available at http://minneapolisfed.org/pubs/ar/ar1982a.cfm.

operate the payments system. If one or more large banks should fail, the risk arises that the payments system could become gridlocked, severely curtailing commerce and damaging consumer confidence. Just such a reality loomed after the stock market crash of October, 1987, but was averted through promises of liquidity from the Federal Reserve System.

How might further banking concentration contribute to what economists now call "systemic risk"? One possible line of argument with which many in Congress in 1994 might have been familiar is that, without appropriate government oversight, larger banks either are more prone to getting into financial trouble than other banks, or that when they do have problems, the risks of failure they pose to the financial system – whether through the payments system or possibly through contagious bank runs – is, almost by definition, much greater than is the case for smaller banks. In 1994, or even in 1982 when Corrigan wrote his article, these were not theoretical concerns. After all, the nation's largest banks did over-extend themselves during the 1980s in lending to less developed countries, a course of activity that put many of them in financial danger. Later in the decade, a number of the same banks (and other large ones, especially in New England), became heavily exposed to commercial real estate borrowers. When real estate markets turned down, those banks suffered steep losses and some of them failed.

Much has changed over the past two decades to ease concerns that these events might repeat themselves. First, and perhaps most important, large banks and indeed the entire banking system are far stronger financially than was true in the 1980s, due largely to FDICIA's stiffer and more effectively enforced capital standards introduced in 1991, as well as to insistence by investors that the banks be even better capitalized than required by law.

Second, the principal payments systems – the privately operated CHIPs system (which processes payments daily by the nation's largest banks) and the Federal Reserve's Fedwire system – are in much stronger shape than they were before the 1987 stock market crash. After that event, CHIPs worked hard to change its various rules so that the system could withstand the failure of not one, but at least two, of its largest members. Meanwhile, the Fed has adopted pricing and other reforms that have dramatically reduced the risks of daily "overdrafts" that pose a financial risk to the Federal Reserve.

Third, as for banks' "special-ness" in lending, that has been eroded significantly over the past two decades as more public companies have turned to the capital markets for funds, issuing either short-term debt (commercial paper) or long-term debt. It is true that commercial paper still typically requires a bank guarantee as a backup source of "credit enhancement," but the primary lending activity is conducted in the market and not by banks. In a related development, banks at the same time have off-loaded increasing amounts of their lending risks to insurance companies and other buyers of "credit derivatives." While there may be legitimate concerns about how this risk is now distributed throughout the financial system, one thing is clear: less of it is concentrated in banks than it otherwise would be.[8]

In sum, the systemic risk rationale for deposit caps is far weaker than it might have been in 1994. Moreover, as is argued below, it is possible that the current deposit market share caps may aggravate that risk to the extent they lead to more large banks that might be deemed "too large to fail."

To prevent the development of "Too big to fail banks":

The third possible justification for a deposit share cap is related to the second: namely, that because large banks arguably entail a disproportionate risk to the overall financial and economic system, having a more concentrated banking system may enhance the number of "too big to fail" (TBTF) banks, or banks that are so large that the federal government cannot permit their uninsured depositors and perhaps other uninsured creditors to take a loss, for fear of triggering a contagious run on other banks in the system.[9]

The TBTF argument was the main rationale for the federal government's protection of uninsured depositors when Continental Illinois failed in 1984, the Bank of New England failed in 1990, and arguably contributed to decisions by federal regulators

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[8] For a thorough discussion of credit derivatives and some of the risks they may present, see Frank Partnoy, "How and Why Credit Rating Agencies Are Not Like Other Gatekeepers," in Yasuyuki Fuchita and Robert E. Litan, eds., *Financial Gatekeepers* (Washington, D.C.: Brookings Institution Press, 2006).

[9] The term "too big to fail" actually is a misnomer. It more accurately refers to banks that are so large that government deems it necessary to bail out their uninsured depositors and possibly unsecured creditors, but not their shareholders.

in the 1980s to not strictly enforce capital standards for large banks that had large unrecognized losses on developing country debt at that time (a policy known as "regulatory forbearance"). One possible argument in favor of the deposit caps is that they might help avert future such episodes, which not only unfairly benefit large banks (and harm smaller banks that do not evoke such guarantees), but also put taxpayers at risk for mistakes made by private sector actors, thus possibly encouraging more of them in the future.

While concerns about TBTF institutions are quite real and remain, the deposit share caps are not likely to reduce the risks they entail, and may even increase TBTF risks. For one thing, the more banks are diversified geographically, the less likely it is that they will fail. Whatever may be the experience nationally at any point in time, the economies of different states and regions always are moving at different speeds and possibly in different directions. Banks that have businesses in many different states are like investors with multiple stocks in their portfolios – they are more broadly diversified, and thus should have smoother earnings than banks that are limited to doing business in small geographic areas or in particular lines of business. Deposit share caps already prevent some of the largest banks from having a significant presence in all 50 states, and thus inhibit the opportunities for geographic diversification by larger banks that could lower their risk of failure, and thus the risk that the TBTF issue might arise.

But even if this were not the case, the hard reality is that since the federal government already has "bailed out" the uninsured depositors of banks with roughly $35-40 billion in deposits, or roughly $100 billion in today's dollars – as it did when the authorities came to the rescue of such depositors of Continental Illinois, the Bank of New England, and several large banks in Texas – then it is highly likely, if not certain, that it would do the same for many and possibly all of the top ten depository institutions today (which as shown in Table 3 all have deposits near or above the inflation-adjusted level of the total deposits of the former Continental and Bank of New England). If this is true, and history suggests that this proposition certainly is plausible, then there is little evidence that the deposit market share caps have limited the TBTF risk.

To the contrary, it is quite possible that the deposit caps could perversely create *more* TBTF banks by limiting the growth of the leading banks, and promoting instead the

growth of many more banks near their size. That is, the nation may face a larger TBTF risk from having a dozen or more large banks, each with say a 5-10 percent market share, than a more concentrated (but still competitive) market in which perhaps 3-4 banks had 60-70 percent of the market among them, with thousands of smaller banks dividing up the rest of the market.

Finally, even if the TBTF rationale for the deposit market share caps had some substance, it must be weighed against the counter-productive impacts of the caps, a subject that is taken up next.

4. Counterproductive Impacts of the Current Deposit Caps

At several points already, I have noted how financial markets and laws have changed dramatically over the past two decades, and since Reigle-Neal become law in 1994 in particular. One other change is noteworthy. As supporters of market share caps correctly anticipated, the legislation allowing interstate branching has led to further concentration in the depository industry, primarily through mergers. Table 3 shows the deposit shares of the top 10 depository organizations in the United States, as of mid-2005 (one of them, Washington Mutual, is not a bank, incidentally). Comparing Table 3 and Table 1, it is evident that all of the top players have larger market shares than did the top players in 1994, before Riegle-Neal became law. None, however, has a national market share over the 10% deposit share ceiling – since, otherwise, none of these banks would be permitted to make any more acquisitions. But Bank of America's market share is right below the 10% limit and JP Morgan Chase and Wachovia (if its merger with Golden West is approved) are close to the limit.

Table 3
Top Nationwide Domestic Deposit Shares, Bank Holding Companies
June, 2005

Organization	Deposits (Billions)	Percentage
Bank of America	577	9.6
JP Morgan Chase	406	6.8
Wachovia Bank*	286	4.8
Wells Fargo	261	4.4
Citigroup	206	3.5
Washington Mutual	185	3.1
U.S. Bankcorp	117	2.0
Suntrust	107	1.8
Royal Bank of Scotland	99	1.7
National City	76	1.3

Source: FDIC (www.fdic.gov)

*This share figure does not account for the increase in deposits that Wachovia will experience if its proposed merger with Golden West is approved.

The rising deposit shares of the top players should be no surprise, since banking markets were fragmented for more than 200 years prior to the enactment of Riegle-Neal. After that bill became law, the quickest way for banks to establish a nationwide footprint, like other retail firms and financial service companies that were not previously limited in where they could conduct business, was to merge with banks in other regions. And that is exactly what most of the firms in Table 3, as well as many other banks right below them in size, have done since 1994.

As long as the nationwide deposit market share cap remains in place, one would expect that other firms on the list right below Bank of America will continue merging until they catch up, in market share, to the market leader. Perhaps that is what Congress intended in 1994 when it put caps into effect in the first place: to ensure that a handful of relatively equal-sized firms developed their own national footprints, and that at a later point, the deposit cap would be lifted. If so, that day is not far off. With the right mergers,

several of the depositories on the top 10 list would jump to parity with Bank of America relatively quickly.

But at that point, and indeed even now for the banks at or near the top of the list, the deposit market share cap creates a number of perverse incentives.

Before outlining them, it is important to recognize, as a threshold matter, that no profit-making organization that sits still can expect much of a future. The stock market only rewards growth. And companies that do not have growth plans invite stagnation at best, or departure of their best people, at worst. Deposit marker share caps, even though applicable to mergers, stunt internal growth, and distort other growth opportunities.

The caps stunt internal growth in the banking business because as banks near the cap they lose the ability to merge and to quickly extend their geographic footprint. As a result, banks near the cap are discouraged from offering their current (let alone prospective) customers competitive interest rates on deposits, which clearly harms their existing customers and reduces competition. These results must be inconsistent with the intent of those who might have advocated the caps in the first place.

Second, if banking organizations cannot expand in their own line of business – sticking to their "core competence," which various management experts have suggested is the soundest business strategy to follow – they have only two other choices for increasing their revenue and profits. Either they can expand into other financial activities in the United States, which GLBA permits them to do, or they can expand abroad.

Judging from the track record of other large banking organization so far, however, the potential profits of the "one-stop shopping" model appear to be elusive. As already noted, Citigroup, perhaps the strongest proponent of this model pre-GLBA, has since sold off some of its non-banking businesses, underscoring the difficulties of cross-selling different types of financial products to the same customer base. To be sure, some non-banking enterprises, including mutual fund companies and some insurers, have opened or acquired their own depository institutions, which seems to validate the one-stop shopping idea. But taken as a whole, the experience of the financial services industry suggests it is far too soon to determine whether expansion by banks in particular into other non-banking financial activities will turn out, on average, to be financially promising.

Meanwhile, despite the increasing globalization of financial activities and capital markets, relatively few American banks have embarked on major global expansions. In part, this may reflect risk aversion stemming from the banks' disappointing (if not disastrous) experience with lending to developing country governments in the 1970s and 1980s. It also may reflect the operational difficulties and risks of expanding into unknown markets, against entrenched local institutions. Whatever the cause, a fundamental question arises: why should U.S. policy have *any* tilt, however unintended, toward encouraging U.S. banks to expand abroad rather than to engage more vigorously in competition at home? Yet that arises precisely because of the existing deposit market share caps. It is an outcome that not only probably was unforeseen by those who supported the caps at the time they were introduced, but is also potentially inconsistent with the objectives of encouraging more banking competition in the domestic market as well as less risky endeavors by banks, so as not to impair their financial soundness.

Third, the deposit caps actually work in two ways to the disadvantage of U.S. banks in the global marketplace, another outcome very likely not anticipated at the time the caps were enacted. For one thing, the caps inhibit U.S. banks from purchasing foreign banks with U.S. subsidiaries or branches that have U.S. deposits that would put the acquiring U.S. bank over the nationwide or state-specific caps. Looking ahead, this constraint is especially binding for U.S. banks that are close to the nationwide cap, which means as a practical matter, one of these banks that wanted to build a global brand by acquiring a major foreign institution would be prevented from doing so even if that institution had only a small fraction of its total deposits in the United States – but just enough to put the acquiring U.S. institution "over the cap." Instead, because of the cap, U.S. banks close to the cap but seeking to build a global brand would be restricted to partnering only with foreign banks that essentially have no U.S. presence. What can possibly be the rationale for a law that, in practice, has the effect of making this distinction?

In addition, since the caps only apply to domestic deposits held in the United States, it does not inhibit foreign banks from buying U.S. banks – even large ones – if the foreign banks are not already highly active in the U.S. market (as a few of them are, such as the Royal Bank of Scotland or HSBC). Meanwhile, because the caps may remove

some U.S. banks as potential acquirers of other U.S. banks, either currently or at some point in the near future, they therefore have the effect therefore of giving large foreign banks an artificial advantage in acquiring U.S. banks. It is highly unlikely that the advocates of deposit market share caps would welcome growing foreign ownership of U.S. banks as an unintended, but potentially very real, outcome of the caps (to the extent foreign acquisition occurs naturally, and not for artificial reasons, this should be welcomed or at least not opposed; it is dubious policy, however, *to encourage* foreign acquisitions of U.S. financial institutions unless it is to help reduce the costs of U.S. bank failures, an objective that is not relevant in today's financial marketplace).

5. Solutions

The obvious implication of the foregoing arguments is that the current deposit market share caps in Riegle-Neal should be repealed, with instructions that bank mergers should be judged by the same competitive standards that now apply to mergers of all other kinds of firms (It is a separate question whether antitrust scrutiny still should be divided between the Justice Department's Antitrust Division and the banking regulatory agencies (the Federal Reserve, the Comptroller of the Currency or the FDIC, depending on the nature of the bank's charter and whether the merger is at the bank or the holding company level. Good arguments can be made on both sides of this question). The competition and regulatory authorities have a long history of applying well-developed guidelines to bank mergers, and there is no reason why these guidelines, together with the merger case law that exists, shouldn't be the exclusive touchstones for evaluating bank mergers.

If Congress is unwilling to go this far, there are two alternative measures it could adopt.

First, since much of the foregoing argument has been aimed at the nationwide cap, any repeal could be limited to this component of the policy, leaving the statewide caps in place. After all, a state in which three banks each had 30 percent of the market

(the default statewide ceiling in Riegle-Neal) easily would be "highly concentrated" under the current antitrust merger guidelines.[10]

Second, the national and state caps would be less binding if the deposit market shares were calculated by expanding the definition of the "market" from the current total of bank and thrift deposits to a new definition that also includes the functional equivalent of these deposits, namely deposits at credit unions and shares held in money market mutual funds. Under this approach, the 10 percent and 30 percent caps would be less restrictive, since a more comprehensive definition of deposits would be in the denominator of the calculation.

Each of these fallback measures are just that, however, fallbacks. The preferable course is to recognize that there no longer is any substantive justification (if there ever was) for singling out bank mergers to be treated any differently from mergers in other industries.

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[10] The sum of the squares of the 30 percent market shares of these banks alone would be 2700 (900 x 3), which would put the HHI well over the 1800 threshold that defines a "highly concentrated" market.