

**‘TOO BIG TO FAIL?’: THE ROLE OF ANTITRUST  
LAW IN GOVERNMENT-FUNDED CONSOLIDATION  
IN THE BANKING INDUSTRY**

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**HEARING**

BEFORE THE

SUBCOMMITTEE ON COURTS AND  
COMPETITION POLICY

OF THE

COMMITTEE ON THE JUDICIARY  
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

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**‘TOO BIG TO FAIL?: THE ROLE OF ANTI-  
TRUST LAW IN GOVERNMENT-FUNDED CON-  
SOLIDATION IN THE BANKING INDUSTRY**

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**TUESDAY, MARCH 17, 2009**

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON COURTS AND  
COMPETITION POLICY  
COMMITTEE ON THE JUDICIARY,  
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 2:06 p.m., in room 2141, Rayburn House Office Building, the Honorable Henry C. “Hank” Johnson, Jr. (Chairman of the Subcommittee) presiding.

Present: Representatives Johnson, Conyers, Jackson Lee, Watt, Sherman, Coble, Chaffetz, and Goodlatte.

Staff Present: (Majority) Christal Sheppard, Subcommittee Chief Counsel; Anant Raut, Counsel; Elisabeth Stein, Counsel; Rosalind Jackson, Professional Staff Member; and (Minority) Stewart Jeffries, Counsel.

Mr. JOHNSON. This hearing of the Subcommittee on Courts and Competition Policy will now come to order.

Without objection, the Chair is authorized to declare a recess of the hearing.

I will now recognize myself for a short statement.

First of all, good afternoon to everyone. This is a topic that many of us want to learn about. The single most important issue on the minds of people today is the state of the global economy.

The statistics are grim. We are in the midst of an economic downturn that, by some measures, is the deepest since the Great Depression: 12.5 million Americans, or 8.1 percent of our workforce, are unemployed. The net worth of U.S. households declined by nearly \$11 trillion in 2008, erasing 18 percent of American wealth in a single year. Every week, local businesses and big national retailers alike announce losses, layoffs, or bankruptcy.

The origins of our current economic downturn can be traced, in part, to the issuance of high-risk mortgage-backed securities in the earlier part of the decade. When the housing bubble collapsed in late 2007, anyone holding these mortgages, or securities derived from these mortgages, got caught in a downward spiral. In spring of 2008, the rapid devaluation of these mortgage-backed securities shook investor confidence and was partially responsible for the credit crisis that began gripping our economy.

Bear Stearns was sold over a weekend to JP Morgan Chase, and the Federal Government put Fannie Mae and Freddie Mac into receivership. Last September, hopes for a quick recovery were dashed when Merrill Lynch had to be sold to Bank of America; Lehman Brothers was allowed to—or forced into bankruptcy, if you will; and AIG, the now well-known company, asked the Federal Government for a \$40 billion bridge loan, which has since escalated, into about \$180 billion or \$170 billion.

Since August of 2008, the Federal Government has invested hundreds of billions of dollars into financial institutions, either directly into these institutions, which have been deemed too big to fail, or through the TARP program, the “Troubled Asset Recovery Program.” Although, the stated goal of the TARP funding is to increase liquidity in the credit markets and to stimulate lending; some of the funds were used by recipient banks to acquire competing banks that, in some cases, had been denied TARP funding.

It is not my intention, ladies and gentlemen, to suggest that either the previous or the current Administration should have sat idly by as the economy plummeted. I believe that my colleagues on both sides of the aisle can agree that the intention of both Administrations was to protect a fragile economy from further destabilization.

Our purpose here, as the Courts and Competition Policy Subcommittee, is to determine whether or not this economic downturn was worsened by antitrust. In particular, there are two interrelated issues I would like for us to consider: one, this concept of “too big to fail.” Are there such things as institutions that are too big to fail? And, if so, should antitrust have prevented them from becoming so embedded in the economy?

The second is the use of TARP money in bank consolidation. When the Federal Government provides funds to the acquiring bank but denies it to the acquired bank, is antitrust law adequately suited to evaluate the competitive effects of these acquisitions when the government, by the stroke of a pen, can radically shift market power? And, by doing so, are we simply creating the next generation of institutions that are too big to fail?

At the end of today, I hope that our panel will have provided us with guidance as to what we can do and what we should do to prevent this type of crisis from reoccurring.

I now recognize my honorable colleague, Mr. Howard Coble, the Ranking Member of this Subcommittee, for his opening remarks.

Mr. COBLE. Thank you, Mr. Chairman.

And it is good to welcome the panel with us this afternoon.

I thank you, Mr. Chairman, for calling this hearing of the Courts and Competition Policy Subcommittee.

Without a doubt—and you have touched on it, to some extent—the current economic crisis has altered the way that we view government intervention with business. Many, including me, were wary of giving large sums of money to financial institutions in the wake of the failure of Lehman Brothers last September. I reluctantly voted for the initial disbursement of emergency economic stabilization funds because of the outcry from many of my constituents, who viewed it as their only means to protect their life savings.

I continue, Mr. Chairman, to be very skeptical of the approach we have taken to stabilize and stimulate our economy. The current AIG bonus controversy is a prime example. That said, today's hearing gives us the opportunity to examine how past government intervention, specifically antitrust enforcement, may have contributed to the current situation.

First, this hearing will examine whether mergers created some of the institutions that were too big to fail. It will also examine whether antitrust law, as it has been traditionally understood, could or should have prevented some of these institutions from getting to the point that the government felt compelled to bail them out.

Secondly, in the course of providing relief funds under the government's TARP program, it appears that the government has in at least one instance deliberately supplied money to one bank for the purpose of acquiring another. In other cases, banks have used the TARP funds to assist in the purchase of other banking institutions. This hearing gives us the opportunity to explore whether the existing antitrust review properly protects taxpayers from ultimately having to save other institutions that are, again, too big to fail.

As a North Carolinian, Mr. Chairman, I am proud that my State is home to two very large financial institutions. One of those, Bank of America, has received TARP funds and has acquired troubled financial institutions, including Merrill Lynch and Countrywide Financial. The other, Wachovia, was not so fortunate. It was recently acquired by Wells Fargo, as you know.

Whether they were being acquired or doing the acquiring, these transactions have had and will continue to have a significant impact on the residents in my State and upon other States. Not unlike all Members, I have a number of small banks and credit unions in my district, Mr. Chairman, as no doubt you do. It is my hope that these essential institutions are not forgotten in this debate or by policymakers here in D.C.

Finally, I would like to note that we are facing a bipartisan problem here. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, which enabled banks to operate across State lines, was passed with strong bipartisan support under a Democratic President and by a Democratically controlled Congress. The Gramm-Leach-Bliley Act, which allowed banks to expand into broader areas of business, including insurance and securities, also enjoyed broad bipartisan support and was passed by a Republican-controlled Congress.

Similarly, President Clinton's Antitrust Division presided over the merger of Citicorp with The Travelers Group in 1998, which created Citigroup, while President Bush's Antitrust Division presided over the Wells Fargo-Wachovia deal, among others. Undoubtedly, the Obama administration will face similar mergers as the financial crisis continues and deepens.

All of this, Mr. Chairman, is to say that this is neither a Democratic nor a Republican problem; it is an American problem. And I appreciate your willingness, Mr. Chairman, to have invited a balanced panel to discuss these issues.

And, with that, I yield back the balance of my time and look forward to hearing from our witnesses.

Mr. JOHNSON. I thank the gentleman for his statement. And, without objection, any additions that you want to make to it will be included in the record, as well.

Do any of my other colleagues on this Subcommittee wish to make opening statements?

Mr. WATT. Mr. Chairman, I won't take the full 5 minutes.

I do think it is interesting that, as a result of serving on both the Financial Services Committee and the Judiciary Committee, on the same day in two separate Committees of jurisdiction we are dealing, in one respect or another, with the question of "too big to fail."

I didn't want to be here to hear the testimony, because I am not sure that whether an institution is acquired or is acquiring another financial institution and that, in and of itself, makes it too big to fail is something that ought to be an independent criteria for evaluation by the Justice Department under the antitrust law. So, while I think this is an interesting inquiry and certainly a topical inquiry, I hope we don't go too far overboard in that direction, because I think that might be an overreaction to what is going on in the current economic context.

That said, I will be very anxious to hear the testimony, and it is certainly a matter that, when it involves antitrust implications, is a matter of the jurisdiction of this Committee and this Subcommittee. And I will be interested in knowing how these witnesses tie this all together.

So, with that, I will yield back. I appreciate the gentleman having the hearing. I guess the more I can talk about "too big to fail," whether in the context of antitrust laws or in the context of how you create a systemic regulator to supervise it, the better off I am, because the more I understand about the issue, the better we are able to legislate on it. And I appreciate it and yield back.

Mr. JOHNSON. Thank you, Congressman Watt, out of California, one of our resident legal scholars on this Committee and especially on this Subcommittee.

I want to welcome also—

Mr. WATT. I thought you were introducing Mr. Sherman. I am from North Carolina.

Mr. JOHNSON. I also want to recognize my colleague from Utah, Mr. Jason Chaffetz. And he is a brand-new Member.

We welcome you to the Subcommittee.

And if there are any other opening statements—I see that my colleague, the cerebral Mr. Brad Sherman out of California, cannot help himself. He must share his knowledge with us, and we definitely appreciate it.

Mr. SHERMAN. Thank you, Mr. Chairman.

"Too big to fail"—those words are an affront to capitalism. Capitalism can only work when entities are allowed to fail. But "too big to fail" is not only an attack on the taxpayers, saying, "You must bail us out, we have created this house of cards, we did it for our own benefit, and you must ensure us against risk," but it is also an attack on competition. Because if an entity claims to be too big to fail, what they are really saying is, "Don't just look at our bal-



ance sheet to see whether we are credit-worthy, look at the balance sheet of the United States Federal Government. That is available to you.” And so these entities are able to borrow at reduced interest rates, giving the “too big to fail” a chance to get bigger at the expense of those who are small enough to fail.

You know, we have faced this in my own community. When you have a financial institution that becomes insolvent, the FDIC takes them over. The insured depositors have paid for that insurance because they get a little lower yield, and the bank has to pay into the FDIC fund, and you paid for the insurance, and, to the extent you are insured, the Federal Government is there to pay on the insurance that you have paid for to the Federal Government. But everybody else—the bondholders of that local bank, the accounts that are in excess of FDIC insurance—they don’t get any taxpayer money. Why? Well, that bank wasn’t too big to fail. That is why we have receivership.

In contrast, you have a dozen or so of the largest financial institutions in the country whose general creditors are being paid with taxpayer money. And the fact that they are being paid is, if anything, proof that if you have to lend money, lend it to somebody who is too big to fail. Give them the good interest rate, give them the chance to succeed.

And so, what we ought to have done, what we can still do, is to put into receivership those financial institutions that are insolvent and deal with them the same way we deal with everyone else.

Now, this will turn them into much stronger financial institutions, because the way you clean up a balance sheet is not by taking off assets, even, quote, “toxic assets”; the way you clean up a balance sheet is you take off liabilities. And that is what happens in receivership. You give a haircut to the general creditors.

These companies are not too big to fail. It is said that they are too interconnected to fail. I don’t think that is true either. They are too well-connected to fail. And so the general creditors are coming here, and so far they have been successful in getting a Federal bailout.

What we see here is a casino, a casino created at AIG’s financial products division, where a lot of people were smart but not smart enough. They placed the winning bets. They went to the AIG casino and they bet against the mortgages being valuable, and they were right on their bet. But there were so many of them that they broke the bank. And now these gamblers are here in Washington, having us bail out the bank that they have broken.

That is not the right role for the Federal Government, and it is not the right competition model for the future, where smaller banks and larger banks should all live by the same rules. And that is, if you pay for Federal insurance you get it up to the terms of that insurance, and otherwise the general creditor is a general creditor. And when you are a general creditor of an insolvent financial institution, you take a huge haircut.

Mr. Chairman, I thank you for the time.

Mr. JOHNSON. Thank you, Congressman. And I will say that it was unexpected to hear you mention the term “haircut” twice.

I am now pleased, ladies and gentlemen—and I am glad you have such a great sense of humor, Congressman. We are all laugh-

ing with you, not at you. And I don't want to put myself in line for replies either.

But I am pleased now to introduce the witnesses for today's hearing.

The first is Mr. Bert Foer, president of the American Antitrust Institute. Mr. Foer is a recognized antitrust expert who served previously as assistant director and acting deputy director of the Federal Trade Commission's Bureau of Competition.

Welcome, Mr. Foer.

Next is Mr. C. R. "Rusty" Cloutier.

I have been struggling with that for a while, Mr. Cloutier.

And Mr. Cloutier is president of the MidSouth Bank. He is also past chairman of the Independent Community Bankers of America. And, in 2004, he was honored by the city of Lafayette, Louisiana, he was given the highest award, the Civic Cup, for his civic actions.

So we appreciate you being here also, sir.

Next is Mr. William Askew, senior policy advisor for the Financial Services Roundtable. In addition to his role with the Roundtable, Mr. Askew is a senior executive vice president of Regions Financial Corporation. Regions Financial Corporation made Forbes' Platinum 400 list of America's best big companies. As head of the retail banking for Regions from 1987 to 2006, Mr. Askew played a leadership role in the acquisition of the consortium of banks that created Regions.

Welcome, Mr. Askew.

Also on the panel is Ms. Deborah Garza, former Assistant Attorney General for the Department of Justice's Antitrust Division. Prior to her most recent tenure at the Department, Ms. Garza chaired the Antitrust Modernization Commission, which is a bipartisan panel created by Congress to evaluate the U.S. antitrust laws and policy recommendations and also to make policy recommendations to the Congress and to the President.

And I would like to add that the members of the commission, as well as its recommendations, are held in highest regard by this Subcommittee. And we thank you and your colleagues for all the work that you have put in for the benefit of the citizens as well as the commercial interests that are so important for this country.

And last but not least, I would like to recognize Dr. Mark Cooper, who is also on our panel. He is the director of research at the Consumer Federation of America. And he has provided expert testimony in over 250 cases for public interest clients, ranging from attorneys general to citizen intervenors, before State and Federal agencies, courts, and legislatures in the United States as well as Canada.

And I want to welcome you all to this important hearing.

And just one housekeeping matter: Any opening statements that have not been presented orally may be submitted in writing. And there will be 5 business days within which that can happen.

And the same goes for the panelists, also. So your written statement will be placed into the record. And we wish to ask you that you limit your oral presentation to 5 minutes. You will note that we have a lighting system, which is right in front of you. It starts with a green light, and then at 4 minutes it displays a yellow light. And then, thereafter, we all know what red means.

After each witness has presented his or her testimony, Subcommittee Members will be permitted to ask questions, subject to the 5-minute rule.

Mr. Foer, please proceed with your testimony.

**TESTIMONY OF ALBERT A. FOER, PRESIDENT,  
AMERICAN ANTITRUST INSTITUTE, WASHINGTON, DC**

Mr. FOER. Thank you, Mr. Chairman, Members of the Committee. And if the Committee wishes to discuss haircuts further, I am happy to take you on.

I am going to pose five questions and try to answer them very briefly, perhaps cryptically. My written statement contains elaboration.

First, what do we mean by “too big to fail”? It is important at the outset to observe that the chief issues are not large size alone or even inadequate competition. The “too big to fail” problems relate to, one, creation of large organizations that are so deeply embedded in the economy that their failure is likely to have ripple effects which, cumulatively, are just not acceptable to the polity; combined with, two, failure of governmental oversight to require relevant disclosure of escalating risks—that is, the information that would be necessary if government were to determine to inhibit the formation of such organizations or to protect against their failure.

Question two: Was antitrust policy responsible for allowing the “too big to fail” problem? Well, it is the more broadly conceived competition policy that I think has failed. The more narrowly defined antitrust enterprise—that is, the Sherman, Clayton, and FTC Acts—was not empowered to stop mergers on the basis of either the absolute size of the resulting institution or a calculation of the systemic consequences of their eventual failure. We lack a workable antitrust mechanism for stopping large conglomerate mergers that create giant corporations without, at the same time, reducing competition in specific markets.

My third question: Can current antitrust law protect us from future mergers that will create a “too big to fail” problem? And my answer, cryptically, is no, not most of the time.

My fourth question: Can current antitrust law be used to break up financial services or other organizations that are deemed too big to fail? And my cryptic answer again is, no.

So let me turn to the final question: What should Congress do? And I have four suggestions.

First, Congress should create within the Department of Justice Antitrust Division and should appropriately budget a new position: Deputy Assistant Attorney General for Emergency Restructuring. The purpose is to give competition policy an important place at the table as regulatory and legislative policies are developed to deal with the recession. I think this should be a high priority, as decisions are being made now that may have long-term competitive effects. Congress should assure that a loud competition voice is heard in a timely and respectful way in the councils that are restructuring our economy.

Second, Congress should emphasize that competition policy concerns be taken into account during a recession and even during

emergency consolidation situations. History suggests that industries faced with downsizing seek ways to do so jointly. The three C's of consumer catastrophe are consolidation, cartelization, and constraints on trade. These strategies have not worked in the past, and we need to remain especially vigilant against them now.

My third proposal: Congress should consider creating legislation that will give the government an opportunity to stop the formation of new organizations that are too big to fail. In my statement, I develop a procedure for facilitating governmental review of mergers that potentially create or exacerbate an unreasonable systemic risk. And when such mergers are identified, they could not be consummated for a period of time, during which a task force of relevant regulators, including antitrust officials, could report on both the beneficial effects and the risks of the merger. The President would be empowered to make a final decision to stop the merger. The process could be truncated during an emergency. The predictions required by this process will be quite difficult, but we should err on the side of not generating new risks of substantial catastrophe, even if the probability of occurrence is low.

I see I am about out of time. Let me make one final point, please.

For the longer term, Congress should create a process for rethinking where we are and where we want to be after the current crisis has settled down. And, in my paper, I propose what I call a TNEC-Two, a new version of the Temporary National Economic Committee that served during the New Deal. I won't have time to go into that right now, but I would be pleased to answer your questions.

[The prepared statement of Mr. Foer follows:]

PREPARED STATEMENT OF ALBERT A. FOER

STATEMENT OF ALBERT A. FOER

PRESIDENT, AMERICAN ANTITRUST INSTITUTE

BEFORE THE U.S. HOUSE OF REPRESENTATIVES JUDICIARY COMMITTEE,  
SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

Re:

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

MARCH 17, 2009

I am Albert A. Foer, President of the American Antitrust Institute, an eleven-year old independent non-profit research, education, and advocacy organization that monitors the antitrust scene and supports the strong and sensible enforcement of our antitrust laws to ensure that markets are competitive for the benefit of consumers and the economy as a whole. Our views on a wide range of competition policy issues are set forth in The Next Antitrust Agenda: The American Antitrust Institute's Transition Report on Competition Policy to the 44<sup>th</sup> President. This book has been provided to Subcommittee Members and is available on our website, [www.antitrustinstitute.org](http://www.antitrustinstitute.org).

In the five minutes I have to speak, I will pose five questions and try to answer them very briefly. This written statement contains elaboration.

**1. What do we mean by "Too Big to Fail"?**

In looking at the problems of the financial services sector and other situations where entities have been declared "too big to fail," the chief issues are not large size alone or even inadequate competition. The problems relate to (1) creation of large organizations that are so deeply embedded in the economy that their failure is likely to have ripple effects which cumulatively are not acceptable to the polity combined with (2) failure of governmental oversight to require relevant disclosure of escalating risks, i.e. the information that would be necessary if government were to determine to inhibit the formation of such organizations or to protect against their failure.

**2. Was antitrust policy responsible for allowing the "too big to fail" problem?**

First, it is necessary to distinguish “antitrust” from “competition policy” which is broader than “antitrust” and takes into consideration sectors of the economy such as banking that are highly regulated apart from the antitrust regime. It is competition policy that has failed.<sup>1</sup> The more narrowly defined antitrust enterprise (the trio of the Sherman, Clayton, and FTC Acts) was not empowered to stop mergers on the basis of either the absolute size of the resulting institution or a calculation of the systemic consequences of their eventual failure. We have lacked a workable antitrust mechanism for stopping large conglomerate mergers that create giant corporations without reducing competition in specific markets.<sup>2</sup>

Antitrust can be taken to task for allowing many industrial sectors to become very highly concentrated and it is possible that this creates a greater risk that an entire industry could fail at once than if the industry were more fragmented. However, this is not the case in the current financial institution crisis or in the automobile industry.

I would also point out that antitrust has done a poor job of dealing with what might be called “the lemming effect” where a particular merger can be predicted to set off a chain reaction of industry consolidation based on strategic rather than efficiency considerations.<sup>3</sup>

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<sup>1</sup> The financial regulatory agencies have failed to use their authority under the convenience and needs or public interest standard to restrict the creation of institutions that emerge from mergers as too big to fail. The antitrust agencies in their advocacy role have failed to address the issue. Congress should consider adding to the public interest review criteria for agencies a systemic risk element.

<sup>2</sup> Throughout this statement I will use the term “merger” to include acquisitions and other forms of consolidation.

<sup>3</sup> For example, today we are witnessing simultaneous merger proposals in the pharmaceutical industry that may trigger several additional merger proposals. An important industry could be transformed by a series of mergers within a short time into a much more concentrated industry. There is no mechanism for considering whether this wave of consolidation will create a situation creating an unacceptable systemic risk. The antitrust agencies typically say that they can only consider one merger at a time.

I do not fault the antitrust agencies for the recent emergency consolidations which have taken two companies that are deemed too big to fail (e.g. Bank of America and Merrill Lynch) and combined them into one even larger company that is much too big to fail. The decisions were too important to leave to antitrust and had to be made quickly. Such is the nature of a systemic risk. But, as I will argue, this should not be the end of the conversation.

**3. Can current antitrust law protect us from future mergers that will create a “too big to fail” problem?**

No, not most of the time. Even if the Sherman Act and the Clayton Act were applied more aggressively than they have been in recent years, they can only protect against large mergers that threaten significantly to reduce head-to-head competition in specific product and geographic markets. While very large financial mergers often involve some competitive overlap, the geographic or product markets where these overlaps occur are likely to involve a sufficient number of other competitors and hence these overlaps are not likely to justify a normal antitrust merger challenge. In other words, there is no currently viable or likely theory for stopping conglomerate mergers, which create both large size and conditions of systemic risk but do not significantly reduce competition in specific markets.

The Federal Trade Commission Act offers somewhat more flexibility than the Sherman and Clayton Acts, but given the conservatism of the federal courts on antitrust matters and the question of whether systemic risk is an appropriate subject for antitrust, there is too much doubt to rely on an expansion of the FTC's ability in this area.

We should recognize that there may be a small set of very large institutions, probably financial in nature, that will be both necessary and too big to be allowed to fail, where downsizing remedies will for one reason or another not work. Stronger



regulatory oversight and greater restrictions on the scope and risk of such enterprises will be necessary.

**4. Can current antitrust law be used to break up financial service or other organizations that are now deemed “too big to fail”?**

No. It would be necessary to demonstrate both that such an organization possesses monopoly power and that it acquired or maintained its monopoly power in ways that can only be remedied by substantially restructuring it into smaller independent units or enjoining it from engaging in exclusionary behavior that harms competition.<sup>4</sup> It is highly unlikely that there is any basis under current law for such actions against any of the “too big to fail” entities that are the central source of concern.<sup>5</sup>

**5. What, then, should Congress do?**

Here are four proposals.

**First, Congress should create within the Department of Justice Antitrust Division and should appropriately budget a new position: Deputy Assistant Attorney General for Emergency Restructuring.** This person, who should be approved by the Senate<sup>6</sup> and would report to the Assistant Attorney General for

<sup>4</sup> Keep in mind that a monopoly case usually takes at least five years and creates a degree of uncertainty during that time. This time frame would not work when there is a crisis at hand.

<sup>5</sup> Recall that the Public Utility Holding Company Act that Congress adopted in the 1930's brought about (with SEC supervision) the restructuring of the investor-owned public utility industry after the collapse of the holding company structure that had controlled the industry.

<sup>6</sup> Senate confirmation is not normally required for a Deputy Assistant Attorney General, but it would elevate the status in this case so that the person would carry additional weight in policy deliberations.

Antitrust, should have the articulated mission of participating in all aspects of national policy relating not only to financial institutions and their regulation but to all other components of financial recovery planning and legislation that may impact competition.

The reason for this proposal is simple: decisions that have already been made and are going to be made this year and perhaps for years into the future will create major changes in the structure of our key industries. Given the reduced consumer demand that is the essence of a deep recession, there will likely be efforts to effectuate policies that have the effect, if not the intent, of causing consolidation, cartelization, and constraints on trade that will be both anti-competitive and anti-consumer. If we care about preserving a competitive economy in the long run, we need today an authoritative voice for competition policy at the negotiating table in order to assure that we do not go down a road of permanent consolidation except where it is absolutely necessary to do so.

**Second, Congress should emphasize that competition policy concerns be taken into account during a recession and even during emergency consolidation situations.** Mergers are generally irreversible and in light of recent Supreme Court cases such as *Trinko*, *Credit Suisse*, and *LinkLine*, it will be particularly difficult for antitrust laws to be applied where there is even a fig leaf of regulatory jurisdiction involved. In the context of emergency bailout consolidations, attention should be given to (a) assuring ultimate divestability of the components and (b) not expanding the “failing company” defense beyond its traditional narrow limits. Consolidation in time of crisis is not likely to be remedied by market forces when the economy rebounds because entry barriers will be high and lenders and entrepreneurs are likely to be cautious for years to come.

**Third, Congress should consider creating legislation that will give the government an opportunity to stop the formation of new organizations that are too big to fail.** How should this be done?

I would be reluctant to impose an antitrust Maginot Line of either absolute size or market share, beyond which an entity would not be allowed to grow. There are many problems with this approach, including that one size will not fit all. Rather, I would suggest something more flexible and targeted, along the following lines:

In ordinary (non-crisis) economic times, either the Antitrust Division or the FTC would be empowered to declare a merger or acquisition that it has investigated pursuant to the Pre-Merger Notification Act as “potentially creating or exacerbating an unreasonable systemic risk;” or a regulatory agency with jurisdiction over an aspect of a merger transaction could make a similar declaration. Flexible guidelines would define the conditions to be taken into consideration in making a declaration.<sup>7</sup> Such declaration would carry with it an automatic suspension of the merger for a period of ninety days, during which the Treasury Department would consult with the antitrust agencies, the Federal Reserve Board, and other national and international authorities that may have views on the effects of a future failure of the merged entity. The Treasury Department would then prepare a report to the President, taking into account likely beneficial effects as well as risks. If the report does not recommend a presidential decision, the merger could proceed. If it does recommend stopping the merger, the President would have thirty days to make a final decision.

Such legislation should carve out mergers approved by the President during an economic emergency, when the President judges that there is not time for the process to fully operate.<sup>8</sup>

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<sup>7</sup> This declaration would not affect the antitrust agency’s jurisdiction to continue its antitrust investigation of anticompetitive effects. The guidelines should be the work product of a joint agency task force that includes both the antitrust agencies and financial regulators.

<sup>8</sup> Again, this is not intended to suspend merger policy during a recession. Actual practice during this recession, however, has been to severely truncate any antitrust analysis while decisions are being made at the political level. Presumably the antitrust agencies have the jurisdiction to revisit emergency recession mergers at a later date even though their normal ability to seek a preliminary injunction was

Why place this discretion in the hands of the President? Time is likely to be of the essence and both the Congress and the federal courts are likely to draw out the process. Congressional decision-making will necessarily be highly political. The courts would be acting without political responsibility in an area that is necessarily discretionary. The President, acting on information and analyses developed by his administration, can act quickly and can take into account the overall context of emergency developments. Moreover, the President will be held responsible for the overall results.<sup>9</sup>

Let me state up front that the necessary analysis and predictions that the process would entail would be extremely difficult. Whether a failure would be tolerable may depend on when it occurs, what other commercial entities might do in the future (i.e., the actions of others such as upstream suppliers could contribute to a systemic risk), future international risks, and the psychology of the times (since a failure when the economy is strong may be much less worrisome than at a time when the economic world seems to be falling apart. I would not expect this process to be invoked very often, but it is also important not to hamstring the government by requiring too high a standard for the prediction. We should err on the side of not generating new risks of substantial catastrophe even if the probability of occurrence is low.

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overrun by events. As noted in the text, post-consummation divestitures have been rare.

<sup>9</sup> It can be argued that a better repository of this decision would be the independent Federal Reserve Board, but because so many interests in addition to those of the financial community are at stake, the decision should probably be that of the nationally elected leader. There is some precedent in the Exon-Florio Amendment for the President to make a non-reviewable decision to stop a merger (a takeover of a U.S. firm by a foreign firm), although this is in the national security context where the President can claim virtually all the relevant expertise. See Section 5021 of the 1988 Trade Act (50 USC Section 2170).

**Fourth, Congress should create a process for re-thinking where we are and where we want to be after the current crisis has settled down. I**

have in mind the establishment of a special commission similar to the Temporary National Economic Committee ("TNEC") of the 1930's. Let's temporarily call it "TNEC-Two." It would include key members of Congress as well as key government officials and academics, would be well-staffed and representative of a wide range of interests, and would take several years to review the evidence on how our economy has changed and what structural changes are needed to assure that markets will be competitive, that systemic risks will be minimized, and that the regulatory structure will be appropriate.

Among other topics, the TNEC-Two should consider whether we should simplify the regulation of financial conglomerates by breaking them into smaller single-industry units; whether we should require a downsizing of financial service companies that have now been deemed "too big to fail;" whether new governmental institutions are needed to deal with the emerging financial services sector; whether the extant "10% cap" on nationwide domestic deposits remains a viable limitation<sup>10</sup>; whether new law is needed for the special oversight of organizations that are deemed "too big to fail" and which cannot reasonably exit from that category; and whether new rules are needed for entities that are not within the financial services sector but represent systemic risks, such as a clarification that the likely triggering of a consolidation wave may be taken into account in an antitrust merger analysis.

About a year ago, the Antitrust Modernization Commission ("AMC") published its report. Lest there be a misimpression that the TNEC-Two already occurred in the form of the AMC, it should be pointed out that the AMC did not consider or report on the types of questions that are posed here, which go beyond a

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<sup>10</sup> The cap has major loopholes, such as not including intrastate mergers or mergers with thrift institutions, or mergers with "distressed banks," which have called its efficacy into question.

standard review of the antitrust laws that was prepared before there was concern about a deep recession.

We are today in an emergency climate. Many major changes are taking place and more will likely take place. Because we do not know how deep this recession will be or what changes in the economy or its regulation will be entailed, it is premature to answer the kinds of questions the TNEC-Two. When matters calm down, like a community after a severe hurricane, we will need to take inventory and develop a consensus both on where we are and where we want to be. Consolidation that is occurring during the crisis should not necessarily be considered either inevitable or permanent, even though it may be very difficult to unwind at a later date. Therefore, we need to put into motion a process to assure that in the longer run we and our children still remain in charge of our destiny. A TNEC-Two should be part of the process.

Thank you for your attention.

Mr. JOHNSON. Thank you, sir.

And before we proceed to Mr. Cloutier, I would like to welcome and recognize the presence of our esteemed Chairman of the full Committee, the Honorable John Conyers from Michigan.

And I would also ask you, sir, whether or not you wanted to make an opening statement.

Mr. CONYERS. No.

Mr. JOHNSON. Okay. So thank you, sir, and we shall proceed with the panel.

Mr. Cloutier?

**TESTIMONY OF C.R. "RUSTY" CLOUTIER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MIDSOUTH BANK, N.A., LAFAYETTE, LA**

Mr. CLOUTIER. Chairman Johnson, Representative Coble, and Members of the Committee, my name is Rusty Cloutier. I am the president and CEO of MidSouth Bank Corp., a \$936 million bank holding company located in Lafayette, Louisiana.

We operate in all of south Louisiana and most of southeast Texas. We are community-oriented and focus primarily on offering commercial and consumer loan and deposit services to individuals and small businesses, middle-market businesses, et cetera.

I am pleased to represent the Community Bankers of America and ICBA's 5,000 members at this important hearing.

While recent government funding has encouraged consolidation in banking, this is nothing new. For decades, antitrust laws, banking laws, and banking regulations have all contributed to consolidation of the banking and financial industry.

I personally have spent years warning policymakers of the systemic risks that were being created in our Nation by unbridled growth in the Nation's largest banks and financial firms. But I was told I just didn't get it, I didn't understand the new global economy, that I was a protectionist and that I was afraid of competition, that I needed to get with the modern times. Sadly, we know what modern times look like, and it hasn't been pretty. Excessive concentration has led to systemic risk and the credit crisis we now face.

Banking and antitrust laws were much too narrow to prevent these risks. Antitrust laws are supposed to maintain competitive geographic and product markets. If there were enough competitors in a particular market, that ends the requirement. This often prevented local banks from merging, but it does nothing to prevent the creation of the giant, nationwide franchises.

Banking regulation is similar. The agencies ask only if a given merger will enhance the safety and soundness of the individual firms. They generally answer, "bigger" is always necessarily a "stronger" financial institution. It can, many say, spread the risk across geographic areas and business lines. No one wonders what would have happened if it and its counterparts jumped off a cliff and made billions in unsound mortgages. We now know. The economy is in a crisis.

The four largest banking companies, many of which have been bailed out by the United States Government, now control over 40 percent of the Nation's deposits and more than 50 percent of the

U.S. bank assets. This is not in the public interest. A more diverse financial system would reduce risk and promote competition, innovation, and the availability of credit to the consumers of various means and business sizes.

We can prove this. Despite the challenges we face, the community bank segment of the financial system is still working and working well. We, the community banks, are open for business. We are making loans, and we are ready to help all Americans weather these difficult times without government assistance.

But I must report that community banks are angry. Almost every Monday morning they wake up to the news that the government has bailed out yet another “too big to fail” institution, while on Saturdays they hear that the FDIC has summarily closed one or two “too small to save” institutions. And just recently, the FDIC proposed a huge special premium to pay for the losses imposed by large institutions.

This inequity must end, and only Congress can do it. The current situation will damage community banks and the consumers and the small businesses that we serve. What can we do? ICBA recommends the following measures.

Congress should direct a fully staffed, interagency task force to immediately identify systemic risk institutions. They should be put immediately under Federal supervision. The Federal systemic risk agency should impose two fees on these institutions that, one, would compensate the agencies for the cost of their supervision, and capitalize a systemic risk fund, comparable to the FDIC, so that the United States taxpayers do not have to pick up their losses in the future.

The FDIC should impose a systemic risk premium on any insured bank that is affiliated with a systemic risk firm. The systemic risk regulator should impose higher capital charges, to provide a cushion against systemic risk.

The Congress should direct the systemic risk regulator and the FDIC to develop procedures to resolve the failure of a systemic risk institution. The Congress should direct the interagency systemic risk task force to order the breakup of systemic risk institutions that cause problems for America.

Congress should direct the systemic risk regulator to block any merger that will result in the creation of a systemic risk institution in the future. And finally, it should direct the systemic risk regulator to block any financial activity that threatens to impose systemic risk.

The current crisis provides you an opportunity to strengthen our Nation’s financial system and the economy by taking these important steps. They will protect the taxpayers and create a vibrant banking system where small and large institutions are able to fairly compete. The ICBA urges Congress to quickly seize this opportunity.

And I look forward to answering any questions you may have. Thank you.

[The prepared statement of Mr. Cloutier follows:]





Testimony of

**Mr. C. R. Cloutier**  
**President and CEO, MidSouth Bank, NA**  
**&**  
**Past Chairman**  
**Independent Community Bankers of America**  
**Washington, DC**

Before the

**Congress of the United States**  
**House Committee on the Judiciary**  
**Subcommittee on Courts and Competition Policy**

on

**"Too Big To Fail"**  
**The Role of Antitrust Law in Government-Funded Consolidation**  
**In the Banking Industry**

March 17, 2009  
Washington, D.C.

Chairman Johnson, Representative Coble and members of the Committee, my name is Rusty Cloutier. I am the President and CEO of MidSouth Bancorp, Inc. MidSouth is a bank holding company located in Lafayette, LA, with total assets of \$936.8 million as of December 31, 2008. Through our wholly-owned subsidiary, MidSouth Bank, NA, MidSouth offers complete banking services to commercial and retail customers in south Louisiana and southeast Texas. We have 34 locations in Louisiana and Texas. We are community oriented and focus primarily on offering commercial and consumer loan and deposit services to individuals, and small and middle market businesses. I am member and a former Chairman of the Independent Community Bankers of America. I am pleased to represent community bankers and ICBA's 5,000 members at this important hearing on "Too Big To Fail"; The Role of Antitrust Law in Government-Funded Consolidation In the Banking Industry.

ICBA agrees with the premise of this hearing and believe it is valid in a broader sense. Antitrust law, banking law, and banking regulation have all contributed to consolidation of the banking and financial industry. Excessive financial concentration was instrumental in creating the current financial crisis. Therefore, ICBA recommends bold and immediate action to deal with the systemic risk excessive financial concentration has created.

#### **Summary of ICBA Systemic Risk Recommendations**

ICBA commends the committee for tackling this issue quickly. The current crisis demands bold action, and we recommend the following:

- Congress should direct a fully staffed interagency task force to immediately identify financial institutions that pose a systemic risk to the economy.
- These institutions should be put immediately under prudential supervision by a Federal agency – most likely the Federal Reserve.
- The Federal systemic risk agency should impose two fees on these institutions that would:
  - compensate the agency for the cost of supervision; and
  - capitalize a systemic risk fund comparable to the FDIC's Deposit Insurance Fund.
- The FDIC should impose a systemic risk premium on any insured bank that is affiliated with a firm that is designated as a systemic risk institution.
- The systemic risk regulator should impose higher capital charges to provide a cushion against systemic risk.
- The Congress should direct the systemic risk regulator and the FDIC to develop procedures to resolve the failure of a systemic risk institution.

- The Congress should direct the interagency systemic risk task force to order the break up of systemic risk institutions over a five year period.
- Congress should direct the systemic risk regulator to review all proposed mergers of major financial institutions and to block any merger that would result in the creation of a systemic risk institution.
- Congress should direct the systemic risk regulator to block any financial activity that threatens to impose a systemic risk.

The only way to maintain a vibrant banking system where small and large institutions are able to fairly compete – and to protect taxpayers – is to aggressively regulate, assess, and eventually break up those institutions posing a risk to our entire economy.

#### **Congress Must Address Excessive Concentration**

ICBA remains deeply concerned about the continued concentration of banking assets in the U.S. The current crisis has made it painfully obvious that the financial system has become too concentrated, and – for many institutions – too loosely regulated.

Today, the four largest banking companies control more than 40% of the nation's deposits and more than 50% of the assets held by U.S. banks. We do not believe it is in the public interest to have four institutions controlling most of the assets of the banking industry. A more diverse financial system would reduce risk, and promote competition, innovation, and the availability of credit to consumers of various means and businesses of all sizes.

Our nation is going through an agonizing series of bankruptcies, failures and forced buy-outs or mergers of some of the nation's largest banking and investment houses that is costing American taxpayers hundreds of billions of dollars and destabilizing our economy. The doctrine of too big – or too interconnected – to fail, has finally come home to roost, to the detriment of American taxpayers. Our nation cannot afford to go through that again. Systemic risk institutions that are too big or inter-connected to manage, regulate or fail should either be broken up or required to divest sufficient assets so that they no longer pose a systemic risk.

In a recent speech Federal Reserve Chairman Ben S. Bernanke outlined the risks of the too-big-to-fail system:

[T]he belief of market participants that a particular firm is considered too big to fail has many undesirable effects. For instance, it reduces market discipline and encourages excessive risk-taking by the firm. It also provides an artificial incentive for firms to grow, in order to be perceived as too big to fail. And it creates an unlevel playing field with smaller firms, which may not be regarded as having implicit government support. Moreover, government rescues of too-big-to-

fail firms can be costly to taxpayers, as we have seen recently. Indeed, in the present crisis, the too-big-to-fail issue has emerged as an enormous problem.<sup>1</sup>

The Chairman of the FDIC, Sheila Bair, appearing on 60 Minutes, recently suggested that too-big-to-fail institutions shouldn't be allowed to exist in the future. She said, "I think we need to really review the size of these institutions and whether we should do something about that, frankly."<sup>2</sup> The Group of 30 report on financial reform stated that, "To guard against excessive concentration in national banking systems, with implications for effective official oversight, management control, and effective competition, nationwide limits on deposit concentration should be considered at a level appropriate to individual countries."<sup>3</sup>

The 10% nationwide deposit concentration cap established by the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 should be immediately reduced and strengthened. The current cap is insufficient to control the growth of systemic risk institutions the failure of which will cost taxpayers dearly and destabilize our economy.

Unfortunately, government interventions necessitated by the too-big-to-fail policy have exacerbated rather than abated the long-term problems in our financial structure. Through Federal Reserve and Treasury orchestrated mergers, acquisitions and closures, the big have become bigger.

Congress should take chairman Bair's suggestion and not only consider breaking up the largest institutions, but order that it take place. It is clearly not in the public interest to have so much power and concentrated wealth in the hands of so few so that they can destabilize our entire economy.

### **Banking and Antitrust Laws Have Failed to Prevent Undue Concentration**

Together with my colleagues I have spent years warning policy makers of the systemic risk that was being created in our nation by the unbridled growth of the nation's largest banks and financial firms. But, I was told that I didn't get it, that I didn't understand the new global economy, that I was a protectionist, that I was afraid of competition, and that I needed to get with the "modern" times.

Sadly, we now know what modern times look like and it isn't pretty. Our financial system is imploding around us. Why is this the case, and why must Congress take bold action?

One important reason is that banking and antitrust laws fail to address the systemic risks posed by excessive financial concentration. Their focus is too

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<sup>1</sup> Financial Reform to Address Systemic Risk, at the Council of Foreign Relations, March 10, 2009  
<sup>2</sup> March 8, 2009

<sup>3</sup> "Financial Reform; A Framework for Financial Stability, January 15, 2009, p. 8.

narrow. Antitrust laws are designed to maintain competitive geographic and product markets. So long as the courts and agencies can discern that there are enough competitors in a particular market, that is the end of the inquiry.

This type of analysis often prevents local banks from merging. But, it has done nothing to prevent the creation of giant nationwide franchises competing with each other in various local markets. No one asked, is the nation's banking industry becoming too concentrated and are individual firms becoming too powerful, both economically and politically.

The banking laws are also subject to misguided tunnel vision. The question is always whether a given merger will enhance the safety and soundness of an individual firm. The answer has been that "bigger" is almost necessarily "stronger." A bigger firm can – many said – spread its risk across geographic areas and business lines. No one wondered what would happen if one firm, or a group of firms, decides to jump off a cliff as they did in the subprime mortgage market. Now we know.

It is time for Congress to change these laws and direct that the nation's regulatory system take systemic risk into account and take steps to reduce and eventually eliminate it.

#### **State of Community Banking is Strong**

Despite the challenges we face, the community bank segment of the financial system is still working and working well. We are open for business, we are making loans, and we are ready to help all Americans weather these difficult times.

Community banks are strong, commonsense lenders that largely did not engage in the practices that led to the current crisis. Most community banks take the prudent approach of providing loans that customers can repay, which best serves both banks and customers. As a result of this commonsense approach to banking, the community banking industry, in general, is well-capitalized and has fewer problem assets than other segments of the financial services industry.

That is not to suggest that community banks are unaffected by the recent financial collapse. The general decline in the economy has caused many consumers to tighten their belts and reduce the demand for credit. Commercial real estate markets in some areas are stressed. Many bank examiners are overreacting, sending a message that contradicts recommendations from Washington that banks maintain and increase lending. That is why it is essential that the government continue its efforts to stabilize the financial system.

But, Congress must recognize that these efforts are blatantly unfair. Almost every Monday morning for months community banks have woken up to news that

the government has bailed out yet another too-big-to-fail institution. On many Saturdays they hear that the FDIC has summarily closed one or two too-small-to-save institutions. And, just recently, the FDIC proposed a huge special premium to shore up the Deposit Insurance Fund to pay for losses imposed by large institutions. This inequity must end, and only Congress can do it. The current situation – if left uncorrected – will damage community banks and the consumers and small businesses that we serve.

#### **Government Funding Through TARP**

ICBA has had to work hard to ensure that community banks were eligible for the Troubled Asset Relief Program's Capital Purchase Program. While the nation's largest banks had ready access to TARP funds, the vast majority of community banks were left out in the beginning stages. Thousands of community banks could not even apply for funding because the Treasury's original term sheet for the program applied only to publicly traded institutions. Privately held banks, banks in Subchapter S form, and mutual banks simply could not apply. There is still no term sheet for mutuals.

Mr. Chairman, the program has changed so much that I believe many of my colleagues are having serious second thoughts about participating, so the question of equity between large and small banks may be moot. Even so, many community banks, like mine, stand ready to aid in our economic recovery. This remains the case, whether or not we receive government capital.

In response to the understandable anger over \$50 million private jets and multi-million dollar bonuses and golden parachutes for CEOs who led their companies into insolvency, or near insolvency, Congress recently enacted executive compensation and corporate governance limits for TARP recipients. The new statutory restrictions in some cases went beyond restrictions put in place by the Obama Administration and took away Treasury's discretion to focus these remedies where the problems actually occurred – in some large TARP recipient institutions.

MidSouth Bank does not engage in the compensation practices that have created the public ire. While we appreciate the changes that diminished the impact of these limits on community banks, we are frustrated by being tarred by the same brush used on the large financial institutions that caused the current economic crisis. MidSouth Bank is a solid, healthy community-minded financial institution and should be treated as a responsible partner in the effort to revitalize the economy.

We saw the CPP as an opportunity to encourage and support economic expansion in every market we serve during a national recession that could last, at least, another 12 to 18 months. After completing the CPP transaction on January 9, 2009, we began to actively promote the availability of \$250 million in

loan opportunities to small businesses and community leaders throughout our service area. MidSouth conducted town hall meetings in 14 communities in south Louisiana and southeast Texas from the end of January through February 19<sup>th</sup>. We focused on small businesses because small businesses drive the economy and create new jobs in our communities.

In addition to the general business community, we are also reaching out to the minority business community, through town hall meetings with the Black Chambers of Commerce of Baton Rouge and Southwest Louisiana and the Group of 100 Black Men, another African-American business organization. Our efforts to publicize the lending program continue with more meetings scheduled with homebuilders, industrial companies and other business groups.

We have also directed an ad campaign at consumers and the general public. We have placed billboards in every market in our service area advertising the availability of \$250 million in loans.

MidSouth's agreement with the government carries significant monetary and other obligations. If the government changes that agreement and adds new burdensome conditions, MidSouth will have to reevaluate its continued participation in the CPP. We are pleased that the economic recovery bill included Chairman Frank's idea to allow TARP participants to repay TARP funds early without penalty. This allows MidSouth and other community banks to keep their options open.

However, community banks interested in returning TARP/ CPP funds are reporting that they are being told they would have to pay or forfeit hundreds of thousands of dollars to the Treasury through payments and warrants even if they held the TARP capital for a short period. This is outrageous and unacceptable and not the intent of Chairman Frank's provision to allow banks to easily return the TARP capital without penalty.

But it would be a shame if new conditions forced us to withdraw from the program. Those community banks that chose to participate in the TARP and CPP did so with the conviction to put those funds to good use through loans to small and mid-sized businesses and consumers. MidSouth has taken the purpose of the CPP seriously by aggressively marketing the credit opportunities afforded by Treasury's investment in the bank. Policymakers should be encouraging the participation of more community banks like MidSouth bank who are willing and ready to be active leaders in our economic recovery.

#### **Maintain a Diversified Financial Regulatory System**

Equitable treatment under the TARP and similar programs is important in the short run, but we are especially concerned about the long-term future of the nation's financial regulatory system.

While ICBA strongly supports creation of an effective systemic risk regulator, we oppose the establishment of a single, monolithic regulator for the financial system. Having more than a single federal agency regulating depository institutions provides valuable regulatory checks-and-balances and promotes “best practices” among those agencies – much like having multiple branches of government. The collaboration that is required by multiple federal agencies on each interagency regulation insures that all perspectives and interests are represented, that no one type of institution will benefit over another, and that the resulting regulatory or supervisory product is superior.

A monolithic federal regulator such as the U.K.’s Financial Service Authority would be dangerous and unwise in a country with a financial services sector as diverse as the United States, with tens of thousands of banks and other financial services providers. Efficiency must be balanced against good public policy. With the enormous power of bank regulators and the critical role of banks in the health and vitality of the national economy, it is imperative that the bank regulatory system preserves real choice, and preserves both state and federal regulation.

For over three generations, the U.S. banking regulatory structure has served this nation well. Our banking sector was the envy of the world and the strongest and most resilient financial system ever created. But we have gotten off the track. Non-bank financial regulation has been lax and our system has allowed – and even encouraged – the establishment of financial institutions that are too big to manage, too big to regulate, and too big to fail.

Congress need not waste time rearranging the regulatory boxes to change the system of community bank regulation. That system has worked, is working, and will work in the future. The failure occurred in the too-big-to-fail sector. That is the sector Congress must fix.

#### **Identification and Regulation of Systemic Risk Institutions**

ICBA recommends that Congress establish an interagency task force to identify institutions that pose a systemic financial risk. At a minimum, this task force should include the agencies that regulate and supervise FDIC-insured banks – including the Federal Reserve – plus the Treasury and Securities and Exchange Commission. This task force would be fully staffed by individuals from those agencies, and should be charged with identifying specific institutions that pose a systemic risk. The task force should be directed by an individual appointed by the President and confirmed by the Senate.

Once the task force has identified systemic risk institutions, they should be referred to the systemic risk regulator. Chairman Bernanke’s March 10<sup>th</sup> speech provides a good description of the systemic risk regulator’s duties: “Any firm whose failure would pose a systemic risk must receive especially close supervisory oversight of its risk-taking, risk management, and financial condition,



and be held to high capital and liquidity standards.” Bernanke continued: “The consolidated supervisors must have clear authority to monitor and address safety and soundness concerns in all parts of the organization, not just the holding company.”

Of course, capital is the first line of defense against losses. Community banks have known this all along and generally maintained higher than required levels. This practice has helped many of our colleagues to weather the current storm. The new systemic risk regulator should adopt this same philosophy for the too-big-to-fail institutions that it regulates.

Clearly, the systemic risk regulator should also have the authority to step in and order the institution to cease activities that impose a systemic risk. Many observers warned that many players in the nation’s mortgage market were taking too many risks. Unfortunately, no one agency attempted to step in and stop imprudent lending practices across the board. An effective systemic risk regulator must have the unambiguous duty and authority to block any financial activity that threatens to impose a systemic risk.

#### **Assessment of Systemic Risk Regulatory Fees**

The identification, regulation, and supervision of these institutions will impose significant costs on the systemic risk task force and systemic risk regulator. Systemic risk institutions must be assessed the full costs of these government expenses. This would entail a fee, similar to the examination fees banks must pay to their chartering agencies.

#### **Resolving Systemic Risk Institutions**

Chairman Bair and Chairman Bernanke have each recommended that the United States develop a mechanism for resolving systemic risk institutions. This is essential to avoid a repeat of the series of the ad hoc weekend bailouts that have proven so costly and infuriating to the public and unfair to institutions that are too small to save.

Again, Bernanke’s March 10<sup>th</sup> speech outlined some key considerations:

The new resolution regime would need to be carefully crafted. For example, clear guidelines must define which firms could be subject to the alternative regime and the process for invoking that regime, analogous perhaps to the procedures for invoking the so-called systemic risk exception under the FDIA. In addition, given the global operations of many large and complex financial firms and the complex regulatory structures under which they operate, any new regime must be structured to work as seamlessly as possible with other domestic or foreign insolvency regimes that might apply to one or more parts of the consolidated organization.

This resolution process will, obviously, be expensive. Therefore, Congress should direct the systemic risk regulator to establish a fund to bear these costs. The FDIC provides a good model. Congress has designated a minimum reserve ratio for the FDIC's Deposit Insurance Fund and directed the agency to assess risk-based premiums to maintain that ratio. Instead of deposits, the ratio for the systemic risk fund should apply as broadly as possible to ensure that all the risks that are covered are assessed.

Some of the systemic risk institutions will certainly include FDIC-insured banks within their holding companies. These banks would certainly not be resolved in the same way as a stand-alone community bank; all depositors would be protected beyond the statutory limits. Therefore, the Congress should direct the FDIC to impose a systemic risk fee on these institutions in addition to their regular premiums.

Last week's news that AIG was required by contract to pay hundreds of millions of dollars in bonuses to the very people that ruined that company point to another requirement for an effective systemic risk regulator. Once a systemic risk institution becomes a candidate for open-institution assistance or resolution, the regulator should have the same authority to abrogate contracts as the FDIC when it is appointed conservator and receiver of a bank. If the executives and other high-paid employees of these institutions understood that they could not design employment contracts that harmed the public interest, their willingness to take unjustified risk might diminish.

#### **Breaking up Systemic Risk Institutions & Preventing Establishing New Threats**

ICBA believes that imposing systemic risk regulation and imposing systemic risk fees and premiums will provide incentives to firms to voluntarily divest activities or not become too big to fail. However, these incentives may not be adequate. Therefore, Congress should direct the systemic risk task force to order the break up of systemic risk institutions over a five year period. These steps will reverse the long-standing regulatory policy that has favored the creation of ever-larger financial institutions.

ICBA understands that this will be a controversial recommendation, and many firms will object. Let me be clear. We do not advocate liquidation of ongoing, profitable activities. Huge conglomerate holding companies should be separated into business units that make sense. This could be done on the basis of business lines or geographical divisions. Parts of larger institutions could be sold to other institutions. The goal is to reduce systemic risk, not to reduce jobs or service to consumers and businesses.

**Maintain and Strengthen the Separation of Banking and Commerce**

Congress has consistently followed one policy that has prevented the creation of some systemic risk institutions. The long-standing policy prohibiting affiliations or combinations between banks and non-financial commercial firms (such as Wal-Mart and Home Depot) has served our nation well. ICBA opposes any regulatory restructuring that would allow commercial entities to own a bank. If it is generally agreed that the current financial crisis is the worst crisis to strike the United States since the Great Depression, how much worse would this crisis have been had the retail commercial sector been intertwined as well? Regulators are unable to properly regulate the existing mega financial firms, how much worse would it be to attempt to regulate business combinations many times larger than those that exist today?

This issue has become more prominent with recent Federal Reserve encouragement of greater equity investments by commercial companies in financial firms. This is a very dangerous path.

Mixing banking and commerce is bad public policy because it creates conflicts of interest, skews credit decisions, and produces dangerous concentrations of economic power. It raises serious safety and soundness concerns because the companies operate outside the consolidated supervisory framework Congress established for owners of insured banks. It exposes the bank to risks not normally associated with banking. And it extends the FDIC safety net putting taxpayers at greater risk. Mixing banking and commerce was at the core of a prolonged and painful recession in Japan.

Congress has voted on numerous occasions to close loopholes that permitted the mixing of banking and commerce, including the non-bank bank loophole in 1987 and the unitary thrift holding company loophole in 1999. However, the Industrial Loan Company loophole remains open.

Creating greater opportunities to widen this loophole would be a serious public policy mistake, potentially depriving local communities of capital, local ownership, and civic leadership.

**Conclusion**

ICBA greatly appreciates this opportunity to testify. We recommend that Congress take a number of steps to regulate, assess, and ultimately break up institutions that pose unacceptable risks to the nation's financial system. At the same time, Congress should avoid doing damage to the regulatory system for community banks, a system that has been tremendously effective. Finally, Congress should prevent the unwise concentration of financial and commercial power that would result if commercial firms like Wal-Mart could combine with federally insured banks.

The current crisis provides you an opportunity to strengthen our nation's financial system and economy by taking these important steps. ICBA urges Congress to quickly seize that opportunity.

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Mr. JOHNSON. Thank you, Mr. Cloutier.  
 We are in the middle of a vote on the floor. We have time for at least one more opening statement.  
 So, Mr. Askew, would you proceed?

**TESTIMONY OF WILLIAM ASKEW, SENIOR POLICY ADVISOR,  
 FINANCIAL SERVICES ROUNDTABLE, WASHINGTON, DC**

Mr. ASKEW. Chairman Conyers, Chairman Johnson, Ranking Member Coble, and Members of the Committee, I am Bill Askew, senior advisor to the Financial Services Roundtable.

At this hearing, I am representing the Roundtable, but I actually wear two hats, as I am also a banker. During the last 25 years, I worked within the antitrust laws as we acquired and merged a number of banks. I know the Antitrust Division of the Department of Justice, the Federal Reserve, and antitrust mechanisms are working well because I have experienced them firsthand.

Divestitures have been one of the most challenging and difficult parts of my job over the last 2 decades. It is not just deposits you give up in a divestiture; it is customers, associates, brick and mortar, and hard-fought market share, all built over many years. But, as difficult as this was, the point is, the system works and antitrust laws do the job as they are intended to do.

As part of this process, the laws are straightforward. Banks know when they agree to merge that certain market share concentrations will probably require divestitures. The Justice Department selects the specific branches based upon independent review. This is the function of antitrust law, to review pending acquisitions and prevent mergers that would substantially lessen competition or restrain trade in any section of the country.

Given the number of participants in the market today, we assess the financial services sector as highly competitive. As of 2007, the financial industry included 5,000 registered broker/dealers, 1,250 thrifts, 8,000 credit unions, 7,250 commercial banks, 1,200 life insurance companies, and 2,700 property and casualty companies.

We believe that the current crisis is not a result of failure of antitrust laws. Rather, it is a combination of several unprecedented and interrelated financial events: large amounts of savings investments flowing into the United States financial system searching for a higher return; a booming housing market with home prices increasing at record levels, served by an under-regulated mortgage lending engine; innovation in largely unregulated credit derivatives, collateralized debt obligations, and credit default swaps; and excessive leverage in firms who failed to put the brakes on their own borrowing in the midst of cheap money supply.

A fragmented system of national and State financial regulations straddled these market conditions. And, in the end, no Federal agency was responsible for examining the totality of the risk created in interconnected firms and markets. Decades of ad-hoc legislation to regulatory updates, not our antitrust laws, has created significant gaps in financial regulation that permitted some financial services firms to operate with minimal oversight.

To address these shortcomings, the Roundtable has developed a proposed financial regulatory architecture, as illustrated in my written testimony. It has six key features.

First, we propose an expansion of the President's Working Group with the Financial Markets Coordinating Council. Second, to address systemic risk, we propose that the Federal Reserve be authorized to act as a market stability regulator.

Third, to eliminate gaps in regulation, we propose the consolidation of several existing Federal agencies into a single national financial institutions regulator. Fourth, to focus greater attention on the stability of the financial markets, the creation of a national capital markets agency.

Fifth, we propose the Federal Deposit Insurance Corporation be reconstituted as an insurer for bank deposits, retail insurance policies written by nationally chartered insurance companies, and for investors who have claims against broker/dealers. Finally, as the market stability regulator interacts with regulators, there is an evident need to create a national insurance regulator.

Mr. Chairman, as a result of this crisis, some financial firms have been labeled "too big to fail." Their counterparty obligations and global reach required that they be treated by the Fed and Treasury differently than typical institutions. It does not, however, make them examples of market power in the truest sense of the antitrust law. The trouble in the financial services sector has exposed severe flaws, regulatory and otherwise, which I have detailed, but a lack of competition and choice for consumers is not one of them.

We commend you and the other Members of Congress for your work to modernize and strengthen financial regulations. This work is of the highest priority. And it will, I am confident, produce a regulatory regime that will help us and every American consumer and the companies with whom they choose to do business emerge from this crisis stronger than before.

Thank you. I look forward to answering your questions.

[The prepared statement of Mr. Askew follows:]

PREPARED STATEMENT OF WILLIAM ASKEW

Statement of William Askew

On behalf of

The Financial Services Roundtable

On

The Role of Antitrust Law in Government-Funded  
Consolidation in the Banking Industry

Before

The Subcommittee on Courts and Competition Policy  
Committee on the Judiciary  
U.S. House of Representatives

March 17, 2009

Chairman Johnson, Ranking Member Coble, and members of the Subcommittee, my name is William Askew. I am an Executive Vice President with Regions Financial Corporation, and also serve as the Anthony T. Cluff Senior Policy Advisor to the Financial Services Roundtable (the "Roundtable"). I am appearing today on behalf of the Roundtable whose members are 100 of the nation's largest integrated financial services firms. Roundtable members provide banking, insurance and investment products and services to American consumers and businesses.

Thank you for the opportunity to participate in this hearing on the role of antitrust policy in financial regulation.

While many factors contributed to the current crisis in our financial markets, that crisis is not a product of our antitrust laws. The crisis is a liquidity crisis, caused by a combination of inappropriate practices by some financial services firms and our fragmented financial regulatory system. The appropriate policy response to this crisis should not be to revise our antitrust laws, but instead, to reform the nation's financial regulatory system.

Banks and other financial services firms are subject to the full range of our nation's anti-trust laws.<sup>1</sup> Depending upon the precise nature of the institution and the transaction in question, mergers, acquisitions and other consolidations may be subject to review by not only federal antitrust enforcers, but also the Federal Reserve Board, the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Securities and Exchange Commission ("SEC"), the Commodity Futures Trading

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<sup>1</sup> Congress also has prohibited any bank from holding more than 10 percent of all deposits. While this deposit cap is intended to limit overall deposit growth and concentration, it is arbitrary from both a policy and economic perspective.

Commission ("CFTC"), and the various state bank regulatory agencies and insurance commissions.

As a result of the application of anti-trust laws, the financial services industry remains extremely competitive. Each year, the Roundtable and the Insurance Information Institute publish a "Fact Book" on the financial services industry. The most recent edition of that publication reports that as of 2007, the financial services industry included 5,000 registered broker/dealers, 1,250 thrift institutions, 8,000 credit unions, 7,250 commercial banks, 1,200 life insurance companies, 2,700 property and casualty companies, and 800 health insurance companies. In addition, the financial services industry includes literally thousands of other commercial and consumer finance companies, hedge funds, and mortgage lenders.

The financial services industry does include some very large organizations. However, the current crisis was not caused by the size of individual institutions. It was the result of excessively risky practices on the part of some institutions and the inability of our existing financial regulatory system to detect and address these practices as they spread risks throughout the system.

Moreover, this crisis has demonstrated that no institution is "too big to fail". Over the past twelve months, large thrifts (e.g., Washington Mutual), large banks (e.g., Wachovia), regional banks (e.g., National City), and large brokers/dealers (e.g., Lehman Brothers and Bear Sterns) have either been sold, reorganized or have been allowed to fail. Nor will AIG emerge from its current state in the same form. Its equity holders have been effectively wiped-out, its management replaced, and its subsidiaries are for sale.

In the case of each of these large institutions, as well as the dozens of smaller banks that have failed during this crisis, regulators have intervened to protect depositors, policyholders, and



the economy as a whole – not to save equity holders or management. Resolution techniques have varied from institution to institution based upon the condition of the institution, and its connections with other market participants. In those cases in which the regulators have continued to operate the institution, such as AIG, they have done so because they believe that a gradual resolution will be the less costly to taxpayers than an immediate dissolution.

As I will explain further below, the real policy answer to the problems confronting our nation's financial markets is to reform the regulation of financial services firms so that risks, especially systemic risks, can be identified and addressed before they cause serious harm to consumers and the economy.

The root causes of this liquidity crisis are two-fold: a breakdown in practices by many, but not all, financial services firms and the failure of our financial regulatory system to identify and prevent such practices.

The industry practices that contributed to the crisis are well documented: Poor loan underwriting standards and credit practices, excessive leverage, misaligned incentives, less than robust risk management and corporate governance. Yet, throughout the run-up to this crisis, no single agency was monitoring the connections between different market participants across the nation's financial markets.

Since the crisis emerged in 2007, the financial services industry has taken actions to correct these practices. Underwriting standards have been upgraded, credit practices have been reviewed and recalibrated, leverage has been reduced as firms have rebuilt capital, incentives have being realigned, and some management teams have been replaced.

The second cause of the crisis, our fragmented financial regulatory system, has yet to be addressed. Crises have a way of revealing structural flaws that long existed, but were little

noticed until the crisis. This crisis is no different in that several structural flaws in our financial regulatory system, including the absence of any comprehensive oversight across financial firms and financial markets, have been identified.

Our current regulatory structure was created in piecemeal fashion over the past 150 years. As it evolved, the various parts of the regulatory system did not logically build upon one another. While the system worked well for many years, its flaws have become evident since the onset of the current crisis in late 2007. Indeed, to say our financial regulatory system is fragmented or uncoordinated would be an understatement.

Our fragmented system of financial regulation is based upon a concept of "functional" regulation. Under this system, firms are regulated according to their charter type, and there is limited coordination and cooperation between different regulators, even though firms with different charters often engage in the same or similar activities. Moreover, no federal agency is responsible for examining and understanding the risks created by the interconnections between firms and markets.

This functional system has resulted in gaps in regulation that permit some financial services firms to operate with minimal oversight and supervision, and it has encouraged firms to engage in regulatory arbitrage.

The regulation of mortgage finance illustrates these structural flaws. No single regulator was accountable for identifying and recommending corrective actions across the mortgage origination and securitization process. Most mortgage brokers were not subject to any licensing and qualification requirements. Over half of all mortgage loans were originated by state-licensed lenders and were not subject to supervision or regulation. Other lenders that were regulated were

able to engage in practices that did not meet basic safety and soundness or consumer protection standards.

The federal banking regulators recognized many of these problems and took actions to address the institutions within their jurisdiction.. Eventually, the Federal Reserve Board's Home Ownership and Equity Protection Act ("HOEPA") regulations did extend some consumer protections to a broader range of lenders, but the Federal Reserve Board does not have the authority to ensure that those lenders are engaged in safe and sound underwriting practices or risk management.

The process of securitization suffered from a similar lack of systemic oversight and prudential regulation. No agency had the authority to prohibit the sale of mortgages that were poorly underwritten. Likewise, no agency was responsible for addressing the over-reliance investors placed upon the credit rating agencies to rate mortgage-backed securities. Moreover, under our state-based system of insurance regulation, no federal agency was paying attention to the role of the mortgage insurance industry and other insurance companies that contribute to the mortgage origination and securitization process.

During the past year, the Roundtable has developed a regulatory reform proposal that is designed to address the structural flaws in our financial regulatory system. We believe that regulatory reforms, not changes in anti-trust policy, hold the answer to the problems that are plaguing our financial markets.

A key feature of our proposal is the creation of a market stability regulator that could identify, and to the extent possible, control systemic risks. Systemic risk is a significant, industry-wide threat or vulnerability based on market interconnections and regulatory gaps across the financial services industry as a whole (including products, markets, and firms), which,

if left unaddressed, could have material and adverse effects on either our financial markets or the U.S. economy.

In other words, systemic risk is not an isolated risk posed by a single institution or a solitary practice. It is a risk that crosses market segments as well as whole markets, domestic and globally, in addition to firms. Although large firms can create large risks, systemic risks can arise from the collective actions of many firms, both small and large.

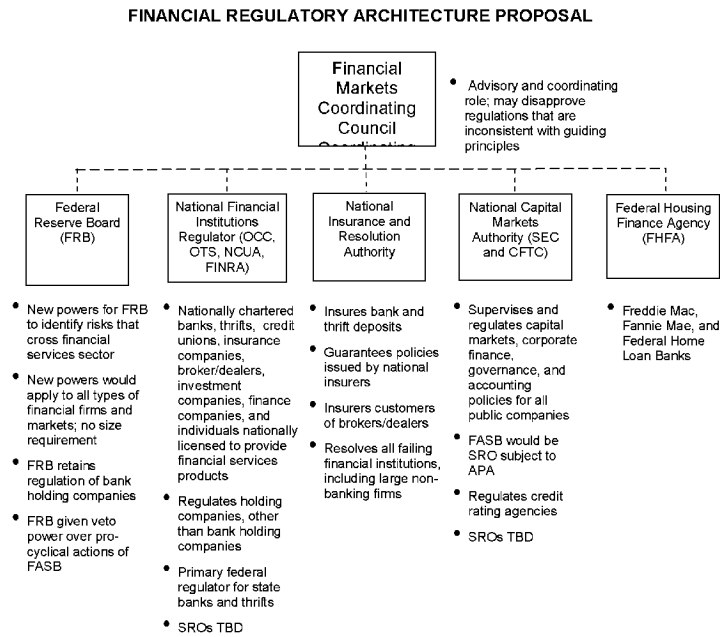
The practices and activities that contributed to the current crisis were not a function of the size of an institution. They were practices and activities that cut across different sectors of the financial services industry, and involved firms of varying sizes and shapes. These practices and activities include underwriting standards based on short-term adjustable rates, not rates over the term of a loan; securitizations based only upon a credit rating, with little due diligence by investors; and pro-cyclical capital standards that promoted the development of off-balance sheet vehicles. Individually these actions did not give rise to systemic risk, but collectively they did.

The Roundtable supports the creation of a market stability regulator to monitor broad trends across markets and firms and identify practices and activities that could pose significant risks to the financial system and our economy. This regulator should have the authority to collect information on all types of financial services firms, including depository institutions, broker/dealers, insurance companies, hedge funds, private equity firms, industrial loan companies, credit unions, and any other financial services firms that facilitate financial flows (e.g., transactions, savings, investments, credit, and financial protection) in our economy.

A market stability regulator should not duplicate the work of other regulators, but should work with other regulators to recommend actions that would prevent and address systemic risks.

This ensures a solid working relationship between the market stability regulator and prudential regulators and ensures that individual prudential regulators are sensitive to larger systemic risks.

Other features of our regulatory reform proposal are illustrated in the following chart.



The key components of this proposed regulatory architecture are as follows. First, to enhance coordination and cooperation among the many and various financial regulatory agencies, we propose to expand membership of the President's Working Group on Financial Markets ("PWG") and rename it as the Financial Markets Coordinating Council ("FMCC" or

"Council"). This Council should be established by law, in contrast to the existing PWG which has operated under a Presidential Order. This would permit Congress to oversee its Council's activities. The Council should include representatives from all major federal financial agencies, as well as individuals who can represent state banking, insurance and securities regulation. The Council should serve as a forum for national and state financial regulators to meet and discuss regulatory and supervisory policies, share information, and develop early warning detections.

The Council should not have independent regulatory or supervisory powers. However, it might be appropriate for the Council to have some ability to review the goals and objectives of the regulations and policies of federal and state financial agencies, and thereby ensure that they are consistent.

Second, to address systemic risk, we propose that the Federal Reserve Board should be authorized to act as a market stability regulator. As a market stability regulator, the Federal Reserve Board should be responsible for looking across the entire financial services sector to identify interconnections that could pose a risk to the financial system. To perform this function, the Federal Reserve Board should be empowered to collect information on financial markets and financial services firms, to participate in joint examinations with other regulators, and to recommend actions to other regulators that address practices that pose a significant risk to the stability and integrity of the U.S. financial services system. The Federal Reserve Board's authority to collect information should apply not only to depository institutions, but also to all types of financial services firms. This authority should not be based upon the size of an institution. It is possible that a number of smaller institutions could be engaged in activities that collectively pose a systemic risk.

Third, to reduce gaps in regulation, we propose the consolidation of several existing federal agencies into a single, National Financial Institutions Regulator ("NFIR"). This new agency would be a consolidated prudential and consumer protection agency for banking, securities and insurance. The NFIR would reduce regulatory gaps by establishing comparable prudential standards for all of these of nationally chartered or licensed entities. For example, national banks, federal thrifts and federally licensed brokers/dealers that are engaged in comparable activities should be subject to comparable capital and liquidity standards. Similarly, all federally chartered insurers would be subject to the same prudential and market conduct standards.

Fourth, to focus greater attention on the stability and integrity of financial markets, we propose the creation of a National Capital Markets Agency through the merger of the SEC and the CFTC, preserving the best features of each agency. The NCMA would regulate and supervise capital markets and exchanges. As noted above, the existing regulatory and supervisory authority of the SEC and CFTC over firms and individuals that serve as intermediaries between markets and customers, such as broker/dealers, investment companies, investment advisors, and futures commission merchants, and other intermediaries would be transferred to the NFIR. The NCMA also should be responsible for establishing standards for accounting, corporate finance, and corporate governance for all public companies.

Fifth, to protect depositors, policyholders, and investors, we propose the creation of the National Insurance and Resolution Authority as an insurer of bank deposits, the guarantor of retail insurance policies written by nationally chartered insurance companies, and a financial backstop for investors who have claims against broker/dealers. These three insurance systems would be legally and functionally separated. Additionally, this agency should be authorized to

act as the receiver for large non-bank financial services firms. The failure of Lehman Brothers illustrated the need for such a better system to address the failure of large non-banking firms.

Finally, to supervise the Federal Home Loan Banks and to oversee the emergence and future restructuring of Fannie Mae and Freddie Mac from conservatorship we propose that the Federal Housing Finance Agency remain in place, pending a thorough review of the role and structure of the housing GSEs in our economy.

Achieving better and more effective regulation will require more than just rearranging regulatory assignments. Consolidation of overlapping regulatory functions and greater coordination between the remaining agencies will be beneficial, but better and more effective regulation also requires (1) greater reliance on principles-based regulations that are responsive to changes in market conditions and are focused on desired regulatory results; (2) greater reliance on a system of prudential supervision that is based upon an on-going exchange of information between regulated firms and regulators that seeks to solve common problems before they pose a risk to consumers or the financial system; and (3) a reduction in the pro-cyclical effects of regulatory and accounting requirements.

Antitrust regulation should not be viewed as a substitute for regulatory reform. Our antitrust laws protect consumers against private agreements among firms that create or facilitate the exercise of market power – often thought of as the power of companies to raise prices or limit output. The Sherman Act (1890), enacted to address Congress's concerns about the impact of large trusts that emerged in the wake of the industrial revolution, protects consumers from private agreements between firms that seek to unreasonably restrain trade, and restricts the ability of individual firms from using improper means to acquire, maintain or exercise such market power. The Clayton Act, first enacted 1914, protects consumers from mergers and



acquisitions that are likely to substantially lessen competition or tend to create monopolies.

Antitrust laws exist because we have an economic system generally grounded in competitive free markets, and it is designed to ensure that private agreements do not interfere with the benefits brought by such competition.

Our existing antitrust laws are flexible and have served the country well – in good times and in bad – for many years. While there are numerous federal statutes that address specific aspects of antitrust law, and the Clayton Act has been periodically amended, the fundamental statutes remain flexible to preserve competition.

I urge the Subcommittee to resist any changes to these basic laws in response to the current crisis. These, and other anti-trust laws, are aimed at preserving competition and guarding against market power, not addressing a liquidity crisis.

A simple hypothetical might be the easiest way to demonstrate the risk of seeking to address the current problems facing our financial markets through changes in anti-trust law. Suppose a merger involves two financial services firms with largely complementary businesses. These firms desire to merge because the combination of their complementary expertise and footprints would enable them to develop new higher quality products and distribute those products at a lower cost than either firm could do individually. Neither firm would endeavor this new product development on its own. The merger also would permit some reductions in overhead expenditures due to duplication in general and administrative office services. In today's highly competitive and unconcentrated financial services industry, this hypothetical transaction is unlikely to raise any antitrust concern. However, if antitrust standards were changed to limit such mergers simply because of the size of the firms involved, consumers would

lose the benefits of new products and services. In other words, any such regime would be an unwarranted intrusion into free markets without any clear benefit.

In conclusion, Mr. Chairman, thank you for inviting me to testify before the Subcommittee today. I look forward to answering any questions you and other members of the Subcommittee may have regarding my testimony.

Mr. JOHNSON. Thank you, Mr. Askew.  
And, at this time, it would be best for us to go into a recess. We will be back in about maybe 20, 25 minutes. We appreciate you all's patience. Thank you.  
[Recess.]

Mr. JOHNSON. We will call the hearing back into order and give you our appreciation for your time.

And thank you for your statement, Mr. Askew.

And now we will turn it over to Ms. Garza.

**TESTIMONY OF DEBORAH A. GARZA, FORMER ASSISTANT ATTORNEY GENERAL, DIVISION OF ANTITRUST, U.S. DEPARTMENT OF JUSTICE, WASHINGTON, DC**

Ms. GARZA. Thank you, Chairman Johnson, Ranking Member Coble, and when they get here, if they do, other distinguished Members of the House Judiciary Committee Subcommittee on Courts and Competition Policy. It is a privilege to be invited to speak today about the role of antitrust enforcement in the current financial crisis.

I am not appearing today on behalf of any organization. I do not purport to express views of either the Antitrust Modernization Commission or the Justice Department. However, my written statement does discuss several relevant recommendations of the AMC.

In addition to discussing those recommendations, my written testimony makes a few points in response to the Subcommittee's specific question about what role antitrust should play in bank mergers today, particularly those funded by the Troubled Asset Relief Program, or TARP, and whether the antitrust laws should be used to block mergers on the basis that the resulting financial firms might subsequently be deemed "too big to fail."

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

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

Third, there is no evidence that the current economic crisis resulted from a failure of antitrust merger enforcement in the banking industry or that current merger law needs to be changed to address bank mergers.

Fourth, antitrust enforcement should continue to focus on whether markets are functioning competitively rather than whether a bank or other financial firm is too big or too systematically significant to fail. Those concepts present political and regulatory issues that are better handled outside the realm of antitrust enforcement.

The AMC made six recommendations relevant to the Subcommittee's questions.

One, the AMC recommended that there is no need to revise the antitrust laws to apply different standards to different industries. Current law, including the Horizontal Merger Guidelines applied

by the Antitrust Division, is sufficiently flexible to address specific competitive circumstances in the banking or any other industry.

Secondly, the AMC recommended that there is no need to revise section 7 of the Clayton Act or the general framework used by the enforcement agencies and courts to assess mergers. The AMC found broad-based consensus that merger enforcement policy has become increasingly predictable, transparent, and analytically sound. This has resulted in a broad consensus in support of current enforcement policy, which has become the paradigm for enforcement around the world.

Third, the AMC recommended that the Antitrust Division and the Federal Trade Commission should work to increase understanding of the basis for and the efficacy of U.S. merger enforcement policy. Notwithstanding the general consensus that exists in support of current policy, the empirical basis supporting assumptions about the effect of concentration, for example, is arguably limited. Although some studies in the banking industry suggest that there is a relationship between concentration and market power, there is substantially less consensus about the level at which antitrust should bite.

Focused study of this issue could improve the enforcement authority's ability effectively to enforce the antitrust laws. Extrapolating from this recommendation, it may be an appropriate time to review the empirical data and existing studies.

Fourth, the AMC recommended that the Antitrust Division and the Federal Trade Commission should increase the transparency of their decision-making to enhance public understanding of the agency's merger enforcement policy. It may be a good time for the Antitrust Division to focus such efforts specifically on bank mergers.

Fifth, the AMC recommended that Congress should not displace free-market competition without extensive, careful analysis and compelling evidence that either competition cannot achieve important societal goals that trump consumer welfare or a market failure requires the regulation of prices, costs, and entry in place of competition. Failing to enforce the antitrust laws where they would otherwise be enforced under current policy is unlikely to resolve the current economic crisis, but it could cause further harm to the economy in the future after markets have stabilized.

Finally, the AMC recommended that even in industries subject to economic regulation, such as the banking industry, the antitrust agencies should have full merger enforcement authority under the Clayton Act. The bank merger review regime closely fits the model proposed by the AMC.

Thank you for your attention, and I look forward to answering any questions.

[The prepared statement of Ms. Garza follows:]

PREPARED STATEMENT OF DEBORAH A. GARZA

STATEMENT OF DEBORAH A. GARZA

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

OVERSIGHT HEARING ON  
“TOO BIG TO FAIL?” “: THE ROLE OF ANTITRUST  
LAW IN GOVERNMENT-FUNDED CONSOLIDATION IN THE BANKING INDUSTRY”

March 17, 2009

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

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

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

- There is no apparent conflict between current antitrust enforcement policy and achieving stability in interbank money markets. The Justice Department's Antitrust Division should continue to assess the likely competitive effects of mergers, including those funded through TARP or involving banks in which the U.S. Government has taken an equity interest.
- There is no evidence that the current economic crisis resulted from a failure of antitrust merger enforcement in the banking industry or that current merger law needs to be changed to address bank mergers. Antitrust enforcement should continue to focus on whether markets are functioning competitively, rather than on whether a bank or other financial firm is "too big" or "systemically significant" to fail, which presents political and regulatory issues better handled outside the realm of antitrust enforcement.

#### **The Continued Relevance of Antitrust**

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

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

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

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

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

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

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

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

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



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

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

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

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

<sup>3</sup> *Id.* at 5.

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

#### **“Too Big to Fail” is not a Question of Antitrust Enforcement**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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<sup>7</sup> Robert Reich, “If They Are Too Big to Fail, They’re Too Big Period” (Oct. 22, 2008), available at [http://www.rgemonitor.com/financemarkets-monitor/254109/if\\_they\\_re\\_too\\_big.htm](http://www.rgemonitor.com/financemarkets-monitor/254109/if_they_re_too_big.htm).

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

#### **Recommendations of the Antitrust Modernization Commission**

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

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

<sup>9</sup> *AMC Report* at 31.

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

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

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

<sup>11</sup>See *AMC Report* at 54-56.

<sup>12</sup>*AMC Report* at 54-55.

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

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

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

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

<sup>15</sup> See *AMC Report* at 62.

<sup>16</sup> *Id.*

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

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

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

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

<sup>18</sup> *AMC Report* at 63.

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

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

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



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

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

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

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

<sup>23</sup> *AMC Recommendations 69-73*.

<sup>24</sup> *AMC Recommendation 74*.

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

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Mr. JOHNSON. Thank you, Ms. Garza.  
And next, and certainly not least, Dr. Cooper, would you grace us with your presentation?

**TESTIMONY OF MARK N. COOPER, DIRECTOR OF RESEARCH,  
CONSUMER FEDERATION OF AMERICA, WASHINGTON, DC**

Mr. COOPER. Thank you, Mr. Chairman, Members of the Committee.

This hearing is about one of the most important problems arising in the inadequately regulated financial sector that has plunged this Nation into the worst economic crisis in three-quarters of a century, the moral hazard of “too big to fail.” But the technical definition of “moral hazard” does not convey the full implications of this problem in the current financial crisis, so let me put a finer point on it: Capitalism without bankruptcy is like Catholicism without hell. It lacks a sufficiently strong motivational mechanism to ensure good behavior.

The financial system never should have been allowed to become exposed to a plague of banks, shadow banks, and financial products that are too big to fail. And, worse still, we have discovered that it is not only size that kills in the financial sector, but complexity and lack of transparency. Complex and opaque products and interconnections among firms that spread like a virus through the financial system and are nearly impossible to unwind also pose systemic risk.

The bipartisan theory of market fundamentalism that got us into this current mess offered the proposition that all we needed to protect us from these problems was the market. But Alan Greenspan, the high priest of market fundamentalism, recently admitted that there is a flaw in his theory. Quote, “Those of us who looked to the self-interest of lending institutions to protect shareholders’ equity, myself included, are in a state of shocked disbelief. I made a mistake in presuming that the self-interest of organizations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their equity in their firms.” If they can’t protect the private interest, you can imagine the mess they make of the public interest.

The flaw in market fundamentalism teaches us that competition alone is not enough to ensure the proper functioning of the financial system. It is clear that the only way to prevent the public from being exposed to the moral hazard of “too big or too complicated to fail” is to regulate financial institutions and products in a manner that imposes effective discipline on their behavior.

And regulation must also address the other problems that afflict this inadequately regulated financial sector, including asymmetric information, agency, conflicts of interest, perverse incentives, and unfairness. All of these are well beyond the reach of the antitrust laws.

Effective, prudential regulation should establish the framework within which competition works. When the New Deal created the institutions of prudential regulation to repair the financial sector after the crash that followed the Roaring Twenties, it did not repeal the antitrust laws; it layered prudential regulation atop the antitrust laws. The result was a most remarkable half-century, the only half-century that was free of a major domestic financial crisis in the history of the Republic.

There is much to do to restore effective regulation but also much to restore effective antitrust oversight. Let me suggest four critical

steps that would have helped to reduce the size of this problem. Could never have solved it, but it might have helped to reduce it.

First, Federal authorities should take their own guidelines more seriously, challenging mergers more consistently in highly concentrated markets. The theory of the dynamic duopoly has proven to be just as wrongheaded as market fundamentalism.

Second, antitrust authorities must return to the fundamentals of head-to-head competition as the foundation of antitrust action. Intermodal and potential competition have simply proved ineffective in disciplining market power. Head-to-head competition is what we need.

Third, antitrust has given far too much deference to efficiency at the expense of competition. The assumption that private actors will be perceptive and well-intentioned in their pursuit of efficiency and share efficiency gains with consumers, even where competition is feeble, never made any sense. And in light of the collapse of market fundamentalism, it must no longer be relied upon. Private actors have proven that they are at least as likely to be myopic, misinformed, and maleficent.

Fourth, the digital economy of the 21st century is made up of platforms in which layers of complementary products and services sit atop one another, and they are closely interconnected, frequently through technology. This renders the threat of vertical leverage much greater than was the case in the physical markets of the 19th and 20th centuries. Tying, anticompetitive bundling, and exclusionary conduct take on much greater significance.

The need for reform does not demand a radical new experiment. Rather, it demands a return to the traditional values, institutions, and practices of progressive capitalism that served us well in the half-century after the New Deal. The market fundamentalism of the past 30 years was the radical experiment, and it has failed miserably. It is time for us to abandon the market fundamentalist view that sees regulation and antitrust as the ex-post cleanup after the occasional market failure, instead viewing antitrust and regulation as the ex-ante prophylaxis to prevent market failure.

Thank you.

[The prepared statement of Mr. Cooper follows:]



**Consumer Federation of America**

**Testimony of Dr. Mark Cooper**

**Director of Research**

**Consumer Federation of America**

**On**

**Too Big to Fail?**

**The Role of Antitrust Law in Government-Funded Consolidation in  
the Banking Industry**

**Subcommittee on Courts and Competition Policy**

**Committee on the Judiciary**

**United States House of Representatives**

**March 17, 2009**

Mr. Chairman and Members of the Committee,

My name is Dr. Mark Cooper. I am Director of Research at the Consumer Federation of America (CFA).<sup>1</sup> CFA greatly appreciates the opportunity to appear before you today to address one aspect of the financial meltdown that has plunged this nation into the worst economic crisis in three quarters of a century. For well over a decade, CFA has been warning policy makers of the dangers of excessive deregulation across a number of financial sectors including banking, credit, financial services, insurance, housing, and commodity futures. The topic of today's hearing, the threat that the principle of "too big to fail" poses to the public and the role of consolidation in the financial sector in magnifying that threat is but one of many problems that afflicts the financial sector.

### **Nobody Should be "Too Big to Fail"**

This hearing is about an important problem that receives a lot of attention under the rubric of "moral hazard."<sup>2</sup> The technical definition of moral hazard – "The effect of certain types of insurance systems in causing a divergence between the private *marginal cost* of some action and the marginal *social cost* of that action thus resulting in an allocation of resources which is not optimal"<sup>2</sup> – does not fully convey the implications of this problem in the current financial mess, so let me put a finer point on it.

**Capitalism without bankruptcy is like Catholicism without hell; it lacks a sufficiently strong motivational mechanism to ensure good behavior.**

The financial system should never have been allowed to become exposed to a plague of banks and other financial institutions that were deemed to be "too big to fail." Moreover, size is not the only cause of systemic risk. As we learned when policymakers determined that Lehman Brothers was not too big to fail, complex and opaque interconnections among firms, most notably through credit default swaps, also create systemic risk. We have also discovered that some products, such as mortgage-backed securities, are so complex and prone to spread like a virus through the financial system that they pose a threat of systemic risk because they afflict so many institutions and they are nearly impossible to unwind when they fail. In other words, we must prevent products and institutions from becoming "too big or too complicated to fail."

<sup>1</sup> The Consumer Federation of America (CFA) is a non-profit association of some 300 consumer groups that was founded in 1968 to advance the consumer's interest through advocacy, research, and education.

<sup>2</sup> The Dictionary of Modern Economics, p. 298. The Wikipedia definition is as follows: **Moral hazard** is the prospect that a party insulated from risk may behave differently from the way it would behave if it were fully exposed to the risk. Moral hazard arises because an individual or institution does not bear the full consequences of its actions, and therefore has a tendency to act less carefully than it otherwise would, leaving another party to bear some responsibility for the consequences of those actions... [financial bail-outs of lending institutions by governments, central banks or other institutions can encourage risky lending in the future, if those that take the risks come to believe that they will not have to carry the full burden of losses. Lending institutions need to take risks by making loans, and usually the most risky loans have the potential for making the highest return. A moral hazard arises if lending institutions believe that they can make risky loans that will pay handsomely if the investment turns out well but they will not have to fully pay for losses if the investment turns out badly.]

### **Restoration of Effective Prudential Regulation is Vitally Necessary to Restore the Health of the Financial System**

While we believe that vigorous antitrust enforcement is critically important to promoting a competitive industry that protects the public from a variety of abuses, we also believe that the only way to prevent the public from being exposed to the moral hazard of “too big or too complicated to fail” is to regulate financial institutions and products in a manner that imposes effective discipline directly on their behavior. Antitrust authorities do not have any special expertise in understanding systemic risk and the principles of antitrust law do not reach systemic risk. Given the financial sector’s tendency to parallel, procyclical behavior (contagion) with complex products and opaque balance sheets, even an unconcentrated market can easily pose a systemic risk.

Moreover, as described in Table 1, we have identified six fundamental flaws that have afflicted the inadequately regulated financial markets of the past several decades, only one of which is the moral hazard involved in “too big or too complicated to fail.” In addition to moral hazard, the flaws in financial markets that we have identified include asymmetric information, agency, conflicts of interest, perverse incentives and unfairness.<sup>3</sup> These problems also exceed the reach of antitrust law in many ways.

The theory of market fundamentalism that got the financial sector and the real economy into the current mess claimed that the market was all we needed to protect us from these flaws. Alan Greenspan recently admitted that this theory suffered from a flaw.

“Those of us who looked to the self-interest of lending institutions to protect shareholders’ equity, myself included, are in a state of shocked disbelief... I made a mistake in presuming that the self-interests of organizations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their equity in the firms.”<sup>4</sup>

Greenspan’s admission of a fundamental flaw in market fundamentalism teaches us that we cannot rely on the market to ensure that the financial system performs its important role in society, as described by the Congressional Oversight Panel in its recent report.

<sup>3</sup> The Wikipedia definition of moral hazard also points out that several of these flaws in the financial markets can be seen as different types of moral hazard: Moral hazard is related to information asymmetry, a situation in which one party in a transaction has more information than another. The party that is insulated from risk generally has more information about its actions and intentions than the party paying for the negative consequences of the risk. More broadly, moral hazard occurs when the party with more information about its actions or intentions has a tendency or incentive to behave inappropriately from the perspective of the party with less information.... A special case of moral hazard is called a principal-agent problem, where one party, called an agent, acts on behalf of another party, called the principal. The agent usually has more information about his or her actions or intentions than the principal does, because the principal usually cannot perfectly monitor the agent. The agent may have an incentive to act inappropriately (from the viewpoint of the principal) if the interests of the agent and the principal are not aligned.

<sup>4</sup> “The Financial Crisis and the Role of Federal Regulators,” Committee on Oversight and Government Reform, U.S. House of Representative, October 23, 2008.

“A well-regulated financial system serves a key public purpose: if it has the power and if its leaders have the will to use the power, it channels savings and investment into economic activity... A healthy financial system, one that allows for the efficient allocation of capital and risk, is indispensable to any successful economy.”<sup>5</sup>

**Table 1: Causes of Market Failure in Deregulated Financial Markets<sup>6</sup>**

Moral Hazard: Traditionally, moral hazard has been the focal point of concern in the financial sector, but the current crisis demonstrates a much broader set of problems and concerns. In the finance sector, there has long been a tendency to shift costs and risks onto the backs of taxpayers, where the government guarantees the ultimate soundness of financial institutions, either directly through insurance, or indirectly, by conceding that some institutions are “too big to fail.” The shift of risk is highly visible where the government acts as insurer, and the counterbalance to that risk was supposed to be vigorous government regulation to constrain risky behavior. But market fundamentalism led to weak government oversight even at insured institutions. Financial institutions outside the insurance system were even less constrained in the risks they could assume. As a result, the government has been driven to bail out not only banks and the government sponsored enterprises, Fannie Mae and Freddie Mac, but also investment banks and the insurer AIG. What was once an abstract threat – that financial institutions would take irresponsible risks in the confidence that the government would bail them out – has become a pressing reality.

Transparency and Asymmetric Information: The second flaw that receives a great deal of attention in discussions of the current financial crisis is information transparency. The availability of information is central to the operation of efficient markets. Lack of transparency makes it difficult to evaluate risk and achieve efficient outcomes, while asymmetry of information between management, stockholders and the public provides an open invitation for mischief. These problems have been manifest in the current crisis in a host of ways, including collateralized debt obligations so complex as to be completely opaque even to many who bought and sold them; financial institutions who used accounting maneuvers to move risky assets off their balance sheet in ways that were supposed to be outlawed after the Enron scandal; and intricate inter-connections of institutions through over-the-counter derivatives transactions that left participants in the dark about the nature and scope of counter-party risk to which they were exposed.

Key players who had critical roles in the information chain had massive conflicts of interest that either blinded them to risks or made them reluctant to convey that information to other market participants. As a result, the quality of information was abysmal. This includes credit rating agencies, whose AAA ratings were essential to creating a market for mortgage-backed securities. Paid by issuers, the ratings agencies’ profitability depended on their ability to win market share in the highly lucrative business of rating structured finance deals, and their ability to win that business too often depended on the “flexibility” of their ratings. Investment bankers, meanwhile, were responsible both for ensuring that credit rating agencies received complete and accurate information regarding the securities they were to rate and that investors received full and fair disclosures regarding the deal. But the massive fees they earned underwriting the securities left them with little incentive other than the public interest to fulfill their information responsibilities diligently.

Agency: The separation of ownership and control has long been recognized as a social problem for the capitalist economy, but the incentive structures of market fundamentalism make it urgent. There is a powerful interaction between information, agency, incentive structures and conflicts of interest. Because of imperfect information, it is often difficult to make sure that an agent does what he is supposed to do. Because of the failure to align incentives, it is often the case that he does not. The problems of agency and perverse incentives intersect in a highly visible issue in the current context – executive compensation.

<sup>5</sup> Congressional Oversight Panel, *Special Report on Regulatory Reform*, January 29, 2009

<sup>6</sup> Mark Cooper and Barbara Roper, *Reform Of Financial Markets, The Collapse of Market Fundamentalism and the First Steps in Revitalizing the Economy*, Consumer Federation of America, forthcoming.



Compensation packages for financial industry executives not only increased dramatically in recent years, but also took on a structure that introduced short-term bias in business decision-making.

Perverse Incentives: Market fundamentalism has a pervasive incentive problem that creates an engine of instability in the structure/conduct heart of the unregulated financial market. This was evident in the current crisis, where a daisy chain of conflict-ridden market participants spread the risks from unsound mortgage loans into every corner of the global financial markets. As fees from making deals became a major source of income, the quality of the deals mattered less and less. After all, the deals could always be sold by conflict-ridden brokers, supported by loans from conflict-ridden banks, securitized by conflict-ridden investment banks, rated by conflict-ridden credit rating agencies, and moved off the balance sheets so that more deals could be made and more fees earned. As long as more money could be pulled in, the day of reckoning could be pushed off. The structure of income and compensation created a perverse incentive to pump up fees and bonuses, with little regard to the quality of the underlying assets and loans.

Conflicts of Interest: Conflicts of interest pervade the financial system. We have already mentioned the key role that conflicts at credit rating agencies and investment banks played in bringing about the current crisis through their impact on incentives. However, conflicts of interest can and do take many other forms as well. When, for example, a single entity owns both an insured business (e.g. a commercial bank) and an uninsured business (an investment bank), or both regulated and unregulated subsidiaries that deal with each other, there is a powerful conflict of interest. Profit can be increased by having the insured (regulated) entity, which is not supposed to get into risky lines of business, subsidize the uninsured (unregulated) ventures that do get into risky businesses, with imprudent loans. Or unregulated entities (such as off-balance sheet investment vehicles) can be used to hide risks assumed by the regulated entity (bank) in order to evade capital requirements designed to protect taxpayers from risk.

At the extreme, where agents not only pursue their interests at the expense of shareholders and the public, but also do so illegally, conflicts of interest become fraud. Fraud is not unique to market fundamentalism, but the institutional structure creates a fertile field for an endemic fraud problem. High stakes, lax oversight, creative accounting and a short-term perspective are conducive to fraud. In an environment that emphasizes short-term stock market returns and allows risk takers to take out earnings quickly, practices degenerate. As the bad actors get their short-term rewards, the good actors become desperate to keep up. In fact, given the structural conduciveness to fraud and the structurally induced race to the bottom in ethics, it is fair to argue that market fundamentalism has a uniquely endemic fraud/abuse problem.

Unfairness/Inequality: The five flaws described above have all been recognized as creating a potential for market failures in unregulated markets. In its report on financial regulatory reform, the Congressional Oversight Panel adds a sixth – unfairness. Unfairness in transactions, the COP argues, can starve the system of resources, raising costs and restricting activity. It describes two categories of problems, outright deception and fraud on the one hand and a more subtle problem that exists when parties to a transaction are unfairly matched. In addition to threatening the flow of resources into the system, unfairness in transactions can result in misallocation of resources, as lenders take advantage of overmatched borrowers to drive up household debt to precarious levels, for example.

This broader conceptualization of the importance of unfairness/inequality as a supply-side issue fits the current crisis in another sense, which is a demand side problem. The severe increase in inequality of income and resources that took place during the reign of market fundamentalism resulted in a failure of incomes to keep up with the rapid expansion of the production capacity of the economy. The rising cost of necessities – housing, education, health care, and energy – put severe stress on household budgets, causing them to plunge into debt to maintain their standard of living. Savings are too low, and concentrated wealth creates rampant speculation rather than productive investment in the real economy.

### Regulation and Antitrust Go Hand-in-Hand

This means that competition alone is not enough to ensure the proper functioning of the financial system. There is no evidence that market discipline alone is sufficient to promote transparency, protect consumers, prevent conflicts of interest, discipline excessive greed and speculation, or solve agency problems, not to mention control systemic risk. On the contrary, competition and regulation should go hand in hand in rebuilding the financial system. Effective prudential regulation should establish the framework within which competition can work. And we should not forget that many of the competition authorities in the U.S. have consumer protection in their portfolio.<sup>7</sup> Therefore, they can play an important role in promoting transparency and fairness in financial markets.

For example, in order to control systemic risk, it is critically important to established effective capital ratios that increase as the size of institutions increase, to require originators of loans and assets to retain a substantial direct interest in those assets (i.e. to have skin in the game) and to ban off balance sheet investment vehicles, among other things. Having established these basic parameters for financial institutions, we still want vigorous competition to promote efficiency, within the constraints that regulation establishes. Financial institutions should not prosper by over leveraging and shifting risk to taxpayers; they should prosper by providing better customer service and having a sharper eye for evaluating risk. Regulation prevents irresponsible behavior that takes advantage of stockholders and consumers; competition promotes the efficient functioning of the market.

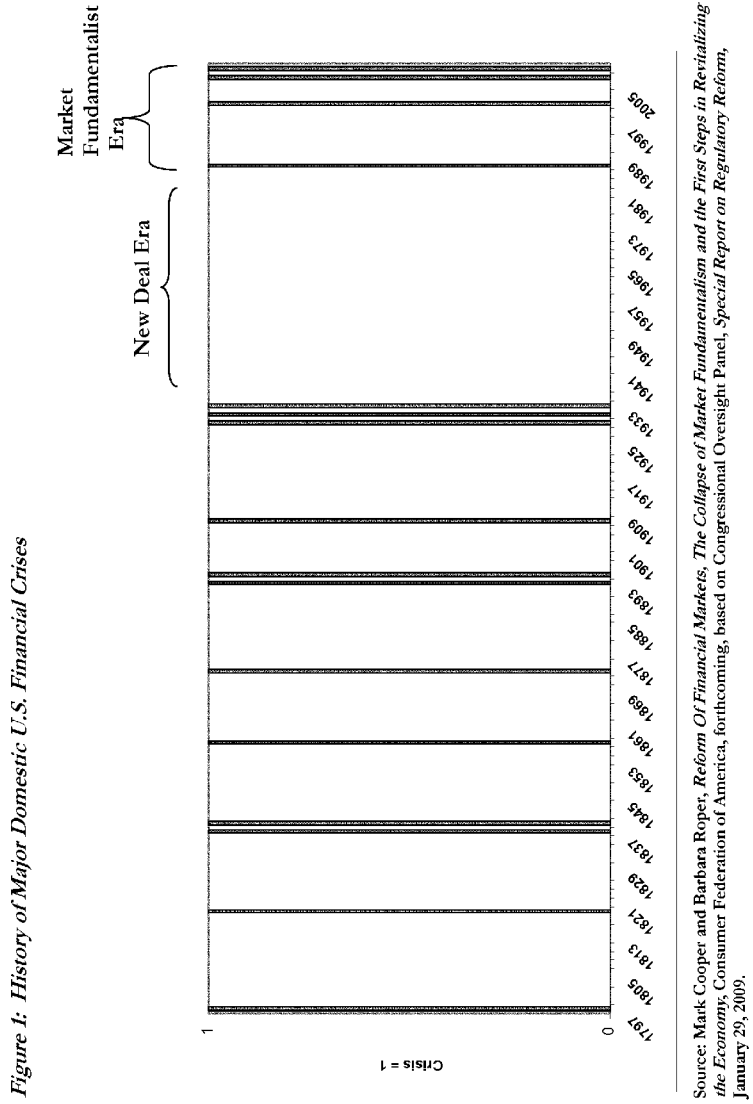
When the New Deal created the institutions of prudential regulation to repair the financial sector after the crash that ended the roaring twenties, *it did not repeal the antitrust laws*. It layered prudential regulation atop the antitrust laws. The result was a most remarkable half century, as depicted in Figure 1; the only half century that was free of major domestic financial crises in the history of the Republic.

### Restoration of Effective Antitrust Oversight is Vitally Necessary to Ensure that Financial Markets Do their Job Efficiently

In order to ensure that competition and regulation work together in the financial sector, the Congress will have to be alert to a nasty trend that has developed lately at the Supreme Court. In a series of cases in the telecommunications sector, the court has ruled that where regulation exists, no matter how lax, the antitrust laws do not apply. That view is

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<sup>7</sup> CFA supports the creation of a modern institution of prudential regulation, an independent federal agency to regulate credit products and payment systems for safety, to protect consumers and repair the financial sector in the wake of the current economic crash. Such an agency has been proposed by the Congressional Oversight Panel, Representative Delahunt (H.R. 7258 in the 110<sup>th</sup> Congress) and Senators Durbin and Schumer (S. 566).



simply wrong. It stems from the extreme market fundamentalist view held by a majority of the members of the court, which fails to recognize the severe market imperfections and the harm of market failure that afflicts many markets in the 21<sup>st</sup> century economy.

In the past three decades, as market fundamentalists dismantled the institutions of prudential regulation, they also relaxed antitrust oversight based on the now discredited belief that the invisible hand of the market would correct its many problems. The combination of inadequate regulation and inadequate competition has produced the current disaster in the financial sector. We must restore the institutions of progressive capitalism, which recognized the need for both regulation and competition. It is time for us to abandon the market fundamentalism view of market failure and regulation and to return to the New Deal view of market failure and regulation. It is time to replace the age of irrational exuberance for markets, where regulation was seen as the *ex post* clean up after the occasional market failure, with an understanding that regulation is the *ex ante* prophylaxis to prevent market failure.

Regulation is not the bailiwick of this committee, so much of what needs to be done will happen elsewhere on Capitol Hill, but there is much to be done in the realm of antitrust enforcement to ensure that financial markets are competitive and produce consumer friendly, economically efficient outcomes within the parameters that regulatory policy sets. There are at least four areas of merger and competition policy in need of immediate and extensive repair.

**Thresholds.** Based upon decades of experience and theory, the Department of Justice's *Merger Guidelines* suggest that mergers in markets that have fewer than the equivalent of six equal-sized competitors are harmful and should be challenged. In the past decade, that standard seems to have deteriorated into a standard of "more than two is enough." The theory of the dynamic duopoly has proven to be just as wrong headed as market fundamentalism. Federal antitrust authorities should take their own guidelines more seriously, challenging mergers more consistently in highly concentrated markets.

**Potential and Intermodal Competition.** The lax standard has been driven in part by an over reliance on intermodal and potential competition to excuse the massive build up of market power that is evident when a rigorous 'traditional' view of product and geographic markets is taken. Intermodal and potential competition has simply not provided the effective disciplining force that head-to-head competition provides. Antitrust authorities must return to the fundamentals of head-to-head competition as the foundation of antitrust action.

**Efficiency Defense.** Over the past several decades antitrust has given far too much deference to efficiency at the expense of competition. The theory that private actors should be allowed to acquire market power where efficiency would be advanced rested in part on the assumption that firms would perceive and pursue their

interest in a manner that promoted the consumer interest. The economic literature is fairly clear that there is not much evidence there are efficiencies from mergers; in financial services the record looks even more dismal. We in the public interest movement have always maintained that the pursuit of private profit is not always synonymous with the public good and challenged the efficiency argument because, absent competition, firms with market power are not compelled to share the efficiency gains with the consumer. But Greenspan's admission raises another even more fundamental challenge and goes us one better, admitting that the pursuit of private profit may not be synonymous with the private interest. The assumption that private actors will be perceptive and well-intentioned in their pursuit of efficiency can no longer be relied upon. Private actors are at least as likely to be myopic, misinformed and maleficent. Competitive market structures should take precedence over claims of efficiency gains.

**Vertical Leverage.** The digital economy of the 21<sup>st</sup> century is very much an economy made up of platforms in which layers of complementary products and services sit atop one another. In traditional antitrust analysis, markets may look like separate markets vertically organized, but their close interconnection, frequently through technological dependency, renders the threat of exercise of vertical leverage much greater than was the case in the physical markets of the 19<sup>th</sup> and 20<sup>th</sup> centuries. Tying, anticompetitive bundling and exclusionary conduct take on much greater significance.

Thus, in the antitrust space, just as in the realm of prudential regulation of financial institutions, we have been afflicted by irrational exuberance for unregulated markets. The need for reform does not demand a radical new experiment. Rather, it demands a return to the traditional values of progressive capitalism that served us so well in the half century after the New Deal. The market fundamentalism of the past thirty years was the radical experiment and it has failed miserably.

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Mr. JOHNSON. Thank you, Dr. Cooper.  
I appreciate, and I am sure we all do, the testimony of you all on this panel.

Without objection, Members as well as witnesses will have 5 legislative days within which to submit any additional written questions and responses. Without objection, the record will remain open

for at least 5 legislative days for submission of any additional materials.

And again, I want to thank everyone for your patience, and it is now time for questions. I will yield to myself 5 minutes for that purpose, and we will be enforcing the 5-minute rule among Congressional Representatives as well, though we may go into a second round of questions.

Looking back over how some of these financial institutions became so big and how the Federal Government responded to their near failures, what are the key lessons that Congress should learn from this economic crisis that we find ourselves in?

And I would like for each of you to answer that question, starting with Mr. Foer.

Mr. FOER. Well, if we might focus on antitrust, the question, I think we have all pretty much agreed that antitrust's actual responsibility for the kinds of conglomerate problems we see now is not a failure of enforcement so much as the absence of authority to actually deal with a conglomerate merger.

Our merger policy is if there is a direct horizontal overlap, then we eliminate the overlap if it is anti-competitive, and we allow the merger to occur.

So to the extent that we are worried about creating very large and complicated organizations whose effects of an eventual failure need to be predicted far down the road, a very difficult prediction, we just don't have a mechanism for dealing with that.

There are other antitrust issues that might go in here, but I don't think the issues that we are looking at are concentration issues in themselves. There is a lot of competition out there.

On the other hand, had we been taking more concern about high levels of concentration, it is possible that some of the very large institutions we are dealing with over time might not have gotten to be this large. And in that regard, one other area I would mention is the lemming effect.

A lot of times we have a merger that we know is going to kick off a series of additional mergers, and yet we don't have a good mechanism for stopping that in its tracks. The agencies typically say we will look at one merger at a time. I will give you an example right now. You have got Pfizer and Wyeth, and at the same time you have got Schering and Merck, and you have got discussions of at least two, maybe three other mergers that will highly concentrate the pharmaceutical industry virtually overnight if they all go through.

I think we need to be able to look at these together. Who knows whether we are going to create—letting these go through one at a time, each one with a couple of overlaps that get laid off, but the companies keep getting bigger and bigger and fewer and fewer, whether we might be creating a risk, a systemic risk right there in that industry.

Mr. JOHNSON. Mr. Foer, thank you for your response. And don't forget about the Ticket Master/Live Nation situation as well.

Mr. CLOUTIER. Mr. Chairman, I will give you a good example. In the year 2000, there was a hearing held in this building by Congressman Baker on Citicorp buying the associates. Quite a bit of discussion was held then about the predatory nature of the whole

Citicorp operation, which later they pled guilty to that, as you are well aware of. They paid a \$200 million fine to the Federal Trade Commission. Citicorp was built on that basis.

And what we have today—and I know many of my colleagues here say, well, we have got good competition—I would like anybody to explain to me how you compete with somebody who has the full faith and credit of the United States Government. So far Citicorp has received guarantees on their loans of \$380 billion, they have a \$10 billion guarantee by the FDIC, and I mean they are too big to fail. It is a perfect example. There are a number of other of the large eight that testified before the House Banking Committee that all had the guarantees of the United States Government. That makes it very difficult to compete again, and they already have got to a size where they are too big to fail, and Congress needs to take immediate action to do something about this. Either that or we continue to pump trillions of dollars into these institutions that are, to a point that they are not competitive, don't have to be competitive.

I would use as another example AIG, who just told the President, "Good luck. We are doing what we want with our businesses."

Mr. JOHNSON. What actions do you think would be appropriate for Congress to make at this particular time?

Mr. CLOUTIER. When Congress sits down and looks at the fact that the eight largest institutions in America now control 66 percent of the assets in this country, I think that is an anti-competitive, monopoly-type of situation and needs to be looked at very closely by this Committee. And I think that no one would disagree when you have that much concentration in a marketplace, they have some real questions about competitiveness.

I understand they say, well, in every market it is competitive, but the fact of the matter is these people control the financial system of America, and it is something that needs to be looked at very carefully.

And all of these mergers were done with, "Don't worry. We have got control of it." I have been told that so many times it is unbelievable. And look at where it has led us. We are bailing out the largest financial institutions in America.

Mr. JOHNSON. Thank you, sir.

It looks like my time has now expired. So, I will now turn it over to the Ranking Member, Howard Coble, for questions.

Mr. COBLE. Thank you, Mr. Chairman. Good to have you all with us today, Panel.

Mr. ASKEW, the Financial Services Roundtable is calling for a streamlined financial regulator, including a national insurance regulator. The insurance industry's antitrust exemption, McCarran-Ferguson, as we all know is tied to the State regulation of insurance. Has Roundtable taken a position on the McCarran-Ferguson appeal?

Mr. ASKEW. Congressman, we agree with the advent of a national insurance regulator that we talk about. We would agree with then the antitrust laws applying to the national insurance.

Mr. COBLE. So you would not be in favor of repealing McCarran-Ferguson, or would you?

Mr. ASKEW. I am—we would agree with the—I guess—I don't want to misanswer your question. I will get you a written answer. I don't want to misstate the opinion of the Roundtable.

Mr. COBLE. I can appreciate that. And for the record, Mr. Chairman, I have always been comfortable with State regulation, for what that is worth, but I will be glad to hear from you.

Mr. ASKEW. What is Roundtable's position toward Gramm-Leach-Bliley and Riegle-Neal and do you think those laws have pretty much accomplished what they were set out to do?

Mr. ASKEW. Congressman, we certainly feel those laws have done what they were set out to do, and we feel comfortable with how they are operating.

Mr. COBLE. Ms. Garza, what is the process for antitrust reviews for mergers utilizing TARP funds, A, and B, is it different than the traditional Hart-Scott-Rodino filing process? Is this consistent with the transparency that the Antitrust Modernization Commission recommended?

Again, I threw three balls at you simultaneously.

Ms. GARZA. The fact that the institution may have been the recipient of TARP funds really doesn't affect the process for review of the transaction. Antitrust review of bank mergers is governed by a set of statutes. It is a little complicated, the extent to which Hart-Scott-Rodino applies. But when there is a bank consolidation that is reviewed by the Federal banking agencies, the Justice Department does receive information at the same time that the banking agencies do relevant to the transaction, and there is a 30-day period, and comparable to the HSR, Hart-Scott-Rodino, period, in which they look at the transaction and report to the banking authorities.

The way that it has worked, in my understanding, is that the Justice Department Antitrust Division has had the opportunity to look at each of the transactions that have occurred where one of the parties was the recipient of TARP funds. So it didn't affect the review of it.

Now, it is the case that some of those transactions were reviewed on an extremely expedited basis because of the exigencies of the circumstances, not because of TARP funds but because of the economic situation of one of the parties.

In those cases, my understanding is that the Antitrust Division was able to conduct the review that it needed to conduct. In the PNC-National Citicorp transaction, for example, the agency did look at the transaction—6 or 7 weeks, I think, is what DOJ took to review it—and did require divestitures, which were agreed to by the parties and incorporated in the order of the Federal Reserve Board.

Mr. COBLE. Thank you. I think I have time for one more quick question.

Mr. Cloutier, in your testimony you indicate that the four largest financial institutions control 40 percent of the Nation's deposits. Riegle-Neal limits bank holding companies to a maximum of 10 percent of deposits. Would you favor lowering that percentage?

Mr. CLOUTIER. Absolutely, sir. And, of course, before this crisis started Ken Lewis of Bank of America was pushing very hard to have that level raised. So absolutely we would prefer lowering it.



And be very careful because there are some banks that would like to raise that limit.

Mr. COBLE. And where would you like to lower it, Mr. Cloutier?

Mr. CLOUTIER. I think 5 percent would be a good place to start to lower it to that level and make sure the 20 top banks in America couldn't control more than 100 percent of the deposits.

Mr. COBLE. I want to beat the illumination of that red light so the Chairman won't come after me with his buggy whip.

Mr. Askew, if you will get back on my question, I would appreciate that.

Mr. Chairman, I yield back.

Mr. JOHNSON. Thank you, Mr. Coble.

Next we will hear from our esteemed Chairman of the full Committee, Chairman Conyers.

Mr. CONYERS. Thank you. I ask unanimous consent to put my statement in the record at this time.

Mr. JOHNSON. Without objection.

And I was wondering why I saw some of my brethren from the other side of the aisle right here at your spot.

And I don't get any laughs on that. But you all know what I meant.

Go ahead, Mr. Chairman.

Mr. CONYERS. This is an important hearing, and I really appreciate the selection of witnesses.

Dr. Cooper, of course, has made the statement which I would like to invite your reactions to. And I am sure heartened by Howard Coble's review of where McCarran-Ferguson and Hart-Scott-Rodino come in.

But look at AIG, for example: \$178 million in bonuses, 73 people got more than a million dollars, some of them not even citizens. And they explained to us, well, it is contractual, Members of Congress. We contracted to do that and you don't expect us to go back on our word, do you?

AIG, nine mergers since 1960. Nine big ones. And 5,400 mergers just between 1990 and 2005 alone. From Reagan on, mergers have been growing and growing. But it was only, I think under perhaps the Bush administration, that they really got into what we call mega mergers, 74 mergers in which each merger partner had more than \$10 billion in assets.

So I am not comfortable to think that the rules are working okay and that mergers are all right. I think there is a connection. When Greenspan can come clean, I don't think it is hard for any of us not to realize that we have got to do something about it.

I have never been comfortable about all the mergers that were going on, all the time, one Administration after the other, including the Democratic administrations.

I would like to get your reactions on that, starting with Dr. Cooper and then Ms. Garza.

Mr. COOPER. Well, it is difficult to see how the antitrust laws will solve the underlying problem of "too big to fail." I do believe that that problem needs to be solved in prudential regulation, and I will give you two examples. And what will happen, however, is that effective prudential regulation will make the mergers go away because essentially what we have to do is make—any financial entity

has to have the capital and pay the insurance so that its failure will not need recourse to the Treasury.

So what we need is dramatically escalating capital requirements as you get bigger and bigger. And, of course, the bankers will tell you if you require me to have more and more capital I can't leverage as much, and so I won't be able to do as many deals. Well, then that is exactly what we want, is we want them not to do as many deals.

Second of all, if you dramatically increase the insurance premiums and the capital requirements, should they fail the insurance fund would have the resources and the capital would be available to resolve these institutions.

Essentially, what we have been told is that it is impossible to resolve AIG without pulling down other institutions. But if AIG had a very high capital requirement, they would have the assets available to resolve their own mess. If they had been required to pay heavy insurance premiums, those resources would be available to the resolution agency to resolve the mess without recourse to the Treasury.

So I believe that if we intend to be serious about preventing "too big to fail," we will do so in a manner through prudential regulation, which will also solve your merger concern.

Mr. CONYERS. Can I ask for a little additional time, Mr. Chairman.

Mr. JOHNSON. Sure.

Mr. CONYERS. Can I ask Mr. Foer's feelings about this part of our hearing.

Mr. FOER. Well, sir, I agree that the problem for this hearing, the "too big to fail" problem, is something beyond what antitrust was really able to do with.

Now, the Cellar-Kefauver Act came out of this Committee. It said that we were going to deal with mergers that concentrate the economy in their incipency. As the Chicago School became dominant in the setting of antitrust policy, with microeconomic analysis at the core, the burden shifted. The burden that I think Congress wanted back in the 1950's is that we would really be worried about mergers and the tendencies they have toward concentration. And we moved away from that and in a way we reversed our presumptions. The presumption today is that mergers are generally and mostly beneficial because they are efficient, and only a few represent problems.

What I would say is the more we know about these things, the more worried we should be that at least very large mergers at the top of the scale we should be reversing the burden, and instead of assuming that they are good and forcing the government to prove that they are bad, we should make the opposite assumption. And if we could work with that, only for the very largest and most concentrating types of mergers, I think we might get back toward what Congress originally was after.

Mr. CONYERS. Ms. Garza.

Ms. GARZA. Obviously, we have a lot of reason to be concerned about the situation we find ourselves in today, but I think that antitrust has had very little role to play in the reasons we are where we are.

It is not so much that the entities that are being bailed out are large. It is what they have done. "Too big to fail," I think there is a relative consensus here, is really not an antitrust concept. Size is certainly relevant to the antitrust analysis of a merger in the sense that it is a starting point—size in terms of market share—is certainly a starting point in the antitrust analysis, but it is only that.

The antitrust analysis today this has evolved far beyond a knee-jerk reaction to a "big is bad" philosophy and it now rests on a very sophisticated assessment of the likelihood that a merger will result in the acquisition or growth of market power based on solid economic principles. And it would be, I think, a mistake to move backward from that. I don't know how you would incorporate a standard or apply a standard that said simply size is a problem.

Having said that, I think, you know, and we looked at this, as you know, at the AMC. We spent 3 years looking in part at the very question of whether current merger enforcement policy was properly calibrated, whether we were not stopping mergers that we should have stopped or stopping mergers that we shouldn't have stopped.

And the general consensus was that merger enforcement policy had evolved to about the right place, where we were carefully considering the effects of a merger on market power, on consumer welfare, but also allowing entities to engage in transactions that either were not anti-competitive or that benefited the economy through efficiencies.

That balance, I think, is the correct way to go.

Now in the banking area, as I said in my written statement, it may be appropriate at this time to shed some light on this, to look at the number of studies that have been conducted and to consider whether or not increased consolidation in the banking industry has resulted in an effect of higher amounts being paid for loans, lower amounts being paid for deposits, other competitive effects.

It would be worthwhile to look and see whether divestitures that have been ordered in past transactions have been effective in what they sought to accomplish. It would be worthwhile to look at what the effects are on the competitive dynamics of a marketplace when you have government intervention. Either government owning, taking partial stake in companies, or subsidizing the operations of companies. It would be useful to take a look at whether or not national concentration has affected the competitiveness of the inter-bank money markets.

All of those things are things to look at. But before Congress does anything, I would suggest that it consider asking the Antitrust Division and the banking agencies to look at the data so that when you do act you are acting on a full sense on what the actual facts are.

Mr. CONYERS. Thank you.

Mr. JOHNSON. You are welcome, Mr. Chairman.

We are joined by our colleague from Texas, Ms. Sheila Jackson Lee. Welcome, Congresswoman.

And now we will go to Mr. Chaffetz.

Mr. CHAFFETZ. Thank you, Mr. Chairman.

Mr. Cloutier, has the TARP process been sufficiently transparent from your perspective and that of the Independent Community Bankers of America?

Mr. CLOUTIER. You know, we don't have enough information yet on the total TARP program to know if it is totally transparent or not. I have to tell you very honestly, Mr. Congressman, that we wake up every morning under some new rules and they continue to change. So you know, is it TARP I, TARP II? It continues to change. And the bailouts, as we have seen with AIG, continue to change.

Mr. CHAFFETZ. Ms. Garza, from a purely procedural view, what steps should the Obama administration take, if any, to ensure the transparency of the merger review process in the context of the TARP funds?

Ms. GARZA. You know, the Antitrust Modernization Commission made the recommendation in fact that the agencies should focus on transparency, and the agencies have taken steps toward that with the merger guideline speeches, testimony, reports.

I actually have said in my written statement I think that it may be appropriate to focus some of those efforts more specifically on the bank mergers. It is important for the public to have confidence in what the antitrust agencies are doing, and it would help build confidence in not only what the government is doing but also that the antitrust agencies are doing their job.

So I think it would help with that if the new Administration would focus on explaining not only to Congress but to the public how it is that they are conducting their investigations in these, with respect to, these bank consolidations that involve TARP funds, where enforcement action is taken, why it is not being taken.

I have no particular reason to believe that the agencies won't act appropriately, but I do think it is useful for them to explain the standards they are applying and explain the decision making. So I think that would be good.

The other thing I suggested is that it may be appropriate for the agency to do something similar to what it did recently in the telecom industry, which is to have a symposium and report on the state of competition in the financial industry and to clarify what its standards are going forward.

I noticed that the incoming head of the Antitrust Division did indicate she had a desire to revisit how bank mergers were being looked at. Hopefully, that revisiting will lead to a transparent policy of discovery in this area, discovery with respect to the data that exists on where we are now and then a discussion about what should be done going forward.

Mr. CHAFFETZ. Mr. Foer, you seem to be in agreement with Ms. Garza and Mr. Askew that antitrust analysis is not to blame for the current crisis, rather it is a problem of the competition policy more broadly defined.

If this is not a problem of antitrust, why do you advocate for the creation of a new deputy provision within Antitrust?

Mr. FOER. There are two issues here. Competition policy really is anything that the government does that affects competition, and that includes your sectoral regulation.

Antitrust is just limited to your three laws, the Clayton, Sherman, and FTC Act, primarily. The Antitrust Division has always had an advocacy function, where it goes before other agencies and it explains what the competition implications of a given regulation or even a legislative proposal would be, and that is a very proper and important function of the Antitrust Division.

No, what I am saying is that this emergency recession situation where we are rapidly restructuring the economy and having huge effects on competition is so important that there should be one person designated to report to the Assistant Attorney General, but to have the backing of Congress to sit there in all the meetings, the various planning meetings, to be able to talk with the Secretary of the Treasury, with the Federal Reserve Bank, and with others in the White House who are doing the planning and to make sure that the voice for competition is heard, because we are going to be making some very tough decisions with long-term consequences, and in some cases it will be necessary to make decisions that are anti-competitive. But let us keep those to the minimum when they are absolutely required.

And the other thing is we have got to deal with this in the future. We shouldn't think that these decisions now are necessarily permanent. We got to come back to all of this after the crisis is over and we have resolved the crisis and then figure out where we want to be, and that is going to take a whole new inventory of where we are and it is going to take building a consensus about where we want to go. I think it is too soon to do that now because we don't know how far down we are going. We don't know when we are going to be at the bottom.

Mr. CHAFFETZ. Thank you, Mr. Chairman.

Mr. JOHNSON. Thank you, sir.

Next, we will have questions from Congresswoman Sheila Jackson Lee.

Ms. JACKSON LEE. Thank you very much, Mr. Chairman. Let me thank you for holding this hearing, you as well as the Ranking Member, Mr. Coble from North Carolina, and certainly the full Committee Chair and the Ranking Member.

I am going to, I guess, be the skunk of the party and indicate that, one, I believe the Judiciary Committee has an amazingly instrumental and intricately important role, if you will, on this whole question of reordering our markets, not to suggest that everyone engaged should be held criminally liable in the markets, no. But I think the partnership of regulation and enforcement is key. And not so much enforcement, for those of you who are certainly proponents of the free market, that we would kill the free market, but I am not totally convinced that the antitrust laws don't have an important role that can be utilized.

And let me just indicate that one of the issues of antitrust laws have been monopolization. And I imagine I would be refuted, if you will, on the issue of monopolization of the banking industry by the fact that they carry different names, and you are absolutely right. So you can't say that Citigroup is a monopoly because their counterparts, their equals, are in the business. But you can say that big banks create a monopoly, and it may be that they are intrinsically part of the capitalistic system. But the named big banks or the en-

tity big banks are a monopoly. And you can point out to me what little guy has risen to be a big guy in the last 50 years, short of the big guys buying them up, and you might say, well, the big guys have now added and so that little guy finally got in. But no, that little guy was eaten up.

So I frankly believe that maybe we need to breath life into the antitrust laws that begin to look at industries in a monopolistic or that they are monopolistic in a fashion in terms of how they bar growth from others who are competing against them.

Some would say community banks, regional banks, and private banks are not competing. They are. Now, these banks have been very proud to say, for example, that it was not us and they are still doing well. They didn't take the marketplace.

Mr. Cloutier, you are familiar that you didn't probably take the kinds of mortgages. You probably knew a lot of those who came into your bank that you gave mortgages to. I don't want to suggest that we don't want to spread the opportunity of home ownership. I was certainly part of that, but I certainly wasn't part of the predatory-type form, the subprime, you know, the people who could afford regular mortgages were getting subprime. Just a skewed marketplace.

So let me raise some questions.

AIG a is a monopoly. How do we allow one company to be the insurer of everything, making bread, going across the street making movies. That is monopolistic. Now, that is insurance. It is a marketplace. It has a marketplace role. I, frankly, believe that our laws have a responsibility, antitrust laws, to address that bigness that injures the marketplace because what happens is AIG is so big and the regulatory process is so limited.

So Mr. Cloutier, since you seem to be the lone wolf trying to argue for this idea of having some involvement, how would you suggest that Congress be creative in its thinking on using antitrust laws that I frankly believe need to be updated. And I want to thank Theodore Roosevelt for his wiseness because we have done well since. But how would you think we would intervene if we were to use antitrust laws?

Mr. CLOUTIER. Well, as I mentioned a while ago in answer to a question, I think the first thing you do is you drop the limit on what a large bank particularly can hold in assets and I think you—

Ms. JACKSON LEE. Do we kill the market that way?

Mr. CLOUTIER. You won't kill the market. I guarantee you in the State of Texas, if Citicorp had to sell branches in the State of Texas, Don Adams would buy them all, and the ones he wouldn't buy Don Powell would. So, you know, you are going to have very good competition.

And I will tell you that I would just point out that yesterday President Obama and Secretary Geithner reached out to the community bankers—I happen to have the picture here of our current chairman, who lives in the State of Texas, who made the presentation yesterday with the President—about small business lending and getting back to the core of America in that type of lending.

Often when these large CEOs buy these companies, Ms. Lee, it is amazing how much they pay themselves for doing that, which has led to where we are today.

Ms. JACKSON LEE. If the Chairman will indulge me an additional minute to raise my other question to Ms. Garza.

Thank you, Mr. Cloutier. You are talking about the limits.

Ms. GARZA, why don't you think modernized antitrust laws could be effective? And would you keep an open mind to the extent there may need to be some modernizing of our laws?

I ask unanimous consent for an additional minute, Mr. Chairman.

Mr. JOHNSON. Without objection.

Ms. JACKSON LEE. Thank you.

Ms. GARZA. Just to be clear, my position isn't that the antitrust laws have no role to play. My statement is very clear that I think they do.

Ms. JACKSON LEE. Thank you for correcting me. Maybe you could expand on that.

Ms. GARZA. So, for example, while we clearly have an interest in shoring up the stability of the markets today, what I have said is that I think we also have to be careful about consolidation that occurs today that may affect the competitiveness of the marketplace in the future.

So I don't think that antitrust should be displaced. I think it has a role to play. But that also says that I don't think you can lay the current crisis at the foot of antitrust enforcement. The issues that have brought us to where—the problems that have brought us to where we are today are much more complex and different than the size of the institutions, and people have mentioned what some of those problems are. And I mentioned them in my paper. Those things have to be dealt with, but they are beyond the scope of antitrust enforcement.

So what I would suggest is that we don't put the antitrust laws on the shelf, we don't do what was mistakenly done at the time of the Depression and say, well, we can't afford the antitrust laws anymore. I think we can afford the antitrust laws, and I do believe that the antitrust laws, the way they are enforced today, are not incompatible with steps that need to be taken to try to shore up the stability of our financial markets.

Ms. JACKSON LEE. Can we not consider, rather than looking at the isolated name groups, Citigroup and others, look at the big banks banking industry in terms of modernizing our antitrust laws to try to penetrate what—not caused them but to keep them from doing that again.

Ms. GARZA. The structure of the market is an important thing to look at. And I can't sit here today and say that I have studied the structure of the market or that I think it is monopolistic or oligopolistic.

What I do think is that this is something that would be appropriately tasked to the Antitrust Division to look at. The Antitrust Division, after all, does have jurisdiction to review bank mergers. They do have a process that has been in place since 1995 for looking at bank mergers that does tend to focus on effects in localized markets where lending is done and deposits are taken. I think that

that process has worked well, but to the extent there are questions about the effect of consolidation now, the effect of the interconnect- edness, whether that is having—whether it is affecting prices that are paid, diversity, et cetera. All of those things I think are legiti- mate to look at. But at this point I can't say that I think antitrust has failed. The only thing I can say is that it may be worth further investigation of how the markets are operating.

I agree with Bert Foer. I don't necessarily agree that there needs to be a new Deputy Assistant Attorney General appointed, but I do agree with him that the Antitrust Division and the Justice Depart- ment should be at the table when steps are taken to ensure there is a voice speaking about the competitive effects of various actions that are taken. I think the Assistant Attorney General probably can fill that role and the Attorney General.

Ms. JACKSON LEE. I would like to make an inquiry of the Chair as I thank him for his leadership on this issue. I think the door that Ms. Garza has opened and the door that I started out on is we are always playing around the edges of antitrust law but we might need some creative updating. I know that one suggestion has been a deputy position and you have disagreed with it. But a cre- ative updating on how we, in essence, restrain some of the bad acts that bigness created.

I still think there is a monopolistic scenario with all the big banks. They are in there together, and I don't think our antitrust laws fit that. They usually fit a big entity like GM, but they don't fit the collective, and we may need to deal with that because we need to get our feet in the door of enforcement. That might help a lot of our citizens who are suffering right now, Mr. Chairman.

And I look forward to working with you on that issue, on that approach.

Mr. JOHNSON. Thank you, Congresswoman, and your point is well taken. We will be having discussions and hearings on that very issue. So thank you.

And the time for this hearing has now expired, and I am sure that you all are happy.

So, again, without objection, Members will have 5 legislative days to submit any additional written questions which we will for- ward to the witnesses and ask that you answer as promptly as you can and they will be made a part of the record.

Without objection, the record will remain open for 5 legislative days for the submission of any additional materials. Again, I want to thank everybody for their time and their patience.

And this hearing of the Subcommittee on Courts and Competi- tion Policy is adjourned.

[Whereupon, at 4:29 p.m., the Subcommittee was adjourned.]



## APPENDIX

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### MATERIAL SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN, CHAIRMAN, COMMITTEE ON THE JUDICIARY, AND MEMBERS, SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

Thank you, Chairman Johnson, for holding a hearing on this important issue.

We are in a situation of our own making. We have sat back and let ourselves be convinced by the argument that bigger is always better.

More than 5400 bank mergers occurred between 1990 and 2005. Those mergers included 74 “mega-mergers” where the buyer and seller each had more than \$10 billion in assets.

As a result of these mergers, the percentage of banking assets and deposits held by the ten largest banks more than doubled, rising to 55% and 45%, respectively.

This was done with the approval of the antitrust enforcement agencies. For years, federal antitrust enforcement has drifted towards the “free market” school of thought, which says that a market with only two or three huge conglomerates is okay as long as they’re competitive. This school of thought assumes that the market will correct itself.

But how can you talk about a “free market” when CEOs whose companies went bankrupt walk away with \$40 or \$50 million?

With incentive structures rewarding short-term risk-taking, Wall Street is in the business of getting bigger and more complex, and taking greater risks with other people’s money, secure in the fact that they will reap all of the benefits, squeezing every dime of profit out, and that the government will bail them out if they fail big enough.

This raises a number of important questions.

First, by picking some banks as winners, and giving them money to buy their competitors, is the Federal Government creating a whole new generation of institutions that are “too big to fail?”

*What kind of seat at the table does antitrust get when Treasury decides which banks get money and which ones don’t?*

*If antitrust law can account for competition from potential entrants, why can’t it also account for systemic risk?*

Thank you.

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PREPARED STATEMENT OF THE HONORABLE SHEILA JACKSON LEE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS, AND MEMBER, SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

Thank you, Mr. Chairman and ranking member for your leadership in holding today’s important oversight hearing on “Too Big to Fail: The Rule of Antitrust Law in Government-Funded Consolidation in the Banking Industry.” Today’s hearing will examine whether the nation’s recent economic downturn was worsened by the policies regarding the antitrust laws and the lessons that we should learn to prevent or limit systemic risk of “too big to fail” institutions. This hearing will focus upon the causes, antitrust enforcement, problems, and possible remedies to address “too big to fail” institutions.

It is interesting that today’s hearing comes just a day after President Obama has signaled that he will freeze releasing additional TARP funds to AIG because of its mismanagement (i.e., AIG was using TARP funds to pay for employees bonuses). The TARP bill proscribed the use of the TARP funds and specified that there would

be repercussions if the TARP funds were used wrongly. AIG has used its funds inappropriately.

The first sign of crisis occurred in March 2008 when investment bank Bear Stearns turned to the federal government and competitor JP Morgan Chase for assistance in addressing a sudden liquidity crisis. At that time, the Federal Reserve provided JPMorgan with funds to complete the merger. Later, in July 2008, the Federal Deposit Insurance Company seized control of IndyMac, the nation's largest home lender.

In September, the federal government put Fannie Mae and Freddie Mac into conservatorship. Since August 2008, the federal government has invested billions of dollars into financial institutions. Much of this money was given directly to large banking institutions. Other money was distributed through the Troubled Asset Relief Program. This program was supposed to increase liquidity in the credit and lending markets. Some of this money, it was later found was mismanaged and was used to buy other banks.

The antitrust questions that these events raise are (1) Were these banks too big to fail and (2) should the antitrust law have prevented these banks from becoming embedded in the economy such that government intervention was required?

I am very interested in hearing the testimony today and will listen with an open mind to whether the antitrust laws have any application to the present banking situation. On October 3, 2008, under the TARP, Congress authorized \$700 billion for the Treasury to buy troubled assets to prevent further disruption in the economy. After the Act was passed, the Administration decided to use a portion of the \$700 billion to recapitalize some of the nation's leading banks by buying their shares. Despite this purchase by the government, many banks had no intention of making new loans. In allocating the TARP fund, Treasury made a determination about which banks would survive and receive funds and which banks, usually smaller, would not. By the end of 2008, nine of the largest banks were participating in the TARP program. AIG, Bank of America, Citigroup all benefitted.

Antitrust does not require that big companies be broken up into smaller ones. Only monopolization violates the antitrust laws. Section 2 of the Sherman Act governs monopolies. Section 7 of the Clayton Act prohibits mergers and acquisitions that tend to lessen competition. The DOJ examines both provisions.

Experts have argued that the mergers should be subject to supply and demand but they require for the merger to divest if the reviewing agency determines that it is appropriate. Other experts suggest that legislation should be introduced to create new standards for merger. Another group of experts argue that the free market should reign.

I am interested in learning our expert witness' perspective on how the current economic and financial situation developed. I am also interested in hearing how antitrust laws can ameliorate the situation. For some aspects of the present crisis, I believe that there were a number of conscious decisions undertaken by bankers, financial institutions, and other lenders that have had a direct and adverse effect on borrower. I will keep an open mind to the issues. I welcome today's testimony and I look forward to hearing from today's important witnesses.

Thank you. I yield back the balance of my time.

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THE FINANCIAL SERVICES ROUNDTABLE

*Impacting Policy. Impacting People.*



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March 20, 2009

The Honorable Howard Coble  
United States House of Representatives  
2468 Rayburn HOB  
Washington, DC 20515

Dear Ranking Member Coble:

I appreciate the opportunity to respond in writing to your question regarding the repeal of McCarran-Ferguson antitrust protections for insurance companies.

The Roundtable believes simply repealing McCarran-Ferguson, without a corresponding overhaul of insurance regulatory structure, will do little to fill gaps in existing regulation, prove costly to consumers, and dampen competition. Any legislative effort aimed at repeal must be accompanied by giving insurers the ability to be chartered and exclusively regulated at the federal level. In the previous Congress, the Roundtable supported The National Insurance Act of 2007 (H.R. 3200/ S.40), which would have accomplished this end by applying federal antitrust laws to federally-chartered insurers to the extent the states no longer regulate their activities.

Again, thank you for the opportunity to testify before your Subcommittee. Please do not hesitate to contact me if you have any questions in the future.

Best regards,

William E. Askew  
Senior Policy Advisor