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# No More Megabanks: 19 Is Enough

Regulators should not allow any more megabank mergers or acquisitions. Rather than wasting time and struggling to define "megabank," we recommend a quicker and more productive approach: Deny any requests if the resulting entity would exceed $100 Billion in assets.

Two practical tests provide a sound basis and justification for our position. In 2005, well before the banking meltdown, we did a study of banks over $100 Billion in assets. We looked at two objective measures over 20 quarters (2000 through 2004): ROA, and safety and soundness as measured by problem loans to assets.

Our ROA study debunks the idea that megabanks enjoy an economy of scale. They have no ROA advantage to bring to any merger or acquisition. In fact, ROA's for these megabanks consistently lagged their next sized peer group ($50 to $100 Billion in assets) for 17 out of the 20 quarters studied, by an average of 19 basis points (bps).

From discussions with current and former regulatory officials, we learned that when megabanks merge or acquire other large banks, it often takes years to integrate their IT systems. This delay represents an affront to the very idea of efficiency. Not to be ignored is the trickle down affect on non-IT operations.

One regulator shared his story of a personal project to obtain data from one of the megabanks. When he contacted the IT department, they told him that the megabank did not have one integrated system to support his request; rather, it had a number of systems that the IT people would have to query. Each legacy system for each of the previously acquired banks would require a separate request, made by a different IT employee. The regulator's megabank contact further explained that each system was so unique that it could not communicate with any of the other systems. The bank had to overlay another higher-level system so the IT department could communicate with each one. Moreover, this overlaid system only served to retrieve certain common data -- and not the specific data that the regulator was looking for. As a result, it would take several weeks to fulfill his request for some detailed data that spanned each of the previously acquired banks.

On to safety and soundness. We defined problem loans as all loans and contracts that are 90 days or more past due, nonaccrual, and renegotiated and restructured. Again, the data does not support the claim of economy of scale. Neither is the assumption that diversification and sophistication of risk are good reasons for mergers or acquisitions. To the contrary, megabanks' increased risk argues against mergers or acquisitions. The ratio of problem loans to assets for megabanks was consistently higher (which is to say worse) then their next peer size for 16 out of 20 quarters, by an average of 23 bps.

As the process of defining systemic risk evolves, the two common sense tests we offer would justify refusing any merger or acquisition that results in an entity with assets exceeding $100 Billion. The ROA is just not worth the risk. In addition, the regulatory risk assessment hurdles presented by inherently incompatible (virtually unconnected) IT systems should be unacceptable to regulators reviewing requests for mergers or acquisitions of this size.

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