

Gill Marcus: Issues for consideration in mergers and takeovers from a regulatory perspective

Speech by Ms Gill Marcus, Deputy Governor of the South African Reserve Bank, at the Institute for International Research 9th Annual Conference held in Johannesburg on 18 July 2000.

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1. Introduction

Mergers and acquisitions in the financial services sector are receiving a great deal of attention at present. The trend is toward the blurring of the boundaries that separated the various parts of the financial sector, particularly commercial banking, investment banking and insurance. More recently, we have been faced with the prospect of the formation of large financial conglomerates.

The ultimate objectives of a financial services institution whether it be a bank, insurance company or securities firm, are, firstly, to be financially safe and sound; secondly, to obtain the confidence of and show fairness to the users of its financial services; and, finally, to be efficient and effective. These objectives should always be consistent with the objectives of the regulatory authorities.

The objectives of the regulator are to:

- Ensure a safe, sound and stable financial system.
- Enhance the confidence of and fairness to investors, by eliminating bad business practices and ensuring healthy competition between financial institutions.
- Ensure an efficient and effective financial system.

It follows that the strategies adopted by banks as financial services institutions and the objectives set by the regulator have to be consistent with each other. The priorities assigned to the ultimate objectives of a bank may, however, differ from those of the regulator. For instance, the bank may have as its primary ultimate objective the maximisation of shareholder value, as measured by the rate of return on equity. This would be in conflict, however, with regulatory objectives if maximisation of shareholder value were to be achieved by the taking of excessive risks.

The primary objective of the Registrar of Banks and, when applicable, the Minister of Finance, therefore, should be to ensure that a merger will not be detrimental to the public interest and also not contrary to the interests of the banks concerned, their depositors or their controlling companies.

We must remember that the responsibility of the directors is to act in the best interest of their shareholders and, thereby, improve or maintain the wealth of their shareholders. The interest of the public and depositors is thus not the primary concern or responsibility of the directors. It is, therefore, imperative that the Registrar of Banks and the Minister of Finance protect the interest of depositors.

Our task, as regulators, is to ensure that, after a merger, acquisition, reconstruction or takeover, a bank or banking group has:

- Suitable shareholders.
- Adequate financial strength.
- A legal structure that is in line with the bank or banking group's operational structure.
- Management with sufficient expertise and integrity.

We are sensitive to the fact that it is not the role of the Bank Supervision Department to judge the wisdom of management decisions and business strategies beyond ensuring that local and international best practice regarding supervision and regulation are met.

Our philosophy is that market principles underlie all activities.

2. Regulatory concerns with regard to mergers and takeovers

The following are regulatory concerns, because they could impact on the stability of the financial system as a whole:

2.1 Contagion risk

In the case of a bank, contagion can best be described as the risk that a problem or problems in one or more associate entities contaminate the bank, leading to negative perceptions of the bank. In some cases, the implications could be so serious as to lead to the failure of the bank. As the potential for contagion increases, so, too, increases the risk of individual financial failure. Although contagion risk is extremely difficult to measure and quantify, it is a risk of which bank management constantly needs to be aware.

Banks operate in a highly competitive environment, encouraged by the developments of new markets, instruments and techniques. Although many of these changes provide the means of diversifying risks, they also allow greater risks to be taken. These developments provide challenges to central banks in attaining the appropriate balance between risk and stability in the financial system. It is the central bank's responsibility to provide a financial system in which the users of financial services can benefit from healthy competition between financial institutions, but, at the same time, to ensure public confidence in the monetary system as a whole.

2.2 Systemic risk

Systemic risk is the possibility that the failure of one bank to settle net transactions with other banks will trigger a chain reaction, depriving other banks of funds and, in turn, preventing them from closing their positions. The consequence is frequently loss of confidence in the whole banking system.

The effects of conglomeration on systemic risk may not be viewed lightly. If risk is not managed properly within a conglomerate, the repercussions could extend beyond a single institution and, even, into the whole financial sector. The regulator's ability to monitor and supervise the group risk-management practices within banks and banking groups is therefore becoming increasingly important.

2.3 "Lender-of-last-resort" assistance

One of the main responsibilities of a central bank is to prevent financial system instabilities. When pressures that cannot be avoided by preventive supervision do arise, central banks should try to contain these pressures through direct central bank intervention, acting as "lender of last resort". This should never be seen as an automatic facility available to all banks in distress, but should be used only when the failure of a bank would pose a serious threat to the financial system as a whole. The primary aim of the "lender of last resort" facility is therefore not to save the bank in distress, but rather to consider the effect that the failure might have on the system and what should be done to protect the system from contagion.

A banking group, including the bank or banks in such a group, could also be contaminated by non-banking activity. This could result in the central bank having to extend lender-of-last-resort assistance to a wider range of activities. This, in turn, raises issues of competitive neutrality, since lender-of-last-resort assistance is not made available to specialist suppliers of non-banking services provided by bank-based financial conglomerates.

2.4 "Too big to fail" factor

What do we mean when we say a financial institution is too big to fail? This term might best be applied to an institution that is so large that its activities make up a significant portion of a country's

payment system, credit-granting process, or other key financial roles. As a result, any substantial disruption in the particular institution's operations would be likely to have a serious effect on a country's financial markets, either preventing the markets from operating properly or raising questions about their integrity. The consequence of the "too big to fail" factor is that countries extend protection to large institutions and their customers that is not granted to others.

Although the new banking and financial conglomerates may pass our traditional statutory and regulatory guidelines, such combinations require that we refocus our attention on a long-standing and vexing concern. To the extent that institutions become too big to fail and are perceived as being protected by implicit guarantees, the consequences may be serious. Moreover, under these circumstances, our current mix of market and regulatory discipline may tend to shift further away from market discipline and, increasingly, toward regulatory discipline, resulting, perhaps, in a less efficient industry.

3. Regulatory framework

The regulatory framework within which supervision takes place, together with the authority, powers and responsibilities of the regulator, is provided by:

- The Banks Act, 1990 (Act No. 94 of 1990 – "the Banks Act"), and the Mutual Banks Act, 1993 (Act No. 124 of 1993).
- The Regulations relating to Banks and the Regulations relating to Mutual Banks ("the Regulations").
- The Core Principles for Effective Banking Supervision ("Core Principles").

3.1 The Banks Act

The sections of the Banks Act that have a bearing on reconstructions, mergers and acquisitions are the following:

Section 37 – Restrictions on shareholding

In essence, Section 37 of the Banks Act provides that prior permission must be obtained from the Registrar of Banks if a shareholder wishes to increase its shareholding beyond 15 percent of the voting share capital of a bank or a bank controlling company. Permission is also required for further increases beyond the predefined levels of 24 percent, 49 percent and 75 percent. The approval of the Minister of Finance must be obtained for increases beyond the predefined levels of 49 percent and 75 percent. Permission for the acquisition of shares in a bank or bank controlling company is not given lightly and is granted only if the Registrar of Banks and, when required, the Minister of Finance are satisfied that the proposed acquisition of shares is not contrary to the public interest and is also not contrary to the interest of the bank concerned or its depositors or the controlling company.

Section 38 – Nominee shareholdings

Essentially, Section 38 of the Banks Act prohibits a bank or bank controlling company from registering its shares in the name of nominees. The objective is to identify the true power behind the bank, because of the potential for the misuse of depositor funds by unscrupulous owners.

Section 42 - Restriction of right to control bank

Section 42 prohibits a person other than a bank, or an institution that has been approved by the Registrar of Banks, to exercise control over a bank, unless such person is a public company and is registered as a controlling company of such bank.

Section 50 – Investments by controlling companies

In terms of Section 50 of the Banks Act, the aggregate amount of a bank controlling company's investments in the following may not exceed 40 percent of its capital and reserve funds:

- Undertakings other than banks.
- Institutions that conduct business similar to the business of a bank in a country other than the Republic of South Africa.
- Controlling companies.
- Companies of which the main object is the holding or development of property.

It follows therefore that at least 60 percent of the bank controlling company's capital and reserve funds should be in banking-related business.

Section 54 – Mergers

Essentially, Section 54 provides that no compromise, amalgamation or arrangement that involves a bank as one of the principal parties to the relevant transaction, and no arrangement for the transfer of all or any part of the assets and liabilities of a bank to another person, shall have legal effect unless the consent of the Minister of Finance, conveyed in writing through the Registrar of Banks, to the transaction in question has been obtained beforehand. The Minister shall not grant his consent unless he is satisfied that:

- The transaction in question will not be detrimental to the public interest.
- The amalgamation is the amalgamation of banks only.
- In the case of a transfer of assets and liabilities that entails the transfer by the transferor bank of the whole or any part of its business as a bank, such transfer is effected to another bank or a person approved by the Registrar.

Section 55 - Reconstructions

Section 55 of the Banks Act requires that any reconstruction of companies within a banking group requires the prior approval of the Registrar.

Section 80 – Shares in any registered insurer

Section 80 requires that no bank and no associate of a bank shall, without the prior written approval of the Registrar, either jointly or individually acquire or hold any shares in any registered insurer as defined in Section 1 of the Insurance Act, 1943 (Act No. 27 of 1943), to the extent to which the nominal value of those shares exceeds 49 percent of the nominal value of all the issued shares of such insurer.

3.2 The Regulations

Regulation 36 of the Regulations deals with the information that should accompany an application for permission to acquire subsidiaries, branch offices, other interests and representative offices of banks and controlling companies.

3.3 Core Principles

The Core Principles for Effective Banking Supervision were issued by the Basel Committee on Banking Supervision in 1997. The particular principles that have a bearing on reconstructions, mergers and acquisitions are the following:

Principle 5 – Major acquisitions or investments by a bank

In terms of Principle 5, “banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision”.

From a supervisory perspective, we need to determine whether the banking organisation has both the financial and the managerial resources to fund the acquisition. We may also need to consider whether the investment is permissible under existing banking legislations. Banking, by its nature, entails taking a wide array of risks. We, as supervisors, need to understand these risks and need to be satisfied that banks are adequately measuring and managing the risks.

Principle 20 – Supervision on a consolidated basis

Principle 20 states that “an essential element of banking supervision is the ability of supervisors to supervise the banking group on a consolidated basis”.

This includes the ability to review both the banking and the non-banking activities conducted by the banking organisation, either directly or indirectly (through subsidiaries and affiliates), and activities conducted at both domestic and foreign offices. In this regard, it is important that we, as supervisors, take into account that the non-financial activities of a bank or group may pose risks to the bank.

Principle 23 – Obligations on home-country supervisors

In terms of Principle 23, “banking supervisors must practice global consolidated supervision over their internationally active banking organisations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organisations world-wide, primarily at their foreign branches, joint ventures and subsidiaries”.

From the above, it is clear that we should take responsibility for our internationally active banking organisations in the capacity of home-country supervisor. In order to assume this responsibility, we should be comfortable with the risks facing these entities and the manner in which these risks are managed.

4. Regulatory principles

The considerations that are taken into account by the Registrar when considering applications are the following:

4.1 Shareholding/Ownership structure

With regard to the shareholding structure, the following aspects are of importance:

Structure

A bank must pay appropriate regard to the interests of its depositors. Therefore, no single shareholder (or group) should be in a position to exercise undue influence over the policies and operations of a bank. The shareholding structure should not be a source of weakness and should minimise the risk of contagion from non-bank activities conducted by shareholders in other entities within the conglomerate.

Transparency of legal structure

Banking groups vary widely in terms of structure, range of activities and complexity. This could complicate the effective supervision of banks within such groups. Furthermore, users of banking services must be able to make a proper assessment of the banking group’s activities and risk profile.

4.2 *Group structures*

As regards group structures, the following are of importance:

Nature of business

The general philosophy behind the supervision and regulation of bank controlling companies and their subsidiaries is to ensure that banking groups do not affiliate with companies engaged in undesirable practices. Bank controlling companies should confine their activities to the management and control of banks and companies engaged in activities considered to be closely related to banking.

Because of the nature of their business, banks tend to invest more in companies that are primarily involved in financial activities. Therefore, financial activities should preferably be structured under a bank, whereas non-financial activities are normally structured under the bank controlling company. In the supervision of financial conglomerates, the primary concerns are contagion, transparency and autonomy. When liquidity and solvency risks manifest themselves in any member of a group, the likelihood of contagion of the banks in a group is a major concern.

Pyramid structure

We are not very comfortable with pyramid structures. A pyramid structure weakens the control over a banking group and increases the complexity of the group structure. The complexity of a group structure also often reduces transparency. The enlarged group structure in a merger/acquisition should have the fewest layers possible and should be as simple as possible. The group structure should clearly indicate which shareholders exercise control over a group and which owners have the financial responsibility of providing the group with future capital.

Cross-shareholdings

Large intragroup holdings of capital increase the possibility of financial difficulties in one entity in the group being transmitted more quickly to other entities in the group. Since intragroup capital does not represent externally generated capital, intragroup capital should be excluded from the assessment of group capital.

Parallel-owned banks

In the case of parallel-owned banks, a bank set up in one jurisdiction has the same ownership as a bank in another jurisdiction, but neither of the banks is a subsidiary of the other. Normally, the controlling companies of such parallel-owned banks are incorporated in unregulated financial centres. There is thus a clear potential for abuse.

A working group of the Basel Committee on Banking Supervision recommended that host-country or home-country supervisors should be vigilant in order to ensure that operations of this kind become subject to consolidated supervision.

Shelf companies

A shelf company is a company that a bank establishes to keep on the “shelf” until such a company is needed for a special purpose. We need to put into place procedures to close any potential supervisory gaps.

4.3 *Management structure*

It is a known fact that by far the most common underlying cause for bank failure is bad management. We cannot involve ourselves in the day-to-day operational decisions or, even, strategies of a bank, since to do so would not only impair our objectivity in assessing the health of a bank, but would be too costly and probably too restrictive. It follows that we have to rely heavily on the competence and integrity of management. Therefore, the following aspects are of importance:

Ability and integrity

Banks and banking groups should be managed only by directors and management with a proved ability and integrity to pursue the interests of shareholders without harming the interests of depositors. The evaluation of the competence and the integrity of the proposed management and board should include a system of following up references, enquiry from other regulators, accessing publicly available data and reportable offences.

Management should at all times put the interests of the organisation and depositors before their own and should act in the best interest of depositors. It is important that the management of a merged entity has the ability to identify the risks and to bed down the merger in the shortest possible time.

Experience and skills

The proposed management and directors should have the relevant banking experience and skills to conduct the proposed business. For example, if a bank proposes to trade in financial derivatives, the senior management and board should have sufficient specific experience in the management of the risks arising from these products.

4.4 Corporate governance, audit and internal control

Aspects relating to corporate governance, audit and internal control that are important include the following:

Corporate governance

Corporate governance may be described as a system of business management and disclosure of information to stakeholders, within a paradigm of management accountability. The Bank Supervision Department regards sound corporate governance as crucial. Since South Africa is now part of the global markets, it is of the utmost importance that South African corporate-governance processes be aligned with international trends.

After a merger or takeover, a banking group has to demonstrate its ability to maintain appropriate corporate governance, management, internal control and risk-management systems, including internal audit and a compliance officer, in order to monitor and limit all the risk exposures of a banking group as of the commencement of business.

The merged entity's internal structure should be sound in terms of generally accepted management principles, and the proposed group structure should not be detrimental to the bank or to the effective supervision of the bank.

Audit and internal control

Since management cannot be everywhere, management has to rely on systems of internal control to ensure the smooth operation of a bank. It has to be possible for the Bank Supervision Department to evaluate these established controls and procedures independently. We also rely on the independent auditors of a bank to enhance the credibility of the qualitative and quantitative information on which we base our opinion.

4.5 Capital

Several aspects relating to capital are relevant:

Importance of capital

Capital adequacy is a vital measure of the solvency of a banking group and a significant indicator of the level of protection that the banking group has against risks. Ensuring adequate levels of capital promotes public confidence in the particular banking group and the entire banking system. A merged

entity should have adequate capital to meet both regulatory requirements and its own internal requirements, taking into account its risk profile.

Purposes of capital

Capital serves the following four purposes:

- It provides a permanent source of revenue for the shareholders and funding for the bank.
- It is available to bear risk and to absorb losses.
- It provides a base for further growth.
- It gives the shareholders reason to ensure that the bank is managed in a safe and sound manner.

Capital adequacy

Minimum capital-adequacy ratios are necessary to reduce the risk of loss to depositors, creditors and other stakeholders of a bank and to help us to pursue the overall stability of the banking system.

The Basel Committee on Banking Supervision recommends that supervisors should apply the minimum capital ratio of 8 percent to all internationally operating banks on both a solo and consolidated basis. In a merger or acquisition, any current or consequential cross-shareholding should also be eradicated in order to avoid double counting of capital.

Availability of additional capital

We also have to assess the ability of the major shareholders of a merged entity to provide additional capital should the bank or banking group experience financial difficulties.

4.6 Risk concentration

Safeguarding against excessive concentration of risk is one of the most important components in any system for the supervision of banking groups. Concentrations of risks cannot be eliminated; concentrations will arise through the specialisation of banks for reasons of competitive advantage and expertise. The risk can and must, however, be contained by ensuring that the exposure of a bank or a banking group is diversified.

Banks should manage their credit risk prudently to ensure that there are no undue concentrations of risks to individual entities, associates, industries geographical areas, sectors or banking products. The risks of a merged entity should not be more than the risks of the two stand-alone entities.

Increasing supervisory attention has to be paid to the credit exposures of the merged entity.

International standards

In terms of international standards, a bank or a banking group may not incur an exposure to an individual borrower or a group of closely related borrowers that exceeds 25 percent of the bank or the banking group's qualifying capital and reserves, and the total of all large exposures may not exceed 800 percent of qualifying capital and reserves of the bank or banking group.

4.7 Public-interest considerations

Any merger of two or more banks should be in the public interest. A proposed merger should therefore add some depth to the local banking sector and make a worthwhile contribution to banking services and the banking industry in South Africa.

As mentioned earlier, competitive markets is the best assurance that consumers receive the highest quality products at the lowest possible prices.

In any merger of two or more banks, there are significant advantages and disadvantages which need to be considered.

4.8 *Risk-management profile*

The emphasis on risk management is most critical at our largest, most sophisticated banks and most internationally active banks. Many of these banks use advanced economic and statistical models to evaluate their market and credit risks. These models are used for a variety of purposes, including allocating capital on a risk-adjusted basis and pricing loans and credit guarantees.

4.9 *Information technology system integration*

Information technology systems should be able to provide management information that is accurate, timely and relevant to manage the bank's risks. A bank's system should be integrated, there should be minimal manual intervention, and the risks emanating within various departments or divisions should be consolidated in the management reports.

A bank's systems should be able to serve the needs of its clients adequately. In any merger, the significant time taken to merge various systems can be seriously detrimental to the ongoing business of the bank.

Implementation of information technology systems is one of the biggest risks for a merged entity, and may have substantial negative impact on all stakeholders if all does not go well.

4.10 *Merging of different cultures*

The question of different cultures is prevalent in any merger. A "hostile" merger could increase the difficulty of merging the cultures, especially at senior level. Perhaps the biggest mistake is to ignore the impact of a merger on employees. Too often, employees spend more time worrying about their futures than they do serving customers. Many simply leave, taking their knowledge and experience with them.

4.11 *Competition/concentration in banking system*

The issue of the optimal structure of a banking system has been much discussed in recent years within banking, political and academic circles. The optimal structure of a banking system is discussed every time that the possibility of a merger or a failure of banks is mentioned. Many arguments in favour of, or against a merger between two banks can be put forward. Apart from taking these general principles into account when the desirability of a merger is discussed, the arguments, conditions and considerations specific to a possible merger are just as important.

When any merger is proposed, one of the major concerns is that competitiveness of the sector could be diminished.

Free competition within the banking system will improve the efficient allocation of resources in the economy, thus enhancing society's wealth and welfare. Increased competition in the banking system may lead, for example, to undue risk taking and thus reduce stability in the banking system. On the other hand, measures taken to increase stability in the banking system through mergers may lead to reduced competition.

When a merger would cause a large concentration in a market that is, or becomes, highly concentrated, we need to give special attention to the impact on competition. High levels of concentration in any banking system could result in relatively high prices for banking services. It is, however, difficult to compare prices before and after a merger in banking because of other factors such as differential central bank policy and inflationary expectations.

The banking system's contribution to the efficient allocation of resources in the economy is reflected by its managerial ability to control input costs (labour, physical capital, deposits) through the

utilisation of the returns of scale, scope and efficiency. Operating costs will eventually determine the optimal structure of the banking system in terms of the number of banks, the size of the banks, the number of branches of banks and possible mergers and acquisitions.

Competitive markets are our best assurance that consumers receive the highest quality products at the lowest possible prices.

5. Recent developments causing banks to merge

Throughout the world, banking industries are undergoing a rapid and sometimes startling process of consolidation, spurred occasionally by hostile takeover bids, but, more often, by friendly mergers by institutions that were once fierce competitors. Several reasons that drive banks to merge can be identified:

Firstly, banks are tussling with the same technology, delivery and customer-service issues that have become pressing for major international banks. Banks are feeling forces of globalisation and technological change and must invest huge amounts in their own information technology systems. The electronic revolution also undermines the traditional role of banks as intermediaries between borrowers and savers, in the process reducing banks' profits. This, in turn, is forcing banks to cut costs more urgently, and a merger with another bank becomes an attractive option for a bank.

Advances in information technology also open up a growing array of delivery channels. Online banking, in all its increasingly varied forms, is poised to become a key channel for transacting banking business. The importance of physical branches in a cyber-world may decline and the nature of the services that branches provide will probably change. Technology is here to stay, and the challenge is for bankers to embrace technology to their own and their customers' advantage.

Secondly, in Europe, economic, monetary and financial unity has implied increased competition among banks and is forcing them to seek ways to cut costs and to increase market share.

Thirdly, it is believed that the banking and securities industry might in time consolidate into about 15 world mega-firms and that the financial institutions that do not merge soon, increase their size and obtain market share might be left in the cold.

Fourthly, it is believed that banks might become too small to compete effectively, except in niches, either in terms of products or geographically. In several countries, governments and regulators are urging banks to merge not because the merger would make them better, safer or more profitable, but because it would allow them to compete internationally with the main American and European banks. What governments and regulators should keep in mind is that, very often, the best way to create local banks that can compete internationally is to allow international banks to compete locally.

Fifthly, the choicest merger partners are taken up very rapidly. It is believed that if a bank does not act soon, it might be left with an unattractive merger partner.

6. Disadvantages of bank mergers

As long as barriers keep out international competitors, mergers may reduce competition and may hurt consumers.

Bigger banks are not necessarily safer than smaller ones. In a report published recently by the Bank for International Settlements, it is stated the current restructuring of the banking industry could cause constraints as competitive pressures interact with stubborn cost structures and heightened incentives for risk taking. This trend is especially dangerous since bigger banks are more likely considered to be "too big to fail".

The international movement towards the consolidation of banking systems has held promise for more efficient, better diversified banks, with more intense competition in local markets. In many cases, especially when acquirers paid a reasonable price and manage the resulting post-merger organisational problems effectively, this promise has certainly come true. There is, however, accumulating evidence

in surveys and empirical research that the promise has not always been fulfilled for retail customers in local banking markets. In many cases, neither greater efficiency nor substantial improvements in diversification appear to have been realised.

The Bank for International Settlements found, and several large banks are learning, that the alleged benefits of banks merging for reasons of profitability often prove to be illusory. Bank profitability has fallen in 12 countries despite a wave of consolidation, mainly because acquirers tend, on the one hand, to overpay and, on the other hand, to underestimate organisational problems.

7. Lessons learnt from other mergers and takeovers

Despite the continued pace of merger activity, new deals are meeting with increasing scepticism among investors. The reason is simple - most mergers have simply not delivered the benefits that were promised. A study by the US Federal Reserve concluded that 50 percent of mergers by big banks in the United States of America eroded returns, whereas only 17 percent produced positive returns.

Although it is not our role to judge the appropriateness of any particular deal, a number of initial lessons may be drawn. I would like to make three comments in this respect:

7.1 Improvement in profitability is not an automatic consequence of a merger

Some recent work has shown that the improvement in profitability has not necessarily been related to size and that the definition of optimal size varies according to the type of institution, activity and business conducted.

Beyond this observation, the restructuring can come up against significant obstacles. For example, the compatibility of respective information systems might cause specific difficulties, the handling of which may turn out to be delicate. The increasing number of decision-making centres and structural differences may affect the efficiency of internal control systems. Some deals have revealed problems relating to the integration of different corporate cultures.

7.2 To be effective these deals need to be part of strategic plans

Another lesson from the American and European experience is that, from now on, credit institutions can no longer contemplate their future without carefully thinking about the changes in their economic, legal and financial environment.

Mergers and acquisitions will be successful when they are part of a strategy aimed at striking a balance between the need to strengthen existing product lines (when the comparative advantage is in principle at its greatest) and the diversification of activity, as part of medium-term plans aiming at extensively reorganising both distribution channels and means of production.

7.3 The emergence of trans-national banking groups will bring new risks, requiring closer cooperation between national banking supervisors

Banking supervisors are responsible for accompanying the restructuring in order to preserve and reinforce the integrity of the banking system as a whole, notably as regards, in particular, interbank operations and payment systems. Banking supervisors must be vigilant to avoid any particular project bringing additional risks. Risks can increase significantly should larger banks be tempted to conquer new markets. The risk of contagion may grow correspondingly, weakening the banking system as a whole. It is therefore imperative that banking supervisors remain vigilant with regard to increasingly complex operations.

8. Closing remarks

The reconstruction of a banking group, or mergers within a banking group, or the acquisition of subsidiaries, joint ventures and branch offices by banks or their controlling companies should be in the

interest of stability of the banking system as a whole. It must, however, be stressed that there are no hard and fast rules, because special circumstances, such as the history of a group and certain practicalities, often necessitate a pragmatic approach.

As mentioned earlier, it is not our role, as regulators, to judge the wisdom of management decisions and business strategies beyond ensuring that local and international best practice regarding supervision and regulation are met.

The restructuring of the banking industry represents a challenge for bankers and for regulators. Besides the strengthening of supervisory arrangements, it is up to the regulators to support the wave of restructuring by continuing to level the playing-field in the banking industry and by eliminating any competitive distortions. This condition needs to be met for restructuring to have its full effects in terms of economic efficiency and proper resource allocation.