# Thinking Through the Capital One-Discover Deal

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Capital One recently announced a $35 billion all-stock acquisition of Discover Financial Services. The response was predictable. Senator Elizabeth Warren (D-MA) claimed that the merger “threatens our financial stability, reduces competition, and would increase fees and credit costs for American families,” and asked regulators to “block it immediately.” Senator Josh Hawley (R-MO) argued that the merger “will create a new juggernaut in the credit card market, with unprecedented powers to extort American consumers.” He concluded that it “cannot be allowed to happen.”

But populist rage about large financial entities is plentiful and cheap these days. How should one *think* about the merger? Lucky for Eakinomics, AAF’s Fred Ashton has already done the heavy lifting in his latest insight.

To begin, one should look through the framework of consumer welfare. In other words, what are the costs and benefits to consumers? The costs are pretty straightforward. Capital One and Discover are both banks; combining them will produce a single, bigger bank. But as Ashton points out, not *that* big. The result would be the sixth-largest bank with nearly $625 billion in domestic assets. He notes: “The combined firm would still be dwarfed by JPMorgan Chase’s $2.6 trillion and Bank of America’s $2.4 trillion in domestic assets. Rivals Wells Fargo ($1.7 trillion), Citibank ($1.0 trillion), and US Bank ($641 billion) round out the top five.”

It is hard to see this diminishing competition for banking services. And while critics in Congress point to the specter of greater systemic risk, the (present value) probability of a systemic event and the taxpayer cost of any response is trivial (at least to my eye). There is simply not much on the cost side of the ledger.

What about benefits? Here it gets interesting, as the union could create a significant payments competitor. The volume of credit cards issued by both firms and Discover’s payment network could allow it to challenge Visa and Mastercard’s prominence. To see the magnitude of payments in play: “If Capital One decided to switch all of its cards to Discover’s network…it would put $351 billion of Mastercard’s volume (25 percent) and $255 billion of Visa’s volume (9 percent) at risk. The transfer would bring Discover’s credit card purchase volume to $817 billion.”

With Capital One credit card volume transitioning to its new Discover payments network, the pool of merchants accepting them will likely expand. Over time, consumers will likely benefit from this increased acceptance of Discover cards. Ashton notes: “Visa and Mastercard boast 130 million, and 100 million merchant locations, respectively. Discover has a distant 70 million. To penetrate the market, Capital One will compete on price, that is, lower swipe fees. Visa and Mastercard will likely need to respond in-kind to encourage merchants to continue accepting their cards.”

In sum, this sounds like the potential for real benefits in the payments market. The benefits appear to easily outweigh the costs.

Does this mean that the merger will sail through? Hardly. As Ashton points out, the merger comes on the heels of President Biden's July 2021 executive order on Promoting Competition in the American Economy. This order "directed the DOJ, the Federal Reserve, Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency to 'adopt a plan…for the revitalization of merger oversight' among financial institutions." A whole host of financial regulators and antitrust agencies will put this under a microscope. As MSNBC summarized it: "The Capital One-Discover merger runs entirely counter to the Biden administration's philosophy. If it goes through, it will turn Capital One — already a financial colossus — into an even bigger giant. Is anyone outside of the financial sector asking for that?"

One of the virtues of conducting merger reviews in the consumer welfare standard framework is that it permitted the facts to trump raw emotion and cheap politics. It is at moments like these that its abandonment by the Biden Administration is most obvious.