

**Directorate for Financial and Enterprise Affairs
COMPETITION COMMITTEE****Annual Report on Competition Policy Developments in Iceland****-- 2016 --****5-6 December 2017**

This report is submitted by Iceland to the Competition Committee FOR INFORMATION at its forthcoming meeting to be held on 5-6 December 2017.

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1. Executive Summary

1. The current policy objectives of the Icelandic Competition Authority (ICA) are to make markets work better for the general public and the economy. On the basis of these general objectives, the ICA has developed more detailed objectives for its enforcement and advocacy (chapter 2).
2. The increased level of common ownership and its effects on competition give rise to concerns, given the oligopolistic nature of the most significant markets in Iceland. The ICA has monitored this development closely, issued reports, and organised or participated in meetings to discuss the possible impact on competition. Furthermore, ICA has addressed the issue in numerous investigations, mainly as concerns merger control. (Chapter 3.1)
3. The ICA entered into settlements with the three main commercial banks regarding actions to spur competition in the retail banking market. The main goals are to reduce costs charged to customers when they switch retail banks, make it easier and more efficient for individuals and small companies to shop around for financial services and counter conditions that may facilitate tacit collusion in the market for retail banking services. (Chapter 3.2)
4. The ICA entered into a settlement with the Iceland Post, designed to resolve competition problems that have crystallised in various formal and informal complaints about the company's conduct. On the basis of the settlement, Iceland Post is making significant changes to its organisation and operations. (Chapter 3.3)
5. The ICA has annulled a merger, where Hagar, Iceland's largest retail chain, planned to acquire Lyfja, a pharmaceutical retailer. Hagar and Lyfja were close competitors in the field of cosmetics, hygiene products, vitamins, supplements, and other health products. The ICA concluded the merger would seriously harm competition, as an important competitor would cease to exist as an independent entity. (Chapter 3.4)
6. The ICA has imposed detailed conditions on a large merger in the field of telecommunications and media, compensating for the otherwise harmful effects of the merger (chapter 3.5).
7. The ICA continues to address competition restrictions in the dairy industry, following up on earlier decisions, where Mjólkursamsalan hf (MS) was found to have abused its dominant position through price discrimination. The case is now before the courts. (Chapter 3.6)
8. For the last two years, the ICA has run a special advocacy initiative through a series of meetings, held under the heading "*Let's talk about competition*". One of the main goals of this initiative is to encourage policy makers and public authorities to adopt the methods of competition assessment, as proposed by the OECD. To this end, the ICA has sought assistance from the OECD Competition Division. (Chapter 3.7)
9. By employing more stringent prioritisation criteria, the ICA has managed to reduce the number of pending cases considerably (chapter 4).

2. Competition policy and priorities in enforcement and advocacy

10. The ICA strives to base its enforcement, as well as its advocacy activities, upon clear policy objectives and well-framed priorities. The board of the ICA reviews periodically these policy objectives, taking into account the economic situation at a given time, the indications of competition problems in individual markets, as well as available resources.

11. According to the ICA's current policy formulation, the main policy objectives are to make markets work better for the general public and the economy. More precisely, the ICA intends to prioritise the following issues in the coming years:

- Monitor the developments in the ownership of undertakings, detecting common ownership and other ownership links that can adversely affect competition.
- Take an active role in discussions on the development of the financial market in Iceland, taking account of earlier experience in the field of competition.
- Monitor the development in the groceries market and address problems that may impede new competition.
- Conclude ongoing investigations into the transport and fuel markets.
- Continue to advocate for the application of competition assessment in the public sector.

12. In its policy formulation the ICA takes into account that comparison shows that the domestic sector in Iceland is lagging behind in terms of productivity when compared to neighbouring countries. The lack of productivity in services is addressed in the following manner in the OECD Economic Survey for Iceland, published in June 2017: *“Robust competition can also support a healthy business environment that is conducive to productivity growth. As noted in the last Economic Survey, competition in services is weak, often due to artificial barriers to entry. The Icelandic Competition Authority has continued to counter abuse of dominant positions and collusions, which are particular problems for very small economies where it is common for a single firm or handful of firms to dominate the market. The authorities are considering using the OECD's Competition Assessment Toolkit to undertake a review of existing laws and regulations as recommended in the previous survey.”*

13. Taking account of this, the ICA strives to maintain firm enforcement and broaden its advocacy role.

3. Key examples of enforcement and advocacy

14. Following are key examples of the ICA's enforcement and advocacy activities, which were addressed in 2016 and concluded that year or in 2017.

3.1. Common ownership and its impact on competition in Iceland

15. As described in the last Annual Report (DAF/COMP/AR(2016)30), Icelandic markets have experienced an increased level of common ownership in the post-crisis era. This has resulted in a market structure where competitors in many significant markets are owned, to a certain extent, by the same set of investors.

16. In a recent article by Óladóttir et al. (2017)¹ the authors find that common ownership of listed firms in Iceland increased considerably after the financial crisis in 2008 and that in the middle of 2016 Icelandic pension funds dominated holdings of shares in most listed companies in Iceland. In three markets that were analysed, the pension funds held commonly over 45% of the shares in real estate companies, 35% in insurance and 50% in telecommunications.²

17. Given the oligopolistic nature of the most significant markets in Iceland, the ICA is concerned about the increased level of the aforementioned ownership structure and its effects on competition. In fact, the ICA has expressed its concerns on the issue as early as in 2012, when the pensions funds had begun to increase their common shareholding.

18. The ICA has monitored this development closely, issued reports, and organised or participated in meetings to discuss the possible impact on competition. Furthermore, it has addressed the issue in numerous investigations, mainly in relation to merger control. Several merger cases have been settled with conditions where common ownership is addressed.

19. One of the most recent examples of this is a merger case that was settled in October 2017, where Vodafone Iceland acquired certain assets of 365, a media and telecom company. These are among the most important companies in Iceland in the field of telecommunications and media. In the ICA's investigation, one of the concerns was a high level of common ownership in relevant markets. Vodafone addressed that issue by proposing behavioral remedies that aimed at guaranteeing the independence of Vodafone's board and its key employees. Therefore, board members of Vodafone, its key employees and their spouses are not allowed to work at or own shares in Vodafone's competitors. Additionally, the board members and key employees are obliged to guarantee that they do not take into account ownership of Vodafone's shareholders in Vodafone's competitors when running the company. Common ownership will as well be addressed in its competition compliance program. More information on the case can be found in chapter 3.5.

20. The ICA will continue to follow these developments closely and welcomes any input from other competition agencies, academics and interested parties. Accordingly, the ICA welcomes the current discussions on the issue in the OECD Competition Committee.

3.2. Measures to spur competition in the retail banking market

21. In 2015, following a decision on interventions into the payment market (see chapter 3.1 of the 2014 Annual Report, DAF/COMP/AR(2015)39), the ICA entered into discussions with the three main commercial banks regarding further actions to spur

¹ Óladóttir, A. D., Friðriksson F. A., Magnússon G., and Þráinsson V.(2017), "Serving the same masters while competing: Common ownership of listed companies in Iceland", *Icelandic Review of Politics and Administration*, Vol 13, No 1 <http://www.irpa.is/article/view/a.2017.13.1.2/pdf>

² The high involvement of pension funds in the ownership of undertakings is also addressed in the OECD Economic Surveys for Iceland, in 2017: „*Pension funds are important shareholders accounting for half of all shares in listed companies, which the competition authorities fear may distort corporate governance. Against this background, pension funds should continue rebalancing their portfolios internationally. With the lifting of capital controls, risk-based supervision should act to reduce geographical concentration in their investment portfolios.*”

competition in the retail banking market. Among the aims of the discussions was to bring closure to investigations into certain practices in the market.

22. The discussions resulted in settlements with the three banks, published in 2017. The main goals of the measures (set out in the settlement as commitments) are to:

- reduce costs charged to customers when they switch retail banks,
- make it easier and more efficient for individuals and small companies to shop around for financial services and thus exert greater competitive discipline on those offering retail banking services,
- counter conditions that may facilitate tacit collusion in the market for retail banking services.

23. The settlement also serves as a contribution to a policy framework pertaining to the banking industry, which the government will need to develop, in view of the current ownership structure of the banks and in relation to rapid developments (FinTech) in banking services internationally.

24. As part of the settlement, the banks commit to adhere to the following conditions in their operations:

- Switching between banks will be facilitated. To attain this goal, the selection, development and installation of systems and technical solutions will take account of this aim. Customer surveys will be used to identify the preferences of customers in this regard and the bank will respond accordingly.
- Switching costs such as repayment fees will not be charged for early redemptions made by debtors in the case of loans that carry variable interest rates, when the borrower is an individual or a small enterprise.
- Caps on fees will apply in the case of charges for transferring tied private pension savings from the banks to other entities that offer private pension fund management. This commitment aims to reduce the tying effects of such charges on the mobility of customers, thereby promoting more effective competition in this field.
- Swapping of mortgage debtors via property transactions will no longer be conditional upon the buyer moving all of his or her banking services to the respective bank. Banking services in this context refer to salary payment accounts together with, if applicable, other services.
- Customers will be notified of significant changes to interest rates and service fees before they take effect, in order to enable customers to transfer their banking transactions elsewhere, should they choose to do so.
- The bank will make sure that all information on general fees, rates and terms that are published on the bank's website, is accessible through an open API (application programming interface), available to third parties (individuals, enterprises or associations) for download and to set up comparison websites. This, in return, can reinforce consumer awareness of prices and consequently trigger more effective competition. The setting up of the API in this regard may also involve certain business opportunities for companies considering entering the field of FinTech in Iceland.
- Certain contractual rights according to the terms of older mortgage loans, that have significant tying effect in the opinion of the ICA, and which triggered an investigation by the ICA, will not be applied by the bank.

25. In addition to the aforementioned commitments, a newly enacted Act on Consumer Mortgages stipulates that it is illegal to charge up-front fees as a proportion of the mortgage amount, but that used to be the standard practice by mortgage lenders, including the banks. When the draft bill to this Act was in preparation, the ICA proposed that this practice would be banned. Subsequently, the Parliament took the proposal on-board.

26. Landsbankinn was the first of the three big banks to complete the settlement negotiations with the ICA, followed by Arion banki and Islandsbanki. The settlements are published in ICA's decisions no. 22, 24 and 25/2017.

3.3. Measures to improve competitive conditions in the postal market

27. The ICA has in past years received numerous complaints regarding the operations of the state-owned incumbent postal service company, Iceland Post (IP). Investigations into several complaints have now resulted in a settlement between the ICA and the IP. The settlement is published in ICA's decision no. 8/2017.

28. The commitments of the settlement are designed to comprehensively and lastingly resolve competition problems that have crystallised in various formal and informal complaints about the company's conduct. Most of the complaints are based, directly or indirectly, on competitors' allegations that IP has been using profit from the state reserved area of its business to cross-subsidise its competitive activities. IP still holds a monopoly for the distribution of letters up to 50 gr. It holds a dominant position in the postal market (for the distribution of postal items weighing up to 2 kg).

29. In order to solve the competitive problems that were identified during the investigations of the underlying cases, certain commitments are introduced in the settlement, involving the requirement to prepare separate LRAIC-based accounting statements for each of IP's significant business areas that are open to competition and a clear criteria is set out for the assessment of potential cross-subsidies from the reserved area to the competing business areas. This criteria is useful both for IP's own internal control and for supervisory bodies, in their assessment of potential violations of competition law, and are designed to prevent cross-subsidisation from IP's monopoly business.

30. The settlement stipulates that IP's subsidiaries shall be operationally and administratively independent from IP and that IP's express mail service business will be moved out of the parent company into a separate entity as a subsidiary.

31. In the settlement, certain restrictions regarding IP's transactions with its subsidiaries are introduced. The purpose is to ensure equal treatment of competitors and IP's subsidiaries when they transact with IP. In the settlement, IP's ability to finance its subsidiaries is also significantly limited to prevent distortions of competition in the markets where IP's subsidiaries operate.

32. The settlement includes provisions intended to ensure that competitors of IP in the distribution of unaddressed advertising mail can buy distribution from IP in remote areas, at the same cost/transfer price as IP itself. Furthermore, the settlement provides that competitors of IP in the field of postal services should get comparable terms and conditions when they do business with IP, as other customers of the company in equivalent transactions. Moreover, IP is prohibited (unless there exists an objective justification) to refuse to sell its services to competitors in the area of universal service.

33. The settlement stipulates certain structural changes in the internal organisation of the parent company. The changes involve a separation of IP's sales operations from the division responsible for cost allocation to different business areas. This separation serves e.g. to guarantee that IP's cost allocation between the company's reserved area on the one hand and its various competitive activities on the other hand, is implemented in an objective manner and does not distort competition. Generally, these organisational changes are conducive to reduce any risk of conflicts of interest.

34. The settlement also stipulates that a monitoring committee shall be established to oversee that the conditions of the settlement are met and to receive complaints and take decisions in accordance with the provisions of the settlement. Two out of three members of the committee must be independent of IP.

3.4. The ICA blocks a merger between the largest retailer and a large pharmaceuticals retailer.

35. The ICA has annulled a merger, where Hagar, an operator of retail companies, planned to acquire Lyfja, a pharmaceuticals retailer. Hagar is the largest retailer in Iceland, operating retail chains such as Bónus (groceries) and Hagkaup (groceries, cosmetics, clothes etc.). Lyfja is one of the two largest pharmaceuticals retailers, also an active retailer of cosmetics, hygiene products etc.

36. The ICA found that Hagar and Lyfja were close competitors in the market for cosmetics and hygiene products, the market for vitamins, supplements and minerals and the market for health related groceries (such as organic and vegan products). Together, they would have held a considerable market share in these markets. In some parts of Iceland, the proposed merged company would have been the only retailer for these products.

37. In earlier cases, Hagar has been considered to hold a dominant position in the market for groceries in Iceland. In this case, the ICA found that its dominant position would be strengthened, through the merger.

38. During the investigation, Costco, the internationally operated retailer/warehouse, opened a large warehouse in Iceland. The merging companies argued that Costco's entry into the market would change the market structure considerably. For that reason, there would be no reason for intervention into the merger. The ICA investigated the effects of Costco's opening, to the extent possible, given the short experience. The ICA concluded that Costco's entry would have positive general effects on competition, but limited effects on the markets that were the most relevant in this case, especially markets for cosmetics and hygiene products.

39. The merging companies also argued that the Keflavik Airport Duty Free Store, which operates stores for both departing and arriving passengers, should be considered to be a part of the relevant market. They also argued that online shopping should be included in the market definition. After a thorough investigation, the ICA concluded that this was not the case.

40. The ICA concluded that the merger would seriously harm competition, as an important competitor (Lyfja) would cease to exist as an independent entity. The ICA also found that remedies proposed by the merging parties would not address the authority's concerns. For this reason, the ICA annulled the merger.

3.5. The ICA clears a merger in Telecoms and Media – Extensive conditions imposed.

41. Following an extensive investigation, the ICA has imposed detailed conditions on a large merger in the field of telecommunications and media. In the case, Fjarsskipti hf. (“Vodafone”) acquired certain assets of 365 miðlar ehf. (“365 media”). Vodafone provides telecommunication service to its customers in Iceland and is an important player in the market. It is active in mobile, landline, television and internet services and has a strong position in the distribution of TV-channels and radio stations in Iceland. 365 media is a leading and a full-scale broadcasting company in Iceland both in television, print, online news and radio. In recent years, it has also offered telecommunication services as a virtual network operator.

42. With the merger, Vodafone acquired all operations of 365 related to telecommunications, television, radio and its online news site, visir.is. Excluded from the acquisition was the operation of a print media, including Fréttablaðið (Iceland’s largest newspaper) and publishing of the Icelandic version of the magazine Glamour.

43. In its statement of objections (SO), the ICA found that the merger led to horizontal, vertical and conglomerate competition concerns. The horizontal overlap of the parties was mainly in the retail markets for the provision of internet and mobile services. Additionally, 365 and Vodafone were important competitors in the so-called triple- or quad-play markets, since both firms sold bundles of telecoms and pay-TV services. Vertical effects were found as well, as Vodafone had a strong position in the distribution of TV and radio and 365 held a strong position in the market for linear/traditional pay-TV and on the market for radio advertisements. It should be noted that in merger cases dealing with media companies, the ICA has to take into account issues related to media plurality and diversity. According to the SO, the ICA found that the merger would harm media plurality and diversity in Iceland.

44. After comprehensive discussions, the ICA and the parties to the merger reached a settlement, addressing the competition concerns. Firstly, to address the loss of an important player offering bundles of telecommunication and pay-TV services, Vodafone entered into a wholesale agreement of TV-channels and IPTV services with a player that had been active in providing telecommunication service in Iceland but had not offered TV service to its customer. Additionally, Vodafone committed to offer players, which had not been active in the market for bundles of telecommunication and pay TV services, TV-channels in wholesale for the next three years on fair and non-discriminatory terms. These players can as well buy related services from Vodafone in wholesale, e.g. IPTV boxes, in order to be better able to offer their customers TV services.. Furthermore, they have the option to distribute the channels through other distributions networks than Vodafone’s, if they prefer.

45. Secondly, to address the vertical competition concerns, Vodafone has committed to offer media companies distribution of TV and radio channels on its network on fair and non-discriminatory terms. Additionally, it will take measures to ensure the independence of Vodafone’s wholesale division by separating it from Vodafone’s retail business. That involves separation of management and accounts of the wholesale division and creation of “Chinese Walls”.

46. Thirdly, to address the high level of common ownership in the relevant markets, behavioural remedies were imposed that aim at guaranteeing the independence of Vodafone’s board and its key employees (see more detailed description in paragraph 19).

47. Fourthly, to address ICA concerns, Vodafone commits to ensure that customers will benefit from efficiencies and positive effects on plurality and diversity that the company claims will result from the merger. For plurality and diversity reasons, Vodafone also commits to guarantee the continued operation of acquired TV and radio stations, including the newsroom and editorial board, and continued production of Icelandic audio-visual content, for at least three years. Vodafone committed as well to facilitate access for at least three independent domestic TV stations with news and cultural content. The commitments that are related to the claimed efficiencies are confidential.

48. Lastly, 365 media has also addressed ICA's concerns as regards ownership ties that would otherwise derive from the merger, as 365 media would own considerable shares in Vodafone, as well as being the owner of Fréttablaðið and the website frett.is. To this end, 365 commits to sell either its share in Vodafone or Fréttablaðið and frett.is, within a specified time limit. While these cross-shareholdings exist, 365 will not increase its share in Vodafone, have a representative in Vodafone board, or influence Vodafone commercial policy that could affect markets where Fréttablaðið operates.

49. The Icelandic Competition Authority found these remedies acceptable and approved the merger in the autumn of 2017.

3.6. Competition restrictions in the dairy industry

50. In July 2016, the ICA imposed a 480 million ISK administrative fine on Mjólkursamsalan ehf. (MS Iceland Dairies), for an abuse of a dominant position. According to the decision, MS abused its dominant position in the market by selling its competitors basic raw material for the production of dairy products at an abnormally high price, while at the same time, MS and associated parties were sold the same raw material at a much lower price, and, additionally, below cost of production. Furthermore, the ICA concluded that MS had provided the ICA with incorrect information and neglected to hand over important information in an earlier case dealing with the same issues. The MS was fined for that negligence.

51. The case is described in more detail in the ICA's last Annual Report (DAF/COMP/AR(2016)30).

52. The ICA's decision was appealed to the Competition Appeals Committee. In a ruling from November 2016, the Appeals Committee annulled the ICA's decision, as to the abuse of a dominant position. In a split decision, the majority of the Committee found that a legal provision in a special law dealing with the dairy industry, exempting dairy companies from the general ban on collusion, had in fact allowed MS to apply price discrimination in this instance.

53. As to the ICA's decision to fine MS for the provision of incorrect information and negligence to hand over important information, the Appeals Committee upheld the decision.

54. The case is now before the Reykjavik District Court, where the ICA seeks to have the majority ruling of the Appeals Committee overturned. On the other hand, MS seeks to have the ruling overturned, as regards the fines for the provision of incorrect information and negligence to hand over information.

3.7. “Let’s talk about competition” – Advocating for a Competition Assessment.

55. During the last two years, the ICA has run a special advocacy initiative through a series of meetings, held under the heading “*Let’s talk about competition*”. One of the main goals of this initiative is to encourage policy makers and public authorities to adopt the methods of competition assessment, as proposed by the OECD.

56. In that regard, the ICA has sought assistance from the Competition Division of the OECD. In February 2017, Ania Thiemann, Head of Global Relations at the Competition Division, was invited to Reykjavík for a series of meetings with ministries, public authorities and other policy makers, to introduce and discuss the methods of competition assessment and what lessons can be learned from earlier experiences worldwide. For this purpose the ICA organised 12 meetings with some 120 participants in total, representing some 30 different ministries, public bodies and industry associations. These meetings followed an earlier visit by Ms Thiemann, in December 2015.

57. Following these meetings, the ICA has been actively advocating for further initiatives from ministries and public bodies, adopting the method of competition assessment, as described in the OECD Competition Assessment Toolkit.

58. In 2016, the ICA held a range of other meetings under the heading of “*Lets talk about competition*“, where competition assessment, among other issues, was discussed. These include a meeting on competition in agriculture, common ownership and enforcement of the EEA Competition rules in Iceland. These meetings are discussed in more detail in the ICA’s last Annual Report (DAF/COMP/AR(2016)30).

4. Resources of the Competition Authority

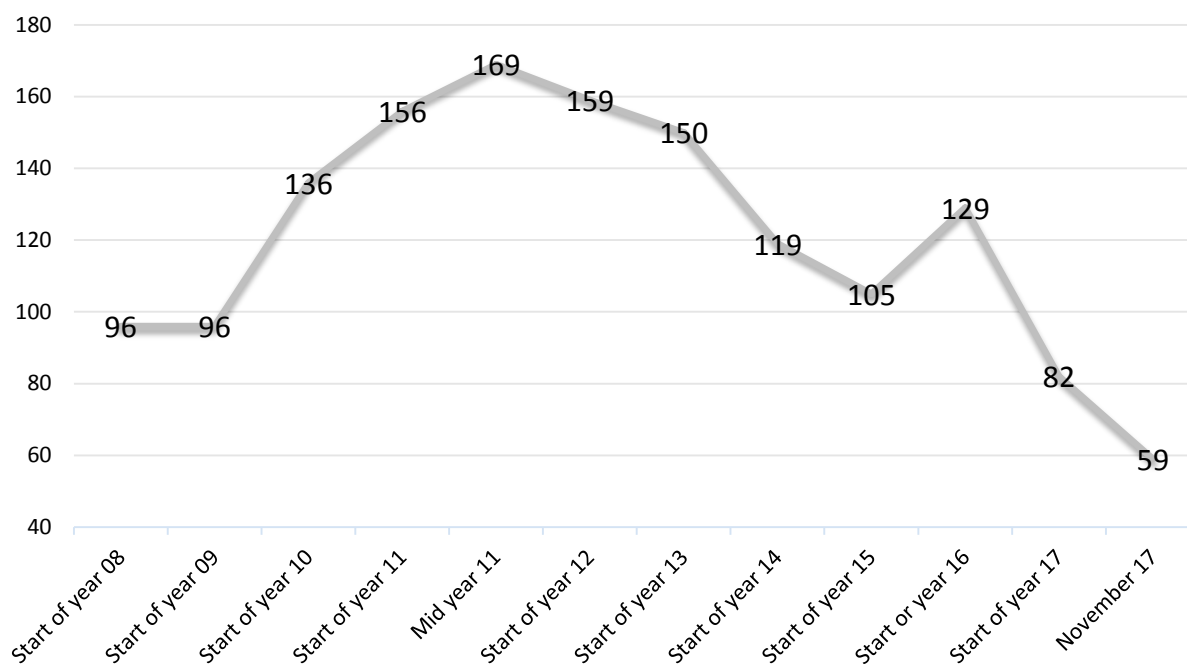
4.1. Budget and pending cases

59. The ICA is funded through the state budget. The budget for 2017 amounts to approx. 3,7 m. EUR.

60. Since the banking collapse in 2008, the ICA has had to apply rigorous prioritisation in response to an increased workload. As shown on figure 1, the number of pending cases rose from around 100 to 170 from 2008 to 2011. By taking up more stringent prioritisation criteria, the ICA has managed to decrease the number of pending cases.

61. In the years 2016 and 2017, the ICA increased the level of prioritisation, bringing the number of cases from 129 in the beginning of 2016, down to 59 in November 2017. This has been done despite a considerable increase in the number of merger cases in the same period.

Figure 1. Number of pending cases



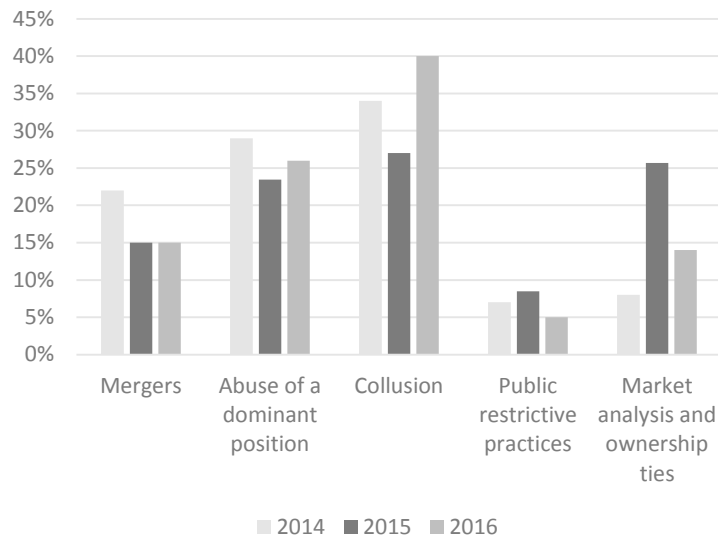
62. In parallel with the increase in the number of cases, the average case duration increased during the crises. By reducing the number of cases through tougher prioritisation, the ICA is working towards decreasing the average case duration.

4.2. Allocation of resources

63. The ICA keeps track of and manages the allocation of employee's work as regards various areas of responsibilities. The breakdown is based on time measurement.

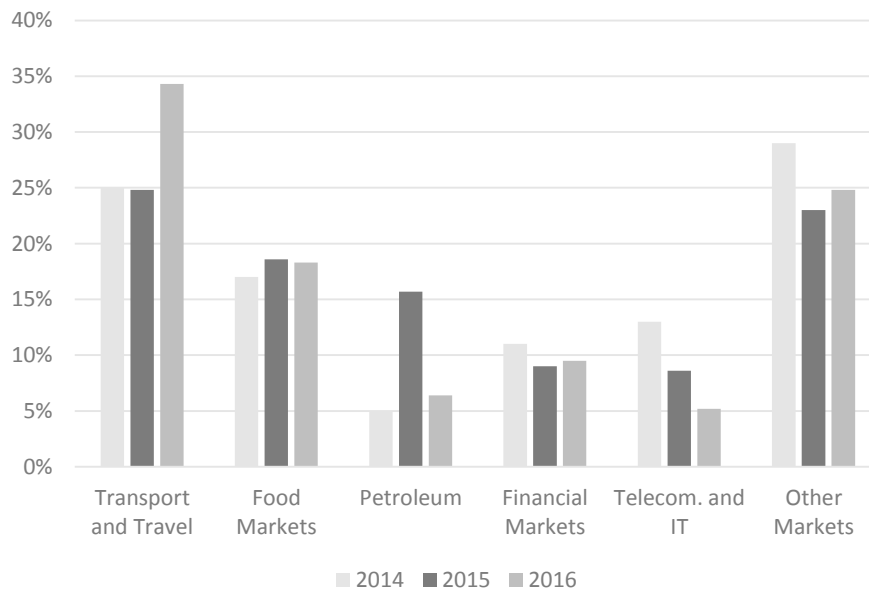
64. As shown in figure 2, cases dealing with abuse of dominant positions is a significant part of the ICA's work. This can be explained by the fact that Iceland is a small economy, with oligopolistic markets in many areas.

Figure 2. Allocation of resources – types of work



65. As shown in Figure 3, a considerable part of the ICA’s time is allocated to transport, due to an extensive investigation into a possible collusion.

Figure 3. Allocation of resources - markets



66. At the end of the year 2016, 24 employees were working at the ICA.