Organisation for Economic Co-operation and Development

DAF/COMP/GF/WD(2019)53

Unclassified **English - Or. English**

24 November 2019

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

Global Forum on Competition

MERGER CONTROL IN DYNAMIC MARKETS – Contribution from Brazil

- Session III -

6 December 2019

This contribution is submitted by Brazil under Session III of the Global Forum on Competition to be held on 5-6 December 2019.

More documentation related to this discussion can be found at: oe.mcdym.

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JT03455209

Merger Control in Dynamic Markets

- Contribution from Brazil[1] –

1. For Cade, one of the challenges of antitrust enforcement in highly innovative markets consists of estimating the long-run effects of antitrust intervention[2]. The Brazilian Competition Law (Law 12.529/2011, herein referred to as "Law") prohibits mergers that (i) results in the elimination of competition in a substantial part of the relevant market; (ii) might create or reinforce dominant position; or (iii) might result in the domination of a relevant market of goods or services[3]. The Law provides, however, that such mergers might be cleared as long as those results are limited to the strictly necessary to fulfill the following goals, cumulatively or alternatively: (a) increased production or competitiveness; (b) increased quality of goods and services; or (c) efficiency and technological or economic development. Additionally, the Law provides that a relevant part of the benefits deriving from the transaction have to be transferred to the consumers.

2. The Brazilian Horizontal Merger Review Guidelines ("Guidelines")[4]-[5], published with the aim of giving CADE's analysis more transparency, state that it is not possible to define, a priori, if the merger will be beneficial or harmful. Therefore, the Guidelines describe that a case-by-case analysis is needed, with consideration of the specific efficiencies of the transaction *vis-à-vis* its negative effects derived from a higher probability of market power exercise. This is what the Guidelines calls the "non-negative liquid effect of the consumer economic welfare"[6].

3. In the same line, for Cade, innovation and dynamic competition should be assessed on a case-by-case basis, taking into account the business reality and the particularities of all sides of the markets. In its review, Cade considers important to take into account the

[1] This document was produced by Christine Park, Consultant at Cade for digital economy, and Patricia Sakowski, Deputy Chief Economist at Cade.

[2] Cade's replies to the Questionnaire contained in the Report of the BRICS Competition Authorities' Working Group on Digital Economy "*BRICS in the digital economy: competition policy in practice*", available at: http://www.cade.gov.br/acesso-a-informacao/publicacoes-institucionais/brics_report.pdf, page 90.

[3] Law 12.529/2011, paragraph 5.

[4] Issued in 2016, available online in Portuguese at: http://www.cade.gov.br/acesso-a-informacao/publicacoes-institucionais/guias_do_Cade/guia-para-analise-de-atos-de-concentracao-horizontal.pdf.

[5] As described in the Guidelines, the Brazilian Competition Authority issued its first guideline on Merger Review in 2001, through a joint Resolution from the Secretariat for Economic Monitoring of the Ministry of Finance (Secretaria de Acompanhamento Econômico - SEAE) and the Secretariat of Economic Law of the Ministry of Justice (Secretaria de Direito Econômico – SDE), based on the provisions of the previous Brazilian Competition Law of 1994.

[6] CADE's Guideline on Merger Review. July 2016. P. 8. Available online in Portuguese at: http://www.cade.gov.br/acesso-a-informacao/publicacoes-institucionais/guias_do_Cade/guia-para-analise-de-atos-de-concentracao-horizontal.pdf.

extent to which a company will continue having incentives to innovate after the approval of a merger or acquisition[7].

1. Merger review process

4. According to CADE's Horizontal Merger Review Guidelines, the competition analysis can occur through various forms. The classical review followed by Cade may be comprised of the following steps:[8]

- relevant market definition;
- analysis of the level of horizontal concentration, that would pinpoint the possibility of market power exercise by the resulting company;
- evaluation of the probability of market power exercise resulting from the transaction, considering variables such as conditions of entry (timeliness, probability and sufficiency) and level of rivalry left in the market;
- evaluation of purchase power existent in the market or resulting from the deal, if the market involved is an input market;
- weighing the economic efficiencies inherent to the transaction.

5. Although market share is the tool traditionally used to evaluate horizontal concentration, Cade's Horizontal Merger Guidelines mentions this is not the only tool that may be used to this end. Complementary and alternative methods of examination include counterfactual analysis, simulations and other factors such as elimination of *maverick* companies[9] and two-sided markets[10]. In fact, these former two aspects were taken into account in Cade's recent review of the Itaú/XP transaction, as will be further described.

6. Cade's Guidelines also include the topic of potential competition in a horizontal merger review. According to the Guidelines, mergers between a company that already operates in the market and a potential competitor in the same relevant market could have the anticompetitive effects similar to those between two active companies in the same relevant market, due to the role played by a potential competitor. The Guidelines note that a company, as a potential competitor, can develop a significant role even if it has left or has not entered the market yet. Therefore, according to the Guidelines, in the context of a

[7] As Cade mentioned for the Report of the BRICS Competition Authorities' Working Group on Digital Economy "*BRICS in the digital economy: competition policy in practice*", available at: http://www.cade.gov.br/acesso-a-informacao/publicacoes-institucionais/brics_report.pdf, page 90.

[8] Cade's Guideline states that, when conducting its review, Cade does not have to follow all these steps nor a predetermined sequence.

[9] The Guidelines' consideration of maverick companies will be provided further in the description of Cade's review of the Itaú/XP case.

[10] According to the Guidelines, what defines a multi-sided market is not solely the existence of a platform connecting two final users, but mainly the relationship between the total volume of transactions with the price structure – in other words, how price is divided between the two final users. The price structure and definition of who bears the costs should incentive the presence of both sides in the market, which means that the price paid by one of the players is not related to its entry cost in the system. In this pricing structure, as described by the Guidelines, while one of the sides pays the cost price, the other pays the price from which it derives profit from the industry.

potential competition, the following non-exhaustive elements are analyzed: (i) if the company is in the imminence of entering the market; (ii) if it has relevant assets that might be easily used to reenter the market, without incurring in significant sunk costs; and (iii) if the company could bear the necessary costs to enter the market in a relatively short timeframe. Potential competition may also be analyzed by Cade through the existence of registry, license or authorization, on which the antitrust authority may request the presentation to public authorities.

2. The Itaú/XP merger review

7. Cade's Guidelines state that it may loosen the use of the Herfindahl-Hirschman Index (HHI) when one of the parties is a maverick type of company or presents a disruptive strategy; or when the merger involves a potential or recent entrant to the market involved in the transaction. The Itaú/XP transaction involved both conditions[11].

8. In 2017, Cade reviewed the proposed transaction between Itaú Unibanco ("Itaú"), Brazil's biggest private bank and XP Investimentos ("XP"), a leading investment platform (Merger Review 08700.004431/2017-16). The transaction consisted in Itaú's acquisition of XP's shareholding, initially held by XP Controle Participações ("XP Controle"), G.A. Brasil N FIP and Dyna IH FIP in three stages: (i) in the first stage, Itaú becomes XP's minority shareholder, with 49.9% of total shareholding and 30.1% of voting shareholding; (ii) in 2020, Itaú acquires additional 12.5% of XP's shareholding, resulting in a 62.4% total and 40% of voting capital shareholding; (iii) finally, in 2022, Itaú acquires additional 12.5% from XP, securing 74.9% of total and 49.9% of voting shareholding. As a result, the voting shareholding would remain with XP Controle, at the same time it would imply in the exit of other shareholders (G.A. Brasil N FIP and Dyna IH FIP). The information presented by the applicants also indicated that, as of 2024, XP could exercise its right to sell its total shareholding to Itaú, and as of 2033, Itaú could exercise its right to buy XP Controle's total shareholding.

9. The transaction resulted in horizontal overlap in the following markets: (i) securities brokerage; (ii) asset management; (iii) third party's resource management; (iv) retail distribution of investment products; and (v) insurance brokerage. The deal also resulted in vertical integrations: (a) strengthening of integration between Itaú's asset management and XP's distribution of investment products; (b) strengthening of integration between Itaú's certificate issuing activities and XP's distribution of investment products; (c) strengthening of vertical integration between Itaú's private pension activities and XP's distribution of investment products; (d) strengthening of vertical integration between asset management and third parties' resource management, operated by both parties; and (e) strengthening of vertical integration between Itaú's insurance activities (life and housing) and XP's insurance brokerage.

10. In its assessment of the relevant markets involved in the transaction, Cade highlighted there was an ongoing shift in the provision of financial services in Brazil, which significantly impacts the dynamic of these markets and the analysis conducted by the competition authority. As Cade noted, in general, it had been considering the "manufacturing" and the commercialization of financial products (especially investment

[11] The description of Cade's review of the Itaú/XP transaction is based on Cade's General Superintendence's Opinion n. 24 of December 27, 2017, as well as on the Reporting Commissioner's Vote of March 15, 2018.

products such as Bank Deposit Certificates), and services in an integrated manner, as pertaining to the same market, with a few exceptions[12]. This understanding derived from the fact that the market players that traditionally commercialized these products or services to the consumer were the same: financial institutions pertaining to the banking system. These institutions issue their own certificates, manage their own investment funds and pension plans and commercializes them exclusively in their respective customer service networks. In other words, the supply for these products was completely integrated and captive to each institution.

11. As Cade described, Itaú, one of the applicants, operates in this traditional business model, in a vertical and captive manner, without distributing third parties' products in its distribution network. Notwithstanding, a new way of commercializing products emerged – marketplaces operating as two-sided platforms, bringing together, on the one hand, various providers (small and medium-sized banks, independent asset management, companies that issue private certificates, etc.) and on the other, final consumers. Cade noted that this new way of providing products and financial services in the market increased competition in the market, as it enabled competition between various providers within the same platform (competition in the platform); promoted competition between these new platforms and traditional banks; and reduced entry barriers to new suppliers that do not need to structure a broad and costly customer service. As Cade noted in its review, this new business model brought benefits to both the providers, that could reduce their distribution costs, and to consumers, due to a significant increase of competition in the market.

12. XP, the other applicant of the deal, on the other hand, was the first mover in this new form of marketing products in the financial market. It launched the first and main open platform that distributes financial products in Brazil. Therefore, considering that the transaction consisted of a disruptive player being partially acquired by a traditional player, there was a concern that the transaction could be part of a strategy adopted by an incumbent company to restrain a disruptive player, which had been gaining a significant share of the financial investment market in Brazil. In this context, Cade expressed in its review concerns about the suppression of potential competition that could have been imposed by XP if it were not for the transaction.

13. In its review, Cade considered that the competition exerted by XP had been resulting in welfare increases to the final consumer due to the supply of more products at higher quality and lower costs than its competitors in the banking system. Therefore, in this case, Cade considered important to focus its review on the risk of mitigation or elimination of the disruptive competition brought forth by XP. For Cade, the preservation of the competition exerted by XP and by other players promoting a change in the way consumers deal with financial services providers was crucial to the increase of competition in this market, since this competitive pressure acted as a catalyst of the reaction by incumbents whom, threatened by these new players, would be compelled to compete more vigorously.

14. Citing the 'World Fintech Report[13]', Cade noted that traditional companies would be considering the establishment of partnerships with or the investment in fintechs an effective reply to the emergence of fintechs. Therefore, Cade considered that preserving competition *vis-à-vis* these movements of the incumbents should be a constant concern by

[12] Such as in the case of insurance, in which the structuring of the product and its commercialization (brokerage service) are carried out by different players, although they might pertain to the same group.

[13] Available online at: https://www.capgemini.com/wp-content/uploads/2017/09/world_fintech_report_2017.pdf.

antitrust authorities since, despite uncertainties related to how the financial market would emerge after this innovation wave, consumers had been reacting positively to this movement that has been bringing better services and products.

15. Cade also observed that, in the context of innovative markets and the emergence of players with disruptive characteristics challenging incumbents' historic positions in the financial market, concerns and challenges also emerged and could demand competition authorities' attention. In its considerations, Cade mentioned the OECD's discussion on disruptive innovation and pinpointed OECD's consideration on how the increase of online platforms, transactions and search options prompted the need to revisit traditional competition analysis methods[14]. In this context, Cade noted that, despite the difficulties that a dynamic environment brings to a competition review, the maintenance of a competitive and favorable environment to the development of innovative companies should permeate the analysis of a concrete case, having as a premise the fact that these companies have been promoting consumer welfare gains.

16. In this context, Cade considered that the concentration levels were not sufficient to support a decision on whether there was a possibility of market power exercise. According to Cade:

> *"the transaction presents elements that suggest a higher level of caution by the competition authorities to conclude for the absence of potential harm to competition based on safe harbours such as economic concentration which, despite translating in objective terms the impact of mergers in most of the situations, may not capture relevant subjective elements related to the effective impact of a suppression of a competitor in the market."*[15]

17. In other words, Cade noted that a competitor's capacity to exercise rivalry in the market could not be reflected in its market share. As can be noticed in the case, Cade took into account the maverick condition of XP to analyze the possibility of market power exercise resulting from the deal.

2.1. Maverick firm concept applied

18. Cade's Guidelines describe maverick companies as those that present a disruptive level of rivalry, having a higher incentive to deviate then most of its rivals. They are described as companies with a low production cost and low pricing policy, which pressures market prices down, or as companies that are characterized by its inventiveness, stimulating permanent innovation in the industry they operate. In this sense, Cade's Guidelines describe that its independent presence in the market can discipline the prices of the companies with the highest market shares in the market. According to the Guidelines, the antitrust authority can consider that a merger that involves a company with a cost, innovation or niche leadership strategy can decrease actual or potential competition in the segment, decrease

[14] Hearing on Disruptive Innovation held in June 2015, summarized by the OECD Secretariat in the document "Key Points of the Hearing on Disruptive Innovation" (DAF/COMP/M(2015)1/ANN8/FINAL) produced in May 2017, available online at: https://one.oecd.org/document/DAF/COMP/M(2015)1/ANN8/FINAL/en/pdf.

[15] Non-official translation of Cade's General Superintendence Opinion on the transaction, n. 24 of December 27, 2017, paragraph 119.

rivalry and discourage innovation in the market under consideration, even if the variation in the concentration resulting from the deal is low[16].

19. Building on the literature[17], Cade considered in its review a possible definition of a maverick company as an observable disruptive force that leads price wars, but also one that refuses to increase prices – or adopt any parallelism strategy – as a result of its rivals' move[18]. Another definition considered by Cade stated that, although a disruptive role would not be sufficient to define a maverick company, a common characteristic involving a company with a disruptive role in merger and acquisitions in the US between 2009 and 2011 had a common aspect: a maverick company was considered one that consistently established prices below its competitors[19].

20. Applying these considerations on how antitrust authorities could identify maverick companies[20] to the concrete case, Cade considered, building upon public information of XP, that it had elements that could classify it as a maverick company. Firstly, in an 'unbanking' context, XP was considered a first mover and protagonist. Additionally, in its review, Cade noted that it had been growing by winning over customers from traditional banks. Also, Cade highlighted that the market itself viewed XP as a disruptive company.

21. It is worth noting that Cade did not consider XP's performance and its characterization as a maverick as applicable to every market in which it holds activities. Cade noticed that XP's growth had been relevant in the markets of securities brokerage and

[16] CADE's Guideline on Merger Review. July 2016. P. 51. Available online in Portuguese at: http://www.cade.gov.br/acesso-a-informacao/publicacoes-institucionais/guias_do_Cade/guia-para-analise-de-atos-de-concentracao-horizontal.pdf.

[17] BAKER, Jonathan B. Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws. New York Law Review. Vol. 77:135. 2002.

[18] Building on Baker (2002), Cade noted that a maverick company would have a higher incentive to deviate coordination conditions than most of its rivals, which suggests that the presence of a player with such characteristics would affect especially coordination conditions among competitors, more than possible unilateral effects. These companies would tend to compete instead of coordinate, because the intention is to maximize profits. By lowering its prices, a company could increase its sales and consequently its profits, given that the profit for sales increase is higher than the losses for reducing its margin. Cade also draws upon the author's idea that currently, the conditions that lead companies to coordinate their behavior do not necessarily lead to a result of maximum joint profit maximization as would be obtained by a monopolist, which is denominated imperfect and incomplete coordination. This would not mean that a collusive behavior would be impossible, but that this imperfect coordination could be challenged by a maverick company, since the coordination will not be successful unless every company in a given relevant market prefer coordination over deviation. However, Cade goes on, when companies are different among themselves, any company that is (almost) indifferent between coordination and deviation will be able to challenge its rival's efforts to make coordination effective. This deviating company would be the maverick company in the industry.

[19] OWINGS, Taylor M. Identifying a Maverick: When Antitrust Law Should Protect a Low-Cost Competitor. Vanderbilt University Law School.

[20] As contained in Cade's General Superintendence's Opinion n. 47/2017, according to Baker (2002), firstly, the antitrust authority should consider how the company has been affecting pricing in the market, considering previous and current behavior of the target company. The second strategy would be natural testing, which would require an increased data quantity. Thirdly, there would be the strategy of "a priori factors" – the reasons for which a company prefers a higher or lower price in a given market.

distribution of investment products. In the markets of asset management and third parties' resource management, XP did not have a relevant market share – below 1%, as well as in the market of insurance brokerage. However, Cade noted that the fact that XP is an open platform and its capacity to challenge traditional banks' position in the market were elements that deserved more attention than its market share could indicate (2.7% in the distribution of investment products and 17.67% in the market of securities brokerage), since it was precisely this recent, sustainable and disruptive growth that, according to Cade, had been bothering traditional banking institutions.

22. It is worth noting that Cade mentioned it was important to look at XP's dynamic behavior throughout the past years more than the current picture, since it had been presenting high growth rates as shown in Table 1, significantly higher than the market in general, creating a perspective of future market significantly higher than it had at the time of the filing.

Table 1. XP's market share development (2012-2017)

Market	Market Share (2012)	Market Share (2017)
Securities Brokerage	1.61%	17.67%
Third party's resource management	0.00%	0.01%
Asset management	0.06%	0.29%
Distribution of investment products	0.6%	2.7%

Source: Cade's General Superintendence's Opinion, n. 24. December 27, 2017, based on information provided by the Applicants, by competitors and by Anbima, the Brazilian Association of Entities in the Financial and Capital Markets

23. In this case, Cade understood that this characteristic imposed the consideration of factors that would dismiss the use of the HHI as a criterion of causal link, since the use of this index was limited to static aspects of the market at the moment the market share information is collected.

24. Considering these aspects, Cade concluded that XP's role in the Brazilian market was evidently one of a maverick company in the markets of brokerage and distribution of investment products. Based on these considerations, Cade eliminated the preliminary conclusion of the inexistence of causal link between the proposed transaction and the increase of possibility of market share exercise.

25. Going further in its review, Cade took into account in its analysis of the probability of market power exercise the fact that XP operated as a two-sided platform in the market of distribution of investment products. According to Cade, this differentiation was relevant as some characteristics of this business model could potentialize anticompetitive effects resulting from a merger.

26. In its review, Cade highlighted that the fact that many platforms charge only one group of consumers would impact competition analysis. Cade concluded that, since the pricing, offer and demand decisions consider different groups, the analysis of possible competition effects should take into account all the groups that trade within the platform. Cade also pointed out in its decision that these characteristics evidence the main particularity of multi-sided markets –network effects. As Cade describes, network effects arise when the utility of a platform increases as new members adhere to the platform on any of its sides. In multi-sided markets, as Cade describes, an indirect network effect takes place – the platform's utility increases, for one of the sides, as new members adhere to the platform on the other side. Therefore, Cade concluded, the determination of the pricing

levels in the platform for each of the sides depend on the level of indirect externalities that the platform triggers in each of its consumer groups[21].

27. Cade also observed another factor that could interfere in the pricing structure of a platform – the multihoming effect, that is, whether consumers of one or various sides of the market trade through more than one platform. Citing the literature[22], Cade noted that most platforms face competition in at least one of its sides. Hence, the possibility of multi-homing exerts pressure on prices, as well as on the pricing structure of the platform, understood as the distribution of prices among its multiple sides. Cade observed that these aspects, in turn, impact entry conditions in a two-sided market.

28. Another potential competitive issue particular to multi-sided markets mentioned by Cade was the challenge of developing both or more sides to a market – the "coordination problem". In other words, the reluctance of consumers of one of the platforms' side to migrate to another platform unless the consumers on the other side also migrate, which would be a direct result of network effects inherent to a multi-sided market. As a consequence, Cade noted that the higher the possibility of multihoming on both sides of the platform, the lower the opportunity costs to adhere to a new platform.

29. As Cade mentioned in its review, understanding how both side of a platform interact among themselves and the indirect network effects over each side of a certain market was essential to understand the pricing structure of the platform and how a merger could impact any of its sides and possibly cause an imbalance that would harm consumers.

30. Bringing these considerations to the concrete case, Cade noticed it was possible to verify indirect network effects on both sides of the investment products distribution platform[23]. Cade considered important to take into account the magnitude of these effects in its competition review, since the capacity of a player to challenge another could depend, for example, on the platform's portfolio. The higher its portfolio, the greater the attractiveness of the platform to the consumer. Cade also noted that this reciprocal interdependency could create a virtuous cycle, in which a broader portfolio would attract more consumers, which in turn would attract more suppliers, increasing the platform's portfolio and so forth.

31. Additionally, Cade considered that the probability of market power exercise was related to the capacity of the platform to impose a price increase to its consumers, on one or both sides. As contained in Cade's analysis, the higher the difference between a

[21] Citing the literature, Cade noted that the relative price structure is determined by the relative indirect network effects in each of the sides of the platform. (EVANS, David S. The Antitrust Economics of Multi-sided Platform Markets. Yale Journal of Regulation. Vol. 20, Issue 2: 2003).

[22] EVANS, David S. The Antitrust Economics of Multi-sided Platform Markets. Yale Journal of Regulation. Vol. 20, Issue 2: 2003.

[23] In this case, Cade notes that these effects might not be equivalent. To consumers, the higher the number of product suppliers in the platform, the higher are the network effects, since there is a 'diversity effect' – the higher the number of suppliers in the platform, the higher is the greater the variety of products available; and the higher the number of suppliers in the platform, the greater (presumed) competition between these competitors, which would create better conditions to consumers. From the investment products suppliers' point of view, there would also be direct effects, as well as indirect ones. The higher the number of customers on the other side of the platform demanding products, the higher the attractivity of that platform. On the other hand, the number of suppliers in the platform could negatively impact its attractivity, due to higher competition within the platform. This is an effect not perceived on the other side of the platform.

dominant player and its competitors, the higher would be its capacity to exercise market power without a loss in the equilibrium, since the indirect network effects tend to be higher. In the Itaú/XP case, this would be the case if an increase in the fees and tariffs paid by the consumers would decrease the quality of the service without impacting the balance in the platform.

32. Additionally, Cade noted the capacity of a platform to exercise market power would also tend to be maximized in light of limitations to multi-homing. For example, in the absence of restriction to both the demand and supply side to adhere to as many platforms as they wish, the greater would be the possibility of competitors to challenge market power. If there is a limitation on that ability, such as exclusivities in relation to any of the sides of the platform, the competition in the market would tend to be chilled.

33. Cade expressed that all these aspects should be taken into account in the concrete case, especially since there was evidence that XP already had the capacity to impose market conditions, which would indicate a market power exercise capacity previous to the transaction, due to its size in the segment of investment product distribution as an open platform, as well as its first-mover position in the market.

34. Therefore, Cade noted, about the context of the deal, that: (i) XP plays a maverick role in the Brazilian brokerage market and in the Brazilian market of investment products distribution; (ii) the traditional players of the financial system do not adequately meet the Brazilian consumers' demand, offering products that are, on average, more expensive and of lower quality, which would denote low rivalry in the market; (iii) it operates in a two-sided market, with particular characteristics such as network effects and multi-homing, that impact competition review; (iv) there are several barriers to entry in the market of investment products platforms, especially related to scale and network effects; (v) fintechs have been promoting a revolution in the provision of financial services, with new products or ways to provide services, causing an increase in the competition and, in general, with a more positive perception by consumers; and (iv) these new businesses, disruptive and intensive in technology, demand special attention from competition authority in relation to dynamic competition[24].

2.2. Concerns resulting from the transaction

35. As contained in Cade's review, the Brazilian competition authority considered it was possible to demonstrate the benefits of the business model introduced by XP in the Brazilian market, and the risks that the elimination of this player, through the acquisition of an incumbent, could bring to the market. In general, Cade concluded XP offered a more satisfactory and less costly portfolio than the ones offered by its traditional competitors. However, Cade considered that the democratization of the access to financial products of quality to all consumer profiles, with lower requisites for the acquisition of such products, was perhaps the greater benefit that open platforms such as XP would offer to its consumers. Other benefits brought forth by the use of online platforms included the easiness to open an account through a digital registration, without the need to physically move to a bank's branch, the absence of costs to maintain an account, as well as the lower cost to use services such as brokerage.

[24] Cade's General Superintendence's Opinion n. 47, 24 of December 27, 2017, paragraph 250.

36. In addition to the benefits brought to the Brazilian consumer, Cade noted that players such as XP threatened incumbents' position in the financial market, since they could stir up a defensive reaction from traditional players, one of them being the acquisition of entrants, which could potentially result in anticompetitive effects. Therefore, the analysis of the effects of the transaction took into account these two aspects, working on the assumption that the competition between traditional players in this market, in itself, would be unable to satisfactorily promote consumer welfare. Therefore, XP's elimination as a competitor in this market could only be approved if its other direct competitors were able to exert the same competitive pressure imposed by XP over the incumbents.

37. Additionally, considering the transaction involved a two-sided market, with suppliers and demand interacting through the platform, the analysis of probability of market power exercise did not differentiate between horizontal or vertical effects with regard to the suppliers, since a hypothetical exercise of market power in relation to the supplier side of the platform had mixed characteristics, with horizontal and vertical effects. The review was divided to demonstrate the effects on each of the sides of the platform – demand and supply.

38. In summary, with regard to the demand side, Cade concluded that the transaction resulted in competition concerns related to the entry of a dominant incumbent from the traditional banking market into the shareholding of an innovative and disruptive company, since Itaú held incentives to decrease competition in the markets of credit and investment products and XP did not have equivalent rivals and had been promoting growth of an open model of investment product and service supply. Additionally, Cade considered that XP's first mover condition gave the company the ability to impose more unfavorable conditions to its suppliers than its younger competitors. For these reasons, Cade concluded that the rivalry existent in the market of open platforms was unable to stop a market power exercise by XP even before the transaction. With Itaú acquiring a stake in XP, Cade understood that the risk of this market power exercise would be potentialized, since Itaú had incentives to chill competition imposed by XP in relation to its own place in the market, restricting the distribution of more attractive products to final consumers or increasing distribution costs with the aim of decreasing the profitability of its products.

39. As for the effects in the demand side, understood as the customers that hold an account at XP and acquire various investment products, Cade understood that their welfare could no longer be maximized by competition between traditional banks, which would be demonstrated by the emergence of open platforms, with the supply of more accessible, cheap and better products and services. In its review of rivalry in the market, therefore, Cade took into account the ability of other players similar to XP of maintaining the level of current competition (at the time of the filing), relativizing competition imposed by traditional banks, since the intensity of rivalry imposed by platforms with relation to the banks was lower than the opposite way. Cade observed that, compliant to the Law, the clearance of the transaction could only happen in case there was no loss of competitiveness.

40. However, due to the format of the platform operated by XP, Cade understood the transaction generated potential anticompetitive effects of two kinds: (i) indirect, deriving from the decrease in the quality of the services provided by suppliers, clients in the other side of the platform, and (ii) direct, deriving from an increase of prices, reduction of quality or any other change that could negatively impact the provision of services in the platform with regard to the customers.

41. Cade considered that these indirect negative effects would be consequence of a possible market power exercise by XP with regard to the suppliers of investment products, whether through the increase in the commission or placement costs, reduction of the

available portfolio of products and services, among other activities that could increase costs, reduce profitability of the products and diversity of options to the consumers.

42. Notwithstanding, Cade also concluded that XP's market power exercise could also create anticompetitive effects with regard to the customers' side in the platform, without any activity of the company with regard to the suppliers' side. XP's ability to exercise market power could be mitigated if its competitors had the ability to absorb possible demand deviation of its customers. However, in its review, Cade concluded that, due to the Brazilian investors' prominently conservative profile, there was a reputational barrier that could not be dismissed as an element that would hinder and limit entry in the Brazilian market, as well as the ability of these companies to effectively compete with the already established players. Therefore, Cade considered that the first mover factor could give XP advantages related to scale, autonomous investment players ("AAIs") and dominance in the market, as well as a reputational gain in relation to its competitors, due to its higher recognition by the Brazilian consumer. As a result, Cade understood that Itaú's partial acquisition of XP's shareholding could give the acquired company an even higher competitive advantage due to the buyer's branding, which would increase XP's market power.

43. Therefore, Cade concluded that its position in the market of open platforms could not be easily challenged by its direct competitors, due to high barriers to entry and to the development of competitors, especially those related to scale gains. Additionally, Cade noted that challenging a two-sided market was more complex due to indirect network effects over both or more sides of the platform, since the competitors' ability would have to meet the demand of both sides of the platform trading in the platform.

44. Cade also considered, after its investigation, that there were evidences that XP was imposing commercial conditions that could hinder its competitors' capacity to exercise effective rivalry in the market. Such limitations would be aimed to both supplying partners as well as AAIs. Such practices would aim to limit, from the point of view of suppliers, the access of these partners to competing platforms, creating behavioural barriers to the access of new players to the market, in addition to the structural barriers inherent to the sector. Cade considered that the transaction could aggravate this scenario, previous to the transaction, since Itaú's acquisition of XP's shareholding could increase incentives to practices tending to foreclose the market or, at least, to decrease competition between XP and traditional banks.

45. In summary, Cade considered that the competition concerns resulting from the deal referred to vertical integrations resulting from the transaction, especially related to risk of discrimination or market foreclosure. Shortly, they were listed as: (i) decrease in the competition pressure exerted by XP in the markets of brokerage and distribution of investment products; (ii) possible imposition of exclusivity obligations, by XP, to suppliers of investment products, hindering other platforms to inputs; (iii) possible imposition of exclusivity obligations to AAIs, hindering access of other platforms to distribution networks; (iv) possible discrimination, by XP, of banks issuing investment products (Itaú's competitors), harming these banks and benefiting Itaú, resulting in the closure of the upstream market; (v) possible discrimination, by Itaú, of open platforms that distribute investment products (XP's competitors) if it decides to distribute its products via XP; and (vi) Itaú leading its clients to XP, enhancing the already dominant position of XP in the among open platforms[25].

[25] Reporting Commissioner's Vote of March 2018, pages 23-24.

46. As a result, Cade considered that the transaction could only be cleared if certain remedies were applied, which would aim to (i) restrict Itaú's power, especially in relation to the decision-making in matters related to commercial strategies, partner choice and provision of products; and (ii) eliminate barriers to entry resulting from practices adopted by XP, so as other players in the market could develop without restrictions related to the access to commercial partners and with greater freedom of signing with AAIs. In sum, the maintenance of XP's Independence in the market.

47. Therefore, Cade and the Applicants negotiated an Merger Control Agreement ("ACC" in its acronym in Portuguese) with behavioral remedies to be observed until 2022, that tackled those two main requirements through obligations of non-discrimination and non-exclusivity, as well as the obligation of Itaú to abstain from intervening on matters related to the choice of XP's portfolio, including negotiation of commercial conditions[26].

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[26] Ex-post, CADE evidenced the transaction led to positive effects in the fintech sector, as many smaller platforms received significant investments.