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**LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM**

**Session III: Addressing Competition Challenges in Financial Markets**

**-- Contribution from Brazil --**

**4-5 April 2017, Managua, Nicaragua**

*The attached document from Brazil (CADE) is circulated to the Latin American and Caribbean Competition Forum FOR DISCUSSION under Session III at its forthcoming meeting to be held on 4-5 April 2017 in Nicaragua.*

Contact: Ms. Lynn Robertson, Global Relations Co-ordinator, OECD Competition Division [Tel: +33 1 45 24 18 77, Email: Lynn.ROBERTSON@oecd.org]

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# LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM



15th Latin American and Caribbean Competition Forum  
4-5 APRIL 2017, Managua, Nicaragua

## Session III: Addressing Competition Challenges in Financial Markets

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### -- CONTRIBUTION BY BRAZIL (CADE) --

#### 1. The Brazilian Banking System<sup>1</sup>

1. The Brazilian banking market has been undergoing several changes in the past years. From 2007 to 2016, many mergers and acquisitions modified the structure of the sector in the country, which has become even more concentrated.

2. In 2007, the Santander Group took over ABN Amro, which had acquired Banco Real in 1998. CADE analyzed this transaction and approved it without restrictions on 12 December 2007.<sup>2</sup> The Reporting Commissioner, Mr. Abraham Sicsú, has acknowledged in his vote that the number of financial institutions was constantly declining since 1994, due to privatizations of public banks, the market entry of foreign banks and the reorganization of financial institutions. However, the Reporting Commissioner concluded that, despite this context, the concentration in the country was not so high.

3. In the following year, there was a merger between Itaú and Unibanco, two of the major financial institutions in the country. The transaction was cleared without restrictions on 18 August 2008.

4. In 2009, the two largest public banks in Brazil undertook transactions in order to acquire smaller institutions. Banco do Brasil purchased 50% of the capital stock of Banco Votorantim.<sup>3</sup> Caixa Econômica Federal acquired 49% of PanAmericano's voting stocks<sup>4</sup>, which was acquired by BTG Pactual two years later.<sup>5</sup> In the same year, BMG also acquired Banco Schahin S.A. CADE approved the transaction without restrictions.<sup>6</sup>

<sup>1</sup> This written contribution was prepared by Marcelo Nunes de Oliveira, Head of Merger and Antitrust Unit 2 of CADE's General Superintendence. The translation was elaborated by Raissa Guerreiro Bonfim and Fábio Lopes de Sousa. For further contact or clarification, please contact [marcelo.oliveira@cade.gov.br](mailto:marcelo.oliveira@cade.gov.br) or [international@cade.gov.br](mailto:international@cade.gov.br).

<sup>2</sup> Merger proceeding n° 08012.010081/2007-11.

<sup>3</sup> Merger proceeding n° 08012.000810/2009-85. The transaction was approved without restrictions on 7 April 2010.

<sup>4</sup> Merger proceeding n° 08012.010345/2009-91. The transaction was approved without restrictions on 9 June 2010.

5. Besides the transactions listed above, CADE analyzed many smaller transactions in the period.<sup>7</sup> Considering the number of total deposits, the five major banks in the country control 86.86% of the market, while, approximately, a hundred other financial institutions were responsible for only 13% of the market. Taking into account the number of total assets, the five largest institutions control 82.51% of the market.

6. The last transaction analyzed by CADE was the acquisition, in 2015, of the HSBC's operations in Brazil – which was, at the time, the sixth largest bank in the country in terms of total assets – by Bradesco, the country's fourth largest bank. The transaction was approved in 2016, restricted to the implementation of behavioral remedies that involved certain obligations. The remedies could be divided into four categories: (i) communication and transparency to the consumer, in order to improve the level of information available to the clients, including information about rights and portability; (ii) staff training for the bank branches staff teams; (iii) quality indicators, including quantitative targets related to improvement of the registration ratings at the Ombudsman Office of the Central Bank of Brazil; and (iv) competition compliance focused on the bank management board members.

7. In this assessment, possibly the most detailed one that CADE has made about the Brazilian banking system, some issues related to merger analysis in the banking market turn up to be especially complex. The first issue refers to the discussion about the relevant market aspect. There is not a consensus, either in the national or in foreign jurisprudences, about a definition of the relevant market for each product, segmented or clustered. Concerning the geographical aspect, it is noteworthy that, although the new technologies enable the consumers to make banking transactions anywhere in the world, bank branches still hold a relevant role in the consumer's choice about where to open a checking account, functioning as a gateway to this market. Considering these aspects, CADE developed an assessment that took into account alternative scenarios, from geographic and the product's perspective of the relevant market.

8. Another matter of greater complexity was the assessment of the causal nexus between the transaction and the possible increased risk of the exercise of market power. In various analyzed scenarios, the concentration would not exceed the 20% threshold of market share, which indicates, according to the Brazilian Competition Law, the existence of dominant position. Besides that, due to the HSBC's low participation in the market, the majority of the reviewed scenarios presented a low variation of the HHI, less than 100 points. However, CADE's concern was that the set of transactions in the market, over the last years, could result in the market concentration, affecting the competition environment, even though each transaction, individually, was not clearly harmful.

9. In addition, there is evidence that indicates that the Brazilian banking market is not very competitive. In this regard, it is interesting to observe the sector's level of profitability and its net interest rate spread in Brazil. The Brazilian net interest rate spread is among the highest in the world. According to the World Bank's data, in 2015, the country held the fifth position in the worldwide ranking of spread, in which 114 countries were assessed. The country has a spread of 22% per year. In this assessment, Brazil is followed by Malawi (spread of 31.1%) and Madagascar (spread of 47.6%). These two countries' added GDPs represent less than 1.7% of the Brazilian GDP. Other countries with similar economies to the Brazilian one, such as the BRICS countries, presented better results: Russia stayed in the 68<sup>th</sup> position with a spread of 5.1%, South Africa stayed in the 95<sup>th</sup> position with a spread of 3.3% and China, with a spread

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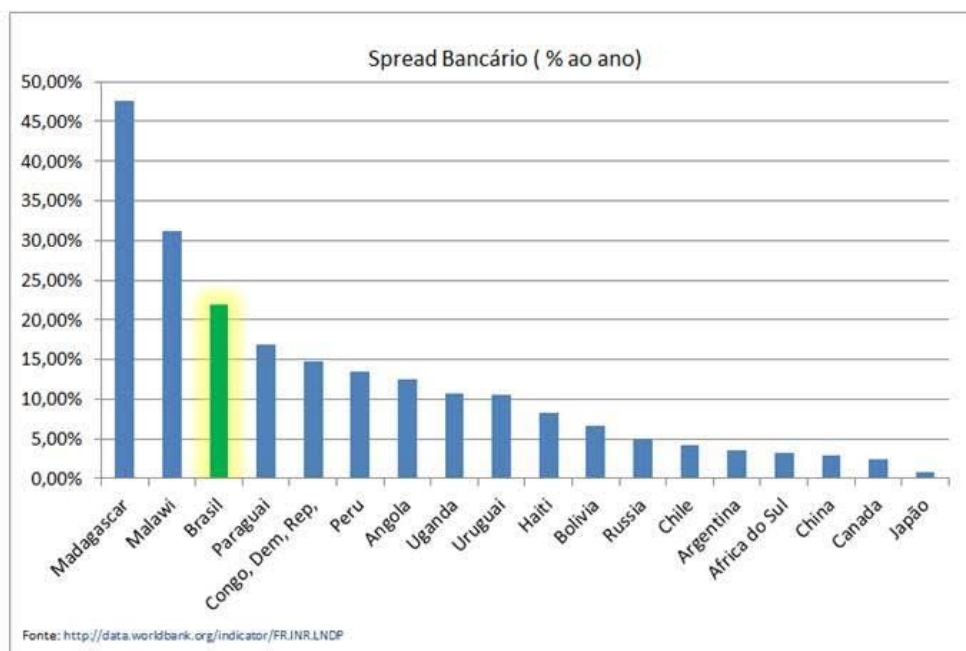
<sup>5</sup> Merger proceeding n° 08012.002350/2011-44. The transaction was approved without restrictions on 4 May 2011.

<sup>6</sup> Merger proceeding n°08012. 004534/2011-49.

<sup>7</sup> Merger proceeding n° 08012.012010/2007-45 (HSBC Asia Pacific Holdings (UK) Limited and Korea Exchange Bank), Merger proceeding n° 08012.011505/2008-38 (Banco do Brasil S.A. and Banco do Estado do Piauí S.A.), Merger proceeding n° 08012.011135/2010-53 (Banco BMG S.A, Banco GE Capital S.A. and General Electric do Brasil Participações Ltda.), among others.

of 2.9%, stayed in the 100<sup>th</sup> position. The graphic bellow compares the Brazilian net interest spread with other countries spread.

**Net Interest Spread**



Source: World Bank in: <https://spreadnet.com.br/blog/o-brasil-e-medalha-de-bronze-no-ranking-de-spread-bancario-mundial/>

10. Moreover, according to the Bank for International Settlements (BIS) report, Brazilian banks are the most profitable of the world, but are also in the group of the less efficient ones.<sup>8</sup> According to the report, between the 2000 and 2007, Brazilian banks were the second most profitable of the world, after the Russian institutions. Between 2008 and 2011, Brazilian banks led the profitability ranking. Between 2013 and 2014, the Brazilian banks held the third position, behind Russia and China. The report also demonstrates that the national institutions are the less efficient among the world’s leading economies, with high administrative costs.

11. In other words, the Brazilian financial institutions are the most profitable of the world despite of being the most inefficient ones, a completely unexpected result for competitive markets.

12. As a result of all these factors, CADE understood that, despite the fact that the transaction did not present a high level of concentration, it contributed to the increase of the general concentration in the national banking market. Due to this reason, it could not be approved without restrictions, which lead to a third issue in the analysis: the possibilities of available remedies.

13. The mere disapproval of the transaction, considering the concentration resulted from the merger itself, would not be a reasonable possibility. Nevertheless, the adoption of structural remedies in the

<sup>8</sup> Available at: <https://www.bis.org/>. See also: <http://www.afbnb.com.br/arquivos/File/Bancos%20brasileiros%20os%20mais%20lucrativos%20do%20mundo.pdf> e <http://www1.folha.uol.com.br/mercado/2014/07/1479570-banco-brasileiro-e-o-terceiro-do-mundo-em-lucro-e-lidera-ineficiencia.shtml>. Accessed on 24 February 2016.

banking market is highly sensitive, which may cause harmful side-effects from the point of view of the prudential regulation and systemic risk. For these reasons, CADE understood that the adoption of behavioral remedies that aimed at improving the corporate governance and the quality of the customer service in the financial institutions would be the most appropriated way to deal with the present case.

14. Such level of concentration also raises concerns regarding potential anticompetitive practices among the market players. In fact, two ongoing investigations by CADE's General Superintendence can be mentioned as examples: (i) exclusivity in granting payroll loans; and (ii) cartel in the exchange markets, onshore and offshore.

15. The first investigation resulted from a previous proceeding that investigated Banco do Brasil, the largest bank of the country, regarding the requirement of exclusivity for granting payroll loans to civil servants. The payroll deductible loan is a type of personal credit in which the loan installments are directly deducted, by the employer, of the employee's paycheck, reducing the risk of insolvency. Because it depends of the employer as a third party for granting the loan, the bank has to sign an agreement with the employer. In this respect, there was evidence that Banco do Brasil required exclusivity from the employer, hindering the consumers' access to other financial institutions. Banco do Brasil signed an agreement with CADE, in order to cease the anticompetitive conduct. However, as a result of this investigation, administrative proceedings were initiated against six other financial institutions for adopting the same practice, which investigations undergoing.

16. The second investigation resulted from a leniency agreement signed between CADE and one of the participants of an alleged cartel. According to the evidence, the parties would have established a cartel to fix price levels (exchange spread), to coordinate currency exchange and price proposals to clients and to hinder or prevent the operation of competitors in the currency exchange market involving the Brazilian currency. The practices would have occurred abroad, but with effects in Brazil (offshore). The following financial institutions are being investigated: Banco Standard de Investimentos, Banco Tokyo-Mitsubishi UFJ, Barclays, Citigroup, Crédit Suisse, Deutsche Bank, HSBC, JP Morgan Chase, Merrill Lynch, Morgan Stanley, Nomura, Royal Bank of Canada, Royal Bank of Scotland, Standard Chartered and UBS, and 30 individuals.

17. A few months after the opening of the abovementioned investigation, CADE initiated a new administrative proceeding in order to investigate market-rigging practices in the spot market and futures market. Such practices would have occurred in Brazil (onshore) and were undertaken and settled in Brazilian currency, Real (BRL).

18. CADE's General Superintendence is still investigating all the mentioned practices.

## **2. The Payments Market**

19. The concentration noticed in the banking market also occurs in the Brazilian payments market. The major banks in the country have market share and/or control the largest acquiring companies in national market. The acquiring companies are responsible for registering and authorizing business premises to enable transactions with credit and debit cards. Besides controlling the acquiring market, the major banks also own payment brands that have an important operational coverage in the country.

20. The payments market is composed by two sides: (i) the issuer's side – agent that issues the credit card to final consumers; and (ii) the accretor/acquirer's side –responsible for the transactions in the retail market. The three largest acquiring companies in the country control over 95% of the Brazilian market. On the other hand, the five major banks hold 80% of the market share in the market of credit card issuance. In other words, we have the presence of the largest banks in the country all over the market, in payments

brands, issuance of credit cards and licensing. The presence of these agents in all market's levels facilitates the coordination of anticompetitive practices.

21. There are elements that suggest that the level of concentration and verticalization of this market has contributed to the emergence of potentially harmful practices to the competitive environment. After several complaints received since 2015, CADE initiated three administrative inquiries in order to investigate practices related to: (i) exclusivity between the credit card brands and some acquiring companies; (ii) tie-in sales, refusal to contract and other practices adopted by the banks in relation to new acquiring companies, which would hinder their performance; and (iii) exclusivity and refusal to contract regarding the electronic devices used in the credit card transactions (Pinpad) in the retail market.

22. All these practices are being targeted by joint investigations coordinated by CADE and the Brazilian Central Bank – the authority responsible for regulating the payments market –, in order to verify potential irregularities regarding competitive aspects and to reduce entry barriers in the Brazilian payments markets.

### **3. Stock Market**

23. Stock markets and the over the counter market entities have as main function the structuring, maintenance and monitoring of appropriate and safe systems for securities' trading. Nevertheless, both markets present substantial differences. The over the counter market is more flexible, allowing the transactions' adjustment to the needs of the market players. In this case, transactions are predominantly bilateral, occurring on a low scale and there is not a requirement of a Central Counterparty – CCP. Additionally, the counter market is less expensive and does not require many obligations from the players, such as guarantee deposits.

24. In contrast, due to its complex infrastructure, the stock market is more liquid and requires higher standards and trading costs. In addition, a CCP necessarily intermediates the trading in a stock exchange, which provides more safety to the participants, but also requires a deposit of guarantee.

25. In Brazil, the stock market and the over the counter market are composed by three levels of services to clients: (i) trading: platform in which the securities' trading occurs; (ii) post trading: stage of settlement and clearance of transactions; and (iii) central depository: stage of services provision and fiduciary custody of the negotiated stocks. The main difference between the stock market and the over the counter market is the infrastructure. In former market, the transactions occur in a trading platform (the stock exchange itself), in the later the transaction may occur on a bilateral basis – out of a trading platform–, as generally it occurs in the Brazilian case.

26. In other countries, the trading, clearance and settlement levels are usually competitive, while the depository level tends to be monopolistic. In that configuration, the central depository provides services to all competitors in the market.

27. Even though competition may occur in the trading and post-trading market, it is unusual to observe several competitors. That absence of players may be related to the fact that this structure does not seem efficient, considering the services' high fixed costs, imposing a pressure over the scale in order to operate efficiently.

28. BMF&Bovespa offers all these services in Brazil, including the central depository, which has a monopolistic aspect. In 2016, CADE initiated an administrative inquiry to analyze a complaint in which the company ATS, which intends to establish a new stock exchange in Brazil, accused BMF&Bovespa of imposing barriers to its entry in the market.

29. ATS has stated that, as a condition to its entry in the Brazilian market, it would have to contract BMF&Bovespa's central depository services, since such structure could not be replicated, considering the hypothesis of an essential facility. However, BMF&Bovespa would also be hindering the provision of these services to the new competitor, preventing the company from obtaining regulatory approval and beginning its operations.

30. During the investigation, BMF&Bovespa bought Cetip, a company that provides over the counter services in the Brazilian financial market. CADE's General Superintendence took into account the national and the international jurisprudences, and the specialized literature to substantiate its analysis. The issued opinion concluded that the exchange market and the over the counter market are considered different markets, being also segmented by the type of assets negotiated (stocks, bank deposit certificate, etc.).

31. Considering such segmentation, the BMF&Bovespa is a monopolist in the stock and futures markets, while Cetip is a monopolist in most of the over the counter markets, competing in some assets areas with BMF&Bovespa. For that reason, the transaction produced monopolies in the assets operated by both of them. Furthermore, the potential competition hypothesis was taken into account, considering the similarities between the stock market and the over the counter market. In fact, Cetip could enter the stock market, and BMF&Bovespa could do so in the over the counter segments, as the later did in the recent past.

32. The General Superintendence also raised concerns regarding the high barriers to entry in both analyzed markets, especially because any new competitors aiming at entering the Brazilian market should contract the depository services. This aspect has been emphasized by ATS' complaint against BMF&Bovespa.

33. However, some aspects considered in the General Superintendence's analysis have mitigated the transactions' potential anticompetitive effect. Firstly, the markets in which the monopolies were being created represented a low percentage, less than 10% of the companies' combined turnover. Secondly, BMF&Bovespa had a market share that corresponded to 5% in most of the markets. Thirdly, there were not enough evidence to confirm the potential competition hypothesis in most part of the analyzed markets, with exception of the segmented assets that in which BMF&Bovespa offered CCP and that Cetip had already declared the intention to offer in the near future. On the other hand, the General Superintendence's analysis indicated that the transaction presented relevant efficiencies, which was confirmed by several market players, including investment banks and other financial institutions, which were clients of the merging companies.

34. Due to these reasons, the General Superintendence contested the transaction and forwarded it to CADE's Administrative Tribunal, recommending its approval with restrictions. The recommendations included the adoption of remedies in order to mitigate the risks of abuse of dominance, specifically regarding the following issues: (i) markets in which monopolies are created; (ii) market segments in which potential competition between companies is eliminated; and (iii) the reduction of entry barriers to new competitors, considering that the central depository services tends to be a natural monopoly.

35. Currently, both cases are under CADE's analysis. While the administrative inquiry regarding BMF&Bovespa is still under the General Superintendence assessment, the merger between BMV&Bovespa and CETIP is in its final stage at the CADE's Tribunal, and a final decision may be issued within two months. According to the Brazilian Competition Law, a merger final decision have to be issued within 240 calendar days, which can be extended for no more than 90 days.