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COMPETITION COMMITTEE**

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ROUNDTABLE ON EXIT STRATEGIES

-- Note by the Delegation of the United Kingdom --

This note is submitted by the delegation of the United Kingdom to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 16 - 17 June 2010.

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ROUNDTABLE ON EXIT STRATEGIES

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1. Introduction

1. Competition policy needs to be an important component of the strategy for exiting recession. It is as an important driver of productivity and growth and thus of promoting economic recovery and, potentially, can support governments in securing lower costs and increased efficiency in the delivery of public services, in turn helping them reduce deficits and tackle fiscal difficulties.

2. Given the nature of the recent recession, the role of competition in supporting productivity and growth through the banking and wider financial system will be especially important.

3. While in many countries, including the UK, policy objectives such as financial stability may have been a primary concern during the financial crisis, exit strategies need to focus on long-term objectives, including effective competition. There is an opportunity for these exit strategies to mitigate some of the short-term negative impacts on competition arising from the financial crisis as well as the prospect of reinforcing the role of competition in the long-term.

4. Aside from the opportunity provided for competition policy to play a more important role, the market situation in some financial markets may also be creating new opportunities for competition. There are signs, for instance, in retail banking that conditions for new market entry or expansion of smaller market players may have become more favourable. For example, profitability on many lines of banking business has risen significantly, trust in established brands has been undermined by the financial crisis, and, divestments by major participants affected by the crisis (as required in the UK for some banks under the EU state aid regime) is creating the possibility for others of growth through acquisition .

5. But there are also risks to competition. Other short-term public policy objectives may continue to be given a higher priority than competition policy. There may be resistance to tackling some of the short-term distortions to competition that have arisen. Perhaps more importantly, the regulatory response to the crisis may itself affect competition by increasing barriers to entry or expansion, through new, tougher regulatory requirements.

6. It is important in this environment for competition authorities to understand and recognise the dynamics of these markets so as to inform their approach. One critical element here is to understand the nature and scale of barriers to entry, expansion and exit. Such an understanding should look beyond the immediate, possibly short-term, shape of the markets and at the more fundamental and long-term challenges to competition. It should help inform the work of competition authorities in, for example, examining relevant mergers and contributing to discussions about future regulation.

7. The rest of this paper focuses on understanding barriers to entry, expansion and exit, referring to a review launched by the OFT in the UK.¹

2. OFT Review of barriers to entry, expansion and exit in retail banking

8. The review is focused on the provision of retail banking services to individuals ('personal banking') and to small-and-medium sized enterprises ('SME banking') and will consider different types of market entry and expansion and whether barriers impact differently depending on the mode of entry/expansion employed.

9. Past market entry in the UK has included:

- entry from providing services to one group of customers (e.g. depositors or individual customers) to another, such as demutualised building societies lending to SMEs²;
- entry from extending a brand from one business sector (e.g. retailing) to another, such as Tesco Bank³;
- foreign entry from outside the market through mergers and acquisition, such as the takeover of Abbey National by Santander⁴, and
- foreign banks establishing a physical presence in the UK, such as Handelsbanken⁵ in the SME banking market, or using other channels such as the internet or telephone banking, such as ING Direct⁶.

10. Barriers may include aspects other than the costs of setting up a bank. Barriers to customers comparing and switching between banks and to establishing new business models are both likely to be important. Four areas of focus are identified for the current review.

11. **Regulatory requirements.** The review is examining the authorisation (often referred to as a 'banking licence') from the Financial Services Authority (FSA) that firms that wish to provide savings or current accounts must obtain, and key aspects of the regulatory requirements that go alongside them,

¹ OFT 1233, Review of barriers to entry, expansion and exit in retail banking. <http://www.offt.gov.uk/news-and-updates/press/2010/55-10>.

² A building society is a financial institution, owned by its members, that offers banking and other financial services, especially mortgage lending. See the BSA website: <http://www.bsa.org.uk/faq/whatisabuildingsoc.htm>.

³ Tesco is a large UK based international grocery retailer that extended into financial services initially through a joint venture with an existing bank.

⁴ Abbey National plc was a United Kingdom-based bank and former building society, acquired by Banco Santander, the largest bank in the 'Euro Zone', in November 2004 to become a wholly-owned subsidiary of Grupo Santander. Abbey was rebranded as Santander on 11 January 2010.

⁵ Handelsbanken (a retail bank in Sweden) opened its first UK branch in 1984. It now has over 40 branches. Its main strategy has been to open branches in key metropolitan areas and to build a presence at local level (as opposed to trying to market the brand nationally).

⁶ ING Direct is ING Group's marketing name for a branchless direct bank with operations in different countries, including the United Kingdom and the United States. It offers services over the Internet, phone, ATM or by mail, and focuses on simple, high-interest savings accounts. ING Direct began operations in the UK in May 2003.

especially concerning capital and funding. Proposed changes in bank regulatory requirements could affect barriers to entry, expansion and exit. The review will examine evidence on how the licensing process for deposit taking activities and the capital and liquidity requirements affect the ability of firms to enter into the provision of banking services or expand their provision of banking services. It will also examine the extent to which other regulations, such as anti-money laundering rules and consumer credit licensing requirements, form significant barriers to entry or expansion, and whether there are there any more subtle sources of regulation which nonetheless form a significant barrier to entry or expansion.

12. **Essential inputs.** Banks require access to specific infrastructure, most importantly payment systems and access to credit risk information on customers. The OFT refers to these as 'essential inputs'. Both, to varying extents, rely on actions of existing banks, given their role in the membership or control of networks and their role in sharing credit data. The review will examine the extent to which new entrants have difficulty in gaining access to these essential inputs.

13. **Barriers to achieving scale.** The review will examine the lack of switching due to customer inertia, the cost of customer acquisition, the cost of setting up branch networks and the value of an established brand or reputation.

14. **Barriers to exit:** Regulation and supervision of financial firms have proved to be necessary to prevent disorderly bankruptcy, and to protect financial stability, in many countries. In the UK, the Banking Act 2009 has established a permanent Special Resolution Regime (SRR) which provides the tools to deal with banks and building societies in financial difficulties, including powers for the Bank of England to transfer all or part of a bank's shares or business. The SRR is intended to prevent disorderly failure, which would create systemic risk, and contributes towards an important policy objective of maintaining financial stability. The review will focus on the way in which regulation and supervision of failing financial firms' impacts upon entry of new firms and expansion of existing ones and whether there are ways in which these regulations could be made more competition-friendly.

15. Findings of the review are due to be published by the autumn of 2010. The review is one of initiatives that the OFT will implement as part of its market study follow up report 'Personal Current Accounts (PCA) in the UK - Unarranged overdrafts'⁷. Going forward, in addition to the review, the OFT will continue to actively monitor the PCA market to ensure that there is movement towards an equilibrium that works well for consumers. It expects to review the PCA market, and the impact of the range of initiatives introduced following the 2008 market study, in around 2012.

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See the OFT website: http://www.of.gov.uk/shared_of/personal-current-accounts/of1216.pdf.