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Summary of Discussion on 10 years on from the Financial Crisis: Co-operation between Competition Agencies and Regulators in the Financial Sector

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More documentation related to this discussion can be found at
www.oecd.org/daf/competition/cooperation-between-competition-agencies-and-regulators-in-the-financial-sector.htm

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Summary of Discussion on 10 years on from the Financial Crisis: Co-operation between Competition Agencies and Regulators in the Financial Sector

By the Secretariat

The Chair introduced the topic of cooperation between competition authorities and regulators in the financial sector. He pointed out that event thought profound regulation have been implemented in the financial sector in recent years, the division of competences of the regulators and competition authorities is not yet settled. Despite the fact that most countries' regulations contain provisions for mandatory cooperation between antitrust authorities and regulators on both sides, asymmetry can still occur. On the one hand, authorities comment on the regulation in order to make sure that the regulation is not unduly restrictive of competition and the regulators accept it or not with respect to macro stability concerns. Furthermore, authorities seek to understand how FinTech companies are accommodated in the regulated financial environment and whether competition authorities have a role to play in this respect. However, on the other hand the regulators contribution to the competition authorities' side is not clear. The regulators participation should be granting their expertise on the sector in order to inform the authority about issues that have been overlooked or issues that have been ignored or data that the authority did not have at its disposal.

The Chair split the discussion into two parts. The first part on the development and the current relationship between the competition authorities and the regulators and the role antitrust authorities in the regulatory process, and the role the regulators play in antitrust enforcement. The second part about how to accommodate technical progress and innovation in the industry and whether the views of antitrust authorities and regulators differ in this respect.

The Chair thanked Elena Carletti and Agnieska Smolenska for the background note that analyses in greater depth the topic, and then introduced the expert panellists: Dr. Miguel de la Mano, the former deputy chief economist of DG Comp and vice president of Compass Lexecon; Professor Paul Grout, Senior Advisor on Competition at the Bank of England and Professor of economics at Bristol University; and Professor Martin Hellwig, economic researcher of Max Planck Institute for Research on Collective Goods.

The Chair opened the first session on the cooperation between competition agencies and regulators, and the effects that agencies bring to the regulatory process. He said that some authorities are left out of the process, and some are not, however often regulators do not think that regulations create competition issues or concerns, or sometimes they see competition authorities as an enforcer and therefore they do not consult with it. The Chair asked the Netherlands to describe the experience in the Netherlands.

The Netherlands said that 2 years ago that the ministry of finance requested the ACM (Dutch Competition Authority) to advise on the impact on competition of the introduction of certain standard financial products. The ACM conducted a study and reached the same conclusion as the financial conduct regulator. The ACM found that these kinds of obligatory products (e.g. insurance for long-term illness and voluntary pension plans) would increase costs and therefore deter switching by consumers. It was considered to be a very positive development that the Dutch ministry gave the ACM a role in this decisionmaking process, and it is especially important because the financial regulators in the Netherlands do not have competition as an objective, not even a secondary one, since there was a fear that giving the financial regulators a secondary objective would detract them from their primary objective of delivering financial stability. In the Netherlands, the ACM can do market studies and based on that, give recommendations, however unlike in the UK, it does not have powers to impose remedies to resolve competition concerns that it identifies.

The Dutch delegation pointed out that there is an asymmetry between financial regulators and competition authorities both in terms of resources and in terms of information available. Two possible solutions to this asymmetry are (i) to give a dual mandate by giving competition objective to the financial regulator and/or by giving the competition authority regulatory powers; and (ii) ensure information exchange by creating a legal framework, since difficulties come from the regulatory framework, which doesnot allow the financial regulator to share information with the ACM.

The **Chair** then asked Professor Paul Grout to explain the secondary objective of promoting competition that had been given to the Bank of England.

Professor Paul Grout explained that the Secondary competition objective was introduced a year after the PRA (Prudential Regulation Authority) was set up. The PRA was set up as part of the reorganisation of the financial regulatory landscape in 2013. It was originally an independent entity but has now been wholly subsumed within the Bank of England. The secondary objective was introduced because of the possibility that ensuring safety and soundness at all costs could lead to the stability of the graveyard approach, and not because there were concern in the PRA's behaviour as such. The PRA cannot act to facilitate competition independently of its activities to discharge its general functions. The PRA sees the objectives, the primary objective of safety and soundness and the secondary objective of facilitating effective competition, as relatively complementary and the PRA is very positive about the secondary objective, and feels that it has had a considerable impact on its actions.

Prof Paul Grout raised two questions to explain how a secondary competition objective works: "why would you have a secondary objective?" and "what makes it secondary?" First, giving a regulator with a primary objective of safety and soundness, a secondary competition objective means that as they work to achieve safety and soundness, they are always being pulled into positions - amongst the set of effective options available - that help protect competition and therefore coordinate better with the authorities that have a primary competition objective. It keeps the primary competition objective in one organisation and the primary safety and soundness objective in another, but helps make them as coordinated as possible.

Second, he explained how the secondary objective is put into practice. One way is to give space to competition only if there are two options that are identical in safety and soundness. The other way is to look within a set of proportional actions to meet a safety soundness objective. In practice it means there is a medium-term safety and soundness objective that is paramount, but in the very short term it is possible to make small movements around this, which may facilitate competition without damaging the medium term primary objective.

He gave some practical examples of how the PRA had facilitated competition. For instance it had acted to make authorisations for new banks easier and evidence suggests that their numbers have increased enormously over this period. In another case in implementing the

Financial Policy Committee's loan to income restrictions, it had acted to exempt particular activities on the grounds of the secondary objective to protect niche markets. Another result of the secondary objective was that the PRA had needed to acquire in-house competition specialists and that in-house knowledge is helping to drive the competition agenda within the organisation.

He also gave a further example of how time can be used to do something in the short run to improve competition without weakening a medium-term protection of safety and soundness. Internal risk-based (IRB) models from Basel allow banks to use their own models to determine the amount of capital that needs to be put aside through the risk weights. If a bank does not have a model it has to use the Basel standardised approach. Part of the problem with Basel's structure is that you need a history of loss given default and you need a history of probability of default to actually apply in the internal rating based models to get the approval. Competition concerns can therefore arise since by definition if you are a new entrant you (i) will not have the history in the first place of your back-mortgage book, and (ii) even with a longer back mortgage book you may not have almost any history of defaults that would allow you to make a reasonable stab at the last given default. As a result of the secondary objective, the PRA made a clarification that banks will be allowed to use other data than their own to calculate loss given default and probability of default, and these rules now allow new entrants to actually apply IRB models and compete on a more level playing field with incumbent banks.

Summing up, he said that three or four years down the line there has been a genuine change and genuine differences in the decisions that have been taken, and these are having significant effects in the marketplace. This type of secondary objective, even without additional power, is therefore really serving a useful purpose in helping the coordination between the competition authorities and the regulators.

Moving on, the **Chairman** said the contribution from Singapore described a forum, the community of practice for competition and economic regulation (COPCOMER), established in 2013 in Singapore, where regulators and competition authorities could share best practices and experiences on competition in a regulatory matter. The chairman asked Singarore if the advice that the Singaporean Competition Committee gives to the financial regulator was through COPCOMER or not.

Singapore explained that it is really a separate process that is bilateral between the Competition Committee of Singapore and the Financial Regulator, the monetary authority of Singapore. The COPCOMER enables the Committee to have a frequent interaction with the regulators. There are a few channels through this platform, like seminars; newsletters about competition cases and developments from around the world; annual events called the regulators lunch or tea on higher level issues, which is more for the Chief Executives of the regulators. A new virtual platform was launched recently, where a COPCOMER group was created to expand the network to also facilitate this information flow and even have more discussions that are informal. The process is led by a secretariat who take the lead in approaching the different regulators and inviting the relevant agencies to contribute. For example, a recent topic was the impact of disruptive innovation in competition in the different industry landscapes.

The **Chair** asked if COPCOMER addresses the same issues as Professor Grout's example about the change of the Basel approach to allow new entrants to use other data instead of their own data to assess risk in order to be able to have a more flexible and less restrictive system of regulation that allows greater competition.

Singapore said that COPCOMER is a multilateral information sharing platform rather than a bilateral platform. It provides advice to government agencies in two ways. One is a more formal public consultation where they can seek feedback from public members and industry stakeholders. Second, by providing advice, COPCOMER can be approached informally at an early stage across different industries but particularly in insurance and financial payments, where more collaboration is needed between industry players in order to avoid issues such as interoperability, and coordination issues in payments.

The **Chair** then turned to Spain, where before the adoption of any regulation, the regulator has to ask an advice to the Competition Authority in case that the regulation may significantly impact on the competition conditions in the market. He asked whether requiring the central bank to expect a significant impact on competition before asking for an opinion from the competition authority was too high a bar, and whether the central bank was well placed to make such a judgement.

Spain noted that the cooperation between the Spanish Competition Authority and the financial regulators is flexible. The competition authority can request for information from both of the two regulators, the Bank of Spain which is in charge if the liquidity of the market and the Spanish Securities Market Authority which is on charge of the quality of the financial product and supervision of the markets. The coordination between the three institutions is more flexible and there is more exchange of information now.

The Chair moved on Sweden, who in their contributed reported a study that the Swedish authority made on the different approaches of the Competition Authority and the financial market regulators.

Sweden said it has a unique experience in the housing market and amortisation that arises from the very fast increase of household debt in the late 1990s. The Swedish Competition Authority started an investigation on the market, and they publicly presented their preliminary assessment that the regulator's recommendation might contravene competition regulations. They also made clear the risks of industry agreements and the benefits of state regulation if amortization needed to be regulated. The new rules on amortization entered into force with a few modifications in June 2016. The Competition Authority was involved in the process but in the end in this issue the matter of financial stability was considered to be more important than competition, and the advice of the competition authority was not heeded. However, there are examples (for example in the insurance market) where the authority's voice was successfully put across.

Professor Grout said that there had been a similar experience in the mortgage market in the UK. The Financial Policy Committee had consulted on a recommendation to the Prudential Regulation Authority (PRA) that it should implement a rule that would limit the mortgage that can be lent. However, it was then found that there was a very small select market niche that would have been highly damaged, so the final version of the recommendation was amended on the grounds of the PRA's secondary competition objective.

The **Chairman** then asked Romania if their suggestion that when implementing the consumer credit directive, the reimbursement fee should be reduced, was accepted and why they did not suggest eliminating the fee altogether instead of just lowering it.

Romania explained that their cooperation is more case-by-case and is a bit entrepreneurial. The regulators are the national bank, the financial supervision authority and the consumer protection agency. One example is from the car insurance market, where the authority carried out a market enquiry and used that data to heavily influence the revision of the legislation that was put through last year.

The **Chairman** then asked Israel about a mixture of cases and a regulatory matter against automated bank services called Shva which was co-owned by the four largest banks in Israel and is in charge of clearing payments for credit cards and transactions among the banks.

Israel explained that the committee for increasing competition in banking and financial services in Israel (the Strum committee) had recommended to separate the banking control from Shva, however the competition authority did not consider this suggestion sufficient, so it did not approve it. Since Shva is a cooperation of competitor banks, Shva is considered a restricted arrangement. As a restricted arrangement, it needs to obtain an exemption from the Antitrust Authority. Now Shva developed a communication protocol that is considered a very high barrier because it was developed in such a way that it did not allow any other acquirers to connect to the system. The authority considered this communication the most important activity that should be separated from Shva in order to allow other competitors to reach and to connect to the system. With the help of the Bank of Israel, the competition authority reached an agreement that Shva would not perform the protocol activity, would not develop the protocol and instead, the Bank of Israel has created another entity that will be a non-profit entity that will perform this important activity and that entity will constitute all the participants in the chain of value that is needed to be communicated via the protocol.

The **Chairman** continued with Hungary where the authority found in a market study that repayment fees for loans in the case of the borrower switching banks was very high, 4 to 10% of the net present value of the loan funded – and proposed that a ceiling should be introduced. The chair asked whether the investigation was carried out with a regulator or by the authority itself, and whether the regulator accepted the proposal from the authority.

Hungary said that it had conducted a sector inquiry on bank switching with a special focus on mortgage market and whether switching costs are too high for the consumers. After the sector enquiry, the authority conducted an enforcement proceeding against the major bank in Hungary, which ended with a commitment to lowering the artificially increased switching costs. It said that on the mortgage market another enforcement proceeding was also carried out because the authority found that there was a cartel between all the banks to limit the effect of a special law on the early repayment of mortgages. Switching costs can be investigated not only on the level of consumers but also on other users of banking services, e.g. retailers who are providing card acceptance services. The authority currently have a new sector enquiry on the conditions of switching between card acceptance providers.

The Chairman then moved on to Italy, where a fact-finding investigation had identified the widespread presence of interlocking directorates in the banking industry and the investigation eventually lead to an Italian government decree approved by parliament to prohibit multiple board positions. The Chairman asked whether the fact-finding investigation was a common initiative of the Competition Authority and the financial regulator, and if the Italian Authority had analysed the effect of the prohibition.

Italy explained that the sector inquiry on the banking and insurance sectors in 2008 was opened, because in the previous two years the authority had experienced a wave of banking mergers in which the issue of corporate governance and interlocking directorates came out very strongly, indeed in several banking mergers the transaction was authorised subject to structural remedies. The enquiry revealed that 80% of the entities have individuals in their boards holding simultaneous positions with competing entities. In 2011, a new decree law was approved banning these cross-apartments on the boards of financial institutions. It said that there had been good cooperation between the authority and the other competent authorities, in particular the Financial Regulator, the insurance regulator, and the central bank each of whom worked on this case. In 2012, the Competition Authority and the regulators signed a memorandum of understanding according to which the authority provides an advisory role to the other regulators in assessing whether the issues at question are relevant to competition or not.

T**he Chair** then described the Australian system, where the cooperation between the ACCC and the banking regulators is quite strong. However, he noted that in 2016 the first report of the house of representatives standing committee of economic review of the four major banks asked the ACCC to establish a team to monitor and report on banking. He asked the Australian delegation to explain the reason why the standing committee addressed this to the competition authority and not the regulator and what the concerns were.

Australia explained that the ACCC has had limited involvement in the regulation, and competition has been given limited attention, but this has changed over the last year. The parliamentary inquiry reflected the perception that the Financial Service regulators had not given a lot of weight to competition. The Financial Services unit that has been created enables the ACCC to engage much more deeply with the financial sector with more broader issues than just enforcement, and it is enabling the ACCC to put resources and effort into advocacy within government on a whole range of issues including both private and public advocacy. Answering the Chairman's question, it said the standing committee addressed the authority because they give more energy and focus to competition in the relevant discussions than the financial regulators.

Australia explained that the government could have suggested the productivity commission, but usually the productivity commission is given a one-off reference to deal with an issue and to consider and report on the issue. What the authority has been given is an ongoing role to engage with competition in the financial sector, so it is not limited to a single report.

The Chairman asked about a Norwegian case, where the authority concluded that the conditions in the mortgages market facilitated coordination on prices, and low consumer mobility, which resulted in banks being able to set higher mortgage rates without losing a significant proportion of their customers.

Norway explained that in 2015 the Norwegian Competition Authority published a market study on the Norwegian mortgage market. The conclusion was that conditions in the mortgage markets could facilitate collusion on prices. The authority also found that stricter capital requirements may have had adverse effects on competition between banks because the regulation is not fully harmonised with the capital regulations in the EU, which means that capital requirements are essentially higher for Norwegian banks than for branches of foreign banks operating in Norway. The Authority advocated that the implementation of the Basel 1 floor should be harmonised, to guard against adverse effects on competition.

The Chair asked Professor Hellwig to make his presentation.

Professor Hellwig said that it is often taken for granted that cooperation between competition authorities and financial regulators is good. However, he suggested that there is a natural antagonism between the two sets of policies. Competition policy involves prohibitions based on abstract and not industry specific concepts. In contrast, sector-specific regulations, like financial regulator are industry-specific. He highlighted some antagonistic features between competition policy and regulatory policy in terms of their coherence, but suggested that these differences can be helpful in some cases.

He noted that financial regulation has a strong anticompetitive tradition, involving prohibition of competition for funding. Much of what is declared as being in favour of safety and soundness is a tool of financial repression. The previous regulatory regime was ended it became dysfunctional. It was replaced largely by a scheme of regulation involving equity requirements, on the basis of the banks' models, and involving a whole-country principle as a basis for competing globally. This new regime was a basis for the vast expansion of the financial sector in the years 1990 until the crisis. But some of this was driven by moral hazard. When you talk about the good features of getting risk measurements into the computation of equity requirements there is empirical work suggesting that banks used the scope given by the internal ratings based (IRB) approach to determining capital requirements for loans to just manipulate requirements.

Prof. Hellwig said that he favoured a leverage ratio approach. The crisis in 2008 was largely concentrated in the trading book, where assets were sometimes backed by less than 1% in equity because they had managed to compute the risks of their positions down to suggest that they did not need much equity. He said we should not let ourselves be fooled by the rhetoric surrounding the risk based approach, in particular the use of their own models.

Turning to the competition issues, he said that first, the financial sector is a sector where it is both difficult and easy to enter. It is easy to enter because you do not have to set up very much but there are barriers to entry, like fixed costs. Regulation has created barriers to entry and having the internal ratings based approach to computing capital requirement is a big fixed cost and introducing that introduces a bias into the systems for the big institutions against the smaller institutions, and the smaller institutions tried to compensate for that in various ways, some of which create additional risk. He said that at the moment, there is also a regulation driven fixed cost which comes from the fact that having a bad conscience about Basel 3 being insufficient, supervisory authorities at least in Europe do all sorts of surveillance of conducts and have all sorts of information requests which multiply over and over again and require institutions to have significant staff to just accommodate the regulators requests. He said that his recommendation would be: just have higher leverage ratio based equity requirements and leave them alone.

He said that network effects can also be important and can contribute to foreclosing markets. He said that in a sense, we have oligopolistic market structures due to barriers to entry at the very retail level, where something like learning by doing, knowing the loan customer, knowing the borrowers because one has learned about their histories, is an important precondition for doing business, and then at the very high end where networking effects in the management of collateral requirements for derivatives again supports oligopolistic structures.

A second set of issues were government protection, implicit subsidies and mergers. Bailout policies can be based on explicit guarantees as in the case of the German public banks, the "Ländesbanken", or on implicit guarantees as in the case of Fanny and Freddy in the US, the so-called government sponsored entities. Following privatisation there was no explicit guarantees, they were just given privileges in terms of access to the treasury for liquidity. Everybody believed that they were guaranteed and in the end, they were bailed out. He said that there are two elements of subsidies that distort competition. One is ex post when the bailout occurs, and government funds are given. The other, and that is much more insidious is ex ante when people form expectations on whether the bailout will occur and anticipation of such a bailout occurring reduces the external funding costs of these banks.

Additionally, large mergers in the US financial banking sector in the 1990s and early 2000s were driven by the availability of implicit interest rate subsidies from becoming too big to fail. There is empirical evidence suggesting that for mergers exceeding balance sheet totals of USD 100B the estimate is that one half of the takeover premium of the shareholders of the bank that was taken over could be attributed to such a subsidy. In the US, of course with merger control largely in the hands of the regulators, that is the Fed had the idea that we had to approve mergers because market power is good for financial stability. In the end, it backfired because "too big to fail" was an issue. There is a proposal by German lawyer Daniel Zimmer, former chair of the monopolies commission to make "too big to fail" concern a part of merger control understood competition policy. Can we articulate the distortion of competition that are associated with anticipations of future subsidies into the standard analysis of merger control? An alternative might be to do this at least in EU law under state-aid control. The problem with state-aid control is that it can work with explicit guarantees but it's not available ex ante for implicit guarantees and ex post when the bank is in trouble, the state controlled agency is in a very weak position as we saw in the crisis.

His last topic was government support and lack of exit. He said that if you take the German Ländesbanken, they never had a real business model except to stand ready for a head of regional government to move some funds without parliamentary control if he so desired, but they did not exit. And in the years 2001-2005 when the end to the guarantees had been decided and they still could borrow with guarantees, they gobbled up lots of funds and wasted them in the crisis. The German covered bond law of 2005 expanded their area of activity and you might say enhanced competition in the covered bond sector. But that had dramatic consequences because competition became so tough on margin that you can only survive through extraordinary maturity transformation, meaning that the excess coverage, the amount by which the collateral has to exceed the nominal value of the covered bond had to be funded very short-term. Some banks did this with deposits, and deposits fortunately exhibits inertia. Some banks like the German real estate or the French Belgian Dexia did this through overnight borrowing in the money market and got into severe problems in 2008 when the money market froze. Now a populist view would be "oh but this is good: lots of competition!" Prices that are favourable to customers, but of course competition policies are not about prices that are favourable to customers but about prices that are appropriate and based on real costs. Now the prices that the Ländesbankes could charge were favourable to customers, but they could charge them because of the guarantees that meant they ended up being funded by implicit subsidies. That put pressure on others who in the end, ended up burdening the tax payers. The 2008 bailout prevented lots of exits, not so much in the US but in the EU and it is currently the cause of the very low profitability of the industry that requires a lack of capitalisation through retentions. Financial supervisors are always afraid of dealing with zombie banks. Banks that are de facto insolvent but nobody acknowledges that because the books are handled in such a way that the numbers appear to be in the black. The Japanese crisis of the 90's provides an instance of the damage that this can do. When zombie banks lend to zombie firms that is a source of low growth because alternative companies do not get funds or they do not even want to get funds because would you compete with someone who has a bank with deep pockets to the back of them?

He finished by saying he thinks that both in terms of merger control to the extent that it is available, state-aid control under or abuse of dominance control, there are reasons to think about whether the application of competition policy in this area does not require some further thinking and adaptation to specifics of the financial sector.

The **Chair** moved to the next section on the role that regulators play in the enforcement of antitrust law. Starting with the US, he highlighted two cases, the LIBOR cartel and exchange rate cartel, in each of which there had been the involvement of regulators. He asked, firstly about the discovery of the cartels and secondly about, the role of the regulators in the cases.

The **US** noted that in each case there was substantial cooperation between the DOJ and the antitrust enforcer and the regulatory agencies both in the US and oversees, since both LIBOR and Foreign Exchange were international conspiracies. Cooperation was therefore needed to understand the markets and they also worked with regulators in the remedial phase. This helped to make sure that the remedies would not have unfortunate impacts on the stability of the markets and was also useful because regulators had additional types of remedies that they could impose such as debarment which might help increase the deterrent effect. The US noted however that some problems have arisen in certain cases where regulators in other countries take civil cases while the DOJ pursues criminal cases. In a recent case a financial regulator in the UK compelled the testimony of defendants, who were then later prosecuted criminally in the United States by the Department of Justice Antitrust and Criminal Divisions. A third defendant who was a co-operator had seen that testimony and so when the co-operator testified in our trial the second circuit court eventually said that that was a violation of the defendant's right against self-incrimination because we had a witness who had seen compelled testimony. Furthermore an FBI agent had spoken to the witness (who had seen compelled testimony) and so the testimony of the FBI agent was found to be tainted. This demonstrated the importance of cooperation and coordination in these types of international investigation.

Australia agreed that the conflicts between civil and criminal systems such as the US have identified are very familiar in their system, not just in dealing with foreign evidence or foreign information, but also in dealing with domestic engagement with securities, regulators, and indeed in dealing with their cases, because they can deal with cases civilly as well as criminally. Australia identified that there are significant advantages of cooperating with other antitrust agencies, since around 50 or 60 agencies now have leniency programs, which cooperate through the system of waivers that is possible in the leniency framework and that can lead to very substantial engagement and cooperation between agencies. However it noted that that tool is not available for financial regulators. They have generally not adopted that sort of programme and so they do not have the capacity to share information through a waiver mechanism. They asked whether this might therefore be a cooperation gap that needs to be filled.

The **Chair** asked about the UK. He said that when looking at the rules in an abstract way, it seems that the CMA is cut out because the regulator would also be the enforcer, they have all the information, the competences and also the law, and so they would enforce the antitrust rules. However to the contrary, coordination seems to be working very well, and the CMA is very much in charge of competition issues in the financial industry. The Chair asked the UK how this cooperation was possible and how the regulators was willing to share and let the CMA do many things.

The **UK** agreed that they are quite unique for having a concurrency regime. The financial conduct authority and the payment services regulator have concurrent competition powers, but the prudential regulation authority does not. Pre-2015, competition law cases and antitrust cases in the financial service sector were led by the office of fair trading and now the competition and market authority (CMA). When the CMA was established, bringing together the OFT and the competition commission, the CMA included in its infrastructure a sector regulation unit. What that does is work very closely with the sector regulators who have concurrent regulation powers. CMA has its concurrency guidelines, which sets out a process for deciding which institution takes the lead on a case. There are two ongoing cases, in the first one, the Financial Competition Authority is taking the lead, but there is extensive sharing of information between the Financial Competition Authority and the CMA, also the CMA has put individuals on secondment into the Financial Competition Authority. The other case relates to most favoured nation clauses in home insurance markets. Here the CMA and Financial Competition Authority agreed that the CMA would take the lead on that. It said that the introduction of concurrency in financial services, and competition duties to the financial regulators undoubtedly have been beneficial. There has been very good cooperation and constructive working relationships between the CMA and the sector regulators.

The **Chair** then asked Denmark about its work on the mortgage market.

Denmark said it had undertaken a sectoral investigation of the Danish market for mortgage loans where there are only four providers. It said that the regulatory requirements on firms imposed caps on the risky loans that they can make, the loans with variable interest they can make, and other lending decisions. It said that the fact that there were just 4 firms in the market and that the aggregate data were public meant that each firm had reasonable visibility on when a rival was approaching a cap (and hence ceased to operate a competitive constraint), allowing it to raise its price. The sectoral study had 16 recommendations, many of them regard the consumer side of the market to make it easier to switch between providers. These included a proposal on a standardised cover that should be introduced to every loan document to make it easier for a consumer to compare between different providers. The agency had conducted an experiment using biometric readings of consumers' facial expressions that showed that when such a cover is used, consumers are less frustrated, they find it easier to find the relevant information like the monthly payment on a loan and they find it easier to compare loans between providers.

The **Chair** then introduced a payment markets case from Finland, where the competition authority cooperated with the financial market regulators to make sure that commitments made to the Finnish competition authority would not violate or would not affect negatively the stability of the payment system.

Finland explained that in the legislator's view there can be a potential conflict between stability and competition, being a reason why the financial regulator is not empowered to enforce competition law. In this particular case the competition authority consulted the commitments offered with the financial regulator. Both authorities agreed how to proceed in the matter. However if there had been a disagreement, ultimately the competition authority would have been the sole enforcer of competition law. Above all, the case represents that competition enforcement and the regulatory stability arguments can be integrated.

The **Chair** then asked Miguel de la Mano to make his presentation on how to accommodate innovative products and new digital players in the industry.

Miguel de la Mano started by saying that the challenge is that financial regulation may be too slow to react to new technology, from crypto-currencies and blockchain to crowd-funding, in the same way as policy makers had missed the risks imbedded in the innovations in the early part of the decade that ultimately fuelled the largest housing bust and financial crisis. He said that a new wave of technological innovations, often called "fintech," are accelerating change in the financial sector. Fintech leverages the explosion of big data on individuals and firms, advances in artificial intelligence, computing power, cryptography, and the reach of the internet. The strong complementarities among these technologies are giving rise to an impressive array of new applications touching on services from payments to financing, asset management, insurance, and advice. Therefore entities driven by fintech may emerge as competitive alternatives to traditional financial intermediaries, markets, and infrastructures.

FinTech firms have attracted substantial investment in recent years while public interest has grown significantly and market valuations of public FinTech firms have quadrupled since the global financial crisis. Although FinTech challengers offer many services traditionally associated with banks such as lending, most are not technically banks. The vast majority do not have banking licenses which means that any money they hold from consumers must not be for deposits, but rather for other purposes such as transferring or lending. The term FinTech sometimes excludes traditional banks. But that's not accurate. All traditional financial institutions have become highly technological. One third of Goldmann Sachs employees are engineers. They have more engineers than Facebook, and Twitter combined. Moreover, the leading banks are each purchasing FinTech start-ups, forming strategic partnerships or internally designing new products. The impact on the financial markets is that banking technological innovations can increase competition by removing or mitigating economic barriers to entry (e.g. by lowering transaction costs in the case of online payment or allowing a more efficient matching of lenders and borrowers in the case of peer-to-peer platforms).

In contrast, banks have steadily gained customers in the midst of technological innovation despite the fact that banks themselves have reacted slowly and late. He said there are many possible explanations for this, but the two most likely are firstly, that too-big-to-fail banks continue to benefit from benefit from being insulated from competition, and secondly, that traditional banks have erected obstacles to data sharing with FinTech. Firstly, as a result of their too-big-to-fail status, some banks now have an implicit government guarantee. In the long run, this increases systemic risk and it restricts competition, but in the short run, from the perspective of micro prudential regulation, it is financial stability that is of immediate importance. In the aftermath of the financial crisis, regulators considered three responses. High capital requirements, structural reform and resolution regimes. He noted that unfortunately the too-big-to-fail problem has not been resolved.

He suggested that financial regulations seek to address vulnerabilities and imperfections in financial markets that weaken financial stability, undermine market efficiency, and expose consumers to risks. Financial regulation should therefore: provide incentives for institutions to take into account systemic risk; protect consumers from conflicts of interest and where information is hard or costly to obtain; and support competition and prevent oligopolistic behaviour. He said that for each policy objective a different competent authority is needed. For example, consider the attitude of a prudential regulator towards FinTech start-ups. The prudential regulator's primary mission is preserving the stability of the financial system. This means preventing large financial institutions from failing, but allowing new FinTech start-ups to compete fully will increase the chances that financial institutions will actually end up failing. He said that similar arguments can be made regarding a prudential authority's incentive to reign-in conflicts of interest or prevent financial institutions from developing and commercialising profitable products, like CDO's. More recently, he said that the selling of bank bonds that can be bailed in to retail consumers has highlighted in the Italian banking cases the need for a strong conduct of business supervisor for banking and other financial services separate from the prudential supervision to ensure a strong focus on interest or consumers.

He noted that in the EU there is a helpful separation in power between competition enforcement (under DG COMP), ensuring financial stability (under the Single Supervisory Mechanism) and consumer protection in financial markets (under the reinforced and revamped ESMA). In the EU, DG Comp has revamped its antitrust enforcement in financial service in the aftermath of the financial crisis. ESMA was created in 2011 to foster convergence and mediate the existing differences of approaches, experiences and effectiveness across member states. ESMA also has some direct supervisor authority but he said its current mandate is not sufficient. The obvious solution is to enhance ESMA's responsibilities. He recommended that its expanded responsibilities should include: authorisation of significant investment intermediaries (for example banks and securities firms); an extended consumer protection mandate allowing them to conduct market investigations and directly impose sanctions at EU level for example in the case of market manipulation, see LIBOR or Forex, data access restrictions or deliberate degradation of interoperability; Supervision of audit firms and enforcement of international financial reporting standard and finally powers to use regulatory sandbox at EU level. He suggested that sandboxes provide a controlled and contained environment in which firms can pilot innovative financial services and products in a timely and cost-effective manner before they go large scale. We need something like that at EU level that strikes a balance between promoting innovation and preserving financial stability and consumer protection

The **Chair** asked Canada about a report that was issued on FinTech companies in reducing regulatory barriers and a number of recommendations in the report.

Canada explained that FinTech was identified during public consultations in 2013 as an area for a potential advocacy initiative, since FinTech represent a really important pillar in the Canadian economy, representing 7% of Canada's GDP. After the financial crisis there was a new wave of FinTech services that emerged around the world, but adoption in Canada was lagging many of its peers. It therefore wanted to spur competition and innovation in the sector. In the report the Competition Bureau had 11 general and 19 much more specific recommendation. They deal directly with the 3 areas of the study, which were retail payments in the payment system, lending and equity crowdfunding in investment dealing in advice, the network and relationships. It said that it has been consulted on regulatory change and has recently made two submissions to finance Canada on their regulatory views on the topic of payment infrastructure and Canada's financial framework. It hoped that the study has positioned competition to be a significant consideration in the development of additional new regulations and opened a seat at the table for the competition bureau.

The **Chair** then asked the European Commission who launched a public consultation in order to explore which policy options to adopt for a more competitive and innovative European sector whether they would take into consideration the suggestions from Miguel de la Mano.

The **EC** pointed out that the Commission has launched a very broad study on FinTech. It noted some emerging trends and said these had led it to structure the questionnaire to address concerns that the combination of new entrants and incumbents might lead to the creation of new standards and if that is the case it said its competition rules will kick in so that it would have requirements to create transparency to make the standard setting open and as accessible as possible and also to licence those standards. It said that at the moment, the EC is devising a FinTech strategy at the Commission level which includes lean regulatory regimes, and so regulatory sandboxing is certainly an element that we are looking into with interest.

The **Chair** then turned to Mexico, asking whether COFECE was concerned that the draft law to regulate FinTech institutions.

Mexico explained that the FinTech regulation should provide incentives for innovation, inclusive growth and competition in the sector and therefore it was important for the Mexican Competition Authority to analyse the draft law and submit its opinion from a competition perspective. The competition authority found that the law has elements that could restrict the potential intensity of competition in the market, including the discretionary power given to regulators in the granting of authorisations. It was also concerned that the regulation does not ensure non-discriminatory access to certain essential inputs so that entrants can effectively compete with incumbents. For example, access to tradition banking services and clients' transactional data is necessary since the possession of data might be an important source of market power and particularly when the data can be used as a barrier to entry. It noted that this information and data about a client's transactions can be shared only if the clients grant their approval. It suggested that these recommendations should be taken into account because even though Mexico has a well-capitalised financial system and low delinquency rates, its banks have few incentives to compete. In addition, the penetration of financial services and financial inclusion in Mexico continue to be very limited so new technologies offering financial alternatives could modify the structure and performance of the sector in the country as long as they generate competitive pressure and traditional banking and provide new options for the benefit of the consumers.

The **Chair** turned to Portugal, where in June 2017, the central bank allowed the opening of the banks to competition from digital channels and where crowd-funding has been allowed since 2015, and electronic money since 2012. The Chair asked Portugal if they were in the same shoes like many jurisdiction, where regulations that are in place for entry in crowdfunding are disproportionate with respect to promoting the actual introduction of the service.

According to **Portugal**, competition authorities need to be more clearly heard and more involved in the financial sector. The stance of the Portuguese Competition Authority regarding these topics but also regarding the development of the FinTech and InsureTech is that the policy in regulatory approach is still very much imbedded with a misperception about a trade-off between competition and sustainability in the financial sector or lack of sustainability. It said it saw no robust empirical evidence that would justify moving away from the competition principles in this sector, therefore it applies competition law to this sector like any other. It said that cooperation and collaboration should focus more on the exchange of information rather than on an actual interference in between regulation and competition policy enforcers. It explained that the crowdfunding regulation from 2015 has not been implemented, and in that case the timing is really important, because one of the entry barriers that FinTech can face is the delay in introduction of legislation, because if it arrives too late then banks themselves might internalise all the innovation and therefore gain an advantage with respect to their younger competitors. It noted that its main concerns are the strategic barriers to entry raised by incumbent banks regarding access to data, and the timing of regulation that seems to be a little bit too slow to encompass innovation and development.

To conclude the discussion, the **Chair** suggested that the main reason why crowdfunding did not work was that the regulation was overly restrictive and imposed the same safety constraints that were imposed in a normal equity issuing companies which made crowdfunding totally unattractive to anyone. He said that as the contributions showed, we are in a process of rethinking the relationship between stability concerns and competition. He also noted that we had heard that many authorities are concerned with the development of the FinTech innovative firms and services and the need for further regulation in this area. As competition authorities he suggested that we needed to advocate to ensure that regulators do not overly protect the existing players for the sake of stability, so that the innovation can thrive and deliver better services and better products for consumers and firms.