Organisation for Economic Co-operation and Development

DAF/COMP/WP2/M(2017)2/ANN2/FINAL

Unclassified **English - Or. English**

5 April 2019

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

Working Party No. 2 on Competition and Regulation

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

Annex to the Summary Record of the 64th meeting of Working Party No 2

4 December 2017

This Executive Summary by the OECD Secretariat contains the key findings from the discussion held during the 64th meeting of Working Party No. 2 on Competition and Regulation on 4 December 2017.
More documents related to this discussion can be found at
www.oecd.org/daf/competition/cooperation-between-competition-agencies-and-regulators-in-the-financial-sector.htm

Please contact Mr. Chris Pike if you have any questions regarding this document
[phone number: +33 1 45 24 89 73 -- E-mail address: chris.pike@oecd.org].

JT03445909

Executive Summary of the discussion on "10 years on from the Financial Crisis: Co-operation between Competition Agencies and Regulators in the Financial Sector" held at the 64th meeting of Working Party No. 2 of the Competition Committee of the OECD

By The Secretariat[*]

From the discussion at the roundtable, the delegates' and experts' written submissions, several key points emerged:

1. In the 10 years since the financial crisis, competition authorities across the OECD have been active in advocating for governments and financial regulators to consider the impacts of their actions on competition between financial institutions. However, while they have in some cases succeeded, influencing these decisions has proved difficult, both in regards to actions taken to maintain stability and to protect consumers.

Bank regulation has a strong anti-competitive tradition, which can be mistaken as implying that there is an intrinsic conflict between the enforcement of competition rules, and vigilant financial regulation. However, as with many other policy questions there are ways to achieve a policy goal that risk damaging competition, and ways that do not. There is therefore increasing agreement that not only can the goal of financial stability be achieved without recourse to anticompetitive measures, but that a pro-active competition policy can play help to achieve this stability. For example, where competition drives institutions to become more efficient this can be expected to reduce the risk that they pose to the rest of the financial system. In this context, many competition agencies have been active advocates for pro-competitive regulation since the financial crisis. This is reflected in the growing number of markets studies and opinions that have been produced (such as in the Netherlands, the UK, Mexico, Sweden, Denmark and Norway).

This activism has achieved some notable successes; for example in the increasingly vigilant application of state aid rules to financial institutions in the EU, open banking API standards in the UK, and the credit and debit card market in Argentina. However, in other cases it has been less successful. For example, the European Capital Requirement Regulation (or at least its interpretation) was identified as distorting competition by favouring large incumbent banks that develop their own internal risk models, over smaller entrants for whom this is not economic. Other examples include a central bank that advocated in a circular that banks set price floors, and a regulator that imposed a transparent cap on the share of loans with high loan-to-value ratios that reduced banks uncertainty on their competitors' reactions when setting prices. Similarly, some regulators have increased information and transparency in order to empower and protect consumers by helping them to make better choices. While this can help consumers to drive more effective competition, it can also facilitate price coordination and hence pose anti-competitive risks. It is therefore

[*] This Executive Summary does not necessarily represent the consensus view of the Competition Committee. It does, however, encapsulate key points from the discussion at the roundtable, the delegates' written submissions, the panellists' presentations and the background note.

important, as competition authorities have identified, to consider carefully what information should be made transparent and when.

One consequence of insufficient action on the anti-competitive effects of regulation may have been the protection of 'zombie' banks. The survival of these unviable institutions risks undesirable and inefficient competition that drives efficient banks into riskier positions (as well as weakening pay restraint for senior managers and hence increasing inequality). The survival of these zombie banks may also result in them facilitating the survival of low productivity 'zombie' firms in order to mask their own unviable nature. The survival of these firms, and hence the resources that remain tied up in them, may account for at least some of the lack of productivity growth that has been observed during the recovery from the financial crises.

2. An important determinant of the effectiveness of a competition agency in ensuring that competitive concerns are reflected in a decision is the way that they cooperate with the regulator. For example, the institutional setting within which cooperation takes place and the objectives set for the regulator can have an important influence. In addition, formal agreements and informal relationships between agencies can result in effective ways to co-operate in some cases.

Perhaps the most effective way to ensure that competitive concerns are reflected in a regulatory decision is to give the regulator a formal secondary objective to promote competition, while meeting its primary objectives. This is not yet common but has been put in place for the prudential regulator in the UK and appears to be working well. The resulting need to assess the anti-competitive implications of different regulatory options then requires the regulator to ask itself the question, and to create an in-house competition expertise, and potentially a role for secondments and movement of staff between the organisations, that can help improve communication and relationships. To be effective this secondary objective would have to be to promote competition, which is quite different from an objective of increasing the competitiveness of a countries firms in international markets (which might for example be interpreted as including measures designed to benefit firms located within the country).

Effective cooperation can be also facilitated through agreements, such as those that require the regulator to obtain an opinion from a competition agency in certain circumstances. In such cases, the details are important for the effectiveness of the arrangement. For example, it will make a difference whether the regulator needs to accept the opinion, respond where it disagrees, or publish the opinion that it receives. In some cases, there is also a threshold on when a regulator has to obtain an opinion and in those cases the identity of the party responsible for making that assessment, and the threshold itself, will each have implications for the degree to which competitive concerns are reflected in regulatory decision-making.

3. Since the financial crisis, financial regulators have provided valuable information and assistance to competition agencies investigating enforcement cases. Nevertheless, there have been some difficulties in co-operating on enforcement cases with regulators in other countries. In merger control, the importance of competition agencies making independent decisions that are informed and enriched by the specific experience of regulators is widely recognised. However, competition agencies might need to go further and assess whether a merger, by making an entity systemically important, and hence the likely subject of state support, can be expected to reduce competition by foreclosing entry or raising rival's costs.

Since the financial crisis, financial regulators have provided valuable information and assistance to competition agencies investigating mergers and enforcement case. For instance, in the US, cartel investigations of municipal bonds, LIBOR and foreign exchange, were all aided by the financial regulator helping the competition agencies to understand the market and how it worked, what technology was used and what types of financial instruments were involved.

Valuable international co-operation between competition agencies has also meant that agencies can often ensure that applicants to their leniency programs provide a waiver for agencies to disclose that information to regulators and competition authorities in other countries. However, it was reported that unlike competition agencies, financial regulators do not have an agreement to include such waivers. Indeed, in some cases this lack of coordination with financial regulators in other countries has prevented competition agencies from exchanging information or conducting joint investigations. Similarly earlier and better coordination with regulators in other countries can help prevent difficulties such as testimony being excluded from trial on the basis that a co-operating witness had seen compelled testimony that had been given to a financial regulator in another country.

Competition agencies generally have a determinative role in merger and enforcement cases in the financial sector. While there are some exceptions, such as Brazilian merger control, this creates a relationship where the competition agency is in the position of potentially requiring information and insight from the financial regulator in order to make its decision. This ensures that merger control and enforcement is not used inappropriately, for example to resolve unrelated market failures.

4. In merger control there is scope for competition agencies to assess the different ways in which consumers might be harmed by mergers of firms in the financial sector. For example, they might consider whether a merger, by making an entity systemically important, and hence the likely subject of state support if it were to require it, can be expected to reduce competition by foreclosing entry or raising rival's costs.

Merger review typically involves not only an assessment of the change in competitive constraints that a merger brings about, but also an assessment of the risk that the merger will create circumstances in which the merged firm has the incentive and ability to foreclose or raise its rivals costs. This concern might for example arise in the assessment of a vertical merger that might give the merged firm the ability and incentive to raise the cost that its rivals pay for access to a key input.

Similarly, it is possible that a horizontal bank merger might create an institution that meets the regulator's existing definition of what constitutes a too-big-to-fail or systemically important firm. If so, this might give the merged firm the advantage of expected access to implicit subsidy from government in the event that it required it. This distortion of the competitive process might therefore reduce rivals' access to funding, damage efficiency, and hence allow the merged bank to raise mark-ups. Furthermore, the artificial cost advantage may be sufficiently large to restrict entry into what are often already highly concentrated markets.

5. The introduction of new financial technology is an important test for the effectiveness of interagency co-operation. On mergers and anticompetitive conduct, insight from regulators can help ensure that competition authorities are up to speed on developments that are expected to have an impact on the market. Meanwhile an openness amongst regulators to testing new ideas in controlled conditions, and doing do so quickly, is a key element of a pro-competitive regulatory environment that

supports innovation. There is also an opportunity for competition agencies to facilitate innovation and drive greater competition in traditional markets by advocating for rules that open access to data.

The development of computing power, cryptography and artificial intelligence, combined with the expanding reach of the internet, and the associated growth of data has created a field of new firms driven by Financial Technology (FinTech) which may emerge as competitive alternatives to traditional financial intermediaries, markets and infrastructures. These may therefore threaten the stability of existing large financial institutions by offering consumers better products. The extent to which agencies cooperate to facilitate such developments is therefore a key test for the post-financial crisis settlement between competition and regulatory agencies.

Competition agencies need to understand these emerging technologies and the regulatory framework in which they will be applied, in order to make forward-looking decisions. For instance they may need to take a view on the impact that these firms will have on competitive constraints within the market as it currently exists. Financial regulators are a key source in this respect since they have sector-specific knowledge without the same market-based incentive to under or over-play the potential impact and its timing.

Competition agencies can also reciprocate by advocating for financial regulators to reduce the barriers to entry that these Fintech firms may face. These may include reforming aspects of the way that incumbents are regulated. For example, removing the advantages of implicit subsidies such as those that might be created by a lack of separation between retail and investment banking, or inadequate leverage ratios. However, they may also involve changes to the way the existing regulations apply to new technologies or business models that entrants are bringing to the market. For example, the introduction of regulatory sandboxes is a promising way of focusing on setting rules that protect consumers from the risks posed by a given business model, rather than simply setting rules that apply to all models without reflecting differences in the risks they pose. The timing of such changes is an important consideration as if the necessary changes are made too slowly this can mean entrants miss their window of opportunity to disrupt incumbents and are instead acquired by those incumbents.

FinTech can also be valuable either as a remedy for competition agencies, or as a tool by which regulators can seek to increase competition. For example, in the case of open API standards in banking, both competition agencies and regulators have sought to actively create the inputs that can facilitate a new class of innovative business model in which third parties help consumers to choose and manage their money and hence increase competition between traditional banking products.