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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
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- Note by Finland****4 December 2017**

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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.

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1. The aim of the OECD roundtable is to identify – as the background paper notes – an appropriate regulatory and competitive framework for the financial sector. This paper explains how the Finnish competition authority and financial market regulator have co-operated in seeking for the ‘appropriate’ regulatory and competitive framework.

2. For Finland, the 2008 financial crisis was not the decisive milestone for building an appropriate framework. The foundations for the co-operation between financial and competition authorities were established before that crisis. Due to this, our contribution takes a bit longer perspective, beyond the 2008.

1. Powers to apply competition rules

3. As OECD notes, after the 2008 financial crisis, there are more and more claims that financial institutions should be regulated ‘more strongly’ to preserve the stability of banking sector. For many, the ‘stronger regulation’ policy can also mean demands for less efficient competition policy.

4. In Finland, the enforcement and regulatory system in the financial sector is quite clear. The Finnish Competition and Consumer Authority (FCCA) is exclusively and independently responsible for competition law enforcement in antitrust cases and mergers in banking and financial services.¹ In cases which have or may have a trade effect between EU members states, the competition arm of EU Commission (DG Competition) is empowered as well. Both EU competition rules and national competition law are fully applicable to banking and financial services. Competition rules apply in the same manner as to other economic sectors.

5. The role of financial regulator in competition law enforcement is a consultative one but still very important. Before the FCCA takes any major enforcement actions or decisions in financial or banking sector, it consults also the financial regulator about the matter. This very practical way of cooperation dates to 1998. Before that the competition law enforcement was shared between competition authority and financial regulator. They were both empowered to apply the competition law. But after the 1998 competition law amendment, the financial authority has had only a consultative role in the enforcement of competition law. The actual enforcement of competition rules was given to the competition authority only.

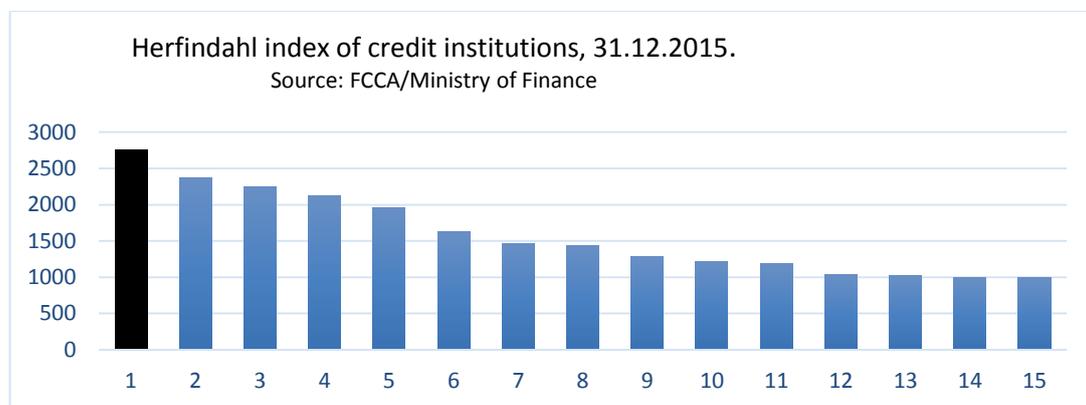
6. Why this change? One aspect for the 1998 competition law amendment related to the stability tasks of the financial regulator. The preambles of the 1998 law argued that there is at least potentially a tension between the tasks to safeguard stability in the financial markets and the tasks to safeguard competition. This ‘potential tension’ was not the major reason for the law amendment, but an aspect in any case. The key reason behind the change was that authorities could cooperate without shared powers in competition law enforcement; only one of them having the role of competition authority. But for the competition authority, it was important to guarantee that financial regulator’s sectoral expertise was available also in the future.

¹ In the following of this contribution, insurance services and pension funds are not included. Therefore, the focus is mainly on ‘pure’ financial and banking services.

7. Basically, the changes in the law confirmed what was the state-of-play already in practice: a good and transparent co-operation between financial regulator and the competition authority. This basic situation and mentality has not changed since 1998.

8. The current roundtable is about stability and competition. This theme has strong links to a question whether competition enforcement should be ‘softened’ to guarantee stability in the banking markets? In terms of the Finnish markets, this question is problematic not least because the financial and banking markets are quite concentrated.

9. Generally, an Herfindahl-Hirschman Index (HHI) below 1500 - defined as the sum of the squares of the market shares of all firms within the industry – signals a competitive marketplace. Values between 1500 and 2500 indicate low or moderate concentration and an HHI index above 2500 signals high concentration in the markets. Among the Finnish credit institutions, the HHI value is in the range of 2500-3000.² Although, market concentration does not automatically mean weak competition, high market concentration is an influential factor that a competition authority need to consider when building the theory of harm in an individual case.



10. The FCCA, being the national competition authority, has naturally a standpoint that competition is important in banking, and not least because of the high concentration levels of the industry. This does not mean that FCCA would not value stability in banking markets. Banks certainly have unique characteristics which make them more vulnerable to instability than firms in other sectors. Competition authorities should care about banks vulnerability, acknowledge this and take it seriously.³

11. As an example of this, when competitive markets encourage efficiency, less efficient firms will have incentives to become more efficient. But if that does not happen, they will suffer economic consequences. Ultimately, they must close their business and exit the financial markets. In this situation, competition authorities may have

² Note that these indicators are calculated on a non-consolidated basis, meaning that banking subsidiaries and foreign branches are considered to be separate credit institutions.

³ For example, banks are vulnerable to runs or panics. The problem is that clear majority of banks' liabilities are liquid deposits, redeemable upon demand, whereas their assets are illiquid loans. Thus, if all depositors tried to withdraw their deposits at the same time, a bank would face serious problems in meeting its obligations to its depositors. Banks can also be susceptible to instability because they are often linked through inter-bank commitments. The failure of a bank (in this inter-bank chain) can lead to the decline in the value of the assets in another bank, sufficient to induce its failure.

to recognize that the exit process must take place in an orderly way. In other words, that the exit process guarantees appropriate also consumer protection and does not threaten financial stability. During the Finnish banking crisis in 1990s, one of largest banks collapsed. The competition authority gave to the remaining banks a six months permission not to acquire customers from other banks. The reasoning for this very exceptional decision was to ensure that exit process after the bank's collapse proceeds smoothly and does not further destabilize the banking sector. The cooperation authority monitored firmly that after six months the situation returned to normal.

2. Stability or competition – right question?

12. Eventually we come to the question whether 'less competition' is a solution for a more stable banking? Is competition a problem for banking stability?

13. The academic literature, both theoretical and empirical, is not conclusive about whether competition reduces stability or increases it. During the 1980s especially, the view was that competition worsens stability. Intense competition was favouring excessive risk taking on the asset side and thus leading to a higher likelihood of individual bank failure. More recent studies point out that competition may be beneficial for banks' stability. Competition may increase banks' incentives to behave prudently, and not to take excessive and uncontrollable risks especially if government's bail out policy is not available.

14. The way FCCA reads the analysis from the 2008 crisis, conclusion seems to be that other factors than 'too much competition' led to the 2008 financial crisis. The crisis was result from insufficient regulation of the financial markets. Factors like loose monetary policy and weak regulatory and institutional frameworks and other regulatory failures were behind the crisis. If this standpoint is accepted, it is difficult to argue that 'less competition' should be the lesson from 2008 financial crisis.⁴ Strengthening of prudential regulation would be a more adequate response, rather than a relaxation of competition policy.

15. Finland experienced a severe banking crisis already in the 1990s. Based on that crisis, the FCCA can argue that 'softening' competition is not the right way forward. With competition, efficiency becomes a factor in the markets. When financial institutions are more efficient, they should be less vulnerable in the event of a financial crisis. This way effectiveness – through competition – should increase stability in the financial markets. A cost-efficient bank and financial institution can surely meet turbulent times in the sector with more confidence than the one which has lost its cost-effectiveness.

16. Given that Finland is part of the euro currency area, many of the new post-2008 crisis regulations are part of wider EU-level policy.⁵ This way, the new prudential

4 Previous OECD roundtables demonstrate that in countries, where financial liberalization was made without adequate changes in the regulatory and supervisory frameworks, the situation caused stability problems. This as well speaks in favour of the following policy: to promote stability in the banking sector, the best solution seems to be to design and apply better regulation, not to restrict competition in the sector.

5 For the European system of financial supervision, see eg. http://www.finanssivalvonta.fi/en/EU_Supervision/Pages/Default.aspx

regulations are not solely a national matter but part of wider EU-framework. Due to this, the powers of a national competition authority are also limited to intervene if anti-competitive prudential regulations are enacted. But even so, we can conclude that the prudential regulations of post-2008 crisis have not restricted the competition authority to enforce competition rules effectively. Policy or regulatory initiatives for ‘stronger regulation’ to improve banks’ resilience, have not hindered efficient competition policy in the Finnish financial sector.

3. Cooperation in retail banking

17. FCCA recognizes that ‘banking’ sector is made up of many diverse types of services and activities e.g. consumer lending, retail banking, wholesale banking and investment banking. All these sub-markets have unique features which may require different regulatory actions as well.

18. Retail banking is perhaps the most problematic area to promote competition. Unlike in wholesale and investment banking, in retail banking for household customers and SMEs, the geographic markets can often be local or regional. Thus, customers may have limited opportunities to acquire banking services outside their local area. Due to this, competition authorities’ special attention has often been in retail banking. That applies also to the FCCA’s priorities. In retail banking, also customers’ switching costs can prevent competition working optimally.

19. In Finland, competition authority and financial regulator have good experiences promoting competition in this area. As the following cases demonstrate, they have also had similar philosophy towards competition.

20. The first case concerned competition in payment transactions, and specifically about so-called no-discrimination rule. This rule, set by number of credit and debit card companies, prohibited retailers/merchants from charging customers a fee for paying with a credit or debit card (issued by that debit or credit card company). In some cases, the rule also prohibited retailers/merchants offering discounts for cash payments. Discounts for cash customers were prohibited even when this customer had no debit or credit card at all.

21. Both the competition authority and the financial market regulator argued against this rule. Their rationale was that the rule is a competition restraint having negative effects on payment systems’ competition process. They argued that no-discrimination rule hindered consumers to identify price differences of different payment methods and react to this information accordingly. As a result, consumers might favour ‘disadvantageous’ means of payment. The competition authority and the financial regulators lost the case. The consumer stakeholders and the courts cleared the rule on the basis that ‘no-fee-policy’ is in the interests of consumers.

22. The second case relates to an initiative in the Finnish Parliament, which aimed at setting a price cap and to regulate prices of some retail banking services. Both the competition authority and financial market regulator argued in the parliamentary hearing that price regulation is not the right tool to fix the problem of ‘excessive prices’. Rather, both authorities argued that the best way to fix the pricing ‘problem’ would be to increase competition in the markets, lower retail customers’ switching costs (to switch banks) and increase price information for customers (to make the ‘right’ switch). Here as well, competition and financial authority shared same concrete philosophy towards competition, arguing for more market-based solutions than regulatory ones.

23. Both cases demonstrate that in banking competition matters, it is not automatically a competition authority ‘versus’ financial market authority situation. Borderlines can be somewhere else, and not necessarily between competition and financial authorities.

4. Cooperation in payment systems

24. The FCCA has recently cooperated with the financial market regulators to guarantee that commitments offered to the FCCA do not have any risk factors in terms payments systems stability. In that case, Automatia Pankkiautomaatit Oy gave commitments to the FCCA to remove competition concerns that the FCCA had in terms of new mobile payment system. According to the FCCA’s preliminary assessment, the mobile payment system could have reduced the incentives of foreign payment service providers to join Automatia’s system. Consequently, this might have hindered the possibility of the customers joining the Automatia system to start using competing, Pan-European standards in the future. Automatia committed, among others, to offer interfaces that conform to the Pan-European standard. When commitment was negotiated with the FCCA and the company, the FCCA had a close cooperation also with the financial authorities so that commitments were in line with payments systems’ stability objectives.⁶

5. Challenges ahead

25. The FCCA believes that it is possible to implement both regulatory and competitive framework that delivers a financial system being both stable and efficient. It is competition that provides the necessary incentives for financial firms to maintain lower prices and to produce new innovative products. These benefits should not be sacrificed for the sake of banking stability when other, prudential tools are also available. If appropriate regulation and supervision are in place, competition does not reduce stability. It is possible to design regulatory systems which simultaneously support competition and stability objectives.

26. A well-functioning dialogue with the competition authorities and financial market regulators is important. For the competition authority, a dialogue is necessary also to ensure that any new stability regulations are consistent with a robust competition policy.

27. New innovations in the banking sector like mobile payments, other new FinTech products and entry of non-banking service providers will be a challenge also for the co-operation between financial regulator and competition authorities. For instance, market operators offering new innovative ‘banking’ services may not hold a banking license at all. Competition authorities, that normally want to safeguard that new innovations can enter into markets to challenge the incumbents, can in this scenario face tough questions about the regulatory level playing field. An open and honest co-operation between competition authorities and financial market regulators is central to meet these challenges.

⁶ For more details, see press release 19th June,2017 (<https://www.kkv.fi/en/current-issues/press-releases/2017/19.6.-fccca-decision-increases-competition-on-the-payment-market/>)