

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

COMPETITION AND FINANCIAL MARKETS

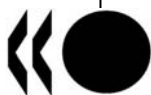
Roundtable 1 on Principles: Financial Sector Conditions and Competition Policy

-- Note by Chile --

This note is submitted by Chile to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 16 - 18 February 2009.

JT03259443

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FINANCIAL SECTOR CONDITIONS AND COMPETITION POLICY

-- Contribution by Chile --

1. How are financial markets distinct from other types of markets?

1. An economy's financial sector is the set of institutions, services and instruments involved in the transference of financial assets and their inherent risks, among economic agents.

2. Since the financial sector embraces money in all of its forms and functions, it is normally referred to as a macroeconomic matter, and treated as such by governments. However, important micro considerations are usually at the centre of the public discussion on the working of the system.

3. Financial markets differ from other markets in several, subtle ways. In particular, they provide the economy with mediums of payments, and generate the mechanisms and instruments that act as a vehicle for savings, deposits and the raising of funds from the public. Yet in this very function lies the intrinsic vulnerability of the sector and of the entire economy thereof: a run on bank deposits for instance – a simultaneous withdrawal–, can render banks insolvent and eventually in default, which would severely impair the economy's payment system.

4. In order to minimize those and other risks, several solutions have been implemented. Needless to say, the first one is the setting up of a sectoral, specialized government supervisor whose regulations actually aim at cautioning the public resources at risk. This is so precisely because of the additional solutions implemented, namely, that the State takes upon itself part of the banking risks by acting, on the one hand, as a provider of deposits insurance, and on the other as a lender of last resort. This in turn entails a risk of abuse or moral hazard arising from the fact that, given the insurance, its beneficiaries (banks and lenders alike) have fewer incentives to prevent the loss occurrence. The government, therefore, charges the banks a number of “deductibles” that are implicit in its regulations.

5. As far as the financial sector is concerned, neither economies of scale –that can be very large– nor natural entry barriers account for a non competitive situation. Yet some situations can arise as the result of the possession of a particular resource, none other than information, at the extent it may be monopolized.

6. Market failures in the financial sector are mainly related to information asymmetries, which allow the privileged side the possibility of operating to the detriment of the other party. This is particularly so if one considers securities markets, a sub-set of the financial sector, since they have no physical nature and so are not directly or immediately assessable by the buyer, who pays for the future delivery of an income flow.

7. The lack of perfect or symmetrical information makes for the market's unpredictability, which translates as risk and /or uncertainty. This is why financial regulation points towards minimizing risks and information asymmetries and their subsequent possibility of fraud, to which said market is so susceptible.

2. In what way might competition policy treat financial institutions and products differently as a result of these differences?

8. Because of the above mentioned particularities, competition policy usually takes a secondary place regarding other regulation goals. Governments generally relegate or even exclude competition policy from their governance of financial markets.

9. However, when allowed to intervene, competition authorities should assess the expected costs and benefits of their interventions.¹ This requires high standards of technical analysis and a great deal of commitment to the technical analysis of this sector, and the allocation of resources, that some small authorities may not always be in condition to assume.

10. In the case of Chile the banking sector is regulated by the Central Bank and by the Superintendence of Banks and Financial Institutions, two agencies that are well resourced and that have developed highly technical teams. In principle, competition authorities can intervene in this sector like in any other, with no specific limitation or exception. Yet the presence of these strong sector regulators undoubtedly makes a difference with respect to other -non regulated- sectors.

11. First, it is possible –and often the case- that the sector specific regulations observe standard competition goals. Yet it is always required that competition authorities advocate for competition goals to be considered a priority by sector regulators, and it is paramount to develop technical skills in order to conduct the necessary analysis at the required standards.

12. There are certain cases in which, although in compliance with the sector regulations, the conduct of financial agents could be at odds with competition law. The competition system will then have to pursue enforcement actions. Some actions are also triggered by mergers that sector regulators may have previously reviewed in the light of their regulations. The following section presents a brief on a number of enforcement cases.

3. Some recent cases in competition enforcement in the Chilean financial sector

3.1 Decisions 1073/ 1999 and 1078/ 1999; Rulings 556/ 2000 and 647/ 2002: Stock Exchanges' fees.

3.1.1 Key facts

13. A regional Stock Exchange accused the country's main stock exchange of charging fees on inter-Exchanges operations

- Relevant market: Inter-Stock Exchanges operations.
- Trial outcome: Accused convicted. Fees charged on another Exchange's brokers are uncompetitive and must be eliminated.
- Appeals: Dismissed.

¹ OECD has issued a set of recommendations concerning the competition authorities' relationship with other regulators, which are applicable in this matter.

3.1.2 *Key elements of the decision*

14. According to the *Comisión Resolutiva*,² those fees distorted the market and raised higher entry barriers for emerging exchanges. Besides, they discouraged arbitrage among Exchanges and differentiated markets that —because of their very nature— had to be unified.

3.2 ***Ruling 639/ 02: Banking merger***

3.2.1 *Key facts*

15. Two Congressmen and the *Fiscalía Nacional Económica*³ objected the acquisition of a main Chilean bank by a large Spanish bank.

- Relevant market: Banking loans
- Trial outcome: Charges dismissed.
- Appeals: No.

3.2.2 *Key elements of the decision*

16. No evidence was found in the relevant market that the behaviour of two banks under the same holding would entail the exclusion of current or potential competitors, neither of price increases or widening of banking spreads. Furthermore, barriers to entry to the relevant market had been decreased, thus reducing the risk of abuse of any dominant position that might be achieved. Restrictions to capital inflows had also been eliminated, thus favouring the raising of fresh funds by incumbent banks. Therefore, the joint control of both banks did not bring about concerns, of a significant risk for competition.

17. However, the bank regulator was ordered to check the interest rates charged by the banks engaged in the operation, particularly in the districts and regions where one or both banks reached a market share above 50%.

3.3 ***Ruling 656/ 02 and 666/02, Information by Commercial Creditors***

3.3.1 *Key facts*

18. The *Comisión Resolutiva* was requested to issue general standards on the information to be disclosed by non banking creditors (retailers) to its targeted customers.

- Relevant market: Credit card issuance by department stores and other retailers.

3.3.2 *Key elements of the decision*

19. Creditors (“lenders”) addressed to by the rulings were ordered to determine on a daily basis the effective interest rates that were to be charged as well as any other charges that could affect the borrowers throughout the credit period, and to inform their customers of such charges.

² This Commission preceded the Competition Tribunal, which is the decisional body since April 2004.

³ The Investigative Agency.

20. This decision came to be particularly important for it was used as a basis in the elaboration of sector's and consumer's regulations.

3.4 *Ruling 704/ 03: Competition Agency vs. Department Stores, on Credit Cards*

3.4.1 Key facts

21. During the 2002 Christmas season, three large department stores refused to accept payments with banking cards that were allowing cardholders to pay in three instalments with no interest. The competition agency accused the stores of abusing their market power, on the grounds of the actual integration of their retail and credit businesses. Relevant market: retail sales payable with credit cards.

- Trial outcome: each department store was fined US\$ 181,000.
- Appeals: Yes. The Supreme Court sustained the *Comisión Resolutiva's* ruling.

3.4.2 Key elements of the decision

22. Evidence gathered showed that between 65-75 % of department stores' sales was paid by means of credit cards of their own issuance, largely surpassing the use of banking cards in those sales. The joint refusal by said stores to accept banking cards constituted an abuse of their respective dominant positions, with the aim of protecting their own credit business.

3.5 *Decision 1270/ 03, and Ruling 29/ 05: Competition Agency vs. Banking Credit Card Administrator*

3.5.1 Key facts

23. Transbank is an outsourcing firm for the management of banking credit cards. In this role, during 2001 and 2002 the firm acted as a monopolist to the trading stores accepting payments and as a monopsonist to the supplier of computer facilities for its business. It was accused, moreover, of imposing a discriminatory tariffs structure to card issuers.

- Relevant market: the management and operation of bank credit cards.
- Trial outcome: Defendant pronounced guilty.
- Appeals: None. The case went on until an agreement was reached between the firm and the Commission, whereby the former was required to engage in fair practices toward its customers.

3.5.2 Key elements of the decision

24. The trial started before the former Competition decisional bodies and ended before the Competition Tribunal with a partial settlement between the firm and the Fiscalía Nacional Económica that provided for the reduction of the operation fees of debit and credit cards. Moreover, the Competition Tribunal imposed the firm a fine of approximately US\$60.000. Finally, the Competition Tribunal decided over the issues which the parties did not agree upon.

3.6 Ruling 719/ 03, Risk Rating Agencies' Merging, 2003: Amendment Advised to the Securities Law

3.6.1 Key facts

25. An insurance company complained that the merging of two risk rating firms was to give rise to the largest, clearly dominant rating agency in the country.

- Relevant market: Risk ratings for corporate bonds.
- Trial outcome: Charges dismissed
- Appeals: No.

3.6.2 Key elements of the decision

26. No evidence was found of either concentration or entrance barriers in the relevant market. Competition authorities, however, remarked that the Securities Law made it mandatory for risk rating firms to display and permanently hold a capital equal to or exceeding the equivalent of US \$ 166,000 as of December 2008. Currently, this directive is no longer justified, professional proficiency and competition being the key elements to ensure safety and trust in the relevant market. Consequently, the competition authority requested the government to consider the elimination, or at least reduction, of that amount, a proposal not agreed upon so far.

3.7 Ruling 15 / 05, Consumers Association vs. Banking Association

3.7.1 Key facts

27. The National Consumers Association accused the Banking Association of anticompetitive behaviour consisting of price agreements, collusion in the determination of the banking interest rate and transparency failures when charging interests, commissions and other items.

- Relevant market: The banking system
- Trial outcome: Allegation dismissed
- Appeals: No.

3.7.2 Key elements of the decision

28. Evidence gathered was deemed insufficient to prove any of the behaviours attributed to the defendant.

3.8 Ruling 63 / 08, Bank vs. Retailers' Credit Cards

3.8.1 Key facts

29. In 2006 two large department stores put undue pressure on their suppliers of electronic household appliances in order for them to resign their participation in a commercial fair organized by a major Chilean bank, thus precluding the fair's achievement.

- **Relevant market:** The distribution and retail sale of electronic household appliances and the related market of credit cards.
- **Trial outcome:** The two defendants were fined the equivalent of US\$ 6 million and US\$ 3.6 million respectively, grounded on collusion and abuse of their dominant positions.
- **Appeals:** Yes, before the Supreme Court, which upheld the Competition Tribunal's ruling, although reducing the total fine in one third.

3.8.2 *Key elements of the decision*

30. With the purpose of making a strong collusion case, apart from plaintiff and defendants' CEOs depositions, telephonic records and e-mail communications were used as evidence, which was an innovation in the Chilean investigative procedures. In determining the amount of the fines, two facts, among others, were considered: first, that the defendants were second time offenders (see Ruling 704 /03 above) and then the seriousness of the conduct incurred.