



POLICY ROUNDTABLES

Enhancing the Role of Competition in Regulation of Banks

1998

Introduction

The OECD Competition Committee the role of competition in the regulation of banks in February 1998. This document includes an executive summary and submissions from Australia, Austria, Canada, the Czech Republic, Denmark, the European Commission, Finland, France, Germany, Greece, Hungary, Italy, Japan, Mexico, Norway, Poland, the Slovak Republic, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States, as well as an aide-memoire of the discussion.

Overview

The banking sector is one of the most closely regulated sectors of OECD economies. A reason advanced for this close regulation is that small depositors cannot compare risks (or have no incentive to do so, because of deposit insurance), so competition would lead banks to take excessive risks. Controls on risk taking are considered essential to ensure that competition between banks promotes efficient outcomes. Public policy concerns focus on how bank failures could affect small depositors, the payments system and the stability of the financial system as a whole. The goal of promoting or preserving competition might conflict with some actions to deal with bank failures, emergency measures or state aid for failing banks or implicit state support for large banks.

In most OECD countries bank regulators and competition authorities are jointly responsible for bank mergers, so interaction and coordination between them are necessary. Because of the political and economic sensitivity of the banking sector, it is perhaps not surprising that some countries apply special competition regimes to it.

Related Topics

OECD Council Recommendation on Merger Review (2005)
Mergers in Financial Services (2000)
Relationship between Regulators and Competition Authorities (1998)
Failing Firm Defense (1995)

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**DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS
COMMITTEE ON COMPETITION LAW AND POLICY**

ENHANCING THE ROLE OF COMPETITION IN THE REGULATION OF BANKS

68810

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FOREWORD

This document comprises proceedings in the original languages of a Roundtable on Enhancing the Role of Competition in the Regulation of Banks which was held by the Working Party n°2 of the Committee on Competition Law and Policy in February 1998.

This compilation, which is one of several published in a series named “Competition Policy Roundtables”, is issued to bring information on this topic to the attention of a wider audience.

PRÉFACE

Ce document rassemble la documentation dans la langue d’origine dans laquelle elle a été soumise, relative à une table ronde sur le renforcement du rôle de la concurrence dans la réglementation du secteur bancaire qui s’est tenue en février 1998 dans le cadre du Groupe de travail n° 2 du Comité du droit et de la politique de la concurrence.

Cette compilation qui fait partie de la série intitulée “les tables rondes sur la politique de la concurrence” est diffusée pour porter à la connaissance d’un large public, les éléments d’information qui ont été réunis à cette occasion.

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EXECUTIVE SUMMARY

Note by the Secretariat

In the light of the country submissions and the oral discussion, the following points emerge:

- *The last two decades have witnessed a significant change in banking regulation. On the one hand, there has been a substantial relaxation in certain regulations such as direct controls on interest rates, fees and commissions, as well as restrictions on lines of business, ownership and portfolios. On the other hand, there has been a strengthening of prudential regulation focused on controls on the capital or “own funds” of banks and an expansion of the number and coverage of deposit insurance schemes. A few countries retain regulations which may restrict competition and are no longer viewed as necessary from a prudential perspective.*

All countries reported significant deregulatory moves in the banking sector. Concurrent with these deregulatory moves, however, were actions to strengthen, or at least harmonise, prudential regulation and, in many cases, to introduce or extend the coverage of deposit insurance.

Although the vast majority of countries have removed controls on interest rates, fees and commissions there remain a few minor exceptions¹. Those countries which still maintain strict line of business restrictions are taking steps to relax these controls.

Although there is a trend towards allowing banks discretion over the contents of their portfolio of assets (in order to assist diversification and risk-reduction) some countries retain quantitative limits on the type or geographical location of assets in which the bank can invest. Certain broad restrictions, such as limits on lending to a single counter-party, are still viewed as necessary.

Most countries have abolished reserve requirements, on the grounds that they are no longer considered essential for carrying out monetary policy. Requirements to hold government securities are typically unnecessary from a prudential perspective and in some cases are little more than revenue-raising measures. In a few countries reserve requirements (and other residual regulations) are not applied in a competitively-neutral manner.

Although all OECD countries regulate entry to the industry, this appears to be primarily as a tool of prudential regulation and is, generally speaking, not used as a mechanism for constraining entry in order to preserve bank profitability. Some countries require, as a condition for licensing, that a new bank demonstrate how it will make a contribution to the existing market environment. In others, regulatory requirements are stiffer for new firms than for incumbents.

In general, trade liberalisation trends (e.g., due to the OECD, WTO, EC and NAFTA) have opened banking markets to foreign firms, through freedom of establishment or cross-border trading. Certain restrictions remain (such as the limit on foreign bank market shares in Mexico).

- *Bank regulation, like other forms of regulation, is justified as necessary to correct a “market failure”. In the case of banks, the market failure arises from the difficulty for banks to credibly demonstrate their level of risk to depositors and other lenders. It is argued that, as a result, in the absence of regulatory intervention, banks would take on more risk than is prudent, bank failures would be more common than is necessary and the financial system would be unstable. In some countries bank regulation may also be separately justified on the grounds of being necessary to protect depositors from the consequences of bank failure or necessary to preserve the stability of the payments system.*

Public policy concerns arise from the combination of liabilities and assets that banks choose to hold (banks are largely funded with short-term debt but hold as assets illiquid, long-term loans) and the lack of transparency over a typical bank’s risk profile. If banks could credibly communicate their risk profile to depositors, riskier banks would (in the absence of deposit insurance) expect to pay a premium to attract funds. The desire to minimise borrowing costs would provide an incentive to bank managers to maintain risk-management procedures. It is argued that banks cannot credibly communicate their risk profile to depositors. As a result banks do not have to compensate depositors for increasing their risk and the desire to maximise profits pushes managers to increase returns even when that implies an increase in risk.² Furthermore, it is argued, the financial system is unstable in that depositors may at any time lose confidence and seek to withdraw their funds to cash. This would lead to the failure of a large number of banks and would cause significant disruption in the real economy. Since such a run on the banking system as a whole could be triggered by the failure of any one bank, the risk-taking by banks has an “external” effect in that it threatens all the other banks. Whether, in fact, depositors are able to distinguish sound from unsound banks has not yet been firmly established empirically.

Some arguments for bank regulation hinge upon the role of banks in the payments system. Under conventional payments systems, banks can build up large exposures to one another during a trading day, which are settled at the end of the day. The failure of one bank to settle could, it is argued, have significant “knock-on” consequences for other banks, even other healthy banks. As a consequence, it is argued that access to payments systems should be restricted to carefully regulated institutions. Many countries are currently implementing so-called “real-time” payments systems which eliminate the build-up of exposures through the day.

In some contexts, it appears that bank regulation arises simply from the desire to protect depositors from loss in the event of the insolvency of their bank.

- *Whether or not this market failure is important, certain regulatory interventions in this sector cause banks to take on more risk than is prudent. In particular, most deposit insurance schemes and other government policies such as “too big to fail” insulate the depositor from the need to be aware of the financial condition of their bank and, in the absence of other interventions, encourage risk-taking. Offsetting these drawbacks, these schemes may have the advantage that they reduce systemic risk.*

In many cases whether or not banks would, in the absence of other interventions, adopt a prudent level of risk is an irrelevant question as the presence of certain interventions have a tendency to cause banks to take on more risk than is prudent.

The most common example is the typical flat-rate deposit insurance scheme, which compensates depositors (in whole or in part) in the event of insolvency. A consequence of the insurance is that

deposits are largely risk free from the viewpoint of depositors. Since banks do not need to compensate depositors for their risk, they have access to a pool of funds independent of the risk that they take on. In the absence of other restrictions, competition between banks would lead banks to take on higher risk in search for higher returns. In principle, these incentives would be reduced or eliminated if the insurance premium for the deposit insurance properly reflected the risk faced by the bank. In practice, relatively few countries implement a risk-based premium. Another alternative is to limit the insurance coverage so that depositors retain some risk of loss.

In a few countries the deposit insurance is not applied in a competitively-neutral manner. In these countries the deposit insurance premium varies between banks in a manner that is unrelated to the risk of the bank.

Deposit insurance may have certain advantages. In the presence of the market failure discussed above, deposit insurance addresses one of the two symptoms of that market failure. Although deposit insurance does not enhance the incentives on banks to behave in a prudent manner, deposit insurance reduces the likelihood of a generalised loss of confidence in the banking system.

- *In general, insolvent banks should be allowed to fail. Policies which prevent banks from exiting from the marketplace in the normal manner will distort competition. Policies which seek to prevent bank failures may also deter entry into the industry. The use of the statutory powers of the state to assist a failing bank may constitute a form of “state aid” which may likewise distort competition.*

In some countries there is an expectation that certain banks will not be allowed to fail. To the extent that depositors in these banks consider that their deposits will be protected, they are insulated from risk and, once again, the bank may be induced to take on higher risk than is prudent. Furthermore, if such a policy favours certain banks in the market place (such as large banks over small banks, or domestic banks over foreign banks) it is also likely to distort competition. A policy of “too big to fail” is an example of such a policy which is likely to favour large (and possibly domestic) banks over other banks.

The direct or indirect use of public funds to support failing banks (such as those which are too big to fail) is a form of public subsidy which may also distort competition. Such subsidies, in the case of the EC, may violate the Treaty of Rome. The EC notes: “State aid for rescuing or restructuring firms in difficulty, in particular, tend to distort competition and affect trade between Member States. This is because they affect the allocation of economic resources, providing subsidies to firms which in a normal market situation would disappear or have to carry out thorough restructuring measures. Aid may, therefore, impede or slow down the structural adjustment...”. The lifting of certain regulatory restrictions for a bank in difficulty is another example of a form of subsidy which may distort competition.

In some circumstances deposit insurance, by increasing the political acceptability of allowing a bank to fail and by applying in a competitively neutral manner, may both “level the playing field” between banks and may eliminate the need to adopt other less desirable forms of aid for failing banks.

- *In some countries the state is directly involved in the banking sector, either through ownership or through the provision of state guarantees to certain banks. In a few countries banks are also tools for the implementation of social objectives.*

In several countries, the state retains a direct ownership interest in the banking sector. The competition effects of state-ownership may be further complicated in the banking sector by a desire to use the ownership interest to pursue banking sector objectives such as the stability of the banking system and to protect depositors. As the EC notes: "State interventions into State-owned banks have often been proved to fulfil more a public goal (maintenance of the entity for social or political reasons) than a private one (return on investment). The goal of defending the conditions for a levelling of the playing field has been too often set aside. This typically generates a vicious circle of insufficient restructuring, repetition of aid and therefore excessive aid and insufficient compensation to competitors. The confusion of roles of the State becomes apparent. ... where the State is the main shareholder of the bank in crisis, its role as shareholder must be separated from its role as the supervisory authority required to safeguard confidence in the banking system. This latter task may lead the State to take measures in support of the bank that are additional to what is really necessary to restore the bank's viability. If we want to assure a level playing field between private and public banks, no different treatment should be allowed between private and public banks."

In some countries certain banks receive state guarantees from national, regional or city governments. Unless these banks are charged a fee for this service (or, more precisely, an appropriate insurance premium based on the risk of the bank) competition will be distorted with other private banks.

In some countries banks serve certain social objectives (such as the directing of credit towards favoured sectors or the promotion of new enterprises). Such social objectives, through a lack of transparency and cross-subsidisation from the public obligations to the competitive business may distort competition.

- *In most countries risk-taking by banks is controlled through controls on the capital or "own funds" of banks, typically following the Core Principles established by the Basle Committee. Under more recent developments the regulatory capital requirements on banks are determined by more sophisticated "in-house" models of banks' risks.*

Recent regulatory reform efforts in the banking sector have tended to focus on enhancing capital requirements for banks. These establish a minimum level of "equity" or "own funds" for banks which provide both a buffer against adverse shocks and enhance the incentives on shareholders to act prudently. In principle the level of regulatory capital should depend upon the risk of the bank which depends in turn, on the portfolio of loans and other assets and liabilities held by the bank. Under the Core Principles advocated by the Basle Committee the loans of banks are grouped into different classes. Banks must hold a different amount of capital for the different classes of loans, varying from zero per cent in the case of loans to governments, to eight per cent in the case of normal commercial lending. This approach, although an advance on earlier practices, has been criticised, in part for not taking account of other forms of risk, such as the risks arising from the portfolio of assets traded by the bank. Partly in response to these criticisms the Basle Committee has extended the original Core Principles. For example the Committee has recently accepted the use of bank's own "in-house" models of the bank's overall risk to determine the level of regulatory capital to be applied to the bank.

- *Many countries seek to facilitate monitoring by depositors through regulatory disclosure requirements. There also appears to be a increasing focus upon enhancing the corporate governance of banks.*

Some countries require banks to publicly disclose certain information to customers. Where the customers have some incentive to take note of this information (i.e., where they bear some of the risk of loss, because they are not fully insured) the availability of information on the risk of a bank can enhance the incentives on banks to minimise their overall risk. Although information typically plays a secondary role in the regulatory regime of most countries, it plays a primary role in the case of one country (New Zealand) where there is no deposit insurance protecting depositors.

There is a trend towards increased focus on the corporate governance of banks and placing more responsibility directly on bank directors and managers.³ In contrast to this trend, many countries reported that they enforce a dispersed shareholding of banks by limits on the size of the shareholding of any one shareholder.

- *Virtually all OECD countries appear to apply national competition law to the banking sector without exception or exemption. In most countries, the competition law is enforced by the competition authority, although in a few, competition law is enforced by the banking regulator. In virtually every country, major structural changes in the banking sector (i.e., mergers and acquisitions) fall under the jurisdiction of both the banking regulators and the competition authority, giving rise to a need for some mechanism for resolving possibly conflicting regulatory decisions.*

Most countries reported that the national competition law applies to the banking sector. A few countries reported that there are specific rules which govern how the general competition laws are applied in this sector. In some cases the competition law itself contained specific restrictions applying to this sector (such as ownership restrictions) that were, in other cases, contained in the banking law. In most countries the objective of “stability” of the banking sector is placed alongside the objective of enhancing competition. Thus, in most countries, the banking supervisors are involved in decisions involving mergers. This gives rise for a need to establish co-ordination, consultation and (possibly) dispute resolution procedures, in the event of differing decisions.

In at least one country competition law enforcement is carried out by the banking regulator. For most countries it appears that the economies of specialisation in competition enforcement outweigh the advantages of detailed industry knowledge, so that competition enforcement in banking is made the responsibility of the competition authority.

- *Nearly all OECD countries are currently experiencing a large number of mergers in the financial sector which are likely to be, in part, a response to recent deregulation and trade liberalisation trends. Although some jurisdictions have, in the past, adopted a “cluster market” approach, the present trend appears to be to define separate product and geographic markets for each of a bank’s important services. Most countries noted that Internet and telephone banking had yet to make a significant impact on market definition issues.*

The important developments in deregulation and trade liberalisation have both enabled banks to expand geographically and across product lines and have simultaneously enhanced the incentives to do so in order to exploit economies of scale and scope.

The consensus of the roundtable is that the geographic scope of markets may be quite different for different banking products and therefore there is a tendency to reject the cluster market approach. There was some consensus that greatest competition concerns focus on the market for the provision of banking services to small businesses. Although most countries noted the existence of telephone and/or Internet banking, this has not yet progressed to the extent that the relevant markets are national (or international) in scope. Australia notes that: "A number of problems are still associated with, for example, Internet banking, that limit its effectiveness as a constraint on the activities of the firms in the various markets. Internet security issues that have not yet been settled, and customer perceptions of security, are significant hurdles yet to be overcome; international specification for authentication of electronic transactions has not yet been endorsed by the relevant authorities; and at present, existing Internet sites are generally promotional."

- *Banks seek to enter co-operative arrangements with other banks for a variety of reasons, many of which may give rise to competition concerns. Some countries noted competition concerns associated with bank distribution of insurance products.*

A partial list of the reasons for entering into co-operative arrangements would include the following:

- the interconnection of networks (such as networks of Automatic Teller Machines, EFTPOS networks);
- the operation of international credit card systems or national debit transfer systems;
- the operation of payments clearing systems;
- the establishment of a system for the joint maintenance of a database of the credit history of consumers;
- joint development and promotion of new products (e.g., Banksys / Belgacom smart card);

In some cases the co-operative arrangements would have natural monopoly characteristics. These would, in turn, give rise to concerns over foreclosure of entrants and the need for mechanisms for guaranteeing access. Where a bank, as a result of its large retail base, has a dominant position in a local area, an exclusive dealing arrangement with a particular insurer may foreclose entry by other insurers and therefore may give rise to competition concerns.

NOTES

- 1 The exceptions include the prohibition on interest on cheque accounts in France and Japan. In some countries ceilings on interest rates result from usury laws.
- 2 Banks increase risk, in part, by increasing the debt/equity ratio. In other words, the market failure makes debt (especially debt in the form of deposits) preferred over equity. This is reflected in the view in the industry that “capital is expensive”.
- 3 The New Zealand government has sought to enhance the incentives on directors and managers of banks by making them certify the truth of information contained in disclosure statements and testify that the bank has an adequate risk management system in place.

SYNTHESE

Note du Secrétariat

Les communications des pays et les délibérations font apparaître les points suivants :

- *On a assisté ces vingt dernières années à une sensible évolution de la réglementation bancaire. D'une part, il s'est produit un considérable assouplissement de certaines réglementations telles que les contrôles directs des taux d'intérêt, des frais et des commissions ou les restrictions concernant certains types d'activités, les participations au capital et les portefeuilles. Par ailleurs, est intervenu un renforcement des règles prudentielles privilégiant les contrôles du capital social ou des "fonds propres" des banques et une extension du nombre et de la couverture des systèmes d'assurance des dépôts. Quelques pays maintiennent des réglementations susceptibles de restreindre la concurrence qui ne paraissent plus nécessaires d'un point de vue prudentiel.*

Tous les pays ont signalé d'importantes mesures de déréglementation du secteur bancaire. Cependant, des initiatives ont simultanément été prises pour renforcer, ou du moins harmoniser, les règles prudentielles et, dans bien des cas, pour instituer l'assurance des dépôts ou en étendre la couverture.

Bien que la grande majorité des pays aient supprimé les contrôles des taux d'intérêt, des frais et des commissions, il subsiste quelques exceptions mineures¹. Les pays qui maintiennent encore de strictes restrictions concernant les types d'activité sont en train de prendre des mesures pour assouplir ces contrôles.

Malgré la tendance à laisser les banques décider librement de la composition de leur portefeuille d'actifs (afin de favoriser la diversification et la réduction des risques), quelques pays continuent à imposer certaines limites quantitatives concernant le type ou l'emplacement géographique des actifs dans lesquels elles peuvent investir. Certaines restrictions générales telles que le plafonnement des prêts pouvant être accordés à un seul bénéficiaire sont encore jugées nécessaires.

La plupart des pays ont aboli les réserves obligatoires au motif qu'elles ne paraissent plus indispensables à la mise en œuvre de la politique monétaire. L'obligation de détenir des effets publics est le plus souvent superflue d'un point de vue prudentiel et ne constitue parfois guère plus qu'un moyen pour l'État de se procurer des recettes. Dans un petit nombre de pays, l'application des réglementations relatives aux réserves obligatoires (ou d'autres réglementations résiduelles) n'est pas neutre du point de vue de la concurrence.

Bien que tous les pays de l'OCDE réglementent l'accès au secteur, il s'agit là essentiellement d'une règle prudentielle et non, de façon générale, d'un moyen d'en restreindre l'accès pour préserver la rentabilité des banques. Certains pays posent comme condition à l'agrément qu'une nouvelle banque montre en quoi elle contribuera à améliorer l'environnement existant sur le marché. D'autres imposent des obligations réglementaires plus strictes aux nouvelles entreprises qu'à celles déjà en place.

En général, les tendances à la libéralisation des échanges (par exemple au sein de l'OCDE, de l'OMC, de la CE et de l'ALENA) ont ouvert les marchés bancaires aux entreprises étrangères, au travers de la liberté d'établissement ou des échanges transfrontières. Certaines restrictions demeurent (telles que le plafonnement des parts de marché des banques étrangères au Mexique).

- *La réglementation bancaire, comme les autres formes de réglementation, est justifiée par la nécessité de corriger un "dysfonctionnement du marché". Dans le cas des banques, ce dysfonctionnement du marché résulte de la difficulté qu'elles ont à démontrer de façon crédible leur niveau de risque aux déposants et aux autres bailleurs de fonds. Il est fait valoir qu'en conséquence, en l'absence d'intervention réglementaire, les banques prendraient plus de risques qu'il n'est prudent, les faillites bancaires seraient plus fréquentes qu'il n'est nécessaire et le système financier serait instable. Dans certains pays, la réglementation bancaire peut également être spécifiquement justifiée par la nécessité de protéger les déposants des conséquences des faillites bancaires ou de préserver la stabilité du système de paiements.*

Les préoccupations des pouvoirs publics résultent de la combinaison d'exigibilités et d'actifs que les banques choisissent de détenir (les banques se financent dans une large mesure par des dettes à court terme mais ont pour actifs des prêts à long terme non liquides) ainsi que du manque de transparence concernant le profil de risque des banques. Si elles pouvaient communiquer de façon crédible leur profil de risque aux déposants, les banques présentant le plus de risques s'attendraient (en l'absence d'assurance des dépôts) à devoir verser une prime pour attirer les capitaux. Le désir de réduire dans toute la mesure du possible les coûts d'emprunt inciterait les directeurs de banque à maintenir des procédures de gestion des risques. Il est fait valoir que les banques ne peuvent communiquer de façon crédible leur profil de risque aux déposants. Il en résulte qu'elles n'ont pas à offrir aux déposants une rémunération en contrepartie de l'augmentation du risque encouru et le désir de maximiser les profits pousse les directeurs de banque à accroître les profits même lorsque cela implique un plus grand risque.² Il est en outre fait valoir que le système financier est instable dans la mesure où les déposants peuvent à tout moment perdre confiance et vouloir retirer leurs fonds en espèces. Cela conduirait à la faillite d'un grand nombre de banques et causerait un important dérèglement de l'économie réelle. Étant donné qu'une telle ruée sur le système bancaire dans son ensemble peut être déclenchée par la faillite d'une seule banque, la prise de risques par les banques a un effet "externe" en ceci qu'elle menace toutes les autres banques. Il n'a pas encore été solidement établi d'un point de vue empirique si les déposants sont réellement à même de distinguer les banques saines de celles qui ne le sont pas.

Certains arguments en faveur de la réglementation bancaire reposent sur le rôle des banques dans le système de paiements. Dans le cadre des systèmes de paiements classiques, les banques peuvent accumuler en un jour d'activité d'importantes dettes mutuelles qui sont réglées à la fin de la journée. Le défaut de règlement d'une seule banque pourrait, est-il avancé, avoir d'importants effets en chaîne sur les autres banques, même celles jouissant d'une bonne santé financière. Aussi est-il fait valoir que l'accès aux systèmes de paiements devrait être restreint à des institutions soigneusement réglementées. De nombreux pays mettent actuellement en œuvre des systèmes de paiement dits "en temps réel" qui éliminent l'accumulation des dettes tout au long de la journée.

Dans certaines circonstances, il apparaît que la réglementation bancaire découle tout simplement du désir de protéger les déposants de la perte en cas d'insolvabilité de leur banque.

- *Que ce dysfonctionnement du marché soit ou non important, certaines interventions réglementaires dans ce secteur font que les banques prennent plus de risques qu'il n'est prudent. En particulier, la plupart des systèmes d'assurance des dépôts et des autres politiques gouvernementales, telles que celle qui veut que "au-delà d'une certaine taille, la faillite est hors de question", épargnent au déposant la nécessité de connaître la situation financière de sa banque et, en l'absence d'autres interventions, encouragent la prise de risque. Malgré ces inconvénients, ces systèmes peuvent présenter l'avantage de réduire le risque systémique.*

Dans bien des cas, la question de savoir si les banques adopteraient ou non un niveau de risque prudent en l'absence d'autres interventions n'a guère d'intérêt dans la mesure où certaines interventions tendent à inciter les banques à prendre plus de risques qu'il n'est prudent.

L'exemple le plus courant est celui du système d'assurance forfaitaire des dépôts typique qui indemnise (en tout ou partie) les déposants en cas d'insolvabilité. Une conséquence de l'assurance est que les dépôts sont dans une large mesure exempts de risque pour les déposants. Les banques n'ayant pas à rémunérer les déposants du risque encouru, elles ont accès à une masse de capitaux quels que soient les risques qu'elles prennent. En l'absence d'autres restrictions, la concurrence entre les banques les conduirait à prendre plus de risques pour atteindre des rendements plus élevés. Ces incitations seraient en principe réduites ou éliminées si la prime d'assurance des dépôts reflétait de façon appropriée le risque encouru par la banque. Dans la pratique, relativement peu de pays appliquent une prime calculée en fonction du risque. Une autre solution consiste à limiter la couverture de l'assurance de sorte que les déposants demeurent exposés à un certain risque de perte.

Dans un petit nombre de pays, l'assurance des dépôts n'est pas mise en œuvre de façon neutre du point de vue de la concurrence. Dans ces pays la prime d'assurance des dépôts varie selon les banques indépendamment des risques auxquels elles sont exposées.

L'assurance des dépôts peut avoir certains avantages. Face au dysfonctionnement du marché évoqué ci-dessus, l'assurance des dépôts s'attaque à l'un des deux symptômes qui en résultent. Bien que l'assurance des dépôts n'incite pas les banques à se comporter de façon plus prudente, elle réduit la probabilité d'une perte de confiance généralisée dans le système bancaire.

- *De façon générale, il faudrait laisser les banques insolubles faire faillite. Les politiques qui empêchent les banques de sortir normalement du marché fausseront la concurrence. Celles qui cherchent à éviter les faillites bancaires peuvent également dissuader l'entrée dans le secteur. L'exercice du pouvoir légal qu'a l'État d'aider une banque en faillite peut constituer une forme "d'aide publique" qui risque pareillement de fausser la concurrence.*

Dans quelques pays, on escompte qu'il ne sera pas permis que certaines banques fassent faillite. Dans la mesure où les déposants considèrent que leurs dépôts dans ces banques seront protégés, ils sont à l'abri du risque et, une fois encore, la banque peut être incitée à prendre plus de risques qu'il n'est prudent. En outre, si une telle politique favorise certaines banques sur le marché (par exemple les grandes banques par rapport aux petites, ou les banques nationales par rapport aux étrangères), elle risque également de fausser la concurrence. La politique selon laquelle "au-delà d'une certaine taille, la faillite est hors de question" est un exemple d'une telle politique susceptible de favoriser les grandes banques (et peut-être aussi les banques nationales) par rapport aux autres.

Le recours direct ou indirect aux fonds publics pour soutenir les banques en faillite (par exemple celles qui sont trop grandes pour qu'on les laisse faire faillite) constitue une forme de subvention publique qui peut également fausser la concurrence. Ces subventions peuvent, dans le cas de la CE, violer le Traité de Rome. La CE note que "L'aide de l'État pour sauver ou restructurer les entreprises en difficulté, en particulier, tend à fausser la concurrence et à affecter les échanges entre États membres. Elle affecte en effet l'allocation des ressources économiques, en subventionnant des entreprises qui dans une situation de marché normale disparaîtraient ou auraient à mettre en œuvre d'énergiques mesures de restructuration. L'aide peut, par conséquent, empêcher ou ralentir l'ajustement structurel...". La levée de certaines restrictions réglementaires accordée à une banque en difficulté est un autre exemple de subvention susceptible de fausser la concurrence.

Dans certains cas, l'assurance des dépôts, en rendant politiquement plus acceptable de laisser une banque faire faillite et à condition qu'elle soit mise en œuvre de façon neutre du point de vue de la concurrence, peut à la fois permettre une "concurrence à armes égales" entre les banques et éliminer la nécessité d'adopter d'autres formes moins souhaitables d'aide aux banques en faillite.

- *Dans certains pays, l'État intervient directement dans le secteur bancaire soit au travers de participations au capital soit en faisant bénéficier certaines banques de garanties publiques. Dans un petit nombre de pays, les banques sont également des instruments de mise en œuvre des objectifs sociaux.*

Dans plusieurs pays, l'État conserve une participation directe dans le secteur bancaire. Les effets sur la concurrence peuvent en être rendus plus complexes dans le secteur bancaire par le désir d'utiliser sa participation au capital pour poursuivre ses objectifs concernant le secteur, tels que la stabilité du système bancaire et la protection des déposants. Comme le note la CE, "Les interventions de l'État dans les banques publiques ont souvent rempli davantage un objectif public (maintien de l'entité pour des raisons politiques ou sociales) que privé (rentabilité des investissements). L'objectif consistant à défendre les conditions d'une concurrence à armes égales a trop souvent été négligé. Cela engendre d'ordinaire un cercle vicieux dans lequel une restructuration insuffisante entraîne un renouvellement de l'aide, et donc une aide excessive et une rémunération insuffisante des concurrents. La confusion des rôles de l'État devient manifeste.... lorsque l'État est le principal actionnaire de la banque en crise, son rôle en tant qu'actionnaire doit être distingué de son rôle en tant qu'autorité de surveillance nécessaire pour sauvegarder la confiance dans le système bancaire. Cette dernière fonction peut amener l'État à prendre des mesures en faveur de la banque allant au-delà de ce qui serait réellement nécessaire pour lui rendre sa viabilité. Si nous voulons assurer une concurrence à armes égales entre les banques publiques et privées, il convient de ne permettre aucune différence de traitement entre elles."

Dans quelques pays, certaines banques bénéficient de garanties publiques accordées par des administrations nationales, régionales ou municipales. À moins que ces banques ne doivent verser une commission pour ce service (ou plus exactement une prime d'assurance d'un montant suffisant calculé en fonction du risque présenté par la banque) la concurrence avec les autres banques privées sera faussée.

Dans quelques pays, les banques servent certains objectifs sociaux (telles que l'orientation du crédit vers des secteurs privilégiés ou l'incitation à la création d'entreprises). Du fait d'un manque de transparence et de la subvention croisée des activités concurrentielles par les obligations publiques, ces objectifs sociaux peuvent fausser la concurrence.

- *Dans la plupart des pays, la prise de risque par les banques est modérée au travers de contrôles de leur capital ou de leurs "fonds propres" qui se conforment généralement aux Principes fondamentaux définis par le Comité de Bâle. En vertu de développements plus récents, les exigences réglementaires en matière de fonds propres auxquelles sont soumises les banques sont déterminées par des modèles "internes" des risques bancaires plus raffinés.*

Les récents efforts de réforme réglementaire dans le secteur bancaire ont généralement été axés sur le renforcement des exigences en matière de fonds propres auxquelles doivent se conformer les banques. Ces exigences établissent un niveau minimum de "capital social" ou de "fonds propres" imposé aux banques qui permet d'amortir les chocs défavorables et incite les actionnaires à faire preuve de prudence. En principe, le ratio de fonds propres réglementaire devrait être fonction du risque pris par la banque qui dépend lui-même du portefeuille de prêts et des autres actifs et exigibilités détenus par la banque. En vertu des Principes fondamentaux préconisés par le Comité de Bâle, les prêts des banques sont groupés en différentes catégories. Les Banques doivent posséder un ratio de fonds propres variable selon les différentes catégories de prêts, dans une fourchette allant de zéro pour cent pour les concours à l'État à huit pour cent pour les prêts commerciaux normaux. Bien que constituant un progrès par rapport aux pratiques antérieures, cette approche a été critiquée, en partie parce qu'elle ne tient pas compte d'autres formes de risques, tels que ceux liés au portefeuille d'actifs négociés par la banque. En partie pour répondre à ces critiques, le Comité de Bâle a élargi ses Principes fondamentaux initiaux. Il a ainsi récemment accepté l'utilisation de modèles "internes" aux banques relatifs au risque global pris par chacune d'elles pour déterminer le ratio de fonds propres réglementaire applicable à la banque considérée.

- *De nombreux pays cherchent à faciliter le contrôle par les déposants au travers d'obligations réglementaires d'information du public. Il apparaît également que l'accent est de plus en plus mis sur l'amélioration de la bonne gestion des banques.*

Certains pays contraignent les banques à divulguer publiquement certaines informations à leurs clients. Pour peu que ceux-ci soient poussés dans quelque mesure à tenir compte de ces informations (c'est-à-dire qu'ils supportent une part du risque de perte parce qu'ils ne sont pas totalement assurés), la publication d'informations sur le risque pris par les diverses banques peut inciter davantage ces dernières à réduire autant que possible leur risque global. Bien que l'information ait d'ordinaire un rôle secondaire dans le régime réglementaire de la plupart des pays, elle joue un rôle primordial dans le cas de l'un d'entre eux (la Nouvelle-Zélande) où il n'existe pas d'assurance des dépôts pour protéger les déposants.

Il existe une tendance à mettre davantage l'accent sur la bonne gestion des banques et à accorder explicitement plus de responsabilités aux administrateurs et aux directeurs de banque.³ Contrairement à cette tendance, bien des pays ont indiqué qu'ils imposent aux banques un actionnariat dispersé en limitant la taille de la participation de chaque actionnaire.

- *Pratiquement tous les pays de l'OCDE appliquent au secteur bancaire le droit de la concurrence national sans exception ni dérogation. Dans la plupart des pays, le respect du droit de la concurrence est assuré par l'autorité responsable de la concurrence, bien que dans un petit nombre d'entre eux, il soit assuré par l'autorité chargée de la réglementation des banques. Dans pratiquement tous les pays, d'importantes évolutions structurelles du secteur bancaire (telles que les fusions et acquisitions) relèvent aussi bien de la compétence des autorités chargées de la réglementation des banques que de celle des autorités responsables de la concurrence, d'où la nécessité de quelque mécanisme permettant de résoudre d'éventuels conflits entre les décisions réglementaires.*

La plupart des pays ont indiqué que le droit de la concurrence national s'applique au secteur bancaire. Un petit nombre de pays font savoir que la façon dont les lois générales sur la concurrence s'appliquent dans ce secteur est régie par des règles spécifiques. Dans certains cas, le droit de la concurrence lui-même définit des restrictions spécifiques applicables à ce secteur (telles que celles relatives aux participations au capital) qui étaient dans d'autres cas prévues dans la législation bancaire. Dans la plupart des pays, l'objectif de "stabilité" du secteur bancaire va de pair avec celui de renforcement de la concurrence. Aussi, dans la plupart des pays, les autorités de surveillance des banques interviennent-elles dans les décisions concernant les fusions. D'où la nécessité d'instaurer des procédures de coordination, de concertation et (peut-être) de règlement des différends en cas de décisions divergentes.

Dans au moins un pays, le respect du droit de la concurrence est assuré par l'autorité chargée de la réglementation des banques. Dans la plupart des pays, il apparaît que les économies liées à la spécialisation dans cette fonction l'emportent sur les avantages d'une connaissance approfondie du secteur, de sorte que la responsabilité d'assurer le respect du droit de la concurrence dans le secteur bancaire est confiée à l'autorité chargée de la concurrence.

- *Presque tous les pays de l'OCDE connaissent actuellement un grand nombre de fusions dans le secteur financier qui sont vraisemblablement en partie une conséquence des récentes tendances à la déréglementation et à la libéralisation des échanges. Bien que certains aient adopté par le passé une approche "agrégée" du marché, la tendance actuelle paraît être à la définition de marchés géographiques et marchés de produits distincts pour chacun des services importants offerts par une banque. La plupart des pays notent que la banque par Internet ou par téléphone doit encore avoir un important impact sur les problèmes de définition des marchés.*

Les importants progrès de la déréglementation et de la libéralisation des échanges ont permis aux banques de poursuivre une politique d'expansion non seulement au plan géographique mais aussi par-delà les frontières entre les gammes de produits et ils ont dans le même temps accru les incitations à agir de la sorte pour tirer parti des économies d'échelle et de gamme.

Le consensus qui s'est dégagé de la table ronde est que l'étendue géographique des marchés peut varier sensiblement selon les produits bancaires, d'où la tendance à rejeter l'approche "agrégée" du marché. Il existe également une certaine convergence de vues sur le fait que c'est le marché des services bancaires aux petites entreprises qui suscite les plus grandes préoccupations du point de vue de la concurrence. Bien que la plupart des pays notent l'existence de banques par téléphone et/ou par Internet, leur progression n'a pas été telle que les marchés correspondants soient devenus de taille nationale (ou internationale). L'Australie note que : "Un certain nombre de problèmes demeurent liés par exemple à la banque par Internet et limitent son efficacité, restreignant de ce fait les activités des entreprises sur les divers marchés. Les problèmes de

sécurité posés par Internet qui n'ont pas encore été réglés, et l'idée que s'en font les clients, sont d'importants obstacles qui restent à surmonter ; les normes internationales d'authentification des transactions électroniques n'ont pas encore été adoptées par les autorités compétentes ; et à l'heure actuelle les sites Internet existants sont en général de nature promotionnelle. ”

- *Les banques cherchent à passer des accords de coopération avec d'autres banques pour une série de raisons dont beaucoup suscitent des inquiétudes du point de vue de la concurrence. Certains pays ont noté des préoccupations en matière de concurrence liées à la distribution de produits d'assurance par les banques.*

Une liste non exhaustive des raisons de passer des accords de coopération inclurait les éléments suivants :

- l'interconnexion des réseaux (tels que les réseaux de distributeurs automatiques de billets ou les réseaux de transfert électroniques de fonds au point de vente) ;
- la gestion des systèmes internationaux de cartes de crédit ou des systèmes nationaux de transfert de débits ;
- le fonctionnement des systèmes de compensation des paiements ;
- la mise en place d'un système pour la tenue conjointe d'une base de données sur les antécédents des consommateurs en matière de crédit ;
- le développement et la promotion en commun de nouveaux produits (tels que la carte à mémoire Banksys / Belgacom).

Dans certains cas, les accords de coopération pourraient avoir les caractéristiques d'un monopole naturel. Celles-ci risquent de susciter à leur tour des craintes de forclusion des entrants et rendre nécessaires des mécanismes pour garantir l'accès. Lorsqu'une banque jouit d'une position dominante dans une localité du fait qu'elle compte un grand nombre de déposants, un accord d'exclusivité avec un assureur peut interdire l'accès à d'autres assureurs et par conséquent entraîner des problèmes de concurrence.

NOTES

- 1 Au nombre de ces exceptions figurent l'interdiction du versement d'intérêts sur les comptes-chèques en France et au Japon. Dans certains pays, le plafonnement des taux d'intérêt est une conséquence des lois sur l'usure.
- 2 Les banques accroissent en partie leur risque en augmentant leur taux d'endettement. En d'autres termes, le dysfonctionnement du marché fait préférer la dette (en particulier sous forme de dépôts) aux fonds propres. C'est ce que reflète l'opinion du secteur selon laquelle « les capitaux propres sont chers ».
- 3 Le gouvernement néo-zélandais a cherché à accroître les incitations fournies aux administrateurs et aux directeurs de banque en leur faisant certifier la véracité des informations contenues dans les notes d'information et à attester que la banque possède un système de gestion des risques approprié.

AUSTRALIA

Why Regulate Banks?

In June 1996 the Treasurer, the Hon. Peter Costello MP, established the Financial System Inquiry. This Inquiry, headed by Mr Stan Wallis, has become commonly known as the Wallis Inquiry.

The Inquiry was charged with providing a stocktake of the results arising from financial deregulation of the Australian financial system since the early 1980s. The forces driving further change were analysed, in particular, technological development. Recommendations were made on the nature of the regulatory arrangements to ensure an efficient, responsive, competitive and flexible financial system to underpin stronger economic performance, consistent with financial stability, prudence, integrity and fairness.

Chapter 5 of the Wallis Report¹, completed in March 1997, discusses the philosophy of financial regulation. The Report observed that regulation of all markets for goods and services can be categorised according to three broad purposes:

- to ensure that markets work efficiently and competitively. Regulation for this purpose includes rules designed to promote adequate disclosure, prevent fraud or other unfair practices and prohibit anti-competitive behaviour such as collusion or monopolisation.
- to prescribe particular standards or qualities of service (or to prohibit certain goods or services). This form of more intensive regulation is restricted to areas where the consumption of goods or services carries risks, so that safety is a focus of concern. While most examples - such as food standards, prescription of medicines, and regulation of air travel - relate to physical safety, regulation may also aim to promote financial safety.
- to achieve social objectives. This includes regulation conferring subsidies on one group of consumers in preference to others. Regulations of this kind are often referred to as “community service obligations” and typically take the form of price controls.

How Are Banks Regulated?

Legislation

The principal statutes applying to the banking sector in Australia are:

- the *Banking Act 1959* assigns responsibility for prudential supervision of banks and bank depositor protection to the Reserve Bank of Australia;
- the *Banks (Shareholdings) Act 1972* (the Shareholdings Act) covers ownership and control of banks; and
- the Uniform Consumer Credit Legislation² is the consumer protection law relating to consumer loans - it applies to all financial institutions.

- Non-bank financial institutions (NBFIs) in Australia (eg. building societies and credit unions) also conduct banking business and are supervised under uniform State and Territory law. Their assets represent only five per cent of the assets of all deposit taking institutions. It is also possible for unsupervised entities to conduct some banking business under the securities provisions of the Corporations Law - e.g. money market corporations (also known as merchant banks) and finance companies.

In broad terms non-bank financial institutions are supervised in a similar manner to banks, so, our answers to the following questions concentrate on banks.

Following the Wallis Inquiry held during 1996 and 1997, the Federal Government is moving to implement a package of Financial System Reforms. These include the establishment of a new body (Australian Prudential Regulation Authority) to supervise banks and other deposit taking institutions (building societies and credit unions), insurance companies, superannuation funds and friendly societies. Relevant proposed reforms are mentioned below.

Details of the current regulatory structure are set out in Appendix C of the Wallis Inquiry Discussion Paper³.

Restrictions on branching and new entry, especially the entry of foreign firms

There are no restrictions on how many branches a bank can have in Australia. Nor are there restrictions on the location of branches.

All banks in Australia are authorised under the Banking Act and their ownership is subject to the Shareholdings Act.

The Shareholdings Act seeks to promote a wide dispersion in bank ownership. To this end, it prohibits any one shareholder, or group of related shareholders, from acquiring shareholdings in excess of 15 per cent. To acquire shareholdings above this threshold, requires an exemption from the Government and the applicant has to demonstrate that the exemption sought would be in the national interest. Such exemptions have been granted to foreign banks to enable them to establish/acquire local banking subsidiaries; for domestic banks to acquire other domestic banks; and for an insurance company to purchase a bank.

After the Financial System Reforms, the Shareholdings Act will be replaced by a single acquisitions Act which will cover banks, building societies, credit unions, insurance companies and their holding companies. The Government will retain the provisions for the need for Government approval of ownership above the 15 per cent shareholding limit. The Government will also seek to inject greater flexibility in bank ownership by relaxing restrictions on commercial companies owning banks (where there is demonstrable congruity between financial and non-financial activities) and by allowing mutual ownership of banks.

Foreign banks can apply for banking status in Australia either through locally incorporated subsidiaries or as branches. Branches are excluded from the depositor protection provisions of the Banking Act and consequently are precluded from gathering retail deposits. (Retail deposits are deposits from persons and non-corporate entities resident in Australia, where the initial deposit is less than \$A250,000.) Foreign bank applicants must establish that they are subject to adequate standards of supervision; will make a worthwhile contribution to banking services in Australia; and have an ownership structure which is generally consistent with the Shareholdings Act.

A minimum level of \$50 million of Tier one capital is required for an Australian incorporated bank. Building societies have a lower requirement (\$10 million), but credit unions do not have a minimum capital requirement, although they have to be mutually owned. There are many other avenues for those with access to only small amounts of capital to participate in the financial sector - for example mortgage managers, small-scale finance companies, financial advisers and funds managers.

Policy on minimum capital is based on the view that to provide the relatively broad range of services expected of banks requires sufficient capital to acquire the necessary expertise and technology, and to generate the required degree of confidence. It is also of considerable importance that confidence in the banking system as a whole is not undermined by the failure of small players lacking sufficient resources. While all deposit taking institutions will be subject to uniform licensing and supervisory oversight, the Australian Prudential Regulation Authority will be able to impose varying conditions (e.g. minimum capital) on the use of names under the Banking Act which will enable a distinction to be retained between the identities of banks and non-banks, while facilitating the entry to the market of small non-bank deposit taking institutions.

Any applicant for a banking authority must demonstrate a capacity for ongoing compliance with prudential requirements.

Restrictions on pricing

There are currently no statutory or regulatory controls that affect the behaviour of banks in this area.

Line-of-business restrictions and regulations on ownership linkages among financial institutions

Banks can be owned by other banks or insurance companies. There are no restrictions on banks investing in other financial institutions (although significant proposals must be referred to the Reserve Bank for comment). The Government has proposed relaxing the requirement that if one bank takes over another bank the two banks should be merged, provided prudential standards are not compromised.

Banking groups can sell the full range of financial products, but are required to undertake funds management and securitisation through subsidiaries. Where banking groups are involved in funds management or securitisation there must be clear separation between the vehicles used and the bank. Investors in a banking group's funds management or securitisation schemes must be made fully aware that their investments are subject to investment risk and do not represent deposits or other liabilities of the banking group. Banks are also allowed to sell products through non-banking organisations and to sell products of third parties subject to badging and disclosure requirements.

Banking groups are free to undertake a range of insurance activities through supervised insurance subsidiaries.

Restrictions on the portfolio of assets that banks can hold

Banks are currently required to hold an amount equal to three per cent of their Australian liabilities (excluding capital) in high quality, readily cashable assets in Australia - including notes and coins, balances with the Reserve Bank and securities issued by Australian governments.

Equity involvements by banks in non-financial businesses are permitted up to an aggregate amount equal to five per cent of a bank's Tier one capital, without prior reference to the Reserve Bank;

individual investments are generally subject to a limit equal to 0.25 per cent of Tier one capital. These limits do not apply to the equity positions of banks in “work-out” situations or as part of their trading portfolios, although the Reserve Bank monitors these closely. Banks generally are not permitted to hold substantial equity interests in non-financial entities.

There are no formal restrictions on the purchase and holding of real estate by Australian banks. Banks are normally expected, however, to restrict their real estate holdings to property required for the conduct of their banking operations.

Banks are required to ensure their credit exposures to a client or group of related clients do not exceed 30 per cent of the bank’s capital base.

Compulsory deposit insurance

There is no deposit insurance in Australia.

Restrictions on capital adequacy

Capital adequacy requirements for banks in Australia follow the capital adequacy framework produced by the Basle Committee on Banking Supervision for both market and credit risk.

Reserve requirements

Banks are required to keep with the Reserve Bank a non-callable deposit equivalent to one per cent of their liabilities (excluding capital) in Australia. Non-callable deposits do not serve any monetary policy or prudential purpose. They are essentially a revenue-raising measure for Government; the deposits receive below market rates of interest. The Government has signalled its intention to abolish non-callable deposits on 1 July 1999.

Requirements to direct credit to favoured sectors

These do not exist in Australia.

Special rules concerning liquidation, winding up, insolvency, composition etc.

A bank incorporated in Australia can be wound up like a normal company under the Corporations Law, although under depositor protection provisions of the Banking Act depositors have priority over all other creditors. Under the Banking Act, the Reserve Bank also has powers to assume control of, and carry on the business of, an Australian incorporated bank which has, or is likely to, become unable to meet its obligations.

If a foreign bank with a branch in Australia becomes unable to meet its obligations, the assets of the bank in Australia are to be available to meet the bank’s liabilities in Australia in priority to all other liabilities of the bank.

Other rules affecting co-operation within the banking sector

There is no single piece of over-arching legislation on payments clearing and settlement in Australia. While some payment instruments, particularly those which are paper-based, are governed by specific Acts of Parliament, for the most part the provision of payments clearing and settlement services in Australia is governed by contract law and other self-regulatory regimes.

The *Cheques and Payment Orders Act 1986* is the principal statute dealing with paper payment instruments in Australia. It establishes the framework under which cheques and payment orders are drawn, cleared and paid. Currently, that Act prohibits the drawing of a cheque on an institution other than a bank. Non-bank deposit-taking institutions may offer cheque account facilities to their customers, but this is currently done through cheque-issuance arrangements with a bank. In August 1997, the Government announced its intention to amend the Act in order to allow non-bank deposit-taking institutions (such as building societies and credit unions) to issue cheques in their own right.

There are no other statutory regulations governing the issue of payment instruments or access to the payments system.

Currently, the Reserve Bank, generally, has no formal responsibility for the regulation or oversight of the major payment and settlement systems in Australia. The proposed Financial System Reforms include legislating to give the Reserve Bank formal powers to regulate clearing and settlement systems. This is to be directed primarily at improving efficiency and competition in the payments system.

Industry regulation

The Reserve Bank of Australia supervises banks. It is a central bank which has responsibilities under two national statutes: the Reserve Bank Act 1959 and the Banking Act 1959.

Section 10 (1) of the Reserve Bank Act states inter alia: "It is the duty of the Board [of the Bank], within the limits of its powers, to ensure that the monetary and banking policy of the Bank ... will best contribute to (a) the stability of the currency in Australia ... and (c) the economic prosperity and welfare of the people of Australia.'

The Banking Act (Division 1A) requires the Reserve Bank to carry out prudential supervision and monitoring of banks including "the encouragement and promotion of the carrying out by banks of sound practices in relation to prudential matters'. Prudential matters in relation to a bank are defined to mean matters relating to the conduct by the bank of its affairs in such a way as to keep itself in a sound financial position and not to cause or promote instability in the Australian financial system. Division 2 of that statute requires the Bank "to exercise its powers and functions ... for the protection of the depositors of ... banks.'

The Reserve Bank is an independent statutory authority and its "Board has power to determine the policy of the Bank in relation to any matter and to take such action as is necessary to ensure that effect is given by the Bank to the policy so determined.' The Reserve Bank Act prescribes procedures if the Reserve Bank and Government have differences of opinion on questions of policy.

From 1 July 1998, subject to the passage of the necessary legislation, the prudential supervision of banks and the protection of depositors will be moved from the Reserve Bank to a new statutory authority, the Australian Prudential Regulation Authority. Responsibility for authorising banks will move from the Treasurer to the Australian Prudential Regulation Authority. The supervision of NBFIs is expected, again subject to the passage of the necessary legislation, to move to the Australian Prudential Regulation Authority from 1 July 1999.

In broad terms, the Reserve Bank's prudential policies are designed so that banks conduct their business in a sound manner and have adequate capital to cushion losses. The policies seek to constrain the level of credit, market and other risks that banks undertake. Policies are formulated in consultation with banks.

Understandings or expectations about the actions of the central bank affecting the behaviour of banks

There are public expectations of official intervention if a bank was to fail. For example the Final Report of the Wallis Inquiry notes that “the regulator will usually respond [to the financial failure of a deposit taking institution] by facilitating a takeover, merger or other reconstruction of the business. In the rare event that these options are not suitable, the regulator must arrange an orderly wind-up.’

The Reserve Bank observed in its Supplementary Submission to the Wallis Inquiry: “In a financial crisis which threatened system stability ... the threat to the real economy would be severe and the Government would probably be prepared to use the public purse to restore and maintain stability.’

The Reserve Bank, however, endeavours to ensure that banks and the public understand that no individual bank enjoys automatic support.

Inter-bank arrangements

The behaviour of banks, insofar as the payments system is concerned, is affected by decisions of the Australian Payments Clearing Association. The Association was established in 1992 as a limited liability company to manage the payments clearing system in Australia. The Association’s Board of Directors is drawn from shareholders in the payments industry, including the Reserve Bank, banks and industry bodies representing building societies and credit unions.

There are four general-purpose payments clearing systems in Australia, which are progressively being brought under the management of the Association.

These clearing systems deal with:

- cheques and other paper instruments;
- bulk electronic payments;
- consumer electronic payments (e.g. ATM - Automated Teller Machine, EFTPOS - Electronic Funds Transfer at Point of Sale); and
- large-value electronic payments.

Management of each of the four clearing systems is in the hands of an Association committee drawn from each system’s participants. The Regulations and Procedures under which the clearing systems operate are determined by the industry and three of the four have been authorised by the national competition enforcement agency, the Australian Competition and Consumer Commission (ACCC), or its predecessor; the fourth (No 3 above) is still awaiting ACCC authorisation.

There are also three other high value payment systems operating in Australia, which are not the responsibility of the Association. There are formal inter-bank agreements covering the operation of these three systems which are contractually binding upon all members of each system.

Influences on government policy making

Influences on the Government in this area are numerous: political parties, the media, bureaucracy, industry and consumer groups all take a keen interest in Government policy on banking.

State ownership

No bank in Australia is controlled by a State or the Federal Government.

Studies of the banking industry

Chapter 16 of the Wallis Report provides a stocktake of financial regulation in Australia following the report of the 1981 Australian Financial System Inquiry (Campbell Report) and discusses the cost of regulation.

In regard to the cost of regulation, the Report states that regulation involves three main costs: the direct (or infrastructure) cost of regulators, the compliance costs of those under regulation, and the allocative efficiency costs of benefits forgone.

What Particular Issues Arise for Competition Authorities in the Banking Sector?***Application of the national competition law to the banking sector***

The Commonwealth does not have legislative power with respect to state based banking. However, the various state and territory Competition Policy Reform Acts apply the Competition Code⁴ to the Crown insofar as it carries on a business, and thus to state banking.

Therefore, in effect, the competitive conduct rules in Part IV of the national competition statute, the *Trade Practices Act 1974* (TP Act), apply in full to the banking sector.

Broadly speaking, Part IV of the TP Act prohibits the following anti-competitive trade practices:

- anti-competitive agreements and exclusionary provisions, including primary and secondary boycotts (s 45);
- misuse of market power (s 46);
- exclusive dealing (s 47);
- resale price maintenance (s 48); and
- mergers which would have the effect or likely effect of substantially lessening competition in a substantial market (ss 50, 50A).

Enforcement of the competition laws in the banking sector?

The ACCC is solely responsible for the enforcement of competition laws in the banking sector, covering all competition and merger provisions. Consumer protection in the banking sector is the responsibility of both the ACCC and all State and Territory fair trading agencies.

However, the point to be made here is that there is no industry specific *competition* regulator in the banking industry.

In addition, also note that the TP Act makes provision for the right of private action by consumers in respect of the competition (and consumer protection) provisions of the TP Act.

Mergers in the Australian Banking Industry

Market Definition

The ACCC has looked at relatively few bank mergers over the past five years. The first significant bank merger, which received a lot of attention, was the Westpac Banking Corporation (WBC) acquisition of Challenge Bank Ltd in September 1995.

Westpac Banking Corporation / Challenge Bank Ltd

- In the WBC / Challenge matter, the Commission identified the product dimension of the market as being a cluster or bundle of services provided by banks to their retail customers. The cluster of services considered by the ACCC included: loans, both home mortgages and consumer credit products; deposits, especially at call but also including term deposits; and payments, especially cheques, ATM and EFTPOS access, as well as credit or debit cards.
- The importance of bank branches to retail customers lead the ACCC to conclude that the relevant geographic market in the WBC / Challenge matter was limited to the state of Western Australia.

The most recent consideration of a bank merger by the ACCC concluded in July 1997 following the announcement by Westpac Banking Corporation (WBC) to merge with the Bank of Melbourne Limited (BML).

Westpac Banking Corporation / Bank of Melbourne Limited

The ACCC identified the following separate product markets (and geographic dimensions):

1. Deposits (state)
2. Home Loans (national)
3. Personal Loans (regional)
4. Small Business Banking (state)
5. Credit Cards (state)
6. Transaction Accounts (regional)

A full competition analysis of this merger can be found on the ACCC's Internet site at: <http://www.accc.gov.au>.

Impact of Internet and Telephone Banking on Market Definition

It is argued that new distribution channels such as telephone, PC and Internet banking are making import competition much more effective, if not widening the geographic dimensions of various markets. However, a number of problems are still associated with, for example, Internet banking, that limit its effectiveness as a constraint on the activities of the firms in the various markets. Internet security issues that have not yet been settled, and customer perceptions of security, are significant hurdles yet to be

overcome; international specification for authentication of electronic transactions has not yet been endorsed by the relevant authorities; and at present, existing Internet sites are generally promotional.

Globalisation has also been identified as having changed the face of banking in Australia. For corporates this is probably the case as major corporates can raise funds in a number of ways including bypassing the bank altogether. Dis-intermediation is a significant factor in this sector of the banking market. However, the ACCC has not yet seen any evidence of the impact of globalisation on the supply of day to day banking services to retail customers in Australia. The Wallis Inquiry produced evidence that would suggest that telephone banking does not appear to have gained appreciable customer acceptance in Australia.

Trade-off between the protection of competition and the protection of stability of the banking sector

Following the release of the Wallis Report, the Treasurer announced that he retains the power to reject mergers under relevant banking and insurance laws. In exercising these powers, the Treasurer will take into account, but not be limited by, assessments by the ACCC under section 50 of the TP Act in relation to competition considerations, and the advice of the relevant prudential regulators on prudential considerations.

At that time the Government further decided that mergers among the four major banks are not permitted. The Treasurer stated that this policy will be reviewed when the Government is satisfied that competition from new and established participants in the financial industry, particularly in respect of small business lending, has increased sufficiently to allow such mergers to be considered.

Remedies for anti-competitive mergers

Where the ACCC concludes that a merger may have the effect of a substantial lessening of competition in a market, the ACCC will advise the parties of its view. The ACCC has the power, under section 80 of the TP Act, to seek a permanent injunction to restrain an anti-competitive merger.

The ACCC may also, in appropriate circumstances, accept undertakings pursuant to section 87B of the TP Act. To date, the ACCC has accepted undertakings from parties to ensure that the merger will not proceed until the ACCC has had the opportunity to make appropriate inquiries; or to resolve matters where the proposed merger is likely to contravene the TP Act. The ACCC is likely to look favourably on proposed undertakings which are able to address structural issues in the relevant markets. Structural solutions (as opposed to behavioural ones) provide an ongoing basis for the operation of competition markets. Further, the regulatory costs are one-off, rather than a permanent burden.

An alternative course of action for parties, if appropriate, is to seek authorisation for the merger under section 88 of the TP Act. Authorisation can be used to grant immunity from legal proceedings, on the grounds of public benefit, to acquisitions and mergers which would or might otherwise contravene section 50 (the mergers provision) of the TP Act.

Case Study: Section 87B Undertakings accepted in the Westpac / Bank of Melbourne merger

In this merger case, the ACCC concluded that there was a significant risk of the exercise of co-ordinated market power in the transaction accounts market in Victoria post-merger.

The ACCC saw it as appropriate that the remedy adopted be both necessary and sufficient to rectify the competition problem created by the merger. The ACCC concluded that s 87B undertakings

would preserve the benefits of convenient, low-cost transaction account banking currently enjoyed by BML transaction account customers for a reasonable time and, in conjunction with local management autonomy and electronic network access arrangements would remedy the likely substantial lessening of competition flowing from the merger in the market for transaction accounts in the State of Victoria.

The undertakings make specific provisions, for a period of three years post-merger, in relation to the level of autonomy of the Victorian management of the merged entity in respect of its Victorian operations and the access arrangements to Westpac's electronic networks.

While the ACCC formed the view that competition was likely to be substantially lessened in the Victorian transaction accounts market, the parties proffered undertakings under s 87B of the TP ACT that sufficiently alleviated the ACCC's concerns in that regard. Consequently, the ACCC decided not to oppose the merger between Westpac Banking Corporation and the Bank of Melbourne.

Collusive arrangements in the banking industry

The ACCC has, on several occasions, received complaints about collusion in the banking industry, particularly in relation to collusion by Australia's four major trading banks on their rates of interest on both deposits and loans.

While the ACCC has investigated such complaints, the ACCC has never had sufficient evidence to support any such allegations of collusion.

Abuse of dominance or vertical arrangements raising competition concerns

There have been no cases of misuse of market power or abuse of vertical arrangements taken in the banking industry in Australia.

Further, issues of vertical integration have not played a material role in the ACCC's consideration of any bank mergers investigated over the past five years.

NOTES

- 1 Financial System Inquiry (FSI) Final Report (Wallis Report), March 1997, pp 177 - 197. This Report, and related documents, are available on the Internet at *<http://www.treasury.gov.au/Publications/FSI/Default.asp>*
- 2 Uniform consumer credit legislation was enacted in each State and Territory based on 'template legislation' developed by the Queensland State Government following agreement between the states and territories in 1993.
- 3 Financial System Inquiry discussion paper, Australian Government Publishing Service, November 1996.
- 4 Under the Conduct Code Agreement (signed by the Commonwealth, States and Territories as part of Australia's national competition policy reforms) the States and Territories agreed to adopt the 'schedule' version of Part IV of the Trade Practices Act. This is done by way of application legislation passed by each State and Territory. The schedule version mirrors Part IV of the Trade Practices Act with the important difference that references to a corporation have been replaced with a reference to persons. This recognises the broader constitutional reach of the States and Territories.

AUSTRIA

The Structure of the Austrian banking system¹

General overview

Austria's banking environment is made up of a large number of smaller banks and few medium sized or large banks. In terms of capital resources Austria's biggest bank ranks about 30th in the European Union.

Austria's 1 019 independent banks had in 1996 a total of 4 696 branches. In 1995 each outlet served 1 416 customers, giving Austria a relatively high branch density. The number of banks has fallen considerably from 2 166 in 1963 to 1 019 at the end of 1996. By the end of 1996, Austrian banks had 13 foreign branches within the European Union and a total of 23 branches abroad. Foreign credit institutions had 19 banks, 7 branch offices and 34 representative offices in Austria.

Until the beginning of the 1990s the Austrian capital markets were fairly well protected from foreign competition. The Austrian financial markets were liberalised in 1991. Since then Austrian citizens have been free to open, for instance, banking accounts in other EU Member States or other countries. Concerning the capital markets this possibility has been quite widely used.

Austria's accession to the European Union was linked to a substantial liberalisation of the Austrian financial markets. However the biggest changes are to be expected with the introduction of the EURO and technological changes (E-Cash, telephone banking) in the financial sector.

Main regulations concerning banks

The principal regulations concerning the banking sector are based on the corresponding EC-Directives and implemented by the new Banking Act (Bankwesengesetz) which entered into force in 1994. The first amendment to the banking act (1996) implemented further directives of the European Union, such as consolidated supervision, monitoring of big loan exposures and deposit guarantees. The second amendment to the banking act in 1997 implemented the European Union's directives on Investment services and on Capital Adequacy. The directive on consumer credits resulted in provisions on the visible display of prices of consumer credit.

The Stock Exchange Act, of 1989 introduced to a large extent the framework of the European Union. An Amendment in 1993 made insider trading a criminal offence, improved trading supervision and extended legal liability for statements in listing particulars. The Securities Supervision Act, which entered into force in 1997, updated the implementation of the relevant EU-directives and put securities supervision on a more solid basis mainly by introducing the Federal Securities Supervision Authority.

1. (This section was compiled by the Official Parties of the Austrian Cartel Court)

The setting up of new branches or new banks requires a licence issued by the federal ministry of finance. However a licence has to be granted if the banks have an equity of at least 70 million ATS (§ 4 banking act).

Industry regulators

Banking supervision is the responsibility of the ministry of finance, (Bundesministerium für Finanzen). Banking supervisors have access to a number of instruments that facilitate early risk detection and timely countermeasures. The Austrian National Bank (Nationalbank) has been charged with a number of supervisory tasks to check the adherence to banking regulations and to prepare expert opinions for the Federal Ministry of Finance.

The Federal Securities Supervision Authority (Bundeswertpapieraufsicht) primarily monitors the correctness of trading on the stock exchange. Moreover it grants licences to some financial enterprises which are not covered by the banking act, such as investment consultants as, earlier, there had been several cases of fraud.

State Ownership

State Ownership has been gradually reduced during the recent years. In 1996 the Österreichische Postsparkasse was transformed from an "institution of public law" into a public limited company. It is still owned by 100 per cent by the Federal State via a holding company "Post und Beteiligungsgesellschaft". However it is intended to sell off its shares on the stock exchange as soon as possible.

Currently the biggest shareholder of Austria's biggest bank "Bank Austria" is Anteilsverwaltung Zentralsparkasse (AVZ), which is closely linked to the City of Vienna.

Application of national competition law to the banking sector

Currently there are no exceptions for banks and financial institutions from the Austrian Cartel Act. Nevertheless the Cartel Act has an exception for "a situation, which on the basis of provisions of the law is subject to the supervision of the Federal Minister for Finance over banks, building and loan associations, or private insurance businesses", but these provisions have been abolished by the new banking act.

However mergers in the Banking sector have to be approved by the Ministry of Finance whenever a stake of 10 per cent, 20 per cent, 33 per cent and 50 per cent is sold to another owner, for reasons of prudence. (§ 29 Bankwesengesetz)

The most important mergers in the banking sector have been dealt with by the European Commission (Bank Austria/Creditanstalt, Bayrische Landesbank/BAWAG). However recent mergers, such as the acquisition of the Girokreditbank by the Erste österreichische Sparkasse, were examined by the Austrian Cartel Court. Since in all relevant markets the size was considerably smaller than the largest Austrian Bank "Bank Austria" it did not raise competitive concerns.

One famous case of the Austrian Cartel court dealt with agreements on fees for consumer accounts. As a result of that case agreements on fees concerning consumer accounts were prohibited. Since then the pricing strategies of the banks are quite different.

Market definition

Austrian banks are generally universal banks. The services typically supplied by a universal bank can be divided in the areas retail banking, corporate banking, financial services and product market interests. Retail banking means banking services to households which consist, for instance, of deposits, credit cards, mutual funds and other forms of asset management. It can be further subdivided in the market for universal accounts, (universal banking market), deposit market, a market for risk instruments and a consumer credit market.

Corporate banking means banking services to corporate clients which can be subdivided into markets comprising, for example, deposits, lending, international payments, letters of credit and support concerning mergers and acquisitions.

With respect to financial markets the following activities may constitute distinct service markets: Trading in equities, bonds and derivatives, foreign exchange and money markets. (i.e. treasury bills and commercial paper from banks and companies)

For private banking the accessibility to the nearest local branch is, despite the rise of telebanking, an issue, and the local distribution of banks might be quite different. Therefore these markets are generally local markets.

With regard to corporate banking, certain product segments are required or supplied on the national level. Moreover small and medium sized enterprises stick to local suppliers of financial services, whereas large enterprises act internationally. Concerning interest in product markets, the same market definition has to be applied as in the relevant product market.

Remedies

In the merger "Bank Austria/Creditanstalt", the Bank Austria, or rather AVZ, committed itself to sell its stake in GiroCredit, a bank owned by Bank Austria at that time. In addition, Bank Austria entered into the commitment to reduce the participation of Bank Austria and Creditanstalt in the Austrian Kontrollbank, a bank active in the area of export insurance and financing, to the level of participation which Bank Austria and GiroCredit currently hold together. Furthermore, Bank Austria committed itself not to extend its influence in Investkredit, active in awarding subsidised credit in the public interest, beyond the level of influence which it had, together with GiroCredit, prior to the concentration.

Competition problems in the construction sector arose as follows. Bank Austria already had close links with several large Austrian construction companies which held a strong position on the Austrian construction markets (particularly in civil engineering excluding the construction of buildings). In addition, Bank Austria acquired, through the acquisition of Creditanstalt, a majority stake in the large Austrian construction company Universale. For this reason, Bank Austria committed itself to either sell its stake in Universale or its participation in another large Austrian construction company, Stuaag.

In the recent years no complaints concerning the banking sector were submitted to the Austrian Competition Authorities.

Outlook

Technological developments are expected to considerably reduce the costs of market entry in the consumer markets. Self service, telebanking, phonebanking, Electronic Money will among others question the need of area-wide distribution networks.

Enterprises of other sectors, e.g.. Software or mail order business already tried to enter the banking sector, although not very successfully until now.

Major changes in the competitive environment will occur with the introduction of the EURO, which will make direct comparisons with banking services in other countries much more transparent and will nullify the risk of exchange rate movement.

CANADA

Introduction

Over the past two decades the financial services industry has undergone profound change. The forces underlying these changes have domestic and international roots. While restrictions do remain in a number of countries, to a very large extent market forces now determine capital flows and prices. The ongoing regulatory reform efforts by OECD countries have blurred traditional distinctions and enabled financial service providers to seek and capitalize on new opportunities outside traditional business spheres and geographic boundaries; the resulting achievement is an industry that is global in its outlook and reach.¹

The internationalization of the financial services industry has a number of important features²:

- increased cross-border capital flows, largely the result of international lending and borrowing activity;
- portfolio diversification, caused by borrowers and investors increasingly willing to deal in a greater variety of currencies and investments;
- tax and regulatory reforms facilitating foreign competition in domestic financial markets;
- factors such as the need for multinational firms to raise money more cheaply and in local currency; and
- the rapid pace of innovation, including the development of new instruments and techniques such as swaps, futures, and securitisation that permit multinational companies and financial institutions to better manage their risk. Innovation has also occurred in financial services, such as the development of computerized trading and global electronic stock exchanges.

The acceptance of the need to deregulate and liberalize has also been driven by the concern on the part of national governments that their respective financial markets could become marginalised if they do not respond in a positive and timely manner to global pressures enveloping financial markets. The inability to attract capital at competitive rates can quickly place a country at a disadvantage relative to countries that have liberalized, making it that much harder to succeed in a globalized world. The competition amongst regulatory authorities to stay one step ahead of their counterparts in other countries, and the recognition that the effects of failures of large institutions almost always spills across borders, has led to a convergence in financial regulation and structure over time.

The financial services industry plays a very important role in facilitating economic growth and prosperity by channelling funds from savers to investors. The more competitive and efficient is this intermediation process, the more likely it is that funds will be made available and allocated according to their highest valued uses. In this regard, it is important to recognize that government policy should generally strive to establish a regulatory framework which fosters a competitive, innovative and efficient financial system in which savers and borrowers have confidence.

The Canadian experience with respect to regulation of the financial industry is not unlike that of other countries. Over the past fifteen years, the federal government has undertaken a number of reforms that have intensified the role of market forces in the Canadian financial industry, thereby enabling financial service providers to offer a wider array of products and services to consumers. This paper reviews the evolution of bank regulation in Canada, and summarizes the involvement of the Competition Bureau in the current reform exercise launched in December 1996.

The Evolution of Financial Sector Regulation in Canada

Twenty years ago Canada's financial services providers were divided into four "pillars" -- banking, insurance, securities underwriting and trust services. Participants were constrained from entering into each other's core businesses. Foreign banks could not be chartered under the *Bank Act*, and generally carried out activities through near-bank affiliates.

Canadian banks have historically been the most important of the "four pillars" of the Canadian financial services industry, concentrating on lending to businesses, collecting household and business deposits and offering payment services through these deposits. Trust and mortgage loan companies concentrated on fiduciary services and mortgage lending to households, life and health insurance companies dealt with insurance and annuity products, and securities dealers focused on the underwriting and marketing of investment products.

Beginning in the mid-1960s and continuing into the present day, the government has undertaken a number of initiatives that have effectively dismantled most of the important divisions between the four pillars and introduced greater competition into the financial services market.³ A recent article by the Bank of Canada observed that the essential blurring of the four pillars has been driven by many factors, including "interest rate volatility, changing demographics, rising household wealth, and adjustments within the financial sector to shifting business prospects"⁴.

In 1980, the *Bank Act* was revised to permit banks to enter the factoring and leasing businesses through wholly-owned subsidiaries.⁵ In the case of bank factoring business, a subsidiary is allowed to take over the management and collection of the client's accounts receivable and guarantees them for a fee. The 1980 reforms also made entry into the banking sector for Canadian-owned entities easier and established the Canadian Payments Association allowing near-banks the opportunity to participate directly in the existing system and to be full partners in its evolution. As well, the 10 per cent rule and 25 per cent ownership rules were introduced. The legislation distinguished between widely held banks (Schedule I banks) and closely held banks (Schedule II banks). In the case of Schedule I banks, they had to be Canadian controlled, one shareholder could not own more than 10 per cent of the voting shares and non-residents in total were only permitted to own up to 25 per cent of the voting shares.⁶ The concept of closely held banks (Schedule II banks) meant that foreign commercial banks were allowed to establish full banking entities in Canada, but had limitations placed on the future growth of their assets. In addition to the limitation on their assets to 20 times paid up capital, the assets of foreign owned subsidiaries could not exceed 8 per cent of the total assets (subsequently raised to 16 per cent) of all banks in Canada.⁷

Financial reforms in 1987 allowed Canadian banks to enter the domestic securities business. Effective June 30, 1987, the province of Ontario has allowed Canadian financial institutions to own up to 100 per cent of a securities dealer in that province. This was the first formal sanctioning of the blurring of the pillars of the Canadian financial services industry. This later came into effect with the federal government amendments to the *Bank Act* allowing banks to own investment dealer subsidiaries.

Over the 1984-1990 period the federal government released three papers dealing with proposed reforms to the Canadian financial services sector. This exercise culminated in the passage of financial services legislation in 1992. The basic thrust of the policy proposals was that "banks and federally incorporated trust, loan and insurance companies generally have the opportunity to offer a similar range of services and compete in markets that were previously not open to them. This will enhance choices available to consumers. The expansion of powers will take place directly or through financial institution subsidiaries"⁸.

Under the 1992 reforms, trust and mortgage loan companies would only be granted full powers to lend to consumers and businesses if they had a minimum capital base of \$25 million and after satisfying the regulators that they had the appropriate staff and controls in place to undertake such credit granting activities. Those institutions not meeting these requirements would be limited to a commercial loan portfolio of not more than five per cent of their assets.

The government passed legislation in 1996 to enhance the safety and soundness of the financial system. The legislation contained a number of key measures, *inter alia* an early intervention policy for problem financial institutions, a framework for enhanced disclosure to the public of information on the financial condition of financial institutions and a stronger prudential framework for the supervision of financial institutions, including enhanced corporate governance.⁹

The 1992 financial services legislation made extensive changes to the regulatory environment, and, in combination with the anticipated need for further changes driven by domestic and international developments in the sector, a sunset clause was incorporated requiring a formal review of it every five years. To prepare for the 1996-97 review, a discussion paper and subsequent White Paper were issued. The White Paper addressed such issues as strengthening consumer protection, easing the regulatory burden and the question of the need to strengthen the corporate governance regime.

In February 1997 the government announced its intention for further reforms based on proposals contained in the White Paper:

- the development of a new framework for foreign bank entry as branches;
- regulated foreign banks which own a Schedule II bank will no longer be required to own other federal financial institution or securities dealer subsidiaries through a Schedule II bank;
- near-banks (entities which do not generally take deposits, are not regulated as banks in their home jurisdiction, but provide one or more banking-type services) which have received approval under part XII of the *Bank Act* to enter the Canadian market will no longer need to seek further approvals under part XII of the *Bank Act* to offer additional products or establish other entities, provided that their activities do not include taking deposits or acquiring financial institutions; and
- near-banks will be permitted to own any non-bank financial institution with Governor-in-Council approval.

Current Situation

At present, the Canadian financial services industry is undergoing significant restructuring. The restructuring was initially prompted in the early 1990s by excess capacity and deteriorating asset values. Its underlying causes, however, are attributable to three structural changes that are affecting the financial needs of customers, as well as the way in which financial services are produced and delivered.

The first of these is the growing trend towards disintermediation, which involves suppliers and users of capital bypassing the traditional intermediation services provided by the financial institutions. Second, demographics are changing the financial needs of retail customers. Traditional intermediation functions are giving way to the widespread introduction of wealth management services and the reliance on fee income. Third, technology is pushing the boundaries of what is possible -- permitting financial institutions to develop new means of producing and delivering financial services and create new services/products in ways that were previously not feasible.¹⁰

These three factors have forced Canadian financial institutions to become flexible, adaptable and more competitive to meet the demands of customers. The need to lower unit operating costs through the acquisition of larger market shares and the move into new business lines has provoked a consolidation in the Canadian financial services industry. A large number of transactions has involved mergers and acquisitions among companies in the same sector, or the sale of blocks of business by one company to another in the same sector.

The Establishment of the Task Force on the Future of the Canadian Financial Services Sector

The 1996 White Paper left the more fundamental questions relating to bank powers and general questions about the future of the Canadian financial services sector to the Task Force on the Future of the Canadian Financial Services Sector. The Task Force, established on December 19, 1996, is inquiring into public policies affecting the financial services sector.

Their report, scheduled for release in September 1998, will make recommendations to enhance:

- the contribution of the sector to job creation, economic growth and the new economy;
- competition, efficiency and innovation within the sector;
- the international competitiveness of the sector in light of the globalization of financial services, while at the same time maintaining strong, vibrant domestic financial institutions;
- the ability of the sector to take full advantage of technological advances as they occur and to meet the competitive challenges resulting from the introduction of new technologies; and
- the contribution of the sector to the best interests of Canadian consumers.

On June 13, 1997 the Task Force released a discussion paper intended to identify the issues and solicit the views of Canadians. The paper makes note of "... (the) need to ensure (that) the financial services sector operates in an environment and a manner so that it will effectively accumulate and allocate credit and capital within the economy ... It must provide a full range of financial services to Canadians, made available by institutions that are financially sound and efficient while leaving room for

innovative and smaller institutions to develop. The sector should be competitive, accessible to all Canadians and carry public confidence". (emphasis added)¹¹

Competition in the Financial Services Sector¹²

The design, implementation and enforcement of regulatory rules governing financial institutions affects the structure and nature of the Canadian financial services sector because they currently impose important constraints on the ownership and business powers of the institutions. This in turn has implications for the competitive process in the financial services industry, and ultimately the type, quality and price of the product offered to business users and consumers. Again, recognizing that regulation can unnecessarily restrict competition, the Task Force asks "whether the regulatory and supervisory structure imposes the minimum level of control necessary to give effect to public policy objectives "¹³.

In response to the Discussion Paper issued by the Task Force the Director of Investigation and Research ("the Director") made a written submission November 27, 1997 ("Task Force" Submission). The central theme of the Bureau's submission is that the public policy objectives which underlie the review can best be achieved by relying upon competition and market forces to the maximum extent possible, rather than through continued or increased regulation. The Bureau recognizes that stability of the financial system is generally the paramount goal of financial market regulation and that stability may come at the expense of competition. In the Bureau's view, however, there are regulatory changes that can increase flexibility and facilitate competition without concurrently compromising the stability and solvency of the financial system.

The submission sets out the Bureau's views on a number of issues pertinent to the questions raised in the Discussion Paper. However, this paper focuses on three such issues: mergers involving federally regulated institutions, ownership restrictions and the question of business powers.

The Treatment of Mergers in the Financial Services Sector

Since 1992, the legislative framework has allowed banks to own trust companies or insurance subsidiaries; insurance companies can own trust companies and widely-held insurance companies can own Schedule II banks. Notwithstanding this legislative framework, there is a perception that government policy has precluded large financial institutions from acquiring other large financial institutions. This "big shall not buy big" policy reflects two concerns: (1) that a merger of two major players could give rise to anti-competitive behaviour; (2) the need to pause after the crumbling of the four pillars in the 1980s to provide institutions the latitude to adjust to new competitive challenges without fear of new and emerging competitors.

Increasing the size of competitors through mergers and acquisitions can raise a number of concerns over the effect of concentration on competition. The first relates to whether or not high levels of aggregate concentration represent undue accumulation of economic, social and political power which can result in corporate influence on government decision making. A second concern relates to concentration of ownership and in particular about self-dealing, conflicts of interest and non-arms length transactions. Finally, there are concerns that aggregate concentration results in concentration and dominance in individual markets, and that this in turn leads to instances of anti-competitive practices and adverse economic effects in those markets.

Generally speaking, concerns that concentration may result in the exercise of market power are intensified as the barriers to entry into a particular market increase and as the availability of close

substitute products diminishes. If entry barriers are low, even dominant firms will have to price at competitive levels and be dynamic and innovative, or else new firms will enter and undercut their prices and fill product and quality gaps. If customers have easy access to close substitutes, firms in concentrated markets will have to behave competitively even in the short run, if they are to avoid losing their market to these substitutes.¹⁴

Therefore, while observed measures of concentration in particular markets are a useful starting point in examining the state of competition, they must be supplemented by other information on the characteristics of the market in question and the extent of potential competition.

An important aspect in this regard is to identify if there are any regulatory barriers to entry. In the case of financial services, regulatory restrictions on the entry and expansion of foreign-owned suppliers may have allowed for increased market concentration and reduced competition. The specification of minimum capital requirements and the examination of the financial strength of applicants may also have deterred entry but there may have been off-setting benefits in the form of greater system stability.

Markets may also be concentrated because economies of scale are realized only by firms that are large relative to the size of the market. If firms compete aggressively under conditions of increasing returns to scale, then perhaps only a few will survive. High levels of concentration may thus be a consequence of intense competition in the past.

Merger Enforcement Guidelines in the Financial Services Sector

The Bureau's general approach to assessing a merger is described in the Director's Merger Enforcement Guidelines (the "MEGs"). Included in the Bureau's submission is a preliminary draft of a supplement to these MEGs outlining the analytical framework the Competition Bureau intends to apply when assessing the competitive effects of a merger involving two or more Schedule I banks. This is the first time that the Bureau has released a document that describes how the general guidelines would be applied to a specific industry sector. The importance of this sector in the economy and to the general public has encouraged the Bureau to provide those involved in the current policy debate regarding the deregulating and liberalizing of the financial services sector with a clearer view of the approach that the Bureau would likely follow when assessing such a transaction. The Bureau is seeking the benefit of public discussion of the draft guidelines and has made them available to all participants in the financial services industry. This consultative process is encouraging public input on all aspects of the proposed approach including comments on the appropriateness of the general Merger Enforcement Guideline principles and definitions pertaining to the threshold tests, the efficiency exceptions and trade-offs as well as industry specific details concerning entry barriers, economies of scale or scope and sources of efficiencies in the context of the banking sector.

Market Definition and Market Share Thresholds in a Bank Merger

As in any merger review the first step is defining the relevant market to identify the products and suppliers with which the merging banks compete and the geographic areas within which such competition takes place. The definition of a relevant market is required to assess whether a merger is likely to result in an increase in market power.

(a) Relevant Product Markets in a Bank Merger

Banks supply a large number of products, and the Bureau expects that any assessment of a major bank merger will involve many relevant markets. Differences in dollar value, terms, collateral, etc. among loans indicates that there are several product markets within the broader category of loans. Similarly, deposits with differing characteristics, as well as the many other products supplied by the banks, should likely be placed in separate product markets. In addition, products supplied by non-bank deposit-taking institutions should be included in relevant bank product markets.

The Bureau normally defines relevant markets by reference to actual and potential sources of competition that constrain the exercise of market power. However, the vast number of products and services offered by banks, and the similarity in the inputs that are required to offer many of these products, would make it difficult to identify and measure the constraining effects of all potential suppliers in a timely manner. As a result, when analyzing a bank merger, defining relevant product markets are initially limited to considering only actual sources of competition. The suppliers that are likely to participate in the market within a year are considered as potential competitors and are excluded from the initial market definition.

The main advantage of using this approach is that it allows the quick identification and exclusion from further analysis of those markets in which market power is unlikely to be of concern. For markets that cannot be excluded, the supply of output that is likely to be added to the market by non-producing firms within a year without significant start-up costs, will be included in the relevant market. If this potential competition eliminates the market power concerns then this market is similarly excluded from further analysis.

The Bureau would consider a "cluster" of banking services to constitute a relevant product market if this included a set of products and services that buyers tend to purchase from a single institution. In such instances, various other factors would be considered to determine whether the components of the cluster can or are likely to be purchased individually in response to a significant non-transitory increase in its price. These factors would include

- Any survey or industry data on consumers' propensity to purchase a number of products from a single institution;
- Data on the number of products purchased per person and the number of products purchased from a given institution per person;
- Any survey data on consumer preferences;
- Data on the extent to which consumers have broken up their purchases of a cluster of products in response to relative price changes.

(b) Relevant Geographical Markets in a Bank Merger

In the banking sector, as is the case in other sectors, the dimensions of the geographic markets will vary with the characteristics of the products, and different geographic markets may be associated with different products. For banking products, geographic markets are likely to be smaller the more important and frequent the interaction between the bank and the customer and the smaller the size of the banking/financial transaction. The Bureau expects the geographic scope of "retail" banking products, including various types of consumer loans, deposits, and loans to small business, are likely to be significantly more limited than the geographic scope of many "wholesale" banking markets. Past Bureau assessments of Schedule II bank mergers have concluded that many banking markets are likely to be local, encompassing only a small geographic area.

(c) Initial Test

In analyzing the competitive effects of a bank merger, it would be difficult in practice and, likely unnecessary for the Bureau, to define markets associated with each product supplied by merging banks and with each prospective geographic market. The vast number of products and services typically offered by banks at such a large number of locations implies that such an exercise would be extremely resource intensive and time consuming. This is particularly true since geographical markets for many products are likely to be local. In practice, the Bureau will attempt to apply an iterative approach to streamline this process to allow the Bureau to quickly focus any analysis on those relevant markets presenting the greatest potential for competitive harm.

For mergers in general the MEG's provide threshold tests to determine whether the merger is likely to result in a substantial lessening or prevention of competition. Accordingly, the Bureau is unlikely to be concerned that the merger will enhance the ability of the merging firms to unilaterally exercise market power if the sum of the pre-merger market shares of the merging parties in the relevant market is less than 35 per cent. Similarly, the Bureau will not be concerned that the merger will increase the likelihood that firms in the market will engage in interdependent behaviour in a way that harms competition if the share of the market accounted for by the largest four suppliers in the market, post merger, is less than 65 per cent. If there is other information to suggest that competition is likely to be lessened substantially even though these thresholds are not surpassed, the Bureau will consider this information in its assessment. The Bureau intends to continue to apply these threshold values to Schedule I bank mergers.

However, in order to expedite this process the Bureau will initially apply the market share and concentration threshold tests to a pre-defined set of product offerings and geographic locations. These sets of products and geographic locations do not necessarily constitute well-defined relevant markets, but rather are chosen to be narrower than the corresponding relevant markets are likely to be. That is, the relevant markets are likely to include more products and the geographic markets are likely to be larger than these pre-defined areas.

The set of pre-defined geographic areas will consist of Canadian census subdivisions which were defined by Statistics Canada for the 1996 Census. Census subdivisions are essentially legally defined municipalities, including large urban centres as well as small rural centres. By using census subdivisions as the pre-defined geographic areas, the Bureau will be focusing its analysis on geographic areas which are likely to be no larger than relevant antitrust geographic markets. At the same time, given the retail nature of many banking products, a single subdivision is likely to represent a large part of the internal core of a relevant market. It is the Bureau's belief that census subdivisions provide good initial approximations of local geographic markets in most cases.

If the thresholds are not exceeded for a given pre-defined product offering and a pre-defined geographic area, the Bureau is unlikely to be concerned that competition in that area will be lessened substantially. In the absence of information suggesting that the relevant geographic market differs significantly from the pre-defined geographic area, the Bureau will exclude this product offering within this geographic area from further review.

If the thresholds are exceeded for a given pre-defined product offering and a pre-defined geographic area, the Bureau will rely on the more traditional analysis to determine whether this area is part of a larger relevant geographic market. If the evidence suggests that the market should be expanded and the thresholds are not surpassed in this broader area, then the Bureau will exclude this product offering within this broader geographic area from further review.

This procedure will also identify certain census subdivisions in which there are unlikely to be competition problems due to their economic integration with other larger census subdivisions. Using 1996 Census commuting data this procedure can identify smaller census subdivisions that satisfy the forward commuting flow rule of a larger census subdivision (census subdivisions for which at least 50 per cent of the employed labour force living in the census subdivision work in and travel daily to the larger urban area). These small subdivisions can be grouped with the larger census subdivisions which do not surpass the threshold tests and excluded from further review. In these cases, the presumption is that the competitive forces of the larger census subdivision will represent a competitive check on competition in the smaller census subdivision. The product and geographic areas which cannot be excluded by this screening process will be subject to the full traditional antitrust merger assessment analysis.

The number of pre-defined product offerings and pre-defined geographic areas that will be used in the initial threshold test are numerous. There will be approximately 6 000 pre-defined geographic areas alone, and a multitude of threshold calculations will therefore be required. In order to make the initial threshold test analytically tractable, the Bureau is in the process of developing a geographic mapping program in association with Statistics Canada. This program will be capable of quickly matching the market shares of each financial institution for each pre-defined product offering within each pre-defined geographic area. The program then applies the threshold calculations to each area and lists the results in tabulated form.

The Bureau had fully expected that there will be a number of mergers announced in the sector within a short time frame should the current restrictions on bank ownership be removed. In fact, on January 23, 1998 the Bank of Montreal and the Royal Bank, two of Canada's largest banks, announced their intention to merge. It is the Bureau's intention to assess each merger on its own merits. Subsequent mergers will be assessed in light of the environment that would exist after this merger has been reviewed.

Last November, the Bureau introduced service standards relating to the maximum turnaround times by which the parties can expect to receive the opinion of the Bureau. The Bureau has indicated three standards for merger review: fourteen days for non-complex transactions, ten weeks for complex transactions and five months for very complex transactions. Regardless of the number of transactions announced, any merger within this sector will at a minimum fall within the definition which the Bureau has established for a complex case.

Given the importance of collecting and analyzing large amounts of detailed information needed to review a Schedule I bank merger and given the time constraints involved, the Bureau is developing available data sources with the Bank of Canada, Office of the Superintendent of Financial Institutions ("OSFI") and with the Canadian Bankers Association. In addition, the Bureau is currently consulting widely within the business, financial and legal communities and with consumer interest groups to refine and perfect its industry specific application of the MEG's to the banking sector.

(d) Review Process

When financial institutions are involved in a merger, three federal authorities have the legislative mandate to review the transaction: the Minister of Finance, the Superintendent of Financial Institutions ("OSFI") and the Director of Investigation and Research (the "Director"). Both OSFI and the Director have clear mandates for review based on prudential and competition considerations respectively. The role of the Minister of Finance is based on broader public interest considerations.

The various acts regarding federally regulated financial institutions such as the *Bank Act* and the *Trust and Loan Companies Act*, give the Minister of Finance the right to approve, or disapprove of

mergers, independent of the *Competition Act*. This creates the possibility the Minister of Finance may not approve a merger which has been cleared by the Director, or, in the alternative, may approve a merger which the Director feels should be modified or challenged before the Competition Tribunal.

In the latter case, under section 94 of the Competition Act, the Competition Tribunal shall not make an order if the Minister of Finance has issued a certificate to the Director that states that the proposed transaction is in the best interest of the financial system of Canada. The effect of this provision is to provide the Minister of Finance with a means of ensuring that a merger which the Director may otherwise challenge is allowed to proceed if, in the Minister's view, it is in the best interests of the financial system.

From the Bureau's perspective, this type of multi-party review of mergers requires a process that is efficient, effective and timely.¹⁵ The submission makes a number of recommendations relating to the issues of transparency and predictability when the three federal institutions review a proposed merger. Of particular note, it recommends a clearer and more precise understanding of when and where the Minister of Finance would exercise the power to approve or disapprove a proposed merger involving federally regulated financial institutions, and the criteria to be employed by the Minister of Finance when evaluating mergers from a broader public policy perspective. It also recommends *inter alia* that the reviews of the three responsible agencies be conducted simultaneously, that there should be an open exchange of information amongst the three federal authorities, and where necessary, that the Minister of Finance would continue to retain the power to block a merger. The submission also recommends that in the event that the Director determines that there is a competition related issue, then "it would be helpful if the Minister (of Finance) would provide both the Director and the parties to the merger with the assurance that there will not be the exercise of Ministerial override once the Director has committed to pursuing the competition remedy". As well, with respect to Ministerial override, the submission argues that this power should be confined to non-competition issues.

Finally, as noted above, there has been a moratorium on large financial institutions merging or acquiring other large financial institutions through the prevailing policy of "big shall not buy big". There are no set definitions on what constitutes "large". Furthermore, this policy does not appear to be based on prudential grounds but rather reflects concerns about the level of corporate concentration. The submission recommends that applying the merger provisions of the *Competition Act* to transactions occurring within the financial services sector will prevent undue market power and achieve the same competition policy objective as the sector specific "big shall not buy big" policy. The submission notes that Section 92 of the *Competition Act* enables the Director to review each merger on its own merits and further that the Competition Tribunal shall not find that a merger prevents or lessens competition substantially solely on the basis of evidence of concentration or market share. This allows the Tribunal to take into account a number of factors in assessing the competitive impact of a transaction.

Ownership

The presence of foreign banks can be an important source of competition in the domestic financial services sector, and contribute to reduced financing cost to the business sector. In addition, as globalization continues, foreign banks can play a key role in the restructuring process through the acquisition of institutions.

The current regulations covering federally regulated financial institutions effectively forecloses the possibility of foreign control of a Schedule I bank. The regulation that no more than 10 per cent of any class of shares of a Schedule I bank can be owned by a single investor, or by investors acting in concert, is not intended to address any competition issues affecting the financial services sector. Rather it can be

ascribed to prudential concerns related to “self-dealing”. The social policy intent is to preclude an entity which has control over a Schedule I bank from redirecting activities and/or assets of the bank to pursue other corporate interests for fear that this may work to the detriment of the institution, potentially jeopardizing its economic well being. The impact that this regulation has on competition must be balanced with the desired intent of the regulation.

Ownership restrictions may limit the options available to Schedule I banks to avail themselves of the competitive pressures of the global economy. Ownership restrictions preclude mergers with foreign banks and other corporate entities, and thereby can adversely affect the ability of domestic banks to successfully compete with large foreign banks in the emerging global markets. Relaxing the regulations governing foreign control of Schedule I banks, keeping in mind prudential concerns related to the safety and soundness of the financial system, would facilitate greater participation of foreign banks in the domestic market through the ownership vehicle, and would be pro-competitive.

At present the law requires a foreign bank that wishes to provide banking services in Canada to do so through a separate subsidiary corporation, and not as a branch of the parent bank. Canada's trading partners have criticized this requirement; in response to these criticisms and competitive considerations, the government proposed February 14, 1997 the relaxation of rules concerning foreign bank entry and at the same time announced that it would develop a new framework for foreign bank entry as branches. The proposed amendment to the *Bank Act* would allow for foreign banks to establish branches in Canada for the purposes of conducting wholesale banking operations; there would still be the requirement to establish a subsidiary for the purposes of taking retail deposits and offering other retail services.

The Bureau supports the removal of the current restrictions on the ability of foreign banks to establish branches subject to other public policy considerations. While it is recognized that the removal of the subsidiary requirement would require new regulations to ensure the prudential operation of foreign banks in Canada, this may be a means to encourage further entry into the domestic marketplace.

Business Powers

There has been a gradual erosion over the years of the distinction between separate sectors or “pillars” as each sector started to penetrate the business of other sectors by offering products that competed with their traditional business. The reforms introduced in 1987 (that allowed other financial institutions to enter the securities business) and in 1992 (various regulated financial institutions were allowed to enter into each other's business through subsidiaries and, to some extent, through their own balance sheet operations) occasioned major consolidation. This has meant a very significant involvement of banks in the securities and trust businesses, and the first steps of a similar movement into life and property and casualty insurance. At the same time, some insurance companies have moved into the trust business and into banking.¹⁶

Despite the progress that has been made to date in freeing up regulatory restrictions in financial services, obstacles to a more competitive environment remain. For example, current regulations prevent banks from offering auto leasing and insurance products to their clients through their branch networks. Concerns have been expressed that there is the potential for the deposit-taking institutions to derive significant competitive advantage in leasing and insurance from their activities in other markets. It is alleged that unless there were enforceable restrictions, deposit-taking institutions could, for example, use information obtained from mortgage activities to cross-sell insurance products without the consumer's permission. Or, in auto leasing, smaller independent leasing companies or automobile retailers could find that their access to capital is available at less favourable rates or is not available. Thus, while the entry of deposit taking financial institutions into leasing and retail insurance has the potential to be

pro-competitive, it is argued that the competitive advantage of the banks is not the result of superior efficiency and that their entry will ultimately reduce competition.

Concern has been expressed about the competitive impact of a dominant firm or a group of integrated firms brought about by the acquisition of a major insurance company by a bank. It is argued that where major market share has been obtained through a merger or acquisition, banks can use their position to give away services in a predatory fashion until such time that they have driven competing insurance companies out of the market. However, for banks to squeeze competitors out of business in the downstream market, dominant firms must suppress competition among themselves in that market if they are to profit from their predatory act.

For banks to act in such a predatory fashion would require them to act in concert which would be a criminal offence under the *Competition Act* that carries a fine of up to \$ 10 million. Such co-ordination would be necessary because predatory conduct requires the ability to control the market supply of the product that is discounted. Predation would also require significant and effective barriers to entry such that the predator(s) can recoup the losses incurred while predating. Ignoring for the moment the fact that it contravenes the law, without a guarantee that entry will be precluded at the onset, predation would be an irrational corporate strategy to adopt.

From an economic perspective, it is reasonable to expect that there will be certain efficiencies associated with bank entry into insurance sales. It has been noted that due to the established relationship with their customers in the sale of banking products, banks have a cost advantage over other insurance providers in certain parts of the insurance market.¹⁷ For instance, a bank can not only provide a mortgage for the purchase of real estate, but also the mortgage insurance. In contrast an insurance company would have to incur the cost, i.e., cold telephone calls, to identify such customers. This type of synergy can also be found in the sale of premium retirement savings products and term life insurance.

It is the Bureau's view that entry into these lines of services would be pro-competitive and consistent with the general trend toward liberalization of financial sector regulations. The greater the number of firms supplying or able to supply a product, the broader the array of price and quality choices available to consumers. The submission, therefore, recommends that subject to other public policy considerations, banks should be permitted to offer auto leasing and insurance products to their clients through their branch network. At a more general level, the submission recommends that all financial institutions should be afforded the greatest flexibility in terms of the choice of financial products and services which they can offer consumers.

Conclusion

The work of the Task Force is critical to the future health and growth of the financial services sector. Efficiency, knowledge and adaptability will be the determining factors in shaping the financial services sector as we move into the next millennium. As the regulatory framework governing the financial services sector continues to shift towards greater reliance on the market, the Bureau's role in promoting competition within the sector will increase. The Bureau's experience is that as industries and sectors deregulate, there are major transition issues that need to be addressed. Markets evolve over time and may not be immediately ready for open competition. Normally, a fair and equitable period of transition should take place in a way that maximizes the benefits of competition but which also ensures the continued viability of the industry. The amount of regulation should decrease as more of the industry

is opened up to market forces. This constantly changing balance is an important, if difficult, task for the Director and regulators to maintain. However, it is recognized that pure competition principles may not always be realistic because of competing objectives, e.g., prudential considerations.

NOTES

- 1 The forces driving the globalization of the financial industry have been reviewed by a number of international organizations, most recently by the Organization for Economic Cooperation and Development (OECD). Please see Regulatory Reform in the Financial Services Industry in *The OECD Report on Regulatory Reform, Volume I: Sectoral Studies*, (Paris:1997).
- 2 Please see Business Implications of Globalization, Working Paper No. 1990-V, Investment Canada, Ottawa, May 1990.
- 3 The first genuine step towards market principles was taken in 1967 with the amendments to the Bank Act that eliminated the six per cent interest rate ceiling on chartered bank loans which chartered banks could charge their customers. The Porter Commission suggested that " the 6 per cent ceiling introduces undesirable rigidity in the financial system and hampers and distorts the working of markets. Please see Canada, *1964 Report of the Royal Commission on Banking and Finance* (Ottawa: Queen's Printer and Controller of Stationary, 1964).
- 4 The Changing Business Activities of Banks in Canada, Bank of Canada Review, Spring 1997, p. 11.
- 5 The *Bank Act* currently does not permit the banks to operate in the automobile-leasing market.
- 6 In 1988 under the Canada-U.S. Free Trade Agreement (CUSFTA) this rule was dropped for residents of the U.S. and subsequently under the NAFTA was also removed for residents of Mexico. In 1995 Canada eliminated the 25 per cent rule following Canada's adoption of the WTO Agreement.
- 7 The federal government has the authority to deem the capital base of a foreign bank to be less than its actual value. This is referred to as "deemed authorized capital". Individual banks approaching their asset ceilings can apply to the Office of the Superintendent of Financial Institutions (OSFI) for an increase in their deemed authorized capital, as long as the total domestic assets of the foreign bank sector is below the ceiling prescribed for foreign banks.
- 8 Canada, Department of Finance, *Reform of Federal Institutions Legislation: Overview of Legislative Proposals* (Ottawa: Minister of Supply and Services, Fall 1990).
- 9 Bill C-15, *An Act To Amend, Enact and Repeal Certain Laws Relating to Financial Institutions*, 1996. See Finance Canada's Internet Website: <http://www.fin.gc.ca>
- 10 For a full elaboration of the key developments affecting the financial services sector, please see C. Freedman and C. Goodlet, *The Financial Services Sector: Past Changes and Future Prospects*, A Background Document for the Ditchley Canada Conference, October 3-5, 1997.
- 11 Task Force on the Future of the Canadian Financial Services Sector, Discussion Paper, June 13, 1997, p. 2.
- 12 The following draws from the Submission of the Director of Investigation and Research to the Task Force on the Future of the Canadian Financial Services Sector, November 1997.

- 13 Task Force Discussion Paper, p. 5.
- 14 With respect to concentration the position of the Department of Finance as stated in the 1997 policy paper, *Review of Financial Sector Legislation: Proposals for Change*, is that there is no "concrete evidence that higher concentration levels have adversely affected competition and that a major overhaul [of the financial sector] to address concentration is not needed" at this time.
- 15 A preliminary report of the Task Force has already made its views known on this topic. See the Report of the Task Force on the Future of the Canadian Financial Services Sector in Response to a request by the Secretary of State (International Financial Institutions) July 11, 1997.
- 16 The recent GATS Agreement on Financial Services will serve to reinforce the trend towards greater competition in the financial services sector by "leveling the playing field " for foreign suppliers of financial services and thereby permitting foreign competitors to compete more effectively with domestic counterparts.
- 17 For a fuller elaboration of the potential efficiencies associated with bank entry into the insurance market, please see I. Horstmann, G.F. Mathewson and N.C. Quigley, *The Evolution of Markets and Organization in Banking and Insurance*, (September, 1995).

OECD QUESTIONNAIRE ON COMPETITION AND REGULATION IN THE BANKING SECTOR

Sector-Specific Regulation in the Banking Sector

The purpose of this section is to show the interaction between regulation and competition in each country, through a description of what is regulated and what is left to the market. Please describe briefly the principal statutory regulations that affect the banking sector, grouping, as far as possible, the regulations in accordance with the following list:

(a) restrictions on branching and new entry, especially the entry of foreign firms;

A foreign bank may choose to carry on a financial services business in Canada by directly establishing a foreign bank subsidiary, a trust or loan company, an insurance company, a foreign insurance branch, or a securities dealer.

The government is developing a branching framework for foreign banks. The Department of Finance outlined the general parameters of that framework in a consultation paper on Foreign Bank Entry issued on September 25, 1997. The legislative drafting process to implement the new branching regime is underway and the legislation should be made public shortly.

Other options to accommodate the entry of foreign banks are being considered. Two possible options were outlined in the September 25 consultation paper. The government is currently reviewing submissions received from interested parties in response to the consultation paper.

(b) restrictions on pricing (interest rate controls and other controls on prices or fees);

None.

(c) line-of-business restrictions and regulations on ownership linkages among financial institutions;

In addition to core banking services, banks are permitted to offer other services including information management, merchant banking, investment management, real estate management and brokerage services. Changes to legislation in 1992 allowed banks to engage in financial leasing, factoring and unlimited mortgage lending.

Services that are the principal activities of other classes of financial institutions (e.g., fiduciary or trustee services, insurance services and securities services) must be provided through separate bank-owned subsidiaries.

Banks do not have the power to engage in auto leasing and they are prohibited from retailing most insurance products through their branch network.

(d) restrictions on the portfolio of assets that banks can hold (such as requirements to hold certain types of securities or requirements not to hold other securities; including requirements not to hold the control of non financial companies);

Bank legislation does not prescribe a detailed set of quantitative or qualitative limits on a bank's investment powers. Rather, banks are required to adhere to investment and lending policies, standards and procedures that a reasonable and prudent person would apply in respect of its investments.

The Bank Act contains a list of investments that are explicitly permitted. These include investments in financial institutions and entities that are closely connected to the business of a financial institution.

Aside from these investments, a bank may have investments in real property, provided the aggregate total does not exceed 70 per cent of the bank's regulatory capital. A bank may also have investments in any entity not specifically permitted in the Act – which may include investments in non-financial entities – as long as the bank's investment in any one entity does not exceed 10 per cent of the voting shares of the entity, or 25 per cent of the shareholders equity. The total of all such equity investments cannot exceed 70 per cent of regulatory capital. Further, the sum total of these equity investments together with all real property investments cannot exceed 100 per cent of regulatory capital.

(e) compulsory deposit insurance (specify whether it is full or partial coverage: is the premium flat-rate, or related to the risk of the bank?);

Bank deposits are insured by the Canada Deposit Insurance Corporation (CDIC), a federal Crown corporation. The CDIC provides coverage of up to \$60 000 per deposit, including principal and interest. This limit applies on a per institution basis, and is applied separately to joint deposits, deposits held in trust and deposits held in Registered Retirement Savings Plans. Deposits excluded from coverage include foreign currency deposits, term deposits longer than five years, and funds repayable at foreign branches of Canadian banks.

Membership in the CDIC is mandatory for banks. In the near future, however, there will be two exceptions. First, an exception was introduced in the spring of 1997 for those banks that serve only the wholesale market (generally subsidiaries of foreign banks). At that time, as part of the government's review of the financial institutions statutes, it was announced that wholesale banks would be allowed to opt out of the deposit insurance system. Banks will be permitted to apply to opt out if less than one percent of their deposits are smaller than \$150 000. Further, to be eligible to opt out, a bank may not be affiliated with institutions that are part of the deposit insurance system. These provisions should come into effect in mid-1998, once the regulations necessary to support the regime are promulgated.

Second, under the government's proposed foreign bank branching regime, Canadian branches of foreign banks would not be insured by the CDIC. These branches would be prohibited from accepting retail deposits, with restrictions mirroring those described above under which less than one percent of the deposits of the branch may be smaller than \$150 000. These branches, however, would not face a restriction on affiliation with CDIC member institutions, such that a foreign bank could operate simultaneously a wholesale branch and a CDIC insured subsidiary in Canada.

Traditionally, deposit insurance premiums have been assessed on a flat-rate basis, with the rate currently set at one-sixth of one percent of insured deposits. However, the CDIC has released a consultation paper proposing a differentiated insurance premium structure based on each member institution's risk profile. The proposed regime is currently slated for implementation in the spring of 1999.

(f) restrictions on capital adequacy;

Banks are required to meet two tests of capital adequacy: 1) an assets to capital multiple which cannot exceed 20 times without the approval of the banking supervisor, and 2) capital as a percentage of risk-weighted assets (on and off-balance sheet). Banks must meet the Tier I and Tier II ratios set by the Bank for International Settlements (BIS).

(g) reserve requirements (requirements to hold a certain quantity of the liabilities of the central bank);

None.

(h) requirements to direct credit to favoured sector;

None.

(i) special rules concerning liquidation, winding up, insolvency, composition or analogous proceedings in the banking sector;

Rules concerning the liquidation, winding up and insolvency in the Canadian financial sector are governed by the "Winding-up and Restructuring Act." This legislation provides a mechanism for the orderly gathering and realisation of the assets of the debtor company and the rateable distribution of assets among creditors under the supervision of the courts.

(j) other rules affecting co-operation within the banking sector (e.g. with respect to payment systems);

Canada's *Competition Act*, the provisions of which deal with a broad range of anticompetitive behaviour, has general application to all firms in all sectors of the economy, including the financial sector. Further, within the Act, there are special provisions that relate specifically to agreements between federal financial institutions. Under these provisions, institutions are prohibited, with certain exceptions, from making agreements with one another with respect to the rates of interest on deposits or loans, service charges, the kinds of loans and services provided to customers, and the persons or classes of persons to whom a loan or other service will be provided or withheld.

With respect to the payments system, the primary piece of payments legislation in Canada is the *Canadian Payments Association Act (CPA Act)*. This Act, passed in 1980, established the Canadian Payments Association (CPA) and gave it a statutory mandate to "operate a national clearings and settlements system and to plan the evolution of the national payments system".

The CPA is essentially an industry association, with some public policy input from government. Under the *CPA Act*, members of the CPA must be federally or provincially regulated deposit-taking

institutions. The CPA sets rules and standards for the exchange, clearing and settlement of cheques and electronic payment items, including procedures to be followed in default situations.

While the *Competition Act* has general application to the financial sector, as discussed above, its specific application to the rules governing financial institutions' participation in the CPA is limited by what is known as the "regulated conduct defence". This defence holds that activity conducted pursuant to a valid scheme of regulation is deemed to be in the public interest, and therefore is considered not to violate the criminal provisions of the Act.

The issuance of credit or charge cards is not formally regulated in Canada. Participation in credit card networks (such as VISA and MasterCard, for example) is subject to rules established by those private networks. Similarly, the national ABM and EFT/POS network in Canada, Interac, sets its own rules. These include a requirement that card issuers be deposit-taking institutions.

Is there an industry regulator or regulators (such as a "Banking Commission", or a "Financial Services Authority" – in some countries this role is played by the central bank)? What is the form of this institution, its principal functions and statutory objectives? What discretion does it have? How does it exercise that discretion? Does it significantly affect the behaviour of the market participants? In what way?

The Office of the Superintendent of Financial Institutions (OSFI) is the primary supervisor of financial institutions in Canada. It has a statutory mandate to regulate financial institutions so as to contribute to public confidence in the Canadian financial system. OSFI's responsibilities include incorporating financial institutions at the federal level, issuing regulations and guidelines, taking enforcement actions and resolving problem institutions. Provincial authorities have responsibility for regulating provincially-registered trust companies and credit unions, both of which carry out activities very similar to banks.

The Canada Deposit Insurance Corporation (CDIC), in addition to its primary function as a deposit insurer, has a secondary supervisory role. The Corporation's legislated objects are to provide insurance against the loss of part or all of deposits, to be instrumental in the promotion of standards of sound business and financial practices for its member institutions and to promote and otherwise contribute to the stability of the financial system in Canada, and to pursue these objects for the benefit of persons having deposits with member institutions and in a manner that minimises the exposure of the Corporation to loss. CDIC maintains a set of Standards of Sound Business and Financial Practices – which deal with such things as liquidity and credit risk management – to which its member institutions are required to adhere. CDIC also has some limited enforcement authority, such as terminating deposit insurance or assessing a premium surcharge, and plays a key role in resolving failed institutions.

The approval of the Minister of Finance is required in respect of certain key supervisory decisions, such as incorporating a financial institution, closing an institution, terminating deposit insurance and approving mergers and acquisitions.

The Bank of Canada has some regulatory and supervisory responsibility for the payments system, with the intent of controlling systemic risk, and serves as a source of emergency liquidity support for the banking industry.

Note: A more detailed explanation of the roles of each of the four primary federal regulatory authorities is contained in the Appendix.

Besides the formal statutory regime, are there any understandings or expectations about the actions of, say, the central bank (such as “lender of last resort” or “too big to fail”) or other government agencies which could affect the behaviour of banks?

Canada depends primarily on its legislative framework to affect the behaviour of its banking sector; however, the Bank of Canada does offer a lender of last resort function should it be necessary.

Are there any important inter-bank arrangements which affect the behaviour of banks, such as industry organizations, codes-of-conduct, inter-bank agreements, etc.?

The Canadian Bankers Association (CBA) is a professional industry association which provides information, research, advocacy, education and operational support services primarily to its members, the chartered banks of Canada. The CBA is a major contributor to the development of public policy on issues which affect financial institutions.

The CBA has developed an industry code (with the encouragement of government) governing privacy protection of customer information, and is currently working with its members on the development of a policy statement on tied selling.

In December 1994, the CBA launched two industry-level initiatives designed to improve the banks' relationships with small business customers: a Code of Conduct and an Alternative Dispute Resolution (ADR) Model. These initiatives establish clearly what small-business customers can expect in terms of service and complaint handling.

The Canadian banking industry has also adopted the ombudsman approach to deal with complaints from small-business owners and retail banking customers. All of the six major banks and several foreign banks have appointed ombudsmen with a mandate to respond to customer complaints and ensure that bank codes of conduct are being followed. In addition, the banking industry has created the office of the Canadian Banking Ombudsman (CBO), which serves as an avenue of appeal from decisions of the individual bank ombudsmen. The CBO is independent of the banks and answers to an eleven-member board of directors, six of whom are not affiliated with the banking industry.

Please identify the main influences on the government when setting policy in this area? For example, are there active industry lobby groups?

The underlying public policy objective for the financial services sector in Canada is to develop a world class industry that provides world class services to Canadians. This means implementing policies that facilitate:

- A safe and sound financial system
- Competitive, innovative and efficient financial services providers that contribute to domestic economic growth

- A wide range of services for consumers and businesses that are delivered in a convenient and cost effective manner
- Sound standards of consumer protection
- Broad sources of credit for individuals and businesses
- Regulation that is effective but flexible enough to foster innovation
- An internationally competitive sector with opportunities for growth.

The main influences on the government's policy-making process would include, inter alia, individual financial institutions, industry associations, consumer groups, individuals, parliamentarians, and other interested parties.

How widespread is state ownership in the banking industry?

Federally chartered Canadian banks are not state-owned. At the provincial level, there are a number of provincially owned financial enterprises that provide deposit-taking and/or lending services. While these are not banks, they offer services similar to banks, especially to retail customers.

Do you know of any studies that assess the effect of the above regulatory regime on the structure, conduct, performance and entry barriers of the industry? Have there been any quantitative studies assessing the magnitude of the costs of regulation or assessments of the gains to the economy as the result of deregulation? Has your own agency carried out such work? In any of these cases, please provide citations of the relevant work.

There are two studies that we would cite as providing useful descriptions/analysis of our regulatory regime. The first is a report number 120-94 by the Conference Board of Canada entitled "The Cost of Regulatory Compliance in the Canadian Financial Sector." The second is entitled "Commercial Banking Structure, Regulation, and Performance: An International Comparison" and was produced by the U.S. Office of the Comptroller of the Currency, Economics Working Paper 97-6, February 1997. In addition the Task Force on the Future of the Financial Sector in Canada is expected to submit its final report to the government of Canada in September 1998. It is anticipated this report will provide an excellent analysis of the financial sector in Canada.

APPENDIX

Detailed Explanation of the Roles of Canada's Four Primary Federal Regulatory Agencies

The government's overall objective for the regulatory framework is to develop and maintain a sound competitive financial system. General objectives relating to the regulatory regime for federal financial institutions are:

- to contribute to public confidence in the Canadian financial system;
- to seek ways to benefit Canadian consumers by providing an environment for financial institutions which encourages competition, domestically and internationally, including improving access to foreign markets and the development of a wide range of products and services;
- to provide an appropriate framework for protecting depositors, policyholders and creditors; and
- to reduce regulatory overlap and duplication in the financial sector, given shared federal and provincial jurisdiction.

Specific objectives are:

- to supervise and regulate Canada's federal financial institutions in a manner which remains up-to-date and responsive to the evolving environment in which these institutions operate;
- to ensure the costs of the supervisory and regulatory systems do not impose an undue burden on financial institutions or on consumers and that there is appropriate accountability and transparency in the supervisory process; and
- to allow Canada's clearing and settlement systems to evolve in order to be internationally competitive and to minimize systemic risk.

Government agencies which comprise the regulatory framework (Finance, Bank of Canada, OSFI and CDIC) each implement elements of these policy objectives within their areas of responsibility. A summary of these is provided below. Descriptions of the roles of OSFI, CDIC and the Bank of Canada are publicly available in their annual reports. CDIC has legislated objects and OSFI has a legislated mandate.

Department of Finance

Policy Objectives

A key priority of the Department of Finance in terms of policy design and implementation is to ensure that the regulatory framework facilitates a sound and competitive financial system.

Responsibilities

The Department of Finance has primary responsibility for providing policy advice to the Minister regarding all aspects of the legislative and regulatory framework for the financial services sector.

In advising the Minister on policy matters, the Department's responsibilities include:

- initiating consultations with interested parties and stakeholders on specific policy issues;
- developing policy and conducting analyses on specific policy issues;
- analyzing and synthesizing policy advice provided by external sources (private sector companies, academics, industry associations, government agencies, and other stakeholders);
- co-ordinating and managing policy input of the various agencies involved in the regulatory system;
- implementing the policy direction set out by the government (e.g., preparing legislation, regulations and other documents); and
- representing the Government in federal-provincial discussions to improve the efficiency of the financial sector regulatory framework and representing Canada in international financial sector discussions and negotiations including NAFTA, GATS, OECD and others.

As the Department's responsibilities with respect to co-ordination are particularly important, a number of mechanisms to facilitate co-ordination with the federal regulatory agencies have been developed, including:

- Senior Advisory Committee (SAC)¹ and its working groups;
- the Deputy Minister, as a member of the CDIC and Bank of Canada Boards, attends their meetings;
- bi-monthly meetings with the heads of CDIC and OSFI.

Office of the Superintendent of Financial Institutions (OSFI)

Policy Objectives

As set out in Bill C-15, which came into force in mid 1996, the Office's mandate is:

- to regulate financial institutions so as to contribute to public confidence in the Canadian financial system.

1. SAC is an inter-agency committee which is chaired by the Deputy Minister of Finance; other members include the Superintendent of OSFI, the Governor of the Bank of Canada, and the Chairman of CDIC. Its chief function is to provide a forum for inter-agency policy discussions, the outcomes of which are incorporated in advice provided to the Minister.

Responsibilities

In fulfilling these objectives, the Office's responsibilities are:

- supervising financial institutions in order to determine whether they are in sound financial condition and are complying with their governing statutes law and supervisory requirements under that law;
- promptly advising the management and the boards of directors of a financial institution in the event that the institution is not in sound financial condition or not complying with its governing statute law or supervisory requirements under that law and, in such a case, to take, or require the management or board to take, the necessary corrective measures or series of measures to deal with the situation in an expeditious manner;
- promoting the adoption by management and board of directors of financial institutions of policies and procedures designed to control and manage risk; and
- monitoring and evaluating system-wide or sectoral events or issues that may have a negative impact on the financial condition of financial institutions.

In meeting the above responsibilities, the Office protects the interests of depositors, policyholders, and creditors while having due regard for the need to allow financial institutions to compete effectively and take reasonable risks and recognizing that, as a result, institutions can experience financial difficulties that lead to their failure.

In addition to the responsibilities outlined above, the Office:

- under an agreement with the Department of Finance takes a lead role in developing proposals and related legislation in the more technical and regulatory parts of the financial institutions legislation. The Office also develops regulations and provides advice from its perspective on other areas of the legislation;
- participates in various international fora as Canada's representative (e.g. the Basle Committee for Banking Supervision and a tripartite group of banking securities and insurance regulators) to develop, implement, and administer international agreements on regulatory issues in pursuit of its objectives; and
- provides actuarial advice to the government in respect of the CPP and provides advice pursuant to the Income Tax Act and other statutes to Revenue Canada and the Department of Indian Affairs and Northern Development vis-à-vis private pension plans.

In pursuit of its objectives and to assist other agencies and the Department of Finance in theirs, the Superintendent chairs the Financial Institutions Supervisory Committee (FISC), a committee created by statute whose mandate is to exchange information related to supervisory issues concerning individual financial institutions. The Superintendent also sits on the Board of CDIC and the SAC.

Canada Deposit Insurance Corporation (CDIC)

Policy Objectives

- to provide insurance against the loss of part or all of deposits (presently up to \$60,000 of eligible deposits);
- to be instrumental in the promotion of standards of sound business and financial practices for member institutions and to promote and otherwise contribute to the stability of the financial system in Canada; and
- to pursue the objectives set out above for the benefit of persons having deposits with member institutions and in such manner that will minimize exposure of the Corporation to loss.

Responsibilities

The deposit insurer requires the appropriate powers to assess and control the risks facing it. At a minimum, these powers include the ability to:

- establish conditions and standards governing insurability;
- control which institutions are eligible to become members;
- monitor and assess ongoing risk to the insurance fund;
- take appropriate action, where necessary, in consultation with participants in the regulatory system, against institutions that are operating outside the established risk and business conduct parameters;
- reimburse insured depositors upon the failure of a member institution;
- manage the orderly exit of weak and troubled deposit-taking institutions from the industry;
- develop the by-laws specified in its Act (e.g. joint and trust disclosure, premium surcharges, etc.); and
- provide advice from its perspective on the CDIC Act and other areas of the legislation through its membership on FISC and SAC.

In pursuit of these objectives, the CDIC Act provides that the board of directors consist of the Chairman of CDIC, the Governor of the Bank of Canada, the Deputy Minister of Finance, the Superintendent of Financial Institutions, the Deputy Superintendent of Financial Institutions and four private sector members.

Bank of Canada

Policy Objectives

- in its role as ultimate lender of last resort, to contribute to the stability of the Canadian financial system.

Responsibilities

In fulfilling the objective described above, the Bank of Canada's responsibilities include:

- providing liquidity to assist the smooth functioning of payments and other major clearing and settlement systems²; and
- providing liquidity to certain financial institutions experiencing liquidity difficulties arising from a loss of depositor confidence.

The Payment Clearing and Settlement Act also gives the Bank of Canada formal and explicit responsibility to:

- oversee major clearing and settlement systems that could pose systemic risk. This oversight responsibility recognizes the central role played by the Bank of Canada in the settlement of obligations among participants of major clearing and settlement systems, and more generally its lender of last resort role.
- approve the arrangements of clearing and settlement systems which are designed to manage and control systemic risks.

In addition to these responsibilities, the Bank of Canada

- provides advice from its perspective in the area of financial institutions legislation and regulation through its membership on the CDIC Board, SAC and FISC.
- participates in international fora (primarily the Bank for International Settlements) in matters concerning the identification and control of systemic risk in clearing and settlement systems and other cross border financial issues.

2. The capacity to make loans to clearing houses is part of the Payment and Clearing and Settlement Act, which came into force in mid 1996.

CZECH REPUBLIC

Regulation Versus Competition in The Banking Sector

Introduction

The current banking sector structure in the Czech Republic has crystallised after seven years of market economy development. Its development was influenced by general economic conditions: the abolishment of economic central planning, the privatisation process, the opening up of our economy to foreign competition and the development of a legal framework. The structure was also substantially affected by a three-year period, characterised by the consolidation program for small banks and a limited number of new licences issued by the CNB.

The Czech banking system is based on the universal banking concept, although, specialised banks are also allowed (mortgage banks) or even necessary in some cases (building societies).

In the Czech Republic, 51 banks or branches of foreign banks currently operate, of which 42 are universal banks and nine are specialised banks. The latter include a group of six building societies which were established in 1993 and 1994 and deal with construction savings of households and granting special credits for housing promotion. Housing support is also connected with the development of mortgage banking, permitted by law in 1995. In the CR, one bank is focused on mortgage banking. The five other banks, which have special licences, required by law to provide mortgage banking services, organise this mortgage banking as part of a universal bank. Moreover, two banks (with universal licences) were established with state participation to support state programs for export promotion and to provide guarantees for small entrepreneurs. Changes in the number of foreign banks and foreign bank branches are due to the transformation of some branches into subsidiaries and vice versa.

Number of Banks by Group
(Banks which started client operation)

	31.12.90	31.12.91	31.12.92	31.12.93	31.12.94	31.12.95	31.12.96	30.06.97
Total Banks	9	24	37	52	55	54	53	51
of which:								
large banks	5	6	6	6	6	6	5	5
small banks	4	14	19	22	21	18	12	8
foreign banks	x	4	8	11	12	12	13	15
branches of foreign								
banks	x	x	3	7	8	10	9	10
specialised banks	x	x	1	5	7	8	9	9
banks under								
conservatorship	x	x	x	1	1	0	5	4
banks without licence	x	x	x	x	1	4	6	9

The legal framework for the banking sector has been created by the Act on Banks (21/1992 Coll.) and the Act on the Czech National Bank (6/1993 Coll.). The former defines banks as "juridical persons with a seat in the Czech Republic, established in the form of a joint stock company (or a state financial institution) which accept deposits from the general public and extend credits and which, for the purpose of performing these activities have been granted permission to act as a bank".

The Czech National Bank (CNB) performs, *inter alia*, banking supervision over the execution of banking operations and cares for the prudential and effective development of the banking system in the CR. Banking supervision includes:

- the assessment of applications for banking licences
- supervision over the adherence to conditions set forth in licences
- supervision over the adherence to legal regulations and measures decreed by the CNB
- the imposition of remedies and sanctions when breaches are detected.

The goal is to support the stabilisation and competitiveness of the banking sector, which will be the result of three factors: regulation and supervision, market discipline and high-quality management of the individual banks. The CNB is gradually creating a legislative and regulatory framework, as well as supervision practice that conforms to international criteria and standards.

Regulation in the banking sector

Entry into the banking sector

Entry into the banking sector is regulated by the Act on Banks. The CNB goal is to ensure full compatibility of the criteria with the EU Directives and internationally accepted standards specified in the Basle Committee Core Principles.

Banking licences for "universal" banks

The CNB licensing policy in 1990 - 1993 was quite liberal as documented in Table No.. At that time, the number of banks (including foreign branches) increased from nine to 52. This period was followed by roughly a three-year period which was characterised by banking sector consolidation and a need to clarify long-term licensing policy with respect to meeting the strategic goals given by the Act to the CNB.

Basic requirements for applicants entering the sector are stipulated by the Act on Banks. An application for a banking licence must be submitted to the CNB. The CNB grants licences in agreement with the Ministry of Finance. The granting of a banking licence is based on the following assessment:

- a) the origin, sufficiency and composition of the equity and of other financial resources of the bank;
- b) the professional competence and public integrity of the persons appointed to the bank's management;
- c) the technical and organisational preconditions of the performance of the proposed activities of the bank;

- d) feasibility of the business plan as to future liquidity and profitability of the bank;
- e) shareholders' competence in the banking sector (with a direct or indirect holding of five per cent or more voting rights).

The CNB will have the right to request a certified copy of a natural entity's crime register.

A foreign bank intending to set up a branch office in the territory of the Czech Republic also submits an application for a banking licence to the CNB.

When granting a banking licence to a foreign bank branch office, the same aspects are considered as in the case of a bank with the exception of capital sufficiency. In addition, the country of origin of the head office is taken into consideration, as well as the level of co-operation with banking supervision in the country of origin. When applying for the establishment of a foreign bank branch office in the CR, the binding declaration of the foreign bank supervisory body is a part of this application, assuming responsibility for the settlement of all branch office assets and commitments, or a binding declaration of this body of transferring foreign bank financial means to the CR in order to settle the liabilities of this branch office, which must be done within the given period, and in compliance with the terms established by the CNB. The CNB can require a transfer of financial funds of up to CZK 500 million (about \$US 15.3 million) prior to the commencement of foreign bank branch office activities.

The CNB will more carefully assess some aspects of the licensing procedure in accordance with the Basle Committee Core Principles: assessment of the related parties of the future bank, competence, the integrity and qualifications of managers, directors, ownership structure, the origin and composition of the initial capital, etc.

The CNB will continue to apply the same requirements to resident and non-resident applicants for banking licences. As far as foreign banks are concerned, the CNB does not prefer in particular any legal form of the foreign bank (e.g. a subsidiary or a branch).

Banking licenses for specialised banks or specialised activities

As mentioned above, 6 building societies operate in the Czech Republic. The system for building societies is covered by the Act on Building Societies and was inspired by the German and Austrian system. Under this Act, the building society must be a legal entity established on the territory of the Czech Republic. The other criteria for granting licences are identical to universal banks. Entry by foreign investors into this specialised area is possible. At present, two societies are fully owned by foreigners, and three others are at least 50 per cent foreign owned. These entities accept state-subsidised deposits and provide credits (to buy or to renovate an apartment or family house).

Mortgage banks are defined as banks which have licences to issue mortgage bonds to finance mortgage credits. In other words, any bank is allowed to grant mortgage credits (i.e. credits collateralised by real estate), but not every bank may issue mortgage bonds. A mortgage bank must be a legal entity established on the territory of the Czech Republic.

Entry of investors into an existing bank

The CNB applies the same criteria to investors entering an existing bank as the investors applying for licences to set up a new bank. Currently, a resident investor (or group of persons acting in accord) must apply in advance for CNB approval to buy shares in an existing bank, if the total exceeds 15

per cent of a bank's equity. A non-resident must apply for establishing capital interest in an already existing bank. The amendment of the Act on Banks will provide the same treatment to both non-residents and residents - they will have to apply in advance for approval to buy shares, if the total exceeds five per cent, 10 per cent, 20 per cent, 33 per cent and 50 per cent of a bank's equity. The investor is obliged to report without delay to the CNB any decrease in participation interest below the limits mentioned above.

Business restrictions and regulations on ownership linkages

Business restrictions

Banks operating in the Czech Republic, in addition to their basic activities, i.e. accepting deposits from the general public and extending credits, are permitted to perform the following activities:

- investment in securities at its own risk
- financial leasing
- payment system and settlements
- issuance of payment instruments such as credit cards and traveller's cheques
- granting guarantees
- opening Letters of Credits
- collection of payments
- trading at its own risk or at a client's risk in foreign currencies, in futures and options, including transactions involving rates of exchange and interest and in negotiable bonds
- participating in the issuance of shares and provision of ancillary services
- financial brokerage
- consulting services and entrepreneurial matters
- portfolio management on behalf of the client at his own risk including consulting
- custody and administration of securities or other valuables
- serving as a depository firm and investment fund
- exchange trading
- providing banking information
- rental of safe deposit boxes.

Only banks may accept deposits from the general public and provide payment system and settlement services. Other services are available to other entities (investment companies and funds, leasing companies, factoring companies, etc.). The following three types of cross-border services are restricted: underwriting and broker/dealer services, custodial and depository services and asset management services - all provided by non-residents on Czech territory.

The banks are not allowed to provide insurance services at their own risk, although they are not prohibited from establishing or participating in insurance companies or from being a dealer of the insurance company on a provision basis.

Regulations on ownership relations among banks, financial institutions and other entities

The CNB does not limit ownership relations among the banks and financial institutions¹ and ancillary services companies directly.

The Act on Banks stipulates, that a bank is prohibited to control² another legal entity, which is not a bank, a financial institution or an ancillary banking services entity.

The qualified participation³ of a bank in a legal entity, which is not a bank, a financial institution or an ancillary banking services entity, may not exceed:

- for a single legal entity - 15 per cent of the bank's capital
- for the total amount of legal entities - 60 per cent of the bank's capital.

These limitations are not valid for:

- qualified interest of a bank in a legal entity resulting from a claim against such a legal entity, provided that the bank holds the qualified interest for a maximum of one year from the date of acquiring it,
- qualified interest of a bank in virtue of its participation in the issuing of securities and the rendering of connected services, provided that the bank holds the qualified interest for a maximum of six months from the date of acquiring it".

The CNB Provision on selected kinds of loans and investments in equity participations stipulates restrictions and terms for related parties (legal entities) which grant loans and make investments. In accordance with this Provision, the Bank is not permitted to acquire the equity of :

- a) a legal entity which is the principle shareholder of the Bank or has control over it;
- b) a legal entity which is under the control of the shareholder who has control over the Bank;
- c) a legal entity which is under the control of the group of shareholders, acting in accord, which has control over the Bank;
- d) a legal entity which is a member of the group of shareholders under c);
- e) a legal entity which is under the control of some of the members of the group under c)

Indirect regulations

Ownership relations among financial institutions are indirectly regulated through the CNB *Provision on Capital Adequacy*:

When calculating capital adequacy, the total amount is deducted from the total book value of capital investments (meaning ownership participations and claims in the form of subordinated debt if it is part of the supplementary capital of a legal entity in which it is invested:

- a) in other banks, if:
 1. the amount of capital investments in some other bank is higher than 10 per cent of the sum of core and supplementary capital of the bank in which it is invested or
 2. the amount of capital investments in some other bank is higher than 10 per cent of the capital of the reporting bank,
- b) other legal entities that are not banks and are controlled⁴ by the bank, where the CNB reserves the right to assess the bank's duty to deduct capital investments originating from a

transfer by the National Property Fund of business shares to the reporting bank as repayment for a credit granted by the reporting bank.

Other regulations and restrictions on assets portfolios of banks

Indirect controls also apply to capital adequacy, credit exposure regulations and foreign exchange positions. These regulations, which are in accordance with international standards (the Basle Committee recommendations and the EU directives), prefer certain type of assets (claims on governments, state owned institutions, banks, cash and international organisations) or limit foreign exchange risk.

All banks (excluding the branches of foreign banks) are obliged to meet eight per cent minimum capital adequacy. There is no diversification by the bank's risk profile. Starting in 1999, capital adequacy will be assessed on the basis of credit and market risks.

Other regulations and rules affecting competition

Reserve requirements

Reserve requirements are used by the CNB exclusively as an instrument of monetary policy. During 1990 - 1997, the CNB used this tool quite actively to fulfil monetary targets. At present, the banks are obliged to hold reserves in the amount of 9.5 per cent of "primary" liabilities⁵. The building societies and the Czech and Moravian Guarantee and Development Bank pay only four per cent of "primary" liabilities. The reserves are held on the accounts with the CNB and are non-interest-bearing.

Deposit insurance

The Deposit Insurance Fund was established in 1995 as a legal entity. The insurance scheme covers all deposits (including deposit interest) in CZK of:

- a natural entity when name, surname, address, birthdate and identification number are provided
- a legal entity when name, address and identification number are provided.

The Fund covers 80 per cent of insured deposits up to 300 000 CZK.

Membership of all banks including branches of foreign banks is obligatory. The banks and branches pay 0.5 per cent of the total insured deposits⁶ per year and building societies pay 0.1 per cent of the total insured deposits. This lowered rate reflects the limited risks of the building societies and efforts to decrease the costs of building societies. If there is a lack of financial resources in the Fund to cover its obligations, the state is allowed to grant financial assistance (50 per cent of the total need) and the CNB is allowed to grant non-interest-bearing credit (remaining 50 per cent). The contribution will be increased twice until the CNB credit and the state assistance are repaid.

The CNB does not place any requirements on direct credits to favoured sectors. It is the exclusive right and responsibility of the bank's management to set their credit and investment policies. The CNB does not apply any restriction to prices and fees. The bank and its management have exclusive control over the pricing policy.

Exit of banks from the sector

If the CNB detects any shortcomings in the activities of banks or of branch offices of foreign banks, it imposes a variety of remedial measures and penalties. If serious shortcomings in the activities of a bank or a branch office of a foreign bank persist, the CNB is authorised to revoke the banking licence. A banking licence may also be revoked if equity is decreased due to a loss of more than 50 per cent in a single year or of more than 10 per cent a year for three successive years, if the bank has not received deposits from the general public for more than 18 months, if the licence was acquired on the basis of false information submitted in the application for the licence, or if the bank in question is a branch office of a foreign bank and this foreign bank has lost its banking licence in the country of origin.

Liquidation procedures as well as bankruptcy and settlement procedures for the banks are governed by the general rules that are valid for legal entities. The CNB is considering legal changes which would allow the bank exit procedure to be organised differently. The new legal framework would reflect the special status that the banks have in the economy and would ensure maximum possible coverage of the bank's debt.

Other issues related to competition***The CNB relations to the Government and the Banking Association***

In pursuing its primary objective, the CNB is independent of any instructions given by the Government. However, the CNB must be ready to solve in co-operation with the Government systemic issues influencing the confidentiality and stability of the banking sector (such as the deposit insurance scheme, consolidation plans, etc.). Government participation in solving serious problems in the banking sector is standard procedure in many countries. The CNB also functions as a consultant to the Government for selling the remaining shares in the four largest banks.

The CNB co-operates with the Banking Association in order to improve the market environment in the Czech Republic, market discipline and the self-regulatory role of the Association. The central bank also discusses practical issues to be solved, such as implementation of the EURO or the year "2000" and information systems.

State participation in the banking sector

The Czech government is a significant co-owner of the four largest banks in the Czech Republic.

	State participation in equity capital, in %	of which: a) NPF participation in equity, in %	b) share of other state entities in equity, in %
Ceská sporitelna	45,00	45,00	--
Ceskoslovenská obchodní banka	65.69	19.59	19.59 - Ministry of Finance 26.51 - CNB
Investicní a poštovní banka	36.29	31.49	4.45 - Česká pošta (the Czech Post) 0.35 - Ministry of Finance
Komerční banka	48.74	48.74	--
Konsolidacní banka	100,00	--	established by the Ministry of Finance

Except for CSOB, these banks have been partly privatised through voucher privatisation. Nevertheless, the Czech government remains very strong, and is, in some instances, virtually the majority shareholder. Its activities hitherto, as a co-owner of the banks, cannot be clearly assessed. State participation has increased the reliability and stability of these institutions, most of which, at the beginning of the 90s, were becoming more well-known in the international banking community and establishing closer contacts, which was reflected positively in the ratings they were given. However, from a long-term perspective, such significant state participation as has been to date, is not considered to be positive or to be a systemic solution to the improvement of individual bank performance and growth in sound competition on the domestic market.

Due to the exclusive position of banks with state capital participation in the banking sector, the privatisation process must be thoroughly and reliably assessed, the accent being put on maximum prudence with the aim of avoiding any destabilising effects on individual banks and eventually on the entire banking sector. A basic motive for considering the privatisation of the remaining state share in these banks is to increase their effectiveness, profitability and competitiveness and to strengthen their reputations, in particular with respect to future EU membership. From the macroeconomic point of view, optimising the mechanisms for credit resource allocation in the economy is becoming more and more important. Therefore, not only the price aspects but others as well (e.g. the benefit from knowledge, investor business strategy, widening of "the range of available services" and their quality, etc.) will be considered during preparations for privatisation and during the assessment of new investors.

A study on the assessment of the effect of the regulatory regime on banking sector structure and performance

Such a study has never been done by the CNB. In addition, we are not aware of any other institution that has produced a similar study. The CNB as well as other authorities assume that the banking sector and the financial sector need a certain amount of space to finish the restructuring process and to increase competitiveness. At the same time, Czech authorities recognise that increased exposure of this sector to competition from abroad would contribute to enhancing the efficiency of domestic financial institutions and reducing further the still high costs of many financial services to the benefit of the non-financial corporate sector. We assume that the Czech banking sector is relatively accessible to market competition. Information from EU countries shows that a higher share of foreign banks in total banking assets can be found in Great Britain, Belgium and probably Ireland than in the CR. The CNB intends, as mentioned above, to create a regulatory framework that conforms to international standards.

	as of 31 Dec. 1996, in %	as of 30 Jun. 1997, in %
large banks	68.23	66.03
small banks	6.29	5.06
foreign banks	18.56	21.60
specialised banks	3.02	3.79
banks under conservatorship	3.91	3.51

Competition Regulation in the Banking Sector

Application of competition law to the banking sector in the Czech Republic

In the Czech Republic, the field of economic competition is regulated by Act No 63/1991 Coll., on the Protection of Economic Competition, in the wording of Act No. 495/1992 Coll. and Act No 286/1993 Coll. (hereinafter referred to as "the Act"). The Act provides a uniform legal regulation applicable to all spheres of the economy with no exemptions. According to § 2 (1,a), the Act applies to "natural and legal persons taking part in economic competition even though they are not business persons". This implies that the provisions of the Act are fully applicable to the banking sector. Introduction of any sector-specific competition rules is neither being proposed in the presently prepared draft amendment to the Act the objective of which will be to achieve a greater compatibility of the Czech competition law with that of the EC.

The only exception to the general applicability of the Act to the banking sector is laid down in § 8, which defines concentrations between undertakings. According to § 8 (3), a concentration is not deemed to arise where banks or other competitors, whose business activities include dealing in securities, hold on a temporary basis shares which they have acquired in another undertaking with a view to reselling them. A precondition for this exception to apply is that banks acquire the securities with a view to reselling them. Thus, they may not exercise voting rights resulting therefrom in order to control the competitive behaviour of the undertaking concerned. The temporary holding is generally accepted to be not more than one year. When the above-mentioned conditions are complied with, banks do not acquire control or rather the control is not actively exercised and, therefore, these transactions are exempted from the merger control⁷.

Enforcement of the competition law in the banking sector

In the Czech Republic, the field of competition law and policy is administered by the Office for the Protection of Economic Competition (hereinafter referred to as "the Office"). With regard to the general applicability of competition law, the enforcement of the Act falls within the full competence of the Office.

Competition environment developments

Presently, the quality of the competition environment within the banking sector is characterised by a considerable concentration of banking services in the hands of four financial institutions⁸ where Komerční banka has the strongest position among Czech banks with regard to granting credits and Česká spořitelna in the area of deposit services. Market shares of the largest banks gradually decreased, in particular in the area of deposits. However, the Czech banking sector may still be characterised as a market with oligopolistic features. The small and medium-sized banks cannot compete with the largest ones. Their future development will probably depend upon their ability to find and fill the gaps in the banking services market. At the same time, it is expected that smaller banks will merge resulting in an increase of competition in deposit, credit and other banking services and the creation of medium-sized banks hitherto insufficiently represented in the Czech market.

Enforcement activity of the Office

Due to a small amount of cases, the Office has so far only limited experience with the application of competition law in the banking sector. Nevertheless, within the framework of its activities, the Office closely follows the developments of market structures in the sector. For the purpose of monitoring the banking services market in the Czech Republic, the Office identifies markets for (i) the granting of credits and (ii) deposit services.

Mergers

Until now, there has been no "qualified" bank merger, i.e., a merger that would require the Office's permission (see footnote 1 above)⁹. A planned merger was being prepared between Ceska sporitelna and Ceskoslovenska obchodni banka - banks that rank among the largest Czech banks¹⁰. The main objective of the intended merger was to set up a bank located in Central Europe capable of competing in this region, as well as to create a viable competitor to the largest bank presently operating on the Czech market, i.e., Komerční banka. However, the management of the undertakings concerned decided not to carry out the transaction.

Abuse of a dominant position

In 1997, the Office investigated, on its own initiative, whether Ceska sporitelna had abused its dominant position on the payment cards market through preventing the interconnection between its ATM system and other financial institutions' ATMs. According to the findings of the Office, Ceska sporitelna began installing its ATMs in 1988 as an off-line system while others set up their on-line ATMs after 1991 on the basis of the Europay/Master Card and VISA licences. Since 1995, Ceska sporitelna has proceeded with a gradual replacement of the original equipment so that presently more than 50 per cent of their ATMs accept EC/MC and VISA cards. Thus, a client of any bank holding an EC/MC or VISA card can use ATMs of all financial institutions including the 500 readjusted terminals of Ceska sporitelna. With regard to the above-mentioned findings, the Office concluded that no breach of the competition law occurred.

In 1995, the Office dealt with a case of an alleged abuse of a dominant position by Ceska sporitelna on the market for the handling of budget accounts in the sense of § 9 (3) of the Act¹¹. After the investigation carried out within the framework of administrative proceedings the Office found that Ceska sporitelna, which holds a dominant position on the defined relevant market, imposed unfair terms and conditions in contracts with its clients. In its contracts Ceska sporitelna required that its clients accept and adhere to a clause stating the "savings bank's right to modify and amend business terms or cancel them through the issue of new ones" provided serious reasons occurred. The contracts further stipulated that an account holder is responsible for all damage and book debts caused by a loss, larceny or forgery of the payment instruments or by falsifying the signatures of persons entitled to handle the account. The administrative proceedings established that Ceska sporitelna refused to accept any changes in the wording of these clauses and conditioned the conclusion of the contracts on the clients' acceptance of these disadvantageous terms.

In its first-instance decision the Office held that the conduct of Ceska sporitelna is a manifestation of an abuse of its dominant position on the market for the handling of budget accounts in the sense of § 9 (3) of the Act, and imposed a fine of one million CZK. Ceska sporitelna subsequently appealed the decision to the Office's Chairman. The Chairman changed the decision to the effect that he annulled the imposition of the fine stating that the statutory time period had lapsed. The Chairman,

however, upheld the conclusions of the first-instance decision relating to the abuse. Ceska sporitelna brought the case before the High Court¹². The Court dismissed the action and thus upheld the decision.

Agreements

The Office has not thus far dealt with any cases of anti-competitive agreements between banks.

Competition advocacy

The Office reviews and comments upon draft government regulations focusing upon any issues that may arise in relation to competition. Within this activity, the Office voiced its comments on the prepared draft amendment of Act No 21/ 1992 Coll., on banks.

Specific features of the Czech financial market

As a result of the voucher privatisation, the Czech financial market has a relatively large amount of shareholders, a preponderance of immaterial forms of securities and non-adequate flow of information about the securities issuers. The financial market is to a great extent unconsolidated, whereby a small group of banks and investment companies holds a dominant position.

A major issue from the point of view of the economic competition protection is the capital interconnection between banks which creates potentially "favourable" conditions for collusive agreements or concerted practices in carrying out the entrepreneurial activities.

For example, a situation may arise where two banks would hold through their investment funds up to 40 per cent of shares in an undertaking that holds a dominant position on the relevant market. Since there is no obligation to inform the Office in this situation, a danger may arise that the Office will not discover this conduct by the banks even though it might eventually affect the environment on the relevant market. A much more dangerous situation would arise where two banks (funds) would control, through the ownership, a substantial part of an industry's undertakings. Consequently, this could result in an unchallengeable conduct, in particular, in direct control of the market with respect to prices.

NOTES

- 1 A financial institution is a legal entity other than a bank providing services stipulated in article 3.1., pension funds, investment companies, investment funds, insurance companies and the Stock Exchange.
- 2 Control means a direct or indirect share higher than 50 per cent of the equity capital of a legal entity or of the voting rights of a legal entity, or the right to appoint or recall most of the members of the statutory body, the Supervisory Board or the possibility of exerting decisive influence over the management of a legal entity in which an entity shall be a partner, shareholder or a member on the basis of an agreement with a legal entity, a provision in the Articles of a legal entity, agreement with other partners, shareholders or members of a legal entity, or the possibility of exerting decisive influence in another manner.
- 3 Qualified participation shall be understood as a direct or indirect share higher than 10 per cent of the equity capital of a legal entity or of the voting rights of a legal entity or exercising significant influence on the management of such a legal entity.
- 4 See footnote No. 2
- 5 Deposits of the Government and municipalities, client deposits, accepted credits from clients, bonds and similar securities held by the banks and with maturity up to five years, bills and other obligations held by the banks with maturity up to five years.
- 6 A deposit in a bank is understood to be any financial means entrusted to the bank which represent an obligation of the bank to the depositor to repay these financial means.
- 7 The Office for the Protection of Economic Competition makes decisions only on the concentrations between undertakings that distort or may distort competition. Competition is deemed distorted if the merging undertakings' shares exceed 30 per cent of the total turnover in the nation-wide or local market for the given product.
- 8 Komerční banka, Česká spořitelna, Československá obchodní banka a Investiční a Poštovní banka.
- 9 In 1996, the Office approved an acquisition of a joint-stock company Prisko by Konsolidacní banka Praha (KOB). KOB deals in particular with the financing of revitalisation and transformation programs of the large Czech enterprises. Prisko was set up as a non-manufacturing entity in connection with the privatisation of Skoda car company in order to settle its selected liabilities and book debts. In its decision, the Office held that a concentration between undertakings concerned will bring a necessary pressure from the new owner leading to an accelerated performance of activities that have been assigned to Prisko.
- 10 Česká spořitelna is a typical savings financial institution for domestic clients. Československá obchodní banka focuses on international transactions.
- 11 Article 9 Monopoly and Dominant Market Positions

(1) If a competitor, either alone or in agreement with other competitors, attains such a position on the relevant market that the competitor is not exposed to any competition (a monopoly position) or to any substantial competition (a dominant position), the competitor is obliged to notify the Ministry of this fact without delay.

(2) A dominant position on the market is that of a competitor who, over a period of a calendar year, supplies the relevant market with at least 30 per cent of its supplies of identical, comparable or interchangeable products.

(3) Monopoly or dominant positions may not be abused by the competitor to the detriment of other competitors or consumers, nor to the public interest. Such abuse may, in particular, consist in:

(a) the direct or indirect imposition of unfair terms and conditions in contracts with other parties on the market, especially enforcing an obligation that is in striking disparity to the counter-obligation provided in return at the time of conclusion of the contract,

(b) making a conclusion of contract subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts,

(c) applying dissimilar conditions to equivalent or comparable transactions with individual trading parties on the market, thereby placing them at a competitive disadvantage,

(d) ceasing or limiting production, markets or technical development of products for the purpose of attaining unjustified economic benefits to the prejudice of buyers.

12 In the Czech Republic, courts review the legality of decisions taken by bodies of state administration on the basis of legal actions.

FINLAND

(Office of Free Competition)¹

A brief survey of the Finnish finance and insurance markets²

Until the beginning of the 1990s, the Finnish service sector was fairly well protected from foreign competition. Finland's EU membership, however, has liberalised the provision of many services which had been heavily regulated. A good example are the finance and insurance markets.

For a long time, banks were the major players as the intermediators of finance in Finland. But since the 1980s, the changes that have occurred have brought about changes in the operating environment of banks. The finance markets were tightly regulated by the public authorities up until the mid-1980s when a gradual deregulation began. Finland's EU membership was instrumental in integrating the Finnish finance markets to the rest of the Europe. The first stage of the European finance market integration has consisted in the freeing of capital movements and the inclusion of financial services within free trade.

During the regulatory period, banks did not compete on prices but on market share and the quality of services. An extensive national network of bank offices provided a strong competitive edge in the attraction of savings at a time when electronic banking was still under development. Flexibility in the availability of banking services was the main form of banking competition during the period of regulation. Though its own support measures, the state promoted the building of branch networks. The dismantling of domestic regulation and European integration mean, in practice, a better choice of banking services. The biggest companies, in particular, are able to exploit foreign providers. Foreign credit institutions also have the right to set up subsidiaries and branch offices in Finland. Swedish banks, in particular, have used this possibility to establish themselves.

Due to the above-mentioned changes, the Finnish financial service sector has come to a major turning point in its existence. The companies have to adapt to foreign competition at the same time as they are still trying to strip off the heavy cost structures of domestic regulation. The changes have already affected the structure of the bank markets. All banks have sought to cut down on their offices and staff. The main reorganisations included the 1993 splitting up of Suomen Säästöpankki (Finnish Savings Bank) and the 1995 merger of KOP (National Bank of Finland) and SYP (Union Bank of Finland). So far, the foreign banks that have come to Finland have been mainly interested in large companies and the providing of general banking services in the population centres. With the development of electronic banking services, a stage may, however, be reached where the offering of banking services no longer requires that a customer visit an office. The retail trade, too, may be increasingly interested in attracting the savings of private citizens, which would serve to strengthen competition in this field.

Replies to the Questions on Regulation in the Finnish Banking Sector

The principal regulations affecting the banking sector are based, for the most part, on the corresponding provisions of the EC Directives.³

From the viewpoint of Finnish competition policy, it may be stated that the general attitude towards the entry of foreign banks is very positive. The foreign banks that have entered Finland have no restrictions on pricing or branching.

On the basis of the EEA agreement, eg. a foreign bank originating from any of the EEA countries has, since 1994, been allowed to offer all the financial services listed in the Second Banking Coordination Directive (89/646/EEC). Such banks have not had to seek a special operating licence.

At the end of 1997, the following representative offices/branches of foreign credit institutions could be found in Finland:

Branches (12)

Citibank Int. plc
Credit Agricole Indosuez
Den Danske Bank A/S
Ellos Finance Ab
Ford Credit Europe
Handelsbanken Finans Ab
Rank Xerox Credit Ab
Scania Finans Ab
Skandinaviska Enskilda Banken
Svenska Handelsbanken Ab
Telia Finans Finland
Unibank A/S

Representative Offices (7)

ABN Ambro Bank
Credit Suisse First Boston
Hambros Bank
Intourbank
Nordbanken
Nordfinanz Bank Zürich
Petrovskiy Commercial Bank

As a general rule, a 28 per cent VAT is collected on the interest paid to savings.

No tax is payable on interest rate income paid on specific, separately listed deposit accounts. A prerequisite for this is that the interest rate does not exceed a certain, previously determined level. The above-mentioned, separately listed deposit accounts of foreign banks in Finland are also tax-free.

With respect to compulsory deposit insurance, a system was introduced in Finland on 1 January 1998 which covers savings up to 150 000 FIM (approx \$US 28 000) per depositor and bank.

Industry regulators

The Ministry of Finance prepares legislation governing the finance markets and guarantees that the prerequisites for effective market performance exist. The Ministry is responsible for safeguarding the stability of the banking system and the control of capital movements. The Ministry is not an actual competition watchdog but finds it important that conditions for competition of the financial system are "balanced and equitable" (see Appendix 1).

It is the task of the Bank of Finland (the central bank) to safeguard the value of the currency, to promote the stability of the financial system and the security and efficiency of the currency supply. The central bank also has the sole right to issue notes and coin. The Bank of Finland maintains relationships with the central banks of various countries, international organisations and the major international financial institutions.

The Financial Supervision Authority (FSA)⁴ supervises financial markets and participants. The operational objective is to promote stable conditions in the financial markets and enhance public confidence in supervision and market behaviour. There are about 500 supervised entities. These include banks, brokerage firms, stock and derivatives exchanges, and management companies for mutual funds. The FSA operates in connection with the Bank of Finland but is an independent decision-making body.

Under the present competition law, the Financial Supervision Authority is also responsible for competition control in conjunction with the Office of Free Competition. The Finnish Government has recently proposed, however, that competition control in the finance markets be centralised solely at the Office. The Government proposal does not alter the other duties of the Ministry of Finance, the Bank of Finland or the Financial Supervision Authority.

On the other hand, it has been proposed that general supervision in the finance markets be reorganised (see Appendix 2).

Active industry lobby groups

The collaboration of banks is coordinated by the Finnish Bankers' Association whose foreign members include Skandinaviska Enskilda Banken (Sweden), Svenska Handelsbanken (Sweden), Citibank International plc (USA), Den Danske Bank (Denmark) and Unibank A/S (Denmark). The main committees and subcommittees of the Association are:

Legal Committee (incl. Accounting Subcommittee, Legal Affairs Subcommittee, Taxation Subcommittee)

Banking Technology Committee (incl. Clearing and Settlement Subcommittee, Payment Systems Subcommittee, Payment Instruments Subcommittee, Security Subcommittee)

Securities Committee (incl. Money Market Board)

Banking Committee (Corporate Customer Subcommittee, Private Customer Subcommittee)

Finance House Committee and International Affairs Committee.

State ownership in the Finnish banking industry is as follows. Postipankki Ltd is entirely owned by the state. Its market share in basic banking activities is approx 13-17 per cent. On 30 October, the state, through its asset management company Arsenal Ltd, had an approx eight per cent share of the capital stock and the voting rights of Merita Bank, the biggest bank in Finland.

Application of the national competition law to the banking sector

The Act on Competition Restrictions fully applies to Finnish banking services.

In the Credit Institutions Act, there are special provisions on bank mergers in the form of ownership control. A credit institution has to notify the Financial Supervision Authority of a minimum of 10 per cent ownership in another credit institution prior to the completion of the acquisition. The Financial Supervision Authority may object to the purchase or deny the owner of the shares the use of the voting rights if it finds it likely that the ownership would harm the functioning of the credit institution in accordance with its cautious and sound operating principles.⁵

At the moment, national competition legislation in the banking sector is enforced by the Office of Free Competition and the Financial Supervision Authority, which also monitors the financial solidity of banks (see above).

The Competition Council – a court-like judicial organ – operates as the court of appeal in exemption matters decided by the Office and, on the proposal of the Office, may also order that other types of competition restriction be terminated. The Council may also impose a fine on an entrepreneur. In addition to the Office of Free Competition, the Financial Supervision Authority may propose that a competition restraint in the banking sector be brought before the Competition Council.

The Financial Supervision Authority does not have the right to veto whether the Office of Free Competition makes a proposal to the Competition Council on the abolishment of a competition restriction in the banking sector, nor does the Office of Free Competition have the right to veto any proposals the Financial Supervision Authority may make to the Competition Council.

With respect to competition control in the banking sector, the position of the Financial Supervision Authority is about to change. The Finnish Government has, in December 1997, brought a bill before the Parliament on the enacting of a new competition law. According to the draft proposal for a new competition Act, the parallel competition control in banking matters would be removed (see Appendix 3).

Since Finnish competition legislation has so far lacked provisions on merger control, national competition authorities have not issued decisions on bank mergers and thus have not been involved in market definitions in merger cases.

Under Article 6 of the Finnish competition legislation, entrepreneurs or associations of entrepreneurs operating on a same production or distribution level shall not, by virtue of an agreement, a decision or a corresponding measure:

- fix or recommend the prices or compensation to be paid when carrying out trade; or
- limit production or divide the market or sources of supply unless this is required by an arrangement boosting production or distribution or one promoting technical or economic development where the benefit finally accrues to the clients or the consumers.

Under Article 19 of the Act on Competition Restrictions, the Office of Free Competition may order, at the request of an entrepreneur or an association of entrepreneurs, that the provisions of Article 6 not be applied to a competition restriction if it promotes the production or distribution of commodities or technical or economic development and if the benefit finally accrues to the clients or the consumers. If the Office deems that preconditions for an exemption do not exist, the issue shall, when the applicant so requests, be referred to the Competition Council for a decision.

In December 1997, the Bank of Finland published a survey comparing the payment methods and payment transfer systems of Finland and seven other EU countries. According to it, the Finnish payment methods (the links between banks and their customers) are the most developed electronically, i.e. they spearhead the EU development in that particular sector. This has obviously added extra challenges for the national competition authorities when they make decisions on the finance markets from a competition law viewpoint.⁶

During 1995-1997, the Office of Free Competition has granted four exemptions for collaboration in the banking sector. The collaboration has involved the joint organising of cash ATMs, giro ATMs, and the marketing, launching and development of the new national general prepaid cards.

The Office of Free Competition has granted the exemptions largely because the cooperation has added to the efficiency in the field at the same time that each bank party to the collaboration has an obligation for independent price setting of all the services offered. Independent pricing is demanded because, in spite of the collaboration, the parties to the collaboration engage in price competition, and the efficiency benefits achieved via the cooperation will thus be channelled to the benefit of the customers, too. In all the four exemption decisions, the parties to the collaboration abided by the decision made by the Office of Free Competition.

During the past two years, the Office of Free Competition has investigated 54 purely national competition cases in the banking sector (regulatory issues included).

So far, Finnish competition authorities have not issued a single decision in the banking sector whereby an individual entrepreneur or an association of entrepreneurs could be considered to hold a dominant position.

- Appendix 1. Government statement to Parliament on measures to develop the financial system and on public support refund (14 May 1996)
- Appendix 2. The proposal of evaluator Björn Wahlroos for the reform of the supervision of the financial markets (24 November 1997)
- Appendix 3. Estimate of the working group revising the Act on Competition Restrictions on the parallel control of the Office of Free Competition and the Financial Supervision Authority (30 January 1997)

APPENDIX 1

GOVERNMENT STATEMENT TO PARLIAMENT ON MEASURES TO DEVELOP THE FINANCIAL SYSTEM AND ON PUBLIC SUPPORT REFUND (14 MAY 1996)⁷

On 14 May 1996 the Finnish Government gave a statement to the Parliament on the plan for measures to develop the financial system and on the refund of public capital support given to the banking sector due to the banking crises in the early 1990s. The main features of the statement are as follows:

The development of the financial system requires an extensive series of measures

The Government statement emphasises that the development of the financial system will involve an extensive programme of measures. Key factors will include, on the one hand, that the general economic environment remains favourable and that conditions for competition are balanced and equitable; on the other hand that there are provisions for protection schemes and supervision of risk management development. Financial intermediation will have to be pursued efficiently, economically and in a safe manner, recognizing the risks involved.

Banks, investment service firms and insurance companies will have to pay greater attention than previously to the fact that the risks they take are in relation to their ability to carry those risks; also that risk management systems are developed in accordance with the requirements set by any changes in the operating environment. In the opinion of the Government an improvement in the risk assessment by the market participants themselves, i.e. market discipline and an increase in risk awareness, will have a significant effect on the functioning of the markets. The development of risk management systems together with diversification of the financial markets will decrease the likelihood of any systemic crises in the future similar to the banking crises in the early 1990s.

Expected public support refund

The expected refund of public support to the State will amount to 30 - 40 billion markkas. The total remaining cost of the banking crises for the State in terms of financial losses and uncertain receivables will amount to 45 - 50 billion markkas.

Excessive protection schemes will be dismantled

The stability of the Finnish economy will to a great extent depend on the reliability and stability of our financial and banking systems. However, as a result of the development of the economy and particularly of the banking system, there will no longer be any need to maintain too extensive protection schemes. In Finland, the maximum amount of compensation allowed under the deposit-guarantee scheme has not been restricted as in the other Member States of the European Union. Also the resolution issued by Parliament in February 1993, according to which the State of Finland guarantees that Finnish banks will meet their commitments under all conditions on a timely basis, has been a significant part of that protection scheme. In addition, the maintaining of this so called Bank Support Resolution will continue to be appropriate only as long as the circumstances within the banking system require.

In the opinion of the Government it will be possible to change over to a restricted deposit-guarantee scheme at some stage in 1997. A maximum limit at 150 000 markkas would be slightly higher

than the minimum limit laid down by the EU directive but about the same as the average in other Member States. In this case, approximately 96,5 per cent of the total number of deposits, representing 59 per cent of the volume would enjoy full coverage, which means that the system would provide adequate protection for small deposits. In order for the transition to take place smoothly the Bank Support Resolution should not be repealed until the new deposit-guarantee scheme has been put in place.

The most appropriate time to repeal the Resolution will be when the profitability of the banks has clearly improved. Furthermore, their solvency must be sufficiently strong with no major problems, particularly with regard to the receivables dating from the time of the banking crises. Therefore, in the opinion of the Government the Parliamentary Bank Support Resolution can be repealed once the restricted deposit-guarantee scheme has been adopted and the banking sector has made sufficient progress.

Risk awareness and market discipline will be increased

The aim is to create conditions favourable for increasing risk awareness in order to in advance prevent the banks from ending up in difficulties. In addition to the provisions of protection schemes it will also be required that comparable information concerning the operations of the banks will be increased. This can be achieved by the increased practice of issuing financial statements and interim reports and also by clarifying the tasks and duties of personnel providing information to the external auditors and those responsible for internal control. Other important means would be an improvement in risk management by banks, insurance companies and investment service firms, as well as cooperation between the various supervisory authorities. It is also important to emphasise the responsibility of the owners and management of the banks operations.

The dismantling of elements, which have provided certain incentives to the banks orientations, such as tax relief for fixed term deposits, the unrestricted deposit-guarantee scheme and the Bank Support Resolution will constitute significant structural changes in the financial markets. The removal of these measures will make conditions for competition in the financial markets more equitable. Consequently, the banks will have to further increase the effectiveness of their operations and pay particular attention to their risk positions and the development of their risk management systems.

Banks improved their results

The situation of the banks has been improving due to the positive economic development since 1993. Most banks were able to halve their credit losses in 1994. However, there are still substantial differences between the banks in degrees and stages of reorganisation. Operational results of the banks in 1995, before credit and guaranteed losses, were below that of the preceding two years. However, in the early part of 1996, bank performances have improved and positive results may be attained by them as a whole in the current year. Furthermore, significant reorganisation measures taken by the major banks should improve their results in 1997-1998.

Availability of financing to corporate sector to be improved

The aim of the development of the financial markets is to improve the opportunities for companies to get finance at every stage of their development. With the amendment of the Companies Act, equity instruments will be diversified. This will significantly facilitate the financial management of companies. Amendments to capital income taxation in 1993 made equity and non-equity financing equal as far as taxation was concerned. In addition, amendments to the Securities Markets Act have been proposed to facilitate the availability of financing for companies. The legislation relating to firms that provide investment services will be brought into force in the summer of 1996. As a consequence, services

such as asset management, market making, dealing and underwriting services will become subject to financial supervision and need an authorization.

The Government has presented to the Parliament a proposal concerning the amendments of the Act on Common Funds aiming at improving the operating conditions for such funds. The proposed amendments will promote the use of common funds in the securities markets and facilitate the establishment of new special funds aiming at improving, for example, the financial management of small and medium-sized companies.

APPENDIX 2

THE PROPOSAL OF EVALUATOR BJÖRN WAHLROOS FOR THE REFORM OF THE SUPERVISION OF THE FINANCIAL MARKETS (24 NOVEMBER 1997)⁸

Assignment

On 11 July 1997, the Ministry of Finance appointed an Evaluator to prepare a proposal on the reform of the supervision of the financial and insurance markets. In accordance with the assignment, a central goal is to ensure that the supervision of the financial markets is efficient, functional and comprehensive in the changing operating environment. The Ministry of Finance invited as Evaluator, Dr Björn Wahlroos, President of Mandatum & Co. The Evaluator submitted his proposal to the Ministry of Finance on 24 November 1997.

In accordance with the assignment, the Evaluator was to take into consideration the effect of the continuous integration and technical development of the financial and insurance markets on supervision. Special attention was to be paid to the changes to be caused by EMU on the operating environment as well as the gradual sectoral shifts in financial markets and the need for supervision of financial conglomerates. In his proposal, the Evaluator was to pay special attention to the appropriateness of the division of responsibilities between the authorities, the simplification of the supervisory system and the comprehensiveness of the supervision of groups of companies offering financial services.

Supervision to be centralised in a new Financial Supervision Authority

The Evaluator has decided to propose the establishment of a new supervisory authority, the Financial Supervision Authority, covering both banking, investment-service and insurance activities. The Evaluator is of the opinion that almost all arguments would seem to favour the combining of the existing separate supervisory organisations. Joint supervision is the optimal barrier against uncovered "black spots" in supervision. It is also the best guarantee for the neutrality of supervision and the most advantageous solution with regard to ensuring and utilising resources. Experiences related to the combining of the supervision of banking and insurance activities are almost solely positive in the other Nordic countries. Most ongoing international reforms of financial supervision are aimed at uniform supervision of the sector. For these reasons, financial supervision should also, in Finland, be organised into one independent supervisory authority.

The organisation of the new Financial Supervision Authority

In the opinion of the Evaluator, the resources allocated to the Financial Supervision Authority will determine its ability to carry out the tasks required. To succeed, the agency must be independent of the State personnel policy and the State budget. The Evaluator proposes that the new Financial Supervision Authority be managed by a Director General appointed by the President of the Republic for a fixed-term and a Board of Directors, with a considerable representation of members from outside State administration familiar with the financial and insurance sectors. A solution under which the Departments of the new Financial Supervision Authority would make their decisions on personnel and other resources within the framework of an annual total budget adopted by the Board of Directors would be ideal according to the Evaluator. The system under which the supervisory authority covers its expenses with

fees collected from those supervised has proved functional and also complies with international practice. There is no reason to change this.

Due to the rapid development of financial and insurance markets and the new types of companies emerging, the Evaluator is of the opinion that the Financial Supervision Authority should be organised on a functional and not on an institutional basis. He proposes that the new Financial Supervision Authority be composed of five Departments: the Credit Department, the Investment Department, the Insurance Department, the System Department and the Securities Markets Department. Their task would be the supervision of the type of risks in question irrespective of the legal form or main business of the supervised organisation. The Financial Supervision Authority should, in addition to the ordinary staff bodies be equipped with a development and monitoring unit, which would be responsible for sectoral monitoring and the relationships with legislative drafting authorities and authorities issuing provisions, as well as a unit responsible for international contacts.

The tasks of the supervisory authority and those supervised

The Evaluator points out that, in a general sense, public supervision is a guarantee of the reliability of the financial system. International rating agencies pay great attention to the arrangements and functionality of financial supervision. In addition, supervision has other more detailed tasks, the most significant of which are (1) the prevention of risk concentrations or chains threatening the stability of the financial system (system risk), (2) ensuring the availability of information and its correctness, adequacy and uniformity, (3) supervision of certain exclusive systems of payment and clearing traffic, (4) supervision of compliance with law and proper practice, as well as (5) ensuring the protection of small customers.

According to the Evaluator, in the light of the rapid development of the financial markets, supervision should be extended to all organisations providing or marketing financial services, such as organisations that (1) take deposits, (2) offer credit or other financing, (3) carry out any insurance activity, (4) act as intermediaries in the provision of securities, deposit, credit, insurance, or other financial services, (5) constitute a market place for securities, insurance policies or other financial products such as derivatives, (6) offer advisory services in the financial sector, (7) manage and/or market participations in mutual funds, (8) accept customer funds for management, (9) manage pension funds, (10) advice and manage the issuing of securities, (11) professionally transfer payments or attend to the clearing of securities or other financial product transactions or (12) manage book-entry registers.

According to the Evaluator, the setting up of the Financial Supervision Authority must not result in lesser responsibility on the part of the owners of financial institutions. In the insurance sector, supervision and the protection of small customers requires further changes by clarifying the statutory definition of property rights, the division of liability between the different investors, and decision-making. The best possible result in the regulation of the risks of financial service companies can never be achieved by mere enhancement of supervision. It is only through the creation of the prerequisites for an efficient allocation of resources based on market mechanisms and owner responsibility that the risks of depositors and insurance-policy holders can be minimised in the banking and insurance sectors.

Supervision and legislative drafting would be separated

The most important single measure in the development of the new Financial Supervision Authority is to separate legislative drafting and the issuing of provisions from the actual supervisory task. In practice, this has already been done in the supervision of the banking and securities markets, but in insurance supervision all the authoritative functions are centralised to the same organisational unit. As the law has

entrusted the insurance supervisor with quite extensive functions and powers, it is evident that the combination of the roles of a legislative authority and supervisor cannot be deemed to comply with good administrative practice or be appropriate with regard to the tasks of the supervision. It also involves a clear policy conflict with the administrative practice that, under a decision of the Constitutional Committee of Parliament, is applied *inter alia* to the supervision of banks.

The conditions of competition in the insurance sector have to be promoted

The report of the Evaluator contains a thorough analysis of the structures and prospects of the banking and insurance sectors as well as the relevant legislation and regulatory practice. He presents as his conclusion that a total reform of the Finnish legislation on pension, life and third-party liability insurance has to be implemented as soon as possible. The aim of the legislative reform should, by the dismantling of regulation, the promotion of owner responsibilities and a clearer definition of property rights, be to further the prerequisites for the development of sound conditions of competition in the insurance markets.

As for the general goals of financial supervision, the Evaluator considers it vital to continue the reform of pension systems with the aim of allowing more efficient and profitable investments in pension funds. When the large age-groups retire, their employment-related pension rights can only be ensured by increasing the yield on funds placed in reserve funds. However, according to the Evaluator, the supervision of investment activities and the definition of investment goals require that the beneficiaries of employment pension insurance be put in a position where they can better supervise pension institutions and obtain competing offers.

Other arrangements relating to the division of labour between the authorities

The Evaluator proposes that the responsibility for legislative drafting and the issuing of provisions be mainly retained in the same ministries as they have been. As an exception he proposes that due to the sectoral shift, legislative work and the issuing of provisions relating to market-based insurance activities, i.e., life and third-party liability insurance, be transferred to the Ministry of Finance. According to the proposal, the Ministry of Social Affairs and Health would thus be responsible for legislation and provisions relating to social insurance, the Ministry of Finance for those relating to credit institutions, securities markets, life and third-party liability insurance, and the Ministry of the Interior for those relating to the Local Government Pension Institution.

The Evaluator proposes that the new Financial Supervision Authority be placed directly under the Council of State. However, it is the opinion of the Evaluator that in the longer term, after the reorganisation has been implemented and it has proved functional, it may be appropriate to transfer the new Financial Supervision Authority to a ministry, and, in that case, primarily to the Ministry of Finance.

APPENDIX 3

ESTIMATE OF THE WORKING GROUP REVISING THE ACT ON COMPETITION RESTRICTIONS ON THE PARALLEL CONTROL OF THE OFFICE OF FREE COMPETITION AND THE FINANCIAL SUPERVISION AUTHORITY (30 JANUARY 1997)⁹

Existing legislation

The banking and insurance business fell under the field of application of the first competition law, the Act on the Competition Restrictions within the Economy effective from 1958. They were, however, removed from the Act on the Promotion of Economic Competition, effective from 1964 and remained so until 1988. With the 1988 revision, the Act on Competition Restrictions was again applied to the banking and insurance business but the main responsibility for competition control fell on the special authorities of the field. The previous Bank Supervision Office was responsible for competition control in the banking sector, and the Ministry of Social Affairs and Health for competition control in the field of insurance. These special authorities had the primary right to bring cases before the Competition Council. The Office of Free Competition was reserved a secondary right to commence negotiations for the removal of a competition restraint in the event that the special authority had not done so.

The inclusion of the special authorities in the competition control of the banking and insurance field was justified, during the preparation of the 1988 Act, by the expertise possessed by them of the field. However, the working party revising the current law found that the special authority is forced, in practice, to pay attention to principles which may contradict with the aims of promoting competition. Due to this, the centralisation of the handling of competition affairs in the Office of Free Competition was seen necessary.

The current Act, effective from 1992, gave the competition authorities independent powers to investigate the competition restraints within banking and insurance. The special authorities were, however, reserved a parallel right for competition control which included a parallel right for making proposals to the Competition Council. It was stated in the commentary to the Act that an appropriate cooperation entails that the other supervisory body be reserved the right to give a statement prior to a Council proposal. The right to give exemptions, however, was solely left for the Office of Free Competition in banking and insurance issues.

According to Article 12, paragraph 4, of the current Act, the Financial Supervision Authority (previous Bank Supervision Office) and the Ministry of Social Affairs and Health are also allowed to make proposals on the competition restraints in the fields monitored by them. In addition, the Credit Institutions Act, Article 11, and the Insurance Companies Act, Article 14a, include provisions on the safeguarding of competition. The said special authorities thus have a parallel right of control with the Office of Free Competition on the fields monitored.

In practice, the parallel right to make proposals has not been significant. During the time the Act on Competition Restrictions has been in force, the Office of Free Competition has investigated several competition restraint and exemption cases within the field of banking and insurance. The special authorities have not made any proposals to the Competition Council under Article 12, paragraph 4. The Office has, however, benefited from their expertise through its cooperation with the said authorities during

its investigation of competition restraints in those particular fields. The Office has also requested statements from the special authorities in all the exemption cases of the two fields.

The possibilities of the special authorities to examine competition restraints in the banking and insurance fields have been reduced by their lack of resources. The cases would have to be investigated by persons whose primary duties are related to questions whose solving may sometimes contradict with the aims of the competition legislation.

Evaluation of necessary changes: conclusions

The experience of the Office of Free Competition of supervision in the field of banking and insurance has shown that the fields in question do not much differ from other specially regulated fields. While investigating competition restraints in other sectors, the Office collaborates with the special authorities in the field. The parallel jurisdiction in the banking and insurance business thus cannot be justified by the special features of the fields in question. On the other hand, the dual control has caused problems eg. during company inspections, and it also enables the making of contradictory decisions by the authorities concerned.

Since, according to the working group proposal, the forbidding of competition restraints would not be brought before the Competition Council at all in the future –the Office of Free Competition would be the first-instance decision-maker – it would no longer be necessary to retain the right for parallel proposals. The experience gained from applying the current Act has also shown that there are no obstacles to the inclusion of competition control in the banking and insurance sector to the general procedure of the Act. The working group finds that the supervisory task in the said fields could be carried out as normal cooperation between two authoritative bodies. The working group thus proposes that Article 12, paragraph 4, of the Act on Competition Restrictions be annulled. This change also requires that the Financial Institutions Act, Article 11, and the Insurance Companies Act, Article 14a, be annulled or revised.

Independent of the new division of powers proposed by the working group, a Financial Supervision committee, which has delivered its report to the Ministry of Finance on 13 December 1996, has proposed that Article 11 of the Financial Institutions Act be annulled. The committee has found (cf. Committee reports of the Ministry of Finance 1996:17, p. 41) that, "The role of the Financial Supervision Authority in competition control is that of a special authority which, with respect to the general supervisory authority, mainly means the exchange of information; making of statements; and, in general, the need for an effective cooperation between the supervisory bodies for the benefit of exploiting the expertise of the special authority in competition control. To carry out this duty, a separate Article is not needed in the Financial Institutions Act; the tasks can be fulfilled as normal cooperation between two authoritative bodies. We thus propose that Article 11 of the Credit Institutions Act be annulled. The aim of this change is not to affect the suitability of the Act on Competition Restrictions in the financial sector. Following the annulment, the Act will still be suitable in the sector and the Office of Free Competition has the powers referred to in the Act to safeguard sound and effective competition in the credit business, too. The aim of the change is to make a distinction between the relevant authorities in competition control."

In order to insure the expertise of the special authorities of the field, the Office of Free Competition, when investigating competition restraints in the banking and finance sectors, should collaborate appropriately with the authorities in question. This requires eg. that, when investigating competition restraints in the banking and finance sectors, the Office reserve the Financial Supervision Authority and the Ministry of Social Affairs and Health to make a statement of a relevant case. The said authorities could naturally direct the Office's attention, when necessary, to any competition restraints they detect in their field of supervision, and cooperate with the Office on the removal of the restraints.

NOTES

- 1 For further information, please contact Senior Research Officer Mr Rainer Lindberg, Office of Free Competition, Haapaniemenkatu 5, P.O.B. 332, 00531 FIN-Helsinki; Tel. +359 9 3387; Fax +358 9 7314 3328; E-mail: rainer.lindberg@finofc.fi.
- 2 Source: Reforming the Finnish Competition Law - Merger Control and Competence Issues (in Finnish); Ad hoc committee reports 3/1997; Ministry of Trade and Industry.
- 3 For more details, see <http://www.rata.bof.fi/english/guidelines/guidelines.html>.
- 4 For a more detailed account on activities, see (<http://www.bof.fi>) and (<http://www.rata.bof.fi/english/index.html>).
- 5 For more details, see <http://www.rata.bof.fi/english/guidelines/guidelines.html>, section "credit institutions", Regulation no 101.6.
- 6 Tuula Hatakka (1997): Payment methods and payment transfer systems in the EU (in Finnish). Bank of Finland Discussion Papers No 19/1997.
- 7 Source: Ministry of Finance (<http://www.vn.fi/vm/english/statem.htm>).
- 8 Ministry of Finance Press Release 24.11.1997 (<http://www.vn.fi/vm/english/bear.htm>)
- 9 Source: Reforming the Finnish Competition Law - Merger Control and Competence Issues; Ad hoc committee reports 3/1997; Ministry of Trade and Industry.

FRANCE

Les règles spécifiques au secteur bancaire

Champ d'application de la réglementation bancaire - Définition

Avant de répondre au questionnaire proprement dit il peut être utile de restituer brièvement les grandes articulations de la loi bancaire de 1984 qui définit notamment le champ d'application de la réglementation bancaire ainsi que les différents statuts qui entrent dans la catégorie générique d'établissement de crédit.

La réglementation bancaire s'applique en France à tous les établissements de crédit qui sont eux mêmes définis par la loi bancaire de 1984¹ comme étant des "personnes morales qui effectuent des opérations de banque à titre habituel". La réception de dépôts du public, la gestion des moyens de paiement et l'octroi de crédits sont considérés comme étant des opérations de banque, les opérations de crédit bail et la délivrance de cautions étant assimilées à des opérations de crédit. Le champ d'application de la loi bancaire, et par conséquent celui de la réglementation qui en découle, est donc défini en France de façon très large.

Au sein des établissements de crédit, on distingue principalement d'une part les banques et les banques mutualistes et coopératives - qui peuvent effectuer toutes les opérations de banques - et d'autre part les sociétés financières qui ont une activité spécialisée (crédits à la consommation, crédit bail, affacturage...) qui est juridiquement limitée par les textes législatifs particuliers ou les statuts qui leur sont applicables. Les sociétés financières ne peuvent collecter des dépôts à vue ou à moins de deux ans à terme qu'à titre accessoire. Les caisses d'épargne et de prévoyance qui relèvent d'un statut juridique particulier sont aussi des établissements de crédit qui peuvent effectuer tous types d'opérations de banque.

Au delà des statuts juridiques différents qui peuvent limiter partiellement leurs activités, les établissements de crédit sont assujettis à une réglementation prudentielle substantiellement identique, sauf en ce qui concerne le capital minimum qui varie en fonction de l'étendue de l'agrément. De même les règles afférentes à l'exécution de tel ou tel type d'opérations, ainsi que le droit de la consommation applicable, ne font aucune différence selon ces statuts.

a) Aucune restriction particulière n'existe pour l'implantation de filiale ou de succursale étrangère en France.

La délivrance des agréments pour la constitution d'un établissement de crédit ou le rachat d'un établissement de crédit par une société étrangère répondent aux mêmes critères que pour les sociétés de droit français.

S'agissant des succursales, il convient de distinguer celles qui émanent d'établissements de crédit originaires d'un pays de l'Union européenne ou de l'espace économique européen et celles qui sont

1. La loi bancaire a été révisée par la loi de modernisation des activités financières du 2 juillet 1996, en application de la directive européenne sur les services d'investissement, qui étend le champ de la compétence des autorités bancaires aux prestataires d'investissement.

originaires d'un pays tiers. Pour les premières aucun agrément n'est requis, les autorités françaises n'ayant aucune responsabilité sur ces entités en application de la 2ème directive de coordination bancaire. Pour les secondes les agréments sont délivrés selon des critères comparables à ceux qui sont retenus pour l'ouverture d'un établissement de crédit bénéficiant de la personnalité morale, selon des procédures classiques.

b) Contraintes réglementaires affectant la définition de certains prix.

La rémunération des dépôts à vue en francs français est interdite, sauf pour ceux qui sont faits par des non résidents.

A coté des produits fiscalisés (SICAV, FCP...), il existe des produits d'épargne particuliers (plans épargne logement, comptes épargne logement, CODEVI...) dont le régime est défini par voie réglementaire. En particulier les intérêts versés sur ces dépôts, qui bénéficient le plus souvent d'avantages fiscaux, sont fixés par les pouvoirs publics.

c) Activités réservées à certains établissements

Tous les établissements de crédit habilités à recevoir des fonds du public peuvent en principe collecter ces types de dépôts à l'exception de produits très spécifiques (livret A) totalement centralisés pour assurer le financement du logement social

Quant aux règles qui encadrent la possibilité de procéder à des échanges de participations, pour limiter la portée de l'autocontrôle, elles sont les mêmes que pour les autres secteurs.

d) Règles relatives à la composition des portefeuilles d'actifs

Les établissements de crédit sont entièrement libres de placer leurs actifs comme ils l'entendent. Aucune règle ne leur impose de détenir tel ou tel type d'actif ou ne leur interdit la détention de tel ou tel autre. Cette liberté est toutefois sans préjudice du respect des règles de solvabilité définies aux niveaux européen et international, qui s'imposent aux établissements de crédit français.

e) Garanties des dépôts

En application des directives européennes les établissements de crédit doivent adhérer à un système de garantie des dépôts. Ces derniers bénéficient ainsi d'une protection en cas de défaillance de l'établissement collecteur pour un montant d'au minimum 400 000 francs.

Les systèmes de garantie sont distincts en fonction du statut juridique de l'établissement de crédit concerné (banque, banque mutualiste ou coopérative, société financière...). Toutefois les modalités générales de fonctionnement des systèmes de garantie et la nature des dépôts couverts sont définis par voie réglementaire.

f) Exigences en fonds propres

La réglementation applicable en France reprend les dispositions des directives européennes qui sont elles mêmes compatibles le plus souvent avec les recommandations issues du Comité de Bâle.

g) Réserves obligatoires

La banque de France a compétence pour exiger des banques que soient maintenues sur ses livres des réserves obligatoires non rémunérées. Toutefois les taux de réserve obligatoire sont aujourd'hui extrêmement faibles de sorte que le dispositif n'a pas d'importance significative.

h) Crédits destinés à soutenir certains secteurs

Il existe des procédures de crédits bonifiés par l'État accordés à différents secteurs : agriculture, pêche artisanale, artisanat, départements d'outre mer. L'enveloppe de ces crédits a beaucoup diminué au cours de ces dernières années de sorte que les crédits bonifiés ne constituent plus qu'une part très minoritaire des concours accordés à ces mêmes secteurs.

Par ailleurs, des procédures d'appels d'offres ont été mises en place de sorte que la distribution des enveloppes de crédit bonifiés peut être ouverte à tous les réseaux bancaires.

i) Règles relatives à l'insolvabilité ou à la liquidation

L'article 52 de la loi bancaire donne la possibilité au gouverneur de la Banque de France d'inviter les actionnaires à secourir un établissement de crédit dans lesquels il sont engagés. Cet article lui permet également de solliciter les autres établissements de crédit de la place lorsque la stabilité ou le renom de cette dernière sont menacés par la défaillance d'une banque.

La Commission Bancaire peut en outre nommer un administrateur provisoire pour les établissements en difficulté.

Descriptions des organes de réglementation et de surveillance bancaires

Le système français d'agrément, de réglementation et de surveillance bancaire constitue un système original, à trois pôles: le Comité des établissements de crédit et des entreprises d'investissement, le Comité de la réglementation bancaire et financière, la Commission bancaire.

Les trois fonctions de ces organes sont bien distinctes. En effet l'originalité du système de contrôle bancaire français tient à la rigoureuse séparation entre les trois fonctions d'agrément, de réglementation et de contrôle, et à leur dévolution à des entités distinctes.

Cependant, si ces organes autonomes sont en outre indépendants les uns des autres, ils sont tous reliés à la banque centrale, la Banque de France qui assume le rôle d'inspirateur du système.

a) Le Comité des établissements de crédit et des entreprises d'investissement (CECEI): la délivrance de l'agrément

Le CECEI délivre des agréments pour les établissements qui sollicitent le droit d'effectuer des opérations de banque à titre habituel (réception de fonds publics, opérations de crédit, mise à la disposition de la clientèle et gestion des moyens de paiement) (article 15 de la loi du 24 janvier 1984). Les conditions posées par cette procédure d'agrément visent à vérifier la solidité financière de l'établissement, le bien fondé économique de son activité et les garanties dues aux déposants. Elles portent donc sur les caractéristiques de l'entreprises (forme sociale, dotations en capital, moyens techniques et financiers, nature des activités), sur le profil des dirigeants (nombre, honorabilité expérience) ainsi que sur la qualité des apporteurs de capitaux et les garants.

b) Le Comité de Réglementation bancaire et financière (CRBF): l'élaboration des règles prudentielles

Le Comité est composé de sept membres, dont le nombre est porté à dix quand il examine des prescriptions d'ordre général, touchant à l'activité des prestataires de service et d'investissement, présidé par le représentant du ministre.

La loi de 1984 a confié au Comité le soin d'établir les normes destinées à garantir la liquidité et la solvabilité des établissements de crédit, à l'égard des déposants et plus généralement des tiers, ainsi que l'équilibre de leurs structures financières.

Ces normes se traduisent directement par:

- des contraintes pesant sur l'activité, la comptabilité et la gestion interne des établissements de crédit (obligations en matière de fonds propres, de couverture et de division des risques, de publicité des comptes auprès des organes de décision, de contrôle et de surveillance;
- l'instauration d'une solidarité financière de place (sous la forme d'une participation obligatoire des établissements de crédit habilités à recevoir des dépôts à vue, à un système de garantie de fonds en cas de défaillance bancaire, d'un mécanisme contractuel de garantie solidaire des dépôts organisé par l'Association Française des Banques, du concours que peut requérir le Gouverneur de la Banque de France auprès de l'ensemble des établissements de crédit lorsqu'il lui apparaît que la situation d'un établissement de la place l'exige -article 52 de la loi bancaire-).

c) La Commission bancaire: le contrôle bancaire

La Commission bancaire est l'organe principal exerçant le contrôle bancaire. C'est une commission indépendante, sans personnalité juridique formelle ni patrimoine propre, mais qui assure une fonction de contrôle. Elle est composée de six membres: le gouverneur de la banque de France, ou son représentant, qui est le président, le directeur du Trésor, ou son représentant, ainsi que quatre autres membres nommés pour six ans par le ministre chargé de l'économie et des finances. Le mandat de la Commission est triple. Elle doit:

- contrôler le respect par les établissements de crédits des dispositions législatives et réglementaires qui leurs sont applicables et en sanctionner les manquements constatés;
- examiner les conditions de l'exploitation de ces établissements et veiller à la qualité de leur situation financière;
- s'assurer du respect des règles de bonne conduite de la profession.

Elle exerce donc à la fois des pouvoirs administratifs et des pouvoirs de sanction administrative. Son rôle va donc au delà du simple respect des normes prudentielles.

Le contrôle effectué est de trois types: un contrôle permanent dit sur pièces, un contrôle sur place et un contrôle général du système bancaire.

Ce contrôle est un contrôle *a posteriori*, les attributions de la Commission bancaire ne lui donnent pas le droit de s'immiscer dans la gestion des établissements de crédits, qui conservent toute latitude dans l'établissement de leur politique commerciale. (modalités de collecte des ressources,

catégories de crédits distribués). La Commission bancaire peut seulement constater, notamment à l'aide d'inspections ciblées et d'un *reporting* rapide, les éventuels déséquilibres financiers résultant des choix opérés par l'établissement; à ce titre, elle demandera, par exemple, un meilleur adossement des ressources aux emplois ou un provisionnement adéquat des risques encourus.

Outre le contrôle a priori qu'elle exerce elle-même par le biais de son Secrétariat général, la Commission bancaire incite les établissements financiers à renforcer leur contrôle interne, confirmant en cela une tendance européenne.

Ainsi, le règlement n°97-02 du 21 février 1997 du Comité de la Réglementation bancaire et financière, portant sur le contrôle interne des établissements de crédit incite ces derniers à la création de comités d'audit. De même, les prérogatives des services de contrôle interne, indépendants de la hiérarchie opérationnelle, et se rapportant directement aux organes de surveillance, au contrôleur bancaire et aux commissaires aux comptes ont été détaillées et renforcées. La tendance à une coopération entre ces derniers et les services de contrôle bancaire, comme en France ceux de la Commission bancaire, est d'ailleurs une tendance bien affirmée en Europe.

d) Le rôle de la Banque de France comme inspirateur du système

La Banque de France a pour mission principale de "définir et de mettre en oeuvre la politique monétaire dans le but d'assurer la stabilité des prix". Depuis le 4 août 1993, la Banque de France est devenue indépendante "Elle ne peut ni solliciter ni accepter d'instructions du gouvernement ou de toute autre personne", mais uniquement pour ce qui concerne la lutte contre l'inflation, car l'article 2 de la loi du 4 août 1993 ajoute que "seul le gouvernement détermine le change et la parité du franc".

Les objectifs de politique monétaire relevant de la Banque de France se traduisent par des contraintes réglementaires pour les établissements de crédit. Dans le but de rendre compatible la croissance de la masse monétaire avec les perspectives d'expansion économique, la banque centrale agit principalement sur les conditions de refinancement des établissements de crédit. Son intervention sur le marché monétaire constitue un instrument de lutte privilégiée contre l'inflation.

Accessoirement, elle dispose également de l'instrument des réserves obligatoires imposées aux établissements de crédit, dont elle contrôle l'assiette et le taux, et qui peuvent s'inscrire dans le cadre comptable de la réglementation bancaire.

Mais le rôle de la Banque de France ne se limite pas à fixer les règles de la création monétaire, elle assure la cohésion de l'ensemble du système de régulation. La Banque de France apporte une contribution décisive au fonctionnement du système de régulation et de surveillance du secteur bancaire français.

En effet, les trois comités mentionnés précédemment ne peuvent fonctionner que grâce à la mise à disposition d'un personnel -désigné sous le nom de Secrétariat -issu de la Banque de France.

Le personnel mis à la disposition de ces trois organes assure l'unité du système, en termes de recrutement et de formation, de méthodes et de buts poursuivis. Cette politique du personnel fait la spécificité du système de régulation bancaire français.

Divers organismes permettent d'alimenter une réflexion de place susceptible d'éclairer les pouvoirs publics sur les conditions de fonctionnement du système bancaire et financier. Le Conseil national du crédit et du titre (CNCT) rassemble notamment autour du Ministre et de la Banque de France,

qui en assure le secrétariat, des professionnels, des clients des banques (entreprises et associations de consommateurs) et des représentants des activités économiques (organisations professionnelles et clientèle des établissements de crédits)

Le Comité consultatif se concentre plus particulièrement sur les questions relatives aux relations entre les établissements de crédit et leur clientèle, les entreprises et les associations de consommateurs.

Enfin à un niveau beaucoup plus technique, le Conseil français d'organisation et de normalisation bancaire (CFONB) vise à élaborer au sein de la profession des normes techniques susceptibles d'assurer l'interopérabilité des opérations de banques entre les différents réseaux (circuits des chèques, compensations des opérations de paiements...).

Parmi les accords interbancaires les plus importants, on peut citer ceux relatifs à l'organisation du système de paiement par cartes bancaires.

Les établissements de crédit sont regroupés, comme n'importe quelle autre profession, au sein d'organisations représentatives, l'Association Française des Etablissements de Crédit Et d'Investissement, (AFECEI) l'Association Française des Banques, (AFB) l'Association des Sociétés Financières (ASF) qui sont chargées de faire connaître et de défendre les intérêts de leurs mandants auprès des autorités publiques, des instances européennes ou encore devant l'opinion.

Le mouvement de privatisation, engagé depuis maintenant plusieurs années, a considérablement réduit l'importance du secteur public qui est maintenant clairement minoritaire. Les deux groupes bancaires significatifs qui restent encore majoritairement détenus par l'État, le Crédit Lyonnais et le CIC devraient faire l'objet prochainement d'un processus de privatisation.

L'application du droit commun de la concurrence aux opérations de banque

a) L'application du droit de la concurrence national

L'article 60.-III de l'Ordonnance du 1er décembre 1986 relative à la liberté des prix et de la concurrence, qui reprend les dispositions de l'article 89 de la loi bancaire du 24 janvier 1984 précitée dispose que "les articles 7 à 10 de l'Ordonnance s'appliquent aux établissements de crédit pour leurs opérations de banque. Les infractions à ces dispositions sont constatées, poursuivies et sanctionnées, par dérogation à l'article 45 de la présente loi (bancaire), dans les conditions fixées par les titres III et VI de l'ordonnance".

Le secteur bancaire est donc soumis, pour ce qui concerne son activité principale, les opérations de banque, à l'interdiction des ententes et des abus de position dominantes, sous le contrôle des autorités de la concurrence et tout particulièrement du Conseil de la Concurrence.

Le Conseil de la Concurrence est simplement tenu de communiquer à la Commission bancaire toute saisine rentrant dans le champ de compétence de cette instance, qui peut ainsi faire valoir ses observations.

b) L'application du droit de la concurrence communautaire

La Cour de Justice des Communautés européennes a confirmé, dans l'arrêt Züchner du 14 juillet 1981 que les articles 85 et 86 du Traité de Rome s'appliquaient bien aux services bancaires. Les banques

n'assument pas des services d'intérêt général au sens de l'article 90 du Traité, et ne peuvent donc pas se prévaloir de ses dispositions pour écarter l'application des règles de concurrence. Il en va ainsi notamment pour la gestion des systèmes de paiement. La Commission européenne estime que l'organisation des systèmes de paiement peut être examinée sous l'angle des pratiques d'entente prohibées par l'article 85.

Certains professionnels contestent régulièrement cette faculté au motif qu'il n'y aurait pas de marché des services interbancaires, mais seulement l'exécution par les banques, hors de toute possibilité de mise en concurrence, des obligations contractées par leurs clients respectifs.

La Commission Européenne considère, pour sa part, que les commissions interbancaires multilatérales inhérentes à la mise en oeuvre d'un système de paiement ont des conséquences directes sur les relations commerciales entre banques et que les conditions de la détermination de ces commissions peuvent entraîner une réduction artificielle de la concurrence.

c) l'activité consultative des autorités de la concurrence

Outre leur activité juridictionnelle, les autorités de concurrence apportent leur conseil pour toutes les questions de concurrence relatives à ce secteur professionnel.

Le Conseil de la Concurrence a d'ailleurs été amené à rendre deux avis circonstanciés sur des questions de concurrence dans ce secteur.

Enfin, pour ce qui concerne les opérations de concentration susceptibles de créer ou de renforcer une position dominante sur un segment du marché bancaire ou d'affecter le fonctionnement de la concurrence, il y a lieu d'articuler les dispositions prévues par l'ordonnance du 1er décembre 1986 sur la liberté de la concurrence avec les règles spécifiques prévues par la loi relative au contrôle des établissements de crédit.

Il y a lieu toutefois, selon les autorités de concurrence, de considérer que ces dernières, édictées dans un but essentiellement prudentiel et étranger aux objectifs généraux de maintien de la concurrence, s'ajoutent aux règles générales de contrôle des concentrations, mais n'y dérogent pas et ne s'y substituent pas.

Les problèmes de concurrence posés aux autorités de la concurrence françaises ou communautaires

Il convient de distinguer deux sortes de distorsions de concurrence:

- celles qui, étant le fait d'entreprises du secteur, ont fait l'objet ou sont susceptibles de faire l'objet d'une décision par les autorités de concurrence, au titre de l'application des règles de concurrence,
- celles qui revêtent un caractère structurel, et dont certaines ont été examinées par le Conseil de la Concurrence dans le cadre de ses attributions consultatives, à la demande du Gouvernement ou du Parlement.

1) Les distorsions de concurrence liées à certaines pratiques anticoncurrentielles

Les instruments de paiement électronique ont connu un essor très précoce, en France. Afin d'améliorer la gestion de ce système de paiement, les établissements ou institutions bancaires ont

constitué un groupement d'intérêt économique (GIE), réunissant la totalité des émetteurs français de cartes bancaires.

Le Conseil de la Concurrence, tout comme la Cour d'Appel de Paris ont eu très rapidement à se prononcer, et à plusieurs reprises, sur les modalités d'organisation et de fonctionnement de ce GIE, qui apparaissait comme une structure d'entente.

Il s'agissait d'abord de savoir si l'offre de cartes bancaires présentait bien le caractère d'un marché spécifique des moyens de paiement, distinct de celui des cartes accréditives. Le Conseil a, dans la décision du 11 octobre 1988, répondu affirmativement.

Examinant ensuite ce groupement, le Conseil a considéré que cette entente n'était pas en soi illégitime. Mais il a relevé que les limitations de concurrence que ce groupement pouvait décider ne pouvaient être admises qu'à la condition qu'elles soient nécessaires au fonctionnement du système ou strictement indispensables à la réalisation du progrès économique, objectif assigné au GIE.

a) Le Conseil a d'abord examiné les conditions d'adhésion au GIE carte bancaire, fixées par le contrat constitutif du groupement.

Étant acquis que l'accès d'un établissement de crédit installé en France au marché des cartes bancaires dépendait de la possibilité d'adhérer au GIE-CB, le Conseil a estimé que la possibilité pour son comité directeur de refuser une adhésion sans motivation pouvait lui permettre de mettre en oeuvre des comportements discriminatoires et de limiter la concurrence.

Le Conseil a donc enjoint au GIE-CB de motiver ce type de décision, afin d'en permettre le contrôle.

b) Il a ensuite condamné deux types de stipulations tarifaires contenues dans le protocole du groupement:

- celles consistant en une tarification minimum du prix de la délivrance des cartes aux porteurs, qui ne se justifiait par aucune considération technique et il en a ordonné sa suppression.
- celles consistant en la détermination par le comité exécutif du GIE d'un taux unique, fixé en pourcentage du montant des transactions, pour la commission d'interchange, perçue entre banques à l'occasion des opérations de crédit-débit consécutives aux paiements effectués par carte bancaire.

Le Conseil a considéré que cette pratique altérerait la capacité de négociation des établissements de crédit vis-à-vis de leur clientèle de commerçants, étant entendu qu'ils étaient incités à pratiquer des taux de cotisation calculés en fonction du coût de cette commission d'interchange.

Il a notamment considéré qu'alors que le taux moyen de fraude et de paiements abusifs enregistré d'une banque à l'autre s'insérait dans une amplitude de variation très large (de zéro pour cent à 5,2 pour cent), le dispositif de cette commission interbancaire avait pour effet de répartir uniformément le poids de la fraude sur l'ensemble des banques, au détriment de celles qui contribuaient le mieux à en limiter la portée et indépendamment des efforts consentis par leur clientèle de commerçants en vue de réduire les risques de fraudes.

Le Conseil, et la Cour d'Appel de Paris, statuant à son tour, ont donc ordonné au GIE "CB" de réformer son mode de calcul de la commission d'interchange de sorte à en garantir le caractère objectif et non discriminatoire, notamment en distinguant, dans le calcul de ladite commission:

- un élément destiné à couvrir les charges fixes inhérentes au traitement de la transaction, qui devait être indépendant du montant de la transaction;
- un élément destiné à couvrir le coût de la garantie de paiement, qui devait être proportionné au taux de fraude et de paiement abusif présenté par chaque établissement et réactualisé périodiquement.

Le GIE n'ayant pas obtempéré immédiatement aux premières injonctions, le Conseil lui a infligé une sanction pécuniaire de six millions de francs.

c) Le Conseil a ensuite examiné les clauses du modèle de contrat d'adhésion des commerçants.

Parmi ces clauses, il a considéré que la clause interdisant aux commerçants de répercuter sur ses clients payant par carte bancaire tout ou partie du prix du service rendu par la carte était licite.

En effet, il a constaté que *"le développement de la carte constituait une contribution au progrès et que cette clause, en empêchant de répercuter le prix du service, interdisait des comportements qui, en rendant moins facile ou plus onéreuse l'utilisation de cette carte pour les porteurs, limiterait son développement"*.

d) Enfin le Conseil a sanctionné l'interdiction faite aux membres du groupement d'émettre l'eurochèque pour un usage en France.

Introduit en France en 1975 par les banques populaires et le Crédit mutuel, le service eurochèque permettait aux détenteurs de la carte "eurochèque", outre le retrait d'espèces, de procéder à des paiements chez les commerçants affiliés en France et dans 13 pays européens. (Ce service est très répandu au Bénélux) La carte eurochèque ne dispense pas d'établir un chèque mais permet la garantie du paiement de ce dernier, jusqu'à un certain montant, par l'établissement émetteur.

Le GIE "carte bancaire" avait soumis l'adhésion des banques susmentionnées au groupement à la condition du renoncement de celles-ci à l'émission des cartes eurochèque et à la garantie gratuite des chèques associés.

Dans sa décision du 15 octobre 1988, le Conseil de la Concurrence a d'abord considéré que cette interdiction avait eu pour effet d'éliminer un produit concurrent de la carte bancaire et ensuite de restreindre la liberté qu'a chaque établissement d'établir sa politique commerciale.

Il a donc enjoint au GIE "CB" de supprimer ladite clause du protocole d'accord avec les banques populaires et le Crédit Mutuel.

2) les distorsions structurelles

a) les distorsions liées à la détention de certains privilèges

Certains établissements bénéficient de privilèges particuliers, liés ou non à leur statut, consistant en l'exclusivité du placement de certains produits bancaires. Dans le cadre de ses activités consultatives, le Conseil de la Concurrence, saisi par la commission des finances du Sénat, a rendu un avis, le

17 septembre 1996 sur les conditions de concurrence prévalant dans le système bancaire et de crédit français et s'est prononcé sur ces privilèges. Cet avis a été publié sous la seule responsabilité du Conseil et n'engage pas le Gouvernement français.

Le Conseil en a analysé principalement deux :

- le monopole de distribution du livret A réservé à la Poste et aux Caisses d'Épargne, et du livret bleu, distribué exclusivement par le Crédit Mutuel

Le livret A et le livret bleu sont des compte d'épargne dont les taux de rémunération sont fixés par l'État, actuellement de 3,5 pour cent, mais défiscalisés. A l'origine, les livrets A étaient destinés à favoriser l'épargne populaire. La collecte de cette épargne permet à ces établissements de réaliser une part importante de leur produit net bancaire (environ 15 pour cent pour les Caisses d'Épargne). Les fonds collectés sont ensuite déposés à la Caisse des Dépôts et Consignation et utilisés pour financer le logement social.

Le Conseil a considéré que si le livret A avait bien le caractère de produit d'appel, et si son placement pouvait générer un avantage concurrentiel, d'autres produits ou services distribués librement, et notamment l'offre de crédit, pouvaient comporter les mêmes effets.

En revanche, il a constaté que ni la Poste, ni les réseaux des Caisses d'Épargne n'étaient investis d'une mission d'intérêt général consistant en la distribution du livret A.

Cependant, dans un avis précédent, en date du *25 juin 1996, relatif aux activités concurrentielles de la Poste*, il s'était demandé, au regard des restrictions de concurrence tolérées par l'article 90-2 du Traité de Rome, si une banque, dont on aurait reconnu la mission de *banque sociale* par un acte de puissance publique, pourrait assurer dans des conditions financièrement équilibrée cette mission, en l'absence de l'attribution de droits spéciaux.

En effet, dans l'hypothèse d'une banalisation du livret A (c'est à dire de la suppression du monopole à la Poste et aux Caisses d'Épargne), le Conseil a suggéré que la politique commerciale sélective menées par les banques laisserait à la charge de ces établissements les comptes les moins rentables, sur lesquels les dépôts sont de faible montant et les opérations nombreuses, sans lui donner l'assurance de couvrir les coûts d'une implantation nationale, dictée notamment par des contraintes d'aménagement du territoire. Car, en pratique, la Poste et les Caisses d'Épargne reçoivent la clientèle qui ne dispose d'aucun autre compte en banque.

Quant à la mission de financement du logement social, assuré de façon indirecte par ces organismes, puisque les fonds qu'ils collectent y sont exclusivement consacrés, le Conseil a considéré qu'aucun élément ne permettait de considérer que l'ouverture à la concurrence serait de nature à le compromettre, à condition toutefois que les établissements nouvellement autorisés à distribuer ce Livret A soient et restent soumis à l'obligation de centralisation des fonds collectés.

- le monopole du dépôt des fonds des particuliers confiés aux notaires, qui est réservé à la Caisse des dépôts et consignation et au Crédit Agricole

La question se posait de savoir si l'attribution de ce monopole était compatible avec l'article 90 du Traité.

Le Conseil a d'abord examiné les justifications avancées. Il a relevé que si celle tenant au financement du logement social pouvait être retenue pour expliquer la centralisation des fonds du livret A auprès de la Caisse des Dépôts et Consignation, en revanche, celle tirée de la nécessaire sécurité des dépôts, qui est considérée comme la principale raison de l'attribution de ce monopole, pouvait être discutée.

Le Conseil a donc considéré que si une réglementation appropriée garantissait de façon obligatoire et illimitée les fonds déposés par les particuliers chez les notaires, d'autres établissements de crédit seraient à même de recevoir ces fonds, et l'attribution de droits exclusifs à ces établissements ne pourrait plus être envisagée comme acceptable au regard de l'article 90 du Traité de Rome.

En outre, il a considéré que l'une des raisons ayant conduit à l'attribution de ce droit exclusif au Crédit Agricole - le souci des pouvoirs publics de faciliter le développement de cet organisme de création récente, en raison du rôle qu'il était appelé à jouer dans les régions rurales en matière de financement de l'agriculture-avait disparu, puisque:

- d'une part, le Crédit Agricole n'est plus un établissement public, mais une société anonyme, dont l'activité s'est banalisée depuis la diversification des opérations qu'il est amené à conduire;
- et que d'autre part, il est devenu l'une des premières banques françaises.

b) les distorsions de concurrence induites par l'exploitation de ressources tirées du service public pour le financement d'activités concurrentielles

Le Conseil de la Concurrence a eu également à se prononcer, dans un avis du 25 juin 1996 sur l'utilisation par la Poste, pour ses activités concurrentielles, (gestion des comptes des chèques postaux, services des mandats, activités de la caisse nationale d'épargne, participation au système d'épargne logement), de l'ensemble des structures (locaux, matériel, personnel) affecté au service de la distribution postale.

Un exemple de la mise à disposition de structures était donné par le fait que certains préposés à la distribution du courrier sont désormais commissionnés pour démarcher les usagers du service public dans le but de placer les produits bancaires et financiers de la Poste.

Dans son avis, le Conseil de la Concurrence a rappelé qu'il ne lui appartenait pas, au titre de ses attributions consultatives, de se prononcer sur la licéité des services de démarchage de la Poste.

En revanche, il s'est interrogé sur l'éventualité d'un abus de position dominante de la part d'un opérateur public détenant un monopole légal sur une activité de service public et agissant dans un secteur concurrentiel.

En l'espèce, il a pris acte du fait que "les services financiers de la Poste et les banques exploitent leurs activités dans des conditions très différentes", rendant malaisé "l'examen comparatif des conditions de concurrence" et que la jurisprudence AKZO de la Cour de Justice des Communautés Européenne était imparfaitement applicable.

Après avoir constaté que la Poste subissait, dans son activité financière, des coûts de gestion découlant de sa mission de Service public, et ne disposait pas des fonds collectés pour développer une activité de crédit, le Conseil a conclu que l'abus de position dominante de l'opérateur public ne pouvait pas être directement établi à partir de "la seule considération des coûts et de sa stratégie de prix."

Développant les conditions d'application de la jurisprudence AKZO, mentionnée ci-dessus, au cas particulier d'entreprises dont le monopole s'accompagne d'obligations de service public, il a indiqué que :

“La seule circonstance que l'opérateur dominant enregistre une perte, fut-elle importante, ne suffit pas à établir que l'opérateur a cherché à éliminer ses concurrents. À l'inverse, le fait qu'un tel opérateur enregistre un bénéfice, pour son activité, pourrait être compatible avec une pratique de prix destinée à éliminer du marché des concurrents aussi efficaces que lui, à condition que cet opérateur public bénéficie pour l'exercice de cette activité concurrentielle, de conditions plus favorables, pour des raisons associées à l'exercice de sa mission de service public.”

Le Conseil a également précisé que les charges particulières que l'État impose à la Poste d'assumer devraient être reconnues en tant que telles, et faire l'objet d'une compensation financière proportionnée, dans le droit fil de la doctrine forgée par la Commission Européenne qui avait établi en 1995 que “les coûts supplémentaires induits par les obligations de service public de la Poste sont supérieurs à l'avantage qui lui est octroyé par l'abattement de 85 pour cent de la taxe professionnelle”.

Le Conseil a enfin indiqué que la prévention des éventuels abus rendait indispensable le perfectionnement de la comptabilité analytique de l'opérateur public, afin d'identifier les coûts résultant des sujétions particulières imposées à l'établissement par les pouvoirs publics, et ne saurait être totalement garantie sans l'intervention d'une séparation des activités sous monopole et des activités concurrentielles, dans le respect si nécessaire de l'unité institutionnelle de la Poste.

c) Les distorsions liées à la propriété du capital et à l'existence d'aides

L'existence d'aides publiques aux entreprises dont l'État possède le capital, peut perturber le bon fonctionnement de la concurrence. La Commission européenne veille à ce que le régime de ces aides soit conforme au droit de la concurrence communautaire. A cet effet, la Commission Européenne applique sa méthode habituelle, qui consiste à se demander si un investisseur privé, agissant dans des conditions normales d'économie de marché, aurait effectué les mêmes opérations. Si la réponse est négative, ces mesures sont qualifiées d'aides et contrôlées par la Commission à la lumière des articles 92 et suivants du Traité de Rome.

GERMANY

Legal basis and aims

The legal basis for the supervision of banking and financial services (“banking supervision”) is the Banking Act. This Act is aimed at safeguarding the viability of the financial sector, which is particularly sensible to fluctuations in confidence, by protecting creditors. The Act seeks to achieve this aim while paying due regard to free market principles, i.e. the entire responsibility for business decisions rests with the managers of the credit and financial services institutions (“institutions”). The activity of the institutions is restricted only by qualitative and quantitative general provisions and the obligation to open their books to the supervisory authorities. The intensity of supervision of the financial services institutions depends on the type and scale of the financial services provided. The supervisory authorities do not intervene directly in institutions' individual operations.

Organisation

Banking supervision is carried out by the Federal Banking Supervisory Office, working in cooperation with the Deutsche Bundesbank. The Act assigns the central role in banking supervision to the Federal Banking Supervisory Office (section 6 of the Banking Act). The Federal Banking Supervisory Office reports directly to the Federal Ministry of Finance.

Recognising that the functions of the authority responsible for banking supervision and those of the central bank are interconnected, the legislature has provided for the Bundesbank to be involved in banking supervision, particularly as the Federal Banking Supervisory Office has no substructure of its own. It is only the Bundesbank system, with its main offices and branch offices, that ensures efficient and cost-effective supervision, at a local level, of the more than 3 600 credit institutions and of the financial services institutions, the number of which is currently unknown as the licensing procedure is still in progress, in the Federal Republic of Germany.

There is a clear division of functions between the Federal Banking Supervisory Office and the Bundesbank in the area of banking supervision:

- Sovereign functions, e.g. the issuing of administrative acts, are the responsibility of the Federal Banking Supervisory Office.
- Before issuing general regulations, the Federal Banking Supervisory Office must confer with the Bundesbank. The degree to which the Bundesbank is entitled to participate is graduated according to the extent to which such regulations affect its functions. Thus, when issuing Principles concerning capital and liquidity, the Federal Banking Supervisory Office is required to reach agreement with the Bundesbank, while in other cases the Bundesbank merely has to be consulted.
- The Bundesbank is fully involved in the regular surveillance of credit and financial services institutions. It analyses their annual and other reports. Observations which the Bundesbank

makes in the course of performing its statutory tasks are likewise used in the monitoring operations.

Development of banking supervision after the Second World War

After the end of the War, banking supervision was initially carried out at Länder Government level. There was no uniform regulatory framework throughout the Federal Republic until the passing of the Banking Act of July 10, 1961, which at the same time created the legal basis for the establishment of the Federal Banking Supervisory Office.

The extension of credit institutions' business operations, in particular outside Germany, fairly soon raised the question of how the instruments of banking supervision could be brought into line with these developments.

The amendment of the Banking Act in 1976 confined itself to closing the gaps in banking supervision which had become particularly obvious upon the failure of Bankhaus I.D. Herstatt in 1974. In preparation for an extensive revision of the Banking Act, the Federal Ministry of Finance set up a Commission of Inquiry into "Basic Banking Questions" in November 1974. The Commission also had to examine whether the structure of the German banking system should be changed. In its report, which was submitted in May 1979, it came to the conclusion that the German banking system had proved to be effective. However, the Banking Act would have to be adjusted to the changes in the credit institutions' risk position. It was necessary to ensure that credit institutions had adequate capital, both individually and on a consolidated basis. These findings of the inquiry were in line with the demands which the banking supervisory authorities had been making in the light of their practical experience.

The Act Amending the Banking Act which came into force on January 1, 1985 introduced a consolidation procedure for banking supervision purposes in addition to the existing supervision of individual credit institutions. Until that time, credit institutions could build up credit pyramids through their subsidiaries without any increase in the parent institution's capital base, and thus bypass the restrictions on business operations that were based on the credit institutions' capital.

The further amendments, the most recent one being the Sixth Act Amending the Banking Act as of January 1, 1998, served to implement Directives of the European Union and thereby to harmonise banking supervision legislation in the European Economic Area (EEA). As a result, the legal conditions have been created for the freedom of banking activities and financial services in the single European market. Throughout the EEA the same regulations now apply to the authorisation and the ongoing supervision of credit and financial services institutions, to the supervision of branches in other EEA countries of credit and financial services institutions having their headquarters in an EEA country by the competent home country authorities (Second Banking Co-ordination and Investment Services Directives), to the definition of capital (Own Funds and Capital Adequacy Directives), to the consolidated supervision of groups of institutions and financial holding companies (Consolidation Directive) and to large exposures (Large Exposures and Capital Adequacy Directives). Principle I was significantly restructured by the implementation of the Solvency and Capital Adequacy Directives. Harmonisation of banking supervision in Europe has thus been largely completed.

The implementation of the Investment Services and Capital Adequacy Directives by means of the Sixth Act Amending the Banking Act has harmonised, in particular, the supervision of investment firms and credit institutions. Investment firms, though they are in direct competition with the German-type

universal banks, have hitherto been subject to limited supervision only. The minimum standards for conducting the business of providing financial services now apply to credit institutions and financial services institutions alike. The Capital Adequacy Directive harmonises the own funds requirements for the assumption of market, free delivery, settlement and large exposures risks associated with carrying out transactions in securities and derivatives (financial instruments).

For this purpose, the concept of "trading book institution" has been introduced into the Banking Act, as only these institutions are affected by the changes of the Sixth Act Amending the Banking Act in respect of market and large exposures risks. Trading book institutions are those institutions which deal for their own account, regardless of whether or not this is done as a service for third parties. Hence the trading book is deemed to include all proprietary positions in financial instruments, marketable assets and equities taken on by the institution with the intention of profiting in the short term from price variations and differences between buying and selling prices.

Institutions with negligible trading book business are not required to comply with the trading book provisions. In this case, the banking book provisions apply to those positions which actually should be included in the trading book. This exemption is subject to the condition that the trading book business does not normally exceed five per cent of the institution's total on and off-balance-sheet business, or ECU 15 million, and never exceeds six per cent, or ECU 20 million.

The definition of financial services institutions used in the Banking Act does not coincide with that of investment firms in the Investment Services Directive. With a view to ensuring comprehensive supervision of the market for financial services in the broader sense, not only investment services providers (own-account trading as a service for third parties, contract and investment broking and financial portfolio management), but also non-EEA deposit broking, financial transfer services and dealing in foreign notes and coins, for example, are defined as financial services, going beyond the scope of the Investment Services Directive. The investment services of financial agency business and underwriting business have been declared to be part of the banking book.

In line with a recommendation from the Council of the European Monetary Institute, the list of banking book business has been extended to include prepaid card business and also network money business. This makes it possible to counteract undesirable developments in the field of these new (electronic) forms of payment at an early stage and to ensure the safety and viability of cashless payments, which play an important role in the economy as a whole.

Under the Post-BCCI Directive, which is likewise being implemented, authorisation of enterprises wishing to conduct banking business or provide financial services is to be refused or withdrawn if the structure of the enterprise or the relationships between it and other entities in the group make it impossible for the enterprise to be supervised effectively. The directive also contains provisions on the exchange of prudential information between supervisory authorities and other bodies and on the obligation of external auditors to provide information.

Basic features of the Banking Act

Scope

All enterprises which conduct the business of banking within the meaning of section 1 (1) of the Banking Act and of providing financial services within the meaning of section 1 (1a) of the Banking Act

commercially or on a scale which requires a commercially organised business undertaking are subject to the Banking Act. It does not matter whether the capital is German-owned or foreign-owned.

A branch of an institution having its headquarters in another EEA state does not require authorisation or any endowment capital and is, in principle, supervised by the competent home country authorities of the institution. By contrast, the branches of institutions in non-EEA countries must be authorised by the Federal Banking Supervisory Office and have endowment capital; they are, in principle, supervised by the Federal Banking Supervisory Office, like domestic credit institutions. Some specialised credit institutions (such as mortgage banks, ship mortgage banks, building and loan associations and investment companies) are, moreover, subject to special laws in addition to the Banking Act. Savings banks must comply not only with the Banking Act but also with savings bank laws passed under Land legislation.

Licensing

Any person who wishes to operate an institution requires a licence from the Federal Banking Supervisory Office (section 32 of the Banking Act). The licence may be limited to certain types of banking business or financial services. Conducting banking business or providing financial services without a licence is a punishable offence (section 54 of the Banking Act). No specific legal form for institutions is stipulated in the Banking Act, although since 1976 institutions have not been allowed to conduct banking business in the form of a sole proprietorship. The licence may be refused only for the reasons listed in section 33 of the Banking Act, e.g. if the minimum initial capital is inadequate, if the managers lack the requisite personal or professional qualifications, if the shareholders are not trustworthy or if the institution does not have at least two managers (principle of dual control).

Capital and liquidity

The Sixth Act Amending the Banking Act has further extended the definition of capital significantly. While the Fourth Act Amending the Banking Act introduced a distinction between superior-quality capital - the core capital (e.g. paid-up capital, published reserves, contributions to the capital by silent partners) - and inferior-quality capital - the additional capital (e.g. unrealised reserves, capital represented by participation rights, subordinated liabilities, the commitments of members of institutions set up as cooperative societies), the Sixth Act Amending the Banking Act now also allows short-term subordinated liabilities and the net profit from the notional closing of all trading book positions to be used as tier 3 funds to back positions arising from the trading book which are subject to market and large exposures risk. However, the tier 3 funds are limited to two and a half times the core capital not needed to cover the default risk included in the banking book.

Furthermore, the own funds provisions have been made more dynamic in two respects. If, for example, an institution raises capital represented by participation rights, such capital is immediately considered to be additional capital without a formal recognition by the Federal Banking Supervisory Office being required, as before. As a result of the limitation of the own funds eligible to support trading book business to two and a half times the available core capital, any banking book transaction (e.g. a loan granted or repaid) changes the eligible tier 3 capital and own funds, as it uses up or releases capital, and thus affects the scope for trading book business.

The new Principle I stipulates that at least eight per cent of both the credit and the market price risks of an institution must be backed by liable capital and tier 3 capital (own funds). Section 10 of the Banking Act defines the concept of liable capital. Besides loans, securities and participating interests, the

risk assets also include financial swaps, futures contracts and option rights. Loans are weighted in accordance with risk categories and included in the Principle. Loans to the domestic public sector and public entities of certain governments are considered to be risk-free and are not included. Financial swaps, futures contracts and option rights are converted into credit equivalent amounts in accordance with their maturity and included in the Principle with the weighting for loans, but with a maximum weighting of 50 per cent. In anticipation of the changes to the Capital Adequacy Directive proposed by the EC Commission, institutions are allowed, as an alternative, to calculate interest rate, exchange rate and other price risks incurred by using risk management models. The use of risk management models may be limited to individual areas (partial use).

In the case of groups of credit institutions and groups of financial holding companies (section 10a of the Banking Act), the parent institutions have to ensure that Principle I is complied with on a consolidated basis, too. The consolidation must include all domestic and foreign subsidiaries, firms controlled by the subsidiaries (majority participating interest or dominant influence), etc. to the extent that the affiliated undertakings are credit institutions, financial services institutions, financial enterprises or ancillary banking services enterprises. Subsidiaries are to be consolidated in full, and minority holdings on a pro rata basis, i.e. in accordance with the amount of the participating interest. The definition of a financial holding group no longer requires that a deposit-taking credit institution is a constituent part of the group. It now suffices that a securities trading house is part of the group (section 1 (3d) sentence 2 of the Banking Act).

Liquidity is assessed according to Principles II and III. Principle II stipulates that the sum of certain long-term assets should not exceed the sum of certain financial resources which are deemed to be long-term. These comprise liabilities with a maturity of four years and more and specific percentages of shorter-term liabilities which, as experience has shown, are available to institutions for their long-term use ("deposit base").

Pursuant to Principle III, the sum of various short and medium-term assets should not exceed the sum of certain short and medium-term financial resources plus the financial surplus or less the financial deficit under Principle II. The Banking Act does not provide for the application of the liquidity principles on a consolidated basis. The liquidity principles are currently being fundamentally revised; the revision is scheduled to come into force on January 1, 1999.

Surveillance of lending business

Loans to a single borrower which, taken together, exceed 15 per cent (as from January 1, 1999: 10 per cent) of the institution's liable capital ("large exposures"; see sections 13, 13a of the Banking Act), and loans to borrowers closely associated personally or otherwise with the lending institution ("loans to managers, etc." (*Organkredite*); see sections 15 to 17 of the Banking Act) are deemed to be particularly risk-prone, and are therefore subject to special provisions regulating decisions to grant them. Large exposures also have to be reported to the supervisory authorities. Moreover, no single large exposure may exceed 40 per cent (as from January 1, 1999: 25 per cent) of the liable capital, and all large exposures taken together must not exceed eight times the liable capital. Trading book positions, however, may, with the approval of the Federal Banking Supervisory Office, reach five times the available own funds. These limits also apply to groups of credit institutions, to groups of financial services institutions and to groups of financial holding companies (section 13b of the Banking Act).

An important source of information, both for the banking supervisory authorities and for lenders, is the credit register concerning loans of three million Deutsche Mark or more in accordance with

section 14 of the Banking Act. This clause stipulates that credit institutions, insurance enterprises, financial services enterprises taking on proprietary positions as a service for third parties and financial enterprises engaging in factoring must report their loans of three million Deutsche Mark or more to the Bundesbank, which adds together the loans to individual borrowers and subsequently notifies the lenders of the total indebtedness of their borrowers and the number of lenders involved. Loans of three million Deutsche Mark or more granted by enterprises which are part of a group of credit institutions or a group of financial holding companies have been included in the reporting procedure since the beginning of 1996. Before granting a reportable loan, enterprises required to report may now request information about the level of indebtedness of the potential borrower, if the latter agrees to the request and the potential loan amounts to 3 million Deutsche Mark or more.

As regards the concepts of "exposure" and "single borrower", and the exceptions to the regulations governing lending, see section 19 ff. of the Banking Act and the Large Exposures Regulation (*Kreditbestimmungs-Verordnung*).

Monthly returns

To enable the banking supervisory authorities to conduct an ongoing analysis of institutions' business, the latter have to submit monthly returns to the Bundesbank. The Bundesbank forwards these returns, together with its comments thereon, to the Federal Banking Supervisory Office. If the Bundesbank collects monthly balance sheet statistics for the purposes of its monetary analysis, these are deemed at the same time to be monthly returns in order to prevent duplication of work for the credit institutions. The parent institution of a group of institutions must submit both its own monthly return and a pro rata consolidated monthly return for the group.

Audits of credit institutions

The reporting system for banking supervision purposes relies heavily on the institutions' data being correct. This is why the reports of auditors of annual accounts must meet particularly high standards. The Federal Banking Supervisory Office and the Bundesbank have no such auditors of their own: instead, the institutions are audited by independent certified auditors whom they select themselves and who, in their audits, have to comply with detailed auditing guidelines laid down by the Federal Banking Supervisory Office. Section 29 of the Banking Act spells out the special duties of the auditors. Institutions in the savings bank and cooperative bank sectors are normally audited by the auditing bodies of their respective associations.

Moreover, the Federal Banking Supervisory Office is empowered to carry out audits even if there is no special reason for them (section 44 (1) of the Banking Act). External certified auditors are entrusted with these audits, too, though not with audits of foreign exchange transactions or of compliance with the minimum requirements for trading activities, which are carried out by the Bundesbank.

The reports on audits carried out by the deposit guarantee funds provide further information. These reports must likewise be submitted to the supervisory authorities immediately (section 26 (2) of the Banking Act).

Powers to intervene

To avert dangers, the Federal Banking Supervisory Office may issue instructions to an institution and its managers which are appropriate and necessary to prevent or remedy irregularities at the

institution. In the event of concrete breaches of prudential requirements, the banking supervisory authorities have graded powers to intervene. The measures permitted in the event of inadequate capital or inadequate liquidity are set out in section 45 of the Banking Act. If the fulfilment of an institution's obligations to its creditors is definitely endangered, the Federal Banking Supervisory Office may take measures pursuant to section 46 ff. of the Banking Act. Revocation of the licence is possible as a last resort. For combating illicit banking and financial services transactions, section 44c of the Banking Act gives the Federal Banking Supervisory Office police powers. It may enter business premises to carry out inspections, conduct searches and secure evidence.

International cooperation between supervisory authorities

Previously, provisions had already been included in the Banking Act which permitted cross-border cooperation between banking supervisory authorities and eliminated barriers to the provision of information. The further harmonisation of banking supervisory regulations in the EEA, which has led to the mutual recognition of banking supervision, entails even closer cooperation between the banking supervisory authorities within the EEA. If German institutions conduct operations in another EEA state, the Federal Banking Supervisory Office and the Bundesbank, to the extent that the latter takes action under the Banking Act, are required to cooperate with the banking supervisory authorities of that state (section 8 (3) sentence 1 of the Banking Act). Cooperation is particularly close and the exchange of information particularly detailed with respect to German institutions which maintain branches in another EEA state and with respect to institutions in another EEA state which have established branches in Germany. For example, the Federal Banking Supervisory Office has to inform the banking supervisory authorities in other EEA states if the licence to conduct banking business of a German institution which maintains branches in other EEA states is revoked (section 8 (3) sentence 3 of the Banking Act). It also has to inform the authorities of the home member states of infringements by domestic branches of institutions having their headquarters in another EEA state of provisions compliance with which is monitored by the Federal Banking Supervisory Office (section 8 (4) of the Banking Act). The details of such cooperation are regulated in bilateral agreements between the banking supervisory authorities.

German statutory provisions which restrict the transmission of data are not to be applied if such transmission is necessary to enable banking supervisory consolidation procedures to be performed abroad, inclusive of subsidiaries in the Federal Republic of Germany (section 44a of the Banking Act). A precondition thereof is that a participating interest of at least 20 per cent is held in the German subsidiary. The Federal Banking Supervisory Office may prohibit such transmission of data if reciprocity is not assured. At the request of the foreign banking supervisory authority, the Office has to check the correctness of the data transmitted abroad or to permit their correctness to be checked.

The secrecy requirement is not contravened if information is passed on exclusively to foreign supervisory authorities which monitor institutions, investment companies, financial enterprises, insurance enterprises and financial markets and payment transactions, provided that these authorities are subject to the secrecy requirement (section 9 (1) of the Banking Act). The revision of this provision by the Fourth Act Amending the Banking Act facilitates international cooperation in the supervision of financial conglomerates. To ensure a mutual exchange of information, the disclosure to the German fiscal authorities of information received from foreign banking supervisory authorities is likewise prohibited (section 9 (2) sentence 3 of the Banking Act).

Deposit guarantee schemes

Virtually all credit institutions which conduct deposit business belong to one of the deposit guarantee schemes set up on a voluntary basis by the banking associations. The schemes established for the commercial banks aim primarily at protecting depositors, while the schemes operated by the savings bank and credit cooperative sectors are designed to avert member institutions' insolvency. Institutions which are not members of a deposit guarantee scheme have to point out this fact to their customers.

The Deposit Guarantee Fund set up for the commercial banks at the Federal Association of German Banks safeguards, in cases of insolvency, non-securitised liabilities to non-bank creditors, per creditor up to the level of 30 per cent of the liable capital at the time of the last published annual accounts of the bank concerned. Larger liabilities are protected up to this guarantee limit. Protection encompasses both deposits in Germany and those at branches abroad, irrespective of the currency in which they are denominated and of whether the creditors are residents or non-residents.

Although, in the case of public savings banks, responsibility for indemnifying depositors ultimately rests, given the existence of what is known as "guarantors' liability", with the local authorities (e.g. town, district) which set up the savings bank, the regional savings bank and giro associations have nevertheless set up guarantee funds. In addition, there is a reserve fund of the Land banks/regional giro institutions, which, notwithstanding guarantors' liability, acts as an extra safeguard for non-bank customers' deposits. The two schemes, i.e. the regional savings bank guarantee funds and the reserve fund of the Land banks/regional giro institutions, are interlinked.

Credit cooperatives' by-laws provide for a limited obligation on the part of members to pay up further capital when called. The guarantee scheme operated by credit cooperatives has, however, ensured up to now that not a single insolvency has arisen in the credit cooperative sector.

In order to prevent liquidity crises in the wake of bank failures, the Deutsche Bundesbank and all groups in the German banking industry joined forces to set up the Liquidity Consortium Bank in 1974; this bank grants, as and when necessary, liquidity assistance to credit institutions of unquestioned soundness.

ANNEX**Questions on sector-specific regulation in the banking sector**

1.
 - a./b. There are no direct elements of statutory intervention in the business activities of banks (e.g. a public need test or interest rate ties).
 - c. There are basically no restrictions regarding the acquisition of a participating interest in a credit institution. However, participating interests of 10 per cent or more must be reported to the supervisory authorities. This report must include information showing the reliability of the acquirer.
 - d. Under section 12 of the German Banking Act, individual participating interests must not exceed 15 per cent of the capital, and all participating interests combined must not exceed 60 per cent.
 - e. For information about the German deposit guarantee scheme please see above. The implementation of the EU Directive on Deposit Guarantee Schemes is in preparation.
 - f. The capital adequacy requirements follow the provisions set forth by the Basle Committee and the EC Capital Adequacy Directive.
 - g. Reserve requirements are part of monetary policy and not of banking supervision.
 - h. There are no regulations governing the granting of credit to privileged sectors.
 - i. In principle, banks are governed by the same bankruptcy legislation as industrial enterprises. The powers of the Federal Banking Supervisory Office are above.
2. The first part of this question will be answered above.
3. Liquidity assistance is performed through a Liquidity Consortium Bank, in which the Deutsche Bundesbank has a 30 per cent stake. Please see above.
6. There is some state ownership of savings banks' (which have a share of the entire volume of banking business of around 35 per cent) and some development banks. They have to fulfil the same requirements laid down in the Banking Act as the whole banking sector.

With the privatisation of the Deutsche Postbank, as of January 1, 1996 this institution has now to fulfil the same requirements under the Banking Act as other banks.
7. No.

GREECE

Banking activities in Greece, are not exempt from the application of the Competition Act. Generally speaking the provisions of the Greek Law are applicable to the banking sector like any other economic sector.

The only special provisions for the financial sector refer :

- to the exemption of a concentration not deemed to arise when credit institutions (or other financial institutions, the normal activities of which include transactions and dealing with securities for their own account or for the account of others) hold on a temporary basis securities, which they have acquired in an undertaking with a view to reselling them, provided that they do not exercise voting rights in respect of those securities with a view to determining the competitive behaviour of that undertaking or provided that they exercise such voting rights only with a view to preparing the disposal of all or part of that undertaking or of its assets or the disposal of those securities and that any such disposal takes place within one year from the date of acquisition. That period may be extended for a reasonable period of time by the Competition Committee, where such institutions or companies can show that the disposal was not reasonably possible within the period set.(Art.4 of the Greek Act)
- to the calculation of market share and turnover in merger cases. [Art 4f of the Greek Act]. The relevant provisions follow the respective Community model as first introduced by Council Regulation 4064/89].

The enforcement of the Greek Competition Act in the banking sector falls exclusively within the competence of the Competition Committee.

Case of relevant interest (attached)

During the period 1995-1996 the Competition Committee issued a decision regarding a complaint lodged against :

- Bank of Piraeus S.A
- ABN-AMRO Bank
- Barclays Bank
- Commercial Bank of Greece S.A
- Bank Societe Generale
- Ergasias Bank S.A
- Commercial & Stock Exchange S.A

for violating articles 1 and 2 of the Greek Competition Act by charging investors when registering to a public registration offer for shares with a letter of credit instead of a cash payment, with a commission levied up to 0.4 per cent of its amount. Following an investigation by the Secretariat of the Competition Committee and the subsequent hearing, it was clearly seen that the Banks as well as the Commercial & Stock Exchange S.A had followed that practice since 1993, until the Committee for the Stock Exchange

Market through its 1994 decision required that registration could only be effected by tying investors' deposit accounts or cash.

According to the legal assessment of the decision, by charging a commission on every letter of credit issued for the relevant purpose, a uniform condition was imposed against investors leading to a violation of article 1, provided that this was based on an agreement or concerted practice between the involved undertakings. Given the fact that no agreement was found to exist between them, violation of article 1 could only be established if this behavior was not the result of an independent business practice exercised by each of the undertakings concerned, but a result of a concerted practice between them. A concerted practice is less likely to occur when it is found to be reasonable and to be expected in the light of the conditions prevailing in the market. The practice in question was found to be reasonable since the registration by letter of credit was an extra service offered to the investor but not provided in the agreement between the firm issuing the shares and the contracting bank. In addition, as the percentage of the commission charged varied (there was a difference of up to 100 per cent) among the banks and even among customers/investors of the same bank the existence of competition between the banks was not precluded. Examining the complaint in the light of whether it constituted a violation of article 2, the Competition Committee stated that even in the case that the commission charged was found not to be a reasonable trading condition, the existence of a dominant position by the undertaking concerned was a prerequisite for article 2 to be applied. As it is generally accepted a dominant position is being established when an undertaking can behave independently in relation to its competitors, customers or suppliers. According to article 2 a dominant position can be a collective one i.e held by more than one undertakings. For a collective dominance to be accepted the existence of an oligopolistic structure of the relevant market is not the only sufficient condition that must be satisfied. There must also be two conditions cumulatively fulfilled: i) the absence of competition among members of the oligopoly and ii) the absence of competitive pressure outside the oligopoly. On that grounds the Competition Committee rejected the complaint.

HUNGARY

Sector-Specific Regulation in the Banking Sector

Principal statutory regulations that affect the banking sector:

- a) According to the Act on Credit Institutions (the Act) there are no restrictions on entry into the banking sector but entry is subject to the conditions contained in the Act. Due to Hungary's commitment to the OECD, the Act was modified in December 1997. According to this modification, branching of foreign banks has been permitted since 1 January 1998. All applicants who wish to open a bank or a branch of foreign bank have to be provided the license if they meet the requirements laid down in the Act. The licensing authority is the Hungarian Banking and Capital Market Supervision (HBCMS).

There are no restrictions on credit institutions licensed in Hungary opening branches anywhere in the country. There is an obligation for registration of these branches at HBCMS.

- b) There are no restrictions on prices and fees. Interest rate controls prevail only if credit institutions provide loans to favoured sectors or activities re-financed by the National Bank of Hungary (NBH), by international financial institutions or subsidized by the government.
- c) All activities that credit institutions may pursue are laid down in the Act. HBCMS licenses an activity of a credit institution only if the credit institution meets the requirement for that specific activity. HBCMS may restrict activities of a credit institution if the credit institution does not meet the requirements for that specific activity or the activity endangers the prudential operation of the credit institution. There are restrictions on the activities of specialized credit institutions (e.g. mortgage institution, EXIM Bank) and of co-operative credit institutions.

Non-banks must not have more than a 15 per cent stake in a credit institution. Exemptions are investment companies, insurance companies and in specific cases the Deposit Insurance Fund and the State. Anyone wishing to obtain a 15 per cent, 33 per cent, 50 per cent or 75 per cent stake in a credit institution has to ask for a permission from the HBCMS. If an owner of a credit institution wishes to reduce its stake under these limits, it has to inform HBCMS.

Credit institutions also have to meet the prudential requirements on a consolidated basis.

- d) Credit institutions are not required to hold certain types of securities. They must not hold securities - except government securities and non-publicly issued securities- for trading purposes. According to the latest modification of the Act, this restriction will be lifted from 1 January 1999. Credit institutions must not have a direct or indirect stake exceeding 15 per cent of their adjusted capital and 51 per cent of the subscribed capital of any undertaking, The joint amount of qualifying stakes¹ - except in other financial institutions, investment undertakings, insurance companies or ancillary undertakings - must not exceed 60 per cent of the adjusted capital. The above mentioned limits may be exceeded if the credit institution meets the eight per cent capital-adequacy ratio after deducting the amounts going beyond the limits from the adjusted capital. The limits do not apply

to those stakes which pass into the ownership because of a debt-property swap or winding up of debtors. These stakes must be sold, however, within 3 years of acquisition.

- e) Compulsory deposit insurance: All credit institutions - except credit cooperatives, and those specialised credit institutions whose liabilities are secured by the state - have to join the National Deposit Insurance Fund. The Fund provides 100 per cent coverage for deposits up to HUF one million (at the current rate equal to USD 4 800). The premium is differentiated and related to the average size of deposits, since those credit institutions which have lower average deposit size require relatively higher financial assistance from the Fund in the case of bankruptcy. According to the Act the Fund may within its discretion increase the fee paid by a credit institution if the institution carries out risky activities.
- f) The calculation of the capital adequacy is in line with the Basle Recommendations and EU directives.
- g) Reserve requirements: Credit institutions have to place compulsory reserves proportional to their HUF and foreign exchange liabilities with the NBH. The reserve rate is currently 12 per cent (and, as an exception, eight per cent for Home Savings and Loan Associations and the Hungarian Development Bank). The reserve base contains all kinds of liabilities except equity, subordinated loan capital, provisions, funds from other credit institutions, the NBH and from abroad. Compulsory reserves may consist of cash and deposits with the central bank. Banks and specialised credit institutions have to fulfill the reserve requirements on a two-week-average basis, while cooperative credit institutions have to comply on a monthly basis. The NBH pays interest on reserves deposited on accounts with the NBH.
- h) Credit to favoured sectors: There are no direct government requirements for banks to finance certain sectors of the economy from their own sources and at the expense of their profitability. Credit institutions participate in channelling funds from the World Bank and other international institutions to favoured sectors. There are also different types of government subsidies, such as interest rate subsidies to certain sectors (e.g.: agriculture, small enterprises) and in some cases NBH also provides refinancing loans. Banks are expected to transfer the preferred funds. One of the tasks of the Hungarian Development Bank is to participate in achieving the goals determined in the regional development law.
- i) A credit institution has to be wound up if the license is withdrawn by HBCMS. Winding-up must be carried out by a non-profit company owned by HBCMS. The liquidation fee is lower than in general insolvency cases. If amounts were paid out by the Deposit Insurance Fund in connection with the credit institution, the Deposit Insurance Fund takes part in the winding-up procedure as a creditor of the credit institution.
- j) Rules affecting cooperation within the banking sector: The Interbank Giro System sets a framework for banking cooperation in the field of interbank payments. This system is currently not operating in real time but a project is launched this year to build up an RTGS (RTGS = Real Time Gross Settlement) by the Summer of 1999.

The Interbank Information System helps banks to identify debtors of poor quality thereby making the operation of the banking sector safer.

The banking industry is regulated by acts and by decrees of the government, the finance minister and the central bank. HBCMS is the agency responsible for their enforcement. (Till the end of 1993 the competition supervision of the sector belonged also to it and, respectively, to one of its legal predecessors, the State Banking Supervision.) It is part of the public administration and operates under the supervision of the government. HBCMS takes an active part in the elaboration of the regulations. Its independence is ensured by the fact, that the president and two vice-presidents of HBCMS are appointed by the prime minister for a term of six years upon the joint recommendation of the finance minister and the president of NBH.

The goal of HBCMS is to promote the prudential operation of organizations pursuing financial services, investment services, clearinghouse activities, investment fund management activities and to promote the prudential operation of the exchanges. It protects the interests of the clients of these organizations, promotes the undisturbed and efficient operation of the money and capital market, the transparency of market conditions and the maintenance of fair and regulated competition on the market.

HBCMS licenses the above mentioned organizations and their activities, supervises the organizations and their activities on-site and off-site. In the case of infringement of regulations, HBCMS may

- call upon the institution to take the necessary measures,
- make proposals to the management or owners of the institution,
- obligate the institution to draw up and implement an action plan,
- impose exceptional information supply obligations,
- impose a fine on the institution,
- send out on-site investigators,
- obligate the institution to draw up or revise and implement internal rules, to professionally retrain employees, hire employees with appropriate professional skills,
- obligate the institution to perform an internal investigation, or to elect another auditor,
- limit or prohibit or bind to conditions the payment of dividends, the remuneration of senior office-bearers, the granting of internal loans, and the opening of new branches,
- impose fines on senior office-bearers (office-bearers, to whom a fine is imposed, cannot hold a senior position in a credit institution)
- obligate the board of directors to convene a general meeting and may obligate the general meeting to discuss certain questions,
- call upon the owners of the institution to take certain measures,
- suspend the voting right of the owners,
- withdraw the license of certain activities,
- withdraw the license of the institution.

Expectations about the actions of the central bank and the government: The Act on the National Bank of Hungary declares that NBH is responsible for the stability of the payment system and has the right to extend extraordinary credit to a financial institution in case of emergency. This is the classical "lender of last resort" function of the central bank.

Moreover the Act on Credit Institutions says that in cases when a credit institution's insolvency substantially endangers the country's economic interest or the reliable operation of the banking system, and the insolvency or liquidation cannot be averted in any other form, the ownership interest of the state may exceed 15 per cent limit for a three year temporary period.

After different types of consolidation programs between 1991-94 - which took the form of portfolio cleansing and capital increase - the Hungarian banking sector stabilised. Now, the vast majority of banks are in private ownership. One of the most important goals of privatisation was to transfer the responsibilities for the safe functioning of banks from the state to private owners.

Interbank arrangements relate to the cooperation in the field of interbank payments and to the interbank loan information system as described above and also to the acceptance of bankcards. There exist of course also professional associations for promoting the interests of members. Such associations are the Hungarian Banking Association, the National Association of Savings Co-operatives and the Corporate Association of Savings Co-operatives. The Hungarian Banking Association established an Ethics Committee. It has three members who are highly respected personalities of the banking world and are not employees of any bank. Issues can be raised by the banks, bank customers and on the motion of the Committee.

All credit institutions are members of the central registry and all credits provided to legal persons and credits provided to natural persons with arrears for more than 90 days have to be registered in it. Credit institutions can get information from the system concerning their customers.

According to the Act on Legislation, the government has to ask for the opinion of the industry organizations in the legislation process. The Hungarian Banking Association and the Association of Savings Co-operatives receive the drafts of pieces of legislation which concern the activity of their members and they may express their opinion. Industry organizations have the right to initiate legislation or changes in legislation.

State ownership in the banking sector: The latest aggregated figures show the extent of state ownership in September, 1997 (see table). Since then the privatisation process has continued so the level of state ownership has shrunk further.

Owners	Shares		
	1997.09.30.	HUF million	%
State Privatization and Holding Co. Limited by Shares	54,651.2		20,12
Government and social security funds	14,950.0		5,50
Total state	69,601.2		25,62
Domestic financial institutions	13,847.6		5,10
Insurance companies, investment firms and funds	6,155.5		2,27
Other	26,033.3		9,58
Other domestic total	46,036.4		16,95
Total domestic	115,637.6		42,57
Foreign financial institutions	116,838.9		43,01
Other foreign	30,487.9		11,22
Total foreign	147,326.8		54,23
Preferential shares	3,235.2		1,19
Own shares	5,454.1		2,01
TOTAL	271,653.6		100,00

Competition Policy in the Banking Sector

In Hungary the general rules of the Competition Act apply to the banking sector. The Competition Act itself contains differences in comparison to other markets in the field of M&A regulations. In the case of concentrations of banks (mergers, amalgamations, acquisitions of decisive influence) the Competition Act provides that ten per cent of their joint total assets shall be considered as the notification threshold in place of the net turnover criteria in the general rules. There is a further specific rule relating to the banking sector, namely, that temporary acquisition of control or ownership by financial institutions in any other undertaking does not qualify as concentration according to the legal concept where this property was acquired for the purposes of preparing a resale. The application for authorisation of planned M&A transactions of financial institutions shall be submitted to the Office of Economic Competition (OEC) at a date identical with that of the application for permission of the bank supervisory authority.

An introduction of the amended Hungarian Competition Act was already made in the report prepared for the 23-24 October 1997 meeting of CLP Committee [DAFFE/CLP(97)11/27] so in this paper only the most important features are outlined as follows.

The first Competition Act relating to market economy conditions, Act No. LXXXVI of 1990 on the Prohibition of Unfair Market Conduct entered into force on 1 January 1991. The law enforcement experiences, the economic changes which had taken place since the entry into force of the Act - transformation of the market structure, forming of decisive weight of private ownership as a result of privatisation, increasing number of market participants, foreign investment in Hungary - and commitments to approximate the Hungarian legislation to the European law were the factors which made necessary to elaborate the new Competition Act, Act No LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices which entered into force on 1 January 1997. Similarly to the previous Competition Act the new Competition Act also covers unfair market practices, unfair manipulation of consumer choice, restrictive agreements, abusive practices and M&A control. The introduction of prohibition on all kinds of restrictive vertical agreements was the most important change of the substantive norms. The extension of the territorial scope of the Competition Act with the introduction of the effects doctrine in respect of antitrust matters was another essential amendment of it.

As far as law enforcement is concerned the Competition Act provides that rules relating to unfair practices (injury of reputation, violation of business secrets, call for boycott, imitation and infringement of the fairness of bidding) fall under the competence of civil courts, all other practices regulated in the Competition Act belong to the competence of OEC. There is no other authority which would have the right to enforce the norms of the Competition Act. Decisions of the OEC may of course be challenged in the court.

Relating to banking industry there was a change from 1 January 1994 as far as the authority exercising competition supervision is concerned. While in the period of 1991 to 1993 the State Banking Supervision was the responsible authority also for competition supervision tasks, since 1994 competition matters of the banking industry have been supervised by the OEC.

The activity of the OEC

In shaping the competitive conditions of the banking industry the OEC participates basically in two ways: through its general advocacy role and by means of competition supervision proceedings.

Besides giving opinions continuously on draft legal rules the OEC also participated in the working party preparing the new Act on Credit Institutions. The main standpoints of its comments were the following: protecting freedom of competition, ensuring equal opportunities, transparency of regulation, promoting its consistence, creating the possibility of the enforcement of consumer interests by furnishing consumers with information which creates the basis of their choice and fulfilling the legal harmonisation requirements stemming from the Europe Agreement. In the course of this activity the OEC made active initiatives e.g. proposals were submitted concerning the unification of proceedings of publishing deposit interest rates and loan interest. To the great extent on the basis of the latter initiative legal rules were adopted according to which banks are obliged to make publicly known the deposit interest rates and the total loan charges counted on the basis of a uniform calculation method so that the consumer should gain a comparative picture when choosing a certain service and bank.

In the course of four years the number of competition supervision proceedings amounted to 71. Out of them 42 per cent related to abuse of dominance, 30 per cent to consumer fraud, 15 per cent to other unfair conduct and 13 per cent to mergers.

The above division of the OEC competition supervision proceedings reflects that state consumer protection does not tackle financial services and customers are not so well-informed as in the more developed countries or on the commodity markets. Some of the banks are not always interested in informing their customers accurately so there were competition supervision proceedings in connection with misleading of consumers.

Merger cases reflect three underlying objectives. In the practice of the OEC there was an example for the application of 'failing firm defence', it was justified by protecting depositors, in another case banks operating in the same ownership field or similar field "married" each other so that a more effective undertaking should go into operation resulting even in a 30-40 per cent cost reduction. The third type was replacing state property in the framework of privatisation by gaining decisive influence by the new owners.

In competition supervision proceedings relating to the banking industry the relevant geographic market is determined typically as the territory of the whole country. It depends on the particular case whether the notion of the relevant market is approached as the whole of the banking services, their main groups (e.g. deposit or credit market, retail services or services for the corporate sector) or as a particular product (bank accounts, credit/debit cards).

As an illustration of the activity of the Office concerning the banking sector the following four cases are presented.

- 1) The National Savings Bank (NSB) published on 28 March 1996 in national daily papers that beginning with 1 April of that year it was going to change fee and commission conditions relating to retail foreign exchange accounts and modifications could be seen in the branches of the bank. The modifications were, amongst other things, the following: a fee of 0.3 per cent but at least \$US two would be introduced at pay off in a currency identical with the currency of the account that earlier used to be free of commission, the bank introduced a closing fee for the currency accounts not exceeding \$US 50 which had no turnover during the 12 months preceding the closing at the end of the year, further the bank raised considerably the transfer charges.

Though in the period of the investigation already 30 banks were engaged in the given service, the National Savings Bank was the market leader, in 1996 it disposed of 57 per cent of all currency accounts.

The Competition Council stated NSB's dominance in respect of customers disposing a foreign exchange account at the Bank already prior to 1 April 1996 since the only working day between 28 March and 1 April did not grant possibility to these customers to make a decision concerning their foreign exchange account, and change their bank and afterwards they could get their money only under considerably more disadvantageous conditions, in the case of significant deposits, a commission amounting to several hundred dollars had to be paid.

The Competition Council considered the conduct of the bank, the enforcement of disadvantageous conditions as an abuse of dominance, the Council banned the continuation of the unlawful behaviour and imposed a fine amounting to HUF five million (USD 24 000). The bank lodged a claim at the court against the ruling, for the time being there is no final decision yet.

- 2) In August 1991 the Hungarian Credit Bank started to distribute the so-called "Chain Bridge Securities". This was a special bond collecting sources, the Credit Bank informed the customers of its essential features on the security (in the security contract) and in advertisements. According to the information the maturity period of the bond was three years, interest rates varied from time to time namely in such a way that the Bank was entitled to modify the interest depending on the interest rate on the money market. Until April 1993 the Bank availed itself of the right of changing the interests and in conformity with the market trend it reduced the starting 36 per cent interest to 16 per cent in several steps. In May 1993 the Bank finished to sell the bond and it did not change the interest till end 1995, though during this period general deposit interest rates increased continuously and to a great extent.

In its decision the Competition Council stated the conduct of the Bank, that it did not change the interest rate of the bond between 13 May 1993, the date ceasing the issuance and 25 February 1995 though it gave the information on the Bond and in its advertisements that the measure of the interest would move together with the money market interest rate, to infringe the requirements of business fairness. Because of the infringement of the ban contained in the Competition Act the Competition Council imposed a fine amounting to HUF 25 million (USD 121 000). The ruling was upheld already by the Supreme Court.

- 3) In Hungary the housing shortage is one of the most serious problems. In the area of housing loans the National Savings Bank has a market share over 90 per cent and has the biggest network of branches. The Bank did not have to reckon with significant competitors within a reasonable time. From 1992 on the Bank has been also the owner of the Garancia Insurance Company. The ownership the relation of the two companies was also strengthened by a cooperation agreement which can be regarded as a vertical cooperation².

One of the competition supervision proceedings conducted in 1996 aimed at examining the general (blanket) contractual conditions and lending practice of the Bank. The investigation stated that even the Bank itself could not interpret in a satisfactory manner the stipulation figuring on its general contractual conditions according to which the Bank was entitled

unilaterally to change the interest rate and commission depending on the current "money market situation". The increases implemented by the Bank were not based on objective market criteria, the inner arguments contained statements that the expectable annual profit of the undertaking as a whole was satisfactory.

In the majority of the documents connected with applicants of housing loans a stipulation was found that the purchase of an insurance service from Garancia Insurance Company, relating to the real estate concerned, was a precondition for concluding a housing loan agreement. The service of the insurance company was available at the bank clerk handling the credit. However, the Bank could prove that housing loans were granted even in cases where the customer insisted on another insurance company (granting a more favourable service or charging a lower fee).

The Competition Council held that the "recommended" text might create the impression in the customers that the Bank would not conclude the housing loan agreement with them inasmuch they would not insure the real estate at the Garancia Insurance Company and typically they had no opportunity to compare the bids of various insurance companies, either.

Deceiving the consumers in this way the Bank abused its dominance by placing in a more advantageous position an undertaking operating on another market, which was a 100 per cent owned subsidiary.

The Competition Council decided the unilateral stipulation of the interest rates and commissions on the side of the Bank that was not based on objective criteria and the deceptive application of the insurance provision as an unlawful conduct, banned this behaviour and imposed a fine amounting to HUF 50 million (\$US 243 000). The Bank challenged the ruling at the Metropolitan Court which mitigated the amount of the fine to HUF 10 million, otherwise it upheld the decision of the Competition Council.

- 4) Arising out of the scope of the Competition Act Bank Austria turned to the OEC for authorisation of the acquisition in Austria of Creditanstalt-Bankverein in 1997. In Hungary both Austrian banks had bank subsidiaries and other subsidiaries. The joint turnover of the Hungarian subsidiaries exceeded the notification threshold stipulated by the Competition Act that is why the concentration was subject to authorisation. Pursuant to the Competition Act the OEC may not refuse the authorisation if the concentration does not create or strengthen a dominant position, does not impede the formation, development or continuation of effective competition on the relevant market or on a considerable part of it. In this particular case the relevant market was the national market of banking, securities and leasing services. The market share of the firms parties to the merger varied from below one per cent to 13.5 per cent. During the proceedings it was stated that the acquisition resulted in no significant effect on the Hungarian market, no change took place in market structure even if both commercial banks would merge.

Since the acquisition did not create or strengthen a dominant position on the relevant markets and did not cause detrimental effects to the consumers the OEC authorised the concentration. Future mergers, concentrations of the affected undertakings will not be subject to OEC authorisation since the Competition Act does not require an authorisation in the case of non-autonomous undertakings (e.g. in the case of undertakings belonging to the same owner).

NOTES

- 1 A credit institution has qualifying stake in an undertaking if it holds more than 10 per cent of the stakes or may exercise a decisive influence on the operation of the undertaking even if its stake is less than 10 per cent.
- 2 This was a special solution under the 1990 Hungarian Competition Act, during the transition period this Competition Act did not consider ownership relations in this respect.

ITALY

Banking Regulation

Introduction

Italian banking legislation was recently consolidated into a codified law that combines the 1936 Banking Law with the many provisions that had been adopted to amend and supplement it, particularly in the 1980s. Legislative Decree no. 385 of 1 September 1993- the 1993 Banking Law- includes the statutory provisions relating to credit authorities, banks and banking groups, supervisory powers and crisis procedures. In many areas the new Banking Law only lays down general principles, entrusting the credit authorities with the task of issuing secondary legislation specifying the technical details.

The Law defines banking as the joint activity of fund raising on a public basis and the granting of credit and recognizes that it is an entrepreneurial activity. The Law establishes that credit authorities shall exercise the powers of supervision conferred on them (including the issue of secondary legislation) having regard to: a) the sound and prudent management of the entities subject to supervision; b) the overall stability of the financial system; c) the efficiency and competitiveness of the financial system; d) compliance with the provisions concerning credit. Moreover, the credit authorities are required to exercise their powers in harmony with the relevant provisions of the EC law.

Restrictions on branching and new entry

The 1936-38 Banking Law gave supervisory authorities large discretionary powers with respect to the authorization to engage in banking and to open new branches. As far as banking authorization is concerned, for a long time the establishment of new banks was generally authorized only in cases where it was a way to provide banking services in previously not banked areas.

Following the First EC Banking Directive 77/780, entry regulation was gradually reformed, substantially eliminating any discretionary power connected with it. In order to establish a new bank in Italy, an authorization by the Bank of Italy is required. The 1993 Banking Law lists the conditions to be met: the legal structure adopted must be that of a limited company, in the form of a *società per azioni* or a *società cooperativa per azioni a responsabilità limitata*; the paid-up capital must not be less than that established by the Bank of Italy; a programme of operations must be submitted; members must satisfy integrity requirements and persons performing administrative, managerial or control functions must satisfy specific experience and integrity requirements. The Bank of Italy can refuse authorization only where the analysis of these conditions shows that sound and prudent management is not ensured.

The regulatory regime for branching has also changed substantially in recent times. Under the 1936-38 Banking Law, credit authorities could deny authorization on the basis of an evaluation of the "economic need" for a new branch in the area concerned, taking both stability and efficiency concerns into account. Since 1990, the authorization could not be denied except for reasons relating to the sound and prudent management of the bank. With the 1993 Banking Law, the establishment of a new branch by an Italian bank, in Italy or in other EC Member States, is no longer subject to authorization; in any case, it should be notified to the Bank of Italy, which may prohibit it only for reasons pertaining to the adequacy

of the bank's organizational structure or to its financial situation. The establishment by an Italian bank of a new branch in a non EC Member State still requires an authorization by the Bank of Italy.

EC banks are free to establish branches and to provide services in Italy, subject to the principles of minimum harmonization and mutual recognition contained in the EC Banking Directives. The rules concerning entry by non EC banks are more complex and still involve some degree of discretionary power. More specifically, for EC banks the establishment of the first branch in Italy shall be preceded by a notice to the Bank of Italy by the competent authorities of the home member state. The establishment of further branches is subject only to the home country control. For non-EC banks, the establishment of the first branch in Italy is subject to authorization by Treasury, in agreement with the Minister for Foreign Affairs, after consulting the Bank of Italy. The following conditions must be met: the paid -up capital must not be less than that established by the Bank of Italy, a programme of operations must be submitted and persons performing administrative, managerial and control functions must satisfy experience and integrity requirements. These conditions are a subset of the ones required to obtain an authorization to engage in banking. Authorization shall be granted having regard, inter alia, to reciprocity. Non-EC banks which have already opened a branch in Italy may establish other branches subject to authorization by the Bank of Italy.

The freedom to provide services without establishing branches is regulated as follows:

- Italian banks may carry on activities subject to mutual recognition in EC Member States in compliance with the procedures established by the Bank of Italy (whom they must notify); operations in a non Member State require an authorization by the Bank of Italy;
- EC banks may carry on activities subject to mutual recognition after the Bank of Italy has been informed by the competent authorities of the home member state;
- the pursuit by EC banks of activities not subject to mutual recognition is regulated by the Bank of Italy, in compliance with the resolutions of the Interministerial Credit Committee;
- non-EC banks may operate in Italy subject to authorization by the Bank of Italy, issued after consulting the Consob in the case of securities business; they may not be authorized to perform activities which EC banks or Italian banks are not allowed to pursue (eg non financial activities).

The above provisions on branching and freedom to provide services for Italian and EC banks also apply to financial companies having their registered office, respectively, in Italy or in a EC member state where the controlling interest is held by an Italian or a EC bank.

Restrictions On Pricing

The 1936-38 Banking Law contained a provision which allowed credit authorities to fix loan and deposit interest rates, but which was never used. Until 1974, however, interbank agreements on interest rates were supported by the authorities. The 1993 Banking Law does not contain any provision allowing the authorities to restrict the banks' freedom to fix interest rates (as well as other prices). The law simply requires that banks follow disclosure rules on the terms and conditions of the contract.

In 1996, however, a special law was enacted which, with the aim of preventing usury practices, establishes ceilings on lending interest rates (Law n.108/96). This law provides that the Treasury classifies

credit operations into homogeneous groups, taking into account their object, amount, term, risk and guarantees; the Treasury must then publish on a quarterly basis the average annual percentage rate (APR) of charge applied by banks and registered financial intermediaries during the previous three months, for each group of operations. The published APR holds for three months. Lending interest rates, for any group of operations, may not exceed 150 per cent of the relevant APR. In its 1997 Annual Report the Italian Competition Authority argued that this kind of price control may be counterproductive, since it may lead to a rationing of bank credit and therefore encourage borrowers to look for illegal providers of credit. Moreover, it stressed that in legal circuits the most effective protection of borrowers comes from competition and not from administrative price controls.

Line of business restrictions and regulations on ownership linkages among financial institutions

Line of business restrictions

The 1993 Banking Law provides that banking, that is the joint activity of fund raising on a public basis (acceptance of repayable funds in the form of deposits or in other forms) and the granting of credit, shall be restricted to banks. The restriction resulting from the 1936-38 Banking Law, which distinguished between those banks which might raise short term funds (*aziende di credito*) and the others, which were not allowed to do so (*istituti di credito*) is eliminated: now all banks (including the previous *istituti di credito*) are allowed to issue instruments of deposit, as well as bonds. Supervisory regulation lays down rules for the control of maturity transformation, to limit the funding of medium/long term assets with short term liabilities.

In addition to banking, banks may engage in any other financial business, in accordance with the provisions applicable to each activity, and in related and instrumental activities. Restrictions established by law on such activities (eg insurance activities are restricted to insurance companies) shall be unaffected. The financial activities which banks can engage in, therefore, include all the activities subject to mutual recognition according to the Second EC Banking Directive (e.g. money transmission services, issuing and managing instruments of payment, trading on own account or on account of customers in financial market instruments, participation in share issues and the provision of services related to such issues, advice to undertakings on capital structure, M&A, industrial strategy, portfolio management and advice).

Ownership linkages among financial institutions

The Second EC Banking Directive, no. 89/646, established minimum harmonization rules on bank shareholdings which must be complied with in all Member States and are a precondition for enjoying mutual recognition. Member states are free, however, to introduce stricter rules.

Bank shareholdings in financial institutions, including firms performing instrumental activities and insurance companies, are not restricted at the EC level. According to a Ministerial Decree of 22 June 1993, Italian banks may acquire shareholdings in other banks and financial institutions; however, where the shareholding exceeds 10 per cent or 20 per cent of the acquired company or results in control of the company, or where it exceeds 10 per cent of the own funds of the acquiring bank, a prior authorization by the Bank of Italy is needed. The same rules apply to bank shareholdings in insurance companies (which therefore can be control stakes); however, the total amount of shareholdings in insurance companies cannot exceed 40 per cent of a bank's own funds.

Restrictions on the portfolio of assets that banks can hold

Bank shareholdings in non financial companies

EC Directive no. 89/646 requires that banks shall not acquire qualified holdings of capital in non financial undertakings (i.e. shares representing not less than 10 per cent of the capital or voting rights or which allow to exert a notable influence on management choices) exceeding 15 per cent of the bank's own funds. Altogether, such holdings of capital may not exceed 60 per cent of the bank's own funds.

This EC provision does not prohibit banks to hold control stakes in non financial companies. The above ratios can be exceeded where 100 per cent of the exceeding part is covered by the bank's own funds and these are not included in the computation of solvency ratios.

As already mentioned, Member state regulation can be more severe than that set forth in the EC Directive. In Italy, following the bank crises of the Twenties and Thirties, which were strictly related to the involvement of banks in the capital of non financial companies, credit authorities, in applying the 1936-38 Banking Law, interpreted for a long time in a very restrictive way the principle of separation of banking and commerce (this law provided that banks' investment in shares of non financial companies had to obtain a prior authorization by the credit authorities, who established a ceiling on the ratio between the bank's capital and the total amount of shares in non financial companies). Now, according to a Ministerial Decree of 1993, a bank's total amount of holdings of capital in non financial companies may not exceed 15 per cent of the bank's own funds (the ceiling is only 7.5 per cent for companies not listed on an official market); moreover, holdings in each non financial company may not exceed three per cent of the bank's own funds; finally, the bank may not hold shares exceeding 15 per cent of the capital of a non financial company and, therefore, cannot control it.

Prudential reasons remain the basis for prohibiting an excessive involvement of banks in the capital of non financial companies. Large banks, with a own funds exceeding 2 000 billion lire and a fully satisfactory solvency ratio, as well as specialized banks (the former istituti di credito) may be authorized by the Bank of Italy to hold larger stakes in non financial companies (respectively, total amount up to 50 per cent or 60 per cent of own funds, single shareholding six per cent or 15 per cent of own funds, shareholdings exceeding the 15 per cent of the capital of the non financial company up to two per cent of the bank's own funds). Recently, all banks have been allowed to acquire control of non financial companies within the limit of one per cent of their own funds.

Holdings of capital in banks

In order to give a more complete view of the rules governing the relations between banks and non financial companies, a brief description of the provisions concerning holdings of capital in banks is needed. The 1993 Banking Law provides that persons who, through subsidiary companies or otherwise, engage in significant business activity in sectors other than banking, finance and insurance, may not acquire shares or capital participations which, when added to those already held, would result in a holding exceeding 15 per cent of the voting capital of a bank or in control of the bank.

Portfolio constraints

The 1936-38 Banking Law allowed credit authorities to restrict the portfolio of assets that banks can hold by indicating the ratio between different assets, taking into account liquidity concerns as well as the recipient economic sectors. From 1973 to 1987 this provision was used as the basis for the so called "portfolio constraints", whereby credit authorities indicated banks some assets in which they were

required to invest part of their funds (especially, bonds issued by medium-long term credit institutes). The legal provision was not eliminated by the 1993 Banking Law; however, it is highly unlikely that in future it will still be used so as to require banks to acquire assets indicated by the authorities.

Compulsory deposit insurance

Since 1996, the EC Directive 94/19 on depositors' guarantee schemes was transposed in the Italian Banking Law, which contains the general rules governing deposit insurance in Italy. Italian banks are required to join one of the depositors' guarantee schemes established and recognized in Italy. Branches of EC banks are free to join one, to supplement the protection offered in the home member state; non EC bank branches shall join one, unless they participate in an equivalent foreign scheme. Each guarantee scheme shall make payments to depositors in case of compulsory liquidation of banks; other forms of intervention are left to the discretion of each scheme.

The Law indicates claims which shall be excluded from protection (e.g. interbank deposits and bonds). Schemes are required to pay each depositor's claim up to a maximum amount of not less than 200 million lire (\$US 113 000). The Bank of Italy, with the aim of protecting savers and the stability of the banking system, shall *inter alia* recognize guarantee schemes and approve their bylaws, coordinate their activity with crisis procedures and supervisory activity and authorize interventions by guarantee schemes.

As far as the already operating schemes are concerned, as of 1987, Italian banks established a voluntary mutual system for the protection of depositors (fondo interbancario di tutela dei depositi), which acts as a general guarantee for the adhering banks' depositors in the event of a bank's default. Before the scheme was established, the area was covered by the Italian banking sector central institutions (*istituti centrali di categoria*). All banks, with the exception of *banche di credito cooperativo*, which have their own system, take part in the scheme. The banks' contributions are calculated by taking into account each bank's liabilities protected by the scheme.

The allowance acts in favour of banks under compulsory administrative liquidation or under special administration. The interventions in favour of banks under special administration can take different forms. In case of compulsory liquidation, the scheme concurs in the payment of the bank's deposits: there is full coverage, up to 200 million lire, for each depositor.

Restrictions on capital adequacy

Italian legislation on capital adequacy is based on EU Directives and the Basle Committee Guidelines. It establishes a solvency ratio between the bank's own funds and the total, risk-adjusted, assets of the bank. Further requirements concern a bank's lending exposure (exposure is defined as including equity participation, bonds, subordinated debt, forex and interest rate sensitive assets held by the bank). Each credit institution must limit its exposure to a single counterpart to 25 per cent of the own funds. Overall, large exposures may not exceed eight times the own funds. As to the limit of 25 per cent, a transitional period allows banks to adopt a less restrictive standard (40 per cent of the bank's own funds) until 31 December 1998.

Banks are required to hold capital against each source of risk which the bank's securities portfolio (both debt and equity securities) is exposed to: (i) positioning risk; (ii) settlement risk; (iii) counterpart risk; (iv) concentration risk; and (v) foreign exchange risk.

Finally, supervisory authorities closely monitor the banks more exposed to the risk of capital losses due to adverse movements in interest rates.

Reserve requirements

While in the past the reserve requirements were also viewed as an instrument of depositors protection, they are now considered simply as one of the instruments the Bank of Italy may adopt to regulate the money supply. The current reserve requirements were established in 1995. Banks are required to maintain a share of their deposits on reserve with the Bank of Italy. The funds subject to reserve requirements are lira and foreign currency-denominated saving accounts, current accounts, cash, certificates of deposit with maturities up to 18 months held by Italian residents (non-banks), and Italian lire accounts by non-residents. On the above mentioned type of deposits the amount required as reserve is determined each month adding the 15 per cent of the monthly variation of the relevant deposits to the amount of reserve in the previous month.

On such reserve, an annual interest of 5.5 per cent is accrued; furthermore, the legislation allows each bank to mobilise up to 12.5 per cent of its own reserve.

Requirements to direct credit to favoured sectors

There are no requirements in Italy for banks to direct credit to favoured sectors.

Special rules concerning liquidation, winding up, insolvency, composition or analogous proceedings in the banking sector

By recognizing the entrepreneurial nature of banking activity, the Banking Law implicitly accepts the principle according to which an insolvent bank should fail. However, in order to prevent bank runs and to protect depositors and the stability of the banking system, special crisis procedures are provided for banks, in which a central role is played by the supervisory authority. The rules governing bank crises should be viewed in the wider context, where the Bank of Italy may also intervene to refinance banks in cases of temporary illiquidity and where the compulsory depositors' guarantee schemes described in a previous section complement the instruments for depositors' protection.

The two crisis procedures regulated in the Banking Law are, respectively, special administration (*amministrazione straordinaria*) and compulsory administrative liquidation (*liquidazione coatta amministrativa*).

Special administration

In cases where one of the following conditions is satisfied:

- a) serious administrative irregularities or serious violations of laws, regulations or bylaws governing the bank's activity are found;
- b) serious capital losses are expected;
- c) the dissolution has been the object of a reasoned request by the bank's administrative bodies or an extraordinary general meeting; the Treasury, acting on a proposal by the Bank of Italy, may issue a decree dissolving the administrative and control bodies of the bank.

Therefore, the preconditions of special administration are not necessarily violations of rules, but also cases of serious mismanagement. The Bank of Italy then appoints one or more special administrators, as well as an oversight committee. The special administrators ascertain the bank's situation, eliminate irregularities and promote solutions which are in the interest of the depositors.

Compulsory administrative liquidation

The Minister of the Treasury, acting on a proposal from the Bank of Italy, may revoke a bank's authorization and order its compulsory administrative liquidation, even where special administration or voluntary liquidation under the ordinary rules are in effect, where one of the following conditions is satisfied:

- a) the administrative irregularities, or the violations of laws, regulations and bylaws are exceptionally serious;
- b) the expected capital losses are exceptionally serious;
- c) a court has declared the insolvency of the bank.

Compulsory liquidation may also be requested (with justification) by the administrative bodies, the extraordinary general meeting of shareholders, the special administrators or the liquidators.

This special regime, which does not set insolvency as a necessary precondition for liquidation, aims to protect depositors from past, as well as possible future, extremely serious mismanagement of the bank.

In order to complete the overview of the institutional setting for dealing with bank crises, one should mention that in many cases the chosen solution is merger with another bank. In the past, these mergers have often been informally supported by the Bank of Italy. A Ministerial Decree of 1974 (Ministerial Decree 27.9.1974) allowed the Bank of Italy to refinance at very favourable conditions those banks which, succeeding to the rights of depositors with respect to a bank in compulsory liquidation, suffered losses. Since such losses were compensated with an increase in money supply, they were partly paid by the public. So far, the decree has not been formally repealed.

Rules concerning the payment system affecting cooperation within the banking sector

Among the statutory functions of the Bank of Italy there is also the promotion of the regular operation of the payment system. To reach this objective, the Bank of Italy provides banks with an interbank payment system characterised by the coexistence of a net settlement system for retail operations and a gross settlement system for large value payments. The latter is part of the European TARGET (Trans European Automated Real Time Gross Settlement Express Transfer System) project.

Industry regulator

The statutory authority for the supervision of Italian banks is the Bank of Italy. Being the Italian central bank, the Bank of Italy is also responsible for monetary policy. Moreover, it plays the role of lender of last resort.

As already mentioned, the Banking Law puts some limits to the Bank of Italy's discretionary powers in exercising the supervisory activity. It establishes that these power shall be exercised having regard to sound and prudent management, the overall stability of the financial system, its efficiency and competitiveness.

The scope of prudential regulation concerns: (i) capital adequacy; (ii) the limitations of risk in its various forms; (iii) permissible holding; (iv) administrative and accounting procedures and internal control mechanism. The Bank of Italy, in the performance of its supervisory functions, may issue regulations in the cases provided for by law, issues instructions, and adopts specific measures (including authorisations) within the scope of its authority. It may promote inspections, and impose reporting requirements to banks. The Bank of Italy often uses measures of informal moral suasion in order to pursue the purposes of supervision established by the law.

Interbank arrangements affecting the behaviour of banks, such as industry organizations, codes of conduct, interbank agreements

See below (Horizontal arrangements).

Industry organizations

Industry organizations have always played a very active role in the Italian banking sector. Historically, banks belonging to the same legal category of credit institution joined their own organization. However, almost all banks, excluding small size cooperative banks, belong to the Association of the Italian Banks (ABI), which is the most important banking association.

State ownership in the banking industry

In order to describe the relevance of public ownership in the Italian banking system, one should consider both banks whose control is held by the State and banks controlled by "Fondazioni" (public entities to act in the public interest).

Public banks operating in Italy are approximately 80, while privately owned banks (often in cooperative form) are more than 800. In any case, public banks still represent almost 50 per cent of the total bank assets. The current ownership structure of the Italian banking system is changing rapidly, with many privatizations taking place.

Application of the national competition law to the banking sector

The ordinary rules of the Competition Act, no. 287/90, concerning agreements, abuse of dominant position and concentrations apply to the banking sector. There is an additional special provision in the law concerning agreements which may affect the stability of the monetary system (Section 20.5). More specifically, anticompetitive agreements which would be prohibited under Section 2 of the Act may be authorized, even when the general conditions for an exemption set forth in Section 4 are not met, in order to guarantee the stability of the monetary system. However, the authorization shall be for a limited period. Moreover, the exemption may not permit restrictions that are not strictly necessary for guaranteeing the stability of the monetary system and may not permit competition to be eliminated in a substantial part of the market. Section 20.5 of the Competition Act has never been applied so far.

The provisions of the Competition Act represent an additional regulation for bank mergers, which are already subject to an authorization procedure under the Banking Law aimed at guaranteeing a safe and prudent management.

Enforcement of competition law in the banking sector

With respect to banks, the provisions of the Competition Act concerning agreements, abuses of dominance and concentrations are enforced by the Bank of Italy (Section 20 of the Competition Act). As already mentioned, the Bank of Italy is in charge of monetary policy and of the supervision of banks and other undertakings operating in the financial sector. The decisions taken by the Bank of Italy in application of the Competition Act are adopted after hearing the opinion of the Italian Competition Authority. This opinion, which is not constraining, shall be issued by the Authority within 30 days from receiving the documentation on which the measure is based.

For the authorization of anticompetitive agreements with the aim of guaranteeing the stability of the monetary system (Section 20.5), the decision must be taken by agreement of the Bank of Italy with the Competition Authority, which is especially charged with the duty to ascertain whether the authorized agreement would impede competition.

Where the agreement, abuse or concentration relates to undertakings operating in sectors falling within the competence of more than one authority (e.g. the acquisition by a bank of the control of an insurance company), each of those authorities may adopt measures falling within its competence under the Competition Act (Section 20.7).

Generally, the opinions given by the Competition Authority were in line with the decisions taken by the Bank of Italy in the enforcement of the Competition Act. In a few cases the conclusions reached by the two Authorities were different; for instance, with respect to the acquisition of control of Banca Popolare di Sassari by Banco di Sardegna, the Competition Authority deemed that the remedies proposed by the Bank of Italy did not eliminate all competition concerns.

Approach to market definition in the analysis of mergers

In the enforcement of merger control, both the Bank of Italy and the Competition Authority do not follow a cluster market approach, but deem it possible that different relevant markets exist for the different services offered by banks. The two authorities agreed to start their analysis of the impact of a concentration on competition in banking, by using provisional market definitions, that is considering the market for deposits (including checkable accounts, time deposits and certificates of deposit) and the market for loans (both short term and medium to long term). The geographical scope of these markets is provisionally defined on the basis of Italian administrative areas; for deposits, each Province is considered; for loans, an aggregate of adjacent Provinces (Region).

This provisional market definition aims at simplifying procedures: when the market share resulting from the concentration does not exceed 15 per cent on the above mentioned markets, usually no further analysis is carried on. When a concentration appears to require a more in depth analysis of its effects on competition, the two institutions may take more punctual information concerning demand and supply substitutability into account, and consider different relevant markets from the ones defined above, from both a product and a geographical viewpoint.

When the parties involved in a concentration were important competitors in the provision of a specific financial service (for instance, leasing, factoring, asset management, securities trading), distinct relevant markets for these services were considered.

Up to now, the use of Internet and telephone banking is not widespread enough to appreciably affect the question of market definition. However, the impact of these technologies on demand and supply substitutability is carefully under consideration.

Possible trade-offs between the protection of competition and the protection of stability of the banking sector in the analysis of mergers

Section 6 of the Competition Act, concerning concentrations that create or strengthen a dominant position on the domestic market with the effect of eliminating or restricting competition appreciably and on a lasting basis, does not provide that enforcers trade-off competition concerns with stability concerns.

Remedies imposed in the case of mergers which gave rise to competitive concerns

The remedies imposed by the Bank of Italy in cases of mergers which gave rise to competitive concerns include the selling of some branches or their closing (Banco Di Sardegna-Banca Popolare Di Sassari), as well as the prohibition to open new branches in the relevant geographical areas for a given period (Banco di Sardegna-Banca Popolare di Sassari; Cariplo-Carinord; Banca delle marche-mediocredito fondiario centro italia-c.r. loreto).

Horizontal arrangements

The competitive impact of a number of interbank horizontal agreements has been investigated by the Bank of Italy in the last few years. In most such cases a central role in the enforcement of the agreement was played by the ABI, which is the Association of Italian Banks to which virtually every bank operating in Italy belongs (*Abi Inter-bank agreements, standard banking rules and the Bancomat agreement*).

In performing its statutory activities to protect the interests of its membership, ABI issues technical circulars to encourage inter-bank agreements, as well as standard conventions to regulate relations between its member banks and their customers. The following inter-bank agreements were deemed to be restrictive of competition:

- agreements establishing the commissions to be charged to customers for automatically direct-debiting their current account to pay telephone and gas bills, and urging the banks to charge prices that would discourage users from paying bills directly at the counters (during the investigation, ABI undertook to eliminate these provisions from the circulars);
- agreements laying down the commissions to be charged to a debtor to perform the transactions needed so that trade receivables would be paid to the payee's bank. In the latter case, an individual exemption was given under Section 4 of the Act. It referred in particular to the reduction of the transaction costs implied by the establishment of inter-bank commissions for this service and to the substantial improvement in the conditions of supply that would ensue in terms of both the quality of the service and lower charges, given that the fixing of inter-bank commissions did not lead to fixing the final prices of the service charged to the customer.

Other agreements were also examined relating to standard contracts for the main banking operations (known as the standard bank rules). These specimen contracts have been regularly issued by ABI to its member banks since the Fifties, using circulars detailing the contents of all the contractual clauses. During the investigation it was found that virtually all the standard bank rules contained clauses restricting competition, laying down prices either directly or indirectly in breach of Section 2 of the Act; ABI was therefore persuaded to delete a number of the clauses set out in the standard bank rules and to amend the wording of others.

Lastly, the interbank agreements concerning the provision of the Bancomat ATM service were analysed. The inter-bank agreement was undersigned by about 700 banks, and subsequently set out in a Regulation which was spread out and amended by ABI (the so-called Bancomat agreement). The fixing of multilateral inter-bank fees under the terms of the agreement was considered in violation of Section 2 of the Act; however, it was given an individual exemption under Section 4. This assessment took into account the method used to establish the amount of this commission (based upon a survey of the direct costs to the individual banks), the reduction of the transaction costs resulting from standardising commissions, the fact that this does not lead to the fixing of the prices charged to the customer, and the intention expressed by ABI during the investigation to amend the agreement so that the commission would henceforth be considered a "maximum commission".

Abuses of dominance or vertical arrangements which have raised competition concerns

Some banks, having an exclusive franchise to collect taxes in specific parts of the country, in providing this service applied more favourable conditions to their own customers than to customers of other banks. This was considered to be an abuse of dominant position (Monte Paschi di Siena-servizio riscossione tributi).

Vertical exclusive agreements between banks and insurance companies for the distribution of insurance products are analysed with particular attention from a competition viewpoint. When the involved bank, given its branch network and its customer base, has a significant market power in retail distribution of financial products, an exclusive distribution agreement with an insurance company may contribute to make entry for other insurance companies particularly difficult. Moreover, when most insurance companies operate in a market through exclusive agreements of this kind, collusion between them can be easier.

JAPAN

Principal statutory regulations that affect the banking sector

(a) Regulations on branching and new entry, especially the entry of foreign firms

The Banking Law provides the following provisions: Unless licensed by the Minister of Finance, none shall engage in banking (§4(1)). To obtain a banking license issued by the Ministry of Finance, a bank must follow, in addition to certain legal conditions (such as the bank having the legal status of limited company, etc.) certain subjective conditions (such as financial capacity, etc.) and certain objective conditions (such as whether the opening of a banking business is appropriate in light of the economic and financial situation at that time) (§4(2)).

In the case where a foreign bank wishes to obtain a banking license, the Minister of Finance shall, generally, examine issues such as whether the bank having its principal office of business in the foreign country, is entitled to a status equivalent in substance to the one given under this Law (§4(3)).

(b) Regulations on pricing

The Interest Rate Temporary Adjustment Law, which provides the upper limit of interest rate was set forth in 1947. At the present time, it provides zero per cent as the upper limit of a current account (a current account yields no interest) and 15 per cent per year as the upper limit of loan interest rate generally, while there is no upper limit in regard to any other interest rate.

(c) Line-of-business restrictions and regulations on ownership linkages among financial institutions

In order to prevent an excessive concentration of economic power by a financial company and to promote fair and free competition, stockholding of a domestic company by a financial company is prohibited, under Section 11 of the Antimonopoly Act (Japanese Competition Law) from exceeding five per cent (or 10 per cent if the financial company is a company engaged in the insurance business) of the total amount of the outstanding stock of the company whose stock is so held.

However, the Point of View for Authorization of Stockholding by Financial Companies under the Provisions of Section 11 of the Antimonopoly Act (December 1997) provides that, in the case whereby the company (hereinafter called "stock issuing company") is a subsidiary of a financial company (hereinafter called "applicant company") which performs business subordinate to the essential business of the applicant company, or whereby the stock issuing company is another financial company, and satisfies the specified requirements, authorization under Subsection 1, Section 11 of the Antimonopoly Act can be given even to the applicant company which would hold more than five per cent of the total outstanding stock of the stock issuing company.

Under Section 13 of the Antimonopoly Act, neither an officer nor an employee of a company including a bank shall hold at the same time a position as an officer in another company or companies in Japan, whether or not the effect of such an interlocking directorate may be to substantially restrain competition in any particular field of trade.

(d) Regulations on the portfolio of assets that banks can hold

The Circular of the Director General of the Banking Bureau of the Ministry of Finance has set targets of percentage of the portfolio of assets in order to maintain the appropriate management for the bank, such as 8 per cent of the ratio of the net worth over the total assets, 30 per cent of the ratio of liquid assets(cash deposit, etc.) over the average total amount of the deposit.

(e) Compulsory deposit insurance

In 1971, the Deposit Insurance Law was set forth and banks, credit banks, credit unions and labor banks became policyholders compulsorily.

(f) Regulations on capital-adequacy

The Banking Law provides that a bank shall be a joint-stock company whose capital equals or exceeds two billion yen (\$US 14.7 million).(\$5)

(g) Reserve requirements

The Banking Law provides that a bank shall transfer a part of its total dividend paid to its earned surplus account, until the balance of the account reaches the sum of its capital.(\$18)

(h) Requirements of direct credit to favored sectors

There is no such requirement.

(i) Special regulations concerning liquidation, winding up, insolvency, composition or analogous proceedings in the banking sector

The Banking Law provides that a competent court and Minister of Finance shall inform and cooperate with each other regarding proceedings of a bank's bankruptcy.(\$46)

(j) Other regulations affecting cooperation within the banking sector

Regulations on the business scope

There are regulations on the business scope such as (1) short-and-long-term finance systems (under the Long Term Credit Banking Law of 1952, short and long term finance are handled separately by different financial companies), (2) separation between the banking business and the trust business (The Law concerning Side Business, etc. of Trust Business by Financial Organs prohibit side business, etc. of trust business by financial companies in general.) and (3) separation between the banking business and the securities business (The Securities and Exchanging Law(\$65) prohibits side business, etc. of the securities business by financial companies in general.)

With regard to (1) short-and-long-term finance systems, these systems have become distinct in name only because the standard bank has been able to accept medium and long term deposits since October 1994. (2) Separation between the banking business and the trust business and (3) separation between the banking business and the securities business has also become distinct in name only since legislation was established under the Financial System Reform in April 1993, permitting banking, securities and trust markets to enter the market though the mutual use of their subsidiaries.

Lifting of the ban on financial holding companies

While the ban on holding companies was lifted following revision of the Antimonopoly Act, the ban on financial holding companies will also be lifted since the draft of the Financial Holding Company Law passed the Diet during the last year session.

Regulations on matters which exert an influence on banking management, etc.

a. Establishment of branches and agencies

When a bank intends to establish or abolish a branch or an agency, the bank shall obtain the approval of the Minister of Finance.(§8)

b. Regulations on bank holidays

Under the Banking Law, from the viewpoint of the public nature of the banking business, bank holidays are limited (§15(1)) and banking hours are regulated with consideration to the situation of financial transactions and other relevant matters (§15(2)).

2-3. The form, the principal functions and the discretion of the industry regulator, and the function of the central bank

The Ministry of Finance supervises financial companies. In the banking sector, mergers, cessations of business, dissolutions and increases in the amount of capital, all require the approval of the Minister of Finance. On the other hand, the Banking Law provides the Minister with the submission of reports and the materials of the banking businesses for each business term and grants him power over supervision, including inspection and other measures.

Obviously the monetary policy of the Bank of Japan (ex. revision of the official discount rate, financial control by means of the operation of bonds and bills) has a significant effect on financial companies.

The function of supervising financial companies, including banks will be removed from the Ministry of Finance and a new body entitled the Agency of Supervision of Financial Companies will be established to assume responsibility of this function.

4. Important inter-bank arrangements, etc.

There is no such arrangement, etc.

8. Application of exemption from the competition law within the banking sector, competition rules that specially apply to the for banking sector.

The Antimonopoly Act is generally applied to all industries including banking.

With regard to banking, whilst market entry and other matters are regulated by the government in order to maintain the financial system and to protect consumers under the Banking Law, the

Antimonopoly Act is applied to cases of anti-competitive conduct by entrepreneurs or trade associations and there is no antimonopoly exemption system from the Antimonopoly act in the banking sector.

In order to prevent an excessive concentration of economic power by a financial company and to promote fair and free competition, stockholding of a domestic company by a financial company is prohibited under Section 11 of the Antimonopoly Act, from exceeding 5 per cent (or 10 per cent if the financial company is a company engaged in the insurance business) of the total amount of the outstanding stock of the company whose stock is so held.

9. An administrative organ to implement the Antimonopoly Act in the banking sector

The Fair Trade Commission is the sole administrative agency to implement the Antimonopoly Act in all industries including the banking sector.

10. Actions taken by the competition authority in the banking sector

(a) Market definition concerning mergers

Section 15 of the Antimonopoly Act prohibits any mergers of companies including banks if the effect of such a merger “may substantially restrain competition in any particular field of trade”. With regard to “particular field of trade”, which means a market, “Administrative Procedure Standards for Examining Mergers, etc. by Companies” (July 15, 1980 Executive Bureau, Fair Trade Commission) stipulated that it is defined in terms of the following four items:

(1) Object(s) of trade (product market)

A particular field of trade is defined in terms of products which are of the same kind in function and utility.

(2) Area or areas of trade (geographic market)

A particular field of trade is defined, with respect to products and securities and service defined under (1) above, according to the actual state of competition in the business area or areas of the parties to the merger. In defining the geographic market, (a) the characteristics of the products and securities, (b) the relationship between the means and the cost of transportation, and (c) business capabilities such as the sales network and the production capacity are taken into consideration.

(3) Stage of trade

As products and services are usually sold through a channel which runs from the manufacturer (service provider) to wholesalers and retailers, and since competition exists at the respective business stage, a particular field of trade is, in general, defined at each stage of trade.

(4) Other trading partner(s)

If there exists a specific group or groups of customers, according to the distinctiveness of the users and the nature of the product and service, there may be an independent particular field of trade for each such group.

In the case of mergers by banks, the Fair Trade Commission defines “particular field of trade”, in terms of the above four view points, according to the situation of each case.

For example, in the case of the merger between the Mitsubishi Bank and the Bank of Tokyo, Ltd. (merger conducted April 1996), the Fair Trade Commission has examined it by deeming that there is a “particular field of trade” in each sector which is a nation-wide level deposit and loan market of city banks, a prefectural area level deposit and loan market of city banks or a nation-wide level foreign exchange market of all foreign exchange banks.

(b) Trade-off between the protection of competition and the protection of stability of the banking sector in the case of merger examinations

In the case of mergers by banks, the stabilization of management might be one purpose of the merger. Stabilization of management may have harmful effects on competition by creating or strengthening dominant powers in the market, on the other hand it may promote competition when the competitiveness of the parties involved in the merger increase and they become influential competitive unit as a result of the merger. There is not necessarily a trade-off relation between the stabilization of management in banking and maintenance of competition.

Under the Antimonopoly Act, merger cases are examined only by means of determining whether or not the merger may have a harmful effect on competition in the market. Therefore, although some mergers may stabilize banking, mergers which may substantially restrain competition in any particular field of trade are prohibited.

(c) Measures which have been taken in the case of mergers which gave rise to competitive concerns

Section 17-2 of the Antimonopoly Act provides that when a merger may substantially restrain competition in any particular field of trade, the Fair Trade Commission may order the entrepreneur concerned to take any necessary measures. In the banking sector, there have not been any cases in which the Fair Trade Commission took any measures according to this provision.

However, in certain cases, at the stage of prior consultation, the Fair Trade Commission pointed out various problems from the viewpoint of competition policy, and the entrepreneurs concerned voluntarily took necessary measures including the transfer of part of their business, in order to prevent the occurrence of such problems.

For example, in the case of the merger between the San-in-godo Bank, Ltd. and the Fuso Bank, Ltd. (merger conducted April 1991), the bank concerned transferred its premises to other financial companies in certain administrative districts where the market share of the merged companies would increase remarkably.

(d) Peculiarities of banking with regard to horizontal agreements -- from the viewpoint of Competition Policy on agreements between banks, electronic commerce, CD systems

With regard to horizontal agreements between banks, the JFTC took legal action against Teikoku Bank, Ltd. et al. in 1947. In this action, the JFTC found that banks conducted interest rate fixing agreements in regard to loans and deposits. In Japan, Antimonopoly Act is applied to horizontal agreements between banks, whereas no other law is applied to such agreements. In the banking sector, the Antimonopoly Act is applied in the same way as in other industries.

On the other hand, there is deemed to be a strong element of conformity among banks. In fact, there is almost no difference among banks in regard to deposit interest rates, handling fees for ATM (automated teller machine), etc. Some reasons are generally recognized to exist behind the scene. First, there is little deference among the interest rates of each bank because they are linked with the official rates. Second, the banking sector has been under government regulation. For example, there are license systems in the banking sector, and regulations such as the number of premises, etc. which influence the management strategy of each bank. These regulations have made it difficult to enter the market, have caused unified services, have enabled inefficient banks to exist, have decreased the incentive to create new goods, have discouraged banks from improving services.

The above-mentioned situation, however, is changing by means of mutual entrance of banking, securities and trust markets using in 1992 their subsidiaries and the Financial Big Bang, which is aimed at (1) reforming from the viewpoint of the user, and (2) stabilizing the financial system by means of the three principles "Free, Fair and Global".

(e) Cases of abuse of dominant positions in the market and vertical agreements

The Antimonopoly Act provides measures against a monopolistic situation, restrictions on private monopolization, the abuse of dominant bargaining positions and the abuse of dominant positions in the market. As a case of action against the abuse of dominant positions in banking, the JFTC took legal action against Nippon Kogyo Bank in 1953. In this case, the JFTC found that the bank, by making use of its dominant position over the company to which it lent money, unjustly in the light of normal business practices, compelled the company to follow its direction regarding the appointment of officers of the said company. Similarly, the JFTC took legal action against Mitsubishi Bank, Ltd. in 1957.

There has been no action against vertical agreements in the banking sector.

11-12 Particular issues or experiences that would be of interest to other OECD competition authorities - the Big Bang in Japan -

The major challenge for Japan in the 21st century is to maintain its economic vitality against the rapid ageing of the population. To meet this end, it is necessary for Japan to undertake a structural reform of its social and economic system. In particular, the financial systems, the artery of the economy, must be reformed so that they effectively support economic activity in the coming century. Furthermore, in light of major changes in the U.S. and European financial markets, it is urgently required to enhance the functioning of the Japanese financial market to prevent its possible hollowing out.

From these points of view, the financial system reform (the Big Bang) is formulated and carried out in accordance with the following basic concepts.

(The Basic Concepts in Formulating the Plan)

(i) Clarification of the Time Schedule

The time schedule for implementation should be clarified in order to promote the reform coherently.

(ii) Broad Market Reforms Based on Clearly Defined Principles

This reform will implement all reform measures that are considered necessary under the following three principles:

- Free (i.e., a liberal market under the market principle);
- Fair (i.e., a transparent and reliable market);
- Global (i.e., an international and advanced market)

(iii) Measures from the Users Perspective

From the standpoint that the reform must benefit the users, the major content of the reform covers all of the following four perspectives;

- i. Expanding the choices of means for investors and borrowers;
- ii. Improving the quality of intermediaries' services, and promoting competition among them;
- iii. Developing a market with further utility;
- iv. Establishing a reliable framework and rules for fair and transparent transactions.

(iv) Stability of the Financial System

In completing the reform, it is important to secure the soundness of financial institutions and other intermediaries by promoting the speedy disposal of the non-performing assets of financial institutions, by introducing the system of Prompt Corrective Action, as well as the enhancement of disclosure requirements, are required to ensure the requirements of disclosure, so as to make sure that the financial system remains stable.

Items of the Big Bang relevant to the banking such are as follows:

items	measures	time schedule
- Authorization for banks to sell securities investment trusts and insurance	<ul style="list-style-type: none"> - Banks will be authorized to sell securities investment trust certificates without going through subsidiaries. - Banks will be authorized to lease their office space to investment trust management companies for direct sale of securities investment trust certificates. - Upon taking measures against abuse, banks will be authorized to sell long-term fire insurance policies and credit life insurance policies which are related to housing loans. 	<ul style="list-style-type: none"> - It is planned that the related bills will be submitted to the next ordinary session of the Diet. - It is planned that this will be implemented during the 1997 fiscal year. - It is planned that this will be implemented around the target year of 2001.
- Utilization of holding companies	<ul style="list-style-type: none"> - The appropriate legal provisions will be made to allow the use of holding companies, and to take necessary measures to protect depositors, investors and insurance policyholders. 	<ul style="list-style-type: none"> - The draft of the Financial Holding Companies Law has passed the Diet during the last year session.
-The business scope of separate subsidiaries	<ul style="list-style-type: none"> - The remaining restrictions on the business scope of securities subsidiaries and trust subsidiaries will be lifted. - Measures will be taken to allow insurance companies and other types of financial institutions to enter each other's business areas by means of area-specific subsidiaries. - Measures will be taken at an earlier time to allow insurance companies to enter the banking, trust and securities businesses by subsidiary structure, and to allow securities companies to enter the insurance business by subsidiary structure. 	<ul style="list-style-type: none"> - The remaining restrictions will be lifted in the latter half of the 1999 fiscal year. - This will be realized at the latest by 2001.
- The abolishment of operational regulations applied to ordinary banks in the short-and long-term finance system	<ul style="list-style-type: none"> - Ordinary banks will be allowed to issue ordinary bonds. - The Foreign Exchange Bank Law will be abolished. 	<ul style="list-style-type: none"> - This will be implemented in the latter half of the 1999 fiscal year. - This will be realized on April 1, 1998.

MEXICO

The Regulation of Banks in Mexico

The main objectives of the regulation of the banking sector are to maintain a safe and sound financial system, to correct market failures and to enhance competition and provide an environment for effective implementation of financial policies.

The supervisory role in the commercial banking sector occurs because banks and their liabilities are seen as special, as they are considered to have the attributes of public goods. In order to preserve systemic stability, the maintenance of confidence in the banking institutions is a public policy objective. Systemic risk is the danger that a sudden and unexpected demise of one or several banks could trigger a domino-collapse throughout the entire banking system. To prevent systemic risk, several measures should be taken. Firstly, a lender of last resort must be established. In Mexico the lender of last resort is the central bank, Banco de México, which provides liquidity during a possible financial crisis, either to individual banks or to the system as a whole. Secondly, deposit insurance should be offered, so that consumers are less likely to run if they suspect the bank is in trouble. Thirdly, regulatory and supervisory measures must be taken.

In this paper some of the most relevant aspects of banking regulation are discussed, such as entry of foreign firms, line of business and ownership regulations, portfolio and lending restrictions, compulsory deposit insurance, interest rate controls and state ownership.

Entry of foreign firms

Before 1994, the establishment of affiliates of foreign financial institutions was not allowed in Mexico. The 1994 North American Free Trade Agreement (NAFTA) was the first step in the liberalization of our financial system. After NAFTA we have entered into other agreements that contain financial services provisions. In these agreements, the guidelines for Mexico's financial opening have been the following:

- Gradual, through individual and aggregate market share limits during a transition period. The rationale for this gradual opening lies in the former restrictions to market access to foreign financial institutions for more than 60 years. Consequently, it was not feasible to grant market access at once. Therefore, in each of the treaties and agreements where direct establishment of affiliates is contemplated, a schedule for the opening of financial services is established. Prior to the liberalization of our financial system, deregulation measures were taken, the banking system was privatized, financial groups were formed, new licenses for domestic intermediaries were issued and the central bank became autonomous. These measures changed our financial system radically, making it necessary to allow a period of time for our domestic institutions to adapt to the transformations. See Table 1 for the individual and aggregate market share limits for foreign banks under NAFTA.
- It benefits those countries with whom Mexico has entered into international agreements that include the liberalization of financial services. Currently, NAFTA and OECD countries, as well as Colombia are allowed to directly establish affiliates in Mexico.

- The opening is limited to foreign financial institutions that are engaged in the same general type of activities. However, banks and securities firms may establish financial groups and provide all types of financial services through their affiliates.
- Establishment is only permitted through subsidiaries. Branches are not allowed in our legislation.
- National treatment is granted to affiliates of foreign financial institutions, except for the following: (i) foreign financial institutions are limited to establish only one institution of the same type in Mexico; and (ii) subsidiaries may not establish branches, subsidiaries or agencies outside Mexico.

Line of business restrictions and regulations on ownership linkages among financial institutions

Each financial intermediary is subject to a list of activities and operations established in the applicable law for those intermediaries. With respect to commercial banks, these activities are established in the 1990 Credit Institutions Law. They include deposit taking; loan and credit granting; credit card issuance and the power to act as trustees; among other operations. Commercial banks may not carry out activities that are not included in the Credit Institutions Law, unless authorized by the Ministry of Finance and Public Credit as analogue or related activities to the banking business.

The 1990 Financial Groups Law established a universal banking system through the formation of financial groups with at least three different types of financial institutions. This allowed banks, insurance companies and securities firms to operate under the same roof. Effective January 1994, financial groups can be formed with two of the following financial institutions: commercial banks, securities firms or insurance companies, or with at least three of the other types of financial institutions. The holding company of the financial group should possess at least 51 per cent of the capital stock of each intermediary. However, each intermediary must carry out its own activities separately from the other financial institutions that conform the group, and may not offer their services in the same location.

Commercial banks may invest in the capital stock of investment companies, managing companies of investment companies, pension funds, managing companies of pension funds and in credit auxiliary institutions that do not belong to a financial group. These investments may not exceed, as a whole, any of the following amounts: (i) the surplus over the minimum capital of paid in capital plus capital reserves; or (ii) fifty percent of the paid in capital and capital reserves.

On the other hand, there is an individual shareholding limit for banks of five percent of their capital stock and up to 20 percent with the authorization of the Ministry of Finance and Public Credit.

Restrictions on the portfolio of assets that banks may hold

The investments in real estate may not exceed 60 percent of the paid-in capital plus reserves of the bank. The total amount of the investments made in financial institutions (previous paragraph) plus the investments in real estate, may not exceed the paid-in capital plus capital reserves.

Commercial banks may invest in non-financial corporations up to five percent of the paid-in capital of the issuer. In order to invest in a higher percentage of the corporation, an authorization of the Ministry of Finance and Public Credit is required. The total amount of investments in non-financial

companies may not exceed five percent of the bank's deposits in the domestic market. Commercial banks may only invest in limited corporations.

Lending Limits

Credit institutions may not lend to an individual more than 10 percent of their net capital or 0.5 percent of the aggregate net capital of the whole banking system, and they are not allowed to lend to a corporation more than 30 percent of their net capital or six percent of the aggregate net capital of the system.

Compulsory deposit insurance

Mexico's central bank manages FOBAPROA (Fondo Bancario de Protección al Ahorro), which is a private trust in charge of carrying out operations to prevent financial difficulties that commercial banks may confront, and to assure the fulfilment of the credit institutions' liabilities.

In order for commercial banks to receive preventive supports, they are required to cover an annual fee, either in capital stocks, governmental bonds or other any other property. Annual fees are fixed for all the banks. However, discounts may be applicable, depending on their capital adequacy and total amount of their liabilities, i.e. a low amount of liabilities and a high capital-asset ratio permit a bank to pay a lower fee.

Restrictions on capital adequacy

In accordance with the Basle Agreement, credit institutions must have a net capital of at least eight percent of their asset-liability portfolio weighted according to their risk level. New capital adequacy regulations were issued in July 1996. In these regulations, credit risks as well as market risks such as interest rate, exchange rate and stock price risks are included. The regulations adapt the Basle methodology to the Mexican context and incorporate its volatility.

Reserve requirements, requirements to direct credit to favored sectors and interest rate controls

Several deregulation measures were taken prior to the liberalization of financial services. These measures included the elimination of mandatory liquidity reserves in the central bank, requirements to direct credits to favored sectors and interest rate controls.

Prior to 1991, the mandatory liquidity reserves in the central bank was 30 percent of the total deposits of each financial institution. The reserve was represented by government securities, cash or deposits. Currently, the central bank has the legal power to impose reserve requirements to commercial banks. Such reserve may not exceed 20 percent of the bank liabilities or 50 percent of trusts operations through which credit institutions receive deposits to grant credits or invest in securities. However, the central bank has not exercised this power since 1991.

Before 1989, there were specific regulations that required commercial banks to direct a percentage of their granted credits to a certain productive sectors of the economy considered as a priority. After the deregulation measures were taken, these requirements were repealed and preferential credit is now only granted through development banks.

Until 1991, the central bank fixed maximum interest rates in the domestic market due to the distortions and high management costs generated by the mandatory reserves that the central bank imposed on the credit institutions. Besides the elimination of the reserve requirements, it was feasible to eliminate maximum interest rates. Currently there are no restrictions on interest rates, prices or fees.

Special rules concerning liquidation, winding up, insolvency, composition or analogous proceedings in the banking sector

The liquidation of commercial banks is subject to the provisions of the Bankruptcy Law, except for the following:

- The receiver must be the Liquidating Trust of Credit Institutions and Auxiliary Credit Organizations.
- The National Banking and Securities Commission may request the bankruptcy and insolvency resolution.
- Subordinated debentures must be paid after the other liabilities of the bank are fully covered.

Other rules affecting the cooperation within the banking sector

Banco de México issues regulations for the clearing of banking transactions. Under those regulations credit institutions may establish, in the most important cities in Mexico, clearing chambers for banking transactions. In the remaining cities, clearing transactions are carried out by a trust called CECOBAN (Centro de Compensación Bancaria).

In 1995, a widespread electronic payment system called SPEUA was established by Banco de México. This system permits the completion of a high volume transactions on the same date, between clients of different banks.

Banking sector regulators

Banking regulators in Mexico are the following:

- Ministry of Finance and Public Credit: This is the most important entity of the Federal Government engaged in banking regulation. Among its powers, it has the faculty to implement, execute and interpret the banking provisions. It is also in charge of the credit and financial guidelines for financial intermediaries. The Ministry of Finance and Public Credit has the power to coordinate, plan and supervise the banking system.
- National Banking and Securities Commission: This is an agency of the Ministry of Finance and Public Credit, in charge of the supervision and surveillance of the banking system, for the protection of consumers.
- Banco de México: This is the autonomous central bank. Among its powers are the regulation of financial services and intermediation, as well as the payments system. It is the reserve bank and lender of last resort. It participates in the exchange markets in charge of foreign exchange policy.

The relationships among these regulating bodies are presented in Figure 1.

Industry organizations

The most important banking organization in Mexico is the National Banking Association, whose goals are, among others, to represent the interests of its members, to foster the development of banking activities in Mexico, to act as a mediator in conflicts arising among its members if requested by the banks, and to represent the Mexican banking industry in the international financial markets. Banks must pay an annual fee in order to be a member of this organization.

State ownership in the banking industry

After 1991, state owned banks were sold to private investors. Currently, state ownership in commercial banks is very small, and is concentrated in the capital stock of the holding company of the financial group, not directly in the capital stock of the bank. The state participation in the capital stock of Bancomer, currently ranked second among Mexican banks, is 15.76 percent. The state's investment in Bital, ranked fourth, is 7.61 per cent of capital stock.

However, it should be noted that in Mexico there are seven development banks and three trusts with a majority state ownership. The development banks are the following: Banco Nacional de Crédito Rural, S.N.C. (BANRURAL); Nacional Financiera, S.N.C. (NAFIN); Banco Nacional de Comercio Exterior, S.N.C. (BANCOMEXT); Banco Nacional de Obras Públicas, S.N.C. (BANOBRAS); Banco Nacional de Comercio Interior, S.N.C. (BNCI); Financiera Nacional Azucarera, S.N.C. (FINA) and Banco Nacional del Ejército, Fuerza Aérea y la Armada, S.N.C. (BANJERCITO).

Competition Regulation in the Banking Sector

The Federal Law of Economic Competition (FLEC), in force since 1993, fully applies to the banking sector. This means that the Federal Competition Commission (FCC) has jurisdiction over banks as far as monopolies, monopolistic practices and mergers are concerned.

The Credit Institutions Law also contains certain rules regarding mergers. Article 27 of that law states that any merger between two or more banking institutions requires approval by the Ministry of Finance and Public Credit, which in turn will consult Banco de México and the National Banking and Securities Commission. In its decisions the Ministry will look after the interests of the public and of the banks' employees. The banks' creditors may object to the merger within 90 days with the sole objective to obtain credit repayment, not to suspend the merger.

Over the past few years the FCC has been very active in reviewing mergers and acquisitions in the banking sector. It furthermore investigated a number of alleged monopolistic practices by banks, specifically in the credit card and government debt markets. These actions are discussed below.

Merger review in the banking sector

Before discussing merger review it is useful to briefly describe the structure of the Mexican banking sector. Ever since the privatization of all 18 commercial banking institutions between 1991 and 1992, the Big Three banks, Banamex, Bancomer and Serfín, have held more than 50 percent of the market (as measured by total banking assets) This can be seen from table 2.

However, important changes in market structure took place among the rest of the banks. The 15 second-tier banks that were privatized in 1991-1992 expanded aggressively in the next two years,

increasing their overall market share from 34.7 to 41.9 percent. However, in 1993 the Mexican banking system began to suffer a shortfall in capital, a situation that was aggravated by the financial crisis that broke out in December 1994. The collapse of the peso, increased nominal interest rates, economic contraction and excessive debt burdens on companies and families led to a worsening of credit portfolios and a massive increase in nonperforming debts. The government, through FOBAPROA, intervened in a number of second-tier banks that had been privatized in 1991-1992.

This gave rise to a bigger market share of certain domestic banks that were founded after 1992 (4.2 percent in 1996). More importantly, however, it led to a significant increase in the participation of foreign banks, from less than 1.5 percent in 1994 to almost 16 percent in 1996.

These new domestic and foreign banks expanded in part through the acquisition of troubled banks, often with FOBAPROA as an intermediary. As a result, the number of mergers notified to the FCC increased, especially during 1996, as Table 3 shows. It is important to note that the FCC did neither object nor condition any of the mergers listed in the Table.

The merger between Banco Unión and Grupo Financiero Cremi, two second-tier privatized banks, in 1993, was one of the first mergers that the FCC reviewed. In this case the FCC defined the relevant product market as that of the whole range banking and credit services provided by commercial banking institutions. The relevant geographic market was national, since there are no legal impediments for banks to establish throughout the country and because the major banks have national coverage. Banco Unión and Cremi would have a combined market share of 4.9 percent in total bank deposits and 5.7 percent of the total loan portfolio. It would rank fifth among all banks, but far behind the Big Three. The FCC further considered that forming larger banks may in some cases be a strategy to face competition in an open market. The merger was therefore not objected.

Since 1995 the FCC has reviewed several acquisitions of (part of) Mexican banks by foreign banks. These acquisitions followed from the restructuring of the Mexican banking sector after the peso crisis. Thus, Spain's Banco Bilbao Vizcaya and Banco Santander acquired Grupo Financiero Probusa and Banco Mexicano, respectively. Other foreign banks took or increased their holdings in different Mexican banks.

In these cases the FCC often defined several relevant markets, since financial groups in Mexico usually have several activities apart from "ordinary" banking, such as securities trade, insurance and leasing. However, all different banking and credit services, "traditional" as well as others, are considered to be in the same relevant market (this approach was also taken in the Banco Unión-Cremi merger described above).

The acquisitions did not grant any substantial power over the relevant markets, since the foreign banks involved did not previously operate in Mexico. On the contrary, because of the capital injections the Mexican banks involved would recover or even increase their competitive capacities. This way, the acquisitions not only helped to strengthen the financial system but also encouraged the development of a more competitive banking market. A trade-off between the protection of competition and the protection of stability of the banking sector did not really exist in this case.

The latter conclusion might not hold, off course, if any of the Big Three banks would decide to acquire a smaller domestic bank. Then, the positive effects on the strengthening of banking sector (if the acquired bank is in financial problems) would have to be weighted against the possible anticompetitive effects such an operation might have. Until now there have been no such cases, but several may be expected in the near future as restructuring of the banking sector continues.

Monopolistic practices in the banking sector

The FCC has intervened in two cases of horizontal arrangements among banks, one in the credit card market and the other in the market for government debt.

During 1994 the FCC investigated the credit card market in Mexico. At that time, invoiced sales with credit cards constituted already over five percent of GDP, and consumer credit granted through these cards represented close to 75 percent of overall consumer credit granted by banks. In Mexico there are three local credit card systems. Two of the Big Three banks, Banamex and Bancomer, operate their own system. The other system, Carnet, is a joint-venture of the third Big Three bank, Serfín, and a number of smaller banks.

Several findings of a preliminary review triggered a formal, ex-officio investigation. First, the average commissions paid by merchants for credit cards receipts seemed to be higher than the average for other countries. Second, merchant commissions turned out to be the same for all credit cards. Third, the interest rates charged to cardholders were substantially the same among the largest issuing banks. Finally, profit margins on credit card operations were high, as compared to other countries and to other bank products in Mexico.

It turned out that the three local credit card systems coordinated their behavior, at least with respect to setting merchant commissions. Bills of sales among the three systems were cleared by means of agreement under which merchant commissions were payable to the card issuing bank. For this reason, acquiring banks had limited incentives to compete by reducing merchant commissions. In fact, these commissions were identical for the three credit cards. Parallel behavior was also detected by issuing banks with respect to interest rates charged to cardholders. Finally, the Commission found that the banks prevented participating merchants from offering discounts to their customers for paying in cash.

In order to remedy these problems, the Commission reached a consent agreement with each of the three credit card systems. The banks involved would undertake the actions to eliminate: (i) information exchange among them aimed at, or resulting in, the setting of common or coordinated merchant commissions, or interest rates to cardholders; (ii) within six months, any obligation on merchants not to offer discounts to consumers who pay in cash; and (iii) within one year, any information regarding merchant commissions from the manual machines (which printed such information on vouchers).

In this case, the network property of credit card systems influenced the behavior of the banks. One hand, agreements to clear bills among banks belonging to different systems may be efficient and beneficial to consumers. On the other, however, the resulting information exchange among banks facilitates collusion.

The other horizontal arrangement concerned the participants in the weekly auctions of Treasury Certificates of the Federation, carried out by Banco de México. Four banks and one investment group were found to have coordinated their bids in 11 auctions at the end of 1993. The companies offered prices that were identical at a two digit level. Thereby they could benefit from an auction rule which determines that in case of a draw the supply will be equally divided among the winners.¹ The FCC fined the companies involved.

As for vertical arrangements, in 1996 the FCC investigated a complaint by American Express. This company was planning to introduce a new credit card in Mexico, but was concerned about VISA International's presumed intentions to prevent its member banks from issuing rival credit cards. American

Express launched similar complaints in several Latin American countries and before the European Commission. Just as happened in Europe, the investigation in Mexico terminated when VISA International's Mexico division stated that it had no intentions whatsoever at present or in the future to impose exclusivity upon its member banks. Still, the FCC formally warned VISA not to incur in monopolistic practices. It considered that VISA would probably be in violation of the law if it imposed exclusivity on its banks, due to its dominant position in the market for international credit cards.² According to American Express, VISA has more than 60 percent of all international credit cards in Mexico and its Mexican member banks issue more than 95 percent of all credit cards.

Conclusion

The Mexican banking system still faces huge problems of nonperforming debt and capital shortage. Restructuring of the sector will continue in the years to come. Restructuring concerns also dominate regulatory and competition policies towards the banking sector. In regulation this takes the form of imposing stricter accounting rules and allowing increased participations of foreign banks. As for competition policy, the restructuring process mainly involves the review of consolidating mergers.

Table 1. Individual and aggregate market share limits for foreign banks under NAFTA

Intermediary	Individual Limits %	Aggregate Limits %	Base
Commercial Banks	1.5	8-15	Net Capital
Securities Firms	4	10-20	Global Capital
Insurance Companies	1.5	6-12	Gross Solvency Requirement
Limited Scope Financial Institutions		3	Sum of Commercial Banks Assets plus Limited Scope financial Institutions Assets
Financial Leasing Companies		10-20	Capital global
Financial Factoring Companies		6-12	Gross Solvency Requirement

**Table 2. Market shares in banking sector (by total banking assets)
(%)**

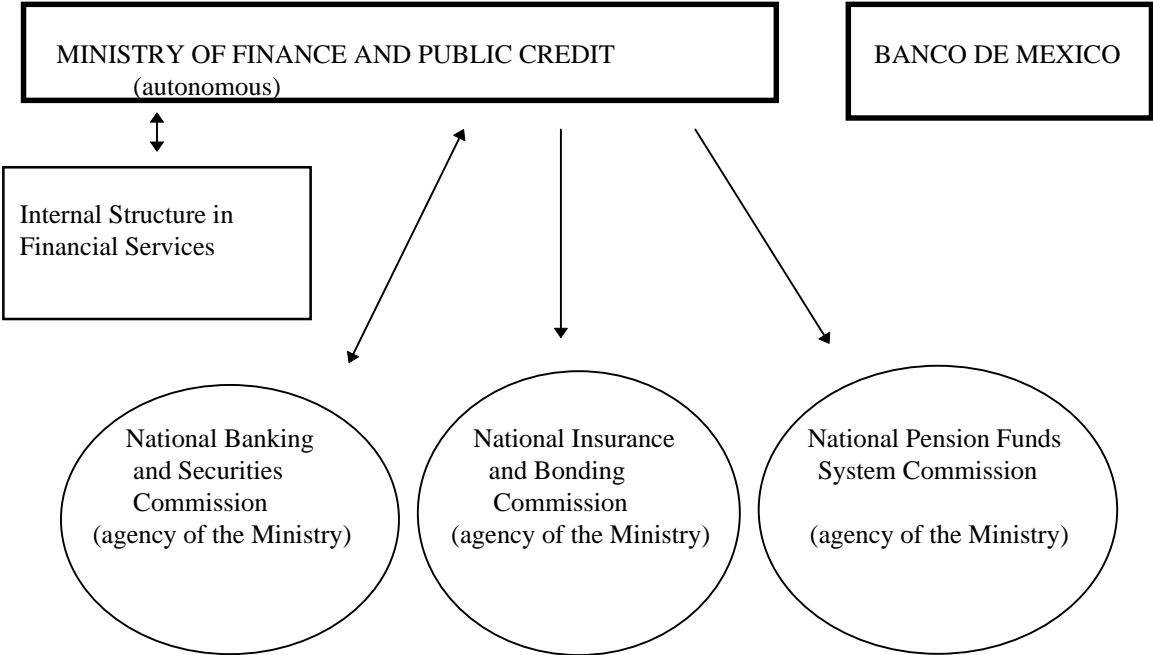
Group of Banks	1992	1994	1996
Big Three banks (Banamex, Bancomer, Serfín)	63.6	54.7	52.0
Rest of the banks privatized in 1991-1992	34.7	41.9	28.3
Domestic banks created after 1992	0.0	1.9	4.2
Foreign banks	1.6	1.4	15.6

Source: National Banking and Securities Commission, Boletín Estadístico de Banca Múltiple, various issues.

Table 3. Merger and acquisition cases involving banks that were reviewed by the FCC

Year	Number of cases	Share of all M&A cases %
1993 (Jun-Dec.)	3	16.6
1994	8	11.3
1995	6	6.8
1996	15	12.2
Total	32	10.7

Figure 1. Relationships among the regulators of the Mexican financial sector



NOTES

- 1 In another case involving government auctions for the procurement of medicines, the FCC recommended the concerning government agencies to change the rule that in case of a draw the demand is divided among the winners. Such a rule clearly invites collusion among the bidders.
- 2 This market is different from the market of *local* credit card systems. The latter was described above in the context of horizontal arrangements.

NORWAY

Sector Specific Regulation of the Banking Sector

Regulations affecting the banking sector

- (a) For established banks there are no restrictions on branching within Norway. However, the Norwegian Banking, Insurance and Securities Commission (the NBISC) and the Bank of Norway should be notified. New entry requires a licence but is otherwise free.

Foreign banks may establish a subsidiary with a Norwegian licence. Furthermore foreign banks from within the EEA may establish branches in Norway pursuant to the banking directives. Banks outside the EEA area may establish branches with a Norwegian licence pursuant to the GATS regulations.

- (b) There are generally no restrictions on pricing.

Section 4-1, first paragraph, of the Competition Act entails that undertakings who retail goods and services to the consumer shall as far as possible provide price information that is easily visible for the consumer. Section 4-1, second paragraph, of the Competition Act empowers The Norwegian Competition Authority (NCA) to lay down regulations on the obligation to provide price information in accordance with section 4-1, first paragraph. To facilitate consumers' appraisal of the price and quality of goods and services, the NCA may also order undertakings to take steps beyond those entailed by the order set out in section 4-1, first paragraph.

Regulations of 27 June and 9 July 1986 delegate supervisory authority under Chapters I and II of the Credit Purchases Act to the NCA. The tasks involved attach to the obligation to provide information to the consumer in connection with credit and account purchases as well as consumer rentals.

- (c) Banks may only engage in businesses and services that it is customary or natural for banks to transact. Holdings of shares in banks are limited to 10 per cent. However, concessions may be granted for the establishment of financial groups where insurance companies may own banks and vice versa. Furthermore, a holding company may acquire a licence to own both insurance companies and banks. Such a company may not own non-financial companies.
- (d) A bank must not carry on or participate as an unlimited liability partner or co-owner in wholesale and retail trade, manufacturing, shipping, insurance or other business activity except activity which it is authorised to perform.

A bank's book value of real properties and of shares and holdings in companies whose object is to own or utilise real property must not exceed four per cent of the bank's total assets. A bank's book value of other shares and holdings must not exceed four per cent of the bank's total assets.

- (e) Banks are required by law to be members of either the Savings Banks' Guarantee Fund or the Commercial Banks' Guarantee Fund. In Norway the annual contribution consists not only of

0.1 per cent of the secured deposits but of an additional payment of 0.05 per cent of the measurement base for the capital adequacy requirement, nonetheless such that a) for a member with tier one capital adequacy below eight per cent the amount of the fee shall be raised by a percentage addition of four times the number of percentage points by which the tier one capital adequacy falls short of eight per cent and b) for a member with a tier one capital adequacy of more than eight per cent the amount of the fee shall be lowered by a percentage deduction of four times the number of percentage points by which the tier one capital adequacy exceeds eight per cent, but the reduction may in no case exceed 35 per cent. The annual payments are suspended, if the schemes have reached their prescribed size.

- (f) The capital adequacy must at all times be at least eight per cent of the measurement base comprised of risk-weighted items both on-balance-sheet and off-balance-sheet, in accordance with recommendations from the Bank for International Settlements and EC regulations.
- (g) Regulations pursuant to the banking acts lay down minimum liquidity requirements. These requirements can be met with several different instruments, but government bonds are used to a large extent.
- (h) Banks are generally not required to direct credit to favoured sectors. Certain specialised state banks provide this type of credit.
- (i) There are special rules concerning the liquidation, winding up etc. in the banking sector.
- (j) There are at present no official regulations of the payment systems and this is currently regulated through contractual agreements between the banks. However, the Banking Law Commission has recently delivered its third report with suggestions for law regulations.

Industry regulator

The NBISC is the supervisory authority of financial institutions. Its principal role is to see that banks, finance companies, credit institutions, mortgage companies and insurance companies, as well as securities trading, estate-agency, accounting and auditing undertakings, operate in an appropriate and satisfactory manner.

The NBISC reports administratively to the Ministry of Finance and is a specialised regulatory body that renders decisions and issues statements on an independent basis. The NBISC prepares matters for the Ministry coming under the financial legislation, which includes processing applications for licences and framing regulations.

Other regulators

Liquidity protection is provided by the Bank of Norway in its capacity as supplier of liquidity to the banking system.

State ownership

As a result of the financial crises early this decade, the Norwegian state now owns majority shares in the two largest commercial banks: Den norske Bank (52,2 per cent) and Kreditkassen (51 per cent). In addition the state owns 100 per cent of Oslo Banken, a minor bank which is winding up. There is at present an ongoing public debate of the state's ownership in the finance-sector.

Competition regulations in the Banking Sector

Competition rules

The Norwegian Competition Act applies to banks without any exclusions or exceptions: Certain restraints on competition are prohibited (price fixing, market sharing, bid-rigging), while otherwise legal restraints are subject to possible intervention by the Norwegian Competition Authority (the NCA) on a case-by-case basis. The Authority may also intervene against mergers and acquisitions.

Certain provisions of the Financial Institutions Act also constitutes part of the competition laws of the banking sector. Chapter 2 contains provisions governing ownership and restrictions on voting rights in financial institutions, cf. question 1(c). Other provisions with important bearings on competition in the banking sector are:

- Anyone who is a member of a controlling body or holds a senior position in a financial institution is prohibited from simultaneously being a member of a controlling body of another financial institution.
- A merger or acquisition requires a licence, of which important aspects is to maintain a financial market structure that ensures financial stability and effective competition.
- Approval procedure for collaboration agreements between financial institutions not forming part of the same group.
- Restrictions on a financial institution's right to offer product packages, i.e. a service offered on condition that the customer concurrently procures another service from the same institution.

Powers under the Competition Act and other acts have equal status as long as there is no basis for assuming otherwise.

Enforcement agencies

Financial institutions and financial markets are of immense economic significance in all modern societies. In Norway, as elsewhere, this is reflected both in special legislation through the establishment of separate supervisory bodies in these areas, and in regulatory systems requiring separate approval of take-overs and mergers etc. Historically speaking the authorities have sought to conduct a separate policy on structural developments in financial markets. Under current legislation the NBISC prepares cases in this field. A number of other considerations have to be safeguarded in addition to competition policy and considerations of efficient resource use. As a rule the NBISC also assess structural policy, the financial strength and cash position of the institutions involved, as well as considerations of financial stability.

The majority of cases dealt with by the NBISC do not have a significant bearing on competitive conditions. In some cases, however, the NBISC may take competitive assessments into account. Pertinent examples are collaboration agreements, mergers and take-overs etc., coming under the financial legislation. In such cases the Ministry of Finance is empowered to include competitive assessments in its overall appraisal of whether or not authorisation should be given.

The NCA is administratively subordinate to the Ministry of Labour and Administration (former the Ministry of Government Administration). The Ministry is the appellate body of decisions rendered by the NCA.

The NCA and its superior body – the Ministry of Labour and Administration (the competition authorities), and NBISC and its superior body – the Ministry of Finance (the financial authorities), represent two differing branches of public administration which, under their respective legislation, wield authority in the same areas of competition.

The fact that the two institutions have overlapping areas of operation does not imply that the basis for their assessments will invariably be identical in all cases handled. Whereas the NCA puts the main emphasis on competitive conditions, other factors such as the financial strength and cash position of the financial institutions involved, as well as considerations of financial stability will also play a substantial role for the NBISC. If a situation were to arise in which the NBISC gave a positive recommendation while the NCA decided to intervene, the issue would have to be resolved in the continuing proceedings in the case.

In 1996 the Minister of Finance and the Minister of Government Administration decided to appoint a working group, which was requested to study the need to co-ordinate practical aspects of the procedures of the NCA and the NBISC in cases which have a bearing on competitive conditions in the financial market. Based on the report from the working group the director-generals signed the enclosed agreement on the relations between the two institutions. The identified need for co-ordination is described in appendix 1.

Particular actions by the competition authority

Market definition

During 1997, the financial sector in Norway experienced numerous attempted take-overs and mergers. The regulatory framework was somewhat altered, and the future structure of the sector has been subject to public debate. Because of this, the Norwegian Competition Authority (the NCA) has investigated the financial markets with the purpose of defining the different relevant markets in the sector. The preliminary report was sent to authorities, financial institutions and sector organisations for comments.

The report should only be looked upon as a starting point to the market definitions in the various cases. The principles will, however, give some important guidelines for the competition authority's approach. Moreover, it is important that the relevant markets are defined without considering supply side substitution. This is in line with the NCA's general approach, which considers such substitution as part of the subsequent market analysis.

In the following, a short summary of the report is given. First, there is an overview of the NCA's approach to market definitions. Thereafter, some figures concerning the various financial institutions are presented.

Relevant markets

Lending

Lending should be divided into mortgage and non-mortgage markets and lending to households should be separated from lending to enterprises. Furthermore, the markets for enterprises should be divided into large enterprises and small- and medium sized enterprises. Except for two of these markets, the NCA considers the markets to be national. The exceptions are the market for mortgage loans to large enterprises which is considered to be international, and the market for mortgage loans to small and medium sized enterprises which is considered local/regional.

Mortgage and non-mortgage lending are separated for several reasons. First, the purpose of the loan from the borrower's point of view is in most cases different. Second, the lenders who offer the two types of loans are often not the same. Third, the interest rate on the two types of loans often differs. One reason is the disparity of risk between the two types of lending.

The product market for mortgage lending is separated into lending to households and to enterprises. A significant distinction between the two groups is the kind of assurance used as mortgage. The taxation of dwellings for borrowing is a standardised procedure that is accepted by most financial institutions. Thus, it is easy for a financial institution to attract household customers from all over the country and vice versa.

The evaluation of an enterprise's financial condition and its assets used as assurance requires a more thorough examination. Assessment of small and medium sized firms' condition may require knowledge of local or regional circumstances, which is not readily available for financial institutions located elsewhere. Large enterprises have a more complex need for financing, which may be met by financial institutions in the national market as well as international institutions. The need for diversification, both for the banks and for the lenders, is also a justification for considering the relevant market as international for the largest enterprises.

Public lending institutions with special purposes should initially be excluded when calculating market shares. These institutions primary object is to fulfil political aims by either subsidise loans and/or lend to certain industries or groups of the population at favourable conditions. Thus, these institutions do not represent an alternative for most customers.

Savings

In the savings markets, the NCA has focused on private savings, as savings for enterprises to a lesser extent will be influenced of mergers between financial institutions, due to better investment alternatives. In the market for private saving, we have included bank deposits, parts of life insurance claims, and savings in funds, stocks, and bonds. Real estate, cash values, and other claims like prepaid interest are considered not to belong to the relevant market for household's savings.

The NCA will, when necessary, consider further whether the private savings market should be considered as a single market or sub-divided into separate markets dependent on financial risk and liquidity. There is a clear distinction between the risk connected to saving in bank and buying stocks for a saving purpose. Further, the liquidity differs, with standard bank deposits at extreme end and saving in life insurance and pension funds at the other. Another question is if collective life insurance and pension funds can be considered as a part of the households savings market. These kinds of arrangements are quite

common in Norway. In this case the households have no direct influence over the decision made. However, it will have impact on other saving decisions made by the households.

It is the NCA's opinion that the savings market(s) should be considered national. This is mainly due to the technological development and new distribution channels (Internet, telephone etc.), which have made these markets open for customers all over the country, regardless of their place of living. Another interesting aspect is the EEA agreement, which has made it easier for financial institutions in the EU and EFTA countries to open a branch of their operations in Norway. Several suppliers have already used this opportunity to open a branch, especially in the life insurance market.

The NCA will focus on separate markets when investigating mergers in the financial sector. However, in some cases it also will be considered how the establishment of financial conglomerates will affect competition.

Some statistics

The table below shows the largest financial institutions in Norway, regardless of whether it is commercial banks, savings banks or public banks, measured by total assets. The rightmost column shows the conglomerate's share of total assets for all institutions, while the other columns shows market share within each group of institutions.

Market shares of financial conglomerates based on total assets September 1997

	Banks percent	Other financial institutions percent	Funds percent	Non-life- insurance percent	Life- insurance percent	Total market share percent
DnB	21	6	14	-	18	17
Christiania Bank	14	23	10	-	3	12
Union Bank	12	10	18	-	2	10
Storebrand	0	0	6	24	32	7
Postbanken	7	-	3	-	-	5
Gjensidige	2	3	5	19	15	5
Landsbank/Samvirke	1	0	-	5	3	2
Coastal Alliance*	12	2	11	-	1	8
Fokus	4	0	2	-	-	3
Sum financial Conglomerates	75	44	69	48	74	70

* Sparebanken Nord-Norge, Sparebanken Midt Norge, Sparebanken Vest, Sparebanken Rogaland an 12 minor savings banks.

Collusive horizontal arrangements

In 1994, the Competition Authority intervened against the fees charged for access to the inter-bank payment service, BBS. The Authority found that the fees could have the effect of preventing establishment of new businesses. The associations of savings- and commercial banks own BBS. The system accounted for 52 percent of the giro-services in Norway in 1994. The State owned "Postbanken" accounted for the remaining part of the market. The Competition Authority stated that the access fees charged prevented establishment of new business, and that costs in the payment system should only be covered through payment per transaction plus actual costs for the connection of new banks. As a result, BBS reduced the access fees considerably.

APPENDIX 1: RELATIONS BETWEEN THE NCA AND THE NBISC

The NBISC
(The Norwegian Banking, Insurance
and Securities Commission)

The NCA
(The Norwegian Competition Authority)

Ministry of Finance, Norway

Ministry of Government
Administration, Norway

20 December 1996

**RELATIONS BETWEEN THE NORWEGIAN COMPETITION AUTHORITY AND THE
NORWEGIAN BANKING, INSURANCE AND SECURITIES COMMISSION**

**Practical co-ordination of work on cases with a bearing on competitive conditions in financial
markets**

Reference is made to identical letters of 4 July from the Ministry of Finance and the Ministry of Government Administration to the NBISC and the NCA respectively, requesting the two institutions to study the need to co-ordinate practical aspects of their procedures in cases which have a bearing on competitive conditions in financial markets.

The NCA and directors representing the NBISC decided in the light of the above request to appoint a joint working group to study the matter. The working group delivered its report on 29 November which is enclosed. The NBISC's board of directors dealt with the matter on 19 December.

The NBISC and the NCA essentially endorse the working group's description of the formal basis for the two institutions' work and the account of practices. They note that some areas overlap. The competence of the two institutions can not however be characterised as overlapping. The NCA has in some cases authority to intervene or grant exemption, while the NBISC prepares cases and submits recommendations to the Ministry of Finance.

The fact that some areas of operation of the two institutions overlap areas does not imply that their basis for evaluation will be identical in all cases dealt with. Whereas the NCA puts the main emphasis on competitive conditions, other factors such as the financial strength and cash position of the financial institutions involved, as well as considerations of financial stability, play an important role for the NBISC.

Against the background of the report it is agreed that future collaboration between the NCA and the NBISC should be based on the following four basic principles:

1. *Safeguarding the institutions' independent role*

Allowance must be made for the two bodies to act as independent institutions, each making an independent assessment on the basis of the same facts. The NCA is authorised to render decisions in its own right, whereas the NBISC prepares cases for the Ministry of Finance, which then renders a decision. Collaboration should not necessarily aim for complete congruence of position but should help to ensure that differing perceptions are not based on misunderstandings or on differences in the facts of cases dealt with.

2. *Effective and satisfactory case-handling procedures*

An aim is to avoid unnecessary duplication of work and to develop modes of collaboration that ensure that the two bodies make decisions on the basis of the same facts.

3. *Predictability for market participants*

Market participants must have necessary information and guidance on which institution they should relate to, and on when it may be necessary to approach both institutions.

4. *Preparation of cases for superior bodies*

Collaboration between the two supervisory authorities should seek to establish arrangements to ensure that the Ministry of Finance will be apprised of the NCA's assessments when dealing with licence applications. The Ministry of National Planning and Co-ordination should likewise be apprised of the NBISC's assessments in concrete cases concerning competitive conditions in financial markets, for instance in connection with appeals against decisions rendered by the NCA.

Based on the above principles, the following guidelines for future collaboration have been agreed:

Corporate acquisitions and mergers

The NBISC will forward a copy of all incoming licence applications to the NCA for its information, but not for formal consultation as was often the case previously. Issuing a statement could entail that the NCA assumes a prior position in cases taken up under the competition legislation. If the NCA finds reason to assess a take-over or merger more closely, it will contact the NBISC forthwith to exchange information and clarify the progress made in the case. Where such cases are referred to the NBISC's board of directors, the NCA will be contacted immediately beforehand to clarify the position of the case.

Collaboration agreements

The NBISC will likewise be required to forward a copy of incoming licence applications to the NCA for its information, so that the NCA can decide whether the agreement should be given exemption from the Competition Act. The NCA will give a preliminary response on the matter to the NBISC within two weeks, indicating when a final reply can be expected. The deadlines for responding will be set taking into account the interests of the parties. The NCA will indicate to the parties whether the collaboration in question is contrary to the prohibition provisions of the Competition Act, whether dispensation can be

expected and, if so, subject to what conditions. The NCA will not normally grant exemption before a licence is granted by the Ministry of Finance.

Product packages

The NBISC will forward applications for dispensation to the NCA for its information. If the NCA finds reason to make a closer assessment, the NBISC will be contacted forthwith in order to exchange information and clarify the progress made in the case.

Any decisions or minutes of meetings on product packages with financial institutions can be forwarded to the NCA for its information.

Information requirement

There should be extensive collaboration between the two institutions with a view to achieving harmonised enforcement of the provisions on information requirements and effective interest rate.

Work on legislation

Proposals for new provisions drawn up by either institution that have a bearing on competitive conditions in financial markets will be submitted to the other supervisory authority for comment.

International matters

Each institution is required to inform the other about international matters of significance to competition in financial markets.

General analyses

General analyses prepared by either institution on changes in financial markets and in particular on competition should be made available to the other institution. The NBISC will be interested in benefiting from the NCA's spearhead expertise in competition matters in general. It is therefore important to maintain good relations and communication. The working group considers that the NBISC and the NCA should also endeavour to keep each other informed about other matters of importance.

Information to other market participants

Where the NBISC receives applications for approval of collaboration agreements that include sections referring to market sharing or price agreements which require exemption from the Competition Act, it is particularly important to inform market participants that an application for exemption must also be sent to the NCA.

In cases calling for intervention under the Competition Act, the NCA will itself take the initiative and establish contact with the parties involved.

Beyond what is entailed by its obligation to provide guidance in a concrete case, the NBISC will in collaboration with the NCA draw up an information document to be kept available to market participants. This will give detailed information on what is required of market participants in the various types of cases. The NBISC will send market participants a circular containing the information document.

Further details on practical follow-up

Responsibility for contact between the institutions will rest with the staff responsible for dealing with the cases in question. The names of the persons responsible will be exchanged together with an overview of organisation charts etc.

Regular liaison meetings will be held every six months between the two director-generals in order to exchange views and to oversee that the collaboration is functioning satisfactorily. Other participants will attend the liaison meetings depending on the cases to be discussed.

POLAND

Activity in the Polish banking system is governed by two acts: the Banking Act and the Act on the National Bank of Poland. The content of these acts undergoes constant amendments corresponding to the reform of the banking system introduced several years ago. Currently binding provisions are to be found in two mentioned above acts of August 29, 1997, which entered into force on January 1, 1998.

The procedures for new entry and branching as well as establishing a representative office are regulated in the provisions of the Banking Act of August 29, 1997, namely in articles 12 - 48. The rules governing new entry are non-discriminatory, and the same regulations are generally applied to Polish and non-Polish banks. Still, it must be added here, that the provision of the article 31 item 2 of the Banking Act (requiring an applicant to provide documentation from his home country supervisory authorities about himself), does apply to new entry or branching of foreign banks.

A joint-stock bank may be established on the basis of an authorisation granted by the Commission for Banking Supervision and issued in agreement with the Minister of Finance, in observance of the procedure laid down in the Commercial Code with respect to joint stock companies. A joint-stock bank may also be established by foreign parties or with the participation of such parties. A bank may commence operations following receipt of an appropriate permit from the Commission for Banking Supervision. The establishment of a branch of a foreign bank in Poland takes place on the basis of an authorisation granted by the Commission for Banking Supervision and issued in agreement with the Minister of Finance. The establishment of a bank abroad by domestic parties or with the involvement of domestic parties, and the establishment abroad of a branch of a domestic bank, shall require a permit from the Minister of Finance. Where the founder of the bank or branch of a bank is a domestic bank, issue of such permit shall require an agreement of the Commission for Banking Supervision.

Maintaining the stability of the prices is expressly mentioned as a basic objective of the National Bank of Poland, as provided for in the article 3 of the Act on the National Bank of Poland, and article 227 of the Constitution, which expressly states in its item 1. That: (...) The National Bank of Poland is responsible for the value of the Polish currency. Also, the Monetary Policy Council - as a Constitutional body responsible for the monetary policy - draws up monetary policy guidelines on a yearly basis and - among others - sets NBP base interest rates and determines the procedures governing obligatory reserves and reserve ratio, as provided for in article 12 item 1 and 2 of the Act on the National Bank of Poland.

Line-of-business restrictions are regulated by art. 25 and 26 dealing with acquisition of bank stock and also by the articles 113-125, and also by the Act on the mergers and Grouping of the Joint-stock Banks of June 14, 1996.

Banking line-of-business activity is divided into three main groups. First, banking operations consist of seven elements such as taking deposits, extension of loans and guarantees, issue of bank securities. Banking operations may be only undertaken by banks. The second group consists of new elements such as extension of cash advances, issue of bank cards, forward financial transactions, performance of foreign operations. While these services are performed by banks, they shall be also deemed banking operations (especially for taxation). The third group consists of an open catalogue of other financial services such as taking up or acquiring shares in public companies, trade in securities, providing financial consulting and advisory. Services from the second and third groups can be also

performed by non-bank institutions. No restrictions on ownership linkages apply to banks when they take up or acquire shares of:

- other banks,
- business providing following services to the bank: issuing of bank cards and performing of operations with the usage of such cards, the training of the bank staff, financial consulting and advice, clearing services,
- inter-bank telecommunication companies, companies running universal or occupational pension schemes, brokerage houses where at least 75 per cent of the equity in such is held by banks,
- institutions collecting and providing banks with information on claims on counterparties, and movements and balances of bank accounts where 100 per cent of the equity is held by banks.

Banks portfolios issues are generally regulated by the article 6 of the Banking Act, still the provisions of the Law on Securities do apply here, namely this type of activity as specified in the article 6 shall not be carried out without the permission from the Securities and Exchange Commission.

Banks may take up or acquire shares in public companies, other legal persons and units in mutual funds, with the provision that the total exposure to one organisation arising from the above shall not exceed 15 per cent of the bank's capital. The total funds applied to such purposes shall not exceed 60 per cent of the bank's capital.

The system of guaranteeing bank deposits was introduced in Poland in 1995 by the Act of 14 December 1994 on the Bank Guarantee Fund, amended later by the Act of 20 February 1997. This Act introduced a general system of guaranteeing deposits accumulated in banks operating in Poland. A new institution - the Bank Guarantee Fund (BGF) was set up in order to pay deposits in case of bank bankruptcy. Pursuant provisions of this Act the Bank Guarantee Fund pays out deposits up to the amount being the equivalent in PLN of ECU 5 000 (\$US 5 500) (deposits up to ECU 1 000, 100 per cent, over ECU 1 000 and up to ECU 5 000 at the rate of 90 per cent). It is planned to raise this amount to ECU 20 000, which is the standard in the countries of the European Union.

The Bank Guarantee Fund guarantees to recover the part or the whole amount of savings-deposits accumulated in banks. All banks acting in Poland contribute to the payment of deposits which is realised by the Bank Guarantee Fund. In accordance with the Act, each entity embraced by the guaranteeing system creates a fund for the protection of guaranteed resources. Its amount is conditioned by the amount of cash resources accumulated in the bank, in all accounts, and the rate defined by the Council of the Fund in an amount is not higher than 0.4 per cent. Up to the end of 1999, for three banks (Polska Kasa Oszczednosci BP, Polska Kasa Oszczednosci S.A. and Bank Gospodarki zywnosciowej S.A.) the Act envisages the establishment of this rate at a lower level (0,2 per cent).

The general principle today is that the State Treasury is not accountable for the commitments of banks, with the exception of commitments concerning savings deposits made by individuals, in amounts exceeding the limits accepted by the Bank Guarantee Fund in the banks: PKO B.P., PKO S.A., BGZ S.A. - until 1999.

Capital adequacy issues are dealt with by the following provisions of the Banking Act: article 32, which states that the initial capital of the bank shall be no less than the zloty equivalent of ECU five million. and article 128, which says that the banks are to maintain their capital base at a level that represents no less than eight per cent of the risk-weighted assets and off-balance commitments (the minimum risk-based capital ratio). A bank commencing operating activity shall be required to maintain its

risk-based capital ratio at no less than 15 per cent for the first 12 months of operation, and at no less than 12 per cent for the following 12 months. Also articles 71 and 72 dealing with credit exposure apply here.

Reserve requirements matters are regulated by the provisions of articles 38 and 39 of the Act on the National Bank of Poland. With a view to managing the money supply and lending activity, the National Bank of Poland (NBP) shall take required reserves from the banks. The NBP Management Board may exempt a bank from the reserve requirement during implementation of a winding up programme. Required reserves shall not bear interests. The reserve ratio may vary according to contractual deposit maturity and the type of currency concerned. The total reserve requirement shall not exceed:

- 30 per cent of the total funds, in the case of demand deposits,
- 20 per cent of the total funds, in the case of time deposits.

Also with a view to balancing the consequence of the risk arising from their activities banks shall build up and hold in appropriated reserves to ensure safety of deposits. The appropriate reserve ratio shall be calculated by the individual evaluation of the risk, which debits certain banking operations. The total appropriated reserve requirement shall be no less than:

20 per cent for substandard dues,
50 per cent for doubtful dues,
100 per cent for loss dues.

As far as favoured sectors crediting is concerned, there is no such requirement in the banking Act. Still, yet there are several acts dealing with credits to certain privileged sectors.

As far as liquidation, winding up and insolvency proceedings in the banking sector, these are regulated by the provisions of Chapter 12 of the Banking Act, namely articles 142-169. In the event of a bank suffering a net loss, being threatened with such a loss or finding itself in danger or insolvency, the management board shall immediately advise the Commission for Banking Supervision to this effect, shall submit a winding up programme, and shall ensure implementation of the mentioned programme. The Commission may order the appointment of a custodian to supervise performance of the winding up programme by bank. Where the bank's management board fails to submit a winding up programme or where performance of this programme proves ineffective, the Commission may order the bank to be placed under administration for the duration of the programme. While the administration is in place, the decision making powers of other directing bodies of the bank shall be suspended.

Where, in the six months following an extraordinary assembly meeting of shareholders convened to examine the bank position, it turns out that the losses incurred by the bank exceed half of its capital the Commission may:

- order the bank to be taken over by another bank,
- order the bank to be into liquidation.

Administration of the assets of a bank under liquidation shall be assumed by a liquidator appointed by the Commission. On that day administration of the assets of the bank under liquidation is assumed by the liquidator. The management board, supervisory board and other directing bodies shall be dissolved.

Where the bank balance sheet indicates that its assets are not sufficient to cover the liabilities, the bank management board, administrators or liquidator shall immediately notify the Commission, which shall order the suspension of the bank operations and thereupon order its take-over by another bank or petition the court of appropriate jurisdiction for a declaration of bankruptcy, advising the Bank Guarantee of this fact. The Commission shall be the sole party empowered to file such a petition for bankruptcy.

The court, sitting in the presence of three professional judges, shall rule on a petition for a declaration of bankruptcy no later than one month of receiving of such petition. The court shall appoint a trustee in bankruptcy, which may also be another bank. In declaring bankruptcy, the court shall also appoint a custodian to represent the bankrupt bank. As of the day administration of the bankrupt bank is assumed by a trustee, the directing bodies of the bank shall be dissolved.

Bank shareholders representing two thirds of the capital of the bankrupt bank may file a petition for the conclusion of a settlement between the bankrupt bank and its creditors. Should the settlement not be reached, the receiving magistrate shall determine the conditions under bank may be acquired by other bank and shall set a closing date for the submission of the relevant bids. Should the bank not be disposed of in whole, the trustee, with the consent of the receiving magistrate, shall proceed to dispose of the component parts of the bank assets.

Bank settlements are regulated by the articles 63-68 of the Banking Act, particularly, as provided for in article 67, banks may establish clearing houses in the form of commercial companies in order to exchange payment instructions and determine their mutual claims arising from such instructions. It must be added here that since 1993 the company established in 1991 by the banks under the name of National Clearing Chamber acts as a clearing house for 73 banks.

Bank settlement shall be understood as operations involving the adjustment of bank account balances, performed on the instructions of customer or as a result of actions which ex lege yield such changes in customers' title to asset. President of the NBP specified, by regulation, forms and procedure for the performance of settlements via bank. Forms of settlements shall be assigned by the parties of the contract. Cash settlements shall comprise: check or cash order to creditor's account. Non-cash settlements shall comprise: clearance check, letter of credit, bank money order or banker's order.

The activities of banks are supervised by the Commission for Banking Supervision which was set up on the base of the Banking Act of January 1, 1998. The Commission is an independent body, which shall rule on matters within its terms of reference by majority vote. The Commission shall be composed of: the Chairperson-President of the NBP, the Deputy Chairperson-Minister of Finance, a representative of the President of the Polish Republic, the President of the Bank Guarantee Fund, the President of Securities and Exchange Commission, a representative of the Ministers of Finance, the General Inspector of Banking Supervision. The responsibilities of the Commission shall include in particular:

- setting out principles for the conduct of banking activity that ensure the safety of the funds held by customers at banks,
- supervising compliance by the banks with the statute, their articles of association and other legal regulations, and also with mandatory financial standards,
- performing periodic assessment of the financial condition of banks and presenting these to the Council, and evaluating the impact of monetary, tax and supervisory policies on the development of banks,

- giving its opinion on the organisational structure of banking supervision and establishing procedures for the performance of such supervision.

The responsibilities of the Commission and the manner in which these are to be discharged shall be as specified in the Banking Act. These are generally licensing and supervisory matters connected with bank rehabilitation proceedings, liquidation and bankruptcies.

The decisions of the Commission, together with the responsibilities it assigns, shall be carried out and co-ordinated by the General Inspectorate of Banking Supervision, a separate organisational unit within the structure of NBP.

In Poland there is no informal understandings or expectations about the actions of central bank or other government agencies which could affect the behaviour of banks.

The main inter-bank organisation is the Polish Bank Association (PBA), which for instance, organises clearing house in order to exchange payment instructions and arrange inter-bank agreements relating to operating automatic teller machines and other banking activities. PBA is an organisation of a corporation character. The representative of the PBA participates in meetings of the Commission for Banking Supervision as a counsellor in following issues: regulation of banking supervision, system of banks' activity due to the matter of deposits' safety.

The Polish Bank Association is the main lobby group in the area of government banking regulations policy. This association played important role during sittings of parliamentary commissions on Banking Act, National Bank of Poland Act and other regulations connected with banking sector, such as tax law. A representative of the Polish Bank Association shall participate in meetings of the Commission for Banking Supervision concerning matters relating to supervisory regulation (with consultative vote) and may also participate in meetings concerning setting out principles for the conduct of banking activity that ensure the safety of the funds held by customers at bank.

By the end of September 1997 the state ownership in the banking sector amounted to 35 per cent (this figure include ownership of the State Treasury, the NBP and state-owned legal persons). The contribution of foreign capital in stock capital of commercial banks amounted 40 per cent by the end of September 1997.

Most banking regulations are effective from January 1998, so there is no prepared studies, which can assess the effect of the above regulatory regime on the structure and other factors of the banking industry.

The banking sector is generally subject to regulations provided for in the Act of February 1990 on Counteracting Monopolistic Practices (with later amendments), in the scope of anti-trust law and as far as shaping of organisational structures of undertakings from the point of view of protection and development of competition is concerned.

In addition to the anti-trust regulations, the control of capital linkages between banks is based on the Banking Act of August 29, 1997 and provisions related to the public turnover in securities. Pursuant to the Article 25 of the said Act, the person intending to acquire or to take over bank shares is obligated to obtain, by intermediary of the bank which shares intends to buy or take over, the permission of the Commission of Banking Supervision if together with the shares already at its disposal they will constitute the block of 10 per cent, 20 per cent, 33 per cent, 50 per cent, 66 per cent or 75 per cent of voting at the general assembly of bank shareholders. In case of banks with public company status, the intention to

acquire shares (25 per cent, 33 per cent or 50 per cent of votes) is to be notified to Securities and Exchange Commission (by virtue of Article 149 of the Law on Securities).

Pursuant to the Article 11. 2 of the Act on Counteracting Monopolistic Practices, obligations to notify merger intention to the President of the Office for Competition and Consumer Protection (OCCP) refers to :

- 1) the merger of entrepreneurs, whose total annual sales volume - in the calendar year preceding year of notification on the intention to merge - exceeds ECU 5 mln,
- 2) the acquisition or takeover by an entrepreneur of an organised part of the property of another entrepreneur,
- 3) the takeover or acquisition of stocks or shares of another entrepreneur, resulting in the reaching or exceeding the limit of 10 per cent, 25 per cent, 33 per cent or 50 per cent of votes at a general assembly of shareholders,
- 4) assuming by the same person the position of a director, assistant director, board member, member of supervisory board, member of auditing commission or chief accountant with competing entrepreneur,
- 5) takeover in other manner, directly or indirectly, of control over another entrepreneur. The threshold for such notification is established as the total annual sales volume of goods - in the calendar year preceding the year of notification on the intention - exceeds ECU 5 mln.

However, the Polish antimonopoly law is more liberal where financial institutions (including banks) are concerned. The thresholds stipulated in Article 11. 2, item 4 are of ECU 5 million for the sale value of the entity to be acquired. For the banks merger the threshold for their combined assets defined in Art. 11.3 is of ECU 50 million. Also the deadline for the President's decision to be delivered, which of two months maximum, in case of banks is shortened to 2 weeks.

The competition authority may ban the merger of entrepreneurs if the concentration could create or strengthen their dominant market position. It assumed that significant competition concerns take place when combined market share of the parties to the concentration exceeds 10 per cent.

Special provisions relating to bank mergers, constituting exemptions from the competition law regulations, are provided for in the Act of June 14, 1996 on mergers and grouping of some banks into joint stock company. Provisions of the Art. 11 of and 11a of the antimonopoly law does not apply to merger of two or more banks which stock capital belongs to:

- State Treasury
- state-owned bank
- state owned undertaking
- joint stock company which stock capital belongs to the State Treasury
- joint stock company which stock capital belongs in whole to the National Bank of Poland or partially to NBP and to one or more of the entities listed above

In addition to merger control the Polish antimonopoly law provides for control over transformations of undertakings, including banks. Pursuant to the Art. 11c intention to transform a state owned undertaking into State Treasury company is subject to notification to the competition authority (annual sales value threshold is of ECU five million). This provisions may apply to the transformation of the state owned bank into joint stock company (such possibility is foreseen in Art. 43-48 of the Banking Act). The limit for the President's of the OCCP decision is two weeks.

The biggest intervention of the competition authority into the structure or scope of the entrepreneur's activities is provided by the provisions of the Art.12. By virtue of this article state owned enterprises, co-operatives and commercial companies with dominant market position may be dissolved or divided upon decision of the competition authority, if they limit competition or conditions for its emergence in a permanent way. The competition authority is also authorised to decide upon limitation of the entrepreneur's scope of activities if he holds dominant market position.

Special rules in banking sector relating to the failing firm defence were described in the first part of our submission.

Administrative decisions of the competition authority may be appealed against to the Antimonopoly Court.

Taking into consideration specific aspects of banking sector and its importance for the economy as well as the necessity to protect interest of the customers, banks are subject to different regulations aimed at increasing security of their functioning and are under more rigorous control compared to other sectors. Such special rules certainly affect competition rules in banking sector. Institutions apart from the OCCP, influencing competition rules in banking sector and their activities were already mentioned: National Bank of Poland, Commission for Banking Supervision, Bank Guarantee Fund.

In principle, the responsibility for competition rules enforcement in banking sector is attributed to the OCCP, but in view of the above other organs play significant role in this process. In their activities they oriented towards other goals than competition protection, but it does not imply that banking sector is exempted from competition provisions. When performing their tasks the National Bank of Poland and Commission for Banking Supervision take account of competition protection and development aspects.

When investigating cases of bank mergers, notified under the antimonopoly law provisions, the competition authority has to define the relevant market taking in to account bank customers (households or natural persons, entrepreneurs) and offered services (money deposits, credits, bank accounts, etc.). The relevant geographic market was most frequently defined as national, in some cases regional (local). New kinds of banking services, such as via Internet or phone are at present offered by very few banks and in limited scope, so for the moment they do not influence market definition for banking services.

In bank merger cases investigated by the competition authority conflicts between competition issues and protection of sector stability were not found until now.

The bank merger cases notified up to the present did not raise competition concerns. It refers also to the cases such as acquisition of bank shares from the State Treasury under condition to tied acquisition of shares of the bank in bad financial position. The Polish banking sector has relatively low level of concentration so bank mergers do not cause significant risks, particularly in the context of the prospective market opening in 1999.

The competition authority had no signals giving assumptions of vertical agreements. Nevertheless we have to admit that no special research was conducted to assess such practices.

The monopolistic practices such as collusion or abuse of dominant positions have not been found.

The only signals related to bank activities received by the competition authority are complaints of individual customers, dissatisfied because of, e.g. banking fees.

In banking sector the Polish competition authority has no experience which could be of interest for OECD Member countries.

During the last two years there were no significant changes in the Polish competition law (the last important amendment, introducing extension of merger control was done in 1995). On the contrary, the Banking Act and the Act on National Bank of Poland, both adopted on August 29, 1997, entered into force only on January 1, 1998.

Their enhancement shall have a tremendous importance for the functioning of the Polish banking system. These two acts lay down new legal and institutional framework which ensures building of a secure and competitive banking system under the advances process of liberalisation of the economy. The changes in national legislation have made the legislation consistent with EU and OECD standards as well as with the requirements of Basle Committee on Banking Supervision. The new legislation aims at increasing central bank independence, transparency of market for banking services and further strengthening of the banking system.

The Banking Act of 29 August 1997 creates a model of universal banks with a status similar to the one of the European Union banks. The provision of the law should improve banks' economic safety and thus increase stabilisation of the whole banking system. At the same time the changes of the regulations should contribute to improving the relations between a bank and its customers.

In relation to the present legal status the law introduces numerous changes:

- There has been formulated a new definition of a bank as a legal person authorised to perform banking operations exposing to risk funds entrusted to the bank and repayable in any way.
- Banking operations are divided into two groups. One of them is reserved exclusively for banks. The other group operations are also treated as banking operations when they are performed by banks, but they can be performed by other entities.
- New standards and indicates of capital involvement of banks in other subjects which are not banks as well as concerning purchasing real estates are determined. The standards are establishes at the level specified in the relevant regulations of European Union. The previous provisions did not fully take into account the above-mentioned standards and indicates effective in EU.
- A new provision which gives a legal basis for performing banking operations with the aid of electronic data media is included.
- The scope of the bank secrecy has been widened and now includes all the information concerning banking operations and persons that are parties to agreements.

Provisions concerning banks' own funds and their finances are adjusted to the requirements of the Law on Accounting and harmonised with the relevant regulations of the EU.

SPAIN

Introduction

This short contribution by the Financial Institutions Department of the Banco de España is divided into three sections: i) an historical review of the liberalisation process of the activities of Spanish credit institutions (hereafter banks), placing special emphasis on the deregulation of interest rates, together with the review of the most significant financial innovations of the last decade in relation to competition and to customer protection regulations which have been incorporated in line with the deregulation process; ii) an analysis of the evolution of interest rates, their shifting to customers and their repercussions on bank spreads and margins; and iii) banking practices related to payment card fees.

It can be deduced from these sections that the current regulation of banks' operations has favoured a high level of competition: the return on banks' own funds (after taxes) is only slightly above that of large and medium-size enterprises in other economic sectors (10.9 per cent for commercial banks and 15 per cent for savings banks against 10.3 per cent at December 1996), these differences being much smaller than those existing in other countries. This situation takes place in a clearly favourable economic context determined by the realisation of substantial capital gains on securities portfolios and a strong reduction of insolvencies.

Bank liabilities and, in particular, private sector deposits have faced very strong competition from investment funds in recent years, partly based on their tax advantages, which has adversely affected financing, with a loss of deposits. Also, there has been strong competition between banks on assets.

Liberalisation and competition in the banking system

The liberalisation of banks' activities and the opening of Spanish financial markets to foreign competition (see Annex) have led to a degree of competition equivalent to that of the other developed countries. At the same time, all these countries, including Spain, have applied more severe regulations to these institutions in respect of their solvency and the transparency in their relations with customers, shareholders and investors in general.

Besides the stimulating effects of deregulation on competition in the banking system, an important financial innovation process has also taken place. This process has multiple causes related to the reaction of credit institutions themselves to a series of factors: changes in the economic situation (inflation variability, interest rate evolution, public deficit levels); increased competition between banks and with new financial institutions; the liberalisation process in general; the internationalisation of economies, markets and banks; the development of new information and telecommunication technologies. This series of factors has allowed and encouraged institutions to offer new products and techniques at the same time as new markets were opened.

This is not the place to talk about financial innovation in general but it is worth recalling briefly the most significant recent events which have occurred as a result of the increasing competition between institutions and with new dealers. This stronger competition prompted specific strategies by institutions which have affected sometimes income from assets and at other times cost of liabilities.

The final break with the status quo in the raising of bank liabilities dates back to the beginning of the so-called super-account war. This war was initiated in September 1989 by one of the major national banks which offered high interest-bearing sight deposits on a general basis and through a widespread advertising campaign. Two years before, small national and foreign banks signalled the coming trend by making selective offers. The purpose of this strategy was to broaden their customer base in order to increase their income from other products, including services, in view of the expected future narrowing of net interest margins brought about by competition.

Other medium and large-size institutions started to make similar offers, to a greater or lesser extent and with or without advertising, at the beginning of 1990. There were indeed market share shifts between institutions, clearly in favour of the bank that provoked the whole situation, but the most important fact, from the current perspective, was the general increase in financial costs which was not confined to sight deposits.

In 1991, coinciding with the downward phase of the economic cycle, competition broke out on the asset side, both in the traditional mortgage loans and in the new consumer credit offers. This gave rise in following years to an increase in the indebtedness of households which has not yet ceased. Institutions' increasing interest in mortgage loans is based on the security, lower own funds requirements and, above all, long-term customer loyalty afforded by these loans. In this case also, there was a certain break when, in mid-1993, the same Spanish bank that had initiated the super-account war launched a massive mortgage loan advertising campaign. The advertised mortgage loan was offered at a fixed-rate around two points lower than the current rate on that type of loan and it did not exclude subrogation of existing loans.

Again, the other banks responded, thus increasing significantly competition in this market segment. Law 2/94 of 3 March on the subrogation and change of mortgage loans was issued to reinforce this competition and to avoid it being restricted to new loans, by galvanising the mortgage market in general. This law implies a strong reduction in costs for shifting a loan with one bank to another or for renewing its financial conditions and maturities agreed with the bank. This reduction applies to the two main costs: notary and registration fees, on the one hand, and charges for anticipated redemption of variable-rate loans which are limited to 1 per cent, on the other hand. It was not considered convenient to regulate redemption charges for fixed-rate operations in which customers may take asymmetrical actions which may cause serious damages to lenders. However, at the end of 1996, the Government reached an agreement with the AEB (Association of Spanish Banks) and the CECA (Association of Spanish Savings Banks) to restrict to 2.5 per cent the charge for anticipated redemption on fixed-rate mortgage loans.

Mortgage loans (whose basic component is financing of housing) currently stand at 40 per cent of total financing to the resident private sector, when it hardly reached 25 per cent in the previous decade. In this financing segment, competition between institutions has not only brought about sharp falls in interest rates but also longer maturities which have allowed a reduction in instalments and an increase in the financed amount in relation to the appraisal value of the housing, which may go up to 100 per cent of such value or even more.

Finally, the competition of investment funds in raising funds from the private sector should also be mentioned. Supported by a favourable tax treatment, which is discriminatory against other financial placements including banks' deposits, these funds have increased their assets from PTA 1.2 trillion at the end of 1990 to PTA 26 trillion at the end of 1997. One of the consequences of this competition has been the difficulty encountered by institutions in shifting the entire fall in interest rates to their liabilities whose attractiveness diminished in relation to the alternative afforded to savers by these funds. This situation jeopardises the possibility of reducing the financial costs of the institutions and, on the other hand, to the extent that it is necessary to hold back the fall of banks' net interest margins, the capacity to cut lending

interest rates. Nevertheless, competition has so far caused a strong shift of the interest rate downturns and a significant reduction in margins.

Banks' interest rates and spreads policy

The most outstanding features of banks' interest rate policy and its effects on their profit and loss account are the following:

- a) Banks have rapidly shifted market interest rate movements to the rates applied to their new customer loans. Actually, the total adjustment carried out since the beginning of 1993 has been fully shifted to the new assets. On mortgage loans, interest rates were lowered to a similar extent and were not restricted to new loans but were also applied to former ones with variable rates. Moreover, competition has reduced the spread applied to variable-rate loans from 1.5-2.5 pp in 1994 to 0.75-1 pp at the present.

On liabilities, the interest rate fall was less significant.

- b) In the strong competition context which prevailed during the whole period under review, institutions have accepted progressive cuts in their customer spread due to the smaller reduction experienced by interest rates applied to liabilities. Thus, in March 1993, banks obtained a spread close to 8 pp between lending and borrowing operations with private customers. In the last quarter of 1997, this spread had dropped to less than half.
- c) The new interest rates were also shifted rather promptly to the average interest rates of assets and liabilities, with the obvious delays in the periods in which there is a change of trend due to the inertia introduced by the maturity of former operations. The speed of this shift depends on the maturity structure of the different lending and borrowing instruments included in the institutions' portfolios. In this regard, the increasing sensibilisation of institutions' balance sheets should be pointed out, as transactions carried out at rates usually indexed to money markets are increasingly gaining importance.
- d) The narrowing of customer spread was the main cause of the fall in the net interest margin of banks. This fall was not only recorded in relative terms of average total assets (ATA) but in some years (1992) it also took place in absolute terms in commercial banks.

The sharpest falls in the net interest margin on ATA occurred between 1989 and 1993 due to the rising price of liabilities (superaccount war). However, this fall continued and the net interest margin obtained by commercial banks in the last year was lower than 2 pp of ATA. In savings banks, the drop in the net interest margin was less significant, standing around 3.2 pp. The greater relative stability of savings banks' net interest margin arises from the lesser speed in shifting the new interest rates to the average interest rates of assets and liabilities due to the greater weight of long-term operations (mortgages).

International comparison of Spanish net interest margins

The total liberalisation of interest rates applied by banks to their customers (which culminated in 1987 but was not massively reflected until the end of 1989) fostered a strong increase in competition between Spanish banks which substantially affected the evolution of their net interest margins.

Thus, until 1993 included, the net interest margin of banks' consolidated profit and loss accounts evidenced a serious downward adjustment in relation to other countries. Spain changed from being the EU country with the highest net interest margins in 1989 -nearly twice the average level of EU countries as a whole (4.9 per cent against 2.4 per cent)- to standing slightly above this average in 1993 (3.0 per cent against 2.5 per cent). As from 1993, the Spanish net interest margin continued to fall but this occurred however within a general international trend. Thus, this margin stands at a practically constant level, slightly above that of the other EU countries, mostly due, at a consolidated level, to the greater weight in the Spanish banking groups of foreign retail banks which operate with higher net interest margins.

Competition in alternative sources of income: the case of fees applied to payment cards

Fees and charges from financial services have become an important source of income for banks limiting the impact of the descending net interest margins. Nevertheless, competition has been again one of the major features in this ground as shows the case of fees applied to payment cards (one of the main components).

The basic operating scheme of the payment mechanism with (credit or debit) cards is the following: the shop has a point of sale (POS) in which data of the transaction to be carried out are introduced. This information is transmitted by phone to the network of which the shop's bank, called "purchasing bank", is a member. The network computer is connected to the computer of the card holder's bank, called "issuing bank", to check if there are sufficient funds available (for debit cards) or a sufficient credit line (for credit cards) in the holder's account to authorise the transaction. When the issuing bank authorises the transaction, it is charged to the card holder's account or it is recorded in his credit line. Finally, the shop's account is credited the amount of the sale less a fee (discount rate) which varies according to the sale.

In these transactions, the issuing bank assumes the risks (card holder default, fraud, operating risks) and most of the costs (technical infrastructure, cost of current assets, network payments, fees for using the card's trademark, promotion, etc.), since it guarantees the payments it has authorised and maintains the technical infrastructure. The purchasing bank does not incur risks but it also bears a series of costs (technical infrastructure), as it is responsible for implementing the transactions.

Shops and customers draw advantages from using these electronic POS in terms of security and comfort and the shop receives a cash service which facilitates his transactions and avoids the credit risk associated with other payment instruments (cheques).

Thus, the issuing bank and the purchasing bank provide a service which gives rise to risks and costs, whereas the card holder and the shop receive and pay for this service. The card holder pays the issuing bank an amount for maintaining and managing his account and a rate for issuing the card but he does not pay any amount in proportion to the purchase made. The shop pays his bank, the purchasing bank, a "discount rate" on the amount of the sales paid by card. As the shop is not directly related to the issuing bank, it is the purchasing bank that must pay for the services. This amount is a rate agreed at the national level by the networks and implies a base on which the discount rates are determined according to the cost and the business policy of the purchasing bank.

The average discount rate percentages applied in Spain and in a number of countries of the same environment in the last three years are the following:

	Germany	U.K.	France	Italy	Portugal	Norway	Belgium	Spain
1995	2,30	1,60	1,00	3,80	2,81	2,24	3,20	2,33
1996	2,10	1,50	1,00	3,20	2,50	2,23	2,40	2,08
1997	2,10	1,50	1,00	2,80	2,30	2,03	1,90	2,00

These data show that Spanish discount rates are not significantly different from the average charged in the countries under review, except for those that apply very different operating conditions, such as France. Moreover, the Spanish discount rate stands at an average international level in spite of the fact that there are two elements that would justify charging higher rates in Spain. Unlike most of the other countries, in Spain purchasing banks do not charge the shop for the POS, which are provided free, and offer more favourable value dates.

It can also be seen that these discount rates have been decreasing in recent years in most countries, including Spain, largely due once again to increasing competition in this business.

REVIEW OF SPANISH BANKING SYSTEM'S LIBERALISATION PROCESS SINCE 1960

The regulation of the credit system in the sixties

To understand the extent of credit institutions' liberalisation, it is necessary to review the basic features of the financial system in the sixties. The Stabilisation Plan of 1959, which implied the first break with the closed post-war economy, required a reform of the financial system but this reform was aimed at achieving the economic objectives set by the Development Plans. Therefore, the Law on the Regulation of Credit and Banks of 14 April 1962 impelled medium and long-term financing mechanisms through the implementation of legal investment requirements, the granting of advantages to a new category of industrial banks for the issue of medium and long-term liabilities (certificates of deposit and debt), the support of official banks and the action of the Medium and Long Term Credit Institute. This law also aimed at fostering securities markets as a business financing alternative but it was not really effective in this respect.

Interest rates, even interbank rates, were rigidly controlled. Until the end of the decade, customers were even applied maximum rates on their liabilities and minimum rates on their assets, thus ensuring the net interest margin. Capital movements control prevented bank customers from evading these conditions by seeking financial alternatives abroad.

The restrictions to the creation and expansion of credit institutions (status quo) implied the practical absence of foreign banks, prevented the creation of new banks during a long time and severely limited the expansion of branch offices. At the same time, regulation tried to delimit the field of action of commercial banks, industrial banks and savings banks. As a result, there was a strong segmentation of customers and markets.

The privileged financing circuits, strengthened after the reform of 1962 and based during a certain time on the special minimum lending rate and later on legal investment requirements, maintained bank resources captive, through the discriminatory financing of given sectors and the distortion of financial markets' efficient operation.

In these conditions, the financial system was based on banks which did not compete among themselves and could count on guaranteed margins and profits. Moreover, cash management (which was anyway impossible due to the lack of an efficient monetary policy and of operational interbank and public debt markets) did not make any sense to them, nor did a consistent liability and investment raising policy, since risk management was totally rudimentary in these institutions.

Liberalisation in the seventies

This period was marked by the Law on the Regulation of Official Credit Institutions of 1971 and the Fuentes Quintana reform of 1977.

The reform of monetary policy was based on the control of the banking system's liquidity and on the creation of an efficient interbank market. Thus, as from 1973, it was attempted to reach M3 growth targets by injecting liquidity through "Monetary Regulation Loans" or withdrawing liquidity through legal reserve requirements. These measures also included placements of Treasury bonds and compulsory interest-bearing deposits with the Banco de España.

The progressive liberalisation of interest rates was encouraged, starting with longer term transactions, so that operations that were more sensitive to interest rates could gradually adapt themselves to the new conditions without giving rise to sudden movements which could endanger the financial balance of institutions used to the former comfortable status quo. In turn, the interest rates of privileged financing got little by little closer to market rates and foreign exchange transactions and interest rates became more flexible.

Most of the banking status quo was dismantled by authorising in the late sixties and early seventies the creation of new banks, deregulating the opening of branch offices (1974) and allowing the establishment of foreign banks (1978). At that point, there was a change in the economic situation which, together with the lack of experience of the new banks and of the supervisory authorities, led to a widespread banking crisis which required a deep revision of regulation and prudential supervision, although this regulation used instruments which were compatible with the operation of a free market.

On the other hand, the treatment of deposit-taking institutions started to be unified at the same time as the global weight of privileged financial circuits was beginning to be reduced, to a very different extent according to the sectors. This process, which was a milestone in respect of levelling the playing field of savings banks with that of commercial banks (1977), continued later with the aim of reaching a vocational specialisation of institutions which would not be imposed by different regulations.

Liberalisation since 1980

The eighties started with the partial liberalisation of all interest rates and privileged financing (where getting closer to market conditions led to the transitory setting of long-term financing ratios at free rates) and ended with the total liberalisation of interest rates and fees (1987), the practical removal of legal investment requirements and the liberalisation of foreign exchange transactions.

Money markets experienced a strong development as a result of the establishment of numerous foreign banks without a customer base that would provide funds and a very active monetary policy. The growth of public deficit led to the development of a deep and efficient government debt market which supplemented or supported money markets at the same time as it reduced the pressure of public deficit on the monetary situation.

The liberalisation of credit institutions' expansion (1985, and 1986 for the opening of savings banks offices outside their region) and creation was completed following Community legislation, although a few strict objective access conditions were maintained to avoid another crisis like that of the early eighties.

The Directives on the liberalisation of capital movements (1986 and 1988, effective in Spain between 1990 and 1992 depending on the different transactions) eliminated exchange controls and liberalised Spanish investments abroad and foreign investments in Spain, thus increasing the operational capacity of banks.

Regulations on customer protection and transparency

The liberalisation of interest rates and fees applied by banks went in line with the concern for banks' solvency and customer protection. The latter has been based on the principle of transparency in customer relations which implies the knowledge by the customer of all the relevant information on a given good or service. In 1981, coinciding with the initial liberalisation, institutions were required to publish interest rates on their most frequent lending operations and to make available to customers a leaflet specifying the charges applicable to the different bank services. The maximum valuation lags of certain operations were also set.

In 1987 the full liberalisation of interest rates was accompanied by various reporting requirements, including information on the effective price of services linked to financing for which a calculation formula was established. This formula, in the form of a rate called the tasa anual equivalente - TAE (annual percentage rate of charge - APR), incorporates the different items of expenditure related to the operation which are paid by the institution and the frequency of such payments. The purpose of expressing price according to that formula was to facilitate comparisons, which was in turn considered as a feature that would introduce competition in the market. For bank services that do not imply financing, the leaflet (or price list) was required to be clear and easy to understand by the public, requirements that would be monitored by the Banco de España.

Together with the required information on prices and price changes, it was established that an essential piece of information would be a written contract whose content was accurately determined. Thus, banks were required to hand over such contract, whenever so requested by the customer and even if the customer did not request it, in the most typical bank operations or in those which affect the largest number of customers.

These banking transparency regulations are currently in use and have been incorporating the specific features of the main financial innovations, such as variable-rate transactions, operations at a non-market related original rate, transactions associated with the obligation to hire given services, etc. The objective features of the reference rates or the calculation formula of the annual percentage rate of charge have also been determined for these cases.

The transparency regulations apply to any operation initiated in Spain by any bank customer, whether consumer or not, and to both existing operations and operations whose advertising refers to the price or return of the relevant product. However, there are certain cases in which protection is more restricted and is only applicable to given transactions, such as the binding offers made in connection with mortgage loans or consumer loans.

The customer protection regulations also include the existence of an ombudsman in the institutions, which is left to their discretion, and of a Complaints Service in the Banco de España which deals with customers of institutions that do not have an ombudsman or whose ombudsman has not settled the claim to the customer's satisfaction.

As far as bank customer protection is concerned, Spanish regulations can be considered as the forerunners of those currently in force in other developed countries, since they anticipated and expanded the protection requirements laid down in the Consumer Credit Directive.

SWEDEN

In Sweden a distinction is traditionally made between two different types of banks, commercial banks and savings banks. In the past, the different types of banks were more or less specialised. Since the end of the 1960s, all banks have been entitled to engage in all kinds of banking activity.

The number of banks has decreased sharply as a result of mergers and amalgamations with merger activity being most marked among the savings banks. From some 450 savings banks at the beginning of 1950s the number had decreased to 87 by the end of 1997. During the past few years, several new banks have been established in Sweden.

All major banks in Sweden are now limited liability banking companies. Many of them are listed on the Stockholm Stock Exchange and the shares in these banks are widely owned among the public.

In December 1997, 20 commercial banks, 87 saving banks and 17 branches of foreign banks were established in Sweden. Most of the clients of foreign-owned banks are in the commercial sector. In addition to foreign banks, a number of small banks have been established in Sweden in recent years. They are often called "niche" banks, since they do not offer a comprehensive range of banking services, but concentrate on selected types of service.

Sector specific regulations

Activities on the credit market are closely regulated by means of laws and ordinances. The banking laws comprise the Banking Business Act, which covers all banks, and separate acts for each type of banking institution, namely the Banking Companies Act and the Savings Bank Act. The rules of the first and second banking directives of the European Union are implemented in the Swedish banking legislation.

Question 1. The main statutory regulations are the following:

- a) There are regulations concerning new entries of banks. Any company wishing to engage in business which involves the provision of services on financial markets must apply for a licence from the Government or from the regulatory authority, Finansinspektionen (the Banking Business Act (1987:617), first chapter, second section).
Foreign banks have been permitted to establish subsidiaries in Sweden since 1985 and branch establishments have been permitted since 1990.
A licence from the Swedish authorities is not required with respect to a banking undertaking which is domiciled in a country within the European Union and the EFTA countries and has obtained permission in the said country to conduct banking business. A notification from the competent authority in the home state concerning the establishment must be forwarded to Finansinspektionen (the Banking Business Act (1987:617), first chapter, fifth, seventh and eight sections).
- b) The only restriction on pricing concerns General Public Savings Funds (the Act on General Public Savings Scheme (1983:890)). These schemes will be discontinued on June 30, 1998.

- c) There are no restrictions on ownership linkages between the financial institutions in Sweden. A bank intending to acquire another bank or insurance company has to apply for a permit concerning the acquisition to Finansinspektionen/Government. (The Banking Business Act (1987:617), second chapter, sixth section).
Mergers above certain thresholds are subject to examination by the Swedish Competition Authority under the Competition Act.
- d) A bank may only own the property that is needed for its business. To be able to avoid losses a bank may hold property with permission from Finansinspektionen (the Banking Business Act (1987:617), second chapter, fourth, fifth, sixth, seventh and eighth section). Banks are under certain conditions allowed to hold securities (fourth chapter second section in the Securities Business Act (1991:981)).
- e) The Swedish Deposit Guarantee Scheme covers deposits in banks and certain credit institutions up to 250 000 SEK per depositor and institute. The idea is that the annual fee paid by an institute to the Scheme should be related to the risk of a bankruptcy in the specific institution. As from 1997 the maximum rate of the fee for an institute is 0,6 per cent and the minimum rate 0,4 per cent of the deposits guaranteed in the institute.
- f) There are restrictions on capital-adequacy. The capital adequacy standard requires a bank's capital base to be equal to at least eight per cent of its riskweighted assets. The assets in this instance are measured in relation to the level of risk they represent. For this purpose, assets are divided into four categories, which are measured at rates of 0, 20, 50 and 100 per cent, respectively. Assets in the zero category for example, require no capital cover at all. Those in the 20 category are weighted for risk at 20 per cent of their value and so on. Examples of assets in each risk category are claims on sovereigns and Swedish local authorities in the zero category, credit institutions in zone A countries (OECD), claims secured by house mortgage in the 50 category and all other claims in the 100 category. There are special restrictions concerning savings banks. (The Act on Capital Adequacy and Large Exposures for Credit Institutions and Securities Companies, 1994:2004, second chapter, second section).
- g) The Central Bank is able to impose reserve requirements. According to the Sveriges Riksbank Act (1988:1385, twentieth section) the Central Bank may, in individual cases, decide to impose cash reserve requirements on credit institutions. As a matter of fact, the Central Bank has not referred to this law since 1994.
- h) There are no general requirements on the banks to direct credit to certain sectors.
- i) There are detailed rules laying down how to treat insolvency, liquidation, bankruptcy etc, in the Banking Companies Act (1987:618), tenth chapter.
- j) Clearing concerning the payment system is not regulated in detail. Furthermore the Competition Act is applicable.

Question 2. A bank is subject to supervision by the Financial Supervisory Authority - Finansinspektionen. Finansinspektionen is a government authority accountable to the Ministry of Finance. Finansinspektionen conducts its activities in three areas: the insurance market, the credit market and the securities market.

Finansinspektionen's overall objectives are to promote the stability and efficiency of the financial system and to provide effective protection for consumers. These objectives are achieved by the following means:

In order to promote the stability of financial markets, Finansinspektionen shall:

- analyse developments on the markets in general and within institutions in particular
- systematically evaluate areas where problems and risks can be identified,
- investigate the activities of institutions and thereby ensure that they function with reasonable level of risk,
- ensure, by laying down regulations, that institutions conduct their business activities in a prudential manner.

In order to promote the efficiency of the financial markets, Finansinspektionen shall:

- seek to ensure that satisfactory information is given to consumers and other players on the financial markets,
- promote self-discipline and self-regulation by enterprises on the financial markets.
- seek to promote transparency in connection with the financial position of institutions.

In order to contribute to the provision of the effective consumer protection, Finansinspektionen shall:

- monitor compliance by institutions with laws, regulations, and other rules
- seek to ensure high ethical standards within the financial system,
- seek to ensure that the players on the financial markets satisfy stringent demands for integrity, competence and sound business practice.

Question 3. The Central Bank (the Riksbank) is required by law to promote the stability and efficiency of the payment system. This task stems from the function of the Central Bank as the provider and central operator of the payment system. Besides overseeing the payment system, the Central Bank therefore needs to analyse the financial system, with particular reference to financial agents who are of central importance for the payment system. In its work on payment system issues, the Central Bank is primarily concerned with reducing and managing systematic risks, that is, risks that represent a threat to the functioning of the financial system as a whole.

In the event of a crisis that threatens stability the Central Bank can take an active part in coordinated public efforts to overcome the crisis or mitigate its effect.

One instrument for this is the possibility, as a last resort, of providing credit without full collateral in order to support liquidity.

Question 4. The banks co-operate in a variety of ways. The Swedish Bankers' Association is a trade association for banks and bank-owned finance companies and mortgage institutions. The Swedish Bankers' Association represents the interests of its members in relation to Government, ministries and authorities expressing opinion on legislative proposals, etc. The independent savings banks are not members of the Association, having their own trade association, the National Federation of Independent Savings Banks. The Swedish Bankers' Association is a member of the European Bankers' Association in Brussels.

Furthermore there are some jointly owned companies, among others Bankgirocentralen BGC AB which handles payments and receipts within the bank giro system.

Upplysningscentralen AB (UC) is jointly owned by the banks and is engaged in credit information activities. UC sells information to banks and to companies within and outside Sweden to enable them to assess the credit standing of customers and partners.

Värdepapperscentralen VPC AB provides share-handling procedures for those limited liability companies, which use the simplified share handling system. The company is half owned by the State, 25 per cent by banks and stockbrokers, and 25 per cent by the Stockholm Chamber of Commerce and the Federation of Swedish Industries.

Question 5. There are industry lobby groups e.g. the Swedish Bankers' Association and the Swedish Mutual Fund Association.

Question 6. The Swedish State owns part of or the whole of some of the companies in the banking industry. The State ownership in Postgirot Bank amounts to 100 per cent. This bank is not allowed to offer their customers a comprehensive range of banking services. The State partly owns one of the major banks in Sweden, Nordbanken. The intention of the government is to dispose of the rest of the shares of this bank, which recently merged with a Finnish bank, Merita. The State owns 100 per cent of one credit institution involved in home mortgage (Sveriges Bostadsfinansieringsaktiebolag) SBAB and has a 50 per cent ownership of AB Svensk Exportkredit, which supports companies' export through loans that are favourable.

Public ownership is not confined only to the State. A number of municipalities are the owners of an institute called Kommuninvest. The institute supports the municipals/local authorities through loans with favourable conditions.

Question 7. There are several studies published in Sweden concerning banking e.g. "Financial Market Report" by the Central Bank.

Question 8. There are no exclusions to the application of the competition law that apply to banks. The Swedish Competition Act is modelled on the EC rules. There are no sector specific competition rules in the banking sector.

Question 9. The Swedish Competition Act is solely enforced by the Competition Authority. The Central Bank and Finansinspektionen are the main agencies responsible for monetary policy and supervision of the banking sector respectively.

Question 10.

- a) The main provisions of the Swedish Competition Act are modelled on the competition rules of the European Community. The approach of the Swedish Competition Authority to market definition is therefore in general based on the definitions laid down by the European Commission in similar cases. The geographic market has, in the cases examined so far, been national.

Access to banks via the Internet and telephone banking has not affected questions of market definition as such but has been important factors in the overall assessment. In the opinion of

the Authority the effects of recent mergers were mitigated by the presence of bank services on the Internet and of telephone banks.

New entrants on the market do not offer a comprehensive range of banking services, but concentrate on selected types of service. Some of the new banks conduct their business in the form of telephone banking - client contacts are primarily made by telephone.

- b) Concerning mergers, there has been no case of trade-off between the protection of competition and the protection of stability of the banking sector experienced.
- c) No cases involving bank mergers have given rise to such competitive concerns that remedies have been imposed.
- d) *i)* The Swedish Competition Authority granted the business banks' cooperation concerning brand name and security systems for ATMs a negative clearance.
ii) CEKAB is a company owned by some of the Swedish banks. The company is a subcontractor in electronic processing of transactions, especially for ATMs and different cards. The Swedish Authority has rejected a negative clearance for the cooperation in CEKAB.
iii) The Swedish Competition Authority is furthermore handling an application for a negative clearance/exemption for the cooperation between banks concerning a giro system, Bankgirocentralen BGC AB.
The companies running these facilities are owned by the major Swedish banks. New established banks have complained about the service fees charged by these companies as the owner banks are charged considerably less. No decision has been taken yet in this case.
iv) The Competition Authority has taken decisions on applications for a negative clearance by Visa Sweden and Europay (Sweden). The applications concerned the international rules and the local Swedish rules for Visa and Europay. Visa and Europay were not granted a negative clearance.

The Swedish Competition Authority concluded that the rule which prohibits an acceptor to pass on the cost or part of the cost to the cardholder restricts competition. Europay has applied to the Competition Authority for an exemption for the non-discrimination rule. Visa Sweden has applied for an exemption for their cooperation and a different rule concerning how a merchant is allowed to charge his customers using Visa-cards.

- e) The Swedish Competition Authority has not taken any decision concerning abuse of dominant position in the banking sector.

Question 11. -

Question 12. During the two last years the most important regulatory changes concerning the Banking Business Act are:

- Non-financial companies are permitted to own a bank. Earlier there were strong requirements on the grounds on which a non-financial company should be granted a permit to own a bank.
- The so-called BCCI Directive (95/26/EC) concerning supervision of the financial companies has been implemented.

SWITZERLAND¹

Sector-Specific Regulation in the Banking Sector

Definition of a Bank

According to the Swiss law the term “*bank*” includes institutions which are active principally in the field of finance, and in particular those who

- accept deposits from the public on a professional basis or solicit them publicly in order to finance in any way, for their own account, an undefined number of unrelated persons or enterprises;
- refinance themselves in substantial amounts from a number of banks which are not significant shareholders and with which they form no economic entity in order to provide any form of financing for their own account to an undefined number of unrelated persons or institutions.

Public solicitation is deemed to include publicity in the form of advertisements, prospectuses, circulars or electronic media. An institution is deemed to be acting on a *professional basis*, when it accepts more than 20 deposits from the public on a continuing basis. “*Substantial amount*” and “*a number of banks*” are defined by the authorities as over CHF 500 million sight and time deposits from over five banks measured on the rolling average of the position of the banks on the last four quarter ends at time of measurement.

Principal Statutory Regulations Affecting the Banking Sector

Introduction

Switzerland has for a long time had an open market for foreign banks and financial institutions, i.e. foreign banks have been allowed to enter the Swiss market on a national treatment basis (with reservation, of course, as to prudential considerations). This open market has recently been strengthened by the agreement on financial services under the GATS/WTO agreement, which, in the future, will render it possible that the basically non-discriminatory treatment by Swiss law can be enforced through the WTO-dispute settlement mechanism.

Most important legislation pertinent for the Swiss banking sector

- Federal Act on Banks and Savings Banks (“Banking Act”) of 1934, which was last amended 16 December 1994;
- Implementing ordinances: “Banking Ordinance” of 1972 and Ordinance on Foreign Banks in Switzerland (“OFB”) of 21 October 1996;

1. The views expressed in the paper do not necessarily represent those of the FCC or the Swiss government.

- Federal Act on Investment Funds of 18 March 1994, incl. implementing ordinance of 19 October 1994 and Ordinance on Investment Funds of the Federal Banking Commission of 27 October 1994
- Federal Act on Stock Exchanges and Trading in Securities of 24 March 1995, in force since 1 February 1997, incl. implementing ordinance of 2 December 1996.

Restrictions on branching and new entry, especially the entry of foreign firms

Before a bank can commence operations in Switzerland it is required to obtain a license from the Federal Banking Commission ("FBC"). Such a license will be granted if the requirements of the Banking Act are met. For foreign banks the Banking Act contains a *reciprocity requirement*, i.e., that the home country of the applicant must permit the establishment of Swiss controlled banks in its territory and the business operations of those banks, as a general rule, must not be subject to materially more limiting provisions than those imposed on foreign banks operating in Switzerland unless there are formal treaties which grant reciprocity on a general basis. Furthermore, a foreign bank must confirm that it will adhere to the policies of the Swiss National Bank ("SNB") at all times. In addition, the OFB contains specific licensing requirements for the establishment of branches, agencies and representative offices of foreign banks.

Restrictions on pricing (interest rate controls and other controls on prices or fees)

Since April 1, 1994, in Switzerland the Consumer Credit Act is in force. Similar to the EC-Directive on Consumer Credit, it contains detailed provisions on the content of consumer credit contracts, on obligations and rights of the contracting parties and on the calculation of the annual percentage rate of charge. In addition, the Swiss Code on Obligations reserves the right of the Cantons to set upper rate of interest limits to prevent abusive behavior of credit institutes and banks. For instance, the Canton of Zurich has set a maximum limit at 18 per cent p.a.

Line-of-business restrictions and regulations on ownership linkages among financial institutions

There exist no provisions on ownership linkages among financial institutions. However, the Banking Act provides that the qualified participation of a bank in an enterprise *outside* the fields of finance or insurance may not exceed the equivalent of 15 percent of its equity. Furthermore, the total of such participation may not exceed 60 percent of equity.

Restrictions on the portfolio of assets that banks can hold

The Banking Ordinance contains detailed rules on *risk diversification*. According to these rules banks have to *notify* risk concentrations. Furthermore, the provisions set an *upper limit* for risk and aggregate risk concentrations and define under what circumstances a group of related counterparties has to be dealt with as a unit.

Compulsory deposit insurance

Switzerland does not know any compulsory deposit insurance. The Swiss Bankers' Association ("SBA") and the Swiss Banks have, however, agreed on a compensation scheme that results in the protection of deposit and savings accounts up to an amount of 30 000 CHF.

Restrictions on capital-adequacy

The Banking Act contains special provisions on the reduction of the equity capital of banks. According to these rules, the general meeting of shareholders may only vote for a reduction of the capital based on a special auditing report showing that the creditors' claims are fully covered, despite a reduction of capital, and that the liquidity remains assured. Furthermore, the Banking Ordinance comprises extensive rules on equity, including provisions on eligible equity, core capital, equity requirements and risk weighting per counter-party according to which the eligible equity must amount to a certain percentage of the sum of the risk weighted positions.

Reserve Requirements

Banks are obliged to transfer at least one twentieth of their yearly net profits into a reserve fund designated to cover losses and to permit write-offs.

Requirements to direct credit to favored sectors

None.

Special rules concerning liquidation, winding up, and insolvency

The Banking Act contains a special section on bankruptcy and arrangements with creditors designed to provide a better protection for creditors than it would be the case under general bankruptcy rules.

Regulators

The Swiss banking system is regulated by the *Federal Banking Commission* ("FBC"). The FBC comprises 7 to 9 members who are elected by the Federal Council. It is independent of the Swiss National Bank ("SNB"). As the highest supervisory authority for the banking sector, the FBC is responsible for the supervision of the banking system and investment trust business. The FBC has the power to grant and withdraw banking licenses, to announce decisions necessary to enforce the Banking Act and to prescribe the content and format of financial statements and audit reports which it receives. The FBC issues circular letters ("Circulars") to banks and audit firms in connection with the application of specific Banking Act regulations or reporting requirements. Its semi-annual bulletin publishes the major decisions, and provides an update on current administrative practice to be followed under Swiss Banking Law. The bulletin also reproduces the most important Circulars.

The *Swiss National Bank* ("SNB"), which has registered places in Zurich and Berne, is a limited company, whose issued capital is held by the Cantons, cantonal banks and local authorities (61 per cent), and private shareholders (34 per cent) with the balance of shares unissued (5 per cent). The SNB is the agent responsible for the implementation of those parts of the government's monetary policy that relate to banks. It issues directives concerning, amongst other things, the maintenance of reserve requirements, expansion of credit facilities, acceptance of foreign source deposits, export of capital and foreign exchange transactions. It publishes extensive statistical data on a monthly basis. The SNB also manages the National Bank clearing house or bank giro, which is mainly used for cash transfers between banks. It is closely linked to other clearing systems such as the Swiss Interbank Clearing System ("SIC") and the Post Office.

Due Diligence Convention

In 1977 the Swiss Banker's Association ("SBA") and the SNB entered into an agreement designed to ensure that banks know the true identity of their beneficial owners when accepting deposits and take measures to prevent the use of such accounts for illegal purposes. In 1987 the agreement was replaced by the Agreement on the Swiss banks' code of conduct with regard to the exercise of due diligence ("Standesregeln zur Sorgfaltspflicht bei Banken [VSB]"), a self-regulatory agreement between the SBA itself and its member banks and finance companies. This agreement was updated in 1992. The current version contains general rules and practices relating to due diligence at all times - specifically on account opening. Under the agreement the banks have committed themselves to:

- identify their contracting partner;
- in cases of doubt, to carry out further research to identify their contracting partner;
- avoid any active assistance to flight capital activities;
- provide no active assistance to tax evasion;
- desist from issuance of any form of declaration or certificates which would be misleading.

This self-regulatory agreement is policed by an arbitration committee to consider breaches. It has the power to levy substantial fines and regularly publishes its decisions. The FBC takes an extremely tough stance on these issues and, independent of the activities of the arbitration committee, will itself investigate breaches and the circumstances leading to them. The Banking Law auditor, whose job it is to check compliance, has little or no flexibility in reporting exceptions to the arbitration committee.

Lobby Groups

The most influential industry body in Swiss banking is the Swiss Bankers' Association ("SBA"). It devotes itself to representation and protection of the interests of the banking industry in general. It actively starts or participates in initiatives designed to strengthen the Swiss banking system from a competitive and service point of view (e.g., Swiss Bankers' travelers' checks, Bancomat cashing facilities). It also co-operates closely with the government, the FBC and the SNB in the development of new banking legislation. Furthermore, it establishes rules and conventions which its members are obliged to follow.

State Ownership in the Banking Industry

In many of the 26 Cantons there still exist state established cantonal banks generally operating with a state guarantee. Their funds are primarily used to finance local commercial and private needs and to extend loans to public authorities. However, in recent years many of these banks have encountered severe financial difficulties resulting in consolidation and acquisition by other banking institutions in a number of cases (see below under "on structural and regulatory changes").

Competition Regulation in the Banking Sector (Issues arising from the Competition Authorities' Point of View)

Introduction - the Situation under the old Act on Cartels and Similar Organizations

Before Switzerland's new (third) Federal Act on Cartels and Other Restraints of Competition (the "Act") entered into force on July 1st, 1996, Swiss competition law was widely considered to be weak. Nevertheless, under the old law it was possible, in the late eighties, to break up the so-called

“conventions” of the Swiss banking sector, which were in fact cartels eliminating competition on prices (and in many instances on other elements of competition) for the most important banking services.

Structural and regulatory changes

Since the late eighties, the Swiss banking sector has undergone a deep change - as have many other banking places. During the Swiss version of the S&L Crisis, almost half of the small regional banks have disappeared, acquired more or less voluntarily by one or the other major Swiss bank. Others have merged or found together under a holding company of regional banks.

But changes were not limited to small banks. Ten years ago, there were five major banks in Switzerland; there are presently three left, and if the pending merger of Union Bank of Switzerland and Swiss Bank Corporation is not prohibited, there will remain only two major Swiss banks. In addition, the mid-sized cantonal banks have lost large amounts during the Swiss real estate crisis of the past seven years. Some cantons had to absorb big losses. Therefore, the future of state-guaranteed banks is presently subject to discussions in Switzerland.

Generally speaking, allegedly over-banked Switzerland is going through important structural changes, i.e. a period of concentrations. Concentration also touches on adjacent markets, e.g. stock exchanges. In the last few years, we have observed the transition from the three traditional stock exchanges of Zurich, Geneva and Basle, regulated by the respective canton where they were located, to one Swiss stock exchange. This new Swiss Electronic Stock Exchange comprises also the Swiss Options and Financial Futures Exchange (SOFFEX), which made the step to an all-electronic system ten years ago.

The regulation of the Stock Exchange has become a federal matter only when the new Swiss Federal Act on Stock Exchanges and Brokerage entered into force on February 1, 1997. This new Act clearly favors self-regulation. The tendency to put some of the responsibility for a working banking system on the market-participants has indeed a long tradition in Switzerland. The SBA with its codes of conduct and codes of ethics has for many years played a prominent role in this area. The most recent example for this approach by the Swiss banking regulators is the acceptance of individual risk-assessment methods and models by the revised banking ordinance for the purpose of determining the necessary own funds of a bank.

Rules Applying to Banks under the new Swiss Act on Cartels

The new Swiss Act on Cartels redesigned Swiss anti-trust law mainly along the lines of European competition law and the practice of the European Competition Authorities. The rules of competition law that apply to banks and the financial industry are basically the same as the general rules applying to all other industries. The task of monitoring the industry from a competition point of view and to prevent or prohibit agreements, mergers or anti-competitive practices falls within the competence of the Federal Competition Commission (“FCC”) and its secretariat.

A special rule addresses the possibility that a bank merger might be the result of one of the merged parties’ standing on the brink of bankruptcy or administrative closure. In such case, if the Swiss FBC deems it necessary in order to protect the interests of creditors, it has the power to take the place of the FCC and to decide with due regard to the “protection of creditors”-issue. This is, however, supposed to be the exception and has not yet occurred since the Act entered into force.

Particular Issues and Experiences

Merger control

In the short period of time the new Act has been in force in Switzerland, there has been no part of Switzerland's economy where the FCC had - or will have, since two of the cases are still pending at the time this paper is written - to pronounce itself on more high profile mergers than in banking. The mergers touch on such diverse issues as possible dominant positions in a geographically small market (*Valiant - Bank in Langnau*, RPW 4/1997, 515) or in very specific product markets (*General Electric Capital Corporation - Bank Aufina*, RPW 3/1997, 358; and *General Electric Capital Corporation - Bank Prokredit*, pending), the creation of one of the biggest banks worldwide and the consequences with regard to its position in the domestic retail banking markets (*United Bank of Switzerland*, pending) and last but not least the creation of one of the most powerful players in the area of so-called "Allfinanz"-services (*Credit Suisse Group - Winterthur Versicherungen*, RPW 4/1997, 524).

Given the number of important mergers examined and the market shares resulting therefrom, the FCC had or will have the opportunity - but also the burden - to define several product markets as well as the geographic delimitation of markets in the Swiss banking sector.

Swiss domestic retail banking is still characterized by the presence of numerous regional banks with relatively high market shares in geographically small markets. In the case of *Valiant - Bank in Langnau*, where a regional bank was taken over by an over-regional bank holding company, the FCC had to pronounce itself 1) on the importance of potential competition from banks present in geographically adjacent markets and 2) on the flexibility of the average retail banking customer to turn to a competitor not physically present in the region defined as relevant geographical market.

With regard to the first issue, the FCC concluded that a supplier of banking services is able to expand to an adjacent geographical market without the need of huge investments if he sees a real opportunity to make profits. The FCC therefore decided that the existence of otherwise potentially problematic market shares of regional banks do not pose problems because potential competition (from banks operating on a nationwide level) does have disciplinary effects. Which does not necessarily mean that the same argument would work when the dominant position (in a specific region) is held not by a small, regional bank but by one of the major banks.

As concerns the second issue, the FCC accepted that the greater mobility of customers may lead to a more flexible definition of geographical markets. It did not, however, make the step to a national delimitation of the geographical markets in retail banking, even after considering the opportunities of telebanking and telephone-banking offered by major banks. There do not seem to exist yet sufficiently reliable figures showing the acceptance of these options by a significant number of retail customers.

With regard to the geographical dimension in retail banking, the FCC has therefore constantly focused on regional markets as a starting point. This does not mean that further arguments might not lead to the conclusion that certain markets have to be defined as nationwide markets. The FCC has made such an argument in a non-bank merger decision (*Migros - Globus*, RPW 3/1997, 364), where it found that the regional markets overlapped to such an extent that a regional price-differentiation was not possible for the suppliers operating nationwide. The FCC therefore concluded that the market was a nationwide market, too. Whether the FCC will accept a similar argument for the retail banking markets remains to be seen.

As far as the definition of the product markets is concerned, the FCC has defined markets rather narrowly. In *General Electric Capital Corporation - Bank Aufina*, it defined the market for consumer

loans as one relevant market, and the market for car-leasing as another. When deciding the pending acquisition of Bank Prokredit by General Electric Capital Corporation (GECC), the FCC will have to reexamine and refine its arguments: The market share of GECC in the consumer loan market as currently defined amounts to more than 60 per cent, and to well over 35 per cent in the car-leasing market. The FCC will have to consider whether the relevant market has been correctly defined very narrowly and to answer - among others - the following two questions: To what extent could credit cards and other customer cards be considered as substitute products for consumer loans? Even if not actually used as credit instruments by many Swiss credit card holders? and: Do other banks extend credit in significant amounts within their regular customer relationships and without reporting such credit extensions as consumer loans? (This would tend to expand the relevant product market.)

In its Credit Suisse Group decision, the FCC has indicated what other product markets it would consider in the banking industry. It mentioned as presumably regional markets consumer loans, real estate loans, loans to small and medium-size enterprises, deposit accounts and payment services, securities accounts and safe deposit services. Other markets, such as the Swiss franc debt market and the Swiss equity market as well as the markets of private banking, targeting the more affluent customers, have been qualified by the FCC as probably nationwide markets. The FCC did not, however, have to test these assumptions in the Credit Suisse Group decision, since banking markets were only marginally (if at all) affected by the acquisition of the "Winterthur" insurance company. The FCC will have to express its views in a more binding way in the pending United Bank of Switzerland merger.

Other antitrust issues in Swiss banking sector

The concentration on banking mergers in the past year should not divert attention from other areas in Switzerland's banking where anti-trust issues exist. One should not assume that the breaking up of the above mentioned "conventions" under the old law resulted in a perfect competitive status of Swiss banking and related markets. Particularly, the Swiss financial industry is characterized by numerous joint ventures set up by the Swiss banks to provide certain services. Given the small size of the Swiss market, all Swiss banks would normally participate in such a joint venture, thereby creating a monopoly. As a consequence, another provider of the same services would face the situation that the established competitor is a subsidiary of virtually all potential customers.

The secretariat of the FCC has, during the past months, begun to study the situation in the credit card services market. It is not the heavily disputed market for the sale of credit cards that deserves attention, but rather the market for related services: Swiss banks have set up Telekurs Holding AG, a joint venture for the processing of payment transactions, including all credit card and debit card payments. This company is not only in a position to dictate - by defining technical standards - e.g. the type of terminals to be used by dealers accepting credit cards. Given its dominance of the market and its relationship to the Swiss banks, Telekurs can also effectively thwart attempts of other providers of such services to establish themselves in the market. In fact, Telekurs has advance information about new products to be brought on the market because it is regularly involved into defining standards and technical requirements for such new products and the related transactions.

Swiss credit card companies have gained the attention of the secretariat of the FCC also with regard to another practice: They uniformly prohibit in their dealer agreements that the dealers pass on to the consumer the fee the credit card companies charge them for the handling of payments. This clause could be viewed to distort competition between different means of payment by prohibiting the allocation of additional costs arising from credit card payments.

Another enterprise in Swiss financial services that enjoys a monopolistic position is - as already mentioned - the Swiss Stock Exchange. The FCC and its secretariat have, whenever they were asked to comment on new ordinances, rules and regulations implementing the Federal Act on Stock Exchanges and Brokerage, insisted on giving competition issues due attention. When bodies have to organize a market and can regulate themselves, they will tend to do so in a way that limits competition. The involvement of the FCC in this area is all the more important than supervising bodies do not have a mandate by the law to consider aspects of competition.

Related to the Swiss Electronic Stock Exchange are other institutions, such as the Swiss listing authority, where important practical decisions are taken. The secretariat of the FCC will concentrate on such gate-keepers in order to ensure that their decisions do not keep competition away and allow the Swiss banks (undeniably facing stiff competition as far as international markets are concerned) to cooperate cosily (and costly for their customers) in the Swiss market.

Coming back to the banks themselves, another interesting issue has arisen that seems to become more and more urgent, also due to the pending UBS-merger. It has been constantly reiterated in political and economic discussion of the past few years that the re-evaluation of their credit-related risks by the major banks - combined with a restrictive approach towards credit-seeking enterprises - has left many small and medium enterprises as virtual hostages of their bank. If their bank considers them to be a deteriorating credit risk and therefore raises interests or denies a credit extension, they have in fact no other bank to turn to. No other bank will extend credit to them.

So far, the secretariat of the FCC has taken the position that this was a problem of individual dependency and not of market domination, because it considered the market to consist of all banks present in a specific region. It therefore refused to analyze specific cases and to ask whether the denial of a credit extension or the interest rate requested was abusive, since it did not consider the banks to have a dominant position, which would have been the precondition for materially qualifying the banks' behavior. Should, however, the situation persist that a credit-seeking customer has in fact no opportunity to turn to another bank, it might be appropriate to consider whether - from the relevant customer's point of view - the pertinent market has to be defined narrowly, always comprising only the one relationship-bank. This would lead the FCC to review individual credit-decisions. One might still have some doubts whether this is indeed a mandate of the Competition Authorities.

Another fact to be considered by the FCC is the enormous financial power of financial institutions such as the proposed merged UBS (if not prohibited) or the constantly acquiring Credit Suisse Group and their influence on Swiss economy. The decrease in numbers of major banks as well as smaller banks in Switzerland make tacit, implicit coordination of competitive behavior more probable.

Summary

The breaking up of the old "conventions" was one of the major successes under the previous Act. This was the beginning of a liberalization process in banking services. Yet there are still many improvements possible and necessary. The small size of Switzerland basically favors restrictive agreements, joint ventures and price leadership. Moreover, the recent merger-wave in Swiss banking makes implicit coordination (concerted practices) more likely and has created banks of enormous financial power and economic importance in Switzerland. The FCC and its secretariat will have to closely observe the developments in the banking industry in the near future. Its task may be facilitated by the internally open market of Switzerland for foreign banks and other financial institutions.

TURKEY

Banking has commonly been treated as a matter of public interest although banks are operated for profit as are all other types of business. In many of the countries in the world bank regulation is more detailed and more strict compared with many other sectors. The basic aim of banking regulation is consumer protection in the general sense and in most cases the term “consumer” is understood as “depositor”. Other major objectives of banking regulation are to promote monetary stability and the efficiency and competition in the financial system.

Turkish Banking System and the Major Aspects of Banking Regulation in Turkey

As of December 1997, there were 72 banks operating in Turkey and seven of these are state owned. As of September 1997 state owned banks held 40 per cent of assets, 38 per cent of loans and 41 per cent of the deposits of the whole system.

There is no restriction on entering into the banking sector for both domestic and foreign investors that fulfill the conditions and qualifications specified in the Banks Act. However according to the Act, the final decision on entry is made by the Council of Ministers. Banks operating in Turkey, with the exception of State Banks, have the right to open up to 10 branches in a calendar year without prior permission if they meet the standard ratios that are put into force according to the Act. However, they have to inform the Undersecretariat of Treasury at least 30 days prior to the date of opening. Banks have to get the prior permission of the Undersecretariat for each of their branches exceeding 10 in a calendar year. If they do not meet the standard ratios they have to get prior permission for each of their branches regardless of the number.

According to the Banks Act, the Council of Ministers has the authority to determine the minimum or maximum rates of interests and other benefits on deposits and the maximum rates of interests to be charged in credit transactions and to liberate them partially or completely. The Council of Ministers also has the right to transfer its authority related to the interest rates on deposits to the Central Bank. In 1987, rates on credit transactions and deposits were liberated by Council of Ministers and the Central Bank respectively. There is no other price restrictions for other banking transactions.

Banks are not allowed to engage in purchase and sale of commodities and real estate for trading purposes. There are no restrictions on ownership linkages among financial institutions. However, according to the capital adequacy regulation, financial subsidiaries of the banks are deducted from the capital.

Banks are not allowed to hold the shares of a non-financial company over 15 percent of their own funds and the total sum of investments in these companies may not exceed 60 percent of their own funds. Banks may not acquire real estates exceeding the number and size needed by them for the banking activities and total registered value of the real estates acquired by banks may not exceed half of their own funds. There are also lending limits in the Banks Act, parallel to the regulations of the EU.

According to the Act, all banks collecting deposits are obliged to have their savings deposits insured. The definition of savings deposits to be insured and the determination of the amount and other

related matters of insurance are at the discretion and authority of the Council of Ministers. According to the Council of Ministers Decree issued in 1994 all savings deposits are covered by deposit insurance without limit. The premium is differentiated according to the capital adequacy ratio of the banks.

Capital adequacy is regulated in the same way as it is in EU directives and in BIS regulations. All banks have to meet the minimum ratio of eight per cent capital base over their risk weighted assets and off-balance sheet items. The minimum capital amount required for new entrants is 3.6 trillion TL which is approximately 18 million USD for the time being.

There are two types of reserves that Banks are required to hold. One is the reserves on deposits and the other is the liquidity reserves. Deposit reserve requirement is eight per cent for Turkish Lira deposits and 11 per cent for foreign exchange deposits. These reserves are kept in cash with the Central Bank. On the other hand, liquidity reserve requirement is differentiated into two categories as reserves against deposits and reserves against liabilities other than deposits. Liquidity reserve requirement is six per cent for Turkish Lira deposits and three per cent for FX deposits, and they have to be kept as government bonds at the Central Bank. Liquidity reserve requirement for other liabilities is eight per cent cash and six per cent government bonds for their TL liabilities and 11 per cent cash and three per cent governments bonds for their FX liabilities. Those also have to be kept with the Central Bank.

There are no requirements to direct credit to favoured sectors, but lending limits in the Act are expanded for the credits that are extended to exporters and foreign construction services.

According to Banks Act, the Council of Ministers is authorized to revoke permission to collect deposits and carry out banking transactions in the case of a bank that becomes insolvent. After that, the Deposit Insurance Fund is obliged to pay the depositors the amount that is covered by the deposit insurance scheme and to request the bankruptcy of the bank. The fund participates in the estate of the bankruptcy administration as a preferential creditor.

The main regulatory agency in the banking industry is the Undersecretariat of the Treasury that is organised under the Prime Ministry. It exercises the power of setting and issuing the regulations concerning the matters for which it has been authorised by the Banks Act.

According to the Act, it is required that, for most of the regulations that will be issued, the Banks Association of Turkey is asked to express its comments. The Banks Association of Turkey is a non-governmental organisation formed according to the Banks Act by all of the banks operating in Turkey and is charged with and authorised for, ensuring the development of the banking profession, securing agreement of the banks to work in unity, in a dignified and disciplined manner as required by the banking profession, and in accordance with the needs and conditions of the national economy and taking and implementing all measures necessary for prevention of unfair competition among banks.

Banking regulation does not prohibit any kind of inter-bank arrangements and agreements unless those arrangements and agreements violate the laws. In Turkish banking industry, such kinds of arrangements and agreements are in the areas which necessitate cooperation and collaboration among banks, such as ATM services. Those kinds of arrangements and agreements do not damage the competition and on the contrary, they serve as consumer protection mechanisms.

Competition Law and the Banking Sector

The national competition law was issued in December 1994 and there are no exemptions of any sectors to the application of law. The law requires the Competition Protection Board to be organised as the enforcement authority and the Board has been organised recently. However, in the Banks Act, an article regulates voluntary mergers and transfers of banks. According to that article, merger of any one of the banks operating in Turkey with one or several other banks or transfer of its debts, credits and deposits to another bank operating in Turkey is subject to prior permission of the Ministry that the Undersecretariat of Treasury is attached. The Ministry gives permission for merger or transfer if it concludes that the merger and transfer is not against the benefits of the parties. On the other hand, competition law prohibits all kinds of mergers and transfers that damage competition in any sector. In that context, the Ministry has to evaluate whether the transfer or merger violates the competition law before giving permission. Those two provisions are complementary. The logic behind the provision on mergers and transfers in the Banks Act is obviously the protection of competition and it is necessitated due to the absence of a general competition law at the date of issuance of the Banks Act.

UNITED KINGDOM

Introduction

In this paper we have sought briefly to describe the structure of the UK banking market, and the ownership of the enterprises which form it. We have included reference to building societies, which, in the UK, compete with banks in providing some services to the personal sector which in other parts of the world are more commonly provided by banks. We have described the regulatory régime, operated and supervised by the Bank of England, in some detail, including comment on the reasons for such regulation. We have also discussed certain additional measures of self-regulation, introduced principally for the purpose of further protecting the interests of consumers.

In the sections on the application of the competition regime, we have very briefly described the principal statutes and their purposes. We have also set out the principal agreements and arrangements between banks. Some of these have required consideration under particular aspects of the statutory competition regime. We have also described the UK's comparatively limited experience of scrutinising mergers between banks. Although stressed later in the paper, it is not too soon, even at this early stage, to mention that, aside from the prudential regulation by the Bank of England, the banking trades in the UK are subject to the competition legislation in the same way as are other businesses. Banks receive no special treatment or privileges; neither are they subject to any especially stringent competition regime.

Finally, we have very briefly outlined the proposed changes in competition law in the UK. These will be brought about by an act of Parliament which is at present going through its constitutional parliamentary processes, and which is expected to become law by late Summer or early Autumn of this year. As with the present one, the new competition regime will apply to banks in the same way as it applies to other businesses.

Why regulate banks?

A number of arguments are made for the regulation of banks. Traditionally a justification for public intervention has been the protection that regulation of banks provides against the risk that failure of one institution might lead to the failure of other sound institutions, creating a wider financial instability and more general economic disruption. Banks in managing the risks of their own business do not allow for damage to the economy at large that would result from individual failures, nor bear the costs themselves. The market failure thus represented justifies official intervention, both in the possible provision of lender of last resort facilities and in the setting of minimum prudential standards for individual banks.

A second argument rests on the asymmetry of information that exists between depositor and bank. The retail depositor is not in a good position to assess the soundness of an individual institution. The setting of minimum prudential standards, and fitness and properness criteria for management, reduces the likelihood of problems. The provision of a limited deposit protection scheme limits the size of loss faced by depositors if a failure were to occur. The purpose of this is essentially social. However, it is important that the protection against loss is limited, so as to avoid the possibility of moral hazard which arises where the likelihood of loss to the depositor is removed altogether. This would provide an incentive

to depositors to place funds with the bank that offers the highest return, without any consideration of the risks involved.

A further aim of regulation is to protect society from activities such as money laundering. Controls on entry in the form of authorization criteria, particularly fitness and properness criteria for controllers and managers of banks, should help to exclude the dishonest from the market. Again, this aim has an essentially social purpose.

A further goal is to achieve the purposes of regulation without introducing unnecessary costs or unnecessarily restricting entry to, or innovation in, the industry.

Structure and ownership of the UK banking industry

In February 1997, there were 554 banks in the UK (institutions authorized under the Banking Act 1987 together with European Authorized Institutions (EAI)). Of these, 516 were permitted to accept deposits. The remaining 38 were those EAIs entitled to carry out only activities other than deposit taking. Of the 361 institutions authorized under the Banking Act at that time, 149 were branches of institutions incorporated outside the EEA; the remaining 212 were incorporated in the UK. Of that 212 in turn, 79 were subsidiaries of overseas companies, and 7 were joint ventures involving overseas institutions. Although their business is often essentially domestic, these clearly have links with international operations.

The larger UK clearing banks are all publicly quoted on the London Stock Exchange, and their shares are widely held. Each of them is a part of a much wider financial group. About half the smaller clearing banks are publicly quoted, the remainder being owned principally by banking interests which are themselves members of wider groups which contain banks. The smaller banking institutions (not clearing banks) incorporated in the UK are on the whole not publicly quoted. Approximately two-thirds of them form part of wider groups, in which a parent, sister or subsidiary company is in some way involved in the financial markets.

Cross-shareholdings between banks are permitted in the UK, but they are rare. In such cases, holdings of other banks' capital are deducted from the investing bank's capital base.

The British Government owns no commercial banks. However, a large number of overseas banks with presences in the UK are owned, directly or ultimately, by overseas governments. Middle Eastern, South East Asian, and African banks are often mainly or wholly owned by their respective governments.

At the retail level, banks compete with each other in offering the usual services to consumers (current accounts, deposit accounts, credit and debit card services, personal loans, etc). Many banks also provide mortgage services, and they have become a significant factor in the market. In this market, they compete with building societies, whose traditional business it is. Moreover, building societies (which are discussed more fully below) have increasingly come during the last ten years or so to compete in the provision of other financial services to the personal sector more commonly and traditionally associated with banks. Some have indeed become banks, through conversion or acquisition.

More recently still, the UK has seen the introduction of the phenomenon of supermarket or grocery banking. Several joint ventures between banks and supermarkets have been launched to provide retail financial services. Typically this involves the bank's providing the operational processing facilities

and the supermarket's providing the marketing and distributional skills. In some cases, it has not been necessary to obtain separate authorization under the Banking Act; typically in a joint venture, the banking partner's existing authorization permits the taking of deposits. However, in at least one case, a supermarket has set up a banking subsidiary which has sought and obtained its own authorization.

It is too early to tell how popular this source of banking services will become, or whether it will have any noticeable effect on the state of competition in the market. The most that can be said so far is that the supermarket/grocery banks increase the choices open to consumers. Their association with a familiar activity could hold an element of appeal for consumers unfamiliar with banks.

Tables of figures of assets of banks and building societies, mergers, and market shares are at Annex 1.

Details of regulatory régime, and brief recent history

Banks - regulated by the Bank of England

Background to development of the current UK régime

Statutory regulation of banks by the Bank of England was introduced in the UK in 1979, following the secondary banking crisis earlier in the decade. It was also needed to comply with the First Banking Co-ordination Directive (1977), which required the authorization of credit institutions in EC member states. Following the failure of Johnson Matthey Bank in 1984, the 1979 Act was replaced by a revised Banking Act in 1987. This legislation forms the basis of the current system of supervision in the UK which is also underpinned by EU banking legislation and the UK's adherence to Basle minimum standards. The Bank of England currently has responsibility for authorization and supervision of UK banks, and a range of powers in respect of banks including the power to revoke or restrict authorizations. A review of banking supervision undertaken in 1996 (following the collapse of Barings in 1995) has led to the introduction of a formalised risk-based approach to supervision (currently in the process of implementation) for both UK-incorporated banks and non-EEA branches, under which supervision will be more intensive for higher risk organizations.

The next major development for banking supervision in the UK will be the transfer of responsibility for authorization and supervision of banks to the newly formed Financial Services Authority, scheduled to take place in the second quarter of 1998 after the enactment of the Bank of England Bill. The Bill transfers the Bank of England's responsibilities under the 1987 Banking Act to the FSA. The formal statutory objectives of the FSA are to be included in the Financial Regulatory Reform Bill which is expected to be enacted in 1999, but it will have responsibility for the authorization and prudential supervision of banks (as well as building societies, investment firms, insurance companies and friendly societies) while the Bank of England will retain responsibility for the overall stability of the financial system as a whole.

Lender of last resort

The Bank of England, as part of its financial stability role, provides lender of last resort facilities to banks. The decision whether to support a particular bank in difficulties is a complex one; the Bank considers the effect of the failure of the institution on the system as a whole and what should be done to protect the system from contagion. The Bank has described publicly the approach it adopts and the principles it has regard to when considering whether and how to provide support to an institution.

Nonetheless, a bank in difficulties would be supported in the UK only if its failure posed a systemic threat, and the Bank has, over the years, allowed several banks to fail.

Second banking co-ordination directive

The UK has implemented the Second Banking Directive (2BCD), with the result that branches of EEA banks set up in the UK under the terms of the directive are primarily the responsibility of their home state supervisors. The detailed requirements described below apply, therefore, to UK incorporated banks and branches of non-EEA banks only.

Outline of current régime

The 1987 Act establishes the framework for authorization of institutions to accept deposits and for the continuing supervision of banks by the Bank of England. It sets the primary objective of the banking supervisor as the protection of depositors (and potential depositors) of individual institutions. The UK operates a system of prudential supervision of banks, which focuses on financial soundness, adequacy of systems and controls and the fitness and properness of controllers, directors, and managers. There is no statutory regulation of conduct of business for deposit-taking activities, and the supervisory régime is a permissive one in the sense that banks are not specifically prohibited by statute from carrying out any activity.

The Banking Act 1987 sets out the minimum criteria for authorization for UK banks. They are in Schedule 3 to the Act, and are described in Annex 2. Institutions have to demonstrate that they meet these at authorization, and that they continue to do so. The Bank's interpretation of the criteria is set out in its Statement of Principles and in detailed policy Notices to Institutions. The current system of supervision is not primarily inspection based, although visits are regularly made to banks by reporting accountants and banking supervisors, particularly to review systems and controls. Banks make regular statistical returns to the banking supervisors who hold regular supervisory meetings with supervised institutions. Banks are required to keep the supervisors informed of any significant developments (proposed) in their business.

The system of prudential supervision of banks requires the banking supervisors to make both initial (at authorization) and continuing judgements about individual institutions. The supervisors have discretion in setting requirements for capital adequacy, liquidity etc, for individual institutions, because each has its own particular characteristics and risks which need to be reflected in the régime applied to it. They rely upon their judgement about each institution to do so, based on detailed knowledge and assessment of risk. The capital requirements at a minimum must meet the EU standards, but are in general higher.

Large exposures régime

A further aspect of the supervisory framework applied to banks is the large exposures régime. This stems from a requirement under the Banking Act to notify to the supervisors exposures which exceed 10 per cent of capital base, and from the implementation of the Large Exposures Directive which limits the size of exposures to single non-bank counterparties. Limits apply also to lending to connected counterparties. Banks are required to prepare a large exposures policy statement.

Restrictions on branching and new entry, especially the entry of foreign firms

New entry - All institutions seeking authorization as banks in the UK must meet the Schedule 3 minimum criteria for authorization, whether they wish to enter as a UK- incorporated bank or branch into the UK. However, EEA banks are able to branch into the UK under the terms of 2BCD and their home state supervisor has primary responsibility for their supervision. Non -EEA firms must demonstrate that Schedule 3 criteria are satisfied if they wish to establish a UK subsidiary or to branch into the UK. (Subsidiaries of EEA banks must similarly show that they meet the minimum criteria.) The Bank of England has developed a risk-based framework - SCALE - for assessing whether non-EEA banks meet the minimum criteria for authorization and that their UK branches meet adequate UK standards.

Once authorized in the UK, further branching of a UK incorporated or non-EEA bank within the UK is not restricted, except insofar as the institution must be able to demonstrate that it will continue to meet the minimum criteria for authorization, in particular that it has adequate systems and controls etc to support the proposed branch(es). Where such issues might be raised by the proposed expansion, the banking supervisors would expect to be consulted in advance.

Restrictions on pricing

In the UK, banking supervisors exercise no restrictions on pricing. The Consumer Credit Act enables borrowers to seek redress against extortionate credit agreements through the courts, but does not impose a numerical limit on interest rates charged.

Line of business restrictions

There are no specific restrictions on lines of business that a bank may undertake. However, the requirement that management conduct the bank's business with integrity and skill, and the general "prudent conduct" criterion mean that the supervisor would generally expect a bank to discuss with it any plans before embarking on any significant new line of business. Also, insurance legislation requires insurance business to be carried out in a separate company, which means that a banking group wishing to carry on insurance business must do so through a separate subsidiary.

Regulations on ownership linkages among financial institutions

No specific restrictions exist, but it must be shown that the shareholder controllers of a bank are fit and proper. If a bank is proposing to acquire or invest in another financial institution there are no specific restrictions, but supervisors must be satisfied that there is no threat to depositors; ie among other things, that systems and controls will be adequate, and that management has the skill to run the new business.

Restrictions on the portfolio of assets that banks can hold (such as requirements to hold certain types of securities or requirement not to hold other securities)

There are no explicit restrictions on assets which banks may hold. Banks are required to make adequate provisions against impaired assets. The large exposure régime limits the size of exposures to individual counterparties which a bank may hold relative to its capital base, and limits the concentration of large exposures. There is no obligation to hold specific types of assets. However, institutions are required to prepare a liquidity policy, and are obliged to maintain adequate liquidity, which for some retail banks involves holding a stock of high quality liquid assets.

Compulsory deposit insurance

The UK deposit protection scheme, (which reflects the implementation of the EU deposit guarantee directive) is compulsory for banks incorporated in the UK and for non-EEA branches, unless the Deposit Protection Board has determined that the bank is eligible not to participate in the UK scheme. In order not to participate in the UK scheme, the bank must satisfy the Board that a scheme exists in its home country which covers depositors with UK offices. This cover must be not less than the level and scope of the UK scheme. The scheme offers only limited protection for retail depositors¹ and is funded by contributions proportional to the deposits protected². The UK scheme was altered to meet the EU requirements - the percentage payout was increased.

Restrictions on capital adequacy

As noted above, UK banks are subject to capital adequacy requirements. As well as a minimum absolute amount of capital, each UK incorporated bank is also required to maintain capital adequacy at or above its individual trigger risk asset ratio.

Reserve requirements

The UK operates a voluntary scheme under which banks authorized to operate in the UK place non-interest bearing cash ratio deposits (CRDs) with the Bank of England. Their purpose is to provide the Bank with income to fund activities not directly recoverable from customers (including Government); they have no monetary policy or supervisory function. The scheme applies to the UK offices of all institutions authorized under the Banking Act 1987, and to European authorized institutions which have established branches in the UK under 2BCD. The size of the CRD is currently set at 0.35 per cent of eligible liabilities³. HM Treasury has recently issued proposals to extend the coverage of the scheme to include building societies and make minor changes to the definition of ELs and to introduce a "banding" provision that would exempt smaller institutions. Under the Bank of England Act 1998 this scheme will be placed on a statutory basis.

Requirements to direct credit to favoured sectors

There are no requirements in the UK for banks to direct credit to favoured sectors.

Special rules concerning liquidation etc

Banks are subject to the usual UK company insolvency legislation. A few special provisions exist regarding for example, the right of the supervisor to petition for winding up, however these do not offer any special protection to banks vis à vis other companies, nor their creditors.

Building societies - regulated by the building societies commission

Background

Although building societies are mutual institutions, taking in personal savings and providing loans for the purchase of, and secured on, domestic property, we have thought it appropriate to include a discussion of them in this paper because, in recent years, many of them have begun to offer additional services (such as current accounts) traditionally more associated with conventional banks. They are regulated as strictly as banks, in some ways more so perhaps, principally for the purpose of protecting

savers and borrowers. UK building societies have many similarities with mutual or co-operative savings and mortgage banks in other countries.

Until the passage of the Building Societies Act 1986, building societies were regulated by the Chief Registrar of Friendly Societies. The 1986 Act allowed them to offer a wider range of commercial services, in recognition of the increasing competition which they faced from other financial institutions. That Act also provided a new system for regulation and supervision, and established the Building Societies Commission to implement it. Another Act, the Building Societies Act 1997, introduced further liberalization. Building societies may now, with a few exceptions described below and which constitute the main operational differences between building societies and banks, conduct any type of business. Their principal purpose, however, is, and is required to be, the making of loans secured on residential property and funded substantially by their members. At least 75 per cent of a building society's business must be in the form of loans fully secured on residential property, either owner-occupied or let. Constitutionally, building societies remain mutual institutions, democratically accountable to their members, who are their savings and mortgage customers.

A fact sheet, prepared by the Building Societies Commission, which describes the regulatory régime for building societies in detail, and which contains further historical background, is available as an addendum to this paper.

Line of business restrictions

Even following the 1997 Act, building societies remain subject to these. As a general rule, they may not act as securities market-makers, or trade in commodities or currencies, and are restricted in their use of derivatives.

Restrictions on assets

Building societies remain subject to aggregate percentage limits on the make-up of the asset and liability sides of their balance sheets. On the assets side, a minimum of 75 per cent of the business assets of the society's group must consist of loans secured on residential property. This limit replaces more complicated asset holding restrictions in the 1986 Act.

Compulsory deposit insurance

Building societies do not pay for compulsory deposit insurance as such. Deposits with building societies (including members' share accounts) are protected in much the same way as in the case of banks; the Building Societies Investor Protection Scheme broadly mirrors the deposit protection scheme for bank depositors. Unlike the banking scheme, however, the BSIPS has never been activated, and involves no standing fund. Building societies have, therefore, never had to contribute to the scheme so far.

Capital adequacy

The Building Societies Commission's rules on capital adequacy are broadly similar to those of the Bank of England, both having to be consistent with the EC's Own Funds and Solvency Ratio Directives.

Reserve requirements

Hitherto, societies have not had to place deposits with the Bank of England (either cash ratio deposits or special deposits). New legislation (the Bank of England Bill) will place the cash ratio deposit régime on a statutory footing; and it will then apply to building societies for the first time, as well as to banks.

Lender of last resort

Neither the Building Societies Commission nor its predecessor authority, the Chief Registrar or Friendly Societies, has or had either the authority or the funds to act as lender of last resort, or to mount as direct rescue a failing building society. The tradition has been that a building society experiencing financial difficulties seeks a merger with a much larger, stronger building society, long before its difficulties become manifest to the public; and the regulator facilitates this process.

The Ombudsman scheme

This is covered principally, together with the Banking Ombudsman Scheme, in the following section. However, it may be useful to point out here that the Ombudsman arrangements for building societies have a different basis from those for banks, although their operations in practice are similar. The banking scheme is purely voluntary. By contrast, building societies have a statutory obligation to belong to a recognised Ombudsman-scheme. There is only one such scheme: the Building Societies Ombudsman Scheme, which was set up by the whole building society industry, and is recognised by the Building Societies Commission. The workings of the scheme must comply with the specification in the 1986 Act.

Conversions

It is important to note the significance of building societies' becoming banks by conversion or acquisition. The 1986 Act provides for building societies to change themselves into public limited companies under the Banking Act of 1987, a process termed conversion. The principal conversions which have taken place are:

- Abbey National - converted - 1989
- Cheltenham and Gloucester - take-over by Lloyds bank - 1995
- National & Provincial - take-over by Abbey National - 1996
- Bristol and West - take-over by Bank of Ireland - 1997
- Alliance and Leicester - converted - 1997
- Halifax - converted - 1997
- Woolwich - converted - 1997
- Northern Rock - converted - 1997

Some of these are very large. The Halifax and the Abbey National, for instance, are now among the ten largest banks in the UK (see Annex 1).

Converting building societies are protected for five years from hostile take-overs. However, they lose that protection if they themselves buy another authorized financial institution.

Additional self-regulatory measures for consumer protection

There are two main voluntary codes of practice, governing their relations with personal customers, to which all high street banks (and building societies) subscribe.

Banking Code of Practice

This sets the standards of good banking practice which are followed as a minimum by banks and building societies. The main sponsoring associations are the British Bankers' Association, the Building Societies Association, and the Association of Payment Clearing Services. The code is now in its third edition and is effective from 1 July 1997. It covers such areas as information, account operations, and how difficulties and complaints should be treated. All banks subscribing to the code must belong to the Banking Ombudsman Scheme. The code is monitored by the Independent Review Body for the Banking and Mortgage Codes.

Office of the Banking Ombudsman

The Banking Ombudsman Scheme includes in practice all high street banks in the UK - covering 99 per cent of all retail bank customers. The scheme covers all complaints about negligence, maladministration, and other breaches of duty (including inequitable treatment) in connection with banking business. If a UK bank which is a subscriber to the Banking Code of Practice fails to inform a customer about the scheme, the Ombudsman can treat this as maladministration. He cannot investigate complaints about a bank's commercial decisions, such as its general interest rate policy; complaints involving claims of more than £100 000; vexatious or frivolous complaints; or complaints which have been, or become, subject to court proceedings. Once a court, or another Ombudsman, has ruled on a complaint, the Banking Ombudsman cannot look at it. Individuals, partnerships, and small companies can use the scheme, which is free to complainants. The Ombudsman can award compensation to a maximum of £100 000. In assessing an award, he may add interest and may take account of inconvenience suffered by a complainant. He may reduce the award to reflect contributory negligence by a complainant.

The Code of Mortgage Lending Practice

This is a voluntary code followed by lenders in their relations with personal customers in the UK. It sets standards of good mortgage lending practice, which are followed as a minimum by the lenders including banks and building societies who subscribe to it. The Code is produced by the Council of Mortgage Lenders. Its first edition was published in March 1997. It is monitored by the Independent Review Body for the Banking and Mortgage Codes. Areas covered include the marketing of mortgages; help on choosing a mortgage; lending; terms and conditions; charges; confidentiality; and financial difficulties and complaints.

The Building Societies Ombudsman

All UK building societies and their group companies are covered by the scheme, which is statutorily based and compulsory. The Ombudsman may investigate complaints about alleged unfair treatment or maladministration; and complaints about breaches by a society of its obligations under the Building Societies Act 1986. Private individuals, groups of individuals, and partnerships can use the scheme which is free to complainants. They must first have exhausted the building society's own internal complaints procedure. The maximum possible award is £100 000. An award can include interest, and legal or other expenses reasonably incurred by the complainant in pursuing the claim. The Ombudsman may also reduce an award if action by the complainant contributed to the loss.

Application of the UK competition régime

The principal feature of the application of UK competition law in this market is that the banking trades, including building societies, are subject to its provisions in exactly the same way as other industries. There is no special competition régime, and there are no special exemptions. Mergers (which are treated more fully below) are examined by the Office of Fair Trading, and may be referred to the Monopolies and Mergers Commission (MMC) in the same way as mergers between other businesses. The Director General may refer instances of monopolistic or abusive behaviour to the MMC, again in the same way as in other industries. Restrictive agreements between banks are subject to the same scrutiny as agreements between other businesses.

Under the Fair Trading Act 1973 and the Competition Act 1980, the Director General may make inquiries into possible abuses of market shares of 25 per cent or more. He may make such enquiries where the 25 per cent market share test is met by a single company - a "scale monopoly". He may also make enquiries into "complex monopolies". A complex monopoly exists where two or more businesses enjoy an aggregated share of a market of 25 per cent or more, and they are conducting their affairs (whether intentionally or not) in a way which adversely affects competition. He may, if he is satisfied that abuses (or other forms of anti-competitive behaviour) are taking place, refer the matter to the MMC for investigation. Alternatively, he may take undertakings from those involved to remedy the adverse effects on competition. Otherwise, all remedial action is reserved to the Secretary of State for Trade and Industry; and can be taken only in the light of a finding by the MMC to the effect that an abuse is adversely affecting the public interest.

The only aspect of banking which has been referred to the MMC under these provisions (which do not cover mergers) is the credit card trade. Further details are at Annex 3.

There have been no investigations into banking by the Director General or by the MMC under the Competition Act.

The Restrictive Trade Practices Act 1976 (RTPA) requires the Director General to maintain a publicly accessible register of agreements between businesses in the UK under which two or more of the parties accept restrictions on their commercial freedom. It also requires that parties to such agreements should lodge them with the Office, within the specified time limits, for scrutiny and assessment of their likely effects on competition. Agreements falling within the RTPA but not lodged with the Office within the appropriate time are void and legally unenforceable. The effect of that is to allow anyone adversely affected by such a void agreement to sue the participants in the civil courts for damages.

As well as that to maintain the public register, the Director General has a duty to refer all agreements which fall within the RTPA to the Restrictive Practices Court. He has no power himself to require restrictions which significantly damage competition to be removed or abandoned; that power is reserved to the court. There is, however, further provision in the RTPA whereby, if the Director General considers that none of the restrictions in an agreement are significant (in other words if he considers that an agreement will have no harmful effects on competition), he may seek to be discharged from his duty to refer that particular agreement to the court by the Secretary of State for Trade and Industry. In practice, the overwhelming majority of agreements considered under the RTPA have been cleared under this procedure, many of them following negotiations between the Office and the parties successfully amending or removing restrictions which would otherwise have led to a reference to the court.

Agreements between banks, except those which are exempted as deriving from financial regulation by the Bank of England or the Treasury are subject to this legislation. The principal of these is that which underpins the operation of the clearing system by the Association for Payment Clearing Services (APACS). Further agreements of significance are that under which the Switch electronic debit card system operates; agreements relating to the development, testing and the ultimate operation of the Mondex electronic purse system; an agreement underpinning the clearing system in Scotland, operated by the Committee of Scottish Clearing Bankers; and an agreement involving the British Bankers' Association and its members, under which the Association has made recommendations on the conduct of certain aspects of its members' business. A feature of the RTPA is that the members of any trade association, or equivalent, are considered to agree to abide by recommendations from that association. Thus, the relationships between trade associations and their members almost invariably constitute, for purposes of the law, agreements falling within the RTPA.

All the agreements listed above, which are described in rather more detail in Annex 4 (except the agreement relating to the actual operation of the Mondex scheme, which is still under consideration) have been cleared under the discharge procedure, without reference to the Restrictive Practices Court. The codes of practice described in the previous section of this paper, although benign in both intention and effect, also fall within the provisions of the RTPA for technical reasons, and have also been cleared under that procedure.

Other arrangements described in the Annex do not fall within the RTPA. Moreover, it is important to know that the Restrictive Trade Practices (Services) Order 1976, which brought service industries under the control of the RTPA, specifically excluded agreements relating to the exercise of financial control by the Treasury or the Bank of England. Thus, the regulation of the banking trades by the Bank of England, and the rules, recommendations, and regulations which that supervision involves do not fall to be considered by the Office under the RTPA, and are not subject to potential action by the Restrictive Practices Court.

For the sake of completeness, it is appropriate to mention the existence of another important piece of competition legislation. The Resale Prices Act 1976 is designed principally to prevent manufacturers compelling retailers of their goods to charge specified prices. It does not apply to the retailing of services; and thus has no bearing on the banking sector.

Mergers

The merger provisions of the Fair Trading Act 1973 apply equally to banking enterprises and other financial services providers as they do to other business sectors. For a merger to qualify for investigation it must satisfy the following criteria:

- a two or more enterprises must cease to be distinct;
- b at least one of the enterprises must be carried out in the UK or under the control of a body incorporated in the UK;
- c either:
 - i the enterprises which cease to be distinct must supply or acquire goods or services of a similar kind and must together supply or acquire at least 25 per cent of all those goods or services in the UK or a substantial part of it; or
 - ii the gross value of the worldwide assets to be acquired must be more than £70 million.

In the case of qualifying mergers, the Director General of Fair Trading advises the Secretary of State for Trade and Industry whether or not they should be referred to the Monopolies and Mergers Commission (MMC) for further investigation. If so, he can also advise the Secretary of State whether undertakings in lieu of an MMC reference may be appropriate to address the competition concerns arising from the merger. Unlike EC merger control provisions, there is no statutory requirement on the parties to mergers to submit particulars to the Office, but the possibility of reference remains a powerful tool for the competition authorities.

In recent years, the UK banking industry has seen a number of significant changes, including the deregulation and demutualization of building societies, the introduction of competition in banking services from other sources such as the major supermarkets, and the introduction of telephone banking.

During this period, the Office has considered a number of mergers involving banks, based both in the UK and abroad, and other organizations in the financial services sector, such as building societies and insurance companies. However, to date, the majority of these cases has not raised competition issues serious enough to warrant a more detailed examination by the MMC. In the last decade, for example, there has been only one reference to the MMC of a banking merger. This was the proposed merger between Lloyds Bank plc and Midland Bank plc in 1992 which, the Director General considered, raised competition concerns in three particular markets - factoring, merchant acquiring, and small business lending. However, the MMC's investigation into the proposed merger did not run its full course, and was set aside when a competing bid from the Hong Kong and Shanghai Bank Corporation (HSBC) was successful. The competing bid, which was dealt with under the EC Merger Regulation, did not raise competition concerns. More recently, the Office examined the proposed merger between Lloyds Bank plc and TSB Bank plc. On the advice of the Director General, this merger was cleared by the Secretary of State in December 1995.

In examining the competition implications of mergers in the banking sector, the Office has in the main defined the relevant economic markets as the various product lines offered by banks in both personal and business services, such as loans, mortgages, current and deposit accounts, merchant acquiring, and factoring, among others. In geographical terms, the scope of these markets has tended to be defined as UK-wide, in view of the competition faced from the national chains and, increasingly, from companies offering telephone banking, and from other companies offering banking services. To date, the role of the Internet has not been considered in detail in our examination of merger cases. Because so few cases have so far given rise to significant competition concerns, it has not been necessary to examine in depth the scope for "trade offs" between the protection of competition and the stability of the banking sector.

Proposed changes in competition law

The Competition Bill was introduced into the UK Parliament in October 1997. It is expected to complete its constitutional processes by the late Summer/early Autumn of this year. The Act, however, is not expected to come fully into force until about a year after that.

The Act will introduce into the UK a competition régime very similar to that which applies under EC competition law. There will be a general prohibition of anti-competitive agreements; and a similar prohibition of the abuse of a dominant position. There will be a system of block exemptions for common categories of agreement, such as exclusive distribution agreements, or franchising contracts. The OFT will have wider powers of investigation, including the right to carry out "dawn raids" similar to that already enjoyed by the EC competition authorities. Moreover, the Director General will be able to fine businesses up to 10 per cent of their turnover for breaches of the prohibitions.

The Act will repeal the RTPA, and the Resale Prices Act 1976. Much of the Competition Act 1980 will also go. The existing mergers provisions of the Fair Trading Act will remain, as will the complex monopoly provisions of that Act, which allow the Director General to investigate practices widespread in an industry, which may adversely affect competition, but which do not amount to the abuse of a dominant position by a single company. The Act will replace the MMC with a Competition Commission. In addition to taking on the role of the MMC, the Commission will act as a Tribunal to hear and decide on appeals against decisions by the Director General.

The situation in respect of banking specifically will not change. As noted above, the Bank of England's supervisory function is to be transferred shortly to the Financial Services Authority. The treatment of the FSA's regulatory actions under competition law is still to be determined. Banks will be subject to the prohibitions of anti-competitive agreements, and of abuse of a dominant position. Although no one bank is likely to be in a dominant position, the banking trade collectively will still remain subject to the complex monopoly provisions of the Fair Trading Act. Banks will also remain subject to the mergers provisions of that Act.

Conclusions

Although there is a comparatively high level of concentration in the UK banking market (in the sense that a small number of very large banks enjoys a very substantial share of it), there appear to be adequate levels of competition in the provision of a variety of services for consumers. The markets are open to both UK and non-UK banks; are shared in many respects with building societies; and have recently been entered by large supermarket chains. Apart from the consideration, required by statute, of a comparatively small number of mergers and agreements, the competition powers of the Director General of Fair Trading have been invoked on only two occasions. Both cases involved the credit card market, and in both cases anti-competitive behaviour was found and remedied. Considering the all pervasive nature of banking, and the number of different sub-markets into which it can be divided and in which anti-competitive behaviour or abuse of market power might have manifested themselves, that is a record on which the UK banking trades might reasonably congratulate themselves.

Aside from the application of the competition régime, banks are strictly regulated, principally for prudential reasons and for reasons of consumer protection. Naturally, this gives rise to some element of restriction of competition and restriction of entry to the market. However the healthy state of competition in the market suggests that these effects have not been significant. We have not been conscious of any serious clash between the application of the competition régime and the requirements of prudential regulation.

ANNEX 1**STATISTICAL TABLES****UK Banking Sector**

· Total assets of UK-registered banks (on a consolidated basis), 1996:

£mns	Total assets	%	Mean average	Median average
UK banks (116)	1,189,620	100	10,166	923
Top 10 banks	961,612	81	96,161	98,314
Top 20 banks	1,071,646	90	53,582	24,979
Top 25 banks	1,120,786	94	37,359	8,949

Source: IBCA

· Top ten UK-registered banks by asset size, 1996:

Top ten banks by asset size 1996	£mns
National Westminster	182,666
Barclays	180,321
Abbey National	116,142
Lloyds	109,744
Halifax	102,300
Midland	94,329
Bank of Scotland	61,121
Royal Bank of Scotland	47,275
Standard Chartered	42,138
TSB	25,577

Source: IBCA

UK Building Societies

· Assets of building societies in 1996:

Top ten building societies by asset size 1996	£mns
Nationwide	37,601
Bradford & Bingley	17,038
Britannia	11,790
Yorkshire	7,143
Portman	4,011
Coventry	3,741
Skipton	3,259
Chelsea	3,016
Leeds & Holbeck	2,648
Derbyshire	2,017

Source: IBCA

Banking Mergers

· Retail banking mergers, 1992-7:

Date	Acquirer	Acquired
1992	HSBC	Midland
1995	Lloyds	TSB
	Lloyds	Cheltenham & Gloucester
1996	Halifax	Leeds
	Abbey National	National & Provincial
	Bank of Ireland	Bristol & West
	NatWest	Gartmore
1997	Halifax	Clerical Medical
	RBS	Birmingham Midshires

Estimated Market Shares

Market share, %	Personal current accounts	Personal lending	Mortgages outstanding	Small business lending	Credit cards (by number of accounts)
Abbey National			15		
Bank of Scotland					5
Barclays	18	18	4	27	28
Halifax			20		
Lloyds TSB	27	17	10	17	18
Midland	12	19	2	15	12
NatWest	18	13	3	28	11
Nationwide			7		
Royal Bank of Scotland					4
Woolwich			6		
Others	25	13	34	13	21

Source: HSBC James Capel (26-06-97)

BANKING ACT - SCHEDULE 3 CRITERIA

Schedule 3 of the Banking Act 1987 sets out the minimum criteria for authorisation. These establish the requirements for entry to the banking sector, for example requiring that management be fit and proper and that an institution has a minimum amount of capital before it can be authorised. The criteria set out in the Act are expressed in general terms. Detailed guidance on the Bank's interpretation of these criteria is given in the Statement of Principles, the Notices to Institutions as well as guidance for completion of statistical returns. The individual Schedule 3 criteria are described briefly below, together with the specific policies stemming from them:

(i) Requirement to conduct business in a prudent manner

As well as an overarching requirement that the business be conducted in a prudent manner a number of separate aspects to this requirement are specified:

- Adequacy of capital - UK banks are required to maintain a level of capital which exceeds its individually set trigger risk asset ratio. The calculation of the risk asset ratio reflects the implementation of the Solvency Ratio Directive and the Capital Adequacy Directive. Capital adequacy of a banking group is also considered on a consolidated basis. Trigger ratios are set for individual institutions based upon the assessment of a number of factors such as adequacy of systems and controls, diversification of assets etc. No trigger ratio is less than 8 per cent. The supervisor has discretion to raise or lower the trigger risk asset ratio.
- Adequate liquidity - banks are required to prepare a liquidity policy statement and follow individual liquidity mismatch guidelines, and in some cases maintain a stock of high quality liquid assets.
- Adequate provisions - banks are required to make adequate provisions against bad and doubtful debts.
- Adequate accounting and other records and adequate systems and controls - the supervisor makes its own review of systems and controls and also relies on the reports of Reporting Accountants (external auditors) on systems and controls of banks.

(ii) Minimum net assets

Own funds of all UK banks must exceed 5m ECU.

(iii) 'Four eyes' criterion; (iv) composition of the board of directors

There is a requirement that the business is conducted by at least two suitably qualified individuals; and that the board of directors is appropriately constituted, including where appropriate non-executive directors.

(v) Fit and proper criterion; (vi) requirement that the business be carried out with integrity and skill

Directors, controllers and managers are required to show that they are fit and proper to occupy their position with the bank. There is also a general requirement that the business must be carried out with integrity and skill.

MMC INVESTIGATIONS INTO THE CREDIT CARD MARKET

The credit card market has been investigated twice. In its first report, into Credit Card Franchise Services, and published in September 1980, the MMC found that the restriction placed on merchants by the credit card companies, requiring them to charge the same prices to customers paying by credit card as to customers paying by other means, commonly known as the no discrimination rule, was contrary to the public interest. It found that the rule had the effect of preventing merchants from competing with each other by offering different prices to credit card users and other customers, depriving customers of an important choice in purchasing goods or services, and, in some cases, possibly raising prices generally to all the customers of that merchant. It recommended that the rule should be prohibited. However, the Government of the day decided not to implement that recommendation, mainly because it considered that consumers were likely to be inconvenienced or confused, and that the display of the information necessary properly to inform consumers of any surcharges would impose undue burdens on merchants, and be difficult to enforce.

A second recommendation was that discussions between the Joint Credit Card Company Ltd and Barclays Bank Ltd (for practical purposes the only two credit card companies and merchant acquirers in the UK at that time), which might materially affect competition between them, should be abandoned. These discussions had covered such matters as floor limits for merchants, rates of interest to cardholders, the possibility of annual charges to cardholders, the enforcement of the no discrimination rule, and merchant service charges. The two companies subsequently gave assurances to the Director General that those discussions would cease.

Further concerns expressed by the MMC, principally about the profits of, and the charges by, the credit card companies, prompted a suggestion, falling short of a formal recommendation, that the Director General should keep all aspects of the market under review, and should consider seeking a further investigation if he judged that the public interest might be prejudiced by developments.

In the light of that process of monitoring and review, the Director General made a further reference to the MMC in 1987. The report of that inquiry was published in August 1989. The MMC again found the no discrimination contrary to the public interest, and again recommended that it should be prohibited. This time, the Government accepted the recommendation. It prohibited the rule by means of a Statutory Instrument - the Credit Cards (Price Discrimination) Order 1990 - which came into force at the end of February 1991. That order was accompanied by regulations - the Price Indications (Method of Payment) Regulations 1991 - which came into force on the same date. Those regulations prescribe the information which merchants must give to consumers in those circumstances where they charge different prices for goods or services according to the method of payment used. The regulations also prescribe the manner in which the information may be given.

A further recommendation concerned a prohibition of restrictions on entry to the merchant acquisition market. It was the practice for the international payment organisations (Visa and MasterCard) to insist that those card issuing members who wished to become merchant acquirers should not be permitted to do so until they had actually issued a specified number of cards. The MMC found this contrary to the public interest as presenting an unnecessary and undesirable barrier to entry to the acquisition market. It recommended that card issuing members should be permitted to acquire merchants immediately (that is,

whether or not they had actually issued any cards) provided that the member and the payment organisation had agreed a business plan for the issue of cards in the future. This recommendation was also accepted by the Government of the day. It was implemented by means of a further Statutory Instrument - the Credit Cards (Merchant Acquisition) Order 1990 - which came into force at the end of February 1991.

ORGANIZATIONS AND CO-OPERATIVE ARRANGEMENTS IN THE BANKING TRADE**APACS**

The Association for Payment Clearing Services (APACS) is the association of those banks and building societies at the heart of the UK payments industry. APACS has three affiliated clearing companies: CHAPS (the high-value interbank funds transfer system), BACS (the automated clearing house), and the Cheque and Credit Clearing Co (for the paper clearings). It sets the criteria for membership of these. All APACS members (currently 21) must belong to one or other of the Clearing Companies. Membership is open to any appropriately supervised credit institution which can demonstrate its ability to meet fair, explicit, and objective criteria.

Within APACS there are also several “common interest groups”, eg the Card Payments Group which considers issues such as measures to reduce the level of plastic card fraud, progress towards the introduction of chip-based credit, debit and ATM cards, and ATM reciprocity.

The Bank of England is a member of APACS, and as such seeks to influence the behaviour and decisions of the membership in line with its broad, public policy objective to maintain the integrity of the financial system, including payment and settlement arrangements. The Bank has a separate role in relation to membership of the clearings, as all direct participants must successfully apply for a settlement account at the Bank. The Bank is also involved through its provision of the Real Time Gross Settlement facility for CHAPS (ie the actual settlement mechanism for the clearing).

BACS, CHAPS, the Cheque and Credit Clearings

BACS Ltd is an automated clearing house, which provides electronic bulk clearing for low to medium value payments, specifically direct debits, standing orders, and non-urgent automated credit transfers. It has 17 members.

The CHAPS Clearing Company Ltd is responsible for the UK same-day, high-value clearing system. CHAPS (Clearing House Automated Payment System) is a guaranteed irrevocable nation-wide electronic sterling interbank funds transfer system. With the advent of Real Time Gross Settlement (RTGS), CHAPS payments are settled in real time across Bank of England settlement accounts, thereby eliminating receiver risk between CHAPS member banks. The Bank provides intra day liquidity on demand to the CHAPS banks, in the form of same-day repos. Some assets held in CGO and CMO (see below) are among those accepted by the Bank to provide CHAPS settlement members with additional intra day liquidity for RTGS.

The Cheque and Credit Clearing Company is responsible for the bulk clearing of cheques and paper credits in England and Wales, and currently has 12 members. One membership criterion which applies to all of the clearings is the requirement that members have a settlement account at the Bank of England. The Bank of England needs to assess the banks who are permitted to hold accounts at the Bank of England, in order to control its own credit risk, particularly in the case of CHAPS banks.

The network of agreements underpinning these arrangements fell within the provisions of the RTPA, and was cleared without reference to the Restrictive Practices Court.

ECU Clearing

The ECU Clearing is a cross-border payment system operated by the Euro Banking Association (EBA) for the payment/ settlement of obligations denominated in ECU. Of the current membership of 50 banks, 11 operate from the UK. There are no statutory regulations governing the involvement of UK entities in this clearing. However, the Bank of England has a potential involvement in that it has established emergency liquidity facilities, offered to UK-based members of the Clearing, to help the end-of-day settlement process in the event of a problem. The Bank is also involved in the oversight of the system through the EMI.

CGO, CMO, RTGS

The Central Gilts Office Service (CGO) provides secure settlement for gilt-edged (and certain other) securities through a system of electronic book entry transfers in real time against assured payments.

The Central Moneymarkets Office Service (CMO) provides a central depository for the immobilization of sterling money market paper and an electronic book entry transfer system for both physical and dematerialised money market instruments, which eliminates the handling of paper between members, and generates associated payment instructions.

These represent arrangements between existing settlement banks. Membership of CGO and CMO is conditional upon the appointment, by the applicant member, of a settlement bank approved by the Bank of England. Settlement bank status is granted by the Bank on the basis of objective criteria. Additionally, the granting of settlement bank status in CGO and CMO is conditional upon all other settlement banks having executed a Deed of Adherence, with the applicant bank, to the provisions of the relevant Service Payment Agreement (effectively giving existing settlement banks some control over the entry of new applicants).

The Bank of England (RTGS) operates the daily settlement of the net payment obligations of the sterling settlement banks in CGO and CMO.

The distribution of banknotes

The Bank of England distributes its new banknotes in a variety of ways. Most of the notes are distributed to the major banks (Lloyds, National Westminster, Barclays, Midland, Co-op, TSB, RBS) through APACS. Essentially, the Bank makes the notes available to APACS, which then oversees the distribution to the individual banks. The banks arrange between themselves who gets how many notes, and of which denomination. Some of the smaller banks (eg Yorkshire, Abbey National, Halifax) and the Post Office have bilateral arrangements with the Bank so that the Bank supplies them with notes direct. The Bank also supplies notes direct to the Northern Irish banks, through an agency arrangement with the Bank of Ireland. The ECU Clearing, the CGO, CMO and RTGS, and the arrangements for the distribution of banknotes, arising from the regulation of banking by the Bank of England, did not fall to be considered under the RTPA. Arrangements for the conduct of monetary policy by the Treasury and the Bank of England are excluded from the coverage of this Act.

Industry bodies

There are several industry bodies, eg the British Bankers' Association (BBA), the London Investment Banking Association, and the Building Societies Association. In general, an important function of these bodies is to act as lobbying groups to represent the interests of their members, eg to attempt to influence new legislative or regulatory initiatives. Such organizations also provide straightforward mutual assistance for their members on non- competitive issues - eg co-ordinating work on the Year 2000 threat.

The BBA is the most influential of these trade bodies, representing over 300 banks, both UK and foreign, which have a presence in the UK. It has played a leading role in establishing industry standards. For instance, it worked with the Bank of England and various law enforcement bodies to produce best practice guidance for banks and building societies on the prevention of money laundering. While this guidance does not have statutory force, the Bank of England now assesses banks' compliance with it as part of determining whether they have adequate systems and controls.

The BBA publishes daily LIBOR fixings, for all major currencies. These are based on quotes from a selection of banks, and provide an industry benchmark rather than a binding price. It has recently added benchmark option volatilities.

The BBA has also issued a number of SORPs (Statements of Recommended Practice), each providing detailed accounting standards for a particular aspect of banking. These supplement the standards issued by the Accounting Standards Board, which apply to companies generally. They are not mandatory, but are generally complied with, since they have been drawn up with wide industry consultation.

Another form of inter-bank agreement worth mentioning is the development of standardized legal documentation. For instance, in 1996 the BBA managed to achieve consensus on a Master Agreement on Deposit Netting. There is no legal requirement to use standard documentation of this sort, but it is widely used because most participants have an interest in using it. For straightforward transactions, it provides certainty and avoids wasteful duplication of effort. Other examples are IFEMA (the International Foreign Exchange Master Agreement) and ICOM (the International Currency Options Master Agreement).

The BBA's rules and recommendations constitute an agreement falling within the provisions of the RTPA. The agreement was cleared without reference to the court.

NOTES

- 1 Each protected depositor receives payment of 90 per cent of his deposit up to a maximum payment of £18 000 (or ECU 20 000 if greater - around £13 400 at current exchange rates). The Scheme covers deposits made in the EEA currencies and ECU with branches of UK banks within the EEA, branches in the UK of banks from outside the EEA and, subject to special rules, branches in the UK of banks from other EEA member states where those banks have opted to participate in the Scheme as well as in the scheme of their home member state.
- 2 The scheme is funded by the payment of a one-off initial contribution. The minimum initial contribution is £10 000 while the maximum amount levied in respect of an initial or further contribution may not exceed £300 000. There is also a ceiling which currently limits payments made under all calls, after allowing for any repayments, to an amount not exceeding 0.3 per cent of each institution's deposit base at the time a particular call is made. The deposit base is broadly defined as retail deposits denominated in EEA currencies and ECU with EEA offices.
- 3 ELs are defined as an institutions gross sterling deposits including repo liabilities and net sterling liabilities to non-resident offices and positive net currency liabilities, but excluding sterling deposits with an original maturity of over two years. These are offset by loans to other UK banks, (except for holding of shares and debt securities with an original maturity of greater than five years), and any balances held with the Bank (excluding CRDs and special deposits). Liabilities arising to the Bank from its money market operations are excluded (ie repos with the Bank).

THE BUILDING SOCIETIES COMMISSION**Introduction**

There are 71 building societies. They are among the nation's most important savings and lending institutions accounting for around 17 per cent of personal sector liquid assets and about 24 per cent of the total UK mortgage market. They have total assets of about £140 billion with 19 million share investors and three million borrowers. Building societies are mutual organisations, jointly owned by their members. They operate within the legal framework established by the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997.

Until the Building Societies Act 1986 building societies were regulated by the Chief Registrar of Friendly Societies. The 1986 Act allowed a wider scope of commercial operation for societies, in recognition of the increasing competition they faced from other financial institutions in a fast changing financial market place. At the same time the 1986 Act provided a new framework for regulation and prudential supervision, and established a new body to carry it out - the Building Societies Commission. The 1997 Act further liberalised the statutory regime for societies who will now, with a few exceptions, be able to conduct any type of business they wish in addition to their principal purpose of making loans which are secured on residential property and which are funded substantially by their members. The statutory principal purpose rule requires that at least 75 per cent of a building society's business assets must be in the form of loans fully secured on residential property, which may be either owner-occupied or let, and at least half of its funding must come from members' share accounts. Further background to the history of societies and the legislative regime is in the Annex.

The Commission

The 1986 Act placed statutory responsibility for the regulation and supervision of building societies on the Building Societies Commission, which was formed on 27 September 1986. It is a body corporate, acting on behalf of the Crown and answerable to Parliament. It must consist of between 4 and 10 members who are appointed by the Treasury.

There are currently eight members of the Commission. The Chairman and First Commissioner is the Departmental Head of the Registry of Friendly Societies and the Deputy Chairman and third Commissioner are also full-time senior officials of the Department. The other five part-time Commissioners have professional and business experience in the building society sector, the civil service, the law, banking and accountancy.

The present membership of the Commission is:

Geoffrey Fitchew CMG (First Commissioner and Chairman)

Martin Owen (Deputy Chairman)

Jeremy Palmer (full-time Commissioner)

Sir James Birrell, former Chief Executive of the Halifax Building Society

Nigel Fox Bassett, former Senior Partner at Clifford Chance

Terry Mathews CBE, former full-time Commissioner and senior Treasury official

Graham Sunderland, former Chief Executive of the Yorkshire Bank

Jock Worsley, former President of the Institute of Chartered Accountants in England and Wales

Functions of the Commission

The 1986 Act lays down the general functions of the Commission as:

- to promote the protection by each building society of the investments of its shareholders and depositors;
- to promote the financial stability of building societies generally;
- to secure that the principal purpose of building societies remains that of making loans which are secured on residential property and are funded substantially by their members;
- to administer the system of regulation of building societies provided for by the Act;
- to advise and make recommendations to the Treasury or other government departments on any matter relating to building societies.

The Commission fulfils its functions under the Act through a combination of supervision and regulation. Supervision is based on close and continuing contact with individual societies coupled with the issuing of guidance in the form of Prudential Notes and other advisory material. Regulation under the 1986 Act operates in two ways - through the exercise of powers of control to ensure that societies adhere to statutory requirements and through the enactment of secondary legislation in the form of Statutory Instruments laying down detailed permissions or prohibitions on specific areas of activity by societies. As a consequence of the 1997 Act liberalisation, statutory regulation of the latter kind will be much reduced in future.

The Commission meets about once a month. It considers a wide range of policy and prudential matters and examines regular supervisory reports on each society. Commissioners also serve on Commission committees, for example dealing with prudential guidance and systems, and on panels considering building society mergers, conversions and takeovers and applications for access to the Register of Members of societies.

Organisation

The Commission has about 50 staff (who are part of the staff of the Registry of Friendly Societies). These are organised into a number of groups including a secretariat, supervisory groups, a central policy unit and a financial monitoring group. In addition the Commission calls upon the support of the Registry's central services staff, including legal and personnel.

The secretariat includes the Secretary to the Commission and provides support services for Commission meetings. It also acts as a general enquiry point for interested organisations and members of the public.

There are three supervisory groups, responsible for providing the Commission with policy advice on specific supervisory issues and for the day-to-day supervision of a number of building societies. Each consists of a Group Head, supervisors, analysts and support staff.

A central policy unit focuses on a range of wider policy issues including building societies legislation, the impact of European financial services legislation and liaison with other regulators. It also manages the Building Society Investor Protection Scheme.

The financial monitoring group is responsible for processing monthly, quarterly and annual monitoring returns completed by building societies and provides an economic and statistical service to the Commission.

The Registry's Legal Division provides legal services to the Commission and the Head of Legal Division is the Legal Adviser to the Commission.

The Registry's Resources Group Division provides IT, finance, accommodation and personnel services to the Commission.

Financing the Commission

The 1986 Act provides for a general charge to be levied on societies which, together with fees for specific activities, "shall be such as to produce an annual revenue of the Commission sufficient to meet its expenses properly chargeable to revenue account, taking one year with another". For 1997-98 the general charge will raise about £2.26 million. Each society pays a £2 250 lump sum plus 0.00081 per cent of total assets up to £30 000 million and 0.000405 per cent of assets over £30 000 million.

Supervision

The Commission's supervisory philosophy is based on encouragement of prudent management by societies of their own affairs supported by a system of regular society reports and to the Commission and face to face contact between Commission staff and societies.

Criteria of Prudent Management

The 1986 Act places on the board of each society the primary responsibility for ensuring that the investments of shareholders and depositors with that society are adequately protected. The Commission has the task of promoting that protection by each society but not of ensuring it.

In order to fulfil this responsibility the board of each society has to observe the provisions of the Act relating not only to the constitution of societies, conflicts of interest etc. but also to certain criteria of prudent management set out in section 45 of the 1986 Act (as amended by Section 21 of the 1997 Act). The amended criteria are:

- i. Compliance with the provisions of the 1997 Act relating to principal purpose, lending and funding limits and restrictions on certain kinds of financial trading
- ii. Maintenance of adequate reserves and other designated capital resources;
- iii. Maintenance of adequate assets in liquid form;

- iv. Maintenance of the requisite arrangements for assessing the adequacy of securities for loans; and for assessing the willingness and ability of borrowers to repay such loans;
- v. Maintenance of the requisite accounting records and systems of control of business and of inspection and report;
- vi. Direction and management:
 - a) by a sufficient number of persons who are fit and proper to be directors or, as the case may be, officers in their respective positions,
 - b) conducted by them with prudence and integrity;
- vii. Conduct of the business with adequate professional skills.

The Commission effectively needs to be satisfied that the board of directors, with the chief executive and secretary, have the capacity and intention to direct the affairs of the society in accordance with the criteria of prudent management and have secured that those criteria are being satisfied.

The System of Prudential Supervision

The Commission seeks to be satisfied that the affairs of every society are directed and managed in accordance with the criteria of prudent management.

For this purpose the Commission has developed a comprehensive system of prudential supervision which seeks not only to scrutinise the past and the present but to look ahead to future developments and risks. Its main elements are:

Prudential Guidance: From time to time the Commission issues prudential and policy guidance to societies. This is mainly done through *Prudential Notes*, which set out the Commission's views on what societies need to do in order to comply with the Criteria of Prudent Management. Prudential Notes are supported by *Guidance Notes* which explain statutory and administrative procedures and *Dear Chief Executive Letters* which provide advice to societies on a wide range of prudential and operational issues. As a consequence of the 1997 Act the whole corpus of Prudential Guidance is currently being revised and updated to bring it into line with the new permissive regime operating for building societies.

Policy statements: Societies are required to produce statements of board policy on the conduct of key aspects of their business. These include statements on balance sheet risk management; funding policy; lending policy; and liquidity management.

Monitoring returns: The Commission receives three regular returns from societies. Monthly returns concentrate on cash flow and balance sheet position, including liquidity. Quarterly returns give information about outturn and forecasts, including income and expenditure, capital adequacy, lending and arrears. Annual returns mainly give information to supplement the published annual accounts and business statement.

Reports on systems: Section 71 of the 1986 Act requires every society to make an annual report on its systems of control of its business and records and of inspection and report. This is complemented by an annual report from the society's external auditors under section 82. Each of these reports is considered by the Commission's Systems Committee.

Annual review: The Commission seeks to have a continuing working relationship with each society it supervises. There are **annual review meetings** between the Commission (often represented by a Commissioner) and the society's board to consider the recent performance and the prospects and plans for the society, and any major supervisory or prudential issues which may be outstanding between the Commission and the society or which may be expected to arise. Soon after this meeting an **annual review report** is presented to the Commission by the society's supervisor. This makes a supervisory assessment of the society in the light of the criteria of prudent management. On the basis of this assessment the Commission determines any supervisory objectives and tasks both for itself and the responsible supervisory group for the following year.

Regular Contact: During the year supervisors keep in close contact with societies by correspondence or telephone to deal with new issues that arise and to follow societies' progress. Visits are made as necessary to societies to see their operations and to review issues with senior management.

Capital adequacy: The Commission sets each society an individual, confidential, threshold above which that society's solvency ratio must be maintained. These thresholds are periodically reviewed, both against current developments in each society and for consistency across the sector.

Statement of Principles

The 1997 Act requires the Commission to publish a Statement setting out the principles it will use to interpret the Criteria of Prudent Management and to make judgements on exercising its powers of control. The Statement of Principles is a key document which will be at the head of the whole family of revised prudential guidance. It summaries the Commission's interpretation of each of the criteria of prudent management, and explains how the criteria are linked both to the way in which the Commission carries out its supervisory responsibilities and to the exercise of its powers of control. A draft of the Statement is currently out for consultation with societies and it is expected that the definitive version will be published in the first half of 1998.

Regulation

For the most part the Commission seeks to secure the sound prudential regulation and supervision of societies through discussion and agreement but, where necessary, it may use its powers of control set out under the Act. These powers are wide ranging and seek to ensure that societies adhere to their relevant statutory limits and to the criteria of prudent management.

Powers of control

The Commission has certain powers of control if a society is in breach of its "nature limits" on assets and liabilities. The most important of these limits are that at least 50 per cent of a society's funding

must come from members' investments in share accounts and that at least 75 per cent of its assets must be in the form of loans fully secured on residential property.

The Commission can require a society to submit a restructuring plan designed to bring its assets and liabilities back within the relevant statutory limits or to call a meeting to consider converting to a company. Failing this the Commission has the power to present a petition for the winding up of the society, or to require a restructuring plan, or to require the modification of business.

Powers in relation to authorisation

Under the 1986 Act as amended by the 1997 Act, the Commission has powers with relation to the authorisation of societies:

- a) The Commission can direct a society to apply for a renewal of its authorisation if it believes that the business is being, or may be, conducted in a way which might not be adequate to protect the investments of shareholders and depositors.
- b) The Commission can impose conditions on the current authorisation of a society where it considers it necessary to do so to protect investors. The conditions may relate to any activities of a society; it may require a society to take certain steps or to refrain from taking certain steps.
- c) The Commission can revoke a society's authorisation.
- d) The Commission can obtain information and documents from a society.
- e) The Commission can appoint accountants to investigate the state and conduct of the business of the society concerned.

Statutory Instruments

The 1986 Act provided for the Commission or the Treasury to make Statutory Instruments (SIs) to amend the Act's provisions in a number of areas affecting how societies operated and the type of business they conducted. As a consequence of the liberalised regime introduced by the 1997 Act, the scope for such SIs or Orders is much reduced, although powers with regard to secondary legislation are retained, for example the Treasury can reduce by Order the percentage of the lending limit down to a minimum of 60 per cent and can by Order vary the criteria of prudent management.

Since 1986 140 Statutory Instruments (SIs) have been made under the 1986 Act of which 75 are currently in force. Many will be spent as and when societies alter their Memoranda and Rules to exercise their new powers. Societies are also subject to a number of SIs made by the Treasury under section 2 of the European Communities Act 1972 to implement European Community directives.

Mergers

The 1986 Act provides for societies to amalgamate or to transfer all or part of their engagements to another society, a process termed a merger.

It is for the boards of societies to assess the case for a merger. However, it is the Commission's function once a merger has been announced to supervise the societies involved in following the procedures laid down by the 1986 Act.

The Commission must be satisfied that the combined society will meet the criteria of prudent management from the time of the merger and prudential information is sought at an early stage. In that regard the Commission pays particular regard to management and such matters as capital adequacy and systems of control, inspection and report.

Members must be fully and clearly informed of the terms of proposals of the transfer of engagements, and the Commission's confirmation is necessary once the merger has been approved by the societies' members.

Interested parties have the right to make written and/or oral representations to the Commission in connection with confirmation. However the Commission must confirm a merger unless it considers that one or more of the following three Confirmation Criteria apply:

- a. some information material to the members' decision about the transfer was not made available to all the members;
- b. the vote on any resolution approving the transfer does not represent the views of the members; or
- c. some relevant requirements of the 1986 Act or the rules of the participating societies were not fulfilled.

The Commission may not consider the merits of the proposed merger nor the fairness of its terms which will have been approved by the members. In the event that the Commission exercises its prudential powers to direct a society to merge with another, the first two criteria at paragraph above shall not apply. However, members must be notified of the merger and be given the opportunity to make representations to the Commission, which must also consider whether the members, or a proportion of them, would be unreasonably prejudiced by the transfer, before it gives its confirmation.

Takeovers

The 1986 Act provides for a society to transfer its business to an existing company which is already or will be at the date of transfer, authorised under the 1987 Banking Act, a process termed a takeover.

It is for the board of a society to assess the case for a takeover and it must explain and recommend its decision to its members. It is the Commission's duty, following the announcement of a proposed takeover, to supervise the society in following the procedures, such as provision of information to members and voting arrangements on the Transfer Resolution, as laid down by the 1986 Act.

Once the takeover has been approved by members, confirmation by the Commission is required. Interested parties have the right to make written and/or oral representations to the Commission in connection with confirmation. However, the Commission must confirm a proposed transfer unless it considers that one or more of the following four Confirmation Criteria apply:

- a. some information material to the members' decision about the transfer was not made available to all the members eligible to vote; or
- b. the vote on any resolution approving the transfer does not represent the views of the members eligible to vote; or
- c. there is a substantial risk that the successor will not become, or as the case may be, remain an authorised institution for the purposes of the Banking Act 1987; or
- d. some relevant requirement of the Act or of the Rules of the society was not fulfilled.

The Commission may not consider the merits of the proposed transfer nor the fairness of its terms which will have been approved by the society's members. In the event that the Commission exercises its prudential powers to direct a society to transfer its business to an existing company, the modified procedure described above will apply.

Conversions

The 1986 Act provides for a society to convert to being a public limited company under the Banking Act 1987, a process termed a conversion.

It is for the board of a society to assess the case for conversion, and it must explain and recommend its decision to the members. It is the Commission's duty, following the announcement of a proposed conversion, to supervise the society in following the procedures, such as provision of information to members and voting arrangements on the Transfer Resolution, as laid down by the 1986 Act.

Once the conversion has been approved by members, confirmation by the Commission is required. Interested parties have the right to make written and/or oral representations to the Commission in connection with confirmation. However, the Commission must confirm a proposed transfer unless it considers that one or more of the following four Confirmation Criteria apply:

- a. some information material to the members' decision about the transfer was not made available to all the members eligible to vote; or
- b. the vote on any resolution approving the transfer does not represent the views of the members eligible to vote; or
- c. there is a substantial risk that the successor will not become an authorised institution for the purposes of the Banking Act 1987; or
- d. some relevant requirement of the Act or of the Rules of the society was not fulfilled.

The Commission may not consider the merits of the proposed conversion nor the merits of its terms which will have been approved by the society's members.

Investor Protection

Sections 24 to 30 of the Building Societies Act 1986, as amended by the Credit Institutions (Protection of Depositors) Regulations (SI 1995/1442) provide for the establishment of a Building Societies Investor Protection Fund (BSIPF) from which payment would be made to investors in a society which became insolvent, and also for an Investor Protection Board to hold and manage the Fund.

The main features of the Investor Protection Scheme are:

the first £20 000 of a person's shares and/or deposits (or aggregate if that person has more than one account) are protected under the Scheme and constitute a "protected investment"

compensation payments amount to 90 per cent of that protected investment, subject to a maximum payment of £18 000;

joint holdings (other than partnership holdings) entitle each holder to £20 000 of protected investment;

the fund would be financed by contributions levied on each society up to a current maximum of 0.3 per cent of its share and deposit base (the percentage may be increased only by an Order made by the Treasury);

not all shares and deposits are protected: for example, permanent interest bearing shares and other deferred shares, certificates of deposit and other negotiable instruments are excluded.

The Building Societies Investor Protection Board (BSIPB) was constituted on 24 April 1987. It has 7 members of whom the Chairman of the Building Societies Commission is also ex-officio member and Chairman.

A report, including accounts, is published each year and may be found in the same volume as the annual report of the Building Societies Commission.

Liaison With Other Regulators

The Commission is the lead regulator for each building society but some parts of their business may require to be authorised by another regulator who then bears primary supervisory responsibility for that business. For example, insurance business is the responsibility of the Department of Trade and Industry while investment business under the Financial Services Act 1986 is the responsibility of the Financial Services Authority and for the time being the self-regulatory organisations, recognised under the Act.

The Commission has close links with the supervisory authorities in the British Overseas Territories (the Channel Islands, Isle of Man and Gibraltar) about the business of building societies or their subsidiaries being carried on in these territories.

The Commission participates in negotiations on European Community legislation as it affects building societies, as well as more generally in various European groups such as the Banking Advisory Committee and the Contact Group of European Supervisory authorities.

Building Societies Ombudsman Scheme

It is not part of the Commission's role to investigate complaints from individual borrowers or investors against building societies. Societies themselves have internal complaints procedures for dealing with such matters and if these fail to bring about a satisfactory resolution the complainant can refer the matter under the Building Societies Ombudsman Scheme for investigation. This scheme, which is recognised by the Commission, was set up under the 1986 Act by the Building Societies Association and came into operation in July 1987. It is funded by contributions from all building societies.

Future of The Commission: Financial Services Authority

The Government announced in July 1997 that the functions of the Commission will transfer in due course to a new single regulator for all financial services in Britain - the Financial Services Authority. The transfer is likely to be completed by the end of 1999 following the enactment of the Financial Regulatory Reform Bill (due to be published draft in the summer of 1998). When the transfer is completed, the Commission as an organisation will disappear, although its staff will transfer to the FSA. BSC staff are participating fully in the formative work for the new organisation. The distinctive constitutional character of building societies will not be changed as a consequence of the move to the FSA.

Reading List

Building Societies Commission Annual Report 1996-97
ISBN 0 9522087-2-5. £12.50

Statement of Principles Consultation Draft. No Charge.

Prudential Note 1997/1 Lending to Business £3.00

Prudential Note 1996/4 Systems £2.00

Prudential Note 1996/3 Capital Adequacy £3.00

Prudential Note 1996/2 Syndicated Lending £3.00

Prudential Note 1996/1 Relationships between Auditors and the Commission £1.30

Prudential Note 1994/4 Boards and Management £2.30

Building Societies Merger Procedures: Guidance Note. Published by the Building Societies Commission
£10

Building Societies Takeover Procedures: Guidance Note. Published by the Building Societies
Commission £10

Building Societies Conversion Procedures: Guidance Note. Published by the Building Societies
Commission £10

Consolidated text of the Building Societies Act 1986, as amended by the Building Societies Act 1997.
Floppy disk. £1.00

The above publications can be obtained from:

The Secretariat
Building Societies Commission
Victory House
30-34 Kingsway
London WC2B 6ES.

Tel: 0171-663 5361
Fax: 0171-663 5062

ANNEX: HISTORICAL BACKGROUND

Building societies first came into existence towards the end of the 18th century. Members paid weekly contributions to a fund which was used to buy land and finance construction of houses for those same members. When the houses were all built the society was wound up. During the 19th century, societies developed into "permanent" institutions attracting funds not just from borrowers but from other savers and lending for purchase of existing houses as well as for building new ones.

By 1900 there were nearly 2,300 societies with around 600,000 shareholders and total assets of some £60 million. Since then the number of societies has steadily decreased, largely through mergers and latterly also conversions and takeovers. Many of those remaining have been transformed from local into national institutions with branch networks throughout the country.

Legislative Framework

Building societies were not regulated until 1836 when the Regulation of Benefit Building Societies Act gave them official recognition. The Act also created the role of "certifying barrister" to register societies' rules and offer advice. In 1846 this post became Registrar of Friendly Societies of England bringing the certification of the rules of all mutual societies within the responsibilities of an office in England, in Scotland and in Ireland. It was in 1855 that the rules of societies were required to be deposited with the Registrars and it was under the Friendly Societies Act 1874 that the Chief Registrar was appointed with Assistant Registrars in England, Scotland and Ireland.

The first comprehensive legislation governing societies was the Building Societies Act 1874. This enabled societies to incorporate and prescribed specific objectives for societies registered under that Act which all had to be incorporated. In more recent times the Building Societies Act 1960 (later consolidated into the Building Societies Act 1962), among other changes, provided the Chief Registrar with wider powers of prudential control over building societies.

There was no further major legislation affecting building societies until the mid 1980s. By that time changes in the financial markets and wider social trends had affected societies' competitive position. The 1986 Act was designed to put societies on a more equal footing with other financial institutions and at the same time provide a new framework for enhanced prudential supervision.

The 1986 Act

The main provisions of the 1986 Act were based on the conclusions of the Green Paper, *Building Societies: A New Framework*, published in July 1984. The premises of the Green Paper followed through in the legislation were that:

building societies should continue as specialist financial institutions with a mutual constitution;

- the principal purpose of societies should remain that of raising, primarily from members, funds for making advances to members secured upon land for their residential use;

- societies should be able to diversify by holding other forms of asset and providing other services;
- if the board of a society did not wish it to continue within that framework, and its members agreed, it could transfer its business to a company;
- the widening of the powers of societies should not lead to an increased risk to investors in societies and since some of the additional powers of societies were inherently more risky this would require a stronger prudential regime.
- the activities of a building society would be confined to those provided for by the Act.

The 1997 Act

The Building Societies Bill was published in draft in March 1996. Following a long period of detailed consultation with societies and other interested parties, the Bill was introduced into Parliament and received the Royal Assent on 21 March 1997. All of its provisions have now been brought into force. Societies will be able to benefit fully from the new permissive regime set out under the Act once they have altered their Memorandum and Rules and registered the changes with the Central Office of the Registry of Friendly Societies. It is expected that the great majority of societies will make the necessary changes to their constitutions by the middle of 1998.

Powers

As a result of the 1997 Act, a building society may pursue any activities set out in its Memorandum, subject only to:

Principal Purpose: Its principal purpose must be that of making loans which are secured on residential property and are funded substantially by its members

Lending limit: At least 75 per cent of its business assets must be loans fully secured on residential property

Funding limit: At least 50 per cent of its funds must be raised in the form of shares held by individual members

Restrictions: It must not:

- act as a market maker in securities, commodities or currencies
- trade in commodities or currencies
- enter into transactions involving derivatives, except in relation to hedging
- create a floating charge over its assets

Prudential: It must comply with the revised criteria of prudent management set out in the 1997 Act

Other changes

The 1997 Act also updated the Commission's powers of control and direction over societies to reflect the new principal purpose and lending and funding "nature limits". It also provided for improved accountability by societies to their members. For example, societies can no longer operate non-voting deposit accounts.

UNITED STATES

Throughout the 1990's, the United States banking industry has experienced dramatic legal and structural changes which continue to redefine the business of banking, the financial services markets more generally and the role of banks in the economy. Among the many changes experienced in the U.S., the banking system has witnessed a breakdown of geographic boundaries and product barriers. Continuing globalization of financial markets coupled with rapidly expanding technological advances, such as electronic banking, have created a new competitive and evolving regulatory environment for banks. In response to these changes, Congressional initiatives continue to seek reform in the financial structure of banks.

Greater competition in traditional banking products from nonbank financial service providers coupled with the ability of many borrowers to directly access the capital markets has increased pressure from banking interest groups to reform the banking system to allow banks to offer a greater array of financial products and services. This paper provides an overview of bank regulation in the U.S. and follows with a discussion of the more significant rulings by federal regulators which have affected competition in the banking industry. As discussed below, rulings from the bank regulators have opened the door for banking competition in an expanding range of financial products. This environment led most recently to the introduction of several financial modernization bills in Congress also discussed below.

Overview: United States Banking System

Much of the banking regulatory system in the United States functions under a dual banking structure. Both state and federal regulatory authorities are empowered by statute to charter banks, credit unions and thrifts. The type of charter a bank or thrift maintains -- state or federal -- and whether the bank is a member of the Federal Reserve System, determines in varying degrees the regulation and regulators to which the bank will be subject. As a result, many banks operate under two interrelated regulatory systems. The ability of banks to choose between federal and state regulators as their charter provider and primary regulator, and the ability to convert from a state or federal charter, incents agencies to continually reexamine their regulatory practices and procedures to enhance their ability to attract and retain bank charters. The result has been a steady stream of innovations that likely would not have proceeded as rapidly or as effectively if the U.S. regulatory structure were governed by one monolithic regulator. In addition to fostering innovation, the dual banking system protects against overly rigid federal regulation and supervision by allowing banks to choose from among more than one federal regulator.

Industry Regulators

Four primary regulating bodies oversee the activities of state and national banks and thrifts: the Federal Reserve Board (the "Fed"), the Office of the Comptroller of Currency (the "OCC"), the Federal Deposit Insurance Corporation ("the FDIC") and the Office of Thrift Supervision (the "OTS"). State banking departments or commissioners also regulate and supervise state chartered banks. Credit unions are separately regulated by the National Credit Union Administration (the "NCUA").

Office of the Comptroller of the Currency

Established by Congress in 1863 as a bureau of the Department of Treasury, the OCC is the oldest federal regulator and serves as the federal regulatory body responsible for chartering and supervising all nationally-chartered banks. 12 U.S.C. § 26 (3)(a) (1994). By year-end 1996, the OCC maintained supervisory authority over 2 726 nationally-chartered banks in the U.S. The OCC also supervises and regulates all federally licensed branches and agencies of foreign banks doing business in the U.S. The Comptroller maintains supervisory authority over the day-to-day activities of national banks including loan and investment policies, trust activities and the issuance of securities.

Federal Reserve System

Created in 1913, the Federal Reserve Board is an independent federal agency. The Federal Reserve Act created a system of federal reserve banks, each acting as central bank for its geographic region and overseen by the Board of Governors of the Federal Reserve System. 12 U.S.C. §§ et seq. (1994). The Fed is primarily responsible for implementing monetary policy and credit policy. 12 U.S.C. §225a. The Fed also prescribes reserve levels, lends money to its reserve members and influences bank reserves and interest rates through the supply of bank liquidity and setting the discount rate for loans to banks in the Federal Reserve System. Member banks include all national banks in the continental U.S. and those state-chartered banks that have applied and received membership. The Federal Reserve System consists of the Federal Reserve Board ("Fed") and staff, twelve Federal Reserve Banks,¹ the Federal Open Market Committee (FOMC), the Federal Advisory Council (FAC) and the commercial banks that are members of the Federal Reserve. Only the Fed, the twelve Reserve Banks and the FOMC have policy making responsibility. 12 U.S.C. §§ 248, 1844 (1994).

The Fed maintains primary supervisory authority over Bank Holding Companies (BHCs) under the Bank Holding Company Act. 12 U.S.C. §§ 248, 1844. Fed approval is needed (i) to become a bank holding company, (ii) to become a subsidiary of a bank holding company, (iii) to acquire more than five percent of the stock in a bank; (iv) to acquire the assets of a bank, or (v) to merge with another bank holding company. By year-end 1996, the number of BHCs in the U.S. totaled 5 998. These organizations controlled 7 213 insured commercial banks and held roughly 93 percent of the assets of all insured commercial banks in the U.S.

The Fed also maintains broad authority to supervise and regulate the U.S. activities of foreign banks that engage in banking activities in the U.S. through branches. The Foreign Bank Supervision Enhancement Act of 1991 requires Fed approval for the establishment of branches, agencies, commercial lending company subsidiaries and representative offices by foreign banks in the U.S. As of year-end 1996, 281 foreign banks from 60 countries operated 432 state-licensed branches and agencies (of which 25 are insured by the FDIC) as well as 66 branches and agencies (of which 6 have FDIC insurance) licensed by the OCC. In 1996, the Federal Reserve approved applications by 19 foreign banks from 12 foreign countries.

Federal Deposit Insurance Corporation

Established in 1933, the Federal Deposit Insurance Corporation ("FDIC") provides primary supervision for state-chartered and national banks that are not members of the Federal Reserve System. 12 U.S.C. § 1813(q)(3) (1994). The FDIC holds a unique position among the federal banking regulatory agencies as the administrator of federal deposit insurance funds for both banks and thrifts. Banks belonging to the Fed automatically receive insurance coverage for their depositors. FDIC coverage for all other institutions is voluntary. As a regulator the FDIC is the primary federal supervisor of 6 414 insured

state non-member banks and state savings banks and the back-up federal supervisor for all other insured depository institutions.

Under the Federal Deposit Insurance Act (FDIA), state chartered member banks as well as national banks are required to obtain deposit insurance from the FDIC, but federal deposit insurance is optional under the FDIA for state chartered non-member banks. The primary statutory mandate has been to provide deposit insurance to all banks qualifying for insurance coverage. The FDIC currently insures bank accounts of the same depositor up to a \$100 000 limit.

Office of Thrift Supervision

The Office of Thrift Supervision ("OTS") was established as a bureau of the Department of Treasury in August 1989 by the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA). OTS is headed by a Director who is appointed by the President for a five-year term. The Director also serves on the board of the FDIC. Over 90 percent of all thrifts have assets of under \$500 million and nearly all of these are locally owned and managed. Federal thrifts may branch interstate, free from state law restrictions. Thrifts play an important role as mortgage and community lenders. Single-family mortgage loans remain the primary type of loan held by thrifts, representing 50 percent of industry assets as of December 31, 1996.

National Credit Union Administration

Credit unions are nonprofit, cooperative financial institutions owned and run by members. Established in 1970, the National Credit Union Administration (NCUA) assumed the functions of chartering, supervising and examining federal credit unions and state-chartered credit unions that are federally insured. Credit union deposits are insured for up to \$100 000 by the National Credit Union Share Insurance Fund. Federally chartered credit unions must take deposit insurance through the NCUA; state chartered credit unions may choose federal or state deposit insurance coverage or none at all. All credit union members regardless of charter have access to emergency credit.

State Regulatory Authorities

State-chartered banks are primarily regulated by each state's department of banking. In order to compete with national banks for deposit funds, virtually all state-chartered banks also are insured by the FDIC. Some state-chartered banks are members of the Federal Reserve System and, therefore, also are regulated by the Fed.

Sector-Specific Regulation in the United States

All commercial banks in the U.S. are subject to supervision and regular examinations. Reserve requirements are strictly enforced as are capital adequacy requirements. Bank regulators have influenced the branching activities, merger activity and product offerings of most banks. Limitations continue to apply to lending limits, and some restrictions remain on investments and deposits.

Reserve Requirements

Requirements that depository institutions maintain a fraction of their deposits in reserve in specified assets is regulated under the Monetary Control Act of 1980. This act requires all institutions, regardless of membership in the Federal Reserve System, including commercial banks, savings banks, savings and loans, credit unions and U.S. branches of foreign banks to maintain a specified level of

reserves. Reserve requirements are set by the Fed under the Depository Institutions Deregulation and Monetary Control Act (DIDMCA). Required reserves are expressed as a fraction of deposits called the reserve ratio which is set by the Board of Governors. The DIDMCA phased in a new "standardized" reserve requirement of 12 percent for "transaction" deposits (including NOW accounts), and three percent for non-personal time deposits, subject to substantial emergency increase authority. In 1990, the Fed reduced reserve requirements from three percent to zero on nonpersonal time deposits and from 12 percent to 10 percent on transaction deposits.

Capital Adequacy

Another major regulatory development occurred in 1985 when regulators agreed on a formal adoption of uniform capital adequacy requirements. Since 1985 the capital rules have continued to be refined to reflect a more precise measurement of risk and allocation of appropriate levels of capital. In 1989 the federal banking agencies adopted substantially all of the provisions of the BASLE Capital Accord, including the 8 percent minimum capital adequacy standards.² Capital adequacy is viewed in terms of continuing financial soundness, and is expressed as a ratio or percentage of total assets (or liabilities). In September 1996, U.S. federal regulators issued final rules to incorporate market risk into bank capital standards. Banks deemed to have inadequate controls for these risks may be required to hold capital above the minimum requirements. The Fed, OCC, FDIC and OTS jointly issued a final rule implementing market risk capital standards effective January 1, 1998.³ The joint rule applies to "any bank or bank holding company whose trading activity equals 10 percent or more of its total assets, or whose trading activity equals \$1 billion or more." The agencies estimate that the rule will affect approximately 15 of the largest U.S. institutions. The joint rule requires the measurement and application of capital charges to market risk, and is independent from and in addition to the risk-based capital components required in the original BASLE Accord. Specifically, an institution must adjust its risk-based capital ratio to take into account the general market risk of all positions located in its trading account and of foreign exchange and commodity positions.

Interbank Arrangements Outside Formal Statutory Regime

Private interbank agreements serve as a disciplining alternative to federal regulations. Viewed by some as an alternative to bank regulation, these arrangements have in many ways succeeded in imposing private, non-governmental discipline between banks.

Automated Teller Machine ("ATM") And Point of Sale Transactions

ATM networks involve cooperative arrangements among banks that are typically private in nature and free from regulatory restraints. An ATM network functions as a privately arranged switch for bank transactions. The network connects one bank's ATM to another bank's debit cardholder account records, so that depositors can access cash, or make deposits, balance inquiries, or transfers at ATMs not owned by the bank that holds their deposits. Accordingly, ATM networks exponentially increase depositors' access to their accounts.

ATM networks can be national or regional. Regional networks principally connect member banks' ATMs in more or less discrete geographical areas. The boundaries of the regional networks often overlap. Many networks freely allow all of their member banks to belong to multiple networks. The two national networks, Plus and Cirrus, allow debit cardholders to access their accounts across the country and even in other countries. Member banks connect to the national networks directly, or via their regional networks. National network transactions tend to be more expensive than regional ones. Moreover, the

national networks typically function as "networks of last resort," so that transactions only pass over them in the absence of an available regional network route.

The regulation of electronic fund transfers largely has been confined to private contract and informal intra-network discipline, although the federal government has attempted to protect consumer interests pursuant to the Electronic Funds Transfer Act ("EFTA") of 1978 enacted as a subsection of the Consumer Protection Act. Specifically, the EFTA extended to consumers engaged in EFTs certain privileges including limited consumer liability, documentation standards, partial stop-payment privileges, and special error-resolution privileges.

Credit Card Transactions

Banks have formed two joint ventures, Visa and MasterCard, to operate settlement and clearing functions and to otherwise facilitate the operation of nationwide bank credit card networks. They are organized as membership corporations and are generally open to FDIC-insured financial institutions. Most banks belong to both systems.

Initially limited to U.S. banks, both systems now operate world wide. The systems are supported by fees paid by the member banks that issue cards and sign merchants to accept cards. The rules of both systems permit banks to determine the annual fees, interest rates, and loan limits on cards that they issue.

Visa and MasterCard rules and regulations govern interaction among the banks within the system, and cover the procedures for authorization, collection and settlement of payments from credit card transactions. Changes to the rules are periodically considered by Visa and MasterCard.

Consumer protection concerns have launched the most explicit governmental regulation to date of the credit card industry. Federal laws protect consumers from banking excesses and have directly affected the credit card industry. The laws include, for example, the Truth-in-Lending Act of 1970, the Fair Billing Credit Act of 1974, the Truth-in-Lending Simplification Act of 1980, and the Fair Credit and Charge Card Disclosure Act of 1988. Credit cards are also subject to state usury limits.

Recent Regulatory Developments

Liberalization of Branching and Entry

Prior to 1994, national banks and most state banks could not branch across state lines. Under the McFadden Act, national banks and state member banks could establish branches only within their home state and only to the extent that state banks could branch under state law. 12 U.S.C. §36(c) and 321. The McFadden Act, however, did not apply to state banks that were not members of the Federal Reserve System. Those banks could establish interstate branches to the extent permitted by state law. The "Douglas Amendment" enacted as Section 3(d) of the Bank Holding Company Act, prohibited a BHC from acquiring a bank across state lines unless the acquisition was specifically authorized by the banking statutes of the acquired bank's home state. 12 U.S.C. § 1842(d). Despite these restrictions, a majority of states allowed interstate bank holding company acquisitions on a reciprocal basis, and some without reciprocity requirements. As a result, more than 150 interstate BHCs were established by 1994 and gained control of over 90 percent of the banking assets in the United States.

With the enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, (the "Riegle-Neal Act") national banks and all state banks so authorized by their state legislatures are able

to branch nationwide except in states that opted out of interstate branching. As a result, states can no longer impose regional or reciprocal limitations on interstate BHC acquisitions. 12 U.S.C. §§ et. seq. 184. All states became open to interstate branching unless they enacted statutes "opting out" of interstate branching by June 1, 1997. The Riegle-Neal Act also established aggregate deposit concentration limits of 10 percent on a nationwide basis and 30 percent on a statewide basis for both interstate acquisitions of banks by bank holding companies and interstate bank mergers. This law has opened the door for further consolidation for U.S. banking and depository institutions.

Riegle-Neal, by increasing competitive rivalry, will generally improve the quality and availability of all types of financial services. Interstate banking and branching will lead to more competitive markets in which depository institutions will have to operate efficiently or exit the market. Market concentration will be less of a problem because greater geographic mobility and the potential for entry will constrain anticompetitive behavior.

Expansion of Securities and Insurance Related Activities of Banks

Historically, federal law limited the powers of national banks to those functions "closely related to deposit taking and lending." These limitations were designed to prevent the risks associated with nonbank activities from undermining the safety and security of the deposit and payment systems. Sections 16, 20, 21 and 32 of the Banking Act of 1933, more commonly known as the Glass-Steagall Act, prevented banks from underwriting, selling or distributing securities, and at the same time prohibited securities firms and brokerage organizations from receiving deposits like commercial banks.⁴ 12 U.S.C.A. §§ 24, 78, 377, 378(a), 335 and 221.

The Bank Holding Company Act prohibits a BHC from acquiring direct or indirect control over any voting shares of any company that is not a bank. There are several exceptions to this rule and the BHC structure has been the vehicle by which banks could expand their reach into other financial markets. Under section 4(c)(8) of the Act, the Fed may approve a BHC's acquisition or control of a nonbanking company. Under this structure, a BHC can control the stock of one or more commercial banks as well as the stock of other non-banking entities that engage in businesses "closely related to banking." BHCs use section 4(c)(8) to engage in securities-related activities through their nonbank, "Section 20" subsidiaries.⁵ This corporate structure offers banks indirect access to broader financial markets while shielding the banks' exposure to the liabilities of non-bank Section 20 affiliates thereby protecting depositors and the insurance fund from the increased risks these activities entail. If a BHC affiliate fails, the consequences fall to the BHC and not to its banking affiliates. As a result, BHC affiliates engage in a variety of financially related activities such as securities trading, mortgage banking, a limited range of insurance underwriting, personal property and real estate leasing and some management consulting. In a series of regulatory decisions by the Federal Reserve Board and the OCC, some of the largest money center banks in the United States now are allowed to underwrite commercial paper, securitized mortgage backed instruments, and even many corporate bonds and stocks, along with lending to support private placements of securities.

In October 1996, the Fed issued final regulations that rescinded its Regulation R, which implemented Section 32 of Glass-Steagall act, and removed various restrictions on the activities between a firm engaged in securities underwriting and dealing covered under Section 20 of the Glass Steagall Act and an affiliated state member bank. Prior to its rescission, Regulation R prohibited officer, director and employee interlocks between member banks and firms "primarily engaged" in underwriting and dealing in securities. In 1996, the Federal Reserve raised the limit on bank securities activities to 25 percent of

revenue in their securities affiliates from 10 percent previously allowed. Only 23 U.S. banks and 15 foreign Bank Holding Companies were using Section 20 affiliates as of mid-1996.

In November 1996, the OCC similarly revised its regulations concerning procedures and criteria with respect to the operating subsidiaries of national banks. The OCC adopted a revised Part 5 regulation enabling national banks to use their own subsidiaries to underwrite and deal in securities. The new "Operating Subsidiary Rule" provides that a national bank may establish or acquire an operating subsidiary to conduct, or may conduct in an existing operating subsidiary, activities that are part of or incidental to the business of banking as determined by the Comptroller of the Currency, pursuant to 12 U.S.C. § 24, and other activities permissible for national banks or their subsidiaries under other statutory authority.⁶ Prior to this ruling, the only national bank affiliate permitted to engage in such activity was a non-bank affiliate of a BHC. An eligible national bank may obtain expedited approval from the OCC with respect to the establishment or acquisition of an operating subsidiary that will engage in such activities as securities brokerage, investment advice, leasing of personal property, underwriting and dealing in securities permissible for national banks. Most of this new underwriting had to be carried on in affiliates where the new activities were not a large part of their business.⁷

One of the benefits expected from these revisions is enhanced operating efficiencies. The revisions allow national banks to choose the form of organization that they find most profitable. Many banks expect to reduce their operating costs significantly by switching from the holding company structure to an operating subsidiary structure. The costs of organizing and maintaining several different corporate structures have been prohibitively high for many small banks that want to enter such bank related business as underwriting municipal bonds and other services. Specific activities are allowed in some form for nonbank subsidiaries of a BHC but are not permitted within the bank itself. Allowing operating subsidiaries to perform such activities may decrease transaction costs for large banks and increase the profitability of product offerings of small banks.

Weighed against an environment of increased efficiency and profitability are the risks associated with allowing banks to enter into higher risk businesses. A main tenet of bank regulation is limitation of risk that could result in bank failure, which could trigger systemic financial collapse among many other banks through deposit and payments systems. To reinforce confidence in bank safety and security, the government insures deposits. As a result, creditors have little incentive to monitor bank activity regularly, banks may take unduly risky actions that endanger the deposit insurance fund. By allowing operating subsidiaries of a bank to engage in broader activities, regulators place the insurance fund at greater risk than they would by not allowing these activities within the BHC structure.

Non-bank competitors have expressed concern that allowing the expansion of bank activities through operating subsidiaries creates an unfair competitive advantage for banks. This is because banks' liabilities are insured and banks are thereby able to attract funds at a lower cost and charge less for their services. Others counter that any purported FDIC subsidy is likely to be offset by the increased costs of FDIC regulation.

Mergers and Other Competition Policy Issues in Banking

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During the last fifteen years the number of banks in the U.S. declined steadily and significantly from 14 478 in 1983 to 9,663 in 1996. Surprisingly, over this fourteen year period, entry of 2 691 newly chartered banks more than made up for the 1 453 banks that failed and exited.⁹ The net decline, therefore, is the result of a wave of merger activity among U.S. banks which has had no parallel since the Great Depression. The number of bank mergers is only part of the story; equally significant is the fact that a number of individual mergers during the 1990s ranked among the largest U.S. bank mergers ever, in terms of the real value of the assets involved, and in terms of the share of total U.S. bank assets accounted for by the merging banks (Rhoades 96a, 97; Nolle 95).

Among the reasons for the consolidation of banking activity in the U.S. are the relaxation of restrictions on the geographic area that a bank can operate in, and elimination of other regulations that may have served to shelter relatively inefficient banks from competition (Rhoades 96b, 97; Berger, Kashyap, and Scalise 95). An additional factor is the adoption of new information processing technologies, which has increased the efficient scale of operation in some bank activities. Some of these same forces are at work in European and other countries, and a review of bank merger enforcement policy in the U.S. may therefore be useful in assessing the role of competition policy in banking markets worldwide.¹⁰

Authority in the U.S. to approve or disprove mergers rests with bank regulatory agencies. These include the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the Federal Reserve Board. The question of which agency has authority over a given proposed merger is determined on the basis of the type of institution that would result from the merger. The Federal Reserve Board or the OCC are the two agencies most often involved. Bank regulatory agencies are charged by U.S. banking laws with considering the possible competitive effects of proposed mergers, and cannot allow mergers that threaten competition unless "the anticompetitive effects are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served." (12 U.S.C. 1828(c)(5)(B)). The Antitrust Division of the Department of Justice reviews proposed mergers and reports its analysis of likely competitive effects to the regulatory agency. The Department can file a suit under U.S. antitrust laws to block a bank merger, even if that merger has been approved by a bank regulatory agency.

Framework for Analyzing Bank Mergers

In reviewing proposed bank mergers that could affect consumers in the U.S., the Department of Justice applies the methodology of the Horizontal Merger Guidelines (U.S. Department of Justice and Federal Trade Commission, 1992) to analyze the likely effect of the merger on competition to supply each product sold by each merging firm in each geographic area in which the product is sold. The goal of the analysis is to assess whether the merger could create or facilitate the exercise of market power, where market power is defined as the ability of firms to increase price or reduce quality from competitive levels. A merger could have anticompetitive effects by making it profitable for a leading firm to exercise market

power unilaterally, or by increasing the likelihood that firms in a market could successfully agree upon and maintain a collusive outcome.

To evaluate the effect of a merger, it is essential to analyze the merger's impact on the range of services provided by banks. Bank services include deposit, loan, and investment services sold to retail consumers; deposit, loan, and various other services sold to businesses, and also correspondent services -- specialized services supplied by a relatively limited number of banks to other banks, often for resale to the ultimate purchaser. Trade finance, custody, check clearing services, and foreign exchange services are examples of correspondent services. Banks in the U.S. face some restrictions in their ability to offer underwriting services, insurance, and some investment products. There are fewer limitations on the ability of banks to offer these products in most other OECD countries.

In general, the analysis of the likely effects of a merger on competition should take into account a number of economic factors. One factor is the possibility that prospective purchasers of a product would choose to substitute to alternative products in response to a small but significant increase in the relative price of the product. If such substitution would not occur in an amount sufficient to make the price increase unprofitable then, in the language of the Merger Guidelines, the product constitutes a relevant product market. A second factor is the possibility that prospective purchasers could turn to alternative sources of supply, including firms that currently produce and sell the product in other geographic areas. If such substitution away from firms located in a given area would not be significant, then the area constitutes the geographic market. The possibility of significant new competition from entry by firms that don't currently produce or sell the product is a third factor.

The structure of competition in the relevant product and geographic markets, including the number and relative effectiveness of current market competitors, helps to determine whether a merger would likely be anticompetitive. Other characteristics of competition in the market also affect the likelihood of anticompetitive effects. For example, if there is significant product differentiation, and if products sold by the merging firms are perceived by purchasers to be relatively good substitutes, then there is a greater possibility of unilateral competitive effects. If firms have good information about the competitive actions of their rivals, and if competitive strategies can be revised quickly, then coordinated competitive effects are more likely. Finally, a proposed merger may hold the promise of real efficiencies that could not reasonably be achieved through other means, and these efficiencies could serve to lessen concerns about the net effects of the merger on competition.

The analytical framework described above could result in different policy recommendations for bank mergers in different countries, because of significant differences in the structure of competition, the preferences of purchasers of bank products (and the set of alternatives they face), and the institutional context. In the U.S., concerns about competitive effects of proposed bank mergers most often center on markets for certain products provided to small and medium sized businesses. Effects on competition in markets for consumer, or retail bank products have less frequently been an issue. A more detailed discussion of common features of the analysis of these markets in the U.S. helps to illustrate the methodology.

Small Business Loans

The most frequent focus of antitrust concerns relating to bank mergers in the U.S. are lines of credit extended to small businesses for business startup and working capital purposes. "Small" businesses, which have annual revenues in the range of one to ten million dollars, typically obtain a variety of credit products, including mortgages on commercial property, and loans to purchase or lease vehicles, equipment, and other capital goods. In many cases, businesses that have a need for a line of credit for

startup or working capital are likely to have a limited ability to substitute to such alternatives. In other cases in which the need for financing derives from a capital expenditure for which alternative forms of credit are available, owners of small businesses may prefer the convenience of drawing on their line of credit to the alternative of applying for and making payments on a loan on a case-by-case basis.¹¹

It is not uncommon for small businesses in the U.S. in need of financing to rely to a significant extent on personal credit, such as general purpose consumer credit cards or a second mortgage on a personal residence. Many small businesses that currently obtain a business line of credit from a bank may view these alternatives as inferior, however, because they are relatively high cost, and they put personal assets at risk. The question for antitrust analysis is whether, as a result of a merger, banks are likely to find it profitable to raise prices. The answer to this question depends on the willingness of businesses that would obtain a line of credit from a bank at prevailing prices to substitute to alternatives such as personal credit in response to an anticompetitive price increase. The fact that some businesses use these alternatives at prevailing prices demonstrates the feasibility of substitution, but does not establish that such substitution would occur in an amount sufficient to make an anticompetitive price increase unprofitable; the analysis must attempt to quantify the likely magnitude of such substitution.

The next step in the analysis of the likely effects of a proposed merger on competition to supply small business lines of credit is the determination of which banks and which bank locations are able to compete effectively to supply the product. Small businesses in the U.S. generally obtain lines of credit and some other key bank products from nearby suppliers (Kwast, Starr- McCluer, and Wolken 97). In part, this is due to the advantages of dealing with a single supplier, coupled with a strong preference that some services used on an almost daily basis, such as transaction services¹² and demand deposit accounts, be quickly accessible.

A second factor that accounts for the relative success of local banks in providing lines of credit is that their knowledge of local business conditions tends to make them better informed about the risks associated with a young firm or new business startup, and their proximity to local businesses tends to lower costs of monitoring performance and updating information about credit risk. Local banks are therefore likely to be able to identify small businesses that are better credit risks and compete successfully for their business by offering relatively favorable terms. It is true that some banks and other providers of credit to small businesses are sometimes located a great distance away.¹³ In the case of vehicle or equipment loans that are secured by the capital good being financed, the riskiness of the loan is reduced and the informational advantage of local banks is eroded. In the case of lines of credit, distant suppliers lacking a branch network or significant presence in a local market are likely to regard all but the most well-established small businesses as relatively high risks. Distant suppliers may compete successfully to make loans that the better informed, local lenders also identify as high risk, but they may not be competitive in the case of borrowers that local lenders identify as relatively good risks. It is competition to supply services to these relatively low risk borrowers that is at issue from a merger of banks in a given geographic area.¹⁴

The Merger Guidelines proposes the Herfindahl-Hirschman Index as an index of market structure. This index takes into account both the number of competitors in the market and their relative market shares. In general, an informative measure of market share predicts how effective a firm is in competing to make sales. A common measure of market share used to analyze the effect of bank mergers in markets for lines of credit to small businesses in the U.S. is a bank's share of deposits in the geographic market. A significant advantage of this measure is that disaggregated data on deposits are readily available, and commercial bank deposits are often a fair proxy for loan activity. Alternatively, deposits can be considered to measure a bank's capacity to make loans. To the extent that the riskiness of small business loans can be assessed and portfolios of such loans can be securitized, the activity of loan

origination can be separated from funding the loan, and deposits are a less meaningful measure. Given the ability to transfer loanable funds within a banking organization, the question of how to treat a bank's out-of-market deposits is also important. Studies in the U.S. have tended to support the view that out-of-market capacity does not make a bank a significantly more vigorous competitor (Wolken and Rose 91, Pilloff 97).

Entry in local banking markets in the U.S. appears to be driven largely by factors such as the growth of economic activity in the area and the current density of banks and branches, rather than by the measured profitability of incumbent banks (Amel and Liang 97). It seems unlikely that an entry decision by a bank would turn on increased profit opportunities in a relatively small activity such as small business lines of credit. In addition, new entrants may require several years to establish themselves as effective competitors to make small business loans, because of the importance of private information and long-standing business relationships in this activity. The possibility of exogenous entry is an important factor to consider, but it may not be possible to count on quick and effective entry to counter the effects of an otherwise anticompetitive merger.

Claimed efficiencies from a bank merger usually include substantial savings due to branch closings (which could, however, bring with it the risk of harm to competition). Additional efficiencies might include consolidation of some "back-room" activities. The important question for merger analysis is the extent to which these savings could also be achieved through out-of-market mergers, or by relying for some functions on third-party processors, who could potentially achieve economies by pooling the activity of a number of banks.¹⁵ If so, they would not be counted as merger-specific efficiencies in the merger analysis.

The hypothesis that the pricing of small business loans is determined by competition among banks in local geographic markets in the U.S. has been tested empirically. Although the available data are imperfect and significant methodological questions can be raised about the different approaches of various studies, measured profitability and pricing appear to be correlated with measures of market structure comparable to those described above (Hannan 91, 97).¹⁶

Middle Market Loans

The analysis of competition in markets for lines of credit to medium-sized businesses in the U.S. is distinct from the analysis of small business lines of credit and sometimes leads to a different conclusion. Medium-sized businesses with annual sales in the range of ten million to 100 or 250 million dollars often have yet to compile a history of performance that would allow them to access national capital markets on favorable terms, so they remain dependent on bank financing. Some small community banks that compete effectively to extend credit to small businesses lack the ability to serve the credit needs of middle-market customers, because of concerns about exposure to a single creditor. Even though banks drawn from a broader geographic area compete effectively to make loans to middle market businesses, the fact that small banks are not participants in the market can sometimes imply that the structure of the market is relatively concentrated.¹⁷

Consumer Bank Products

In the case of some important consumer bank products in the U.S. such as home mortgages, car loans, and credit card loans and transactions services, distant banks and specialized non-banks have demonstrated their effectiveness as competitors. The analysis of consumer home mortgages and car loans bears some similarity to the analysis of asset-backed loans made to businesses: the fact that the collateral is relatively easy to evaluate explains the success of non-local suppliers. Credit cards are marketed on a

national basis by direct mail and telephone. Credit card issuers rely on credit histories assembled by third-parties and on credit-scoring software that predicts credit risk. Credit-scoring algorithms have so far proven to be more useful in this application than in the case of small business lines of credit.

Surveys of consumers reveal a preference to obtain checking account services from a conveniently located supplier (Kwast, Starr-McCluer, and Wolken, 97). Because many consumers who commute a significant distance to work consider a bank location near their workplace to be a good substitute for a bank location near home, the geographic market for consumer checking accounts is relatively large. Also, in contrast to the analysis of small business bank products, other federally insured depository institutions such as thrifts (savings and loan institutions) and credit unions are active suppliers of consumer bank products. As a result, antitrust concerns relating to consumer bank products in the U.S. are relatively less common, although the Federal Reserve has sought divestitures before approving some bank mergers based in part on concerns about consumer bank products.¹⁸

The advent and spread of ATMs, electronic funds transfer, and the development of home banking via computer or telephone raises the possibility that local banks with branch networks will lose their competitive advantage, and that geographic markets for consumer bank products will become much larger. During the same period that has seen a significant reduction in the number of banks and a huge increase in the number of ATMs, the number of bank branches in the U.S. has actually increased, however (Rhoades 96b). In addition, survey evidence indicates that consumers are not yet ready to embrace home banking alternatives.¹⁹

Cluster Market Approach

The methodology described above considers separately the effects of a bank merger on competition to supply each bank product. An alternative approach is recommended in a series of U.S. Supreme Court opinions from the 1960s and early 1970s, which stated that the relevant product for analyzing bank mergers consists of the cluster of products and services that constitutes "commercial banking."²⁰ This cluster includes consumer loans and consumer banking services as well as business loans and products. In the U.S., the cluster market approach guides the decisions of the Federal Reserve and the OCC.

Some have argued that the cluster approach is not appropriate because banks are not constrained to raise the prices of all services they offer uniformly. Banks would not be deterred from raising the price of one product, such as a small business line of credit, by the possibility that prospective loan customers would substitute to other products in the cluster, such as a checking account. Nor would an increase in the price of the loan be defeated by competition banks face to supply other products in the cluster.

On the other hand, others believe that the cluster market approach gives the right answer, especially if there were strong economies of scope in production, so that all firms supplied all products in the cluster in the same proportion, and if there were strong complementarities in demand, so that all consumers consumed all products in the cluster in the same proportion. For example, in analyzing a merger of firms that produce shoes, it probably would not matter much to the conclusion if the analysis was done in terms of right shoes, or left shoes, or pairs of shoes.

In the case of the "commercial banking cluster", some firms in fact compete very effectively in supplying some, but not all, products in the cluster. In addition, although consumers and businesses do tend to purchase multiple services from their primary financial institution (Kwast, Starr-McCluer, and Wolken 97), they do unbundle purchases today, and would likely unbundle to a greater extent if their

current bank increased prices of some products in the cluster. The cluster market approach appears to understate competition in the market by ignoring the role of specialized providers of some services.

The cluster market approach may overstate competition in the market by wrongly inferring from the existence of abundant competition to supply one product in the cluster that competition in other product markets is sufficient. For example, the Federal Reserve defines geographic markets in the U.S. for the cluster based in part on commuting patterns. This is sensible in the case of consumer banking products, for which consumers consider services from banks located near their home or near their work to be good substitutes. But the resulting geographic markets are sometimes far larger than is appropriate to analyze competition for many small business bank products, for which proximity of the bank to the place of business is key. In cases in which the structure of competition is not homogeneous throughout the broad geographic market, the cluster market approach may miss adverse effects of the merger on local competition.^{21,22}

Tying and Bundling of Bank Products

Banks in the U.S. have been restricted from tying products or offering discounts on some products conditional on the purchase of other products when the tying product that is discounted is a "traditional" bank product. These include loans, discounts, deposits, and trust services. Banks are presumed to have an advantage in offering these traditional products, and the concern is that banks could exploit this advantage to disadvantage competitors in the sale of other products, such as brokerage accounts or investment services.

Restraints imposed by a firm on the sale of complementary products are often procompetitive, and the conditions under which it would be appropriate for a competition agency to prohibit tying or bundling of bank products are somewhat restrictive. One useful economic model recognizes the possibility that the tie may foreclose sales opportunities to competitors in the market for the tied product, and harm competition by denying competitors the opportunity to achieve economies of scale (Whinston 90). In order for this model to be applied to banking, it is necessary to conclude that *an individual* bank has market power in the sale of some traditional bank product, and that the cost structure for the tied product is characterized by significant economies of scale over a wide range of output.²³

Line of Business Restrictions

Banks in the U.S. are restricted in their ability to compete to sell securities, insurance, and real estate; some other countries apply similar restrictions. One rationale for restricting the activities of banks is that it facilitates the task of regulators in auditing banks. A second rationale is that restricting banks from diversifying into areas outside of their expertise eliminates the possibility that a bank would be tempted to take greater risks in its banking activities to offset losses in its non-banking activities. In principle, there is a trade-off between the public policy objective of ensuring the safety and soundness of banks, and the desire to promote competition in other activities. This calculus is more difficult if, absent the participation of banks, competition in these other activities is limited, or if banks could exploit significant economies of scope and be relatively efficient competitors in these other activities.

NOTES

- 1 Reserve banks are quasi-governmental corporate entities comprised of stockholder member banks.
- 2 The OCC requires at least \$1 million of initial capital for a national charter. The Fed requires the same for membership. The FDIC also now requires \$1 million of capital for a new insured bank or savings institution.
- 3 Risk-Based Capital Standards: Market Risk, 61 Fed. Reg. 47,358 (1996) (to be codified at 12 C.F.R. 3, 208, 225 and 325).
- 4 Section 16 applies only to national banks and state Federal Reserve member banks and established three limitations on commercial bank securities activities: (1) the purchase and sale of certain equity securities is limited to transactions for bank customers; (2) the purchase and sale of debt securities is limited to "investment securities," the definition of which has been specifically limited through regulations issued by the Comptroller of the Currency and (3) commercial banks may only underwrite and deal in U.S. Treasury and governmental agency debt obligations, and general debt obligations of state and local governments.

Section 20 applies to national banks, state Federal Reserve member banks, and their corporate affiliates -- a national bank subsidiary, a holding company parent of the bank, and a non-bank subsidiary of the holding company -- and bars such entities from "affiliating" with organizations "engaged Principally" in the investment banking business.

Section 21 prohibits any persons engaged in the business of issuing, underwriting, selling, or distributing securities from engaging at the same time in deposit-taking "to any extent whatever." This section recognizes the same three exceptions to the broad prohibition against commercial bank involvement in securities activities noted in the discussion of section 16, and in fact extends these restrictions to state banks that are not members of the Federal reserve System.

Section 32 prohibits interlocking management between national banks and other Federal Reserve System member banks, and firms "primarily engaged" in the securities business. This section is intended to eliminate the potential for conflicts of interest that could adversely affect both depositors and the public investors.
- 5 Section 20 prohibits a bank from establishing or acquiring a non-bank subsidiary if they are engaged principally in any of the activities listed in this section.
- 6 The Comptroller has outlined several safeguards for operating subsidiaries to ensure that their activities will not have adverse effects on national banks. In order to prevent conflicts of interest, the regulation applies sections 23A and 23B of the Federal Reserve Act to banks' relations with their subsidiaries. These Sections impose lending limits and require arm's-length dealings between banks and their nonbank affiliates. In addition, to eliminate confusion between a bank and its subsidiary, the Comptroller requires a separate facility and name and clear disclaimers identifying which activities are and which are not insured by the FDIC. Both the subsidiary and the bank establishing the subsidiary are required to be adequately capitalized. In

addition, the bank's investment in the subsidiary is limited to ten percent of the bank's capital and this investment does not count toward the bank's capital requirements.

7 National banks are still prohibited from engaging in general underwriting of securities other than their own.

8 Mr. Rubinfeld is Deputy Assistant Attorney General (Economic Analysis) and Mr. Rozanski is Chief of the Economic Regulatory Section at the Department of Justice's Antitrust Division. The authors would like to thank Robert Adams, Joseph Burns, J. Robert Kramer, Constance Robinson, Stephen Rhoades, and Sally Van Siclen for helpful comments, and Naomi Feldman and Ann Plamondon for their assistance.

9 NIC Data base, Board of Governors of the Federal Reserve System

10 Description and some discussion of changes in regulations and other forces relevant to the competitive analysis of banking markets in Europe can be found in Gual and Neven (92), and Dermine (93).

11 The practices and preferences of U.S. small businesses in obtaining credit are reported in Cole and Wolken (95), and Cole, Wolken, and Woodburn (96). Based on a 1988 survey of small businesses, the median size line of credit loan was eighty thousand dollars; the mean was 260 thousand dollars (Denis, Dunkelberg, and Van Hulle 88).

12 Transaction services include the provision of currency and coin, acquisition of credit card receipts, night deposits, and electronic funds transfers.

13 Wells Fargo & Co., a California bank, initiated a strategy in 1995 of marketing lines of credit to small businesses nationwide using direct mail. Some other banks have imitated this strategy (Oppenheim 96, 97). More recently, Wells Fargo has solicited applications through its web page.

14 In the case of a market such as that for small business lines of credit in which suppliers are significantly differentiated based on their locations, competitive interactions among firms located along a geographic continuum may imply that the geographic market is much larger than is indicated by the strong preferences of customers for local sources of supply. Each firm is constrained only by the few competitors in its immediate neighborhood, but the effects of competition at one end of the spectrum may be transmitted from local area to local area and may be felt at a great distance. In theory, however, even if there is no break in the geographic "chain of substitutes" the exercise of market power over a limited portion of the spectrum may be profitable because the profits that can be earned by increasing price to inframarginal customers who lack good alternatives more than makes up for the loss of business at the margin (Werden and Rozanski 94). In the case of bank loans, the possibility of price discrimination simplifies the analysis, and may make it possible to define geographic markets that are quite narrow. Price discrimination in the case of small business loans is likely to be a successful strategy: significant arbitrage among borrowers is implausible, and banks can use information obtained in the loan application process to develop good information about the willingness of customers to substitute toward other suppliers. Banks can meet competition at the margin by lowering prices selectively to some customers.

- 15 Studies based on U.S. data have generally found that economies of scale in traditional banking activities are exhausted at relatively modest scale. Berger, Hunter, and Timme (93) review this literature. Geroski and Szymanski (93) similarly conclude that there is little evidence of significant economies of scale in banking in the U.K., France, and other European countries.
- 16 In cases in which the Department of Justice believes that a proposed bank merger is likely to significantly lessen competition in markets for small business loans in a particular geographic area, the Department's concerns are usually sufficiently addressed by divestiture of a package of bank offices, branches, assets, and deposits in the area. A typical divestiture package includes specifically identified branches, including all assets and deposits of those branches, small business loans associated with those branches, and deposits of those loan customers. The Department usually prefers that a significant part of the total divestiture package go to a single purchaser. The intent is to create a new competitor, or to enhance the effectiveness of an existing competitor, by transferring a network of well-situated, profitable branches that will provide a network for gathering deposits and making loans, as well as a solid base of commercial loan relationships.
- 17 Tannenwald's (94) study of markets for middle-market loans in the Northeastern U.S. is supportive of this analysis, although the heavy reliance of the study on the pattern of existing relationships between banks and firms does not capture the important prospective nature of merger analysis.
- 18 Studies of the correlation between deposit interest rates and the structure of competition in local markets in the U.S. are consistent with the view that markets for some consumer products, such as checking and savings accounts, are local. See for example Berger and Hannan (89) and Hannan and Prager (96).
- 19 Rhoades, 96b. A recent survey indicates that an increasing number of consumers access their bank using home computers, but this option may simply displace use of the telephone to make account enquiries, and not represent a good substitute for the branch office to meet other banking needs (Kutler 97).
- 20 *U.S. v. Philadelphia National Bank*, 374 U.S. 321 (1963); *U.S. v. Phillipsburg National Bank & Trust Co.*, 399 U.S. 350 (1970)
- 21 Banks may find it relatively easy to extend their operations into nearby geographic areas. This possibility can imply that the structure of competition in a broad geographic area is more homogeneous than a static analysis would suggest.
- 22 The Australian Competition and Consumer Commission rejected the cluster market approach when analyzing the 1997 Westpac/Bank of Melbourne merger. The ACCC concluded that the geographic market for home loans was national, but that geographic markets for demand deposits and small business banking products did not extend beyond state boundaries. The existence of national competitors in the home loan market was correctly understood to be irrelevant to the competitive analysis of other product markets.

With the recent relaxation of limits on trade in banking products in Europe and the inevitable geographic expansion of some banks through merger or direct investment, it may be the case that geographic markets for some banking products will cross national borders, and that

branches or subsidiaries of some foreign banks will be effective competitors in local geographic markets for some banking products. The fact of such competition is not sufficient to conclude that bank mergers will not have substantial anticompetitive effects in local markets for other banking products, however.

- 23 The analysis is further complicated by the observation that, if economies of scale in the tied product are very important, it may be efficient to have fewer competitors.

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Question 4 (interbank arrangements)

Yes, there are many interbank arrangements which require antitrust scrutiny. In the field of payment systems, these range from sector-wide arrangements involving dozens, hundreds or even thousands of banks (e.g. international credit card systems or national debit transfer systems) to forms of cooperation involving a more limited number of banks (e.g. cross border credit transfer systems set up by a “family” of banks, for instance postal banks). Some other interbanking arrangements may aim at the creation of a global cooperative alliance falling short of a genuine merger (e.g. BNP/Dresdner Bank) or at the supply of an innovative product (e.g. Banksys / Belgacom smart card).

Question 8 (exemptions)

Banks are not automatically “exempted” from the applicability of the EU competition rules. The antitrust as well as the state aid rules do in principle apply to them. The Court of Justice has firmly established this point many years ago. That is not to say that the EU Commission cannot take into account certain specificities of the sector when it applies the competition rules to banks. As a matter of fact, these rules leave the Commission with a certain margin of discretion to decide whether or not a particular agreement (or state subsidy) should be stopped. And this holds true for all sectors where there is economic activity and where thus competition rules apply. No treaty provision singles out the banking sector as one that should receive a more lenient competition scrutiny.

Question 9 (competent authorities)

The EU Commission’s competition services are solely responsible to enforce the competition laws in the banking sector. They will, however, keep a close and constant liaison with other Commission services, in particular those in charge of banking regulation and of economic and monetary policy, and - as for any other sector - the Commissioner in charge of competition policy will have important decisions adopted by the full Commission (i.e. the college of 20 Commissioners). The liaison with other Commission services involves regular information and, occasionally, consultation. To this it could be added that formal draft Commission decisions are subject to a consultation procedure involving the national competition authorities and that in some Member States these also have prudential tasks (e.g. Banca d’Italia).

Question 10 (cases)

d) agreements relating to credit debit cards or to wholesale markets?

These arrangements indeed raise antitrust concerns.

Those relating to credit or debit cards raise first of all concerns about certain pricing matters (multilateral interbank fees, no discrimination rule or ban on dual pricing). Other concerns deal with the question of cross-border issuing or acquiring (and the obstacles erected against such cross-border activities).

As to wholesale markets, including the market for government debt, the Commission's competition services do indeed occasionally have to look into allegedly anticompetitive practices. More generally, they are increasingly looking into financial markets, because they receive either notifications of agreements (e.g. among derivatives exchanges) or (usually) informal complaints about allegedly anticompetitive practices occurring on these markets.

e) abuse

Last year the Commission raised formal objections against Swift following a complaint from the French Post that it was not given direct access to Swift, and that the refusal was based on non-objective criteria and, in any event, on criteria which were applied in a discriminatory manner. Swift offered to change the access criteria. It finally subscribed to a detailed undertaking which was published in the EU Official Journal. The handling of the case has now been suspended.

ANNEX**Introduction**

EC State aid regulation is an essential part of competition rules which are relevant for banks. State aid rules, which in fact apply to all economic sectors, find their origin in the Treaty of Rome of 1957. The basic idea behind these rules can be found in the attempt to limit distortions of competition which may arise from Member States' support to their own national companies competing in a unified internal market. Therefore, the Treaty gives the Commission the authority to prohibit or approve State aid, imposing if necessary conditions in order to limit distortions of competition which are caused by the State intervention.

Banks are not excluded from the application of State aid rules, nor is a special treatment reserved for them. Although the Commission acknowledges the peculiarities of the banking sector, it considers that these peculiarities do not justify an exemption from the State aid rules. It follows that many financial transactions such as State rescues of failing banks, State capital injections into State-owned banks, fiscal advantages and other financial advantages granted to credit institutions by public bodies are subject to the Commission's scrutiny under the terms of Articles 92 and 93 and have to be notified *ex ante*.

The application of State aid rules in the financial sector is relatively new. Several factors can explain the increase of the Commission's activity in this specific field. Regulatory changes, such as the freedom to move capital across countries and the adoption of EC directives harmonising the rules governing the exercise of banking activity in Europe (mutual recognition, freedom to establish, home country control), as well as technological improvements and "disintermediation" have increased the competitive pressures on banks and pushed for the restructuring of national systems and in particular of less efficient intermediaries. It is clear that in a market which becomes more and more competitive and where banks' activities are gradually liberalised, banks can no longer count on a steady flow of profits nor on State interventions to support them when they get into difficulty. In this respect, the application of State aid rules to this sector means a radical change with respect to the traditional national public authorities' tendency to discretely solve the problems of their own failing banks.

Although the Treaty rules date from 1957, the Commission has only recently had to address State aid cases in the banking sector. It was at the beginning of the 1990's, with the single market and the mutual recognition of the rights of Member States' banks that cross-border competition became more important. Since then, the Commission has examined a number of cases of possible State aid to banks, mainly banks in difficulty, such as Banesto, Crédit Lyonnais, Comptoir des Entrepreneurs, Crédit Foncier de France, Société Marseillaise de Crédit, CIC-GAN, Banco di Napoli, Westdeutsche Landesbank. In all these cases, the European Commission has played a major role as the authority responsible to ensure that distortion of competition affecting trade resulting from State support was minimised.

In the following, the basic State rules are recalled (§ 2) before some specific problems are addressed (§ 3). It is important to note that we will not discuss the (serious) problem of the consequences for banks when they lend to a company benefiting from illegal State aid (e.g., State guarantees,) which have not been approved by the Commission.

Basic State aid rules

The assessment of State intervention is made through two linked but distinct steps. First the Commission assesses whether the State intervention qualifies as State aid. Then, it verifies whether the aid can be found compatible with the common market.

The first step is carried out on the basis of Article 92.1 of the EC Treaty, which states that:

Save otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

When the State directly, or through State-controlled bodies, intervenes to help private banks State aid is almost certainly involved. State interventions into State-owned banks can be less transparent. In order to assess the aid content of an intervention by the State as a shareholder, the Commission applies the so-called "market-economy investor principle" (MEIP). This principle provides that aid is involved if a private investor operating in a market economy would not have in similar circumstances made the financial support available to the beneficiary of the aid. State aid for rescuing or restructuring firms in difficulty, in particular, tend to distort competition and affect trade between Member States. This is because it affects the allocation of economic resources, providing subsidies to firms which in a normal market situation would disappear or have to carry out thorough restructuring measures. Aid may, therefore, impede or slow down the structural adjustment induced by the increasingly competitive conditions of the single market, which will be intensified upon introduction of the single currency. They would shift the burden of structural change on to other more efficient firms and encourage a bidding war over the size of subsidies. Moreover, aid may also favour certain undertakings in the field of acquisitions or attraction of customers, thereby falling within Article 92(1) and requiring prior notification to the Commission.

Articles 92(2) and (3) of the EC Treaty provide for the possibility of exemption of aid banned in principle by Article 92(1). Apart from cases of aid to make good the damage caused by exceptional occurrences which are exempted by art. 92(2)(b), the only basis for exempting aid for rescuing or restructuring firms in difficulty is art. 92(3)(c). Under this provision, the Commission has the power to authorise "*aid to facilitate the development of certain economic activities... where such aid does not adversely affect trading conditions to an extent contrary to the common interest*".

The compatibility of the aid measures must be assessed in the light of the specific rules on restructuring aid. The Commission considers that aid for restructuring may contribute to the development of economic activities without affecting trade to an extent contrary to the common interest where the following conditions are met:

- (a) a restructuring plan based on realistic assumptions is comprehensively implemented, making it possible to restore within a reasonable timescale the requisite minimum return on capital invested and thus to ensure the long-term viability of the business;
- (b) there exists an adequate *quid pro quo* to offset the distortive effect of the aid on competition and thus to make it possible to conclude that the aid is not contrary to the common interest;

- (c) the aid is proportional to the objectives sought and limited in amount to the strict minimum necessary for the restructuring in order that the recovery effort might be borne as much as possible by the firm itself;
- (d) the restructuring plan and any other obligations provided for in the final Commission decision are carried-out in full;
- (e) a system for monitoring compliance with the preceding conditions is set up.

In order to assess the extent to which the above conditions are met and Article 92(3)(c) is complied with, the Commission takes account of the particular sensitivity of the financial sector to the difficulties of the failing institution.

The Commission can identify all measures it considers appropriate as compensation. Typically, compensatory measures include sale of assets, closure of subsidiaries or branches, growth ceilings, minimum pay-out ratios, etc. The Commission cannot impose privatisation for compensatory reasons, as Article 222 of the Treaty states that the Treaty shall in no way prejudice the rules in Member States governing the system of property ownership. However, privatisation is sometimes necessary to ensure viability, as it provides for greater support and restoration of a sound corporate governance system. Anyhow, it is clear that the Commission considers a Member State's commitment to privatisation as a very important element of its assessment, as it minimises the risk of future State aid to the same undertaking ("*one time last time*" principle) and often improves the bank's corporate governance system.

Some specific issues

Below, we discuss four specific problems we think are of particular interest for the treatment of competition aspects in this sector. All of them deal with the management of bank failures. We will first address the issue of the importance of the type of State aid measures for the calculation of the aid; then, we will examine a problem linked to the qualification of interventions by the Central bank of a Member State; this will lead us to the third issue, that is the problem of State aid procedures and the urgency generally attached to State interventions; eventually, we will touch upon the nature of some "public" interventions such as those of certain deposit guarantee schemes.

Type of aid and assessment of the financial benefit to the failing bank

The management of bank difficulties involves a large set of possible measures that can be adopted to help their solution. One common measure (see for instance Crédit Lyonnais, Comptoir des Entrepreneurs, GAN-CIC, Banco di Napoli) is the break up of the bank into two entities, a good bank and a bad bank, the latter charged with the liquidation of the bad assets of the failing bank. The losses of the bad bank and its debts are normally covered by a State guarantee. Given the uncertainty of the future losses and the need to de-consolidate the bad bank from the good one, the guarantee is often unlimited.

When faced with such a situation, the Commission has first to assess the amount of the aid. Without a calculation of the aid, the Commission is not able to take a final decision. It is not able to assess the impact on competition and fix the compensatory measures which are necessary to reduce the distortions of competition caused by the aid. Now, the aid in this mechanism is clearly the value of the guarantee. However, it is particularly difficult to come *ex-ante* to a good estimate of the value of such a guarantee. The revisions of the estimates of the losses of the bad bank of Crédit Lyonnais are a clear

example. The assets which were hived-off were so many and so complex that it took several years to come to a reasonable estimate.

What happens if the actual losses are much higher than foreseen at the moment of the Commission decision? The Commission cannot use the standard argument according to which the amount of aid has to be evaluated at the moment of its adoption, because at that time a proper estimate was not available. Therefore, the Commission is obliged to put a ceiling on the aid that it approves and declare that if losses exceed the aid approved, they would have to be considered as a new aid to the old bank. It is evident that the good bank still bears a responsibility on the increase of the losses of the hived-off assets because their increase comes from a better assessment than was possible at the time of the Commission's decision. It follows that the Commission decision on compensatory measures cannot be considered as definitive, if the aid ceiling is breached. The new *Crédit Lyonnais* case is a good example of such an approach of the Commission.

A particular problem is however caused when the beneficiary of the aid is a State owned bank which has been then sold to a new private investor. To what extent can the buyer be considered as responsible of the new losses of the old bank ? No answer has yet been given to this problem.

Central Banks' interventions and State aid rules

Interventions by Central banks are of great relevance for the application of State aid rules as they certainly constitute State resources. The Commission has not made its position fully clear on the type of the central bank's interventions that are subject to Article 92 of the Treaty. However some observations can be made.

The qualification of a State intervention as State resources does not immediately lead to their qualification as State aid. Given its responsibility for monetary policy, the central bank's intervention through open market operations to provide liquidity to the market does not constitute State aid.

Direct liquidity support to a bank in difficulty may be State aid if it is not granted under normal market conditions. In this respect it is likely that the Commission would require, in order to declare that this is not a State aid, that the Central bank's support is granted at a penalising interest rate and on the basis of an appropriate security given by the bank in difficulty.

The release of regulatory constraints is likely to constitute State aid. For instance, if the Central bank decides to release the sum deposited by a bank as a mandatory reserve in order to help it to overcome its difficulties, this is clearly a State aid. This was the Commission assessment in the *Banco di Napoli* case, where it considered that the decision of the central bank to partially release the reserve requirement of the bank, had to be considered as a State aid. At the same time the Commission stated that the aid could be considered compatible with the common market, although it was not notified to the Commission. This leads us to the following issue.

Procedural issues linked to the adoption of State aid in the framework of banking crises

As we previously indicated, State aid measures require a formal notification to the Commission before they are adopted. This means that the "Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the common market having regard to Article 92, it shall without delay initiate the procedure provided for in paragraph 2" (article 93.3 of the Treaty). The latter states that the Commission has to give notice of the aid to interested parties in order for them to submit their comments.

It is not necessary to enter into the details of the procedural rules. What is important, is to realise that State aid procedures are normally quite long. Unless the Commission immediately finds the aid is compatible, no final decision can be given within a short time. Even such a direct approval takes time (1 to two weeks) which may in the banking sector be too long. A bank's difficulties may come up overnight and may require a rapid action to prevent further deterioration in the bank's financial situation and sometimes to prevent a systemic crisis.

As we have previously indicated, the Commission considers that liquidity support by the central bank through open market operations does not constitute State aid. State aid in the meaning of Article 92 arises when the support is addressed through State resources to a specific bank who would not otherwise have been able to obtain the necessary funds on the open market.

Although we think that the necessary actions to prevent a systemic crisis should not normally require State aid, this cannot be always excluded. In such circumstances it is very likely that the Member State would consider that it is obliged to grant aid to avoid the bank's collapse which could cause major difficulties going beyond the limits of the bank in question and it would do it before the Commission has been able to take a final decision. Such a State decision to grant the aid in breach of the State aid rules, however, may have serious consequences.

First, the Member State's decision is clearly illegal, as Article 93.3 also states that "*the Member State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision*".

It is true that the Commission, as stated by the Court of Justice, cannot declare the aid incompatible because it is illegal, but must in any case carry out its assessment and eventually come to a final decision to approve or to reject the aid. And Member States may rely on that to put the measure into force and then convince the Commission of its compatibility. It is clear from a Member State's perspective that once the aid is granted, it becomes much more difficult to come back to the original situation. Typically, if the Member State grants a rescue aid to keep the failing bank afloat before a new solution is found, the Commission will have no other option than approve such an aid, even if the form or the amount of aid were not the best choices from the perspective of State aid rules.

The Commission can certainly assess the compatibility of the aid foreseen in the package of restructuring aid and possibly try to correct the "overshooting" of the rescue aid granted illegally. However, it is evident that if the aid was properly notified, the Commission could have immediately obliged the Member State to correct the aid form or amount to make it fully compatible, so minimising distortions of competition. The Commission can also adopt a provisional decision to suspend the payment of the aid and even oblige the Member State to recover the aid, if this is considered necessary. However, it will find it difficult to take such a decision for a rescue aid granted in breach of the procedural rules, because it would immediately provoke the bank's collapse.

It is therefore clear that the Commission has a strong interest to ensure that procedural rules are complied with in order to ensure that the aid does not cause unnecessary distortions of competition and avoid that in the banking sector illegal aid becomes the norm.

Member States and the beneficiaries of the aid, if they are not short-sighted, should share the Commission's view, at least because an illegal aid is easily subject to attack from competitors. The Court of Justice takes the view that national courts, when hearing an action brought by interested parties, have a role to play in eliminating unlawful State aid. If they find that an aid measure has been put into effect before being notified to the Commission and before the latter has stated whether it is compatible with the

common market, in breach of the Article 93(3) procedure, which clearly and unconditionally produces direct effects in relations between Member States and those undertakings under their jurisdictions, they must, in accordance with the legal rule that Community law takes precedence over national law in the event of conflict, find the aid unlawful and order, where appropriate, the recovery of the financial assistance granted in disregard of the provision and draw all legal consequences, both public and commercial. Furthermore, it has to be recalled that the recipient of the aid cannot rely on legitimate expectations when procedural conditions of the Article 93 have not been observed. It has to verify itself that the aid is legal and compatible.

In order to solve the problem of proper notification and permit the rapid approval of the adoption of rescue measures for banks when their failure would cause major disruption in the financial markets, the Commission services have drafted a proposal for a new fast accelerated procedure. Although the proposal has not been adopted yet and has not reached its final version, it is possible, within the limits of the disclosure rules for draft proposals, to indicate the principles and problems that are on the agenda for the final adoption of this proposal. The idea is that the Commission would give its green-light, in a very short period of time, normally 1 day, to a notified rescue aid if it fulfils some conditions fixed beforehand, which would allow the Commission to take a decision under the delegation procedure. The conditions will concern the form and the time length of the aid measure and will require a certification from the Central bank of the Member State concerned testifying the urgency and the necessity of the proposed aid, in order to prevent major difficulties to the financial stability of the Member State, as well as an commitment from the Member State to submit a thorough restructuring plan to the Commission within a few months.

State aid rules and the intervention of a Deposit guarantee fund to rescue a bank

Since 1 July 1995, the date of entry into force of directive 94/19/EC of the European Parliament and the European Council, each Member State had to ensure that within its territory one or more deposit-guarantee schemes (DGS) are introduced and officially recognised. Except in some specific circumstances, no credit institution authorised in that Member State may take deposits unless it is a member of such a scheme. The directive does not say which kind of scheme shall be adopted and how it should work. The DGS simply stipulates that the aggregate deposits of each depositor must be covered up to ECU 20 000 in the event of deposits' being unavailable.

A DGS normally intervenes to repay depositors at least a part of their holdings in a bank that has been put into liquidation. This kind of intervention certainly falls outside of the scope of Article 92. In some Member States, however, DGS can choose other types of intervention, if they are less expensive than depositors' reimbursement. Accordingly, a DGS may intervene before liquidation and grant financial support to the bank to allow it to recover and avoid the loss of the bank's goodwill. It is also possible that the DGS intervenes during liquidation by assuming some of the losses of the bank's bad assets, so as to clean the portfolio and make the economic activity of the failing bank more attractive for its sale.

In these cases, DGS interventions may be relevant from a State aid perspective. In order to assess whether such interventions constitute aid within the meaning of Article 92, the character of the financial resources provided by the DGS has first to be examined. Because banks' contributions are compulsory, the qualification of the DGS as a private scheme is not sufficient and the contributions may be considered as State resources. Compulsory contributions by private entities to a system which is used by the State or under State influence to help one or more enterprises clearly constitutes a State aid scheme and has to be notified to the Commission to verify its compatibility.

The Commission has not yet published its approach towards DGS interventions, in particular when they allow a failing bank to stay afloat. However, a few remarks can be made to clarify some of the

problems before us. Certainly, a distinction has to be drawn between compulsory contributions set and used by a public authority and other compulsory contributions whose amount and use are set by the members of the system. As long as member-banks are free to set the level and the rules governing the collection of the members' contribution and their use, it could be argued that the DGS acts as a private investor, choosing the least costly solution. But, if the use of the funds is decided by a public body, then DGS interventions, when they allow an economic activity to continue where otherwise it would be entirely liquidated or greatly reduced, have to be examined by the Commission as they may very well constitute State aid within the meaning of Article 92.

Some conclusions

From a competition perspective, the way Member States decide to intervene to solve a bank crisis is of great importance. When it is decided to save the bank or its economic activity and discard the option of a full liquidation, major distortions of competition may arise, because the failing institution should normally exit the market. In a market subject to competitive pressures and technological changes, excess of capacity is likely if exit from the market is blocked. The Commission is aware that in the banking sector the full liquidation of a bank is sometimes blocked because of the negative consequences it may have on competitors and financial markets. We think that if it has been decided that the bank liquidation can pose a threat to the rest of the banking system, a private market solution is still possible, namely through DGS interventions instead of other more distortive State interventions. In principle a DGS should be able to deal with it and State aid should not be necessary. The Spanish Banesto case represents a good example in this respect.

This Spanish case allows us to make two further comments. First, from a State aid perspective, a DGS intervention to keep a bank alive instead of reimbursing depositors should be freely decided upon by the bank-members with a significant participation of private members. If the decision is subject, directly or indirectly, to the influence of a public authority, the DGS intervention becomes a State aid.

Second, it is important that the DGS owns a well endowed fund to intervene if necessary. Many times, DGS refused the intervention because they did not own a fund sufficiently large but they had simply the right to call on the bank's contributions when necessary. Because a bank's crisis is often linked to a general weakness of the national banking system, other banks may be very reluctant to intervene and would push for a State intervention, claiming that the necessary contribution would be too costly. The weak endowment of the DGS should not be a way of transferring problems to the public authorities. A DGS based on a regular funding should become the normal way to treat a single bank crisis. The Spanish DGS constitutes in this respect a good example. It is worth noticing that in the case of Banesto, in spite of the fact that the funds provided for the rescue were particularly large with respect to the fund's endowment, the latter has been able to finance itself by issuing bonds on the market backed by the members' future contributions to the Fund.

Sometimes, the refusal of the fund to intervene is also linked to the fact that the failing bank was State owned, leaving the State with the main responsibility as a shareholder of the bank. However, State interventions into State-owned banks have often been proved to fulfil more a public goal (maintenance of the entity for social or political reasons) than a private one (return on investment). The goal of defending the conditions for a levelling of the playing field has been too often set aside. This typically generates a vicious circle of insufficient restructuring, repetition of aid and therefore excessive aid and insufficient compensation to competitors. The confusion of roles of the State becomes apparent. As it was stated by the Commission in the first final decision for the State aid to *Crédit Lyonnais*, "where the State is the main shareholder of the bank in crisis, its role as shareholder must be separated from its role as the supervisory

authority required to safeguard confidence in the banking system. This latter task may lead the State to take measures in support of the bank that are additional to what is really necessary to restore the bank's viability". If we want to assure a level playing field between private and public banks, no different treatment should be allowed between private and public banks.

SLOVAK REPUBLIC

Please describe briefly the principal statutory regulations that affect the banking sector and grouping in the banking sector in accordance with the following list:

a) restrictions on branching and new entry, especially the entry of foreign firms:

Banks and branch offices of foreign banks may enter the financial market of the Slovak Republic only on the basis of a banking licence granted by the central bank - the National Bank of Slovakia. The amendment to the Banking Act of 1996 introduced a two-step licensing procedure, similar to that used in other European countries, for banks and branch offices of foreign banks, consisting of a licence to establish a bank and a licence to operate as a bank. Permission is granted solely for activities specified in the Banking Act. However, foreign companies or banks may establish a bank or a branch office in the SR and obtain permission for the performance of banking activities under the same conditions (i.e. according to the amount of registered capital and the form of licence application) as the banks owned by domestic entities. Based on the recommendations of OECD, a new amendment was made to the Banking Act in December 1997, according to which the establishment of a new bank and the commencement of operations will not be subject to a two-step licensing procedure, but will be permitted by a single decision.

The difference that previously existed between domestic and foreign entities in acquiring a property share in the equity capital of a bank, has been eliminated by the recently passed amendment to the Banking Act. At present, prior approval of the NBS is still required for the establishment, or increase in the capital interest of a foreign entity in the equity capital of an existing bank, which exceeds 3 per cent of such equity; and, in the case of domestic entities, for the establishment of capital participation in excess of 15 per cent of the bank's equity. After the amendment becomes effective, both foreign and domestic entities will need prior consent from the NBS for the acquisition of a stake in a bank's equity capital, which exceeds 10 per cent, 33 per cent, and 50 per cent of such equity.

The central bank grants, under the same conditions for domestic and foreign entities, prior approval for an increase or decrease in a bank's equity capital, and for the consolidation, merging, or winding-up of a bank, and the sale of a bank, branch office of a foreign bank, or parts of the same.

If a bank based in the SR seeks to establish a branch office in the country, it shall notify the NBS of this fact in writing well in advance. A bank based in the SR may open a branch office abroad only on the basis of prior consent from the NBS.

b) restrictions on pricing (interest rate controls and other controls on prices or fees):

The NBS does not determine the price of products and services provided by banks, nor the level of commissions charged for these products and services. Such prices and charges are set by the banks concerned, according to market conditions.

c) line-of-business restrictions and regulations on ownership linkages among financial institutions:

The regulation of ownership linkages among financial institutions is applied directly by the NBS solely in the following cases:

- assessment of applications for permission to establish a new bank or a branch office of a foreign bank; such a licence is granted by the NBS;
- decision in the matter of granting approval for the acquisition of a stake in a bank's equity capital, which the NBS monitors with special care to check that it is not a case of a group of persons acting together;
- decision in the matter of granting approval for the acquisition of capital interest by a bank in the equity capital of a non-bank entity, where such interest exceeds 10 per cent of the equity.

Without prior approvals as listed above, the acquisition of a stake in the equity capital of a bank, to the extent specified under item 1 letter a), or the acquisition of a stake by a bank in the equity capital of a non-bank company, becomes invalid.

The NBS is able to influence, to a certain extent, the ownership structure of shareholders, especially when a new bank is to be established by untrustworthy entities, etc.

d) restrictions on the portfolio of assets that banks can hold (such as requirements to hold certain types of securities or requirements not to hold other securities, including requirements not to hold control of non-financial companies):

Banks may acquire shares or capital interest in excess of 10 per cent of the equity of a non-bank entity, only with the prior consent of the NBS. Similarly, a bank may purchase shares or acquire capital stakes in non-bank entities in excess of 25 per cent of the bank's equity capital and reserves, only with the prior consent of the NBS.

To minimise losses in the banking sector, banks are required to ensure that:

- the total amount of loans granted to a single borrower, or an affiliated group of borrowers, does not exceed the prescribed percentage of the bank's capital and reserves;
- the total amount of loans provided to the largest borrowers, or economically linked groups of debtors, does not exceed the prescribed percentage of the bank's total capital and reserves.

According to relevant NBS regulations, the limit on net credit exposure to a single borrower, or a group of economically linked borrowers, represents 25 per cent of the bank's capital. The net credit exposure to a single bank based in the SR, or in a OECD country, must not exceed 80 per cent of the bank's capital. The total amount of credit exposure (exceeding 15 per cent of the bank's capital) must not exceed 800 per cent of the bank's capital base.

e) compulsory deposit insurance (specify whether it is full or partial coverage; is the premium flat-rate, or related to the risk of the bank?):

In accordance with the law on the protection of bank deposits, which came into effect on 1 July 1996, banks and branch offices of foreign banks accepting deposits from private individuals in the SR, are under obligation to protect bank deposits. All banks and branches of foreign banks are obliged to participate in the protection of private deposits via the Deposit Protection Fund and to pay contributions to the Fund for this purpose. The obligation to protect deposits is not derived from the risks of bank business.

A depositor is entitled to compensation for a lost deposit, the maximum amount of which is set at thirty (30) average monthly salaries in the SR; the depositor's liabilities towards the bank will be deducted from this compensation. Depositors having a special relationship to the bank as stated in the

Banking Act (e.g. members of the bank's supervisory board and statutory body, etc.) are not entitled to compensation.

f) restrictions on capital adequacy:

In accordance with the Banking Act, banks are required to maintain a predetermined ratio of capital and reserves to assets, and/or to liabilities. The NBS has set requirements for the capital adequacy of banks in accordance with the recommendations of EU guidelines, according to which banks are obliged to maintain capital adequacy at a minimum level of 8 per cent; the actual ratio of capital adequacy must be reported to the NBS in writing on a quarterly basis.

It follows from the Banking Act that the loan portfolios of the three largest banks - which are controlled by the State through the National Property Fund of the SR - will be restructured with the help of the State. During this period, the said banks will be allowed to reach the ratio of capital adequacy prescribed by law.

g) minimum reserve requirements:

The minimum level of liquid assets that banks are required to maintain on money reserve accounts with the NBS in Slovak crowns, as minimum required reserves, represents:

- a) for banks and branch offices of foreign banks, nine per cent of liabilities payable on demand and of term liabilities towards all entities with the exception of banks, branches of foreign banks, and building societies;
- b) for building societies, three per cent of liabilities payable on demand and of term liabilities towards all entities with the exception of banks;
- c) for banks, branches of foreign banks, and building societies, the amount of financial resources determined in NBS decrees (e.g. Decree No. 13/1996 stipulating the foreign exchange position of banks for monetary purposes);
- d) banks engaged in mortgage transactions, three per cent of the volume of issued mortgage bonds;

Minimum required reserves, except those listed under letter c), attract interest at a rate of 1.5 per cent per annum.

h) requirements to direct credit to favoured sectors:

In general, neither the NBS nor the Government places special demands on banks in connection with the provision of credits to selected sectors. An exception of is made for the financing of development in the field of nuclear engineering (construction of modern nuclear power plants in the SR), which is considered to be important with regard to maintaining electricity supplies to industry and households. Up to now, this financing has been ensured through one bank, in which the State has a controlling stake via the National Property Fund of the SR.

i) special rules concerning liquidation, winding up, insolvency, composition or analogous proceedings in the banking sector:

For banks, there are no special legal regulations pertaining to the termination of operation as a result of liquidity problems and where this occur, the situation would be governed by the law on composition and settlement.

Unlike other business entities, the NBS is entitled to place a bank under control of a conservator, and to start bankruptcy proceedings only after the conservatorship proves ineffective. The term in which the debtor is obliged to submit a proposal for the announcement of bankruptcy, is different for banks. Unlike other business entities, banks are not subject to the 60-day period, which runs from the day the bank is found to be insolvent, with regard to the performance of banking activities.

j) other rules affecting co-operation within the banking sector (e.g. with respect to payment systems):

In accordance with the National Bank of Slovakia Act and related decrees stipulating the principles of interbank payments, payments and settlement between banks in the SR are realised exclusively through the Banking Clearing Centre, a legal entity established for this particular purpose.

Is there an industry regulator or regulators in the banking sector? What is the form of this institution, its principal functions and statutory objectives? What discretion does it have? How does it exercise that discretion? Does it significantly affect the behaviour of the market participants? In what way?

The banking sector is regulated by the National Bank of Slovakia, established on 1 January 1993 under the NBS Act No. 566/1992 Zb. According to the National Bank of Slovakia Act of 1992, the main task of the NBS is to guarantee the stability of the Slovak currency. To this end, the Bank formulates and implements the country's monetary policy, issues banknotes and coins, controls the circulation of the currency, co-ordinates the smooth and efficient operation of the payments and settlement system, supervises the activities of banks, and ensures the prudential and purposeful development of the banking system through banking supervision.

The Banking Supervision Division of the NBS, which is responsible for banking supervision, is one of the key organisational units of the central bank. The Division is a member of the Group of Banking Supervisors of Central and Eastern Europe (BSCEE), which organisationally belong to the Basle Committee on Banking Supervision at the Bank for International Settlements. The above regional organisation of banking supervisors issues annual reports on banking supervision in the individual member countries. Detailed information about the position and performance of banking supervision in the SR may be obtained from these reports. According to the National Bank of Slovakia Act and the Banking Act, the main tasks of the Banking Supervision Division of the NBS are:

- to assess applications for permission to operate as a bank (banking licence);
- to supervise the fulfilment of conditions set out in the banking licence;
- to assess, in certain cases, applications for prior approval for the establishment of capital participation of a non-bank entity in the equity capital of an already existing bank, the establishment of capital participation of a bank in a non-bank entity, for the increase or decrease in a bank's equity and for the sale of a bank, branch office of a foreign bank, or organisational parts of the same;
- to impose measures upon banks and branches of foreign banks to remedy deficiencies revealed in the conduct of banking business, including the imposition of conservatorship and the revocation of a banking licence;
- to supervise compliance with NBS decrees (i.e. binding legal regulations issued by the NBS), especially decrees governing the prudential conduct of banking business (regulation of capital adequacy, bank liquidity, credit exposure, the monetary positions of banks and the classification of credit portfolios of banks). These decrees - generally binding legal

regulations, through which the NBS regulates the development of the banking sector, were drawn up in accordance with relevant EU directives.

In accordance with the National Bank of Slovakia Act of 1992, the Ministry of Finance of the SR, or a body authorised by the Ministry, performs government inspection of the activities of local banks. Government inspection includes supervision of compliance with laws, provided the Ministry is authorised to do so by law, supervision of compliance with generally binding legal regulations issued by the NBS, and supervision of compliance with directives issued by the Ministry during the performance of government inspection. In practice, however, the Ministry of Finance does not perform government inspection of the operations of banks, and is not even organisationally prepared for this activity.

In cases specified by law, the Ministry collaborates with the NBS in the assessment of applications for banking licences (in these cases, the Ministry has the right of veto), or applications for prior approval of the NBS (in this case, the Ministry specifies its position on such applications).

Besides the formal statutory regime, are there any understandings or expectations about the actions of, say, the central bank (such as ‘lender of last resort’ or ‘too big to fail’), or other government agencies which could affect the behaviour of banks?

It follows from the Banking Act that the NBS may grant credit to banks for a period of up to six months; the credit must be secured in an adequate manner prescribed by law. To maintain the level of liquidity, the NBS may provide short-term loans to banks for a period of a maximum three months in exceptional cases. However, this extraordinary procedure has not been used by the NBS so far.

During the period of conservatorship, the NBS may provide financial assistance to the bank concerned as a remedy for the temporary shortage of liquidity. The Claim to the repayment of such financial assistance has priority over the other liabilities of the bank.

As far as the principle of ‘too big to fail’ is concerned, this is not regulated by any law or decree. There is simply a moral principle followed by the central bank in certain situations; however, it pays respect to the economic consequences of a bank’s eventual bankruptcy. The NBS has no experience in this area, since none of the big banks has gone bankrupt in the SR so far. In several cases, the licences of certain branches of foreign banks have been revoked after the banks had lost their licences to operate in their country of origin.

Are there any important inter-bank arrangements which affect the behaviour of banks, such as industry organisations, codes-of-conduct, inter-bank agreements, etc.?

Banks and branch offices of foreign banks operating in the SR are members of associations and organisations, such as the Association of Banks, the Association for Bank Cards, the Association of Dealers in Securities, the Banking Clearing Centre.

Within the Association of Banks, the member banks are subject to a banking code of conduct.

Please identify the main influences on the Government when setting policy in this area. For example, are there active industry lobby groups?

According to the National Bank of Slovakia Act, the central bank supports, within the limits defined by the Act, the economic policy of the Government; however, the Bank ensures the fulfilment of its tasks independently of instructions given by the Government. The Governor of the NBS, or the Vice-Governor, shall attend the sessions of the Government and inform the Government of decisions passed by the Bank Board and of the results of the Board's deliberations.

The sessions of the Bank Board may be attended by a member of the Government, appointed by the Government, with an advisory vote.

How widespread is state ownership in the banking industry?

The State holds, through the National Property Fund, a majority share in three major banks and in a minor bank (it owns 17,7 per cent of the subscribed capital of these banks).

The State has established, through the Ministry of Finance, two specialised financial institutions. The Ministry of Transport, Postal and Telecommunications Services and the Ministry of Agriculture are shareholders in another two banks. Their share in the subscribed capital of these banks is below 11,6 per cent.

The share of state companies in the subscribed capital of banks (a total of five banks) represents 7,1 per cent of the total volume of bank capital.

The share of the State (through the National Property Fund, ministries, and state-owned companies) in the subscribed capital of banks (except financial resources of provided to the branches of foreign banks for permanent use) represents 36,4 per cent in total.

The given data refer to December 31st 1997. At the end of 1997, the subscribed capital of banks operating in the SR increased, while the share of the State decreased somewhat (approximately by two per cent).

Do you know of any studies that assess the effect of the above regulatory regime on the structure, conduct, performance, and entry barriers of the industry? Have there been any quantitative studies assessing the magnitude of the costs of regulation or assessments of the gains to the economy as the result of deregulation? Has your own agency carried out such work? In any of these cases, please provide citations of the relevant work.

The Banking Supervision Division of the NBS has no knowledge of any studies dealing with these issues.

Competition regulation in the banking sector

Please describe the application of the national competition law to the banking sector. Are there any exemptions to the application of the national competition law that apply to banks? Are banks subject to their own competition rules (i.e., are there special provisions relating to bank mergers,

inter-bank agreements, failing firm defence and so on)? If so, are these sector-specific competition rules more restrictive or less restrictive than the national competition laws? What was the public policy reason behind sector-specific competition rules?

Who enforces the competition laws in the banking sector? Is it the sole responsibility of the national competition authority? If not, is the responsibility shared with another agency, or solely the responsibility of another agency? What are the other institutional functions of the other agencies involved? If the responsibility is shared, how is it shared? Does one agency have a veto over another, or must both agree? If another agency has sole responsibility for all or part of the competition laws in the banking sector, does the national effect? Please comment on the decisions taken by this other agency, from a competition perspective.

The legal framework of competition policy enforcement in the Slovak Republic is created by the Act No. 188/1994 Collection of Laws on Protection of the Economic Competition. The purpose of this Act is to protect economic competition in the markets for products and services against prevention, restriction or distortion (hereinafter only “restriction on competition”) as well as to create conditions for its further development, in order to promote economic progress for the benefit of consumers.

This Act shall apply to entrepreneurs, other natural persons and legal persons who undertake economic activities and their associations, and to state administrative authorities and municipalities in their administrative activities which are linked to economic competition.

Consequently the Act shall apply in full to banks and branch offices of foreign banks.

The Antimonopoly Office of the Slovak Republic (hereinafter “Authority”) is authorised to carry out protection of economic competition and is responsible for protection of economic competition in the banking sector as it concerns either agreements restricting competition, abuse of a dominant position or merger evaluation. Since for the merging or winding-up of a bank as well as for a change of control over a bank the prior approval of the National Bank of Slovakia is required, the decision of the central bank is not tied with the decision of the Authority and vice-versa.

In accordance with the Act agreements and concerted practices among entrepreneurs as well as decisions of their associations, which have as their object or effect the restriction on competition (hereinafter only “agreements restricting competition”), are prohibited. The ban shall not be applied to agreements restricting competition that at the same time:

1. contribute to improving the production or distribution of goods or to promoting technical and economic progress,
2. allows users a fair share of the resulting benefit,
3. do not impose on the parties to the agreement restricting competition such restrictions which are not indispensable to the attainment of these objectives,
4. do not afford the parties to the agreement restricting competition the possibility of eliminating competition in respect of a substantial part of the goods in question.

The Authority may require entrepreneurs to prove that their agreements restricting competition fulfil the above conditions.

The entrepreneurs can apply to the Authority for a decision, whether or not the agreements restricting competition are prohibited, i.e. the entrepreneurs may ask the Authority for a so called negative clearance.

Please comment on particular actions taken by the competition authority:

(a) In the case of mergers, what has been the approach of the competition authority to market definition? Which separate markets were identified, why? Have you treated banks as offering a bundle of services to each customer or as offering a multi-product range, with different markets for each products? What was the geographic scope of each market? Has the Internet or telephone banking appreciably affected questions of market definition?

(b) In the case of mergers, have cases of trade-off between the protection of competition and the protection of stability of the banking sector been experienced? How have they been treated?

(c) Were remedies, and of what kind, imposed in the case of mergers which gave rise to competitive concerns?

(d) In the case of horizontal arrangements, have you found that features of the banking industry facilitate collusive arrangements? Have interbank agreements relating to, say, ATMs, electronics processing of transactions, payment systems or joint marketing of credit/debit cards given rise to competition concerns? Have concerns been raised about bank collusion in the wholesale markets, such as the market for government debt?

(e) Have there been specific instances of abuse of dominance or vertical arrangements which have raised competition concerns?

The Authority, on the basis of competencies under the Act has addressed the Credit Card Association (whose basic line of activity is supporting the development of credit cards in the Slovak Republic) for submission of the basic documents of the Association. With regard to the fact that membership in the Association simultaneously enables the access of bank clients to a cash dispenser network, the Authority conducted an investigation, whether the rules for accepting new members are clear, transparent and do not restrict entry in the market. Such practices have not been detected by the Authority.

In accordance with the Act, a dominant position in the market occurs when an entrepreneur or several entrepreneurs, who are not subject to substantial competition, can behave independently from other entrepreneurs and consumers and can restrict competition. If it is not proved otherwise, it shall be presumed that an entrepreneur is not subject to substantial competition, if its share on supply or purchase of identical or interchangeable goods in the relevant market is at least 40 per cent.

In the field of providing banking services this kind of restriction on competition has not been come across by the Authority, so we do not have any experiences in this unlawful practices.

The principles underlying the merger regulation are fully applied to banks. However, a concentration shall not be deemed to occur where credit and other financial institutions or insurance companies temporary acquire securities providing control over an enterprise with the view to reselling it, provided they do not exercise voting or other rights with a view to determining the competitive behaviour of that enterprise. These cases are not considered to be acquisition of control and hence as concentration.

Two decisions have been issued by the Authority in the field of unlawful restrictions on the economic competition and concentrations which concern banks. Both cases have dealt with bank mergers.

The Authority uses the same standards to assess the competitive impacts of all mergers:

- the relevant markets are defined (their product, geographical and time dimension),
- shares of concentration participants in defined relevant markets are determined,
- then the level of concentration before and after concentration,
- analysis of entry barriers for potential competitors (it is considered as relatively rapid and adequate entry in the market with low sunk cost) is determined,
- the pace at which the size of market may be expanding or contracting,
- eventually proof of concentration participants, that the harm which results from the restriction of competition will be outweighed by overall economic advantages of the concentration.

In the mentioned cases the acquirer was a bank, which had been operating in the market during the period of one year, and the acquired firms were the branch offices of foreign banks.

Any concentration is subject to control by the Authority, if:

- a) the combined turnover of the participants of the concentration is at least 300 million Slovak crowns and at least two of the participants of the concentration achieved a turnover, of at least 100 million Slovak crowns for the previous accounting time period, or
- b) the joint share of the participants of the concentration exceed 20 per cent of the total turnover in identical or interchangeable goods in the market of the Slovak Republic.
(Regarding banks it is not possible to define a turnover in the same way as is other entrepreneurial subjects. Hence the Authority after consultations together with the National Bank of Slovakia defined in place of turnover of banks the sum of cash and interbanking operations income, income from operations with clients, income from financial leasing, income from stocks operations, income from foreign currency operations and other operating income.)

In the first case the criteria conditions for compulsory concentration notification have not been fulfilled (neither from the view of turnover amount, nor from the view of shares in the relevant markets) and the mentioned concentration was not subject to the Authority's control.

In the second case, with regard to the fact, that a dominant position in the defined relevant markets has been neither created nor strengthen, the mentioned operation has been allowed by the Authority without establishing additional conditions.

During the evaluation of the bank merger in question we defined the relevant product markets as a bundle of services. We focused on such products and services, which in keeping with the Banking Act only banks are authorised to provide. We evaluated the amounts of bank assets, aggregate accepted deposits, accepted citizen deposits, loans granted for citizens and loans granted for entrepreneurs. The concentration participants had very low shares in such defined relevant markets namely in the range from 0,008 per cent to one per cent.

Later, we moved to a more detailed specification of banking products and services, that we have divided into three essential categories:

1. retail banking services,
2. wholesale banking services for undertakings and legal entities,
3. activities related to financial markets.

Referring to the fact, that the Act defines the relevant market as a geographical and temporal equilibrium of supply and demand of such group of goods which are for the satisfaction of certain needs of users identical or mutually substitutable, in the framework of above mentioned essential spheres of banking products and services we have defined individual relevant product markets and their geographical dimension.

We have defined the following relevant product markets within retail banking services: current accounts, saving accounts, term accounts, customer credit, mortgage loans, loans guaranteed by other loans, all other types of customer credit, all types of cheques, bank cards, debit cards, credit cards, safety deposit boxes, stockbroking, management of stock deposits.

From the view of the assessment of geographical markets we proceeded from the fact, that providing of products and services in the framework of retail banking is tied to mutual bank-client interaction and is realised in the scope of existing network of bank's branch offices. Therefore we have defined these markets as local markets, which are determined by the location of branch offices of the bank in question.

Wholesale banking services comprise the following activities: current accounts of entrepreneurial subjects, deposits of entrepreneurial subjects, ensuring of payment relations (divided into foreign and domestic), granting loans to entrepreneurs (divided into domestic currency and foreign currencies), granting loans to public authorities, leasing, factoring, participation in issuing of inscribed stocks and providing portfolio management, bank cards, debit cards, credit cards. Equally the products of wholesale banking services, provided to small and medium-sized entrepreneurs, are tied on mutual relations of bank and client and hence they have generally local character. In a few cases small and medium-sized entrepreneurs contact banks operating outside region of their residence, but it is negligible.

In the scope of activities focused on financial markets it is mainly dealing with trading on money market from the view of active operations and from the view of passive operations, trading on the foreign currency market, are trading on the stock market. These markets have not a local character, but a national character and as far as banks make an entry into international markets it has an international geographical dimension.

QUESTIONNAIRE SUBMITTED BY THE SECRETARIAT

Sector-Specific Regulation In The Banking Sector

1. The purpose of this section is to show the interaction between regulation and competition in each country, through a description of what is regulated and what is left to the market. Please describe briefly the principal statutory regulations that affect the banking sector, grouping, as far as possible, the regulations in accordance with the following list:

- (a) restrictions on branching and new entry, especially the entry of foreign firms;
- (b) restrictions on pricing (interest rate controls and other controls on prices or fees);
- (c) line-of-business restrictions and regulations on ownership linkages among financial institutions;
- (d) restrictions on the portfolio of assets that banks can hold (such as requirements to hold certain types of securities or requirements not to hold other securities; including requirements not to hold the control of non financial companies);
- (e) compulsory deposit insurance (specify whether it is full or partial coverage; is the premium flat-rate, or related to the risk of the bank?);
- (f) restrictions on capital-adequacy;
- (g) reserve requirements (requirements to hold a certain quantity of the liabilities of the central bank);
- (h) requirements to direct credit to favored sectors;
- (i) special rules concerning liquidation, winding up, insolvency, composition or analogous proceedings in the banking sector;
- (j) other rules affecting cooperation within the banking sector (e.g. with respect to payment systems)

2. Is there an industry regulator or regulators (such as a "Banking Commission", or a "Financial Services Authority" - in some countries this role is played by the central bank)? What is the form of this institution, its principal functions and statutory objectives? What discretion does it have? How does it exercise that discretion? Does it significantly affect the behaviour of the market participants? In what way?

3. Besides the formal statutory regime, are there any understandings or expectations about the actions of, say, the central bank (such as "lender of last resort" or "too big to fail") or other government agencies which could affect the behaviour of banks?

4. Are there any important inter-bank arrangements which affect the behaviour of banks, such as industry organisations, codes-of-conduct, inter-bank agreements, etc.?
5. Please identify the main influences on the government when setting policy in this area? For example, are there active industry lobby groups?
6. How widespread is state ownership in the banking industry?
7. Do you know of any studies that assess the effect of the above regulatory regime on the structure, conduct, performance and entry barriers of the industry? Have there been any quantitative studies assessing the magnitude of the costs of regulation or assessments of the gains to the economy as the result of deregulation? Has your own agency carried out such work? In any of these cases, please provide citations of the relevant work.

Competition Regulation In The Banking Sector

8. Please describe the application of the national competition law to the banking sector. Are there any exemptions to the application of the national competition law that apply to banks? Are banks subject to their own competition rules (i.e., are there special provisions relating to bank mergers, inter-bank agreements, failing firm defense and so on)? If so, are these sector-specific competition rules more restrictive or less restrictive than the national competition laws? What was the public policy reason behind sector-specific competition rules?
9. Who enforces the competition laws in the banking sector? Is it the sole responsibility of the national competition authority? If not, is the responsibility shared with another agency, or solely the responsibility of another agency? What are the other institutional functions of the other agencies involved (e.g. monetary policy, supervision of the banking sector, deposit insurance etc.)? If the responsibility is shared, how is it shared? (i.e., are some components of competition law, such as horizontal agreements, the responsibility of one agency and other components, such as the regulation of mergers, the responsibility of another?) Does one agency have a veto over another, or must both agree? If another agency has sole responsibility for all or part of the competition laws in the banking sector, does the national competition authority have the right to provide advice? Has it done so? To what effect? Please comment on the decisions taken by this other agency, from a competition perspective.
10. Please comment on particular actions taken by the competition authority:
 - (a) In the case of mergers, what has been the approach of the competition authority to market definition? Which separate markets were identified, why? Have you treated banks as offering a bundle of services to each customer or as offering a multi-product range, with different markets for each product? What was the geographic scope of each market? Has the Internet or telephone banking appreciably affected questions of market definition?
 - (b) In the case of mergers, have cases of trade-off between the protection of competition and the protection of stability of the banking sector been experienced? How have they been treated?
 - (c) Were remedies, and of what kind, imposed in the case of mergers which gave rise to competitive concerns?

- (d) In the case of horizontal arrangements, have you found that features of the banking industry facilitate collusive arrangements? Have interbank agreements relating to, say, ATMs, electronic processing of transactions, payment systems or joint marketing of credit/debit cards given rise to competition concerns? Have concerns been raised about bank collusion in the wholesale markets, such as the market for government debt?
 - (e) Have there been specific instances of abuse of dominance or vertical arrangements which have raised competition concerns?
11. Are there any other particular issues or experiences in the enforcement of competition law that you think would be of interest to other OECD competition authorities? If so, please describe them briefly and, where relevant, provide citations to any relevant publications.
12. Have there been any important regulatory changes (relating to any of the components of the regulatory regime discussed in the previous paragraphs) in the past two years? If so, briefly describe the situation before the change and the principal effects of the change.

AIDE MEMOIRE OF THE DISCUSSION

Why Regulate Banks?

Liberalisation

The discussion began by covering recent important developments in banking regulation including liberalization of restrictions on entry, removal of restrictions on interest rates, relaxation of controls on ownership and banking activities, and harmonisation of regulatory regimes across financial sector firms.

The Role Of International Organisations

The delegate from the Bank for International Settlements noted that the question of whether banks need to be regulated is closely linked with the question of why banks exist. The modern banking literature justifies the existence of these intermediaries as a consequence of their role as providers of monitoring and liquidity services. As providers of monitoring services, banks contribute to the efficiency of the economy by avoiding the duplication of monitoring costs. Rather than having multiple investors evaluating a firm prior to making a loan and then simultaneously monitoring the borrower's actions once the loan has been granted, potential investors may find it advantageous to delegate these tasks to a bank, through which they all provide funding to the firm. As providers of liquidity services, banks improve the efficiency of the economy because they design securities (demand deposits) that insure investors against a random shock to their preferences for the timing of consumption.

Research also shows that banks' provision of liquidity services leaves them subject to runs. The reason is that the liquidation value of the bank's portfolio of assets is less than the value of its liquid deposits. As a result, a run can occur without a triggering event. If depositors panic, they may try to withdraw their funds out of fear that other depositors will do so first, thus forcing an otherwise sound bank into bankruptcy. A bank run is costly because it forces the premature liquidation of assets, thus disrupting the production process. Furthermore, it may cause contagion runs, which may culminate in a system failure with severe negative effects on the economy. It is this risk of a system failure that is usually presented as the main reason for regulating banks. The desire to protect certain depositors, usually the small, less sophisticated ones, is also frequently cited in some countries as an additional reason for regulating banks.

There is a growing consensus on the importance of having certain principles embodied in the regulatory framework, such as relying on accurate measures of solvency, giving the market a greater incentive to monitor banks, making provision for intervention when performance deteriorates and having a credible mechanism that allows for the transfer of control to a regulatory agency when the bank's solvency is low. Some of these principles, in fact, are now incorporated in the Core Principles for Effective Banking Supervision that were drawn up by the Basle Committee on Banking Supervision.

The efficacy of such principles will depend on the institutional structure of the agencies in charge of regulation and supervision. Until recently, the main concern in this area was whether banking regulation and supervision should be conducted by the country's central bank. As banks have become more involved, in other, non-traditional banking activities, such as insurance and investment banking, a

new set of questions relating to the design of the regulatory framework and the institutional structure of the regulatory agencies start to arise. Is it preferable to design regulations along institutional or functional lines? Is it preferable to have a single regulatory and supervisory agency or multiple agencies? In the latter case, how should the powers and responsibilities be allocated among the agencies? What should be the role of the country's central bank in this new environment? These are questions to which we do not yet have definitive answers.

The delegate from the World Trade Organisation began by summarising the WTO financial services agreement which was reached on December 12, 1997. The financial services agreement of 1997, came out of the so-called "built-in agenda" of the Agreement on Trade in Services (the "GATS" agreement). The GATS agreement establishes some basic obligations on governments - relating to MFN, transparency, non-discrimination and so on. A large part of the impact of the GATS agreement derives from the sector-specific agreements which were anticipated in the GATS agreement. The present financial services agreement was one of those. In these sector-specific agreements, governments are asked to make specific commitments regarding the elimination of existing restrictions and extension of national treatment and market access guarantees in regard to particular types of services. These specific commitments are spelled out in very detailed annexes and schedules.

Neither the GATS Agreement nor the December 12 agreement on financial services eliminates the right of governments to impose prudential regulations. These are specifically exempted under an annex to the agreement. However, this annex also states that prudential measures cannot be used as a means for avoiding or circumventing the commitments and obligations under the GATS. Monetary and exchange-rate policies are also outside the scope of the GATS.

The European Commission noted that the EU has introduced a series of Directives aimed at removing barriers to the provision of cross-border financial services and the achievement of a minimum level of harmonisation of the rules governing credit institutions in the different member states.

One of the key directives is the Second Banking Directive of 1988 which sets out a number of important principles, such as the principle of *home country control*, meaning that the responsibility for authorisation and financial supervision of credit institutions remains with the supervising institution in the so-called "home country"; the principle of the *single banking license*, meaning that a bank which is authorised to carry on business in one member state may carry on banking business in another member state; and the principle of *mutual recognition*, meaning recognition by all member states of each other's banking laws and regulations.

In addition to the Second Banking Directive, some more technical directives have been adopted which set common standards on prudential supervision, such as, for example, the Own Funds Directive, which identifies the items that are included in the EC definition of own funds; the Solvency Ratio Directive, which ensures that banks have sufficient own funds to protect them against credit risk; and the Large Exposure Directive, which restricts large exposures, since an excessive concentration of exposures to a large client or to a group of connected clients may result in an unacceptable risk of loss. These directives set minimum standards - member states remain free to apply more stringent provisions.

The Commission is currently investigating the impact of these directives. A recent report concludes that trade barriers in European banking markets have been reduced, the number of cross-border branches has increased and competition has intensified in member states. This has resulted in a decrease in the price of certain financial services, particularly the prices of deposit and loans. The impact has not been the same in all member states and the impact has been more significant in the corporate than in the retail sector.

The liberalization process has also resulted in new forms of cross-border cooperation between banks and an increasing tendency towards mergers. Europe is still over-banked. For example, in Belgium there is one bank branch for approximately every 800 inhabitants, while in the U.S., there is only one branch for every 4,700 inhabitants.

Regulation and Deregulation Developments

The discussion of banking deregulation continued with a discussion of some of the more important regulatory restrictions, the reason behind those restrictions and, where they have been eliminated, the reasons behind their elimination.

Interest Rate Controls and Entry Restrictions

The delegate from the United States noted that in 1994 the U.S. began to change its policies towards entry of state and national banks into other states. Prior to that, there had been a belief that each state was responsible for regulating its own banking sector and there were great risks associated with expansion geographically. After 1994 there was a very strong relaxation of those rules in various areas. For example, the Riegle-Neil Interstate Banking And Branching Efficiency Act of 1994 authorised both national and state banks in the United States to branch nationwide (except in the case of a few states in which it was not allowed). This greatly increased the ability of banks to expand geographically and greatly increased competition at both the state and national bank level. These developments led to a significant consolidation and growth in the size of banks, reflected in a decline in the number of banks from 14,000 in 1983 to 10,000 last year.

This consolidation and merger wave in United States has increased the pressure for efficiency in banking and the further elimination of restrictions. There are several reasons for this. One reason is that there is now a greater emphasis on economies of scale in banking. Banks can take advantage of some of the technologies available to operate more efficiently across different geographic areas and across aspects of the banking business. This is related to the fact that information processing technologies have enhanced economies of scale, increasing the efficient size of banks.

The United States was questioned whether the economies in banking are scale or scope economies as research that has been undertaken of the U.S. financial system by the Federal Reserve shows that the realization of economies of scale (economies of scope may be another story) is problematic. The U.S. (DoJ) agreed that after a relatively small scale all the efficiencies appear to be realized. The U.S. (FTC) added that there is also a concern on the part of non-bank financial institutions that have not been allowed to engage in extension of lines of business, that they are losing the economies that are really scope economies as opposed to scale economies.

The Mexican delegate noted that interest rates were deregulated in Mexico in 1989. At that time, the banks were still in the hands of the government. As a result, the transition to deregulated interest rates was rather smooth. There have been no abrupt changes in the spread between the active and passive rates.

After the privatization of the banks (in 1991-93) interest rates moved in a parallel fashion, suggesting the possibility of implicit coordination among the banks. More recently, there are some indications that there is some increased diversity among interest rates. A recent study by the competition commission in Mexico revealed that different banks do not have exactly the same interest rates for similar

transactions are there is been enhanced differentiation of interest rates according to the risk levels of borrowers. This points in the direction of more efficient determination of interest rates in the Mexican banking sector.

It was only in 1994 with the entry into force of the NAFTA agreement, that the banking sector was opened to foreign participation. Since 1994 foreign bank participation has increased dramatically. It started at 1.4 per cent in 1994 and increased to over 15 per cent in 1996. This increase was mainly a result of acquisitions of smaller privatized banks.

The Spanish delegate highlighted a couple of events which illustrate its experience in the transition to deregulation. The first related to the so-called “super account war”, initiated in September 1989 by one of the major national banks in Spain. The liberalization of interest rates had occurred in 1987, two years earlier. During the subsequent two years, there were no noticeable effects on interest rates. Then, in 1989 one of the major banks launched a big campaign to increase its market share by raising the interest rate it offered on deposits. It was very aggressive in this strategy and successfully increased the number of accounts. The same bank, some years later, launched another war, offering lower interest rates on mortgages and private consumer loans.

This competition was further reinforced by a new law which minimised the cost of changing from one mortgage provider to another, and reduced the costs and fees associated with a mortgage. These political, regulatory and market measures have lead to a dramatic drop in the interest margin. Currently the interest margin is half that of 4-5 years ago.

To an extent, the reduction in the interest margin has been offset by an increase in fixed incomes from fees. Banks have raised their commissions, but, here again, competition has acted as a discipline.

The delegate from Finland noted that Finland gradually began to lift interest rate controls in the mid 1980s. In brief, the effect of lifting interest rate controls has meant that competition has increased both on deposit markets and on loan markets. Another reason for the increased competition on these markets has been the emergence of new financial instruments which compete with bank deposits.

Finland lifted legal entry barriers in the early 1990s. Finland joined the EU in 1995, which meant adopting the major part of the EU directives, which has greatly assisted foreign bank entry into Finland. There are now about 12 foreign banks in Finland, mostly from EU countries, but also from certain other countries as well. At first the foreign banks concentrated on providing financial services to larger companies only. Therefore, at the beginning, the physical presence of new foreign banks in Finland did not directly help the smaller corporate or household customers. However, foreign banks in the Finnish markets have the opportunity to provide all sorts of financial services, and their presence has therefore enhanced the level of potential competition in Finland. More recently Swedish and Danish banks, in particular, have been recruiting new household customers and small corporate customers, as well.

In brief, lifting the interest rate controls has increased competition. Lifting entry barriers has increased the physical presence of foreign banks. Also, the resulting potential competition effects have been very beneficial.

Line of Business Restrictions and Shareholding Restrictions

The delegate from Australia began with an overview of the history of bank regulation in Australia. From the 1930s until the 1980s the activities of banks were very tightly regulated. Entry, rates

of interest, quantitative controls on lending, ownership restrictions, line of business restrictions and so on. In many ways, these restrictions operated to the benefit of banks. In particular, there was a prohibition on paying interest on bank deposits in the form of cheque accounts. As a result, even if inflation was 15 per cent, the rate of interest paid on bank deposits was zero per cent.

In the 1980s, this all changed. Banks started to lose from the system because other financial institutions sprang up in competition. Non-bank financial institutions were able to provide services in areas in which the banks could not. Technology, globalization, and increasing economies of scale of banking made traditional regulation very difficult, impractical and produced all sorts of unintended side-effects. The Campbell report (of the early 1980s) set in train a general process of deregulation that was continued by the subsequent Labour government.

More recently another report was published on the future of the regulatory regime for financial services in Australia, known as the Wallis report. This report was prompted by the idea that as a result of globalization, new technologies and the convergence between the different financial institutions, Australia needed a system of banking regulation which was appropriate for the new world of financial institutions. Wallis was particularly concerned that historically banks, insurance companies, superannuation companies, credit unions, building societies, savings and loan associations and so on, each had their own specific regulator. As Australia liberalized, the banks started becoming involved in insurance and superannuation (pensions), the credit unions in banking, the building societies in insurance and banking and so on. Any new initiative required approval from half a dozen regulators.

Wallis proposed that the industry-specific regulation be replaced with functional regulation. The new scheme (which has now been approved by the government) is that the Reserve Bank simply does monetary policy. There will be a single industry-wide prudential regulator which undertakes prudential regulation for all the different financial institutions, using somewhat different rules for each of them. The competition regulation will be carried out by the ACCC under the Trade Practices Act. The basic consumer and investor protection will be carried out by a new agency, the CFSC, which will be formed out of the securities and exchange regulator.

The other broad reform was to sweep away most of the remaining restrictions on competition in the financial area -- foreign ownership, licensing restrictions and so on. The deregulation of the 1980s and 1990s has been beneficial for competition and efficiency. It has, however, been associated with some major bank failings, which required rescue by the central bank. This was, however, due to unrelated factors, such as an over-permissive tax regime and some other distortions.

The delegate from Canada noted that Canada currently has its own commission considering the future of financial regulation in Canada, called the Task Force On The Future Of Canadian Financial Services appointed in 1997. Banking reform in Canada can, however, be dated back to 1964. In that year a Royal Commission was appointed which reported on the financial services industry, concluded that there were undesirable rigidities in the system and made recommendations for a broad regulatory review.

In Canada, the financial sector features four "pillars". Institutions at that time fell into one or other of the regulatory categories known as pillars - banks, insurance companies, trust companies (which are similar to building societies and credit unions) and securities companies. At that time there were strict regulations to ensure that each of the pillars did not compete with each other. They were all separately regulated and each provided separate products.

There were recommendations to try to eliminate a lot of these rigidities in 1964. These were virtually ignored. In any event, the market overtook the industry and forced the regulator, beginning in

1980, to liberalize the system. It began by eliminating some of the barriers to entry, which primarily involved easing the process of obtaining operating licenses for banks. (At that time, it would take a bank approximately four years to obtain a banking license to enter the banking industry). Other reforms allowed some cross-competition between the pillars. Some limited foreign entry into the Canadian market was allowed by creating a "schedule" system of banks. In Canada, "schedule 1" banks, which are traditional banks, have to be widely held, in that no single corporation or person can hold more than 10 per cent of the shares of these banks. The reforms created a "schedule 2" level of banks, which do not have to be closely held. The schedule 2 banks allowed foreign entry, but only on a rather limited basis.

After this blurring of the pillars took place, competition between the pillars increased to the point that it was very difficult to determine what was a bank, what was an insurance company and what were the products offered by each. It came to the point that, although there were pillars, each regulated separately, they were competing and offering products (including consumer products) in each other's market. The regulatory regime was out-of-step with the marketplace reality. This was the reason behind the establishment of the Task Force.

The United States delegate from the DoJ recalled that, historically in the United States, under federal laws national banks were greatly limited in the kind of business in which they could engage - they were largely limited to deposit taking and lending. This was to prevent the risks associated with non-bank activities affecting the safety and security of deposits. Despite that rule, and despite the horrible experience during the 1980s with the savings and loans crisis, the United States has, nevertheless, moved towards greatly relaxing those rules, to take advantage of cost efficiencies in banking.

Some of the relaxation occurred under the Bank Holding Company Act of 1933. This Act allowed the Federal Reserve to approve the acquisition of non-banking companies as long as they engaged in "closely related" banking activities. Through the creation of subsidiaries of these bank holding companies, banks began to expand the kind of activities that they engaged in, supported by the Federal Reserve. These activities included securities trading, mortgage banking, insurance underwriting, personal property and real estate leasing and other management consulting. More recently legislation has been passed in the United States which has allowed greater expansion by banks into other lines of business. For example, in November 1996, the Comptroller of the Currency revised its regulations enabling national banks to use their subsidiaries to underwrite and deal in securities. A new operating subsidiary rule provided that national banks may establish or engage in conduct with operating subsidiaries. These activities do not need to be "directly related" banking, they just need to be "incidentally related" to banking. This has led to great expansion in banking activities, in securities brokerage, investment advice, personal property underwriting etc.

The primary advantage of this expansion of lines of business is increased operating efficiencies. Banks may choose a form of organization which allows them to reduce transactions costs and to operate most efficiently.

The United States delegate from the Federal Trade Commission commented that in the United States the legislation which governs banks and separates banking from insurance and financial services activities is still in place, even though, for the last 10 years there have been efforts to eliminate legislative barriers between these activities. The industry regulators have figured out ways, by way of regulations, extensions and loopholes in the laws to enable this increased competition. It is a fascinating that the regulation can be relaxed notwithstanding the legislative superstructure that has not changed since the 1930s.

In response Canada gave an example of how the market may leave the regulator behind. Recently, a large American bank Wells Fargo has begun to sell loans into Canada by telephone. By an ingenious legal manoeuvre Wells Fargo has been able to find a loophole under which, in Canada, they are technically not considered to be a bank, but they can offer business loans to Canadian consumers willing to pick up a telephone. (The United States delegate (DoJ) noted that they are now also using the Internet to offer loans in Canada as well.)

The United Kingdom delegate noted that there were few line of business restrictions on banks in the UK. In the UK, banks can enter all types of businesses (but they are expected to discuss significant new proposals with the regulators in advance). Therefore, the delegate focused on developments with building societies arising from two pieces of legislation, in 1986 and 1997 which considerably liberalized the regime governing building societies. Building societies can now enter virtually all types of business and many of them are offering services which are more traditionally associated with banks, such as a current account service. The building societies are still required to accept various restrictions on the type of business they can undertake and they must retain their "essential nature" as a savings institution and as a provider of loans secured on residential property. For example, they must not trade in commodities or currencies and at least 75 per cent of their business assets must be secured on residential property. The 1986 Act also enabled building societies to convert into banks. In fact, of the top five institutions defined as banks, two of those were previously building societies. Lastly, it is interesting to note that UK supermarkets are choosing to provide banking services.

Ownership Restrictions And Lending Restrictions

The delegate from Japan noted that the first of the recent developments concerning ownership restrictions in Japan relate to financial holding companies. The ban on financial holding companies will be lifted because the financial holding company law was enacted last year. Secondly, concerning the regulation of ownership and shareholding, in order to prevent an excessive concentration of power by any financial company and to promote fair and free competition, the stock holding of a domestic company by a financial company is limited to 5 per cent under section 11 of the Antimonopoly Act. There are some exceptions to this general rule. In the case that the stock issuing company is a subsidiary of a financial company or the stock issuing company is another financial company and satisfies certain requirements, the financial company may be authorized to hold more than 5 per cent of the stock issuing company.

The Australian delegate was asked why, in Australia, authorisation is required for shareholdings in banks over 15 per cent. The delegate noted that the rationale for this restriction is not at all clear. It is partly to stop banks being taken over by non-banks and partly something that banks have wanted in order to protect themselves against take-overs (reflecting the self-interest of management). There is also a general suspicion of powerful banks. The official rationale is that there should be widespread dispersion ownership of bank shares because of their importance in society.

The Swedish noted that in 1996 Sweden changed the legislation governing ownership of banks. Earlier there were very strong requirements on non-financial owners which made it almost impossible for them to own a bank in Sweden. This rule has however now been liberalized. This is part of a policy to improve competition in the Swedish banking sector, which for a period has been dominated by a few big banks. The other reasons for these changes are the need to harmonize with the rules of other European countries which permit non-financial ownership of banks and to increase access to funds, and to encourage strong ownership that can take responsibility for the banks. The financial supervisory authority does, however, consider if the owner is "fit and proper", financial or non-financial before the permit is given and the owner is accepted.

Deposit Insurance Schemes

The Chairman asked Switzerland about the voluntary deposit insurance scheme that operates in Switzerland. The Swiss delegate commented that there were three possible types of answers. The first a “legal” answer; the second a “conventional” answer; the third answer a “factual” answer.

The “legal” answer is that there is no mandatory deposit insurance in Switzerland. Nevertheless the Cantonal banks (i.e., the banks owned by the Cantons) normally have the full guarantee of the state. In recent years five Cantons have intervened in difficulties of banks, including, importantly, the Bank of Bern.

The “conventional” answer is that the Swiss Banking Association (which includes practically all Swiss banks) has decided to adopt a collective arrangement. This arrangement was examined and accepted by the Swiss cartel commission, on the basis that it was necessary in order to provide insurance to deposits and savings. The scheme is not very impressive. First, it is limited to 30,000 Swiss francs (\$US 20,000). Second, it is only an advance against any funds recovered in insolvency (under the Swiss bankruptcy laws the deposit and savings holders have a privilege in insolvency up to 30,000 francs).

The “factual” answer is that in practice the Swiss banks have decided that they will take over small and medium banks that have difficulties rather than let them fail.

The delegate from Australia stated that the official position in Australia, as stated by the Governor of the Reserve Bank (and reiterated by the Treasurer), is that there is no deposit insurance in Australia. However, many experts and many commentators find it hard to believe that, if a major bank were to collapse there would not be a scheme under which there was protection of depositors. It remains to be seen what would happen with a run on a major bank. There are some informal mechanisms in place to try to prevent a run from happening. There have been lesser banks, but not big ones, that have had trouble. Invariably the Reserve Bank has intervened and has either forced mergers or allowed other institutions to take them over. In some cases the Bank has given a certain amount of assistance to avoid more serious problems.

Other financial institutions have complained that banks have an advantage over them because of the perception that the government is going to protect at least the major four banks (or possibly all banks) in contrast to other deposit taking institutions. To some extent the Australian government has tried to balance up the playing field by imposing a special tax on banks in return for the privilege of assumed protection. In marketplace inquiries carried out by the ACCC in the context of bank mergers it was found that there is, in fact, an extensive belief by consumers that banks offer special privileges in regard to the protection of deposits and that this has been a major reason why people go to banks rather than other financial institutions, despite higher interest rates elsewhere.

The European Commission commented that that the EC Directive On Deposit Guarantee Schemes, which was adopted by the EU council in 1994, requires member states to ensure a harmonized minimum level of deposit protection. This was put in place because deposit guarantees were found to be essential to protect consumers and also to increase the stability of the financial system. The objective of the Directive is to ensure a harmonized minimum level of deposit protection wherever deposits are located within the community in order to decrease the disparities in compensation and unequal conditions of competition between national banks and branches of banks from other member states.

Poland was asked why certain banks contribute at a lower rate to the Polish bank guarantee fund. The delegate noted that under the Bank Guarantee Fund Act of 1995, the amount which banks are

obliged to pay to the fund differs between banks. The contribution depends on the amount of cash resources accumulated in the bank and on the rate decided by the council. In the case of three banks in Poland (two big savings banks and one agricultural bank) this rate was fixed at half of the rate (0.2 per cent rather than 0.4 per cent) paid by the other commercial banks. Before the big banking reform, these three banks were the only providers of savings deposits. They had 100 per cent state guarantee for deposits. After implementing the new bank guarantee fund, the state still guarantees the funds in those three banks, but only the amount which exceeds the sum which banks may receive from the bank guarantee fund. This regulation is only temporary and it is not intended to maintain it any longer than is absolutely necessary.

General Discussion

The delegate from the WTO initiated a time of general discussion by asking: does not the provision of mandatory insurance introduce a kind of moral hazard problem into financial market regulation? Is it not the case that if the deposits are insured, this induces the financial institution to not be as cautious as it otherwise might be, and, in the end, there may be more failures, rather than less?

The UK delegate responded that this question of moral hazard is a very important one. The UK scheme has a limit on the payouts to depositors specifically to control moral hazard. In the event of a failure all depositors would suffer a loss, as only 90 per cent of the eligible deposits are covered by the scheme.

The delegate noted that large banks in the UK argue that with a flat rate deposit insurance premium they are subsidising the smaller banks, as there is very little risk that they would actually fail leading to a payout to the depositors. The response of the Bank of England has been to put this in the context of the whole array of weapons that are available to the regulator to penalize risk-taking by the institutions. In the UK there are variable capital ratios (which can be adjusted so that risky banks are required to hold more capital than a less risky banks). There is also the possibility of charging variable funding costs to banks to cover the costs of potential supervision (i.e., if a bank takes up more of the supervisors time it might have to pay more).

The EC delegate noted that the Deposit Guarantees Schemes Directive doesn't say anything about how such schemes should be implemented, organized or financed. Member states within the European Union have the freedom to establish very different schemes. The delegate went on to note that the moral hazard effect depends on how the banking crisis is solved, whether it is decided to liquidate the bank to pay the depositors or to have a kind of state intervention, or have some public or private body rescue the bank before the liquidation is over. The delegate emphasised that the state aid rules of the Treaty of Rome will apply in the case of a bank crisis which involves intervention which is sustained or pushed by the state. Even a mandatory private scheme may fall under the state-aid rules if the state has a major say in how the bank should be saved.

The delegate from France sought to emphasise that a system of mandatory deposit insurance can be favourable to the growth of competition in the banking sector. First, when the system of bank guarantees functions well, it is easier to let banks fail because one knows that consumers (for whom there is an important policy interest) will be, at least to a minimum extent, protected from the consequences. Second, a system of mandatory deposit insurance reduces the inequality between the large and small banks, resulting from the fact that certain banks are too big to fail. In the absence of a system of deposit insurance an individual depositor who cannot analyse the accounts of the bank knows only that the bank a

particular bank is a large bank and that as a result, his money will be protected. A deposit insurance scheme may, in a similar manner, level the playing field between domestic and foreign banks.

The Canadian delegate noted that although in Canada the insurance system guarantees a certain percentage, up to a certain level of your deposits, “stacking” is allowed, which permits a depositor to split his deposit in such a way that he can almost recover 100 per cent. In contrast to Australia, the response of the banks that are covered and are forced to participate in the insurance system is to argue that they are placed at the disadvantage simply because they are forced to participate.

The Secretariat (CMF) responded to the European Commission and the Bank of England comments on the question of moral hazard. Moral hazard arises when the depositor does not take account of the risks that the institution is undertaking (because he or she will be compensated in the event of insolvency) and, as a response, the institution itself undertakes risky kinds of activities. The delegate noted that there is a need for the state to be involved in regulating banks because it is undesirable to have bank customers trying to determine whether or not their bank solvent. Bank customers will not typically be able to determine whether or not their bank is solvent because the necessary information is not available to them in a form they can digest.

The Australian delegate noted that it is quite clear that one of the big causes of the current problems in Asia relate to problems of supervision and other regulatory arrangements concerning the whole financial sector. Some of supervision arrangements appear to have given rise to a good deal of moral hazard type behavior.

The Australian delegate went on to mention a couple of alternative perspectives on the need for bank regulation from the writings of Professor Hayek. He firmly believes that the regulation of banks is the cause of existing problems in the financial sector. He points out that for many years the banking system was privately run. He attributes the monopoly on the printing of money and the centralization of regulation of banks to be the real cause of the inflation we have experienced since the these regulations were implemented. Under a private banking system, the incentives for banks to keep the rate of depreciation of their own currency down would be large, whereas the exact opposite incentives apply when governments operate a monetary policy. He had similar views on these other regulatory issues. As competition policy and market functioning become more important in the public policy calculus, we should critically evaluate the effects of deposit insurance schemes and bring them to the attention of policymakers.

Towards Market-Oriented Regulation

The second part of the discussion focused more directly on regulatory reform. This part of the discussion addressed issues such as: What is banking regulation trying to achieve? and How can we achieve these objectives with a greater reliance on market forces?

What Is The Market Failure?

The Secretariat from the Competition Law and Policy Committee raised the question: what is the market failure in banking? If we do not know what is the market failure, then we cannot know whether the regulatory interventions that are being discussed are effective, or well-targeted, or whether they are necessary at all. The delegate emphasized that there is a strand in the economics literature which questions

whether there is a market failure in the banking sector demanding regulation at all. This literature argues that greater reliance on market forces would not jeopardise stable, prudent banking outcomes.

The primary public policy concerns in the banking sector relate to the consequences of bank failures. Therefore it is necessary to determine what it is about bank failures, as opposed to failures in other sectors of the economy, which yield particular public policy concerns. There are three possible lines of argument:

- (1) First, that the failure of a bank is more serious than the failure of a similarly sized nonbank firm.
- (2) Second, that the failure of a bank can lead to runs on other banks leading to the failure of other banks including other solvent banks.
- (3) Third, that the failure of an individual bank could lead to a loss of confidence in the banking sector as a whole leading to a loss of stability in the banking system with potentially serious macroeconomic consequences.

In regard to the first argument, that the failure of a bank is inherently more serious the failure of a non-bank, it was noted that bank services are relatively homogeneous from one bank to the next, therefore there are often different suppliers of relatively close substitute products -- for consumer loans consumer credit business loans etc. Some customers make an investment in bank specific information and these customers will lose, and incur costs in switching to alternative providers. Overall it does not appear that bank insolvencies are systematically worse for shareholders and creditors than non-bank insolvencies.

In regard to the second argument, that the possibility that a bank failure could trigger a run leading to the failure of other, potentially solvent banks, the Secretariat noted that economic studies of this point find that runs, when they occur on insolvent banks, do not spread to other solvent banks. The economic evidence shows that bank runs do not threaten other solvent banks. Instead, running depositors can distinguish between solvent and insolvent banks.

The third argument was that there is a public policy concern relating to bank failures because widespread bank failures could cause a significant contraction in the money supply which would have important macroeconomic consequences. However, the Secretariat noted that depositors, if they can distinguish sound from unsound banks, when they withdraw their money from an unsound and insolvent bank, are likely to simply redeposit their money in another bank. The net effect on a money supply as a whole is limited or zero, especially if the banks hold similar reserve ratios. So, in that circumstance, there is no effect on the overall money supply and therefore no overall macroeconomic consequences. There is the possibility that depositors could lose confidence in the banking system as a whole and withdraw their deposits and hold cash. In such circumstances there could be a role for the central bank to intervene to offset the reduction in the money supply. However, there is no necessary link between bank failures and macroeconomic effects, especially if the central bank can play a role.

The UK suggested that there are two features of banks' balance sheets which make them special. One is the extent of interbank exposure - unlike banks one corporation is not likely to be engaged in a significant amount of lending to a competitor. The presence of interbank lending means that regardless of runs, the failure of one institution can lead to failures at other institutions. The second special feature of the banking industry is that banks engaged in maturity transformation. Their assets are illiquid and their liabilities are, to a large extent on call. So a bank run can turn a solvent institution into it insolvent institution if they cannot liquidate assets quickly enough.

The Secretariat (CLP) responded to these questions, starting with the question of large interbank exposures. If a bank lends to an individual, to a firm or to another bank, that is part of the normal credit risk that a bank manages as part of the ordinary course of its business. If a bank happens to lend to the residential housing sector and a large number of residential housing loans go bad and the bank fails as a result, that is not normally a public policy concern. For the same reason, if a bank lends to other banks, and the other banks fail and, as a result the first bank fail, that is not normally a public policy concern.

This argument puts to one side payment-system risk. The payment system may create particular problems. It is possible that, as a result of the payment system, large inter-bank exposures may build up, particularly during a single day (in many systems settlement does not occur until the end of the trading day), but with new developments in payments systems, such as real-time settlement these exposures are significantly reduced or eliminated, virtually eliminating payments system risk.

In regard to the question of the illiquidity of assets and the potential for runs to turn a solvent bank into an insolvent bank, it was argued that it cannot be simply the *illiquidity* of the assets that is at stake. Non-financial firms also invest in what are clearly illiquid assets. In fact, it is quite hard to imagine a non-financial firm with entirely liquid assets. What is important is that, a large proportion of the liabilities of a bank can be withdrawn on demand. However, even the liquidity of liabilities does not clearly make banks different from other firms. It is quite common for loans to non-financial firms to have a term which says that the entire amount outstanding falls due upon the trigger of some event, such as the failure to make a payment. As a result, runs can and do happen on non-financial firms. It is not uncommon to have a situation where you have a large number of creditors swooping on an insolvent firm to claim its assets. The standard insolvency laws of the economy are designed to deal with such "runs". It is not clear that the insolvency of financial firms (and banks in particular) is sufficiently different to justify special public policy treatment.

The United Kingdom responded by noting that there is a large body of literature on why banks are special. The delegate noted that if one bank failure can, in theory, trigger a chain of bank failures and you are therefore facing the possibility of a large proportion of a nation's banks becoming insolvent then this would be a public policy concern.

Moves Toward Reliance On Market Forces

The Chairman noted that some of submissions contained statements that suggest a movement towards greater emphasis on market mechanisms and competition. For example, there is a statement in a Canadian report which reflects the views of the Canadian Bureau of Competition which says that: "the public policy objectives that underline the review can best be achieved by relying upon competition and market forces to the maximum extent possible rather than through continued or increased regulation. The Competition Bureau of Canada recognizes that stability of the financial system is generally a paramount goal of financial market regulation and that stability may come at the expense of competition. In the Bureau's view however, there are regulatory changes that can increase regulatory flexibility and increase competition without compromising the stability and solvency of the financial system."

In response the Canadian delegate noted that the Bureau of Competition Policy does a great deal of advocacy work, including advocating greater reliance on market mechanisms in the financial sector. The Competition Bureau wants to signal to policymakers that they should not disregard reliance on the market mechanism. The delegate also noted that the process of reform is likely to be iterative and should be structured in a coherent manner so as to make a smooth transition from a regulated system to a market system.

The delegate from Finland noted that their submission quoted a statement in which the Finnish government states that it wishes that market discipline will take a more important role in preventing bank failures. The reason for this is that placing more reliance on market forces would mean that the bank owners would look more carefully at what the bank is doing and, in particular, what kind of risk-taking policy it is operating. The practical implementation of this will differ from country to country according to the nature of the regulations in each country.

The Secretariat (CLP) noted that in this discussion of reliance on market forces, the regulatory regime for banking in New Zealand is relevant because the New Zealand government has tried to go further than most countries in relying upon market forces to ensure incentives for discipline and prudent behaviour in banks. In the banking sector in New Zealand, there is no statutory deposit insurance; no lender of last resort; and no expectation of government assistance in the event of financial difficulty. The objective is to give depositors, especially large lenders and large financial institutions, strong incentives to diversify and to assess and monitor the condition of their debtor bank. Of course, that, in turn, provides incentives for the bank itself to undertake, and to demonstrate that it is undertaking, measures to limit the risk to which it is exposed, including, payment system risk, market risk, credit risk and so on.

New Zealand has focused its regulatory interventions in three directions. First, they have sought to enhance disclosure. Banks in New Zealand are required to produce a quarterly disclosure statement which is made available to the public. An important component of that is that they are required to publish their credit rating from a recognised rating agency. These disclosure statements are widely reported in the press. Second, the regulations have sought to enhance competition and remove regulatory constraints (such as line of business restrictions, portfolio restrictions, and that sort of thing). The idea is to make sure that the government policy does not impede the development of active inter-bank markets, diversification of funding instruments and sources, the development of institutional investors and the entry of sophisticated foreign players. Third, the New Zealand government have sought to enhance the incentives on directors and the upper-level management of banks to take personal responsibility that the bank is managed in a sound and responsible manner. One important aspect of this is that there is a requirement for directors to sign a statement testifying to the accuracy of the disclosure and the bank has satisfactory risk management policies in place.

The following observations were made about this regime. First, the compliance costs are low. The Wallis Inquiry found that compliance costs in the New Zealand regime, measured in terms of basis points were about half that of the UK, about five times lower than in Australia and about eight times lower than in the USA. Second, there is no evidence, so far, that the financial markets consider this regime any riskier than the previous regulatory regime. Risk margins have, in anything, narrowed since the introduction of the new regime. Third, so far the capital-adequacy ratios of New Zealand banks have remained comfortably above the 8 per cent recommended by the Basle Committee.

A criticism that is often heard is that New Zealand is a special case because virtually all the New Zealand banks are foreign owned. Therefore they can "free-ride" upon the prudential regulation standards of other countries.

Elimination of Anticompetitive Features

At this point France presented two cases in which the Competition Council had issued opinions on structural distortions to competition. These related to, first, distortions associated with a legal monopoly in the selling of certain banking products and, second, distortions induced by cross-subsidization from public service activities to competitive activities.

The delegate discussed first the competition distortions associated with certain exclusive or monopoly rights. Two types of privileges were identified which could justify regulatory and legislative changes. The first privilege concerned a monopoly in the distribution of the so called "livret A" which was granted exclusively to the French post and to the Caisses d'Epargne and of the "livret B" which is distributed exclusively by the Crédit Mutuel. The objectives of these monopolies were the encouragement of private saving and the financing of social housing. The Council suggested that, if the monopoly of the Post and the Caisses d'Epargne was removed, the commercial policies of other banks would leave the Post and the Caisses d'Epargne with the least profitable accounts (those with the smallest deposits and the most numerous transactions), potentially rendering these entities unprofitable. In response, the Council suggested that the maintenance of such unprofitable accounts should be explicitly recognised as a public service and separately funded by the government. As for the role of these monopoly rights in the financing social housing, since the funds for that purposes are explicitly separated from the other funds of the banks, the Council considered that (in contrast to the above) this objective would not be compromised by an opening to competition provided that the newly authorised agencies were subject to the same obligations in the collection of these funds.

The second competition distortion arose in connection with a monopoly over the deposits of notaries of the funds of individuals. This monopoly was granted for "security reasons" to Crédit Agricole, la Poste and, above all, to the Caisses des Dépôts et Consignations. The question was whether or not this monopoly was compatible with article 90 of the Treaty of Rome. There were three key arguments; First, the Council examined the reasons given and found that the reasons related to the desire to finance social housing were valid and could explain the monopoly in the distribution of the "livret A" in the Caisses des Consignations. On the other hand, justifications based on the need to ensure the security of deposits was debatable. Second, the Council considered that if the regulatory regime created an obligatory and unlimited guarantee scheme for funds deposited with notaries, other credit establishments should also be able to receive these funds. As a result, the granting of exclusive rights to these establishments (Caisses d'Epargne, Caisse de Dépôts et Consignations, Crédit Agricole) could not be considered as acceptable with respect to article 90 of the Treaty of Rome. Thirdly, and above all, the Council considers that one of the reasons for the granting of monopoly rights to the Crédit Agricole was due to the concern of the public authorities to facilitate the development of this entity at the time of its creation as a result of the role it was called to play, particularly in rural regions and in the financing of the development of agriculture. This role has disappeared for two reasons. On the one hand, the Crédit Agricole is no longer a public entity but a privately held company, with diversified operations. On the other hand, the Crédit Agricole has become one of the leading French banks. As a consequence, the Council gave its opinion that this monopoly right in respect of the Crédit Agricole is not justified.

The Japanese delegate explained the Japanese financial system reforms - the so-called "Big Bang" in Japan. First, banks will be authorised to sell securities, investment trusts and insurance. Banks will be authorised to sell securities investment trust certificates without going through subsidiaries. With regard to insurance, banks will be authorised to sell long-term fire insurance policies and credit life insurance policies, which are related to housing loans. It is planned that this will be implemented around 2001. Second, the appropriate legal provisions will be made to allow the use of holding companies and to take necessary measures to protect depositors, investors and insurance policy holders. Third, the remaining restrictions on the business scope of securities subsidiaries and trust subsidiaries will be lifted in the latter half of 1999. Fourth, operational regulations applied to ordinary banks in the short and long-term finance system will be abolished. Ordinary banks will be allowed to issue ordinary bonds in the latter half of 1999.

The delegate from Czech Republic commented that at the moment the Czech banking sector is characterised by a considerable concentration of banking services in the hands of four large banks. As a

result, this market has oligopolistic features. Czech banks can be divided into three categories. First, the four large banks, which each have a strong ownership interest by the state of around 36-40 per cent (in one case more than 50 per cent). This group of large banks has about 66 per cent of the assets of the banking market. Second, foreign banks. Third, a group of small banks with mostly Czech capital. This group of small banks was important in the first phase of the introduction of competition in banking services because they supported this process. On the other hand they had shortcomings in strategy, in management direction and lack of experience. In the end, they were also the most problematic part of the banking sector. The result was the withdrawal of banking licences in the case of nine banks, and a special regime in the case of four other banks. These small banks can fill gaps in banking services; satisfy regional needs and offer specialised activities.

At present, the only bank for which privatisation has been prepared is the "Investment and Postal" bank. The Czech Bank Nomura is intending to take a share in this bank of 36 per cent. It is not clear that this transaction will go ahead as the transaction must be approved by the Czech Government.

The Czech Republic continued with comments from the Czech National Bank. The CNB considers that competition is strong among foreign and large banks for top-level clients (i.e., large companies, large exporters, joint ventures and so on. There is less competition in retail banking.

The delegate acknowledged that the Czech banking sector has had difficulties. At the beginning of the 1990's the CNB had very liberal rules for new entry into the market, in order to increase competition. As a country in transition, the new clients of the banks had no history and little or no experience with their own businesses. In addition, the bankers had little or no experience with the business of banking. Furthermore, banking supervision had very limited human resources and therefore an inadequate level of regulation. Finally the general legal environment was simply not appropriate. For example, it was very difficult to speed up bankruptcy procedures.

In response, the CNB applied more strict assessment of new applicants for banking licences, new investors buying into established banks as well as for the new top managers in existing banks. The CNB also eliminated numerous banks from the market and pushed the government to sell their shares in large banks to increase their competitiveness, to inject some capital and to improve the allocation function of these banks. The CNB also introduced a so-called stabilisation programme for those small banks which were able to survive and to find a viable position in the market. In addition, Czech legislation was harmonized with the EU Directive and Basle Committee recommendations.

The European Commission explained the concept of state aid, noting that EC state aid regulation is an essential part of the European competition rules which are relevant for banks. Banks are not excluded from the application of state-aid rules, nor is special treatment reserved to them. Although the Commission acknowledges the peculiarities of the banking sector, it considers that these peculiarities do not justify exemption from the state-aid rules. It follows that many financial transactions like state rescues for failing banks, state capital injections into state-owned banks, fiscal advantages and other financial advantages granted to credit institutions by bodies under public authorities' influence are subject to the Commission scrutiny under the terms of Article 92 and 93 of the Treaty. This also implies that all these kinds of interventions should be first notified in advance to the Commission to allow the Commission to assess whether or not the aid is compatible with the Common Market.

The application of state-aid rules in the financial sector is relatively new. Although the treaty rules date from 1957, the Commission has only recently had to address state-aid cases in the banking sector. That is a result of the increasing liberalisation in the market and increasing integration of European

markets. In these cases, the Commission's approach is to try to assess what kinds of conditions can be imposed on the failing institution, if a rescue is absolutely necessary.

General Discussion

The Italian delegate noted that thanks mainly to the work done by the Basle Committee, a new supervisory model is emerging. This model tries to reinforce market mechanisms rather than substitute for them. The model is based on three elements:

- (1) *Capital Adequacy*; Capital is a cushion against losses. Capital also reduces shareholders' willingness to place depositors' money at risk. In the future, it is presumed that banks will be asked to calculate their own capital requirements, using their internal models for measuring risks, as is already happening for market risk.
- (2) *Internal Controls*; As above, supervisors do not ask banks to adopt a particular organisational model. They are just asked to establish their own internal guidelines and organisation in a way consistent with their risk profile.
- (3) *Disclosure*; As has been said many times, providing reliable and comparable information to the market reinforces market discipline.

The delegate considered that market discipline would not be a complete substitute for prudential supervision, for the following reasons: First, it is not possible to disclose all the relevant information. Second, small depositors are not able and willing to monitor their banks on a continuous basis.

This was followed up by an intervention from the Secretariat (CMF) who noted that if the parent bank of a New Zealand bank got into trouble it would be likely that the subsidiary or the branch in New Zealand would have to pay a cost in the interbank market for lending. In fact, if the parent gets into sufficient trouble there could be a run on a New Zealand bank for nothing that it has done, but simply as a result of the action of the parent.

The Secretariat (CMF) questioned whether it is possible that regulation could be strongly affecting competition as it was observed that banks appear to be competing with each other. Indeed, in the case of the Asian crisis, the banks in the industrialised democracies were lending to the Asian countries at spreads off U.S. Treasury Bonds that some of the industrialised countries would have been happy to borrow at a number of years ago. However, the delegate simultaneously noted that there was a problem with regulation - with slow learning by regulators, their unwillingness to intervene ex ante, but their great willingness to intervene ex post, with taxpayers money.

The delegate noted that in the Czech Republic, during a period when financial laws were not strictly enforced, there was clear insider trading in the Czech markets. The delegate also noted that there were likely to be macroeconomic effects of the fragile position of the banks in Japan. The delegate asked why banks in Europe and Japan did not limit their exposure to banks in Asia and why the regulators did not force them to do so.

The UK responded that the regulators have to strike a balance between running the bank, or allowing the bank managers to run the bank. In general, in the Asian crisis, or in any crisis, the regulators' mode of intervention is through the capital arrangements for banks. These are not an intrusive means of regulation. They simply ensure a cushion of capital to protect against losses. The fact that the regulators

did not stand up and say “you are lending too much to Asia” does not imply that they did not have an intervention policy.

The Bank for International Settlements emphasised that why banks are different from other firms has to do with asymmetry of information and free-riding problems in deposit-monitoring. It is a result of the nature of both the assets and the liabilities of banks. If banks were funded with loans rather than with deposits, the situation would be different. The delegate noted that it remains to be seen how the New Zealand system will behave under stress. We can get an idea of what would happen if one of the holding companies that owns one of the banks in New Zealand suddenly got in trouble by looking at what happened in the '70s and '80s when some U.S. bank holding companies' non-bank subsidiaries got in trouble. That motivated runs on the banks that were part of the same holding company. It is likely that the same would happen in the New Zealand case.

The Australian delegate asked to what extent are banks different simply as a result of the system of regulation. Is the maturity structure of their borrowing and lending partly a consequence of the regulatory system that we have? Is the high degree of interbank lending a function of the regulatory system, or the other way around? If we didn't have regulation, what sort of market devices would spring up to overcome the prudential concerns? Some kind of market mechanisms would very likely come in to place. The remaining market failures may still justify some regulation. However, it is probably the case that the regulatory system itself actually inhibits the development of market-type responses in these situations.

In regard to the large literature favouring regulation, the delegate predicted that a large proportion of the literature justifying banking regulation comes from bank regulators.

The delegate from the Slovak Republic summarised the banking regime in that country. The Slovak Republic does not have any controls on interest rates or other controls on prices or fees. Banks and branch offices of foreign banks may enter the financial market of the Slovak Republic on the basis of a banking licence granted by the central bank (the NBS). An amendment to the banking act of 1996 introduced a two-step licencing procedure similar to that used in other European countries for banks and branch offices of foreign banks, consisting of a licence to establish a bank and a licence to operate as a bank. In granting a licence the NBS imposes strict requirements governing the quality of investors, credibility, transfers and the contribution of the bank to the market in terms of introducing new banking products and know-how. The strategic intention of the NBS, rather than encouraging the entry of a new universal bank to the market, is to create favourable conditions to attract potential investors to make capital contributions into existing banks. The reason for this is that the Slovak market is rather small and there are already 20 banks competing in the market, 4 foreign branches and 10 representation offices.

Ownership linkages among financial institutions are regulated directly by the NBS in its assessment of applications for permission to establish a new bank or branch office. Banks may acquire shares in excess of 10 per cent of the equity of a non-bank entity only with the prior consent of the NBS. Similarly a bank may purchase shares or acquire capital stakes in bank entities in excess of 25 per cent of a bank's equity capital and reserves only with prior consent of NBS. All banks and branches of foreign banks are obliged to participate in the protection of private deposits by a deposit-protection fund and pay the contribution to the fund for these purposes. There are also restrictions on capital adequacy, minimum reserve requirements, requirements to direct credit to private sectors and other prudential operations.

Conclusion

The Chairman concluded this part of the roundtable noting that we didn't solve the major philosophical problem, whether banks should or should not be regulated. The Chairman agreed with Australia, that maybe most of the problems are created by regulation. The market might find other solutions and these solutions would not necessarily be less efficient than the outcomes that we have now with regulation. At this stage it is not possible to be certain.

However, market mechanisms and competition are becoming more and more important in the banking industry. More and more it is possible for banks to choose the form of organisation that they find most profitable. The desirable outcome in this and other markets is a system by which regulation is not impeding (in an unjustifiable way) the functioning of the market and is not distorting choices between firms.

The roundtable highlighted the problem of risk and the association of this risk with deposit insurance schemes. If banks' liabilities are protected, because of the deposit insurance scheme, then of course they would be more likely to enter into riskier business than an institution that does not have that type of protection. Deposit insurance schemes should be structured in such a way as to prevent this type of distortion from occurring, perhaps by making the deposit insurance scheme more risk-oriented.

Interaction Between Sector-Specific and Competition Regulation

At this point the discussion turned to focus directly on competition law enforcement issues, beginning first with a discussion of the institutional arrangements for enforcing competition law and continuing with issues that arise for the competition authority in this sector.

Institutional Arrangements For Enforcing Competition Law

Application Of Competition Law and Institutional Arrangements

The delegate from Portugal noted that there are some special features of the Portuguese competition law with respect to banks and financial institutions. In general, the Competition Council has the power to decide on competition law violations, without restriction. But, in the case of banks, it must obtain an opinion from the central bank (Banco de Portugal) on the issue at stake. There are also some cases which may be a violation of the competition law in general but which are exempted in the case of banks. Until now the Competition Council has not decided any cases concerning restrictive practices by banks.

Concerning mergers, in general the power to authorise mergers is exercised by the government, after obtaining an opinion from the Competition Council. In the case of banks, this power to authorise mergers is held by the central bank, after obtaining an opinion from the Competition Council. An amendment to this law is expected.

The delegate from Norway explained that in Norway there is a single regulatory authority for the financial sector, called the Norwegian Banking, Insurance and Securities Commission, subordinated to the

Ministry of Finance. The majority of cases and issues dealt with by this Commission do not have a significant bearing on competitive conditions, but in some cases, the Commission may take competitive conditions into account, for example, with respect to collaboration agreements, mergers or takeovers coming under the financial legislation.

Two years ago a working group was appointed to study the need for coordination of the procedures of the competition authority and the securities commission in cases which have a bearing on competitive conditions in the financial markets. Based on the report from the working group, the Director-Generals signed an agreement on relations between the two institutions. The agreement contains a description of the areas of overlapping competence between the two authorities. The agreement does not, however, restrict the legal competence and the use of instruments of either authority.

Due to this, there is in the financial markets, as in several other markets, a surveillance system with substantial overlapping competence, duplication of personnel and legal uncertainty. The two authorities do not have identical criteria for assessing the effect of, for instance, a merger between two financial institutions. The objective of the Competition Act is the efficient utilisation of societies' resources whereas the securities commission emphasises financial strength, financial stability and competition aspects. The different approaches could very well imply that the authorities could draw different conclusions from an investigation of a merger. It is, for instance, possible that the securities commission would authorise a merger if it would strengthen the new unit's financial position, while the competition authority, after an investigation, would intervene against the merger if it would restrict competition. The conflict of interest would then have to be dealt with during the appeal procedure.

Canada noted that there are three Canadian regulators that may have jurisdiction over a merger - the Competition Bureau (which deals with the competition issues), the Office of the Financial Supervisor of Financial Institutions (which looks after prudential issues) and the Minister of Finance (who bases a decision on public interest). The roles are well defined with the exception of the public interest criteria applied by the Minister of Finance. Investigation and analysis work is done simultaneously by all three bodies. The decisions that are taken are usually issued simultaneously, but not jointly.

OSFI can block a merger for prudential reasons and if so, the Competition Bureau cannot force the merger to go ahead (technically there is no longer a merger for the Competition Bureau to evaluate). If, on the other hand, the Bureau decides that a merger will result in a substantial lessening of competition, regardless of the decision of the prudential regulator, the merger will be referred to the Competition Tribunal. The prudential regulator cannot force approval. If all three regulators agree there is no problem, the merger will go ahead. If the Minister decides to block it for public interest reasons, he has the right to issue a certificate to the Competition Bureau not allowing the merger to be challenged or taken to the Competition Tribunal.

The Bureau has recommended that the Minister of Finance make it clear exactly what constitutes the public interest criteria and that competition issues do not fall within that criteria so that he would not block or force approval of a merger based on competition issues.

Competition Authority vs. Banking Regulator Enforcement

Should competition law be applied in this sector by the competition authority or by the banking sector regulator? There are some countries in which the role of the sectoral regulator is quite important in the application of competition law (e.g. Italy and the United States).

The Italian delegate acknowledged that in Italy the Bank of Italy enforces the competition law in the banking sector. Competition decisions are taken by the Bank of Italy after obtaining an opinion from the Italian Competition Authority.

There are three possible reasons for the choice of the Bank of Italy as enforcer of competition law in banking. The first relates to the specificity of the banking sector. This sector is different from others. No other sector can influence the economy of one country as the banking sector. The second point relates to the track record of the Bank of Italy. Since the beginning of the '80s, the Bank of Italy has actively pursued a higher level of competition in the banking system and has successfully promoted competition, not only inside the banking market but also between different financial markets. The third argument is that obviously the Bank of Italy has an enormous knowledge of the banking system.

In practice the competition law is enforced in a department that is completely separate from the supervision department - the procedures, the people and the decisions are completely separate. There are no differences in principle in the manner in which the laws are enforced by the bank of Italy compared to the competition authority.

The U.S. delegate indicated that the U.S. system of "cooperation" or "consultation" between the prudential authority and the competition authority works well. Some of the reasons for the way the system evolved are historical. There are four separate agencies which are involved in regulating financial institutions. In addition to the Federal Reserve system, there is also some regulation carried out by the Comptroller of the Currency and through the Federal Deposit Insurance Corporation and the Office of Thrift Supervision. With respect to financial mergers, the Federal Reserve or the OCC is usually involved but other regulators may be involved also.

Over the last 20-40 years a system has been developed that works quite well. Typically, most banking mergers are handled by the Federal Reserve Board. They are charged under the U.S. banking laws with not allowing mergers that threaten competition unless the anticompetitive effects are clearly outweighed in the public interest by the probable effects of the transaction in meeting the needs and convenience of the community to be served. They delegate the analysis of the competition issues to the Antitrust Division. The AD reviews mergers and reports to the appropriate authority the likely competitive effects of the merger. If there is no competitive problem, a letter is sent to that effect. If there is a competitive problem, the nature of the problem is spelt out in great detail and, in many cases, a resolution to the problem is proposed, and in some cases, negotiated with the merging parties.

In the rare case that there was an anticompetitive effect, but the Federal Reserve (or other authority) decided that the merger was in the public interest, the AD would still have authority under the Federal antitrust laws to file suit within 30 days of the transaction to block it, based on its own competition analysis. Despite the vast number of cases (few of which are challenged) there has been no significant disagreement with the regulatory authorities when the AD has proposed resolutions or remedies.

In Finland the task of enforcement of competition law with respect to banks has been shared between competition authorities and supervisory authorities. Since the Act on Competition Restraints 1988, there are no substantial competition law exemptions for the banking sector. However, both the supervisory authority and the competition authority have responsibilities for competition enforcement in the banking sector. According to the Act of 1988, the competition authority had only a secondary right to bring cases before the Competition Council (the decision-making body in competition cases in Finland). The primary right was reserved to the Financial Supervision Authority. The competition authority could act only if the supervisory authority did not. The current act, which entered into force in 1992 changed this

division of competence. Since then the competition authority and the Financial Supervision Authority have had parallel rights to investigate competition restraints in the banking sector and to bring cases before the Competition Council. However, the Office of Free Competition has had the sole right to grant exemptions.

At the end of 1997, the Finnish government brought a Bill before the Parliament enacting a new competition law. According to that Bill, the competition enforcement rights of the financial supervision authority will be removed and the competition authority will have the sole right to investigate competition restraints in the banking sector and bring cases before the Competition Council. This was done for the following reasons. First, the government wants to simplify and clarify the procedural rules of competition law. There is no reason to keep the exceptional procedural rules concerning the banking sector. In all sectors (including banking) the competition legislation should be applied and enforced only by the competition authority. This avoids dual control and the associated problems of contradictory decisions, dual resources and so on. Second, in practice, the right of the Financial Supervision Authority have not been exercised at all, since during the last five years that the current act has been in force, the authority has not brought any cases before the Competition Council. The enforcement of competition has been carried out, in practice, only by the competition authority.

There is no merger regulation in the Finnish competition law - so the above relates only to cartels, abuse of dominance and vertical restraints. In the Bill there is also a proposal that merger control should be included in the national competition law. Under that proposal there are no specific rules applying to banking.¹

Competition Issues In The Banking Sector

The final topic discussed related to issues arising from the enforcement of competition law in this sector. This discussion primarily focused on issues of market definition and merger enforcement.

Market Definition And Issues In Merger Enforcement

The delegate from the U.S. noted that when the Antitrust Division analyses proposed bank mergers, the joint FTC-DoJ horizontal merger guidelines are applied - the same guidelines that are applied to analyse any merger.

Generally speaking, when market definition is considered the AD focuses on both product markets and geographic markets. When the merger involves competition having a broad geographic effect -- either nationwide or worldwide effect -- there is unlikely to be a competitive problem. Most of the problems seen in recent years have been problems that involve localized geographic markets -- sometimes localized within a metropolitan area -- sometimes even quite a small geographic area. The concerns have been twofold: first, there is sometimes a concern about the market for small-business loans. There is a concern that banks have, historically, had advantages to being localized, to having knowledge of the local area, and people who submit applications for small business loans typically do not look very far to do so. A merger of two banks, both involved in small-business loans in a geographic area might create a competitive problem. Similar concerns apply to "middle market" loans - that is, loans taken up by

1. The Bill was passed in March 1998, and the amended competition act will enter into force on 1 October 1998.

somewhat larger companies in the area of \$10 million to \$100 million of sales. A third area in which the AD occasionally has concerns is consumer bank products.

Concerning market definition generally, there are differences of opinion about the right way to approach this issue. Back in the 1960s and 1970s there were a series of U.S. Supreme Court decisions involving challenges to bank mergers. The net result of those opinions was to encourage looking at the relevant market for products as clusters of markets that constitute commercial banking -- that would include consumer loans and banking services as well as business lines and other products. As a result of those decisions, the Federal Reserve has typically applied a "cluster market" approach and has defined a series of geographic areas based on cluster markets. Others, including some at the Antitrust Division, argue that the cluster market approach may not always be the best approach. It may be that the cluster market makes sense if you think that there are economies of scope in production so that all of the individual activities of the bank should be viewed as a group. On the other hand, it may be that certain banks specialize in one or two parts of the cluster and not in others. It could be that a merger which does not appear to be a problem at the cluster level, still could be a problem if you break down the services into individual products. The issue of cluster markets is still under discussion.

The Norwegian delegate noted that in preparation for an anticipated wave of mergers and acquisitions in the financial sector in Norway, the Norwegian competition authority undertook a study of the concept of the relevant market for the financial sector. There is now a degree of consensus or understanding with regard to the general principles of market definition. The starting point, of course, is the standard definition of the relevant market with product and geographic dimensions. On that basis two major groups of markets are defined: lending markets and savings markets. From there, a hierarchy of markets is disaggregated, depending on, for example, the type of collateral, risk exposure, sector breakdown (for example lending to enterprises and to households) and even according to the size of the enterprise.

The position taken in Norway is that the savings market should be considered to be national in scope. This is due to technological developments and new distribution channels (for example the Internet and the telephone) which has opened these markets to customers all over the country regardless of their place of residence. In addition the European Economic Area agreement has made it easier for financial institutions in the EU and EFTA countries to open branches in Norway.

Switzerland noted that in contrast to the US, the Swiss Competition Commission has in principle exclusive jurisdiction over questions of merger. There is one exception, in the case in which the merger is required to preserve the interests of the creditors - e.g., the case in which the objective of the merger is to save a small bank in difficulty.

On the definition of the market, the current tendency in Switzerland is to keep the product markets separate (as opposed to the cluster market approach). In regard to geographic market definition, it is clear that for some products the relevant market is international or national and, in these markets, there are no competition problems. As in the US, it is the regional and local markets which give rise to the biggest competition concerns. The view of the competition authority is that the changing attitude of consumers to modern technology is not yet sufficient to change the definition of markets. Swiss consumers are conservative and not yet ready to opt for new technology that allows access to national banks (let alone foreign banks).

Mexico began by noting that a number of radical changes have taken place since 1993 that have completely changed the competition situation in the Mexican banking sector, including the opening of the banking sector to foreign firms; and the financial crisis at the end of 1994 which brought quite a number

of banks very close to bankruptcy. So even if the argument that foreign banks enhance competition in the market were put aside, there remained the failing-firm defense argument to support a more tolerant position towards mergers.

Since then, there have been quite a number of mergers in the banking sector, of three main types: First, foreign affiliates in Mexico buying small privatized banks were which were on the edge of bankruptcy with relatively low market shares (failing firm defenses have been the main arguments to allow those mergers to proceed). Second, big Mexican banks have strengthened their position by alliances with foreign banks located abroad. These alliances do not affect the market structure within Mexico there is not a problem with these mergers either. The third kind of merger involves restructuring of financial groups and relates to the way in which banking and insurance and securities firms are separated in Mexico.

The Italian delegate explained how the Italian competition authority determines the market power of banks. Their approach is to use the normal instruments of antitrust. The Bank of Italy, as a general rule, bases its analysis on the substitutability of demand. Supply-side substitutability may also be taken into account in the definition of the market when its impact is equivalent to that of demand substitution in terms of immediacy. The Bank of Italy does not accept the cluster analysis as such, because different markets can be distinguished within the overall activities of banks, but recognise the existence of “rage effects” on competition due to the possible substitutability between different products offered by the banks. The competition authority agreed with the Bank of Italy upon a definition of the relevant geographic markets that differs according to whether the product under consideration is loans, deposits, or Internet banking. A recent joint inquiry on corporate finance sets out the definitions of the different markets that have been found to be important in corporate finance. The authority measures market power in the normal ways: Herfindahl indexes, brand names, strength of competitors, and so on. In regard to remedies the authority tries to intervene primarily using structural measures and to avoid the use of behavioural remedies and other regulatory instruments.

The Issue Of “Too Big To Merge”

The Australian delegate noted that, in general, the government entrusts competition decisions to the competition regulator, but, in regard to the big four banks merging, it will not let that be dealt with, at this stage, by the competition regulator alone. It has decided to simply prohibit those mergers. The government has said that this is because of concentration in the banking market and, in particular, the lack of competition in small-business lending and in some other markets, mainly the transactions market for consumer affairs. It has also been argued that in the national market there are four big players and a few fringe players. There is an argument that if, No. 4, merges with No. 1, then, inevitably No. 2 and No. 3 will merge. In addition, the central bank argues that if there were just two major banks, a failure of one of those banks would lead to severe problems in managing the monetary system. The underlying reasons for opposing big bank mergers are partly related to public opinion. Public liking of the banks is very low.

The Wallis report that was mentioned earlier recommended a lot of very important pro-competitive reforms. One of the reasons for not allowing big bank mergers at the moment is that the government considers that these mergers, if they occurred before the pro-competition reforms are completed, would stop competition from developing. There are also political reasons for opposition to big bank mergers include fear over loss of jobs. That would not be popular at the present time.

In response the French delegate raised a question about economies of scale and scope. Recalling that the Australian delegate mentioned that a merger of two large banks would lead to significant

redundancies, the French delegate questioned whether this was a result of economies of scale. There could be redundancies that are not linked to economies of scale (if, for example, new technology changed the methods of production), but this does not apply if the redundancies are explicitly linked to a merger - in this case the redundancies can only be explained by important economies of scale. However, earlier it had been noted that economies of scale in banking are not as important as economies of scope.

The Canadian delegate noted that Canada has a "big shall not buy big" policy. However, recently the largest and the third-largest banks announced plans to merge. This places the future of this policy in doubt. The Bureau made a submission to the Task Force suggesting that if the underlying rationale for "big buying big" was simply economic concentration, then this should be dealt with by the Competition Bureau and the Competition Tribunal, rather than having a blanket rule issued by the Minister of Finance. The merger that was announced will not be completed until after the decision of the Task Force. Whatever the recommendation of the Task Force, the Minister may decide to retain a "big shall not buy big" policy in Canada.

General Discussion

Italy noted that the situation hypothesised by Australia would produce completely different consequences in different countries. A concentration between two large banks in the United States (and probably also in Switzerland) leads to unemployment of say 20 per cent of the people employed in the two banks (perhaps as a result of closing overlapping branches). However, this situation will not arise in Italy because of the existence of some rigidities in the labour market.

Austria raised a question with regard to non-banking stakes of banks. Are there big non-banking interests of banks in other countries and are they also seen as part of the banking conglomerate and secondly, do competition authorities see loans to big companies as completely competitively neutral?

Germany responded that, in fact, there is a substantial shareholding by German banks in all kinds of industry. Usually, it does not exceed 50 per cent but there is often cross shareholding. The competition law was amended to be able to control mergers below the threshold of 25 per cent to handle cases like these. In general, these fears have not materialized because there are limits to how many positions bank managers can take on company advisory boards. There have also been some problems linked to the fact that there are strong state-owned banks involved in industry, e.g., West LB, which is very much engaged in the tourism sector. Private banks claim that they are at a competitive disadvantage because it is much easier for state-owned bank to raise capital at low interest rates. The German competition authority has been looking deeply at these issues.

Conclusion

The Chairman concluded with a very brief summary of this last session. As before, in deregulation, there is an evolution towards greater competition and greater influence of market mechanisms in the way that banks are organized and in what banks are allowed to do. The Chairman noted that this brief discussion of competition enforcement and competition law, demonstrate that regardless of the different institutional setup competition law is applied everywhere to the banking industry, with very similar results and with very similar principles.

AIDE-MEMOIRE DE LA DISCUSSION

La réglementation bancaire, pourquoi faire ?

Libéralisation

Les débats débutent par l'examen des importantes évolutions récentes intervenues dans la réglementation bancaire, dont la réduction des obstacles à l'entrée, la suppression des restrictions concernant les taux d'intérêt, l'assouplissement des contrôles du capital social et des activités des banques, ainsi que l'harmonisation des régimes réglementaires applicables aux différentes entreprises du secteur financier.

Rôle des organisations internationales

Le délégué de la Banque des règlements internationaux note que la question de savoir si le secteur bancaire doit être réglementé est étroitement liée à celle de la raison d'être des banques. Les auteurs modernes justifient l'existence de ces intermédiaires par leur rôle de prestataires de services de suivi d'une part et de gestion des liquidités d'autre part. En fournissant des services de suivi, les banques contribuent à l'efficacité de l'économie, puisqu'elles évitent les surcoûts entraînés par les activités de suivi faisant double emploi. Au lieu de procéder chacun de leur côté à l'évaluation d'une entreprise avant de lui consentir un prêt, puis au suivi du cours de ses actions, les investisseurs potentiels peuvent juger préférable de déléguer ces tâches à une banque par l'intermédiaire de laquelle ils fourniront des fonds à l'entreprise. En fournissant des services de gestion des liquidités, les banques accroissent l'efficacité de l'économie dans la mesure où elles proposent des placements (dépôts à vue) qui protègent les investisseurs contre les aléas qui pourraient affecter leurs préférences quant à l'échelonnement dans le temps de leur consommation.

Les travaux de recherche montrent également qu'en fournissant des services de gestion des liquidités les banques s'exposent à des retraits massifs de fonds. La raison en est que la valeur de liquidation du portefeuille d'actifs des banques est inférieure à la valeur de leurs dépôts liquides. Il peut s'ensuivre une ruée sur les guichets de banque sans qu'il soit besoin d'aucun événement pour la déclencher. Si les déposants paniquent, ils peuvent chercher à retirer leurs fonds de crainte que d'autres le fassent avant eux, entraînant la faillite d'une banque par ailleurs saine. Une ruée sur les guichets de banque s'avère coûteuse parce qu'elle contraint à la liquidation prématurée des actifs, ce qui perturbe le processus de production. Elle peut en outre se propager à d'autres banques par simple contagion, ce qui risque d'entraîner l'effondrement du système, avec de graves conséquences pour l'économie. Ce risque est la principale raison invoquée pour réglementer les banques. La volonté de protéger certains déposants, et notamment les plus petits et les moins avertis d'entre eux, constitue également une justification supplémentaire de la réglementation des banques fréquemment citée dans certains pays.

On s'accorde de plus en plus à reconnaître combien il importe que le cadre réglementaire intègre certains principes tels que la nécessité de s'appuyer sur des indicateurs de solvabilité précis, d'encourager un plus grand contrôle des banques par le marché, de prévoir des interventions lorsque les performances se dégradent et de pouvoir compter sur un mécanisme crédible qui permette le transfert du contrôle à un organisme de réglementation lorsque la banque ne dispose que d'une faible marge de solvabilité. Certains

de ces principes figurent déjà parmi les Principes fondamentaux pour un contrôle bancaire efficace définis par le Comité de Bâle sur le contrôle bancaire.

L'efficacité de ces principes dépendra de la structure institutionnelle des organismes chargés du contrôle et de la réglementation. Jusqu'à une date récente, le principal souci en ce domaine était de savoir si le contrôle et la réglementation bancaires doivent être assurés par la banque centrale. À mesure que les banques s'engagent davantage dans d'autres activités que celles qu'elles réalisent traditionnellement, telles que l'assurance et la banque d'affaires, de nouvelles questions liées à la conception du cadre réglementaire et à la structure institutionnelle des organismes de réglementation se posent. Vaut-il mieux établir les réglementations sur des bases institutionnelles ou fonctionnelles ? Est-il préférable qu'il y ait un seul organisme de contrôle et de réglementation ou plusieurs ? Dans ce dernier cas, comment les compétences et les responsabilités doivent-elles être réparties entre eux ? Quel doit être le rôle de la banque centrale dans ce nouvel environnement ? Ces questions n'ont pas encore reçu de réponse définitive.

Le délégué de l'Organisation mondiale du commerce commence par résumer l'accord de l'OMC sur les services financiers conclu le 12 décembre 1997. Cet accord est l'aboutissement du "programme implicite" de l'Accord sur le commerce des services (AGCS). Celui-ci impose certaines obligations fondamentales aux gouvernements – concernant la NPF, la transparence, la non-discrimination, etc. L'impact de l'AGCS tient en grande partie aux accords sectoriels qu'il prévoit. L'actuel accord sur les services financiers est l'un d'entre eux. Ces accords sectoriels invitent les gouvernements à prendre des engagements spécifiques en matière de suppression des restrictions existantes et d'extension du traitement national et des garanties d'accès aux marchés en ce qui concerne certains types de services. Ces engagements spécifiques sont définis dans des annexes et des listes très détaillées.

Ni l'AGCS ni l'accord du 12 décembre sur les services financiers ne retirent aux gouvernements le droit d'imposer des règles prudentielles. Celles-ci bénéficient d'une dérogation expresse en vertu d'une annexe à l'accord. Cependant, cette annexe stipule également que les mesures prudentielles ne peuvent être utilisées pour éviter ou tourner les engagements et les obligations contractés dans le cadre de l'AGCS. Les politiques monétaires et de taux change échappent au champ d'application de l'AGCS.

La Commission européenne note que l'UE a adopté une série de directives visant à lever les obstacles à la fourniture de services financiers par-delà les frontières et à assurer une harmonisation minimum des règles régissant les établissements de crédit dans les différents États membres.

L'une des plus importantes est la deuxième directive de coordination bancaire de 1988 qui établit un certain nombre de principes essentiels, tels que celui du *contrôle par le pays siège*, en vertu duquel l'agrément et le contrôle financier des établissements de crédit relèvent de la responsabilité de l'organisme de contrôle du "pays siège" ; celui de l'*agrément bancaire unique*, qui veut qu'une banque autorisée à exercer des activités dans un des États membres puisse également entreprendre des activités bancaires dans un autre pays membre ; et celui de la *reconnaissance mutuelle*, qui implique que tous les États membres reconnaissent leurs législations et leurs réglementations bancaires respectives.

Outre la deuxième directive de coordination bancaire, certaines directives plus techniques qui établissent des normes communes en matière de contrôle prudentiel ont été adoptées. Il s'agit notamment de la directive concernant les fonds propres des établissements de crédit qui précise quels sont les éléments couverts par la définition communautaire des fonds propres, de la directive du Conseil relative à un ratio de solvabilité des établissements de crédit qui garantit que les banques possèdent suffisamment de fonds propres pour les prémunir contre le risque d'insolvabilité, et de la directive du Conseil relative à la surveillance et au contrôle des grands risques des établissements de crédit qui restreint les grands risques

car une concentration excessive du risque sur un gros client ou un groupe de clients interdépendants peut créer un risque de perte inacceptable. Ces directives établissent des normes minimales – les États membres demeurent libres d'appliquer des mesures plus strictes.

La Commission étudie actuellement l'impact de ces directives. Un récent rapport conclut que les obstacles aux échanges sur les marchés bancaires européens ont diminué, que le nombre de succursales étrangères a progressé et que la concurrence s'est intensifiée dans les États membres. Cela a abouti à une baisse du prix de certains services financiers, et notamment des dépôts et des prêts. L'impact n'a pas été le même dans tous les États membres et il a été plus important dans le secteur des services aux entreprises que dans celui des services aux particuliers.

Le processus de libéralisation a également suscité de nouvelles formes de coopération transfrontalière entre les banques et une tendance croissante aux fusions. L'Europe demeure surbancaisée. On compte ainsi en Belgique une succursale bancaire pour environ 800 habitants, contre seulement une pour 4 700 habitants aux États-Unis.

Évolution de la réglementation et de la déréglementation

Les débats sur la déréglementation bancaire se poursuivent par l'examen de certaines des restrictions réglementaires les plus importantes, de leur raison d'être, ainsi que des motifs qui ont éventuellement poussé à les lever.

Contrôles des taux d'intérêt et restrictions à l'entrée

Le délégué des États-Unis note que c'est en 1994 que les États-Unis ont commencé à modifier leurs politiques concernant l'implantation des banques à charte d'État et des banques fédérales dans d'autres États. On considérait auparavant que chaque État était responsable de la réglementation de son propre secteur bancaire et que l'expansion géographique engendrait de grands risques. Après 1994, ces règles ont été considérablement assouplies dans plusieurs États. Le *Riegle-Neil Interstate Banking And Branching Efficiency Act* de 1994 autorise ainsi les banques fédérales comme les banques à charte d'État américaines à ouvrir des succursales sur l'ensemble du territoire national (à l'exception d'un petit nombre d'États où cela leur demeure interdit). Il s'en est suivi un notable accroissement de la capacité d'expansion géographique des banques et une nette intensification de la concurrence entre les banques à charte d'État comme entre les banques fédérales. Ces évolutions ont entraîné une importante concentration et une sensible augmentation de la taille des banques, qui se traduisent par une diminution de leur nombre, qui est passé de 14 000 en 1983 à 10 000 l'année dernière.

Cette vague de concentrations et de fusions observée aux États-Unis a accru les pressions en faveur d'une plus grande efficacité dans le secteur bancaire et de la levée de nouvelles restrictions. Il y a plusieurs raisons à cela. L'une d'elles est que l'on insiste désormais davantage sur les économies d'échelle dans le secteur bancaire. Les banques peuvent s'appuyer sur certaines des technologies disponibles pour mener à bien leurs activités de façon plus efficace dans les différentes zones géographiques et les différents compartiments de l'activité bancaire dans lesquels elles opèrent. Les technologies de traitement de l'information ont en effet accru les économies d'échelle, d'où un relèvement de la taille minimale d'efficacité des banques.

Les États-Unis sont interrogés sur le point de savoir si le secteur bancaire bénéficie plutôt d'économies d'échelle ou de gamme, étant donné que les recherches entreprises par la Réserve fédérale

sur le système financier américain montrent que la réalisation des économies d'échelle (la situation pourrait être toute autre pour les économies de gamme) s'avère problématique. Les États-Unis (ministère de la Justice) conviennent qu'au-delà d'une échelle relativement modeste, tous les gains d'efficacité semblent être réalisés. Les États-Unis (Commission fédérale du commerce) ajoutent que les institutions financières non bancaires, qui n'ont pas été autorisées à élargir leur gamme d'activités, craignent de passer à côté d'économies qui sont en fait des économies de gamme et non des économies d'échelle.

Le délégué du Mexique note que les taux d'intérêt sont déréglementés depuis 1989 dans son pays. À l'époque, les banques étaient encore propriété de l'État. Aussi le passage à des taux d'intérêts libres s'est effectuée relativement en douceur. L'écart entre les taux créditeurs et débiteurs n'a pas connu de brusques modifications.

Après la privatisation des banques (en 1991-93) les taux d'intérêt ont évolué de façon parallèle, ce qui suggère un possible accord tacite entre les banques. Plus récemment, certains indices révèlent une plus grande diversité des taux d'intérêts. Une étude récente de la commission de la concurrence mexicaine montre que les différentes banques n'appliquent pas tout à fait le même taux d'intérêt pour des opérations similaires et qu'il existe une plus grande différenciation des taux d'intérêts selon l'importance du risque que présentent les emprunteurs. Cela donne à penser que la fixation des taux d'intérêt est désormais plus efficace dans le secteur bancaire mexicain.

Ce n'est qu'en 1994, avec l'entrée en vigueur de l'ALENA, que le secteur bancaire s'est ouvert à la participation étrangère. Depuis lors, la participation des banques étrangères s'est spectaculairement accrue. De 1,4 pour cent en 1994 elle est passée à plus de 15 pour cent en 1996. Cette progression résulte principalement des acquisitions de petites banques privatisées.

Le délégué de l'Espagne attire l'attention sur deux événements qui illustrent l'expérience du pays en matière de déréglementation. Le premier a trait à ce que ce l'on a appelé la "guerre des comptes rémunérés" engagée en septembre 1989 par une des principales banques nationales espagnoles. Les taux d'intérêt avaient été libérés en 1987, deux ans auparavant. Au cours des deux années qui ont suivi, il n'en est pas résulté d'effets notables sur les taux d'intérêts. C'est alors qu'en 1989 une des principales banques a lancé une vaste campagne pour accroître sa part de marché en relevant le taux d'intérêt servi sur les dépôts. Adoptant une stratégie très agressive, elle est parvenue à accroître le nombre de comptes ouverts chez elle. Cette même banque a déclenché une nouvelle guerre quelques années plus tard en offrant des taux d'intérêt plus bas sur les prêts au logement et les crédits à la consommation privée.

Cette concurrence a encore été renforcée par une nouvelle loi qui réduit au minimum le coût du changement de fournisseur de prêts au logement et diminue les coûts et les frais liés aux crédits immobiliers. Ces initiatives politiques, réglementaires et commerciales ont provoqué une baisse spectaculaire de la marge d'intérêt. Celle-ci est actuellement moitié moindre qu'il y a quatre à cinq ans.

La diminution de la marge d'intérêt a dans une certaine mesure été compensée par une augmentation des revenus fixes tirés des commissions. Les banques ont relevé leurs commissions, mais, là encore, la concurrence a imposé une certaine discipline.

Le délégué de la Finlande note que celle-ci a progressivement commencé à lever les contrôles des taux d'intérêt au milieu des années 80. La levée des contrôles des taux d'intérêt a donc, pour résumer, accru la concurrence à la fois sur les marchés de dépôts et de prêts. Une autre raison a été l'émergence de nouveaux instruments financiers qui concurrencent les dépôts bancaires.

La Finlande a levé les obstacles juridiques à l'entrée au début des années 90. Elle a adhéré à l'UE en 1995 et a en conséquence adopté la majeure partie des directives européennes, ce qui a grandement facilité l'entrée des banques étrangères dans le pays. On compte désormais une douzaine de banques étrangères en Finlande, pour la plupart originaires des États membres de l'UE, mais aussi d'un certain nombre d'autres pays. Au début, les banques étrangères offraient essentiellement des services financiers aux grandes entreprises seulement. Dans ces conditions, au début, la présence physique de nouvelles banques étrangères en Finlande n'a pas directement bénéficié à la clientèle formée par les petites entreprises ou les ménages. Les banques étrangères ont toutefois la possibilité de fournir toute la gamme des services financiers et leur présence a par conséquent accru le degré de concurrence potentielle en Finlande. Depuis une date plus récente, les banques suédoises et danoises, en particulier, s'adressent aussi bien à une nouvelle clientèle formée de ménages et de petites entreprises.

Pour résumer, la suppression des contrôles des taux d'intérêt a intensifié la concurrence. La levée des obstacles à l'entrée a accru la présence physique des banques étrangères. Il en est résulté également des effets très bénéfiques pour la concurrence.

Restrictions relatives aux types d'activité et aux participations au capital

Le délégué de l'Australie commence par une vue d'ensemble de l'histoire de la réglementation bancaire en Australie. Des années 30 jusqu'aux années 80, les activités des banques étaient très strictement réglementées : obstacles à l'entrée, fixation des taux d'intérêt, contrôles quantitatifs des prêts, restrictions concernant le capital social, limitation des types d'activité, etc. Sous bien des aspects, ces restrictions jouaient en faveur des banques. Il était notamment interdit à celles-ci de servir des intérêts sur les dépôts bancaires sous forme de comptes-chèques. En conséquence, même si l'inflation était de 15 pour cent, le taux d'intérêt rémunérant les dépôts bancaires était de zéro pour cent.

Dans les années 80, tout cela a changé. Les banques ont commencé à être victimes de ce système lorsqu'elles se sont trouvées confrontées à la concurrence d'autres institutions financières. Les institutions financières non bancaires étaient à même de fournir des services dans certains domaines interdits aux banques. La technologie, la mondialisation, et les économies d'échelle croissantes dans le secteur bancaire rendaient la réglementation classique très difficile et peu réaliste et engendraient toutes sortes de retombées imprévues. Le rapport Campbell (au début des années 80) a mis en branle un processus général de déréglementation qui a ensuite été poursuivi par le gouvernement travailliste.

Plus récemment, un autre rapport sur l'avenir du régime réglementaire applicable aux services financiers en Australie, mieux connu sous le nom de rapport Wallis, a été publié. Ce rapport part de l'idée qu'en raison de la mondialisation, des nouvelles technologies et de la convergence entre les différentes institutions financières, l'Australie a besoin d'un système de réglementation bancaire adapté au nouvel environnement des institutions financières. Wallis était en particulier préoccupé par le fait que par le passé chaque catégorie d'établissement, banques, compagnies d'assurance, sociétés de gestion de fonds de pension, coopératives de crédit, sociétés de crédit immobilier, caisses d'épargne, etc., avait sa propre autorité responsable de la réglementation. Au fur et à mesure de la libéralisation en Australie, les banques ont commencé à se lancer dans l'assurance et les fonds de pension, les coopératives de crédit dans les activités bancaires, les sociétés de crédit immobilier dans l'assurance et la banque, etc. Toute nouvelle initiative exigeait l'approbation d'une demi-douzaine d'autorités responsables de la réglementation.

Wallis proposait que la réglementation sectorielle soit remplacée par une réglementation fonctionnelle. Dans le nouveau système (qui a désormais été approuvé par le gouvernement) la Banque de réserve se contentera de définir la politique monétaire. Un seul organisme de réglementation commun à

tout le secteur fixera les règles prudentielles applicables aux divers types d'institutions financières, qui seront légèrement différentes pour chacune de celles-ci. La réglementation de la concurrence sera appliquée par l'ACCC en vertu de la loi sur les pratiques commerciales (*Trade Practices Act*). La protection de base des consommateurs et des investisseurs sera assurée par une nouvelle instance, le CFSC, dont les membres seront issus de l'organisme de réglementation des changes et des valeurs mobilières.

L'autre grande réforme a été la levée de la plupart des restrictions à la concurrence qui subsistaient dans le secteur financier – restrictions concernant les participations étrangères au capital, la délivrance de l'agrément, etc. La déréglementation des années 80 et 90 a été bénéfique au plan de la concurrence et de l'efficacité. Elle a cependant été associée à la défaillance de certaines grandes banques, qui ont dû être renflouées par la banque centrale. Ces défaillances étaient cependant dues à des facteurs sans lien avec elle, tels qu'un régime fiscal trop généreux et certaines autres distorsions.

Le délégué du Canada note qu'une commission spéciale, le Groupe de travail sur l'avenir du secteur des services financiers canadiens créé en 1997, se penche actuellement sur les perspectives futures de la réglementation financière dans son pays. Il est cependant possible de faire remonter la réforme bancaire au Canada à 1964. Cette année, une commission royale a été constituée pour établir un rapport sur le secteur des services financiers dans lequel elle concluait à l'existence de rigidités peu souhaitables au sein du système et recommandait une vaste révision des réglementations.

Au Canada, le secteur financier s'appuie sur quatre "piliers". Les institutions financières entraient à l'époque dans l'une ou l'autre des catégories réglementaires connues sous le nom de piliers – banques, compagnies d'assurance, sociétés fiduciaires (similaires aux sociétés de crédit immobilier et aux coopératives de crédit) et maisons de titres. À l'époque, des réglementations strictes veillaient à ce que ces piliers ne se concurrencent pas mutuellement. Chacun était soumis à des réglementations distinctes et fournissait des produits bien différents.

Il avait été recommandé dès 1964 de tout faire pour éliminer une grande partie de ces rigidités. Il n'en a pratiquement pas été tenu compte. Quoiqu'il en soit, le marché a rattrapé le secteur et contraint l'autorité chargée de la réglementation à libéraliser le système à compter de 1980. Elle a commencé par lever certains des obstacles à l'entrée, ce qui s'est principalement traduit par une accélération du processus d'obtention de l'agrément nécessaire aux banques pour exercer leur activité. (À l'époque, il aurait fallu environ quatre ans à une banque pour obtenir un tel agrément.) D'autres réformes ont permis une certaine concurrence mutuelle entre les piliers. Une entrée limitée des banques étrangères sur le marché canadien a été autorisée grâce à la création d'un système classant les banques dans deux "annexes". Au Canada, le capital des banques "de l'annexe 1", qui sont des banques traditionnelles, doit être largement réparti, c'est-à-dire qu'aucune personne physique ou morale ne doit en contrôler à elle seule plus de 10 pour cent. Les réformes ont créé une nouvelle catégorie de banques : celles "de l'annexe 2", dont le capital ne doit pas être étroitement contrôlé. L'annexe 2 permet l'entrée des banques étrangères, mais seulement de façon assez limitée.

Une fois les frontières entre les piliers ainsi estompées, la concurrence entre eux s'est intensifiée au point qu'il était bien difficile de distinguer une banque d'une compagnie d'assurance et de dire quels étaient les produits offerts par chacune. C'en est arrivé au point que, bien qu'ils soient soumis à des réglementations distinctes, les piliers se livrent concurrence, chacun proposant des produits (y compris des produits de consommation) sur le marché des autres. Le régime réglementaire n'était plus conforme à la réalité du marché. C'est ce qui a motivé la création du Groupe de travail.

Le délégué des États-Unis représentant le ministère de la Justice rappelle que, par le passé, dans son pays, en vertu des lois fédérales, les banques fédérales ne pouvaient s'engager que dans des types d'activités très limités – elles se bornaient dans une large mesure à recevoir des dépôts et à accorder des prêts. L'objectif était de prévenir le risque que les activités non bancaires compromettent la sécurité des dépôts. En dépit de ce principe, et malgré le mauvais souvenir laissé par la crise des caisses d'épargne au cours des années 80, les États-Unis se sont acheminés vers un net assouplissement de ces règles pour accroître les performances du secteur bancaire.

Cet assouplissement a en partie été assuré par la loi sur les holdings bancaires (*Bank Holding Company Act*) de 1933. Cette loi permettait à la Réserve fédérale d'approuver l'acquisition de sociétés non bancaires à condition que leurs activités soient "étroitement liées" à celles du secteur bancaire. Au travers de la création de filiales de ces holdings bancaires, les banques ont commencé à s'engager dans de nouveaux types d'activités avec l'appui de la Réserve fédérale. Au nombre de ces activités figurent le placement de valeurs mobilières, le crédit hypothécaire, l'assurance, le leasing mobilier et immobilier, ainsi que d'autres services de conseil en gestion. Plus récemment, les États-Unis ont adopté une nouvelle loi qui permet aux banques d'élargir encore leur gamme d'activités. L'organisme de contrôle des banques à statut fédéral a ainsi révisé en novembre 1996 ses réglementations et autorisé les banques fédérales à s'engager au travers de leurs filiales dans la prise ferme et le placement de valeurs mobilières. Une nouvelle règle applicable aux filiales exploitantes prévoit que les banques fédérales peuvent s'établir ou s'engager dans certaines activités par leur intermédiaire. Il n'est pas nécessaire que ces activités aient un "rapport direct" avec le secteur bancaire, il suffit qu'elles aient un "quelconque rapport" avec lui. Il en est résulté une forte expansion des activités bancaires dans le courtage de valeurs mobilières, le conseil en placements, l'assurance de biens mobiliers, etc.

Cette expansion des types d'activités a eu pour principal avantage d'accroître l'efficacité de fonctionnement. Les banques peuvent en effet choisir une forme d'organisation qui leur permet de réduire les coûts de transaction et de mener à bien leurs activités de la façon la plus efficace.

Le délégué des États-Unis représentant la Commission fédérale du commerce précise que la législation américaine qui régit les banques et distingue les activités bancaires de celles du secteur de l'assurance et des services financiers demeure en vigueur malgré les efforts déployés au cours des 10 dernières années pour lever les barrières d'ordre législatif entre ces activités. Les autorités responsables de la réglementation du secteur ont trouvé le moyen de permettre cette concurrence accrue par le biais de réglementations, d'interprétations extensives des textes, ainsi que des lacunes de la législation. Il est tout à fait remarquable que la réglementation ait pu être assouplie sans que le cadre législatif ait changé depuis les années 30.

En réponse, le Canada donne un exemple de la façon dont le marché peut prendre de vitesse l'autorité responsable de la réglementation. Récemment, une grande banque américaine, Wells Fargo, a commencé à effectuer des opérations de prêt au Canada par téléphone. Grâce à une astuce juridique, Wells Fargo a su tirer parti d'une lacune de la législation qui lui permet de ne pas être officiellement considérée comme une banque au Canada mais de proposer toutefois des crédits commerciaux aux consommateurs canadiens prêts à décrocher leur téléphone. (Le délégué des États-Unis (ministère de la Justice) note que cette banque utilise aussi à présent Internet pour proposer des prêts au Canada.)

Le délégué du Royaume-Uni note qu'il n'existe que peu de restrictions concernant les types d'activités que peuvent entreprendre les banques dans son pays. Les banques peuvent en effet s'y engager dans tous les types d'activités (mais elles sont censées s'entretenir au préalable des nouvelles propositions importantes avec les autorités chargées de la réglementation). Aussi le délégué met-il l'accent sur les évolutions qu'ont connues les sociétés de crédit immobilier à la suite de deux textes de loi de 1986 et 1997

qui ont considérablement libéralisé le régime qui leur est applicable. Les sociétés de crédit immobilier peuvent désormais s'engager dans pratiquement tous les types d'activités et nombre d'entre elles proposent des produits comme les comptes courants que l'on a plutôt coutume d'associer aux banques. Les sociétés de crédit immobilier doivent encore accepter diverses restrictions concernant les types d'activités qu'elles peuvent entreprendre et elles doivent conserver leur "caractère fondamental" d'organismes d'épargne et de prêts hypothécaires. Elles doivent ainsi s'abstenir d'effectuer des opérations sur marchandises ou sur devises et au moins 75 pour cent de leurs actifs doivent être garantis par des hypothèques sur des immeubles d'habitation. La loi de 1986 autorise également les sociétés de crédit immobilier à se transformer en banques. En fait, deux des cinq principaux établissements ayant le statut de banque étaient auparavant des sociétés de crédit immobilier. Il est pour finir intéressant de noter que les supermarchés britanniques proposent des services bancaires.

Restrictions concernant le capital social et limitation du montant des prêts

Le délégué du Japon note que la première des récentes évolutions intervenues dans son pays dans le domaine des restrictions concernant la composition du capital social intéresse les holdings financières. L'interdiction des holdings financières sera levée dans le prolongement de la promulgation de la loi sur les holdings financières l'année dernière. Par ailleurs, en ce qui concerne la réglementation relative à la composition du capital social et à l'actionnariat, afin d'éviter qu'une société financière concentre un pouvoir excessif entre ses mains et de favoriser une concurrence libre et loyale, la participation d'une telle société au capital d'une société japonaise est limitée à 5 pour cent en vertu de l'article 11 de la loi antitrust. Cette règle générale connaît certaines exceptions. Une société financière peut en effet être autorisée à détenir plus de 5 pour cent du capital d'une société si celle-ci est la filiale d'une société financière ou est elle-même une société financière et réunit certaines conditions.

Le délégué de l'Australie est interrogé sur les raisons pour lesquelles toute participation au capital d'une banque supérieure à 15 pour cent requiert une autorisation dans son pays. Le délégué note que la raison d'être de cette restriction n'est pas du tout claire. Elle vise en partie à empêcher que les banques soient rachetées par des établissements non bancaires et répond en partie au souhait des banques de se protéger contre les tentatives de prise de contrôle (conformément aux intérêts personnels des dirigeants). Il existe également une suspicion générale à l'égard de la puissance de certaines banques. La justification officielle de cette restriction est qu'il convient que le capital social des banques soit largement réparti en raison de l'importance de leur rôle dans la société.

La Suède note qu'elle a modifié en 1996 la législation relative au capital social des banques. Auparavant, les actionnaires autres que les établissements financiers devaient satisfaire des conditions très strictes, ce qui fait qu'il leur était quasiment impossible de prendre le contrôle d'une banque en Suède. Cette règle est désormais supprimée. Cette évolution s'inscrit dans une politique visant à accroître la concurrence au sein du secteur bancaire suédois, qui a été pendant un certain temps dominé par quelques grandes banques. Elle répond également à la nécessité d'une harmonisation avec les règles des autres pays européens, qui autorisent que les banques soient contrôlées par des établissements non financiers, ainsi qu'à celle de permettre l'accès à de plus larges sources de financement et d'encourager un actionnariat puissant qui soit à même d'assumer la responsabilité des banques. L'autorité chargée du contrôle financier vérifie cependant si l'actionnaire "convient", qu'il s'agisse d'une société financière ou non financière, avant de lui donner son agrément.

Systèmes d'assurance des dépôts

Le Président interroge la Suisse sur le système d'assurance facultative des dépôts en place dans ce pays. Le délégué de la Suisse indique que trois types de réponses sont possibles. La première est "juridique", la deuxième "conventionnelle", et la troisième "factuelle".

La réponse "juridique" est qu'il n'existe pas d'assurance obligatoire des dépôts en Suisse. Néanmoins, les banques cantonales (c'est-à-dire celles qui appartiennent aux cantons) sont normalement intégralement garanties par l'État. Ces dernières années, cinq cantons sont intervenus pour aider des banques en difficulté, parmi lesquelles figure notamment la Banque de Berne.

La réponse "conventionnelle" est que l'Association suisse des banquiers (qui regroupe la quasi totalité des banques suisses) a décidé d'adopter un accord collectif. Cet accord a été examiné et approuvé par la commission sur les cartels suisse, au motif qu'il était nécessaire pour pourvoir à l'assurance des dépôts et de l'épargne. Le système n'a rien de très remarquable. Premièrement, il est limité à 30 000 francs suisses (20 000 dollars américains). Deuxièmement, cette indemnité n'est qu'une avance sur les sommes recouvrées en cas d'insolvabilité (en vertu des lois suisses sur la faillite les titulaires de comptes de dépôts et d'épargne comptent parmi les créanciers privilégiés à concurrence de 30 000 francs en cas d'insolvabilité).

La réponse "factuelle" est que dans la pratique les banques suisses ont décidé qu'elles rachèteraient les petites et moyennes banques confrontées à des difficultés plutôt que de les laisser faire faillite.

Le délégué de l'Australie indique que la position officielle de son pays, telle qu'elle a été formulée par le Gouverneur de la Banque de réserve (et confirmée par son Trésorier), est qu'il n'existe pas d'assurance des dépôts en Australie. Beaucoup d'experts et de commentateurs ont cependant peine à croire qu'aucun système n'assurerait la protection des déposants si une grande banque venait à sombrer. Reste à savoir ce qui se passerait si une ruée sur les guichets d'une grande banque devait se produire. Certains mécanismes informels ont été mis en place pour tenter d'éviter qu'un retrait massif de fonds ait lieu. Certaines banques de moindre importance ont connu des problèmes, mais aucune des grandes ne s'est trouvée dans ce cas. La Banque de réserve est toujours intervenue et a imposé des fusions ou autorisé leur rachat par d'autres établissements. Dans certains cas, la Banque a fourni une certaine aide pour éviter des problèmes plus sérieux.

Les autres institutions financières se sont plaintes de ce que les banques sont avantagées par rapport à elles, leur sentiment étant que le gouvernement est à tout le moins prêt à protéger les quatre grandes banques (et peut-être même toutes les banques) mais pas tous les établissements qui reçoivent des dépôts. Le gouvernement australien s'est dans une certaine mesure efforcé de rétablir les conditions d'une concurrence à armes égales en imposant une taxe spéciale sur les banques en échange du privilège que constitue cette protection tenue pour acquise. Il ressort des enquêtes de marché effectuées par l'ACCC à l'occasion des fusions bancaires que les consommateurs sont largement convaincus que les banques offrent des privilèges spéciaux du point de vue de la protection des dépôts et que c'est là une des principales raisons pour lesquelles ils s'adressent aux banques plutôt qu'aux autres institutions financières, même si celles-ci leur offrent des taux d'intérêt plus élevés.

La Commission européenne indique que la directive CE relative aux systèmes de garantie des dépôts adoptée par le Conseil de l'UE en 1994 exige que les États membres assurent un niveau minimal harmonisé de protection des dépôts. La garantie des dépôts paraissait en effet essentielle pour protéger les consommateurs mais aussi pour accroître la stabilité du système financier. L'objectif de la directive est

d'assurer un niveau minimal harmonisé de protection des dépôts où qu'ils se trouvent au sein de la Communauté afin d'atténuer les disparités d'indemnisation et l'inégalité de la concurrence entre les banques nationales et les succursales des banques d'autres États membres.

La Pologne est interrogée sur la raison pour laquelle certaines banques versent une moindre contribution en pourcentage au fonds polonais de garantie des banques. Le délégué note qu'en vertu de la loi sur le fonds de garantie des banques de 1995 la contribution obligatoire qui doit être effectuée au bénéfice du fonds varie selon les banques. Elle est fonction du montant des ressources disponibles accumulées dans les caisses de la banque et du taux établi par le conseil. Dans le cas de trois établissements bancaires polonais (deux grandes caisses d'épargne et un organisme de crédit aux agriculteurs) ce taux a été fixé à la moitié de celui auquel sont soumises les autres banques commerciales (0,2 pour cent au lieu de 0,4 pour cent). Avant la grande réforme du secteur bancaire, ces trois établissements étaient les seuls à proposer des comptes d'épargne. L'État garantissait 100 pour cent des sommes déposées dans ces établissements. Depuis la mise en place du nouveau fonds de garantie des banques, l'État continue à accorder sa garantie, mais uniquement pour la part des dépôts supérieure à l'indemnité que les banques peuvent recevoir de ce fonds. Cette réglementation n'a qu'un caractère temporaire et il n'est nullement prévu de la maintenir au-delà du strict nécessaire.

Échange de vues général

Le délégué de l'OMC engage un échange de vues général en posant les questions suivantes : une assurance obligatoire n'introduit-elle pas un certain risque moral dans la réglementation des marchés financiers ? L'assurance des dépôts n'incitera-t-elle pas les institutions financières à être moins prudentes qu'elle ne le seraient autrement, et n'y aura-t-il pas en fin de compte plus de faillites et non moins ?

Le délégué du Royaume-Uni répond que cette question du risque moral est très importante. Dans le système britannique, les indemnités versées aux déposants sont plafonnées afin de lutter contre le risque moral. En cas de faillite tous les déposants auraient à supporter une perte, puisque le système ne couvre leurs dépôts qu'à hauteur de 90 pour cent.

Le délégué note que les grandes banques britanniques ont affirmé que le caractère forfaitaire de la prime d'assurance des dépôts a pour effet qu'elles subventionnent dans la pratique les banques plus petites, étant donné que le risque qu'elles fassent faillite et que leurs déposants doivent être indemnisés est extrêmement faible. La Banque d'Angleterre leur a répondu qu'il ne s'agit là qu'un élément parmi bien d'autres de l'arsenal dont dispose l'autorité responsable de la réglementation pour pénaliser les établissements qui prennent des risques. Au Royaume-Uni, les ratios de solvabilité sont variables (et peuvent être ajustés de telle sorte que les banques qui prennent le plus de risques aient à détenir davantage de fonds propres que celles qui en prennent moins). Il est également possible d'exiger des banques qu'elles s'acquittent de frais d'un montant variable en vue de couvrir les coûts de contrôle éventuels (c'est-à-dire que les banques dont le contrôle demande plus de temps pourraient devoir payer une plus grosse somme).

Le délégué de la Commission européenne note que la directive relative aux systèmes de garantie des dépôts ne prévoit rien d'autre quant à la façon dont ces systèmes doivent être mis en œuvre, organisés ou financés. Les États membres de l'Union européenne sont libres de mettre en place des systèmes très différents. Le délégué fait ensuite observer que l'incidence du risque moral dépend de la façon dont la crise bancaire est résolue, selon qu'il est décidé de procéder à la mise en liquidation de la banque pour rembourser les déposants ou de recourir à quelque intervention de l'État, ou encore de faire appel à un organisme public ou privé pour renflouer la banque avant d'en arriver à sa liquidation. Le délégué

souligne que les règles du Traité de Rome relatives aux aides d'État s'appliqueront au cas d'une crise bancaire donnant lieu à une intervention soutenue ou encouragée par l'État. Elles peuvent même valoir pour un système obligatoire privé si l'État joue un rôle déterminant dans le choix des moyens de porter secours à la banque.

Le délégué de la France tient à souligner qu'un système d'assurance obligatoire des dépôts peut favoriser une plus grande concurrence dans le secteur bancaire. Premièrement, lorsque le système de garantie des banques fonctionne bien, il est plus aisé de laisser les banques faire faillite puisque l'on sait que les consommateurs (dont les pouvoirs publics se préoccupent tout particulièrement) seront au moins dans une certaine mesure à l'abri des conséquences. Deuxièmement, un système d'assurance obligatoire des dépôts réduit les inégalités entre les grandes et les petites banques qui résultent du fait que certaines banques sont trop grandes pour qu'on les laisse faire faillite. En l'absence d'un système d'assurance des dépôts, un déposant isolé qui ne peut analyser les comptes de la banque ne sait qu'une chose : cette banque particulière est une grande banque et son argent est de ce fait à l'abri. Un système d'assurance des dépôts peut, de la même façon, permettre une concurrence à armes égales entre les banques nationales et les banques étrangères.

Le délégué du Canada note que, si dans son pays les systèmes d'assurance garantissent un certain pourcentage des dépôts dans la limite d'un certain montant, les déposants sont autorisés à "ne pas mettre tous leurs œufs dans le même panier" et à répartir leurs dépôts de telle façon qu'ils peuvent quasiment en recouvrer la totalité. Contrairement à ce qui se produit en Australie, les banques qui bénéficient de cette garantie et sont tenues de participer au système d'assurance se plaignent d'être désavantagées par le simple fait d'être contraintes d'y prendre part.

Le Secrétariat (CMF) répond aux commentaires de la Commission européenne et de la Banque d'Angleterre sur la question du risque moral. Ce dernier apparaît lorsque le déposant ne tient pas compte des risques pris par l'établissement (parce qu'il sera indemnisé en cas d'insolvabilité) et que l'établissement lui-même se lance de ce fait dans des types d'activités risqués. Le délégué note qu'il est nécessaire que l'État intervienne pour réglementer les banques car il n'est pas souhaitable que les clients de celles-ci aient à déterminer si leur banque est ou non solvable. Les clients des banques ne seront généralement pas en mesure de vérifier si leur banque est ou non solvable car ils ne disposent pas des informations nécessaires sous une forme qui leur soit assimilable.

Le délégué de l'Australie note qu'il apparaît assez clairement qu'une des grandes causes des difficultés que connaît actuellement l'Asie est liée aux problèmes de contrôle et de réglementation de l'ensemble du secteur financier. Certains des dispositifs de contrôle paraissent avoir engendré bien des comportements relevant du risque moral.

Le délégué de l'Australie poursuit par deux ou trois remarques sur la nécessité de la réglementation des banques inspirées des écrits du Professeur Hayek. Il est fermement convaincu que la réglementation des banques est à l'origine des actuels problèmes du secteur financier. Il souligne que pendant bien des années le système bancaire a été géré par le secteur privé. Il voit dans le monopole de la création monétaire et dans la centralisation de la réglementation des banques les véritables causes de l'inflation enregistrée depuis l'adoption de ces règles. Dans un système bancaire privé, les banques seraient grandement incitées à contenir le rythme de dépréciation de leur propre monnaie, alors que les incitations agissent dans un sens exactement opposé lorsque les gouvernements mettent en œuvre une politique monétaire. Il porte la même appréciation sur ces autres problèmes de réglementation. À mesure que la politique de la concurrence et le fonctionnement du marché entrent pour une plus grande part dans les calculs des pouvoirs publics, il conviendrait d'évaluer de façon critique les effets des systèmes d'assurance des dépôts et de les porter à l'attention des responsables de l'action gouvernementale.

Vers une réglementation favorisant les mécanismes du marché

La seconde partie de l'échange de vues est plus directement centrée sur la réforme des réglementations. Cette partie de l'échange de vues porte sur des questions telles que la finalité de la réglementation bancaire et les moyens d'atteindre ces objectifs en s'appuyant davantage sur les mécanismes du marché.

En quoi consiste le dysfonctionnement du marché ?

Le Secrétariat (CLP) pose la question : en quoi consiste le dysfonctionnement du marché dans le secteur bancaire ? Si l'on ne sait en quoi consiste le dysfonctionnement du marché, on ne peut dire si les interventions réglementaires dont il est question sont efficaces, ou bien ciblées, ni même si elles sont vraiment nécessaires. Le délégué souligne que tout un courant de pensée économique doute qu'il existe dans le secteur bancaire un dysfonctionnement du marché exigeant une quelconque réglementation. Ce courant affirme que s'appuyer davantage sur les mécanismes du marché ne compromettrait en rien la stabilité et la saine gestion des banques.

Le principal motif de préoccupation des pouvoirs publics dans le secteur bancaire a trait aux conséquences des faillites de banques. Il est donc nécessaire de déterminer ce qui distingue les faillites bancaires de celles observées dans d'autres secteurs de l'économie et qui justifie que les pouvoirs publics y attachent une importance particulière. Trois types d'argument sont possibles :

- (1) Premièrement, la faillite d'une banque est plus grave que celle d'une entreprise non bancaire de taille similaire.
- (2) Deuxièmement, la faillite d'une banque peut provoquer des retraits de fonds massifs dans d'autres banques, même solvables.
- (3) Troisièmement, la faillite d'une banque donnée risque de provoquer une perte de confiance dans le secteur bancaire dans son ensemble, d'où une moindre stabilité du système bancaire qui risque d'avoir de graves conséquences macro-économiques.

En ce qui concerne le premier argument, selon lequel la faillite d'une banque est en soi plus grave que celle d'un établissement non bancaire, il est fait observer que les services bancaires sont relativement homogènes d'une banque à l'autre, et qu'il existe donc souvent plusieurs fournisseurs de produits de substitution assez proches – pour les prêts à la consommation, les crédits commerciaux à la consommation, etc. Certains consommateurs effectuent un investissement dans une banque sans disposer d'informations particulières, ils subissent une perte, et ils auront à supporter des frais pour changer de fournisseur. Dans l'ensemble, il n'apparaît pas que l'insolvabilité d'une banque ait systématiquement de plus graves conséquences pour les actionnaires et les créanciers que celle d'un établissement non bancaire.

Quant au second argument, selon lequel la faillite d'une banque pourrait déclencher une ruée sur les guichets bancaires, entraînant la faillite d'autres banques, même solvables, le Secrétariat note que les études économiques consacrées à cette question parviennent à la conclusion que les retraits massifs de fonds qui affectent les banques insolubles ne se propagent pas aux banques solvables. Les données économiques montrent que les autres banques solvables ne sont pas menacées par des retraits massifs de fonds. Les déposants qui se ruent sur les guichets de banque font la différence entre les banques solvables et celles qui ne le sont pas.

Le troisième argument est que les faillites bancaires sont un motif de préoccupation pour les pouvoirs publics parce que leur généralisation pourrait entraîner une sensible contraction de la masse monétaire, ce qui aurait d'importantes conséquences macro-économiques. Le Secrétariat note cependant que, s'ils sont capables de distinguer les banques saines de celles qui ne le sont pas, les déposants qui retirent leur argent d'une banque peu saine et insolvable se contenteront probablement de le déposer dans une autre banque. L'effet net sur la masse monétaire dans son ensemble est limité ou nul, surtout si les banques détiennent des taux de réserve similaires. Il n'en résulte donc dans ces circonstances aucun effet sur la masse monétaire globale et donc aucune conséquence macro-économique d'ensemble. Il se peut que les déposants perdent confiance dans le système bancaire dans son ensemble et retirent leurs dépôts pour détenir des espèces. Dans ce cas, la banque centrale pourrait avoir à intervenir pour compenser la réduction de la masse monétaire. Les faillites bancaires et les effets macro-économiques ne sont pas nécessairement liés, surtout si la banque centrale a la possibilité de jouer un rôle.

Le Royaume-Uni avance que le bilan des banques possède deux caractéristiques qui font d'elles des établissements pas comme les autres. La première tient à l'importance des engagements interbancaires – contrairement aux banques, il n'est guère probable qu'une entreprise prête une somme importante à un concurrent. L'existence des prêts interbancaires a pour conséquence que la faillite d'un établissement peut en entraîner d'autres sans qu'il soit besoin d'une ruée sur les guichets des banques. La seconde de ces caractéristiques particulières du secteur bancaire est que les banques sont engagées dans la transformation des échéances. Leurs actifs sont immobilisés alors que leurs dettes sont pour une large part remboursables sur demande. De sorte qu'une ruée sur les guichets de banques peut rendre insolvable un établissement solvable s'il ne peut réaliser ses actifs dans des délais suffisamment brefs.

Le Secrétariat (CLP) répond à ces questions, en commençant par celle des importants engagements interbancaires. Si une banque prête à un particulier, à une entreprise ou à une autre banque, cela fait partie du risque de crédit normal qu'elle doit gérer dans le cours habituel de ses activités. S'il arrive qu'une banque accorde des prêts immobiliers, qu'un grand nombre de ces créances s'avèrent irrécouvrables, provoquant sa faillite, ce n'est normalement pas l'affaire des pouvoirs publics. Pour la même raison, si une banque prête à d'autres banques, que celles-ci font faillite et l'entraînent dans leur chute, ce n'est normalement pas l'affaire des pouvoirs publics.

Cet argument néglige le risque lié au système de paiements. Ce dernier peut créer des problèmes particuliers. Il est possible qu'en raison du système de paiements, d'importants engagements interbancaires puissent s'accumuler, notamment en un seul jour d'activité (dans beaucoup de systèmes le règlement n'a lieu qu'à la fin de la journée), mais grâce aux nouvelles techniques telles que le règlement en temps réel, ces engagements sont sensiblement réduits ou supprimés, éliminant dans la pratique le risque lié au système de paiements.

En ce qui concerne l'immobilisation des actifs et la possibilité que des retraits massifs de fonds rendent insolvable une banque solvable, il est fait valoir que l'*immobilisation* des actifs ne peut être seule en cause. Les entreprises non financières investissent également dans des actifs manifestement immobilisés. Il est en fait assez difficile d'imaginer une entreprise non financière dont les actifs seraient parfaitement liquides. L'important, c'est qu'une grande partie des exigibilités d'une banque peuvent être retirées à vue. Cette liquidité de leurs exigibilités ne fait pas pour autant des banques des entreprises tout à fait à part. Il est assez fréquent que les crédits accordés aux entreprises non financières soient assortis d'une clause prévoyant que la totalité de la somme restant due sera exigible si un certain événement, comme par exemple un défaut de paiement, se produit. Les entreprises non financières sont donc bel et bien exposées à des retraits massifs de fonds. Il n'est pas rare qu'un grand nombre de créanciers s'abattent sur une entreprise insolvable pour réclamer leur créance. Les lois ordinaires qui régissent l'insolvabilité au sein de l'économie sont destinées à répondre à de tels "retraits massifs de fonds". Il n'apparaît pas

clairement que l'insolvabilité des entreprises financières (et des banques en particulier) soit suffisamment différente pour justifier un traitement spécial de la part des pouvoirs publics.

Le Royaume-Uni répond en faisant observer qu'il existe bien des études sur ce qui fait la spécificité des banques. Le délégué note que si la faillite d'une banque peut en théorie déclencher des faillites bancaires en chaîne et si l'on se trouve confronté au risque qu'une grande partie des banques d'un pays deviennent insolubles, ce sera alors l'affaire des pouvoirs publics.

Une plus grande place pour les mécanismes du marché

Le Président note que certaines des communications contiennent des déclarations qui suggèrent une tendance à mettre davantage l'accent sur la concurrence et les mécanismes du marché. Un rapport canadien contient ainsi une déclaration qui reflète la position du Bureau de la politique de la concurrence du Canada selon laquelle les objectifs des pouvoirs publics dont il est ici question peuvent être mieux atteints en s'appuyant dans toute la mesure du possible sur le libre jeu de la concurrence et des mécanismes du marché qu'en maintenant ou en développant la réglementation. Le Bureau reconnaît que la stabilité du système financier constitue généralement un objectif primordial de la réglementation des marchés financiers et que cette stabilité peut devoir être assurée aux dépens de la concurrence. Le Bureau estime cependant que certaines réformes peuvent accroître la souplesse de la réglementation et augmenter la concurrence sans compromettre la stabilité et la solvabilité du système financier.

En réponse, le délégué du Canada note que le Bureau de la politique de la concurrence fait de gros efforts de sensibilisation pour convaincre notamment de la nécessité de s'appuyer davantage sur les mécanismes du marché dans le secteur financier. Le Bureau veut faire comprendre aux gouvernants qu'ils ne doivent pas négliger de s'appuyer sur les mécanismes du marché. Le délégué note également que le processus de réforme sera probablement itératif et devra être structuré de façon cohérente afin d'assurer le passage en douceur d'un système réglementé à un système de marché.

Le délégué de la Finlande note que sa communication cite une déclaration du gouvernement finlandais dans laquelle celui-ci affirme souhaiter que les mécanismes du marché jouent un plus grand rôle dans la prévention des faillites bancaires. Accorder une plus grande place aux mécanismes du marché inciterait en effet les propriétaires des banques à s'intéresser davantage aux activités de celles-ci et, en particulier, au type de politique de risque qu'elles mettent en œuvre. L'application pratique de ce principe diffèrera d'un pays à l'autre selon la nature des réglementations de chacun.

Le Secrétariat (CLP) note que le régime réglementaire auquel est soumis le secteur bancaire néo-zélandais présente un grand intérêt pour les débats sur la place à accorder aux mécanismes du marché car le gouvernement de la Nouvelle-Zélande s'est efforcé de s'appuyer davantage que la plupart des autres pays sur ces mécanismes pour inciter les banques à la discipline et à la prudence. Dans le secteur bancaire néo-zélandais, il n'existe ni assurance obligatoire des dépôts, ni prêteur en dernier ressort, ni aucune aide à attendre de l'État en cas de difficultés financières. L'objectif est d'inciter fortement les déposants, et notamment les gros prêteurs et les grandes institutions financières, à diversifier les risques ainsi qu'à évaluer et à suivre la situation de la banque dont ils sont les créanciers. Bien sûr, la banque se trouve de ce fait elle-même incitée à prendre, et à faire savoir qu'elle prend, des mesures pour limiter les risques auxquels elle se trouve exposée, dont le risque lié au système de paiements, le risque de marché, le risque de crédit, etc.

La Nouvelle-Zélande a axé son attention sur ses interventions réglementaires dans trois directions. Premièrement, elle a cherché à accroître l'information du public. Les banques néo-zélandaises

sont tenues de diffuser une note d'information trimestrielle auprès du public. Elles sont notamment tenues de publier à cette occasion leur degré de solvabilité évalué par un organisme de notation réputé. Ces notes d'information bénéficient d'une large diffusion dans la presse. Deuxièmement, les réglementations ont visé à renforcer la concurrence et à lever les obstacles réglementaires (tels que les restrictions relatives aux types d'activité, à la composition des portefeuilles, etc.). L'idée est de faire en sorte que la politique gouvernementale n'entrave pas l'épanouissement de marchés interbancaires actifs, la diversification des instruments et des sources de financement, le développement des investisseurs institutionnels et l'entrée d'acteurs étrangers à la pointe du progrès. Troisièmement, le gouvernement néo-zélandais s'est efforcé d'encourager davantage les administrateurs et les hauts responsables des banques à s'assurer personnellement que celles-ci sont gérées de façon saine et responsable. Les administrateurs sont notamment tenus de signer une déclaration attestant que les informations publiées sont exactes et que la banque applique des politiques de gestion des risques satisfaisantes.

Ce régime suscite les observations suivantes. Premièrement, les coûts d'application de la réglementation sont peu élevés. L'Enquête Wallis a constaté que dans le régime néo-zélandais les coûts d'application de la réglementation mesurés en points de base sont moitié moindres qu'au Royaume-Uni, environ cinq fois moins élevés qu'en Australie et environ huit fois plus faibles qu'aux États-Unis. Deuxièmement, rien n'indique à ce jour que les marchés financiers jugent ce régime plus risqué que le régime réglementaire antérieur. Les marges de risque sont plutôt plus étroites depuis l'introduction du nouveau régime. Troisièmement, les ratios de fonds propres des banques néo-zélandaises demeurent jusqu'à présent nettement supérieurs aux huit pour cent recommandés par le Comité de Bâle.

Il est fréquemment objecté que la Nouvelle-Zélande constitue un cas à part puisque la quasi totalité des banques néo-zélandaises sont sous contrôle étranger. Elles pourraient donc avoir un "comportement opportuniste" par rapport aux règles prudentielles des autres pays.

Élimination des caractéristiques anticoncurrentielles

A ce stade des débats, la France présente deux affaires dans le cadre desquelles le Conseil de la concurrence a rendu des avis sur les distorsions structurelles de la concurrence. Celles-ci sont tout d'abord liées au monopole légal du placement de certains produits bancaires et, en second lieu, à la subvention croisée des activités concurrentielles par les activités de service public.

Le délégué examine en premier lieu les distorsions de la concurrence liées à certains droits exclusifs ou monopolistiques. Deux types de privilèges pourraient justifier des réformes réglementaires et législatives. Le premier a trait au monopole de la distribution du "livret A", qui est une exclusivité de La Poste et des Caisses d'Épargne, et de celle du "livret bleu", assurée par le seul Crédit Mutuel. Ces monopoles ont pour objet d'encourager l'épargne privée et le financement de logements sociaux. Le Conseil a estimé que du fait des politiques commerciales des autres banques la suppression du monopole de La Poste et des Caisses d'Épargne ne laisserait à celles-ci que les comptes les moins rentables (ceux caractérisés par les dépôts les plus faibles et le plus grand nombre d'opérations), ce qui compromettrait la rentabilité de ces établissements. Le Conseil a donc suggéré que le maintien de ces comptes non rentables soit explicitement reconnu comme un service public et financé séparément par l'État. Quant au rôle de ces droits monopolistiques dans le financement des logements sociaux, étant donné que les fonds affectés à cet usage sont explicitement séparés des autres ressources des banques, le Conseil considère que (contrairement au cas précédent) cet objectif ne serait pas compromis par l'ouverture à la concurrence à condition que les nouveaux établissements autorisés à recevoir ces dépôts soient soumis aux mêmes obligations en matière de collecte des fonds.

Le second type de distorsions de la concurrence est lié au monopole des dépôts de fonds appartenant à des particuliers effectués par les notaires. Ce monopole a été accordé pour des “raisons de sécurité” au Crédit Agricole, à La Poste et, surtout, à la Caisse des Dépôts et Consignations. La question est de savoir si ce monopole est compatible avec l’article 90 du Traité de Rome. Il a été tenu compte de trois grands éléments. Premièrement, le Conseil a examiné les raisons avancées et constaté que celles liées à la volonté de financer les logements sociaux sont valables et peuvent justifier le monopole de la distribution du “livret A” dont jouit la Caisse des Dépôts et Consignations. Par ailleurs, les justifications fondées sur la nécessité d’assurer la sécurité des dépôts sont discutables. Deuxièmement, le Conseil a considéré que si le régime réglementaire crée un système de garantie obligatoire et illimitée des fonds déposés chez les notaires, les autres établissements de crédit devraient également pouvoir recevoir ces fonds. L’attribution de droits exclusifs à ces établissements (Caisses d’Épargne, Caisse des Dépôts et Consignations, Crédit Agricole) ne peut donc être considérée comme acceptable en vertu de l’article 90 du Traité de Rome. Troisièmement, et surtout, le Conseil considère qu’une des raisons pour lesquelles des droits monopolistiques ont été accordés au Crédit Agricole était liée au souci des pouvoirs publics de favoriser le développement de cet établissement à l’époque de sa création compte tenu du rôle qu’il était appelé à jouer, notamment dans les zones rurales et dans le financement du développement de l’agriculture. Ce rôle a disparu pour deux raisons. D’une part, le Crédit Agricole n’est plus un établissement public mais une société de droit privé aux activités diversifiées. D’autre part, le Crédit Agricole est devenu une des principales banques françaises. Le Conseil a donc émis l’avis que ce droit monopolistique n’est pas justifié en ce qui concerne le Crédit Agricole.

Le délégué du Japon explique les réformes du système financier japonais – ce que les Japonais ont appelé le “Big Bang”. Premièrement, les banques seront autorisées à placer des valeurs mobilières, des FCP et des contrats d’assurance. Les banques seront autorisées à placer des valeurs mobilières et des parts de FCP sans passer par des filiales. En ce qui concerne les produits d’assurance, les banques seront autorisées à placer des contrats d’assurance incendie et d’assurance vie à long terme liés aux prêts immobiliers. Cela devrait avoir lieu aux environs de 2001. Deuxièmement, les dispositions juridiques appropriées seront prises pour permettre le recours à des sociétés holding et pour protéger les déposants, les investisseurs et les souscripteurs de polices d’assurance. Troisièmement, les restrictions qui subsistent concernant le champ d’activité des filiales spécialisées dans le placement de valeurs mobilières et la gestion des FCP seront levées au cours du second semestre 1999. Quatrièmement, les règles de fonctionnement auxquelles sont soumises les banques ordinaires dans le cadre du système de financement à court et à long terme seront abolies. Les banques ordinaires seront autorisées à émettre des obligations ordinaires à compter du second semestre 1999.

Le délégué de la République tchèque fait observer que le secteur bancaire de son pays se caractérise pour l’heure par une considérable concentration des services bancaires entre les mains de quatre grandes banques. Ce marché possède donc des caractéristiques oligopolistiques. Les banques tchèques peuvent être classées en trois catégories. La première se compose des quatre grandes banques, dans chacune desquelles l’État possède une forte participation d’environ 36-40 pour cent (plus de 50 pour cent dans un cas). Ce groupe de grandes banques possède environ 66 pour cent des actifs du marché bancaire. La deuxième catégorie correspond aux banques étrangères. La troisième est constituée par un groupe de petites banques dont le capital est essentiellement d’origine tchèque. Ces petites banques ont joué un rôle important dans la première phase de l’introduction de la concurrence dans les services bancaires car elles soutenaient ce processus. Elles souffraient néanmoins de faiblesses au niveau de la stratégie et de la gestion, ainsi que d’un manque d’expérience. Au final, elles se sont également révélées l’élément le plus problématique du secteur bancaire. Neuf banques se sont en conséquence vu retirer leur agrément, et quatre autres ont été soumises à un régime spécial. Ces petites banques peuvent combler des lacunes dans le domaine des services bancaires, satisfaire des besoins régionaux et offrir des produits spécialisés.

La “Banque postale et d’investissement” est à ce jour la seule dont la privatisation ait été préparée. La banque tchèque Nomura a l’intention d’acquérir 36 pour cent de son capital. Il n’est pas certain que cette opération aboutisse car elle doit être approuvée par le gouvernement tchèque.

La République tchèque poursuit par certaines observations formulées par la Banque nationale tchèque. Celle-ci juge qu’il existe une forte concurrence entre les banques étrangères et les grandes banques pour attirer la clientèle haut de gamme (c’est-à-dire les grandes entreprises, les gros exportateurs, les coentreprises, etc.). La concurrence est moindre dans la banque de détail.

Le délégué admet que le secteur bancaire tchèque a connu certaines difficultés. Au début des années 90, la Banque nationale tchèque appliquait des règles très libérales en matière d’entrée de nouveaux acteurs sur le marché afin d’accroître la concurrence. S’agissant d’un pays en transition, les nouveaux clients des banques n’avaient pas d’antécédents et ne possédaient que peu, voire pas du tout, d’expérience dans leur propre domaine d’activité. Les banquiers n’avaient eux-mêmes que peu ou pas du tout d’expérience du métier. Qui plus est, le contrôle des banques ne comptait que sur des ressources humaines très limitées et assurait donc un respect de la réglementation insuffisant. Enfin, l’environnement juridique d’ensemble n’était tout simplement pas approprié. Il était ainsi très difficile d’accélérer les procédures de faillite.

La Banque nationale tchèque a réagi par une évaluation plus stricte des nouveaux candidats à l’agrément bancaire, des nouveaux investisseurs rachetant des parts dans des banques déjà en place, ainsi que des nouveaux dirigeants des banques existantes. La Banque nationale tchèque a également éliminé de nombreuses banques du marché et poussé le gouvernement à vendre ses parts dans les grandes banques pour accroître leur compétitivité, leur injecter des capitaux et améliorer la fonction d’allocation des ressources qu’elles assurent. Elle a par ailleurs introduit un “programme de stabilisation” à l’intention des petites banques qui ont été capables de survivre et de se faire une place viable sur le marché. En outre, la législation tchèque a été mise en harmonie avec la directive européenne et les recommandations du Comité de Bâle.

La Commission européenne explique le concept d’aide d’État et fait observer que la réglementation communautaire en la matière constitue un élément essentiel des règles de la concurrence européennes qui s’appliquent aux banques. Les banques n’échappent pas aux règles relatives aux aides d’État, et aucun traitement spécial ne leur est réservé. Bien qu’elle reconnaisse la spécificité du secteur bancaire, la Commission considère que cette spécificité ne justifie pas de dérogation aux règles relatives aux aides d’État. Il s’ensuit que de nombreuses opérations financières telles que le sauvetage par l’État des banques défailtantes, les injections de capitaux publics dans les banques contrôlées par l’État, les privilèges fiscaux et les autres avantages financiers accordés aux établissements de crédit par les organismes sur lesquels les pouvoirs publics exercent une influence sont soumises à l’examen de la Commission en vertu des dispositions des articles 92 et 93 du Traité. Cela implique également que tous ces types d’interventions doivent d’abord faire l’objet d’une notification préalable à la Commission afin de permettre à celle-ci d’évaluer si cette aide est ou non compatible avec le marché commun.

L’application des règles relatives aux aides d’État dans le secteur financier est relativement nouvelle. Bien que les règles instaurées par le Traité remontent à 1957, la Commission n’a eu que depuis peu à se pencher sur des affaires relatives aux aides d’État dans le secteur bancaire. C’est là un résultat de la libéralisation croissante et de l’intégration de plus en plus poussée des marchés européens. Dans le cadre de ces affaires, la Commission s’efforce d’évaluer quels genres de conditions peuvent être imposés à l’institution défailtante si un sauvetage s’avère absolument nécessaire.

Échange de vues général

Le délégué de l'Italie note que, grâce principalement aux travaux du Comité de Bâle, un nouveau modèle de contrôle est en train de se dégager. Ce modèle s'attache à renforcer les mécanismes du marché plutôt qu'à s'y substituer. Il repose sur trois éléments :

- (1) *Volume de fonds propres requis* : Les fonds propres constituent un matelas de sécurité contre les pertes. Ils réduisent également la propension des actionnaires à risquer l'argent des déposants. Dans l'avenir, il sera probablement demandé aux banques de calculer elles-mêmes leurs ratios de fonds propres à l'aide de leurs modèles internes d'évaluation des risques, comme c'est déjà le cas pour le risque de marché.
- (2) *Contrôles internes* : Comme cela a été précédemment mentionné, les autorités de contrôle n'imposent pas aux banques un modèle d'organisation particulier. Il leur est juste demandé d'adopter des orientations et une organisation internes compatibles avec leur profil de risque.
- (3) *Information du public* : Comme cela a déjà été dit de nombreuses fois, la publication d'informations fiables et comparables renforce les mécanismes du marché.

Le délégué considère que les mécanismes du marché ne pourront pas se substituer totalement au contrôle prudentiel pour les raisons suivantes. Premièrement, il n'est pas possible de rendre publiques toutes les informations pertinentes. Deuxièmement, les petits déposants ne sont ni capables ni désireux de contrôler leur banque en permanence.

Suit une intervention du Secrétariat (CMF) qui note que, si la banque mère d'une banque néo-zélandaise connaît des difficultés, il est probable que cela entraîne un coût pour la filiale ou la succursale néo-zélandaise sur le marché des prêts interbancaires. En fait, si la banque mère connaît suffisamment de difficultés, il pourrait se produire une ruée sur les guichets d'une banque néo-zélandaise sans que celle-ci y soit pour rien, du seul fait de la situation de la banque mère.

Le Secrétariat (CMF) doute que la réglementation puisse affecter notablement la concurrence puisqu'il apparaît que les banques sont en compétition les unes avec les autres. Ainsi, dans le cas de la crise asiatique, les banques des démocraties industrialisées prêtent aux économies d'Asie à des taux, mesurés par rapport au rendement des obligations du Trésor américain, auxquels certains pays industrialisés auraient été bien contents d'emprunter voici quelques années. Cependant, le délégué note dans le même temps que la réglementation pose problème – en raison de la lenteur avec laquelle les autorités responsables de la réglementation tirent les leçons de l'expérience, de leur réticence à intervenir ex ante et de leur grande propension à intervenir ex post avec l'argent des contribuables.

Le délégué note que dans la République tchèque, à une époque où les lois financières n'étaient pas strictement appliquées, il y a de toute évidence eu des délits d'initiés sur les marchés tchèques. Il fait également remarquer que la fragilité des banques japonaises a probablement eu des effets macro-économiques. Il demande pourquoi les banques européennes et japonaises ne limitent pas leurs engagements à l'égard des banques asiatiques et pourquoi les organismes chargés de la réglementation ne les y contraignent pas.

Le Royaume-Uni répond que les organismes chargés de la réglementation doivent trouver un juste milieu entre gérer eux-mêmes la banque et laisser ce soin aux dirigeants de celle-ci. En général, dans la crise asiatique, comme dans toutes les autres crises, les organismes chargés de la réglementation interviennent au travers des dispositions relatives aux fonds propres des banques. Ces dispositions

n'impliquent pas d'ingérence dans leur gestion. Elles imposent tout simplement un matelas de fonds propres protégeant des pertes. Le fait que les organismes chargés de la réglementation n'aient pas fait entendre leur voix pour dire "vous prêtez trop à l'Asie" n'implique pas qu'ils n'aient aucune politique d'intervention.

La Banque des règlements internationaux souligne que les raisons qui font que les banques se distinguent des autres entreprises sont liées à l'asymétrie de l'information et aux problèmes liés aux "comportements opportunistes" en matière de surveillance des dépôts. C'est là un résultat de la nature des actifs et des exigences des banques. Si les banques étaient financées par des prêts plutôt que par des dépôts, la situation serait différente. Le délégué note qu'il reste à voir comment le système néo-zélandais se comporterait en cas de difficultés. Il est possible de se faire une idée de ce qui se passerait si une des sociétés holding qui détiennent le contrôle d'une des banques néo-zélandaises éprouvait soudain des problèmes en regardant ce qui s'est produit dans les années 70 et 80 lorsque certaines filiales non bancaires des holdings bancaires américaines ont traversé une période difficile. Il s'en est suivi une ruée sur les guichets des banques contrôlées par la même société holding. Il se produirait probablement la même chose dans le cas de la Nouvelle-Zélande.

Le délégué de l'Australie demande dans quelle mesure la spécificité des banques n'est pas simplement un résultat du système de réglementation. La structure des échéances de leurs emprunts et de leurs prêts n'est-elle pas en partie imputable au système réglementaire en place ? L'importance des prêts interbancaires est-elle une conséquence du système réglementaire, ou bien est-ce l'inverse ? Si aucune réglementation n'était en place, quels types de dispositifs de marché pourraient éclore pour répondre aux impératifs de sécurité ? Certains types de mécanismes de marché feraient probablement leur apparition. Les dysfonctionnements du marché qui subsisteraient pourraient néanmoins justifier une certaine réglementation. Il est toutefois probable que le système réglementaire lui-même inhibe de fait l'émergence de réponses à ces situations qui soient fondées sur les mécanismes du marché.

Quant aux nombreux écrits en faveur de la réglementation, le délégué gage qu'une bonne part des publications qui justifient la réglementation bancaire émanent des organismes de réglementation des banques eux mêmes.

Le délégué de la République slovaque décrit brièvement le régime auquel sont soumises les banques dans ce pays. La République slovaque n'applique aucun contrôle des taux d'intérêt ni aucun autre contrôle des tarifs ou des commissions. Les banques et les succursales de banques étrangères peuvent entrer sur le marché financier de la République slovaque à condition d'obtenir l'agrément de la banque centrale (la Banque nationale de Slovaquie). Un amendement à la loi sur les banques de 1996 a introduit une procédure d'agrément en deux étapes similaire à celle utilisée dans d'autres pays européens pour les banques et succursales de banques étrangères et dans laquelle il faut d'abord obtenir l'autorisation d'établir une banque, puis celle de mener des activités bancaires. Lors de l'octroi de cet agrément, la Banque nationale de Slovaquie impose de strictes conditions concernant la qualité des investisseurs, la crédibilité, les transferts, ainsi que ce que les banques apportent au marché du point de vue de l'introduction de nouveaux produits et de nouvelles techniques bancaires. L'objectif stratégique de la Banque nationale de Slovaquie n'est pas d'encourager l'entrée d'une nouvelle banque universelle sur le marché mais de créer des conditions favorables pour attirer des investisseurs potentiels et les amener à injecter des capitaux dans les banques existantes. Le marché slovaque est en effet assez restreint et 20 banques, quatre succursales étrangères et 10 bureaux de représentation s'y livrent déjà concurrence.

Les liens de capitaux entre les institutions financières sont directement vérifiés par la Banque nationale de Slovaquie lors de son évaluation des demandes d'agrément en vue de l'établissement d'une nouvelle banque ou d'une nouvelle succursale. Les banques ne peuvent acquérir une participation

supérieure à 10 pour cent du capital social d'un établissement non bancaire qu'avec le consentement préalable de la Banque nationale de Slovaquie. Elles ne peuvent de même acquérir une participation supérieure à 25 pour cent du capital social et des réserves d'un établissement bancaire qu'avec le consentement préalable de la Banque nationale de Slovaquie. Toutes les banques et les succursales de banques étrangères sont contraintes de participer à la protection des dépôts privés par un fonds de garantie auquel elles doivent cotiser. Elles doivent également respecter des restrictions concernant le volume de fonds propres requis, des taux de réserve obligatoires, des prescriptions en matière d'octroi de crédits au secteur privé, ainsi que d'autres règles prudentielles.

Conclusion

Le Président conclut cette partie de la table ronde en faisant observer qu'il n'a pas été apporté de réponse au principal problème philosophique, celui de savoir si les banques doivent ou non être réglementées. Le Président partage l'opinion de l'Australie selon laquelle la plupart des problèmes sont peut-être créés par la réglementation. Le marché pourrait trouver d'autres solutions et ces solutions ne seraient pas nécessairement moins efficaces que les résultats actuellement obtenus avec la réglementation. À ce stade, on ne peut avoir aucune certitude.

Les mécanismes du marché et la concurrence occupent cependant une place de plus en plus importante dans le secteur bancaire. Les banques ont de plus en plus la possibilité de choisir la forme d'organisation qui leur paraît la plus rentable. Sur ce marché comme sur les autres il est souhaitable de parvenir à un système dans lequel la réglementation n'entrave pas (de façon injustifiable) le fonctionnement du marché et ne fausse pas le choix entre les différentes entreprises.

La table ronde a mis l'accent sur le problème du risque et sur le fait que celui-ci est lié aux systèmes d'assurance des dépôts. Les banques dont les exigences sont protégées par un système d'assurance des dépôts seront bien entendu probablement plus enclines à se lancer dans des activités plus risquées que les établissements ne bénéficiant pas d'une telle garantie. Les systèmes d'assurance des dépôts doivent être conçus de manière à empêcher ce type de distorsions, peut-être en faisant en sorte qu'ils tiennent davantage compte du risque encouru.

Interaction entre la réglementation sectorielle et le droit de la concurrence

A ce stade des débats, l'échange de vues porte directement sur les problèmes d'application du droit de la concurrence et commence par un examen des dispositifs institutionnels visant à en assurer le respect, puis se poursuit par celui des questions auxquelles se trouve confrontée l'autorité chargée de la concurrence dans ce secteur.

Dispositifs institutionnels visant à assurer le respect du droit de la concurrence

Application du droit de la concurrence et dispositifs institutionnels

Le délégué du Portugal note que le droit de la concurrence applicable aux banques et aux institutions financières dans ce pays comporte certaines caractéristiques spéciales. En général, le Conseil de la concurrence a le pouvoir de juger toutes les infractions au droit de la concurrence sans aucune restriction. Toutefois, dans le cas des banques, il doit demander l'avis de la banque centrale (Banque du

Portugal) sur le problème en question. Certaines pratiques peuvent par ailleurs constituer une infraction au droit général de la concurrence mais bénéficier d'une dérogation dans le secteur bancaire. Jusqu'à présent, le Conseil de la concurrence n'a jugé aucune affaire concernant les pratiques restrictives des banques.

Quant aux fusions, c'est en règle générale le gouvernement qui a le pouvoir de les autoriser après consultation du Conseil de la concurrence. Dans le cas des banques, ce pouvoir d'autoriser les fusions est exercé par la banque centrale, après consultation du Conseil de la concurrence. Cette loi sera probablement amendée.

Le délégué de la Norvège explique que dans son pays il existe une seule autorité responsable de la réglementation du secteur financier : la Commission norvégienne de la banque, de l'assurance et des valeurs mobilières, qui dépend du ministre des Finances. La plupart des affaires et des problèmes dont a eu à connaître cette Commission n'ont pas d'effet notable sur les conditions de la concurrence, mais la Commission peut dans certains cas prendre ces dernières en considération, par exemple en ce qui concerne les accords de coopération, les fusions ou les absorptions qui tombent sous le coup de la législation financière.

Voici deux ans, un groupe de travail a été chargé d'étudier la nécessité de coordonner les procédures appliquées par l'autorité responsable de la concurrence et celles mises en œuvre par la commission des valeurs mobilières s'agissant des affaires ayant une incidence sur les conditions de la concurrence sur les marchés financiers. Sur la base du rapport de ce groupe de travail, les directeurs généraux ont signé un accord sur les relations entre les deux institutions. Cet accord contient une description des domaines de chevauchement des compétences des deux instances. Il ne restreint cependant ni la compétence légale ni l'utilisation des instruments dont chacune dispose.

Il existe de ce fait sur les marchés financiers comme sur plusieurs autres marchés un système de surveillance caractérisé par des chevauchements de compétences, des effectifs faisant double emploi et des incertitudes juridiques d'importance non négligeable. Les deux instances n'appliquent pas les mêmes critères pour évaluer par exemple l'effet d'une fusion entre deux institutions financières. La Loi sur la concurrence vise à assurer une utilisation efficiente des ressources de la société alors que la commission des valeurs mobilières met l'accent sur les aspects relatifs à la puissance financière et à la stabilité financière, ainsi qu'à la concurrence. Les différences d'approche peuvent très bien faire que ces instances tirent des conclusions divergentes de l'examen d'une fusion. Il est ainsi possible que la commission des valeurs mobilières autorise une fusion si elle renforce la situation financière de la nouvelle entité et que l'autorité chargée de la concurrence intervienne à l'issue de l'examen pour s'opposer à cette fusion si elle restreint la concurrence. Le conflit d'intérêts devrait alors être réglé au cours de la procédure d'appel.

Le Canada note que trois autorités canadiennes chargées de la réglementation peuvent être compétentes en matière de fusions – le Bureau de la politique de la concurrence (qui connaît des problèmes de concurrence), le Bureau du surintendant des institutions financières (qui traite des questions de contrôle prudentiel) et le ministre des Finances (dont les décisions se fondent sur l'intérêt général). Les rôles sont bien définis, sauf pour ce qui est des critères d'intérêt général appliqués par le ministre des Finances. Les travaux d'enquête et d'analyse sont effectués simultanément par les trois organismes. Les décisions prises sont habituellement rendues publiques simultanément, mais non conjointement.

Le BSIF peut s'opposer à une fusion pour des raisons prudentielles et le Bureau de la politique de la concurrence ne peut alors imposer la poursuite de la fusion (il n'a techniquement plus de fusion à évaluer). Si, d'autre part, le Bureau juge qu'une fusion entraînera une diminution notable de la concurrence, la fusion sera portée à l'attention du Tribunal de la concurrence, quel que soit l'avis de l'autorité chargée du contrôle prudentiel. Celle-ci ne peut en imposer l'approbation. Si les trois

organismes de réglementation s'accordent à penser qu'elle ne pose aucun problème, la fusion sera menée à son terme. Si le ministre décide de s'y opposer pour des raisons d'intérêt général, il est en droit de demander au Bureau de la politique de la concurrence que la fusion ne soit ni examinée ni portée devant le Tribunal de la concurrence.

Le Bureau a recommandé que le ministre des Finances définisse avec précision les critères d'intérêt général et que les problèmes de concurrence n'entrent pas parmi ces critères, de sorte qu'il ne puisse interdire ni imposer l'approbation d'une fusion pour des questions de concurrence.

Application par l'autorité chargée de la concurrence ou par l'autorité de réglementation du secteur bancaire ?

L'application du droit de la concurrence dans ce secteur doit-elle être assurée par l'autorité chargée de la concurrence ou par l'autorité de réglementation du secteur bancaire ? Cette dernière joue un rôle assez important dans l'application du droit de la concurrence dans certains pays (à savoir, l'Italie et les États-Unis).

Le délégué de l'Italie confirme que c'est bien la Banque d'Italie qui assure le respect du droit de la concurrence dans le secteur bancaire dans son pays. Les décisions en matière de concurrence sont prises par la Banque d'Italie après consultation de l'Autorité de la concurrence italienne.

Trois raisons peuvent expliquer que la Banque d'Italie ait été choisie pour assurer le respect du droit de la concurrence dans le secteur bancaire. La première tient à la spécificité de ce dernier. Ce secteur est différent des autres. Aucun autre secteur ne peut exercer une telle influence sur l'économie d'un pays. La seconde de ces raisons est liée au passé de la Banque d'Italie. Celle-ci s'est activement efforcée d'assurer depuis le début des années 80 un plus haut degré de concurrence à l'intérieur du système bancaire et elle a encouragé avec succès la concurrence non seulement au sein du marché bancaire mais aussi entre les différents marchés financiers. Le troisième argument est que la Banque d'Italie possède à l'évidence une profonde connaissance du système bancaire.

Dans la pratique, le respect du droit de la concurrence est assuré par un service tout à fait séparé de celui chargé du contrôle du secteur bancaire – ses procédures, ses effectifs et ses décisions sont totalement distincts. Il n'existe en principe aucune différence dans la manière dont la Banque d'Italie et l'autorité chargée de la concurrence assurent le respect des lois.

Le délégué des États-Unis indique que le système américain de "coopération" ou de "consultation" entre l'autorité chargée du contrôle prudentiel et celle responsable de la concurrence donne de bons résultats. Certaines des raisons qui expliquent la façon dont le système a évolué sont d'ordre historique. Quatre organismes distincts interviennent dans la réglementation des institutions financières. Outre le Système fédéral de Réserve, l'organisme de contrôle des banques à statut fédéral (l'OCC), la société d'assurance fédérale des dépôts (*Federal Deposit Insurance Corporation*) et le bureau de surveillance des institutions d'épargne (*Office of Thrift Supervision*). En ce qui concerne les fusions financières, la Réserve fédérale ou l'OCC interviennent habituellement mais d'autres organismes de réglementation peuvent également avoir leur mot à dire.

Au cours des 20 à 40 dernières années, un système donnant d'assez bons résultats a été mis en place. Le Conseil de la Réserve fédérale s'occupe généralement de la plupart des fusions bancaires. La législation bancaire américaine lui donne pour mandat de s'opposer aux fusions qui constitueraient une menace pour la concurrence, à moins que leurs effets anticoncurrentiels ne soient clairement compensés

par les avantages potentiels qu'elles présentent du point de vue de l'intérêt général en répondant aux besoins et aux attentes de la population intéressée. Il délègue l'analyse des problèmes de concurrence à la Division antitrust. Celle-ci examine les fusions et informe l'autorité compétente de leurs effets probables du point de vue de la concurrence. S'il n'existe aucun problème de concurrence, il en est donné notification par courrier. Dans le cas contraire, la nature du problème est indiquée de façon très précise et une solution est bien souvent proposée et dans certains cas négociée avec les parties prenantes à la fusion.

Dans les rares cas où il existerait un effet anticoncurrentiel mais où la Réserve fédérale (ou une autre autorité) déciderait que la fusion est conforme à l'intérêt général, la Division antitrust serait encore habilitée par la législation antitrust fédérale à engager une action dans les 30 jours de l'opération en vue d'y faire obstacle, en se fondant sur sa propre analyse de la concurrence. Malgré le grand nombre de fusions (dont rares ont été celles qui ont soulevé des objections), aucun désaccord avec les autorités chargées de la réglementation n'est survenu lorsque la Division antitrust a proposé des solutions ou des actions correctrices.

En Finlande, la charge d'assurer le respect du droit de la concurrence dans le secteur bancaire est partagée entre les autorités responsables de la concurrence et les autorités de contrôle. Depuis la Loi sur les restrictions de la concurrence de 1988, les banques ne bénéficient plus de dérogations notables du point de vue du droit de la concurrence. Cependant, tant l'autorité de contrôle que l'autorité chargée de la concurrence ont des compétences en matière d'application du droit de la concurrence dans le secteur bancaire. Aux termes de la loi de 1988, l'autorité chargée de la concurrence n'avait qu'accessoirement le droit de porter une affaire devant le Conseil de la concurrence (l'organe de décision compétent en la matière en Finlande). C'est en effet à l'autorité de contrôle du secteur financier qu'il appartenait en priorité d'exercer ce droit. L'autorité chargée de la concurrence ne pouvait agir que si l'autorité de contrôle ne le faisait pas. La loi actuelle, entrée en vigueur en 1992, a modifié ce partage des compétences. Depuis, l'autorité chargée de la concurrence et l'autorité de contrôle du secteur financier exercent parallèlement le droit d'enquêter sur les restrictions de la concurrence dans le secteur bancaire et de saisir le Conseil de la concurrence. Cependant, le Bureau de la libre concurrence s'est vu conférer le droit exclusif d'accorder des dérogations.

À la fin de 1997, le gouvernement finlandais a soumis au Parlement un projet de loi visant à réformer le droit de la concurrence. En vertu de ce projet de loi, l'autorité de contrôle du secteur financier se verra retirer ses compétences en matière d'application du droit de la concurrence et l'autorité chargée de la concurrence sera seule habilitée à enquêter sur les restrictions de la concurrence dans le secteur bancaire et à saisir le Conseil de la concurrence. Les raisons en sont les suivantes. Premièrement, le gouvernement veut simplifier et clarifier les règles de procédure du droit de la concurrence. Il n'y a aucune raison de maintenir des règles de procédure dérogatoires pour le secteur bancaire. Dans tous les secteurs (dont la banque) l'application et le respect du droit de la concurrence devraient être exclusivement assurés par l'autorité chargée de la concurrence. Cela éviterait un double contrôle ainsi que les problèmes découlant de décisions contradictoires, la dualité des ressources, etc. Deuxièmement, dans la pratique, les compétences n'ont pas du tout été exercées, dans la mesure où depuis cinq ans que la loi actuelle est en vigueur, l'autorité de contrôle du secteur financier n'a saisi d'aucune affaire le Conseil de la concurrence. Le respect du droit de la concurrence a été dans la pratique exclusivement assuré par l'autorité chargée de la concurrence.

Le droit de la concurrence finlandais ne réglemente pas les fusions – aussi les remarques précédentes ne concernent-elles que les ententes, l'abus de position dominante et les restrictions verticales. Le même projet de loi propose également d'introduire le contrôle des fusions dans le droit

national de la concurrence. Aux termes de cette proposition, aucune règle spécifique ne s'appliquerait au secteur bancaire.¹

Problèmes de concurrence dans le secteur bancaire

La dernière question abordée a trait aux problèmes que soulève l'application du droit de la concurrence dans ce secteur. Les débats portent principalement sur les questions de définition du marché et de contrôle des fusions.

Définition du marché et problèmes de contrôle des fusions

Le délégué des États-Unis note que, lorsqu'elle analyse des projets de fusions bancaires, la Division antitrust applique les lignes directrices communes en matière de fusions horizontales établies par la Commission fédérale du commerce et le ministère de la Justice – les mêmes que pour n'importe quelle fusion.

En règle générale, s'agissant de la définition du marché, la Division antitrust s'intéresse essentiellement aux marchés de produits et aux marchés géographiques. Lorsque la fusion a une vaste incidence géographique – c'est-à-dire à l'échelle nationale ou mondiale – il est improbable qu'elle pose problème sous l'angle de la concurrence. La plupart des problèmes rencontrés ces dernières années ont intéressé des marchés géographiques localisés, parfois limités à une zone métropolitaine, voire même à un périmètre assez restreint. Les craintes ont été doubles. Le premier sujet d'inquiétude concerne le marché des prêts aux petites entreprises. Les petites entreprises ont pu par le passé bénéficier de certains avantages du fait de leur implantation locale ainsi que de leur bonne connaissance de leur environnement immédiat, et celles d'entre elles qui ont besoin de crédits ne vont généralement pas les chercher bien loin. La fusion de deux banques accordant toutes deux des crédits aux petites entreprises dans une même zone géographique pourrait donc créer des problèmes de concurrence. Les crédits aux "moyennes entreprises", c'est-à-dire les prêts à des entreprises déjà relativement grandes dont le chiffre d'affaires se situe aux alentours de 10 à 100 millions de dollars, suscitent des craintes similaires. Un troisième domaine dans lequel la Division antitrust intervient parfois est celui des produits proposés par les établissements parabancaires.

Concernant la définition du marché en général, les avis divergent quant à la meilleure façon d'aborder cette question. Dans les années 60 et 70, la Cour suprême américaine a rendu une série de décisions sur des affaires de fusions bancaires. Ces décisions ont eu au final pour effet d'encourager une approche "agrégée" du marché de produits pertinent regroupant l'ensemble des activités de banque commerciale – prêts à la consommation, services bancaires, produits destinés aux entreprises, etc. De ce fait, la Réserve fédérale a généralement adopté une approche "agrégée" du marché et défini sur cette base une série de zones géographiques. D'autres instances, dont la Division antitrust, font quant à elles valoir que l'approche agrégée du marché n'est peut-être pas toujours la meilleure. Elle peut certes avoir un sens si l'on pense qu'il existe des économies de gamme dans la production, de sorte que toutes les activités de la banque forment un ensemble. Certaines banques peuvent cependant se spécialiser dans un ou deux éléments de cet ensemble et pas dans d'autres. Une fusion peut ne pas présenter de problème au niveau global mais en poser toutefois si l'on considère chacun des éléments de l'ensemble de produits proposés un par un. L'approche agrégée du marché demeure l'objet de débats.

1. La loi a été adoptée en mars 1998 et la loi de la concurrence amendée entrera en vigueur le 1er octobre 1998.

Le délégué de la Norvège note qu'en prévision d'une vague de fusions et d'acquisitions dans le secteur financier de son pays, l'autorité norvégienne chargée de la concurrence a entrepris l'étude du concept de marché pertinent pour le secteur financier. Il existe désormais un certain accord sur les principes généraux de la définition du marché. Est bien entendu prise pour point de départ la définition habituelle du marché pertinent, avec ses dimensions géographique et relative aux produits. Sur cette base, deux grands groupes de marché sont définis : les marchés du crédit et ceux de l'épargne. Partant de là, une hiérarchie des marchés est établie, selon par exemple le type de garanties, le risque encouru, la ventilation sectorielle (par exemple prêts aux entreprises et aux ménages), et même selon la taille de l'entreprise.

On estime en Norvège que le marché de l'épargne est d'ampleur nationale. Cela est dû au progrès technique et aux nouveaux moyens de distribution (tels que l'Internet et le téléphone) qui ont ouvert ces marchés à l'ensemble des consommateurs du pays, quel que soit leur lieu de résidence. L'accord instituant l'Espace économique européen a en outre facilité l'ouverture de succursales en Norvège par les institutions financières des pays de l'UE et de l'AELE.

La Suisse note que contrairement aux États-Unis, la Commission suisse de la concurrence a en principe une compétence exclusive sur les questions relatives aux fusions. Seules font exception les fusions nécessaires pour préserver les intérêts des créanciers – telles que celles dont l'objectif est de sauver une petite banque en difficulté.

En ce qui concerne la définition du marché, la tendance actuelle en Suisse est au maintien de la distinction entre les différents marchés de produits (contrairement à l'approche agrégée). Quant à la définition du marché géographique, il est clair que pour certains produits, le marché pertinent est international ou national, or à cette échelle il n'existe pas de problèmes de concurrence. Comme aux États-Unis, ce sont les marchés régionaux et locaux qui suscitent les plus grandes préoccupations de ce point de vue. L'autorité chargée de la concurrence estime que les technologies modernes n'ont pas encore entraîné une évolution suffisante du comportement des consommateurs pour modifier la définition des marchés. Les consommateurs suisses sont conservateurs et ne sont pas encore prêts à adopter les nouvelles technologies qui leur permettraient d'avoir accès aux banques nationales (sans parler des banques étrangères).

Le Mexique commence par noter que la situation du secteur bancaire mexicain s'est trouvée complètement modifiée sous l'angle de la concurrence par un certain nombre de changements radicaux intervenus depuis 1993, dont l'ouverture du secteur aux entreprises étrangères et la crise financière de la fin de 1994, qui a mis bon nombre de banques au bord de la faillite. De ce fait, même si l'on néglige que les banques étrangères accroissent la concurrence sur le marché, il demeure toujours possible d'invoquer la défense des entreprises défaillantes pour justifier une plus grande tolérance à l'égard des fusions.

Le secteur bancaire a depuis connu un assez grand nombre de fusions, que l'on peut classer en trois grandes catégories. Premièrement, les filiales étrangères au Mexique ont acheté de petites banques privatisées au bord de la faillite et dont les parts de marché étaient relativement faibles (la défense des entreprises défaillantes a été le principal argument invoqué pour permettre ces fusions). Deuxièmement, les grandes banques mexicaines ont renforcé leur position en s'alliant avec des banques étrangères sises à l'extérieur du pays. Ces alliances n'ont pas d'incidence sur la structure du marché intérieur mexicain et ces fusions ne posent pas non plus de problème. La troisième catégorie de fusions est liée à la restructuration des groupes financiers et elle affecte le cloisonnement des activités des banques, des sociétés d'assurance et des maisons de titres au Mexique.

Le délégué de l'Italie indique comment l'autorité italienne chargée de la concurrence détermine le pouvoir de marché des banques. Elle a pour ce faire recours aux instruments habituels de la lutte contre

les monopoles. En règle générale, la Banque d'Italie fonde son analyse sur la substituabilité de la demande. La substituabilité de l'offre peut aussi être prise en compte dans la définition du marché quand son effet est équivalent à celui de la substituabilité de la demande en terme d'immédiateté. La Banque d'Italie n'accepte pas l'analyse "agrégée" en tant que telle car différents marchés peuvent être identifiés dans le cadre des activités d'ensemble des banques mais reconnaît l'existence d'effets sur la concurrence, dus à la substituabilité potentielle entre les différents produits offerts par les banques. Elle définit le marché en se fondant sur le principe de substituabilité des produits pour l'acheteur et elle rejette l'approche "agrégée" du marché, car il est possible de distinguer différents marchés au sein des activités d'ensemble des banques. L'autorité chargée de la concurrence a établi d'un commun accord avec la Banque d'Italie une définition des marchés géographiques pertinents qui diffère en fonction du produit, selon qu'il s'agit de prêts, de dépôts, ou de services bancaires par Internet. Une récente enquête conjointe sur le financement des entreprises définit les différents marchés qui s'avèrent importants pour le financement des entreprises. L'autorité chargée de la concurrence mesure le pouvoir de marché de façon classique : indices de Herfindahl, marques de commerce, puissance des concurrents, etc. Pour ce qui est des actions correctrices, l'autorité chargée de la concurrence s'efforce de mettre principalement en œuvre des mesures structurelles et d'éviter de recourir aux interventions sur les comportements ou aux autres instruments réglementaires.

Le principe "trop gros pour fusionner"

Le délégué de l'Australie note que le gouvernement confie en général à l'autorité chargée de la concurrence le soin de prendre les décisions en matière de concurrence, mais qu'il ne la laisserait pas au stade actuel s'occuper seule de la fusion des quatre grandes banques. Le gouvernement a décidé d'interdire purement et simplement ces fusions. Il a invoqué pour ce faire la concentration du marché bancaire et notamment le manque de concurrence dans le secteur des crédits aux petites entreprises et sur quelques autres marchés, dont principalement celui des prêts à la consommation. Il a également été avancé que le marché national compte quatre grandes banques et un petit nombre d'acteurs marginaux. Il est fait valoir que si la quatrième par ordre d'importance fusionne avec la première, la seconde et la troisième seront inévitablement amenées à les imiter. En outre, la banque centrale soutient que s'il n'existait plus que deux grandes banques, la faillite de l'une d'entre elles créerait de graves problèmes de gestion du système monétaire. Les raisons qui sous-tendent ce refus de la fusion des grandes banques sont en partie liées à l'opinion publique. Les banques n'inspirent en effet qu'une sympathie très limitée à celle-ci.

Le rapport Wallis précédemment mentionné recommandait un grand nombre de très importantes réformes en faveur de la concurrence. Une des raisons avancées par le gouvernement pour ne pas autoriser au stade actuel les fusions de grandes banques est qu'elles empêcheraient selon lui le développement de la concurrence si elles survenaient avant que ces réformes aient été menées à bien. Il a également des raisons politiques de s'opposer aux fusions de grandes banques, parmi lesquelles la crainte des destructions d'emplois. Celles-ci ne seraient guère populaires dans la situation actuelle.

En réponse, le délégué de la France soulève une question concernant les économies d'échelle et de gamme. Rappelant que le délégué de l'Australie a mentionné que la fusion de deux grandes banques entraînerait d'importants licenciements, le délégué de la France doute que ce soit là le résultat d'économies d'échelle. Les licenciements ne sont pas nécessairement dus aux économies d'échelle (si par exemple une nouvelle technologie modifie les méthodes de production), mais tel n'est pas le cas si ces licenciements sont explicitement liés à une fusion – ils ne peuvent alors s'expliquer que par d'importantes économies d'échelle. Il a cependant été précédemment indiqué que les économies d'échelle ne sont pas aussi importantes que les économies de gamme dans le secteur bancaire.

Le délégué du Canada note que son pays a pour politique d'interdire le "rachat des gros par les gros". La première et la troisième plus grandes banques ont cependant récemment annoncé leur intention de fusionner. Cela fait douter de l'avenir de cette politique. Le Bureau de la politique de la concurrence a suggéré au Groupe de travail que si le "rachat des gros par les gros" a pour seule justification la concentration économique, il conviendrait que le Bureau de la politique de la concurrence et le Tribunal de la concurrence soient saisis, au lieu que le ministre des Finances prenne des dispositions générales. La fusion annoncée ne sera menée à son terme qu'après que le Groupe de travail aura rendu sa décision. Quelle que soit la recommandation du Groupe de travail, le ministre pourra décider de maintenir une politique interdisant le "rachat des gros par les gros" au Canada.

Échange de vues général

L'Italie note que la situation prise pour hypothèse par l'Australie aurait des effets totalement différents selon les pays. La concentration de deux grandes banques aux États-Unis (et probablement aussi en Suisse) conduirait au licenciement de 20 pour cent des effectifs des deux banques (peut-être du fait de la fermeture des succursales faisant double emploi). Par contre, cette situation ne se produira pas en Italie en raison de l'existence de certaines rigidités du marché de l'emploi.

L'Autriche pose une question concernant les participations des banques dans le secteur non bancaire. Les banques possèdent-elles d'importants intérêts dans le secteur non bancaire dans d'autres pays, ces intérêts sont-ils également considérés comme un élément du conglomerat bancaire, et les autorités chargées de la concurrence jugent-elles que les prêts aux grandes entreprises sont totalement neutres du point de vue de la concurrence ?

L'Allemagne répond que les banques allemandes possèdent en fait d'importantes participations dans tous les secteurs d'activité. Elles n'excèdent généralement pas 50 pour cent mais il s'agit souvent de participations croisées. Le droit de la concurrence a été réformé afin de permettre le contrôle des fusions en dessous du seuil de 25 pour cent de sorte qu'il soit possible d'intervenir en pareil cas. Les craintes en la matière ne se sont généralement pas concrétisées, car il existe une limite au nombre de conseils d'administration d'entreprises au sein desquels les dirigeants des banques sont autorisés à siéger. Certains problèmes sont également apparus du fait que de puissantes banques publiques ont des participations dans le reste de l'économie, telles que West LB, qui est très engagée dans le secteur du tourisme. Les banques privées affirment qu'elles souffrent d'un handicap concurrentiel dans la mesure où il est bien plus aisé aux banques publiques de se procurer des capitaux à faible taux d'intérêt. L'autorité allemande chargée de la concurrence s'est attentivement penchée sur ces questions.

Conclusion

Le Président conclut par un très bref résumé de cette dernière session. Comme cela a déjà été dit au sujet de la déréglementation, on constate une tendance à une plus grande concurrence et à une plus grande influence des mécanismes de marché dans le mode d'organisation des banques et dans les activités qu'elles sont autorisées à mener. Le Président note que ce bref examen du droit de la concurrence et de son application met en évidence que, malgré les différences institutionnelles, le droit de la concurrence s'applique partout au secteur bancaire, avec des résultats et selon des principes très similaires.

ACCESS DEMANDS AND NETWORK JOINT VENTURES

*David A. BALTO*¹

The central message of the Sherman Act is that a business entity must find new customers and highest profits through internal expansion -- that is, by competing successfully rather than by arranging treaties with its competitors.¹

Introduction

Joint ventures play a critical role in the U.S. economy. Often they will seek to limit their membership and when they do they face the risk that an excluded party will resort to antitrust litigation in order to compel its admission.² Antitrust access disputes have had a profound impact on competition among network joint ventures, which include credit cards, Automated Teller Machine (ATM), and Point of Sale (POS) networks. There recently has been a bounty of litigation in this area, spurred because of the lack of clarity in the legal standards.³ Thus, competitors are often encouraged to compete through litigation (or by arranging treaties), rather than by offering better products or services.

This chapter describes a model for structuring the analysis of these access claims, which will lead to more effective judicial decision making and greater network competition. Section 1 describes how the lack of a structure for analyzing access demands involving payment networks has led to less competition. Section 2 discusses recent developments involving access demands brought against single firms. Courts have become more sensitive to the economic impact of these access demands and consequently have carefully structured their analyses of these claims. Section 3 explains how the lessons of those single-firm cases can be applied to demands for access to joint venture networks. This chapter suggests how analysis of these access demands should be structured. In Section 4, this chapter considers why membership restrictions are efficient. It considers whether the typical rationale for denying access to a joint venture -- the prevention of free-riding -- applies to network joint ventures, such as credit card and ATM networks, which generally appear to be more efficient as they grow in size.

1.0 Access Demands and Payment System Network Joint Ventures

In order to function, joint ventures often adopt membership eligibility standards. These standards may operate to exclude from the venture firms that compete with the member firms, which may result in one or more competitors of the joint venture's members being excluded from the venture. The excluded party may then sue the venture and its members contending that its exclusion constituted an unlawful group boycott in violation of Section 1 of the Sherman Act.⁴ Litigation involving access demands has played an important part in the development of both credit card and ATM joint ventures.

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1.1 The Worthen Case

VISA and Mastercard are associations whose membership consists primarily of the banks that issue their cards. Today, practically all banks are members of both associations. This was not always the case, however. When Mastercharge (the predecessor to Mastercard) and National BankAmericard (the predecessor to VISA) were first formed, their memberships were separate and there was vigorous competition between the two card systems. Card-issuing banks⁵ were either a National BankAmericard bank or a Mastercharge bank. This situation evolved due to a National BankAmericard "anti-duality" rule, which prohibited banks from issuing both National BankAmericard and Mastercharge cards.

In the early 1970s the anti-duality rule was challenged by an Arkansas bank, Worthen Bank, in Worthen v. National BankAmericard.⁶ Worthen, a National BankAmericard member which sought to become a Mastercharge card-issuer and have both Mastercharge and National BankAmericard accounts, challenged the BankAmericard anti-duality rule as a per se illegal group boycott, in violation of Section 1. The lower court agreed with Worthen, but the Eighth Circuit, relying extensively on an amicus brief from the Antitrust Division of the Department of Justice, reversed.⁷ The litigation was settled after the appellate court decision.

In order to clarify the antitrust risk posed by its anti-duality policy, National BankAmericard sought the advice of the Antitrust Division. National BankAmericard sought a business review letter from the Department approving a proposed expanded anti-duality rule. After considering the matter for more than a year the Division declined to approve the proposed anti-duality rule. It suggested that a prohibition on duality among card-issuing banks might be permissible, but declined to approve a restriction on merchant bank duality, primarily because insufficient information was available to determine the competitive effects of the rule.⁸ Faced with the threat of expensive private litigation and an ambivalent antitrust Division, National BankAmericard changed course, reversed its position, and abandoned its anti-duality rule.

The ultimate result of the Worthen litigation and the Justice Department position did not benefit competition. With the anti-duality rule removed both banks and merchants rushed to join both associations, and within a short time National BankAmericard and Mastercharge had largely overlapping memberships. The impact of duality on credit card competition has been mixed.⁹ On the one hand, the emergence of "duality" enhanced both consumer and merchant convenience by permitting merchants to use a single bank for both National BankAmericard and Mastercharge transactions. During the 1970s and 1980s there was a tremendous increase in the number of merchants that would accept credit cards. On the other hand, it sounded a death knell to competition between the two card associations.¹⁰ Under duality there has been relatively little competition between the two associations. Since their memberships overlap there is a significant incentive for most members to assure that both associations offer nearly identical products and there has been relatively little competition between the associations in either interchange fees¹¹ or systems developments. State antitrust enforcement officials, in particular, have recognized the "corrosive effect of duality."¹²

1.2 The National Bank of Canada Case.

In 1980 Mastercard's anti-duality rule for its Canadian licensees was challenged in National Bank of Canada v. Interbank Card Association.¹³ Mastercard (Interbank) was a late entrant into the Canadian credit card scene, and like VISA had an anti-duality rule for its Canadian members. When a Mastercard bank merged with a VISA bank, Mastercard, invoking its anti-duality rule, gave the bank an

ultimatum: either withdraw from VISA or lose its membership in Mastercard. Mastercard subsequently terminated the bank and this litigation followed.

As in Worthen, the court rejected the bank's claim that the anti-duality rule was per se illegal and chose to apply the rule of reason. It upheld the rule, focusing extensively on the efficiency rationale for restricting membership. The court considered that the rule was: (1) adopted when Mastercard entered the market; (2) necessary to protect the original members' start-up costs in the venture; and (3) for a limited period of time (i.e., eight years based on anticipated recovery of start-up costs). Moreover, the court noted that the "underlying purpose of the exclusivity provision was to enhance competition in the Canadian credit card market by introducing a new product, Mastercard."¹⁴

Thus, in Canada, unlike the United States, membership in either Mastercard or VISA has remained exclusive. Because of the distinct membership, competition between Mastercard and VISA is far more vibrant in Canada than in the United States.¹⁵ Interchange fees seem more competitive: they change more frequently and currently are less than those in the U.S. Similarly, merchant discounts are on average over 40 per cent less than in the U.S. Merchants often switch banks for a very few basis points on the discount.¹⁶ VISA and Mastercard also compete aggressively on systems innovations. From the cardholder perspective, non-duality has led to a proliferation of product development and product innovations. Credit card usage is approximately 60 per cent greater in Canada than in the U.S., in spite of the fact there are fewer cards per consumer in Canada.¹⁷

1.3 ATM Networks

ATM networks have also been the subject of several access demands. In the mid-1980s there was aggressive competition in New England between BayBanks, at the time the largest proprietary ATM network in the United States, and Yankee 24, a joint venture ATM network, formed to enable banks with smaller ATM systems the opportunity to compete with BayBanks. Yankee 24 offered an aggressive pricing structure to attract banks and both networks offered low fees to consumers in order to attract accounts. BayBanks sought access to Yankee 24 and when it was rebuffed sued claiming that its exclusion was an illegal group boycott.¹⁸ The parties settled, BayBanks was admitted and Yankee 24 eliminated its incentive pricing structure. Soon thereafter, consumer fees increased.

In 1983, the PULSE ATM network in Texas faced a similar access demand from First Texas Savings and Loan ("First Texas"). At the time there was aggressive competition in Texas between PULSE and a similar-sized network named MPACT. First Texas, a member of MPACT, claimed that its exclusion from PULSE would constitute an illegal group boycott. Recognizing that admitting First Texas could create a de facto merger with MPACT, PULSE sought a business review from the Justice Department. PULSE posed three alternatives to the Division: (i) admitting First Texas; (ii) generally admitting members of competing networks; or (iii) implementing an anti-duality rule. The Department addressed only the first alternative, saying that at that time, admitting First Texas would not pose an antitrust violation. The Department noted that the incremental consumer convenience that would result from admitting First Texas (and permitting First Texas cardholders to have access to both PULSE and MPACT) appeared to outweigh the loss of rivalry that might occur between the two competing networks.¹⁹

Within six months after the business review letter was issued practically every MPACT member joined PULSE. MPACT eliminated its incentive pricing. There was a similar impact on consumers, as several banks increased their consumer fees.²⁰

1.4 The VISA/Discover Card Case.

The most prominent network access dispute involved a suit by Dean Witter (the issuer of the Discover Card²¹) which sought access into VISA for its financial institution subsidiary, MountainWest Financial.²² Dean Witter sought to issue a VISA card, known as "Prime Option." Dean Witter sued VISA claiming that its bylaw (2.06) which denies membership to any institution that issues Discover cards, American Express cards "or any other card deemed competitive by the Board of Directors" was an illegal group boycott in violation of Section 1. In response, VISA contended that its exclusion of a competitor was justified by the need to maintain and promote intersystem competition and to prevent free-riding on the VISA system and mark by a competitor. VISA also filed a counterclaim that alleged Dean Witter's acquisition of MountainWest's assets violated Section 7 of the Clayton Act,²³ by in effect partially merging the competing credit card systems and significantly reducing intersystem competition in the general purpose credit card market.²⁴

1.41 District Court Opinion

VISA moved for summary judgment, arguing that because Dean Witter was a viable competitor in the credit card market, VISA's action in excluding Dean Witter from membership, as a matter of antitrust law and policy, could not violate Section 1. VISA argued that Dean Witter had a viable antitrust claim only if it could demonstrate that either: (1) VISA possessed market power in the relevant market and Dean Witter was foreclosed from competition with cardholders or merchants or (2) VISA membership was an "essential facility" necessary for Dean Witter to compete in the general credit card market. Under these standards it was clear the court would have granted summary judgment for VISA, because Discover Card had clearly been able to compete successfully even without VISA membership. In August 1992, the court rejected VISA's motion. Although it observed that VISA's policy argument was "well taken" and "made with considerable force and persuasion," the court declined to dismiss the case observing that the situation was "unique. . . in antitrust jurisprudence" and that there was "no controlling authority directly on point."²⁵ Moreover, there were several factual disputes, such as VISA's market power, that could only be resolved at trial.

The jury returned a verdict for Dean Witter and on April 1, 1993 the judge denied VISA's motion for judgment notwithstanding the verdict. VISA argued that although the case was subject to a rule of reason analysis, the court should have dismissed the case as a matter of law based on the use of a preliminary "legal screen." The court considered three screens: a market power screen; an "economic sense" screen; and an essential facility screen. As to market power, the court held the plaintiff presented evidence sufficient to enable the jury to conclude that VISA members, through their combined share in VISA and Mastercard (of approximately 72 per cent), possessed market power in the relevant market.²⁶ Further, it held that Dean Witter had presented an economically plausible claim, since it was arguably in the interests of VISA members to exclude Dean Witter.

The focus of the decision was on VISA's argument that the court should adopt an "essentiality" threshold, i.e., that the case should be dismissed unless Dean Witter could demonstrate that membership in VISA was essential for it to compete. Under the essentiality threshold proposed by VISA, where a joint venture excludes a competitor, it should not be subject to rule of reason examination "unless the competitor meets a heightened standard -- showing that it is unable to compete without the withheld property."²⁷ In other words, the plaintiff must demonstrate that the venture is an "essential facility" necessary for it to compete.

VISA argued that absent such a rule cooperative activity and innovation would be inhibited. "Compulsory sharing of private property discourages innovation and the creation of new products" and therefore VISA's "right to deal with whomever it chooses should be upheld and respected by the antitrust laws" unless it was found to possess monopoly power, or unless the property was an essential facility for competition in the market.²⁸ A "duty to share or deal must be imposed only under very limited conditions -- conditions captured in the notions of essentiality or market power . . . tantamount to monopoly or deprivation of an input necessary to effective competition."²⁹

Dean Witter had conceded at trial that it could not demonstrate that access to VISA was essential to its ability to compete. The remarkable success of the Discover Card, which in a five-year period had become the most popular card in the U.S., would have made that argument difficult. Moreover, Discover Card had effectively replicated VISA's transaction clearance system and had arrangements with 80 per cent of VISA's merchant base. Rather, Dean Witter argued that without access to the VISA mark its proposed Prime Option card would be placed at a competitive disadvantage vis-a-vis cards issued by VISA members. In effect, it argued there was a certain group of consumers who perceived the VISA or Mastercard mark as providing a certain value and the mark provided a competitive advantage in competing for these consumers.

On the essential facilities question, the court observed that "Sears clearly cannot make such a showing . . . [i]t does not need membership in VISA in order to compete in the general purpose charge card market."³⁰ But the court relied heavily on the Supreme Court's 1945 decision in United States v. Associated Press,³¹ which permitted access where the excluded parties suffered a "competitive disadvantage," to hold that a showing of "essentiality" was unnecessary. (As suggested later, courts may do well in refraining from relying on Associated Press as precedent for their decisions.)³²

Having determined that there was no basis in the law to reverse the jury's verdict, the court reviewed whether there was a legally sufficient evidentiary basis. At the beginning of its analysis, the court made clear that "its view of the evidence differs from the jury's findings."

If the court had been the fact-finder . . . it would most likely not have concluded that keeping Sears out of the VISA system substantially harms competition in the relevant market. In fact, the court would have concluded that the harm to competition from letting Sears into the VISA system is greater than any harm from keeping Sears out. If it had been the fact-finder, the court would have been inclined to find no net harm to competition from Bylaw 2.06. . . .³³

The court believes that Bylaw 2.06 fosters intersystem competition in the relevant market. . . . Simply adding another high-priced card issuer, as Sears has always been with both the Discover Card and the Sears charge card, to the VISA system will not solve the problem. It may provide short-term intrasystem competitive benefits within the VISA system, but in the long run, in the court's judgment, the damages from such inclusion will outstrip the benefits. Eventually, consumers will be left with one more top-ten VISA issuer charging relatively high interest rates and a VISA/MasterCard system which will dominate the general purpose charge card field to an even greater extent than it does today.³⁴

The court's observations about the competitive impact of permitting Dean Witter to join VISA are particularly noteworthy since it was the trier of fact in equity for VISA's counterclaim. Thus, like the jury it also had to weigh the evidence. Although the court clearly disagreed with the jury's assessment of the competitive effect of excluding Dean Witter, the jury's verdict could not be upset because there was sufficient evidence to support its findings.

The analysis of the Section 7 counterclaim focused on the effect of Dean Witter's admission into VISA on intersystem competition. The court found that intersystem competition was important and helped "promote innovation in the development of transactional processing systems and merchant base expansion, thereby benefiting consumers."³⁵ Intersystem competition would likely be harmed because Discover would not compete as vigorously with VISA after it issues Prime Option and Dean Witter would have access to VISA confidential information. Despite these findings, the court declined to enter judgment on the counterclaim for VISA because it did not believe that the likely harm to competition would be significant in light of Dean Witter's expressed intention to continue to market Discover vigorously. Therefore, the court dismissed the Section 7 counterclaim.

1.42 Tenth Circuit decision.

On September 23, 1994, in an opinion by Judge Moore, the Tenth Circuit Court of Appeals reversed the district court.³⁶ The Tenth Circuit began by emphasizing that the focus of the antitrust laws is on the impact of a practice on consumers. Early on, the court quoted Justice Breyer that the objective of antitrust regulation is "to improve people's lives . . . [through] economic efficiency . . . and more efficient production methods . . . [and] through increased innovation."³⁷ Considering the context -- that of an antitrust suit where "a successful competitor alleges antitrust injury at the hands of a rival" -- a focus on the actual impact on consumers was very important. As the court observed, quoting Judge Easterbrook, whenever competitors "invoke the antitrust laws and consumers are silent" an inquiry into the impact on "consumers becomes especially pressing."³⁸

Thus, the court used the prism of "impact on consumers" in analyzing the critical issues of market power and efficiency. Using this approach, the appellate court ended up with an entirely different result than the trial court.

1.421 Market power -- expert testimony alone is not enough.

The court began its analysis with consideration of whether VISA possessed market power. Identifying the existence of market power begins with definition of the relevant market, which in this case had been obscured. Although the parties had appeared to litigate the case based on a systems market, the real focus of Discover's claims was on issuer competition. Discover argued that: (1) the purpose of excluding it from VISA was to protect VISA members from competition at the issuer level, and that (2) the benefits of the entry of Prime Option would be on credit card issuance. Thus, the court concluded that the focus of the inquiry was on market power in the credit card issuer market.

The issuer market did not appear very concentrated. There are thousands of credit card issuers and no single issuer has more than a 12 per cent market share.

The Tenth Circuit then addressed the district court's use of the aggregation theory proposed by Discover's expert, and the expert's claim that VISA's ability to pass a rule that excluded Discover was evidence of its market power. The court observed that collective rulemaking should not be suspect because joint ventures are made more efficient through such ancillary restraints. It is the effect of the rules and not the rulemaking itself that should be the focus of the market power inquiry, according to the court. In this respect, Discover's case was wholly lacking: there was no evidence that VISA's rule led to higher prices or lower output. The court, quoting the Supreme Court, rejected the expert's testimony, because "[e]xpert testimony is a useful guide to interpreting market facts, but it is not a substitute for

them."³⁹ Thus, the court concluded that the evidence was insufficient to demonstrate that VISA possessed market power.

1.422 Efficiency -- excluding a competitor may be procompetitive.

The court went on to determine whether the VISA rule which prohibited its competitors from becoming members was "reasonably necessary" to the success of the venture. VISA claimed that the purpose of the rule was to protect its property from intersystem competitors who sought to free-ride on its efforts. It also claimed that, because of the small number of intersystem competitors, admitting Discover might harm intersystem competition and eventually lead to government regulation of VISA as a possible monopolist. Both of these concerns have been recognized in the case law and government antitrust guidelines.

Discover presented two arguments that these efficiency claims were pretextual. First, Discover claimed that the real purpose of the rule was to prevent entry of a low price competitor. This argument was unavailing, because intent to harm a rival was simply irrelevant to whether the restraint harmed consumers. Thus, the evidence the district court relied upon, that VISA's members sought to harm Discover, was "not an objective basis upon which . . . liability may be found."⁴⁰

The second argument was more novel. Discover suggested that the efficiency justification was pretextual because VISA, unlike most joint ventures, was "open," i.e., it had admitted thousands of members after its risk taking phase. In addition, since VISA was a network joint venture, whose integrative efficiencies grew as its membership increased, a rule excluding others could not be procompetitive.

The court did not directly address this claim. Rather it found that neither policy nor precedent supported this claim. In doing so, the court explained how the trilogy of Supreme Court exclusionary restraint cases -- Terminal Railroad,⁴¹ Associated Press,⁴² and Aspen Ski⁴³ -- did not compel a contrary result: Terminal Railroad was an extraordinary case; Associated Press never stated that a joint venture could not exclude; and Aspen Ski focused on conduct that changed the character of the market -- a condition absent in this case. More important, the court emphasized that exclusion from VISA did not equate to exclusion from the market and that there was no evidence that Discover could not develop the Prime Option card under its own mantle.

Thus, the court determined that the bylaw was collateral to VISA's business in that it prevented competitors from free riding on its efforts. In doing so the court relied on an extensive discussion of Rothery Storage & Van Co. v. Atlas Van Lines, Inc.⁴⁴ (a decision by former Judge Bork, who had filed an amicus brief supporting Discover, which had been joined by Justice Ginsburg) which held that a joint venture's exclusivity rule was a legitimate response to the threat of free riding.

More important than the lack of legal support for Discover's arguments was the fact that there was no evidence that the bylaw harmed consumers. Indeed, the court observed that the credit card market is "structurally competitive," with scores of issuers "targeting different consumer groups and consumer needs."⁴⁵ Discover already competes vigorously in the market, and a goal to compete "more effectively" did not "constitute[] the proverbial sparrow the Sherman Act protects."⁴⁶ Thus, the court concluded that because

there was no evidence price was raised or output decreased or [Discover] needed VISA USA to develop the new card, we are left with a vast sea of commercial policy into which [Discover]

would have us wade. To impose liability on VISA USA for refusing to admit [Discover] or revise the bylaw to open its system to intersystem rivals, we think, sucks the judiciary into an economic riptide of contrived market forces. Whatever currents [Discover] imagines VISA USA wrongly created . . . can be better corrected by the marketplace itself. The Sherman Act ultimately must protect competition, not a competitor, and were we tempted to collapse the distinction, we would distort its continuing viability to safeguard consumer welfare."⁴⁷

1.5 The Mastercard/Discover Card Case.

After the favorable jury verdict in the VISA case, Dean Witter submitted an application on behalf of Mountainwest to issue a "Prime Option" Mastercard. On March 4, 1993, Mastercard's board of directors denied the application. Perhaps anticipating a suit by Dean Witter, Mastercard filed suit seeking a declaration that its refusal to admit Dean Witter did not violate state or federal antitrust laws. Dean Witter filed a counterclaim against Mastercard and several Mastercard board members asserting that their refusal to permit issuance of the Prime Option card violated the antitrust laws.

Mastercard filed a motion to dismiss the counterclaim which the district court rejected in August 1993.⁴⁸ First, the court rejected Mastercard's claim that Dean Witter failed to allege sufficient facts to establish concerted action. The court held that allegations that "alleged competitors entered into an agreement which was designed to further their own economic interests" sufficiently demonstrated concerted action. At this early stage of litigation, allegations that executives of the Mastercard member banks serving on the Mastercard board when the alleged exclusionary decisions were made were sufficient to survive the motion to dismiss.⁴⁹

Second, the court rejected Mastercard's claim that Dean Witter failed to properly allege an unreasonable restraint of trade. As in the VISA case, Mastercard argued there was no unreasonable restraint of trade because Dean Witter is still able to compete in the credit card market. The court disagreed: like the court in Utah it relied on Associated Press to hold that a restraint need not inhibit all competition in the relevant market to fall within the scrutiny of the antitrust laws. The parties settled the case in November 1993.⁵⁰

1.6 A Net Assessment of Access Demands in the Context of Banking Joint Ventures.

The record of over twenty years of access demands is not a promising one for competitors or consumers. First, in spite of the frequency of litigation, the standards governing these claims seem particularly cloudy. Although the VISA case was judged under the rule of reason, the failure to structure that inquiry, by adopting a threshold inquiry, makes it difficult to predict how any factfinder is likely to assess the "reasonableness" of an exclusion from membership. The fact that the judge and the jury reached opposite conclusions about the competitive effect of the admission of Dean Witter into VISA only emphasizes the magnitude of this uncertainty.

Second, because of this uncertainty, banking joint ventures are often presented with a difficult and unsalutary choice: either admitting the competitor and facing the risk of government enforcement action (as described below),⁵¹ or denying access and litigating all the way to the jury with little certainty of success, substantial litigation costs, and the threat of treble damages (the treble damages in the VISA case were estimated at approximately \$1 billion). Banking joint ventures, which are typically not-for-profit entities, do not possess either the capital or the stamina for private litigation. Faced with the choice between the risks of private litigation versus those of government enforcement, in most cases, the likelihood is that the venture will disregard the threat of litigation with the enforcement agencies and

admit the competitor. It is no surprise that the two other access cases brought in the early 1990s, involving suits against Mastercard and NYCE, were settled with the admission of the competitor.

Third, although the Tenth Circuit decision in VISA provided some clarification, it failed to address the crucial issue in most of these cases -- how essential must access be in order to compel access. Many courts, like the district court in VISA, adopt a standard that compels access when the venture offers some "competitive advantage." This standard often may lead to anticompetitive results. It may lead to the diminution of competition between the venture and its competitors, because if the venture gains a competitive advantage a court may compel the venture to share the advantage with its competitors. If a competitor knows it can stand on the sidelines and later gain access to the competitive advantage through antitrust litigation, it has little incentive to replicate or surpass the advantage on its own.

Finally, as the BayBanks and PULSE matters demonstrate, the uncertainty in legal standards provides an incentive for potential or actual competitors to avoid competition with the venture by demanding and receiving access. As described in the last section, joint ventures often seek to restrict participation for legitimate competitive reasons. Where efficient scale can be attained with only limited industry participation, such restrictions may be desirable because they enable the development of multiple, competing ventures and are more likely to yield an efficient market outcome. Where the legal standards are unclear, private parties have been able to use antitrust litigation, or the threat of litigation, to compel admission to banking joint ventures. In this way, competition between banking joint ventures has and will continue to diminish.

2.0 The limited circumstances in which courts have ordered access involving single firms.

Access claims are often brought against single firms challenging the denial of access to a facility or business relationship as a violation of Section 2 of the Sherman Act,⁵² under what has been characterized as the "essential facility" doctrine. That doctrine requires a monopolist to share its facility or business relationship where the denial of access would permit the monopolist to extend its monopoly into an adjacent market. The circumstances in which the courts have required access are very limited. Requiring access to a facility is really a public utility type of regulation and is at cross purposes with some of the essential ingredients of antitrust -- freedom of association, right not to sell to a buyer,⁵³ encouraging rivalry and innovation. Thus, a leading antitrust treatise has suggested that the essential facility doctrine should be limited to "facilities that are a natural monopoly, facilities whose duplication is forbidden by law, and perhaps those that are publicly subsidized and thus could not practicably be built privately."⁵⁴

Perhaps the most important and the paradigm of an essential facility case was MCI's successful suit against AT & T in the early 1980s.⁵⁵ MCI, an emerging long distance carrier, sought access to AT & T's local telephone exchange. AT & T refused and MCI sued claiming that the refusal violated Section 2. MCI claimed that without access to the local exchange it would be unable to effectively offer long distance service to local residential customers. In finding that a jury could have concluded that the refusal constituted an act of monopolization, the court assessed the challenged conduct under the essential facility doctrine. The court set forward a four-part test for establishing liability for essential facility claims:

- (1) control of an essential facility by a monopolist; (2) a competitor's inability practically or reasonably to duplicate the essential facility; (3) the denial of the use of the facility to a competitor; and (4) the feasibility of providing the facility.⁵⁶

The court's rationale for applying the doctrine to single-firm conduct was that "a monopolist's control of an essential facility (sometimes called a 'bottleneck') can extend monopoly power from one stage of production to another, and from one market to another."⁵⁷

The essential facility doctrine was very much in vogue in the mid to late 1980s.⁵⁸ In 1988, the ABA Antitrust Section held a seminar on "cutting edge" issues that focused largely on that doctrine.⁵⁹ Since that seminar was held there have been a number of interesting trends in cases decided under the doctrine. First, the courts have increasingly recognized that the concern of the doctrine is with the effect on competition in the primary market, i.e., the market in which the excluded party competes with the owner of the facility.⁶⁰ Second, courts have held that the fact that a facility offers a service that is simply less costly than other alternatives (or offers some type of competitive advantage) does not make the facility essential.⁶¹ Third, the courts have focused on the effect of the exclusion on the "competitive process," rather than on the harm to any individual plaintiff.⁶² What is most remarkable about some of these cases is that the facility at issue was of the type traditionally perceived as essential: natural gas pipelines, electric utility transmission lines, railroad lines, or computer reservation systems. It is also notable that all of these cases were resolved by the courts without a full trial.

The most critical issue is the degree of competitive impediment that must be imposed to compel access. In the joint venture context, as in the VISA case, a plaintiff could argue that access should be required if it would offer a "competitive advantage." That argument is based on the Supreme Court's opinion in Associated Press v. United States.⁶³ In the single firm context, recent court decisions have soundly rejected the notion that a "competitive advantage" is sufficient to compel access. For example, in City of Anaheim v. Southern California Edison Co.,⁶⁴ the Ninth Circuit considered a claim brought by municipal utilities that the denial of access to certain high-power transmission lines (the "Pacific Intertie"), that provided access to power at significantly lower cost than other sources of power, violated the essential facility doctrine. The court rejected the argument that the high-power transmission lines were essential, because the municipal utilities had many alternatives to obtain power at reasonable rates.⁶⁵ Moreover, the theory that access should be compelled because it would offer a source of less expensive power was inconsistent with the purposes of the doctrine. The court, quoting the district court judge, explained:

the Cities' whole argument asks the Court to turn the essential facilities doctrine on its head. Rather than seeking to impose a duty to deal based on the harm that would result to competition from the monopolist's refusal, the Cities seek to impose a duty to deal based on the extent to which a competitor might benefit if it had unlimited access to the monopolist's facility.⁶⁶

The court concluded that the fact that the plaintiffs could achieve savings if access was provided was not enough to turn the Pacific Intertie into an essential facility.

The clarity in the law appears to be having a desired effect. In the past several years, all of the reported essential facility cases have been resolved without a trial on the merits.

3.0 What is the appropriate approach to compulsory access claims involving network joint ventures?

Unfortunately, the clarity arising in the law of single firm cases such as MCI and City of Anaheim has not always found its way to access demands brought against joint ventures. The Supreme Court's 1984 decision in Northwest Wholesale Stationers clarified the scope of per se illegality for access demands when it declared that exclusions by joint ventures are not per se illegal where the venture "does

not possess market power or exclusive access to an element essential to effective competition."⁶⁷ Although Northwest Wholesale Stationers clarified the dimensions on per se liability, it did not explain how the liability inquiry under the rule of reason should be structured. Despite the need for an analytical framework for resolving liability under the rule of reason without a full-trial, no appellate court has furnished one. Thus, the courts have had little guidance for structuring analysis under the rule of reason in order to resolve liability without a full trial.⁶⁸

3.1 Preliminary Observations

This analysis begins with discussion of two issues: (1) the policy considerations that inform the analysis of exclusion claims, and (2) whether the legal standards applied to denials by single firms should be applied to denials by joint ventures.

3.11 Policy considerations.

Analysis of antitrust claims based on an exclusion of a competitor from a joint venture should address three important policy considerations. First, in many circumstances, requiring rivals to collaborate may diminish competition by placing what otherwise would be an effective independent competitor to the joint venture within the venture. Second, requiring joint ventures to admit rivals may diminish incentives to form collaborative ventures by denying co-venturers who undertook significant risks to achieve market acceptance to share the benefits of market success with parties that did not share the risks.

Perhaps the most important concern is that of predictability. Where legal standards are ambiguous, it is difficult for businesses to assess the risks of certain conduct. As Congress recognized when it passed the National Cooperative Production and Research Act of 1993 ("NCPRA"),⁶⁹ uncertainty in the law may deter desirable joint activity, by creating the perception of exaggerated antitrust risks. This cost is especially significant when it involves collaborative activity, because these ventures often can bring new products and services to the market that can not be provided by any individual member of the venture.

Thus, the rule of law governing mandatory access should be predictable so that business executives can plan collaborative activities with an understanding of the effective legal standard. A broad "reasonableness" standard lacks that predictability and, to that extent, may inhibit procompetitive collaboration that requires a limited membership.

A final policy consideration is the effective use of judicial resources. Antitrust trials are costly, both for the parties and the courts. Thus, in many contexts, the courts have attempted to optimize their efficiency, as well as foster predictability, by structuring the relevant legal inquiry so that a full trial may be unnecessary.⁷⁰ Notably, while almost all the recent Section 2 access cases have been resolved based on summary motions, several Section 1 cases have not.⁷¹ Thus, in order to facilitate effective use of the courts and improve predictability, the rule of law should provide for a threshold inquiry in which the court can resolve the litigation.

3.12 Is a more lenient standard for joint ventures appropriate?

The more difficult policy question is why a more lenient standard should be applied to a refusal to provide access by a joint venture than a refusal by a single firm. After all, the effects of the denial of access on the plaintiff and the market are the same whether the facility is owned by a single firm or a joint

venture. A single firm typically faces liability for a refusal to provide access under Section 2 only if: (1) it is a monopolist, (2) its facility is essential to the plaintiff's competitive viability, (3) the facility is not capable of duplication, and (4) there is no reasonable basis for the denial. For joint ventures the standards are far less clear, but the decisions in the banking cases may suggest that there may be liability under Section 1 if: (1) the joint venture possesses a large market share (but is not a monopolist) and (2) the facility offers a competitive advantage.⁷² Thus, the standards for joint ventures seem considerably more lenient than those for single firms.⁷³

Applying a more lenient standard for joint ventures needs explanation. Generally, the Supreme Court has observed that there are stricter standards for finding liability under Section 1 than Section 2 because of the risks of collusion.⁷⁴ The few commentaries that have addressed the issue in the context of access demands have suggested that the differing standards are based on the distinction between unilateral and concerted action and the greater likelihood that refusals to deal by joint ventures will lead to collusion among its members.⁷⁵

It is questionable whether a collusion assumption, i.e., that joint ventures will exclude members in order to enforce a collusive agreement (e.g., an agreement restricting its members prices or output), is justifiable. First, the single firm standard of illegality should accurately detect joint behavior that threatens economic harm. As Professors Areeda and Turner have observed, joint action in the form of a cartel is hampered by "divergent interests, strong temptations to cheat on the cartel price, non-price competition and changes in market shares."⁷⁶ In order to overcome these problems, the members of a cartel would have to "emulate monopoly and fully control the operations and sales of the members."⁷⁷ Second, an assumption that joint venturers will exclude members in order to enforce a collusive agreement also runs counter to economic theory, which suggests that cartel members will seek to include all competitors in order to police behavior and ensure cooperation.⁷⁸

The more lenient standard applied to concerted action can yield inconsistent results in the market, as joint ventures, unlike single firms, are restrained from certain efficient conduct which may restrain trade to the same extent as a single firm, yet incur liability the single firm would escape, even though the firms acting in concert did not possess monopoly power collectively.⁷⁹ Finally, the remedy sought in a compulsory access claim, that of admitting the excluded party, seems inconsistent with the concern of preventing collusion. Compelling the admission of new members, especially competitors, would appear to raise rather than reduce the risks of collusion.⁸⁰ Applying more lenient standards to joint ventures than single entities may have several adverse effects on competition. First, as Congress recognized in passing the NCPRA, joint ventures serve an important role in bringing productive activity to the economy that often can not be provided by single firms. Applying stricter, or even less precise standards, may deter this productive activity. Second, in markets where single firms compete with joint ventures, the joint ventures may be placed at a competitive disadvantage, because they face a greater threat of liability if they deny access. Third, under the Associated Press standard, if the joint venture acquires some sort of competitive advantage it may be compelled to share it with its competitors. Thus, the threat of compulsory sharing dampens the incentives to compete vigorously, for if the joint venture succeeds and acquires a competitive advantage or market power, it might be compelled to grant competitors access. Similarly, it dampens the incentives to innovate, for if the joint venture invents a "better mousetrap," that innovation may have to be shared. Fourth, the stricter standard creates disincentives for the creation of competing joint ventures, since competitors can use the compulsory access doctrine in order to free ride on an existing successful venture, rather than to suffer the risk associated with organizing a venture of their own. Finally, in order to avoid the risk of liability based on market power, a venture may choose to operate at "a suboptimal scale for fear that an efficiently sized venture would lead to compulsory access."⁸¹

Thus, several recent commentaries have suggested that access to joint ventures should be judged by essentially the same standards as are applied to single firms.⁸²

3.2 How should the analysis be structured?

This chapter proposes a three-part inquiry, similar to that used in single firm essential facility cases, to structure the analysis of a joint venture access demand.⁸³ First, is the joint venture's facility critical to the ability of the excluded party to compete in the market? Second, can the excluded party duplicate the facility either individually or with others? Finally, does the joint venture possess market power? Unless each of these conditions are met, the access demand should not reach the jury.

3.21 Is the facility necessary to compete in the market?⁸⁴

The first question focuses on how the competitive process is effected by the exclusion. The Supreme Court has proclaimed that the antitrust laws were enacted for the "protection of competition, not competitors."⁸⁵ As the Tenth Circuit observed in the VISA case, although a party may be prevented from joining a collaboration, that exclusion does not necessarily have a significant impact on the market. The mere fact that a party is excluded from a collaboration is, in and of itself, insufficient to demonstrate injury to competition. The exclusion of competitors is cause for antitrust concern only if it impairs the health of the competitive process itself.⁸⁶ The Supreme Court in Northwest Wholesale implicitly recognized the importance of this distinction when it approved of the district court's analysis which dismissed the case because there "simply [was] no showing by the Plaintiff . . . of a restraint of competition as distinguished from possible damage to the Plaintiff from being expelled from the association."⁸⁷ Similarly, the FTC and the Justice Department, in their Health Care Policy Statements observed that "[t]he focus of the analysis is not on whether a particular provider has been harmed by the exclusion, but rather whether the exclusion reduces competition among providers in the market and thereby harms consumers."⁸⁸

Thus, the court should perform a preliminary inquiry of whether membership in the venture is necessary in order for the excluded firm to compete effectively in the relevant market. The "necessary to competition standard" is that adopted in essential facility claims.⁸⁹ That is if the plaintiff is able to compete without access to the venture, then it is not essential. For example, MCI could not effectively compete as a long distance telephone service without access to the local telephone exchanges, because that was the only means to reach local customers. Moreover, MCI could not replicate the AT & T local exchanges, because they were a regulated monopoly.

Focusing on whether the facility is necessary to competition in the market will fulfill the policy objectives discussed earlier. First, if the party seeking access is an effective independent competitor, access would not be compelled. Thus, competition at the level of the joint venture will not diminish. Second, identifying whether the party seeking access is capable of effectively competing in the market, in many cases, may be relatively simple.⁹⁰ Thus, this test will improve predictability and business planning.

When the facility offers some sort of cost advantage, such as in the electric utility litigation discussed earlier,⁹¹ this inquiry becomes more complicated. Such an advantage normally should not make a facility essential. As a former Acting Director of the FTC's Bureau of Competition has stated: "[i]f the facility offers a cost advantage or is capable of being duplicated, the denial of access will typically not raise antitrust concerns."⁹² For example, Northwest Wholesale Stationers involved the membership rules of a stationery buyer's cooperative. The excluded party, Pacific Stationers lost about \$10,000 in rebates,

which apparently had little or no effect on its ability to compete.⁹³ This was not a sufficient advantage to make the purchasing cooperative essential.

In other cases, the cost advantage may be so substantial that the denial of access effectively precludes the excluded party from effectively competing in the market.⁹⁴ For example, an alternative form of access may be so costly that the excluded party is unable to compete in terms of price. Before accepting the claim, one should look for evidence that because of this impediment the excluded party was a relatively insignificant competitor in the market.

Some courts, like the district court in the VISA case have used a fairly lax standard of necessity - that access should be required if it would offer a "competitive advantage." That argument is often based on the Supreme Court's opinion in Associated Press v. United States.⁹⁵ Associated Press ("AP") was a cooperative wire service that prohibited its newspaper members from making news gathered by themselves available to nonmembers prior to publication by AP. The organization's membership requirements permitted an incumbent member to veto the admission of a competing newspaper in its geographic area. These restrictions were challenged by the Justice Department. In defense, AP argued that since other wire services (INS and UPI) were available to non-members and because nonmember papers could gather their own news its services were not strictly necessary in order to operate a competing newspaper. The Court rejected that argument. It held that inability to belong to and buy news from the largest news agency could seriously affect the publication of competing newspapers.⁹⁶ Based on this reasoning, the courts in the credit card cases have assumed that the competitive advantage offered by a venture need not be indispensably necessary to competitive survival to require access to the joint venture; it may be sufficient that without it the excluded competitor is at a significant competitive disadvantage.

Associated Press is 50 years old and has not played a prominent role in decisions involving access claims. With the exception of the credit card cases, none of the other recent decisions that have permitted the plaintiff to go to trial have relied upon or even cited Associated Press.⁹⁷ Some have argued that the facility in Associated Press was essential to competitive viability.⁹⁸ It is worth noting that the decision is not a paradigm of clarity: the opinion of the Court garnered only three votes. The majority consists of three different opinions and it is difficult to decipher the grounds for the judgment of illegality.⁹⁹ One of the opinions relied explicitly on First Amendment concerns.¹⁰⁰ The plurality opinion seems to assume that AP had market power based on the fact that it was "large," rather than by defining the relevant market and determining the existence of market power. The opinion does not even discuss the potential loss of competition between AP and INS and UPI by permitting members of competing news services to compel their admission into AP.¹⁰¹

Many prominent antitrust commentators have criticized the decision. Judges Posner and Easterbrook observed that the decision undermined incentives for venture members to invest in the venture.¹⁰² Former Judge Bork noted that the opinion never addresses the "real question [of] whether exclusivity of membership tended to make possible efficiencies of operation or merely injured rivals for the purpose of establishing local monopolies."¹⁰³ Former Assistant Attorney General Donald Baker observed that Associated Press is inconsistent with the efficiency based thinking of the Supreme Court's recent joint venture cases, Broadcast Music and NCAA.¹⁰⁴ Thus, the precedential value of Associated Press is open to question. Moreover, even if Associated Press provided a sound legal basis for compelling access where a facility offered only a competitive advantage, such an interpretation may lead to less than competitive results. Such a rule would encourage competitors to seek access whenever their competitor had acquired some sort of advantage in terms of cost or product differentiation. This result would spur litigation and dampen the incentives for innovation. Any competitive advantage that resulted from innovation would have to be shared with one's rivals. Permitting access based solely on competitive

advantage would be an insurance policy for laggards, encouraging competitors to sit on the sidelines and demand access only after the competitor's product has succeeded. From an economic perspective, it would be preferable for the excluded competitor to attempt to replicate or surpass the competitive advantage, by producing a better product.

3.22 Can the facility be duplicated?

The second inquiry focuses on the question of whether the plaintiff, within a reasonable time, either alone or with others, create an alternative to the facility. If the defendant could establish that the plaintiff could either alone or with others provide an alternative facility within a reasonable period of time, the access claim should be dismissed. This inquiry would require analysis of two subsidiary issues. The first focuses on entry barriers and the second focuses on the structure of the market. First, whether there are regulatory or other barriers to entry at the venture level. Second, whether there is sufficient network demand available to create an alternative network.¹⁰⁵ If the joint venture has less than 50 per cent of the available market demand, it seems likely there is sufficient available demand to create an alternative network.¹⁰⁶

Second, membership in the venture must confer cost advantages that cannot be replicated, either individually or in combination with others. This prong of the test will fulfill the policy objective of improving predictability. A joint venture network is in perhaps the best position to determine if there are barriers to entry or sufficient demand available to create an alternative network. Based on this information, it should be able to assess whether an excluded competitor is capable of replicating the network, and in turn, the risks of exclusion.

One example where these standards were met involves the challenge brought in the mid-1970s by the Justice Department against two regional Automated Clearing Houses ("ACHs") that excluded thrifts from their membership.¹⁰⁷ On the issue of duplication the Department believed that there was insufficient available volume for the thrifts to create a competing ACH. Moreover, the Federal Reserve Board's almost total subsidy of the ACH operations made independent competitive alternatives economically unfeasible. The cases were settled with the admission of the thrifts.

The ability of the plaintiff to replicate the network is critical. Where the excluded party is able to compete effectively with the joint venture, its mandatory admission into the venture is likely to diminish competition in the market in which the venture competes. It will diminish the likelihood that the excluded party will enter independently to compete against the joint venture. As described earlier, in the ATM area, the compulsory admission of competitors has led on several occasions to the diminution of intersystem competition.

Where competition at the joint venture or system level is possible, courts should be reluctant to mandate access too readily because of the impact on system competition. An example of this comes from development of authorization technology for credit card transactions. When Dean Witter began issuing the Discover Card, VISA denied Dean Witter access to its point of sale transaction authorization terminals. (At the time, these terminals were not as universal as today.) Faced with this denial of access, Dean Witter had two choices. It could litigate or innovate. Conceivably it could have brought an antitrust claim arguing that the transaction clearance system was essential, because without it the cost of authorizing transactions would have been much higher. Dean Witter chose the path of innovation and created its own terminals and transactions authorization system. These terminals were found by many merchants to be more attractive than the products offered by VISA and Mastercard, and Discover Card led the conversion of merchants from paper to electronic processing. In response, VISA and Mastercard had

to improve their transaction processing system. Ultimately consumers benefitted through lower cost and more efficient transaction processing.

3.23 Does the joint venture currently possess market power in the primary market?

Courts, like the Tenth Circuit in VISA, increasingly have used a market power screen to dismiss cases, the theory being that if the firms imposing the restraint lack market power, there is little chance consumers will be injured.¹⁰⁸ Cases involving access demands have met a similar fate where the excluding party lacked market power.¹⁰⁹

The use of a market power screen or of an assessment of the existence of a monopoly on the basis of market shares, may not always lead to accurate results. In a network it is very difficult to measure market shares: what constitutes an appropriate measure is not a simple question. William Blumenthal has observed that various properties of networks -- alternative routings, market failure, and critical mass -- make it difficult to use historic transaction data as a measure of market power.¹¹⁰ Moreover, as noted earlier, the approach in the VISA and Mastercard district court decisions -- of aggregating transactions of venture members regardless of which network was used -- may lead to misleading results. An example will clarify how. Assume a metropolitan area with 200 ATMs, and one wanted to determine the market power of the networks participating at those ATMs. Further assume that every one of the ATMs had the service mark of the CIRRUS national network. Under the VISA district court precedent it would be appropriate in calculating market shares to say that all of the transactions at any given ATM should be considered CIRRUS transactions. That might lead one to conclude that CIRRUS is a monopolist in the market. Yet assume each of those ATMs also had the logos of MOST, PLUS, and several other ATM networks. Using this approach each of these networks would also seem to be a monopolist.¹¹¹ An approach that would define each network as a monopolist does not make sense.

The existence of market power in terms of large market shares raises a perplexing problem. To the extent that the joint venture's market power is a concern, augmenting that power by bringing a rival into the venture would seem to be the opposite of what is required. If a joint venture is "too large," it is difficult to see why a court should attempt to "cure" the exercise of market power by forcing the venture to accept more market power. As the Justice Department noted in its amicus brief in Northwest Wholesale Stationers:

It would make little sense indeed to interpret the antitrust laws as providing for the forced expansion of a procompetitive horizontal arrangement to the point where the arrangement itself violates those laws. Not only does such an approach have little to recommend it as a matter of consistency, it could also lead to a loss of the substantial procompetitive benefits usually associated with purchasing cooperatives and similar joint ventures.¹¹²

Since market shares may be deceptive or uninformative, other types of evidence should be used to identify the existence of market power. There are three types of evidence that would be probative. First, there may be evidence that the exclusion either raised prices or decreased output. Second, the members of the joint venture may possess such an overwhelming proportion of the potential volume of transactions (or other measure of potential capacity) that no other comparably efficient joint venture is likely to have the minimum efficient scale to compete effectively. Third, there may be unique barriers to duplication of the joint venture facility (such as those created by regulation in the MCI case).

In determining market power, a factfinder should proceed with caution. The key to the market power inquiry is the question of "essentiality." As the Acting Director of the FTC's Bureau of Competition has observed:

the relevant market power inquiry . . . is whether the membership at issue is an "element essential to effective competition." An association's members could have a large market share in some market, but unless the facility controlled by the association was essential to competition in that market, exclusion from the facility might not have any effect on competition in that market.¹¹³

3.3 Remedy.

The question of remedy is not a simple one. Where a competitor prevails in a compulsory access claim, that does not mean it should be admitted into the venture and should be able to use the venture's service or trademark. Permitting such broad access would diminish product differentiation and the incentives to compete in product development. Providing open access to a trademark may diminish the incentives for firms to maintain the value of the mark or the product; in turn, the value of the mark may diminish. Moreover, as the legislative history of the National Cooperative Research Act suggests,¹¹⁴ compulsory licensing may also serve as a long-run disincentive to risk-taking and product differentiation. Thus, compulsory licensing of the trademark should be disfavored out of deference to the public policies which give trademark owners broad rights to refuse to deal with others.¹¹⁵

In addition, where a competitor has prevailed in an access claim, its admission may raise concern of improper information exchanges or other forms of improper coordination. Admission into the venture may facilitate the exchange of competitively sensitive information, without the procedural safeguards against such sharing that antitrust orders have imposed on co-venturers in concentrated markets.¹¹⁶

For example, assume that a court found that an ATM network transaction authorization system could not be replicated (the example is described below). The excluded competitor should not necessarily be admitted as a full member. A preferable result might be to permit access to the transaction authorization system, but not to permit access to the service or trademark or full membership in the joint venture. In this way, the excluded party will continue to offer competition in terms of product differentiation and development. Moreover, because the competitor is not a full member, the risks of improper information exchanges or other forms of improper coordination will be diminished.¹¹⁷

Finally, as many commentators have noted, where access is compelled the new members should be required to "pay their fair share of total investment,"¹¹⁸ taking into account the risk and investment incurred by the earlier members of the venture.

3.4 Analysis under the structured inquiry

The structured inquiry would lead to more efficient decision making and fewer anticompetitive results. For example, in the BayBanks/Yankee 24 dispute described earlier, access to Yankee 24 was not "vital to competition," since BayBanks was already a viable and strong competitor in the market. Moreover, since BayBanks had already created its own ATM network, replication was not at issue. Thus, the court would be able to dismiss the case without sending it to the jury, which would improve the use of judicial resources.

Other types of claims may require full analysis under the rule of reason. For example, assume that an ATM network has a transaction authorization system for point of sale transactions, which includes a computer switch, a data base, and terminals at merchants. A competing ATM network seeks access to that system. Because space at merchants is at a premium, merchants are unwilling to have more than one authorization terminal. Assuming that the competing network lacks a sufficient volume of transactions (either alone or with others) to create an alternative authorization system and that merchants are unwilling to accept the competing network's card without an authorization system, an access claim may be worth further analysis. The advantage of the structured inquiry is that it will focus analysis under the rule of reason on the issues that are most likely to be dispositive -- the impact on competition and the ability to replicate the facility.

4.0 Efficiency rationales for limiting membership in a joint venture

The antitrust enforcement agencies and many commentators have observed that limitations on membership offer great procompetitive potential, in terms of protecting risk taking and preventing free riding.¹¹⁹ As the former Assistant Director of the FTC's Office of Policy and Evaluation has observed:

Venture participants have a legitimate interest in ensuring that their co-venturers make valuable contributions to the mission of the enterprise, and for this reason require the ability to exclude potential participants who cannot make meaningful contributions to the enterprise or would fail to share fully in the risks of the venture. . . . If free and open access is required, potential venturers may decide to avoid entering a joint venture, and incurring the risk that membership in the venture entails, because they may be required to share the fruits of the joint venture with outsiders if the venture succeeds but will be required to bear the losses alone if the venture fails. This free rider effect creates a serious risk that some efficiency-enhancing projects would be delayed or altogether deterred.¹²⁰

A second important objective of membership restrictions is to prevent a venture from being overinclusive so that its size or scope would deter the development of competing ventures.¹²¹ Overinclusiveness has been identified as a particular risk in joint ventures to provide health care services. Both federal antitrust agencies have stated that overinclusiveness, rather than membership exclusions, is the primary concern when analyzing joint ventures.¹²² Both agencies have recently challenged physician joint ventures because they were overinclusive.¹²³ The Health Care Enforcement Policy Statements recently issued by the FTC and the Justice Department also recognize this issue.¹²⁴

In order to preserve the opportunities for competition with the joint venture and to protect from the risk of market power, it is often appropriate to restrict the size of the venture. In the context of a network joint venture, such as ATM and credit card joint ventures, "size" issues may appear more complex than in a typical merger or joint venture, because increased size may lead to significant efficiencies, known as network externalities.¹²⁵ However, the existence of these externalities does not mean that enforcement agencies are or should be indifferent to size issues. For example, William Baxter, the former Assistant Attorney General in charge of the Antitrust Division, has observed that although ATM joint ventures can achieve efficiency benefits related to economies of scale, these efficiencies will cease to be significant once a joint venture reaches a certain size. Because of these efficiencies it may be preferable for the network to remain open, however. Beyond the point where these efficiencies are significant, Baxter suggests that it is preferable to permit the network to close in order to encourage the creation of competing networks rather than one large network.¹²⁶

This issue of whether the efficiencies inherent in a network joint venture require the venture to be open or closed was also studied by the National Commission on Electronic Funds Transfer (NCEFT) in the mid-1970s. At the time, some commentators argued that because of the efficiencies of EFT networks that these networks should be compelled to share their facilities to all comers and some states incorporated this concept in state sharing statutes. In proceedings before the NCEFT, the Justice Department opposed the concept of mandatory sharing, in particular, because it would deter the incentives to create competing networks.¹²⁷ The NCEFT adopted the Justice Department's view.¹²⁸ In addition, the Justice Department actively opposed the adoption of state sharing statutes.¹²⁹

Thus, limitations on membership serve a valuable goal in that they may preserve both actual and potential competition with the venture. If a firm may obtain the product or service provided by the venture elsewhere, exclusion may be procompetitive, so long as it provides non-affiliated firms an incentive to support a competing joint venture or compete on their own.¹³⁰

The concern about overinclusiveness was part of the reason why the state attorneys general challenged the Entree point of sale ("POS") debit card joint venture.¹³¹ Entree was a joint venture of Mastercard and VISA and thus, consisted of many of the most likely entrants into the national POS market.¹³² The states alleged that by entering through a single joint venture, VISA and Mastercard in effect foreclosed the development of competing POS ventures. The case was settled when VISA and Mastercard agreed to abandon the Entree joint venture. VISA and Mastercard have since created their own independent POS networks, Interlink and Maestro. In response to the concerns of the states, each network adopted rules preventing any bank member from belonging to a competing network.¹³³ Competition between the networks, in terms of product promotion, product development and pricing has been aggressive, and far more significant than that in the credit card market.¹³⁴ Competition between the networks, in terms of product promotion, product development and pricing appears aggressive, and far more significant than that in the credit card market. Each of the networks competes in product diversity and systems. Each competes vigorously to sign up both banks and merchants, by offering lower fees and other incentives. In addition, the fees charged within the networks, including interchange fees, are less than those involving credit cards.¹³⁵ The active competition between Maestro and Interlink indicates that the states' judgment in challenging duality was correct.

One argument posed in the VISA litigation was that even if these free-riding and overinclusiveness justifications are generally legitimate, they are inapplicable to banking joint venture networks because these networks have admitted thousands of members after the risk-taking phase. The argument is that the traditional free-riding justification is inapplicable because: (1) the membership rules at issue permit admission of any financial institution except a competitor, and (2) these networks are efficient particularly because they are "open."

4.1 Should a different rule of law apply to a rule that excludes only competitors?

Not all access demands are problematic: where a prospective member does not compete with the venture (and is not a potential competitor of the venture) its admission may raise few competitive problems. However, a competitor may not be a typical potential member (i.e., one that wishes to improve its ability to compete), but rather, a competitor may be a potential member that intends to subvert the competitive process. As described earlier, there have been a number of cases involving banking joint ventures where competitors of the joint venture network have used antitrust claims to compel admission into the venture and the result has been a diminution of competition.

A rule of law that made it easier for competitors to compel access into a joint venture may diminish competition in the market in which the venture competes.¹³⁶ Such a rule is without precedent. In no case other than the VISA district court decision has a joint venture been compelled to admit new members when these members were actual or potential competitors of the joint venture. Only one other compelled admission case arguably did not concern a bottleneck monopoly. That case, Associated Press, dealt solely with competition against the venture's members, as the newspapers seeking admission did not compete with Associated Press in supplying a wire news service. Associated Press did not compel the defendant to admit any entity, but merely banned the practice of permitting incumbents to veto membership of new applicants. The order did not require the admission of any entity that would have competed with the Associated Press and the Court's analysis surely would have been different had the excluded party been the Reuters or INS wire service rather than local newspapers.

Where competitors have been able to use access claims (and the threat of treble damages) to force their way into joint ventures, consumers have not benefitted for several reasons. First, the dynamics of joint venture decision making are delicate because ventures are collaborative bodies. It may be very difficult for a venture to act against the interests of any individual member, especially a large member.¹³⁷ Or a single member may attempt to tailor the joint venture's product to fulfill its own competitive agenda. As a leading commentary on payment systems has observed:

The competitive complexity of a payments partnership is enhanced by the fact that its members are primarily competitors in selling the joint payments product to consumers and merchants. . . . Since individual members have separate and distinct business strategies, a major member may be expected to try to tailor the joint product or its terms to serve its parochial needs. If successful, these efforts may make the joint product less attractive to other members, merchants, or consumers -- all to the detriment of the payments partnership's broad mission.¹³⁸

Second, selectivity in membership will often enhance a venture's ability to compete. Admission of members with diverse or contrary interests (especially the forced admission) may lead to competition only on a least common denominator basis. Ultimately, mandating access may diminish the ability of the venture to compete. As Joseph Kattan has aptly explained in discussing why selectivity in membership may be critical to the ability of a joint venture to innovate:

Because joint ventures have multiple owners who may otherwise compete with one another, the enterprise provides fertile ground for conflict. Decisionmaking can suffer when participating firms have differing objectives or opinions on the course of the venture, and the enterprise is vulnerable to efforts by participants to free ride on co-venturers. . . . This "problem of trust" can stifle the transfer of technology that may be critical to the success of joint ventures and, indeed, may inhibit would-be collaborators from entering into ventures in the first place.¹³⁹

Third, selectivity in membership can be vital to the success of a collaboration. A venture may seek to compete by offering a certain type of product or a certain standard of quality. If the venture cannot limit its membership to those which adhere to its objectives, success may be elusive. For example, in Hassan v. Independent Practice Associates,¹⁴⁰ the court rejected a claim brought by two allergists that their exclusion from an independent practice association was an illegal group boycott. The record was undisputed that the plaintiffs disagreed with the IPA's cost containment policy (which the plaintiffs had violated). Thus, the court concluded that the expulsion of the plaintiffs was "justified by enhancing economic efficiency and making markets more competitive."¹⁴¹

Finally, mandating access for a competitor may be a poor solution, because it may increase disputes within the venture, especially if the member has a different competitive strategy. Mandating access cannot eliminate the basic conflicts between an outsider and its new partners. At best, it simply shifts the conflicts from the courthouse to the governing bodies of the joint venture.¹⁴² If the "outsider" competes with the joint venture, it may have a special incentive to use its voice and vote to retard the joint venture's efforts and innovations in the network market. For example, in the BayBanks/Yankee 24 matter described above, once BayBanks compelled its admission as a member of Yankee 24 the aggressive competition between the two networks decreased.

4.2 Should a different rule of law apply if the joint venture has been "open" or the venture exhibits positive network externalities?

Arguably the free-riding and risk-taking rationale for membership exclusions may be inapplicable for joint ventures, like ATM and credit card networks, which have admitted members after their risk-taking phase and generally have an "open" membership policy. This argument distinguishes between open joint ventures (i.e., that admit new members) and closed joint ventures (i.e., that restrict membership). Network joint ventures benefit through their inclusiveness, since they are characterized by positive network externalities. Thus, as the plaintiff in the VISA case, one could argue that where a joint venture is characterized by positive network externalities, it should not be permitted to exclude members if those members can improve competition within the joint venture.

There are a number of reasons to question this argument. First, it would turn any joint venture which was characterized by network externalities into a public utility with the obligation to admit all comers. Some potential venture participants might offer little to the venture; others may pose a significant threat of free riding. Still others may want to join to impede the competitive efforts of the venture. A rule of law that required open access would prohibit a venture from excluding any of these participants.¹⁴³

Second, where a joint venture is characterized by positive network externalities, a joint venture would have no basis to ever deny access to a competitor. The fact that network externalities exist does not mean that they are infinite. At some point those externalities may cease to be significant and a network may reach an optimal size.¹⁴⁴ When a network reaches optimality, adding members wastes resources. There may also be other beneficial reasons for denying access even where network externalities exist.¹⁴⁵ A rule of law that prohibited a venture from closing, taken to its logical conclusion, would permit competitors access regardless of whether externalities continue to exist or whether admission of a new member was economically efficient.

Under such a rule of law, practically any competitor could argue that it can offer more competition if it has access to the joint venture and can offer the joint venture's product. This will ultimately lead to more consolidation and the creation of a single network. While a joint venture may need to be open at its inception, at some point the members of the joint venture may choose to close ranks and decide that the venture is large enough. (Perhaps all of the economies of scale have been achieved and further expansion would not be profitable.) Such a rule of law would prohibit a joint venture from ever being able to make that decision without facing liability.

Third, as noted earlier, a rule of law that compelled a joint venture to admit new members might be inconsistent with the interests of competition policy, by forcing an entity to accept market power. As an Antitrust Division official recently stated "an antitrust rule forbidding exclusion, could result in the creation of market power that was not there to start with. That would make no sense."¹⁴⁶

Fourth, treating a joint venture with network externalities like a public utility would impede risk-taking and innovation. If joint ventures are "told in advance, as a matter of law, that they are going to have to grant compulsory access to their competitors whenever they achieve a really significant success, then the law has blunted their incentive to invest and innovate."¹⁴⁷

Fifth, this argument goes beyond the few cases which have compelled access. For example, in Associated Press the Supreme Court did not prohibit Associated Press from being closed. It only prohibited Associated Press from permitting local newspapers to veto the membership of competing newspapers.¹⁴⁸

It is difficult to predict the impact of a rule of law that would treat VISA or Mastercard like a public utility and require them to be open to any new member. In the ATM area, however, where sharing has been compelled consumers have not benefitted. Some states have adopted a public utility model and have enacted mandatory sharing statutes which compel ATM networks to provide open access. Other states have not addressed the issue and have permitted sharing to evolve of its own accord. The Federal Reserve Board has studied the impact of state mandatory sharing statutes on ATM deployment and usage. It has found that in those states which have compelled mandatory sharing, output in terms of ATM deployment and card usage is less than in those states that do not require sharing.¹⁴⁹

Finally, a rule of law that compelled a joint venture network to provide open access would close the book on the opportunity for competition with the network. Rather than creating a competing product, potential entrants into the network market will simply demand and receive access to the venture. Thus, the opportunities for network competition, which could bring consumers better products and lower prices, will be lost.

5.0 Conclusion

Because of the recent antitrust litigation, the banking industry faces a critical turning point. How access claims are resolved has a significant impact on the level of competition between bank networks and the growth of various consumer financial services. The lack of clarity as to the legal standards governing access demands has inhibited the development of these ventures and has encouraged competitors to compete in the court house, rather than in the marketplace. When competitors force their admission into a venture, rather than by competing by offering better products and services, consumers do not benefit.

As the courts seek to clarify this complex area of the law, they should recall President Clinton's words when he signed into law the National Cooperative Production Act. The Act provides that research and development and production joint ventures can receive limited protection from treble damage liability by submitting a notice filing with the antitrust enforcement agencies. When President Clinton signed the Act, he explained

By clarifying and eliminating the apprehensions about antitrust risk, this legislation will allow joint ventures that can increase efficiency, facilitate entry into the markets, and create new productive capacity that otherwise would simply not be achieved. . . . Now is the time to strip away outdated impediments to economic growth and to our potential and to begin real movement in this last decade of the 20th century.¹⁵⁰

President Clinton's concern about "outdated impediments" is germane as the courts evaluate the guidance provided by Associated Press. Joint ventures are an ever more essential facet of the economy; providing a clear, predictable standard for the risks they face from access demands will enhance their ability to compete.

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NOTES

1 United States v. Citizens & Southern Nat'l Bank, 422 U.S. 86, 116 (1975).

2 The term "access demands" as used in this article refers to situations in which a joint venture refuses a person participation in a venture. This assumes that the restriction in membership is not used to impose any other type of restraint. In other words, the source of any anticompetitive effect is the denial of access and not any other restraint imposed by the venture. Membership restrictions which are used to impose other types of restraints, would be analyzed under the rubric appropriate for that type of restraint.

3 See SCFC ILC, Inc. v. VISA U.S.A., 819 F. Supp. 956 (D. Utah 1993), rev'd, 36 F.3d 958 (10th Cir. 1994), cert. denied, 115 S. Ct. 2600 (1995); Mastercard Int'l Inc. v. Dean Witter, Discover & Co., 1993-2 Trade Cas. (CCH) ¶ 70,352 (S.D.N.Y. 1993). See also Balto (1993a).

4 15 U.S.C. § 1 (1988).

5 Banks perform two separate functions involving credit cards: (1) "card-issuance," issuing credit cards to consumers, and (2) "merchant processing," handling businesses credit card transactions. Thus, the article refers to banks as card-issuers and merchant banks.

6 345 F. Supp. 1309 (E.D. Ark. 1972), rev'd, 485 F.2d 119 (8th Cir. 1973), cert. denied, 415 U.S. 918 (1974).

7 485 F.2d at 130.

8 See Letter to Francis R. Kirkham from Thomas E. Kauper, Assistant Attorney General, Antitrust Division (Oct. 7, 1975).

9 For a detailed discussion of the impact of duality, see Balto (1994).

10 See Baker and Brandel (1988) ¶ 23.O2[3]; Balto (1993a) pp. 266-68; Baxter (1980); Bernard (1980).

11 An interchange fee is a fee paid by the merchant's bank to the cardholder's (consumer's) bank for processing the transaction. The interchange fee is set by the bank card association and until the entry of the Discover Card, was set by both VISA and Mastercard on a fully allocated cost basis.

12 See Constantine (1990) at 84 ("it is now the states' role to halt the corrosive trend of duality"). Constantine is the former head of the Antitrust Division in New York State.

13 507 F. Supp. 1113 (S.D.N.Y. 1980), aff'd, 666 F.2d 6 (2d Cir. 1981).

14 Id. at 1123. The Second Circuit affirmed the district court opinion in part on the merits and in part on grounds that appellant failed to demonstrate a link between the behavior complained of and anticompetitive consequences to United States commerce. 666 F.2d 6 (2d Cir. 1981).

15 See Baker (1993) pp. 1065-68 (describing how credit card competition is more aggressive in Canada than in the United States).

- 16 Id.
- 17 See Balto (1994).
- 18 See BayBanks, Inc. v. New England Network, Inc., No. 86-3532-K (D. Mass. filed Dec. 9, 1986).
- 19 See Letter from William F. Baxter, Assistant Attorney General, Antitrust Division, to Donald I. Baker (Aug. 3, 1983). The other two alternatives were not addressed because they were not considered ripe for review.
- 20 Ironically, three years later First Texas attacked PULSE's interchange fee structure, relying on PULSE's market power which was in part due to the de facto merger with MPACT. In re Arbitration Between First Texas Savings Ass'n and Financial Interchange, Inc., 55 Antitrust & Trade Reg. Rep. (BNA) No. 1380, at 340 (Aug. 25, 1988); see Grimm and Balto (1993) pp. 852-57. First Texas sued seeking the ability to assess additional charges for PULSE cardholders using First Texas ATMs. The arbitrator ruled that PULSE was required to permit surcharges or rebates at their ATMs.
- 21 The Discover Card was originally issued by a financial subsidiary of Sears. Thus, the district court opinion refers to the plaintiff as Sears. Dean Witter formerly was a subsidiary of Sears.
- 22 See SCFC ILC, Inc. v. VISA U.S.A., 819 F. Supp. 956 (D. Utah 1993), rev'd, 36 F.3d 958 (10th Cir. 1994), cert. denied, 115 S. Ct. 2600 (1995).
- 23 15 U.S.C. § 18 (1988).
- 24 The case has been the subject of extensive legal and economic analysis. See Baker (1993); Carlton and Frankel (1995); Carlton and Salop (1995); Evans and Schmalensee (1995); Piraino (1995).
- 25 SCFC ILC, Inc. v. VISA U.S.A., 801 F. Supp. 517, 521 (D. Utah 1992).
- 26 The court arrived at this share by aggregating the shares of each VISA member in the general credit card market, regardless of what brand of card the member issued. This effectively merged the market shares of VISA cards (46 per cent) and Mastercard cards (26 per cent).
- The court's aggregation of market shares in this fashion is open to question. Courts apply a market power screen to determine if a practice will adverse effect prices or output. Measuring the aggregated market shares of VISA members is uninformative. The fact that VISA cardholders possess a 72 per cent market share does not mean that Dean Witter is excluded from that portion of the market, since those cardholders are not restricted from acquiring a Dean Witter card.
- 27 Id. at 972.
- 28 Id. at 973.
- 29 Id. at 974.
- 30 Id. at ___.

31 326 U.S. 1 (1944). The decision in Associated Press is of dubious precedential value. See infra
notes ___-___ and accompanying text.

32 The court also determined that the bylaw went beyond a simple refusal to deal and prevented
current VISA members from issuing their own proprietary cards. 819 F. Supp. at 977.

33 819 F. Supp. at 983.

34 Id. at 983-84 (emphasis added).

35 Id. at 995.

36 SCFC ILC, Inc. v. VISA U.S.A., 36 F.3d 958 (10th Cir. 1994), cert. denied, 115 S. Ct. 2600 (1995).

37 Id. at 962.

38 Id. at 965.

39 Id. at 969 (quoting Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp., 113 S. Ct. 2578,
2598 (1993)).

40 Id. at 970.

41 United States v. Terminal R.R. Ass'n, 224 U.S. 383 (1912).

42 Associated Press v. United States, 326 U.S. 1 (1945).

43 Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985).

44 792 F.2d 210, 229 (D.C. Cir. 1986), cert. denied, 479 U.S. 1033 (1987).

45 VISA, 36 F.3d at 972.

46 Id.

47 Id. For criticism of the Tenth Circuit's decision, see Carlton and Salop (1995); Piraino (1995).

48 1993-2 Trade Cas. (CCH) ¶ 70,352 (S.D.N.Y. 1993).

49 Id. at 70,839.

50 Under the settlement, Mountainwest was not admitted into Mastercard. Rather, NationsBank, a
Mastercard member, was permitted to issue a Prime Option Mastercard, co-branded with Dean
Witter. See 61 Banking Report (BNA) 850 (Nov. 29, 1993). See also "Seeking an Edge, Prime
Option Opts to Lower Its Interest Rate," Credit Card News, (Feb. 15, 1994) (although the card has
yet to be issued, NationsBank has already had to "cut the [card's interest] rate to make Prime
Option stand out in a market crowded with low-rate cards. . . . Observers say the flood of new
low-rate cards in just the three months since Prime Option was announced forced the card to lower
its pricing.").

- 51 Payment systems joint ventures face the risk of government enforcement from three sources: the Antitrust Division of the Justice Department, the Federal Reserve Board, and State Attorneys General. For a description of the risks of government enforcement, see Balto (1993b).
- 52 15 U.S.C. § 2 (1988).
- 53 See United States v. Colgate & Co., 250 U.S. 300, 307 (1919) ("[i]n the absence of any purpose to create or maintain a monopoly, the [Sherman Act] does not restrict the long-recognized right of a trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.").
- 54 Areeda and Hovenkamp (1993). The only successful essential facility cases are those that have effectively met those standards. See, e.g., Otter Tail Power Co. v. United States, 410 U.S. 366 (1973) (electric power lines); United States v. Terminal Railroad Ass'n, 224 U.S. 383 (1912); Fishman v. Estate of Wirtz, 807 F.2d 520 (7th Cir. 1987) (basketball arena); Aspen Highlands Skiing Corp. v. Aspen Skiing Co., 738 F.2d 1509 (10th Cir. 1984) (mountain), aff'd on other grounds, 472 U.S. 585 (1985); MCI Communications Corp. v. AT & T, 708 F.2d 1081 (7th Cir.) (local telephone exchanges), cert. denied, 464 U.S. 891 (1983); Hecht v. Pro-Football, Inc., 570 F.2d 982 (D.C. Cir. 1977) (football stadium), cert. denied, 436 U.S. 956 (1978).
- 55 MCI Communications Corp. v. AT & T, 708 F.2d 1081 (7th Cir.), cert. denied, 464 U.S. 891 (1983).
- 56 Id. at 1132-33.
- 57 Id. at 1132. See City of Anaheim v. Southern Cal. Edison Co., 955 F.2d 1373, 1379 & 1380 n.5 (9th Cir.), cert. denied, 113 S. Ct. 305 (1992); Alaska Airlines v. United Airlines, 948 F.2d 536, 544-46 (9th Cir. 1991), cert. denied, 112 S. Ct. 1603 (1992).
- 58 At the time, Judge Michael Boudin observed that "[d]espite its embarrassing weakness, the [essential facility] doctrine is nevertheless alive and well in the lower courts, doing mischief and gaining momentum." Boudin (1986) p. 402.
- 59 ABA, Section of Antitrust Law (1989).
- 60 See supra note ____.
- 61 See, e.g., City of Chanute v. Williams Natural Gas Co., 955 F.2d 641, 648-49 (10th Cir.) (no "severe handicap" imposed by requiring city to purchase pipeline's gas rather than less expensive gas from third party; showing of "inconvenience or economic loss" insufficient), cert. denied, 113 S. Ct. 96 (1992); Alaska Airlines, 948 F.2d at 544-46 (rejecting essential facility claim because denial of access would only impose financial burden on excluded competitors, not "eliminate" them); Laurel Sand & Gravel, Inc. v. CSX Transp., 924 F.2d 539, 544-45 (4th Cir.) (denial of trackage rights did not support essential facilities claim where plaintiff could have purchased (more costly) train service), cert. denied, 112 S. Ct. 64 (1991); Twin Labs. v. Weider Health & Fitness, 900 F.2d 566, 569-70 (2d Cir. 1990).
- 62 See Alaska Airlines, 948 F.2d at 544 (facility "will be considered 'essential' only if control of the facility carries with it the power to eliminate competition in the downstream market."); see also

- City of Anaheim, 955 F.2d at 1380 ("unless [the facility] can be and is used to improperly interfere with competition, it can not be called essential.") (footnote omitted).
- 63 326 U.S. 1 (1945).
- 64 955 F.2d 1373 (9th Cir.), cert. denied, 113 S. Ct. 305 (1992).
- 65 Id. at 1381.
- 66 Id.
- 67 Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284, 296-97 (1985).
- 68 For a thorough and insightful analysis of the inadequacy of traditional rule of reason analysis, see Baker (1993) pp. 1036-41.
- 69 15 U.S.C. §§ 4301-4305 (1993). The Senate report that accompanied the NCPRA stated: "Our antitrust laws rely on private as well as public enforcement, however, and the fear of a private action for treble damages can be a powerful deterrent to procompetitive conduct where uncertainty exists regarding the applicable antitrust standards." Senate Report for S. 574, reprinted at 64 Antitrust & Trade Reg. Rep. (BNA) 725, 729 (June 10, 1993).
- 70 See American Bar Association (1992) 57; Baker (1993), pp. 1103-04; Calkins (1994) (describing how recent Supreme Court decisions have sought to establish relatively clear, generalized rules to improve certainty in the law).
- 71 Compare supra note ___ with supra note ___.
- 72 See supra section 1.0.
- 73 See Blumenthal (1989), pp. 864-69.
- 74 See Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 768-69 (1984) ("Concerted activity inherently is fraught with anticompetitive risk. It deprives the marketplace of independent centers of decisionmaking In any conspiracy, two or more entities that previously pursued their own interests separately are combining to act as one for their common benefit.").
- 75 Areeda and Hovenkamp (1993) ¶ 736.1d (The law is more concerned with concerted action because "conspiracies . . . are relatively infrequent, easily appraised for reasonableness, and simply remedied through prohibition."); Gerber (1988) pp. 1095-98.
- 76 Areeda and Turner (1978) ¶ 405b; see Volvo N. Am. Corp. v. Men's Int'l Prof. Tennis Council, 857 F.2d 55, 67 (2d Cir. 1988) ("the cartel is inherently more fragile than the single-firm monopolist. The interests of the cartel as a whole often diverge substantially from the interests of individual members.") (quoting Herbert Hovenkamp, Federal Antitrust Law § 4.1, at 83 (1985)).
- 77 Areeda and Turner (1978) ¶ 405b.

78 Gerber (1988), pp. 1095-98 (explaining why the collusion assumption is inconsistent with economic theory).

79 Blumenthal (1989), pp. 866-67.

80 Cf. Areeda (1986), ¶ 1477 (suggesting, in the trade association context, that the stricter Section 1 standard be applied to only to trade association activities that restrict competition between the association's members, whereas the single firm standard should apply to other types of restraints).

81 Blumenthal (1989), p. 868.

82 See Baker (1993), pp. 1102-11; Blumenthal (1989), p. 868; Werden (1987), pp. 477-78; see also Kattan (1993), p. 963 (1993) ("the requirement of open access is limited to cases that fall within the 'essential facility' rubric, such as real estate multiple listing services."); Steptoe (1994), p. 25 ("the requirement of open access should be limited to situations in which membership approximates what has been characterized as an essential facility."); See also Department of Justice (1988), ("the Department generally will be concerned about a joint venture's policy of excluding others only if (i) an excluded firm cannot compete in a related market or markets (that is, a market or markets with respect to which the joint venture product or service is a complement or an input) in which the joint venture members are currently exercising market power without having access to the joint venture and (ii) there is no reasonable basis related to the efficient operation of the joint venture for excluding other firms.").

83 This discussion assumes that the denial of access is simply an exclusion from the venture, rather than part of an underlying agreement not to compete by the members of the venture. If the denial of access is part of a membership restriction that enforces an underlying agreement not to compete, the restriction may be subject to summary condemnation. For example, if members of a venture restrain competition among themselves by agreeing to refrain from advertising, that agreement might be condemned without full rule of reason analysis. The venture's exclusion from membership of those who engaged in advertising might also be summarily condemned. See Steptoe (1994) pp. 16-17.

This distinction helps to clarify the result in Associated Press. In Associated Press, the members had agreed to a system of exclusive territories. Each member had the power to veto the admission of new applicants in its territory. Exclusion from the association raised competitive concerns because it enforced that system of exclusive territories. The Court's concern was with the underlying restraint, not with the mechanism used to enforce it. Thus, the Court only struck down a member's veto power. It did not compel Associated Press to admit anyone. See 326 U.S. at 24 (Douglas, J. concurring). See also Consolidated Metal Prods., Inc. v. American Petroleum Inst., Inc., 846 F.2d 284, 291-92 n.21 (5th Cir. 1988) (the holding in AP "may be based more on the territorial division imposed by AP than on any boycott"); United States v. Realty Multi-List, Inc., 629 F.2d 1351, 1366-67 n.30 (5th Cir. 1980) (same); Areeda (1989), p.842, ("remedy was to enjoin the discrimination, but the Court was very careful not to say that the Associated Press had to admit everyone.").

84 A preliminary factor that should be considered in each step of the analysis is defining precisely the facility to which the claimant seeks access. For example, does the claimant seek access to a computer system, a trademark, a group of merchants or a group of banks? Some facilities, such as an interchange system, may be far more difficult to replicate than a product mark assuming, for

instance, insufficient demand to support a second network. A factfinder that defines the facility at issue too broadly may erroneously decide the joint venture possesses a facility impossible to economically duplicate, while factfinder that defines the facility too narrowly risks erroneously deciding the joint venture's facilities may all be duplicated in a piecemeal fashion, overlooking a significant positive externality deriving from sheer size. See Stevens (1993), pp. 597-98 & nn. 109-112 (describing effect in which increase in network's size increases its value to the consumer); id. at 601 & n. 124 (positing that first firm to establish large base in network industry captures the most significant positive externality available in the market). Thus, disaggregating the elements of a payment system will lead to clearer decision making. See Baker (1993), pp. 1099-1102.

85 Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962) (emphasis in original).

86 See, e.g., National Ass'n of Review Appraisers v. The Appraisal Foundation, 64 F.3d 1130 (8th Cir. 1995); Capital Imaging Assocs. v. Mohawk Valley Med. Assocs., 996 F.2d 537, 547 (2d Cir. 1993); Fishman v. Estate of Wirtz, 807 F.2d 520, 543 (7th Cir. 1986) ("The concern of the antitrust laws with the integrity of the competitive process . . . means that we can only find a violation . . . if we have reason to believe that the competitive process has been subverted."); Products Liability Ins. Agency, Inc. v. Crum & Forster Ins. Cos., 682 F.2d 660, 663-665 (7th Cir. 1982); Alabama Sportservice, Inc. v. National Horsemen's Benevolent & Protective Ass'n, 767 F. Supp. 1573 (M.D. Fla. 1991); Weight-Rite Golf Corp. v. United States Golf Ass'n, 766 F. Supp. 1104 (M.D. Fla. 1991); Martin v. American Kennel Club, Inc., 697 F. Supp. 997, 1002-03 (N.D. Ill. 1988); Pretz v. Holstein Friesian Ass'n, 698 F. Supp. 1531, 1539 (D. Kan. 1988); Hassan v. Independent Practice Associates, 698 F. Supp. 679, 695 (E.D. Mich. 1988).

87 472 U.S. at 297, n.9.

88 Department of Justice (1994) --

89 See Alaska Airlines, 948 F.2d at 544 (facility is "essential" if it is vital to competitive viability and competitors cannot effectively compete in the relevant market without access to it).

90 In fact this issue has been dispositive in resolving a number of single firm access cases without a trial. See note ___, infra.

91 See supra notes ___-___ and accompanying text.

92 Steptoe (1994), p. 24; Department of Justice (1988), at ¶ 3.42, n.95 ("The mere fact that it is more costly for excluded firms to enter the joint venture market or markets on their own rather than through the joint venture does not by itself make access to the joint venture essential.").

93 During the period of its exclusion, Pacific's sales actually increased by 33 per cent.

94 For example, in the MLS cases brought by the FTC, it was clear that the MLS network could not be replicated and denial of access prevented the excluded brokers from effectively competing in the market. See, e.g., United Real Estate Brokers of Rockland, Ltd., C-3461 (Sept. 27, 1993) (Commissioner Azcuenaga concurred in part and dissented in part). See also Austin (1970) (explaining that firms denied access to a MLS often cannot compete effectively with member firms).

- 95 326 U.S. 1 (1945).
- 96 Id. at 17-18.
- 97 See, e.g., Denny's Marina, Inc. v. Renfro Productions, Inc., 1993-2 Trade Cas. (CCH) ¶ 70,402 (7th Cir. 1993); Thompson v. Metropolitan Multi-List, 934 F.2d 1566 (11th Cir. 1991), cert. denied, 113 S. Ct. 295 (1992); Spence v. Southwestern Alaska Pilots Ass'n, 789 F. Supp. 1014 (D. Alaska 1992); Medlin v. Professional Rodeo Cowboys Ass'n, 1992-1 Trade Cas. (CCH) ¶ 69,787 (D. Colo. 1991); Carleton v. Vermont Dairy Herd Improvement Ass'n, 1992-1 Trade Cas. (CCH) ¶ 69,761 (D. Vt. 1991).
- 98 The Court observed that failure to have access to AP news could "have the most serious effects upon the publication of competitive newspapers" and it was practically impossible for a newspaper to develop a competitive source of news. Associated Press, 326 U.S. at 17. Antitrust commentators and the Justice Department appear to have interpreted Associated Press as applying essential facility principles. See Areeda (1989), p.842; Brief for the United States as Amicus Curiae, Northwest Wholesale Stationers, Inc. v. Pacific Stationery and Printing Co., No. 83-1368, at 16, n.14 (citing Associated Press for the proposition that "[w]here a joint venture of competitors provides a product or service necessary to effective competition, depriving a competitor of access to the product or service might well be found to be anticompetitive.") (emphasis added).
- 99 Associated Press, 326 U.S. at 32 (Roberts, J. dissenting) ("I am unable to determine on which of [the] possible [Sherman Act] grounds the judgment of illegality is rested.").
- 100 Id. at 28 (concurrence of Frankfurter, J.).
- 101 Justice Roberts in his dissent observed that the result in the case "may well result not in freer competition but in a monopoly in AP or UP, or some resulting agency." Id. at 48. Justice Roberts observations seem quite prescient, since AP today has a nearly-monopoly position in the news service market. See Baker (1993), pp. 1034-35, 1068-72.
- 102 See Posner and Easterbrook (1981), pp. 768-69.
- 103 See Bork (1978), p. 341. Later he observed that "[p]erhaps the decision stands for the proposition that efficiency is lawful so long as when there is a means by which the law can require that it be shared. Where it cannot be shared . . . the cause of the efficiency must be destroyed." Id. at 342.
- 104 Baker (1993), p. 1036. See also Areeda (1989), pp. 844-45.
- 105 If a network has achieved a certain "critical mass" there may be insufficient demand for the creation of an alternative network. See Stevens (1993), pp. 592-93.
- 106 See Baker (1993), p. 1108.
- 107 See United States v. Rocky Mountain Automated Clearing House Ass'n, No. 77-391 (D. Colo. 1977); United States v. California Automated Clearing House Ass'n, No. 77-1643-LTL (D. Cal. 1977).

- 108 See Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 229 (D.C. Cir. 1986) (Bork, J.), cert. denied, 479 U.S. 1033 (1987); Forest City Enterprises v. Polk Bros., 776 F.2d 185, 191 (7th Cir. 1985) (applying market power threshold in upholding horizontal restraint); see also Easterbrook (1984), p. 19.
- 109 See Capital Imaging Assocs., 996 F.2d at 547; Charley's Taxi Radio Dispatch Corp. v. SIDA of Haw., 810 F.2d 869, 878 (9th Cir. 1987); Rickards v. Canine Eye Registration Found., 783 F.2d 1329, 1333 (9th Cir.), cert. denied, 479 U.S. 851 (1986); Rothery Storage & Van Co., 792 F.2d at 229; Goss v. Memorial Hosp. Sys., 789 F.2d 353, 355 (5th Cir. 1986). Cf. Kattan and Balto, (1993), p.17 ("joint ventures ordinarily have no cause for concern about liability for membership exclusions unless they are potentially vulnerable to a determination of market power.").
- 110 See Blumenthal (1989), pp. 861-64.
- 111 The more appropriate approach may be to calculate market shares based on the ATM network's share of all transactions sent through a ATM network. See Northwest Wholesale Stationers, 472 U.S. at 296 ("Unless the cooperative possesses market power or an element essential to effective competition, the conclusion that expulsion is virtually always likely to have an anticompetitive effect is not warranted.") (emphasis added).
- 112 Brief for the United States as Amicus Curiae, Northwest Wholesale Stationers, Inc. v. Pacific Stationery and Printing Co., No. 83-1368, at 16. See Steptoe (1994), pp. 27-28 ("If a joint venture is too large, it is difficult to see why a court should attempt to remedy the potential exercise of market power by forcing the venture to accept more market power. Interpreting the antitrust laws to require the forced expansion of a procompetitive venture to the point where the venture itself violates those laws, would make little sense indeed.").
- 113 Steptoe (1994), pp. 23-24.
- 114 See note __, supra and accompanying text.
- 115 See Baker (1993), pp. 1099-1101, 1117-22; Werden (1987), p.475 ("The patent and copyright laws provide substantial freedom for intellectual property owners to insure that adequate resources are devoted to the creation of productive new ideas. Restricting this freedom pursuant to the essential facilities doctrine would most likely lessen economic welfare substantially.").
- 116 See, e.g., General Motors Corp., 103 F.T.C. 374 (1984).
- 117 This was fundamentally the approach taken in litigation involving access demands brought against electric power pools. See Central Iowa Power Cooperative v. FERC, 606 F.2d 1156, 1165 (D.C. Cir. 1979) (no anticompetitive harm where the nonmember of an electric power pool could receive the benefits of the pool by purchasing power from pool member).
- 118 See Baker (1993), pp. 1122-24; Kattan (1993), p. 963; Pitofsky (1986), p.903.
- 119 Although this discussion focuses on the justification of preventing free riding, there are many other potential justifications that may be relevant in any individual case. For example, providing access may not be technically feasible. See Otter Tail Power Co. v. United States, 410 U.S. 366, 378 (1973).

- 120 Kattan (1993), p. 963; see Areeda (1990), pp. 849-50; Pitofsky, supra note 118, at 902; Stevens (1993), pp. 620-21; Department of Justice (1988) § 3.42 ("Forcing joint ventures to open membership to all competitors . . . would decrease the incentives to form joint ventures, particularly those that are formed to undertake risky endeavors such as research and development and innovative manufacturing. . . . An enforcement policy that denied a joint venture the ability to select its members might also encourage firms to forego risky endeavors in the hope of being able to gain access through antitrust litigation to the fruits of the successful endeavors of others.").
- 121 See Department of Justice and Federal Trade Commission ("in certain circumstances network membership restrictions may be procompetitive by giving non-member providers the incentive to form other networks in order to compete more effectively with the network."); Federal Trade Commission (1981) 48990-91 ("serious antitrust concerns might arise if the formation of a plan appeared to eliminate a significant amount of 'potential competition'. . . . If the formation of a plan . . . makes impracticable the formation of other plans that would otherwise be likely to enter the market, potential competition from those plans may be eliminated and enforcement action may be warranted.").
- 122 See Rule (1988), p.15.
- 123 See United States v. Health Choice of Northwest Missouri, Inc., Case No. 95-6171-CV-SJ-6 (W.D. Mo.; filed Sept. 13, 1995), 60 Fed. Reg. 51808, 51815 (Oct. 3, 1995); United States and State of Connecticut v. HealthCare Partners, Inc., Case No. 395-CV-01946-RNC (D. Conn.; filed Sept. 13, 1995), 60 Fed. Reg. 52018, 52020 (Oct. 4, 1995); Justice Department, Antitrust Division, Press Release, Oct. 12, 1983 (announcing Department's intention to challenge creation of Stanislaus Preferred Provider Organization, Inc.; 50 to 90 per cent of the providers in the relevant market were members of the PPO). Cf. Home Oxygen & Medical Equipment Co., No. 901 0109, and Homecare Oxygen & Medical Equipment Co., No. 911 0020 (consent orders issued for public comment Nov. 2, 1993) (Commissioner Azcuenaga concurred with separate statement; Commissioner Starek dissented).
- 124 Department of Justice (1994).
- 125 "Network externalities" in this context reflect the fact that the value of a network to a consumer depends upon the number of users and the identities of other specific users. The larger the network, the greater the number of consumers who will join it and conversely, the smaller the network, the fewer the number of consumers who will join it. "Positive" network externalities reflect the fact that the value of the network increases to all of its incumbent users as new users join. See Stevens (1993), pp. 597-98; Katz and Shapiro (1985).
- 126 See Baxter (1977); Balto (1993b) pp.113-114.
- 127 See Department of Justice (1977). At the same time, the Division has also declined to approve a statewide ATM/POS network in Nebraska, largely on the ground that the network, by including virtually all the financial institutions in the state, was overinclusive. See Letter from Donald I. Baker, Assistant Attorney General, Antitrust Div. to William B. Brandt, Nebraska Bankers Association (Mar. 7, 1977).
- 128 National Commission on Electronic Fund Transfers (1977).

- 129 Rule (1985) A-141, n.5.
- 130 Steptoe (1994), p. 19.
- 131 See State of New York v. Visa U.S.A., Inc., 1990-1 Trade Cas. (CCH) ¶ 69,016 (S.D.N.Y. 1990).
See Balto (1993a), pp. 116-17.
- 132 VISA and Mastercard also allegedly controlled the two national ATM networks, PLUS and Cirrus, which were also considered to be potential entrants into the market.
- 133 The district court decision in VISA would appear to have put these anti-duality rules at risk. If a bank member of one of the POS networks wanted to issue the card of the other network, it could bring an antitrust suit challenging the anti-duality rule as an illegal group boycott.
- 134 See "Bankers are Burying the Hatchet to Join Forces for Debit Push," American Banker, 20 (Feb. 8, 1994).
- 135 See Balto (1994); "Bank of America is Going to Bat for Maestro," American Banker, 10 (Apr. 5, 1994); "Debit Card War Faces Tough Choices," American Banker, 17 (Feb. 7, 1994); "Economics - More Issuers Get Debit Interchange," POS News, (Jan. 1, 1994) (describing competition in interchange fees).
- 136 That is why cases in which the courts have mandated admission of competitors into collaborative ventures typically have involved "bottleneck"-type ventures which could not be effectively replicated by the plaintiff.
- 137 There was evidence presented at the VISA trial that Dean Witter's purpose in seeking membership in VISA was to deter VISA from competing as aggressively against Discover Card. See Balto (1993a), pp. 271 & n.38.
- 138 Baker & Brandel (1988), ¶ 23.01, 23-4.
- 139 Kattan (1993), pp. 944-45; see Volvo N. Am. Corp. v. Men's Int'l Prof. Tennis Council, 857 F.2d 55, 67 (2d Cir. 1988) (observing how the interests of a cartel as a whole often diverge substantially from the interests of individual members).
- 140 698 F. Supp. 679 (E.D. Mich. 1988).
- 141 Id. at 694. Enforcement agencies have also recognized the importance of this type of exclusivity. See Department of Justice and Federal Trade Commission (1994), p. 103 ("there may be procompetitive reasons associated with [excluding health care providers], such as the provider's competence or ability and willingness to meet the network's cost-containment goals"). See also FTC Staff Opinion Letter to J. Bert Morgan, Esquire (Nov. 17, 1993) ("exclusion of physicians [from proposed physician network] appears likely to be procompetitive, by helping [network] to establish and maintain a reputation as a truly 'preferred' provider network, and thus distinguishing [network] and its physicians from other, lower quality, or more costly physicians and networks competing in the market.").
- 142 Baker (1993), pp. 1098-99.

- 143 Some may claim that this argument is supported by the district court's decision in the VISA case. However, the court's decision in the VISA case does not adopt the distinction between open and closed ventures. Consequently, the decision may tend to inhibit the formation of all sorts of joint ventures, rather than merely reduce incentives to maintain open networks.
- 144 See Stevens (1993), pp. 621-22; Gerber (1985), p. 1111.
- 145 A survey of electronic service networks suggests three reasons why denial of access may be socially beneficial, even in the presence of network externalities: (1) it is necessary to ensure the quality of network services, (2) if the excluded firms constrain the prices of the firms using the network, or (3) if supracompetitive profits produced by the exclusion are necessary to induce firms to undertake the risky investments required to develop the network. See Guerin-Calvert and Wildman (1991), p. 19.
- 146 FTC Watch, 3 (Feb. 28, 1993) (description of remarks of Willard K. Tom, Counselor to the Assistant Attorney General, Antitrust Division, before the 30th Annual Symposium on Associations and Antitrust Trade Association and Antitrust Law Committee Bar Association of the District of Columbia (Feb. 16, 1994)).
- 147 Baker and Brandel (1988) ¶ 21.05(2), pp. 21-36; Pitofsky (1985) p. 902 ("Incentives for risk-taking and innovative efforts will certainly diminish if advantages of the undertaking must be made available to non-participants.").
- 148 See note ____, supra.
- 149 Laderman (1990).
- 150 Remarks on Signing the National Cooperative Production Amendments of 1993 (June 10, 1993) (emphasis added).

THE MURKY WORLD OF NETWORK MERGERS: SEARCHING FOR THE OPPORTUNITIES FOR NETWORK COMPETITION

*David A. BALTO*¹

Introduction

One of the most difficult issues faced by antitrust enforcers is how to analyze mergers between networks. Part of the difficulty involves balancing the competitive ledger of network mergers. On the one hand, network consolidation may often provide fairly obvious benefits of increasing economies of scale and scope. On the other hand, networks may become monopolies and the opportunities for network competition may be lost. This may occur because the perception of network how networks compete may not be particularly clear. In the past, enforcers and regulators have resolved these issues with a very permissive view and permitted network consolidation. More recently these mergers have received more careful scrutiny.

To illustrate these issues, this article discusses the evolving views of competition in automated teller machine (ATM) networks. The article begins by describing how views of network competition evolved -- from one of network competition in which it was envisioned that numerous competing networks would exist -- to one of network monopoly -- where consolidation was permitted to achieve economies of ubiquity. The second part of the article describes how mergers of ATM network mergers are analyzed. The article concludes that although enforcers in the 1990s began to recognize the elements of network competition, they mistakenly are giving too much weight to the economics of ubiquity, with the result that almost all areas will be served by a single dominant ATM network. The article examines how the monopoly/public utility model appears to have prevailed in the ATM network merger context.

I. The Search For Payment Systems Competition: Trends In Enforcement

Views of payment systems competition have evolved during the past generation. When ATM networks were first created in the 1970s, policy makers considered two models for these emerging networks: (1) a monopoly/public utility network model, with open access obligations and (potentially) some form of regulation, or (2) a competing network model -- with numerous networks competing in a lightly regulated environment. This article describes how these visions of network competition have evolved. Even though the network competition model was chosen in the 1970s, because of a history of non-enforcement by antitrust agencies and regulators, it appears that by the close of this century the monopoly/public utility model may be victorious.

1. Mr. Balto is an attorney advisor to Chairman Robert Pitofsky of the Federal Trade Commission. This paper does not necessarily represent the views of the Commission, of any individual Commissioner, or of any other member of the staff.

A. The 1970s -- Providing the Opportunities for Network Competition in New Markets

As the technology for automated payment systems arose, Congress perceived the need to address the creation of these systems in a single forum, and created the National Commission on Electronic Funds Transfer (NCEFT). The Antitrust Division of the Department of Justice played an important role in informing the NCEFT on whether and in what form competition could arise in the newly formed networks.

One important question was whether these networks would be "natural monopolies," because of the substantial processing efficiencies involved. At the time, some commentators argued that ATM networks were natural monopolies because a single network could serve ATMs at lower cost than multiple networks. Based on that conclusion, they argued that the networks should be "open," i.e., compelled to share their facilities with all financial institutions in a given area. Some states incorporated this concept in statutes that required sharing.

In proceedings before the NCEFT, the Antitrust Division opposed the concept of mandatory sharing, in particular, because it would deter the incentives to create competing networks.¹ At the time some thoughtful economic studies suggested that an individual region could support several competing ATM networks.² The NCEFT adopted the Antitrust Division's view. It observed that mandatory sharing "would inevitably result in fewer competitors. . . . Maximum competition usually spells rapid technological improvement and lower prices to consumers."³ Thus, the Commission expressly rejected any sharing requirement, based on its assessment that there was potential for the creation of a number of competing networks.⁴

The Antitrust Division continued to advocate its vision of network competition in a number of forums. It actively opposed the adoption of state sharing statutes.⁵ The Division argued that mandatory sharing would undermine the incentive to create networks in the first place, by creating a "free rider" problem. That is, if the creator of a network knew it would have to share ownership with others after the network succeeded, and share the fruits of its efforts, it might be deterred from creating the network in the first place. Moreover, the Division suggested that mandatory sharing would lead to the formation of monopoly networks.

In spite of the Division's intervention, many states adopted different forms of mandatory sharing. Since these laws require a network to admit any bank as a member, they dampened the opportunity for intersystem competition. More recent economic analysis of these sharing laws suggest that the Division was correct in suggesting that mandatory sharing would not serve the interests of consumers. In those states with mandatory sharing laws, output in terms of ATM deployment and card usage is less than in those states that do not require sharing.⁶

In the 1970s, scores of shared ATM networks were created. Where these networks appeared to interfere with the potential for network competition, for example, by being too large or "overinclusive," the Division raised concerns and threatened enforcement. In 1977, the Division issued a business review letter⁷ refusing to clear a proposed statewide EFT network in Nebraska, primarily because of the proposed venture's all-inclusive nature. At the time of the letter, the proposed network consisted of 66 percent of the commercial banks in the state, which collectively accounted for 86 percent of the deposits. The network attempted to justify its size based on the amount of capital required, the degree of risk, and the economies of scale involved in operating an EFT system. The Division concluded that these efficiencies did not necessarily justify the all-inclusive nature of the proposed network.⁸ Because of the Division's action, competing networks were created in Nebraska.

B. The 1980s -- "Economics of Ubiquity" take center stage

In the 1980s, payment systems basically disappeared from the Antitrust Division enforcement radar. The lack of enforcement, especially in the merger area, was based on the recognition that there were efficiencies from the consolidation of ATM networks. Former Antitrust Division Assistant Attorney General Charles Rule discussed this factor in a 1985 speech. Rule stated that the Division was focusing more on the "economies of ubiquity" and the resulting consumer benefits achievable by widespread sharing of ATMs. Rule observed that the consolidation of ATM networks benefits consumers by, among other things, increasing the available ATMs in a single network; similarly, increasing the number of cardholders tends to increase the deployment of ATMs. Thus, Rule indicated that the Division would not challenge the creation or merger of shared ATM networks based on size alone.⁹

Unsurprisingly, the Division did not challenge, or even apparently investigate, any ATM mergers during the 1980s. The Federal Reserve Board approved every ATM merger before it, because it viewed the ATM network as little more than a system of computers -- thus, focusing almost exclusively on the network's back office operations.¹⁰

Perhaps the most notable matter was the acquisition of the Cashstream Network by the MAC network in 1988, which involved the merger of two competing mid-Atlantic networks. The merger was the subject of a private antitrust challenge brought by a competing ATM network. The District Court rejected this challenge, adopting an approach similar to the Board's that the market included anyone capable of providing computer processing and that market was unconcentrated. MAC continued to acquire almost all of its neighboring networks, ultimately securing a dominant position in Pennsylvania and many adjoining states.

Financial Interchange business review. The one matter that forced the Division to confront intersystem competition was a business review request submitted by the PULSE ATM network in 1983. At the time there was aggressive competition in Texas between two similar sized networks: PULSE and MPACT. MPACT, in particular, competed through an incentive price program. First Texas Savings and Loan, a member of MPACT, sought to join PULSE and PULSE declined.

PULSE was faced with a peculiar quandary posed by the antitrust laws. If PULSE refused to admit the bank, First Texas could claim that its exclusion from PULSE constituted an illegal group boycott and it could seek treble damages in a private antitrust suit.¹¹ If PULSE admitted First Texas, this would create a de facto merger with MPACT,¹² and PULSE might face a government antitrust challenge because the network had become too large and the merger eliminated intersystem competition.

Faced with this dilemma, PULSE sought a business review from the Antitrust Division. PULSE posed three alternatives to the Division: (i) admitting First Texas; (ii) generally admitting members of competing networks; or (iii) implementing an anti-duality rule, that would prohibit membership to members of competing networks.

The Division addressed only the first alternative, saying that at that time, admitting First Texas would not pose an antitrust violation. The Division noted that the incremental consumer convenience that would result from admitting First Texas appeared to outweigh the loss of rivalry that might occur between the two competing networks.¹³ The other two alternatives were not addressed because they were not considered ripe for review. Within six months after the business review letter was issued, practically

every MPACT member joined PULSE. MPACT eliminated its incentive pricing. There was a similar impact on consumers, as several banks increased their consumer fees.

C. The States intervene -- The Entree case.

Because of the Division's inaction, attention to intersystem competition issues seemed dormant and ATM network consolidation seemed uncontroversial. Into this enforcement void stepped the state attorneys general. In the late 1980s they challenged the formation of the "Entree" national POS (point of sale) joint venture between VISA and MasterCard.¹⁴ (VISA and Mastercard had informed the Antitrust Division of the formation of Entree, but no enforcement action was taken.) The complaint filed by the New York State Attorney General (on behalf of twelve states) alleged that VISA and Mastercard violated the antitrust laws through the formation of the Entree POS debit program, their respective acquisitions of interests in PLUS and CIRRUS (the national ATM networks), and VISA's acquisition of Interlink, a California POS network.

The states alleged that by forming Entree and acquiring the ATM networks, the associations intended to retard the development of on-line, POS debit, a payment system which they feared would compete with and erode the profitability of credit cards. Entree, the states alleged, was a combination of the five most likely entrants into the POS market. The states further alleged that as part of the joint venture, MasterCard and VISA had agreed not to introduce their own separate systems to compete with Entree. As part of their allegations, the states challenged provisions in the agreement that formed the venture that limited its membership to banks that were members of both associations, thereby excluding non-banks such as Sears/Discover Card and American Express from participating.

The complaint sought divestiture of CIRRUS (by MasterCard), and PLUS and Interlink (by VISA), as well as an injunction against the implementation of Entree. In 1990, VISA and MasterCard agreed to abandon the Entree joint venture.¹⁵ VISA kept its ownership of Interlink and both card associations were permitted to keep their interests in the national ATM networks.¹⁶

Although arguments about the "economics of ubiquity" may have been persuasive in other contexts, they did not persuade the States. One could argue that a single national POS network would have offered the opportunity for greater customer convenience, by putting all of the POS terminals in a single network. Similarly, aggregating all of the card holders in a single network may have persuaded merchants to use the new POS network. But these arguments were unavailing. The States recognized that even of a single network might present some of these efficiencies, they were outweighed by the potential loss of potential competition between competing POS networks.

The settlement expired in 1997 and it generally appears that the States' assessment was correct. After the settlement, VISA and Mastercard created their own independent POS programs (Interlink and Maestro, respectively). In response to the concerns of the states, each of the national POS networks adopted "anti-duality" rules, which prevent any bank member from belonging to a competing network. Competition between the networks, in terms of product promotion, product development and pricing has been aggressive, and far more significant than that in the credit card market, where duality is permitted.¹⁷

Each of the networks has competed vigorously to sign up both banks and merchants. Both networks have adopted different switch and interchange fees,¹⁸ in order to offer more attractive packages to consumers. The fees charged by the networks, including interchange fees, are far less than those involving credit cards.¹⁹ Interlink charged additional "annual card service fees" and "merchant location fees." When Maestro entered, it did not charge these fees. Of particular significance, Interlink initially

charged a "transaction service fee" of \$0.02 per transaction conducted by an Interlink cardholder at an Interlink terminal even if the transaction was actually processed through a regional network (in other words if the bank attempted to bypass the Interlink network). Maestro entered without such a "bypass" fee, and its entry forced Interlink to eliminate the fee, showing that anti-duality provisions coupled with independent entry and expansion, reduced the costs of POS debit card transactions.

In April 1994, Maestro sought to eliminate its anti-duality rule to permit issuer duality. After considering the proposal for over five months, the States rejected it in December 1994. The States observed that both networks were competing aggressively and that the networks appeared to be thriving in terms of transaction volumes and merchant participation. Moreover, unlike other payment system markets, competition from non-banking participants, such as Discover Card or American Express, was unlikely because debit card services are necessarily linked to a financial institution's demand deposit account. Most important was the States' concern that eliminating Maestro's anti-duality rule "would bring to an end the aggressive intersystem competition between the two bankcard associations" in the POS market. Thus, the states concluded that they could not assure Maestro that elimination of their anti-duality rule would not lead to an enforcement action.²⁰

For the States, abstract arguments about efficiencies were simply a guise to deter the emergence of intersystem competition. Their enforcement action led to increased intersystem competition and concomitant benefits for consumers. As important, the Entree case began to effect how regulators and enforcement agencies assessed the opportunities for network competition.

D. The 1990s -- Renewed Attention to Network Competition

The States' challenge of the Entree joint venture served as a renew interest by antitrust enforcers in network competition. The States focus on the importance of network competition and the potential for the creation of alternative networks provided a new perspective on the dogma of network ubiquity. With a change in political administrations, the federal antitrust enforcers began focusing on the elements of network competition in the 1990s.

1. Exclusive Processing Rule Challenged -- MAC ATM Network Settlement.

The reemergence of the Antitrust Division in the payment system competition venue occurred in April 1994, when the Division challenged the exclusivity rules of the MAC ATM network. In the six years since the Division took a pass on the Cashstream acquisition, MAC had acquired almost all of its neighboring competing networks, and had become the largest ATM network in the United States. At issue at this point was not a merger, but rather certain exclusivity arrangements which MAC used to enforce its monopoly position. The Division challenged these restrictions as illegal tying and monopolization, under Sections 1 and 2 of the Sherman Act.²¹ This was the first tying and monopolization case to be brought by the Antitrust Division in well over a decade.

To understand the reason for the action, we set forward the different functions of an ATM network. In its most basic sense an ATM network consists of a trade mark, a computer switch, and a set of rules. Some networks have their own computer system which drives the computer switch; other networks contract for that service. Some networks "drive" or operate their members ATMs; other networks permit their members to drive their own ATMs or use third parties, such as EDS Corp.

Electronic Payment Services (EPS), which operates the MAC network, is a joint venture of four bank holding companies: CoreStates Financial Corp., Banc One Corp., PNC Bank Corp., and Society

Corp. The MAC network has approximately a 90 per cent market share in Pennsylvania and a dominant position in adjacent mid-Atlantic states. The MAC network handles 92 million transactions each month for 27 million depositors of more than 13,000 ATMs.

Most ATM networks are non-exclusive, i.e., they permit their members to belong to any of a number of networks. Until 1992, MAC generally did not permit its bank members to participate in rival ATM networks while also participating in MAC. These "exclusivity rules" created an almost impervious barrier to competitive entry, since if a bank wanted to join a competing network it would have to withdraw all of its ATMs from MAC. Any individual bank was unlikely to make that decision unless a sufficient number of other banks made the identical decision to provide a minimum level of ubiquity expected by the bank's cardholders. Faced with that "all or nothing" decision, few banks chose to align with competing networks.²² The rules assisted MAC to acquire and maintain its dominant position in the market. The rules against multiple affiliations was formally dropped in 1992 after being challenged in a private antitrust suit.²³

In this case, the Division's focus was on other rules that barred banks that belonged to its network from using third parties for ATM driving and restricted the ability of banks to participate in other networks. The Division alleged that a rule that required banks either to obtain ATM driving from MAC or to provide ATM driving in-house (which is prohibitively expensive for many smaller banks, thrifts and credit unions) effectively made it impossible for these smaller banks to belong to rival networks while belonging to MAC. MAC generally forbid its network members from obtaining ATM driving from any of the several data processing firms, such as EDS and ACS, that provided that service.

The MAC rules and practices, the complaint alleged, "prevent willing buyers and sellers from conducting business at competitively determined prices and terms." In addition, by preventing banks from obtaining ATM driving from others, MAC effectively prevented these banks from participating in other ATM networks. In turn, MAC's rules made it substantially more difficult for other networks to enter into MAC's area of dominance, thereby excluding competitors and maintaining MAC's monopoly position.

The Division alleged that "regional ATM network access" and "ATM processing" were separate products, and that MAC's rules and practices effectively forced its customers to purchase ATM processing from MAC. The monopolization claim alleged that MAC "willfully has maintained its monopoly power in the market for regional ATM network access in the affected states through exclusionary practices."

The consent decree requires MAC to open its network to independent ATM processors on a non-discriminatory basis. MAC is prohibited from tying the use of its trade mark to the purchase of processing services. Under it, MAC must permit its participants to use third-party providers of ATM processing, to display multiple network trademarks on all their ATMs, and to permit multiple branding of ATM cards issued by MAC members in areas where MAC has or could soon have market power.

The objective of the decree is to provide banks with the opportunity to use other networks or third party processors for their processing services. MAC is also required to sell its network services "at prices that will not vary with the process selected" and to provide a more open environment for third-party processors. In addition, MAC would be limited in the extent to which it can keep banks from displaying symbols of other ATM networks on their ATMs and ATM cards.

The decree permits a wide range of other activities which may raise exclusionary concerns. First, MAC is permitted to charge a royalty fee for transactions processed outside the MAC switch.²⁴ Second, MAC can prohibit its members from bypassing the switch, a practice known as subswitching.

Third, MAC is permitted to provide volume discounts, but these must be provided on a non-discriminatory basis (i.e., they can not discriminate between members by different classifications). Whether the decree adequately "solved" the competitive problem is an open question. The consent decree received a tremendous amount of adverse commentary; many competing networks stated that the proposed decree would permit MAC to achieve the same objective through a variety of other types of exclusionary conduct.²⁵ For example, rather than attempting to collect monopoly profits through a switch fee, MAC can attempt to recover comparable profits through the use of a royalty fee. In addition, as described below, the Board staff raised concerns over the sufficiency of the relief in when it examined the EPS-National City Bank merger.²⁶

The results of the decree have been mixed. On the one hand, new third-party processors have entered the market. Three years after the decree was entered, about 5 per cent of MAC ATMs are driven by third party processors who were excluded from the market prior to the decree.²⁷ On the other hand, there has been relatively little entry by competing regional networks and MAC's monopoly position in the "branded regional ATM access" market seems secure.

The Division's enforcement action demonstrated that the "economics of ubiquity" no longer ruled the day. The Division was able to go beyond that theory by separating ATM services into two separate product markets: ATM processing (or the back office operations) and branded regional ATM access (which reflects the value of membership in the network and the network mark). As the Division observed, ATM processing can be provided as a service distinct from branded ATM network access, and can be performed in the facilities of the ATM switch, a depository institution's own facilities, or in the facilities of a data processing service organization.

Of course, the irony here is that had the Division not signed on to the "economics of ubiquity" band wagon, and had examined the nature of network competition more carefully, it may have challenged the earlier acquisitions by MAC, and ultimately this enforcement action may have been unnecessary.

2. Payment Systems Merger Challenge -- Consumer Money Transfer Services

The only enforcement action brought against a payment systems merger was the challenge by the Federal Trade Commission to the acquisition of the Western Union consumer money transfer system (owned by First Financial Management Corp.) by First Data Corp., the owner of the MoneyGram system.²⁸ Consumer wire money transfer systems involve one-way money transfers, typically between two consumers.²⁹ Wire transfer agents include a wide variety of retail outlets including grocery stores and check cashing outlets.

Western Union has been the dominant firm in the market and had been a regulated monopoly until the late 1970s. The Federal Communications Commission had deregulated Western Union based on the expectation that technological advancement had reduced the barriers to entry.³⁰ Those expectations were overly generous and entry was neither easy, nor timely.

In the mid-1980s, Citibank attempted to enter the market, but their entry was stifled by two factors: (1) developing a minimum viable scale nationwide network of money transfer agents; and (2) establish name recognition and customer acceptance of its services through large-scale advertising and promotion. Long term agent contracts utilized by Western Union made acquiring a sufficient agent network difficult. To build brand name recognition was substantial investment would be required over a number of years. Citibank's attempted entry failed after several years of significant losses.³¹

MoneyGram, which was originally owned by American Express, entered in the late 1980s. It was able to overcome these barriers in part because it could rely on the trade name and the agent base of American Express. After several years of losses, MoneyGram overcame the barriers to entry and introduced competition into an environment in which a monopolist had dictated annual price increases.

Competition from MoneyGram led to lower prices, better services, and higher commissions for agents. MoneyGram entered by competing aggressively on price; Western Union responded by refraining from price increases and offering special promotions and discounts to customers.³² In 1994, MoneyGram launched a "frequent user" discount program to increase sales and customer loyalty; Western Union responded with a similar program. Non-price competition increased, including increased price advertising, the development of a more extensive "will-call" system, and free long distance telephone calls.

Competition also led to almost a threefold increase in wire transfer agents, which provide consumers with increased convenience when using a money transfer service. The increased number of locations has dramatically improved the convenience of the service for consumers. As both networks competed for agents, agent commissions increased, the networks provided greater amounts of cash at more agent locations, and increased advertising. Competition has indirectly created these consumer benefits by pushing the companies to pay their transfer agents higher commissions and significant bonuses for increasing customer volume.

At the time of the FTC's action, Western Union had approximately a 90 per cent market share. According to the complaint, MoneyGram and Western Union were the only two services in the United States consumer money transfer market, and it would be very difficult for new companies to enter this market. The complaint noted that First Data's acquisition of Western Union would create a monopoly in the market. Further, the FTC contended that entry was unlikely because of the difficulty of gaining brand name recognition and establishing a nationwide network of retail outlets. Thus, absent the settlement, the FTC alleged that the acquisition would increase the likelihood that consumers, among other things, would be forced to pay higher fees and receive less service and that agents would be forced to accept reduced commissions.

The proposed consent agreement permits First Data to acquire Western Union as long as it divests either the MoneyGram or Western Union consumer money wire transfer business. The divestiture package would include the MoneyGram or Western Union trade name, contracts with sufficient retail sales agents to have a minimum viable scale network, and other assets necessary to run the business. The settlement also includes various provisions designed to ensure that there would be an agent network sufficient to support the divested business. Finally, the settlement expressly permits First Data to provide data processing services to the acquirer of the MoneyGram or the Western Union assets, provided that First Data, among other things, shields any nonpublic information it receives from any First Data employees who are involved in First Data's consumer money wire transfer.

The importance of the FTC's action was in differentiating between the importance of the "back office" or "systems operation" and the agent network and trade name. Like the FCC, the FTC did not contend that the back office operation posed an entry barrier. However, the years of experience since the FCC decision had shown that ease of entry at the back office level would not guarantee a competitive market. Rather the critical elements to new entry were the trade name and the existence of a sufficient agent base.³³ Thus, the proposed consent order does not require the divestiture of the back office system and, in fact, permits First Data to provide back office services to the acquirer of the divested assets.

Rather, the FTC focused its relief on the trade name and agent network, which it contended were the most significant barriers to entry.

From a preliminary perspective, the FTC's enforcement action appears to have led to a stronger competitor and lower prices to customers. Following this consent agreement, MoneyGram advertised a promotional price that undercut Western Union's prices by as much as seventy percent.³⁴ Moreover, MoneyGram's market share, at least in the short term increased somewhat. In November 1996, Moneygram became an independent firm and competes directly with Western Union.

II. ATM Network Merger Analysis

Antitrust analysis examines the effects of mergers on competition. The purpose of this analysis is to determine if the effect of an acquisition "may be substantially to lessen competition or to tend to create a monopoly."³⁵ Under the Horizontal Merger Guidelines the enforcement agencies analyze: (1) the relevant product and geographic market; (2) the existence of market power; and (3) the likelihood of entry. If a merger poses a significant threat to competition the agencies also analyze whether the efficiencies from the merger will outweigh the anticipated harm. This section discusses the Merger Guidelines framework and applies it to mergers of ATM networks.

A. Market Definition Issues.

Antitrust analysis of payment system mergers or other competitive activity depends critically on whether the system has market power. This is typically a difficult question to answer in part because the delineation of relevant markets is itself a complex and uncertain undertaking. The definition of the relevant market has both product and geographic market components. In both respects, the markets defined in ATM network mergers have become more precise and narrow over time.

1. Product Market Definition. One of the uncertainties in counselling payment systems is traceable to the difficulties in defining the relevant product market for purposes of measuring market power. A number of different approaches have been utilized. Product market definition has become more precise, as regulators have become more sensitive to the competitive problems raised by network competition. In particular, both the Antitrust Division and the Board have begun to differentiate between the back office and trade mark aspects of a network in defining the market. Typically factfinders define the product market from the perspective of the cardholder (the retail market) and the card issuing bank (the wholesale market).

A "Payment Systems" Market. One of the earliest cases, NaBanco, involved a challenge to a credit card interchange fee. The district court defined a very broad retail market consisting of all "payment systems," which it defined further as:

a market consisting of VISA and all payment services used in retail sales. This market includes VISA, MasterCard, T & E cards, merchants' proprietary cards, merchants' open book credit, cash, travelers cheques, ATM cards, personal checks and check guarantee cards."³⁶

The court acknowledged that none of these were a perfect substitute, but relied on an examination of cross-elasticities of supply and demand to determine that they were sufficiently close substitutes for the VISA card.

A "Data Processing" Market. In terms of a wholesale market, in early cases factfinders emphasized the data processing functions of bank ATM networks. For example, in The Treasurer³⁷, the district court adopted a broad definition of the relevant product market. That case involved a challenge by The Treasurer ATM network in New Jersey to the acquisition of the Cashstream network by Philadelphia National Bank, the owner and operator of the shared, proprietary MAC network. Although he ultimately dismissed the case for lack of antitrust injury, Judge Politan also examined the case on the merits. In so doing, he defined the relevant product market as "electronic data processing to all ATMs plus all of those institutions which have unaffiliated ATM systems and those institutions which do not currently have ATMs but have the capacity to install them and utilize market technology to its fullest."³⁸ In other words, the market included all firms capable of performing the electronic communication function performed by an ATM network.

Similarly, in the 1980s in orders approving bank holding companies' acquisitions of voting stock in shared EFT networks, the Federal Reserve Board typically defined the relevant market as "the provision of data processing services to unaffiliated financial institutions."³⁹ In addition, the Board noted that the market for data processing and related ATM services is "unconcentrated, with many competitors and few barriers to entry."⁴⁰

An "ATM Services" and "Network Switching" Market. In more recent decisions and enforcement actions, factfinders have defined more narrow markets, focusing primarily on demand side factors. For example, in the Financial Interchange arbitration, which involved ATM network interchange fees, the arbitrator rejected proposed markets of "all payment systems" and "all means of obtaining cash," similar to the approach taken by the Board or the courts in NaBanco or The Treasurer. Instead, it identified a narrow retail market of "ATM services" on the ground "that there is a significant group of ATM users who value the characteristics of ATMs and for whom other means of obtaining cash are not reasonable substitutes."⁴¹

In addition, in Financial Interchange, the arbitrator identified a wholesale market for "network switching," and concluded that PULSE had market power because "existing subnetworks, regional networks and national networks do not presently provide a reasonable substitute for the [switching] service PULSE provides to its members."⁴²

In the EPS consent decree, the Antitrust Division took a similar approach, albeit focusing on the wholesale side of the market.⁴³ First, it defined a market for "regional ATM service," based on the needs of banks to provide depositors "ubiquitous access to their accounts." It observed that "[w]hile a bank can deploy its own ATMs, the advantage to a shared ATM network is that a bank's depositors will be able to use ATMs at many more locations than one bank alone could practicably support. The areas a bank seeks to serve through a shared ATM network include the areas in which its depositors live, work and shop, and the broader areas in which they move regularly. A bank's ability to offer its depositors access to other banks' ATMs, and thereby to offer its depositors convenient access to their accounts, is in most bankers' view necessary to attract and retain deposits. . . . Because no other service constitutes a reasonably close substitute for regional ATM network access, regional ATM networks constitutes a product market"⁴⁴

Similarly it defined a second market for ATM processing. This market involves "providing the data processing services and telecommunications facilities and services used" in providing regional ATM access.⁴⁵

"Network access," "network services," and "ATM processing." In its analysis of the EPS-National City Bank merger (hereinafter Banc One Corp.), the Federal Reserve Board further refined the

DOJ approach by defining 3 markets: (1) network access (access to an ATM network identified by a common trademark or logo displayed on ATMs and ATM cards); (2) network services (the switching functions for the network); and (3) ATM processing (the data processing and telecommunications facilities used to operate, monitor, and support a bank's ATMs).⁴⁶

According to the Board, network access includes: (1) the right to "brand" ATMs and ATM cards with the trademark or logo of the ATM network; (2) the ability of the ATM cardholder with an account at one member depository institution to initiate withdrawal and other account transactions at an ATM owned by another depository institution that is a member of the same network; and (3) minimum standards for network performance and products offered through the network.

Similarly, the Board defined network services as including the switching functions performed by the ATM switch and gateway services with other networks. Finally, the Board defined ATM processing as including the provision of terminal driving, transaction routing and authorization, and account reconciliation services.

An observation. The critical element in the analysis of relevant market is the weight is accorded to the value of the network trademark. If one looks only to the data processing function of shared ATM networks, it may be plausible to conclude, as did the Treasurer court, that the market is one of data processing and that market is unconcentrated, that there are numerous alternatives available to financial institutions to perform their data processing, and that a network -- even a dominant regional network -- does not have market power. On the other hand, if the network is viewed not so much as a vendor of undifferentiated data processing services, but rather as the purveyor of a unique branded product marketed under the network logo, the fact finder may reach a very different conclusion, as in EPS, First Data, or Financial Interchange.

2. Geographic Market Definition.

The geographic market can be defined only with reference to a specific product or service market, and there are uncertainties here as well. Markets have been defined as national, regional, or local depending upon the product market selected.

For example, early court opinions that addressed the geographic market applicable to a "payment systems" market suggested that it is national.⁴⁷ If the focus of a factfinder is on a product market defined in terms of "data processing for unaffiliated institutions" or "network switching" services, the geographic market should be national, since those services are generally provided on a national basis. On the other hand in cases such as Financial Interchange, which focused on a retail market, the geographic market was assumed to be local in scope.⁴⁸

The most recent decisions have defined ATM networks as participating in regional markets.⁴⁹ In Banc One Corp., the Board observed that most networks were regional in scope, and a study by Board economists found that the markets for network services and ATM processing were at least regional.⁵⁰ The Board decided that the appropriate geographic market in which to analyze the competitive effects of the merger was MAC's Mideast region (western Pennsylvania, Ohio, Indiana, Kentucky, and West Virginia).

In Banc One Corp., the Board also seems to suggest that, where the product market at issue involves ATM processing the geographic market may be national in scope.⁵¹ The Board observed that companies are able to provide ATM processing and network services through data processing facilities regardless of geographic proximity, and that some firms provide these services on a nationwide basis.

Generally, markets should be defined narrowly. The appropriate geographic market for most functions of an ATM market should be no larger than a region of the United States.

B. Measuring Market Power.

Once the relevant market is defined, competitive effects are evaluated. The analysis begins by measuring industry concentration and the market shares of the combining firms. A merger resulting in excessive concentration in a market is presumptively illegal and "must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects."⁵² Market concentration is commonly measured in terms of percentages or "concentration ratios." The methodology set forward in the government's Merger Guidelines⁵³ and increasingly used by the courts, applies a measure known as the Herfindahl-Hirschman Index (HHI).

There is relatively little authority as to what statistical base should be used as a surrogate for measuring the power of a particular network. In Financial Interchange, the arbitrator variously examined the share of all ATM transactions (which "understate[d the venture's] position in the market"), the share of interprocessor switching transactions, the share of available ATMs, and cardholder base.⁵⁴

In The Treasurer, Inc. v. Philadelphia Nat'l Bank⁵⁵, the court suggested that market power should be measured by the number of ATMs. It wrote that "the principal competitive advantage of any ATM network is the number of ATMs utilized by the system."⁵⁶ The court also examined financial institution deposits in holding that measurement of the market cannot be confined to network ATMs, but must take account of "the large number of unaffiliated ATMs that are open territory for competition."⁵⁷

Market share is not a determinative factor, but rather one indicia of whether market power may exist. Ultimately, in the bank network context, statistical market share evidence -- at least in terms of a share of ATM transactions -- may be an imperfect measure of market power. Where there is evidence of active participation in multiple networks, historical market share may overstate the market power of a network. Yet because of the difficulty of competing networks to acquire the necessary critical mass, market shares may tend to understate market power. Thus, a fact finder must exercise caution before relying on any individual statistical measure.⁵⁸ Critical to the determination of market power is whether entry is possible at the network level.

C. Analysis Of Entry

Essential to the analysis of market power in payment system cases, is consideration of the existence of entry barriers. The agencies evaluate whether entry would be sufficient either to deter or to counteract the competitive effects of concern and be both timely and likely to occur. The Merger Guidelines observe that market power cannot be created or its exercise facilitated when entry into the market is sufficiently easy.⁵⁹ Where entry is "easy," it is difficult for a network to raise prices or reduce output since that exercise will lead new firms to enter the market and cease the competitive opportunity. According to the Antitrust Division and the FTC entry is "easy" only if it would be timely, likely and sufficient in magnitude to counteract the competitive effects of concern.⁶⁰

On the one hand, entry into ATM networks should seem relatively simple. There are no technological barriers and the back office operations can be acquired from a number of sources. On the other hand, development a brand name and reputation can be expensive and there will be certain costs of reissuing cards.

In the network environment analysis of entry becomes more complex because of the critical mass nature of networks. A network may not be able to effectively enter unless it acquires a sufficient number of participants to offer a viable product. This poses a "chicken and egg" problem; potential members are reluctant to join unless they are assured that a sufficient number of other firms will join to make the network viable. Moreover, there must be a sufficient geographic dispersion (of ATMs) to offer cardholders a sufficient level of convenience.⁶¹

There has been practically no successful entry at the regional ATM network for the past decade. As one commentator has observed:

There have been relatively few new entries into the branded ATM network market anywhere in the country. It requires a critical mass of cards and ATMs. Participating institutions have a lot of reasons to be concerned about having to switch from one network to another -- in part because it involved reissuing cards and re-assigning ATMs, and perhaps more important, re-educating customers.⁶²

Moreover, network externalities may also impose significant entry barriers. ATM networks provide an example that illustrates the difficulty a challenger faces in duplicating the network externality of an incumbent firm. ATM networks exhibit a positive externality: large networks yield increased convenience to consumers, thus increasing the network's value to the consumer. Thus, a new network is unlikely to succeed unless it can demonstrate that a substantial number of transactions and cardholders within the market will be available on a long-term basis. Effective entry requires that a new ATM network offer the same (or better) convenience and ubiquity offered by the incumbent network. As the Antitrust Division observed in the EPS competitive impact statement, in order to be competitive a network must provide "enough of a presence to provide [their] depositors with sufficient ubiquity and convenience."⁶³

As in the analysis of relevant product market, the analysis of entry barriers in the network context has varied significantly. One approach, which focuses on competition at the "back office" level, has been to suggest that entry can be accomplished relatively easily. For example in The Treasurer, the court focused on competition in providing automated data processing services to banks. In this market there were a number of potential entrants including third party processors, regional and national ATM networks. Of course, The Treasurer was decided in 1988, in a context in which there were large numbers of banks that were unaffiliated with any network and in which no network was dominant. Thus, the potential for a new network to arise and compete with MAC was far more significant than it is today.

A more sophisticated approach to analysis of entry was provided by the arbitrator in the Financial Interchange matter.⁶⁴ The PULSE network argued that barriers to entry might not be significant. Faced with the exercise of market power, PULSE suggested, individual banks could use other networks or form their own quasi-network, by bypassing the PULSE network switch. Although these opportunities for bypass existed, the arbitrator suggested that entry barriers were significant because of both network externality and critical mass factors. Although there was the opportunity for the formation of smaller networks through individual bypass between member banks, this was insufficient to alleviate the concern over market power. Expert testimony established that a new ATM network could not succeed without providing consumers a level of convenience comparable to that of the PULSE network. The arbitrator found that a new network could not support the number of ATMs required to furnish such convenience without achieving "major defections" from PULSE, and that such defections were unlikely. These

findings ultimately led the arbitrator to conclude that the PULSE network did have market power, even though the complainants could have bypassed PULSE and created their own local network.

One Justice Department economist has made a similar observation. He observes that the

value to belonging to a network lies in the potential for interchange with other members. A financial institution that is dissatisfied with a regional network's price or service quality may not gain by unilaterally leaving to join another regional network that offers better terms. Doing so could sever interconnection with the institutions with whom the institution typically interchanges, or require more costly or roundabout interchange with them through national networks. A financial institution would prefer to leave as part of a coalition that have frequent interchange with one another. . . . But such coordinated action is difficult to accomplish, and the difficulties multiply with the size of the potential coalition.⁶⁵

He concludes that a network may have market power based on the disorganization of its members.

Analysis of entry barriers is essential to determining whether networks have the ability to exercise market power. This analysis should focus on whether potential entrants have the ability to attract a sufficient number of firms to join a new network and whether that network has the ability to deter the exercise of market power. This analysis should focus on competition at the brand or ATM access level, where network externalities and critical mass play an important role.

D. Efficiencies

Even where there is evidence that a merger may lead to anticompetitive effects the enforcement agencies may decline to prosecute if there is evidence that there are efficiencies that outweigh these effects. Section 4.0 of the Merger Guidelines recognizes that many mergers create efficiencies and that the Guidelines do not provide an obstacle to the achievement of these efficiencies. The Guidelines do provide a rather stiff evidentiary burden however. The Guidelines note that "the Agency will consider only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects."⁶⁶

The courts have rarely accepted efficiencies as a counterweight. A "defendant who seeks to overcome a presumption that a proposed acquisition would substantially lessen competition must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition and, hence, consumers."⁶⁷ Thus, to prevail, the merging parties typically have to show that the efficiency savings would be passed on to consumers,⁶⁸ that the efficiencies could only be obtained through an anticompetitive acquisition,⁶⁹ and that the efficiency savings would outweigh the anticompetitive costs of the acquisition.⁷⁰

III. Recent Atm Merger Decisions -- Repaving The Road To Regional Monopoly

Since the mid-1980s there has been tremendous consolidation among ATM networks. The number of regional ATM networks has been reduced substantially, and in relatively few areas is there head to head competition between networks. Some commentators have predicted there may be as few as 10 regional networks by the end of the century.⁷¹

In three decisions from 1994-96, the Federal Reserve Board grappled with issues of network competition. Prior to that time network competition received little or no attention as mergers were approved without extensive analysis. The outcome however, was not completely salutary.

A. Yankee 24/NYCE.

In the fall of 1994 the Board and the Division approved the merger of the NYCE and Yankee 24.⁷² NYCE was the third largest network in the U.S. with 95 million transactions monthly and over 13,000 ATMs and has a dominant position in New York. Yankee 24 was the ninth largest network with 23 million transactions and over 4,000 ATMs, and competed throughout New England.

Even though there was direct competition between the two networks, it received minimal attention in the Board's decision. There was significant competition especially in Massachusetts, Rhode Island, and Connecticut, where NYCE had substantially increased its market presence in the early 1990s. Moreover, the two networks competed for bank members and NYCE had recently entered into exclusive arrangements with former Yankee 24 members, such as Fleet Bank. Arguably those exclusivity arrangements may have driven Yankee 24 below minimum viable scale.

The Board did not address the nature of the head to head competition between the networks or its significance. Nor did it analyze the potential for the merged network to exercise market power. In approving the merger, the Board did not appear to believe that the loss of competition between the two networks would be significant. It observed that "a number of factors should mitigate the loss of Yankee 24 . . . as an independent competitor."⁷³ In particular, the Board observed that other providers of EFT services would remain in the market, including third party processors, and other regional and national ATM and POS networks.

The most interesting aspects of the Order were not the observations about the level of current competition, but rather what the Board had to say about the merged network's commitment to an "open architecture" structure and the existence of potential efficiencies and how these two factors justified the loss of competition.

Operating rules -- the importance of an "open" network structure. The critical factor from the Board's perspective was the new operating rules offered by the network, which permitted all non-equity members to "bypass" the network and enter into arrangements with alternative networks or third party processors. The network's operating rules permit: (1) third party processors to participate in the network, (2) members to participate in other networks, (3) card issuers determine routing, and (4) institutions to participate on a nondiscriminatory basis.⁷⁴

The first and second of these rules provide member banks with possible alternatives to the network services, including processing and ATM-operating services from major third party sources and ATM switching services from other networks. The third and fourth rules provide mechanisms by which small institutions can enhance their ability to obtain competitively-priced services from the network. Of particular importance may be the card-issuer routing rule, which would permit banks to choose lower cost networks, if the new network attempted to raise prices.⁷⁵

Of particular importance is the card-issuer routing rule. Where both the card and ATM belong to multiple networks the bank that controls routing will choose which network to "send" or "route" the transaction on. In an ATM network the card-issuer pays the fees of every transaction (an interchange and

switch fee). In most ATM networks the ATM owner determines routing. The card-issuer will seek the network with the lowest fees; the ATM owner will seek the network with the highest fees.

A card-issuer routing rule gives the card-issuing bank the ability to search for lower cost alternatives. If the network attempts to exercise its market power by increasing its fees, a card-issuer routing rule will permit the card-issuing bank to choose a lower cost network (if one is available). Absent a card-issuer routing rule a bank may have little alternative to pay the higher fees.

Efficiencies. The Board also found that the merger would result in "public benefits" that outweighed any loss of competition, including: (1) increased transaction volume, which would reduce costs due to economies of scale (primarily in transaction processing); (2) increased ability to offer POS services to retailers; and (3) increased consumer convenience. NYCE owns its own switch and switches its own transactions. Yankee 24 purchased switching services from a third-party processor. Thus, the merger would enable NYCE to spread the costs of the switch over two networks. The second efficiency came from increased economies of scope by extending the geographic range of teach network's POS operations.

B. Banc One Corp. -- The EPS-National City Bank merger.

Sometimes networks expand by admitting new financial institutions in adjacent areas as owners. One such merger that received a lot of scrutiny by the Federal Reserve Board is the application to admit National City Bank of Ohio as an owner of EPS, which was approved by the Board, in a 5-1 vote, in March 1995.⁷⁶

Compared to a merger with a neighboring network, this may appear to be a preferable (and less expensive) method of expanding geographically. Antitrust enforcers, however, should treat these transactions as mergers, because in many cases, they may result in the diminution of competition between the two networks. For example, if the expanding network has some sort of exclusivity arrangement (either de jure or de facto), the transfer of one institution's ATMs could drive the neighboring network below the minimum efficient scale needed to operate. In other words, the net result could be the same as a merger.

National City (NCB) sought to join EPS as a 20 per cent equity member and in turn, EPS would acquire National City's branded ATM network ("Money Center"), which operates in Ohio, Indiana, and Kentucky (it has just under 900 ATMs).⁷⁷ NCB was one of the largest members of Money Station, a neighboring joint venture network in Ohio. The merger would have increased EPS' market share from 31 per cent to 45 per cent of all ATMs in Ohio. Money Station filed a protest before the Board; the Board staff considered the application for several months, received several pleadings from the parties and conducted an informal hearing.⁷⁸

The loss of competition. Money Station claimed that the acquisition would eliminate actual and potential competition and would increase the barriers to entry or expansion by existing or potential ATM networks. By acquiring NCB's share of Money Station, EPS would have a substantial share of ATMs in several Ohio markets, including Cleveland and Columbus. In Money Station's view, by permitting the acquisition, NCB would be eliminated as an actual or potential competitor, because as an equity owner of EPS it would have no incentive to participate in alternative networks. In addition, the merger would increase the difficulty for existing or potential competing ATM networks to retain or assemble the necessary "critical mass" of terminals and cardholders required by economic considerations, such as economies of scale and ubiquity, to be effective competitors of MAC. Thus, NCB and its cardholders could be viewed as an essential input into the network.

The Board focused its analysis on MAC's Mideast region (western Pennsylvania, Ohio, Indiana, Kentucky, and West Virginia). The Board rejected the argument that anticompetitive effects would result, because the facts of record did not support the view that NCB would be particularly likely to enter the market independently, or through another joint venture in competition with MAC, if this proposal were denied. NCB's network -- Money Center -- was not in direct competition with EPS's MAC network, nor was it a potential future competitor. Of particular importance was the fact that NCB had abandoned its attempts to form a new regional ATM network with other large banking organizations in 1992, and instead became a participating member of the MAC network. NCB also ceased offering ATM processing services to unaffiliated third parties, thus the loss of actual competition in network services was minimal. Further, according to the Board, the consolidation of the MoneyCenter's network services with the MAC network would not significantly increase barriers to the entry of other ATM service providers, nor would it create an undue concentration of resources.

In addition, although the merger appeared to expand the scope of the MAC monopoly, the Board observed that MAC would remain subject to actual and potential competition from other providers of EFT services. Thus, the Board concluded there was no significant loss of competition.

Operating Rules. The Board relied heavily on the role the DOJ consent decree would play in assuring that the market remained competitive. In particular, the Board appeared to believe that by opening the MAC network to third-party processors, banks could easily find a competitive alternative to MAC. Moreover, the Board held that these third-party processors could provide a channel for entry by competing regional ATM networks. The Board did not provide any detail as to whether these rules had led to an increase in competition.

Money Station contended that various MAC rules permitted the network to thwart any procompetitive effects achieved under the DOJ consent decree. The Board staff investigated the effects of four rules: (1) MAC's prohibition on subswitching between members, (2) MAC's rights under the Consent Decree to charge a royalty fee if subswitching were to be permitted, (3) MAC's requirement that national network transactions be routed through the MAC network, and (4) MAC's holding company rule that generally requires membership of all affiliated banks. The Board staff specifically asked the parties what the competitive effect would be of changing these rules.⁷⁹ Without securing any evidence, the Board concluded that modification of these rules was not necessary (although Vice Chairman Blinder would have required the changes).

Ultimately, the Board held that modification of the MAC operating rules was unnecessary because "the Consent Decree recently became effective, and that its terms are designed to achieve procompetitive effects over time during the ten-year duration of the decree."⁸⁰

Efficiencies/Public benefits. The Board concluded that there were potential public benefits because NCB would make cash infusions that would enable EPS "to continue and expand its research and development efforts," improving its ability to offer innovative electronic banking products and services sooner, ensure the quality of the products being offered, and allow it to provide these products to a broad customer base.

Dissent. Vice Chairman Blinder dissented. He noted that although the loss of competition was modest, the public benefits did not outweigh this loss of competition:

it seems undeniable that allowing National City's ATM network to be merged into the MAC network would result in some adverse effect on competition. Therefore, to approve this transaction, the Board must find that there are sufficient public benefits to outweigh the loss of competition. The application, per se, demonstrates no such benefits to the public in my view.⁸¹

The Vice Chairman would have required modification of MAC's operating rules, as apparently suggested by the staff, in order to meet the public benefits test.

Appeal. The case was appealed to the D.C. Circuit which vacated the Board's decision in a 2-1 vote.⁸² Although the reversal was based on the fact that Board had violated the Administrative Procedures Act by failing to hold a hearing on the public benefits of the acquisition, the decision includes a number of important observations about the Board's analysis of ATM mergers.

Assuming the inevitability of monopoly. The court noted that rather than grapple with the competitive effects of the acquisition and evaluating "MAC's size and dominant market position, the Board basically assumed away the issue by focusing narrowly on the marginal effects of this transaction rather than on the entire competitive situation in the ATM market."⁸³ Basically, the court characterized the Board's position as concluding "bigger is better" without much analysis. The court said: "[w]hile this approach conveniently allowed the Board to dismiss any concerns about monopoly concentration, it certainly cannot be deemed a conclusion that no adverse effects would arise from this transaction."⁸⁴

In particular, the Court was troubled with the implication of the Board's position "that through a slow process of accretion, a network like MAC can establish a large and potentially harmful monopoly position, provided that none of the company's individual acquisitions standing by itself is too large. To treat a company's size and market position before a proposed transaction as irrelevant in determining whether there are potential adverse effects from a transaction is scarcely consistent with the Act's goals of 'increasing competition' and preventing an 'undue concentration of resources,' nor does it appear consistent with the Board's own precedents of looking at the degree of monopolization of markets in analyzing transactions."⁸⁵

The Court held that there was some evidence of anticompetitive effects, thus it was the Board's burden to demonstrate "some reasonable expectation of public benefits" that outweighed the competitive harm. Here too the Board's analysis was deficient.

Public benefits. The Court found that the Board's public benefits findings were too speculative, and were not based on substantial evidence in the record. In particular, the Court criticized the Board's argument that cash infusions from the merger would provide capital infusions which would enable EPS to continue and to expand its research and development efforts, and offer innovative products (such as at-home banking or stored value cards). This argument was deficient for two reasons. First, the parties had acknowledged in their application that the cash infusion would be used to reduce debt, not to engage in new research & development. Second, and more determinative, the Board had failed to analyze whether there were less restrictive means of attaining these efficiencies. Analysis of whether there are less restrictive alternatives is required by the courts and the Merger Guidelines.⁸⁶ There was no discussion or evidence of why EPS could not get the capital to develop these products in the absence of this transaction. Nor was there any evidence that these products could not be developed absent the transaction.

Judge Harry Edwards dissented arguing there were no conceivable anticompetitive effects and that a hearing was unnecessary. The panel opinion was vacated when the Circuit ordered rehearing en banc. The case was settled by the parties.

C. Honor/Most/Alert merger.

The largest ATM merger to date was the merger between three adjoining networks in the southeast United States -- Honor, Most, and Alert.⁸⁷ The Board approved the merger, but their analysis was slightly different than that of previous cases. All three networks were in the southeast United States and the merger created a single network from Virginia to Alabama. Prior to the merger, Most was the ___ largest network, Honor was the ___ largest network, and Alert was the ___ largest network.

Competitive effects. As in Banc One the Board reaffirmed that the economic and structural features of the market are likely to lead to a single dominant network in a multi-state region. The Board noted that "the competitive advantage produced by economics of scale, and the desire to undertake" R&D and enhance product offerings were factors that led to network consolidation.

Perhaps because of the criticism of the D.C. Circuit, the Board provided the most extensive discussion of competitive effects of any recent decision. The focus of its analysis was on "network access" since that was the only market in which all three firms participated. Unlike the earlier decisions, it was willing to acknowledge that the merging networks had competed with each other. Both Most and Honor had a significant presence in many states in each other's region. Honor had a significant presence in Alabama.

The Board's recognition that the regional networks compete is a step forward. But they were unwilling to venture too far. Apparently unwilling to explore the implications of that overlap, the Board attributed it to the fact that two large interstate banks were members of both networks. The Board did not analyze whether the merging networks had some kind of competitive impact in each other's region. For example, a neighboring network can be an important competitive alternative for banks seeking alternatives to their "home" network. A South Carolina bank is far more likely to turn to a network in Virginia or Alabama as alternatives than one in Chicago. The lack of analysis is all the more surprising since the Board explicitly relied on the potential for competition from much more distant networks -- MAC and NYCE -- as "competitive constraints to the proposed network."

As in earlier decisions, the Board also relied on alternative networks such as smaller networks, third party processors, and national networks as competitive constraints. Of course, the degree that these could truly provide a competitive constraint would depend upon the number of ATMs connected to a competitive alternative. In this regard it is worth observing that although national ATM networks have almost universal coverage, the Justice Department excluded them as a competitive alternative in their EPS consent. There is no evidence that any banks have chosen to forgo membership in a regional network and rely wholly on membership in national networks.

Like the Bank of New York case, the Board relied extensively on operating rules adopted by the network to assure that smaller members had competitive alternatives to the network. In fact these rules seemed to play a critical role since the Board conditioned its approval on the network's promise to enact these rules. The rules were: (1) banks could participate in the network on a non-discriminatory basis and could join other networks and co-brand their cards and terminals; (2) members could interconnect to national networks without going through the regional network switch; (3) members could use third-party processors and permit unbranded switching subject only to a royalty fee.⁸⁸ These were the types of rules that the Board's staff investigated in the Banc One merger and the parties were probably astute in anticipating the Board's concerns in this area.

However, one significant omission was the lack of a card-issuer routing rule. As discussed above, a card-issuer routing rule is essential for smaller banks to have the opportunity to avoid the exercise of market power. Why the Board stepped back from the requirement imposed in Bank of New York was not explained.

Royalty fee. Perhaps what might become the most controversial part of the order is the Board's implicit acceptance of the imposition of a royalty fee for transactions outside the network. The ability to "bypass" the network is important. If the network were to charge certain members (e.g., non-owners) supracompetitive fees, bypass would enable the members to seek out lower priced alternatives.

But permitting royalty fees may eviscerate the importance of these forms of bypass. For example, assume the network charged non-owners a 15 cent a transaction switch fee. A national network offers to switch transactions for 5 cents a transaction. The incumbent network could make bypass unprofitable just by assessing a 10 cent royalty fee.

Do these operating rules provide sufficient protection against the exercise of market power? Only time will tell. Without a card-issuer routing rule the remainder of the rules may have little impact. Moreover, royalty fees may just lead to numerous competitive disputes. These disputes can be very complex and contentious.⁸⁹

Public benefits. The Board found several public benefits: (1) added availability and convenience to consumers by expanding the geographic scope of the network; (2) the merger would enable small banks to compete with larger banks; (3) reducing switching costs by providing it internally since Most and Alert purchased more expensive switching from third parties; and (4) increased research & development and product development.

Although the Board is somewhat more creative about the scope of the potential efficiencies their analysis suffers from the infirmities in the earlier cases. Many of these efficiencies can be achieved through less restrictive alternatives. For example, increased geographic scope can be achieved simply by establishing a "gateway" between the merging networks. Many regional networks have achieved these economies of scope through gateway relationships with other regional networks.

D. Assessment

The Board's approach in these cases is very much a mixed bag. Some aspects of their decision making appear to give credence to the opportunities for network competition, yet ultimately they seem to assume that a regional monopoly is foreordained.

1. Defining the relevant market.

Critical to understanding the analysis of network mergers is disaggregating the different dimensions of the network, and analyzing the impact of mergers on competition for each dimension. A network has several components: a trade mark, a computer switch, operating rules, etc. As noted earlier, too often enforcers and regulators have focused on the unconcentrated nature of the "back office" operation, and have given too little attention to competition at the "brand" level.⁹⁰ Differentiating between the two is important because there may be relatively few firms capable of competing at the brand level. Similarly, even though there may be efficiencies from consolidation at the "systems" level, these efficiencies may not outweigh the loss of brand competition.

The most encouraging aspect of the Board's decision in Banc One Corp. was their effort to disaggregate the dimensions of competition in their analysis of the relevant product market. As noted earlier, the Board had previously viewed the relevant market as basically the network's back office operations -- an unconcentrated market in which entry barriers would be relatively trivial.

In Banc One Corp., the Board recognized the distinction between the back office and brand aspects of competition. As noted earlier, it defined three relevant markets: "network access," "network services," and "ATM processing." The last two markets reflect the value of the back office operations and the network switch, respectively. The first market reflects the value of the brand name, reputation, and agreements between the network and its members.⁹¹

Yet the Board's analysis of competitive effects seems deficient for several reasons. First, in Bank of New York and Barnett Bank, the Board seemed to consider third party processors as potential competitors in the ATM network access market, even though they only compete at the ATM processing or back office level. Simply because third party processors enter the market does not mean that the prices for ATM network access will be competitive. Second, in Banc One, the Board arguably failed to consider how competition would be adversely affected by the merger at each level of the market. Although the availability of third-party processors might reduce the opportunity for competitive harm in the ATM processing market, there is no reason to believe that they are a competitive alternative in either the network access or network services markets.

2. Competitive Effect Analysis.

Critical in the analysis of any merger is a determination of the competitive effects of the merger, i.e., what will be the ability of the merged firm to exercise market power after the merger. In both Bank of New York and Banc One Corp., the Board appeared to rely on the general structure of the market and the operating rules (discussed below) in concluding that anticompetitive effects were unlikely. Yet in neither case did the Board describe in detail the dimensions or degree of competition between the merging networks. Particularly in Bank of New York, where the two networks had competed directly and aggressively in Connecticut and Massachusetts, an analysis of the impact of that competition on both banks and consumers would have been useful. Some relevant issues, similar to those in First Data, would have included the impact of network competition on network fees, fees to consumers, output (in terms of ATMs and transactions), advertising, and revenue to bank members. Although the Board had a longer discussion of competitive effects in Barnett Banks, these issues went unaddressed.

Another important issue in Banc One Corp. was whether NCB's incentives in participating in alternative networks would be altered because of becoming an equity owner of EPS. If NCB's incentives were altered and it dedicated its ATMs exclusively to MAC, Money Station might fall below minimum viable scale and its competitive viability might be in doubt. The Board concluded that this concern was "too speculative at this time to represent a significant potential adverse effect," since MAC no longer required exclusivity for its members.

The Board's analysis of the likelihood of de facto exclusivity may be deficient, by failing to recognize how NCB's ownership interests in EPS would effect its incentives. NCB has no ownership in Money Station. As an owner of EPS, it is in NCB's interest to direct as many transactions as possible through MAC. Thus, it seems simple to predict that the likely outcome is that NCB will dedicate its transactions to the network that will enhance its revenue. That a financial interest can create de facto exclusivity has been recognized by the Division and the FTC in several recent cases in non-banking

markets and in the recently issued Health Care Policy Statements.⁹² And this sort of analysis, although somewhat speculative, is always necessary.

Ultimately the Board's analysis of competitive effects will not improve until they can describe how ATM networks compete. Until they can articulate a model of network competition, analytical improvements, such as more refined relevant markets, will not make much difference in the ultimate resolution of these mergers.

3. Analysis of competitive alternatives

One of the most elusive aspects of analysis of competitive effects is the value given to the network mark. On the one hand, ATM networks can be perceived as such groups of telecommunications connections and any entity providing those connections could be perceived as a competitor, as in The Treasurer. On the other hand, the regional network mark could be seen as being of supreme value, and thus nonbranded processors and national networks might be inconsequential alternatives. The truth probably lies somewhere between these two alternatives. One might observe, however, that very few banks withdraw their ATMs from regional networks and become unbranded or rely only on national network status.

The Board seems to consider national networks as equal alternatives to the regional monopolies and they seem to believe that unbranded access through third-party processors also may be a viable alternative. There is little evidence from the market that this is the case. Almost all ATMs have access to PLUS and/or CIRRUS, the national ATM networks. But banks perceive national networks as some sort of supplemental coverage, basically for out-of-town travelers. Whether a bank could rely solely on a national network seems questionable. In the Financial Interchange arbitration, the arbitrator held that national ATM networks did not provide an adequate alternative to PULSE because neither could duplicate the coverage of the PULSE network. The Antitrust Division in the EPS consent has taken a skeptical position about the level of competition offered by national networks. In its Competitive Impact Statement it observed that:

National ATM networks exist, but these are by design networks of last resort, used only where the two banks involved in a transaction do not both belong to any one regional ATM network. National ATM network transactions are typically more expensive, and those networks provide only a subset of the transactions available through regional ATM networks.⁹³

Moreover, banks typically have access to regional networks only through the regional network. Thus, the regional network might have the ability to discipline a bank's attempt to bypass its network, by delaying access to the national network or attempting to assess a routing fee.

4. The importance of network operating rules.

The Board's approach to the importance of operating rules seems confusing. In Bank of New York, the availability of an "open architecture" that permitted members to bypass the network and enter into arrangements with alternative networks or third party processors appeared critical to the Board's conclusion that there was little concern over the potential for exercise of market power.

Yet in Banc One, the Board seemed unwilling to follow that precedent. The Board staff appeared concerned that MAC rules that imposed restrictions on subswitching between members, would make it difficult for members to bypass the network. Vice Chairman Blinder would have preferred that

the Board require that MAC amend these rules. If the Board was correct in Bank of New York, that would seem the preferable approach.

Finally in Barnett Banks the Board took a halfway approach. On the one hand it relied more heavily on the promise of these rules, compelling their enactment as a condition of approval. On the other hand it failed to require the central rule to an open architecture -- a card-issuer routing rule. Moreover, permitting the assessment of royalty fees may significantly dampen the attractiveness of bypassing the network since the network can acquire the same monopoly profits through the royalty fee.

Amending network rules may be necessary to resolve concerns over the exercise of market power, but is it sufficient? Should network rules that create an "open architecture", in and of themselves, immunize a merger where the merged firm will have market power? Is the opportunity to form subnetworks between individual network members sufficient to alleviate concerns about market power?

The Board is basically sailing on uncharted waters in this area. The one case to address the issue, the Financial Interchange arbitration, did not provide clear guidance on whether open architecture would alleviate the concerns of market power. (In this case, the network (PULSE) permitted its members to route transactions through subnetworks).⁹⁴ The arbitrator wrote:

Because ATM owners control routing of ATM transactions, they could choose in some instances to elect to route transactions within a subnetwork. If, for example, the interchange fee within the subnetwork is higher than that of PULSE, the ATM owner has the incentive to use subnetwork routings if available. The same could be true in reverse if issuers could control routing. This competition within the existing structure could decrease PULSE's revenue. . . . Interprocessor subnetworks functioning within the PULSE system can provide some limit on PULSE's freedom to establish interchange fees.⁹⁵

Nonetheless, the arbitrator discounted the significance of this open architecture in part because of the universal access offered by PULSE:

The very fact that all Texas subnetworks are PULSE members at least suggests that they perceive the need for sharing on a broader basis. The number of cards and ATMs in each of these networks is far smaller than in PULSE. Moreover, single processor capability is limited. Even within local markets such as Dallas or Houston, the access provided by subnetworks falls far short of that of PULSE. Unless cardholders are indifferent to the added access PULSE participation provides, intraprocessor switching is not an adequate substitute; reliance solely on such switching would place financial institutions at a significant disadvantage. . . . The combination of existing subnetworks might of course provide an alternative to PULSE, . . . but single subnetworks as they now exist are no real substitute. . . .⁹⁶

Ultimately, individual subnetworks (or third party processors) were not a viable competitive alternative because they did not offer the level of universal access provided by PULSE. Similarly, although individual third party processors might be capable of entering into the area dominated by MAC, it seems unlikely any of them could provide the level of universal access provided by MAC.

Have the operating rules in the DOJ consent decree made a difference? Three years after the decree was entered the evidence on its effects is mixed and it depends which market you consider. In the "ATM processing" market, several third-party processors have entered and approximately 5 per cent of the transaction processing is now being performed by these processors. This, in turn, has led MAC to

reduce its transaction processing fees.⁹⁷ In the "regional ATM network access" market, MAC remains dominant in the mid-Atlantic region, and there has been no significant entry by competing networks. Even if the consent created an "open architecture" structure, there are several reasons why that structure might not assure that a network -- especially a dominant network -- cannot exercise market power.

Even with an open architecture a network might attempt to impose de facto exclusivity through other types of rules or fees (e.g., royalty fees) that raised the costs of entering into alternative arrangements. These fees seem to be expressly permitted in Barnett Banks. In addition, other incentives such as ownership in the network, may discourage the use of alternative arrangements.

Perhaps a preferable approach would be to rely on an open architecture only where the parties were able to demonstrate that banks were currently able to bypass the network and were engaging in bypass. Such an approach is suggested in the enforcement agency's analysis of exclusivity in health care joint ventures. In the Health Care Policy Statements the agencies say that simply saying that a network is non-exclusive is not enough. Rather, the agencies analyze whether "physicians in the network actually individually participate in, or contract with, other networks or managed care plans, or there is other evidence of their willingness and incentive to do so."⁹⁸

Ultimately, "open architecture" may be an illusory solution. If members start to bypass the network to any significant extent, free-rider problems will arise; in turn, members may become increasingly reluctant to invest in the network. The network may respond by "closing" the network or imposing a fee for bypassed transactions. For example, a network could impose a fee on transactions routed outside the network. These free-riding/routing disputes are some of the most contentious in the ATM area.⁹⁹

The Board's failure to address the operating rules in Banc One Corp. or their failure to require card-issuer routing in Barnett Banks, send a confusing message to ATM networks. If these rules are important to reducing the likelihood of the exercise of market power, they should be imposed where that threat is present. But even if the Board believes that operating rules can remedy the threat of market power, relying on this factor is at best a second rate solution. If operating rules are important, a preferable position might be that taken by the States in Entree -- to prevent the merger and permit the networks to compete in terms of operating rules.

Finally, there is a greater public policy issue raised by relying on operating rules. Approving mergers based on operating rules could set an unwise precedent. When these rules become an issue of dispute the parties will bring those disputes to the Board. This in turn will place the Board in the position of increasingly regulating these networks and eventually arbitrating the intra-network disputes. Whether the Board should adopt such a regulatory role is open to question. Yet if it fails to, what assurance is there that the rules will be effective?

5. The importance of efficiencies/network externalities.

In merger cases, the enforcement agencies evaluate whether the efficiencies that may arise from a merger may outweigh the potential for competitive harm. Prominent in network merger cases are arguments that efficiencies in terms of "network externalities" will outweigh any competitive harm. "Network externalities" reflect the fact that the value of a network to a consumer depends upon the number of users and the identities of other specific users. The larger the network, the greater the number of consumers who will join it and conversely, the smaller the network, the fewer the number of consumers

who will join it. Network externalities are especially common in electronic networks, such as payment systems.¹⁰⁰

In Banc One Corp., the Board recognized the importance of network externalities. It observed that:

as an ATM network expands the number of its financial institution members and available ATMs, its value to network cardholders increases due to the greater accessibility of their deposit accounts. Similarly, as the number of cardholders increases, so will the number of transactions and hence the economic return on ATM terminals deployed in the network. This increased economic return provides incentives for banks to establish additional ATMs, thereby further enhancing the network's value to cardholders. Accordingly, banks tend to place a greater value on membership in a network as its membership expands.¹⁰¹

Some commentators have suggested that the existence of network externalities may counsel for a more laissez faire approach in analyzing payment systems mergers.¹⁰² Although the existence of network externalities may suggest greater potential for the existence of efficiencies, that does not mean that those potential efficiencies should lead to less antitrust enforcement.¹⁰³ First, many of those efficiencies could be achieved by less restrictive alternatives. In the ATM context, for example, a gateway arrangement (between the two networks) may permit the networks to achieve a level of ubiquity, without eliminating competition at the brand level.

Moreover, network externalities are not without limit. William Baxter, the former Assistant Attorney General in charge of the Antitrust Division, has observed that although ATM joint ventures can achieve efficiency benefits related to economies of scale, these efficiencies will cease to be significant once a joint venture reaches a certain size. Beyond the point where these efficiencies are significant, Baxter suggests that it is preferable to limit the size of the network in order to encourage the creation of competing networks rather than one large network.¹⁰⁴

The Board's overall analysis of efficiencies in these cases seems lighthanded and superficial. It is particularly problematic because efficiencies were used to approve mergers to monopoly, a position no court has ever adopted.¹⁰⁵ The approach taken by the FTC and the Antitrust Division require the parties to demonstrate that there are no less anticompetitive means for achieving the efficiencies and that these benefits will be passed on to consumers.¹⁰⁶ In Banc One Corp., the argument -- accepted by the Board -- that NCB would make cash infusions that would enable EPS to continue and expand its R&D efforts would not pass this test, since there are a number of alternative sources of revenue to fund such research. Similarly, the processing economies of scale recognized in Bank of New York or Barnett Banks could have been achieved through a more limited merger of the two networks' back office operations, while preserving competition between the networks -- similar to the FTC approach in First Data.

6. The vision of the regional network monopoly.

Although the Board's analysis in these areas seems conventional, one aspect of the decision in Banc One Corp. poses a "dark cloud on the horizon." In response to the concerns about the loss of competition, the Board articulated a vision of regional network monopolies apparently fated by economics.

[T]he significant position of a regional ATM network is not, standing alone, contrary to the public interest. Network externalities, such as the economies of ubiquity, tend to promote

consolidation of regional ATM networks. As a result, in various geographic areas, like the Mideast region, dominant ATM networks have been emerging throughout the EFT industry. One recent study indicates that the ten largest regional networks now account for 80 percent of all regional ATM network transactions in the United States. In this light, the Board believes that, as a result of economic and market structure conditions, regions are likely to have one dominant ATM network.¹⁰⁷

The Board appears to view the road to regional monopoly as being foreordained and dictated by the economics of networks. Is that vision correct? The panel decision of the D.C. Circuit seemed particularly troubled by that conclusion. The enforcement actions taken by the States in *ENTREE* and the FTC in *First Data* suggest that monopoly is not a foregone conclusion, even in settings where there may appear to be significant network externalities. In both cases, the antitrust enforcers were able to spur network competition by focusing on the impediments to entry at the brand level and carefully assessing efficiencies at the systems level.

Ultimately, the Board's view seems to harken back to the day when "economics of ubiquity" placed ATM network mergers into the "per se legal" category. Although its decision in *Bank One Corp.* appears to advance the analysis of mergers, the Board's conclusion appears to be that competition is not worth the candle. If the Board's prevails, the road to regional monopoly may turn into a superhighway.

IV. Conclusion

Network mergers are particularly complex, because they require careful distinctions among the elements of competition and thoughtful assessment of the potential for efficiencies. Too often antitrust enforcers have quickly grasped the potential for theoretical efficiencies, without giving sufficient attention to the opportunities for network competition. Payment systems networks play an increasingly important role in the today's economy. A monopoly/regulatory model -- which may be the result of the Board's recent ATM decisions -- may lead to less competition and higher prices.

Essentially, we have come full circle, with a reliance on vague arguments of network ubiquity to support monopoly networks. While network externalities suggest that networks become more efficient as they grow larger, they also enhance (or make more durable) the market power of dominant networks. Thus, courts and antitrust enforcers need to recognize that regional networks monopolies, freed from facing competition in the market may become inefficient or decline to pass on efficiencies to consumers. Courts and antitrust enforcers must also recognize the different species of competition among networks -- branding, access, and processing. Only when these elements are carefully distinguished, will factfinders arrive at a more accurate assessment of anticompetitive effects and efficiencies. And they will realize that some forms of regulatory relief, granted in the past, are insufficient to remedy the underlying threat of competitive harm. The task is not a simple one, but it is crucial if the opportunity for network competition will be recognized.

NOTES

- 1 See Department of Justice, Antitrust Division, Policy Statement on Sharing to the National Commission on Electronic Fund Transfers (Jan. 13, 1977).
- 2 See William F. Baxter, Paul H. Cootner and Kenneth E. Scott, Retail Banking in the Electronic Age: The Law and Economics of Electronic Funds Transfer (1977).
- 3 See EFT in the United States, Final Report of the National Commission on Electronic Fund Transfers 57 (1977).
- 4 At the time, because ATM networks were in their infancy, there were no significant barriers to entry.
- 5 See "Antitrust Analysis of Joint Ventures in the Banking Industry: Evaluating Shared ATMs," Remarks by Charles F. Rule, Acting Assistant Attorney General, Antitrust Division, Department of Justice, before the Federal Bar Ass'n and American Bar Ass'n (May 23, 1985), reprinted in Donald I. Baker & Roland E. Brandel, The Law of Electronic Fund Transfer Systems, Appendix F, at A-141, n.5 (2d ed. 1988).
- 6 Elizabeth S. Laderman, The Public Policy Implications of State Laws Pertaining to Automated Teller Machines, Federal Reserve Bank of San Francisco Economic Review (Winter 1990).
- 7 The Division has a procedure in which it will give advice about whether it will bring an enforcement action, known as a business review.
- 8 See Letter from Donald I. Baker, Assistant Attorney General, Antitrust Division, to William B. Brandt, Nebraska Bankers Ass'n (March 7, 1977).
- 9 See Rule, supra note __ at A-142-43.
- 10 See infra notes ___ and accompanying text. The Board did appear to consider whether a proposed network "may represent so large a proportion of possible ATM terminals in local markets that no other switches could successfully compete." See Barclays Bank PLC, 71 Fed. Res. Bull. 113, 114 (1985); Centerre Bancorporation, 69 Fed. Res. Bull. 643 (1983).
- 11 Section 1 of the Sherman Act, 15 U.S.C. § 1 (1988), prohibits certain restraints of trade. Courts have held that the denial of membership in a joint venture may violate Section 1. See Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284 (1985). For an extensive discussion of access demands and membership issues in payment systems joint ventures, see David A. Balto, "Access Demands to Payment Systems Joint Ventures," Harvard Journal of Law & Public Policy (1995).
- 12 Up until that time both networks were exclusive. If First Texas was a member of both networks it would serve as a gateway and could enable any bank in one network to access the ATMs in the other network. Once the exclusivity provisions were bridged, arguably intersystem competition between the two networks would diminish.

- 13 See Letter from William F. Baxter, Assistant Attorney General, Antitrust Division, to Donald I. Baker (Aug. 3, 1983).
- 14 See State of New York v. VISA, U.S.A. and MasterCard Int'l, No. 89-Civ.-5043 (S.D.N.Y. filed July 26, 1989).
- 15 See State of New York v. VISA U.S.A., Inc., 1990-1 Trade Cas. (CCH) ¶ 69,016 (S.D.N.Y. 1990).
- 16 See Presentation of Lloyd E. Constantine, before the Charles River Associates, Antitrust Issues in Regulated Industries (Dec. 6, 1990).
- 17 See "Bankers are Burying the Hatchet to Join Forces for Debit Push," American Banker, 20 (Feb. 8, 1994); David A. Balto, 11 Review of Banking and Financial Services 105 (May 31, 1995).
- 18 The "switch fee" is the fee charged by the network for moving a transaction over the network's switch. The "interchange fee" is a fee paid between the merchant bank and the cardholder's (consumer's) bank for processing a credit card or debit card transaction. Both fees are set by the bank card association.
- 19 See "Bank of America is Going to Bat for Maestro," American Banker, 10 (Apr. 5, 1994); "Debit Card War Faces Tough Choices," American Banker, 17 (Feb. 7, 1994); "Economics -- More Issuers Get Debit Interchange," POS News, (Jan. 1, 1994) (describing competition in interchange fees).
- 20 See "State Antitrust Officials Criticize Mastercard Debit Rule," American Banker 1, 17 (Dec. 17, 1994). See also "VISA's Dominance Seems a Debit-Card Liability," Wall Street Journal, June 6, 1996 at B1 (describing how banks play off VISA and Mastercard in the POS market); Testimony of Joseph Oppen, New York State Attorney General's Office, before the FTC Hearings on Competition 3674-78; David A. Balto, "End of On-line Debit Decree Raises Questions," Am. Banker, May 8, 1997 at 15; David A. Balto, "Antitrust Curb Perverted Economics of Off-Line Debit," Am. Banker, May 9, 1997 at 9.
- 21 United States v. Electronic Payments Services, Inc., No. 94-208 (D. Del. Apr. 21, 1994), 59 Fed. Reg. 24,711 (May 12, 1994), 59 Fed. Reg. 44,757 (Oct. 14, 1994).
- 22 As the Department observed: "The small banks that wish to join another network (which might offer ATM network access at lower prices) will not be able to do so unless the other network has enough of a presence to provide small banks' depositors with sufficient ubiquity and convenience. The entrant network, of course, cannot achieve the critical mass necessary to attract banks." Elec. Payment Servs., 59 Fed. Reg. at 24,720 (emphasis added).
- 23 See BuyPass Corp. v. New York Switch Corp., No. 93-CV-3201 (E.D. Pa. filed June 15, 1993). The rule had survived a private antitrust challenge, when MAC acquired Cashstream in 1988. See The Treasurer, Inc. v. Philadelphia National Bank, 682 F. Supp. 269, 280 (D.N.J.) (upholding provisions which "were and are intended to structure [the owner's] distribution of network services, and to provide a return to [the owner] for developing, maintaining and promoting the [ATM] network and to prevent free riding by competitors on [the owner's]

efforts"), aff'd mem., 853 F.2d 921 (3d Cir. 1988). Because MAC had adopted its exclusivity requirements from the outset, the court found the provisions presumptively reasonable and even procompetitive: "The restriction is merely part and parcel of an obviously successful, comprehensive marketing strategy." Of course, in 1988, MAC had a far less significant competitive presence.

Perhaps the most problematic aspect of the decision was its assumption that exclusivity was procompetitive because MAC had required it even when it had no market power. The economic error is fairly clear: although exclusivity provisions may be appropriate and even procompetitive when a firm has little or no market power, they may result in more severe anticompetitive effects as time goes on, particularly if there is no competition within the joint venture. The court compounded its economic error by concluding that CashStream's acquisition actually opened up opportunities for the Treasurer. If CashStream had previously been nonexclusive, its members could also participate in the Treasurer network. Now presented with an all-or-nothing choice by an ATM network with significant market share (which is itself independently significant in network industries driven by economies of scope and scale), former CashStream members were forced either to join MAC (which had already secured participation by Mellon) or to continue to compete in a number of smaller networks. Once again, assuming that CashStream was nonexclusive, the Treasurer (which was nonexclusive) could only lose from the sale of CashStream to MAC. Not only would MAC be able to charge consumers higher prices, but it would simultaneously prevent the Treasurer from obtaining the economies of scope and scale necessary to develop a viable competing network.

- 24 A "royalty fee" requires the ATM owner to pay a fee to the network for each transaction it chose to route through an alternative network.
- 25 See Public Comments on Proposed Final Judgement, Electronic Payment Services, 59 Fed. Reg. 44,757 (Aug. 30, 1994).
- 26 See fns __ and accompanying text.
- 27 See Bank Network New _____
- 28 First Data Corp., C-3635 (Jan. 16, 1996). The FTC brought an earlier action against First Data in August 1994, when it intended to bid on the assets of Western Union in a bankruptcy court auction. First Financial was the successful bidder and the FTC's settlement was never made final. First Data Corp., FTC File No. 931-0090 (Aug. 18, 1994).
- 29 Consumer money transfer services involve the transfer between two parties of funds through consumer money transfer agents, typically check cashing, private postal, or grocery stores. Customers wishing to transfer money today begin the process by going to a consumer money transfer agent, such as a check casher or grocery store, and completing a transaction form which includes an explanation of how the recipient will identify himself or herself when seeking to receive the cash. The sender then gives the agent the money to be transferred and pays the transaction fee. The transferring agent then inputs the information into the database by computer (or by calling the service supplier, who inputs the information). This database allows the receiving customer to go to any receiving agent in that service's agent network and obtain the cash by demonstrating his or her identification.

- A large portion of consumer money transfer users do not have banking relationships, which account for 20-25 per cent of U.S. households. For those consumers with limited or nonexistent banking relationship, consumer money transfers offer the only means to transfer money quickly from one person to another.
- 30 See Graphnet Systems, Inc., 71 F.C.C. 2d 471, 515 (1979) ("We are confident that the public will be served by enabling multiple entry into this market.").
- 31 See "Citicorp Express and Western Union Escalate War of the Wires," American Banker, Nov. 18, 1987.
- 32 When MoneyGram entered it priced domestic transfers with a value of \$300 or less at \$9; at the time Western Union priced these transfers at between \$13 to \$29. Western Union brought an antitrust suit charging that MoneyGram's pricing was predatory. The suit was unsuccessful. See Western Union Financial Services v. First Data Corp., 20 Cal. App. 4th 1530 (1993).
- 33 The order in First Data requires the divestiture of an agent base of at least 10,000 wire transfer agents. The agent base must be sufficiently diverse in dispersion to provide a nationwide network.
- 34 See William J. Baer, Director, Bureau of Competition, FTC, The Dollars and Sense of Antitrust Enforcement 3, Remarks Before the Antitrust Section of the New York State Bar Association (Jan. 25, 1996) <<http://www.ftc.gov/speeches/other/nystate.htm>>.
- 35 15 U.S.C. § 18 (1988).
- 36 National Bancard Corp. ("NaBanco") v. VISA U.S.A., Inc., 596 F. Supp. 1231, 1258 (S.D. Fla. 1984), aff'd, 779 F.2d 592 (11th Cir.), cert. denied, 479 U.S. 923 (1986). See also William F. Baxter, et al., Retail Banking in the Electronic Age, 117 (1977) ("no significant degree of market power" will exist in that stratum of communities serviced by only one on-line system because "the preexisting technology," defined to include "currency, checks, off-line credit cards and check guarantee cards subject to floor limits," "will constrain pricing freedom and service quality."). The NaBanco analysis is criticized in a recent article. See Dennis W. Carlton & Alan S. Frankel, The Antitrust Economics of Credit Card Networks, 63 Antitrust L.J. 228 (1995). It, however, was adopted by a recent district court decision involving ATM network fee setting. See Southtrust Corp. v. PLUS System, Inc., 1995-2 Trade Cas. (CCH) ¶ 71,219 (N.D. Ala. Aug. 10, 1995).
- 37 The Treasurer, Inc. v. Philadelphia National Bank, 682 F. Supp. 269 (D.N.J.), aff'd mem., 853 F.2d 921 (3d Cir. 1988)
- 38 682 F. Supp. at 279 (emphasis in original).
- 39 See, e.g., CB&T Bancshares, Inc., 70 Federal Reserve Bulletin 589 (1984); Atlantic Bancorporation, 69 Federal Reserve Bulletin 639 (1983); cf. Centerre Bancorporation, 69 Federal Reserve Bulletin 643 (1983) ("the provision to unaffiliated financial institutions of data processing services, particularly the operation of an ATM network exchange"); Interstate Financial Corp., 69 Federal Reserve Bulletin 560 (1983) (same).

- In other orders, it defined the markets more narrowly. See, e.g., Citicorp, 72 Federal Reserve Bulletin 583 (1986) ("provision of ATM services"); Sovran Financial Corp., 72 Federal Reserve Bulletin 347 (1986) (same); Barclays Bank PLC, 71 Federal Reserve Bulletin 113 (1985) ("competition in the provision of ATM or POS services").
- 40 E.g., Sovran Financial Corp., 72 Fed. Res. Bull. 347, 348 (1986).
- 41 In re Arbitration between First Texas Sav. Ass'n & Financial Interchange, Inc., 55 Antitrust & Trade Reg. Rep. (BNA) 340, 356 (Aug. 25, 1988) ("Financial Interchange") (arbitration decision by Professor Thomas Kauper, former Antitrust Division Assistant Attorney General).
- 42 Id. at 355. Other regional networks were found to be only potential alternatives for Texas ATM owners and "substantial barriers" (including the national networks' antidualty membership rules, the preference by banks for local networks and the fact that PULSE was very efficient and well-established) were said to impede competition from the national networks, PLUS and CIRBUS. Id. at 353-54. For a similar approach, Rule, supra note __, at A-144 (assessing ATM networks in terms of wholesale and retail ATM services).
- 43 United States v. Electronic Payments Services, Inc., No. 94-208 (D. Del. Apr. 21, 1994), 59 Fed. Reg. 24,711 (May 12, 1994).
- 44 59 Fed. Reg. 24,713 (May 12, 1994).
- 45 59 Fed. Reg. 24,712 (May 12, 1994).
- 46 Banc One Corp., 81 Federal Reserve Bulletin 491, 494 (May 1995).
- 47 See NaBanco, 596 F. Supp. at 1259 (where the parties agreed that the market was nationwide); see also Complaint, ¶¶ 77-80 in New York v. VISA U.S.A., Inc., No. 89-Civ.-5043 (S.D.N.Y. July 26, 1989) (alleging nationwide market for credit cards and point of sale debit cards marketed by national joint venture).
- 48 See Financial Interchange, 55 Trade Reg. Rep. (BNA), No. 1380, at 356 (although the geographic boundaries of the retail market were not directly addressed in this proceeding, the arbitrator observed that retail markets were presumably local since consumers will only use ATMs close to where they live and work).
- 49 See EPS consent decree, 59 Fed. Reg. 24,711; Banc One Corp., 81 Federal Reserve Bulletin at 494.
- 50 See McAndrews and Kauffman, "Network Externalities and Shared Electronic Network Adoption," Working Paper No. 93-18 (Nov. 1993).
- 51 Banc One Corp., 81 Federal Reserve Bulletin at 494.
- 52 United States v. Philadelphia National Bank, 374 U.S. at 363.
- 53 1992 Horizontal Merger Guidelines of the Department of Justice and the Federal Trade Commission, 4 Trade Reg. Rep. (CCH) ¶ 13,104 (April 2, 1992) ("Merger Guidelines").

- 54 55 Trade Reg. Rep. (BNA), No. 1380, at 353, 356.
- 55 682 F. Supp. 269 (D.N.J.), aff'd mem., 853 F.2d 921 (3d Cir. 1988).
- 56 Id. at 271.
- 57 Id. at 279.
- 58 See William Blumenthal, Three Vexing Issues Under the Essential Facilities Doctrine: ATM Networks as Illustration, 58 Antitrust Law Journal 855, 864 (1989).
- 59 Merger Guidelines at § 3.0.
- 60 Id. Perhaps the most critical factor is the history of entry, which is particularly probative in assessing the likelihood of future entry. See United States v. Baker Hughes, 908 F.2d 981, 988 (D.C. Cir. 1990) (two firms had entered within the past year and were poised for future expansion); United States v. Waste Management, 743 F.2d 976, 982 (2d Cir. 1984) (history of recent entry indicated low entry barriers); United States v. United Tote, 768 F. Supp. 1064, 1076, 1080-82 (D. Del. 1991) (lack of entry supported finding of barriers); Calif. v. American Stores, 697 F. Supp. 1125, 1131-33 (C.D. Cal. 1988), aff'd in relevant part, 872 F.2d 837 (9th Cir. 1989), rev'd on other grounds, 495 U.S. 271 (1990). There has been no new development of an ATM networks in over a decade.
- 61 For example, there has recently been a great deal of discussion about the development of new ATM networks in response to ATM surcharges, i.e., the practice of many ATM owners of charging consumers an additional per transaction fee. ATM surcharges have a particularly adverse effect on small banks which primarily compete by offering low cost retail deposit accounts. See David A. Balto, "ATM Surcharges: Panacea or Pandora's Box," 12 Rev. of Banking and Financial Services 169 (Oct. 9, 1996). In response groups of small banks have formed "no surcharge" coalitions, which promise to offer ATM access without a surcharge. See "Small Banks Join No-Fee Alliances in Bid to Retain Customers," American Banker (July 25, 1997) at 1; "Yet Another Surcharge Issue Lands in the Laps of Regional EFT Networks," Debit Card News (July 17, 1997). One reason these coalitions have not blossomed into networks is that they lack the geographic dispersion to offer sufficient convenience to consumers. See Testimony of Thomas M. Caron, President, Easton Cooperative Bank, Easton, Massachusetts, before the Senate Banking Committee (July 29, 1997).
- 62 Donald I. Baker, Shared ATM Networks, the Antitrust Dimension, 41 Antitrust Bull. 399 (1996).
- 63 EPS, 59 Fed. Reg. at 24,720.
- 64 In re Arbitration between First Texas Sav. Ass'n & Financial Interchange, Inc., 55 Antitrust & Trade Reg. Rep. (BNA) 340 (Aug. 25, 1988).
- 65 Alexander Raskovich, "Some Antitrust Issues in ATM Network: Network Growth and Operating Rules," before the ABA Antitrust Section (May 24, 1996).
- 66 Merger Guidelines, § 4.0 (revised Apr. 6, 1997).

67 FTC v. University Health, Inc., 938 F.2d 1206, 1223 (11th Cir. 1991); FTC v. Staples, Inc., 1997 U.S. Dist. LEXIS 9322; 1997-2 Trade Cas. (CCH) ¶ 71,867 (June 30, 1997).

68 As the Eleventh Circuit observed in University Health

[W]e hold that a defendant who seeks to overcome a presumption that a proposed acquisition would substantially lessen competition must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition, and hence, consumers.

Id. at 1222-23 (emphasis supplied). See also United States v. United Tote, 768 F. Supp. 1064, 1084-85 (D. Del. 1991) (even assuming efficiencies would occur they were rejected because "there are no guarantees that these savings will be passed on to the consuming public."); California v. American Stores, 697 F. Supp. 1125, 1133 (C.D. Cal. 1988) (rejecting claimed efficiencies of over \$50 million since efficiencies will not "invariably" be passed on to consumers), aff'd in part and rev'd on other grounds, 872 F.2d 837 (9th Cir. 1989), rev'd on other grounds, 495 U.S. 271 (1990).

69 See University Health, 938 F.2d at 1222 n.30 ("it might be proper to require proof that the efficiencies to be gained by the acquisition cannot be secured by means that inflict less damage to competition. . ."); United States v. Mercy Health Services, 902 F. Supp. 968, 987 (N.D. Iowa 1995)("it is generally accepted that if the efficiencies may be obtained through a method which would not limit competition, then they may not be used as a valid defense.").⁶⁹ As the court in United States v. Rockford Mem. Corp., 717 F. Supp. 1251 (N.D. Ill. 1989), aff'd, 898 F.2d 1278 (7th Cir.), cert. denied, 111 S. Ct. 295 (1990) articulated

[B]ecause competition, not competitors, is protected under § 7 savings relevant for determining pro-competitive efficiencies must be made only through the merger and in no other manner. . . . Efficiencies benefitting the merged entity, but obtainable by means independent of merger, are not relevant for § 7 purposes.

717 F. Supp. at 1289 (emphasis in original).

70 See United States v. Rockford Mem. Corp., 717 F. Supp. 1251, 1289-91 (N.D. Ill. 1989), aff'd, 898 F.2d 1278 (7th Cir.), cert. denied, 111 S. Ct. 295 (1990).

A merger between ATM networks also must receive approval from the Federal Reserve Board under section § 4(c)(8) of the Bank Holding Company Act. That statute applies an arguably stricter standard to demonstrate efficiencies. It requires the applicants to demonstrate the existence of efficiencies regardless of the level of anticompetitive effects. In order to receive approval from the Board, it is not enough for a bank holding company to show an absence of potential adverse effects. Rather, "the burden is on the holding company to affirmatively show that public benefits from the transaction could reasonably be expected, and would outweigh the possible adverse effects." Money Station, Inc. v. Board of Governors of the Fed. Resv. Sys., 81 F.3d 1128 (D.C. Cir. 1996), rehearing en banc granted, 93 F.3d 658 (1996). See Citicorp v. Board of Governors, 589 F.2d 1182, 1190 (2d Cir.) ("legislative history indicates the burden is on the applicant affirmatively to establish the net public benefit of its proposal"), cert. denied, 442 U.S. 929 (1979). As described infra, the Board has applied a relatively lighthanded approach to efficiencies.

- 71 See The Bankers Roundtable, Banking's Role in Tomorrow's Payments System 47 (Furash & Co. 1994).
- 72 Bank of New York Co., 80 Federal Reserve Bulletin 1107 (1994).
- 73 Id.
- 74 The parties also agreed that if the if a bank chose to bypass the network, it would not have to pay a royalty or bypass fee. See Application of Infninet Payment Services, Inc., June 6, 1994, at 29.
- 75 For a discussion of the importance of card-issuer routing rules, see Karen L. Grimm & David A. Balto, Consumer Pricing for ATM Services: Antitrust Constraints and Legislative Alternatives, 4 Georgia State Law Review 839 (Spring 1993).
- 76 Banc One Corp., 81 Federal Reserve Bulletin 491, 494 (May 1995) (Vice Chairman Blinder dissenting).
- 77 The transaction as originally proposed would have had Mellon Bank acquiring a 16.67 per cent interest in EPS. However, due to the lengthy regulatory proceeding in approving the merger, Mellon eventually withdrew as a potential owner. See "Mellon Ditches Plan to Buy into MAC," American Banker (Jan. 30, 1995).
- 78 Although Money Station did not prevail in any of the legal challenges, its challenge did have one important effect -- the regulatory delay led Mellon to withdraw as a potential owner of EPS. In July, 1997 Mellon then joined Money Station as a 20 per cent equity owner. Mellon's new ownership role in Money Station is credited with reviving competition between Money Station and EPS. By joining Money Station, Mellon gave the network coverage of about 90 per cent of the ATMs in Western Pennsylvania.
- 79 Letter from Stephen A. Rhoades, Assistant Director, Division of Research and Statistics, to Allen Raiken et al. (Feb. 15, 1995).
- 80 The Board's understanding of the purpose of consent decrees appears mistaken. The purpose of the decree is to remedy the competitive problem at the time the decree is entered, not during the pendency of the decree.
- 81 Dissenting Statement at 1.
- 82 Money Station, Inc. v. Board of Governors of the Fed. Resv. Sys., 81 F.3d 1128 (D.C. Cir. 1996), rehearing en banc granted, 94 F.3d 658 (July 31, 1996).
- 83 Id. at 1133.
- 84 Id.
- 85 Id. at 1133-34.
- 86 Id. at 1135-36.

- 87 See Barnett Banks, Inc., 83 Federal Reserve Bulletin 131 (Dec. 9, 1996). At the time, Honor was the fourth largest network in the United States, Most was the fifth largest, and Alert was the 23rd largest.
- 88 Unlike the prior orders, the Board conditioned approval on the network's adoption of these rules and providing appropriate notification.
- 89 See Karen L. Grimm and David A. Balto, "Consumer Pricing for ATM Services: Antitrust Constraints and Legislative Alternatives," 9 Georgia State Law Review 839 (Spring 1993).
- 90 See Donald I. Baker, Compulsory Access to Network Joint Ventures Under the Sherman Act: Rules or Roulette?, 1993 Utah L. Rev. 999 (1993).
- 91 The Board explained that "network access" includes: (1) the right to "brand" ATMs and ATM cards with the trademark or logo of the ATM network; (2) the ability of the ATM cardholder with an account at one member depository institution to initiate withdrawal and other account transactions at an ATM owned by another depository institution that is a member of the same network; and (3) minimum standards for network performance and products offered through the network.
- 92 Department of Justice and Federal Trade Commission, Statements of Antitrust Enforcement Policy in the Health Care Area, 4 Trade Reg. Rep. (CCH) ¶ 13,153 (August 1996).
- 93 59 Fed. Reg. 24,719 (May 12, 1994). The Federal Reserve Board has taken a similar position. Banc One Corp., 81 Federal Reserve Bulletin at 494, n.21.
- 94 A "subnetwork" could be an alternative ATM network.
- 95 55 Trade Reg. Rep. (BNA), No. 1380, at 353.
- 96 Id.
- 97 cite bank network news Articles
- 98 4 Trade Reg. Rep. (CCH) at 20,815.
- 99 See Grimm & Balto, supra.
- 100 See John M. Stevens, Antitrust Law and Open Access to the NREN, 38 Villanova L. Rev. 571, 597-98 (1993); Michael L. Katz & Carl Shapiro, Network Externalities, Competition and Compatibility, 75 American Econ. Rev. 424 (1985).
- 101 Banc One Corp., 81 Federal Reserve Bulletin at 494, n.20.
- 102 See Margaret E. Guerin-Calvert, Key Economic Issues in Network Merger Analysis, Economists Ink (Fall 1994).
- 103 The Agencies have challenged network mergers even where there were network externalities present. For example, in 1989 the Antitrust Division announced that it would challenge the proposed joint venture of the CRS systems of American Airlines and Delta Air Lines, alleging

- that the proposed joint venture “would violate Section 7 of the Clayton Act and Section 1 of the Sherman Act because it would substantially lessen competition both in the sale of CRS services to travel agents and in the provision of scheduled airline passenger service.” It found that there are only five computer reservation systems in the United States and concluded that the elimination of one of the five competitors “could result in higher charges to travel agents for using CRS services.” Department of Justice Press Release, 89-191 (June 22, 1989). See also Automated Data Processing, Inc., Docket No. 9282 (June 17, 1997) (settlement of merger between two firms which provided transaction network for automobile replacement parts firms).
- 104 See William F. Baxter, Paul H. Cootner and Kenneth E. Scott, Retail Banking in the Electronic Age: The Law and Economics of Electronic Funds Transfer (1977).
- 105 See FTC v. Alliant Techsystems Inc., 808 F. Supp. 9, 23 (D.D.C. 1992) (where merger would create firm with market power, efficiency claims are "insufficient to override the public's clear and fundamental interest in promoting competition"); FTC v. Imo Indus., 1992-2 Trade Cas. (CCH) ¶ 69,943, at 68,560 (D.D.C. 1989); United States v. United Tote, 768 F. Supp. 1064, 1084-85 (D. Del. 1991); see also Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines § 4.0 (1997) ("Efficiencies almost never justify a merger to monopoly or near-monopoly.").
- 106 See FTC v. University Health, Inc., 938 F.2d 1206 (11th Cir. 1991) (a "defendant who seeks to overcome a presumption that a proposed acquisition would substantially lessen competition must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition and, hence, consumers.").
- 107 Banc One Corp., 81 Federal Reserve Bulletin at 497.

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