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DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

ANNEX TO THE SUMMARY RECORD OF THE 120th MEETING OF THE COMPETITION COMMITTEE HELD ON 26 FEBRUARY 2014

- Draft Summary Record of the Discussion on the Role of Competition in Financial Consumer Protection -

The attached document is an annex to the Summary Record of the meeting held on 26 February 2014. It is circulated to Delegates FOR APPROVAL UNDER WRITTEN PROCEDURE. Delegates are requested to respond with any written corrections by 6 June 2014 to Ms Patricia Hériard-Dubreuil [patricia.heriard-dubreuil@oecd.org] and Ms Marianne Aalto [marianne.aalto@oecd.org].

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SUMMARY OF DISCUSSION

1. **The Chairman** opened the discussion on the role of competition in financial consumer protection and explained that the discussion would be based on 18 country contributions received in response to a questionnaire that was sent by the OECD G20 Task Force on financial consumer protection.

The Chair noted that the discussion would cover three main topics:

- The benefits of and obstacles to switching;
- An overview of competition issues arising in the context of financial markets; and
- Structural separation in financial markets.

The Chair then gave the floor to the Secretariat of the OECD Task Force, which offered to provide an overview of the work that has been undertaken by the OECD for the G20 in relation to financial consultation.

2. **Michael Chapman** began by reminding that in 2010 the Committee on Financial Markets held a special session on financial consumer protection and that it quickly became clear that discussed issues were of significant importance. In the aftermath of that session a Task Force of experts has been established. Subsequently, the G20 leaders called upon the Financial Stability Board (FSB), the OECD and other international organisations to examine how consumer finance protection could be enhanced. The OECD was called to develop high level principles on financial consumer protection. Eventually, the G20/OECD Task Force developed a set of ten high level principles, which the G20 endorsed at the Cannes Summit. The OECD was then asked to continue to report back on the implementation of these principles and to develop further guidance if appropriate. In July 2012, the OECD Council adopted the high level principles as a recommendation.

3. Michael Chapman explained that the discussion that took place focused overall on identifying effective approaches. Accordingly, the OECD Task Force decided to develop effective approaches on three priority principles, which concerned disclosure and transparency, responsible business conduct as well as complaint handling and redress. While developing these approaches, the OECD Task Force identified (i) common approaches, i.e. measures that support the implementation of the principle and are consistent through a number of jurisdictions, and (ii) innovative or emerging approaches, i.e. practices that respond to potentially new challenges and are either being developed only by a few or in some cases by just one jurisdiction, or that are related to a particular financial service. The G20 leaders endorsed the first set of effective approaches at the St Petersburg Summit in September 2013. The OECD Task Force then set to develop effective approaches for the next six principles. Michael Chapman concluded by noting that because a lot of work has been done through the G20 international network on financial education on the principle concerning financial education and awareness, at the moment the OECD Task Force is not identifying effective approaches for this principle in order to avoid duplication of work done by the G20.

4. The **Chairman** thanked Michael Chapman for the overview and remarked that the discussion will focus on Principle 10. This principle states: "*Nationally and internationally competitive markets*

should be promoted in order to provide consumers with greater choice amongst financial services and create competitive pressure on providers to offer competitive products, enhance innovation and maintain high service quality. Consumers should be able to search, compare and where appropriate switch between products and providers easily and at a reasonable and disclosed cost". The Chair then gave the floor to Mary Starks, the Competition Director of the UK Financial Conduct Authority and one of the members of the OECD task force.

5. **Mary Starks** began by noting that the ten principles previously mentioned by Mike Chapman are quite closely interrelated and that competition in the context of financial markets has a very strong consumer focus, which means that there is much less of a focus on competition as a driver of economic growth. Therefore, one of the interesting questions is the extent to which financial regulators consider the impact of their interventions on competition and consumers. Mary Starks pointed out that there is a broad consensus among regulators that in a more competitive environment, other things being equal, consumers will be better off. However, there are also quite a lot of concerns around how competition relates to other objectives of financial regulation, notably consumer protection, but also market integrity and financial stability. Ms Starks stressed that the relationship between competition and other objectives is complex. While the objectives are often in mutual support, this is not always the case and therefore there are occasions when the objectives come into tension.

6. Mary Starks argued that financial regulators should focus more on regulatory barriers to entry. In the UK, for example, the review of capital requirements revealed that authorisation requirements were rather appropriate in a static situation for a bank that was already operating in the market. However, they proved to be extremely difficult and expensive for new entrants. Therefore, regulators should focus more on the question of whether the barriers to entry are in the right place or whether they need to be re-evaluated.

7. Mary Starks also informed that one of the questions in the questionnaire concerned institutional arrangements, and in particular the relationship between the financial regulator and competition authority. For example, fairly few financial regulators have promotion of competition as an explicit primary objective or have powers to enforce competition law. Still, some regulators are required to consider the impact of their regulatory interventions on market and competition. For example, there is a very wide range of tools that financial regulators can use to support choice, from more straight forward rules around disclosure and provision of information to rules around conflicts of interests and impartiality. However, because behavioural economics has put into question the extent to which disclosure of information is an effective tool for supporting consumers' choice, there is also an increasing focus on ensuring that such measures are actually behaviourally informed.

8. The **Chairman** agreed that indeed very few financial regulators have promotion of competition as a primary objective and that often they do not believe that competition can help achieve adequate level of consumer protection, market integrity or financial stability. The Chair then gave the floor to Federica Maiorano from the OECD Secretariat.

9. **The Secretariat** discussed the importance of switching costs.[1] When switching costs are substantial, customers are locked in with their current provider who in turn may enjoy ex post market power. This means that firms compete ex ante for their customers rather than on a period-by-period basis. One relevant policy question is whether competition for new customers is an adequate substitute for the more traditional competition on a period-by-period basis. Another factor that may complicate switching in the banking sector is the practice of bundling services together. On the one hand, there is a cost that customers incur when they buy services from different suppliers; on the other, the convenience of

[1] OECD (2014), *Competition Role in Financial Consumer Protection*, DAF/COMP(2014)6.

obtaining different services from the same provider may restrict the way in which new providers can compete or even enter the market. On top of that, the current provider has access to the best information on the customer's credit history. This means that new suppliers cannot observe the real credit-worthiness of the new customers who decided to switch to a new bank.

10. The Secretariat then discussed the relationship between the observed switching rates and competition. In theory, high switching rates imply that customers are shopping around and in this way they discipline the market. However, both theoretical and empirical evidence indicate that switching can actually be inefficient. There are examples from energy, telecoms, and even banking pointing to consumers moving to inferior alternatives. On the other hand, low switching rates may be consistent with the story of a competitive market where competition does not take place on a period-by-period basis. The Secretariat remarked that even a credible threat of switching may be sufficient to discipline the market. The fundamental question is therefore whether switching costs are to blame for the switching rates. There are a lot of surveys which examine the reasons behind the consumers' decisions to search, not to search, to switch and not to switch. Some of these surveys revealed that the nature of the services themselves matters, e.g. whether they have to be renewed regularly or not. Also, the extent of the gains that consumers expect from switching may have an impact on their decision whether to switch or not.

11. The **Chair** pointed out that to understand the extent to which switching rates can be useful in explaining competition and consumer protection issues, it is necessary to examine evidence and understand how much consumers actually do benefit from shopping around. The Chair then invited interventions from countries that have done studies on the benefits of switching.

12. The delegate from **Belgium** pointed towards the evidence from the energy sector. After the liberalisation, the switching rate remained low and the government decided to launch an information campaign in cooperation with the competition authority on the advantages of switching. As part of this campaign information desks were opened in around four-fifths of all local town halls. In six months the rate of switching was dramatically transformed. The lesson from the campaign was that while websites allowing for a price comparison are an important tool, face-to-face contact should not be underestimated. Given the success of that campaign, Belgium decided to implement similar measures in the mobile telephony and internet markets. No similar action, however, has been taken so far with respect to financial services since there was more switching that in other sector and thus, the government did not consider that such an action was required.

13. The delegate from the **Netherland**s informed that the Dutch competition authority had established a Monitor Financial Sector unit. This unit identified fifteen most popular products that consumers buy and it calculated how much consumers could save by shopping around. Its study revealed that savings could be substantial. For example, consumers could save between 300-400 EUR per year on mortgage. For some products, such as travel insurance, personal property insurance and building insurance, the price of the highest provider could be twice as high or even three times higher as the price of the lowest provider. The unit calculated the potential saving for eight different households taking into account a different mix of financial services. The calculation revealed that a retired couple could save almost 650 EUR per year and a young couple with two children could save up to 1000 EUR per year.

14. The delegate from **Norway** referred to the interbank agreement that was entered in 2008 and remarked that it made it very easy for customers to switch. Essentially, the new bank takes care of everything for the customer, transferring all kind of financial obligations and accounts. The delegate also noted that a survey of the banking association revealed that approximately 5 per cent of the customers switch banks and that customers who switch are mostly between 40 and 44 years old.

15. The delegate from **Italy** explained that the competition authority in cooperation with the financial authority issued a series of recommendations to improve transparency of the costs incurred with respect to current accounts. These recommendations were issued in the aftermath of the 2007 survey that the competition authority carried out to analyse the switching rates. However, under the pressure that was coming from the public that it was still very difficult to switch accounts, the competition authority carried out another survey in 2012. This survey revealed that the switching rate has not changed. Yet, the benefit of switching is sufficiently significant – around 180 EUR per year. Therefore, the competition authority issued another set of recommendations in order to improve the information about the synthetic cost that each typical customer may face when subscribing to some accounts. The delegate referred as well to an investigation that was carried out with the help of the financial regulatory authority who has very detailed data concerning the mobility and the switching rate within a single bank. The data show that the switching rate is very low and that over 70 per cent of customers have not changed their account for the last five years, a decision which imposes on them a cost that is on average about 50 EUR more than the cost of the best offer actually available in the bank. These data reveal that first, possibly more can be done to improve the information available to the individual customer on the offers of their bank, but also that potentially small gains are insufficient to induce customers to switch.

16. The delegate from **Germany** noted that since its competition authority has not carried out any survey or sector inquiry, the evidence on switching rates in the financial markets comes mostly from the merger assessment regarding local saving banks. Confirming the views already expressed by the delegates from Italy and Norway, the delegate stressed that customers are quite inactive about the switching because it is burdensome and involves a lot of bureaucracy. Also, because it is difficult to identify the price of all bundled products, it is not easy for the customer to understand what the real costs are when they choose to switch. The delegate then explained that the competition authority has identified a special problem concerning small and medium size enterprises, which usually have long term commercial relationships with their local banks. The findings revealed that the assessment of the credit worthiness of small and medium size enterprises is sometimes better at the local banks, and therefore in the long run it may not pay off for these firms to switch to another bank even if the credit conditions might be better in a single case.

17. The delegation from the **United States** agreed with the observation made by the delegate from Germany and pointed towards the importance of obtaining credit particularly during an economic downturn, which could affect the willingness to switch. In addition, the experience of the United States reveals that customers' willingness to switch also varies depending on the type of product.

18. The delegate from **Ireland** remarked that a number of provisions were put in place in Ireland in the context of the collapse of the banking sector and the Troika bailout to facilitate competition in the sector. The delegate then referred to a comparator website that was initially run by the central bank and was subsequently transferred to the national consumer agency. The current website covers 230 individual products and it does a lot of comparisons, in particular for students' products. The delegate explained that very often people select a bank very early in their lives and possibly do not change it ever again. Hence, it is important to have such focused comparisons as well. Another measure that was adopted as part of the state aid decision was to put the code of conduct on switching of current accounts on statutory footing, whereas previously there was only a voluntary code. To conclude, the delegate pointed out that the national consumer agency, which measures switching rates every six months, had observed that the rate had increased from about 2 per cent per annum in November 2011 to 6 per cent in December 2013 – a number that should still be considered low in light of a huge amount of forced exit from the market.

19. The **Chair** explained that the next part the discussion will focus on two questions, namely the instruments that have been used in attempts to increase switching rates and whether behavioural economics can explain consumers' behaviour. Before giving the floor to Mexico the chair asked whether the threat of switching has led to increased switching or to the alignment of offers, since this would also be an effect on

competition. The Chair also remarked that it is very hard to know in a normative way what the right rate of switching would be.

20. The delegate from **Mexico** discussed the situation in the market for retirement saving funds, a priority market for the Mexican competition authority. In 2006, the Commission considered that it was necessary to allow employees to freely choose retirement funds. In particular, the authority suggested that switching between the funds should not be subject to constraints of timing, rate of return or level of commissions. The law at that time prevented the workers from changing the retirement saving funds more than once a year. In 2007, however, the law was amended to allow transfers if a recipient fund performed better than the originating fund. However, the exercise of this right was subject to a methodology designed to calculate a minimum difference in performance between two funds. Also, employees were required to stay at least for 12 months with the recipient fund. The delegate added that there is no evidence that the regulatory change had an impact on facilitating customers' mobility. Before the reform, employees had very low possibility of changing a retirement fund. While the reform was planned to facilitate the mobility, in the delegate's view it has not produced the expected result. In response to the Chair's question the delegate remarked that in his view it is the lack of transparency that hampers switching as recipient funds have the incentive to attract new customers and indeed they do offer some gifts in order to win new customers. However, apparently consumers do not take into account the economic benefits of changing.

21. The delegate from **Romania** explained that they have a rather positive experience with switching, which has doubled, albeit from a relatively low level. The delegate said that the competition authority in cooperation with the consumer protection authority put forward a proposal to eliminate an early reimbursement fee. According to the delegate the increase in switching could be attributed to the measure because the rate has doubled in just over a one year period. The delegate added that the area in which the progress has not been made concerns the prudent banking regulation introduced by the national bank. In particular, consumers whose incomes have decreased may be trapped with the existing loans because they do not qualify for refinancing.

22. The delegate from **Chinese Taipei** commented on the case concerning improper collection of housing loans prepayment, and in particular the setting up of penalties that increased the switching cost. By charging a higher amount of penalties the providers of financial services were in the position to restrict consumer options. The FTC investigated the issue and found that prepayment provisions had not complied with the guidelines on charging penalties for the prepayment of housing loans by financial enterprises. The guidelines foresee that financial institutions should provide consumers with some options that should facilitate prepayment and switching to other financial services when consumers can find a better interest rate. The guidelines therefore encourage competition in the market for housing loans by reducing consumers' switching cost and providing more options to consumers.

23. The delegate from **Korea** discussed a cartel case in the insurance market, in which sixteen life insurance companies mutually agreed on the level of interest rate applied to reserved funds from 2001 to 2006. The companies were able to secure stable profits by preventing their customers from switching. The Commission issued a cease and desist order against the cartel and imposed a fine of about 340 million US dollars.

24. The delegate from **Poland** discussed the issue of switching in the context of an abuse of dominance case that involved PZU Życie, a Polish insurance firm. The firm operated in the market for employee group insurance and abused its dominant position by imposing unfavourable contract terms. In particular, it created artificial barriers to entry by discouraging its clients from switching to other insurance providers. For example, one of the requirements foresaw that it was necessary to obtain consent from at least 75% of the insured employees to terminate the agreement, even though the employer was a party to the contract, not the employees. This requirement was difficult to satisfy given the extremely strong

position of the firm on the market: the company has been providing the employee group insurance for over 50 years in Poland, and until 1989 it was the only company offering this kind of financial product. Also, the firm has a very well developed distribution chain as its agents work within the insured firm (they are usually recruited among the staff of the human resources department). According to the competition authority, for some groups of employers, in particular those financially weaker like schools, kindergartens, or small firms, this requirement provided a sufficient incentive to stay with PZU Życie and promote its products within its staff. The delegate concluded by explaining that no survey has been conducted to verify whether the situation has changed. However, the number of insurance firms has been growing and PZU Życie no longer has 90 per cent of market shares, which allows one to assume that this is the outcome of the competition authority's actions.

25. **Mary Starks** observed that one important aspect that has not been raised in the discussion is the link between switching and new entry. Referring to the remarks made by the Irish delegate on the fact that banks often pick up their customers when they are students, Mary Starks noted that a decision to build a viable bank by just trying to win a few of each generation of students would imply that it is an incredibly long term business model to aim to. If so, then while the ease of switching is a necessary condition for competition to be effective in the market, it is not a sufficient condition. She then mentioned the example of the annuities market and the theoretical policy option that would require all consumers to make an active decision at the point of retirement.

26. The **Chair** thanked the delegates and Mary Starks for their interventions and moved the discussion to the next part, which focused on the insights offered by behavioural economics with respect to switching.

27. The delegate from **Finland** draw attention to the fact that financial markets are highly complex and difficult for consumers to understand which is why irrational behaviour and decision making errors exist. The delegate then referred to the use of behavioural economics in the authority's work in the planning of the supervisory actions and statements concerning legislative initiatives which relate mostly to the fact that information in the banking sector is hard to understand.

28. The delegate from **Denmark** noted that the Danish competition authority prepared a report on the retail banking market (2013) using behavioural economics. The delegate also mentioned that the authority had recommended another initiative, which sought to encourage consumers to put their loans on auction.

29. The delegate from **Ireland** mentioned research that is currently being conducted by the Economics and Social Research Institute on behalf of a set of institutions on the ability of consumers to value and compare complex product offerings. The aim is to try to evaluate how complex the products have to be before the consumer starts making systematic mistakes when evaluating and comparing products and how those limitations affect decision-making in energy, financial services and telecommunications.

30. At the Chairman's invitation, the delegate from **BIAC** discussed the advantages and disadvantages of using behavioural economics. First, the delegate noted that price is not the only element that consumers are interested in. In the context of switching, competent authorities cannot implement effective measures if they do not fully understand how and why consumers behave the way they do. This is where behavioural economics come into play. First of all, it offers some insights into the ways consumers behave: if an authority understands better consumers' behaviour it might be able to understand the source of the problem and design remedies that address the problem. The delegate then remarked that one of the concerns is that consumers simply do not understand the interest rates or are being misled by banks, which reflects the belief that interest rates are important and should motivate consumer behaviour. If that is the case the remedy would be to require banks to provide more transparency. However, the real problem is that

the vast majority of customers simply do not seek to understand interest rates. In fact, some research has shown that interest rates play a small role in psychology of savings. The delegate then pointed towards some limitations of behavioural economics. First, authorities should be careful when using behavioural economics as the only basis for their decisions as the possibility of errors is quite significant. Second, there are also inherent limitations concerning the methodology used as well as the evaluation of surveys and data. The delegate then noted that there is a common consensus that customers must be able and willing to switch banks in order to drive and stimulate competition in retail banking. However, there is also a perception that sometimes authorities put too much weight on the importance of switching rates in the banking sector to assess whether the market is competitive or not. Switching levels alone are not a good indicator of how competitive the market is or whether the consumers are getting good outcomes.

31. The **Chair** thanked BIAC for its interesting contribution and remarked that the discussion would now focus on the competition issues arising in the financial sector.

32. The delegate from **Japan** explained that the Japanese competition authority is concerned with the situation of small and medium size enterprises. A survey that was done some time ago revealed that around 71.8 per cent of these companies had not switched. The casual observation suggested that those companies are in an inferior position and may not be able to find other banks to borrow from. In those cases there is a risk that banks may engage in an anticompetitive behaviour by taking advantage of their superior bargaining position. For example, in 2005 the competition authority investigated an abuse of the superior bargaining power and found that the major bank forced the borrowers to purchase an interest rate swap, which is a kind of a financial derivative that is not actually related to the loan.

33. The delegate from **Portugal** started by pointing out that financial services markets exhibit a number of features which pose particular challenges for the delineation of relevant market and assessment of market power. The difficulties relate to the multiple product nature of firms and the supply of bundles, cross-selling, complex pricing structures, the ability to price discriminate as well as the existence of searching and switching cost. According to the delegate, the magnitude of switching costs and the mobility rate can be useful for market definition as well as for market power assessment but in order to be fully informative it needs to be accompanied by a variety of statistics and information concerning, for instance, pricing strategies, the ability to price discriminate, the ratio of new to locked in customers. The Portuguese competition authority has actually used this kind of information in its merger control. Switching costs reduce the degree of substitutability between different products and products from different suppliers, therefore the demand response to changes in prices will be reduced and this has obvious implications for market definition. Economic analysis, however, has no simple prediction on the relationship between the levels of switching cost and market power. The impact of switching on prices depends, among others, on the level of contestability on the market. Therefore, the presumption that high switching cost leads to higher market power needs to be justified. Also, the use of switching rates needs to be complemented with other information. The delegate also pointed out that the implications of switching costs in the financial sector are also potentially different for different products. For example, the market study developed by the competition authority in collaboration with the Portuguese central bank revealed that price differentiation between locked in and new consumers for mortgage loans was much higher than that found for personal consumption loans, which was probably related to the duration of the contract.

34. The delegate from the **UK** explained that although the UK carried out investigations into a number of financial markets over the years, its intervention will focus on the market for payment protection insurance that was examined under the market study regime. The study revealed that there was a lot of circumstantial evidence that customers were not shopping around, which gave the incumbent bank (the provider of loans) an absolutely huge competitive advantage on the point of sale. While the initial assumption was that it was the market for personal loans with the insurance offered as a by-product, it became clear that it was actually the market for personal insurance, and that the loan was a by-product. The

authority decided that the market failure was so grave that a ban should be imposed on the sale of these products at point of sale, in other words the banks could not offer insurance at the same time they are offering a loan. To date, banks have paid out in compensation more than 10 billion EUR and the total provision on their books for mis-selling payments is actually in excess of 25 billion EUR. The delegate pointed towards the use of behavioural economics during this study and explained that it helped the authority to recognise that certain economic solutions might not work. Overall, the delegate argued that behavioural economics provides a very good reason why it is very important that competition and consumer protection should go hand in hand because sometimes it is extremely difficult to differentiate between a competition and a consumer protection issue.

35. The delegate from **Denmark** explained that the financial service authority is developing some product governance rules to protect consumers and the FSA shall develop product intervention rule.

36. The **Chair** announced that the discussion will move to its final part and focus on the structural separation of the banks.

37. The **OECD Secretariat** explained that in response to the financial crisis there has been renewed attention to the banking sector, and more specifically to very large banks that are so interconnected that any risk and imbalance in their operations has an impact on the rest of the financial market. First point is that these big banks are considered to be too big to fail. In fact, customers consider them to be safer than other banks under the belief that governments would intervene in the event of trouble. This means that investors and customers may accept lower returns than they would otherwise because they believe their money is safer there than in other banks. Overall, this means lower funding costs and lower cost of capital for big banks. Also, if a bank benefits from a lower cost of capital it may engage in a higher risk project, which in turn may offer higher returns. This compounds the initial benefit of enjoying lower cost in the first place. While these arguments could be seen as advantages of making banks smaller and safer from a competition point of view, one has to recognise that breaking up a vertically integrated bank may lead to the loss of economies of scale and scope. Yet, in the case of banks there does not seem to be a consensus with respect to the actual extent of the economies of scale and scope. The Secretariat also pointed towards the risk of some conflict of interest and possibility of information sharing. A large bank could presumably use information from one of its departments to inform the activities of another department, an advantage that is not available to smaller or less diversified banks. Finally, there is a question of whether the implementation of structural separation at the national level can create some imbalances at the international level given that there is an almost global market for capital. If so, there may be the need for greater coordination.

38. The delegate from the **EU** presented the Commission's proposal for a regulation that was adopted on 29th January 2014 as a part of a package. The delegate referred to the US Glass Steagall Act and noted that the issue of separation of banking activities is not new. However, prior to the crisis the universal banking model philosophy became prevalent and the firewalls between commercial and investment banking were removed. After the crisis, the debate on separation was revived. The US adopted the so-called Volcker rule which bans trading activities at the bank level within the group. The UK has passed a law basically enforcing ring-fencing in the deposit taking entities, which are incorporated in the UK. A number of other member states have taken similar measures and so structural measures have been considered appropriate in France, Germany and Belgium. It is in this context that the EU proposal and the Liikanen report has been put forward. The report made five recommendations to the banking community and to the Commission. These recommendations concern the separation of trading activities, the need to set up recovery and resolution plans, the use of bailing instruments, extra capital, surcharge and higher risk for a number of activities and enhanced corporate governance. The Commission's proposal deals with the first recommendation and to a certain extent with the second (corporate governance) and fifth (recovery and resolution plans). The delegate remarked that the Commission's proposal comes at the very end of a series

of reforms, which have taken place in the last five years. The Commission has adopted more than 30 different regulations and directives in the financial sector related to capital, liquidity, leverage requirements, enhanced supervision, credit rating, hedge funds, crisis management resolution, single supervision authority, and banking union. The delegate added that because in the EU banks operate within a single market; it would be difficult to implement different separation models, which is why the EU action is definitely warranted. While financial stability is obviously at the centre of the Commission proposal, there are a number of subset objectives such as reduction of the excessive risk taking, facilitation of orderly resolution and recovery, efficient management and supervision of banks and promotion of undistorted competition.

39. The delegate remarked that there is nothing more distortive than the implicit subsidies that some large banks enjoy. These implicit subsidies actually decrease the cost of the funding operations. The delegate added that according to the estimations there would be 30 to 35 banks that would be covered by the Commission's regulation. However, this number may change by the time the regulation enters in force around 2016 and 2017 as current projections are based on historical data from 2000 to 2006. In terms of the territorial scope, the regulation will apply to the European banks and banks with headquarters in Europe, which this means that also overseas subsidiaries of the European banks will be captured unless the regimes in which they operate are considered equivalent. The regulation will also apply to foreign branches operation in Europe but will only cover their EU activities. The delegate added that exposure to hedge funds is also prohibited when it is connected to proprietary trading. However, there are a number of exceptions to this prohibition, the most particular one is the EU sovereign debt trading or any trading related to clients' needs or services for hedging or cash management. The delegate then explained that the proposal provides a series of tools that may be used to separate banks whenever such solution is considered appropriate. Basically, the proposal identifies activities that should be subject to review by the supervisor in order to be separated if a number of risk metrics are met. The risk metrics that the Commission has identified are related to size, leverage, interconnection, credit rates, market rates, and complexity of trading assets. The delegate stressed that the proposal does not foresee separation by law, but rather it gives discretion to the supervisors. While in certain circumstances separation will be somewhat automatic if the thresholds of the metrics are met, banks will still be able to avoid the separation if they can convince the supervisor that the activities subject to a separation are not posing any particular problem to the financial stability of the bank. If the regulation is adopted in 2015, the proprietary trading ban will come into force in January 2017 while the separation would become effective as of 2018.

40. The **Chair** stressed that while separation is going to protect consumers by reducing systemic risk and therefore increase the security of the financial sector it remains to be seen how it is going to ensure undistorted competition.

41. The delegate from the **EU** replied that the question about the impact of banking separation on competition is certainly a very interesting one. Large universal banks enjoy the so-called implicit subsidy because of their size and importance in the system. This is a very distortive competitive advantage. While separation is not a panacea, it certainly mitigates the problem of implicit subsidies, at least for the trading aspect. After separation, trading activities will no longer enjoy, for example, grade rating of the group. The grade rating agencies are in fact already changing the ratings as a result of the structural reform. According to the delegate this is a major gain in terms of fair competition. Of course, given the variety of reforms undertaken in individual countries there is a risk of further fragmentation, which is clearly not desirable. The delegate concluded by adding that hopefully the FSB and G20 will put forward some mechanisms that will mitigate the risk of incompatibility of reforms in the financial markets.

42. The **Chair** summarised the discussion noting that it explored a number of ways in which competition authorities seek to ensure that there is a more vibrant competition in the financial markets and that consumers are well protected.

43. **Mary Starks** concluded by stressing the importance of financial markets and pointing out that they are being increasingly seen as necessities for a modern life and that functioning in a modern developed country without a bank account may no longer be feasible.