



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

**DAF/COMP/WD(2010)13  
For Official Use**

**ROUNDTABLE ON COMPETITION, CONCENTRATION AND STABILITY IN THE BANKING  
SECTOR**

**-- Note by the delegation of Chile --**

*This note is submitted by the delegation of Chile to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 16 - 17 February 2010.*

**JT03277293**

Document complet disponible sur OLIS dans son format d'origine  
Complete document available on OLIS in its original format

**English - Or. English**

## ROUNDTABLE ON COMPETITION, CONCENTRATION AND STABILITY IN THE BANKING SECTOR

-- Note by Chile --

### 1. Measurement of Competition in the Financial Sector

1. The usual measures of concentration (market share, the Herfindahl-Hirshman index, others) are not particularly suitable to assess competition in the banking sector, partly because this one is a complex multiproduct industry dealing with a number of relevant markets, businesses and customers in different geographical settings. This alone lessens the meaning, or even precludes the application of a single figure or measure to the system as a whole.

2. That is why, when analysing the banking sector, the Chilean competition authorities have often employed the standard measures of concentration, only applying them separately to every core business within a bank - mortgage loans and other retail banking, corporate borrowing, securities and information intermediation, and so forth. The concentration figure for the whole banking sector in a given moment, then, will vary according to which business is under scrutiny. That notwithstanding, interest rates and commissions charged, that is, prices in this sector, have also been used by our agency to appraise the competitiveness and/or dominant position of a bank.

3. Furthermore, the Chilean competition agency, FNE, has released guidelines to analyse and evaluate economic concentration in our midst, but before going into that, a brief explanation is in order. The Chilean jurisdiction has neither mandatory premerger notification for mergers and acquisitions (M&A), nor specific rules for their review, but provides for just a voluntary application or opinion sought instead. Following the 2004 amendments to the Competition Act, M&A may be examined by the Competition Tribunal if, according to an interested party such merger may prevent, restrain or obstruct free competition as established in article 3 of the Act. In other words, while M&A are not *per se* open to objection, the Competition Act considers ways in which the Competition Tribunal may deter or condition harmful M&A.

4. In May 2006 the Chilean Competition Agency, FNE, uploaded a first draft of an Internal Guidelines for the Assessment of Horizontal Mergers on its Website, in order to collect comments from law firms, media, academics and other interested parties. Four months later the FNE released the final version of the Guidelines, whose general standards have been followed by the FNE in concentration investigations ever since. A Spanish version of the text is available at [http://www.fne.cl/?content=guia\\_concentracion](http://www.fne.cl/?content=guia_concentracion).

5. The Guidelines are an internal working tool providing useful information and orientation for firms and interested parties on the main aspects, procedures and methodology applied by the FNE to the inspection of a horizontal merger. It reflects the FNE's understanding that that task aims at weighing up the risks of the consolidated firm carrying out anticompetitive conducts due to the higher market concentration, *vis-à-vis* the M&A's efficiency improvements. The Guidelines focuses on relevant market definition, concentration degree, entrance conditions, risks from the M&A and the expected efficiencies involved therein. The Guidelines are not binding for the TDLC. The FNE is currently reconsidering its text to include recent experiences in its application, changes in the legal framework and new procedural regulations issued by the TDLC.

## 2. Competition, Concentration and Crisis

6. Back in the early 1980 the Chilean economy went through a very serious financial crisis, as a result of which the Central Bank acted as a lender of last resort for a number of major banks, with the ensuing economic costs. One of the outcomes of the process was the thorough amendment to the General Banking Law and regulations to include stern provisions for the safeguard of the stability and solvency of the Chilean banking sector. These provisions, coupled with a highly specialised supervision, have been enforced throughout the nearly three decades elapsed since.

7. This being so, the recent systemic crisis of 2008 brought about no significant consequences on the Chilean banking industry. Indeed, the crisis came to be quite surmountable on the economy as a whole, cushioned as it was by a fiscal structural rule, a sound monetary policy and a favourable and sustained international price of copper - the country's chief tradable good.

## 3. Consolidation in the Chilean Banking System

8. The Chilean banking sector is, and has been for a while, a quite concentrated one, where two large banks of all 25 incumbent ones hold an indisputable dominant position, encompassing nearly 45% of the system's loans. In the last decade before the crisis our banking sector has increased its consolidation or concentration process, as can be seen in the following table.

**Table 1. Chile 1990-2009:  
Number of banks, yearly movements and loan market concentration**

Years	# of entries, exits and M&A			# of banks (as of December)	Concentration in loans	
	Exits	Entries	M&A		HHI	CR4 (%)
1990	1	2	0	36	861	49,29
1991	2	1	0	35	824	46,60
1992	0	2	0	37	822	44,86
1993	3	0	1	34	819	44,91
1994	0	0	0	34	802	44,70
1995	1	0	0	33	772	43,26
1996	1	1	1	33	826	47,75
1997	1	0	1	32	844	54,01
1998	1	2	1	33	848	53,93
1999	3	1	2	31	902	53,14
2000	1	1	0	31	923	51,68
2001	2	0	0	29	943	52,22
2002	4	3	2	28	1.356	66,45
2003	1	1	1	28	1.284	65,04
2004	1	3	1	30	1.294	65,31
2005	1	0	1	29	1.319	66,33
2006	0	0	0	29	1.305	65,95
2007	2	2	0	29	1.292	64,75
2008	2	1	1	28	1.328	66,58
2009	0	0	1	25	1.341	67,64 *

Source: FNE's Research Division, upon Banking Superintendence's data.

(\*) As of October 2009.

9. As shown in the table, there have been a number of M&A in the Chilean banking system both before and throughout the 2008 systemic crisis. Neither of the two latest M&A is to be, nevertheless, mainly linked or ascribed to it.

10. It is frequently said that consolidation in the Chilean banking sector has taken place roughly for the same reasons M&A happen in many comparable markets and which can be summarised as follows:

- To reach economies of scale and of scope. It is well known that some costs decrease notoriously when the volume of operations doubles, while the back-office efficiencies achieved also allow substantial cost savings. As to the economies of scale, operational costs recede when the number, variety and quality of products per customer are improved. As a result, a big bank's profitability largely exceeds that of a small bank.
- To attain an optimum operational scale. The banking business requires an optimal level of investment in technology and a critical mass of customers, below which some projects cannot be carried forward. The investment level has a perverse side as well, in the sense that banking firms with excess capacity have a tendency to merge, so to avoid, among other reasons, pressures on their margins. Both aspects of the operational scale encourage M&A in the Chilean banking sector.
- To secure a larger market share for the resulting firm.

11. Additionally, M&A in the Chilean banking industry often take on traits or reasons peculiar to the country. Chile has a sound, profitable, well-regulated financial market, which entices overseas investment groups to come in for joint ventures and/or to make use of our market as a springboard to enter the remaining South American region. Conversely, local holdings use to look for foreign partners to bring in fresh equity at a lower capital cost, which in turn makes growth easier by means of a lesser lending rate. That increase in our banks' capital also allows them to cope with the Basle and other regulatory requirements, and particularly to come along with the Chilean corporations investing and dealing abroad.

12. Now, because of the small relative size of the Chilean banking sector and the high economic and technical standards demanded to banks by their regulator, it is faster and easier for locals and foreigners alike to purchase market participation rather than reach it through sheer commercial growth. So did, for instance, Scotiabank and Rabobank. Foreign banks (the HSBC, for instance) have been known to stand by for as long as necessary for the opportunity to purchase an incumbent firm in the industry. As it happens, there are large, precise monetary figures ascribed to every basis point of market share in our financial market.

#### **4. Some Banking Cases Reviewed by Competition Authorities**

##### ***4.1 Case 1: Merger of Banco Santiago and Banco Santander, CR Ruling N° 639, 2002***

13. *Key facts:* In 1999 a merger of two banks - Santander and Central Hispano - into the Banco Santander Central Hispano (BSCH) was announced in Spain. Now each merging party had a stake in a bank operating in Chile, namely, Santander-Chile and Santiago, the common control of which would command a 30% market share in Chile. In April 2000 the Competition Agency requested the Resolutive Commission <sup>1</sup> the issuance of regulations aiming at precluding anticompetitive effects of that control, and eventual merging.

14. *Trial outcome:* In January 2002 the Resolutive Commission ruled the allegations out, sustaining that the BSCH's control over Santiago and Santander-Chile entailed no competition risks for the industry. The key element of the decision was that no evidence was gathered that the operation of two banks under a

---

<sup>1</sup> A quasi-judicial body with adjudicative powers that preceded the current Competition Tribunal.

common control result in anticompetitive conducts. Concerns emerged about possible abuses upon small and medium size firms and individual customers; they were deemed, though, not crucial enough as to justify objecting the concentration, but only to advise the banking regulator to oversee those banks' behaviour towards these customers. At the same time, the Banking Superintendence stated the prerequisites it would demand to authorize future M&A in the sector.

#### **4.2 Case 2: Competition Court's Decision N° 15 / 2005**

15. *Key facts:* The Consumers and Customers' National Association presented charges against the Banking Association, contending that banks did not pass lower interest on to borrowers; and that the information provided was too scant and misleading for borrowers to be certain of the loan rate effectively charged.

16. *Trial outcome:* Allegations were overruled by the Court on the grounds that the evidence put forward was insufficient, and that the case had financial risk and monetary policy lags to be taken into account. Shortly after the filing of the charges (2002), the Banking Superintendence regulated the conditions and figures that banks were to disclose from then on to borrowers.

#### **4.3 Case 3: Agency's Investigation on Banco de Chile / Citybank Association (2007)**

17. *Key facts:* In September 2007 the Chilean conglomerate Quiñenco agreed with Citibank Inc. the joint control of the former's holding LQFI, which in turn controlled the Banco de Chile. The Competition Agency initiated an investigation to evaluate the risk that the strategic association might entail, and concluded that it gave no good reason for filing a complaint before the Competition Court.

18. *Key elements of the decision:* Following its Internal Guidelines of Investigative Proceedings, the FNE analysed every item included there: definition of relevant markets (different products, geographic) and of entry conditions to each of them; concentration and thresholds, types of entry barriers, sunk costs, opportunity and sufficiency of entry, and strategic behaviour. None of them involved a real threat to competition in this case, hence the investigation was filed

### **5. Issues in Banking from a Competition Point of View**

19. From a competition perspective, there are specific issues to be addressed in the Chilean retail banking industry, such as:

- Information asymmetries, mainly regarding consumption and mortgage loans and operations and products for the Small and Medium Size Enterprises (SMEs);
- High switching costs and guarantees for the average customer, including SMEs;
- The definition of relevant markets, which amounts to determine the substitution degree among different banking products, schemes, operations;
- The design of industry-specific concentration measures. Interest rates and commissions charged appear to be fit in this regard;
- Network externalities (e-banking, on-line cashiers, databases, among other) and the sluggishness at passing them on to the average customer;
- Unilateral modifications of contractual terms;
- Tying and bundling of different product and services.