

Competition Policy and Financial Market Integration

Summary: Competitiveness of European financial markets and institutions is a key Single Market goal. This was recently reinforced by Barroso's refocus on the Lisbon Strategy, where financial services was recognised as an as yet incomplete area of the Single Market. The refocus acknowledges the importance of overcoming the EU's financial markets segmentation and granting business and consumers direct access to cross-border financial institutions. The Commission concluded that financial services integration warrants further attention and a fresh approach incorporating new instruments beyond further regulation. The Commission recognised that competition policy can make a significant additional contribution in this area.

Background

Use of competition policy to further financial services integration opportunities should be viewed in the context of the overall integration effort. The introduction of the euro and the opportunity to equip the EU with a modern financial apparatus in which the cost of capital and financial intermediation are kept to a minimum, thereby raising the competitiveness of the single market for financial services and by extension the competitiveness of the European Union, are two key elements.

The quest for increased competitiveness was significantly boosted in 1999 with the launch of the Financial Services Action Plan (FSAP), which set out a clear set of tasks and a timetable for promoting the single market for financial services. The FSAP was widely acclaimed as a success in terms of process, though the implementation of many legislative and other measures has yet to deliver the full effect. The huge progress towards an integrated market in the wholesale area, supported by the introduction of the euro, is clear. We need to recognise: (a) even-handedness in implementation is critical to ensuring fair competition; (b) while regulatory authorities naturally prefer differentiated markets applying the same rules for global competition, it is fundamental to preserve market differentiation to enable "like to compete with like".

The Commission recently issued a Green Paper on Financial Services Policy priorities 2005–10, setting out further aspirations to promote the integration process, though acknowledging the need for a "regulatory pause" and for consolidation of the final measures via implementation and enforcement at national level.

Competition Policy and Financial Services – Instruments and Practice

Commissioner Kroes drew the inspiration for her policy priorities from the refocused Lisbon Agenda. It is also important to pay attention to her desire to review sectors where competition is not optimal yet. The financial services sector is tagged for such reviews, probably focusing on retail banking and business insurance, which further highlights its significance to the EU's overall competitiveness. The Commission's decision to launch the reviews is imminent.

The EC anti-trust provisions cover all forms of cooperation between undertakings, and include the review of mergers ('concentrations') under the EC Merger Regulation, provided certain turnover thresholds are exceeded. The Commission decides if the merging parties would significantly impede effective competition, in particular via creation or strengthening a dominant position, and depending on this decision remedies can be offered. The Commission has no sole jurisdiction to review mergers of financial institutions, and authority for reviewing prudential safety and soundness concerns is reserved for financial supervisory authorities. The Commission also has the power to investigate non-merger related anti-competitive practices under Art. 81 and 82 of the Treaty of Rome. In the field of financial services, however, certain market cooperation or concentration practices require a differentiated approach.

Competition policy also covers public authorities via state aid policy. In the financial sector, illegal state aid investigations can arise to prevent a banking crisis, or by public support in ownership or structure.

Following anti-trust and merger control reforms, the enforcement of EC competition rules is now shared between the Commission, national authorities and courts. National competition authorities exercise jurisdiction over concentrations falling below the thresholds for DG Competition review, and have the right to investigate other anti-competitive practices within their jurisdictions.

Under the so-called “modernisation” reforms, national competition authorities may directly apply the anti-trust provisions of the Treaty when agreements, decisions or practices under consideration affect trade between Member States. The notification system for obtaining prior clearance by the Commission services regarding proposed agreements between market participants was abolished with the introduction of the new enforcement rules. However, it is too early to assess how this new framework will affect the application of competition law across the EU.

Competition Policy and Financial Services – Forward Agenda

The Commission’s Competition and Internal Market services are cooperating closely on financial sector competition issues, for example the review and monitoring of cross-border mergers. The consolidation process has slowed down following a period of intense activity in the late 1990s, which was largely confined to consolidations on a domestic level. Interest has shifted away from the domestic to the European dimension, but the relatively small numbers of cross-border mergers and acquisitions points to structural barriers to cross-border merger and acquisition activities.

DG Markt is asking for comments on a series of barriers to cross-border mergers and acquisitions which have been brought to their attention, ranging from tax, legal, accounting and reporting problems, to cultural, prudential, supervisory and political issues. The Commission will then prepare a report for the Ecofin meeting in September, putting possible solutions to the perceived obstacles, whether political, regulatory, distortions caused by state aid or private barriers. Obstacles identified as serious barriers to cross-border mergers and acquisitions will by their nature either threaten the feasibility of a possible consolidation or impair its efficiency by preventing it from attaining the desired synergies and cost savings.

Mergers and acquisitions can be seen as a sensible way to build economies of scale, leading to better efficiencies. The major focus for financial sector mergers has traditionally been cost reduction. However, synergies and savings have been more readily available in the domestic context. More recently there is evidence that management and investors have been more prepared to consider value creation factors rather than merely cost reduction factors as benefits of cross-border consolidation.

Financial sector consolidation is not an end in itself, but a means to promote efficiency, to introduce new technology and management skills. Also, it is only one, and not the only, way to improve price, quality and variety of products.

The Global Context

The debate on continued integration can easily turn inward looking, but this would overlook that the competitiveness challenge for financial services is set in a global context, thus requiring a wider perspective.

There is significant consolidation activity taking place from Europe to the Americas to Asia in the banking area, where size and scale matter more than ever before. The global consolidation trend is driven by banking crises, excess capital build up from high returns on equity; economies of scale and efficiencies and maintaining competitive position in the wake of similar moves by competitors. The US consolidation process illustrates that large scale consolidation is a multi-year, multi-transaction process. In all four cases of the largest consolidated banks, it took over ten years and the combination of numerous banks, some of which were thought of early on as consolidators themselves. Hence, while there may be a competitiveness issue for those European banks wishing to compete effectively for banking assets in emerging markets, a sudden wave of consolidation is unlikely.

However, there are also potential disadvantages to scale such as over-complexity and being less nimble, which could leave global giants at a competitive disadvantage in local markets vs. local banks. There may be an opportunity for the smaller domestic players to become more focused, and compete more on service levels than on price, leveraging their distribution reach, local management talent, superior knowledge of local markets and companies, and commitment to the local economy. In short, competitiveness may be achieved through a variety of means and models in the market place.

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

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