COMPETITION ISSUES
IN
BANKING SECTOR

PRESENTATION

BY

COMPETITION COMMISSION OF INDIA (CCI)
www.competitioncommission.gov.in

ORGANISATION OF THE PRESENTATION

1. Competition Act, 2002
2. Competition Issues in Banking Sector – OECD, ICN
3. Some Competition Cases in Banking Sector
4. Competition In Indian Banking – Some Observations

DUTIES OF COMPETITION COMMISSION

Competition Act,2002 notified in Gazette in January, 2003. Preamble's stated objective is to establish the Commission to

- Eliminate practices having adverse effect on competition;
- Promote and sustain competition
- Protect consumers' interests
- Ensure freedom of trade carried on by other participants in markets, in India

[Section 18]

MAIN FEATURES OF COMPETITION ACT

With the above objective, the Act:

- Prohibits Anticompetitive Agreements.
- Prohibits Abuse of Dominant Position.
- Provides for Regulation of Combinations, and
- Enjoins Competition Advocacy

[Sections 3, 4, 5, 6 and 49(3)]

ANTICOMPETITIVE AGREEMENTS - 1

- **Horizontal Agreements, including cartels**

Four types <u>presumed</u> to have appreciable adverse effect on competition

Price fixing
Bid rigging
Quantity limiting
Market sharing

- **Exempt from Sec 3 (3) efficiency enhancing Joint Ventures**

ANTICOMPETITIVE AGREEMENTS - 2

- **Based on 'rule of reason'**

  > Other horizontal agreements; and

  > Vertical Agreements
  - **Tie in**
  - **Refusal to deal**
  - **Exclusive supply arrangement**
  - **Exclusive distribution arrangement**
  - **Resale price maintenance**

Exempt from Sec 3
- **Exports**
- **IPRs**

ABUSE OF DOMINANCE - 1

- **Dominance,** ***determined, inter alia, by:***

  - Market share

  - Share of competitors

  - Entry barriers

  - Size and resources of enterprises and competitors

- **Abuse of dominance**

  > Exclusionary

  Predatory pricing, denying market access, use dominance in one market to enter another market

  > Exploitative

  Discriminatory price/condition

ABUSE OF DOMINANCE - 2

- Dominance is position of strength enjoyed by an enterprise in the **relevant market** which enables it to:
  - Operate independently of competitive forces prevailing in relevant market or
  - Affect its competitors or consumers or the **relevant market** in its favour
- Ability to prevent effective competition ***and***
- Ability to behave independently of two sets of market actors, namely:
  - Competitors
  - Consumers

ABUSE OF DOMINANCE - 3

Dominant position linked to a host of factors

- Market share of enterprise
- Size and resources of enterprise
- Size and importance of competitors
- Commercial advantage of enterprise over competitors
- Vertical integration
- Dependence of consumers
- Dominant position as a result of a statue
- Entry barriers
- Countervailing buying power
- Market structure and size of market
- Social obligations and costs
- Contribution to economic development
- Any other factor

ABUSE OF DOMINANCE - 4

- Imposing unfair or discriminatory price or condition in purchase or sale, including predatory pricing
- Limiting production or scientific development to the prejudice of consumers
- Denial of market access in any manner
- Conclusion of contract subject to supplementary obligations
- Use of position in one relevant market to enter into or protect other relevant market

Appreciable adverse effect on competition need not be proved

REDEMIES

FOR ANTICOMPETITIVE AGREEMENTS AND ABUSE OF DOMINANCE

- Cease and desist
- Imposition of penalties
- Award of compensation/damages
- Structural remedies including ‘division of dominant enterprise
- Such other order as may be deemed appropriate by Commission

COMBINATIONS -1

- Combination covers
  - **Merger & Amalgamation**
  - **Acquisition**
  - **Acquiring control**

- Any combination which causes or is likely to cause appreciable adverse effect on competition (AAEC) is void

- **However, under Sec 6 (4) the share subscription or financing facility or any acquisition, *inter alia*, by a bank pursuant to any loan or investment agreement enjoys exemption from the rigours of combination provision**

- **The concerned bank is, however, required to make disclosure to CCI within 7 days**

COMBINATIONS -2

- While Agreements and abuse of dominance are prohibited, combinations are regulated
- Indian Combination regulation liberal
- High threshold limits

If combining parties are in India:

- **Combining parties' assets in India > Rs 1000 cr or turnover > Rs 3000 cr**
- **If combining parties are a group, assets in India > Rs 4000 cr or turnover > Rs 12000 cr**

If any of the combining parties are outside India:

- **Assets in India and outside India > US$ 500 m or turnover > US$ 1500 m**
- If any of the combining parties belong to a group and any one of them is outside India, assets > US$ 2 b or turnover > US$ 6 b

COMBINATIONS -3

Remedies: -

- Commission can
  - Approve
  - Approve with modifications
  - Not approve
- If no order within 90 days, the combination is deemed to have been approved
- Structural as well as behavioural remedies

APPRECIABLE ADVERSE EFFECT ON COMPETITON (AAEC) - 1

- AAEC has to be determined in the relevant market (Product and Geographic)

- Factors to be considered to determine AAEC in Relevant Market in Combinations:

  - Actual and potential competition through imports-imports/trade agreements
  - Entry barriers- sunk cost/technological lead
  - Concentration level - CR, HHI
  - Countervailing power
  - Likelihood of increase in prices or profit margins
  - Effective competition after combination
  - Substitutes – actual or potential

APPRECIABLE ADVERSE EFFECT ON COMPETITON (AAEC) - 2

- Factors to be considered to determine AAEC in the Relevant Market: (Contd.)
  - Share
  - Removal of vigorous and effective competitor or competitors in the market
  - Extent of vertical integration
  - Failing business
  - Nature and extent of innovation
  - Contribution to economic development
  - Whether benefits outweigh the adverse impact
- Similar factors for AAEC in case of ACA and AoD

Competition Advocacy

- **With Government/Regulators**, to promote pro-competition policies, laws, regulations
- Competition principles interface with policies relating to: disinvestment, concessions, industrial policy, international agreements, entry/exit policies etc.
- **Public awareness**: with industry, trade associations etc. to strengthen competition culture and improve compliance
- Under Sec 49 Central Government may make references to the CCI on competition policy and law issues.
- CCI is required to give opinion in 60 days. CCI opinion advisory
- Under Sec 21 statutory authorities may make references to CCI on competition issues. CCI opinion advisory
- RBI as regulator can also make a reference for an Inquiry (Sec. 19)

COVERAGE OF THE ACT

- Public sector enterprises and Government Departments covered (in CA, 2002), except when engaged in discharge of sovereign functions (Currency, Atomic energy, Space and Defence)
- Extra-territoriality
- Provision to enter into MOUs with foreign competition authorities

RELEVANT MARKET - 1

- **Dominance Is In The Context Of Relevant Market**
  - Relevant product market; and
  - Relevant geographical market
- Relevant Product Market is the smallest set of close substitutes
- Factors to be considered while determining relevant product market:
  - **Physical characteristic of product/service**
  - **End-use of product/service**
  - **Price**
  - **Consumer preference – empirical evidence**
  - **Classification of products – NIC**
- SSNIP test

RELEVANT MARKET - 2

‘Relevant Geographic Market’: Factors -

- Regulatory trade barriers’
- Local specification requirements
- National procurement policies
- Adequate distribution facilities
- Transport costs
- Language
- Consumer preferences
- Need for secure or regular supplies or rapid after-sales services

COMPETITION ISSUES IN BANKING SECTOR

- COMPETITION AND REGULATION
- ISSUES IDENTIFIED BY OECD
- ISSUES IDENTIFIED BY INTERNATIONAL COMPETITION NETWORK (ICN)
- INDIAN SCENARIO

COMPETITION AND REGULATION - 1

- **Competition enhances efficiency and consumer welfare**
- **Where competition does not/cannot exist, regulation is required. For example, in natural monopolies and network industries**
- **In banking regulation is required due to its special features, necessitating prudential norms**
- **To the extent feasible all regulation should be competition based/driven**

COMPETITION AND REGULATION - 2

ICN study concludes that:

- Some problems necessitate regulatory intervention, such as:
  - protection of small depositors
  - proper regulation of bank settlements
  - mandatory information disclosures
  - risk adjusted stability concerns
- For the rest, the banking sector can be subjected to competition law
- Switching costs increase market power and need to be addressed

COMPETITION AND REGULATION - 3

- **There is need for separation between enforcement of 'prudential regulation' and of 'general competition rules'**
- **Competition authorities should build good working relations with regulatory authorities and coordinate their efforts in reviewing particular matters**
- **Apply in enforcement the usual rules of anti-trust analysis , including market definition, market power/dominance, remedies**
- Information sharing in the financial sector should not be allowed to lead to restrictions on competition
- Reduction in switching costs by depositors, for example by asking for disclosure rules (cost associated with closing of an account or paying off a mortgage)

COMPETITION ISSUES
IN BANKING SECTOR (OECD) -1

OECD has indicated a number of competition issues in banking

I. Multi-market contacts: banks that compete in many markets recognize the need to co-exist rather than compete

II. Barriers to entry: Contestable markets are highly competitive. However, entry restrictions exist in the form of:

> Regulatory barriers: minimum capital requirements (above Basel norms ?); restraints on lines of business; licensing of branches or subsidiaries; restrictions on entry of foreign banks etc.

> Substantial state ownership of banks would mean that foreign firms cannot take over domestic banks of any substance

> Exit barriers in the form of measures to prevent bank insolvencies, especially the 'too big to fail' factor

COMPETITION ISSUES
IN BANKING SECTOR (OECD) - 2

- ➢ Access to competitor's proprietary ATM networks and to competitor run or dominated credit card networks and cheque clearance system. Electronic networks can be a barrier entry
- ➢ Access to the networks on fair and reasonable terms is important in facilitating entry and in ensuring fair competition. Incumbent banks may not allow the network access easily

- **Economies of scale and scope and branch networks:** Bank's market access depends on the network of branches it has and its nation or world wide presence

COMPETITION ISSUES
IN BANKING SECTOR (OECD) - 3

- **Switching costs and asymmetric information:** Banks provide long and short term credits to customers, some of which can be called back at short notice, with discretion by the bank. When a customer shifts to another bank for a new service the first bank can make matters difficult for the customer.
  - Customers may find it difficult to transfer their accounts of different types from one bank to another. There are substantial switching costs
  - Incumbent banks have several reputational and informational advantages over the new entrant. Incumbents may not share credit risks with new entrants

COMPETITION ISSUES
IN BANKING SECTOR (OECD) - 4

- Efficiencies: Especially in merger cases efficiencies arise. One example is that by closing redundant branches. However, from competition policy point of view this may be at the cost of competition in the relevant geographic market.
- Remedies: Mergers that might initially be prohibited will eventually be permitted subject to certain conditions, which would ensure competition in the markets (Behavioural and Structural)
  - Obtain commitments to restrain the exercise of market power
  - Obtain commitments to indirectly facilitate new entry or strengthen existing competitors
  - Require steps intended to directly transfer market share i.e. divest part of business – usually branches or lines of activities

COMPETITION ISSUES
IN BANK MERGERS (OECD) -1

Another OECD document on competition issues in bank mergers indicate that:

- The impact of electronic banking developments on proper market definition and assessment of barriers to entry must be carefully considered in bank merger cases;
- Competition problems in bank mergers are most commonly encountered as regards loans to small and medium sized businesses;
- Barriers to entry in banking could well be high enough to prevent a sufficiently rapid neutralization of any anti-competitive effects that may be expected from bank mergers in sufficiently concentrated markets.

COMPETITION ISSUES
IN BANK MERGERS (OECD) - 2

- Efficiencies could be relevant in bank mergers, but competition officials should be skeptical of claims linked to supposed economies of scale especially in dealing with mergers where all the parties are sufficiently large that each has probably exhausted virtually all available economies of scale;

- When faced with anti-competitive bank mergers, competition agencies should consider proposals to make appropriate changes in the transaction, but should generally avoid “remedies” requiring ongoing monitoring and enforcement;

COMPETITION ISSUES
IN BANK MERGERS (OECD) - 3

- There is little inherent potential for conflict between competition agencies and prudential regulators; and
- The general competition law should be applied to bank mergers by the general competition agency. It is also essential to foster co-ordination and co-operation between prudential regulators and competition agencies.

COMPETITITON ISSUES IN BANKING SECTOR (ICN) - 1

International Competition Network (ICN) has observed the following (not covered by OECD)

- **Restrictions on the portfolio of assets that banks can hold** (such as requirements to hold certain types of securities or requirements and/or not to hold other securities, including requirements not to hold the control of non financial companies);
- **Compulsory deposit insurance**
- **Requirements to direct credit to favoured sectors or enterprises (in the form of either formal rules, or informal government pressure);**

COMPETITON ISSUES IN BANKING SECTOR (ICN) - 2

- Expectations that, in the event of difficulty, banks will receive assistance in the form of "lender of last resort";
- Special rules concerning mergers (not always subject to a competition standard) or failing banks (e.g., liquidation, winding up, insolvency, composition or analogous proceedings in the banking sector);
- Other rules affecting cooperation within the banking sector (e.g., with respect to payment systems)

COMPETITION ISSUES IN BANKING SECTOR (CASES) - 1

Agreements and Cartels

Horizontal agreements

1. Coordinated actions by Association of Italian Banks (ABI)
2. Horizontal agreement among credit card marketing systems investigated by Federal Competition Commission (FCC) of Mexico
3. Concerted action in weekly auction of treasury bills investigated by FCC

Vertical agreements

1. *Tie in arrangement*

COMPETITION ISSUES IN BANKING SECTOR (CASES) - 2

Abuse of Dominance

1. American Express Vs Visa International in Mexico

Mergers

1. Acquisition by Bank Austria of Creditanstalt Bankverein in 1997. Subsidiary of Bank Austria in Hungary approached Office of Economic Competition (OEC), Hungary for clearance since both the banks had subsidiaries in Hungary
2. Merger of Banco Union and Grupo Financiero Cremi in Mexico
3. Merger of First Union and CoreStates in US in 1997

COMPETITION ACT, 2002 & BANKING SECTOR

- **Competition Act covers all sectors, including banking and other financial sector activities**
- **CCI is competent to inquire into agreements – both horizontal and vertical - among banks; abuse of dominant position and mergers between banks above the prescribed thresholds**
- **Being the regulator RBI may make reference to CCI for opinion any issue suspected to have competition angle, including agreements, abuse of dominant position and combinations (Sec 21)**
- **CCI can *suo motu* inquire into such anti-competitive practices**
- **The share subscription or financing facility or any acquisition, *inter alia*, by banks, FIIs, VCFs and PFIs pursuant to any loan or investment agreement does not, however, require scrutiny from competition angle**
- **The concerned bank is, however, required to make disclosure to CCI within 7 days of acquisition of shares /control**

INDIAN BANKING: SOME OBSERVATIONS - 1

Banking sector has seen considerable liberalization, since 1991: Narasimham Committees I and II

However,

- Public sector banks account for 75 % market share (deposits)
- Interest on savings deposit accounts (3.5 % based on recommendation by IBA), NRI deposits, small loans upto Rs. 2 lakhs, farmers' credit upto Rs. 3 lakh and export credit regulated
- Limited new private sector entrants in recent years

INDIAN BANKING: SOME OBSERVATIONS - 2

- Factors creating distortions in market
  - Continued heavy investment in government securities: lazy banking
  - Directed credit and cross subsidization
  - Traces of financial repression
  - Entry barriers:
    - > Branch licensing
    - > Foreign banks
    - > ATMs
    - > Locational restrictions

INDIAN BANKING: SOME OBSERVATIONS - 3

– Treatment of private and public sector
– Treatment of foreign banks
– Continued predominance of the public sector
– Deposit insurance unrelated to risk, administered by single agency directly under the regulator
– Regulator and supervisor of the sector being same

THANK YOU