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Competition Policy in the Financial Sector in Latin America Mexico's Contribution

1. The regulatory framework for the banking sector

1.1 Sectoral regulation and regulators

The legal framework for the banking industry in Mexico is determined by the following laws: the 1990 Law for Credit Institutions (LIC) and the 1990 Law Regulating Financial Groups (LRAF). Their purpose is to regulate the organization and operation of credit institutions and any activities that they might develop, as well as to ensure their healthy and balanced development while safeguarding the public's interests. Other rules governing the operations of financial entities are the Circulars of Banco de México (BM) and those of the National Banking and Exchange Commission (CNBV).

Seven agencies are in charge of regulating financial services, five of these overseeing the banking sector: the Ministry of Finance (SHCP), BM, CNBV, the Institute for the Protection of Bank Savings (IPAB), and National Commission for the Defense of Financial Services Users (CONDUSEF). The first three regulate banking services; the fourth protects savings in banks and manages financial recovery programs; the fifth defends the rights of financial services users but has no regulatory powers. The relationship between the first three regulators can be broadly characterized as follows: SHCP is in charge of designing the rules that apply to the banking system, BM must make these rules operational, and CNBV is in charge of supervising their compliance.

1.2 Competition law in the sector

Banks are not exempted from the application of the competition law. According to article 3 of the Federal Law of Economic Competition (LFCE) the law applies to all economic agents, "whether individuals or corporations, agencies or entities of the federal, state or local administration, associations, professional groups, trusts or any other form of participation in economic activities". On the other hand, banking legislation does not establish specific responsibilities for the sectoral regulator to enhance and protect competition, hence, under the current legal framework, competition and banking authorities must act in a coordinated manner.

Regarding mergers, both the LFCE and the LIC establish controls and require prior notification of the transaction. Under article 20 of the LFCE, merging parties must notify concentrations that surpass certain thresholds. Pursuant to article 27 of the LIC, any merger between two or more banking institutions requires approval by SHCP, which must consult with BM and the CNBV. The Federal Competition Commission (CFC or Commission) may require information from financial authorities, but its analysis and resolutions are independent of their decisions and none of the regulators have veto over the other's decisions.

2. Payment card systems¹

2.1 Regulatory framework

Debit cards are associated to a deposit account so that all financial institutions that accept deposits may issue debit cards and face no restrictions in addition to those related with their entry as depositor institutions. This is not the case for credit cards, where banking and non-banking institutions (Sofoles)² may issue credit cards.³ Article 48 in the LIC subjects interest rates, fees, commissions and all other characteristics of credit institutions services to the authority of BM. The 2004 Law of Transparency and Financial Services Restructuring (LTOSF) extended BM's responsibilities to regulate commissions and fees, into promoting transparency and eliminating discriminatory practices.

In credit card issuing services rules are very detailed, a stark contrast with the acquiring side of the market where regulation is basically absent. Regarding competition, BM has jurisdiction to evaluate if there are "...reasonable competition conditions regarding fees and commissions on deposits, loans and other services provided by financial entities..." but must request the opinion of the CFC. Based on the CFC's opinion, BM can take appropriate measures in markets where there is a lack of effective competition, as long as these conditions persist.

2.2 Competition issues and regulatory actions in payment cards

Potential competition issues in payment cards can be grouped into two general areas: price and non-price behavior. Claims of excessive prices for credit cards include the interchange fee (IF), the discount rate, and consumer fees and commissions. In debit cards, high fees such as foreign fees, both for withdrawals and balance inquiries, have also come under criticism. Nevertheless, it is difficult to assess prices in this sector since product differentiation is prevalent in banking services, and there are no benchmarks that summarize multidimensional services into a single price that allows for meaningful comparisons.

One of the key competition issues in payment card systems has been the setting and level of the IF. This fee is charged by issuers to acquiring banks, and represents close to 90% of the discount rate, the fee that acquirers charge merchants, it ultimately impacts final consumers as merchants pass-on this charge through increases in the price of the goods and services that they offer. In Mexico, the Association of Mexican Bankers (ABM) sets the same IF schedule for the two four-party platforms in the country, Visa and MasterCard.

¹ This section draws largely from Mexico's recent contribution to the OECD's Roundtable on Competition and Efficient Usage of Payment Cards. Working Party No. 2 on Competition and Regulation, June 2006. DAF/COMP/WP2/WD(2006)32.

² Sociedades Financieras de Objeto Limitado (Sofoles) are credit institutions that do not take deposits and provide loans for specific purposes. They were recently authorized to provide credit cards for the first time, see Rules 8-III and 17 of the "Reglas generales a que deberán sujetarse las sociedades a que se refiere la fracción IV del artículo 103 de la Ley de Instituciones de Crédito", issued December, 19, 2005, Federal Official Gazette.

³ See article 46-VII of the Law of Credit Institutions or LIC.

Until recently, the schedule was set according to merchant volume of sales but is now set according to the merchant's line of business. The setting of the IF may inhibit competition between platforms, the level of the IF, while no longer discriminating against small merchants, is still a concern as fees are perceived to be unusually high.

Other areas of concern lie in the non-price rules governing card associations, such as the *no surcharge* rule (and/or the *no discount* rule) which prevent merchants from passing on their cost of different payment methods to individual consumers. Additionally, the institutional features of Mexico's financial system may contribute towards increasing entry barriers, especially for non-banks. For example, common infrastructure and auxiliary services (such as switches and the credit bureau), which are central to the entry and growth of an issuer or acquirer, are owned by banks so that non-banking institutions may face an unfavorable playing field when trying to compete with banks. Although recent regulatory changes have sought to ease entry for non-banks, revealed entry continues to be limited among non-banks (Sofoles).

Federal Competition Commission

In 1994, the CFC allowed merchants to offer discounts for cash or other cheaper forms of payment, thus avoiding the cross-subsidization between low cost payment mechanisms toward higher cost mechanisms. Through a 1996 complaint, the Commission also warned agents against imposing a *duality rule* in credit card payments, a rule set by a platform to prevent banks from issuing cards from competing associations.

With the recent congressional approval of reforms to the LFCE, in force since 1993, the CFC will now be able to investigate additional anticompetitive practices, including discrimination in buying and selling conditions, predatory pricing and cross subsidization. The new law will further empower the Commission to issue binding opinions on administrative acts that unduly damage the process of competition and free market access.

Banco de México

BM has sought to increase transparency and efficiency in payment systems by requiring banks to inform the public about their service fees (2004); and by publishing prevailing levels of interchange fees and discount rates (2006). It has sought to promote competition in credit card balance transfers by requiring that banks receive interbank checks and electronic transfers to pay for credit card loans provided by the receiving bank (2005); by allowing merchants to accept only one type of card -debit or credit- or both (a modified *honor all cards* rule); and by opening access to switches, Prosa and e-Global, for non-banks.

Although these actions do not involve direct price regulation, the threat of this type of regulation has induced greater transparency and fee reductions by banks in payment card services. This is the case of the ABM's proposed reduction and change to the IF in 2004, which used to discourage the use of cards at POS by discriminating against small merchants.

3. Cases reviewed by the competition authority

3.1 Selected bank mergers

BBV / Bancomer⁴

On April 2000, Grupo Financiero BBV-Probursa (BBV) and Grupo Financiero Bancomer (Bancomer) submitted a merger notification. At the time of the notification, Bancomer was the second largest financial institution in Mexico, behind Banamex and the merger would make this the largest financial group in the country. In its analysis the CFC evaluated the following markets: banking, investment societies and brokerage houses, insurance and pension funds administrators (Afores). The geographic dimension in all cases was national, although regional-level concentration of bank branches was also evaluated. In its analysis of barriers to entry, the CFC considered that foreign investors could participate in financial institutions through affiliates, and only in the case of Afores were there explicit market share limits.

Since both parties had an ownership stake in telecommunication companies, the CFC also undertook an analysis of these markets and determined that Bancomer participated in long distance and internet access services, while BBV participated in information services through the internet. These activities, the Commission concluded, belonged to different markets. The Commission authorized the concentration subject to the selling of BBVA's ownership titles in *Profuturo GNP Afore* over the course of one year.

Citigroup / Banamex Merger⁵

On June 2001, Citigroup Inc. (Citigroup) and Grupo Financiero Banamex SA de CV (Banacci) submitted a merger notification. This transaction involved one of the largest financial institutions in the world and the second largest Mexican institution; it would create the largest financial group in the country. The CFC assessed the impact of this transaction in the following broadly defined markets: pension funds, consumption financing and auxiliary services for electronic payment processing.

The Commission ordered the divestiture of one pension fund administrator to prevent a single agent from concentrating an excessive market share and to preserve competition in this market. It also ordered Citigroup to divest its share from a Sofol that it jointly owned Grupo Financiero Bancomer, Banacci's main competitor. In auxiliary services for electronic payment processing, the Commission noted that Citigroup and Banacci had an ownership stake in the two switches and, following an appeal, allowed the merged agent to select which technological platform it would retain.

3.2 Selected investigations into payment cards

Investigation of competition conditions in commercial bank credit cards⁶

In 1993, the Commission opened an investigation into competition conditions in the market for commercial bank credit cards, having observed that bank charges to merchants were identical, and that interest charges to cardholders were similar among the largest banks. The case resulted in a signed agreement between the Commission and the three largest banks, and set out three main conditions for banks to fulfill: (1) eliminate any exchange of information with other banks or credit card payment systems that would facilitate price

⁴ File CNT-54-2000.

⁵ Files CNT-99-2001 and RA-46-2001.

⁶ File IO-02-93.

fixing for fees or interest charges, among others, (2) modify merchant contracts allowing them to offer discounts for cash payments while maintaining the no-surcharge rule, (3) comply with all competition laws, rulings and applicable norms.

*Credit cards: foreclosure of new entrants through exclusivities*⁷

In 1996 American Express (Amex) opened a complaint before the CFC alleging that Visa was obstructing its access to the banking distribution channel for the issuing of credit cards. Amex had been attempting to get banks to issue American Express branded cards, and it claimed that Visa had been attempting to reach an exclusivity arrangement requiring its members not sell cards of any network competitor under threat of losing their membership. The Commission imposed cautionary measures and warned Visa about establishing exclusivity conditions until the investigation process ended. Visa informed the CFC that it had not imposed and did not plan to impose exclusivity conditions in the future. Based on Visa's response and Amex's agreement, the Plenum determined to end the investigation prematurely.

*Allegations of price fixing in merchant fees*⁸

In 2003, the Commission investigated possible absolute monopolistic practices (collusive behavior) in credit card acquirer services for supermarket and department stores. The investigation revolved around the two largest participants in this market, Banamex and Bancomer, who hold a sizeable share of this service, and acquire at least 75% of merchants in this line of business.

In its consultations with banks and merchants, the CFC found that both banks charged identical fees, which raised the possibility of price fixing. Nevertheless, the need for more in-depth knowledge and understanding of the market, led to the closing of this investigation. The Plenum instructed instead an extensive study of the payments system.

4. Concluding remarks

Although the background note argues that competition agencies' actions in payment cards is the result of regulatory inaction, this does not accurately reflect the Mexican situation. In this case, regulatory 'inaction' can be viewed as positive considering the lack of information and understanding of the workings of the sector. Furthermore, given that both regulatory authorities as well as leading academic discussion recognize the benefits that arise from cooperation in this sector, it would be imprudent to act unilaterally and in an uncoordinated manner to address competition problems. As a consequence, the CFC and BM have established an informal ad hoc working group that is currently evaluating competition conditions in the credit card payment market.

⁷ File DE-06-96.

⁸ File IO-04-2003.