SUMMARY RECORD OF THE 79th MEETING OF THE COMMITTEE ON COMPETITION LAW AND POLICY HELD ON 5 AND 6 JUNE 2000

-- Executive Summary of the Roundtable Discussion on Mergers in Financial Services --

The attached document is an annex to the Summary Record of the meeting held on 5-6 June 2000. It is circulated to Delegates FOR INFORMATION. Delegates are requested to respond with written comments, if any, by 8 September, after which, the proceedings including this document will be published.

94577

Document complet disponible sur OLIS dans son format d’origine
Complete document available on OLIS in its original format
1. Considering the discussion at the roundtable, the delegate submissions, and the background paper, the following key points emerge:

- In many OECD countries, the last few years have witnessed a substantial increase in the frequency and significance of bank mergers. The increased activity is driven by four interactive forces: regulatory reform; ongoing globalisation in both financial and non-financial markets; excess capacity/financial distress; and technological change including the development of electronic banking.

2. So far, most of the bank mergers have taken place among banks based in the same national market, but there is an increasing incidence of cross-border deals. Among OECD countries, there are few remaining regulatory barriers standing in the way of such take-overs. There may, however, be a number of political obstacles.

3. As the following points illustrate, consideration of bank mergers in OECD countries normally involves the application of economy-wide merger guidelines and practices, tailored to the specifics of the banking industry.

- Typically the first stage of analysis involves a preliminary assessment based on concentration ratios as to whether or not a proposed bank merger is likely to harm competition. This, in turn, requires attention to the definition of the relevant markets. Banks offer a large number of products and services to a number of different classes of customer. The size of the relevant geographic market differs among products and among different customers, and so might the identity of firms serving the different markets.

4. As reflected in various country submissions, market definition is a highly empirical issue that should be addressed by examining consumers’ actual willingness to substitute in response to changes in relative prices. The nature of the relevant market will differ from product to product, customer to customer and country to country.

5. Important differences in geographic markets would be missed if competition agencies insisted on identifying a single product market such as one grouping together all the services traditionally offered by commercial banks. In addition, such a grouping could lead to errors in assigning market shares. The competition provided by firms specialising in mortgages would be ignored, for example, if the market were defined to be a commercial banking cluster.

6. In the case of business lending, loans to small and medium sized enterprises (SMEs) should be distinguished from loans to large businesses. This is due first and foremost to differences in the average size of loans made to the two groups of firms. Enterprises with large financial requirements are much more able to bear the substantial fixed costs associated with borrowing directly from national or even international capital markets as opposed to proceeding through a financial intermediary. It follows that loans to larger businesses may have a wider set of product substitutes than do loans to SMEs.

7. Not only are SMEs more dependent than larger businesses on bank loans, this is also true as regards dependence on local banks. There are three reasons for this. First, larger businesses tend to take out larger loans, hence are more willing to incur the fixed transactions and information costs required to search for and borrow from more distant banks offering more favourable terms. Second, SMEs generally have a greater need for a local depository for cash and cheques. This point acquires greater significance when it is noted that compared with a larger business, an SME’s ability to obtain bank credit on reasonable terms is more likely to be improved by locating its transactions accounts in the same bank it borrows from. Third, again as regards establishing creditworthiness, SMEs find it relatively more important to develop...
and maintain good personal relationships with bank managers/loan officers. This is arguably easier to do when the SME and bank are located close together.

- Low post-merger concentration ratios in appropriately defined antitrust markets usually indicate an absence of significant competition problems, but high concentration levels are inconclusive unless barriers to entry are also high. In considering barriers to entry in banking, particular attention should be paid to the extent to which electronic banking developments have reduced the need for extensive, expensive branch networks and lowered the cost of monitoring.

8. Before the advent of automated teller machines (ATMs), electronic funds transfer at point of sale (EFTPOS), and Internet banking, it was widely believed that barriers to entry in some banking markets were reasonably high because of the need for a network of branch offices. Some commentators hold that electronic banking has greatly reduced the need for branches and simultaneously considerably widened geographic markets. Others maintain that many customers consider electronic access to their accounts and to nearby branches to be complements rather than substitutes.

9. If it turns out that electronic banking is more a complement than a substitute for traditional branch banking, electronic banking may not only fail to lower barriers to entry, it may actually raise them. This is because new entrants will be under competitive pressure to provide the same geographic access to ATM and EFTPOS networks as larger incumbent banks offer. Larger banks may be in a position to charge higher access fees to smaller new entrants than the fees they charge each other.

10. Since SMEs are particularly prone to suffer from anti-competitive bank mergers, it is worth noting that the impact of electronic banking on such clients is not yet clear or uniform. On the one hand, electronic banking should lower the costs of screening potential borrowers and monitoring at a distance, thereby increasing the number of potential lenders to SMEs. Indeed, there is a growing use of computerised credit scoring models in making some types of loans to SMEs. On the other hand, SME’s may find that certain kinds of loans continue to be cheaper and easier to arrange with local as opposed to distant banks. These are the loans for which a lending bank’s credit assessment depends heavily on having the borrower’s transactions account business, and on developing a close personal relationship with the borrower.

11. In the long run, the effect of electronic banking on barriers to entry will depend on more than how such developments impact on the need for local branches. It will also be linked with how standards are developed and with whether banks are permitted to merge or enter joint ventures with significant telecommunications companies and/or Internet players. Both issues are being closely watched in areas where electronic banking is currently most developed.

- Any examination of barriers to entry must include a look at switching costs. These could be quite significant in certain banking markets, especially for households and SMEs.

12. At least three countries presented evidence that many customers are reluctant to switch all or part of their business across different banks. This could be due to the administrative difficulties encountered in altering direct electronic payment arrangements and/or costs of establishing a reputation for creditworthiness. The second point is likely to be much more important for households and SMEs than for larger businesses.

13. In the extreme case where consumers are highly reluctant to switch, bank competition focuses only on new customers or newly-established businesses.
• Where banks hold considerable equity positions in non-financial companies, some bank mergers can lead to a post-merger bank having considerable influence over competing enterprises. This may call for appropriate divestments in bank holdings to be made prior to a merger being approved.

14. The most radical form of this problem arises when a bank merger directly implies a merger among non-financial companies. Traditional merger review would apply in such cases. Less extreme situations include those in which bank shareholdings confer the power to influence rather than control the managements of downstream competing enterprises. Ideally, such problems should be addressed through divestments. A second best solution would be restrictions concerning representation on the governing bodies of affected enterprises.

• As in other sectors, bank mergers might create important efficiencies as well as potential anti-competitive effects. Such efficiency claims should carry little if any weight in a merger review unless they are specific to the merger, and there is good reason to believe the efficiencies will be realised post-merger.

15. Bank mergers posing risks for competition are often justified on the basis of certain efficiency benefits such as economies of scale and scope and/or reductions in risk obtained through loan diversification. Existing research underlines the need for caution in assessing such claims, including in determining whether savings in back office costs may be obtainable through other arrangements less anti-competitive than a proposed merger.

16. Experience has shown that bank mergers are more likely to deliver on claimed efficiencies if the more efficient of the merging banks will be in firm control post-merger, and that enterprise has already been involved in a successful bank acquisition.

• Branch divestiture and behavioural constraints are both used to attenuate the anti-competitive effects associated with some bank mergers. Competition agencies have good reasons for generally preferring divestitures, but these must be carefully executed to ensure that clients rather than merely bricks and mortar are passed on to the purchaser.

17. Behavioural remedies, such as requiring certain terms and conditions to be applied to loans post-merger or obtaining commitments that the management of an acquired bank will enjoy some continued autonomy, are notoriously difficult to monitor and enforce. As a result competition authorities typically prefer some form of divestiture, i.e. a "structural" solution. In banking mergers, however, even the structural approach typically calls for a considerable investment in time and effort by the competition agency.

18. Branch divestitures seek to create new or stronger competition for a merging bank. To achieve that result, a competition agency must be closely involved in choosing exactly which branches are divested and who is permitted to buy them. It should also devote attention to constraining for some transitional period what the merging bank is permitted to do in terms of trying to retain or win back staff or clients associated with the divested branches. Such constraints are particularly relevant in the typical case of divestments being made with the intention of reducing competition problems in local markets. In such situations, customers of the surviving bank may have the option of remaining with that institution by switching to another nearby branch.

19. When the post-merger bank will carry the name of a pre-existing bank, it would be helpful to concentrate any necessary divestment on branches bearing name(s) that will be eliminated by the merger.
• In most countries, bank mergers are subject to review by prudential regulators as well as competition offices. To the extent both agencies act proscriptively rather than prescriptively, there should be little conflict between them. Formal co-operation accords exist in many countries and have played a constructive role in reducing uncertainties associated with multiple agency review.

20. Competition policy and prudential regulation, to the extent that both seek to prohibit undesirable behaviour, are mutually compatible. In particular, as long as both prudential and competition authorities confine themselves to blocking undesired (rather than forcing or requiring) mergers, banks will have no difficulty abiding by both agencies’ merger decisions.

21. As regards certain mergers, prudential regulation and competition policy can be complementary. A prominent example is mergers creating "too big to fail" banks, i.e. banks that are so large that market participants assume the government would take whatever steps might be necessary to preserve their solvency in a crisis. Such banks might be inclined to take what regulators regard as excessive risks. Banks seen by consumers as too big to fail could also give rise to competitive distortions since they may have an artificial advantage in raising funds, especially in markets where deposit insurance is inadequate.

22. There is a limited potential for conflict between prudential and competition policy goals when it comes to mergers designed to shore up a failing or weakened bank. Even in such cases, however, it will normally be possible to avoid competition problems by choosing the right partner, or by structuring the merger so as to minimise its effects on local market concentration. In any case, conflict between prudential and competition policy goals can be reduced by close co-operation, including prior consultation between the pertinent agencies.