

COMPETITION AUTHORITY



Summary of the Submissions on the Banking Study Terms of Reference

Date:

5 November 2002

1 INTRODUCTION

The Competition Authority proposes to carry out, under Section 30(1)(a) of the Competition Act 2002 ('the Act'), a study of competition in the provision of banking services in the State. On September 13, 2002 the Authority published a preliminary consultation document that outlined, and sought feedback on, the Authority's draft terms of reference for a study of the Irish banking sector. It was suggested that respondents answer a series of questions that the Authority raised, though they were not confined in terms of raising other issues. This document provides a brief summary of the substantive issues raised in the submissions.

There were 15 submissions in all, including submissions from firms in the industry, industry organisations, financial sector employee unions, public bodies, consumer organisations and private individuals. The Central Bank and Irish Financial Services Regulatory Authority kindly offered to provide assistance to the Authority in conducting the study. The Department of Finance referred the Authority to a number of competition issues that were raised in the submissions it received in relation to a consultation on the Central Bank and Financial Services Authority of Ireland (No. 2) Bill 2002.

2 QUESTIONS AND RESPONSES

Question 1: Do you think that the range of markets in which the clearing banks operate (e.g. loans, savings, current accounts, money transmission, etc.) is wide enough to include all retail banking markets where there are potentially competition problems?

A number of submissions agreed with the range of markets, but it is worth noting that three submissions questioned the choice of markets in the proposed terms of reference. One submission stated that "Banking" needs to be defined having regard for the range of institutions offering savings and personal investment products. According to them the implication was that the following markets would not to be included in the study:

-
- Bancassurances, stock broking and those offering equity based products; and
 - The non-clearing banks and other credit institutions such as An Post, the Credit Unions, the former building societies, credit card companies and organisations like Fexco that compete with banks for foreign exchange and stock broking.

They also suggested that a distinction be drawn between personal and business/SME customers and that concession groups such as students or Pay Path Senior Citizens be isolated.

Another submission was of a similar view. It suggested that the Terms of Reference should include all retail financial services providers in a particular market. It was believed that limiting the scope of the study to clearing banks would exclude An Post, Credit Unions and other domestic and international banks (127 of which have notified their intention the Central bank of their intention to take deposits on a cross-border basis) that are direct competitors of the clearing banks.

Another submission queried whether the terms of reference were enough to include all retail banking markets. It suggested the including the market for the provision of credit card services, overdraft facilities, invoice discounting, hire purchasing, leasing, bonds and guarantees, foreign exchange and all payment services.

Furthermore, some submissions asked for clarification either on the meaning of investment banking or on why investment banking is excluded from the study.

Discussion:

The study will follow a typical competition analysis. Markets in which the clearing banks operate will be identified and the degree to which they face competition will be assessed. Of course, it will only b markets where there are prima facia competition concerns that will be subject to any detailed analysis.

The final terms of reference state that the “ ... scope of the study will be wide enough to include any of the markets in which the clearing banks operate.” Thus, to the extent that other credit institutions (e.g. the Credit Unions, An Post and the other credit institutions mentioned above) operate in the same markets as the clearing banks, they

will fall within the scope of the study. The terms of reference also state that “ ... the study will examine market structure and identify relevant sub-markets.” It is at this stage the concession groups and other groups will be distinguished.

It is widely accepted that market for investment banking services is international in nature and highly competitive. Similarly, there is no general feeling that the relevant market for large firms would be limited to Ireland alone. The Authority therefore decided to exclude sectors such as these from the scope of the study.

Question 2: Do you think that analysing the state of competition in a market from the perspective of barriers to entry and the degree of rivalry is the appropriate approach?

Overall, the submissions addressing this question agreed that the approach was the appropriate one. However, a number of remarks were made:

- The concept of rivalry should be applied to attributes other than price such as quality, service levels, customer relations and convenience;
- One submission highlighted that benchmarking the profitability of the Irish Banks against comparable overseas competitors would help to ascertain “the true level of competition and the reasonableness of bank profits in the Irish market”.

Response:

The Authority agrees that rivalry occurs through mechanisms other than price and intends to investigate these during the course of the study. The concept of rivalry extends to all characteristics that might make one institution more attractive to consumers than another.

The Authority intends to draw on international experience of banking to assist its competition analysis. This is likely to include comparisons of profitability, which

though problematic to compare on a fair basis, can be indicative of competition concerns.

Question 3: When examining barriers to entry, do you think that the Public-Private-Exogenous taxonomy is useful? Do you think that this approach fails to cover any barrier or class of barriers to entry?

Overall, the submissions addressing this question agreed with the proposed taxonomy. One of them stressed the role of ownership and control of payments systems via (IPSO). It was also suggested that industry associations (IBF, IMSA IFHA) as well as the Irish Credit Bureau have a role in imposing barriers to entry.

In addition, one submission suggested that a further distinction be drawn between:

- The requirements imposed by application of EU Directives or Regulations over which the Irish Government has no control; and
- The matters that fall within the competence of the Irish Government.

Response:

The Authority also regards this further taxonomy of public barriers to entry useful and intends to make use of it in the course of the study. The source of any particular entry barrier will guide any recommendations for change. Issues that come within the competence of the Irish Government will be particularly highlighted due to the ability to make changes that ensure competition delivers increased benefits for consumers.

Question 4: Do you think that the proposed approach towards the analysis of rivalry in banking markets is appropriate?

One submission expressed that it would like to see more detail on the methodology for appraising rivalry. Another one suggested that the study should provide the opportunity

to investigate the extent to which bank policies are resulting in financial exclusion and to what extent consumers experience difficulties in opening accounts. In addition, a number of comments were made:

- That regard should be given to the size of the Irish market and the potential for new entrants to achieve economies of scale. One submission pointed out that the “interplay between the loss leaders, such as Money Transmission Services, the effects of price control and the entry of niche players in key markets should be examined”.
- That there is little inter-channel competition in the Irish banking market. The existence of cross-subsidisation across channel and product groups was also mentioned.
- It was pointed out that in November 1995, The Competition Authority dealt with the Clearing Rules and the General Principles for participation in the Clearing Systems and concluded that “the arrangements regarding the operation of the Payment Clearing System are not anti-competitive”. It added that since then, the rule for membership of the Clearing companies have been approved by the Central Banks as Regulator of Payment Systems pursuant the Central Bank Act 1997.
- The proposed approach should be extended to examine the “importance or otherwise of allowing one or both of the major bank groups in Ireland to be taken over by a larger European bank group”. The operation of the clearing system should receive attention in terms of the value dating practice.
- The lack of development of Independent Financial Advisor network in Ireland.

Response:

The standard approach toward the analysis of competition in any sector is to define the relevant antitrust markets and to assess the state of competition therein from the perspective of barriers to entry and rivalry. In the analysis of rivalry a number of factors will be examined including price rivalry, the pace of innovation, and the degree of market segmentation. This is the standard methodology that is employed in the

examination of rivalry. As the study progresses more detail on this will emerge and the public will be given an opportunity to make comments at an appropriate stage.

All Authority decisions under the old notification regime were made on the basis of the facts in the Authority's possession at that time. The Authority maintained the power under the previous legislation to revoke Certificates or Licences, however as of July 1, 2002 all individual Certificates and Licences stood revoked as of that date.

The study is looking at the retail banking sector as it is currently constituted and, as such, there can be no extension of the terms of reference to include future potential events such as take-overs etc.

Question 5: Apart from switching costs and information difficulties, what other factors might explain consumer inertia? Please provide details, indicating in particular whether the source of consumer inertia is banks' behaviour, some legislative provision or otherwise.

One submission stated that the study should firstly determine if consumer inertia exists at all. Another submission provided a list of factors contributing to consumer inertia:

- Practical obstacles to switching imposed by the banks in relation to direct debits, standing orders;
- Inability to operate direct debit from deposit account;
- Interlocking of various banking facilities through the imposition of the bank cross security requirements;
- Unwillingness of certain banks to facilitate customers who wish to multi-bank, through a refusal to share security and enter pari-passu arrangements;
- Customers' perception that payments they make to other financial institutions, through their clearing bank, are subject to scrutiny and intelligence gathering by the clearer.

Other remarks were also made:

-
- There are a limited number of institutions providing a full service and their products are either indistinguishable or difficult to compare.
 - That some institutions are linking products leveraging from one product (mortgage or SSIA) to sell current account as there is a perception that the transfer mechanisms between institutions are unreliable.

Response:

As it stands consumer inertia has not been established, but rather it is expected to be a feature of the market. The study will examine this and other issues to determine the extent to which they exist and their impact on entry and rivalry.

The Authority will take into account the information provided in response to this question in its analysis of switching costs.

3 ADDITIONAL REMARKS

One submission stated that the terms of reference should provide an opportunity to examine both the provision of a universal service to customers in the industry and the minimum levels of services to be provided for customers in a competitive market to ensure that competition does not result in a reduction of choice or services to customers

One submission believed that the terms of reference were such that the test of being to “the detriment of consumers” will be a defining one in this study. It commented “that on any aspects of competition there are a number of parties of whom the consumer is but one. For instance inappropriate competition practices can harm competitors or be against public interest.” It also stated that, in many instance, in the Banking study, “there may be conflicts between the general economic interest of the country and the interest of consumers and we would expect that the broader public interest would take precedence in such cases”.

Response:

Experience in other markets has shown conclusively that an increase in competition is associated with both decreases in price and in improvements in service to consumers. However, the setting of any universal service requirement in retail banking is better addressed by other bodies, as it is a policy issue that is not directly related to competition.

The Competition Authority has consistently argued that any restriction on competition to serve a public interest must be proportionate to the stated public policy objective. The Authority will continue to apply this principle in undertaking the study.