Unclassified **DAF/COMP/LACF(2017)39**

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development **31-Mar-2017**

English - Or. English

DAF/COMP/LACF(2017)39
Unclassified

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

LATIN AMERICAN AND CARIBBEAN COMPETITION

Session III: Addressing Competition Challenges in Financial Markets

-- Contribution from Portugal --

4-5 April 2017, Managua, Nicaragua

The attached document from Portugal is circulated to the Latin American and Caribbean Competition Forum FOR DISCUSSION under Session III at its forthcoming meeting to be held on 4-5 April 2017 in Nicaragua.

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JT03411794

English - Or. English

LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM

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15th Latin American and Caribbean Competition Forum
4-5 APRIL 2017, Managua, Nicaragua

Session III: Addressing Competition Challenges in Financial Markets

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-- CONTRIBUTION FROM PORTUGAL --

1. Co-operation between competition agencies and regulators in financial markets

1. Since its creation in 2003, the Portuguese Competition Authority (AdC) has carried out its mission to enforce competition rules, as enshrined in the Portuguese Constitution and the Treaty on the Functioning of the European Union (TFEU).

2. The regulation of the financial sector is conducted by the following three sector regulators: the Portuguese Central Bank (BdP) which is both the macro-prudential authority and the micro-prudential supervisor; the Portuguese Securities Market Commission (CMVM) which is the supervisor and regulator of securities markets (and markets for other financial instruments); and the Insurance and Pension Funds Supervisory Authority (ISP), in charge of supervising and regulating the insurance and pension funds sector.

3. Co-operation among financial regulators falls under the National Council of Financial Supervisors (CNSF), in which the three national financial regulators are represented. The CNSF provides a forum for information exchange and aims at enhancing co-ordination among the sectoral authorities.

4. Financial regulators are not responsible for the enforcement of competition law. There is however co-operation between the AdC and financial regulators in the application of competition law in financial markets. The Portuguese Competition Act[1] envisages the co-operation between the AdC and sectoral regulators, for example, through opinion requests by the AdC to the regulator and reporting from the regulator to the AdC whenever the regulator finds indicia of a potential competition law infringements in the sector. In mergers control, the AdC may request information or data to the sectoral regulators. The AdC can also issue opinions regarding the competition impact of the regulatory framework. In addition, co-operation between regulatory bodies is set out in Law No 67/2013 (the legal framework applicable to independent regulatory bodies). The *Legal Framework of Credit Institutions and Financial Companies*[2]

[1] Law No 19/2012 that replaced Law No 18/2003.

[2] www.bportugal.pt/sites/default/files/anexos/documentos-relacionados/rgicsf_en_2017.pdf

also accounts for the co-operation between the AdC and the BdP, within the section of consumer protection and competition.[3]

5. Financial regulators are not entitled to directly intervene to address structural features of financial markets that hinder competition, such as high concentration or vertical integration. Nonetheless, financial regulators play an important role in strengthening consumer protection in financial markets. There have been a number of measures aimed at ensuring greater protection of consumers in financial markets and setting best practices for credit institutions. For example, under the Decree-Law No 133/2009, the BdP issues quarterly announcements regarding the maximum fee levels for different types of consumer credit contracts. The focus of Decree-Law No 133/2009 is on the marketing of consumer credit products/services, in particular in strengthening the degree of consumer protection and in promoting the mobility of bank customers.

6. In addition, the BdP sets rules for transparency of information in retail banking markets, so as to promote the comparability of the conditions of supply and allowing for better informed choices, while fostering competition in retail banking markets.

7. Portugal is represented in the European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA), by the CMVM and the BdP, respectively.

8. ESMA, with which the CMVM is actively engaged in a number of working groups, contributes to safeguarding the stability of the European Union's financial system by enhancing the protection of investors, fostering information regarding all financial products and promoting stable and orderly financial markets.

9. The EBA works to ensure effective and consistent prudential regulation and supervision across the European banking sector. Its overall objectives are to maintain financial stability in the EU and to safeguard the integrity, efficiency and orderly functioning of the banking sector.

10. Both ESMA and the EBA are independent EU authorities and part of the European System of Financial Supervision (ESFS), together with the European Systemic Risk Board (ESRB), the European Insurance and Occupational Pensions Authority (EIOPA), as well as the national competent authorities of Member States.

11. The BdP is also part of the International Financial Consumer Protection Organisation (FinCoNet) which is an international organisation of supervisory authorities established in 2013, grounded on the collaboration between international supervisors of the financial system, with responsibilities in the area of financial consumer protection.

2. Financial market studies in Portugal[4]

12. In 2009, the AdC and the BdP undertook a joint market study which led to the report "*Mobility in the Retail Banking Sector in Portugal*" published in December 2009.[5]

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3 See Role of competition in financial consumer protection, contribution from Portugal, DAF/COMP(2014)28, available at www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP(2014)28&docLanguage=En

4 This section is partly based on See Role of competition in financial consumer protection, contribution from Portugal, DAF/COMP(2014)28, available at www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP(2014)28&docLanguage=En.

5 Available at (in Portuguese) http://clientebancario.bportugal.pt/pt-PT/Publicacoes/OutrosDocumentos/Documents/Estudo_Mobilidade_Sector_da_Banca_2003_2007.pdf

13. This market study analysed the degree of mobility of retail banking clients in Portugal, including individual consumers and small and medium enterprises (SMEs). It also identified factors that may constitute barriers to searching and switching within the banking sector.

14. The market study reviewed the literature on competition in markets with consumer switching costs with a special focus on retail banking. This literature review showed that switching and searching costs (and especially its cumulative effect) may have a negative impact in the degree of mobility of retail banking clients and lead to poor competition.

15. The market study also identified the European best practices concerning the reduction of switching costs in financial services markets. In order to collect information on the European best practices, the AdC and BdP launched a consultation via the Expert group of the Committee of the European Banking Supervisors (CEBS) and the European Competition Network (ECN). The analysis of the gathered information revealed that a significant proportion of consumers perceive switching accounts between banks as a complex process and thus switching rates tend to be very low.

16. The characterisation of the Portuguese retail banking markets was based on a number of statistics computed using data collected via information requests sent to the main Portuguese credit institutions. The degree of mobility, measured by the churn rate, was low and lower than the European average for both individual consumers and SMEs. Accordingly, the average longevity of the client/bank relationship was found to be higher than the European average.

17. The market study identified factors that may constitute switching barriers, such as contractual and bureaucratic costs involved in ceasing the client/bank relationship, the relationship of trust between clients and account managers, difficulties in carrying the acquired creditworthiness to the new bank, closing costs and asymmetry of information. The costs associated with asymmetric information were found to be particularly relevant to SMEs.

18. The report also addressed the issue of cross-selling and its implications for consumer mobility. The analysis showed a negative relation between cross-selling ratios (*i.e.* average number of products per client of a given product) and consumer mobility, which suggests that cross-selling is a relevant strategy for consumers lock-in.

19. The report draws a number of conclusions related to the negative impact of search and switching costs and identifies the following main measures to tackle these costs:

- measures to promote information transparency and comparability;
- measures limiting the closing costs, in particular commissions on the early repayment of mortgage and consumption loans; and
- measures to promote financial education in order to achieve a higher level of financial literacy.

20. These measures were designed and implemented during the course and shortly after the market study, and benefited from an effective cooperation between the AdC and the financial sectoral regulators. In particular, the BdP undertook a series of measures aimed at increasing price transparency and comparability. The ultimate aim was to allow consumers to be able to make informed purchasing decisions, fully aware of the price, risks and returns of any given financial product before and the moment of signing a contract with a credit institution.

21. The BdP also updated the information requirements of credit institutions in relation to the disclosure of comparable price and product features information. These regulations made it compulsory for credit institutions to list the interest rates and other price items, such as the maximum level of fees, commissions and other charges. The price lists of credit institutions must be composed of a leaflet of commissions and charges and a leaflet of interest rates, in accordance with a standardised mode. The BdP also intervened in information requirements in advertising campaigns (e.g. media, leaflets, emailing), which are understood as having a substantial impact on consumers' search and choice of supplier and product.

22. A portal for bank costumers was created providing relevant financial information for costumers, including simulators for financial operations and forms for complaints, a summary of the relevant legislation, a glossary of financial terms and frequent Q&As.

23. In May 2011, the CNSF developed initiatives aimed at improving financial literacy (which includes the National Plan for Financial Education[6]), aimed at promoting financial literacy. As part of this plan, the Ministry of Education in partnership with the financial regulators, developed a financial education benchmark, aimed at providing knowledge and skills in areas such as budget planning and management, savings and indebtedness[7].

24. In addition, credit institutions adopted the "Common Principles for Bank Account Switching" in March 2010.

3. Sector specific lessons learnt

25. There are a number of market specificities which make market definition and market power assessment in the financial sector particularly challenging. These relate to the multiproduct nature of firms, the supply of bundles and cross selling strategies, the complex pricing structures, the possibility of price discrimination, at least in what concerns some products or some price components, as well as the multisided platform nature of some product markets, such as credit cards.

26. The experience gathered through the competition law enforcement record of the AdC in financial services, together with the insights brought by the joint report of the AdC and the BdP, highlight the relevance of an analysis based on the articulation and joint interpretation of a variety of statistics and information on the specifics of the market at hand.

27. For example, in market contexts characterized by search and switching costs, it is very important to assess firms' ability to discriminate between types of customers. If credit institutions can price discriminate between locked in and new consumers, this implies that the competitive conditions faced by the two consumer groups may differ substantially. This may have implications in terms of market segmentation according to consumer groups, namely locked in and new consumers.

28. If, on the other hand, firms do not have the ability to price discriminate, then there will be only one market for new and locked in consumers. In this case, switching costs will affect the terms and conditions offered to all consumers; the extent of this effect depends on the ratio of new to locked-in consumers. If the ratio is high, then the impact of switching costs on market is small and locked-in consumers will benefit from the competition for new consumers. If the ratio is small, the impact of switching costs in market conditions is potentially larger, and firms will focus their strategies in extracting rents from their existing customer base rather than competing for new consumers. This also entails that market shares will be more informative concerning market power, as banks strategy will be very much

6 http://www.todoscontam.pt

7 http://www.todoscontam.pt/SiteCollectionDocuments/ReferencialEducacaoFinanceira.pdf.

determined by the magnitude of their market shares. These complementary statistics help evaluating the relative significance of the harvesting and investment effects, i.e., firms setting high prices to exploit locked-in consumers, and firms setting low prices to attract new consumers.

29. Within the financial sector, the implications of switching costs and the interpretation of a given mobility rate are also potentially different for different products. In the market study developed by the AdC and the BdP, the price differential between locked in and new consumers was found to be larger for mortgage loans than for consumption loans, which have smaller contract lifespans.

30. There are also other strategies in banking markets which may have implications for this strategic environment, namely cross-selling. Bundling and Cross-selling imply that switching costs in some products may have an impact on the competitive conditions on other products. To this respect, it is also important to highlight that current accounts and mortgage loans are the anchor products for private consumers, while loans assume that role for SME (according to the results of the report conducted by the AdC and the BdP). Mobility barriers in these products will have an impact on consumer’s sensitiveness to price changes in other products the consumer has in the bank.

31. Relying on a variety of different statistics and articulating them, while not free from limitations, might allow more robust inferences.

4. Final remarks

32. The market study conducted jointly by the AdC and the BdP is a relevant example where co-operation between competition agencies and sectoral regulators can be effective. This co-operation allowed a more smoothly implementation of the solutions identified. In addition, this co-operation created important synergies, allowing to address a combination of competition and consumer protection issues.