European Commission
Competition

GCLC Lunch Talk
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An Overview of Competition Measures in State Aid Banking Cases during the Financial Crisis

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Outline

A. The “competition measures” requirement
B. Practice during the crisis
C. Case studies

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B. Practice during the crisis

C. Case studies

A. The “competition measures” requirement

- Distortion of the market mechanism and in the internal market
  - Maintenance of aided banks’ market position in the absence of resolution
  - Adjustment efforts shifted onto other MS
- Moral hazard
  - “Reward” of reckless expansion / excessively risky strategy
  - Weakened incentives for competitors to invest, innovate and compete
- Financial crisis related effects
  - Distressed vs fundamentally sound banks (the 2 sides of the coin)
  - Retrenchments and fragmentation of the internal market
  - Budgetary constraints leading to unequal support
  - Limited burden sharing for financial stability reasons
  - Extensive State involvement and need to preserve competitive markets

A. The “competition measures” requirement

- Rather than “compensatory measures”, the Restructuring Communication refers to “measures to limit distortions of competition”.
- Competition measures should not compromise viability and should be defined on the basis of the restructuring plan.
- May address assets and/or liabilities
- Measures should allow markets to remain open and contestable (para. 32)

A. The "competition measures" requirement

- Two key criteria for assessment:
  - Amount of the aid and the conditions and circumstances under which it was granted
  - Characteristics of the market(s) on which the beneficiary bank will operate.
- Overall balancing
  - Degree of competition measures linked to amount and conditions of aid (including amount of burden sharing and pricing) and market characteristics (Restructuring Communication para. 30)
  - If greater burden sharing / own contribution, fewer negative consequences from moral hazard.

A. The "competition measures" requirement

- Menu of possible measures:
  - Divestments (para. 35)
  - Limits on expansion (para. 36)
  - Acquisition ban (para. 40)
  - Claw-back mechanisms (para. 42)
  - Price leadership ban (para. 44)
  - Advertising ban (para. 44)
  - Market opening measures (para. 45)

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A. The “competition measures” requirement

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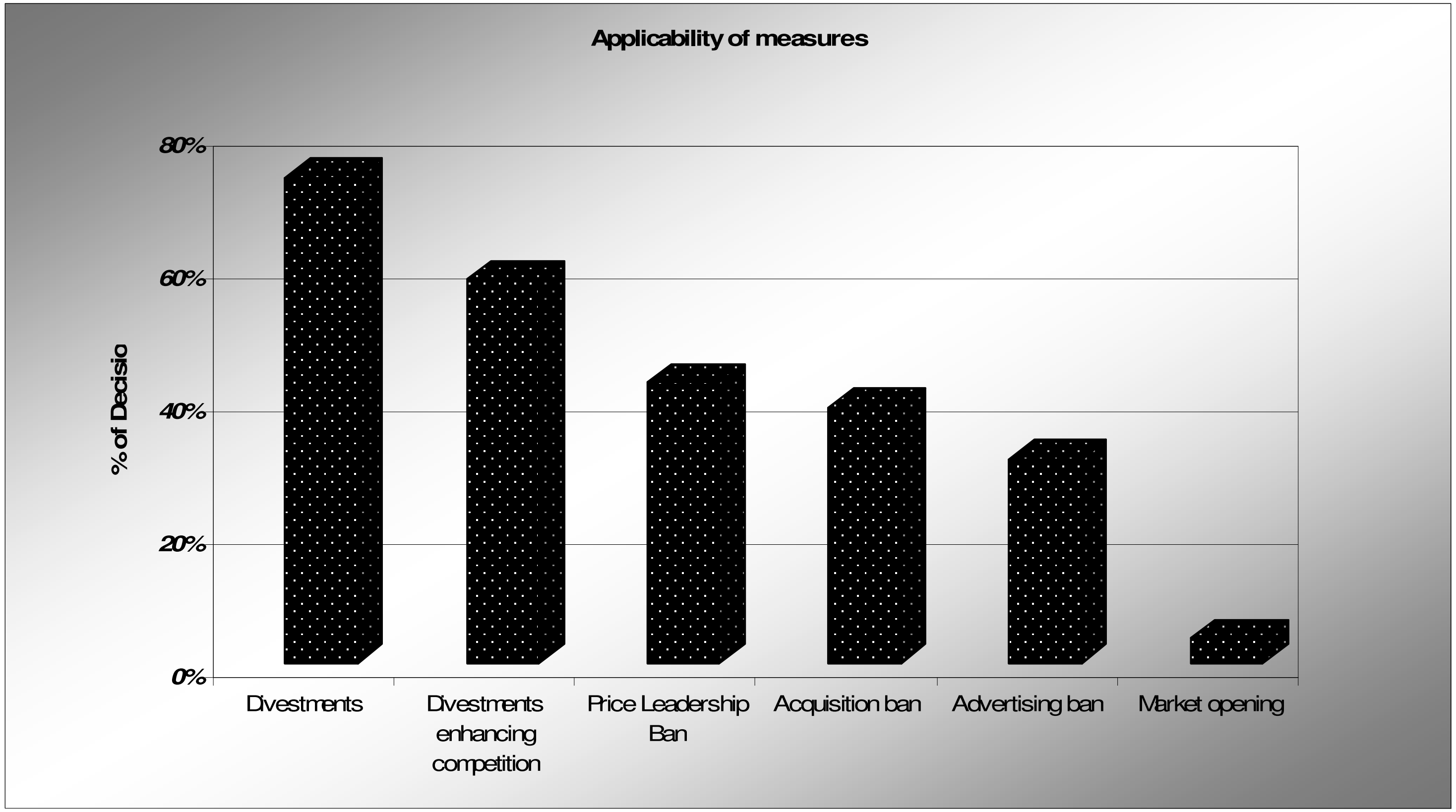
B. Practice during the crisis



B. Practice during the crisis

- Divestments required to limit distortions of competition in around 60% of cases
- Practice drew on experience with merger remedies:
  - need for the divested business to be viable
  - need for a suitable purchaser
  - need to preserve the business pending divestment

B. Practice during the crisis

- Price leadership bans, acquisition bans each in around 40% of cases
- Issues included:
  - defining a suitable “peer group” for PLBs
  - link with viability for PLBs
  - defining the scope of the acquisition ban – eg other financial firms only?

B. Practice during the crisis

- Advertising bans in around 30% of cases
- Specific market opening remedies very rarely used in practice (being hard to target to remedy the benefit obtained by the specific beneficiary)

Outline

A. The “competition measures” requirement

B. Practice during the crisis

C. Case studies

C. Case Study 1: Dexia

- Dexia's pre-crisis business:
  - a core local authority business where it was a key player in BE, FR and IT;
  - a retail banking business with much smaller market shares; and
  - a search for margins outside traditional activities.

C. Case Study 1: Dexia

- Key role of divestments and turnover limits:
  - substantial divestments required in core local authority market due to its concentrated nature
  - less need for competition measures on the less concentrated retail market
  - no strict delimitation of divestments for viability and as competition measures – but former focuses more on divestment of non-core activities

C. Case Study 1: Dexia

- Price leadership ban
  - no ban as such – but the pricing limitation (RAROC of 10%) contributes to avoiding excessively aggressive pricing
- Acquisition ban
  - no acquisition of any other credit institution, investment firm or insurance company
- Advertising ban
- Market opening measures
  - FR to ensure that the local authorities develop their competitive procurement practices when procuring funds
  - BE to monitor the publication of contract award notices relating to the financing of the local public authorities

C. Case Study 2: KBC

- KBC's pre-crisis business:
  - an integrated bancassurance provider, within the top 2 or 3 providers in BE, with substantial presence in CEE and smaller presence in several other countries
  - a private banking business; and
  - origination of CDOs.

C. Case Study 2: KBC

- Calibrating the degree of competition measures required:
  - KBC received a large amount of aid…
  - but need for competition measures less because of adequate remuneration; substantial burden sharing (listing of 40% of subsidiaries in CZ and HU); moral hazard addressed by cessation of CDO business

C. Case Study 2: KBC

- Balance between structural and behavioural measures:
  - In CEE, competition measures focused on expansion limits in non-core markets (some overlap with viability here)
  - Therefore in markets where KBC is well-established and no pro-competitive structural measures, PLB required
  - Design of PLB: KBC not to offer best pricing compared to competitors with top ten market shares

C. Case Study 2: KBC

- Balance between structural and behavioural measures – in BE, structural measures were apt to encourage competition on a previously concentrated market:
  - Sale of profitable businesses with a recognised brand name (Centea and Fidea)
  - Easily separable from KBC's other businesses in BE
  - Limitations on market share of potential purchaser
  - Inclusion of value preservation commitments and appointment of hold separate manager

C. Case Study 2: KBC

- Acquisition ban
  - no acquisition of control of financial institutions;
  - no acquisition of control of other businesses if that would slow down repayment of the aid
- Advertising ban

C. Case Study 3: RBS

- RBS's pre-crisis business:
  - a key player in UK retail and small business banking , with other substantial retail businesses in the US and Ireland;
  - a major "global markets" business serving large corporates and financial institutions
  - heavily exposed to the crisis by a high-risk strategy, heavily dependent on wholesale financing

C. Case Study 3: RBS

- Calibrating the degree of competition measures required:
  - very large amount of aid
  - substantial market presence (market leader in highly concentrated UK SME banking)
  - strong moral hazard problem, due to excessive risk-taking

C. Case Study 3: RBS

- Focus on the quality of the divestment in the key UK retail market:
  - viable business: critical mass of customers, good geographical spread, existing brand
  - value preservation commitments and appointment of hold separate manager
  - suitability of purchaser, including market share limit and independence requirement

C. Case Study 3: RBS

- Balanced approach to other divestments:
  - divestment on the smaller Irish market not required
  - withdrawal from risky activities in many cases achieved through scaling back activities – but with further divestments required if balance sheet reduction targets not met

C. Case Study 3: RBS

- Acquisition ban
  - no acquisition of other financial institutions
  - no other acquisitions whose purpose is to expand RBS's activities outside of its business model
  - subject to a *de minimis*
- Advertising ban

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