COMPETITION AUTHORITY

Submission on Financial Sector Regulation: New Proposals

Submission No. **S/02/004**

Date: **20 September 2002**

TABLE OF CONTENTS

Table of Contents ii
1 Introduction 1
2 Comments 1
2.1 The Consultative Panels 1
2.2 Information and Enforcement 2
2.3 Mergers 4
3 Concluding Comment 6

1 INTRODUCTION

In June, the Minister for Finance, Mr Charlie McCreevy, introduced in the Dáil the Central Bank and Financial Services Authority of Ireland Bill, 2002. The Bill establishes the *Irish Financial Services Regulatory Authority (IFSRA)* with a mandate to supervise all financial institutions in Ireland and provide an enhanced level of protection to consumers of financial services. IFSRA will be part of a new *Central Bank and Financial Services Authority of Ireland* (CBFSAI).

This submission outlines the main concerns of the Competition Authority ('the Authority') with the proposed Bill as it currently stands. In particular, the Authority has concerns relating to the proposed consultative panels, the provisions relating to the information exchanges between enforcement authorities and the merger provisions; each of these is outlined in turn.

2 COMMENTS

2.1 The Consultative Panels

Part III of the Bill provides for the creation, and describes the functions, of three consultative panels: a consumer panel; an industry panel; and a joint committee comprising of members from each of the other two panels. The Authority has a number of concerns in relation to the role that these panels will play. In particular, the Authority is concerned about the possibility that the industry, via the industry panel, may be able to 'capture' the regulatory process.

Underpinning the philosophy of market regulation is consumer protection. Firms are generally a focussed and well-resourced group, skilled in representing their own needs and interests. In contrast, consumers are generally a diffuse and amorphous group and consequently are often unable to represent their interests effectively. For this reason, the Authority wholly welcomes the provisions in the Bill relating to the consumer

consultative panel, but has grave reservations about the industry consultative panel. Moreover, in light of the fact that industry participants, as already mentioned, are generally well resourced, it is questionable whether it is appropriate that the activities of an industry consultative panel be financed from the IFSRA budget.

The Authority also has competition concerns relating to provisions that encourage industry participants to form a common view on issues where consumer welfare would be better served if each responded individually. In this regard it is worth recalling the recommendations contained in the Authority's submission to the Department of Finance Working Group on the Strategic Review of the Future of Irish Banking. On the question of a future system of banking regulation the Authority stated:

> "Regulation should minimise, rather than create, opportunities for anti-competitive behaviour. For example, regulatory rules should not require or encourage the sharing of information between competitors, or give blanket approval to arrangements jointly proposed by competitors."

Head 21(1) of the Bill provides that the "… *the consultative panels shall where relevant consult and co-operate with each other and shall where practicable seek to provide agreed joint views to the Irish Financial Services Regulatory Authority*". Head 21(2) goes on to describe how the industry and consumer consultative panels report their agreed joint view to a joint committee who relays these views to the IFSRA. While the requirement that the consultative panels present a joint view to the joint committee is not binding, it nevertheless introduces an extra layer into the process where the consumer interest might become diluted. It may be more appropriate to allow the consultative panels to present their views independently.

2.2 Information and Enforcement

In general, the proposed provisions in the Bill do strike the correct balance between encouraging the flow of information between financial institutions and IFSRA, which is necessary for IFSRA to do its job properly, while not exempting IFSRA from acting on

the public policy objective of maintaining high standards of compliance by financial institutions with their statutory obligations.

The Authority recognises the danger that the provisions in the Bill could be misunderstood as giving IFSRA a general policing role in relation to compliance by financial institutions with statutory obligations for which other regulatory/enforcement authorities have responsibility. To avoid this danger, some of the provisions might be re-worded in a way that makes it clear that it is not the function of IFSRA to seek out breaches of the law for which other agencies have responsibility, but that it has a duty, where such breach comes to its attention, to bring it to the notice of the proper authority.

Thus, Head 35(9) might be re-worded as follows (proposed amendment in italics):

> "Notwithstanding subsections (2) to (5), the CBFSAI may, with the aim of strengthening the stability, including integrity of the financial system, exchange information *tending to show that there is or has been a breach of company law* with the competent authorities or bodies which are responsible under law for the detection and investigation of breaches of company law"

Head 37(2) is very widely drafted at present, and might indeed give the impression of a general policing role. It too might be re-worded as follows:

> "Provide for the Irish Financial Services Regulatory Authority being obliged … to report to [the various named entities] or any other authority responsible under law for the enforcement of law or regulation, *matters which come to its attention which tend to show that a breach of a relevant law has occurred or is occurring*"

Head 37(4) should then be amended consistently with the above.

With regard to the suggested 'Disclosure Notice' and 'Special Compliance Report' system, these appear to be effective ways of dealing with situations where direct reporting by IFSRA to another statutory body is not possible due to confidentiality provisions in EU law. However, can the 'Disclosure Notice' be enforced in any way? What happens if the directors do not publish it in their annual report? Should there be provision for a sanction?

Head 35 of the Bill omits any specific reference to provision of confidential information to the Competition Authority. Although the provision of such information is probably covered by the 'without prejudice' clause in Head 35(2)(a), nevertheless, for the avoidance of doubt, we suggest that a new sub-head be inserted after Head 35(9) to cover the matter expressly. As in the case of our suggested amendment to Head 35(9), the information provided should be "*information tending to show that there is or has been a breach of competition law.*" If Head 35 is amended as suggested above, Head 36 ought also to be amended to include a reference to breaches of competition law.

Finally, it may also be worth bearing in mind that Section 34 of the Competition Act 2002, provides for co-operation between the Authority and certain other statutory bodies. At present these bodies are the Broadcasting Commission of Ireland, The Commission for Energy Regulation, the Commission for Aviation Regulation and the Director of Telecommunications Regulation. The Competition Act however, provides that this list may be extended to include other statutory bodies.

2.3 Mergers

The Competition Act 2002 removes the exemption of licensed credit institutions from merger legislation. Part III of the Act, which comes into effect on 1 January 2003, also provides that the Authority will assume responsibility from the Minister of Enterprise, Trade & Employment for vetting takeover/merger activity involving Irish companies in all sectors, including banking, from a competition perspective. The Authority would have concerns about any proposed financial services legislation that lessened the scope of this provision, particularly any potential to use such a provision to permit mergers that were anti-competitive and negatively affect consumer welfare.

The Authority recognises the importance of a reliable banking structure to the overall stability of the economy. In particular, it understands the necessity for consumer confidence in the liquidity of the banking sector, and the potential damage that would arise if such confidence collapsed. To that end, it supports the implementation of

appropriate instruments to ensure the maintenance of liquidity and confidence in the system.

With regard to whether bank mergers should be subject to approval from CBFSAI/IFSRA, the Authority is unclear as to what exactly would be the test to be used. The Authority appreciates that the phrase "*the orderly and proper regulation of banking*" is time-honoured, and is in use for many years in banking legislation. It is, however, vague, and the Authority is not clear as to its meaning or interpretation in practice. It would be helpful for the Authority in finalising its view on this issue if it was made clear – preferably in statute – what exactly this test means, and how, in practice, it would be implemented.

The Authority is strongly of the opinion that, whatever test is to be used, it should not interfere with the Authority's mandate to consider a transaction in terms of whether it leads to a substantial lessening of competition. If there are to be two simultaneous regimes for bank merger evaluation, then it is best that they operate independently from each other. In practice, this requires a transaction to surmount two 'regulatory hurdles'. Neither should one test should dominate the other: if a merger is harmful to competition then it should be prevented on those grounds. Similarly, if a merger is harmful to orderly banking regulation, then it should be prevented on those grounds. Thus, the Authority wishes to be clear that its own function will not be affected by this new provision: if the Authority prohibits a merger on competition grounds, then that prohibition cannot be undone, save by the Courts. If the Authority allows a merger, it can still be prohibited by IFSRA.

If there are fears about the possible publicity attending a transaction, and any resulting dangers in terms of its effect on consumer confidence, it might be noted that the Competition Act 2002, allows the Authority to withhold publication of the notification of a merger. The Authority would ordinarily be reluctant to do this, but accepts that there may be situations where it is in the public interest.

The consultation document poses the question of whether it is sufficient that the Minister for Finance, on behalf of the Government, can make his views known to the Authority or

EU Commission on a particular merger or acquisition. Part 3 of the Competition Act 2002 (Mergers), was devised partly to avoid any impression of political interference in merger evaluation. Similarly, any notification to the European Commission is intended to proceed independently of political scrutiny. The Authority thus sees the possibility of any ultimate decision in relation to bank mergers lying purely with the Minister of Finance as being unworkable. However, it fully supports the notion that, in any merger investigation, it would be open to the Minister of Finance to give his/her views about the nature and effect of such a transaction, and the Authority would take these fully into account in coming to a determination. Also, the Authority would be very interested in obtaining – and would seek out – the views of the proposed Consumer Director of CBFSAI/IFSRA on any proposed merger, particularly since assessing the impact on competition (and by extension consumers) is the primary goal in any Authority merger review.

Finally, Head 40 of the Bill proposes to allow a maximum of three months for CBFSAI/IFSRA to evaluate a proposed bank merger. The Authority's timelines are set out in the Competition Act, and specify an initial one-month period, after which the transaction may be approved. Should there be serious competition concerns, a second-stage investigation of up to three months takes place, at the end of which the transaction is approved, approved with conditions, or prohibited. Thus, the overall timeframe available is up to four months. While this is not that dissimilar from the three-month period envisaged for CBFSAI/IFSRA, nevertheless it might be helpful to provide that a proposed transaction must be notified to both the Authority and CBFSAI/IFSRA simultaneously.

The Authority would welcome a discussion with the Department of Finance on these topics. Such discussions could also explore various possibilities for cooperation between the Authority and CBFSAI/IFSRA in relation to mergers in the banking sector.

3 CONCLUDING COMMENT

The Authority is available, and would welcome the opportunity, for further discussion of the views expressed in this submission or any other relevant matters.