

Client Advisory | April 2010

## Banking in the Antitrust Crosshairs - the EU Situation

The financial crisis and the resulting recession have led to increased consolidation in the banking sector across the world, as failing banks have been acquired by stronger institutions or the state itself. They have also led to increased public hostility towards the institutions and individuals who are held by many voters to be responsible for causing the crisis in the first place.



*Becket McGrath, Partner*

As politicians struggle to manage the political and economic consequences, it is not surprising that competition law (i.e. anti-trust) is being considered as a means of both addressing some of the consequences of such enforced consolidation and helping to avoid some of the problems that contributed to the crisis in the first place.

Competition law generally operates in a retrospective way, by punishing companies that have entered into anticompetitive agreements or abused a dominant market position. As such, it is different from the other principal means of tackling market failure, namely regulation, which specifies in advance the behaviour to be expected from companies operating on a particular market. The UK's market investigation regime is an important exception to this principle, in that it allows an entire market to be reviewed by the Competition Commission, and potentially draconian remedies to be imposed, without any breach of competition law having occurred.

Although the financial crisis has been characterised as primarily a failure of regulation, for example concerning the control of banks' capital holdings, there is clearly a potential role for competition law oversight in financial markets, given the effect of enforced consolidation on market structures. This is particularly relevant where consolidation has taken place without the usual merger control scrutiny, as was the case with the takeover of the UK's HBOS by Lloyds, which was completed only after the government overrode usual merger control procedures.

Until recently, the focus of European Union (EU) and UK competition enforcement in the financial services sector has tended to be on markets of direct relevance for consumers and small businesses or, in the case of enforcement by the European Commission, on apparent barriers to European market integration. Thus, for example, the Commission's 2007 report on its sector inquiry into retail banking<sup>1</sup> identified problems in payment card systems, which it claimed had a knock-on impact on prices in the retail sector. The Commission also observed that the high levels of market concentration witnessed in some EU countries (this was pre-crisis, remember) raised concerns over the competitiveness of retail banking services for consumers and small firms. Although there was little that the Commission could do directly about levels of concentration, it has acted to address issues in European payment systems and has launched investigations of the interchange arrangements applicable to credit cards. With some exceptions, such as the Commission's recent consultation on the effects on competition of bundling in the retail financial services sector,<sup>2</sup> its main priority of late has been to prevent intervention by Member State governments to save ailing domestic banks from unduly distorting banking markets on a lasting basis.<sup>3</sup>

Turning to the UK, the 2000 report on the government's banking review (dubbed the Cruickshank Review, after its author)<sup>4</sup> raised concerns over a lack of competition in money transmission systems and in the provision of banking services to individuals

and to small and medium sized enterprises (SMEs). The review's report led directly to the government referring providers of SME banking services to the Competition Commission in 2000,<sup>5</sup> which in turn produced a suite of remedies designed to facilitate customer switching and improve price transparency. A number of narrowly focused market investigation references by the Office of Fair Trading (OFT) to the Competition Commission since 2000 (concerning store cards, home collected credit, personal banking in Northern Ireland and payment protection insurance),<sup>6</sup> as well as OFT inquiries and enforcement action involving bank overdraft charges, credit card fees, personal current accounts, unsecured and 'high cost' consumer credit and payment systems, reflect a continuing and intensive focus on retail financial services. This trend looks set to continue, with news emerging on 31 March that a consumer body had lodged a 'super complaint' with the OFT concerning interest payments on cash ISAs (a form of tax-free collective investment).

Recent months have seen the emergence of a number of new themes, however. On the one hand, the focus of regulatory attention has broadened, away from narrow areas in which vulnerable consumers or SMEs may be losing out to encompass the structure of the banking sector as a whole. In this respect, the debate is taking on aspects of the Cruickshank Review, which started from the observation that 86% of SME banking services were at that time provided by just four banks. A further signal, buried in the OFT's announcement on 16 March of the findings of its market study into fees for unarranged overdrafts on personal current accounts, was the potentially significant news that the OFT will be studying barriers to entry in the personal current account market "during 2010".<sup>7</sup>

The debate has also taken on a more overtly political flavour, with the opposition Conservative party committing itself to asking the OFT and Competition Commission to conduct

a 'focused examination of the effects of consolidation on the retail banking sector'.<sup>8</sup> Any Competition Commission investigation is likely to revisit many of the issues examined by the Cruickshank Review and the Competition Commission ten years ago, albeit this time in the context of an even more concentrated banking market, in which state-controlled banks now play a major role. In committing itself to this course of action, the Conservatives may be taking a side-swipe at the contribution to market consolidation flowing from the decision of the Labour government to promote and clear the acquisition of HBOS by rival bank Lloyds.

It is also interesting to note the increased prominence of investment banking in discussions concerning competition in the financial sector. This is a particularly interesting development since, until now, the unspoken policy assumption seemed to be that investment banking customers were big enough to look after themselves and that competition in investment banking was vigorous enough to prevent problems emerging. As a result, intervention was limited to retail financial markets.

Recent rises in underwriting fees, as well as in fees and banks' margins in other areas of investment banking, have undermined this assumption, as indeed has the financial crisis itself, leading to calls for action by shareholders and other investors. This has come to a head recently, with the Association of British Insurers writing to the Secretary of State for Business criticising underwriting fees and the City minister Lord Myners calling for some form of inquiry.<sup>9</sup> Apparently spurred on by the Liberal Democrats' high-profile Treasury Spokesman, Vince Cable, who has publicly criticised what he has referred to as an investment banking 'cartel',<sup>10</sup> the OFT's Chairman Philip Collins has recently announced that the agency will be looking into this issue.<sup>11</sup> In a public lecture on 30 March,<sup>12</sup> Mr Collins queried whether the particular nature of wholesale financial markets

in the City of London might drive up costs to users and lead to misallocation of rewards and risks.

Things are still at a very early stage, with the OFT confirming that it only has a "small team" working on this initiative. Mr Collins has also warned that enforcement action will not necessarily follow. It is nevertheless clear that simply shining a spotlight on wholesale financial markets will subject them to greater competition law scrutiny than has previously been the case. Given the close-knit relationships that underpin the City, this could be an uncomfortable process.

The OFT provided a reminder of quite how uncomfortable things can get with its announcement on 30 March that the Royal Bank of Scotland had agreed to pay a fine of over £28 million for a breach of the Competition Act. Following a tip-off from Barclays Bank, the OFT found that individuals within RBS had unilaterally disclosed confidential future pricing information relating to the pricing of loan products to large professional services firms to their counterparts at Barclays. According to the OFT, the disclosures took place on the fringes of social, client or industry events or through telephone conversations. This marks the first, and so far only, time that a bank has been fined by the OFT for a breach of competition law.

Meanwhile, there is evidence of investors asserting themselves in the private equity sphere. Specifically, certain institutional investors have formed a trade association (the Institutional Limited Partners Association) to formulate a set of principles to which they believe that those managing their money should adhere.<sup>13</sup> These include a call that management fees should not be excessive and stipulations concerning the calculations of a fund manager's profit shares (known as the 'carry'). A vocal debate has now broken out over whether the collective promotion of these principles breaches competition law.<sup>14</sup> This debate takes place in a sector where historical price alignment around the

'2 and 20' rule, under which private equity funds typically charged investors a 2% management fee and a 20% share of profits, has raised eyebrows and now appears to be coming under pressure. Ironically, the apparent shift towards more variable remuneration levels for funds suggests that general

partners may be responding to competitive pressures in the sector, which would itself argue against intervention by the authorities in this instance.

As governments and the world economy continue to work through the implications of the financial crisis and recession, it is becoming increasingly

apparent that competition law enforcement will not be neglected, and that it will be considered alongside more traditional regulatory measures. Whether it will succeed in addressing some of the more deep-rooted characteristics of financial markets remains to be seen, however.

<sup>1</sup> Available at [http://ec.europa.eu/competition/sectors/financial\\_services/inquiries/retail.html](http://ec.europa.eu/competition/sectors/financial_services/inquiries/retail.html).

<sup>2</sup> See [http://ec.europa.eu/internal\\_market/consultations/2010/tying\\_en.htm](http://ec.europa.eu/internal_market/consultations/2010/tying_en.htm). It is notable that this document has been published by the part of the Commission responsible for the European internal market, rather than for competition.

<sup>3</sup> For a list of relevant legislative measures, see [http://ec.europa.eu/competition/state\\_aid/legislation/temporary.html](http://ec.europa.eu/competition/state_aid/legislation/temporary.html).

<sup>4</sup> Available at [http://www.hm-treasury.gov.uk/fin\\_bank\\_review.htm](http://www.hm-treasury.gov.uk/fin_bank_review.htm).

<sup>5</sup> Report available at [http://www.competition-commission.org.uk/rep\\_pub/reports/2002/462banks.htm#full](http://www.competition-commission.org.uk/rep_pub/reports/2002/462banks.htm#full).

<sup>6</sup> Reports available at <http://www.competition-commission.org.uk/inquiries/subjects.htm>.

<sup>7</sup> Specifically, the OFT states that it "will be undertaking a short piece of work during 2010 looking at barriers to entry to consider whether there are any obstacles to entrants providing a competitive stimulus." It goes on to say that the work "will focus on the PCA market but consider other aspects of retail banking and banking for SMEs as appropriate" and that it "intends to publish a short consultation paper on the issues to be covered by this short review in the next couple of months" – see <http://www.of.gov.uk/news/press/2010/26-10>.

<sup>8</sup> See the Conservatives' July 2009 Policy White Paper, From Crisis to Confidence: Plan for Sound Banking, available at [http://www.conservatives.com/Policy/Where\\_we\\_stand/Economy.aspx](http://www.conservatives.com/Policy/Where_we_stand/Economy.aspx). It has since been clarified that this commitment anticipates a ministerial market investigation reference of both retail and investment banking to the Competition Commission. Under section 132 of the Enterprise Act 2002, a minister may refer a market to the Competition Commission if he or she is 'not satisfied' with a decision by the OFT not to make a reference itself or that the OFT will decide whether or not to make a reference within a reasonable time. This power is intended to be used only in exceptional circumstances.

<sup>9</sup> See, for example, The Daily Telegraph, 25 March 2010, 'Myners calls for inquiry into bank fees', reported at [www.telegraph.co.uk](http://www.telegraph.co.uk).

<sup>10</sup> For example, during the televised debate on 29 March 2010 between Chancellor Alastair Darling and his Conservative and Liberal Democrat counterparts.

<sup>11</sup> See The Financial Times, 20 March 2010, 'OFT has sights on investment banking fees', reported at [www.ft.com](http://www.ft.com).

<sup>12</sup> The Currie Lecture 2010, Making financial markets work well for consumers. A version of the speech appeared as an opinion piece in The Daily Telegraph on the same day., Both are available at <http://www.of.gov.uk/news/speeches/2010/0310>.

<sup>13</sup> Available at <http://www.ilpa.org/files/ILPA%20Private%20Equity%20Principles.pdf>.

<sup>14</sup> See 'Investor Principles Rankle Buyout Shops', in The Wall Street Journal, 23 March 2010, reported at [online.wsj.com](http://online.wsj.com); 'The LP Collusion Canard', PEHub Wire, 24 March 2010, available at <http://em.mansellgroup.net/ThomsonNewLetter/HostedWires/NewsLetters/march24-10.htm>; and 'Fear of an ILPA Planet', 15 March 2010, available at [www.privateequityonline.com](http://www.privateequityonline.com).

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Becket McGrath, Partner

+44.207.556.4125

[bmcgrath@eapdlaw.com](mailto:bmcgrath@eapdlaw.com)

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