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Client Advisory | *June 2010*

Antitrust and Banking in the EU - UK Update

Although it has only been two months since our client advisory, Banking in the Antitrust Crosshairs,[1] a number of developments have occurred in the UK since the general election on 6 May, and an update is necessary.

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As mentioned in the last client advisory, before the election the Conservative party committed itself to ask the UK's competition authorities, the Office of Fair Trading (OFT) and Competition Commission (CC), to conduct a "*focused examination of the effects of consolidation on the retail banking sector*".[2] This was reflected in the party's manifesto as a commitment to "*increase competition in the banking industry, starting with a study of competition in the sector to inform … strategy for selling the government's stakes in the banks*".[3] The Liberal Democrats, in contrast, adopted a more aggressive position in their manifesto, promising to "*break up the banks*" and to require financial regulators to maintain "*a diversity of providers in the financial services industry*".[4] The Liberal Democrats' Treasury Spokesman, Vince Cable, has been a particularly fierce critic of the banking sector and an active proponent of structural separation of banks into distinct deposit-taking and trading institutions.

The fact that the election resulted in a formal coalition between the Conservatives and Liberal Democrats (the first coalition government the UK has experienced since 1945) necessitated a root and branch review of each party's manifesto, to produce an agreed Programme for Government[5]. The two parties' different positions on the way forward for the banking sector were reconciled by a commitment in the Programme to establish an independent commission "to investigate the complex issue of separating retail and investment banking in a sustainable way". The potential for disputes over whether banking reform would be led by the Treasury (under the Conservative Chancellor of the Exchequer, George Osborne) or the Department for Business, Innovation and Skills (under Vince Cable, as Secretary of State) was reduced by the creation of a new Cabinet Committee on Banking, to be chaired by the Chancellor, with the Secretary of State as deputy chair.

On 16 June, the day of the Chancellor of the Exchequer's Mansion House speech, the Treasury confirmed the remit of the new Independent Commission on Banking. As expected, the Commission will be asked to make recommendations covering "structural measures to reform the banking system and promote stability and competition, including the complex issue of separating retail and investment banking functions", with a view to "promoting competition in both retail and investment banking", as

1 See http://www.eapdlaw.com/newsstand/detail.aspx?news=1905.

2 See 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. 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.

3 Manifesto available at http://media.conservatives.s3.amazonaws.com/manifesto/cpmanifesto2010_lowres.pdf.

4 Manifesto available at http://network.libdems.org.uk/manifesto2010/libdem_manifesto_2010.pdf.

5 Available at: www.cabinetoffice.gov.uk/media/409088/pfg_coalition.pdf.

well as “reducing systemic risk”. It is now clear that the creation of the Banking Commission has replaced the earlier Conservative proposal to use the statutory market investigation procedures, as applied by the OFT and CC, to review the sector. This marks a clear shift in approach from one in which decisions on remedies, potentially including structural change, could be taken by the independent competition authorities, to one in which final decisions will be left to politicians, albeit in the context of the Banking Commission’s expert recommendations.

The Commission has until the end of September 2011 to produce its final report to the Cabinet Committee on Banking. The composition of the Independent Commission, which was also announced on 16 June, is particularly interesting. It will be chaired by Sir John Vickers, who has the unique distinction of being both a past Chief Economist of the Bank of England and a past Chairman and Chief Executive of the OFT. He will be joined on the Commission by Martin Taylor, a former chief executive of Barclays (one of the country’s largest banks); Claire Spottiswoode, a former regulator; Bill Winters, the former co-head of investment banking at JPMorgan; and Martin Wolf, a *Financial Times* columnist. Mr Wolf is another interesting appointment. As well as being a highly respected financial journalist, Mr Wolf has written at length on the challenge of “halting the financial doomsday machine” through “fundamental changes in policy towards – and the structure of – the financial system”.[6] Ms Spottiswoode’s career as entrepreneur, energy regulator, formal representative of Norwich Union life insurance policyholders and, back in the 1970s, a Treasury economic adviser, should also contribute to what is bound to be a lively discussion between Commission members.

The Chancellor also used his Mansion House speech to confirm that the coalition government would proceed with the abolition of the Financial Services Authority (a unified regulator of the financial services industry, created by the last Labour government). This will involve the transfer of the FSA’s prudential regulatory function to the Bank of England and the transfer of its consumer protection and financial services supervision powers to a new Consumer Protection and Market Authority. Mr Osborne also confirmed that the Government will create “a single agency to take on the work of tackling serious organised crime”. At the time of writing, the impact of these two developments on the OFT, which has both consumer protection and criminal enforcement powers, is not clear.

Over at the OFT, the initiatives mentioned in the last advisory have moved forward. First, the OFT’s review of barriers to entry, expansion and exit in retail banking was formally launched on 26 May, with a call for evidence. The OFT is concerned to identify any obstacles faced by new entrants to the banking sector and smaller banks seeking to expand. It is interesting to note that this review is not being undertaken as a market study, which might anticipate concrete actions by the OFT, potentially including a formal market investigation reference to the CC. Rather, the OFT is billing this initiative as a ‘review’, which is “intended to help the OFT and others in: assessing and advising on options for change in the regulatory framework for banking; assessing any relevant mergers that may arise in the banking sector, including any such arising from divestments under EC state aid requirements; contributing to any relevant reviews or other work undertaken by the Government or other public authorities; and determining future work priorities in retail banking”.[7]

In contrast to the retail banking review, the OFT has chosen to take forward its work on equity underwriting (also flagged in our earlier client advisory) as a market study. In a press release on 10 June,[8] the OFT noted that initial discussions with corporate users of equity underwriting services had indicated “some dissatisfaction” with the services provided. It went on to confirm that it would be launching a full market study “this summer” to consider whether these concerns are justified. Its work will include an

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6 See *The challenge of halting the financial doomsday machine*, FT, 20 April 2010, and *Why cautious reform is the risky option*, FT, 27 April 2010.

7 See OFT Call for Evidence, available at http://www.oft.gov.uk/shared_oft/personal-current-accounts/OFT1233.pdf.

8 OFT Press Release 61/10, available at http://www.oft.gov.uk/news-and-updates/press/2010/61-10.

assessment of "the level of competition" for such services and how "different services such as advice, arranging the issue and the actual underwriting are sold". The OFT is asking for views by 9 July on the scope of the study, including whether it should include capital raising by companies on the London Alternative Investment Market (AIM) or initial public offerings. It is not yet clear what further action the OFT will take if it identifies what it has referred to as "areas for improvement". It does appear, however, that, as with the OFT's work on barriers to entry in retail banking, the study will feed into the Government's 'wider thinking' about wholesale financial markets.

In the midst of all this activity, it will be little comfort to mainstream financial institutions that the OFT has decided not to refer the 'high-cost credit sector' to the CC, notwithstanding the concerns identified, given their lack of involvement in the sector.[9]

Overall, while the pace of developments should become slightly less frenetic over the next few months, it is clear that the UK banking sector faces an uncomfortable period, as far as regulatory intervention is concerned.

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9 See OFT Press Release 63/10, available at http://www.oft.gov.uk/news-and-updates/press/2010/63-10. 'High-cost credit' is defined for these purposes as pawnbroking, payday loans, home collected credit and rent-to-buy credit. Such products are typically provided to people on low incomes who are unable to access mainstream credit.

This advisory is for guidance only and is not intended to be a substitute for specific legal advice. If you would like further information, please contact the Edwards Angell Palmer & Dodge LLP attorney responsible for your matters or the attorney listed below:

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