THE BANKING LAW JOURNAL

VOLUME 127 NUMBER 6 JUNE 2010

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POSTMASTER: Send address changes to The Banking Law Journal, A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207.

Banking and Antitrust: The View from the UK

BECKET McGRATH

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. The author describes the banking and antitrust situation in the UK.

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. As politicians struggle to manage the political and economic consequences of these developments, it is not surprising that competition law (*i.e.* antitrust) 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 AND BANKING

Competition law generally operates in a retrospective way, by punishing companies that have entered into anticompetitive agreements or abused a

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Published in the June 2010 issue of *The Banking Law Journal.*
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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 plc by Lloyds TSB Group plc. That merger was completed at the height of the financial crisis only after the government had used exceptional statutory powers to bypass normal merger control procedures, in the face of competition concerns from the Office of Fair Trading ("OFT").

THE EUROPEAN COMMISSION

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[1] 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 improve 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,[2] 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.[3]

THE SITUATION IN THE UK

Turning to the UK domestic situation, the 2000 report on the government's banking review (dubbed the Cruickshank Review, after its author)[4] 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,[5] 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 OFT to the Competition Commission since 2000 (concerning store cards, home collected credit, personal banking in Northern Ireland and payment protection insurance),[6] 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 the OFT currently investigating a "super complaint" from Consumer Focus against providers of cash ISAs (a form of tax-free collective investment). In summary, the complaint alleges that the ways in which cash ISAs are sold and managed harm the interests of consumers. Under the super complaint procedure, which spans competition and consumer protection issues, the OFT has 90 days from receipt of the complaint (in this case, March 31) to publish its response. At the time of writing, the OFT had undertaken an initial consultation and was considering its next steps.

Recent months have also seen the emergence of a number of new themes. First, 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 earlier Cruickshank Review, which started from the observation that 86 percent of SME banking services were at that time provided

by just four banks. A further signal, buried in the OFT's announcement on March 16 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."[7] The review was officially launched on 26 May, with the publication by the OFT of a "call for evidence."[8]

Secondly, the recent general election has, perhaps inevitably, led to the debate over the banking sector taking on a more overtly political, and even populist, flavour. There was clearly a risk that the issue of the structure of the banking sector would become politicised, given that the decision to use ministerial powers to clear the acquisition of HBOS by Lloyds, notwithstanding the competition issues it apparently raised, was closely associated with the last Labour government. It was therefore unsurprising in this context that the Conservative party's manifesto committed the party 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."[9] This followed a commitment in an earlier policy paper to ask the OFT and Competition Commission to conduct a "focused examination of the effects of consolidation on the retail banking sector."[10] The Liberal Democrats adopted an even 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."[11] The Liberal Democrats also indicated that they would introduce a general public interest test into domestic merger control law. Were it to go ahead, such a move would presumably replace the current "substantial lessening of competition" test with a looser test akin to that provided for under the old merger control law, which was repealed in June 2003.

With the new Conservative/Liberal Democrat coalition government only weeks old at the time of writing, it remains to be seen which of these policies will be adopted as government policy. The first concrete signal of the government's intentions was the statement in the coalition agreement between the parties[12] that it is the new government's intention to "create a more competitive banking industry." This was subsequently fleshed out in the coalition's full "Programme for Government" document,[13] which confirmed the creation of an independent Banking Commission to consider the case

for separating retail and investment banking. The Commission, which will publish its terms of response shortly, will have one year to prepare its report. The appointment of the banking commission, which was in part a measure for dealing with policy differences on this issue between the Conservatives and Liberal Democrats, appears to have replaced the earlier commitment by the Conservatives to launch a full Competition Commission reference. While this could still arise from the parallel work by the OFT on retail banking, this will take some time to come to fruition. In the meantime, prospective changes to takeover and merger control rules, and the creation of a dedicated "serious economic crime agency" remain items to watch. As far as personnel are concerned, the appointment as Secretary of State for Business of the Liberal Democrats' vocal Treasury Spokesman, Vince Cable, who has publicly criticised investment banks for operating a "cartel,"[14] is unlikely to be viewed with enthusiasm by the banks, given his department's responsibility for competition policy and business regulation.

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 given that, 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, appear to have undermined this assumption, as indeed has the financial crisis itself, leading to calls for government action by shareholders and other investors. This came to a head in the run-up to the general election, with the Association of British Insurers writing to the Secretary of State for Business criticising underwriting fees and the previous City minister Lord Myners calling for some form of inquiry.[15] Apparently spurred on by public comments of Vince Cable (before he entered government), the OFT's Chairman Philip Collins announced that the agency will be looking into this issue.[16] In a public lecture on March 30,[17] 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 March 30 that the Royal Bank of Scotland ("RBS") had agreed to pay a fine of over £28 million for a breach of the Competition Act. Following a tipoff 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.[18] 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.[19] 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 two percent management fee and a 20 percent 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.

CONCLUSION

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.

NOTES

[1] Available at http://ec.europa.eu/competition/sectors/financial_services/inquiries/retail.html.

[2] *See* 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.

[3] For a list of relevant legislative measures, *see* http://ec.europa.eu/competition/state_aid/legislation/temporary.html.

[4] Available at http://www.hm-treasury.gov.uk/fin_bank_review.htm.

[5] Report available at http://www.competition-commission.org.uk/rep_pub/reports/2002/462banks.htm#full.

[6] Reports available at http://www.competition-commission.org.uk/inquiries/subjects.htm.

[7] 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.oft.gov.uk/news/press/2010/26-10.

[8] Available at http://www.oft.gov.uk/shared_oft/personal-current-accounts/OFT1233.pdf.

[9] Manifesto available at http://media.conservatives.s3.amazonaws.com/manifesto/cpmanifesto2010_lowres.pdf.

[10] *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 anticipated 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.

[11] Manifesto available at http://network.libdems.org.uk/manifesto2010/libdem_manifesto_2010.pdf.

[12] Published on 11 May 2010 and available at http://www.conservatives.com/News/News_stories/2010/05/Coalition_Agreement_published.aspx.

[13] Available at http://programmeforgovernment.hmg.gov.uk/banking.

[14] For example, during the televised debate on March 29, 2010 between the then Chancellor of the Exchequer Alastair Darling and his Conservative and Liberal Democrat counterparts.

[15] *See*, for example, *The Daily Telegraph*, March 25, 2010, "Myners calls for inquiry into bank fees," reported at www.telegraph.co.uk.

[16] *See The Financial Times*, March 20, 2010, "OFT has sights on investment banking fees," reported at www.ft.com.

[17] 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.oft.gov.uk/news/speeches/2010/0310.

[18] Available at http://www.ilpa.org/files/ILPA%20Private%20Equity%20Principles.pdf.

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