Regulation and Competition in EU Banking: Before, During and After the Crisis

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Regulation and competition in banking: friends or foes?

- **Competition can be detrimental to stability**
  - Need to protect the charter value of banks
  - Keeley (1990); Hellman, Murdock and Stiglitz (2000); Repullo (2004)
  - Implications:
    - derogation from antitrust rules
    - regulatory authorities as dominant players
- **No clear trade-off between stability and competition**
  - Carletti and Hartmann (2003); Boyd and DeNicolo (2005)
  - Allen and Gale (2004): “The relationship between competition and stability is complex: sometimes competition increases stability”
  - Vickers (2010 BIS conference): today the “greater risk is too little competition [in banking] than too much”
  - Implications:
    - Need to find a balance between regulation and competition
    - increasing role for competition authorities
    - Potential conflicts between regulatory and competition authorities

Regulation and competition in EU banking

- **Before the crisis** (e.g. Carletti and Vives, 2008)
  - Initially: stability concerns and regulatory authorities dominate
  - Gradual shift as a result of
    - Global trend
    - EU integration, but imbalance between market and policy integration
- **During the crisis** (e.g. Pisani-Ferry and Sapir, 2010)
  - No EU resolution authority, only national resolution authorities
  - Increased role of EU competition authority, not only for level playing field but also moral hazard ('too much aid')
  - But no authority in charge of CB crisis resolution ('too little aid')
- **After the crisis** (e.g. Dewatripont, Nguyen Praet and Sapir, 2010)
  - Towards an EU banking resolution authority?
  - What relationship with EU competition authority?

Before the crisis

- **Mismatch between market and financial regulation integration**
  - Rising market integration
  - Slow regulatory policy integration, especially supervision

- **No mismatch between market and competition policy integration**

- **Hence: two potential conflicts between supervisors and competition authorities in the EU**
  - Stability vs. competition logic
  - National vs. EU logic

Rising market integration: EU and global

- **EU promotion of financial integration**
  - Prohibition of capital controls (Maastricht treaty)
  - Single market legislation
  - Market infrastructure
  - Commission offensive against banking protectionism
  - Euro
  - Integration of NMS

- **Global activity as well:**
  - Adoption of global standards, such as Basel II

Internationalization in EU banking

- **Intense M&A activity, more and more cross-border (CB)**

- **EU banks increasingly Europeanized:** market share of banks from other EU countries in national EU banking markets is 20% and rising

- **~40 EU systemic groups, half with significant CB activity:** share of total consolidated assets held in foreign branches & subsidiaries within EU-27 is 25% on average for the 40 banks, but varies from 50% for large Belgian banks to 5% for large UK banks

EU competition policy has played an important role

- **Competition policy in the EU**
  - Both a national (NCAs) and EU (DG COMP) competence
  - National competition policy increasingly applies to the banking sector (but national supervisors retain important power in some countries)
  - EU competition applies in full to the banking sector (but with a role for national supervisors in the case of merger control)
- **Specificity competition policy at EU level: applies to anti-competitive behavior of both**
  - *Firms* (anti-trust policy, including merger with EU dimension)
  - *Governments* (state aid control)
- **Important decisions of DG COMP in banking before the crisis:**
  - Merger control: BSCH/Champalimaud (1999); ABN/Antonveneta (2001-2005)
  - State aid: German landesbanken (1997-2002)
  - Sector enquiry on retail banking (2005-2007)

Regulatory policy integration has been slow

- **Harmonized regulatory framework, but…**
- **Financial stability remained a national competence**
  - No specific EU or ECB competence for financial stability
  - Crisis prevention and management based on decentralization, segmentation and cooperation (Nieto and Schinasi 2007)
    - Decentralization to national authorities
    - Segmentation across sectors and institutions (no single template for institutional architecture)
    - Cooperation among countries and institutions (very weak)
- **Several warnings about the lack of EU institution**
  - The EU's financial institutional set-up is "suboptimal for crisis prevention (and potentially also crisis management)" (Lamfalussy, 2004)
  - The EU's "financial trilemma": Market integration, national supervision and financial stability are incompatible (Schoenmaker, 2007)

Why so little and so slowly?

- Hope that crises would wait until integration is completed
- National champions / regulatory capture
- Fear of potential budgetary consequences
- Regulatory turf war

Summary: Pre-crisis division of labor

	National	Euro area	EU	Global
Regulation				
Supervision				
Crisis resolution				
Antitrust policy				
State aid control				

Regulation vs. competition: The view of DG COMP

- "The literature increasingly shows that **competition cannot be viewed as in any way inconsistent with banking sector stability**. Against a background of increasing stability and more effective supervision in the banking sector, the emphasis of policy in the European Union and other advanced economies is quite rightly on increasing competition. Member State authorities are encouraged to ensure that competition policy applies fully to the banking sector and to ensure that the policy environment is favorable to tough competition." (Sector enquiry report, January 2007)

During the crisis

- **Absence of common resolution framework in September '08:**
  - 27/09/08: Fortis (B/NL) break-up along national lines
  - 30/09/08: Irish government unilaterally decides to guarantee all deposits and debts of 6 banks

- **Crisis resolution framework put in place in October '08:**
  - 12/10/08: Concerted action plan (euro area + UK, adopted by all EU countries at European Council of 15-16/10) for liquidity provision + bank funding guarantees + recapitalization by **national authorities**
  - 13/10/08: Commission communication on state aid (SA) control for the financial sector (FS): Temporary flexibility in the application of state aid rules, subject to conditions (non-discriminatory, proportionate and temporary assistance) and to **DG COMP** monitoring
  - But sill no mechanism for resolution of CB crises!

Large amounts of state aid to the EU banking sector

Effective amounts (Oct ‘08 – Dec ’09)

TYPE OF INTERVENTION	EUR billion	% of EU GDP
Recapitalization	226.5	1.9
Relief of impaired assets	329.3	2.8
Guarantees on bank liabilities	916.4	7.7
Liquidity & bank funding support	66.8	0.6
TOTAL	1539.0	13.0

But large differences across EU countries

An apparent paradox?

- During a crisis one would expect more concern for stability than for competition

- But because of the division of responsibility between national governments in charge of stability and EU authorities in charge of state aid control, the crisis has witnessed a large increase of activity on grounds of both stability (at national level) and competition (at EU level)

- In fact most of the activity of DG COMP in the banking sector so far has focused on state aid control

Special rules for R&R* state aid to banking in the crisis

- **Primary objective of the rules: ensure that rescue measures guarantee**
  - Financial stability
  - Maintenance of credit flows
- **But at the same time, the rules need to**
  - Ensure a level playing-field between banks
  - Limit moral hazard
- **=> DG COMP must ensure that banks receiving significant** rescue aid engage in restructuring so as to**
  - Restore their long-term viability, possibly by appropriate divestment
  - Ensure effective competition, possibly by appropriate divestment
- **Hence, the role of DG COMP in the banking crisis has extended beyond traditional mission to crisis resolution**
  - It does not intervene directly in rescue because it provides no funding
  - But it plays a major indirect role in rescue by imposing restructuring conditions

*R&R = rescue and restructuring

**Significant means recapitalization and asset relief measures > 2% of the bank's total (risk weighted) assets

Most EU systemic banks have received R&R state aids

- **Among the 37 main systemic banks in 2008**
  - 21 received recapitalization or asset relief state aid
    - 11 under national schemes
    - 10 under ad hoc measures

- **All 10 banks benefitting from ad hoc measures and one bank receiving aid under a national scheme (Commerzbank) had to accept restructuring measures (divestment for viability and/or competition)**

Top 10 EU systemic banks by assets, 2008

Banks		Total consolidated assets, 2008 (€billion)	Share of total consolidated assets held in foreign branches & subsidiaries in EU27, 2008 (percent)	Recapitalization and asset relief: State aid granted under national scheme or ad hoc measure
RBS	UK	2,481	1.5	Scheme + ad hoc measure*
Deutsche Bank	D	2,328	**25.9**	**No state aid**
Barclays	UK	2,121	6.3	**No state aid**
BNP	F	2,076	**27.7**	Scheme
HSBC	UK	1,782	13.2	**No state aid**
Crédit Agricole	F	1,580	10.5	Scheme
Société Générale	F	1,130	12.4	Scheme
BSCH	SP	1,045	**35.1**	**No state aid**
ING Bank	NL	1,035	**36.5**	Ad hoc measure*
Unicredit	IT	973	**44.9**	**No state aid**

- Among the 5 largest CB banks (DB, BNP, BSCH, ING, Unicredit), only ING was hit hard
- The other hard hit bank, RBS, has no CB activity in the EU

Next top 10 EU systemic banks by assets, 2008

Banks		Total consolidated assets, 2008 (€billion)	Share of total consolidated assets held in foreign branches & subsidiaries in EU27, 2008 (percent)	Recapitalization and asset relief: State aid granted under national scheme or ad hoc measure
Dexia	**B**	651	**92.6**	Ad hoc measure*
Rabobank	**NL**	612	20.7	**No state aid**
Fortis/BNP	**B**	587	15.9	(new entity)
Intesa-Sanpaolo	**IT**	559	4.6	**No state aid**
Commerzbank	**D**	543	19.9	Scheme*
BBVA	**SP**	532	18.3	**No state aid**
Nordea	**SW**	474	**70.9**	Scheme
Lloyds/HBOS	**UK**	451	1.1	Scheme + ad hoc measure*
BayernLB	**D**	406	22.9	Ad hoc measure*
KBC	**B**	319	**30.9**	Ad hoc measure*

- Dexia is also among the largest CB banks that was hit hard

After the crisis (1)

- **The role of DG COMP towards moral hazard**
  - Some argue that the role of competition authorities is only to preserve competition, not to limit moral hazard, which is the sole responsibility of regulators (Vives, 2010)
  - Others, however, welcome the activist role of DG COMP in trying to limit moral hazard , which is especially in the EU because of the decentralized nature of bank bailouts (Beck et al, 2010)
  - But all seem to agree that there needs to be closer collaboration between regulatory authorities and DG COMP, and in particular that there needs to be a protocol for cooperation between the two sides for dealing with crises
  - But who should resolve differences between them? As long as crisis resolution remains national, it would make sense that DG COMP has the last word.

After the crisis (2)

- **Need a mechanism for cross-border bank resolution**
  - 1st best solution: European banking resolution authority
  - 2nd best solution: effective mechanism for coordinating national authorities
- **What would be the role of DG COMP?**
  - In 1st best solution: ex post assessment and control of decisions by the European resolution authority aimed at limiting moral hazard and avoiding excessive bailouts
  - In 2nd best solution: ex post assessment and control of decisions by national resolution authorities aimed at discouraging non-cooperative behavior and avoiding insufficient bailouts
- **Relationship between resolution and competition authorities**
  - In 1st best solution: need for a body to resolve conflicts
  - In 2nd best solution: should also be a body to resolve conflicts

Conclusions

- **At times of financial crises, the balancing act between stability and competition obviously tilts towards stability**

- **Yet stability comes with a price tag: huge public money and therefore concerns for**
  - Moral hazard
  - Level playing field

- **In the EU where resolution authorities are purely national and state aid control is at the EU level, competition authorities have played a central role**
  - Not only in ensuring a level playing field
  - But also in limiting moral hazard, a task normally assigned to regulators

- **Future relationship regulation / competition authorities very open**