CPI COMPETITION POLICY INTERNATIONAL

CPI Antitrust Chronicle
July 2011 (2)

Financial Services & Competition Law in the United Kingdom: The Quest for Pro-competitive Objectives and Suitable Tools

Emanuela Lecchi
Watson, Farley and Williams LLP

Financial Services and Competition Law in the United Kingdom: The Quest for Pro-competitive Objectives and Suitable Tools

Emanuela Lecchi[1]

I. INTRODUCTION

In the United Kingdom, the debate on competition and financial services has focused lately on a fairly esoteric discussion about whether one of the new envisaged regulators, the Financial Conduct Authority (the "FCA"), should or should not have competition as a "primary objective." In this article we aim to clarify the terms of this debate. We provide first an overview of past competition enforcement activities in the financial services (I) and then turn to the proposed options for reform, which purport to promote both competition and stability in the sector (II). In this latter respect, we focus on the creation of the FCA and, in particular, on the indeterminacy of its powers (III).

II. OVERVIEW OF PAST ENFORCEMENT ACTIVITIES IN FINANCIAL SERVICES

When the Independent Commission on Banking (the "ICB")—the body appointed in the United Kingdom to consider possible reforms to the banking sector to promote financial stability and competition—issued its Call for Evidence in September 2010,[2] it stressed that in the past 10 years there had been 18 investigations of the financial services sector by the competition authorities in the United Kingdom, excluding merger investigations.[3]

In the course of its enforcement activities, the Office of Fair Trading ("OFT") has relied on a mixture of competition law and consumer protection law, with varying results. In 2007-2009 the OFT made one failed attempt to use consumer protection laws to deal with the issue of unauthorized overdraft charges, in response to "tens of thousands of complaints." The OFT took the view that the Unfair Terms in Consumer Contracts Regulation applied to these clauses. A number of banks disagreed, arguing that those charges are part of the core bargain between a consumer and their bank and therefore outside the Regulations. Despite the OFT succeeding in the High Court and in the Court of Appeal, the Supreme Court found in favor of the banks.[4]

The OFT was more successful with competition law; in March 2010, RBS agreed to pay a fine of £28.59 million for disclosing to Barclays confidential information on future pricing relating to loans to professional practices. This followed an OFT investigation prompted by Barclays under the OFT's leniency policy.[5]

---

[1] Emanuela Lecchi is Partner in the Competition, Regulation and Networks Group of Watson, Farley and Williams, LLP.

[2] http://bankingcommission.independent.gov.uk/wp-content/uploads/2010/07/Issues-Paper-24-September-2010.pdf, page 24.

[3] For those who are interested, there have been 9 cartel investigations of the financial sector by the European Commission since 2000. There have been 32 investigations at the national level within the EU in the past five years, leading to 16 infringement decisions and 5 settlements.

[4] http://www.oft.gov.uk/OFTwork/consumer-enforcement/consumer-enforcement-completed/UTCCRs/ .

[5] http://www.oft.gov.uk/news-and-updates/press/2010/34-10 .

In other areas, the OFT has preferred to deal with the issues identified by way of "market studies" and "market investigations." Market studies are just what the name says—studies about the dynamics in a market that do not generally lead to findings of infringement. The latest such study was a study on the cost of equity underwriting whose results were published in January 2011. Despite a finding that "the market is not working well, with little effective competition on underwriting fees," the OFT decided not to make a market investigation reference to the Competition Commission and leave it to "companies and institutional shareholders" to implement certain recommended options.[6] Concerns about the time it would take for the Competition Commission to come to a conclusion might have been relevant in reaching this outcome.

In the well-known payment protection insurance ("PPI") case, a so-called "super complaint" by the Citizens Advice in September 2005 started the investigation. The OFT decided to launch a "market study" in December 2005; then consulted on its "emerging thinking" in August 2006; published the results in October 2006;[7] and finally referred the matter to the Competition Commission in February 2007 for a "market investigation."[8] The Competition Commission published "provisional findings" in June 2008; "supplementary findings relating to retail PPI" in October 2008; consulted on provisional remedies in November 2008, and issued the final report in January 2009. There was then an appeal to the Competition Appeal Tribunal and a final decision of the Competition Commission in October 2010, over five years after the start of the investigation.[9] Meanwhile, the Financial Services Authority ("FSA") intervened on the regulatory side. In December 2010 it introduced rules that required providers to explain the features of PPI to their customers and make it clear that PPI is optional. The rules were to apply to new policies and to complaints received prior to the entry into force of the new rules. The inevitable challenge (by the British Bankers' Association ("BBA") in this case) followed. The High Court found in favor of the FSA and the BBA did not appeal the finding further.[10]

This brief overview highlights the fact that issues in financial services, not dissimilarly perhaps from issues in other industries characterized by structural integration across wholesale and retail and by their importance for the economy as a whole (such as the communications industry), require an approach which coordinates action across regulation, competition, and consumer protection. The United Kingdom has a number of "converged regulators" which are given the tools to operate across these different fields of law.

II. OPTIONS FOR REFORM, THE ICB PROPOSALS, AND THE TRADE-OFF BETWEEN COMPETITION AND STABILITY

In the current debate on financial services in the United Kingdom, the key issue is whether it can be said that competition poses a threat to financial stability. If so, then on the one hand it is arguable that the financial sector should be sheltered from the full rigors of competition law and economic regulation. We cannot in this article provide a detailed review, but after

---

[6] http://www.oft.gov.uk/news-and-updates/press/2011/08-11 .

[7] http://www.oft.gov.uk/OFTwork/markets-work/completed/payment .

[8] http://www.oft.gov.uk/shared_oft/reports/financial_products/oft899(1).pdf .

[9] *See* the Competition Commission explanatory note at: http://www.oft.gov.uk/shared_oft/monopolies/PPI_Explanatory_Note.pdf .

[10] http://www.fsa.gov.uk/pages/consumerinformation/product_news/insurance/payment_protection_insurance_/ppi_judgment_accepted/index.shtml

consideration of available economic evidence, there does not seem to be an unambiguous finding that competition poses a threat to financial stability. On the other hand, it appears sufficiently clear that restrictions of entry and ownership harm both competition *and* financial stability. In the absence of restrictions of entry and ownership, a market that works properly should, over time, become more competitive and less concentrated. Instead, the financial crisis has lead to further consolidation and "concentration levels in the personal current account market are now higher than at the time of the Cruickshank report."[11]

The U.K. government followed a two-pronged approach in response to the financial crisis. On the one hand, it appointed the ICB, chaired by Sir John Vickers, previously the OFT's Chairman. The remit of the ICB is to consider structural and related non-structural reforms to the U.K. banking sector to promote … financial stability and competition. The ICB is asked to publish its final report with recommendations to Government by the end of September 2011.

An interim report was published in April 2011 (the "ICB Report).[12] The ICB Report set out a number of structural reforms for financial stability, which have been well publicized.[13] Chief among them is the recommendation that the retail operations of financial institutions should be ring-fenced. Among other potential benefits of this proposal, the ICB lists the fact that it would then be possible for wholesale and investment banking activities to fail, without risk to the tax payers and customers of the retail operations. These structural reforms for stability could go some way towards increasing competition among financial institutions and removing a number of skewed incentives, as well as mitigating the implicit subsidy that institutions which are "too big to fail" appear to enjoy. Specifically on reforms to promote competition, the ICB considers a possible divestiture package for Lloyds Banking Group; a review of barriers to entry; and improvements to the switching process.[14] Perhaps the most interesting proposal for the purposes of this article is that the new regulator, the FCA should have "pro competitive objectives and suitable tools,"[15] namely a "clear primary duty to promote competition," and, crucially, the tools to discharge this objective.

Unfortunately this concept of having appropriate tools to discharge duties is not further elaborated in the ICB Report and it seems that the debate has since been caught in a loop in which the focus is exclusively on whether the FCA should have a "primary duty" to promote competition, forgetting that a duty to promote competition without the tools to enforce competition may end up being a rather empty duty.

---

[11] I.e., 1998. *See* the House of Commons Treasury Committee, *Competition and Choice in Retail Banking*, Ninth Report of Session, ¶16 (2010-11).

[12] *Available at*: http://s3-eu-west-1.amazonaws.com/htcdn/Interim-Report-110411.pdf .

[13] The House of Commons Treasury Committee published an evaluation of the ICB Report on July 21, 2011 (http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1069/1069.pdf). The Committee focuses on the proposal that retail operations should be ring-fenced and asks for the debate to take place more in the public domain and for more evidence to be made available in the ICB Final Report in September.

[14] The ICB hypothesis is a "full account number portability" – similarly to what happens when switching mobile phone providers, account holders should be able to switch without changing account numbers, which would make it possible to switch without the need to transfer all standing orders and direct debits. This measure in the past had been considered too expensive (ICB Report, *supra* note 12, point 5.17) and this may be true, although it is difficult to see that the technical solutions required would be more complex than those required for mobile phone number portability.

[15] ICB Report, *supra* note 12, ¶5.25.

IV. THE FCA AS A PAPER TIGER?

The creation of the FCA—not to be confused with the existing FSA, the Financial Services Authority—is part of the second prong of the U.K. approach to the financial crisis, namely the regulatory approach. According to the February 2011 consultation by HM Treasury, "A new approach to financial regulation: building a stronger system," it is intended that the Bank of England will oversee the new regime, with a general role to protect and enhance "the stability of the financial system of the UK."

A body within the Bank of England, the FPC, will have an overarching "financial stability objective" and the ability to issue mandatory directions to two further bodies: the PRA (whose strategic objective is also the promotion of stability but with the operational objective of prudential supervision, namely ensuring the soundness of authorized persons) and the FCA. This regulator would have a special remit to consider conduct regulation, mostly, although not exclusively, at the retail level (but note that the ICB report highlights the risks that structural integration with wholesale and investment banking poses to retail banking). Its strategic objective is to ensure "confidence in the UK financial system." It has three operational objectives, namely (i) efficiency and choice; (ii) 'appropriate' consumer protection; and (iii) integrity of the U.K. financial system. The FCA then should also have a duty to promote competition unless this would be incompatible with its strategic and operational objectives. A simplified overview of this new structure is provided below at the end of the paper.

One issue with this proposed framework is that it is unclear what the FCA is supposed to be. In an earlier consultation in July 2010,[16] it was envisaged that this regulator (then provisionally named the "CPMA," the Consumer Protection and Markets Authority) would be a "consumer watchdog." That original emphasis was then watered down considerably to the point where the FCA's role is now to ensure "appropriate" consumer protection, as seen above. The Government envisages that the FCA will also not be an "economic regulator," although there is no explanation for this statement. We read, "given that FCA will not be an economic regulator and in light of key differences between financial services and other sectors…"[17], the Government has decided, when it comes to tools, that the FCA will not be a converged competition and regulatory authority, with concurrent powers of enforcement with the OFT. Rather, it may be given the power to "initiate a referral to the OFT," when it identifies "a structural competition issue of concern."[18] Without more, one is left with the impression that the FCA may end up in the same position as Citizens Advice when this body identified an issue (perhaps not even structural) relating to PPI in 2005, mentioned above.

The House of Commons Treasury Committee has issued two main reports, one on a preliminary consideration of the Government's proposals for financial regulation (in February 2011) and one on Competition and Choice in Retail Banking (published in April 2011). In both of them, the Treasury Committee expresses a view that the FCA should have "competition as a primary objective." The Government's response so far has been that there is a trade off between regulation, competition, and consumer protection in financial services, which would not be captured by giving such a primary objective to the FCA.[19] This is the reason why Ofcom, the

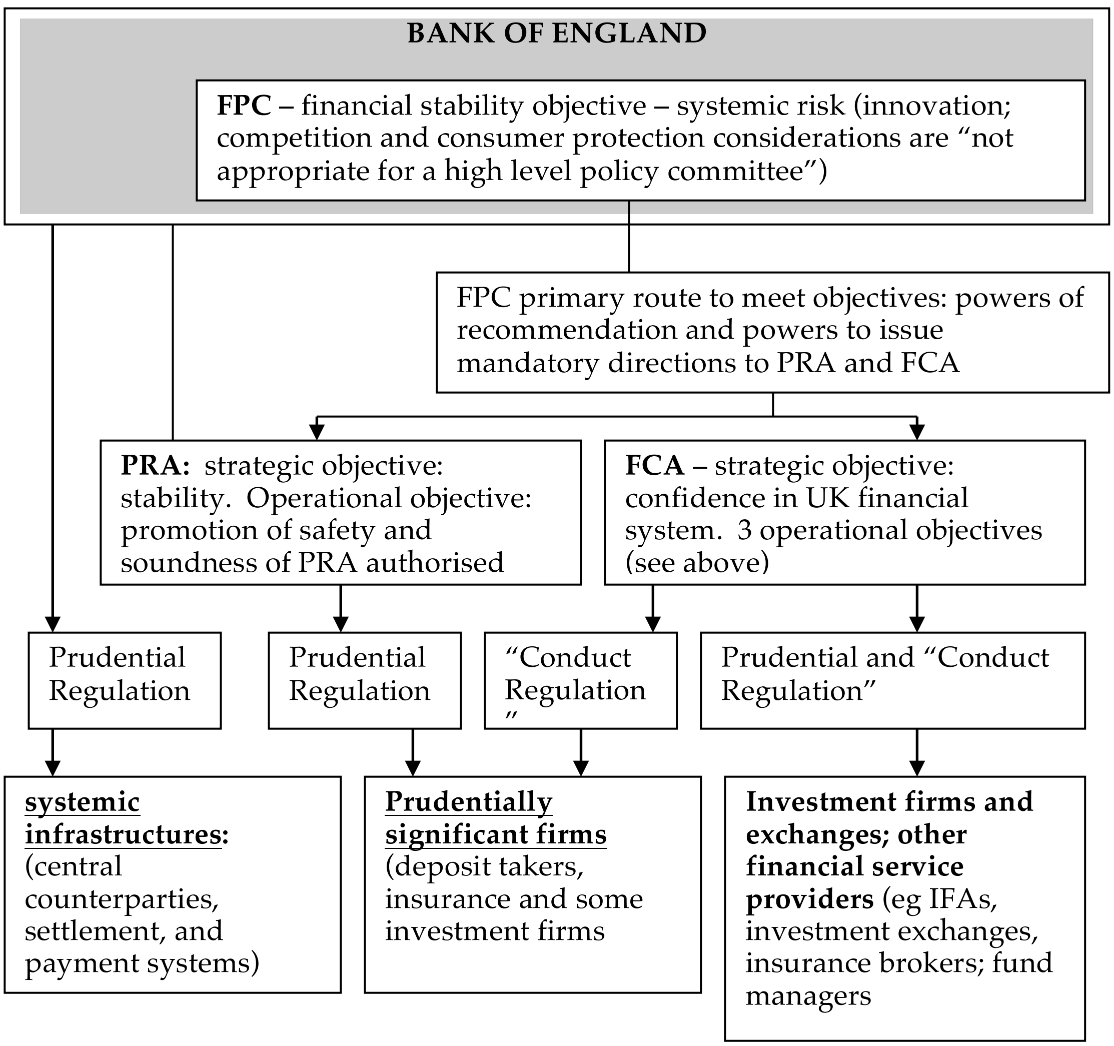
---

[16] http://www.hm-treasury.gov.uk/consult_financial_regulation.htm.
[17] *Id.* ¶4.97
[18] Speech by Mark Hoban MP, Financial Secretary to the Treasury, to the Which? Conference, 27 June 2011.
[19] *Id.*

regulator for the communications sector, for example, does not have competition as a primary objective. Ofcom has several "objectives and duties," which it fulfils by exercising the functions of (i) regulation; (ii) competition enforcement (concurrently with the OFT); and (iii) consumer protection (as *tools*), taking into account different factors, which are not perfectly aligned and require it to exercise discretion.

The debate on whether the FCA should have competition law as a primary objective may therefore turn out to be largely irrelevant. Objectives, duties, and factors have little meaning if a regulator does not have the powers to pursue them.

V. APPENDIX



Source: HM Treasury Consultation – February 2011 (simplified)