EU competition policy in the European Banking Union – are the good old policies good enough?

This paper explores how the balance between different policy objectives in the financial sector has been struck within the European Banking Union (EBU) context. In particular, we focus on the implementation of competition and financial stability policies, suggesting institutional amendments and policy calibration oriented at facilitating a better aligned and more transparent balancing of objectives.

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1. EUROPEAN BANKING UNION (EBU) BEYOND FINANCIAL STABILITY

During the Great Financial Crisis,[1] financial stability achieved an unprecedented centrality as a policy objective in the European Union (EU). Stability, it is argued, is necessary given the role finance plays as the infrastructure underpinning modern economies and to avoid the social costs of instability and financially driven downturns in terms of dampened GDP growth and increased public debt.[2] 10 years on, financial stability remains a primary objective for EU's financial supervisors and central banks, who take the lead in post-crisis supervision of our banks. Financial stability, however, is one, but not the only, aim of public intervention in the banking sector. It exists along other, dynamic and forward-looking aims: such as protection of creditors and depositors or delivery of critical functions by credit institutions, such as lending to the real economy. Additionally, horizontal modes of regulation, such as competition policy in the EU, seek not only to ensure that free market processes lead to efficiency gains and innovation, but also enhance consumer welfare and – following the German ordoliberal tradition – restrain private market power. Combined, policy implementation by different authorities should facilitate the operation of EU banking markets which are efficient, effective, inventive and adaptable to change through the right mix of incentives, business freedom and rules. Coordination between policy implementation is required to ensure consistency and coherence.

As the GFC subsides, a debate is re-emerging, however, as to what is the socially desirable balance between multiple policy objectives and tools of governing the financial sector which often pull in antithetical directions, most notoriously, albeit not only, in the case of financial stability and competition policy. Trade-offs in policy implementation exist not only between bank-specific (financial regulation) and non-bank specific regulation (such as competition or data protection),[3] but also between different modes of regulation (microprudential, macroprudential and/or resolution regimes).[4] Excessively restrictive regulation could come at a cost of lower growth, distorting lending incentives. Good governance requires transparency and equity in the process of balancing various objectives, given the social and economic (including distributional) consequences of this process. Arguably, increased transparency of the decision-making processes can also lead to outcomes more beneficial to consumers and to the economy at large as well as to alleviate dangers of regulatory capture exasperated in a highly-concentrated market.

In this context, policy implementation within the European Banking Union (EBU) is somewhat problematic, since only decision-making with respect to financial regulation is centralised within the Single Supervisory and Single Resolution Mechanisms, without (or with few) specific arrangements for coordination with other policy objectives, such as competition or consumer protection.[5] The implementation of other policies was not

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[1] In this paper, the concept of financial crisis is understood as a major collapse of the financial system involving lack of capacity to provide payments services or to allocate credit to productive investment opportunities, and is considered to have commenced on 15 September 2008 at 6.56am, when Lehman Brothers Holdings Inc. filed for bankruptcy (Great Financial Crisis, or GFC).

[2] Andy Haldane, "Rethinking Financial Stability", speech delivered at the Jackson Hole conference, 12 October 2017.

[3] Rory Van Loo, 'Making Finance More Competitive', *Oxford Business Law Blog*, 2017.: "… *in some countries, the same administrative agency advances both bank competition and bank safety and soundness. That conflicted dual mission submerges competition under the more salient task of preventing bank failures*."

[4] For example, when the regimes create different incentives for credit institutions, e.g. in terms of risk-taking.

[5] The exception here is state aid control, where in the case of bank resolution a specific state aid framework and procedure is set down by Article 18(4) of SRM Regulation (Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014). With respect to other areas of competition policy, the EBU legal framework states that the ECB is to carry

necessarily adjusted to the new realities of the EBU, including the specific challenges which the latter brings about. Such (incomplete) push for centralisation leads to an asymmetric policy balancing process in the EU banking market. We argue that such symmetry is essential – in the absence of explicit prioritisation of objectives at a political level – also as a system of checks and balances. This is especially as it is not a foregone conclusion that the flurry of regulatory reform in the aftermath of the Great Financial Crisis has, or is able to, achieve its stated stability aims in the long-term – in fact, by some accounts, there is more risk in the banking system today than there was before 2008.[6]

2. EBU AND MARKET INTEGRATION

The EBU – also by promoting a more integrated EU banking market - is presented as the antidote to ineffective financial supervision over the banking sector in the EU before the GFC, seeking to break the vicious circle between the sovereigns and the banks, while restoring the safety and soundness of the latter.[7] More integration of the EU banking market – also through higher consolidation levels - is believed to be one of the most efficient ways to reinforce the EBU and to restore financial stability. To this end, recent research has questioned whether the EU is not overbanked, that is whether the existing number of institutions and branches causes inefficiencies in the sector. To attain the EBU objectives, emergence of EU bank champions is seen as a potential solution that would restore banks' profitability,[8] transforming the so far *predominantly national* landscape of EU retail banking sector. Consolidation and market integration have been promoted by EU's supervisors, for example by calls for further harmonisation of substantive rules.[9] A substantial restructuring of the EU banking sector is already taking place, and according to ECB's statistics, the number of credit institutions in the Eurozone has declined by 25% since 2008.[10] Such decline can be partially explained by the exit from the sector of inefficient banks, either through resolution[11] or liquidation in the post-crisis regulatory and supervisory EU regime. The increasing concentration in the EU banking sector, however, raises several concerns from the competition policy perspective in the long-term, these relating in particular to the impact of growing market power of large market players. This trend could furthermore lead to entrenching the position of too-big-to-fail financial institutions, rather than make banks "safe to fail" as the post-crisis regime claims to do.[12] Consequently, as the implementation of the EBU moves forward, pushing for a more integrated and homogenous EU banking market and for the centralisation of financial supervision powers with the European Central Bank (ECB), questions which arise are how other policies should be enforced in the context of banks supervised within the Single Supervisory Mechanism (SSM). Here we explore whether in particular a specific competition policy regime should not be established to mirror EBU oversight.

This question should be placed in the context of broader adjustments of the EU banking sector to the new regulatory regime, as well as business model transformations under pressures from new technologies, including FinTech. In empirical terms, some post-crisis characterisations of the financial sector are relevant here: (a) risk-taking is not necessarily decreasing at least by the known measures;[13] (b) diversity of banking models in the sector is decreasing;[14] and (c) there is increasing concentration in the sector by various measures.[15] While this

out its tasks subject to and in compliance with relevant EU law, including competition law - Recital 32 of SSM Regulation (Council Regulation (EU) No 1024/2013 of 15 October 2013).

[6] Natasha Sarin and Lawrence H. Summers, "Understanding Bank Risk through Market Measures", Brookings Papers on Economic Activity, Fall 2016, pp. 57-126 showing how risk measured by market measures has increased in global financial markets.

[7] Since this sovereign-bank-nexus – also referred to as bank-sovereign doom loop - was seen to be at the centre of both the financial (due to distorted incentives for risk-taking resulting from implicit subsidies) and sovereign debt (caused by the socialisation of private loses) crises.

[8] ESRB, "Is Europe overbanked? 2014.

[9] ECB, "Special feature: Cross-border bank consolidation in the euro area" in *Financial Integration in Europe Report*, 2017, p. 41.

[10] ECB, "*Report on Financial Structures*", 2017, p.23.

[11] If the failing bank is put under resolution, one situation where the resolved entity will exit the market is when it is sold to another market player, as was the case of Banco Popular Español, as discussed below.

[12] Thomas F. Huertas, "*Safe to Fail: How Resolution Will Revolutionise Banking*" (London: Palgrave Macmillan, 2014).

[13] N. Sarin and L. Summers 2017 (n. 4) provide evidence that risk in the financial sector has increased across a number of global jurisdictions since the GFC, providing evidence specifically for stock price volatility, option-based estimates of future volatility, beta, credit default swaps, price–earnings ratios, and preferred stock yield.

[14] Where diversification is considered one of the risk-mitigating strategies, decrease of diversity can lead to more herding. Some argue, however, that less diversity of banking models makes the system more manageable from a supervisory perspective (reduction of complexity associated with diversity), and this therefore reduces financial instability (see A. Haldane, n. 2, p. 26).

triple scanning does not necessarily indicate the failures or inefficiency of regulatory policies as the transition to the new regime takes place, it nevertheless suggests a more long-term approach to regulating the EU banking sector may be required to prevent a destabilising financial repression scenario. Such long-term regulatory approach should include all the policy tools at the disposal of EU authorities, and competition policy in particular. In this brief paper, we focus on the merger control, however similar considerations could apply to other antitrust areas as well.

3. EU COMPETITION POLICY IN THE BANKING SECTOR BEFORE AND DURING THE GREAT FINANCIAL CRISIS

EU Competition Policy

The European Commission is the EU competition authority and therefore, through the Directorate-General for Competition, DG COMP, it directly enforces the EU competition rules under EU Treaties. Articles 101 to 106 TFEU (together with the EC Merger Regulation)[16] refer to merger control[17] and anticompetitive behaviour, whereas Articles 107 to 109 TFEU relate to state aid. The European Commission is primarily responsible for the EU's competition policy, which, very briefly, focuses on the application of rules to ensure that companies (regardless of the sector) compete equally and fairly with each other.

Within the EU's competition policy, depending on whether it covers state aid or merger control, the competences of the European Commission vary. Competition policy in the EU – as opposed to the US antitrust – could be seen as having played a triple role under the EU legal system: by being a tool for European integration in the internal market in the 1990s and seeking to establish a level playing field to ensure a competitive market; by promoting economic efficiency of market; and by seeking to increase consumer welfare (since restraints on competition can produce a deadweight loss for the economy and harm to consumers).[18]

In merger control, the task of overseeing companies' concentrations is shared between the European Commission and the national competition authorities (NCAs).[19] Merger control relies on a one-stop-shop rule according to which companies apply for regulatory clearance for a concentration. The notification of the envisaged merger, depending on specific turnover or market share thresholds, is made to the European Commission or to the competent NCA. Such repartitioning of responsibilities in the merger control assessment partially resembles the competences set-up under the SSM, although the EC does not enjoy the ultimate control over the repartitioning of competences as the ECB does within the Banking Union.[20] The EC Merger Regulation introduced a referral system between the European Commission and the NCAs to ensure a case allocation mechanism (regardless of the turnover or market shares thresholds) that picks the best authority to deal with each concentration, in accordance with the subsidiarity principle.

EU Competition Policy in the banking sector

There was nothing in the Rome Treaty that – in theory - prevented the full application of articles 85 and 86 (currently articles 101 and 102 TFEU) to the EU banking sector. Nonetheless - in practice - the European

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[15] Measured by various indicators such as market share of the largest 3 or 5 market actors (e.g. see European Commission, "Coping with the international financial crisis at the national level in a European context Impact and financial sector policy responses in 2008 – 2015", Report, 2017) as well as dynamic competition measurements such as the Boone indicator (see World Bank Group, "The Little Data Book on Financial Development 15/16, 2015).

[16] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), OJ L 24/1, 29 January 2004 (EC Merger Regulation). A general overview of main legislative texts for merger decisions, can be found in EC's website at http://ec.europa.eu/competition/mergers/legislation/Merger2015.pdf

[17] Merger control was introduced in the EU in 1989 and reformed in 2004 through the EC Merger Regulation.

[18] *Competition Policy in the EU. Fifty Years on from the Treaty of Rome.*, ed. by Xavier Vives (Oxford, United Kingdom: Oxford University Press, 2009), p. 1.

[19] The EC Merger Regulation applies to *all concentrations with a Community dimension as defined in* Article 1 (*Scope*) of the Regulation.

[20] A concentration has a community dimension when, *inter alia, the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 5 000 million; or the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 250 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.* In the banking sector, the calculation of turnover is adjusted to banks (Article 5(3) of the EC Merger Regulation) and there is a special rule about the temporary holding of company assets by a financial institution for resale (Article 3(5) of the EC Merger Regulation).

Commission did not enforce competition in the banking sector before the early 1980s.[21] Only in 1981 the European Court of Justice (ECJ) ruled that competition rules were applicable in full to credit institutions. Although the parties argued that banking undertakings were "*entrusted with the operation of services of general economic interest*" (and therefore were not subject to the Treaty rules on competition),[22] the Court did not accept this argument.[23] This ruling, which allowed for a number of substantive actions to be taken by the European Commission to ensure the level the playing field in EU financial and banking markets, was coupled with a period of significant liberalisation of financial activities.[24] After this liberalisation period, progressive harmonisation of EU banking law and the establishment of the single currency, facilitated cross-border banking activity in the EU. Since then, while the integration of financial supervision was still lagging behind at this stage,[25] EU competition policy was applied with full vigour, not only by prosecuting anticompetitive behaviours (such as cartels and abuse of dominant position), but also through state aid and merger control (the latter, only introduced in 1989). Since the current EC Merger Regulation was put in place, only between 1 January 2004 and 15 September 2008 (*i.e*. the date of collapse of Lehman Brothers), the European Commission was notified in 103 cases for merger operations within the financial sector.[26] In the great majority of the cases (99 notifications), the European Commission cleared the operation without demanding any kind of remedy prior to the clearance.[27] During this 4-years-period, the merger control policy in the EU banking sector could therefore be considered shallow, which partially explains the lack of preparation of the European Commission when the Great Financial Crisis reached Europe.[28] Furthermore, lax approach towards banking mergers (between 2004 and 2008) partially explains the size and interconnectedness of some EU banks, which made the crisis management much more complex.[29]

EU competition policy enforcement has already been historically somewhat calibrated in the banking sector - a business activity which due to a combination of unique characteristics is particularly fragile and susceptible to instability.[30] The traditional economic debate on the potential trade-off between financial stability (pursued *inter alia via* regulation) and competition (including merger control), spanned arguments which go both ways: increased concentration in the banking sector may improve financial stability by better aligning risk-taking incentives of borrowers (challenging the trade-off claim), or, in the alternative, more competitors may cause instability in the banking sector, where low franchise value due to competitive pressures induces more risky behaviours by banks (supporting the trade-off claim).[31] Across a number of jurisdictions, the enforcement of competition and financial stability is controlled by different entities, begging for coordination between both.[32] Recent research, however, nuances significantly the existence of a trade-off between the two policy objectives, by pointing to conditions on supply and demand sides of the banking markets as affecting the trade-off.[33] Vives, for example, emphasises the central importance of the institutional arrangements in achieving an optimal

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[21] Elena Carletti and Phillip Hartmann, 'Competition and Stability: What's Special about Banking?', in *Monetary History, Exchange Rates and Financial Markets: Essays in Honour of Charles Goodhart*, P. Mizen, Cheltenham: Edward Elgar., 2002, II.

[22] For more details, see, for example: Ignazio Angeloni and Niall Lenihan, 'Competition and State Aid Rules in the Time of Banking Union', *in: "Financial Regulation: A Transatlantic Perspective" (E. Faia et al (eds).*, (Cambridge: CUP, 2015).

[23] Paragraph 7 of the Case 172/80 - *Gerhard Züchner v. Bayerische Vereinsbank AG*, 1981.

[24] See, for example, P. G. Teixeira, "*Europeanising prudential banking supervision. Legal foundations and implications for European integration*", in: Fossum, John Erik, and Agustin Jose Menendez. 'The European Union in Crises or the European Union as Crises?' ARENA Report, 2014.

[25] For arguments explaining the division between monetary policy and banking supervision see: Tomasso Padoa-Schioppa, "*Regulating Finance: balancing freedom and risk*", (Oxford: OUP, 2004). For arguments on centralization of bank supervision in the EU see: Despina Chatzimanoli, "*Law and Governance in the Institutional Organisation of EU Financial Services: The Lamfalussy Procedure and the Single Supervisor Revisited*", PhD Thesis, European University Institute, 2008.

[26] Data used in accordance with data available on the EC database.

[27] Only in one case – *Case M.4844, Fortis/ABN Amro* – the European Commission imposed conditions to the merging entities before clearing the operation (which happened on 3 October 2007).

[28] Rupprecht Podszun, 'Rethinking Competition Law after the Financial Crisis', in *EU Law after the Financial Crisis* (Cambrigde; Antwerp; Portland: Intersentia, 2016), pp. 163–86 (p. 167).

[29] Podszun, p. 168.

[30] *Competition and Financial Markets, Volume 1,* Policy Roundtables (OECD. Directorate for Financial and Enterprise Affairs. Competition Committee., 8 June 2009), p. 102., Mathias Dewatripoint, 'European Banking: Bailout, Bail-in and State Aid Control', *International Journal of Industrial Organization*, 34.C, 37–43 (p. 41)., and Stan Maes and Stephen Mavroghenis, 'Aid in the Banking Sector', in *EU State Aid Control: Law and Economics*, ed. by Phillipp Werner and Vincent Verouden (Alphen aan den Rijn: Kluwer Law International, 2017), pp. 759–820 (p. 759).

[31] For an overview about the interplay between short-run stability and long-run healthy competition, see Carol Ann Northcott, 'Competition in Banking: A Review of the Literature', *Bank of Canada Working Paper*, 2004–24 (2004).

[32] In institutional terms, however, there seems to be no prevailing model. See *inter alia* Carletti 2002, OECD 2017.

[33] John H. Boyd and Gianni De Nicolo. '*The Theory of Bank Risk Taking and Competition Revisited'*. The Journal of Finance 60, no. 3 (2005): 1329–1343.

balance between the two policy objectives, especially when these policy objectives are pursued by distinct authorities.[34]

Consequently, the main question which arose under the 'trade-off' paradigm was whether the objectives of banking competition and European financial stability should be weighted case by case or rather whether a permanent exception should be made for either of the policies (and mainly, whether the banking competition objective should always be subordinate to the financial stability objective).[35] If the two objectives must be weighted, then the role of the EU institution empowered to take the final decision is vital to determine – *in casus* - the weight given to the objectives of stability and competition. The nuanced post-crisis approach, supported by empirical evidence undermining the crude 'trade-off' thesis, suggests that where the enforcement remains distinct, institutional set-up and symmetry in institutional clout and toolbox are necessary to ensure an optimal balancing of objectives.

EU Competition Policy in the banking sector during the GFC

When the Great Financial Crisis reached Europe, there were neither bank specific insolvency nor resolution regimes in place at a EU-level, nor specific 'financial stability' tools. As a consequence, as soon as EU banks started being hit, the European Commission made use of the existing tools to prevent the contagion and spill-over effects, that is state aid rules in particular, to facilitate the coordination of crisis measures at EU level.[36] State aid control under Article 107 TFEU was more lenient than prior to the GFC and as such criticised for being too permissive.[37] Supporters of this lenient approach argue that the temporary relaxation of the state aid rules was the less of two evils,[38] in particular where early calls were made for full suspension of competition policy for reasons of public interest in financial stability. The application of EU antitrust rules meanwhile continued to apply – formally at least – in the same way as prior to the GFC.[39] Nonetheless, at a national level, some Member States adopted a more lenient control of banking mergers. In particular, when parties to a banking merger invoked the failing firm defence argument, some national competition authorities accepted it and cleared the merging operation with view of *stability of the financial sector.* [40]

Regardless however, of whether rules where applied less or more leniently over the course of the Great Financial Crisis, it remains the case that the European Commission remained exclusively competent for the enforcement of competition policy in the context of activity falling within the scope of EU law. The crisis-specific rules which have been put in place, furthermore, are explicitly of a temporary nature.

4. COMPETITION POLICY FOLLOWING THE GFC AND AFTER THE BIRTH OF THE EBU – TENSIONS BETWEEN COMPETITION AND FINANCIAL REGULATION

The post-crisis decade brought about a reframing of the aims of financial regulation, and therefore also – at the institutional level - the terms of engagement between different financial regulators and competition authorities in the EU and Member States. More precisely, the EBU established a centralised (albeit in a dynamic way) mechanism for supervision of EU banks. The primary objectives of establishing the EBU are to ensure safety and soundness of financial institutions (via microprudential supervision), their resolvability and resilience (through EU resolution law) and, also the stability of the financial system as a whole (with macroprudential

[34] Xavier Vives, "Competition and Stability in Banking: The Role of Regulation and Competition Policy" (Princeton: Princeton University Press, 2016).

[35] *The Single Resolution Mechanism. Introduction to Resolution Planning*, Publications Office of the European Union (Luxembourg, September 2016), p. 9.

[36] See Communication from the Commission — The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, OJ C 270, 25.10.2008, p. 8–14: *where the entire functioning of financial markets is jeopardised* (paragraph 11).

[37] Thomas Ackermann, *Legal Challenges of the Global Financial Crisis*, ed. by Wolf-Georg Ringe and Peter M. Huber, Studies of the Oxford Institute of European and Comparative Law (Portland: Hart Publishing. Oxford and Portland, Oregon, 2014), XVIII, 149 by Wolf-Geor and Ioannis Kokkoris, 'State Aid Law v Single Resolution Mechanism: David v Goliath or Vice Versa?', *International Corporate Rescue*, 10.6 (2013), 387–94.

[38] John Fingleton, 'Competition Policy in Troubled Times' (presented at the Annual Charles River Associates Conference, Brussels, 2008)..

[39] Massimo Merola, Jacques Derenne, and Josnd Jos *Competition Law in Times of Economic Crisis. In Need of Adjustment? / [8th Annual GCLC Conference in November 2012]*, GCLC Annual Conference Series, 4 (Bruxelles: Bruylant, 2013), pp. 25, 31.

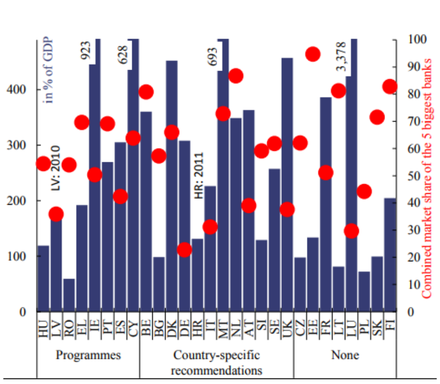
[40] For example, the TSB plc/HBOS plc merger, which was cleared on the 31st October 2008 in UK.

supervision).[41] EBU's supervisors have also been (both explicitly and implicitly) empowered with competition policy-related competences such as prudential control over mergers and acquisitions in the banking sector and competences which affect the conditions of entry and/or exit for market participants or the level playing field in the sector. The institutional trend in some national jurisdictions has been towards combining in the same entity the coordination between several competition and financial stability concerns. Arguments for a separate and distinct enforcement remain strong however, including the lack of transparency and potential hierarchizing which can occur when pursuit of multiple aims is conferred to the same institution.

Within the EBU, financial supervisors and resolution authorities (both national and European) are expected to take into consideration competition concerns, although they cannot enforce competition rules. Financial supervisory actions and, to some extent, resolution actions, have an impact on the structure of the EU banking sector, and therefore the terms of competition. Regulation can, for example, distort incentives or favour particular market players. This is acknowledged by the EBU framework and substantive EU microprudential law for banks – *inter alia*, by requiring that the conditions imposed on market players are proportionate.[42] Even if indirectly, the pursuit of microprudential supervision goals may affect long-term efficiency of the EU banking sector beneficial to the financial consumer.

The enforcement of competition policy remains predominantly with the competent competition authority (either the European Commission or NCAs).[43] However, the exact cooperation models of policy implementation within the EBU-context are still being ironed out, with calls for "new forms of engagement" already being made.[44] The structural evolution in the EU banking sector, which tends to more concentration after the GFC, raises the question of the new emerging risks in this regard, including entrenching too-big-to-fail positions, as well as raising entry barriers and stifling "good innovation".

Graph I.1.1: **Banking system's size and concentration in 2008**



Source: ECB

Source: European Commission, 2017

5. CHALLENGES IN ENFORCEMENT COMPETITION POLICY UNDER THE EBU

A reassessment of the competition-financial stability policy implementation in the EBU specific context is therefore required. In particular, the pursuit of safety and soundness of EU credit institutions through implementation of microprudential supervision (within the SSM), should not increase the risk of excessive market concentration in the EU banking sector, which would stifle the competitive processes. Such cause-effect reaction is especially relevant in a sector where market power is particularly important and barriers to entry are often prohibitively high to new market entrants.[45] Considering the EBU aims for (more) market integration, in multiple ways, it encourages cross-border banking mergers and creates incentives for market concentration in

[41] Macroprudential supervision did not exist in the EU before the Great Financial Crisis. When designing the post-crisis reform, EU policymakers realised that the stability of the whole financial system deserved a proper oversight, not exclusively focused on the performance of specific financial institutions.

[42] BIS, "Proportionality in banking regulation: a cross-country comparison", August 2017.

[43] Although in some Member States merger decisions of the competition authority can be overturned by the executive where they conflict with the assessment of the supervisor (e.g. Netherlands). See X. Vives, n. 34, p. 151 - Reference incomplete

[44] Ignacio Angeloni, "Bank Competition and Bank Supervision", 2016, https://www.bankingsupervision.europa.eu/press/speeches/date/2016/html/se160704.en.html.

[45] OECD, "10 years on from the Financial Crisis: Co-operation between Competition Agencies and Regulators in the Financial Sector", 2017.

the EU banking sector. A more concentrated banking market will entail less, yet bigger banks. Under the EBU framework, EU banks are subject to different supervisory and resolution rules and solutions, depending on their size and/or importance. In general terms, larger financial institutions benefit from *premia* associated with the safeguards of the resolution regime, which allows for more favourable conditions; whereas small, insignificant banks are more likely to be liquidated in accordance with insolvency regimes (as was the case for small Italian banks Veneto Banca and Banca Popolare di Vicenza recently). The lowering of cross-border entry barriers (e.g. in terms of regulatory differences) is another factor increasing big banks' geographic presence in different Member States. Although the increasing market concentration is also partially a consequence of pressures on existing bank business models after the GFC, from a competition policy point of view, it seems that a specific and ongoing assessment is required to assess the interaction between competition and financial regulation goals. Furthermore, a re-calibration of competition policy implementation by the European Commission in the banking sector could be required for several reasons we explore below.

6. SYMMETRY BETWEEN COMPETITION AND FINANCIAL REGULATION UNDER THE EBU

Balancing the goals of competition and financial stability requires symmetry in their enforcement. However, a symmetric enforcement also requires a (still non-existent) symmetry between the content of applicable legislation. EU competition policy control is only partially inbuilt into the EBU bank supervision and resolution procedures, typically when the provision of state aid is at stake. The remaining antitrust regime – specially merger control between banks - is not specifically covered by the post-crisis supervisory and resolution EU framework. This example shows immediately that there is no full symmetry between the implementation of the two objectives under the EBU framework. We find lack of convergence in two further dimensions: firstly, at which level (national or European-wide) policy implementation occurs; and secondly, the timing of enforcement. Extreme cases of bank failures in particular show problems in effecting coherent policy implementation which may arise because of such asymmetry.

Level of policy implementation

Within the EBU, some tasks were centralised while others were left to the Member States. Consequently, some supervisory and resolution actions are taken at a EU-level whereas others have exclusively a national-wide dimension. The same happens with competition policy, both in state aid and merger control assessments. Under EBU however, the level of policy implementation is not symmetric to that of other policies such as competition policy.

Failure of an EU bank can trigger a resolution procedure or start a liquidation process. The choice between one path or the other is usually perceived as a financial topic, despite having distinct competition implications, potentially undermining the level playing field in the market. For instance, in cases sale of business (of a failing bank) is the chosen resolution tool, the search for a private buyer (for the business) may lead to a banking merger with a *community dimension*.[46] This being the case, the European Commission will play its role as EU competition authority and will assess the banking merger from a competition perspective (as in the case Banco Santander/ Banco Popular Español S.A (BPE) merger discussed below). However, no specific competences are conferred on the European Commission when the failing entity is liquidated and sold in accordance with national law – even when it was the ECB (EU-level) declaring the bank as *failing or likely to fail*.[47] This means that, the trigger for bank resolution or insolvency at EU-level does not necessarily trigger an EU-wide competitive assessment of any subsequent actions.[48] To converge competition and financial stability ("resolution") policy implementations, it is necessary therefore, to reconsider the criteria for *community dimension* in merger control within the EBU.

[46] If the banking merger has no *community dimension,* the assessment will be carried out by a NCA.

[47] See e.g. SRB Notice summarising the effects of the decision taken in respect of Banca Popolare di Vincenza S.p.A., 23 June 2017 upon ECB decision that the Bank is failing/likely to fail (available at: https://srb.europa.eu/en/node/341), the national competition authority decision: Autorita Garante della Concorrenza e del Mercato, Provvedimento C12103 Intesa San Paolo/ Rami di Azienda di Banca Popolare Vincenza-Veneto Banca, 5 July 2017, available at: http://www.agcm.it/concorrenza/concentrazioni/open/41256297003874BD/4C62AB34C5F3A984C1258159003C57A6.htm.

[48] The thresholds for "centralization" of the decision-making within the SSM are much higher than in the case of competition policy, i.e. a bank is deemed 'significant' when the total value of its assets exceeds EUR 30 bn or the ratio (Article 6 of SSM Regulation). While this threshold is higher than in the case of merger policy as a rule, the ECB enjoys residual power over the financial system as a whole. Furthermore, in a number of cases, e.g. declaration of *failing or likely to fail* or authorization procedures, the ECB enjoys responsibility for all credit institutions established on the territory of the EBU (Article of 4 SSM Regulation).

Secondly, while European Supervisory Authorities, also in the EBU context, have an on-going role in the shaping of the regulatory environment,[49] and so does the ECB via its administrative rule-making, limited role in rule-setting to this end is played by competition authorities. A stronger advocacy role for competition and its benefits to the financial consumer could be envisaged for the European Commission as well as tailoring of anticompetitive behaviour control to the particularities of the banking sector.

Timing of policy implementation

The second dimension where the lack of symmetry in policy implementation is evident concerns the time where within administrative procedures financial supervisors and competition authorities play a role, where parallelism of procedures – where these are not properly adjusted – could lead to under-enforcement of one of them. An example of a failing bank resolved through a private sector measure (such as sale of business) is illustrative of this point, a pioneering example most recently being the takeover of Spanish BPE by Banco Santander in 2017.

In the beginning of June 2017, the liquidity situation of BPE rapidly deteriorated, and on 6 June 2017 the bank was declared *failing or likely to fail* by the ECB. EU resolution law foresees three alternatives in such cases: (a) a private sector measure; (b) normal insolvency of the bank; or (c) intervention through resolution by authorities. In the case of BPE, a (private) buyer was found (Banco Santander). Under the resolution scheme adopted by SRM transfer of the failing bank to Banco Santander for EUR 1, inclusive of BPE's liabilities, was agreed.

The acquisition fell within the scope of EC Merger Regulation given the market share/turnover of the banks concerned, thereby requiring that both resolution and competition policies were applied by relevant EU authorities. In the light of the urgency of the transaction to ensure the continuity of the critical functions performed by BPE, in a decision dated 6 June 2017, the European Commission allowed the merger to go ahead before its final approval. Only a preliminary market assessment was performed by the European Commission (through the DG COMP) at that stage, which considered that the market share of the joint new entity would be below 20-30% in the market for credits, consumer funds or in terms of number of branches, and close to 20-30% in in SMEs lending.

The derogation was conditional on Banco Santander submitting a complete notification of the transaction. The acquiring bank was required to take only actions that were necessary to restore BPE's viability and to ring-fence BPE's business until the final decision by the European Commission was taken. The acquisition was approved under EU merger rules on 8 August 2017 without objections. The European Commission's investigation concluded that the transaction did not raise competition concerns, as the parties' combined market shares would generally remain limited (below 25%) and strong competitors would remain in all affected markets.[50] The transaction was therefore cleared unconditionally. Pursuant to the transaction, Banco Santander holds the biggest market share in Spain for SME (25%), loans (19.5%), and customer funds (18.8%).

First, the case proves, that although merger control was formally exercised, its timing might have precluded a full assessment of the transaction before its completion. Secondly, the BPE/Santander merger raises the question of whether situations where a resolution procedure is triggered do not require an adjustment of the merger control policy to the banking sector. In order words, resolution procedure requires a tailored-made merger control policy. This question might suggest that, to ensure a competitive process in the long-term, also other competition policy tools, apart from merger control, might be used in the banking sector, such as market studies. This is especially relevant since the outlook of competition policy tends to be more dynamic than the prudential supervision stance.[51] Furthermore, an exclusive focus on the safety and soundness of the banking sector may lead to moral hazard situations, may create lower quality inefficiencies, may decrease consumers' choice or may facilitate abuse of dominant position.

A tailor-made approach of competition policy under the EBU

Competition law tools (and not only state aid) should therefore be adjusted to the banking sector. But how? There are two possible views towards the merger control policy which has been followed by the European Commission since the beginning of the EBU: either it has been pursuing a merger-constraining policy by

[49] For example through their role in preparing implementing and delegated acts, see Arts. 289-291 TFEU.
[50] European Commission, 2017, "Mergers: Commission approves acquisition of Banco Popular Español S.A. by Banco Santander", http://europa.eu/rapid/press-release_IP-17-2421_en.htm; full.
[51] The enforcement of new areas relevant to competition policy, such as data protection and data sharing rules, might prove particularly relevant in this regard.

dynamically using its powers to block potential concentrations; or, in alternative, it has been pursuing an integrationist policy by building up larger European firms through banking mergers.[52] A 'merger constraining' policy means that the European Commission has been vigorously using its legal powers *vis-à-vis* mergers that risk increasing the market power of firms, in particular if those firms already have such power. Thus, mergers have been blocked by the European authority or when approved, they have been subject to tough conditions that offset gains in market power. An 'integrationist policy' results in a significant number of approved mergers that increase the market power of firms, if they also enhance European integration. This being the case, the European Commission would rarely use its powers to investigate, impose conditions or block mergers, particularly if these are cross-border concentrations which will deepen European integration. The BPE/Santander merger suggests that the European Commission is taking an integrationist approach. Where the prudential supervision and implementation of resolution policy seems to take the lead in terms of promoting market integration., competition policy enforcement should focus on the role of safeguarding the competition processes and conditions in the sector across the EBU and EU as a whole.

However, since the European Commission is bound by the best interest of the EU and seeking to keep a level playing field, it might not be able to choose between an integrationist or a merger constraining approach.[53] A more integrated EU banking market might reflect higher levels of market concentration; whereas a rigid approach towards banking mergers may not be compatible with the resolution regime foreseen by the EBU framework.

To seek a more integrated EU banking market, the European Commission may clear most of the notified banking mergers, yet demand a specific set of procedures and commitments to safeguard a level playing field in the sector (by applying a bank-specific competitive assessment). Such commitments may include geographic constraints of specific financial activities in some of the potential affected markets: retail banking,[54] corporate banking, investment banking, leasing, factoring, payment cards, financial market services or asset management. They can also include temporal constraints, to avoid medium or long-term competition distortions in a specific national banking sector, e.g. commitment to divest one specific branch in a 5-years-period since the regulatory clearance.

Alternatively, the constraining approach of merger control can be combined with a policy of rescue mergers (of banks), when a financial institution is *failing or likely to fail.*[55] In this context, the concept of rescue merger is not new to the EU competition policy.[56] The Great Financial Crisis was, nonetheless, the first time where this question was dealt with within the financial sector. This created the situation where competition authorities allowed systemically important banks – that would not be allowed to exist the market - to engage in a rescue merger, as an alternative to the use of state aid measures.[57] However, rescue mergers have further potentially destabilising implications (on top of the moral hazard) shared with direct State assistance.[58]

Similar to the enforcement of a rescue merger policy is the use of the failing firm defence in a banking merger. There are three criteria that must be fulfilled before the failing firm defence may be invoked. The first criterion is that, without the proposed merger, the allegedly failing firm would be forced out of the market. A further criterion for failing firm is that, the asset of the firm will inevitably exit the market, unless this merger takes place. The damage to financial stability that results from a bank failure is not exclusively caused by the assets leaving the market, but also through the two mechanisms, interconnectedness and intra-market contagion. The final criterion for the failing firm defence is that there is no less anticompetitive alternative to the banking merger. If the European Commission, under the EBU goals, accepts the use of the failing firm defence (by the

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[52] Mark Thatcher, 'European Commission Merger Control: Combining Competition and the Creation of Larger European Firms', *European Journal of Political Research*, 53 (3) (2013), 443–64 (pp. 9–10).

[53] See Article 17(1) of the TEU: "*The Commission shall promote the general interest of the Union and take appropriate initiatives to that end*."

[54] For an overview of what is the understanding of the European Commission on retail banking, see M.4844 - Fortis/ABN AMRO Assets; and M.5948 - Banco Santander/Rainbow; M.3894, Unicredito/HVB.

[55] an anticompetitive merger that relies on the absorption of a distressed bank by a healthy market player may prevent the establishment of a sound efficient new bank (enhancing future systemic crises).

[56] It is understood as a merger that can prevent the collapse of a systemically important bank when there is no less-destabilising alternative to the merger (and that otherwise would leave the market). In this case, the risk of destabilising the market is outweighed by the stabilising effect of the merger. Christopher Johnson, "Has the European Commission had a policy of taking stability into consideration when making horizontal merger decisions in the commercial banking sector?", LLM Thesis, EUI, 2015, p. 71-72.

[57] Such lenient application of merger control rules brought a moral hazard problem.

[58] The effects of a lax merger control in a regulated market take time to have an impact (and may not be enough to save the bank in distress), whereas state aid support is provided immediately (tailored to the specific problems of the bank in distress).

parties to a banking merger), it means that more transactions will be cleared unconditionally without taking duly into account the long-term implications for incentives and the competitive structure of the sector.

7. TRANSITION FROM CRISIS TO 'STEADY-STATE' POLICY IMPLEMENTATION

As a result of the deep economic impact of the GFC, regulatory reform in the EU reframed both substantive rules and institutional arrangements for the oversight of the banking sector. The complex post-crisis architecture of financial oversight with numerous new authorities as well as new regulatory objectives raises concerns from the perspective of high barriers to entry and differentiated impact of regulation on market actors. The challenge of ensuring contestability of financial markets as well as a level playing field remains a key concern from a competition point of view in emerging areas such as FinTech, growing challenges such as consumer protection as well as established fields such as competition policy enforcement.

The possibility of producing additional negative externalities/external social costs by bank failures (partially) justifies the need for a specific insolvency regime for failing banks: resolution.[59] If the new EU resolution framework accepts that for financial stability concerns, insolvency proceedings cannot be started, some banks will not be allowed to fail (again). Hence, the post-crisis regulatory EU regime will put under resolution those banks whose failure could affect the EU financial system. In other words, the new EU resolution regime will continue to favour the safeguarding of financial stability over banking competition concerns.[60] Increased market concentration – with the potential emergence of EU bank champions – is perceived as stabilising by supervisors. While such an approach undoubtedly can be justified from a prudential perspective, to ensure a socially optimal balance between various policy objectives EU, a calibration of EU competition policy in the banking sector is required. Lack of convergence and symmetry between competition and supervision/resolution procedures is particularly noticeable in extreme cases of bank failures, where policy implementation rather than the overall regime determines a de facto hierarchy of objectives.

As evidenced by recent cases as well as general market trends, one could ask whether the combined application of the post-crisis regulatory and supervisory EU framework might not result in an emergence of too-big-to-fail institutions. There seems to be plenty evidence that competition policy was applied in a somewhat more lenient way over the course of the Great Financial Crisis, as the crisis subsides however, and in the context of the EBU in particular, there are plenty of arguments to support a tailor-made – yet proactive – competition policy implementation in the banking sector which is becoming increasingly concentrated, even if financial stability concerns remain paramount. This requires a shift of thinking from using EU competition policy as a crisis management fire-fighting tool, to employing it in a forward-looking dynamic manner.

Ultimately, a healthy and growing economy also depends on a competitive and efficient banking market. This is an important lesson learnt from the Great Financial Crisis.[61] The expected outcome of competition policy enforcement is dynamic efficiency in the financial sector, optimising long-term performance and behaviour of market players; whereas, the expected outcome of financial supervision and regulation is the focus on the current state of supervised entities (rather than on longer term processes) and the safeguarding of financial stability. Still, although competition and financial regulation policies seek different goals, their enforcement should be carried out – also in institutional terms – in a way which ensures financial and banking markets are robust in the long-term. Lack of specific rules which provide for symmetry and convergence in implementation of various policies under EBU obscures the process of balancing of various objectives. Lack of transparency precludes the accountability of relevant actors in the long-term.

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[59] Richard S. Grossman, 'Banking Crises', *Oxford Business Law Blog*, 2016.

[60] David Howarth and Lucia Quaglia, *The Political Economy of European Banking Union* (Oxford University Press, 2016), p. 115.

[61] Danièle Nouy, '"A Penny for Your Thoughts – What"s on the Mind of a Supervisor?", Speech by the Chair of the Supervisory Board of the ECB', 2017.: "*The easy answer is this: some banks will take action; they will adapt to the challenges, they will survive and prosper. Other banks won't.*"