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BRIEFING

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Re: **The European Commission shifts its focus to the enforcement of competition policy in financial services**

1. **Introduction**

Mr Barroso, President of the new European Commission, recently cited¹ financial services as one of the areas where competition rules must be applied more rigorously, EC competition policy is seen as a cornerstone for ensuring a more competitive European market in the future. The President voiced concerns that the Single Market does not “fully function” in the financial services sector and called for a sectoral enquiry to identify the reasons for this failure.

The new Competition Commissioner, Neelie Kroes, has confirmed Mr Barroso’s statement in recent speeches². She has added that the Commission will use its powers to conduct investigations “...with an open mind and constructive approach” and in cooperation with national administrations, regulatory bodies and competition authorities. During her speech to the OECD Global Forum on Competition³, the Competition Commissioner explained the process as one comprising two steps:

- sectoral investigations to identify and remove regulatory, State subsidy or private barriers to competition; and
- the routine examination of draft European and national legislation for its potential impact on competitiveness.

Given that the sector is clearly on the Competition Commissioner’s agenda, this article:

- provides an overview of the relationship between EU/EC competition policy and the financial services industry to date;
- summarises the Commission’s key powers and the consequences of failure to comply with competition rules; and

¹ See “Communication to the Spring European Council: Working together for growth and jobs. A new start for the Lisbon Strategy”, 2 February 2005

² See “Building a Competitive Europe - Competition Policy and the Re-launch of the Lisbon Strategy”, 7 February 2005 and “Taking Competition Seriously - Anti-Trust Reform in Europe”, 10 March 2005

³ See “Regulating for Competition and Growth”, 17 February 2005

- recommends ways of minimising such risks.

2. **Why competition policy?**

The Commission sees as its biggest challenge the fragmentation of the European financial services market. Fragmentation prevents the full benefits of a market comprising 25 Member States and 450 million consumers from being realised. The recent controversy over foreign acquisitions in the Italian banking market is an example of such difficulties. As in similar cases in the past, the Commission has questioned the Italian government and central bank in relation to allegations that they oppose attempts by banks from other Member States to acquire controlling shareholdings in Italian banks.

EC competition policy is particularly suited to combating such fragmentation, since one of its key objectives is to prevent market partitioning. The EC competition rules furthermore: prohibit cartels (unless justified) the abuse of a dominant position and unlawful State aid. These rules apply fully to the financial services sector, which therefore needs to be aware of their terms.

3. **The Commission and financial services: the position to date**

As regards identification and removal of private barriers to competition, the European Commission has conducted significant investigations in the financial services sector.

Examples of such intervention in recent years include:

- (as regards insurance) insurance and re-insurance pools, shipping insurance, aviation insurance and the adoption of the recent “block exemption” Regulation (which exempts certain agreements which would otherwise be considered anti-competitive);
- (as regards banking) charges levied on the exchange of national currencies to euros, multilateral interchange fees for payment cards, agreements restricting access to the issuing market for payment cards, restrictive by-laws for Visa cards and barriers to cross-border mergers; and
- (as regards securities clearing and settlement) refusal to supply clearing and settlement services, fee rebates for securities trading in the context of a consultation on arrangements for securities trading, clearing central counterparties and securities arrangements.

Unlawful State aid has also been targeted. The German *Landesbank* guarantees and French tax breaks for certain mutual insurance coverage are two recent, very sensitive examples.

4. **The Commission’s powers**

Companies and associations should be aware that the Commission’s fact-finding capabilities include both the issue of requests for information and inspections.

The Commission has extensive powers to:

- enter the premises, land and means of transport of an entity (including the homes of directors, managers and other members of staff);
- examine books and other records related to the business (and take copies or extracts in any form);
- seal business premises and books or records;
- ask any representative or member of staff of the entity for explanations of facts or documents relating to the subject matter and purpose of the inspection; and
- take statements from any person who consents to be interviewed.

5. **Self-assessment**

Whilst the Commission enjoys extensive investigative powers, under a modernisation of the rules which entered into effect in May 2004, much of its enforcement role has been decentralised to the national and individual entity level. This means that, in principle, companies and associations must now “self-assess” the conformity of their agreements with EC competition rules.

That said, Community based sanctions remain draconian. The Commission can impose a fine of up to 10% of the company’s annual turnover. For example, in June 2002, the European Commission imposed a fine of over €124 million on eight Austrian banks for their participation in a price cartel. In addition to a fine, the damage to a company’s reputation may also be considerable.

It is therefore advisable that any self-assessment should be regular and based on an effective and comprehensive compliance programme (which can also address any “legacy” issues). In practice, the Commission will take into account an effective compliance programme as a mitigating factor when deciding the size of fines.

6. **Compliance programme**

Although there is no hard and fast rule as to what constitutes an effective compliance programme the following are some practical pointers:

- **Tailor-made:** The compliance programme must be tailor-made for the company or association using it by addressing the specific competition issues in the sector e.g. it is imperative for a company with a market share of over 50% to address any risk of abuse of a dominant position (although substantially smaller market shares may also require attention). Defining the financial service or product and where it is sold therefore become key issues in understanding market share;

- Legal audit: This will ensure that there are no “skeletons in the closet” and, if there are, will give the company the opportunity to apply for leniency and avoid a fine;
- Compliance manual: This sets out the company’s compliance programme and serves as guidance to both employees and management. However, compliance with the EC competition rules must be pervasive. Companies need to ensure that appropriate cross-references exist in other manuals and procedures;
- Robust policies and procedures: The programme should set out effective disciplinary procedures;
- Training: In addition to a compliance manual, the training of employees is vital in order to alert them to the applicable EC legislation and its impact on the company and working practices;
- Legal vetting of documents: Certain documents may require legal review e.g. in the case of a trade association, the terms of a meeting agenda should be checked to ensure the meeting complies with EC law;
- Information exchange: Guidance on disclosure of confidential or other information in both professional and social interactions with competitors is vital;
- Senior management: Compliance should have (and be seen to have) the full backing and support of senior management. The appointment of a senior manager as the compliance officer is now recommended practice; and
- Regular evaluation: As market conditions and the business of the company may change over the years, it is imperative that the compliance programme is updated accordingly.

7. Private actions for damages

Compliance programmes do not only mitigate the risk of a Commission fine. They reduce the risk of competition law infringements generally. Infringements can lead to:

- legal actions for damages and/or interim measures in national courts;
- unenforceability of contractual obligations; and
- serious damage to a company’s reputation, rating and share price.

In particular, as regards private actions for damages, the Commission is committed to encouraging them⁴ and has already made significant steps towards facilitating more effective private enforcement of competition law. Far from copying what it sees as the ‘excesses of the

⁴ See speech by Mario Monti to IBA’s 8th Annual Competition Conference, Fiesole 17 September 2004.

American system', the Commission intends to support public enforcement through extensive private sector involvement.

8. Conclusion

The new Commission has explained that it will not be drafting any new financial services legislation except in certain specified areas. Instead, it will concentrate both on the implementation and consolidation of existing texts and on ensuring a 'level playing field' in the financial services sector. Likewise, the Commission views financial services as a sector deserving priority action in order to make the EC the most competitive economy in the world.

Competition policy will be one of the main tools in achieving these objectives. Financial services market players will be able to benefit from a more efficient market. However, to do so, they must be capable of: (i) successfully defending any allegation of a breach of the rules; and (ii) turning the rules to their advantage by challenging anti-competitive behaviour of other market participants.

We shall continue to report on the Commission's focus on the financial services sector. If, meantime, you would like to discuss this briefing in greater details, please call your usual contact in Steptoe & Johnson or contact Philip Woolfson, Craig Simpson or Zoi Sazaklidou on: international + 32 2 626 0500 or pwoolfson@steptoe.com.

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