



This update provides an overview of the key legal and policy developments in UK & EU Competition law in September 2011. For further information, please contact a member of the Burges Salmon competition team.

Independent Commission on Banking proposes reforms to improve competition in the UK retail banking market

On 12 September 2011, the Independent Commission on Banking (ICB) published its final report, setting out its recommendations for reforms to improve competition and stability in the banking sector.

Key Points

- In order to improve competition, the ICB recommends that the government enhance the obligations on Lloyds Banking Group to divest some of its assets.
- The ICB also recommends measures to improve switching and transparency for retail banking customers.
- The ICB concluded that the new Financial Conduct Authority must have a clear role in promoting competition.

Background

The ICB was established by the coalition government in June 2010, with Sir John Vickers appointed as chair. In light of the weaknesses in the current banking system exposed by the global financial crisis, the ICB's role is to examine questions about the structure of the UK banking sector and to make recommendations on measures to promote stability and competition in banking for the benefit of consumers and businesses.

The ICB has now published its final report, setting out its recommended reforms for promoting stability and competition in UK banking. The recommendations on financial stability call for both structural reform and enhanced loss-absorbing capacity for UK banks. The recommendations on competition set out reforms for structural change in UK banking markets; for improving switching and consumer choice; and for pro-competitive regulation of financial services.

Recommendations on financial stability

In terms of financial stability, the ICB recommends a combination of capital measures to increase loss-absorbing capacity and a structural ring-fence between retail banking and wholesale/investment activities of universal banks.

The objective of a retail ring-fence would be to isolate those banking activities where continuous provision of service is vital to the economy and to a bank's customers. The aim of this would be to ensure that such provision could not be threatened by activities that are incidental to it and that it could be maintained in the event of the bank's failure without government solvency support.

In practical terms, this would require banks' UK retail activities to be carried out in separate subsidiaries. They would have distinct governance arrangements, and should have different cultures.

Recommendations on competition

Long-standing competition issues in UK retail banking

The ICB noted that there are long-standing competition issues in UK retail banking, particularly in markets for personal current accounts and banking services for small and medium sized enterprises (SMEs).

On the supply side, core markets are concentrated, with the largest four banks accounting for 77% of personal current accounts and 85% of SME current accounts.

On the demand side, competition between bank's current accounts is muted by difficulties of switching providers and by lack of transparency about banking services on offer. There are significant barriers to entry and poor conditions for consumer choice.

Structural reforms

The ICB's view is that the best way to address problems of concentration, a lack of challengers to the large banks, and barriers to entry in the current structure of the retail banking market, is to secure the emergence of a strong, new bank.

In the context of a State aid clearance, to remove distortions of competition resulting from the aid provided to the Lloyds Banking Group, the government and the European Commission agreed that Lloyds Banking Group should divest the TSB brand with a retail banking business of at least 600 branches in England and Wales and at least 4.6% of the personal current account market in the UK.

However, the ICB has concluded that these divestitures would be unlikely to give rise to a strong challenger, at least in the short to medium term. The ICB recommends that the government reach agreement with Lloyds to ensure that the entity that results from the divestiture has a funding position at least as strong as its peers and has a share of the personal current account market of at least 6%.

Improving the switching process

The ICB found that competition between banks is blunted by the actual and perceived difficulties for customers in identifying the right account for their needs and switching to it. Annual switching rates for banking products are low and there is significant evidence that consumers are put off by the current switching process.

To remedy this issue, the ICB recommends the early introduction of a redirection service for personal and SME current accounts which, among other things, transfers accounts within seven working days, provides seamless redirection for at least 13 months, and is free of risk and cost to customers. This should boost confidence in the ease of switching and enhance the competitive pressure exerted on banks through customer choice. The redirection service should be fully operational by September 2013.

Improving transparency

The ICB also concluded that transparency should be improved by requirements on banks to disclose more information about prices, including by displaying interest forgone, relative to the Bank of England base rate, on annual current account statements, and through the sector regulator acting to make current accounts more easily comparable.

Regulation by the new Financial Conduct Authority

The ICB believes that one of the reasons for long-standing problems of competition and consumer choice in banking has been that competition has not been central to financial regulation.

The proposed creation of the Financial Conduct Authority (FCA) a new specialist regulator to whom conduct of business regulation will be transferred, should be seen as an opportunity to change this. In the ICB's view, as well as tackling issues of switching and transparency (see above), the FCA, with strong pro-competitive powers and

duties, could make markets work much better for consumers and tackle barriers to entry and growth of smaller banks.

To this end, the ICB recommends that in the FCA's draft objectives, the efficiency and choice operational objective should be replaced with an objective to 'promote effective competition' in markets for financial services.

Next steps

The ICB stated that it hopes that the government and Parliament will respond positively to its recommendations for financial stability by enacting reform measures soon.

Chancellor George Osborne welcomed the ICB's final report:

"The government welcomes the final report of the Independent Commission on Banking. It is an impressive report and an important step towards a new banking system that supports lending to businesses and families, supports the economy and jobs ... We will now get on with implementing its recommendations – let's get the legislation through parliament in this parliament."

As a long-stop, if one or more of the recommendations set out by the ICB is not achieved by 2015, the ICB considers that an in-depth market investigation reference by the Competition Commission should be actively considered.

Proposed joint venture in construction materials market referred to the Competition Commission for in-depth investigation

On 2 September, the OFT announced its decision to refer the proposed 50:50 joint venture between the subsidiaries of Anglo American plc and Lafarge S.A. to the Competition Commission. The transaction will bring together the UK construction material assets of Tarmac and Lafarge.

The OFT expressed concerns regarding supply overlaps in aggregates, asphalt and ready mix concrete, an increased prospect of co-ordination in the supply of bulk grey cement and the potential for independent ready mix concrete suppliers to be foreclosed.

The OFT states that the parties did offer undertakings in lieu of reference. However, the OFT did not consider that the parties' offer to divest a variety of assets would be sufficient to resolve all of its competition concerns.

This is the ninth merger referred by the OFT to the Competition Commission so far in 2011.

It should also be noted that the OFT is currently consulting on its provisional decision to make a market investigation reference to the Competition Commission in relation to the markets for the supply of aggregates, cement and ready-mix concrete in the UK.¹ One of the features identified by the OFT in its market study was the high levels of concentration in these markets.

¹ See pages 2-3 of the August 2011 issue (Issue 13) of this update.

Department of Health disputes claim that health service reform will lead to increased application of competition law to the NHS

On 6 September, the Department of Health (DoH) published a response to a legal opinion on the application of procurement and competition law prepared for the campaigning organisation 38 degrees. The opinion discusses whether, and how, the Health and Social Care Bill has implications for the application of the procurement and competition rules to the NHS.

The DoH does not accept the view that it is more likely that NHS providers are (or will be) economic undertakings that are subject to competition law. DoH reiterated that competition law would apply, where it applies, with or without the Bill.

Under the Bill in its current form, a new regulator, Monitor, will have concurrent powers with the OFT to identify and investigate breaches of competition law within the health and social care services market. This raised concerns that Monitor would actively seek to promote competition in the health sector. However, DoH emphasised that Monitor will have an overriding duty in the Bill to protect and promote patients' interests. It would not have a duty to promote competition for competition's sake, but only to address anti-competitive activities.

Moreover, DoH rejects suggestions that the Bill would lead to a system geared heavily in favour of private companies. It notes that there are provisions in the Bill to outlaw any such favouritism.

OFT calls for evidence on UK car insurance market

On 8 September, the OFT called for evidence to enable it to better understand the workings of the car insurance market. In particular, it wishes to establish the background to recent reports of rising UK private motor insurance premiums so that it can consider whether further work may be necessary to improve the way the market works.

The OFT states that it has received reports that comprehensive car insurance premiums have risen by 40% in 2010 to 2011.

Back in January 2011, the OFT announced that it had provisionally accepted formal commitments from a number of leading insurance companies to address competition concerns arising out the exchange of pricing information via the WhatIf? Private Motor market analysis tool. The OFT had concerns that the use of this tool increased the risk of price co-ordination among motor insurers.

The OFT explained that this call for evidence does not constitute a market study. It will not involve the same level of detailed analysis that would ordinarily be undertaken as part of a market study.

European Commission decision in Dutch beer cartel annulled

On 15 September, the General Court of the European Union announced that it had annulled the European Commission's findings that Grolsch had participated in a cartel with Heineken, InBev and Bavaria brewers.

The Commission had originally found that the brewers had co-ordinated prices and price increases, allocated customers and co-ordinated on other commercial terms. However, Grolsch successfully argued that there was insufficient evidence to establish its participation in the cartel. Whilst it was accepted that employees of a wholly owned subsidiary took part in certain meetings between the competitors, the Commission had failed to adequately explain the reasons why liability should be attributed to Grolsch.

The General Court's decision follows a previous decision in June this year reducing the fines for Heineken and its subsidiary Bavaria in respect of their involvement in the cartel.

OFT to consider functioning of the dentistry market

On 15 September, the OFT announced it has launched a market study into the public and private dentistry market. Market studies are conducted by the OFT where it believes particular markets are not working well for consumers.

The study will focus on how dentistry services are sold, whether patients are given appropriate information to help them choose between dental practices, the types of treatments on offer and different payment methods in the context of both NHS and private dentistry.

It will also look at how easy it is to change dentists and whether there are any unnecessary barriers to new practices entering either private or NHS funded markets, and will consider the issue of professional restrictions on direct access to specialists or providers of auxiliary services, such as hygienists.

A study will typically last 12 months during which time the OFT will gather information from economic operators and consumers, before preparing a final report. The OFT can take various corrective measures from establishing industry-agreed standards to pursuing competition enforcement remedies. Alternatively, it can refer the matter to the Competition Commission for an in-depth market investigation.

For more detail on the potential implications of a market study, please see the September 2010 issue of this update.

BAA appeals against Competition Commission's decision to require divestment of airports

On 22 September, the Competition Appeal Tribunal (CAT) published a summary of an application by BAA to challenge the legality of the Competition Commission's decision that there are no material changes in circumstances that would justify amending its decision in 2009 to require BAA to divest Stansted airport and either Edinburgh airport or Glasgow airport.

As we reported in the July 2011 issue of this update,² on 19 July the Competition Commission published its final decision that there are no material changes of circumstances or special reasons that would

² See page 4 of the July 2011 issue (Issue 12) of this update.

justify amending its decision to require BAA to divest Stansted and either Glasgow or Edinburgh airports. The Competition Commission concluded that it was still necessary to remedy the adverse effects on competition identified in its original 2009 report arising from BAA's common ownership of Heathrow, Gatwick and Stansted, and that the remedies proposed in the 2009 report were still proportionate and appropriate.

BAA claims that the Competition Commission's decision is flawed and irrational in a number of respects, in particular due to failure to take into account relevant considerations relating to the current situation at Stansted. BAA is also seeking an interim order to suspend the effect of the Competition Commission's decision.

Under section 179 of the Enterprise Act 2002, the CAT will, on application, review the decisions of the Competition Commission in relation to market investigation references. In conducting a review, the CAT will apply the same principles as would be applied by a court in judicial review proceedings.

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