Achieving Competition in the Financial Sector

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Good afternoon to everyone in the panel and also to those who have tuned into this conference.

I must congratulate the Hellenic Competition Commission and its President, Ioannis Lianos, for taking up the issue of competition in financial services.

In my years as president of the Portuguese Competition Authority, almost four now, I have seen only a few – very few- discussions at the national level on the interplay between competition and the financial sector.

There are significant differences across countries: some experience an open system; others maintain several barriers to new entrants.

Such barriers have been explicitly addressed by the European Commission at several times, and more recently with the revised Payment Services Directive (PSD2) and the Digital Finance Package, the latter just about a month ago.

A source of barriers is precisely the transposition moment. We witness often that whenever a directive has a goal of minimum harmonization, protectionist hurdles can be found in the choices made by member states.

And this is contrary to the spirit of the Single Market,

And contrary to an increase in consumer welfare in our countries.

Where we are at the moment

We are twelve years after the 2008 financial crisis, and in the midst of a new one, the Covid-19 pandemic.

Both have had or will have tremendous effects on economic growth.

So my understanding is that wherever competition policy can help reduce prices to the consumer –

and by consumer I mean individuals but very much also businesses-,

or help increase convenience in dealing with financial services,

or create new jobs,

or increase financing alternatives,

[1] Presentation at the joint conference "Sector inquiry into FinTech" by the Hellenic Competition Commission and the Central Bank of Greece.

then a wise national choice, by policy-makers, should be the one that enables innovation, cheaper prices, more choice in services overall.

Now, all this promise of disruption by FinTech players **focuses on the consumer**. And this may seem at odds with the goals of other regulators, namely those who need to preserve financial stability.

At the same time, competition authorities sometimes face **misplaced beliefs** from prudential regulators that competition hurts financial stability.

Economic literature[2] however, does not seem to grant support to the argument that high market power and profitability levels deliver high stability for the financial sector.

In fact, several theoretical and empirical studies identify a **positive impact** of competition in the efficiency and stability of the financial sector.

Competition can actually be key in mitigating the too-big-to-fail problem.

Moreover, **financial instability cannot be attributed to a** competition-driven problem,

but rather to one that relates to other serious external shocks or even to the adequateness of the regulatory framework when market circumstances are adverse.

We believe that true and enduring competition is actually what brings banks, insurers and other companies in the sector to remain **resilient**, i.e. more cost effective, more innovative, relevant to their clients.

And therefore allowing for such firms' survival in the long run.

And this is why it is **crucial that prudential regulators embrace competition policy**

without unnecessary delays,

without overriding competition goals in favor of a more lenient position regarding concentration, or market power, or barriers that contribute to the latter.

The AdC's activity on Fintech

All these concerns triggered a continuous focus on the sector, from the Portuguese Competition Authority, since 2018.

The authority has been a **forerunner** in sparking a much needed debate on the topic in Portugal, with visible results.

The rhetoric used by both incumbents and regulators is nowadays noticeably **different** in Portugal than it was when the AdC began its advocacy initiatives in this field.

[2] See, for example, Schaeck, K., Cihak, M. e Wolfe, S. (2009), "Are Competitive Banking Systems More Stable?" Journal of Money, Credit and Banking, 41: 711–734. De Nicolò, G., Bartholomew, P., Zaman, J. e Zephirin, M. (2004), "Bank Consolidation, Internationalization and Conglomeration: Trends and Implications for Financial Risk," Financial Markets, Institutions and Instruments, 13(4): 173-217. 2 Amidu e Wolfe (2012), "Does Bank Competition and Diversification Lead to Greater Stability? Evidence from Emerging Markets", Review of Development Finance, 3(3): 152-166. Schaeck, K. e Cihák, M. (2014), "Competition, Efficiency, and Stability in Banking" Financial Management, 43(1): 215–241.

In particular, the AdC has sought to raise awareness to barriers that can prevent the entry of new competitors or distort competition in markets affected by digital innovation.

In addition to an Issues Paper published in 2018, the AdC has contributed to the legislative process through written opinions and parliamentary hearings.

And currently, we are conducting a sector inquiry on Fintech and barriers to entry

because despite PSD2, new entrants still face hurdles, some legislative, some of a technical nature.

Which barriers?

Let me go through the main barriers identified.

Concerning payment services, the Authority identified a market foreclosure risk by incumbents with respect to fundamental inputs that new entrants need

i.e. payment account data and banking infrastructure.

These inputs are in the possession of incumbent banks, who have the ability to foreclose.

We found that incumbent banks have the incentive to foreclose new entrants, as they will be direct competitors for some products and services.

Furthermore, new entrants can challenge the traditionally strong bank-client relationship.

This risk is reinforced by specific characteristics of the Portuguese financial sector where the main banks are shareholders the quasi-monopolistic payments processor. This company:

- Provides payment solutions based on new technologies, thus acting as a direct competitor of Fintech players;
- Has a mandate from the central bank to manage the national clearing and settlement retail payments system;
- It provides access, in a single entry point, to account data of almost all banks in Portugal. – i.e., inputs that are essential for new entrants.

The AdC put forward recommendations directed at the central bank and the legislator aimed at mitigating these concerns over payment services:

- A timely regulatory response to market developments;
- Wherever European legislation allows (e.g. PSD2), choose what is more favorable to competition and market access;
- Eliminate the dependence that new payment service providers may have vis-à-vis banks in accessing banking infrastructure;
- Reduce incumbents' degrees of freedom while establishing PSD2's subsequent regulation, namely by ensuring that no unnecessary barriers are maintained. Here, it is vital to ensure the interoperability of the systems, the quality of access (i.e. very small fails in transactions), the absence of obstacles to obtaining consumers consent, the sufficient degree and granularity of information, and that no charges are applied.

Last, but not least, the AdC advocated for the adoption of innovation hubs and regulatory sandboxes, in tandem. Subsequently, in Portugal, an innovation hub was set up by the three financial regulators. Also, in July 2020, the

Portuguese Parliament approved the preparation of a report on regulatory sandboxes by the National Council of Financial Supervisors.

These are all positive steps, but in our opinion **very small steps in a very long time span**.

This may deter new entrants from even thinking of operating in Portugal. Why should they? There are other larger and more open markets, possibly with less barriers.

What next: the 2020 sector inquiry

Because two years after our first recommendations only small concrete steps have been taken, the Authority launched a sector inquiry earlier this year.

This inquiry aims at assessing barriers to entry and expansion in the financial sector in Portugal, with an emphasis on

(i) the access to account data and

(ii) the effectiveness of the PSD2 implementation in promoting competition.

We have sent a survey to **139 national and international firms** that provide financial services based on digital features, with the objective of better understanding market entry conditions.

So far, we have received a total of 88 replies, of which 61 from companies based in Portugal, as well as 27 replies from companies based outside of Portugal.

In general, companies have reported the existence of **relevant market barriers**, such as:

- The difficulty to access the interbank clearing system (SICOI), managed by the incumbent banks' holding group mentioned earlier, by contract awarded by the central bank and;
- The difficulty to access the national ATM network and the sole domestic debit payment scheme (*Multibanco*);
- The lack of performance of dedicated interfaces (API) provided by the main firm to third party providers (in the context of PSD2);
- The closed ecosystem in Portugal, with fears of retaliation common to very closed ecosystems; and
- The absence of a regulatory sandbox.

On the other hand, some firms supervised in Portugal mention a **demanding, unclear or uncertain** regulatory framework as a barrier to entry or expansion.

Again, **these barriers are not in line with the spirit of the Single European Market, which aims at a seamless payment services market**, particularly in the Euro zone.

To conclude

To sum up, it is the Authority's opinion that the future, if not already the present, of financial services is digital.

And as such, the benefits of digital innovation should not be delayed.

There are incentives, some of which of a prudential nature, so that banks' profits remain stable.

But protecting incumbent operators in the financial sector by shielding them from competition will not help them thrive in the mid/long-term.

We strongly believe that it is the discipline imposed by competitors, who are more agile and/or offer cheaper services, that will cause other companies to innovate and adapt – which will ultimately benefit their financial stability.

*C*ompetition can improve the financial sector's efficiency and stability. But for this to occur, we need prudential regulators to work alongside competition authorities and provide, among others, an adequate *ex ante* regulation.

Thank you.