

Editorial

Achieving Competition in the Financial Sector

Margarida Matos Rosa*

Ten years after the start of a period of severe crisis, the financial sector is in an interesting phase of consumer-focused innovation. Notwithstanding the changes induced by several European directives such as MiFID II (in financial instruments), PSD II (in payment services), the review of Solvency II (in insurance) and also CRD IV (capital requirements) earlier in the decade, the sector itself is evolving in a direction that seems likely to gather support from consumers. New entrants, be it full-fledged banks (also known as neobanks) or other financial service providers (aggregators and robo-advisers, for instance) are disrupting traditional business models in banking, investment advisory, and insurance.

Such new business models have caused two reactions from incumbents: one that embraces innovation and tries to compete with newcomers; and another that attempts to delay as much as possible the entrance of cheaper, leaner, faster new entrants. Competition authorities are understandably concerned about the latter and have pursued both advocacy and enforcement strategies in order to address the matter. Crucial to the success of either one or the other strategy is the involvement of regulators, in particular in prudential areas.

Competition authorities face misplaced beliefs from those concerned with prudential supervision that competition hurts financial stability. While the economic literature is varied in terms of results and perspectives, it does not find support for the argument that high market power and profitability levels deliver higher stability for the financial sector. In fact, several theoretical and empirical studies identify a positive impact of competition on efficiency and stability in the financial sector, particularly when adequate *ex-ante* regulation is in place. Competition can actually be key in mitigating the too-big-to-fail problem. Moreover, financial instability should not be regarded as a competition-driven problem, but rather one that relates to the adequateness of the regulatory framework when market circumstances are adverse.

The tension between prudential and competition concerns can easily arise when the financial sector is fragile. Ten years beyond the onset of the last financial crisis,

cases may persist where the sector regulator prefers to take a protective stance. This may lead to a situation where prudential concerns override competition worries, triggering a more lenient position from regulators regarding concentration and market power in the financial sector.

Competition authorities, as independent and sector-agnostic entities, are therefore key to ensure that competition policy and competition law are adequately applied across the economy. It ensues that there are significant risks from government-led proposals to spread competences in the application of competition law. The idea that a sector regulator, such as a prudential regulator, may be more adequately positioned to enforce competition law in a sector that it supervises encounters unsurmountable conflicts of interest when applying sanctions and fines. Hence, the coherence in the application of competition law and the deterrence effect would be severely diminished in such a scenario.

Competition authorities have a key role in advocating for competition in the financial sector – a role that has room to grow more vocal. They can raise awareness regarding the role of competition in ensuring innovation, efficiency and better deals for consumers in the financial sector. Currently, this can be witnessed in the developments of technological innovation applied to financial services (FinTech and InsurTech), which offer interesting prospects in terms of competitive dynamics and efficiency for the sector. But incumbents less able to embrace such innovation at a fast pace may try to protect their market position.

This is why, in April 2018, Autoridade da Concorrência (AdC) launched a public consultation on the topic ('Technological Innovation and Competition in the Financial Sector in Portugal'). With respect to payment services, the AdC identified barriers to innovation and entry arising from the regulatory framework applicable to the provision of financial services based on new technologies and, in a more permanent way, the risk of market foreclosure by incumbent banks. In Portugal, FinTech entrants face increased difficulties due to the specificities of the Portuguese payment

* President of the Portuguese Competition Authority (Autoridade da Concorrência).

systems. The owner of the nationwide ATM network and quasi-monopolist of processing services for payment cards, the SIBS group, also manages the national retail payments settlement and clearing platform and most of its share capital is held by the five leading banks in Portugal. Moreover, the significant delay in transposing a directive (PSD II) that encourages competition has been in itself a barrier to entry. With respect to crowdfunding, the AdC identified a lack of common legislation on crowdfunding at the EU level and regulatory barriers (e.g. investment limits) for investment-based and lending-based crowdfunding models, along with a lack of consumer trust in crowdfunding services. Given the situation, the AdC issued a set of recommendations to regulators and government aimed at promoting competition in payment services and crowdfunding activities. In particular, the AdC highlighted the relevance of establishing licensing requirements and other regulatory provisions that observe the principles of efficient

regulation, i.e., they should be proportional to avoid placing unnecessary burdens on FinTech players, thus preventing an overstatement of the risks associated with the activity they undertake. The AdC also advocated for the introduction of regulatory sandboxes and innovation hubs so as to mitigate the existing barriers to entry and expansion.

Current circumstances in the financial sector thus allow for competition authorities to meaningfully voice the benefits of stronger competition and new business models that bring increased efficiency and innovation, both in favour of consumers. It is also a remarkable opportunity for prudential regulators and competition authorities to work alongside to achieve the benefits of their respective missions. As long as both are considered as equally important for society.

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