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Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

29-Jan-2010

English - Or. English

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

DAF/COMP/WD(2010)3
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ROUNDTABLE ON COMPETITION, CONCENTRATION AND STABILITY IN THE BANKING SECTOR

-- Note by the Delegation of Germany --

This note is submitted by the Delegation of Germany to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 16 - 17 February 2010.

English - Or. English

JT03277688

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ROUNDTABLE ON COMPETITION, CONCENTRATION AND STABILITY IN THE BANKING SECTOR

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1. Introduction

1. At its February 2009 meeting, the Competition Committee held a roundtable discussion on the topic of Competition and Financial Markets.[1] Further continuing and deepening this discussion, the Committee will at the February 2010 meeting deal with the relationship between competition, concentration and stability in the banking sector. It will also discuss the question whether "excessive competition" in the banking sector has contributed to the recent financial crisis.[2] The following submission seeks – from a German perspective – to clarify the relationship between competition, concentration and stability in the banking sector. It builds on the contribution by the Federal Republic of Germany (*Bundeskartellamt*) to the February 2009 roundtable.[3]

2. Any discussion on the relationship between competition, concentration and stability in the German banking sector must at the outset recognise one salient principle: namely, that the Bundeskartellamt is an authority charged with protecting competition, and not with performing other regulatory functions. Other institutions – such as the Federal Financial Supervisory Authority (*BaFin)* and the German Central Bank (*Deutsche Bundesbank*) – oversee and regulate banks and other financial institutions in a broader sense, focusing on such issues as capital and liquidity requirements, and internal risk management.

3. With this central principle in mind, this contribution begins with an overview of the structure of the German banking industry, noting in particular its deconcentrated and competitive nature (subsequently 2.). It then proceeds to highlight some of the consequences caused by the financial crisis, including a brief discussion of the emergency measures that the German government implemented to mitigate any damage the financial crisis might have on the financial system and the broader economy (3.). It concludes by describing and commenting on how the Bundeskartellamt has reacted to these developments in its recent enforcement practice (4.).

2. The Structure of the Banking Sector in Germany

4. The German banking sector is shaped by a large variety of financial institutes. Important criteria for differentiation are the legal structure, ownership (public or private), corporate objective, balance sheet total and number of employees of the institutes. Depending on their legal structure, financial institutes are

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1 See *Competition and Financial Markets - Background Note by the Directorate*, OECD Doc. DAF/COMP(2009)2.

2 OECD Doc. COMP/2009.114, dated 02 December 2009.

3 *Competition and Financial Markets – Roundtable 4 (Going Forward: The Adaption of Competition Rules, Processes and Institutions to Current Financial Sector Issues) – Note by Germany,* OECD Doc. DAF/COMP/WD(2009)18/ADD1.

traditionally separated into three groups. This separation results in the so-called "three column structure" (*Drei-Säulen-Struktur*), in which private banks (*Geschäftsbanken*) account for the first, public banks (*öffentlich-rechtliche Banken*) for the second and co-operative banks (*Genossenschaftsbanken*) for the third column.

5. Private banks generally operate as universal banks and are typically organised as stock companies. Currently, there are four large private banks in Germany: Deutsche Bank AG, Commerzbank AG (post-merger with Dresdner Bank AG), Postbank AG (will soon fall under the control of Deutsche Bank AG) and Hypo Vereinsbank AG (affiliate of the Unicredit S.p.A.). Roughly 160 smaller banks (often private partnerships with a regional focus), more than 100 affiliates of foreign banks and several specialised banks (e.g. mortgage banks) also belong to this group.

6. Public banks include the banks operated by most federal states (hereinafter: "*Landesbanken"*), public saving banks (*Sparkassen*) and federal banks with special tasks (like the KfW Bankengruppe). Public banks are generally owned by the respective entities at federal, state or local level and are usually dedicated to serving the public interest. Currently, there are roughly 400 – mainly independent – public saving banks in Germany, all of which are organised on a regional basis and closely linked to the respective local entities which control them. The eleven Landesbanken (four of which are, in turn, controlled by other Landesbanken) also serve as central banks for the (private and public) banks in their respective territories.

7. Co-operative banks are banks that are owned by their members, who are at the same time the owners and customers of their bank. In terms of their business policies and the customers they serve, co-operative banks generally have a predominantly local or regional focus. Like public savings banks, each co-operative bank typically acts independently, but there are also two larger central institutes (DZ Bank AG and WGZ Bank AG) that serve as a form of "central bank".[4] Currently, there are roughly 1,200 co-operative banks operating in Germany (number including co-operative building societies (*genossenschaftliche Bausparkassen*)).

8. While still largely deconcentrated, the German banking sector has undergone a continuous process of consolidation in the last twenty years, whereby the total number of roughly 4,500 banking institutions in late 1990 had fallen to around 2,000 by 2008.[5] This process could be observed particularly in the co-operative banks segment, where the total number of banks fell from roughly 3,400 institutes in late 1990 to slightly more than 1,200 institutes in 2007.

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4 In December 2008, these two banks notified the Bundeskartellamt of their intention to merge. WGZ Bank was to transfer all its assets to DZ Bank with effect from 1 January 2009. The Bundeskartellamt cleared the merger in the First Phase after establishing that it would not create or strengthen a dominant position. In April 2009, however, both parties announced that the merger had been placed on hold indefinitely as a result of valuation disagreements during negotiations.

5 Regarding this process see, e.g., the German Council of Economic Experts (*Sachverständigenrat)* – Das deutsche Finanzsystem: Effizienz steigern – Stabilität erhöhen, June 2008, paras. 152ff. (available in German only at http://www.sachverstaendigenrat-wirtschaft.de/en/publikat/expertise.php) and *Heitzer*, Banken zwischen Fusionen und staatlicher Rettung – Auswirkungen auf den Wettbewerb, in: Orientierungen zur Wirtschafts- und Gesellschaftspolitik 120, pages 34ff. (2/2009; available in German only at http://www.bundeskartellamt.de/wDeutsch/download/pdf/Stellungnahmen/090626_Orientierungen_Finanzmarkt.pdf).

9. Whilst the consolidation process is ongoing, the Bundeskartellamt has in various recent proceedings found that the German banking sector is characterised by "intensive competition".[6] In this context, it has also pointed out that barriers to entry are in many segments relatively low as foreign banks are increasingly entering the market. Moreover, the supply-side substitutability is apparently high because there are no major technical barriers to product changes. Further, marketing – in particular via internet – allows competitors to react quickly.

3. Impact of the Financial Crisis on the German Banking Sector

10. The world-wide financial crisis has wrought considerable havoc in Germany.[7] Particularly banks that held large positions in international real estate financial products – mainly derivative securities whose value was based on subprime mortgage loans emanating largely from the United States – have suffered considerably. A number of Landesbanken, for instance, took advantage of the availability of cheap credit before the crisis, and heavily reinvested the money in such derivative securities.[8] With the collapse of the US-American housing market, the value of these securities plunged, leaving these banks dangerously exposed. However, a considerable portion of the banking sector in Germany has, at least so far, coped comparatively well. This may well be because of the relatively strong regional focus in the business of the vast majority of financial entities – in particular as far as the business of public saving banks and co-operative banks is concerned. Whether the relative stability of the less internationalised segments of the financial sector will endure, is, however, still not yet fully clear.[9]

11. In response to the crisis the German legislature passed the "Finanzmarktstabilisierungsgesetz" (FMStG – Act on the Stabilisation of the Financial Markets) in October 2008 to prevent any more devastating impact on the financial sector and the broader economy.[10] This law has ramifications for merger control. Specifically, it provided for the creation of a state fund allowing the German federal government to acquire stakes in financial institutions that are in distress. To facilitate the speed and efficacy of such rescue operations, the FMStG stated that the relevant provisions of the German Act against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen*, ARC) would not apply to the newly created fund.[11]

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6 See in particular the case summaries on *Major Mergers in the Banking Sector* (Deutsche Bank AG / Deutsche Postbank AG; Commerzbank AG / Dresdner Bank AG and DZ Bank AG / WGZ Bank AG), page 6 (case summary available in English at http://www.bundeskartellamt.de/wEnglisch/download/pdf/Fallberichte/B4-133-08-E.pdf?navid=35); regarding the degree of competition in the German banking sector see also *Heitzer* (article cited footnote 5), page 34 and the German Council of Economic Experts (*Sachverständigenrat)* (report cited footnote 5), paras. 164ff.

7 The German Council of Economic Experts (*Sachverständigenrat)* notes that, as far as the total amount of adjustments (*Wertberichtigungen*) is concerned, Germany is – along with the United Kingdom and Switzerland – one of three European countries that has suffered most from the financial crisis (see the report cited in footnote 5, para 199).

8 Regarding the performance of the Landesbanken during the financial crisis see, e.g., the German Council of Economic Experts (*Sachverständigenrat)* (report cited footnote 5), paras. 207ff.

9 See *Deutsche Bundesbank*, Finanzmarktstablisierungsbericht 2009, page 9f. (available in German at http://www.bundesbank.de/download/volkswirtschaft/finanzstabilitaetsberichte/finanzstabilitaetsbericht2009.pdf).

10 BGBl. 2008 I, page 1982.

11 FMStG Art. 2, Section 17, "Die Vorschriften des Ersten bis Dritten Teils des Gesetzes gegen Wettbewerbsbeschränkungen finden keine Anwendung auf den Fonds." (The provisions from the first to the third parts of the Act Against Restraints of Competition do not apply to the fund).

12. This means that the acquisition by the state fund of a stake in a bank or other financial institution would not be subject to merger control by the Bundeskartellamt. The legislature has, in effect, accepted that a dominant position in the sector could emerge for a limited period. Once any state-owned undertakings are sold back into the private market, however, the ARC will once again apply. So far, the FMStG has in only one case prevented the application of German merger control (acquisition of a 25 % stake plus one share by the state fund in Commerzbank AG).[12]

4. Recent Enforcement Practice

13. The financial crisis has led to a series of mergers in the banking industry.[13] As a result of heavy losses in subprime-mortgage backed derivative securities, the Sächsische Landesbank, IKB Industriekreditbank AG and Düsseldorfer Hypothekenbank AG were all rescued from insolvency through mergers or by selling a majority stake to other entities.[14] The Bundeskartellamt acted swiftly to approve these transactions, both because they posed no serious threat to competition, and because excessive delay might have caused the banks to collapse.

14. While not a direct consequence of the financial crisis, two recent large mergers have significantly changed the private banking landscape in Germany.[15] First, Commerzbank AG effectively acquired control over Dresdner Bank AG at the end of 2008. Specifically, Commerzbank AG acquired all the shares held by Allianz SE in Dresdner Bank AG. As part of its compensation, Allianz attained 18.45% of the voting rights in Commerzbank, as well as control over former Commerzbank subsidiary Cominvest. The transaction, in short, resulted in one of Germany's major private banks exiting the field, and a larger Commerzbank in which Allianz possesses a significant minority stake.

15. Another significant merger was announced in early 2009, when Deutsche Bank AG notified the Bundeskartellamt that it intended to acquire a controlling position in Deutsche Postbank AG. The transaction anticipated that Deutsche Bank AG would acquire a 22.9% stake of Postbank AG in 2009, as well as a convertible bond from Postbank AG that would automatically convert to a 27.4% stake in 2012. The initial 8% stake in Deutsche Bank AG received by Deutsche Post AG as part of the purchase price has in the meantime been divested. The end result is that Deutsche Bank AG will acquire a controlling interest in Postbank AG as of 2012, while Postbank AG will retain a minority interest in Deutsche Bank AG.

16. The Bundeskartellamt cleared both mergers in the so-called "first phase" of its examination (one month time limit and no formal decision), because despite the fact that there was some overlap in the business activities of the relevant parties, analysis demonstrated that neither merger would create or strengthen a dominant position in any of the relevant markets. More specifically, the combined market shares of the new entities in the areas of private customer business (including such segments as deposits and loans, issuance of credit cards and asset management) and corporate banking (including such segments as deposits, loans, financing, asset management and investment banking) would each be less than 15%. Slightly higher market shares in areas such as mortgage bond trading and foreign trade financing did not give rise to any serious competition concerns either. Thus while these mergers represent significant developments in the private German banking market – two of five major players having departed the field

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12 The acquisition by the state fund of the Hypo Real Estate AG by way of public bid was notified to the European Commission.

13 See *Heitzer* (article cited footnote 5), page 36.

14 The Sächsische Landesbank survived only by being taken over by the Landesbank Baden-Württemberg. IKB Industriebank was saved by selling a majority stake to the investor Lone Star Funds, while the Bundesband Deutscher Banken took over the Düsseldorfer Hypothekenbank.

15 Regarding these mergers, see the case summaries cited in footnote 6.

– no substantial competitive problems were foreseen because the German banking industry as a whole would remain deconcentrated and competitive.

17. As demonstrated, the Bundeskartellamt considered the standard structural measures of competition (e.g., market shares, market entry barriers) applied to any other sector to be equally suitable to assess the degree of competition in the financial sector. This coherence in substantive analysis may also serve to emphasise the Bundeskartellamt's view that the financial crisis was not caused by "too much" or "excessive" competition. Rather, the Bundeskartellamt is convinced that the crisis and its adverse effects, at least in Germany, were caused by an insufficient regulation of the financial markets and that it can only be effectively overcome by adhering to the principles of free and competitive markets within a framework of sound regulation.[16]

5. Conclusion

18. As noted at the outset, the Bundeskartellamt is a competition authority and not a general regulatory body with competence for the banking industry. In this capacity, it has recently reviewed a series of mergers in the banking industry and has quickly declined to intervene in any of them. While the outbreak of the financial crisis has led in some cases to a sense of urgency with respect to bank mergers – and has contributed to the Bundeskartellamt reviewing them very swiftly – it has not fundamentally altered the analysis that the Bundeskartellamt has undertaken. The German banking industry remains deconcentrated and competitive, meaning that the mergers under review did not give rise to any substantial competitive concerns.

19. The German federal government's reaction to the financial crisis, meanwhile, demonstrates that the German system is nimble enough to react to extreme challenges. The government recognised the inherent dangers to the financial system, and implemented a law that temporarily created a special regime for dealing with acquisitions by the state of stakes in financial institutions. While such a law was generally justified given the then prevailing circumstances, the Bundeskartellamt remains fundamentally of the view that the financial crisis did not result from too much competition in the banking sector, but rather from insufficient regulation of the financial markets. The financial markets do not need less competition, but rather effective regulation, particularly of systemically important financial institutions, hedge funds and rating agencies. The value of a competitive market economy should not be lost amid all of the emergency measures undertaken to stabilise the financial system.

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16 See, e.g., *Heitzer*, "Die Wettbewerbsaufsicht durch das Bundeskartellamt – Ordnungspolitischer Schatten der unsichtbaren Hand", (Competition Policy of the Bundeskartellamt), speech delivered at the Zentrum für Europäische Wirtschaftsforschung, Mannheim, 02.04.2009 (in German available at http://www.bundeskartellamt.de/wDeutsch/download/pdf/Diskussionsbeitraege/090402_Mannheim_ZEW.pdf); see also Heitzer (article cited in footnote 5), page 38.