2ND MISES SEMINAR

7-8 OCTOBER 2005

# "Banks and Competition: Crying Out For What?"

by Riccardo Gotti Tedeschi

**Summary**: - Introduction; Section 1 - The integration of the market of financial services; 1.1 The legislative framework; 1.2 Relevant market; 1.3 Transnational mergers; 1.4 National mergers; 1.5 Conglomerate mergers; 1.6 Recent cases of big withdrawn projects; 1.7 The "National interest"; Section 2: The Italian banking market; 2.1 The Italian peculiarity: the powers of Bank of Italy; 2.2 The current situation; Final considerations

## *Introduction: the development of competition in the banking sector*

The last decade in Europe and in Italy showed favourable conditions for the growth of competition in the financial markets. Main contributions to this phenomenon come from the evolution of the legislative framework, which furthered the liberalization and privatisation of the banking system, from the growing integration of the markets and – in regard of the Italian situation – for the role played by the Bank of Italy for the promotion and the safeguard of competition.

Competition in this sector should guarantee the stability, and moreover it should incentive banks to operate in an efficient way by containing the costs, developing new sectors of activity, and improving the procedures of selection of credit activity.

According to the 2004 Report of the International Monetary Fund, laid out according to Article IV of its own Charter, banking system in Italy has found a big deal of change as from the early 90's. The Report remarks more competition in the operational costs of banks, in the increase of productivity and in the tightening of the difference between active and passive rates. The assumed higher stability of the system finds evidence in positive economic results and sound management. Beside these general aspects just a mention deserves the issue of transparency of conditions in the offer of financial products, which is deemed to be in steady progress in Italy as well as throughout Europe.

The increase of competition pressures should bring about an intensive process of concentration (or better said, *consolidation*) and rationalization of the organization in the banking system. After all high competition means high process of rivalry between market operators, thereby high rivalry may imply creation of alliances and finally *mergers* in the narrower sense. The wider is the market, the higher is the necessity for enterprises to deal with it and to enlarge their business view: hence cross-border mergers are of paramount importance as an economic tool for banks to carry out the business beyond the national borders

However available data speak out clearly: as it will be shown by the upcoming Financial Integration Monitor Report elaborated by the European Commission, in the lapse of time reaching from 1999 until 2004, cross-border mergers and acquisitions (M&A's) within the European Union amounted to

20% of the total value of M&A's in the financial sector, whereas cross-border deals represented 45% of M&A's in other sectors over the same period of time [1].

The present globalisation of the economy, as supported by the basic freedoms granted by the EC Treaty, is one of the main forces that supposedly drive the process of internationalisation undertaken by firms and companies in a context of free market. This process is evident in almost all branches of the European industrial and commercial sectors: however it must be pointed out that one of the fields which raises the most thorny issues in the competitive framework – and which deserves a deeper analysis – is definitely the financial market.

Banking sector covers the whole range of characteristics of services – intangibility, heterogeneity, simultaneity of production and consumption, and their perishable nature – and this aspect raises the difficulty of standardizing the performance of a service and the problem of measuring its quality. Mergers in the financial sector are the primary method for those financial institutions (banks) that decide to lay down a strategy of external growth, and the abovementioned aspects are undoubtedly a condition for the formulation of a service firm's international strategy.

In fact international expansion may be done through the opening of branches and representative offices – thus giving rise to the *internal growth* – or by acquiring majority shareholdings in other banks and by undertaking merger plans (*external growth*).

Economies of scale and scope are likely to be motives for banks in pushing towards an international expansion. Economies of scale, indeed, suggest that a bank is able to decrease costs by increasing the volume of output of products and services it already produces. Through an expansion to another country, a bank increases its potential client base and thus could achieve those economies of scale as prospected.

In fact the factors, which may stimulate credit institutions to expand their activities abroad, can be broadly classified into two major groups[2]:

- The degree of integration of the country of origin and that of destination of the investment: banks basically follow their clients into foreign markets;
- Profit opportunities, those countries where they can predict a larger stream of future cash flows should attract banks as "profit-maximising" institutions.

These economic considerations, of course, have to be analysed within the scope of the regulatory and institutional barriers, which play an important role in shaping the patterns of cross border activities.

Since the introduction of the Euro as the single currency of the European Union on January 1st 1999[3], the process of integration and consolidation of the European financial market found a remarkable acceleration by way of mergers and acquisitions. This process, aiming of course to privilege an external growth of bank groups rather than an internal growth (which however it is not negatively affected), was indeed characterized by three main factors.

The Second Banking Directive 89/646/EEC, which came into force on January 1st 1993, has created the ideal framework within which it could be possible to drive and to establish a single market in

1 The issue of cross-border consolidation (meant as consolidation involving entities located in different member states) in the financial market was recently discussed by the informal Ecofin Council held in Scheveningen last September 2004 and the data presented therein gave rise to some concern within the EU context. The mentioned report is supposed to be published in the "Financial Integration Monitor – 2005" on May 2005.

2 See D. Focarelli, A.F. Pozzolo, *"Where do banks expand abroad? An empirical analysis"* , SSRN Electronic Paper Collection

3 All Member States of the EU except Denmark, Greece, Sweden and the U.K. joined the single currency area, thus giving rise the European Monetary Union (EMU)

banking services in the E.U.[4] The main goal of this directive is to enabling any credit institution established in a Member State to find a relatively easy access to the financial market of another Member State. These market conditions work as a very good push for any bank to seek local or foreign partners for mergers or acquisitions as a means of protection against hostile takeover bids, without losing the *status quo* in the own domestic market. We will see along this work whether the expected results have taken place, especially in the light of the internal market and the basic freedoms granted by the EC Treaty and of course within the inevitable confrontation with US market.

The second fundamental factor, which contributed to the integration of the financial market in the European Union, is the establishment of the economic and monetary union (EMU) and the introduction of the Euro as the single currency of the E.U.

This condition should ease the expansion of banks, and likewise drive the local banks to seek partners locally and abroad in order to become bigger players in the larger European single financial market. The euro - as a matter of fact - should play as a key tool for raising large sums of capital, thus making transactions easier across the borders. There are aspects of nationality and *national interest*, however, which cannot be neglected on this issue.

Beside the two important factors as highlighted above, technological innovations – such as internet and the telephone banking services - must be mentioned since they have also contributed to the restructuring and modernizing of the financial services sector in the E.U.

These elements may be helpful in understanding the present situation: the progressive relaxation of barriers in the financial sector within the Common Market gives rise to a process of increased competition within and across countries – testified by a bunch of mergers and acquisitions over the last 10 years – and meantime to a process of re-adaptation by bank institutions in order to get ready for competition on a wider scenario. The "side-effects" which must be taken into serious account by the same bank institutions are definitely linked up with their size and how they fit with such a bigger market after a long-lasting period of existence spent within the national borders. The exposure of banking firms – indeed – to other competitors from both national and foreign markets may entail a certain threat for market share and profits.

The all discussion cannot be developed without considering the general legislative/regulatory framework within which the process of consolidation of banks is taking place: whether a common legal system has a positive impact on cross-border mergers or whether the fact of belonging to a different legal environment makes the target bank more attractive or less attractive is subject to debate[5].

Key aspects, issues and differences will be deepened properly along this paper.

---

4 See Sideek Mohamed, *"Limitations to free movement of banking services"*, in J.I.B.L. – The Journal of International Banking Law, 1997, p. 67

5 One expectation could be that the presence of a common legal system has a positive impact on cross border transaction. The fact that the target bank has experience in dealing with a different legal system could make it an attractive partner, thus here the effect of a common legal system could be negative. See C.M. Buch, G.L. DeLong, *"Cross Border Bank Mergers: What Lures the Rare Animal?"*, in the Kiel Working Paper no. 1070, August 2001, p.6

## *Section 1 - The integration of the market of financial services*

### *1.1 The legislative framework*

The steps made towards the establishment of a EU single market in financial services have included the introduction of seven main banking directives. Among them are the First Banking coordination Directive (77/780/EEC of 12 December 1977[6]) and the Second Banking Directive (as already mentioned, the Council Directive 89/646/EEC, which partially amends the previous one).

In 2000 both the Directives were codified and combined in a single text for reasons of clarity and rationality, hence the Parliament and the Council adopted the Directive 12/2000/CE on 20 March 2000.

The First Banking Directive was adopted in 1977, for implementation in 1979, but it led to little cross-border movement by banks. Essentially it set out the criteria for expansion across national boundaries within the Common Market by incorporating the concept of "host-country rule".

Under the "host-country rule", a foreign bank or branch was required to gain permission from the supervisory authorities in the *host* country before it was allowed to operate in the hosting nation.

As the impetus for integration grew over the years, the Second Banking Directive came out in 1988. It was adopted in 1989 for the implementation on January 1, 1993. It replaced the host country rule with a *home* country rule, and it also adopted some other major principles designed in order to create unified banking regulations and a more efficient banking sector.

This Second Directive provides for a structure of conciliation between the right of establishment joint with the freedom to provide services in any Member State and the proper control and supervision which must be necessarily given, required by the special characteristics of such enterprises. The principle inspiring this Directive is the necessity to create a single market in banking services in the EU, thus maintaining it open through an elimination of all barriers to cross-border provision of banking services within the Common Market.

Here below are the main features of the Second Directive:

The concept of *home state control* is introduced as the key-principle governing the freedom to establish a credit institution in the common market. Host member state may no longer require a proper authorization or endowment capital (as previously provided by art.4 of the First Banking Directive) for branches of credit institutions which take up business in another member state.

Financial soundness of a credit institution and its solvency rest with the competent authorities of its home member state[7] (art.13 of the Directive), but the host member state's competent authorities do retain responsibility for the supervision of liquidity and monetary policy. As regards the supervision of market risk, this is subject to close cooperation between the competent authorities of the home and the host member states.

The role played by the host member state authorities must be focused.

---

6 This directive focuses on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions. Although the principle of home state control does not play any role yet, a coordination among competent authorities (by supply of information and collaboration, with the assistance of the Advisory Committee, which is set up alongside the Commission) is promoted as necessary in order to monitoring the solvency of credit institutions and their liquidity and the other measures which may serve to ensure that savings are protected.

7 According to definitions in article 1 of the Second Directive, home member state shall mean the Member state where a credit institution has been authorized in accordance with article 3 of Directive 77/780/EEC. Host member state is the member state where the credit institution has a branch or in which it provides services.

First of all its competent authorities must be reported periodically by the credit institutions about their activities in the host country (art.21), and they may require, beside this, any information demanded as well to the national credit institutions. Any credit institution must comply with the legal provisions adopted in that (host) state, and in case of infringement by the foreign branch, then authorities may require the institution concerned to put an end to the irregular situation.

From one hand this sort of double control may appear as a little constraining, but as a matter of fact it's a suitable measure in order to make the whole market integrated and harmonized.

Since this Directive is into force, the authorization granted to credit institutions by the competent national authorities acquires a community-wide application, and not any longer a merely nation-wide one, as previously provided by art.4 of the First Directive. The Second Directive promotes the principle of *mutual recognition*, according to which the need for banks to obtain a local banking charter from the host country for branches and/or bank products (permitted by their home country bank regulations) is eliminated. Essentially this allows inter-nation banking and branching within the Common Market.

Both the Directives play an important role in defining a regulation that, as secondary legislation, must be set – by definition - within the frame of the EC Treaty and thereby within the basic freedoms envisaged by the EC Treaty[8].

As concerns the freedom of establishment (embodied in **Article 43** of the EC Treaty), this is a fundamental pillar over which the Banking Directives find a legal basis: "*Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State. Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the chapter relating to capital*".

Beside this, the freedom to provide services, which is guaranteed by **Article 49** of the Treaty, reads as follows: "*Within the framework of the provisions set out below, restrictions on freedom to provide services within the Community shall be prohibited in respect of nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended.*

The Council may, acting by a qualified majority on a proposal from the Commission, extend the provisions of the Chapter to nationals of a third country who provide services and who are established within the Community".

Finally, free movement of capital – as set out in **Article 56** of the Treaty - must be referred too:

*"Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.*

8 It worth it to remember that eight more banking Directives were adopted between 1986 and 1992 and were scheduled to be implemented before the 1st January 1993. They required that banks be examined annually at the fully consolidated banking institution level for risk exposure and management, set minimum capital and solvency standards, limited an institution's exposure to large borrowers, and set standards for reporting financial and accounting data. Adoption of all of these directives by each of the member nations was crucial to the long-run integration of the EC banking market.

*Within the framework of the provisions set out below in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited*".

This framework of primary and secondary legislation seemed to offer in 1993 the best premises in order to trigger up a sensible integration of the financial market and therefore a major degree of competition between banks. This process, then, would have expectedly implied a logical increase of cross-border merger deals between credit institutions.

As a matter of fact the financial sector in all its branches is very sensitive for any State: the more the State participates in ownership in the financial sector, the more - as an obvious consequence - it will be concerned for any change in its proprietary structure and organization.

Nevertheless, the lowering of restrictions within the Common Market did not produce the **expected results** mostly as concerns the merger activity.

According to an analysis recently carried out by Thompson Financial, **cross-border bank mergers in the last ten years represented, in terms of volume, only the 2% if compared to 37% taking place in the other sectors (manufacture, services)**.

Between 1997 and 2002 the number of banks in the European Union slightly decreased: from 9.077 to 7.756. **The majority of M&A's has taken place in the single national markets (about 80% in Italy, France, Germany and Austria)** and on the "emerging" markets out of the European Union, such as Latin America and South East Asia.

According to Fitch Ratings, *Bank of America* is quite close to hold 10% of the overall deposits in the US market, whereas, in comparison, the biggest European bank as for market value, *Deutsche Bank*, holds only 4% of the overall deposits in the European Union.

It's interesting to consider the position uphold by Focarelli and Pozzolo (1999), even though this is limited to a certain time lapse and to OECD countries only. However they highlight two main issues that should stimulate banks to merge overseas[9]: i) growth of the host market ii) potential for diversification.

Furthermore, the more efficient is a bank, the more likely it is to go abroad. These authors underline that the degree of openness of the host economy is statistically significant but it does not have a remarkable marginal effect on banks investment decisions.

## *1.2 Relevant market*

Banking market definition is a pivotal issue often discussed within the EU legal documents. The Commission has traditionally divided banking services into **three main sub-sectors**: i) **retail banking;** ii) **corporate banking;** iii) **financial markets**. Parties to the transaction often invoke a more favourable definition of the market in order to decrease their market power[10]. The main issue that pops up from the case law in the market definition concerns the linkage between certain insurance products and banking services. In the *Allianz/Hermes*[11] case the parties argued that credit insurance should be regarded as a part of the banking market, whereas in the case *Allianz/AGF*[12]

9 The authors use the expression FDI, Foreign Direct Investment.

10 In the Decision *Fortis/CGER* of 2/10/1997 (Case No IV/M.981), the parties suggested the following subdivisions: as for retail banking, this includes the universal banking market, the deposit market, the off-balance sheet savings, and the credit to private individuals. Corporate banking would encompass domestic corporate, public sector, financial institutions and international credits. Finally, financial markets would comprise money markets operations, foreign exchange trading and derivatives. The Commission concluded not to be necessary the existence of separate product markets, since even on the narrowest definition the operation did not create or strengthen a dominant position.

11 Commission Decision of 27/9/1996, Case No IV/M.813

12 Commission Decision of 8/5/1998, Case No IV/M.1082

the insurer AGF held that credit insurance could be a substitute for factoring and letters of credit. The Commission kept its conservative approach in both the decisions – and afterwards as well, although some disagreement in the doctrine[13] – and stressed the point that these financial products are not developed enough to substitute banking services, but they are supplementary in nature.

### *1.3 Transnational mergers*

This issue should reveal the real openness of the Common Market and its assumed integration.

No big cross-border bank mergers have taken place in Europe so far: in fact merger deals between banks occur predominantly at the national level.

The first necessary observation regards the peculiarity of the banking market and the consequent approach adopted by the Commission along the years. As a matter of fact, looking through the case law of the Commission in application of the "Merger Regulation", namely Reg. 4064/89 (now Reg. 139/2004), most of the decisions adopted are in favour of clearing the concentration without raising any competition concerns. The reason lies in the fact that the banking market has been always considered as a national one. Although a different geographical impact can be found if the analysis falls within one of the three traditional subdivisions of the main market (retail banking, corporate banking and financial markets), the basis is that banks are national, they are considerably rooted into the home-country and they have a very strong connection with the national economy of the State where these are established. For this reason takeovers and cross-border bank mergers have been quite encouraged by the EU Commission.

The only cases of approval given by the Commission under conditions or commitments have regarded national "mixed" (or conglomerate) mergers[14].

As above said, the general complaint about the rare frequency of cross border bank mergers at the Community level finds on the other hand a remarkable favour turned by the Commission towards the integration of the financial market and the banking sector in particular.

Within the decisions in "phase 1" - where the Commission, according to article 6 (1)(b), declares a concentration compatible with the common market raising no serious doubts – the case law of the recent years includes interesting operations such as, in 1998, the acquisition of Belgium's *BBL* by *ING Bank*[15], other than the acquisition of *Bank Austria* by the German *HypoVereinsbank*[16] in 2000, and the takeover of the French *CCF* by the UK's *Bank HSBC*[17] in 2000 as well.

Along this range of successful cases, *BSCH/Abbey National*[18] sticks up to be a quite remarkable cross-border merger fully promoted and encouraged by the former EU Competition Commissioner.

13 C. Veljanavski, *"Banking Mergers: Transaction Costs and Market Definition"*, ECLR, p.195. Here the author proposed a cluster-based approach to replace the traditional product-based approach for banking merger assessment.

14 *Commission Decision of 8/11/2001 (Case No IV/M.2567-* NordBanken/PostGirot*), Commission Decision of 19/7/2001 (Case No IV/M.2431-*Allianz/Dresdner*), Commission Decision of 11/3/1997 (Case No IV/M.873-*Bank Austria/CreditAnstalt*). See also, though in the insurance market, the Commission Decision of 12/1/2000 (Case No IV/M.1712-*Generali/Ina*).*

15 Commission Decision of 22/1/1998, Case No IV/M.1061 - *ING / BBL*

16 Commission Decision of 22/11/2000, Case No IV/M.2125 - 4* *REUTERS/VERLAGSGRUPPE HANDELSBLATT/METEOR*

17 Commission Decision of 30/05/2000, Case No IV/M.1944 - *HSBC/CCF*

18 Commission Decision of 15/09/2004 (Case No IV/M.3547 – *Banco Santander / Abbey National*)

*Banco Santander Central Hispano* (BSCH) is the Spain's leading banking and financial services group. In Europe, however, the group operates mostly in Spain and Portugal, thus the Commission stated it found no geographical overlaps with the activities of Abbey – a UK banking group with a focus on the UK banking market – or they are insignificant.

However, when notifying the bid to the Commission, BSCH indicated that, in order to avoid risks of overlapping, it had agreed with Royal Bank of Scotland (RBS) to terminate certain aspects of their 1988 alliance. RBS is indeed one of the four big banks in the UK.

One such aspect concerns the reciprocal representation on each other's boards, or cross-directorships. The agreement to amend the Banco Santander/RBS alliance, by which Santander has reduced its shareholding in RBS to 2.54% of RBS's issued ordinary share capital, has been considered as a fact in the Commission's assessment of the proposed operation.

For these reasons, the Commission has concluded that the proposed transaction raised no competition concerns; hence this was declared compatible with the common market.

In all the cases abovementioned the Commission did not oppose because there were no serious competition concerns in the banking sector, hence it cleared the operations in phase 1 (according to article 6 (1) (b) of the Merger Regulation) declaring each of them compatible with the common market.

### *1.4 National mergers*

National mergers may raise less interest on the European scenario where they do not have community dimension, especially in a market such as the *retail banking*, which is extremely connected with the territory where credit institutions operate and has its own different features from country to country.

The process of consolidation at the national level in Italy is overviewed by the Bank of Italy, which exercises the functions of a special Antitrust Authority, for safeguarding the structure of competition between financial and credit institutions, and has the power to prohibit mergers which are able to impede competition in the national market provided that the Italian Antitrust Authority – "Autorità garante della concorrenza e del mercato", or AGCM - has given its opinion on the effects of the notified concentration. Beside these special functions, the Bank of Italy carries out the functions of a supervisory authority, which should guarantee the sound and prudent management of the credit institutions, the whole stability, the efficiency and the competitiveness of the financial system[19]. The issue of these two functions of the Bank of Italy will be dealt with in the section devoted to the Italian situation and its own peculiarities.

According to the Annual Report of the Bank of Italy, the concentrations notified in 2001 were 54, then they were 32 in 2002[20], whereas 53 mergers were notified in 2003 [21] and 27 were notified in 2004. The fact of the clear convergence with the opinion of the National Competition Authority and the lack of prohibitions along the last four years explains a lot about the reasonable process of consolidation within the national borders.

In the section devoted to the Italian situation and its peculiarities more issues will be developed.

---

19 See art. 5 of the Legislative Decree 385/1993 (Testo Unico Bancario – TUB) where it reads at paragraph 1: *"Le autorità creditizie esercitano i poteri di vigilanza a esse attribuiti dal presente decreto legislativo, avendo riguardo alla sana e prudente gestione dei soggetti vigilati, alla stabilità complessiva, all'efficienza e alla competitività del sistema finanziario nonché all'osservanza delle disposizioni in materia creditizia".*

20 In three cases in 2002 the Bank of Italy started a preliminary investigation. It concerned the following concentrations: *SanPaolo IMI/CARDINE Banca, Intesa BCI/Cassa di Risparmio di Terni e Narni, Banca di Roma/Bipop CARIRE.*

21 Data regarding 2004 are not published yet.

### *1.5 Conglomerate mergers*

This type of mergers includes transactions which entail the enlargement of credit activity to the insurance sector, giving rise to a more complete and fully-fledged flow of services under the exclusive control of one subject.

The Commission has very recently approved the proposed acquisition of 51% of the insurance business of the Portuguese company *Banco Comercial Português (BCP)* by the Netherlands-based *Fortis Insurance International NV (Fortis)*, which belongs to the international *Fortis Group*. As the insurance activities of *BCP* are concentrated exclusively in Portugal and as *Fortis* is not active in the insurance market in Portugal, the Commission has concluded that the transaction would not significantly impede effective competition in the European Economic Area (EEA) or any substantial part of it.

BCP is a banking and financial services group that is mainly active in Portugal. It has transferred its four life and non-life insurance businesses to a newly established Portuguese based company Milleniumbcp Fortis Grupo Segurador, SGPS, SA (NHC).

Fortis is an international banking and insurance group with its centre of interest in the Netherlands and Belgium. With this transaction Fortis acquires a 51% stake in the new company NHC and BCP will retain the remaining 49% share. The two companies will have joint control over NHC and hence over the insurance businesses of BCP.

The market for life and non-life insurance products of NHC have previously been considered to be national and as Fortis is not active in the Portuguese market for these products there is no overlap of activities. The only exception is for marine and transport insurance for which the market may be considered to be wider. Fortis is active in the EEA in the market for marine and transport insurance, however given the combined market shares at this level, the Commission concluded that the proposed concentration does not result in any competition concerns.

Another outstanding decision regarding the merger of banking and insurance activities under the same control is the *Allianz/Dresdner* concentration notified in 2001.

The Commission's investigations in this case focused on the consequences of the creation of a strong "*bancassurance*" group and the impact of the planned takeover on the relationship between the new Allianz/Dresdner group and the Münchener Rück/Ergo group, a major competitor.

Allianz AG is the largest life and non-life insurance company in Germany, whereas Dresdner Bank AG is Germany's third-largest universal commercial bank. Both companies are also actively involved in asset management. The merger will create the largest "bancassurance" group in Germany.

Although the activities of the two companies presented very small overlaps, the Commission carefully examined the possible consequences of the merger plan, given the strong distribution networks of both companies. It also looked at the new group's position on the new growth market for personal pension schemes (the so-called Riester pension).

The Commission's examination led it to conclude that, while Allianz would have improved its competitive position as a result of the "bancassurance" alliance with Dresdner, there was no risk of a dominant position being created or strengthened.

However, in the course of its review the Commission noted a large number of structural and economic links, between the new Allianz/Dresdner group and the Münchener Rück/Ergo group (a major competitor), which would have been considerably strengthened by the merger. In view of the strong position on the market of the Münchener Rück/Ergo group, which, together with the Bayerischen Hypo- und Vereinsbank AG (HVB), has also developed into a major "bancassurance" group, the Commission had serious misgivings on this score.

Therefore Allianz and Münchener Rück had declared their intention to reduce their mutual holdings to around 20% as part of the planned merger. In order to remove the Commission's concerns, Allianz and Dresdner gave a

legally binding assurance that they would have reduced their joint holdings in Münchener Rück to 20.5% by the end of 2003 and would not in the meantime exercise more than 20.5% of their voting rights at Münchener Rück's annual general meetings. At the moment of the decision of clearance by the Commission, Allianz and Dresdner hold 24.9 % and 7.4%, respectively, in Münchener Rück.

Accordingly, the Commission has reached the conclusion that the planned merger would neither create nor strengthen a dominant position capable to restrict competition within the Community. Therefore it considered the notified operation to be compatible with the common market.

Along this range of few cases of "mixed" bank mergers, it's notable to see that the takeover of *Creditanstalt* by Bank Austria (respectively the second and the first largest banks in Austria) was cleared by the Commission under some conditions and obligations. This operation created the first banking group in Austria[22].

As long as the Commission will maintain a consolidated interpretation of the market as it was done so far, with a product-based approach, this kind of mergers will be considered as conglomerate or "mixed".

### *1.6 Recent cases of big withdrawn projects*

A special mention on this regard must be given to the possible merger between *Deutsche Bank* and Dresdner Bank, the Germany's largest and third largest bank respectively, in 2000. This ambitious project of merger reveals quite a lot about the possible changes in the banking market which would have flown out if the operation was notified and eventually approved by the Commission. The "giant" formed by this project would have been the biggest financial institution in the world in fierce competition with the most important American banks[23].

In any case, many elements such as the "cultural discrepancies" between the two banking groups, the concern to reduce 16.000 jobs as an effect of the merger, the strong endurance by the union representatives, added to the cold assessment of the analysts (which stated that this merger would have "set free too little synergy"), carried this "merger of equals" to fail just one month after the announcement of the agreement between the two groups.

The merger plan between the third Italian banking group *SanPaolo Imi* and the first Belgian Bank Dexia, which got much attention at the end of 2004, offered another good example of "merger of equals" which failed at an early stage.

The initial rough agreement reached by the CEO's did not suffice in this case. The wrong strategy behind the plan and the unprofitable consequences from the whole operation made the operation fail.

In fact the strategy of *Dexia* was to merge in order to avoid possible hostile takeovers on the market, and an equal partner such as *SanPaolo Imi* would have fit this project: the purpose of the operation was basically defensive and not industrial.

The outcome of the deal would have not been profitable: the lack of synergies, difficulties in the structure of the new entity and the lack of plus value after the merger played an important role within the decision making of the boards of the two groups, and even the analysts considered this merger of equals quite "cold" indeed.

---

22 In 2004, the British financial magazine "Euromoney" named Bank Austria Creditanstalt the "Best Bank in Austria" for the thirteenth time in succession. Moreover it's remarkable the strategy of expansion in the central and eastern Europe pursued by the Group.

23 The merger would have created the most powerful banking group in the world with a balance sheet total of nearly (at that time) 2.5 trillion marks and a stock market value of around 150 billion marks. These figures would have enabled the group to overcome the US Citigroup as well as the Japanese groups shaping from the mergers Dai-Ichi/Fuji/Industrial Bank (2.4 trillion marks balance-sheet at the time) and Sumitomo/Sakura Bank (1.7 trillion marks balance-sheet total).

This recent possible merger deal gives opportunity to deepen the issue of building up real European banks within an integrated market. The EU legislation, both primary (the Treaty) and secondary (Directives and Regulations) is clearly made up in order to stimulate an integration of the market and therefore an higher degree of competition, but recent years have revealed that at the same time the regulation at the higher level finds a limit in the regulation at the national level. The reason is outstanding: financial market has peculiarities which are strictly connected with the economic history of a country, so a reasonable assignment of functions between the Community level (central level) and the national level is more than necessary, in accordance with the principle of subsidiarity.

Member States must be left indeed the proper power (according to a principle of proportionality granted and strongly rooted into the EC Treaty as well[24]) to be exercised in order to guarantee not only the fulfillment of the obligations arising out of the Treaty, but also to overview special and delicate sectors strictly connected with the national economy.

Italy, in the specific, has inherited a peculiar economic history that implies a proportionate and necessary structure able to overview and to encourage the process of liberalization in the national banking sector, and at the same time to participate at the process of the consolidation prospected in the Common Market.

Whether the "Italian case" is really behind compared to the other member states will be object of a proper exam. Consolidation and liberalization must be read in parallel.

### *1.7 The "national interest"*

Because of the special feature of the financial services industry, Member States are normally given a relatively wide competence to derogate from their obligations imposed by the EU law on grounds of consumer protection, national interest etc[25]. In the field of free movement of capitals (as well as in the other three freedoms) for instance, an exception to the main rule of free circulation of capitals can be found in article 58 of the Treaty which states, *inter alia*, that Member States can derogate from this Treaty obligation on grounds of public policy or public security. Besides these specific provisions, judicial exceptions – such as the notions of "mandatory requirements"[26] and "general good"[27] – adopted by the ECJ cannot be disregarded.

The European Merger Council Regulation on the control of concentrations between undertakings – in its course of amendments and revisions from 1989 until 2004, today Reg. 139/2004 – lays down in article 21 (4) (previously art. 21 (3)) the basic provision to which Member States may refer to in order to withdraw the normal competence of the Commission in specified cases where *national interest* is at issue[28]. This provision represents the sole and apposite way by which the protection of

---

24 See Article 10 of the EC Treaty: *"Member States shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of this Treaty or resulting from action taken by the institutions of the Community. They shall facilitate the achievement of the Community's tasks.*

*They shall abstain from any measure which could jeopardise the attainment of the objectives of this Treaty*".

25 It is noteworthy that special rules for financial institutions are also contained in article 5 (3) of the ECMR, according to which calculation of the turnover is made through a "banking income concept" (annual and consolidated accounts after deductions of VAT and other taxes directly related to those items) to determine whether a merger agreement in the financial services has a Community dimension.

26 This notion was developed in the well-known case of *"Cassis de Dijon"* , Decision of 20/2/1979, Case 120/78

27 This exception was developed in the case *Veronica v. Commissariat voor de Media* , Decision of 3/2/1993, Case 148/91

28 Article 21 (4) of Regulation 139/04 reads as follows: *"Notwithstanding paragraphs 2 and 3, Member States may take appropriate measures to protect legitimate interests other than those taken into*

national interest can be claimed in order to prohibit or suspend a cross-border merger and acquisitions of financial institutions in derogation to the "one stop shop" principle[29].

If a Member State wishes to exercise this "veto power" claiming a legitimate interest other than those three set out in the provision - *i)* **public security;** *ii)* **plurality of the media;** *iii)* **prudential rules** - then it must notify such interest to the Commission for a proper assessment of its compatibility with the general principles. We can realize at this stage that this provision aims to balance the respective powers of the Commission and those of the Member States (and consequently their national regulatory Authorities).

The concept of *national interest* inevitably involves a wider discussion regarding the discretion adopted by the single Member States that are supposed to interpret it in order to safeguard their competence for special reasons. The same wording of the three cases of national interest expressed in article 21 (4) seems to be quite vague and therefore open to interpretation by the governments.

The exclusive power of the Commission must be balanced where delicate issues are better assessed at the national level, but on the other hand the power of national authorities must be clearly defined and inspired to a decentralization fairly applied.

Beside this, the highly controversial issue in relation to cross-border bank mergers concerns the leeway of Member States in referring to *"any other public interest"*, even if this is subject to a communication to the Commission and to the wait for its assessment. The risk that can arise is that art. 21 (4) become an accessible and too easy instrument in the hands of the governments of Member States, which want to protect their political interest with the consequence of "over-affecting" or at worse withdrawing the legitimate Commission's exclusive jurisdiction. The spook feared by commentators on this point is indeed the influence of politics on the notion of "national interest".

For the sake of legal certainty and predictability, the Notes enclosed to the Merger Regulation ("Notes on Council Regulation (EEC) 4064/89") offer some guidance in regard to the principles of necessity, efficacy and proportionality, which must drive the action of a Member State in reference to an appeal to the "national interest".

In the view to clarifying the scope of article 21 (3) (now 21 (4)), the Notes on this point set out that, in order to enable the Commission in recognizing the compatibility of the public interest claimed by a Member State with the general principles and other provisions of EC Law, it is essential that prohibitions or restrictions placed on the forming of concentrations constitute **neither a form of arbitrary discrimination nor a disguised restriction in trade between Member States**. In application of the **principles of necessity or efficacy** and in respect of the **rule of proportionality**, those measures that may be adopted by Member States must satisfy the **criterion of appropriateness** for the objective and must be limited to the **minimum of action** necessary to ensure protection of the legitimate interest in question. So where alternatives exist, Member States must choose the measure which is objectively the least restrictive to achieve the end pursued.

The term "*prudential rules*" included in Article 21 (4) is a term with a specific meaning within the Community Law. It's clear that not every interest that a Member State would consider as being prudential should be considered as such by Community Law and, therefore, covered by Article 21 (4).

---

*consideration by this Regulation and compatible with the general principles and other provisions of Community law.*
*Public security, plurality of the media and prudential rules shall be regarded as legitimate interests within the meaning of the first subparagraph.*
*Any other public interest must be communicated to the Commission by the Member State concerned and shall be recognised by the Commission after an assessment of its compatibility with the general principles and other provisions of Community law before the measures referred to above may be taken. The Commission shall inform the Member State concerned of its decision within 25 working days of that communication".*

29 According to this basic principle set out in the ECMR the Commission has the exclusive competence in assessing and clearing concentration plans which have a community dimension.

In reference to the explanatory "Notes on Council Regulation 4064/89", we may realize that the Council interpreted the "prudential rules" as those measures addressed, for example, to ensure the good reputation of individuals managing such undertakings, the honesty of transactions and the rules of solvency. The same Notes make a reference to the on-going process of harmonisation of prudential rules at EC level. These harmonizing provisions, therefore, should also be taken into account in order to determine the community notion of prudential interest, which should include those interests protected by the harmonisation directives[30].

Although the frame looks a bit clearer, the issue to be analyzed is still the extent to which a Member State could prevent foreign takeover bids of its domestic financial institutions on grounds of legitimate national interests. This prevention can turn out to be a loophole in the process of consolidation, however obvious (and, as above said, "historically justifiable") reasons stay behind this exception.

Where this prevention is based on considerations such as keeping foreign competitors out of its nationwide financial market, then it would result in being an evident obstacle to the integration of the financial market and so it would constitute a breach of the Treaty, in particular the rules on free movement of capital.

The case *Banco Santander Central Hispano* (BSCH) / *A. Champalimaud*[31] is of paramount importance because it gives the typical example of a national interests response to a cross-border bank merger.

A summary of the merits of the case follows here below.

**Facts and legal grounds.** The Spanish bank BSCH agreed to take a 40% stake of the Portuguese based AC holding company, which controls an insurance company (Mundial Confianca SA) and majority stakes in several banks. The planned alliance would have given BSCH a big majority stake and management control over the Portuguese group's retail banking. AC and BSCH then entered into a shareholders agreement which granted BSCH the rights to appoint some members to the boards of administrative and the executive commission of the AC holding companies and their subsidiaries, as well as to veto essential decisions adopted by these companies.

When the two parties concerned directly notified their concentration to the Commission, and there was quite an evidence that the Commission would have authorized this operation (the decision of authorization was adopted on 3 August 1999), the Portuguese Ministry of Finance adopted on 18 June 1999 an administrative decision vetoing the deal and suspending the voting rights on shares in the AC Group[32]. The Portuguese Government brought two arguments to support the blocking of the operation: i) the deal was in breach of national procedural law, which states that any acquisition of a holding company in an insurance undertaking should be notified in advance to the supervisory authorities; ii) the cross border operation interfered with the national interest and strategic sectors of the Portuguese economy and financial system.

Since the non-compliance with a procedural requirement is not specifically included in article 21 (4) as a possible ground to prohibit the deal at issue, the Portuguese government should have followed the provision of paragraph 3 of the same article 21 (4), where it reads that any national interest other than those specifically listed in the Regulation should be communicated with a notification to the Commission for its prior approval.

Hence the Portuguese government, whose the aim of the opposition was to guarantee a sound and prudent management of Mundial Confianca and to ensure an appropriate supervision by the competent authorities, has

30 In the present case, the provisions in question are the Council Directive 92/49/EEC of 18 June 1992 on the co-ordination of laws, regulations and administrative provisions relating to direct insurance other than life insurance and amending Directives 73/239/EEC and 88/357/EEC (third non life insurance directive) as well as Article 14 of Council Directive 92/96/EEC of 10 November 1992 on the co-ordination of laws, regulations and administrative provisions relating to direct life insurance and amending Directives 79/267/EEC and 90/619/EEC (third life insurance directive) as well as the measures amending them.

31 Case No IV/M. 1616 *BSCH / A. Champalimaud*, Commission Decision of July 20, 1999

32 Despacho No. 233/99-XIII of June 18, 1999

failed to comply with the obligation to notify such prudential concerns to the Commission, and therefore it was in breach of the procedural requirement set out in the third paragraph. Moreover even if the lack of sound and prudent management was notified, then it would have been necessary to bring evidence of that.

In its assessment contained in the decision of the 20 of July the Commission found that the opposition decision by Portugal was incompatible with the principle of proportionality: the government should have used a more suitable and proportionate remedy such as an injunction to suspend the merger. Thereby the Commission in its decision provisionally suspended the measure adopted by the Portuguese Minister for Finance, mainly referring to article 21 of the EC Merger Regulation, which grants it exclusive powers to assess concentration operations of community dimension. It was the first time the Commission adopted a decision suspending a Member State decision to block a concentration of community dimension.

On 8 September 1999, following the complains lodged by BSCH and AC, the Commission decided to initiate accelerated proceedings against Portugal for failure to comply with the decision of 20 July 1999. On 13 October, the Commission decided to send a reasoned opinion, giving Portugal one week to reply. On 20 October, the one-week deadline expired without any reply from the Portuguese authorities having been received, so the Commission opened a formal infringement procedure (art.226 of the EC Treaty) against Portugal concerning the measures adopted by its authorities to block the cross-border transaction. The referral to the European Court of Justice with an application for interim measures was necessary because the Portuguese authorities had still not suspended their decision of the 18 of June, so the merger approved by the Commission had consequently still not been implemented.

The most interesting part, indeed, regards the **settlement of the dispute**: in order to avoid the process before the ECJ - which, in lack of strong legal grounds to the arguments put forward, would have likely leaded to an unfavorable verdict - the Portuguese Government proposed an "out of court" package of compromises aimed to solve the dispute with the Commission and the two notifying parties. According to the government, the new proposed deal would protect the rights of minority shareholders, ensure a better functioning of the market and comply with the required supervisory standards.

**Consequences and considerations.** According to the new proposed operation, the AC group would be split up between BSCH and the Portugal's biggest state bank, Caixa Geral de Depositos (CGD). BSCH, which sought full control of the Champalimaud financial conglomerate, secured only a slice of it for 2.2 billion and 12% of Portugal,s banking market. The state-owned CGD would acquire Banco Pinto Sotto Mayor, the biggest bank in the group, an insurance company and two banks, whereas BSCH would keep Banco Totta-Acores and the mortgage bank Credito Predial Portugues as well as the insurance and the investment banking businesses.

The statements of the Portuguese Minister of Finance are outstanding in disclosing the Portuguese standpoint: he underlined the necessary restructuring of the Portuguese financial market at the national level, without any perturbation from outside (see paragraph 21 of the Decision).

Apparently this state-sponsored compromise could strengthen the public ownership in the financial sector. The government sought to justify CGD's dominant position in the Portuguese financial market as it was the only bank left in State's hands, and that there was nothing exceptional in maintaining a state presence in banking, like in Germany for example.

Eventually, since the Court accepted the new changed deal "proposed" by the Portuguese Government and consisting in the acquisition of two banks of Champalimaud Group by BSCH, such an operation was then notified to the Commission, which cleared them on 12 of January 2000.

Competition Commissioner Monti welcomed the final result in this case and expressed a certain trust towards more integration in the banking sector: «*This shows that European competition rules have an important role to play in the creation of a genuine single market. It should also serve as a lesson that Member States must not try and prevent the opening to non-nationals of the financial services sector. There have been few trans-national mergers so far in this key sector for the single market. I did therefore consider it particularly important that an operation which does not raise competition concerns can go ahead*».[33]

The motivation of the Portuguese government was clearly to ensure the control of such an important financial institution in their own hands. The terms of the case indicate that BSCH did not get all it was planned in the original merger plan and then cleared by the Commission.

33 Commission Press Release, IP/00/21, of 12 January 2000

The fact that the Commission could not defend its merger decision in its entirety, and moreover the way this dispute was settled "out of court" with the ECJ, brought about a worrying signal among commentators and economists as regards the still very long way to run before seeing cross-border bank mergers in the single market. If State intervention can affect so remarkably the exclusive jurisdiction of the Commission over merger deals that can contribute to the integration of the common market and favor the free movement of capital, then there is a clear and present danger to the good of the internal market.

The natural consequence of this negative scenario risks giving rise to less prominent cross-border alliances by European banks: this is seen by undertakings as a necessary means to avoid state interventions. The further consequence of this "deterrence" from growing across the borders brings inevitably to a decrease of the EU banks' competitiveness especially in respect of the big American and the Japanese credit institutions.

It is to be highlighted, indeed, that after the BSCH/AC case, only one more relevant case took place – involving again the Portuguese Government – in reference of Article 21 of the European Merger Regulation. This is the *Secil/Holderbank/Cimpor*[34] case, where the Commission did not accept the measures adopted by the government, and subsequently the contested decision was brought before the ECJ, which rejected the action of the Portuguese government in June 2004[35].

Beside the intervention of the Member State in the assessment procedure of a concentration, which is regulated by art. 21 (4) of the ECMR, the power of ***moral suasion*** exercised by the same national authorities cannot be disregarded nor underestimated. This "soft power" can play a key role as a useful alternative to the referral of art. 21 (4): the persuasive activity, exercised by a national authority with certain "discretional power", can either inspire an official procedure according to Article 21 (4), either prevent it.

Where a national interest is justified by one of the three requirements listed in art.21 (4), or it justifies a measure that complies with the principles of efficacy, necessity and proportionality as developed in the Notes, then appropriate measures to protect legitimate interests can be adopted by the Member State (thus by the national authority). Where clear arguments of protection of the national market rise in sensitive sectors, on the contrary, *moral suasion* of national regulatory authorities may interfere in the deal at issue.

There are several occasions on which the Member States have directly interfered with cross-border merger activities. In early 1999 when *Banque Nationale de Paris* (*BNP*) advanced a takeover bid for *Société Générale* and *Banque Paribas*, the French authorities – while clearing the operation at stake – made it clear that they opposed any foreign ownership of a principal French bank[36]. *Société Générale* tried hard to resist the takeover bid of *BNP* by calling the spanish *Banco di Santander Central Hispano* as a "white knight" in order to enter its capital and contrast the takeover bid. The

34 Commission Decision of 22 November 2000 (Case No COMP/M.2054 *Secil/Holderbank/Cimpor*). In this case the Commission intended to protect its exclusive right to review mergers with a Community dimension and decided that, the measures taken by the Portuguese authorities against the proposed takeover bid by Secil Companhia Geral de Cal e Cimentos SA and Holderbank for Portuguese company Cimpor Cimentos de Portugal SGPS, were incompatible with EU competition law. The decisions taken by the Portuguese Minister of Finance in July and August 2000 opposing the bid were found not to protect any legitimate interest recognized under article 21 of the European Merger Regulation.

35 Judgment of the Court (Full Court) of 22 June 2004, Case C-42/01, *Portuguese Republic v. Commission*

36 After Paribas and Société Générale announced, on February 1st 1999, their plans to merge, BNP launched two takeover bids for Société Générale and Paribas on March 9. The French financial markets watchdog authority, the Conseil des Marchés Financiers, decided that the merger could proceed. At the end of August, it announced the final results: BNP held 37% of the capital and 32% of the voting rights of Société Générale, and 65% of the capital and 65% of the voting rights of Paribas.

The new BNP Paribas Group, with a net income of 1,348 million euros and 77,000 employees working in 83 countries around the world, from the very outset ranked among the foremost financial institutions in France and Europe.

national authorities, at this point, first opposed any foreign interference in such a national deal, then eventually allowed *BSCH* to purchase a stake about 10% of the capital of *Société Générale*. Afterwards, in front of an expressed desire of the spanish financial group to increase its presence in *Société Générale*, the French authorities let them know that they would not have allowed any growth, and *BSCH* decided then to quit and sell all the stakes of the french bank. It's remarkable in this case the *moral suasion* exercised by the national authorities[37].

After the *BSCH/AC* case, one more case of "State's influence" took clearly place in the banking sector[38]: at the end of 1999 *ING Group* had to withdraw the takeover bid previously made to *Credit Commercial de France* because (also) of the concerns and reservations expressed by the Bank of France[39].

This is another example of the reluctance of Member States to let their financial institutions fall into foreign hands: if *ING* had been successful in this deal, it would have opened the way for the first foreign takeover of a French bank. It's significant to see that only few months later *CCF* was acquired by *HSBC Holdings*, the biggest bank in UK and an English global player in the banking and insurance sectors[40].

The power of Member States to adopt "*appropriate measures*" at the decentralized level, then, can be observed from two sides: it can be legitimate power to withdraw the exclusive jurisdiction of the Commission, or it can flow out as soft power such as "moral suasion".

In anyway this is seen, the "national interference" as regulated by the EC Merger Regulation at Article 21, is subject to review of the European Court of Justice, and it must be compatible – as above said – with the general principles and other provisions of Community Law.

## *Section 2 – The Italian banking market*

In 2005 the issue of the integration of the financial market focused the whole attention of the media in Italy and opened up the new year in a quite lively way. The meeting between the Governor of Bank of Italy and the Italian Prime Minister – where the "italianity" of the bank system arose as the main priority for the future and as a point of common interest – together with some whispered complains expressed to the Commission by some big European credit institutions turned on the dispute and created a climate of tension and pointed eyes towards Italy. These complaints eventually stemmed out in a formal letter by the Commissioner of Internal Market addressed to the Governor (February 2005)[41].

---

37 Today BNP Paribas has no presence in Société Générale. The major stakes of this financial institution are quite small: 7.4% belongs to the Employees Fund, then Groupama holds 3%, and Fondazione CRT holds 1.66%. The rest of shareholding is very widespread.

38 However one more case which took place in a "sensitive sector", such as the telecommunications, can be mentioned: the opposition of the German government in the hostile takeover of Mannesmann by Vodafone Airtouch (UK) raised again the issue of State intervention to protect the own industry.

39 *Financial Times*, December 14, 1999

40 The takeover bid proposed by HSBC Holdings plc over the French bank CCF S.A. was cleared by the European Commission on 31 of May 2000.

41 There was a lot of expectation in Italy around the "Savings Decree" which, beside the main function of offering a more transparent protection to the public of savers, turns on the thorny issue of change of competence as for competition authority over the bank sector, and therefore by devolving to the Market Authority the all functions so far kept by the Bank of Italy.

On 2nd of March 2005 the Decree ("Savings Decree") confirmed the competence of Bank of Italy and left the mandate of the Governor still endless.

## *2.1 The Italian peculiarity: the powers of Bank of Italy*

The first impression we may get through a first analysis of the Italian banking market is the peculiarity of its own regulation.

Indeed, according to a special piece of legislation (D.Lgs. 1/9/1993 n.385 *"Testo Unico delle leggi in materia bancaria e creditizia"*) the Bank of Italy ("Banca d'Italia") has the power to supervise banks and non-banks intermediaries. The objectives of this supervision are the sound and prudent management of intermediaries, the overall stability, efficiency and competitiveness of the system, and the compliance with rules and regulations governing credit. These purposes are in clear harmonization with the criteria set out in the "Second Banking Directive" - the Council Directive 89/646/EEC - in Article 11, now after the union of the first and second banking directive, in the Directive 12/2000/EC at Article 16.

Besides this task the Bank of Italy is the competition Authority in the credit sector pursuant to article 20 of Law 287/1990[42]. In this way competition is protected and promoted as a necessary condition for an efficient and sound banking and financial system. As a competition authority, indeed, the Bank of Italy is empowered to prevent mergers and acquisitions *from creating or strengthening a dominant position* in the national and local markets, and to intervene in case of abuse of a dominant position and collusion between intermediaries. The Bank adopts any decision taking account of the opinion formulated by the Italian Competition Authority (the "AGCM", Autorità Garante della Concorrenza e del Mercato)[43].

These two functions carried out by the Bank of Italy might show some contradictions upon the same Authority. Bank of Italy has a "double hat", since it has to safeguard competition and to oversee sound and prudent management of banks. This situation means that Bank of Italy must exercise the oversight function without infringing the principle of free competition within the market, which means that it must ensure the protection of the consumer – considered as "user" less informed – by guaranteeing products and services of quality at competitive prices.

Some doctrine is sceptical about the conciliation of these two functions, insofar as free competition seems to be a limit at the activity of Bank of Italy that is bound to comply with it in the exercise of the oversight function. The argument regards the fact that the elements that favour stability of the market might, at the same time, hinder the free competition by levelling price conditions and slowing down the process of rivalry.

The issue is delicate as well as the sector at stake: the unique Authority has capacities to find the proper balance in carrying out the two functions.

To go back to the European context, it must be highlighted the strong role acknowledged by the Directive 2000/12/CE to Member States authorities to oppose a merger plan in view of the need to

---

42 See L.287/90 art.20 par. 2-3: *"(…)2. Nei confronti delle aziende ed istituti di credito l'applicazione degli articoli 2, 3, 4 e 6 spetta alla competente autorità di vigilanza. 3. I provvedimenti delle autorità di vigilanza di cui ai commi 1 e 2, in applicazione degli articoli 2, 3, 4 e 6, sono adottati sentito il parere dell'Autorità garante della concorrenza e del mercato di cui all'articolo 10, che si pronuncia entro trenta giorni dal ricevimento della documentazione posta a fondamento del provvedimento. Decorso inutilmente tale termine l'autorità di vigilanza può adottare il provvedimento di sua competenza.(…)"* (underline added).

43 The Consiglio di Stato ( which is the Court of Appeal for administrative proceedings) has given a clear-cut definition on the competences of Bank of Italy and AGCM: *"Il riparto di competenza tra la banca d'Italia e l'autorità garante della concorrenza e del mercato in tema di vigilanza sugli istituti di credito può essere così definito: 1) qualora in un mercato operino sia aziende ed istituti di credito sia altri soggetti, e di conseguenza il mercato interessato non sia riservato agli enti creditizi, la valutazione degli effetti concorrenziali compete al garante della concorrenza e il mercato; 2) quando invece si tratti di attività riservate per legge alle banche, e nella fattispecie siano coinvolte solo aziende o istituti di credito, a applicare la disciplina antitrust è competente la banca d'Italia; 3) infine, se un'operazione produce effetti sia su mercati bancari che su mercati non bancari, unitamente alla competenza della banca d'Italia sussiste quella dell'autorità per gli effetti sui mercati non bancari".* See Consiglio di Stato, sez.VI, 16/10/2002, n.5640 in Foro It., 2003, III, col.73

ensure sound and prudent management of the credit institution[44]. This function, which corresponds in the national legislation to art. 5 of TUB (as already mentioned, the Legislative Decree 385/1993 which implemented the "Second Banking Directive"), concerns the power of Bank of Italy to supervise the stability of the financial market and the sound and prudent management of the operating institutions.

According to Article 19 paragraph 1, acquisition of stakes in Italian bank institutions by any investor – national or non-national – must be cleared in advance by Bank of Italy if the participation exceeds 5% of the capital either represented by shares or by voting rights and, regardless this limit, anytime the participation entails control of the bank itself.

Besides, any variation in the participation, able to exceed the threshold of 5% must be subject to prior authorization by the Bank of Italy[45].

Another important limit reads at paragraph 6 of Article 19: those subjects who carry out economic activities in non-banking sectors or non-financial sectors cannot be authorized to own participations exceeding 15% of the capital of bank institutions or even the control of the same banks.

The power of supervision exercised by Bank of Italy may join properly the role of "watchdog" of competition insofar as competition pressures push and stimulate for better organization and business schemes, in a context of sound and prudent management.

This "double armed" power upon the same Authority can be fairly arguable, and the discussion is still going on in view of a possible reformation.

### *2.2 The current situation*

When last January the European Commissioner at the Internal Market Mr. McCreevy sent the formal "warning" letter to the Governor of the Bank of Italy Mr. Fazio, a mild wind of quarrel blew over the Italian banking market.

The main charge on the Governor's shoulders is basically the assumed attitude of protectionism and defence of national banks from the foreign attack.

However, in opposition to this argument, official data speak in favour of a current process of integration, which although carefully is taking place in the Italian context.

In the comparison of stake capital owned by foreign investors in the top four bank institutions of the main European countries an average rate of 16% lies in Italy, whereas Germany has a rate of 7%, then 3% in France and 2.6% in Spain.

This is very significant. Of course these data are given notwithstanding the outcome of recent events linked with the *ABN-AMRO/Antonveneta* and *BBVA/BNL*[46] deals.

Historical reasons then must be pointed out to explain the process of integration not yet advanced in the Italian setting. We must bear in mind that the banking sector in Italy has been under the

---

44 See art. 16 par. 1, second part, of Directive 2000/12/CE, which repeats art. 11 of the previous "Second Banking Directive" (Dir. 89/646/CEE): "*Without prejudice to the provisions of paragraph 2 the competent authorities shall have a maximum of three months from the date of the notification provided for in the first subparagraph to oppose such a plan if, in view of the need to ensure sound and prudent management of the credit institution, they are not satisfied as to the suitability of the person referred to in the first subparagraph. If they do not oppose the plan referred to in the first subparagraph, they may fix a maximum period for its implementation*".

45 Indeed Artiche 19 (2) of the TUB reads as follows: "*La Banca d'Italia, inoltre, autorizza preventivamente le variazioni della partecipazione quando comportano <u>partecipazioni al capitale della banca superiori ai limiti percentuali stabiliti dalla medesima Banca d'Italia</u> e, indipendentemente da tali limiti, quando le variazioni comportano il controllo della banca stessa*" (underline added).

46 As latest news confirm, the *BBVA/BNL* deal failed and *Unipol* (an Italian assurance group) is succeeding in the counteroffer aimed to have exclusive control over *BNL*, thus creating a big bank-assurance group.

State's control until fifteen years ago. Privatisation and liberalization, so furthered by the European Union, needs a proper time lapse. The process of restructuring, which started in Italy in the early 90's, was a process of "protective" consolidation aimed to create big holdings able to defend themselves and oriented to the control of the market. This process turned out to be much slower than in the rest of Europe for two basic reasons:

1. As strong *politicisation* that slowed down every decision which entailed loss of power
2. An inflexible cost of the labour (for reasons connected to the strong influence of trade unions) and consequent inefficiencies flowing from the public structure.

In the light of the second reason, the fact of liberalizing is without any doubt the best "medication" to speed up an upward process that can provide efficiencies.

Every country in the Union has its own economic situation and its own economic history; we cannot disregard it by suddenly hiding it under the formal umbrella of the European Union where any country must fulfil the same requirements. Reciprocity, then, cannot work out properly as long as differences are not bridged.

**Here below a scheme of the foreign participations over Italian bank institutions:**

| | |
|---|---|
| **Banca Intesa** | |
| Credit Agricole | 14.81% |
| Commerzbank | 3.39% |
| **Gruppo Capitalia** | |
| ABN-AMRO | 8.94% |
| *Libyan Arab Foreign Bank* | 3.01% |
| **BNL** | |
| Banco Bilbao Vizcaya Argentario SA[47] | 14.71% |
| **Gruppo Sanpaolo IMI** | |
| Banco Santander Central Hispano | 8.45% |
| Group Caisse d'Epargne | 1.50% |
| *Deutsche Bank* | 1.40% |
| **Gruppo Banca Antonveneta** | |
| ABN-AMRO | 12.68%[48] |
| **Carifirenze** | |
| BNP Paribas | 6.55% |

47 This data regard March 2005. Last 29 March 2005 then, *BBVA* launched a public bid ("offerta pubblica di scambio" - OPS) on the overall of shares of *BNL*. The bid was approved by unanimity of the Board of *BNL* last 8 of April 2005. Then all business plan then failed before the *Unipol's* counteroffer.

48 This data regard March 2005. Now ABN-AMRO, after a public offer upon Antonveneta and a going on series of events controls the Board of Antonveneta.

## *Final considerations*

The process of consolidation between bank institutions in Europe is still at the first steps and clearly very slow.

The issue is that a real European model in the banking sector does not exist.

The present situation gives evidence of the strong attachment of banks to the home-country, for reasons that clearly concern a different economic history. Every banking system is daughter of its own economy.

France has different features from Spain, and from Germany as well, where for instance there is a huge dissemination of domestic banks spread all over the territory.

UK has a model which can hardly be encompassed in the European one, but it is rather more resembling with the American one.

Italy inherited a long period – 50 years - of "statalization" in this sector, and only in the last ten-fifteen years liberalisation took place, dragging with it the inefficiencies of the previous public control. However, the side effects of this phenomenon must be borne in mind.

Whereas in previous times the State used to protect the whole industrial sector, then banks – once they were privatised – replaced the State in this "task". That is why it's quite remarkable to notice that nowadays the banking system in Italy sustains many economic sectors. In this process their role may change as well: it can turn from lender into shareholder, so the perfect replacement State/Banks takes place.

The pending question is how to regulate this process, which is necessarily different in each country. The market economy should provide the answer: it is evident that the operating of more players in the open market, pushed by the individual interest in order to improve the own performances whatsoever has positive social effects. In this setting *depoliticisation* measures should be implemented.

This process, in respect of Authorities, cannot disregard another issue: the relation between the central Authority (European Commission) and national Authorities, which should aim to a proper balance of functions but oriented to a process of free competition.