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Barriers to entry into the Dutch *retail* banking sector

Monitor Financial Sector
The Netherlands Authority for Consumers & Markets
June 2014

Please note that, although every effort has been made to ensure this translation is accurate and consistent, it is for informational purposes only. In case of any dispute or inconsistencies, the Dutch version is authentic.

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About the Monitor Financial Sector and this study

The Monitor Financial Sector or MFS (*Monitor Financiële Sector*, MFS) is a part of the Netherlands Authority for Consumers & Markets (*Autoriteit Consument & Markt*, ACM). The MFS carries out studies into the degree and developments of competition in the Dutch financial industry.

We have been able to prepare this report in part thanks to the comments made in a personal capacity by: Thorsten Beck (Tilburg University), Michiel Bijlsma (Netherlands Bureau for Economic Policy Analysis (*Centraal Planbureau*)), Jaap Bikker (Utrecht University and the Dutch central bank DNB), and Jarig van Sinderen (Netherlands Authority for Consumers & Markets (*Autoriteit Consument & Markt*, ACM).

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Executive Summary

The Dutch retail banking sector has become less competitive since the financial crisis

Competition in the Dutch retail banking sector (hereinafter: the Dutch banking sector) had already been less than optimal prior to the financial crisis. A large share of the sector was held by four systemic banks. An uncontrolled bankruptcy of a single systemic bank can cause significant damage to the financial system and the real economy. Consequently, these banks benefit from an implicit guarantee from the government, and therefore also from taxpayers. This implies that the systemic banks will be rescued in the event of an (impending) bankruptcy. Consequently, banks that are systemic can borrow at more advantageous rates than those that are not. The guarantee shields systemic banks from the disciplining effects of competition.

Competition in the Dutch banking sector has declined further since the beginning of the crisis. For example, according to the 2013 study of the Netherlands Authority for Consumers & Markets (hereinafter: ACM), competition in the mortgage market[1] has declined further due to the exit of foreign providers and the need of Dutch providers to reinforce their balance sheets. This decrease in competition has led to significantly higher mortgage rates for consumers.[2]

ACM studies barriers to entry and makes concrete policy recommendations for a structural improvement of competition

Higher lending interest rates and lower savings interest rates, caused by reduced competition, are detrimental to consumers and to businesses. Higher interest rates also slow down the economy's recovery by limiting the purchasing power of consumers, reducing lending, and weakening the viability of businesses. Therefore, it is important to improve competition in the Dutch banking sector in a structural manner.

The entry of new players or even merely the threat thereof will increase competition in the Dutch banking sector. In that regard, removing or lowering barriers to entry are effective ways to encourage competition. With this study, ACM intends to contribute to a structural improvement of competition in the Dutch banking sector. The importance of this study has been emphasised by the Dutch Cabinet and the House of Representatives.

In addition to competition, policymakers and politicians must also include other objectives, such as financial stability, when shaping policy for the financial sector. Ultimately, it is up to politicians to achieve a balance between these objectives, if necessary. It is sometimes argued that increased competition comes at the expense of financial stability. ACM would like to emphasise that competition and stability are not necessarily mutually exclusive objectives, but can in fact reinforce each other.

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[1] In this document, the term 'market' does not refer to the term 'relevant market' as defined in the Dutch Competition Act.

[2] ACM (2013a).

In this study, ACM has identified the most important barriers to entry[3] in the Dutch banking sector.[4] ACM has subsequently investigated what solutions (in terms of policy or otherwise) could reduce those existing barriers. In total, ACM makes nine concrete recommendations for lowering existing barriers to entry. It believes that these recommendations can be implemented without any adverse effects on financial stability. These recommendations are set out below.

A more effective resolution mechanism and a European deposit guarantee scheme can remove the existing capital restrictions

The European banking industry has become fragmented since the crisis. The departure of foreign providers from the Dutch banking sector fits in with the trend of European banks withdrawing to their domestic markets. This fragmentation is caused by measures, among other causes, imposed on banks by national regulators to restrict the free movement of savings between countries (capital restrictions).

ACM concludes that capital restrictions are an important barrier to entry. Capital restrictions can limit the use of foreign deposits for lending in the Netherlands. A European banking union can lower the incentive to impose capital restrictions, by supplying European agreements that minimise the impact of bankruptcies of cross-border banks on national governments. Significant steps have already been made towards the creation of such a banking union.

However, there are still imperfections in the current structure of that banking union. As a result, the capital restrictions have not fully been removed. Firstly, a European deposit guarantee scheme (hereinafter: DGS) should still be created so that the costs of providing a guarantee scheme for savings are shared at the European level. Secondly, the European resolution mechanism can be improved. It is important that unhealthy cross-border banks can be resolved without affecting financial stability and the real economy. The European resolution mechanism exists for that purpose. Though great steps have been taken to achieve this mechanism, there is doubt about the effectiveness of the resolution mechanism in its current form. The reason for this is the potential interference from national interests in the resolution of banks. An effective banking union requires an effective resolution mechanism, in combination with a European DGS. ACM recommends that the Dutch Cabinet, in European settings, advocates for an effective resolution mechanism and a European DGS. In this manner, the incentive to impose capital restrictions will be diminished and it will be easier to enter the Dutch banking sector.

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[3] ACM defines a barrier to entry as any factor which causes a smaller difference between the expected profits and the sunk costs.

[4] ACM has not investigated whether the barriers to entry are higher in the Netherlands than in other countries. After all, lowering a barrier (in the Netherlands) always means that the Netherlands becomes more attractive as a market, even when the specific barrier is not higher in the Netherlands than in other countries.

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Improving the effectiveness of the banking union also contributes to the resolution of another barrier to entry: the cost advantages enjoyed by systemic banks with respect to funding. Due to the government guarantees, systemic banks have a cost advantage unavailable to new entrants (provided that these are not systemic banks themselves). In this study, ACM concludes that the systemic-bank status of the four largest banks in the Dutch banking sector constitutes a barrier to entry. An effective resolution mechanism can remove this barrier by ensuring that large banks can also go bankrupt, without causing significant damage to the financial system and the real economy. This will reduce the need for a government rescue of banks and the ensuing costs will no longer be passed on to taxpayers.

There are many complex financial laws and regulations that frequently change

The crisis has resulted not just in the fragmentation of the European banking sector, but also in many new laws and regulations. Since the crisis, the financial laws and regulations have been modified to prevent a recurrence in the future. This has further increased the scope and complexity of existing laws and regulations.

Based on its study, ACM concludes that the overall package of laws and regulations constitutes a barrier to entry into the banking sector, due to its scope, complexity, and the frequent changes it undergoes. The compliance costs associated with the laws and regulations are often sunk costs. Higher sunk costs reduce the incentive for entry into the market. Moreover, compliance costs are often fixed costs, such as the cost of setting up an ICT system or to implement the regulation. By creating economies of scale, the higher fixed costs result in an unequal playing field for small entrants and existing large players.

ACM recommends that the Minister of Finance evaluates the current Dutch laws and regulations for the purpose of simplifying them and reducing their number. With respect to future new laws and regulations in the Netherlands, ACM emphasises the need for consistent use of sound cost-benefit analyses that also include alternative solutions.

There is little differentiation on the basis of systemic risk in the financial laws and regulations

ACM concludes that the limited differentiation in the prudential laws and regulations and the supervision thereof, constitutes a barrier to entry, in addition to the scope and complexity of the total package of laws and regulations. Even though the bankruptcy of a small bank with little systemic importance is less injurious to the real economy than that of a large systemic bank, the current laws and regulations (including the supervision thereof) make little distinction as to the harm caused to the real economy by a bankruptcy of a financial institution. This causes the prudential laws and regulations (including the supervision thereof) to be disproportionately burdensome for smaller institutions, which results in a cost disadvantage for entrants that are of no systemic importance.

ACM recommends that the Minister of Finance strives for prudential laws and regulations, including the supervision thereof, that are better in line with the risk a bank forms for the financial stability and the real economy in case of bankruptcy. Recent initiatives of the Dutch central bank (DNB) for more 'damage-based' supervision are a step in the right direction. In the short term, the Minister of Finance could investigate how much latitude the Netherlands has in the implementation of European laws and regulations and how much additional discretion DNB can wield. In the long term, the Minister could investigate how to structure the European and international laws and regulations in such a manner that smaller banks are not burdened unnecessarily.

Limited differentiation in financial laws and regulations holds back credit unions
It is apparent that the limited differentiation in prudential laws and regulations is a barrier to entry in the case of credit unions, an alternative source of financing for SMEs. ACM concludes that the current prudential laws and regulations, and more specifically the prevailing capital and liquidity requirements, restrict the entry of credit unions to the market for SME lending. The compliance costs involved in the comprehensive package of laws and regulations are very considerable in proportion to the limited scope of the existing initiatives for credit unions in the Netherlands. Moreover, the minimum requirements with respect to the required equity capital are unrealistic in view of the average size of a credit union, even though the impact of possible bankruptcies of credit unions on the financial system and the real economy is limited. The business case of credit unions in the Netherlands is negative due to the regulatory demands currently imposed on them.

ACM recommends that the Minister of Finance applies to the European Commission for an exception to the current European prudential laws and regulations for credit unions. The regulatory framework that is to replace the current regulations must not be more burdensome than necessary to counteract the limited risks that the current initiatives for credit unions constitute for the real economy and the financial system.

The licencing system is deemed 'unnecessarily' stringent by market participants
Concerning the licencing system, ACM concludes that the difficulties in obtaining a banking licence, as perceived by the market participants, constitute a barrier to entry. According to the market participants, it is difficult to obtain a banking licence in the Netherlands compared to other countries. Market participants identify three specific issues in this respect: the length of the licencing process, the uncertainty affecting the licence requirements and therefore the outcome of the licencing process, and the unforthcoming attitude of DNB. ACM is unable to make statements about the accuracy of these specific signals, but concludes that the perception itself reduces the incentive for entering the Dutch banking sector.

Therefore, ACM recommends that the licencing system (laws and regulations as well as their implementation by DNB) be evaluated. This evaluation can be initiated by the Ministry of Finance. It should cover whether and how the length of the licencing process can be shortened/maximised and what the options are for enhancing the ex ante guidance concerning the licencing process, among other aspects.

Uncertainty about regulation constitutes a barrier to entry in the mortgage market

Uncertainty about future regulations in the mortgage market also plays an important role in the decision to enter the Dutch market for mortgage loans. In the survey performed by ACM, a sizeable majority of the market participants interviewed indicated that this uncertainty forms a significant barrier. The fact is that there is still a debate about the 'sustainability' of the policy for important topics that influence the profitability of mortgages. Examples of these topics are the mortgage interest tax deduction; the maximum permitted *LTV* ratio; and the scope of the National Mortgage Guarantee (NHG). The uncertainty about future policy created by this debate causes potential entrants to postpone their decision to enter the market or to assume a scenario that is overly negative.

For that reason, ACM recommends that the current and future Dutch administrations minimise the uncertainty about future policy for the mortgage market. The uncertainty can be removed by better explaining the sustainability of the current policy so that there is no more cause for debate or by amending the policy if necessary.

Consumer inertia reduces the incentive for entry

Finally, consumer behaviour also influences entry. Limited switching behaviour of consumers (consumer inertia) reduces the incentive for entry. Namely, consumer inertia reduces the options of new entrants for creating sufficient market share. ACM has observed consumer inertia in the savings market as well as in the market for current accounts.

In the Dutch savings market, half of all consumers have never switched. ACM concludes that this consumer inertia restricts the scope of the market for a new entrant and that it constitutes a barrier to entry. Consumer inertia in the savings market can be explained by the fact that consumers deem the safety of savings important when selecting a bank, while being relatively unaware of the deposit guarantee scheme (DGS). As a result, consumers possibly do not switch because they wrongly assume that their savings are not safe at a new, smaller financial institution.

New entrants must be able to communicate that savings are also guaranteed at their institution and be able to explain what the scope of that guarantee is. The existing Dutch laws and regulations are not clear enough about the latitude the banks have for informing consumers about guarantee schemes. ACM recommends that, when implementing the new European rules, the Minister of Finance makes it clear that banks have the latitude to inform consumers about guarantee schemes and to specify what this latitude exactly is.

As mentioned before, the Dutch current account market is also subject to consumer inertia. Seventy-three percent of current account holders aged 18 or older has never switched. Barriers to switching in the form of ‘hassle’ are a plausible explanation for this consumer inertia. ACM concludes that consumer inertia also constitutes a barrier to entry in the current account market.

As current accounts function as gateways to other markets, e.g. the savings market, consumer inertia in the market for current accounts also diminishes the incentive to enter other banking markets.

Number portability reduces the 'hassle' considerably more than existing switching services. Hence, ACM welcomes the European decision to perform a cost-benefit analysis in 2019 of the introduction of number portability at the European level. Hereby, ACM emphasises the importance of an *independent* estimate of the costs of number portability. ACM also deems it important that the determination of the benefits of number portability also includes the impact on markets for which the current accounts function as a gateway (in addition to the impact on the market for bank accounts). ACM therefore recommends that the Minister of Finance advocates the independence and broad focus of the planned cost-benefit analysis in Europe.

The potential implementation of number portability can only be achieved in the longer term. In the meantime, the current Dutch Switching Service (*Overstapservice*) can be a reasonable alternative. However, the number of switches since the introduction of the Switching Service is still very low. Moreover, the survey performed by ACM has demonstrated that the majority of consumers are not familiar with the Switching Service. ACM recommends that the Minister of Finance investigates how to enhance the effectiveness of the Switching Service. In any case, the consumers' familiarity with the Switching Service must be enhanced.

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List of recommendations

1 Why a study into the existence of barriers to entry in the Dutch banking sector?

The retail banking sector has become less competitive since the crisis

The Dutch *retail* banking sector (hereinafter: Dutch banking sector) has always been a highly concentrated market.[5] The financial system consists largely of a few large banks: in 2011, the Dutch government designated the four largest Dutch retail banks (ABN AMRO, ING Bank, Rabobank, and SNS Bank) as systemic banks.[6]

This status has an adverse impact on competition. After all, systemic banks enjoy an (implicit) guarantee against bankruptcy. As a result, they have access to more advantageous financing in the capital market compared to banks that are not of systemic importance. This means that they are partially shielded from competition.[7] Furthermore, systemic banks are subject to the risk of moral hazard: the guarantee protects systemic banks to a certain extent from risks and therefore causes them to take in fact more risks than when they themselves have to absorb the full costs of a bankruptcy.

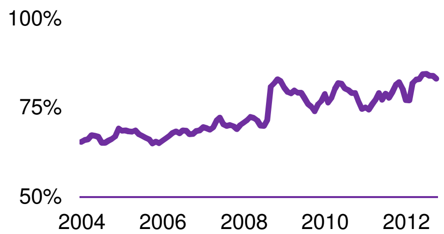

Figure 1: C4 ratio mortgage market (ACM, 2013a).

Research by DNB has revealed that the market has become even more concentrated after the crisis. According to DNB, the market share of the three major banks in the Dutch banking sector exceeded 80% in 2011.[8] Subsectors such as the mortgage market have also become more concentrated since the crisis (see Figure 1). The combined market share of the three largest banks is very high in a number of other subsectors. As such, the three major banks had a combined share of more than 90% of the market for current accounts[9], as well as in the area of SME lending. While the degree of concentration of a market is not necessarily an adequate benchmark for competition, empirical studies do in general indicate a

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[5] The degree of concentration can provide an indication of the level of competition in the banking sector and is often defined as the combined market share of the four largest companies (the C4 ratio).

[6] A systemic bank is a bank of which the bankruptcy will endanger the financial system and cause considerable damage to the real economy. Consequently, systemic banks are subject to tightened supervision by DNB (Minister of Finance, 2011, page 16). In addition, the Bank Nederlandse Gemeenten, de Nederlandse Waterschapsbank, and RBS N.V. are also considered to be Dutch systemic banks.

[7] Bijlsma, et al. (2014), page 11.

[8] DNB (2012a), page 63.

[9] GfK (2014d). The figures are based on the number of current accounts.

negative relationship between concentration and competition in the banking sector.[10] The increase in concentration is partially attributable to the consolidation in the Dutch banking sector. This is caused by mergers, as well as bankruptcies of e.g. DSB and the absence of significant new entrants.

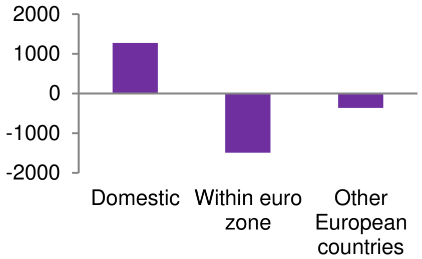

Figure 2: change in the size of loans to non-MFIs in the period September 2008 – September 2012 in mrd. EUR by EMU banks (Enoch et al., 2014, p.14).

Furthermore, the European financial market has the tendency to become increasingly fragmented. Instead of achieving a single European financial market, various foreign banks have in fact drastically scaled back their activities in the Netherlands since the start of the crisis. This phenomenon of banks pulling back to their domestic market is taking place throughout Europe. For example, Figure 2 shows that European banks are increasingly investing in their domestic market rather than participating in cross-border lending.

These changes are detrimental to the consumer

Insufficient competition is accompanied by high prices, poor quality, limited innovation, and reduced lending to consumers and companies.[11] Research performed by the MFS of ACM into e.g. the mortgage market has shown that the margins earned by the banks in the mortgage market have increased considerably since the crisis began (see Figure 3).[12] These higher margins have an adverse impact on the interest rates for consumers. There are also indirect adverse consequences ensuing from reduced competition. For example, reduced competition in SME lending can lead to higher lending rates. This impedes economic growth and innovation.

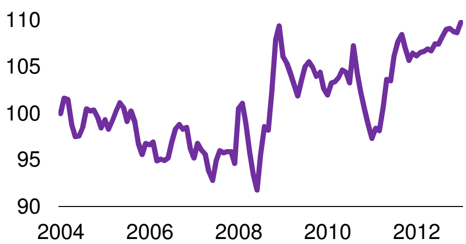

Figure 3: evolution of the margin on mortgages. Index: 1 January 2004 = 100 (ACM, 2013a).

Removal of barriers to entry desirable

New market entrants or even the threat thereof — not only foreign market participants but also e.g. pension funds, insurers or new initiatives — can stimulate competition in the Dutch banking sector. Removing or lowering the barriers to entry makes it easier for such new entrants to

[10] For a list of these empirical studies, see Van Hoose (2010), page 58-61.

[11] Refer also to the Vision Document on the Future of the Financial Landscape (*Visiedocument Toekomst Financiële Landschap*) (NMa, 2010).

[12] ACM (2013a).

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become active in the Dutch banking sector.[13] This increases the pressure on the existing market participants and ensures that there is more capital available to fund Dutch activities. Ultimately, this additional competition will result in lower prices, better quality, increased innovation, and more lending to consumers and firms.

Box 1: The relationship between competition in and the stability of the financial system

Competition and stability are not necessarily mutually exclusive. From a theoretical as well as an empirical perspective, there is no consensus about the question of whether more competition results in a more stable industry or, in fact, in greater instability. Empirical studies, e.g. by Beck, et al. (2006), show that competition and stability can coexist, provided that there is adequate prudential regulation.

According to Allen & Gale (2004), it is important to find a good balance between competition and stability, even if there are trade-offs between these two objectives. While a financial crisis can lead to considerable costs for the financial sector as well as for the real economy, reduced competition also involves costs, e.g. as a consequence of inefficiencies at banks and higher prices for consumers and companies. Contrary to a crisis, which occurs periodically and is temporary, the higher costs resulting from reduced competition are permanent.

In addition, new entrants can also cause a decline in the systemic importance of the existing market participants, as Dutch consumers then become less dependent on the existing large market participants.[14]

Purpose of the study

The degree of competition in the Dutch banking sector was already suboptimal before the crisis and became worse from there on. The entry of new market participants in the Dutch banking sector, or the threat thereof, can encourage competition. The importance of stimulating competition is emphasised by the Dutch House of Representatives and Cabinet.[15] It is necessary to lower the barriers to entry as much as possible in order to encourage new market participants. Structural improvements can be effected in this manner, including creating a single European market. This ensures a robust and competitive Dutch banking sector in the long term.

In view of the above, ACM has decided to conduct this study of barriers to entry. The focus of this study is on retail banking markets in which consumers and SMEs are the buyers. Concrete recommendations are made for the significant barriers identified by ACM that can be reduced

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[13] ACM has previously published a vision on the possible negative impact of the National Mortgage Institution (*Nationale Hypotheek Instelling*, NHI) on the position of the new entrants (ACM, 2013b). This vision showed that, depending on its shape, the NHI can result in a reduced incentive for entering the market, namely when the benefits of the NHI's government guarantee flow back primarily to the existing providers of housing finance with a sizeable NHG portfolio.

[14] Naturally, small banks can also be of systemic importance, e.g. because of their interdependence with the rest of the financial sector. In general, the smaller (relatively) a bank is, the less likely it is that it will be interdependent (Sachs, 2010, page 26).

[15] See the official report of the House of Representatives, TK-105, dated 3 September 2013 and titled *'Extra hypotheekbetalingen en hogere winsten van banken'* (Additional mortgage payments and higher profits of banks), in which the Ministry of Economic Affairs says: *'In the end, the consumer benefits most from healthy competition.'* The Minister then discusses the importance of entry in more detail.

through policy.

In addition to competition, policymakers and politicians naturally also include other objectives, such as financial stability, when shaping policy for the financial industry. Ultimately, it is up to the politicians to achieve a balance between these objectives, if necessary. Here, ACM would like to emphasise that competition and stability are not necessarily mutually exclusive objectives, but can in fact reinforce each other (see also Box 1), according to recent scientific literature. Hence, the widely-held view that there is a trade-off between competition and financial stability is not unequivocally true.

Reader's Guide

Below, we will first describe the manner in which ACM has designed the study of the barriers to entry and which criteria were used to select the barriers to entry.

Next is chapter 3, which deals with the recent developments in the banking sector. The conclusion of this chapter presents five recommendations that deal with barriers to entry into the Dutch banking sector.

The report concludes with four chapters on the most important subsectors: SME lending, mortgage lending, the savings market, and market for current accounts. Each chapter begins with a section covering the competitive conditions in the concerned market, followed by a second section in which recommendations are made for lowering barriers to entry into the concerned market.

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2 Research methodology

In this chapter, we define what a barrier to entry is and what types of entrants there are. Next, we cover the manner in which ACM has identified the relevant barriers to entry into the Dutch banking sector. Finally, we explain the criteria used to select the barriers that may be lowered.

What is a barrier to entry?

There exist several definitions of a barrier to entry. Some authors define a barrier to entry as *"all costs or losses of income that result in a reduction of the profitability of entering the market"*. Others do not focus on the costs for the entrants, but rather on the difference between the costs to be incurred by an entrant and the costs incurred by the existing market participants. McAfee, et al. (2004) and OECD (2006) provide a list of the most important definitions mentioned in the literature.

In this report, ACM applies a practical definition of a barrier to entry: a barrier to entry is that which causes a smaller margin between the expected profits of entry and the sunk costs.[16] The benefit of this definition is that it includes not just barriers to entry, but also barriers to growth and exit barriers.

What types of entrants are there?

There are various types of potential entrants to the Dutch banking sector. New competitive pressure can come from a bank that is currently active in the savings market, but that wants to expand its range of services with e.g. current accounts, for instance. Another possibility is an insurer expanding into specific banking markets, such as mortgage lending. Entrants originating from other European countries or from outside Europe are also possible. Finally, new (innovative) banks and other initiatives can increase the level of competition in the Dutch banking sector.

In this report, the term entrant is interpreted in a broad sense and includes all of the above-mentioned types of entrants. The analyses and recommendations for the reduction of barriers to entry therefore apply to barriers for one or more of these types of entrants.

How have relevant barriers to entry been identified?

ACM has used different sources for the identification of the relevant barriers to entry into the Dutch banking sector. First, ACM has reviewed the literature to identify potential barriers to entry into the Dutch banking sector. It should be noted that, for the identification of barriers in laws and regulations, ACM has only reviewed laws and regulations that specifically apply to the banking sector.

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[16] Sunk costs are cost incurred that can no longer be recovered (e.g. by means of the sale of the investment).

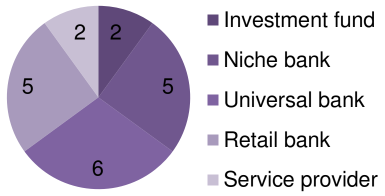

Figure 4: types of interview partners KPMG (2014).

In addition, ACM commissioned a survey among (potential) entrants.[17] KPMG interviewed 20 parties on an anonymous basis. Each of the parties interviewed were asked about what barriers to entry they experience or have experienced. Next, they were asked to rank these barriers in function of their importance and various hypotheses of potential barriers to entry were tested. The results of the interviews have been summarised in KPMG (2014). KPMG considers these results to be representative.

Finally, ACM itself has collected information from various (potential) entrants, including savings banks with a foreign parent company and new initiatives in SME lending.

ACM realises that market participants could have the incentive to answer the questions in a strategic manner. In order to minimise this risk, ACM interviewed a wide range of potential entrants, as well as existing Dutch systemic banks and relevant stakeholders such as DNB and the Ministry of Finance. These various perspectives ensure a balanced picture. The review of the literature serves to prevent the omission of important barriers. Moreover, ACM has subjected the barriers identified by the market participants to further review. For example, market participants designated the switching behaviour of consumers as a barrier to entry. To verify this, ACM has further analysed the consumer behaviour by having GfK perform a survey among consumers.[18]

How have the recommendations been selected?

Not all entry barriers identified have resulted in specific recommendations. ACM's selection of the barriers for which recommendations have been formulated is based on the following two criteria:

1. Is the barrier designated as important by (potential) entrants?
2. Is it possible to formulate a specific recommendation for reducing the barrier?

With respect to the first criterion, it is evident that the most important barriers would be the first to be reduced. Potential entrants best understand which barriers prevent them most from becoming active in the Dutch banking sector. These potential barriers are identified in this study.

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[17] KPMG (2014) contains an overview and analysis of the interviews done anonymously by KPMG with (potential) entrants.

[18] GfK (2014a) and GfK (2014b).

Second, ACM has focused on the barriers that are suitable for specific recommendations. Following the package of recommendations should result in a reduction of the barriers to entry and, in doing so, in an increase in the level of competition in the Dutch banking sector.

3 Development of the Dutch banking sector

Banks perform payment transactions for their clients, issue loans to businesses and consumers, and offer opportunities for savings and investments. This chapter illustrates a number of relevant developments that influence competition in the Dutch banking sector.[19]

Dutch retail banking sector is large and has four systemic banks

The banking sector in the Netherlands is sizeable in proportion to the overall economy. The 2013 combined balance sheet total of the Dutch banks was four times as much as the GDP of the Netherlands. As such, it exceeded the European average of approximately three times GDP.[20] The Netherlands has thereby one of the largest banking sectors in the world, relatively speaking.[21]

The four largest banks in the Dutch banking sector are systemic banks. The systemic status of ABN AMRO, ING Bank, Rabobank, and SNS Bank was recognised expressly in 2011.[22] The bankruptcy of one of these banks would have a significant impact on the Dutch financial system and thereby on the economy. This status makes it possible for these banks to have access to more advantageous funding than banks that do not have the status of systemic bank. This funding advantage results in a competitive disadvantage for banks that do not have a systemic status.

The crisis has had a considerable impact on the Dutch banking sector

The Dutch banking sector experienced significant growth from the beginning of the nineties of the previous century. In the period 1990–2007, the balance sheet total increased from 440 billion euros to 2,168 billion euros.[23] In this period, Dutch banks became increasingly active internationally by acquiring foreign banks. Examples of this are the acquisitions by ING Bank of the British Barings Bank and the Belgian Bank Brussel Lambert at the end of the nineties, and the acquisition by ABN AMRO of Antonveneta in 2006. The strong expansion of the Dutch banking sector ended as a consequence of the international financial crisis in 2008.

The financial crisis caused a number of Dutch banks to suffer significant losses.[24] In 2008, one year after ABN AMRO's acquisition by Fortis, Royal Bank of Scotland, and Banco Santander, the State nationalised the Dutch segments of Fortis/ABN AMRO for 29 billion euros.[25]

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19 Chapters 4 to 7 cover the competition per banking market segment.

20 DNB, http://www.dnb.nl/en/news/news-and-archive/dnbulletin-2014/dnb306988.jsp.

21 EBF (2012).

22 In the Netherlands, ABN AMRO, ING Bank, Rabobank, and SNS Bank have been designated as being of systemic importance (Ministry of Finance, 2011, page 16).

23 DNB, http://www.statistics.dnb.nl/financieele-instellingen/banken/binnenlandse-bankbedrijf-monetair/index.jsp

24 Committee on the Structure of Dutch banks (*Commissie Structuur Nederlandse Banken*) (2013), figure 1, page 14.

Moreover, the Dutch government created a capital injection facility in the amount of 20 billion euros. In doing so, the government made a commitment to provide capital to banks and insurers that, as a result of the financial crisis, were unable to fulfil the capital requirements deemed necessary by DNB.[26] Three parties made use of the capital injection facility for a total amount of 14 billion euros.[27]

In addition to this nationalisation and capital support, the government also provided a guarantee facility of 200 billion euros until 31 December 2010. This guarantee facility was an attempt to resolve potential liquidity issues, thereby guaranteeing that lending from banks to businesses and consumers would continue.[28] In the course of 2008-2009, various parties[29] made use of this facility in the amount of 50 billion euros.

The European Commission approved the state aid of the Dutch government to various financial institutions during the crisis, but this approval was subject to conditions. Depending on the financial institution, the Commission imposed a restructuring obligation.[30] For ING Bank, the state aid means that it has to split into a bank and an insurer.

The European Commission also imposed price leadership restrictions on a number of financial institutions that enjoyed aid. These restrictions meant that these banks were not allowed to be price leaders in various segments, including the markets for savings, mortgages, and SME lending.[31]

Since the crisis, the Dutch banks have begun to phase out their activities; the demand for bank products such as mortgages[32] and SME loans[33] has declined; and the banks have begun to cut

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[25] Parliamentary Inquiry into the Financial System (*Parlementaire Enquête Financieel Stelsel*) (2012), page 175.

[26] Parlementaire Enquête Financieel Stelsel (2012), page 316.

[27] The following banks and insurers made use of the capital injection facility: ING 10 billion euros, Aegon 3 billion euros, and SNS Reaal 0.75 billion euros. In addition, ING received an 80% guarantee for its American Alt-A mortgages in the amount of 27.8 billion euros (Parlementaire Enquête Financieel Stelsel, 2012, page 316).

[28] Parlementaire Enquête Financieel Stelsel (2012), page 380.

[29] LeasePlan, NIBC, SNS Bank, Fortis Bank Nederland, ING Bank, and Achmea Hypotheekbank (Parlementaire Enquête Financieel Stelsel, 2012, page 380).

[30] EBA (2013), page 5.

[31] Regarding the mortgage market, ACM has reviewed whether the price leadership restrictions for ABN AMRO, ING, and Aegon resulted in a restriction on competition. Although the mortgage margins increased after 2008, it could not be explained by the price leadership restrictions. This was because the margins had already begun to increase before the price leadership restrictions took effect. This does not affect the fact that the margins might have evolved differently without the price leadership restrictions (NMa, 2011, page 40 and ACM, 2013a).

[32] DNB. http://www.dnb.nl/nieuws/nieuwsoverzicht-en-archief/statistisch-nieuws-2014/dnb307673.jsp.

their costs through restructurings. In the period of 2008–2013, the overall balance sheet total of the Dutch banks declined by 18.7% from 2,994.7 billion euros to 2,433.7 billion euros.[34]

At the same time, foreign banks left the Netherlands or phased out their activities. The French bank BNP Paribas decided at the end of 2011 to no longer grant mortgages in the Netherlands, for instance.[35] Furthermore, Deutsche Bank opted in 2013 to no longer grant loans to SMEs and to sell off existing loans.[36]

The financial crisis also had an impact on the Dutch real economy. The Dutch economy went into a recession after 2008 and experienced a contraction of 3.7% in 2009. Following a weak recovery in the period 2010-2011, the Dutch economy again shrank by 1.2% in 2012 and 0.8% in 2013.[37] In addition, unemployment doubled from 3.8% in 2008 to 8.3% of the labour force in 2013.[38]

The worsened macroeconomic conditions, including the weakened demand for bank products, resulted in a deterioration of the climate for establishing a business in the Netherlands.

The concentration has traditionally been historically high in the Dutch banking sector and remains so after the crisis

The sector experienced a consolidation wave from the nineties of the previous century, in part due to the abolition of the structural policy on 1 January 1990. The goal of the structural policy was to prevent market concentrations of banks. This resulted in a long-lasting ban on mergers between large Dutch banks and between banks and insurers.[39] A factor in the decision to abolish the structural policy was that the European internal market would be opened up in 1992. This meant that the Dutch banks would have to compete directly with foreign banks, which would drastically change the strategic playing field. Consequently, a (domestic) ban on mergers was no longer deemed necessary, for reasons of competitiveness. Once the structural policy was abolished, there was a consolidation in the Dutch banking sector.

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[33] DNB. http://www.dnb.nl/nieuws/nieuwsoverzicht-en-archief/statistisch-nieuws-2014/dnb307673.jsp

[34] DNB. http://www.statistics.dnb.nl/financieele-instellingen/banken/geconsolideerd-bankbedrijf-toezicht/index.jsp.

[35] Het Financieele Dagblad (10 December, 2011). *BNP Paribas stopt met hypotheken in Nederland* (BNP Paribas ceases mortgage lending in the Netherlands). Available through: http://fd.nl/beleggen/781144-1112/bnp-paribas-stopt-met-hypotheken-in-nederland

[36] Deutsche Bank (2013).

[37] Statistics Netherlands (CBS). http://statline.cbs.nl/StatWeb/publication/?DM=SLNL&PA=81117NED&D1=65&D2=31-43&VW=T.

[38] Statistics Netherlands (CBS). http://statline.cbs.nl/StatWeb/publication/?DM=SLNL&PA=80479ned&D1=0-5,10-17&D2=0&D3=0&D4=12,25,38,51,64,77,90,103,116,129,133-146&HDR=T&STB=G1,G2,G3&VW=T

[39] DNB (2010), page 34.

Since then, the number of credit institutions[40] has steadily been declining. In the period from 1998 to 2007, the number of credit institutions declined by approximately 46% to 341 institutions in 2007.[41] At the same time, the concentration of the Dutch banking sector is increasing. According to DNB, the market share of the three major banks in the Dutch banking sector exceeded 80% in 2011.[42]

The foreign banks withdrawing to their domestic markets since the crisis has caused the Dutch banking sector to remain highly concentrated. Developments such as the absorption of the Dutch activities of Fortis Bank by ABN AMRO, Rabobank's takeover of Friesland Bank and the bankruptcy of DSB Bank have also contributed to this.

The concentration has increased in various market segments. In the mortgage market, the average C4 ratio increased from 68.1% for the period 2004-2008 to 79.3% for the period 2008-2012. In 2012, the C4 ratio was even 82.3%.[43]

Fragmentation of the European banking sector

Following the financial crisis, the European financial sector is now experiencing fragmentation. Banks are phasing out their foreign activities and are focusing more on their domestic market. The fragmentation of the banking sector is caused by deleveraging and restrictions on international capital flows, among other causes.

Deleveraging consists of lowering the debt positions of a bank. This can be achieved by attracting additional capital or by decreasing the assets of a bank.[44] This should be seen in the context of the more stringent capital requirements for banks stipulated by Basel III and the Capital Requirements Directive IV (CRD IV).[45]

These more stringent capital requirements have resulted in the European financial industry becoming less integrated. According to Goodwin, this was caused by the authorities not defining how the banks should fulfil these more stringent capital requirements. European banks have

[40] Banks and electronic money institutions (EMI) are jointly referred to as credit institutions.

[41] ECB Data Warehouse, http://sdw.ecb.int/quickview.do?SERIES_KEY=187.MFI.M.NL.102.T.1.

[42] DNB (2012a), page 63.

[43] ACM (2013a), page 18.

[44] Blundell-Wignall & Atkinson (2012) and Vause, et al. (2012).

[45] The Economist (12 October 2013). *Financial Fragmentation: Too Much of a Good Thing*. Available through: http://www.economist.com/news/special-report/21587378-2008-global-financial-integration-has-gone-reverse-too-much-good-thing

decided to reduce their outstanding loans in countries other than their traditional domestic market.[46]

Another reason for this fragmentation is that national prudential regulators impose measures on banks to restrict international capital flows. This is attributable to the absence during the international crisis of (firm) international agreements on how to deal with bankruptcies of cross-border banks.

It is likely that competition in certain subsectors has declined due to capacity restrictions
It is difficult to measure competition in the banking sector. The same applies to its various market segments. A study of ACM[47] did reveal that the margins on new mortgage loans have increased since the beginning of the financial crisis. ACM attributes this increase in the margins to the existence of capacity restrictions at mortgage lenders and to a lack of (the threat of) new entrants. The margins in oligopolistic markets with capacity restrictions are in general higher, as capacity restrictions limit the opportunities for competitors to discipline each other. It is likely that capacity restrictions have also changed the conditions of the competition in other lending markets, such as SME loans (see chapter 4).

The European banking union must prevent the need for national governments to support failing banks
The European banking union is being created to prevent contagion between banking institutions and public finances and to reverse thereby the fragmentation of the European financial markets. The banking union entails (i) single supervision of credit institutions, (ii) a European mechanism for the resolution of failing banks, and (iii) a single deposit-guarantee scheme. The first two pillars of the banking union have since been realised, but the third pillar is not yet part of the banking union.

The second pillar is an important instrument for dealing with the issue of the status of systemic bank, as it makes it possible to let banks go into bankruptcy without significant damage to the real economy.

Other laws and regulations have also been introduced to prevent a future crisis and to resolve the systemic bank status
In order to prevent a new financial crisis, international agreements have been concluded to increase the capital and liquidity requirements for banks. These agreements have been laid down in Basel III and are being implemented in Europe via the CRD IV and the Capital

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[46] Het Financieele Dagblad. (25 April 2014). *Voorkomen crisis simpeler gezegd dan gedaan* (Preventing the crisis easier said than done). Available through: http://fd.nl/economie-politiek/426561-1404/voorkomen-crisis-simpeler-gezegd-dan-gedaan

[47] ACM (2013a).

Requirements Regulation (CRR). Enhancing the financial buffers of banks makes them more resistant to significant losses.

Conclusion

Traditionally, the Dutch banking sector is heavily concentrated and has remained so after the crisis. Even though it is difficult to measure the competition in the banking sector, it is likely that certain subsectors, namely those pertaining to lending, have become less competitive since the crisis.

Reader's guide: recommendations for lowering barriers to entry into the banking sector

Less competition in the Dutch banking sector translates into higher prices, lower quality, less innovation, and less lending. In doing so, it slows the recovery of the Dutch real economy.

One of the ways in which competition in the Dutch banking sector can be stimulated is to encourage new entrants. On the basis of literature and its own research, ACM has identified a number of general barriers to entry that impede entry in all subsectors. The identified barriers to entry, for which ACM is making recommendations below, concern the licencing process at DNB, differentiation in supervision, the complexity of regulations, and the European banking union.

There are also identified barriers for which ACM is not making any recommendations. For example, this ACM study has revealed that the current adverse macro-economic circumstances in the Netherlands are one of the most important reasons for not entering the Dutch banking sector. ACM recognises that this is a significant barrier to entry, but is not making a recommendation. It is difficult to formulate a recommendation for this barrier that consists of more than meaningless generalisations.

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Recommendation 1: Advocate for the improvement of the European resolution mechanism.

"Concerns aside, it's a significant step, in theory. How it works in practice remains to be seen."

- Irish Independent about the SRM

In the Netherlands, there are systemic banks with funding advantages

ABN AMRO, ING Bank, Rabobank, and SNS Bank have been designated as systemic banks in the Netherlands.[48] This means that these banks are important for the proper functioning of the financial system and thereby for the functioning of the economy and society. A bankruptcy of a systemic bank would have such a considerable impact on the economy that they will be saved by governments in the event of an impending bankruptcy. This constitutes an implicit government guarantee and makes these banks *Too Big To Fail* (TBTF).

Box 2: The resolution of banks

The Single Resolution Mechanism (SRM) will take effect on 1 January 2015 and provides a framework within which (systemic) banks can be resolved in an orderly fashion. This framework entails the stabilisation of the critical economic functions and the restructuring of a bank (Ministry of Finance, 2014, page 2).

In the stabilisation phase, the losses incurred are absorbed and the bank is provided with adequate capital and liquidity. These losses are charged to the providers of equity and debt of that bank, the so-called bail-in. When at least 8% of the total liabilities have been subject to the bail-in, possible other losses (up to a maximum of 5% of total liabilities) will be borne by the resolution fund (refer to box Single Resolution Fund). The bail-in will take effect on 1 January 2016.

Besides the bail-in, regulators can also i) sell a segment of the bank, ii) form a public bridge institution to which the good assets are transferred, and iii) transfer the bad assets to a bad bank.

This government guarantee makes it possible for systemic banks to have access to more advantageous funding than banks that do not have the status of systemic bank. Namely, systemic banks benefit from a lower credit spread in international capital markets due to the lower risk of bankruptcy.[49] The Netherlands Bureau for Economic Policy Analysis (*Centraal Planbureau*, CPB) estimates the systemic banks' funding advantage, resulting from the government guarantee, to be approximately 67 to 121 basis points.[50]

The European resolution mechanism can remove the financing advantage

A European banking union is currently being formed, which will result in an international financial policy and supervision. This will make it possible to maintain an integrated European market. In addition, the banking union will contribute to a level playing field in the banking sector. Banking supervision will become more uniform and will provide fewer

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[48] Minister of Finance (2011), page 16.

[49] The higher the creditworthiness of the government in the concerned country, the higher this funding advantage will be. See Schich & Lindh (2012) and De Grauwe & Li (2013).

[50] Bijlsma, et al. (2014), page 11.

opportunities for national options and decisions.

An effective banking union rests on three pillars. These are (i) a single supervision of the banks by the ECB, (ii) a single resolution mechanism, and (iii) a single European deposit-guarantee scheme (DGS). The second pillar, the Single Resolution Mechanism (SRM), must enable systemic banks to go into bankruptcy without endangering financial stability.[51,52,53]

Box 3: The *Single Resolution Fund*

The Single Resolution Fund (SRF) is being created as part of the SRM. The SRF is principally intended for those resolution instruments that cannot be funded by the bail-in, such as guarantees on assets and liabilities and the financing of a bad bank. The resolution fund, provided for an inter-governmental agreement (IGA) between participating member states, is to be financed ex-ante with risk-based contributions by the banks. From 2016, the fund will be built up over a period of 8 years until it reaches a minimum size of 1% of the deposits covered by the DGS. In 2024, the fund will then amount to 55 billion euros. If the ex-ante financing turns out to be inadequate, then banks will be assessed ex post (Proposal for Regulation 1093/2010, § 4.3.2; EC, 2014). In addition, during its development phase, the resolution fund will be able to borrow on the basis of the future resolution contributions to be paid by banks

The SRM provides the national resolution authorities with the option to intervene in systemic banks in the case of an (impending) bankruptcy, to resolve these in a prudent manner (see Box 2).[54] This results in the removal of the systemic banks' funding advantage as the implicit government guarantee no longer exists and the providers of capital experience a higher credit risk. The providers of capital will demand a higher risk premium and the financing costs of systemic banks will (more adequately) reflect the risk of the underlying assets.

There is a debate about the design of the SRM

The introduction of the SRM represents a significant step towards removing the funding advantage. This is also demonstrated by Fitch's downgrading of Dutch systemic banks pursuant to the European agreement on the SRM.[55] The only question in this respect is whether the current design of the SRM has sufficient credibility to completely convince providers of equity and debt that a systemic bank will effectively be resolved in the case of an impending bankruptcy. Only in that case will it be possible to fully remove the financing advantage, a consequence of the implicit government guarantee. There is a debate about the current design

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[51] Proposal for Regulation 1093/2010 and Ministry of Finance (2014), page 43.

[52] The SRM will be implemented in the national legislation.

[53] The introduction of the systemic buffer in CRD IV also contributes to the reduction of the risk of bankruptcy of a systemic bank and thereby the improper financing advantage of systemic banks.

[54] The Financial Institutions (Special Measures) Act (*Wet bijzondere maatregelen financiële ondernemingen*; "Intervention Act") came into force on 13 June 2012 with retroactive effect from 20 January 2012. At the national level, the Intervention Act provides powers to DNB and the Minister of Finance to intervene in financial companies in trouble.

[55] Het Financieele Dagblad. (27 March 2014). *Ratings banken lager na EU-akkoord*. (Banks' ratings lower after EU agreement.) Available through: http://fd.nl/beurs/168352-1403/ratings-banken-lager-na-eu-akkoord?visited=true.

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(and thus effectiveness) of the SRM and accompanying procedures. This debate is primarily focussed on the potential for interference from national interests in a resolution procedure.

The procedure for the resolution of a bank under ECB supervision[56] can be summarised as follows: i) ECB reports that a bank is failing or is about to fail;[57] ii) the Single Resolution Board (SRB) prepares a resolution plan, iii) on the proposal of the EC, the Council of the European Union can raise an objection or make proposals for changes to the resolution plan; and iv) the plan is implemented by the national resolution authority. The SRB consists of four permanent members and a Chair. The relevant national resolution authorities will complement the SRB during the preparation of and the vote on a resolution plan.[58] The resolution plan specifies how the concerned bank will be resolved and which instruments will be used to what extent.

Due to the design of the above resolution process, it is deemed possible that national interests will continue to play a role in the resolution of banks.[59] Namely, national resolution authorities are a part of the SRB. Consequently, they automatically exert influence on the shape of the resolution plan, in spite of the voting ratios in the SRB and the role of the EC, for instance. The influence of the resolution authorities pertains to e.g. the extent of the bail-in (above the minimum of 8%), the providers of capital to be affected by the bail-in, the identity of the candidate for a takeover, and the design of a potential bad bank. Moreover, it cannot be excluded that the concerned resolution authorities would be influenced by national governments in this regard. There is no legal obligation for the resolution authority to be an independent body.[60] Secondly, national authorities have a motive for influencing the resolution authorities, as the resolution of a systemic bank is accompanied by economic (unemployment, etc.), political, and budgetary costs.[61] As a result, a national authority could influence the resolution plan to such an extent that the providers of capital of systemic banks remain partially protected.

[56] The national resolution authority is responsible for winding up banks under national supervision.

[57] For the criteria, see Merler (2014), page 5.

[58] The amount of financing to be supplied by the SRF will determine whether only the concerned resolution authorities will be part of the SRB or all resolution authorities.

[59] Natixis (2014), page 5.

[60] Natixis (2014), page 5.

[61] Natixis (2014), page 5.

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Box 4: Size of the SRF

There is doubt as to whether the SRF will be large enough, during or after the development phase, for the required recovery and resolution plans. If the SRF would run dry, e.g. due to a big financial crisis (for an estimate of the costs in the case of a crisis, see Van Beers, et al., 2014, page 41), then it will no longer be possible to resolve a bank with the help of the SRF and the possibility will continue to exist that a national government will support a systemic bank subject to an impending bankruptcy. In order to prevent the SRF from running dry, the Eurogroup has announced that a backstop will be developed in the future (Eurogroup, 2013). This means that a procedure will be prepared that prescribes what happens when the SRF runs out of sufficient funds. The final backstop must take effect at the latest from 2026. In the meantime, a so-called 'bridging loan' will be used. This means that the national government, or in extreme cases the ESM, will provide the necessary financing when the SRF has insufficient funds.

However, there is a concern that this situation might not be realistic. Some calculations show that, in the current form of the SRM, the bail-in would have been more than sufficient during the current crisis in almost all countries. According to these calculations, it would not have been necessary to use the SRF (Natixis, 2014, page 2). Yet, these calculations could have been an underestimate as the government aid did not remain limited to direct investments, but also included guarantees (EC 2013). The guarantees have possibly limited the losses incurred, causing those losses to be underestimated. Moreover, larger crises potentially loom on the horizon and it might therefore become necessary to make claims on the SRF after all.

The influence of governments on the national authorities could become more significant, if the bail-in turns out to be insufficient and the SRF runs out of sufficient funds (see Box 4). Namely, in the development phase of the SRF, the national governments will be expected to pre-finance a resolution if the SRF runs out of funds. This increases the risk of interference from national interests in the resolution process even more due to the principle of 'he who pays the piper calls the tune'. According to Merler (2014), this situation is the same as the current situation without SRM, thus with interference from the national government in the resolution of banks.[62]

Moreover, there is still a debate about the speed of the decision-making during a resolution procedure. As many different parties are involved in this process, there is the expectation that a swift and effective decision regarding the resolution plan is difficult to achieve, notwithstanding various deadlines on paper.[63] According to the Financial Times, in an extreme case, it is possible that 9 committees with 143 votes issued in total will have to decide on the resolution plan.[64] This would be at the expense of the effectiveness and credibility of the SRM.

A more effective SRM contributes to the reduction of barriers to entry

An effective and efficient resolution mechanism is an important condition for fully removing the implicit government guarantee for systemic banks. The current debate on the SRM increases

[62] Merler (2014), page 6.

[63] There are potentially seven different bodies involved in a resolution, with the number of members varying from 3 to 28 (Merler, 2014, page 6).

[64] Financial Times (17 December 2013). *EU ministers set to define banking union*. Available through: http://www.ft.com/intl/cms/s/0/c552f182-6736-11e3-a5f9-00144feabdc0.html.

the doubt as to whether or not this is already entirely the case. The interference from national interests, through the influence of non-independent resolution authorities, in the resolution of (systemic) banks can signify that providers of capital to systemic banks remain partially protected. In this manner, a (improper) funding advantage could continue to exist for systemic banks.[65]

If a form of state aid continues to exist, then the systemic banks will partially retain their competitive advantage.[66] Due to this funding advantage, systematic banks compete at (artificially) lower costs against banks that are not of systemic importance. This cost disadvantage for banks that are not of systemic importance, such as new entrants, has a negative impact on the margins, reduces the expected profit of entering the banking sector, and therefore the incentive of entering the market.[67] This naturally does not apply to foreign systemic banks that benefit from the same funding advantage in their home country.

Conclusion
With the current form of the SRM, it is not entirely impossible that national interests will continue to play a role in the resolution of systemic banks. The decision-making regarding the resolution plans and the influence of national governments and resolution authorities on the resolution plans form potential risks for the effectiveness of the resolution mechanism. This gives rise to the risk of interference from national interests and, in doing so, to potential protection of providers of capital to systemic banks. Consequently, the financing advantage is not fully removed and the barrier to entry continues to exist.

Recommendation: Advocate for the improvement of the European resolution mechanism.
As interference from national interests in the resolution of systemic banks remains a risk, ACM recommends that the Dutch Cabinet advocates at the European level for a European resolution mechanism that would resolve a systemic bank as effectively as possible in the case of an impending bankruptcy. For that purpose, the procedures leading to an effective resolution must prevent interference from national interests and ensure a process that is as swift as possible. The funding advantage of systemic banks will be fully removed only when Europe is capable of creating a completely credible SRM. It is in any case desirable in the short term that the national resolution authorities are made as independent as possible, to limit interference from other interests.

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[65] Stern & Feldman (2004).

[66] Soussa (2000), page 11–12, Noss & Sowerbutts (2012), page 4 and Schich & Lindh (2012), page 15.

[67] The extent to which the financing advantage constitutes a barrier to entry was not assessed in the interviews performed in the context of this study (KPMG, 2014). However, the financing advantage by itself was discussed in four interviews. For example, a European insurer argued that systemic banks are able to obtain cheaper financing and thus have an advantage compared to banks that are not of systemic importance. On the other hand, other parties, including a Dutch systemic bank, asserted that there is no (significant) financing advantage for systemic banks.

It should be noted in that regard that the manner in which the European resolution mechanism is effectively implemented in practice is more important than how the design of the European resolution mechanism is described on paper. In addition to the improvement of the official design of the European resolution mechanism, its consistent, optimal, and effective application in concrete cases is important to its credibility.

Recommendation 2: In addition to a more effective European resolution mechanism, advocate for a European deposit-guarantee scheme

"Too few foreign banks are currently entering the market because they experience difficulties in obtaining the authorisation from their local regulator for the cross-border transfer of funding from the home country."

- Foreign investment company (KPMG, 2014)

From integration to fragmentation of the European banking sector

Until 2008, the European banking sector was characterised by an extensive integration of the national financial markets. Interbank loans between European banks increased and so did cross-border investments by banks in foreign countries.

The beginning of the financial crisis launched a movement in the opposite direction. For example, the number of cross-border interbank loans in the euro area declined by 670 billion euros (-42%) and by an additional 285 billion euros (-23%) in the other European member states.[68]

One of the explanations for the fragmentation pertains to the formal and informal restrictions imposed by regulators on banks in order to restrict international capital flows (hereinafter: capital restrictions).[69] Regulators can impose capital restrictions in a number of ways, such as by restricting the amount of foreign assets a bank may possess or by exerting pressure to divest foreign assets. In addition, there can be formal and/or informal restrictions on deposits. For example, several regulators have indicated that deposits can only be put to a cross-border use to a limited extent.[70]

Prudential regulators impose capital restrictions to limit the losses, to their own financial sector and the taxpayers, ensuing from the bankruptcies of the foreign activities of banks.[71] The absence during the financial crisis of (firm) international agreements on how to deal with bankruptcies of cross-border banks resulted in the costs of resolving and rescuing such banks to be borne by the country of origin. In addition, it became clear that some national deposit-

[68] The loans from banks to foreign private parties fared the same way with the decline of 450 billion euros (Enoch et al., 2014, page 141).

[69] Cerutti, et al. (2010), page 4.

[70] The Economist (12 October 2013). *Financial Fragmentation: Too Much of a Good Thing.* Available through: http://www.economist.com/news/special-report/21587378-2008-global-financial-integration-has-gone-reverse-too-much-good-thing

[71] Van Rijckeghem & Weder di Mauro (2013), page 3.

Box 5: European banking union - the necessity of the three pillars

The European banking union is based on three pillars, namely: (i) European supervision (SSM), (ii) a European resolution mechanism (SRM) and (iii) a European deposit-guarantee scheme (DGS). The proper functioning of the banking union requires that the three pillars be provided for at the same level (national or European). The wrong incentives can arise if this is not provided for at the same level. Suppose that the supervision is at the European level and the resolution at the national level. A situation could then arise in which national resolution authorities allege that the European supervision has failed and that they are unwilling to pay due to that inadequate supervision at the European level (Gros & Schoenmaker, 2012). Inversely, the same applies to national supervision combined with European resolution and between supervision and a (European) DGS (Enoch, et al., 2014, p. 244).

If supervision, resolution, and deposit guarantees take place at the same level, then the European level prevails over the national level. European supervision ensures consistency in the regulatory requirements, creates a more level playing field for banks, and prevents regulatory arbitrage (DNB, 2013a). European supervision also attenuates the incentive to postpone painful measures for the domestic banking industry or to depict the situation too optimistically. A European resolution mechanism ensures that the resolution can better take account of cross-border effects and that it will be less vulnerable to the interference from national interests (Goyal, et al., 2013, page 8; Goodhart, C., 2012, page 105). Finally, a European DGS can remove the distrust of national supervisory authorities with respect to deposit guarantee schemes of other countries and, in doing so, attenuate the incentive to impose capital restrictions.

guarantee schemes (DGS) were forced to pay savers of a foreign bank[72], as the home country turned out to be incapable of fulfilling the guarantee.[73] In response, national regulators began implementing capital restrictions. Capital restrictions are at odds with the goal of the European Union to create a single internal market.

European banking union can resolve fragmentation and capital restrictions

Schoenmaker (2011) asserts that there is a financial 'trilemma'.[74] According to Schoenmaker, the combination of 'financial stability, international financial integration, and national financial policy' cannot be achieved at the same time. Only two of these elements can be combined simultaneously.[75] This means that an integrated European financial market can only be achieved when the supervision has also been provided for at the European level. This can be achieved by the European banking union currently being formed. The three pillars that support the banking union can remove the incentive to use capital restrictions as the costs of bankruptcies of banks are borne by the whole of Europe.

Significant progress has been made, but there is still room for improvement in the European banking union

The banking union (currently being formed) has made significant progress in interrupting the negative interaction between authorities and the financial sector and in strengthening the banking supervision. Nevertheless, there is still room for improvement. With regard to the first two pillars,

[72] The subsidiaries of international banks (subsidiaries) are subject to the DGS of the host country, while a branch office is subject to the DGS of the home country (Gerhardt & Lannoo, 2011, page 11).

[73] An example of this was Icesave.

[74] Schoenmaker (2011).

[75] Refer to Schoenmaker (2011) and Freixas (2003) for the models underlying the financial trilemma.

the European supervision and the resolution mechanism, an agreement has been reached between the Trilogue parties (the European Commission, the European Parliament, and the European Council). The debate on the effectiveness of the second pillar is still ongoing (see Recommendation 1: Advocate for the improvement of the European resolution mechanism.). The third pillar, the European DGS, is not yet a part of the banking union. This is partially attributable to the fact that a European DGS requires solidarity between banks and member states in Europe.[76]

As the European banking union is affected by a number of imperfections, including the lack of a European DGS, the risk remains that prudential regulators will continue to apply capital restrictions (see also Box 5).

Box 6: Reports from market participants about restrictions on savings

'For that matter, the Netherlands is not the only one with regulations pertaining to keeping funding in the country. I have heard that Germany is also considering regulations to discourage savings from leaving the country. I believe that we will see few new entrants in the savings market in the short to medium term, certainly due to the new regulations on investing in high-risk assets outside the EU."

- Niche bank that finances trade between the west and emerging markets

"DNB has also indicated that we could use savings solely to fund growth and not to reduce the funding need (of the foreign parent company). I believe that this was motivated by the sole purpose of creating barriers to prevent us from effectively entering the savings market. They did not want Dutch savings to be transferred to [the country of our foreign parent company]."

- Retail bank that is part of a European banking and insurance group

Another market participant alleged that the restriction "(...) [constitutes] a barrier that prevents banks from entering the Dutch [savings] market, in spite of the latter being attractive."

- English investment company

"We can still retrieve money in Germany and invest that money in the Netherlands. However, the regulations on this matter are indeed uncertain and we are trying to match our assets and liabilities as much as possible per country."

- Dutch retail bank

Market participants report that national regulators are imposing restrictions to savings

In the context of this study ACM commissioned interviews with (potential) new entrants, about the most important barriers to entry.[77] Seven of the twenty parties interviewed talked about capital restrictions by the regulators.[78] Six parties indicated that the national regulators impose formal or informal restrictions on the cross-border use of savings.[79] Of those six, five specifically

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[76] If a member state has in general healthier banks than another member state, then this will result in a situation in which healthier banks from a certain member state (and thereby indirectly the citizens of that member state) help pay for the problems of less healthier banks (and thereby pay to the savers of other member states).

[77] See also KPMG (2014).

[78] The group of interviewed parties that discussed capital restrictions consisted of an investment company, two foreign universal banks, a European bank as part of a banking and insurance group, a foreign niche bank, and a Dutch universal bank.

[79] In addition to the KPMG interviews, ACM has also interviewed three savings banks. Two of the three savings banks interviewed indicated that DNB is imposing restrictions on savings.

referred to restrictions imposed by DNB. One Dutch bank indicated that it is still possible to invest savings collected from abroad in the Netherlands.

ACM deems it likely that capital restrictions constitute a barrier to entry to the savings market as well as to the credit markets

According to ACM, the restrictions limit the access of potential new entrants in two ways. First, the restrictions prevent foreign banks from investing Dutch deposits abroad. This restriction lowers the incentive of foreign parties to enter the Dutch savings market, because they can only invest the deposits to a limited extent abroad. Second, foreign banks encounter similar restrictions in their home country. This causes them to have fewer deposits with which they can enter Dutch banking markets for lending, such as SME lending and mortgages.

Therefore, the restrictions serve to shield national markets. This means that the existing domestic market participants are less subject to competitive pressure. In addition, the restrictions diminish the opportunities for investing internationally available funds in the best location.[80]

Conclusion

Since the financial crisis, banks have been withdrawing to their domestic market. This is referred to as fragmentation. One of the reasons for this fragmentation is capital restrictions imposed by national prudential regulators. The regulators are inclined to restrict the activities of foreign banks outside the country of the regulators, in order to limit the damage caused to their own economy by a bankruptcy of the foreign bank. These restrictions on the activities of foreign banks constitute a barrier to entry.

The banking union effects supervision at the European level. This reduces the incentive for shielding one's own market. Significant progress has been made in achieving the banking union. Yet, in its current form, it is still subject to a number of imperfections. On the one hand, the SRM has to be improved and, on the other hand, a European deposit-guarantee scheme has to be created. As long as this is not the case, the national regulators will continue to be inclined to shield their domestic market.

Recommendation: In addition to a more effective SRM, advocate for a European deposit-guarantee scheme.

ACM recommends that the Dutch Cabinet advocates at the European level for the implementation of a European deposit-guarantee scheme, in addition to a more effective SRM. Together with a more effective SRM, the implementation of a European DGS will make capital restrictions redundant, which will remove a barrier to entry into the Dutch banking sector.[81]

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[80] This means an inefficient allocation of capital.

[81] This also applies to the other member states participating in the banking union.

It should be noted that a European banking union can contribute to the reduction of the fragmentation of the European banking sector. However, it is not a solution for capital restrictions in respect of banks outside the banking union. As a worldwide banking union does not appear to be feasible yet, it is important to reflect on alternative ways to reduce capital restrictions at the global level, such as a so-called 'equivalence study'. This study should be focused on the quality of regulators in non-European countries and the deposit-guarantee schemes that apply there. This can increase the level of trust between regulators, which will decrease the inclination to impose capital restrictions.

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Recommendation 3: At the national and European level, strive for simplicity in laws and regulations

"Modern finance is complex, perhaps too complex. Regulation of modern finance is complex, almost certainly too complex."

– A. Haldane & V. Madouros. Bank of England

There are many laws and regulations governing banks. These laws and regulations are complex, change often, and are costly.

There are many laws and regulations for banks. KPMG has recently documented the number of laws and regulations for Dutch banks.[82] It analysed a total of 38 new rules and initiatives for the Dutch banking sector that are or have become legally valid since 2008 (Figure 7). This provides a snapshot of the number of laws and regulations recently added for banks.

Box 7: Rules and initiatives from KPMG (2012)

EU

AIFMD, CRD IV Package, CSDD, CCD, Consumer Finance Protection, Corporate Governance in Financial Institutions and Remuneration Policies, CRA II & III, Crisis Management Framework, DGS, EMD, EMIR, FICOD, ICS, IFRS 9, MAD II, MiFID II, Mortgage Credit Directive, Omnibus I & II, PRIPs, SLD, Short Selling Regulation, UCITS, Transparency Directive

NL

Bankenbelasting (Banking Tax), Code Banken (Banking Code), Ex ante depositogarantie stelsel (Ex ante deposit-guarantee scheme), Geschiktheid (Suitability), Hypotheektarieven Garantie (Mortgage Interest Rate Guarantee), Interventiewet (Intervention Act), Ken uw klant (Know Your Customer, KYC), Prospectusplicht (Obligation to publish a prospectus), Provisieverbod (Ban on commissions), Raamwerk Herstelplan (Recovery Plan Framework), Regeling beheerst beloningsbeleid Wft (Regulation on Sound Remuneration Policies pursuant to the Financial Supervision Act 2011).

The existing laws and regulations are also becoming more extensive. This is clearly exemplified by the number of capital and liquidity requirements.[83] The first Basel Accord, Basel I, consisted of 30 pages. Its revision in 2004, Basel II, had expanded to 347 pages. The last revision in 2010, Basel III, covers 616 pages. As such, it is twice as big as Basel II, and more than twenty times as big as the original accord of 1988.

In addition to the considerable number of laws and regulations for banks, those laws and regulations are complex. The capital and liquidity requirements are also a good example of this complexity. Initially, Basel I had five risk categories for the calculation of the risk-weighted capital of a bank. Under Basel II and III, this increased to more than 200,000 risk categories for a large bank. A comparable evolution is that of the number of calculations to be made by a large bank to determine its risk-weighted capital. This number increased from a few calculations under Basel I to more than 200 million calculations under Basel III.[84]

[82] KPMG (2012).

[83] The evolution of the size of the Basel Accords is documented in Haldane & Madouros (2012).

[84] Haldane (2011).

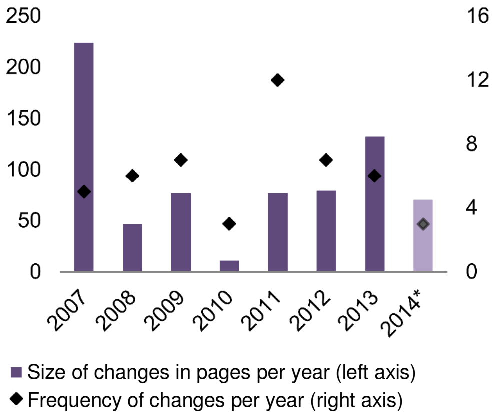

Figure 5: Changes in the Financial Supervision Act 2011 (wetten.overheid.nl, adaptation by ACM).

* For 2014, only the changes up to and including April have been included

The fact that the capital requirements have become complex has been confirmed by the Basel Committee on Banking Supervision. In a discussion paper on Basel III, the Committee writes: "*There is no doubt that, in pursuit of greater risk sensitivity, parts of the Basel capital adequacy framework have become very complex*".[85]

Laws and regulations for banks are not only extensive and complex, but also subject to much change. A good example of this is the Dutch Financial Supervision Act 2011 (*Wet op het financieel toezicht*, Wft). Figure 5 indicates how often and to what extent the Wft has been amended since its introduction in 2006. In total, the act has been amended 49 times since 2006.[86] This is on average more than five times per year. The act has also changed a lot in size: since its implementation in 2006 (296 pages, not depicted in figure), the changes cover on average approximately 90 pages per year.

The size and complexity of laws and regulations bring about costs

The implementation of the Capital Requirements Directive IV (CRD IV) illustrates that compliance costs can be high. The estimated implementation costs for the Dutch banking sector range from 96 to 400 million euros in one-off implementation costs, and from 56 to 200 million euros in structural (annual) costs.[87] The varying amounts of the estimates show that they are steeped in uncertainty. Nevertheless, the estimates show that the compliance costs of CRD IV are high in absolute terms. Note that this solely concerns the additional costs of CRD IV, and not the compliance costs of other, already existing laws and regulations (such as CRD III).[88] It is thereby likely that the implementation costs of CRD IV for new entrants are (considerably) higher than these estimates.

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[85] BIS (2013).

[86] Due to the Act's overarching nature, an amendment to the Wft can represent an amendment to existing laws, a translation of European Directives into Dutch law, or entirely new laws.

[87] EC (2011, page 184), Härle, et al., (2010) and the explanatory memorandum to the legislative proposal of 22 January 2014 for the Act implementing the capital requirements directive and regulation.

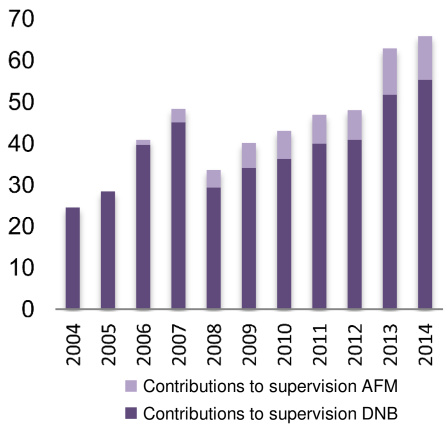
[88] Hence, this concerns the estimated implementation costs for an existing bank that has already implemented all existing laws and regulations, including CRD III, and has already incurred the structural compliance costs in this regard. A number of complex parts of Basel III, such as the use of internal calculation models (internal ratings-based approach or IRB), already existed under Basel II. Because of that, these compliance costs are (partially) not included in the estimates.

In addition to the internal compliance costs, firms in the financial sector contribute funds for the supervision of DNB and the Netherlands Authority for the Financial Markets (*Autoriteit Financiële Markten*, AFM). The contribution of market participants to DNB and AFM supervision has increased from just under 25 million euros to just over 65 million euros in 2014 (see Figure 6).[89]

Experts assert that regulation has become needlessly expensive and complex

Various parties have expressed criticism on the volume and complexity of banking regulations, in particular where it concerns the capital and liquidity requirements of the Basel Accords (see Box 8).

The literature mentions multiple reasons for preferring simpler laws and regulations to complex laws and regulations (other than the cost mentioned earlier). First, complex rules would lead to more opportunities for evading the law and regulations.[90] An unwelcome side effect of this is that, in practice, these are often large and established parties that are best able to make use of these vulnerabilities in the law. This makes complex laws and regulations relatively more costly for (smaller) new entrants.[91] Second, complexity can be at the expense of transparency.[92] This makes it more difficult for



The chart includes the contributions for DNB of banks, electronic money institutions (*elektronischgeldinstelling*, egi), and other credit institutions. In the case of the AFM, it concerns the contributions of providers of banking services, electronic money, payment services, and credit.

Figure 6: Financial contributions of banks to AFM and DNB supervision (millions). Corrected for inflation, in 2014 prices (budgets of DNB an AFM and Public body accountability reports of DNB, adaptation by ACM).

[89] This increase was caused by two reasons. First, the cost of supervision has increased. Second, the government itself is contributing increasingly less to the cost of supervision, causing the sector's contribution to increase.

[90] For innovative products designed to circumvent regulations (e.g. by using derivatives), refer to Blundell-Wignall and Atkinson (2010), IMF (2012) and Masera (2012). For the manipulation of internal risk models, refer to Admati & Hellwig (2013). See also Slovik (2011), who demonstrates that the ratio of risk-weighted assets (RWAs) relative to the total assets of systemic banks has declined over the past decades. See also: Reuters (18 March 2013). *JPMorgan and other banks tinker with risk models*. Available through: http://www.reuters.com/article/2013/03/18/us-banks-capital-idUSBRE92H02I20130318

[91] For the anti-competitive effect of complexity (economies of scale due to complex regulations), refer to Masera (2012), IMF (2012) and Haldane (2013). See also Hoenig (2012), who demonstrates that large banks maintain much less capital relative to their total assets than small banks (at comparable RWAs).

[92] Refer to e.g. Haldane (2011) and Hoenig (2013). Research of the Basel Committee (2013a, 2013b) into internal risk models demonstrates that there are considerable differences between assets with comparable risks in the amount of capital maintained for that purpose.

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market participants (and regulators themselves) to assess the risks at banks and to compare banks with each other. Finally, there are also experts who argue that simple rules are optimal in complex environments. Complex rules would create an illusion of precision, whereas simple rules are more effective in practice.[93]

Box 8: Basel III/CRD IV as an example

There is considerable debate in the literature about the volume, complexity, and effectiveness of the laws and regulations applicable to banks. Most of the attention is devoted to the capital and liquidity requirements of Basel III/CRD IV. In this chapter too, Basel III/CRD IV is often referred to as an example. That is not a coincidence. Besides the fact that these requirements are crucial in the overall range of regulations for banks, Basel III/CRD IV has opted to give a voluminous and complex substance to these requirements. In doing so, Basel III is an excellent example of laws and regulations that might be too voluminous or too complex.

In order to reduce the complexity of Basel III, it is often proposed to use only the leverage ratio instead of the current method, which uses a risk-weighted capital ratio and a leverage ratio.[94] The leverage ratio would be less complex (and therefore more transparent and less easily to manipulate) and just as effective as risk-weighted capital requirements.[95] Yet, the leverage ratio also has disadvantages. For example, it is unsuitable as an instrument for risk management and potentially provides banks with the incentive to take more risks.

The criticism on the complex regulations of Basel III has also been noted by the Bank for International Settlements (BIS), the regulators behind the Basel Accords. They responded to this criticism in a discussion paper.[96] The BIS acknowledges the importance of simplicity in laws and regulations, and therefore proposes to expressly include simplicity as a goal in preparing new laws and regulations in the future. The BIS has also indicated that it wants to perform more research in the long term into simpler methods for determining capital requirements (such as a tangible leverage ratio or a leverage ratio combined with standard risk weights).

ACM agrees that complex and voluminous laws and regulations, through compliance costs and costs of supervision, constitute a barrier to entry.

More regulation or more complex regulation results in higher compliance and supervisory costs. Compliance and supervisory costs can constitute a barrier to entry in three ways.

First, compliance and supervisory costs reduce the profitability of the activities in the banking sector. In doing so, these costs lower the profit expectations of all banks and therefore also of potential new entrants, thereby reducing the incentive of entering the market.

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[93] Refer to e.g. Haldane & Madouros (2012), Hoenig (2012), and Plosser (2013).

[94] Note that, in that case, the leverage ratio should be higher than the 3% now used in Basel III. This is because the leverage ratio can currently be used only as a backstop, to restrict the unbridled use of internal calculation models. In other words, in that case, the leverage ratio would have to be higher than it is now, because it is currently used for another purpose than when that risk-weighted method would be replaced in its entirety.

[95] For example, IMF (2009) demonstrates that the leverage ratio has a more significant predictive value than capital ratios in predicting bank failures during the crisis. This is also demonstrated by research in Haldane & Madouros (2012).

[96] BIS (2013).

Second, compliance costs are largely sunk costs.[97] When a new entrant is unsuccessful in its attempt to enter the market and has to exit, it permanently loses the part of the investments that consist of sunk costs. If a potential new entrant takes this possibility into account, it reduces the incentive for entering the market.

Third, compliance costs are largely fixed costs. As a result, compliance costs are relatively higher for small banks. As it is likely that new entrants are smaller than existing banks, it disadvantages new entrants relative to existing banks. Regulation is creating economies of scale, as it were.[98]

The above-mentioned consequences of compliance and supervisory costs could be the result of European as well as Dutch laws and regulations. Regarding laws and regulations that are only applicable in the Netherlands and that are complex and/or voluminous, an additional consequence is that the Netherlands becomes relatively less attractive to new entrants in comparison with other countries. This is independent of the complexity or volume of regulations in other countries.

ACM understands that compliance and supervisory costs are an inevitable part of supervision. ACM is by definition not opposed to voluminous or complex laws and regulations. It even deems it desirable when it is the most efficient way to manage risks. It is also understandable that banks are being regulated more strictly since the crisis. The crisis exposed inefficiencies in the laws and regulations (e.g. a lack of liquidity requirements) and it is preferable to resolve them.

On the other hand, laws or regulations that are needlessly voluminous or complex result in real social costs. These costs go further than just the direct costs. It can also result in indirect costs, e.g. because it impedes entry and harms competition in doing so.

Conclusion
ACM concludes that there are many laws and regulations for banks, that these are complex, and that they are often amended. According to experts, financial laws and regulations can be simplified without affecting effectiveness. ACM cannot assess the accuracy of these reports. It does conclude that complex and voluminous laws and regulations have a negative impact, in various ways, on the incentive to enter the market, through compliance and supervisory costs.

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[97] The implementation costs consist for large part of e.g. costs to set up ICT systems. See EC (2011), page 184, Härle, et al. (2010) and the explanatory memorandum to the legislative proposal of 22 January 2014 for the act implementing the capital requirements directive and regulation.

[98] This is not just limited to the compliance costs, but can also concern the content-related compliance costs. See also “Recommendation 5: Strive for prudential laws and regulations that are geared to the risks a bank engenders to the financial stability and the real economy”.

Recommendation: At the national and European level, strive for simplicity in laws and regulations.

When existing financial laws and regulations are needlessly voluminous and complex, as alleged by various experts, then their simplification can increase the incentive to enter the banking sector without affecting financial stability. ACM therefore deems it crucial for competition in the banking sector that the volume and complexity of laws and regulations be reduced where possible. On the other hand, ACM acknowledges that it is not the most appropriate party to determine which laws and regulations this specifically affects.

ACM recommends that the Minister of Finance assesses the current Dutch laws and regulations in order to simplify them and to reduce their number. As a significant part of the financial laws and regulations are prepared at the European level, the Minister could raise the issues of simplicity and a reduction of the volume of laws and regulations at that level.

With respect to future new laws and regulations, ACM emphasises the need for sound cost-benefit analyses that also include alternative solutions. In addition to dealing with existing laws and regulations, it is also important to prevent laws and regulations from becoming too voluminous or complex in the future. ACM supports already existing initiatives that assess the necessity of new laws and regulations, such as the impact assessments performed at the European level and the integrated assessment framework for policy and regulations (*Integraal Afwegingskader voor beleid en regelgeving*, IAK) in the Netherlands. However, ACM has only limited information about the current IAK analyses, e.g. about their scope and how extensive they are. IAK analyses are not made public by default.

Potential criticism on this recommendation could be that existing laws and regulations cannot be simplified, e.g. because interests other than the competition carry more weight, and that the current laws and regulations should therefore be accepted as is.

ACM thinks that it is wrong to assume that existing laws and regulations are designed optimally and that there is no room for improvement. Such assumption implies that the potential learning effects concerning financial laws and regulations have already been exhausted. The shortcomings in the laws and regulations exposed during the crisis and the existing academic debate on the current laws and regulations make it unlikely that we have reached the highest point on the learning curve regarding financial regulation.

ACM is aware that the above recommendation has been formulated at a general level and that it is not making any specific suggestions for simplifying laws and regulations. As indicated earlier, ACM is not the most appropriate party to determine which specific laws and regulations can be simplified. Yet, ACM is making this recommendation because, as the competition authority, it wants to emphasise that voluminous and complex regulations impede entry and are harmful to competition, in addition to other potential disadvantages. It therefore believes that the pursuit of simplicity should be an essential component in the design of laws and regulations.

Recommendation 4: Evaluate the system for obtaining a banking licence

"The regulations concerning the formation of a bank are very stringent compared to those abroad."

- Investment company in the United Kingdom (KPMG, 2014)

New entrants must apply for a licence from De Nederlandsche Bank

A bank[99] must apply for a licence from De Nederlandsche Bank (DNB) to become active in the Dutch banking sector.[100,101] Parties with a banking licence in a different EU country can become active in the Netherlands by means of a notification procedure in their country of origin (the so-called 'European passport').[102] The licencing system is a result of the law and regulations and additionally by the substance given to it by DNB.[103] The purpose of a licence is to guarantee that the entering bank has adequate financial resources and is managed in a prudent manner.[104]

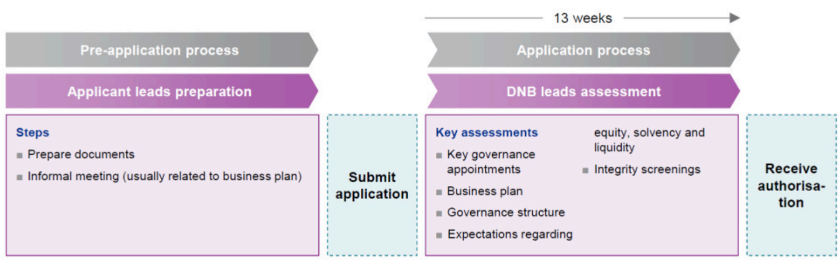

Figure 7: Licencing process at DNB.

The bank compiles all necessary information in the preparation phase of the licencing procedure.[105] For that purpose, it must use the licence application form posted by DNB on its

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[99] "A bank is a party whose business it is to obtain the disposal of repayable funds from others than professional market parties beyond a restricted circle, and to extend loans at its own expense." (http://www.toezicht.dnb.nl/2/50-201916.jsp)

[100] Article 2:11 of the Act on Financial Supervision (Besluit Markttoegang financiële ondernemingen Wft), paragraph 1, and Article 2:20 of the Wft.

[101] There is little public, quantitative information available about the licencing process of the DNB (length of the process, number of rejected licence applications, informal discussions, etc.).

[102] Article 2:14 of the Wft, paragraph 1.

[103] Refer to the Decree on the Market Access of Financial Enterprises pursuant to the Act on Financial Supervision (*Besluit Markttoegang financiële ondernemingen*, Wft), among other sources.

[104] DNB. http://www.dnb.nl/toezichtprofessioneel/de-consument-en-toezicht/banken/

[105] This information is specified in Article 8 of the BMfo.

website.[106] This form specifies the information that must be supplied, which is based on Article 8 of the Decree on the Market Access of Financial Enterprises pursuant to the Act on Financial Supervision (*Besluit Markttoegang financiële ondernemingen Wft*, BMfo). The BMfo is largely based on Section 2 of the Act on Financial Supervision (Wet op het financieel toezicht, Wft). This results in applicants having to provide information about the business plan, the governance structure, and the management of capital and liquidity requirements, among other information.[107] In addition, DNB can only grant a licence when the applicant demonstrates that the (co-) policymakers of the bank are suitable and reliable. The Netherlands Authority for the Financial Markets (*Autoriteit Financiële Markten*, AFM) also plays a role in this regard as a non-licencing regulator, as it has the authority to make binding recommendations in respect of the suitability or reliability of the (co-) policymakers.[108] Moreover, in order to obtain a licence, banks must fulfil all requirements of the ongoing supervision of DNB. New entrants are classified in the second highest risk category, in accordance with the 'FOCUS!' policy vision.[109]

If so desired, an informal meeting can be held with DNB on the initiative of the applicant. As a condition, however, DNB requires that there is an elaborated business plan and that the party has specific questions. If the party wants to proceed with a licence application, then it must submit all information required. Next, DNB must assess the application within 13 weeks.[110] If DNB deems it necessary, it can request additional information and, in doing so, 'stop the clock' until the response has been received. This can cause the actual process to last longer than 13 weeks. If DNB rejects the licence application, then the applicant can appeal against this decision in court. According to DNB, a licence application has never been rejected to date. Rather, the applications are withdrawn by the market participants.[111] The licence being rejected constitutes a supervisory antecedent for the applicant[112]. This is not the case if the application is voluntarily withdrawn.

As from November 2014, the European Central Bank (ECB) will become the party ultimately responsible for licencing.[113] DNB does retain an important role.[114] Namely, a licence application

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[106] DNB. http://www.toezicht.dnb.nl/binaries/50-214063.pdf.

[107] DNB. http://www.toezicht.dnb.nl/2/50-201882.jsp

[108] Article 1:49 of the Wft.

[109] DNB uses four risk categories (low, neutral, high, and urgent) to determine the intensity and strictness of the supervision. According to DNB, new entrants belong in the risk category 'high' in function of the complexity (DNB, 2012b, page 20).

[110] Article 1:102 of the Wft.

[111] Discussion between ACM and DNB.

[112] Article 2 Policy Rule on Integrity Screening (Appendix C).

[113] Article 4 (1) (a) of the SSM Regulation.

[114] The law and regulation provides member states with latitude in imposing additional rules pertaining to the licencing.

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will first be screened by DNB.[115] Once DNB approves, it will propose to the ECB that the licence be granted.[116] If DNB rejects the licence application, it will not be submitted to the ECB.

The current licencing system is perceived as a barrier to entry

In the context of this study, (potential) new entrants were interviewed, on behalf of ACM, about the most important barriers to entry.[117] Seventeen of the twenty parties interviewed discussed the licencing system.[118] These interviews reveal that several market participants consider the current licencing system to be a barrier to entry. Market participants identified three specific issues in this respect: the length of the licencing process, the uncertainty regarding the licencing process, and the unforthcoming attitude of DNB.

Of these seventeen parties, seven discussed the length of the licencing process. They asserted that the licencing process takes at least 6 to 18 months. This vastly exceeds the term of 13 weeks. However, the duration is in only one case explicitly referred to as a barrier to entry.

Seven parties mentioned the uncertainty of the licencing process. Four parties alleged that it is difficult to understand what DNB's assessment criteria are and which information must therefore be supplied. The fact that there is a lack of clarity has been confirmed in a meeting with DNB. The latter argues that a licence application is almost never complete the first time around. According to the market participants, this uncertainty about the assessment criteria impacts the length of the process as well as the uncertainty about the outcome of the process. Hence, it is difficult for market participants to assess in advance what their chances are of obtaining the licence. To the above, two parties explicitly added that this uncertainty increases consultancy costs. In this context, three parties referred to the implications for ICT investments. They indicated that all investments must already have been made prior to gaining insight in a potential licencing. If this is correct, it becomes uncertain whether they can recuperate the investments made. Hence, this constitutes a considerable risk for them. Two of the seven parties indicated that DNB's requirements are easy to understand.

Finally, twelve of the seventeen parties mentioned the unforthcoming attitude of DNB as a barrier to entry.[119] One market participant asserted that DNB "*(...) used to do its best to let new banks enter and to retain them. Nowadays, they prefer as few banks as possible.*" In that

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[115] Regulation 1024/2013, Article 14.

[116] The ECB can then still decide to reject the licence application.

[117] KPMG (2014).

[118] The group of parties interviewed that touched on the supervision by DNB consisted of large and small parties, domestic and foreign parties (EU and non-EU), various kinds of banks (universal, retail, niche, investment, and banking and insurance), and various kinds of service providers.

[119] In this context, a unforthcoming attitude is understood to mean a needlessly strict assessment of the licence application and the regulator not being very cooperative.

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regard, various parties referred to foreign regulators that allegedly impose less stringent requirements. Three of the twelve parties specifically indicated that DNB is unforthcoming towards new entrants with a European passport.[120] Of the remaining five parties, two were positive and three were neutral towards DNB's attitude. Many of the market participants linked the unforthcoming attitude of DNB to the bankruptcies of Icesave and DSB Bank. According to market participants, DNB is focused more on preventing future bankruptcies than on the positive impact of new entries, in part due to statements made by politicians.

In a meeting with ACM, DNB has confirmed that it is not directly clear what the applicant must submit in the case of a licence application. According to DNB, this is mainly attributable to the ambiguous structure of the law and regulations (Wft). In addition, DNB indicates that parties in a licence application are given the opportunity to submit a concept application, which will then result in further discussion. As a result, an application is never finalised the first time around, as it is an iterative process that is completed together. This should in fact facilitate the entry. According to DNB, further guidance on the basis of existing regulations, supervisory frameworks, and international guidelines is provided in this process.

ACM observes differences between the licencing processes of the United Kingdom and the Netherlands

Hence, a number of the (potential) new entrants into the Dutch banking sector perceive challenges in obtaining a banking licence in the Netherlands. In addition, there are market participants that allege that it is difficult to enter the market in the Netherlands with a European passport. It is not easy to make a judgment on the market participants' perceptions of DNB. Questions such as "when is a regulator too strict?", "when does a licencing process take too long?, and "when is there too much uncertainty regarding a licencing process?" are difficult to answer. These questions require detailed knowledge of the individual cases and clearly defined benchmarks with which to compare DNB's licencing process. What can be determined is that an important part of the interview partners perceive difficulties with respect of the licencing system in the Netherlands.

ACM agrees that it is unfavourable for new entrants when a prudential authority is 'needlessly strict' or is perceived to be so. In that case, new entrants anticipate a larger risk of rejection, which results in fewer new entrants (applications). Uncertainty about the licencing process and the precise way in which the prudential authority[121] shapes this process can result in longer processes[122] and higher (consultancy) costs for new entrants. This leads to higher sunk costs and, in doing so, a reduced incentive to enter the Dutch banking sector. If the licencing process takes too long, it is at the expense of future profitability. This also reduces the incentive for

[120] This concerned a Dutch retail bank, a European retail bank, and a Dutch service provider.

[121] For example, about which information must be supplied and how this is assessed in the end.

[122] As DNB requests additional information in the course of the 13-week term and thus stops the clock.

entry. In addition, a long process results in the postponement of the increase in prosperity gained by entering the market (as the market is entered later), which is also harmful.

There were also reports in the United Kingdom that the licencing system is possibly a barrier to entry. Therefore, it was decided to evaluate the licencing system for the purpose of finding the proper balance between competition and financial stability in the licencing system.[123] The reason for the evaluation were the reports of the Independent Commission on Banking[124] and the Office of Fair Trading[125], which determined that (i) the licencing process potentially took too long and was steeped in uncertainty, and that (ii) the capital and liquidity requirements were potentially too stringent for new entrants. As it was not inescapably clear that the licencing system was a barrier, an evaluation was performed. This evaluation resulted in modifications to the system. Many of the parties interviewed also referred to this new system. For these reasons, ACM has performed an initial comparison between the licencing systems in the Netherlands and the United Kingdom. This comparison revealed the following differences.

First, the licencing process in the United Kingdom cannot exceed 12 months.[126] With its term of 13 weeks, the process in the Netherlands seems relatively swift. However, since DNB can stop the clock, the process can take longer, even longer than 12 months. In addition, the system in the Netherlands creates more uncertainty about the actual length of the process.

Second, there is also a difference between the Netherlands and the United Kingdom in the clarity offered about the information to be provided in the licence application. In the United Kingdom, there is much ex ante guidance about which documents must be supplied and which details these documents must contain. In the Netherlands, on the contrary, authorities mainly refer to articles of the law with general descriptions. An example is the requirements imposed on an ICT system. In the United Kingdom, there is an extensive checklist that the ICT system must fulfil.[127] In the Netherlands, an ICT system is not even explicitly referred to in the application form (and the underlying law and regulations), even though this likely is an assessment criterion. The situation in the United Kingdom creates more certainty for a party that the licence application is complete and that the licence can be granted (or rejected) sooner.

Third, two licence applications are specified explicitly in the United Kingdom: type A and B. Type A leads directly to a full banking licence. Type B leads to a provisional licence, following which the bank has 12 months to fulfil all requirements. The latter offers the opportunity for

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[123] Bank of England & Financial Services Authority (2013).

[124] Independent Commission on Banking (2011).

[125] OFT (2010).

[126] This is in the event that the application is incomplete. In the case of a complete application, the maximum term is six months.

[127] http://www.fca.org.uk/static/fca/documents/forms/detailed-it-controls-form.xlsm.

postponing necessary (ICT) investments until a provisional licence has been obtained. In the Netherlands, these two processes are not explicitly defined. A licence application normally results in a full licence and all investments must already have been made prior to the licence application. Since the outcome of the licence application is unclear, there is uncertainty as to whether these investments can be recovered. It should be noted in this regard that DNB does have the option of granting a licence under conditions. For example, DNB can grant a provisional licence at the moment that the approved plans for the ICT system have not yet been implemented and tested.[128] It is unclear to what extent the applicant can work towards this and whether this also applies to other subjects.

Conclusion
In order to enter the Dutch banking sector, a bank requires a licence or a bank from an EU country can enter the sector with a European passport. New entrants report that it is difficult to obtain a banking licence or to enter the Dutch sector by means of a European passport. Market participants identify three specific issues in the licencing process: the length of the licencing process, the uncertainty regarding the licence requirements and therefore the outcome of the licencing process, and the unforthcoming attitude of DNB. ACM cannot assess the accuracy of these reports. Nevertheless, it can be concluded that potential entrants experience this as a significant barrier. In the United Kingdom, the licence system has been evaluated pursuant to similar complaints. This evaluation has resulted in improvements.

Recommendation: Evaluate the system for obtaining a banking licence
It is important to give serious consideration to the reports from new entrants about the licencing system. Therefore, ACM recommends that the licencing system (laws and regulations as well as their implementation by DNB) will be evaluated. This evaluation can be initiated by the Ministry of Finance. Its purpose must be to simplify the licencing system without affecting the financial stability. In doing so, special attention must be devoted to the ex ante guidance, the (maximum) length of the process, and the possibility of different licencing processes.

The evaluation must in any case ensure that the perception of market participants converges with reality, even when modifications do not appear to be necessary. By itself, this will already lead to an increased incentive to enter into the Dutch banking sector.

A possible modification of the formal rules in a licence application only has added value if DNB is not publicly castigated by society every time a bank goes into bankruptcy. In that case, DNB will adopt a fundamental risk-adverse attitude when granting licences. Hence, this includes a role for society. A bankruptcy is an integral part of competition and does not necessarily have to result in significant damage to the real economy and financial stability.

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[128] Regarding the requirement of making of investments in advance, there seems to be a difference in perception between a number of market participants and the position of DNB.

Recommendation 5: Strive for prudential laws and regulations that are geared to the risks a bank engenders to the financial stability and the real economy

"Each time, DNB selects the best pupil in the classroom and actually expects everyone else to fulfil the same standards"

- *Foreign bank active in the Dutch savings market (KPMG,2014)*

Prudential laws and regulations and the supervision thereof are differentiated little in function of risk

Credit institutions[129] must fulfil an extensive package of prudential laws and regulations. An important part thereof has been laid down in national laws and regulations.[130] These laws and regulations will be amended in the near future, when the European Capital Requirements Directive (CRD IV) is implemented in national law and regulations.[131] These laws and regulations are implemented nearly unchanged, as the Netherlands can only deviate from the European rules to a limited extent.

According to the law and regulations, banks must fulfil specific capital and liquidity requirements and hold a minimum amount of equity.[132] In addition, banks must comply with governance rules. These rules include requirements about the suitability and trustworthiness of managing directors, the composition of management and the supervisory board, operations, the control structure, the bonus policy, and the integrity policy.[133]

The purpose of the law and regulations is to prevent instability of the financial system, to protect the consumer, and to prevent significant harm to the real economy in the case of a bankruptcy of a bank.[134] The extent to which this harm materialises, depends on the size of a bank, among other things. The bankruptcy of a (systemic) bank that is considerably intertwined with other financial institutions and that serves a large segment of the Dutch banking sector, will cause more harm to the real economy and the financial system than that of a new entrant of which the

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[129] Banks and electronic money institutions (EMI) are jointly referred to as credit institutions. The definition of a bank is: 'a party whose business it is to obtain the disposal of repayable funds from others than professional market parties beyond a restricted circle and to extend loans at its own expense' (Article 1:1 of the Wft).

[130] The Financial Supervision Act (*Wet op het financieel toezicht*, Wft).

[131] The Financial Supervision Act and the legislative proposal for the act implementing the capital requirements directive and regulation, Dutch Lower House, 2013-2014 session, 33 849, no. 2, 7, and 10.

[132] Article 2:12 (1) (i) - (k) of the Wft and Article 92 et seq. of the CRR. The Capital Requirements Regulation (CRR) is a part of the CRD IV package and applies directly, without requiring implementation in Dutch law. Refer to Regulation (EU) No. 575/2013 of 26 June 2013 and Regulation (EU) No. 648/2012.

[133] Article 2:12 (1) (a) - (h) of the Wft and Article 88 et seq. of CRD IV.

[134] Carletti (2008), Van Hoose (2010), and Vives (2010).

scale is still limited.[135] However, the formal law and regulations make little distinction between parties of which the bankruptcy will have a considerable impact and those of which the impact will be limited.

The systemic buffer is an important exception to the limited differentiation.[136] This additional capital requirement only applies to systemic banks of which the bankruptcy would have significant consequences for the stability of the financial system and the real economy. In addition, systemic banks are also subjected more to stress tests and recovery and resolution plans. Moreover, certain elements of the capital regulation cause a differentiation between large and small banks. An example is the Internal Ratings Based (IRB) approach, which has as a consequence that larger banks have to hold less equity in comparison to the standardised method (see box), through a more precise risk assessment.[137] Due to the high costs of its implementation, this method is less available to small banks.[138]

Box 9: Internal Ratings-Based approach

Larger established banks can use the Internal Ratings-Based (IRB) approach to calculate the minimum capital requirements. If the use of the IRB approach leads to lower risk weights, this would result in the banks requiring less equity to finance their activities. This does not necessarily have to apply to all activities of a bank. However, a bank will only opt for the IRB approach if this yields a cost advantage on average. For a bank, equity is relatively expensive compared to debt.

Due to the complexity of the IRB approach, its use and thereby its benefits are in practice reserved solely for the larger banks, according to Hakenes & Schnabel (2011). To limit abuses of the IRB approach, the models used by a bank must fulfil a very extensive package of conditions, as defined in numerous articles in the Capital Requirements Regulation (hereinafter: CRR). One of the requirements is that the bank must have three years of experience in using IRB models (Article 145 of the CRR). Finally, the bank must have the models verified by the prudential regulator (DNB) to prevent improper use (Article 138 of the CRR). Hence, the cost advantage is mostly available to the larger banks.

Discretion in implementation of laws and regulations

The extent to which the Netherlands can deviate from the European rules in the implementation

[135] See Sachs (2010) for an analysis of the relationship between size, concentration, and interdependence of the bank.

[136] The systemic buffer is an increased capital requirement for banks of which the bankruptcy would have significant negative consequences for the financial system and the real economy. See: http://www.dnb.nl/nieuws/nieuwsoverzicht-en-archief/dnbulletin-2014/dnb306988.jsp.

[137] If the IRB approach results in more capital being required than in the case of the standardised approach, then it is not evident that a bank would opt for the IRB approach.

[138] Only standard risk weights were used in Basel I. Compared to that situation, the introduction of the IRB approach in Basel II has been detrimental to small banks. Another plausible scenario is the one in which the introduction of Basel II would have forced all banks to use the IRB approach. Compared to that scenario, the current form in which banks can opt for the standardised approach is less detrimental to small banks.

of CRD IV differs for each article, but is in general limited.[139] Some rules, such as the leverage ratio, have not yet been finalised in CRD IV.[140] As a result, the Netherlands can apply its own policy for the requirements that have not been laid down. For other requirements, options for deviating from the basic rule have explicitly been included in CRD IV. For example, a member state is allowed to enforce a more stringent bonus policy than prescribed by default in CRD IV.[141]

Discretion in supervision of laws and regulations

While there is limited differentiation in function of the systemic importance of a bank in the formal laws and regulations and in the implementation of European laws and regulations in the Dutch laws and regulations, there seems to be more room for differentiation in the supervision by De Nederlandsche Bank (DNB). Namely, DNB has some discretion in its exercise of supervision of the laws and regulations. For example, the manner in which the suitability of management is assessed leaves room for interpretation. In this assessment, DNB evaluates the form of management, the organisation, the strategy, communication, the manner in which decisions are made, the operations, compliance, etc., among other aspects.[142] DNB also has latitude e.g. in determining the speed with which banks must fulfil the new capital requirements, some of which will take effect only from 2016.[143] Moreover, in 2012, DNB announced its new supervisory style, 'FOCUS!', which is more risk-based. In 'FOCUS!', DNB classifies banks into risk classes that determine the intensity of the supervision.[144] Within their risk class, new entrants are thereby classified in the 'high' supervisory regime.

New entrants allege that the prudential law and regulations and the supervision thereof are too strict for small banks

In the context of this study, ACM commissioned interviews with (potential) new entrants, about the most important barriers to entry.[145] Thirteen of the twenty interviewed parties mentioned the

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[139] Explanatory notes to the amendment pertaining to the Act on Financial Supervision (...), Dutch Lower House, 2013-2014 session, 33 849, no. 3, Section V (2:12 Wft).

[140] Het Financieele Dagblad. (26 April 2014). No ECB veto on more stringent requirements Dutch banks. (*Geen veto ECB voor hogere eisen Nederlandse banken.*) Available through: http://fd.nl/economie-politiek/103374-1404/geen-veto-ecb-voor-hogere-eisen-aan-nederlandse-banken.

[141] Article 94 (9) (i) of CRD IV.

[142] Netherlands Law Gazette (*Staatscourant*). 2012 policy rule on suitability. Staatscourant 13546, 3 July 2012. This test has not yet been defined at the European level.

[143] ACM (2013c).

[144] DNB uses four supervisory regimes in its 'FOCUS!' supervisory approach: low, neutral, high, and urgent (DNB 2012b, page 20).

[145] KPMG (2014).

cumbersomeness of the law and regulations and/or the supervision thereof.[146] Ten of these thirteen parties expressed criticism on the cumbersomeness of the law and regulations and/or the supervision thereof. One of the new entrants indicated e.g. that DNB's interpretation of directives makes their business model unprofitable. As a result, they decided to stop the licencing process (see also "Recommendation 4: Evaluate the system for obtaining a banking licence"). Seven of the final ten parties specifically discussed the cumbersomeness of the capital and liquidity requirements and/or the supervision thereof.[147]

While the formal law and regulations make a limited distinction in function of the harm caused by a bank going into bankruptcy, new entrants confirm the impression that there seems to be more latitude in the supervision thereof. As such, four of the parties interviewed indicated that they have the impression that the supervision of small banks is in fact stricter than that of systemic banks.[148]

DNB has indicated that it does not acknowledge market participants' observations of banks without systemic importance being supervised more strictly or of there being no differentiation in supervision. DNB asserts that the explicit guiding principle in its new (2012) supervisory framework, FOCUS! is that institutions are classified in risk classes that determine the intensity of the supervision. In addition, according to DNB, systemic banks are regulated more strictly by means of systemic buffers, stress tests, recovery and development plans, and by the creation of the Single Supervisory Mechanism (SSM).

Cumbersome prudential laws and regulations can constitute a barrier to entry
The banks' costs[149] accompanying the formal laws and regulations and the supervision thereof are related to their cumbersomeness.

The formal law and regulations differentiate little in function of the harm that a potential bankruptcy of a bank would inflict on the real economy and financial stability. The limited differentiation results in an unequal level playing field. In this manner, new entrants that are of no systemic importance experience too heavy a burden, which reduces the incentive for entry. The costs resulting from the law and regulations namely have a negative impact on the expected profitability of a new entrant.

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146 The group of parties interviewed that did touch on the cumbersomeness of the law and regulations and/or the supervision thereof consisted of large and small parties, domestic and foreign parties (EU and non-EU), various kinds of banks (universal, retail, niche, investment, and banking and insurance), and various kinds of service providers.

147 For example, an Eastern European bank stated: "*From a risk perspective, we believe that the requirements for capital are excessive. As a result, we are hindered in the implementation of our business model.*"

148 This concerned three foreign parties (EU and non-EU), including a retail bank and a bank that is a part of a banking-insurance group), and one Dutch party (a bank that is a part of a banking and insurance group).

149 EC (2011), page 184.

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There is however some degree of differentiation pertaining to the intensity of the supervision. For example, DNB uses a method in which the intensity of the supervision (not the formal law and regulations) depends on the extent to which a bank constitutes a risk to the 'supervisory objectives'.[150] This is a positive development. However, multiple new entrants have indicated that they in fact believe that they are treated more strictly than systemic banks. An explanation for this could be that new entrants are classified in the 'high' supervisory regime during the initial one to two years, while existing banks with a comparable risk profile would be classified in the 'neutral' supervisory regime.[151]

Conclusion

The current prudential law and regulations and the supervision thereof make a limited distinction in function of the risk that the bank constitutes for the financial system and the real economy. It is plausible that these risks are smaller in the case of banks that are not of systemic importance, as many small banks are, than in the case of large systemic banks.[152] This causes the prudential laws and regulations (including the supervision thereof) to be disproportionately burdensome for smaller banks, which results in a cost disadvantage for them. To the extent that new entrants are not of systemic importance, this reduces the incentive to enter the banking sector.

Recommendation: Strive for prudential laws and regulations and the supervision thereof that are geared to the risks a bank engenders for the financial stability and the real economy.

ACM recommends that the Minister of Finance strives for prudential laws and regulations, as well as the supervision thereof, that are geared to the risks a bank engenders to the financial stability and the real economy. Existing initiatives of DNB for a more risk-based supervision are a step in the right direction. In the short term, the Minister of Finance must investigate which discretion in interpretation the DNB can be exploited more and which latitude the Netherlands has in the implementation of the European laws and regulations. In the longer term, the Minister should investigate how to structure the European (and via Basel III, the international) laws and regulations in such a manner that banks that are of no systemic importance are not needlessly burdened. The Minister of Finance can take the

Box 10: Evaluation of the law and regulations and the supervision in the United Kingdom

The supervisory requirements for new entrants in the United Kingdom have recently been subjected to an evaluation (Financial Services Authority, 2013). This evaluation revealed a number of specific aspects that can be improved. One of these aspects is to use a gradual introduction model for new entrants regarding the minimum capital requirements. It also turned out to be possible to facilitate new entrants in their implementation of the IRB approach, so as to limit as much as possible the benefit incumbents enjoy in using the IRB approach.

[150] DNB (2012b), page 14.

[151] DNB (2012b), page 20.

[152] Naturally, there has to be a minimum level of prudential regulation, to prevent abuses of the DGS, for instance.

lead in this at the European level.

The above recommendation has been formulated generally. An analysis of the specific elements of the law and regulations that can be changed, can best be performed by an authority with expert knowledge of (prudential) regulation. With this recommendation, ACM wants to emphasise that the effort to achieve differentiated regulation must always remain at the top of the agenda, despite the fact that significant changes can only be achieved in the longer term. However, this does not mean that a number of improvements cannot already be made in the short term. Examples thereof are a lowering of the capital requirements for credit unions (see "Recommendation 6: Develop a less stringent supervisory regime for credit unions.") and a less stricter implementation by DNB of the supervision of new entrants that are not of systemic importance.

A potential criticism on this recommendation can be that the bankruptcy of a small bank can also disproportionately affect the confidence in the financial sector which could require small banks to also be stringently regulated. Such view seems to assume that all banks are of systemic importance. Even if this is the case, it is better to resolve the potential impact of a bankruptcy of a bank on the confidence in the financial system, than to regulate small banks more strictly. This can be achieved by ensuring that banks can go bankrupt in a controlled fashion without harming the real economy and the financial stability, while explaining this to the consumers. In addition, the deposit-guarantee scheme ensures that the impact on consumers of a potential voluntary liquidation of a bank remains limited. This approach guarantees competition as well as financial stability, while ensuring that a possible bankruptcy does not affect the trust in the financial system.

4 SME lending

Banks provide an assortment of services to SME companies, including current accounts, savings accounts, financing, export support, and payment services. This chapter focuses on a few aspects of the competition, including barriers to entry into the market for SME lending by banks.

Size of the market

There are indications that, since the beginning of the crisis, SME companies have been encountering difficulties in obtaining financing. With 45%, the percentage of Dutch SME companies experiencing financial obstacles[153] in obtaining bank financing is quite substantial.[154] Only Greece (64%), Ireland (59%), and Spain (51%) exceed this percentage. Combined with a decline in the demand for SME lending[155], this has resulted in a decline of about 12% in lending to small businesses (see Figure 9). An important explanation for the reduced supply of SME lending is the increased credit risk.[156] Another potential explanation of the decline in the supply is that there are capacity restrictions in lending. It is likely that these restrictions cause a change in the nature of the competition, comparable to the situation in the mortgage market.[157]

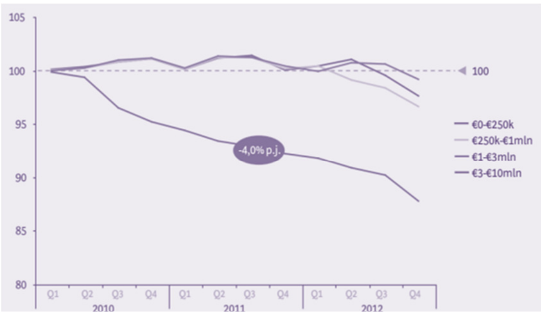

Figure 9: Evolution of outstanding loans to businesses; 2010-2012 (Commissie Hoek, 2013)

Concentration

80% of SME lending is provided by a bank.[158] Figure 8 shows that 92% of the business financing provided by banks is supplied by three banks. The market share in business financing of the other banks is limited.

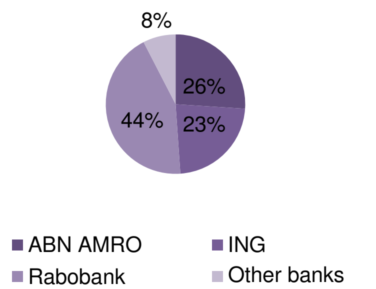

Figure 8: Market shares in SME lending (GfK, 2014c)

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[153] The ECB defines a financing obstacle as 'the sum of the percentage of SMEs reporting loan applications that were rejected, loan applications for which only a limited amount was granted, loan applications that were dropped by the SME because the borrowing cost was too high, and the percentage of SMEs that did not apply for a loan for fear of rejection.'

[154] ECB (2013).

[155] DNB. http://www.dnb.nl/nieuws/nieuwsoverzicht-en-archief/statistisch-nieuws-2014/dnb307673.jsp.

[156] ECB (2014).

[157] ACM (2013a).

[158] Commissie Hoek (2013).

Price developments

The ECB has analysed changes in the interest rates for SME lending.[159] As shown by Figure 10, according to their own sources, SMEs in the Netherlands have mainly been confronted by increases in interest rates. Only in the last period were there as many interest rate increases as decreases. Looking at the actual rates reveals a different picture. This shows that the interest rates for SME lending up to 1 million euros experienced a significant decline since September 2008. From December 2008, the interest rates appear to be relatively stable. However, the difference with interest rates for financing exceeding 1 million euros has increased considerably in this period.[160]

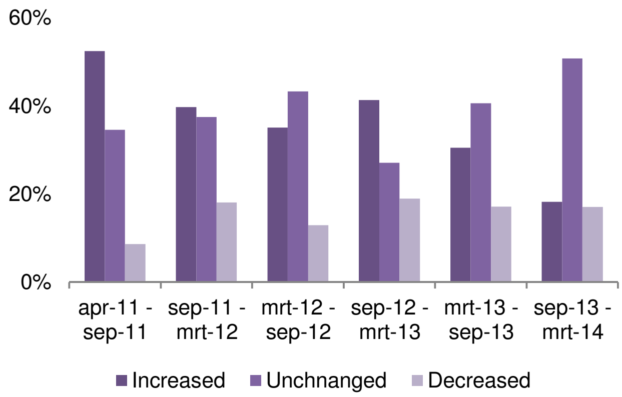

Figure 10: Changes in interest rates for SME lending (ECB, Survey on the access to finance of SMEs in the euro area)

Switching behaviour

There are no specific (annual) switching figures for SME lending. However, the switching behaviour for SME lending can be assessed on the basis of switching behaviour in current accounts. Figure 11 shows that more than 70% of all SME companies have never switched their current account. In addition, the fact that SME companies opt for financing from the bank where they have their current account[161] in two out of three cases and that three quarters of the SMEs ask only for one offer, indicates that there is little searching and switching behaviour in the market for SME lending.

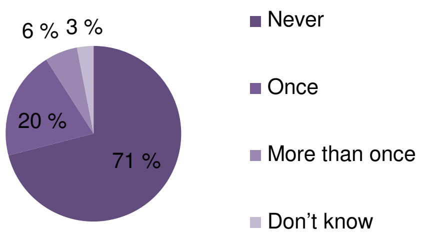

Figure 11: Switching behaviour in SME current accounts (GfK, 2014c)

Entry and barriers to entry

New entries into the market for SME lending are few and far between. Except for the new forms of financing, which still experience only limited growth, there has not been any new entry into this market. On the other hand, e.g. Deutsche Bank did exit the market for SME lending. However, there do seem to be new entrants in the form of financing alternatives such as crowdfunding, credit unions, and business angels. The absolute growth of these alternatives in the market for

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[159] ECB, Survey on the access to finance of SMEs in the euro area.

[160] ECB Statistics. MFI Interest Rate Statistics.

[161] GfK (2014c), page 25.

SME lending is nevertheless still very limited.[162] According to ACM's interviews with market participants, with respect to credit unions, this is in any case due to prudential regulation that is too much of an impediment. In addition, the Dutch Investment Institution (*Nederlandse Investeringsinstelling*, NII) has recently been formed. The plan is for the NII to create a special fund that will provide subordinated loans to SMEs.[163]

The first potential barrier to entry is the access to customer information. In order to provide financing, it is necessary to be able to make a proper risk assessment of the customer. Otherwise, it is possible that financing provided is too inexpensive or too expensive. Due to its history and the relationship with the customer, the principal bank has insight into e.g. the payment history, historical flows of funds, and the amount of outstanding credit. As a consequence of the relationship, this information is primarily only available to the principal bank. Other banks, and therefore also new entrants, would not be able to compete properly with the principal bank due to the absence of this information. As a result, banks have a certain degree of market power (or informational rents).

Various studies point to the negative impact the limited availability of payment information exerts on market access.[164] ACM has therefore also investigated this barrier, but it deems it unlikely that this is a significant barrier to entry in the Netherlands. Market participants are not labelling the lack of this information as an important barrier[165] and they are also indicating that there is much information available in the Netherlands about SME companies. There are private companies such as Dun & Bradstreet and Graydon that provide a large amount of the information relevant to new entrants (for a surcharge). Hence, ACM will not formulate a recommendation in this regard.

The second potential barrier is the need for a branch network. The OFT[166] and various market participants interviewed in the context of this study[167] indicated that a branch network offers added value, for the SME companies as well as for the bank. The necessity to create a branch network demands significant investments. These costs constitute a barrier to the extent that the creation of a branch network is required. Such investments are inextricably linked to entry into the market. Pursuant to this report, ACM will not formulate a recommendation in this regard.

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[162] This is probably attributable in part to the increased credit risks and the decreased demand for SME lending.

[163] Het Financieele Dagblad. (22 May 2014). Investors investing in SMEs (*Beleggers stappen in MKB*). Available through: http://fd.nl/Print/krant/Pagina/Voorpagina/769628-1405/beleggers-stappen-in-mkb_bron_fd_krant

[164] According to Degryse and Ongena (2013), the competition in the market for SME services can be increased by making such information more widely accessible.

[165] KPMG (2014).

[166] OFT (2010).

[167] KPMG (2014).

Finally, the interviews administered in the context of this study revealed that the current pricing structure in the Netherlands is perceived as a barrier to entry.[168] Parties interviewed alleged that the current (low) interest rates make it impossible to achieve an adequate return in comparison to the risks. According to the parties interviewed, this is caused by the current banks using cross-selling and compensating for the (excessively low) returns by selling other products. On the other hand, the parties interviewed noted that the interest rates have since become more commensurate with the underlying risks.

Conclusion

A number of negative signals concerning the competition in the market for SME lending emerge from the available information. The market is concentrated, switching behaviour seems restricted, interest rates appear to have risen, and the access to bank financing seems to have decreased in the past years. Moreover, there seem to be capacity restrictions in the market for SME lending.

Reader's guide: recommendations for lowering barriers to entry into the market for SME lending

There are various barriers to entry into the market for SME lending. However, the creation of a branch network, the current pricing structure, and the access to customer information do not seem to be significant and/or concretely resolvable barriers to entry. Yet, ACM hereinafter recommends that the entry of financing alternatives, specifically credit unions, should be facilitated.

[168] KPMG (2014).

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Recommendation 6: Develop a less stringent supervisory regime for credit unions.

"Alternative forms of lending to small and medium-sized businesses are curtailed by the rigid system of banking licences."

- A group of former bankers in the FD of 8 August 2012

In the Netherlands, credit unions must potentially comply with CRD IV

Credit unions are "specialised non-profit deposit banks in which members of the credit union deposit savings in return for interest. The funds are lent to members".[169] Credit unions can meet the financing need of SMEs.

Abroad, credit unions are a familiar phenomenon, for lending to SMEs as well as to consumers. At the end of 2012, there were more than 55,000 credit unions worldwide, spread over 101 countries. The total assets of these credit unions combined amounted to almost 1,700 billion US dollars.[170] The market shares of credit unions in SME loans differ from country to country: In Canada, 15% of the SME lending is supplied by credit unions[171]. In the United States, this is 6%.[172] At this time, credit unions are not yet active in the Netherlands. However, according to the Association of Credit Unions in the Netherlands[173] (hereinafter: Kredietunie Nederland), there are approximately 90 initiatives to form credit unions. These initiatives are focused on lending to SMEs.

In a number of countries such as England and Ireland, a specific (less stringent) prudential regulatory framework has been developed for credit unions. In the Netherlands, there is no distinct regulatory framework for credit unions. Credit unions are being qualified as banks as referred to in Article 1:1 of the Wft.[174] The extensive capital regulations as laid down in the Capital Requirements Directive IV (CRD IV) will therefore also be applicable to credit unions in

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[169] This does not mean that credit unions in the Netherlands are not able or allowed to make a profit, because profits can e.g. serve to strengthen the capital buffers.

[170] World Council of Credit Unions (2013).

[171] Credit Union Central of Canada (2013).

[172] Wilcox (2011).

[173] "The association of credit unions in the Netherlands is an association that facilitates and supports the introduction of a system of credit unions in the Netherlands." (*"De Vereniging van Kredietunies in Nederland is een vereniging die de invoering van een stelsel van kredietunies in Nederland faciliteert en begeleidt*".) Source: http://www.kredietunienederland.nl/.

[174] Banks and electronic money institutions (EMI) are jointly referred to as credit institutions. The definition of a bank is: 'a party whose business it is to obtain the disposal of repayable funds from others than professional market parties beyond a restricted circle, and to extend loans at its own expense.' The definition of an EMI is: 'a party whose business it is to issue electronic money.'

the Netherlands. This means that credit unions must maintain a minimum equity of 5 million euros, among other requirements. They must also fulfil the solvency and liquidity requirements and the requirements regarding management, as elaborated in the capital requirements directive and regulation (CRD IV).

Current law and regulations for credit unions are experienced as a barrier to entry
Kredietunie Nederland alleges that credit unions barely make it out of the starting blocks in the Netherlands due to the lack of (clarity about future) suitable regulation of credit unions. According to Kredietunie Nederland, the requirements of CRD IV are not in proportion to the size and risks of credit unions. As a result, the business case of credit unions in the Netherlands would be negative.

There has also been reflection on whether credit unions could be shaped such that they would not be required to request a banking licence and therefore would not have to comply with CRD IV. DNB and AFM have indicated in a position paper that credit unions do not have to apply for a banking licence if they finance themselves with non-repayable funds.[175] However, the Minister of Finance has indicated this approach is not optimal in the long term.[176]

Finally, the Christian Democratic Party (CDA) believes that the bank regulation for credit unions is too cumbersome and it deems the introduction of credit unions necessary to make SMEs less dependent on banks.[177] Therefore, a legislative proposal for the regulation of credit unions is currently being prepared.[178]

ACM concurs that the current law and regulations constitute an entry barrier for credit unions
Credit unions entering the market can provide added value to the market for SME lending. In other countries, credit unions compete with banks. This results in lower interest rates for financing and higher interest rates for savings.[179] In addition, credit unions can service SMEs that currently do not have financing from banks.[180]

However, in the current situation, credit unions would have to comply with the same regulations

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[175] According to DNB and AFM, it would be feasible if credit unions would work with perpetual member certificates or by means of the system of credit intermediation. In that case, they are not a 'credit institution' in accordance with the Wft. Source: http://www.kredietunienederland.nl/wettelijk-kader.

[176] Minister of Finance (2013b).

[177] CDA. https://www.cda.nl/standpunten/standpunt/kredietunies/.

[178] CDA. https://www.cda.nl/fileadmin/Personen/vanhijum/20140225_Wetsvoorstel_toezicht_kredietunies_EvH.pdf.

[179] In this regard, see e.g.: Emmons & Schmid (1999), Emmons & Schmid (2000), Tokle and Tokle (2000), Feinberg (2001), Hannan (2003), and Feinberg (2003).

[180] Credit unions use a lending model in which borrowers are coached to minimise credit risks.

as banks, including CRD IV. If they have to comply with the same regulations, then the compliance costs involved are extensive, certainly in the credit unions' start-up phase in which their scale is still limited. According to the Impact Assessment of the European Commission, the annual compliance costs for the components of CRD IV for small banks on average amount to 686,000 euros and the one-off costs per bank amounted to 1,470,100 euros.[181] Moreover, the minimum requirement of equity of 5 million euros[182] does not seem feasible at this scale. For example, Kredietunie Zeeland wants to start up with total assets in the amount of 2.5 million euros. They would therefore need more than twice as much equity as the loans they intend to grant. As a result, credit unions enjoy a cost disadvantage compared to banks with a more advantageous leverage ratio.[183]

In addition, it is not clear whether there is a need for (far-reaching) regulation of credit unions. The two objectives of bank regulation that are mentioned the most often are the prevention of instability in the financial system and the need for protection of the consumer (Carletti, 2008; Van Hoose, 2010).[184] Due to the interdependence of large banks and the services to consumers, it is therefore understandable that these banks are subject to far-reaching regulation.

Yet, credit unions will scarcely be intertwined with other financial institutions and will also not participate in the deposit-guarantee scheme. It is also plausible that SME entrepreneurs can be expected to demonstrate more self-reliance and responsibility than consumers.[185] As a result, they require less protection. Finally, the instability of a credit union will only have a limited impact on the real economy in the case of limited scale. For that reason, there seems to be no need for (extensive) regulation of credit unions.

Conclusion

ACM concludes that the current bank regulations are mainly focused on the impact of bankruptcies of large banks on the financial stability and real economy. Credit unions have a much smaller harmful impact. ACM believes that the current banking regulations restrict credit unions from entering the market. In order to create room for new initiatives, the regulation of

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[181] EC (2011), page 184. These estimates concern banks with a turnover lower than 3 billion euros.

[182] Refer to Article 48 of the Decree on Prudential Rules pursuant to the Wft.

[183] If credit unions finance loans of 2.5 million euros with equity capital of 5 million euros, then this results in a leverage ratio of 100% (equity capital/assets). The proposed minimal leverage ratio in CRD for banks is 3%. This is a difference of 97%. According to estimates, a leverage ratio that is one percent higher results in a 15- basis-points increase in the financing costs (Santos & Elliott, 2012, Table 3).

[184] Another reason for stricter regulation of banks in comparison to other businesses could reside in the prevention of a significant negative impact on the real economy in the event of liquidation bankruptcy of a bank (Vives, 2010).

[185] This is based on the assumption that providers of capital are accurately informed about the risks affecting their investment.

financial institutions should be dependent on the risks engendered by those financial institutions. This also applies to the specific case of credit unions.

Recommendation: Develop a less stringent supervisory regime for credit unions.

In the short term, ACM therefore recommends that the Minister of Finance asks the European Commission for an exception to CRD IV for credit unions. The regulatory framework that the European Commission will possibly ask for must then fit in as much as possible with the risks of credit unions, from the perspective of financial stability and consumer protection. This recommendation takes into account the need for regulation that fits in as much as possible with the risks of (categories of) financial institutions. This is examined in more detail in "Recommendation 5: Strive for prudential laws and regulations that are geared to the risks a bank engenders to the financial stability and the real economy". This manner of regulating results in a more reduced burden of supervision and a more significant increase in new initiatives, while not being at the expense of financial stability and the protection of consumers.

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5 Mortgages

One of the most important activities of Dutch banks is granting mortgages to consumers and firms. This chapter focuses on a few aspects of the competitive situation, including barriers to entry into the mortgage market.

Size of the market

In February 2014, there were outstanding mortgage loans to Dutch households in the amount of approximately 540 billion euros.[186] This is approximately 30% of total lending in the Netherlands.[187] The size of the mortgage market is still increasing, even though this increase is considerably lower than ten years ago (see Figure 12). This can be explained by the decline in the demand for mortgages, e.g. due to a stagnating housing market, as well as by the more stringent lending criteria.

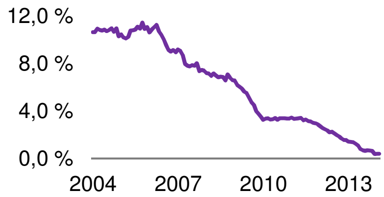

Figure 12: year-on-year growth of mortgage lending by the Dutch financial institutions (DNB).

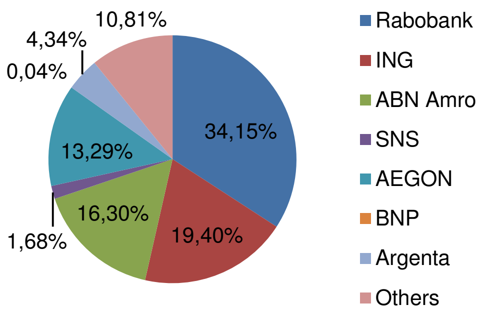

Figure 13: Market shares in October 2012 based on new mortgages (ACM, 2013a).

Concentration

The market for mortgages is rather concentrated. The four largest providers– Rabobank, ING Bank, ABN AMRO, and AEGON – grant approximately 80% of all mortgage loans. Moreover, the C4 ratio and the Herfindahl-Hirschman Index (HHI), both measures of the degree of concentration, have risen in recent years.[188]

Price developments

Compared to the surrounding countries, the Netherlands has relatively high mortgage rates. What stands out here is that the interest rates in other countries show a downward trend, while the Dutch mortgage interest rate has remained relatively stable since 2006. However, the amount or evolution of the mortgage interest rate does not measure the degree of competition, as that interest rate depends on

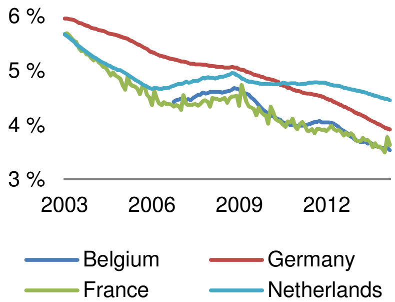

Figure 14: mortgage rate 5 years fixed (ECB).

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[186] DNB. http://www.statistics.dnb.nl/usr/statistics/excel/gmon3n.xls.

[187] The total amount of outstanding loans is some 1.7 billion euros. DNB. http://www.statistics.dnb.nl/usr/statistics/excel/t5.6nk.xls, 3rd quarter 2013.

[188] The C4 ratio is defined as the sum of the market shares of the four largest lenders. The Herfindahl-Hirschmann Index (HHI) is defined as the sum of the squares of the market shares of all providers in the market.

multiple factors, including the height of the credit risk and the costs of funding such as debt and equity.

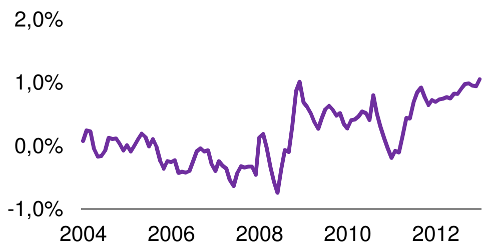

Figure 15: evolution of margin on mortgages (ACM, 2013a).

Margins

The study of ACM (2013a) revealed that the margins on new mortgage loans have increased since the beginning of the financial crisis. ACM attributes this increase in the margins to the existence of capacity restrictions at mortgage lenders and to a lack of (the threat of) new entrants. As mortgage lenders have been dealing with capacity restrictions since the credit crisis, it is possible that the nature of the competition has changed. The margins in oligopolistic markets with capacity restrictions are generally higher, as the capacity restrictions limit the opportunities for competitors to discipline each other.[189]

Switching behaviour

ACM (2011) has studied the switching behaviour of consumers. This study revealed that the switching costs are considerable, but that 60% of the respondents considered switching to be easy or very easy.[190] Mortgage lenders did however inform customers rather late about the expiration of the fixed-interest period and the options for switching provider. Since then, this has been improved and consumers have more time to compare mortgage lenders at the occasion of an interest refixing.[191]

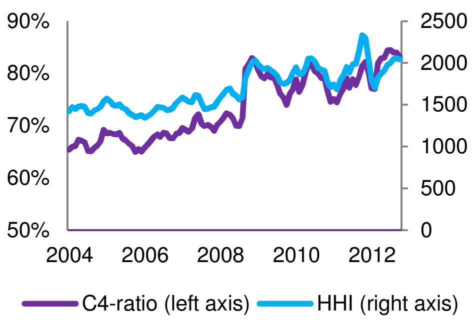

Figure 16: Evolution of concentration ratio's (ACM, 2013a).

Entry and barriers to entry

In spite of the increased mortgage margins, barely any new providers have entered the Dutch mortgage market since the beginning of the financial crisis. On the contrary, a number of banks have left the Dutch mortgage market, such as GMAC and BNP Paribas. In part because of that, the concentration has increased in recent years (see Figure 16).

A study by the OFT into barriers to entry and growth in the retail banking sector of the United kingdom mentions the development of an extensive network

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[189] ACM (2013a).

[190] Only 9% of the respondents found switching to be difficult or very difficult (NMa, 2011, page 57).

[191] Minister of Finance (2012).

of branches as a potential barrier to growth.[192] This is attributable to the high initial investment costs involved in developing a network of branches. Yet, in the Netherlands, the development of a network of branches seems to be less relevant. The study of NMa (2011) revealed that new entrants are capable of gaining a significant market share without a network of branches, due to the existence of a large number of intermediaries.[193] Interviews administered in the context of this study[194] have also revealed that the development of a network of branches is not considered to be a barrier to entry.

In the context of this study, ACM commissioned interviews with various market participants about the entry barriers into the Dutch mortgage market. According to the new entrants, the second most important barrier is that, in the Netherlands, relatively large mortgages are granted in proportion to the value of the home (high LTV ratio).[195] This creates the perception at e.g. the foreign parent company that the risk of an investment in the Dutch mortgage market is considerable. However, ACM does not see this as a significant barrier to entry, as the actual credit risk can in principle be priced into the mortgage interest rate.

By far the most important barrier referred to in the interviews is the political uncertainty about the regulation. This uncertainty ensues from the debate on the tenability of high LTV ratios in the long term and the mortgage interest relief. This debate creates uncertainty about the future policy in the mortgage market and consequently about the business case of new entrants. Consequently, the latter prefer to wait until this is resolved.

Conclusion
The mortgage market has become increasingly concentrated in recent years. In addition, the margins on mortgages have increased after the crisis. There are also no significant new entries at this time. These factors are indicative of a decline in competition in the mortgage market.

Reader's guide: recommendations for lowering barriers to entry into the mortgage market
New entrants in the mortgage market are preferable for more competition. The uncertainty about future regulations in the mortgage market does however constitute a significant barrier to entry into the mortgage market. New entrants are assuming a wait-and-see attitude because of that uncertainty. A recommendation for reducing this barrier is made below.

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[192] OFT (2010), item 9.15.

[193] NMa (2011), page 43.

[194] KPMG (2014).

[195] Various international organisations confirm the perception that the LTV ratios in the Netherlands are relatively high (OECD, 2014, page 77).

Recommendation 7: Minimise the uncertainty about the law and regulations in the mortgage market

"The rules change quite often, which is not preferable for banks".
– International full-service bank active in the Netherlands (KPMG, 2014)

There is uncertainty about future regulation of the mortgage market
The Dutch housing market has many laws and regulations that influence the future of the mortgage market. For example, the mortgage interest relief provides borrowers with a tax advantage, the maximum allowed Loan-to-Value (LTV) ratios and the National Mortgage Guarantee (*Nationale Hypotheek Garantie*, NHG) limit the credit risk, and the National Mortgage Institution (*Nationale Hypotheek Instelling*, NHI) strives to stimulate the housing market.

For a long time already, there has been an ongoing debate on how future-proof these laws and regulations are. On the one hand, incentive measures are being phased out: the mortgage interest relief is being reduced, the scope of the NHG is being limited, and the maximum allowed LTV ratio is being lowered.[196] Some stakeholders, such as the IMF, the OECD, the European Commission, and the Committee on the Structure of Dutch banks (*Commissie Structuur Nederlandse Banken*, CSNB), believe that these changes are not far-reaching enough to reduce the distortions in the Dutch housing market. A few among them are advocating a quicker and farther-reaching reduction of the mortgage interest relief[197] or a further lowering of the maximum LTV ratio.[198]

On the other hand, initiatives are also being developed to stimulate the demand for and supply of homes and mortgages. For example, the Dutch Cabinet intends to create a National Mortgage Institution (*Nationale Hypotheek Instelling*, NHI) that will guarantee an advantageous and stable source of funding for loan providers.[199] In addition, in May 2012, the transfer tax for homes has been permanently lowered from 6% to 2% in order to stimulate the housing market and individual homeownership.[200]

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[196] For an overview, see: http://www.rijksoverheid.nl/onderwerpen/koopwoning/nieuwe-regels-hypotheek.

[197] Council of the European Union (2013), item 11, IMF (2013), page 23 , OECD (2014) and http://ec.europa.eu/europe2020/pdf/csr2014/csr2014_netherlands_nl.pdf.

[198] Minister of Finance (2013a), page 11, recommendation 5, in which it is recommended that the LTV ratio must be lowered to 80% after 2018. The Council of the European Union also asserts that "the loan-to-value ratio of 100% that should be attained in 2018, [...] [is] still too high. See: http://ec.europa.eu/europe2020/pdf/csr2014/csr2014_netherlands_nl.pdf.

[199] ACM (2013b).

[200] Netherlands Law Gazette (*Staatscourant*). Property transfer tax. Rate reduction for acquisition of homes. Staatscourant 10885, 30 May 2012.

New entrants see the uncertainty about the mortgage market as a risk

In the context of this study, ACM commissioned interviews with (potential) new entrants about the most important barriers to entry.[201] Fourteen of the twenty parties interviewed specifically discussed the mortgage market.[202] Eight parties indicated that the uncertainty surrounding laws and regulations in the mortgage market constitutes a barrier to entry. In this regard, they specifically mentioned the uncertainty regarding the mortgage interest relief (five parties) and the uncertainty about the LTV ratio (two parties). For example, a European investment company said that "[it is] difficult for a bank to make a good risk assessment, as they cannot properly assess the direction in which the regulation (e.g. LTV, deduction) is evolving or can evolve". The six remaining parties did not mention the uncertainty concerning laws and regulations (two parties) or indicated to be neutral in that regard (four parties).

The uncertainty constitutes a barrier to entry

ACM comes to the conclusion that the uncertainty regarding future laws and regulations can constitute a barrier to entry.

In deciding to enter the Dutch mortgage market, a new entrant takes into account the (evolution of the) demand for mortgages and the risks of these mortgages. Future laws and regulations exert an influence on these factors. The level of the mortgage interest relief determines to what extent the consumer can deduct the mortgage interest paid from his or her income. The higher the mortgage interest relief, the lower the effective price of a mortgage will be and the higher the demand for homes and mortgages. The credit risk can also become lower in the case of a higher mortgage interest relief, as a smaller amount of income has to be spent on mortgage costs. In addition to the mortgage interest relief, the level of the maximum LTV, the limit for the NHG, and whether or not the NHI will be formed also influence the demand for and supply of mortgages.[203] However, the demand for homes and mortgages will be affected most by a change in the mortgage interest relief, because it has an immediate impact on the monthly charges of a mortgage.

This uncertainty can result in providers assuming a scenario for the mortgage market that is too pessimistic or in providers postponing their decision to enter the market. Both effects have a negative impact on the incentive to enter the market. In the first case, they might unnecessarily

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[201] See also KPMG (2014).

[202] The group of interviewed parties that did touch upon the mortgage market consisted of seven foreign parties (EU and non-EU) and seven Dutch parties, including an investment company, a niche bank, multiple universal and retail banks, and several banks that are part of a banking and insurance group.

[203] A limit on the maximum LTV lowers the maximum loan amount. This engenders a lower amount for mortgages, as well as a lower credit risk. The limit for participation in the NHG determines which mortgages qualify for the government guarantee. The lower this amount, the fewer 'subsidised' mortgages can be sold. The demand will be less as fewer people can make use of the NHG.

assume a worse business case for entry. The second effect arises when the entry is accompanied by significant sunk investments. In that case, a new entrant will postpone its decision to enter the market until there is more certainty. This is because the new entrant can better assess whether it will recuperate its investment when there is more certainty about the future of the mortgage market.[204] More certainty about the future laws and regulations, and thereby about the expected profitability, creates therefore a larger incentive to enter the market.

Conclusion

The Dutch administration devotes its continuous attention to the stability in the housing and mortgage markets. However, there is still a debate on topics that can significantly influence the expected profitability in the mortgage market. Examples of these topics are the mortgage interest relief, the maximum permitted LTV ratio, and the scope of the guarantee of the NHG. ACM concludes that the uncertainty about future policy, created by this debate, is designated by (potential) entrants as the most important barrier to entry into the mortgage market. Consequently, potential entrants may assume a future scenario that is too negative or may be inclined to postpone their decision to enter the market.

Recommendation: Ensure that the uncertainty about the law and regulations in the mortgage market is minimised.

It is the task of the current and future administrations to reduce to a minimum the uncertainty in the mortgage market about future policy in order to encourage new entries into the market. The uncertainty can be removed by better explaining the sustainability of the current policy so that there is no more cause for a significant debate or by amending the policy if necessary. That would address the objections of the IMF, the European Commission, and the OECD, among other parties, to the current policy, thus creating more certainty concerning the long term. This does not mean that the policy must be changed, as long as the uncertainty is removed.

[204] The positive relationship between uncertainty and the postponement of the decision to enter the market originates from the option pricing literature. See also: Dixit & Pindyck (1995). In addition to postponing the decision, banks can also prefer more certainty because they are risk-averse (Nishiyama, 2007).

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6 Savings market

The savings market generates funding required by banks to issue loans. This chapter focuses on a few aspects of competition, including barriers to entry.

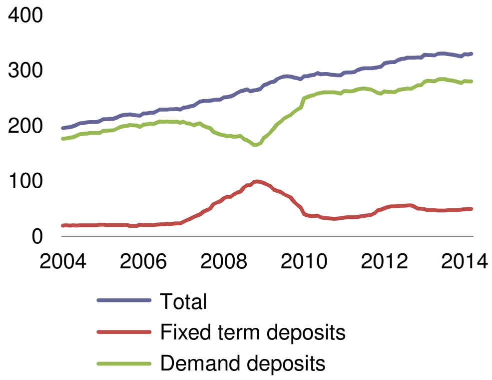

Figure 17: Dutch households have billions in savings (DNB).

Scope of the market

Figure 17 shows that the amount of savings on average increases every year by slightly more than six percent. It also shows that the amount of savings of households has been growing slower since the crisis than in the period preceding the crisis. The most important form of savings for households are deposits redeemable at notice (withdrawable free of charge).

Concentration

The Dutch savings market is highly concentrated. The four largest banks have a combined market share of approximately 84% (see Figure 18). The remainder of the market is divided between many small providers, all of which have a market share of less than 2%. These providers include smaller Dutch banks (e.g. Knab), foreign banks (e.g. Argenta, Anadolubank, Lloyds bank), subsidiaries of major banks (e.g. MoneYou), and other financial institutions, such as insurers and pension funds (e.g. Aegon and Delta Lloyd), among other parties.

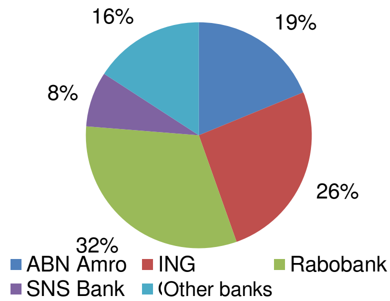

Figure 18: Market shares in Dutch savings market 2011 (Cabinet's vision for Dutch banking sector).

Level of savings interest

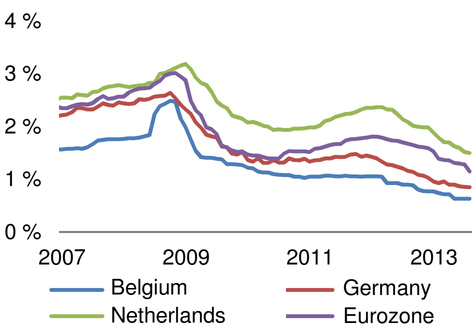

Figure 19: Savings interest on bank sight accounts (ECB).

As shown by Figure 19, the savings interest rate in the Netherlands is relatively high compared to the interest rates in other countries. The savings interest rate for bank sight accounts in the Netherlands is on average sixty basis points higher than in e.g. Germany. This high savings interest rate is often linked to the 'funding gap' (*depositofinancieringsgat*). This gap is the difference between the loans to households and companies and their deposits. At the end of 2012, this funding gap amounted to 452 billion euros.[205]

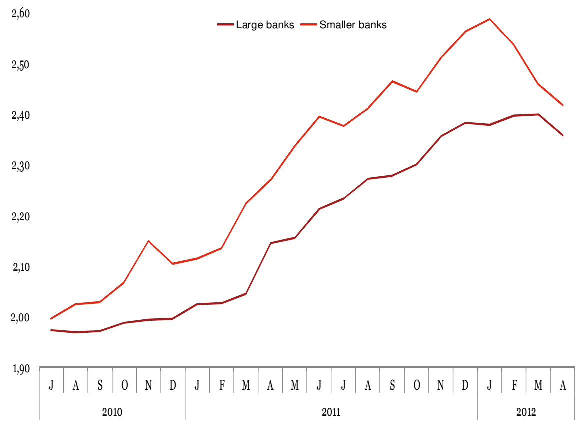

Figure 20: Weighted average interest demand deposits (Cabinet's vision on the Dutch banking sector).

The savings interest rate offered by the major banks is also structurally lower than the savings interest rate offered by small banks (see Figure 20). At this moment, the difference between the interest rate of the major banks and the highest rate in the market approximately amounts to 50 basis points.[206]

Switching behaviour of consumers

There are significant differences in the extent to which consumers are switching with their savings in the private savings market.[207] On the one hand, there is a large group of consumers who are not price-sensitive and who (almost) never switch. These consumers are almost always customers of one of the major banks. In addition, there are consumers who do switch. A part of this group will actively look for the highest interest and will switch regularly or even often. Another part of the group switches occasionally.

A survey was conducted among consumers with a savings account, on the behalf of ACM. This survey revealed that approximately half of all consumers have never switched banks with their savings.[208] Research of the CPB has also revealed that only 13% of the consumers surveyed

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[205] DNB (2013b), page 23.

[206] However, this interest rate difference is only an indication. The interest rates were obtained from the comparative site http://www.sparen.nl (consulted on 19 May 2014), using a deposit of 5000 euros, an account without restrictive terms, and solely savings accounts that are subject to the Dutch deposit-guarantee scheme. In this case, the three highest interest rates are ZwitserLeven (Internetsparen, 1.70%), MoneYou (Vrij opneembaar (withdrawable free of charge), 1.70%), and Nationale Nederlanden (Internetsparen, 1.70%). In the case of the major banks, the interest rates are 1.25% at ABN AMRO (Direct sparen), 1.25% at ING (Comfortspaarrekening), and 1.10% at Rabobank (Rabo Internetsparen).

[207] Switching consists of the consumer opening a new savings account at a different bank and depositing his or her savings in that account.

[208] This percentage is based on information from GfK (2014b). 79% of all savers did not move savings to another bank in the past 12 months (page 10). 73% of this group has never considered switching banks for their most important savings account (page 25). For by far most of these savers, their most important savings account is also their only savings account (page 15). This means that, in any case, 79% x 73% = 58% of the consumers has never switched savings bank.

have indicated planning to switch banks.[209]

The perception that the market consists of a small group of savers who frequently switch and a large group of savers who almost never switch, is confirmed by DNB, which writes that: "*by offering higher deposit interest rates, new entrants might be able to attract quantities of savings that are relevant to them, but this has as yet not resulted in large shifts in the savings market as a whole. [...] the majority of Dutch savers seem thereby relatively interest rate-indifferent.*"[210]

Entry and barriers to entry

There are new entries into the savings market, but the market shares of these new entrants remain limited to a maximum of 2%. This could be a consequence of their own limited need for savings, but could also be attributable to barriers to growth.

A study by the OFT of barriers to entry and to growth in the retail banking sector of the United Kingdom mentions (limited) switching behaviour as a potential barrier to growth.[211] This is because limited switching behaviour of savers makes it more difficult to gain customers and thereby to secure a significant market share. In the context of this study, (potential) new entrants were interviewed, on the instructions of ACM, about the most important barriers to entry.[212] Several parties have indicated in these interviews that there is limited switching behaviour in the savings market and they also refer to this as a barrier to growth.

In addition, almost half of the (potential) new entrants interviewed have indicated that the high savings interest rate in the Netherlands does not make its appealing to enter the Dutch market, from an international perspective.

Finally, several of the interviewees have indicated that the Dutch savings market is becoming less attractive because the amount of savings that banks can collect in a country are restricted, as is the extent to which they can use the money collected for cross-border purposes (see "Recommendation 2: In addition to a more effective European resolution mechanism, advocate for a European deposit-guarantee scheme").

Conclusion

The savings market is concentrated. In addition to the major banks, there are many smaller participants in the savings market, but the latter's market share remains limited. The average savings interest rate in the Netherlands is high in comparison with the surrounding countries, and the savings interest rate offered by major banks is structurally lower than the interest

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[209] CPB (2005), page 51.

[210] DNB (2009), page 14.

[211] OFT (2010).

[212] See also KPMG (2014).

offered by smaller banks. There seem to be two types of savers: a small group of (price-sensitive) savers who frequently switch and a large group of (not price-sensitive) savers who (almost) never switch. The savers who are not price-sensitive are mainly serviced by the major banks, while the price-sensitive savers are primarily looking for a higher savings interest rate.

Reader's guide: recommendation for lowering barriers to entry into the savings market

Limited switching behaviour constitutes a barrier to growth and entry into the savings market, because it limits the potential size of the market for new entrants. Below, ACM will formulate a recommendation to reduce consumer inertia concerning savings accounts. This will encourage entry into and competition in the Dutch banking sector. Restrictions on savings imposed by national regulators also constitute a barrier to entry. ACM already did make a recommendation in this regard in “Recommendation 2: In addition to a more effective European resolution mechanism, advocate for a European deposit-guarantee scheme” of this report.

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Recommendation 8: Provide banks with maximum latitude in informing consumers in a factual manner about the guarantee scheme for savings

"You put money away for a longer period and consequently receive more interest."

– Answer of respondent to the question of what is meant by the 'deposit-guarantee scheme' (GfK, 2014b)

The safety of the savings is an important aspect in the selection of a bank
There are significant differences between major banks and smaller banks in the level of the interest rate. At this moment, that difference is approximately 50 basis points for sight savings accounts. This difference can be larger in the case of fixed term deposits. These differences in interest rate between major banks and smaller banks seem to be structural. In spite of these differences in interest rates, a survey conducted in the context of this study on the instructions of ACM[213] revealed that approximately half of all consumers have never switched banks with their savings (hereinafter: non-switchers).[214]

When these non-switchers were asked about the reason for which they would switch after all, they often mentioned "diminished confidence in the current bank" (53%) and "a savings interest rate that is too low" (35%).[215] The group of consumers who recently switched also mentioned the level of the savings interest rate and the safety of the savings as important aspects in the selection of a new bank.[216] In selecting a bank, consumers therefore value the safety of their savings.

The safety of savings is guaranteed for an amount of up to 100,000 euros by the Dutch deposit-guarantee scheme (DGS).[217] Almost all banks active in the Netherlands are subject to the Dutch DGS.[218] As a result, the safety of the savings is the same at each bank for amounts up to 100,000 euros.

The survey also revealed that consumers are ill-informed about the DGS. 39% of the non-switchers have indicated that they are not familiar with the DGS.[219] Another 30% of the non-

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[213] GfK (2014b).

[214] See footnote 208.

[215] GfK (2014b), page 26.

[216] GfK (2014b), page 27.

[217] That safety means that savings of up to 100,000 euros are guaranteed if the bank encounters financial problems.

[218] A number of banks are subject to a foreign DGS such as Argenta (Belgium) and Lloyds Bank (United Kingdom).

[219] GfK (2014b), page 20. In comparison, almost everyone in the group of consumers who frequently switched banks knew what the DGS entails.

switchers do indicate being familiar with the DGS, but then provide an inaccurate description of the DGS. These respondents often confuse the DGS with a fixed term deposit.

Laws concerning the use of the DGS in advertisements of banks

Pursuant to Article 3:264, paragraph 1, of the Wft, banks are prohibited from using the DGS in advertisements.[220] However, pursuant to paragraph 2, this prohibition does not apply to "*(...) financial undertakings that state in an advertisement that a guarantee scheme applies to them.*" These two provisions seem to be in conflict with each other.

In April 2014, the European Parliament adopted a new Directive targeting the standardisation and improvement of the existing DGS's in Europe.[221] A component of this directive is that banks provide consumers with better information about which DGS is applicable. Regarding advertisements by banks, the directive states that references in publicity to deposit-guarantee schemes must remain restricted to brief and factual statements.[222]

In summary, it can be asserted that approximately half of all consumers have never switched their savings account. The safety of the savings at a bank is an important driver for switching. The DGS, which virtually equalises the safety of savings among banks, is however hardly known among non-switchers.

Market participants confirm the perception that a considerable segment of the savings market does not easily switch banks

In the context of this study, (potential) new entrants were interviewed, on the instructions of ACM, about the most important barriers to entry.[223] Fifteen of the twenty parties interviewed specifically discussed the savings market. Five interviews dealt extensively with the savings market. Three of these five parties indicated that there is a large group of savers that is not switching. For example, a Dutch bank, member of a banking and insurance group, stated: "*There is only a small segment that is really actively switching. 60 to 70% of the consumers opt for convenience.*" Four parties indicated that it is fairly easy to attract a limited amount of funding (less than 2% of the market), but that relatively high interest rates must be offered in order to attract these savers. One of these four expressly mentioned that it is challenging to

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[220] The Implementation Act memorandum of amendment stipulates in this regard: "The prohibition is based on the idea that a guarantee scheme in principle applies to all banks and investment firms registered in the member states. Advertising, generally intended to distinguish one product from other products or one provider from other providers, will then also rather result in confusion than in more clarity concerning the applicability of a guarantee scheme."

[221] European Parliament. http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2010/0207(COD).

[222] For example, see https://www.eerstekamer.nl/eu/europeesvoorstel/com_2010_368/document/f=/vih09a2vfkct.pdf, page 18.

[223] See also KPMG (2014).

gain a sizeable market share.

ACM deems it plausible that consumer inertia in the savings market has a negative impact on entry into that market

According to economic literature, the fact that consumers do not switch providers often (hereinafter: consumer inertia), e.g. as a consequence of barriers to switching, has an ambiguous impact on entry. On the one hand, lowering consumer inertia results in a larger market size for the new entrant. On the other hand, it also results in a lower margin per customer, as competition increases.

Yet, in the case of the savings market, new entrants are already active in a segment with little consumer inertia. They compete for the consumers who are prepared to switch. It is therefore plausible that the second effect, the lower margin, does not play a significant role in the case of the savings market. Lowering consumer inertia therefore would result in a more significant incentive to enter the savings market.[224]

Lowering consumer inertia may be achieved by creating more awareness of the guarantee scheme applicable to a bank. Consumers value the safety of their savings very much, but are partially unfamiliar with the existence of guarantee schemes such as DGS. Due to this unfamiliarity, non-switchers possibly believe that their savings are less safe at smaller banks, independent of whether the latter are owned by a foreign banking group, even though savings are also guaranteed for up to 100,000 euros there.

Banks can resolve this by informing consumers that they are subject to a guarantee scheme. More information also contributes to the public awareness of guarantee schemes in general and therefore of financial stability, as it prevents bank runs.[225] The current Dutch law and regulations governing the use of guarantee schemes in publicity statements do however seem contradictory and consequently create lack of clarity. This may cause doubt among banks how they can use the guarantee scheme in advertisements.

Conclusion

ACM concludes that a large segment of the savings market shows consumer inertia. This perception is confirmed by market participants. This inertia reduces the size of the potential market for new entrants and, in doing so, reduces the incentive to enter the Dutch savings market. Unawareness of guarantee schemes can (partially) explain the consumer inertia, as consumers possibly are not switching because they unjustly believe that their money will not be

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[224] In addition, lowering consumer inertia results in a higher average interest rate in the savings market as a whole.

[225] The existence of the DGS also creates a moral hazard as savers have no incentive to monitor the risk profile of banks. The consequences thereof must be curtailed as much as possible by means of the risk-based contribution to the DGS, the prudential requirements, and the supervision thereof.

safe with a new provider. It is therefore important that banks can communicate to consumers that the guarantee scheme is applicable to them and what its scope is. However, the existing regulations in the Netherlands are not clear on what the options are in that regard, making new entrants possibly (too) wary of publicity statements. It must be clearly explained in the implementation of the new European Directive, in which the possibilities for publicity statements about guarantee schemes have been included, that there is latitude and how much.

Recommendation: provide banks with maximum latitude in informing consumers in a factual manner about the deposit guarantee scheme.

ACM recommends that the Dutch Minister of Finance, in the implementation of the new European Directive, offers maximum latitude, as well as clarity in that regard, to banks in order to inform consumers in factual manner about the guarantee for their savings.[226] This latitude must be adequate enough to make it clear to consumers that their savings are safe with the concerned bank (up to 100,000 euros). In the Explanatory Memorandum to the bill, it should be explained what is and is not permitted. As long as the European Directive has not yet been implemented, the DNB, which supervises Article 3:264 of the Wft, could inform banks about the scope of this article.

[226] In this regard, ACM notes that future publicity statements should not imply that one bank is safer than another bank, as this could harm the purpose of guarantee schemes, which is the prevention of bank runs.

7 Personal current accounts

Payment packages for consumers consist in any case of the current account, a bank card, and the possibility to perform bank transactions via a mobile phone or the Internet. Depending on the package, additional products are sometimes included, such as a credit card, the possibility to incur an overdraft, and additional bank cards.[227] This chapter focuses on a few aspects of the competition, including barriers to entry into the market for current accounts.

Scope of the market

In 2013, there were approximately 15.5 million personal current accounts for consumers who are 18 years old or older in the Netherlands. This number has slightly increased in recent years, but has remained stable between 14.5 and 15.5 million when seen over a longer period (2002 up to 2013 inclusive). In recent years, approximately 712,000 new current accounts have been opened annually, while 388,000 have been closed. Approximately 70% of all consumers who are 18 years old or older had only one current account in 2013.[228]

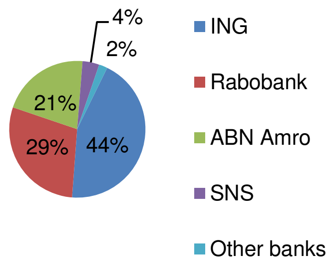

Figure 21: Market shares current accounts. Average from 2002 to 2012, on the basis of the number of existing accounts (GFK, 2014d).

Concentration

In the period of 2002-2012, the average combined market share of ABN AMRO, ING Bank, Rabobank, and SNS Bank[229] amounted to 98% (see Figure 21). The C4 ratio measured in newly opened current accounts is approximately equal, in which SNS Bank is growing faster than the other three major banks.

Margins/Profitability

Banks seem to make little or no profit in offering current accounts. In 2006, on the instructions of the Netherlands Bankers' Association (*Nederlandse Vereniging van Banken*, NVB) and DNB, McKinsey (2006) conducted research into the expenses and revenues of providing current accounts. That research revealed that the banking sector in the Netherlands incurred a loss of 642 million euros in 2005 on personal current accounts.[230] In the personal and business segments combined, the banks approximately achieved a break-even. In 2010, the NVB performed an update on the basis of an extrapolation of the information from 2006. This update yielded roughly the same conclusions as the research performed by McKinsey (2006).

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[227] Hereinafter, a package is referred to as a 'current account' for convenience.

[228] GfK (2014d).

[229] Banking and insurance firm SNS Reaal includes SNS Bank, Regio Bank, and ASN Bank.

[230] It is unclear in McKinsey (2006) how certain joint or common costs are divided between the personal and business segment.

Switching behaviour of consumers

Various studies indicate that consumers do not often switch[231] banks often with their current account, in comparison with other financial products as well as with other European countries.[232] In the context of this research, ACM commissioned a survey among consumers with a current account.[233] The survey confirms this situation: 73% of all consumers who are 18 years old or older have never voluntarily switched banks, while 24% have done so only once.[234]

In this survey, consumers have also been asked about the level of the financial incentive (discount) required to convince them to switch. It appears that many consumers would only switch at a relatively high discount. 31% of respondents would switch at a discount of at least 50 euros, while another 35% indicate that they would not switch banks for any discount.[235] The fact that consumers do not often switch banks with their current account is hereinafter referred to as 'consumer inertia'.

Entry and barriers to entry

The two recent, most important new entrants in the Netherlands in the segment of personal current accounts are Triodos Bank (2006) and Knab (2012). Triodos Bank is operating at a profit and had approximately 240,000 current accounts at the end of 2012, of which the majority belonged to consumers.[236] Knab had less than 30,000 customers at the end of 2013.[237] Combined, these banks have a market share of less than 2% on the basis of the number of existing current accounts and 4% on the basis of newly opened current accounts in 2013.[238]

Relatively few studies have been conducted concerning barriers to entry on the market for personal current accounts. In 2004, four national competition authorities, including ACM (at that time: NMa) conducted a comparative study of the competition in domestic banking sectors.[239] Investing in a network of branches and consumer inertia were mentioned as the most important entry barriers for the Dutch market. In 2010, the OFT also concluded that consumer inertia was an important barrier to entry in the United Kingdom.[240] The OFT perceived the development of a

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[231] Switching consists of the consumer opening a new current account at a different bank and having most expenditure and receipts go through this new account.

[232] Consumentenbond (2002), KPMG (2004), Gallup Organisation (2009), Consumentenbond and Trigenum (2011).

[233] GfK (2014a).

[234] GfK (2014a), page 17.

[235] GfK (2014a), page 27.

[236] 2012 Annual Report Triodos Bank.

[237] Het Financieele Dagblad, http://fd.nl/Print/krant/Pagina/Ondernemen/108914-1311/internetbank-knab-heeft-moeite-om-consument-te-laten-wisselen-van-bank_bron_fd_krant

[238] GfK (2014d).

[239] European Competition Authorities (2005).

[240] OFT (2008).

large-scale network of branches to be a potential barrier to entry, but it noted in that regard that a new entrant could also begin with a small number of bank branches and then gradually expand in the future.

In the interviews administered to (potential) new entrants in the context of this study, consumer inertia is mentioned as the most important barrier to entry.[241] In addition, the initial investments in the required ICT systems and marketing costs are referred to as barriers to entry by a number of market participants. According to new entrants, these investments amount to tens of millions of euros. New entrants also report that the current low profitability constitutes a barrier to entry for new entrants that only want to offer payment services, as potential losses cannot be compensated with profitable cross-selling (see below). ACM has also investigated whether there are barriers for entry into interbank payment systems. ACM has not received specific reports that this is likely.

Current accounts as a gateway for other financial products

Current accounts function as a gateway for other financial products. It is easier for banks to sell other financial products (such as savings accounts, mortgages, and insurance) to customers who already have a current account, than to other customers. Various studies indicate the existence of a gateway function for current accounts.[242] The function of a current account as a gateway for cross-selling is also indicated in the interviews conducted in the context of this study[243] and in meetings of ACM with banks. Concerning savings accounts, the survey revealed that relatively many consumers deposited (the majority of their) savings in the bank where they also have their bank account.[244]

Personal current accounts having a gateway function can influence the profitability of entering other retail banking markets. For a (potential) new entrant that does not offer bank accounts, it is more challenging to gain customers when consumers prefer buying multiple products from a single bank.

Conclusion

The modest profitability of banks in the market for current accounts means that there are no immediate indications of problems relating to competition in this market. However, current accounts have an important gateway function. Through the current account, banks can develop a relationship with a customer, to then sell other financial products. Lowering the barriers to entry is therefore also important in this market, in part to encourage the competition in other

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[241] KPMG (2014).

[242] See e.g. Competition Commission (2002, page 27), European Commission (2007, page 70), and OFT (2010, page 132).

[243] KPMG (2014).

[244] GfK (2014a), page 13 and page 14.

banking markets.

Reader's guide: recommendation for lowering barriers to entry into the market for personal current accounts

An important barrier to entry into the market for current accounts is the existence of consumer inertia. Therefore, ACM will hereinafter make a recommendation to reduce consumer inertia concerning personal current accounts. According to new entrants, investment costs accompanying the development of an ICT system and marketing costs also constitute a barrier to entry. ACM is not making a recommendation in this regard, as these investment costs are inextricably connected to entering the market. ACM does also not make a recommendation regarding the development of a branch network, because consumers increasingly take care of their bank transactions via the Internet and because two recent new entrants are operating without a network of branches. The development of a branch network therefore no longer seems to be a significant barrier to entry.

Recommendation 9: Take measures to reduce consumer inertia in the market for current accounts

"Customer inertia remains a key barrier for potential entrants and smaller firms to attract customers and achieve sufficient scale to be able to recover costs, many of which are sunk."

- Office of Fair Trading (2010)

Barriers to switching constitute an important explanation of consumer inertia
A survey was conducted among consumers with a current account, on behalf of ACM.[245] This study indicated that Dutch consumers switch[246] less between banks with their current account compared to other financial products as well as to other European countries. 73% of the consumers aged 18 or older have never switched.[247] Hereinafter, this is referred to as 'consumer inertia'.

37% of the consumers interviewed specified 'switching banks costs me too much time and/or effort' as one of the most important reasons for not switching.[248] This points to the existence of barriers to entry. If the respondents were then further questioned about important barriers to entry, the lack of number portability[249] is mentioned most often.[250]

In addition to barriers to switching, consumers have other reasons for not switching banks. For example, 27% of the consumers interviewed indicated that they are satisfied with their current bank.[251] Results of the survey revealed a negative Net Promoter Score, a method intended to measure the degree of satisfaction.[252] This means that there are more dissatisfied customers than loyal customers. In addition to 'hassle' and satisfaction, 31% of the consumers interviewed

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[245] GfK (2014a).

[246] Switching consists of the consumer opening a new current account at a different bank and having most expenditure and receipts go through this new account.

[247] GfK (2014a), page 17.

[248] GfK (2014a), page 18.

[249] Number portability means that the consumer retains his or her account number when switching banks.

[250] GfK (2014a), page 19.

[251] GfK (2014a), page 16.

[252] GfK (2014a), page 15. The NPS is based on the idea that a company can classify its customers in three categories: Promoters, Passives, and Detractors. These categories can be identified by asking the question: how likely is it that you will recommend [company X] to a friend or colleague? Customers respond using a 0-to-10 rating scale. Promoters (9 and 10) are loyal customers who are very positive about their current provider. Passives (7 and 8) are customers who are somewhat satisfied but are open to competing offers. Detractors (0 to 6) dissatisfied customers. The NPS is calculated as the difference between the percentage of Promoters and the percentage of Detractors. In the case of current accounts, there are relatively many Passives (67%).

indicated that switching banks yields too few financial advantages.[253]

Initiatives for lowering barriers to switching

Since 2004, consumers and companies can make use of the 'Interbank Payment System Switching Service' (*Interbancaire Overstapservice Betalingsverkeer*) (hereinafter: Switching Service). This service ensures that direct debits and payments are forwarded to the new current account for a period of thirteen months. The Switching Service was introduced as an alternative to number portability, due to the alleged high implementation costs of the latter.[254] The purpose of the service is to lower the barriers to switching for current accounts and thereby promoting competition.

The annual number of consumers using the switching service is relatively low and has not experienced an upward trend since the introduction of that service.[255] In the period from 2004 to 2012 inclusive, the number of users varied between 60,000 and 100,000 per year, approximately 90% of which are consumers. Annually, this is less than 1% of all personal account holders.[256]

From the consumer's perspective, number portability is a better alternative than the Switching Service.[257] In the case of number portability, it is e.g. not necessary to inform companies and authorities about the new account number. In comparison with the Switching Service, number portability will result in a further lowering of the barriers to switching concerning bank accounts.[258] Studies into the impact of number portability in mobile telecommunications demonstrate that the degree of switching has significantly increased since the introduction of number portability.[259]

New entrants confirm consumer inertia concerning current accounts

In the context of this study, (potential) new entrants were interviewed, on behalf of ACM, about the most important barriers to entry.[260] Four of the twenty parties interviewed specifically

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[253] GfK (2014a), page 18.

[254] Parliamentary Papers II 2002/03, 27863, 12, p. 4. For that matter, an extensive advice from NIP Capital to the 'Switching Costs' MDW working group of 2002 indicated that number portability could have been implemented relatively easily and at low costs (NIP Capital, 2002).

[255] Consumentenbond & Trigenum (2011), page 8. ACM has data from 2011 and 2012.

[256] In 2013, there were approximately 15.5 million current accounts for consumers aged 18 or older (GfK, 2014d).

[257] European Commission, http://ec.europa.eu/internal_market/finservices-retail/docs/inclusion/20130508-impact-assessment_en.pdf, page 211-216.

[258] Number portability will not eliminate all barriers to switching, such as the application for a current account at the new bank and the wait for a new PIN card.

[259] Grzybowski (2005) and Lyons (2006).

[260] See also KPMG (2014).

discussed current accounts.[261] Three of these four parties indicated that many Dutch consumers are loyal to their bank and switch only to a limited extent. One party did indicate that the Dutch consumer is prepared to switch , but the party did not specify whether this concerns all consumers or only a segment thereof. One partner interviewed asserted that it is probably impossible to reach the required scale needed to operate profitably quickly enough due to consumer inertia. Finally, two market participants indicated that number portability could reduce consumer inertia.

ACM deems it plausible that consumer inertia exerts a negative impact on the access to and competition in the Dutch banking sector

The existing barriers to switching contribute to the consumer inertia in the market for current accounts. In general, barriers to switching result in less competition between firms and thereby in higher prices, lower quality and/or less innovation.[262] Whether barriers to switching also lead to a reduced incentive to enter the market depends on the specific market conditions.

As barriers to switching become higher, it is increasingly difficult for new entrants to poach customers from established providers. This means that the incentive to enter the market become smaller. On the other hand, barriers to switching increase the profit per customer as a consequence of the decreased competition. This is a positive impact on the entry into the market.[263]

The first impact seems to be more important in the case of current accounts. The increase in the number of consumers who are opening a current account for the first time is namely limited. It is therefore important to poach customers from the competition in order to be able to grow.

In addition, there are economies of scale in current accounts due to the relatively high fixed costs. This means that the costs per customer will decline as the bank gains more customers. It is thus important for a new entrant to gain sufficient customers in order to be able to compete with the existing providers of current accounts.

Regardless of the impact on market access, lowering barriers to switching creates more competition between existing banks. In doing so, it leads to lower prices, better quality and/or more innovation. This impact is not limited just to bank accounts. When a consumer switches his or her current account to another bank, there is a chance that this consumer will also

[261] Current accounts were not discussed in all interviews, e.g. because the (potential) new entrant did not intend to become active in this product in the Netherlands. The parties that did touch upon this topic were two Dutch service providers, a European universal bank, and a Dutch bank that is a part of a Dutch banking and insurance group.

[262] Farrell & Klemperer (2007), page 1987 and Motta (2004), page 81.

[263] OFT (2003), from paragraph 4.51.

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purchase other financial products from the new bank.[264]

Conclusion

ACM concludes that consumer inertia constitutes a barrier to entry in the market for current accounts. Thereby, it also constitutes a barrier to entry in markets for which current accounts function as a gateway. Consumer inertia limits the size of the market for the new entrant and thus reduces the incentive to enter that market. Barriers to switching in the form of 'hassle' are a plausible explanation for consumer inertia.

Recommendation 1: Conduct extensive and independent research into the social costs and benefits of number portability at the European level.

In April 2014, the European Parliament has adopted a new directive concerning current accounts. This directive aims to promote switching behaviour in Europe.[265] Several measures have been considered in this process, including the introduction of nationwide or European Union-wide number portability. In this context, rough assessments have been made of the social costs and benefits. Ultimately, the conclusion was that "*the long-term benefits of EU-wide portability will need to be weighed up more carefully against the technical issues behind modifying payment infrastructures. For the time being, however, implementation of this option is disproportionate to the identified problems.*"[266]

ACM deems it important that number portability remains an item on the European agenda.[267] New research is required in order to obtain a good cost-benefit assessment. ACM therefore welcomes the European decision to perform a cost-benefit analysis, five years from now, of the possible introduction of European number portability.[268] In doing so, ACM emphasises the importance of an *independent* estimate of the costs of number portability. The estimates in earlier cost-benefit analyses in the Netherlands were notably based on the input from the sector itself. Those results differed considerably from the estimates made by independent third parties. ACM also emphasises that the determination of the benefits of number portability also includes the impact on markets for which the current accounts function as a gateway, in addition to the impact on the market for bank accounts. In the past, potential spillover effects into other banking

[264] See the description of the gateway function on page 78.

[265] See e.g. European Commission, http://europa.eu/rapid/press-release_STATEMENT-14-123_en.htm, page 215.

[266] European Commission, http://ec.europa.eu/internal_market/finservices-retail/docs/inclusion/20130508-impact-assessment_en.pdf, pages 211-216.

[267] The introduction of the international bank account number (IBAN) has made the introduction of number portability at the domestic or European level more difficult, but not impossible. See European Commission, http://ec.europa.eu/internal_market/finservices-retail/docs/inclusion/20130508-impact-assessment_en.pdf, page 212.

[268] European Parliament, http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2014-0356&language=NL&ring=A7-2013-0398, item 56.

markets namely were not taken into account. Consequently, the benefits of number portability have potentially been underestimated.

ACM recommends that the Dutch Minister of Finance advocates at the European level for a comprehensive and independent study of the costs and benefits of number portability at the European level.[269] The above-mentioned benefits must be included in this study.

Recommendation 2: Increase the effectiveness of the Switching Service to reduce consumer inertia in the market for current accounts.

The potential introduction of number portability can only be achieved in the long term. In the short term, the Switching Service could be an effective alternative for reducing consumer inertia regarding current accounts.

The Switching Service was evaluated extensively in 2008 and in 2011.[270] The conclusions of those evaluations were that users of the service were satisfied with its functioning and that it has reduced the barriers to switching banks as perceived by the users of the service.

Box 11: Transparency of annual costs

The recently adopted European directive also includes a provision that makes it mandatory for banks to send their customers a statement of the bank costs (including additional payment services, such as outside Europe) each year. Following publication of this directive in the Official Journal of the European Union, the individual member states have two years to implement this directive in their national laws.

ACM welcomes this new directive. Issuing an annual statement of costs can make consumers more aware of their actual expenditure and potential cost-saving benefits concerning current accounts. In addition to the above-mentioned recommendations, this can further reduce consumer inertia in the market.

The evaluations did not investigate whether the Switching Service effectively resulted in less consumer inertia, which should be an explicit objective for that service. A survey conducted in the context of this study revealed that the degree of switching pertaining to current accounts is still relatively low following the introduction of the Switching Service.[271]

ACM sees room for improvement. The survey demonstrated that approximately 60% of the consumers are not familiar with the Switching Service.[272] Furthermore, ACM has received negative signals about the role played in the switching service by the former bank. Consumers are purportedly required to keep their old current account during the switch. They are

[269] ACM agrees with the European commission that number portability at the European level is preferred over various portability systems at the level of individual countries.

[270] SEO (2008) and Consumentenbond/Trigenum (2011).

[271] GfK (2014a), page 9.

[272] GfK (2014a), page 22. A 'Current account Switching Service' was introduced last year in the United Kingdom. Half a year later, approximately 60% of the population was familiar with this service. See http://www.paymentscouncil.org.uk/media_centre/press_releases/-/page/2863/.

consequently confronted with double the costs. The website and brochure of the Switching Service do not explicitly deal with whether or not the old current account should remain active during the switch. According to the Dutch Payments Association (*Betaalvereniging Nederland*), responsible for the communication of this service, the old current account can be closed during the switch via the switching service, provided that this is possible according to the former bank.[273] It would be desirable to have more transparency of the conditions under which the old current account must be kept active during the switch. Finally, ACM has received signals that one major bank still debits instalments of loans, such as the monthly mortgage payment, from the old current account (at that bank) after the Switching Service ends and also recommends customers to leave an adequate positive balance in that account. This happens even though the new account number of the departing customer has been known for quite a while.

ACM recommends that the Dutch Minister of Finance investigates how to enhance the effectiveness of the Switching Service in reducing consumer inertia. In any case, the consumers' awareness with the Switching Service must be enhanced.

[273] The old current account cannot be closed when there is an ongoing (judicial) investigation of the consumer or when there is a negative balance, for instance.

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