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COMPETITION COMMITTEE**

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Working Party No. 2 on Competition and Regulation

ROUNDTABLE ON COMPETITION AND REGULATION IN RETAIL BANKING

-- Turkey --

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The attached document is submitted by the delegation of Turkey to the Working Party No. 2 of the Competition Committee FOR DISCUSSION under Item III of the agenda at its forthcoming meeting on 16 October 2006.

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1. Banking Sector in Turkey

1. Turkey has gone through an economic crisis in 2000-2002 that was characterized by severe inflation and disruption in the banking system. New monetary and fiscal policies have subdued inflation, while restructuring and improved regulation and supervision in the banking sector has increased credit funding for investment¹.

2. The banking sector is subject to detailed legal regulations and supervisions due to the delicate function it fulfils between savings holders and those requesting funds. Therefore, in the banking sector the joint existence of efficiency, competition and stability in legal regulations is important.

3. Traditionally, the banking system has a majority share in the financial sectors in Turkey. In the Turkish banking sector, the products or services (credit, deposits, stocks and bonds...) provided by the banks are to a great extent homogenous. The prices of different products (interest rates, commissions, and expenses) differ from one bank to another, in other words the government does not limit them. Nevertheless, banks are using various selling and marketing techniques. In addition to that, they try to further strengthen their brand images via advertisements. Moreover, banks aim to increase their customer portfolio by product differentiation. These efforts show that banks in Turkey try to increase their market shares not only on the basis of price competition but also on the basis of non-price competition².

4. New regulations were introduced in the Turkish banking system via the Banks Act no 4389, adopted on 18.06.1999 which was amended by the Act no 4491, adopted on 17.12.1999. With the regulations put forward, the "Banking Regulation and Supervision Agency" having the nature of an independent administrative institution has been set up for purposes of ensuring regulation and supervision in the banking sector. The Banking Regulation and Supervision Agency founded through amendments to those articles of the Banks Act, which provide the supervision of banks has been empowered with transferring banks in difficulty to the "Savings Deposit Insurance Fund" (TMSF). With the regulations set forth in article 14 paragraph 6 of the Act, entitled "Measures to be Taken As a Result of Supervisions", the Fund has been conferred the power to transfer banks in difficulty to other volunteering banks or to a bank to be established, or to merge them with another bank which has a volunteer. In implementation of this power, an exception has been brought to the controlling power of the Competition Board *in transfer and merger transactions to be carried out by the Fund*, via the provision in the same article, reading as "...articles 7, 10 and 11 of the Act on the Protection of Competition No. 4054 shall not be applicable provided that the sectoral share of the total assets of the banks to be subjected to transfer or merger does not exceed 20 %...". In case of the practice of this authority, the power of the Turkish Competition Authority (TCA) to control is limited in merger and acquisition transactions to be made by the *Fund*. Later on with an amendment made in the Banks Act, this exclusion was widened to comprise *all banks*. In year 2005, the Banks Act no 4389 was replaced by the new Banks Act no 5411.

2. Competition Law and Banking

5. Under the *Turkish Competition Law*, there is no sector in which the competition rules cannot be implemented except for the above mentioned merger transactions in the banking sector. Emergency banking legislation that adopted in 1999, subsequently expanded and renewed in 2005 is the only example in Turkish competition law of an *exclusion* from the Act on the Protection of Competition no. 4054 (the Act on Competition no 4054).

¹ OECD Peer Review Report "Competition Law and Policy in Turkey", 2005, p.12.

² Güzel O., "AT Rekabet Hukuku Kurallarının Bankacılık Sektörüne Uygulanması", Rekabet Kurumu Yayınları 2003, p. 123-124.

6. According to the Turkish current banking legislation (article 19 of the Banks Act no 5411), mergers in which the merged entity has a market share below 20% of the Turkish banking market are expressly made exempt from the merger provisions of the Act on Competition no 4054 and they are subjected to control only by the National Banking Regulation and Supervision Agency. This ceiling is high enough to constitute a *de facto* exclusion of all bank mergers given the fact that even if the biggest two commercial banks with private capital would merge, their *sectoral share of total assets* would be below the threshold limits mentioned in the Banks Act no 5411, thus they would be out of the scope of the article 7 of the Act on Competition no 4054 and Communiqué no 1997/1 on the Mergers and Acquisitions Calling for the Authorization of the Competition Board (Communiqué 1997/1). In fact, the threshold unity -in the form of *sectoral share of total assets*- that is used to exclude certain mergers out of the scope of competition law is different than the market share criteria used in the competition law and policy applications.

7. The reason for such exemption is explained as follows: The unhealthy functioning experienced in the banking sector for long years has transformed into a systemic crisis within the year 2001 due to the failure of the economic program implemented. Thus, restructuralization and reform works required to be carried out in the sector, ensuring stability in financial markets. In the meantime, in works carried out under the rehabilitation of public banks, transfer transactions have also been realized between public banks in accordance with the provisions of private law. The TCA proposed the repeal of this exemption in 2002 once the bank emergency had been resolved, although there is no conflict of power in between the agencies (the banking sector regulator and the TCA). Within the same respect, in the Peer Review Report 2005 prepared by the OECD it is recommended that Turkey shall restore competition policy oversight of banking sector³. Furthermore, as pointed out in the same report the government has not proposed such legislation despite the urging of the TCA⁴ to date.

8. Nevertheless, *antitrust rules* found in the Competition Act no 4054 -mainly in two forms-, are still applicable to those anticompetitive practices of undertakings in the banking sector. Accordingly:

- Agreements which restrict competition are prohibited (Article 4 of the Competition Act no 4054),
- Abuse of dominant position is prohibited (Article 6 of the Competition Act no 4054).

9. Although the regulations that are carried out under the Banks Act no 5411 and steps taken for ensuring efficiency and stability in the regulation and supervision of the sector via banking regulator especially following an economic crisis period are favourable, the permanent implementation of the Banks Act no 5411, which take mergers and acquisitions in the area of banking out of the control of the competition agency is not compatible with the perspective of competition policy in the long run - as competition policy deemed to play a central role in the process of restructuralization following an economic crisis.

10. In the meantime in Turkish banking sector, there are legal barriers to entry arising from banking regulation in force. Those banks that are established in Turkey should be joint stock companies having 20 trillion TL paid capital. Moreover, they need authorization from the Banking Regulation and Supervision Agency.

³ OECD Peer Review Report “Competition Law and Policy in Turkey”, 2005, p.8.

⁴ Ibid, p. 27

3. An Opinion and A Case

11. Below initially, the opinion of the Competition Board on the theme of providing commentary with respect to proposed legislation arose from an application filed by the Banks Association of Turkey that complained about certain existing laws is discussed. Afterwards, a recent case about an infringement of competition through fixing clearing commission rate by the banks is given:

3.1 *The opinion of the Competition Board upon the application of Turkish Union of Banks (dated 15.05.2003 and numbered 03-32/404-176):*

12. In the application filed with the Competition Authority by the Banks Association of Turkey⁵ (TBB) in year 2003, it was communicated that with the then Banks Act issued in 1999 and the amendments to this act, differences between public and private banks were eliminated, but intervention in the selection of banks where public institutions and organizations would deposit their monies, through the provisions introduced in budgetary acts not only contradicted with the principle of free competition but also was contrary to the Constitution's principle as to "The Equality Before Law", "The Fundamental Principles of Law", and the notion of "Legal State". It has been stated that the efficiency which might be displayed by the banking system in the collection of resources and having them utilized within the market mechanism would be distorted by such interventions preventing the flow of resources, and it would lead to serious negativities in the bank system which was undergoing the stage of reform.

13. Provisions introduced in statutory regulations mentioned in the application of TBB, and practices based on such provisions are not compatible with the principles of free competition due to the limiting and discriminatory provisions introduced in the entry of public resources to the banking system, and do mean a discriminatory practice between banks which have to operate within same conditions. In the same way, the limitation of activities of state economic enterprises, their affiliated partnerships, establishments and enterprises which are supposed to utilize their resources and operate within the system under the conditions of free market presents as distorting competitive conditions in the sector where these enterprises operate. In this context, the claim by TBB that public treasury is required to be conducted by all banks is justifiable in terms of competition policy. Even though it is accepted that the policy-making as to how to incorporate the resources of public institutions into the system would be a political choice, the ability to verify such a choice in terms of competition policy may be possible if it encompasses an equal practice for all actors.

14. With regard to the legislative regulations mentioned and in accordance with the Competition Act no 4054, the Competition Board possesses the task of notifying that an amendment be made to the relevant legislation, in case the State commits practices distorting competition, through acts and other legislations, or decisions of the Council of Ministers which is the executive body. The issue was discussed in the Competition Board meeting dated 15.05.2003 and numbered 03-32/404-176 as a result of which the Board advised the government to remove provisions in various budget acts that required public institutions to maintain their accounts at public banking institutions rather than at private banking companies. As mentioned in the "Peer Review Report 2005" prepared by OECD, banking legislation in 1999 had formally eliminated the distinctions between the two types of financial institutions and there was no reason to deny public organisations the benefits of competition as customers for financial services. However, the Board's recommendation is pending⁶.

⁵ The Association bears a legal entity and is the representative body for all the banks operating in Turkey. All banks operating in Turkey are legally bound to become members of the Banks Association of Turkey.

⁶ OECD Peer Review Report "Competition Law and Policy in Turkey", 2005, footnote 82 on p.84.

3.2 *Interbank Card Centre (BKM) Decision (dated 01.07.2005 and No. 05-43/602-153)*

15. Upon the complaint of Turkish Union of Employers of Gasoline Dealers and Gas Companies (TABGİS), the TCA initiated an investigation against Interbank Card Centre (BKM) in order to determine whether there is an infringement of competition through fixing clearing commission rate by the banks under the body of BKM. During the investigation process, BKM requested for *exemption* for its practice of fixing a common clearing commission and as a result, assessment for exemption is included in the investigation decision. In the Decision, the relevant market for fixing clearing commission rate is determined as “market for paying services by credit cards”.

16. BKM is a joint stock company carrying out clearing transactions between banks in the card payment system. In card transactions, BKM’s Board of Directors determines the clearing commission rate paid by the acquiring bank to the issuing bank. *Issuing banks* are those which publish credit cards and distribute them to customers; *acquiring banks* are those which provide point of sale (POS) terminals for member stores by means of making agreements with these stores against a certain amount of commission (member store commission). Clearing commission obtained by issuing banks from acquiring banks are reflected on acquiring banks as cost and acquiring banks reflect this cost to member stores as member store commission. Clearing commission rate is equally applied among all of the banks. Essentially, clearing commission is a service cost reflected first by the issuing bank to the acquiring bank and then by the acquiring bank to the member store within member store commission; therefore it has a nature of price.

17. In card payment systems, clearing commission determined by banks together with financial institutions is a practice that calls for the attention of competition authorities and thus has been the subject of a number of cases throughout the world.

18. BKM argued that fixing clearing commission rates is not contrary to the Competition Act No. 4054 and exemption should be given to the application of fixing common clearing commission rate. Moreover, it is argued that each of the items contained in the fixed clearing commission rate is an element of cost in terms of issuing banks. In this frame, it is stated that BKM needs a centralized clearing commission rate since payment guarantee provided by issuing bank includes risks such as fraud in the card market and thus constitutes a high-cost item. Moreover, it is put forward that the funding costs resulting from the period between shopping date and payment date are a burden for issuing banks.

19. During the investigation process, it is understood that the BKM fixes some of the costs and the income of issuing and acquiring banks. Furthermore, the determination of a common clearing commission rate among banks affects competition at issuing and acquiring levels. Besides, issuing banks cannot pursue an individual pricing policy for the services they provide for acquiring banks. Last but not least, the clearing commission, which is the minimum price for member store commission, also constitutes an important element of the cost from the member store perspective. Within this regard, fixing clearing commission rates by the BKM is considered as “a decision of an association of undertaking” according to Article 4 (prohibiting restrictive agreements) of the Competition Act No. 4054, which is contrary to the law.

20. As a result of this anti-competitive conduct, the TCA imposed a minimum administrative fine on and it added that the application of fixing clearing commission rate can be granted an exemption if certain conditions⁷ are fulfilled -due to the peculiar conditions of card payment systems market.

⁷ The individual exemption might be granted upon the fulfillment of the following condition: overnight interest rate determined by the Turkish Central Bank shall be taken as a basis in the formula applied by BKM for the calculation of funding cost and sunk cost is not taken into consideration in operational costs item. The period of exemption is set as 2 years following the fulfillment of necessary requirements. The

4. Conclusion

21. As discussed above, except for a certain type of merger in the banking sector, competition rules can be enforced without exception to all sectors of the economy in Turkey. The TCA following the restructuralization period of the banking sector due to the 2000-2002 financial crisis, proposed the restore of competition policy oversight of the banking sector which is also supported by the Peer Review Report 2005.

reason for the minimum administrative fine arises from the provisions foreseen for the individual exemption.