



**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

**Cancels & replaces the same document of 26 September 2006**

**Working Party No. 2 on Competition and Regulation**

**ROUNDTABLE ON COMPETITION AND REGULATION IN RETAIL BANKING**

**-- Lithuania --**

**16 October 2006**

*The attached document is submitted by the delegation of Lithuania 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.*

**JT03214523**

Document complet disponible sur OLIS dans son format d'origine  
Complete document available on OLIS in its original format

## 1. Switching costs

1. The main factors influencing the private consumers' choice are<sup>1</sup> (in the order of importance): 1) the brand name associated with the reliability and safety of the bank; 2) speed and quality of service, attitude to a client; 3) the convenience to use banks services (the location of the divisions, ATMs, e-banking services, etc); 4) the cost of the services; 5) other factors (one-stop shopping, image, unchanging staff). The factors influencing the business clients have different priority: the quality and range of the services; pricing and quick service delivery time the competence of the staff, etc. The mobility of the customers in the retail banking sector is quite low. The proportion of the closed current accounts as compared to that of newly opened in household sector varies from bank to bank. In 4 out of 7 banks it does not exceed 11% and has a tendency to decrease. In the non-financial corporation sector the mobility is much higher – 29% approximately. The newly opened accounts do not necessarily mean that customers have terminated their earlier bank relationship. Nevertheless, the greater customer activity shows the demand of the service, and the demand in turn determines the importance of different parameters for competition in the sector. Besides that, the high percentage of the closed current accounts could be treated as an indicator of quite favorable conditions to choose the credit institutions without heavy costs.

2. The intention for customer to switch can be based either on dissatisfaction with their current bank or the better products offered by competing banks. The willingness to switch is usually constrained by some factors, for example by switching costs, personal relations with banking staff or a lack of information. The first factor is the most important. Switching costs first of all mean direct expences. If the customer uses wider range of services, usually he has to incur some costs in order to discontinue his relations with a bank. The cost of closing of a deposit account before the certain date includes the accumulated interest (plus a debit charge in certain banks). The lending facilities cannot be directly transfered to another bank: the customer can only refinance the loan by lending the necessary amount from another bank. This is a costly procedure: if the customer repays his debt before the appointed term, he has to pay a particular percentage of the debt (in some minor banks it varies from 0.5-1 %; in major banks it amounts up to 3% of the payout). But in some credit institutions this is not a rule: the customer has possibility to repay the rest of loan without additional fees. Such conditions, when the customer has a possibility to choose, reduce the market power of the remaining credit institutions, acting in the lending market.

3. There are some additional fees. The credit refinance fee is 250 LTL (app. 72 EUR) and more, depending on the amount of the loan. Besides, the customer has to bear other costs, e.g. mortgage fee, notarial services, real estate assessment, etc; these fees are unavoidable and paid not to the bank, but to the relevant institutions (hypothec institutions, notaries, center of registers).

4. The indirect costs are related to difficulties and inconveniencies that customer faces when changing a bank. It is also the responsibility to inform all relevant parties (employee informs his employer, entities inform theirs customers, and other parties, e.g. sometimes utility companies) about the new account details. Such payments as wages or loan repayments are completed during the switching process (i.e. when changing the credit institution the liabilities cannot be transfered directly).

5. The credit institutions share the information between themselves about the solvency and riskiness of the customers. They use some data basis. One of such data basis functions in the Bank of Lithuania (The Data Basis of the Risk of the Loans). Another data basis is owned by special company “Infobankas” that

---

<sup>1</sup> The data included in this contribution were collected from a questionnaire sent to 7 commercial banks operating in the Lithuanian payment card market, to the Association of the banks. The inquiry covers a 3 years' period (2003-2005).

administrates the information system of debtors. These systems contain the information about entities as well as about persons. The “Infobankas” reaches the information about the debtor if its debt exceeds 20 Lt (app. 6 EUR) and delayed more than 90 days. The quite sensitive information systems create the situations where the bank that currently has a customer has no superior information about the riskiness of the customer than other banks, i.e. the information about the potential client is available to all credit institutions. Therefore the banks do not become less willing to take on new customers, and this, in turn, reduces the bank’s interest to lock-in the existent clientele.

6. To sum up, the switching costs have double purpose. On the one hand, switching costs seriously impact on the mobility of the consumers and create a lock-in. Therefore very often it is safer and less inconvenient for a customer to be a client of several banks than to switch from one bank to another.

7. On the other hand, by setting various fees for cancellation of the agreement (either the deposit account or long-term loans or other) the commercial bank intends not only to keep a particular client, but first of all to be able to better plan its own flows of money and the management of the loans. This could be confirmed by the fact that all the commercial banks open and close current accounts, terminated deposit accounts for free as well as the agreements of the internet banking, i.e. the conditions to choose a credit institution and its services are quite favorable to the customers. Some banks indicated that they have reward programs to loyal clients. These programs also serve as a marketing instrument used to retain customers.

## **2. Conflicts of interests**

8. According to the answers provided by the commercial banks, a conflict of interest is possible in cases where a bank is able to offer to its customers investment funds, which contain the bonds and the shares of the companies to which the bank lends money. In order to avoid such conflict of interest, the bank implements internal control of the transactions involving securities. The risk of the possible conflict is managed by various measures: organizational, preventive, risk management. Furthermore, The Lithuanian Securities Commission has adopted the rules on organizing internal control of trading of securities<sup>2</sup>. The rules state that special attention shall be paid to the strict delimitation of duties of employees of the intermediaries dealing with inside information, prevention of the abuse of inside information, supervision of transactions with securities concluded for the account of the intermediaries or their employees, supervision over the avoidance of the conflict of interests and fair treatment of the customers, and the imposition of sanctions for the failure to observe the established rules.

## **3. Access to common platforms**

9. One of the common settlement systems is called LITAS. It is created to provide clearing, processing, management of risk, related to transactions. The payment system LITAS started its operation on 19 January 2004. At the end of 2005 LITAS participants were the Bank of Lithuania, 9 commercial banks, 2 foreign banks branches, 10 financial brokerage firms, the Central Securities Depository of Lithuania (CSD) and the Central Credit Union of Lithuania (CCU).

10. LITAS is designed to process payment instructions in real time and at designated time. The system processes credit and debit transfers. The Bank of Lithuania is the owner and the operator of the system. Settlements are carried out in the national currency litas. LITAS provides the cash leg of securities transactions in real and at designated time following the DvP (*delivery versus payment*) principle. It also

---

<sup>2</sup> Rules on organising internal control of the activity of intermediaries of public trading in securities (approved by Lithuanian Securities Commission Resolution No. 13, 21 May, 1999 (as amended 25 September, 2003))

establishes a possibility for other payment systems to perform settlements through the accounts of their participants with the Bank of Lithuania. LITAS is regulated by the Rules of Operation of the Payment System LITAS<sup>3</sup> and bilateral bank account agreements between the Bank of Lithuania and other system participants. The operator of the payment system determines membership conditions (licenses, technical basis, etc).

11. The system is open to banks that have a banking license issued by the Bank of Lithuania and foreign bank branches that have a permission of the Bank of Lithuania to operate in the country, the Central Securities Depository, financial brokerage firms, the Central Credit Union and clearing houses registered in the Republic of Lithuania. A credit institution of a state located in the European Economic Area and, on the decision of the Board of the Bank of Lithuania, a financial or clearing institution of such state may also join the system. All members of the System have a full member status.

12. The system operator presents the following technical documentation to persons that submitted an application to participate in the system: requirements and recommendations with respect to information systems of system participants and the hardware and system software of connecting servers, descriptions of the information exchange flows, descriptions of message structures, list of instructions for changing payment instructions and their processing conditions, list of priorities and user manual.

13. Another payment system is called KUBAS<sup>4</sup>. KUBAS is intended to make payments between credit unions or credit union customers (internal payments) and payments between credit unions and credit institutions or credit institution customers (external payments). Lithuanian Central Credit Union and 56 credit unions are members of KUBAS. Central Bank supervises a functioning of KUBAS. Internal payments are made through the accounts of system participants with the Central Union. External payments are made through the account of the Central Union with the Bank of Lithuania. Participation in the payment system KUBAS is open to the Central Union and credit unions that are members of the Central Union.

14. There are no actual barriers for new participants to enter the Lithuanian payment systems. LITAS or KUBAS payment systems operate on an “open membership” principle. Both systems have no any membership fee. Working principles of LITAS do not contain any special legal or technical conditions of membership that could restrict entry of new members. Current technical requirements are only of general nature and are necessary for the systems to work. All members of the LITAS and KUBAS do not distinguish direct or partial members; all members participate in the systems under equal rights. Only the operators of the systems (i.e. the Central Bank and the Central Union) are authorised to admit new members. The present members have no influence on the process of the new entries.

15. LITAS service fees are set in accordance with the Resolution of the Board of the Bank of Lithuania<sup>5</sup> based on the principles of full cost coverage, transparency and equal rights of system participants. As from 1 April 2006, the following service fees have been set:

1. the price for settling an urgent payment instruction – LTL 0.31 (0.0897 EUR);
2. the price for settling an ordinary payment instruction – LTL 0.28 (0,0811 EUR).

---

<sup>3</sup> Rules of operation of the payment system LITAS. (Approved by the Resolution of the Board of the Bank of Lithuania No. 124 of 11 December 2003 (as amended by the Resolutions of the Board of the Bank of Lithuania No. 87 of 20 May 2004, No. 150 of 2 September 2004 and No. 84 of 29 June 2006))

<sup>4</sup> Resolution of the Board of the Bank of Lithuania No. 11, 12 February 2004.

<sup>5</sup> Resolution of the Board of the Bank of Lithuania No. 136 of 24 December, 2003 “On Approving the Procedure for Calculating Service Fees of the Payment System LITAS”

16. The Departments of Information Technologies and of the Payment Systems are responsible for developing, installation and maintenance of software and hardware. Besides that, the Departments evaluate the safety of the system LITAS and prepare necessary documentation.

17. The transactions with plastic payment cards are not carried out through the payment systems LITAS or KUBAS. Payments between banks are fulfilled through the international or local payment card system.

#### **4. Entry restrictions**

18. The Law on the Bank of Lithuania<sup>6</sup> determines the power of the Central bank to issue licenses to credit institutions. Some entry restrictions of a very general nature to the market of banking services can be found in the Law on Banks<sup>7</sup>. They include formal requirements to banks, licensing procedure and standard minimum capital required. The banks equity capital must be not less than EUR 5 million if the bank's activity isn't specialized; and EUR 1 million if the specialized bank has been authorized only to issue and manage electronic money. The supervisory authority (the Central Bank) examines submitted application and takes a decision on the issuance of a licence not later than within 3 months.

19. A licence issued to a branch of the foreign bank is also governed by the same provisions of the Law on Banks that are applied to domestic credit institution.

20. The right to provide financial and investment services is given by the license, if this activity is not restricted in the license. The Lithuanian Securities Commission provides its findings to the Bank of Lithuania on the readiness of the commercial bank to provide investment services. The requirements and limitations applied are the same as to the financial brokerage firms.

#### **5. Relationship between banking regulator and competition authority**

21. The implementation of the Law on Competition is the competence of the Competition Council. Although the Bank of Lithuania does not apply directly the provisions of competition law to the banking sector, there are some common aspects between these two institutions.

22. Law on the Bank of Lithuanian states that the main goal of the Central Bank of Lithuanian is to pursue the stability of the prices. In order to implement this goal the Lithuanian Bank issues and recalls the licences to the domestic credit institutions, issues and recalls permissions to establish branches of the foreign credit institutions. Besides, the Bank of Lithuania supervises the activities of aforementioned institutions, and takes measures to insure the effectiveness of the credit system. The Bank of Lithuania implements these functions *inter alia* by deciding whether to permit the mergers of banks. Therefore, concentrations in the banking sector are reviewed both by the Competition Council and the Central Bank. The Law on Bank of Lithuania does not provide specific criteria for the merger clearance. Therefore the Lithuanian Bank has adopted the rules itself<sup>8</sup>. The rules state that the Central Bank would not allow the purchase of shares when this could affect the security and reliability of a credit bank or could endanger the effective functioning of the credit system. The Central Bank evaluates the security and reliability of the possible concentration according to the requirements, set in the Law on Banks, i.e. the requirements of capital adequacy, liquidity, maximum loan to a single borrower and other. Besides that the Central Bank

<sup>6</sup> Law on the Bank of Lithuania, 1994.12.23, No. 99 (VŽ, 2001, No.: 890), acting edition since 25.04.2006

<sup>7</sup> Law on Banks, 30.03.2004, No. IX-2085.

<sup>8</sup> Decision of the Board of Lithuanian Bank No. 144 of 26 June, 1997, "The rules of the issuing the Lithuanian Bank's permission to obtain or (and) to administer the portfolio of Commercial Bank"

evaluates if the new entity will be able to fulfill the settlements, if the new structure of the shareholders satisfies the requirements. In other words, the Bank of Lithuania assesses the possibilities of the bank to work in the financial market after concentration. The Central Bank has no special rules to assess the effect on competition in the market after the concentration. After the Central Bank issues its clearance, the Competition Council starts another review. According to the Law on Competition, the credit institutions are obliged to present the finding of the Central Bank to the Competition Council together with the notification of concentration. Hence the Competition Council, having the findings of the Central Bank, assesses in detail the impact of the notified concentration to competition. In order to do that the Competition Council performs usual steps of inquiry, that is defines the relevant markets, the aggregate turnover and determines market shares of the merging parties.

## **6. Competition law and banking**

23. Neither the Law on Banks, nor any other laws regulating the Lithuanian banking sector foresee any exemptions from the application of the Law on Competition. The said law, however, does not define any special rules for the calculation of the aggregate turnover of the merging parties. The Law on Competition only foresees the additional requirement to provide the findings of the Bank of Lithuania. According to the Law on Competition a concentration shall not be deemed to arise where commercial banks, other credit institutions, intermediaries of public trading in securities and other financial companies acquire more than  $\frac{1}{4}$  of shares in another enterprise with a view to transferring them, provided that they do not exercise voting rights in respect of those shares. Any such disposal shall take place within one year of the date of acquisition.

24. Neither the procedure for the calculation of the aggregate turnover nor any other rules make any distinction between the domestic and foreign acquirers. Therefore in this respect the application of the Law on Competition does not cause any distortive effect.

25. All things considered, a conclusion may be drawn up that the general competition rules are in all respects applicable to the banking sector save for certain insignificant exceptions provided for in the Law on Competition.