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Dr. Shlomi Parizat
Israel Antitrust Authority

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Facilitating Practices in the Israeli Retail Banking Sector

Dr. Shlomi Parizat[1]

On April 26th 2009, the Director General of the Israel Antitrust Authority exercised her authority under § 43(a)(1) of the Restrictive Trade Practices Law (Antitrust Law), and determined that information exchanges among Israel's five largest banks constituted a restrictive arrangement.[2] In particular, it was established that these practices harmed competition in the market for the provision of retail banking services to households and small businesses in Israel. This short article outlines several key findings and analyses underlying the determination.[3]

Retail banking in Israel has traditionally displayed very little competition coupled with significant levels of concentration and high entry barriers. In 1984, Bank Hapoalim, Bank Leumi, Israel Discount Bank, and Bank Mizrachi admitted to illegally colluding to fix interest rates.[4] At that time, the aforementioned banks made up 80-90 percent of the market. Little has changed since that time in terms of market structure. In 2004 Bank Hapoalim held 30.6 percent of the total assets in the banking sector in Israel, Bank Leumi held 29.8 percent, Israel Discount Bank held 16.7 percent, Bank Mizrachi held 9.7 percent and the First International Bank held 8 percent.[5] Together, the five Banks account for 94.8 percent of total assets in the banking sector and 94 percent of all branches in Israel.

Furthermore, a Parliamentary Inquiry into the banking sector held that in 2007 the Israeli banking system displayed high levels of concentration and little competition. The general view among policy makers, regulators, and industry specialists was that, as a result, banks in Israel were able to charge supra-competitive fees and commissions for banking services offered to households and small businesses. The IAA investigation focused on the way these fees and commissions were determined.

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[1] Chief Economist and Director of the Economics Department at the Israel Antitrust Authority. The views expressed here are the author's and do not necessarily represent those of the IAA.

[2] Those banks are: Bank Hapoalim, Bank Leumi, Israel Discount Bank, Bank Mizrachi, and the First International Bank [of Israel] (hereinafter: "the Banks"). §2(a) of the Restrictive Trade Practices law defines a restrictive arrangement as an arrangement entered into by persons conducting business, pursuant to which at least one of the parties restricts itself in a manner likely to prevent or reduce competition in the marketplace between it and the other parties to the arrangement, or any of them, or between it and a person not party to the arrangement.

[3] Note only the Hebrew text, available at http://archive.antitrust.gov.il/ANTItem.aspx?ID=9880, is the legally binding one.

[4] CrimC (TA) 7873/84 State of Israel v. Bank Leumi, [1986] IsrDC 5746(3) 368.

[5] The IAA started its investigation on November 2004. 2004 therefore represents the end of the relevant period under scrutiny.

It has been established that two main considerations, apart from revenue maximization, governed the process. First, the alignment of price levels with those of the competitors'. In almost all cases, fees and commissions were increased (but almost never decreased) so as to align present price levels with those charged by competing banks. The second main consideration was the relative rank held by each bank in the "banking services price index" reported monthly by the Bank of Israel. In each bank a designated "fees and commissions" expert team gathered relevant revenue information and periodically presented a recommendation to change the level and/or structure of the bank's tariff to their corresponding CEO.

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Banks in Israel are bound by regulation to publicize all charges, commissions, and fees associated with their services. As it so happens, banking tariffs are highly complex and barely decipherable documents. Indeed, bank executives themselves stated that "those tariffs can only be understood by the person who actually wrote them" and that in fact "it may well be written in Chinese." As such, the quality of information provided to consumers was low; it was difficult for consumers to understand what exactly they were paying for; and, it made the comparison of prices across competing banks quite a formidable task.

Following a comprehensive investigation, the IAA found concrete evidence that beginning in the early 1990s and up to November 2004, bank executives routinely exchanged information regarding current fees and tariffs as well as regarding future conduct concerning fees to be collected from the public. Information exchanges took place in direct phone calls conducted regularly between executive experts in the "fees and commissions" teams. In such conversations, detailed explanations were requested and received by each of the Banks as to the manner in which certain fees were structured as well as their respective levels. In addition, discounts given to particular segments of the population, the scope and extent of the segments involved as well as the rational underlying certain pricing decisions were discussed and explained.

Information exchanges among the Banks allowed them, but not their customers, to decipher the cryptic language of the tariffs. Such information was unavailable

publicly. The competitive effects associated with this ongoing practice included:

1) Reducing uncertainly regarding exact price levels, charging methods and even the business rational underlying pricing decisions which facilitated better coordination between the competing Banks;
2) Reducing the need to supply customers with clear and readily interpretable information regarding tariffs. While the Banks had access to the "true meaning" of their rival's pricing code, they could continue providing their customers with indecipherable tariffs—resulting in higher search costs for consumers, and softening inter-bank competition.
3) Given the aforementioned effects, the Banks were able (and indeed the data supports this) to almost perfectly align the total cost of a representative basket of fees and commissions (as measured and defined by the Bank of Israel). The resulting lower variance in prices negatively affects consumer incentives to "shop around" for competing banks.

Bank executives also discussed future conduct. In particular, they discussed whether the "fees and commissions" team planned to meet in the near future (which implied a probable increase in fees) and when such increases were likely to take place. The IAA has found proof that such information exchanges affected the decision-making process at competing banks.

In light of the nature of the exchanged information, the ongoing competitive shortcomings of the Israeli banking system as discussed above and the switching and search costs for consumers, the IAA found the exchange of information between the Banks constituted a restrictive arrangement according to Restrictive Trade Practices Law. These arrangements are even more troublesome considering the extended period of time over which they were practiced. It is also important to note that this decision serves as *prima facie* evidence in all legal proceedings. The decision therefore lends itself to being used by any member of the public who has been injured by such conduct.

This is the first time the Director General of the Israel Antitrust Authority has enforced an information exchange case. In her decision, DG Kan sends a clear message to both the business community and to the general public that practices whose goal is to soften, relax, or otherwise mitigate competition or act to artificially increase search or switching costs for consumers are illegal and will not be allowed to go unchecked.