



**Anti-Competitive Behaviour in the Financial Sector —
A Tool Kit for Internal Auditors**

FINAL REPORT – Executive Summary

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Executive Summary

An important aspect of the reform programmes in Malaysia has been the passage of the Competition Act (CA) (Act 712), which was gazetted on June 2010. The CA of 2010 became law on January 1 2012 in Malaysia. Despite this important achievement, to effectively advocate, implement and enforce the CA, there is a need for better understanding of the extent to which businesses conduct (or unfair trade practices) hamper competition in specific sectors, and to identify policy approaches to address anti-competitive policies and conduct. Little is known about how the Malaysian financial sectors have adjusted to the new obligations imposed by the 2010 Act. The Malaysia Competition Commission (MyCC), for one, focuses primarily on education and on the public policy side of antitrust enforcement. However, little work has been done teaching companies how to self-police. Given widespread anti-competitive behaviour among financial organisations in other countries — we believe the Malaysian financial sector could well use these results.

This study, therefore, examines the competition issues and behaviour of the Malaysian banking sectors. Secondly, the study conducts an internal audit of a medium-sized Malaysian bank to understand the competition issues and to develop a tool kit. The internal audit focuses on a wide range of issues which includes awareness of the 2010 Competition Act and principles of competition law in general; the extent of components of financial services antitrust compliance programme that might be appropriate; the practices and controls in place to respond to the risks posed by competition law; and other laws regarding financial institutions.

The findings from both the quantitative as well as qualitative analysis indicate the following. Based on the concentration ratio, market power seems to be in the hands of a few banks. Although it strengthens the financial sectors to have large banks, especially to maintain financial stability, but yet the higher market power and concentration ratio would and could normally lead to anti-competition issues. However, when the study analyses the net interest margins it suggested that Malaysian banks cannot take advantage of their market power (probably for regulatory reasons) given lower net interest margins posed by the banking sectors at large. Indeed, the first glance evidence suggests no obvious collusion or abuse of market power in Malaysian banking. Moreover, lending by one bank does not seem to "rely" on lending by another bank. More advanced analysis fails to provide evidence of any obvious anti-competitive behaviour among Malaysia's banks. However, in terms of ownership e.g. politically connected and family owned, given the ownership and control structure of Malaysia's banks, it is likely that this will lead to anti-competitive behaviour. Financial conglomeration and cross-institutional control of Malaysia's financial institutions by the government and families likely reduces actual competition in Malaysia's financial services. The data strongly suggest that government and family "insider" ownership and control provide strong incentives for banks to engage in anti-competitive capital allocation (and/or favourable pricing behaviour). Extensive government (and family) control of Malaysian banks provides strong incentives to use such banks to act anti-competitively. It is important that Bank Negara and the Malaysian Competition Commission to advocate and education the banking sectors about the anti-competition issues within the banking system.

In addition, evidence from the case study, shows that banking sectors lack the knowledge about competition issues and laws. Indeed, the lack of monitoring and compliance efforts would likely to promote anti-competitive behaviour in the future. More often self-regulatory is missing within the sector and the banking sectors, mostly relied and received directives from the central bank, Bank Negara.

As a result, it is recommended that MYCC to work closely with Bank Negara on issues of competition given that in Malaysia the banking sectors receive directives from Bank Negara. It is also essential that the banking sectors engage itself in self-assessment with regards to compliance to competition regulation and identify risks of anticompetitive behaviour. For this more effort is needed, especially in educating the sectors to be more vigilant.

The report also highlighted the general and specific recommendations. As general recommendations, Bank Negara in collaboration with MYCC should involve in the

- Provisions Governing Surveillance and Investigation
- Cooperation on the Application of Antitrust Remedies
- Dealing with potentially anticompetitive rulemaking

- Dealing with potentially harmful effects of competition policy on banking stability
- Dealing with anti-trust oversight of self-regulating organisations
- Foreign cooperation in antitrust issues

MYCC and Bank Negara should also consider undertaking the following exercise:

1. Assessing if there is any crowding out of investment in the banking sectors due to the active participations of the GLCs.

2. Conducting a thorough analysis of Malaysia's existing financial laws and regulations in order to identify areas that requires changes
3. Disseminating information on anti-competitive behaviour.
4. Implementing competition compliance programmes.
5. Promoting greater competition in the Malaysian banking sector by creating a level playing field and allowing the banks to compete for customers and business (without jeopardising the financial stability). It means increasing transparency and making it easier to switch and reduce barriers to growth and new entrants.

Specifically, the banks with the assistance of MYCC should:

- Revise and post in internal, public spaces about the Dos and Don'ts of Competition
- Invite external and/or internal lawyers to give a 30 minute lunch speech about the Competition Act
- Sign up for competition law email news service especially by the Compliance Director and Risk Management Director
- Involve in internal audit to assess whether competition law-related compliance audits needed during each year's preparation of the annual audit plan
- Open a hotline for customer complaints

As a whole, financial system regulation regime in Malaysia needs to be designed to balance the goals of stability, competition, efficiency, market integrity and consumer protection. Indeed, efforts to be consistent with international best practice in some areas can be promoted. The tool kit established in this report can be used as a guide to monitor the quality of compliance to competition regulation.