GAZDASÁGI
VERSENYHIVATAL

The amendment of the law will result in increased competition of banks for consumers

On 23 March 2009 the Parliament adopted a law amendment that will limit the possibilities of banks unilaterally to change their contracts with consumers. According to the Gazdasági Versenyhivatal (GVH – the Hungarian competition authority), contrary to the opinion of the Banking Association, the changes will generate enhanced competition between banks, consequently the granting of loans will not slow down and loans will not become more expensive either.

In February 2007 the GVH initiated an inquiry into the sector of bank services due to some implications since market processes suggested that in the case of certain bank services – in the field of retail banking and bank services for small enterprises – bank switching was extremely rare or this switch caused high costs to consumers and this could lead to distortion or restriction of competition. Even prior to the initiation of the sector inquiry the GVH suspected that the information asymmetry favouring the banks could allow retaining consumers in loan constructions which otherwise became disadvantageous for them and that banks – exploiting this favourable situation – banks could enjoy advantages which they could not on an appropriately functioning competitive market. Due to this captured situation of consumers competition could appreciably weaken what is harmful to customers.

The conclusions of the sector inquiry, which was closed in December 2008, justified the suspicions of the GVH. It has been found that due to the difficulties of bank switching on loan markets – which can be characterised by long-term contractual relations - there is an asymmetry favouring the service providers. On loan markets the GVH identified four factors which distort competition. To resolve the problems, the GVH has made several proposals.

1. **Current practice of unilaterally changing contracts**

   The current practice does not provide appropriate possibility fo customers to react on the merits to changes introduced by the banks, which are otherwise unacceptable to them. To eliminate this phenomenon the GVH initiated the elaboration of a regulation which allows the unilateral changing of the contracts by the banks only if that the changing could be objectively justified and it can be deemed to be an external necessity from the point of view of bank operation.

2. **Costs of bank switching**

   In the GVH's view, bank switching on loan markets involves considerable costs. The charges of bank switching are extremely high, their minimum extent could be as high as 4-10 percent of the loan present value in the case of the loan products examined in the sector inquiry. Therefore, in accordance with European regulatory initiations, or by extending those initiations to some extent, the GVH suggested the maximizing of one of the most considerable cost elements, namely the early repayment charges.

3. **Comparable prices:**

The prices of bank services can be hardly compared, which makes the evaluation of banks' behaviour difficult for customers. Therefore the GVH initiated the setting up of an independent and controllable website which could make product comparison possible.

4. **Lack of portability of subsidized loans**

This rule further increase contractual asymmetry favouring loan providers, since in the case of a possible decision about the re-financing of a loan, customers also have to reckon with the losing of the subsidy. In order to reinforce customers' position in these contractual relations, the GVH suggested subsidies to become portable.

The GVH was pleased to learn that as a result of its suggestions described above a draft bill was elaborated to resolve at least in part the problems raised (unlimited possibility for unilateral changing of contracts, price comparability, diminishing of the costs of bank switching).

The GVH is convinced that after enacting the amendment of the law there will be more lively competition in the banking sector and customers will be better off. This improvement is not hindered by the fact that mortgage loans are not covered by these new rules fostering competition.

However the GVH finds it peculiar that in its communication the Banking Association alarms that – due to the amendment of the law protecting customers' interest and favouring competition – consumers could get loans under more difficulties and they would need to pay more for the loans. (The GVH today sent a letter to the Banking Association requesting the Association not to misinterpret the new rules).

Current practice shows that prices are formed on demand-driven markets where not exclusively the real costs but also the willingness of consumers to pay play decisive roles. Analyses of the GVH show that Hungarian net interest margins are rather high in regional (Czech, Slovak, Polish) comparison. On this basis, as a consequence of the amendment of the law, a considerable price increase cannot be expected, especially if consumers make use of the possibility of bank switching, as a result of which the costs of bank switching will decrease (since, in the case of an unfavourable change of the contract, customers can exit without any cost consequences). This may have a preventive effect on banks. Should prices nevertheless increase, this would primarily be the sign of risks of macroeconomic nature – contrary to the argumentation of the Banking Association. At the same time, a general price increase tendency may signal to the competition authority that market participants are engaged in practices restricting competition what is prohibited under competition law.

As a result of the law amendment loan products with variable interest rate will probably also be available. As a consequence of the current regulation and practice such products do not exist in Hungary, since so far loans have been provided with adjustable rather than variable interest rates. A direct consequence of this situation for consumers is that banks immediately pass any disadvantageous change on to them, but they did not pass or pass only in part any favourable change on to consumers and with a considerable delay only. According to the new regulation the modifying of the repayment instalments bound to a pre-defined reference interest rate will not qualify as a changing of the contract. If a loan-taker intends to bear the risks resulting from the changes of external circumstances and instabilities of the economy as he hopes he can get better conditions over the life of the loan, he will be able to do it by choosing a better controllable, variable interest rate. Markets are expected to shape solutions (e.g. in the area of bank deposits such a product has already appeared), but it remains a task of regulators to prevent an environment from being created which could block the introduction of such products.

In the GVH's opinion the enactment of the law amendment is a big step towards generating competition in the banking sector as well as improving the efficiency of the sector and increasing consumer welfare. The GVH believes that the realization of the two further suggestions that it made in the report about its sector inquiry may result in further steps in the direction of the accomplishment of competition.

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