



European Banking Consolidation: Can a view to the past inform current policy efforts?

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This paper begins with an overview of the historical parallels between German and US bank expansion efforts from the 1970s to date. It then moves on to examine some of the many practical and regulatory challenges for pan-European banking. It may surprise readers younger than retirement age that the lumbering large German domestic banks of today were once at the forefront of pan-European banking while the largest US international banks were restricted to territories as small as counties, with no hopes of covering even a US State, let alone the country from ocean to ocean. The paper moves on to suggest that pan-European banking will likely be a pipe dream until a vast array of current limitations, particularly idiosyncratic creditor protections, are tackled. Finally, the paper asks if the increased use of (financial) technology will be the catalyst for European (particularly German) banking to mimic the US consolidation of the late twentieth century.

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Part I – Perspective

The lust of eurozone commercial bankers for a single financial market of a size and scope to rival that in the US is palpable, but unlikely to be satisfied anytime soon. Even as they envy JPMorgan's market capitalisation and global clout, many are retreating further behind national borders – and that is often the correct step for now. But there was a time when things were different. Given the ongoing speculation about the futures of Commerzbank and Deutsche Bank, it is worth looking back to when US banks cast an envious eye on Europe. Once, before the introduction of the euro, European banks had size on their side.

Germany has long been the biggest economy in Europe. In 1970, its GDP was \$215bn and France, its next-largest neighbour, had a GDP of \$148bn (all figures from the World Bank and in current dollars). In the 1970s, what is now the European Union area had a GDP at least on a par with that of the US, depending on how the figures are translated into today's dollars, and Germany's Commerzbank had ambitions of becoming a truly pan-European bank.

In the US in 1970, things looked more provincial. Banks such as Citi (First National City Bank) and JPMorgan Chase (Chemical Bank & Manufacturers Hanover Trust) were limited to having branch offices in New York City and adjacent counties. They could not even have retail branches for weekenders on eastern Long Island, let alone in Chicago.

Commerzbank, however, formed Europartners Bank, a group including Crédit Lyonnais (France), Banco di Roma (Italy), and later Banco Hispano Americano (Spain). Those three countries represented both a large chunk of European GDP and a big slice of the non-communist map of Europe. While Commerzbank was forging a cross-border European bank, the US banks had “correspondents” in “domestic” geographies – yes, that means in the same country. Interstate banking was largely prohibited by the 1927 McFadden Act.

The competitive zest of Commerzbank may surprise those who associate German banks with the joke made by Mario Monti, when he was the EU commissioner responsible for competition, that the only two German words he knew were *Gewährträgerhaftung* and *Anstaltslast* – two forms of state guarantees for German public sector banks that he saw abolished in 2002 (and that did not apply to Commerzbank before its bail-out).

No range at home

In 1970, it was US banks that felt the need for a more market-based approach. They wanted to consolidate but even domestic efforts along the lines of Europartners were inconceivable. Bizarrely, US banks were able to carry out certain business functions outside the country that they were barred from offering inside. I worked for the Manufacturers Hanover Trust Company of New York (MHT), which owned a subsidiary in London that could underwrite corporate bonds – a business activity that was a strict “no” in the US under the Glass-Steagall Act, then still in force.

Having one leg in London to do business like that was commonplace for large US banks as their home retail growth was so restricted. While Glass-Steagall wasn't the catalyst for the creation of Eurodollars or Eurobonds, the way in which it spurred US commercial banks to develop underwriting capability in London was certainly central to the re-emergence of the City of London as a global financial centre. In general, European financial regulations were much less restrictive.

In the 1970s, retail banking had largely been consolidated in France and in the UK. Building society demutualisation in the UK in the 1980s was the last big leg. Of course, US banks did make plans to acquire other banks in the US – the potential cost-efficiencies of consolidation were obvious in a largely homogenous market, as were the revenue and product opportunities. Larger customer bases not only support economies of scale, they can provide stimulus for product innovation and be a funding source to invest in such products.

Pacman makes perfect

As their move into Europe shows, US banks found plenty of temporary loopholes while they waited for regulators to allow consolidation at home. For example, “non-bank” subsidiaries – those not funded with deposits – and credit cards could be set up nationally. The compelling economics of US consolidation, and the then ugliness of Latin American economic woes, concentrated US banking minds on their domestic market. With each acquisition, banks such as the National Bank of North Carolina (now known as Bank of America after an acquisition) became better at integrating their targets, which became ever bigger. Imagine an old Pacman game. You can actually improve your M&A skills when repeated acquisitions are in similar businesses, with similar regulations and IT. As the biggest US banks got bigger, their international interests waned, but this was not the pattern for banks in Germany, Spain or Italy at the time.

It needs to be stressed that, in contrast to US bank consolidation after the 2008 crisis, which was about survivors buying the desperate, most of the US consolidation in prior decades saw relatively strong banks getting stronger, gaining customers, shedding fixed expense and adding expertise. It did not always work – and it took place at the same time as a substantial portion of the US mutual banking sector failed – but those mutuals were not rescued, they were liquidated or absorbed. In Germany, Spain and Italy, there was no drive to large-scale consolidation. Small (often very small) institutions lived on through the late 1970s to the 1990s, which meant that those markets were very fragmented. During the heady days of US consolidation, the incoming winners (i.e. Wells Fargo, Bank of America, Wachovia (now Wells), among others) focused on growing in a big, and largely homogenous, domestic market and left more splintered international business to others.

Pressing for control

With the big US players focused on their home turf in the 1970s and 1980s, the Europartners group chased international ambitions. In particular, it wanted to allow retail customers from one country to access the branches of the others. It also wanted to combine investment banking across the then European Economic Community (EEC). Remember, this was long before the euro was conceived. Its ambition had to vault over different currencies, regulations, laws (for example, on insolvency) and huge cultural challenges. At the same time, the group missed out on much of the domestic opportunities for increasing efficiency and for more manageable risk consolidation that the US banks sought. The Europartners took equity participations in each other – some as high as 10 per cent – which even then must have looked like a recipe for contagion. Who owns 10 per cent of any major national bank today? It was certainly risk-taking without control.

And control is what matters in M&A, as Europartners discovered. Although the cross-holdings were large, and in substantial banks, the much-vaunted cooperation did not seem to go much further than branding. Students might be forgiven for thinking Europartners died because of burdensome regulation or meddling politicians – today’s real or imagined bogeymen of European bank consolidation. But, although there were such barriers, it was mostly about bad banking decisions, distrust and national obstinacy at each constituent bank.

The unravelling started before they got very far. The French and German banks had a Spanish partner but were also keen on having their own offices in Spain. Could you be a partner and competitor? Many European national authorities were also not enthusiastic about foreign ownership of a major domestic bank, which must have further strained trust. Then came the scandal and bail-out that undermined *Crédit Lyonnais* in the early 1990s.

But looking abroad for growth was in style at large German banks, if only because they all faced the same problem: a highly fragmented market with many state-sponsored players. The other two big institutions – *Deutsche Bank* and *Dresdner Bank* – took a different tack to *Commerzbank*. They went on buying sprees well beyond their expertise or principal domicile and they often bought perceived second-tier overseas businesses in which they had limited background and that they stood little chance of integrating well. *Deutsche Bank*'s London investment bank was built off a £950m (£2.5bn today) purchase of a weakened *Morgan Grenfell* in 1989. *Morgan Grenfell* had already sold off its securities trading business, leaving no overlap between the two banks, which was expected to make them “an excellent fit”. *Deutsche*'s US investment bank was largely built on the \$9.2bn (\$16bn today) purchase of a former US custodial or “trust” bank that had been trying to become an investment bank – *Bankers Trust* – in 1998. At the time, it was the largest-ever acquisition of a US bank by a foreign firm and *Bankers Trust* was available partly because of a scandal around interest-rate derivatives in 1994.

To be fair, US banks also bought second-tier banks overseas with limited success, but those acquisitions were toes in the water in comparison with *Deutsche*'s deals. US domestic consolidation also brought benefits that eluded European banks. In 1996, for example, *Chemical Bank* bought *Chase* for \$10bn, but it expected to reduce costs by \$1.5bn per annum and shed almost 15 per cent of staff, while retaining the combined customer/revenue base. *Deutsche*'s deals offered none of the above. Instead they generated a legacy of high costs that has haunted *Deutsche*'s wholesale business for decades.

Deutsche's neighbour in Frankfurt, *Dresdner Bank*, suffered a similar fate. In 2000, when it was Germany's third-biggest bank, it bought London's *Kleinwort Benson* and New York's *Wasserstein Perella (WP)*. *WP* cost \$1.4bn (\$4bn today) and was a 600-person advisory “boutique”. Its assets were its people but *Bruce Wasserstein*, the big gun at the firm, left in 2002.

Start klein

What does the future hold for German banking M&A and for big German banks? There has to be domestic consolidation to create a more efficient system, but not at the top. It has to come at the bottom. A merger of *Commerzbank* and *Deutsche Bank* – Germany's two largest international banks, which was discussed, and then rejected in 2019, – might reduce costs if it could be managed, but it would also reduce international skills¹ rather than boost systemic efficiency. Such a merger would also likely bring together similar domestic risk portfolios increasing systemic risk.

Good banking M&A would mean consolidation among Germany's multitude of mutual and public providers. That holds the promise of reducing overheads and redirecting funds for expanded services, but it will not happen

¹ International banking skills may sound esoteric, however, these are fundamental to internationally growing business seeking global capital and access. A short walk around the City of London reveals the reduced German banking presence compared to two decades past; there are the shrinking footprints of *Deutsche Bank* and *Commerzbank*, the substantially reduced activities of the surviving *landesbanks*, and minor representations from private banks and the collective vehicles of the public and cooperative banks. A combination of *Commerz* and *Deutsche* would seem certain to have fewer international specialists than resident today in London, with a likely similar effect in Germany.

without incentives and legal facilitation. Demutualisation could be a start, but mutuals might also lead with capital innovation.

The digital age will erode the economics of small banks in Germany and reduce the cultural differences in consumer banking across Europe. It is also likely to make the Europartners' ambition a reality. But, in the near to medium term, most of the eurozone banking challenge is still about building stronger, more product-diversified and skilled domestic banks. Only then can European banks think about uniting for the transatlantic challenge they clamour for.

Eurozone regulators will have to grapple with a changed "too big to fail" challenge, but one that is inevitable in each jurisdiction before any big European bank can become pan-European.

Part II - What is Pan-European?

The Europartners project was an ambitious attempt to bring together banks across the then EEC, but could it have ever become a pan-European bank? What, after all, is a pan-European bank? Hindsight gives a bleak view of many of the challenges that may or may not have been contemplated at the time by the Europartners: competing regulators, business practices and business models. At its best, Europartners might have achieved some efficiency with a common marketing platform (common logo) and perhaps cross-introduction (versus cross-selling) opportunities across the Europartners banks. Real pan-European banking – moving assets or liabilities among the Europartners – was a long way off. They never went any further than sharing minority equity holdings. They never reached the point, or perhaps never intended to, of offering cross-border services. Perhaps such services were anticipated, but the business never progressed to a stage where the future strategy was clear.

Of course, most large EU banks, then and now, have offices in other EU countries. These may support wholesale activities, serve as representatives, or house a locally focused business. Regulators have traditionally preferred non-resident banks to open local operating subsidiaries for retail and SME banking. They are more accepting of branching for wholesale activities. The EU allows banks passporting rights, which technically limits the requirement for subsidiarisation. However, in practice, cross-border retail activities are overwhelming undertaken through subsidiaries. Regulators have a clearer control position when they are the "home" regulator, which is the case with a subsidiary. If, in contrast, they are "host" to a foreign branch they are potentially just an onlooker should resolution become necessary. Regulatory preference for control, and the historical backdrop, mean that a bank operating in various EU countries is a collection of local subsidiaries and not a pan-European bank. Indeed, those who have had long careers in banks often speak of capital resources and funding being trapped in subsidiary banks. That, of course, is just the way regulators like it – it should reduce demand for lending of last resort – but it also means that the capital is not available for business opportunities beyond the subsidiary jurisdiction.

It is clear, then, that the concept of pan-European banking must include an ability to move capital and funding resources between EU nations without friction. Yet, that seems only half the answer. Facilitating the application of funds (e.g. consumer and business lending) between EU nations without friction must also be part of the equation.

Recently (November 2019), Olaf Scholz, the German Federal Finance Minister, expressed his personal views on enabling European banking union in the *Financial Times*². He did not provide a definition of banking union, but he wrote about a number of steps that he believed would lead to it. This paper assumes that banking union means pan-European banking. Mr Scholz discussed support for a form of common deposit insurance, using the U.S. Federal Deposit Insurance Corporation (FDIC) as an example of how it might be implemented, and called for a cross-border, common bank resolution regime. Both suggestions would certainly facilitate the cross-border movement of funds in the EU. For example, they might mean that a German citizen would, hypothetically, find that the risk of investing in a bank in Italy or in Germany was the same. However, Mr Scholz's suggestion is for a multi-layered approach to deposit insurance that would still mean sand in the gears. For example, if the Italian bank failed a German depositor would likely face a more complex and time delayed process to retrieve their money than an Italian depositor would or certainly the German depositor in a German bank.

Still, Mr Scholz's proposal is a large step in the direction of encouraging cross-border deposit movement in the EU. However, does moving deposits cross border make banking pan-European? A common deposit insurance scheme, in theory, allows depositors a wider (cross-border) opportunity to find a higher rate of interest. They would, presumably, end up turning to the foreign banks that have better lending opportunities than the banks in their home country. Thus, deposit insurance would allow the liability side of a bank balance sheet (i.e. deposits, debt, and equity) to be more pan-European. What, though, about the asset side of the balance sheet – i.e. lending cross-border?

Half way – just a liability

For true pan-European banking to develop, banks also need to cross national borders with the asset sides of their balance sheets. The Scholz proposal, on its own, would likely benefit banks with relatively high funding costs. Those tend to be banks with high levels of non-performing loans and/or those that are based in less dynamic economies. So, the proposed insurance scheme could provide an Italian bank with lower-cost funding because it reduces depositor risk compared to the stand-alone Italian national scheme. Should banks lack deposit funding in Italy, such funding might also facilitate new lending and economic growth. However, claiming that deposit insurance could make the bank loan market in Italy more competitive is to stretch the arguments in favour of deposit insurance to the snapping point. Access to cross-border funding in no way implies new competition into the market. It does not mean that new competitor banks will necessarily be founded in Italy.

There is, however, another element that could drive greater bank competition and productivity. Imagine a mid-sized business in Alsace, France, on the west side of the Rhine. The owner visits her local French banks with a view to borrowing to fund a new manufacturing facility. She then crosses the Rhine into Baden, Germany and, meeting a supplier, finds out that loan terms are much easier on the east side of the Rhine. What is the likelihood of her sourcing a loan from the German banker across the river? The economics for the German bank may be strong. Perhaps it raises deposits at a lower cost? Perhaps it has insufficient loan demand locally? The potential French borrower's business might even be visible through the German banker's window – but, as things stand, the loan would not be forthcoming. Why not? It could be culture, national distrust, taxes, or tradition, but let us think of banking basics like loan collateral.

² Scholz O (2019), 'Germany will consider EU-wide bank deposit reinsurance'. *Financial Times*, 5 November 2019. www.ft.com/content/8ea7e002-ffce-11e9-b7bc-f3fa4e77dd47

Truly Pan-European – Another U.S. Example?

In the early-1980s, I led a loan sales business based in New York. These were the beginnings of securitisation, but, of course, we couldn't know that in advance and our purpose was largely boosting bank liquidity.

Our business got off the ground selling packages of car loans. Compared to today's vast array of securitisations of heterogeneous loan pools, those early car loans were very plain vanilla. Perhaps all two-year or three-year maturities, all with monthly payments, all collateralised by new cars, etc. Yet, as we assembled these from banks and manufacturers, we noticed some peculiar absences – particularly along U.S. state lines. For example: no loans from the State of Louisiana or the State of Utah. When I asked why, I was told creditor law was different in Louisiana – it used civil law, thanks to its French history while other U.S. states used common law derived from English precedents. When I asked about Utah one lender told me they believed that Utah courts would not support out of state creditors' rights to the same degree as in-state creditors, thus risking subordination to local creditors. Eventually, these issues were rectified. However, they made me wonder how creditors' rights could be enforced across any state lines in the U.S. if creditor laws were by state. How did small business and retail lending across the U.S. evolve?

The federal basis of the U.S. divides legal authority between the national government and the states. More specifically, it provides the national government with responsibility for interstate activity, but most commercial law developed early on within each U.S. state in a world that was much more locally themed. This lack of uniformity was perceived as a hindrance to finance as early as the late 19th century. The National Conference of Commissioners on Uniform State Laws was set up in 1892. In 1940 it set out to consider a common code for certain commercial laws to be enacted by the U.S. states. It is important to note that these commissioners were not government officials, though largely appointed by state governors, but interested members of the legal profession. It was a private effort focused on commercial benefits and was supported by local banking interests. (See Schnader (1967) for a review of the these efforts³.)

By 1950, the Commissioners had arrived at a recommended uniform commercial code (UCC) for the states to adopt. It took three more years to agree (or drop) a number of sections. Pennsylvania was the first state to adopt the Code into law, in 1953. Other states followed, but New York, perhaps the most significant commercial state at the time, enacted the Code in 1962. It took until in 1968 for all states (except Louisiana) to enact the Code into law. Yet, this was not a blanket approval. Schnader notes approximately 775⁴ non-uniform amendments with almost half of these related to "secured transactions". Collateral rights are critical to lenders operating across jurisdictions.

A key part of the UCC became the filing of a UCC-1. The UCC-1 is a legal form that a creditor submits to give notice that it has an interest in the property of a debtor. It is not a unique concept and most countries would be expected to have an equivalent. The significant point about the UCC-1 is that it became a standard and that a large number of states had to agree to change their laws to reach that standard.

I raise this discussion because the UCC was fundamental to the practical delivery of financial services across state lines. It meant that a California-based bank could as easily understand its collateral position on a car loan

³ Schnader W A (1967), 'A Short History of the Preparation and Enactment of the Uniform Commercial Code'. University of Miami Law Review, 22 (1), 1-12. <https://repository.law.miami.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=3027&context=umlr>

⁴ Ibid, p.10

extended in Florida as on one extended at home in California. The UCC made US 'cross-border' loans possible. Just as importantly, such legal standardisation also facilitated cross-country banking consolidation in the U.S. The UCC was not agreed on overnight, and nor was US banking consolidation, but agreement was found. Consider the parallel of a bank in France extending a car loan in Italy, or a German local bank extended a business loan across the Rhine: how much legal certainty do they have? What would it take to get there?

The facilitation of credit provision across US state boundaries benefitted businesses seeking debt financing. More providers meant more competition which might have been expected to bring enhanced provision of credit, service and price efficiency. Certainly, a welcome strategy for banks seeking efficiencies through pan-European banking would be to consider mobilising businesses and national chambers of commerce to drive creditor right standardisation throughout Europe.

What about Regulation?

The European Central Bank directly supervises 119 'significant' banks (at the time of writing), with an estimated 6,000 banks operating across the EU⁵. As Mr Scholz has suggested consideration of the U.S. FDIC model, it is important to note that the FDIC is as much a regulator and supervisor as it is a provider of deposit insurance. By number, most EU banks are obviously not supervised by the ECB. In many ways, this parallels the multiple regulator system of the 4,800 (est. 2019) banks in the U.S. However, in the U.S. the FDIC effectively dually supervises (with federal and/or state regulators) and more actively manages failures than other regulators. The FDIC system certainly works to facilitate banks in the State of Idaho accessing deposit funding from residents of New York. As a side note, prudential supervisors in the U.S. have historically monitored cross-state funding of banks as a warning indicator (for a range of problems from excess risk taking to liquidity challenges). So, if the EU moved ahead with pan-European deposit insurance would it then require a vastly increased regulatory effort? How long would that take to construct, staff, and train?

If a body analogous to that of the FDIC were established in the EU, it would have major political ramifications. At present, the EU relies on the Single Resolution Board (SRB) to deal with the largest bank resolutions. The 119 banks directly supervised by the ECB are largely 'too big to fail' banks. Following EU capital requirements directives (CRDs), such large banks are subject to recovery and resolution procedures, with the likely result of restructured capitalisations or mergers with other financial institutions (e.g. Banco Popular of Spain⁶) should one fail.

The FDIC takes a very different approach. Typically there is direct movement to the resolution or liquidation of a failing bank. Its assets and liabilities are sold with the FDIC attempting to maximise value (or reduce the cost of its insurance payments). Communities in the U.S. have long experience of such FDIC resolution, but how might a German, French or Italian community view the closure of its bank – especially if the money saved will go to a central EU pot? Further, the management of small European financial institutions can be highly politicised. In Germany, for example, many savings banks are chaired by elected politicians.⁷ Then, there are issues around the management of an EU FDIC itself. Would its employees include all EU nationalities? Large banks in the EU are

⁵ Author's note: I recognise that hundreds of banks in Germany are part of cross guarantees, while hundreds of banks in France are part of large groups. However, there remain thousands of small banks in the EU.

⁶ Single Resolution Board, Banco Popular, 7 June 2017, European Union website. <https://srb.europa.eu/en/content/banco-popular>

⁷ Markgraf J, Véron N (2018), 'Germany's savings banks: uniquely intertwined with local politics'. Bruegel, 18 July: <https://bruegel.org/2018/07/germanys-savings-banks-uniquely-intertwined-with-local-politics/>

used to joint national and ECB oversight, but how might those 2-4,000 smaller banks react to a new ‘foreign’ regulator? How might disagreements be resolved between the EU supervisor and a national supervisor when it comes to banks that only operate on a local level?

Capital Markets Union Lessons for Pan-European Bankers

A recent SUERF Policy Note (Issue No 103)⁸ highlights the growth of non-bank financial assets in the euro area as a positive trend toward Capital Markets Union (CMU) – and specifically the growth in non-bank investors and EU investments over the past decade. That growth certainly suggests progress in the Capital Markets Union Action Plan launched in 2015. However, a European corporate bond market may still be some way off. The Association for Financial Markets in Europe (AFME) in October 2019⁹ cited the U.S. Federal Reserve statistics that U.S. bank lending is stable at 30% of total lending to non-financial corporations. The equivalent figure in the EU is 86%. AFME adds that there are different bases for calculation,¹⁰ but the *Financial Times* was more forthright in an article dated 4th November 2019: “Can the EU’s failed Capital Markets Union be revived?”.¹¹ It pointed out that the EU’s effort at building capital markets is turning into more of a savings or investment union.

On the surface, the SUERF Note, AFME and *Financial Times* may seem to contradict each other. However, they note a movement of funds to non-banks (i.e. funds), which do not appear to be boosting lending to businesses. This seems to bolster the argument about an EU deposit guarantee easing cross-border investment collection, but not facilitating asset generation (i.e. cross-border lending).

That lack of cross-border lending –lacking because the legislation, regulation, and perhaps culture, to support it are lacking – shows why true pan-European banking will struggle unless all forms of capital can move freely. Focusing on the liability side (i.e. deposits/funding) of banking union and missing the need for work on the asset side (i.e. cross-border lending), will hobble competitive banks and prop up the laggards.

The Hidden Benefits - Diversification & Discipline

Pan-European banking holds the promise of freer capital flows and of more efficient banking that could boost the EU economy. Perhaps the greatest benefits that it could offer are more diversified risk and economic portfolios (i.e. capital that is currently employed only locally or domestically moving to more productive opportunities). After all, in general terms, the more local the bank the more pressure may be exerted to extend forbearance beyond reason. More arms-length risk decisions should improve overall EU economic performance. This is a discipline worth having and should reduce the number of ‘zombie’ non-performing loans – as well as the number of zombie banks and companies. Even looking across local borders should help banks gain risk perspective on their home territories. Local, and sometimes national, banks can suffer from a type of risk myopia by design; extending their territorial reach may sharpen their home perspective.

⁸ Pires F (2019), ‘Non-banks in the EU: ensuring a smooth transition to a Capital Markets Union’. *SUERF Policy Note*, 103 https://www.suerf.org/docx/f_8f4d94fa779cb6b74225a9e26c700a39_8061_suerf.pdf

⁹ Association for Financial Markets in Europe, Capital Markets Union: Key Performance Indicators, Second Edition, website <https://www.afme.eu/reports/publications/details/Capital-Markets-Union--Key-Performance-Indicators-Second-Edition>

¹⁰ Ibid, p. 60.

¹¹ Jenkins P (2019), ‘Can the EU’s failed Capital Markets Union be revived?’. *Financial Times*, 4 November. <https://www.ft.com/content/d7140246-fc07-11e9-a354-36acbbb0d9b6>

The Hidden Drivers – Demographics & Data

One of the easiest routes to dismissing pan-European banking as unworkable is to point out the cultural differences. Attitudes toward borrowing and savings, pricing structures and product mix are certainly different from country to country in Europe. Banks began locally and as they grew nationally, and even internationally, carried much of their founding culture with them. The key word here is 'grew'. Even smaller, local banks have grown with their economies. With an increasing focus on sustainability, changes in demographics, and ongoing low interest rates, pressures on traditional measures of growth are certain. This has huge implications for both mortgage/housing finance and business lending.

A decreased birthrate implies a long-term decrease in the demand for housing – though that burden is certain to be unequal. A lack of long-term population growth holds many other challenges for banking. Will there be fewer new businesses? Or, perhaps the greater reliance on technology that comes with a smaller workforce will mean fewer businesses with tangible assets that can be used as typical bank collateral. Think fewer mortgage loans and fewer business loans. An aging population, already housed, creates more imbalance toward saving over borrowing. These challenges make more flexible banking models imperative.

But banks of the future will not only have to be flexible. They will also need scale. And, they will need to rethink their concepts of service. The use of 'financial services' as a combining noun for banks, insurance companies, and asset managers took off in the 1990s. At the time, most financial services firms earned their profits through basic intermediary services. Yet, it was also a time of payments mastery and of the growing importance of moving money around more quickly, more safely and in exponentially increasing volumes. Today, banks are moving rapidly down the path of being data managers.

In a world of advancing payments technology and electronic money, banks will collect, analyse and secure ever greater volumes of customer data. For banks, this is about more than decisions on how to use the data. The cost of receiving that data, of managing storage, of compliance, legal reporting and other critical issues, will continue to rise. Regulation is only going to raise the bar for operational risks and controls. The role of the Chief Data Officer did not exist a decade ago: today it is critical. An EU money laundering regime or regulator will likely soon set new standards for information gathering. More data requires more technology and expertise and the cost of those must be offset by a revenue stream. The bank with a limited business model will have data costs, but is unlikely to be able to invest enough to make good use of the data. Just as importantly, that same small bank will be in competition with institutions that can gather, or purchase, data from many different sources. That means it is unlikely to have enough data to underpin a competitive business model. In future, lack of access to data will be just as crippling as lack of access to funding.

Yet, it is the use of all that data that will be the opportunity of the future for banks. Internet access to vast information disintermediates intermediaries. Banks will be no different and pressure on intermediation profits will only accelerate. Banks will need to provide a greater service than simple savings and lending by making use of their data. Amalgamation and pan-European banking will result from the bank data model. Many of the EU's thousands of banks may be some way off from appreciating this trajectory, but it is accelerating. Soon banks will be able to use our data to improve financial, and perhaps many other major life decisions, for individuals and businesses.

Coming back to demographics: anecdotal evidence suggests different rates of adoption of eBanking in different countries and the EU 27 will be no exception to that. However, technology adoption rates are largely a function of age. As the EU population ages, the usage of local physical offices (i.e. branches) seems almost certain to decline

in favour of eBanking. In a world where banking is increasingly online, I wonder how we will even define a local or national bank. And I wonder how clearly this issue is perceived in banks. It could be, of course, that some firms will be able to use data such as mobile location, or details of social networks, to provide 'local' services. However, that presumes access to that data.

Conclusions

Germany's banks were leaders in pan-European expansion a half-century ago and, sadly, their misfortunes have led them to be leaders in national retrenchment today. This is an experience shared by other nations' banks, too. Perhaps they were overly ambitious in ignoring so many hurdles, both those that were there from the start and arose along the way? Some of those hurdles have yet to be overcome, but pan-European banking is now firmly on the agenda. As things stand, the discussion about the way forward is largely focused on liability side remedies like deposit insurance and insolvency regimes. I suggest the debate also needs to focus on the asset side (i.e. EU common creditor protections) and culture.

European banking will become a cross-border activity. It has to because banking is becoming a data management and personalised service industry without borders. If banks are not able to provide data-led service, it seems almost certain that a data-led industry will do so and provide basic banking services, too. Cross state creditor laws facilitated US bank consolidation in the late 20th century. As US banks crossed state lines, businesses encountered new and better capitalised providers of banking services. Data and technology costs seem likely to accelerate the consolidation of US banking in the 21st; small banks are almost certain to lose financial viability in the data and technology evolution sweeping the US and Europe. European governments, businesses and regulators should consider all efforts to facilitate consolidation – focusing on both sides of the balance sheet is worthy of consideration.

The way forward is binary: we are headed towards a pan-European banking industry or no European banking industry at all. In the latter case, banking services would be just another part of the service offers on a data platform. I hope European banking can rally its customer base to encourage or facilitate pan-European banking.

About the author

Peter Hahn is Dean and Henry Grunfeld Professor of Banking at The London Institute of Banking & Finance. Dr Hahn was Senior/Special Advisor to banking supervision at the Bank of England and the UK Financial Services Authority from 2009-2014 and had a substantial career in commercial and investment banking prior to re-joining academia in 2004. His banking career began at a retail branch of the Société Générale in France in 1980 then moved to the US working in a variety of wholesale banking roles for Manufacturers Hanover Trust (now JPMorganChase) and Kidder, Peabody (now UBS) and then moved to London where he was Senior Corporate Finance Officer for the UK and a Managing Director at Citigroup until 2003. Prof Hahn lectures on strategy for financial institutions and has advised a variety of domestic and international institutions and governments on banking strategies. He is a member of the oversight body of the Association of Corporate Treasurers.

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