Cross-border bank mergers in Europe: not such a grand idea

SCOPE Scope Insights

Cross-border bank M&A in Europe remains a much-needed missing link for many in the market and for regulators, despite banks' understandable reluctance to proceed. The outlook of sub-par profitability – very likely for this year and beyond – keeps the syren song of M&A alive. Many see transformational cross-border consolidation as the panacea to cut costs, improve earnings, and achieve much-desired deeper financial market integration.

And yet Europe's large banks are not taking the bait, not even within the euro area (EA). And who can blame them? Top bank executives remain grounded in caution, suggesting that transformational cross-border bank mergers will not take off in scale any time soon. Which does not mean that such deals will never occur, especially now, with a supervisory level playing field across the EA finally in place (even if more fine-tuning is still needed).

Two essential questions are:

1. Beyond the regulatory aspects and improved efficiency arguments, does cross-border "analog" (read legacy) bank M&A still make sense in the age of mobile technology, open digital platforms, and changing customer habits in accessing financial services?
2. Are EU regulators and policymakers convinced that if a cross-border group gets into trouble, the national government of the financially healthier member of the group will not again prevent it from transferring funds to the weaker member in another country (despite pan-EA level playing field regulations)?

Credit investors should take a very guarded view of any deal and its likely consequences. Besides, any bank M&A transaction should be judged on its own economic and value-creation merits, rather than part of a more trend towards general landscape restructuring

Market actors are rooting for more cross-border consolidation…

At present, there is a certain element of dullness in the European banking sector after the agitated post-crisis decade: no earth-shattering developments, either on the upside or on the downside. The announcement of one or more transformational cross-border M&A deals would spur the horses onto the racetrack, creating a new price-moving narrative and thus more business for these market actors.

Dealers and sell-side analysts are rooting for bank mergers, especially on the equity side. Ditto the financial media. A who's-merging-with-whom frenzy would start flying again with a vengeance.

Author

Sam Theodore
+44 (0)776 932 1043
s.theodore@scopeinsights.com

Media

Keith Mullin
k.mullin@scopegroup.com

Scope Insights

Suite 204
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Scope Group

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

www.scopegroup.com

Bloomberg: SCOP

This report is published by Scope Insights, a Scope Group subsidiary which is separate from Scope Ratings. The content is an independent view not related to Scope's credit ratings.

… and so are EA supervisors (for different reasons)

Top ECB supervisors rightly believe that more EA cross-border bank consolidation would lead to a deeper integration of the sector, which is a sine qua non for a true single market. And they are also right to point out that, as far as they are concerned, there is a supervisory level playing field across the EA. Some national discretions persist, but they could be addressed through some additional steps.

The regulators' thinking – not only the ECB but also the IMF and the EBA – is that true pan-EA champions would lead to more efficiency and stronger profitability while pushing back against large, more profitable and better capitalised US groups. While they don't explicitly say so, EA supervisors plausibly (from their perspective) feel that their role, as first pillar of the Banking Union, would be better safeguarded against national interference if they had more pan-EA groups under their jurisdiction.

EA cross-border banking is targeting specific regions and business lines

Arguably, there are only two true large cross-border banking groups in the EA: UniCredit and BNP Paribas – both with dominant presence in their home markets but also in other large EA markets (Germany/Austria, and Italy/Belgium, respectively). A third one, ING, has an extensive pan-European presence mostly channelled through online banking.

Other than that, large Western European banks have for decades been actively pursuing cross-border activities mostly for specific geographies or business lines. Examples of the former are Central and Eastern Europe (Société Génerale, Erste, Raiffeisen Bank International, KBC, Intesa, again UniCredit, etc.), the Nordic region including the Baltics (Nordea, Swedbank, SEB, Danske), or the Iberian area (large Spanish banks into Portugal). Examples of the latter are specialised business lending/leasing, consumer and car finance, asset management etc.

German banks have retrenched to their home market, trying to address their low-profitability challenges. The large Nordic banks have not shown much interest in materially expanding further south through "analog" operations. As for the UK players, HSBC is aiming to sell its large French retail operations, probably to another French bank. And post Brexit, a mainstream expansion of any UK bank into Europe is not in anyone's playbook.

It is likely that cross-border expansion – within the EA and EMEA in general – will continue along the same direction: targeted acquisitions of specific business lines (including fintechs) and in specific geographies. As well, increasingly, as partnerships in joint digital platforms and distribution structures. Transformational cross-border M&A should remain off the map for the time being.

Why large cross-border M&A is not such a grand idea

Digital challenges: Competition in banking is now coming mostly via digital channels: fintechs, neobanks, digital platforms set up by other banks, etc. The new digital ecosystem has been driving, and in turn is being driven by changes in customer behaviour. Rather than buying or merging with the distribution infrastructure of another legacy bank in a different country, banks would be better off investing in digital capacity by buying fintechs or creating their own. In an era of digital speed and transparency, banks should think twice before buying someone else's bricks and mortar, even if the plan is to subsequently trim down the branch network and the back office. And on the evidence banks seem to be thinking precisely that.

In an era of emerging open banking, spurred by the implementation of the EU's Revised Payment Services Directive (PSD2), accessing new customers and new segments can be achieved better through open APIs and other digital distribution platforms. In fact, several banks, like ING, BBVA, DNB (and other Nordics) are doing exactly this.

Product commoditisation: Most financial products are commoditised and demand for customised high-touch products has shrunk after the crisis in both banking and asset management. Accordingly, products and services can be more easily replicated than in the past through technology, without merging with or buying another factory.

Higher efficiency: Creating larger groups is not the elixir for cutting excess capacity, especially across borders. If, say, an Italian bank bought a German bank today and then tomorrow started to slice down its branch network and back office there would probably be an unsavoury political price to pay. France is dominated by six large banks, the definition of a consolidated market. Yet significant excess capacity persists, and the French banks display sub-par cost-income ratios.

Investment vs. retail banking: In investment banking (IB) it tends to be accepted that European players need to build more muscle to compete against the US giants. But the major eight European IB firms (with the exception of Deutsche) also run and generate substantial earnings from large domestic and in some cases foreign retail and commercial banking operations: Barclays, HSBC, Credit Suisse, UBS, BNP Paribas, Societe Generale, and Credit Agricole. A cross-border merger between any of these groups, as implausible as it is, may make their IBs more efficient (though not necessarily less risky), but would add few synergies to their retail and commercial networks. The pre-crisis experience (which to all intents and purposes has not changed for the better since the crisis) showed that the retail and commercial banking businesses of cross-border groups have remained largely a national affair. Again, unlike IB.

To reach critical scales in IB, it is more likely that the large European players will start considering partnerships and joint ventures, rather than the unlikely (and undesirable) scenario of merging among themselves.

Assessing non-parametric risks in M&A: Prudential and financial metrics are relatively transparent and can be assessed with some confidence by the parties to a merger. However, new and growing areas of risk, such as misconduct/money laundering, cyber risk, and increasingly climate-change risks, are opaque and more difficult to gauge. A cautious bank should hesitate before walking into a mega-transaction without reasonable comfort about these risks vis-à-vis the merger party. This should be a growing reason to derail future combinations, especially cross-border.

Social and political backlash (especially in difficult times): At this stage, it is evident that political sensitivities to cross-border consolidation in Western Europe are heightened compared to the pre-crisis decade which saw a number of large such transactions. Creating a truly integrated pan-EA market is no doubt a lofty goal, but too much too fast may create a backlash. National populism is only one election away from political power. If a cross-border group were to run into trouble, it is doubtful that intra-group liquidity and capital transfer to the entity in need would go that smoothly, even if the supervisory framework allowed it. Local politicians could call for the protection of the national entity of such a cross-border group, regulations notwithstanding. And there is little such a group could or would do against it.

Stating the obvious, unlike the US, the EA is not a single country with one government. While there is acceptance of current EU rules and institutions for banking and financial services, including the EA's Banking Union, national governments are still very much in the driver's seat and not about to step away from it. Under a not-so-implausible scenario, the politically loaded sentence: "our relatively healthy bank which is part of a cross-border group is asked to support a troubled entity of the group from a different country" may in fact find substantial popular support.

Scope Insights GmbH

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

Disclaimer