The future of cross-border banking in a fragmented Europe

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The protracted fragmentation of retail lending markets in Europe is a multifaceted issue stemming cultural factors, regulatory barriers and economic reasons.

The cultural factors were mainly language and physical presence which are becoming less important thanks to the generalised use of technology in the relationship between borrower and lender.

The regulatory barriers remain and even grow. The most important are three: the differences in insolvency law between countries, the constrained movement of liquidity and capital across borders and the rise of additional local requirements.

As a consequence, the retail lending business at European scale is confronted with multiple challenges that banks and other financial institutions cannot overcome by themselves.

Challenges to cross-border banking

The relatively small size of many European national markets combined with the local regulatory hurdles result in a weak economic rationale for cross-border acquisitions and European-wide consolidation.

Looking backwards, the first wave of cross-border banking activity in Europe was triggered by a regulatory change, the Second Banking Coordination Directive which was adopted in 1989 and resulted in the implementation of the Single Banking Licence in 1993. In the following two decades, we witnessed many mergers and acquisitions between European banking groups. The Global Financial Crisis (GFC) of 2008 put a sudden end to the European banking integration process. Since then, bank consolidation has only been witnessed within local markets.

The conditions for a more active consolidation of the banking system across EU borders have not been created yet.

Preconditions for European bank consolidation

There are three factors that can stimulate consolidation: rising interest rates, tackling the sovereign gap and reviewing the regulatory obstacles.

The interest rate environment was not conducive to mergers and acquisitions during the low-for-long era. But this has changed with the currently higher interest rates. The increasing bank profit is generating resources that could be used by banking groups to expand their business models abroad. But having the necessary resources is not enough. The outlook of the acquisition has to convince shareholders and investors in order to be approved. Other factors have to be taken into account.

The sovereign nexus is still prevalent in the EU banking system. The lack of a common crisis management and deposit insurance framework is a major obstacle. There needs to be willingness by Member States to break the link.

The third factor is banking regulation. The EU Single Rulebook has been a step in the right direction, however as the old national discretions were being closed, new local powers were being granted to Member States, mainly in the space of macroprudential tools, which have marred the efforts for harmonisation.

Adapting to changing customer preferences and the growing fintech industry

The banking sector today is confronted with a series of concurrent trends in the customer base which are of different sorts: social, technological, economical and political.

The management of climate change related risks is a general transformational trend. Be it a preference or an obligation, the green transition is changing the priorities and business models of bank customers as well as the evaluation of the risks involved.

Technology is cross-border in nature. Fragmentation is an obstacle for technology adoption by European banks who often need to comply with different requirements in the various jurisdictions they are active. At the same time, as new players are entering the financial system, regulation should follow the principle that the same activity and risk should be subject to the same rules and the same supervision.

If we are serious about creating the conditions for bank consolidation in Europe, regulatory harmonisation with a pan-European approach and equivalent regulatory and supervisory requirements for all players are essential for banks to adapt to the current and future customer trends.