Box 11

SURVEY ON EU BANKS' PERCEPTION OF THE FUTURE EU BANKING LANDSCAPE

The assessment of the EU banking landscape over the next five to ten years critically depends on expected changes in banks' operating environment. This Box describes the results from a survey of major EU banks concerning the factors that EU banks considered to be of higher importance in shaping their business environment over this time period, and then outlines the main challenges that they identified.

The survey was conducted simultaneously through February and March 2005 in all EU Member States, with a maximum of five banks participating per Member State. It aimed at identifying a) what the participating banks perceived to be the major factors likely to determine the banking industry in their country, and b) what major challenges they expected to affect the banking landscape over the next five to ten years. Responses were received from 99 banks (see the notes to Table B11.1 for a more detailed description of the sample).

Most banks surveyed considered that the most important factors in determining the future course of banking would be the competitive environment, regulatory changes and risk management (see Table B11.1). Regarding the first of these, the competitive environment has changed substantially in the past. National banking sectors have experienced significant consolidation and have generally become more concentrated, with the share of the 25 largest banks in the euro area banking sector growing from 37% in 1997 to 45% in 2004 (see

Table B11.1 Survey of EU banks on major changes in the banking environment over the next five years

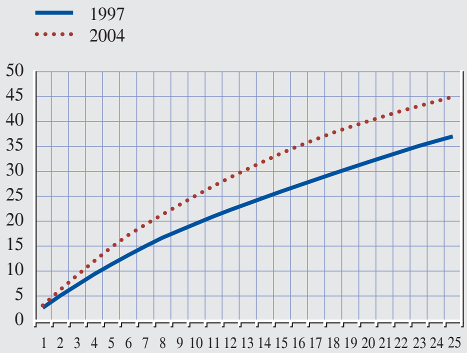
(% of respondent banks)

	euro area			non-euro area		
	percent of sample	very important	medium – somewhat	percent of sample	very important	medium – somewhat
Changes in the external environment						
Regulations	86	60	32	70	59	41
Economic growth	60	38	62	32	50	50
Technological innovation	40	12	88	45	10	90
Demand factors/financing households	58	12	88	41	26	74
EMU	12	40	60	52	10	90
Changes in the banking sector						
Competition	77	33	67	96	43	57
Consolidation	72	68	32	59	42	58
Concentration	47	45	55	39	55	45
Outsourcing	49	0	100	29	6	94
New players	26	0	100	30	29	71
Changes at the firm level						
Changes in risk management	79	65	35	75	67	23
Business model	51	27	73	45	24	76
Distribution model	53	30	70	43	17	83
Income	33	21	79	43	29	71

Source: BSC survey of EU banks held in February-March 2005.
Notes: The table shows the percentage of banks mentioning a specific factor in their top three lists, as well as the distribution (in % of answers) over the top rank (*very important*) and second and third rank combined (*medium-somewhat*). Total number of respondents = 99, of which 43 were from the euro area and 56 from non-euro area countries. Not shown are factors identified by less than 25% of the surveyed banks. No answers were received from banks in Ireland. Two answers were received from banks in Slovakia, three from banks in Belgium, Denmark, Finland, France, Greece, Luxembourg, the Netherlands and Estonia, four from Sweden and Portugal, and five from other EU Member States.

Chart B11.1 Cumulative share of the 25 largest euro area banks

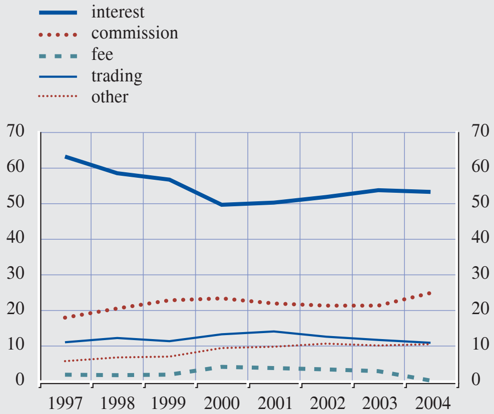
(% of total euro area banking sector assets)



Sources: Bureau van Dijk (Bankscope) and ECB calculations.

Chart B11.2 Evolution of euro area banks' operating income

(% of total operating income)



Source: Bureau van Dijk (Bankscope).
Note: The sample consists of all banks with consolidated statements, without dependency on another entity. The number of banks in the sample differs across years. Reported figures are weighted averages.

Chart B11.1). In the coming years, additional M&A activity can be expected, possibly on a pan-European basis (see also Charts S51 and S52). The second identified factor, regulation, is by definition very important for banks. In the past ten to twenty years, the EU banking sector has changed dramatically as a result of deregulation, financial liberalisation and the process of European integration. In the future, further regulatory changes are expected, including the transposition of the Basel II Capital Adequacy Directive into EU law, the execution of and follow-up on the EU Financial Services Action Plan (FSAP), as well as a possible revision of corporate governance principles for banks. Finally, banks' risk management has changed very rapidly in recent years, in part as a consequence of the rapid pace of technological and financial innovation. Most banks seem to expect that changes in risk management will have a further impact, e.g. leading to more accurate predictions of losses, better credit risk assessment of customers and, subsequently, higher profitability.

Furthermore, changes in business and distribution models and challenges related to the economic environment and to technology were mentioned by around half of the respondent banks as significant issues affecting the EU banking landscape. The impact of Economic and Monetary Union (EMU) was mentioned by around one-third of the banks (mainly those outside the euro area). Two additional factors identified by about a third of the banks were the financial behaviour of households and the impact of demographic trends. The latter may have more significant effects for banks' business strategies and performances over the longer run. For instance, it may lead to a more dramatic change in banks' income patterns, resulting in an increase in non-interest income (commissions from insurance and pension provisions and asset management fees), instead of interest income from deposit-taking and lending (see Chart B11.2).

In the second part of the survey, respondent banks were asked to assess the importance of several sector-wide developments in more detail (see Table B11.2). On the whole, euro area banks did not see broad structural issues as representing a major challenge, except to a certain

Table B11.2 EU banks' assessment of the importance of specific changes expected over the next five years

(% of respondent banks)

	euro area			non-euro area		
	very high	high	lower imprtance	very high	high	lower importance
Competition	16	7	16	30	23	14
Mergers and acquisitions (M&A)	0	23	19	2	14	48
Inward/outward internationalisation	14	7	23	2	14	48
Changes in the number of banks and branches	5	9	28	14	11	36
Changes in funding patterns	0	14	35	0	29	36
Changes in business lines	2	7	33	11	9	41
Diversification of activities	0	7	33	7	7	45
Conglomeration and cooperation	7	5	28	0	4	59
Relationship versus transaction-based banking	0	9	28	2	13	46
Risk transfer	0	14	28	0	7	54

Source: BSC survey of EU banks held in February-March 2005.
Notes: The table shows the percentage of banks mentioning a specific issue in their top three lists, as the top priority (*very high*), second and third rank combined (*high*), or ranked as medium or low (*lower importance*). See also notes to Table B11.1.

extent changes in competition, M&A and internationalisation. Non-euro area banks, by contrast, generally regarded most issues as representing greater challenges than their euro area counterparts, except the further pace of internationalisation and M&A activity (which could be considered as more advanced already), and conglomeration and risk transfer (both of which could perhaps increase in relevance in the future).

Most banks felt that competition could become more intense, especially in retail and commercial banking and asset management. To the extent that banks' interest margins are eroded or credit standards lowered, this might lead to some financial stability concerns.[1] Likewise, more M&A activity was expected to take place, mainly in retail banking, asset management and the insurance business. These were also the business lines that banks indicated as being major growth areas. More detailed evidence also showed that over half of the banks believed that further consolidation would go hand in hand with the development of looser forms of cooperation between institutions, as opposed to maintaining full control over services in-house. Furthermore, many banks expected funding to become less deposit-based, and more reliant on subordinated debt and securitisation. Banks' opinions on the use of equity and flows from parent companies were balanced, with around a quarter expecting these either to increase or to decrease. Finally, when asked explicitly, around 75% of the respondent banks felt that the banking industry would increasingly rely on risk transfer techniques.

The findings of this survey are broadly in line with other recent studies on this topic, although the coverage and time frame in some cases differ.[2] They are also in line with a similar exercise held in 1999 at the launch of EMU, although the emphasis on the different developments has changed since then.[3]

1 ECB (2005), "EU banking structures", October, analyses in more detail competitive conditions in EU mortgage markets and the structure of EU consumer lending markets.
2 See for example Mercer Oliver Wyman (2004), "The future of financial services: Future industry scenarios", December; FDIC (2004), "The future of banking in America", *FDIC Banking Review*, Vol. 16 (1); PricewaterhouseCoopers (2005), "Piecing the jigsaw: The future of financial services", Connected Thinking.
3 See ECB (1999), "Possible effects of EMU on the EU banking system in the medium to long run", February. This report predicted that EMU was likely to reinforce the reduction of excess capacity, geographical diversification, internationalisation and increased M&A activity. Competition was anticipated to increase considerably, putting banks' profitability under pressure.