Obstacles to crossborder consolidation in Europe

HIGH LEVEL SEMINAR
BANKING SUPERVISION AND FINANCIAL STABILITY IN EURO-MEDITERRANEAN COUNTRIES
IMPACT OF FINANCIAL REFORMS IN THE EURO-MEDITERRANEAN AREA

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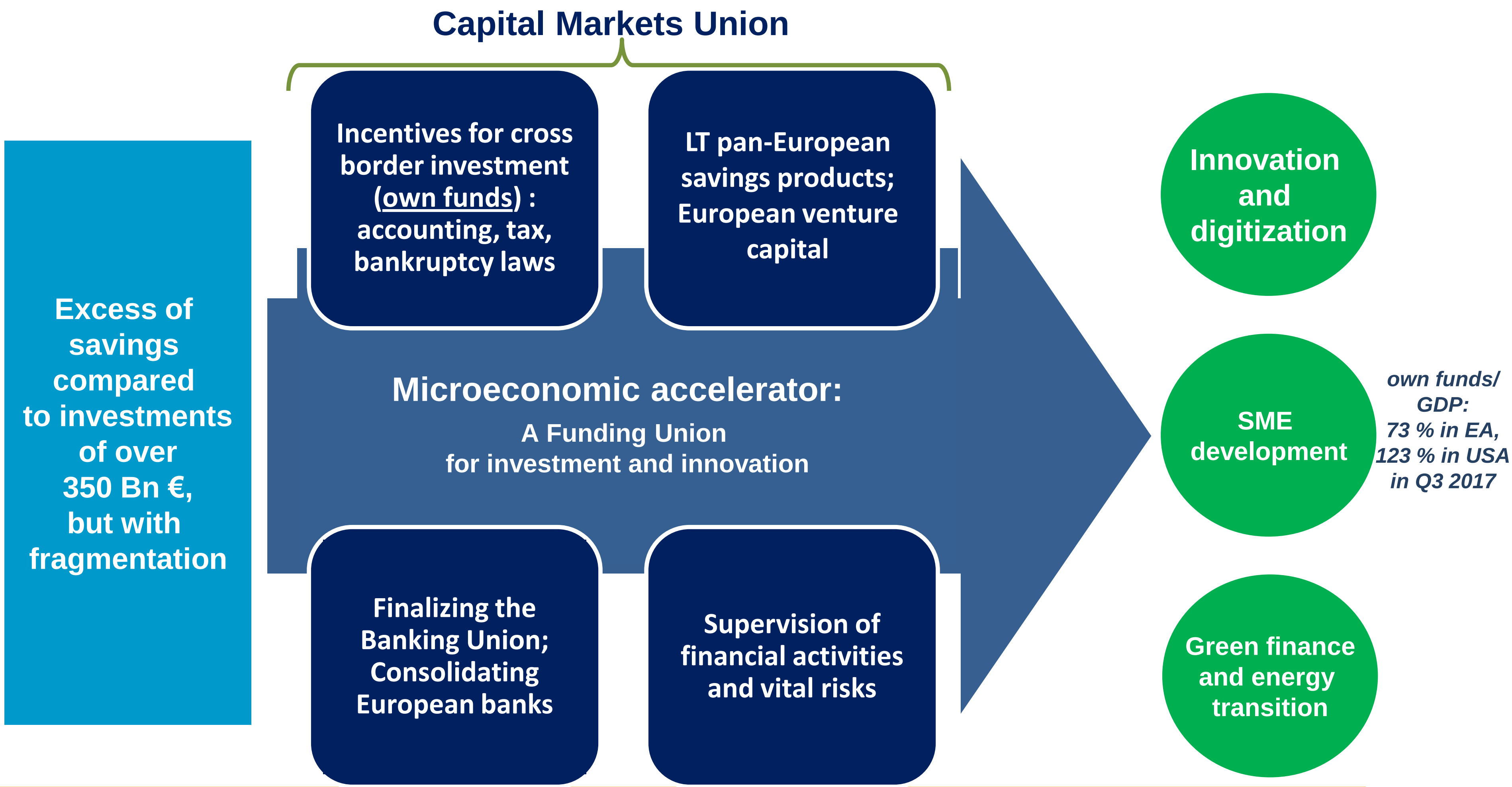
Frédéric VISNOVSKY   Secrétaire général adjoint

1. Post crisis reforms have strengthened the resilience of European banks

but to ensure the future of the European Union in the medium term, the EU needs to be even more resilient to future crises

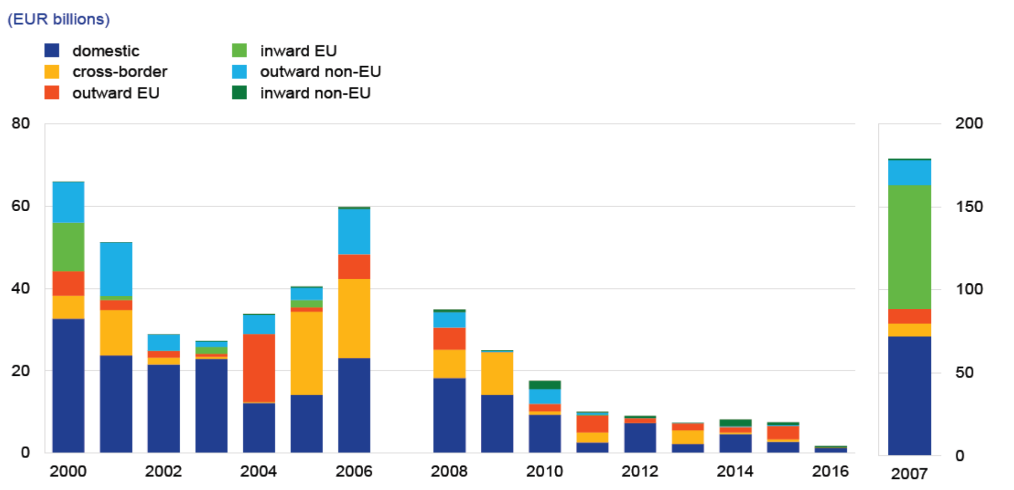


2. The banking system in Europe is still fragmented

The introduction of the euro in 1999 and the development of the single market have made a contribution to increasing bank MNA activity

- Ever since the financial crisis in 2008, these transactions have slumped

Bank M&As involving euro area banks – value of transactions



Sources: Dealogic and ECB calculations.

- Very diverse concentration of banking systems

Market share for the 5 lead banks	
USA	40 %
Europe	20 %

3. The advantages of mitigating fragmentation

- Furthering financial integration
- Offering more opportunities to invest and afford access to new sources of financing
- Optimizing risk sharing which will bolster stability and efficiency of the European economy
- Fostering geographical diversification
- Allowing economies of scale and being more efficient
- Helping to reduce excess capacity
- Improving the position of European banks with international competition

⇒ Reducing obstacles to cross border consolidation in terms of :

1	**Management**
2	**Regulations**
3	**Supervision and resolution**

4. Obstacles related to management

- **M&A activity is highly cyclical** : upturns are more favourable for transactions with far more optimism about expected profit.
- **A high level of non performing assets**, despite a slight drop down to 800 billion euro in the EU after topping out at almost 1000 billion in 2016 (6.7% of GDP) which only serves to increase doubts about asset quality of potential M&A targets..
- **Banks are in a position to estimate that M&A activity is inadequate** at a time when business models are being reshaped.
- **IS integration is** a major operational obstacle for banks (as is also the case with difficulties encountered when restructuring brands, branch networks and staff management).
- **Shareholders are often hostile** towards transactions that dilute their stake in a company.

5. Obstacles related to regulations (1/2)

- Applying prudential rules to individual banks and consolidated groups is also a potential obstacle as there are **no cross border waivers for capital requirements**.

- Concerning liquidity, it can be hard to meet the conditions required for granting waivers on capital requirements for individual banks whereas **centralized liquidity management** tends to be safer from a prudential standpoint as it affords better access to financial markets and fosters quicker allocation of funds to groups that need them.

- **Maintaining options and discretionary** powers when implementing banking regulations with a tendency to reduce consistency across Europe.

- The regime for qualifying holdings has been harmonized to a large extent in the SSM, but **national standards for mergers** tend to be far more varied.

5. Obstacles related to regulations (2/2)

- **Buffers for systemic groups** (G-SIBs) (i.e. an additional capital buffer imposed on G-SIBs) tend to weigh heavily on the cost of acquisitions of other entities by G-SIBs, given the more stringent capital requirements for assets (and also the fact that the **EU is not recognized** as a single jurisdiction).

- Certain **differences in national tax legislation** have a significant impact on banks – which is especially true of the treatment of deferred tax assets.

- Part of the **legislative framework** (laws regarding insolvency and legal takeover bid protection measures) and **regulations** on consumer protection, remain country specific

6. Obstacles related to supervision and resolution

- Capital allocation flexibility, in the context of a crossborder acquisition, is restricted by the **PIllar 2 capital requirement calculation** (additional capital requirements required by the supervisory authority) in respect of subsidiaries.

- Crossborder consolidation **generates a lot of decisions** by the supervisory authority – approval of a merger and/or qualified holdings, decisions on own funds, liquidity, leverage, use of internal models.

- Crossborder transactions can **involve several European and national authorities**, which can have an effect on operation timelines.

- Crossborder consolidation generates **restructuring risks** and transaction costs. Supervisors tend to consider that they temporarily impair the risk profile of the banks, which has an impact on Pillar 2 requirements and the assessment of internal models or operational risk.

- After a crossborder transaction, **recovery and resolution plans** become more complex and have to be updated.