

**RETAIL BANKING SECTOR INQUIRY
PRELIMINARY REPORT II
CONSULTATION FEEDBACK FORM**

Name of organisation: The Finnish Bankers' Association

Type of organisation: Trade association

Address: PL 1009, 00101 Helsinki

Country: Finland

Have you received a request for information as part of the sector inquiry:

Yes

No

Specific questions from Executive Summary:

GENERAL REMARKS

The Finnish Bankers' Association welcomes the opportunity to comment on the Interim Report. Well-functioning financial markets are essential to European Union competitiveness. However, we do not fully agree with the methods, analysis and observations presented in the Interim Report. Though methodological problems may be relevant to all or some countries, we will mainly comment on issues regarding the Finnish financial market.

The Finnish Bankers' Association would like to note that a country comparison between bank markets, where there are considerable cross-border activity, different banking structures and different statistical practices, do not necessarily provide a reliable base for drawing far reaching conclusions. In the Finnish case, the conclusions of the interim report are not even based on correct statistics. For instance the figures of the biggest bank operating in Finland, the Nordea Bank Finland, do not depict the bank's activity only in Finland.

The publication of the Commission Interim Report has in Finland led to a lively discussion in the media, where the conclusions have mostly been reported in a negative way from the banks' point of view. As it is extremely difficult afterwards to correct figures and undo a negative image, it would be highly recommendable that the information contained in these kinds of reports be checked carefully before publication. Concerning information on the

Finnish financial sector, the Finnish Bankers' Association would be pleased to assist in this task.

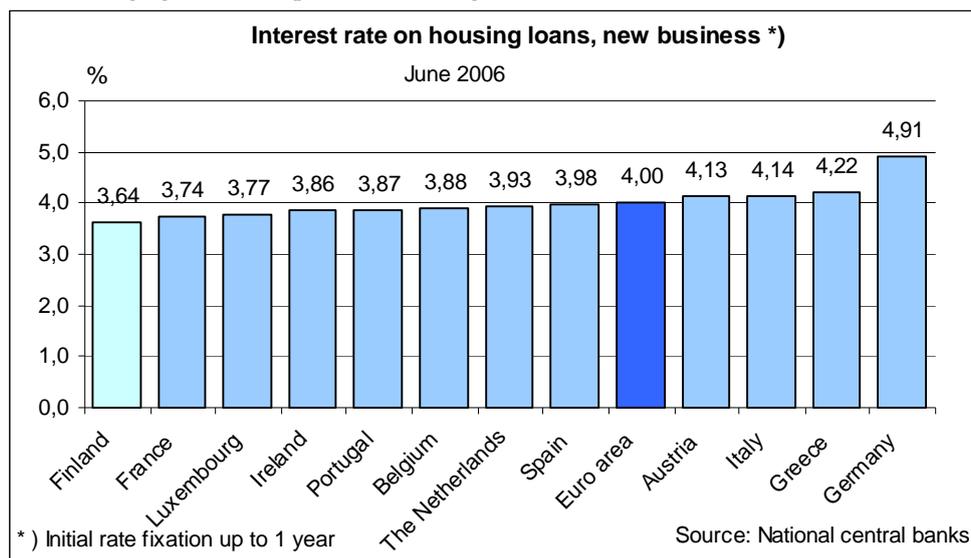
A. Market structure and fragmentation

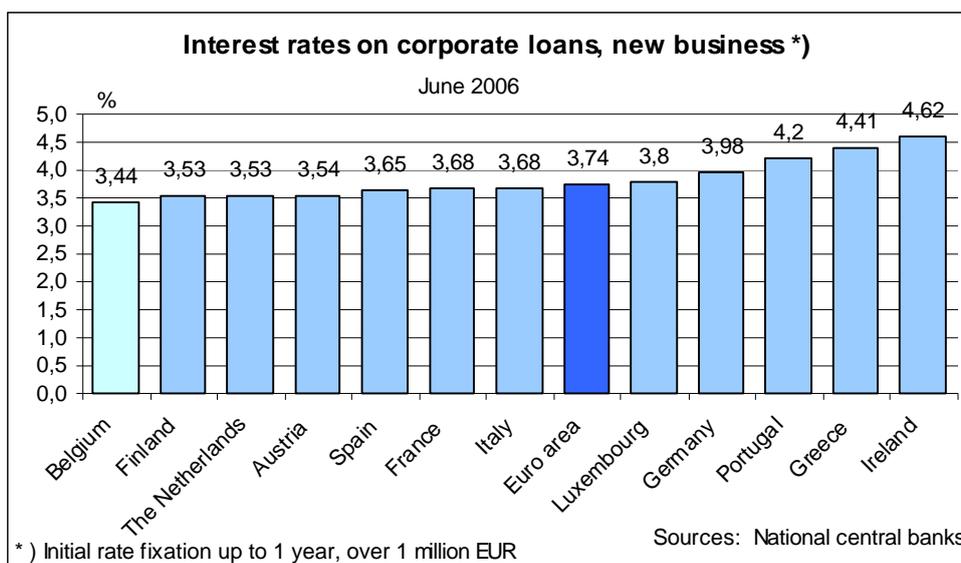
1. What are the main reasons for market fragmentation in Europe's retail banking sector? Please identify whether they are mainly of regulatory, structural or behavioural nature.

The regulatory and policy nature of fragmentation is evident. On the one hand fragmentation is seen as a hindrance of pan-European financial market and further consolidation is seen needed. On the other hand a lot of attention is paid to concentration ratios and implicitly it is assumed that high concentration ratios represent lack of competition. For example, the concentration ratios presented in the Interim Report about Finland reveal that the concentration ratio seems to be very high in Finland. Yet at the same time there were a total of 345 banks with independent decision making bodies in Finland at the end of 2005. This would imply high fragmentation even in absolute numbers not to mention relative numbers in a European context. Of these, 278 were co-operative banks, 40 savings banks, 12 commercial banks and 13 branches of foreign credit institutions that have the licence to receive deposits. Surely, Finland can not be at the same time both highly concentrated and highly fragmented. Market structure deserves more sophisticated analysis and interpretation than what simple ratios or single figures can ever offer.

2. What are the main causes and implications of the different level of concentration in the EU retail banking markets?

As far as Finland is concerned, the banking crises in early 1990'ies had a major effect on the concentration level of banking in Finland (e.g. the then two biggest banks merged). Concentration and a low number of big banks should, however, not be taken as a sign of insufficient competition. Despite the high level of concentration, the Finnish markets are extremely competitive as indicated by the very low margin added to the reference rates in both mortgage and corporate lending.





It is natural that the concentration ratios are higher in smaller markets than in larger ones. Banking has economies of scale and scope and in order to service customers efficiently banks strive for these economies. In smaller markets there is just not enough room for many large banks.

The issue of fragmentation and consolidation in banking in EU countries is also connected to public ownership in banking. In Finland this does not constitute a problem as the State of Finland has only a minor shareholding in banking, and consequently, the private ownership in the Finnish banking sector is very high. The conflicts of interest and vested political interest may adversely affect the harmonisation of the retail banking market. We feel that this issue should deserve further analysis.

The EU countries have experienced different stages and speeds in banking sector consolidation, and as a consequence financial market sizes differ markedly between EU countries. The birth of the euro was generally believed to become a catalyst for a more rapid consolidation. However, in the Nordic region the consolidation was already well under way before the introduction of the euro due to the banking crisis in the early 1990's. Panel data in the Interim Report for cross-country comparison may lack sufficient years to analyse different phases of consolidation in EU countries.

B. Banks' financial performance and pricing

3. What are the main reasons for the varying rates of profitability and income in retail banking across the Member States?

The Interim report does not give the right picture of the profitability of the Finnish banking sector. This is due to the problems in the figures used. As financial markets have evolved, the banks are more and more part of financial groups. Thus, it becomes increasingly harder to analyse profitability of individual deposit banks, and emphasis should instead be directed towards analyzing financial group profitability.

The figures for profit before tax also contain extraordinary items. In the Finnish figures, these items had a major impact on the total during the years under review. The Nordea Bank Finland, as part of the Swedish Nordea Group, made during those years huge intra-group restructurings and the results were booked in the Nordea Bank Finland. It is obvious that such statistics cannot constitute the base for analyzing domestic figures (a probably more reliable picture of the profitability of the Finnish banking sector is in attachment). Please, find enclosed the summary of the profit and loss accounts of domestic banks and the Nordic banks operating in Finland.

Another “impossible” result in the report is the ROA of 2.75 % for Finnish banks in 2001. This is another indication of the weakness of the statistical base.

According to the report, the main source for the profit and loss information is OECD statistics (that for the bank groups only contain information of the parent bank). Of the available statistical sources, we find the ECB as the most reliable, as it has already for quite some time worked on harmonizing the financial statistics. The ECB statistics are also more current than OECD statistics. Also, we feel that in order to obtain more robust observations of the national financial markets it would make sense to use local analysts. This would help in weeding out the obvious pitfalls in a simple blanket approach.

C. Entry barriers in retail banking

4. Are there other types of entry barriers in retail banking that have not been identified in the preliminary report?

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5. Where and how does competition law have a role in tackling barriers to entry in retail banking?

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6. Access to credit databases and payment infrastructures are sometimes cited as a barrier to entry in retail banking markets. Are there significant barriers to access which merit further investigation?
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D. Customer choice and mobility

7. What are the main reasons for the low mobility of retail banking customers?

As far as the definition is concerned, we don't believe that low mobility of current accounts necessarily implies low mobility of customers. Many reasons therefore can be listed.

Normally, there are no costs relating to opening and maintaining an account. Consequently, people have little reason to close accounts. Even when customers are switching a mortgage from one bank to another, they may keep the old current account in the old bank and open a

new account in the new bank from which the mortgage is served. Therefore it is commonplace for people to have accounts in several banks. In Finland there are about 5.2 million people and some 12 million accounts. The number of current accounts is around 10 million. Around 60 percent of the SMEs have current accounts in more than one bank.

In Finland, one does not need to open a new account in case one moves to another part of the country. A customer can, for example, have his current account in his birth town bank and yet live in another town without any problem of using that account. The high penetration of internet banking and payment cards in Finland makes the use of an account independent of distances.

In the case of mortgages, there is certainly not low mobility of customers. On the contrary, customers are keen to compare mortgage rates and easily switch banks when offered a better margin. The customer even needs not to do anything, the new bank offering the better mortgage rate normally handles all the work of terminating the old mortgage in the old bank.

Finally, it could be noted that there is no reason for a satisfied customer to switch bank. According to the Epsi Rating Customer Satisfaction 2005 survey, Finnish customer satisfaction was the highest or among the highest in this survey covering 11 countries including our natural peer group, the other Nordic countries.

E. Development of payment infrastructures in the context of the Single Euro Payment Area

8. Are there features of the payment industry that limit competition either at the level of provision of clearing and settlement services or the provision of retail banking services? Please indicate areas that merit further investigation.

9. Are interchange fees necessary for the development of payment instruments (credit transfers and direct debits) in the EU?

10. Are there issues related to industry initiatives in the context of SEPA that should be assessed from a competition view point?

F. Other issues

11. Please provide comments on any other competition-related issues in relation to retail banking markets.

The bundling of the services into customer packages should be viewed as a result of economies of scope. Banks offer several services through the same delivery channels whether it is internet banking or branch service. Just as economies of scale may affect unit costs and

pricing, so can economies of scope lead to service packages that can be more attractively priced provided that the customer uses several services via the delivery channels. Therefore, it is economically reasonable that package pricing may not be directly compared to the pricing of a single service or product.

Bundling may also be seen as a one-stop service, similar to what the public sector is trying to offer. Instead of customers having to allocate time and effort to seek information of different delivery channels and service providers, customer can enjoy a one-stop service.

In Finland, both private customers and SMEs are generally internet advanced and can therefore search and compare information on both service and pricing.

General questions:

1. Did you find the content of the report easily accessible and understandable?

- Yes, fully
- The report was too general
- The report was too technical

2. Did you find that the level of detail in the report was:

- about right
- not sufficiently detailed
- too detailed

3. Did the information contained in the report was:

- generally new to you/the retail banking industry;
- mostly known to you/the retail banking industry.

4. Did the market analysis in the report:

- confirm your views on the operation of the retail banking market;
- challenge your/industry's views on the operation of the retail banking market
- represent a mix of both aspects

5. Did the report raise the right policy issues;

- yes, covered most of the key issues;
- no, there were some significant issues left out.