σ Finanzgruppe
Deutscher Sparkassen- und Giroverband

Position Paper on the Interim Report II – Current accounts and related services published by the European Commission

The European Commission published its Interim Report II – Current Accounts and Related Services on 17 July 2006, in which it presents its provisional findings from the sector inquiry on current accounts and related services and asks stakeholders for their comments on this subject.

We are pleased to avail ourselves of the opportunity to comment. As umbrella association for the Sparkassen-Finanzgruppe, we represent the interests of some 650 undertakings, including 463 savings banks, 11 Landesbanken, the investment fund service provider DekaBank, 11 Landesbausparkassen and other companies providing financial services. In total, some 377,000 people are currently employed in the Sparkassen-Finanzgruppe. The condensed balance sheet total amounts to EUR 3.3 trillion (position at the end of 2005). Before we comment on the individual questions raised by the Commission, we venture to make the following general observations.

I. General observations

In the interim report submitted, the European Commission complains of "fragmentation" of the retail markets. The reproach of fragmentation relates on the one hand to the still comparatively low volume of cross-border transactions and on the other to the comparatively large number of independent credit institutions in individual Member States, especially Germany. The Commission thereby tries to establish a connection between size of institution of the market participants and their profitability.[1] In addition to the low degree of concentration in any case at national level, the regional or local character of retail banking and the existence of different forms of undertaking are also criticised.

We support the creation of well-functioning, integrated and competitive financial markets which the interim report names as an aim of European competition policy. However, founding the sector inquiry on alleged "market fragmentation", market entry barriers and limited product variety[2] is not understandable for retail banking in Germany for the following reasons.

1. Methodology and data of the interim report open to attack

The interim report displays significant methodological weaknesses which result in the data analyses presented being unsustainable and failing to meet the qualitative requirements which citizens and undertakings in Europe must rightly set for such investigations by the European competition authority. This is all the more problematic when, through the presentation of the very comprehensive data alone, the unfounded impression of sound scientific preparation is conveyed.

---

1 See European Commission, Interim Report II - Current Accounts and Related Services, July 2006, p. 79 ff.

2 Cf. European Commission, Interim Report II – Current Accounts and Related Services, July 2006, p. 158.

- **Basis of data is unsustainable**

Firstly, it is found that the data compiled in the interim report are to a large extent insignificant. The report itself expressly refers to this at various points. Nevertheless, comparisons are drawn from such an inadequate basis and pronouncements are made which do not withstand critical examination.

The data presented in the interim report are in any case not representative of the German market. In total, 250 institutions from all 25 Member States were questioned, with a view to obtaining a representative result (secured with coverage of 60%-70% of the deposits of non-banks in the respective Member State). For Germany, it is aptly pointed out in this connection that over 2000 independent credit institutions exist. Nevertheless, 50%-60% coverage is to be achieved by the inquiry. To arrive at this quota, all the big banks (including Postbank with about 18% share of customer deposits), all the savings banks (approximately 25% share of customer deposits) and all the cooperative banks (approximately 17% share of customer deposits) should have been questioned. This would have achieved around 60% coverage. To the best of our knowledge, however, from the savings bank sector, for example, only 16 institutions were asked for information. Together, the share of customer deposits of these institutions in the entire German market is calculated at only just under 5%. Assuming that the Commission had also questioned the 5 big banks, a total quota of approximately 23% would have been reached (savings banks and big banks questioned). Since the cooperative sector in Germany still to be included additionally is distinctly smaller scale than the savings banks sector, reaching the coverage rate of 50%-60% indicated for Germany seems to be precluded. This is all the more true if in total only 250 institutions were questioned Europe-wide, with the consequence that the quota allotted to the German market must have been distinctly limited. To achieve a certain market coverage at all, the inquiry was obviously also confined to larger institutions. All the savings banks questioned were large savings banks. The smallest of these institutions – measured in terms of 2005 balance sheet total – is ranked 36 out of 463 savings banks, whereas the other 15 savings banks are all among the TOP 25, and most of them even in the TOP 15. Hence the results are not representative for either the savings bank sector or the German banking sector as a whole.

- **Comparisons are unsustainable**

The information contained in the interim report on gross income per customer in private customer and SME business by product line is misleading.[3] The comparisons, through which it is obviously to be shown that customers in individual Member States have to pay excessively high prices for certain services, leave to be desired.

[3] European Commission, Interim Report II – Current Accounts and Related Services, July 2006, Table 19, p. 69 and Table 20, p. 71.

This is shown by the following **example**: Table 19 shows that the average customer in Poland has to pay €409 for his mortgage, whereas the average customer in Germany has to pay €1,319, i.e. more than three times as much. However, in this comparison, no account is taken of the fact that, according to EUROSTAT data, wage costs per employee in the German credit sector are more than four times the wage costs per employee in the Polish credit sector, which already puts the at first glance impressive price differential distinctly into perspective. In addition, the statistical data on the "costs or gross income per customer" remain more or less completely meaningless if they are not related to the corresponding services. The question arises in particular of: how much is the mortgage of the average Polish and German customer respectively? The interim report makes no pronouncements on this subject. These amounts also cannot be read off from publicly available statistics. However, an impression is conveyed, for example, by the data published by the European Central Bank in the "EU Banking Structures".[4] The data available there on the total volume of housing credit and on the number of inhabitants in the individual EU Member States allow at least the volume of housing credit per inhabitant to be determined. In 2004, this amounted to €281 in Poland, whereas it was €11,508 in Germany, i.e. more than forty times as much. Even if it is assumed that the proportion of housing credit customers of the total population is considerably higher in Germany than in Poland, the fact remains that housing credit of the average German customer amounts to a multiple of that of his Polish neighbour. No-one can be seriously surprised by the fact that the expenses or income of his credit institution are then also correspondingly higher. To draw conclusions from this with regard to the competitive situation in the German or Polish credit sector is accordingly inappropriate.

The weaknesses shown here in the form of examples are also applicable to the other product lines.

- **Survey of gross incomes and costs undifferentiated**

Furthermore, in the questionnaire, the gross retail income is only examined in very global terms. From the response of the institutions, it is not obvious how this was ascertained (e.g. only margin or full interest rate). However, the effects of differing calculation bases with regard to the gross income determined are enormous and may diverge by a multiple from one another. The same applies in relation to the enquiry about retail business costs. The institutions were not informed in the questionnaire whether for example costs should be taken into account in full or in part. Diverging approaches lead here too to massive distortions in the profitability indices. Since the customer segmentations and the product classifications could be chosen by each institution independently and at the same time the method of calculating income and costs was not clearly specified, there is a lack of comparability in the indices referred to in the report. This reason alone is sufficient to make the analyses based on them unreliable.

- **Observations on the degree of concentration do not reflect reality**

[4] European Central Bank, EU Banking Structures 2005.

It is emphasised several times in the interim report that the degree of concentration on the German retail banking market is very low by European comparison. On the other hand, there is a comparatively high concentration at regional level. The differing results are attributable to the fact that, when considering the national market, the Commission considers savings banks and cooperative banks as independent institutions, whereas in its regional analysis all savings banks or cooperative banks respectively existing in a district are considered in each case as one institution.[5] This differing point of reference is obviously inconsistent.

Furthermore, the results presented in the figure on page 55 of the interim report do not reflect reality. According to these results, in several regions of Germany (at NUTS 2 level), the CR3 ratio for current accounts comes to 1.0. This would mean that the entire market is served by only 3 suppliers. How far this result is from reality is clearly illustrated by the following **example**: For instance, the figure on page 55 shows for the Karlsruhe district (NUTS DE 12), among others, a CR3 ratio of 1.0. According to the Deutsche Bundesbank statistics, there were a total of 1823 bank branches (not including branches of Bausparkassen) in the district of Karlsruhe in 2003 (more recent figures are not available on account of the discontinuance of these regional statistics in the meantime). 690 of these branches were cooperative banks, 590 savings banks and a further 370 belonged to the Postbank. In view of this high density of branches, it can be assumed that these three suppliers or groups of suppliers in the district of Karlsruhe also have the largest combined market share of current accounts. However, that they together achieve a market share of 100% in this business field – as the Commission shows on page 55 – is out of the question, as this would mean that all other banks, which are nevertheless represented by 173 outlets in the district of Karlsruhe, and the direct banks without local branches, do not administer a single current account there. Similar results also emerge for the other NUTS 2 regions in Germany, for which the Commission indicates a CR3 ratio of 1.0.

It is clear from this example that the data collection prior to the interim report was extremely deficient. Comprehensive data collection – on the same basis in all European regions – would therefore be essential before making such important pronouncements, such as for example on the degree of concentration in the retail sector.

- **Lack of comparability through non-uniform segmentation**

It is correctly stated in the interim report that a national or even Europe-wide uniform definition of the concept of “retail banking” does not exist. The Commission itself defines this as primary banking transactions with consumers (private individuals or users of private banking products) and small and medium-sized enterprises. It draws the threshold for small and medium-sized enterprises at a maximum annual turnover of EUR 10 million. However, this is a clear departure from current practice for forming customer groups at savings banks and cooperative

[5] Cf. European Commission, Interim Report II – Current Accounts and Related Services, July 2006, p. 56 ff.

banks in Germany. From the point of view of the savings banks, the corporate customer sector regularly already starts from an annual turnover of generally over EUR 1 million (commercial companies over EUR 3 million) or a commercial liability of over EUR 250,000. Large parts of the segment investigated by the Commission – in so far as available at all in terms of orders of magnitude – are therefore dealt with in the savings banks as corporate customers. Since in the context of its inquiry the Commission has expressly allowed different segmentations and product classifications by the individual institutions, this gives rise to clear distortions both for the national results and in intra-European comparison. It is therefore to be surmised, with a high level of probability, that within the collection there is a mixture of incompatible responses from institutions: on the one hand, replies based on the EU definition and on the other communications based on the customer group formation specific to the individual institutions. For instance, in footnote 95 on page 63 of the interim report, express reference is made to the fact that in the United Kingdom several large banks for the classification criterion “small and medium-sized enterprises” did not keep to the EU definition of EUR 10 million, but opted for far lower turnover thresholds of around EUR 2 million. It is concluded from this that the indices of the small and medium-sized enterprises in the United Kingdom turn out particularly low by comparison. In our opinion, this comment should not be confined to the United Kingdom.

On account of the non-uniform segmentation, the pronouncements made in the report on “small and medium-sized enterprises” are unsustainable. Depending on the classification of the larger enterprises, the sector of small/medium-sized enterprises is excessively high in terms of the index figure (since relatively large enterprises are included in accordance with the EU definition) or on the contrary relatively low (if these enterprises were not included on account of the criteria of the individual institution).

- **Connection between market conditions and business performance not demonstrable**

On pages 76 to 80 of the interim report, the attempt is made for the institutions questioned to derive statistical evidence via regression analyses on correlations between different factors. Statistical relationships were generated between bank size and profitability, market share and profitability, bank size and cost-income ratio (CIR) and between market size and CIR, which are intended to prove the existence of dependencies. A customary criterion to assess the quality of a regression estimate is the coefficient of determination (R^2). The closer the value of R^2 is to 1.0, the stronger the correlation between the variables examined.

In the interim report, the coefficient of determination is shown for all the investigations undertaken. However, this lies far below the value of 0.8 necessary for a significant pronouncement (in many cases only at 0.00x). It is true that express reference is made to this – in passing – but prominence is give even to minimal correlations in the text. In addition, under a statistical model developed by the Commission itself, still further factors were added and new conclusions drawn from this. The interim report contains only rudimentary information on this model and the concrete approach followed.

Furthermore, from additional investigations, negative correlations are derived between bank size and CIR and positive correlations between market share and profitability. This approach is extremely problematic in terms of methodology on account of the low statistical dependencies established (almost non-existent), the small size of the sample and the fact that data from only one year were considered.

Overall, the statements made in the interim report on relationships between the factors bank size, profitability, CIR, market share and market size are untenable.

2. Premises of the competition inquiry open to attack

Furthermore, the following observations arise on the premises for the competition inquiry.

- **Competition policy should aim to secure and strengthen competition and not to create market power**

The criticism of alleged fragmentation[6] obviously refers to three aspects: the rather low level of cross-border transactions in the Commission's view, the number of cross-border mergers and acquisitions deemed by the Commission to be small, and the large number of independent credit institutions in some Member States, especially Germany, brought out several times in the interim report. These premises are mainly unfounded and in some cases are in conflict with the recognised objectives of competition policy.

- **Retail banking is primarily regional or local in character.** This circumstance is essentially attributable to the demand behaviour of consumers and small and medium-sized enterprises. In financial matters, these groups still want local talking partners, with whom personal contact is possible at any time and without language barriers, and who, on account of their in-depth knowledge of the local conditions, can offer optimum financing solutions (cf. reply to question 1). The needs of customers and information advantages through local presence make an essential contribution to savings banks and cooperative banks continuing to concentrate on local markets. This regional principle in the savings banks and cooperative sector in Germany is incomparable with the strict geographical restrictions, as laid down by law in the USA until the 1990s, mentioned in the interim report.[7]

- The **small number of cross-border mergers and acquisitions** pointed out by the Commission in the interim report should be put into perspective. The Commission itself found in a document[8] published on 25 October 2005 that in 2005 40% of the mergers and acquisitions carried out in the banking sector were cross-border. Is such a proportion small?

---

6 Cf. European Commission, Interim Report II - Current Accounts and Related Services, July 2006, p. 22.
7 European Commission, Interim Report II – Current Accounts and Related Services, July 2006, p. 37.
8 Commission staff working document on cross-border consolidation in the EU Financial Sector, SEC (2005) 1398.

Essentially, there are two important economic reasons for cross-border mergers and acquisitions not yet having reached the same scale as those at national level: on the one hand, no significant gains in market share are to be achieved through cross-border mergers and acquisitions on markets in which the acquiring institution was previously not appreciably represented. In contrast to nationally consolidating mergers, in the case of cross-border mergers and acquisitions there is no gain in market power which could be an economic motive for such transactions. On the other hand, in many cases only slight synergy effects are to be achieved from cross-border mergers. This applies in particular in relation to overlapping of the existing infrastructure, for example in combining business premises.

- **The Commission expresses repeated criticism of the comparatively large number of independent credit institutions in Germany**. In this connection, it should first be pointed out that the degree of concentration in an economic sector – including in the credit sector – is dependent on a number of factors. For instance, in a centralised State structure, credit institutions are predominantly established in central locations. On the other hand, where the State is decentralised, the economy is structured on a decentralised basis, which means that credit institutions will also be established in less central regions. Furthermore, the economic stability of an economy also has an impact on the degree of concentration. In States with long-lasting, stable economic development, a larger number of credit institutions would exist than in States with a less stable economic trend, as the economic development of credit institutions is always also dependent on the economic development of the economy as a whole.

  Furthermore, the comparatively large number of independent credit institutions in Germany results in high-quality financial services being offered nationwide at favourable prices. Against this background, it seems surprising that the low concentration is not shown in a positive light, but on the contrary is even presented as an alleged shortcoming. Since, as is well-known, it is quite decisively attributable in Germany to the coexistence of private, cooperative and public credit institutions, the impression arises that competition law is being exploited here to justify demands for privatisation and constraint as to legal form.

  The whole purpose of competition law on the other hand is precisely to ensure freedom of competition and to limit economic power where it impairs the effectiveness of competition and its inherent tendencies to boost performance and calls into question the best possible supply for consumers.[9] The repeated call in the interim report for consolidation and hence strengthening of market power of only a few suppliers is in clear contradiction with this. If need be, it can be justified only if the existing plurality were to lead to market failure. This is not the case in Germany and – as far as can be seen – no-one is arguing that it is. In addition, demands to abolish the variety of legal forms are wrong in the present context, since precisely the pluralism of legal forms results in intensive competition and optimum supply of financial services for consumers and businesses.

---

[9] Cf. Immenga/Mestmäcker, GWB – Kommentar zum Kartellgesetz, 3. Aufl. 2001, Einl., Rnr. 1.

The premise at the basis of the interim report of "excessive fragmentation" must therefore be critically questioned. How incorrect it is to use the large number of independent savings banks and cooperative banks in Germany as an indicator of alleged fragmentation was recently shown by Citigroup in a study on the German banking market: "*Putting things another way, any personal or small business customer in any given location in Germany will be subject to competitive offerings from one savings bank, one cooperative bank ... and at least five quoted banks. So much for the non-quoted banks being the fragmentation problem."*[10]

II. Comments on the questions raised in the interim report

These general observations having first been made, we should now like to deal with the individual questions raised by the Commission.

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.

At several points, the interim report criticises alleged market fragmentation. In so far as this is attributed to a comparatively small number of cross-border mergers and acquisitions and the large number of legally independent credit institutions in some Member States, reference is made to our general observations above and to the comments made on question 2. In so far as the Commission is considering what it considers to be the excessively small scale of cross-border banking transactions, a differentiation is to be made between the following.

The **purchase of financial services in other Member States** is in fact of secondary importance. This is essentially attributable to the wishes and needs of consumers and small and medium-sized enterprises to obtain personal advice on financial matters if need be or to have recourse to products of regional suppliers tailored to their specific needs. The reasons are accordingly predominantly "behavioural" within the meaning of the question. It is true that Internet banking is becoming increasingly important. Usually, however, the modern distribution channels supplement the care at the local branch and do not replace it. Getting into contact with foreign credit institutions, which maintain no national branches as a rule, is not possible just like that, already on account of language differences. In addition, precisely in the field of the financing of small and medium-sized enterprises, it is of particular importance on account of information asymmetries that credit institutions exist with structures allowing a local credit decision. In the case of bundling credit or financing decisions in central units, information shortfalls arise which lead to inefficiency. This may, for example, result in loans being rejected which a local supplier could grant. All this advocates nothing changing in the regional stamp of

---

[10] Citigroup, Global Markets, Equity Research, German Banks, 21 September 2006.

the retail markets in the foreseeable future and, from the macroeconomic point of view, nothing should change either.

The **purchase of financial services from domestic subsidiaries or branches of foreign credit institutions,** on the other hand, is increasing steadily in Germany. Alongside established affiliated banks, such as the American Citibank with over 3 million customers in this country, there is a series of further successful foreign institutions, such as for example the Santander Consumer CC-Bank, the Swedish SEB, the Dutch ING-DiBa or the American GE Money Bank. In the case of instalment credit, the foreign banks[11] on the German market have in the meantime achieved a market share of 24.9%. For current accounts of private individuals, their market share comes to 19.9%.[12] The success of these banks is attributable to the fact that they consider the demand behaviour of the customers described above and either try to reach the customers through local branches or offer such products solely or as a priority for which there is no need for personal advice from the customers' point of view. These specific successes of the new foreign suppliers are also evidence of the free entry and openness of the German banking market.

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

- **Large number of suppliers to be considered positively in terms of the competition theory**

The large number of independent credit institutions in Germany is mentioned several times in the interim report. Under competition theory, a market structure is optimal in terms of the overall economy if – as on the German market – a large number of suppliers are available to a large number of customers. In this case, competition prevents either side from building up market power and using it to the detriment of the respective other side. Derogations from this atomistic ideal could only be contemplated if there were drastic advantages of scale – in the extreme case a natural monopoly. This is not the case on the German market. Professors *Andy Mullineux* (University of Birmingham) and *Eva Terberger* (University of Heidelberg) in the study published by the Anglo-German Foundation "The British Banking System: A good role model for Germany?" come to the conclusion that the comparatively high profitability of the British banks is based not on cost leadership, for instance, but for large parts of their market power on a "complex monopoly". The comparatively lower profitability of the German institutions goes hand in hand with a nationwide supply of financial services, with precisely the

---

[11] Under the concept of foreign banks, the Deutsche Bundesbank includes banks which are majority owned by foreign banks and branches of foreign banks, Deutsche Bundesbank, Bankenstatistik, Statistisches Beiheft 1 zum Monatsbericht, August 2006, p. 110.

[12] Deutsche Bundesbank, Bankenstatistik, Statistisches Beiheft 1 zum Monatsbericht, August 2006, p. 76.

savings banks and the cooperative banks having shown above-average profitability in the German banking system.[13]

Nevertheless, the low degree of concentration in Germany is referred to as problematic in the Commission interim report in that for example the attempt is made to establish a positive correlation between bank size and profitability. Such a correlation cannot be underpinned by statistics and in fact does not exist. The arguments in the report therefore reinforce the impression that the attempt is made here to justify political demands for structural changes which are not backed by competition arguments.

- **Mergers and acquisitions potentially restrict competition**

Without cogent justification, the interim report gives blanket approval to mergers and acquisitions. This is not justified, but rather is in principle contrary to the objectives of competition policy.

Mergers result in the number of suppliers declining and conversely the market power of the merged undertaking growing, which should be viewed rather critically by competition policy. The *acquisition* of an existing supplier, on the other hand, is neutral in terms of competition policy. The mere change of control of this supplier does not result for the customer in any automatic improvement in the provision of services or the price. On the contrary, deterioration may even occur, for instance if deposits are withdrawn in the target country to be issued as credits in another region where higher profits are beckoning; in such a case, the credit competition in the country of the target company is reduced.

In principle, more competition is created on the other hand by cooperative agreements, cross-border service relations and the development of subsidiaries or establishments, as this approach in each case entails the entry of a new competitor on the market in the interests of customers and consumers. This preferable way of developing cross-border activities from the competition point of view is only discussed briefly in the interim report.

This too confirms the impression that the main purpose of the inquiry is to attack credit sector structures in individual Member States. The public legal form of credit institutions is presented several times in the report as an allegedly protectionist measure or as “prevention of cross-border market entry”.[14] The fact that the existence of public credit institutions and that of the cooperative banks does not in fact impede entry to the German retail banking market is already shown by the substantial market shares of foreign banks in this sector (see comments on question 1).

---

[13] Cf. *Mullineux/Terberger:* Report of the Anglo-German Foundation, The British Banking System: A good role model for Germany? (http://www.agf.org.uk/pubs/pdfs/1448web.pdf), p. 18.

[14] Cf. European Commission, Interim Report II – Current Accounts and Related Services, July 2006, p. 10, 20, 21, 23.

- **No efficiency shortcomings in the case of smaller institutions**

In the interim report, it is at least suggested that the low degree of concentration and the resulting coexistence of a large number of rather smaller institutions leads to inefficiency. This is to be evidenced by an (in fact unascertainable) connection between bank size and CIR. We already pointed out in the general observations that no efficiency shortcomings exist in the case of smaller institutions. This is clear in particular on the basis of the figures published by the Deutsche Bundesbank for the individual groups of institutions in Germany. These show a distinctly higher pre-tax return on equity for the savings banks in direct comparison with the big banks in 8 of the past 10 years (annual net profit as % of the average equity shown on the balance sheet). As a result of exceptional effects in 2005 (in particular restatement of amounts for the trading positions), it is true that the return on equity of the big banks is currently above that in the savings banks sector. As the time series shows, the results of the big banks are however in principle very volatile. For instance, in 2002 to 2004, they show negative return on equity, whereas the German savings banks during the same period achieved average results of between 8% and 11%. Also with regard to the CIR, the savings banks achieved good values (CIR 2005: savings banks approximately 67%, cooperative banks approximately 74% and big banks approximately 81%).[15] The basic pronouncement is also confirmed if a longer time series is considered (e.g. for the past 10 years). The business figures of the savings banks also show in principle that there is no connection between size of institution and business success indices. The results of small and medium-sized savings banks basically are no different from those of the large savings banks in such important indices as the CIR and return on equity.

- **Existence of different types of business organisation makes sense in terms of the overall economy**

The coexistence of different types of business organisation prevents concentration movements on the financial services markets which are detrimental to the economy as a whole and thereby contributes to stability and competitiveness. The plurality also represents added value for all market participants on account of different business objects, business philosophies and structures. For example, quoted joint stock companies typically pursue the sole aim of maximising returns for the shareholders. Public credit institutions, on the other hand, fulfil tasks in the general interest, for example by ensuring that all customers have access to banking services. For the cooperatives too – which are also not susceptible to acquisition – special and different operating principles apply than for joint stock companies, for example. On account of their regional roots, savings banks and cooperative banks counter economic impoverishment even in structurally weak regions.

The big banks, focusing exclusively on shareholder value, on the other hand, have made territorial withdrawals in Germany in recent years. Today, they no longer maintain any branches at all in every one in ten German rural districts – in the new Länder, it is even in every one in six rural districts. In contrast, the savings banks and cooperative banks, already on

---

[15] Deutsche Bundesbank: Monthly Report, September 2006, p. 22 and 29.

account of their regional roots, continue to have a very dense branch network at their disposal and thereby ensure provision of financial services to the population nationwide. The withdrawal of the big banks inevitably leads to the strong representation of savings banks and cooperative banks in rural and structurally weak regions.

- **Credit institutions have to prove themselves in competition**

It is ultimately the customer who decides on the success of different business models. It is in this competition that the various business models have to prove themselves and not in a political structure debate. Outstanding products and conditions are the decisive factor here. The disintegration of pluralistic structures, which ensure customers the choice between different forms of credit institutions, would be detrimental to them. The alternative would consist in a small number of similarly structured big banks with a similar business policy orientation. As the situation in other Member States shows, such a structure would be damaging to competition and contrary to the interests of consumers.

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 EU Commission report evaluates the efficiency of the financial sector on the basis of the profitability and income of the banks. In our opinion, however, an efficient market is characterised far more by a large variety of products and price competition, from which consumers benefit. On the other hand, high profitability and earning power of the banks are of no advantage to consumers – as the Commission assumes.

Furthermore, we have methodological doubts about the representativeness and consistency of the definitions and parameters used in the report, which have a considerable impact on the cogency and reliability of the results. We should therefore like below to give a few suggestions to be taken up in the further investigation by the EU Commission.

There are a large number of – at times related – parameters for the profitability and income of the banks. Before the components "profitability" and "income" are commented on in more detail, a comment is first made on two macroeconomic parameters.

- **Macroeconomic approach**

From the macroeconomic point of view, profitability and income depend on:

- the general level of income:
  As shown in the EU report, income per consumer in the new EU Member States is lower than in the EU-15 countries (cf. on this subject the comments in the general observations

on the differing wage costs). For instance, the per capita income in Lithuania is a fifth of that obtained in Luxembourg.[16] Consequently, Luxembourg is also in the lead for per capita income from current accounts (expressed in absolute figures), whereas Lithuania brings up the rear.[17] To be able to achieve meaningful results from such a consideration, comparisons must also take account of purchasing power.

- general economic efficiency:
  The general economic efficiency – expressed for example in the per capita growth rate of annual real GDP – differs significantly within Europe, as shown by the Eurostat data for the years 1996 to 2005. This is attributable inter alia to the different stages of development of the markets. It is therefore hardly surprising that the Baltic States at present have the highest growth rates (e.g. Lithuania with an annual average growth rate of 6.9%); but also in countries such as Germany or Spain with a similar level of development, the growth rates of 1.3% and 2.7% respectively differ considerably.[18]

- **Microeconomic approach**

The income obtainable by a bank is determined by a large number of factors. The most obvious is the ability of the bank to generate business through attractive products and services for customers. Other factors are determined externally however and should be considered in a comparison with other States.

- Competition:
  On a market with intensive competition, productivity increases do not result in higher income for the supplier, but are passed on in the form of price reductions to customers. Banking in Germany is a good example of pronounced competition on account of the large number of suppliers. The concentration is correspondingly low: the share of assets of the five largest credit institutions of Germany amounts to only 22.9% – in contrast to the (unweighted) EU-25 average, which stands at 59%.[19] Even in areas with low population density, several banks are represented. Furthermore, there are many new competitors, in some cases with very aggressive prices. This is also a consequence of the low market entry barriers. The fact that German banks are forced to pass on productivity increases to customers is a sign of efficient markets, not of inefficient services on the part of the banks.[20] In contrast to this, other countries with a high degree of concentration show trends towards oligopolistic price fixing.[21]

---

[16] Eurostat News Release 75/2005, June 2005, p. 1.
[17] EU Commission, Interim Report II Current Accounts and Related Services, July 2006, p. 67.
[18] Eurostat Report “Growth rate of real GDP per capita”, cf. www. epp.eurostat.ec.europa.eu/portal; own calculation.
[19] ECB, EU Banking Structures Report, October 2005, p. 50.
[20] KfW-Studie “Das deutsche Kreditgewerbe im internationalen Vergleich, July 2005, p. 5 ff.
[21] EU Commission, Interim Report II Current Accounts and Related Services, July 2006, p. 158 with a reference to Corvoisier/Gropp (2002). For the United Kingdom: Mullineux/Terberger: Report of the Anglo-German Foundation, The British Banking System: A good role model for Germany? (http://www.agf.org.uk/pubs/pdfs/1448web.pdf), p. 9 and 10.

- Interest margin:
  The interest rate margin also has to be considered in any comparison of profitability of banks. In Europe, the interest rate margins at times differ considerably in terms of both absolute amounts and in rates of change – which in turn has a considerable impact on profitability.[22] In Germany, for example, in recent years the in any case relatively small interest rate margin has declined constantly and sharply, by nearly 40% from 1993 to 2001 alone; in Italy, for example, the comparable value lies at 15% with the interest rate margin at a generally higher level.[23]

- Country-specific habits and behaviour patterns:
  The EU report shows that country-specific parameters also exist in the case of financial services, such as different price strategies (e.g. discount versus premium) and models (lump sum versus fee per transaction) on the supply side and behaviour patterns of customers (e.g. number of transfers or direct deposits).[24] These specific national characteristics determine the structure of bank income and make their comparability significantly more difficult.

- Provision of basic banking services:
  Exclusively shareholder-oriented banks close less lucrative locations and avoid dealing with non-profitable customers or impose heavy charges for such services, as shown by the example of the banks in the United Kingdom.[25] These measures have a positive impact on the profitability of the banks, but have considerable negative social consequences. The responsibility for the social aspects of banking is transferred to society. Groups of institutions with a different business philosophy, on the other hand, feel responsible for the provision of basic banking services for the population. In this way, on account of their public mandate and communal ownership, the savings banks in Germany allow access to banking services by all customers in all regions and in this way ensure the provision of basic services for the population.

- Business model:
  The sources of income are a further profitability parameter. Whereas retail banks obtain the lion's share of their income from (mostly highly standardised) interest rate products, mention should also be made of fee-based transactions, on the other hand. Both

---

22 Herr Christl, Austrian National Bank, confirms that the higher interest margins are the main reason for the comparatively better profit trend in Central and Eastern Europe; www.fondsprofessionell.de.

23 KfW Study "Das deutsche Kreditgewerbe im internationalen Vergleich", July 2005, p. 2.

24 EU Commission, Interim Report II Current Accounts and Related Services, July 2006, p. 87-90.

25 Mullineux/Terberger: Report of the Anglo-German Foundation, The British Banking System: A good role model for Germany? (http://www.agf.org.uk/pubs/pdfs/1448web.pdf), p. 8; here reference is made to "… a significant percentage of British people that (in 2002) did not have a bank account".

segments differ in profitability and volatility of income. However, no account is taken of these different business models in the interim report.

The cost aspects represent a further facet of the profitability discussion:

- Factor costs:
  In general, the demand for banking services is local. The customer needs a local ATM and receives counselling in accordance with the statutory provisions of his region – and not according to those of other Member States, irrespective of how reasonably priced this might be. Therefore little knowledge is gained from comparing factor costs cross-border.

- Cost-Income-Ratio (CIR):
  The CIR is readily enlisted for any discussion on the profitability of banks. However, as already mentioned above, there are hefty variations in costs and income and so too in the CIR between countries. The CIR is therefore not an appropriate parameter for comparison (although this parameter would be favourable for the savings banks sector in Germany, see question 2).

- Risk-return aspects:
  In principle, the profit-making potential of a bank is greater, the higher the risks. The "appetite for risk" of a bank is the outcome of the individual strategy. In principle, institutions active in all fields of retail business are subject to lower risks. A lower return on equity may also be attributable to a relatively high capital base and is therefore not necessarily a sign of lack of efficiency.

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?

As already stated regarding question 1, a large number of foreign credit institutions have managed to make a successful entry into the German market. This shows that the German financial services market is not partitioned off. The question about "other types of entry barriers" does not therefore arise for Germany.

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

The whole purpose of competition law consists in ensuring freedom of competition and in limiting economic power where it impairs the effectiveness of competition and its inherent tendencies to boost performance and calls into question the optimum supply for consumers. On the other hand, it is not for competition law to make regulatory interventions in market structures. This applies more than ever if an extensive product range and competitive end-customer prices exist – as in Germany.

The Commission seems to be more concerned about the predominant structures in Germany and the presence of a large number of relatively small market participants than about the concentration efforts especially on the part of the private big banks.

In view of the well-functioning competition and the possibility of market entry shown by the success of foreign credit institutions on the German market, the requirements for “fair” competition are met. There is therefore no cause for doubts about competition in Germany.

In no way can the need indicated in the interim report for privatisation of public credit institutions or the abolition of the variety of legal forms as a whole be derived from competition law. The pluralism characterising the German market ensures intensive competition and nationwide provision of cost-effective financial services for the population. To abolish them would therefore be counterproductive from the point of view of competition policy. Instead of promoting consolidation, the guardians of competition should rather counteract concentration movements which are damaging to the economy as a whole.

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?

- ***Access to credit databases***

The possibility exists for German credit institutions to cooperate with various credit agencies (e.g. Expirian, InFoScore, SCHUFA-Holding AG). SCHUFA also provides information to European credit agencies in the home country of the debtor. In this respect, the European credit agencies have agreed to the following: a European credit agency can carry out a SCHUFA inquiry where a customer resident in Germany would like to do business in another EU Member State. This inquiry is noted in the SCHUFA database. In return, the European credit agency notifies SCHUFA of the data it has available on the payment behaviour of customers. The same applies conversely for a customer resident in another EU Member State if the latter would like to transact this business in Germany. SCHUFA ensures that, in respect of the data communicated by SCHUFA, contracting parties with their registered office outside Germany are contractually bound to the principles of data protection corresponding to the data protection rules valid in Germany and the specifications of the European Data Protection Directive. We do not therefore find on the whole that there are any barriers restricting competition in the credit databases business field.

- ***Access to payment infrastructures***

The following applies in respect of access to different payment systems in the Federal Republic of Germany.

The legal and organisational framework conditions for different payment procedures (e.g. “agreement on transfers”, “agreement on the collection of cheques”, “agreement on direct debit operations”) are drawn up by the key associations of the credit industry cooperating within the Central Credit Committee (CCC) and the Deutsche Bundesbank and are exempted by the Federal Cartel Office. Legally, the agreements are multilateral contracts. Individual credit institutions in each case have the possibility of recognising that the agreements drawn up in this way are binding on them and after that of taking part in the respective payment system in accordance with the rules of the agreement. Accordingly, in particular, the CCC associations are not the economic operators of the respective payment systems. They also obtain no income from the systems mentioned. The CCC associations legally have the status of registered, non-commercial associations within the meaning of § 21 of the Civil Code, to which gainful economic activity is prohibited by law. A credit institution wishing to join the individual payment systems accordingly does not have to pay any licence fee etc. to the CCC. The payment systems mentioned are “open systems”, in which alongside the credit institutions belonging to the key credit associations, other credit institutions can also participate. In this respect, it is possible for any interested foreign credit institution to participate in the German payment systems. To do so, this credit institution merely has to accept the agreement existing for the respective payment system.

Furthermore, we venture to refer to the reply of the Central Credit Committee of 12 September 2005 to the European Commission’s request for information (Case COMP/D1/39.190), in which we commented on questions relating to the organisation and settlement of national card-based payments.

D. Customer choice and mobility

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

- **Customer loyalty through customer satisfaction**

The interim report points out that in the past year throughout Europe “only” 9.11% of customers switched credit institution – in Germany 9.73%. The Commission sees this to be an indicator of lack of mobility and competitive shortfalls.

This is not convincing. Stable customer relations are more the expression of customer satisfaction, whereas high rates of change show dissatisfaction with the services offered by the supplier. A long-term customer relationship is based on confidence, in the interests of the bank and the customer, who as a result can rely on counselling tailored to his needs. Contrary to the assertions of the interim report, lower profits for the institutions in the case of frequent customer changes are also not necessarily an indication of more competition or better services. They can also quite simply result from the acquisition of new customers basically costing money.

- **Artificial barriers to change do not exist**

The information asymmetry and low price transparency named in the interim report as potential "barriers to mobility" are not discernable in Germany. Already on the basis of the current legal provisions, the German credit institutions provide extensive information in a manner open to scrutiny on the essential product characteristics and prices of the services they offer. Furthermore, consumers can themselves compare complex products in daily newspapers, specialist magazines, such as FinanzTest, and on Internet platforms.

As regards cross-selling, the interim report acknowledges that, in the case of a long customer relationship based on confidence, this may bring advantages to customers and credit institution. As far as bundling of products is concerned, the existing price transparency as a rule leads to a deliberate customer decision in favour of the offer which is the most advantageous to him on the basis of the components of the respective product package.

Charges for winding up an account which could be imposed on customers when switching their account are not made by savings banks, quite simply because these would be contrary to the case-law of the Federal Supreme Court. On the other hand, a distinction must be made between charges for winding up accounts and the compensation in the event of early repayment of fixed-interest long-term mortgages. In the latter case, it is a matter of compensation for the loss incurred by the institution as a result of the early termination of the contract, i.e. the behaviour of the customer in breach of the contract.

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.

As already stated in respect of question 6, the payment systems in the Federal Republic of Germany are open. Restrictions to access or entry barriers do not exist.

In Germany, with "DTAUS", a payments format exists which allows straight-through processing in the chain between the instructing customer, his credit institution, a clearing credit institution possibly included, the beneficiary's credit institution and the beneficiary, which is without conversion and as a result cost-effective. With this payment format, any credit institution or any customer in Germany can be addressed for payments; it is therefore capable of catering for multiple banks and multiple customers. This also means that there are no barriers to switching credit institution as a private or business customer. The payments formats of the Central Credit

Committee are public and can be used without licence fee (cf. www.zka.de). Furthermore, there is a uniform communications procedure which all banks in Germany offer their customers. For business customers, this is a procedure based on the communications protocol FTAM, which is to be replaced from 2008 by an Internet-based procedure obligatory for all institutions (EBICS – Electronic Banking Internet Communication Standard). In addition, there is an established, dialogue-oriented procedure predominantly in the private customer sector (FinTS).[26]

In most other EU Member States, there are often only proprietary payment formats and communication procedures which make it considerably more difficult for customers to switch banks on account of the outlays to be made.

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

In the field of transfers, there is no need in our opinion to introduce an inter-bank fee. Well-functioning procedures already exist here, which are established Europe-wide.

The situation is different however in the direct debits field. Within the European Payment Council (EPC), the conditions for the European direct debit (SEPA direct debit) have currently been established. The success of the SEPA direct debit depends in particular on customer acceptance, but also on acceptance by the credit institutions in Europe. In particular, the paying agencies are already facing considerable extra expense in the context of the European direct debit procedure. In this respect, it seems appropriate to establish an inter-bank fee in the context of the European direct debit procedure which the paying agency can charge for the service it provides as first collection point. The introduction of an inter-bank fee in the context of the European direct debit procedure prevents paying agencies charging their customers individually for their participation in the direct debit procedure on the basis of the activity they perform, since this would lead to an undesirable increase in the cost of payments for private customers and could result in private customers refusing to participate in the new European direct debit procedure.

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

On 1 December 2005, the European Commission presented a proposal for a Directive on payment services in the internal market (COM (2005) 603 final). The aim of the European Commission is, through the proposed Directive to eliminate the legal and technical barriers to the creation of a Single European Payments Area (SEPA) and in this way to boost competition

---

[26] Cf. www.hbci-zka.de.

within the payments systems. The proposal for a Directive covers payment transactions (transfers, direct debits, debit and credit card payments and on-line banking) in euros and in foreign currencies, where either the payer's service provider or the payee's service provider (or both) have their registered office in the European Union.

The Sparkassen-Finanzgruppe in principle supports the creation of a single payments area. To this end, together with the European credit industry, we are developing new payment procedures, such as the SEPA direct debit and the SEPA transfer. However, the at times very detailed requirements of the proposal for a Directive interfere unduly in the product design and pricing, which would have the effect of cartellising and be detrimental to innovation. Rather, care should be taken that, on the basis of the specifications of the Directive, and especially the implementation deadlines, credit institutions should not be forced to become direct participants in a centralistic clearing system which can be used for bulk payments, as this would result in considerably higher investment and settlement costs and not least in monopolistic structures in European payments.

11. Conclusion

The interim report as a whole would indicate that the Commission is trying to derive arguments from the sector inquiry in favour of its politically strived-for changes to the banking structures in some Member States, including Germany. We venture to summarise our main criticisms once again as follows:

<u>Firstly</u>: The interim report displays significant methodological weaknesses and is not representative of either the banking sector in Europe or banks and savings banks as a whole. Since the method of calculating income and expenses and the customer segmentations and product classifications are not clearly stipulated, the data established are not comparable and the pronouncements then made not founded.

<u>Secondly</u>: The reproach that smaller institutions work less efficiently than large ones, is incorrect. This is already shown by the figures published by the Deutsche Bundesbank for the individual groups of institutions in Germany. They show distinctly higher success indicators for savings banks in comparison with the big banks. This is true of the cost-income ratio as well as for the return on equity.

<u>Thirdly</u>: The repeated demand in the interim report for consolidation and hence strengthening of the market power of just a few suppliers is in clear contradiction with the very purpose of competition policy and competition law. According to this, a market structure makes macroeconomic sense if – as on the German market – a large number of suppliers cater for a large number of customers. It is precisely the large number of independent credit institutions in Germany which results in it being possible to offer high-quality financial services nationwide at favourable prices.

Fourthly: The public legal form of credit institutions too does not prevent access to the German retail banking market. The Commission fails to realise that mergers and acquisitions in themselves do not lead to more competition. Mergers have the consequence that the number of suppliers declines and conversely the market power of the merged enterprise grows. It is true that the acquisition of an existing supplier, on the other hand, is neutral in terms of competition policy. However, the mere change of control of this supplier does not result for the customer in any automatic improvement in the provision of services or the price. On the contrary, deterioration may even occur, for instance if deposits are withdrawn in the target country to issue them as credits in another region where higher profits are beckoning; in such a case, the credit competition in the country of the target company is reduced. In principle, more competition is generated on the other hand by the development of subsidiaries or establishments. This preferable way of developing cross-border activities from the competition point of view is not mentioned further in the interim report. In addition, the Commission fails to recognise that it is precisely the plurality of legal forms and the associated different business philosophies and strategies which guarantee intensive competition and optimum supply of financial services for consumers and businesses.

Berlin, 9 October 2006