RETAIL BANKING SECTOR INQUIRY
PRELIMINARY REPORT II
CONSULTATION FEEDBACK FORM

Name of organisation:	Erste Bank der oesterreichischen Sparkassen AG
Type of organisation:	Stock Corporation, Savings Bank
Address:	1010 Vienna, Graben 21
Country:	Austria

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

☐ Yes

☑ No

General Statement:

The Erste Bank der oesterreichischen Sparkassen AG ("Erste Bank") supports increased integration of the European retail banking market, which to us means the market for services aimed at private clients, and small and medium enterprises. We support efficient, competitive, sustainable markets that bring benefits to customers. However, we feel that care and a sense of proportion will be needed to attain this objective.

We therefore believe that restricting the first stage of retail market integration to the sole issue of consolidation of the banking sector and the growth opportunities offered by cross-border mergers and acquisitions would be an inherently flawed approach. There is a danger that reform will totally ignore the customer's perspective and the need for Europe to reconnect with its citizens.

Bridging the gap between Europe and its citizens means meeting their expectations in terms of adequate access to financial services, and strengthening the sense of familiarity and ease that comes from proximity relationships.
The key to success is building a single European retail market based on decentralised structures — a market that is capable of delivering customer driven services because of the providers' in-depth knowledge of local circumstances.

The players in the kind of well balanced, integrated retail market that the EU needs must thus be aware that different banking models are required to satisfy different customer groups and to achieve economies of scale.

One possible different banking model is the institutional protection scheme which is a contractual arrangement that was signed between Erste Bank and the vast majority of Austrian savings banks. Close cooperation in the development and sale of banking products and the day-to-day business management generates necessary economies of scale for all participating members. This in turn assures economic survival of small and medium sized regional savings banks and consequently secures product and market diversity for costumers.

The importance of diversity should not be obscured by an abstract political debate, and sight should not be lost of the fact that financial services exist to serve the consumer. The aim must be to promote pluralistic markets that leave room for all types of ownership structures, whilst observing the principle of “same business, same risks, same rules”.

Ultimately, what counts are satisfied costumers! It is in everyone’s interest for a variety of providers to offer the widest possible range of services.

Against this background, we are concerned that the EU financial services policy could be directed exclusively towards fostering cross-border consolidation to the detriment of the mid-sized banks which form the bulk of the banking sector, assure access to finance and banking service trough their wide presence in rural and urban areas and are well adopted to meet the needs of SME´s, local costumers, including lower income client.

The role of competition policy is manifold. However, the main objective of competition policy is to ensure competition to guarantee the improvement of consumer’s well-being and beyond that the welfare of the whole European economy. Thus, competition policy shall preserve diversity of goods and services by fostering the variety of suppliers. Hence, especially from a competition point of view a high market seller concentration should be avoided.

EU competition policy regarding financial markets should not only be driven by the development of distinctive capabilities for global competitiveness but as well by national considerations to ensure a balanced approach.

Economic theory provides theoretical tools to confirm that firms in a concentrated market tend to gain supernormal profits at the expense of consumers who have to pay high prices and fees. The rationale for the link between seller concentration and price in an industry is that firms that operate in concentrated markets are sheltered from competitive pressures, and therefore are able to charge prices that are substantially higher than those that they would charge if they competed against many other firms. A concentrated market structure, having negative effects on competition, is detrimental to the welfare of consumers.

Additionally, empirical studies have revealed that no statistical evidence is given for assumptions such as: economies of scale just depend on the pure size of a firm or profitability depends on the size of a firm or profitability depends on the level of concentration.

Consequently, it must be recognized that:

- small firms can create economies of scale;
- small firms can be as profitable as large firms;
- higher concentration of markets does not entail higher profitability of firms.

Therefore the challenge of EU-competition policy is to eliminate market inefficiencies, especially in markets where there are significant returns to scale. The best way to secure market efficiency is to foster pluralism of market participants. Harmonisation will reduce the number of suppliers. Consequentially, harmonisation distorts market efficiency and competition.

The main task of competition policy shall be to encourage competition. Enhancing a pluralistic banking market structure is the best way to sustain competition in financial markets.

<u>Specific questions from Executive Summary:</u>

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 most important obstacle or rather the most important reason why banks are reluctant to engage in cross-border consolidation is, that benefits from synergies in cross border deals are less than in domestic merger and acquisitions. Moreover, many of those obstacles that offset most of potential efficiency gains include difficulties in managing and monitoring foreign branches, different language and culture, different board structures and corporate governance as well as the specificities of local product and service demand.

European savings banks also highlighted multiple reporting requirements and taxation on dividends as the principle obstacle to cross-border consolidation.

Some argue that banks with a certain ownership structure are one reason for market fragmentation. However, to consider certain ownership structure as obstacle to integration is misleading as no legal form can be said to be superior to another, and all are necessary as they fulfil different missions. European costumers could only lose out if the variety of suppliers would disappear.

Each legal form pursues a different set of ‚ownership-linked' objectives which their structures are geared to fulfil: The ownership objective of a public bank is to satisfy the needs of the community in its provision of banking services, a foundation bank's objective is the distribution of own resources for public-benefit purposes and a cooperative bank's objective is the satisfaction of its members' needs while that of a joint-stock bank will be to seek to offer banking services in a way that focuses primarily on maximising shareholder returns.

High levels of uniformity in terms of legal structures and hence business strategies are potentially damaging to the overall economic development in the financial services market.

The existence of different ownership structures developing different business models generally result in more diversified market structures and actors which has risk mitigating effects on financial markets.

There is a clear sentiment that the markets should be left to consolidate, and that regulators or legislators should not intervene to artificially influence the process.

However, regulators should keep a watchful eye over cases of consolidation as regards the competitive risks that may be involved. Individual instances of consolidation need to be assessed for the potential for increased risk of market power concentration, increased risk to the stability of the sector an increased risk for access to finance.

Moreover, it must be stressed that even fragmentation of markets contributes to a higher level of competition. Fragmentation offers many chances to highly innovative and efficient firms being able to react immediately to changing needs of consumers and SMEs. Fragmentation, unlike harmonisation, is contributory to achieve a high number of firms within a market offering a wide range of goods and services. Thus, fragmentation promotes competition, resulting in normal profits for firms and low prices for consumers.

The European economic area is mainly composed of SMEs. The European Commission describes SMEs as the backbone of the European Union, and the best potential source of growth and jobs. To unlock the power of entrepreneurship SMEs need the access to tailor-made financial services. To be in line with the European Commission’s SME policy, the EU competition policy therefore shall ensure the diversity of financial institutions in order to provide adequate financial instruments reflecting the different needs of SMEs and consumers.

For the sake of market efficiency, the welfare of consumers and the overall Lisbon goals, EU-competition policy should be driven by preventing an increasing market concentration and by promoting the diversity within the European Union’s financial market.

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

See Answer to Q 1.

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 different degree of price adjustments in Member States is one major reason for varying rates of profitability. High standards of consumer protection can lead to over proportional costs in retail business. Supervisory obligations are an additional burden creating cost intensive transactions.

Another important reason is the diverse demographic characteristic in Member States with regard to population structure, employment market, income structure and such like.
Against this background costumer behaviour differs widely in terms of consumption and savings having major impact on the profitability of banks in the retail segment.

As has been stated on various occasions different legal tax systems create uneven conditions for comparing the profitability of banks.

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?

No.

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

From our point of view there are no entry barriers for banks of another Member State in Austria. There is no distinction between EU-banks and Austrian-banks. The convergence of the supervision banking law seems to be clear and sufficient and the provisions of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuing the business of credit institutions will be transferred into the Austrian banking act per 1.1.2007.

Competition law maybe could have a role in tackling entry barriers in retail banking regarding too sophisticated and over-boarding legal frameworks in the area of consumer protection and taxation. A convergence among national consumer protection regimes could lead to a more efficient competition.

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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?

No; According to Article 1 para. 2 of the directive 95/46/EC on the protection of individuals with regard to the processing of personal data and on the free movement of such data, Member States shall neither restrict nor prohibit the free flow of personal data between Member States.

The fact that there is no central clearing system in Austria allows any bank to access the payment infrastructure at the same cost within Austria and for foreign banks at the same cost as any other Austrian bank.

D. Customer choice and mobility

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

The fact that customer mobility in retail business is very low is no surprise – it is rather logical considering customer habits and expectations.

Financial matters are one of the most sensitive spheres in customer lives. The fundamental basis of the relationship between a customer and a bank is the confidence and trust in the adviser as a representative of the bank.

Customer polls have confirmed that customers prefer one defined contact for all financial matters. That is what most retailbanks put their focus on by providing an all-in-one service philosophy ("one-stop-shop")

The customer expects a continuous servicing from an adviser he is familiar with, who takes care of his financial needs, who advises and services him entirely. Once this confidence is established, the customer feels comfortable with a professional service, he is satisfied, which consistently brings about a high level of loyalty.

Consumer satisfaction polls, which are carried out periodically, proof this right. The most loyal customers are those who can rely on a long term intensive and complete service of a defined adviser. On the other hand there is a higher fluctuation when changing the adviser several times.

The overwhelming majority of retail customers are satisfied with their banks, which is due to personal service within a needs-driven customer care concept. More and more customer loyalty programmes try to reward the customers for their loyalty. There is a big added value for being a loyal customer – and the customers appreciate that.

A recent "customer satisfaction inquiry", conducted by an independent Austrian institute for market research, called "market", has come to the following conclusion:

Based on a coverage of 63% of all Austrian savings banks customers, it has shown that 72% (+5 compared to the figures of 2003) are well satisfied with the customers oriented proactive service by savings banks, where the focus lies on the financial needs of the client.

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 stated in Q6, there is no central clearing system in Austria, therefore, no limitation to the competition at the level of provision and settlement services.

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

Interchange fees are the re-balancing of costs for services rendered by a bank to another bank within a transfer. Therefore, such fees are necessary to avoid any discrepancies in the cost sharing between the different kind of banks offering payments services.

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

SEPA will allow an opening of the EURO payments infrastructure within the SEPA area. The SEPA migration will then drive to a broader competition on payments services between the banks in the SEPA area. As a consequence, the retail banking product offering in SEPA should have no barriers any more within SEPA.

F. Other issues

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

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 payment cards industry;
- ☐ mostly known to you/the payment cards industry.

4. Did the market analysis in the report:

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

5. Did the report raised the right policy issues;

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