



DANISH BANKERS ASSOCIATION

To
The European Commission
Competition DG
Financial Services

Sent by e-mail

25. september 2006

Response to the European Commission's Interim Report II on Current Accounts and related services

The Danish Bankers' Association is hereby pleased to submit our response to the Commission's Interim Report II on Current Accounts and related services.

The Danish Bankers' Association is the representative body for the banking and financial services sector in Denmark. Our membership comprises banks and financial services institutions both domestic and international operating in Denmark. Our purpose is to foster the development of a stable, dynamic and innovative banking and financial services sector.

The response from the Danish Bankers' Association will follow the designated feedback form as requested by the Commission. We would like to point out that the response to the report will be focusing on the aspects concerning the Danish market.

Overall comments

Danish Bankers' Association acknowledges that the report finds the results based on the number of current accounts for less reliable. The report faces methodological difficulties in general. Measures should be based on value figures such as banks assets and liabilities, and it is a problem, that figures are non-consolidated. Danish Bankers' Association supports this view, and the difficulties should be kept in mind when making certain conclusions and recommendations.

A. Market structure and fragmentation

A1: 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.

Fragmentation can mainly be explained by cultural differences and historical circumstances. Customers tend to stay with their local bank, even if the bank is acquired by some other (foreign) bank. This partly has to do with the fact that their personal adviser normally continues in the acquired bank.

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One cannot ignore a structural explanation as well. There are considerable sunk costs when starting up a new bank. There are several foreign banks operating in Denmark through subsidiaries and branches. The large market shares of foreign banks in Denmark are primarily due to mergers and acquisitions rather than the establishment of new branches and subsidiaries. It is far less complicated to acquire a local bank than starting from scratch and then have to deal with hiring new employees, investing in capital equipment etc.

Finally, due to regulation, it is fairly tedious work to start up a new bank business. Moreover, the fact that legislation is still not fully harmonized is also regarded as a significant barrier to entry in retail banking markets.

A2: What are the main causes and implications of the different level of concentration in the EU retail banking markets?

Chapter 4 states that the Danish retail banking sector is reasonably concentrated compared to other nations. It goes without saying that smaller nations tend to be more concentrated. Danish Bankers' Association therefore welcomes these first steps to calculate regional concentration levels. It clearly demonstrates that smaller countries as Finland, The Netherlands, Sweden and Denmark should not be compared with larger countries, but instead with regions of similar population sizes, e.i. Hamburg in Germany. Hence these economies financial service sectors do not seem to be particularly concentrated.

There could be regulatory issues which reduce cross-border activity as well. The structural entry barriers are relatively few. Payment systems and clearing infrastructure are easy to access for foreign competitors. I.e. joining fees are low etc.

Moreover, the Danish banking sector is characterized by many small banks. Smaller banks focus their activities on local customers, and most of them only have branches in their own local areas. For historical reasons the Danish banking sector has a relatively large number of branches which to some degree is demand-determined as retail customers have traditionally favoured personal contact.

Concentration could be an inappropriate measure for competition. Studies have shown (see Laeven (2004) among others) that concentration in some cases is negatively correlated with structural indicators for competition (founded on organizational econometrics).

However, we did pay attention to one small error in the presentation. The regional level analysis is apparently conducted on level NUTS2. The entire nation of Denmark is only one region under NUTS2, which is why figure 11 and 12 must contain a colour mistake.

B. Banks' financial performance and pricing

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B3: What are the main reasons for the varying rates of profitability and income in retail banking across the Member States?

Structural changes across Europe and some country-specific factors make it difficult to see the outcome from the levels and changes in net operating profits and profitability.

As for Denmark low nominal interest rates, the consumers strong belief in their own economy, and good macroeconomic conditions have boosted banks' lending to households. Lending toward companies have also grown due to the favourable economic climate. Lending growth is generating more net interest income despite the narrowing of interest rate margins. But non-interest income has been the largest contributor to income growth as income from loan-conversion, security trade and so forth have boomed.

Business cycles play a large role in the varying rates of profitability across nations and time. As the Danish economy has flourished in the last couple of years bank profits have followed.

The Danish Bankers Association acknowledges, that it is very difficult to compare the prices and income of different banking systems.

It is questionable whether the profitability rates from the survey (three years top) allows for an adequate comparison. Figure 21 is extremely sensitive to variations in business conditions. Therefore, we recommend that only the figures from the OECD profitability database is used. The same applies for the regressions and correlations in chapter 5 which serves no purpose. The coefficients of determination are low, and the regressions suffer from multicollinearity and have few degrees of freedom.

It is disapproving that the gross income per consumer data are based on the number of current accounts. Differences in the number of accounts per inhabitant across countries can bias these findings to a large extent. The gross income measures in table 19 (as well as the estimated income on management fees and payment transactions in figure 33) ought to be corrected by purchasing power parity. As such the current figures do not allow a fair comparison within the EU.

In chapter 6 it is questionable to determine service payments per account. This should be compared to a value measure, not volume. Additionally, dispersion in interest rates is not a proper measure of competition intensity. Credit lines from other than banks seldom appear in this measure, and the measure is biased towards zero when the economy is thriving.

Finally, one cannot compare payment transactions fees without considering the interest level on accounts. Very often there is an inverse relationship.

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C. Entry barriers in retail banking

C6: 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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The Danish retail banking sector is subject to regulation. The Danish competition authorities continuously evaluate the sector concerning prices and structure to prevent anticompetitive behaviour.

To access the Danish payment infrastructure a bank has to pay a joining fee which is equal to all members regardless of the bank being a direct or an indirect member. However, this fee is fairly small (3,1 mio DKK), compared to the strict capital adequacy requirements a bank has to fulfill. Furthermore the specific amount is approved by the Danish competition authorities.

Another significant barrier to entry in retail banking markets are legislation, especially consumer protection laws. In this case it is important that these laws are fully harmonized.

The Report regards the fact that most countries only have one clearing infrastructure as an anti-competitive factor. A comparison can be made to railway lines, only one set is available, which all operators are allowed to use. However, conditions have to be proportional, transparent and not be discriminating. Furthermore having only one infrastructure does not mean that the banks cannot set up different conditions for its customers. Finally in terms of SEPA, EU is referring to a joint infrastructure.

D. Customer choice and mobility

D7: What are the main reasons for the low mobility of retail banking customers?

In general, Danish customers seem to be content with their banking relationship. A Danish survey showed that 4-5 percent switched bank in 2004.

The reasons for switching bank is often better prices and better services in other banks or a change in life situation (marriage, move, new job etc.)

There are no clearly defined reasons why Danish Customers choose to keep their banking relationship. However, various surveys have revealed that some specific preferences are more common than others.

A common explanation as to why a customer chooses to be a customer in a certain bank is old habit or tradition. A good relationship with a personal banking advisor in the local branch can also be an important reason.

Furthermore, some customers are more loyal to their bank because they believe that it will be easier to obtain a loan if suddenly in need.

Finally, lack of interest seems to be a common feature among retail banking customers.

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The Danish legislation contains a general rule that mandates that everybody has the right to open a basic account (not including overdraft facilities, credit facilities or cash card). The banks also have to give a factual reason to close an account. All this makes it easier for customers to switch banks.

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The Danish Bankers Association makes a big effort to break barriers to customer mobility.

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For instance The Danish Bankers Association has recommended its members not to charge any unreasonable fees as regard to a customer's switch from one bank to another, and not to delay the switch.

Given a recommendation from The Danish Minister for Economic and Business Affairs Bendt Bendtsen, The Danish Bankers Association and The Danish Consumer Council agreed in 2004 to co-operate to develop a database on the internet, in which the consumers are able to compare the prices of Danish banks.

The database contains nine different model households with different economy and different civil status and makes it possible to compare the combined bank costs, interest etc. for a household. The database also makes it possible to compare single products.

The Danish Bankers Association has recommended its members to participate on the database to improve transparency of prices. 123 banks have chosen to participate, which is around 90 percent of the relevant banks.

To bring a higher standard of transparency of prices, the members of The Danish Bankers Association are also recommended to send an annual listing of fees to each individual private customer, which the consumers have paid within the year.

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

E8: Are there features of the payment industry that limit competition either at the level of provision of clearing and settlement service or the provision of retail banking services? Please indicate areas that merit further investigation.

The issue concerning membership of payment infrastructure on the basis of direct contra indirect membership is seen as a potential anti-competitive aspect. Participation can be relatively expensive because the system may have specific demands, which require certain features in the direct member's IT-system. Moreover, being a direct member it is necessary to have an account in Nationalbanken. In these circumstances it can be a benefit to have an indirect membership if it is a fairly small bank. Hereby a more varied sector structure is possible in which there is room for large as well as small banks, and in the end this is an advantage to the customers.

The report states that it can be a problem if membership of the payment system is on the condition that the member is a regulated financial institution. This means that non-bank enterprises can not be direct members of the clearing system. The retail banking sector is subject to heavy regulation,

for instance the strict capital adequacy requirements. Within the system the capital requirements are reassuring for the other members, because they do not have to be concerned about another bank in the system failing to make its payments. Equally important is the fact that non-banks are not as regulated which means a lack in terms of level playing field.

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It is also suggested that consumers and processors are taking part in the decision making process. The payment infrastructure can be described as a technical instrument, that ensures payments being settled. The banks are professional, they know the market, they are in contact with their customers on a daily basis, product development is being focused on continuously.

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The report ascertains that volume discounts creates a competitive advantage for large entities. The competitive authorities acknowledge the volume discounts. They are essential in order to obtain economic of scale to the benefit of all – both small and large banks. The amount of transactions handled by the payment infrastructure is also of critical importance, because most costs are fixed, and therefore it is advantageous if these costs are shared by a large amount of members. Thus, the conclusion is that the mentioned discounts can be advantageous for the community of banks.

E9: Are interchange fees necessary for the development of payment instruments (credit transfers and direct debits) in the EU?

Interchange fees are necessary because they give the possibility to provide services, which can be available to people who are not customers in the particular bank. As an example the Danish creditcard "Dankort" can be used in every ATM independent of customer relationship. Moreover, the interchange fee provide the incentive to develop products, which potentially can be beneficial to the customers of other banks as well.

Finally, the Danish Bankers' Association would like to thank The European Commission for its time, attention and hopefully responsiveness to this correspondence.

Yours sincerely

On behalf of the Danish Bankers' Association
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