

RETAIL FINANCIAL SERVICES: WHAT EUROPE HAS TO OFFER

Summary: Retail banking in Europe has gone from being based on a range of limited products and lack of competition, to the development of new personalized IT-based products. In the future, consolidation, convergence and geographic scope will continue to increase and technology will allow the industry to offer increasingly sophisticated, integrated and customised services at lower cost of delivery. Brand differentiation, excellent marketing skills, and superior customer value propositions will provide key sources of competitive advantage. Wealth product and services will continue to grow in importance. The outlook for customers in Member States which welcome inward investment and competition should be good as they will see both increased choice and a lowering of cost driven by the increased competition. Conversely, Member States who seek to hinder such an approach will deprive their customers of the opportunities of innovation, choice and cheaper products. For banks that take the comfort and security of continued protected domestic markets for granted the implications are serious. On the other hand, for banks with an eye to creating distinctive and exportable competitive advantage and whose brand can travel, erasing European borders from their minds is an exciting new opportunity.

The Past

Retail Banking in Europe has traditionally been based upon local branches offering a limited range of products all of which were manufactured in-house. There was limited competition between retail financial service providers with customers typically staying with their bank for life. As with all characterisations, this is something of an over simplification but in essence it does describe what retail banking looked like in Europe until very recently.

However, there have been a number of significant forces of change acting to a greater or lesser degree in each Member State. The first of these was a growing awareness amongst customers that their requirements need not necessarily be satisfied by one provider alone. As consumers became generally more sophisticated, their requirements for differentiated products grew and, therefore, there was a demand led change in the retail banking industry. There was also an increase in the level of competition between retail banks and, in addition, non-banks also entered the market place. This increased competition arose in part from increased demands being made by shareholders for a better return on their investment but also because of a realisation by the banks themselves that they needed to ensure their levels of profitability. On top of this was the availability of new technology which meant that different ways of cheaply and massively delivering products became available which had not existed previously. IT is interacting with growing customer expectation and sophistication to create an upward spiral of demand and supply that is revolutionising the business. Woe betide the bank that falls behind in this race - either through incompetence, a failure of imagination or by the lack of financial capacity to put the necessary chips in the game.

The Present

What we see now therefore is the growing development of a multi-channel rather than a local branch based approach with 'bricks and clicks' tending to become the prevalent model. Customers want to bank anytime, anywhere, anyhow they choose. It seems that the right strategy is to build a technology infrastructure that permits a "plug and play" capability, however the device universe unfolds, and the ability to integrate all the channels. At the height

of dot.com fever it might have been considered a bit odd to question the wisdom of bolting on stand-alone Internet operations and letting legacy systems wither on the vine. Now it seems the prize will go to those who e-enable their organisation from front to back, and who use legacy systems as an asset not a liability. There are a number of examples of Internet only retail banking offerings but the success of these ventures has been limited to date. And in fact a number have withdrawn from the market place recently.

We have also seen the development of niche players particularly, say, in the United Kingdom in the credit card market. In addition, there is a move towards supplying products which have not been 'manufactured' in house. In some instances this has been through the formulation of formal alliances, particularly in both the cards and insurance market and through joint ventures, especially where a non-financial retailer with a good brand has entered the market by teaming up with a 'traditional' bank to supply know-how and product.

The proliferation of market players has led to an increase in levels of competition and therefore customers are able to choose from a greater variety of products and services which should enable them to choose the one most suited to their needs. However, we are also seeing a greater degree of regulation, some of which is aimed at new selling techniques, for example, that relating to unsolicited mail and email and in other areas it relates to products themselves, for example UCITS.

What these generalisations hide, however, is the great difference between Member States in terms of the development of their market places. Some Member States are further ahead in the use of e-commerce, some have seen greater consolidation in terms of the number of providers and some operate under more or less innovative regulatory systems.

The Future

We would like to highlight 5 key trends that we believe will dominate developments during the next decade:

First, consolidation, convergence and geographic scope will continue to increase. There is, however, no automatic correlation between scale and value maximisation. It is therefore critical to understand which markets are global or European and which are likely to remain local, and to align strategy and resources accordingly. For example, investment banking and institutional asset management are truly global, while retail and commercial banking are likely to remain multi-domestic.

Second, technology will continue to transform financial services, allowing the industry to offer increasingly sophisticated, integrated and customised services at lower cost of delivery. Not surprisingly, customers are demanding these services as they become available. The ability to respond to this opportunity rapidly and at scale will be an important determinant of future competitive performance not just of individual players but of European providers as a whole.

Third, brand differentiation, excellent marketing skills, and superior customer value propositions will provide key sources of competitive advantage in retail financial services. In that respect, integrated distribution strategies, delivered through a fully e-enabled infrastructure, will be critical, as will competencies such as risk-based pricing.

Fourth, wealth product and services will continue to grow in importance, particularly in the larger countries of continental Europe, where capital markets are relatively underdeveloped and demographic shifts are creating profound structural changes. This is driving rapid growth in private pension provision and in long-term savings and investments.

Fifth, value chain disaggregation and reaggregation into new business models will gather pace. For example, advantaged capabilities and scale will favour value chain specialists, particularly in areas like transaction processing. At the same time, technology and information management capabilities will shift the value balance toward product distributors away from manufacturers as products become increasingly commoditised.

But there is no one winning model for financial services in the future, any more than there was a single model in the past. Each financial institution will need to focus on areas where it has existing sources of competitive advantage or where it has the foundations on which to build competitive advantage.

New Retail Services

There are two main themes which are driving the provision of new retail services across Europe. The first is a realisation that there are a growing number of wealthy individuals who demand services associated with both short and long term investments. To this is coupled the increasing realisation that pension provision will need to be moved from the State to companies, groups and to individuals and therefore there is, or will be, a greater demand for this kind of long term savings product. It has now become common to see retail financial services companies announcing the creation of a division aimed specifically at this market place. One of the particular features of this customer group is that they may be assumed to be more likely to move across the EU, or globally, because of their employment. This will then place an additional challenge on retail financial services institutions to be able to provide their valuable customers with a service wherever the customer happens to be. This will challenge the traditional Member State by Member State approach which most organisations have adopted so far.

Also coupled with the growth in wealth has been the development of execution only services. These provide customers with a cheap and easy method of investing in assets. It particularly suits those customers who do not want to pay for advice and who know what transactions they wish to undertake. The other main theme is clearly the rise of the Internet and the provision of e-banking facilities. The initial enthusiasm now seems to have waned slightly in as much as Internet-only offerings are now very rare. However, the use of the Internet as an integral part of a multi-channelled delivery offering to customers has become very commonplace indeed.

EU Legislative Developments

Looking to the recent past the E-Commerce Directive, whilst being useful in setting out clearly a country of origin approach, has had only a limited liberalisation effect on retail financial services. There are a number of obvious reasons for this. Firstly, insurance and UCITS were excluded from the scope of the Directive. In addition, consumer contractual obligations were also excluded and as all financial services are in the nature of contractual obligations, then it is easy to see why the Directive has been of limited use to retail financial service providers.

The Brussels Regulation also provided scope for much debate which has been well rehearsed elsewhere. In a recent speech to AIM Brand Forum, 6th November 2001, Robert Coleman (Director-General of the Health and Consumer Affairs DG at the Commission) said in essence that he did not know what the fuss was about. Clearly in financial services it is absolutely essential to know whose law and jurisdiction applies so that contracts and therefore the services offered can be framed appropriately. And in this context, the Brussels Regulation, which covers the choice of jurisdiction, is seen as setting a precedent for the Rome 'Regulation' which will cover applicable law.

As an industry, we have long supported the use of ombudsmen, complaints committees, etc., and we were therefore very pleased to support the creation of Fin-Net which will provide for a way of providing customers who are not from the country of the supplier being able to take their case to an ombudsman in the supplier's country.

Looking forward, there is the Distance Marketing of Consumer Financial Services Directive, the exact impact of which is still being debated in terms of what the political agreement reached by the Council really means and whether the Directive, with various levels of harmonisation, is really going to be a useful instrument in providing legal certainty for banks operating cross-border and in enhancing consumers' protection. In this respect, the role of the European Parliament will be key in clarifying exactly what is meant by the compromise amendments which led to the agreement. In its recent Resolution on the Commission communication on E-Commerce and Financial Services, Parliament indicated a reasonable way to follow in order to achieve a coherent legal framework for E-commerce in the Single Market – i.e., the immediate move to the country of origin approach, pending further convergence of national rules relating to consumer contracts for financial services.

The forthcoming revision of the ISD, in particular the effective application of country of origin to the cross-border provision of investment services to retail and the harmonisation of conduct of business rules will also be an essential instrument to foster consumer's choice and enhance competition. Looking slightly further forward, a review of the Consumer Credit Directive is underway and concrete proposals from the Commission are awaited with interest.

Obstructions

There are obvious barriers to the cross border provision of retail financial services which centre around culture and language. These may be very difficult to overcome in the long term let alone the short term. Additionally, some products are built specifically for certain tax regimes and the creation of pan-European products in this area may very well be a hard nut to crack. In addition, there are clear differences in attitude amongst Member States in terms of how much foreign competition they are willing to see in their country. There are only number of well-known high profile cases where governments have stepped in to ensure that a domestic take-over, rather than a cross border take-over, occurs.

Another clear difficulty which financial services organisations face is that they need to comply with different sets of law in each of the Member States in which they operate. This increases the costs of entering a new market. A further factor is that certain market places are just not big enough in terms of the total client pool available to warrant the investment necessary to make an entry. And finally, certain countries have high levels of social protection which mean that exit

costs are much higher. Companies take this into account when considering whether or not to invest there in the first place.

Outlook

The outlook for customers in those Member States which welcome inward investment and competition should be good as they will see both increased choice and a lowering of cost, driven by the increased competition. Conversely, Member States who continue to seek to hinder such an approach will deprive their citizens of the opportunities of innovation, choice and cheaper products. For banks that take the comfort and security of continued protected domestic markets for granted, or assume their competition is the same bunch of traditional rivals across the street, the implications are quite dangerous. On the other hand, for banks with an eye to creating distinctive and exportable competitive advantage and whose brand can travel, erasing the borders from their minds is an exciting new opportunity. We are likely to see further development of niche approaches with retail financial service providers seeking out the most profitable customer groups wherever they may be found. However, the likelihood is that this will be on a Member State by Member State basis rather than on a pan-European basis. European legislation as currently developed is not helping to change this trend.

Briefing notes are prepared by the Industry Advisory Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Advisory Committee.

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