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COMMISSION OF THE EUROPEAN COMMUNITIES

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PART I

**COMMISSION STAFF WORKING DOCUMENT**

**Cross-border consolidation in the EU financial sector**

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## COMMISSION STAFF WORKING DOCUMENT

### Cross-border consolidation in the EU financial sector

#### INTRODUCTION

In September 2004, the Council of Economic and Financial Affairs, meeting informally in Scheveningen, discussed the issue of lagging cross-border consolidation<sup>1</sup> in the banking area. The discussion was fuelled by a paper presented by the Presidency indicating low level of cross-border consolidation in this area and presentations by CEOs of leading European banks explaining the reasons behind this phenomenon.

Whereas the discussion focused primarily on the banking industry, it is well known that this low level of cross-border consolidation is not only confined to this market segment. It is largely relevant for the whole financial sector, with some nuances.

As a follow-up to their discussion, Finance Ministers invited the Commission to examine further possible explanations for the low level of pan-European restructuring specific to the financial sector. To this effect, the Ministers mandated the Commission to review the obstacles to cross-border mergers and acquisitions (M&As), in order to identify possible internal market failures, gaps or shortcomings. Finance Ministers also took note of the Commission's intention to review how the supervisory approval process could be improved.<sup>2</sup>

The primary role of the Commission is to ensure that existing EU law is enforced properly. The Commission does not favour specific business models or shape of markets, as long as they are in conformity with the European law. On that basis, it is the role of the Commission to analyse the functioning of the market, in order to detect any unjustified obstacles that would hamper companies in making their own decisions regarding the organisation of their business in the Internal Market. In addition, the Commission has also the task of proposing growth supportive actions within the context of the overall EU competitiveness policy.

In the banking sector, the misuse of supervisory powers to block cross-border mergers has been identified by Ministers of Finance as a possible obstacle to cross-border mergers and acquisitions. The Commission has already taken the initial steps to propose legislative changes, aimed at improving and clarifying the current provisions in the relevant directive<sup>3</sup>, to avoid such situations. In order to ensure cross-sectoral consistency, similar provisions in the insurance sector<sup>4</sup> are also examined, in the ongoing preparatory work for the Solvency II project.

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<sup>1</sup> Cross-border consolidation here means consolidation involving entities located in different EU Member States. Domestic consolidation is to be understood as consolidation occurring within a single EU Member State.

<sup>2</sup> The results of the Informal Meeting of Economics and Finance Ministers can be found at the end of this document.

<sup>3</sup> Article 16 of the Codified Banking Directive 2000/12/EC, which lays down the supervisory approval process for the acquisition of a "qualifying shareholding" in a credit institution

<sup>4</sup> Article 15 of the Codified Life Insurance Directive 2002/83/EC and article 15 of the Third Non-Life Insurance Directive 92/49/EEC.

At the same time, there may be other factors explaining the lack of cross-border mergers in the financial services sector. This paper aims to provide a thorough analysis of these issues, in order to foster the political debate and provide evidence-based guidance to possible future policy actions:

- Firstly, the cross-border consolidation process of the EU financial sector since 1999 is described in detail, to paint the background picture and provide an objective view of what is happening on the ground;
- Then the views of market participants (gathered through an open survey conducted in Spring 2005) are presented, as they are the best placed to explain what are the main drivers and the main obstacles behind companies' decisions to engage or not in cross-border activities;
- Finally, the issues raised by the economic analysis and the market participants' views are examined, in order to prepare the political debate.

**PART I:**  
**CROSS-BORDER CONSOLIDATION WITHIN THE EU FINANCIAL SECTOR**  
**BETWEEN 1999 AND 2004**

This part provides a description of the cross-border consolidation process in the EU financial sector. It examines merger and acquisition deals that took place between 1999 and 2004 by looking at the question from 3 different perspectives:

- Firstly, the specificities of the financial sector, by comparing consolidation in the financial sector with consolidation in the other, non-financial, sectors;
- Secondly, the differences between cross-border and domestic consolidation within the EU financial sector, looking at the characteristics of the mergers and acquisitions to identify similarities and discrepancies;
- Finally, the geography of the consolidation process, with an attempt to map out the linkages resulting from it.

It draws on a more detailed analysis (see separate working paper of the Internal Market and Services DG of the European Commission<sup>5</sup>), where precise definitions and methodological explanations can be found.

## **1. CONSOLIDATION IN THE FINANCIAL SECTOR COMPARED TO OTHER SECTORS**

This section aims to analyse how the financial services sector differs from other sectors. Therefore it looks at, on the one hand, the set of intra-EU deals within the financial services area<sup>6</sup> and, on the other, intra-EU deals in other sectors<sup>7</sup> observed as having been completed between 1999 and 2004 (some 4,000 deals with a total value of €2,600 billion).

Before comparing financial sector deals to deals in other sectors, one has to check whether this comparison makes sense. Could it be that the economic cycle of the financial sector is very different from that of other sectors, making such a comparison biased? The facts confirm that, even though the peak of activity in 2000 was slightly more marked in the financial sector, overall the economic cycle of consolidation activity in the financial sector does not seem to differ considerably from other sectors. A comparison is therefore justified.

### **1.1. Size characteristics**

First of all, the average financial sector M&A-deal differs by its size; consolidation in the financial sector involves larger buying institutions as well as larger target institutions. This was especially true in the years 1999-2000, when a series of huge domestic deals took place. Indeed, in those 2 years, the average size of deals in the financial sector was close to

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<sup>5</sup> Addendum to the Financial Integration Monitor 2005 report, available on the Commission website at: [http://europa.eu.int/comm/internal\\_market/finances/cross-sector/index\\_fi.htm#tracking](http://europa.eu.int/comm/internal_market/finances/cross-sector/index_fi.htm#tracking)

<sup>6</sup> Transactions where both the target and the acquirer are EU-based companies and belong to the financial sector

<sup>7</sup> Deals with at least one entity (acquirer or target) outside the financial sector

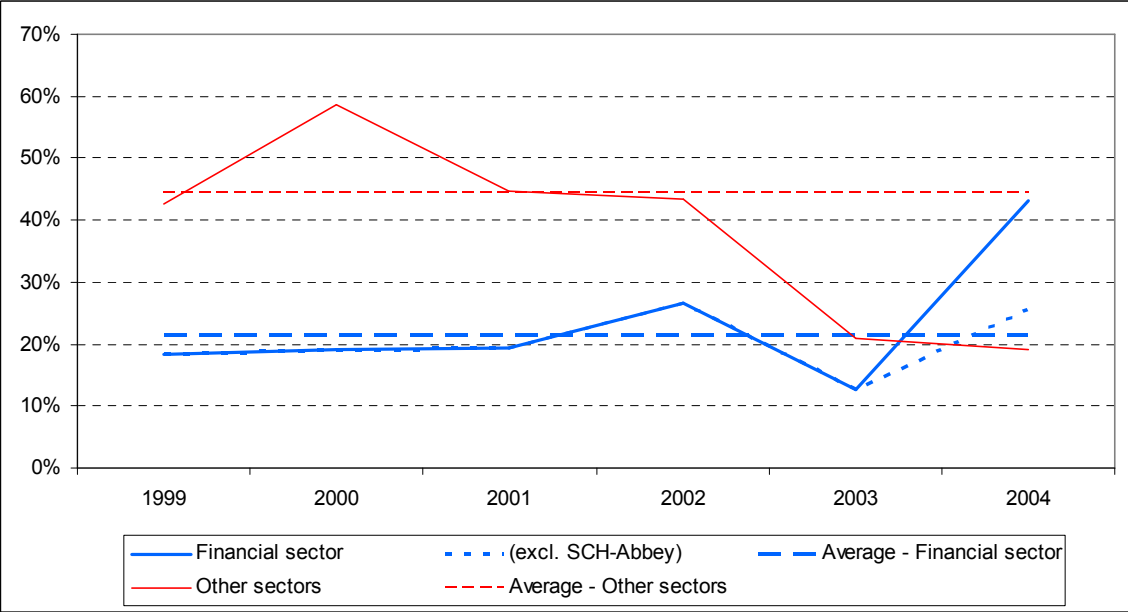
€650 billion, whereas the average size of an intra-EU deal in other sectors was around €250 billion. From 2001 onwards, there was a clear drop in average sizes both in the financial sector and in other sectors, but there remains a large difference, with an average value of €150 billion in the financial sector for the period 2001-2004, against €80 billion in other sectors.

Deal values only represent one dimension of the size of a merger or an acquisition, that of the acquired or absorbed entity weighted by the size of the undertaking. By looking at the other side, i.e. the size of the acquiring companies (measured by their asset value), significant differences are also to be found between the financial sector and other sectors. Whereas the average total assets of a financial company buying a stake in another financial company has been steady between €50 billion and €75 billion since 1999, the corresponding figure in non-financial sectors has remained between €10 billion and €30 billion.

**1.2. Proportion of cross-border activity**

A second marked difference is the low proportion of cross-border deals in the financial sector. Between 1999 and 2004, cross-border EU deals accounted for around 20% of the total value of deals within the financial sector. Despite similar proportions in terms of the number of deals, the proportion of cross-border transactions in value equalled 45% when looking at the other sectors (see graph 1).

**Graph 1: Proportion of cross-border deals in intra-EU deals, in the financial sector and in other sectors (measured by value)**



Source: Bureau van Dijk, Zephyr database

Over time, the proportion has remained stable in the financial sector, with the exception of a remarkable surge to 40% in 2004. However this surge should not be over-interpreted since it is mostly attributable to a single deal (the acquisition of Abbey National plc (“Abbey”) by Banco Santander Central Hispano SA (“SCH”)). If we remove this single deal, the proportion falls back to around 20%, in line with the trend of the 4 past years. In the other sectors, the proportion remained stable until 2002, but fell to 20-25% in 2003 and 2004.

### **1.3. Different cross-border consolidation processes at play**

Overall, the picture of cross-border activity in the financial sector is in line with the findings of other studies on this subject: cross-border activity is weak when compared to other sectors. This difference in value of deals (20% cross-border in the financial sector vs. 45% in other sectors) seems to reflect fundamental differences in the underlying consolidation processes rather than simply a relatively slower cross-border consolidation of the financial sector.

In the financial sector, domestic deals are significantly larger than cross-border ones (leading to ‘domestic champions’ strongly focused on one country). This appears to have been especially true in the years 1999-2000. This is further analysed in the next section. By contrast; in the non-financial sectors, cross-border deals appear to be larger than domestic ones, with a differential in sizes of the acquiring and acquired companies smaller than that in the financial sector, leading not to ‘domestic champions’ with secondary activities in EU countries, but to real pan-European companies with a more balanced breakdown of activities across countries.

## **2. COMPARING CROSS-BORDER AND DOMESTIC CONSOLIDATION IN THE FINANCIAL SECTOR**

In this section, the differences between cross-border and domestic mergers in the EU financial sector are considered. In a perfectly integrated market, such differences, if any, should be minimal. By contrast, should significant differences be evident, this could highlight a lack of integration in specific market segments.

### **2.1. Distinctive features between domestic and cross-border transactions**

Within the EU25 financial sector, cross-border mergers and acquisitions present visible distinctive characteristics when compared to domestic ones.

The first distinctive feature relates to the size of the companies involved. The size of acquiring companies in cross-border deals is much bigger, whereas there does not seem to be a marked difference in terms of the size of the targets. Indeed, since 1999, the average size of a company acquiring a majority stake through a cross-border acquisition has been close to €150 billion. In contrast, the average size of acquiring companies involved in domestic deals has remained at around €50 billion. On the target side, no such difference can be noticed between domestic and cross-border deals. The average size has remained stable at around €10 billion.

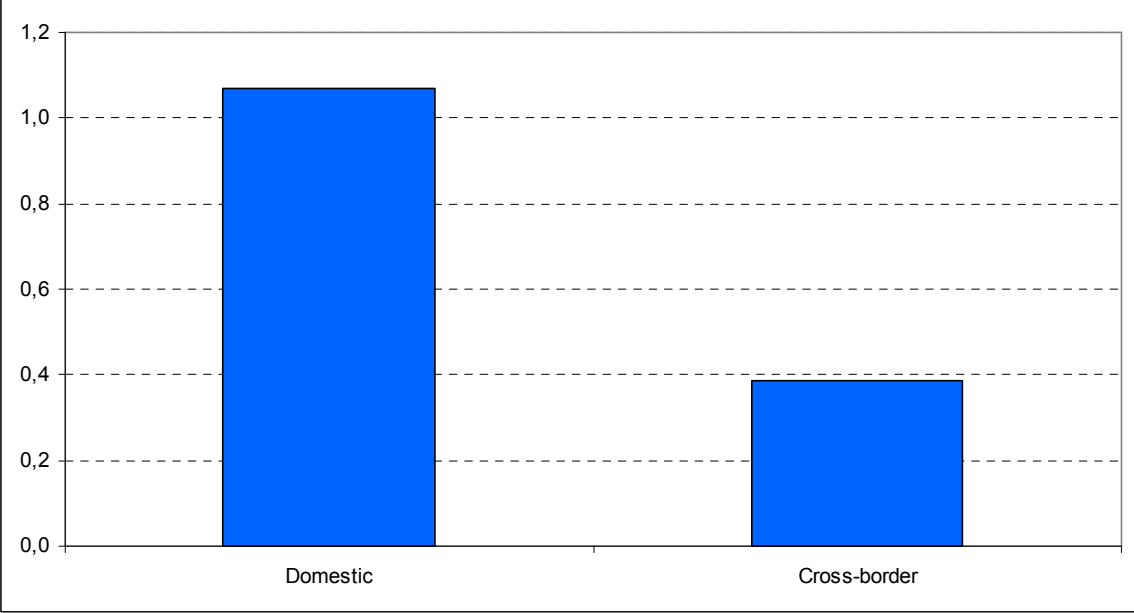
As a result, there is a big difference between cross-border transactions and domestic ones in the ratios between target and acquirer sizes, as measured by their total assets (see graph 2). Looking at the majority acquisitions weighted by the deal value, this ratio is close to 1 for domestic deals (meaning that the two companies are roughly the same size), whereas it is below 0.4 for cross-border deals (meaning that the acquiring company is much larger).

Therefore, only very large institutions appear to engage in the cross-border consolidation process, and in doing so they are competing with the smaller local players in acquiring the same targets.

A second distinctive feature lies in the sectoral mix of the transactions. Cross-border consolidation occurs more often within the same sectors (i.e. are scale driven) than domestic

mergers. In domestic transactions, cross-sectoral diversification is more commonplace, which can probably be explained by relatively high concentration ratios in some home markets that drive companies to grow outside their core sector.

**Graph 2: Average ratio of target assets over acquirer assets weighted by the deal value for majority undertakings (between 1999 and 2004)**



Source: Bureau van Dijk, Zephyr database

For instance, whereas “bank buys domestic insurance company” represents around 10% of the total domestic acquisitions by banks, “bank buys foreign insurance company” represents less than 4% of banks’ total cross-border acquisitions. Similarly, “insurance company buys bank” represents slightly less than 40% of domestic deals and around 20% of the cross-border deals. This trend is even more pronounced in the securities trading and post-trade activities (i.e. all activities related to financial markets, including broking, stock exchanges and clearing and settlement activities), where intra-segment operations account for almost 50% of domestic deals and more than 95% of cross-border deals.

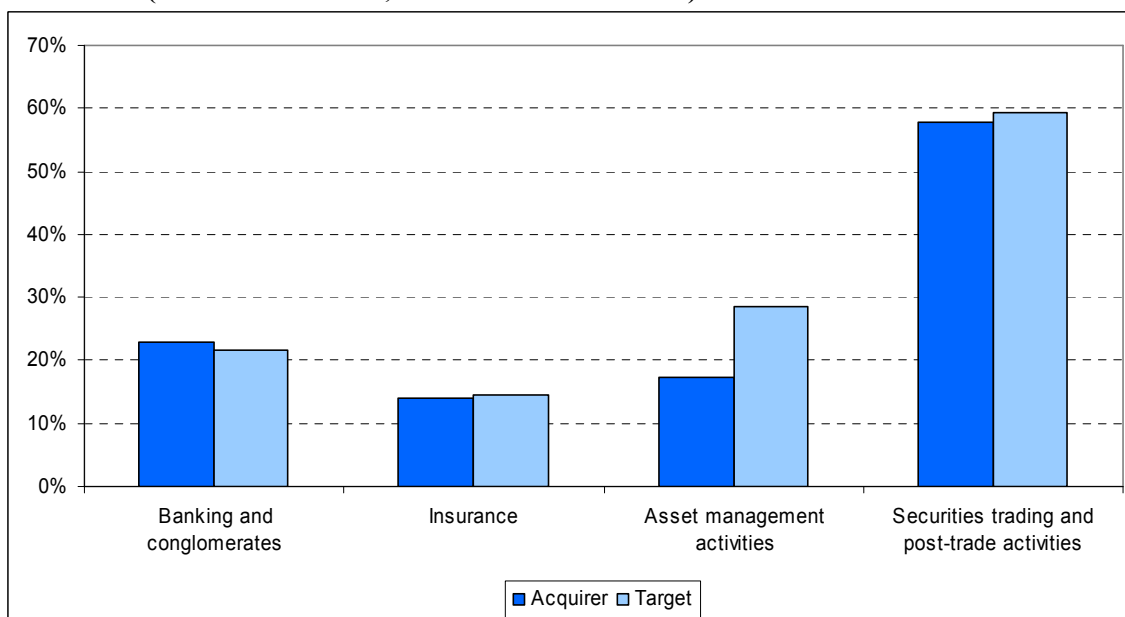
**2.2. Nuances according to the market segments**

Besides these common trends, differences can also be seen in the cross-border consolidation process according to market segments, with two polar (schematic) situations, on the one hand the ‘institutions’ area (banks, insurance companies and conglomerates) and on the other hand the ‘markets’ area (securities trading and post-trade activities).

The proportion of cross-border deals in the banking and the insurance sector is pretty low (whether from the acquirer’s or the target’s sides), at around 20% for banking and 15% for insurance (see graph 3). In contrast, the proportion of cross-border deals is very high in the securities trading and post-trade activities segment, with a proportion of almost 60% in value (against 20% in the financial sector as a whole and 45% in non-financial sectors). In the segment of asset management activities (i.e. all activities related to institutional investment and private investments, such as investment funds either as product developers or investors,

private banking, private equity<sup>8</sup>), the situation is between the two, with a proportion of slightly less than 20% when considering the acquirers, and around 30% when considering targets.

**Graph 3: Proportion of cross-border deals by market segment of acquirer and target (measured in value, between 1999 and 2004)**



Source: Bureau van Dijk, Zephyr database

By looking at the type of transactions, further differences in the cross-border consolidation process according to sector can be noticed. In the banking, insurance and asset management segments, the proportion of minority investment in cross-border deals is above the average for all cross-border transactions in the financial sector: whereas minority undertakings account for around 12% on average in cross-border transactions, this ratio is around 15% when looking at cross-border acquisitions made by banks or insurance companies. Only in the securities trading and post-trade activities segment is this ratio of minority investment lower than the average (below 5%).

Patterns appear to differ, with those segments with the least cross-border operations making a higher proportion of minority acquisitions, and the most integrated segment being more frequently involved in direct cross-border majority acquisition.

A final element of differentiation between market segments is the respective deal sizes of cross-border and domestic transactions. While the size of a cross-border acquisition by a banking institution or an insurance company is on average half that of a domestic merger, a cross-border deal by a firm in the securities trading and post-trade segment is more than 5 times larger than a domestic merger.

<sup>8</sup> It should be noted however that the category ‘asset management activities’ only covers the independent asset management companies, and not the asset management departments included in bank groups or insurance companies (which are included in the categories ‘Banking’ or ‘Insurance’). Furthermore, this statistic measures only consolidation at the level of the institutions managing the assets, not mergers of the funds themselves, which are faced with a number of specific obstacles. For more information, please see the Commission’s Green Paper on the enhancement of the EU framework for investment funds: [http://europa.eu.int/comm/internal\\_market/securities/docs/ucits/greenpaper\\_en.pdf](http://europa.eu.int/comm/internal_market/securities/docs/ucits/greenpaper_en.pdf)

In short, in the area of banks, insurance companies and conglomerates (i.e. ‘institutions’), the proportion of cross-border deals is lower than the financial sector average, with proportionally more minority acquisitions and significantly larger domestic deals. In the area of securities activities (i.e. ‘markets’), cross-border transactions are far more frequent, are comparatively larger than domestic ones, and consist more often of acquisitions of controlling stakes.

### **2.3. Domestic giants or pan-European institutions?**

The conclusion is that lagging cross-border consolidation is not only due to a slower pace but can also be partly explained by the differences in deal sizes, especially in the period 1999-2000 when domestic activity peaked (note that since the stock market valuations were uniformly high across the EU, there should be no bias when comparing the value of domestic and cross-border deals at a given time). Only in one segment (‘market’ activities) are cross-border deals significantly bigger, and this is the segment where cross-border consolidation is the most significant.

It would therefore appear that within the financial sector, cross-border restructuring is not at a stage where it is likely to lead to real pan-European institutions. Indeed, comparing average size has shown that domestic mergers are leading to the creation of domestic merged entities whose size is more or less comparable with the large cross-border groups, which grow through smaller acquisitions (and often minority investments). This trend was especially pronounced in 1999-2000, when domestic consolidation led to huge domestic groups with no comparable cross-border groups being formed.

## **3. GEOGRAPHY OF THE RESTRUCTURING OF THE FINANCIAL SECTOR**

The purpose of this section is to explore further the geographical breakdown of merger and acquisition flows in the EU financial sector, first by assessing them on the global stage, second by identifying the main underlying trends.

### **3.1. The significance of intra-EU restructuring on the global stage**

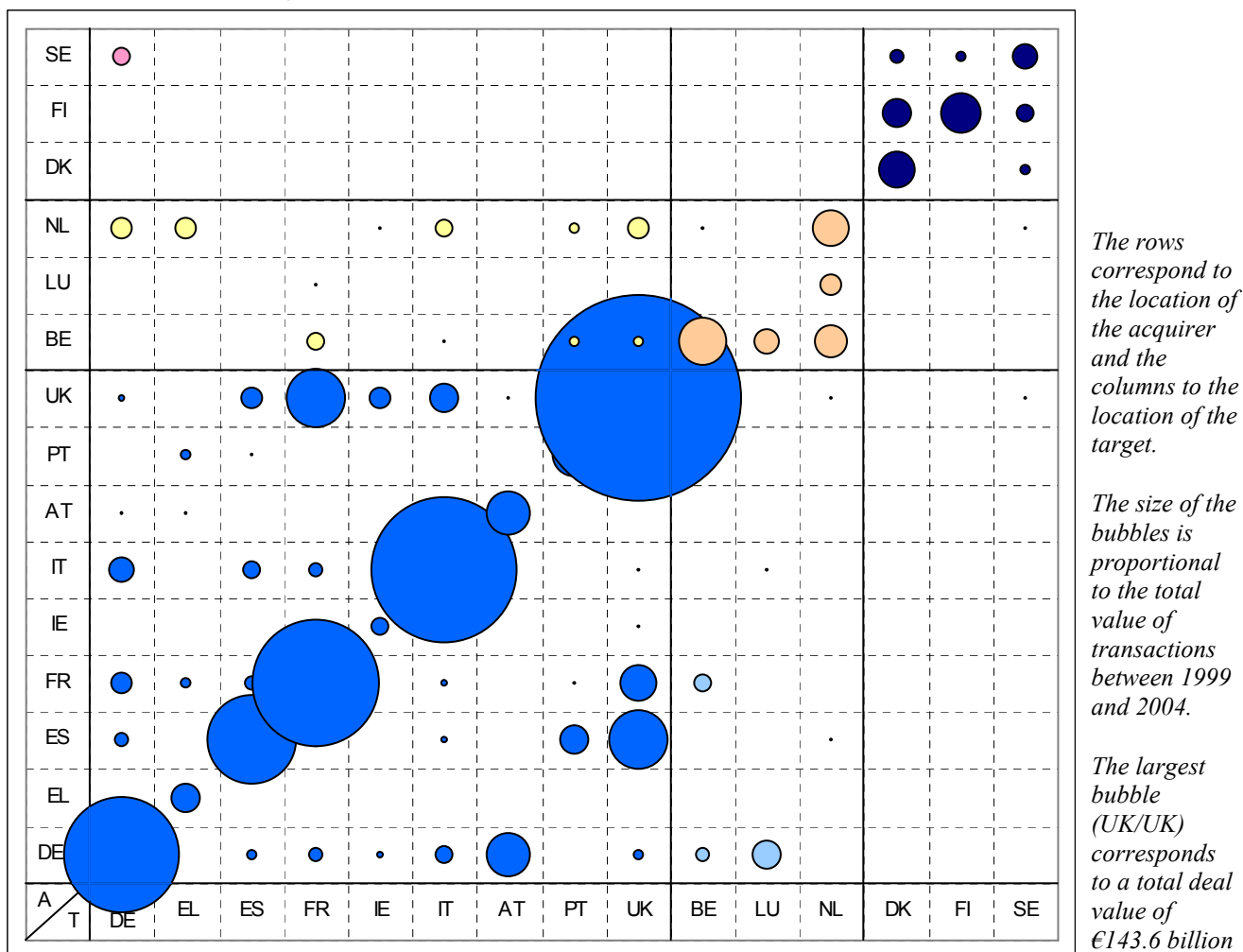
It is noticeable that the total value of intra-EU25 deals (domestic and cross-border alike) is not significantly lower than that of intra-North American deals (€500 billion vs. €580 billion). In other words, the intensity of restructuring has not been lower in the EU25 since 1999, even though the adoption of the Gramm-Leach-Bliley Act in 1999 provoked a wave of US domestic consolidation. In relative terms, i.e. if market sizes are taken into account, it implies that the intensity of restructuring in the EU25 is probably even higher.

Excluding domestic transactions, intra-EU25 activity (i.e. M&As between EU companies based in different Member States) is far more intense than in any other geographical area. In other words, one can see an impact of the Internal Market on the consolidation trends. Between 1999 and 2004, intra-EU25 cross-border deals amounted to €109 billion, accounting for nearly 30% of worldwide cross-border transactions (with EU acquisitions in North America accounting for another 20% of worldwide cross-border deals). This shows that, although it is not fully comparable to the domestic consolidation process, intra-EU cross-border consolidation is more intense than the global one and therefore is not attributable to globalisation trends only.

### 3.2. Regional clusters within EU15

On the European stage, at a regional level, domestic consolidation prevails, as set out in the previous sections (see graph 4). However, several linkages between geographical regions can be distinguished, chiefly within some geographically close areas (Benelux and the Nordic Countries<sup>9</sup>). Indeed, these two ‘regional clusters’ stand out clearly by the magnitude of bilateral flows between the countries included in the cluster, especially the Nordic Countries where intra-regional deals represent 90% of the deals involving at least one Nordic entity. This ratio is around 60% for the Benelux region.

**Graph 4: Total value of deals within EU15 between 1999 and 2004 (numerical data at section’s end)**



Source: Bureau van Dijk, Zephyr database

Apart from those clusters, no real trends appear at the country level in the EU15. Significant intra-EU15 cross-border flows seem to be largely unilateral and explained by a few large one-off deals, rather than a series of geographically similar mergers and acquisitions. For instance, the flow from UK to FR can be put down to HSBC’s acquisition of CCF (for a value of €11.2 billion), the flow from ES to UK by SCH’s acquisition of Abbey (€12.1 billion) and the flow from DE to AT by HypoVereinsbank’s acquisition of BA-CA (€7.8 billion).

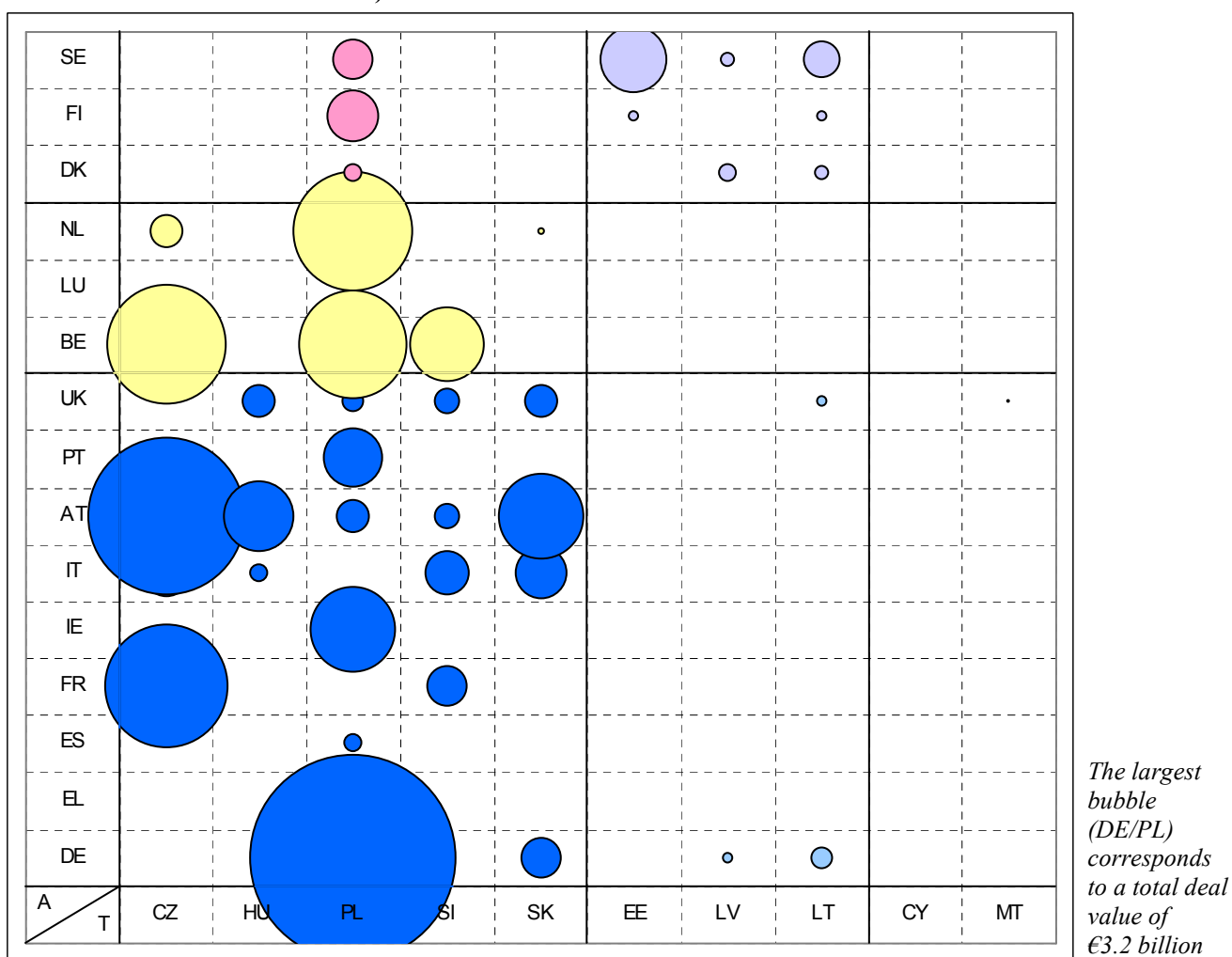
<sup>9</sup> Benelux: Belgium, Luxembourg, The Netherlands; Nordic Countries: Denmark, Sweden, Finland

### 3.3. Large capital inflow directed at new Member States

Even though intra-EU15 flows account for the majority of intra-EU25 flows, the relative size of markets and institutions in the different areas have to be borne in mind. Against this background, the large inflows directed at new Member States are noticeable (see graph 5). Of course, one should keep in mind the special circumstances that may have fostered such flows (e.g. run-up to EU Membership, privatisation processes).

Among those flows, EU15 countries can be grouped in 3 categories. Firstly, countries whose institutions have a strategy aimed at a specific region. This is the case for BE/NL, AT, and to some extent UK and IT, with Central Europe<sup>10</sup>. The same applies to SE and DK with the Baltic States<sup>11</sup>. Secondly, some countries are home to institutions adopting a more targeted approach, with acquisitions in only one or two specific countries. This is the case for DE with PL/SK, FR with CZ/SI, IE with PL and PT with PL. Finally, institutions in a couple of countries (ES, EL) are scarcely engaged in cross-border mergers with the new Member States.

**Graph 5: Total value of deals from EU15 to NMS10 between 1999 and 2004 (numerical data at section's end)**



Source: Bureau van Dijk, Zephyr database

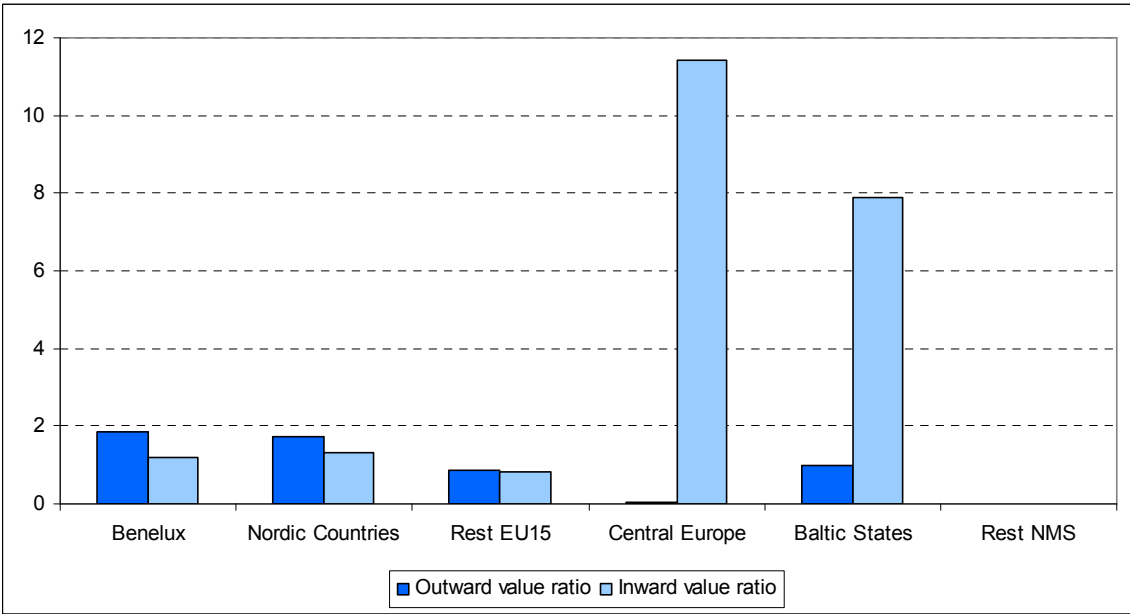
<sup>10</sup> Czech Republic, Hungary, Poland, Slovenia, Slovakia

<sup>11</sup> Estonia, Latvia, Lithuania

Within the EU15, intra-regional flows appear to be primarily attributable to geographical proximity. Whereas geographical proximity may also be an explanation for the Nordic entry into the Baltic States, this does not apply completely to Member States in Central Europe. For instance, Benelux countries account for around 25% of acquisitions in those Member States. This may be explained by the relative maturity and concentration of the Benelux markets, which drive the institutions to look for new business opportunities in areas with high growth potential.

Finally, in relative terms (i.e. taking into account the relative size of each domestic financial sector), it becomes clear that the restructuring process has been especially intense in the new Member States, where merger and acquisition activity has involved a significant proportion of the local financial sector. Using total banking assets as a proxy for estimating the size of the financial sector, it can be seen that acquisitions have been 8 to 11 times more intense in new Member States (excluding Malta and Cyprus) than in EU15 countries (see graph 6).

**Graph 6: Ratio of intra-EU deal values between 1999 and 2004, directed towards or originating from an EU region, over national bank assets (normalised at 1 for the EU25 as a whole)**



Source: Bureau van Dijk, Zephyr database

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\*

To conclude, it can be broadly confirmed that the consolidation of the EU financial sector is less advanced than in other sectors. Consolidation is well underway in the securities trading and post-trade activities. Some regional clusters also start to appear and large capital inflows directed at the new Member States can be observed. However, the overall proportion of cross-border deals remains quite low in comparison to other sectors and in most market segments the average size of cross-border deals is lower than the average size of domestic deals. Cross-border restructuring is therefore not at a stage where it can lead to genuine pan-European institutions.

## Numerical data on intra-EU mergers and acquisitions

- Total value of deals within EU15 between 1999 and 2004, in € billion (Graph 4)

SE	1,6												0,8	0,6	2,6
FI													3,3	6,5	1,7
DK													4,8		0,5
NL	2,2	1,8		0,2	1,6		0,5	2,0	0,2		4,9				0,1
LU			0,1								2,1				
BE			1,3		0,2		0,5	0,4	8,6	2,6	3,9				
UK	0,3		2,0	12,5	1,9	3,4	0,1	0,2	143,6		0,0				0,2
PT		0,5	0,1					7,8							
AT	0,1	0,1					7,4								
IT	2,4		1,2	0,9		70,8		0,1		0,1					
IE				1,7				0,1							
FR	2,0	0,5	1,1	56,0		0,4		0,1	5,2	1,7					
ES	1,1		28,3	0,8		0,3		3,6	12,1			0,1			
EL		3,1													
DE	44,4		0,5	0,9	0,3	1,3	7,8		0,6	0,9	3,4				
A T	DE	EL	ES	FR	IE	IT	AT	PT	UK	BE	LU	NL	DK	FI	SE

*The rows correspond to the location of the acquirer and the columns to the location of the target.*

*For instance, acquisitions by UK firms in FR amounted to €12.5 billion between 1999 and 2004.*

- Total value of deals from EU15 to NMS10 between 1999 and 2004, in € billion (Graph 5)

SE			0,14			0,34	0,02	0,10							
FI			0,22			0,02		0,01							
DK			0,03				0,04	0,03							
NL	0,09		1,06		0,00										
LU															
BE	1,10		0,92	0,44											
UK		0,10	0,04	0,06	0,10					0,02				0,00	
PT			0,27												
AT	1,86	0,39	0,08	0,05	0,56										
IT	0,20	0,03		0,15	0,23										
IE			0,59												
FR	1,19			0,14											
ES			0,03												
EL															
DE			3,21		0,14			0,01	0,05						
A T	CZ	HU	PL	SI	SK	EE	LV	LT	CY	MT					

**PART II:**  
**OBSTACLES TO CROSS-BORDER CONSOLIDATION**  
**IDENTIFIED BY MARKET PARTICIPANTS**

The first part of this document shows that not only is there little cross-border consolidation in the European financial sector (except in the regional clusters and towards new Member States), but also that there are structural differences between domestic and cross-border consolidation. Furthermore, disparities can also be noted between the different geographic areas.

From a policy point of view, it is essential to understand whether those facts can be explained by specific factors, in order to guide future policy actions that could remove potential bottlenecks, improving the functioning of the financial sector or addressing regulatory gaps. This is not an easy task, given the numerous legal, economic and behavioural factors to take into account. However, market participants experience these issues daily, and are thus best placed to point out those obstacles that would limit them in exploiting the full opportunities of an integrated European market for financial services.

That is why the European Commission launched a public survey directed at market participants, asking them to identify those obstacles to cross-border consolidation which they considered to be the greatest or the most problematic. A number of responses were also received from representative bodies for the financial sector and other institutions and individuals. These were also included in the analysis. The methodology of the survey is further explained hereafter.

**1. THE SURVEY AND THE METHODOLOGY USED TO ASSESS THE RELEVANCE OF OBSTACLES**

Between 18 April 2005 and 15 June 2005, the European Commission conducted an open online survey of stakeholders on why cross-border consolidation in the financial sector is so limited. This section explains the methodology used for elaborating the survey questionnaire and the subsequent analysis of answers received.

**1.1. The questionnaire**

In order to ensure a maximum of responses from a representative sample of the European financial sector, a simply structured on-line questionnaire was devised. Respondents were invited to identify, within a pre-established structured list of potential obstacles, those obstacles that, in their view, constituted the greatest impediments to cross-border consolidation in the European financial sector (it must be noted that the respondents had the possibility of adding an obstacle not initially on the list).

The list of obstacles cited in the online questionnaire was explained and detailed in a background paper, which is publicly available<sup>12</sup>. This list was drawn up on the basis of research using existing economic literature, as well as previous inputs to public consultations

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<sup>12</sup> The background paper is downloadable at:  
[http://europa.eu.int/comm/internal\\_market/finances/docs/cross-sector/mergers/consultation\\_en.pdf](http://europa.eu.int/comm/internal_market/finances/docs/cross-sector/mergers/consultation_en.pdf)

conducted by the European Commission (notably on the post-FSAP strategy) and industry position papers. Direct contacts with interested stakeholders helped to refine the list. To facilitate the analysis, the list of obstacles was structured according to the nature of the obstacles (legal, tax, supervisory, economic, attitudinal) and to their consequences (increased risk of execution, additional one-off costs, additional ongoing costs).

The survey was advertised through a Commission press release<sup>13</sup>, a dedicated page on the Internal Market and Services DG website, as well as direct mailings to the main industry federations and a number of market participants having expressed interest in the issue.

When the survey closed, 363 answers had been received, of which 326 were from financial institutions, 24 from representative bodies of the financial sector and 13 from various organisations (national authorities, consulting firms, universities, etc.). An overwhelming majority of financial institutions that answered are banking institutions. However, it should be mentioned that some of them have significant activities in other market segments (e.g. life insurance) and that some of the largest European insurance companies also took part in the survey. Therefore, the survey results do not only represent the banking sector's perspective. About fifteen respondents complemented their online response with detailed written submissions. 95% of the respondents judged the survey 'appropriate'; the remaining 5% considered it either as 'too general' or 'too difficult to understand'.

## 1.2. Analysis – The methodology

In order to analyse the answers received, we must first distinguish between answers from market participants and other respondents (representative bodies for the financial sector and others).

As regards responses received from market participants, a quantitative analysis is possible, given the number of answers received and the relative comparability of the respondents' characteristics. However, it must first be verified whether the sample is somehow representative of the European financial sector and therefore immune from severe bias. The detailed breakdown of respondents' characteristics is presented in Annex A, in absolute numbers of answers received but also in relative terms, weighted by the respondents' total assets<sup>14</sup>.

In terms of geographic representation, the three main financial markets (UK, DE, FR) account for the bulk of answers received, either in number (with a very large majority of DE institutions) or in assets (with a rather balanced repartition between the three countries). A few, but very large, institutions from outside the EU also took part in the survey. A number of answers were received from ES, IT, AT and SE, although their share in the sample (in terms of number or value of assets) is probably low compared to the actual sizes of those markets. Finally, responses were also received from LU, PL and PT among EU15 countries, and from CZ and HU in the group of new Member States. Therefore, the geographical breakdown is not optimal. However, the countries indicated correspond to the location of the respective company headquarters, and as a number of the institutions responding have activities in many Member States, their answers also encompass the realities of those markets.

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<sup>13</sup> European Commission press release IP/05/444, dated 18 April 2005

<sup>14</sup> Total assets value at end-2003 (source: Bureau van Dijk, Bankscope database). For diversified conglomerates, only the total assets of the financial sector activities were taken into account.

In terms of size, corporate structure and previous experience with cross-border M&As, the sample is rather diversified, both in terms of number and assets. Obviously, in terms of numbers, the smaller institutions appear overrepresented, while in asset terms the very large ones appear more prominently. Given this diversity in respondents' characteristics, which is representative of the variety in the European financial sector, a disaggregate quantitative analysis (meaning an analysis category by category) seems preferable over a completely aggregate analysis (where all answers are added, weighted by total asset value or not). Therefore, for each feature (size, corporate structure, previous experience with cross-border M&As), the answers from each subgroup are considered to detect possible common trends or disparities.

As regards the input from representative bodies for the financial sector and other organisations, it is more difficult to perform a purely quantitative analysis, given the smaller number of responses but also the variety of respondents. However, those answers provide valuable qualitative input, which can be used to fine-tune the quantitative approach.

For these reasons, the approach chosen in the following section is to first analyse quantitatively the responses from financial institutions, according to their characteristics (since some obstacles may be relevant only for some of them), and to refine this quantitative analysis with the qualitative input received from the professional bodies and other respondents.

A detailed breakdown of the answers received can be found in the annex.

## 2. RESPONSES RECEIVED

One potential obstacle has been highlighted by nearly all respondents. More than 90% of them pointed to ***non-overlapping fixed costs*** as a possible deterrent to engaging in cross-border undertakings. In all categories described further below (in terms of sizes, corporate structures or prior experience with cross-border M&As), this obstacle ranks in the top three, if not in the first place. This also the view of more than 80% of the representative bodies of the financial sector that participated.

In simple terms, it illustrates the fact that when two companies merge cross-border (or one acquires another), the cost synergies in the combined entity (for instance resulting from combined IT systems or streamlined business organisation) are not sufficient to offset the merger or acquisition costs in order to generate a sufficient return on investment. Similarly, the cost synergies resulting from a cross-border transaction are significantly smaller than those of a domestic operation, making the latter more attractive. The potential for cost synergies is a key driver, especially in an industry such as financial services where the proportion of fixed costs in total costs has increased rapidly as a result of profound changes of the business economics<sup>15</sup>.

There are many factors to take into account in order to explain this lack of cost synergies.

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<sup>15</sup> For instance, one study estimates that, in banking, the proportion of fixed costs has increased from 10-15% in the early 1990s to about 25-30% today (source: Morgan Stanley / Mercer Oliver Wyman, *European Banking Consolidation*, Feb. 05).

## 2.1. According to the size of the institutions (in terms of assets)

We first distinguish between very large (assets over €100 billion), large (assets between €1 billion and €100 billion) medium-sized (assets between €100 million and €1 billion) and small (assets less than €100 million) institutions.

Among the largest institutions, obstacles related to the consequences of supervisory requirements for cross-border activities rank in first position as an explanation for the lack of fixed cost synergies. For instance, the constraint of *multiple reporting requirements* ranks second, behind the overarching issue of non-overlapping fixed costs. This item ranks also in the first positions for smaller institutions (for instance, all institutions with assets less than €100 million mentioned it), but only the very large ones also mention the *divergence of supervisory practices* and the complexity of *supervisory approval processes* as significant deterrents to cross-border transactions (for instance, divergence of supervisory practices ranks fourth for institutions with assets over €100 billion). This is not surprising, since most of those very large institutions already have cross-border businesses, and are therefore already familiar with the supervision of cross-border business.

The *consumers' and employees' negative perception of foreign entities* is mentioned by the majority of small and medium institutions, while it does not rank highly with the largest ones (especially with regard to consumer perception).

Smaller institutions primarily identify product-related obstacles, notably the *differences in tax treatment* (either discriminatory or resulting from specific domestic tax breaks). For example, a bank acquiring a bank in another Member State will have to offer local saving schemes because they benefit from specific tax advantages. Because of those differences, it can be difficult for cross-border companies to sell similar/comparable products in different countries, and therefore streamline their business functions on a cross-border basis. *Uncertainties as to the VAT treatment* applicable in other Member States are also seen as an obstacle. More generally, the smaller institutions insist on the *differences in product mix* between countries, which limit the scope for cross-border cost synergies. As explained above, those differences may be partially explained by differences in tax regimes. More deeply rooted factors, such as history (consumers being used to specific products) or culture (especially linguistic considerations) may additionally come into play. The survey results also point at factors of a legal nature, such as *divergent consumer protection rules* or *differences in private law*.

## 2.2. According to the corporate structure of institutions

We now distinguish between answers emanating from share capital companies, cooperative institutions and savings institutions (including related entities which may not be *stricto sensu* savings institutions).

Among share capital institutions, two groups of obstacles appear clearly. First, obstacles related to the overall environment of a cross-border transaction are often cited. Those are *political interference* in the deal process, possible *misuse of supervisory powers* to dissuade or block a transaction, *opaque decision making processes* in the potential target companies and the existence of *defence mechanisms* or even of *limits or controls on foreign participation*, all of which if they do not simply block the cross-border transaction, certainly increase the execution risks thereof. Managers' freedom to combine their cross-border business post-merger may also be limited by *impediments to effective control* or *political concessions* imposed to conclude the deal.

A second group of obstacles identified by share capital institutions comprises obstacles that could hamper companies in streamlining and reorganising their business functions on a cross-border basis. The one most often mentioned by this category is *employment legislation*. Then come the *legal structures* of the companies (which may render impossible an effective merger or acquisition) and possible risks of double taxation resulting from *exit taxes on capital gains* when transferring activities from one Member State to another. The issue of *inter-group VAT* in the financial services sector (where the VAT is not fully refundable, in contrast to other sectors) is also among the obstacles most often mentioned.

Responses from cooperative and savings institutions are rather homogeneous and focus mostly on the product- and reporting-related obstacles mentioned previously. A striking difference with share capital institutions is that *employees' reluctance* is cited by nearly 90% of both cooperative and savings institutions (against less than 10% for share capital companies). The issue of *consumer mistrust* also ranks very highly for cooperative institutions (over 70%), which might be partially explained by the special structures of these, mainly consumer-owned, companies.

Finally, the *taxation on dividends* is identified as an obstacle by nearly all the savings institutions that took part in the survey.

### 2.3. According to previous experience with cross-border M&As

The last distinction we make is between respondents that have indicated they had previously experienced cross-border M&As, companies that indicated having tried to carry out such a transaction but been blocked by specific obstacles, and companies that indicated having no previous experience with cross-border M&As.

By comparing those institutions with previous experience in cross-border M&As (either 'positive', i.e. completed, or 'negative', meaning the institution has been blocked at some stage) with those with no such experience, the execution risks appear more often, especially those related to inappropriate interference in the transaction process, which may block or hamper market participants in carrying through their business decisions.

For instance, the following issues are mentioned more often by companies having positive experience in cross-border M&As: *political interference* (nearly 30%), *misuse of supervisory powers* (nearly 20%), or *limits or controls on foreign participation* (nearly 20%). Similarly, political interference ranks 4th amongst the companies having been blocked in the process of a cross-border transaction. It is also noticeable that *employees' reluctance* ranks in third position among companies that have experience of cross-border deals, which may reflect might result difficulties experienced in post-merger reorganisation.

One could expect such results. Indeed, an acquisition or merger decision is primarily driven by strategic and economic motives. Once the company has decided that there is a case for launching the transaction, only then do those execution risks materialise. On the contrary, if a company considers that there is no business case for a cross-border deal, the execution risks will not come into play and will not be considered as an obstacle to carrying out the transaction.

We can see this in the responses emanating from companies with no previous experience with cross-border M&As. The obstacles identified are exclusively related to the economics of a potential transaction, i.e. *non-overlapping fixed costs* essentially due to *differences in*

*product mix* and *multiple reporting requirements*, or to *a priori consumers' and employees' reluctance*. All the execution risks identified by the two other categories are almost never mentioned here.

#### 2.4. From representative bodies of the financial sectors and other respondents

As explained previously, given the heterogeneity of the survey respondents other than financial institutions, it is more difficult to perform a purely quantitative analysis. Furthermore, some professional federations preferred to send detailed written submissions with further analysis of some specific aspects. Therefore, the analysis of answers from representative bodies and other respondents cannot be summarised in percentage terms. However, these answers either reinforce the financial institutions' replies or complement them, and allow us to refine further the analysis with input of a qualitative nature.

Answers from representative bodies for the financial sector are consistent with market participants' input, although the rankings may, in some cases, be slightly different. The issue of *non-overlapping fixed costs* is indisputably identified as obstacle number one (with over 80% of professional bodies considering it as one of the main obstacles), followed closely by *multiple reporting requirements*. The issue of *dividend taxation* ranks third, alongside *differences in product mix* and *employees' reluctance*. The other obstacles identified fall into the categories previously identified, i.e. impediments to corporate reorganisation, differences in tax treatment and interference with the transaction process.

Answers from respondents other than representative bodies for the financial sector are also broadly consistent with markets' participant input. One obstacle that ranks higher is the *shareholders' apprehension of failure risks* acting as a potential deterrent. It is interesting to note that obstacles of a more economic nature, such as *absence of critical size* or *differences in economic cycles* are also mentioned.

### 3. SYNTHESIS

Table 1 provides a more detailed breakdown of the obstacles identified as relevant. Among the initial list submitted to respondents, only those items that have been raised by a non-negligible number of respondents have been kept in this table (roughly speaking: this table covers more than 90% of the answers). We provide three levels of intensity, from +++ meaning that the item has been selected very often, to + meaning that the item has been selected by a non-negligible number of respondents (the intensity indicated also takes into account the qualitative input emanating from representative bodies for the financial sector and other respondents).

#### 3.1. Elements that lower the economic value of cross-border acquisitions

The key message is that obstacle number one is the low-level of fixed cost synergies in cross-border mergers when compared to domestic ones. This results in a lack of substantial economic value from cross-border M&As, especially when opportunities for domestic growth are (or were) available.

The survey identifies three explanatory factors for the lack of cross-border synergies.

### *3.1.1. Difficulties in selling the same products across countries*

Respondents emphasise the differences in product mix from one country to another. For that reason, post-acquisition production streamlining remains limited and does not offer sufficient fixed cost synergies, whilst the proportion of fixed costs in total costs has been rising significantly over recent years.

These differences can be explained by divergences in consumer protection rules or private law, and also by differing consumer habits across EU countries. However, the survey also highlights the influence of taxation regimes, which, by favouring specific domestic products or discriminating against foreign products, limit the potential of an acquirer based in another EU country to streamline its product line on a group basis. It has to be noted that such explanations are essentially specific to the financial sector, given its highly customised and regulated products with a potentially strong tax impact.

### *3.1.2. Implications of supervision for cross-border institutions*

Another reason provided by respondents to explain the lack of cross-border fixed cost synergies is the current supervisory arrangements for cross-border activities. Because of multiple reporting requirements by different national authorities, it is more difficult for a cross-border company to unify some of its back-office operations. By contrast, within a domestic group, those functions are more easily combined, leading to corporate structure streamlining, increased efficiency and monitoring, and therefore greater potential for business performance improvements. Respondents also pointed at divergences in supervisory practices, as well as potential problems arising in the transaction process due to the current supervisory approval processes.

Here again, it must be underlined that those obstacles are very specific to the financial sector, and that there may be some differences between individual market segments depending on the degree of prudential supervision of the activities concerned.

### *3.1.3. Legal impediments to corporate expansion and reorganisation*

A third reason identified for a lack of cross-border synergies is that it is difficult to reorganise business operations on a cross-border basis, as one would do in a domestic group. For instance, different taxation schemes for dividends or exit taxes on capital gains may hamper an efficient reorganisation of head office functions. Those issues are not specific to the financial sector, however they add to other specific factors that reduce the economic attractiveness of a cross-border deal.

Among obstacles specific to the financial sector, one can find the problem of inter-group VAT, due to its partial non-recoverability, and also the differences in legal structures of companies, which are sometime more constraining in the financial sector than in other economic sectors.

## **3.2. Elements contributing to an unfavourable/disabling environment**

The second most important issue is the unfavourable environment to cross-border transactions, which may dissuade market participants from launching a cross-border bid or block them once they have launched one. It is telling that, among those companies that have

completed or tried to carry out a cross-border acquisition or merger, such obstacles rank in the first positions.

It is difficult to characterise these obstacles exactly, as they may take very different forms, from legal measures hampering or preventing acquisitions to direct political interference in the transaction process, indirect interference influence at the different decision making levels, or abuse of otherwise legitimate legal provisions or discretionary powers.

Even though past experience has shown that such elements were not necessarily limited to the financial sector, anecdotal evidence seems to show that the financial sector is often considered as a strategic one, and therefore interference with business decisions is more likely.

### **3.3. Consequences of individual perception of EU foreign entities**

A final element identified by the survey is the general negative perception of a takeover or merger involving an acquiring company from another Member State. Survey respondents notably pointed at employees' hostility to cross-border takeovers, which may dissuade a potential bidder who will have to manage those employees if the acquisition or the merger is carried through. A respondent also underlined the role played by the target institution's management, whose perception of the transaction also plays a significant role.

The importance of consumers' perception was also highlighted. Given the special relationship between a financial services provider and its clients (where trust is a key driver for consumer choice, maybe more so than in other sectors), an institution identified as 'foreign' may have a disadvantage over its local competitors if consumers do really attach importance to their provider's nationality. In the case of a merger or an acquisition, such behaviour might lower the value of the acquisition, either because a replacement of a local brand by a group brand is perceived negatively by consumers, or because the continuation of different brands within the same group limits cost synergies.

**Table 1: Synthesis of the answers to the online survey**

	<b>Intensity</b>	<b>Especially relevant for:</b>
<b><u>I. Elements that lower the economic value of cross-border acquisitions</u></b>	<b>+++</b>	
30. Non-overlapping fixed costs*	+++	Across the board
<b>I.1 Difficulties in selling the same products across countries</b>	<b>+++</b>	Smaller institutions
29. Different product mixes	+++	
21. Discriminatory tax treatments	+++	
20. Specific domestic tax breaks	+++	
15. Uncertainty on VAT regime	++	
11. Divergent consumer protection rules	++	
13. Differences in private law	+	
<b>I.2 Implications of supervision for cross-border institutions</b>	<b>++</b>	Large and very large institutions
27. Multiple reporting requirements	+++	
26. Divergences in supervisory practices	++	
25. Supervisory approval processes	++	
<b>I.3 Legal impediments to corporate expansion and reorganisation</b>	<b>++</b>	Large institutions, with cross-border M&As experience or having tried cross-border M&As (except for dividends taxation which was raised by all types of institutions)
22. Taxation on dividends	+++	
9. Employment legislation	++	
3. Legal structures	++	
18. Inter-group VAT	+	
16. Exit tax on capital gains	+	
<b><u>II. Elements contributing to an unfavourable/disabling environment</u></b>	<b>++</b>	
35. Political interference	+++	Share capital companies, large and very large institutions, with cross-border M&As experience or having tried cross-border M&As
39. Political concessions	+	
24. Misuse of supervisory powers	++	
4. Limits or controls on foreign participations	++	
2. Opaque decision making processes	+	
5. Defence mechanisms	+	
6. Impediments to effective control	+	
<b><u>III. Consequences of individual perception of EU foreign entities</u></b>	<b>++</b>	
36. Employees' reluctance	+++	Smaller institutions, cooperative and savings institutions
40. Consumer mistrust in foreign entities	++	

\*NB: The number next to each item corresponds to the numbering of the background paper that served as a reference for the online survey.

## **PART III:** **EMERGING ISSUES**

In the two previous parts, it has been shown that the cross-border consolidation process in the EU financial sector is probably not what could be expected from a perfectly functioning Internal Market. Not only are cross-border transactions less frequent in the financial sector than in other sectors, but they also differ in nature from domestic transactions. Those facts do not seem to result from inescapable specificities of the financial services sector. Rather, market participants clearly point at a number of concrete obstacles, often specific to the financial sector.

In this part, we put into perspective those obstacles identified to examine the key issues they raise. The purpose here is not to propose any policy orientation, but rather to initiate the discussions that should take place at the political level on what should or could be done (and not done) to improve the functioning of the Internal Market for financial services, in accordance with the mandate of EU Finance Ministers.

We successively examine the three groups of obstacles identified by market participants.

### **1. ELEMENTS THAT LOWER THE ECONOMIC VALUE OF CROSS-BORDER ACQUISITIONS**

Cross-border mergers and acquisitions exhibit distinctive characteristics when compared to domestic transactions. On average, the economic incentive for a cross-border merger or acquisition appears lower. Individual transactions are rather explained by the need to expand out of an already mature market (such as Benelux or the Nordic countries), by opportunities in high growth areas such as the new Member States, or by one-off opportunities, than by a continuous trend of rationalisation aimed at improving efficiency through economies of scale, as witnessed at a domestic level.

Almost unanimously, market participants taking part in the survey put this down to the lack of fixed cost synergies. Cross-border economies of scale appear much less substantial than those at the domestic level. Therefore, the economic case for a cross-border merger or acquisition is less attractive, and does not compare with that for a domestic transaction. Many factors come into play. However, the previous section shows that the reasons for a lack of fixed cost synergies can be classified into 3 groups, which are further analysed below.

#### **1.1. Implications of supervision for cross-border institutions**

In previous stakeholder consultations, the industry has underlined many times that the current EU supervisory arrangements are probably not the most cost-efficient for large cross-border institutions. Such companies are sometimes confronted with a large number of different supervisors with different (if not diverging) practices and requirements. This also appears here, where market participants see those inefficiencies as an additional cost when comparing cross-border and domestic expansion. The message is especially clear from those large cross-border institutions that have taken part in the survey, which already experience these supervisory arrangements in their day-to-day business.

### Issues at EU level

- Improving EU supervisory structures was also highlighted as one of the flagship areas for work in the Commission's Green Paper on Financial Services Policy 2005-2010. There is an ongoing debate at the EU level on what needs to be done and how it should be done, for instance in the EU Council<sup>16</sup> and the European Parliament<sup>17</sup>. As regards the retail financial markets, this has been identified in the Commission's Green Paper on Financial Services Policy 2005-2010<sup>18</sup> as one of the policy areas where initiatives might bring benefits to the European economy.
- A specific point raised by the Finance Ministers, during the Scheveningen informal Ecofin Council, and also by market participants in the survey, is the current organisation of the supervisory approval processes. In the banking sector, responding to the mandate of Finance Ministers, the Commission has been working, in cooperation with Member States representatives, on an overhaul of the relevant provisions (article 16 of the Codified Banking Directive<sup>19</sup>). The objective is to implement an improved process, by ensuring increased efficiency and legal certainty. In order to ensure cross-sectoral consistency, a possible revision of the corresponding rules of the Insurance Directives is being considered within the Solvency II project<sup>20</sup>.
- The importance of converging supervisory practices as well as streamlining reporting requirements has been recognised in the Lamfalussy structure, where the committees of national supervisors ('Level 3' committees – CEBS, CEIOPS, CESR) have the role of fostering convergence of supervisory practices. In June 2003, a forum group mandated by the Commission set out several recommendations<sup>21</sup>, which are now being followed up by practical projects at Level 3<sup>22</sup>.

### Issues at national level

- In the current debate on efficient supervisory structures, there is little debate on the need for the right level of intervention, i.e. the European level (if not global). However, political support from EU-lawmakers, Member States and national supervisory authorities is essential if the objective of improving the supervisory arrangements for EU financial institutions is to be achieved.

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<sup>16</sup> Report of the Financial Services Committee Subgroup on Supervision, for the consideration of Finance Ministers

<sup>17</sup> See the European Parliament report on the current state of integration of EU financial markets (report A6-0087/2005).

<sup>18</sup> Green Paper on Financial Services Policy 2005-2010, COM(2005) 177, downloadable at : [http://europa.eu.int/comm/internal\\_market/finances/docs/actionplan/index/green\\_en.pdf](http://europa.eu.int/comm/internal_market/finances/docs/actionplan/index/green_en.pdf)

<sup>19</sup> See the call for technical advice to CEBS, available on the Commission website: [http://europa.eu.int/comm/internal\\_market/bank/calls/index\\_en.htm](http://europa.eu.int/comm/internal_market/bank/calls/index_en.htm)

<sup>20</sup> A specific call for advice on the fit and proper criteria has been included in the 2<sup>nd</sup> wave of Calls for advice on Solvency II to CEIOPS. Text available at: [http://europa.eu.int/comm/internal\\_market/insurance/docs/markt-2506-04/annexe2-2nd-wave\\_rev2\\_en.pdf](http://europa.eu.int/comm/internal_market/insurance/docs/markt-2506-04/annexe2-2nd-wave_rev2_en.pdf)

<sup>21</sup> For more information, see the Commission website: [http://europa.eu.int/comm/internal\\_market/finances/cross-sector/index\\_en.htm#reporting](http://europa.eu.int/comm/internal_market/finances/cross-sector/index_en.htm#reporting)

<sup>22</sup> For instance, CEBS announced a series of consultations on the convergence of supervisory practices: <http://www.c-eps.org/press/19012005.htm>

## 1.2. Legal impediments to corporate expansion and reorganisation

A second reason put forward by market participants to explain the lack of economic value of cross-border consolidation in the present circumstances is the complexity of corporate reorganisation on a pan-European basis.

Some of those obstacles that prevent cross-border companies from streamlining their corporate organisation are not specific to the financial sector (e.g. taxation of dividends, employment legislation, exit tax on capital gains). But some of them are specific to the financial sector. For example, in some Member States, specific legal entities cannot *de facto* or even *de jure* be acquired by companies which have different organisational and legal features. Some economic actors feel such limitations prevent them from expanding their activities and reap the full benefit of sensible business opportunities, which may in turn increase the overall efficiency of the EU financial sector in the international competition. Another example specific to the financial sector is inter-group VAT. Due to the partial non-recoverability in this sector, cross-border reorganisation may result in new VAT liabilities. Such specific issues add to the overall difficulties of efficient corporate reorganisation, and thus reduce the potential for cross-border cost synergies.

It is interesting to note that few responses (if any) referred to issues such as the legal uncertainty of the merger process or accounting systems, where recent EU legislation has been put in place. One could mention for instance the European Company Statute, the IAS Regulation or the recently adopted Cross-Border Mergers Directive. Sufficient experience of some of these new rules has not yet been gained to give a final judgement on their efficiency, however it should be noted that market participants seem to consider that the obstacles initially targeted are no longer the most important ones.

### Issues at EU level

- One of the outstanding issues of particular relevance at the EU level is the inter-group VAT. In the past, the Commission has attempted to address the provisions of the 6th VAT Directive (77/388/EEC) dealing with financial services but without much success<sup>23</sup>.

### Issues at national level

- These are essentially the issues related to product taxation, specific legal structures and employment law.

## 1.3. Difficulties in selling the same products across countries

A third reason for the lack of offsetting fixed costs across EU countries is the fact that a cross-border institution finds it difficult to sell the same products across countries. In other words, the well-documented lack of integration of the retail financial markets has a direct impact on the economic attractiveness of cross-border mergers and acquisitions.

It is true that a local cultural component may play a role in consumers' choices and composition of product mix. Therefore, cross-border consolidation has first taken place in geographically close areas such as Benelux and the Nordic countries, although the maturity of

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<sup>23</sup> For further information, see the Commission's Communication 'Review and update of VAT strategy priorities', COM(2003) 614.

those financial markets has also probably played a decisive role in pushing companies to look for cross-border expansion possibilities.

However, the survey responses also point to the impact of tax arrangements on the product mix. Obviously, potential differences in tax treatments on foreign financial products, although similar to local products, disadvantage cross-border groups which try to streamline their product offer, and therefore to exploit economies of scale. Similarly, specific domestic tax breaks targeted at local financial products present a sort of ‘positive differentiation’ by establishing a taxation scheme whereby a non-domestic company wishing to enter a given market has to offer products relevant for this sole market if it hopes to attract customers (who have a strong financial incentive to prefer this product).

### *Issues at EU level*

- The case for further integration of EU retail financial markets in terms of consumer benefits (through improved choice at a better price and higher returns for lower risk) is therefore reinforced by considerations related to cross-border M&As. Increased economies of scale on a pan-European basis and intensified competition between financial services providers through market entry are essential if those benefits are to be delivered. The Commission proposed in its Green Paper on Financial Services Policy 2005-2010<sup>24</sup> to look further into some areas. In particular, it is suggested to focus on a number of products where there could be a real business case, once the impeding regulatory obstacles are removed through EU initiatives (cf. consumer credit, mortgage). Such a method could address part of the concerns expressed by survey respondents.
- As regards possible tax discrimination against financial products sold by EU financial institutions, in breach of the Treaty provisions, the opening of infringement cases by the Commission contributes to ending unacceptable distortion of the Internal Market<sup>25</sup>.

### *Issues at national level*

- Although some tax issues are dealt with at EU level (for instance some VAT-related aspects), they are mainly in the remit of individual Member States.

## **2. ELEMENTS CONTRIBUTING TO AN UNFAVOURABLE/DISABLING ENVIRONMENT**

### **2.1. Political interference and misuse of supervisory powers**

A number of respondents, especially those with past experience with cross-border M&As, have pointed at environmental factors that discourage or block cross-border transactions, such as political interference in the process and misuse of supervisory powers. It is perceived by a number of market participants that some supervisors will indeed, with the consent of the national political authorities, use their powers in order to block the entry on their market of financial institutions already established in other Member States.

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<sup>24</sup> See footnote 18.

<sup>25</sup> A number of cases specific to financial products (notably UCITS) have been subject to an infringement procedure by the Commission. See for instance cases 2000/5059, 2002/4714, 2003/2009, 1994/476, 2003/2010.

Such elements not only discourage companies from seizing business opportunities and consumers from benefiting from increased competition, resulting in lower prices with increased choice, but they also contradict the spirit and the basic principles of the Treaty freedoms underpinning the completion of the Internal Market. The political objectives of strong economic growth and higher employment throughout Europe will be severely undermined, should the European economy not be supported by an efficient, vibrant and safe financial marketplace. Market participants should be certain that the common rules are applied fairly, without discriminations based on nationality and that opportunities offered by the Internal Market are not closed off to them for unjustified reasons.

## **2.2. Legal obstacles**

Obstacles can sometimes also take the form of concrete legal obstacles. In that respect, it is noteworthy that one of the obstacles considered as relevant by survey respondents is the continued existence of defence mechanism ('poison pills'), which the initial Commission proposal on a Takeover Bids Directive proposed to abolish. This provision that was not maintained in the final Directive adopted in April 2004.

### *Issues at EU level*

- The Treaty provisions governing the free movement of capital and the freedom of establishment in the financial services sector are clear. So is European Court of Justice case law. Freedom of capital movement and right of establishment are the rule, not the exception. On 21 October 2005, the Commission adopted an Interpretative Communication<sup>26</sup> to clarify its understanding of the Treaty provisions and prevent any unjustified use of discretionary possibilities, by alerting market participants of their rights.

### *Issues at national level*

- All EU companies should be able to make their own business choices and benefit from the Internal Market, without improper interference for unjustified nationally-minded reasons.

## **3. NEGATIVE INDIVIDUAL PERCEPTION TOWARDS EU FOREIGN ENTITIES**

The final group of obstacles identified as possible deterrents to cross-border consolidation is probably the most difficult to address, as it results from individual perceptions and probably individual fears or lack of trust (of foreign employers or of foreign institutions entrusted with investors' assets). In any case, such perceptions take time to change, but the negative impact of the other obstacles (especially those related to a disabling environment) should not be underestimated.

### *Issues at EU level*

- As in some other fields of European policy, the survey gives attention to consumers' and citizens' perceptions. Thought should probably be given to improving communication toward the end-consumer on EU policies and their benefits. This would help to dampen down consumer and employee mistrust in foreign EU entities, which are, for instance,

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<sup>26</sup> Communication from the Commission on "Intra-EU investment in the financial services' sector", adopted on 21 October 2005

subject to equivalent minimal prudential controls (capital requirements, deposit guarantees) and therefore offer an appropriate and comparable level of protection. The Commission's Green Paper on Financial Services Policy also pointed at the need for more intense interaction with consumer groups, even though previous attempts have not produced the expected results.

*Issues at national level*

- Member States also have a role to play in better explaining the opportunities of the Internal Market to employees and consumers, taking a resolutely European stance in accordance with the fundamental principles that govern the EU.

**ANNEX:**  
**RESULTS OF INFORMAL MEETING OF ECONOMICS AND FINANCE MINISTERS,  
THE HAGUE, 10-11<sup>TH</sup> SEPTEMBER 2004 – BANKING AND COMPANY TAXATION<sup>27</sup>**

MEMO/04/214

Brussels, 13th September 2004

**Possible obstacles to cross-border mergers and takeovers in the banking sector**

The Economics and Finance Ministers called up the Commission to study possible obstacles to cross-border mergers and acquisitions in the wholesale and retail banking sectors arising not only from different supervisory practices but also other broader factors. In addition, the Ministers took note of the Commission's intention to review those parts of the EU's Banking Directive (2000/12/EC) that allow Member States to block mergers and acquisitions on prudential grounds.

Currently, Article 16 of the Directive states that "The Member States shall require any natural or legal person who proposes to hold, directly or indirectly a qualifying holding in a credit institution first to inform the competent authorities, telling them of the size of the intended holding. Such a person must likewise inform the competent authorities if he proposes to increase his qualifying holding so that the proportion of the voting rights or of the capital held by him would reach or exceed 20%, 33% or 50% or so that the credit institution would become his subsidiary."

"The competent authorities shall have a maximum of three months from the date of the notification provided for in the first paragraph to oppose such a plan if, in view of the need to ensure sound and prudent management of the credit institution, they are not satisfied as to the suitability of the person referred to in the first subparagraph. If they do not oppose the plan referred to in the first subparagraph, they may fix a maximum period for its implementation."

The aim of the review of the Banking Directive to be undertaken by the Commission will be to try to ensure that supervisory authorities have to be as specific and transparent as possible if they have doubts about the "sound and prudent management" of the credit institution. This would ensure that there would be less scope for prudential rules to be invoked for political reasons.

Under the terms of the EU's Merger Regulation (134/2004/EC), the European Commission has sole jurisdiction over mergers and takeovers over a certain size<sup>28</sup> and can already challenge Member States' measures to stop a cross-border deal. Article 21 of the Merger Regulation allows a Member State to intervene to protect legitimate interests, including on prudential grounds, but the Commission has the power to verify that the intervention is indeed founded and proportional. However, a potential problem is that banks considering a merger or

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<sup>27</sup> Press release downloadable at:

<http://europa.eu.int/rapid/pressReleasesAction.do?reference=MEMO/04/214&format=HTML&aged=1&language=EN&guiLanguage=en>

<sup>28</sup> See article 1 of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (OJ L 24, 29.01.2004).

takeover may be dissuaded by preliminary contacts with banking supervisory authorities before any formal bid is launched.

Speaking after the meeting, Commissioner Bolkestein stated that “a strong healthy banking sector in Europe is crucial to help the EU reach its targets for economic growth and to maintain financial stability. More competition is needed – in wholesale, but also in retail –to close the present competitiveness and profitability gap with the US.”

### **Company taxation**

Following a political discussion over lunch on company taxation in the EU, a large majority of Ministers supported the creation of a working group of Member States, chaired by the European Commission, to consider the idea of allowing all companies to use a common consolidated set of rules for calculating their EU-wide taxable profits and a pilot project that would allow SMEs to use the tax rules of their home state for calculating their EU-wide taxable profits. The Ministers discussions were based on two Commission non-papers that are available from the Commission’s website:

[http://europa.eu.int/comm/taxation\\_customs/taxation/company\\_tax/developments.htm](http://europa.eu.int/comm/taxation_customs/taxation/company_tax/developments.htm)

The Commission intends to establish the working group within the next few weeks. Speaking afterwards, Commissioner Bolkestein expressed the hope that all Member States would participate in the group’s work.

During a previous debate on reducing the administrative burden on companies, Commissioner Bolkestein pointed out to Ministers that companies operating in more than one Member State currently face considerable red tape as a result of having to calculate their tax liabilities according to different sets of rules. For example, different countries have different rules on transfer pricings and losses in one Member State cannot be offset against profits in another.