EUROBANKING, THE STRATEGIC ISSUES

by

J. DERMINE *

98/74/FIN

* Professor of Banking and Finance at INSEAD, Boulevard de Constance, 77305 Fontainebleau.

EUROBANKING, THE STRATEGIC ISSUES*

by Jean Dermine
INSEAD, F-77300 Fontainebleau
September 1998

***Prepared for the SUERF Colloquium on *The Euro : A challenge and opportunity for financial markets*, Frankfurt, October 15-17 1998.**

Eurobanking, the Strategic Issues

Abstract

The purpose of the paper is twofold. Firstly, it helps to identify how, besides an obvious fall in revenue from intra-European currencies trading, a single currency will alter fundamentally and permanently European banking markets. A common currency will change the sources of competitive advantage in various markets such as those of government bonds and of the fast growing interest rate derivative markets, of corporate bonds and equities, of foreign exchange, and of fund management. The paper evaluates whether an international reserve currency status matters for European banks, and provides an assessment of the impact of the single currency on loan credit risk and on bank profitability in a low inflation environment. Secondly, the paper identifies the strategic options available to financial services firms.

"Anyone who wants to conquer the markets of the future cannot stay locked into the defensive territorial thinking of the past" (Mr Thiemann, Chairman of DG Bank, 1998).

1. Introduction

Although a large series of papers have been concerned with macroeconomic issues such as price stability or employment, very few studies have discussed the impact of the euro on the competitive structure of European banking markets. Two questions are being addressed in this paper. How does the move from national currencies to the euro alter the sources of competitive advantage of banks ? What are the main strategic options available to financial firms ?

A casual analysis of the structure of the banking industry raises the question of the importance of a national currency factor. For instance, the markets for pension funds and mutual funds management, or the Euro-Francs and Euro-Lira bond markets are quite fragmented with domestic institutions capturing a very large market share. Although this fragmentation is explained in part by regulations and history, it could reflect the importance of national currencies. Another example is the leading role of American institutions in the dollar-denominated Eurobond market. Will the emergence of a new world currency competing with the US dollar help the competitiveness of European banks ? This paper will attempt to show how, besides an obvious loss of intra-European currencies trading business, the introduction of a common currency will change fundamentally the sources of competitive advantage of banks. This calls for a major review of strategic options.

The paper is structured in two parts. In the first one, eight impacts of the euro are identified and

analysed. In the second part, the strategic options are discussed.

2. Banking with a Single Currency[1]

Eight impacts are identified and analyzed. The first six concern capital markets, including the government bond market and its fast growing appendix the interest rate derivative market, the corporate bond and equity markets, institutional fund management, the Euromarket, the foreign exchange market, and the competition between the euro and the US dollar as international reserve currencies. The last two effects concern commercial banking with the impact of the single currency on credit risk and on bank profitability in a low inflation environment.

The Government Bond Market, Underwriting and Trading

One observes that the government bond market in Europe is a very fragmented market with domestic players capturing a large market share of the underwriting and secondary trading business. This raises the question of the sources of competitive advantage for local banks.

As concerns the underwriting and trading of government bonds, Feldman-Stephenson (1988), a Federal Reserve Study (1991), and Fox (1992) show that the dominance of local players is the result of three main factors. The first is historical with local players having a privileged access to the public debt issuer ; the second is domestic currency denomination which facilitates the access to a large investor home base, providing a significant advantage not only in placing, but also in understanding the demand/supply order flows. Finally expertise in the domestic monetary environment provides essential information to operate on the secondary bond market.

---

[1]This section draws on Dermine (1997, 1998) and Dermine-Hillion (1998).

Will these sources of competitive advantage survive with a single currency ? As domestic currency denomination, the main source of competitive advantage identified for local banks in the literature, will disappear, it is quite likely that we shall observe the emergence of a truly integrated European bond market. If access to a Europe-wide investor base does facilitate placement and if access to information on the supply/demand order flows seems essential for secondary trading, then very likely operations on a large scale and at a European-wide level will become a necessity[2] and one will observe a consolidation of the government bond underwriting and trading businesses.

The Corporate Bond and Equity Markets, Underwriting and Trading

As is the case for government bonds, a key issue concerns the sources of competitive advantage of local institutions in corporate bond and equity underwriting and secondary trading. As explained earlier, customer relationship, assessment of credit (business) risk, and currency denomination are critical sources of competitive advantage. The Eurobond market presents an interesting case. A study by the Federal Reserve Bank of New York (1991), confirmed in Dermine (1996), McCauley-White (1997) and Harm (1998), reports a strong correlation for non-dollar issue between the currency denomination and the nationality of the lead bank manager. This is illustrated in Table 1 which shows that, for instance, French banks are the lead managers 86 percent of the time for French francs-denominated eurobonds issued by French companies, and 75 percent of the time for similar bonds issued by non-French borrowers. The domestic currency denomination facilitating the access to an home-investor base was a key-source of competitive advantage for placement but also for secondary trading. Indeed, an understanding of local monetary policy would give a competitive advantage to forecast interest rates and price

[2]The relative merits of large domestic scale vs large European scale are discussed in the third section.

movements. The leading role of American institutions in the dollar-denominated Eurobond market is explained not only by large issues by American companies, by their expertise developed in their home corporate securities markets, but also by the important advantage linked to the dollar denomination of many bonds. Indeed, access to home investors, and an understanding of US order flows and US monetary policy provide a decisive advantage in secondary trading as it helps to predict price movements.

A single currency in Europe will change fundamentally the competitive structure of the corporate bond and equity markets as one key-source of competitive advantage, namely home currency, will disappear. Indeed, savers will diversify their portfolio across European markets, the exchange rate risk being eradicated. Moreover, a single currency will suppress the secondary trading advantage for domestic banks derived from a better understanding of order flows and monetary policy in the domestic country. Therefore, the two main sources of comparative advantage remaining for local players will be historical customer relationship and the understanding of credit (business) risk through a better knowledge of the accounting, legal, fiscal (not to mention language) environment. Whenever the business risk embedded in corporate securities can be better assessed by domestic banks, these players will control underwriting and secondary trading. Local expertise would be particularly valuable for smaller companies, venture capital or the real estate market. However, for larger corporations, worldwide industry expertise will most likely dominate any national advantage. For instance, to serve a Volvo corporation, it is unlikely that Swedish expertise is of great help to local institutions. What is needed is expertise in the global automobile industry.

To conclude this analysis of the impact of a single currency on the corporate bond and equity markets, it seems that customer relationship and an understanding of business risk could remain

two sources of strength for domestic firms in some segments of the market. But, placing power and trading across Europe coupled with global industry expertise are forces that lead to consolidation in a major part of the securities industry. As a tentative base for comparison, it is symptomatic to observe in Table 2 that the top ten American underwriters of investment grade debt control 87 percent of the US market.

Fund Management

An important segment of capital markets business is the fund management industry, pensions funds or mutual funds. As Table 3 illustrates for France and the United Kingdom, it is symptomatic to see the total dominance of the fund management industry by local firms[3]. In view of this extreme fragmentation, specially in comparison with other segments of the capital markets, one is wondering about the impact of the single currency on the fund management industry. In this case too, an understanding of the main sources of competitive advantage needs to be developed. They concern the retail distribution network, the home-currency preference, research expertise, and the existence of economies of scale (Kay, Laslett, Duffy, 1994).The first source of competitive advantage in the retail segment is the control of the distribution network, in the hand of local banks in several countries. Domestic control of distribution is even protected under current European legislation framework which gives to national authorities the right to regulate the marketing of funds into one's territory. Obviously the advantage derived from the control of the distribution network applies to retail investors only, as it will not be a barrier of entry in the institutional market. A second source of competitive advantage was the customer preference for home-currency assets, often imposed by regulation. A single currency will of course eliminate this factor and reinforce the need for European-wide portfolios. A large part of

[3]Some of these, such as Morgan Grenfell, have been purchased by continental firms.

these will be provided by index-tracking investment funds. A third source of success is excellence in research-based management. As to the existence of economies of scale and scope in the fund management industry, it is still a subject of debate (Bonnani, Dermine and Röller, 1998). If scale seems important for index-tracking funds, it could be less relevant for actively-managed

A single currency will eliminate the obstacle to international diversification. One will observe quite likely very large low cost European index-tracking funds competing with smaller research-based funds. On the retail distribution side, domestic banks will keep their competitive advantage as long as the branch network remains a significant channel of distribution.

The Euro-Deposit Market

An extremely efficient Euro-deposit market was created thirty years ago to circumvent various forms of domestic regulations[4]. A first issue concerns the size, coverage and remuneration of the reserve requirement on euro-denominated deposits in the future. Indeed, foreign currency-denominated deposits are not subject to reserve requirements in most countries. A second and more significant issue will be the fiscal treatment of the income earned on these assets in the future. The imposition of a 20 percent witholding tax or information sharing between tax authorities on interest paid to EU citizens would no doubt affect the location of the euromarkets.

Foreign Exchange Markets

A direct effect of the single currency is that not only intra-European foreign exchange

[4]Some creative wording will be needed as one must distinguish *euro-deposit*, deposits from non-residents, from *euro-denominated deposits*.

transactions will disappear, but that the competitive advantage of a particular bank in its home currency vis-à-vis third country currencies will change as well. As an example, a Belgian bank operating in New York will not be anymore the Belgian franc specialist, but will compete with other European banks on the euro/dollar business. As is the case for the government bond markets for which an understanding of the supply/demand order flows is important to predict the direction of price movements, one is likely to observe a consolidation of the commodity-type low cost spot foreign exchange business. This conjecture is consistent with the analysis by Tschoegl (1996) of the sources of competitive advantage in the currency market, namely size and the international status of the home currency. Differentiated products based on quality of service or innovations such as options will be another source of competitive advantage.

Euro as an International Currency : Which Benefits for the Banks ?

One of the asserted benefits of EMU is that the single currency will become a challenger to the US dollar as the dominant international currency used for units of accounts, store of value and means of payments (Emerson, 1990, Alogoskoufis-Portes, 1991, and Maas, 1995). But, one has to realize that contrary to a national currency which is imposed as sole tender by national legislation, the role of an international currency is fixed by demand and supply on world capital markets. Two questions are being raised. Firstly, is the euro likely to compete away the US dollar in international financial markets ? Secondly, from the perspective of this paper, what are the benefits derived for banks of having an international currency status for the euro ?

Whether one looks at the role of the dollar as a unit of account, a store of value, or a mean of payment, it still is today by far the prime international currency. For instance, 60 percent of the foreign exchange reserves of central banks are denominated in dollar, while US exports represent

only 12 percent of world exports. To assess the chance of the euro to accelerate the relative decline in the dollar, it is instructive to have a look at history and the relative fall of sterling and rise of the dollar in the international payment system.

In 1914 on the eve of the First World War, the City of London was indisputably the world's leading international financial center, with the sterling pound the major international currency. According to economic historians, the weakness of the pound started with the first world war. The war of 1914-1918 saw the emergence of large bond financing in the USA. This was coupled with the events of 1931 -the insolvency of the Creditanstalt in Vienna and the inconvertibility of the pound. The development of the second world war succeeded in increasing even more the statute of the dollar which was confirmed in its international role by the 1944 Bretton Woods agreement[5]. One can conclude that the rise of the dollar over a thirty years period was very much helped by the two world wars, and that despite the abandon of convertibility into gold in 1971 and continuous devaluation, the dollar is still maintaining twenty five years later a leading role as an international currency. Based on the recent two decades which have seen a progressive erosion of the dollar and a slow rise of the Deutsche Mark, in view of the relative economic size of Europe, and building on the potential for growth in the eastern part of Europe, one can extrapolate and forecast that euro will replace the D-Mark and be a strong competitor to the dollar. But in the author's opinion, any forecast on the relative importance of the US dollar and the euro in the future is premature and beyond our understanding.

What are the implications for banks of having euro as an international currency ? Three benefits can be identified. The first one is that an increased volume of euro-denominated assets or

---

[5]According to McKinnon (1993), a key factor increasing the role of the dollar was the European Payment Union established in September 1950 for clearing payments multilaterally, using the US dollar as the unit of account and as the mean of payment.

liabilities will ease the foreign exchange risk management of bank equity. Indeed, a large part of bank assets will be denominated in the same currency as the equity base, easing the control of currency-driven asset growth and capital management. Secondly, access to a discount window at the European Central Bank will make the liquidity management of euro-based liabilities marginally cheaper. Finally, if third countries issue assets denominated in euro or use the European currency as a vehicle, European banks will be well positioned in secondary trading for the reasons mentioned earlier.

EMU and Credit Risk

Many of the channels which have been identified did concern the money and capital markets. An additional impact of the euro is its potential effect on credit risk. There are reasons to believe that the nature of credit risk could change under a single currency. The argument is based on the theory of Optimum Currency Areas and on the objective of price stability inscribed in the Treaty on European Union.

There is an old debate on the economic rationale that leads a group of countries to adopt a common currency[6]. The story is the following. The more countries are subject to asymmetric economic shocks, the more they would appreciate monetary autonomy to cancel the shock. Indeed, with symmetric shock there would be a consensus among the members of a currency union on economic policy, but with asymmetric shocks the policy run from the center may not be adequate to all the members of the union. Recent economic developments have strengthen the argument. For instance, one can wonder whether the rapid recovery enjoyed by British banks in 1994 has not been helped partly by the 1992 devaluation which has reduced somewhat a bad

[6]The Theory of Optimum Currency Areas (Mundell, 1961 ; McKinnon, 1963).

debt problem. Similarly, the devaluation of the Finnish Markka has helped the restructuring of the country after the collapse of one of its major trading partner, the Soviet Union. How could the introduction of a single currency affect credit risk ? If a bank concentrates its business in its home country, and if that country is subject to asymmetric shocks, it is quite possible that a central monetary policy will not be able to soften the shock. Some have argued that the adverse consequences of such a shocks could be dealt with at European level and that in any case, these shocks would be quite rare. Indeed, severe asymmetric shocks could in principle be mitigated by fiscal transfers across Europe. But, this is only a possibility that remains to be verified. As to the argument that asymmetric shocks are rare events, it is indeed the case, but a fundamental mission of any bank risk management system is to ensure the solvency of financial institutions in precisely those rare but significant events.

An indirect and interesting corollary of the Optimum Currency Area theory is that for banks operating in a single currency area, the need to diversify their loan portfolio increases the more their home country is likely to be subject to asymmetric (uncorrelated) shocks. This can be achieved through international diversification or with the use of credit derivatives.

A related effect of EMU on credit risk is that the statute of the European Central Bank will prevent inflationary policies. Ceteris paribus, this could increase the potential for losses resulting from default, as one cannot count anymore on a predictable positive drift for the value of collateral assets[7]. The inability of a country to devalue and the very strict anti-inflationary policy of the ECB imply that, whenever a need to restore competitiveness will arise in a particular region, the only tool available will be a reduction of nominal wage and prices. This will change

[7] Although an argument can be made that non-inflationary policies will reduce the amplitude of business cycles.

fundamentally the nature of credit risk as firms and individuals cannot rely anymore on the nominal growth of their revenue to reduce the real value of their debt. This new world call for innovative techniques to handle potential deflations[8].

Banking in a Low Inflation Environment

The last effect of a single currency discussed in this essay concerns the impact on bank profitability of doing business in a low inflation environment. Indeed, in the last twenty years, higher inflation and interest rates have provided substantial interest margins on price-regulated deposits. For instance, as is documented in Table Four for the 1980-1985 period, interest margins on demand deposits were above ten percent in Belgium, France, Denmark or Spain. If new products, such as money market funds competed with these deposits, it is important to notice that these demand and savings deposits represent still more than forty percent of client resources collected by banks in Belgium or France (Commission Bancaire, 1996 ; Banque de France, 1996). As Table Four documents, margins on these products have been seriously eroded with the overall decrease in the interest rate level in recent years. One can safely conclude that an objective of monetary stability and low inflation pursued by an independent European Central Bank will reduce the source of profitability on the deposit funding business. However, if this effect is quite significant in a large number of countries, two additional effects of a low inflation environment might soften the impact of lower margins on deposits.

The first is that a low interest rate environment leads usually to much higher margin on personal loans because of the relative inelasticity of interest rate on personal loans. For instance, in France,

[8] A tool could be the creation of securities indexed on regional prices.

loan rate stickiness has raised the margin on *hire purchase* (consumer) loan from 6.3 % in 1990 to 10.1 % in 1996, a period of rapidly declining market rates (Banque de France, 1996). A second positive impact of a low inflation environment is that the so-called 'inflation tax' will be much smaller (Fisher-Modigliani, 1978). A simple example will give the intuition beyond the inflation tax. Consider a case with no inflation in which equity is invested in a 3 % coupon bond. After a thirty corporate tax is deducted, the revenue is 2.1 % ((1-0.3) x 3%). The full profit can be paid as dividend as there is no need for retained earnings and higher capital since there is no growth of assets. If because of a 10 % inflation, the same equity is invested in a 13 % coupon bond, the profit after tax is only 9.1 % ((1-0.3) x 13%), a figure too small to finance a necessary equity growth of 10 %. No dividend can be paid in this case and equity holders have suffered from an 'inflation-tax'.

Therefore, the impact of a low inflation environment on the profitability of banks will depend on the relative importance of reduced margins on deposits, higher profit on personal loans and on the significance of the 'inflation-tax.

3 The Strategic Issues

As Table Five shows, a considerable amount of domestic restructuring has already taken place in Europe. This was driven by the creation of the single market in 1992. In most cases, domestic mergers were driven by cost-cutting reasons. For instance, White (1998) reports that the restructuring of the Finnish banking system undertaken after a severe financial crisis has reduced employment by 32 percent[9]. These domestic mergers have increased concentration and produced

[5]This has to be compared to a drop of bank employment of 5 % in France and 0.3 % in Germany (White, 1998).

firms of bigger size, albeit at national level. A first series of cross-border deals, documented in Table Six, took place in the merchant banking area, where independent merchant banks (many of those British) were purchased by continental banks. These acquisitions were no doubt motivated by the wish to acquire rapidly a necessary expertise in securities-based corporate finance and asset management. Until quite recently, cross-border mergers of commercial banks of significant size have been rare. The difficulty in merging two national culture was often put forward as a barrier to cross-border mergers. But two noticeable deals have taken place recently : The purchase of the Belgian Banque Bruxelles Lambert (BBL) by the Dutch Internationale Nederland Groep (ING), and the merger between the Swedish Nordbanken with the Finnish Meritabank. These cross-border deals are noticeable because they involve very large domestic players . Worth to notice, these deals involve small countries with banks attempting to create a larger home- base.

As discussed in the second section, the arrival of the euro will change rapidly the sources of competitive advantage in various segments of the capital markets, namely government bonds, corporate securities (bonds, shares, asset-backed securities), foreign exchange, and asset management. If one accepts the argument that size will matter on some of these markets, a question is raised of either exiting (outsourcing) part of these activities, or of either reaching the appropriate size. Moreover, one should of course bear in mind that an additional, potentially much more significant, change concerns information technology. IT should allow, in principle, the distribution of financial services to retail clients across borders and without a physical presence. As concerns this threat (or opportunity), the key issue is the speed of acceptance of this new delivery channel by customers and their willingness to address a significant part of their financial affairs to a foreign supplier. In view of this new Eurobanking world, banks do face

three major strategic options : National champion, European strategy through cross-border acquisition or merger, or European strategy through a cooperative structure.

National (regional) champion : a firm acquires through acquisition a significant market share on its domestic market. It outsources part of capital markets activities to larger international firms. Domestic size will allow to achieve cost efficiency and will allow to offer high quality services. This strategy can survive until new technology allows large foreign firms to target directly local clients, disintermediating the local financial supermarket. Under such a scenario, the domestic champion will be absorbed sooner or later by a large international player who would benefit from large low cost operating platform. Given the loyalty of retail clients and the particular nature of financial services for which trust is an essential element which can not be acquired so rapidly, one could take the view that significant competition from foreign competitors on the retail market will not take place before several years. This domestic strategy could be adopted by national banks or even by some regional banks, such as the *Cajas* in Spain, who have a very strong local retail franchise.

Cross-border merger or acquisition. This allows to reach size and international coverage rapidly. Corporate control can be efficient as the process is managed with authority from a center, but the allocation of responsibilities in the newly created entity appears to have been a very difficult process for many financial firms[10]. This is the top/down approach.

The cooperative strategy (bottom up approach). As much as decades ago local cooperative

---

[10]An interesting case in 1998 is that of the highly praised Wells Fargo failing to integrate successfully FirstInterstate, and recently being forced into a merger by Norwest.

created national centers to serve their treasury or international needs (the case of the Rabobank in the Netherlands, or of the Crédit Agricole in France), groups of national institutions could create European centers taking care of asset management and, potentially, large international corporate. This approach has the merit of being decentralized at the national retail level, with an efficient management of capital markets activities at the international center. As history has shown (such as that of European American Bank or European Asian Bank), the danger is a lack of control or speed of decision by the various members.

A premise of the above analysis has been that size will be important to operate on some segments on the markets and that a European coverage will be necessary. This premise demands to identify the major competitive difference between large domestic size versus large size at the European level. Indeed, one could argue that two large banks of an equal size (one domestic and the other one European) could have the same leverage on the bond or currency markets. That question is indeed quite relevant as, no doubt, it will be much more difficult to create an international institution as opposed to a domestic one. It is the author's belief that European coverage dominates a domestic one for two major reasons. The first is that some corporate clients become increasingly international, giving preference to banks with an international coverage. The second, more significant, argument in favor of a European coverage is that it provides a much welcome source of diversification. This is of course necessary to reduce credit risk, but is also relevant to stabilize the demand for services in capital markets. Indeed, if because of a recession or change in the legal-fiscal environment, the demand for foreign exchange services for instance, or pension funds investment in bonds change dramatically, a large domestic bank would loose rapidly what was deemed necessary to compete : size to analyze the supply/order flows or to have the placing power. A European coverage would be a way to stabilize business flows, allowing to retain

permanently an adequate size.

4 Conclusions

The objective of the essay has been to identify the various ways through which the euro would alter the sources of competitive advantage of European banks and to analyze the various strategic options available. Besides the obvious fall in revenue from intra-European currencies trading, the analysis has identified significant and permanent effects on several segments of the industry. One can forecast a rapid consolidation of the commodity-type business, government bonds, interest rate derivatives, and spot currency trading. This is motivated by the loss of a main domestic source of competitive advantage, namely the national currency. If domestic expertise in the accounting, legal and fiscal environment will give a competitive advantage to domestic players in some segments of the corporate bond and equity markets, other factors such as placing power across Europe, trading capacity, and global industry expertise will lead to consolidation of that industry. On the fund management side, very large European-wide index-tracking funds will compete with specialized funds. As concerns the Euro-deposits market, the rules of monetary and fiscal policies still have to be known to assess the impact of a single currency on the size and location of this market. On the commercial banking side, the nature of credit risk is likely to change as one of the instrument of monetary policy, devaluation, will not be available. Finally, the impact of a low inflation environment on bank profitability will work through reduced margins on deposits, higher profits on personal loans, and a lower 'inflation tax'.

Furthermore, one should highlight the obvious but important fact that the single currency will make *irreversible* the creation of a single European banking market. A more predictable environment will facilitate the exploitation of economies of scale and the optimal location of

processing units.

If the premisses underlying the above analysis are verified in the future, one can anticipate the creation of a new Eurobanking world. A major international consolidation of the European banking industry will take place in the capital market business, and further domestic rationalization of commercial banking will be needed. An important premise of the analysis has been that European size would dominate domestic size because of the diversification benefits it allows to realize.

The objective of the 1992 single market programme was to reinforce the efficiency and competitiveness of European firms. As concerns banking, it is a clear conclusion that the introduction of a single currency will not only make the creation of a single market irreversible, but that it will, besides the obvious fall in revenue from intra-European currencies trading, alter fundamentally the nature of several businesses. A new banking world will emerge with very different sources of competitive advantage. If this challenge is met successfully by European banks, there is little doubt that it will reinforce the competitiveness of European banks operating in the capital markets of third countries such as those of Asia, Latin America or the United States.

Table 1 : Currency and home-country relationship in the choice of the bond bookrunner (1996)

Percentage market share won by bookrunners of indicated nationality

German bookrunners			French bookrunners		
Borrower	Currency		Borrower	Currency	
	Mark	Other		French Francs	Other
German	44	16	French	86	10
Other	37	2	Other	75	2
All	39	4	All	77	2
UK bookrunners			**Dutch bookrunners**		
	Currency			Currency	
Borrower	Pound	Other	Borrower	Guilder	Other
UK	40	21	Dutch	83	26
Other	48	3	Other	85	2
All	44	4	All	84	2
US bookrunners			**Japanese bookrunners**		
Borrower	Currency		Borrower	Currency	
	Dollar	Other		Yen	Other
US	86	46	Japanese	75	46
Other	54	13	Other	87	6
All	64	16	All	84	8

Source : McCauley-White (1997)

Table 2 : Top Underwriters of Investment Grade in USA (1996)

Manager	1996 ECU bn	Market Share
Merrill Lynch	79	18.3 %
Salomon Brothers	54	12.5
Goldman Sachs	46.9	10.8
JP Morgan	45	10.4
Lehman Bros	43.7	10.1
Morgan Stanley	40.8	9.4
CSFB	29	6.7
Bear Stearns	29	3.1
Smith Barney	12.8	3.0
NationsBank	12.3	2.8

Source : Securities Data Co.. Taking into account the merger of Smith Barney and Salomon Brothers, the five largest have a cumulative market share of 65.1 %.

Table 3a : Mutual Funds (OPCVM) Managers in France (December 1996)

	ECU bn	Market Share (%)
Société Générale	31.3	7.4
Crédit Agricole	25.1	5.9
Crédit Lyonnais	24.1	5.7
BNP	23.96	5.68
CDC-Trésor	18.5	4.4
La Poste	16.3	3.9
CIC-Banque	14	3.3
Caisses d'Epargne	12.9	3.1
Banques Populaires	12.3	2.9
Paribas	8.2	1.95

Source : EuroPerformance, AFG-ASSFI.

Table 3b : UK League of Fund Managers

	Total Assets Under Management ECU bn (Market share %)
Prudential	123.4 (9.6 %)
Schroder	119.3 (9.3)
MAM	116.6 (9.1)
Morgan Grenfell	93.6 (7.3)
Commercial Union	92.2 (7.2)
Fleming	78.6 (6.1)
Invesco	78.6 (6.1)
PDFM	77.3 (6)
Gartmore	69.2 (5.4)
Standard Union	65 (5)

Excludes the assets managed by Wells Fargo Nikko, the US fund management arm of Barclays.

Table 4 : Interest Margins of Commercial Banks

	Belgium	Denmark	France	Germany	Spain
Average margin on demand deposits[1]					
(1980-85) (%)	**11.2**	**16.2**	**11.7**	**6.5**	**14.5**
(1987-92) (%)	**8.7**	**9.0**	**9.7**	**7.2**	**6.0**
(1994-95) (%)	**5**	**NA**	**6.1**	**4.8**	**3.6**
Average margin on savings deposits[1]					
(1980-85) (%)	**5.6**	**8.9**	**4.3**	**2.8**	**10.7**
(1987-92) (%)	**3.9**	**7.0**	**5.2**	**2.2**	**9.0**
(1994-95) (%)	**1.9**	**NA**	**1.6**	**2.9**	**5**

[1]Current short-term rate minus interest rate paid on deposits.
Source : OECD

Table 5 Domestic Mergers in Europe (Not complete. For illustration only).

Belgium	1992	CGER-AG (Fortis)
	1995	Fortis-SNCI
	1995	KB-Bank van Roeselaere
	1997	BACOB-Paribas Belgium CERA-Indosuez Belgium
	1998	KBC (KB-CERA-ABB)
Denmark	1990	Den Danske Bank Unibank (Privatbanken, Sparekassen, Andelsbanken)
Finland	1995	Merita bank (KOP-Union Bank of Finland)
France	1996	Crédit Agricole-Indosuez
Germany	1997	Bayerische Vereinsbank-Hypo-Bank
Italy	1992	Banca di Roma (Banco di Roma, Cassa di Risparmio di Roma, Banco di Santo Spirito) IMI - Cariplo San Paolo- Crediop
	1995	Credito Romagnolo (Rolo)-Credit Italiano
	1997	Ambroveneto-Cariplo
Netherlands	1990	ABN - AMRO
	1991	NMB-PostBank-ING
	1998	Rabobank-Achmea
Portugal	1995	BCP-BPA
Spain	1988	BBV(Banco de Vizcaya-Banco de Bilbao)
	1989	Caja de Barcelona-La Caixa
	1992	Banco Central-Banco Hispano
	1994	Santander-Banesto
Sweden	1993	Nordbanken-Gota Bank
Switzerland	1993	CS-Volksbank-Winterthur
	1997	SBC-UBS
United Kingdom	1995	Lloyds-C&G-TSB

Table 6a :International Mergers in Europe[2]

BUYER	TARGET
Deutsche Bank	Morgan Grenfell
ING Bank	Barings
Swiss Bank Corp	Warburg, O'Connor, Brinson, Dillon Read
Dresdner	Kleinwort Benson
ABN-AMRO	Hoare Govett
UNIBANK	ABB Aros
Merrill Lynch	Smith New Court (UK) FG (Spain), MAM
CSFB	BZW (equity part)
Société Générale	Hambros (UK)

2 Not complete. For illustration only.

Table 6b : International Mergers in Europe

BUYER	TARGET
DEXIA (F, B, L)	Crédit Communal, Crédit Local, BIL
BACOB (B)	Paribas (NL)
ING (NL)	BBL (B)
FORTIS (B, NL)	AMEV+Mees Pierson (NL) / CGER/SNCI (B)/Generale Bank
NORDBANKEN (S)	MERITA BANK (F)
GENERALE BANK (B)	Crédit Lyonnais (NL), Hambros (UK, corporate)

References

Alogoskoufis, G. and Portes, R. (1991). "International Costs and Benefits from EMU", in *The Economics of EMU*, European Economy.

Banque de France (1996) : *Bulletin Trimestriel*, December.

Bonanni, C., J. Dermine and L.H. Röller (1998) : "Some Evidence on Customer 'Lock-in' in the French Mutual Funds Industry", *Applied Economics Letters* (5), pp 275-279..

Dermine, J. (1996) : "European Banking with a Single Currency", *Financial Markets, Institutions & Instruments,* 5 (5).

Dermine, J. (1997) : "Eurobanking, a New World", Laureate of the 1997 EIB Prize, *EIB Papers* (2).

Dermine, J. (1998) : *The Euro World, a Strategic Analysis*, Brussels : Video Management.

Dermine, J. and P. Hillion eds (1998) : *European Capital Markets with a Single Currency, an ECMI Report*, Oxford : Oxford University Press, forthcoming.

Eichengreen, B. (1993). "European Monetary Unification". *Journal of Economic Literature*, 31, pp. 1321-1357.

Emerson, M . (1990). "One Market, One Money", *European Economy*, 44, October.

Feldman, L. and Stephenson, J. (1988). "Stay Small or Get Huge-Lessons from Securities Trading". *Harvard Business Review* : May-June, pp. 116-123.

Federal Reserve Bank of New York (1991). International Competitiveness of US Financial Firms. New York : Staff Study.

Fisher, S. and Modigliani, F. (1978). "Towards an Understanding of the Real Effects and Costs of Inflation", *Weltwirtschaftliches Archiv,* 114, pp. 810-833.

Fox, M. (1992). "Aspects of Barriers to International Integrated Securities Markets. *Journal of International Securities Markets,* Autumn, pp. 209-217.

Harm, C. (1998) : "European Financial Markets Integration : The Case of Private Sector Bonds and Syndicated Loans", mimeo, Copenhagen Business School, pp 1-26.

Kay, J., Laslett, R. and Duffy, N. (1994). The Competitive Advantage of the Fund Management Industry in the City of London. London : *The City Research Project.*

Maas, C. (1995). Progress Report on the preparation of the Changeover to the single Currency. Brussels.

McCauley R. And W. White (1997) : "The euro and European Financial Markets", BIS WP 41.

McKinnon, R. (1963). "Optimum Currency Areas". *American Economic Review,*53, pp.717-725.

McKinnon, R. (1993). "The Rules of the Game , International Money in Historical Perspective". *Journal of Economic Literature,* 31, pp. 1-44.

Mundell, R.A. (1961). "A Theory of Optimum Currency Areas". *American Economic Review*, 51, pp. 657-665.

Tschoegl, A. (1996) : "Country and Firms Sources of International Competitiveness : The Case of the Foreign Exchange Market", The Wharton School.

White W. (1998) : "The Coming Tranformaion of Continental European Banking ?, BIS WP 54.