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OPINION

European banks

European banks need cost-cutting not cross-border M&A

Jamming large struggling banks together will not fix the sector's problems

JERRY del MISSIER

The calls for cross-border European banking deals are mounting again. Not for the first time, we are being told that consolidation of international banking groups will "fix" the problems faced by the industry, this time those caused by the pandemic.

Over the years, various combinations of UniCredit, Société Générale or Commerzbank have been touted, as well as tie-ups between banks from the same country, such as Deutsche Bank and Commerzbank or UBS and Credit Suisse. Yet nothing tangible ever seems to come from these discussions. And with good reason. It is hard to see who would benefit from such deals, other than the mergers and acquisitions advisers involved in the transactions.

While the industry is in desperate need of consolidation, this would be the wrong way to go about it. Here's why. Despite years of effort to integrate European banking, we are still a long way off from a true single market. The European Central Bank has overall supervisory responsibility, but too much leeway still exists at the national level.

The work of the Single Resolution Board, which has EU-wide authority to supervise the orderly resolution of failing banks, is a prime example. The SRB was an important step towards banking union, yet its power has been structurally compromised by inclusion of national governments in the winding-up process.

Resolution remains one of the biggest stumbling blocks for cross-border deals. What national authority would let a local bank acquire a large, complex foreign institution when its taxpayers would be on the hook if it failed?

The lack of a strong resolution authority has contributed to the generally unfinished business of cleansing the European banking system. There are still too many undercapitalised, unprofitable and uncompetitive institutions. Some are large institutions waiting for a revenue rebound to bail them out of their predicament. Merging two big, struggling banks will not create a thriving national champion, no matter what advocates say.

Measures intended to support the economy have also provided life support for struggling banks. We have ended up with a valuation gap between winners and losers that is far tighter than it should be. This further stymies the needed cleansing.

What is the solution? A sound financial system must begin with robustly capitalised, well-managed institutions capable of sustained profitability. Revenue growth headwinds are likely to be with us for years to come, so radical cost-cutting must be the key. This means leaving businesses that management teams have clung to in the vain hope of cyclical rebounds.

The sector does need M&A, but not the type that is so regularly floated. We require consolidation not across borders or between bloated giants, but domestically to reduce fragmentation and eliminate the subscale players. Barely profitable, they are not capable of making the required technology investments.

Regulators have an important part to play. They must pressure weaker players (and the governments covering for them) to have a plan or face resolution. Their oversight should reward successful banks, so that they can play the leadership role in the industry. Blanket application of rules, such as dividend bans, only serves to stifle success and protect the weak. Regulators must differentiate more than they have.

The result would be a smaller number of healthier, more profitable institutions better able to invest and adapt to a new, more digital future. At that point, as pan-European regulation continues to evolve towards a more tangible single market, cross-border consolidation would start to make sense. Only then will we see the end, once and for all, of the rolling financial crisis that has been with us since 2010.

The writer, a former chief operating officer of Barclays, is the founder of Copper Street Capital

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