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Mobility of bank customers in the EU: Much ado about little

Retail banking markets in most EU member states are highly competitive. Direct banks and the ever rising availability of price-comparison websites and online credit intermediaries enable customers to choose the most attractive provider with minimal effort. Moreover, the general openness of national markets to competitors from other EU member states raises competitive pressure further.

Nevertheless, the European Commission wants to stimulate competition in the market for current accounts and related services, because it is of the opinion that artificial barriers prevent customers from switching from one bank to another. It cites low customer mobility as evidence of the perceived obstacles to switching.

Yet numerous studies and surveys show that customer mobility in national markets is low (which indeed it is) not because of obstacles to switching, but because customers are by and large satisfied with their respective banks. Even so, the financial industry submitted a list of proposals dedicated to the further fostering of customer mobility by June 2008 – as requested by the Commission. At the same time, the Commission circulated a draft regulation.

The subsequent negotiations between the Commission and the financial industry yielded a workable solution. On a self-regulatory basis, the financial industry pledged to henceforth offer customers a far-reaching account switching service.

Going forward, the discussion should change its focus. The actual problem is not low customer mobility in national markets, but low cross-border account mobility. Here, indeed, there is need for Commission action so that one day opening a bank account abroad and transferring banking business to another country will pose as few problems as switching from one bank to another in the national context today.

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Background: The Commission's sector inquiry and the expert group report

The current debate about the mobility of retail banking customers results from a sector inquiry the Commission initiated in 2005. According to the final report (released in January 2007), there is not enough competition in the European retail banking markets. As evidence for this, the Commission points to the fact that indicators such as profit margins, prices and selling patterns vary significantly between EU member states, whereas the same indicators are found to converge within individual member states. Additionally, the sector inquiry diagnoses low customer mobility, both within member states and across national borders. Differences in prices and policies as well as low customer mobility result, in the Commission's opinion, from perceived obstacles like information asymmetries and the high cost of switching. For example, the latter comprises the administrative burden of switching and artificial barriers like tying banking products to others or imposing high closing charges.

Against this background, the Commission appointed an expert group in order to explore "customer mobility in relation to bank accounts" in more detail. The expert group released its final report in May 2007. To the extent that obstacles and solutions are the same or similar as for current accounts, the sector inquiry also focuses on two more product categories: first, payment facilities attached to current accounts, whereby the term "payment facilities" mainly refers to products like credit transfers, direct debits and cash withdrawals; and second, simple savings accounts, excluding savings in the form of, e.g., securities accounts or life insurance. As to the client groups targeted, the report focuses on individuals and small enterprises.

On November 20, 2007, the Commission launched a series of initiatives aimed at improving customer choice and mobility within the single market. The list of proposals – which is part of the Commission's communication "A Single Market for the 21st Century" – is based on the assumption that consumers face obstacles when attempting to switch from one provider to another. From this perspective, removing these obstacles is the prerequisite for making customers more mobile, fostering competition and broadening the spectrum of products consumers can choose from.

As regards the way of achieving this goal, the Commission prudently exercised caution in its first step. In its above-mentioned communication, it invited European financial services providers to develop, on a self-regulatory basis, a set of common rules dedicated to fostering customer mobility (see section 5 below). The rules had to be submitted by mid-2008. Banks delivered self-regulation on time (i.e., in June 2008). At the same time, the Commission circulated a draft regulation. On this basis, the Commission and the financial industry began to negotiate.

1. Introduction: A thought experiment

Imagine a couple that has been married for 40 years. What is the secret behind such a long marriage? Simple really, isn't it? The marriage has only lasted this long because one of the partners has made it too expensive for the other to seek a divorce.

Presumably, not many people would concur with this explanation – and not just for romantic reasons. Rather, on the basis of our life experience, most of us would assume that the couple has stayed together that long because they are happy with each other.

Yet, when it comes to retail banking markets, which, similarly, are marked by long-lasting relationships between banks and their customers, many are quick to assume that this situation cannot simply reflect a high level of customer satisfaction. Instead, they claim that the longevity of business relations must, of course, reflect barriers to exit – in spite of the fact that basic economic considerations suggest otherwise: banks themselves can be expected to be interested in high customer satisfaction. Banks with satisfied customers will try to maintain and even raise customer satisfaction, whereas banks with customers who are dissatisfied will aim at making their customers more satisfied. If they fail to do so, customers will switch to competing banks that promise to be more responsive to their demands. In the end, all customers receive high-quality services at reasonable prices. In other words: "the fundamental things apply" in the financial industry, too, if the market is allowed to work.

Nonetheless, it is, of course, legitimate – for market participants, researchers and policy-makers alike – to investigate whether the market mechanism does indeed work satisfactorily and whether the interests of all market participants are safeguarded. Driven, inter alia, by this motivation, the European Commission has subjected customer mobility in relation to bank accounts to critical scrutiny (see box). As regards the basic question raised above, the Commission has concluded that barriers to competition are to blame for low customer mobility. However, whether this causality really exists is a highly controversial matter. In what follows, we therefore explore the issue of customer mobility in more detail. Specifically, we will try to answer two questions. First, is low customer mobility really a proof for barriers to competition or is it more a reflection of high customer satisfaction? Second, if we differentiate between switching from one bank to another in a national as compared to an international context, how can cross-border mobility of bank customers be made easier?

2. Is there a case for Commission action? Some basic caveats

Retail banking already highly competitive

The financial industry already is a highly competitive sector, serving the consumers' interests by delivering a broad set of products at affordable prices. Competition has increased further in recent years with the opening of retail banking markets to foreign-owned banks. The market share of foreign-owned banks has risen in almost all member states of the EU. Moreover, financial services are certainly among the industries where existing consumer policy provisions are already comparatively extensive.

What is more, competition in the retail banking segment does not only take the shape of a customer switching from one bank to another, but also of a customer maintaining business relationships with several banks at the same time. These multiple banking relationships enable customers to choose the best offer from a variety of providers without having to close his or her account at one bank and open a new one at another bank.

Domestic switching vs. cross-border switching

There are two forms of customer mobility

Nevertheless, in what follows we will have a closer look at the market for current accounts in order to find out whether and, if so, what kind of regulation is necessary for raising customer satisfaction. An aspect that, so far, has not been given sufficient attention in the debate on customer mobility is the need to differentiate carefully between switching from one bank to another in the domestic context on the one hand and cross-border switching on the other. Such differentiation is essential, because there is an important difference between domestic switching and cross-border switching: in the case of domestic switching, the focus of the debate is on barriers that prevent customers from *ending* the business relationship with a bank. In contrast, in the case of cross-border switching, the focus is on factors that might prevent customers from *starting* a new business relationship with another bank that is domiciled abroad.

Motivation of customers varies

Today, this differentiation is mainly rooted in the differing motivations for domestic and cross-border switching, respectively. Domestic switching usually reflects the relative attractiveness of the new bank's offer and/or the customer's dissatisfaction with the old bank's service. Thus, domestic switching is the result of a deliberate decision. While the "new" bank is very interested in the new customer – and opening an account should not pose a problem – it may theoretically be possible that the "old" bank or other determinants prevent the customer from closing the existing account. In contrast, the need for cross-border switching is now predominantly a reflection of non-bank-related factors in the customer's life, e.g. moving from one country to another.

National and cross-border bank switching will converge

However, it needs to be noted that, with EU retail banking markets becoming more and more integrated, domestic and cross-border switching will converge in the future. Banks will increasingly try to attract non-domestic customers. Notwithstanding linguistic and cultural barriers (which could be overcome by multi-lingual websites), bank customers, in turn, will increasingly choose foreign providers for their daily business not because of a job change or other non-bank-related factors, but because they aspire to a better cost-benefit ratio. Nevertheless, one important difference will remain: banks offering cross-border services and customers demanding them will have to cross legal borders – in the sense of complying with the respective country's regulatory framework. For instance, the customer may face difficulties to open an account in another country due to legal obstacles such as anti-money-laundering or know-your-customer (KYC) rules. Similarly, the bank has to cope with the consumer protection provisions of the customer's home country.

Need for action with regard to cross-border switching

Hence, as to cross-border switching, the existing legal framework suggests that indeed there are and will be obstacles – especially legal and regulatory ones – which prevent customers from opening an account abroad. With regard to domestic switching, the situation is completely different, because in the domestic context the

competitive mechanism described above works fairly well. Thus, we come to the conclusion that there is no need for action regarding domestic switching, while cross-border switching needs to be facilitated by suitable regulatory steps.

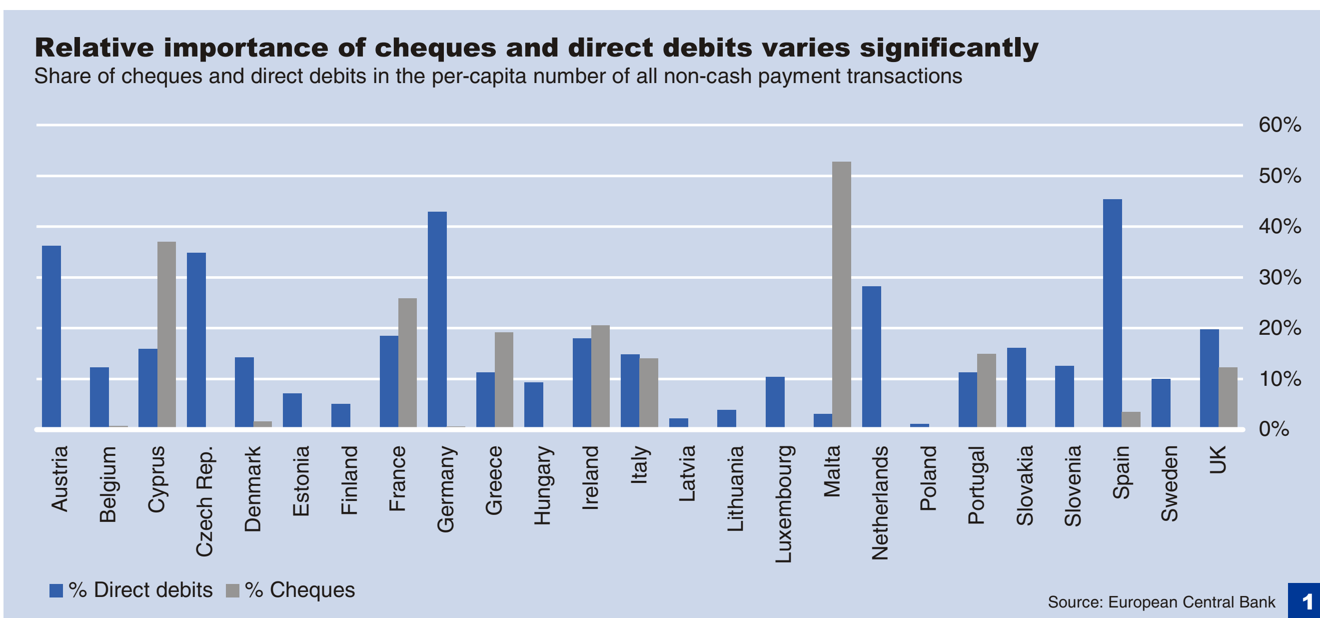
"One size fits all" not feasible

Differentiated approach necessary,...

Apart from the distinction between domestic and cross-border switching, it should be noted that European markets for current accounts and related (payment) services are currently so diverse that a "one-size-fits-all" solution is not to be recommended. Thus, irrespective of whether domestic switching must be fostered or not, it must be noted that the situation in national retail banking markets and potential remedies must be explored cautiously and on a case-by-case basis.

... because national payment customs differ from each other

For example, cheques are common in only nine EU member states, while direct debits are – with a greatly varying degree of significance – in use in all member states. Hence, policy proposals aimed at, say, alleviating problems in the transfer of direct debit orders from one bank to another (see below) would benefit bank customers in different countries to a very different extent. The same would be true for political action with regard to cheques. If such proposals involved costs for the market participants, banks and customers in all EU member countries would have to bear them. In the end, all Europeans would have to pay for measures which only some would benefit from.



3. Domestic switching: Is there really a problem?

European bank customers are satisfied with their banks

"Churn and "longevity" as indicators of customer mobility

Chart 2 displays two key figures, "churn" and "longevity", which give an insight into customer mobility in the EU member states. According to the source of the data, the Commission's "Report on the retail banking sector inquiry", "churn" tries to capture the share of customers who change providers in a given year, while "longevity" is a measure of the average age of existing banking relationships. For a

variety of methodological reasons[1], current accounts can be expected to significantly outlast their current "longevity", and, similarly, the churn rate can be expected to overestimate the rate of customers moving accounts. Nevertheless, the chart gives an insightful overview of customer mobility in Europe, allowing the following major conclusions:

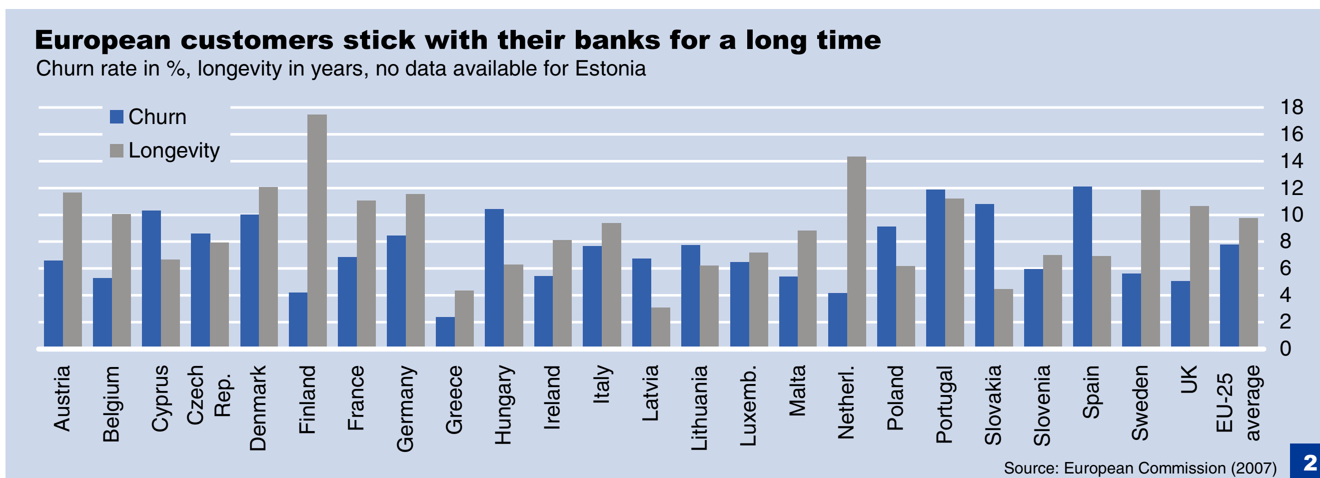
— Even conceding that the data given above overestimates customer mobility, the statistics clearly show that customers in Europe change their bank relationship only infrequently. Only about eight percent of customers decide to change from one bank to another every year, and the average age of existing active current accounts is nearly ten years.

— As regards the churn rate as an indicator, customer mobility is lowest in Greece (2.36%) and highest in Spain (12.12%). Customer mobility is higher in the new member states (average 9.02%) than in the EU-15 (average 7.55%).

— Taking longevity as an indicator, one has to keep an important caveat in mind: the new member states' banking markets were shaken up enormously when the iron curtain fell. Against that backdrop, it does not come as a surprise that the average lifetime of currently existing accounts is significantly lower in the new member states (average 6.28 years) than in the EU-15 (average 10.4 years). In the EU-15, longevity is lowest in Greece (4.34 years) and highest in Finland (17.44 years).

European customers stick with their banks for a long time

Churn rate in %, longevity in years, no data available for Estonia



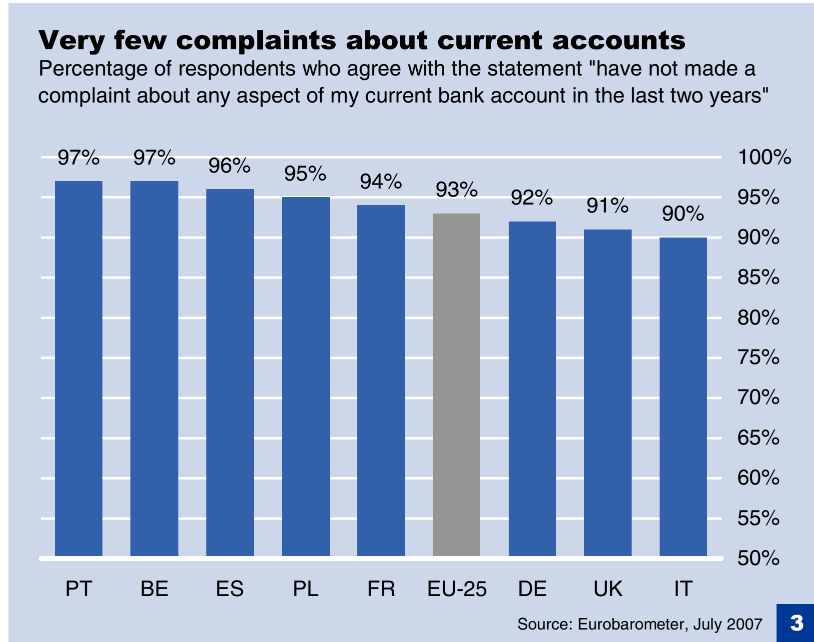
Source: European Commission (2007) **2**

Customers are satisfied…

As already stated, the low number of customers switching from one bank to another theoretically could be seen as evidence of a lack of competition in national banking markets. But what if there is a simpler and more obvious explanation for low customer mobility? What if customers are, by and large, satisfied with their bank – so that, from each customer's perspective, there simply is no need to change banks? This is exactly what many customer surveys, some of which are even cited in the expert group's report[2], suggest. For instance, according to a Eurobarometer survey, 93% of the respondents in the EU-25 claim that "they have not made a complaint about any aspect of their current bank account in the last two years".

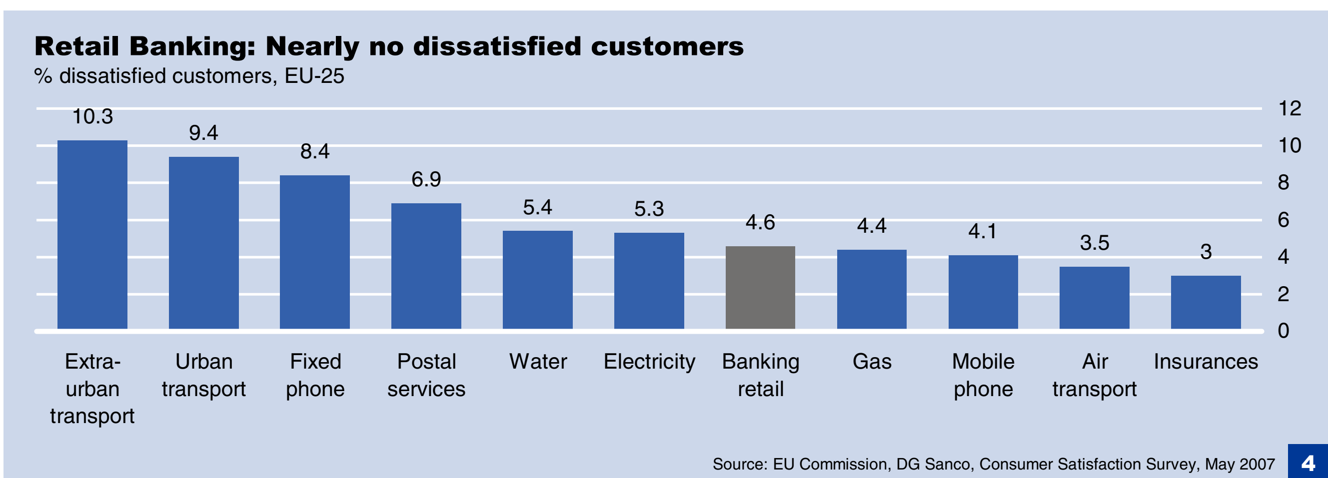
[1] European Commission (2007). Report on the retail banking sector inquiry. Commission Staff Working Document, pp. 71-72.

[2] European Commission (2007). Report on the retail banking sector inquiry. Commission Staff Working Document, p. 66.



... and therefore stick with their banks for a long time

Obviously, most customers simply do not *want* to change their bank. Thus, it is no wonder that in the “Report on the retail banking sector inquiry”, the Commission states: “It is likely that a large proportion of banking customers – probably the majority in most Member States – would describe themselves as satisfied with their current bank.” The findings of a cross-sectional study conducted on behalf of the European Commission support this view. While about every tenth customer of transport services calls himself dissatisfied, not even five percent of retail banking customers do.



Non-monetary factors explain long-lasting banking relationships

Additionally, there are other factors with an impact on customer mobility, but these are often neglected when overly simple cost-benefit analyses are made because very often non-monetary determinants of a bank-customer relationship are not taken into account. These include geographic proximity[3] to the branch and “relationship banking” factors like a family history with a particular provider or trust in the well-known employees working in a branch in

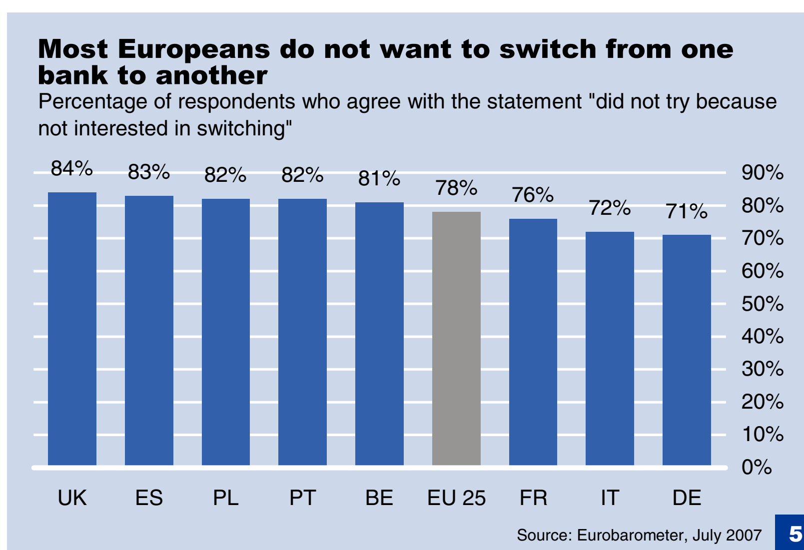
[3] See European Commission, Interim report II – Current accounts and related services, p. 96/97.

the customer's hometown.[4] According to the interim report II, e.g., British consumers cite a bank's proximity to the home or workplace as the main reason for having chosen it. Similar results can be found for Irish, Dutch and Swedish bank customers.[5]

Therefore, it is easily conceivable that customers may be satisfied with their bank for reasons beyond narrow cost-benefit analyses. And as long as customers are satisfied with their current bank's service they just do not try to switch banks, as a Eurobarometer survey confirms.

Most Europeans do not want to switch from one bank to another

Percentage of respondents who agree with the statement "did not try because not interested in switching"



Source: Eurobarometer, July 2007 5

A closer look at the perceived obstacles to switching

Nevertheless, it is worthwhile to have a closer look at the arguments brought forward to explain the low incidence of switching. The expert group was mandated to explore to what extent low customer mobility can be traced back to four potential explanations:

— information asymmetry and intransparency of prices

— bundling and tying

— closing charges

— the administrative burden for customers willing to switch

Below, we are going to explore these potential obstacles to customer mobility in more detail.

Information asymmetry

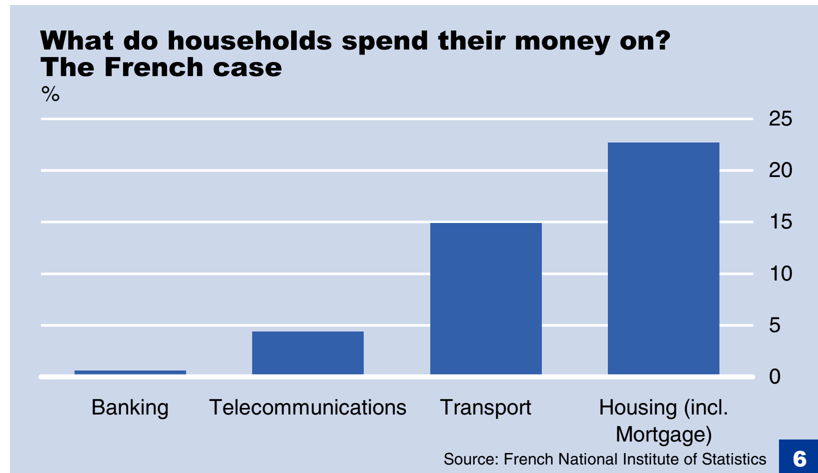
Customers are well informed

From the European Commission's point of view, low customer mobility may be rooted in the fact that customers are not sufficiently informed about alternative offers with a more favourable cost-benefit ratio. Yet, in this context, it is worth mentioning that price transparency is already high due to far-reaching consumer information regulations. For instance, in Germany, banks are required to display a catalogue of their services including the prices thereof in their branches, the so-called "*Preis- und Leistungsverzeichnis*". Beyond such regulatory factors, the use of the internet is an important factor in overcoming any information asymmetry that may exist. The cost of comparing prices has decreased significantly and will further

[4] Financial services action plan – progress and prospects, expert group on banking, 2004, p. 6 and 18.

[5] See European Commission, Interim report II – Current accounts and related services, p. 96/97.

decrease due to the rising popularity of price-comparison websites. Additionally, SEPA and further innovations will raise competitive pressures in the payments markets. Payment services will be increasingly provided by new players (mobile operators, internet service providers etc.), and the number of payment relationships will increase (internet payments, payments via mobile phone and payments using contactless technology).



More regulation would do more harm than good

Thus, consumers can be expected to be increasingly well informed about competitive offers that might beat those of their current bank. Moreover, even if it were correct that some customers are not perfectly informed, that would not necessarily prove a need for regulatory action. The reasons are, first, that a lack of information could result from rational behaviour because customers' expenditures on banking services are insignificant compared with other expenses for average households. Against this background, investing too much effort in price comparisons would entail opportunity costs that easily outpace potential savings from switching to another bank. Second, in case regulators impose additional information duties on banks, the information provided could be excessive. If they are provided with too much and too detailed information, average customers will feel overpowered by a deluge of information and will refrain from using any of it. As a consequence, they would receive less instead of more information.

There is no lack of information

For a variety of reasons, therefore, information asymmetries do not prevent customers from switching from one bank to another. And even if there were informational barriers, this would not suggest imposing new information duties on banks, because the latter could have contra-productive effects.

Bundling and tying

Bundling and tying often are beneficial

The expert group report says that bundling and tying[6] of products can weaken competition by raising switching costs, reducing price transparency and discouraging the entry of new players (especially mono-line suppliers). On the one hand, the expert group report may theoretically be right. On the other hand, there is no doubt that, in general, bundling and tying are beneficial for consumers, as buying

[6] According to the European Commission, bundling occurs where two or more products are sold together in a package, although each product is also available separately. Tying occurs when two or more products are sold together in a package, and at least one of these products is not sold separately.

packages of products instead of each product individually decreases transaction costs.

Product packages have to be transparent

The cardinal question is: Under what circumstances can the advantages for the customers be achieved without raising switching costs and reducing price transparency? First of all, information plays a decisive role, with information having a dual meaning here. On the one hand, it reflects the basic advantage for the customers, viz. lower information(-gathering) costs. For example, if a bank offers a package including, say, a current account, an overdraft credit facility, a debit card and a credit card, it will be more convenient for the customer to compare this package with packages of other providers than to assess the relative cost-benefit ratio of four different products – provided the respective packages are comparable with regard to the individual products they comprise. On the other hand, in order to assess the benefit from product bundling, the customer will need to obtain all relevant information about the price of the package and about the products included. Thus, bundling will only be above doubt if customers are well informed about the product offers.

Terminating a banking relationship is facilitated

Additionally, product packages can alleviate problems in switching from one bank to another not only by reducing information cost, but also by facilitating the closing down of a business relationship with a particular bank, because it is easier to terminate a single contract on a product package than to cancel several individual products separately.

Product variety reflects preferences of banks and customers

Against that backdrop, the broad range of products (with product features ranging from basic to complex) results from free decisions of both financial services providers and their customers acting in a competitive environment. Thus, many types of charges as well as combined product offerings are developed in line with customers' and banks' preferences.

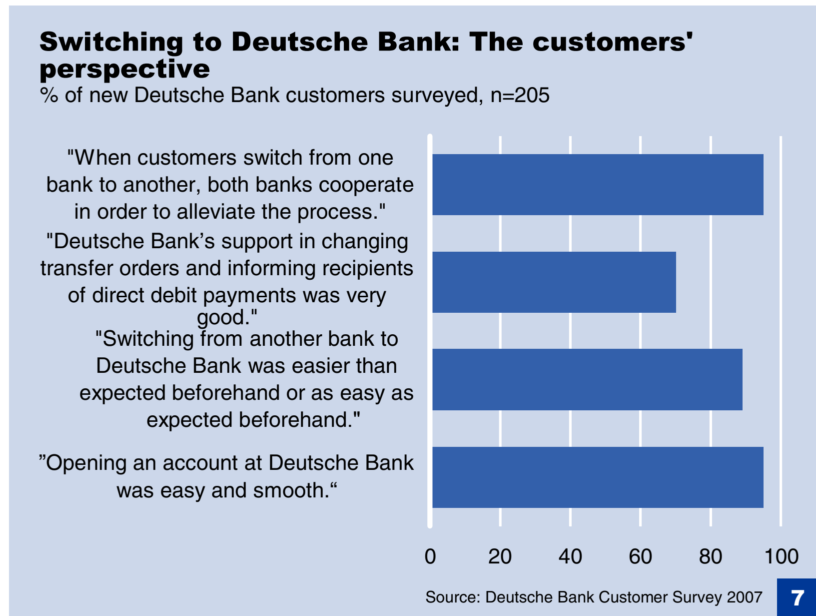
Closing charges

Closing charges will vanish

As to closing charges, they are uncommon already today. For example, German banks do not charge account closing fees at all. In Italy, they were abandoned in 2006. According to the "Report on the retail banking sector inquiry" (published in January 2007), in a majority of EU member states customers are not charged for closing their current account. Moreover, closing charges will be forbidden by the Payment Services Directive (PSD) anyway. The respective passage (Article 45) of the PSD reads: "Termination of a framework contract which has been concluded for a period of 12 months or for an indefinite period shall be free of charge for the payment service user after the expiry of 12 months. In all other cases charges for the termination shall be reasonable and in line with costs." Since bank accounts usually are based on contracts concluded for an indefinite period, this means that the PSD effectively prohibits closing charges.

Customers themselves say: "Switching is easy and smooth"

We have determined that neither information asymmetries nor bundling and tying nor closing charges can be assumed to effectively prevent customers from domestic switching. As the above-mentioned surveys underline, for most customers there is just no convincing reason to do so. But assuming that they wanted to switch, *could* they? The sector inquiry and the expert group report suggest they would face an enormous administrative burden.



Deutsche Bank customers do not spot obstacles

In order to shed light on this question, Deutsche Bank conducted a survey among new account holders. The message is very clear: results show that, at least in Germany, switching from one bank to another is not unduly hampered by the tasks involved in closing an account at one bank and opening one at another. In fact, a full 95% of Deutsche's new clients agreed with the statement that "opening an account at Deutsche Bank was easy and smooth". Two-thirds of the respondents considered switching from another bank to Deutsche Bank "much easier than expected beforehand" or "easier than expected beforehand". An additional 23% perceived it as "as easy as expected beforehand". But what is most important: only 4% of all respondents complained about a lack of cooperation between their former bank and their new bank. Accordingly, 96% of all customers switching to Deutsche Bank think that, when customers switch from one bank to another, both banks cooperate in order to alleviate the process. These results clearly confirm our assessment that, in the domestic context, low customer mobility really reflects high customer satisfaction rather than high barriers to competition, and that those (few) customers willing to switch are by no means confronted with severe obstacles. Consequently, in Germany, at least, the measures discussed in the expert group report with a view to increasing customer mobility would in fact attack a strawman of non-existing obstacles. Rather than being beneficial, these measures would simply cause higher costs for consumers that, in their vast majority, are highly satisfied today.

Banks offer variety of switching services

This does not only hold true for Germany. According to a Eurobarometer survey, seven out of ten EU citizens believe they can easily change banks. There is a variety of switching facilities (switching services and switching guides) provided by the banking industry in the European markets that make switching from one bank to another convenient. The results of the DB and the Eurobarometer surveys indicate that, regarding the administrative cost of switching from one bank to another, one has to differentiate between the abstract perception of the public and the experience of those customers who actually have switched.

Case study: The Netherlands – very low customer mobility despite benchmark switching service

In the Netherlands, bank switching is very easy

Beyond tracing low customer mobility to high customer satisfaction, it is worthwhile to have a closer look at particular national retail banking markets in order to find out whether the design of switching facilities influences the behaviour of customers.

In this regard, the Netherlands can serve as an example. Since January 1, 2004, the Dutch "Interbank Switch Support Service" (IBSS) has aimed at guaranteeing bank customers in the Netherlands a simple, seamless switch of their payment transactions to a new bank:

- For 13 months after the closure of an account direct debit payments and credits are automatically re-routed to the customer's new current account.
- The corporate customer that has initiated a direct debit is automatically informed of the new account number, and is requested to update his database.
- In case of regular credit transfers received (e.g. salaries), the current account holder must inform his debtors of the new account number, for which a special brochure provides him with standard cards.
- The old bank cancels the standing orders for the old account, and provides the customer with a list of the specifics. It is up to the customer to give this list to the new bank, requesting it to activate some or all of the standing orders on the new account.

Nonetheless, customer mobility is low

Against the backdrop of this far-reaching switching arrangement, one might expect customer mobility in the Netherlands to be exceptionally high. Yet quite to the contrary, it is among the lowest in the EU (churn rate: 4.17%), second only to Greece (2.36%), while the EU average (7.78%) is nearly twice as high. Thus, the existence of a customer-friendly switching scheme does not seem to be a sufficient condition for high customer mobility.

Therefore, costly switching services seem to be non-effective

That again corroborates our hypothesis that low customer mobility in the national retail banking markets mirrors high customer satisfaction – and not a variety of obstacles to switching. Additionally, it reinforces the above-raised concerns that implementing far-reaching policy measures could make all bank customers pay for a measure which only few would benefit from. This would not only betray the causative principle, but also cast doubts on the economic reasonableness of such switching schemes, because the average cost of each switching case would in most cases outstrip its respective benefit by far.

4. Cross-border switching: Problems exist, but the proposed remedies will fail

The goal is non-controversial, the means are not

Cross-border switching must become easier

In contrast to domestic switching, *cross-border* account mobility does indeed offer a field to which the efforts of the European Commission could usefully be applied. As our analysis will show, the related problems touch upon difficulties that are most familiar from efforts to integrate other segments of the EU retail banking markets.

The starting point of discussion obviously must be to ask whether there really is any significant demand for cross-border bank

Demand seems to be low

accounts. At first glance, customer demand seems to be mainly domestically oriented. According to a Eurobarometer survey, only 7% of consumers would consider opening an account abroad within the next five years. Indeed, there are specific obstacles to cross-border opening of bank accounts, especially cultural and linguistic ones. When it comes to maintaining a banking relationship, many customers want to feel at home with regard to the accustomed business practices, the language and so on.

... but it can be expected to rise

Nevertheless, ever more customers demand cross-border opening of bank accounts, e.g. non-residents living near a border, non-resident property owners (e.g. of secondary homes), foreign students, expatriates etc. Moreover, with the European market for current accounts and related services becoming more and more integrated, the target group for cross-border services will rise significantly beyond this type of customer. In such an environment, nearly every inhabitant of the EU becomes a target customer for cross-border services with respect to bank accounts and payments. In turn, providing accounts for non-resident customers can become a profitable business for pan-European-oriented banks. Therefore, facilitating cross-border opening of bank accounts would be beneficial for banks and a growing number of customers alike, because both could reap the benefits of a more integrated European market. Thus, in the case of cross-border switching, it is not the goal which is disputed but the possible means that have to be applied in order to achieve the goal. In this context, it is only logical to have a look at the potential obstacles.

The expert group focused on four alleged obstacles to cross-border opening of accounts, namely:

- legal and regulatory barriers
- information barriers and uncertainty
- commercial decisions by banks
- opening and closing charges

Policy-makers should focus on regulatory obstacles

Taking this list of potential obstacles, the expert group recommends that the Commission focus on removing the legal and regulatory barriers in all cases where it is noted that legal and regulatory barriers themselves bring about information barriers and uncertainty. Thus, it does not make sense to explicitly distinguish between legal and regulatory barriers on the one hand and information barriers and uncertainty on the other. In the following, we will focus on these potential obstacles, because removing them can be expected to open the door to more cross-border business in the field of current accounts and related services.

Closing charges will become insignificant

In contrast, closing charges will not play a role hereafter (see above), and commercial decisions made by banks should – in line with the principles of a market economy and to the extent that they do not purposely disadvantage consumers – not be an issue for EU regulators.

Banks should decide on their product offerings freely

Providing bank accounts for customers residing in another EU member state is a specialist product which is offered by banks only if they deem the cost-benefit ratio beneficial. Basically, banks should have the right to freely decide on whether and how they want to offer bank accounts to non-resident customers. For instance, linguistic diversity might prevent many banks from offering cross-border services in each and every branch. Instead, they can be expected to provide targeted platforms (e.g. multi-lingual websites) and special services dedicated to serving specific customer segments (e.g.

German or British desks in distinctive “second-home regions” like coastal areas in Mediterranean countries). This exemplifies that commercial decisions made by banks in this area cannot be made subject to “one-size-fits-all” regulatory measures.

Against this background, commercial decisions made by banks or banks’ product policies (e.g. bundling and tying) are not feasible starting points for regulatory action. Experience has shown that, otherwise, there would be more harm done than good.

Imposing account number portability would do more harm than good

Numbering of bank accounts is a complex matter

Among all the expert group proposals to remedy the asserted difficulties in switching from one bank to another, we are especially sceptical towards account number portability, because, for historical reasons, the numbering of bank accounts is based on differing logical systems, which is reflected in a variety of national idiosyncrasies:

- The number of digits constituting an account number differs not only between but in some cases even within member states.
- In some member states, account numbers can comprise letters.
- In some member states, bank identifier codes exist while in others they do not.
- The length (i.e. number of digits) of the bank identifier codes varies between member states.

There are two ways of implementing account number portability, ...

Generally, if full account number portability is desired, there are two ways to deal with the differing systems. Either, if customers can keep their account number when switching from one bank to another, there have to be central authorities, i.e. in every single member state, which “translate” the existing account number into a new virtual account number that enables the system to track down the customer within Europe. Alternatively, each and every current account in the European Union would have to be assigned a new number that meets the requirements of EU-wide portability.

... which entail technical difficulties...

Each of the two ways raises a variety of questions as regards technical issues in the course of implementation, but there is no denying that implementing either of them would carry enormous costs and operational risk.

Adapting IT infrastructure would be very costly

... and enormous cost

As to the cost, the factors include the direct costs resulting from building up the necessary IT infrastructure and – in case all accounts are assigned a new number – the indirect costs resulting from the fact that all bank customers and their respective counter-parties have to cope with the new number in their everyday business transactions (which include activities like reprinting stationery and forms or updating customer databases). The direct costs for building up the necessary IT infrastructure can be expected to be extraordinarily high, because the existing variety of account numbering systems (see above) and the IT infrastructure behind them are rooted in the idiosyncratic historical development of 27 member states of the European Union – let alone that there even may be two or more systems existing in parallel within particular countries.

Thus, account number portability is not realisable at reasonable cost. Even more importantly, the latter would have to be borne not only by those customers who actually want to move their bank

account across the border, but also by customers who do not intend to switch to another bank at all. Hence, every customer would pay for a measure that would only benefit a small fraction of all customers.

IBAN and BIC standards would have to be abolished

Furthermore, introducing portable account numbers would mean that the current IBAN and BIC standards – which have just been agreed upon as the standards for the SEPA formats – would have to be replaced. The Commission itself states in the impact assessment of the PSD: "… the recently introduced EU-wide IBAN-BIC numbering system is not compatible with the portability of account numbers without incurring disproportionately high costs and provoking problems for efficient straight-through processing."[7]

Fiddling with account number systematics carries significant risk

In addition, there is operational risk

As to the risk associated with introducing account number portability, one has to keep in mind that customers and public authorities make heavy demands on payment systems. Therefore, bank account number portability and mobile phone number portability are not comparable. As regards payment systems, technical problems cannot only entail direct economic damage, but also pose a challenge to financial stability and cause leaks which can be starting points for criminal action. So, incalculable operational risk would accompany the necessary changes in the IT systems resulting from the introduction of account number portability. Of course banks would make arduous efforts to get these risks under control, yet this again would raise the cost of account number portability.

Against the backdrop of the problems that account number portability would entail, the Commission prudently decided to abandon account number portability for the time being.

Full targeted harmonisation should remove legal and regulatory barriers

Legal and regulatory barriers and the related information barriers should take centre stage in the Commission's considerations. Although European policy-makers generally are on the right track and already have taken important steps towards better integrating EU retail banking markets, legal and regulatory barriers still make the cross-border opening of accounts difficult for both banks and customers alike.

Cross-border opening of back accounts is difficult

For example, at a cross-border level, customers are less likely to have a choice as to the distribution channel (branch, internet, call centre etc.) because travel time and costs make frequenting a branch costly and can be an obstacle if for whatever reason face-to-face-contact becomes necessary. Therefore, facilitating "know-your-customer"-compliant rules for digital signatures is essential. This would help to overcome obstacles to cross-border switching which result from regulatory requirements on banks. Banks are obliged to apply a variety of "know-your-customer" rules as well as anti-money-laundering and tax rules when opening an account. Similarly, extensive KYC rules make it difficult for customers to open an account abroad because it is difficult for them to get information about what documents they need to provide. Even if they manage this hurdle, customers will then have to submit their choice of product and the KYC-related information and documents to the bank they want to

[7] European Commission (2005). Annex to a proposal for a Directive on Payment Services in the Internal Market. Commission Staff Working Document pp. 85-86.

open an account with. If this required face-to-face contact with the bank, they would possibly have to bear high travel costs.

Digital signature would be helpful

As this example shows, setting the legal framework for a KYC-compliant digital signature scheme at a European level would be a good example of how a useful and essential measure would materially benefit both banks and consumers. Here, European policy-makers could make a real contribution towards promoting consumer welfare in the EU. Instead of getting bogged down in removing a variety of perceived obstacles to cross-border switching, EU regulators should target a few, carefully selected issues that advance the integration of the EU retail banking markets.

5. The (regulatory) way ahead: "Common principles for bank account switching" proposed by the industry vs. formal regulation by the Commission

The EBIC proposals for self-regulation and the Commission's draft regulation

The European Banking Industry Committee (EBIC) met the European Commission's demand to develop proposals for self-regulation by mid-2008, and it released its "Common principles for bank account switching" in time. The Commission, pursuing a two-pronged strategy, had published a draft regulation on the subject at the same time and by doing so presented the measures it deemed essential to foster customer mobility. The subsequent negotiations between EBIC and the Commission produced a compromise: EBIC integrated major provisions of the draft regulation in its proposal for self-regulation, so that the Commission could reach its goals without having to impose a formal regulation on the industry. The negotiations between EBIC and the Commission focused on three cardinal issues: first, the list of services which the old and the new bank should offer a customer in the course of bank account switching; second, what fees banks can impose for their services; and third, the monitoring of progress in the implementation of self-regulation.

Direct debit systems

By referring to "Annex 1" of the "Common principles", EBIC subjects the provisions on direct debit mandates to certain restrictions, because direct debits can be designed in two profoundly different ways. Either, the consumer mandates the bank to transfer money on his or her legitimate creditors' request. This is the kind of direct debits the EBIC "Common principles" are based on. Here, the bank oversees all direct debit mandates the customer has agreed on. Hence, the old bank can transfer complete information to the new bank not only about standing credit transfer orders, but also about all existing direct debit mandates. Alternatively, the consumer can entitle a third party to debit the bills outstanding directly – without notifying his bank about which creditors he has mandated. The German direct debit scheme (predominantly in the form of the "Einzugsermächtigung") is currently organised this way. In this case, the old bank does not have knowledge of the complete list of direct debits. Therefore, it is not capable of providing far-reaching switching support with regard to direct debit mandates. The latter problem will sooner or later dissolve to the extent that SEPA direct debits gradually replace existing national formats, because SEPA-compliant direct debit mandates are placed with the bank, and not the creditor.

Services in the course of bank account switching

Most of the services shall be provided by the new bank if the consumer chooses the new bank as his primary contact point during the switching, in which case:

— the new bank contacts the former bank (upon authorisation of the customer) and requests information on standing orders and any available direct debit mandates on the former account. Furthermore, it requests the former bank to close standing orders for credit transfers and stop direct debits, upon explicit authorisation of the customer. According to the "Common principles", the former bank will provide all the available information within 7 working days of receiving the request.

— the new bank helps the consumer to provide the new account details to relevant third parties, in particular with regard to recurrent incoming credit transfers (as for example employers) and direct debits, if the customer has mandated the bank (direct debits following the debtor mandate driven flow), and not his respective creditors (direct debits following the creditor mandate driven flow). In case of the latter, neither the new nor the former bank has the respective information (see textbox on page 16);

therefore, the new bank can only support the customer by providing draft letters to inform respective creditors about the new account details.

— the new bank will re-establish earlier standing orders for credit transfers and accept direct debits on the new account within 7 working days of receiving the relevant information from the former bank or the consumer.

If the customer not only wishes to open a new account but also close the old account, the new bank will provide him with draft letters requesting account closure and the transfer of the available balance of the former account to the new account. In this case, the customer is obliged to return his payment cards and unused cheques to the former bank. The former bank will on request of the customer transfer any available positive balance to the new account and close the former one, unless any problems (as for example a negative account balance or unreturned payment cards) arise.

Fees

The new and the former bank will not impose fees for the switching services (neither on the customer nor on each other), unless

— the account to be closed has been open less than 12 months (in accordance with the Payment Services Directive)

— the information to be transmitted is not available through an automated process at the respective bank or does go back more than 13 months.

If a bank imposes fees for switching related services, the fees shall be appropriate and in line with costs. Consumers will not be subject to any fees imposed by the banks as a result of the banks' own errors during the switching. Furthermore, the consumers should not be subject to any unjustified delay in switching due to banks.

Monitoring of the implementation

National banking associations will monitor the implementation of and compliance with the "Common principles". There will also be a review process on the national level which will be conducted by a body involving national consumer associations or by an independent body.

6. Summary: The dos and don'ts of EU retail banking integration policy

Customer mobility and retail banking integration: similar challenges

The discussion about low customer mobility and the alleged barriers to switching resembles the broader debate about retail banking integration in Europe. In many cases, e.g. the mortgage and consumer credit markets, the European Commission diagnoses limited competition in national markets and virtually no cross-border business, which it traces to barriers to retail banking integration. Quite apart from the question of whether this diagnosis is correct, it is of paramount importance to apply suitable tools in order to put things right. In the case of customer mobility in relation to bank accounts, the Commission and the financial industry prudently agreed – as a workable compromise – on a self-regulatory approach.

Prudent approach necessary

As a basic principle, it is beyond debate that the financial industry is already a highly competitive sector, serving the consumers' interests by delivering a broad set of products at affordable prices. Moreover,

financial services are certainly among the industries where existing regulatory provisions are already comparatively extensive; therefore, political initiatives should be carefully targeted so that they address actual needs without causing unnecessary costs. In fact, we observe that, up until now, there has been a tendency for consumer protection in financial services to become ever stricter. This has not only saddled financial firms with higher fixed costs, but has often cut off customers from certain offers and financial services, either because these services became too expensive for certain customer groups, or because they became too expensive to produce, or because the legal risks for firms became too high. Moreover, banks are forced to factor these costs into their prices, so all customers have to pay for measures that only benefit a few.

Full targeted harmonisation

The upshot is that, instead of imposing a long list of provisions which banks would have trouble complying with, EU regulation should concentrate on full harmonisation of core issues, combined with mutual recognition of non-core issues. This so-called targeted harmonisation approach should apply to issues like KYC rules and the digital signature scheme, in particular.

Reliable framework instead of case-by-case regulation

At the end of the day, the discussion about customer mobility teaches us the dos and don'ts of EU retail banking policy. Policy-makers should not try to stipulate market results. Instead, we need a reliable framework (e.g., exemplified by the "digital signature") within which competing banks develop targeted solutions that benefit European consumers best.

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