

The formation of cross-border financial groups is a challenge to these groups themselves, which have to adapt to the situation, where an important share of a group's activities are run in another country or countries, as well as to the institutions, which have to protect the interests of the clients of these companies as well as those of the general public. In the pre-previous issue of *Kroon and Economy* Jana Kask discussed the topic "Management of Financial Crises in the Case of Cross-border Banking Groups", describing the possible problems arising from the present role distribution in the European Union between the competent authorities of different countries in preventing and managing crises in the case of cross-border financial groups and banks from the viewpoint of the host country¹. The current article will examine why these questions are especially important from the viewpoint of Estonia.

SHARE OF CROSS-BORDER FINANCIAL GROUPS AND BANKS IN THE EUROPEAN, NORDIC AND BALTIC BANKING SECTORS

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Despite the steps taken in the European Union in the last decades to facilitate financial integration, the statistics show that the provision of cross-border retail banking services in the EU-15 countries has still remained more modest than expected². The most common form of entrance into another country's retail banking market continues to be through establishing a subsidiary or a branch, cross-border merger or acquisition.

Although the decrease in the number of credit institutions indicates the consolidation of the European banking sector (according to the European Central Bank the number of credit institutions in the euro area has decreased from ca 9,500 in 1995 to 6,400 in 2004³), the consolidation has thus far occurred mainly at national level. At the end of 2004, in the European Union the share of assets of the subsidiaries and branches of non-resident credit institutions was on aggregate less than 25% of credit institutions' total assets⁴.

¹ See Kroon and Economy No 2, 2005.

² According to a study, only less than 5% of the EU citizens have purchased a financial product from another Member State. See the 2004 and 2005 annual reports of the European Commission "Financial Integration Monitor" and the ECB annual report 2005 "EU banking structures".

³ See the article entitled "Consolidation and diversification in the euro area banking sector" in the May 2005 issue of the ECB's Monthly Bulletin.

⁴ See the ECB's "Report on EU Banking Structures" of October 2005.

While the assets of foreign subsidiaries and branches account for more than 71% of the total banking sector assets of the new Member States, the respective euro area indicator (although country indicators vary significantly) has remained less than 16% (see also Figures 1 and 2).

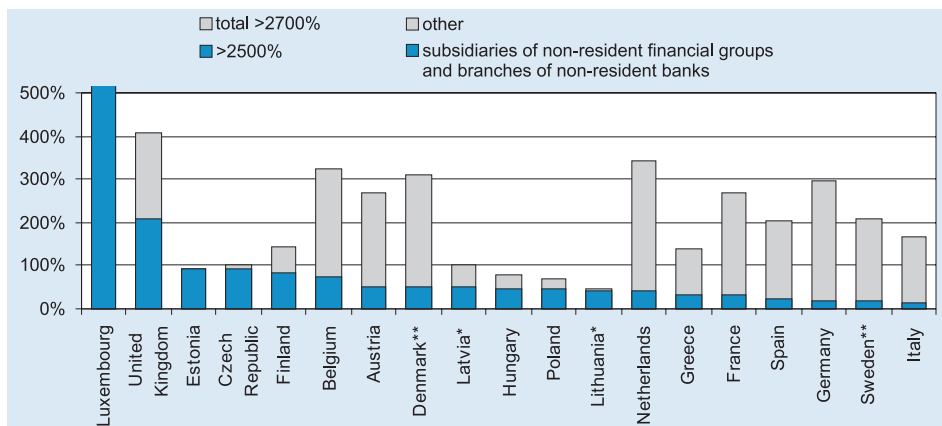


Figure 1. Ratio of total assets of credit institutions to GDP in 2004

Source: European Central Bank, "EU Banking Structures", October 2005

* Source: central banks and banking associations

** Data on the assets of branches of banks licenced in a non-EEA country not included

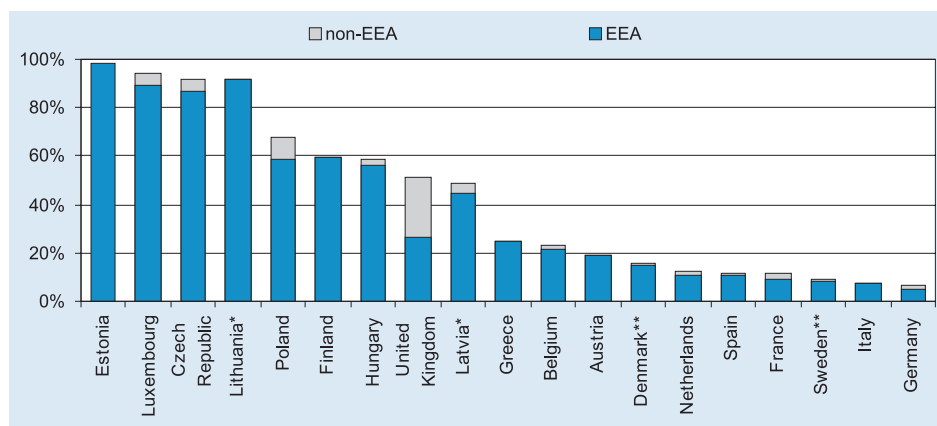


Figure 2. Share of assets of subsidiaries and branches of non-resident credit institutions in banking sector total assets at the end of 2004

Source: European Central Bank, "EU Banking Structures", October 2005

* Source: central banks and banking associations

** Data on the assets of a branch of a credit institutions from a non-EEA country are not included

Even though according to formal criteria the financial markets of the Nordic countries can be considered relatively open today, the **consolidation in the Nordic countries has also**

taken place first at national level and only then regionally. The presence of financial groups from other regions has remained relatively modest in Scandinavia.

Although the number of credit institutions in the Nordic countries still reaches hundreds (e.g. at the end of 2004, 363 credit institutions operated in Finland, 212 in Sweden and 202 in Denmark according to the European Central Bank⁵), as a result of the deregulation in the 1980s, the crises period in the 1990s and other factors, today the majority of the local credit market is divided between larger financial groups (see also Figure 3). The assets of the five largest credit institutions form today more than half of the total banking sector assets in all Nordic countries and, as a result of cross-border mergers, in several countries the assets of companies belonging to the Nordea Group make up a substantial share of banking sector assets (see also Figure 4). Though the Swedish Financial Supervisory Authority is currently the competent authority for supervision over Nordea at the group level, according to its market share Nordea is currently the largest credit provider in Finland. In Denmark and Norway Nordea Group is the second largest, and in Sweden only the fourth largest creditor according to its market share⁶.

In addition to regional mergers, since the end-1990s the Nordic financial groups have started to look more actively for possibilities of expansion into other countries in the Baltic Sea area, for example Germany, Poland and the Baltic States. In most cases this has taken place through acquiring a holding in a company (e.g. the expansion of the SEB Group into the Baltic States and Poland; the expansion of FöreningsSparbanken, i.e. the Swedbank Group, and the Sampo Group into the Baltic States) but also by opening a branch (e.g. the Nordea Group).

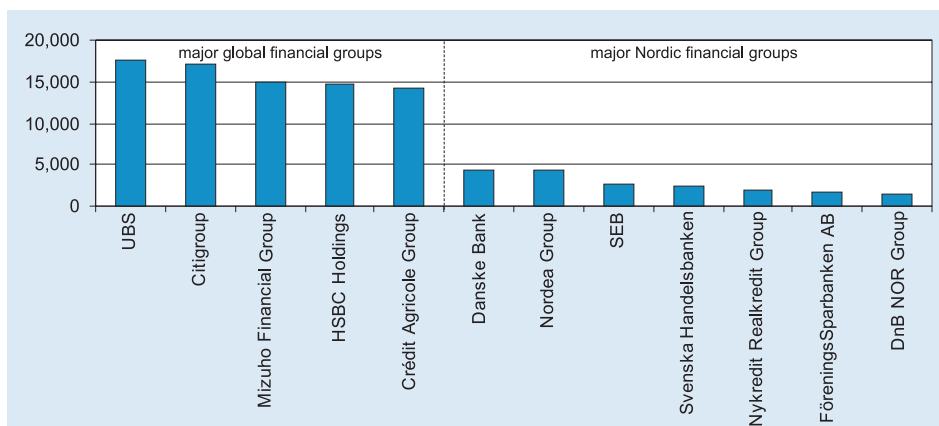


Figure 3. Financial groups by assets in 2004 (EEK bn)

Source: The Banker, July 2005

⁵ See the ECB's "Report on EU Banking Structures" of October 2005.

⁶ If until now the Nordea Group has been operating in different countries mainly through subsidiaries, in 2003 they declared their intention to start reorganising the group into a European Company (Societas Europaea). As the first step, subsidiaries were brought under the Swedish parent company.

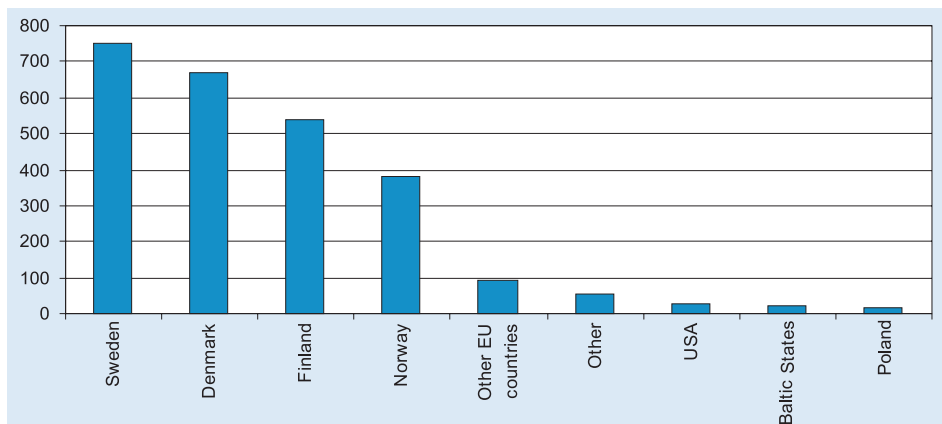


Figure 4. Geographical distribution of the loan portfolio of Nordea Group in 2004 (EEK bn)

Source: annual report of Nordea Group

Although in the case of larger groups the expansion into other countries may sometimes seem of little importance from the viewpoint of that group itself, a bank belonging to a cross-border financial group or a branch of a non-resident credit institution may have a significant role in that local banking sector. In the case of Estonia, the assets of branches of foreign banks and subsidiaries of foreign financial groups account for more than 99% of the total assets of Estonian banking sector (see Figure 5) and, like in several other new Member States, the Estonian banking sector is highly concentrated. While in the euro area the average asset share of the five largest banks stood at 53% at the end of 2004, in the case of Estonia also this indicator exceeded 99% at the end of the first half of 2005.

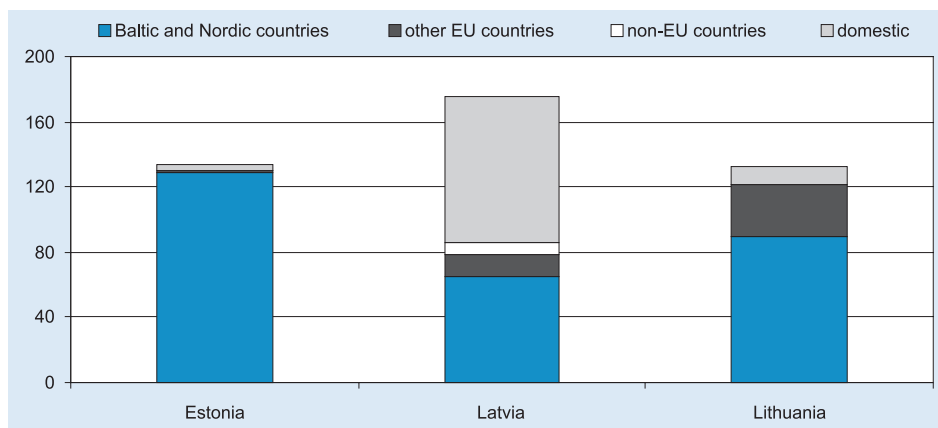


Figure 5. Baltic banking sector assets by the home country of the credit institution's parent company or in case of a branch of the credit institution in 2004 (EEK bn)

Source: central banks and banking associations

■ Summary ■

Despite the steps taken in the European Union in the last decades to facilitate financial integration, the provision of cross-border retail banking services has remained modest in the EU and the most common form of entrance into another country's retail banking market has remained to be the opening of a branch or a subsidiary, a cross-border merger or acquisition. **The growth and expansion of cross-border financial groups sets increasingly greater challenges for the groups themselves, but the increasing importance of the activities of cross-border financial groups and branches of non-resident banks on local banking markets also for the institutions, which have to protect the interests of the clients of these companies and those of the general public. While in the euro area domestic financial groups still mainly form the largest share in local banking sectors, in the Nordic and Baltic banking markets cross-border banking groups are of significant importance already today.** In the case of Estonia, the assets of banks belonging to cross-border financial groups amount to more than 99% of the total assets of the banking sector.