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Volker Brühl – Jan Pieter Krahnen

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House of Finance | Goethe University
Theodor-W.-Adorno-Platz 3 | 60323 Frankfurt

Tel. +49 69 798 33684 | Fax +49 69 798 33910
policy_center@safe.uni-frankfurt.de | www.safe-frankfurt.de

An open banking platform for Germany - a future-oriented alternative to a merger of Deutsche Bank / Commerzbank*

Volker Brühl, Center for Financial Studies (CFS)

Jan Pieter Krahnen, Goethe University Frankfurt, SAFE and CEPR

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Abstract

In this exploratory article, we consider the future of Deutsche Bank and Commerzbank and develop a new approach to the topic: instead of a merger of DB and CB we propose to consider a partial merger of the IT and related back office functions in order to create the basis for an Open Banking platform in Germany. Such a platform would act as a cross-institutional infrastructure company in which the participating banks develop a common data and IT platform (while respecting the data protection regulations). Significant parts of the transaction processes would be pooled by the institutions and executed by the Open Banking platform. Moreover, the institutions remain legally independent and compete with each other at the level of products and services that are developed and produced using just this common data and IT platform – "national champions" would not be created.

But such an "Open Banking Platform" could become even the nucleus of a European Banking platform that could be competitive with existing global data platforms from the USA and China which are already offering financial services and are likely to expand their offerings in the foreseeable future. The proposed model of an open data platform for banks prevents the emergence of national champions and supports the main goal of the banking union: creation of a financial system, in which single banks can be resolved without provoking a systemic crisis and forcing taxpayers to finance bailouts.

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I. Introduction

A potential merger of Deutsche Bank and Commerzbank is brought back into the political discussion as a unique solution, which simultaneously creates a national champion and prevents the otherwise threatening takeover of the two institutions by foreign competitors or financial investors. Although the

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financial results of both institutions have improved significantly, the perspectives of a stand-alone strategy appear to be questionable. But would a domestic merger actually make sense in a world where business models and value chains in banking are subject to digital transformation and changing market environments?

We are convinced that banking will increasingly evolve into a data-driven platform business, raising the question as to which core competencies will a bank maintain in the future and which activities should be provided by a cross-institutional platform.

The basic idea of our proposal is to create a common infrastructure company ("Open Banking Platform Germany") in which the participating banks outsource not only their IT but also substantial parts of their back office (e.g. transaction execution or loan processing). The competition among banks then takes place at the level of products and services that are developed and produced using this common data and IT platform.

Internet giants such as Amazon and Google already demonstrate how business models based on data platforms could work. In simple terms, their high return on capital is based on the intelligent use of their ever-growing data pools combined with optimal utilization of their infrastructure (IT, logistics) through the highest possible transaction volumes. This results in economies of scale and scope that attract more users so that self-reinforcing platform effects can arise.

We will see similar effects in the future banking business, because the intelligent collection, matching, analysis and examination of data will be the basis for customized banking products and services, up to personalized pricing.

In the following, we will (1) explore the idea of a common banking platform, (2) explain it considering the example of Deutsche Bank / Commerzbank, and finally (3) present the implications for modern banking supervision that could benefit from real time availability of regulatory and financial data.

II. Open Banking Platform Germany

Technological innovation and competition policy are key drivers for promoting the idea of "open banking", which prompts banks to provide third parties access to customer and transaction data by appropriate interfaces (Application Programming Interface, API). Conversely, banks can use APIs to integrate third-party providers into their product offering (front-end) and offer their customers additional services. PSD2, the second extended EU Payment Services Directive that is in force since January 2018, creates precisely the regulatory preconditions conducive to open banking.

The establishment of a common banking platform can be achieved through the joint development and operation of a modern, modularized and agile IT infrastructure, including key back office processes.

Multiple investments in IT infrastructures could be avoided and economies of scale by using a common platform could be achieved.

In a first stage, data sovereignty could remain with the participating banks. In a second stage, the joint platform could be expanded by collecting, processing and providing regulatory, financial and customer-specific data based on different levels of access and usage rights of the participating institutions.

The establishment of a common data pool has to comply with banking regulation, data protection and business secrecy rules. Therefore access and usage rights have to be carefully balanced: e.g. each participant could have full access to his own data, while the data of all other participants can only be viewed and used in an anonymized form. The high start-up costs of such a platform are to be considered, as the old systems have to be operated in parallel for a transitional period. Such a common platform company would provide its respective services on a cost covering basis and would basically operate as a utility owned by its users. Furthermore, such a platform is supposed to be an important innovation partner for new banking technologies such as the blockchain technology or AI. Another possibility is the existence of several competing banking platforms, such as the three-pillar model in the German banking market.

III. Open Banking platform considering the example of Deutsche Bank / Commerzbank

What do these considerations mean for the German banking landscape, especially with regard to the scenario of a merger between Deutsche Bank and Commerzbank?

Industry experts agree that such a full merger would have few advantages but many disadvantages. Not only the huge overlap in the German corporate and retail banking business has to be considered, but also the differences regarding brand image and corporate culture should not be underestimated. A merger can certainly lead to cost reductions, particularly by combining centralized functions, back office operations and branch portfolios. However, cost-saving potentials, especially in large mergers, are often overestimated while integration costs (especially in IT) are underestimated. In addition, in a merger between Commerzbank and Deutsche Bank, revenue losses would have to be expected, as corporate clients would shift part of their business to other banks in order to avoid too much dependency on a specific institution.

The same applies to retail clients. A merger could be deterrent for those customers who have deliberately decided against one of the two banks and then went to the other bank. At the end of a multi-year integration phase, one brand would most likely disappear (presumably the one of Commerzbank) and an institution may have emerged that would be marginally larger but by no means more competitive in a global context than the two banks are today. This is clearly demonstrated by the takeover of Dresdner Bank by Commerzbank, which even 10 years after closing has not yet been fully completed and has not generated any noticeable improvement in international competitiveness for Commerzbank.

Despite many efforts and considerable staff reductions, both Deutsche Bank and Commerzbank remain in terms of profitability and stock market valuation in the third league, far away from leading European competitors, not to mention the major US banks. Both major German banks are struggling with outdated IT infrastructures that don´t meet modern requirements of modular, agile and open banking systems. In addition, the persistently low-interest rate environment, high regulatory costs and increasing competition from young technology companies and internet giants continue to weigh on profitability. Therefore, a strategic solution for the two German large universal banks has to take into account the changing market and competitive conditions and at the same time it has to ensure competitive cost structures.

A partial merger by establishing a joint open-banking IT platform could therefore be a better solution than a full merger of Deutsche Bank/Commerzbank. Such a structure could prevent double investments and allow for economies of scale, especially if a common IT infrastructure includes not only the IT function but also the essential back-office functions such as the processing of loans and securities transactions as well as the regulatory and financial reporting. In such a constellation, competition on a product or services level - be it in retail banking, corporate or investment banking - would be maintained while fixed costs could be reduced by a common basic infrastructure. Such a platform could also be open to other institutes in Germany and Europe.

IV. The perspective of banking supervision

From the point of view of banking supervision, the idea of one or several open banking platforms could be also advantageous. The central, standardized collection of data at the level of entire groups of institutions, in the long run covering ideally the entire banking system, can considerably simplify work for both the supervisory authorities and the supervised financial institutions. In addition, real-time banking supervision combined with an early-warning system would be within reach, since supervisors could flexibly access regulatory and other relevant data via corresponding interfaces. Finally, an open banking platform would facilitate the individual resolvability of financial institutions because it would be much easier to settle or transfer transactions to other providers.

In conclusion, we propose to use the current discussion about a further consolidation in the German banking sector to pave the way for an open banking platform. Such a platform would act as a cross-institutional infrastructure company in which the participating banks develop a common data and IT platform (while respecting the data protection regulations). Significant parts of the transaction processes would be pooled by the institutions and executed by the Open Banking platform. Moreover, the institutions remain legally independent and compete with each other at the level of products and services that are developed and produced using just this common data and IT platform.

Such a banking architecture would be an alternative to a high-risk merger of major banks like Deutsche Bank and Commerzbank. It takes into account the strategic importance of data in the banking business of the future and creates the preconditions for remaining competitive with Internet companies in the years to come.