Tech Disruption In Retail Banking: In Belgium, Smaller Players Could Have A Hard Time Keeping Up With The Big Banks

October 7, 2020

PRIMARY CREDIT ANALYSTS

Philippe Raposo
Paris
(33) 1-4420-7377
philippe.raposo
@spglobal.com

Emna Chahed
Paris
+ 33 14 075 2524
emna.chahed
@spglobal.com

David Szalai
Paris
david.szalai
@spglobal.com

SECONDARY CONTACTS

Stanislas De Bazelaire
Paris
(33) 1-4420-6654
stanislas.bazelaire
@spglobal.com

Pierre Gautier
Paris
(33) 1-4420-6711
pierre.gautier
@spglobal.com

Key Takeaways

- We believe traditional Belgian banks are fairly well positioned to satisfy customers' increasing digital preferences, and their first-mover advantage will provide them with some leeway before new entrants and Big Tech ramp up their efforts.
- The relatively small size of the market compared with that of larger neighbors, lack of opportunities for new entrants in the lending space, and tendency for cooperation between incumbent players on payment solutions should protect incumbents' positions.
- However, we believe savings products, such as asset management or other investment schemes, are the most likely activities to be disrupted in the medium term; up to €3 billion in associated revenue, or roughly 13% of total consolidated revenue in 2019, could be affected.
- In our view, larger banks will fare much better in the digitalization race than smaller rivals lacking sufficient scale and profitability to replace legacy IT systems.
- We observe that the COVID-19 pandemic is further accentuating customers' preferences for digital solutions, with fast-increasing mobile adoption rates and product sales through direct channels.

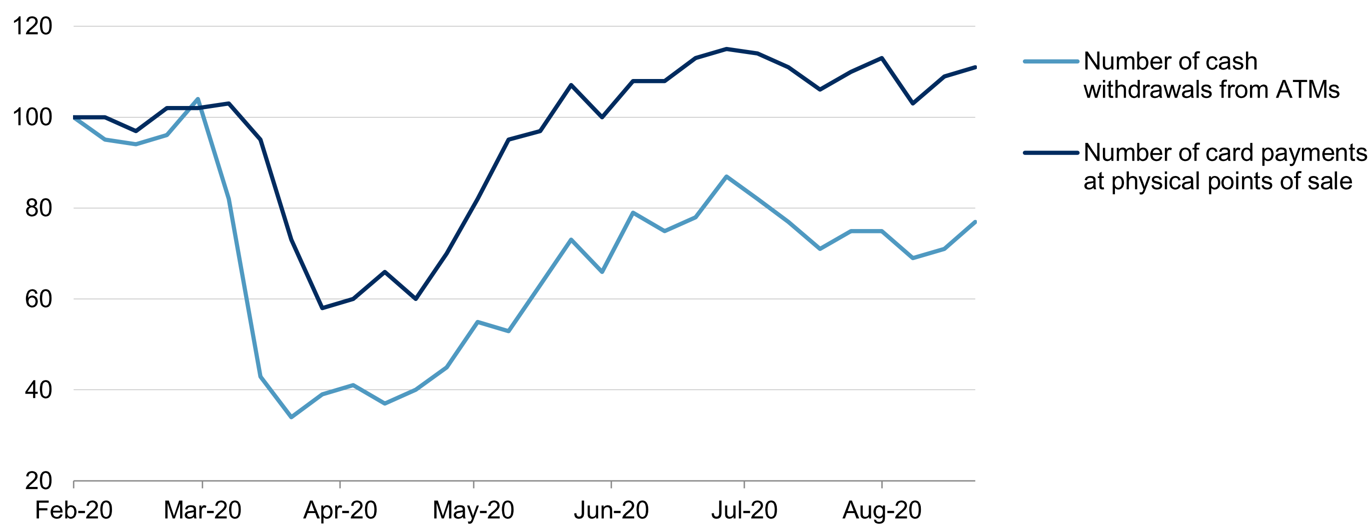
S&P Global Ratings believes that Belgian banks are fairly well positioned to meet the population's increasingly digital preferences through their already largely digitalized infrastructure and proven willingness to cooperate in developing new market standards. However, this could change because Belgian customers are some of the most digitally savvy in Europe, so failing to keep up with technological innovation could bring about dire consequences for digital laggards. In our opinion, the most important risks for incumbents are concentrated on their savings products revenue, such as asset management or life-insurance schemes, because of disruptive joiners to the industry (like robo advisors) and banks' underpricing behavior of nonbanking products amid the low yield environment. Despite the low level of fintech penetration in Belgium, we still believe that incumbents could soon face tougher competition, because new entrants and Big Tech could increase their efforts to lure away digitally agile customers. New technologies are widely available to incumbents and challengers, but the level of implementation varies. S&P Global Ratings believes that, while regulatory authorities are promoting initiatives to increase fintech development, they do not actively push for the banking industry's disruption.

COVID-19 Is Accelerating The Adoption Of Digital Technologies

The pandemic and related containment measures have further accelerated the adoption of financial technology in Belgium, and we believe that consumer preferences will not revert to the pre-pandemic state. This shift is particularly true for the payment habits of Belgians. According to the Belgian Financial Sector Federation (Febelfin), from February-August, the proportion of contactless payment in all card payments has more than doubled, as customers tried to minimize physical contact (see charts 1 and 2). Illustrating this was the fast and sharp recovery in card payments following the shock of the introduction of lockdown measures, while ATM use remains depressed. The higher usage of digital channels is also seen in banking product sales across players, because branches were closed during lockdowns and the population was almost forced to use digital alternatives, hastening the fast adoption rate. Questions remain on the long-term usage in a post-COVID-19 world, but we believe this test demonstrated to clients that visits to branches could become less frequent, changing the habits of initially digital reluctant customers.

Chart 1

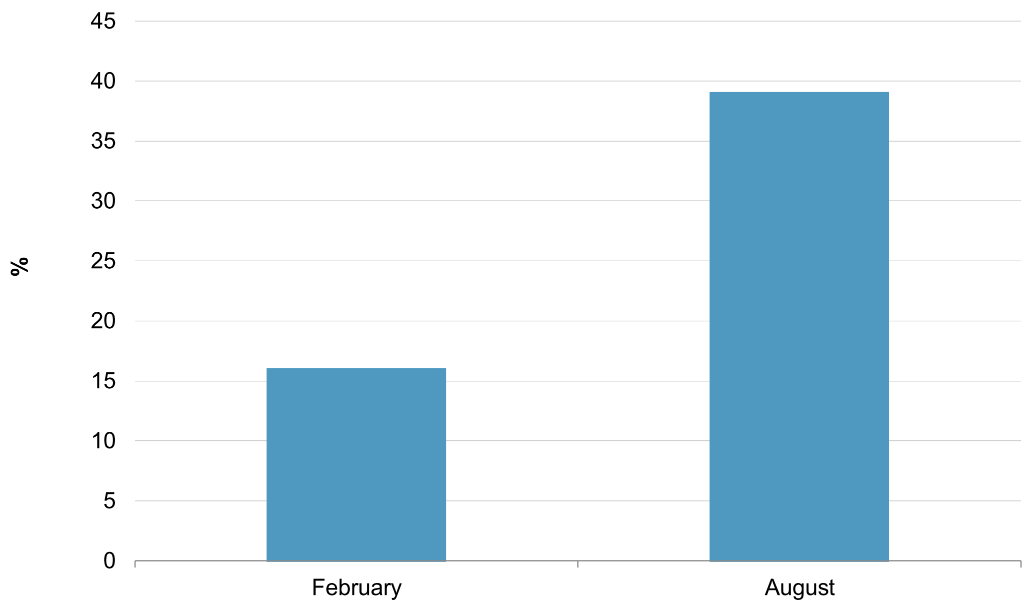
The COVID-19 Pandemic Has Hurt Cash Use...
Index rebased to 100 (weekly, week of February 3 = 100)



Source: S&P Global Ratings, Febelfin, Worldline.

Chart 2

…But Accelerated The Adoption Of Contactless Payments
Share of contactless payments in the total number of card payments



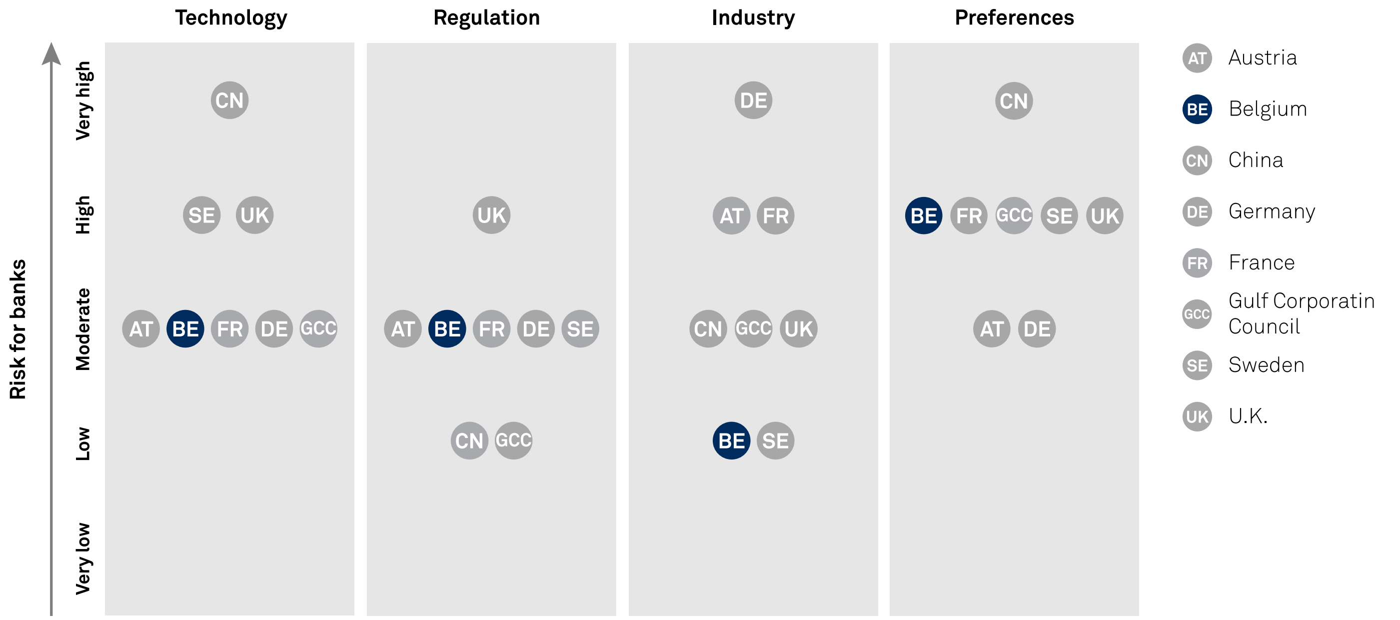
Sources: S&P Global Ratings, Febelfin, Worldline.

Larger And More Advanced Banks Are Well Placed To Withstand Digital Disruption

We measure the risk of digital disruption for Belgian banks using our four-factor TRIP analysis (see chart 3) to examine the banking system's technology and regulation, the industry in general, and customer preferences. Although the Belgian banking industry has invested in digitalization for years, because of customer preferences, we believe smaller players face a higher risk than the top 4 incumbents. This is because their lack of scale makes it more difficult to cope with the high cost of being digital front-runners. Second-tier banks are therefore taking a fast-follower approach, which is usually more cost efficient, hoping that customers will not switch banks in the meantime.

Chart 3

Banking Industry Able To Satisfy Customers' Digital Preferences--For Now



Our view of digital disruption risk is the outcome of a point-in-time analysis of four factors of a country's banking industry relative to peers. There is no explicit quantitative analysis behind the scoring; the assessment is the view of S&P Global Ratings' analysis that includes their discussions with market participants. 1--Bank's technological capabilities. 2--Protectiveness of regulation for the banks' market position. 3--Structure of the banking system and its ability to adapt and invest. 4--Customer's preferences for emerging technologies and digital banking, and percieved likelihood to switch to nonbank competitors. Source: S&P Global Ratings.

Industry: Disruption Risk | Low

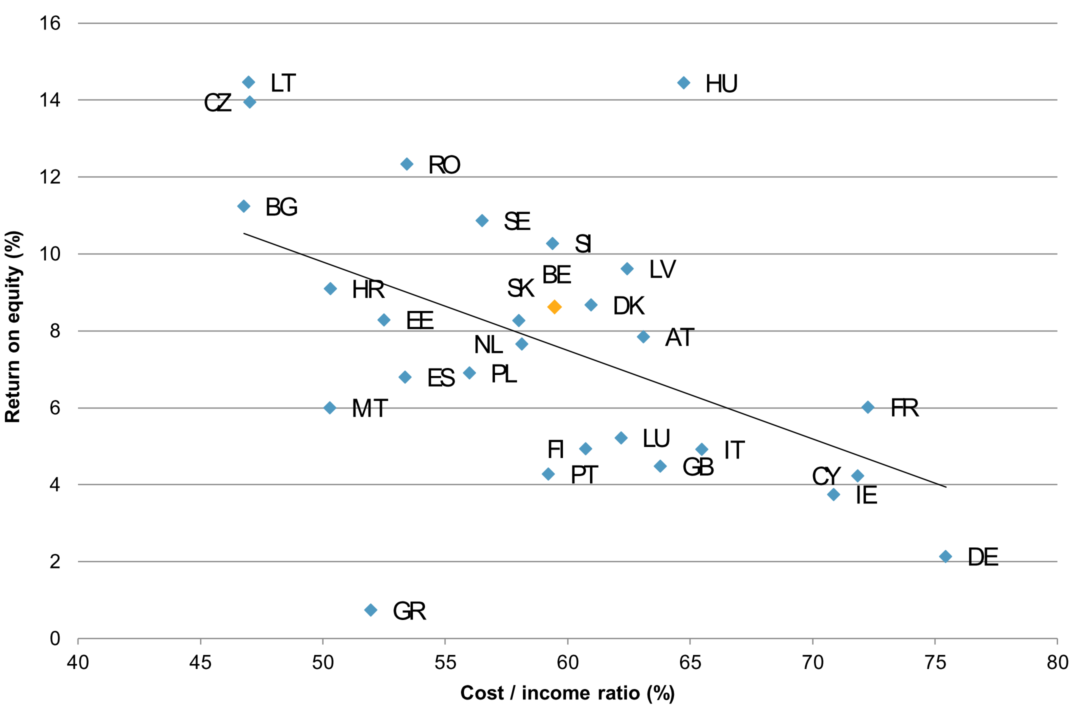
Large banks are generally well prepared, but not invincible

Relatively stable industry dynamics and adequate profitability have allowed Belgium's largest banks to embark on a digital transformation wave. The fairly high degree of digital advancement and the universal banking model cover most, but not all, activities of large banking groups. We believe that, as long as emerging digital players do not propose competitive home loan products, which seems unlikely in the next three-to-five years given the regulatory cost barrier, the predominance of incumbents on the retail space is not at risk. We also consider payment services well protected from disruption due to the existence of a joint and convenient card and mobile payment infrastructure. However, we think revenues from savings products in this wealthy country are more at risk. S&P Global Ratings estimates the total systemwide revenue potentially at risk of disruption is approximately €3 billion, amounting to about 13% of consolidated revenue from the sector in 2019.

The Belgian banking market remains dominated by four main players--BNP Paribas Fortis, KBC Group, Belfius Bank, and ING Belgium--which together represented about 85% of the banking system's total domestic loans as of year-end 2019. This relative stability in industry dynamics, and adequate levels of profitability, have allowed the sector to embrace digital innovation relatively early on compared with banks in other countries (see chart 4), and Belgium's largest banks often are first movers of the digital transformation wave. However, we believe that digitalization will affect the Belgian banking industry unevenly. Larger banks could benefit more from the shift, as the richness of digital offering becomes a differentiating factor between players; smaller banks that lack scale and profitability to invest in digital technologies risk falling further behind (see chart 5).

Chart 4

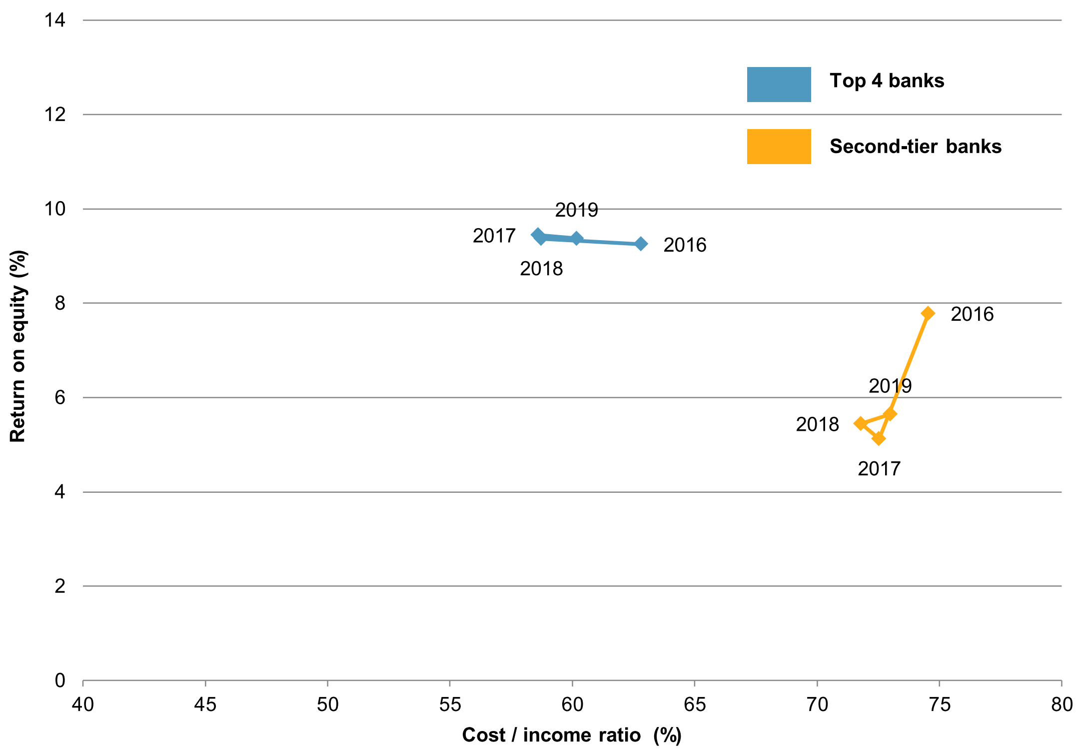
Belgian Banks Decent Profitability And Efficiency Levels Allow For Further Digital Investment



Source: ECB, S&P Global Ratings. Data at end-2019.

Chart 5

A Wide Gap Exists Between Top And Second-Tier Belgian Banks



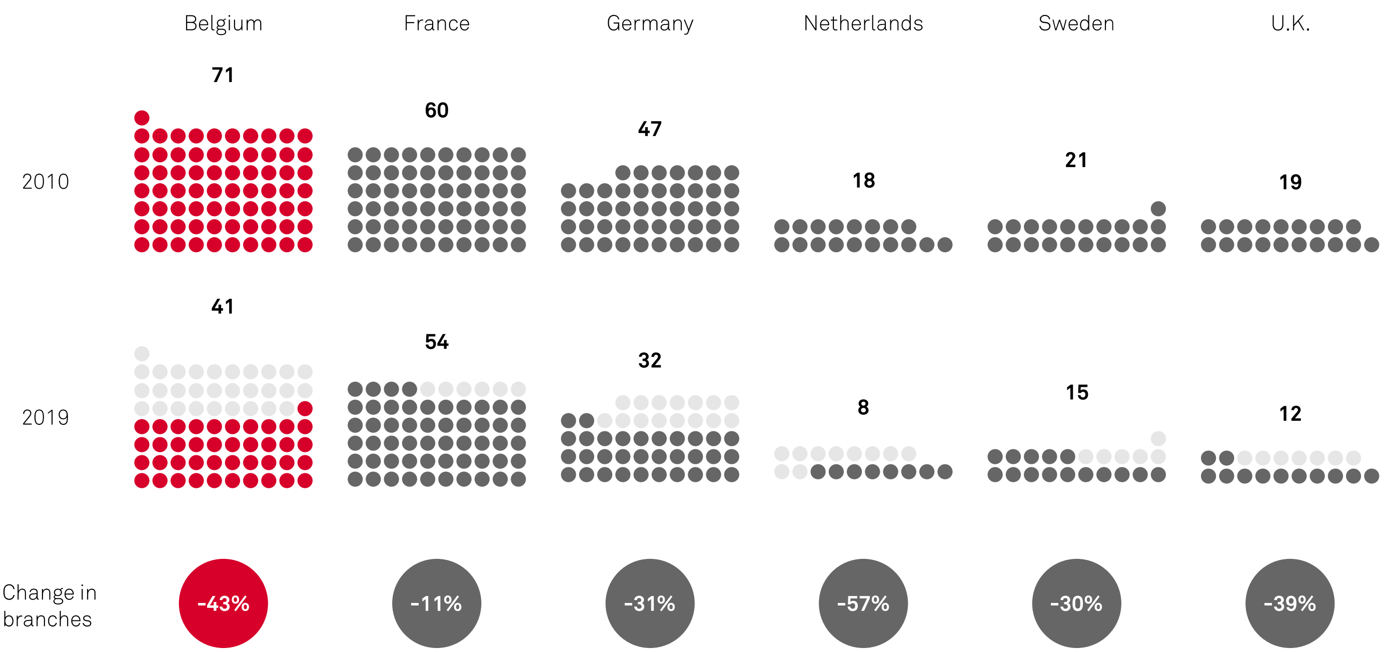
Source: S&P Global Ratings.

The Belgian banking model share some similarities with the French universal banking one, where large actors act as one-stop shops, relying on cross-selling various banking services ranging from traditional banking products to consumer finance, insurance, and asset management; some are even starting to sell nonfinancial products. We believe that this particularity is a double-edged sword for bancassurance groups. Indeed, each activity needs to digitize many different segments to avoid being disrupted, leading to potentially high IT expenditure. However, it also provides resilience to the overall business model, as customers tend to be more loyal to their banks. This banking model centers on offering relatively cheap home loans, which serve the purpose of hooking customers in, to promote the cross-selling of other banking and insurance products. Therefore, we believe that as long as disruptors do not propose competitive home loans, we doubt the largest banks would suffer much.

Chart 6

Branch Density Remains High In Belgium Despite A Strong Decrease In Past Years, Leaving Additional Room For Cost Efficiency

Number of bank branches per 100,000 inhabitants

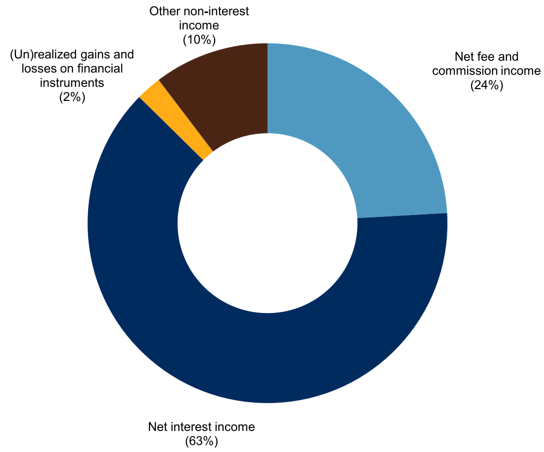


Changes in branches describes the percentage change in the number of branches between 2010 and 2019. Note: Includes branches owned or rented by delegated agents for Belgium. Sources: S&P Global Ratings, European Central Bank, Febelfin.

Despite creating some protection against any potential disruption in the lending business, the universal banking model also adds risk for disruption in the remaining segments. Looking systemwide, net interest income represented 65% of banks' revenue in 2019, and fees and commission income, about 24% (see chart 7). S&P Global believes that of Belgian banks' various revenue sources, lending and payment services are the least likely to be disrupted, whereas savings and investment management could be most at risk (see chart 8). We estimate the total revenue at risk of disruption is approximately €3 billion, amounting to about 13% of sector revenue in 2019.

Chart 7

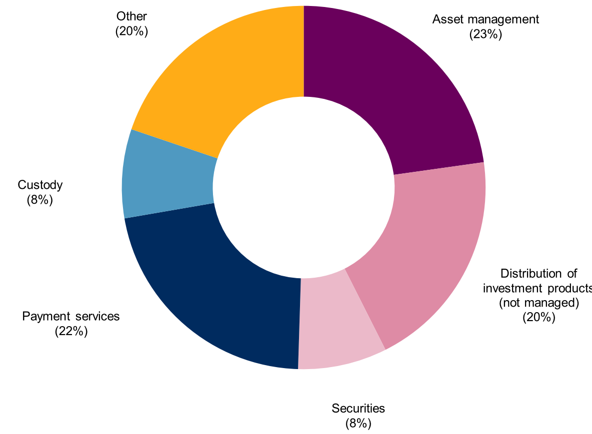
Fee And Commission Income Make Up A Quarter Of Banks Revenue...
Breakdown of total revenue



Source: S&P Global Ratings, NBB. Data at end-2019.

Chart 8

A Significant Portion Of Them Could Be Challenged By New Entrants
Breakdown of gross fee and commission income by source

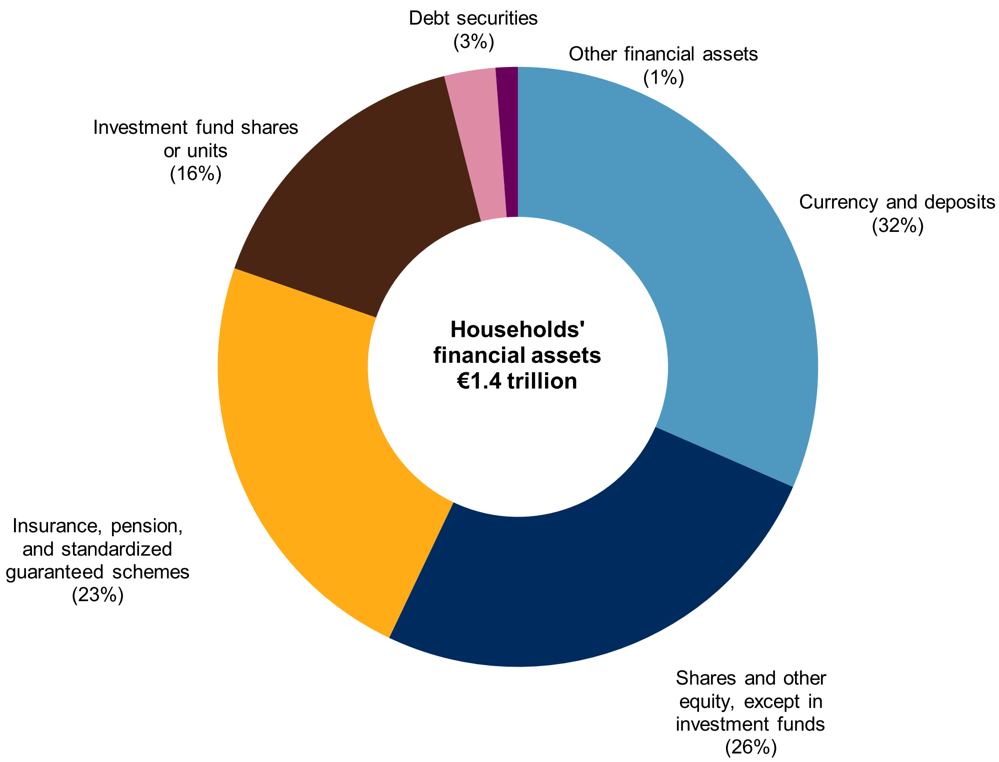


Source: S&P Global Ratings, NBB. Data at end-2019.

Belgian households are some of the richest in Europe, making them a coveted target for asset managers. They own a significant amount of financial assets, at about €1.3 trillion (or 3x Belgian GDP), most of which are in predominantly liquid assets categories such as shares or investment funds (see chart 9). This is in stark contrast with the Netherlands, where the bulk of savings are usually kept in much less liquid pension funds. The potential flexibility of financial savings also poses a threat to the industry, because with low interest rates, customers looking for higher yields could look elsewhere. In addition, in Belgium, two-thirds of assets under management come from retail clients, while only one-third comes from institutional investors; in the European average it is the opposite. With the rise of low-commission and zero-commission retail trading platforms around the world, incumbents risk being undercut on pricing, triggering an exodus of assets under management. In an adverse scenario, these combined risks total 40% of systemwide gross fee and commission income that could be threatened.

Chart 9

Belgian Households' Financial Assets Are Fairly Liquid

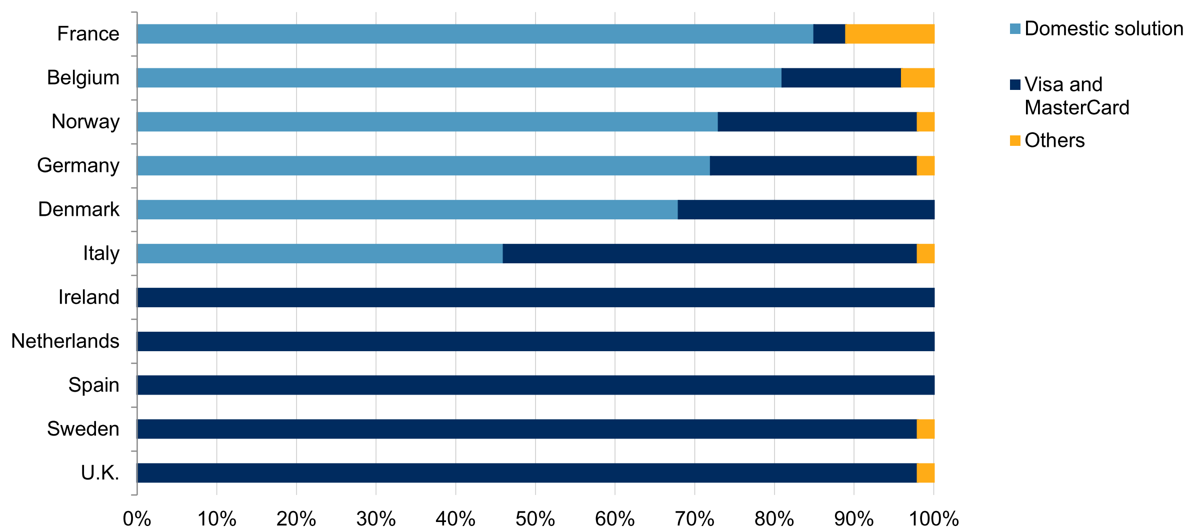


Source: S&P Global Ratings, NBB.

Digital partnerships among large banks and the sharing of infrastructure are much more pronounced in payment services than in most European markets (except for Sweden and other Nordic countries), which we believe create major barriers to entry for potential disruptors. One such example is the widespread use of the Bancontact payment scheme, which is owned by a consortium of the largest Belgian banks. Bancontact only exists in Belgium and uses debit cards from the country's banks to pay for goods purchased either online or in a brick-and-mortar store. In 2019, 1.6 billion transactions were made using this payment scheme, making up 81% of all transactions processed in the country (see chart 10). Moreover, many shops only accept Bancontact as a means of payment by card because it's cheaper than competing payment schemes, so a card with only an international payment circuit can often be refused. In 2018, Bancontact merged with mobile payment provider Payconiq, and has become a market leader in mobile payments in Belgium. Today, most Belgians use its solutions for everyday operations, because the Payconiq application centralizes the user's bank cards, enables customers to use mobile phones for payment online or in stores, and also allows users to pay back individuals easily. Another example of industrywide cooperation is an electronic identification solution called itsme, owned by a consortium of four leading Belgian banks and mobile network operators. Of note, itsme is also used outside of banking, for example in accessing online public services, signing official documents, or creating different online accounts. The existence of joint, convenient payment infrastructure appears to be a showstopper for new players, at least for now.

Chart 10

Bancontact Provides Cover For The Belgian Payments Industry
Market share of payment card schemes in Europe



Data at end-2018. Domestic solution stands for payment card schemes that only exist within specific countries and are either not known or not commonly used abroad. Domestic solutions: Bancontact (Belgium); Dankort (Denmark); Cartes Bancaires (France); Girocard (Germany); Bancomat (Italy); BankAkzept (Norway). Source: S&P Global Ratings.

As for everyday banking activities, we consider Belgian banks fairly well-prepared to fend off the new generation of digital challengers. Due to widespread use of convenient and integrated mobile payment solutions, fintech penetration, specifically neobank penetration, has been relatively lackluster compared with in other Western European countries. For an equivalent population base with internet access, both N26 and Revolut have roughly 2x fewer customers in Belgium than in France. While Revolut has over 10 million clients globally, the London-based fintech company only recently achieved 100,000 customers in Belgium; N26, with its 5 million clients worldwide, is only now approaching 100,000. Together, these two neobanks represent about 1% of all current accounts opened in Belgium. Also, only two banks out of 14 charge a monthly account maintenance fee, which could explain the slower take-up of neobanks in the country. We note the small size of the market, especially compared to those of neighbouring countries like Germany, France, or the U.K., which limits its attractiveness for new entrants, especially given the huge initial investments to make and the difficulty to generate any returns the first years. For that reason, we believe Belgium may be more shielded than those in some other markets from appetite of international fintechs or challenger banks.

Preferences: Disruption Risk | High

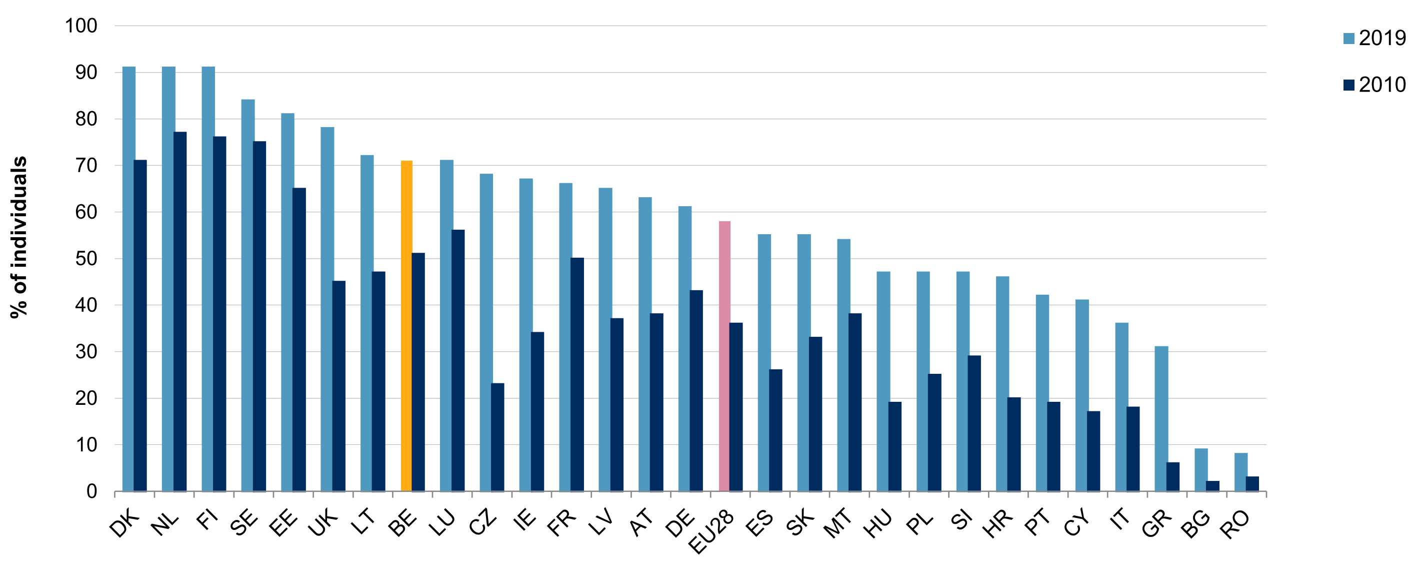
Belgian customers are agile, and the digital banking adoption rate is increasing

The Belgian population is tech-savvy and is enabled by modern technologies available on a large scale across the country. We expect the shift in channel preferences from physical to digital to further accelerate with the rising popularity of mobile banking usage. Incumbents are well-positioned to capitalize on this trend because their current mobile offering is usually well-received, and their expansion is set to continue thanks to favorable demographic trends. Nevertheless, despite the popularity of digital banking and until COVID-19, the average Belgian customer preferred physical branches, using mobile banking only for everyday operations.

Customer preference for digital solutions is indicated via several statistics: according to Eurostat data, online banking penetration is on the higher end of the EU spectrum and has been constantly improving across all age groups in recent years (see chart 11). In addition, a survey from CBC Banque shows that online banking is widely adopted in the country, and it is the second-most common activity online (65%), after reading and writing emails (76%), but before any social media activities (62%).

Chart 11

Internet Banking Penetration Is Fairly High
Internet banking penetration by country (2019, 2010)

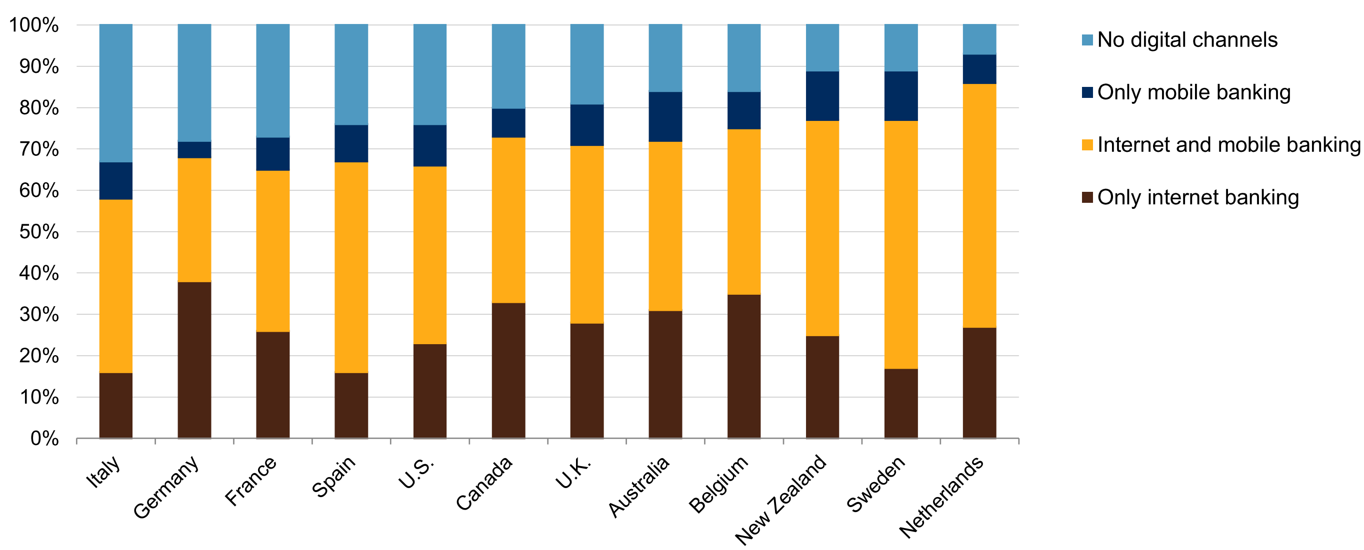


Source: S&P Global Ratings, Eurostat.

Whereas internet banking has been a well entrenched habit for years in Belgium, mobile banking has only recently gained traction. So much so that according to Febelfin, its use has already eclipsed internet banking in the country. In 2018, only 63% of those having an internet banking subscription have effectively used it, while 87% of those having downloaded a banking application logged in at least once during the year. We expect this trend to continue due to favorable demographics, because younger generations tend to adapt faster to new technological solutions. As shown by a McKinsey survey, the shift away from brick-and-mortar is almost complete by now in Belgium, as only 16% of the population avoid online channels when interacting with their bank (see chart 12).

Chart 12

Digital Channels Dominate In Belgian Banking
% of customers that use channel at least once per month (2018)



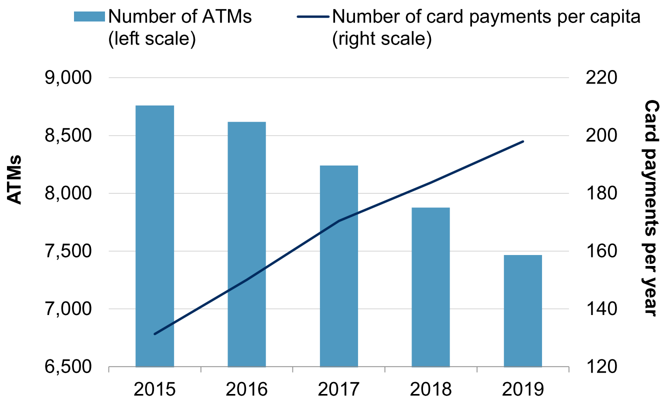
Source: S&P Global Ratings, McKinsey.

The rise of the mobile channel has been actively supported by Belgian banks. While customers have high expectations for their mobile applications, they are also regularly encouraged by their banks to use the mobile channel as more functionalities are rolled out onto that platform. These investments in IT solutions not only help reduce costs, but could also increase customers' brand loyalty. So far, incumbents are winning the battle against neobanks, as neobank penetration has been relatively low, and the banking applications of Belgian incumbents are usually well-received by the public. Looking at mobile applications download statistics, the main mobile applications of the four large incumbents all figure in the top 10 of the finance category for both Apple App and Google Play stores, while no neobank app has managed to crack the top 25 as of August 2020.

As for the payments sector, we observe a drop in ATM numbers and usage across Belgium. Similarly to other European countries, the number of card transactions is gradually increasing, whereas the importance of cash is decreasing (see charts 13 and 14). Most of these long-term trends were around before COVID-19, but in our opinion the pandemic will accelerate the shift.

Chart 13

Belgians Are Increasingly Favoring Card Payments Over Cash...

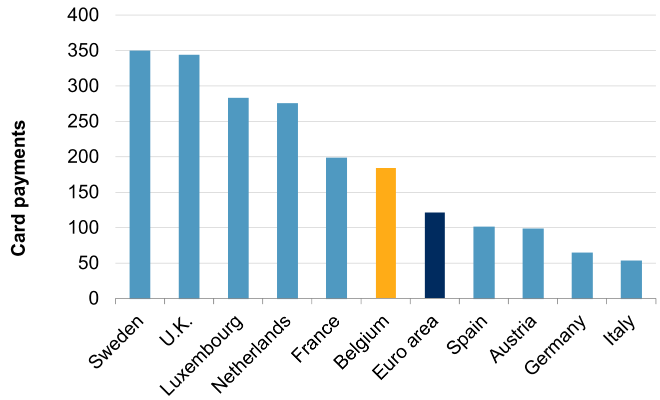


2019 average number of card payments per capita estimate. Source: S&P Global Ratings, Febelfin, ECB.

Chart 14

...But Card Payments Continue To Lag Behind Europe's Most Digital Countries

Number of card payments per capita (2018)



Source: S&P Global Ratings, ECB.

Technology: Disruption Risk | Moderate

Digital technologies are widely available, the level of implementation varies

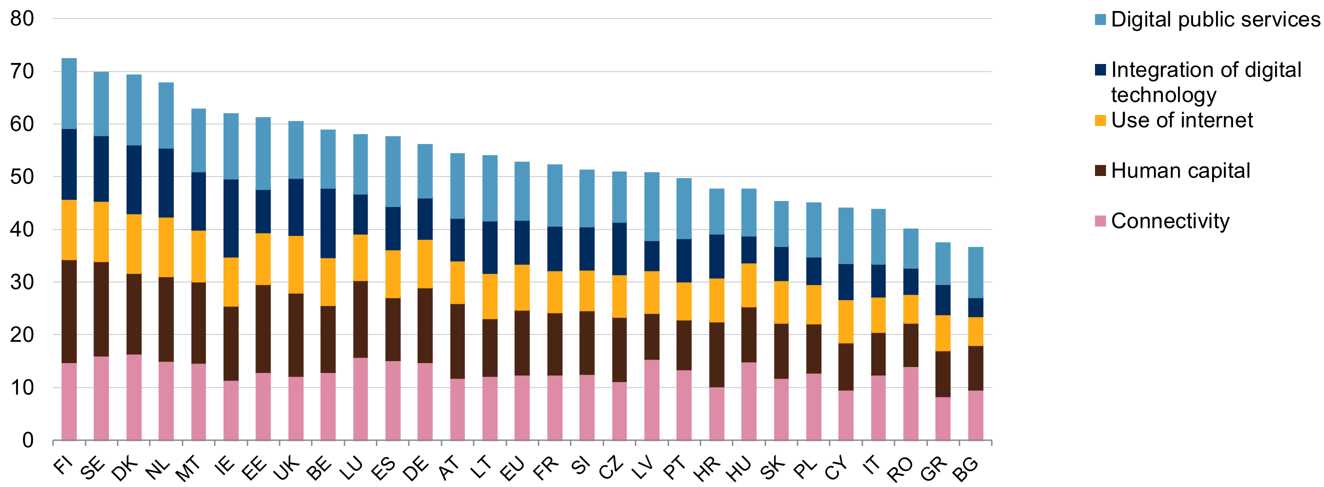
Belgium regularly shows up at the top of global digital technology adoption rankings, comparing favorably with most European peers. Therefore, we believe that the availability of new technologies will not be a deciding factor in the digitalization race. However, we reckon that their implementation will be crucial, as smaller and less profitable incumbents might struggle to finance their technological transitions. In these situations, industry level cooperation can help reduce IT development costs, which we have seen before. As for emerging technologies, large banks have for some time already embraced regtech solutions, robo-advice and credit scoring technologies. When it comes to European Payment Services Directive (PSD2), most Belgian banks have already launched developer portals and open banking platforms based on application programming interfaces (APIs), to which third-party solutions can be added.

New technology is the root of innovative product solutions, and Belgium fares well in the diffusion and use of digital technologies across industries. The country ranks 12th of 157 countries assessed by the U.N. Digital Access Index, which measures the overall ability of individuals in a country to access and use new information and communications technology.

Belgium's widespread adoption of digital technologies is also confirmed by the European Commission's Digital Economy and Society Index, which measures the digital competitiveness of EU members. In the 2020 edition of the ranking, the country places ninth, behind the digital frontrunners of Nordic countries and innovation centers of the U.K. and Netherlands, but ahead of Germany, France, and Southern and Eastern Europe (see chart 15). Belgium scored particularly well in the integration of digital technology metric (digitization of businesses and e-commerce), but there is room for improvement in developing relevant human capital and the digitization of government services.

Chart 15

Belgium Ranks In The Top Third Of Digital Technology Adoption
Digital Economy and Society Index (DESI - 2020)



Source: S&P Global Ratings, European Commission.

Belgium's network infrastructure is only average compared with that of European peers, especially when it comes to fiber deployment and the rollout of 5G technology. The rollout, which was slowed down by health concerns voiced by the government and by political disagreements over the distribution of proceeds, was launched only in first-half 2020. The technology is pivotal to improve network coverage for future needs, but Belgium's current infrastructure is more than sufficient to facilitate standard banking services.

Looking more specifically at Belgian banks, the availability of new technologies does not seem to be an issue for incumbents and new entrants alike, although smaller banks operating on narrower margins could face some hurdles in financing their IT transitions. This is particularly true for incumbents still needing to replace inefficient legacy IT systems, which are largely constraining change. As for the country's four largest banks, we believe that they will be able to leverage their size in spreading the costs of their IT investments.

A strategy to alleviate the financial burden of the digital transition is to pool resources together for technological gain. We have seen that large Belgian banks are willing to cooperate to develop new technological standards for the country, as with Bancontact and Payconiq. Another example of cooperation was the introduction of instantaneous money transfers, rolled out in March 2019 after a three-year period of joint testing. This practice also benefits smaller actors and fast followers, because while they are not obliged to develop proprietary technologies, they will still be able to join the existing platforms. However, for smaller players, there is always a risk of being left out of industry cooperation and falling even further behind in the technological arms race.

Large Belgium banks are acting pragmatically in the technological race. They do not hesitate to engage proactively with fintech companies, which possess a piece of technology that banks need and do not yet have, to develop partnerships and even ultimately acquire some innovative companies with unique models or technology. As an example, new business models focusing on regtech solutions, (alternative) credit scoring, and robo-advice are attractive and are gradually reaching maturity. They present opportunities to develop new business or improve efficiency by partnering with new players active in these domains. On the other hand, banks are rather developing internally, via large investments, technologies, and platforms to compete fiercely with those new comers offering peer-to-peer transfers, mobile banks and savings and deposit marketplaces.

According to the National Bank of Belgium (NBB), large incumbent banks already have several running projects involving new technologies, although the actual use cases already deployed are rather limited, except for APIs related to the PSD2 and cloud computing. Incumbents have already launched developer portals and open banking platforms based on APIs, to which they can add third-party solutions, in accordance with PSD2. However, according to consulting firm Roland Berger, open banking technologies will require significant investments and take away from revenue, especially given that according to a CBC Banque poll, 61% of Belgians would be favorable to seeing information on all their bank accounts and banking products combined into a single application.

Although the technology looks promising, actual use cases for distributed ledger technologies are still relatively limited in number and in scope according to Belgian banks. Similarly, use cases on artificial intelligence/machine learning relate mainly to chatbots and robotics applications for now.

Finally, with the rise of new technological solutions, we expect cyber risk to develop into a major risk for incumbents, raising the importance of focusing on a well-managed technological transition.

Regulation: Disruption Risk | Moderate

Broadly in line with EU standards

We consider Belgium's regulatory framework largely aligned with European standards, and the country has benefited from harmonized microprudential and macroprudential policies since the 2009 financial crisis, including Basel standards and European bail-in regimes. While regulatory authorities have adopted policies to promote innovation in the fintech scene, we do not view them as actively pushing for the disruption of retail banking in Belgium.

The NBB and the Financial Services and Markets Authority have jointly established a Fintech Portal as a single point of contact for companies with new business models to foster dialogue between fintech companies, incumbents, and the regulator. Through this portal, fintechs can also ask for assistance from the regulator to better understand the applicable regulatory framework. However, the regulator has decided not to implement a regulatory sandbox approach for fintech companies for now.

While not purposefully promoting fintech innovation, the NBB still actively monitors the evolution of technologies from a regulatory perspective, and takes part in various initiatives at the EU and national level with lawmakers aimed at adapting the Belgian regulatory framework to the new, changing financial environment.

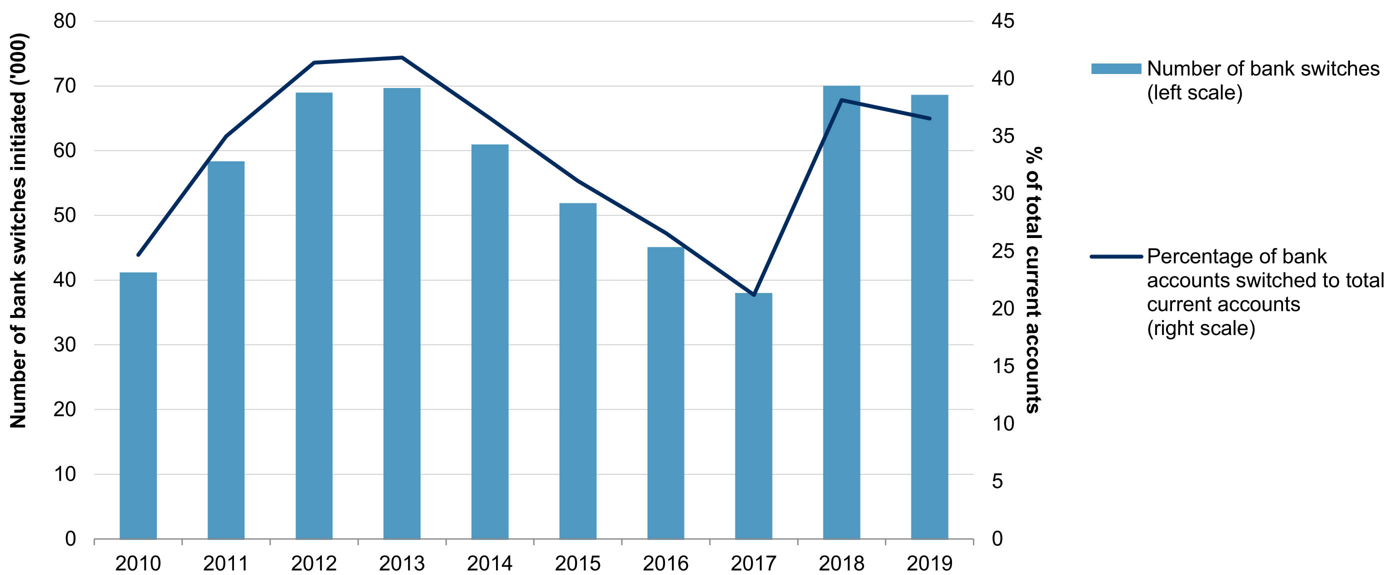
On a national level, various licences are required to operate in certain business segments in Belgium, which can sometimes be difficult and lengthy to obtain (banking licence, payment institution licence, investment products, and others).

As for legislative action, a number of reforms have been undertaken in the past decade to enhance consumer protection and increase competitiveness between banks through a banking mobility act. Switching between banks is now much easier and cheaper for clients since February 2018, as the acquiring bank handles all of administrative steps. The impact has been close to negligible so far in terms of current account market share, but it gives neobanks a chance to become a customer's main bank. Thanks to the new Bankswitching service, the number of switch requests almost doubled to 70,000 in 2018 from 38,000 in 2017, but the overall number is still relatively small, at less than 1% of the population (see chart 16).

Chart 16

The Banking Mobility Act Of 2018 Has Not Changed The Banking Landscape Drastically

Bank switches initiated per year



Number of current accounts estimated. Source: S&P Global Ratings, Febelfin.

As of May 2018, the EU's General Data Protection Regulation imposes stricter rules about data confidentiality and access, alongside harsh fines for noncompliance. Its revised PSD2, which took effect in January of that year, indicates that regulators are aiming to establish a more level payment services playing field. PSD2 constitutes a risk to banks' franchises and customer bases (see "European Banks Face Risks In Race To Implement PSD2," published May 16, 2019, on RatingsDirect). We see risks stemming from changes to the traditional acquirer-issuer card-based payment model, which could lead to lower payment revenue. PSD2 also has the potential to transform traditional banking relationships, especially with customers who are increasingly using third-party applications to manage their finances.

No immediate risks to our ratings

Belgian banks ratings remain strong in a global context, supported by a wealthy and resilient economy, and very diversified revenue streams thanks to their universal model. We do not see any immediate impact from the tech disruption on our ratings on large incumbents in the near term because we believe bank management teams clearly identified the risks and opportunities, and are implementing well-defined strategies to address them.

Still, the medium-term picture in not that clear for their domestic retail business lines, especially for savings and investment management activities. Due to the lower-for-longer interest rate environment, lending margins are already compressed, and fee and commission income has become more important to maintain profitability. Although Belgian banks are currently well-positioned to satisfy their client needs, failure to keep up with evolving customer preferences would put significant pressure on profitability, especially on some key non-interest-driven segments.

We also consider the risk of disruption higher for second-tier banks. Most of them are taking a fast-follower approach to digital change, and cannot invest large amounts on the back of business models that are structurally less efficient. This risk would be heightened if clients' digital adoption accelerates further, giving them incentive to switch banks for more advanced mobile services.

This report does not constitute a rating action.