European Banking Sector Facts & Figures 2013

European Banking Federation

The Voice of Europe's Banks

Credits

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Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of almost 4,500 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU only.

The EBF is committed to supporting EU policies to promote the single market in financial services in general and in banking activities in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.

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Abbreviations Used in the Report

CG – central government
CI – Credit Institution[1]
DGS – Deposit Guarantee Scheme
EBA – European Banking Authority
ECB – European Central Bank
EUR – euro
GG – general government
HH – households
ICPF – insurance corporations and pension funds
LTD – Loan to Deposit Ratio
LTRO – Long-Term Refinancing Operation
MFI – Monetary Financial Institution[2]
NFC – non-financial corporations
NPL – non-performing loans
OFI – other financial institutions
Refi rate – the ECB's official refinancing rate (a monetary policy instrument)

1 For reference: as defined by the ECB: "**credit institution** shall mean (a) an undertaking whose business is to r***eceive deposits or other repayable funds*** from the public and to grant credits for its own account; or (b) an electronic money institution within the meaning of Directives 2005/60/EC and 2006/48/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions" (source)

2 For reference, as defined by the ECB: **monetary financial institutions** are "financial institutions which together form the money-issuing sector of the euro area. These include the Eurosystem, resident credit institutions (as defined in Community law) and all other resident financial institutions whose business is to receive deposits and/or close substitutes for deposits from entities other than MFIs and, for their own account (at least in economic terms), to grant credit and/or invest in securities. The latter group consists predominantly of money market funds." See also this explanation. NB: all numbers presented for MFIs in this report are 'excluding the Eurosystem'.

Note from the Authors

Welcome to the fourth European Banking Federation's publication the EU Banking Sector Facts and Figures, the 2013 edition!

The structure of the report remains largely similar to the one of last year (http://www.ebf-fbe.eu/uploads/FF2012.pdf), so the regular reader will feel at ease navigating through the document. The first two chapters of the report cover the trends in banking and the economy registered for 2012. This time the authors made an effort to expand the EU-level overview of banking sector figures with the data on securities, to be found at the end of Chapter 1, Section 7. Special features, this year, focus on euro area deposits (Chapter 3) and on trade finance (Chapter 4).

In addition, authors are proud to present overviews of the national banking sectors in Cyprus, Estonia, Germany, Hungary, Iceland, Latvia, Lithuania, Malta, Romania, Norway, Slovenia, Slovakia, Spain, and the UK, featuring in Chapter 5. This year's publication completes the set of EBF Members' national banking sector descriptions; those of other EBF Members' banking sectors can be found in the previous year's publication.
As last year, data for the EU27 Member States are taken from the European Central Bank (Balance sheet of Monetary Financial Institutions: http://sdw.ecb.europa.eu/browse.do?node=2018811, and Consolidated Banking Data: http://sdw.ecb.europa.eu/browse.do?node=71390), unless stated otherwise. Data on the EFTA countries' banking sectors is reported by the respective EBF member associations.

This report is available in electronic format on the EBF website (www.ebf-fbe.eu), under Publications – Statistics.

- Chapter 1-
Size and Structure of the European Banking Sector

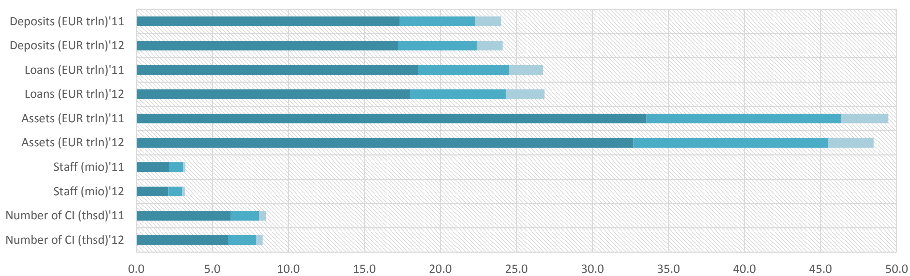
This year's report points at a continued general trend of shrinkage and disintegration of the European banking sector. The economic situation is less than favourable; different nations within the EU take different approaches to dealing with their challenges. To generalise, the euro area banking sector is taking the strongest hit (banking presence has reduced in terms of numbers and financial activity), while the non-euro area banks are faring well. Within the euro area, banks' hardest hit counterparties are: inter-bank lending and loans to businesses. These trends are tinted by the EU financial services regulation which is being progressively phased in by the industry. While banks are struggling to perform despite the reforms and grim economic environment, non-bank financing is flourishing.

1. Number of banks, Bank Assets, Deposits and Loans

The European banking sector had a turbulent year, 2012. Long-term trend continued its course: total **number of Credit Institutions** (CI) in the EU decreased by 199, of which the biggest change was recorded in Italy (-40 CI), followed by Germany (-29), Spain, France and the Netherlands (-21 CI each). These changes reflect banks' effort to consolidate. The only countries where the change was positive, are: Lithuania (2), Malta (2) and Sweden (1).

As a result of bank closure, some 5.5 thousand **branches** were closed. The countries concerned are mainly Germany, Spain and Italy, where 1.6 thousand, 2 thousand and 1 thousand branches closed, respectively. In tune with that, the number of **staff employed in the banking sector** fell by over 51 thousand or 1.7%, not least on the account of Spain (over 11.7 thousand), Italy (over 6.8 thousand), France (5.4 thousand), Germany (4.7 thousand), Poland (4.3 thousand) and Romania (4 thousand). By contrast, Sweden saw the biggest rise in the bank staff count, by 2.4 thousand.

Figure 1: Total assets, loans, deposits, number of credit institutions and number of staff employed in 2011 and 2012



	Number of CI (thsd)'12	Number of CI (thsd)'11	Staff (mio)'12	Staff (mio)'11	Assets (EUR trln)'12	Assets (EUR trln)'11	Loans (EUR trln)'12	Loans (EUR trln)'11	Deposits (EUR trln)'12	Deposits (EUR trln)'11
Euro area	6.0	6.2	2.1	2.2	32.7	33.6	18.0	18.5	17.2	17.3
Non euro area EU	1.8	1.9	0.9	0.9	12.8	12.8	6.3	6.0	5.2	5.0
EFTA	0.4	0.5	0.1	0.1	3.0	3.1	2.6	2.3	1.7	1.7

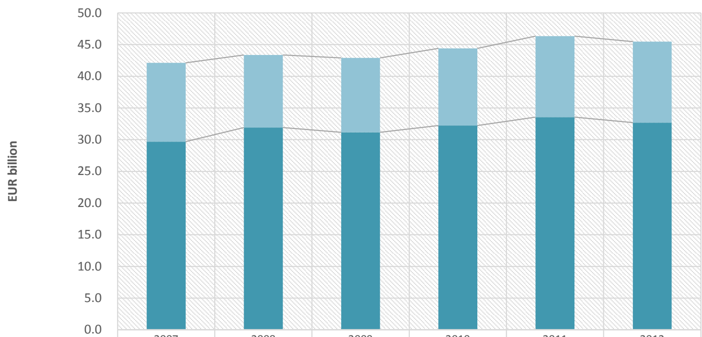
The turbulence also had an impact on banks' financial figures in 2012. **Assets** shrank by 1.9% or EUR 863 billion. Total stock of **loans** in the EU fell by EUR 206 billion (0.8% of total stock of loans), while stock of **deposits** increased by EUR 177 billion. These figures are a tangible manifestation of the impact of financial regulation, which eventually leads to deleveraging and restructuring of the banking sector. Next sections go into more detail on these, and other, parameters.

2. Assets

In 2012, total assets of banks operating in the EU fell by EUR 863 billion (1.9% of total stock). From the geographical perspective, the largest contribution to the fall in the stock of assets is attributable to the euro area (-2.5%) while the non-euro area countries' asset stock remained broadly unchanged.

Considering the country breakdown, a number of EU Member States experienced a significant reduction in their stock of assets in 2012 (see Figure 3). The largest decline – in absolute terms- was registered in France: 316 billion (3.6% of France's total asset base), Germany: EUR 167 billion (2%), and the UK: EUR 149 billion (1.5%), followed by such countries as Ireland: EUR 143 billion (10.9%), Luxembourg: EUR 140 billion (12.7%), and Belgium: EUR 113 billion (9.4%).

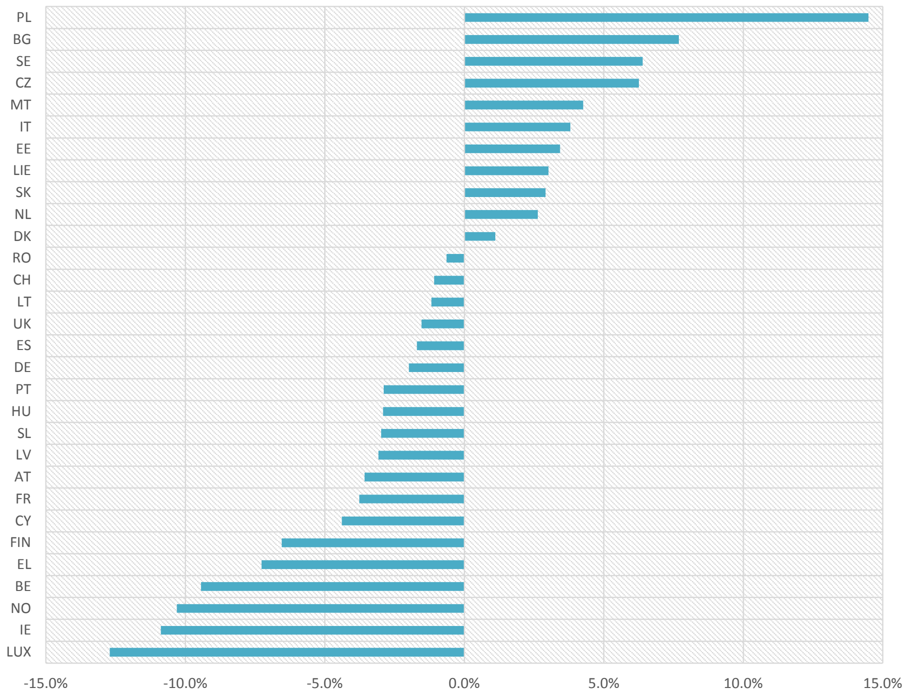
Figure 2: EU27 MFI total assets



	2007	2008	2009	2010	2011	2012
Non-euro area EU	12.4	11.5	11.7	12.2	12.8	12.8
Euro area	29.7	31.9	31.2	32.2	33.6	32.7

The negative trend was somewhat outweighed by strong asset growth in both mature and emerging markets in Europe. In absolute terms, at the top is Italy: EUR 155 billion (3.8% of national level bank asset growth), followed by Sweden EUR 73 billion (3.4%) and the Netherlands: EUR 64 billion (2.6%). In Eastern Europe, Polish banks' assets grew by close to 15% or EUR 45 billion (14.5%), Czech banks' assets increased by EUR 12 billion (6.3%).

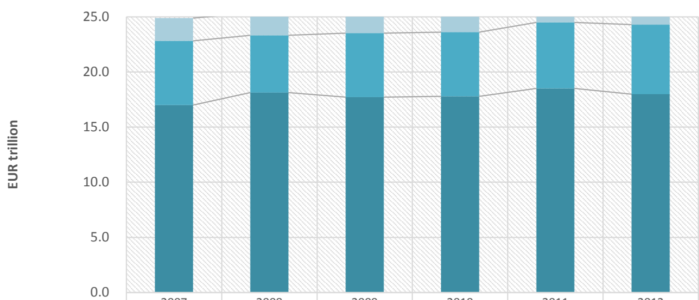
Figure 3: Changes in national MFI asset stocks, 2012, %



3. Loans

Over the year 2012, the euro area banks' stock of **loans** shrank by EUR 518 billion. At the same time, the non-euro area countries' bank loans increased by EUR 312 billion. The cumulative result for the EU27 is a -0.8% decline in the loan stock in 2012.

Figure 4: Total loans



	2007	2008	2009	2010	2011	2012
EFTA	2.1	2.0	1.8	2.1	2.3	2.5
Non-euro area EU	5.8	5.2	5.8	5.8	6.0	6.3
Euro area	17.0	18.1	17.7	17.8	18.5	18.0

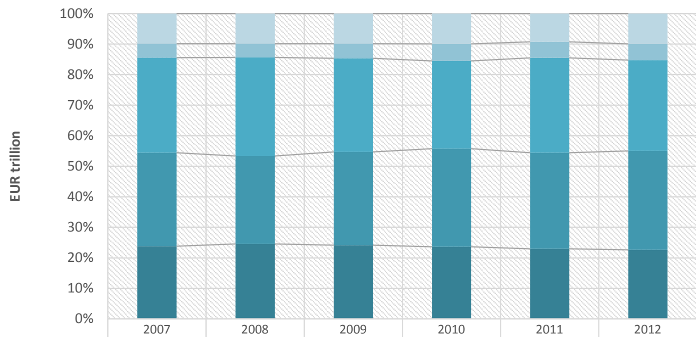
Inter-bank lending was the EU banks' counterparty that saw the biggest decline in loans: it shrank by over EUR 440 billion, or 6%, in 2012. The ECB's long-term refinancing operations (LTRO) introduced about two years ago, are being gradually phased out, and that has direct implications on inter-bank lending positions. In addition, ever scarcer collateral (which has become a very important factor for loan provision) creates a negative impact on market making, not least for the inter-bank market.

Second largest decline in the stock of loans in absolute terms was registered for **loans to businesses** (NFC), which fell by over EUR 175 billion, or 3.2% in 2012. Such a figure may sound alarming; however, this fall in bank lending to NFC was dwarfed by what corporations received in non-bank financing over the same period (see Chapter 1 - Section 7 for more detail). It can be said that in 2012, large EU companies did not suffer from lack of funding sources.

The decline in the banks' loan stock in the EU is a result of several phenomena, such as necessary deleveraging (imposed by the new EU financial regulation) and loan sale programmes of banks. This is particularly important in countries where target loan-to-deposit ratios are imposed. Other reasons for the decline in loans are that the rate of return for lending to businesses is simply not high enough, pushing some banks to buy government bonds instead. That said, real lack in demand is yet another explanation to the observed SME lending trend.

The stock of loans for **house purchase**, and loans to **other** (non-MFI) **financial institutions** grew in 2012 by 1.2% and 5.5% respectively.

Figure 5: EU27 MFI Loan breakdown by Counterparty



	2007	2008	2009	2010	2011	2012
Other loans	2.19	2.25	2.22	2.27	2.20	2.31
Loans to GOV	1.03	1.03	1.07	1.29	1.24	1.23
Loans to MFI	6.91	7.34	6.89	6.58	7.37	6.93
Loans to HH	6.80	6.57	6.88	7.34	7.47	7.55
Loans to NFC	5.29	5.60	5.43	5.41	5.44	5.27

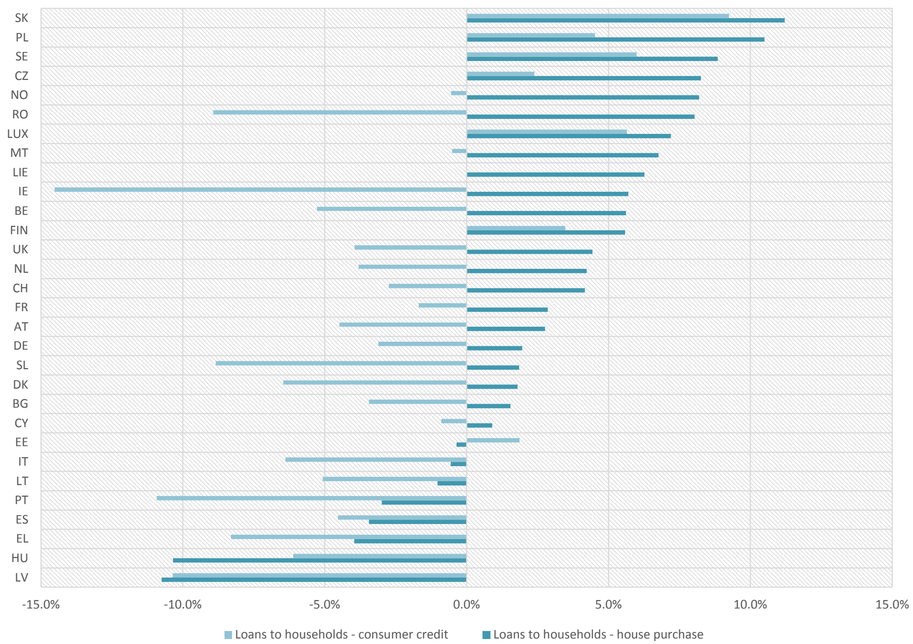
The EU27 **national breakdown** shows a lot of diversity in banks' year-end lending results. Ireland, Greece, Luxembourg and Belgium registered the biggest decline in the stock of loans in 2012 (-19.7%,-13.5%,-13.0%, and-10.0% respectively).

For Ireland, bank lending to all counterparties declined (notably, inter-bank lending shrank by a third and loans to government halved), except to households for house purchase (the latter grew by 5.7%). In Greece, lending to all counterparties was in the red in 2012 (interbank lending and loans to government shrank by over a third each), except loans extended to other (non-bank) financial institutions, which grew by 7.5%. In Luxembourg, lending to all counterparties but households (up by 7%) decreased. Similar picture was in Belgium, where only lending for house purchase grew (by 5.6%).

This decline was compensated by the loan growth in Poland (15%), Estonia (9.7%), Sweden (8.4%) and the UK (5.2%).

In Poland, the biggest contribution to loan growth was on the account of bank lending to businesses and to households for house purchase, by 11% and 10.5% respectively; smaller loan portfolio counterparties grew substantially, too. Banks in Sweden also extended 8.8% more loans to households for house purchase and 5.4% more to businesses; although their inter-bank lending was affected (-6.4%)

Figure 6: Changes in stock of loans to households: for house purchase and for consumer credit in 2012, %

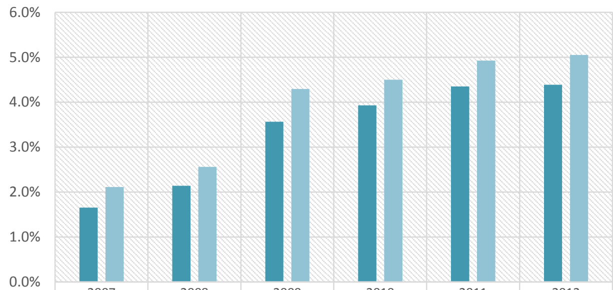


as in most other countries. In the UK, the biggest contribution to loan growth was on the account of loans for house purchase (4.4%), as well as bank loans to other (non-bank) financial institutions (6.2%); inter-bank lending shrank by over 8%. In Finland, bank loans to households grew by 5.6%. The growth in loans in Estonia is mostly owing to the phenomenon of 1.5 times' growth in inter-bank lending (from just under one billion euro to over two billion euro).

It is interesting to consider the dynamics of the breakdown of the stock of loans to households. Figure 6 reflects a very sporadic picture: while **consumer credit** is shrinking in the majority of the countries, **loans for house purchase** seem to be mostly growing. In Latvia, Hungary, Greece, Spain, Portugal, Lithuania and Italy, the entire loan portfolio to households is shrinking. In the Czech Republic, Poland, Sweden, Slovakia, Finland and Luxembourg, households seem to be borrowing more for both purposes. In the rest of the countries (which represent half of EU membership), the picture seems to be mixed.

According to the Consolidated Banking Data published by the European Central Bank, the mean of **total gross doubtful and non-performing loans** across the EU member states has been steadily increasing over the past five years. As a share of total debt instruments and advances, it has grown from just over 2% in 2008 to 5.1% in 2012. For the euro area, the figures stand at 1.7% and 4.4% respectively.

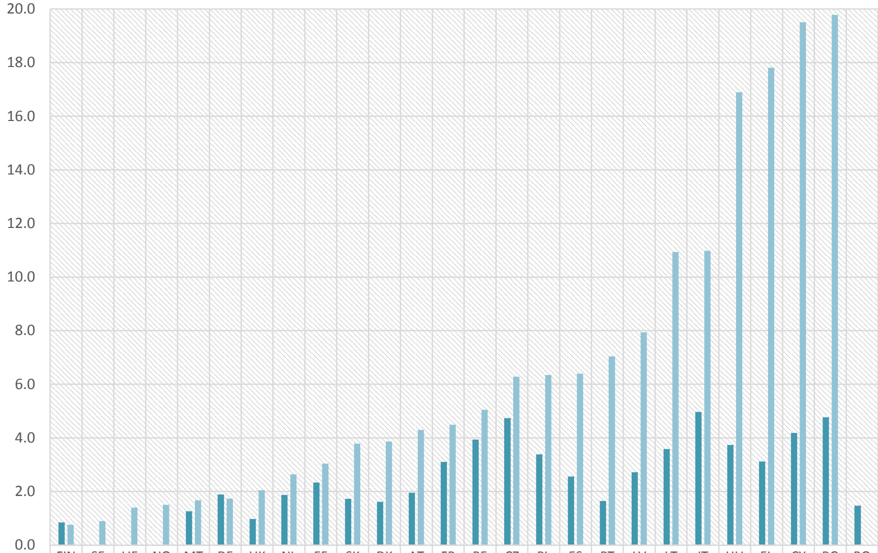
Figure 7: EU27 gross total doubtful and non-performing loans, % of total debt instruments and total loans and advances



	2007	2008	2009	2010	2011	2012
Median - euro area	1.7%	2.1%	3.6%	3.9%	4.4%	4.4%
Median - EU-27	2.1%	2.6%	4.3%	4.5%	4.9%	5.1%

This indeed reflects the fact that the socio-economic situation is weak, preventing an ever larger share of borrowers to repay their loans, be it a private, institutional or corporate client. This is part of the reason for an overall decline in the total volume of loans (see above): banks are more prudent with their clients. Certainly, the situation across the EU Member States varies (see Figure 8). While the share of non-performing loans increased in more or less all countries in Europe, in some, like Spain, Portugal, Latvia, Lithuania, Italy, Hungary, Greece, Cyprus and Bulgaria, it exploded over the past few years.

Figure 8: Gross total doubtful and non-performing loans, % of total debt instruments and total loans and advances, by country



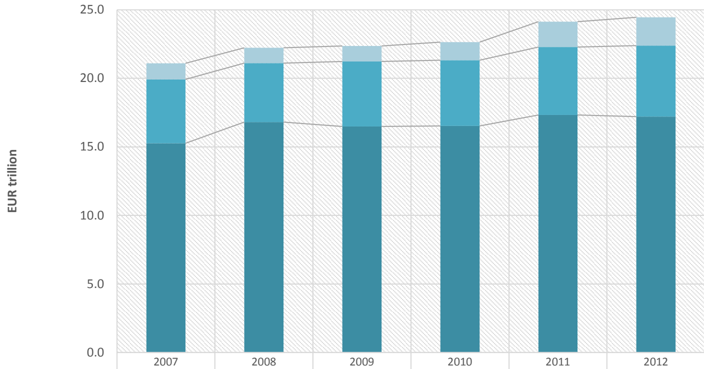
	FIN	SE	LIE	NO	MT	DE	UK	NL	EE	SK	DK	AT	FR	BE	CZ	PL	ES	PT	LV	LT	IT	HU	EL	CY	BG	RO
2008	0.8	0.0			1.3	1.9	1.0	1.9	2.3	1.7	1.6	2.0	3.1	3.9	4.7	3.4	2.6	1.6	2.7	3.6	5.0	3.7	3.1	4.2	4.8	1.5
2012	0.8	0.9	1.4	1.5	1.7	1.7	2.0	2.6	3.0	3.8	3.9	4.3	4.5	5.1	6.3	6.4	6.4	7.0	7.9	10.9	11.0	16.9	17.8	19.5	19.8	0.0

NPL ratios of over 10% are certainly unsustainable, and need to be brought back to lower levels. This will be possible when the economic situation stabilises, and the entire set of new financial sector regulation is fully phased in. The process is complex and current economic environment is not favourable, so it may take a few years before all EU Member States bring their NPL ratios down. Moreover, it would also be helpful to unify the definition of terms, such as non-performing loans (NPL), in order ensure that everybody refers to the same concept across all EU Member States (a task now being tackled in the context of setting up a new supra-national EU supervisory framework).

4. Deposits

Total stock of **deposits** in the EU grew by 0.5% in 2012, however, growth is only attributable to the non-euro area EU countries (by EUR 232 billion or 4.7% for the region), while euro area banks' stock of deposits declined by EUR 115 billion, or 0.7%. (For a detailed analysis of euro area deposits, see Chapter 3).

Figure 9: Total deposits



	2007	2008	2009	2010	2011	2012
EFTA	1.2	1.1	1.1	1.3	1.9	2.1
Non-euro area EU	4.7	4.3	4.7	4.8	5.0	5.2
Euro area	15.3	16.8	16.5	16.5	17.3	17.2

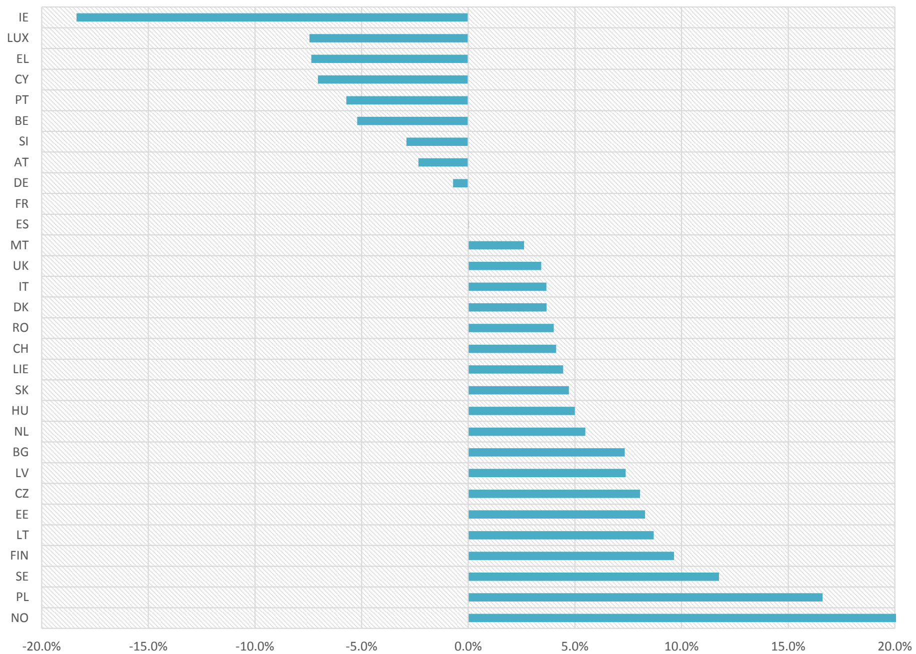
Analysis of the EU banks' major counterparties shows that the biggest decline in banks' deposit base took place within the **inter-bank** deposits: they decreased by EUR 283 billion, or 2.2%. The only other counterparty whose deposit base shrank was central governments: a fall of EUR 16.5 billion, or 7.2% in 2012.

On balance, EU deposits from non-monetary financial institutions grew by a steady 2.2%, of which **deposits from corporates** increased by a healthy 5.1% (or by EUR 108 billion).

Country breakdown shows a disparate picture, just like with loans. The strongest growth in the deposit base was registered in Poland: an impressive 16.6%, which was mainly fuelled by deposits from the real sector. The same scenario occurs in Sweden and Finland, where deposits grew by 11.8% and 9.6% respectively. In absolute terms, the largest contribution to growth in deposits was in the UK, where deposit base grew by EUR 133 billion (or 3.4%); this growth was, on the one hand, spurred by real economy's increased deposits in the banking sector, and, on the other, weighed down by a drop in inter-bank deposit-taking.

In Ireland, drop in the stock of deposits in 2012 was significant: EUR 105 billion, or 18.4%. This country is followed by Luxembourg, Belgium, and Germany (total deposit base fell by 7.4%, 5.2% and 0.7% respectively). The reason for the overall drop in the stock of deposits in Belgium and Germany is that the decline in the interbank lending was not sufficiently compensated by fresh deposits from other counterparties (i.e. households, corporates, government, etc.). By contrast, in Luxembourg, the only counterparty with the growing deposit base is that of the non-financial corporations, but the increase in this position was not sufficient to compensate for the drop in all other ones.

Figure 10: Change in the MFI stock of deposits in 2012, %



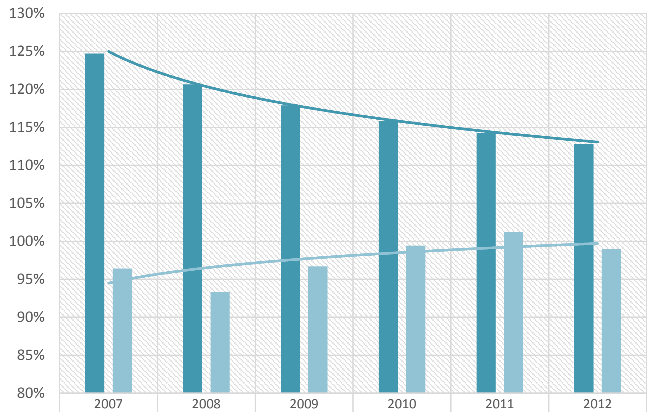
5. Loan-to-Deposit Ratio

The ever-more important **Loan-to-Deposit Ratio** can be analysed with the help of Figure 11.

The ratio of loans to deposits in the sector of other than monetary-financial institutions has been gradually falling during the past five years, reaching 113% in 2012. In other words, non-financial sector has been reducing its balance-sheet leverage. On the other hand, the inter-bank Loan-to-Deposit ratio has been less steady. Owing to the fact that inter-bank loan base fell much more rapidly than the deposit base in 2012, the ratio dipped to 99%.

It can be concluded from the above, that 2012 was a year of a reduction in the on-balance sheet banking sector leverage. This is in line with the general aim of the regulators, although the fact that lending to SMEs was in decline in 2012, the year of negative economic growth, is not quite the perfect outcome no matter which side one looks at it. Following a number of academic studies[1], bank lending lags behind economic growth anywhere between 12 and 18 months, which means that economic expansion must be led by a strong and sustainable non-banking stimulus (such as innovation, new trading partners, external demand, etc.) in order to get companies to start borrowing again to cater for new orders. This will spur new employment and also help households consider taking on new loans. For this to happen, a credible growth agenda needs to be put in place by the national and EU policy makers.

Figure 11: EU27 loan-to-deposit ratio, %



	2007	2008	2009	2010	2011	2012
LDR (non-MFI)	125%	121%	118%	116%	114%	113%
LDR (MFI)	96%	93%	97%	99%	101%	99%

6. Payments

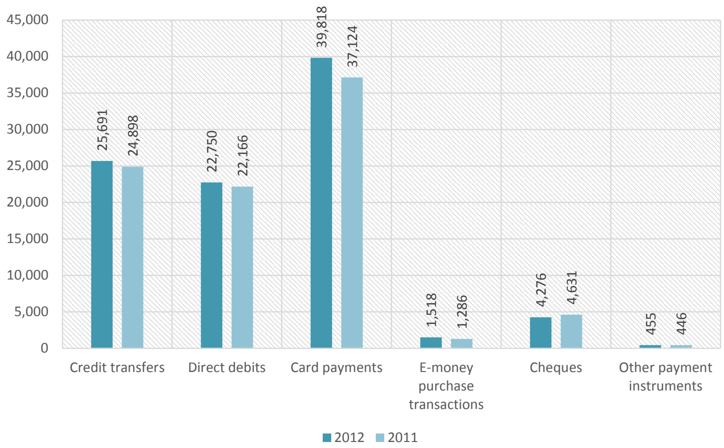
Considering all **non-cash transactions** in the EU last year, their **number** grew by 4.2%, and the **volume** of money transacted grew by 6.3%. Given that the EU27 GDP contracted in 2012, such growth in cashless transactions can be explained by the fact that citizens and businesses increasingly turn away from using cash. This is reinforced by the fact that more businesses give clients an opportunity to pay with their cards: the number of points of sale (POS) grew by 10% in 2012, the number of card transactions at the POS by 8% and their value by 6.6%.

At the same time, the number of cash withdrawals in the EU27 fell by 0.2% over the same period. In tune with that, the number of ATMs decreased by 0.4%, and the number of transactions made via the ATMs dropped by 1.7%.

1 Those studies include the EBF's EMAC paper on Pro-cyclicality and Macro-prudential policy (2011)

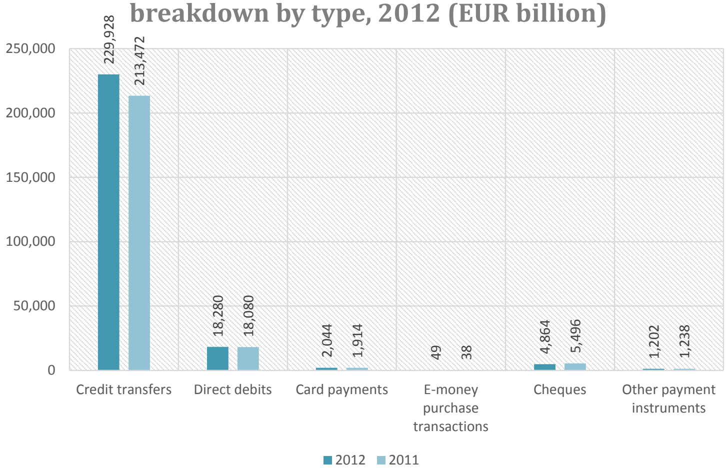
Another increasingly unpopular means of payment is cheques. The number of cheques written in the EU27 in 2012 decreased by 7.7%, and the value of those cheques fell by 11.6%.

Figure 12: Number of non-cash transactions, breakdown by type, 2012 (million)



Of all non-cash transactions, the ECB reports that in 2012, the strongest growth was in the **number** of e-money purchase transactions (just over 18% compared with 2011), followed by the number of card payment transactions (over 7% annual growth). In terms of **value** of transactions conducted, e-money purchases grew by over 30% in 2012, credit transfers grew by 7.7%.

Figure 13: Value of non-cash transactions, breakdown by type, 2012 (EUR billion)

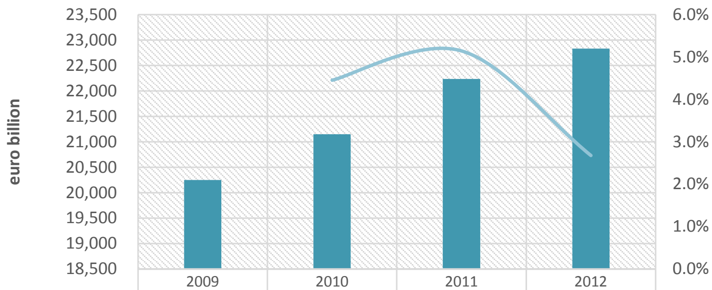


Compliance with SEPA[2] (Single Euro Payments Area) is increasing in the EU. For example, **SEPA Credit Transfers** represented 35.6% of all credit transfers in December 2012, and the number keeps rising steadily. **SEPA direct debits** represented 1.9% of all direct debit transactions. This number is relatively low owing to the fact that most of direct debit agreements are domestic (rather than cross-border) which makes it less urgent to shift to the SEPA standard. Finally, over three quarters of **card payments** are SEPA compliant in the EU27.

7. Securities

According to the ECB's Securities Issues' statistics, total outstanding amount of **debt securities** issued in the EU27 grew by 2.7% in 2012 to EUR 22.8 trillion, somewhat slower than in the previous years.

Figure 14: EU27 securities other than shares, excluding financial derivatives



	2009	2010	2011	2012
EUR billion	20,248	21,149	22,237	22,833
% change		4.5%	5.1%	2.7%

The largest proportion of securities is issued by the national general governments, which at the end of 2012 stood at EUR 9.3 trillion or 41% of total debt securities issued. The close second is the monetary financial institution sector, which trades EUR 7.4 trillion or 32% of the EU total. The rest is shared between non-MFI financial intermediaries (19%) and non-financial corporations, 8% of total.

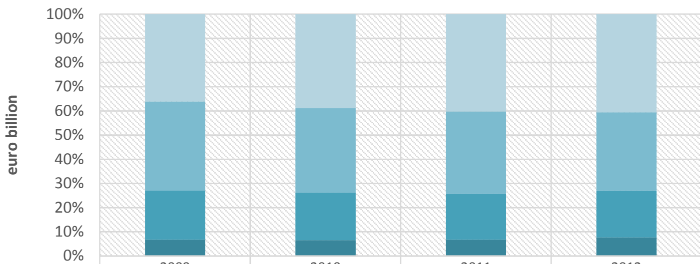
Although starting from a low base, the total debt security issuance by **non-financial corporations** has been growing strong over the past few years; i.e. between 2009 and 2012 it grew by 28% or EUR 387 billion. This is more than double the decline in the total stock of bank loans to non-financial corporations (EUR 165 billion) over the same period. Over 90% of NFC debt securities issued is long term (i.e. with the

2 Information extracted from here: http://www.ecb.europa.eu/paym/sepa/about/indicators/html/index.en.html

maturity longer than one year), and both short and long-term securities issues were growing at a similar pace.

The other fast-growing component of debt securities issues was **general government**: between 2009 and 2012 their total outstanding amount of debt securities grew by almost EUR 2 trillion. Little wonder: governments are seeking to finance their structural reforms and support their national economies in these difficult times. Almost 90% of general governments' debt securities issued are long-term. Since 2009, the EU Member States' general governments were issuing long-term debt, while gradually phasing out the short-term debt security segment.

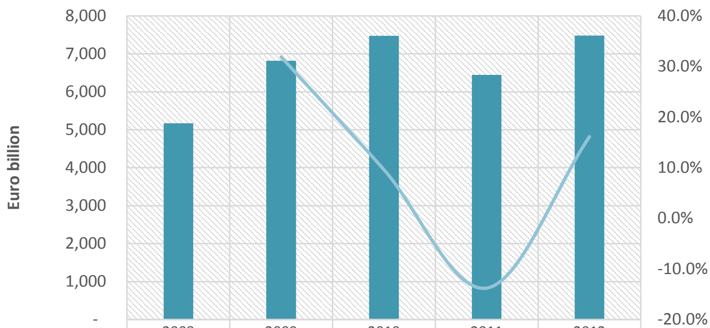
Figure 15: EU27 Securities other than shares, excluding financial derivatives



	2009	2010	2011	2012
GOV	7,310	8,240	8,955	9,266
MFI	7,475	7,381	7,581	7,420
Non-MFI FI	4,100	4,146	4,203	4,397
NFC	1,363	1,383	1,498	1,750

The outstanding amount of **quoted shares** at the end of 2012 was almost EUR 7.5 trillion (see Figure 14). After a fall in the volume of quoted shares in 2011 by 14%, 2012 saw a steep rise of 16% (or over EUR 1 trillion), eventually leading to a new all-time high in the quoted shares in the EU.

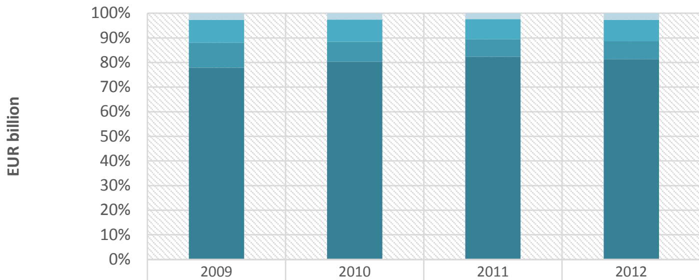
Figure 16: EU27 quoted shares



	2008	2009	2010	2011	2012
EUR bn	5,170	6,818	7,474	6,444	7,483
% change		32%	10%	-14%	16%

As expected, over 80% of all quoted shares belong to **non-financial corporations**, i.e. to large EU corporates (see Figure 15), and in 2012 this position grew by 15% or EUR 783 billion. That, combined with securities issued by NFC in 2012, the non-bank financing acquired by EU companies totalled EUR 1,035 billion.

Figure 17: EU27 quoted shares by counterparty



	2009	2010	2011	2012
ICPF	186	190	155	200
Other FI exc. ICPF	632	676	532	645
Other MFI	693	607	454	552
NFC	5,306	6,001	5,304	6,086

Volumes for all other issuers of quoted shares grew by between 20 and 30% during that period.

The strong growth in debt securities and issuance of shares by non-banks indicates that these sources of liquidity / finance are becoming strongly complementary to bank financing.

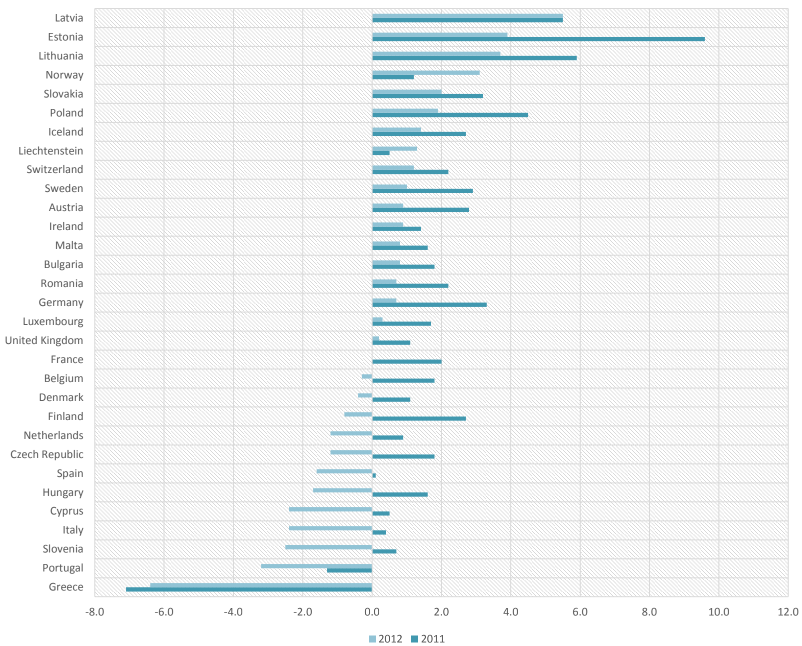
- Chapter 2 -
European Economic Environment and Banking Sector Performance

This year's report points at a continued general trend of shrinkage and disintegration of the European banking sector. The economic situation is less than favourable; different nations within the EU take different approaches to dealing with the challenges. To generalise, the euro area banking sector is taking the strongest hit (banking presence has increased in terms of numbers and financial activity), while the non-euro area banks are faring well. Within the euro area, banks' hardest hit counterparties are: inter-bank lending and loans to businesses. These trends are tinted by the EU financial services regulation which is being progressively phased in by the industry. While banks are struggling to perform despite the reforms and grim economic environment, non-bank financing is flourishing.

1. European Economy

After a modest recovery in 2011, European economy fell back into recession in 2012. Aside from such programme countries like Greece, Portugal and Cyprus, negative **GDP** growth was registered in Italy, Slovenia, Hungary, Spain, Czech Republic, the Netherlands, Denmark, and Belgium (see Figure 18 for more detail). French economy ended the year with zero growth. Fastest growing EU economies last year were the Baltic States, Slovakia and Poland. All EFTA countries registered steady positive growth: anywhere between 1 and 3%.

Figure 18: GDP growth, % per annum



Although negative risks have recently somewhat receded, the European economy may take a long while to recover and it will need an effective growth strategy to give a strong impetus for re-starting sustainable business activity. A prospect of prolonged below-potential growth, compounded with ageing population and heavy debt burdens in all sectors of the economy, present a formidable challenge to the EU policy-makers.

2013 is yet another year of contractionary **fiscal policy** right across the euro area perimeter. A number of European governments made a substantial effort to reduce government spending and achieve a primary budget surplus. This effort yielded some fruit: after-4% deficit in 2012, both this year and next are expected to result in a less than 3% **government budget** (cyclically unadjusted) deficit. That said, more effort is required to bring budgets to an actual balance or even surplus, in order to escape from the downward spiral of debt accumulation. This may lead to a prolonged period of stringent fiscal discipline, leaving the private sector on its own in an attempt to restart economic growth in the euro area, while trying to support economic growth with a sounder fiscal environment in the medium term.

Prolonged crisis in the EU is the reason for which the **government debt** has climbed to 85.2%. This phenomenon is inevitable in the context of a continued crisis, as well as governments being in the middle of the process of budget consolidation. To get the EU economy into a healthy state, the level of public debt must come down significantly, and this will take a while. Prolonged fiscal austerity is considered to be politically unacceptable. Economic growth, coupled with the objective of a primary fiscal surplus, would help bring down the debt ratio, a welcome development for all parties involved. Essentially, this is the goal that the EU Treaty on Stability, Coordination and Governance[1] in the Economic and Monetary Union (also known as “fiscal compact”) *inter alia* tries to achieve.

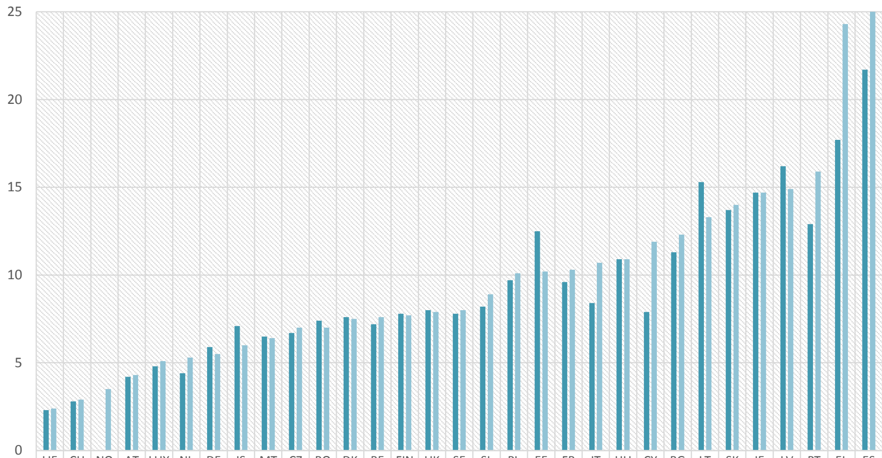
The ongoing deleveraging in the financial and corporate and household sectors, weak confidence and financial market tensions keep economic activity muted in the euro area. Lack of enthusiasm from domestic consumers and producers is reflected in various economic parameters. At the end of 2012, the **unemployment** level reached 10.8% in the EU and is expected to remain persistently high at around 11% in 2013. The unemployment level remains high because euro area companies are not recruiting. They are facing a high degree of uncertainty about the development of their national economy, the soundness of the financial system and even about the future of EMU. Since the domestic near-term prospects do not appear bright, most European companies are not developing new business (nor are they taking on new bank loans for investments). Today’s level of industrial production is mainly

1 See http://www.european-council.europa.eu/home-page/highlights/fiscal-compact-enters-into-force-on-1-january-2013?lang=en

supported by export markets which develop at a healthier rate than those of the home economy. As a result, exports are growing at a faster pace than imports, which helps improve the EU trade balance.

The lowest level of unemployment last year in the EU was registered in Austria (4.3%), followed by Luxembourg (5.1%), the Netherlands (5.3%) and Germany (5.5%). A special mention must be made of the three EFTA countries: Norway, Switzerland, and Liechtenstein, where unemployment rate is remarkably low: between 2.4 and 3.5%. The fourth EFTA country, Iceland, registered 6% unemployment rate in 2012, which is a very good result for a country coming out of a serious crisis (see Section on Iceland in Chapter 5). At the other end of the spectrum are the programme countries: Spain (25%), Greece (24.3%), Portugal (15.9%), and Ireland (14.7%). Having just come ‘out of the woods’, Latvia is also part of the heavily hit labour market segment with the unemployment level of 14.9% at the end of 2012. Lack of new work placements results in citizens spending and investing less. Followed by a decline in **consumer spending** by 1.3% in 2012, it is expected to contract further by 0.8% this year.

Figure 19: Unemployment rate, % of total labour force



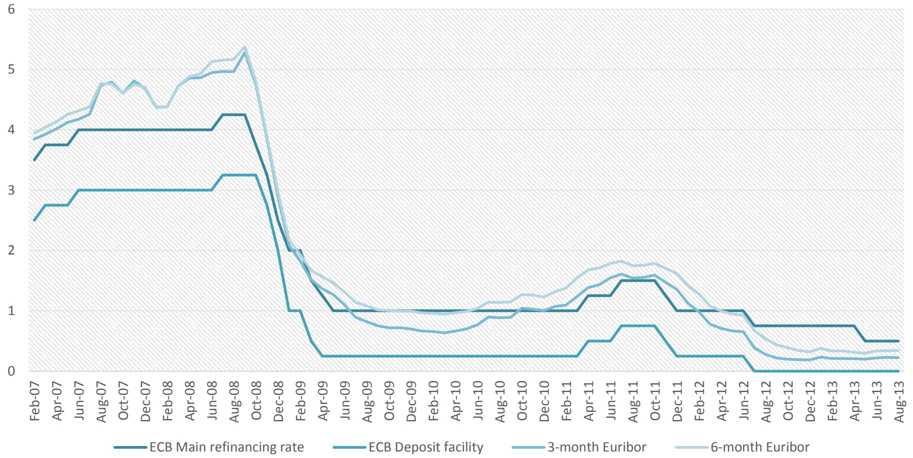
	LIE	CH	NO	AT	LUX	NL	DE	IS	MT	CZ	RO	DK	BE	FIN	UK	SE	SL	PL	EE	FR	IT	HU	CY	BG	LT	SK	IE	LV	PT	EL	ES
2011	2.3	2.8		4.2	4.8	4.4	5.9	7.1	6.5	6.7	7.4	7.6	7.2	7.8	8.0	7.8	8.2	9.7	12.5	9.6	8.4	10.9	7.9	11.3	15.3	13.7	14.7	16.2	12.9	17.7	21.7
2012	2.4	2.9	3.5	4.3	5.1	5.3	5.5	6.0	6.4	7.0	7.0	7.5	7.6	7.7	7.9	8.0	8.9	10.1	10.2	10.3	10.7	10.9	11.9	12.3	13.3	14.0	14.7	14.9	15.9	24.3	25.0

One of the key stabilising elements for the European economy was the announcement of the European Central Bank to ‘do whatever it takes’ to preserve stability. The **Outright Monetary Transactions Programme**[2] (OMT) in secondary sovereign bond markets, which was announced to safeguard an appropriate monetary policy transmission and the singleness of the monetary policy, did not need to be activated; its mere announcement in August 2012 was sufficient to stabilise the markets. Of

2 http://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html

other measures, the ECB lowered its **main refinancing rate**[3] to 0.75% in July 2012, followed by another cut by 0.25 basis points in May 2013.

Figure 20: ECB rates & Euribor benchmarks, %



During the spring 2012, the **Euribor** rates dived again below the key refi rate, owing to lack of inter-bank lending activity (see Section 1.3, above). Essentially, this points to the fact that it is the deposit rate which is the leading reference rate in the euro area at the moment. Given such low margins between the lending and the deposit rate, banks' profits from lending activities are squeezed. At any rate, banks are now more conscious about risk management than about volumes of lending, which is also reflected in the data presented in Chapter 1. This leads to banks hoarding plenty of liquidity which they receive from the ECB, and stingy lending practices. It is clear that commercial banks' dependence on the ECB liquidity provision should be phased out in order to restore the interbank market activity and motivate banks to re-start lending to the economy.

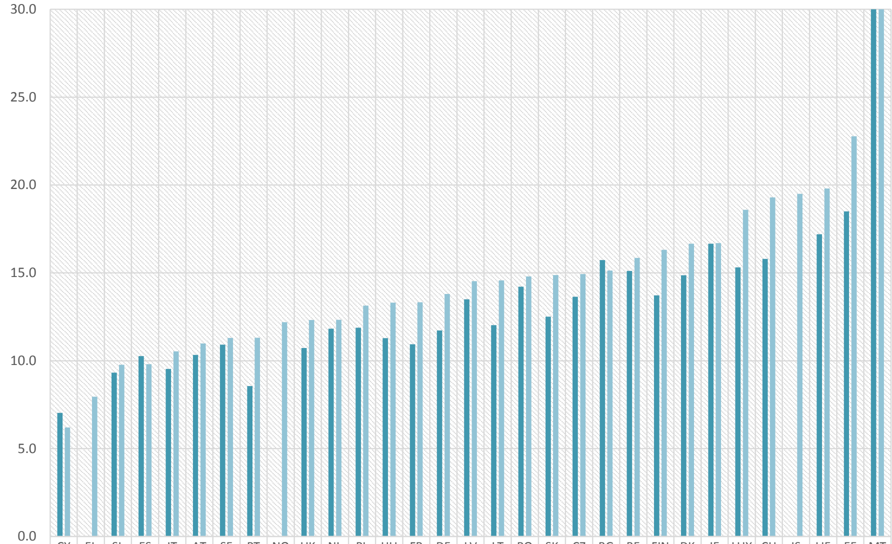
2. Bank Capital

Figure 21 quantifies the effort of European banks to strengthen their Tier1 capital base over the past year. With the exception of Cyprus and Greece, every other country's banks have improved their Tier 1 capital ratio, according to the European Central Bank's Consolidated Banking Figures. In 2012, the calculated median of the national Tier1 ratios of all banks operating in the EU27 member states was 13.8%, a vast improvement compared to the 9.6% in 2008[4] .

3 http://www.ecb.europa.eu/stats/monetary/rates/html/index.en.html

4 Tier1 ratio of EU domestic banking groups and standalone banks (i.e. excluding non-EU subsidiaries and non-EU branches), published by the ECB, was at 12% in 2012, up from 8% in 2007. (source)

Figure 21: Tier1 capital, %



	CY	EL	SL	ES	IT	AT	SE	PT	NO	UK	NL	PL	HU	FR	DE	LV	LT	RO	SK	CZ	BG	BE	FIN	DK	IE	LUX	CH	IS	LIE	EE	MT
2011	7.0		9.3	10.3	9.5	10.3	10.9	8.6		10.7	11.8	11.9	11.3	10.9	11.7	13.5	12.0	14.2	12.5	13.6	15.7	15.1	13.7	14.9	16.7	15.3	15.8		17.2	18.5	52.2
2012	6.2	8.0	9.8	9.8	10.5	11.0	11.3	11.3	12.2	12.3	12.3	13.1	13.3	13.3	13.8	14.5	14.6	14.8	14.9	14.9	15.1	15.9	16.3	16.7	16.7	18.6	19.3	19.5	19.8	22.8	49.6

Owing to continued business-related and regulatory challenges, banks have been struggling to improve their efficiency. As a result, the calculated median of **cost-to-income** ratio of all banks operating in the EU27 at the end of last year inched up to 58.6%, from 58.3% in 2011[5]. The most remarkable improvement was registered in Luxembourg (by over 10 percentage points), Denmark (6.3 p.p.), Malta (6.1 p.p.) and Austria (4.2 p.p.). The efficiency ratio notably worsened in Ireland, Hungary, Greece and Slovakia (NB: costs here include provisions).

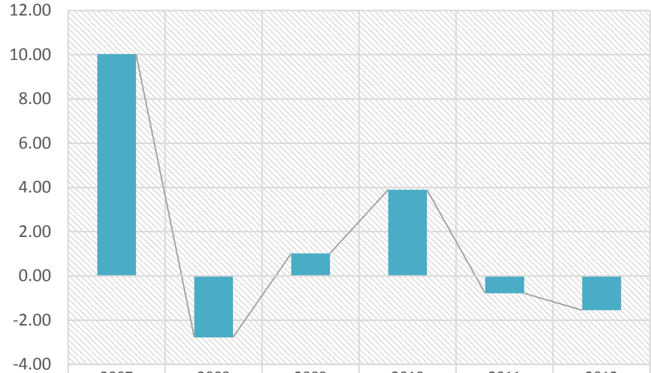
3. Banks' Profitability

European banks' figures on the Return on Equity remain weak. Figure 23 shows that in 2012, the calculated median value of all return on equity of all banks operating in the EU, as registered by the ECB, was a meagre 3.4%[6].

5 Cost-to-Income ratio of EU domestic banking groups and standalone banks (i.e. excluding non-EU subsidiaries and non-EU branches), published by the ECB, was at 65.8% in 2012, up from 62.4% in 2011. (source)

6 Return on Equity of EU domestic banking groups and standalone banks (i.e. excluding non-EU subsidiaries and non-EU branches), published by the ECB, was at -1.6% in 2012, compared with 10% in 2007. (source)

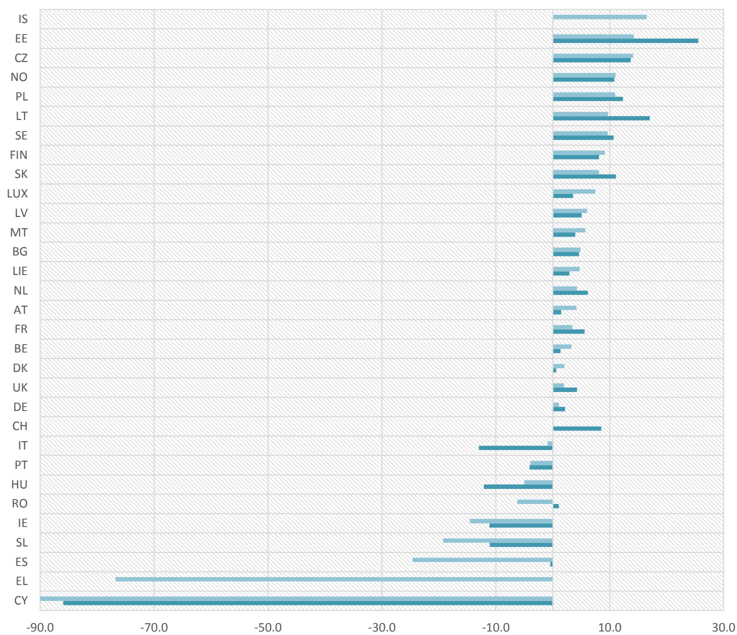
Figure 23: EU27 banks' ROE, %



	2007	2008	2009	2010	2011	2012
EU27 ROE, %	10.02	-2.78	1.02	3.90	-0.78	-1.55

The situation in EU Member States is very varied. Banks in a number of countries are struggling with the negative return on equity: Cyprus, Greece, Spain, Slovakia, Ireland, Romania, Hungary, and Portugal. Difficulties are related to such aspects as sector restructuring and cost efficiency, as well as lack of growth in the real sector. On the other hand, double digit returns on equity were registered in Estonia, Poland and Czech Republic. Figure 23 gives a detailed account of the situation.

FIgure 24: Return on Equity, %



	CY	EL	ES	SL	IE	RO	HU	PT	IT	CH	DE	UK	DK	BE	FR	AT	NL	LIE	BG	MT	LV	LUX	SK	FIN	SE	LT	PL	NO	CZ	EE	IS
2012	-90	-76	-24	-19	-14	-6.	-5.	-4.	-0.	0.1	1.1	1.9	2.0	3.3	3.4	4.1	4.2	4.7	4.9	5.7	6.0	7.5	8.1	9.1	9.6	9.7	10.	11.	14.	14.	16.
2011	-86		-0.	-11	-11	1.1	-12	-4.	-13	8.5	2.2	4.2	0.6	1.4	5.6	1.5	6.2	2.9	4.6	3.9	5.1	3.6	11.	8.1	10.	17.	12.	11	13.	25.	

- Chapter 3-
Statistical Portrait of Euro Area Deposits

This chapter is written based on the data published by the European Central Bank on the deposits in Monetary Financial Institutions operating in the euro area. The data was extracted in August 2013, so the breakdowns presented below are all for the most recent available period at the time: June 2013. The chapter does not dwell on national comparisons, but rather looks at deposits in the euro area as a whole. The more curious minds willing to study national figures are welcome to consult the ECB's Statistical Data Warehouse page, using the following link: http://sdw.ecb.int/browse.do?node=2019191. Special thanks to Anthony O'Brien (Irish Bankers' Federation, anthony.obrien@ibf.ie) for the inspiration and significant contribution to the drafting of this chapter.

Summary

Monetary Financial Institutions (MFI) operating in the euro area hold deposits to the tune of EUR 17,115 billion. The euro area deposit base has been growing steadily since 2006 by 38%. Domestic deposits have been growing faster than deposits from other euro area member states.

Key depositors are: governments (CG), monetary financial institutions (MFI), businesses (NFC), households (HH), insurance corporations and pension funds (ICPF) and other financial institutions (OFI). The table below shows the breakdown of these counterparties' main deposit types.

Table 1: Euro area MFI deposit counterparties: breakdown by type of deposit, EUR million, June 2013, Source: ECB, EBF calculations

Counterparty / deposit type	Total deposits	*Share of each counterparty in total*	Breakdown by type of deposit: Overnight deposits	Deposits with agreed maturity	Deposits redeemable at notice	Repurchase agreements
NFC	1,763,134	*10%*	1,152,787	505,827	94,047	10,473
HH	6,208,910	*36%*	2,445,421	1,699,112	2,058,159	6,218
ICPF	678,583	*4%*	104,123	557,360	8,197	8,904
OFI	2,123,334	*12%*	455,156	1,225,119	17,089	425,969
Sub-total: non-MFI	***10,773,961***	***63%***	***4,157,487***	***3,987,418***	***2,177,492***	***451,564***
Share of deposit type in sub-total, %			*39%*	*37%*	*20%*	*4%*
CG	209,011	*1%*				
MFI	6,132,460	*36%*				
TOTAL	**17,115,432**	**100%**				

A detailed breakdown for deposits from governments and MFIs counterparties is not available. Thus, based on the available breakdown of Monetary Financial

Institutions' non-MFI counterparties, the following conclusions can be drawn. From the counterparties' behavioural point of view, corporates and households enjoy the freedom of 'parking their cash' in banks and the ability to take it out as soon as they need it. The share of term deposits in these two counterpart sectors is relatively low, and can be characterised as mostly short term. Insurance corporations and pension funds, as well as other financial institutions prefer to deposit their cash safely in banks for a longer period of time. OFIs are also heavy on repos.

This means that out of EUR 17,115 billion of euro area deposit liabilities, only EUR 2,363 billion (15%) are with the maturity of over 2 years; EUR 370 billion are of maturity under 1 and below 2 years, and only EUR 90 billion are redeemable at over 3 months' notice.

By contrast, at least EUR 4,157 billion are overnight deposits, while EUR 1,254 billion are deposits with agreed maturity of under 1 year and EUR 2,087 billion are redeemable at under 3 months' notice.

The figures presented above give a glimpse of the scale of euro area banks' activity of maturity transformation, which is necessary in order to manage the generally short-term and liquid nature of deposits versus the generally long-term and less liquid nature of loans.

From the point of view of stability of funding, euro area banks' non-MFI deposits, which could be considered long term, represent only a quarter of the total deposit base as recorded on the balance sheet[1]. At the same time, three quarters of deposits are overnight, so in order to put those EUR 7.5 trillion to use, banks must perform their job of maturity transformation practically on a daily basis. Indirectly, this fact points out to the important need for banks to be able to access inter-bank markets in order to successfully perform their basic duties.

It is important to keep in mind that households are very sensitive to changes in economic situation, and when growth halts, non-financial private sector saving rate drops significantly, too (although remains positive). This phenomenon was observed in the current crisis period, starting in 2009. Moreover, having gone through an era of debt accumulation, euro area private sector has now changed its course and has taken a path of incremental reduction of its debt mountain. This implies that part of retained earnings goes to paying off debt, rather than deposit making.

A final word must be said about the impact of regulation on euro area deposits. The exact formulation of the Deposit Guarantee Scheme Directive (of course, taking also

1 If it were possible to include the MFI deposits and those from the Central Government, the proportion may have been different.

into account the speed at which the EU economy will revive) will define the shift in behaviour of economic agents, not least in their decisions about reallocation of the non-guaranteed part of their cash: investment into property, buying shares or bonds, or simply migrating to an overseas bank account.

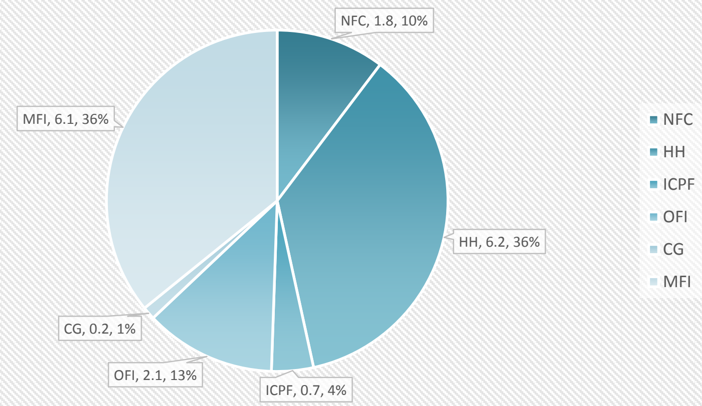
1. General picture

Euro area Credit Institutions' counterparties can be broken down into:

a. Central Governments (CG) who hold in deposits EUR 209 billion, or 1% of total euro area deposits;
b. Monetary Financial Institutions (MFIs, i.e. inter-bank deposits) hold EUR 5,889 billion in deposits, or 35% of the total euro area deposits; and
c. Non-MFIs, a big grouping of non-financial corporations (NFC), households (HH), insurance corporations and pension funds (ICPF), and other financial institutions (OFI), which together account for EUR 11,017 billion in deposits, which is 64% of the total.

Over the past seven years (between Q1-2006 and Q1-2013) **euro area credit institutions' total deposits grew by 38%**, of which deposits from CG grew by 41%, deposits from other MFIs grew by 18%, and those from ***non-MFIs, grew by 50%***, the actual driving force of the deposit base expansion.

Figure 25: Euro area Credit Institutions' deposits - by counterparty, EUR trillion, June 2013



Euro area Credit Institutions accept deposits also from residents who live outside the euro area. The graph below shows that deposits from residents outside the euro area have been growing significantly between Q1-2006 and Q3-2008, reflecting the pace of expansion of deposits from euro area residents. After Q3-2008, non-euro area depositors started withdrawing their deposits from euro area countries. The drop of extra-euro area deposits from the peak in Q3-2008 to date is 30%. The line in Figure 26 shows that the non-euro area deposits in the euro area banks is declining faster than the euro area deposits.

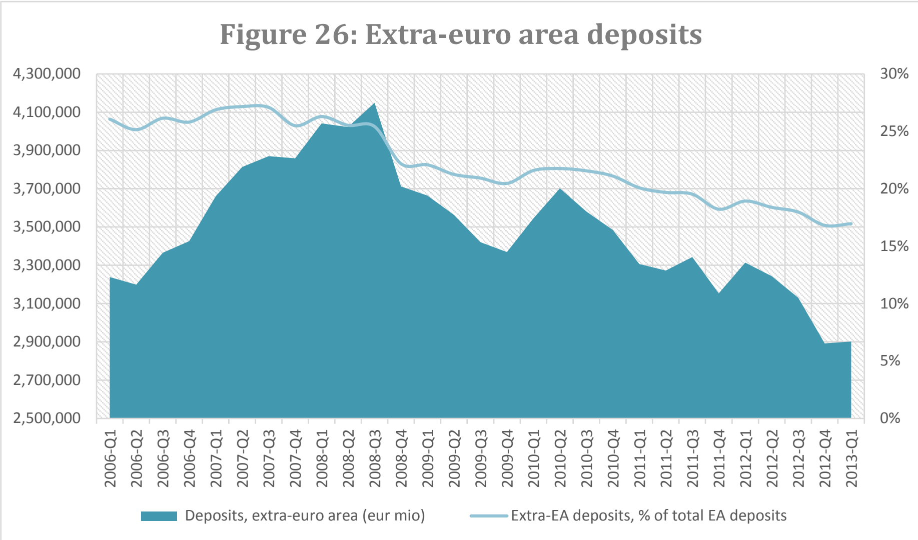
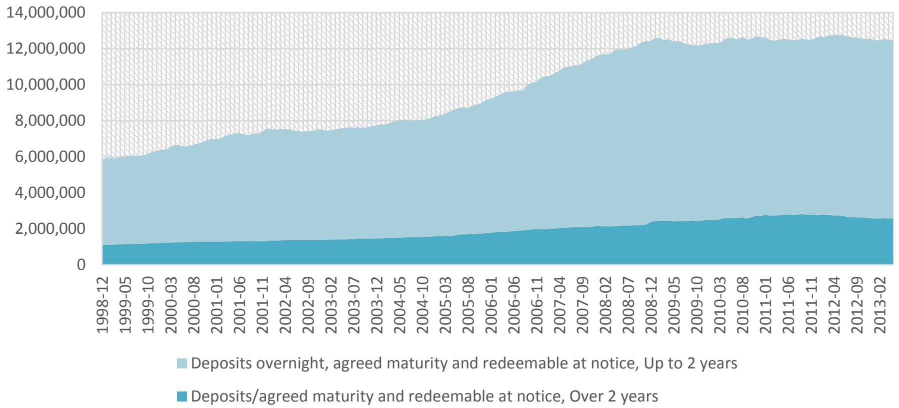


Figure 27 shows that the euro area CI's deposits with longer maturities (of over 2 years) have been growing at a faster pace than those of shorter maturities (under 2 years). However, the former still represents only roughly a quarter (EUR 2,572 billion) of the latter (EUR 9,885 billion). The short-term nature of maturities of euro area deposits presents a conundrum to European banks, which need to comply with the new Basel III liquidity ratios requiring liquid assets over a 30-day time horizon in the Liquidity Coverage Ratio requirement and long-term stable funding in the form of the Net Stable Funding Ratio still to be calibrated. Should European banks not be able to attract more stable deposits and long-term funding, the alternative will be for banks to disengage themselves further from their traditional maturity transformation functions.

Figure 27: Breakdown of euro area deposits by maturity, stocks, EUR million



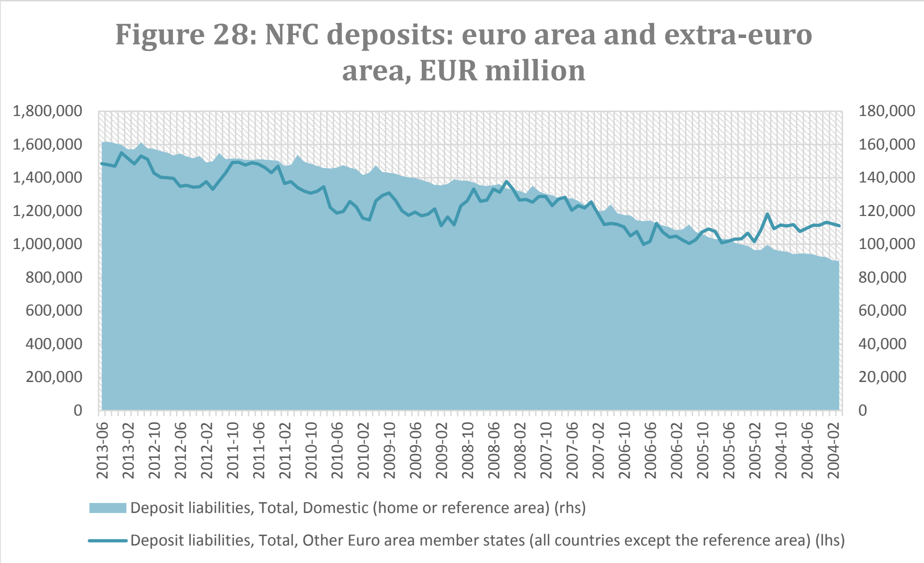
2. Breakdown by Counterparty

Structural and developmental behaviour of euro area deposits within different counterparties of euro area banks are not identical. Broadly speaking, **non-financial corporations and households enjoy the freedom of 'parking their cash' in banks and the ability to take it out as soon as they need it. Share of term deposits in these two counterpart sectors is relatively low, and their deposits are mostly short-term. Insurance corporations and pension funds and other financial institutions prefer to deposit their cash safely in banks for a longer period of time**. OFIs are also heavy on repos. The sub-sections below go into more detail, using monthly observations during 2004- 2013.

2.a. Deposits from Non-Financial Corporations

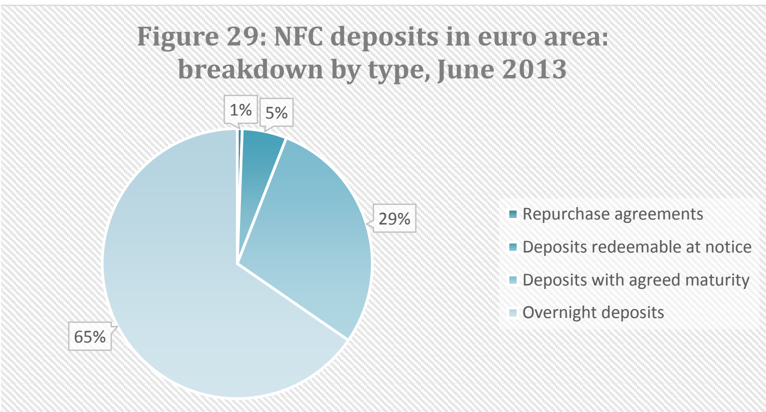
Within the euro area, deposits are accepted, both from the inhabitants of the country, and from residents of other euro area countries. As far as **deposits from businesses** are concerned, domestic resident corporations' deposit base has been growing steadily, and in June 2013 stood at EUR 1,615 billion. By contrast, the amount of deposits from non-domestic euro area corporations (i.e. cross-border deposits from corporates within the euro area) have always represented a small proportion (8% of total deposits) and have been on a gradual decline. In June 2013 this parameter stood at EUR 148 billion.

The dynamics of deposits from businesses has been always positive between 2004 and today. Although pre-crisis, this growth was 8-14% year-on-year (y-o-y), post-crisis it dropped to 0-6%.



Taking the view of all corporate deposits in the euro area, the following picture emerges. At present, 65% of all corporate deposits are overnight; that is EUR 1,153 billion of deposits which do not stay in banks for longer than overnight. This phenomenon may be explained by the fact that companies' accounts might be considered as operational deposits, and while cash on those accounts is fully accessible to the account holder at any time, in practice, these deposits remain more stable, which is why this statistic could appear misleading.

Another 29% of corporate deposits, or EUR 506 billion, are with agreed maturity, of which two thirds (EUR 333 billion) are maturing within a year. Almost a quarter of deposits with agreed maturity are over 2 years' maturity (24%). A small fraction of corporate deposits is redeemable at notice: it comprises 5% of total corporate



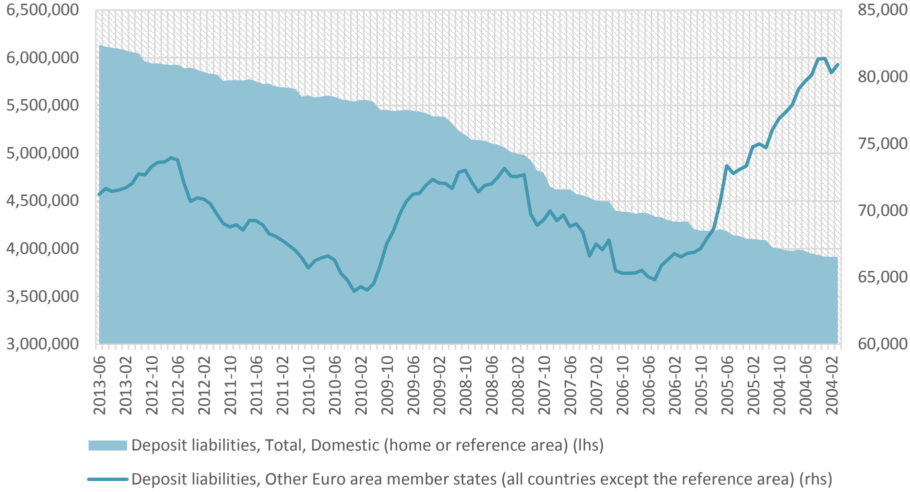
deposits, or EUR 94 billion. An impressive 92% of those are redeemed within 3 months. Businesses typically do not deposit a lot of money which they cannot redeem at short notice; and until 2009 this bank service was in a decline. Since early 2010, however, it has been experiencing high growth, and had almost quadrupled to EUR 92 billion by June 2013.

2.b. Deposits from Households

In June 2013, euro area deposits from households represented EUR 6,209 billion, of **which deposits from non-domestic euro area households represented only 1.1% of this total** (and 98.9% domestic). Not only non-domestic euro area households' deposits are very small in value, they are also cyclical.

Growth in deposits from households is reliably positive; however the pattern is unstable. Between 2004 and mid-2006 the household deposit growth was around 5% (y-o-y); between mid-2006 and mid-2007 growth gradually accelerated to over 10% (y-o-y). With the start of the crisis it has dropped and is now observed at a rate of between 2 and 4% (y-o-y).

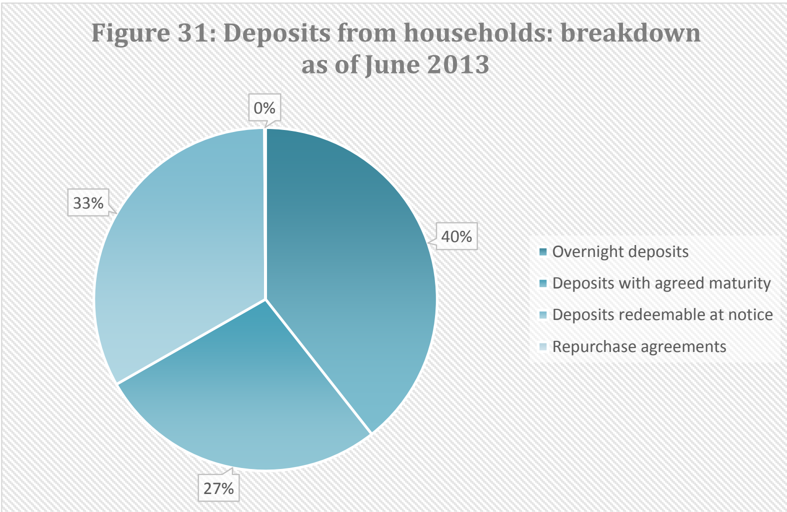
Figure 30: Household deposits: euro area and extra-euro area, stocks, EUR mio



EUR 2,445 billion, or almost 40% of household deposits, is **overnight**. Again, this could be explained by the fact that citizens' current and savings accounts are considered overnight deposits and not term deposits and can thus be withdrawn at any time. Another 27% (EUR 1,699 billion) are household deposits with **agreed**

maturity. Only 45% of those are with the maturity of over 2 years; the remaining 55% or EUR 929 billion are with the maturity of less than 2 years. Within the span of two years, between Q3-2006 and Q3-2008, deposits with agreed maturity of up to one year have doubled in volume (to EUR 1,209 billion in November 2008), after which this category of deposits with agreed maturity lost its shine and was partially taken over by the deposits with agreed maturity of between 1 and 2 years, and partly by the maturities of over 2 years.

Finally, 33% of total household deposits, EUR 2,058 billion, are **redeemable at notice**. Of those, almost 96% are redeemable within less than 3 months. Until October 2009, deposits redeemable at notice of more than 3 months, had been gradually increasing. Since then, they are in a steady decline, giving way more and more to deposits which are redeemed at short notice.



2.b.1. *New deposits from HH and NFC (flow data)*

It is also useful to consider the flow data of new deposits from households and non-financial corporations. Between 2004 and mid-2006 the monthly inflow of new deposits from these two counterparties was quite steady. The period between mid-2006 and mid-2008 was marked by a particularly strong inflow of new deposits. Since October 2008, it slowed down significantly. In June 2013, issuance of new deposits (monthly flow data) was EUR 187.5 billion (36% less than the volume of new NFC and HH deposits issued in July 2011, and 60% less than in June 2008).

Moreover, the *structure* of new deposits has also been going through a transformation. Term deposits, with the maturity of up to 1 year have always been dominant in terms of new volumes: in June 2013 they represented 80% of NFC and HH new deposits with agreed maturity. This category of deposits has been in decline: total new deposits issued in the euro area in June 2013, amounted to EUR 150 billion, which is -41% compared with June 2011 and -66% compared with June 2008.

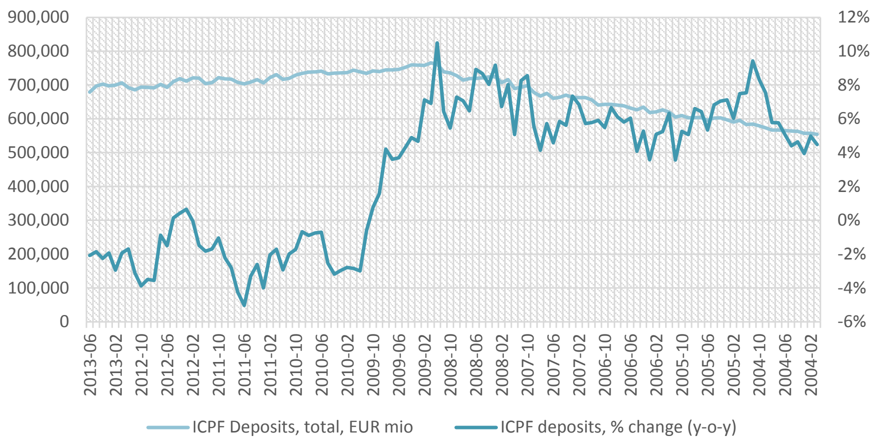
Volumes of new deposits with a maturity of over 2 years, and those of a maturity between 1 and 2 years, are much less important in the total volume of new deposits: they represent 8% and 12% respectively of all new euro area deposits accepted with agreed maturity. Both categories have been growing since mid-2006 to date, taking ever more weight in the term deposit structure, although their volatility has increased significantly. Monthly issuance of new deposits with agreed maturity of between 1 and 2 years has increased by over 40% since June 2008; that of deposits with agreed maturity of over 2 years has more than doubled.

Repurchase agreements on HH and NFC's new deposits has gone down by over 90%.

2.c. Deposits from Insurance Corporations and Pension Funds

The volume of euro area deposit stock from Insurance Corporations and Pension Funds (ICPF) represents only 4% of the total euro area of MFIs' deposits. However, the nature of their deposits is different from those of businesses or households, and therefore important for euro area banks. Until May 2009, the total stock of deposits from the ICPF had been steadily growing at around 4-8% (y-o-y). Following the financial crisis in 2008-2009, insurances' and pension funds' deposits in banks

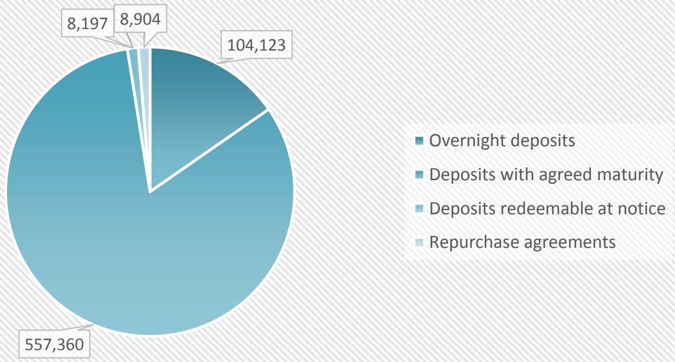
Figure 32: Evolution of total deposit stock of euro area ICPF, EUR mio



started gradually declining, at a rate of-2 to-5% per annum. In June 2013, the total stock of deposits in the euro area totalled EUR 679 billion (a cumulative 10% decline from the peak in February 2009).

The largest share of the ICPF's deposits are with agreed maturity, of which 86% or EUR 478 billion are with **agreed maturity of over 2 years**. The nature of insurance corporations' and pension funds' business is essentially long-term investment, which explains their longer term nature of business with banks. Some 16% of ICPF's deposits with banks is overnight; and only 1% is redeemable at notice.

Figure 33: Composition of deposits from insurance corporations and pension funds, as of June 2013



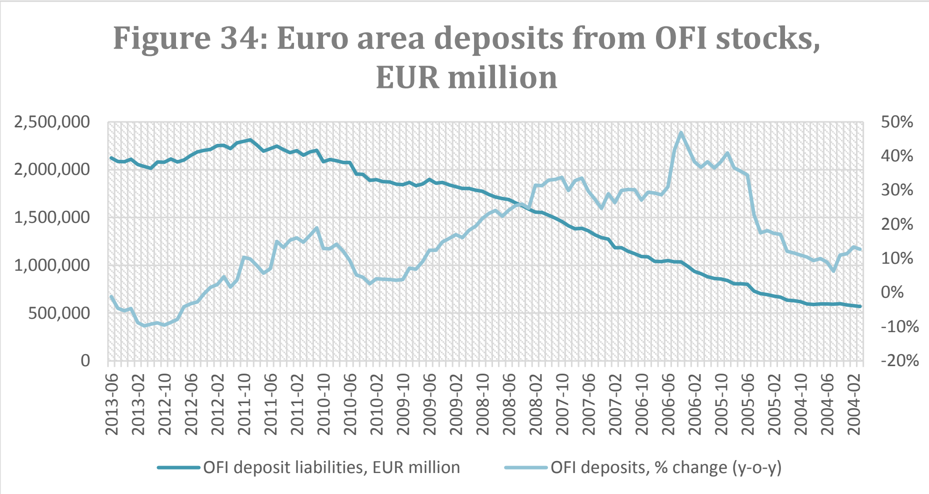
2.d. Deposits from Other Financial Institutions

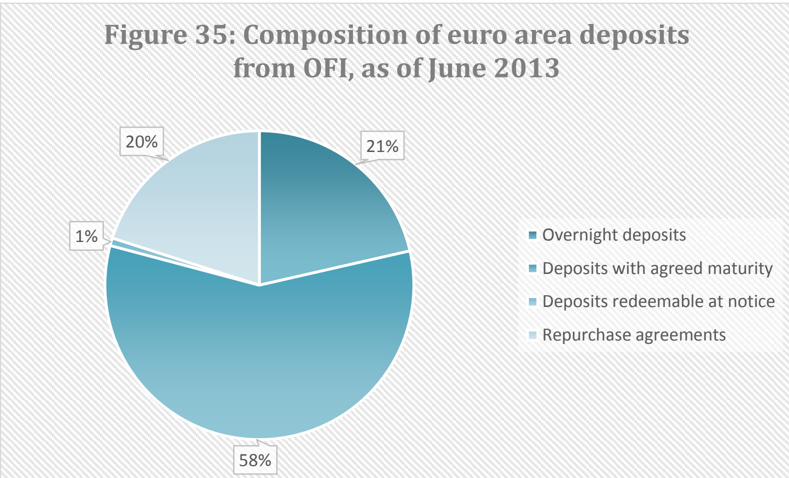
The amount of deposits from Other Financial Institutions (OFI[2]) represents 12% of all deposits in the euro area, and grew fast until the crisis period began. Total volume of deposits from OFIs has more than tripled between June 2006 and June 2013, reaching EUR 2,123 billion. This said, from May 2012 to date, the volume has been on a gradual decline.

The structure of other financial institutions' (OFI) deposit stock is similar to those of insurance corporations and pension funds, owing to a similar nature of business. As a result, almost 60% of all OFI deposits are with **agreed maturity**, over four-fifths (EUR 994 billion) of which are with the maturity of over 2 years. The rest

2 According to the ECB definition, **OFIs are**: Corporations or quasi-corporations other than insurance corporations and pension funds such as investment funds that are engaged mainly in financial intermediation by incurring liabilities in forms other than currency, deposits and/or close substitutes for deposits from institutional entities other than MFIs, also those entities engaged primarily in long-term financing, such as corporations engaged in financial leasing, financial vehicle corporations created to be holders of securitised assets, financial holding corporations, dealers in securities and derivatives (when dealing for their own account), venture capital corporations and development capital companies.

of OFI's deposits are more or less equally split between **repurchase agreements** and **overnight** deposits (over EUR 400 billion each). Deposits **redeemable at notice** comprise only 1% (EUR 17 billion) of the total OFI deposited amount, and are mainly the deposits which are redeemable within 3 months.

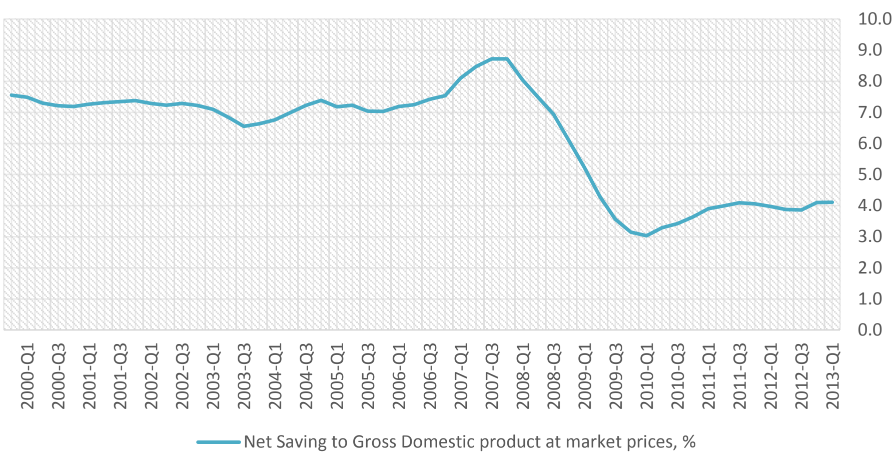




3. Broader Perspective

An economy's level of deposits is linked to the population's desire to save money for a rainy day. For the euro area economy as a whole, **net saving[3] to GDP** has experienced a paradigm shift: from the level of around 7% of GDP between 2000 and mid-2006, it peaked at 8.7% in the second half of 2007, and then fell to 3% by Q1-2010. Since then it levelled at around 4%. In other words, the level of national saving today is roughly two thirds of what it was pre-crisis. Such **net saving** behaviour to GDP reflects its high sensitivity (elasticity) to economic conditions.

Figure 36: Euro area's net saving to GDP, %



Another relevant parameter to consider is the euro area households' ratio of **gross saving[4] to gross disposable income**[5]. After fluctuating between 13 and 14.5%, in 2009 this parameter peaked at 15.2%, to then drop to 12.8% in the first quarter of this year. This shows that no matter crisis or not, well over 10% of gross disposable income of the euro area households is devoted to investment and savings.

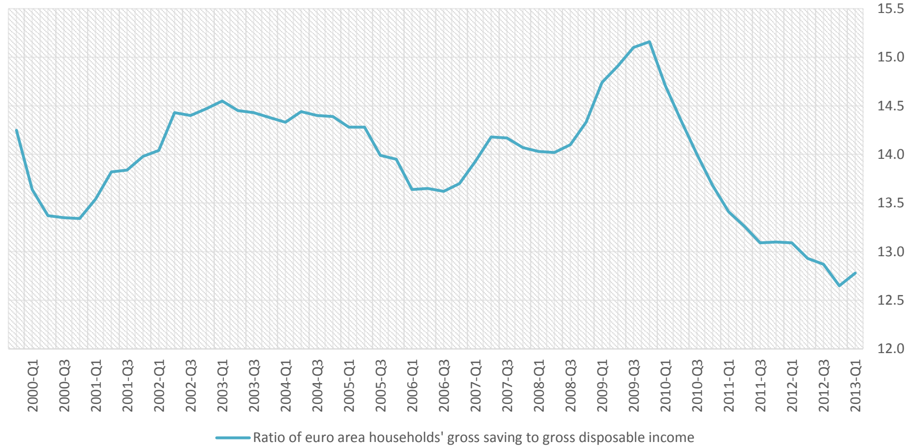
3 **Net saving** is defined as: net disposable income, less final consumption expenditure. Put differently, net saving is: gross national income, less consumption of fixed capital, plus net transfers, less final consumption expenditure (i.e. cash remaining after all income has been spent on consumption and fixed capital, and which is therefore available for investment and/or deposit making).

4 **Gross saving** is defined as: gross income, less total consumption plus net transfers. Or as gross disposable income less final consumption expenditure. In other words, gross saving is the cash that remains, after consumption, for investment and deposit making.

5 Gross income is gross disposable income plus net transfers.

The private sector in the euro area showed resistance to eating into their savings[6]. Private sector debt has been gradually falling in the euro area, from 170% of GDP in 2009 to 167.9% in Q1-2013. **It can be concluded that euro area private sector is on a path of gradual deleveraging: not spending everything they earn, and little by little paying off their debts**. Of course, changes in the saving rate may have as much to do with debt repayments as changes in saving patterns.

Figure 37: Euro area households' gross saving to gross disposable income, %



All this is an important backdrop to the fact that deposit base in the euro area has been inching downwards since the start of the crisis.

Deposit insurance also plays a role in the possible future transformation of the euro area deposit structure. The increase in the coverage level for insured deposits from EUR 20,000 to EUR 100,000 encouraged individual depositors to continue putting more money aside. By contrast, those bank clients, who hold over EUR 100,000 in a bank, may consider alternatives, such as opening another bank account, or investing money in shares or bonds, buying property, etc. The exact formulation of an EU-wide Deposit Guarantee Scheme (DGS) Directive will have an impact on the final choice of behaviour of economic agents. The impact will probably have a different effect in diverse EU Member States, where differences in current regimes persist. Recently, depositors have been seen to adjust their deposit holdings in line with the interim insurance ceiling of EUR 50,000. Increasing awareness of deposit insurance in Europe is set to dictate consumer and SME behaviour. However, big corporates

6 NB: overall euro area picture does not presume that each euro area member country has the same pattern; namely, crisis countries are indeed running down their savings and in some they even take out their deposits and spend them.

and financial intermediaries are expected to place less thought on deposit insurance considerations given their operational needs. As a result, banks can expect DGS to create an impact on deposits made by the NFC and HH counterparties, a bulk of which totals some EUR 8 trillion.

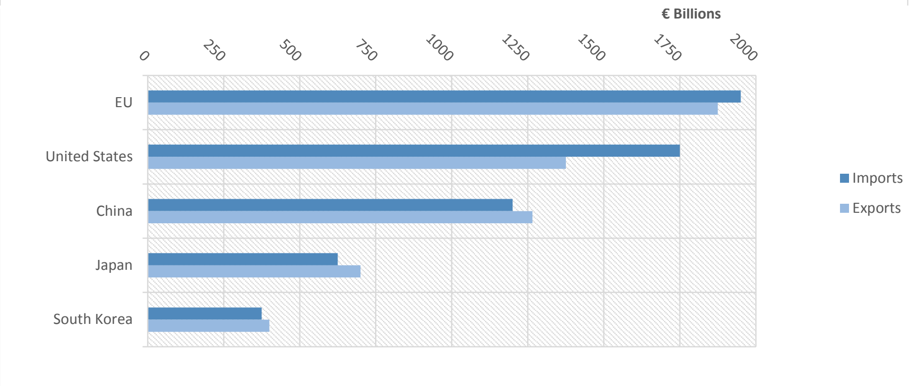
- Chapter 4 -
Finance for International Trade

1. International Trade and the Economy

International trade is closely allied to economic growth, bringing a wide range of benefits, such as greater consumer choice, new ideas and technology, greater competitiveness and more jobs. The World Trade Organisation (WTO) points out in its 'World Trade Report 2013'[1] that world merchandise and commercial services trade reached a peak of US$ 18 trillion and US $4 trillion respectively in 2011. The EU's open economy has drawn much of its prosperity from this source. The EU now represents the world's largest single market, and is the world's largest exporter, with a 20% share of total exports. It is also the world's largest importer; and the largest provider and recipient of foreign direct investment[2].

Europe's exporting prowess has been a lifeline in the years since the financial crisis erupted in 2008. In 2012, EU net exports were the sole component of demand to make a positive contribution to GDP growth, contributing 1.1%, at a time when overall growth fell by-0.3% (Commission Spring 2013 European Economy Forecast)[3]. Merchandise exports alone account for around a third of EU GDP. The new business generated is a formidable job-creator, not only in the sector concerned, but also in other parts of the economy: the Commission has estimated that, for every 10 jobs created in industry, between 6 and 20 new jobs are created elsewhere.

Figure 38: Trade in goods and comercial services 2010, European Commision



1 http://www.wto.org/english/res_e/publications_e/wtr13_e.htm
2 http://trade.ec.europa.eu/doclib/docs/2013/april/tradoc_151052.pdf
3 http://ec.europa.eu/economy_finance/publications/european_economy/2013/pdf/ee2_en.pdf

Against this background, it is not surprising that the promotion of exports is a central part of the EU's current efforts to restore economic growth and increase employment. In fact, for decades, governments around the world have supported their exporters, as a means of stimulating growth at home while supplying goods and services to customers abroad. It is estimated that some 80% to 90% of trade transactions are backed by a financing instrument. Much of this finance is short term (normally up to one year), and self-liquidating, with the credit repaid on delivery of the goods. This type of financing is often obtained through inter-company loans or tailored financial products such as letters of credit. Within the financing world, these shorter term, lower value international sales are termed 'trade finance'. On the other hand, sales of high value, which require credit of two years to beyond ten years, is termed 'export finance'. The length of these loans normally reflects the time required for the goods to be installed and/or generate a return. These export finance or 'export credit' transactions are complex, and engage large companies as well as Small and Medium-sized Enterprises (SMEs). Because of the long-term character of export credit, refinancing such credit is a key task of banks.

It is in the area of medium and long-term export finance, that government support has been most needed, precisely because many of these sales are to purchasers outside the home region, often in developing countries, and require large loans for lengthy periods. Government support has generally taken the form of cover for the risks attached to the export loan.

2. Structures of support for the Financing of Exports

To ensure that exporters obtain the necessary finance to compete on international export markets, many governments provide guarantees and insurance to cover the political and economic risks faced by financial intermediaries. These services are channelled through their Export Credit Agencies (ECAs). ECAs' activities in medium- and long-term export credit usually support capital goods producers, for example for renewable energy and infrastructure projects. They also support SMEs, which are often suppliers and sub-contractors to the bigger companies. From a banking perspective, export credit insurance frees up capital in banks, and thus lowers costs.

The many ECAs around the world exist largely to support their own exporters, who are conducting business in the highly competitive world markets. Since the 1970s, an international set of rules established by the OECD has provided a framework for the activities of OECD members' ECAs. This is intended to ensure that the terms and conditions of the government support are comparable and market-based, and that competition among exporters is based on the features of the goods being sold, rather than the associated financial terms. The OECD 'Arrangement on export credits' fixes levels, terms and conditions of public support[4]. Its general conditions cover different aspects of the export credit contract, such as down-payments, level of official cover of risks, repayment periods and interest rates; as well as the premium charged by the ECA for its cover. Separate agreements provide rules for handling other aspects of export credits, such as their environmental and social effects. (Comprehensive information on export credit in the EU, and the international regimes governing the activity, can be found on the websites of the European Commission and the OECD[5].)

Importantly, the OECD Arrangement contains provisions to ensure the avoidance of subsidies, thereby meeting the objectives of the WTO Agreement on Subsidies and Countervailing Measures. These provisions require, *inter alia*, that premium rates shall be risk-based, and shall not be inadequate to cover long-term operating costs and losses[6].

A major benefit of the ECA insurance backing for export credits is that public insurers can more readily accept high risk and large volumes. This provides borrowers with a reasonably stable source of funding, particularly important at times of market turbulence, as seen recently. The public commitment underlying ECA-covered export credits is often the only way to conduct business in certain countries, where risks and uncertainty make it impossible for private sector companies.

A recent study by the ICC Banking Commission, the 2013 Global Risks Trade Finance Report, has provided a pool of performance data on both short-term trade finance and (for the first time) medium- and long-term export finance. This initiative aims to "evaluate the long-held claim that trade and export finance is a relatively low risk form of financing", and is of considerable potential interest to bankers and regulators. While the collection exercise for export finance will need to be further developed over time, on the basis of this year's data the ICC reported as follows on the overall expected loss (EL): "as with the short-term results, the observed EL figures appear to be lower than the EL one would expect for 'vanilla' corporate lending, reflecting the benefits of the ECA guarantees/insurance.[7]"

The support provided to international trade through insurance and associated finance is very significant in scale and in its influence on global trade flows. Figures from the Berne Union – International Union of Credit & Investment Insurers – show

4 http://www.oecd.org/document/42/0,3746,en_2649_37431_40898090_1_1_1_37431,00.html.

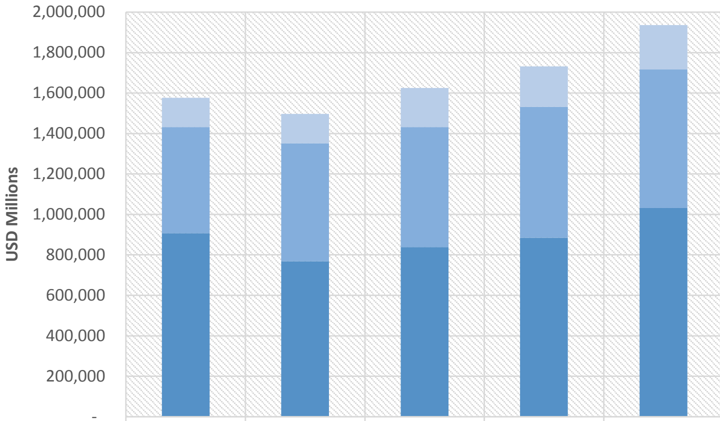
5 http://ec.europa.eu/trade/creating-opportunities/trade-topics/export-credits/index_en.htm; http://www.oecd.org/tad/xcred/.

6 http://www.wto.org/english/tratop_e/scm_e/scm_e.htm

7 http://www.iccwbo.org/products-and-services/trade-facilitation/icc-trade-register/

that the exposure of its members (including ECAs) to medium and long term export credit insurance reached an all-time high of USD 1.7 trillion[8] at the end of 2012. Taking account of short as well as longer term insurance, Berne Union members collectively insured more than 10% of international trade in 2012.

Figure 39 Exposure



	2008	2009	2010	2011	2012
INV - Investment Insurance	145,580	145,785	193,368	200,355	219,348
MLT - Medium Long Term Export Credit Insurance	523,704	582,792	593,089	646,373	684,463
ST - Short Term Export Credit Insurance	907,619	768,525	838,573	884,662	1,032,223

3. Troubled Times

This long-standing framework of support for larger, longer term financing has become more important since the crisis. Unfortunately, in its wake, conditions for European banks active in the market became more difficult.

A number of trends were responsible:

- political and economic risk increased, making buyers and sellers more cautious;
- long term funding costs for European banks rose;
- for a period, euro area difficulties led US-based financial institutions to reduce dollar lines to euro area banks, making dollar funding difficult;
- new banking regulation, in particular the new capital requirements initiated by the Basel Committee, required many banks to improve balance sheet ratios;

8 http://www.berneunion.org/statistics/

- banks took steps to deleverage, reducing their asset volumes in relation to capital, which had the effect of reducing their ability to provide the funding for export credit; and
- pressure from the authorities and market conditions made banks more selective in taking on assets.

Apart from the market difficulties resulting from macro-economic and political trends, it became evident that the nature of the new post-crisis regulation to be imposed on banks was likely to make them less effective in financing economic activity.

In the EU, Member States' export credit activities alone are estimated to have reached a total exposure in excess of EUR 250 billion in 2011, representing a very considerable investment in the European economy. Urgent efforts needed to be focused on preventing the new rules from harming a business which is not only crucial for growth, but also relatively low risk. This threat led to a concerted campaign among banks and industry to raise awareness of the unintended problems for trade. During the legislative process for the EU's Capital Requirements Directive (CRD IV), which implements the Basel III rules, improvements were made to the detail of the legal texts to better reflect the features of the financing of international trade, in particular its low risk. The outcome is seen in the new CRD IV requirements adopted by the EU Council on 20 June 2013, which will enter into force on 1 January 2014[9].

4. What Lies in the Future?

Political leaders and policy-makers (including the G-20 Leaders' group, the Basel Committee, the IMF and the EU institutions) recognise that it would be most unfortunate to introduce measures which would hamper trade at the present time. They are concerned that not only the economies of the export credit donor nations, but also those of emerging markets, might suffer. As a result, steps are being taken to address both legislative and market causes of difficulty.

On the EU legislative side, there remains uncertainty about the application and likely consequences of the main provisions of the CRD IV. The risk that the new rules will damage banks' ability to finance exports has been lessened, although not eradicated. More work is needed, such as exploring the scope for treatment of all assets eligible as collateral at Central Banks (which might in future include export credits) as High Quality Liquid Assets. Areas of uncertainty, such as the treatment of cash outflows under the Liquidity Coverage Ratio remain to be clarified. The European Banking Authority (EBA) will have a crucial part to play in the success of the legislation. It

9 http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/137544.pdf

has the task of reviewing the likely consequences of the main regulatory devices introduced in the CRD IV, with specific reference to the consequences for trade financing, including lending under official export credit schemes. The real economic effects of the entire package will be seen in future years.

The market difficulties referred to above have moderated since the height of the crisis in the euro area, but problems remain. EU banks' difficulty in funding loans, particularly in US dollars for longer durations, is still leading to relatively high interest rates. Depending on the industrial sector and region of activity, many EU-based banks are unable to match the terms offered by their competitors. However in a good number of countries the authorities have adapted the structure of their support to make it easier for banks to access capital markets for funding: for example, by offering securitisation guarantees in addition to the traditional insurance or guarantee. These are welcome steps[10]. Banks, on their side, are working to include institutional investors in government-backed export credit finance, with the job of credit management remaining in their own hands, for example through the issue of covered bonds. Both investors and supervisors will need to know and understand more about the character of this kind of finance and how it works, but the signs are promising.

Such developments, alongside a continuing political commitment to protect trade financing, should enable European banks to continue to play their part in finding a way out of the crisis. In future, the rapid growth of non-EU economies will bring even greater opportunities for Europe's export-oriented economy.

10 See EBF position, 27th May 2013: "Funding conditions in export credit markets: 2013 edition" on www.ebf-fbe.eu.

- Chapter 5 -
National Contributions

Last year's publication of Facts and Figures contained 16 national chapters. This year's publication completes the set of EBF Members' national banking sector descriptions.

1. Bulgaria

The financial sector in Bulgaria is dominated by the banks owing to their traditional role in financial intermediation in the country. In 2012, the number of banks in Bulgaria was 31 as 7 of them were branches of foreign banks (one bank branch was in a process of liquidation). The level of concentration in the banking sector in the country continued to be high despite the fact that there was a decrease in the market share of the five biggest banks, and the total amount of their assets reached 49.5% of the total amount of assets in the banking system, as of December 2012.

The Bulgarian banking sector is dominated by foreign banks as the market share of the EU subsidiary banks was 65.3% at the end of 2012. The total amount of assets in the Bulgarian banking system reached 82.4 billion BGN. The amount of funds attracted by the banks reached BGN 70.7 billion, with national currency dominating the currency portfolio. The Bulgarian banks are of the universal type and the banking system continues to follow its traditional business model orientation by investing most deposits in loans and a part of them in highly liquid assets.

Considering the characteristics of the Bulgarian banking system it should be pointed out there is a high amount of funds attracted from local resources, which reflects the confidence in the national banking system. The liquidity buffers are consistent with the balance sheet structure and business environment perceptions and the quality of the capital remains sustained. The liquid asset ratio remains at levels exceeding 25% in the recent years. The accumulated resources from the household sector in the country continue to play an important role regarding the constant increase of the funds attracted by the banks, thus making the subsidiaries of the foreign banks less dependent on funding by the mother banks.

The higher growth of deposits compared with the growth of loans is a factor leading to the maintaining of higher liquidity in the Bulgarian banking system as well as to changes in the banks' balance sheets as the share of cash and government securities in the banks' portfolios increases compared to the share of assets providing high returns. These features are mainly due to the negative global economic tendencies that affect not only the banks' behaviour but also that of the companies and households. The demand for loans by the companies is weak due to the uncertainty in the perspectives for the economic development. What is more, households keep their strong desire to save, thus leading to constant increase in the level of deposits. Corporate loans were the main driver in the banks' loan portfolios in 2012. Local banks were more active in granting loans as they provided more than 80% of credit growth in the system over the last year. There is tendency for the households to limit the demand for new loans from the banks which is more obvious for the consumer loans.

Credit risk continues to be the major risk for the Bulgarian banks. As a result of the write-off and sales of portfolios, as well as the acquisition of collateral, there was a decrease in the total amount of overdue loans (over 90 days) in the last quarter of 2012.

The trends in the classification structure of the assets reflect the intensive credit risk management performed by the banks. The indicators for the banks' profitability and management are influenced by the macroeconomic environment. At the end of 2012 there was a slight decrease in the profit realised by the banking system and the ROA and ROE equalled 0.71% and 5.71% respectively. The main factors affecting negatively the banks' profitability were related to a decrease in the net interest margin, lower revenues from fees and commissions realized by the banks, and increased expenses for provisions. Additionally, the lack of investment alternatives, low demand of loans as well as the lack of enough optimization in the administrative expenses of banks led to the decreased profitability of the banking system.

The regulatory capital of the banking system is characterized by retained soundness and quality of the capital position, strengthened reserves and Tier 1 capital, and the favourable effect of the actions initiated to reduce the risks in the banks' loan portfolio. At the end of 2012, the total capital adequacy of the Bulgarian banking system was 16.66% and the adequacy of the Tier 1capital, 15.16%. These levels are significantly higher than the minimum levels for the Bulgarian banking system according to the regulatory requirements which are respectively 12% and 6%. The available capital surplus provides additional buffer for covering the classified exposures of impaired assets.

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2. Cyprus

The banking sector in Cyprus comprises two tiers: (a) locally active commercial banks, subsidiaries and branches of foreign banks which are supervised by the Central Bank of Cyprus (CBC) and (b) Co-operative Credit Institutions.

The Cooperative Credit Societies came under the supervision of the CBC as from the end of July 2013, as part of the agreement for an economic adjustment programme between the Cypriot government and the European Commission, the European Central Bank, and the International Monetary Fund (the "Troika").

The domestic banking sector represented until 2012, 550% of the country's GDP. Following the decision reached by the Eurogroup on the 25 March 2013, the country's two major banks (Cyprus Popular Bank and Bank of Cyprus) have undergone resolution and restructuring, aimed at bringing down the size of the banking sector as a percentage of the country's GDP to the EU average by 2018. It should be noted that the shrinkage of the sector was implemented abruptly, through the imposed bail-in of unsecured debtors. Other than the capital controls, that apply to cash held as of 26 March 2013, the rest of the banks operating in Cyprus were not affected by this decision.

Banks have traditionally dominated the domestic financial system, holding approximately 80% share of loans and deposits. Beyond the traditional deposit and lending services (to households, corporations, SMEs), banks in Cyprus operate under the "universal banking model" as they offer a diverse range of products and services. Their operations include hire purchase finance facilities, investment services, factoring and invoice discounting services, electronic and telephone banking, private banking as well as all types of insurance services. Deposits from customers have traditionally been the main source of funding for banks. During 2012, the number of bank staff declined by 2% and the number of bank branches declined by 6%. During the first 7 months of 2013, a further 16% of employees participated in voluntary retirement schemes. This trend is expected to continue as the two largest banks restructure following the decision of the Eurogroup and the signing of the economic adjustment programme with the troika.

a. General overview

Banking sector developments in the past twelve months were dominated by the decisions of the Eurogroup on 25 March 2013, and the conclusion of an agreement with the Troika for a loan of EUR 10 billion and for funding from own resources. As a precursor to this loan agreement, a decision was taken by the Eurogroup that resulted in a substantial reduction in the size of the banking system as well as in the resolution of the second largest bank in Cyprus and the restructuring and recapitalization of the largest bank in Cyprus.

It should be stressed that up until the Euro Summit decision of 26 October 2011, when the sharp write-down of Greek state bonds was decided, Cypriot banks proved to be remarkably resilient to international and domestic shocks. The Greek PSI cost the three largest Cypriot banks a total amount of EUR 4.5 billion, an amount equivalent to 25% of the country's gross domestic product. Several days prior to this political decision, the International Monetary Fund mission that had just completed the regular review of the Cypriot economy and banking sector based on Article IV procedures concluded: "Cyprus' large banking sector, with assets of over eight times GDP, is a pillar of the economy, directly generating a high share of jobs and income, and indirectly supporting other business services."

Losses from Greek government debt exposures and the ongoing recession have had a considerable negative impact on the banking system, capsizing the stability and profitability of the previous years. When Cyprus became the fifth member state to request financial assistance, the Bank of Cyprus and Cyprus Popular Bank were found to be in need of sizeable capital injections to reach minimum capital adequacy. As part of the Agreement, the Troika stipulated that no support would be provided for the recapitalization of the island's two main banks and that they would undergo resolution and bail-in of unsecured depositors.

A comprehensive framework was legislated for the recovery and resolution of credit institutions, naming the Central Bank of Cyprus as the single resolution authority. On the basis of this framework, the resolution of Cyprus Popular Bank and Bank of Cyprus took place. Bank of Cyprus became fully recapitalized through the full contribution of the shareholders and bondholders of the bank and through the conversion of 47.5% of the uninsured deposits into equity. The insured deposits, part of the assets and the interbank liabilities and the Emergency Liquidity Assistance (ELA) of the Cyprus Popular Bank were transferred to the Bank of Cyprus. Uninsured deposits and remaining assets were left in the Cyprus Popular Bank which is under liquidation. As the value of the transferred assets exceeded the value of the liabilities, the unit under liquidation received shares in the Bank of Cyprus amounting to 18% of its share capital. Insured depositors in both banks (representing over 95% of the total number of account-holders in the two affected banks) have been fully protected. Additionally, the Greek subsidiaries of Cyprus banks were sold off.

The bail-in of both banks has now been completed and Bank of Cyprus has now been fully recapitalized and taken out of resolution. This represents a key step towards restoring normal operations. The Bank's core Tier 1 ratio is over 12% and has regained its eligible counterparty status for participating in regular Eurosystem monetary policy operations.

As a condition of the reform programme, all banks and cooperative credit institutions have to maintain a minimum core tier 1 capital ratio of 9% by 31 December 2013. The cooperative credit institutions are in process of being recapitalized by the state using EUR 1.5 billion from the loan programme, thereby making the state the majority shareholder. An additional amount of EUR 1 billion of funds from the economic assistance programme has been earmarked for the recapitalization of any other financial institution deemed viable, which has a capital shortfall and fails to recapitalize through private funds. Additionally, the reform of the cooperative sector is under way, involving mergers and restructurings, which is expected to result in 18 financially sound cooperative credit institutions (from 93).

b. Regulation and Supervision

To strengthen the credit institutions' ability to withstand shocks, the CBC will review the current regulatory framework with respect to the entire loan process to identify and address any gaps. The CBC will introduce tighter rules on the composition of the boards of credit institutions and on lending to Board members. In addition, the governance of the CBC will be enhanced through the appointment of two executive directors. The central credit register will be strengthened to allow a better assessment of the credit worthiness of borrowers as well as better pricing of loans. A framework for dealing with troubled borrowers is being introduced.

c. Restrictive measures

In order to alleviate the pressure on bank liquidity while the restructuring of the sector took place, exceptional measures were necessary to prevent large deposit outflows. Cash withdrawals, electronic payments and transfers abroad were temporarily restricted. The measures have gradually been relaxed. The authorities are looking for ways to lift them as soon as conditions allow and have agreed with the Troika a roadmap of milestones to achieve this.

d. Financial Transparency

Cyprus has been handed a clean bill of health in the recent independent evaluations, which discredited mounting accusations by its European partners of a weak anti-money laundering (AML) system. The two parallel audits, conducted during April 2013, by Deloitte Financial Advisory (Italy) and Moneyval of the Council of Europe, which were set as a precondition for the international bailout, evidence the island's commitment to strict implementation of effective anti-money laundering measures. Moneyval and Deloitte have prepared their reports following an in-depth assessment/audit of the effective implementation of the Customer Due Diligence requirements in Cyprus banks. It should be noted that the nature and depth of these assessments are unique as no other European Member State has been subjected to such a rigorous and exhaustive AML check to date.

The outcome of the assessments indicates a solid level of compliance across the sector. The findings made no reference to systemic deficiencies, according to the Central Bank of Cyprus. On the contrary, the reports indicated that the standard building blocks are in place, the AML preventive measures and procedures in banks are sound, and in general, the banks have a high level of compliance with the statutory and regulatory requirements, which in some areas are more demanding than the EU and international requirements.

The AML regime in Cyprus will continue to apply, and to follow the FATF and EU recommendations on AML; it will be strengthened where and when necessary. The upcoming amendments in the CBC's AML Directive will enforce further AML controls on Cyprus banks, and will continue to be stricter than the EU AML standards.

e. The Road Ahead

Despite the short-term pains of adjusting to a stricter framework of fiscal discipline and stronger supervision, the economic adjustment programme is aimed at creating a robust banking sector with an even stricter regulatory framework. Based on our international lender's assessments, the financial adjustment programme, ensures that the country's public debt will be sustainable, a necessary condition for Cyprus' future economic prosperity. The major structural reforms, underway, at all levels of economic activity, and the continuous monitoring of the programme implementation by the Troika, provide the opportunity to international investors to reaffirm their presence in a financially healthier Cyprus in the years to come.

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3. Estonia

Estonian banking sector consists of 17 banks of which 8 are licensed credit institutions in Estonia and 9 are operating as branches of foreign credit institutions. Banking sector assets constitute EUR 19.37 billion accounting for 113% of Estonian GDP. The Estonian banking sector is dominated by Scandinavian Banking groups holding 95% of banking sector assets.

The market is chiefly divided between Swedbank, SEB Bank, Nordea Bank and Danske Bank. Banks are serving 2.2 million corporate customers through 165 bank branches. Estonian customers are operating 1.8 active current accounts per 1 inhabitant and 1.25 active internet bank accounts per 1 inhabitant. Estonian banks have issued 1.4 bank cards per inhabitant, 80% of issued cards are debit cards, and 20% credit.

Banks hold EUR 12.60 billion worth of deposits and operate loan portfolios to the value of EUR 18.31billion. The rapid growth of deposits in the real sector in recent years has allowed banks operating in Estonia to base their financing on domestic retail deposits. The volume of domestic household and corporate deposits grew by around 700 million euros, or 9%, in 2012 meaning that the loan-to-deposit ratio fell to 1.1 by the end of 2012, despite the increased borrowing activity and growth in the loan balance, seen during the year. Cash flows from domestic repayments of loans and the increased deposits from the real sector are enough to finance the current loan turnover. The banks have not required any additional resources to fund domestic lending activity since the fourth quarter of 2008. Alongside the domestic deposits, deposits by non-residents in banks in Estonia have also sharply increased since the second half of 2012. The growth in deposits has allowed the banks to pay back the funds, they received from their parent banks and decrease their dependence on being financed by them. Deposits rose as a share of banks' liabilities by 5% at close of 2012 from the 78% level a year earlier. Now, even though the banks in Estonia need substantially fewer funds from their parent banks, they are not completely independent of the financing circumstances of the parent banks. Hence, negative developments for the parent banks would probably have an effect on the price of funds of Estonian banks and on their lending offers.

Estonian banks maintained stability through the crisis years without external intervention. Various crisis management procedures set in place multilaterally by EU institutions, central banks, and banks operating in the region etc. helped to sustain financial stability. The year 2012 was a successful one for banks operating in Estonia and net income rose by 8% and Estonian banks earned EUR 350 million.

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4. Germany

Germany's banking system comprises three "pillars"—private commercial banks, public-sector banks, and cooperative banks—distinguished by the legal form and ownership structure.

- The private-owned commercial banks represent the largest segment by assets, accounting for 39% of total assets in the banking system. They include both big and small banks, banks operating worldwide and banks with a regional focus, universal banks and banks specialising in individual lines of business. An important feature of the private banks is that they compete keenly not only with banks in other sectors of the industry, but also among themselves.

  The private banks play a key role for German export economy: they are involved in 80% of German exports. The private banks maintain almost three quarters of the German banking industry's foreign network.
- The public banking sector comprises savings banks (Sparkassen), Landesbanken and the DekaBank, which acts as the central asset manager of the Savings Banks Finance Group and represents 28% of total banks' assets.
  - ◊ There are currently 426 savings banks. They are normally organised as public-law corporations with local governments as their guarantors/owners. The basis for their activities is set out in the savings bank acts and savings bank regulations of Germany's federal states. Their business is limited to the area controlled by their local government owners. Other than this regional focus, their business does not differ in any way from that of the private commercial banks. As a result of the so-called "regional principle", savings banks do not compete with one another.
  - ◊ Landesbanken were originally designed to act as central banks for the savings banks. In recent years, however, they have been increasingly involved in wholesale funding, investment banking, and international business activities, thus directly competing with commercial banks. The Landesbanken are owned by the federal states and the regional associations of the savings banks. During the financial crisis, several Landesbanken required state support. At present, there are still eight Landesbanken.
- In the past, savings banks and Landesbanken were backed by state guarantees (Gewährträgerhaftung and Anstaltslast). The state guarantees were of key importance to Landesbanken since they enabled them to obtain AAA ratings and lower their funding costs. These guarantees were terminated in July 2005. Grandfathering arrangements remain valid until 2015, however.

The cooperative sector consists of cooperative banks (Volks- und Raiffeisenbanken) and two central cooperative banks (DZ Bank AG and WGZ Westdeutsche Genossenschaftszentralbank eG). It accounts for around 55% of institutions by number and 12% of total bank assets. The cooperative banks are owned by their members, who are usually their depositors and borrowers as well. By virtue of their legal form, cooperative banks have a mandate to support their members, who represent about half their customers. But cooperative banks also provide banking services to the general public. Like the savings banks, cooperative banks have a regional focus and are subject to the regional principle.

The number of banks in Germany has dropped sharply in recent years, and by 45% since 1995. Consolidation to achieve economies of scale has taken place largely within the existing "pillars", and mostly in the savings bank and cooperative sectors. In most cases here (in opposite to mergers in the private sector), consolidation has been the result of stress rather than proactive business considerations. After the mergers between Deutsche Bank AG and Postbank AG and between Commerzbank AG and Dresdner Bank AG, the potential for consolidation in the private sector has probably been largely exhausted.

Unlike in other European countries, current German law does not allow private-owned banks to have stakes in public-owned banks which have been created by law (such as most savings banks). However, some Landesbanken and savings banks have bought private banks. The level of public involvement in the system therefore remains substantially unchanged and continues to be much higher than in other countries of the European Union.

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5. Hungary

Hungary is a small, very open economy and its financial sector is tightly linked to Western Europe. Most of the financing of the economy is done by banks whereas capital markets are relatively underdeveloped and with the nationalization of private pension funds the role of banks has increased in importance.

a. The Banking Sector in Hungary

Credit institutions in Hungary employed roughly 39,000 people at the end of 2012. Gross value added (GVA) by the financial sector was 4.5%, and within that GVA of the banks was 3.2% of total GVA by businesses in 2012.

There were 29 banks, 6 private specialized credit institutions (mortgage banks and building societies), 9 foreign branches (with a single European passport) and 128 savings cooperatives with licence to do business in Hungary at the end of 2012. The level of concentration is moderate, the share of the 5 largest banks' total assets is 55%, while the share of the so called big banks' assets (the 8 largest) is 75%. However, in certain segments of the market, concentration is more evident. Foreign ownership is dominant in the Hungarian banking sector as more than 90 % of all assets are controlled by parent banks in developed countries, mainly in Austria, Belgium, Germany and Italy. During and after the crisis these parent banks played an important stabilising role in Hungary by securing financing and capital in the spirit of the Vienna initiative.

b. Deleveraging

The Hungarian banking sector has undergone significant changes since the financial crisis. The reasons are twofold. On the one hand, there was a need to adjust to the new reality, which in the Central and Eastern European region also meant the 'stand-alone' banking model, whereby as far as possible subsidiaries must provide the necessary funding and capital in their balance sheet by themselves. This required a significant deleveraging in the Hungarian banking sector and, as a result, the loan-to-deposit ratio decreased from 152% in 2008 to 114% in 2012. Total banking assets to GDP declined from 134% in 2009 to 106% in 2012. On the other hand, the government sensing the general mistrust and dissatisfaction with banks by the public at large introduced heavy taxes on the banking sector in several rounds so as to make the banks share part of the burden caused by the financial crisis. These banking sector specific taxes are the highest in Europe and by starving banks of capital they accelerate the deleveraging process further.

To a large extent, the deleveraging reflects the necessary and painful reduction of the outsized foreign exchange (fx) denominated loan book that built up pre-crisis. In the last 3 years two relief schemes were introduced by the government, with limited burden sharing, that speeded up the decrease in foreign exchange loans. The share of fx in household credit declined from around 70% at the end of 2008 to 55% by the end of 2012. This process is still going on and the government declared its intention to phase out fx-loans as soon as possible. In the corporate sector the decrease was only modest as many firms are in a natural hedge position but the share of Swiss franc loans, where natural hedge is not typical, declined from above 16% in Q4 2008, to 9.5% in Q4 2012.

c. Profitability and capitalisation

The previous relief schemes and the large sector taxes put a great burden on banks on top of the costs that the bursting of the credit bubble and the recession caused. Thus, in spite of the downsizing and cost-cutting programmes the banking sector overall made deep losses in both 2011 and 2012. Banking sector ROE was -6.3% in 2012, a slight improvement from 2011. Banks have laid off 11% of their workforce since 2008 and closed 9% of their regional branches since 2009. The cost-to-income ratio of banks was 50% in 2012. Despite these difficult circumstances the Hungarian banking sector remained stable, thus none of the banks needed government bail-out either during the crisis or afterwards. The banking sector is highly liquid and well-capitalized, the capital adequacy ratio stood at 15.7% at the end of 2012.

d. Banking Regulation and Policy

Currently, the Hungarian Supervisory Agency (HSA) is responsible for supervising the financial sector in Hungary. Its tasks involve the regulation of both financial institutions and markets, the protection of customers and investors, licensing and prudential legal enforcing. Maintaining oversight of the payment system and the day-to-day liquidity situation of banks belongs to the central bank (CB). Frustration about the inability of banking regulation to prevent the build-up of household fx-debts during the time leading up to the crisis, and also about the role of the tripartite Financial Stability Board (consisting of the HSA, the Central Bank (CB) and the Ministry for National Economy), led to a government initiative to merge the HSA with the CB. The motion is in the Parliament, and the ECB already gave a conditional nod to the plan, which is to go into effect in 2014.

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6. Iceland

Although the Icelandic banking sector was hit hard during the financial crisis of 2008 the transformation and restructuring of the banks laid solid foundations for the continuation of highly developed banking services. The commercial banking sector now consists of four universal banks. Three of them are continuations of the three large banks that failed during the crisis of 2008. The fourth survived the crisis but has been restructured and recapitalised after a change of ownership.

Along with those four major banks, the banking sector is made of one investment bank, based on the estate of one of the failed banks, and nine small saving banks that operate in the rural areas. The banks and savings banks operate 115 branches all around Iceland and employ around 3,300 people.

During the crisis of October 2008 the parliament passed emergency legislation which gave deposits priority over the claims in default estates of deposit institutions. The legislation also granted the Icelandic FSA power to take control over failing financial institutions and dispose of assets and liabilities and set up new banks. Most domestic assets and liabilities, including deposits, were transferred to the new banks at fair value and at the same time other assets and liabilities remained in the estates of the default banks. Today the ownership of two of the major three banks is primarily in the hands of the estates of their predecessors and the Icelandic state is the owner of the third one.

The restructuring of the banking system implies a huge balance sheet adjustment. Total assets have shrunk from ISK 14,900 billion in Sept. 2008 to ISK 3,008 billion at end of July 2013 or what amounts to ten times the GDP to under twice the GDP. The banks are predominantly funded with domestic deposits which are around ISK 1,591 billion or around 100% of GDP at the end of July 2013. On average, 47.8% of total financing of the banks comes from deposits, 17.8% from equity, and 28.3% from bond issuance, first and foremost the issuance of contingent and covered bonds. Total loans in the banking sector amount to ISK 1,801 billion.

All major banks have been profitable since the start of operation four years ago, but with irregular factors, such as sale of assets and revaluation of loan books contributing to the Return on Equity. Average interest rate margin has risen, reflecting partly the increased share of retail deposits in bank funding. Capital adequacy ratios (CAR) have risen well above the 16% requirement by the regulator and are now generally in the range of 20-25% of risk weighted assets.

Since the Icelandic economy was highly leveraged when the financial crisis broke out in 2008, debt restructuring has been a key issue in the banking sector over the last four years. The currency crisis resulted in a devaluation of the Icelandic Krona by over 50% compounded by the debt crisis, as the majority of corporate debt and a significant share of household debt was foreign currency linked or denominated in foreign currency. Some ISK 50 billion of household debt has been written off in the past four years through various forms of payment and debt restructuring. This amounts to little less than 13% of GDP. The write- downs of corporate debt amount to ISK 1,000 billion. The banking sector has been able to go to those extreme measures without challenging the capital adequacy ratios (CAR) required of the new banks, 16%, because all of them have CAR above 20%. This debt restructuring along with a gradually improving overall economic performance has led to steady improvement of delinquency ratios.

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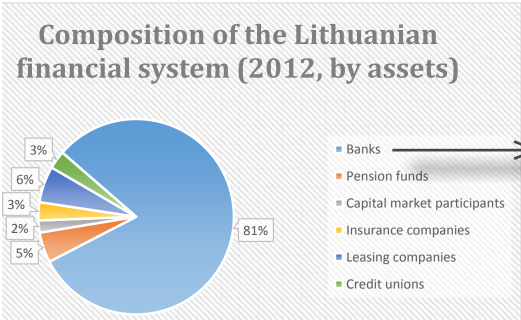
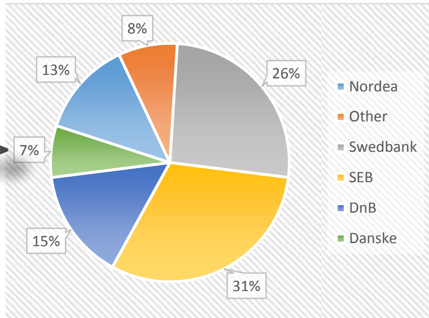
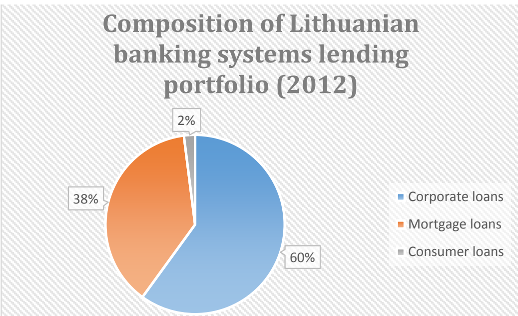
7. Lithuania

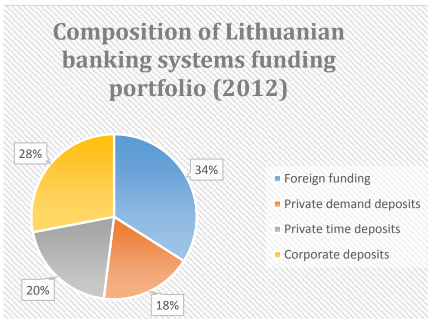
The Lithuanian financial system is dominated by the banking sector which represents more than 80% in terms of assets. Currently 7 commercial banks hold a licence from the Bank of Lithuania. Alongside those, 9 foreign bank branches and 2 foreign banks' representative offices are based in the country, and 268 EU banks provide cross-border services in the Republic of Lithuania without having a branch operating in the country.

Lithuanian banking market is dominated by universal Scandinavian banks such as Danske, DnB, Nordea, SEB and Swedbank. The two largest banks, SEB and Swedbank made up 57% of the total market by assets. The Lithuanian banking sector's total assets amounted to EUR 22 billion in 2012 (66% of GDP).









The Lithuanian banking sector has undergone major changes over the last 10 years. In 2002, the banking sector's assets made up only 32% of the country's GDP. The ensuing economic expansion, together with a rapid lending expansion, supported mostly by Scandinavian parent banks' funds flowing into the market, boosted banking sector's assets to GDP ratio to a peak of 92% in 2009.

The economic crisis, which started in 2008, had a severe impact on the banking industry. New lending has stalled and high provisioning and write-down of loans (mostly given to sectors most severely hit by the economic downturn e.g. real estate and transportation) led to assets to GDP ratio gradually dropping to 66% in 2012. Market gross lending portfolio shrank by almost 1/3 during 2008-2012.

Despite this shakedown, the banking sector proved to be stable and able to withstand high shocks: no bank went bankrupt or required financial aid from the country during the financial crisis period (2008 - 2012).

Local deposit growth over the crisis period is also proof of trust in banking systems' stability: the compound annual growth rate of deposits over the crisis period (2008-2012) stood at +2%. Banking market's loan to deposit ratio fell from 211% in 2008 to 137% in 2012 shifting the banking system funding from foreign to local.

At present, signs of stabilisation and recovery are seen: most of the write-downs have already been made; lending portfolio contraction has almost stopped; new lending activities show slight improvements in the private sector, and corporate new lending trend will also soon change its direction to positive.

The main risks to the country's financial system are related to external factors, like continuing sovereign debt crisis which may intensify further and spill over to the real economy by triggering a serious and long-term economic downturn in euro area countries. Although the sovereign debt problems have had no direct effect on our country's financial system, the worsening situation in the euro area may hamper domestic export, affect expectations and confidence in general, and boost funding costs for financial institutions.

Banking sector's profitability has reached pre-crisis level. Banks have strengthened their capital: Capital Adequacy Ratio reached 15.3% in Q1 2013 (minimum requirement is 8%). Recent stress-testing results have revealed that the banking sector is capable of withstanding severe shocks, but some banks should boost their capital reserves.

It should also be noted that operations of two banks were stopped over the last 2 years (at the end of year 2011 and beginning of year 2013). Reasons behind this were mainly related to poor corporate governance and inability to meet sustainable banking standards. Consequently, the fact that the operations of the two banks were stopped had only minor influence on the banking system.

To sum up, the local banking market in recent years has become stronger, more resilient to external and internal challenges and better prepared to work in the new economic environment.

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8. Latvia

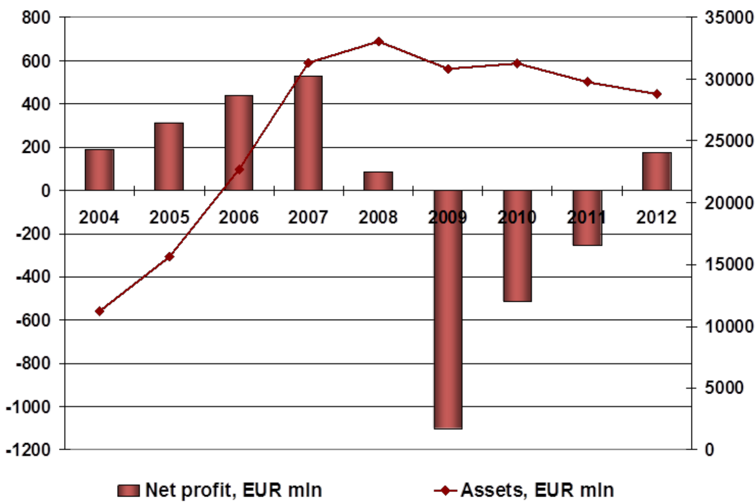
Latvian banks form an important sector of the national economy, amounting to about 6% of gross domestic product (GDP). Overall in 2012, the performance of banks could be characterised by a sound and modest growth in view of the recovery of the Latvian economy after the crisis, as well as its growth in, and stabilisation of, lending. In 2012, GDP in Latvia increased by 5.5%, whereas unemployment rate fell to 14.9%. The banking sector recovered from the crisis of 2009-2011: its profitability has resumed, banks now ensure high capital adequacy and liquidity ratios, and the quality of their credit portfolios has improved.

a. Bank Activities

In 2012, 29 banks and branches of foreign banks were operating in Latvia, and of them 20 were registered in Latvia and 9 were branches of banks registered in the EU. 12 branches of Latvian banks were operating abroad.

As of end-2012, total assets of the Latvian banking sector amounted to EUR 28.8 billion. Year-on-year, assets had decreased by 3.3%, triggered by the exit of two problem banks from the market. Excluding the data of those two banks, total bank assets had increased by slightly more than 4% in 2012.

Overall in 2012, the banking sector was performing with a profit that amounted to EUR 174 million. Bank profitability was positively affected by a further stabilisation of the quality of the credit portfolio, and consequently, smaller loan loss provisions, as well as increasing income from commission fees and trading in financial instruments.

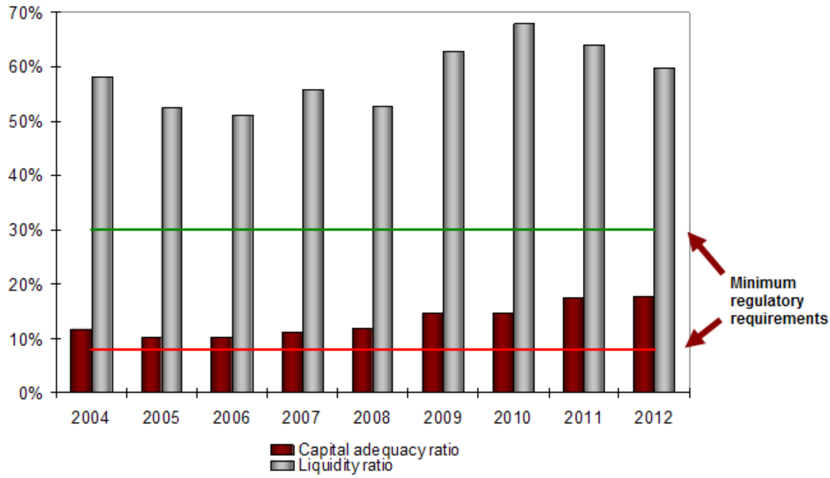


In 2012, the dynamics of the credit portfolio could be characterised as an attempt to break the downward trend that had been in evidence for over four years. With the volume of repaid and written-off loans still exceeding the flow of new loans, total credit portfolio of the banking sector also fell to EUR 16.7 billion in 2012; however, the accelerating lending activities contained the trend. Banking was dominated by lending to the corporate sector, i.e., loans to businesses. Lending to private persons was less pronounced in 2012.

At the end of 2012, the volume of deposits with banks was EUR 18 billion. Year-on-year, deposits had increased by nearly 13%.

In 2012, the capitalisation level of the banking sector remained high and several banks strengthened their capital base by including in it the profit of the current year of operation and also increasing their share capital. Capital adequacy ratio of the banking sector reached 17.6% at the end of 2012 (the minimum capital requirement was 8%).

In addition, liquidity of the banking sector was unfailingly high: at end of December 2012, the liquidity ratio was 59.7%, twice exceeding the established minimum requirement.



b. Regulation and Supervision

In Latvia, the activities of credit institutions are governed by a special Credit Institution Law, as well as other laws and regulations drawn up by the supervisory authority. Bank operations are supervised by the Financial and Capital Market Commission, an independent and professional supervisory authority. Banking regulations, including the norms for preventing money laundering and terrorist financing, fully comply with the highest EU and international standards to ensure credible, transparent and efficient operation of banks.

In Latvia, interests of depositors are safeguarded by the Deposit Guarantee Fund whose funding is ensured by bank contributions on a regular basis; furthermore, deposits of up to EUR 100,000 are guaranteed by the state. In 2010, the financial stability fee was introduced in Latvia; its volume is established in a special law and is calculated in light of bank assets. Instead of accumulating the fee in a special fund, it is credited to the total revenues of the state budget.

c. Challenges in 2013

For the Latvian economy in general, the greatest challenge in 2013 is to maintain the growth begun. At the same time, banks must ensure funding for economic development. Even if banking risks have diminished considerably compared to that seen during the crisis, both external and internal risk factors should still be taken into account. In view of Latvia's intention to join the euro area and introduce the euro on 1 January 2014, banks will increasingly pay attention to the transition from the Lats to the euro, throughout 2013, to ensure a comfortable and understandable currency exchange process for the public at large. Corporate social responsibility issues, especially activities towards improving financial knowledge, gradually rank higher in banking activities. The aim is to raise Latvians' awareness and understanding on financial and economic issues.

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9. Malta

Over the past two decades, the banking sector in Malta has grown from four retail banks serving the local population to 26 licensed banks, only three of which are Maltese majority-owned. The other banks originate from various EU and non-EU jurisdictions, including Austria, Australia, Belgium, Germany, Greece, Kuwait, Portugal, Turkey and the United Kingdom. As such, around 96% of the banking sector's total assets of around EUR 53 billion are foreign-owned.

The sector is very diverse in terms of inter-linkages with the domestic economy, and can be split into three groups according to the extent of linkage with the Maltese economy.

(i) Five "**core domestic banks**", whose assets (around EUR 14.3 billion) represented 211% of Malta's GDP at the end of 2012, and which employ 86% of the sector's workforce numbering around 4,000 employees. Two of these banks are the local market leaders, owning over 80% of this group's assets, and operating 63 of the 89 core bank branches on the Maltese islands. The core banks exercise a conservative business model consisting mainly in the raising of deposits and the granting of loans to Maltese residents.

These banks rely mainly on resident deposits for their funding, and have a stable deposit base thanks to the high propensity of Maltese households to save. Their loan-to-deposit ratio is low, at around 70%, and this insulated the banks from the volatility on the international wholesale markets during the financial crisis. In effect, the banks did not need any Government support, nor did they need to resort to the ECB's long-term refinancing operations to any meaningful degree to improve their liquidity. On the asset side, over 98% of total loans are to Maltese residents, with the banks applying prudent lending norms and loan-to-value ratios, as well as a cautious valuation of collateral. Their investment portfolios are also widely diversified in well-rated securities.

Overall, the core domestic banks are characterized by a sound capital base (Tier 1 CAR of around 10%), high liquidity and a healthy profitability (return on assets of 1.4%, and a return on equity of around 20%). These positive features were acknowledged in the International Monetary Fund's Report on Malta for 2013, which attributed to Malta's remarkable economic resilience in the past few years, its sound banking system, and its robust export growth.

(ii) Eight "**non-core domestic banks**", whose assets (EUR 5.3 billion) represented 78% of Malta's GDP at the end of 2012. These banks undertake some business with Maltese residents, but not as their core activity. Resident deposits only represent around 10% of total liabilities for this banking group. On the asset side, resident assets likewise account for only 9% of total assets, which are largely diversified between non-resident loans to companies and banks, as well as a mix of corporate, Government and other banks' debt securities. With a Tier 1 capital adequacy ratio of around 26%, these banks have a good shock absorbing capacity to cover a potential deterioration in asset quality. Considering their limited exposure to the domestic economy, these banks are deemed not to pose a threat to domestic financial stability.

(iii) Thirteen **internationally-oriented banks** which are mainly subsidiaries and branches of large international institutions. These banks have almost no links to the domestic economy, with resident liabilities and resident loans both standing at less than 0.5% of the respective totals. Their combined assets, amounting to EUR 33.3 billion at the end of 2012, represented around 500% of Malta's GDP. They finance themselves mainly through the wholesale market or through their parent banks, and deal mainly with intra-group activities. Overall, this group is also very well capitalized, has strong liquidity, and is profitable. Here again, there is a very low level of business carried out with residents, and the fact that these banks have negligible contingent claims on the Deposit Guarantee Scheme, mitigates possible concerns regarding the size of their asset base in relation to GDP, or the threat which they might pose to domestic financial stability.

Since 2002, the Malta Financial Services Authority (MFSA) has assumed full regulatory and supervisory powers as the single regulator for financial services in Malta. The MFSA is therefore the sole regulator for all banking, investment, and insurance business carried out in, or from the Maltese islands. On the other hand, the Central Bank of Malta is primarily responsible for maintaining price stability through the formulation and implementation of monetary policy. It is also responsible for the promotion of a sound financial system and orderly capital markets. To this end, a Joint Financial Stability Board, set up between the MFSA and the Central Bank of Malta, focuses on macro-prudential aspects of financial stability, extending its remit to the entire financial sector.

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10. Norway

The Norwegian banking sector is characterized by a few large commercial banks, many smaller commercial ones, and by savings banks. At the end of 2012, the Norwegian banking sector consisted of 109 savings banks, 17 commercial banks and 52 finance/mortgage companies. In addition, there were 42 branches of foreign banks and credit institutions in Norway. A substantial part of the banking system (approx. 25%) in Norway consists of foreign bank branches (mostly Scandinavian).

At year-end 2012, the aggregate assets of the entire banking sector (including foreign entities) amounted to EUR 643 billion, corresponding to 163 % of Norway's total GDP (in nominal terms). The financial intermediation sector contributes to approximately 4% of national GDP and the industry employs around 30 000 people. There were 1,127 branches by the end of 2012, and the overall number of inhabitants per bank branch stood at around 4 500. As more and more people are using banking services online, the number of branches has decreased significantly over the last years.

Norwegian banks are solid and profitable, and loan losses are at a low level. Return on equity was 11% in 2012. Norwegian banks have also strengthened their financial position in recent years by retaining profits and raising fresh capital in the market. The overall solidity level for Norwegian bank groups was 13.3% by the end of 2012. In addition, increased liquidity buffers and longer term funding have put Norwegian banks in a better position to tackle a new tightening of liquidity.

Norwegian banks fared relatively well during the financial crisis and incurred limited loan losses. Profits were however somewhat poorer than in the years prior to the crisis. The main challenge facing Norwegian banks during the financial crisis was liquidity shortage, owing to the heavy dependency on foreign funding sources which subsequently dried up. There was, however, no solidity crisis and no severe credit contraction in Norway. Also, the negative consequences were mitigated by government liquidity support.

Norwegian banks' liabilities largely comprise retail deposits, covered bonds and senior bonds. Large banks have a considerably larger share of market-based, international funding than smaller banks, which base their operations largely on depository funding and inter-bank loans. Small Norwegian banks are dependent on funding provided to them by the large banks. More than 80% of small banks' interbank debt is to the large banks.

Bank deposits are guaranteed by the Norwegian deposit guarantee scheme and have thus proven to be a stable source of funding, also during the financial crisis. The guarantee provided by the Banks' Guarantee Fund covers up to NOK 2 million (approx. EUR 270,000) per depositor per bank. Banks' deposit structure is dominated by household deposits, which represents about 37% of all non-financial sector deposits, while corporate deposits represent about 22%. The deposit-to-loan ratio (customer deposits as a share of gross loans to customers) for banking groups as a whole was 56% at year-end 2012. This figure has been quite stable for the past three years or so.

In recent years, banks' covered bond issues have been an increasingly popular source of funding. The interest rate paid by banks' residential mortgage companies on covered bonds is significantly lower than the rate paid by banks when issuing senior bonds, due to the lower risk associated with covered bonds. Moreover, covered bonds have met investors' need for secure and liquid investments in Norwegian securities, and this has enabled mortgage companies to issue covered bonds on particularly good terms.

There has been a high demand for bank loans in Norway the last couple of years, with a credit growth at about 7% in 2012. However, this is still lower than before the crisis. Credit to households has had the strongest growth rates over the last years, which must be seen in conjunction with the steep rise in housing prices. Households stand for 58% of total loans outstanding, of which over 80% comprised lending for house purchase. Loans to non-financial corporations represented 33%, and local governments 8%.

Norwegian banks strongly support the progress in the stability and governance of the European financial sector, as well as the increasing harmonisation of regulation and supervision throughout Europe, in order to ensure a level-playing field, and improve the functioning of the market economy. Norwegian supervisory practice in the capital area has been stringent from a European perspective. The new capital requirements for Norwegian banks entered into force on 1 July this year. The new regulatory framework is based on the EU's Capital Requirements Directive. Implementation will, however, take place in Norway earlier than scheduled in the international framework.

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11. Romania

The banking sector of Romania - made up of 40 banks at the end of December 2012 - mainly finances the Romanian economy, providing about 92% of the total financing granted by the Romanian financial system. The banking system has proven to be resilient during the crisis, continuing to grant funding to the Romanian economy. The economic growth outlook, influenced by the absorption of European funds, make Romania an attractive destination for investors who invest in the banking sector.

The banking sector's assets stood at EUR 83 billion, their weight against the Gross Domestic Product (GDP) amounting to 62%. The structure of the Romanian banking sector at the end of 2012 included two banks with fully or majority state-owned capital, three banking institutions with majority domestic private capital, 26 banks with majority foreign capital, eight branches of foreign banks and one credit cooperative.

The weight of the assets belonging to banking institutions with foreign capital against total assets of the Romanian banking sector advanced from 83% in December 2011 to 89.8% in December 2012. As regards the origin of the shareholders' function of assets, the banks with Austrian capital hold a market share of 37.7%, followed by the banks with French capital of 13.6% and those with Greek capital of 12.2%. The weight of the first five banks as regards asset volumes stood at 54.7%, as regards loans at 54.4%, as regards deposits at 54.9%, as regards own funds at 52.8%, and as regards government securities at 56.3%, according to the National Bank of Romania (NBR) data.

The level of financial intermediation, calculated as the weight of non-government credit against the GDP, stood at 38.4% in 2012, a value similar to the one registered in 2008, before the crisis, which is down below the maximum of 40.1%, registered in 2011. The controlled financial disintermediation process has happened in the context of the contraction of forex denominated lending and of consumer credit.

What is more, the main challenges to financial stability are credit risk, especially the credit risk associated with lending denominated in foreign currency and the risk of a disorderly development of external financing. In Romania, the recommendations of the European Systemic Risk Board to all EU authorities concerning lending denominated in foreign currency were also extended to companies.

The expectations of the banking sector regarding the overall economic circumstances, the NBR's adopting some prudential regulations intended to curb the growth of lending denominated in foreign currency, and the maintenance of a high level of indebtedness of some borrower categories have all contributed to the shrinking of the balance of non-government credit by 3.5% compared to the end of 2011.

The loans granted by credit institutions amounted to about EUR 64 billion, with the balance of non-government credit standing at EUR 51 billion at the end of December 2012. The balance of deposits raised by banks stood at EUR 43 billion.

Banks have changed their orientation from a fast expansion to a prudence-oriented strategy, by adapting their branch networks and their employee number. The number of bank outlets was about 5,700 at the end of December 2012, while the number of employees across the sector was adjusted to 61,700 from 72,000 in 2008.

Higher unemployment, a significant reduction of wages and the downsizing or even the termination of the business of some companies, have all contributed to the ongoing drop of the loan reimbursement capacity with direct consequences upon the quality of banks' loan portfolios. This, in turn, has led to a higher volume of provisions which credit institutions had to establish.

The loss reported across the banking sector was generated by more provisions - taking into account that the rate of NPLs reached 18.2% - and by the reduction of net interest income. The level of coverage of NPLs with IFRS provisions and the corresponding prudential filters stood at 86.3% at the end of 2012. Considering the expectations regarding lower expenses for the provisions underlying credit risk and the restructuring process that credit institutions have been undergoing, the prerequisites for 2013 pre-announce a better outcome across the sector.

The commitment of credit institutions' shareholders has provided for the maintenance of capital adequacy at comfortable levels. The Romanian banking sector continues to hold solid capital reserves, the solvency ratio standing at 14.9%. This calculation includes the effect of the prudential filters.

The solvency ratio is better than the prudential threshold of 10% recommended by the National Bank of Romania (NBR) at the beginning of the period when the effects of the global crisis began spreading. According to the NBR estimates, the current level of capitalisation allows for the implementation of the new capital requirements in conformity with the Basel III Capital Accord, taking into account that, with a weight of 92% on 31 December 2012, the Tier 1 own funds are dominant against the total own funds of the banks that are Romanian legal persons. During the crisis, the Romanian banking sector did not need support from public money.

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12. Slovakia

For over more than 20 years the Slovak banking sector has overcome several significant obstacles. Mainly state owned and undercapitalized banks have been transformed into one of the most stable, soundest and profitable banking sectors in the EU. Slovakia, with about 90% of foreign capital, is among one of the few countries in Europe that has avoided the crisis in the banking sector without government support. The main reason has been the banking sector's orientation to conservative banking functions: receiving deposits and providing loans in domestic currency. As we now witness, traditional business banking model fared well in the financial crisis.

Slovak banking sector consists of 28 financial institutions. The majority of them are universal banks, focused on retail and corporate banking. In Slovakia there are 3 specialised banking institutions – building societies. Since privatisation (1999-2001) most of the banks in Slovakia are controlled by foreign entities, mainly banking groups from Austria, Italy and Belgium. Only 4 banks are now fully controlled by domestic investor groups or government.

Top five banks in Slovakia

1. Slovenska sporitelna - Erste Bank group (Austria)
2. VUB banka – IntesaSanpaolo group (Italy)
3. Tatra Banka – Raiffeisen International (Austria)
4. CSOB – KBC group (Belgium)
5. UniCredit bank Slovakia - UniCredit group (Italy)

Slovak banking sector is concentrated in the hands of five major players who control up to 71% of the banking assets. Despite this concentration, some new players have entered the market in recent years. On the other hand, last year two small corporate banks (branch office of foreign banks) ended their activity in Slovakia.

In comparison to the national GDP, the banking sector is one of the smallest in the EU. Assets to GDP ratio is 81% and Slovak banks directly contribute more than 3% to GDP. Slovakia has some of the most stable and sound banks in the euro area. According to study of The World Economic Forum (The Global Competitiveness Report 2012-2013), Slovakia has the fourth most sound banking sector in the euro area. Slovakia is also among the 4 countries in the euro area to have avoided the crisis in the banking sector without government support.

One of the principal differences between Slovak financial institutions and banks in most of the EU countries, is their liquidity position. Funding of Slovakian banks is based primarily on the domestic client's deposits. The loan to deposit ratio is still one of the lowest in the EU (87%). Therefore, Slovak banking sector is well insulated from shocks, and banks can support the economy.

During the crisis, Slovak banks have remained profitable. In 2011, the banking sector achieved the highest-ever profit (EUR 674million) but last year's profits declined by more than 30%. The main reason was the highest bank levy in the euro area, on the one hand, and on the other, the decline in the interest rate margins. ROE in 2012 significantly declined from 14.19% to 9.09%.

In the last five years more than 51% of net profits have supported the capital bases of Slovak banks. Thanks to previous profits, Tier 1 capital ratio, a core measure of the financial strength of banks, increased in average to 14.79 % (2012) with the lowest individual level at 10.9%. Every bank exceeded the 9%, the minimum level of Tier 1 according to the central bank's recommendation.

By virtue of the stability of the financial institutions, domestic economy has not been affected by the credit crunch. A significant trend in the banks has been an increase in the volume of total loans (mainly household loans). Loans for households in 2012 grew by 10%, the highest level in the euro zone. On the other hand the outstanding amount of corporate loans in 2012 began to decrease. The main reasons were tight credit standards and weakening demand.

The key change and potential risk factor for the Slovak banking sector in 2012 was the introduction of a national bank levy, which is the highest in the monetary union (e.g. 10-20 times higher than the bank levy in Germany). The levy primarily affected the sector's net profit last year which diminished by 30%. In 2012, the total amount from the bank levy was EUR 170m, representing 35% of the reported sector's profit. In their last statement, the IMF recommended reducing the bank levy, because the high levy could be burdensome on financial intermediation. Furthermore, the bank levy at its current level will adversely affect financial intermediation in the medium term.

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13. Slovenia

The Slovenian financial system has traditionally been dominated by the banks whose total assets amounted to EUR 46.1 billion, the equivalent to 130% of GDP at close of 2012. This was roughly 16 percentage points down from the peak value in 2009 when the banking sector reached its size of 146% GDP after several years of consistent growth. This ended when the second-round effect of the global financial crisis hit the Slovenian banking sector. There was no major impact of the global financial crisis detected immediately after the onset of the global financial crisis in 2007 and 2008.

Nonetheless, the indirect aftermath had significant adverse effects on the individual banks and the banking sector as a whole. This means that at least some banks still have to face considerable restructuring and most of the others have to reconsider their respective strategies. A substantial ownership consolidation is expected to take place in the years to come and a noteworthy reshuffling of market shares is likely to be a part of the restructuring process.

a. The structure of the banking sector

There were 17 banks operating at the end of 2012, of which 7 were in the majority ownership of the foreign parent banks and 10 banks were predominantly owned by the domestic shareholders; 3 banks were in the direct majority state ownership, while additional 2 banks were either completely controlled by a state-owned shareholder, or a state-owned company was the largest individual shareholder of the bank.

With regard to the market structure, banks in the majority foreign ownership represented only 30.7% of the market as measured by banks' total assets at the end of 2012, and the remaining 69.3% belonged to the banks in domestic ownership, of which only 9.3% market share was covered by small domestic banks. The market share of the state-owned banks, measured by total assets, was 58% . Both market share, i.e. the share of the state-owned banks and the share of the foreign-owned banks, reflect two distinct characteristics of the Slovenian banking sector when compared to other countries in the Central and Eastern European region. First, a noticeable involvement of the state in the ownership structure and the corporate governance of banks. Second, a relatively low presence of foreign-owned banks on the market. In most other countries in Central and Eastern Europe, the presence of government in the ownership of banks has been minimised as most of the once state-owned banks were privatised, mostly by selling banks to foreign investors.

The concentration ratios reveal a picture of a banking market with a relatively high degree of concentration, although the concentration rates have decreased over the last five years as a result of crisis-related distress. So the market share of the top three banks at the end of 2012 was 43.2% as measured by total assets, 42.5%, as measured by loans to non-bank borrowers and 49.7% as measured by liabilities to non-bank customers. The same top three banks' concentration ratios, calculated at the end of 2008 were 47.7% of total assets, 46.7% of loans to non-bank borrowers and 55.9% of liabilities to non-bank customers, indicating a gradual but detectable decrease in the market share of the biggest three banks on the market. As the biggest banks were also significantly affected by the recent financial and economic crisis and a number of severe corrective measures are still expected to take place, we can also anticipate subsequent restructuring of the individual banks and their repositioning in the market to happen in the coming years.

b. The causes for the banking sector and the after-crisis developments

The prevalent business model adopted by most banks in Slovenia in the years just before EU accession in 2004 and in the following years, has been severely challenged and has turned out to be unsustainable in the long run. It was based on accelerated credit growth, which could not be entirely supported by an equivalent growth in customer deposits. Therefore, most of the banks have significantly increased their money market indebtedness (by relying more on wholesale markets and/or borrowing from the internal markets of parent banks) in order to be able to compete for customers in the credit market and enhance their profitability. So the annual growth of credit to non-financial corporations changed from a moderate 11.5% in 2002 to 37.8% in 2008 and has never dropped below 20% per annum in the intervening years. The annual growth rates of credit to households have been more moderate and have never exceeded 28% per year. As a result, total assets of the banking sector have grown from a subdued 85.1% of GDP in 2002 to a much more perceptible 146% of GDP in 2009. This happened to be a turning point in the growth of the banking sector, since the total assets of the banks shrank from EUR 51.6 billion, at the end of 2009 to EUR 46.1 billion at the end of 2012.

The buoyant credit growth in the pre-crisis period of the economic expansion, when GDP growth rates reached 6.9% per year at the peak of the business cycle in 2007, have resulted in the accumulation of dubious credit claims and insufficient, unmarketable, and often doubtful collateral. In the last four years of economic uncertainty (2008–2012) there happened to be only a temporary and a short-lived recovery in 2010 (1.4% annual growth), followed by a stagnating +0.6% growth in 2011, and a substantial 2.3% drop of GDP in 2012. The developments in the banking sector have been deeply intertwined with the developments in the rest of the economy, and particularly with those in the non-financial companies, which have traditionally, primarily used bank funding for their investment projects. In the

2001–2008 period of economic expansion the corporate sector almost exclusively relied on bank funding when investing in new projects, which was especially the case for the construction sector.

Additionally, many of the MBO projects (of which several were mismanaged and deeply flawed from the onset), were financed by the banks by using collateral whose value plummeted with the collapse of the local stock exchange in 2008.

The data on the funding structure reveal a significant increase in financial leverage in the corporate sector just before the crisis-year 2008. As a result, the leverage, measured as the debt-to-equity ratio, almost doubled in the Slovenian corporate sector, where the ratio reached the level of 95% at the end of 2008, while the leverage level in 2004 was only 53%. The aggregate leverage level of Slovenian corporates in 2008 was also the highest among the Central and Eastern European countries within the EU, since the leverage of Polish companies amounted to only 55%, the leverage of the Hungarian companies to 52%, Czech companies to 47%, Estonian companies to 67%, and Slovakian companies to 60% in 2008. A sharp increase in leverage for the Slovenian corporates in 2008 can to some extent, at least, be attributed to the deteriorated market value of equity (the SBI-TOP stock exchange index dropped by 66% y-o-y in 2008). Nonetheless, it can be said that the general upward trend of corporate leverage was heavily fuelled by bank loans obtained from the Slovenian banks after the year 2003. At the year-end 2004 (Slovenia's entry into EU) the aggregate loan-to-deposit (LTD) ratio in the Slovenian banks was as low as 92.8%, the LTD extended to an unrestrained 154% in 2008, which was substantially higher than the LTD in Austria (117%), Germany (101%) or France (137.8%) the same year, and clearly not a sustainable level of the ratio.

As a result, the banks found themselves in an extremely vulnerable situation at the beginning of the global financial crisis in 2008. On the one hand, their indebtedness in the interbank market was, historically, at the highest level, and on the other hand, their credit exposure to the rapidly growing corporate borrowers, especially the construction sector companies, and the immensely leveraged financial holdings, was also unprecedentedly high. Consequently, most of the banks had to face significant refinancing difficulties and quickly deteriorating quality of their credit portfolios, not to mention the capital crunch they had to confront.

The unenviable and deteriorating developments in the Slovenian banking system are also reflected in some key parameters describing banks' operations. Namely, the loan loss provisions at the level of the banking system escalated from EUR 1.31 billion (i.e. 3.2% of classified banks' assets) at the year-end 2007 to EUR 4.16 billion (i.e. 8.7% of classified banks' assets) at the end of 2012. What is more, this seriously affected the profitability of the banking sector. The profitability measured by the ROE indicator collapsed from the pre-crisis solid positive return of 15.14% in 2006 to the most recent deeply negative return of-18.85% in 2012.

Table: Selected performance indicators for Slovenian banking sector

	2006	2007	2008	2009	2010	2011	2012
ROA	1.24	1.35	0.67	0.32	-0.19	-1.06	-1.59
ROE	15.14	16.28	8.15	3.87	-2.3	-12.54	-18.85
CIR	57.91	52.94	57.27	53.95	52.22	53.68	47.42
NIM*	2.35	2.32	2.21	1.98	2.14	2.13	1.93

** Net interest margin is calculated as net interest income percentage in total interest-bearing assets Source: Financial Stability Report, Bank of Slovenia, June 2013, p. 57; The Bank Association of Slovenia*

The consequences of the refinancing crisis that have hit Slovenian banks after the onset of the financial crisis in 2008 can easily be seen in the changing structure of the funding sources. The liabilities to foreign banks, which represented 34% of total funding at the end of 2007, shrank, in March 2013, to only 14.8%. This means that banks have repaid EUR 8.4 billion of debt (equivalent to 24% of GDP) to banks' creditors located outside Slovenia, since 2008. As a result, banks have been compelled to restructure their funding and /or to shrink their credit activity. Most of the funding restructuring was achieved by increasing the indebtedness with the ECB, by expanding the deposits (especially retail and state deposits), and by issuing their own debt securities. At the same time, the maturity structure of banks' liabilities has improved somewhat as the share of short-term deposits has decreased from 53% to 29% and the share of long-term deposits has grown from 9.7% to 32.3% of non-banking sector liabilities. The second means of adjustment to the deleveraging pressures was completed by the contraction of the credit activity of banks, seen in the negative growth rates of credit to corporates after 2008. The volume of loans to the corporate sector reached its peak level of EUR 20.26 billion at the end of 2008 and dropped to EUR 16.44 billion end-2012, when the annual decrease in volume of credit to the corporate sector was-10.3%. The peak level of retail loans, to the amount of EUR 9.06 billion or 18.4% of total assets, was reached in 2011, and afterwards the growth rates of retail lending became negative (e.g. -2.3% in 2012).

Both the decreasing volume of credit activity and more expensive funding available to banks contributed to the decelerating net interest margin that shrunk, at aggregate level, from 2.35% in 2006 to 1.93% in 2012. What is more, these put additional pressure on the deteriorating profitability of the banks in the Slovenian banking system.

The average capital adequacy of the banks has gradually improved after the beginning of the crisis, not only in terms of quantity, but also in terms of quality.

Nevertheless, the most troublesome banks will still need a significant recapitalization in the upcoming year. The data show that the average capital adequacy ratio for the banking system grew from 11.2% at the end of 2007 to 11.9% at the end of 2012 and during the same period the core Tier 1 ratio improved from 7.3% to 10.0%. The improvement of the capital adequacy was not only a result of additional recapitalizations but also a result of gradual credit portfolio divestment and partial restructuring of the banks' assets. Among all the banks, the foreign-owned banks maintain a consistently higher capital adequacy ratio than the domestic banks. For example, at the end of 2012 the capital adequacy ratio achieved by foreign-owned banks was 13.2%, compared to the average ratio of 11.9% for the entire banking system. Especially for the state-owned banks, a series of required recapitalizations has proved to be quite a challenging task for the government, leading to increased budged deficit and deteriorating public finance picture.

c. The recent developments in Slovenian banking

In the National reform program (NRP) submitted to the European Commission, beginning of May 2013, the government announced a comprehensive stabilisation strategy consisting of:

- the transfer of the non-performing banks' assets to the Bank Asset Management Company (BAMC), i.e. Slovenian version of a bad bank;
- recapitalisation of banks;
- consolidation of the banking sector and
- privatisation of the state shareholdings of banks.

The BAMC, which is already operational, is expected to purchase the non-performing assets from the commercial banks by issuing BAMC bonds guaranteed by the government. In a special government act ("Measures of the Republic of Slovenia to strengthen the Stability of Banks Act"), the government earmarked guarantees of up to EUR 4 billion for providing guarantees for BAMC bonds. The transfer of non-performing bank assets to the BAMC is planned to take place in three separate packages: (1) claims against clients in bankruptcy procedures; (2) claims against non-payers collateralised with real estate; and (3) other claims against companies under restructuring procedures (including financial holdings).

As reported in the National Reform Program (NRP) and the follow-up to the Program, the three largest banks in the banking system have been identified for the transfer of their non-performing assets to the Bank Asset Management Company (BAMC). Under the plan revealed in the NRP, the banks will have to be recapitalised by up to EUR 900 million; and the amount of non-performing assets transferred to the BAMC is estimated to amount to EUR 3,337 million, with a transfer value of

EUR 1,147 million. After the transaction, the proportion of non-performing assets in the banking system is expected to drop from 16.9% to 10.4%, and in the three participating banks from 24.6% to 8.8%. The core Tier 1 ratio in the three target banks is expected to improve from 7.93% to 11.84% after the transaction.

This said, the transfer of the non-performing assets has not yet begun. This is owing to the requirement by European Commission that the asset quality review, and the adequate stress tests, be performed by external agencies before the transactions actually take place. As announced by the government officials on several occasions, the transfer of the non-performing assets should start by September 2013.

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14. Spain

Spain has a highly developed banking system. At the end of the financial year 2012, a total of 314 credit institutions were registered with the Bank of Spain. These included commercial banks, savings banks, credit unions, finance companies and the Instituto de Crédit Oficial (ICO, the government financial agency with a banking licence). Additionally, 85 branches of foreign credit institutions, mostly from other EU countries, operate in Spain.

The sector's total aggregate balance sheet (based on individual financial statements) comes to EUR 3.4 trillion, approximately three times the country's GDP. Spain has a total of 38,000 bank branches, employing almost 236,000 people (1.4% of the national workforce). The six biggest banks and savings banks account for 52% of domestic business (52% of credit and 52% of customer deposits).

The 55 finance companies and the ICO are not authorised to take customer deposits. Together they account for 1.6% of the aggregate balance sheet. The 70 credit unions, which are currently undergoing an intensive process of consolidation, account for a further 4%, and the rest is divided between the savings banks and commercial banks. Of the latter, 20 are subsidiaries of foreign institutions and, together with the branches of foreign institutions, have a market share of around 8.8%.

Up until 2008 the savings banks accounted for almost half of the domestic market, but have been severely affected by the crisis as a result of their excessive exposure to the property sector. A substantial transformation is underway in the sector, reflected by its intense consolidation: of the 46 independent savings banks that existed at the end of 2009, just eight to ten groups of savings banks are likely to remain. Those banking groups where the parent entity of a savings bank and their banking activity is conducted by a financial subsidiary (commercial bank).

A total of eight institutions have been bailed out by the Bank of Spain since the start of the crisis. By the end of 2012 four of them had been sold to other institutions by competitive auction. A further four, representing 15.6% of the sector's total balance sheet, are currently fully, or majority government-owned and managed by the FROB (Fund for Orderly Restructuring of the Banking Sector), a government agency, with restructuring or resolution plans approved by the European authorities.

Spain's commercial banks have shown themselves to be much more resistant to the crisis and none of them have needed public capital injections. Spanish banks operate according to the retail banking model, with diversified business. In recent years, they have expanded abroad extensively, with subsidiaries in Latin America, the United States, and the European Union.

Spain's banking groups (i.e. groups whose parent entity is a bank), have a total consolidated balance sheet of EUR 2.4 trillion, a BIS (Banking International Settlements) ratio of 12.8%, and a core capital ratio of 10.5%; 35% of their total attributed earnings in 2012 came from the business of their foreign subsidiaries.

The restructuring of the banking sector in Spain

On 25 June 2012, the Spanish Government requested external financial assistance in the context of the ongoing restructuring and recapitalization of its banking sector. This assistance was agreed by the Eurogroup on 20 July 2013 and reflected in the Memorandum of Understanding (MoU). The key component of the programme is a review of the vulnerable segments of the Spanish financial sector and consists of the following three elements:

- determination of the capital requirements of each bank, assessing the overall asset quality of the banking sector, and a stress test, bank by bank, under a very adverse macroeconomic scenario;
- recapitalization, restructuring and/or orderly resolution of weak banks, based on plans that address the capital deficits detected in the stress test, and;
- segregation of impaired assets in the banks that would require public support for recapitalization without this segregation, and transfer of these assets to an Asset Management Company (AMC).

On 28 September 2012, the first element was completed with the presentation of the Oliver Wyman evaluation of the Spanish banking system's capital needs on the basis of the stress tests performed under the sector's recapitalization and restructuring process, as envisaged in the Memorandum of Understanding agreed on 20 June 2012, by the Spanish and European authorities.

The 14 main Spanish banking groups (taking into account the integration processes currently under way) participated in this test. The groups account for around 90% of the Spanish banking system's assets.

The results confirm that the Spanish banking sector is mostly solvent and viable, even in an extremely adverse and highly unlikely macroeconomic setting:

- seven banking groups, accounting for more than 62% of the analysed portion of the Spanish banking system's credit portfolio, do not have additional capital needs;
- additional capital needs have been identified for the remaining groups, on top of those existing as of 31 December 2011, that amount to EUR 53.75 billion

(around 86% of this capital shortfall is in those banks which are majority-owned by the FROB: BFA-Bankia, Catalunya Banc, NCG Banco and Banco de Valencia) when the mergers under way and the tax effects are considered.

The estimated capital needs outlined in the report by Oliver Wyman for various Spanish banks will, generally, not coincide with the amount of State aid required for their recapitalisation. The difference between the capital needs evaluated in the stress test and the State aid ultimately necessary will depend on the various actions that banks incorporate into their recapitalization plans.

Indeed, the banks will finally receive a total of EUR 38.83 billion, after deducting the capital needs identified in the stress tests through the burden-sharing exercises and the transfer of problem assets to AMC.

At the end of 2012 and the first few months of 2013, the setting up of the AMC (SAREB) and the Commission's approval of the restructuring plans for State-aided banks, constituted a decisive step taken, not least by meeting the commitments entered into in the Memorandum of Understanding.

This same conclusion has been clearly highlighted by the IMF in its report on Spain. Financial sector reform: second progress report (March 2013). The main finding of this report is that "major progress has been made in implementing financial sector reforms. The programme remains on track: the clean-up of undercapitalised banks has reached an advanced stage, and key reforms of Spain's financial sector framework have been either adopted or designed. Indeed, the bulk of all of the measures for the entire programme have now been completed."

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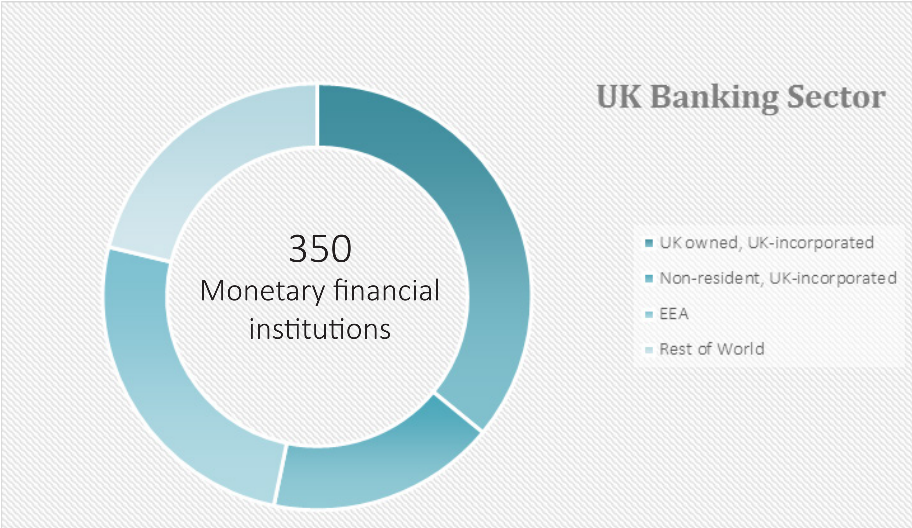
15. United Kingdom

The UK is the second largest banking sector in the world. It hosts more foreign banks than any other financial centre, holds assets of more than USD 12.6 trillion, is the largest sector in Europe and the largest single centre in the world for cross border banking.

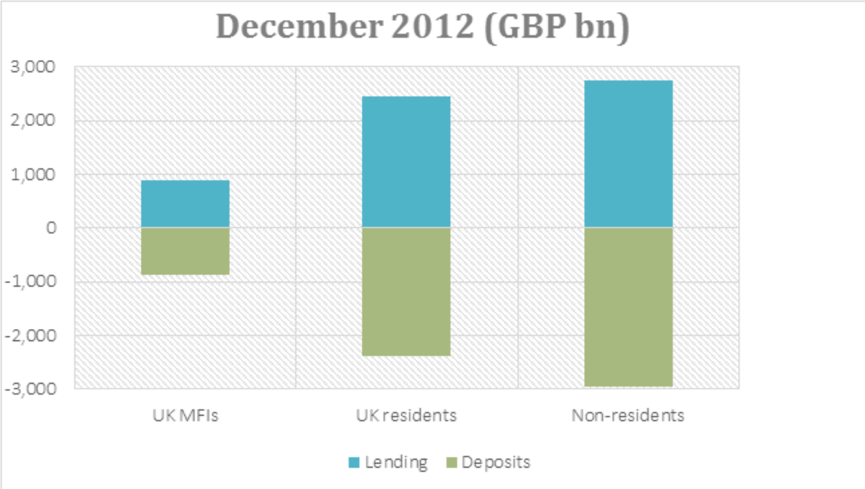


The sector employs some 450,000 people (one-third in London) who pay over GBP 17 billion annually in income tax and national insurance, around 10% of the national total. Banking sector output is the equivalent of 4.8% of the UK's GDP and, in a significant contribution to the UK's balance of payments, accounts for more than half the net exports of financial services (some GBP 25 billion in 2011).

Foreign direct investment into the UK banking sector more than doubled over the past decade to reach GBP 60 billion in 2010. During this period outward direct investment grew more than five times to GBP 80 billion.

Domestic banking in the UK is concentrated, with the main high-street banking groups accounting for around two-thirds of retail activity. Banks in the UK operate around 150 million current and deposit accounts for households, with some 50 million operated on-line. Plastic card holding has increased rapidly over the last decade with 60 million credit cards and 90 million debit cards now in issue. They can be used across a network of 66,000 automated teller machines (ATM) and a consequence of the growth in 'distance-and-convenience banking' has been a contraction in branch networks, though there are still 10,000 bank branches and 11,000 post offices where transactions can be made.

Almost half (45%) of the UK banking sector aggregate balance sheet is held by non resident MFIs and only around one-third is denominated in British pounds. More than half (55%) of the balance sheet relates to the banking activities of UK resident counterparties.

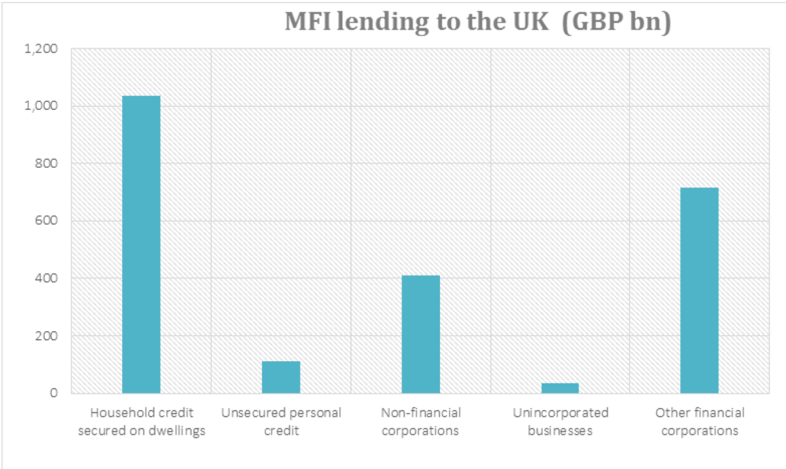


Many UK banks were impacted by the financial crisis due to exposures to sub-prime securities and the subsequent deterioration of UK credit and funding markets. Liquidity in the UK's banking system was at its highest level for some 17 years in 2007, but excessive leverage (overly large balance sheets relative to equity) and the rise of complex financial products contributed to disproportionate risk-taking. In the 5 years leading up to the crisis, UK bank leverage increased from around 20 times to up to 40 times in 2008, but as funding pressures increased and liquidity from wholesale markets reduced, banks became reluctant to commit funding to interbank markets. Leverage in 2011 returned to assets being 20 times capital and is expected to fall further as banks transition to higher capital requirements under Basel III.

In 2008, the UK Government nationalised Northern Rock, part-nationalised Bradford & Bingley (both previously mutual building societies), brokered a merger of Lloyd's TSB and Halifax Bank of Scotland and provided recapitalisation and guarantees for the enlarged Lloyds Banking Group (65%) and Royal Bank of Scotland Group (70%). UK Financial Investments Limited was set up to manage the UK Government's investments in financial institutions.

The largest retail banking groups operating today in the UK are Barclays, Lloyds Banking Group, HSBC, RBS Group and Santander. They are supplemented by a tier of medium sized providers such as the Clydesdale Bank, Co operative Banking Group and the recently launched TSB (a sale of 630 branches by the Lloyds Banking

Group, in compliance with state aid rules) but there is also an emerging group of smaller 'challenger' banks such as Virgin Money, Tesco Bank, Sainsbury's and Metro Bank which are building their retail customer bases. Overseas banks operating in niche areas such as corporate and trade finance, providing banking for expatriate or local communities or participating through branches in the UK wholesale markets complete the varied spectrum of banking in the UK.



The provision of finance by MFIs is spread throughout the UK economy, with outstanding credit of GBP 2.3 billion provided to UK residents at end-2012.

In July 2012, the Bank of England and the UK Government launched the Funding for Lending Scheme (FLS) designed to incentivise MFIs to boost their lending to the UK real economy. The scheme provides funding for an extended period, with both the price and quantity of funding linked to lending performance. The scheme allows participants to borrow UK Treasury Bills in exchange for eligible collateral, with the fee charged and the amount that can be borrowed dependent on their lending growth. The FLS was extended in April 2013 to January 2015, with incentives to boost lending towards small- and medium-sized enterprises (SMEs) and expanded to include non-bank providers of credit to the UK real economy.

Regulation of MFIs in the UK changed fundamentally in 2013. The Bank of England was, in addition to its responsibility for monetary stability, given statutory responsibility for financial stability, bringing together macro- and micro-prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms in a new Prudential Regulation Authority, whilst organised financial markets and conduct of business is regulated by a separate Financial Conduct Authority.

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- Statistical Annex-

Key Banking Sector Indicators by country, 2012 (source: ECB)

	Number of credit institutions	Total assets (EUR million)	Total loans (EUR million)	Total deposits (EUR million)	Capital and reserves (EUR million)
Austria	751	974,264	587,507	532,721	100,876
Belgium	103	1,085,303	490,268	636,945	56,960
Bulgaria	31	45,407	33,250	28,717	5,511
Cyprus	137	128,127	81,811	73,587	15,129
Czech Republic	56	191,686	110,491	132,185	22,192
Germany	1,869	8,226,623	4,660,414	4,542,837	416,168
Denmark	161	1,157,645	638,540	291,184	61,116
Estonia	16	19,673	16,256	12,779	2,525
Spain	314	3,581,073	2,096,561	2,269,793	402,865
Finland	313	600,304	303,282	175,282	24,878
France	639	8,075,875	4,417,682	3,960,179	518,166
UK	373	9,559,302	4,405,570	4,002,954	887,598
Greece	52	442,214	266,592	317,146	53,220
Hungary	189	111,574	69,281	59,596	10,015
Ireland	472	1,170,002	419,090	465,736	136,309
Italy	714	4,219,490	2,470,631	2,296,689	372,703
Lithuania	94	24,405	18,562	13,455	3,322
Luxembourg	141	961,507	408,195	431,317	54,435
Latvia	29	28,555	17,447	9,513	2,739
Malta	28	53,527	16,084	19,205	10,873
Netherlands	266	2,492,764	1,375,855	1,066,622	118,993
Poland	695	354,687	249,530	221,770	49,963
Portugal	152	557,078	307,443	321,182	49,767
Romania	39	91,176	65,285	49,858	16,339
Sweden	176	1,213,374	686,125	377,926	72,101
Slovenia	23	50,788	36,924	36,837	3,872
Slovakia	28	59,716	39,100	44,149	8,450
Total EU27	**7,861**	**45,476,138**	**24,287,778**	**22,390,166**	**3,477,085**

Hereafter, numbers are collected from the EBF members, and refer to banks in each of the countries:

Iceland	4	18,100			
Liechtenstein	16	46,309	33,179	30,014	4,830
Norway	126	643,869	544,005	367,030	49,046
Switzerland	297	2,302,187	1,962,828	1,302,185	134,363
Total EFTA	**445**	**3,010,465**	**2,540,012**	**1,699,229**	**188,239**