

Risk Assessment of the European Banking System

January 2013

Risk Assessment of the European Banking System

Table of contents

Executive summary	3
1. Introduction	5
Purpose of the report	5
Data sources	5
Organisation of the report	5
2. External environment	6
Market sentiment and macroeconomic environment	6
Regulatory developments	7
Fragmentation and the Single Supervisory Mechanism	8
3. Business models and banks' internal drivers	10
Risk appetite and the operating model	10
Profitability	12
Legal and reputational concerns	14
4. Liabilities	16
Funding	16
Recapitalisation results	22
5. Asset Quality	24
6. Banking services and consumer protection	30
Appendix: Samples	33
Annex	35

Executive summary

Since the publication of the EBA's last risk assessment report (*Report on Risks and Vulnerabilities of the European Banking System*, July 2012) the EU banking sector has seen some improvement in market confidence – from both debt and equity investors. Nevertheless, these signals may prove temporary and the macroeconomic environment for most European banks remains fragile, especially for banking systems in countries where the sovereign itself is financially-stressed. Thus, serious challenges remain due to increasing credit risk and low profitability levels that could be further depressed by rising loan-loss provisions.

Measures adopted by policy makers, central banks and supervisors have addressed some immediate concerns. The **improvement in markets for bank funding** has been noticeable since the second half of August, when vital policy and regulatory steps were seen as positive moves which reduced the risk of the euro zone disintegration or outright sovereign defaults. Secondary-market **prices for both debt and equity have improved** and a number of banks – including some in financially-stressed sovereigns – have been able to issue new debt, the greater part of which is senior unsecured. However, spreads remain high and the level of **asset encumbrance**, particularly for some banks, may eventually have a negative effect on **the availability and cost of funding**, unless banks, with the aid of supervisors, return to greater reliance on diversified market funding. Promoting the use of regulatory convertible bonds as a buffer to increase loss absorbency of banks is one of the solutions which will increase confidence and cause funding costs to fall.

The ongoing improvement in the bank funding situation cannot alter the fact that the **EU banking sector remains fundamentally fragile** overall, with structural stresses still to run their course. A large number of banks have been massively supported by central bank funding¹. The banking industry **needs to return to diversified private funding sources** on a sustainable basis and the transition should be pro-actively managed by banks and properly overseen by supervisors.

The risk appetite of banks is changing and **business models are adapting** both due to internal drivers as well as in response to regulatory and market developments. Although there is variation within Europe, de-risking is proceeding, albeit at a slower pace than in other parts of the world. Indeed in a majority of EU countries, excessive or disorderly asset deleveraging has not occurred, especially insofar as assets related to the real economy are concerned. In addition, while the search for more stable and sustainable business models is a welcome development, it creates heightened strategic risks, especially during the transition period to new business models.

EU banks have significantly strengthened their capital positions over the last two years, also following the EBA capital exercise launched in 2011. However, concerns remain about the impact on capital of future loan losses. Indeed, uncertainty about the **quality of banks' asset and valuation criteria** in many jurisdictions creates challenges in attracting private investors. Market confidence in credit portfolios needs to be restored and this process will need to be supported by the supervisors. Bank credit **forbearance**, though not universal, is widespread, as indicated by the respondents to the Risk Assessment Questionnaire (RAQ). While this has helped address difficulties and support banks' borrowers and their ability to honour their obligations, forbearance may have also led to an underestimation of the scale of problem loans. The actual magnitude of credit risk in banks' portfolios

¹ 523 banks participated in the first tranche of the ECB LTRO and 800 in the second.

and adequate provisioning levels must be made clear so as to renew market confidence and stabilise private funding markets at viable spreads.

The **emerging new regulatory landscape** can create the framework for a more resilient banking sector. However, uncertainty about the timing and content of the incoming regulations remains a short-term challenge for banks' business models, funding and capital planning.

The crisis has had a **material impact on cross-border banking**. A major risk, already flagged in the EBA's risk assessment report last July, is that of **pan-EU fragmentation and retrenchment within national boundaries** by the larger cross-border banking groups, potentially leading to market inefficiencies and to an erosion of the single market. This development could and should be countered by the timely implementation of an effective and credible framework for a Single Supervisory Mechanism (SSM) in the euro zone, a single rulebook for EU bank regulation and supervision, and other specific EU support measures.

Finally, a large number of banks across the EU are currently **dealing with poor reputation and low levels of customer trust** due to those banks' past involvement in inappropriate practices. In addition to leading to a potential loss of reputation, such misguided practices can also generate prudential risks for those banks, such as regulatory penalties and provisions for litigation resulting from banks' breaching of **consumer protection** rules. Banks are aware of this situation and there does seem to be a **drive to improve institutional governance and culture**, plus the selective build-up of provisions to offset costs from fines or legal action.

1. Introduction

Purpose of the report

This report provides an update on risks and vulnerabilities in the EU banking sector. With this report and that prepared in July 2012, the EBA discharges its responsibility pursuant to Recital 43 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 to monitor and assess market developments and provide information to other EU institutions and the general public.

Data sources

Key Risk Indicators and the EBA risk dashboard

Among other sources of information, this report is drawn from the EBA Key Risk Indicators (KRIs), a set of 53 indicators which has been collected quarterly by national supervisors from a sample of 57 European banks in 20 EEA countries from 2009 onwards. The banks in the sample cover at least 50% of the total assets of each national banking sector. The definitions used are consistent with the Supervisory Common Reporting (COREP) and Financial Reporting (FINREP). The charts of KRIs show the dispersion of data points for the relevant KRI over time, with 5th, 25th, 50th (median), 75th and 95th percentiles. The reference date for the most recent data is 30th June 2012.

Information about the sample and descriptive statistics of the latest KRIs can be found in the Appendix and Annex.

Risk Assessment Questionnaire

The EBA conducts a semi-annual survey, the Risk Assessment Questionnaire (RAQ), asking banks and/or their supervisors a number of multiple choice questions². Information from the questionnaire completed in September/October 2012 from a sample of 35 banks listed in the Appendix was used for this report.

Micro Prudential expertise and College information gathering

The report also analyses information gathered by the EBA from the European Colleges of Supervisors.

Organisation of the report

The report views banks as a set of balance sheets, and looks at the processes by which they balance liabilities and assets in a given environment. It considers this environment, the assets and liabilities in the system, and includes the regulatory environment as part of the analysis. It also touches on aspects of banks' relationship with investors, the wider public and, crucially, the banks' customers.

² For all graphs based on the RAQ, the height of the bars shows the number of respondents who agreed or mostly agreed with the statement on the x-axis. There is an exception when the x-axis carries the distribution ABCDE, i.e. answers to closed questions, namely: 'A' - agree; 'B' - mostly agree; 'C' - mostly disagree; 'D' - disagree; and 'E' - not applicable or no opinion.

2. External environment

Market sentiment and macroeconomic environment

The macroeconomic landscape across the EU remains difficult and challenges are expected to remain throughout 2013, ranging from sluggish economic growth to continuing recessionary conditions. The difficult macroeconomic landscape will continue to have a negative effect on the earnings capacity of EU banks and the level of credit expenses, although to different degrees depending on the country and the bank.

Against this difficult backdrop, market confidence in EU banks has been improving since mid-summer 2012. This is mainly due to the announcement of the following policies and regulatory measures to decouple banking risk from sovereign risk and reinforce banks' balance sheets:

- (i) the ECB's Outright Monetary Transactions (OMT),
- (ii) the Commission's Crisis Management Directive (CMD),
- (iii) the EBA's recapitalisation exercise resulting in an additional aggregate EUR 200bn of capital for EU banks,
- (iv) the activation of the European Stability Mechanism (ESM); and
- (v) the announcement of a euro zone banking union, which may include non-euro zone member states that decide to opt-in, starting with the Single Supervisory Mechanism (SSM) and continuing with a common resolution scheme and perhaps harmonised deposit guarantee scheme(s) (DGS).

Figure 1 shows how these initiatives have influenced the markets' view of the EU banking sector in terms of EU bank share prices. Of note is a significant improvement in the banks' share price index since mid-summer 2012.

Figure 1: Euro 300 Banks share price index (source: Bloomberg, E3BANKS)



Policies and political commitments on the preservation of the euro zone in its present form have made further progress and national ratifications of the fiscal compact should contribute further to the material scaling-down of tail risks.

The improvement in market conditions for bank debt and equity is visible in several ways. New debt issuance in the primary markets has resumed – senior unsecured, covered bonds and subordinated securities alike – although the few second-tier banks or large banks in financially-stressed sovereigns which have issued bonds have had to offer high spreads (ca. 300-500 bps above mid-swaps during Q4 2012). Average credit spreads in the secondary markets have more than halved since their peak earlier in 2012 and are now closer to (although still above) equivalent non-financial corporate spreads. Bank equity valuations have also materially improved, by more than one-third on average since the year's lowest levels, however this was only enough to return to levels at end-November 2011 or mid-2009 (see Figure 1 above). Nonetheless, a majority of EU bank shares continue to trade at prices below book values.

Improvements should not mask the ongoing fragility of the EU banking sector, most recently reflected by modest earnings reported for Q3 2012. It is expected that weak revenues and negative asset-quality indicators will continue to hurt bank earnings in 2013.

To reinforce the note of caution, despite recent encouraging signals, the RAQ response shows that 34 out of 35 respondents are still convinced that the link between banks and sovereigns exists as far as markets are concerned.

Regulatory developments

Some of the regulations (CRD IV, Solvency II/ Omnibus II) that will shape the landscape for financial services for the years to come are still under discussion for finalisation. Other regulatory initiatives are appearing and may eventually result in further rulemaking (e.g. the Liikanen Report). This creates uncertainty for investors and consequently increases the risk premium that is demanded for investment, driving up the cost of funding and borrowing.

One short-term concern for investors in bank instruments and other market participants is the uncertainty related to the timing and contents of the new regulatory initiatives currently underway. It is important that clear policy and regulatory rules be finalised so that the market will be able to price risk and move capital and credit efficiently. Clarifications on the technical details and implementation timing for CRD4/CRR – on capital, liquidity and funding – will contribute to further reinforcement of market confidence in the EU banking sector. The announcement of implementation details by the Basel Committee on Banking Supervision on the liquidity coverage ratio in early January 2013 is an important step towards global liquidity standards.

The opportunity is there for policy makers and the regulatory community to shape up and implement a framework which would allow the market for bank debt and equity to function efficiently and more robustly than in the past.

Fragmentation and the Single Supervisory Mechanism

There is evidence of increasing national retrenchment of both assets and liabilities for banks, with material scaling back of global financial activities – trade and commodity finance, international cross-border lending and leasing, trading and investment banking – as well as scaling back of intra-EU cross-border lending, especially into economies experiencing stress or recession.

This increases the risk of fragmentation of the single market. Such fragmentation is costly and may affect the free movement of capital and funding, increasing inefficiencies and preventing the extension of credit in sectors and geographies where it may be used most effectively.

There are both ‘private’ – i.e. linked to firms’ decisions – and ‘policy’ drivers to cross-border retrenchment tendencies.

The ‘private’ drivers rest mostly with banks, and with wider market pressures that drive banks to exit assets (which may be wider sectors or regions) that are perceived as either non-core or risky compared with their own risk tolerance. One example of market funding shortages is in USD funding (the main currency in which global transactions are denominated) which since mid-2011 has led the large euro zone banks to pull back from these areas. Banks may also choose to scale back or exit capital-intensive activities, or activities that entail lower profitability. Indeed, earnings pressure in business models is leading banks to refocus on core activities, while reducing or exiting other business. In this respect, exiting cross-border interbank lending and deleveraging abroad may be linked to higher general risk aversion.

Apart from being viewed as a strategic response to the crisis, cross-border retrenchment and the scaling back of related lending may have been reinforced by local regulators imposing in areas subject to their authority either explicit or implicit requirements to match liabilities and assets. In such cases, the banks facing difficulty in attracting funding in a particular market are under pressure to deleverage. Unilateral action by national supervisory authorities can weaken the single market, and can create potential pressure on the financial stability of cross-border groups at times of heightened uncertainty. Divestment of assets abroad may be also linked, for some banks under restructuring, to the application of EU State aid rules.

Should this situation remain in place over the longer term, it could lead to more permanent negative consequences. On the one hand, lending to the real economy in some countries could be affected, especially in those where the large local banks are subsidiaries of cross-border groups. On the other hand, a relative marginalisation of the EU banking sector’s role in global financial transactions could have a lasting negative impact both on those global markets (as non-EU banks, while more active globally, are not expected to take up that important role to its full extent) and on the EU’s position in world trade and finance.

The EBA thus continues to strongly support colleges of supervisors as the proper forum for discussion and agreement on appropriate supervisory measures for cross-border banking groups.

In June 2012, the European Council decided that the countries of the euro zone, and other Member States that may wish to opt in, would create a single supervisory mechanism (SSM) for banks mainly as a response to the banking and sovereign crisis, and the December 2012 ECOFIN made specific

progress in this direction. The SSM, combined with other measures to drive further integration – such as the European Stability Mechanism (ESM) and, possibly, harmonised deposit guarantee scheme(s) – may also be used to combat fragmentation by strengthening the single market between the ‘participating’ countries, promoting banking union and reducing market inefficiencies. The EBA will continue pursuing its objectives of advancing towards an EU-wide single rulebook and promoting regulatory convergence across the Union, in both rules and practices.

3. Business models and banks' internal drivers

Risk appetite and the operating model

EU banks continue to embrace risk-averse strategies which came into being at the height of the financial crisis. The pre-crisis market premium on risk taking and aggressive leverage has long been replaced with a more risk-adequate view.

Spurred by both new, tighter regulations and increased market scrutiny, banks have been avoiding material risk-taking, both in credit and market activities. Strategies have focused on boosting conservative funding – primarily customer deposits – and limiting asset growth or even deleveraging. The banks' aversion to risk has also been underpinning their focus on building ample liquidity positions – e.g. via deposits with the ECB for euro zone banks – and (for some banks) avoiding cross-border interbank lending.

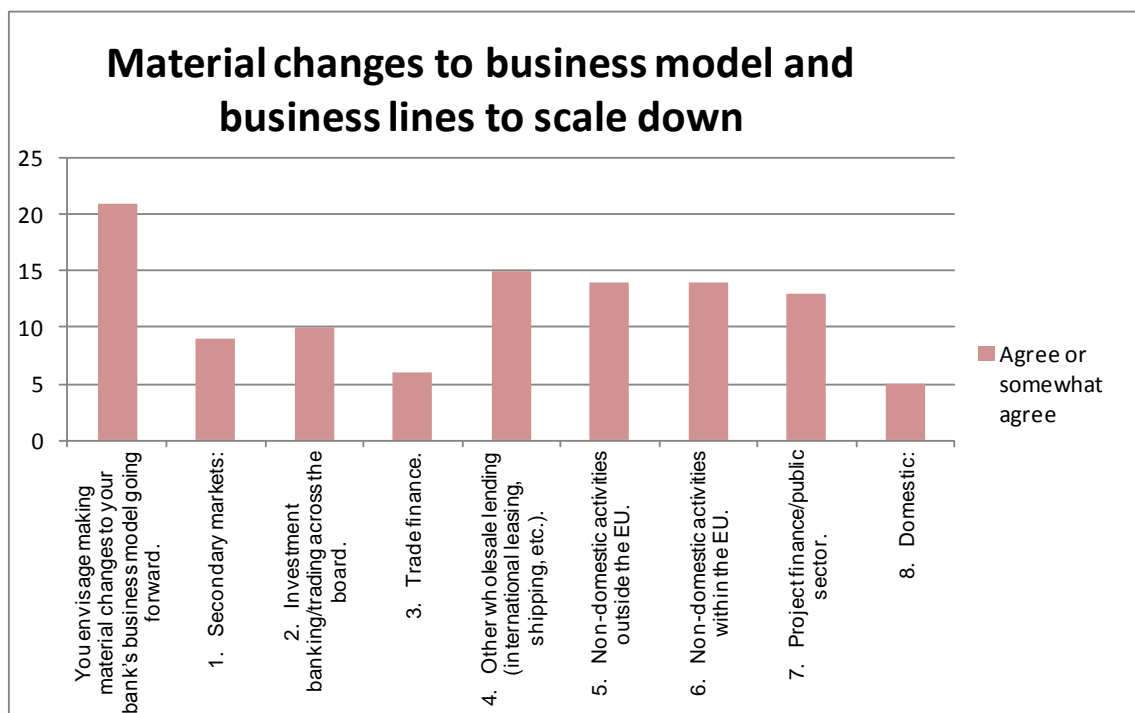
There is still a risk that the persistence of the banks' cross-border risk aversion may have an impact on the banks' key role of efficiently providing credit to the real economy at home and abroad.

Banks continue to move away from excessive reliance on high-risk high-return activities. One example is the continuing retrenchment from large-scale investment banking and trading, also linked to regulatory developments. Several banks with previously large investment banking books have been moving towards a more balanced approach to balance sheet growth, with an emphasis on retail activities.

Related to both reduced risk appetite and scarcer and more expensive wholesale funding (especially in USD) is the gradual withdrawal of large EU banks from global finance – trade finance, cross-border leasing, etc. As a sector, EU banks were on aggregate by far the largest participants in these activities. The current retrenchment trend is unlikely to reverse itself in the foreseeable future, which may have an impact on international trade financing (as the place left vacant by EU banks may not be taken at full capacity by other international banks – e.g., from North America or the Asia-Pacific region).

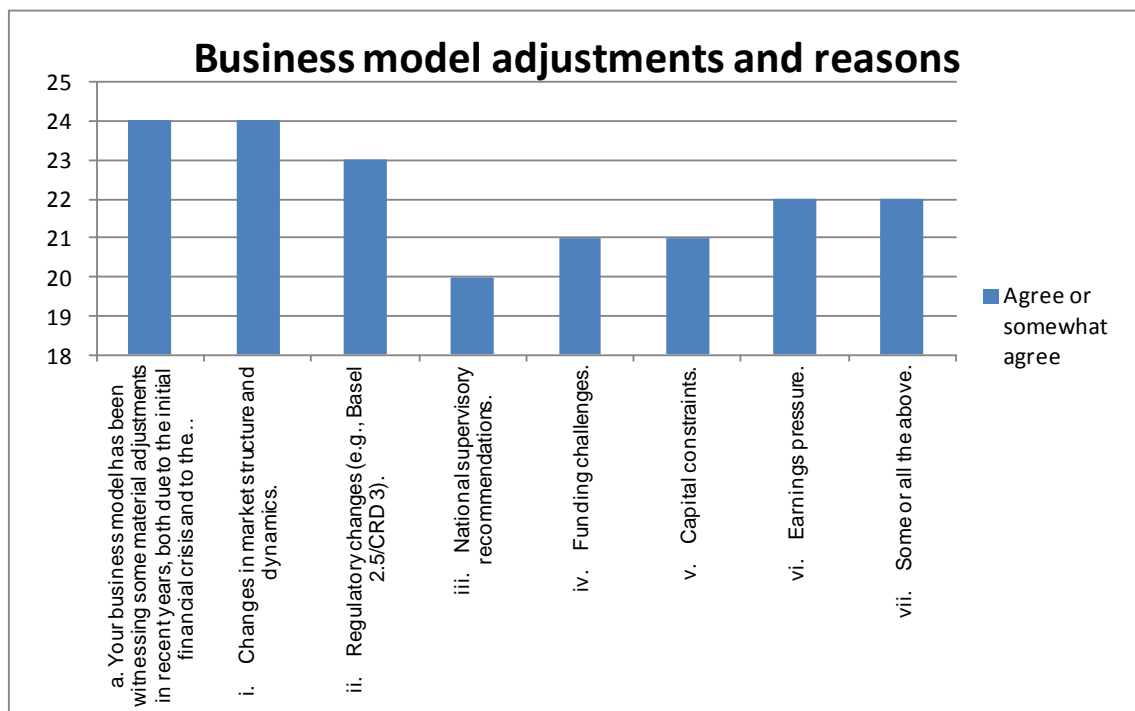
Figure 2 shows the RAQ respondents' views on changes to business models and the scaling down of business lines.

Figure 2: Changes to business model (source: RAQ)



There are several factors underpinning this trend: (i) new regulations (e.g., Basel 2.5, transition towards Basel 3) that lead to increased capital charges and funding/liquidity constraints; (ii) reduced opportunities for new entrants and second-tier participants in investment banking and trading; (iii) heightened investor scepticism regarding the quality and sustainability of earnings from trading and investment banking, as figure 3 below shows:

Figure 3: Business model adjustments (source: RAQ)



Similarly, banks are seeing a marked decline in lending to large corporates. The latter are now able to access the debt market directly at funding conditions which are better than those of the equivalent banks'. This trend could continue, although it is expected that the level of credit disintermediation away from the banking sector in the EU will not reach the higher levels existing in the US market in the near future.

In EU banks' home markets retail and business (primarily SME) lending remains constrained, as shown by recent statistics and ECB lending surveys. Again, this trend is unlikely to reverse itself in the immediate future – at least not while domestic economies do not show clear signs of recovery.

These changes have led some banks to be confronted with a situation where their current business model is becoming unviable, while it is not clear from where their future drivers of profitability will originate.

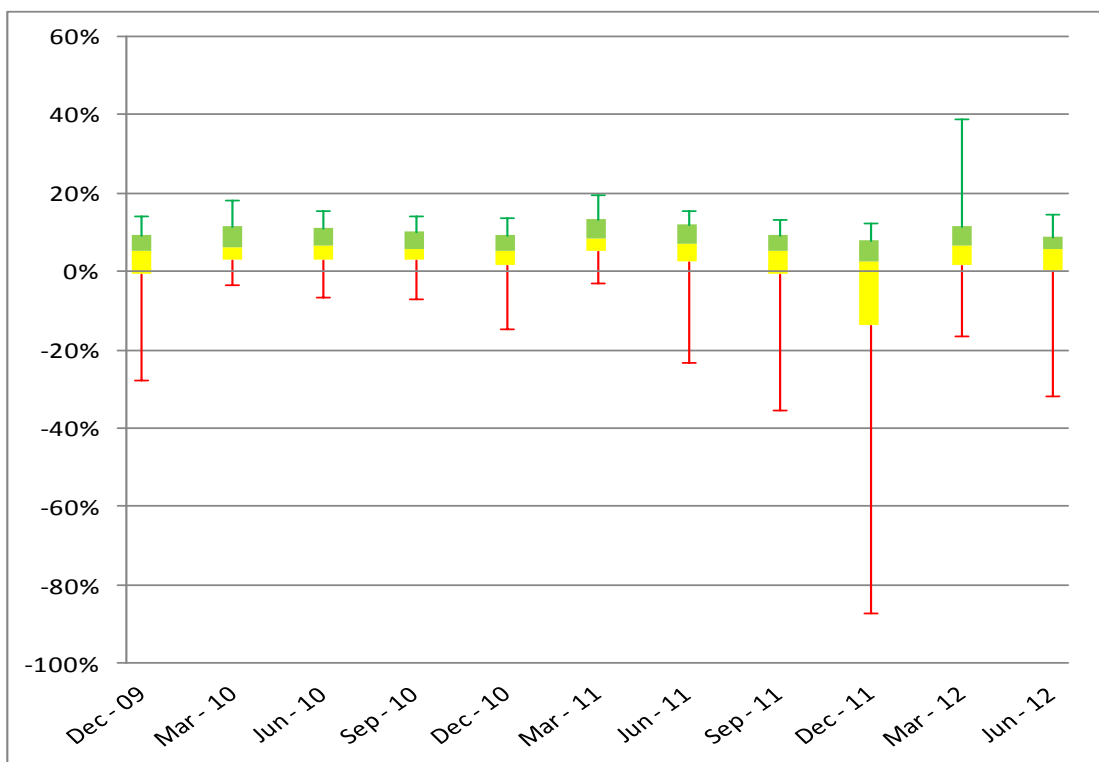
Profitability

To different degrees, EU bank profitability continues to be faced with significant headwinds which are not likely to dissipate in 2013. Profitability is affected by several factors:

- Net interest margins – which are becoming an increasingly important component of earnings as banks shift to more traditional business models – are pressured by high funding costs, both wholesale and retail, which are not being matched by a full re-pricing of assets. The latter is explained by a mix of political and social considerations (business and retail borrowers facing economic difficulties), reduced credit demand, and the persistence of historically low policy rates.
- At the same time reduced demand for banking products and services (e.g., credits and investment banking) blunts growth-generated earnings hikes.
- Fees and commissions, which have traditionally been an important source of earnings for banks, are also under pressure due to reduced levels of activity and many banks' reluctance to hike customer fees aggressively when faced with heightened regulatory scrutiny and socio-political pressures.
- Importantly, credit costs are also rising, as the weak economic conditions in many countries, alongside more transparency on impairments and potential losses, lead to higher levels of loan-loss provisions. When benchmarked against flat or declining volumes of loans, higher credit costs are an important driver for weaker earnings.

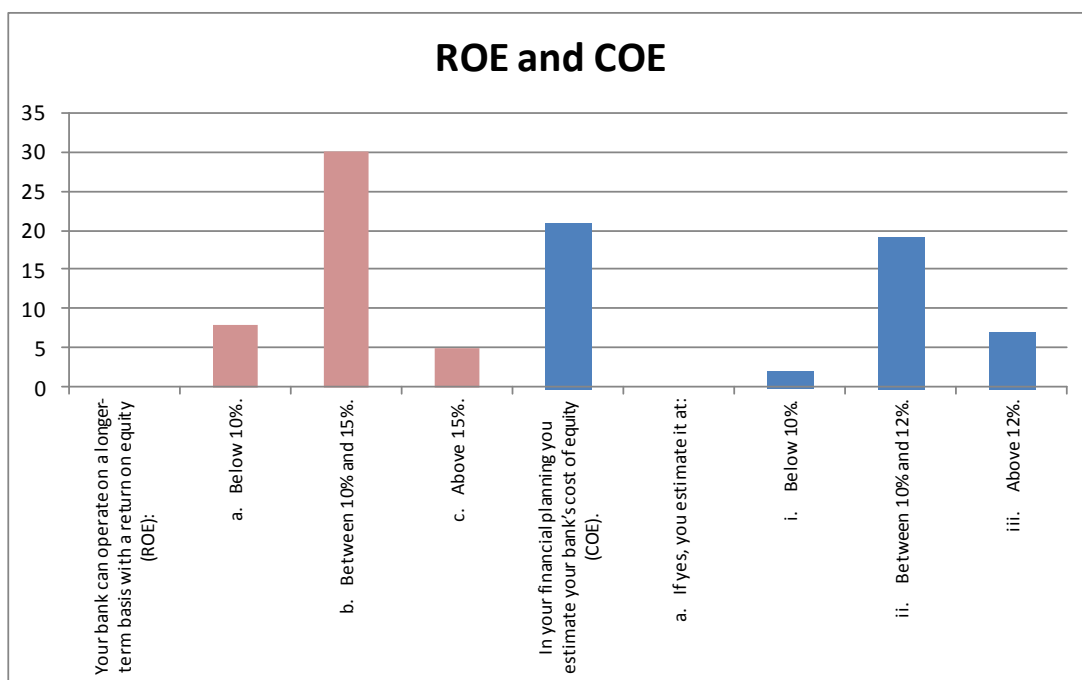
As the following KRI chart shows, Return on Equity (RoE) in June 2012 (median: 5.7%) has greatly increased in the headlines since December (median: 2.7%) but has eroded since March 2012 (6.7%).

Figure 4: Return on Equity (source: KRI) - 5th and 95th percentiles, interquartile range and median



Most respondents to the RAQ consider a RoE value in the range of 10%-15% as the target for the long-term viability of their businesses, as shown in the following chart. Most respondents that calculate their Cost of Equity believe it to be in the 10%-12% range.

Figure 5: Return on Equity and Cost of Equity (source: RAQ)



Legal and reputational concerns

Recently, some incidents involving European banks have come to light that have had an adverse impact on the banks involved. First, the banks involved have paid fines for wrongdoing. Second, this affects the reputation of the banking sector as well customers' trust and market confidence in EU banks.

In the last few months an investigation by the US and UK authorities concluded that several large banks were manipulating LIBOR. More or less concurrently, another investigation showed that some banks had deficient know-your-client procedures, thus making money laundering possible, or had knowingly breached international sanctions for certain states. Other banks, notably in the UK, have raised provisions against further regulatory sanctions related to mis-selling of Payment Protection Insurance (PPI) products. Recently, the EBA and ESMA have carried out joint work that has identified significant weaknesses and insufficiencies in the governance of the Euribor rate-setting mechanism³ and European competent national authorities are also conducting legal investigations. On the risks related to consumer protection, the reader is invited to refer to the relevant section later in the report.

Collectively, these incidents represent a failure in risk management and in compliance procedures that may point to a cultural problem that should be addressed by banks, and by supervisors, through more intense supervision.

In our RAQ, most respondents believe that the legal and reputational concerns are going to intensify. Most respondents aim to address this through improving culture and risk management, but some are also raising reserves as the following figures 6 and 7 attest.

³ <http://eba.europa.eu/News--Communications/Year/2012/ESMA-and-the-EBA-take-action-to-strengthen-Euribor.aspx>

Figure 6: Trends in reputational risk⁴ (source: RAQ)

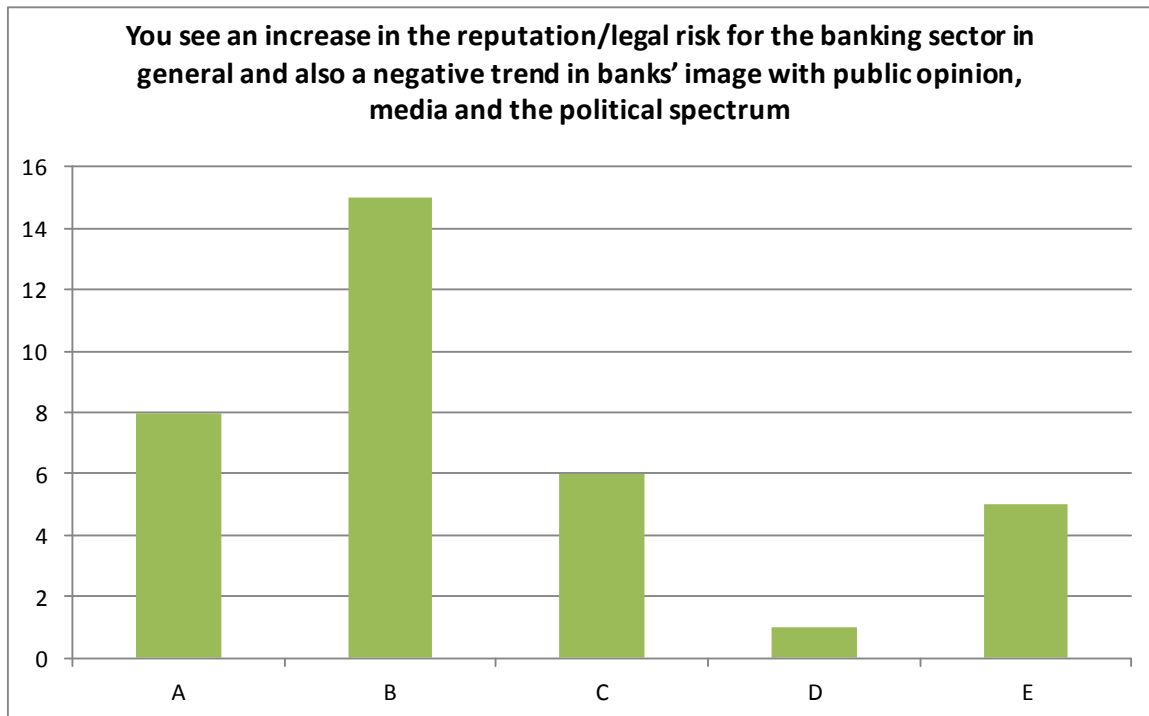
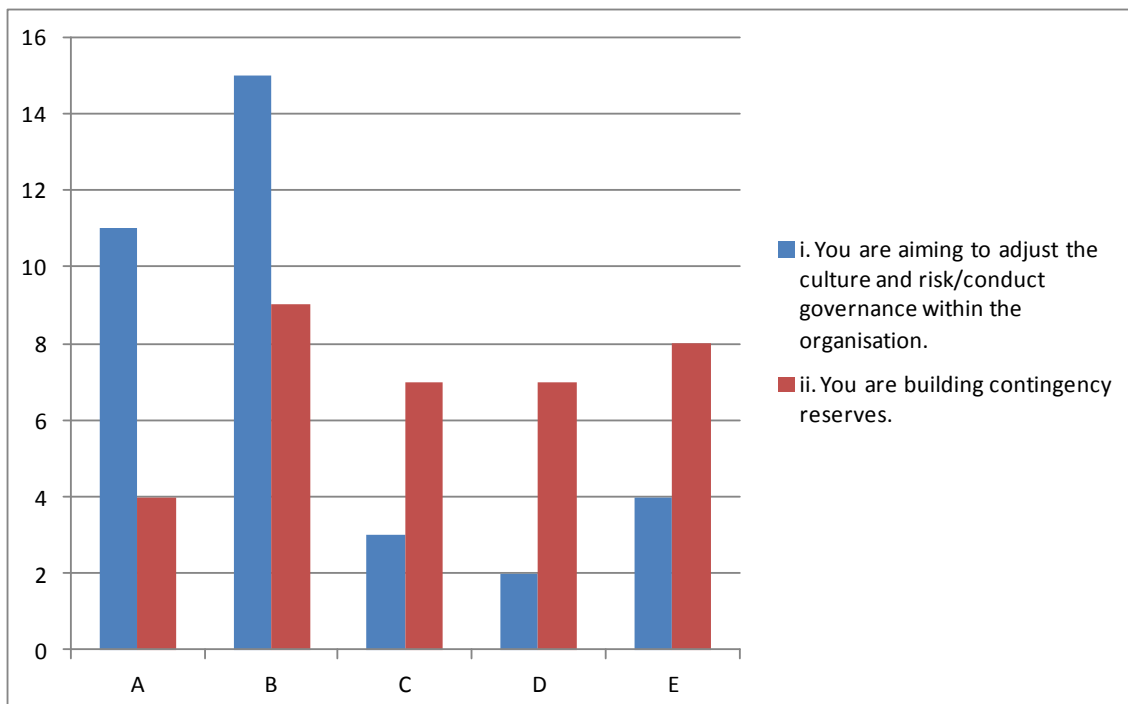


Figure 7: Addressing reputational risk (source: RAQ)



⁴ The horizontal axis of the two graphs on this page denotes the following: A:agree B: mostly agree; C: mostly disagree; D: disagree; E: no opinion or not applicable.

4. Liabilities

Funding

Financially stronger banks have again been issuing unsecured debt in recent months. This is a welcome development, but caution is needed and it is too early to say whether there is a thaw in funding conditions, especially for lower-rated banks, or for banks domiciled in financially-stressed sovereigns (the strongest of these banks also issue, but do so at high spreads). Particularly in those financially-stressed sovereigns, the sovereign-bank link continues to impact funding conditions. For all that, funding conditions are better than they have been in the last three years.

Asset encumbrance and collateral

The increased importance of secured funding has created a significant amount of asset encumbrance, though the specific level varies by institution, business model and jurisdiction.

Encumbrance of assets could be harmful and self-reinforcing in cases where it exceeds certain thresholds. To the extent that fewer unencumbered assets, which are additionally likely to be of lower quality, remain available for unsecured creditors and depositors, it is harder for the respective bank to source unsecured funding at viable prices. This, in turn, leads to the issuance of more secured funding, thereby encumbering more assets.

Forthcoming regulations as well as other developments are likely to lead to an increase in the demand for collateral. In particular, high quality collateral would become more expensive, thereby increasing the funding costs for banks, for the following reasons:

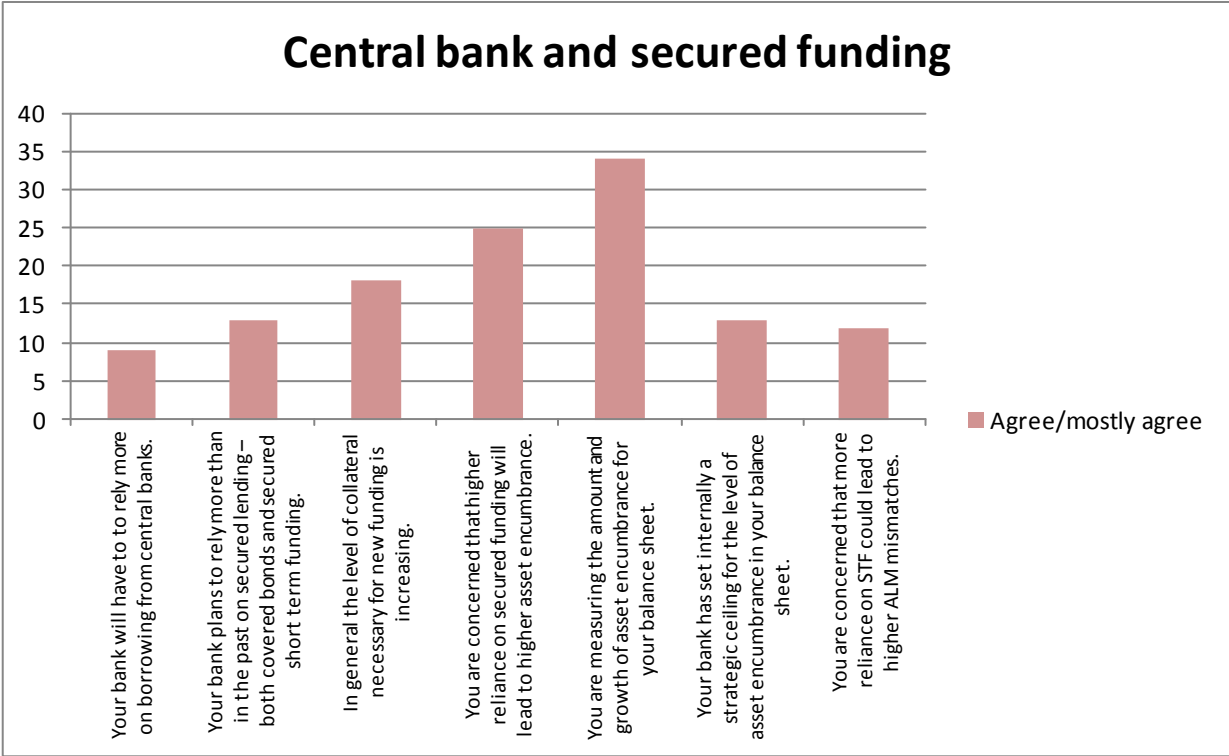
1. There is increased demand for high quality (HQ) collateral, in part due to Solvency II and Basel 2 / Basel 3 requirements. Additionally, there is the demand generated by increased reliance on secured funding, and in particular central bank secured funding.
2. Banks are hedging and matching liabilities with HQ assets in the current shift towards de-risking, further spurred on by the expected introduction of Liquidity Coverage Ratio (LCR) requirements.
3. With the introduction of Central Counterparties (CCPs), HQ collateral will be required from participants. Central banks also require HQ collateral for repo transactions. In both cases, the collateral pledged cannot be re-used for further transactions (as would be the case from some private repo transactions). This reduces the overall available supply of collateral in circulation.⁵
4. Enough domestic HQ assets (in this case, predominantly EEA domestic-currency government bonds) may not exist in all jurisdictions – to the point where some banks may face a problem with meeting the LCR, especially if sovereign bond buyers behave in a ‘nationalistic’ way. The latter action also erodes the single market. The recent BCBS decision on LCR qualifying securities may alleviate this problem to an extent.
5. Though not a new development, pension funds are traditionally demanding HQ assets as a result of their nature and mandate.

⁵ However increased use of CCPs should lead to increased netting benefits and thus have a limiting influence on additional collateralisation requirements.

The move away from central bank support and towards increasing the use of unsecured funding on private markets, while not a short-term concern, is essential and will contribute to collateral availability and increase collateral velocity, thereby aiding the efficient functioning of the credit markets and increasing credit provision to the real economy. Regulators therefore need to pay particular attention to the banks' plans to wean themselves from central bank support in the coming months and years.

A promising trend, although too early to consider it a sustainable development, is that a majority of RAQ respondents seem to think that there will be less need for central bank borrowing and do not plan to rely more on secured lending as shown in Figure 8 below.

Figure 8: Central bank and secured funding (source: RAQ)



The Role of Central Banks

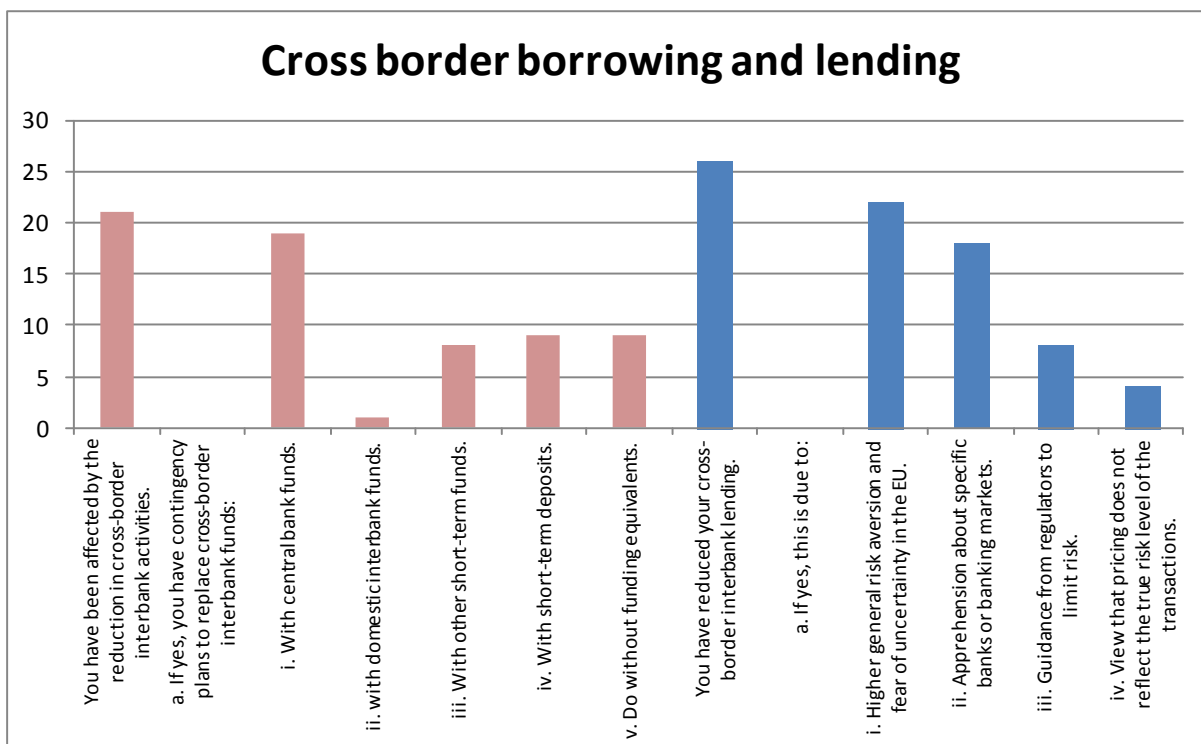
The banking and sovereign crisis across the EU has led to a severe collapse of market confidence in the banking sector, in particular from financially-stressed euro zone countries (the so-called 'peripherals'). Aside from a virtual freeze of market access, some of these banks have also been witnessing a negative outflow of deposits, especially in the context of apprehension about the sovereign situation of the respective banks' home countries. Borrowing from the ECB/Eurosystem thus became a prime funding avenue for many EU banks (including the two LTROs from late 2011 (523 banks participated) and early 2012 (800 banks)). Banking systems in 'peripheral' countries saw a strong rise in ECB borrowing from mid-2011.

While recognising that central bank borrowing has represented a sine-qua-non alternative when market funding proved very difficult for some banks, a degree of apprehension needs to be expressed regarding this trend. Specifically we would point to the following:

- A viable business model under which banks are able to lend on a sustained and predictable basis to the real economy (households and businesses) should not be based on growing dependence on central bank borrowing, which short-circuits the normal funding and liquidity flows of free-market economies.
- LTRO funds will need to be repaid or refinanced at the latest at end 2014-early 2015, which will require that by that time banks have normal market funding access.
- Central bank borrowing is all secured, thus requiring banks to earmark significant amounts of collateral in their balance sheets, thus leading to a material spike in asset encumbrance (see above).
- Sustained lending to private banks leads to a rapid swelling of the ECB/Eurosystem's aggregate balance sheet, with potentially negative consequences for financial stability and fuelling further funding disequilibria across the euro zone.
- At the same time it crowds out transactions among banks across borders, thus leading to a severe slowdown in cross-border interbank activities (which has been occurring since mid-2011). Figure 9 below shows the RAQ respondents' view that retrenchment is being underway.

These are all arguments militating for the need to restore market access for banks – both in terms of costs and availability. This has been happening since mid-summer but it is still too early to view this positive trend as sustainable over the medium-term given the ongoing structural weaknesses of the banking industry and the still strong links between banks and their sovereigns.

Figure 9: Cross border borrowing and lending (source: RAQ)



Deleverage

In a majority of EU countries excessive or disorderly asset deleveraging has not occurred, especially insofar as assets related to the real economy (loans to businesses and households) are concerned.

More severe deleveraging has been occurring this year in financially-stressed countries and this trend is set to continue, as local banks have been facing funding shortages (including in some cases negative deposit flows) and especially weak credit demand stemming from recessionary economies. On a selective basis, some banks which have been unable to adjust their business models and balance sheets (including levels of capital) to the new realities have started deleveraging.

As long as EU economies remain either in recession or modest growth, it is unlikely that bank lending will resume to higher levels. At the same time, if credit demand revives, economies cannot be expected to pick up sustainable growth without more vigorous bank lending. Breaking this negative loop is a function of restored market confidence and better regulatory clarity (the former being to some extent a function of the latter), which will enable banks to resume normal funding for growth and target the appropriate strategies to that effect.

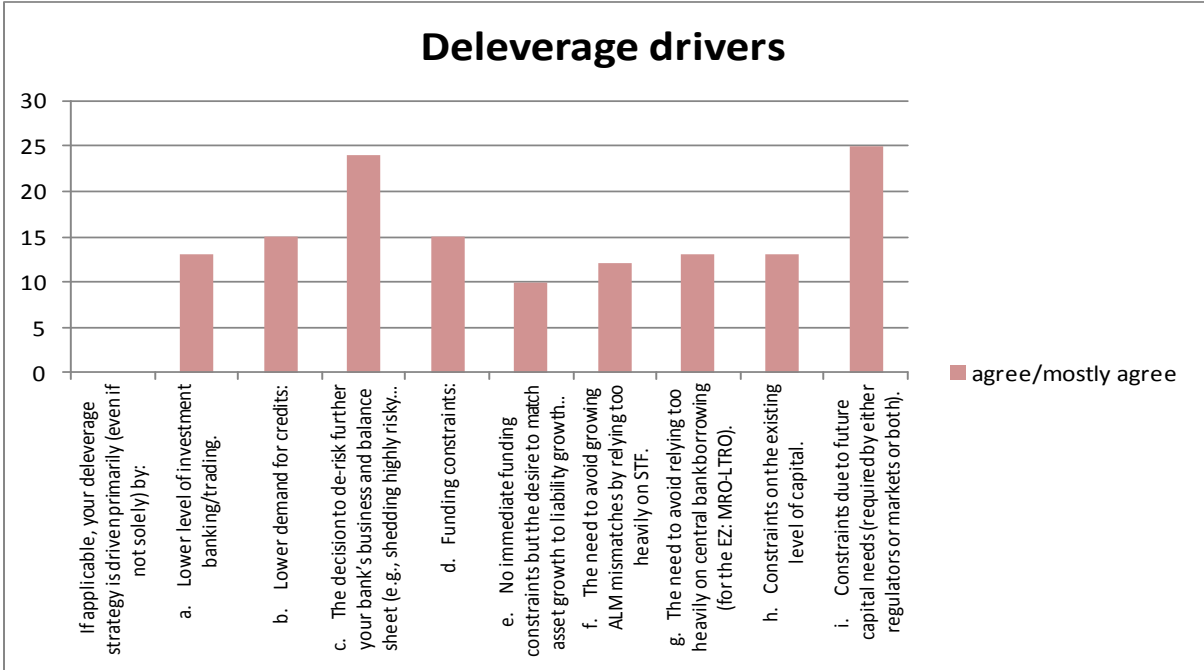
In the RAQ, a majority of respondents were deleveraging for both ‘private’ drivers as described earlier, i.e. their own business strategy reasons, and in some cases official requirement or encouragement, as figure 10 below shows.

Figure 10: Deleverage (source: RAQ)



Further de-risking and capital constraints are the most popular reasons cited in the RAQ responses in Figure 11 below.

Figure 11: Deleverage Drivers (source: RAQ)



In keeping with the de-risking reasoning, most RAQ respondents consider shedding investment banking and related activities primarily, followed by other general wholesale assets.

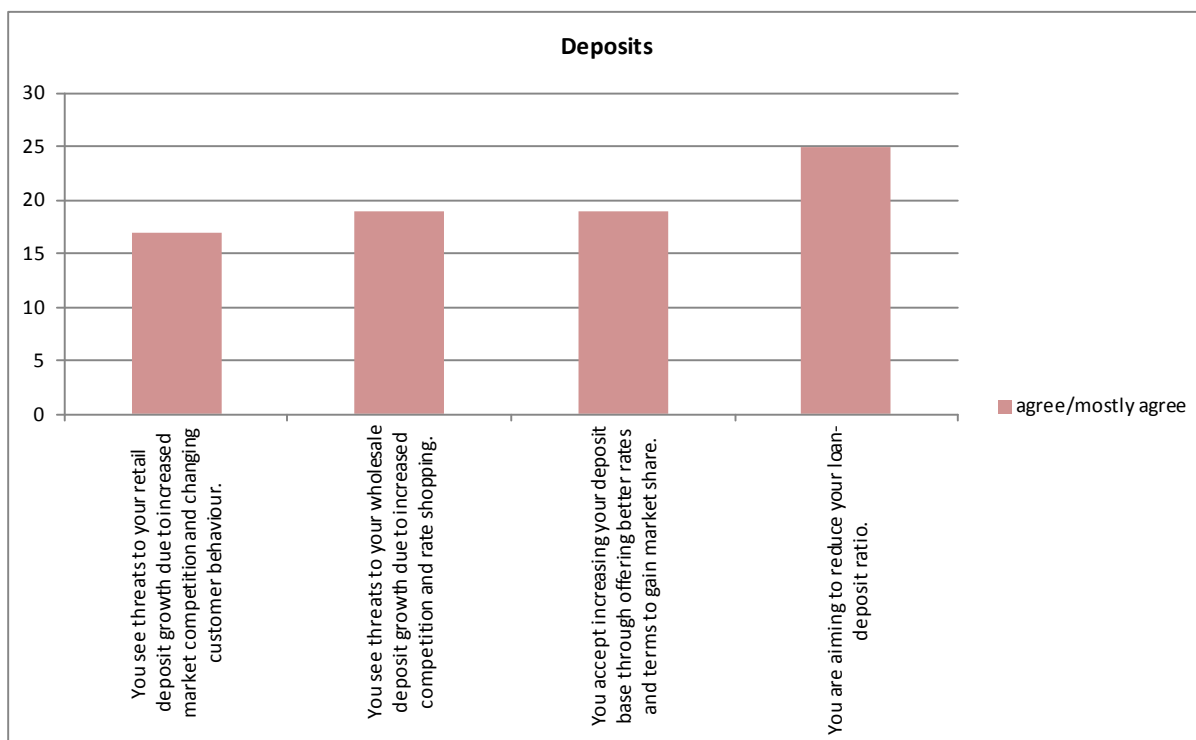
Competition for deposits

As a lesson-learned from the crisis, all banks have defined their strategies as focusing primarily on collecting deposits – to target lower loan-deposit ratios and to cope with the shortage of new market funding – resulting in an increase of in-market competition among banks for new deposits. This competition has led to more competitive rates offered to depositors in some countries, especially for longer-term savings.

Aiming for higher reliance on deposit funding is leading to more balance sheet stability and a better funding mix, but at the same time is raising overall funding costs thus challenging profitability. This trend is heightened by the fact that often banks encourage savings re-intermediation, meaning bringing back to their balance sheets customer funds which in earlier years had been invested in mutual funds or life insurance. The incentives offered to customers to shift their savings into bank deposits include a cost element.

RAQ respondents are alive to the push for more deposits, the resulting competition and accept that they will have to offer better rates in order to help achieve the aim of reducing loan to deposit ratios.

Figure 12: Deposits (source: RAQ)



Consequences of Solvency II

The Solvency II regulation that is being introduced affects insurance companies that have been traditional buyers of securitisation. Some of the effects under Solvency II will include:

- Very severe treatment of securitisation⁶: prime AAAs attract capital charges from a minimum of 7% to a maximum of 42% for different durations (1-6 years).
- Very favourable treatment of covered bonds which attract a comparatively smaller charge than securitisation (as an example, securitisation has a 7-18 *times* higher capital charge for AAA/AA depending on duration and rating) and a smaller capital charge for AAA/AA than similarly dated and ranked corporate bonds (the charge for CBs is 78%-83% smaller) – though the charge is the same for other ratings.
- Very favourable treatments of EEA domestic-currency bonds charged at zero and which therefore attract no capital charge.
- No special treatment of banks' bonds, which are classed as corporate. Risk weights are based on rating and duration, with long-dated bank debt more unattractive. This is working against insurance firms helping extend banks' debt maturity profile. Insurers need long-dated bonds, but may move to mismatched shorter-dated debt and use swaps to hedge for duration. Additionally, banks with a low rating will have trouble attracting any insurers as investors for their bonds – a BBB 5 year bond would attract a 12.5% capital charge.

The net effect on banks may be:

- A reduction of exposure of European insurers to the European ABS market, which is a major risk to the efforts of the authorities to restart the securitisation market as a funding mechanism for banks, since insurers have historically been important buyers of securitisation. This has started already. As things stand, there are, by comparison, direct capital incentives to invest in sovereign or covered bonds instead.

⁶ The industry comments suggest that the calibration has been fitted to the US subprime at its worst point and then extended to all securitisations. The 42% referred to above would correspond to an observed global default rate of 4.6%.

- A shortening of the maturity profile (to the extent that the unsecured debt market still functions). This may also result in more expensive products for insurance customers or lower income streams for them, as there will be the added cost of interest rate swaps.

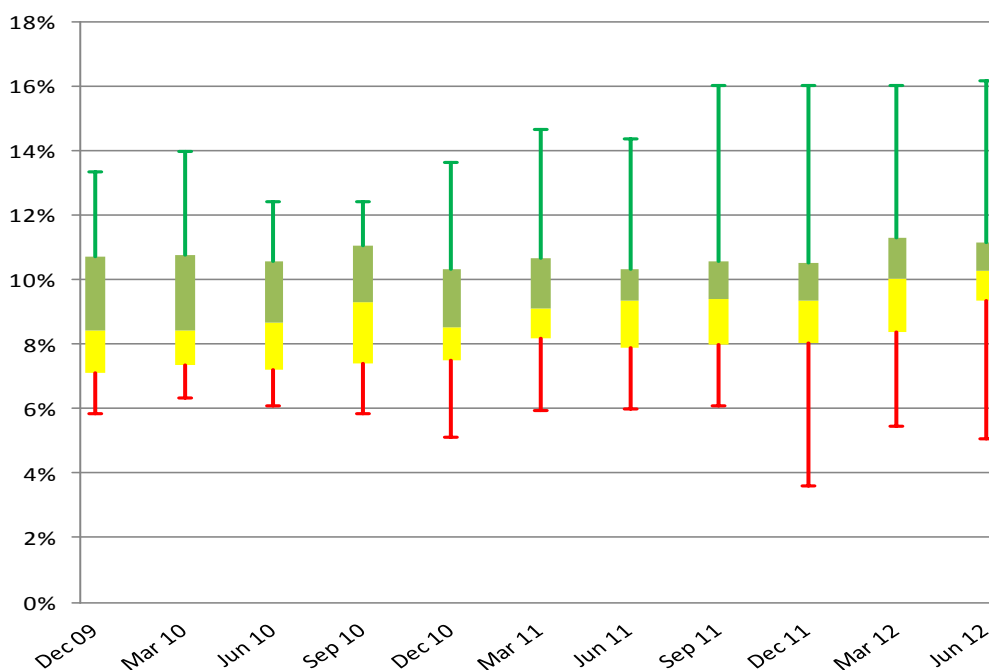
This would impact on banks (especially those with low ratings) because they may have difficulties in funding lending, or parcel and transfer their loan risks off their balance sheets. Deleveraging risks may increase, as parts of their funding stream would be reduced or become more expensive. It will moreover be difficult for banks to lengthen maturity profiles and improve their Net Stable Funding Ratio (NSFR). As a second order effect, Solvency II will also help make high-quality collateral more desirable, adding to the pressure described in the encumbrance section above.

Recapitalisation results

During the first half of 2012, notwithstanding the challenging conditions in financial markets, the banks' capital position has strengthened further:

- the median Tier 1 ratio increased by almost 1 percentage point, from 10.9% to 11.7%;
- banks with a Tier 1 capital ratio above 12% represented around 60% of the total assets of the KRI sample as of June 2012 (almost three times the December 2009 value);
- this positive trend is also confirmed looking at the Tier 1 ratio excluding hybrid instruments (a rough proxy of the Core Tier 1 ratio) which increased from 9.4% to 10.3%.

Figure 13: Tier 1 Ratio (excl. hybrid instruments) (source: KRI) - 5th and 95th percentiles, interquartile range and median

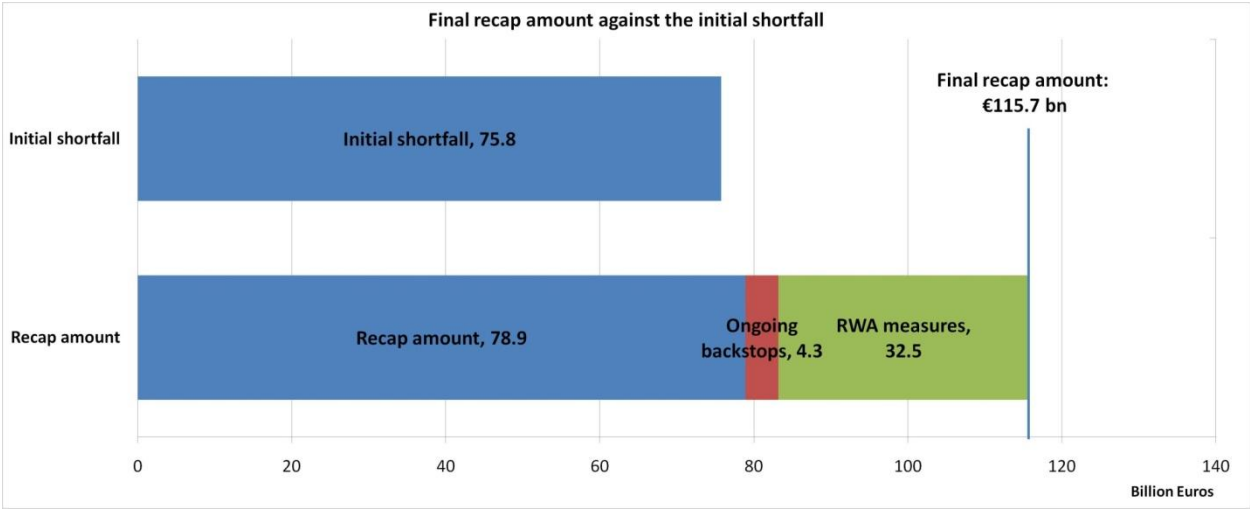


Capital strengthening is a result of various drivers, including measures taken by EU banks to comply with the 2011 EBA Recommendation which asked EU banks to raise their Core Tier 1 ratio (CT1) to 9%, after accounting for an additional buffer against sovereign risk holdings. Overall, the capital

exercise led to an increase in banks' capital positions of more than EUR 200 bn. For the 27 banks which were requested to submit capital plans, because of a capital shortfall of EUR76 bn, the exercise resulted in an aggregate recapitalisation amount of EUR116 bn.

Compliance with the recommendation has been achieved mainly via new capital measures (retained earnings, new equity, and liability management), and, to a lesser extent, by releasing capital through measures impacting RWAs. Aggregate data shows that these new capital measures have been more than enough to cover the initial shortfall.

Figure 14: Initial capital shortfall and final recapitalisation amount (source: EBA Staff analysis)



While the banks' capital position has improved, the continuing health in this area can only be the result of sustained profitability. As already mentioned, this is a quest that is still ongoing for many banks.

5. Asset Quality

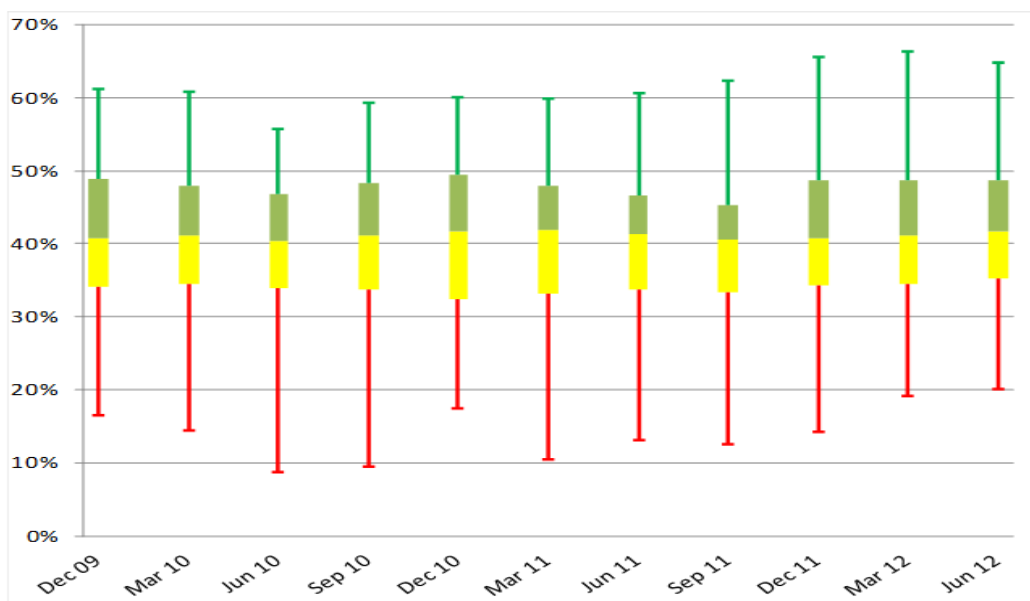
The quality of banks' loan portfolios continued to deteriorate during Q2 2012. Responses to the RAQ and Q2 2012 KRIs on asset quality both point to a continued deterioration of asset quality in the last few months. Although the deterioration in asset quality is spread across the EU, the intensity of concern varies considerably across geographies and portfolios.

Loans in arrears, and impaired assets in particular, have increased markedly. Yet provisioning has not always increased in line with rising credit risks (e.g. average provisions for exposures to real estate) raising questions about the extent to which provisioning is adequate. This could be partially due to the nature of the backward looking policy of provisioning conditional on a trigger event. Indeed, responses to forward-looking questions in the RAQ indicate that there are expectations of increasing impairment provisioning for this year and the next, in line with deteriorating asset quality and increasing residual credit risk throughout loan portfolios. Respondents also expect the level of non-performing loans to remain high, further pointing to expectations of ongoing deterioration of asset quality. Such deterioration would require increasing impairment provisioning and would not only adversely affect already subdued earnings, but sometimes also pose challenges to the maintenance of adequate capital levels.

The dynamics of the most recent set of KRI reflect declining asset quality, as both the ratio of average impaired assets to total assets and the ratio of accumulated impairments on financial assets to total assets increased markedly in the last quarter. Banks holding ca. 40% of total assets now show a ratio of impaired loans to total loans of over 5%.

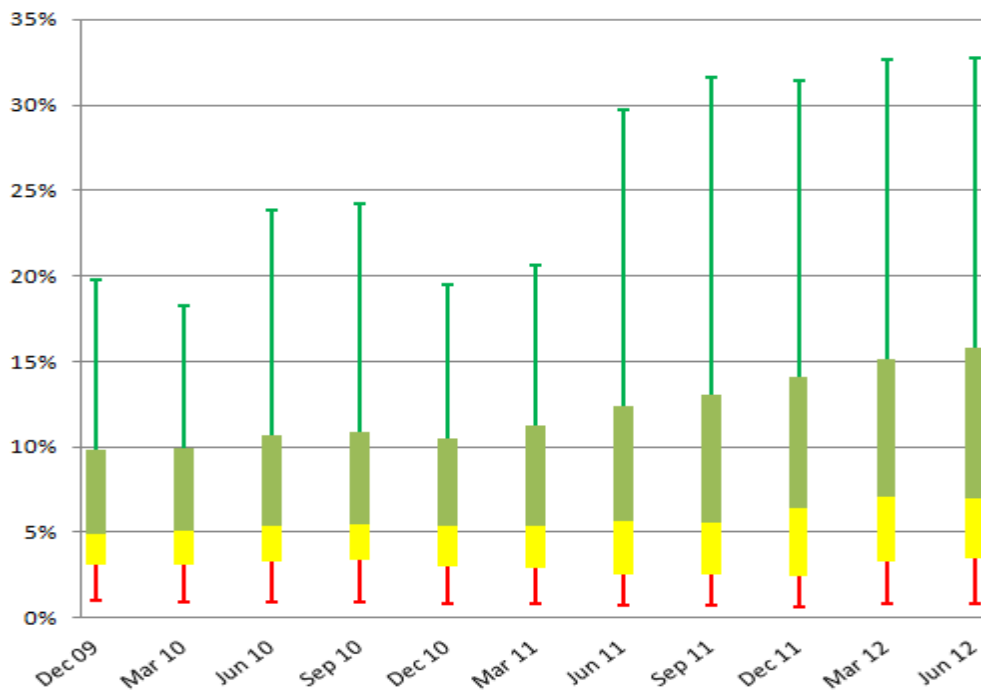
Impaired loans are on the rise, and over the last 12 months the median of Impaired loans and Past due (>90 days) loans to total loans has increased from 5.6% to 7.0%. Indications of increasing dispersion in Europe can also be observed regarding the level of impaired loans, as both bank-specific and country dispersions in the level of impairments increased in the last quarter. Banks with a ratio of more than 10% in Q2 2012 represent ca. 12.1% of total assets, up from 9.7% a year ago. Banks with a coverage ratio of less than 25% represented around 13% of total assets of the KRI sample in Q2/2012.

Figure 15: Coverage ratio (specific allowances for loans to total gross loans; source: KRI) - 5th and 95th percentiles, interquartile range and median



A trend of growing geographical dispersion of asset quality indicators across Europe can be identified, indicating an increasing divergence in loan portfolio quality. Impairments continued to increase particularly in banks in financially-stressed countries, while they have remained stable in other regions. Real estate portfolios have been particularly affected. Banks from six countries have values of impaired loans to total loans of more than 16%, while the figure is less than 2% for banks from four other countries. Looking forward, responses to the RAQ indicate expectations of further deterioration in asset quality and of further increasing impairment levels for a majority of banks. The responses show expectations of further increasing impairments from banks in financially-stressed countries, but also in countries with significant recent asset price increases.

Figure 16: Impaired loans and Past due (>90 days) loans to total loans (source: KRI) - 5th and 95th percentiles, interquartile range and median



Further reflecting expectations of exacerbated asset quality concerns in the light of a deteriorating economic environment, a large majority of respondents of the RAQ expect deteriorating quality of loan portfolios across most portfolios, but in particular in portfolios of SME lending, lending to the business sector, larger corporates, and in consumer credit.

Figure 17: Quality of loan portfolios (source: RAQ)

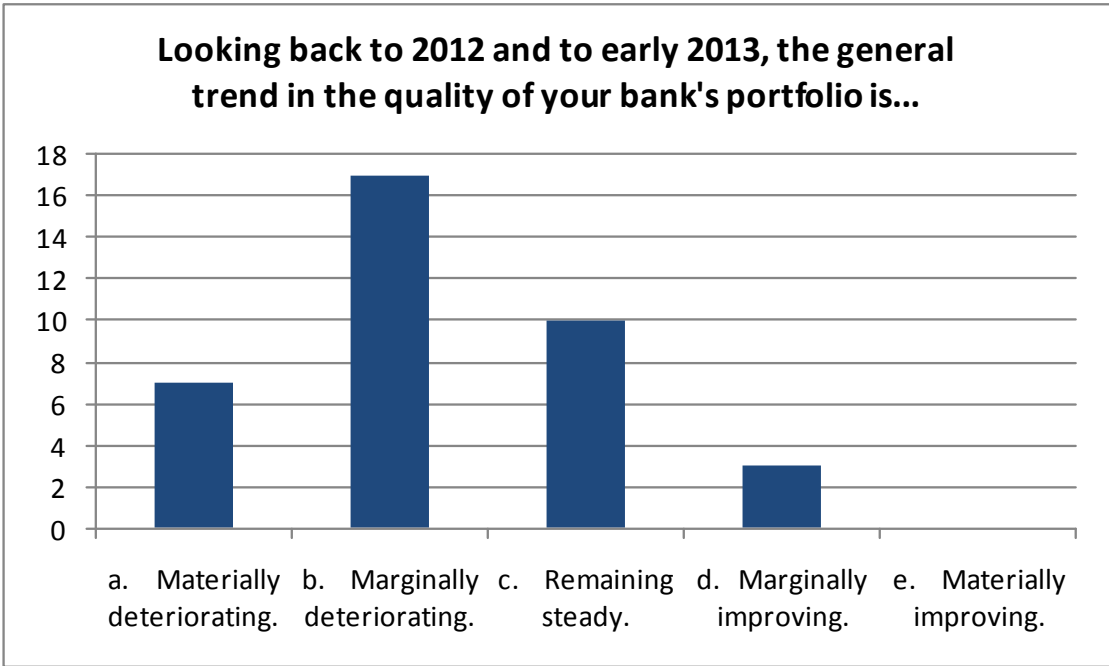
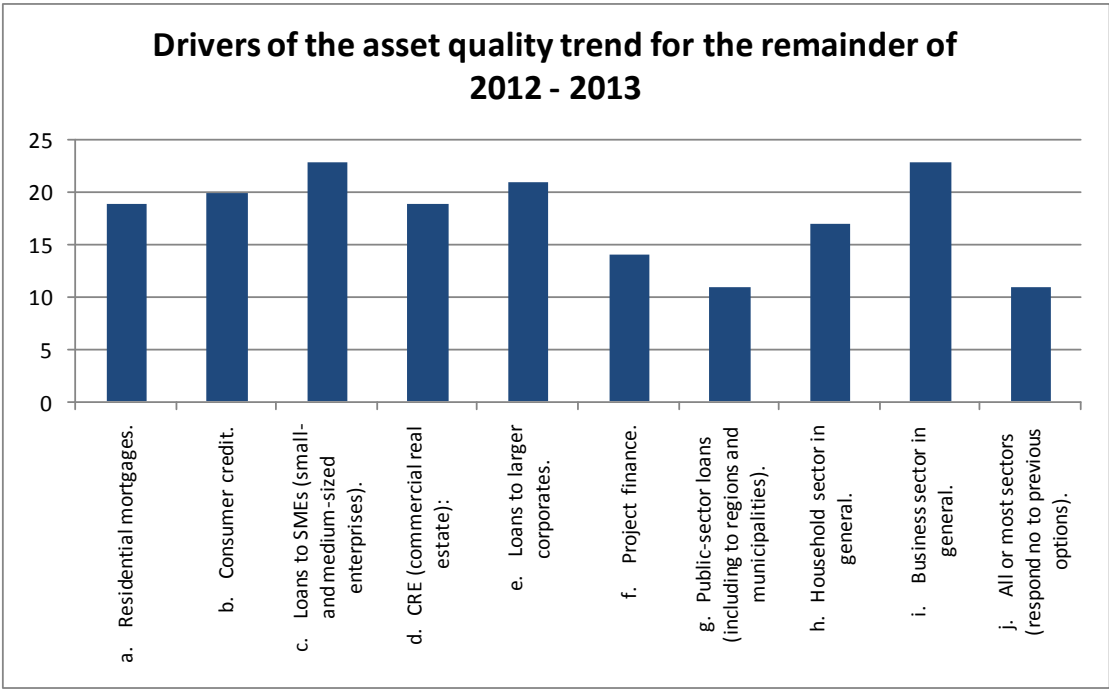


Figure 18: Drivers of asset quality trend (source: RAQ)



In line with deteriorating asset quality, a large majority of RAQ respondents have stepped up efforts to monitor institutions' asset quality. They have recently introduced or strengthened regular reviews of different loan portfolios conducted to assess their current quality, and they have introduced or strengthened reviews of existing policies for arrears management.

Figure 19: Expectations for impairments (source: RAQ)

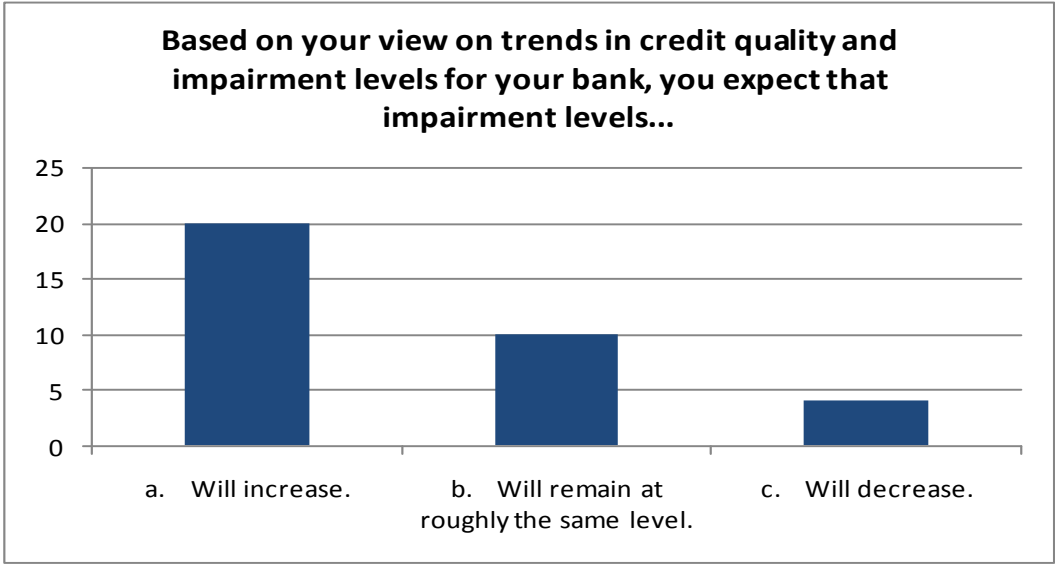
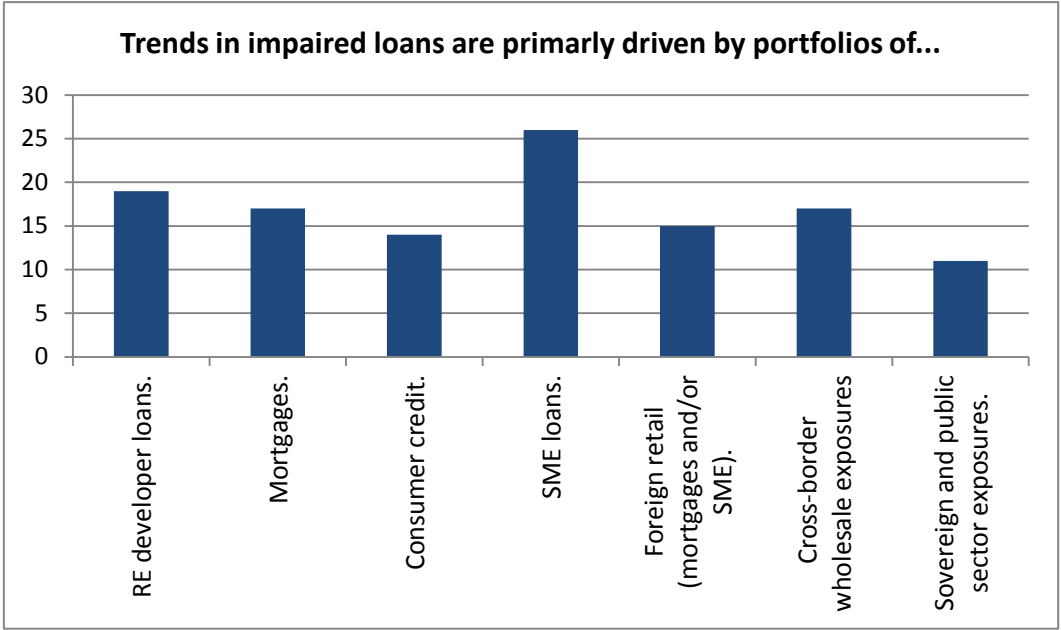


Figure 20: Drivers of impaired loans trends (source: RAQ)



While many supervisors have stepped up efforts to monitor asset quality, a range of different national approaches makes it difficult to obtain a clear picture of the extent of asset quality problems across the EU in a transparent way. Differing practices across jurisdictions to address not only asset quality concerns, but also debt forbearance, create uncertainties about the actual level of credit risk in banks' balance sheets and the valuation of bank assets. For example, there are differences in loan classifications (performing loans, non-performing loans (NPL), 'doubtful' loans, 'watchlist') and how forbearance is defined, assessed, classified and reported. Uncertainties also arise through accounting

practices for loans in arrears, uncertainties of the status of restructured loans, and through different practices of reclassifying performing loans which can distort information on reported NPLs.

Further supervisory actions to reduce uncertainties surrounding asset values would be beneficial to restore market confidence about the reliability of reported asset values and of the status of banks.

Forbearance

While the EBA's KRIs point to the worsening of asset quality, this did not deteriorate to the extent that could be expected in an environment of significant economic strain. The average ratio of past-due (but not impaired) loans to total loans did not increase, and average arrears to total loans ratio decreased, both indicating that loan portfolios might have been subject to some form of debt forbearance masking the problem.

Forbearance can be a useful remedial tool since it allows stressed borrowers to more easily honour their obligations in times of temporary distress, and eventually return to a healthy status. However, it can also disguise credit risks and result in banks' postponing the recognition of possible losses. Moreover, different approaches to restructuring loans may yield different results. A simple switch to an interest-only structure may not address the underlying problem whereas more radical approaches to restructuring, including partial write offs, may have more permanent effects.

Most respondents to the RAQ indicated that forbearance is mostly granted to residential real estate portfolios, with other less widespread usage for commercial real estate (primarily loans to real estate developers) and in the retail and business sector in general.

In the light of expectations of further deteriorating asset quality there is a need to assess and address loan forbearance in banks, as it may be relied upon as a way to provide temporary relief to distressed borrowers, especially in a prolonged adverse economic environment, but will ultimately be unsustainable. The ESRB has recently identified the need to properly assess forbearance on a consistent basis across the EU.

A common definition has been deemed necessary in order to clearly capture the extent of forbearance in a comparable way. The EBA in cooperation with ESMA, the EBA has started work on identifying common definitions of forbearance and on non-performing loans. Based on such definitions, comparable reporting of forbearance and aggregation may beshould become possible. In addition, it may become easier to identify cases of forbearance where loans have been restructured in order to avoid reclassification.

6. Banking services and consumer protection

If the financial system is to serve the economy properly, its users need to have the choice, but also the education and information needed, to make informed choices about the products and services they buy. In that area, there are potential risks for consumers, particularly retail consumers, who may be mis-sold opaque products with little understanding of the risks they entail. This creates reputational risks for banks as well as legal risks, as they may be sued, and prudential risks as they may be fined by the relevant consumer protection authorities.

Investors do not always have the knowledge or sufficient data to evaluate financial products properly. This becomes more relevant when the products become more complex, like structured products (SPs). For non-professional investors, this risk is especially relevant from the point of view of consumer protection, and is strongly connected with reputational risk. However, this kind of risk is not negligible for professional investors either. For non-professionals, names such as 'capital guaranteed structured deposits' can give misleading associations. Also the term 'deposits' can seem misleading; a customer might associate it with falling under the deposit guarantee scheme and/or the option of always having access to the full deposited amount, while in fact the total capital with these products is not protected by governmental schemes and only 'guaranteed' to be returned in its entirety at maturity.

A different kind of problem is linked to mispriced products. In practice many products are bought (or traded) by investors at higher prices than those which, in normal circumstances, could be considered as 'fair value'. Mispricing is usually connected with commissions, explicit or implicit.

In the next box we touch on some products that we consider as meriting special attention in the current environment.

Contracts for Difference

Contracts for Difference (CfDs) are leveraged derivative instruments that entitle the owner to mirror the performance of a share or an index, speculating on the movement of an asset price. A CfD is in essence an agreement between the buyer and the seller to exchange the difference in the current value of a share, currency, commodity or index and its value in the future. This does not involve the purchase or sale of the CfD's underlying asset. If the asset rises in the price, the buyer (who is long) receives cash from the seller (who is short), and vice versa. There are no restrictions on the entry or exit price of a CfD, no expiry date is placed on when this exchange happens and no restriction is placed on buying first or selling first. The contract can be closed by making the reverse transaction.

In Europe, CfDs are available in the UK, the Netherlands, Poland, Portugal, Cyprus, Germany, Greece, Switzerland, Italy, Sweden, Norway, France, Ireland and Spain. They are banned in the US because of laws that restrict bucket shop practices by limiting the ability of brokerage houses to create and trade certain types of over-the-counter securities.

CfDs are not exchange traded and the market remains one of the most opaque in the financial sector. The lack of disclosure of major economic interests in shares can lead to asymmetry of information which in turn can lead to imperfect pricing in the market, a distorted market for takeovers and diminished market confidence.

The leverage of CfDs consists in allowing investors to bet on rises and falls in the prices of the underlying assets by putting up only a small fraction of the market value (sometimes as little as 0,5%). The actual percentage that investors have to provide will vary for different CfD providers and for different asset classes. Where the market is against the bet made by the investor, the loss can be many times higher than the amount of money originally invested. The range of potential risks includes:

- Contagion and concentration risk – CfD providers use a limited number of banks as counterparties.
- Market risk: CfDs are traded on margins (1 – 25 %), and the leveraging effect of this increases the final loss (or profit) amount significantly.
- Liquidation risk – appears when prices move against an open CfD position and additional variation margin is required to maintain the margin level; The CfD provider may liquidate the collateral and pursue the holder for further funds.
- Counterparty risk – this is associated with the financial stability or solvency of the counterparty to a contract. If the counterparty fails to meet its financial obligations, the CfD party in a transaction may receive little or no value of the underlying instruments.
- Gapping risk – is a fundamental risk when trading CfDs. The prices of CfDs can move very quickly and skip price points which make trading limits ineffective in mitigating the risk of markets moving against the bets made by investors. Therefore, in stress situations when price ticks can be large, the losses can reach significant amounts even if clients have stop-losses in place.

Product development

There are concerns whether product manufacturers are undertaking sufficient work to ensure that:

- they have in place a robust internal product approval, development and review procedure or framework for new and/or redesigned products or services;
- products and services are designed giving due consideration to consumers and are fit for purpose at the time they are designed and/or redesigned;
- manufacturers devise appropriate marketing and distribution strategies, having regard to the target market for each product or service, its characteristics and the risks to consumers if the product or service is inappropriately distributed; and
- products and services are monitored internally to ensure they function as expected over time.

The above-mentioned concerns, if confirmed, would require supervisors to take swift action in relation to ensuring that product oversight and governance within the banks are robust and achieve desirable outcomes.

Structured products

After the financial crisis of 2008 and the collapse of the Interbank Market, in a climate of increasing distrust of financial markets by investors credit entities have become more dependent than usual on retail funding. This encouraged a certain return to traditional financial products. Structured Products (SPs), though complex in nature, have traditionally been sold to retail investors as substitutes for simple products. SPs are generally understood to be an investment product that is constructed from other products, such as a bond and an option. Performance is (partially) conditional on one or more underlyings. Typically the pay-off is non-linear. SPs are usually sold through retail and private banking networks. Some entities are issuing products dedicated to third-party institutional investors, mainly external private banks, while some are exclusively distributing their products to their internal distribution channel (the main example is a bank having both retail and private banking activities and which does not provide products from/for external market participants). The business models can vary from one entity to another, some entities are in favour of an internal product offering while some others are in 'open architecture' with several issuers.

Leveraged products in particular – sometimes called 'turbos' – are also classified as SPs by several banks.

Leveraged products are characterised by an amplification of the price movement of the underlying. While an investor can potentially lose all of his investment, this is offset by the potential for higher gains. Despite the trend towards capital-protected SPs, several banks have reported a (sometimes growing) market appetite for these leveraged products as well. Investors in these products are mostly not the same investors that invest in capital-guaranteed SPs. Also, distribution is different from other SPs: mostly via online channels on an execution-only basis.

Banks could use retail SPs as a cheap source of funding. Retail customers usually take into account the credit standing of a bank much less than institutional investors and other eligible counterparties. Because of this, the risk premium these customers receive (if any) is less than a badly funded bank would pay in the rest of the market. For example: Lehman Brothers, in the months before its demise, issued an increasing amount of retail structured capital guaranteed products. This was because (some) professional market participants already priced in the increased credit risk, whereas retail investors did not. The name 'capital guaranteed' proved misleading when Lehman Brothers fell and many investors lost their savings. Banks could become dependent on this source of funding that can dry up when households withdraw suddenly. This is also a consumer risk in the sense that the deposit guarantee scheme does not always apply to these products; it is a risk for financial institutions if they prove to be too dependent on this source of funding, and possibly also a macro prudential risk.

Appendix: Samples

Below we list the banks that made up the sample population for the Risk Assessment Questionnaire (RAQ) and the Key Risk Indicators (KRI).

Risk Assessment Questionnaire

	Bank name	Bank code for KRI submission	Home country
1	Erste Group Bank AG	AT302	AT
2	Raiffeisen Zentralbank	AT305	AT
3	KBC Group	BE001	BE
4	Marfin Popular Bank Public Company Limited	CY010	CY
5	DZ BANK AG	DE009	DE
6	Deutsche Bank AG	DE028	DE
7	Commerzbank AG	DE041	DE
8	Bayerische Landesbank	DE515	DE
9	Danske Bank A/S	DK001	DK
10	National Bank of Greece	GR011	EL
11	Alpha Bank AE	GR014	EL
12	Piraeus Bank	GR017	EL
13	Eurobank Ergasias	GR026	EL
14	Banco Santander SA	ES001	ES
15	BNP Paribas	FR001	FR
16	Crédit Agricole Group-Crédit Agricole	FR002	FR
17	Société Générale	FR003	FR
18	OTP Bank NYRT	HU001	HU
19	Bank of Ireland	IE011	IE
20	Allied Irish Banks plc	IE012	IE
21	Gruppo UniCredit	IT001	IT
22	Gruppo Bancario Intesa Sanpaolo	IT004	IT
23	ABN Amro	NL149	NL
24	ING Groep NV	NL163	NL
25	Rabobank Group-Rabobank Nederland	NL600	NL
26	DnB NOR	NO001	NO
27	Banco Comercial Portugues	PT033	PT
28	Skandinaviska Enskilda Banken AB	SE001	SE
29	Nordea Bank AB (publ)	SE002	SE
30	SWEDBANK AB	SE003	SE
31	Svenska Handelsbanken AB	SE004	SE
32	Barclays Plc	GB001	UK
33	Lloyds Banking Group Plc	GB002	UK
34	HSBC Holdings Plc	GB006	UK
35	Royal Bank of Scotland Group Plc (The)	GB007	UK

Key Risk Indicators

	Bank name	Bank code for KRI submission	Home country
1	Erste Group Bank AG	AT302	AT
2	Oesterreich Volksbanken	AT304	AT
3	Raiffeisen Zentralbank	AT305	AT
4	KBC Group	BE001	BE
5	Dexia	BE003	BE
6	Bank of Cyprus	CY002	CY
7	Marfin Popular Bank Public Company Limited	CY010	CY
8	DZ BANK AG	DE009	DE
9	WestLB AG	DE010	DE
10	Landesbank Baden-Wuerttemberg	DE021	DE
11	Deutsche Bank AG	DE028	DE
12	Commerzbank AG	DE041	DE
13	Norddeutsche Landesbank GZ	DE358	DE
14	Bayerische Landesbank	DE515	DE
15	Hypo Real Estate	DE649	DE
16	Danske Bank A/S	DK001	DK
17	National Bank of Greece	GR011	EL
18	Alpha Bank AE	GR014	EL
19	Piraeus Bank	GR017	EL
20	Eurobank Ergasias	GR026	EL
21	Banco Santander SA	ES001	ES
22	Banco Bilbao Vizcaya Argentaria SA	ES002	ES
23	La Caixa	ES003	ES
24	Banco Financiero y de Ahorro	ES004	ES
25	OP-Pohjola Group	FI002	FI
26	BNP Paribas	FR001	FR
27	Crédit Agricole Group-Crédit Agricole	FR002	FR
28	Société Générale	FR003	FR
29	Credit Mutuel	FR005	FR
30	Group BPCE	FR010	FR
31	OTP Bank NYRT	HU001	HU
32	Bank of Ireland	IE011	IE
33	Allied Irish Banks plc	IE012	IE
34	Gruppo UniCredit	IT001	IT
35	Gruppo Monte dei Paschi di Siena	IT003	IT
36	Gruppo Bancario Intesa Sanpaolo	IT004	IT
37	Gruppo Banco Popolare	IT021	IT
38	Bank of Valletta (BOV)	MT001	MT
39	ABN Amro	NL149	NL
40	ING Groep NV	NL163	NL
41	Rabobank Group-Rabobank Nederland	NL600	NL
42	DnB NOR	NO001	NO
43	PKO Bank Polski	PL102	PL
44	Banco Comercial Portugues	PT033	PT
45	Caixa Geral de Depositos	PT035	PT
46	Espirito Santo Financial Group (ESFG)	PT998	PT
47	Skandinaviska Enskilda Banken AB	SE001	SE
48	Nordea Bank AB (publ)	SE002	SE
49	SWEDBANK AB	SE003	SE
50	Svenska Handelsbanken AB	SE004	SE
51	Nova Ljubljanska Bank (NLB)	SI123	SI
52	Barclays Plc	GB001	UK
53	Lloyds Banking Group Plc	GB002	UK
54	Standard Chartered Plc	GB004	UK
55	HSBC Holdings Plc	GB006	UK
56	Royal Bank of Scotland Group Plc (The)	GB007	UK
57	Nationwide Building Society	GB009	UK

Annex

Descriptive statistics from the EBA Key Risk Indicators with data to Q2 2012.

<i>KRI</i>		<i>Descriptive Statistics</i>	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Solvency	1 - Tier 1 capital ratio	Weighted average	10.2%	10.2%	10.4%	10.6%	11.0%	11.3%	11.4%	11.4%	11.3%	11.9%	12.1%
		25th percentile	9.0%	9.0%	8.8%	9.0%	9.3%	9.7%	9.4%	9.6%	9.5%	10.1%	10.5%
		50th percentile	9.8%	10.1%	10.1%	10.3%	10.6%	11.2%	11.1%	11.0%	10.9%	11.4%	11.7%
		75th percentile	11.3%	11.1%	11.4%	11.6%	12.3%	12.7%	12.5%	12.6%	12.7%	13.0%	13.3%
	2 - Total capital ratio	Weighted average	12.9%	12.9%	12.9%	13.1%	13.5%	13.7%	13.6%	13.5%	13.3%	13.8%	14.0%
		25th percentile	11.5%	11.2%	11.4%	11.5%	11.7%	11.9%	11.6%	11.4%	11.3%	11.6%	12.1%
		50th percentile	12.5%	12.6%	12.2%	12.4%	12.8%	13.3%	13.0%	12.8%	12.6%	13.9%	14.1%
		75th percentile	14.0%	13.9%	14.1%	14.6%	14.9%	15.3%	15.1%	15.1%	15.1%	15.6%	15.6%
	3 - Tier 1 ratio (excluding hybrid instruments)	Weighted average	8.9%	9.0%	9.2%	9.3%	9.0%	9.3%	9.3%	9.4%	9.4%	10.1%	10.4%
		25th percentile	7.1%	7.3%	7.2%	7.4%	7.5%	8.2%	7.9%	8.0%	8.1%	8.4%	9.3%
		50th percentile	8.5%	8.5%	8.7%	9.3%	8.5%	9.1%	9.3%	9.4%	9.4%	10.0%	10.3%
		75th percentile	10.7%	10.8%	10.6%	11.1%	10.4%	10.6%	10.3%	10.6%	10.5%	11.3%	11.2%
Credit Risk and Asset Quality	13 - Impaired loans and Past due (>90 days) loans to total loans	Weighted average	5.1%	5.0%	5.1%	5.3%	5.3%	5.2%	5.4%	5.4%	5.8%	5.7%	5.8%
		25th percentile	3.1%	3.1%	3.3%	3.4%	3.0%	2.9%	2.5%	2.6%	2.5%	3.3%	3.5%
		50th percentile	4.9%	5.1%	5.4%	5.5%	5.4%	5.4%	5.6%	5.6%	6.4%	7.0%	6.9%
		75th percentile	9.8%	9.9%	10.7%	10.9%	10.5%	11.3%	12.4%	13.1%	14.1%	15.2%	15.8%
	14 - Coverage ratio (specific allowances for loans to total gross impaired loans)	Weighted average	42.4%	40.4%	37.1%	36.5%	37.0%	35.8%	41.0%	38.9%	41.1%	41.5%	41.8%
		25th percentile	34.0%	34.4%	33.9%	33.8%	32.4%	33.1%	33.7%	33.3%	34.4%	34.5%	35.3%
		50th percentile	40.8%	41.1%	40.4%	41.1%	41.8%	41.8%	41.2%	40.5%	40.6%	41.2%	41.8%
		75th percentile	49.0%	48.0%	46.9%	48.3%	49.5%	48.0%	46.6%	45.2%	48.7%	48.6%	48.7%
	18 - Impaired financial assets to total assets	Weighted average	1.6%	1.4%	1.9%	1.4%	2.1%	1.9%	1.8%	1.7%	1.9%	1.8%	1.9%
		25th percentile	0.9%	1.0%	1.1%	1.0%	1.2%	1.1%	0.6%	1.0%	1.0%	1.0%	1.1%
		50th percentile	1.8%	1.7%	1.8%	1.7%	2.0%	1.9%	1.9%	2.0%	2.2%	1.9%	2.0%
		75th percentile	3.4%	3.4%	3.6%	3.8%	4.0%	4.3%	4.6%	5.3%	5.6%	5.8%	6.9%

<i>KRI</i>		<i>Descriptive Statistics</i>	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
	20 - Accumulated impairments on financial assets to total (gross) assets	Weighted average	1.3%	1.2%	1.3%	1.3%	1.4%	1.3%	1.4%	1.3%	1.5%	1.4%	1.5%
		25th percentile	0.9%	0.9%	0.8%	0.8%	0.8%	0.8%	0.8%	0.7%	0.8%	0.8%	0.7%
		50th percentile	1.5%	1.5%	1.5%	1.6%	1.7%	1.6%	1.5%	1.5%	1.6%	1.6%	1.7%
		75th percentile	2.2%	2.3%	2.3%	2.8%	2.7%	2.9%	2.9%	3.1%	3.7%	3.7%	4.0%
	21 - Impairments on financial assets to total operating income	Weighted average	25.6%	17.2%	19.2%	18.1%	18.2%	12.9%	17.9%	20.3%	21.8%	19.4%	22.1%
		25th percentile	20.7%	15.5%	17.5%	14.5%	14.3%	5.0%	10.0%	14.7%	14.8%	8.4%	9.9%
		50th percentile	26.9%	20.4%	22.9%	21.0%	21.5%	12.6%	20.2%	21.6%	26.2%	19.6%	21.7%
		75th percentile	39.6%	28.1%	31.9%	31.6%	30.7%	25.1%	32.0%	36.9%	55.7%	31.1%	39.8%
	22 - Return on equity	Weighted average	4.5%	1.9%	3.6%	5.0%	5.9%	2.1%	3.5%	3.6%	1.7%	1.4%	1.8%
		25th percentile	-0.5%	3.0%	3.0%	3.0%	1.7%	5.3%	2.8%	-0.7%	-13.7%	1.7%	0.1%
		50th percentile	5.4%	6.3%	6.4%	5.7%	5.4%	8.6%	7.2%	5.3%	2.7%	6.7%	5.7%
		75th percentile	9.1%	11.5%	11.1%	10.1%	9.5%	13.3%	12.1%	9.5%	7.8%	11.4%	9.1%
Profitability	24 - Cost-to-income ratio	Weighted average	55.2%	53.3%	54.7%	55.7%	56.2%	58.9%	58.2%	59.6%	60.1%	60.5%	59.0%
		25th percentile	47.2%	46.9%	49.1%	48.7%	49.2%	49.2%	49.7%	51.0%	50.4%	48.4%	50.4%
		50th percentile	57.8%	55.1%	56.2%	57.7%	57.8%	55.9%	57.3%	58.6%	60.1%	56.8%	58.4%
		75th percentile	64.3%	62.1%	62.4%	63.5%	64.1%	63.2%	63.8%	63.9%	64.5%	68.1%	69.9%
	26 - Net interest income to total operating income	Weighted average	57.9%	56.2%	58.7%	58.4%	58.1%	56.6%	57.4%	60.3%	60.9%	61.7%	61.7%
		25th percentile	52.8%	53.2%	52.3%	53.2%	51.9%	48.9%	50.4%	52.5%	54.2%	51.7%	52.6%
		50th percentile	64.1%	61.9%	62.5%	64.9%	64.2%	59.2%	62.8%	65.0%	63.5%	63.9%	63.2%
		75th percentile	74.1%	72.5%	72.5%	77.5%	76.8%	77.4%	75.4%	75.2%	76.0%	74.5%	77.9%
	27 - Net fee and commission income to total operating income	Weighted average	26.0%	25.8%	26.7%	26.7%	26.8%	26.6%	27.0%	27.6%	27.6%	27.1%	26.9%
		25th percentile	16.7%	14.9%	15.6%	15.1%	15.8%	13.1%	16.1%	16.7%	16.3%	17.8%	16.9%
		50th percentile	22.6%	23.5%	24.3%	24.0%	24.1%	23.7%	24.4%	25.8%	24.1%	23.1%	24.4%
		75th percentile	29.0%	30.6%	31.5%	30.8%	30.6%	30.2%	29.2%	30.5%	30.9%	28.2%	29.0%
	33 - Net income to total operating income	Weighted average	9.3%	16.3%	16.5%	15.2%	13.4%	19.6%	16.7%	11.9%	4.5%	12.5%	11.4%
		25th percentile	-3.1%	7.3%	7.0%	7.1%	5.6%	14.2%	8.7%	-3.6%	-34.0%	4.1%	0.9%
		50th percentile	10.9%	17.4%	16.0%	15.4%	14.7%	19.8%	17.8%	13.2%	9.9%	16.3%	13.6%
		75th percentile	19.3%	23.0%	24.0%	23.4%	22.3%	30.4%	26.4%	22.6%	19.3%	28.6%	22.4%
	34 - Loan-to-deposit ratio	Weighted average	148.9%	148.9%	147.6%	146.5%	144.2%	144.1%	145.3%	147.0%	142.9%	144.5%	144.5%
		25th percentile	125.2%	125.2%	128.6%	123.8%	124.5%	118.3%	126.4%	127.8%	126.7%	123.9%	126.3%
		50th percentile	147.4%	144.6%	146.7%	150.0%	147.7%	148.5%	151.1%	152.0%	148.9%	146.6%	146.1%
		75th percentile	174.6%	179.7%	186.6%	178.4%	170.4%	175.9%	170.5%	169.5%	176.8%	184.4%	186.9%

		<i>KRI</i>	<i>Descriptive Statistics</i>	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Balance Sheet Structure	35 - Customer deposits to total liabilities	Weighted average		40.6%	39.7%	39.6%	40.5%	42.5%	43.1%	43.2%	40.1%	41.6%	41.7%	41.9%
		25th percentile		35.6%	35.0%	33.3%	34.7%	37.4%	39.3%	38.5%	35.0%	35.2%	36.3%	35.8%
		50th percentile		49.7%	49.5%	43.5%	45.8%	46.9%	48.8%	48.3%	44.6%	46.0%	45.7%	44.5%
		75th percentile		59.2%	58.1%	56.8%	58.1%	59.9%	60.3%	57.7%	56.1%	56.4%	56.6%	56.3%
	36 - Tier 1 capital to [total assets - intangible assets]	Weighted average		4.2%	4.3%	4.3%	4.2%	4.5%	4.6%	4.6%	4.4%	4.5%	4.6%	4.9%
		25th percentile		3.9%	4.0%	3.8%	3.9%	4.1%	4.1%	4.1%	3.9%	4.0%	4.0%	4.1%
		50th percentile		5.5%	5.2%	5.0%	5.0%	5.2%	5.2%	5.2%	5.0%	5.0%	5.3%	5.2%
		75th percentile		5.9%	6.1%	5.9%	5.9%	6.2%	6.3%	6.1%	6.2%	6.1%	6.1%	6.3%
	45 - Debt-to-equity ratio	Weighted average		1870.6%	1916.7%	1946.9%	1929.6%	1825.7%	1783.3%	1794.6%	1940.7%	1935.8%	1869.9%	1859.4%
		25th percentile		1205.0%	1262.2%	1305.2%	1285.1%	1248.0%	1225.7%	1265.8%	1309.8%	1372.9%	1329.3%	1375.1%
		50th percentile		1494.5%	1534.7%	1607.3%	1696.9%	1659.0%	1622.0%	1722.9%	1716.9%	1763.8%	1752.4%	1708.2%
		75th percentile		2258.1%	2297.7%	2443.8%	2435.8%	2407.7%	2284.2%	2174.6%	2514.9%	2512.6%	2436.4%	2305.9%
	46 - Off-balance sheet items to total assets	Weighted average		18.1%	17.7%	17.6%	17.3%	17.6%	17.4%	17.3%	16.3%	18.2%	17.4%	17.5%
		25th percentile		8.9%	8.5%	8.2%	8.6%	8.5%	8.2%	8.0%	7.7%	8.5%	8.3%	7.9%
		50th percentile		14.7%	14.4%	14.4%	14.2%	14.0%	14.0%	13.8%	13.4%	14.5%	14.5%	14.3%
		75th percentile		20.8%	20.0%	19.8%	20.2%	18.9%	18.8%	18.5%	17.4%	19.0%	19.0%	19.1%