



RISK ASSESSMENT OF THE EUROPEAN BANKING SYSTEM

DECEMBER 2014



EBA

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Abbreviations

AQR	asset quality review	GSIB	global systematically important bank
AT1	additional tier 1	IAS	International Accounting Standard
BIS	Bank for International Settlements	ICAAP	internal capital adequacy assessment process
BRRD	Bank Recovery and Resolution Directive	IOSCO	International Organisation of Securities Commissions
CCP	counterparty clearing party / parties	IRB	Internal rating-based
CDS	credit default swap	KRI	key risk indicators
CDX	CDS index	LGD	loss given default
CERT	Computer Emergency Response Team	LTRO	long-term refinancing operation
CET1	common equity tier 1	NPL(s)	non-performing loan(s)
CoCo	contingent convertible	OTC	over the counter
CoE	cost of equity	PD	probability of default
CRD	Capital Requirements Directive	PONV	point of non-viability
CRR	Capital Requirements Regulation	RAQ	risk assessment questionnaire
DDoS	Distributed denial of service	RAR	report on the risks and vulnerabilities of the European Banking System
EBA	European Banking Authority	RoE	return on equity
Ecofin	Economic and Financial Affairs Council	RWA	risk-weighted assets
ECB	European Central Bank	SME	small and medium-sized enterprises
EDF	expected default frequencies	SREP	supervisory review and evaluation process
EEA	European economic area	TLAC	total loss absorbing capacity
EMIR	European Market Infrastructure Regulation	TLTRO	targeted long-term refinancing operations
ESMA	European Securities and Markets Authority		
ESRB	European Systemic Risk Board		
EURIBOR	Euro interbank offered rate		

Executive summary

Market sentiment and confidence is improving; however, the signs of recovery remain modest and fragile. Since mid-2014, following the publication of the European Banking Authority's (EBA) last report on the risks and vulnerabilities of the European Banking System (RAR, June 2014), the EBA has continued to observe significant improvements in market confidence towards the EU banking sector, from both debt and equity investors, despite some volatility in stock markets. On the other hand, a dislocation between financial markets and the real economy continues to be observed. Annual gross domestic product (GDP) growth in the EU in 2014 is now projected by the European Commission to be 1.3 % [instead of 1.5 % as forecasted in spring 2014], while growth in the euro area is expected to be 0.8 % and there is a looming risk of deflation. The reductions of the previous forecasts reflect not only the materialisation of some of the risks identified in spring 2014, and also mentioned by the EBA's RAR in June 2014, but also a reassessment of the underlying dynamics of domestic demand. Nevertheless, all EU countries are expected to register positive growth in 2015 and 2016. This is also when the lagged impact of already implemented reforms should be felt more strongly. European banks have accomplished significant adjustments on the asset side by cutting risky assets, front-loading impairments and shrinking their balance sheets. Although these are positive developments there is still no room for complacency.

European banks have also continued to take advantage of favourable market conditions to raise capital. Largest European banks reached in June 2014 a weighted average tier 1 ratio of 12.9% and a common equity tier 1 ratio of 11.8%, similar to the largest US banks. In the second half of 2013 the EU banks raised over EUR 40 billion in total capital and, between January and September 2014 alone, they have raised a further EUR 53.6 billion of equity (EUR 39.2 billion net of repayments and buybacks) and EUR 39.1 billion of contingent convertible instruments (both additional tier 1

(AT1) and tier 2), in preparation to the release of the results of the 2014 EU-wide stress test. The banks' issuance of equity as well as debt instruments has been widely spread across the EU; also large banks in financially stressed countries have been able to benefit from a benign market sentiment.

The EBA published the results of the 2014 EU-wide stress test of 123 banks. On average, the exercise showed that EU banks' common equity tier 1 (CET1) ratio would drop by 260 basis points under the adverse scenario, from 11.1 % at the start of the exercise, after the asset quality review's (AQR) adjustment, to 8.5 % after the stress. The results marked a step change in the process of balance sheet repair. However, more needs to be done in order to meet regulatory requirements still being phased in or calibrated, to foster consistency of risk-weighted assets (RWAs) and ensure sustainability of business models.

Further challenges lie ahead and the ongoing repair of individual banks' balance sheets continues to be a fundamental issue. The most important challenges within the EU banking sector are the heavy debt overhang and the necessary restructuring of the debt-laden corporates and households, the potential impact of conduct-related issues, and the squeezed net interest margins and profitability. Therefore, further challenges lie ahead and the ongoing repair of individual banks' balance sheets and sectoral restructuring should continue to be a key priority for the medium term.

The quality of banks' loan portfolios in general did not deteriorate further but continues to present worryingly high levels. After the AQR there are significant differences in asset quality between banks as well as regions. Impaired and past due loans remain at historically high levels and therefore a concern across the EU. In the first half of 2014, the ratio of impaired and past due (> 90 days) loans to total loans decreased slightly to 6.4 %. Since mid-2012, the average ratio has been in

a range between 6.3 % and 6.8 %; it was 5.1 % in December 2009. The dispersion on the higher end is becoming broader again, with the 95th percentile as high as 45 %. At the same time, in some cases, provisioning has not increased in conformity with rising credit risks and dispersion is high. The average coverage ratio (specific allowance only, i.e. not taking in general loan loss allowance) is still within a range of 46 % to 47 %, broadly unchanged from the last three quarters. However, the share of banks with a coverage ratio below 25 % increased markedly from 13.2 % to 19.9 % in the second quarter 2014. The first application of the harmonised definition of NPLs across the EU in the AQR resulted in an increase of the NPL volume of EUR 136 billion (+18.4 %). The highest relative increase was identified in the large corporate portfolios (+33.3 % or EUR 33.8 billion), whereas the highest absolute impact could be seen in the real estate portfolios (EUR 36.7 billion or 18.4 %).

EU banks' income and profitability is still under significant pressure, which is unlikely to dissipate in 2015. In the first half of 2014, the total profits (after tax and discontinued operations) declined by EUR 13 billion (– 24 % compared to June 2013) and the total operating income declined by EUR 19 billion (– 7 % compared to June 2013). The main drivers were asset quality deterioration and the balance sheet clean-up of EU banks as well as costs related with conduct and IT risk. Going forward, the continued balance sheet repair and provisioning for non-performing loans (NPLs), increasing costs associated to past business misconduct, a protracted low interest rate environment and a disappointing economic growth may further affect banks' income and profitability. Moreover, banks with a return on equity (RoE) of less than 8 % – which is identified as the relevant benchmark for the expected cost of equity in the responses to the risk assessment questionnaire (RAQ) – continue to increase, and represented 76.3 % of total assets in the sample in June 2014 (up from approximately 69 % and

75 % in June 2013 and December 2013, respectively). Banks with a RoE of less than 3 % represented 14 % of total assets in June 2014. The pressure on profitability, combined with the new regulatory environment and modest growth outlook, will continue to present a challenge for management in terms of sustainability of some banks' business models.

Supervisors will need to assess banks' profit and funding models, risk pricing, business mix, management strength and strategy, and engage with banks' management on appropriate action where sustainability is in question. A process of consolidation and resizing has already been ongoing since 2008 and fundamental structural issues will make it impossible to maintain business as usual, thus a smooth exit of the weakest and non-profitable banks would contribute to competitive efficiency. In this respect it is important that solid recovery and resolution mechanisms – for which the legislation process in the EU is currently in progress – are in place to enable such smooth exits. These exits might have to continue further with a view to eliminating excess capacity in the industry and restore adequate profitability.

Geopolitical risks and potential distress in emerging markets need to be closely monitored, in light of their potential adverse impact on GDP growth and banks' asset quality. The political turmoil in some emerging markets and uncertainties from either geopolitical concerns or a normalisation of monetary conditions in major jurisdictions, after a prolonged period of monetary accommodation, will require close monitoring. For some EU banks, the exposure to emerging markets is relatively large in terms of contribution to banks' profits and in terms of total assets. The two most important channels through which risk might materialise are the deterioration of asset quality and the possible slowdown of the global economy: these could disturb capital flows and strain the markets' confidence in a still modest economic recovery.

1. Introduction

This is the sixth semi-annual report on risks and vulnerabilities of the European banking sector conducted by the EBA. This report describes the main developments and trends that have affected the EU banking sector since mid-2014 and provides the EBA's outlook on the main micro-prudential risks and vulnerabilities looking ahead.

The EBA considers that the information contained in the report provides the relevant stakeholders with a useful benchmark for analysis ⁽¹⁾. The report draws on the views of banks and national supervisors to construct a forward-looking view of risks that are of concern to regulators and policymakers. Among other sources of information, this report is based on four main exclusive data sources, namely:

- (a) EBA key risk indicators (KRI);
- (b) EBA RAQ for banks;
- (c) EBA RAQ for market analysts; and
- (d) micro-prudential expertise and college information-gathering.

The EBA KRI are a set of 53 indicators collected on a quarterly basis by national supervisors, from a sample of 53 European banks in 20 European economic area (EEA) countries from 2009 onwards. The banks in the sample cover at least 50 % of the total assets of each national banking sector. Most of the indicators are not publicly available: therefore, these data provide a unique and valuable source of information. The reference date for the most recent data is 30 June 2014. Information about the sample and descriptive statistics of the latest KRI can be found in both the appendix and annex. The weighted average ratios are described unless stated otherwise. Since KRI are collected at a point in time, they tend to be backward-looking in nature. They are thus complemented with various forward-looking sources of information and data, such as semi-annual and ad hoc surveys.

⁽¹⁾ With this report, the EBA discharges its responsibility to monitor and assess market developments and provides information to other EU institutions and the general public, pursuant to Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), and amended by Regulation (EU) No 1022/2013 of the European Parliament and of the Council of 22 October 2013.

The RAQ is a semi-annual survey conducted by the EBA, asking banks and/or their financial supervisors a number of multiple-choice questions. Information from the questionnaire completed in October 2014 and comparisons with previous responses from a representative sample of 39 European banks (Annex I) are used in this report. In addition, the EBA conducted a survey (RAQ for market analysts) asking market analysts (21 respondents) a number of questions in a multiple-choice format with responses reflecting the degree of agreement with a given statement.

The report also analyses information gathered by the EBA from the European colleges of supervisors and from informal discussions as part of the regular risk assessments and ongoing dialogue on risks and vulnerabilities of the EU banking sector. The report is organised as follows.

Chapter 2 looks at the external environment and processes by which EU banks' assets and liabilities are developing in a given market sentiment and macroeconomic environment, taking into account the regulatory developments and structural and institutional reforms at EU level. Chapter 3 focuses on the assets side, explaining the ongoing de-risking process, the respective influence in banks' business models and risk appetite and the dynamics of asset quality. Chapter 4 provides an overview of the banks' capital positions and respective positive trends, taking into account the banks' efforts to progress towards strong capital buffers. Chapter 5 considers in more detail the liabilities' side, presenting the evolution of funding conditions. It also discusses the development of asset encumbrance and highlights remaining structural fragilities and challenges. Chapter 6 describes banks' income and profitability and the significant headwinds during 2014 and future evolution. Chapter 7 touches on aspects of banks' consumer issues and reputational concerns, business conduct, effective and potential financial costs stemming from mis-selling and other unfair past business practices. Finally, Chapter 8 presents policy implications and possible measures to address the prudential issues mentioned in the previous chapters.

2. External environment

2.1 Market sentiment and macroeconomic environment

Most RAQ respondents (both banks and market analysts) see the emerging-market risk as an important and increasing risk for their institutions in the next 6 months. The RAQ for banks shows that the three most important channels through which risk will materialise are the geopolitical risks, deterioration of asset quality in emerging markets, and the possible slowdown of the global economy. On the contrary, the withdrawal of foreign currency funding and the possible increasing of sovereign risk of the emerging markets are considered less significant as risk channels in Europe. The RAQ for market analysts shows that the most important risks are the potential losses due to financial markets and currencies of emerging markets dropping, the deteriorating asset quality in emerging markets, and the risk of global economic slowdown (Figure 1) ⁽²⁾.

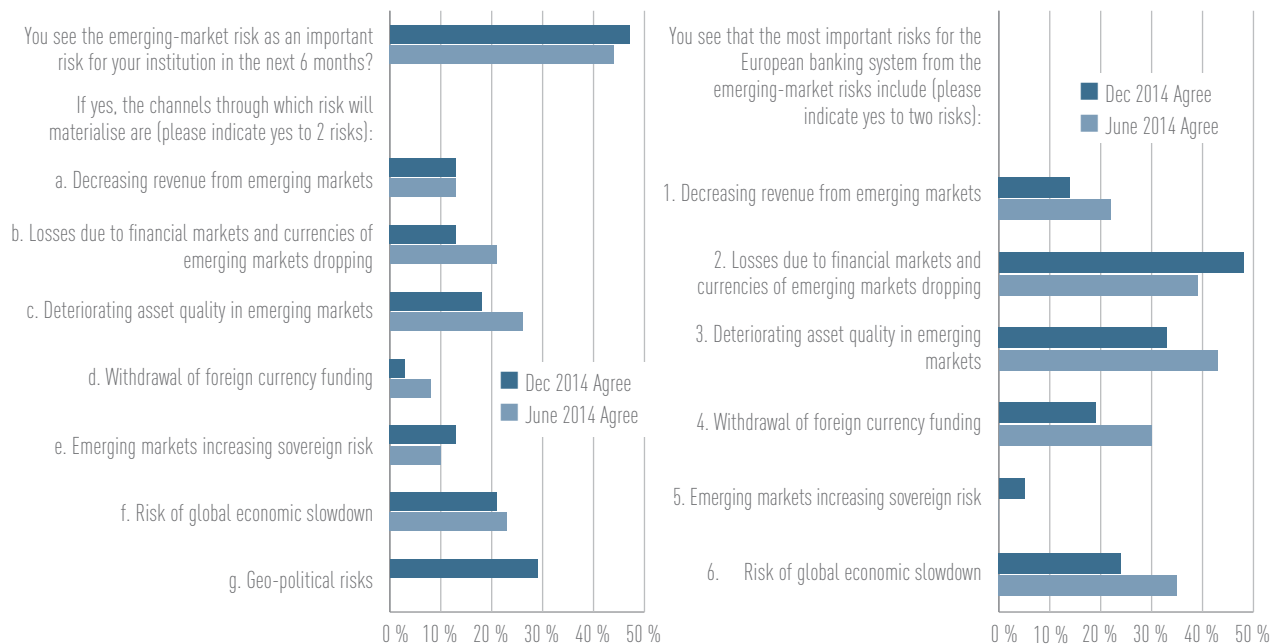
⁽²⁾ For the EBA RAQ for banks and RAQ for market analysts, the length of the bars shows the percentage of respondents who: agreed; somewhat agreed; somewhat disagreed; or disagreed with the statement, on the y-axis.

It is clear that NPLs may rise significantly as these emerging economies slow down — some of them, such as Ukraine and Russia, due to political uncertainty. In addition, increasing uncertainties and risk aversion may translate into a repricing in financial markets and higher levels of banks’ funding costs. The possibility of sanctions against banks and other counterparties from states may also create some volatility and tensions; consequently, banks and supervisors will need to continue monitoring external exposures to emerging markets and discuss contingency plans.

Geopolitical risks and potential distress in emerging markets may raise risk aversion and affect capital flows giving slowing growth and rising bad loans

Geopolitical risks remain high. Some banks are exposed to Russia and Ukraine, and also exposed to other countries in central and Eastern Europe, which show an economic slow-down and rise in bad loans. These banks could suffer more if the geopolitical tensions escalate. Among several emerging markets, the macroeconomic development is on the decline. For example, there are continued signs of weaknesses in China (bad loans have been rising steadily at most

Figure 1: Emerging-market risk
Source: EBA RAQ for banks (left) and RAQ for market analysts (right).



of China’s banks over the past quarters following the rapid credit expansion over recent years), Russia, Turkey and Ukraine.

However, European credit is, in general, showing some resilience to emerging-market risks as it is a very specific risk. EU banks and business are even seeing inflows of funds as investors switch out of emerging economies into Europe, for example looking for yield in EU’s bond markets. Investors remain underweighting emerging markets on slowing growth, rising bad loans and geopolitical risks. The indices of tradable CDS (CDX) for emerging market spreads continue to widen as geopolitical tensions between Russia and Ukraine resurfaced. Venezuelan spreads also widened significantly due to concerns that falling oil prices will squeeze the country’s growth. Contagion from emerging markets could spread through several channels such as trade links and bank lending. At the same time, the banking assets in emerging markets continue to be relatively large for some EU countries or banks, for example in terms of contribution to profits or foreign claims (Figure 2).

Certain market risk parameters indicated a positive market sentiment...

The initial positive market sentiment views about the AQR and the 2014 EU-wide stress test were maintained after the publication of the respective results, and regard the findings as positive for the European financial sector. Some identified ‘failures’ have underlined the credibility of the exercises and an open communication of ‘failure’ banks about their anticipated plans to cover capital shortfalls was considered also positive by the market participants. EU banks’ capital positions have increased and funding condi-

tions continued to improve during 2014. Sovereign debt spreads have continued to tighten and even banks in countries with financially stressed sovereigns have continued to access both the debt and the equity markets. Increased confidence is also observed in the iTraxx euro financial credit default swap (CDS) index and the EBA EU bank CDS index, with positive evolutions since July 2013 (Figure 3). These views reinforce a positive stance on financial and bank bonds across Europe, including financially stressed countries.

A positive market sentiment, despite some volatility in November 2014, is also visible through a declining trend in EU banks’ expected-default frequencies ⁽³⁾ (EDF). This evolution is in part related to the positive actions that were taken to strengthen EU banks’ capital and funding. The tightening of the EDF quartiles and the reduction in the respective volatility have been positive signs since the end of 2013 and throughout 2014 in comparison to previous years (Figure 4).

... but confidence indicators have been declining since mid-year and are now back to where they were at the end of 2013

Bank debt issuance has continued to develop positively in benign funding conditions as a consequence of decisive policy measures and regulatory steps, particularly for banks in financially stressed countries, both for large and small banks. EU banks in financially stressed countries are returning to the markets and wholesale funding markets are open to most EU banks.

⁽³⁾ Moody’s KMV EDF is a measure of the probability that a company will fail to make scheduled debt payments over a specified period — typically one year.

Figure 2: Banking system exposure to emerging markets — percentage of total foreign claims — consolidated data on an ultimate risk basis (data as of Q2 2014)
 Source: Bank for International Settlements (BIS), EBA calculations. Definitions of group of emerging countries according to the BIS (Russia not shown separately for some countries).

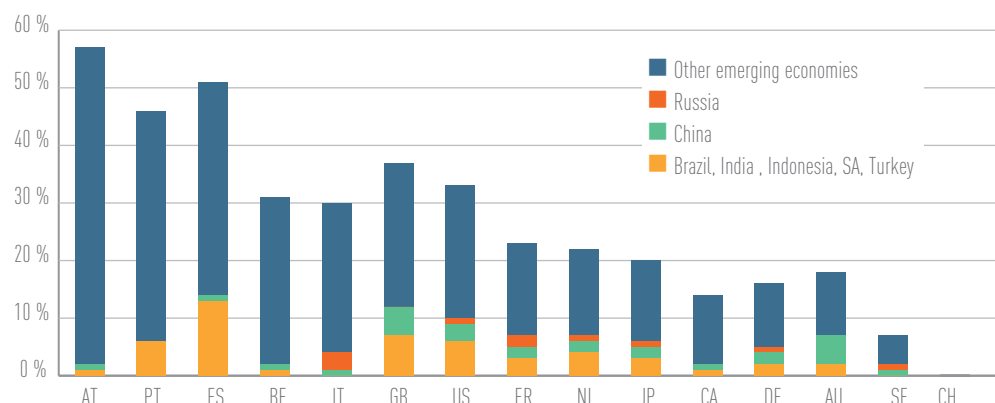
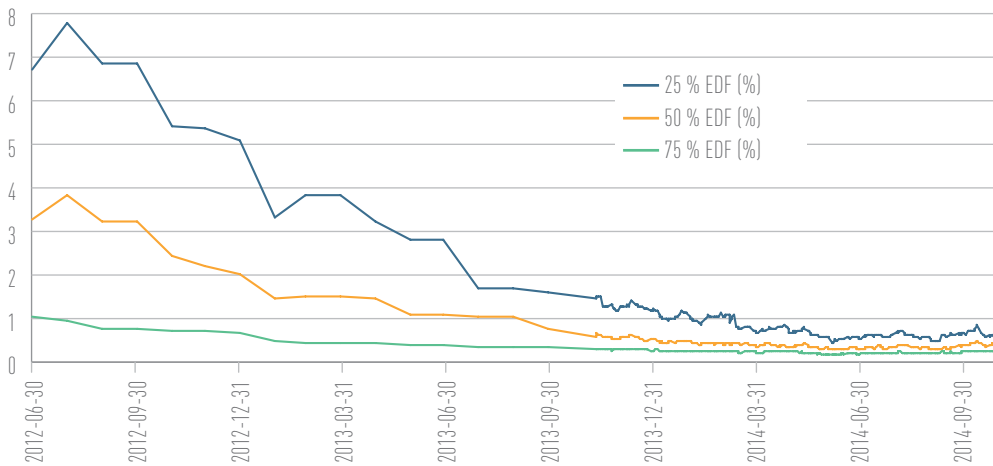


Figure 3: Stock index — STOXX® Europe 600 banks share price index and CDS index — EBA EU banks CDS index (average December 2011 = 100)
 Source: Bloomberg, EBA calculations.



Figure 4: Expected default frequencies
 Source: EBA KRI banks — listed; Moody’s KMV (Kealhofer, McQuown and Vasicek).



However, high public debt overhang and a re-heightening of debt sustainability concerns together with significant amounts of domestic sovereign debt on banks’ balance sheets may fuel detrimental banks–sovereign linkages. Therefore, risks of realignment remain and detrimental linkages between banks and sovereigns persist even if less pronounced. Moreover, despite some improvements, geographical fragmentation of lending and funding conditions continues, with significantly different rates for similar companies in different countries.

While some uncertainty has receded, growth remains modest and fragile

In Europe, in the first half of 2014, GDP growth struggled to gather momentum, leaving the recovery not only subdued but also fragile. GDP growth forecasts have therefore been revised down to reflect a reassessment of the underlying dynamics of domestic demand, particularly investment, which has failed so far to emerge as a strong engine of growth. Annual GDP growth in the EU this year is now projected to be 1.3 %, while growth in

the euro area is expected to be 0.8 %. With confidence indicators declining since mid-year and now back to where they were at the end of 2013, it is becoming harder to see the dent in the recovery. Lending activity remains subdued, after a significant decline since the crisis (around EUR 600 billion, or – 12 % according to some market analysts), despite recent stabilisation in bank balance sheet data and lending surveys, and investors prefer to stick to relatively liquid and safer assets and avoid lower-rated high yield credits. Reasons to worry are outflows and lack of liquidity in secondary markets, especially as dealers reduce risk into year-end.

The weak demand will continue to contribute to low inflation. The outlook for inflation in the EU has been lowered substantially in the last few months and is expected to decrease to 1.2 % in 2014 before rising to 1.5 % in 2015 (the decrease in the euro area is expected to be 1 % in 2014 before rising to 1.3 % in 2015). The risk of a too-prolonged period of low inflation deserves further attention and subdued pressures are expected to maintain inflation at low levels.

2.2 Regulatory developments

The numerous regulatory reforms still underway continue to be an issue of concern for investors and other market participants, well acknowledged in the RAQ responses, particularly in regard to the timing and respective contents. As a result of the completion of significant elements of the legislative programme, significant execution risks remain ahead; for example, concerns on the execution of information technology (IT)-related risks, implementing 'bail-in' rules or the near-term delinking of sovereigns and banks.

The EBA's regulatory work in 2014 focused on credit and market risk, the prudential areas of liquidity and leverage, as well as on recovery and resolution. Meanwhile, the EBA will continue pursuing its objectives in advancing towards a single EU wide rule book and promoting regulatory and supervisory convergence across the Union, in both rules and practices. It is fundamental to complete the legislative process with structural and institutional reforms at European level given the concerns on the integrity of the single mar-

Figure 5: Regulatory technical standards (RTS) and Implementing technical standards (ITS) adopted and published
Source: European Commission.

#	RTS - Title	Reference	#	ITS - Title	Reference
1	Specification of the calculation of specific and general credit risk adjustments	CRR Art 110(4)	1	Own Funds disclosure	CRR 437(2), 492(5)
2	Own Funds (Part 1, 2 and Gain on Sale)	CRR Art 26(4), 27(2), 28(5)(a), 29(6), 32(2), 36(2), 41(2), 52(2), 76(4), 78(5), 79(2), 83(2), 481(6) and 487(3)	2	Supervisory reporting	CRR Art 99(5), 99(6), 101(4), 394(4), 430(2), 415(3)
3	Financial conglomerates	CRR Art 49(6)	3	Reporting of Hypothetical Capital of a CCP	CRR Art 520
4	Identified Staff	CRD Art 94(2)	4	Information Exchange	CRD Art 50(7)
5	Close correspondence	CRR Art 33(4)	5	Supervisory practices relating to the securitisation retention rules	CRR Art 410(3)
6	Materiality of model changes and extensions (credit and operational risk)	CRR Art 143(5), 312(4)(b)(c)	6	Supervisory disclosure	CRD Art 143(3)
7	Information exchange	CRD Art 50(6)	7	Joint decisions	CRD Art 113(5)
8	Risks in activities of options and warrants	CRR Art 329(3), 352(6), 358(4)	8	Passporting notifications	CRD Art 35(6), 36(6), 39(5)
9	Definition of materiality thresholds for specific risk	CRD Art 77(4)	9	Diversified indices	CRR Art 344(1)
10	Definition of the term market	CRR Art 341(3)			
11	Determination of methods for CVA capital charge	CRR Art 383(7)			
12	Instruments used for variable remuneration	CRD Art 94(2)			
13	Securitisation retention requirement	CRR Art 410(2)			

ket. The unity and integrity of the EU single market will thereby be strengthened through the development and implementation of uniform rules in key areas. At the same time, the EBA will promote and monitor convergence in supervisory practices through the issuance of guidelines, its handbook, and through participation in colleges of supervisors for cross-border banking groups across the EU as a whole.

Regulatory and supervisory efforts across the single market will continue

The regulatory reform agenda has notched up some significant achievements with the adoption of a slew of landmark reforms and the main bulk of reform is now through. Recovery and resolution planning, remuneration rules, the impact of the Basel Committee's responses to the financial crisis including regulatory capital requirements and liquidity issues, the development of new trading systems and other market infrastructure regulation, derivatives reform, developments in clearing OTC derivatives and regulatory investigations are important areas with significant developments.

In January 2014, the European Commission proposed a regulation on the reform of the structure of the EU banking system, built on the recommendations of the 'Liikanen report' ⁽⁴⁾. The proposal completes the financial regulatory reforms undertaken over the last few years by setting out rules on structural changes for 'too-big-to-fail' banks.

The EBA would be consulted by competent authorities when taking certain decisions as set out in this proposal and would be required to assess the potential impact of such decisions on the financial stability of the EU and the functioning of the internal market. This would ensure the effective and consistent supervision and the development of the single rule book in banking. In addition, the EBA would be required to prepare draft regulatory measures and implementing technical standards, and submit reports to the European Commission.

With regard to the macro-prudential rules in the capital requirements regulation (CRR) and the capital requirements directive (CRD), the EBA has been consulted by the European Commission, as envisaged in Article 513 of the CRR. The EBA answered this call for ad-

vice by issuing this Opinion ⁽⁵⁾ in the context of Article 8(1)(a) of the EBA regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council). The review of macro-prudential instruments of CRD/CRR is underway, with a consultation paper expected by the end of 2014 and a report to the European Commission by mid-2015.

Regarding the extension of the transitional periods related to own funds requirements for exposures to central counterparty clearing parties (CCPs) (CRR, Article 497), the adoption and publication in the Official Journal was in June 2014.

Moreover, in 2013 and 2014, there were 13 regulatory technical standards (RTS) that were adopted and published by the European Commission and 30 RTS are in progress. With regard to implementing technical standards (ITS), there are nine that were adopted and published and 15 ITS are in progress (Figure 5).

Recovery and resolution legislation continues to progress

In September 2014, the agreement on a draft bank recovery and resolution directive (BRRD) by the Economic and Financial Affairs Council (Ecofin) was an important step in the development of an effective EU bank resolution framework, including a credible bail-in tool. Progress has also been made on several outstanding issues, such as the treatment of intragroup liabilities and the position of market infrastructures and investment firms. The acts should be legally adopted and enter into force by the beginning of 2015. It is expected that banks will have to pay their first contribution by September 2015.

The international agreements on derivative contracts will allow mutual access and exchange of information

In September, the Council working group on European Market Infrastructure Regulation (EMIR) met to provide a mandate to the European Commission to negotiate the international agreements with several countries, such as Australia, Brazil, Canada, Japan, the US, etc., with regard to the mutual access to, and exchange of information on, derivative contracts held in trade repositories which are established in these third countries.

⁽⁵⁾ The EBA's opinion on the macro-prudential rules in CRD/CRR is published here: <https://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-06+++EBA+opinion+on+macroprudential+rul es+in+CRR-CRD.pdf>

⁽⁴⁾ High-Level Expert Group on reforming the structure of the EU banking sector, chaired by Erkki Liikanen, 2 October 2012.

3. Assets side

In 2014, the EBA’s KRI demonstrate that in general the quality of banks’ loan portfolios did not deteriorate further. In the first half of 2014 the ratio of impaired and past due (> 90 days) loans to total loans (weighted average) went slightly down to 6.4 %, and thanks also to slight recovery in loans. Since mid-2012, the average ratio has been in a range between 6.3 % and 6.8 %. In the previous years before mid-2012, the average ratio had continuously increased since December 2009 from 5.1 %. The dispersion on the higher end is becoming slightly broader again. The 95th percentile of the ratio of impaired and past due (> 90 days) loans to total loans goes as high as 45 %.

There are still significant differences in asset quality depending on the size of the banks as well as the regions, though the trend of a mitigating deterioration in asset quality can be seen all over the EU. This trend also meets the expectations expressed in last time’s RAQ, according to which more than 70 % of the banks expressed their opinion that asset quality would either improve or at least remain stable in the near future. The expectation of improvements emerged for the first time in the June 2014 RAQ after several months of rather negative prospects. According to the results of the current RAQ, again about 70 % of the banks as well as mar-

ket analysts expect a similar development, i.e. a further stabilisation or improvement of asset quality. Nevertheless, in some (sub-) sectors, for example shipping, market analysts still expect a further deterioration of asset quality. At the same time, investor capital returned to Europe and banks have been able to sell NPLs to external investors.

3.1 De-risking

The gross loan volume stabilised in the first quarter of the year and even grew slightly in the following quarter. The development of total assets was roughly similar. This means that the overall deleveraging in the sector – that could be seen in the years before – stopped, even though banks still reduce their exposure in certain sectors or regions.

As banks stated in the RAQ, deleveraging in 2014 was strongly driven by disposals and, for example, closures of business units or branches. Such a trend, for example in the form of loan portfolio sales, could indeed be seen in the form of ongoing NPL transactions throughout the year which might also result from increased market demand for such assets. In contrast, in the years before 2014, deleveraging of the loan portfolios has mostly been achieved through run-off, rather than sales of assets.

Figure 6: Deleveraging strategy and expected asset sales
 Source: EBA RAQ for banks (left) and RAQ for market analysts (right).



Figure 7: Total asset and loan volumes (trillion EUR)

Source: EBA KRI and EBA calculations.

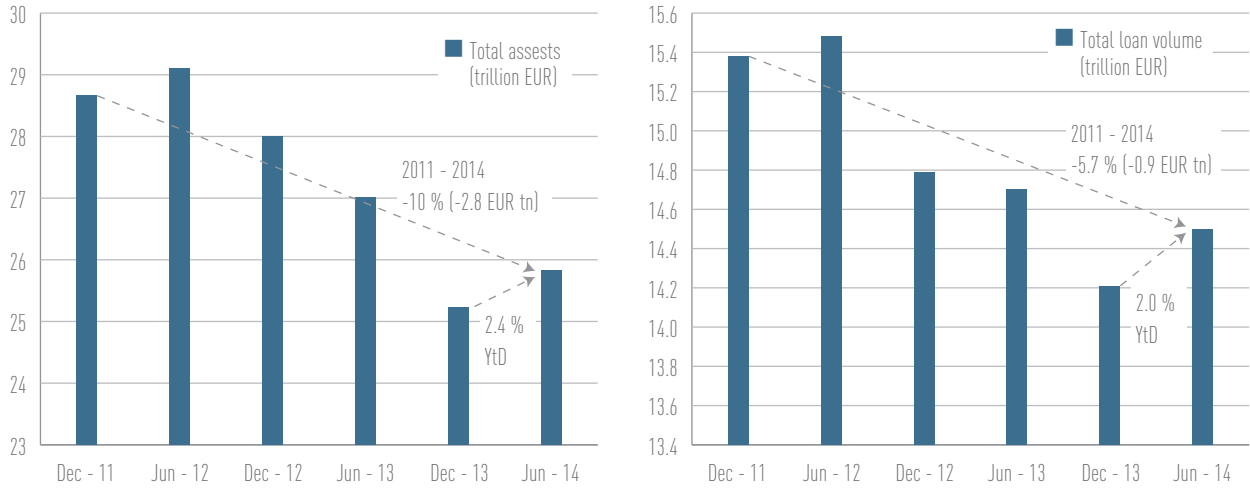
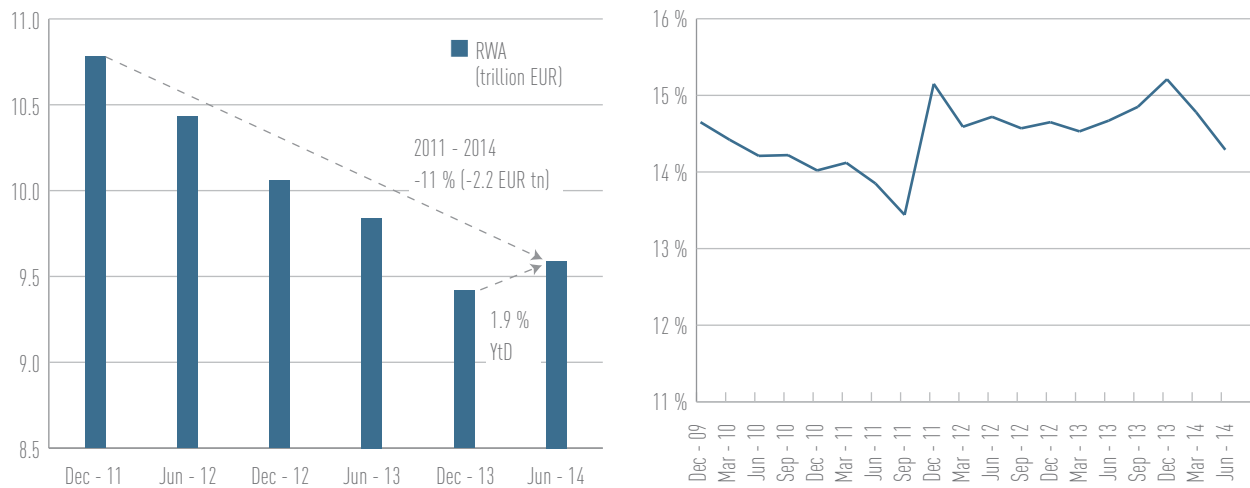


Figure 8: Risk-weighted assets (trillion EUR) and off-balance sheet items

Source: EBA KRI and EBA calculations.



During the first two quarters of 2014 the sector- or region-specific deleveraging can still be understood as a trend to frontload the adjustments that result from the EU-wide AQR and stress test. This could be seen as proven by the fact that significantly in sum more than half of the banks said in the RAQ that the main driver for deleveraging would either be regulatory requirements, capital restraints or decisions of further de-risking. Market analysts also confirmed this assumption, as more than 40 % of them expect more asset sales (sum of 'agree' and 'somewhat agree'), and if they expect it, they see it rather in specific portfolios or regions than across the board (Figure 6).

The financial crisis has exposed weak business models and business lines. Even though there is a reversal of the former trend of decreasing asset and loan volumes for the first time since 2012 (Figure 7), there is still a need for adjustments in order to restructure balance sheets, to set capital for riskless business free and to set the basis for a more stable and sound banking sector. In general, with lower leverage, in a low inflation and low risk environment, the RoE ratios will necessarily fall, also influenced by regulatory standards.

The overall reduction of RWAs in the years 2011 to 2014 confirms the general ongoing de-risking of the bank's balance sheets and business in parallel to the deleveraging

(Figure 8). One should have in mind that a certain part of de-risking might also result from optimization of risk-weighted assets, for example. In percentages, the de-risking was slightly above the deleveraging. For the latest growth of assets, the increase in RWAs was below the increase in asset volumes in relative terms (Figures 7 and 8). The lower absolute as well as relative decrease of loan volumes compared to total assets, shows that the deleveraging has not only been driven by the banks' lending business, but might also be due to the fact that the reduction of loan volumes takes, in general, a longer time than reducing, for example, positions in traded bonds. Furthermore, the off-balance sheet items, like guarantees or loan commitments, have shown a rather stable development (ratio to total balance sheet total), i.e. their influence on the deleveraging and de-risking can also be considered as unchanged over time (Figure 8).

Even though an increase in loan volumes, as could be seen in the first half of 2014, can be understood as a positive sign, there is still doubt as to whether this can become a persistent trend and as to whether it is consistent all over the EU banking sector. For

example, more than 20 % of the banks still responded in the RAQ, that they agree or somewhat agree with the idea that their de-leverage activities would principally focus on reduced lending. It is an indication that these banks still have a negative net growth of their loan volumes. This could also be understood as a signal that there are material differences between certain banks and regions which was also an outcome of the AQR and stress test: the results showed that several banks will still have to focus on capital needs instead of growing their loan book, at least in the near future.

In any case, lending volumes are not only driven by the supply side but also by the demand from, for example, retail or corporate clients for loan-based financing. For example, nearly 20 % of the banks indicated in the RAQ that deleveraging would be driven by reduced demand for credit. The answers also confirm that any trend in deleveraging or balance sheet growth is not limited by any funding constraints. Finally, the overall supply and demand are strongly influenced by general economic dynamics which showed some uncertainty after mid-2014.

Comparability of risk-weighted assets

The EBA is currently developing a wider and deeper analysis on the consistency of RWAs across European banks. The analysis is based on benchmarking exercises for the low default portfolios (central governments, credit institutions and large corporations). The objective is to identify any material difference in banks' assessments of risks and to understand the main drivers of such differences.

The policy responses that the EBA considers as particularly important for addressing concerns about RWA consistency are the following:

- (a) enhancing disclosure and transparency of RWA-related information;
- (b) supporting competent authorities (CA) in properly implementing the single rule book with the delivery of existing

mandates set out in the CRR and CRD (these include the important benchmarking work on RWA parameters that supervisors can use to assess model outcomes);

- (c) developing additional guidance that specifically addresses and facilitates consistency in supervisory and banks' practices, which includes, for example, uniform default definitions and harmonised treatment of defaulted assets under the internal rating-based (IRB) approach, clearer guidance on probability of default (PD), loss given default (LGD) estimations and treatment of low-default assets.

The EBA considers that the understanding, transparency and consistency of RWAs will improve through the abovementioned policy responses and will help to restore market confidence in risk-sensitive measures of capital adequacy.

Volatile trends in respect of de-risking: closer supervision on risk-weighted asset calculations is needed

Indicators show de-risking and downsizing of banks' balance sheets since 2009, with volatility in between. The higher decrease of RWAs compared to the reduction in total assets can be seen as a signal for de-risking. The ratio of RWAs to total assets confirms this general trend, even though it shows an increasing trend in 2012 and 2013, it becomes flat and even negative again in 2014. At the same time, the calculation of banks' RWAs remains an area for close supervision (Figure 9).

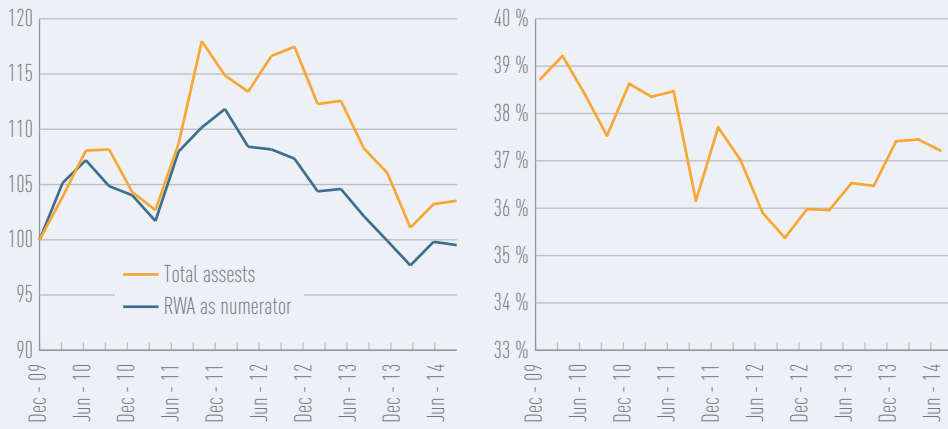
RWAs play an enormous role in respect of (de)leveraging and de-risking, but also in respect of capital allocation to segments, etc. As such it is not surprising that the calculation of banks' RWAs was also an impor-

tant topic in the RAQ responses from market analysts who, for example, stressed the need for their rapid comparability in order to create a proper level playing field across the EU. The need for comparability in RWAs was also a topic that many analysts mentioned in their comments on the results of the AQR and stress test in October 2014. This is also driven by the idea that capital ratios can only be compared if the respective basis for calculation, i.e. the RWAs, is similar. As such it remains an area for close supervision and further deeper analysis on the consistency.

In this context it should also be noted that the reduction of the average risk weights does not necessarily result from a risk reduction in the loan portfolio solely, but also from shifts in asset composition as well as shifts in RWAs for market and operational risk.

Figure 9: Evolution of total assets and RWAs and the ratio between RWAs and total assets [December 2009 = 100] ⁽⁴⁾

Source: EBA KRI.



⁽⁴⁾ In 2011 there were changes in the data delivered by some banks, e.g. due to restructuring processes.

A trend of slowing deleverage

Banks' plans to deleverage show a clear trend over time according to the results of the RAQ. In June 2013, about 25 % of the banks envisaged asset reductions of 6 % and more, with 15 % of the banks planning reductions in the range between 6 % and 10 %. In December 2014, only 10 % of the banks still envisage reductions of 6 % and more. The results of the latest RAQ show that asset reduction became less important as a general trend in the banking sector: 40 % of the banks still envisage future deleveraging measures in general — half of them envisaging deleveraging less than 2 % — whereas in June 2013, more than 60 % of the banks had planned asset reductions (Figure 10).

Even though a reduction in new lending shall be one of the means for deleveraging, according to the banks (in sum slightly more than 20 % 'agree' and 'somewhat agree'), the focus is rather on disposals and closures of business units, subsidiaries or foreign operations. This means that, for example, asset sales should still be expected as a means for asset reduction. However, an increase of asset sales is less probable according to the RAQ results from market analysts. Their expectation of more asset sales decreased significantly from nearly 50 % in the June 2014 results to less than 20 % in the December 2014 questionnaire. This assumed changing trend could already be considered as at least partially proven by the fact that loan volumes showed a slight growth in the second quarter

Figure 10: Banks' actions and plans for deleveraging
Source: EBA RAQ for banks.

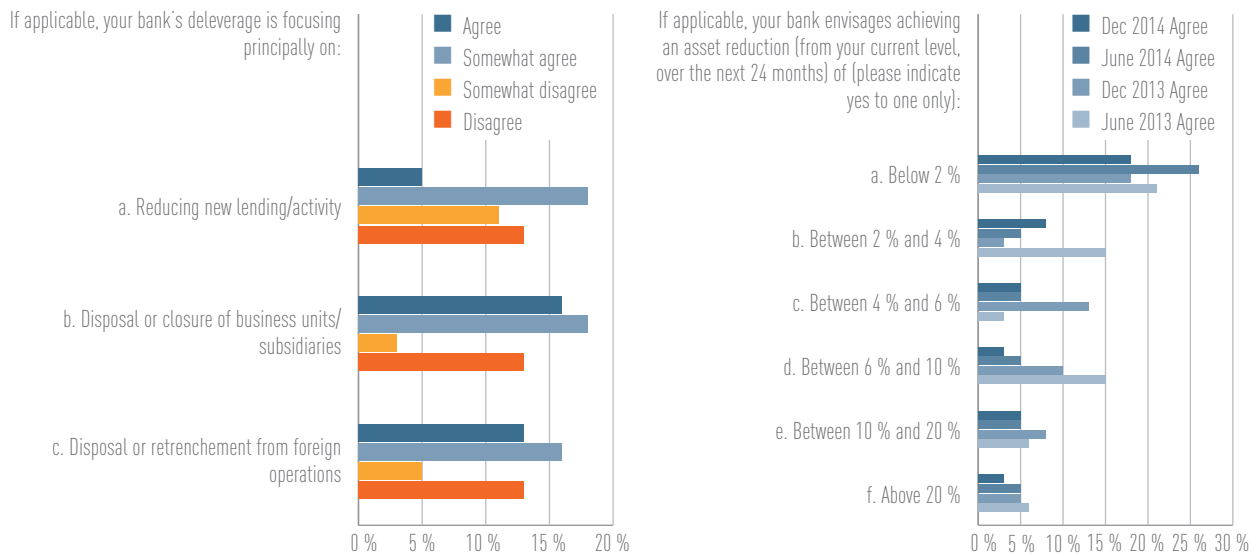


Figure 11: Asset sales expectations of market analysts
Source: EBA RAQ for market analysts.

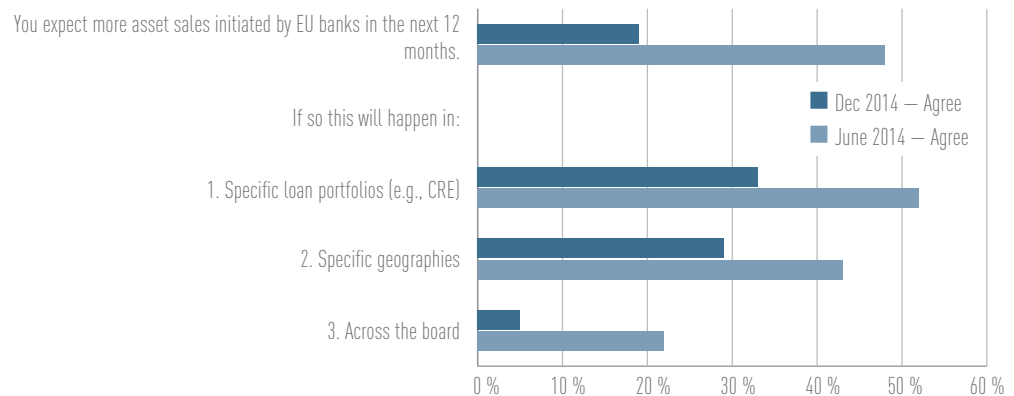
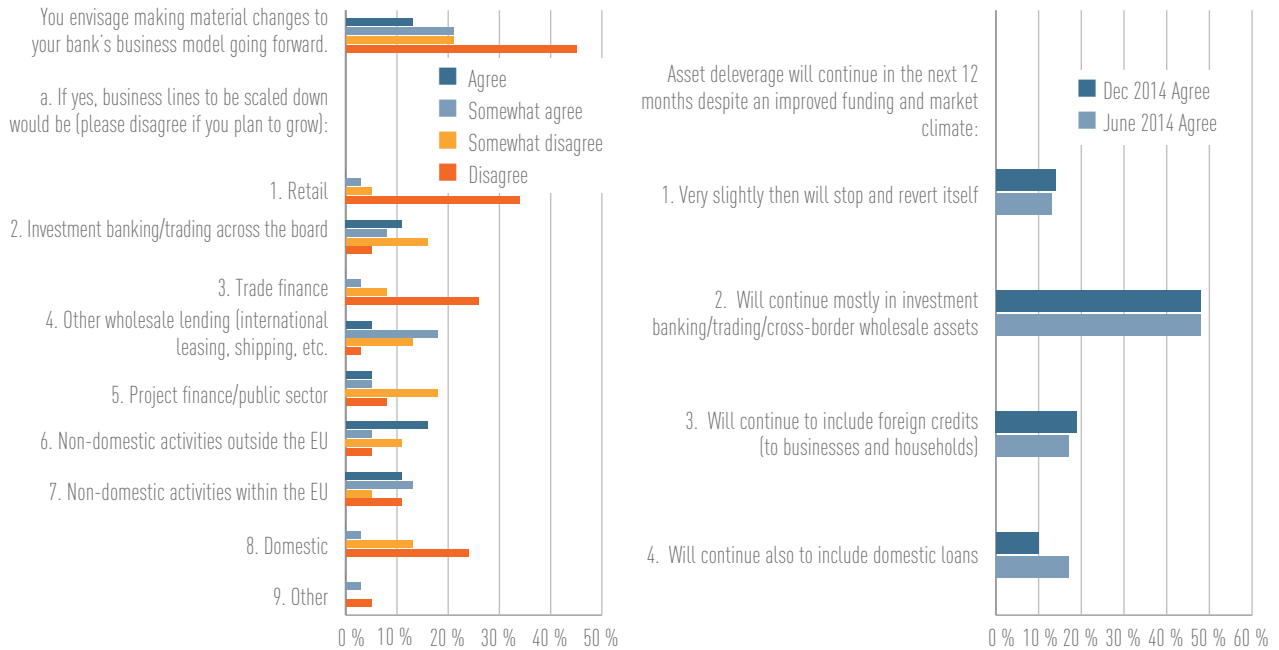


Figure 12: Banks' material changes in their business model and focus of deleveraging for market analysts
 Source: EBA RAQ for banks (left) and RAQ for market analysts (right).



of 2014 for the first time in the last few years, resulting in a growth of the loan and asset volume in the first half of 2014 (Figure 11).

About 12 % of the RAQ respondents (RAQ for banks) agree with the plan of making material changes to their business models. Anyhow, about 80 % of the banks still expect a change of their earnings mix to match better their risk-return targets. This implies that there are still changes going on in detail (smaller ratios of deleverage, risk-return idea in the earning mix becoming even more important on an already high level), but that material impacts should not be rather expected. However, it also implies decreasing RoE in future.

Investment banking and foreign activities still in the focus of deleveraging

There have been hardly any shifts in expectations about the areas in which deleveraging will mainly take place — in case it is expected. According to the responses from the market analysts, in the RAQ, the rate of agreement — which was nearly unchanged compared to the results of the last RAQ — is the highest in respect of, for example, investment banking and cross-border wholesale assets.

The market analysts' assumption seems to fit to what the banks answered in respect of planned material changes to their business model. For example, the rate of agreement was — in sum — the biggest for envisaged scale-downs of non-domestic activities

(mainly covering activities outside the EU, but also within the EU). The second important part for planned scale-downs made the investment banking and trading segment. Other wholesale lending, like shipping or international leasing, is last but not least also in the focus of scale-downs (Figure 12).

There is still some ambiguity concerning banks' strategy, capital allocations, and a general scepticism about the investment banking business model, taking into account profitability, market positioning and litigation risks. The pressure on investment banking revenues, forcing restructuring and cost-cutting among European banks.

There are signs of a resurgent risk appetite

Despite the experience of the financial and economic crisis there has been an increase in popularity of high-yield bonds in euro during the last years, whereas European leveraged loans have decreased in popularity. At the same time, the share of covenant-lite loans in companies' financing volumes has risen during the last years. The re-emergence of lending to leveraged clients and in the form of covenant-lite loans should increase the interest and close monitoring of the banking supervisors, particularly regarding the lending practices of EU banks and the possible repetition of excessive risk-taking. Supervisors should challenge banks' risk appetite and test the application of their risk appetite across all asset

classes as banks could increase risk taking in less obvious loan or asset classes (via price, credit grade or lending terms and conditions) as they look to improve yields.

Moreover, the real estate markets are showing divergent valuations within the EU as well as within certain countries (for example,

showing increasing price differences between rural and metropolitan areas), reflecting a significant heterogeneity in housing markets. Given the fact that, in some countries and / or regions, property prices have risen significantly, this is raising concerns about possible risks of overvaluation and sinking prices in the near or mid-term future.

Figure 13: Ratios of impaired and past due assets to total assets, loans and debt instruments (weighted average)

Source: EBA KRI.

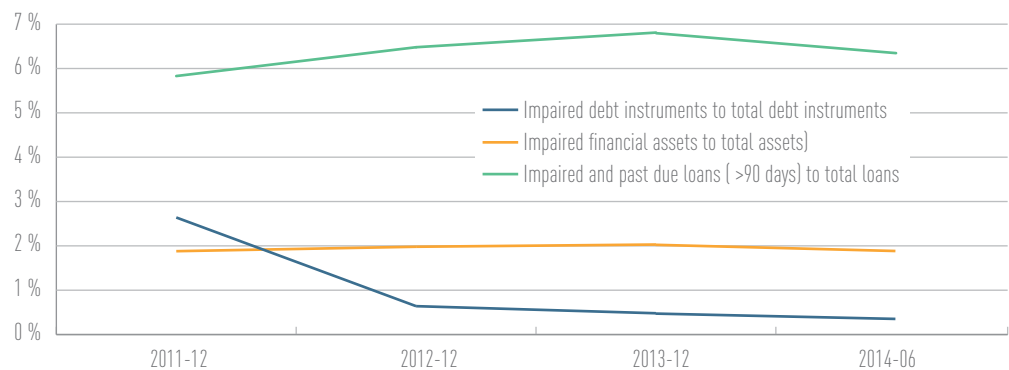
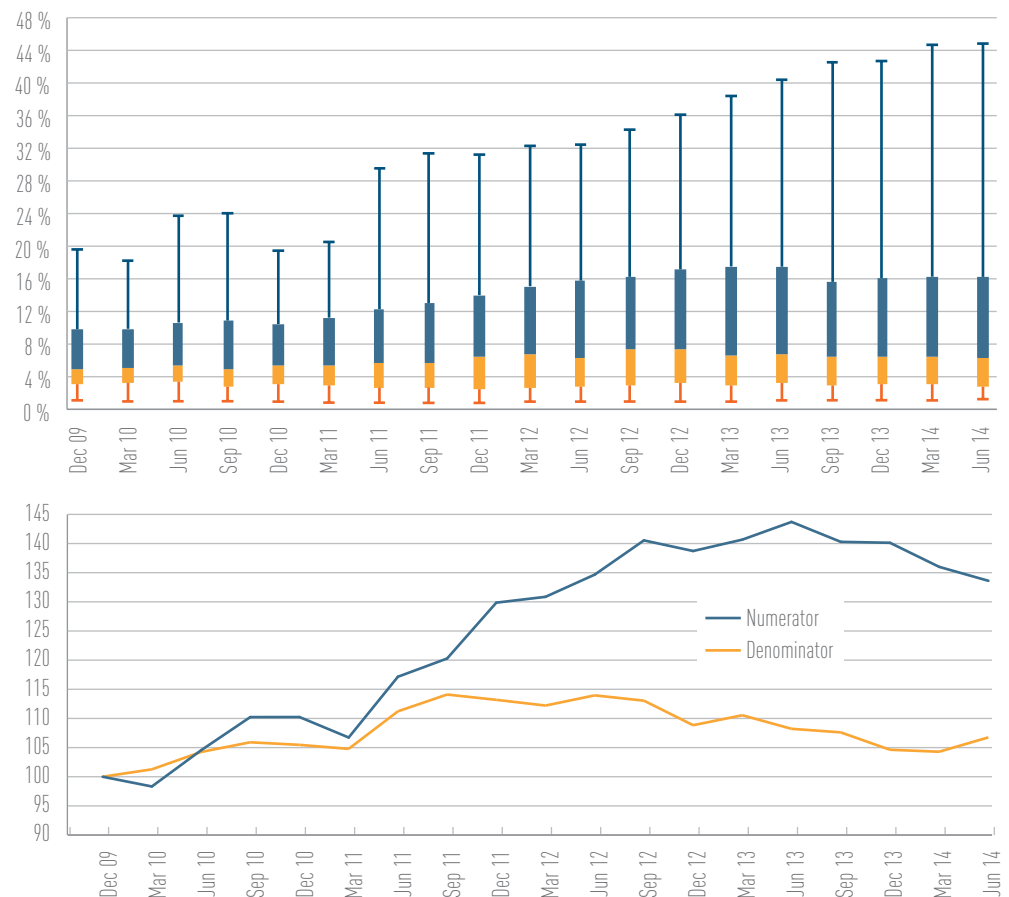


Figure 14: Impaired loans and past due (> 90 days) loans to total loans— 5th and 95th percentiles, interquartile range and median, numerator and denominator trends (December 2009 = 100)

Source: EBA KRI.



3.2 Asset quality

The ratio of impaired financial assets to total assets has been relatively stable since 2012. This has been influenced by a decreasing impairment ratio for debt instruments since 2012, on the one hand, and a — first increasing and later on decreasing — ratio of impaired loans and loans past due (> 90 days) to total loans, on the other hand (Figure 13).

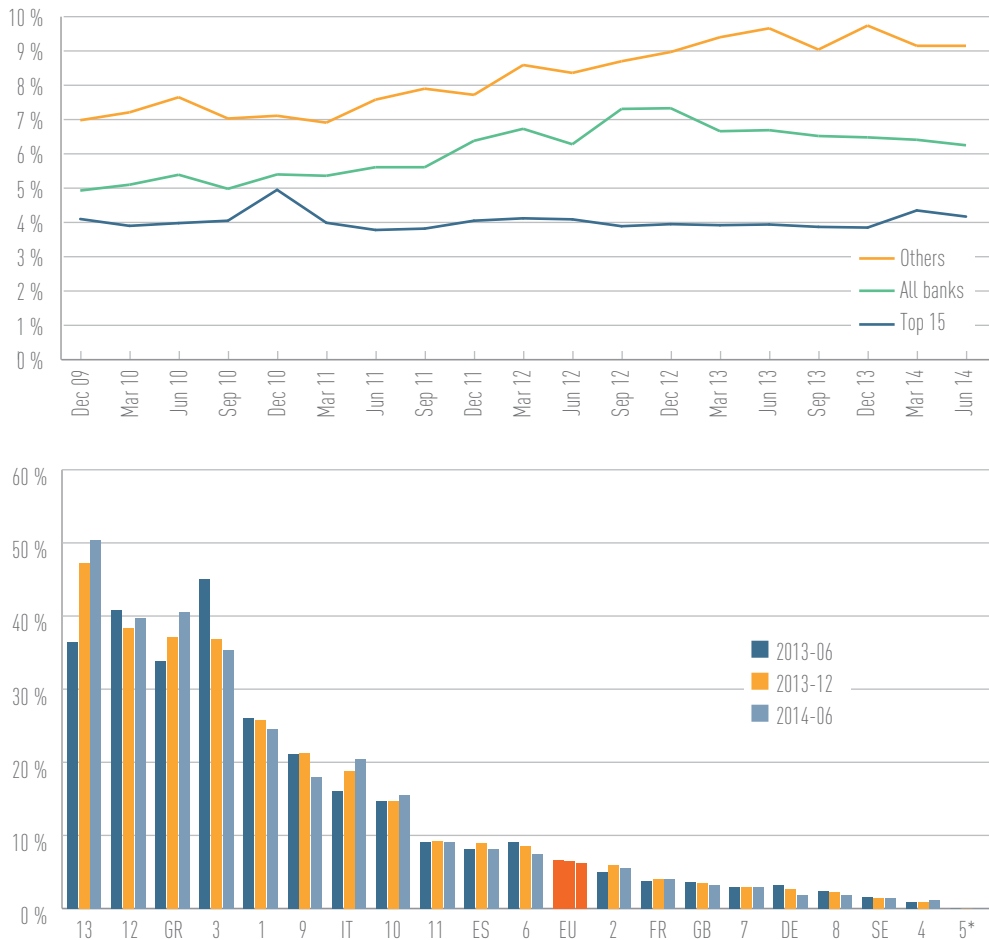
However, it is mainly the ratio of impaired loans and loans past due (> 90 days) to total loans that keeps the average proportion of impaired assets to total assets at its level of about 2 %: when the respective percentage for other debt instruments significantly declined during 2012 this had no respective impact on the average ratio as the ratio for loans slightly increased in the same period.

Asset quality stabilising on a low level

In the first half of 2014, the ratio of impaired and past due (> 90 days) loans to total loans (weighted average) went slightly down to 6.4 %. Since mid-2012, the average ratio has been in a range between 6.3 % and 6.8 %. In the previous years before mid-2012, the average ratio had continuously increased since December 2009 from 5.1 %. Such an average of about 5 % still looks like being far away from being reachable as of now, taking into account the results of the AQR and newly rising uncertain economic developments (Figure 14).

The split of the two parameters of the ratio shows that the recent evolution is mainly driven by a decreasing numerator, i.e. decreasing volumes of impaired and past due (> 90 days) loans, for example through as-

Figure 15: Impaired loans and past due (> 90 days) loans to total loans — country dispersion — medians by country and by size class; banks by size class according to their average total assets
Source: EBA KRI.



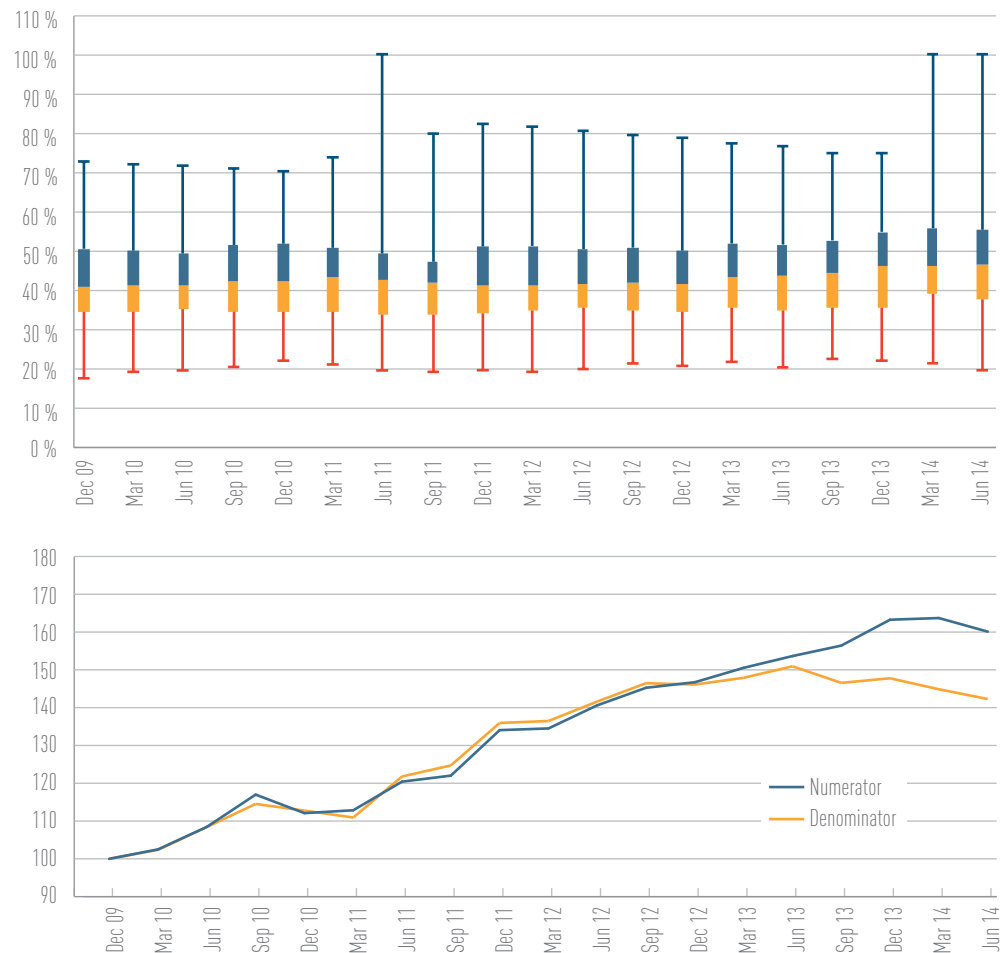
set sales. In contrast, the denominator, i.e. the loan volume, remained stable in the first quarter of 2014 and even grew in the second quarter of 2014. The big challenge from such a development might be that it is not yet clear how the risk profile of the newly acquired business will develop.

Furthermore, the dispersion on the higher end is becoming slightly broader again: the 95th percentile goes as high as 45 %. It can be understood as a further increasing risk resulting from banks that show a high ratio in this respect. This dispersion has become broader since 2011. On the contrary, the 75th percentile remained relatively stable during the last quarters, but is still well above historical levels for this percentile. In respect of the country dispersion it can be seen that banks (weighted averages) from financially stressed countries still show the highest ratios and in respect of size the top 15 banks (in respect of average total assets) show the lowest ratios (Figure 15).

Coverage ratios show growing divergence across banks, with the share of banks with a coverage ratio below 25 % increasing from 13.2 % to 19.9 %

The coverage ratio (specific allowance only, i.e. not taking general loan loss allowance into account) is still within a range of 46 % to 47 %, that is, similar in the last three quarters (weighted average of 46.8 %). However, the share of banks with a coverage ratio below 25 % strongly increased from 13.2 % to 19.9 % in the second quarter 2014, i.e. the banks with relatively low coverage ratios significantly increased. The results of the AQR seem to have significantly influenced the evolution of this ratio during the first half of 2014. In parallel, dispersion on the higher levels became significantly broader, with the 95th percentile going up to a coverage ratio of 100 %. The last time that such a high end of the 95th percentile could be seen was mid-2011. It can be assumed that the results of the AQR contributed in general to a further

Figure 16: Coverage ratio – specific allowances for loans to total impaired gross loans – 5th and 95th percentiles, interquartile range and median, numerator and denominator trends [December 2009 = 100]
Source: EBA KRI.



increase of the coverage ratio (in particular for the medium-sized banks), despite the growing of the share of banks with a coverage ratio below 25 %.

Even though the numerator and denominator had been moving more or less in parallel till mid-2013, they showed a widening gap in the following quarters, proving that the increase in the coverage ratio indeed resulted from an increase in specific allowances. The trend of the increased coverage seems to be relatively stable. In the second quarter of 2014, the specific allowance (numerator) as well as the impaired loan volume (denominator) went down in parallel, again (Figure 16).

Even though the coverage ratios do not move absolutely in parallel for the top 15 (size class) and other banks, they at least seem to be closer during recent quarters. This indicates that after a significant increase of the coverage ratio for the medium-sized banks (non-top 15) in the first half of 2014, there

are no longer the large differences in coverage ratios between big and mid-sized banks. The country dispersion does not show any clear trend, but banks from five countries still show a weighted average coverage ratio lower than 40 % (Figure 17).

Modest improvements in asset quality are expected in the near term

According to the RAQ as of June more than 70 % of the banks expected marginal improvements or no changes in asset quality during the following 12 months. As of December 2013, nearly 60 % of the banks expected an unchanged asset quality. Looking back, such trends could indeed be seen in the loan portfolios, as the weighted average ratio of impaired and past due loans to total (gross) loan volumes slightly shrunk in 2014. The results of the recent RAQ for banks and RAQ for market analysts show that this trend is even expected to continue: more than 70 % of the banks expect either no changes or mar-

Figure 17: Coverage ratio — specific allowances for loans to total gross loans — country dispersion — medians by country and by size class; banks by size class according to their average total assets

Source: EBA KRI.

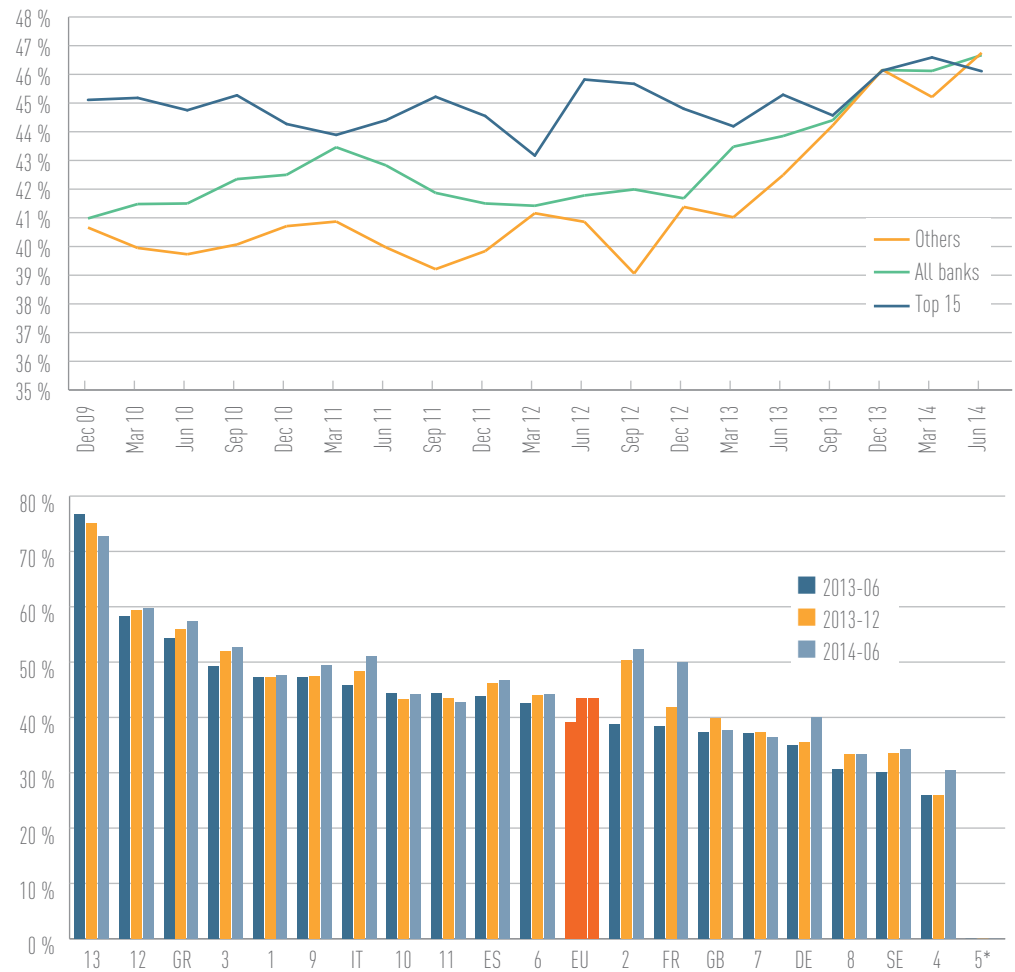


Figure 18: Quality of loan portfolios
 Source: EBA RAQ for banks.

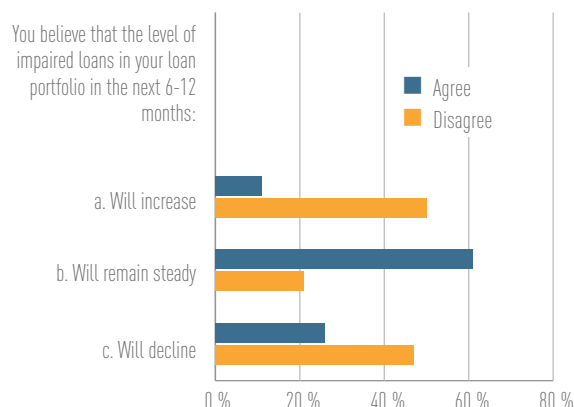
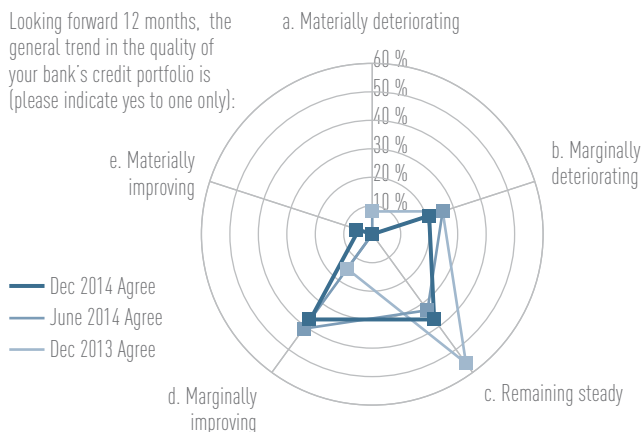
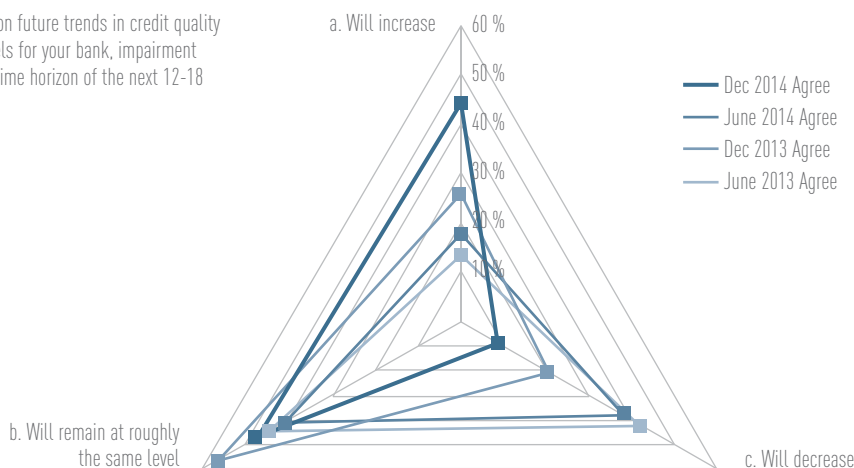


Figure 19: Expectations in respect of impairment provisions
 Source: EBA RAQ for banks.

Based on your view on future trends in credit quality and impairment levels for your bank, impairment provisions over the time horizon of the next 12-18 months:



ginal improvements. Compared to June 2014 results, there has been a small shift from marginal improvements to a 'no changes in quality' expectation. However, in aggregate the sum of 'marginal improvements' — or 'no changes in quality' — expectations has remained at 70 % in the three recent RAQs (Figure 18).

Banks' views are similar to market analysts'. About 70 % of the market analysts assume a stabilisation or improvement of the asset quality in the following 12 months according to the results of the RAQ. Furthermore, 60 % of the banks expect an unchanged level of impaired loans in their portfolio, and about 25 % of the banks even assume a declining level of impaired loans. This goes in parallel with the banks' expectation that impairment

provisions will either remain at roughly the same level in future or decrease (Figure 19).

Based on the results of the RAQ for market analysts, a potential further deterioration of asset quality is neither expected for sectors like mortgage or real estate finance, nor for large corporates. However, market analysts agree or somewhat agree with a rate of more than 60 % each that such deterioration would be in specific geographies or in particular sub-sectors like shipping. Furthermore, more than 40 % agree or somewhat agree that potential deterioration would occur in the SME loan portfolio.

From the RAQ for banks, the trends in impairments are strongly driven by certain geographies. Furthermore, taking a 'net posi-

tion' of agree versus disagree, impairment provisions will also be driven by the SME segment (agreement about 50 %, disagreement about 20 %), whereas, for example, real estate developers (disagreement about 45 % with lower agreement of about 25 %) or large corporates (disagreement slightly above 40 % with lower agreement of above 20 %) are not expected to contribute materially to the moves of the impairment levels according to the RAQ results. As such these assumptions roughly correspond to the market analysts' answers. However, the AQR results showed a big impact in the real estate financing portfolios. It is also considered as an asset class with increasing risks resulting from possible overvaluations and sinking prices in the near or mid-term future.

Nevertheless, it seems to be surprising that market analysts expect further deterioration in sub-sectors like shipping (indirectly implying increasing rates of impairments), whereas from the banks' side, the rate of disagreement is even bigger than the rate of agreement that these sub-sectors will show moves in the levels of impairment provisions (Figure 20). However, it always depends on which sub-sector is considered. Furthermore it should be seen that still nearly 30 % of the banks expect that these sub-sectors will show moves in impairment levels. In any case, real estate as well as sub-sectors with high risks should stay in the focus of supervisors as they have been during the AQR (e.g. shipping portfolios).

Focus of corrective actions in a post-AQR and stress test world on real estate and business clients

Banks plan to focus their corrective actions mainly on commercial real estate (CRE), small and medium-sized enterprises (SMEs), residential mortgages, consumer credit loans and on corporates in the post-AQR and stress test environment. Taking again the difference between the rate of agreement and disagreement, the other sectors will not really be the focus. For example, for structured or project finance portfolios, the banks disagree at a by far higher rate than that at which they agree.

It might be understood as an indication and confirmation that the sectors that are expected to be the focus for corrective actions are those that might have been in trouble, but still offer the biggest chances for restructuring (Figure 21).

New definitions shine a light on extent of forbearance

According to market analysts' views (RAQ for market analysts), difficulties in enforcing creditor rights, impediments to the sale of collateral and general long delays in processes are causing the main challenges in debt restructuring (rate of agreement of about 50 %). The second most important challenge is immature regulations for out-of-court debt restructuring regulations in certain countries. Operational capacity con-

Figure 20: Drivers for asset deterioration and impairment moves
Source: EBA RAQ for banks (left) and RAQ for market analysts (right).

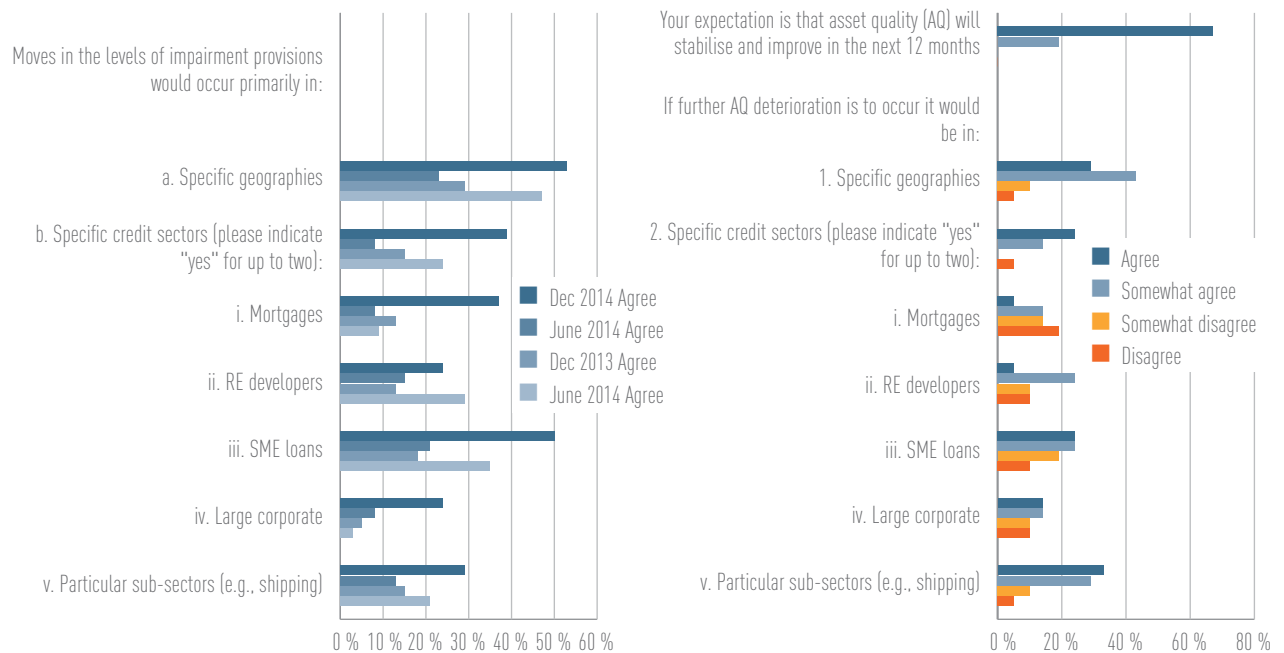
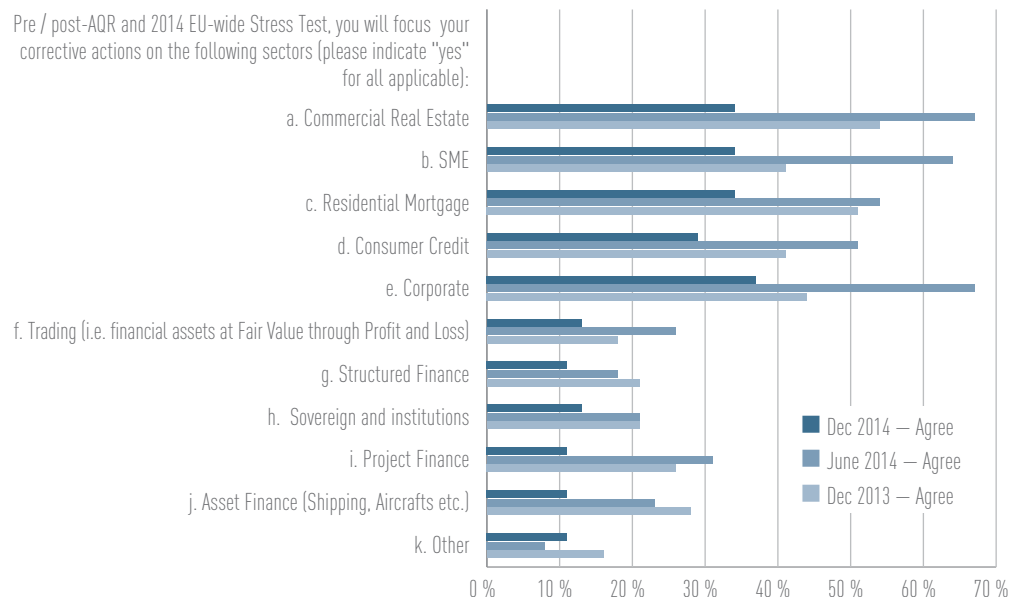


Figure 21: Portfolios for future corrective actions
 Source: EBA RAQ for banks.



straints, actually to be seen as the contrary, are considered with a rate of about 15 % as a challenge in debt restructuring (Figure 22).

Regarding forbearance issues, again, like in the questionnaires before, more RAQ respondents agree that forbearance is practised. The rate of agreement increased from about 50 % to 60 % compared to the results from the RAQ as of June. This increase might also result from the common definitions of 'non-performing exposures' and 'debt forbearance' that were published in October 2013 by the EBA ^(?) (Figure 23).

The practice of forbearance is happening in general and mainly seen as prevalent in residential mortgages and the business sector. At the same time, the extent of forbearance practices may influence the level of impairment provisioning. However, the rate of RAQ respondents that agree with the idea that if no forbearance had been practised, provisions would have been higher than they currently are, is relatively low (about 15 %). Moreover, the number of replies agreeing that policies are in place to govern forbearance outline triggers and thresholds (if and when loans which have been subject to some form of forbearance become subject to credit workout procedures) has again increased (Figure 24).

^(?) The EBA published the final draft of the technical standards on NPLs and forbearance reporting requirements (<http://www.eba.europa.eu/-/eba-publishes-final-draft-technical-standards-on-npls-and-forbearance-reporting-requirements>).

Figure 22: Reason for challenges in debt restructuring

Source: EBA RAQ for market analysts.

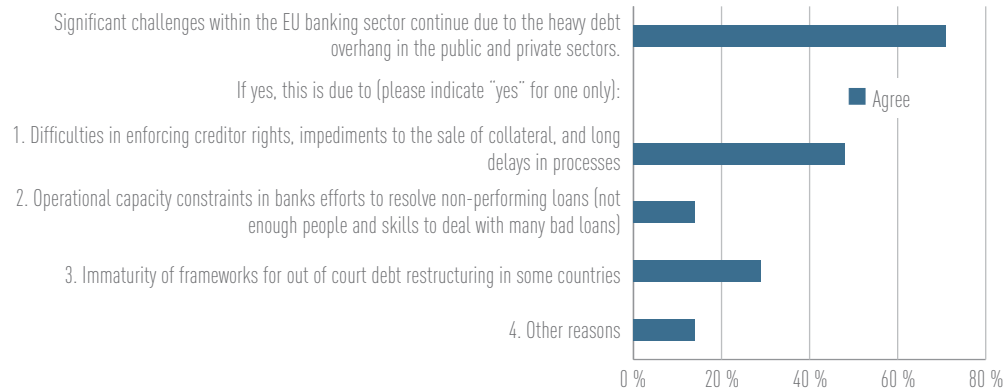


Figure 23: Forbearance practices

Source: EBA RAQ for banks.

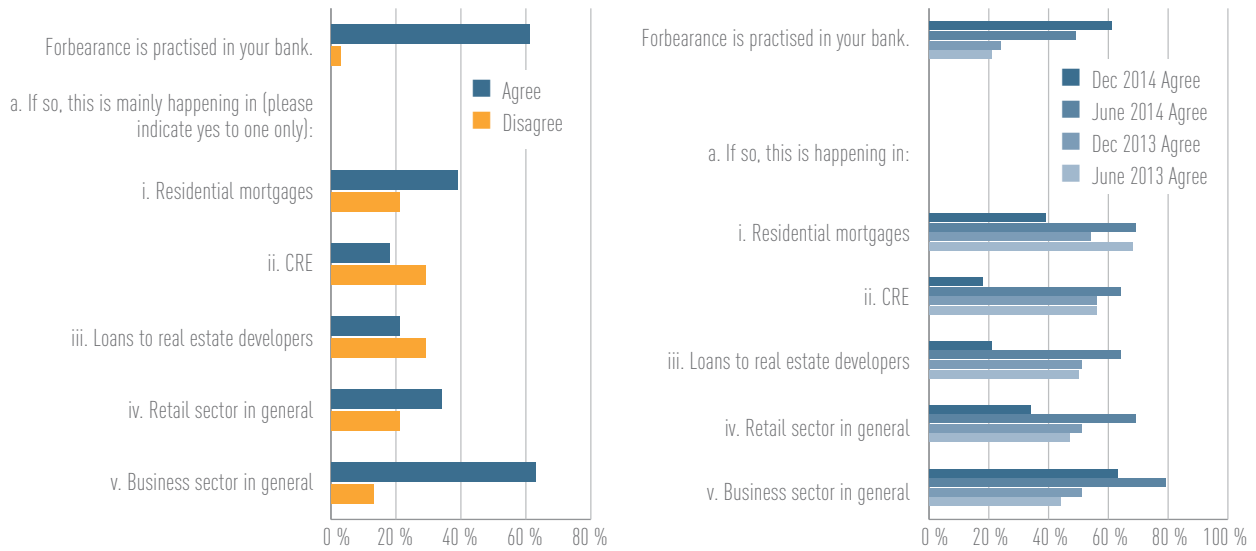
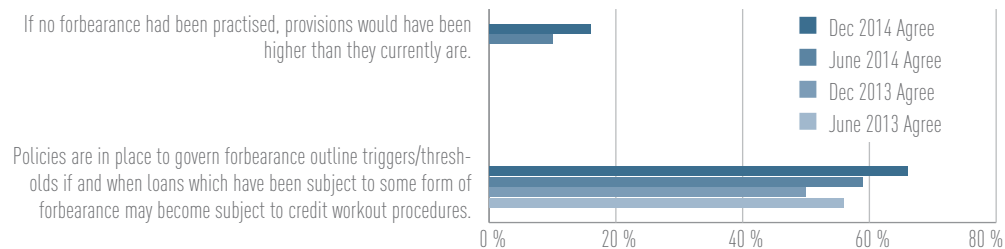


Figure 24: Forbearance policies in place and practiced

Source: EBA RAQ for banks.



4. Capital

Over the course of 2013 and first half of 2014, EU banks' capital positions continued to maintain an important increasing trend and made significant progress in strengthening their capital positions, as the CET1 ratio levels show in preparation for the EU-wide stress test. In the second half of 2013 the EU banks raised over EUR 40 billion in total capital and between January and September 2014 alone, they raised a further EUR 53.6 billion of equity (EUR 39.2 billion net of repayments and buybacks) and EUR 39.1 billion of contingent convertible instruments (both AT1 and tier 2). That is more than some initial market estimates (around EUR 60 billion). However, this was also on the back of falling RWAs (Figure 25).

Improvement of common equity tier 1 capital levels

The weighted average CET1 ratio further increased in 2014, even though the growth rate was slower. For the largest European banks, the weighted average CET1 ratio stood at 11.8 %, in June 2014 (compared to 11.6 % in December 2013 and 11.1 % in June 2013). There is further evidence of infusions of capital into European banks, also triggered by the 2014 EU-wide AQR and stress test exercise. Indeed, the result of the stress test after capital infusions performed in 2014 proves that banks were anticipating their capital needs from these European exercises. The number of banks in the sample of the stress test that

showed a shortfall went down from 24 to 9 institutions, whereas the shortfall went down from EUR 24.2 billion to EUR 9.5 billion, when comparing the results of the stress test before and after capital injections performed in 2014.

Different developments in the tier 1 and common equity tier 1 ratios

Since 2012, the KRI confirmed that the EU banks' capital positions continued to maintain an important increasing trend and have improved significantly. In the second quarter of 2014, the tier 1 capital ratio rose by 50 basis points to 12.9 %, after a decrease of 70 basis points in the first quarter of 2014 (weighted average). This decrease in the first quarter of 2014 was driven by a decrease of the numerator, as well as an increase in the denominator (i.e. the RWAs, increase e.g. due to a growth of total assets, but also due to the recognition of CVA charges in RWAs).

In contrast, in the second quarter of 2014, the RWAs (denominator) slightly decreased and the capital (numerator) sharply increased, mainly due to the described issuances of tier 1 and contingent convertible (CoCo) instruments. In the same period, the median tier 1 capital ratio increased by 100 basis points (from 12.3 %, in March 2014, to 13.3 % in June 2014), after a decrease of 50 basis points in the first quarter of 2014. Banks with a tier 1 capital ratio less than 12 % increased and

Figure 25: Common equity tier 1 ratio (till December 2013: Tier 1 ratio excluding hybrid instruments) – weighted average

Source: EBA KRI and EBA calculations.

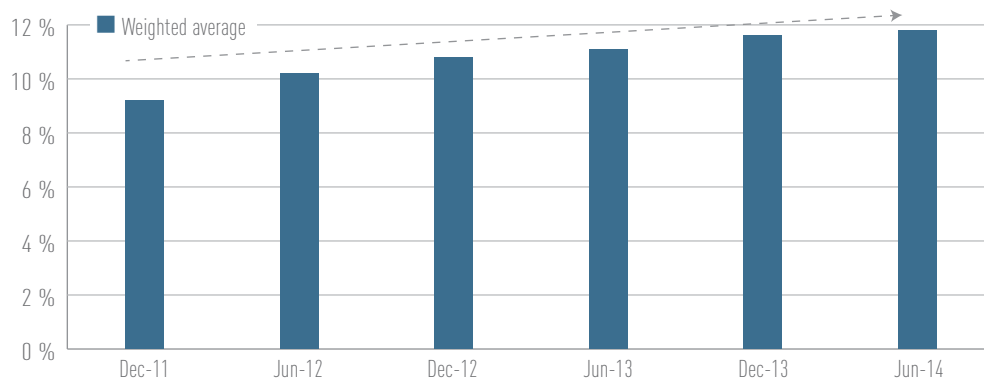


Figure 26: Tier 1 capital ratio – 5th and 95th percentiles, interquartile range and median, and by size class (medians)
 Source: EBA KRI.



represented 37 % of total assets in June 2014 (from around 27 % in December 2013). The positive evolution of the tier 1 capital ratio is also confirmed when considering the size class of banks (i.e. for the top 15 banks) in terms of total assets, and for the remaining banks of the KRI sample (Figure 26).

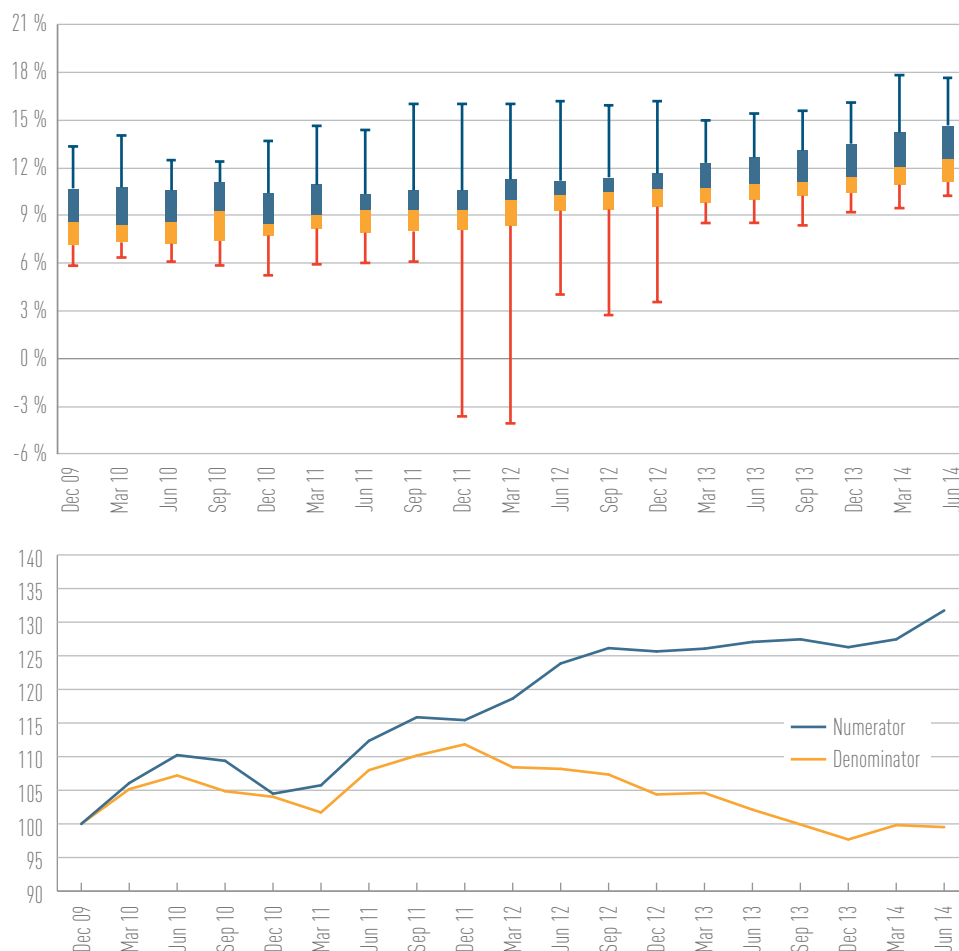
This positive trend is also confirmed when looking at the median of the CET1 ratio, which increased from 11.4 % to 12.6 % in the first six months of 2014. At the same time, banks with a CET1 ratio higher than 10 % increased once more and represented 93 % of total assets in June 2014 (from 87 % in December 2013). The dispersion of capital indicators has remained relatively stable since March 2013, also suggesting that banks in the sample stay in general in a rather conservative solvency base.

In respect of the capital ratio, the development of the numerator confirms the build-up of capital in the first half of 2014. The denomi-

nator is at least partially influenced by Basel III effects in the first quarter which result in an increase of RWAs (besides the effect from an increase in total assets in the same quarter), and then slightly decreasing in the second quarter which also contributes to the increase of the CET1 ratio. Such an effect in the second quarter of 2014 – an increase in capital ratio at least partially driven by the denominator – also shows the impact of RWAs on the capital ratios. And it makes clear that it should remain or become an area for closer supervision in future, especially in respect of the RWAs' comparability. It is a topic the EBA is currently working on in its Task Force for Supervisory Benchmarking, by considering the comparability of credit and market RWAs (Figure 27).

While capital positions for the EU banks are stronger than in the past and are on a comparable basis to those of international peers, the continuation of important risks resulting

Figure 27: Common equity tier 1 ratio (till December 2013: Tier 1 ratio excluding hybrid instruments) – 5th and 95th percentiles, interquartile range and median, numerator and denominator trends (December 2009 = 100)
 Source: EBA KRI.



from economic uncertainty is expected, including risks from emerging markets which may have impact on a potentially growing impairment provisioning. In addition, the low levels of profitability might not contribute to a build-up of retained earnings as part of the common equity. Therefore, there is still no room for complacency and these aspects have been well expressed by the results of the EU-wide stress test in 2014.

Increase in contingent convertible and additional tier 1 instrument issuances

In parallel to the increase of their common equity capital base, European banks also issued significant volumes of hybrid instruments, i.e. CoCos (Figure 28). Based on their structure and conditions, CoCos can be considered as AT1 or tier 2 instruments. The consideration as AT1 instrument is subject to certain conditions, for example AT1 instruments shall be perpetual (or callable subject to approval of the supervisory authority),

whereas tier 2 instruments in general have a stated maturity. Furthermore, coupons on AT1s must be fully discretionary.

This increase in issuance volumes in 2013 and 2014 could also be considered as triggered by the AQR and stress test exercises, and in parallel driven by the investors’ chase for yield in a low interest rate environment. Under CRD IV, CoCos are, in general, loss-absorbing capital, either by conversion into equity or facing write-down, when a certain capital level is breached. This capital level should be 5.125 % or higher for instruments considered in AT1.

According to RAQ respondents, the cost of equity is currently considered to be in the 8–10 % range, while the coupons on AT1 or CoCos (considered in AT1 or tier 2) might be about 7 % (and tax deductible), thus driving tightening spreads (Figure 29). However, such an interest rate is still above the weighted average RoE of 5.7 % as of June 2014.

Figure 28: Total issuance of Contingent Convertibles by EU banks (billion EUR)

Source: SNL Financial, Bloomberg, EBA calculations.

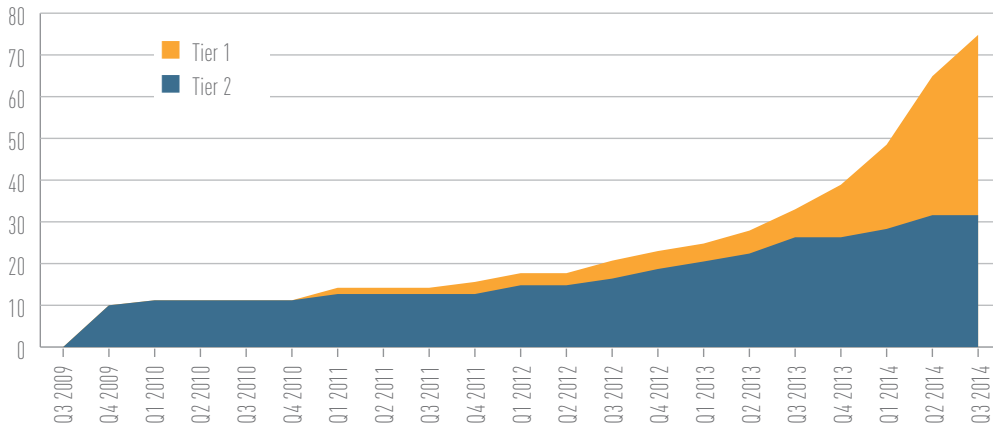


Figure 29: Cost of equity

Source: EBA RAQ for banks.

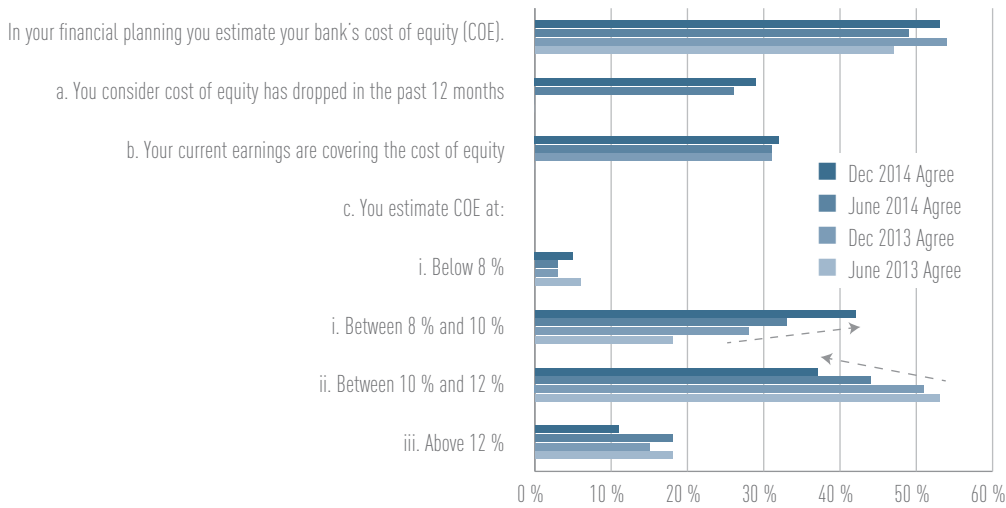
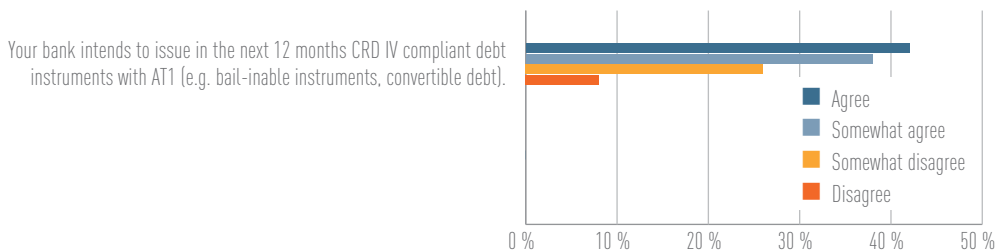


Figure 30: Planned issuance of AT1 instruments

Source: EBA RAQ for banks.



The demand for hybrid instruments was relatively high in the first half of 2014 despite regulatory uncertainty and the lack of a clear-cut standardised product. For example, among many characteristics to take into account, CoCos can be perpetual or callable (for instruments considered in AT1 their call-ability is subject to the approval of the competent authority), converted or written-down, and with possible coupon suspension. Coupon payments for AT1 instruments are constrained by the maximum distributable amount (MDA) which includes dividends and AT1 coupons.

Furthermore, based on the regulations of the BRRD, resolution authorities will have the mandate to trigger AT1 and CoCo instruments in case a bank reaches its point of non-viability (PONV). As this trigger might be higher than the trigger according to the contract of the respective instruments, there is an additional risk for investors.

This aspect, like the call-ability and other characteristics of the individual instruments, contributes to challenges when it is about the instruments' valuation, for example. For investment decisions and valuations, different factors should be considered, such as the risk of conversion and coupon deferability, demonstrating that CoCos remain a complex asset class for supervisors, banks, and in-

vestors. They should remain and even shift further into the focus of supervision as banks plan to issue more instruments as could be seen in the results of the RAQ (Figure 30).

Risks arising from the possible need and issuance dependence of AT1 instruments

On the supply side of the market for tier 1-instruments, banks started holding back their issuances at the beginning of the second half of 2014 after a positive trend in the first six months of 2014. Depending on a more optimistic view for subordinated debt instruments, this may create a certain risk as banks might not be able to cover their funding needs in AT1 and CoCo instruments. Shortage of funding in these instruments or an increase of these instruments' spreads would have a negative impact on the process of the banks' adoption to funding and capital structures required by new regulatory requirements and/or the banks' profitability.

Additional risks on the funding market for the upcoming years might result from the requirements of the total loss absorbing capital (TLAC) for global systemically important banks (GSIBs). These risks result from the potential need of additional funding volumes, for example subordinated debt instruments, and as such a potential increase of funding spreads in search of investors.

The 2014 EU-wide stress test results

The 2014 stress test includes 123 banking groups across the EU and Norway with a total of EUR 28 000 billion of assets covering more than 70 % of total EU banking assets. The EU-wide stress test was co-ordinated by the EBA across the EU and was carried out in cooperation with the European Systemic Risk Board (ESRB), the European Commission, the ECB as well as competent authorities from all relevant national jurisdictions. The EBA developed the common methodology and ensured a consistent and comprehensive disclosure of results. The ESRB and the European Commission provided the underlying macroeconomic scenarios. Competent authorities including the ECB were responsible for the quality assurance of banks' results, as well as for the AQR informing about the starting point of the stress test. They are also responsible for deciding on follow-up actions in the supervisory reaction function.

The impact of the stress test is assessed in terms of the transitional CRR/CRD IV CET1 capital ratio for which a 5.5 % and 8.0 % hurdle rate are defined for the adverse and the baseline scenarios respectively. Whilst the definition of capital varies somewhat depending on national transitional rules, the EBA has ensured all jurisdictions apply the same rules for unrealised gains/losses on sovereign exposures and has provided full disclosure of the consistently defined fully implemented capital ratios under CRR/CRD IV.

The weighted average CET1 capital ratio as of end 2013 is 11.5 %. After a reduction of 40 basis points due to the AQR, primarily in SSM countries, the starting capital ratio for the stress test is 11.1 % CET1 capital. In the adverse scenario, the projected aggregate CET1 ratio falls by approximately 260 basis points. This corresponds to a total capital depletion of EUR 261 billion over the three years of the exercise including the impact of total risk exposure amount

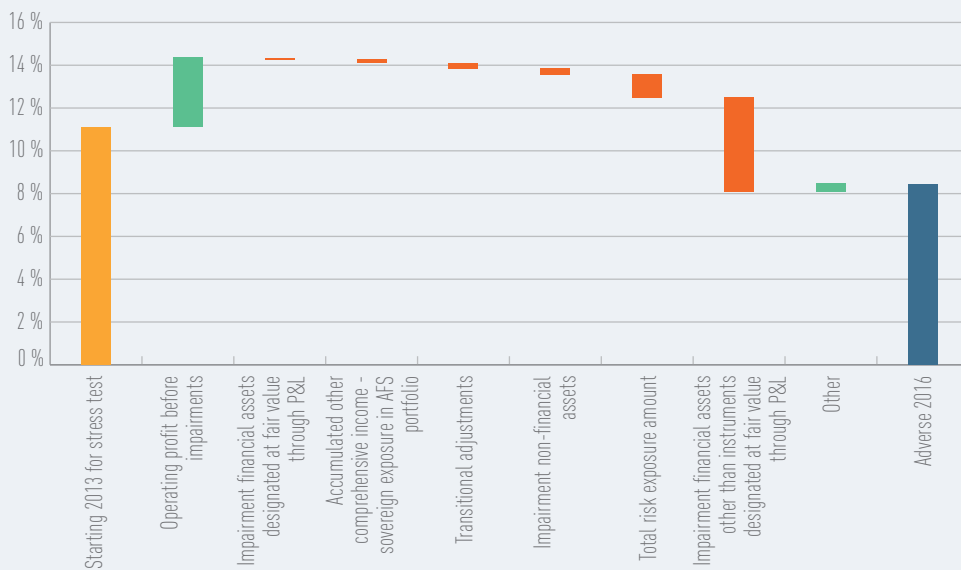
(EUR 67 billion), after which the aggregate EU CET1 ratio is at 8.5 % (7.6 % on a fully implemented CRR/CRD IV basis). The main drivers for this impact are credit losses (- 440 basis points impact on CET1 capital ratio) and an increase in total risk exposure amount (RWAs) with an impact of - 110 basis points on the CET1 capital ratio. This more than offsets the positive net effect on capital due to operating profits before impairments (+ 320 basis points impact on CET1 capital ratio), which are constrained by the methodology and scenario, with net interest income falling 16 %.

Another minor but still positive component of operating profit is net trading income, i.e. after the initial effect of the market risk shock assumed in the stress scenario which in many cases sees trading profits wiped out, some recovery is projected over the remainder of the stress test. The net effect of losses of sovereign exposure held

as available for sale makes only a relatively small contribution to the overall impact (- 20 basis points impact on CET1 capital ratio). Other drivers with less significant impact are impairments on other financial assets, and non-financial assets, for example value reductions of real estate held by banks. Transitional adjustments, i.e. the phasing in of CRR/CRD IV provisions, other than those concerning the treatment of sovereign exposure held as available for sale, have a negative effect on capital (- 30 basis points impact on CET1 capital ratio) that is included in the overall impact.

Twenty-four participating banks fall below the defined thresholds leading to an aggregate maximum capital shortfall of EUR 24.6 billion. The additional capital raised in 2014 by banks with a shortfall reduces the capital needs for those banks to EUR 9.5 billion and the number of banks with a shortfall to 14.

Figure 31: Contribution of different drivers to the change in Common Equity Tier 1 Capital ratio from 2013 to 2016 in the adverse scenario
 Source: EBA Results of 2014 EU-wide stress test.



5. Liabilities side

Market funding data show a steady flow with some volatility of secured and unsecured issuances since the beginning of 2014. Cumulative issuance volumes in 2014 were higher than in 2013 for unsecured funding (senior debt), as well as for covered bonds. Even though volumes of issuances were volatile over 2014 no real shortage of market funding could be seen.

The figures on balance sheet funding instruments confirm, on the one hand, that the banks could slightly increase their general funding basis (increase of overall debt instrument volume in Figure 32 between December 2013 and June 2014). On the other hand, they show that in the first half of 2014 the share of funding through market instruments as well as through deposits from customers remained rather stable: the share of funding through bonds and debt certificates was nearly unchanged with 23.1 % as of June 2014 whereas the share of customer deposits slightly decreased from 64.2 % (December 2013) to 63.5 % in June 2014 (Figure 32).

Financial institutions, especially from financially stressed countries, benefited from the strong investor demand for European banks' debt in combination with the reduction of their issuance volume. Like in the first half of 2014, spreads on average have decreased further for secured, as well as unsecured euro funding since mid-2014. In parallel to the decline of the average spreads, and for instance Eu-

ribor benchmark rates, deposit rates were also decreasing on average during 2014. At the same time, the spreads for lower tier 2 instruments did not show a clear trend.

The total funding volume through the ECB's long-term refinancing operations (LTROs) decreased in 2014. Even though the general trend in respect of the outstanding LTRO volumes has been negative in 2014, the targeted LTRO (TLTRO) in September was used by banks. However, as of mid-November 2014, the ECB's covered bond purchase programme 3 has been used to a low degree only (purchase volume of about EUR 10.5 billion).

The level of dependency from ECB funding (measured by the ratio of provided liquidity to total assets volume) differs from country to country, but is more pronounced for financially stressed countries. Nevertheless, also for these countries, the dependency from ECB funding declined in 2014. Target 2 imbalances also slightly decreased in 2014.

The results from the RAQ show that the share of market analysts who believed that the availability of funding and its conditions will remain benign or continue to improve increased compared to the first half of 2014. This included an expected improvement of the funding conditions also for non-core countries and the expectation that the linkage between banks and their sovereigns will decrease in the near future. Interestingly,

Figure 32: Mix of debt instruments
Source: EBA KRI.

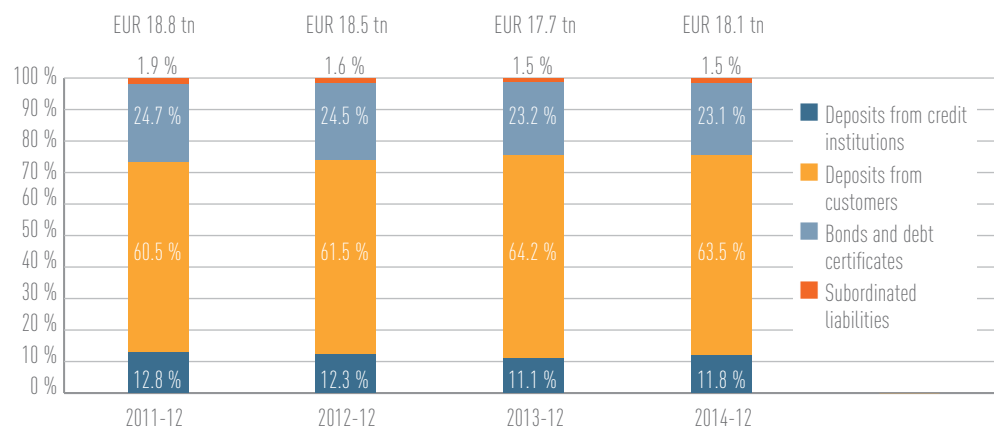
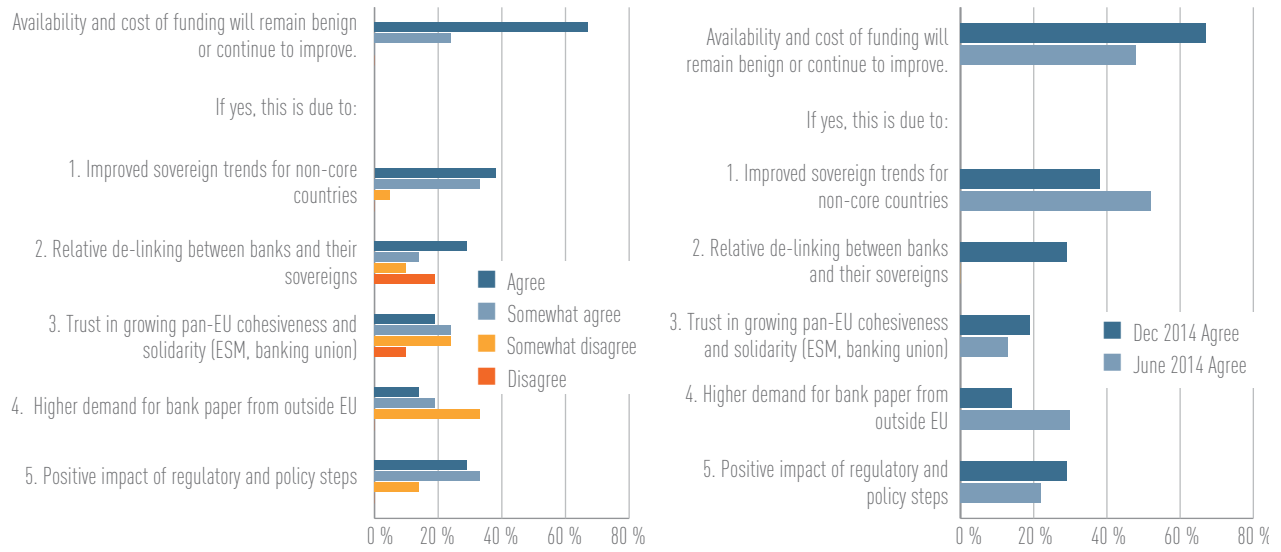


Figure 33: Expectations in respect of funding volume and conditions

Source: EBA RAQ for market analysts.



the expectation of higher demand of bank issuances from outside the EU has lessened compared to the first half of 2014 (Figure 33). In addition, in the RAQ, nearly half of the market analysts indicated that they would expect a shift of the funding sources, mainly to unsecured funding as well as subordinated debt.

As a summary, like in the first half of 2014, decisive policy measures and central banks' engagement in unconventional policies to support macroeconomic stability and bank funding have improved market sentiment, reduced the perceived equity risk premium and helped ease funding pressures. However, the conditions for the issuance of AT1 instruments deteriorated until the end of October 2014 mainly due to general market trends and, despite improvements also in fundamentals, some banks still face continued structural funding challenges, in particular in countries having experienced some sovereign stress. Regardless of benign funding conditions in general, financial markets remain in an overall fragile state and more volatile. Banks should continue repairing their balance sheets to be able to withstand adverse changes in funding conditions.

5.1 Funding

Since mid-2014, funding markets have showed higher volatility of pricing and issuance volumes compared to the first half of 2014. The volatility results from uncertainty in respect of the AQR and stress test, as well as a slightly deteriorating general market sentiment which is influenced by weakening actual and forecasted economic data.

However, the pricing of both short-term and long-term funding that could be seen in the first half of 2014 has continued to improve on average. Investors have been looking for yield in a low interest rate environment, resulting in ongoing demand, especially for bonds issued by banks domiciled in financially stressed sovereigns. In combination with the reduced funding volumes (influenced or driven by the deleveraging process and reduction of total assets) this contributed to the fact that spreads of some of these banks have reached pre-crisis levels. In late 2013 and also during 2014, smaller banks domiciled in financially stressed countries returned to the unsecured funding markets.

Conditions for secured and unsecured funding have improved but uncertainty has created high volatility of pricing and issuance

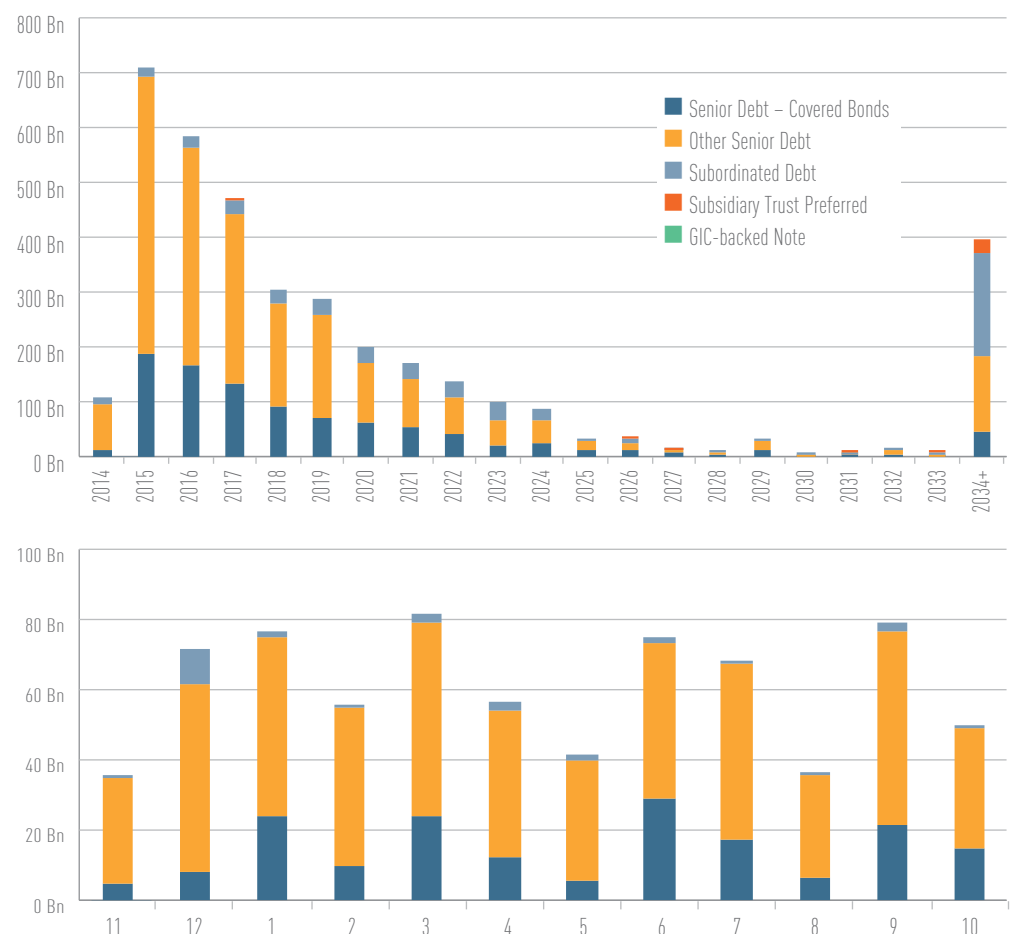
Funding activity in 2014 has been more focused on unsecured funding than on secured funding. Issuance volumes of unsecured funding have been relatively high in early 2014. However, they decreased after the summer break. The lower funding levels since mid-2014 result – besides further deleveraging – from substantial pre-funding levels in the first half of 2014 and increased central bank funding: ECB funding through (T)LTRO and asset purchase programmes were considered more attractive funding instruments by most of the banks.

EUR denominated covered bond issuance is net negative. However, in total, issuance volumes of covered bonds are above the funding levels of previous years, whereas the funding level of European securitised products

(asset-backed securities (ABS) and similar products) is nearly at the same level as previous years. As such, the share of the issued secured funding instruments in overall issuance volumes (secured plus unsecured funding issuances) increased compared to the beginning of 2014.

The debt maturity profile is relatively similar to the data one year ago, i.e. in 2015, the maturing unsecured debt makes more than EUR 500 billion, whereas the maturing of outstanding secured funding (covered bonds) is nearly EUR 200 billion. In case there will be no major changes in the general funding market conditions and in the general market assumptions compared to 2014, the data show that the resulting refinancing volume of secured and unsecured funding in 2015 could, in general, be fundable again for the banks (Figure 34). The answers from the market analysts to the RAQ could be also taken into account by saying that they expect unchanged or even improved funding conditions in the future.

Figure 34: Bonds – Aggregated debt maturity profile – 20-year breakout and next 12-month breakout (billion EUR; data as of October)
 Source: SNL Financial data, EBA calculations.

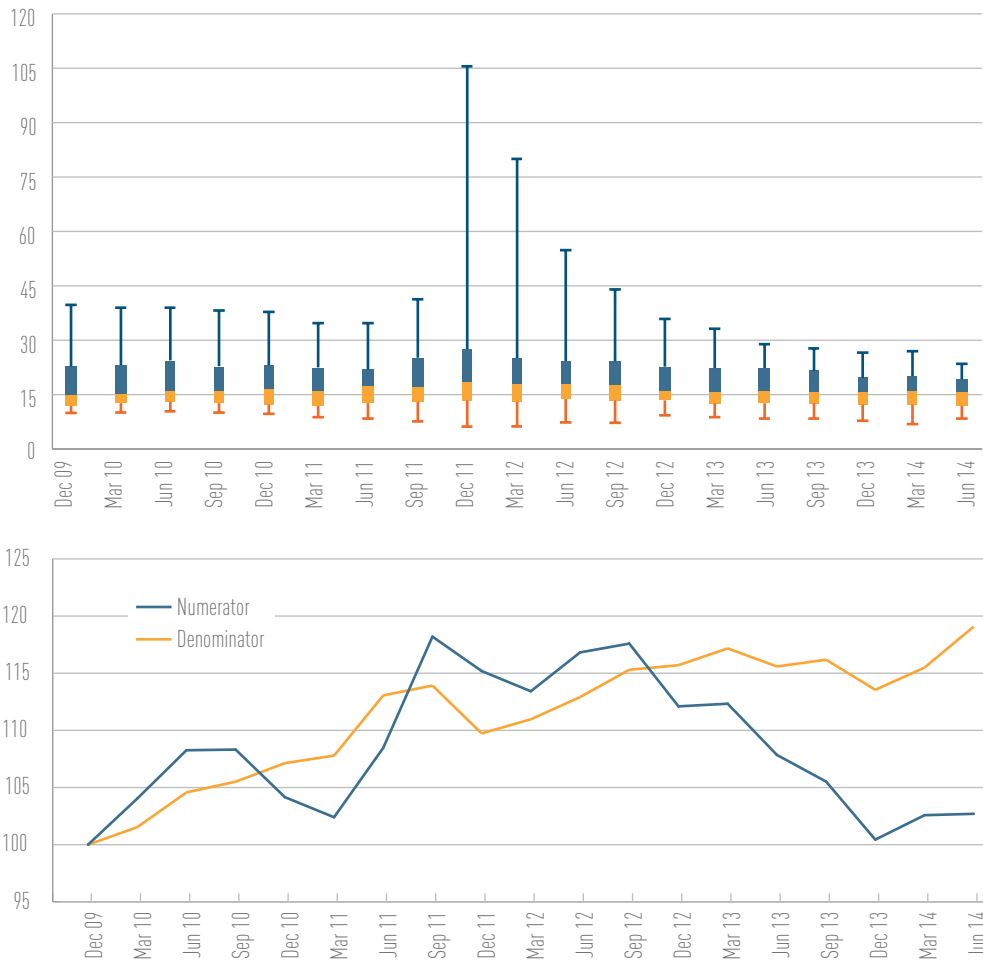


Deleveraging can also be seen on the liability side

During the first six months of 2014 the weighted average of debt-to-equity ratio slightly decreased from 16.5 % to 16.1 %, i.e. the decline that started in mid-2012 (19.4 % in June 2012) has further continued. This decline since mid-2012 resulted from reduced debt volumes, on the one hand (numerator),

and increasing volumes of total equity (denominator). In respect of the debt-to-equity ratio the differences within the considered peer group remained stable on a relatively small level since mid-2013, after having significantly contracted between March 2012 and June 2013. In the second quarter of 2014, the differences within the peer group, i.e. the dispersion, even contracted further (Figure 35).

Figure 35: Debt-to-equity ratio – 5th and 95th percentiles, interquartile range and median, and by size class – medians (as of June 2014); banks by size class according to their average total assets
 Source: EBA KRI.

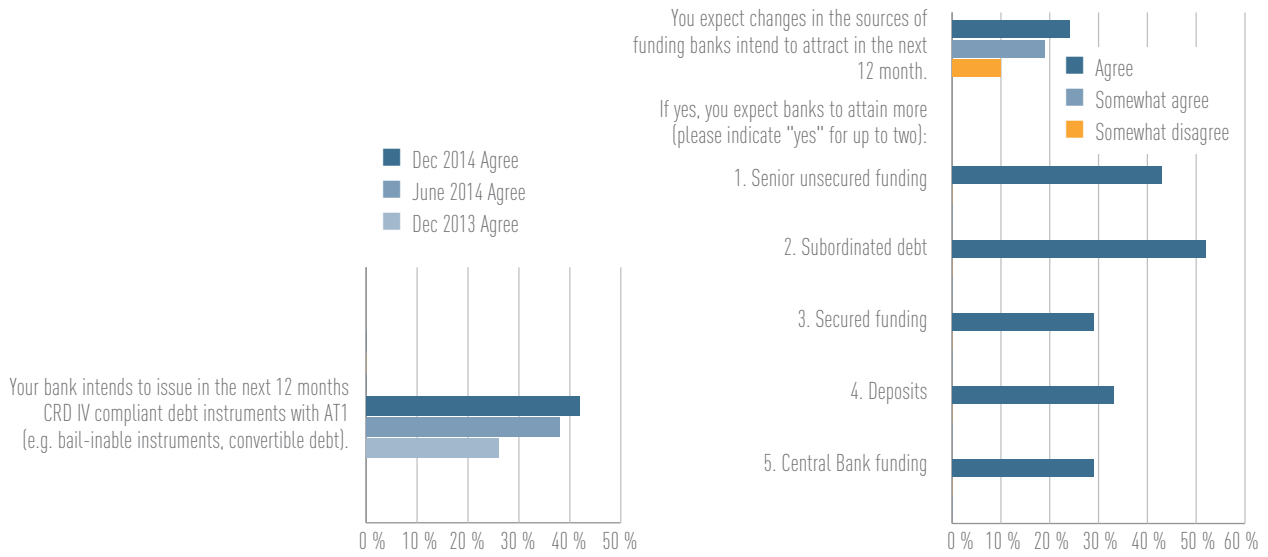


Banks have started to adapt their funding and capital structures to the new regulatory requirements

Issuances of AT1 instruments significantly picked up in the beginning of 2014 and volumes were already reaching the levels of 2013. Even though this trend did not continue between July and October 2014, nearly half of the banks still plan to issue convertible debt and bail-inable instruments, according to the

results of the RAQ for banks. The respective share of banks that plan such issuances has again risen compared to the last questionnaires. More than 50 % of the market analysts also expect a further growth of subordinated debt issuances. These plans and expectations are mainly driven by regulatory requirements. As such, in the funding markets there lies a certain risk in the need for further issuances in this segment (Figure 36).

Figure 36: Issuance of convertible debt and bail-inable instruments during 2014
 Source: EBA RAQ for banks (left) and RAQ for market analysts (right).



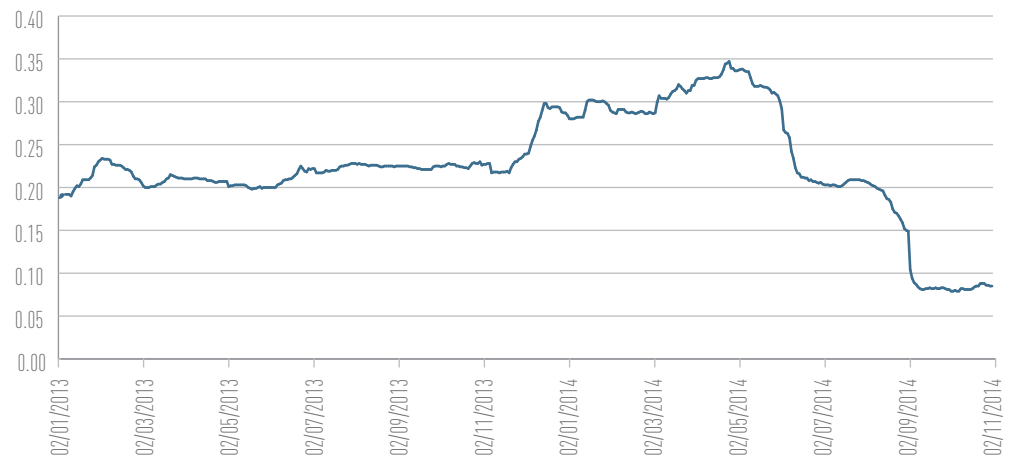
Spreads narrowed for secured and unsecured funding

Even though funding costs have evolved differently for the different main instruments over 2014, several general trends could be identified. Spreads for euro-based funding decreased, and spreads for banks within the EU narrowed for secured as well as unsecured issuances. One of the reasons for the spreads' reduction and narrowing was the decline of overall funding volumes needed

from the banks on the supply side (negative net funding volumes) in combination with the search of investors for ongoing investment opportunities on the demand side. This trend supports the positive expectation for the further development of this market segment.

In addition to the decrease of the spreads for secured and unsecured funding, the basis rates showed also a decline, for instance for the three months' rate of the Euribor (Figure 37).

Figure 37: Euribor 3 months rates
 Source: Bloomberg.



Sovereign–bank link decreasing and signs of reduced fragmentation

Indications of a further weakening correlation between sovereign and bank CDS spreads, a further stabilisation of deposit flows in financially stressed countries (though still, on average, a negative growth), as well as a continued decrease of Target 2 imbalances are the first signs of weakening links between banks and sovereigns (Figure 38).

Cross-border lending of European banks became more stable after a falling trend in the previous years. However, it remains subdued indicating the continuation of market fragmentation. Despite converging costs of funding, smaller banks domiciled in finan-

cially stressed countries in particular continue to face higher funding costs than their peers in other EU countries. Market analysts also confirmed in the RAQ the existence of a sovereign–bank linkage by confirming a relatively strong correlation in market sentiment on banks and their respective home countries’ sovereign debt, nevertheless expecting a general relative further de-linking (Figure 39).

The re-emergence of an active cross-border interbank market would be a strong sign of regained confidence in the EU banking system. Despite some encouraging signs of stabilisation, cross-border interbank activities remain at low levels, signalling still a fragmentation of single market funding conditions.

Figure 38: Average correlation of CDSs for 17 major EU banks and respective sovereigns – 60 day rolling window

Source: EBA calculations, Bloomberg data.



Figure 39: Evidence of fragmentation of the EU single market: Consolidated total foreign claims (ultimate risk basis) of reporting European banks vis-à-vis selected countries, Q4 2010 = 100

Source: Bank for International Settlements (BIS), EBA calculations.

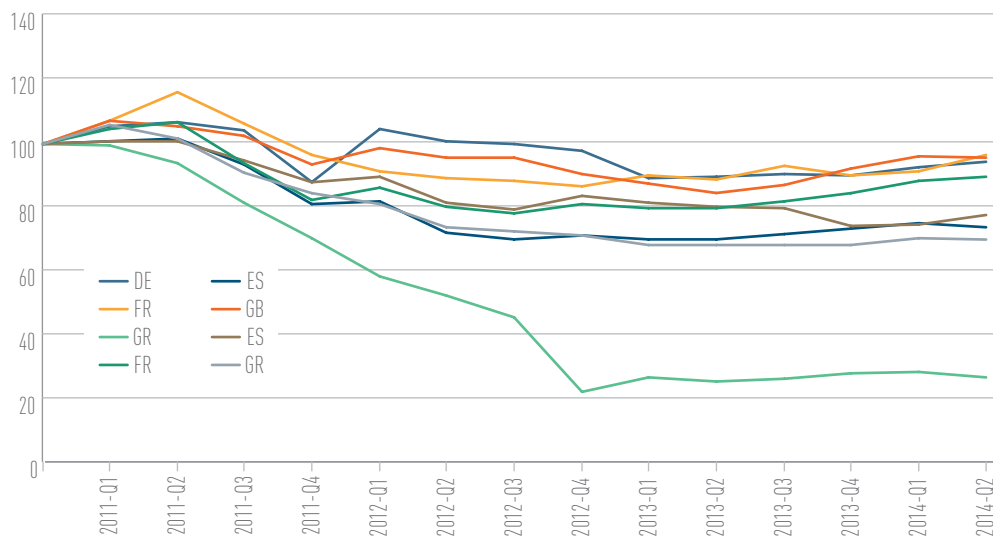


Figure 40: Cross-border borrowing and lending
 Source: EBA RAQ for banks.

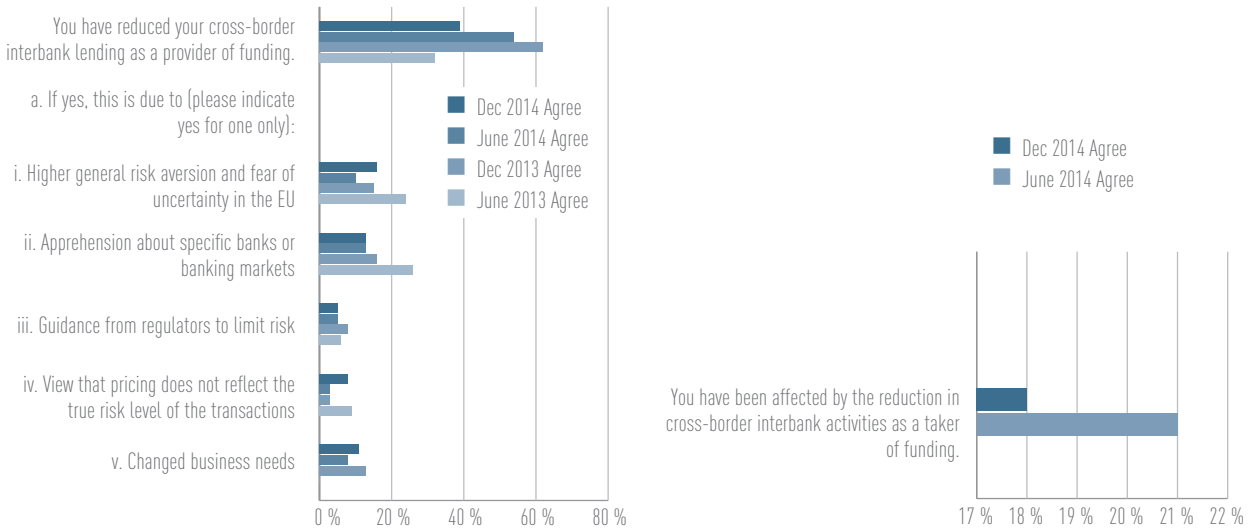
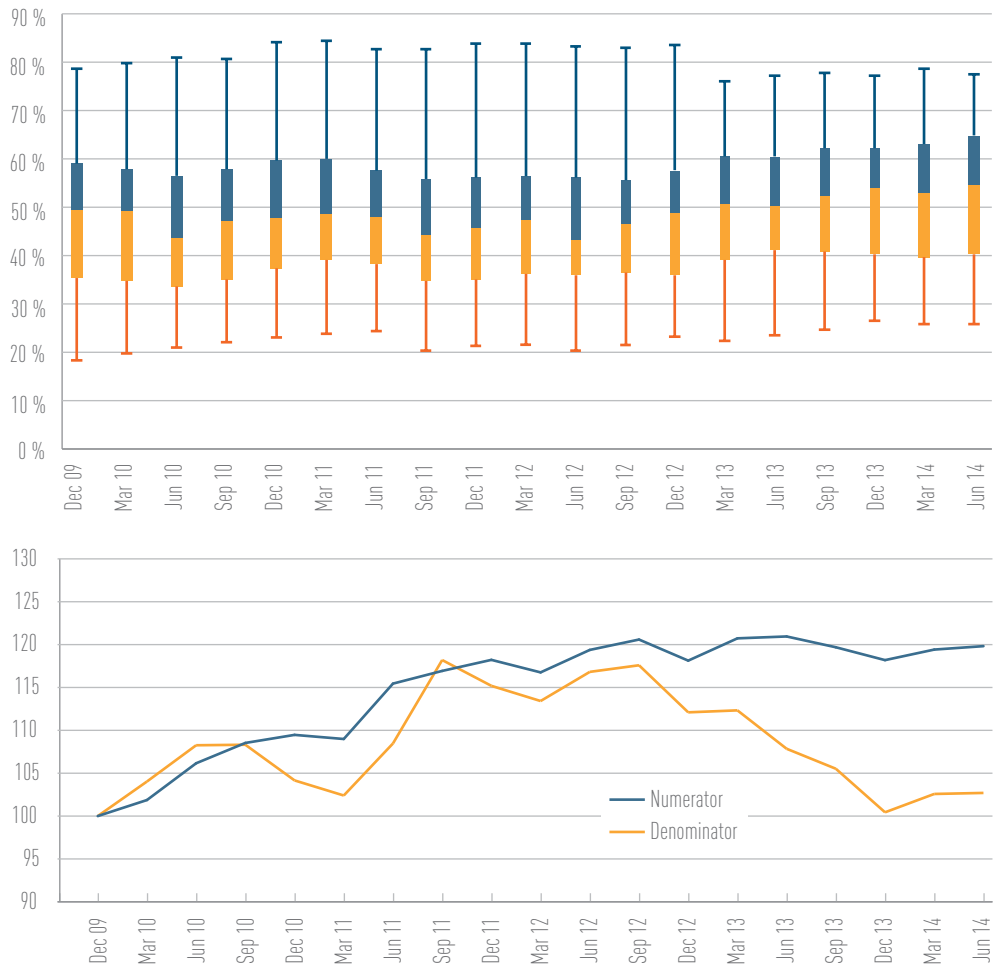


Figure 41: Customer deposits to total liabilities — 5th and 95th percentiles, interquartile range and median, numerator and denominator trends (December 2009 = 100)
 Source: EBA KRI.



In comparison with previous periods fewer respondents report that they are reducing their cross-border interbank lending. At the same time, the number of respondents affected by reduced cross-border activity as takers of funding has fallen significantly. This might result from the fact that banks have accommodated less cross-border interbank funding.

The main reasons for the reduced cross-border interbank activity continue to be higher general risk aversion and fear of uncertainty in the EU, and the apprehension about specific bank or banking markets. In some jurisdictions, supervisory measures have also impacted on cross-border lending. Despite continuing to be a less important factor, the view that pricing does not reflect the true risk level of the transactions has now increased and is at the same level as June 2013 (Figure 40). It shows a risk if pricing and risk perception might no longer coincide.

5.2 Deposits

The pressure on European banks to restructure their balance sheets, de-risk their positions, and align their business models hardly decreased in 2014. Finding the right balance between adjustments of the funding structures to the current market conditions, on the one hand, and the banks' funding needs, on the other hand, are forcing banks to pay greater attention to long-term funding sources.

In general, the dependency from funding through deposits remained relatively stable during the first half of 2014 compared to 2013. This implies an unchanged risk from maturity mismatch in the funding structure, as deposits are rather short term compared to, for example, long-term secured and unsecured funding through bond issues. The share of customer deposits in the overall funding volume slightly decreased during the year, whereas the share of deposits from financial institutions slightly increased (Figure 32 and 41).

Figure 42: Customer deposits to total liabilities – country dispersion and by size class (medians)
Source: EBA KRI.

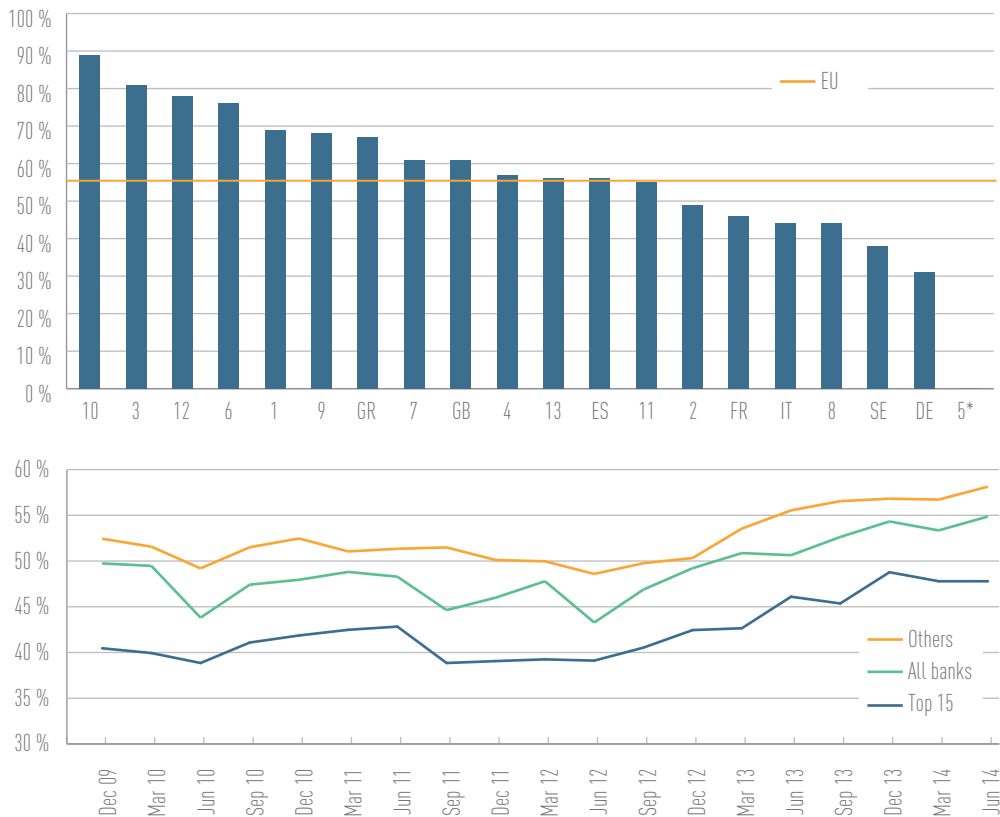
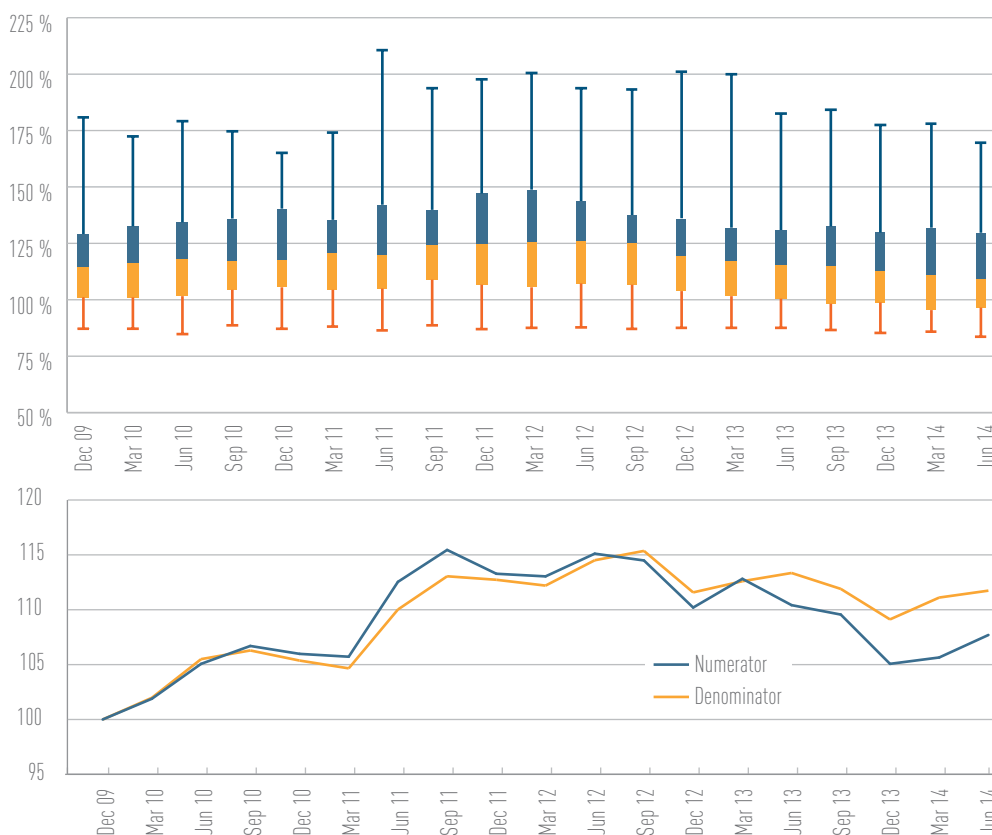


Figure 43: Loan-to-deposit — 5th and 95th percentiles, interquartile range and median, and by size class —; banks by size class according to their average total assets
 Source: EBA KRI.



Shares of deposit funding have stabilised after an increase in previous quarters

In absolute terms, the banks’ deposit volumes did not materially change in the first half of 2014. However, there is a different evolution if considering regions, for example.

In financially stressed countries, a decline in deposits could still be recognised. This decline was mainly driven by a reduction of deposits from financial institutions. Interestingly, some financially stressed countries showed an increase of customer deposit volumes.

Even though the general development of average stable deposit volumes is allowing EU banks to attain lower loan-to-deposit ratios and leading to greater balance sheet stability, it also results in an unchanged liquidity risk: a bigger share of deposit funding might increase the risk that parts of the funding can be withdrawn in a rather short term whereas many of the assets are fixed for longer terms.

A country-by-country level comparison still shows a different general reliance on deposit funding between geographies. The higher the dependency on deposits, the higher the

implicit liquidity risk might be, especially in countries that are not yet financially fully stable. There are also concerns about the behaviour of large depositors that are not covered by deposit guarantee schemes, especially when new resolution and bail-in requirements come into force, and they might withdraw parts of their deposits due to the upcoming new regulations (Figure 42).

The loan-to-deposit ratio is relatively stable

The loan-to-deposit ratio remained nearly unchanged in the first half of 2014 at 112.9 % (weighted average in the second quarter 2014), which is a result of parallel trends in loan and deposit volumes in this period. As such, the ratio has not continued its former downward trend that could be seen since March 2012 which supports the idea of a generally stabilised funding ratio through deposits. However, the dispersion of the loan-to-deposit ratio has remained relatively broad, as it was for the country dispersion that showed a range between about 60 % and about 160 %, supporting the idea of big differences in funding through deposits for different countries (Figure 43).

Decreasing interest rates for all term structures

Euribor, as a benchmark for interbank interest rates, declined for all terms in 2014. In the second half of the year, short-term Euribor rates (one-week and two-week terms) even became negative (information as of October 2014). In parallel, rates for customer deposits were decreasing on average during the year for all term structures. This trend seems to continue as, based on the results of the RAQ, most of the banks do not plan to increase their deposit rates or the terms.

This is a significant change compared to the years before and will consequently reduce competition, at least temporarily. Should deposit volumes and/or other funding channels, like secured or unsecured issuances, result in significant liquidity outflows, pricing of deposits might abruptly go up again and impact the already small interest margins (Figure 44).

5.3 Asset encumbrance and collateral

In the last few years, the reliance on secured funding has increased the amount of encumbered collateral. When the market funding conditions was most challenging, banks needed to rely on secured funding from markets and central banks resulting in significant amounts of encumbered assets in their balance sheets.

Further secured and central bank funding will keep the pressure on collateral use

Especially the trend of decreased funding from central banks in the first six months contributed to a decrease of encumbered assets. The increased use of central bank funding through, for example, TLTROs and the ECB's asset purchase programmes resulted in an inversion of this trend in the second

Figure 44: Deposits
Source: EBA RAQ for banks.

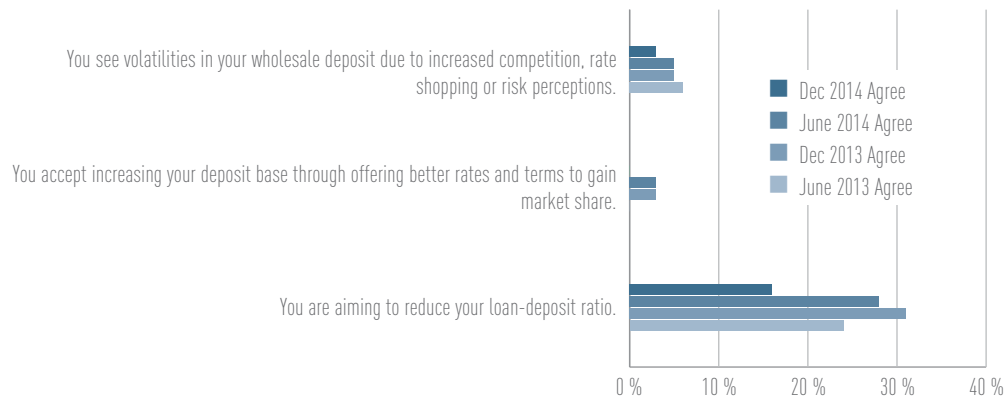


Figure 45: Central bank funding
Source: EBA RAQ for banks (left) and RAQ for market analysts (right).

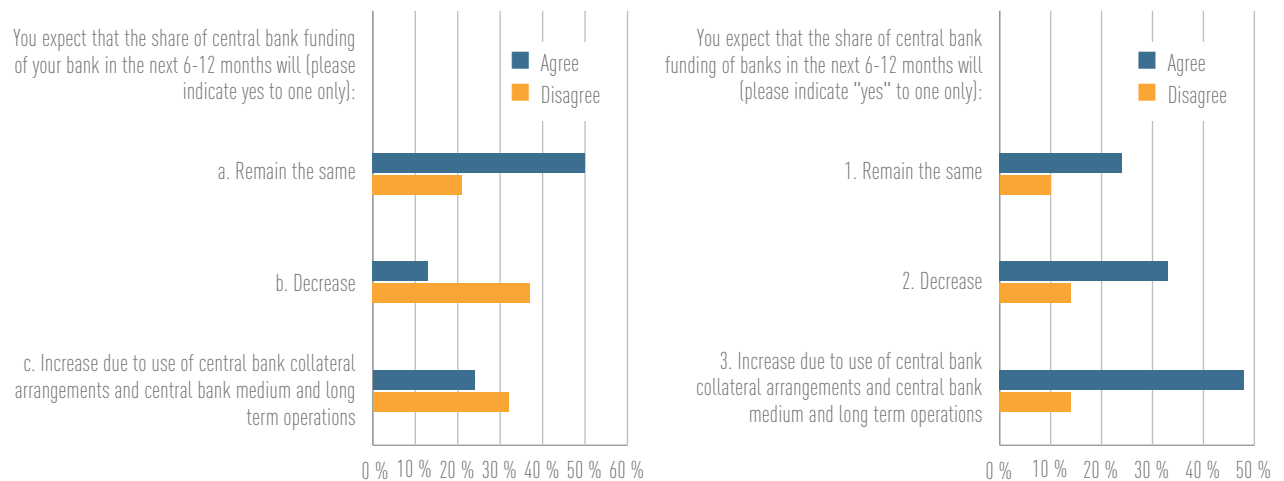


Figure 46: Secured funding
 Source: EBA RAQ for banks.

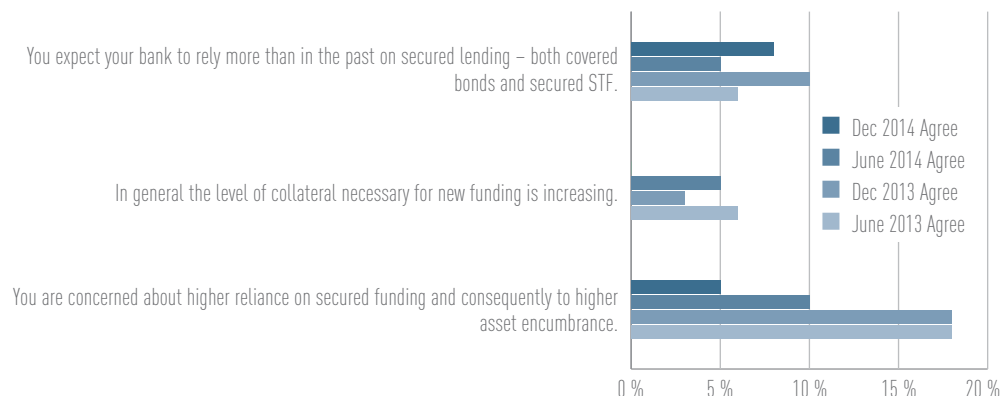
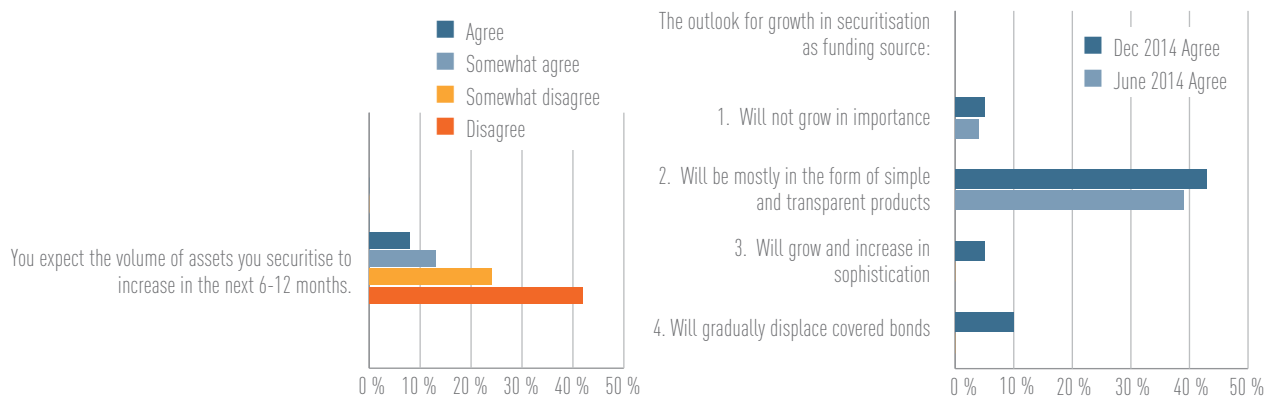


Figure 47: Securitisations
 Source: EBA RAQ for banks (left) and RAQ for market analysts (right).



half of the year again (information as of October 2014). In future, new liquidity and capital regulations will put additional emphasis on collateralisation. However, high levels of asset encumbrance can be harmful and self-reinforcing.

Looking ahead, several banks remain dependent on central bank support, and future withdrawals of public funding sources continue to be a challenge for some of them. In the RAQ for banks, the majority expect that the share of central bank funding in the next 6 to 12 months will remain the same. In fact, more than 20 % of the banks expect that the share of central bank funding will increase due to use of central bank collateral arrangements and central bank medium- and long-term operations. From another perspective, almost 40 % of the respondents disagree that the share of central bank funding in the next

6 to 12 months will decrease. In the RAQ for market analysts, nearly half of the respondents expect that the share of central bank funding in the next 6 to 12 months will increase (Figure 45).

Moreover, the number of banks expecting to rely more than in the past on secured funding has increased again. On the other hand, a reduced number of respondents said that the level of collateral necessary for new funding is increasing, and there is also a significant reduction in the number of banks that are concerned about higher asset encumbrance (Figure 46).

Regarding securitisations, the RAQ for banks shows that only a minority of the banks agree or somewhat agree that the volume of assets they will securitise in the next 6 to 12 months will increase. More than 40 % disagree that

the volume of assets used for securitisations will increase. The answers to the RAQ for market analysts show that the securitisations are expected to be simple and transparent, i.e. the former trend of complex securitisations is not expected to return, and a minority of the respondents are now referring for the first time, in comparison with June 2014, to the idea that the growth in securitisations as a funding source will gradually displace covered bonds (Figure 47).

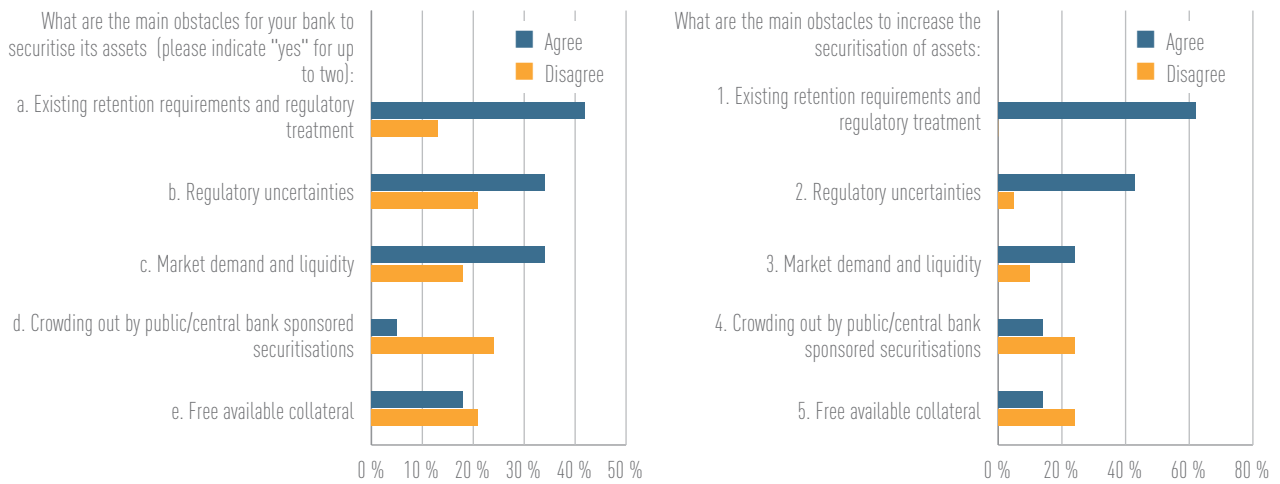
The RAQ for banks and the RAQ for market analysts refer to the same main obstacles to increase the securitisation of assets, name-

ly: the existing retention requirements and regulatory treatment; regulatory uncertainty. In addition, the RAQ for banks refers also to market demand and liquidity as another main obstacle to increase the securitisation of assets (Figure 48).

These results of the RAQs, as well as the latest trends in the last months of 2014 are slightly increasing concerns regarding the levels of encumbered assets (i.e. assets earmarked as collateral for specific secured funding). The level of pledged assets should be followed carefully during the upcoming months.

Figure 48: Securitisations

Source: EBA RAQ for banks (left) and RAQ for market analysts (right).



6. Profitability

During 2014, EU banks' income and profitability levels have continued to face significant headwinds. These challenges are not likely to disappear in the near term and some question marks over some institutions' future profitability and viability – both driven by structural as well as cyclical factors – are evident. In the first half of 2014, the total profits (after tax and discontinued operations) declined EUR 13 billion (– 24 % compared to June 2013). The total operating income declined EUR 19 billion (– 7 % compared to June 2013). The main drivers were asset quality concerns and the balance sheet clean-up of EU banks as pre-emptive measures in preparation for the EU wide AQR and 2014 EU-wide stress test exercise, as well as litigation costs.

The continued balance sheet repair and provisioning for NPLs, as well as increasing costs associated with past business misconduct in combination with a low interest rate environment and a disappointing economic growth may further affect banks' income and profitability.

Banks will need to adjust expectations and manage risks strictly in accordance with their risk appetite, which also means managing expectations about returns. A process of consolidation and resizing has already been ongoing since 2008 and fundamental structural issues will make it impossible to maintain business as usual, thus a smooth exit of the weakest and non-profitable banks would contribute to competitive efficiency as part of this cleansing process and might have to

continue further with a view to eliminating excess capacity in the industry and restore adequate profitability.

Consequently, supervisors will need to assess banks' profit and funding models, risk pricing, business mixes, management strengths and strategies, and engage with banks' management on appropriate action where sustainability is in question.

Challenges continue as the profitability and viability of some banks remain subdued

Despite a small increase of the net interest income (+ 2 % in comparison with June 2013), EU banks have seen their net interest margins compressed while the fragile economic environment continues to provide limited new lending opportunities. In some cases, earnings may not be sufficient to cover high levels of bad loans adding some uncertainty and leaving some question marks over some institutions' future profitability and viability. In addition, the low interest rate environment continues to put pressure on the business model sustainability of some banks which find overall net interest margins squeezed, contributing to profitability challenges.

Moreover, banks with an RoE of less than 8 % continue to increase and represented 76.3 % of total assets in the sample in June 2014 (up from approximately 69 % and 75 % in June 2013 and December 2013, respectively). More specifically, banks with an RoE of less than 3 % represented 14 % of total assets in June 2014 and more than 50 % of total assets

Figure 49: RoE by bucket and percentage of banks' total assets
Source: EBA KRI data and EBA calculations.

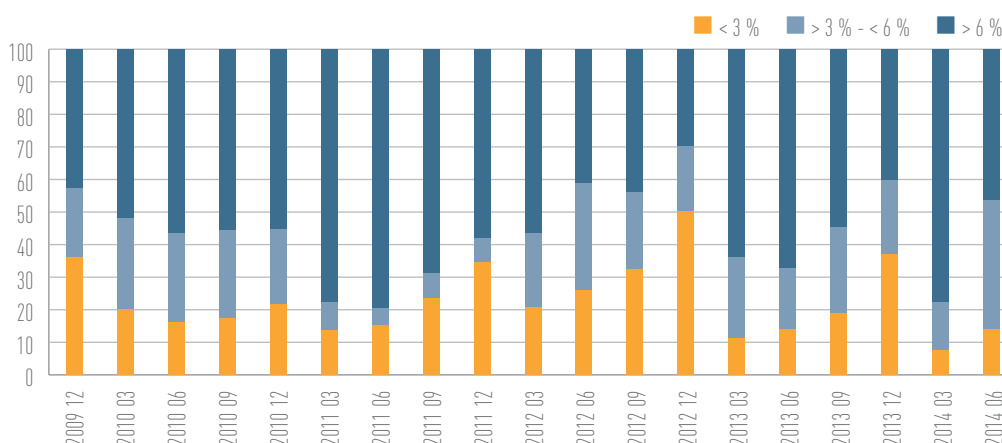
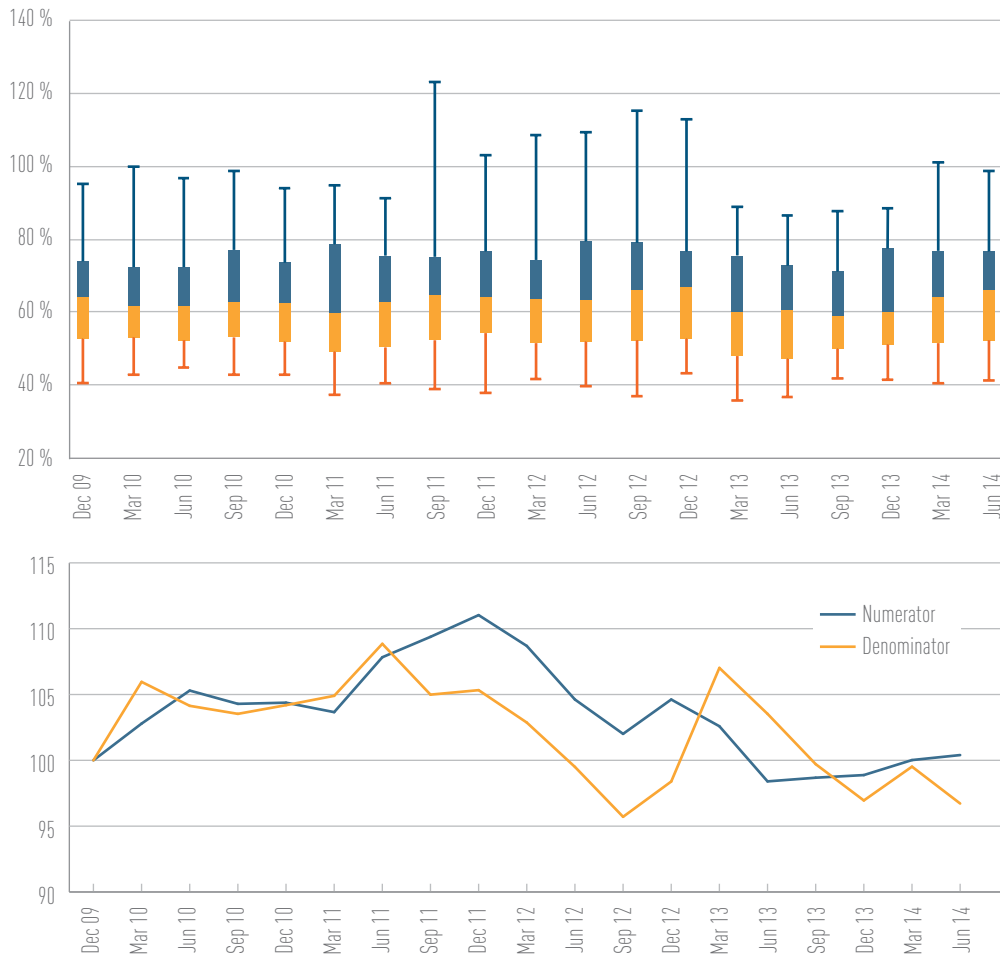


Figure 50: Net interest income to total operating income – 5th and 95th percentiles, interquartile range and median, numerator and denominator trends (December 2009 = 100)

Source: EBA KRI.



present an RoE of less than 6 %, a perturbing situation that is recurrent in the last few years (Figure 49).

Net interest margins continue to be under pressure. However, it is possible to observe a stabilisation since June 2013, after a downward trajectory initiated in December 2011, and they are approximately at the levels of 2009 (- 7 % and - 4 % in comparison with December 2011 and December 2012, respectively). There are also less outliers and the dispersion is decreasing which could indicate that the industry earnings are becoming more stable and more predictable (Figure 50). Fees and commission income in proportion to total operating income stayed, on average, the same. A general decrease has been recorded in some EU countries, while an increase of fees in the income is present in other EU countries. Contributions from trading and other income to the total operating income have neither changed on average.

Total operating income has maintained the downward trajectory since March 2013 and presents one of the lowest levels in the last 4.5 years (- 11 % and - 3 % in comparison with June 2011 and June 2012, respectively).

The first half of 2014 points to improved capital positions owing to run-offs of non-core assets and cost-containing efforts flowing through. Nevertheless, it is necessary to continue to maintain a cautious outlook on revenues in light of the weak macroeconomic environment and expected generally weak business generation towards the first months of 2015. The banks' possible attempts to increase lending rates in order to achieve a full repricing of assets may prove not plausible, and is possibly insufficient, to address the current low interest rate environment. The economic downturn is affecting customer capacity to bear higher lending rates and potential full repricing of assets, limiting banks' possible actions. At the same time, there is

at least for several banks a persistent risk on litigation costs especially connected to trading misconduct and mis-selling and according to market predictions more litigation costs are expected.

The return on equity (RoE) continues to decrease

The RoE decreased once more in the first half of 2014 in comparison with the same period in 2013. The weighted average RoE has decreased (down from 7.6 % in June 2013 to only 5.7 % in June 2014). The median and the 75th percentile have also decreased since June 2013 (from 6.4 % and 10.4 % to 5.5 % and 9.5 %, respectively, in June 2014). The total profit or loss after tax and discontinued operations (annualised) continues to show strong volatility and presents lower levels than in the previous year (- 24 % in comparison with June 2013). In addition, the disper-

sion continues to decrease and banks from eight countries continue to present median values of RoE less than 5 % (and 11 countries below the EU median of 5.5 %), and without significant differences per banks' size class (Figure 51).

In comparison with the median and the 75th percentile (5.5 % and 9.5 % respectively in June 2014), an increasing majority of RAQ for banks continue to consider a RoE value in the range of 10 % to 12 % as the target for the long-term viability of their businesses. In the last few years, the median presents a RoE of around 5.5 %, a declining trend and significantly lower than the target for the long-term viability mentioned by RAQ respondents. In addition, the number of respondents that agree to consider a RoE value below 10 % stabilised and in the range of 12-14 % has significantly been reduced, maintaining a downward trend since June 2013. This con-

Figure 51: Return on equity – 5th and 95th percentiles, interquartile range and median, numerator and denominator trends (December 2009 = 100)
Source: EBA KRI.



Figure 52: Return on equity – 50th and 75th percentiles and comparison with RAQ for banks
 Source: EBA RAQ for banks and EBA KRI.

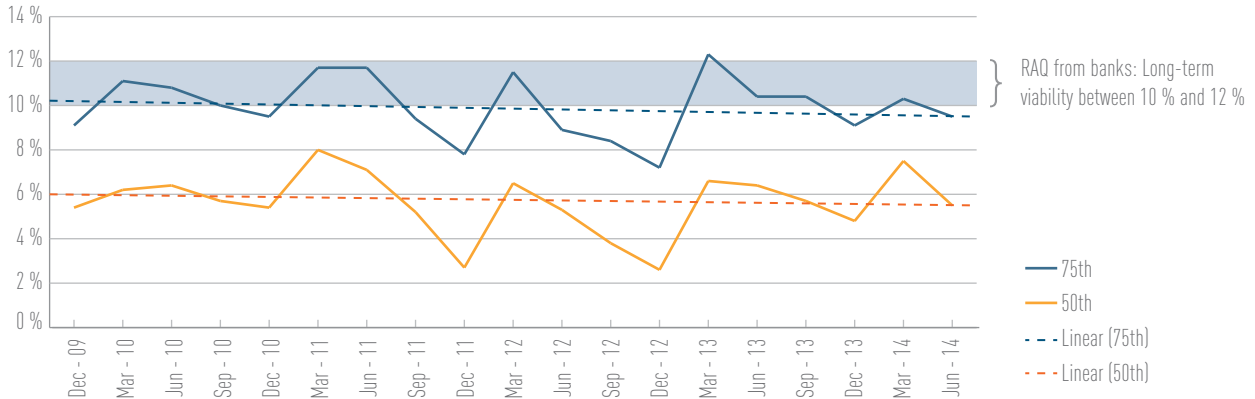
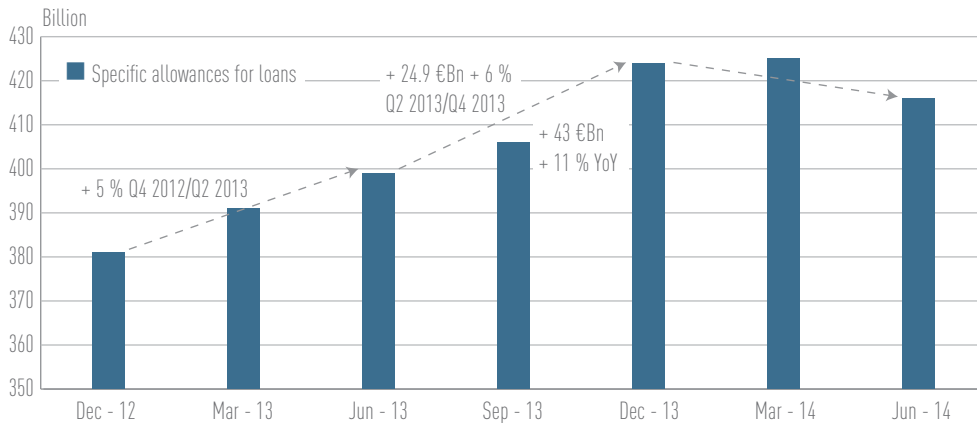


Figure 53: Evolution of specific allowances for loans (billion EUR)
 Source: EBA KRI data and EBA calculations.

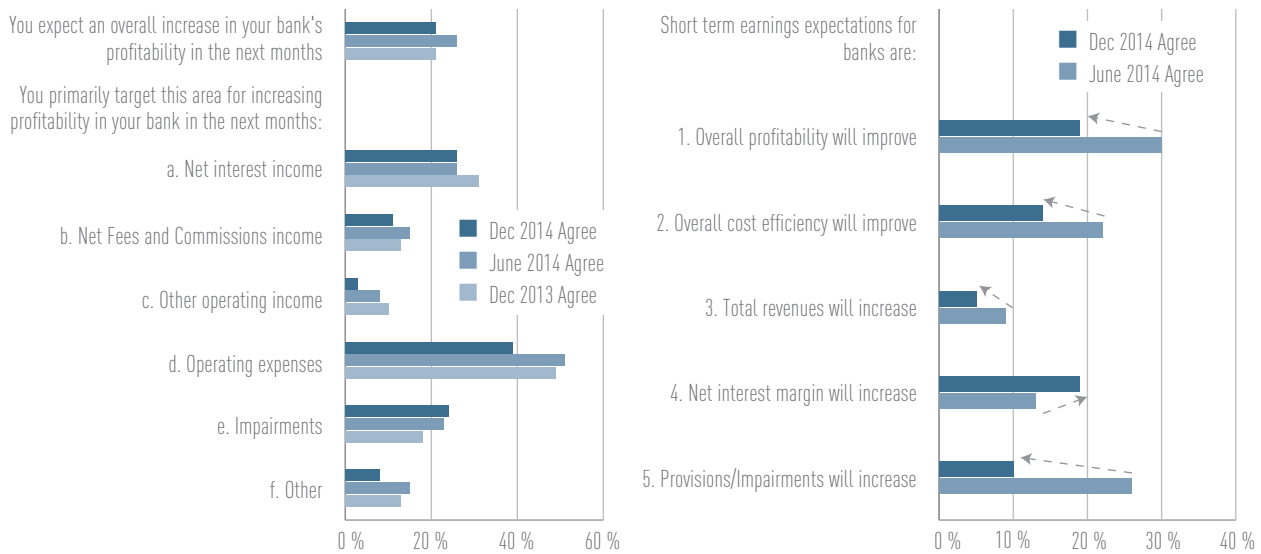


continues to provide strong evidence of a significant reduction in terms of RoE expectations, nevertheless far from median levels of RoE in the last 4.5 years (Figure 52).

For RAQ respondents from banks, the main factors that will influence the RoE in coming months continue to be operating expenses, net interest income and the level of impairments (another increase in comparison with the previous semesters). The percentage of respondents that agree with the expectation of an overall increase in their respective bank's profitability in the next months has been reduced. The increased cleaning of balance sheets, ahead of the AQR and EU wide stress test exercise, shows significant front-loading impairments during 2013 with additional provisioning of EUR 25 billion between June 2013 and December 2013 and the maintenance of such levels during the first half of 2014 (Figure 53).

The percentage of market analysts (RAQ for market analysts) that strongly believe in an improvement of banks' profitability in the short term decreased from 30 % to 20 % (compared to June 2014). Furthermore, the percentage of market analysts that agree that both overall cost efficiency will improve and total revenues will increase have also significantly diminished. Interestingly, the percentage of market analysts that agree that net interest margins will increase, regarding the short-term earnings expectations is higher than in December 2013. Regarding provisions from impairments, the percentage of market analysts that expect an increase in the short term has significantly diminished. This indicates an increase in optimism about future prospects that started in the previous six months. The reference to net interest income as an area to achieve higher levels of profitability points to a realignment of revenue streams since net interest income is under

Figure 54: Evolution of profitability in the next months and main drivers
 Source: EBA RAQ for banks (left) and RAQ for market analysts (right).



pressure in the currently low interest rate environment due to the tightening margin between deposits and loans (Figure 54) ⁽⁸⁾.

Selectivity needed in cost cutting

In addition, for the RAQ for banks, the vast majority of respondents agree that they are reducing costs through reductions in overheads and staff costs. The cutting of non-profitable units is also another factor mentioned, whereas the outsourcing of some of the administrative and development departments are the least expected area for reducing costs (with higher levels of disagreement from the respondents).

From a supervisory perspective, in the cost-cutting plans mentioned, banks will need to take into account possible problems created by previous cutbacks due to the growing need for some specific and definable skills in certain areas such as cyber-security, anti-money laundering, internal audit, and risk management areas (see also Chapter 7. Consumer issues, reputational concerns and IT-related operational risks). Many banks are now involved in outright reductions in operating cost levels, but also improvements in cost-efficiency metrics such as the cost-to-income ratio as initiatives aiming at reducing their cost base.

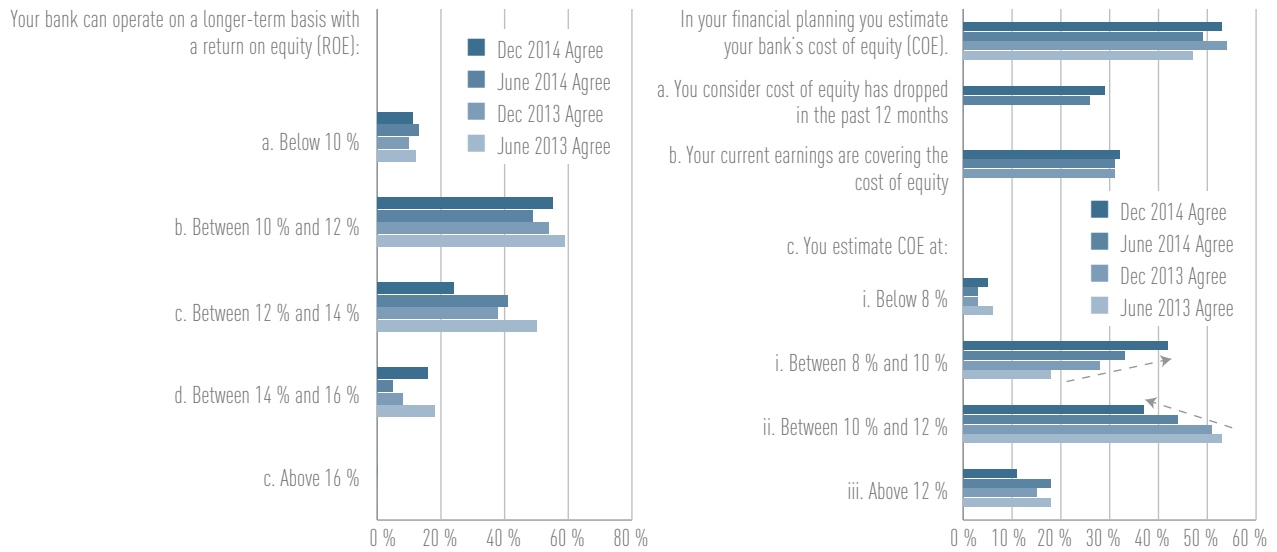
There are prudential risks — primarily operational and strategic risks — which require supervisors’ attention. The simplest changes, and not necessarily the least risky, with a limited impact on existing business practices, are driven by front-loaded cuts, for example in real estate units or staff expenses.

More fundamental actions change the operating model and processes of banks, which should ultimately drive a lower staff requirement in the medium to longer term. This may affect the organisational structure, resources and processes, and create less tangible risks. For example, an ill-executed cost-reduction programme may lead to legal penalties, the size of which may be easy to measure. On the other hand, the outcome of cost-reduction programmes will be more uncertain when the risks do not only stretch to the current income statement but also to the future income-generating capacity in the form of strategic risk.

Therefore, while acknowledging that well-implemented change initiatives can have positive medium-term and long-term implications for a bank’s value and capital generation, it is also important to take into account that cost-reducing measures can be highly complex, can require material changes to a bank’s business model and may pose significant risks.

⁽⁸⁾ When interest rates fall, deposit rates have to remain non-negative, while loan rates are compressed. A floor on deposit rates imposes a tightening margin to a deposit-funded bank that has floating rate loans.

Figure 55: Return on equity and cost of equity
 Source: EBA RAQ for banks.



The cost of equity (CoE) is decreasing but not enough which may make some business models unviable

In regard to the cost of equity (CoE), in the RAQ for banks most respondents believe current CoE to be in the 8–10 % range (a reduction in comparison with the previous range, i.e. 10–12 % in December 2013). In addition, the dispersion decreased, with fewer respondents answering both additional possibilities (i.e. CoE between 10 % and 12 % and CoE above 12 %). A downward trend is clearly visible, with a reduction of the range 10–12 % (the same range for the RoE that is expected a bank can operate on a long-term basis) and a similar increase of the range 8–10 %. Moreover, only around 30 % of the respondents agree that their current earnings are covering the cost of equity (Figure 55).

On the one hand, the number of respondents that agree that cost of equity has dropped in the past 12 months has increased. On the other hand, there are still limited and less flexible levers available to meet minimum returns in the context of a general slowdown in economic activity. Persistently low real economic growth combined with a low inflation and low interest rate environment may further affect banks' income and profitability. At the same time, banks need to provide a return to investors at, or above, their CoE and a significant percentage of respondents still mention a current CoE to be in the 10–12 % range, which may make some business models unviable.

No clear trend of improvement identifiable for the cost-to-income ratio

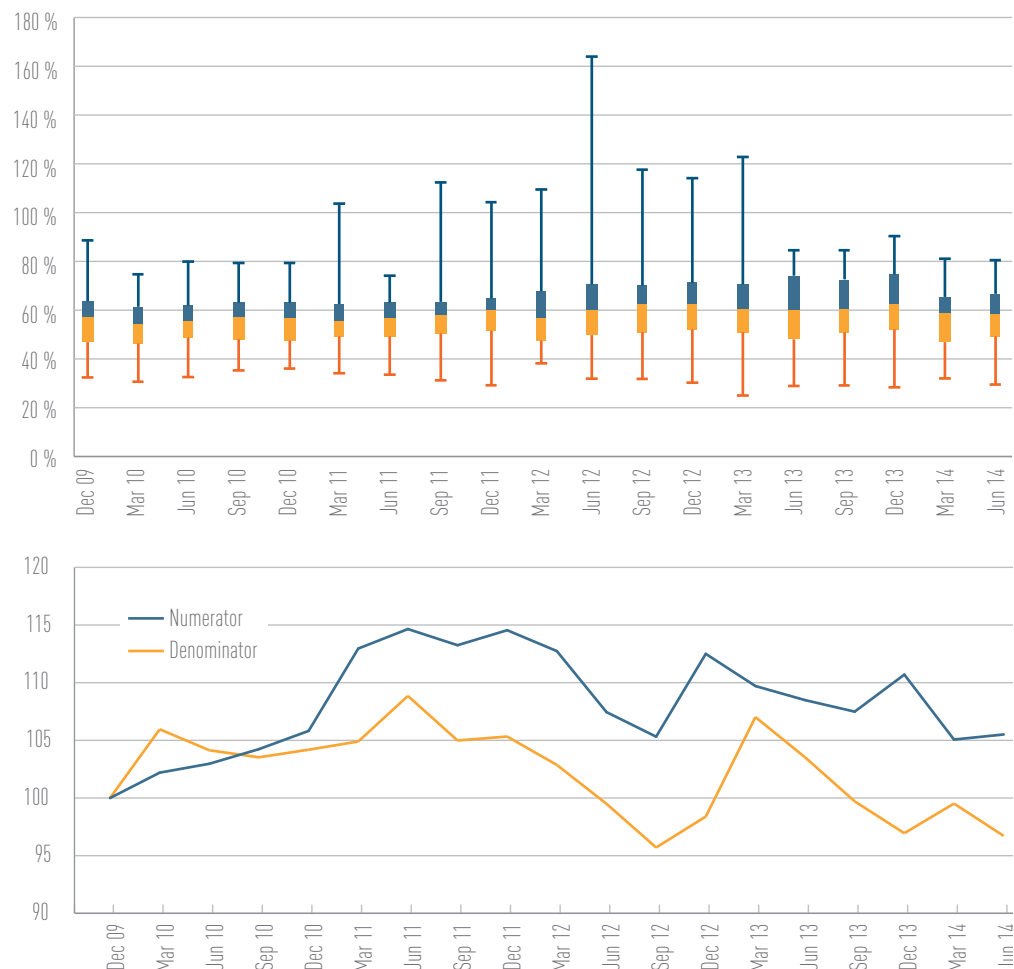
The cost-to-income ratio decreased from a weighted average of 63.1 % in December 2013 to 60.3 % in June 2014. However, it continues to show higher levels than in previous years (Figure 56). Interestingly, the 75th percentile has significantly decreased (from 75 % in December 2013 to 67.2 % in June 2014) after an upward trend since March 2010 (from 62.1 % to 71.6 % in December 2012 and 75 % in December 2013). The reduction of administration costs and depreciations has been evident since June 2011 (- 8 %).

Nevertheless, the top 15 banks still maintain an upward trend (weighted average of 67 % in June 2014 and 64 % in June 2013) in comparison with a downward trend since June 2012 for the remaining banks in the KRI sample (weighted average of 55 % in June 2014 and 60 % in June 2013). It is obvious that for a number of banks, the reduction in administration costs has not been sufficient to compensate the decrease of total operating income. The dispersion of the median by country is high. In June 2014, banks from seven countries presented median values of cost-to-income ratios higher than the EU median of 59 % (Figure 57).

In this context, supervisors need to be particularly vigilant to moves by banks to stretch their risk appetite or move outside their stated risk appetite in terms of both revenue generation and sustainable cost reductions.

Figure 56: Cost-to-income ratio – 5th and 95th percentiles, interquartile range and median, numerator and denominator trends (December 2009 = 100)

Source: EBA KRI.



Changes to business models in search of solid profitability is still not clear

The changing regulatory environment is applying pressure on the parameters within which banks have been operating, prompting a paradigm shift in some metrics and asset/liability structures and respective business models. At the same time, the fragile macroeconomic environment in some areas does not allow for growth of revenues. The low interest rate environment supports repayments by borrowers by reducing interest costs, but negatively impacts the net interest margin generation by banks, as banks' loans are also suppressed. Moreover, the increased capital which has bolstered the European banking system and rendered it safer has led to pressures on the cost of equity. In addition, the search for yield by investors may lead them away from bank bonds towards other asset classes, and sectors such as insurance or shadow banking. These challenges imply

significant changes to some business models in search of solid profitability; however, this search is still not clear for banks that may not be able to survive in the long run.

The RAQ for banks on changes to business models show that banks continue to reduce their intention of making material changes. The main reason is that banks consider that they have already implemented change programmes and have adapted to the new environment. For the minority that envisage making changes, the business lines to be scaled down continue to reflect, to some extent, the refocusing on core activities and markets. For this reason, non-domestic activities, both within the EU (which has market fragmentation as a side-effect) and especially outside the EU, continue to be a prevalent choice for scaling-down. With respect to the banks' earning mix, respondents continue to anticipate changes in order to match better their risk-return targets (Figure 58).

Figure 57: Cost-to-income ratio – KRI by size class (banks by size class according to their average total assets) and country dispersion (median by country; the name of the country is disclosed if there are more than three reporting institutions)
 Source: EBA KRI.

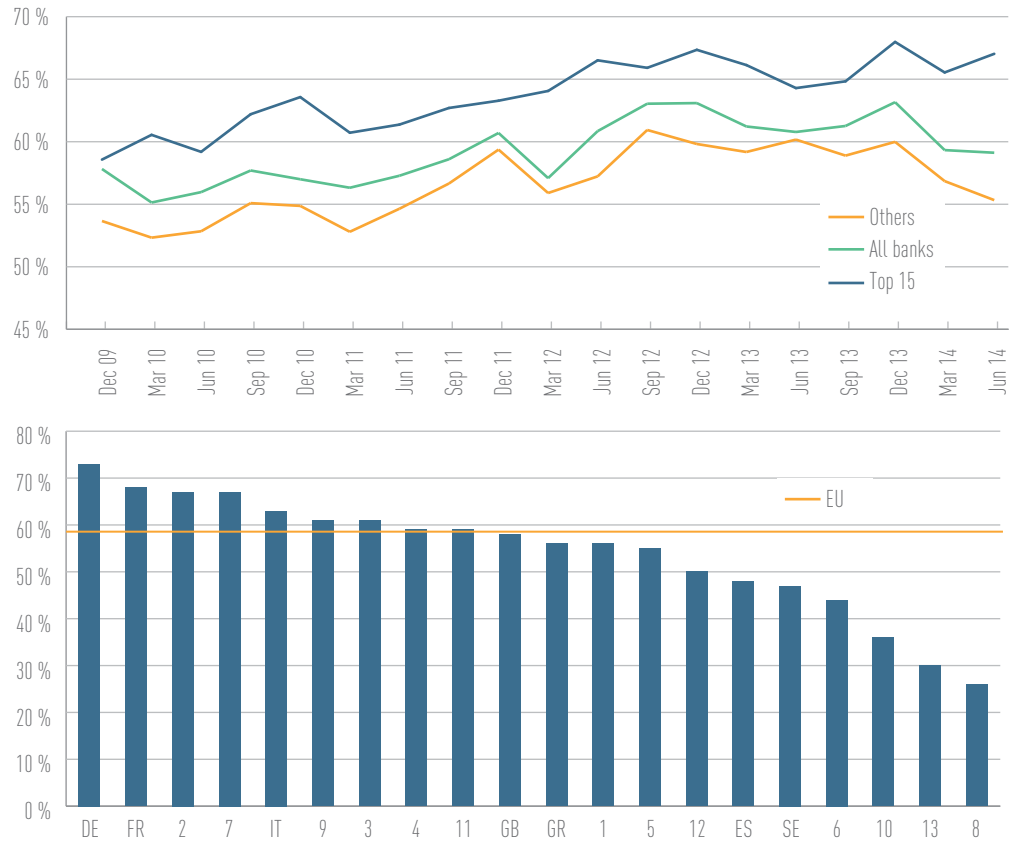
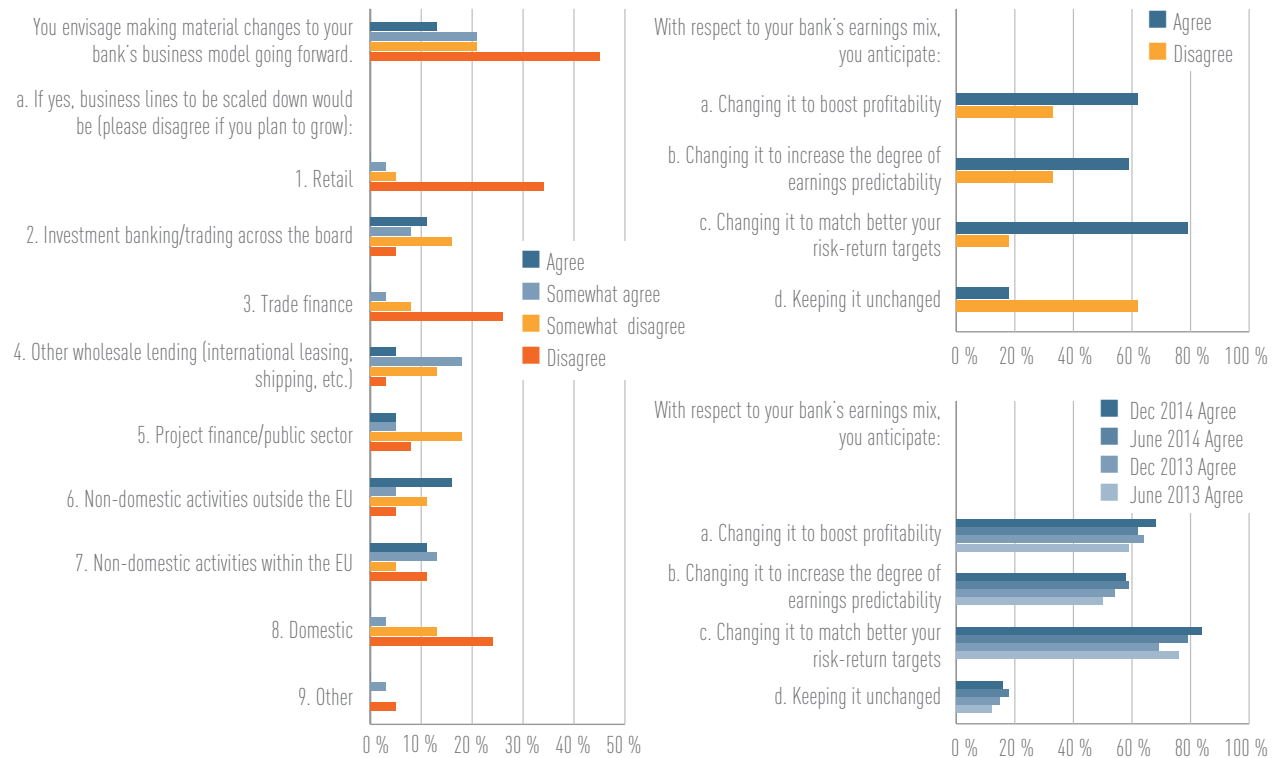


Figure 58: Changes to the business model
 Source: EBA RAQ for banks.



7. Consumer issues, reputational concerns and IT-related operational risks

Risks related to detrimental business practices of EU banks have been high on the agenda of both supervisors and institutions for some time. The recent substantive materialisation of these risks, with a further increased frequency and a magnitude of costs of identified and alleged mis-conduct, have led to wider debates and further prioritisation of related risks on supervisory agendas. Since some banks are coping with further rising materialised and potential redress costs, addressing these risks has been identified as a priority not only for soundness of banks, but also for systemic stability. In addition to conduct concerns, intensity, sophistication and frequency of information, technology-related operational risks remain a significant concern.

7.1 Consumer issues and reputational concerns

An increasing scope and numbers of inappropriate conduct have already been mentioned in previous reports. Adverse practices of mis-selling of banking and other products to consumers, failures with regard to rate benchmark setting processes, violations of trade sanctions and misconduct related to foreign exchanges have been identified to have the biggest impact on the banks concerned.

Many such practices remain an issue of substantive supervisory concern. The scope of alleged inappropriate practice remains wider and additional cases of alleged malpractice continue to come to the fore in addition to a range of previously identified or alleged cases of malpractice.

Further widening scope and impact of inappropriate practices

Responses to the RAQ indicate an ongoing widening of the scope of banks affected by conduct concerns, while the magnitude of financial impact from misconduct increases at the same time. In the ongoing financial year, almost all (96 %) participating banks

had to render some compensation, litigation and similar payments. Thirty-five per cent of participating banks paid out litigation and similar payments of over EUR 100 million in the ongoing financial year, and 16 % had to render such payments of over EUR 1 billion. Such high payments have increased substantially; in the December 2013 RAR, only 8 % of participating banks paid out amounts of over EUR 1 billion in the respective financial year.

The increasing magnitude of compensation, litigation and similar payments can significantly affect profitability and capital-generating capacities of banks concerned, and can also lead to substantial reputational damage. When taking into account a longer time horizon, it can be noted that since the end of the financial year 2007/08, 28 % of participating banks have meanwhile rendered such payments of more than EUR 1 billion.

Looking forward, uncertainty over the scope of potential further financial and reputational impact stemming from pending and potentially new misconduct cases casts a shadow on banks involved in alleged misconduct, and reputational and financial concerns are not expected to abate soon. Accordingly, 68 % of respondents to the RAQ see an increasing reputational and legal risk in the banking sector in general, and a negative trend in the banks' image with public opinion. Such concerns may also impact consumer confidence and financial stability, and conduct concerns should therefore remain high on the supervisory agenda.

Provisioning and disclosure of conduct risk

Some growing awareness of conduct risk can be identified at institutions, and a trend of modest improvement in provisioning on conduct risk indicated in the last risk report is continuing. Thirty-nine per cent of respondents indicate that they set aside contingent liabilities for potential compensation, redress, litigation, and potentially similar payments. Only 28 % of respondents set aside such contingent liabilities in the previous RAQ.

However, it should be noted that banks often do not capture specific litigation provisions, but appear, rather, to make general provisions which are internally marked for litigation purposes, often on a probability-weighted basis for a range of potential conduct costs.

Disclosure on conduct risks remains limited, albeit improving. Eighteen per cent of respondents indicate that they provide specific Pillar 3 disclosure, compared to 11 % in the previous RAQ. Only a minority of respondents (now 39 %, and 38 % in the previous RAQ) provide estimates on specific contingent liabilities, in spite of International Accounting Standards (IAS) stipulations to set aside contingent liabilities with no impact on the income statement if reliable estimates of actual and potential redress costs cannot be made and therefore provisions cannot be recognised. This may be driven by reputational concerns which may arise when indicating actual and potential redress costs affecting the bank.

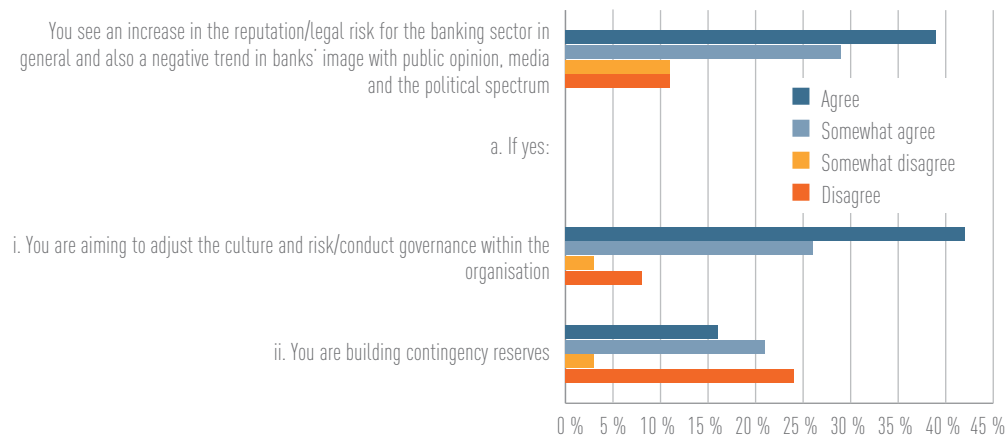
An increasing number of respondents consider it necessary to build up contingency reserves for related risks, and 37 % of participating banks are building up such reserves, compared to 18 % in the previous RAQ. However, the number is still rather low in light of elevated risk and the scale of business concerns that have in some instances materialised. Since a large majority of respondents identify increasing legal risk in the banking sector, building up further contingency reserves should be a priority for institutions, and an issue of supervisory scrutiny (Figure 59).

Addressing conduct risk

In line with heightened risks, institutions should further adjust and improve risk cultures, and strive to further anchor conduct of business concerns in their governance and risk management arrangements. These arrangements in the past often fell short of preventing issues of conduct concerns from arising. This includes that banks should take conduct risk into account in their internal capital adequacy assessment processes (ICAAP), irrespective of approaches used for the purposes of calculating regulatory capital for operational risk, under which conduct risk is usually covered. As regards operational risk, risk models banks use should capture conduct risk and its events, and it should also be included in institutions' stress testing programmes.

Following the issue of recommendations and principles on rate benchmark setting by the EBA and ESMA, administrators of key interest reference rates continue to make significant progress in enhancing the governance, transparency and reliability of their benchmarks, as also pointed out by the International Organisation of Securities Commissions (IOSCO). The number of panel banks submitting their data for the Euribor benchmark nevertheless has continued to drop. This is an issue of supervisory concern as it is increasingly jeopardising the representativeness and credibility of this benchmark.

Figure 59: Reputation/legal risk for the banking sector
 Source: EBA RAQ for banks.



7.2 Information and communications technology-related operational risks

Operational risks related to information and communications technology for institutions have increased further since the last risk report. Dependency on and usage of information technology continues to grow, for example in retail payment systems through mobile and online banking, while IT systems of institutions are becoming increasingly complex and interconnected. At the same time, IT-related threats have become more complex and intense. They increasingly target the confidentiality and integrity of information systems, by, for example, aiming to access institutions' internal information systems. Sophistication and intensity of risks is therefore increasing, and the vulnerability of institutions is growing as the potential impact of disruptions of IT systems increases. Accordingly, over 80 % of respondents to the RAQ agree that increased sophistication and complexity of threats is a major challenge to increased resilience against cyber and IT-related risks. Also, the European Commission has emphasised cyber risk as a major risk area [9].

Information Systems and Communication Infrastructures are susceptible to disruptions caused by a variety of technical and non-technical issues. Disruptions of IT systems especially can be caused by cyber and other malicious attacks upon systems, or by is-

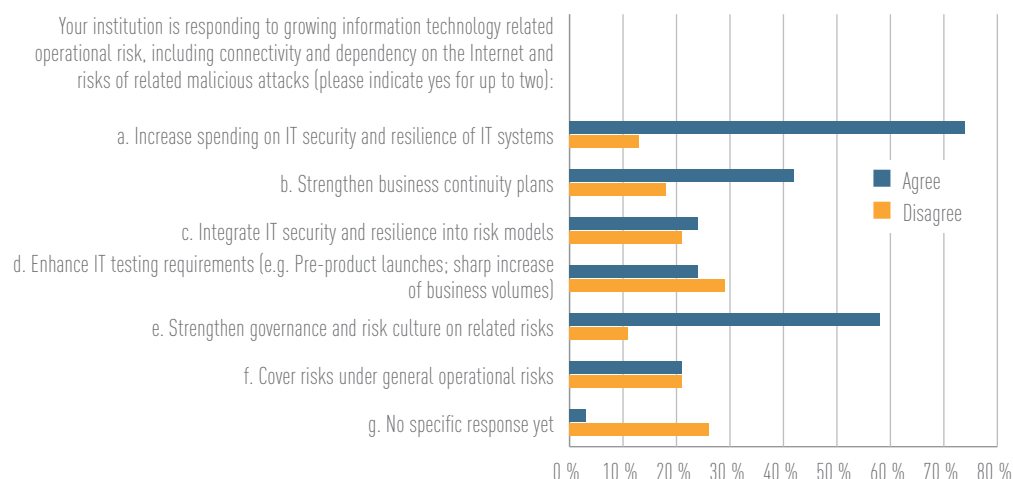
[9] The Commission identifies large-scale cyber-attacks as one of the main challenges to the EU in the field of security. See, for example, 'Europe's future security challenges', http://europa.eu/rapid/press-release_IP-14-693_en.htm.

suues with legacy and heterogeneous systems. While legacy and heterogeneous systems have to be updated or refitted to mitigate risks, in some cases the update and patch process itself can lead to disruptions. Such risks can be increased by an investment backlog. Banks have been affected by further high-profile attacks such as distributed denial of service (DDoS), and by other outages. Exposure to risks appears to be widespread, and industry surveys indicate that more than half of the world's largest banks' websites have been hit by security incidents in the past eight years. In the retail sector, IT-related attacks like for example phishing or drive-by attacks of infected websites are not only causing financial damage for the institutions concerned, such as recovery and liability costs, but can also significantly undermine consumer confidence in the institutions concerned, and in the financial system as a whole.

Responses to increasing risks

An awareness of institutions to the need to address IT-related risks can be identified, and 74 % of respondents to the RAQ agree to have increased spending on IT security and resilience of IT systems. However, in the June 2014 RAQ, more respondents (87 %) indicated to have increased such spending. Banks' responses to risks are often aimed at increasing the resilience of IT systems and online banking systems against disruptions such as DDoS attacks. Efforts also include employing technologies such as transaction-filtering systems, which can detect and deter potentially fraudulent transactions at an early stage.

Figure 60: Information technology related operational risk
Source: EBA RAQ for banks.



The RAQ also shows that institutions' efforts to respond to heightened IT-related risks have become more targeted and focused (Figure 60). While in the previous RAQ most respondents indicated risks coverage under general operational risks as a main response to growing IT-related risks (64 % of respondents), a higher number of respondents now indicate more targeted responses. More respondents are strengthening governance and risk culture on related risks (58 % of respondents) or are strengthening business continuity plans (42 %), rather than coverage of IT risks under a general operational risk only (21 %).

In an environment of protracted low profitability in the banking sector, it will be important to ensure that spending on IT systems and security are safeguarded against budgetary pressures to reduce costs and that related internal controls remain robust. Institutions should maintain an increased priority to address related risks and reinforce IT controls and audits, not least since IT risks still appears to not sufficiently be understood across EU banks, and continues to evolve and become more complex.

Policies, institutions' approaches to address IT risks, should be broad-based and not only focus on prevention of risk, but also on iden-

tification and recovery procedures, as well as on procedures to response to risks. Policies and procedures should also reconsider the relevance of IT risks for all operational processes in institutions. IT audits and controls should cover all parties along the value-added chain of IT at institutions, such as third-party IT providers and outsourcing providers.

Supervisory responses

Supervisors are encouraged to ensure that banks devote adequate resources and due care in the proper management of their IT environment and risks. Supervisory efforts should also be stepped up to fully recognise IT-related risks, and to factor their mitigation into regular risk assessments. Mitigation measures should also include IT inspections with a necessary scope and depth.

It would also be desirable for more supervisory authorities to intensify activities related to the Computer Emergency Response Teams (CERT), which have been launched in some jurisdictions. Coordination and cooperation of authorities involved in addressing IT-related risks is increasingly important, not least on a European level. The scale of IT challenges often exceeds the domestic level and adequate expertise might be scarce.



8. Policy implications and possible measures

The stress test will inform on a range of supervisory actions. Some capital and liquidity actions will take place in the short term to cover shortfalls, but in other cases, weaknesses in capital and funding plans may lead to other types of capital strengthening, including restrictions on dividends. In preparation for the stress test, EU banks have made significant progress in strengthening their capital positions. European banks have accomplished significant adjustments on the asset side by cutting risky assets, front-loading impairments and shrinking their balance sheets. These are positive developments but there is still no room for complacency. There is a broad range of other actions that might be considered including changes to banks' strategies, reducing concentrations, cost reduction and continued cleaning or reduction of balance sheets by disposing of non-performing and other assets.

The consistency of the calculation of banks' RWAs remains an area for close supervision and attention in the near future. A clear picture of the quality of European banks' assets was necessary in order to dispel persistent concerns and reassure potential investors about the robustness of the EU financial system. There is strong evidence that the EU wide AQR were an important catalyst for addressing uncertainties surrounding EU banks' asset quality in the current context and that they will support future monitoring changes in asset quality after the 2014 EU wide stress test exercise. At the same time, the consistency of the calculation of banks' RWAs is another area for close attention and the EBA is currently developing a wider and deeper analysis of the RWAs across European banks. The objective is to identify any material difference in banks' assessments of risks and to understand the main drivers of such differences. The regular benchmarking exercises will be an important tool in enhancing the comparability of the banks' RWAs.

Supervisors need to develop a coordinated analysis of banks' business models across the EU. Some EU banks are facing strong challenges in adapting to the many changes derived from the emerging new economic,

regulatory and financial landscape. The EU banks' income and profitability levels and the sustainability of some business models remain a cause for concern and it is still unclear where some EU banks' future profitability drivers will originate from. Some EU banks' business models are experiencing pressure through stronger competition and supervisors are required to have an accurate assessment of core banking risks and to challenge banks' business plans. For these reasons, supervisors will need to assess banks' profits and funding models, business mixes, management strengths and strategies, among other issues, and taking into account there are banks which are not planning to change their business model.

The EBA will continue to foster and promote convergence in European banking regarding the development of recovery and resolution plans by institutions. The resolution and recovery plans will help the respective bank and the supervisory authorities in preparing for crisis situations and potential resolution of the bank. The resolution and recovery plans will be also instrumental in assessing the viability of current business models and will provide an opportunity to tackle issues such as banks' profits and funding models, business mixes, management strengths and strategies. The EBA will continue to provide guidance and assist competent authorities in the assessment of such recovery plans, and develop a comprehensive library of recovery best practices in European banking.

The EBA will continue to be actively involved in the establishment and monitoring of resolution colleges that will be created under the BRRD mandate. Resolution colleges will provide a forum to exchange information and for the coordination of resolution measures, in order to ensure coordination at cross-border or EU level between all the national authorities involved in the resolution of institutions. In the event of disagreement between national authorities on decisions to be taken with regard to institutions, the EBA will have a role of mediation similar to that which it plays in supervisory colleges.

Supervisors should pay additional attention to monitoring if adequate provisioning for reputational and legal risks has been made, and if contingency reserves are being built. The EU banks' reputational and legal risks remain a concern due to potential prudential impact of conduct-related issues. A number of detrimental business practices of some European banks have significantly affected consumer confidence and had an adverse impact on the respective banks involved. In light of indications of insufficient and decreasing disclosure of conduct risks, auditors and supervisors should pay additional attention to monitoring if adequate provisioning for related risks has been made. A more general reassessment of the relationship between banks and their customers remains a priority. Further educational efforts to improve the financial literacy of consumers are also important. Supervisors should assess whether prudential risks stemming from banks' business practices are adequately reflected in an institution's ICAAP. Likewise, an assessment of such risks should be increasingly reflected in the supervisory review and evaluation process (SREP).

Supervisors need to develop a coordinated analysis of IT-related risks and should factor these risks into regular risk assessments. IT controls and audits should be reinforced, and institutions should strive to integrate IT security and resilience into the risk models they apply. This includes IT inspections with a necessary scope and depth, while institutions should give increased priority to related risks. The evolving nature of IT-related risks and rapid technological advances highlights the need for sound management practices and a strong, professional risk culture which can swiftly react to new threats and deliver appropriate levels of employee awareness about evolving risks.

The need for continued regulatory and supervisory convergence across the EU will remain a key challenge for the EBA. The institutional reforms at EU level are crucial in the establishment of the banking union, including the implementation of a more integrated framework for bank resolution and an appropriate single deposit guarantee system scheme. A coordinated policy action remains fundamental for the coherence of the single market and new regulatory requirements for banks (for example the CRD IV-CRR and the BRRD) are fundamental for the ongoing repair of the EU banking system.



Annex I – Samples

Below is a list of 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	Home country
1	Erste Group Bank AG	AT
2	Raiffeisen Zentralbank	AT
3	KBC Group	BE
4	Bank of Cyprus Public Company Ltd	CY
5	Bayerische Landesbank	DE
6	Commerzbank AG	DE
7	Deutsche Bank AG	DE
8	DZ BANK AG	DE
9	Hypo Real Estate Holding	DE
10	Norddeutsche Landesbank Girozentrale NORD/LB	DE
11	Danske Bank A/S	DK
12	Alpha Bank AE	EL
13	Eurobank Ergasias	EL
14	National Bank of Greece	EL
15	Piraeus Bank	EL
16	Banco Bilbao Vizcaya Argentaria SA	ES
17	Banco Santander SA	ES
18	BNP Paribas	FR
19	Crédit Agricole Group-Crédit Agricole	FR
20	Société Générale	FR
21	OTP Bank NYRT	HU
22	Allied Irish Banks plc	IE
23	Bank of Ireland	IE
24	Gruppo Bancario Intesa Sanpaolo	IT
25	Gruppo UniCredit	IT
26	ABN Amro	NL
27	ING Groep NV	NL
28	Rabobank Group-Rabobank Nederland	NL
29	DNB Bank	NO
30	Banco Comercial Português	PT
31	Nordea Bank AB (publ)	SE
32	Skandinaviska Enskilda Banken AB	SE
33	Svenska Handelsbanken AB	SE
34	Swedbank AB	SE
35	Barclays plc	UK
36	HSBC Holdings plc	UK
37	Lloyds Banking Group plc	UK
38	Royal Bank of Scotland Group plc (The)	UK
39	Standard Chartered plc	UK

Key risk indicators ⁽¹⁰⁾

	Bank name	Home country		Bank name	Home country
1	Erste Group Bank AG	AT	30	HSBC Holdings Plc	GB
2	Oesterreich Volksbanken	AT	31	Royal Bank of Scotland Group Plc (The)	GB
3	Raiffeisen Zentralbank	AT	32	Nationwide Building Society	GB
4	KBC Group	BE	33	National Bank of Greece	GR
5	Dexia	BE	34	Alpha Bank AE	GR
6	Bank of Cyprus	CY	35	Piraeus Bank	GR
7	Marfin Popular Bank	CY	36	EFG Eurobank Ergasias	GR
8	DZ BANK AG	DE	37	OTP Bank NYRT	HU
9	WestLB AG	DE	38	Bank of Ireland	IE
10	Landesbank Baden-Wuerttemberg	DE	39	Allied Irish Banks plc	IE
11	Deutsche Bank AG	DE	40	Gruppo UniCredit	IT
12	Commerzbank AG	DE	41	Gruppo Monte dei Paschi di Siena	IT
13	Norddeutsche Landesbank GZ	DE	42	Gruppo Bancario Intesa Sanpaolo	IT
14	Bayerische Landesbank	DE	43	Gruppo Banco Popolare	IT
15	Hypo Real Estate	DE	44	Bank of Valletta (BOV)	MT
16	Danske Bank A/S	DK	45	ABN Amro	NL
17	Banco Santander SA	ES	46	ING Groep NV	NL
18	Banco Bilbao Vizcaya Argentaria SA	ES	47	Rabobank Group-Rabobank Nederland	NL
19	La Caixa	ES	48	DnB NOR	NO
20	Banco Financiero y de Ahorro	ES	49	PKO Bank Polski	PL
21	OP-Pohjola Group	FI	50	Banco Comercial Portugues	PT
22	BNP Paribas	FR	51	Caixa Geral de Depositos	PT
23	Crédit Agricole Group-Crédit Agricole	FR	52	Espirito Santo Financial Group (ESFG)	PT
24	Société Générale	FR	53	Skandinaviska Enskilda Banken AB	SE
25	Credit Mutuel	FR	54	Nordea Bank AB (publ)	SE
26	Group BPCE	FR	55	SWEDBANK AB	SE
27	Barclays Plc	GB	56	Svenska Handelsbanken	SE
28	Lloyds Banking Group Plc	GB	57	Nova Ljubljanska Bank (NLB)	SI
29	Standard Chartered Plc	GB			

⁽¹⁰⁾ During recent years there have been a small number of changes in the data basis delivered by the banks, e.g. banks in restructuring are not further considered.

Annex II – Descriptive statistics from the EBA key risk indicators

Descriptive statistics from the EBA key risk indicators with data to Q2 2014.
The charts of KRI show the dispersion of data points for the relevant KRI over time, with 5th, 25th, 50th (median), 75th and 95th percentiles.

KRI	Descriptive statistics	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14
1 – Tier 1 capital ratio	Weighted average	10.2 %	10.2 %	10.4 %	10.6 %	11.0 %	11.3 %	11.4 %	11.4 %	11.1 %	11.6 %	12.0 %	12.3 %	12.5 %	12.4 %	12.6 %	12.9 %	13.1 %	12.4 %	12.9 %
	First quartile	9.1 %	9.0 %	8.8 %	8.9 %	9.3 %	9.7 %	9.4 %	9.6 %	9.4 %	9.8 %	10.4 %	10.3 %	10.5 %	10.8 %	11.0 %	11.1 %	11.4 %	11.3 %	11.7 %
	Median	9.9 %	10.2 %	10.1 %	10.3 %	10.6 %	11.1 %	11.1 %	11.0 %	10.9 %	11.4 %	11.7 %	11.7 %	11.7 %	11.6 %	12.0 %	12.3 %	12.8 %	12.3 %	13.3 %
2 – Total capital ratio	Third quartile	11.3 %	11.1 %	11.4 %	11.6 %	12.4 %	12.7 %	12.5 %	12.8 %	12.8 %	13.0 %	13.3 %	13.4 %	13.5 %	13.4 %	13.8 %	13.9 %	14.8 %	14.8 %	15.4 %
	Weighted average	13.0 %	12.9 %	12.9 %	13.1 %	13.5 %	13.7 %	13.6 %	13.5 %	13.1 %	13.6 %	13.9 %	14.1 %	14.4 %	14.8 %	15.1 %	15.4 %	15.7 %	15.2 %	15.8 %
	First quartile	11.5 %	11.2 %	11.4 %	11.5 %	11.7 %	11.8 %	11.6 %	11.4 %	11.3 %	11.5 %	12.0 %	12.0 %	12.1 %	12.6 %	13.1 %	13.0 %	13.4 %	13.8 %	14.7 %
3 – Tier 1 ratio (excluding hybrid instruments)	Median	12.5 %	12.6 %	12.2 %	12.4 %	12.8 %	13.3 %	13.0 %	12.8 %	12.8 %	13.9 %	14.1 %	14.0 %	13.9 %	14.4 %	14.4 %	14.6 %	14.8 %	15.5 %	16.2 %
	Third quartile	14.0 %	13.9 %	14.0 %	14.6 %	14.9 %	15.0 %	15.1 %	15.1 %	15.0 %	15.4 %	15.8 %	15.8 %	16.2 %	16.3 %	16.8 %	17.1 %	17.4 %	18.2 %	17.6 %
	Weighted average	9.0 %	9.0 %	9.2 %	9.3 %	9.0 %	9.3 %	9.3 %	9.4 %	9.2 %	9.8 %	10.2 %	10.5 %	10.8 %	10.8 %	11.1 %	11.4 %	11.4 %	11.6 %	11.4 %
3 – Tier 1 ratio (excluding hybrid instruments)	First quartile	7.1 %	7.3 %	7.2 %	7.4 %	7.7 %	8.2 %	7.9 %	8.0 %	8.1 %	8.3 %	9.3 %	9.4 %	9.5 %	9.8 %	10.0 %	10.2 %	10.4 %	10.9 %	11.1 %
	Median	8.6 %	8.5 %	8.6 %	9.3 %	8.5 %	9.0 %	9.3 %	9.4 %	9.4 %	10.0 %	10.3 %	10.5 %	10.7 %	10.7 %	11.0 %	11.1 %	11.1 %	11.4 %	12.1 %
	Third quartile	10.7 %	10.8 %	10.6 %	11.1 %	10.4 %	10.9 %	10.3 %	10.6 %	10.5 %	11.3 %	11.2 %	11.4 %	11.4 %	11.6 %	12.3 %	12.6 %	13.1 %	14.2 %	14.7 %

SOLVENCY

KRI	Descriptive statistics	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14
13 – Impaired loans and past due (> 90 days) loans to total loans	Weighted average	5.1 %	4.9 %	5.1 %	5.3 %	5.3 %	5.2 %	5.4 %	5.4 %	5.8 %	5.9 %	6.0 %	6.3 %	6.5 %	6.5 %	6.8 %	6.6 %	6.8 %	6.6 %	6.4 %
	First quartile	3.1 %	3.1 %	3.3 %	2.8 %	3.0 %	2.9 %	2.5 %	2.6 %	2.5 %	2.5 %	2.8 %	2.8 %	3.1 %	3.0 %	3.2 %	2.9 %	3.0 %	3.0 %	2.7 %
	Median	4.9 %	5.1 %	5.4 %	5.0 %	5.4 %	5.4 %	5.6 %	5.6 %	6.4 %	6.7 %	6.3 %	7.3 %	7.3 %	6.7 %	6.7 %	6.5 %	6.5 %	6.4 %	6.2 %
14 – Coverage ratio (specific allowances for loans to total gross impaired loans)	Third quartile	9.8 %	9.9 %	10.7 %	10.9 %	10.5 %	11.3 %	12.4 %	13.1 %	14.1 %	15.2 %	15.8 %	16.3 %	17.3 %	17.6 %	17.6 %	15.7 %	16.2 %	16.4 %	16.3 %
	Weighted average	41.6 %	41.7 %	41.6 %	42.5 %	41.4 %	42.3 %	41.2 %	40.7 %	41.0 %	41.0 %	41.3 %	41.3 %	41.8 %	42.4 %	42.4 %	44.4 %	44.4 %	47.0 %	46.8 %
	First quartile	34.5 %	34.8 %	35.2 %	34.6 %	34.5 %	34.6 %	33.8 %	33.8 %	34.3 %	34.8 %	35.8 %	35.1 %	34.7 %	35.6 %	34.9 %	35.6 %	35.6 %	39.2 %	37.6 %
18 – Impaired financial assets to total assets	Median	41.0 %	41.5 %	41.5 %	42.4 %	42.5 %	43.5 %	42.8 %	41.9 %	41.5 %	41.4 %	41.8 %	42.0 %	41.7 %	43.5 %	43.8 %	44.4 %	46.1 %	46.1 %	46.7 %
	Third quartile	50.7 %	50.1 %	49.4 %	51.5 %	51.9 %	50.9 %	49.3 %	47.2 %	51.1 %	51.4 %	50.6 %	50.9 %	50.1 %	52.0 %	51.7 %	52.8 %	55.0 %	55.9 %	55.5 %
	Weighted average	1.6 %	1.6 %	1.6 %	1.6 %	1.7 %	1.7 %	1.8 %	1.7 %	1.9 %	1.9 %	1.9 %	1.9 %	2.0 %	2.0 %	2.1 %	2.0 %	2.0 %	1.9 %	1.9 %
20 – Accumulated impairments on financial assets to total (gross) assets	First quartile	1.0 %	1.1 %	1.1 %	1.2 %	1.2 %	1.2 %	1.1 %	1.0 %	1.0 %	1.1 %	1.2 %	1.1 %	1.2 %	1.2 %	1.2 %	1.2 %	1.1 %	1.2 %	1.1 %
	Median	1.9 %	1.9 %	1.8 %	1.9 %	2.0 %	1.9 %	2.0 %	2.1 %	2.2 %	2.1 %	2.1 %	2.2 %	2.4 %	2.4 %	2.6 %	2.5 %	2.4 %	2.4 %	2.3 %
	Third quartile	3.5 %	3.5 %	3.6 %	3.9 %	3.9 %	4.1 %	5.3 %	5.3 %	5.6 %	6.2 %	6.6 %	7.2 %	7.4 %	8.7 %	8.9 %	7.9 %	7.1 %	6.7 %	6.7 %
21 – Impairments on financial assets to total operating income	Weighted average	1.3 %	1.3 %	1.3 %	1.4 %	1.4 %	1.4 %	1.4 %	1.3 %	1.6 %	1.5 %	1.5 %	1.5 %	1.6 %	1.6 %	1.7 %	1.8 %	1.9 %	1.8 %	1.8 %
	First quartile	0.9 %	0.9 %	0.9 %	0.8 %	0.9 %	0.8 %	0.8 %	0.7 %	0.8 %	0.8 %	0.7 %	0.7 %	0.7 %	0.7 %	0.8 %	0.8 %	0.8 %	0.8 %	0.7 %
	Median	1.5 %	1.5 %	1.5 %	1.6 %	1.7 %	1.6 %	1.5 %	1.5 %	1.6 %	1.6 %	1.7 %	1.7 %	1.8 %	1.7 %	1.8 %	1.8 %	1.8 %	1.7 %	1.7 %
21 – Impairments on financial assets to total operating income	Third quartile	2.2 %	2.3 %	2.3 %	2.8 %	2.7 %	2.9 %	2.9 %	3.1 %	3.7 %	3.7 %	3.7 %	3.8 %	3.9 %	4.0 %	4.1 %	4.2 %	4.3 %	4.4 %	4.3 %
	Weighted average	26.6 %	17.2 %	20.1 %	18.2 %	19.4 %	13.8 %	17.9 %	20.3 %	26.7 %	17.9 %	24.6 %	24.9 %	27.0 %	16.9 %	18.6 %	18.6 %	22.7 %	13.7 %	16.1 %
	First quartile	21.0 %	15.5 %	17.5 %	14.5 %	15.5 %	7.4 %	10.0 %	14.7 %	14.8 %	8.4 %	9.9 %	10.4 %	10.8 %	9.0 %	9.8 %	10.4 %	11.0 %	6.7 %	7.4 %
21 – Impairments on financial assets to total operating income	Median	27.4 %	20.4 %	23.3 %	21.1 %	23.9 %	15.7 %	20.2 %	21.6 %	26.2 %	19.7 %	18.7 %	20.9 %	22.4 %	19.4 %	19.2 %	20.0 %	21.4 %	11.6 %	15.2 %
	Third quartile	41.0 %	28.1 %	33.5 %	31.6 %	31.3 %	25.9 %	32.0 %	36.9 %	56.8 %	32.1 %	39.8 %	44.4 %	56.0 %	34.2 %	30.8 %	31.9 %	43.3 %	30.6 %	27.6 %

CREDIT RISK AND ASSET QUALITY

KRI	Descriptive statistics	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14
22 – Return on equity	Weighted average	4.5 %	7.4 %	7.3 %	6.7 %	5.9 %	8.3 %	7.1 %	4.9 %	0.0 %	5.6 %	3.4 %	2.6 %	0.5 %	9.3 %	7.6 %	6.4 %	2.7 %	7.5 %	5.7 %
	First quartile	-0.5 %	3.1 %	3.1 %	3.0 %	1.7 %	5.0 %	2.8 %	-0.7 %	-15.7 %	1.8 %	-0.9 %	-1.5 %	-6.5 %	1.4 %	2.2 %	1.5 %	-2.9 %	2.9 %	2.5 %
	Median	5.4 %	6.2 %	6.4 %	5.7 %	5.4 %	8.0 %	7.1 %	5.2 %	2.7 %	6.5 %	5.3 %	3.8 %	2.6 %	6.6 %	6.4 %	5.7 %	4.8 %	7.5 %	5.5 %
	Third quartile	9.1 %	11.1 %	10.8 %	10.0 %	9.5 %	11.7 %	11.7 %	9.4 %	7.8 %	11.5 %	8.9 %	8.4 %	7.2 %	12.3 %	10.4 %	10.4 %	9.1 %	10.3 %	9.5 %
24 – Cost-to-income ratio	Weighted average	55.2 %	53.3 %	54.6 %	55.6 %	56.1 %	59.5 %	58.2 %	59.6 %	60.1 %	60.6 %	59.7 %	60.8 %	63.2 %	56.6 %	57.9 %	59.6 %	63.1 %	58.3 %	60.3 %
	First quartile	47.2 %	46.9 %	49.1 %	48.7 %	47.9 %	49.6 %	49.7 %	51.0 %	52.0 %	48.1 %	50.4 %	51.4 %	52.5 %	51.2 %	48.2 %	51.2 %	52.8 %	47.3 %	49.6 %
	Median	57.8 %	55.1 %	56.0 %	57.7 %	57.0 %	56.3 %	57.3 %	58.6 %	60.7 %	57.1 %	60.9 %	63.0 %	63.1 %	61.2 %	60.8 %	61.3 %	63.2 %	59.3 %	59.1 %
	Third quartile	64.3 %	62.1 %	62.2 %	63.3 %	63.8 %	63.2 %	63.8 %	63.9 %	65.2 %	68.3 %	71.0 %	70.3 %	71.6 %	70.9 %	74.6 %	73.1 %	75.0 %	65.6 %	67.2 %
26 – Net interest income to total operating income	Weighted average	57.9 %	56.2 %	58.6 %	58.3 %	58.0 %	57.2 %	57.4 %	60.3 %	61.1 %	61.2 %	60.9 %	61.7 %	61.6 %	55.5 %	55.1 %	57.3 %	59.1 %	58.2 %	60.1 %
	First quartile	52.8 %	53.2 %	52.3 %	53.2 %	51.9 %	49.0 %	50.4 %	52.5 %	54.2 %	51.7 %	51.8 %	52.5 %	52.6 %	47.8 %	47.4 %	50.1 %	51.1 %	51.4 %	52.3 %
	Median	64.1 %	61.9 %	61.6 %	62.8 %	62.5 %	59.9 %	62.8 %	65.0 %	64.0 %	63.9 %	63.2 %	65.9 %	66.9 %	60.0 %	60.5 %	59.1 %	60.2 %	64.1 %	66.1 %
	Third quartile	74.1 %	72.5 %	72.2 %	77.1 %	73.6 %	78.6 %	75.4 %	75.2 %	76.6 %	74.2 %	79.3 %	79.0 %	76.7 %	75.6 %	72.7 %	71.1 %	77.7 %	76.8 %	76.7 %
27 – Net fee and commission income to total operating income	Weighted average	26.0 %	25.8 %	26.7 %	26.7 %	26.8 %	26.9 %	27.0 %	27.6 %	27.6 %	27.3 %	27.1 %	27.7 %	27.9 %	25.8 %	26.7 %	27.7 %	28.4 %	27.6 %	28.5 %
	First quartile	16.7 %	14.9 %	15.6 %	15.1 %	15.8 %	13.3 %	16.1 %	16.7 %	16.5 %	18.1 %	17.9 %	17.6 %	17.9 %	16.0 %	15.3 %	15.3 %	15.6 %	15.1 %	15.6 %
	Median	22.6 %	23.5 %	24.0 %	24.0 %	24.1 %	24.1 %	24.4 %	25.8 %	24.1 %	22.8 %	24.4 %	24.2 %	25.7 %	24.6 %	23.6 %	23.5 %	25.3 %	24.4 %	24.3 %
	Third quartile	29.0 %	30.6 %	31.5 %	30.8 %	30.6 %	30.4 %	29.2 %	30.5 %	30.9 %	28.2 %	29.1 %	29.9 %	30.6 %	31.2 %	31.4 %	32.6 %	31.3 %	33.0 %	31.3 %
33 – Net income to total operating income	Weighted average	9.3 %	16.3 %	16.6 %	15.2 %	13.4 %	18.9 %	16.7 %	11.9 %	0.0 %	13.6 %	8.6 %	6.9 %	1.2 %	23.1 %	19.3 %	16.8 %	7.3 %	19.7 %	15.7 %
	First quartile	-3.1 %	7.3 %	7.0 %	7.5 %	5.6 %	14.0 %	8.7 %	-3.6 %	-36.3 %	4.6 %	-2.5 %	-6.3 %	-17.7 %	4.9 %	7.2 %	6.1 %	-10.5 %	8.8 %	8.5 %
	Median	10.9 %	17.4 %	16.6 %	15.4 %	14.6 %	19.3 %	17.8 %	13.2 %	7.7 %	16.3 %	12.0 %	10.7 %	9.0 %	15.9 %	16.6 %	16.5 %	13.8 %	17.9 %	16.7 %
	Third quartile	19.3 %	23.0 %	24.0 %	23.4 %	22.3 %	29.7 %	26.4 %	22.6 %	18.8 %	28.6 %	20.5 %	21.1 %	18.5 %	33.4 %	30.9 %	29.5 %	30.9 %	35.9 %	32.2 %

PROFITABILITY

KRI	Descriptive statistics	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14
34 – Loan-to-deposit ratio	Weighted average	117.1 %	117.0 %	116.6 %	117.6 %	117.8 %	118.3 %	119.8 %	119.6 %	117.7 %	118.0 %	117.7 %	116.2 %	115.7 %	117.4 %	114.1 %	114.7 %	112.8 %	111.4 %	112.9 %
	First quartile	100.3 %	100.6 %	100.9 %	103.7 %	105.3 %	103.7 %	104.2 %	108.7 %	106.0 %	105.1 %	106.6 %	106.4 %	103.6 %	101.3 %	99.9 %	97.8 %	98.0 %	95.0 %	96.3 %
	Median	114.1 %	115.7 %	117.4 %	116.8 %	117.5 %	120.2 %	119.5 %	124.5 %	124.1 %	125.3 %	125.9 %	124.6 %	119.1 %	116.8 %	115.0 %	114.6 %	112.1 %	110.9 %	108.8 %
35 – Customer deposits to total liabilities	Third quartile	128.4 %	132.2 %	133.9 %	135.6 %	140.0 %	135.0 %	141.7 %	139.4 %	146.7 %	148.3 %	143.4 %	137.1 %	135.7 %	131.5 %	130.5 %	132.1 %	129.4 %	131.5 %	129.2 %
	Weighted average	40.6 %	39.7 %	39.8 %	40.6 %	42.6 %	43.2 %	43.2 %	40.1 %	41.6 %	41.8 %	41.5 %	41.6 %	42.7 %	43.6 %	45.5 %	46.0 %	47.7 %	47.2 %	47.3 %
	First quartile	35.6 %	35.0 %	33.7 %	35.3 %	37.5 %	39.4 %	38.5 %	35.0 %	35.2 %	36.3 %	36.0 %	36.6 %	36.1 %	39.4 %	41.4 %	41.2 %	40.5 %	40.0 %	40.6 %
36 – Tier 1 capital to (total assets – intangible assets)	Median	49.7 %	49.5 %	43.8 %	47.4 %	47.9 %	48.8 %	48.3 %	44.6 %	46.0 %	47.8 %	43.3 %	46.9 %	49.2 %	50.9 %	50.6 %	52.6 %	54.3 %	53.4 %	54.9 %
	Third quartile	59.2 %	58.1 %	56.8 %	58.1 %	59.9 %	60.3 %	57.7 %	56.1 %	56.4 %	56.6 %	56.3 %	55.9 %	57.9 %	60.8 %	60.8 %	62.4 %	62.4 %	63.3 %	65.1 %
	Weighted average	4.2 %	4.3 %	4.3 %	4.2 %	4.5 %	4.6 %	4.6 %	4.4 %	4.4 %	4.5 %	4.5 %	4.5 %	4.7 %	4.7 %	4.9 %	5.0 %	5.1 %	4.7 %	4.8 %
45 – Debt-to-equity ratio	First quartile	3.9 %	4.0 %	4.0 %	3.9 %	4.1 %	4.1 %	4.1 %	3.9 %	3.8 %	3.9 %	4.1 %	4.1 %	4.2 %	4.3 %	4.5 %	4.5 %	4.6 %	4.4 %	4.5 %
	Median	5.5 %	5.2 %	5.1 %	5.0 %	5.3 %	5.2 %	5.2 %	5.0 %	4.6 %	4.8 %	5.1 %	4.9 %	5.1 %	5.4 %	5.4 %	5.5 %	5.5 %	5.1 %	5.3 %
	Third quartile	5.9 %	6.1 %	5.9 %	5.9 %	6.2 %	6.3 %	6.1 %	6.2 %	5.9 %	6.0 %	6.2 %	6.3 %	6.3 %	6.7 %	6.8 %	6.6 %	6.7 %	6.5 %	6.5 %
46 – Off-balance sheet items to total assets	Weighted average	18.7	19.2	19.4	19.2	18.2	17.8	17.9	19.4	19.6	19.1	19.4	19.1	18.1	17.9	17.5	17.0	16.5	16.6	16.1
	First quartile	12.0	12.6	13.1	12.8	12.3	12.0	12.7	13.1	13.6	13.2	13.6	13.5	13.3	12.7	12.5	12.6	12.1	12.5	11.9
	Median	14.9	15.3	16.0	16.1	16.6	16.0	17.2	17.2	18.4	18.1	18.1	17.7	16.2	15.9	16.0	15.6	15.9	16.0	15.6
46 – Off-balance sheet items to total assets	Third quartile	22.6	23.0	24.4	22.8	22.9	22.5	21.7	25.1	27.5	25.0	24.1	24.1	22.7	22.1	22.3	21.4	19.6	20.1	19.2
	Weighted average	18.1 %	17.7 %	17.6 %	17.3 %	17.7 %	17.4 %	17.3 %	16.3 %	18.6 %	17.8 %	17.7 %	16.8 %	17.4 %	17.6 %	18.1 %	18.6 %	19.0 %	18.7 %	18.8 %
	First quartile	8.9 %	8.5 %	8.2 %	8.2 %	8.3 %	7.8 %	8.0 %	7.7 %	8.8 %	8.3 %	8.3 %	7.7 %	7.4 %	8.0 %	7.6 %	7.8 %	7.7 %	8.3 %	8.2 %
46 – Off-balance sheet items to total assets	Median	14.7 %	14.4 %	14.2 %	14.2 %	14.0 %	14.1 %	13.8 %	13.4 %	15.1 %	14.6 %	14.7 %	14.6 %	14.7 %	14.5 %	14.7 %	14.9 %	15.2 %	14.8 %	14.3 %
	Third quartile	20.8 %	20.0 %	19.8 %	20.3 %	19.1 %	19.0 %	18.5 %	17.4 %	19.1 %	19.9 %	19.7 %	19.1 %	18.5 %	19.5 %	20.4 %	21.7 %	22.2 %	22.3 %	21.3 %

BALANCE SHEET STRUCTURE

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