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Acronyms

ACOFL	Average Cost on Financial Liabilities
AIFM	Alternative Investment Fund Managers
AIFMD	Alternative Investment Fund Managers Directive
AMA	Advanced Measurement Approach
APB	Associação Portuguesa de Bancos
AROFA	Average Return on Financial Assets
ATM	Automated Teller Machine
BCBS	Basel Committee on Banking Supervision
BdP	Banco de Portugal
CCPs	Central Counterparties
CIRC	Código do Imposto sobre o Rendimento das Pessoas Colectivas
CIRE	Code on Insolvency and Recovery of Companies
CIS	Stamp Duty Code
CIRS	Personal Income Tax Code
CMVM	Comissão do Mercado de Valores Mobiliários
CPC	Code of Civil Procedure
CRA	Credit Rating Agency
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSDs	Central Securities Depositories
CSMA	Customer Services and Market Activities
CTI	Cost-to-income
DGI	Directorate-General for Taxation
D-SIBs	Domestic Systemically Important Banks
E	Equity
EAP	European Adjustment Programme
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
EIOPA	European Insurance and Occupational Pensions Authority
EMIR	European Market Infrastructure Regulation
EMU	European Monetary Union

ESM	European Stability Mechanism
ESMA	European Securities and Markets Authority
ETF	Exchange Traded Fund
EU	European Union
EUR	Euro
FA	Financial Assets
FAP	Financial Adjustment Programme
FGD	Deposit Guarantee Fund
FL	Financial Liabilities
FSB	Financial Stability Board
GDP	Gross Domestic Product
GOR	Gross Operating Result
G-SIBs	Global Systemically Important Banks
G-SIFIs	Global Systemically Important Financial Institutions
IAIS	International Association of Insurance Supervisors
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IMI	Municipal Property Tax
IOSCO	International Organization of Securities Commission
IRC	Personal Income Tax
IRS	Corporate Income Tax
ISE	Interest and Similar Expenses
ISI	Interest and Similar Income
JF	Joint Forum
LTRO	Long-Term Refinancing Operations
MiFID	Markets in Financial Instruments Directive
MRO	Main Refinancing Operations
NGCSM	Net Gains from Customer Services and Market Activities
NGFC	Net Gains from Fees and Commissions
NIBT	Net Income Before Taxes
NII	Net Interest Income
OC	Operating Costs
OI	Operating Income

OIP	On-Site Inspections Programme
OMT	Outright Monetary Transactions
OR	Other Results
OTC	Over-the-counter
PARI	Default Risk Action Plan
PBS	Portugues Banking System
PERSI	Extrajudicial Default Regularisation Procedure
PI	Provisions and Impairments
POS	Point of Sale
PRIPs	Packaged Retail Investment Products
RGICSF	Legal Framework on Credit Institutions and Financial Companies
ROA	Return on Assets
ROE	Return on Equity
ROFA	Return on Financial Assets
SAMS	Serviço de Assistência Médico-Social (Medical and Social Assistance Service)
SIC	Standing Interpretations Committee
SIFI	Systemically Important Financial Institution
SIP	Special Inspections Programme
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
TA	Total Assets
UCITS	Undertakings for Collective Investment in Transferable Securities
USD	United States Dollar
VAR	Value-at-risk
VAT	Value-Added Tax

Executive Summary

In 2012, the activity of the 22 Members of the Portuguese Banking Association (APB), which at the end of the year represented 96.1% of the total consolidated bank assets in Portugal, was determined and strongly conditioned by an unfavourable macroeconomic framework in Portugal and abroad, a financial framework of high volatility and aversion to risk and countless legal and regulatory restrictions and obligations. In spite of this highly adverse scenario, the member institutions managed to increase their solvency, make their funding structure more stable, promote a more meticulous policy on allocation of resources and improve their operating efficiency.

2012 was a particularly difficult year for financial institutions. The successive downward revisions of world growth scenarios along with the sovereign debt crisis in the euro area and greater fears about the reversibility of the single currency shook confidence all over the world, especially in the peripheral European countries. Combined with the ongoing adjustment processes, generally more restricted fiscal policies, an increase in unemployment and moderate foreign demand, retraction of business activity in the euro area became a reality.

For Portugal, the fragility of foreign economies (especially those in Europe) and the limitations resulting from the international financial adjustment plan that the country had been undergoing since 2011 were the main obstacles to Portugal's economic growth. Efforts towards fiscal consolidation, an increase in the tax burden and the implementation of austerity measures leading to progressive deleveraging of the economy had a substantial negative impact on domestic demand and economic agents. There was an accentuated deterioration in the business world, a drop in gross fixed capital formation, an increase in the unemployment rate and a reduction in households' disposable income and the Portuguese economy contracted 3.2% in real terms in 2012.

The climate of instability in the financial markets continued, along with a negative sentiment about the future of the European project, especially in the first half of the year. Aversion to risk in the public debt market resulted in a fall in the implicit interest rates of bonds in the reference markets while the peripheral countries' risk premiums reached new highs. It was only in the second half of the year that these risks were toned down by measures defined in the euro area in the meantime, particularly after a more interventional stance was taken by the European Central Bank. In Portugal, this calming of the risk was reflected by a substantial reduction in yields on medium- and long-term treasury bonds that brought the Portuguese Treasury back to the primary public debt market in 2013.

2012 also witnessed a national and international agenda packed full of legislation aimed at the reform of the financial system following the global financial crisis.

More specifically, the deterioration in the country's economic situation adversely affected private citizens' solvency and capacity to service their debts. This, in turn, had serious repercussions on the legislator's concerns and, during the year, there were a large number of legislative initiatives in the area of consumer protection, which can be expected to have negative effects on financial institutions' profitability.

Another set of initiatives was aimed at increasing the powers of Banco de Portugal in anticipation of the Draft Directive for the Recovery and Resolution of Credit Institutions, which is currently being discussed at European level. Financial institutions were now subject to stricter reporting measures (obligation to submit annual recovery plans and provide the information necessary for drafting resolution plans), loss of autonomy in managing the business in the event of a very serious financial situation and the obligation to contribute to a Resolution Fund, the funding system of which was approved in 2013.

At European level, the treaty establishing the Stability Mechanism came into effect. At the same time, the European legislator dealt with remedying the shortcomings found in supervision following the global financial crisis. The spread of the crisis, which was worsened by fiscal imbalances in some euro area countries, exposed the problem of an interconnection between sovereign risk and banking risk, which has resulted in the progressive fragmentation of the financial market in the area. This process has caused serious difficulties in access to financing for the economies of the affected Member States and has hindered their economic recovery and boosted the search for a general solution to restore confidence and the integrity of the euro area's banking sector. The idea of creating a banking union, which would entail creating a single supervision mechanism with one set of prudential rules, known as the Single Rulebook, and the creation of a single resolution mechanism, appeared in 2012 as a solution to these problems.

At the same time, the global financial crisis brought to light other problems, which required reinforcing the financial institutions' resilience in terms of capital and liquidity. As a result, the prudential requirements for credit institutions made it necessary to adapt the reform of the regulation system, known as Basel III, to the circumstances in Europe. 2012 witnessed trialogue negotiations of a compromise text between the European Commission, European Parliament and Presidency of the Council.

Meanwhile, the very paradigm of the banking business in Europe was called into question, leading the authorities to look at alternatives for the reform of the banking sector's structure. The issues of macro-prudential regulation and supervision of the parallel banking system were addressed on a global scale.

In this scenario, as a result of the slump in economic activity and some specific demands made on the banking sector by Banco de Portugal under the Economic Adjustment Programme (reduction in the transformation ratio to 120% by the end of 2014 and an increase in solvency levels to 10% by the end of 2012), the APB member institutions' aggregate assets went down considerably in 2012, falling to levels lower than in 2009, following a trend that began in 2011. Domestic financial institutions and subsidiaries, especially the large ones, contributed considerably to this trend. The cause of the contraction in banking activity in 2012 was a reduction in almost all asset items, particularly the stock of customer loans.

A reduction in demand for loans from private customers and companies, credit portfolio sale operations mainly to restructuring funds, the deterioration of impairments and higher provisions due to the increase in the credit risk were essential factors in the reduction in net stock of customer loans. It is true that the challenge posed to the banking sector to rebalance its balance sheets in view of restrictions on access to the international debt and capital markets and comply with the transformation and capital ratios imposed by the regulators had an impact on the supply of credit by financial institutions. This impact resulted in more selective lending policies and therefore in a reorientation of resources to credits of better use and quality rather than the option to generally reduce lending to the economy by financial institutions.

These effects influenced all segments in 2012, although they were felt more in loans to companies and the public administration. According to Banco de Portugal data, and as in 2011, credit contracted most in the small private company segment, mainly due to the weight of the construction and real estate sectors. Also according to Banco de Portugal, the retraction in private spending, an increase in saving and a rise in spreads were decisive in reducing borrowing. While the demand effect dominated for mortgages, as the criteria for granting them were no stricter in 2012, the supply effect for consumer credit was felt at the same time, given the high risk of default on this type of loan, particularly when the unemployment rate is higher and expected to go up even further.

A positive aspect of the year was, however, the support that Portuguese banks were prepared to go on providing to the economy, even though it was on highly adverse terms, while this support was increasingly channelled to more efficient, profitable uses.

Other very positive aspects of the member institutions in 2012 were a rise in solvency levels, a more stable funding structure and better levels of operating efficiency.

The considerable reinforcement of the member institutions' solvency in 2012 was due to a number of factors. Firstly, it was a result of compliance with new capital requirements in Portugal and the rest of Europe. These new requirements arose from the European Banking Authority Capital Exercise in October 2011, which imposed a minimum core Tier 1 ratio of 9%, an additional temporary core capital buffer to offset exposure to sovereign debt by June 2012. In Portugal, pursuant to the Financial Adjustment Programme (FAP), Banco de Portugal increased the minimum core Tier 1 ratio limit to 10%, to be met by the end of 2012. Secondly, compliance with these requirements also entailed the need to record impairments and increase provisions as a result of the Special Inspection Programme (SIP) and the transfer of pension funds to Social Security, which took place in 2011, but were only accounted for in the first half of 2012 for prudential purposes.

The increase in solvency levels was essentially achieved (around 90%) with very rigorous recapitalisation processes undertaken by several institutions. They involved raising capital subscribed by private entities (to around 2 billion euros), capital increases and the issue of hybrid instruments qualifying as core Tier 1 underwritten by the state, totalling 7.25 billion euros. Of the amount provided by the state, 5.6 billion euros were financed via the 12-billion-euro public recapitalisation line provided for in the FAP. A reduction in risk-weighted assets in 2012 due to the deleverage effect and, particularly a reduction in the average risk of assets also made it possible to reduce treasury stock requirements, which in turn contributed to an increase in solvency levels. Thanks to these steps, the member institutions ended 2012 with aggregate core Tier 1 and solvency ratios of 11.7% and 12.9% respectively, both 2.3 percentage points above 2011 levels.

Greater stability was also achieved in the member institutions' funding structure in 2012. Customer deposits continued to be the main source of borrowing and accounted for almost half the member institutions' funding in 2012. In terms of composition, customer deposits included more term deposits than other types (term deposits rose and other types fell), which reinforced the stability and solidity of this source.

The favourable performance of customer deposits (thanks to an increase in savings and the banks' active policies to attract them) was important in covering part of the member institutions' funding needs. At the same time as a lower credit stock, the credit to deposit ratio fell from 156.8%

in 2009 to 130.7% in 2012. Banco de Portugal expects the transformation ratio to be close to 120% for the eight largest banking groups at the end of 2014.

Furthermore, persistent difficulty in accessing the international debt (interbank and debt securities) and capital markets continued during the year and resulted in an ongoing reduction in the stock of debt securities and non-securitised debt. This difficulty forced the banks to deleverage their investment portfolios, whose degree of coverage by these sources was slightly over 100% in 2012. It also meant that deposits from central banks were once again an important alternative in guaranteeing coverage of the funding gap.

Dependence on central banks increased in 2012, particularly in the first half of the year, because of high participation in the second European Central Bank refinancing operation, which was extended to three years, as part of its non-conventional monetary policy measures. Wide subscription of this long-term operation increased the maturity of funding from the Eurosystem, which in turn reduced the refinancing risk and made the banks' funding structure more stable.

Finally, there was a general improvement in the member institutions' aggregate levels of operating efficiency. 2012 marked a turning point for the financial institutions' main efficiency indicator, their cost-to-income ratio. Contrary to what had been happening since 2010, the cost-to-income went down, thanks to a slight improvement in operating income but mainly to substantial containment of costs. This turnaround was also due to significant gains in competitiveness in the larger institutions, thanks to the current restructuring of financial institutions with state aid.

In contrast to these positive aspects, the climate in which the member institutions operated in 2012 still had a negative impact on the banks' profitability. In 2012, pre-tax return on equity was -12.2%, as opposed to 7.52% in 2011. It was the effect of pre-tax return on assets that most adversely affected profitability, as the financial leverage effect only had a low negative impact.

In spite of the efforts made to capitalise during the year, average equity fell proportionally more than average total assets and so the financial leverage ratio rose 3.4% against 2011. Two factors contributed to this reduction. On the one hand, there was a net loss in 2011, deeply affected by the impact of the extraordinary measures taken at the end of the year and its consequent inclusion in retained earnings. On the other were the losses in the year.

Pre-tax return on assets fell 57.5% in 2012. This unfavourable performance was due to deterioration in the macroeconomic scenario in Portugal and a series of exogenous factors that placed high pressure on the member institutions' pre-tax result. They recorded a loss for the second year running, reflecting an increase in the credit risk (resulting from growth in impairments) and lowering of net interest income. The historically low Euribor interest rates, which are used as a reference in most lending operations, the low number of new loan operations to offset new market conditions, an increase in overdue loans following a rise in defaults, the high remuneration of deposits and high interest rates paid for financing via instruments subscribed by the state placed negative pressure on net interest income in 2012 and considerably outweighed the positive effect of the fall in the cost of funding from the European Central Bank.

The highly negative performance of net interest income was slightly offset by growth in profits from market activities, which benefitted from gains achieved with the sale of debt securities, mainly public debt, and an appreciation in the stock market.

Apart from net interest income, pre-tax results were adversely affected by an increase in the annual amount of impairments and provisions. In fact, the impairments and provisions set up for credit in 2012 totalled 5 billion euros, which reflected the deterioration of the credit risk in Portugal and inclusion of the results of the On-Site Inspection Programme conducted by Banco de Portugal during the year. This inspection focused on the eight largest Portuguese banking groups' exposure to companies in the construction and real estate sectors. Investments in subsidiaries and associates also affected this item.

In contrast, other factors mitigated these negative impacts on pre-tax results. In 2012, operating costs continued their downward trend of the previous year, thanks to a stricter policy of rationalisation of the member institutions' operating structure. The policy's aim was to improve their efficiency and focused particularly on reducing personnel costs (with a reduction in personnel working in domestic activity, especially following the closure of branches).

Finally, a reference goes to the Members' international activity. Contrary to domestic activity, there was no deleveraging policy or consequent reduction in assets and their international business increased in 2012. Expansion abroad was based essentially on attracting customer deposits, which helped to reinforce the stability of sources of funding and reduce the transformation ratio, as the growth of customer loans, though positive, was not as substantial.

This performance affected results, however. Net interest income fell in the wake of the transformation ratio and general reduction in yields on public debt securities and Euribor. Operating costs also rose, but it was the increase in annual impairments and provisions reflecting the higher credit risk in some countries in which the Members operate that had the greatest impact on results.

In view of current forecasts of macroeconomic growth in Europe and Portugal and of stricter credit quality control requirements, due to the recessive scenario that is expected to continue in 2013, there is likely to be some stagnation in member institutions return and a growing effort on their part to increase their solvency and improve their sources of funding.

I. Foreword

This Activity Report refers to 2012 and describes the aggregate banking activity of the financial institutions making up the APB's Members[1].

Our analysis of this activity is based on the macroeconomic, regulatory and legal background at the time. 2012 was particularly difficult for the member institutions, with successive downgrades of world growth scenarios and continuing difficulty in access to international financial markets. The implementation of the measures set out in the Financial Adjustment Programme as a result of the Portuguese government's request for foreign financial assistance in 2011, an increase in the tax burden, a contraction in domestic demand, deterioration in economic activity, a rising unemployment rate and low interest rates were some of the factors that considerably limited the Portuguese financial institutions' performance.

This Activity Report is based on aggregate financial and non-financial information on business activity in Portugal and abroad (through branches and representative offices) by each financial institution (banks, savings banks and mutual agricultural savings banks) belonging to the APB. This aggregate is obtained by adding up each institution's individual financial statements and other management indicators. Exceptions are the aggregate information used to analyse international business activity of Members with a significant presence abroad and the solvency analysis, as they refer to consolidated data.

The analyses concentrate on member institutions' performance in 2012, though always viewed in a perspective of evolution over time, while they are also put into a temporal context. Please note that, based on the information and details provided by the Members, more detailed analyses may be limited to a more restricted sample or period of analysis.

The sample includes 32 financial institutions of the 34[2] in the group of 22 APB Members on 31 December 2012 (see Chart 1, p. 3). This sample was redefined whenever necessary for the comparability of some results. These situations are clearly pointed out in the report or footnotes.

These are some of the events affecting Members in 2012:

- There was a merger between two Members. In June 2012, Banco BIC Português, S.A. acquired Banco Português de Negócios, S.A. from the Portuguese state. In December, the merger by incorporation of the acquiring company (Banco BIC) into the acquired company (BPN) was completed with the total transfer of its assets. The new company took the name Banco BIC Português, S.A.[3].

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[1] These institutions are referred to as member institutions in this report.

[2] The two financial institutions not included are NCG Banco, S.A., Sucursal em Portugal, as it was undergoing internal restructuring and was unable to provide the data, and Banco Efisa, S.A., as it did not send information in time.

[3] As a result of the merger, Banco BIC (encompassing BPN) was included in the sample for the purpose of aggregating financial information for 2012. The comparative data for 2011 only include Banco BIC's original financial statements (without BPN) in order to maintain the conclusions set out in the previous Activity Report. The comparative data prior to 2012 in the non-financial information have been adjusted in terms of the number of branches and employees and capacity indicators to reflect BPN's past activity.

- The Banco Português de Negócios Group, which included BPN and Efisa, ceased to exist and Banco Efisa, S.A. became a separate Member.
- The Banif Group was restructured in the second half of 2012 resulting in a merger by incorporation of Banif SGPS, S.A. into Banif – Banco Internacional do Funchal, S.A., which had the effect of simplifying the group.
- BNP Wealth Management, S.A., Sucursal em Portugal, which belonged to the BNP Paribas Group, closed in December 2012[4].
- This Activity Report is structured as follows. Chapter II describes the macroeconomic background and Chapter III details the legal and regulatory framework that influenced Members' activity during the year. Chapter IV characterises the member institutions, including changes in their numbers in recent years, and analyses their representativity in the Portuguese banking system. Chapter V analyses their human resources and Chapter VI the degree of banking coverage. Chapter VII analyses the member institutions' performance in a detailed study of the main items on their balance sheets and income statements. This chapter also includes an analysis of return and solvency. Chapter VIII provides the main efficiency indicators, while Chapter IX addresses the consolidated international activity of Members with a significant presence abroad.

[4] Because of this operation, for the sake of comparison, the data on BNP Wealth Management were excluded from years prior to 2012.

Chart 1: Index of the APB Members and of the financial institutions that belonged to them as at 31 December 2012

Financial institutions - Domestic

Members	Financial Institutions	Acronyms
Banco BIC Português, S.A.	Banco BIC Português, S.A.	Banco BIC
Banco BPI, S.A.	Banco BPI, S.A.	Banco BPI
	Banco Português de Investimento, S.A.	BPI
Banco Comercial Português, S.A.	Banco Comercial Português, S.A.	Millennium bcp
	Banco ActivoBank, S.A.	Activobank
	Banco de Investimento Imobiliário, S.A.	BII
Banco de Investimento Global, S.A.	Banco de Investimento Global, S.A.	BIG
Banco Efisa, S.A.	Banco Efisa, S.A.	Efisa
Banco Espírito Santo, S.A.	Banco Espírito Santo, S.A.	BES
	Banco Espírito Santo de Investimento, S.A.	Besi
	Banco Espírito Santo dos Açores, S.A.	BAC
	BEST - Banco Electrónico de Serviço Total, S.A.	Best
Banco Finantia, S.A.	Banco Finantia, S.A.	Finantia
Banco Invest, S.A.	Banco Invest, S.A.	Invest
Banif - Banco Internacional do Funchal, S.A.	Banif - Banco Internacional do Funchal, S.A.	Banif
	Banif - Banco de Investimento, S.A.	Banif Inv
	Banco Banif Mais, S.A.	Banif Mais
Caixa Central - Caixa Central de Crédito Agrícola Mútuo, CRL	Caixa Central - Caixa Central de Crédito Agrícola Mútuo, CRL	CCCAM

Caixa Económica Montepio Geral	Caixa Económica Montepio Geral Finibanco, S.A.	Montepio Finibanco
Caixa Geral de Depósitos, S.A.	Caixa Geral de Depósitos, S.A. Caixa - Banco de Investimento, S.A.	CGD CBI

Financial institutions – Subsidiaries

Members	Financial Institutions	Acronyms
Banco Bilbao Vizcaya Argentaria (Portugal), S.A.	Banco Bilbao Vizcaya Argentaria (Portugal), S.A.	BBVA
Banco Itaú BBA Internacional, S.A.	Banco Itaú BBA Internacional, S.A.	Itaú
Banco Popular Portugal, S.A.	Banco Popular Portugal, S.A.	Popular
Banco Santander Consumer Portugal, S.A.	Banco Santander Consumer Portugal, S.A.	Sant Consumer
Banco Santander Totta, S.A.	Banco Santander Totta, S.A.	Santander Totta

Financial institutions – Branch offices

Members	Financial Institutions	Acronyms
Banco do Brasil AG - Sucursal em Portugal	Banco do Brasil AG - Sucursal em Portugal	BB
Barclays Bank PLC, Sucursal em Portugal	Barclays Bank PLC, Sucursal em Portugal	Barclays
BNP Paribas	BNP Paribas	BNP
	BNP Paribas Securities Services, S.A. - Sucursal em Portugal	BNP SS
	Fortis Bank – Sucursal em Portugal	Fortis
NCG Banco, S.A., Sucursal em Portugal	NCG Banco, S.A., Sucursal em Portugal	NCG
Deutsche Bank AG, Sucursal em Portugal	Deutsche Bank AG, Sucursal em Portugal	Deutsche Bank

Source: APB

II. Macroeconomic Background[5]

2012 was once again influenced by a particularly difficult international financial environment, which reflected on confidence and overall activity indicators. During the year, growth scenarios were successively downgraded and the International Monetary Fund (IMF) estimated in its *World Economic Outlook* of April 2013 that overall growth had fallen 3.2%, a slowdown in relation to the previous year (4%) and to an initial forecast of 4% made in late 2011. The developed economies showed historically low expansion levels (1.2% against 1.6% in 2011), but it was the emerging countries that offered the most negative surprises (China, with its lowest growth since the late 1990s at 7.8% and Brazil, which grew only 0.9%), showing an inability to break free from the performance of the large economic blocs, in spite to their growing contribution to overall performance.

The first half of the year was overshadowed by the euro sovereign debt crisis, which limited the effects of the European Central Bank's (ECB) accommodative monetary policy. The political crisis and elections in Greece and the negotiations on pardoning the Greek debt were basic milestones in the period due to growing fears of the reversibility of the euro. As a result, there were significant drops in confidence not only in the European Union (EU) but also in the other economic blocs. In addition to the ongoing balance sheet adjustment process, moderate foreign demand, more restrictive fiscal policy and higher unemployment explained the contraction in activity in the euro area (where the gross domestic product (GDP) decreased by 0.6% during the year).

The restructuring of Greece's debt, which resulted in a pardon of 50% of the face value for private creditors, while the official creditors (ECB, IMF and European Commission) kept their preferred status, resulted in even less confidence in the peripheral countries receiving assistance. Market fragmentation increased, creating a more restrictive financial environment for the countries in question. Spain was one of the states that suffered most from contagion effects and a combination of a number of negative factors: the Greek crisis, a new reform in the Spanish banking sector and nationalisation of the fourth largest private bank in terms of assets. These fears resulted in a formal request for foreign assistance to recapitalise the Spanish banking system, which took place in the second half of 2012.

The so-called long-tail effects were diluted after the ECB's President stated in July that he would do anything to save the euro. This position resulted in an announcement of a purchase programme for sovereign debt with maturities of up to three years (OMT[6]) for unlimited amounts, provided that there was an overall or preventive adjustment programme under the European Financial Stabilisation Mechanism (EFSM)/ European Financial Stability Facility (EFSF), which were later replaced by the European Stability Mechanism (ESM). The ECB also agreed to accept a status equivalent to that of the investors and waived its senior debt rights. There was an obvious improvement in sentiment resulting from these monetary authority decisions, as the risk premium of the peripheral countries began to fall in summer 2012, even though the OMT Programme had not been activated.

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[5] The Portuguese Banking Association would like to thank the Economic and Financial Study Office at Banco BPI, S.A. for preparing this chapter on the macroeconomic background.

[6] Outright monetary transactions.

The fall in risk premiums of the sovereign debts under scrutiny, the controlled situation in Greece, whose financing conditions were revised by the EU/IMF when they reduced interest and extended debt maturities, and the successful advance of recapitalisation plans and intervention in the Spanish banking system reduced tensions in the international financial markets. This more favourable context had positive impacts on the financial institutions' balance sheets and results in the countries receiving assistance, as they were more exposed to investment in public debt securities in their countries. This made it possible for some companies and banks in the peripheral countries to return to the wholesale debt markets. This included Portuguese companies and banks and was an important step forward in normalising the funding situation.

In 2013, Standard & Poor’s changed its outlook rating for Ireland's and Portugal's debt to stable.

The Summit of Heads of State or of Government in June 2012 decided to reinforce the architecture of Monetary Union with greater political, banking and taxation integration. The first steps towards banking union were thus taken. There was also an agreement to create a single supervisory mechanism under the auspices of the European Central Bank, which is expected to go into operation in the fourth quarter of 2014. A proposal for a Directive on the Recovery and Resolution of Credit Institutions, which was published in 2012 and is to come into effect in 2015, laid the foundation for a single resolution mechanism that had been taking shape in 2013. All these initiatives are steps towards breaking the link between sovereign risk and the banking system's risk.

II.1. Financial markets

2012 witnessed high volatility in the financial markets and was dominated by high aversion to risk due to fears of the reversibility of Economic and Monetary Union (EMU) in the first six months and mitigation of these risks in the second half, thanks to measures defined in the euro area in the meantime. The EUR/USD exchange rate went from 1.29 at the start of the year to 1.20 mid-year and then recovered to 1.32 at the end. Sentiment with regard to the European single currency remained unfavourable, however, as a reflection of pessimism in the first half of 2013 as to Europe's economic situation and the cohesion of the European project, which was shaken by Cyprus's turbulent bailout.

Aversion to risk in the public debt market led to a fall to under 2% in the implicit interest rates of bonds in the benchmark markets, while the peripheral countries' risk premiums hit new highs. In the refuge markets, high liquidity, low short-term interest rates, anaemic growth, elasticity in the factor markets and absence of inflationary pressure justified this development. Spreads in the peripheral countries only went down after the ECB took a more interventional stance. There were significant gains in the Portuguese public debt market during the year. The yield on 10-year treasury bonds was 7.2% at the end of 2012, as opposed to 13.4% in December 2011 and 5-year interest rates went down from 16.4% to 5.3%. This movement was behind the Portuguese Treasury's return to the primary public debt market in 2013.

Accommodative monetary policies in the developed economies were stepped up and the central banks continued to resort to non-conventional instruments after exhaustion of the interest rate instrument. The Anglo-Saxon central banks stepped up purchases of assets and the ECB reduced its main refinancing rate to 0.5% in 2013. In 2012, the ECB: i) abolished rating limits and extended the rules on acceptance of eligible collateral for financing operations, ii) set up a public debt purchase programme for unlimited amounts in the secondary market and iii) reduced the interest rate on banks' ECB deposits to zero. The financial system's substantial liquidity was reflected in a reduction in Euribor rates and the six-month indexer went from 1.62% in December 2011 to 0.32% at the end of 2012. There was a similar movement in the United States and the six-month Libor for the dollar fell from 1.58% to 0.22% at the end of 2012.

II.2. Portugal

Portugal's GDP decreased 3.2% in 2012, after a 1.6% contraction in 2011. The limitations resulting from the fact that Portugal was under an international financial assistance plan – especially its efforts at fiscal consolidation and the deleveraging process - and the fragility of foreign economies were the main limitations on growth. The contributions of domestic and net foreign demand were very different, with domestic demand taking seven percentage points off GDP and net foreign demand partially offsetting this, with a positive contribution of 3.9 p.p. Net foreign demand benefitted from a fall in imports and a good performance by exports of goods and services. Gains in competitiveness due to a fall in labour unit costs and greater focus on searching for alternative markets resulted in gains in market share and expansion of sales to large markets (e.g. the United States of America) or those with high growth potential (e.g. China, Brazil, Angola and other PALOPs[7], North Africa, etc).

On the positive side, Portugal had achieved a practically balanced external financial situation by the end of the year – slim foreign financing capacity, reflecting slightly positive current and capital balances.

This external adjustment was a good sign and favoured dilution of the stock of foreign borrowing (more than 100% of GDP). Nonetheless, the sharp fall in domestic demand limited fiscal performance and made it necessary to take extraordinary measures to meet the FAP targets. Public debt was 4.7% of GDP in 2012 according to the adjustment programme criteria, better than the required 5%. In the national accounts, the 2012 fiscal balance was -6.4% of GDP according to Eurostat criteria, however. Recognition of the government's fiscal consolidation performance resulted in a revision of goals for the deficit, which are currently 5.5% (4.5% before) of GDP in 2013 and 4% (2.5% before) in 2014. Excluding non-recurring measures, the fiscal balance went from -7.4% in 2011 to -5.8% of GDP in 2012. Around 2/3 of fiscal consolidation in the last two years reflects savings on the expenditure side which, excluding interest, went down 15.5%, i.e. around 13 billion euros against 2010, when it reached its highest ever. A reduction in personnel costs and purchase of goods and services largely explains most of this trend. Some of these reductions in expenditure were, however, non-recurring, as shown by the expected increase in public spending against GDP in 2013.

Considerable progress was made in implementing structural reforms, such as those in the home rental market, which fostered geographical mobility, and in the labour market, which increased flexibility and duality. Some steps have been taken in the reform of the judicial system and

[7] Portuguese-speaking African countries.

there has also been progress in the public administration, where the number of departments and bodies has been reduced, thereby simplifying the structure and fostering greater efficiency.

On the negative side, the employment market deteriorated and the average unemployment rate was 15.7%, which was 2.9 percentage points higher than in 2011.

The inflation rate went down to 2.8% in average terms in 2012, reflecting the increase in indirect taxes at the beginning of the year.

Ongoing efforts were made to reduce the imbalances in the Portuguese banks' funding in 2012. There was well-ordered deleveraging (the credit/deposit ratio was 127.5% in December 2012) in a more restrictive policy on loans, selective sale of non-strategic assets and no distribution of dividends to shareholders, among others. Of the 12 billion euros available in the Bank Recapitalisation Fund, along the lines of the FAP, around 5.8 billion were being used at the end of the year. As a result, the overall core Tier 1 capital ratio for the banking sector was 11.5%, thereby meeting the 10% required set out in the FAP.

Deposits in the resident non-financial private sector (private and business customers) grew 3.8% in annual average terms in 2012 (5.3% in 2011). The performance can be explained by an increase in private customers' deposits (6.1% in annual average terms), while non-financial companies' deposits fell by around 4.5%. Deposits in the private non-financial sector went down during the year and had fallen to 3.7% in December year on year, more markedly in the business sector. Private customers' remained at practically the same levels as at the end of 2011 (year on year). A slight increase in term deposits offset the reduction in current account deposits. Deposits from non-financial companies went down in annual average terms (4.5%) and year on year (18.8% in December). On the one hand, a reduction in households' disposable income affected their ability to save. Nonetheless, there was an additional effort towards saving in this sector, as demonstrated in the increase in the savings rate. This was mainly due to precautionary measures and changes in consumption patterns and preferences. On the other hand, efforts towards deleveraging and restructuring in the business sector resulted in predominant recourse to own funds, which conditioned the performance of deposits from the sector. The performance of deposits also benefited from the appearance of alternative investments, which reflected an improvement in the higher-risk financial asset market sentiment and from a cautious policy on remuneration of deposits followed by the majority of the financial institutions. The cost of new term deposit operations for private customers fell from 3.6% (2011 average) to 3.2% (2012 average) and was 2.4% in December.

In 2012, loans and advances to residents showed a clear downward trend, in line with the desired reduction in borrowing in all sectors of economic activity. In December, this aggregate fell 6.6% year on year, similar to the annual average. Excluding the public administration, lending went down by 6.1%. The stock of credit fell in all sectors, particularly non-financial businesses (7.4%) and private customers 4% (mortgages 3%), which accounted for around 89% of bank credit granted.

The trend towards higher default rates continued in all sectors of activity, although there was a clear slowdown in the growth of non-performing loans during the year. The default rate for private customers and non-financial companies was 6.3% at year end, as opposed to 4.6% at the end of 2011. This ratio rose from 3.3% to 3.8% in the private customer segment. It was 2.1% in mortgages, which represent a substantial part of loans granted by banks. Default by non-financial companies went from 6% at the end of 2011 to 9.4% in December 2012, the worst sectors being construction (18.6%), real estate (11.6%) and trade (12.3%).

III. Legal and Regulatory Framework

2012 witnessed a very full agenda of legislation as part of the reform of the financial system following the global financial crisis. These initiatives can be divided into three main groups: (i) Portuguese laws and regulations associated with or with an impact on banking (Annex A), (ii) international public consultation, proposals for legislation and laws (Annex B) and (iii) the main changes to international accounting standards (Annex C).

III.1. Laws and regulations in Portugal[8]

The deterioration of the country's economic situation adversely affected the solvency of private customers and their ability to service their debts, which in turn had a considerable impact on the lawmakers' concerns. In this context, there was a wide range of consumer protection legislation.

A law was passed obliging credit institutions to have a Default Risk Action Plan (PARI), with a view to early detection of a risk of default and take measures to prevent it. If default is unavoidable, credit institutions must implement the Extrajudicial Default Regularisation Procedure (PERSI) and, whenever possible, propose regularisation solutions suited to the customer's profile[9].

Other legislation allowed borrowers to use their savings/education funds to amortise or pay mortgage instalments for their own permanent residence without forfeiting the products' tax benefits and, whenever possible, avoid foreclosure in the event of default[10]. Restrictions were also imposed on credit institutions' right to terminate the contract in the event of default and defaulting borrowers were given the right to resume the contract on certain conditions[11]. The Portuguese lawmakers changed the rules on the sale of mortgaged properties in order to increase the minimum value of their sale, if it is not possible to avoid foreclosure on the mortgage[12].

The duty to provide information to customers was extended in the negotiation, conclusion and effect of mortgage agreements and connected loans[13]. Regulation CMVM[14] 2/2012 of 26 November set out that sellers of savings products must provide a document entitled *Key Investor Information*, or a subsequent document, containing information on the risks of complex financial products, in order to warn bank customers of the risks of their investment decisions.

In addition to their concerns about lenders, the lawmakers also increased the size of the Deposit Guarantee Fund (FGD). Banco de Portugal Notice 6/2012 changed the formula for calculating participating credit institutions' contributions. Pursuant to this notice, the balances of deposits recorded at the end of each month must include accrued interest for the purpose of calculating annual contributions to the fund.

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[8] Annex A presents the chronological listo f the laws and regulations that became effective in Portugal in 2012.
[9] This obligation was introduced by Decree-Law 227/2012 of 25 October which should be read in conjunction with Banco de Portugal Notice 17/2012.
[10] Changes made by Law 57/2012 of 9 November and Law 58/2012 of 9 November.
[11] Law 59/2012 of 9 November.
[12] Law 60/2012 of 9 November.
[13] Banco de Portugal Notice 16/2012.
[14] Comissão de Mercado de Valores Mobiliários (Portuguese Stock Exchange Commission).

Some measures were also introduced to make financial institutions' current management more flexible, for example their liquidity management. Following a European Central Bank decision[15], BdP published an instruction[16] making criteria for determining eligibility of assets to be used as a guarantee in Eurosystem monetary policy operations more flexible.

Additional measures were also taken to reinforce the financial soundness of credit institutions in 2012. They included a new form of public investment called contingency convertibles or COCO bonds eligible for core Tier 1 funds[17]. These changes in the law opened the door for three Portuguese banks to use these instruments in recapitalisation operations in summer 2012. The procedures required for these operations were set out in Ministerial Order 150-A/2012 of 17 May, which regulated the subscription or acquisition price of special by the state and the forms of capitalisation operations via state subscription of this new type of instrument.

Other initiatives were designed to increase Banco de Portugal's powers in anticipation of the proposal for a Directive on the Recovery and Resolution of Credit Institutions, which is currently being discussed at European level. Institutions were now subject to stricter reporting measures and loss of autonomy in management of the business in the event of a very serious financial situation.

The additional reporting requirements meant that credit institutions that were incorporated under Portuguese law[18] and authorised to receive deposits were obliged to submit recovery plans and provide the information necessary for preparing resolution plans[19]. Decree-Law 31-A/2012 of 10 February gave Banco de Portugal the power to intervene in credit institutions in situations of financial imbalance or if an institution does not meet or is at risk of not meeting the requirements it needs for continued authorisation to do business. The decree-law also complemented BdP's increased powers of intervention by establishing a Resolution Fund[20]. The fund's financing methods and calculation of participating institutions' contributions were approved in 2013[21].

Finally, the legal framework for the creation and operation of transition banks[22] was set up as an auxiliary instrument in the resolution of credit institutions. As part of the creation of a new framework for the resolution of credit institutions, a pre-judicial liquidation procedure was set up for institutions under Banco de Portugal supervision[23].

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[15] Decision BCE/2011/25.
[16] Banco de Portugal Instruction 7/2012.
[17] Instrument introduced by Law 4/2012 of 11 January and made eligible by Banco de Portugal Notice 4/2012, which amended Banco de Portugal Notice 3/2011.
[18] As a result, branches of banks with their head offices in other countries are excluded from this obligation.
[19] Obligations introduced by Banco de Portugal Notice 12/2012 on Recovery Plans and 18/2012 on Resolution Plans.
[20] The Resolution Fund's Regulations were approved by Ministerial Order 420/2012 of 21 December, which set out the rules of operation and duties of the Resolution Fund Management Commission and of the chairman of the commission.
[21] Decree-Law 24/2013 of 19 February and Banco de Portugal Notice 1/2013.
[22] Banco de Portugal Notice 13/2012.
[23] Decree-Law 31-A/2012 of 10 February.

III.2. International initiatives regulating the financial sector

As in previous years, there were international legislative initiatives aimed at reforming the financial system in 2012.

The treaty establishing the European Stability Mechanism came into effect in Europe. The mechanism is designed to allow Member States in the euro area access to financial assistance programmes in the event of sovereign crises or instability of systems caused by decapitalisation of their financial sectors. It is now the only mechanism responsible for granting financial aid to Member States and replaces the two existing ones – the European Financial Stabilisation Mechanism and the European Financial Stability Fund. Unlike these two, it is a permanent facility.

In addition to the financial support required to guarantee stability in the euro area, the European lawmakers proposed broader measures capable of offsetting the gaps identified in the European supervision process following the global financial crisis and the problems that it caused. The spread of the crisis, which was deepened by successive fiscal imbalances in some of the weaker countries in the euro area, exposed the problem of interconnection between the banking risk and sovereign risk, which has resulted in progressive fragmentation of the area's financial market. This process has created serious difficulties in access to finance by the economies of the affected Member States, hindering their economic recovery and urging the Europe's lawmakers to find an overall solution that can restore confidence in the sector and bring back the integrity of the bank market in the euro area.

The idea of creating a banking union first came up in 2012 as a solution to this problem, as it was thought that it could restore the resilience and stability that the European financial system needed to resist future crises. This union involves introducing three basic pillars: a Single Supervisory Mechanism (SSM), a Single Rulebook and a Single Resolution Mechanism (SRM).

The foundations for the first pillar were laid with the publication in September of a Proposal for a Council Regulation setting out that the prudential supervision of credit institutions in all Member States in the euro area would be coherent, effective and equitable and that the ECB, as the central bank of the euro area, with its vast experience in the field of macroeconomic and financial stability, would be the guarantor of its high quality by taking on specific prudential supervision functions and the final responsibility for the articulated, integrated functioning of the mechanism.

Meanwhile, in its conclusions in December 2012, the European Council said, "In a context where bank supervision is effectively moved to a single supervisory mechanism, a single resolution mechanism will be required, with the necessary powers to ensure that any bank in participating Member States can be resolved with the appropriate tools".

In anticipation of the creation of this single resolution mechanism, it was essential to define a minimally harmonised framework at European level establishing solutions and tools enabling the authorities to intervene early and rapidly enough in any institution experiencing financial difficulties or on the brink of insolvency in order to ensure the continuity the institution's minimum functions with the lowest possible impact on the stability of the financial system.

With this purpose in mind, In June 2012, the European Commission issued a proposal for a Directive on the Recovery and Resolution of Credit Institutions intended to replace the current national frameworks on insolvency of credit institutions by a new, common regime on the prevention, early monitoring and implementation of orderly resolution of these institutions. The European Commission was convinced that the proposed framework would prevent destabilisation of the financial markets, minimise costs to taxpayers, break down barriers to the normal functioning of the domestic market and cooperation between national authorities and, finally, reduce distortions in competition between different institutions belonging to the same European Union.

The negotiations on this proposal have not been easy and the parties involved have taken very different positions. The main difficulties are the fact that some of the powers supposed to be given to the competent authorities[24] are bones of contention, especially the authority's power to bail in a bank's debt to third parties.

The formulation of Banking Union had an indirect impact on EU legislation on financial conglomerates. The Commission decided to conduct a complete revision of Directive 2002/87/EC of the European Parliament and of the Council of 16 December and issued a call for evidence in 2012 inviting interested parties to contribute to this revision. The final report on this consultation advised against proposing any legislative amendment on the supervision of financial conglomerates in 2013 before the Banking Union mechanisms had been fully implemented.

Just as the supervision process was being organised, the very paradigm of the banking business in Europe was called into question, leading the European authorities to study alternatives to the reform of the banking sector's structure. In October 2012, a report was published containing a list of recommendations made by a group of experts headed by Erkki Liikanen. One of the reform alternatives that it put forward was ring-fencing of the different business areas within a banking organisation and stricter capital requirements for highest-risk activities, such as real-estate investment and trading.

The most important prudential requirements in credit institutions' current management are in capital and liquidity. In 2012, the reform of the prudential regulation system, Basel III, was adapted to the European reality. This adaptation had already taken the form in 2011 of the European Commission's third revision package for Directive 2006/48/EC of the European Parliament and of the Council of 14 July. It consisted of a draft capital requirements regulation (CRR[25]) and a proposal for a directive on access to deposit taking activities (CRD4[26]). Alternative proposals were also submitted in 2012 for the European Commission's text and for trialogue negotiation of a compromise text between the Commission, European Parliament and Danish Presidency.

The issues of macro-prudential regulation and supervision of shadow banking were addressed at global level in 2012.

Where macro-prudential regulation was concerned, the framework proposed in the previous year for globally systemic institutions was extended to systemic institutions at domestic level. Recommendations made by the Basel Committee on Banking Supervision (BCBS) addressed principles such as the methods for assessing the nature and systemic degree of institutions and identify capitalisation requirements for increasing capacity for absorption of losses. At the same time, work

[24] Entities responsible for prudential supervision and responsible for resolution of institutions.
[25] Capital Requirements Regulation.
[26] Capital Requirements Directive.

continued on establishing the basic elements of recovery and resolution plans for systemic institutions.

Shadow banking continued on the agenda of the Financial Stability Board (FSB) and, as in 2011, the board monitored its activity and published several reports and consultations on stepping up the system's regulation and supervision.

There were a number of regulatory initiatives on the capital market, which is intrinsically associated with the shadow banking system, such as those on rating agencies, securities settlements, short selling and credit default swaps, collective investment undertakings, packaged retail investment products and functioning of the over-the-counter (OTC) derivatives market.

III.3. Amendments to international accounting standards[27]

Amendments to two international financial reporting standards endorsed by the European Union, IFRS 7 and International Accounting Standards (IAS) 12, came into effect on 1 January 2012. Meanwhile, the International Accounting Standards Board (IASB) conducted a number of public consultations in 2012. The amendments and consultations are detailed in Annex C.

[27] The-international accounting rules comprise the International Accounting Standards (IAS) laid down by the International Accounting Standards Committee (IASC) and the International Financial Reporting Standards (IFRS) defined by the International Accounting Standards Board (IASB), which took over from the IASC in 2001. The IAS and IFRS systems currently operate simultaneously, though it is agreed that the IFRSs take precedence in the event of a conflict. The rules also include interpretations by the International Financial Reporting Interpretations Committee (IFRIC), which replaced the Standing Interpretations Committee (SIC) at the same time as the IASB took over from the IASC.

Chart 2: Chronological development of the main laws and regulations in Portugal, in 2012

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
• Recapitalization with State funds	Law 4/2012 of 11 January				Ministerial Order 150-A/2012 of 17 May							
• Recovery Plans										Banco de Portugal Notice 12/2012		
• Resolution Plans												Banco de Portugal Notice 18/2012
• Resolution of Financial Institutions and Resolution Fund		Decree-Law 31-A/2012 of 10 February										Banco de Portugal Notice 13/2012
• Additional Credit Claims: Assets Eligibility			Banco de Portugal Instruction 7/2012									
• PER – Insolvency and Recovery of Companies - Special Revitalisation Process[a)]				Law 16/2012 of 20 April								
• SIREVE – Revitalise Programme - System for Extrajudicial Recovery of Companies [b)]								Decree-Law 178/2012 of 3 August				
• Pre-arrears Action Plan – PRAP / Out-of-court Arrears Settlement Procedure – OASP										Decree-Law 227/2012 of 25 October		Banco de Portugal Notice 17/2012
• Extraordinary regime for protecting housing loan borrowers in very difficult situations											Law 57/2012; 58/2012 and 59/2012 of 9 November	Banco de Portugal Circular 93/2012/DSC

[a)] See p. 167.
[b)] See p. 170.

Chart 3: Chronological development of the main regulatory initiatives on the financial sector at international level, in 2012

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
• Financial Stability in the Euro Area		Treaty of the European Council – European Stability Mechanism of 2 February										
• Macro-Prudential Regulation										Final Report on Consultation of the BCBS of 11 October	FSB Report and Consultation of 18 November	
• Single Supervisory Mechanism (SSM)									Proposal for a Council Regulation of 12 September			
• Crisis Management						Proposal for a Directive of the EP [a] and of the Council of 5 June						
• Reform of the European Banking Sector										*Liikanen* Report		
• Financial Conglomerates									Final Report of the JF[b] Consultation of 24 September			Final Report of the Public Consultation of the CE[c] of 20 December
• Capital and Liquidity						CRR/ CRD4 legislative package under implementation						

[a] European Parliament.
[b] Joint Forum.
[c] European Commission.

Chart 3: Evolução cronológica das principais iniciativas de regulação do sector financeiro a nível internacional em 2012 (cont.)

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
• Capital Market			Proposal for a Regulation of the EP and of the Council of 7 March Regulation of the EP and of the Council of 14 March				Proposal for Regulation of the EC of 3 July Regulation of the EP and of the Council (*EMIR*) of 4 July					
• Audit Policy						Final Report of the Consultation by the BCBS of June						

IV. Analysis of APB Member Institutions

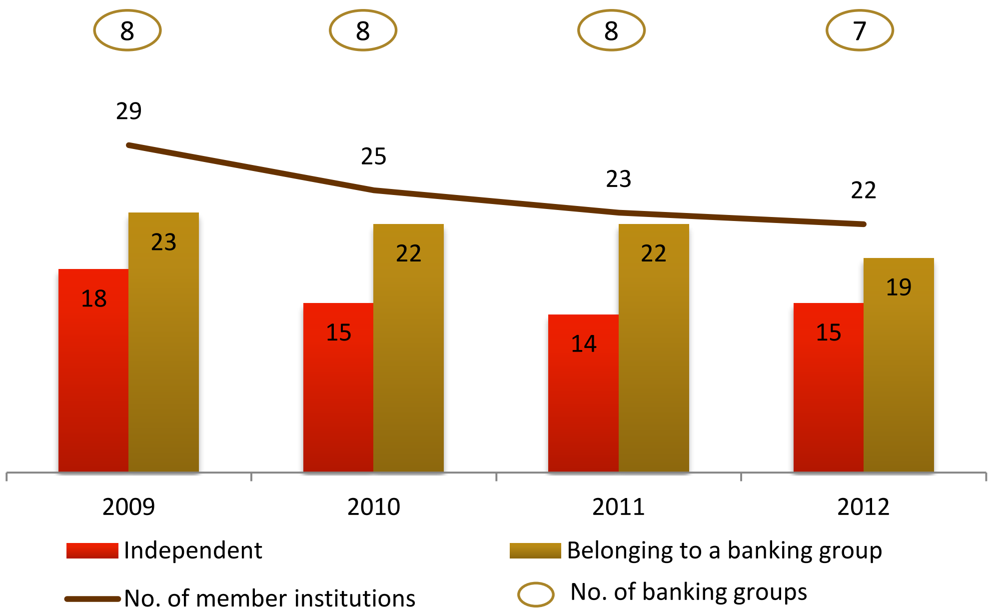
IV.1. Number of institutions

On 31 December 2012, the Portuguese Banking Association represented 22 Members comprising 34 financial institutions (see Graph 1). The APB was originally founded in 1984 by 17 institutions. Its main mission is to represent the banking sector in Portugal and foster and develop the Portuguese banking and financial system.

The changes in the APB's membership, i.e. individual institutions and those belonging to banking groups that have left or joined in the last four years (2009-2012), are detailed in Graph 1 and Chart 4 on p. 23.

Incorporation and merger operations in the period have been the main reasons for the reduction[28] in the number of Members and their financial institutions since 2009.

Graph 1: Number of independent institutions and institutions belonging to banking groups, among the APB Members as at 31 December (2009 – 2012)



Source: APB.

Of the 34 financial institutions represented by the APB in 2012, 15 operated independently in Portugal and 19 belonged to seven banking groups: Banif, BCP, BES, BNP Paribas, BPI, CGD and Montepio.

There were some significant changes in the APB's membership structure in 2012, such as the merger of BPN - Banco Português de Negócios, S.A. and Banco BIC Português, S.A. Banco BIC

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[28] Activity Report 47 of December 2011 analyses membership of the APB between 2008 and 2011 in more detail.

acquired BPN from the Portuguese state in June and carried out a merger by incorporation (completed in December 2012) of the acquiring company (Banco BIC) into the acquired company (BPN) via total transfer of assets. The new company took the name Banco BIC Português, S.A. As a result of this acquisition and subsequent merger, the Banco Português de Negócios Group, which included BPN and Banco Efisa, S.A. ceased to exist and Efisa became an independent Member.

The Banif Group was reorganised in the second half of 2012. This resulted in the merger by incorporation of Banif SGPS, S.A. into Banif – Banco Internacional do Funchal, S.A. in order to simplify the group.

The branch in Portugal of BNP Wealth Management, part of the BNP Paribas Group, was closed.

Chart 4: Changes in the number of member institutions (2009 – 2012)

Year	Acquisitions	Integrations / Mergers	New Entry	Exit	Change in the No. of Financial Institut. B.Group[a)]	Change in the No. of Financial Institut. Indep.[b)]	Total
2009	• Banif SGPS, S.A. acquires 100% of Tecnicrédito, S.A.´s share capital[e) f)]. Banco Mais, S.A. now belongs to Banif Group.	-	-	-	+1	-	41[c)]
	• Banco Cetelem, S.A.[d)] acquires 100% of Cofinoga (Portugal), SGPS, S.A.´s[e) g)] share capital. Credifin – Banco de Crédito ao Consumo, S.A. now belongs to Cetelem Group.	-	-	-	+1	-	42
	• BNP Paribas[d)] acquires 74.9% of Fortis Banque´s (Belgium) share capital. This operation had an impact on Fortis´ national branch office[d) h)].	-	-	-	+1	-1	42
	-	• Banco Millennium bcp Investimento, S.A.[d)] integrated in Banco Comercial Português, S.A.[d)]	-	-	-1	-	41
	-	• Banco Banif e Comercial dos Açores, S.A.[d)] integrated in Banif - Banco Internacional do Funchal, S.A.[d)]	-	-	-1	-	40
	-	-	Banco BIC	-	-	+1	41

Chart 4: Changes in the number of member institutions (2009 – 2012) (cont.)

Year	Acquisitons	Integrations / Mergers	New Entry	Exit	Change in the No. of Financial Institut. B.Group [a)]	Change in the No. of Financial Institut. Indep. [b)]	Total
2010	• Montepio Geral – Associação Mutualista[e)] acquires 100% of Finibanco Holding SGPS, S.A.´s share capital. Caixa Económica Montepio Geral[d)] and Finibanco, S.A.[d)] are no longer independent financial institutions as they now belong to Montepio Group.	-	-	-	+2	-2	41
	-	• Banco Santander de Negócios Portugal[d)], S.A. integrated in Banco Santander Totta, S.A.[d)]. They are no longer institutions belonging to a banking group, and Banco Santander Totta, S.A.[d)] becomes an independent financial institution.	-	-	-2	+1	40
	-	-	BNP SS	-	+1	-	41
	-	-	-	RBS[i)]		-1	40
	-	-	-	Cetelem	-2 [j)]	-	38
	-	-	-	BPP[k)]		-1	37

Chart 4: Changes in the number of member institutions (2009 – 2012) (cont.)

Year	Acquisitions	Integrations / Mergers	New Entry	Exit	Change in the No. of Financial Institut.		Total
					B.Group [a)]	Indep. [b)]	
2011	• Caixa Económica Montepio Geral [d)] acquires 100% of Finibanco Holding, SGPS, S.A.´s share capital from Montepio Geral – Associação Mutualista. Finibanco, S.A.[d)] now belongs to Caixa Económica Montepio Geral.[l)]	-	-	-	-	-	37
	-	• Merger between Caixanova[d)] and Caja de Ahorros de Galicia, Branch office[d) m)].	-	-	-	-2 +1[n)]	36
2012	• Banco BIC Português[d)] acquires 100% of BPN – Banco Português de Negócios, S.A.'s[d)] share capital.	• Fusão por incorporação do Banco BIC Português, S.A.[d)] no Banco Português de Negócios, S.A.[d)] e alteração da denominação social para Banco BIC Português, S.A.[d)] O Banco Efisa, S.A.[d)] passa a instituição autónoma.	-	-	-2	+1	35
			-	BNP WM	-1[o)]	-	34 [p)]

Source: FIs, APB.

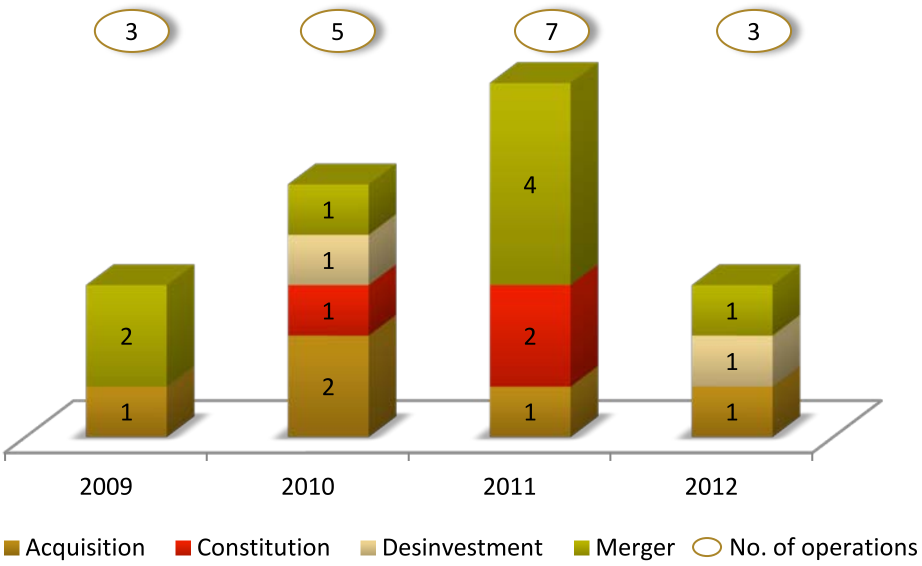
a) B.Group – Financial institutions integrated in banking group.
b) Indep. – Independent financial institution. c) As at 31 December 2008 40 financial institutions constituted the group of APB members.
d) Member institution.
e) Non-member institution.
f) Tecnicrédito, S.A. owned 100% of Banco Mais, S.A. (actual Banif Mais, S.A.).
g) Cofinoga (Portugal), SGPS, S.A. owned 100% of Credifin – Banco de Crédito ao Consumo, S.A.. The last became APB member institution.
h) Fortis Bank – Branch office in Portugal is not longer independent financial institution as it now belongs to BNP Group.
i) RBS – Royal Bank of Scotland, S.A. – Branch office in Portugal
j) Exit of Banco Cetelem, S.A. and of Credifin – Banco de Crédito ao Consumo, S.A.
k) BPP – Banco Privado Português, S.A.
l) This operation did not impact the total number of financial institutions, with both institutions being integrated in Montepio Group.
m) See Activity Report nº 47 December 2011 - Chapter I – Foreword, p. 1, for more details on this operation.
n) l) Two independent institutions no longer exist. Instead, only NCG Banco, S.A., Branch office in Portugal continues being independent institution.
o) O BNP Paribas Wealth Management, S.A. – Sucursal em Portugal encerrou a actividade em 14 de Dezembro de 2012.
p) For complete listing of 34 financial institutions integrated in APB Member Group as at 31 December 2012, consult Chart 1, p. 3.

IV.2. Restructuring and expansions operations

In the last four years (2009-2012), the member institutions have sought to reorganise and implement internationalisation strategies by restructuring and expanding their activity. There were 18 operations[29], which can be classified into four categories: acquisition (5), constitution (3), disinvestment (2) and merger (8) (see Graph 2).

While 2011 was more significant in terms of number of operations (total of 7), 2012 was particularly important due to the acquisition and subsequent merger of two member institutions.

Graph 2: Number of restructuring and expansion operations by nature – acquisition, formation, disinvestment and merger (2009 – 2012)



Source: FIs, APB.

The total value of the 18 operations from 2009 to 2012 was 1.459 billion euros[30] (see Table 3, p. 29). A disinvestment operation performed in 2010 stands out in this total. It involved divestment of its insurance business by the group of one of the member institutions to an amount of 774 million euros (see Table 1, p. 27 and Table 3, p. 29). In individual terms, however, the amounts of each operation were small compared to the size of the financial institution in question. In fact, the average weight of each operation in the sample was only 0.3% (see Table 3 and Graph 3, p. 29).

[29] The restructuring operations analysed in this chapter were performed by the 32 institutions in the sample on other financial institutions, in accordance with the following restrictions. Acquisitions may only include those resulting in a 20% “percentage of capital held after the operation”, while disinvestments may only include those where the financial institution owned a holding of 20% or more before the operation. In all other cases, no restrictions were imposed on the operations included in the analysis.

[30] This figure refers only to acquisition, constitution and disinvestment operations. Mergers were not included, as they are internal restructuring operations and have no impact on value.

Table 1: Nature of restructuring and expansion operations by objective (2009 – 2012)

	2009	2010	2011	2012	Total	
					Nº	%
International expansion						
Acquisition	1	2	-	-	3	-
Constitution	-	1	2	-	3	-
Disinvestment	-	-	-	1	1	-
Total	1	3	2	1	7	*38.9%*
Internal reorganisation						
Acquisition	-	-	1	1	2	-
Merger	2	1	4	1	8	-
Disinvestment	-	1	-	-	1	-
Total	2	2	5	2	11	*61.1%*
Total	3	5	7	3	18	*100%*

Source: FIs, APB.

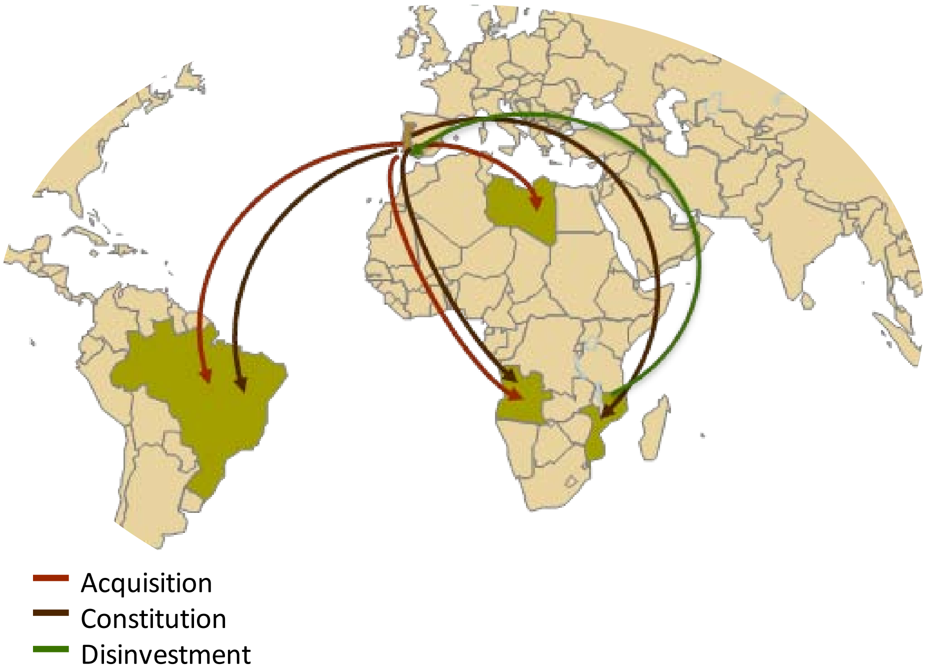
Internal reorganisation operations were the most frequent between 2009 and 2012 and accounted for more than 50% of member institutions' operations (see Table 1). They were also the most substantial and totalled around 80% of their value (see Table 3, p. 29).

The two acquisition operations for reorganisation purposes, which are shown in Table 1, were of different natures. The first (2011) occurred within the group and resulted in the incorporation of the acquired into the acquiring institution. The second (2012) involved acquisition of a domestic institution with no connections to the buyer. These two operations totalled 381 million euros and represented an average of 1.2% of the total assets of the acquirer (see Table 3, p. 29). Meanwhile, the fall in profitability of financial institutions in the last two years and the regulatory requirements imposed on the banking sector by the FAP made it necessary to rationalise structures and optimise costs to improve efficiency. This aim was the real driving force behind the five mergers in 2011 and 2012.

International expansion (see Table 1) slowed down in 2012 as no acquisition or constitution operations took place and there was one disinvestment, which involved the sale of a shareholding by a member institution.

Contrary to 2012, there were six operations between 2009 and 2011, their aim being to enter emerging markets, mainly in Africa and Brazil, in order to accompany customers' international activity and attract business with high growth potential. The acquisition of shareholdings and creation of new companies in partnership with local institutions in Portuguese-speaking countries has been the Portuguese groups' strategy where international expansion is concerned (see Figure 1, p. 28).

Figure 1: International expansion by country and nature of operation (2009 – 2012)



Source: FIs, APB.

As shown in Table 2, all the internationalisation operations expanded networks to areas of business similar to those in Portugal, taking advantage of domestic know-how.

Table 2: Percentage of operations in member institutions´ identical business areas (2009 – 2012)

	Number of Operations	% of Operations in Member Institution´s identical business areas
International Expansion		
Acquisition	3	*100.0%*
Constitution	3	*100.0%*
Disinvestment	1	*100.0%*
Internal Reorganization		
Acquisition	2	*100.0%*
Merger	8	*87.5%*
Disinvestment	1	-
Total	18	-

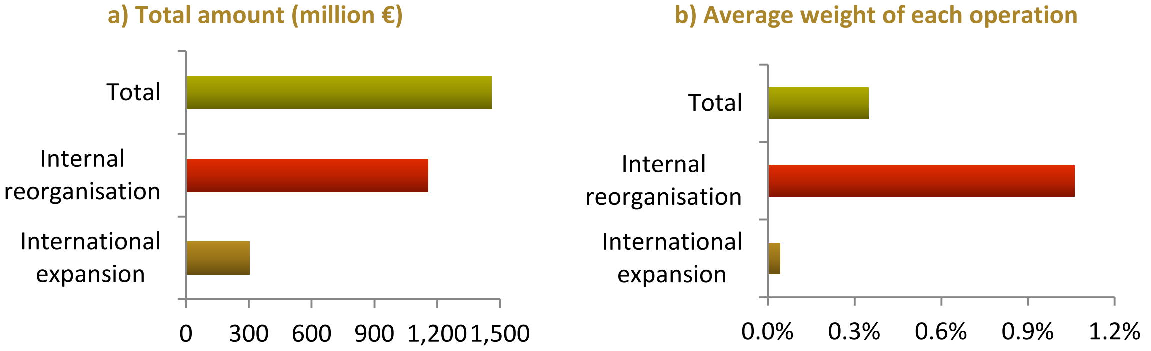
Source: FIs, APB.

Table 3: Total amount and average weight of restructuring and expansion operations (2009 – 2012)

	Total amount (thousand €)	Average Weight of Each Operation
International Expansion		
Acquisition	92	*0.0%*
Constitution	184	*0.1%*
Disinvestment	28	*0.0%*
Total	304	*0.0%*
Internal Reorganization		
Acquisition	381	*1.2%*
Merger	-	-
Disinvestment	774	*0.8%*
Total	1,155	*1.1%*
Total	1,459	*0.3%*

Source: FIs, APB.

Graph 3: Total amount and average weight of restructuring and expansion operations (2009 – 2012)



Source: FIs, APB.

IV.3. Representativity and characterisation of institutions

The Portuguese Banking Association represents a large portion of the banking sector in Portugal.

As at 31 December 2012, the 22 APB Members represented 96.1% of the total Portuguese banking system (PBS), measured as the value of consolidated banking activity, which was very similar to the previous year (see Table 4, p. 30). The 22 Members represented only around 20% of the entities making up the PBS at the time, however.

This applied to all the types of members, regardless of their origin and type of legal structure. However, it was more notable in the domestic institutions, which on average represented only 17.7% of the PBS, though they accounted for 98.7% of the segment's consolidated assets. As with the domestic institutions, the representativity of the branch offices and subsidiaries of APB-Member foreign banks operating in Portugal was highly significant as a percentage of the corresponding consolidated assets in the PBS. The average in the last two years was 93.2% for branch offices and 76.7% for subsidiaries (see Table 4, p. 30).

Table 4: Representativity of the APB member institutions in the Portuguese banking system by origin/type of legal structure as at 31 December (2011 – 2012)

	Portuguese Banking Association (APB)		SPortuguese Banking System (PBS) [31]		APB as % of Total PBS	
	2011	2012	2011 [32]	2012	2011	2012
By No. of Entities [33]						
Domestic	13	12	71	70	*18.3%*	*17.1%*
Subsidiary	5	5	10	10	*50.0%*	*50.0%*
Branch office	5	5	29	29	*17.2%*	*17.2%*
Total	23	22	110	109	*20.9%*	*20.2%*
By assets [34] **(million €)**						
Domestic	395,443	381,386	400,540	386,504	*98.7%*	*98.7%*
Subsidiary	64,444	60,731	69,383	65,049	*92.9%*	*93.4%*
Branch office	32,628	34,710	43,246	44,529	*75.4%*	*77.9%*
Total	492,515	476,827	513,169	496,082	*96.0%*	*96.1%*

Source: BdP.

The sample on which this report is based includes 32 financial institutions[35], which had aggregate assets of 475.6 billion euros as at 31 December 2012 (see Table 5, p. 31)[36]. This table also shows that, in numerical terms, the majority of the member institutions are still of domestic origin (65.6% of the sample), small in size (59.4%) and involved in multi-specialised business (71.9%).

[31] In this table, the financial institutions belonging to a group were counted as a single entity and the value of its assets corresponded to the consolidated banking assets of the financial institutions in it. The figures shown for the PBS were provided to the APB by Banco de Portugal.
[32] The 2011 figures for the PBS do not coincide with that in Activity Report 47 (2011) due to a subsequente afjustment made by Banco de Portugal to the data provided on the previous year.
[33] In the case of the APB, the entities are its Members.
[34] The assets shown for the APB and PBS are defined on the basis of "Aggregated balance sheet of the banking system - consolidated activity, excluding institutions off-shore" published by Banco de Portugal (BP*stat*).
[35] See footnote 2, p. 1.
[36] The figure for aggregate assets is not comparable to the total assets shown for the APB in Table 4 (see footnote 34), as it is the result of the simple sum of assets, under assets, in the separate balance sheets of the member institutions.

Table 5: Characterisation of member institutions as at 31 December 2012

	No. of Financial Institutions	As % of Total	Aggregate Assets (million €)	As % of Total
By size[37]				
Large	5	*15.6%*	339,512	*71.4%*
Medium-sized[38]	8	*25.0%*	105,897	*22.3%*
Small	19	*59.4%*	30,176	*6.3%*
By origin/type of legal structure				
Domestic	21	*65.6%*	383,224	*80.6%*
Subsidiary	5	*15.6%*	58,874	*12.4%*
Branch office	6	*18.8%*	33,487	*7.0%*
By business area[39]				
Multi-specialised	23	*71.9%*	451,636	*95.0%*
Specialised	9	*28.1%*	23,949	*5.0%*
Total	32	*100.0%*	475,585	*100.0%*

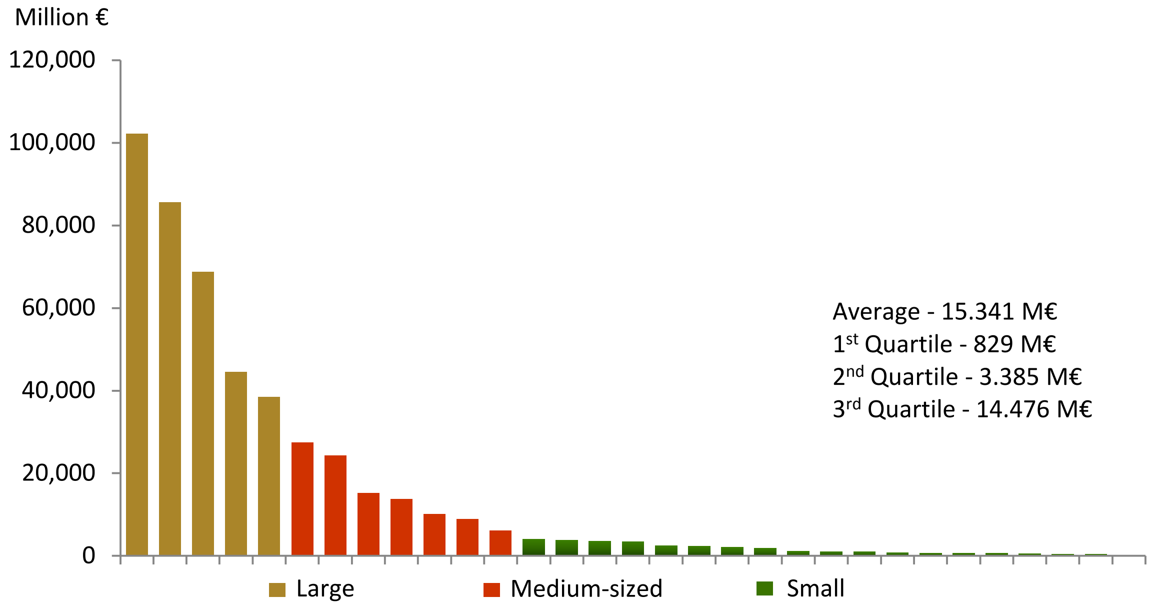
Source: FIs, APB.

In terms of aggregate assets, domestic institutions carry the most weight in total assets of the sample (80.6%), while subsidiaries account for only 7% in spite of their numerical weight in the sample (18.8%). The activity of financial institutions that operate in a specific market segment is very small and multi-specialised financial institutions account for almost all the aggregate assets (95%) (see Table 5).

If we analyse the sample on the basis of size, we find that only seven[40] financial institutions have above-average aggregate assets (15.341 billion euros), meaning that the asymmetry continues and smaller institutions predominate in number. In fact, 75% of the financial institutions in the sample account for less than 3% of the total aggregate assets (3rd quartile = 14.476 billion euros) and represent no more than 17.7% of the total. Only seven financial institutions account for the remaining 82.3% (see Graph 4, p. 32).

[37] Large financial institutions are those that represent 5% or more of aggregate assets, medium-sized institutions represent 1% to 5% and small account for 1% or less.
[38] In 2011, includes Finibanco, which went from small to medium-sized after acquisition by Montepio.
[39] A financial institution is said to be specialised if it devotes itself exclusively or mainly to one of the following activities: consumer credit, mortgage loans, car loans or investment banking. In all other cases, financial institutions are classified as multi-specialised.
[40] In Graph 4, p. 32, Montepio and Finibanco were considered to be a single institution in terms of size.

Graph 4: Aggregate assets by size das member institutions as at 31 December 2012



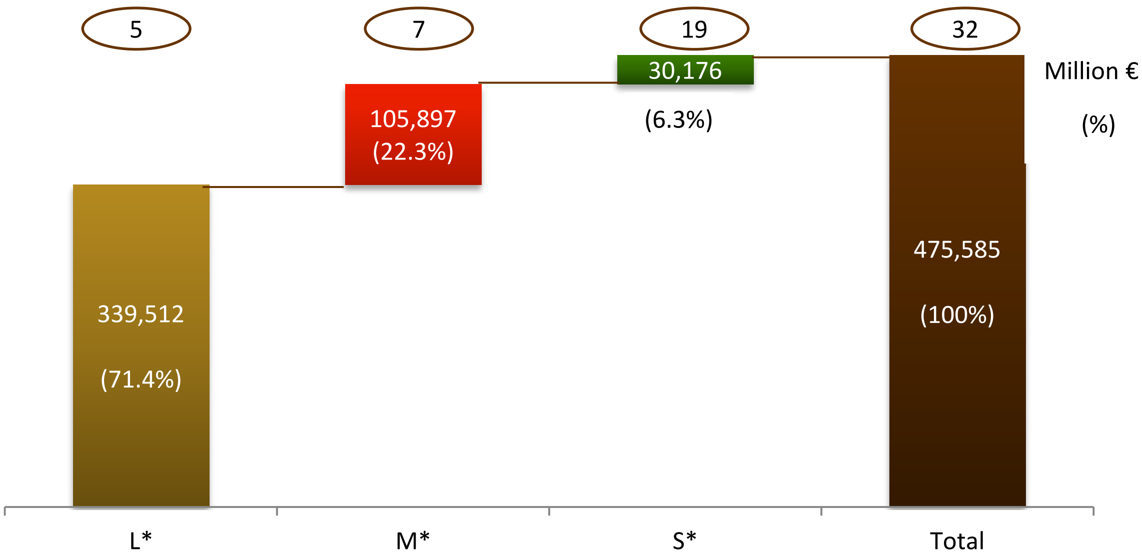
Source: FIs, APB.

All together, the 13 large and medium-sized financial institutions (around 41% of the sample) have a market share (based on total aggregate assets) of 93.7% (see Table 5, p. 31 and Graph 5, p. 33). In spite of evidence of concentration, the market in the Portuguese banking sector is moderately concentrated, based on a Herfindahl[41] index of 1,239. This figure shows a slight rise in competition in the sector in 2012 when compared with the 1,303[42] in 2011. This change has to do with the obligation to deleverage imposed on the eight largest banks by Banco de Portugal as part of the adjustment requirements laid down for the Portuguese banking sector and an increase in aggregate assets in the small and medium-sized segments in 2012 (see Table 8, p. 37).

Graph 6 on p. 33 and Graph 7 on p. 34 cross-reference the size variable with the origin/type of legal structure and business area respectively. These graphs are self-explanatory and show no major changes in relation to 2011. Two points are worth mentioning in 2012[43]: (i) a decrease in the market share of branch offices in all size segments mainly in favour of domestic institutions, with the exception of the medium-sized segment, where the share was lost to subsidiaries and (ii) the market share of small, multi-specialised financial institutions, which overtook the specialised institutions.

[41] This figure was obtained by adding the square of the market shares of the 32 financial institutions in the sample measured in terms of assets. As a rule, a score of under 1,000 indicates low concentration, 1,000 to 1,800 moderate concentration and above 1,800 high concentration.
[42] See Activity Report 47 (2011), p. 26.
[43] By comparison with 2011. See Graph 6 in Activity Report 47 (2011), p. 27.

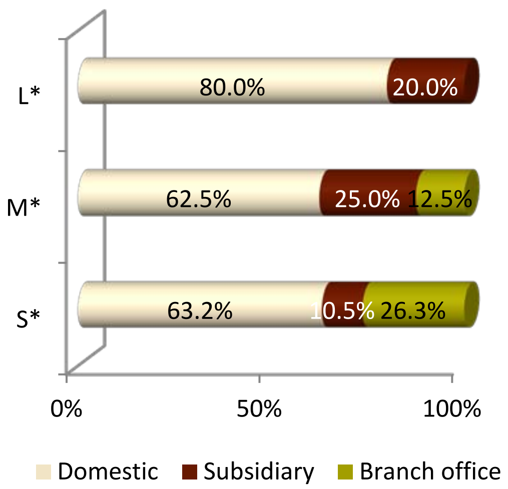
Graph 5: Concentration of aggregate assets by size of member institutions as at 31 December 2012



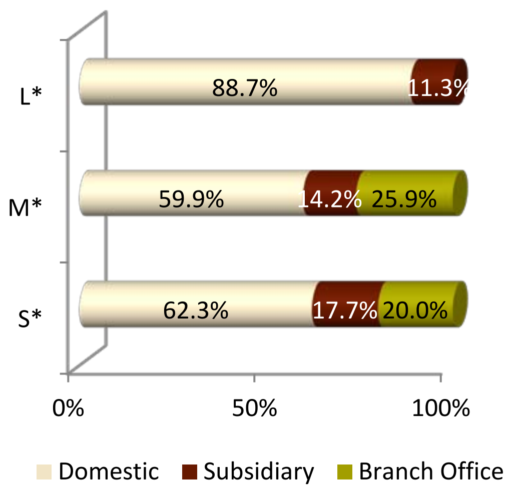
Source: FIs, APB.
Note: *L – Large; M – Medium-sized; S – Small
O No. of memeber institutions

Graph 6: Characterisation of member institutions by size and origin/type of legal structure as at 31 December 2012

(a) In terms of total institutions

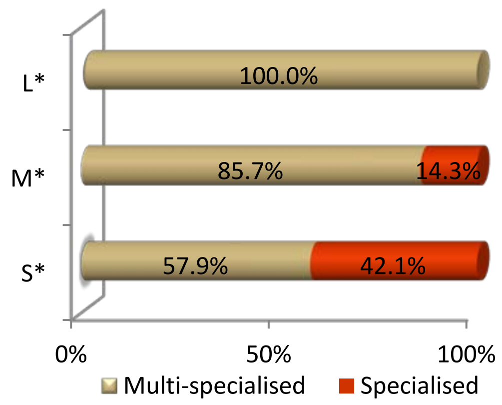


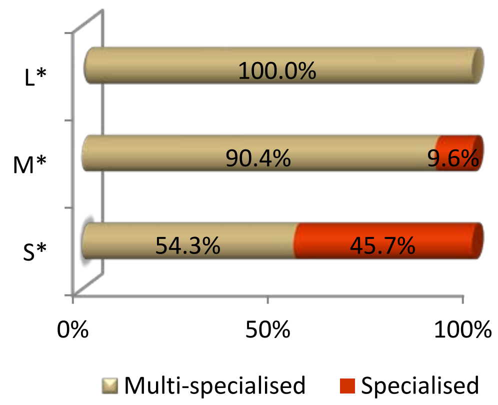
(b) In terms of aggregate assets



Source: APB.
Note: *L – Large; M – Medium-sized; S – Small.

Graph 7: Characterisation of member institutions by size and business area as at 31 December 2012



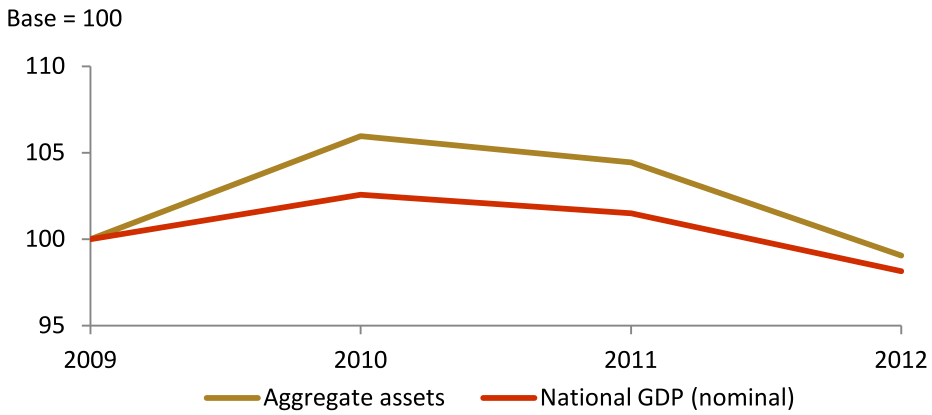


Source: APB.
Note: *L – Large; M – Medium-sized; S – Small.

IV.4. Aggregate assets

The difficult international financial setting in 2012, especially in the euro area, still feeling the effects of the financial crisis that broke out in 2008, and the circumstances in Portugal resulting from the sovereign debt crisis had an adverse effect on the country's economic situation. The policies of fiscal restraint resulting from the Financial Adjustment Programme agreed upon by Portugal and the Troika, an increase in the tax burden and austerity measures aimed at progressive deleveraging of the economy had a substantial negative impact on domestic demand and the different economic agents. As a result, there was a sharp deterioration in the business sector, a fall in investment, a rise in the unemployment rate and a reduction in households' disposable income, and the Portuguese economy contracted 3.3% in 2012 (see and Graph 8 and Table 6, p. 35).

Graph 8: Aggregate assets and national GDP (2009 – 2012)



Source: FIs, Statistics Portugal.

As a result of the decrease in economic activity and specific demands imposed on the banking sector by Banco de Portugal pursuant to the FAP (reduction in the credit-to-deposit ratio to 120% by the end of 2014 and increase in solvency levels to 10% by the end of 2012), the member institutions'[44] aggregate assets fell 5.2% in 2012 (see Graph 8, p. 34 and Table 6), reaching levels lower than in 2009, which resulted in a negative annual average growth rate in the last three years (see Table 6). The banking sector's weight in the economy fell again in 2012, going from 293.1% in 2011 to 287.5% in 2012 and dropping 6.8 percentage points against 2010 (see Table 6).

Table 6: Aggregate assets and national GDP (2009 – 2012)

	2009	2010	2011	2012	Average
Aggregate assets					
Total (milhões €)	480,093	508,725	501,404	475,573	-
Taxa de crescimento anual	-	*6.0%*	*-1.4%*	*-5.2%*	*-0.2%*
National GDP (Nominal)					
Total (milhões €)	168,529	172,860	171,065	165,409	-
Taxa de crescimento anual	-	*2.6%*	*-1.0%*	*-3.3%*	*-0.6%*
Aggregate Assets as % of GDP	*284.9%*	*294.3%*	*293.1%*	*287.5%*	*289.9%*

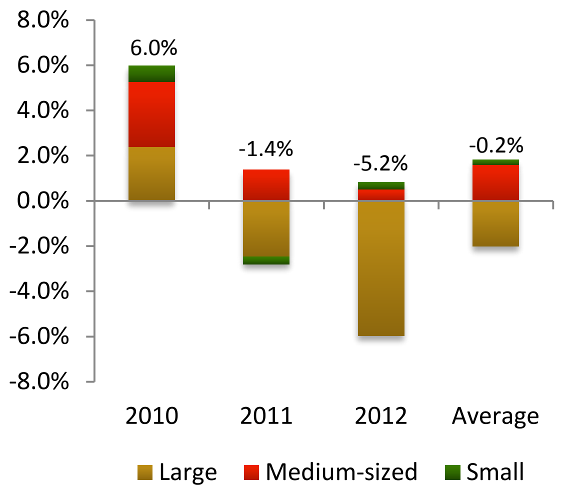
Source: FIs, APB, Statistics Portugal.

An analysis of changes in aggregate assets over time by sample segment shows that it was the large financial institutions (-2%) and branch offices (-1%) that contributed to the contraction in the three-year average (see Graph 9 and Table 7, p. 36)[45]. Their performance was particularly noticeable in 2012, when the large institutions contributed -6% and branch offices -1.9%, further exacerbated by a highly negative contribution (3.8%) from domestic institutions, a segment that is normally responsible for the highest growth in the sector (see Graph 9 and Table 7, p. 36).

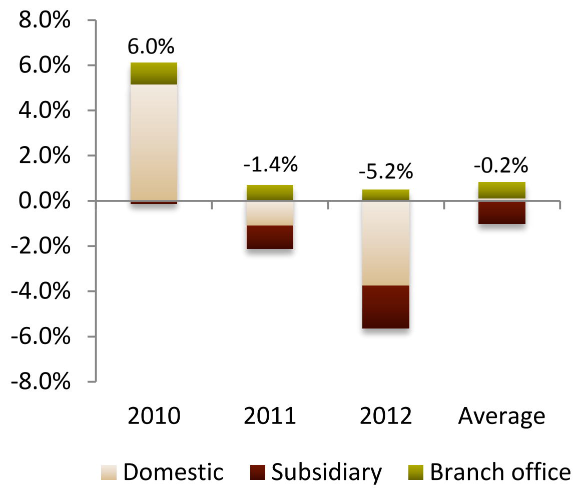
[44] The 2009 – 2012 analysis includes 31 financial institutions, as opposed to the 32 institutions making up the base sample for this Activity Report. BNP SS was excluded as there was no historical information on it for 2009.
[45] In 2011, Deutsche Bank went from a branch office to a subsidiary and Finibanco from a small to a medium-sized institution. For the sake of comparison, they were reclassified in their new category retroactively to 2010, to make it possible to analyse growth in their aggregate assets over time. In the case of the acquisition and later merger/incorporation of BPN, the balance-sheet data were not adjusted retroactively as they distorted the reality of the banking sector in previous years.

Graph 9: Contribution from member institutions to growth in aggregate assets (2010 – 2012)

(a) By size



(b) By origin/type of legal structure



Source: FIs, APB.

As a result of this deleveraging, the large financial institutions lost 5.8 percentage points in market share between 2009 and 2012, mainly due to medium-sized institutions, which attracted 88% of this loss after growing an average of 8.8% a year (see Table 8, p. 37). Branch offices' market share fell 3.1 percentage points in the same period (alongside a 7.3% annual average decrease in aggregate assets) which have been consistently captured by the subsidiary segment (see Table 8, p. 37).

Table 7: Contribution from member institutions to growth in aggregate assets by size and origin/type of legal structure (2010 – 2012)

	2010	2011	2012	Average
By size				
Large	2.4%	-2.5%	-6.0%	-2.0%
Medium-sized	2.9%	1.4%	0.5%	1.6%
Small	0.7%	-0.3%	0.3%	0.2%
Total	6.0%	-1.4%	-5.2%	-0.2%
By origin / Type of Legal Structure				
Domestic	5.2%	-1.1%	-3.8%	0.1%
Subsidiary	-0.1%	-1.0%	-1.9%	-1.0%
Branch office	1.0%	0.7%	0.5%	0.7%
Total	6.0%	-1.4%	-5.2%	-0.2%

Source: FIs, APB.

Table 8: Aggregate assets by size and origin/type of legal structure as at 31 December (2009 – 2012)

	2009	2010	2011	2012	Average
By size					
Large					
Assets (million €)	370,656	382,126	369,495	339,512	-
Annual growth rate	-	*3.1%*	*-3.3%*	*-8.1%*	*-2.8%*
Market share	*77.2%*	*75.1%*	*73.6%*	*71.4%*	*74.3%*
Medium-sized					
Assets (million €)	82,560	96,380	103,359	105,897	-
Annual growth rate	-	*16.7%*	*7.2%*	*2.5%*	*8.8%*
Market share	*17.2%*	*18.9%*	*20.6%*	*22.3%*	*19.8%*
Small					
Assets (million €)	26,877	30,219	28,550	30,164	-
Annual growth rate	-	*12.4%*	*-5.5%*	*5.7%*	*4.2%*
Market share	*5.6%*	*5.9%*	*5.7%*	*6.3%*	*5.9%*
By origin/type of legal structure					
Domestic					
Assets (million €)	382,833	407,585	401,987	383,224	-
Annual growth rate	-	*6.5%*	*-1.4%*	*-4.7%*	*0.1%*
Market share	*79.7%*	*80.1%*	*80.2%*	*80.6%*	*80.2%*
Subsidiary					
Assets (million €)	74,311	73,616	68,367	58,874	-
Annual growth rate	-	*-0.9%*	*-7.1%*	*-13.9%*	*-7.3%*
Market share	*15.5%*	*14.5%*	*13.6%*	*12.4%*	*14.0%*
Branch office					
Assets (million €)	22,949	27,524	31,050	33,475	-
Annual growth rate	-	*19.9%*	*12.8%*	*7.8%*	*13.5%*
Market share	*4.8%*	*5.4%*	*6.2%*	*7.0%*	*5.9%*
Total	480,093	508,725	501,404	475,573	-

Source: FIs, APB

V. Human Resources

V.1. Changes

The austerity measures imposed in Portugal aimed at gradual deleveraging of the economy and fiscal consolidation, the recessive macroeconomic context and difficulty in accessing the international financial markets, combined with the requirements imposed on the banking sector by the FAP, led to a reduction in credit in the economy and institutions' net interest income. As a result, one of the institutions' management priorities was reducing costs, and workforces had to be adjusted to the sector's new circumstances.

The contraction in business and narrowing of their margin were key in the member institutions' decision to restructure their payrolls, thereby combining cost reductions with rationalisation of their structures.

Restructuring took place mainly in domestic activity, where the number of employees fell 4.3% in 2012. This reduction was part of a trend that had been in place since late 2009 (see Table 9).

Table 9: Number of employees as at 31 December (2009 – 2012)[46]

	2009		2010		2011		2012		Average
Global Number of Employees									
Total	60,046		59,943		58,416		56,052		-
Annual growth rate	-		*-0.2%*		*-2.5%*		*-4.0%*		*-2.2%*
In Domestic Activity									
Total	58,194	*96.9%*	58,069	*96.9%*	56,559	*96.8%*	54,120	*96.6%*	-
Annual growth rate	-		*-0.2%*		*-2.6%*		*-4.3%*		*-2.4%*
In International Activity									
Total	1,852	*3.1%*	1,874	*3.1%*	1,857	*3.2%*	1,932	*3.4%*	-
Annual growth rate	-		*1.2%*		*-0.9%*		*4.0%*		*1.4%*

Source: FIs, APB.

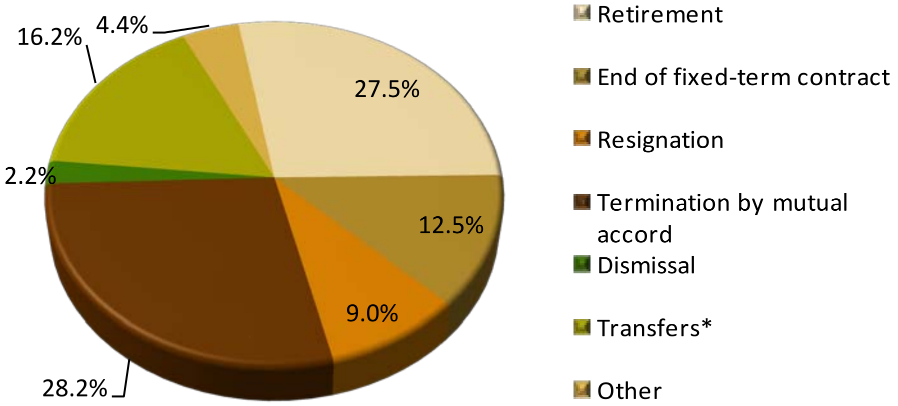
On the other hand, growth in the number of employees working in international activity in the three-year period (annual average growth rate of 1.4%) illustrates the member institutions' concern for offsetting the lack of growth prospects in the domestic market by stepping up their presence in foreign markets (see Table 9).

Downsizing the domestic workforce in 2012 took a number of forms and affected 3,900 people[47]. Termination of employment was mainly achieved in rescission by mutual agreement (28.2%) and retirement (27.5%) (see Graph 10), 72% of which was early. Only 2.2% of employees who

[46] Please note that the figures shown here are slightly diferente from those in Activity Report 46 (2010) and 47 (2011) because of corrections of some historical figures by two APB Members. It should also be highlighted that as a consequence of the merger between Banco BIC and BPN, comparable data before 2012 were readjusted, in order to reflect the past activity of BPN (see footnote 3, p. 1).
[47] Total employees leaving in 2012, while 1.400 new employees were recruited.

left were dismissed, as the banks preferred to negotiate with their personnel. People leaving voluntarily and at the end of fixed-term contracts accounted for 21.5% of the reasons, in contrast to 46.8% in 2011.

Graph 10: Reasons for employees´ leaving in 2012



Source: FIs, APB.
Nota: * Transfers due to judicial reasons on the integration process of Banco BIC Português, S.A. on BPN – Banco Português de Negócios, S.A..

All the member institutions, irrespective of their size, reduced their workforces in domestic activity in 2012 (see Table 10, p. 41). As in the two previous years, the greatest variation in absolute terms occurred in the large institution segment. In all three years, this segment accounted for more than 50% of the reduction in the number of employees (see Table 10 and Graph 11 a), p. 41). In spite of this, the representativity of the large member institutions in the total banking population working in domestic activity remained stable in the period at an average of 66.4%[48], as a result of similar developments in the other segments (see Graph 12 a), p. 43).

[48] Against an average weight in that period of 26.2% and 7.4% respectively for small and medium-sized financial institutions (see Graph 12 a), p.43).

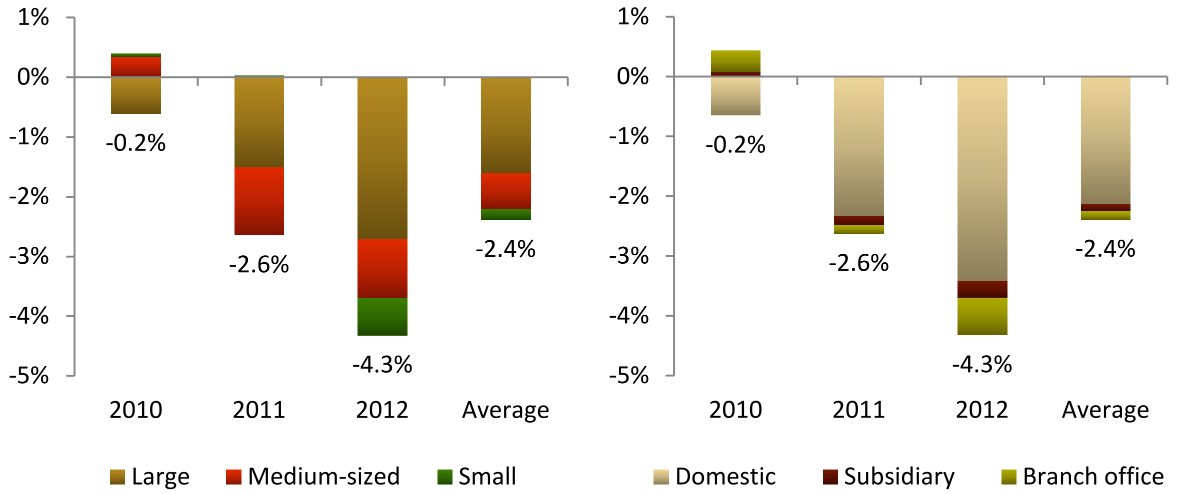
Table 10: Number of employees in domestic activity by size as at 31 December (2009 – 2012)

	2009	2010	2011	2012	Average
Large					
Total	38,737	38,383	37,504	35,966	-
Annual growth rate	-	*-0.9%*	*-2.3%*	*-4.1%*	*-2.4%*
Contribution to growth in the number of employees	-	*-0.6%*	*-1.5%*	*-2.7%*	*-1.6%*
Medium-sized	.	.	.	.	.
Total	15,207	15,407	14,750	14,192	-
Annual growth rate	-	*1.3%*	*-4.3%*	*-3.8%*	*-2.3%*
Contribution to growth in the number of employees	-	*0.3%*	*-1.1%*	*-1.0%*	*-0.6%*
Small	.	.	.	.	.
Total	4,250	4,279	4,305	3,962	-
Annual growth rate	-	*0.7%*	*0.6%*	*-8.0%*	*-2.2%*
Contribution to growth in the number of employees	-	*0.1%*	*0.0%*	*-0.6%*	*-0.2%*

Source: FIs, APB.

Graph 11: Contribution from member institutions to growth in the number of employees in domestic activity by size and origin/type of legal structure (2009 – 2012)

a) By size **b) By origin/type of legal structure**



Source: FIs, APB.

The small-sized financial institutions were able to maintain a positive net hiring level until 2012, when it was no longer possible to adjust their workforces to the new limitations in the sector. The adjustment affected 8% of the workforce, which was the only reason why the segment eventually showed a negative annual average growth in number of employees working in domestic activity (-2.2%) 2009-2012 (see Table 10 and Graph 11 a)).

Table 11: Number of employees in domestic activity by size and origin/type of legal structure as at 31 December (2009 – 2012)

	2009	2010	2011	2012	Average
Domestic					
Total	47,205	46,828	45,473	43,535	-
Annual growth rate	-	*-0.8%*	*-2.9%*	*-4.3%*	*-2.7%*
Contribution to growth in the number of employees	-	*-0.6%*	*-2.3%*	*-3.4%*	*-2.1%*
Subsidiary	.	.	.	.	.
Total	8,104	8,154	8,066	7,910	-
Annual growth rate	-	*0.6%*	*-1.1%*	*-1.9%*	*-0.8%*
Contribution to growth in the number of employees	-	*0.1%*	*-0.2%*	*-0.3%*	*-0.1%*
Branch office	.	.	.	.	.
Total	2,885	3,087	3,020	2,675	-
Annual growth rate	-	*7.0%*	*-2.2%*	*-11.4%*	*-2.2%*
Contribution to growth in the number of employees	-	*0.3%*	*-0.1%*	*-0.6%*	*-0.2%*

Source: FIs, APB.

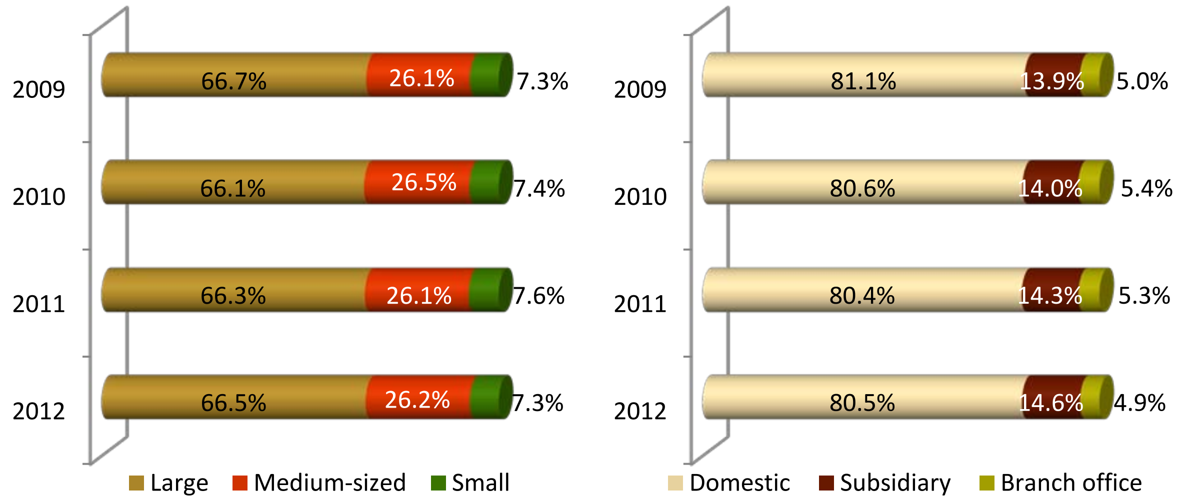
An analysis of the segmentation of member institutions by origin/type of legal structure shows that all the market segments reduced their workforce in 2012. The highest reduction was in subsidiaries, at 11.4%, while the decrease was 4.3% in domestic financial institutions and 1.9%, in branch offices (see Table 11).

The number of employees in subsidiaries and branch offices went from growth in 2010 to a decrease in 2011, coinciding with the deterioration of the economic situation in Portugal and the beginning of the adjustment programme. Because of the crisis and its adverse effects on the macroeconomic scenario, foreign financial institutions had to downsize their presence in Portugal. While for their branch offices this downsizing occurred mainly in a setting of economic contraction and mandatory deleveraging, subsidiaries downsized and reduced their personnel while their assets in Portugal were actually increasing.

In absolute terms, domestic financial institutions form the segment that has the largest workforces (employing 80 to 81% of the banking population (see Graph 12 b), p. 43) and that has naturally suffered most from the adjustment. The number of employees was reduced by around 3,700, over 50% of whom left in 2012 (see Table 11). It was therefore this segment that contributed most (2.1%) to the total decrease (2.4%) in the banking population working in domestic activity in the three years (see Graph 11 b), p. 41 and Table 11). Total employees of subsidiaries and branch offices fell by 404 and their joint contribution to the reduction in workforce was only 0.3%.

Graph 12: Representativity of member institutions in terms of employees in domestic activity by size and origin/type of legal structure as at 31 December (2009 –2012)

a) By size **b) By origin/type of legal structure**



Source: FIs, APB.

V.2. Characteristics

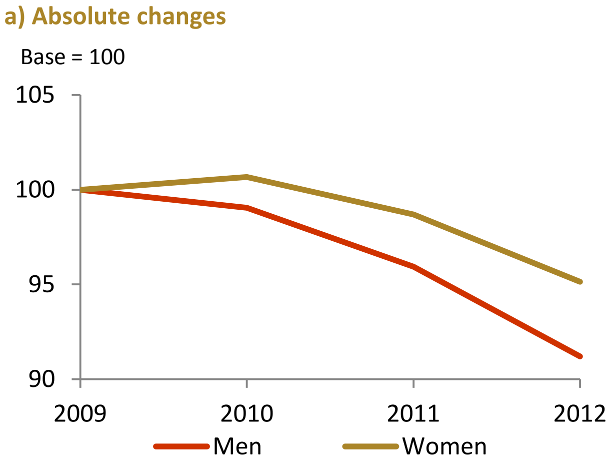
At the end of 2012, the member institutions' workforces working in domestic activity totalled 54,697 people[49], almost all of them permanent employees (97.4%). With no significant changes against 2011, the majority were males (53.4%), aged between 30 and 44 (54.5%) and had university degrees (52.8%). Long-term employment with the financial institution predominated (44.2% had worked there for over 15 years), as did specific jobs (41.2%), as the majority of the banking population worked in commercial activity (65.1%) (see Table 17, p. 52).

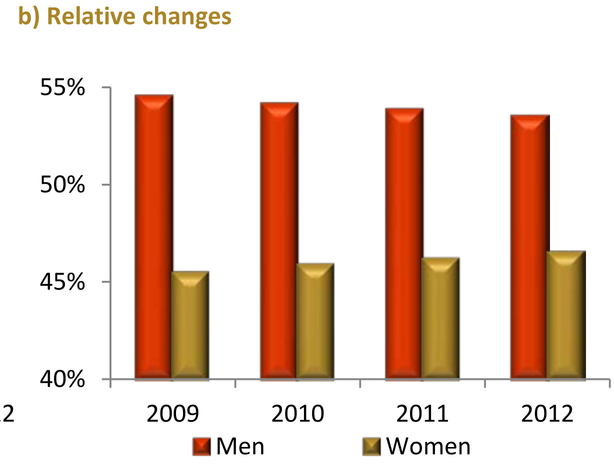
The reduction in numbers of bank employees that began in 2009 has affected the male population more (down 8.8%, as opposed to 4.9% in the female population), which has helped bring gender representativity closer in the sector (see Graph 13, p. 44 and Table 18, p. 53).

In spite of this trend in all the segments of member institutions, which was only broken in the small institution segment in 2012, the majority of the workforce throughout the sector is still male, with the exception of subsidiaries (see Table 17, p. 52).

[49] This figure refers to the sample of 32 member institutions, which is why it is not the same as that in Table 9, p. 39 and Table 18, p. 53 (54,120 employees), which refers to the sample adjusted for time purposes (see footnote 44, p. 35).

Graph 13: Number of employees in domestic activity and their representativity by gender as at 31 December (2009 – 2012)

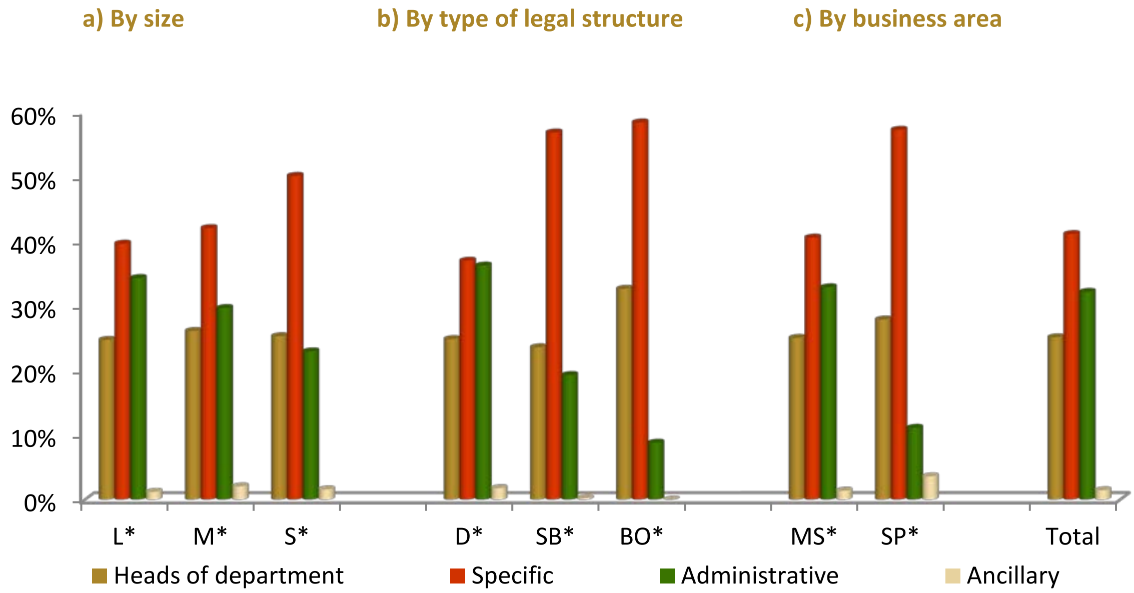




Source: FIs, APB.

As mentioned above, most of the workforce working in domestic activity was in specific jobs (41.2%) in 2012, as opposed to 32.2% in administrative jobs and 25.1% as heads of department (see Table 17, p. 52). This distribution does not apply to all segments, however. While it represents the large and medium-sized segments, domestic institutions and multi-specialised financial institutions, this was not the case in the other segments, where specific jobs and heads of department predominated (see Graph 14).

Graph 14: Characterization of the positions of the human resources in domestic activity by size and origin/type of legal structure and business area at 31 December 2012



Source: FIs, APB.

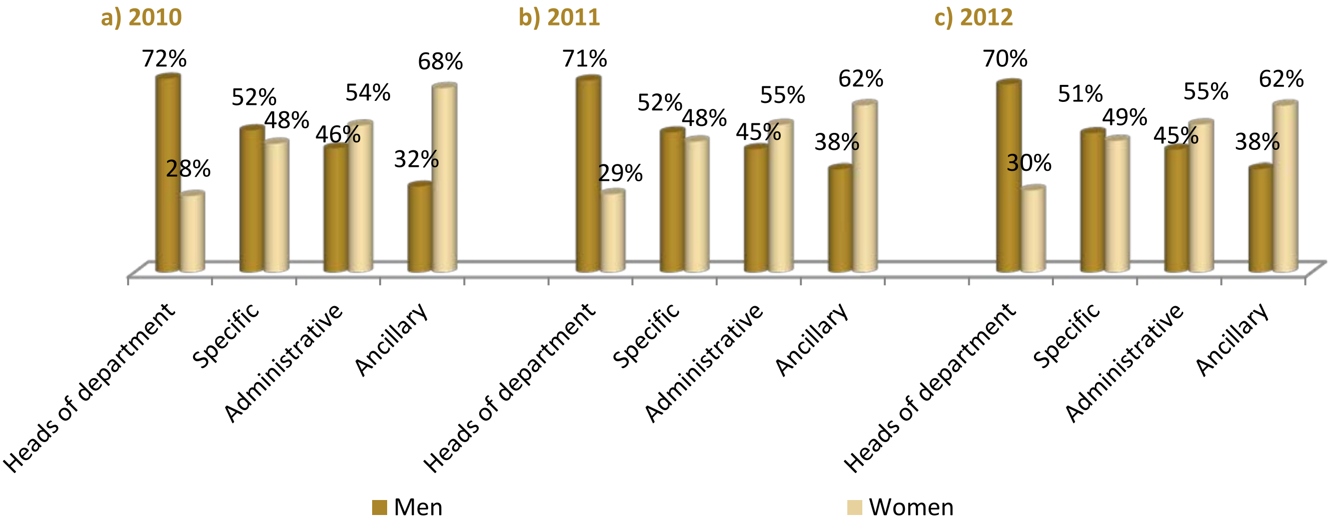
Note: * L – Large; M – Medium-sized; S – Small; D – Domestic; SB – Subsidiary; BO – Branch office; MS – Multi-specialised; SP – specialised.

These two different patterns may be explained by the dominant business model. A strategy aimed at market niches focusing on more complex products and services requires more specialised personnel. It is therefore natural for smaller member institutions, branch offices and subsidiaries to depend more on specific jobs (over 50% of employees). On the other hand, the large and medium-sized segments and domestic entities operate mainly in retail banking, which requires not only specialised employees but also a wide network of administrative support. This explains the higher proportion of administrative staff in these segments (see Table 17, p. 52).

In an analysis over time (2009-2012), the overall number of banking employees fell in all but specific jobs. The administrative area contracted most (15%) followed by heads of department (4.2%) (see Table 18[50], p. 53). As a result, the representativity of specific jobs in the workforce increased (2.6 p.p.), in detriment to that of administrative staff (-3.3 p.p.) (see Table 18, p. 53). While investments in technology and information systems may have made it possible to let some administrative staff go, the reduction is mainly due to the need to downsize balance sheets and improve efficiency and so this population offering less value added is more vulnerable.

An analysis by gender shows that heads of department and staff in specialised jobs were mainly male in 2012[51]. However, in spite of the predominance of men in positions requiring a higher level of responsibility, qualifications and experience, their weight has been decreasing. The two percentage point increase in the proportion of female heads of department between 2010 and 2012 and the higher percentage of women in technical jobs (1 p.p.) (see Graph 15) were due not only to a reduction in the number of men in these positions (6.7% and 1.1%, respectively) but also to a 3% increase in the number of women occupying them.

Graph 15: Human resources by gender and position as at 31 December (2010 – 2012)



Source: FIs, APB.

[50] For the analysis over time (2009-2012) of classifications by job and type of contract, the sample has been adjusted to 30 financial institutions, as Banco BIC and BPN were excluded due to lack of data.
[51] For the cross analysis of gender and jobs, the sample has been adjusted to 31 financial institutions, as one was excluded due to lack of data.

The predominance of women in the other positions (administrative and auxiliary staff) continued, as in previous years, though was an increase in the representativity of male auxiliary staff (6 p.p.) in 2010-2012 (see Graph 15, p. 45).

The increase in the number of men in jobs traditionally held by women and in women as heads of department and in specific jobs reflects a positive step towards greater equality between genders in the distribution of jobs and responsibilities in the sector.

These conclusions are much the same if we analyse the member institutions on the basis of size and origin or type of legal structure. It is clear, however, that the small and medium-sized institutions are more conservative than the larger ones in terms of hiring women as heads of department and in specific jobs, although there was some progress in the period. They are also more traditional regarding genders in auxiliary and administrative jobs and the divergence in gender representativity usually found in these jobs predominates there (see Table 12).

Table 12: Human resources by gender and position, by size of member institutions as at 31 December (2010 – 2012)

	2010			2011			2012		
	M*	W*	D* (pp)	M*	W*	D* (pp)	M*	W*	D* (pp)
Large									
Heads of department	69.0%	31.0%	*38.1*	68.3%	31.7%	*36.6*	67.0%	33.0%	*34.1*
Specific	49.9%	50.1%	*-0.1*	49.4%	50.6%	*-1.1*	48.6%	51.4%	*-2.9*
Administrative	45.0%	55.0%	*-10.0*	44.6%	55.4%	*-10.7*	44.5%	55.5%	*-10.9*
Ancillary	36.2%	63.8%	*-27.5*	47.3%	52.7%	*-5.4*	49.8%	50.2%	*-0.5*
Medium-sized									
Heads of department	77.7%	22.3%	*55.3*	77.1%	22.6%	*54.8*	76.4%	23.6%	*52.8*
Specific	56.4%	43.6%	*12.8*	55.2%	44.8%	*10.4*	55.9%	44.1%	*11.8*
Administrative	49.0%	51.0%	*-1.9*	49.3%	50.7%	*-1.4*	49.0%	51.0%	*-2.0*
Ancillary	21.1%	78.9%	*-57.8*	19.7%	80.3%	*-60.6*	18.2%	81.8%	*-63.7*
Small									
Heads of department	75.8%	24.2%	*51.7*	74.6%	25.4%	*49.1*	71.6%	28.4%	*43.2*
Specific	62.2%	37.8%	*24.3*	60.4%	39.6%	*20.8*	62.0%	38.0%	*24.0*
Administrative	42.6%	57.4%	*-14.8*	41.5%	58.5%	*-16.9*	40.7%	59.3%	*-18.6*
Ancillary	59.5%	40.5%	*19.0*	60.8%	39.2%	*21.6*	51.4%	48.6%	*2.8*

Source: FIs, APB.

Note: *M – Men; W – Women; D – Difference.

Table 13 does not reveal any marked difference between financial institutions in terms of origin or type of legal structure, though subsidiaries have been outsourcing auxiliary work.

Table 13: Human resources by gender and position by origin/type of legal structure of member institutions as at 31 December (2010 – 2012)

	2010			2011			2012		
	M*	W*	D* (pp)	M*	W*	D* (pp)	M*	W*	D* (pp)
Domestic									
Heads of department	71.0%	29.0%	*42.0*	70.3%	29.7%	*40.6*	69.0%	31.0%	*38.0*
Specific	52.3%	47.7%	*4.6*	51.5%	48.5%	*2.9*	50.8%	49.2%	*1.5*
Administrative	45.8%	54.2%	*-8.4*	45.6%	54.4%	*-8.8*	45.3%	54.7%	*-9.4*
Ancillary	30.7%	69.3%	*-38.6*	37.4%	62.6%	*-25.1*	37.5%	62.5%	*-25.1*
Subsidiaries									
Heads of department	75.3%	24.7%	*50.6*	75.0%	25.0%	*50.0*	74.3%	25.7%	*48.6*
Specific	53.0%	47.0%	*6.0*	52.7%	47.3%	*5.4*	53.2%	46.8%	*6.4*
Administrative	45.8%	54.2%	*-8.5*	45.2%	54.8%	*-9.7*	45.8%	54.2%	*-8.5*
Ancillary	92.9%	7.1%	*85.7*	73.7%	26.3%	*47.4*	73.7%	26.3%	*47.4*
Branch offices									
Heads of department	70.7%	29.3%	*41.3*	67.6%	32.4%	*35.1*	55.4%	44.6%	*10.9*
Specific	55.0%	45.0%	*10.0*	50.7%	49.3%	*1.5*	55.4%	44.6%	*10.7*
Administrative	40.8%	59.2%	*-18.3*	40.0%	60.0%	*-20.0*	46.4%	53.6%	*-7.2*
Ancillary	0.0%	100.0%	*-100.0*	0.0%	100.0%	*-100.0*	0.0%	0.0%	*0.0*

Source: FIs, APB.

Note: *M – Men; W – Women; D – Difference.

If we analyse the member institutions' human resources on the basis of area of activity, we find an absolute reduction of close to 3,000 employees in the period and the majority, 53%, left in 2012 (see Table 18, p. 53). This reduction is consistent (correlation of 0.65[52]) with the simultaneous decrease in number of branches as part of a policy of rationalising the branch network[53], also dictated by deleveraging, cost cuts and higher efficiency.

As in 2011, an analysis of variations in the number of employees in specific and administrative jobs and the number of employees in commercial activity suggests that administrative jobs at bank branches that closed were affected most by the fall in commercial activity, while employees in specific jobs were apparently relocated within the institutions[54] (see Table 18, p. 53).

In spite of a substantial reduction in commercial employees between 2009 and 2012 (7.8%), accounting for 74% of the total decrease in the member institutions' personnel, the weight of commercial activity in relation to the other areas remained relatively stable (an average of 65.9% with a loss of only 0.6 p.p.), which shows its continued importance in the banking business (see Table 18, p. 53).

In spite of the growth in virtual banking and 24/7 access, financial consultancy still falls to commercial activity, as it offers greater value than online channels. Trust in commercial managers

[52] In 2011, the correlation was 0.88, which reflected lower homogeneity in growth in the number of branches and employees in commercial activity in 2012.

[53] See Subchapter VI.1 Branch network in Portugal, p. 59 and Table 22, p. 59.

[54] Reallocation to similar duties in other branches, expanding distribution networks or direct sales to customers

and their knowledge of bank products and services is an important driver of quality in management of customer relations.

Where age was concerned, in line with 2011, the member institutions' workforces remained relatively young, with the majority of employees aged 30 to 44 (54.5%) (see Table 17, p. 52) in spite of the 8% reduction in this age group over the three years, 62% of which occurred in 2012 alone. The most drastic reduction (42.5% between 2009 and 2012) was in the under-30 age group, whose weight in the total domestic workforce fell to its lowest level of the period in 2012 (8% against 13% in 2009). On the other hand, the number of employees aged 45 and over has been increasing at member institutions (+9.2% since 2009, +2.5% in 2012) (see Table 18, p. 53).

As a result, the average age of the workforce rose from 43 in 2009 to 45 in 2012. This trend was visible in all segments of member institutions, by size or origin/type of legal structure (see Table 14, p. 49).

The increase in member institutions' employees aged 45 or over and a simultaneous reduction in the number of younger employees also resulted in an increase in average years of service from 16.8 years in 2009 to 18.6 in 2012 (see Table 15, p. 49). Employees with more than 10 years of service rose 8.7 percentage points in the period and accounted for more than 50% of the workforce in all segments except small institutions and subsidiaries (see Table 17, p. 52 and Table 18, p. 53). The higher average age and years of service over the three years were certainly linked to the high costs of terminating the employment of more senior employees and the need to keep employees with more experience and know-how to offset downsizing of personnel.

In line with previous years, there was a positive relationship between member institutions' size and their average age, which can broadly explain the positive relationship between their size and their employees' average age and years of service (see Graph 16, p. 50). The large institutions are the ones that have been operating in Portugal the longest, at an average of 69 years. They are also the ones with the highest average age of their workforce, which was over 46 in 2012 (see Table 14, p. 49) and the largest number of employees who have worked in the sector longest (20.6 on average) (see Table 15, p. 49).

Of all the segments by size or origin/type of legal structure, subsidiaries have the lowest average age and years of service, at 38 and 7.5 years respectively in 2012 (see Table 14 and Table 15, p. 49).

Table 14: Average age of the employees in domestic activity by size and origin/type of legal structure as at 31 December (2009 – 2012)

	2009	2010	2011	2012	Average
Average age (years):					
Total	43.5	43.8	44.4	45.1	-
Variation	-	*0.7%*	*1.5%*	*1.5%*	*1.2%*
By size:					
Large	45.0	45.2	45.7	46.2	-
Medium-sized	40.8	41.5	42.3	43.5	-
Small	38.9	39.1	39.9	40.7	-
By origin/type of legal structure:					
Domestic	44.2	44.4	45.0	45.5	-
Subsidiaries	41.7	42.6	43.8	44.8	-
Branch offices	36.5	37.1	37.0	38.2	-

Source: FIs, APB.

Table 15: Average years of service of the employees in domestic activity by size and origin/type of legal structure as at 31 December (2009 – 2012)

	2009	2010	2011	2012	Average
Average years of servisse (years):					
Total	16.8	17.4	17.3	18.6	-
Variation	-	*3.2%*	*-0.6%*	*7.5%*	*3.4%*
By size:					
Large	19.1	19.7	20.1	20.6	-
Medium-sized	13.5	14.0	12.4	16.1	-
Small	8.0	8.7	9.5	9.4	-
By origin/type of legal structure:					
Domestic	17.5	18.0	18.0	19.4	-
Subsidiaries	16.9	17.7	17.0	17.7	-
Branch offices	6.3	6.7	6.7	7.5	-

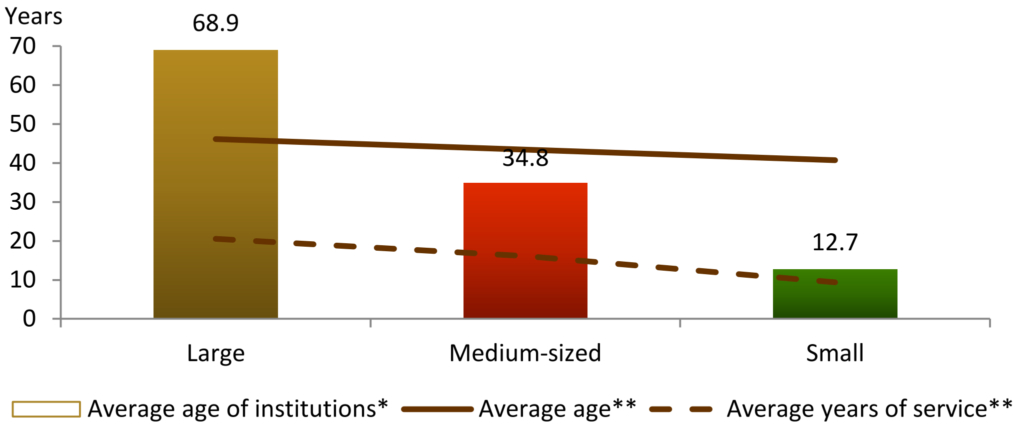
Source: FIs, APB.

At the end of 2012, the majority of the member institutions' employees had university degrees (52.8%). The growing weight of these employees in 2009-2012 was due to a reduction in numbers of those with compulsory or upper secondary education diplomas (27% and 10.6%, respectively) and not an increase in those with degrees, which remained stable over the period.

As is to be expected, there continues to be a relationship between academic achievement and the qualifications and experience required by the type of job. People with compulsory education therefore predominate in auxiliary jobs and those with upper secondary diplomas in administrative positions, while personnel with a degree predominate in specific jobs and as heads of department.

If we use the type of employment contract as a criterion, there has been a successive, highly substantial decrease (53%) in the number of employees with fixed-term contracts since 2009, while the number of permanent employees (although decreasing) did not change very much (-3%). This is clearly linked to the sharp fall in the number of employees aged under 30, as it is young people who are generally given fixed-term contracts. There was however an expected reversal in this trend in 2012, as downsizing needs affected permanent employees for the first time (-1,898 permanent employees against -208 with fixed-term contracts) (see Table 18, p. 53).

Graph 16: Comparison between the average age of member institutions and the age and years of service of their employees by size of member institutions as at 31 December 2012



Source: FIs, BdP, APB.
Note: *Weighted average age of APB member institutions by number of employees assigned to domestic activity in each size category.
**Arithmetic mean claculated with interval grouped data.

Finally, human resources by work schedule were the most stable variable in 2012. The vast majority, 94.3%, were full-time employees, and flexible work schedules were the second most favoured. There continued to be more women working part time and flexible schedules and more men working full time (see Table 16).

Table 16: Human resources by gender and type of work arrangement in domestic activity as at 31 December 2012

	Men	Women	Total	%
Full-time	27,881	23,674	51,555	*94.3%*
Part-time	35	333	368	*0.7%*
Flexi-time	1,173	1,364	2,537	*4.6%*
Shifts	119	118	237	*0.4%*
Total	29,208	25,489	54,697	*100.0%*

Source: FIs.

Summing up, the member institutions' human resources decreased by 6.7% from 2009 to 2012. The greatest reduction occurred in domestic activity, where the decrease in the number of employees accompanied the climate of uncertainty and economic contraction. In order to offset the decline in banking activity in Portugal, the member institutions looked for growth in foreign markets, which resulted in an increase (4.3%) in the number of employees working in international activity.

In spite of the contraction of the branch network, commercial activity maintained its importance and continued to play a vital role in selling financial products and services and enhancing customer relations. Where jobs are concerned, specific jobs have predominated in bank personnel and there has been a gradual rise in their representativity though mainly because administrative staff and heads of department have left.

University qualifications gained ground over others in the period, thanks to the skills and value they bring to the institutions. There was also greater proximity between genders in the financial institutions' workforces, particularly in specific jobs and heads of department.

Finally, although 2012 was a difficult year for the member institutions in terms of regulatory requirements and pressure on the banking sector to meet the economy's financing needs, downsizing of personnel occurred mainly via retirement and rescissions by mutual accord. Dismissals accounted for only 2.2% of total human resources leaving in 2012.

Table 17: Characterisation of employees in domestic activity by size and origin/type of legal structure as at 31 December 2012[a)]

	Total		Large		Medium-sized		Small		Domestic		Subsidiary		Branch office	
Number of employees														
Total	54,697	.	35,966	.	14,192	.	4,539	.	43,535	.	7,910	.	3,252	.
By Gender														
Men	29,208	*53.4%*	18,615	*51.8%*	8,010	*56.4%*	2,583	*56.9%*	23,115	*53.1%*	4,493	*56.8%*	1,600	*49.2%*
Women	25,489	*46.6%*	17,351	*48.2%*	6,182	*43.6%*	1,956	*43.1%*	20,420	*46.9%*	3,417	*43.2%*	1,652	*50.8%*
By Age														
Up to 30 years	4,599	*8.4%*	2,768	*7.7%*	1,174	*8.3%*	657	*14.5%*	3,376	*7.8%*	609	*7.7%*	614	*18.9%*
30 to 44 years	29,811	*54.5%*	18,357	*51.0%*	8,493	*59.8%*	2,961	*65.2%*	23,211	*53.3%*	4,386	*55.4%*	2,214	*68.1%*
45 years or over	20,287	*37.1%*	14,841	*41.3%*	4,525	*31.9%*	921	*20.3%*	16,948	*38.9%*	2,915	*36.9%*	424	*13.0%*
By Years of Service														
Up to 1 year	1,221	*2.2%*	360	*1.0%*	163	*1.2%*	698	*15.4%*	911	*2.1%*	128	*1.6%*	182	*5.6%*
1 to 5 years	9,450	*17.3%*	4,614	*12.8%*	3,373	*23.8%*	1,463	*32.2%*	6,063	*13.9%*	1,281	*16.2%*	2,106	*64.8%*
6 to 10 years	8,304	*15.2%*	5,012	*13.9%*	2,306	*16.2%*	986	*21.7%*	6,415	*14.7%*	1,374	*17.4%*	515	*15.8%*
11 to 15 years	11,562	*21.1%*	7,177	*20.0%*	3,425	*24.1%*	960	*21.2%*	9,458	*21.7%*	1,948	*24.6%*	156	*4.8%*
Over 15 years	24,160	*44.2%*	18,803	*52.3%*	4,925	*34.7%*	432	*9.5%*	20,688	*47.6%*	3,179	*40.2%*	293	*9.0%*
By Type of Employment Contract														
Permanent	53,273	*97.4%*	35,172	*97.8%*	13,802	*97.3%*	4,299	*94.7%*	42,444	*97.5%*	7,758	*98.1%*	3,071	*94.4%*
Fixed term	1,424	*2.6%*	794	*2.2%*	390	*2.7%*	240	*5.3%*	1,091	*2.5%*	152	*1.9%*	181	*5.6%*
By Academic Qualifications														
9th grade	3,923	*7.2%*	2,887	*8.0%*	924	*6.5%*	112	*2.5%*	3,631	*8.3%*	284	*3.6%*	8	*0.2%*
12th grade	21,898	*40.0%*	14,267	*39.7%*	6,102	*43.0%*	1,529	*33.7%*	17,293	*39.7%*	3,849	*48.7%*	756	*23.2%*
Higher education	28,876	*52.8%*	18,812	*52.3%*	7,166	*50.5%*	2,898	*63.8%*	22,611	*51.9%*	3,777	*47.7%*	2,488	*76.6%*
By Position														
Heads of department	13,753	*25.1%*	8,897	*24.7%*	3,707	*26.1%*	1,149	*25.3%*	10,824	*24.9%*	1,866	*23.6%*	1,063	*32.7%*
Specific	22,532	*41.2%*	14,278	*39.7%*	5,978	*42.1%*	2,276	*50.1%*	16,131	*37.0%*	4,500	*56.9%*	1,901	*58.5%*
Administrative	17,616	*32.2%*	12,359	*34.4%*	4,215	*29.7%*	1,042	*23.0%*	15,803	*36.3%*	1,525	*19.3%*	288	*8.9%*
Ancillary	796	*1.5%*	432	*1.2%*	292	*2.1%*	72	*1.6%*	777	*1.8%*	19	*0.2%*	-	*0.0%*
By Activity														
Commercial	35,609	*65.1%*	24,004	*66.7%*	9,526	*67.1%*	2,079	*45.8%*	29,374	*67.5%*	4,820	*60.9%*	1,415	*43.5%*
Other	19,088	*34.9%*	11,962	*33.3%*	4,666	*32.9%*	2,460	*54.2%*	14,161	*32.5%*	3,090	*39.1%*	1,837	*56.5%*

Source: FIs, APB.

[a)] Data from the sample of 32 member institutions.

Table 18: Number of employees in domestic activity as at 31 December (2009 – 2012) [a)]

	2009		2010		2011		2012	
Number of employees								
Total	58,194		58,069		56,559		54,120	
By Gender								
Men	31,744	*54.5%*	31,440	*54.1%*	30,455	*53.8%*	28,953	*53.5%*
Women	26,450	*45.5%*	26,629	*45.9%*	26,104	*46.2%*	25,167	*46.5%*
By Age								
Up to 30 years	7,542	*13.0%*	7,192	*12.4%*	5,686	*10.1%*	4,337	*8.0%*
30 to 44 years	32,087	*55.1%*	31,876	*54.9%*	31,100	*55.0%*	29,503	*54.5%*
45 years or over	18,565	*31.9%*	19,001	*32.7%*	19,773	*34.9%*	20,280	*37.5%*
By Years of Service								
Up to 1 year	2,740	*4.7%*	2,223	*3.8%*	1,080	*1.9%*	1,072	*2.0%*
1 to 5 years	11,592	*19.9%*	11,879	*20.5%*	11,564	*20.4%*	9,048	*16.7%*
6 to 10 years	10,519	*18.1%*	8,729	*15.0%*	9,030	*16.0%*	8,291	*15.3%*
11 to 15 years	10,323	*17.7%*	11,228	*19.3%*	12,388	*21.9%*	11,552	*21.4%*
Over 15 years	23,020	*39.6%*	24,010	*41.4%*	22,497	*39.8%*	24,157	*44.6%*
By Type of Employment Contract [b)]								
Permanent	52,931	*93.8%*	53,757	*95.4%*	53,267	*97.0%*	51,369	*97.3%*
Fixed term	3,477	*6.2%*	2,609	*4.6%*	1,624	*3.0%*	1,416	*2.7%*
By Academic Qualifications								
9th grade	5,375	*9.2%*	5,017	*8.6%*	4,573	*8.1%*	3,923	*7.2%*
12th grade	24,442	*42.0%*	23,897	*41.2%*	23,008	*40.7%*	21,850	*40.4%*
Higher education	28,377	*48.8%*	29,155	*50.2%*	28,978	*51.2%*	28,347	*52.4%*
By Position								
Heads of department	14,009	*24.8%*	13,832	*24.6%*	13,854	*25.2%*	13,421	*25.4%*
Specific	21,486	*38.1%*	21,497	*38.1%*	21,407	*39.0%*	21,472	*40.7%*
Administrative	20,113	*35.7%*	20,298	*36.0%*	18,812	*34.3%*	17,100	*32.4%*
Ancillary	800	*1.4%*	739	*1.3%*	818	*1.5%*	792	*1.5%*
By Activity								
Commercial	38,621	*66.4%*	38,122	*65.6%*	37,205	*65.8%*	35,607	*65.8%*
Other	19,573	*33.6%*	19,947	*34.4%*	19,354	*34.2%*	18,513	*34.2%*

Source: FIs, APB.

[a)] The values of 2012 do not coincide with those in Table 17, p. 52, due to the fact that human resources growth over time imposed an adjustment to the sample of 31 member institutions (see footnote 44, p. 35.).

[b)] For the analysis over time by type of employment contract and by position, the sample has been adjusted to 30 institutions by the additional exclusion of Banco BIC and BPN due to lack of data.

V.3. Training[55]

In 2012, the banking sector in Portugal had to adapt to a new reality created by the economic and financial crisis and its negative effects. The member institutions' need to improve their cost-to-income ratio was the real stimulus behind their cost containment policy. It is therefore not surprising that training was affected or that its main indicators fell substantially.

It was not only situational factors that resulted in a drop in the main training indicators over the three years, however. Factors of a structural nature, such as the increase in personnel with degrees and other qualifications at member institutions (see Table 18, p. 53) also reduced the workforces' training needs and contributed to the decline in training.

Table 19: Training at member institutions (2009 – 2012)

	2009	2010	2011	2012	Average
Number of Trainees					
Total	51,351	52,660	50,516	47,802	-
As % of number of employees in domestic activity	*91.4%*	*93.7%*	*92.3%*	*90.8%*	-
Annual growth rate		*2.5%*	*-4.1%*	*-5.4%*	*-2.3%*
Number of Participants in Training Courses	.	.	.	.	.
Total	427,965	491,453	376,072	340,143	-
Annual growth rate		*14.8%*	*-23.5%*	*-9.6%*	*-6.1%*
Number of Training Hours	.	.	.	.	.
Total	2,350,124	2,219,044	1,840,476	1,487,385	-
Annual growth rate		*-5.6%*	*-17.1%*	*-19.2%*	*-13.9%*
Average Duration of Training Courses	.	.	.	.	.
Average (hours)	15	19	10	16	-
Number of Training Courses	.	.	.	.	.
Total	11,799	13,466	12,074	8,708	-
Annual growth rate	.	*14.1%*	*-10.3%*	*-27.9%*	*-8.0%*

Source: FIs, APB.

As a result, there was a 5.4% reduction in the number of trainees in 2012, the most significant fall, though in line with the one that occurred in 2011 (see Table 19). Taking into account that this reduction was higher than that for the year among employees working in domestic activity, the training participation rate[56] fell 1.5 p.p. against 2011.

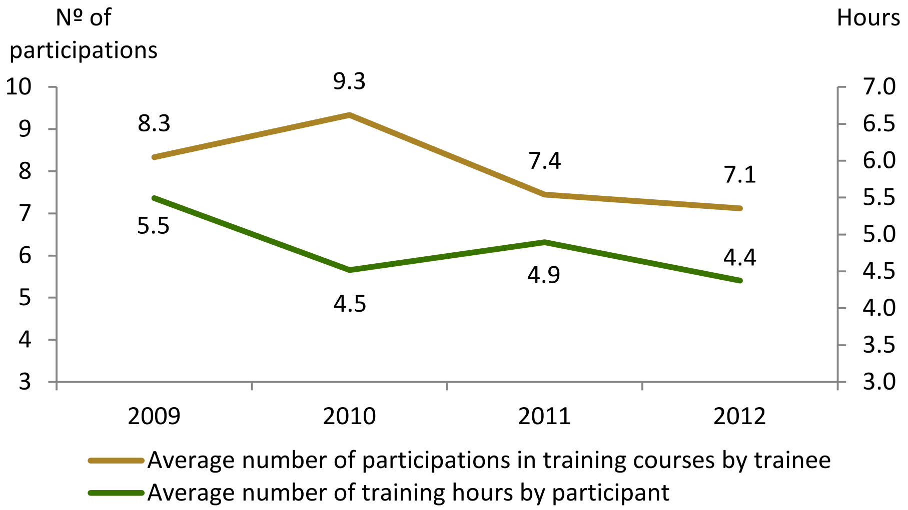
[55] Due to lack of data, and also for the reasons pointed out in footnote 44, p.36, all the indicators on training of human resources refer only to 28 of the 32 financial institutions in sample used in this Activity Report. Banco BIC, Banco BNP, Banco BNP SS and Banco do Brasil were excluded. One member has corrected its 2011 historical data related to training.

[56] The participation rate is calculated by dividing the number of employees attending training by the total number of employees working in domestic activity.

In addition to the decrease in the number of trainees, there was less involvement in training on their part. Each trainee participated in an average of 7.1 training courses in 2012, as opposed to 7.4 in 2011 and 9.3 in 2010 (see Graph 17). The number of participants in training has fallen around 150,000 since 2010 (see Table 19, p. 54) and is now at levels lower than in 2008.

Meanwhile, the data for 2012 are revealing, and confirm the downward trend in the amount of training in the previous two years. Measured by total hours, training has fallen considerably since 2009, representing an annual average decrease of 13.9% for the period (see Table 19, p. 54).

Graph 17: Comparison between the average number of participations in training courses per trainee and the average number of training hours per participant (2009 – 2012)



Source: FIs, APB.

As the decrease in the amount of training was greater than that in the number of participants, average training hours per participant went down against 2011. While in 2011 each participant spent an average of 4.9 hours in training, in 2012 the time went down to 4.4 hours (see Graph 17). This reduction is in contrast with an increase in the average duration of courses (see Table 19, p. 54), which suggests that the range of short courses may have been reduced while the financial institutions continued to prefer shorter courses for most of their trainees. This certainly had to do with the need to rationalise and increase the profitability of available training and to reduce the time spent away from the job, given the huge demands placed on the financial institutions' workforce in 2012 by the new compliance and prudential supervision rules.

There was an opposing trend in the average number of participants per course, which rose from 36 in 2009 to 39 in 2012, due to a sharp drop in the number of courses held in the period (see Table 19, p. 54). Pressure on the banking sector to reduce costs resulted in disinvestment in training, and so efforts were made to capitalise on existing training by involving more employees in each course, particularly in in-house training (see Table 20, p. 56).

The reduction in the number of courses occurred in external and in-house training. While in-house courses fell by 34% against 2011 (see Table 20, p. 56), external courses decreased very little (by only 0.3%). This suggests that the know-how of external entities specialising in more advanced training continues to be valued, especially considering the growing importance of specific jobs at the member institutions and the greater demands on these jobs. Corroborating this is the very substantial, almost 50% growth in the number of participants in external training, which raised their average number from 8.3 in 2011 to 12.3 in 2012 (see Table 20). Furthermore, the unfavourable economic situation in Portugal has resulted in price adjustments in certain business sectors. Specialised training entities were no exception and they will certainly have made their prices more competitive.

Table 20: Type of participation, training courses and corresponding methods (2009 – 2012)

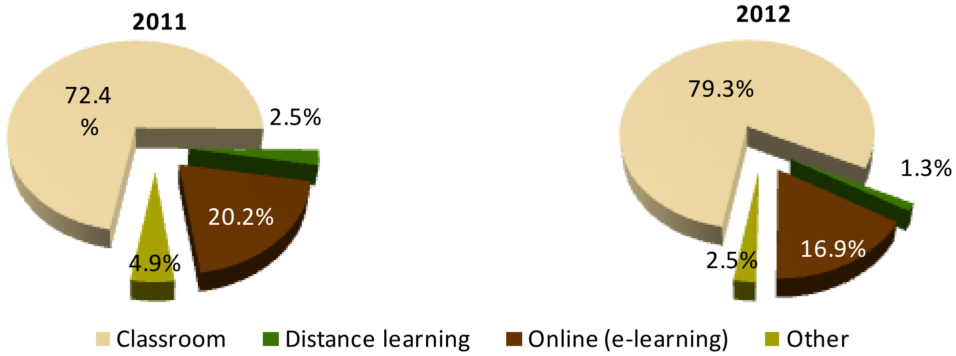
	2009		2010		2011		2012		Average
Type of Training Courses									
In-house	9,394	*79.6%*	10,962	*81.4%*	9,880	*81.8%*	6,521	*74.9%*	*79.4%*
External	2,405	*20.4%*	2,504	*18.6%*	2,194	*18.2%*	2,187	*25.1%*	*20.6%*
Participations in Training Courses									
In-house	405,737	*94.8%*	465,898	*94.8%*	357,928	*95.2%*	313,300	*92.1%*	*94.2%*
External	22,228	*5.2%*	25,555	*5.2%*	18,144	*4.8%*	26,843	*7.9%*	*5.8%*
Training Methods									
Classroom	65.7%		68.7%		72.4%		79.3%		71.5%
Distance learning	5.3%		7.4%		2.5%		1.3%		4.1%
Online training (e-learning)	21.9%		9.2%		20.2%		16.9%		17.1%
Other	7.0%		14.6%		4.9%		2.5%		7.3%

Source: FIs, APB.

The sharp reduction in internal courses in 2012 reduced their representativity in the training panorama for the first time. Even so, in-house courses continued to predominate in training and represented 74.9%, as opposed to 25.1% for external courses (see Table 20).

Both in-house and external courses used different methods, such as classroom training, distance learning and online training, among others (see Table 20). There was more classroom training in 2012 and an ongoing reduction in other categories (see Table 20 and Graph 18).

Graph 18: Training methods (2011 vs. 2012)



Source: FIs, APB.

The member institutions' disinvestment in training totalled around 2.8 million euros in 2012. All together, 15.2 million euros were allocated to training (i.e. 0.8% of general administrative expenditure), which represented 84.4% of the amount allocated in 2011 (see Table 21).

Table 21: Spending on training (2009 – 2012)

	2009	2010	2011	2012	Average
Spending on Training					
Total (thousand €) a)	32,251	21,667	18,059	15,243	-
Expenses with external organisations	14,085	13,084	10,670	8,618	-
Internal expenses	18,167	8,583	7,389	6,625	-
Annual growth rate b)		*-32.8%*	*-16.7%*	*-15.6%*	*-21.7%*
As % of general administrative expenses c)	*1.6%*	*1.0%*	*0.9%*	*0.8%*	*1.1%*
Costs per Training Course					
Total (€)	2,733.40	1,608.98	1,495.67	1,750.48	-
Annual growth rate		*-41.1%*	*-7.0%*	*17.0%*	*-10.4%*
Costs per Trainee					
Total (€)	628.06	411.44	357.48	318.88	-
Annual growth rate		*-34.5%*	*-13.1%*	*-10.8%*	*-19.5%*
Costs per Participant					
Total (€)	75.36	44.09	48.02	44.81	-
Annual growth rate		*-41.5%*	*8.9%*	*-6.7%*	*-13.1%*

Source: FIs, APB.

a) Expenses with external organisations and internal expenses are not directly related with the classification of training as internal and external.

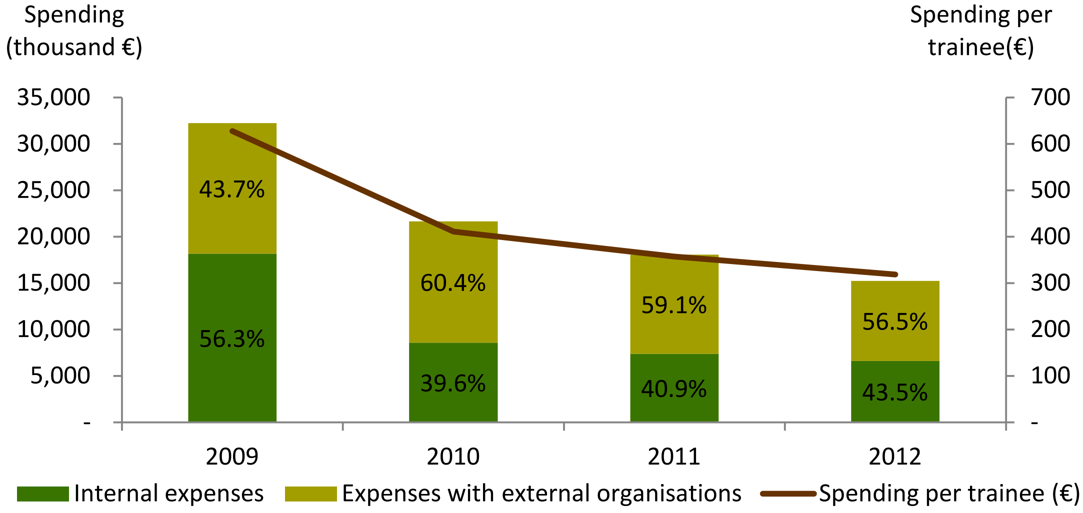
b) Annual growth rate of total spending on training.

d) Total spending on training as a percentage of total general administrative expenditures.

Costs of both external and in-house training went down, and those of external courses in particular fell 19.2% against 2011 (see Table 21). This reduction can be partially explained by the adjustment in prices by training entities and the current contraction of costs in the Portuguese banking sector. The effort to reduce internal costs was less successful (10.3%) than that for external entities, as most of these costs are fixed. The financial institutions are therefore faced with limits on internal cost reductions and so have less possibility of making adjustments.

Because of the circumstances described, the weight of internal training costs increased 2.6 p.p. in 2012. Costs of external entities still accounted for the lion's share of training expenditure (56.5%), although its weight has been falling since 2009 (see Graph 19, p. 58).

Graph 19: Spending on training (total and per trainee)



Source: FIs, APB.

Meanwhile costs per course rose in 2012 (17%), reversing the downward trend since 2009 (see Table 21, p. 57). Most of this can be explained by a change in the course mix offered, as longer courses gained more weight (due to a reduction in the number of shorter courses), which explains the increase in average duration in 2012. Longer courses tend to be external and their content more complex and advanced, and so it is not surprising that they are more expensive and that costs per course increased.

This seems to reflect the member institutions' stake in continuing to offer their employees longer, higher quality courses to minimise the impact of the overall disinvestment in training.

The rise in costs per course is in contrast to the gains in efficiency achieved in spending per participant and especially per trainee, which went down 6.7% and 10.8% respectively in 2012. These gains are the result of attempts to optimise the number of employees in training, albeit at the expense of lower average participation by each individually and higher attendance of participants in shorter courses (see Table 21, p. 57).

VI. Banking Coverage Indicators

VI.1. Branch network in Portugal

At the end of 2012, the member institutions had close to 6,000 branches[57], 5.1% fewer than in 2011 (see Table 22).

The period of economic growth in Portugal fostered the expansion of the branch network. New branches were considered a competitive advantage in view of growing competition[58]. Proximity to customers and quality of service were decisive in maintaining market shares and encouraged financial institutions to increase penetration of the network. Technology also facilitated expansion as fewer employees were needed to open a new branch and so personnel costs were lower.

This strategy was based on overoptimistic forecasts of growth in economic activity. The financial crisis, contraction of the economy and simultaneous expansion of electronic channels showed that there were too many branches and this was incompatible with the need to reduce costs, optimise resources and improve efficiency. As a result it was essential to close branches that were not offering the expected return.

Table 22: Number of branches in Portugal as at 31 December (2009 – 2012)[59]

	2009	2010	2011	2012	Average
Number of Branches in Portugal					
Total	6,383	6,457	6,307	5,988	-
Annual growth rate	-	*1.2%*	*-2.3%*	*-5.1%*	*-2.1%*

Source: FIs, APB.

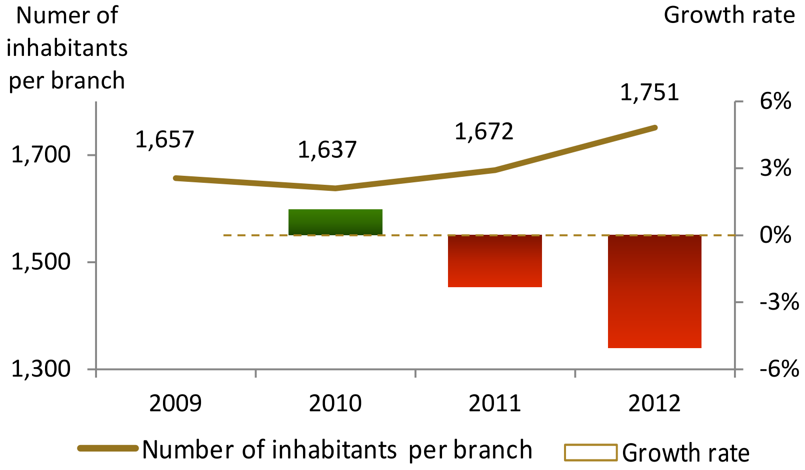
The number of inhabitants per branch increased from 1,672 in 2011 to 1,751 in 2012. Although Portugal's resident population decreased in 2012, the reduction in the number of branches explains the indicator's 4.8% growth in 2012 (see Graph 20, p. 60).

[57] The sample used for analysis of growth (2009 - 2012) has been adjusted to 31 financial institutions, as BNP SS was excluded in the reasons set out in footnote 44, p. 36. As a result of the Banco BIC - BPN merger, the comparative data prior to 2012 were adjusted to reflect BPN's past activity (see footnote 3, p. 1).

[58] Seven of the 32 institutions went into business in the early 2000s.

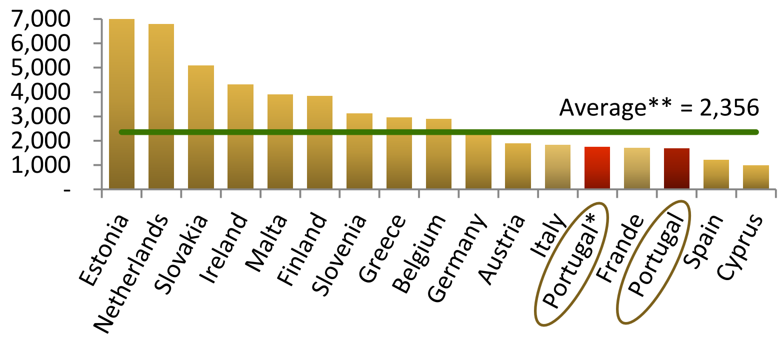
[59] The number of branches does not coincide with that in Activity Report 47 (2011) and 46 (2010) due to a change in historical data made by two APB members.

Graph 20: Number of inhabitants per branch vs. branches´ growth rate (2009 – 2012)



Source: FIs, APB.

Graph 21: Number of inhabitants per branch in the euro area as at 31 December 2012



Source: FIs, Eurostat, ECB, APB.

Note: * Includes only branches of APB member institutions.

** Weighted average of number of inhabitants per branch by the population of each country.

Compared to other countries in the euro area, Portugal still has a high number of branches in relation to its population. Graph 21 confirms this and shows that only Spain's and Cyprus's branch networks have greater coverage than Portugal. Even so, assessment of the extent of a country's bank network should also take account of population density, in that fewer inhabitants per branch may mean a more highly dispersed population rather than an oversized network.

A more detailed analysis shows that, regardless of their size or origin/form of legal structure, all the member institutions reduced their branch networks (see Table 24 and Table 23, p. 63). All the large institutions cut down their networks (see Chart 5, p. 61). The medium-sized segment also generally followed a reduction strategy. This is in direct contrast to the small financial institutions, the majority of which (around 63%) maintained their branch networks. All the institutions that decided to increase their number of branches were domestic and in this segment.

All the foreign financial institutions chose to maintain or reduce their branch networks (see Chart 5, p. 61). It is clear that the reduction in coverage of the banking network left by the financial institutions that deleveraged was used not by foreign institutions wishing to expand their positions but by small Portuguese institutions to grow and capture a larger market.

Chart 5: Changes in the member institutions´ branch network by size and origin/type of legal structure (2011 – 2012)

	Increase	Maintenance	Decrease	TOTAL Σ
Large	0	0	5	5
Medium-sized	0	1	6	7
Small	3	12	4	19
Domestic	3	8	9	20
Subsidiary	0	1	4	5
Branch office	0	4	2	6
TOTAL	3	13	15	31

Source: FIs, APB.

Note: The chart demonstrates the number of financial institutions, in the sample of 32 that expanded, maintained or reduced their branch network in each segment. The sum up of the parcels result in 31 since Montepio and Finibanco were analysed conjointly.

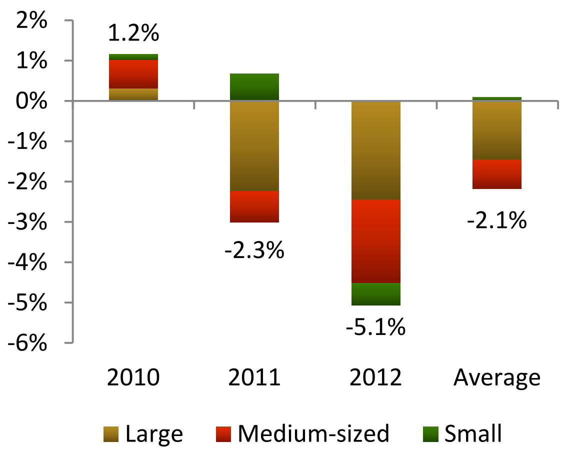
In segmentation by size, the largest financial institutions have the most sizeable branch networks (around 60%) in Portugal (see Table 23, p. 63 and Graph 23 a), p. 62) and so they were the ones that most contributed (2.5%) to this reduction (5.1%) in the number of branches in 2012. The medium-sized financial institutions made a similar contribution (2.1%). While the contraction in the large institutions' branch network began in 2011 and was evenly distributed in the last two years, 72% of the small institutions' reduction occurred in 2012. The small institutions only contributed in net terms to the deleveraging of the sector in 2012 (see Table 23, p. 63 and Graph 22 a), p. 62).

In terms of the member institutions' origin/form of legal structure, domestic institutions are once again those that have contributed most to the reduction in number of branches since 2010 (1.7% in 2011 and 3.1% in 2012). There was also a considerable decrease in the number of branches of branch offices and subsidiaries, especially against 2011. The networks of these two segments contracted 8.3% and 11% respectively, which may be linked to external deleveraging requirements, especially for branch offices, and a reduction of exposure to peripheral countries, which include Portugal, particularly in the case of subsidiaries (see Table 24, p. 63 and Graph 22 b), p. 62).

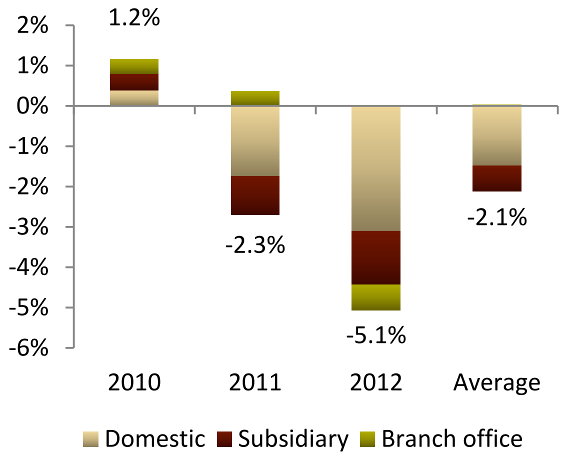
This contraction in the number of branches of subsidiaries and branch offices naturally resulted in lower representativity, meaning that domestic institutions' market share rose 0.9 p.p. (see Graph 23 b), p. 62).

Graph 22: Contribution to the rate of change of the number of branches in Portugal by size and origin/type of legal structure as at 31 December (2010 - 2012)

a) By size



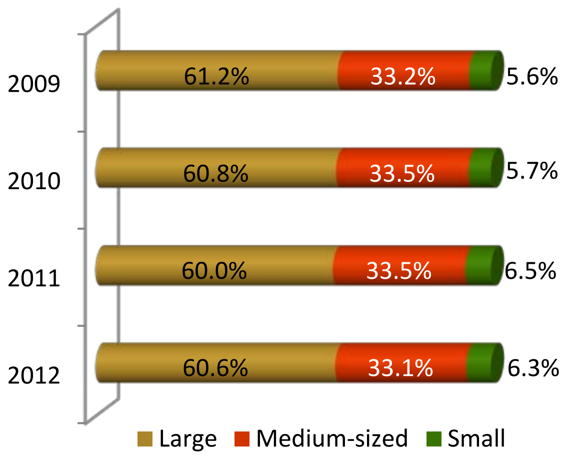
b) By origin/type of legal structure



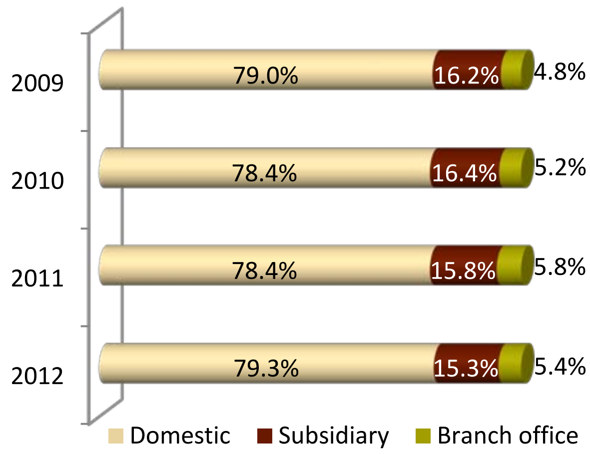
Source: FIs, APB.

Graph 23: Representativity of member institutions in term of number of branches in Portugal by size and origin/type of legal structure as at 31 December (2009 - 2012)

a) By size



b) By origin/type of legal structure



Source: FIs, APB.

Table 23: Number of branches in Portugal by size as at 31 December (2009 – 2012)

	2009	2010	2011	2012	Average
Large					
Total	3,906	3,926	3,782	3,628	-
Annual growth rate	-	*0.5%*	*-3.7%*	*-4.1%*	*-2.4%*
Contribution to growth in the number of branches	-	*0.3%*	*-2.2%*	*-2.5%*	*-1.5%*
Medium-sized					
Total	2,120	2,165	2,115	1,984	-
Annual growth rate	-	*2.1%*	*-2.3%*	*-6.2%*	*-2.1%*
Contribution to growth in the number of branches	-	*0.7%*	*-0.8%*	*-2.1%*	*-0.7%*
Small					
Total	357	366	410	376	-
Annual growth rate	-	*2.5%*	*12.0%*	*-8.3%*	*2.1%*
Contribution to growth in the number of branches	-	*0.2%*	*0.7%*	*-0.5%*	*0.1%*

Source: FIs, APB.

Table 24: Number of branches in Portugal by origin/type of legal structure as at 31 December (2009 – 2012)

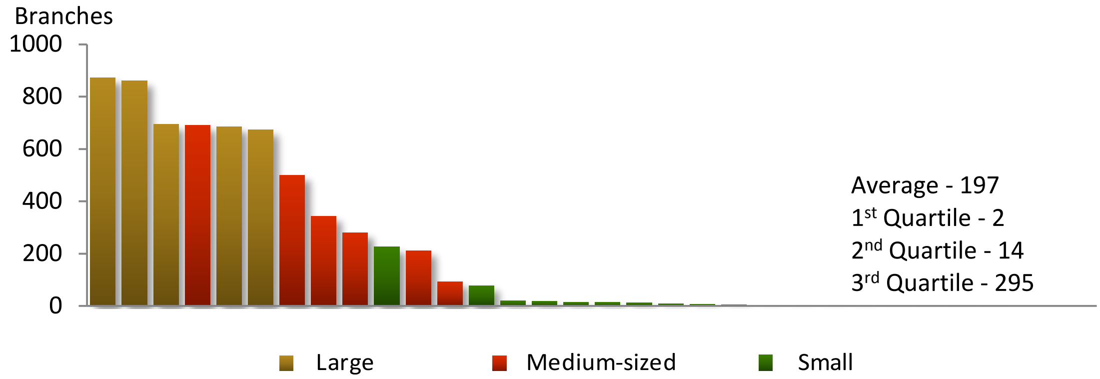
	2009	2010	2011	2012	Average
Domestic					
Total	5,035	5,060	4,947	4,751	-
Annual growth rate	-	*0.5%*	*-2.2%*	*-4.0%*	*-1.9%*
Contribution to growth in the number of branches	-	*0.4%*	*-1.7%*	*-3.1%*	*-1.5%*
Filiais					
Total	1,033	1,059	997	914	-
Annual growth rate	-	*2.5%*	*-5.9%*	*-8.3%*	*-3.9%*
Contribution to growth in the number of branches	-	*0.4%*	*-1.0%*	*-1.3%*	*-0.6%*
Sucursais					
Total	315	338	363	323	-
Annual growth rate	-	*7.3%*	*7.4%*	*-11.0%*	*1.2%*
Contribution to growth in the number of branches	-	*0.4%*	*0.4%*	*-0.7%*	*0.0%*

Source: FIs, APB.

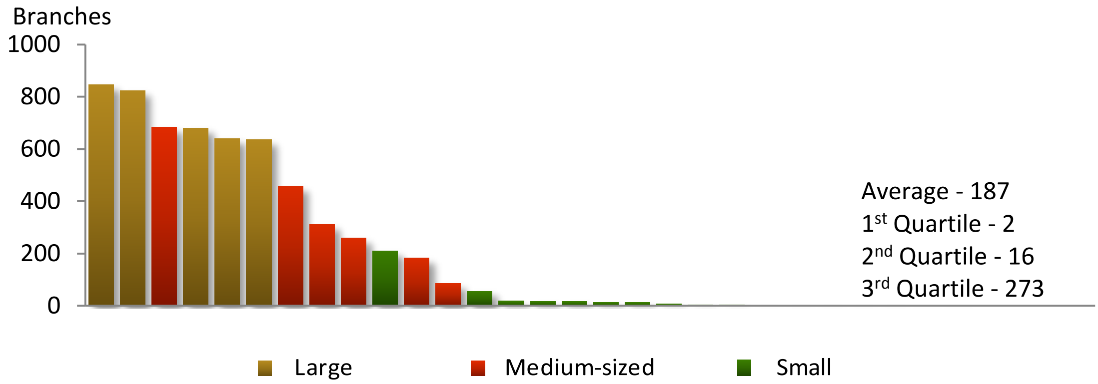
The increase in the large and domestic financial institutions' market share in terms of number of branches in 2012, at the expense of the others, resulted in an increase in the concentration of the banking market and accentuated differences from previous years, as shown in Graph 24, p. 64.

Graph 24: Number of branches of 33 member institutions as at 31 December (2011 e 2012)

a) 2011



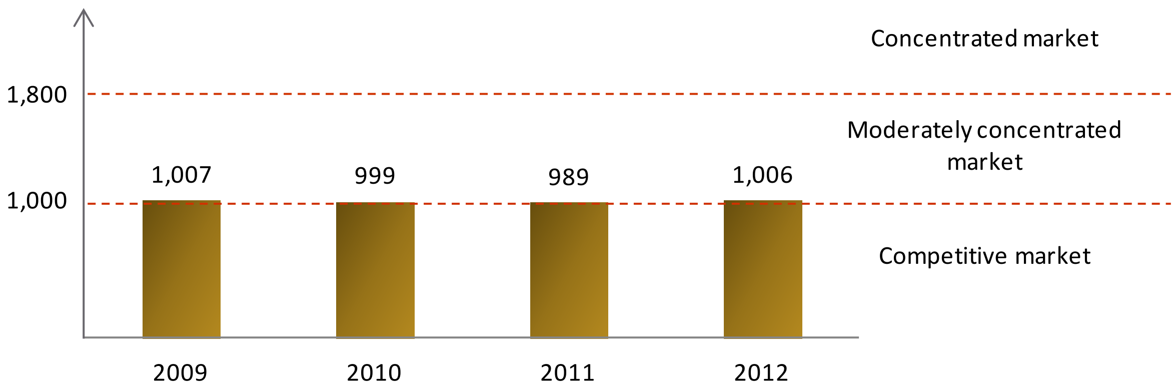
b) 2012



Source: FIs, APB.

The rise in the Herfindahl Index from 989 in 2011 to 1,006 in 2012 corroborates this. At the end of the year, the Portuguese market in terms of bank network was back at an intermediate level, as in 2009, and could be considered moderately concentrated (see Graph 25).

Graph 25: Herfindahl Index as at 31 December (2009 – 2012)[60]



Source: FIs, APB.

[60] The absolute value of the Herfindahl Index is different to the one shown on Activity Report (2011) (1,067, 1,060 and 1,050 for year 2009, 2010 and 2011, respectively) due to the inclusion of BPN in the sample of institutions used in this Activity Report.

Where geographical distribution of the member institutions' branch network was concerned, the largest concentration of branches was in the most populated districts. This is not surprising, as proximity to customers is one of the decisive factors in geographical expansion, corroborated by the correlation of 0.98 between the population and the number of branches that serve it. The most populated districts, Lisbon and Porto, are still the two main centres with the highest number of branches (38.8% of the total), while the least populated, Horta and Angra do Heroísmo, have the smallest branch network (1.2% of the total) (see Graph 26 b), p. 66).

Meanwhile, population dispersal also has considerable influence on the geographical distribution of the branch network, as greater concentration of inhabitants reduces the number of branches needed to serve them. The data also confirm that a district's area and resident population explain banking coverage in Portugal, as shown by a regression analysis of the three variables[61].

Although to different extents in absolute and percentage terms, all the districts' branch networks were reduced in 2012. Bragança was the only exception, as no changes were made.

Angra do Heroísmo was the district with the greatest reduction (7.7%) in 2012, followed by greater Lisbon and Porto. Funchal remained at the top of the list in relative terms of districts whose branch networks were reduced most (6.3%). In absolute terms, not including Lisbon or Porto, the districts of Leiria, Aveiro, Braga, Setúbal and Coimbra suffered reductions of between 15 and 19 branches. With the exception of Bragança, three inland districts (Beja, Évora and Portalegre) and two in the islands (Horta and Angra do Heroísmo), all the others were reduced by 5 to 11 branches, as shown in Graph 26 a), p. 66.

The generalised but differentiated reduction in the number of branches, along with changes in population distribution in the various districts, resulted not only in an increase in the number of inhabitants per branch in most of them but also some changes in the relative position of the districts on the basis of the indicator in question. They include Ponta Delgada, Funchal, Angra de Heroísmo and Beja with the highest growth against 2011, as opposed to Leiria, Guarda and Santarém, with the greatest reduction.

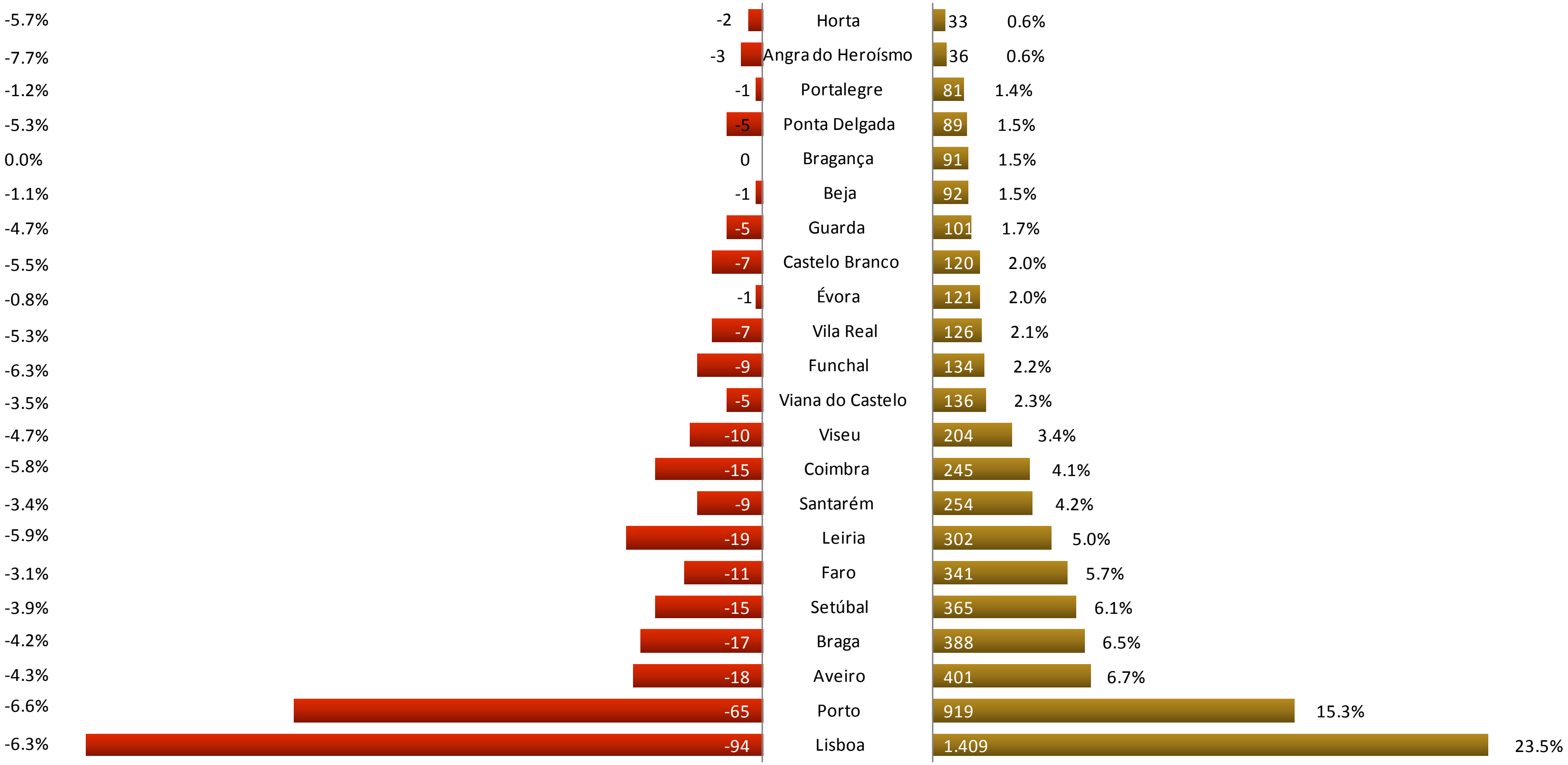
The district of Horta represents the highest point and Setúbal the lowest on the scale in 2012 (see Graph 27, p. 67). Horta, the district with the fewest inhabitants and the fewest branches in Portugal, had 1,012 inhabitants per branch. Setúbal, which was third in number of inhabitants and fifth in number of branches, had 2,340 inhabitants per branch in 2012.

[61] Results of significance test and adjusted determination coefficient, adjusted R^2.

Graph 26: Branch network per district 2012 and respective changes against 2011

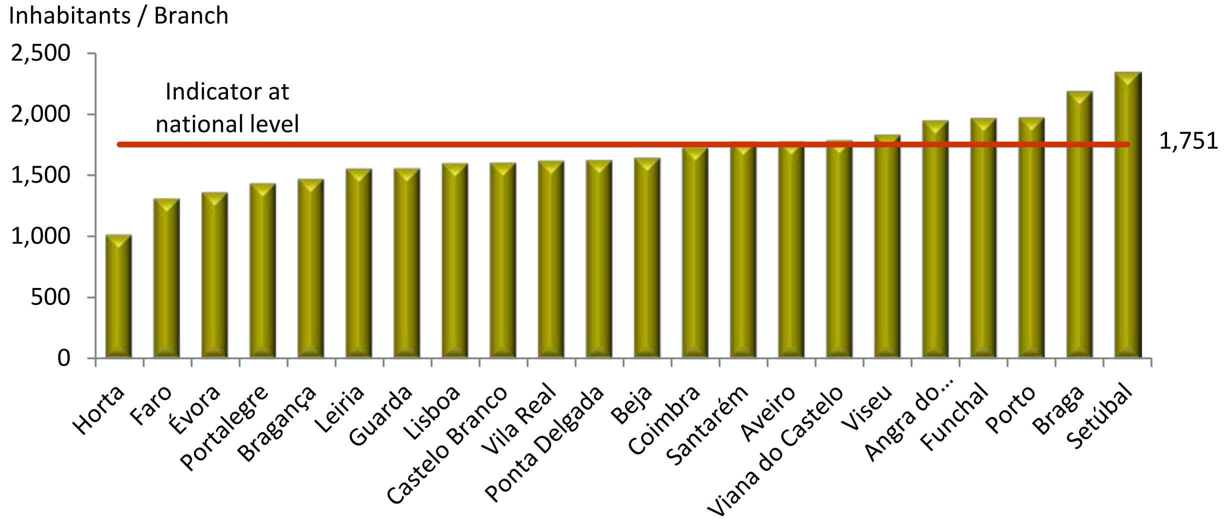
a) Absolute and percentile variation in the number of branches per district

b) Branch network in absolute and percentage terms per district, in 2012



Source: FIs, APB.

Graph 27: Inhabitants per branch by district as at 31 December 2012

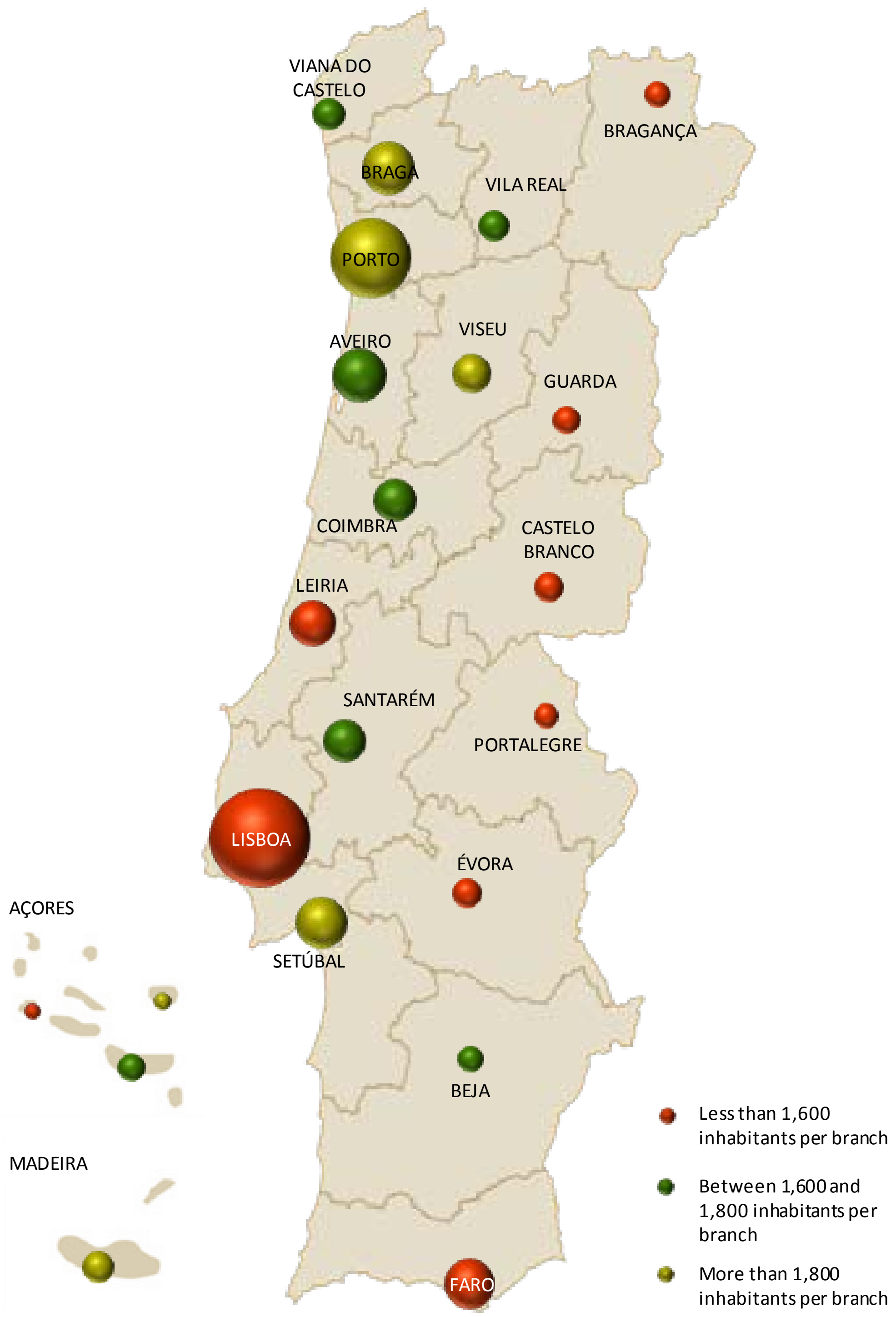


Source: FIs, APB.

Figure 2, p. 68, offers a visual representation of the geographical distribution of branches and number of inhabitants per branch.

The large member institutions' predominance in most districts (see Graph 28, p. 69) in terms of coverage per branch network by size is confirmed. Their presence in this segment is especially high in mainland Portugal (all 18 districts), all with a market share of over 50%, particularly in Setúbal and Lisbon. Their presence tends to go down in less populated districts. There are proportionally more medium-sized financial institutions in the Azores, while small institutions have a higher presence in Ponta Delgada, Horta and Leiria. A more detailed analysis shows an association between geographical distribution of branches and the origin of some institutions, as they have more branches in their districts of origin.

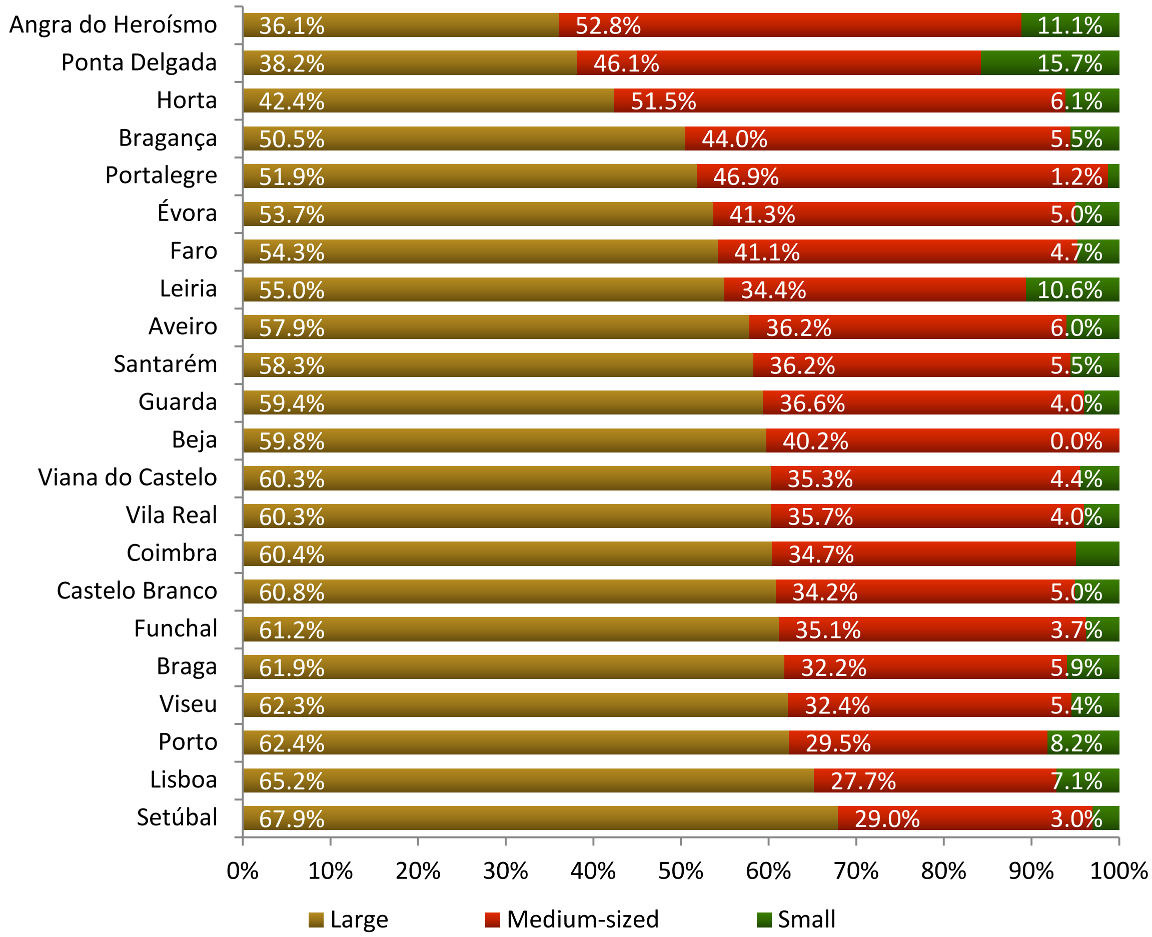
Figure 2: Branches and number of inhabitants per branch by district as at 31 December 2012



Source: FIs, Statistics Portugal, APB.

Note: The size of the bubbles indicates the absolute number of branches in the district, while the colour shows the number of inhabitants per branch.

Graph 28: Percentage of branches by size and district as at 31 December 2012



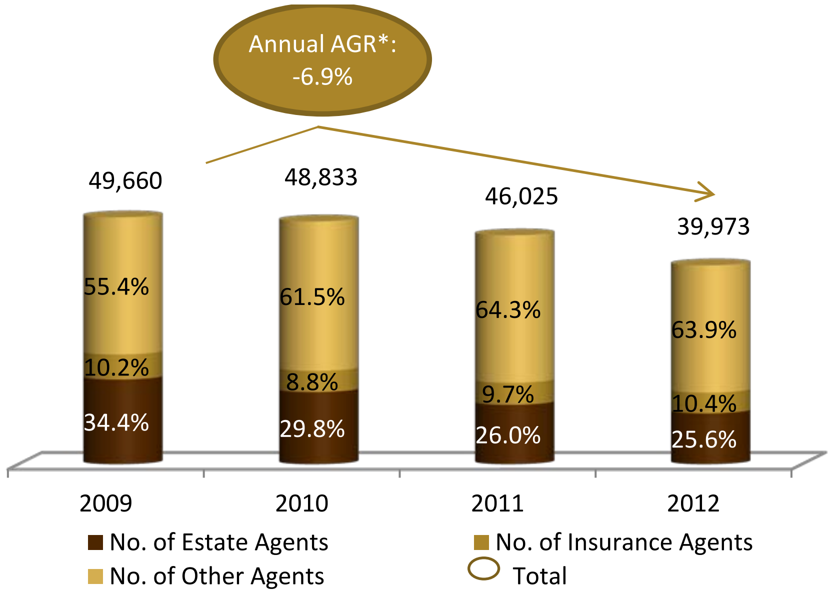
Source: FIs, APB.

In addition to their branches, the member institutions also use external promoters as distribution channels. They sell bank products but do not belong to the financial institutions themselves. Their numbers have been decreasing significantly since 2009. The annual average decrease over the three years was 6.9% and the reduction was 13.1% in 2012 (see Graph 29 and Table 25, p. 70).

The most accentuated reduction was in the estate agent segment (40% over the three years), which can be explained by the contraction in the property market and lower demand for mortgages in Portugal (see Table 25, p. 70). As a result, the representativity of estate agents among external promoters has fallen 8.8 p.p. since 2009.

In spite of an increase in their weight in external promoters, the number of insurance brokers fell from 5,065 in 2009 to 4,174 in 2012. To a lesser extent, other promoters also showed an annual average reduction (2%) in the period.

Graph 29: Number and type of external promoters as at 31 December (2009 – 2012)



Source: FIs, APB.
Note: *Average annual growth rate.

Table 25: Number of external promotores in Portugal by type as at 31 de December (2009 – 2012)

	2009	2010	2011	2012	Average
External Agents					
Total	49,660	48,833	46,025	39,973	-
Annual growth rate	-	*-1.7%*	*-5.8%*	*-13.1%*	*-6.9%*
Estate Agents					
Total	17,070	14,531	11,970	10,249	-
Annual growth rate	-	*-14.9%*	*-17.6%*	*-14.4%*	*-15.6%*
Insurance Agents					
Total	5,065	4,293	4,456	4,174	-
Annual growth rate	-	*-15.2%*	*3.8%*	*-6.3%*	*-5.9%*
Other Agents					
Total	27,525	30,009	29,599	25,550	-
Annual growth rate	-	*9.0%*	*-1.4%*	*-13.7%*	*-2.0%*

Source: FIs, APB.

Table 26: Number of branches per district by size and origin/type of legal structure as at 31 December 2012

	Total		Large		Medium-sized		Small		Domestic		Subsidiary		Branch office	
Number of Branches														
Total	5,988		3,628		1,984		376		4,751		914		323	
Per District														
Aveiro	401	*6.7%*	232	*6.4%*	145	*7.3%*	24	*6.4%*	323	*6.8%*	60	*6.6%*	18	*5.6%*
Beja	92	*1.5%*	55	*1.5%*	37	*1.9%*	-	*0.0%*	83	*1.7%*	7	*0.8%*	2	*0.6%*
Braga	388	*6.5%*	240	*6.6%*	125	*6.3%*	23	*6.1%*	308	*6.5%*	59	*6.5%*	21	*6.5%*
Bragança	91	*1.5%*	46	*1.3%*	40	*2.0%*	5	*1.3%*	79	*1.7%*	9	*1.0%*	3	*0.9%*
Castelo Branco	120	*2.0%*	73	*2.0%*	41	*2.1%*	6	*1.6%*	101	*2.1%*	15	*1.6%*	4	*1.2%*
Coimbra	245	*4.1%*	148	*4.1%*	85	*4.3%*	12	*3.2%*	202	*4.3%*	35	*3.8%*	8	*2.5%*
Évora	121	*2.0%*	65	*1.8%*	50	*2.5%*	6	*1.6%*	106	*2.2%*	11	*1.2%*	4	*1.2%*
Faro	341	*5.7%*	185	*5.1%*	140	*7.1%*	16	*4.3%*	262	*5.5%*	57	*6.2%*	22	*6.8%*
Guarda	101	*1.7%*	60	*1.7%*	37	*1.9%*	4	*1.1%*	93	*2.0%*	7	*0.8%*	1	*0.3%*
Leiria	302	*5.1%*	166	*4.6%*	104	*5.2%*	32	*8.5%*	251	*5.3%*	37	*4.0%*	14	*4.3%*
Lisboa	1,409	*23.5%*	919	*25.3%*	390	*19.7%*	100	*26.6%*	1,032	*21.7%*	266	*29.1%*	111	*34.4%*
Portalegre	81	*1.4%*	42	*1.2%*	38	*1.9%*	1	*0.3%*	68	*1.4%*	11	*1.2%*	2	*0.6%*
Porto	919	*15.3%*	573	*15.8%*	271	*13.7%*	75	*19.9%*	699	*14.7%*	164	*17.9%*	56	*17.3%*
Santarém	254	*4.2%*	148	*4.1%*	92	*4.6%*	14	*3.7%*	204	*4.3%*	36	*3.9%*	14	*4.3%*
Setúbal	365	*6.1%*	248	*6.8%*	106	*5.3%*	11	*2.9%*	287	*6.0%*	57	*6.2%*	21	*6.5%*
Viana do Castelo	136	*2.3%*	82	*2.3%*	48	*2.4%*	6	*1.6%*	106	*2.2%*	23	*2.5%*	7	*2.2%*
Vila Real	126	*2.1%*	76	*2.1%*	45	*2.3%*	5	*1.3%*	108	*2.3%*	15	*1.6%*	3	*0.9%*
Viseu	204	*3.4%*	127	*3.5%*	66	*3.3%*	11	*2.9%*	177	*3.7%*	22	*2.4%*	5	*1.5%*
Funchal	134	*2.2%*	82	*2.3%*	47	*2.4%*	5	*1.3%*	112	*2.4%*	17	*1.9%*	5	*1.5%*
Angra do Heroísmo	36	*0.6%*	13	*0.4%*	19	*1.0%*	4	*1.1%*	34	*0.7%*	2	*0.2%*	-	*0.0%*
Horta	33	*0.6%*	14	*0.4%*	17	*0.9%*	2	*0.5%*	31	*0.7%*	2	*0.2%*	-	*0.0%*
Ponta Delgada	89	*1.5%*	34	*0.9%*	41	*2.1%*	14	*3.7%*	85	*1.8%*	2	*0.2%*	2	*0.6%*

Source: FIs, APB.

Table 27: Number of branches per district as at 31 December (2009 - 2012) [a)]

	2009		2010		2011		2012	
Number of Branches								
Total	**6,383**		**6,457**		**6,307**		**5,988**	
Per District								
Aveiro	430	*6.7%*	424	*6.6%*	419	*6.6%*	401	*6.7%*
Beja	93	*1.5%*	94	*1.5%*	93	*1.5%*	92	*1.5%*
Braga	403	*6.3%*	407	*6.3%*	405	*6.4%*	388	*6.5%*
Bragança	92	*1.4%*	92	*1.4%*	91	*1.4%*	91	*1.5%*
Castelo Branco	122	*1.9%*	130	*2.0%*	127	*2.0%*	120	*2.0%*
Coimbra	254	*4.0%*	264	*4.1%*	260	*4.1%*	245	*4.1%*
Évora	123	*1.9%*	123	*1.9%*	122	*1.9%*	121	*2.0%*
Faro	354	*5.5%*	362	*5.6%*	352	*5.6%*	341	*5.7%*
Guarda	106	*1.7%*	109	*1.7%*	106	*1.7%*	101	*1.7%*
Leiria	319	*5.0%*	325	*5.0%*	321	*5.1%*	302	*5.1%*
Lisboa	1,554	*24.3%*	1,574	*24.4%*	1,503	*23.8%*	1,409	*23.5%*
Portalegre	81	*1.3%*	84	*1.3%*	82	*1.3%*	81	*1.4%*
Porto	988	*15.5%*	999	*15.5%*	984	*15.6%*	919	*15.3%*
Santarém	266	*4.2%*	265	*4.1%*	263	*4.2%*	254	*4.2%*
Setúbal	393	*6.2%*	396	*6.1%*	380	*6.0%*	365	*6.1%*
Viana do Castelo	141	*2.2%*	142	*2.2%*	141	*2.2%*	136	*2.3%*
Vila Real	131	*2.1%*	132	*2.0%*	133	*2.1%*	126	*2.1%*
Viseu	212	*3.3%*	216	*3.3%*	214	*3.4%*	204	*3.4%*
Funchal	155	*2.4%*	153	*2.4%*	143	*2.3%*	134	*2.2%*
Angra do Heroísmo	41	*0.6%*	41	*0.6%*	39	*0.6%*	36	*0.6%*
Horta	31	*0.5%*	32	*0.5%*	35	*0.6%*	33	*0.6%*
Ponta Delgada	94	*1.5%*	93	*1.4%*	94	*1.5%*	89	*1.5%*

Source: FIs, APB.

[a)] Despite the analysis of the evolution of the branch network over time made it necessary to adjust the sample, as indicated in footnote 44, p. 35, the 2012 figures not coincide with those in Table 26, p. 71 and Graph Graph 26, p. 66, because the institution excluded has no branch offices in Portugal.

VI.2. Branch offices and representative offices abroad[62]

The financial and economic crisis affected the member institutions' investment capacity and consequently their international expansion strategy. While there was considerable expansion in 2011, the trend was reversed in 2012 and the number of branch offices and representative offices abroad fell 1.4% (see Table 28).

Relevant to this context, 2012 was affected by the cessation of the Tax Benefit Statute on 31 December 2011, which determined the end of tax benefits for financial branch offices based in the Madeira Free Trade Zone. This and a cost reduction policy resulted in the closure in 2012 of seven of the 13 branch offices existing in the area at the end of 2011. If we exclude the effect of this closure of branch offices in Madeira, there was a 2% growth rate in the number of branch offices and representative offices abroad in 2012. Even so, there was a slowdown in growth in the international market.

Table 28: Number of branch offices and representative offices abroad as at 31 December (2009 – 2012)

	2009	2010	2011	2012	Average
Branch offices and Representative Offices Abroad					
Total	193	192	210	207	-
Annual growth rate	-	*-0.5%*	*9.4%*	*-1.4%*	*2.5%*

Source: FIs, APB.

The main factors in choosing locations for financial institutions' internationalisation are traditionally geographic, economic and cultural proximity. Over the years, their international expansion policy has focused particularly on Portuguese-speaking countries and economic allies.

Figure 3, p. 74, shows that the network of branch offices and representative offices abroad is concentrated in Europe and especially in Spain, France and Switzerland. The network in these countries and also in Luxembourg grew by five units in 2012.

The financial and economic crisis revealed a need for the financial institutions to find other markets outside Europe, also to keep up with Portuguese companies' exports and geographical diversification. As a result, exposure to Europe fell against the same period in 2011, while expansion in Africa gained weight (1.6 p.p. in 2012), as indeed in previous years. At the end of 2010, the Members had seven branch offices and representative offices in Africa, while by the end of 2012 they had 18, after the opening of two branch offices (in Angola and Cape Verde) and a representative office in Algeria. This office in Algeria was the first in a new international location, which reflects the member institutions' constant search for opportunities in markets less affected by the crisis.

Finally, four representative offices were closed in 2012 (in the United States and Italy), resulting in a final net aggregate increase of four units abroad, excluding the reduction in branch offices in Madeira.

[62] The number of.branch offices and representative offices abroad does not coincide with that in Activity Report 47 (2011) and 46 (2010) due to a change in historical data made by two APB members.

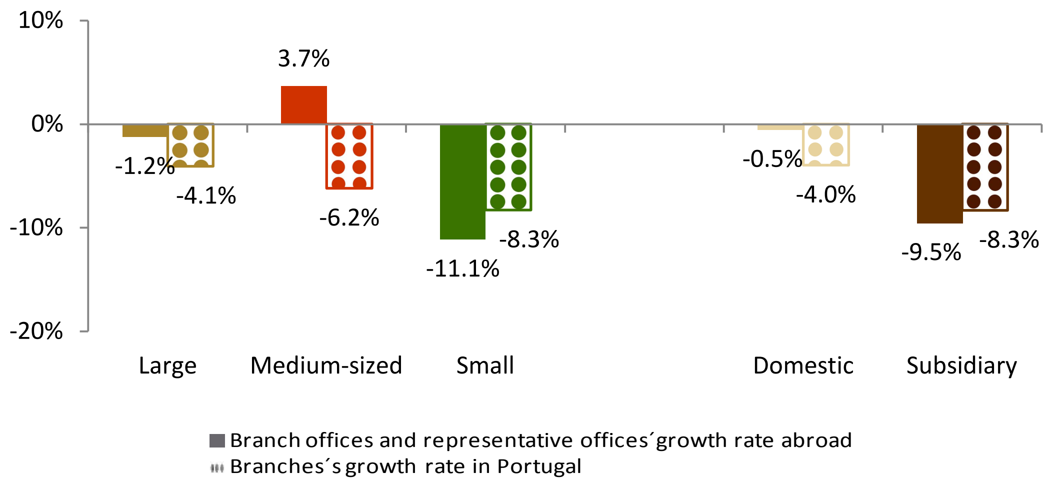
Figure 3: Geographical distribution of branch offices and representative offices abroad as at December 2012

Source: FIs, APB.

Note: This Figure represents an aggregated geographic distribution of APB member institutions on the individual and not consolidated basis.

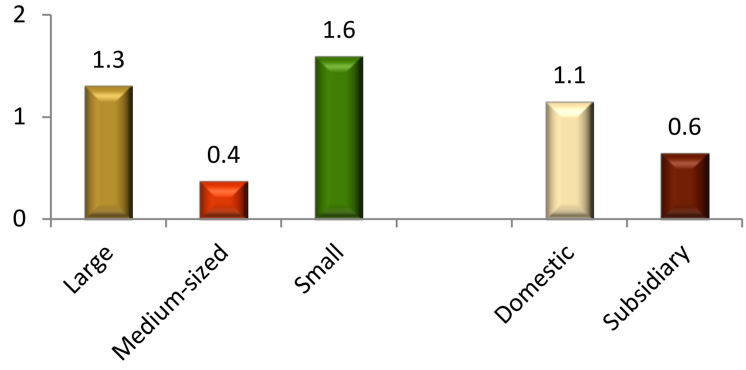
In terms of the member institutions' representativity by size and origin/type of legal structure outside Portugal, only the medium-sized institutions aimed at growth in the international markets in 2012 (see Graph 30 and Table 29, p. 75). Representation of the other segments abroad decreased and the highest reduction was in small financial institutions. There was a greater fall in the number of branch offices abroad than in Portugal (see Graph 30).

Graph 30: Changes in the number of branches, branch offices and representative offices abroad by size and origin/type of legal structure (2011 – 2012)



Source: FIs, APB.

Graph 31: Relative indicator of member institutions internationalisation by size and origin (2009 – 2012)



Source: FIs, APB.

Although the medium-sized institutions' foreign networks expanded over the three years and grew more in percentage than the other segments in the last two years, they are the ones that have shown the least international expansion[63]. An analysis of this indicator (see Graph 31) highlights the small financial institutions, which are more highly internationalised than the others (in spite of the sharp in number of units abroad over the three years) (see Table 29).

Table 29: Representativity of member institutions in the branch network in Portugal and branch offices and representativity offices abroad by size and origin/type of legal structure as at 31 December (2009 – 2012) [64]

	2009	2010	2011	2012	Average
In absolute value:					
Large	149	152	165	163	-
Medium-sized	21	21	27	28	-
Small	23	19	18	16	-
Total	193	192	210	207	-
Domestic	174	170	189	188	-
Subsidiary	19	22	21	19	-
Total	193	192	210	207	-
Percentage:					
Large	*77.2%*	*79.2%*	*78.6%*	*78.7%*	*78.4%*
Medium-sized	*10.9%*	*10.9%*	*12.9%*	*13.5%*	*12.1%*
Small	*11.9%*	*9.9%*	*8.6%*	*7.7%*	*9.5%*
Total	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*
Domestic	*90.2%*	*88.5%*	*90.0%*	*90.8%*	*89.9%*
Subsidiary	*9.8%*	*11.5%*	*10.0%*	*9.2%*	*10.1%*
Total	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*

Source: FIs, APB.

[63] Analysed on the basis of the relationship between average representativity of financial institutions in total branch offices and representative offices abroad from 2009 to 2012 (see Table 29) and in the total branch network in Portugal (see Graph 24 a) and b), p. 64).

[64] Branches in Portugal were excluded from the table due to the fact that they do not have a network abroad (composed either by branches or representative offices in a foreign country).

VI.3. ATMs and home banking

As at 31 December 2012, the member institutions' automated teller machines (ATMs)[65] totalled 17,484 (see Table 30), which was 2.8% fewer than in 2011[66]. This can mainly be explained by the removal of machines from branches that were closed down.

The trend towards a reduction in the ATM network was found not only in the financial institutions in the sample, but also throughout the country. The member institutions' representativity in the Multibanco network remained high at around 97%. At the end of 2012, the Members' ATM networks consisted mostly of machines in the Multibanco system (74.4%), while the other 25.6%) belonged to their own networks (see Table 30).

The number and amount of ATM operations fell slightly in 2012[67]. The number of transactions went down 0.6%, while their amount decreased by 1.1% against 2011 (see Graph 32, p. 77). This was mainly due to the ongoing reduction in withdrawals, which continued to be the main type of ATM operation at around 73% of total transactions and around 63% in terms of value in 2012.

Table 30: Number of Member Institutions ATMs, including those belonging to the Multibanco network as at 31 December (2010 – 2012)

	2010	2011	2012	Average
Number of Member Institutions ATMs				
Total	18,343	17,986	17,484	-
Multibanco network	13,701	13,475	13,015	-
Own network	4,642	4,511	4,469	-
Annual growth rate	-	*-1.9%*	*-2.8%*	*-2.4%*
Number of ATMs belonging to the Multibanco [a] network				
Total	14,126	13,911	13,400	-
Annual growth rate	-	*-1.5%*	*-3.7%*	*-2.6%*

Source: SIBS, FIs, APB.

[a] Number of ATMs belonging to the Multibanco network in Portugal (includes the equipment of other financial institutions which are not APB members).

On the other hand, the number and value of payments for services and transfer operations at ATMs increased. Even so, this trend was unable to reverse the reduction in withdrawals, as they account for most ATM operations.

The fall in number and value of ATM withdrawals was essentially related to the deterioration of Portuguese households' economic situation since the start of the crisis. Nonetheless, the essential nature of some regular utility payments (such as water, electricity and gas) and increasing use in

[65] Automated teller machine

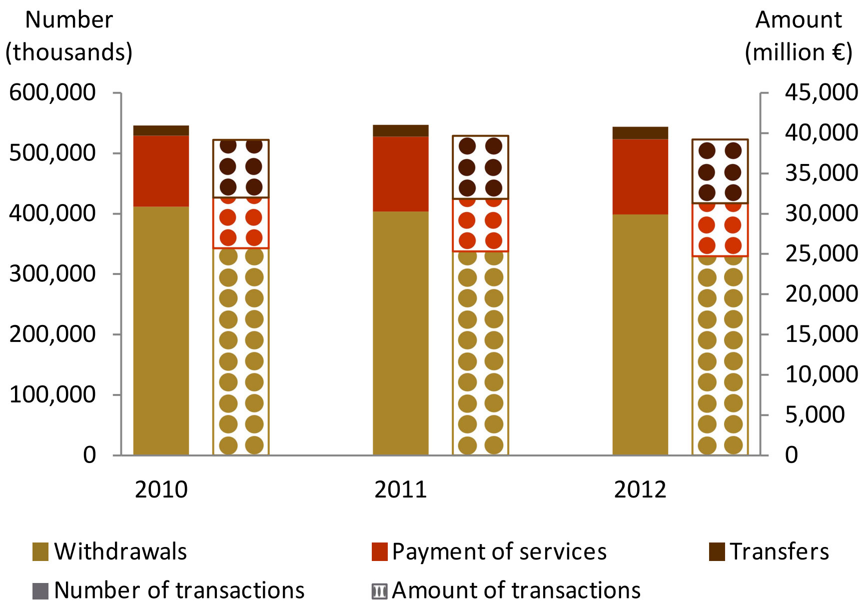
[66] The sample for our analysis of the ATM network consisted of only 25 institutions, as BIG, Invest, Santander Consumer, Barclays, BNP, BNP SS and Fortis were excluded due to lack of data.

[67] All data on the number and value of ATM transactions covers all 32 member institutions.

Portugal of new technology to make their everyday payments (phone, transport, etc) explain the growth in this type of transaction.

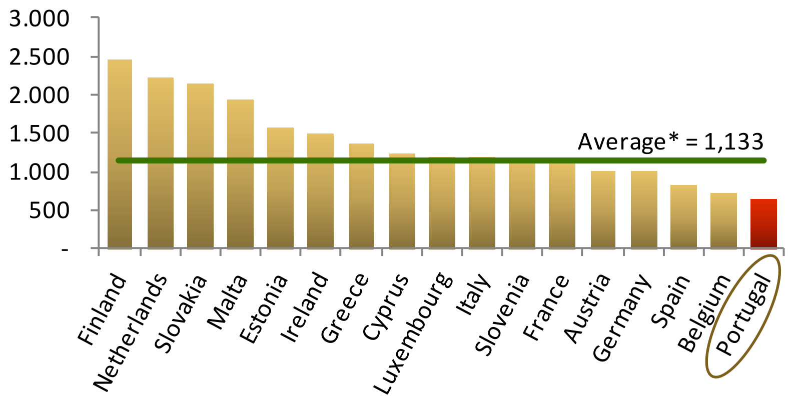
In spite of the fact that the number of ATMs fell in 2012, we find that Portugal has fewer inhabitants per ATM than the other euro area countries. Given the large size of its ATM network in relation to the population that it serves, Portugal is top of the rankings, as shown in Graph 33

Graph 32: Number and volume of transactions in ATMs by type (2010 – 2012)



Source: SIBS.

Graph 33: Number of inhabitants per ATM in the euro area as at 31 December 2012



Source: Eurostat, ECB, APB.

Note: * Weighted average of number of inhabitants per point of sale by each country´s population.

The number of home banking users[68] increased 7.9% in 2012, which made up for the reduction in 2011 and placed use of the channel slightly above the figure for 2010 (see Table 31, p. 78).

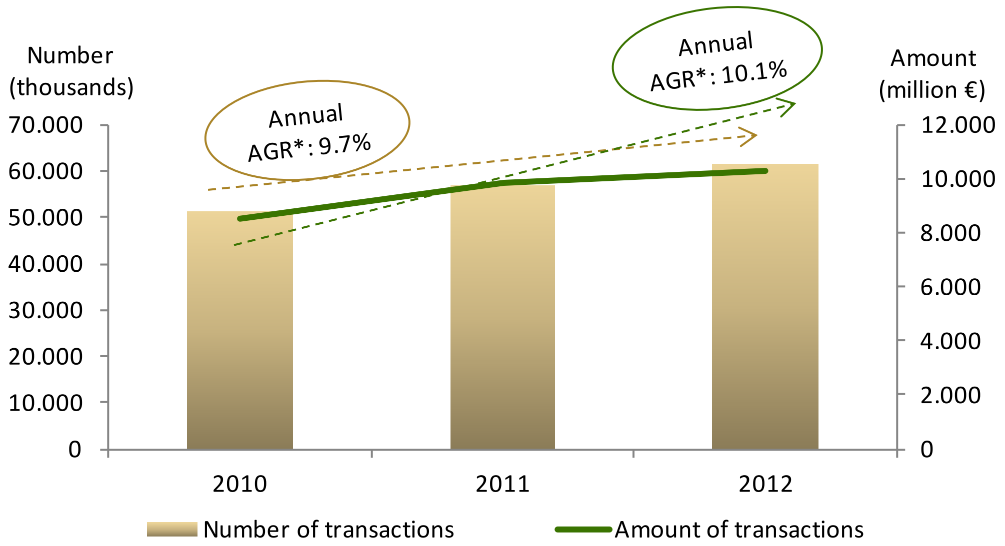
Table 31: Number of users of home-banking as at 31 December (2010 – 2012)

	2010	2011	2012	Average
Number of Users of Home-banking				
Total	3,038,471	2,841,702	3,065,061	-
Annual growth rate	-	*-6.5%*	*7.9%*	*0.7%*

Source: FIs, APB.

The number and amount of transactions[69] rose 8.6% and 4.8% respectively in 2012. This reflects increasing use of online banking services between 2010 and 2012, measured by the annual average growth rate in the number (9.7%) and amount (10.1%) of transactions (see Graph 34).

Graph 34: Number and volume of service payments via home-banking (2010 – 2012)



Source: SIBS.
Note: *Average annual growth rate.

[68] The sample in the analysis of the number of home banking users contains only 24 institutions, as it does not include BIG, BES, BAC, Invest, Santander Consumer, Banco do Brasil, Barclays or BNP SS due to lack of data. Two institutions altered their data on the number of home banking users.
[69] All the data on the number and amount of home banking transactions refer to the 32 member institutions.

VI.4. Active accounts and cards and POS[70]

The number of active bank accounts[71] at member institutions fell 6% in 2012 (see Table 32). The unfavourable macroeconomic situation in Portugal, with an increase in the unemployment rate and company insolvencies, contributed to this decrease.

The effect of the poor economic climate was also reflected in the number of active cards[72] (see Table 32). Both credit and debit cards decreased in number, 1.5% and 0.9% respectively[73]. It was, however, the reduction in debit cards that counted most towards this, although they continued to represent around 60% of all active cards in 2012. The reduction in the number of credit cards reflects a fall in households' borrowing.

Table 32: Number of active bank accounts, credit and debit cards and POS as at 31 December (2010 – 2012)

	2010	2011	2012	Average
Number of Active Bank Accounts				
Total	13,922,262	13,570,701	12,761,962	-
Annual growth rate	-	*-2.5%*	*-6.0%*	*-4.2%*
Number of Credit and Debit Cards				
Total	13,839,185	14,425,601	14,244,302	-
Annual growth rate	-	*4.2%*	*-1.3%*	*1.5%*
Number of POS[a)]				
Total	250,319	247,249	233,361	-
Annual growth rate	-	*-1.2%*	*-5.6%*	*-3.4%*

Source: FIs, APB.
[a)] Point of sals.

For the same reasons, the fall in the number of POSs[74] that had begun in 2011 continued in 2012. In spite of the 5.6% reduction in 2012 (see Table 32), Portugal was still below the European average for number of inhabitants per point of sale (POS) (see Graph 35, p. 80).

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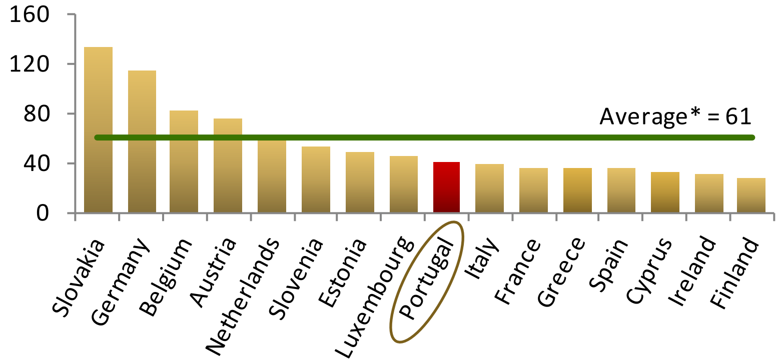
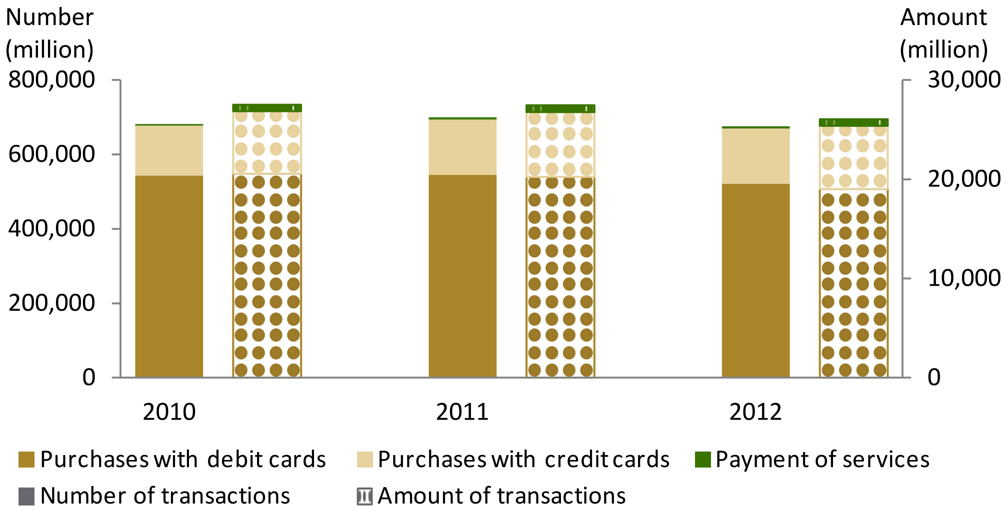
[70] For the analysis of the number of active accounts, the sample was reduced to 25 institutions. BIG, Besi, BAC, Invest, Santander Consumer, Barclays and BNP SS were excluded due to lack of data. One institution changed its historical data on the number of active accounts.
[71] Active private and business accounts are those that have more than €125 in turnover on balance, a minimum of 10 debits or credits in the last three months or those with overdue credit.
[72] Active debit and credit cards are those defined as such in the financial institutions' information systems and can therefore be used immediately by customers.
[73] For the analysis of the number of active cards, the sample was reduced to 25 institutions. BIG, BAC, Invest, Santander Consumer, BNP, BNP SS and Fortis were excluded due to lack of data. Two institutions changed their historical data on the number of active cards.
[74] The sample in the analysis of the number of POS includes 25 institutions and excludes BIG, Invest, Santander Consumer, Barclays, BNP, BNP SS and Fortis due to lack of data.

Graph 35: Number of inhabitants per POS in the euro area as at 31 December 2012



Source: Eurostat, ECB, APB.
Note: * Weighted average of number of inhabitants per POS by each country´s population.

Graph 36: Number and volume of transactions via POS by type (2010 – 2012)



Source: SIBS.

The reduction in the number of POS was accompanied by a drop in the number and value of POS transactions (3.4% and 5.1% respectively) (see Graph 36). The values of transactions fell for debit and credit card payments and payments for services. The fall in the number of transactions was due exclusively to a reduction in the use of debit cards. Owing to their substantial weight in total POS transactions, they offset the positive contribution from the number of payments of services and stabilisation of the number of credit card operations in 2012 (0.3% and 8.2% growth, respectively). These trends are very similar to those in ATM payment operations ATMs.

VII. Performance Analysis

VII.1. Balance sheet

VII.1.1. Structure

The activity of the financial institutions covered by the APB Activity Report, measured in terms of aggregate assets as at 31 December 2012, totalled 475.6 billion euros, which was 5.2% lower than 2011 (see Table 33).

Table 33: Aggregate balance sheet (million €) as at 31 December 2012[75]

	2012	As % of Total
Assets		
Cash and deposits at Central Banks and other credit institutions	8,883	*1.9%*
Financial investments[a)]	107,046	*22.5%*
Loans and advances to credit institutions	60,407	*12.7%*
Loans and advances to customers	259,291	*54.5%*
Other assets [b)]	39,958	*8.4%*
Total Assets	475,585	*100.0%*
Liabilities and Equity		
Deposits from Central Banks and other credit institutions	123,689	*26.0%*
Deposits from customers	209,793	*44.1%*
Debt securities issued and other equity instruments[c)]	67,576	*14.2%*
Other financial liabilities[d)]	37,806	*7.9%*
Other liabilities[e)]	11,245	*2.4%*
Equity	25,476	*5.4%*
Total Liabilities and Equity	475,585	*100.0%*

Source: FIs, APB.
[a)] Includes financial assets held for trading, other assets at fair value through profit or loss, available-for-sale financial assets, held-to-maturity investments and assets with repurchase agreements.
[b)] Includes hedging derivatives with positive fair value, non-current assets held for sale, investment properties, other tangible and intangible assets, investments in subsidiaries and associates, current and deferred income tax assets and other assets.
[c)] Includes debt securities issued, subordinated liabilities and equity instruments.
[d)] Includes financial liabilities held for trading, other financial liabilities at fair value through profit or loss and financial liabilities associated with transferred assets.
[e)] Includes hedging derivatives with negative fair value, provisions, current and deferred income tax liabilities and other liabilities.

As in previous years, the most significant asset item in the aggregate balance sheet was loans and advances to customers, at 54.5% of the total. In second place, financial investments represented 22.5%, followed by loans and advances to credit institutions, at 12.7% of total aggregate assets (see Table 33).

On the liabilities and equity side, deposits from customers and other loans are the member institutions' main source of funding and accounted for 44.1% of the balance sheet total. Deposits

[75] At the end of chapter VII.1 Balance sheet, pages 108 and 109, there is an Annex with the aggregated off-balance sheet items of the institutions included in the sample as at the end of 2012.

from central banks and other credit institutions accounted for 26%, while securitised debt and other equity instruments represented 14.2%. Equity accounted for 5.4% of total member institutions' deposits (see Table 33, p. 81).

2012 witnessed a worsening of the economic and financial crisis in Portugal and other euro-area countries. Implementation of the measures imposed by the FAP, the economic situation, a reduction in credit portfolios and financial investments and difficulty in access to the capital markets, especially in the first nine months of the year, contributed to the slowdown and resulting contraction in banking business.

Table 34: Aggregate assets structure as at 31 December (2009 – 2012)[76]

	2009	2010	2011	2012	Average
Cash and Deposits [a)]					
Total (million €)	10,593	7,265	9,139	8,883	-
Annual growth rate	-	*-31.4%*	*25.8%*	*-2.8%*	*-2.8%*
As % of total assets	*2.2%*	*1.4%*	*1.8%*	*1.9%*	*1.8%*
Financial Investments					
Total (million €)	82,736	116,519	115,905	107,046	-
Annual growth rate	-	*40.8%*	*-0.5%*	*-7.6%*	*10.9%*
As % of total assets	*17.2%*	*22.9%*	*23.1%*	*22.5%*	*21.4%*
Loans and Advances to Credit Institutions					
Total (million €)	65,377	57,538	56,945	60,407	-
Annual growth rate	-	*-12.0%*	*-1.0%*	*6.1%*	*-2.3%*
As % of total assets	*13.6%*	*11.3%*	*11.4%*	*12.7%*	*12.2%*
Loans and Advances to Customers					
Total (million €)	286,786	288,403	278,128	259,291	-
Annual growth rate	-	*0.6%*	*-3.6%*	*-6.8%*	*-3.3%*
As % of total assets	*59.8%*	*56.7%*	*55.5%*	*54.5%*	*56.6%*
Other Assets					
Total (million €)	34,601	39,000	41,287	39,946	-
Annual growth rate	-	*12.7%*	*5.9%*	*-3.2%*	*5.1%*
As % of total assets	*7.2%*	*7.7%*	*8.2%*	*8.4%*	*7.9%*
Total Assets	480,093	508,725	501,404	475,573	-
Annual growth rate		*6.0%*	*-1.4%*	*-5.2%*	*-0.2%*

Source: FIs, APB.

[a)] At Central Banks and other credit institutions.

The member institutions' performance varied between 2009 and 2012. While in 2010, total assets grew 6%, mainly influenced by an increase in financial investments (40.8%), in 2011 activity

[76] The 2009 – 2012 analysis includes 31 financial institutions, as opposed to the 32 institutions making up the base sample for this Activity Report. BNP SS was excluded as there was no historical information on it for 2009. Banco BIC (encompassing BPN) was included in the sample for the purpose of aggregating financial information for 2012. The comparative data for 2011 only include Banco BIC's original financial statements (without BPN) in order to maintain the conclusions set out in the previous Activity Report.

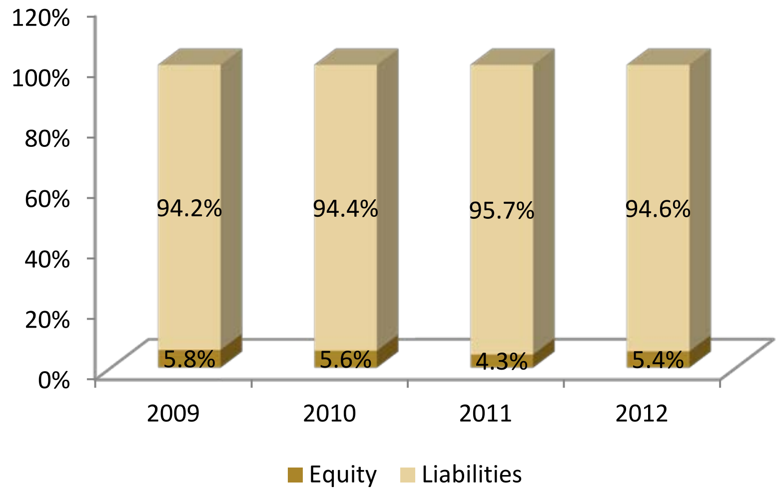
decreased 1.4%, as a result of a 3.6% reduction in loans and advances to customers. In 2012, with the exception of an increase in loans and advances to credit institutions, the other asset items went down (see Table 34, p. 82) and assets fell by 25.8 billion euros against 2011.

The financial institutions' ongoing deleveraging, a reduction in demand for credit on the part of private and business customers[77], sales of credit portfolios, a deterioration in impairments and increase in provisions as a result in a higher credit risk were decisive factors in the reduction in loans and advances to customers (see Table 34, p. 82). This item has fallen around 29 billion euros since the end of 2010, at an annual average rate of 5.2%.

Financial investments were the item that contracted most in 2012 (see Table 34, p. 82). After over 40% growth in 2010, with substantial purchases of public debt securities, the reduction in 2012 occurred essentially in bonds issued by other bodies in portfolios of available-for-sale financial assets. This can mostly be explained by the reversion of some securitisation operations, as the underlying securities ceased to be accepted as collateral at the European Central Bank to guarantee lending operations.

In terms of financing structure, the member institutions' aggregate liabilities fell 6.2% in 2012, while borrowing went down 1.1 percentage points against 2011. In compensation, equity increased 17.8% against 2012 to 5.4% of the balance sheet, in contrast to the 94.6% weight of total liabilities (see Table 35, p. 84 e Graph 37).

Graph 37: Aggregate financing structure as at 31 December (2009 – 2012)



Source: FIs, APB.

Lower reporting of reserves at negative fair value associated with available-for-sale financial assets contributed to the growth in the member institutions' equity. This increase in reserves resulting from appreciation or sale of these assets more than offset the net losses recorded in 2012, sales of assets having been highly affected by the reporting of impairments.

[77] According to data in Banco de Portugal survey of banks on the credit market, January 2013.

Table 35: Aggregate financing structure as at 31 December (2009 – 2012)

	2009	2010	2011	2012	Average
Deposits from Central Banks					
Total (million €)	17,639	45,649	47,375	53,369	-
Annual growth rate	-	*158.8%*	*3.8%*	*12.7%*	*58.4%*
As % of total assets	*3.8%*	*9.0%*	*9.5%*	*11.2%*	*8.4%*
Deposits from other credit institutions					
Total (million €)	91,652	96,574	85,002	70,313	-
Annual growth rate	-	*5.4%*	*-12.0%*	*-17.3%*	*-8.0%*
As % of total assets	*19.1%*	*19.0%*	*17.0%*	*14.8%*	*17.5%*
Deposits from customers					
Total (million €)	187,208	194,904	208,232	209,793	-
Annual growth rate	-	*4.1%*	*6.8%*	*0.7%*	*3.9%*
As % of total assets	*39.0%*	*38.2%*	*41.5%*	*44.1%*	*40.7%*
Debt securities issued and other equity instruments [a]					
Total (million €)	101,382	81,819	70,023	67,576	-
Annual growth rate	-	*-19.3%*	*-14.4%*	*-3.5%*	*-12.4%*
As % of total assets	*21.1%*	*16.1%*	*14.0%*	*14.2%*	*16.4%*
Other financial liabilities					
Total (million €)	41,459	49,276	56,870	37,806	-
Annual growth rate	-	*18.9%*	*15.4%*	*-33.5%*	*0.3%*
As % of total assets	*8.6%*	*9.7%*	*11.3%*	*7.9%*	*9.4%*
Other liabilities					
Total (million €)	12,680	12,110	12,277	11,241	-
Annual growth rate	-	*-4.5%*	*1.4%*	*-8.4%*	*-3.8%*
As % of total assets	*2.6%*	*2.4%*	*2.4%*	*2.4%*	*2.5%*
Total Liabilities (million €)	452,020	480,332	479,779	450,098	-
Annual growth rate	-	*6.3%*	*-0.1%*	*-6.2%*	*0.0%*
As % of total assets	*94.2%*	*94.4%*	*95.7%*	*94.6%*	*94.7%*
Equity					
Total (million €)	28,073	28,393	21,625	25,475	-
Annual growth rate	-	*1.1%*	*-23.8%*	*17.8%*	*-1.6%*
As % of total assets	*5.8%*	*5.6%*	*4.3%*	*5.4%*	*5.3%*
Total Liabilities and Equity	480,093	508,725	501,404	475,573	-

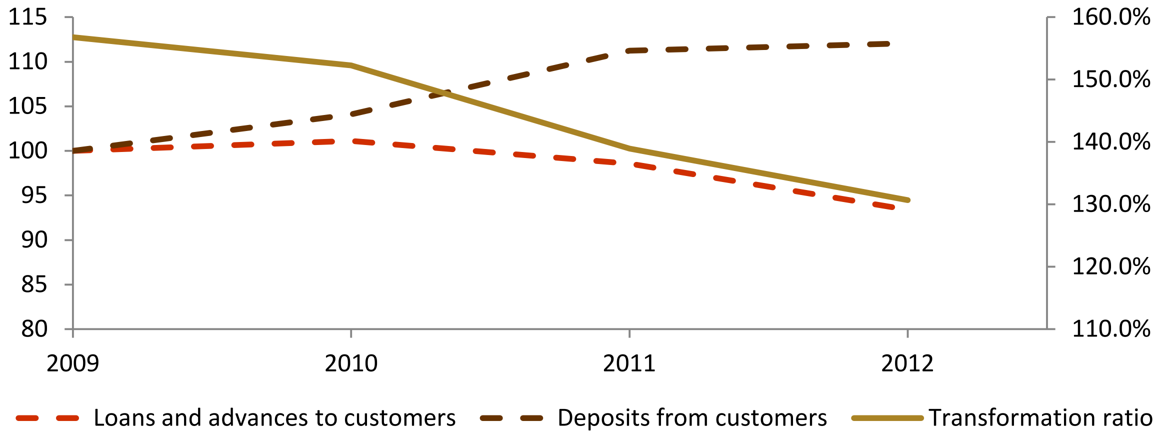
Source: FIs, APB.

[a] Includes subordinated liabilities.

From 2009 to 2012, deposits from customers were the member institutions' main source of funding and accounted for an average of 40.7% of the balance sheet total over the four years. As an absolute figure, the item went up 22.6 billion euros, which was only possible because of the highly favourable performance of deposits, even though their growth slowed down in 2012 (see Table 35).

The financial institutions' deleveraging under the FAP, the reduction in demand for credit from private and business customers and an increase in deposits from customers reduced the credit-to-deposit ratio from 156.8% in 2009 to 130.7% in 2012. Banco de Portugal has indicated that this ratio will be close to 120% for the eight largest banking groups at the end of 2014 (see Graph 38).

Graph 38: Transformation ratio (2009 – 2012)



Source: FIs, APB.

The items deposits from other credit institutions and debt securities issued contracted once again in 2012, with average reductions between 2009 and 2012. The weight of these two sources of funding, which together accounted for around 40% of the balance sheet total in 2009, fell to 29% in 2012. This was due to difficulty in placing new issues in the international wholesale finance markets because of the downgrade in Portugal's sovereign rating and that of the Portuguese financial institutions (see Table 35, p. 84).

More specifically, net [78] deposits from other credit institutions in 2012 fell by 64.7% against 2011. This can be explained by difficulties in accessing the interbank market, which significantly affected deposits.

In early 2012, the state provided a line of 12 billion euros, which was negotiated under the FAP and was for use by Portuguese financial institutions in their recapitalisation, in order to meet the prudential and capital requirements imposed by the European Banking Authority and Banco de Portugal. Two financial institutions used this line and in June 2012 issued hybrid subordinated debt instruments[79], repayable for a period of five years. They qualified as core Tier 1 capital and were subscribed in full by the state. The amount used as at 31 December 2012 was 4.2 billion euros and has been included under debt securities issued and other capital instruments. This item went down 3.5% overall in 2012 (see Table 35, p. 84). This shows that, if we exclude recapitalisation plan issues, the financial institutions were once again generically faced with the practical difficulty of placing debt

[78] Minus loans and advances to credit institutions (see Table 34, p. 82)
[79] Instruments also known as CoCos (contingent convertibles), which are debt instruments that can be converted into capital in certain circumstances, such as breach of an institution's recapitalisation plan or non-payment of all CoCos by their maturity.

on the international markets, which is why these operations are still not used much as a source of funding.

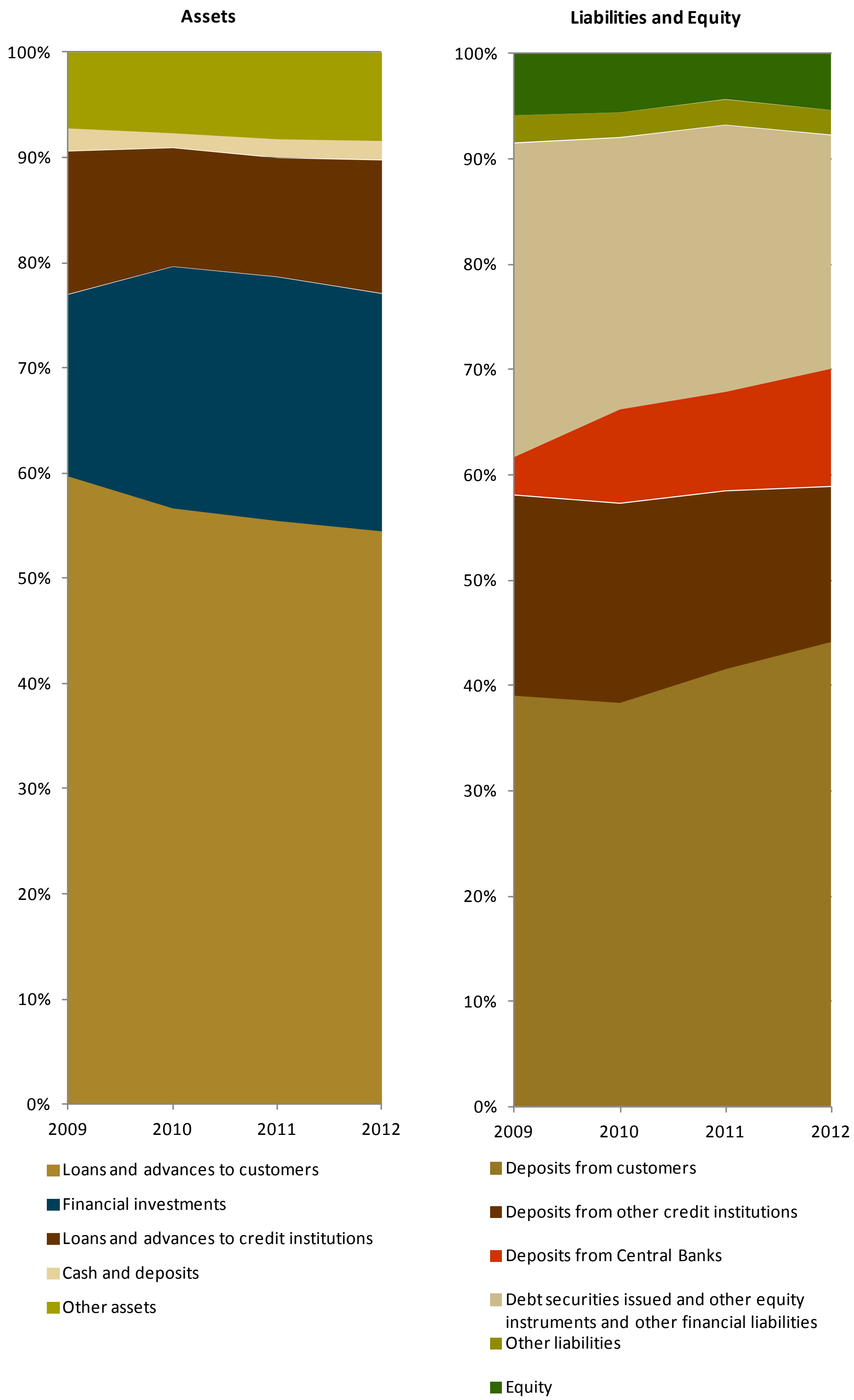
In view of the persisting difficulty in accessing the interbank and debt markets, the member institutions took advantage of three-year long-term refinancing operations (LTRO)[80] offered by the ECB in February 2012 and increased recourse to the European Central Bank to finance their operations. Their stock in the Eurosystem increased 12.7% against 2011 (see Table 35, p. 84). In the three-year period, this item's weight in the balance sheet total went up 7.4 p.p. to 53.4 billion euros at the end of the year.

Finally, other financial liabilities fell by 33.5%, the largest decrease in the member institutions' entire aggregate balance sheet, mainly due to the transfer of securitised debt to unsecuritised debt, as most of this item consists of liabilities from loan securitisation operations that are not recognised in the balance sheet.

Graph 39, p. 87, summarises these trends, particularly the increase over the three years in coverage of loans and advances to customers by deposits that resulted from a sustained contraction in the former (due to the need for deleveraging by financial institutions and effects on demand for credit in an economic recession) and from highly satisfactory growth in the latter (thanks to an increase in savings and the financial institutions' active policy of encouraging saving).

[80] Long-term refinancing operation

Graph 39: Aggregate balance sheet structure as at 31 December (2009 – 2012)



Source: FIs, APB.

This graph also shows the effect of the financial institutions' lack of access to the international wholesale finance markets, as demonstrated by an ongoing reduction in the stock of securitised debt, other capital instruments and other financial liabilities and the net stock of deposits from other financial institutions. While in 2009 this aggregate stock represented twice the balance sheet total of financial investments, coverage gradually fell over the three years to just over 100% in 2012, even with the deleveraging in the institutions' investment portfolio. With the exception of an increase in equity in 2012, the ongoing contraction in these sources of funding was inevitably reflected in a need for growing recourse to financing from the Eurosystem to cover the funding gap.

Table 36 shows indicators of the member institutions' aggregate balance sheet structure between 2009 and 2012.

Table 36: Indicators calculated on figures in the aggregate balance sheet as at 31 December (2009 – 2012)

		2009	2010	2011	2012
Quick Ratio	Cash and deposits at Central Banks / Financial liabilities[a)]	1.6%	0.8%	1.1%	1.3%
Transformation Ratio	Gross loans / Deposits from customers	156.8%	152.3%	138.9%	130.7%
Overall Lending Capacity	Gross loans / Financial liabilities	66.6%	63.2%	61.7%	62.2%
Finance of Financial Assets	Financial liabilities / Financial assets [b)]	98.5%	99.6%	101.6%	100.8%
Importance of Deposits from Customers	Deposits from customers / Financial liabilities	42.5%	41.5%	44.4%	47.6%
Relevance of Subordinated Debt	Subordinated liabilities / (Own funds + Subordinated liabilities)	34.3%	30.4%	28.1%	23.7%
Gross Solvency[c)]	(Own funds + Subordinated liabilities) / Assets	8.9%	8.0%	6.0%	8.2%

Source: FIs, APB.

a) Financial liabilities include deposits from Central Banks and other credit institutions, deposits from customers, debt securities issued, other equity instruments, other financial liabilities and hedging derivatives.

b) Financial assets include cash and deposits at Central Banks and other credit institutions, financial investments, loans and advances to credit institutions, loans and advances to customers and hedging derivatives.

c) Solvency in accounting terms, i.e. equity + subordinated liabilities.

VII.1.2. Loans and advances to customers

The member institutions' deleveraging efforts were aimed at balancing their balance sheets, due to the restrictions on access to the international debt and capital markets, and achieving the solvency and credit-to-deposit ratios imposed by the regulators. These efforts were reflected in their stock of loans and advances to customers, resulting from more selective lending policies and the sale of credit portfolios, mainly to restructuring funds. The macroeconomic background and austerity policies led to a reduction in investments by companies and an increase in the number of insolvencies. At the same time, households' lower disposable income due to a high unemployment rate and an increase in the tax burden, a need to save more and a general climate of uncertainty resulted in a considerable drop in demand for credit.

Table 37: Gross loans and advances to customers, provisions and impairments as at 31 December (2011 – 2012)[81]

	2011	2012
Loans and Advances to Customers (Outstanding)		
Total (million €)	268,310	250,449
Annual growth rate	-	*-6.7%*
Loans and Advances to Customers (Overdue)[82]		
Total (million €)	10,671	14,720
Annual growth rate	-	*37.9%*
Total loans and advances to customers (gross)	278,981	265,169
Annual growth rate	-	*-5.0%*
Provisions and Impairments		
Total (million €)	(10,540)	(14,164)
Annual growth rate	-	*34.4%*
Total loans and advances to customers (net)	268,441	251,005
Annual growth rate	-	*-6.5%*

Source: FIs, APB.

Comparing 2011 and 2012, in a sample of 31 member institutions gross loans and advances to customers fell 5% against 2011. The decrease was the result of a 6.7% fall in performing loans, as overdue loans increased in 2012. Overdue loans rose to 14.7 billion euros, which was 37.9% up on 2011. As a result of the increase in defaults, provisions and impairments increased by 34.4% (see Table 37).

In 2011, as part of the Financial Adjustment Programme, Banco de Portugal developed the Special Inspection Programme (SIP) for the eight largest Portuguese banking groups. The programme evaluated credit portfolios on the basis of impairment of a sample of loans and appreciation of impairment calculation models and associated policies and procedures. The process for calculating credit risk equity requirements was also revised and the methods and parameters used in stress test exercises conducted regularly by these groups under the FAP were validated.

In 2012, in view of the financial institutions' high exposure to companies in the construction and property sectors, Banco de Portugal undertook an On-Site Inspection Programme[83] of the eight largest Portuguese banking groups as at 30 June 2012, covering exposure to the two sectors in Portugal and Spain.

As a result, Banco de Portugal estimated that, on a consolidated basis, it was necessary to increase provisions by 861 million euros. According to the information given to the APB, as at 31 December 2012 813 million euros of this amount had formed provisions and impairments arising from the programme and were recognised in the separate accounts of each institution.

[81] One institution was not included in this detailed analysis of the past two years due to lack of detailed data. Therefore the figures in Table 37 do not coincide with those in Table 34, p. 82, due to differences in the sample used.
[82] Loans overdue for more than 30 days.
[83] On-Site Inspection Programme of financial institutions' exposure to the construction and property sectors, as set out in Banco de Portugal Notice of 3 de December de 2012.

VII.1.2.1. Analysis of loans and advances to customers

Gross loans and advances to customers, which include loans[84], non-derecognised securitised credit[85] and other securitised receivables, totalled 265.2 billion euros on 31 December 2012 (see Table 37, p. 89).

There was a significant change in the composition of gross loans and advances to customers in 2012 and the weight of loans rose 4.5 percentage points against non-derecognised securitised credit. This somewhat atypical effect can be explained by the European Central Bank's changes to the eligibility criteria of assets to be used as collateral for its monetary policy operations. As a result, some financial institutions reversed securitisation operations and so there was a transfer of non-derecognised securitised credit from the balance sheet to the loan portfolio. If we exclude this effect, there was an approximately 6.7% reduction in loans granted in relation to 2011 (see Table 38).

Table 38: Gross credit to customers by nature as at December (2011 – 2012)

	2011	2012	Average
Loans[86]			
Total (million €)	226,042	226,635	-
Change in absolute value (million €)	-	593	-
Annual growth rate	-	*0.3%*	-
As % of total	*81.0%*	*85.5%*	*83.2%*
Non-derecognised Securitised Loans			
Total (million €)	42,022	26,309	-
Change in absolute value (million €)	-	(15,713)	-
Annual growth rate	-	*-37.4%*	-
As % of total	*15.1%*	*9.9%*	*12.5%*
Other Loans and Amounts Receivable (Secured)			
Total (million €)	10,917	12,225	-
Change in absolute value (million €)	-	1,308	-
Annual growth rate	-	*12.0%*	-
As % of total	*3.9%*	*4.6%*	*4.3%*
Total gross loans to customers	278,981	265,169	-

Source: FIs, APB.

Other secured loans and amounts receivable grew 12% against 2011 (see Table 38) mainly due to underwriting of commercial paper. This portfolio includes bonds that are not tradable on active markets with no intention to sell.

[84] Loans to the public administration, non-financial companies, private customers and overdue loans

[85] Loans that were the target of securitised operations but in which the financial institutions keep all the risks and benefits associated with their ownership and therefore cannot be derecognised on the balance sheet

[86] Due to lack of detailed information provided by Members, overdue credit was assumed to refer entirely to loans.

If we analyse gross loans and advances by borrower, we find that those to companies and the public administration accounted for 53.6% of the total on average in the last two years. This means a reasonable balance between financial institutions' loans and advances to this segment and to private customers (see Table 39)

The table shows that the contraction in gross loans and advances affected all segments in 2012, though it was more substantial in loans and advances to companies and the public administration. This was due on the one hand to the decline in investment and on the other to the financial institutions' more selective lending criteria. In fact, the stock of loans and advances in this segment fell by 9.2 billion euros, 6.1% lower than in 2011, accounting for 66.6% of the total contraction in 2012. According to Banco de Portugal data[87], as in 2011, small private companies accounted for the greatest reduction in loans and advances, mainly due to the high weight of construction and property in this segment.

Table 39: Gross credit to customers by borrower as at 31 December (2011 – 2012)

	2011	2012	Average
Loans to Companies and Public Administration			
Total (million €)	150,525	141,325	-
Change in absolute value (million €)	-	(9,200)	-
Annual growth rate	-	*-6.1%*	-
As % of total	*53.9%*	*53.3%*	*53.6%*
Mortgages			
Total (million €)	109,561	106,201	-
Change in absolute value (million €)	-	(3,360)	-
Annual growth rate	-	*-3.1%*	-
As % of total	*39.3%*	*40.1%*	*39.7%*
Consumer Credit and Other			
Total (million €)	18,895	17,643	-
Change in absolute value (million €)	-	(1,252)	-
Annual growth rate	-	*-6.6%*	-
As % of total	*6.8%*	*6.6%*	*6.7%*
Total gross loans to customers	278,981	265,169	-

Source: FIs, APB.

Also according to Banco de Portugal[88], private customers' savings increased to the highest levels since the introduction of the euro, in spite of the reduction in households' disposable income. The decrease in private spending, climate of uncertainty and reduction in mortgage interest rates indexed to Euribor were the main contributing factors to the increase in the private customers' saving rate in 2012 and the consequent reduction in borrowing.

[87] Banco de Portugal, "Financial Stability Report", May 2013.
[88] Banco de Portugal, "Financial Stability Report", May 2013.

The stock of mortgages represented about 86% of total loans and advances to private customers in 2012, although it was 3.1% lower than in 2011. This contraction was mainly due to amortisation of debt and a reduction in demand as a result of larger spreads, as the lending criteria were no stricter in 2012. There was a more substantial fall in consumer credit (6.6%) as a result of the drop in domestic demand and the high risk of default of this type of loan, particularly when the unemployment rate is high and expected to rise further (see Table 39, p. 91).

The transfer between non-derecognised securitised credit and loans affects our analysis of the individual performance of each of these categories by borrower and makes it unadvisable, as inaccurate conclusions may be drawn on the basis of partial results, in contradiction of the above considerations on the performance of the total stock of credit by borrower (see Table 40 and Table 41, p. 93).

Table 40: Credit by borrower as at 31 December (2011 – 2012)

	2011	2012	Average
Companies and Public Administration			
Total (million €)	123,823	120,156	-
Change in absolute value (million €)	-	(3,667)	
Annual growth rate	-	*-3.0%*	-
As % of total	*54.8%*	*53.0%*	*53.9%*
Mortgages			
Total (million €)	86,350	90,422	-
Change in absolute value (million €)	-	4,072	
Annual growth rate	-	*4.7%*	-
As % of total	*38.2%*	*39.9%*	*39.0%*
Consumer Credit and Other			
Total (million €)	15,869	16,057	-
Change in absolute value (million €)	-	188	
Annual growth rate	-	*1.2%*	-
As % of total	*7.0%*	*7.1%*	*7.1%*
Total loans	226,042	226,635	-

Source: FIs, APB.

Where non-derecognised securitised credit was concerned, in spite of the transfer, some financial institutions performed mortgage securitisation operations to an amount of around one billion euros and also of consumer credit, though to a very limited extent, in 2012. In this portfolio, the dominant operations were still associated with mortgages, accounting for 60% of the total, followed by loans and advances to companies and the public administration and then consumer credit operations (see Table 41, p. 93). The stock of loans consisted mainly of loans to companies and the public administration (53%) (see Table 40).

Table 41: Non-derecognised securitised loans by borrower as at 31 December (2011 – 2012)

	2011	2012	Average
Companies and Public Administration			
Total (million €)	15,786	8,944	-
Change in absolute value (million €)	-	(6,842)	-
Annual growth rate	-	*-43.3%*	-
As % of total	*37.6%*	*34.0%*	*35.8%*
Mortgages			
Total (million €)	23,211	15,779	-
Change in absolute value (million €)	-	(7,432)	-
Annual growth rate	-	*-32.0%*	-
As % of total	*55.2%*	*60.0%*	*57.6%*
Consumer Credit and Other			
Total (million €)	3,025	1,586	-
Change in absolute value (million €)	-	(1,439)	-
Annual growth rate	-	*-47.6%*	-
As % of total	*7.2%*	*6.0%*	*6.6%*
Total non-derecognised securitised loans	42,022	26,309	-

Source: FIs, APB.

VII.1.2.2. Quality of loans and advances to customers

The worsening of the economic situation in Portugal and abroad in 2012 helped to accentuate the deterioration in quality of loans and advances granted by member institutions.

Overdue credit increased 37.9% to 14.7 billion euros, which represented 5.6% of gross loans and advances in 2012, 1.8 percentage points higher than in 2011 (see Table 37, p. 89).

Companies and the public administration were once again the segment in which overdue loans rose most (48.2% against 2011) and represented 69.5% of total overdue loans in the average of the last two years (see Table 42, p. 94). According to Banco de Portugal data[89], this exacerbation of companies' credit risk was particularly relevant in the construction and property sectors and small companies. This is not surprising as these companies and sectors were those most affected by the economic situation and those who had the highest increases in borrowing before the crisis.

Overdue loans represented 30.5% of the average for the last two years in the private customer segment. By type of loan, it was consumer and other credit that increased most in terms of amount and percentage, reaching around two billion euros at the end of 2012. The growth rate in overdue mortgages was 7.8%, which was lower than in 2011 and much lower than that of consumer credit, which was 29.5% (see Table 42, p. 94).

Where each segment's stock of gross loans and advances was concerned, in 2012 overdue loans in consumer and other credit accounted for 11.1% of the total, which was 3.1 percentage points higher than in 2011. The largest change was, however, in overdue loans to companies and the

[89] Banco de Portugal, "Financial Stability Report", May 2013

public administration, which accounted for 4.7% of the corresponding gross loans and advances in 2011 and for 7.5% in 2012. There was little change in overdue mortgages, which were 1.8% in 2011 and 2% in 2012 (seeTable 39, p. 91 and Table 42).

Table 42: Overdue loans as at December (2011 – 2012)

	2011	2012	Average
Companies and Public Administration			
Total (million €)	7,152	10,597	-
Annual growth rate	-	*48.2%*	-
As % of total	*66.9%*	*72.0%*	*69.5%*
Mortgages			
Total (million €)	2,006	2,163	-
Annual growth rate	-	*7.8%*	-
As % of total	*18.8%*	*14.7%*	*16.8%*
Consumer Credit and Other			
Total (million €)	1,513	1,960	-
Annual growth rate	-	*29.5%*	-
As % of total	*14.2%*	*13.3%*	*13.7%*
Total loans overdue	10,671	14,720	-

Source: FIs, APB.

In September 2011, Banco de Portugal began asking the financial institutions for information[90] on non-performing loans and credit risk. These ratios deteriorated considerably in the last two years in all the segments analysed (see Table 43, p. 95).

The overdue loans ratio rose two percentage points against 2011, reaching 6.5% of the member institutions' total gross loans and advances[91]. Consumer credit was the segment with the highest default rates in the last two years. The default ratio for non-financial companies increased the most (3.5 p.p.) from 2011 to 2012. The performance of loans at risk was similar to that of non-performing loans although there was a rise in loans at risk in relation to non-performing loans in all the segments in 2012 (see Table 43, p. 95).

The increase in defaults, which resulted in the above figures, forced the member institutions to substantially increase provisions, with the consequent impact on profits. Total provisions and impairments rose 34.4% to 14.2 billion euros in 2012, i.e. 96.2% coverage of total overdue loans. This continuing trend means that financial institutions will have to keep on increasing their provisions and impairments next year, as defaults are not expected to slow down in the near future.

[90] Banco de Portugal Instruction 23/2011 of 17 October, which amended Instruction 16/2004 of 16 August– Disclosure of reference indicators

[91] This analysis does not include foreign banks' subsidiaries operating in Portugal, as they are not obliged to prepare this information for Banco de Portugal, or Banco BIG due to lack of data.

Table 43: Overdue and non-performing loans' ratios as at 31 December (2011 – 2012)

	2011	2012
Overdue Loans Ratio[92]		
Total	4.5%	6.5%
Mortgages	2.8%	3.0%
Consumer credit and other	9.2%	11.8%
Credit to non-financial organisations	6.1%	9.6%
Credit to non-residents	3.2%	5.8%
Non-performing Loans Ratio[93]		
Total	7.2%	9.8%
Mortgages	5.1%	5.6%
Consumer credit and other	12.4%	15.7%
Credit to non-financial organisations	9.1%	13.7%
Credit to non-residents	6.2%	10.0%

Source: FIs e APB.

In short, the quality of member institutions' loans has deteriorated, mostly due to the unfavourable economic situation in Portugal. The reduction in economic activity, the increase in the number of insolvencies and the rise in the unemployment, among other factors, have contributed to the increase in defaults by non-financial companies and consumer credit to private customers.

VII.1.3. Financial investments

As in most of the member institutions' aggregate asset items, financial investments fell in 2012. While there had been a small reduction in 2011, the contraction in 2012 was considerable and was reflected in an 8.2 billion euro, or 7.2%, reduction in the net amount of this item against 2011 (see Table 44, p. 96).

This contraction was due almost exclusively to a fall in the gross stock of financial investments, while aggregate provisions and impairments hardly changed in 2012. In fact, the increase in provisions and impairments in the portfolio of available-for-sale financial assets as a result of the depreciation of some capital securities, bonds associated with securitised portfolios and investment funds was offset by a reduction in impairments associated with the portfolio of held-to-

[92] According to Banco de Portugal, an overdue loan (including doubtful debt) includes principal and interest overdue for more than 90 days and other doubtful debts.

[93] According to Banco de Portugal, non-performing loan is the total debt that has had payments of principal or interest overdue for 90 days or more, the total amount owing of restructured loans not covered by the previous item that have had payments of principal or interest overdue for 90 days or more, have been capitalised or refinanced or their payment date has been postponed, without their guarantees having been properly increased or their interest and other overdue expenses being paid and the total value of the credit with payments of principal or interest overdue for less than 90 days but for which there is evidence justifying their classification as non-performing loans, such as bankruptcy or liquidation of the debtor.

maturity investments resulting essentially from the use of provisions to an amount of approximately 360 million euros in the restructuring of Greece's sovereign debt (see Table 44).

Table 44: Financial investments portfolio as at 31 December (2011 – 2012)

	2011	2012	Average
Financial Assets Held for Trading and Other Assets at Fair Value through Profit or Loss			
Total (million €)	15,454	13,590	-
Annual growth rate	-	*-12.1%*	-
As % of net total	*13.5%*	*12.8%*	*13.1%*
Available-for-sale Financial Assets			
Gross amount (million €)	82,885	77,044	-
Annual growth rate	-	*-7.0%*	-
As % of net total	*72.5%*	*72.6%*	*72.6%*
Impairment (million €)	(1,360)	(1,493)	-
Annual growth rate	-	*9.8%*	-
As % of net total	*-1.2%*	*-1.4%*	*-1.3%*
Held-to-maturity Investments			
Gross amount (million €)	15,524	15,445	-
Annual growth rate	-	*-0.5%*	-
As % of net total	*13.6%*	*14.5%*	*14.1%*
Impairment (million €)	(394)	(39)	-
Annual growth rate	-	*-90.1%*	-
As % of net total	*-0.3%*	*0.0%*	*-0.2%*
Other [a)]			
Total (million €)	2,231	1,616	-
Annual growth rate	-	*-27.6%*	-
As % of net total	*1.9%*	*1.5%*	*1.7%*
Total of financial investments (gross)	116,094	107,695	-
Total impairments	(1,754)	(1,532)	-
Total of financial investments (net)	114,340	106,163	-
Annual growth rate	-	*-7.2%*	-

Source: FIs, APB.

[a)] Assets with repurchase agreements.

The portfolios of available-for-sale and held-for-trading financial assets and financial assets at fair value through profit or loss contributed decisively to this contraction. A fall of 5.8 billion euros in the former explains practically 70% of the total gross contraction in financial investments in 2012. The latter accounted for 22%, a reduction of 1.9 billion euros (see Table 44).

In spite of the decrease in available-for-sale financial assets, essentially due to reversion of loan securitisation operations and consequent write-off of portfolio securities, it was still the portfolio with the highest weight and represented 71.5% total gross financial investments in 2012. Meanwhile, the portfolio of held-to-maturity gained weight over that of held-for-trading financial assets and financial assets at fair value through profit or loss in 2012. While in 2011, these two portfolios accounted for around 13.4% each in total gross financial investments, the former accounted for 14.3% and the latter 12.6% in 2012. Variations in the weight of these two portfolios are no surprise, given their different purposes and their different volatilities due to their valuation methods (see Table 44, p. 96).

As in 2011, almost 90% of the securities portfolio in the financial investment portfolio was composed of debt securities in 2012. These securities showed different performances depending on whether the issuer was public or private. While the weight of public issuers in the portfolio grew by almost 10 percentage points due to a highly significant (27.8%) increase in stock, the representativity of private issuers fell 11.3 percentage points following a drop of almost 16 billion euros (22.7%) in the stock (see Table 45).

Table 45: Structure of the securities portfolio by type of instrument as at 31 December (2011 – 2012)

	2011		2012		Change	
	million €	%	million €	%	million €	%
Securities Portfolio[a)]						
Debt securities issued by public bodies[b)]	25,186	*24.3%*	32,191	*33.4%*	7,005	*27.8%*
Debt securities issued by other bodies[b)]	70,201	*67.6%*	54,277	*56.3%*	(15,924)	*-22.7%*
Shares	3,845	*3.7%*	4,679	*4.9%*	834	*21.7%*
Other securities	4,559	*4.4%*	5,218	*5.4%*	659	*14.5%*
Total	103,791	*100.0%*	96,365	*100.0%*	(7,426)	*-7.2%*

Source: FIs, APB.

[a)] Impairment gross amounts. Does not include assets with repos and derivatives.

[b)] Including bonds and other fixed-income securities.

According to Banco de Portugal data[94], without prejudice to purchase transactions in 2012, the increase in the financial institutions' exposure to public debt issuers can also be explained by the general appreciation of national and foreign sovereign debt in 2012. Excluding sales transactions, the substantial reduction in the value of the portfolio of debt securities issued by other bodies was largely due to reversion of loan securitisation operations resulting from the ECB's change in the eligibility criteria for assets collateralising lending operations. The criteria for securitised assets were tightened and the ECB now required two AAA ratings on the date of issue of securities used as collateral[95].

There was an albeit modest (2.2 p.p.) increase in the representativity of portfolios of shares and other securities in the overall securities structure and both grew substantially (see Table 45).

[94] Banco de Portugal, "Financial Stability Report", May 2013

[95] Banco de Portugal, "Financial Stability Report", May 2012

Table 46: Structure of financial investments [a) b)] by type of portfolio and instrument as at 31 December (2011 – 2012)

	2011		2012		Change	
	million €	%	million €	%	million €	%
Financial Assets Held for Trading and Other Assets at Fair Value through Profit or Loss						
Debt securities issued by public bodies [c)]	1,579	*10.2%*	1,381	*10.2%*	(198)	*-12.5%*
Debt securities issued by other bodies [c)]	704	*4.6%*	388	*2.8%*	(316)	*-44.9%*
Shares	919	*5.9%*	553	*4.1%*	(366)	*-39.8%*
Other securities	2,180	*14.1%*	1,554	*11.4%*	(626)	*-28.7%*
Derivatives	10,072	*65.2%*	9,714	*71.5%*	(358)	*-3.6%*
Total	15,454	*100.0%*	13,590	*100.0%*	(1,864)	*-12.1%*
Available-for-Sale Financial Assets						
Debt securities issued by public bodies [c)]	18,329	*22.1%*	26,660	*34.6%*	8,331	*45.5%*
Debt securities issued by other bodies [c)]	59,251	*71.5%*	42,594	*55.3%*	(16,657)	*-28.1%*
Shares	2,926	*3.5%*	4,126	*5.3%*	1,200	*41.0%*
Other securities	2,379	*2.9%*	3,664	*4.8%*	1,285	*54.0%*
Total	82,885	*100.0%*	77,044	*100.0%*	(5,841)	*-7.0%*
Held-to-Maturity Investments						
Debt securities issued by public bodies [c)]	5,278	*34.0%*	4,150	*26.9%*	(1,128)	*-21.4%*
Debt securities issued by other bodies [c)]	10,246	*66.0%*	11,295	*73.1%*	1,049	*10.2%*
Total	15,524	*100.0%*	15,445	*100.0%*	(79)	*-0.5%*
Total	113,863		106,079		(7,784)	*-6.8%*

Source: FIs, APB.
[a)] Gross amounts.
[b)] Does not include assets with repurchase agreements.
[c)] Includes bonds and other fixed-income securities.

A more detailed analysis of each financial investment portfolio shows that all types of instruments in the portfolio of held-for-trading assets and other assets at fair value through profit or loss decreased in 2012 (see Table 46). The reduction was due to the volume effect of divestments, which were higher than acquisitions in all instruments. In debt securities in general and Portuguese debt in particular, the divestments occurred mainly late in the year, to take advantage of a rise in these securities' market prices and allow the financial institutions to make capital gains[96].

A variation in available-for-sale financial assets explains most of the total gross contraction in financial investments in 2012. There was an increase in the value of the stock of public debt securities as a result of new acquisitions (Portuguese public debt) and the appreciation of these securities. This effect was not, however, sufficient to offset the contraction in debt securities issued by other bodies, which was the result of the reversion of some loan securitisation operations. The performance by capital securities was mainly due to net acquisitions, while the increase in other

[96] Banco de Portugal, "Financial Stability Report", May 2013

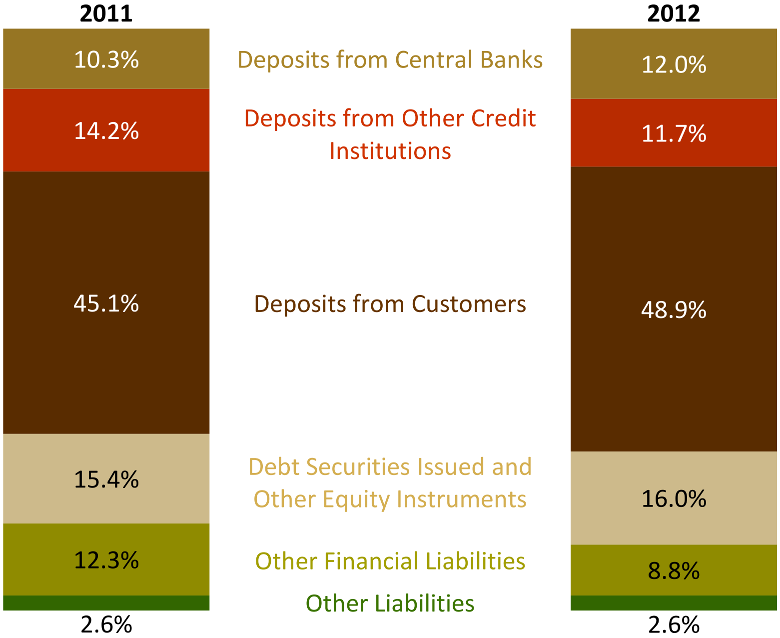
securities resulted essentially from acquisitions of units in restructuring funds following the sale of loans by some financial institutions (see Table 46, p. 98).

Finally, there was a slight 0.5% contraction in held-to-maturity investments against 2011. In terms of composition, there was a reduction in the stock of debt securities issued by public bodies due to redemption on maturity of Portuguese public debt and restructuring of Greece's sovereign debt. In spite of the maturity of bonds during the year, the increase in debt securities issued by other bodies was essentially due to a financial institution's acquisition of securities issued by its parent company (see Table 46, p. 98).

VII.1.4. Funding structure[97]

Throughout 2012, the member institutions' funding was severely limited by the instability of the financial markets resulting from the sovereign debt crisis in Europe, to which Portugal was particularly exposed. In this context, deposits from customers were important as they remained the principal source of borrowing for the member institutions and reached practically half of their borrowing at the end of 2012. The other classes of liabilities therefore played a less important role. On the other hand, the weight of debt securities issued and other capital instruments and deposits from central banks in the borrowing structure increased in 2012, while deposits from other credit institutions and other financial liabilities went down (see Graph 40).

Graph 40: Aggregate borrowing structure as at 31 December (2011 – 2012)



Source: FIs, APB.

[97] As in the previous sub-chapters, the analysis of funding was base on a sample of 31 financial institutions, excluding one institution for the reasons set out in footnote 81, p. 89.

In spite of a considerable increase in percentage of deposits from customers in the member institutions' borrowing structure in 2012, in absolute terms they rose only 0.8%[98] (see Table 47).

The slowdown in growth in customers' deposits was to be expected, as their substantial increase since 2010 was a trend that could not go on for long in a macroeconomic context like that in Portugal. While the uncertainty in the economic climate was a factor encouraging households to save, the corporate sector was seriously affected by the recession that hit Portugal. An increase in business insolvencies and the shaky situation of many companies eventually countered initial growth of their loans and advances to financial institutions.

It is also necessary to note that a part of this growth in deposits in previous years was due to the transfer of private customers' savings that were invested in other, higher-risk financial products and services. After the 2008 crisis, investors were more averse to risk in a number of sectors of the economy, ranging from private customers to financial and non-financial companies, leading to greater preference for more traditional investment choices. This has had considerable influence on growth in deposits in recent years, as they proved to be a well remunerated, lower-risk alternative, though they eventually stabilised.

Furthermore, other factors also contributed to the slowdown of growth in deposits, such as the resurgence of debt securities issues with very attractive maturities and interest rates by some key Portuguese companies, which competed with loans and advances to financial institutions. These issues were particularly attractive because of their low risk and remuneration reflecting Portugal's high sovereign risk.

Table 47: Deposits from customers as at 31 December (2011 – 2012)

	2011	2012	Average
Demand Deposits			
Total (million €)	52,998	50,999	-
Annual growth rate	-	*-3.8%*	-
As % of total	*25.8%*	*24.7%*	*25.2%*
Term Deposits			
Total (million €)	137,856	141,749	-
Annual growth rate	-	*2.8%*	-
As % of total	*67.2%*	*68.5%*	*67.9%*
Other Funds			
Total (million €)	14,354	14,028	-
Annual growth rate	-	*-2.3%*	-
As % of total	*7.0%*	*6.8%*	*6.9%*
Total deposits from customers	205,208	206,776	-
Annual growth rate	-	*0.8%*	-

Source: FIs, APB.

[98] This increase was due to the merger of Banco BIC and BPN, as BPN was not included in the 2011 sample. Without this effect, loans and advances from customers would have fallen slightly by 0.3%.

The composition of deposits from customers showed an increase in term deposits over the other components in 2012, which further reinforced the stability and soundness of this type of funding. This development was due to 2.8% growth in term deposits in 2012, thanks to households' higher propensity for saving, and more than offset the fall in demand and other deposits, 3.8% and 2.3%, respectively (see Table 47, p. 100).

Although slight, the growth in deposits from customers was important in covering part of the member institutions' funding needs due to the ongoing restrictions on access to the wholesale finance markets, especially deposits from other credit institutions and secured debt markets.

In fact, deposits from other credit institutions fell quite sharply (23.6%) in 2012, essentially due to a reduction in deposits which contributed more than two-thirds of the total drop in this item. This decrease was basically due to a non-dynamic interbank market in Europe, which has especially affected institutions in countries with financial adjustment plans (see Table 48).

Table 48: Deposits from other credit institutions as at 31 December (2011 – 2012)

	2011	2012	Average
Deposits			
Total (million €)	41,379	30,793	-
Annual growth rate	-	*-25.6%*	-
As % of total	*64.1%*	*62.4%*	*63.3%*
Interbank Money Market Funds			
Total (million €)	1,404	981	-
Annual growth rate	-	*-30.1%*	-
As % of total	*2.2%*	*2.0%*	*2.1%*
Loans			
Total (million €)	7,767	9,449	-
Annual growth rate	-	*21.7%*	-
As % of total	*12.0%*	*19.2%*	*15.6%*
Sale Operations with Repurchase Agreements			
Total (million €)	7,790	5,280	-
Annual growth rate	-	*-32.2%*	-
As % of total	*12.1%*	*10.7%*	*11.4%*
Other Funds			
Total (million €)	6,184	2,794	-
Annual growth rate	-	*-54.8%*	-
As % of total	*9.6%*	*5.7%*	*7.6%*
Total	64,524	49,297	-
Annual growth rate	-	*-23.6%*	-

Source: FIs, APB.

If we analyse these deposits in net terms, by subtracting deposits at other credit institutions from the gross amount, we find an even sharper decrease (76.9%). At the end of 2012, net funding from this source represented just over a quarter of the amount in 2011 (see Table 49, p. 102).

This scenario was because, although deposits at other credit institutions fell by around 3.1 billion euros (6.3%) in 2012, gross deposits fell around five times more (15.2 billion euros) (see Table 48, p. 101 and Table 49).

In this context, in September 2012 Banco de Portugal opened a platform so that institutions operating in Portugal could conduct unguaranteed interbank money market operations with each other. The aim of the platform was to overcome the difficulties in accessing the international markets and create a more efficient interbank money market in Portugal to facilitate transmission of monetary policy decisions.

Table 49: Net resources from other credit institutions as at 31 December (2011 – 2012)

	2011	2012	Average
Deposits[a)]			
Total (million €)	16,911	5,533	-
Annual growth rate	-	*-67.3%*	-
As % of total	*107.0%*	*151.3%*	*129.1%*
Interbank Money Market Funds			
Total (million €)	(241)	221	-
Annual growth rate	-	*191.7%*	-
As % of total	*-1.5%*	*6.0%*	*2.3%*
Loans			
Total (million €)	(4,405)	(1,322)	-
Annual growth rate	-	*70.0%*	-
As % of total	*-27.9%*	*-36.1%*	*-32.0%*
Sale Operations with Repurchase Agreements			
Total (million €)	6,343	3,086	-
Annual growth rate	-	*-51.3%*	-
As % of total	*40.1%*	*84.4%*	*62.3%*
Other Funds			
Total (million €)	(2,793)	(3,861)	-
Annual growth rate	-	*-38.2%*	-
As % of total	*-17.7%*	*-105.6%*	*-61.7%*
Total	15,815	3,657	-
Annual growth rate	-	*-76.9%*	-

Source: FIs, APB.

[a)] Deposits from other credit institutions net from “deposits at other credit institutions” and from amount of the item in loans and advances to other credit institutions’ item.

In the spite of the greater importance of debt securities and other capital instruments in the member institutions' borrowing structure at the end of 2012 than in 2011 (16% vs. 15.4%), their amount went down 3.5%, or 2.4 billion euros. This reduction was due entirely to debt securities issued, which fell by 7.4 billion euros, though partially offset by an almost 5 billion euro increase in subordinated liabilities and equity instruments (see Graph 40, p. 99 and Table 50, p. 103).

Table 50: Debt securities issued and other equity instruments as at 31 December (2011-2012)

	2011	2012	Average
Debt securities issued			
Total (million €)	61,442	54,046	-
Annual growth rate	-	*-12.0%*	-
As % of total	*87.8%*	*80.0%*	*83.9%*
Subordinated Liabilities			
Total (million €)	8,475	9,259	-
Annual growth rate	-	*9.3%*	-
As % of total	*12.1%*	*13.7%*	*12.9%*
Equity Instruments			
Total (million €)	81	4,262	-
Annual growth rate	-	*5,161.7%*	-
As % of total	*0.1%*	*6.3%*	*3.2%*
Total	69,998	67,567	-
Annual growth rate	-	*-3.5%*	-

Source: FIs, APB.

As mentioned before, these items' performance reflects the financial markets' resistance to absorbing debt and equity instruments issued by financial institutions in peripheral European countries, including Portugal, which took the form of a number of events reflecting this scenario.

Firstly, there was an increase in the outstanding amount of equity instruments due exclusively to the issue of hybrid instruments qualifying as core Tier 1 capital,[99] which were fully subscribed by the state. There were two issues of this type in 2012 to a total of 4.5 billion euros, which were recognised in this item. One of them was reimbursed to the amount of 300 million euros before the end of 2012. These operations are part of the FAP recapitalisation scheme[100], with a line of 12 billion euros (see Table 50).

Secondly, it was also reflected in the performance of subordinated liabilities, especially bonds, which rose just over one billion euros, mainly as a result of a third issue of CoCos to the amount of 900 million euros, which were subscribed by the state. It had a negative effect on the remaining subordinated liabilities, due to the absence of a rollover of the debt maturing in the year (see Table 51, p. 104).

Finally, it also resulted in a decline in debt securities issued, which was affected by two opposite effects.

On the one hand, the gross amount issued in the same item increased 3.4 billion euros to around 94.3 billion euros at the end of 2012 (see Graph 41, p. 105), essentially due to the issue of almost 5 billion euros in senior bonds, as certificates of deposit increased little in absolute terms (383

[99] See footnote 79, p. 85.

[100] The difference from the 5.8 billion euros indicated in Sub-chapter VII.4 Solvency, p. 141, is due to a third issue, which was recognised in subordinated liabilities and a fourth, in January 2013, which was recognised for prudential but not for accounting purposes at the end of 2012.

million euros) and other liabilities fell as a result of repayment of debt (2 billion euros). Around 13.2% of the senior bonds issued were mortgage bonds.

The issue of senior bonds benefited from the fact that financial institutions could use Portuguese state guarantees on payment of a commission[101]. Four issues were made under this scheme to the amount of 4.7 billion euros in 2012. Even so, the amount of these issues was well below those in 2011 (10.8 million euros). An announcement by the ECB that new issues would soon cease to be eligible as collateral meant that these instruments lost their attraction for this purpose.

Table 51: Debt securities issued and subordinated liabilities as at 31 December (2011 – 2012)

	2011		2012		Change	
	million €	%	million €	%	million €	%
Debt securities issued						
Certificates of deposit	821	*1.3%*	1,186	*2.2%*	365	*44.5%*
Bonds	55,471	*90.3%*	49,629	*91.8%*	-5,842	*-10.5%*
Other liabilities	5,150	*8.4%*	3,231	*6.0%*	-1,919	*-37.3%*
Total	61,442	*100.0%*	54,046	*100.0%*	-7,396	*-12.0%*
Subordinated Liabilities						
Loans	3,107	*36.7%*	2,866	*31.0%*	-241	*-7.8%*
Bonds	5,077	*59.9%*	6,139	*66.3%*	1,062	*20.9%*
Other subordinated liabilities	291	*3.4%*	254	*2.7%*	-37	*-12.7%*
Total	8,475	*100.0%*	9,259	*100.0%*	784	*9.3%*
Total	69,917		63,305		-6,612	*-9.5%*

Source: FIs, APB.

On the other hand, the issue of senior bonds for placing on the retail and institutional markets was limited to only a few operations, mainly in the last quarter of 2012. The vast majority of the issues were for the repurchase of new securities by the institutions themselves. Together with the acquisition on the secondary market of securities issued in previous years, there was an increase of around 10.8 billion euros in the portfolio of the institutions' own senior bonds, more than 63% of which was via acquisition of covered bonds in 2012. These repurchases have been used more and more by financial institutions to increase their portfolios of collateral so that they can obtain funding from the Eurosystem and interbank market, where guarantees are essential. As covered bonds are guaranteed not only by the issuer but also by loan portfolios (mostly mortgages), thereby reducing their credit risk, the haircut to which they are subject in the ECB's monetary policy operations and the interbank is lower than for classic bonds, making them an important element in the member institutions' collateral portfolios.

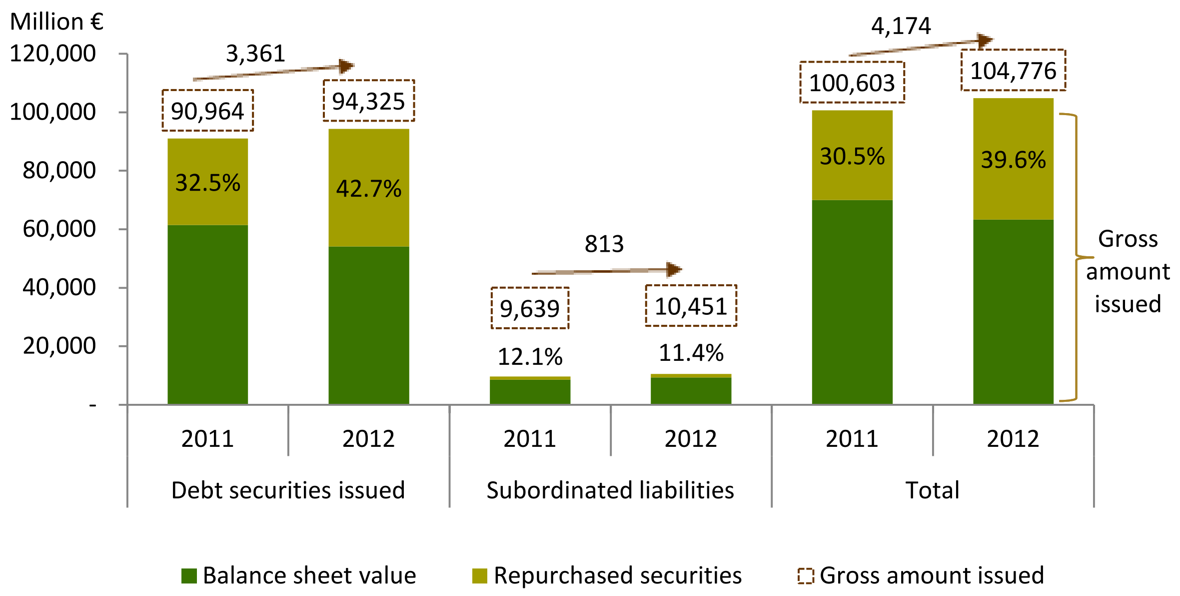
As a result of these two opposite effects, the balance sheet value[102] of financial institutions' senior bonds fell by approximately 5.8 billion euros. This and the above-mentioned non-renewable

[101] The extraordinary state guarantee scheme under the FAP has a budget of 35 billion euros. It was set up in 2008 as part of the Financial Stability Facility.
[102] Repurchase of own securities results in a balance sheet write-off of the instruments in question.

maturity of other debt securities issued and low issue of certificates of deposit brought down the balance under debt securities issued by 7.4 billion euros in 2012 (see Table 50, p. 103).

The substantial repurchase of senior bonds (10.8 billion euros) was reflected in a 38.3% increase in stock against 2011, which was decisive in the increase from 92% to 95% [103] in its weight in the financial institutions' overall portfolio of securities and subordinated liabilities in 2012. Another result was a substantial increase in the proportion of the value of this portfolio in the gross total value of securities and subordinated liabilities issued by the institutions, reaching almost 40% at the end of the year (see Graph 41).

Graph 41: Gross amount of debt securities and subordinated liabilities issued as percentage of repurchased securities as at 31 December (2011 – 2012)



Source: FIs, APB.

In this context, deposits from central banks were once again an important alternative to obtaining funding from the wholesale markets for the financial institutions. As a result, their dependence on these deposits increased by almost 4 billion euros in 2012, an 8.5% rise against 2011. Their weight in the member institutions' funding structure also rose (see Table 52, p. 106).

This item's performance was not constant during the year, however. These deposits increased substantially in the first months of 2012, thanks to the many subscribers of the ECB's second LTRO at the end of February[104], one of its non-conventional monetary policy measures. These operations involve fixed-rate auctions in which demand is totally guaranteed. The Eurosystem was therefore an important source of liquidity in the first half of the year to meet the funding needs resulting from a reduction in deposits from other credit institutions and debt securities issued.

[103] Also due to a slight fall in repurchases of certificates of deposit, debt securities issued and subordinated bonds in 2012 (51 million euros)

[104] The first operation took place in December 2011. For more details, see Activity Report 47, for 2011.

Table 52: Deposits from Central Banks as at 31 December (2011–2012)

	2011	2012	Average
Deposits from Banco de Portugal			
Total (million €)	40,516	44,295	-
Annual growth rate	-	*9.3%*	-
As % of total	*86.3%*	*87.0%*	*86.6%*
Deposits from Other Central Banks			
Total (million €)	6,409	6,609	-
Annual growth rate	-	*3.1%*	-
As % of total	*13.7%*	*13.0%*	*13.4%*
Total deposits from Central Banks	46,925	50,904	-
Annual growth rate	-	*8.5%*	-

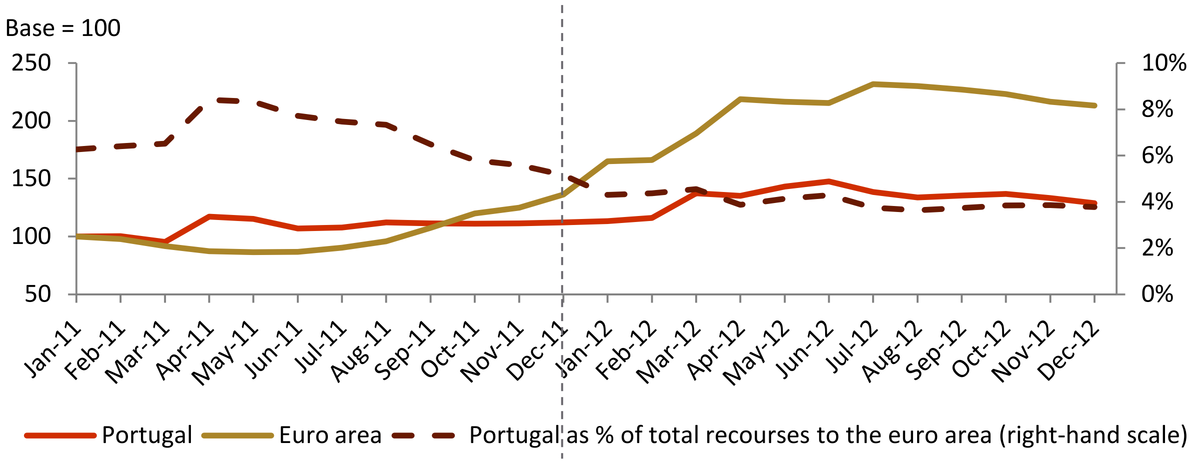
Source: FIs, APB.

Contrary to the first half of the year, between June and December 2012 Eurosystem funds fell, reflecting the member institutions' efforts to reduce their dependence on the ECB (see Graph 42).

In spite of the gross increase in Portuguese institutions' finance from Eurosystem funds, their weight in the total amount lent to euro-area institutions went down due to high use of the three-year LTRO in February, especially by Spanish and Italian institutions (see Graph 42).

Finally, as the ECB's monetary policy operations are conducted via national central banks, the financial institutions' funding at the end of 2012 was essentially centralised at Banco de Portugal (87%). It was higher than in 2011, in detriment to the others (see Table 52).

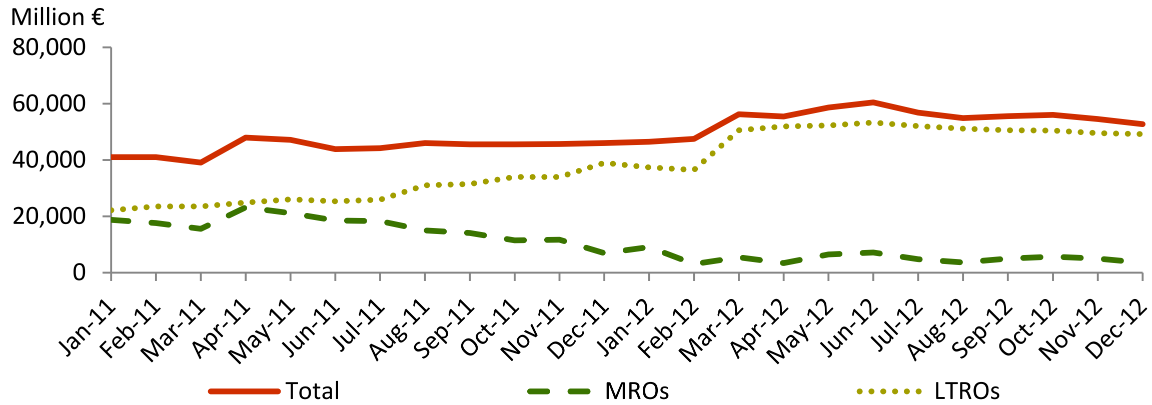
Graph 42: Recourse to funding from the European Central Bank by the national financial institutions against the euro area



Source: BdP, ECB.

Wide subscription of the LTRO made it possible to increase the maturity of Eurosystem resources more than in 2011. Balances from other, shorter operations (MROs[105]) by the member institutions were low in the total funding obtained from the ECB at the end of 2012, which reduced the refinancing risk and ensured greater stability (see Graph 43).

Graph 43: Recourse to funding from the European Central Bank by the national financial institutions



Source: BdP.

In conclusion on the subject of the financial institutions' funding, it is worth mentioning a substantial variation in other financial liabilities in 2012, which went down 33.9% (19 billion euros), mostly through financial liabilities associated with transferred assets (which fell by 16.4 billion euros). The performance of the latter item, which contains the consideration for non-derecognised securitised, reflects the reversion of several securitisation operations during the year. The fact that the ECB's collateral policy was altered and now accepted bank loans, benefited direct use of some credits as opposed to securities issued in the corresponding securitisation operations.

[105] Main refinancing operations

Table 53: Off-balance sheet aggregate items as at 31 December 2012

	2012 million €
Guarantees Given and Other Contingent Liabilities	**157,466**
Guarantees and sureties	29,528
Acceptances and endorsements	12
Transactions with recourse	-
Stand-by letters of credit	476
Open documentary credits	4,293
Sureties and indemnities (counter-guarantees)	940
Other personal guarantees given and other contingent liabilities	2,107
Real guarantees (assets pledged as collateral)	120,110
Guarantees Received	**484,881**
Guarantees and sureties	96,733
By acceptances and endorsements	2,268
By transactions with recourse	-
By stand-by letters of credit	560
By open documentary credits	26,171
By sureties and indemnities (counter-guarantees)	5,217
Other guarantees received	30,295
Real guarantees (assets received as collateral)	323,637
Commitments to Third Parties	**53,714**
Options on assets (sold)	59
Term operations	422
Term deposits contracts	30
Irrevocable credit lines	7,866
Securities subscription	5,046
Commitment for retirement and survivor pensions not yet received	19
Term commitment to make annual contributions to the deposit guarantee fund	447
Potential commitment to the investor indemnity system	110
Other irrevocable commitments	5,844
Revocable credit lines	29,470
Overdraft facilities	2,215
Other revocable commitments	2,186

Source: FIs, APB.

Table 53: Off-balance sheet aggregate items as at 31 D0ecember 2012 (cont'd)

	2012 million €
Commitments by Third Parties	**1,875,950**
Options on assets (bought)	-
Irrevocable credit lines	3,021
Securities subscription	69
Other irrevocable commitments	782,857
Revocable credit lines	63
Overdraft facilities	33
Other revocable commitments	1,089,907
Foreign Exchange Operations and Derivative Instruments	**412,093**
Spot foreign exchange operations	2,363
Forward foreign exchange operations – trading	5,711
Forward rate agreement - trading	370
Swap operations – trading	313,587
Futures and other forward operations – trading	5,789
Options – trading	13,616
Forward foreign exchange operations – hedging	284
Forward rate agreement - hedging	-
Swap operations – hedging	40,650
Futures and other forward operations – hedging	166
Options – hedging	24,671
Interest rate guarantee contracts (caps and floors) - hedging	4,886
Responsibilities for Services Provided	**374,234**
Deposit and safeguard of assets	332,675
Amounts for collection	3,585
Assets managed by the institution	36,796
Consigned funds	1
Other	1,177
Services Provided by Third Parties	**287,545**
Deposit and safeguard of assets	207,058
Amounts for collection	910
Assets managed	157
Other services	79,420
Other Off-balance Sheet Items	**(2,323,965)**

Source: FIs, APB.

VII.2. Income statement

VII.2.1. Structure

The external environment in which the member institutions operated in 2012 exerted considerable negative pressure on their income statements.

Table 54: Aggregate income statement (2012)

	2012	
	million €	**% NIBT**
+ Interest and similar income	20,129	
- Interest and similar expense	15,890	
Net Interest Income (NII)	**4,239**	***44.7%***
+ Fee and commission income	3,374	
- Fee and commission expense	-701	
Net Gains from Fees and Commissions	2,673	*28.2%*
+ Net gains from assets and liabilities at fair value through profit or loss	-15	
+ Net gains from available-for-sale financial assets	1,140	
+ Net gains from foreign exchange differences	13	
Net Gains from Financial Operations	1,138	*12.0%*
+ Income from equity instruments	781	
+ Net gains from sale of other assets	-33	
+ Other operating income and expense	683	
Other Results	1,431	*15.1%*
Operating Income (OI)	**9,481**	***100.0%***
- Personnel costs	2,858	
- General administrative expenses	2,072	
- Depreciation and amortisation	431	
Operating Costs	5,361	*56.5%*
Resultado Bruto de Exploração (RBE)	**4,120**	***43.5%***
- Provisions net of reversals	79	
- Value adjustments relating to loans and advances to customers and receivables from other debtors (net of reversals)[106]	5,008	
- Impairment on other financial assets net of reversals	625	
- Impairment on other assets net of reversals	1,526	
Provisions and impairment	7,238	*76.3%*
Net Income Before Tax (NIBT)	**-3,118**	***-32.9%***

Source: FIs

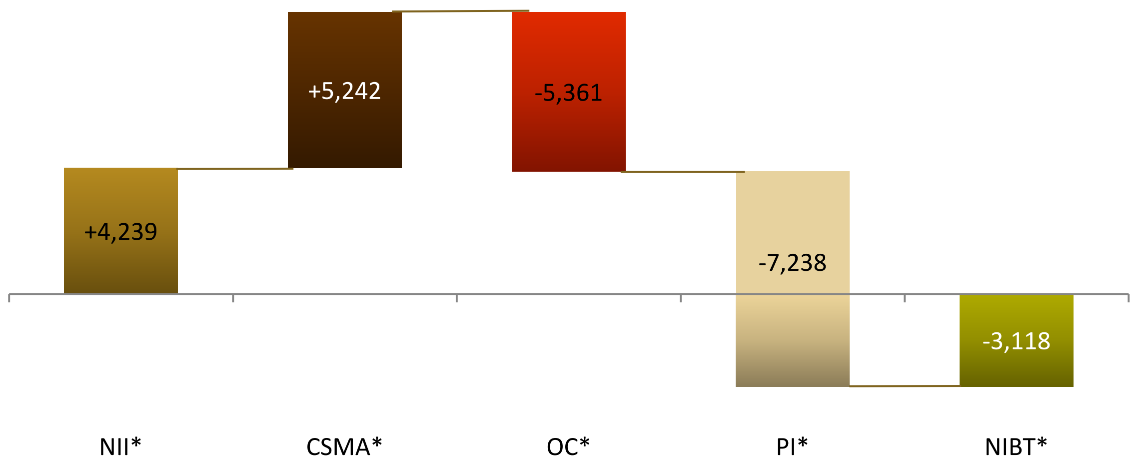
[106] Throughout the analysis, this item is also named credit impairments.

The member institutions[107] recorded a pre-tax loss of 3.1 billion euros, which reflected the higher credit risk and narrower net interest income resulting from low interest rates and the ongoing deleveraging process (see Table 54, p. 110).

Unusually in banking, net interest income ceased to be the main component of operating income in 2012 and income from customer and market services[108] now accounted for 55.3% of the indicator (see Table 54, p. 110 and Graph 46, p. 113).

The member institutions' earnings showed a move from intermediation in product sales to provision of customer and market services.

Graph 44: Aggregate earnings before tax formation (2012)



Source: FIs.

Note: * NII – Net interest income; CSMA – Customer service and market activities; OC – Operating costs; PS – Provisions and impairment; NIBT – Net income before tax.

In the cost structure, operating costs accounted for 56.5% of total operating income in 2012. Their largest component was personnel costs, followed by general administration expenses (see Table 54, p. 110).

Costs of provisions and impairments came to 7.2 billion euros, which was 76.3% of the total operating income (see Table 54, p. 110 and Graph 44), and exceeded operating costs. Those set up for credit during the year totalled 5 billion euros, reflecting deterioration of the credit risk and inclusion of the results of Banco de Portugal's On-Site Inspection Programme for the eight largest banking groups in Portugal.

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[107] Based on this report's sample of 32 member institutions

[108] The net gains from customer and marker services include fees and commissions, results of financial operations and other gains (see Table 54, p. 110).

As shown in Graph 44, p. 111, the cost component (operating costs plus provisions and impairments) totalled 12.6 billion euros in 2012, exceeding operating income by 33%, and resulting in the pre-tax loss mentioned above (see Table 54, p. 110).

In the preceding four years, 2012 was the second year running in which the member institutions recorded a net loss before tax. Income fell by 131.6% in three years. While the fall was caused by extraordinary factors in 2011[109], in 2012 it was determined by a reduction in net interest income and an increase in provisions and impairments (see Table 55). As a percentage of operating income, net interest income before tax fell 49.3 percentage points between 2009 and 2012. The most substantial drop was in 2011 (31.8 p.p.) due the extraordinary impacts (see Graph 45, p. 113).

Table 55: Main items in the aggregate income statement (2009 – 2012)

	2009	2010	2011	2012	Average
Net Interest Income (NII)					
Total (million)	5,431	5,094	5,128	4,239	-
Annual growth rate	-	*-6.2%*	*0.7%*	*-17.3%*	*-7.6%*
Customer Service and Market Activities (CSMA)					
Total (million)	5,131	4,808	4,276	5,218	-
Annual growth rate	-	*-6.3%*	*-11.1%*	*22.0%*	*1.5%*
Operating Income (OI) [a)]					
Total (million)	10,562	9,902	9,404	9,457	-
Annual growth rate	-	*-6.3%*	*-5.0%*	*0.6%*	*-3.6%*
Operating Costs (OC)					
Total (million)	5,624	5,790	5,707	5,339	-
Annual growth rate	-	*3.0%*	*-1.4%*	*-6.4%*	*-1.6%*
Provisions and impairment (PS)					
Total (million)	3,222	3,098	5,727	7,238	-
Annual growth rate	-	*-3.8%*	*84.8%*	*26.4%*	*35.8%*
Net Income Before Tax (NIBT) [b)]					
Total (million)	1,716	1,014	-2,030	-3,120	-
Annual growth rate	-	*-40.9%*	*-300.2%*	*-53.7%*	*-131.6%*

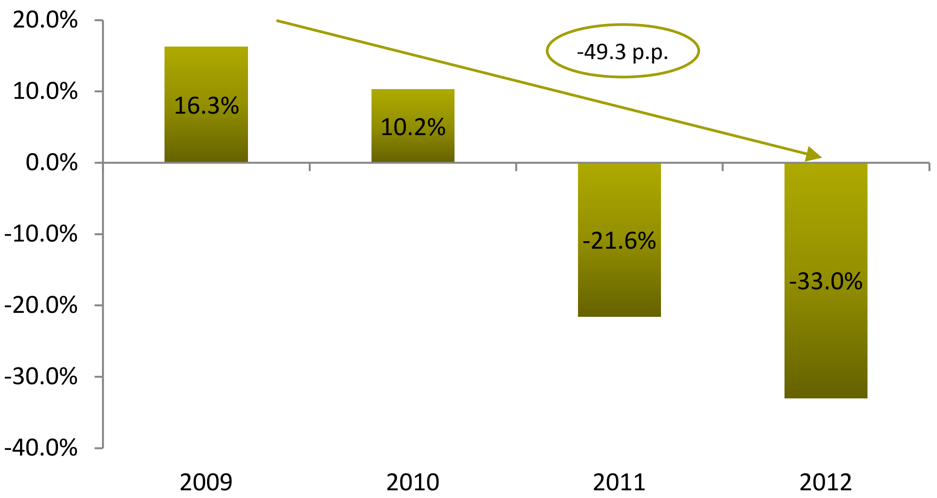
Source: FIs.

[a)] OI = NII + CSMA

[b)] NIBT = OI - OC - PS

[109] These extraordinary factors resulted from non-recurring events such as an increase in impairments recognised during the Banco de Portugal Special Inspection Programme, losses resulting from a haircut for the Greek sovereign debt and costs of the partial transfer of the banks' pension funds to the state.

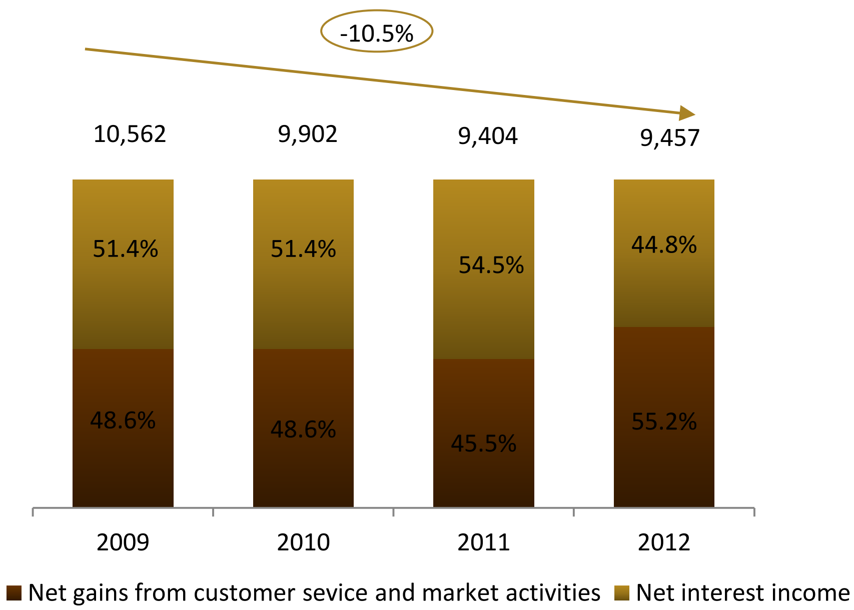
Graph 45: Net income before tax as percentage of operating income (2009 – 2012)



Source: FIs, APB.

Operating income showed a downward trend between 2009 and 2011 (falling at an annual average rate of 5.7%). This trend ended with a slight 0.6% growth in 2012. A 22% increase in net gains from customer and market services against 2011 offset the fall in net interest income (17.3%), thereby contributing to albeit modest growth in operating income (see Table 55, p. 112 and Graph 46). The low Euribor interest rates used as a reference in most lending operations, the small number of new lending operations and higher customers' deposits placed negative pressure on net interest income and narrowed the difference in volume between interest received and paid.

Graph 46: Net interest income and net gains from customer service and market activities as percentage of operating income (2009 – 2012)



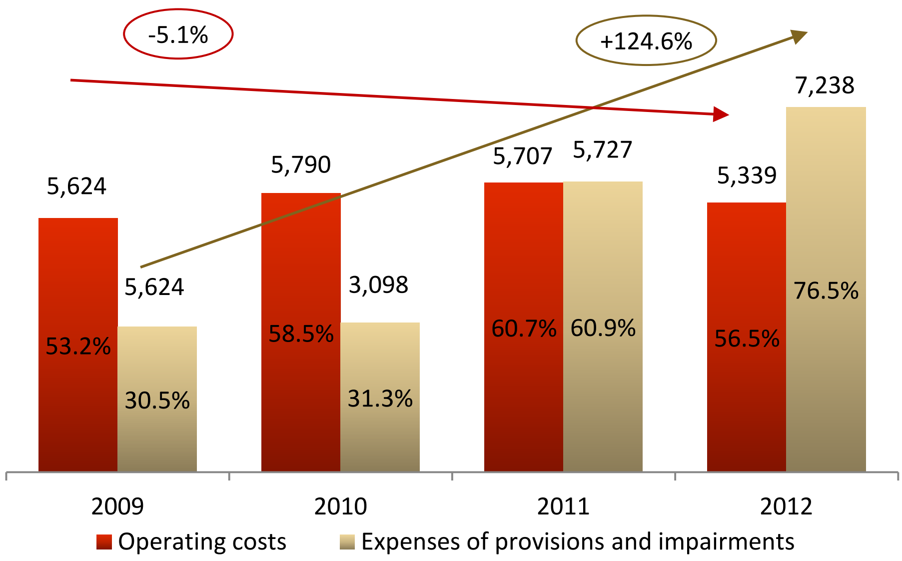
Source: FIs, APB.

The cost component also showed different performances. After a 3% increase in 2010, operating costs then began to fall, in reflection of the financial institutions' cost-cutting in the last two years (see Table 55, p. 112 and Graph 47).

In 2012, operating costs were 5.3 billion euros, i.e. 451 million euros less than in 2010. On the other hand, provisions and impairments rose at an annual average rate of 35.8% from 2009. The deterioration in credit and market risk has explained the financial institutions' growing need to set up provisions as they are aware that this is what the situation requires (see Table 55, p. 112 and Graph 47).

The result of these different performances was a change in the financial institutions' cost structure, as shown in Graph 47. In the first two years, operating costs were almost twice provisions and impairments. In 2011 they were the same, while in 2012 provisions and impairments exceeded operating costs by 35.6%.

Graph 47: Operating costs, provisions and impairment as percentage of operating income (2009 – 2012)



Source: FIs, APB.

VII.2.2. Net interest income

The member institutions'[110] aggregate net interest income was almost 4 billion euros (see Graph 48, p. 115 and Table 60, p. 120). This includes positive contributions from net income on customer operations[111] (4.3 billion euros) and on financial security operations[112] (550 million euros),

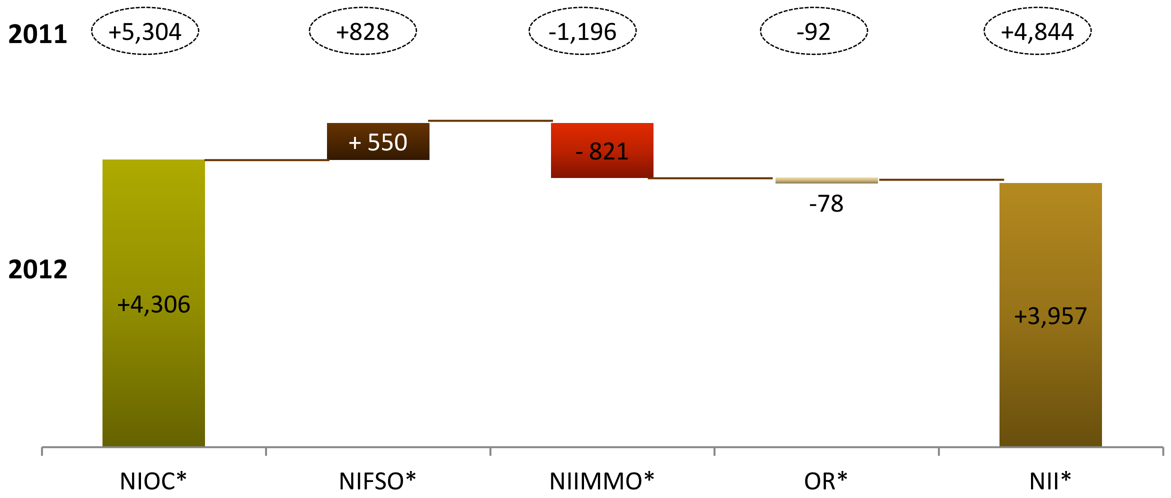
[110] The sample in this analysis does not include one financial institution due to lack of detailed information, as mentioned in footnote 81, p. 89.

[111] Net income on customer operations includes interest on loans and customer deposits (see Table 56, p. 115).

[112] Net income on financial securities operations comprises the following items: interest on held-for-trading financial assets and at fair value through profit or loss, interest on available-for-sale financial assets, interest on held-to-maturity investments, interest on hedging derivatives (income and expenses), interest on held-for-trading financial liabilities, interest on debt securities issued and interest on subordinated liabilities (see Table 58, p. 118).

as opposed to the losses on operations in the interbank money market[113] (821 million euros) and other operations (78 million euros) (see Graph 48).

Graph 48: Breakdown of aggregate interest income (2011 - 2012) by type of results (million euros)



Source: FIs, APB.
Note: * NIOC – Net income from operations with customers; NIFSO – Net income from financial securities operations; NIIMMO – Net income from interbank money market operations; OR – Other results; NII – Net interest income.

Net interest income fell 18.3% against 2011, essentially due to a reduction in net income on customer operations (-998 million euros). Net income on financial securities operations were 33.6% or 278 million euros lower than in 2011, unlike those from operations in the interbank money market, which, although negative, grew 31.4% year-on-year (up 375 million euros) (see Graph 48 and Table 60, p. 120).

Table 56: Breakdown of aggregate results from operations with customers (2011 – 2012)

	2011	2012	Change	
	million €	million €	million €	%
Operations with Customers				
+ Interest on credit	9,724	9,434	-290	*-3.0%*
- Interest on deposits from customers	4,420	5,128	708	*16.0%*
Total	5,304	4,306	-998	*-18.8%*

Source: FIs, APB.

As mentioned above, income on customer operations, the main component of net interest income, fell by approximately one billion euros, which is 18.8% lower than 2011 (see Table 56).

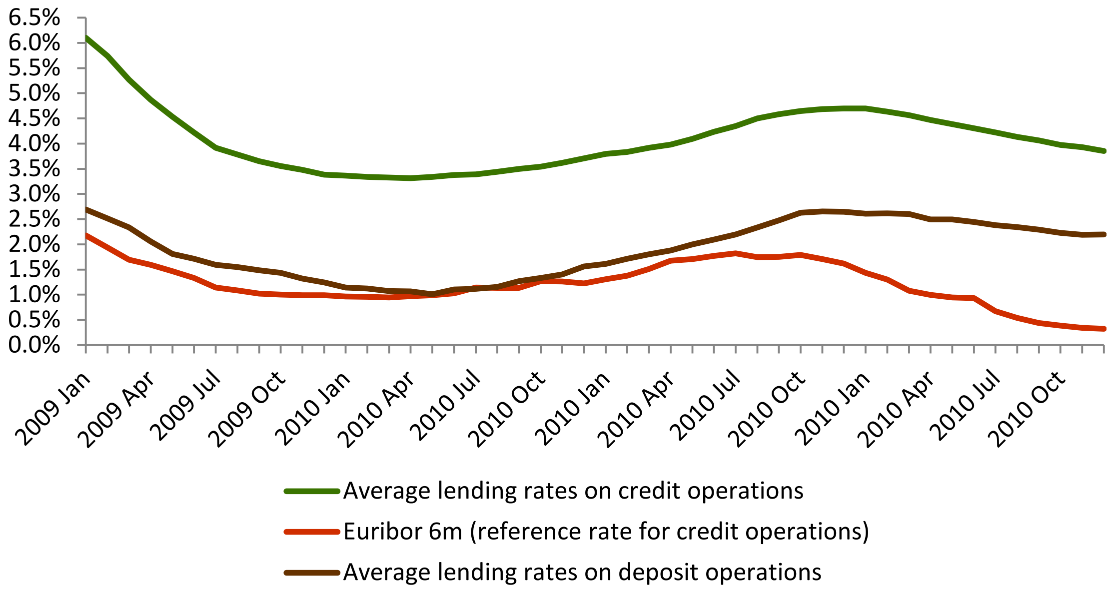
[113] Income on interbank money market operations include interest on deposits at central banks, interest on deposits at other credit institutions, interest on deposits from central banks and interest on deposits from other credit institutions (see Table 59, p. 119).

This performance reflects not only a decrease in lending and simultaneous increase in deposits from customers, which had a negative effect, but also a reduction in the difference between interest rates on loans and deposits. Although higher spreads have been in effect for new operations, they did not offset the low spreads in mortgage portfolios, normally indexed to Euribor, which fell to all-time lows in 2012. This portfolio accounted for around 40% of the member institutions' loan portfolio. After a rise in interest rates in 2011 due to more aggressive policies to attract deposits, interest rates on deposits from customers went down in 2012, accompanying the trend in the interbank money market and a change by Banco de Portugal[114] aimed at moderating the rise in interest rates, which penalised deposits with rates considered excessive in terms of own funds.

Graph 49 shows the performance over time of average monthly interest rates on deposits and lending operations. Table 57, p. 117, indicates average, maximum and minimum rates and 6-month Euribor in 2011 and 2012.

As we can see, 2012 witnessed a slight fall in lending and borrowing rates on customer operations and also a drop in Euribor, though it was much greater. The annual average lending rate remained unchanged in 2012 year on year. Nonetheless, there was an upward trend in 2011, while the opposite was the case in 2012 and the rate reached its lowest in December. The annual average borrowing rate rose to 0.2 percentage points higher than in 2011, on average (see Table 57, p. 117).

Graph 49: Euribor (6m), average lending rates on credit operations and average interest rates on deposit operations (Jan. 2009 – Dec. 2012)



Source: Bloomberg, BdP, APB.

Note: The average lending rate on credit operations was obtained by weighting monthly interest rates on balances of loans granted by monetary financial institutions to residents in the euro area by the end-of-month balance

The average lending rate on deposit operations was obtained by weighting monthly interest rates on balances of term deposits of residents in the euro area granted by monetary financial institutions by the end-of-month balance (data from the Banco de Portugal Statistical Bulletin (May 2013)).

[114] Banco de Portugal, "Financial Stability Report", May 2013 and Banco de Portugal Instruction 28/2011

Table 57: Main descriptive statistics indicators for Euribor (6m), average lending rates on credit operations and average lending rates on deposit operations

	Euribor 6m (E)	Average lending rate on credit operations (C)	C – E (pp)	Average lending rate on deposit operations (D)	D – E (pp)
2011					
Average	1.6%	4.3%	2.7	2.2%	0.6
Maximum	1.8%	4.7%	-	2.7%	-
Minimum	1.3%	3.8%	-	1.6%	-
Variation Jan. – Dec. (pp)	0.31	0.90	0.59	1.04	0.73
2012					
Average	0.8%	4.3%	3.5	2.4%	1.6
Maximum	1.4%	4.7%	-	2.6%	-
Minimum	0.3%	3.9%	-	2.2%	-
Variation Jan. – Dec. (pp)	-1.3	-0.84	0.46	-0.45	0.85

Source: BdP.

Monthly average lending rates with customers fell more than borrowing rates in 2012 (see Graph 49, p. 116). Although they both showed a downtrend during the year, the difference between the minimum and maximum rates was greater in monthly average lending rates, at-0.84 percentage points, than the -0.45 percentage points in borrowing rates (Table 57).

The rise in the average borrowing rate was particularly influenced by performance in the first quarter of 2012, when it stayed at 2.6%. From April to November these rates fell steadily and then stabilised in December. This performance reflected interbank market interest rates[115] and Banco de Portugal's[116] intervention to moderate the high interest on deposits that member institutions were offering. This measure was introduced in November 2011 and began to bring average borrowing interest rates down in the second quarter of 2012.

Meanwhile, the sharper fall in the average borrowing rate was essentially due to a reduction in Euribor[117] which reached all-time lows. The six-month rate (reference rate for mortgages) was 0.32% at the end of 2012. The increase in financial institutions' spreads (visible in the increase in the difference between the annual average of monthly average lending rates and annual average Euribor: 2.7 p.p. in 2011 to 3.5 p.p. in 2012 (see Table 57) was not enough to offset the fall in Euribor, due to the decrease in lending and the fact the new lending operations were not large enough to make up for existing low spreads, especially in the mortgage stock. For companies, as their operations are usually shorter, the rates are adjusted to market conditions and so the fall in Euribor was offset by larger spreads.

[115] According to Banco de Portugal information- see "Financial Stability Report", November 2012.
[116] Banco de Portugal Instruction 28/2011, in which it introduced penalties in terms of own funds for institutions offering excessive rates on their deposits.
[117] As most loans to private customers and companies in Portugal are at variable rates indexed to Euribor, changes in the indexer affects the average lending rate. The impact is not immediate, however, because the lending rate is reviewed not daily but for the same period as the indexer (six months in this case). See Banco de Portugal Circular 1/2008/DSB of 15 February.

Net income on financial securities operations contributed to net interest income, though less than in 2011 (-278 million euros). This occurred in all this item's components, but was most significant in income from other operations which decreased by 189 million euros (see Table 58). This was essentially due to an increase in interest paid on debt securities issued and subordinated liabilities. Regarding the former, an issue of bonds by one of the member institutions in 2012 that was underwritten by another institution in the same group explains part of the deterioration in income on financial securities operations. At the group level, however, this operation also had a positive impact via interest on held-to-maturity investments for the underwriting institution. In subordinated liabilities, a 212 million euro increase was due to the amount paid to the state for convertible bonds.

Table 58: Breakdown of net gains from operations with financial securities (2011 – 2012)

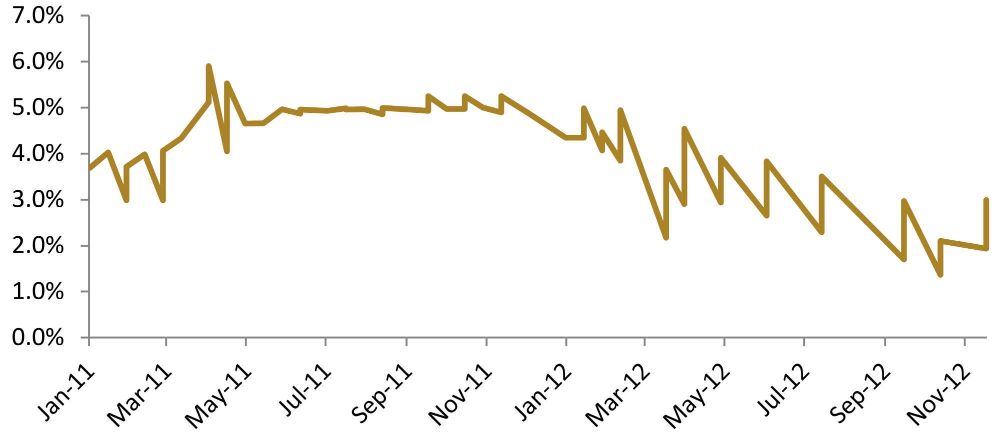
	2011	2012	Change	
	million €	million €	million €	%
Trading Operations				
+ Interest on financial assets held for trading and at fair value through profit or loss	3,739	2,739	-1,000	*-26.8%*
- Interest on financial liabilities held for trading	3,454	2,462	-992	*-28.7%*
Total	285	277	-8	*-2.9%*
Hedging Operations				
+ Interest on hedging derivatives	1,275	1,093	-182	*-14.3%*
- Interest on hedging derivatives	1,103	1,002	-101	*-9.1%*
Total	172	91	-81	*-47.1%*
Other Operations				
+ Interest on available-for-sale financial assets	2,479	2,721	242	*9.8%*
+ Interest on held-to-maturity investments	508	938	430	*84.5%*
- Interest on debt securities issued	2,251	2,900	649	*28.8%*
- Interest on subordinated liabilities	365	577	212	*58.2%*
Total	371	182	-189	*-50.9%*
Total	828	550	-278	

Source: FIs, APB.

As shown in Graph 50, p. 119, the weighted average weight of public debt auctions (treasury bills) was highly volatile in 2012. This performance and the fall in Euribor, to which some derivatives in the trading portfolio (accounting for over 70% of it) are indexed, resulted in a drop in interest paid and received. The income on these operations varied little against 2011 (see Table 58).

The 375 million euro increase in income from interbank money market operations can be explained by the less negative performance than in 2011 of operations with central banks (-126 million euros in interest paid by the financial institutions). In other credit institutions, it was lending operations that contributed most to income on interbank money market operations, with growth of 33.6%, i.e. 360 million euros more than in 2011 (see Table 59).

Graph 50: Weighted average rate on Treasury Bill auctions[118] (Jan. 2011 – Dec. 2012)



Source: IGCP.

Table 59: Breakdown of net gains from monetary interbank market operations (2011 – 2012)

	2011	2012	Change	
	million €	million €	million €	%
Operations with Central Banks				
+ Interest on deposits to and loans and advances at central banks	53	20	-33	*-62.2%*
- Interest on deposits from central banks	610	484	-126	*-20.6%*
Total	-557	-464	93	*16.7%*
Operations with Other Credit Institutions				
+ Interest on deposits to and loans and advances at other credit institutions	1,073	1,433	360	*33.6%*
- Interest on deposits from other credit institutions	1,712	1,790	78	*4.6%*
Total	-639	-357	282	*44.2%*
Total	-1,196	-821	375	

Source: FIs, APB.

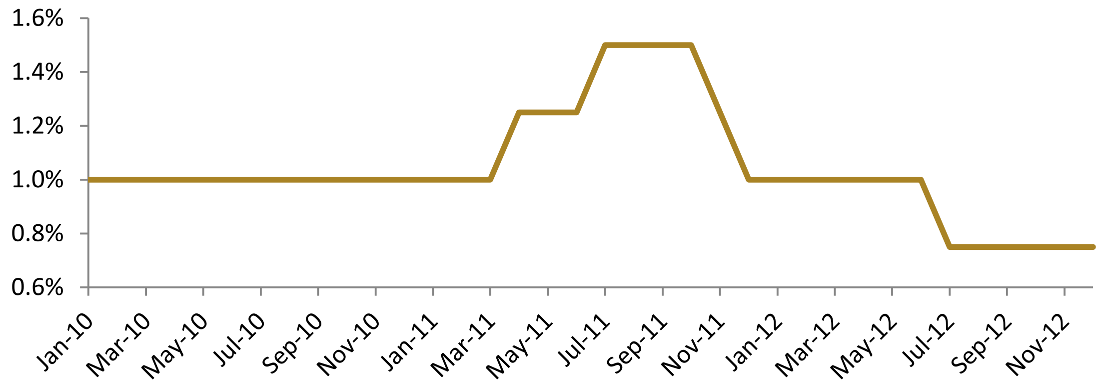
The member institutions continued to use the European Central Bank as a source of funding in 2012, as their restricted access to the wholesale debt markets continued from previous years. In spite of a four billion euro increase in the financial institutions' liabilities due to deposits from central banks (see Table 52, p. 106), interest on this item fell 20.6% against 2011 (see Table 59). This can be explained essentially by a reduction in the Refi[119] rate, which reached its lowest ever level in 2012 (see Graph 51, p. 120), as a result of the ECB expansionist monetary policy aimed at stimulating economic activity in the euro area.

Losses on operations with other credit institutions were lower than in 2011, at 282 million euros (see Table 59). This performance was due to a decrease in deposits from other credit institutions (volume effect) (see Table 53, p. 108). These items were, however, influenced by an

[118] In 2012, after the beginning of the Economic Adjustment Programme, the Portuguese State only issued Treasury Bills and no Fixed Rate Bonds.
[119] European Central Bank policy rate.

intra-group operation that made the variation in earnings and costs positive against 2011. Without this effect, although there was a growth in the result, interest on deposits from other credit institutions went down due to the fall in interest rates in 2012.

Graph 51: ECB Refi rate (Jan. 2009 – Dec. 2012)



Source: Bloomberg.

Table 60: Breakdown of aggregate net interest income (2011 – 2012)

	2011	2012		Change	
	million €	million €	%	million €	%
Interest and Similar Income (ISI)					
Interest on credit	9,724	9,434	*48.8%*	-290	*-3.0%*
Interest on financial assets at fair value through profit or loss	3,739	2,739	*14.2%*	-1,000	*-26.8%*
Interest on deposits at and loans and advances to central banks	53	20	*0.1%*	-33	*-62.2%*
Interest on deposits at and loans and advances to other credit institutions	1,073	1,433	*7.4%*	360	*33.6%*
Interest on available-for-sale financial assets	2,479	2,721	*14.1%*	242	*9.8%*
Interest on hedging derivatives	1,275	1,093	*5.7%*	-182	*-14.3%*
Interest on held-to-maturity investments	508	938	*4.8%*	430	*84.5%*
Other interest and similar income	1,385	962	*4.9%*	-423	*-30.6%*
Total	20,236	19,340	*100.0%*	-896	*-4.4%*
Interest and Similar Expense (ISE)					
Interest on deposits from central banks	610	484	*3.1%*	-126	*-20.6%*
Interest on deposits from other credit institutions	1,712	1,790	*11.6%*	78	*4.6%*
Interest on debt securities issued	2,251	2,900	*18.8%*	649	*28.8%*
Interest on deposits from customers	4,420	5,128	*33.3%*	708	*16.0%*
Interest on hedging derivatives	1,103	1,002	*6.5%*	-101	*-9.1%*
Interest on subordinated liabilities	365	577	*3.8%*	212	*58.2%*
Interest on financial liabilities held for trading	3,456	2,462	*16.0%*	-994	*-28.8%*
Other interest and similar expense	1,475	1,040	*6.9%*	-435	*-29.5%*
Total	15,392	15,383	*100.0%*	-9	*-0.1%*
Net Interest Income (NII)	4,844	3,957	-	-887	*-18.3%*

Source: FIs, APB.

VII.2.3. Customer services and market activities

In 2012, income from fees and commissions totalled 2.5 billion euros and, as in 2011, was the main item responsible (49.9%) for the 5 billion euros in income from customer and market services (see Table 61). The other 2.5 billion euros came from other income (1.3 billion euros) and net income on financial operations (1.2 billion euros).

Aggregate net income from fees and commissions was 987 million euros higher than in 2011, mainly due to net income from financial operations, particularly a 1.3 billion euro increase in income from available-for-sale financial assets. On the other hand, other income fell by 797 million euros. This unfavourable performance affected all its items. The most substantial reduction was in income from capital instruments (415 million euros less than in 2011) (see Table 61).

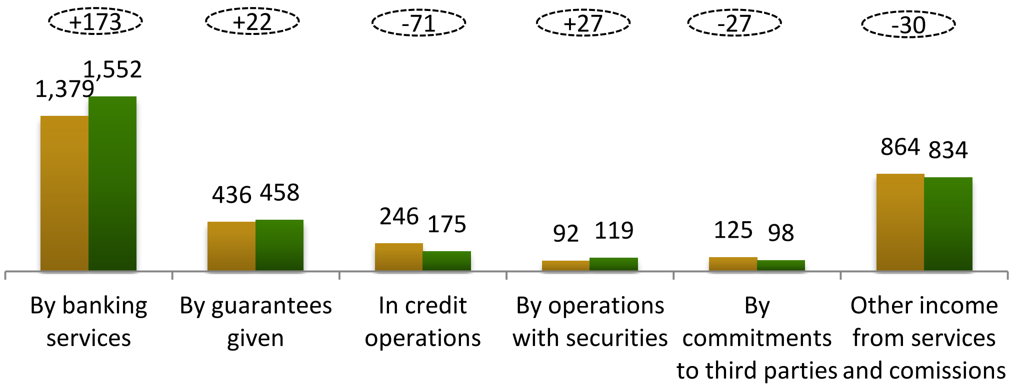
Table 61: Breakdown of net gains from customer services and market activities (2011 – 2012)

	2011	2012		Change	
	million €	million €	% NGCSM	million €	%
Net Gains from Fees and Commissions (NGFC)					
+ Fee and commission income	3,142	3,236	*63.5%*	94	*3.0%*
- Fee and commission expense	592	692	*13.6%*	100	*16.9%*
Total	2,550	2,544	*49.9%*	-6	*-0.2%*
Net Gains from Financial Operations (NGFO)					
+Net gains from assets and liabilities at fair value through profit or loss	-464	63	*1.2%*	527	*113.6%*
+ Net gains from available-for-sale financial assets	-119	1,139	*22.4%*	1,258	*-1,061.2%*
+Net gains from foreign exchange differences	3	8	*0.1%*	5	*125.4%*
Total	-580	1,210	*23.8%*	1,790	*-308.7%*
Other Results (OR)					
+ Income from equity instruments	1,170	755	*14.8%*	-415	*-35.5%*
+ Net gains from sale of other assets	160	-19	*-0.4%*	-179	*-112.0%*
+ Other operating income and expense	808	605	*11.9%*	-203	*-25.2%*
Total	2,138	1,341	*26.3%*	-797	*-37.3%*
Net Gains from Customer Services and Market Activities (NGCSM)	4,108	5,095	*100.0%*	987	*24.0%*

Source: FIs, APB.

Net income from fees and commissions remained stable against 2011 and the increase in income kept up with that in expenses (see Table 61). The weight of commissions fell in relation to total income from customer and market services from 62% in 2011 to 49.9% in 2012.

Graph 52: Breakdown of income from fees and commissions, million euros (2011 – 2012)

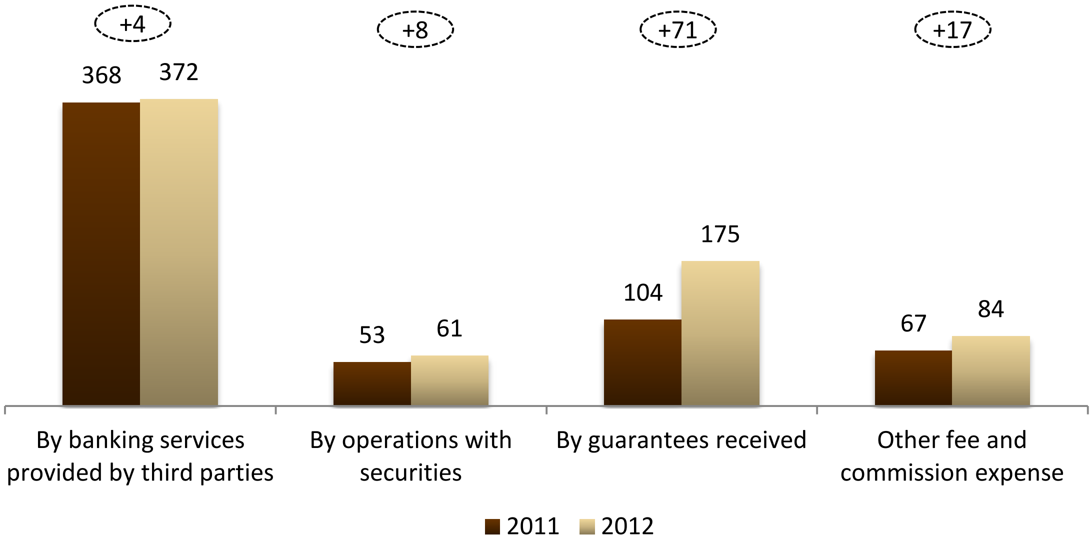


Source: FIs, APB.
Note: 2012/2011 change

The 94 million euro increase in income in 2012 was mainly due to an increase in the banking services item and a reduction in commissions received on lending operations (Graph 52) as a result of fewer new lending operations because of the recessive economic context.

As in 2011, growth in expenses (see Graph 53) was mostly due to an increase in the value of guarantees received, coming mainly from commissions paid in bond issues guaranteed by the state.

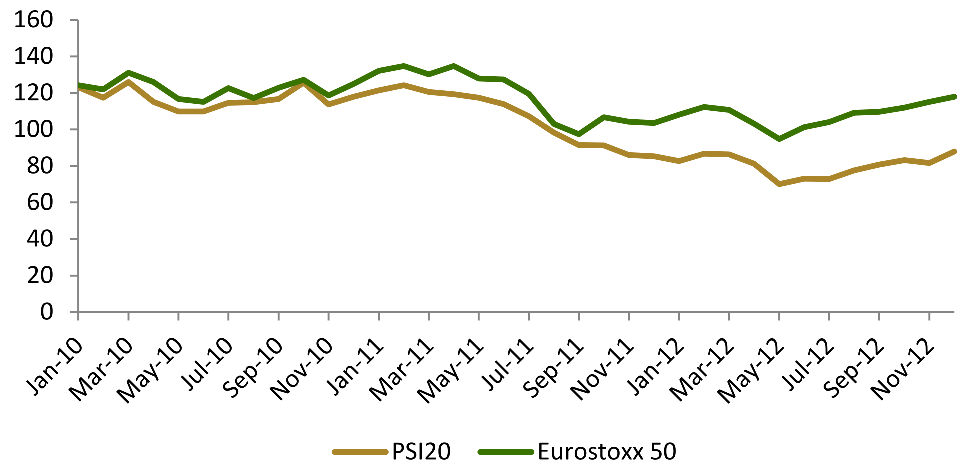
Graph 53: Breakdown of expenses from fees and commissions, million euros (2011 – 2012)



Source: FIs, APB.
Note: 2012/2011 change

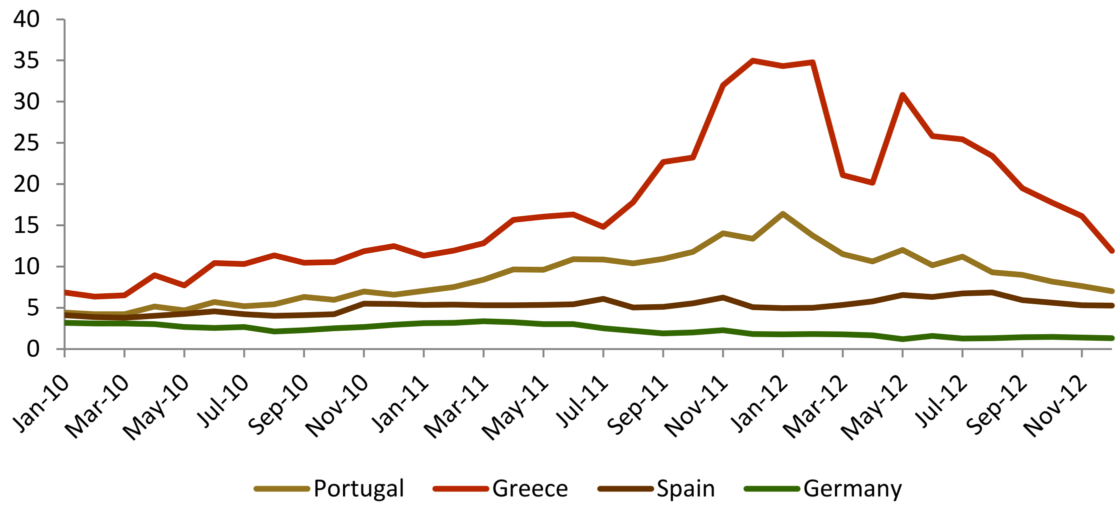
The balance of financial operations was 1.8 billion euros higher in 2012 than in 2011. Gains achieved from the sale of debt securities, mainly public debt (see Graph 55, p. 123 and Graph 56, p. 124) and some appreciation in the stock market (see Graph 54, p. 123) explain the 1.3 billion euro increase (see Table 61, p. 121) in the item net income from available-for-sale financial assets in 2012.

Graph 54: Main share indexes (Jan. 2010 – Dec. 2012)



Source: Bloomberg.

Graph 55: Yield-to-maturity for Portuguese, Greek, Spanish and German sovereign debt (Jan. 2010 – Dec. 2012)

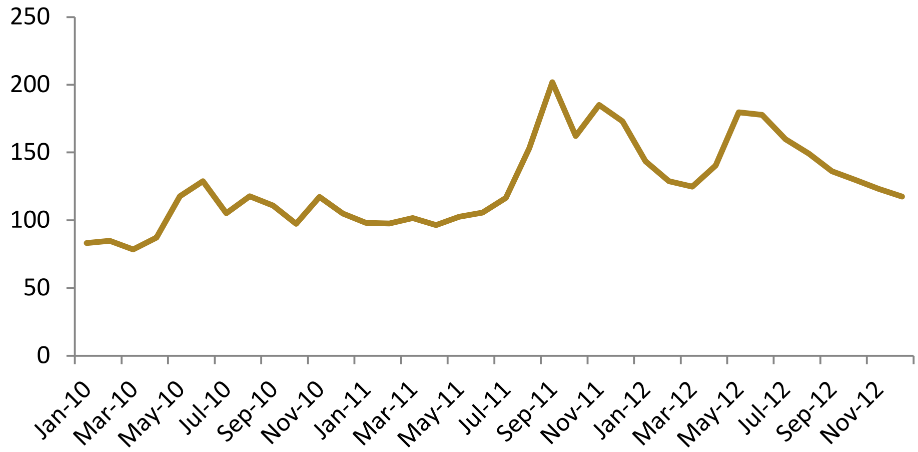


Source: Bloomberg.

The variation in income on assets and liabilities at fair value through profit or loss resulted essentially from recognition of gains on debt securities and losses in value on (mainly interest rate) derivatives. There was a recovery in the variable income securities markets, while in the debt markets there was a reduction in yields-to-maturity and credit default swaps (Graph 55 and Graph 56, p. 124) against 2011.

Finally, the item other results decreased by 37.8%% (see Table 61, p. 121), essentially due to a 415 million euro drop in income from capital instruments (dividends).

Graph 56: Credit default swaps of European institutions considered investment grade. 5-year bonds (Jan. 2010 – Dez- 2012)



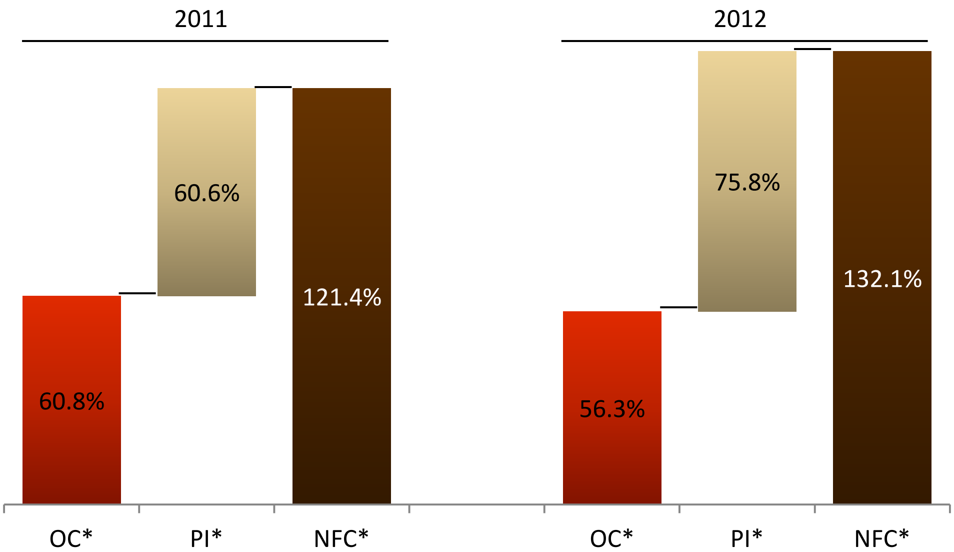
Source: Bloomberg.
Note: Used index - Markit iTraxx Eur CDSI Generic 5Y Corp.

VII.2.4. Operating costs, provisions and impairments

As mentioned above, in 2011 and 2012, earnings from bank intermediation and customer and market services were not enough to cover all the costs (see Table 63, p. 129).

As we can see from Graph 57 provisions and impairments as a percentage of operating income went from 60.6% in 2011 to 75.8% in 2012. The weight of operating costs fell 4.5 percentage points (60.8% in 2011, 56.3% in 2012).

Graph 57: Breakdown of operating costs, provisions and impairments as percentage of operating income (2011 – 2012)



Source: FIs, APB.
Note: *OC – Operating costs; PI – Provisions and impairments; NFC – Non financial costs.

All together, the costs borne by the member institutions increased by one billion euros against 2011. While provisions and impairments rose 1.4 billion euros, operating costs fell by 345 million euros, mainly due to a reduction in personnel costs (-326 million euros) (see Table 62). Even so, personnel costs still had the highest weight in operating costs (54.2% in 2012).

Table 62: Breakdown of operating costs, provisions and impairments (2011 – 2012)

	2011		2012		Change	
	million €	%	million €	%	million €	%
Operating Costs (OC)						
Personnel costs	3,088	*56.7%*	2,762	*54.2%*	-326	*-10.5%*
General administrative expenses	1,930	*35.5%*	1,928	*37.8%*	-2	*-0.1%*
Depreciation and amortisation	424	*7.8%*	407	*8.0%*	-17	*-4.1%*
Total	5,442	*100.0%*	5,097	*100.0%*	-345	*-6.3%*
Provisions and Impairments (PI)						
Provisions net of reversals	-207	*-3.8%*	68	*1.0%*	275	*132.9%*
Value adjustments relating to loans and advances to customers and receivables from other debtors (net of reversals)	3,138	*57.8%*	4,659	*67.9%*	1,521	*48.5%*
Impairment on other financial assets net of reversals	1,425	*26.3%*	606	*8.8%*	-819	*-57.5%*
Impairment on other assets net of reversals	1,070	*19.7%*	1,530	*22.3%*	460	*42.9%*
Total	5,426	*100.0%*	6,863	*100.0%*	1,437	*26.5%*
Total Costs (TC)	10,868	-	11,960	-	1,092	*10.0%*

Source: FIs, APB.

In December 2011, following an agreement between some financial institutions and the Portuguese government, their liabilities for current pensions (retirees and pensioners) were partially transferred to Social Security. Certain assumptions defined by the state were used to calculate the value of the liabilities and in most cases they were different from those used by the institutions in their accounts. These divergences resulted in differences between the amount of liabilities transferred and the value of the pension funds' assets, which were mostly recorded under personnel costs[120]. These differences totalled 201 million euros and so, without this extraordinary event, personnel costs would have been 2.9 billion euros in 2011 and 125 million euros, or 4.3%, lower in 2012 (see Table 62).

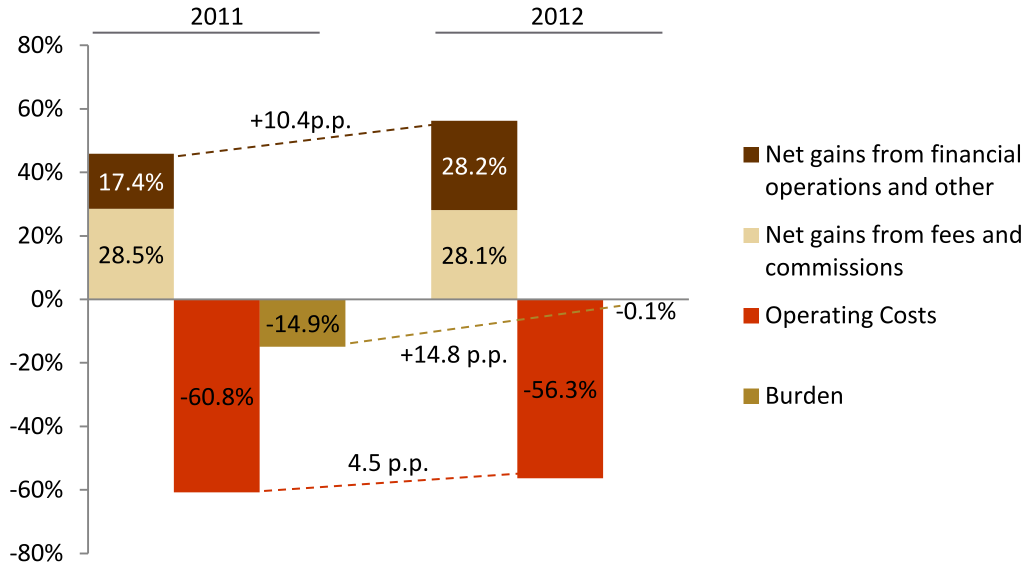
General administrative expenses stabilised, though their weight in operating costs increased (2.3 percentage points up on 2011), which demonstrated the importance of outsourcing to banking activity (see Table 62). The weight of depreciation in the two years was negligible compared to other costs.

The 6.3% reduction in operating costs also resulted in a 4.5 percentage point decrease in its weight against operating income in 2012. At the same time, growth in income from customer and market services (24%), in contrast to a fall in net interest income (-18.3%), increased its weight

[120] Four institutions recorded these differences in other operating income and not personnel costs, to a total of 207 million euros in 2011.

against operating income by 10.4 percentage points. This meant capacity to cover operating costs by net income from fees and commissions and financial operations improved in 2012, as the burden went from -14.9% in 2011 to -0.1% in 2012 (see Graph 58).

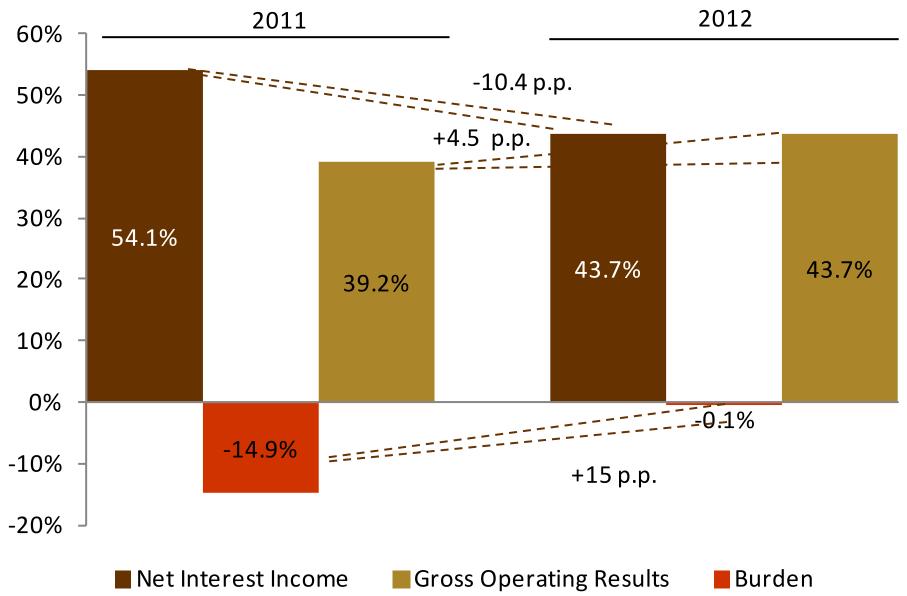
Graph 58: Burden as percentage of operating income (2011 – 2012)



Source: FIs, APB.

The 10.4 percentage point reduction in net interest income as a percentage of operating income was offset by the increase in the burden, which resulted in a 4.5 percentage point higher gross operating result in 2011 (see Graph 59).

Graph 59: Gross operating results as percentage of operating income by comparison between net interest income and burden (2011 – 2012)



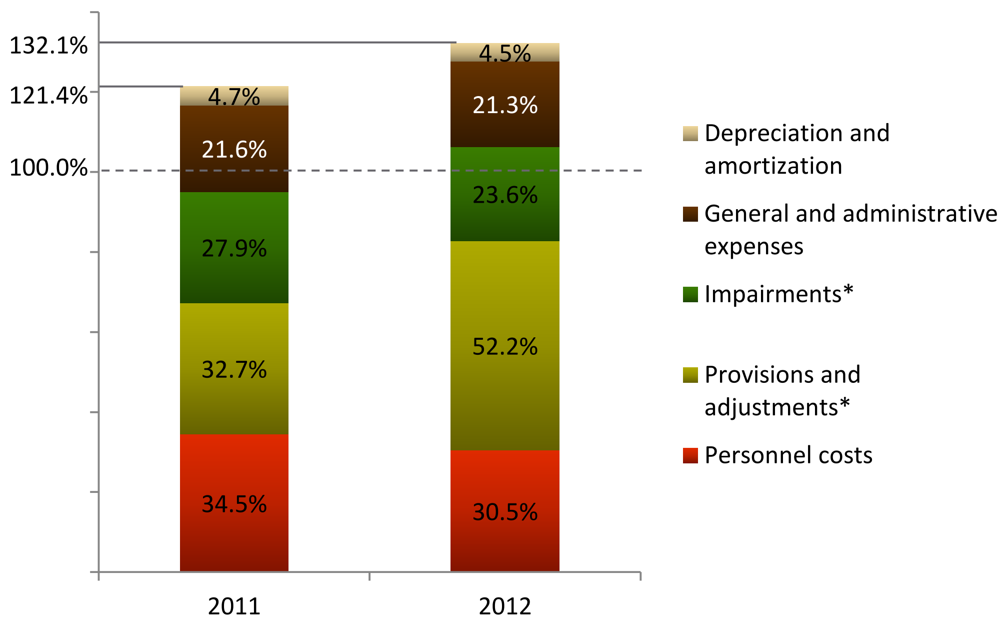
Source: FIs, APB.

Credit impairments stood out in total costs of provisions and impairments, (57.8% in 2011 and 67.9% in 2012). Appreciation in financial assets in 2012 helped to reduce their impairments, whose weight went from 26.3% in 2011 to 8.8% in 2012. The weight of impairments of other assets net of reversals increased by 2.6% to 22.3% of the total (see Table 62, p. 125).

A 1.5 billion euro increase in corrections associated with loans and advances to customers was due to the deterioration and consequent materialisation of the credit risk, as demonstrated by an increase in overdue loans. At the same time, Banco de Portugal conducted an on-site inspection programme of the eight largest banking groups. It focused on exposure to the construction and real estate sectors and resulted in an 861 million euro increase in provisions. As mentioned above, according to information given to the APB, 813 million euros in provisions had been set up as at 31 December 2012 (see Table 62, p. 125).

Impairments for other assets rose to 1.5 billion euros in 2012, mainly reflecting losses on investments in subsidiaries and associates (see Table 62, p. 125).

Graph 60: Weight of operating costs, provisions and impairments in operating income (2011 – 2012)



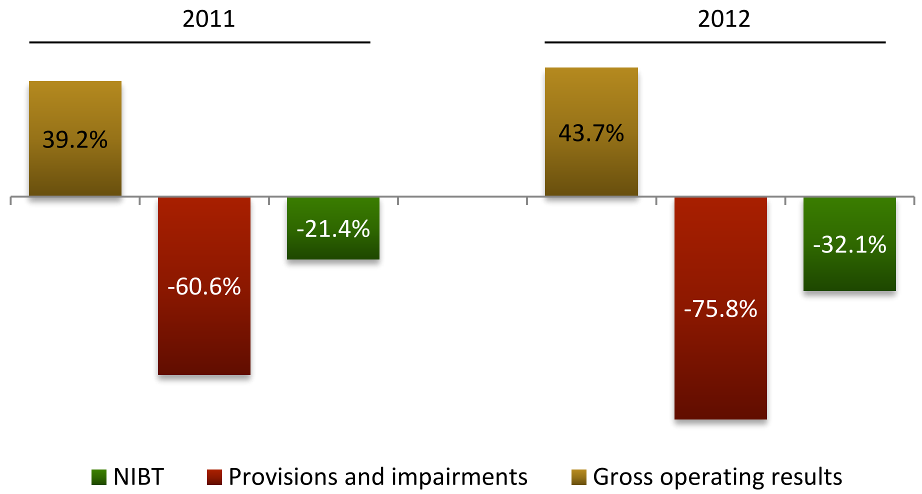
Source: FIs, APB.

Note: *Impairments – include Impairment on other financial assets net of reversals and impairment on other assets net of reversals; Provisions and adjustments – include provisions net of reversals and credit impairment.

The weight of provisions and corrections associated with credit was half the financial institutions' operating income in 2012 (Graph 60), almost the same as that of total operating costs. If we add impairments for other financial and non-financial assets, they represented 75.8% of operating income (see Graph 61, p. 128 and Table 63, p. 129).

In spite of the increase in gross operating result, due to the albeit small increase in operating income and the reduction in operating costs, it was not enough to absorb the amount of provisions and impairments in 2012. This had a serious adverse effect on the member institutions' net income before tax (see Table 63, p. 129).

Graph 61: Net income before tax as percentage of operating income by comparison between gross operating results and provisions and impairments (2011 – 2012)



Source: FIs, APB.

Table 63: Aggregate income statement of the sample of 31 institutions for comparison between 2011 and 2012[121]

	2011		2012		Change	
	million €	% OI	million €	% OI	million €	%
+ Interest and similar income	20,236		19,340			
- Interest and similar expense	15,392		15,383			
Net Interest Income (NII)	4,844	*54.1%*	3,957	*43.7%*	-887	*-18.3%*
+ Fee and commission income	3,142		3,236			
- Fee and commission expense	592		692			
Net Gains from Fees and Commissions	2,550	*28.5%*	2,544	*28.1%*	-6	*-0.2%*
+ Net gains from assets and liabilities at fair value through profit or loss	-464		63			
+ Net gains from available-for-sale financial assets	-119		1,139			
+ Net gains from foreign exchange differences	3		8			
Net Gains from Financial Operations	-580	*-6.5%*	1,210	*13.4%*	1,790	*308.7%*
+ Income from equity instruments	1,170		755			
+ Net gains from sale of other assets	160		-19			
+ Other operating income and expense	808		605			
Other Results	2,138	*23.9%*	1,341	*14.8%*	-797	*-37.3%*
Operating Income (OI)	8,952	*100.0%*	9,052	*100.0%*	100	*1.1%*
- Personnel costs	3,088		2,762			
- General administrative expenses	1,930		1,928			
- Depreciation and amortisation	424		407			
Operating Costs	5,442	*60.8%*	5,097	*56.3%*	-345	*-6.3%*
Gross Operating Results (GOR)	3,510	*39.2%*	3,955	*43.7%*	445	*12.7%*
- Provisions net of reversals	-207		68			
- Value adjustments relating to loans and advances to customers and receivables from other debtors (net of reversals)	3,138		4,659			
- Impairment on other financial assets net of reversals	1,425		606			
- Impairment on other assets net of reversals	1,070		1,530			
Provisions and impairment	5,426	*60.6%*	6,863	*75.8%*	1,437	*26.5%*
Net Income before Tax (NIBT)	-1,916	*-21.4%*	-2,908	*-32.1%*	-992	*-51.7%*

Source: FIs, APB.

[121] Ver nota de rodapé 81, pág. 89.

VII.2.5. Taxation and parafiscal levies

Financial institutions are subject to corporate income tax, just like companies in the other economic sectors.

An analysis of the Corporate Income Tax Code (CIRC) shows that the adjustments that apply to financial institutions' income in the calculation of the tax base are the same as those for companies in general. They are as follows:

- Capital gains and impairment (net) (Articles 35 to 40 and 46 to 48 of the CIRC)
- Elimination of double taxation of distributed profits (Article 51 of the CIRC and Article 42 Tax Benefit Statute)
- Non-deductible expenses (Article 45 of the CIRC)
- Provisions for other risks (Articles 35 to 40 of the CIRC)
- Allocation of profits of companies subject to special tax schemes, net of deductions (Article 66 of the CIRC)
- Pension funds (Article 43(2) and (3) of the CIRC [122]);
- Provisions for credit impairment (Article 35 et seq of the CIRC, Banco de Portugal Notice 3/95 and Banco de Portugal Notice 1/2005). The fact that this adjustment is regulated by Banco de Portugal only means that the way of taxing banks is different from that for companies in other sectors, as "the accumulated annual amount of impairment losses and other value adjustments for the specific credit risk and country risk referred to in Article 35(2) of the CIRC must not exceed the amount resulting from the enforcement of the mandatory minimum limits laid down in notices and instructions issued by the supervisory body" (Article 37(1) of the CIRC). In short, banks have no special advantage and they are only subject to a different rule on the calculation of provisioning limits that are tax-deductible (Banco de Portugal 3/95 e Banco de Portugal Notice 1/2005).[123].

The banking sector only received favourable treatment in one concrete situation, which was that of financial branch offices in the Madeira tax-free area, and this rule expired on 31 December 2011. It is worth noting, however, that the tax exemption for income obtained by these branch

[122] In practice, the rules on pension funds in the banking sector are actually stricter. In the general rules, pensions are the responsibility of Social Security, and the contributions paid by companies are not limited in terms of corporate income tax. Retirement pensions in the banking sector are the banks' responsibility and the tax cost associated with them cannot exceed 25% of salaries.

[123] In fact, banks end up having to pay corporate income tax to the state early, since credit impairments resulting from almost all their normal activity (loans with real guarantees) are not tax deductible (the other sectors do not usually grant loans guaranteed by real rights).

offices, which did not apply to other companies with their head office and control in Portugal, was limited to 15% of the credit institution's taxable income. This substantially reduced its impact[124].

The tax benefits for the banking sector are the same as those for other companies (Articles 19 and 61 to 66 of the Tax Benefit Statute). On the other hand, a number of measures restricting tax benefits have been announced, with banks as their main targets. For example, there is an increase from 60% to 75% in the minimum limit of corporate income tax paid after deduction of the tax credit for international double taxation and tax benefits introduced by the 2010 State Budget Law.[124]

An approximate aggregate amount of the corporate income tax payable to the state by member institutions was calculated in order to confirm the above tax scheme analysis[125] (see Table 64, p. 132). This calculation considered the estimated tax base for 2011 and 2012 calculated on the basis of net income before tax and changes in equity recognised in reserves and retained earnings and corrected by the above-mentioned adjustments made pursuant to the CIRC. Income tax was also estimated by applying the corporate income tax rate stipulated for each year[126] to the tax base calculated in accordance with current taxation rules.

On the basis of the results (see Table 64, p. 132), the corporate income tax payable to the state by member institutions is estimated at around 94 million euros in 2012 (as opposed to 42 million in 2011). This corresponds to an estimated corporate income tax rate of 25.2% (as opposed to 26.4% in 2011). According to statistics provided by Direcção Geral dos Impostos (DGI - Directorate-General for Taxation) for 2011, the average effective corporate income tax rate for companies in the financial and insurance sector was 21%, which was above the national average of 17%.

[124] Duro Teixeira, M., 2011, "A Tributação da Banca em Tempos de Crise", *Revista de Finanças Públicas e Direito Fiscal, Ano IV, nº 1 (Primavera), pp. 113-142*

[125] For the purpose of this calculation, and because of a shortage of or non applicable data, it was based on 29 of the 32 financial institutions from the sample in this report. It did not include Banco BIC, o Barclays or CCCAM. The data for 2011 were corrected for purposes of comparison due to the closure of the subsidiary in Portugal of BNP Wealth Management at the end of 2012 and the inclusion of Banco Finantia.

[126] This rate was around 25% in 2011 and 2012,.

Table 64: Approximate total amount of tax payable to the state in terms of corporate tax in 2011 and 2012. It is based on estimate figures for the tax base, which were calculated from the net income before tax and changes in equity recognised in reserves and retained earnings

	2011 million €	2012 million €
Net Income Before Tax [a)]	**(2,001)**	**(2,944)**
Adjustments for calculation of taxable income / tax loss		
Applicable to all taxpayers subject to corporate income tax:		
Capital gains and impairments in investments (net)	256	1,125
Elimination of double taxation of distributed profits	(958)	(569)
Tax benefits	(44)	(94)
Non-relevant expenses and income for tax purposes	24	21
Provisions for other risks	911	(75)
Allocation of profits of non-resident companies subject to special tax schemes	353	93
Employment termination and retirement benefits and other post-employment or long-term benefits	60	(484)
Impairments for credit-risk	846	1,825
Other[b)]	259	(251)
Applicable to credit institutions and financial companies:		
Impact of the tax regime on financial branch offices' activity in the Madeira tax-free area	(41)	-
Taxable Income / Tax Loss	**(335)**	**(1,353)**
Use of tax losses from prior years	(385)	(455)
Tax Base[c)]	**159**	**373**
Income tax	42	94
Income Tax Rate (%)	***26.4%***	***25.2%***

Source: FIs, APB.

[a)] Net income before tax of the 29 financial institutions in the sample in this chapter.

[b)] Includes positive and negative changes in equity not reflected in the net income for the year but recognised in reserves and retained earnings.

[c)] Aggregate taxable income consists of the sum of taxable income and tax losses of the financial institutions in the sample. The institutions that have recorded a tax loss in the year have no tax base, which is why the aggregate figures for members that record taxable income are only included in the tax base field (even after deduction of losses). This figure is naturally higher than that of aggregate taxable income (which contain said losses).

In addition to corporate income tax, financial institutions pay local state taxes and are subject to autonomous taxation and the taxes levied in the foreign countries in which they operate. In 2011 and 2012, the member institutions paid around 41 and 79 million euros, respectively (see Table 65, p. 133).

Table 65: Approximate local taxes, autonomous taxation and income tax levied in foreign countries (2011 – 2012)

	2011 million €	2012 million €
Income tax levied in foreign countries net of the deduction of double taxation	11	15
Autonomous taxation	14	14
Local taxes[a)]	16	50
Total Local Taxes, Autonomous Taxation and Income Tax Levied in Foreign Countries	**41**	**79**

Source: FIs, APB.

[a)] Local taxes were calculated at 1.5% of taxable income in 2011 and 2012 plus an additional 2.5% for the state levy introduced under the Stability and Growth Programme.

In addition to the above-mentioned expenses, financial institutions are subject to other operating taxes, such as stamp duty, non-deductible value-added tax (VAT) and municipal property tax (IMI). In Table 66, p. 134, these taxes are grouped under the heading operating tax costs.

Meanwhile, Article 141 of the 2011 State Budget (Law 55 – A/2010 of 31 December) laid down a levy on the banking sector. As set out in Ministry of Finance and public administration Order 121/2011 of 30 March, this contribution applies to:

a) liabilities calculated and approved by taxable persons minus base (Tier 1) and complementary (Tier 2) equity and deposits covered by the Deposit Guarantee Fund, at a rate of 0.05% of the amount calculated

b) the notional value of off-balance-sheet derivatives calculated by taxable persons, at a rate 0.00015% of the amount calculated

As shown in Table 66, p. 134, the levy on the banking sector for the member institutions totalled 136 million euros in 2012 (139 million euros in 2011).

Parafiscal levies consist of contributions to Social Security, SAMS (Medical and Social Service) and pension funds. The decrease in these levies in 2012 was due to a reduction in contributions to pension funds as a result of an amendment to Decree-Law 133/2012 of 27 June, which changed the method for calculating death subsidies thereby reducing liabilities for services rendered. This reduction resulted in recognition in costs of negative past services and led to a reduction in pension expenses.

Table 66: Tax and parafiscal burden (2011 – 2012) [a)]

	2011 million €	2012 million €
Tax Burden		
Operating taxes[b)]	290	301
Contributions on the Banking Sector	139	136
	429	437
Parafiscal Burden		
Single social rate	335	329
Pension expenses	415	132
Other expenses	137	131
Total	887	592
Total	**1,316**	**1,029**

Source: FIs, APB.
[a)] Only Banco BIC, CCCAM and Finantia are not included in this table, due to lack of data.
[b)] Including stamp duty, non- deductible VAT and IMI.

VII.3. Return

The member institutions'[127] once again showed a loss in 2012, in line with the year's results. Return on equity (ROE)[128] before tax was -12.2%, as opposed to -7.52% in 2011.

This deterioration was due to the decline in the macroeconomic context in Portugal, which adversely affected the member institutions' performance in 2012, and a series of external factors. These factors included the historically low interest rates in the European interbank market, which have pressured net interest income, which fell by 18.5% against 2011. This situation was particularly hard on the Portuguese banking sector for two reasons. The first was the financial institutions' greater sensitivity to the price of financial assets than financial liabilities in Portugal. Most loan agreements are indexed to Euribor plus a fixed spread. When the reference rate goes down, as has been the case since October 2008, spreads and average return on assets feel the effects. In addition, there is the amount of loans, which has been falling due to the deleveraging process, thereby preventing the financial institutions from reflecting changes in market conditions in their assets.

[127] The sample used in the analysis of return has been adjusted to 30 financial institutions as Barclays and Finantia were excluded due to lack of broken-down data.
[128] The analysis of return in this chapter uses average balance sheet figures, which were calculated on the basis of quarterly balance sheets (in line with Banco de Portugal Instruction 16/2004 of 16 August), which makes it possible to eliminate end of year effects and give a more stable overview of the balance sheet. The income statement figures are from year end. It is important to note that, since Activity Report 46 (2010), the analysis of return has been based on net income before tax and not net income for the year.

Table 67: ROA and ROE (2011 – 2012)

		2011	2012	Change
	Balance Sheet Average Values (Million €)			
ØTA	Average total assets	481,503	461,885	*-4.1%*
ØFA	Average financial assets	443,813	424,127	*-4.4%*
ØFL	Average financial liabilities	444,676	427,709	*-3.8%*
ØE	Average equity	25,738	23,868	*-7.3%*
	Income Statement (Million €)			
	+ Interest and similar income	20,143	19,228	*-4.5%*
	- Interest and similar expense	15,332	15,308	*-0.2%*
	Net Interest Income	4,811	3,920	*-18.5%*
	+ Net gains from fees and commissions	2,548	2,542	*-0.2%*
	+ Net gains from financial operations	-573	1233	*-315.2%*
	+ Other results	2,130	1,334	*-37.4%*
	Operating income	8,916	9,029	*1.3%*
	- Operating costs	5,436	5,088	*-6.4%*
	- Provisions and impairments	5,415	6,852	*26.5%*
NIBT	Net Income Before Tax	-1,935	-2,911	*50.4%*
	Return [a)]			
NIBT/ØTA	Return on assets before tax (ROA)	-0.40%	-0.63%	
ØTA/ØE	x Financial leverage	18.71	19.35	
NIBT/ØE	Return on equity before tax (ROE)	-7.52%	-12.20%	

Source: FIs, APB.
[a)] Values rounded to two decimal points.
Note: Changes are measured in percentage.

Another factor with an adverse effect on net interest income was an increase in funding costs. It arose on the one hand from deterioration in the sovereign risk, which has affected the wholesale markets' perception of the Portuguese financial institutions' risk. On the other hand, it was the result of high interest on state aid for the financial sector, such as issues of hybrid instruments subscribed by the state (229 million euros), to meet the FAP and EBA[129] (European Banking Authority) capital requirements and commissions on guarantees granted for the member institutions' debt issues (214 million euros).

A substantial increase in the domestic credit risk was also a negative factor as it resulted in a 26.5% growth in impairments and provisions, which placed even more pressure on net income before tax. This item was adversely affect by additional provisions and impairments to the amount of 813 million euros resulting from the Banco de Portugal On-site Inspection Programme for eight banking groups, to a total of 18 financial institutions.

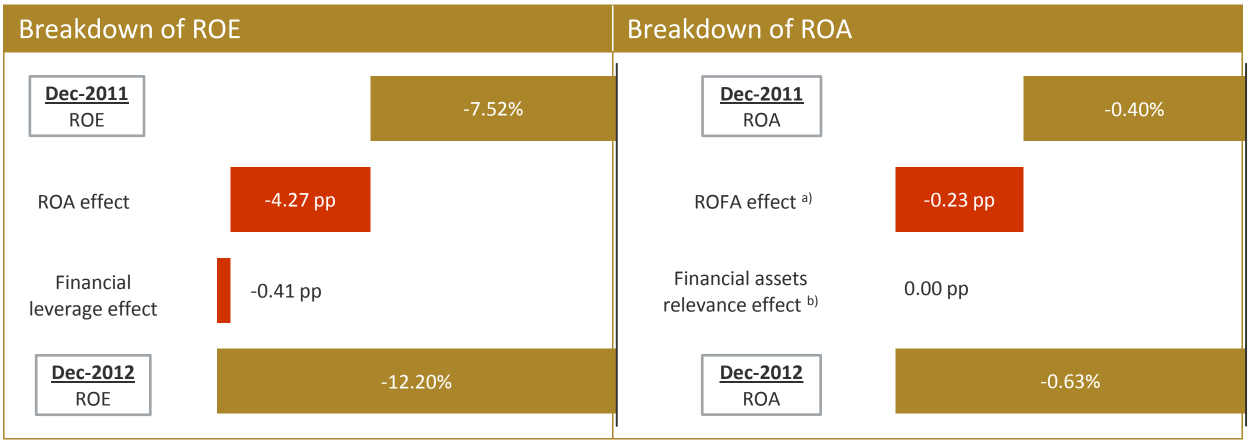
With this adverse situation in mind, it is worth noting that, with the impacts of impairments resulting from the On-Site Inspections Programme (OIP) and interest and commissions paid for state

[129] European Banking Authority

aid, the member institutions' return would still have been negative, with a pre-tax return of -0.36% and ROE of -7.51%[130].

There were also factors that mitigated these negative effects, however. There was an increase in net income on financial operations thanks to a rise in yields from public debt, particularly Portuguese debt, and a reduction in operating costs from rationalisation of operating structures.

Chart 6: Breakdown of effect on ROE and ROA (2011 - 2012)



Source: FIs, APB.
a) ROFA – return on financial assets before tax.
b) Financial assets relevance is given by ratio between financial assets and total assets.

On average, the member institutions' equity fell 7.3% in 2012, in spite of efforts towards capitalisation, which raised equity by year end against 2011. This reduction was mainly due to two factors. On the one hand, there was the net loss in 2011, due to the high impact of extraordinary measures in the last quarter of the year[131], and its consequent incorporation in retained earnings. On the other hand, there were the losses also recorded in 2012.

Total average assets also decreased against 2011, though to a lesser extent. The former effect was superimposed on the latter resulting in greater average financial leverage. Nonetheless, higher leverage had a low impact on ROE in 2012 and was responsible for only 8.8% of the total variation (-0.41 percentage points in -4.67 percentage points). It was return on assets before tax that most affected ROE and explained the remaining variation of-4.27 percentage points (see Chart 6).

The cause of the decrease in return on assets (ROA) was return on financial assets, as their composition effect had zero impact. Chart 6 shows that it was return on financial assets (ROFA) that caused the above changes in performance indicators.

[130] This approximate figure was obtained by adding one billion euros to net income before tax and average equity. It therefore does not take account of any tax impacts through the net income of the year on equity and also ignores the time lapse of some measures, which would affect the quarterly balance sheets differently.
[131] The extraordinary impacts of around 1.9 billion euros in 2011 include the effects of the partial transfer of pension funds to the state, recognition of credit impairments resulting from the Special Inspection Programme, a haircut of the Greek sovereign debt and the Levy on the Banking Sector. For more details, see Activity Report 47 (2011).

If we analyse the items in the income statement as a percentage of average financial assets, we find that their direct impact on the reduction in return on financial assets before tax was 25 basis points between 2011 and 2012 (see Table 68). The contraction in net interest income had a considerable effect, as it was responsible for 16 basis points in the reduction in ROFA. An additional 40 basis points in the weight of provisions and impairments was also significant. On the other hand, income from financial operations grew 42 basis points, thus offsetting part of the negative effects.

Table 68: Return on financial assets (2011 – 2012)

		2011	2012	Change
	Income Statement as Percentage of Financial Assets [a)]			
	+ Interest and similar income	4.54%	4.53%	*-1 bp*
	- Interest and similar expense	3.45%	3.61%	*15 bp*
	Net interest income	1.08%	0.92%	*-16 bp*
	+ Net gains from fees and commissions	0.57%	0.60%	*3 bp*
	+ Net gains from financial operations	-0.13%	0.29%	*42 bp*
	+ Other results	0.48%	0.31%	*-17 bp*
	Operating income	2.01%	2.13%	*12 bp*
	- Operating costs	1.23%	1.20%	*-3 bp*
	- Provisions and impairment	1.22%	1.62%	*40 bp*
NIBT/ØFA	Return on financial assets before tax (ROFA)	-0.44%	-0.69%	*-26 bp*

Source: FIs, APB.

a) It is to be remembered that income statement figures are of the year end, while the denominator of all the percentages, financial assets, was calculated based on average balance sheets figures.

Note: Change is measured in percentage (bp).

For more detail on the factors behind the variation in weight of net interest income in average financial assets (representing its contribution in the variation in ROFA), we now analyse interest, income and expenses in the income statement and relate them to their items in stock on the balance sheet. The aim of the analysis is to ascertain whether variations in interest resulted from a change in the implicit interest rate or changes in the composition of financial assets/liabilities (interest rate and composition effect, respectively)[132].

Although net interest income made a practically zero contribution to the variation in ROFA from 2011 to 2012, there were important positive and negative features that offset each other (see Table 69, p. 138). Firstly, interest on financial assets held for trading and at fair value through profit or loss fell 20 basis points in terms of average financial assets. On the other hand, interest on held-to-maturity investments and available-for-sale financial assets increased, accounting for another 11 b.p. and 8 b.p. of average financial assets respectively.

[132] See Sub-chapter VII.3.1 of Activity Report 46 (2010) for a detailed explanation of this breakdown.

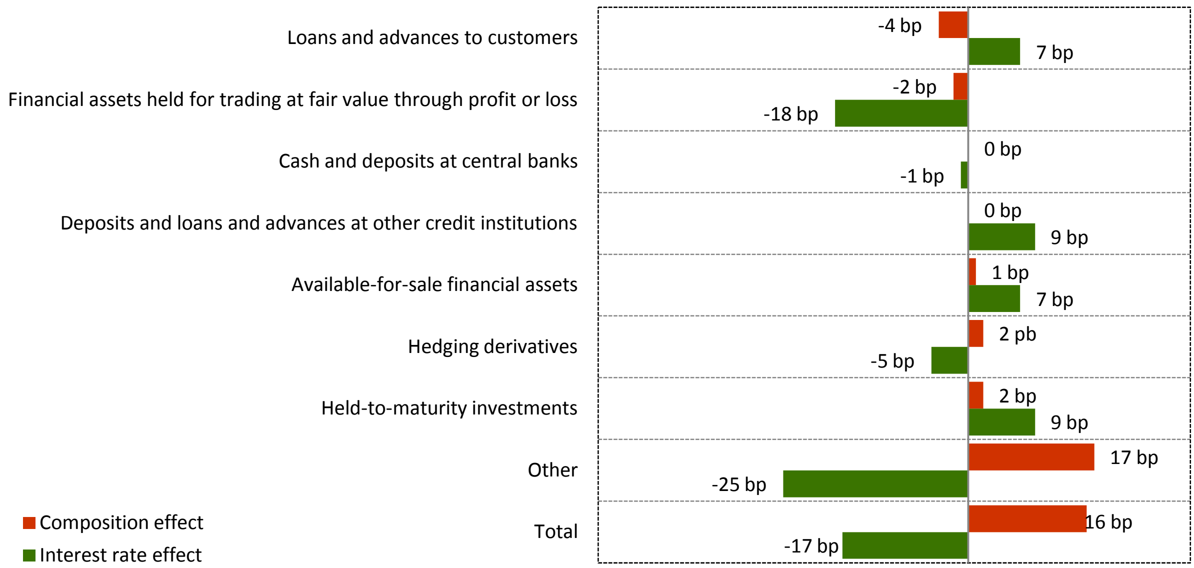
Table 69: Interest and similar income of net interest income (2011 – 2012)

	2011	2012	Change
Interest and Similar Income as Percentage of Average Financial Assets			
Interest on credit	2.19%	2.22%	*3 bp*
Interest on financial assets held for trading at fair value through profit or loss	0.84%	0.64%	*-20 bp*
Interest on deposits and loans and advance to Central Banks	0.01%	0.00%	*-1 bp*
Interest on deposits and loans and advance to other credit institutions	0.24%	0.33%	*9 bp*
Interest on available-for-sale financial assets	0.55%	0.63%	*8 bp*
Interest on hedging derivatives	0.29%	0.26%	*-3 bp*
Interest on held-to-maturity investments	0.11%	0.22%	*11 bp*
Other interest and similar income	0.31%	0.23%	*-8 bp*
Interest and similar income	4.54%	4.53%	*-1 bp*

Source: FIs, APB.
Note: Change is measured in basis points.

A slight variation in interest and similar income in terms of financial assets was mainly due to a negative interest rate effect (17 b.p.), which was partially offset by a positive composition effect (16 b.p.) (see Graph 62). Interest on loans and advances to customers benefited from an increase in the underlying interest rate but was adversely affected by a negative composition effect due to a contraction of the item in total financial assets. Interest on available-for-sale financial assets and held-to-maturity investments increased not only because of the rise in implicit interest rates but also because of their higher relative importance.

Graph 62: Breakdown of changes in interest and similar income of net interest income (2011 – 2012)



Source: FIs, APB.
Note: This graph breaks down the total variation shown in Table 69 by composition and interest rate effect.

Where deposits at credit institutions were concerned, the rise in interest rate shown in Graph 62, p. 138 was influenced by an operation between two institutions from the same group. Excluding this operation, the item would have decreased by 5 b.p., due to a composition effect of -3 b.p. and an interest rate effect of -2 b.p., in line with the drop in interest rates in the European interbank market. This operation was also responsible for the positive interest rate effect of interest on held-to-maturity investments.

Table 70: Interest and similar expense of net interest income (2011 – 2012)

	2011	2012	Change
Interest and Similar Expense as Percentage of Average Financial Liabilities			
Interest on deposits from central banks	0.14%	0.11%	*-3 bp*
Interest on deposits from other credit institutions	0.38%	0.41%	*3 bp*
Interest on debt securities issued	0.51%	0.68%	*17 bp*
Interest on deposits from customers	0.99%	1.20%	*21 bp*
Interest on hedging derivatives	0.25%	0.23%	*-2 bp*
Interest on subordinated liabilities	0.08%	0.14%	*6 bp*
Other interest and similar expense	1.10%	0.81%	*-29 bp*
Interest and similar expense [a)]	3.45%	3.58%	*13 bp*

Source: FIs, APB.

[a)] These figures are different from those at the beginning of Table 67, pág. 134 since here they are measured in relative terms against average financial liabilities and not average financial assets.

Note: Change is measured in basis points.

Now analysing interest and similar expenses, we find a 10 basis point increase in the average cost of financial liabilities to 3.58% in 2012. The components that contributed most to this rise were interest on debt securities issued and customer deposits of 17 basis points and 21 basis points, respectively. On the other hand, other interest and similar costs fell by 29 basis points, essentially due to a sharp drop in interest on liabilities for transferred assets, due to the reversion of a number of securitisation operations in 2012.

The price effect was clearly preponderant in the total increase in the average cost of financial liabilities and contributed 21 b.p.This growth was partially offset by a reverse composition effect (-8 b.p.) resulting from changes in the structure of financial liabilities (see Graph 63, p. 140).

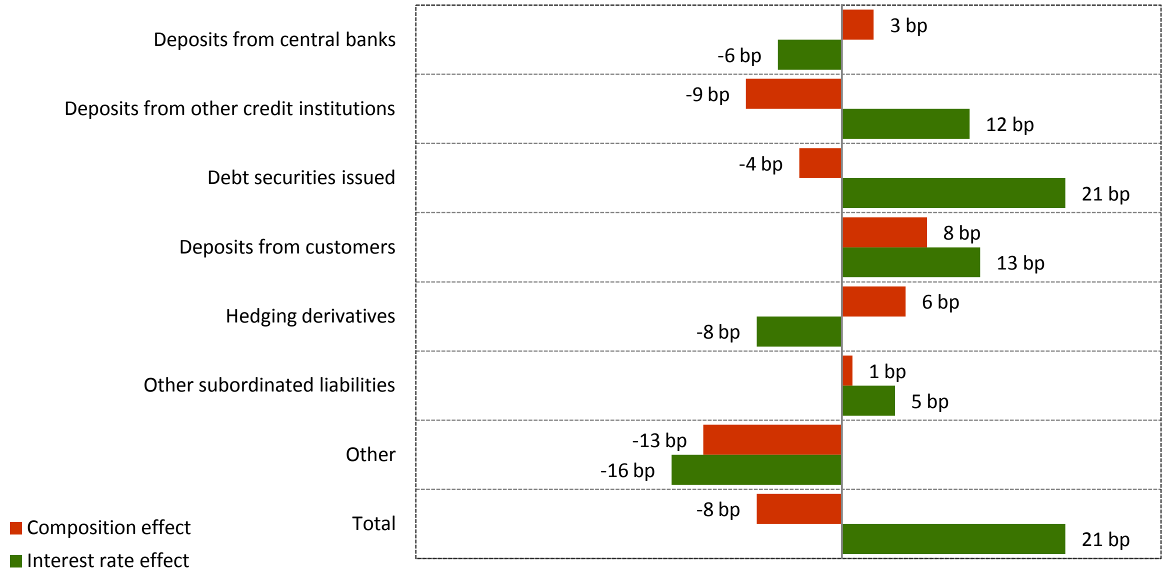
One of the items most affected by the rise in the interest rate was deposits from other credit institutions, which also suffered a negative composition effect. This reflected the financial institutions' difficulty in accessing the interbank market, due to its perception of their degree of risk, which was affected by the Portuguese sovereign risk. Average remuneration on debt securities issued increased for the same reasons.

There was also an increase in interest on subordinated liabilities due to a composition and interest rate effect, which resulted from the issue of high-remuneration hybrid instruments subscribed by the state.

Conversely, interest on deposits from central banks benefited from the reduction in ECB reference rates, as part of its monetary policy aimed at restoring confidence and stability in the European financial system.

Finally, interest on deposits from customers was affected by a composition and interest rate effect. The need to obtain stable funds, such as deposits, led to greater competition among the financial institutions and a consequent rise in their remuneration.

Graph 63: Breakdown of changes in interest and similar expense of net interest income (2011 – 2012)

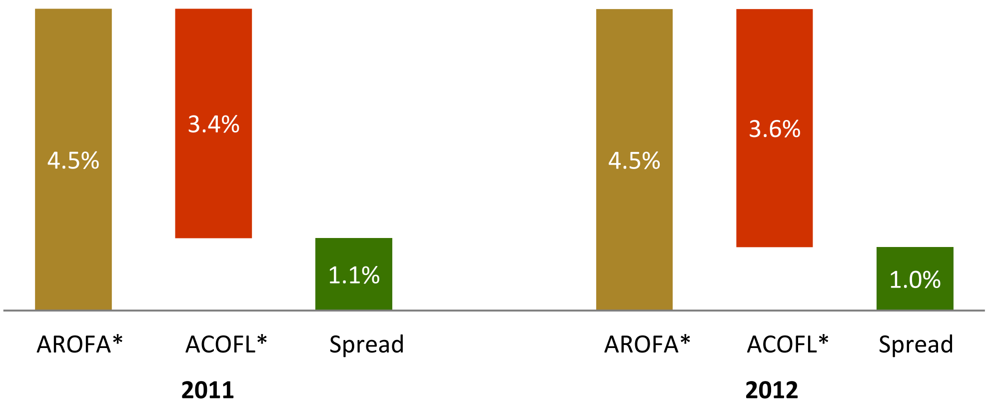


Source: FIs, APB.

Note: This graph breaks down the total variation shown in Table 70, p. 139, by composition and interest rate effect.

The difference between the average interest rates of financial assets and liabilities, called the spread, is the institutions' return on their intermediation, as it relates the cost of funding to the income from investment of funds. The increase in the costs of liabilities, which was only accompanied by a slight rise in revenue from assets, led to a contraction in the spread from 1.09% to 0.95%. This indicator reflects only return from the financial institutions' main function of intermediation (see Graph 64).

Graph 64: Spread decomposition (2011 – 2012)



Source: FIs.

Note: * AROFA – Average return on financial assets; ACOFL – Average cost of financial liabilities.

VII.4. Solvency

The member institutions' solvency levels improved considerably in 2012. The new minimum capital ratio requirements in Portugal and the rest of Europe entailed strict recapitalisation by a number of institutions.

As part of the Financial Adjustment Programme in Portugal, Banco de Portugal raised the minimum limit of the core Tier 1 ratio from 9% to 10%, to be met by the end of 2012. As a result, the solvency[133] level of the financial institutions[134] analysed here improved, with an aggregate core Tier 1 ratio of 11.7%, which was 2.3 percentage points higher than in 2011.

This rise resulted mainly from an increase in the core elements of base own funds, better quality capital, whose growth rate was 21% higher than in 2011 (see Table 71, p. 142). This increase is mainly the result of several institutions' capitalisation operations.

During these operations, there was an increase in capital subscribed by private entities to the amount of around 2 billion euros along with capital increases and the issue of hybrid instruments[135] qualifying as core Tier 1 subscribed by the state, totalling 1.45 billion and 5.8 billion euros, respectively. Of the amount from the state, 5.6 billion euros were financed from the 12 billion euro FAP public recapitalisation line. One of the institutions that used this facility amortised 300 million euros in CoCos, meaning that 44% of the line had been used by the end of 2012.

Fulfilment of the above core capital requirements was affected by the need to record impairments and increase provisions, also a result of the Special Inspection Programme and the partial transfer of pension funds to Social Security in 2011. These two events resulted in very large losses close to the end of 2011 (1.3 billion euros), causing Banco de Portugal to apply filters[136] that allowed the financial institutions to postpone recognition of impacts for prudential purposes until the first half of 2012.

Another adverse effect on core capital was a requirement imposed by Banco de Portugal[137] at the end of 2011 obliging financial institutions offering interest rates on deposits higher than a certain cap to make deductions from own funds. In 2012, these deductions had a negative impact of 350 million euros on the core elements of the member institutions' basic own funds.

[133] The financial supervisors require financial institutions to fulfil minimum capital ratios, which are calculated by dividing their own funds by their risk-weighted assets. From a prudential point of view, the concept of own funds is different from the accounting concept of equity, while it recognises the existence of different categories of own funds, which are distinguished in theory by their capacity to absorb losses. Therefore, from a prudential viewpoint, different capital ratios are monitored by the supervisory authorities.

[134] The solvency analysis is based on financial statements subject to the prudential requirements. This criterion resulted in a sample of 16 institutions, three of whose separate accounts were used (Banco BIC, Popular, Sant Consumer), while the others' consolidated accounts were used (Banco BPI, Millennium bcp, BIG, Finantia, Invest, CCCAM, Montepio, CGD, BBVA, Itaú, Santander Totta, Espirito Santo Financial Group and Banif S.G.P.S., S.A.). The last two groups mentioned take the place of BES and Banif, respectively, due to the scope of their supervisions.

[135] See footnote 79, p. 85

[136] Notice 1/2012

[137] Notice 7/2011 and Notice 8/2011

Table 71: Capital adequacy as at 31 December (2011 – 2012)

	2011	2012	Change
Total Assets (Million €)			
Total assets [a)]	463,942	460,237	*-0.8%*
Own Funds (Million €)			
Original own funds (Tier 1)	27,013	32,582	*20.6%*
Of which: Core elements	27,435	33,189	*21.0%*
Additional own funds (Tier 2)	4,643	4,312	*-7.1%*
Deductions from total own funds	-1,015	-398	*-60.8%*
Total own funds	30,641	36,496	*19.1%*
Risk-weighted Assets (Million €)			
Credit risk	266,357	259,143	*-2.7%*
Market risk	4,863	4,174	*-14.2%*
Operational risk	20,530	19,548	*-4.8%*
Total risk-weighted assets	291,750	282,865	*-3.0%*
Capital Ratios (%)			
Core Tier 1 ratio	9.4%	11.7%	*2.3 pp*
Tier 1 ratio	9.3%	11.5%	*2.3 pp*
Solvency ratio	10.5%	12.9%	*2.4 pp*

Source: FIs, APB.

[a)] Does not include off-balance sheet items.

Note: Changes in total assets, own funds and risk-weighted assets are expressed in percentage. Changes in capital ratios are expressed in percentage points (pp).

The solvency ratio, which takes account of all eligible own funds, benefited from this considerable rise in core capital. The ratio increased by 2.4 percentage points to 12.9% at the end of 2012 (see Table 71).

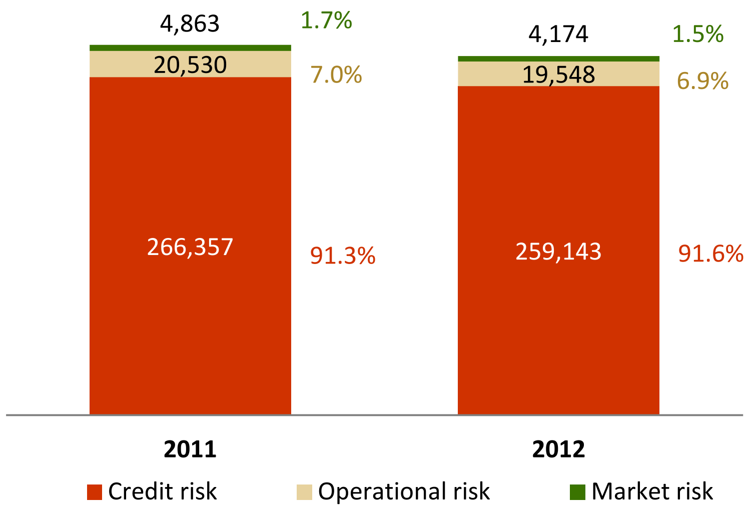
Nonetheless, deductions from own funds went down substantially, thereby increasing the effect of the rise in core capital on the improvement in the solvency ratio. The fall in these deductions was related to a reduction in the amounts exposed to risk in loan securitisation positions and the prudential amortisation of properties from foreclosures.

On the other hand, the 3% reduction in risk-weighted assets made it possible to lower own fund requirements, which also increased the member institutions' solvency levels. This reduction was significantly greater than that in total assets (only 0.8%), indicating a lower average risk of assets thanks to risk mitigation measures, especially the credit risk[138] and stricter lending criteria. As a result, risk-weighted assets fell 8.9 billion euros, 81.2% of which represented credit risk.

Even so, credit was still the main source of capital consumption in 2012 and absorbed 91.6% of total requirements (see Graph 65, p. 143).

[138] Such as higher collateral and guarantee requirements.

Graph 65: Composition of the risk weighted assets of the institutions (2011 – 2012)

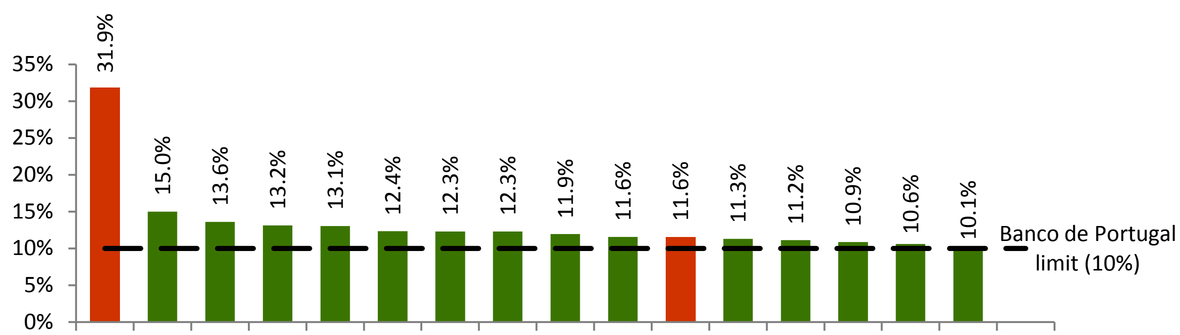


Source: FIs, APB.

Now analysing the member institutions individually, it is important to note that all of them met the Banco de Portugal solvency requirements, as shown in Graph 66. Although one of the institutions that had recourse to state capital only completed the operations set out in its Recapitalisation Plan in early 2013, they were defined and approved at the end of December 2012 and so were recorded for the purpose of calculating own funds.

The increase in solvency levels in 2012 applied to the vast majority of member institutions, as the Tier 1 core ratio of only two went down in the period. In neither case was fulfilment of the supervision requirements compromised.

Graph 66: Core Tier 1 Ratios as at 31 December 2012



Source: FIs, APB.

Note: Core Tier 1 ratios by decreasing order. Red (green) columns identify the institutions that decreased (increased) their core Tier 1 ratio between 2011 e 2012.

The variations in core Tier 1 ratio can be explained by its three elements: core Tier 1 capital, as mentioned above, total assets and average risk of assets[139].

All these elements made a positive contribution to the core Tier 1 ratio for the sample of financial institutions analysed in this subchapter between 2011 and 2012. The increase in core capital was the main factor in improving the ratio and contributed almost 90% of the total variation (2 percentage points in a total of 2.3). ´The reduction in average risk of assets from 62.9% to 61.5% played a less important role and was responsible for almost 9% of the increase in the financial institutions' core Tier 1 ratio. The 0.8% reduction in total assets was the least important factor in this process (see Table 71, p. 142 and Chart 7, p. 145).

These trends are quite similar to those in the five largest banking groups, though these institutions achieved a higher core Tier 1 ratio than the total sample at the end of 2012, while the opposite was the case at the end of 2011.

The two institutions that reduced their average core Tier 1 ratio from 13.5% in 2011 to 12.6% in 2012 did so exclusively by increasing total assets. There was therefore no reduction in better quality own funds or a growth in risk (see Chart 7, page 145).

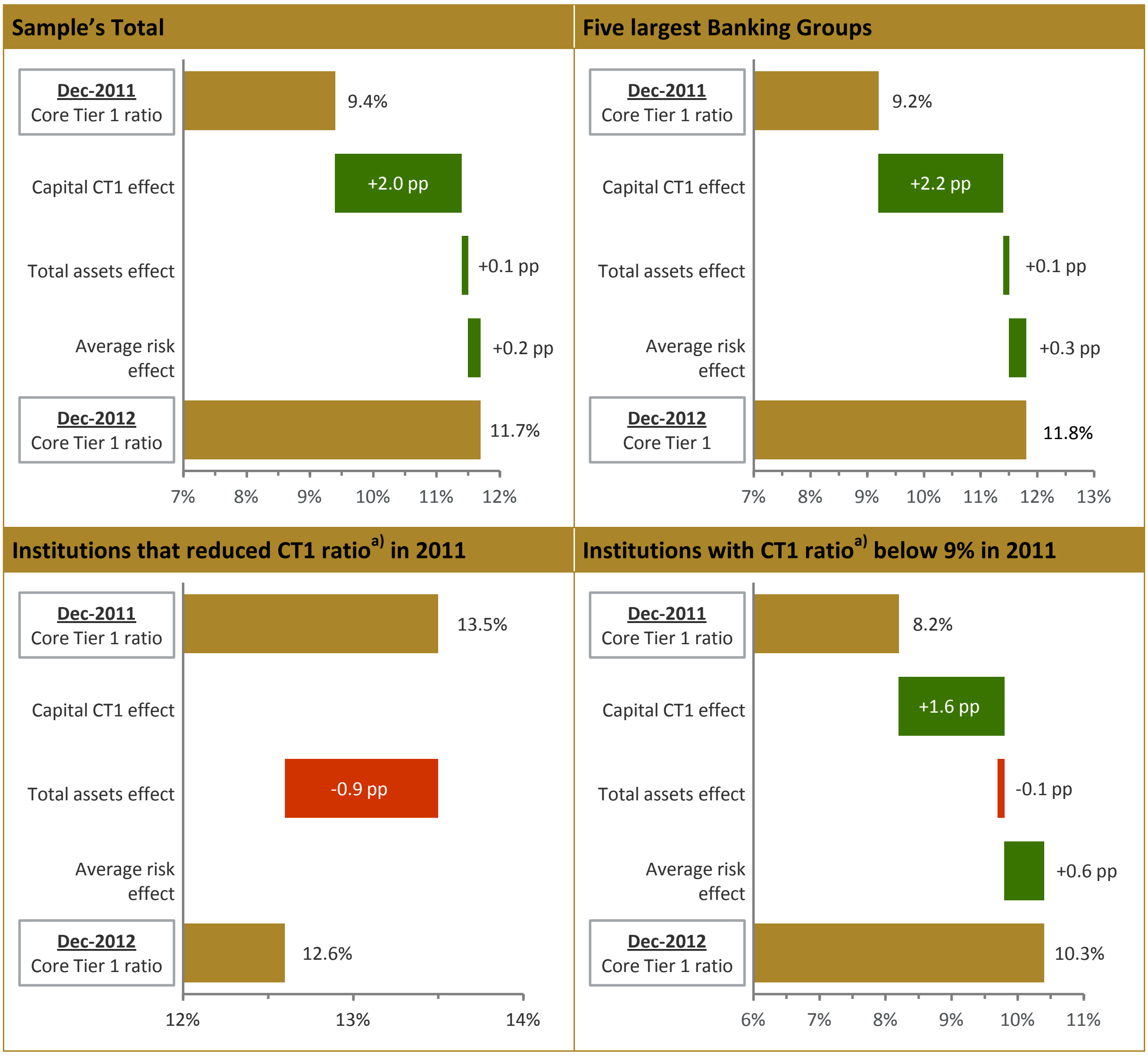
There is a final subgroup of financial institutions that were unable to meet the 9% requirement for 2011. These two banking groups made a considerable effort to improve their solvency levels, especially by increasing core capital. Nonetheless, a reduction in the average risk of assets also played a major role, as it raised their core Tier 1 ratio 0.6 percentage points (see Chart 7, page 145).

[139] In order to distinguish between these effects, it is necessary to rewrite core Tier 1 ratio as follows

Core Tier 1 ratio = Capital core Tier 1 / (Total assets * Average risk),

in which the "average risk" is the ratio between risk-weighted assets and total assets and can also be called the weighted average risk of assets .

Chart 7: Breakdown of the Core Tier 1 ratio by subgroups (2011 – 2012)



Source: APB.

[a] CT1 – Core Tier 1.

Note: Subgroups of institutions that reduced CT1 ratio in 2012 and institutions with CT1 ratio below 9% consist of 2 financial institutions, oppositely to the universe of 16 financial institutions analysed in this chapter.

International capital requirements arose from the European Capital Exercise conducted by the European Banking Authority in October 2011 as the financial crisis in Europe worsened. At the time, the EBA and the European Council agreed on a package of measures designed to increase the banking system's resilience and stability, reduce systemic risk and restore confidence in the financial sector. The measures had to be taken as of June 2012, in order to recapitalise the European banking system including the obligation to achieve a minimum core Tier 1 ratio of 9%[140] and set up a temporary additional buffer core capital to deal with exposure to sovereign debt. This buffer was

[140] The EBA's criteria for calculating core capital are different from those used by Banco de Portugal. In particular, BdP's do not include deduction of holdings in financial institutions that do not consolidate or deduction of deferred tax assets and are therefore not so strict.

calculated on the basis of the amounts of exposure on the balance sheet of each institution or financial group on 30 September 2011.

Initially, both measures applied to the 91 financial institutions that participated in the EBA stress tests in 2011[141], which included four Portuguese banking groups. The Greek banks were later excluded from the exercise as their recapitalisation was being considered and monitored under Greece's Financial Adjustment Plan. Four other banks were also excluded from the tests (one Austrian, one Belgian, one German and one Spanish) as they were undergoing profound restructuring and were being closely monitored by their national authorities.

In December 2011, the EBA published a formal recommendation to ensure fulfilment of these measures[142] and the results of assessment to ascertain ensuing additional capital needs[143] (European Capital Exercise). The additional capital needs identified for the 61 relevant institutions to meet the two requirements were calculated at 75.8 billion euros, 7 billion (9.2% of the total)[144] of which applied to the four Portuguese financial groups included: CGD, BCP, Espírito Santo Financial Group and Banco BPI.

In October 2012, the EBA confirmed that the majority of the 61 financial institutions had managed to achieve[145] the goals by 30 June 2012, with the exception of four banks whose capital levels had not reached the minimums.

The Portuguese banking groups met the standards by raising their core capital 5.4 billion euros in the first half of 2012 while reducing their risk-weighted assets by 1.3 billion euros. These measures enabled them to achieve a core Tier 1 ratio of 9.6% and set up a capital buffer of 3.2 billion euros. They achieved the increase in core capital by raising funds from the public and private sectors in operations totalling 6.7 billion euros, 500 million of which came from private investors (see Chart 8, p. 147).

In the second half of the year, the four Portuguese institutions continued to fulfil these requirements and actually increased their aggregate core Tier 1 ratio to meet the above-mentioned domestic requirements.

[141] With the exception of 20 exclusively domestic institutions, which were exempt

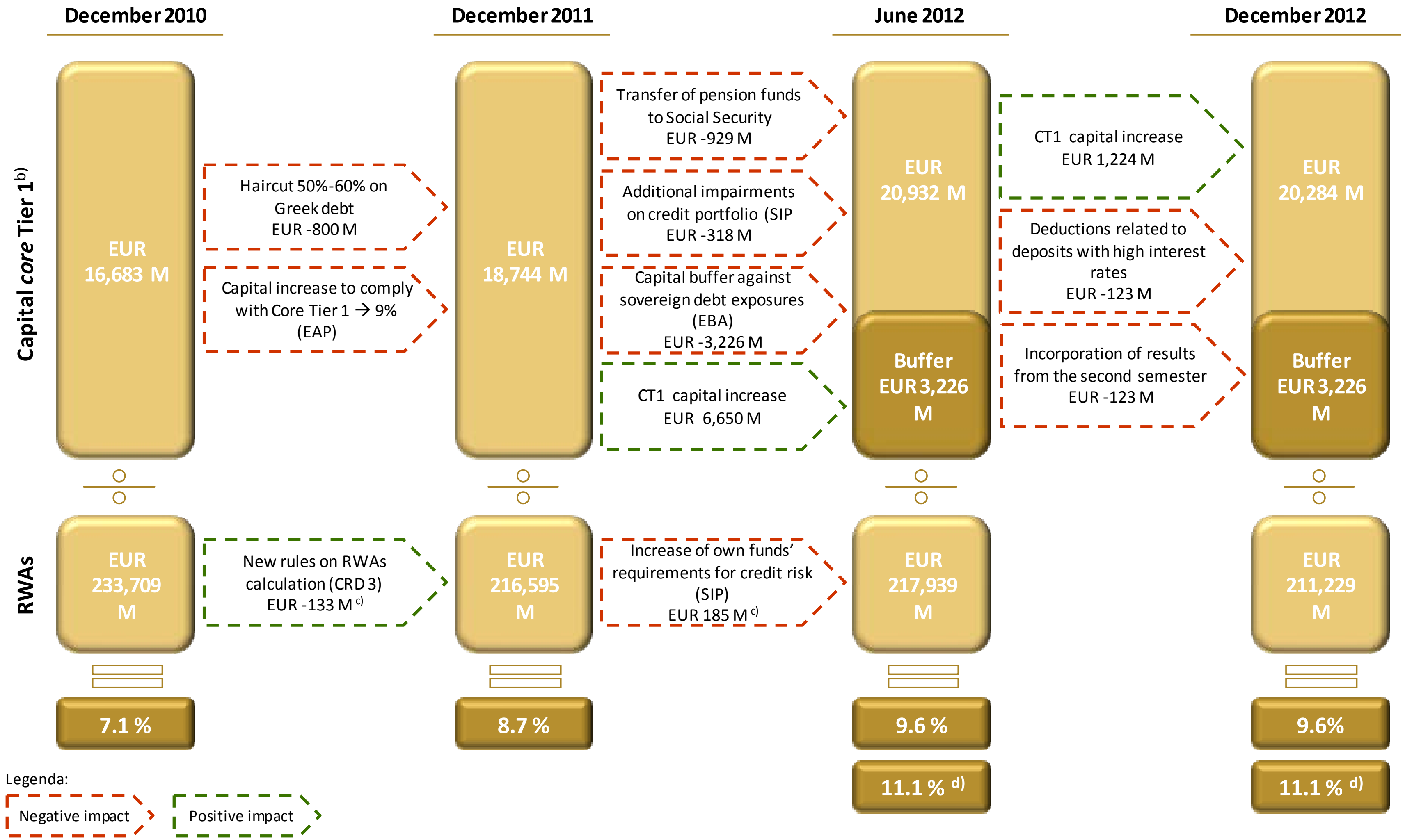
[142] EBA, "European Banking Authority 2011 EU-Capital Exercise - Results of bank recapitalisation plan", 8 December 2011
http://stress-test.eba.europa.eu/capitalexercise/EBA%20BS%202011%20173%20Recommendation%20FINAL.pdf

[143] EBA, "European Banking Authority 2011 EU-Capital Exercise - EBA Recommendation on the creation and supervisory oversight of temporary capital buffers to restore market confidence", 8 December 2011
http://stress-test.eba.europa.eu/capitalexercise/Presenting%20the%20results%20of%20the%20recapitalisation%20exercise.pdf

[144] Capital needs were calculated as at 30 September 2011.

[145] EBA, "Final report on the implementation of Capital Plans following the EBA's 2011 Recommendation on the creation of temporary capital buffers to restore market confidence", 3 October 2012.
http://www.eba.europa.eu/capitalexercise2012/Finalreportrecapitalisationexercise.pdf

Chart 8: Estimates on evolution of Core Tier 1 ratio and impact on capital and risk-weighted assets for Portuguese financial groups involved in EU Capital Exercise [a]



Source: BdP, EBA, FIs, APB.

a) The described events do not explain the full transititon between the two periods since there were also others of less relevance.

b) ICore Tier 1 capital calculated according to the EBA rules.

c) Direct impact of the events on the capital requirements.

d) Core Tier 1 Ratio calculated without deducting the buffer.

VIII. Efficiency Indicators

VIII.1. Cost-to-income ratio[146]

The cost to income ratio (CTI) is a critical bank indicator for measuring financial institutions' efficiency. It reflects the percentage of earnings from banking activity absorbed by operating costs. Therefore, the lower the ratio is, the more efficient bank management is.

This ratio is particularly valuable from an analytical point of view for financial institutions and also external agents, such as consultants, market analysts, the media etc). Financial institutions use it as a strategic goal and competitive advantage in management, while external agents use it as a source of information to assess and compare the performance of financial institutions and their managers.

Table 72: Operating costs, operating income and cost-to-income (2009 – 2012)

	2009	2010	2011	2012	Average
Operating Costs [a)]					
Total (million €)	5,624	5,790	5,707	5,339	-
Annual growth rate	-	*3.0%*	*-1.4%*	*-6.4%*	*-1.6%*
Operating Income [a)]					
Total (million €)	10,562	9,902	9,404	9,457	-
Annual growth rate	-	*-6.3%*	*-5.0%*	*0.6%*	*-3.6%*
Cost-to-Income					
Total	53.2%	58.5%	60.7%	56.4%	57.2%
Change (percentage points)	-	*5.3*	*2.2*	*-4.3*	*1.1*

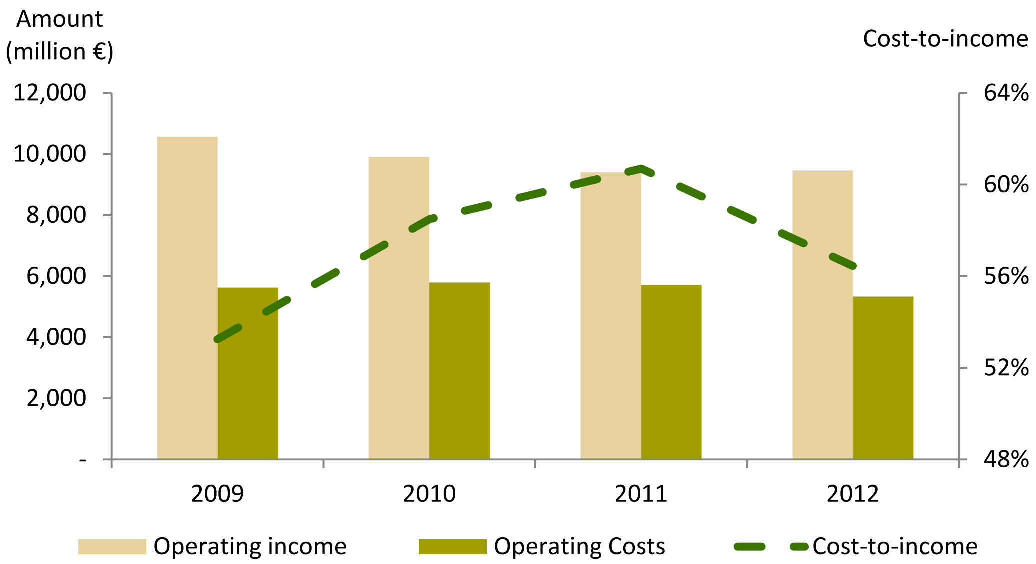
Source: FIs, APB.

[a)] See Table 55, pág. 112.

There were two different phases in the period in question. The first was between 2009 and 2011, in which the sector lost efficiency due to a reduction in operating income and a rise, in 2010, in operating costs. The second was in 2012, when the sector proved more efficient and managed to combine an increase in operating income (0.6%) with a cost containment policy that reduced the ratio's numerator by 6.4% (see Table 72 and Graph 67, p.150).

[146] As the analysis in this chapter was made from an evolutive perspective, the sample only consists of 31 institutions, for the reasons given in footnote 44, pág.35.

Graph 67: Cost-to-income and its main components (2009 – 2012)



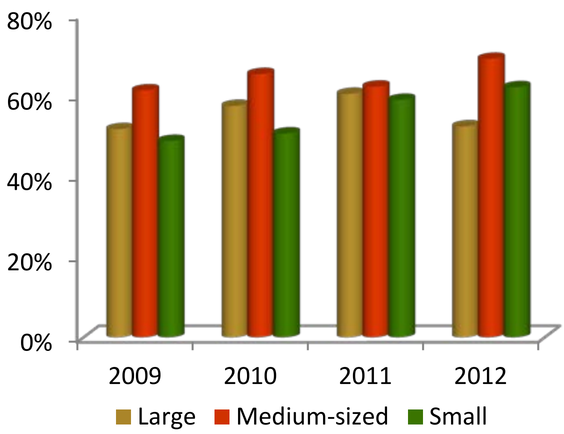
Source: FIs, APB.

An analysis of the cost-to-income ratio by size of member institution shows that the small ones have been the most efficient during the period, with the exception of 2012 (see Graph 68 a)).

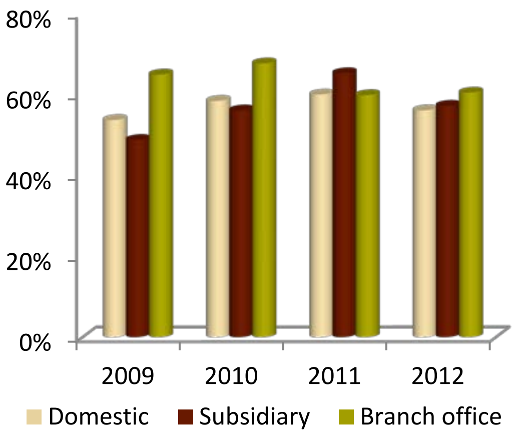
There has, however, been a progressive decline in efficiency in this segment and it deteriorated further in 2012, against the aggregate trend in the sector. There were considerable gains in competitiveness in the larger institutions in 2012, mainly due to ongoing restructuring of financial institutions receiving state aid. The least impressive performance up to and including 2012 has been in the medium-sized segment, and it promises to continue (see Graph 68 a)).

Graph 68: Cost-to-income by size and origin/type of legal structure of member institutions (2009 – 2012)

a) By size



b) By origin/type of legal structure

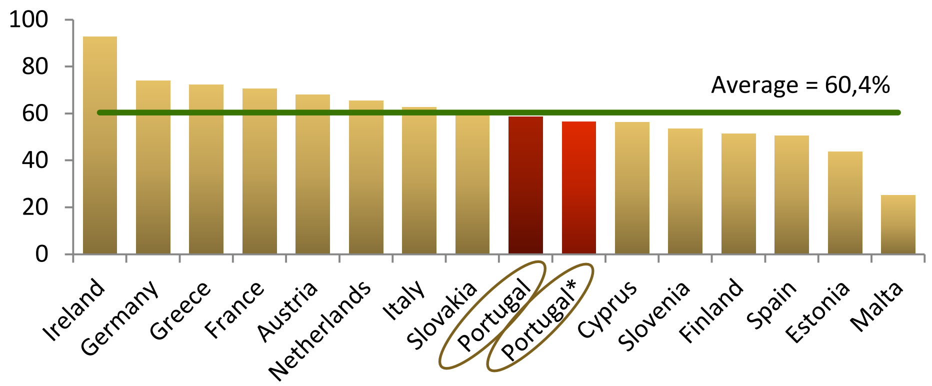


Source: FIs, APB.

By origin or type of legal structure, it was the domestic institutions and branch offices that committed most to improving efficiency in 2012. Subsidiaries have always had unfavourable cost-to-income ratios in absolute terms and in relation to the other segments (see Graph 68 b), p. 150).

According to 2012 data, the member institutions' cost-to-income ratio stands out in comparison to the other countries in the euro area as it is slightly below the European average (see Graph 69).

Graph 69: Cost-to-income of the indtitutions in euro área countries (2012)



Source: ECB, FIs, APB.
Note: *Cost-to-income ratio of the institutions Members of APB.

VIII.2. Loans and deposits per employee and number of employees per branch[147]

Another efficiency indicator is the ratio of loans and deposits per employee, as it reflects ability to attract business by labour factor unit. By relating the amount of activity, measured by the aggregate value of loans and deposits, to the human resources involved in producing it, the ratio is an essential barometer, as it analyses the productivity of financial institutions' human resources.

From 2009 to 2012, the indicator rose every year with an annual average growth of 2% (see Table 73, p. 152). This was mainly thanks to the financial institutions' consistent policy of reducing their workforces, as, although the aggregate amount of loans and deposits increased and helped in 2011, the drop in 2012 more than cancelled out previous growth in the banking business (see Graph 70, p. 152).

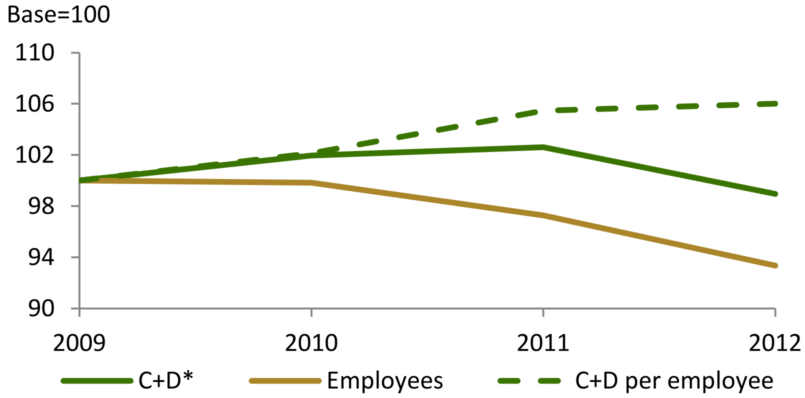
[147] The analysis in this sub-chapter was based on the total number of employees (in domestic and international activity) and the total number of branches (including bank branches in Portugal and branch offices and representative offices abroad).

Table 73: Credit and deposits, overall number of employees and credit and deposits per employee as at 31 December (2009 – 2012)

	2009	2010	2011	2012	Average
Crédito + Depósitos a) b)					
Total (million €)	473,994	483,307	486,360	469,084	-
Annual growth rate	-	*2.0%*	*0.6%*	*-3.6%*	*-0.3%*
Número Global de Empregados c)					
Total	60,046	59,943	58,416	56,052	-
Annual growth rate	-	*-0.2%*	*-2.5%*	*-4.0%*	*-2.2%*
Crédito e Depósitos por Empregado					
Amount (thousands €)	7,894	8,063	8,326	8,369	-
Annual growth rate	-	*2.1%*	*3.3%*	*0.5%*	*2.0%*

Source: FIs, APB.
a) Net loans to customers as shown in Table 34, pág.82.
b) Deposits from customers as shown in Table 35, pág. 84.
c) See Table 9, pág. 39.

Graph 70: Credit and deposits against overall number of employees as at 31 December (2009 – 2012)



Source: FIs, APB.
Note: *C+D – Credit and Deposits.

In 2012, the amount of loans and deposits per employee was the highest in the period in question, which is synonymous with a real improvement in the productivity of human resources in primary banking activity. It is expected to be sustainable.

The development of the number of employees per branch has been influenced by changes in the branch network and the member institutions' workforces in recent years. As the reduction in total branches, subsidiaries' branches and representative offices abroad has been higher than that in the number of employees, the ratio increased slightly in 2012 (see Table 74 and Graph 71, p. 153). This increase contrasts with the reduction in this indicator in previous years. All changes in the ratio have been minimal, however and they have remained stable, with a negligible annual variation rate.

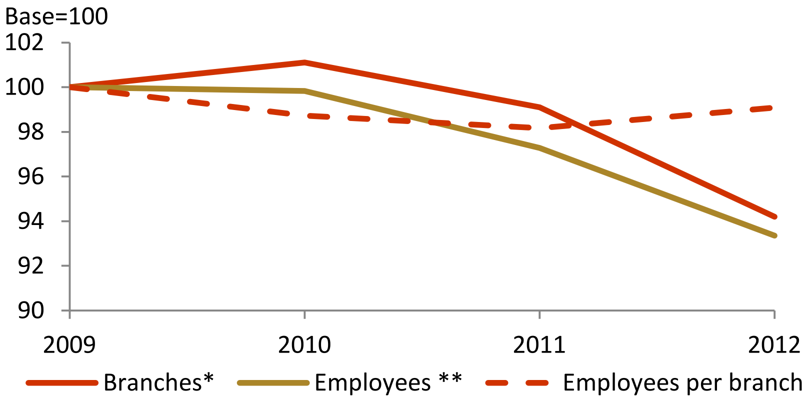
Table 74: Number of branches and number of employees per branch as at 31 December (2009 – 2012)

	2009	2010	2011	2012	Average
Number of Branches [a]					
Total	6,576	6,649	6,517	6,195	-
Annual growth rate	-	*1.1%*	*-2.0%*	*-4.9%*	*-1.9%*
Número de Empregados por Balcão					
Total	9,13	9,02	8,97	9,05	-
Annual growth rate	-	*-1.3%*	*-0.6%*	*0.9%*	*-0.3%*

Source: FIs, APB.

[a] Including the number of branches in Portugal and branch offices and representative offices abroad. (see Table 22, pág. 59 e Table 28, pág. 73).

Graph 71: Number of branches against overall number of employees as at 31 December (2009 – 2012)



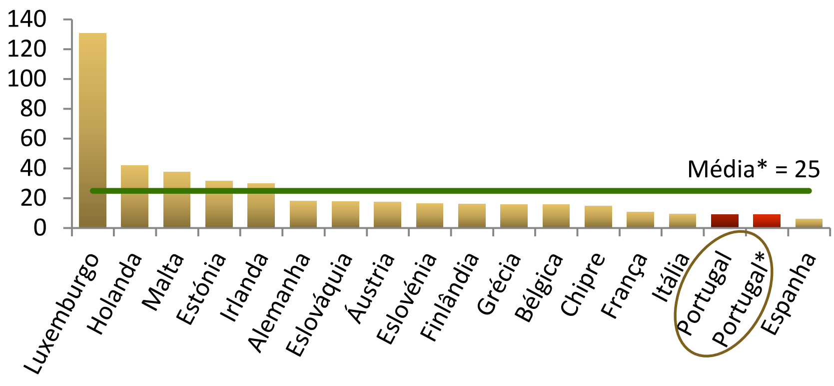
Source: FIs, APB.

Note: *Including number of branches in Portugal and branch offices and representative offices abroad.

**Global number of employees in domestic and international activity.

The member institutions stood out from their peers in the euro area as they had the second lowest and best ratio of number of employees per branch, behind only Spain (see Graph 72).

Graph 72: Number of employees per branch in the euro area as at 31 December 2012



Source: FIs, ECB, APB.

Note: *Includes only member institutions.

VIII.3. Assets per employee

This is the result of the quotient between the aggregate value of the financial institutions' net assets and number of employees. As with loans and deposits per employee, this ratio analyses human resources' production capacity. The variations in this ratio over time make it possible to monitor the member institutions' operating efficiency.

Table 75: Annual growth rates in aggregate assets and overall number of employees, and assets per employee as at 31 December (2009 – 2012)

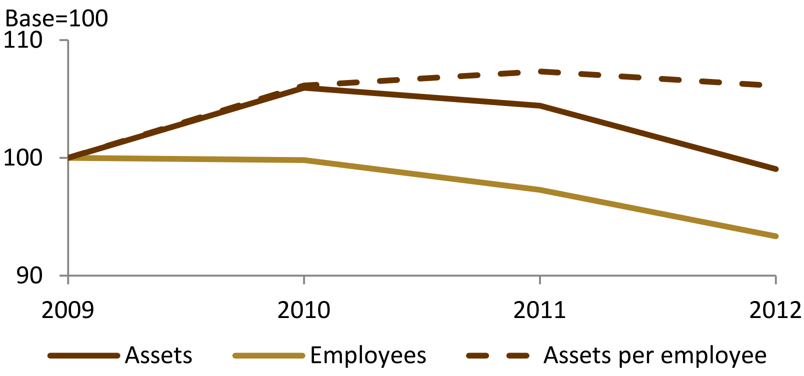
	2009	2010	2011	2012	Average
Aggregate assets [a)]					
Total (million €)	480,093	508,725	501,404	475,573	-
Annual growth rate	-	*6.0%*	*-1.4%*	*-5.2%*	*-0.2%*
Número Global de Empregados					
Total (million €)	60,046	59,943	58,416	56,052	-
Annual growth rate	-	*-0.2%*	*-2.5%*	*-4.0%*	*-2.2%*
Activo por Empregado					
Amount (million €)	7,995	8,487	8,583	8,484	-
Annual growth rate	-	*6.1%*	*1.1%*	*-1.2%*	*2.0%*

Source: FIs, APB.

a) See Table 34, pág.82.

In the period in question, the largest increase in the ratio was in 2010, when a simultaneous rise in aggregate assets and a reduction in the number of bank employees contributed to a growth rate of 6.1% (see Table 75 and Graph 73). The contraction in the financial institutions' workforce the following year played a decisive role in a favourable ratio. The sharp fall in aggregate assets, which exceeded the reduction in the workforce in 2012, was responsible for a 1.2% fall in the indicator. An analysis of this indicator must also take account of the country's economic context and especially the banks' deleveraging process.

Graph 73: Aggregate assets against overall number of employees as at 31 December (2009 – 2012)



Source: FIs, APB.

IX. International Activity[148]

Members' domestic activity was influenced by deleveraging and consequent contraction in assets in 2012. The same cannot be said for the international area where aggregate assets increased 5.8% and now accounted for 18.9% of their total assets (see Table 76).

Table 76: Consolidated balance sheet regarding international business activity as at 31 December (2009 – 2012)

	2009	2010	2011	2012	Average
Aggregate Assets					
Total (million €)	79,928	76,360	73,507	77,737	-
Annual growth rate		*-4.5%*	*-3.7%*	*5.8%*	*-0.8%*
Weight in total consolidated net assets	*18.6%*	*17.3%*	*17.6%*	*18.9%*	*18.1%*
Loans and Advances to Customers [a)]					
Total (million €)	42,707	45,591	44,733	46,015	-
Annual growth rate		*6.8%*	*-1.9%*	*2.9%*	*2.6%*
Weight in total consolidated net assets	*14.2%*	*14.8%*	*15.3%*	*16.4%*	*15.2%*
Deposits from Customers					
Total (million €)	36,628	38,479	40,024	45,565	-
Annual growth rate		*5.1%*	*4.0%*	*13.8%*	*7.6%*
Weight in total consolidated net assets	*19.1%*	*18.8%*	*18.4%*	*20.7%*	*19.3%*

Source: FIs, APB.
[a)] Gross credit.

Where their international activity was concerned in 2012, the Members' expansion abroad was based essentially on attracting deposits from customers, where the 13.8% increase was higher in absolute terms than that of total assets. The rise accounted for 20.7% of total deposits from customers taken at consolidated level, which partially offset difficulties in accessing the market and made sources of funding more stable.

There was a negligible increase in loans and advances to customers, at a growth rate of 2.9%. In this context, the difference between the amounts of loans and deposits decreased and the transformation ratio of international business fell more than 10 percentage points to close to 100% at the end of 2012 (see Table 76).

In spite of the growth in the Members' balance sheet for international activity, net income before taxes fell 79.2% against 2011, thereby serving to offset only part of the losses in the domestic segment (see Table 77, p. 156).

[148] The analysis of international business was based on the consolidated activity of seven member banking groups (Banif, BCP, BES, BPI, BST, CGD and Montepio).

Table 77: Consolidated income statement - international business activity (2009 – 2012)

	2009	2010	2011	2012	Average
Net Interest Income					
Total (million €)	1,473	1,922	1,850	1,667	-
Annual growth rate		*30.5%*	*-3.7%*	*-9.9%*	*5.6%*
Weight in total consolidated net interest income	*23.8%*	*31.0%*	*29.9%*	*32.5%*	*29.3%*
Operating Income					
Total (million €)	2,507	2,834	3,040	2,757	-
Annual growth rate		*13.0%*	*7.3%*	*-9.3%*	*3.7%*
Weight in total consolidated operating income	*21.9%*	*24.1%*	*28.5%*	*25.4%*	*25.0%*
Operating Costs					
Total (million €)	1,191	1,442	1,519	1,609	-
Annual growth rate		*21.1%*	*5.3%*	*6.0%*	*10.8%*
Weight in total consolidated operating costs	*18.5%*	*21.5%*	*23.0%*	*26.3%*	*22.3%*
Provisions and Impairments[a)]					
Total (million €)	566	576	546	945	-
Annual growth rate		*1.7%*	*-5.1%*	*73.1%*	*23.2%*
Weight in total consolidated provisions and impairments	*21.9%*	*21.1%*	*8.6%*	*15.0%*	*16.7%*
Net Income Before Tax and Minority Interests					
Total (million €)	750	817	975	203	-
Annual growth rate		*8.8%*	*19.4%*	*-79.2%*	*-17.0%*
Weight in total consolidated NIBT[b)]	*30.9%*	*35.2%*	*-43.4%*	*-12.8%*	*2.5%*

Source: FIs, APB.

[a)] Includes negative consolidation differences and net gains from associates and joint ventures (equity method) whose figures are immaterial.

[b)] Net interest income before tax and minority interests.

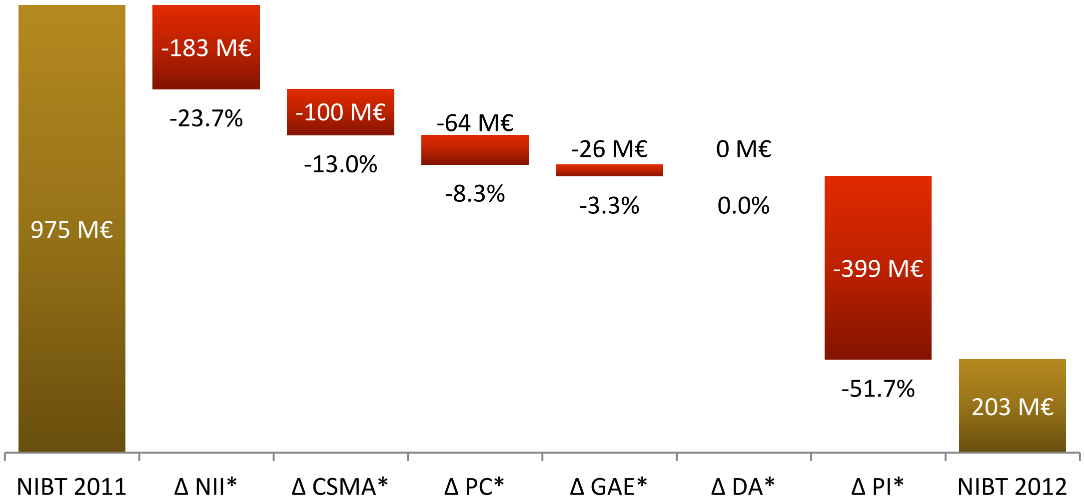
There was a reduction of 9.3%, or 283 million euros, in operating income in 2012. This was due to a 183 million euro decrease in net interest income and an albeit smaller fall (100 million euros) in income from customer and market services (see Table 77).

The performance of the ratio between loans and deposits, the consequent impact on the amount of intermediation and a general reduction in yields on public debt securities, which led to a decrease in Euribor and interest from portfolios of these kinds of assets, played a decisive role in the fall of net interest income.

An 8.2% rise in personnel costs and a 4.2% rise in general administrative expenses were other factors that had a negative effect on net income before tax, resulting in a 90 million euro increase in operating costs in 2012 (see Table 77).

It was, however, the 399 million euro (73.1%) rise in provisions and impairments that had the greatest impact on the reduction in net income before tax in 2012, explaining more than half its total variation (see Graph 74, p. 157). This performance reflects the deterioration of the macroeconomic context and consequent increase in credit risk in some countries in which the Members operate.

Graph 74: Contribution from the main components of the international activity NIBT to its change between 2011 and 2012



Source: FIs, APB.

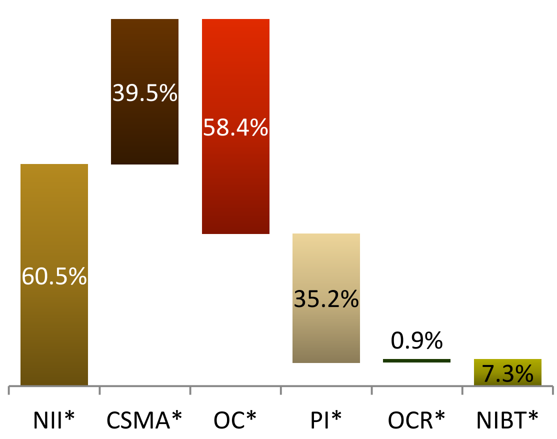
Note: * Δ NII – Variation of net interest income; Δ CSMA – Variation of customer services and market activities; Δ PC – Variation of personnel costs; Δ GAE – Variation of general and administrative expenses; Δ DA – Variation of depreciation and amortization; Δ PI – Variation of provisions and impairments.
The percentages below the columns in the graph indicate the conribution of each item to the total change in the international activity net income before taxes between 2011 and 2012.

The income structure of international activity was different from that in the domestic segment (see Graph 75, p. 158). Net interest income was clearly predominant in the formation of operating income in activity abroad in 2012. This was not the case in activity in Portugal, where income from customer and market services was more important.

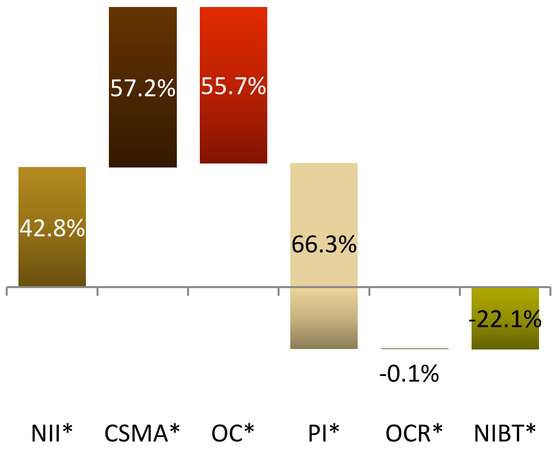
Where costs were concerned, operating costs had a higher weight in international than in domestic activity in terms of operating income. On the other hand, provisions and impairments were 31.1 percentage points higher in domestic business than in international activity in terms of operating income in 2012 (see Graph 75, p. 158). The particularly negative macroeconomic context in Portugal seriously affected the financial institutions' credit risk, which was reflected in provisions and impairments. Proof of this is the fact that the ratio of impairments in gross credit was higher in domestic activity (5.4% vs. 5% in international activity).

Graph 75: Decomposition of the NIBT as a percentage of the operating income (2012)

a) International activity



b) Domestic activity

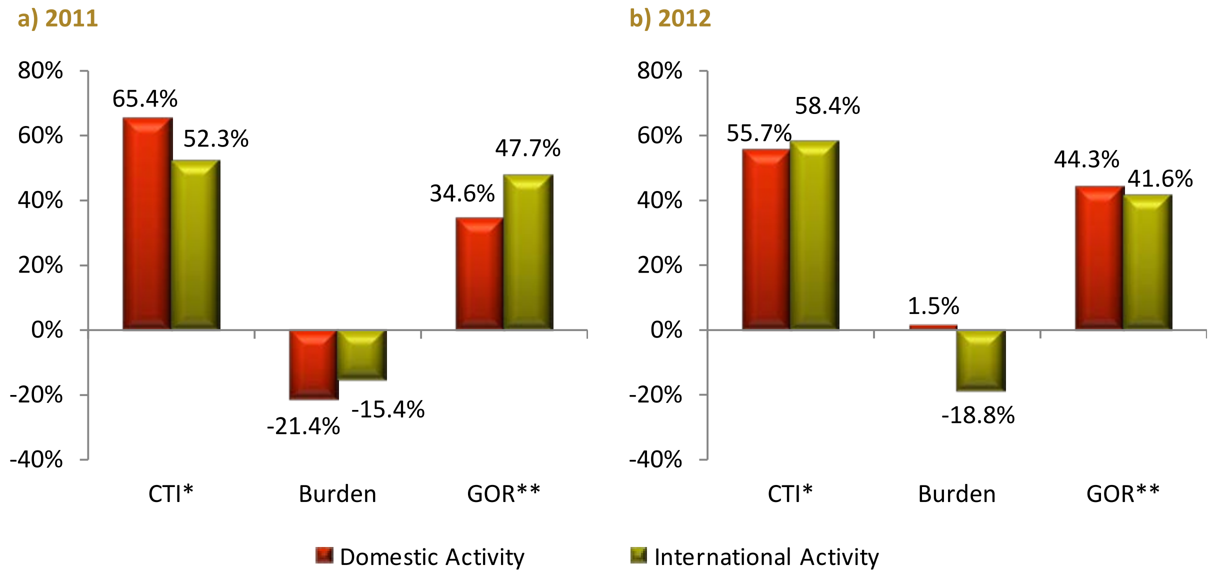


Source: FIs.

Note: *NII – Net interest income; CSMA – Customer services and market activities; OC – Operating costs; PI – Provisions and imparities; OCR – Other consolidated results; NIBT – Net income before tax.

As a result, 2012 witnessed a turning point in the comparison of some efficiency and return indicators for the two activities. While the international segment's indicator used to be better, the opposite was the case in 2012 (see Graph 76).

Graph 76: Performance indicators for domestic and international activity



Source: FIs, APB.

Note: *CTI – Cost-to-Income

**GOR – Gross operating results as percentage of operating income.

The success of the Members' cost reduction policy in their domestic business resulted in an improvement in their cost-to-income ratio. In business abroad, however, the opposite occurred due to a reduction in operating income and growth in personnel costs and general administrative expenses (see Graph 76, p. 158). As a result, gross operating return based on operating income was higher in domestic activity.

The burden of domestic activity was positive in 2012, due to an increase in the weight of income from customer and market services in operating income. This indicator in international activity was less able to cover operating costs with the income from these additional activities.

In 2012, the destinations of Members' international expansion were much the same as in 2011. The Members continued to focus on countries with close cultural ties to Portugal that had been experiencing a period of high growth, such as Angola, Mozambique, Cape Verde and Brazil. They also kept up their presence in countries with important trade relationships with Portugal, such as Spain, and others with more developed capital markets, such as the United States.

The Members' activity in Angola, Mozambique and Brazil has been acquiring particular importance in that its contribution to income from overall international activity global has been growing. The vitality of these economies contrasted with the weakness in Europe in 2012, which especially affected the member institutions' business in Greece and Spain.

X. Annexes

Annex A – Laws and regulations in Portugal

Annex B – International regulation of the financial sector

Annex C – Alterations to international accounting standards

Annex A – Laws and regulations in Portugal[149]

January

Pay Practices at Credit Institutions

- Banco de Portugal Notice 10/2011 (published in *Diário da República* IIª Série on 9 January 2012)

This notice sets out the principles and obligations governing pay policies of credit institutions, investment companies and subsidiaries in Portugal and of credit institutions and investment companies based outside the European Union.

It also sets out the obligations to disclose information on remuneration policy of the members of institutions' management and supervisory bodies.

http://dre.pt/pdf2sdip/2012/01/006000000/0069600700.pdf

Measures to Reinforce Credit Institutions' Financial Soundness

- Law 4/2012 of 11 January

This law makes a third amendment to Law 63-A/2008 of 24 November, which sets out measures to reinforce credit institutions' financial soundness.

Own funds, especially core Tier 1 funds, are reinforced through public investment via: (i) purchase of the credit institution's own shares, (ii) underwriting or guaranteed placing of share capital increases or (iii) subscription of other instruments eligible for core Tier 1 funds (contingency convertibles or CoCo bonds).

http://dre.pt/pdf1sdip/2012/01/00800/0006200073.pdf

Own Funds

- Banco de Portugal Notice 1/2012 (published in *Diário da República* IIª Série on 20 January)

In view of the terms of the Financial Adjustment Programme for Portugal, this notice allowed the institutions under Banco de Portugal supervision to defer until 30 June 2012 the impacts of the Special Inspection Programme (one of the state's commitments in this regard) and of the transfer of the pension funds of some credit institutions to Social Security.

It refers to the impacts that these measures had on calculation of institutions' own funds and establishment of minimum own funds requirements, which included effects of the allocation to the pension funds of the liquid resources needed to hand them over to the state.

http://dre.pt/pdf2sdip/2012/01/015000000/0242902430.pdf

[149] The Centre for Financial Studies would like to thank the APB Legal Department for compiling a list of the main legal and regulatory documents published in Portugal in 2012.

- Banco de Portugal Notice 2/2012 (published in *Diário da República* IIª Série on 20 January)

This notice amends Banco de Portugal Notice 6/2010 of 31 December for the second time. It adds a new element concerning pension funds to the list of prudential filters for calculation of basic own funds of institutions under Banco de Portugal supervision.

http://dre.pt/pdf2sdip/2012/01/015000000/0242902430.pdf

Pension Funds

- Banco de Portugal Notice 3/2012 (published in *Diário da República* IIª Série on 20 January)

This notice amends Banco de Portugal Notice 11/2008 and establishes how to update the value serving as a reference for calculating actuarial deviations, as a result of the reduction in liabilities for pensions on the part of organisations whose defined post-employment benefit plans have been transferred to Social Security.

http://dre.pt/pdf2sdip/2012/01/015000000/0242902430.pdf

Core Tier 1 Ratio

- Banco de Portugal Notice 4/2012 (published in *Diário da República* IIª Série on 20 January)

This notice amends Banco de Portugal Notice 3/2011 and includes new positive elements of basic own funds among those eligible for calculating the core Tier 1 ratio of institutions subject to Banco de Portugal supervision. The aim of this amendment is to allow possible state intervention in strengthening credit institutions' financial soundness.

http://dre.pt/pdf2sdip/2012/01/015000000/0242902430.pdf

Temporary Capital Buffers

- Banco de Portugal Notice 5/2012 (published in *Diário da República* IIª Série on 20 January)

This notice sets out that institutions subject to Banco de Portugal supervision on a consolidated basis must abide by the EBA/GL/2011/01 guidelines, which are aimed at a selected group of banks. The aim of the recommendation is the creation by 30 June 2012 of a temporary, exceptional capital buffer against exposure to sovereign debt assessed at market prices at the end of September 2011, and achievement of a Tier 1 ratio of 9% (on the basis of EBA criteria).

http://dre.pt/pdf2sdip/2012/01/015000000/0242902430.pdf

February

Deposit Guarantee Fund – Calculation of Contributions

- Banco de Portugal Notice 6/2012 (published in *Diário da República* IIª Série on 3 February)

Pursuant to this notice, accrued interest should be included in the balances of deposits recorded at the end of each month when determining the annual contribution to the Deposit Guarantee Fund.

http://dre.pt/pdf2sdip/2012/02/025000000/0433804338.pdf

Reorganisation and Winding Up of Institutions under Banco de Portugal Supervision

- Decree-Law 31-A/2012 of 10 February

This decree-law grants powers to Banco de Portugal to intervene in institutions under its supervision in the event of financial imbalance. It also creates a resolution fund and a pre-judicial liquidation procedure for institutions subject to Banco de Portugal supervision.

http://dre.pt/pdf1sdip/2012/02/03001/0000200101.pdf

Own Funds

- Banco de Portugal Instruction 2/2012 of 15 February

This instruction provides templates for reporting to Banco de Portugal the results of measuring the impacts of the Special Inspection Programme conducted under the Financial Assistance Programme for Portugal and of the transfer of some credit institutions' pension funds to Social Security, which were deferred for the purpose of calculating own funds and determining minimum own funds requirements, pursuant to Banco de Portugal Notice 1/2012.

http://www.bportugal.pt/sibap/application/app1/instman.asp?PVer=P&PNum=2/2012

March

Additional Credit Claims: Eligibility of Assets

- Banco de Portugal Instruction 7/2012 of 15 March[150]

European Central Bank Decision ECB/2011/25 relaxed the criteria for determining eligibility of assets used as a guarantee in Eurosystem monetary policy operations. As a result, this instruction provides for the possibility of Eurosystem credit operations being guaranteed by additional credit claims that satisfy a minimum credit quality assessment corresponding to a probability of default of no more than 1.5%.

Pursuant to this instruction, Banco de Portugal allows direct discount of additional aggregate credit claims (portfolios) on loans granted to households, retail purchase and companies that are not investment firms.

http://www.bportugal.pt/sibap/application/app1/insthis.asp?PVer=P&PNum=7/2012

April

Transfer of Assets to Funds or Vehicles

- Banco de Portugal Circular 13/2012/DSP of 3 April

This circular lays down an obligation to send Banco de Portugal the external auditor's opinion on operations transferring assets to funds or vehicles in exchange for direct or indirect subscription of positions in these funds or vehicles.

http://www.bportugal.pt/sibap/application/app1/circular.asp?PVer=P&PNum=13/2012/DSP

Information on Stress Tests

- Banco de Portugal Instruction 14/2012 of 16 April

This instruction amends Banco de Portugal Instruction 4/2011 and sets out that: (i) credit institutions must send Banco de Portugal relevant information and a self-assessment for stress tests conducted and any additional information and (ii) in addition to the aforementioned self-assessment, credit institutions must submit information whenever they wish to introduce new stress tests or make any significant changes to existing tests.

http://www.bportugal.pt/sibap/application/app1/insthis.asp?PVer=P&PNum=14/2012

[150] Previously amended by Banco de Portugal Instructions 9/2012 and 29/2012

Information on High-interest Deposits

- Banco de Portugal Instruction 16/2012 of 16 April

Banco de Portugal Notices 7/2011 and 8/2011 provided for deduction of an amount for high-interest deposits from own funds. This instruction determines that credit institutions based in Portugal and subsidiaries in Portugal of credit institutions based outside the European Union must send information on these deposits to Banco de Portugal.

http://www.bportugal.pt/sibap/application/app1/insthis.asp?PVer=P&PNum=16/2012

Insolvency and Recovery of Companies - Special Revitalisation Process

- Law 16/2012 of 20 April

This law makes the sixth amendment to the CIRE[151] and focuses on the recovery of companies that are insolvent or at imminent risk of insolvency with a view to keeping debtors operating, whenever their recovery is possible, and avoiding liquidation of their assets.

One of the most important amendments in this law is the creation of a special revitalisation process for debtors that are in difficulty or at imminent risk of insolvency but are still recoverable before actual insolvency occurs. It enables them to negotiate with their creditors and reach an agreement aimed at their revitalisation.

There is a restriction on deals that can be resolved to the benefit of the insolvent estate. Now only deals concluded in the two years prior to the start of insolvency proceedings may be resolved. Resolution in favour of the insolvent estate is not allowed for deals concluded during a special revitalisation provided for in this law, a recovery or reorganisation proceeding or resolution measures as set out in Title VIII of the General Regime on Credit Institutions and Investment Firms (RGICSF) or any other equivalent procedure set out in special legislation aimed at providing a debtor with sufficient financial resources for its recovery.

http://dre.pt/pdf1sdip/2012/04/07900/0222302231.pdf

[151] Code on Insolvency and Recovery of Companies

May

Amending Budget

- Law 20/2012 of 14 May

The Amending Budget made several alterations to taxation, in particular:

- Legislative authorisation for the government to set up a major taxpayers' unit
- Revocation of Part III of the Investment Tax Code, concerning taxation of investors with non-habitual resident status
- Change in Municipal Property Tax on the purchase and sale of property by natural persons residing in tax havens
- Power to the tax authority to ask credit institutions and financial firms for information about credit and debit card payments through them by taxpayers with incomes in IRS[152] and IRC[153] Category B without identifying the cardholders
- Abolition of exemption from IMI for financial and insurance intermediaries and institutions operating in activities auxiliary to financial and insurance intermediation, so-called “intra-group insurance”, if any of them has been or is licensed to operate in the Madeira or Santa Maria tax-free zone, if the property or part thereof is directly intended for the pursuit of their object.

http://dre.pt/pdf1sdip/2012/05/09300/0248102516.pdf

Recapitalisation of Credit Institutions

- Ministerial Order 150-A/2012 of 17 May[154]

This order sets out the procedures for implementing Law 63-A/2008 of 24 November, which approved measures for increasing the financial soundness of credit institutions in capitalisation operations with recourse to public investment. It regulates the following aspects of the law:

- Price of subscription or purchase of special shares by the state
- Capitalisation operations via state subscription of other financial instruments eligible for own core Tier 1 funds, called contingent capital instruments or CoCos.

http://dre.pt/pdf1sdip/2012/05/09601/0000200006.pdf

[152] Personal income tax
[153] Corporate income tax
[154] Subsequently amended by Ministerial Order 421-A/2012 of 21 December

June

Labour Code - Revisions

- Law 23/2012 of 25 June[155]

This law makes the third amendment to the Labour Code approved by Law 7/2009 of 12 February. The alterations that it makes fall under the Commitment to Growth, Competitiveness and Employment signed by the government and social partners (except the CGTP[156]) on 18 January 2012 and commitments made to the Troika in the Memorandum of Understanding of 17 May 2011.

The following are the most important matters: (i) introduction of individual and group hour pools, (ii) alteration of rules on rest breaks, (iii) abolition of compensatory breaks for extra work, a 50% reduction in extra pay for extra work and an increase in pay for normal work on public holidays for companies not obliged to close on that day and the duration of the compensatory rest days that workers can choose as an alternative, (iv) elimination of public holidays, (v) elimination of up to three days' increase in leave for good attendance as of 1 January 2013, (vi) rules on unjustified absences for a whole or half day immediately before or after a day off or public holiday, (vii) elimination of reporting obligations concerning supervision of working conditions, (viii) rules on termination of employment as a result of redundancy and on dismissal for unsuitability and (ix) changes in the rules on severance pay.

http://dre.pt/pdf1sdip/2012/06/12100/0315803169.pdf

July

Treaty on Stability, Coordination and Governance in Economic and Monetary Union

- Parliamentary Resolution 84/2012 (Published in *Diário da República* Iª Série on 3 July)

This decision by the Portuguese Parliament ratified the Treaty on Stability, Coordination and Governance in Economic and Monetary Union. Portugal was the first Member State to do so.

The treaty requires national budgets to be balanced or in surplus. This rule must be incorporated in national law within one year of its entry into force. The rule will be deemed to have been respected if the country-specific medium-term objective has been achieved, as defined in the revised Stability and Growth Pact with a lower limit of a structural deficit of 0.5% of GDP (the structural deficit is the difference between public revenue and costs, excluding one-off and temporary measures).

http://dre.pt/pdf1sdip/2012/07/12700/0337903386.pdf

[155] Rectified by Corrigendum 38/2012 of 23 July
[156] Confederação Geral dos Trabalhadores Portugueses

August

Revitalise Programme - System for Extrajudicial Recovery of Companies

- Decree-Law 178/2012 of 3 August

This Decree-Law creates a system for extrajudicial recovery of companies (SIREVE), which is for companies in financial difficulty or for which insolvency is imminent or has occurred. The company signs an extrajudicial agreement with all or some of its creditors representing at least 50% of its total debts.

The idea is recover the company and make it viable as opposed to the judicial proceedings set out in the CIRE.

http://dre.pt/pdf1sdip/2012/08/15000/0408204086.pdf

The Law on Financial Guarantee Contracts

- Decree-Law 192/2012 of 23 August

This decree-law makes the second amendment to the legal rules on financial guarantee contracts first approved by Decree-Law 105/2004 of 8 May. It alters the rules on financial guarantees for credit claims provided by credit institutions in borrowing operations from the central bank to avoid fulfilment of requirements such as registration or notification of the debtor. It is now enough to include them in a list of credits submitted to Banco de Portugal to identify a credit claim and prove the guarantee between the parties or in relation to the debtor or third parties.

In this type of financial guarantee, possession of the credit claims is now transferred to the beneficiary of the guarantee by the mere effect of the guarantee contract. The efficacy of the credit in relation to the debtor requires only notification, unless the beneficiary of the guarantee requires the guarantor to perform in his name and on his behalf all appropriate acts for the proper management of credits and their guarantees, including collection services and relations with debtors.

http://dre.pt/pdf1sdip/2012/08/16300/0463704638.pdf

Access to the Business of Electronic Money Institutions and Issue of Electronic Money

- Law 34/2012 of 23 August

In the transposition to Portuguese law of Directive 2009/110/EC of the European Parliament and of the Council of 16 September, this law grants the government legislative power to regulate access to the business of electronic money institutions and issuance of electronic money.

http://dre.pt/pdf1sdip/2012/08/16300/0462404630.pdf

Electronic Communications - Processing of Personal Data and Protection of Privacy

- Law 46/2012 of 29 August

It transposes Directive 2009/136/EC of the European Parliament and of the Council of 25 November, regarding the part that amends Directive 2002/58/EC of the European Parliament and of the Council of 12 July on processing of personal data and protection of privacy in the electronic communications sector and makes the first amendment to Law 41/2004 of 18 August and the second amendment of Decree-Law 7/2004 of 7 January.

http://dre.pt/pdf1sdip/2012/08/16700/0481304826.pdf

September

Statistics on Foreign Operations and Positions

- Banco de Portugal Instruction 27/2012 of 17 September[157]

This instruction regulates the communication of statistical information to Banco de Portugal. Its main aim is the compilation of statistics on foreign operations and positions recorded in Portugal's balance of payments and international investment position. It revokes Banco de Portugal Instruction 34/2009, with effect on 1 July 2013.

It applies to all natural and legal persons residing or operating in Portugal who conduct economic or financial operations with foreign countries or who perform exchange operations, as set out in Decree-Law 295/2003 of 21 November.

http://www.bportugal.pt/sibap/application/app1/insthis.asp?PVer=P&PNum=27/2012

October

Deposit Guarantee Fund - Base Contribution Rate for 2013

- Banco de Portugal Instruction 33/2012 of 15 October

This instruction sets the annual contribution to the Deposit Guarantee Fund for 2013 at 0.03%.

http://www.bportugal.pt/sibap/application/app1/insthis.asp?PVer=P&PNum=33/2012

Deposit Guarantee Fund – Limit on Irrevocable Payment Commitment

- Banco de Portugal Instruction 34/2012 of 15 October

The credit institutions participating in the Deposit Guarantee Fund cannot replace their annual contribution to the Deposit Guarantee Fund by irrevocable payment commitments in 2013.

http://www.bportugal.pt/sibap/application/app1/insthis.asp?PVer=P&PNum=34/2012

[157] Subsequently amended by Banco de Portugal Instructions 56/2012 and 3/2013

Access to Minimum Banking Services

- Decree-Law 225/2012 of 17 October

This decree-law makes the second amendment to Decree-Law 27-C/2000 of 10 March, which was amended by Law 19/2011 of 20 May, approving the system for access to minimum banking services. It clarifies the legal rules on the system and sets out the rights and obligations of the banking customers and credit institutions involved.

http://dre.pt/pdf1sdip/2012/10/20100/0591005924.pdf

Recovery Plans

- Banco de Portugal Notice 12/2012 (published in *Diário da República* IIª Série on 17 October)

This notice complies with Article 116-D (4) of the RGICSF, which authorises Banco de Portugal to issue notices defining the contents of the recovery plans set out in point one of the said article and other additional rules necessary for the execution of these plans.

It therefore defines (i) information to be given to Banco de Portugal on submission of recovery plans and additional information to be given to it after submission of the plan, (ii) the procedure for applying for exemption from the obligation to submit recovery plans and (iii) the time limits for compliance with Article 116-D of the RGICSF.

http://dre.pt/pdf2sdip/2012/10/201000000/3451534516.pdf

Creation and Operation of Bridge Banks

- Banco de Portugal Notice 13/2012 (published in *Diário da República* IIª Série on18 October)

This Banco de Portugal notice sets out the rules on the creation and operation of bridge banks pursuant to Article 145-G (9) of the RGICSF.

It establishes the legal rules on bridge banks and regulates their constitution and the minimum information to be set out in their articles of association. It binds the bank to certain guiding principles in its activity and operation, specifies cases of closure and sets out rules on the bank's organisation.

http://dre.pt/pdf2sdip/2012/10/202000000/3461534618.pdf

Commercial Practices of Credit Institutions and Transparency of Information

- Decree-Law 226/2012 of 18 October

This decree-law extends Decree-Law 51/2007 of 7 March to mortgage agreements or other agreements guaranteed by property with natural persons acting in a capacity other than their commercial or occupational activity.

Decree-Law 51/2007 regulates credit institutions' commercial practices with a view to transparency of information provided during the conclusion, renegotiation and transfer of loans for the purchase or construction of or alteration work on permanent or secondary dwellings or dwellings for rent and for the purchase of land for construction of the borrower's own home.

http://dre.pt/pdf1sdip/2012/10/20200/0592905930.pdf

Prevention and Regularisation of Default on Agreements Concluded with Credit Institutions

- Decree-Law 227/2012 of 25 October

The decree-law lays down measures for the prevention of default and regularisation of default on loan agreements with customers who prove unable to fulfil their financial commitments to credit institutions.

It requires each credit institution to draft a default risk action plan based on this decree-law and in particular its Article 11 - “Default risk action plan", procedures and measures for monitoring performance of loan agreements that can detect signs of default risk in advance and monitor customers who say they are having difficulty in fulfilling their agreements and foster speedy measures to prevent this default.

Articles 12 to 21 also define an extrajudicial default regularisation procedure under which credit institutions assess the one-off or lasting nature of the default, assess the customer's financial capacity and, whenever feasible, make regularisation proposals suitable to the customer's goals, needs and financial situation.

http://dre.pt/pdf1sdip/2012/10/20700/0602506033.pdf

Second Amending Budget 2012

- Law 55-A/2012 of 29 October

In addition to amending the State Budget, this law altered (i) the CIRS[158], concerning special and withholding rates applicable to income from capital earned in Portugal and income on securities owed by entities not established in Portugal that are paid or placed at their recipients' disposal by residents in Portugal, (ii) the CIRC[159], concerning high rates on income from capital earned by non-residents and rates for withholding at source applicable to resident entities, (iii) to the CIS[160], setting out that stamp duty applied to properties with a taxable value of over one million euros and (iv) the General Taxation Law on outward signs of wealth and indirect assessment of the tax base.

http://dre.pt/pdf1sdip/2012/10/20901/0000200005.pdf

Short Selling

- CMVM Regulation 1/2012 (published in *Diário da República* IIª Série on 31 October)

Regulation 236/2012 of the European Parliament and of the Council of 14 March harmonises the European rules on short selling, without prejudice to Member States being allowed to maintain in effect until 1 July 2013 any national rules on short selling that came into force before 15 September 2010.

CMVM Regulation 1/2012 revokes CMVM Regulation 4/2010 and its instruction, as the CMVM is of the opinion that the new European Union rules on the matter allow better integration thereof among the states and favours investor compliance and more effective supervision.

http://dre.pt/pdf2sdip/2012/10/211000001/0000200002.pdf

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[158] Personal Income Tax Code
[159] Corporate Income Tax Code
[160] Stamp Duty Code

November

Electronic Money

- Decree-Law 242/2012 of 7 November[161]

This decree-law transposes to Portuguese law Directive 2009/110/EC of the European Parliament and of the Council of 16 September on the taking up, pursuit and prudential supervision of the business of electronic money institutions, amending a number of legal regimes on the matter, including: (i) the General Law on Credit Institutions and Financial Firms; (ii) Law 25/2008 of 5 June, which sets out measures to fight money laundering and the funding of terrorism; (iii) Decree-Law 156/2005 of 15 September, which obliges all suppliers of goods and service providers who have contact with the general public to provide a complaint book, (iv) Decree-Law 95/2006 of 29 May, which lays down the rules on remote agreements on financial services concluded with customers, (v) Law 5/2002 of 11 January, which sets out measures to combat organised and financial crime, (vi) Decree-Law 3/94 of 11 January, which amends the law on exchanges bureaus, and (vii) the legal rules on access to the business of payment and payment service institutions, which was approved in an annex to Decree-Law 317/2009 of 30 October, now called the Law on Payment Services and Electronic Money.
http://dre.pt/pdf1sdip/2012/11/21500/0640206452.pdf

Protection of Borrowers in Difficult Economic Circumstances

- Law 57/2012 of 9 November

This law amends Decree-Law 158/2002 of 2 July so that participants in retirement savings and education plans can request reimbursement to enable them to make mortgage repayments.

http://dre.pt/pdf1sdip/2012/11/21700/0647306473.pdf

- Law 58/2012 of 9 November

This law lays down an extraordinary regime for the protection of mortgagees in very difficult economic circumstances and applies if all the following occur: (i) default on mortgage agreements for the purchase, construction or alterations of a permanent residence; (ii) households in very difficult economic circumstances, (iii) the property is the household's only dwelling and is mortgaged with no other real or personal guarantees.

Consequently, in the event of default on a mortgage covered by this law resulting in foreclosure on the property, the mortgagees are entitled to benefit from one of the following protection measures: (i) mortgage debt restructuring plan, (ii) additional measures to the restructuring and (iii) measures replacing foreclosure.

http://dre.pt/pdf1sdip/2012/11/21700/0647306481.pdf

[161] Rectified by Corrigendum 1-A/2013 of 4January

- Law 59/2012 of 9 November

This law amended Decree-Law 348/98 of 11 November, which sets out the law on home mortgages. The alterations include a restriction on credit institutions' right to terminate the agreement on the grounds of default on at least three instalments. This law also enshrines a borrower's right to resume the agreement within the time limit for opposing foreclosure, if he pays the overdue instalments, late payment interest and the credit institution's expenses, thereby annulling the termination.

Lending credit institutions are also not allowed to increase the expenses of the loan in the event of renegotiation resulting from (i) the fact that the borrower has leased out all or part of the home following certain events (such as unemployment), or (ii) divorce, legal separation, dissolution of a common-law marriage or death of one of the spouses if the loan passes to a borrower who can prove that his/her household has an income resulting in a debt-servicing rate of less than 55% or 60%, depending on its composition.

http://dre.pt/pdf1sdip/2012/11/21700/0648106490.pdf

Enforcement Procedures – Seizure of Real Property

- Law 60/2012 of 9 November

This law altered the rules in the Code of Civil Procedure (CPC) on the order of seizure of real property and calculation of the basic sales value of this property in an enforcement procedure.

The alterations include a change in the rule on calculation of the basic sales value of property and the value is now the larger of the following: taxable value in an evaluation made less than six years ago or the market value. If the seized property is sold by means of sealed bids, the value announced for the sale will be 85% of the basic value of the asset, when it used to be 70%.

http://dre.pt/pdf1sdip/2012/11/21700/0649006491.pdf

Duty of Information on Complex Financial Products and Sale of Investment-fund-related Operations and Insurance

- CMVM Regulation 2/2012 (published in *Diário da República* IIª Série on 26 November[162])

This regulation applies to complex financial products, including insurance and capitalisation operations linked to investment funds whose sale is supervised by the CMVM and which is intended for at least five non-qualified investors who are resident or established in Portugal. It lays down that the seller must ensure that there is a basic investor information leaflet, or a suitable substitute, providing information on the risks of the complex financial product, generic mentions, a graphic warning, information about return and expenses related to the investor or product and past return and risk. The leaflet must be approved and published by the CMVM before sale of complex financial products.

Advertising of complex financial products also requires prior CMVM approval, which is deemed to have been given if the CMVM does not give an opinion within 10 days of submission of the advert.

http://dre.pt/pdf2sdip/2012/11/228000000/3802038028.pdf

[162] Rectified by Corrigendum 134/2013 of 29 January

December

Closure of Central Securities Depository SITEME

- Banco de Portugal Notice 14/2012 (published in *Diário da República* IIª Série on 6 December)

Banco de Portugal closed SITEME and therefore repealed Banco de Portugal Notice 5/99.

http://dre.pt/pdf2sdip/2012/12/236000000/3888038880.pdf

Protection of Bank Customers

- Banco de Portugal Notice 15/2012 (published in *Diário da República* IIª Série on 13 December)

This notice, which repeals Banco de Portugal Notice 4/2011, sets out credit institutions' duties when announcing their compliance with the minimum banking services law and the advertising of legal conditions for natural persons to benefit from it.

http://dre.pt/pdf2sdip/2012/12/241000000/3975339754.pdf

- Banco de Portugal Notice 16/2012 (published in *Diário da República* IIª Série on 17 December)

This notice amends Banco de Portugal Notice 2/2010, which sets out minimum information to be given by credit institutions for the negotiation, conclusion and duration of mortgage agreements and connected loans. It extends the requirements to other mortgage loans, covering loans guaranteed by a mortgage or another real property right, which were not covered by Notice 2/2010.

http://dre.pt/pdf2sdip/2012/12/243000000/3993839938.pdf

- Banco de Portugal Instruction 45/2012 of 17 December

This instruction revoked Banco de Portugal Instruction 10/2010 and approved a new standardised information form for mortgages and connected loans and now also for other mortgage loans.

http://www.bportugal.pt/sibap/application/app1/insthis.asp?PVer=P&PNum=45/2012

Protection of Borrowers in Difficult Economic Circumstances

- Banco de Portugal Notice 17/2012 (published in *Diário da República* IIª Série on 17 December)

This notice sets out the duties of credit institutions in the prevention and extrajudicial regularisation of default on loan agreements, as a result of Decree-Law 227/2012 of 25 October, which set up the PERSI.

It also regulates PARI reporting to Banco de Portugal and the internal document describing PERSI procedures.

http://dre.pt/pdf2sdip/2012/12/243000000/3993839945.pdf

Protection of Bank Customers

- Banco de Portugal Circular 86/2012/DSC of 20 December

This circular sets out the good practices that Banco de Portugal considers appropriate for credit institutions when selling and concluding loan agreements with retail bank customers in a currency other than the legal tender in Portugal.

http://www.bportugal.pt/sibap/application/app1/circular.asp?PVer=P&PNum=86/2012/DSC

Resolution Fund and Resolution Plans

- Ministerial Order 420/2012 of 21 December

This order approves the regulation of the resolution fund set out in Articles 153-B et seq of the General Regime on Credit Institutions and Investment Firms and defines the rules on the functioning and powers of the fund's executive committee (whose work will be monitored by the Banco de Portugal Audit Board) and the powers of the chairman of the executive committee. It also allows the committee to appoint a secretary general.

http://dre.pt/pdf1sdip/2012/12/24700/0721907222.pdf

Recapitalisation of Credit Institutions

- Ministerial Order 421-A/2012 of 21 December

It amends Ministerial Order 150-A/2012 of 17 May on the procedures necessary for executing Law 63-A/2008 of 24 November, which is aimed at measures for increasing the financial soundness of credit institutions in capitalisation operations using public investment and aligns them with European Union guidelines on state aid, particularly the rules on calculation of the percentage of share capital held by the state.

http://dre.pt/pdf1sdip/2012/12/24701/0000200003.pdf

- Banco de Portugal Notice 18/2012 (published in *Diário da República* IIª Série on 26 December)

This notice sets out the information necessary for Banco de Portugal to draw up the resolution plans provided for in Article 116 of the RGICSF and other additional rules for that purpose.

The institutions in question must send Banco de Portugal at least annually the information set out in the annex, which includes their organisational, operating and business structure, certain financial information, payment systems, governance and physical safety and management of their premises.

http://dre.pt/pdf2sdip/2012/12/249000000/4056040563.pdf

Protection of Borrowers in Difficult Economic Circumstances

- Banco de Portugal Circular 93/2012/DSC of 28 December

This circular addresses articulation between the framework set up by Law 58/2012 and the PERSI. According to Banco de Portugal's interpretation, a bank must negotiate with the customer in question and find a solution under the initial regime and only agreements whose application under Law 58/2012 has been rejected can be included in the PERSI.

http://www.bportugal.pt/sibap/application/app1/circular.asp?PVer=P&PNum=93/2012/DSC

2013 State Budget

- Law 66-B/2012 of 31 December[163]

This law approved the State Budget for 2013 and made important changes in taxation, including:

- IRS: (i) reduction in brackets from eight to five and alteration of general progressive income tax rates, which now range from 14.5% to 48% (previously 11.5% and 46.5%); (ii) an additional 2.5% is levied on tax bases between 80,000 and 250,000 euros; (iii) a 3.5% surcharge on income subject to aggregation (including some income subject to special rates), applicable to the part that exceeds the annual guaranteed monthly wage (485 euros); (iv) increase to 28% of withholding rates applicable to income on capital obtained in Portugal; (v) increase to 28% of special rates on capital gains and other income earned by non-residents not subject to the withholding rate and the special rate applicable to a positive balance between capital gains and losses on securities and income from capital owed by non-resident entities if they are not subject to withholding at source (previously 25%); (vi) introduction of a final special rate of 28% for property income; (vii) increase to 25% of the withholding at source rate on income from professional activities (category B, previously 21.5%) and property income (category F, previously 16.5%).
- Extraordinary Solidarity Contribution: gross pensions of over 1,350 euros are subject to a progressive extraordinary contribution varying between 3.5% and 40%.
- IRC**:** (i) the undercapitalisation regime is abolished and a limitation is placed on the deductibility of net funding expenses; (ii) increase from 15% to 25% of rates on income earned by non-residents in the form of royalties, commissions, services and property income; (iii) alteration of the state tax, such as rates on taxable profit; (iv) increase in payments on account to 80% of net tax for the previous year when turnover is 500,000 euros or less and to 95% when it is higher than 500,000 euros; and (v) increase in the rate on additional payments on account.
- VAT[164]: new rules on recovery of VAT on bad and doubtful debts, applicable to loans overdue as of 1 January 2013; (ii) reinstatement of exemption from VAT on the transfer of copyright and permission to use an intellectual work if the creator is a legal persn; and (iii) exemption from IVA of donations of assets to the state for distribution to the disadvantaged.
- Stamp Duty: 20% on the aprt of winnings from the Euromillions, National Lottery, scratch cards, Totobola, Totogolo, Totoloto and Joker exceeding 5,000 euros
- Tax Benefits Statute: (i) property income and capital gains (other than from property) on equity investment funds and capital gains from securities investment funds are taxed separately at 25% (previously, 21.5%); (ii) revocation of exemption from income tax on capital gains resulting from sale of securities up to 500 euros; and (iii) revocation of exclusion from capital gains from investment funds (if not mixed or closed or private subscription) on the sale of shares held for more than 12 months, bonds or other debt securities.

[163] Rectified by Corrigendum 11/2013 of 28 February and amended by Law 39/2013 of 21 June and Law 51/2013 of 24 July

[164] Value Added Tax

- General Tax Law: (i) increase to 12 years for the time limit on the right to settlement of tax events connected to accounts of deposits or securities at financial institutions resident outside the European Union or at subsidiaries located outside the European Union of resident financial institutions, whose existence is not mentioned in the tax returns of personal income taxpayers; and (ii) extension of the obligation to report accounts opened abroad to accounts held by personal income taxpayers or which they are authorised to use (in addition to those of which they are holders).

http://dre.pt/pdf1sdip/2012/12/25201/0004200240.pdf

Annex B – International regulation of the financial sector

I. Financial Stability in the Euro Area

II. Macro–Prudential Regulation

III. Banking Union

    III.1. Single Supervisory Mechanism

    III.2. Single Resolution Mechanism

IV. Reform of the European Banking Sector

V. Financial Conglomerates

VI. Capital and Liquidity

VII. Reporting and Disclosure

VIII. Capital Market

IX. Audit Policy

I. Financial Stability in the Euro Area

In December 2010, the European Council agreed on the introduction of an amendment to Article 136 of the Treaty on the Functioning of the European Union allowing Member States in the euro area to set up a mechanism to ensure the stability of the single currency when necessary.

This decision resulted in the treaty establishing the European Stability Mechanism, which came into effect after ratification on 27 September 2012. The ESM gives Member States in the euro area access to financial aid programmes in the event of sovereign crises or decapitalisation of their financial sectors that might pose a threat to the area's stability. The ESM took the place of two existing mechanisms, the European Financial Stability Mechanism and the European Financial Stability Facility. As of 1 July 2013[165], it was the only structure for handling new requests for financial aid by Member States in the euro area.

This mechanism differs from the EFSM and EFSF in that it is permanent. It has a total capital total of 700 billion euros (80 billion of which are fully subscribed in ordinary shares and the rest in the form of other eligible capital instruments). Its maximum lending capacity is 500 billion euros, 60 billion of which can be used for direct recapitalisation of banks. Its financial assistance to Member States in the euro area is subject to strict compliance with stringent conditions under economic adjustment programmes previously ratified by the Member State in the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and, as of January 2014, incorporation of the fiscal compact in its national law.

With the same idea of maintaining the unity and adequate transmission of monetary policy, on 2 August 2012 the ECB Council announced its decision to launch a programme for repurchase on the secondary market of sovereign debt up to three years issued by countries in difficulty in the euro area.

On 6 September, an ECB press release announced the technical details of the programme and established that the transactions would be called outright monetary transactions. Access to this programme is strictly conditioned to the Member State's participation in an appropriate EFSF/ESM programme (now the ESM). Such programmes can take the form of a full EFSF/ESM macroeconomic adjustment programme or a precautionary programme (Enhanced Conditions Credit Line), provided that they include the possibility of EFSF/ESM primary market purchases.

Following the launch of the OMT Programme, the Securities Markets Programme was cancelled and securities in its portfolio would be held to maturity.

[165] As of this date, the EFSM and EFSF are still active only for execution and monitoring of the ongoing financial adjustment programmes for Portugal, Ireland and Greece.

Related documents

Treaty of the European Council (2 February)

Treaty establishing the European Stability Mechanism

http://www.european-council.europa.eu/media/582311/05-tesm2.en12.pdf

Note Verbale of the European Council (27 September)

Entry into force of the Treaty establishing the European Stability Mechanism

http://www.efsf.europa.eu/attachments/esm_entry_into_force.pdf

ECOFIN press release (27 September)

Declaration on the European Stability Mechanism

http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/132615.pdf

European Central Bank Press Release (6 September)

Press Release – Technical features of Outright Monetary Transactions

http://www.ecb.int/press/pr/date/2012/html/pr120906_1.en.html

Banco de Portugal Press Release (6 September)

Technical features of outright monetary transactions

http://www.bportugal.pt/pt-pt/obancoeoeurosistema/sistemaeuropeudebancoscentrais/bce/comunicados/paginas/combce20120906-1.aspx

II. Macro-Prudential Regulation

In the field of macro-prudential regulation, which is concerned with the stability of the financial system as a whole, 2012 was another year of Financial Stability Board initiatives, taking the form of reports and consultations.

The Basel Committee on Banking Supervision extended the regime set up and discussed in 2011 for global systemically important banks to domestic systemically important banks (D-SIBs). It launched a consultation on 29 June, followed by a final report published on 11 October.

Unlike the framework for the G-SIBs[166], which was more prescriptive, as it set concrete targets with regard, for example, to additional capital buffers to mitigate the systemic risk, that for D-SIBs is more a set of principles. This solution is necessary to be able to accommodate the different structural characteristics of diverse jurisdictions that might condition the applicability of concrete measures. The proposed framework therefore consists of a set of principles: (i) the methodology for assessing the systemic importance, particularly aspects such as size, interconnectedness, substitutability, complexity and infrastructure owned; and (ii) identification of capitalisation requirements in order to increase the institution's loss absorbency potential.

In spite of the absence of concrete guidelines, the document's purpose is the same as that for the G-SIBs framework. When analysing institutions National authorities must be able to identify negative externalities that make a bank critical to the stability of the domestic financial system.

Consultations and analyses were also conducted on the basics elements of recovery plans and resolution of systemic institutions. These concerns arose after the adoption of an international standard for resolution of financial institutions, set out in *FSB Key Attributes of Effective Resolution Regimes for Financial Institutions,* which was published in November 2011. The Financial Stability Board issued a public consultation for pinpointing key attributes in the drafting of recovery and resolution plans by financial institutions in general.

Under this standard, the guarantee of institutions' solvency must involve at least the formation of crisis management groups, cross-border cooperation agreements and mandatory submission of recovery and resolution plans by G-SIFIs[167], plus a mandatory analysis of their recovery.

Identification of systemic financial institutions in these measures was conducted for the first time in November 2011 and then again in November 2012. The Financial Stability Board issued a specific report for the purpose.

That same month, the FSB published an observation report on shadow banking based on data at the end of 2011.

The FSB also published a list of recommendations entitled Shadow Banking: Strengthening Oversight and Regulation in October 2011. A new report was issued in April 2012. On the basis of the previous report, it suggested working on solution for priority areas. A series of consultations was launched on the subject on 18 November.

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[166] Global Systemically Important Banks

[167] Global Systemically Important Financial Institutions

Related documents

Bank of England discussion paper (20 December 2011 to 10 February 2012)

Instruments of macroprudential policy – A Discussion Paper

http://www.bankofengland.co.uk/publications/Documents/other/financialstability/discussionpaper111220.pdf

Financial Stability Board Report (16 April)

Extending the G-SIFI Framework to domestic systemically important banks

http://www.financialstabilityboard.org/publications/r_120420b.pdf

Financial Stability Board Report (16 April)

Strengthening the Oversight and Regulation of Shadow Banking

https://www.financialstabilityboard.org/publications/r_120420c.pdf

Consultation of the Basel Committee on Banking Supervision (29 June a 1 August)

A framework for dealing with domestic systemically important banks – Consultative Document

http://www.bis.org/publ/bcbs224.pdf

Final Report on Consultation of the Basel Committee on Banking Supervision of 29 June (11 October)

A framework for dealing with domestic systemically important banks

http://www.bis.org/publ/bcbs233.pdf

Financial Stability Board Report (1 November)

Increasing the Intensity and Effectiveness of Systemically Important Financial Institutions' (SIFI) Supervision

http://www.financialstabilityboard.org/publications/r_121031ab.pdf

Financial Stability Board Report (1 November)

Update of group of global systemically important banks (G-SIBs).

http://www.financialstabilityboard.org/publications/r_121031ac.pdf

Financial Stability Board Consultation (2 November to 7 December)

Recovery and Resolution Planning: Making the Key Attributes Requirements Operational – Consultative Document

https://www.financialstabilityboard.org/publications/r_121102.pdf

Financial Stability Board Consultation (18 November 2012 to 14 January 2013)

Strengthening Oversight and Regulation of Shadow Banking. A Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities – Consultative Document

https://www.financialstabilityboard.org/publications/r_121118a.pdf

Financial Stability Board Consultation (18 November 2012 to 14 January 2013)

Strengthening Oversight and Regulation of Shadow Banking. An Integrated Overview of Policy Recommendations – Consultative Document

https://www.financialstabilityboard.org/publications/r_121118.pdf

Financial Stability Board Report (18 November)

Global Shadow Banking Monitoring Report 2012

https://www.financialstabilityboard.org/publications/r_121118c.pdf

Financial Stability Board Report (November)

Resolution of Systemically Important Financial Institutions – Progress Report

http://www.financialstabilityboard.org/publications/r_121031aa.pdf

III. Banking Union

The global financial crisis brought to light a number of shortcomings in bank regulation and supervision. Prudential standards proved contradictory, incomplete or insufficient to handle and absorb the shockwaves of a systemic crisis of huge proportions. The supervisory structure in place at the time proved incapable of preventing, managing or solving the crisis.

The financial crisis also uncovered the incompatibility between national supervisory systems and the financial institutions' cross-border business, as the prudential mechanisms and rules were powerless to deal with institutions that were too large or complex.

While some countries in the euro area, weakened from the start by a fragile economic situation and profound fiscal imbalances, spread the crisis to their domestic banking sector, others chose to bail out large financial institutions in trouble, which in turn led to an imbalance in their public accounts. As a result the interconnection between banking and sovereign risk became increasingly obvious.

In line with the intentions announced by G-20, the European Commission undertook to guarantee the EU's financial stability in the future and defined its top priorities as: i) stepping up the financial institutions' resilience and transparency, ii) setting up pan-European structures to make supervision stricter and improve coordination between national supervisors, iii) defining a framework for ordered resolution of financial institutions, iv) introducing new, stricter, more consistent and uniform banking regulation and v) breaking the link between sovereign and banking risk.

Since 2008, the European Commission has issued some 30 sets of rules that today make up the basic framework applicable to the 28 Member States regarding the functioning of the single financial market and its different players. In addition to increasing regulation of the sector it also wished to improve the quality of its supervision.

In June 2009, the European Council recommended adoption of a Single Rule Book for a single European Union financial market. The Single Rule Book has been in place since then and will be an extremely important factor in guaranteeing fair, uniform enforcement of the rules on the single financial services market and a level playing field between Member States.

In January 2011 new European Union supervisory and coordination bodies were set up and the European System of Financial Supervision came into effect. The system consists of the European Systemic Risk Board, which is responsible for macro-prudential supervision, and three European micro-prudential supervision bodies – the European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA).

Extremely important prudential and crisis management measures were taken to restore confidence and strengthen the financial sector. At prudential level, the process of increasing banks' capital requirements began, with additional obligations for SIFIs[168], plus improvement in the quality of this capital and introduction of liquidity requirements, among others. The European Commission

[168] Systemically Important Financial Institution

issued a proposal for a Directive for the Recovery and Resolution of Credit Institutions, where crisis management was concerned.

Finally, in response to the challenges diagnosed and continuing the above framework, the Heads of State undertook in June 2012 to form a banking union in Europe capable of restoring the banking market's integrity and universal access to funding by the Member States' economic agents.

The European Commission issued a proposal for banking union in late 2012. It is based on three main pillars: the Single Supervisory Mechanism, Single Resolution Mechanism and European Deposit Guarantee Fund. Work began immediately on the first two pillars, while there has been no development so far in the third.

III.1. Single Supervisory Mechanism and Single Rule Book

The Single Supervisory Mechanism, or SSM, arose as a proposal for a regulation of the European Commission in September 2012. The regulation granted the European Central bank (ECB) powers of supervision over all banks in the euro area and put it in charge of coherent, consistent enforcement of the Single Rule Book.

As a result, the ECB is now responsible not only for supervising all the banks in the euro area but also the banks in other Member States that decided to join the mechanism.

The ECB will supervise the largest banks in each jurisdiction directly and monitor the national authorities' enforcement of its guidelines in smaller banks. It may, however, take over direct supervision of any of the financial institutions in the SSM at any time.

The EBA will continue to play its dominant role in enforcing the Single Rule Book throughout the European Union and will ensure the consistency of treatment among SSM and non-SSM banks.

III.2. Single Resolution Mechanism

A proposal for a regulation setting up the Single Resolution Mechanism was issued in 2013 and has not yet been finalised.

The SRM is to be a corollary of the SSM and will be in charge of uniform, coherent, centralised application of the rules set out in the proposal for a directive on the Recovery and Resolution of Credit Institutions to all financial institutions in the Single Supervisory Mechanism. This will ensure consistent decisions on bank resolution and ways of funding these decisions. The SRM must ensure that resolution processes are managed rationally, methodically and efficiently and will play a particularly important role in the event of failures of systemically important banks with cross-border business.

The proposal is expected to be finalised in 2014 and come into effect in early 2015. As the SRM is complementary to the SSM, Member States not belonging to the euro area that choose to join the SSM will also be covered by this resolution mechanism.

There are still fundamental issues to be discussed. Firstly, full operation of this mechanism will require a single European resolution authority. The first proposal on the matter, as part of the SRM regulation proposal, considered a future authority as a board consisting of a directorate of 17 euro-area national resolution authorities under a chair and vice-chair. The European Commission and ECB would only be observers in the directorate.

In addition to a single resolution authority, the SRM regulation proposal includes a proposal to set up a single resolution fund, as the European Commission had pointed out a need for one in a communiqué in 2010[169]. In the event of failures in systemically important banks with cross-border business, a single fund would be must more effective than the network of national funds and would also reinforce the idea of European unity.

Related documents

EBA Public Consultation (15 May to 15 June)

EBA Discussion Paper on a template for recovery plans

http://www.eba.europa.eu/documents/10180/41487/Discussion-Paper-on-Template-for-Recovery-Plans.pdf

Proposal for a Directive of the European Parliament and of the Council (5 June)

Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0280:FIN:EN:PDF

European Commission Working Document (6 June)

Impact Assessment accompanying the document. Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms

http://ec.europa.eu/internal_market/bank/docs/crisis-management/2012_eu_framework/impact_assessment_final_en.pdf

Proposal for a Council Regulation (12 September)

Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies regarding to the prudential supervision of credit institutions

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0511:FIN:EN:PDF

[169] European Commission - *Communication on bank resolution funds* – May 2010

Proposal for a Regulation of the European Parliament and of the Council (12 September)

Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards its interaction with Council Regulation (EU) No…/… conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0512:FIN:EN:PDF

Public Consultation of the European Commission (5 October to 28 December)

Consultation on a Possible Recovery and Resolution Framework for Financial Institutions other than Banks

http://ec.europa.eu/internal_market/consultations/2012/nonbanks/consultation-document_en.pdf

Public Consultation of the Financial Stability Board (November)

Recovery and Resolution Planning: Making the Key Attributes Requirements Operational - Consultative Document

https://www.financialstabilityboard.org/publications/r_121102.pdf

IV. Reform of the European Banking Sector

The extent of the global financial crisis caused the world authorities to reflect deeply on the organisation of the banking sector. This concern resulted in an in-depth analysis of its structure, and reforms were suggested by a number of countries (Volcker's Rule in the United States and the Vickers Report in the UK) in order to improve its stability. In the European Union, a report drafted by a group of experts headed by Erkki Liikanen, Governor of the Bank of Finland and a member of the Governing Council of the European Central Bank, pointed out a similar goal. The recommendations include ring-fencing the different business area in a banking organisation and stricter requirements for capitalisation of higher-risk activities, such as property investment and trading.

Related documents

Liikanen Report (2 October)

The report prepared by the High-level Expert Group on reforming the structure of the EU banking sector

http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf

V. Financial Conglomerates

Following the amendment of EU legislation on financial conglomerates [170] (in Directive 2011/89/EU of the European Parliament and of the Council of 16 November), the Joint Forum[171] issued a consultative document in 2011 with a view to reviewing the principles regarding their supervision that it had published in 1999. The final report setting out the new principles was published in September 2012.

Directive 2011/89/EU, which took the form of a technical review of Directive 2002/87/EC of 16 December[172], asked the European Commission to conduct a complete review of it with a view to appropriate additional supervision of bank and insurance groups, including those that were part of a mixed financial structure. The DG internal Market and Services of the European Commission issued a call for evidence inviting comments and suggestions on a set of issues. On 20 December, the European Commission published a final report on this consultation identifying potential areas for alteration in the next legislative review. At the same time, the Commission recommended not proposing any changes in legislation in 2013 before implementation of banking union, which would bring profound changes to the supervision of financial conglomerates.

Related documents

Joint Forum Consultation (19 December 2011 to 16 March 2012)

Principles for the supervision of financial conglomerates – Consultative Document

http://www.bis.org/publ/joint27.pdf

Public Consultation of the European Commission (February to 19 April)

Call for evidence for Fundamental Review: Financial Conglomerates' Supervision

http://ec.europa.eu/internal_market/financial-conglomerates/docs/info-letter/022012_en.pdf

Final Report of the Joint Forum Consultation (24 September)

Principles for the supervision of financial conglomerates

http://www.bis.org/publ/joint29.pdf

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[170] A financial conglomerate is a financial institution that has significant activity in more than one financial sector, such as when it combines banking and insurance.

[171] The Joint Forum is an international organisation founded in 1996 under the aegis of the BCBS, IOSCO and IAIS that handles matters concerning the banking and insurance sectors and the securities market, including the regulation of financial conglomerates.

[172] Directive 2002/87/EC of the European Parliament and of the Council of 16 December granted the authorities in the financial sector powers and additional instruments for the supervision of groups made up of many regulated entities operating in different sectors of the financial markets.

Final Report of the Public Consultation of the European Commission February (20 December)

The review of the Directive 2002/87/EC of the European Parliament and the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0785:FIN:EN:PDF

VI. Capital and Liquidity

In this area, 2012 continued with the adaptation to the European Union of the reform of the prudential regulation system, called Basel III, announced by the Basel Committee on Banking Supervision in late 2010. The adaptation took place in July 2011 in the third review package of Directive 2006/48/EC of the European Parliament and of the Council of 14 July, which consisted of a proposal for a regulation (CRR) and a proposal for a directive (CRD4).

2012 also witnessed submission of proposed alternatives to the European Commission document by the European Parliament and the Danish Presidency and the negotiation of a compromise text in the trialogue between the three joint legislators.

Meanwhile, the EBA, which had been tasked by the future CRR/CRD4 package with producing guidelines and Draft Regulatory Technical Standards on a number of matters, began the preparatory work by issuing 11 public consultations during the year, although they were prepared on the basis of the provisional CRR/CRD texts.

The BCBS issued seven consultations on capital and liquidity in 2012 focusing essentially on securitisation, central counterparties, risk management and liquidity.

Related documents

Consultation of Basel Committee on Banking Supervision (21 December 2011 to 17 February 2012)

Application of own credit risk adjustments to derivatives - Consultative Document

http://www.bis.org/publ/bcbs214.pdf

Report of Basel Committee on Banking Supervision (3 April)

Progress report on Basel III implementation

http://www.bis.org/publ/bcbs215.pdf

Report of Basel Committee on Banking Supervision (12 April)

Results of the Basel III monitoring exercise as of 30 June 2011

http://www.bis.org/publ/bcbs217.pdf

Consultation of the Basel Committee on Banking Supervision (3 May to 7 September)

Fundamental review of the trading book - Consultative Document

http://www.bis.org/publ/bcbs219.pdf

Consultation of the Basel Committee on Banking Supervision (26 June to 28 September)

Principles for effective risk data aggregation and risk reporting - Consultative Document

http://www.bis.org/publ/bcbs222.pdf

Consultation of the Basel Committee on Banking Supervision (2 July to 14 September)

Monitoring indicators for intraday liquidity management - Consultative Document

http://www.bis.org/publ/bcbs225.pdf

Consultation of the Basel Committee on Banking Supervision (6 July to 28 September)

Margin requirements for non-centrally-cleared derivatives - Consultative Document

http://www.bis.org/publ/bcbs226.pdf

Consultation of the Basel Committee on Banking Supervision (17 August to 12 October)

Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions - Consultative Document

http://www.bis.org/publ/bcbs229.pdf

Basel Committee on Banking Supervision Report (20 September)

Results of the Basel III monitoring exercise as of 31 December 2011

http://www.bis.org/publ/bcbs231.pdf

Basel Committee on Banking Supervision Report (8 October)

Report to G20 Finance Ministers and Central Bank Governors on Basel III implementation

http://www.bis.org/publ/bcbs234.pdf

Basel Committee on Banking Supervision Report (29 October)

Progress report on Basel III implementation

http://www.bis.org/publ/bcbs232.pdf

Consultation of the Basel Committee on Banking Supervision (18 December 2012 to 15 March 2013)

Revisions to the Basel Securitisation Framework - Consultative Document

http://www.bis.org/publ/bcbs236.pdf

EBA Public Consultation - CP 51 (13 February to 26 March)

EBA Consultation Paper on Draft Implementing Technical Standards on Supervisory reporting requirements for large exposures

http://www.eba.europa.eu/documents/10180/38429/CP51-ITS-on-reporting-of-LE.pdf

EBA Public Consultation - EBA/CP/2012/02 (4 April to 4 July)

EBA Consultation Paper on Draft Regulatory Technical Standards on Own Funds - Part One

http://www.eba.europa.eu/documents/10180/38255/EBA-BS-2012-059--CP-2012-02v2.pdf

EBA Public Consultation - EBA/CP/2012/03 (18 April to 18 July)

EBA Consultation Paper on draft Guidelines for assessing the suitability of members of the management body and key function holders of a credit institution

http://www.eba.europa.eu/documents/10180/38240/CP-on-GL-on-the-assessment-of-the-suitability-of-directors-and-key-function-holders.pdf

EBA Public Consultation - EBA/CP/2012/04 (7 June to 31 July)

EBA Consultation Paper on Draft Implementing Technical Standards on Disclosure for Own Funds by institutions

http://www.eba.europa.eu/documents/10180/38225/EBA-CP-2012-04--CP-on-ITS-disclosure-for-own-funds-.pdf

EBA Public Consultation - EBA/CP/2012/05 (7 June to 27 August)

EBA Consultation Paper on Draft Implementing Technical Standards on Supervisory reporting requirements for liquidity coverage and stable funding

http://www.eba.europa.eu/documents/10180/37226/EBA-CP-2012-05--CP-on-ITS-liquidity-reporting-.pdf

EBA Public Consultation - EBA/CP/2012/06 (7 June to 27 August)

EBA Consultation Paper on Draft Implementing Technical Standards on Supervisory reporting requirements for leverage ratio

http://www.eba.europa.eu/documents/10180/38102/CP06-CP-on-ITS-Leverage-Ratio-Reporting.pdf

EBA Public Consultation - EBA/CP/2012/07 (12 June to 12 August)

EBA Consultation Paper on Draft Regulatory Technical Standards on the concept of Gain on Sale associated with future margin income in a securitisation context

http://www.eba.europa.eu/documents/10180/38087/EBA-CP-2012-07--CP-on-RTS-Gain-on-Sale-on-securitisations-.pdf

EBA Public Consultation - EBA/CP/2012/08 (15 June to 31 July)

EBA Consultation Paper on Draft Regulatory Technical Standards on Capital Requirements for CCPs

http://www.eba.europa.eu/documents/10180/38072/EBA-CP-2012-08--CP-on-RTS-on-Capital-Requirements-for-CCPs-.pdf

EBA Public Consultation - EBA/CP/2012/09 (11 July to 15 September)

EBA Consultation Paper on Draft Regulatory Technical Standards for credit valuation adjustment risk on the determination of a proxy spread and the specification of a limited number of smaller portfolios

http://www.eba.europa.eu/documents/10180/38057/EBA-CP-2012-09-CP-credit-valuation-risk.pdf

EBA Public Consultation - EBA/CP/2012/10 (17 July to 30 September)

EBA Consultation Paper on Draft Regulatory Technical Standards on the specification of the calculation of specific and general credit risk adjustments according to Article 105(4) of the draft Capital Requirements Regulation (CRR)

http://www.eba.europa.eu/documents/10180/38042/EBA-CP-2012-10-CP-on-RTS-on-SCRAs-and-GCRAs.pdf

EBA Public Consultation - EBA/CP/2012/11 (9 November to 21 December)

EBA Consultation Paper on Draft Regulatory Technical Standards on Own Funds under the draft Capital Requirements Regulation - Part Two

http://www.eba.europa.eu/documents/10180/38528/EBA-BS-2012-211-final-for-publication--Consultation-paper-on-draft-RTS-on-Article-25-2--a--.pdf

EBA Guidelines - EBA/GL/2012/01 (6 January)

EBA Guidelines on Advanced Measurement Approach (AMA) - Extensions and Changes

http://www.eba.europa.eu/documents/10180/105108/EBA-BS-2012-267--AOB_GL-AMA-extensions-changes-_1.pdf

EBA Guidelines - EBA/GL/2012/03 (16 May)

EBA Guidelines on the Incremental Default and Migration Risk Charge (IRC)

http://www.eba.europa.eu/documents/10180/104828/EBA-BS-2012-79--GL-on-IRC-.pdf

EBA Guidelines - EBA/GL/2012/02 (16 May)

EBA Guidelines on Stressed Value-At-Risk (Stressed VAR)

http://www.eba.europa.eu/documents/10180/104547/EBA-BS-2012-78--GL-on-Stressed-VaR-.pdf

EBA Guidelines - EBA/GL/2012/05 (7 July)

EBA Guidelines On the Data Collection Exercise Regarding High Earners

http://www.eba.europa.eu/documents/10180/107643/EBA-GL-2012-05---GL-5-on-remuneration-data-collection-exercise-_1.pdf

EBA Guidelines - EBA/GL/2012/04 (27 July)

EBA Guidelines on the Remuneration Benchmarking Exercise

http://www.eba.europa.eu/documents/10180/111703/EBA-2013-01-29--Compliance-GL-2012_04-.pdf/3617f8db-ed9b-4f83-b5ed-e9e3317c54ad?version=1.0

EBA Guidelines - EBA/GL/2012/06 (22 November)

Guidelines on the assessment of the suitability of members of the management body and key function holders

http://www.bankofgreece.gr/BogDocumentEn/EBA_GL_2012_06_Guidelines_on_the_assessment_of_the_suitability_of_persons.pdf

VII. Reporting and Disclosure

In November 2011, the European Securities and Market Authority began a public consultation on considerations of materiality in financial reporting. Replies were to be sent by 29 February 2012.

Related documents

ESMA Public Consultation– ESMA/2011/373 (9 November 2011 to 29 February 2012)

Considerations of materiality in financial reporting – Consultation Paper

http://www.esma.europa.eu/system/files/2011_373_.pdf

VIII. Capital Market

There were a number of European Union regulatory initiatives for the capital market in 2012. The issues they addressed included settlement of securities, short selling, credit default swaps, retail investment product packages, undertakings for collective investment in transferable securities, rating agencies, alternative investment funds, sales prospectuses and OTC derivatives, central counterparties and trade repositories.

As part of the European Union's efforts to create a sounder financial system, on 7 March 2012 the European Commission submitted a proposal for a regulation on the security and efficiency of securities settlement and Central Securities Depositories or CSDs. The material changes proposed included reduction and harmonisation of the settlement time to T+2, the dematerialisation of securities, provision of banking services in addition to main CSDs services, behavioural and prudential rules common to CSDs, passports and penalties for CSDs authorised under the new regime.

The adoption on 14 March 2012 of the regulation on short selling and certain aspects of default swaps, complemented by other regulations, ended the legislative process that began in June 2010 establishing a European framework on the transparency of net short positions on shares and sovereign debt, the method for calculating these positions, conditions in which short selling is allowed and the circumstances in which ESMA and national authorities can take exceptional measures, such as restrictions on naked short-selling of shares or sovereign debt.

On 3 July 2012, the European Commission submitted a proposal for a regulation on the key information that must accompany the sale of packaged retail investment products (PRIPs). This proposal for the entire financial sector (banks, insurance and markets for financial instruments) is aimed at providing non-qualified or non-professional investors with an informative document with a short, simple, standardised structure, presentation and content, enabling them to understand an investment product being offered and compare to others so that they can make an informed decision.

UCITS V[173] was a European Commission proposal for legislation setting out alterations in the UCITS Directive concerning depositaries, remuneration for management entities and penalties**.**

A second, different package of alterations to the UCITS Directive was also submitted for public consultation by the European Commission in July. They are to be included in a future UCITS VI Directive and include (i) money market funds, (ii) eligibility of assets held by UCITS, (iii) asset portfolio management techniques, (iv) the European passport for depositaries, (v) exposure to OTC derivatives and (vi) master-feeder structures, UCITS mergers and notification procedures between Member States.

In response to the G20 mandate, the regulation on OTC derivatives, central counterparties and trade repositories (the European Market Infrastructure Regulation or EMIR) was approved on 4 July 2012. EMIR provides for centralised settlement of operations involving certain types of OTC derivatives, risk mitigation techniques for OTC derivatives operations not settled centrally and

[173] Undertakings for collective investment in transferable securities

obligations to report information to trade repositories and regulates the activity of central counterparties and trade repositories.

Three delegated regulations complementing the regulation on rating agencies were approved in 2012. They set out rules on information provided to ESMA by rating agencies and standards on the fees charged for their supervision, registration and certification. The main changes have to do with greater transparency of sovereign ratings, reduction in excessive or mechanical reliance on ratings, greater independence and accountability of rating agencies and stricter rating of structured products.

Two delegated regulations making up the new prospectus directive (Directive 2010/73/EU of the European Parliament and of the Council of 24 November) on the form and content of prospectuses, disclosure requirements, use of information and the obligation to submit a report drafted by independent accountants or auditors were approved in 2012.

In December, a ESMA issued three consultative documents of guidelines and recommendations on (i) key concepts of the directive on alternative investment fund managers, (ii) rating agencies and (iii) assessment of the consistency, efficacy and efficiency of interoperability agreements concluded under EMIR.

Related documents

Implementing Regulation 272/2012/EU of the European Commission (7 February)

Regulation supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to fees charged by the European Securities and Markets Authority to credit rating agencies

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:090:0006:0010:en:PDF

ESMA Guidelines – ESMA/2012/122 (24 February)

Guidelines on Systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities

http://www.esma.europa.eu/system/files/esma_2012_122_en.pdf

Proposal for a Regulation of the European Parliament and of the Council (7 March)

Proposal for a Regulation on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0073:FIN:EN:PDF

Regulation 236/2012/EU of the European Parliament and of the Council (14 March)

Regulation on short selling and certain aspects of credit default swaps

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:086:0001:0024:en:PDF

Regulation Supplementing Regulation 448/2012/EU of the European Commission (21 March)

Regulation supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards for the presentation of the information that credit rating agencies shall make available in a central repository established by the European Securities and Markets Authority

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:140:0017:0031:EN:PDF

Regulation Supplementing Regulation 449/2012/EU of the European Commission (21 March)

Regulation supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards on information for registration and certification of credit rating agencies

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:140:0032:0052:en:PDF

Regulation Supplementing Regulation 486/2012/EU of the European Commission (30 March)

Regulation amending Regulation (EC) No 809/2004 as regards the format and the content of the prospectus, the base prospectus, the summary and the final terms and as regards the disclosure requirements

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:150:0001:0065:en:PDF

Regulation Supplementing Regulation 862/2012/EU of the European Commission (4 June)

Regulation amending Regulation (EC) No 809/2004 as regards information on the consent to use of the prospectus, information on underlying indexes and the requirement for a report prepared by independent accountants or auditors

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:256:0004:0013:en:PDF

Regulation Supplementing Regulation 826/2012/EU of the European Commission (29 June)

Regulation supplementing Regulation (EU) No 236/2012 of the European Parliament and of the Council with regard to regulatory technical standards on notification and disclosure requirements with regard to net short positions, the details of the information to be provided to the European Securities and Markets Authority in relation to net short positions and the method for calculating turnover to determine exempted shares.

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:251:0001:0010:en:PDF

Implementing Regulation 827/2012/EU of the European Commission (29 June)

Implementing Regulation laying down implementing technical standards with regard to the means for public disclosure of net position in shares, the format of the information to be provided to the European Securities and Markets Authority in relation to net short positions, the types of agreements, arrangements and measures to adequately ensure that shares or sovereign debt instruments are available for settlement and the dates and period for the determination of the principal venue for a share according to Regulation (EU) No 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:251:0011:0018:en:PDF

Proposal for a Regulation of the European Commission (3 July)

Proposal for a Directive amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions

http://ec.europa.eu/internal_market/investment/docs/ucits/20120703-proposal_en.pdf

Proposal for a Regulation of the European Parliament and of the Council (3 July)

Proposal for a Regulation on key information documents for investment products

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0352:FIN:EN:PDF

Regulation 648/2012/EU of the European Parliament and of the Council (4 July)

Regulation on OTC derivatives, central counterparties and trade repositories

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF

Regulation Supplementing Directive 918/2012/EU of the European Commission (5 July)

Regulation supplementing Regulation (EU) No 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps with regard to definitions, the calculation of net short positions, covered sovereign credit default swaps, notification thresholds, liquidity thresholds for suspending restrictions, significant falls in the value of financial instruments and adverse events

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:274:0001:0015:EN:PDF

Regulation Supplementing Directive 919/2012/EU of the European Commission (5 July)

Regulation supplementing Regulation (EU) No 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps with regard to regulatory technical standards for the method of calculation of the fall in value for liquid shares and other financial instruments

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:274:0016:0017:EN:PDF

ESMA Guidelines – ESMA/2012/387 (6 July)

Guidelines on certain aspects of the Markets in Financial Instrument Directive (MiFID)[174] suitability requirements

http://www.esma.europa.eu/system/files/2012-387.pdf

European Commission Public Consultation (26 July to 18 October)

Proposal for a Directive amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions

http://ec.europa.eu/internal_market/investment/docs/ucits/20120703-proposal_en.pdf

ESMA Guidelines– ESMA/2012/832 (18 December)

Guidelines on ETFs and other UCITS issues

http://www.esma.europa.eu/system/files/2012-832en_guidelines_on_etfs_and_other_ucits_issues.pdf

Regulation Supplementing Directive 231/2013/EU of the European Commission (19 December)

Regulation supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:083:0001:0095:EN:PDf

ESMA Public Consultation– ESMA/2012/844 (19 December 2012 to 1 February 2013)

Draft regulatory technical standards on types of AIFMs

http://www.esma.europa.eu/system/files/2012-844.pdf

ESMA Public Consultation– ESMA/2012/845 (19 December 2012 to 1 February 2013)

Guidelines on key concepts of the AIFMD

http://www.esma.europa.eu/system/files/2012-845.pdf

ESMA Public Consultation - ESMA/2012/841 (20 December 2012 to 20 February 2013)

Guidelines and recommendations on the scope of the credit rating agency (CRA) Regulation

http://www.esma.europa.eu/system/files/2012-841.pdf

[174] Markets in Financial Instruments Directive

ESMA Public Consultation– ESMA/2012/852 (20 December 2012 to 31 January 2013)

Guidelines for establishing consistent, efficient and effective assessments of interoperability arrangements

http://www.esma.europa.eu/system/files/2012-852.pdf

IX. Audit Policy

Regarding external audit policy, the European Commission launched a public consultation on Audit Policy: Lessons from the Crises in October 2010. The aim was to begin a discussion on the role of auditors, their communication with stakeholders, international audit standards and audit and supervision companies' governance and independence. Following this consultation, in November 2011, the European Commission issued a proposal for a regulation on specific requirements for audits of public-interest entities and a proposal for an alteration to Directive 2006/43/EC of the European Parliament and of the Council of 9 June on statutory audits of annual and consolidated accounts.

In the field of internal audit policy, the BCBS began a consultation on the internal audit function in banks in December 2011. Following this consultation, the BCBS published a final report setting out some principles on internal audit function in banks taking account of the developments in supervision entities and banks' own internal organisation in June 2012. It replaced the 2001 document entitled Internal audit in banks and the supervisor's relationship with auditors.

Related documents

Proposal for a Regulation of the European Parliament and of the Council (30 November 2011)

Proposal for a Regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities

http://ec.europa.eu/internal_market/auditing/docs/reform/regulation_en.pdf

Proposal for a Directive of the European Parliament and of the Council (30 November 2011)

Proposal for a Directive of the European Parliament and of the Council amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts

http://ec.europa.eu/internal_market/auditing/docs/reform/directive_en.pdf

Consultative Document of the Basel Committee on Banking Supervision (2 December 2011 to 2 March 2012)

The internal audit function in banks – Consultative Document

http://www.bis.org/publ/bcbs210.pdf

Final Report of the Consultation by the Basel Committee on Banking Supervision of 2 December (June)

The internal audit function in banks

http://www.bis.org/publ/bcbs223.pdf

Annex C – Alterations to international accounting standards

Standards coming into effect in 2012

IFRS 7 (Amendment) – Financial Instruments: Disclosures - Transfers of Financial Assets

In October 2010, the International Accounting Standards Board published an alteration to International Financial Reporting Standards (IFRS) 7 – Financial Instruments: Disclosures – Transfers of Financial Assets, effective for financial years as of 1 July 2011, though it could be adopted before.

The amendment has regard to alterations in disclosures on operations involving the transfer of financial assets, including securitisation of financial assets. The aim is for users to be able to assess the risk and impacts of these operations on their financial statements.

IAS 12 – (Amendment) – Income Taxes - Deferred Tax: Recovery of Underlying Assets

In December 2010, the IASB published an amendment to IAS 12 – Income Tax - Deferred Tax: Recovery of Underlying Assets mandatory for financial years beginning on or after 1 January 2012.

This amendment lays down that the carrying amount of the underlying asset will be recovered through sale when determining deferred taxes on investment properties.

All standard issued are available on www.ifrs.org.

Public consultations in 2012

IASB Public Consultation - ED/2012/1 (5 May to 5 September 2012)

Exposure Draft - Annual Improvements to IFRSs 2010—2012 Cycle

http://www.ifrs.org/current-projects/iasb-projects/annual-improvements/ed-may-2012/documents/edannualimprovementstoifrss20102012_website.pdf

IASB Public Consultation - ED/2012/2 (20 November 2012 to 18 February 2013)

Exposure Draft - Annual Improvements to IFRSs 2011—2011 Cycle

http://www.ifrs.org/current-projects/iasb-projects/annual-improvements/exposure-draft-and-comment-letters-nov-2012/documents/ed_annual%20improvements_web_with%20bookmarks.pdf

IASB Public Consultation - ED/2012/3 (22 November 2012 to 22 March 2013)

Exposure Draft - Equity Method: Share of Other Net Asset Changes - Proposed amendments to IAS 28.

http://www.ifrs.org/current-projects/iasb-projects/equity-accounting/exposure-draft-november-2012/documents/ed-equity-method-nov-2012-web.pdf

IASB Public Consultation - ED/2012/4 (28 November 2012 to 28 March 2013)

Exposure Draft - Classification and Measurement: Limited Amendments to IFRS 9 Proposed amendments to IFRS 9 (2010).

http://www.ifrs.org/current-projects/iasb-projects/financial-instruments-a-replacement-of-ias-39-financial-instruments-recognitio/limited-modifications-to-ifrs-9/documents/ed-classification-and-measurement-november-2012-bookmarks.pdf

IASB Public Consultation - ED/2012/5 (4 December 2012 to 2 April 2013)

Exposure Draft - Clarification of Acceptable Methods of Depreciation and Amortisation Proposed amendments to IAS 16 and IAS 38.

http://www.ifrs.org/current-projects/iasb-projects/depreciation-and-amortisation/exposure-draft-and-comment-letters-%5bdec-2012%5d/documents/ed-clarification-of-acceptable-methods.pdf

IASB Public Consultation - ED/2012/6 (13 December 2012 to 23 April 2013)

Exposure Draft - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture Proposed amendments to IFRS 10 and IAS 28.

http://www.ifrs.org/current-projects/iasb-projects/ifrs-10-ias-28/exposure-draft-december-2012/documents/ed-2012-6.pdf

IASB Public Consultation - ED/2012/7 (13 December 2012 to 23 April 2013)

Exposure Draft - Acquisition of an Interest in a Joint Operation Proposed amendment to IFRS 11.

http://www.ifrs.org/current-projects/iasb-projects/acquisition-joint-operation/exposure-draft-december-2012/documents/ed-2012-7.pdf

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