Activity Report

Portuguese Banking Association

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Acronyms

AAGR	Annual Average Growth Rate
AIG	American International Group
APB	Associação Portuguesa de Bancos (Portuguese Banking Association)
APR	Annual Percentage Rate of Charge
ATA	Autoridade Tributária Aduaneira
ATM	Automated Teller Machine
BCBS	Basel Committee on Banking Supervision
BdP	Banco de Portugal (Bank of Portugal)
CAFEB	Caixa de Abono de Família dos Empregados Bancários (Bank Employees´ Family Allowance Fund)
CDS	Credit Default Swaps
CEBS	Committee of European Banking Supervisors
CIMT	Municipal Real Estate Transfer Tax Code
CIRC	Corporate Income Tax Code
CMVM	Comissão do Mercado de Valores Mobiliários (Portuguese Securities Market Commission)
CRA	Credit Rating Agency
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSMA	Customer Services and Market Activities
DGCI	Direcção-Geral dos Impostos (Directorate-General for Taxation)
DGF	Deposit Guarantee Fund
E	Equity
EAP	Economic Adjustment Programme
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EIOPA	European Insurance and Occupational Pensions Authority
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
FA	Financial Assets
FI	Financial Institution
FL	Financial Liabilities
FSB	Financial Stability Board

GDP	Gross Domestic Product
GOR	Gross Operating Result
GSIBs	Global Systemically Important Banks
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
INE	Instituto Nacional de Estatística (Statistics Portugal)
IREF	Initiative to Strengthen Financial Stability
ISE	Interest and Similar Expenses
ISI	Interest and Similar Income
LTRO	Long-Term Refinancing Operations
MiFID	Markets in Financial Instruments Directive
MRO	Main Refinancing Operations
NGCO	Net Gains from Customer Operations
NGCSM	Net Gains from Customer Services and Market Activities
NGFC	Net Gains from Fees and Commissions
NGFO	Net Gains from Financial Operations
NIBT	Net Income Before Tax
NII	Net Interest Income
OC	Operating Costs
OI	Operating Income
OR	Other Results
PBS	Portuguese banking system
PI	Provisions and Impairment
POS	Point of Sale
PSI	Portuguese Stock Index
RFSO	Return on Financial Securities Operations
RGICSF	Legal Framework on Credit Institutions and Financial Companies
RIMMO	Return on Interbank Money Market Operations
ROA	Return on Assets
ROE	Return on Equity
ROFA	Return on Financial Assets
RWA	Risk-Weighted 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
SIS	Standardised Information Sheet
SME	Small and Medium-Sized Enterprise
TA	Total Assets
TARGET	Trans European Automated Real-Time Gross Settlement Express Transfer System
USA	United States of America
USD	United States dollars
VAT	Value-Added Tax

Executive summary

Associação Portuguesa de Bancos, the Portuguese Banking Association (APB) represents 36 monetary financial institutions (banks, savings banks and mutual agricultural savings banks), around 60% of which belong to eight banking groups, thus making a total of 23 Members as at 31 December 2011. These Members are highly representative of activity of the entire Portuguese banking system (PBS). While the Members accounted for just over one fifth of all the entities in the PBS at the end of 2011, in terms of the value of consolidated bank assets (492.5 billion euros) they were responsible for 96% of all the sector's activity (513.2 billion euros).

For a number of reasons, only 33 of the 36 member institutions make up the base sample of this report for the purpose of analysing aggregate activity in 2011. Nonetheless, because comparability of this activity over more or less time is important, the sample often had to be redefined due to unavailability of data.

In general the 33 financial institutions in the sample are mostly set up under Portuguese law and engage in multi-specialised activity. In terms of value of assets as a measurement of size, the sample is dominated in numbers by 20 small financial institutions that together have a market share of only 5.7%, while the remaining 94.3% of aggregate assets are concentrated in 13 large and medium-sized institutions. Even so, the Herfindahl index points to moderate market concentration when analysing value of assets. This is not the case when this concentration is analysed in terms of the extension of the member institutions' branch network. There is greater homogeneity here between the number of each financial institution's branches, and the market is close to the threshold of a competitive market. These results point to the existence of greater competition between the institutions in the sample in the retail banking market and in attracting business through the branch network as opposed to other types of banking activity.

In 2011, the activity of our member institutions took place-in a particularly difficult, unfavourable financial and macroeconomic framework. This was not only due to the scenario of economic slowdown, uncertainty as to the future of the euro and instability in the international financial markets in Europe and the rest of the world but also to the extra need for the member institutions to adjust their activity to the new prudential requirements set out in the European Union and International Monetary Fund (IMF) Economic Adjustment Programme (EAP) following Portugal's request for foreign financial help that year.

In the international financial markets, 2011 witnessed a progressive increase in aversion to risk on the part of investors. The disruption of their climate of confidence affected the normal operation of the financial markets resulting in a return to high volatility. Worldwide, the main share indexes tended to lose value, especially in the peripheral European markets and the financial institution segment. Credit spreads grew on the basis of exposure to more financially vulnerable countries and the euro depreciated globally. All this performance led to a growing decline in the interbank markets and low activity in the bond markets, posing very high risks to the European economies.

Meanwhile, the structural imbalances in the Portuguese economy, reflected by high levels of public and private borrowing in a context of slim economic growth and deteriorating perception of credit risk of sovereign debt, made Portugal's finance conditions in the international markets too severe and obliged the country to request foreign financial assistance in April 2011. From mid-year, the EU and IMF Economic Adjustment Programme resulting from the request dictated the terms of all Portugal's economic and financial activity and imposed requirements aimed at improving its economic growth potential over time and ensuring the recovery of its access to the international debt markets in 2013.

These demands inevitably extended to the financial sector and the banks were obliged to fulfil a number of new prudential requirements: increasing their minimum core Tier 1 capital ratio to 9% and 10% by the end of 2011 and 2012 respectively; reducing their transformation ratio to 120% by December 2014 and conducting inspections to assess their credit portfolios as at 30 June 2011 as part of the Banco de Portugal Special Inspection Programme (SIP) for the eight largest banking groups; and a review of the system for the reorganisation and winding-up of financial institutions set out in the Legal Framework on Credit Institutions and Financial Companies (RGICSF) in order to strengthen bank recovery and resolution mechanisms.

At the same time, in view of the deleveraging challenge faced by the banks in a framework of prolonged lack of access to the international financial markets and an unfavourable economic scenario, the EAP reinforced two existing lines of support for Portuguese banks. The first was the provision of an extraordinary state guarantee on bond issues by the banking sector, while the EAP laid down the possibility of banks issuing state-guaranteed debt to a maximum of 35 billion euros (these guarantees totalled 11.825 billion euros in 2011). The second was the availability of a fund, which it was not necessary to use in 2011, for recapitalisation of credit institutions to the amount of 12 billion euros included in the overall package of 78 billion euros in financial assistance to Portugal.

At the same time, due to a need for fiscal consolidation, the government introduced a Levy on the Banking Sector for the highest-risk liabilities on the balance sheet. It was intended not only to be an additional tax contribution from the banks but also a mitigating factor for their systemic risks. At the end of the year, the government decreed a partial transfer of the pension funds of some member institutions to Social Security.

The external and internal circumstances in 2011 naturally had repercussions on the member institutions, particularly their business activity, funding and performance.

2011 constituted a turning point in the historical growth trend (though it was slowing down) in the aggregate assets of the member institutions. They fell by 1.4% against 2010, which is not only in line with the 1% fall in GDP and therefore with the reduction in demand, but is also a product of the banks' deleveraging policy and a number of important outside factors.

The requirement to step up solvency levels imposed on the banks by the EAP was determined by the need for deleveraging of banking activity. The member institutions' difficulty in accessing capital markets under normal conditions meant that they had to try and achieve this goal by reducing assets (selling non-core assets and/or reducing their credit portfolios) and by changing the composition of their assets, with a corresponding reduction in their average risk.

The deleveraging process affected the grant of credit, as risk assessment criteria and loan criteria were more selective and restrictive. It was also reflected in the sale of credit portfolios, mainly credit to companies. Meanwhile, compliance with the EAP recommendation to reduce the transformation ratio not only led to efforts by the banking sector to attract more customer deposits, but also created additional pressure on the grant of credit. If we add to these factors the natural contraction in demand for credit by the non-financial private sector in 2011 due to the recession, it is no surprise that the gross stock of credit on the balance sheet decreased in 2011. The data confirm that gross credit to companies and the public administration, which accounted for more than 50% of the gross customer credit portfolio in 2011, was what contributed most in absolute value and as a percentage to the reduction in the portfolio. According to official data, smaller private, less capitalised companies are thought to have been most affected by the banks' stricter requirements when granting credit. At the same time, the banking sector remained under pressure to meet the funding needs of state-owned companies, which explains the growth in credit to them. Where credit to private customers was concerned, that which fell substantially was consumer and other credit, while mortgages, which constituted almost 40% of the gross customer credit portfolio and represented more than 85% of personal loans in 2011, increased.

Meanwhile, the deterioration of the economic climate in Portugal, where the unemployment rate hit all-time highs and the number of companies declaring insolvency increased, explains the decline in the quality of credit on the balance sheet. In fact, overdue credit grew by 32.8% in 2011, which represented 3.8% of the total gross credit stock at the end of the year. The general increase in credit risk is clearly visible in the default ratio and the non-performing loans ratio, which rose around 1.2 and 2 percentage points respectively in 2011. Both ratios show a similar pattern in all segments, with particular focus on consumer credit and loans to non-financial companies. In order to deal with this situation, the APB member institutions increased their provisions and impairment by 2.473 billion euros in 2011 (31% up on 2010). They include the amount of the increase (520 million euros) in provisions and impairment estimated in the results of the first phase of the SIP.

Finally, the contraction in aggregate assets was also a result of important factors outside banking activity. On the one hand, the banks' financial investment portfolio decreased 0.4% in net terms. In general, their portfolio of financial assets (particularly for trading and available for sale) was affected by a substantial depreciation of securities as a result of the highly unfavourable performance of the international debt and capital markets. The deterioration in the sovereign debt risk premium of the peripheral European countries and the repercussions of and uncertainties about Europe's economic, financial and political were the main cause of the great instability in financial markets worldwide.

The same scenario had indirect effects on portfolios of available-for-sale financial assets and impairment of held-to-maturity investments, where the great impact was due to the statement of losses arising from the restructuring of Greece's sovereign debt (874 million euros). Nonetheless, the fall in the share market resulted in recognition of impairment in shares held by member institutions, such as those in PSI 20 companies. If there was any activity effect in terms of financial investments, it took the form, due to deleveraging imperatives, of sale of some assets, especially non-strategic ones in available-for-sale portfolios and the acquisition of Portuguese public debt securities. This shows that the member institutions continued to finance the Portuguese government.

Furthermore, the disappearance from the balance sheet of the corridor for past actuarial deviations associated with banks' pension funds due to a change in accounting policy was a factor that contributed to the contraction in the member institutions' aggregate assets.

The funding of the member institutions' activity continues to be based on customer deposits and other loans, which exceeded 200 billion euros in 2011 and accounted for over 45% of the sample's total borrowing. Last year, this item grew by a substantial 7.4% as a result of considerable expansion of term deposits. There were several reasons for this performance, including a rise in demand for low-risk investments from small investors and the financial institutions' strong need to attract more stable funds. Specifically, there was a reduction in the transformation ratio and a deterioration in access conditions to wholesale funding markets (interbank and debt securities) by Portuguese financial institutions in 2011. Inevitably, competition among the banks intensified in the market to attract deposits in 2011. The main result was a generalised increase in interest rates offered on them, followed later by Banco de Portugal intervention to curb this sharp rise.

Meanwhile, the considerably diverse performance of gross customer credit (-8.062 billion euros or -2.8%) and customer deposits and other loans (+14.092 billion euros or +7.4%) resulted in s highly positive change in the transformation ratio, which fell from 152.2% in 2010 to 139% in 2011.

Regarding the member institutions' funding structure, it is also important to mention the performance of Central Banks' deposits, which grew much more moderately in 2011 than in previous years due to the contraction in banking activity and their active policy of attracting deposits. The member institutions' dependence on the Eurosystem continued, however, and the main cause was again difficulty in access to loans on the international wholesale markets. The European Central Bank (ECB) has sought to make up for this difficulty with more or less conventional monetary policy measures, such as the recent long-term refinancing operation (three-year LTRO) launched last December. The widespread subscription of this issue by the member institutions was almost entirely used to reduce the balances of other, short-term operations (MROs), a practice that they began in the second half of 2011. This performance, along with the attraction of substantial long-term customer deposits, provided a more stable aggregate funding structure in terms of maturity.

Finally, once again due to difficulty in placing new debt on the wholesale financial markets, there was a considerable reduction in balance sheet totals under deposits from other credit institutions, debt securities issues and subordinated liabilities in 2011. The fall in the last two items was accentuated not only by the repayment of debts reaching maturity and not renewed but also by the member institutions' purchase on the market of their own bonds.

In general, in spite of a reduction in aggregate debt, the degree of financial leveraging rose in 2011 due to a substantial fall in the absolute value of equity. Indeed, equity suffered negative effects from three sources: losses from recognition in retained earnings of past actuarial deviations associated with pension funds due to changes in accounting rules, losses on financial investments recognised in fair value reserves and losses in the year, most of which were due to extraordinary impacts of non-recurring events.

The member institutions' performance in 2011 contrasted considerably with that of previous years, to such an extent that they sustained a net loss before tax of -21.7% of operating income. Even though this performance reflects some deterioration in earnings of the banking business, it is largely the result of higher costs borne, especially those related to non-recurring events.

As usual in the banking business, intermediation activity constituted the member institutions' main source of earnings in 2011, although it fell slightly. The main contribution to the reduction in net interest income came from decreases in earnings from operations with customers and interbank money market operations. The former was the net product of efforts made by most of the financial institutions to attract more stable funding by means of commercial policies focusing on more attractive interest rates on deposits and to moderate the grant of loans by requesting higher lending rates. In the end, the positive volume/price effect in borrowing operations with customers was not in proportion to the volume/price effect in lending operations and so net interest income was lower in 2011. The latter variation was essentially the result of the increase in the member institutions' net liabilities with regard to the Central Banks, which combined with a price effect resulting from a rise in the annual average ECB reference rate in 2011. In operations with other credit institutions, although there was a decrease in net liabilities to them in 2011, the impact of the increase in the annual average Euribor was greater than the volume effect. On the other hand, the increase in earnings from operations in financial securities made a contrary contribution to the performance of net interest income from 2010 to 2011. In spite of losses on interest from trading portfolios and hedging operations, gains from interest on available-for-sale assets offset these losses thanks to a positive volume effect (amounts in portfolio increases, essentially due to the acquisition of Portuguese public debt) at the same time as an also positive price effect (the interest rates on Portugal's funding were higher in 2011 than in 2010).

While aggregate net interest income went down slightly overall (-0.4%), aggregate earnings from customer and market services fell considerably more (-11.7%) and were the main item with a negative influence on operating income. In fact, the largest negative contribution came from earnings on financial operations due to the particularly unfavourable performance of net gains from available-for-sale financial assets (capital losses on the sale of shares and bonds) and net gains from assets and liabilities at fair value through profit or loss on derivatives and bonds and equities. The second greatest negative contribution came from gains on fees and commissions (due to a reduction in income from a smaller volume of financial operations and an increase in commissions paid for guarantees received from the state with bond issues). Only other earnings made a positive contribution, due to gains on the sale of other assets and the acquisition of own bonds, in spite a reduction in income on capital and the extra burden from the Levy on the Banking Sector (73 million euros) in 2011.

As mentioned above, operating income generated in 2011 was not enough to support all operating costs or expenses of provisions and impairment. Not even operating cost reduction policies, which included the closure of some bank branches, cuts in spending on training and containment of costs of advertising and specialised services on the part of the member institutions, were enough to offset the large increases in provisions and impairment or the shock to costs of the partial transfer of pension funds from the banks to Social Security in late 2011. This shock, which totalled 408 million euros, was the result of the use of certain assumptions defined by the state, which in most cases were different from those used by the financial institutions in their accounting. This divergence in criteria resulted in differences between the amount of liabilities transferred and the value of the pension fund assets that had to be carried at cost by the financial institutions involved.

Meanwhile, the highly substantial increase in provisions and impairment can be explained by the reasons already mentioned. The increase in impairment of available-for-sale financial assets and investments held to maturity was due essentially to the restructuring of Greece's sovereign debt and recognised losses on Portuguese shares resulting in considerable depreciation in the PSI 20. Growth in credit impairment was caused by the economic recession and was reflected in higher materialisation of the credit risk. At the same time, it was necessary to recognise additional, extraordinary impairment following the results of the first phase of the Special Inspection Programme.

In the end, all together operating costs, provisions and impairment accounted for 121.7% of operating income in 2011, reflecting an aggregate net income before tax of -1.938 billion euros and return on assets (ROE) of -7.53%, as opposed to +3.85% in 2010. This accentuated deterioration in return is due, one the one hand, to the economic recession in Portugal in 2011 and, on the other hand, to the negative impact of four extraordinary factors, three of which were non-recurring: the partial transfer of the banks' pension funds to the state (408 million euros), recognition of additional impairment resulting from the SIP (520 million euros), a haircut of the Greek sovereign debt (874 million euros) and the Levy on the Banking Sector (73 million euros).

If these extraordinary impacts of around 1.875 billion euros are eliminated, the aggregate net loss before tax would be 63 million euros in 2011, resulting in an ROE of practically zero.

In spite of a performance that reflected the tough conditions that they had to face, the member institutions (with the exception of two banking groups) ended the year in compliance with the minimum capital requirements imposed by the EAP. The aggregate core Tier 1 ratio achieved was 9.4%, which reflects a substantial effort on the part of the member institutions to meet the supervisor requirements in the face of added demands and difficulties. On average, the increase in core Tier 1 capital accounted for more than half of the rises in core ratios and was higher than the impact of contraction of total assets. The conversion of non-core into core capital was the main source of this increase, although there were some share capital increases in the year. In conclusion, it is important to remember that core capital was only not greater in 2011 because of the need to recognise losses and mainly due to exogenous events. The result is a more solid, more robust banking sector that is better prepared to face the challenges of 2012.

I. Foreword

This annual Activity Report essentially analyses and interprets the aggregate activity of the APB member institutions.[1]

The analyses and comments in this report provide an in-depth, comprehensive view of these institutions' banking activity and are placed within the macroeconomic, legal and regulatory context of the period. In 2011 in particular, the member institutions' activity was profoundly affected by an exceptionally difficult scenario characterised by a downturn in global growth prospects, the exacerbation of the sovereign debt crisis in the euro area, the instability of the international financial markets and Portugal's request for external financial assistance, which resulted in new prudential requirements for the sector under the Economic Adjustment Programme (EAP) for Portugal undertaken by the European Union and International Monetary Fund.

For analysis purposes, this Activity Report is based on aggregate financial and non-financial information on business activity in Portugal and abroad (through representative and/or branch offices) by each financial institution (banks, savings banks and mutual agricultural savings banks) belonging to the APB. This aggregate is obtained by merely adding up each financial institution's individual financial statements and other management indicators. Exceptions are the aggregate information used to analyse the international business activity of Members operating abroad, the solvency analysis and the analysis of stress tests and European Union Capital Exercise, as they refer to consolidated data.

The analyses concentrate on member institutions' activity in the year to which the report refers, though always viewed from a perspective of evolution over time. It is important to note that, based on the information and details provided by the Members, more detailed analyses may be limited to a more restricted sample and/or period of analysis.

The sample includes 33 financial institutions of the 36[2] in the group of 23 APB Members on 31 December 2011 (see Chart 1, p. 3). This sample was redefined whenever necessary for the comparability of some analyses. These situations are clearly pointed out in the report or footnotes.

These are some of the events affecting Members in 2011:

- There was a merger between two Members: Caixa de Aforros de Vigo, Ourense e Pontevedra (Caixanova) and Caja de Ahorros de Galicia, Sucursal in early 2011. The name of the resulting institution was Caixa de Aforros de Galicia, Vigo, Ourense e Pontevedra – Sucursal em Portugal. At the end of the year, as a result of an operation in Spain, the new company's assets and liabilities were transferred to NCG Banco, S.A., Sucursal em Portugal (currently an APB Member).
- Banco Itaú Europa, S.A. changed its name to Banco Itaú BBA Internacional, S.A. in February.
- Caixa Económica Montepio Geral acquired 100% of Finibanco Holding, SGPS, S.A. from Montepio Geral – Associação Mutualista in March. In this operation, the assets and liabilities

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

[2] The three financial institutions not included are: o NCG Banco, S.A., Sucursal em Portugal, as it was undergoing internal restructuring and was unable to provide the data, Banco Efisa, S.A., as it did not send information in time and BPN – Banco Português de Negócios, S.A. as its current data seriously distort the aggregate trends.

of Finibanco, S.A. were incorporated into Caixa Económica Montepio Geral with the exception of the real estate belonging to Finibanco, S.A. As it was now a part of Caixa Económica Montepio Geral, Finibanco, S.A. ceased to be an APB Member in 2011.

- The form of legal representation of Deutsche Bank (Portugal), S.A. changed, as it ceased to be a subsidiary and became a branch office of the German parent company in December. It changed its name to Deutsche Bank AG, Sucursal em Portugal.
- Totta Crédito Especializado – Instituição Financeira de Crédito, S.A. was integrated into Banco Santander Totta, S.A. in January.
- The assets corresponding to loan activities and insurance brokerage of Sofinloc – Instituição Financeira de Crédito, S.A. were integrated into Banco Finantia, S.A. in October.
- There was a demerger-merger of Banif Go, Instituição Financeira de Crédito, S.A. in December. Its assets and liabilities from financial leasing and hire purchase loans were integrated into Banco Banif Mais, S.A. and those from property leasing into Banif – Banco Internacional do Funchal, S.A.
- Popular Gestão de Imóveis, Lda. was integrated into Banco Popular Portugal, S.A. in December.
- A framework agreement was signed by the Portuguese government, as a shareholder in BPN – Banco Português de Negócios, S.A. and Banco BIC Português, S.A. in December).

This Activity Report is structured as follows. Chapters II and III describe the macroeconomic, legal and regulatory scenarios that influenced Members' activity during the year. Chapter IV characterises the number of member institutions, including changes in recent years, and analyses their representativity in the Portuguese banking system. Chapter V analyses human resources and Chapter VI deals with banking coverage. Chapter VII analyses the Members' performance in a detailed study of the main items on their balance sheets and income statements. This chapter also includes an analysis of return, solvency and resilience to stress tests. Chapter VIII provides the main efficiency indicators, while Chapter IX addresses the consolidated international activity of Members operating abroad.

Chart 1: Index of the APB Members and of the financial institutions that belonged to them as at 31 December 2011

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.[3]	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

[3] Although it belongs to the BPN Group, Banco Efisa is an independent Member.

BPN - Banco Português de Negócios, S.A.	BPN - Banco Português de Negócios, S.A.	BPN
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	Montepio
	Finibanco, S.A.	Finibanco
Caixa Geral de Depósitos, S.A.	Caixa Geral de Depósitos, S.A.	CGD
	Caixa - Banco de Investimento, S.A.	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
	BNP Paribas Wealth Management, S.A. - Sucursal em Portugal	BNP WM
	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[4]

The economic recovery that began in 2010 lost its momentum in 2011, affected by the complexity of the solutions for structural imbalances in the developed economies, the intention to standardise monetary policy in the emerging economies, the dynamics of the production cycle following a period of deep recession and some more atypical phenomena, such as uncertainty in the European institutional framework.

Many of these factors remain valid as conditioners of economic activity, the financial markets and expected banking business in 2012. In the face of active restrictions on room for manoeuvre in fiscal policy, the Central Banks of the developed countries have played a dominant role in supporting economic activity and mitigating financial risks by taking less conventional measures to offset the decreasing efficacy of very low nominal interest rates.

In April 2011, the Portuguese authorities committed to the European Union and International Monetary Fund Economic Adjustment Programme. The aim of the programme is to correct recurring macroeconomic imbalances (fiscal and external deficit), ensure the sustainability of public finances and financial stability and achieve a structural change in the Portuguese economy in order to improve economic growth potential over time. In return, official loans will satisfy a substantial proportion of Portugal's funding needs until 2013. The consolidation of public finances associated with the adjustment programme will have considerable repercussions on households' disposable income and activities more directly dependent on state spending, thereby affecting saving capacity and short-term economic growth.

Economic and financial uncertainty had a seriously adverse effect on the performance of the Portuguese financial system, volume of business activity, quality of credit and banks' return in a more restrictive framework determined by the need to meet regulatory recapitalisation and liquidity requirements. It was very important to attract stable financial resources, be selective in granting credit and identify more competitive business sectors, which were essential factors in reconciling the dual goal of meeting deleveraging targets and promoting growth in the economy in a context of strict restrictions on funding.

II.1. Global economic activity

The global economy was negatively affected in 2011 by exceptional, temporary, exogenous factors, such as the natural catastrophe in Japan, systemic phenomena with effects on markets performance and global political developments with as yet undetermined impacts. In addition to intermittent spending and investment in the advanced economies due to the correction of high levels of public and private borrowing and the persisting climate of uncertainty, there was an increase in political tensions in the Middle East and North Africa and unwonted instability in the European financial system with effects on international trade and the global economy's growth potential.

[4] The Portuguese Banking Association would like to thank the Economic Study Office at Banco Comercial Português, S.A. for preparing this chapter on the macroeconomic background.

Estimates as to global economic growth have been reduced to under 4% for 2011-2012, a lower rate than the long-term average and that recorded in 2010. The difference in performance between the advanced and developing economies widened. The expected growth rate for the emerging economies in 2011 and 2012 is approximately three times that for the developed countries (6.2% and 1.8% respectively).

The United States showed a better performance at the end of 2011, thanks to a boost from spending. Nonetheless, fiscal restrictions and limited monetary policy options as a stimulus to the economy restricted growth potential over time, with more relevant risks to household expenditure.

In the euro area, the worsening and spread of the systemic risk as a result of fears of interdependency mechanisms between sovereign risk, the financial system and the real economy contributed to a progressive deterioration in economic activity, and the creation of wealth was lower than that at the start of the crisis in 2008.

The persisting legacy of over-indebtedness will continue to affect economic performance in 2012. The sustainability of public finances may require additional, ongoing fiscal consolidation measures in order to make up for the effects of the adverse economic cycle immediately and the challenges of an ageing population at longer term. Very moderate, uncertain economic growth is forecast for 2012, with continuing disparity in performance between the countries on the periphery and in the centre and east of Europe, due to the weakness of public finances and exposure to the foreign sector and the overall investment cycle.

Return to more robust, sustained growth in the euro area will depend on a capacity for and speed of correction of economic and financial imbalances and investors' reactions to measures taken to mitigate uncertainty as to the future of the European Union, particularly the stabilisation of the Greek economy, the support and implementation of the reformulated fiscal pact and the execution of the European financial stabilisation mechanisms.

The slowdown in the global economy mitigated inflationary pressure in the emerging economies, which enabled them to follow less restrictive monetary policies to boost economic activity. Their contribution to correcting global macroeconomic imbalances constitute a structural challenge for the emerging economies in terms of transition from a development model based mainly on external stimuli to a new model with growth factors more sustained by domestic demand offering a generalised, sustainable improvement in standards of living.

II.2. Financial markets

2011 witnessed renewed volatility in the financial markets and a progressive increase in aversion to risk. Rumours of a possible redefinition of the group of single-currency countries fuelled a vicious cycle of instability in the European markets and, by contagion, the global markets. The main share indexes tended to fall, especially in the southern European markets and financial institution segment. Credit spreads grew on the basis of exposure to countries with higher financial vulnerability. The euro generally depreciated and went back to levels below USD 1.30. On the other hand, typical refuge financial assets, such as German and American bonds, gold and short-term positions in currencies like the Swiss franc or the yen, were supported. Raw materials continued to appreciate in 2011, though more moderately than in 2010 and less homogeneously between the different classes of commodity.

As the global economic growth rate and inflationary risks diminished, the priorities of economic policy were sustaining economic growth and mitigating financial risks. The serious disruption of the climate of confidence adversely affected the regular operation of the financial markets, with highly significant risks to the funding of the European economies. The growing breakdown of the interbank markets and reduced activity in the debt markets resulted in the European Central Bank lowering interest rates to 1%, intervening in the secondary European sovereign debt markets and strengthening liquidity mechanisms (unlimited lending for three years, reduction by half of minimum cash reserves and review of securitisation eligibility criteria) in order to restore greater efficacy to the mechanism for transmitting monetary policy to the economy. The implicit rates in the futures markets suggest that interest rates will remain low for a long time.

II.3. Portugal

In 2011, the structural imbalances in the Portuguese economy became predominant. High levels of public and private borrowing in a scenario of low economic growth and deterioration in perception of the country's sovereign debt credit risk drove funding conditions to a sate where they were unaffordable and prompted a request for international financial assistance in April. Since then, the economic and financial scenario in Portugal has been governed by the European Union and International Monetary Fund Economic Adjustment Programme.

In promoting financial stability, the economic adjustment plan sets out goals for reducing the transformation ratio (the ratio between credit and deposits), reinforcement of capital and liquidity ratios in the financial system and a reduction in external finance needs. These conditions are considered necessary to ensure renewed access to the international debt markets in 2013. During this adjustment period, there will be limited capacity to replace the current financing structure by stable domestic funds, i.e. funds less sensitive to changes in perceived risks by international investors. The funding of the economy will therefore continue to be institutional (European funds and ECB) and will evolve on the basis of the balance achieved between the deleveraging process and the adverse collateral effects on economic activity and the production sector.

Progressively weaker domestic demand has accentuated the recession that the Portuguese economy has been experiencing since the first quarter of 2011. Private and public consumer and investment expenditure fell substantially as a reflection of the correction of unsustainable financial imbalances and the considerable rise in current and future taxation. A contraction in economic activity throughout the year (1.6% fall in gross domestic product (GDP) in real terms) was mitigated by more favourable performance in net external demand. A highly favourable performance in exports and a more pronounced contraction in imports resulted in a substantial reduction in the Portuguese economy's financing needs in 2011. At the end of the year, there was a balance in the Portuguese economy's external current accounts, a rare occurrence but demonstrative of its capacity for adjustment. The public sector deficit totalled 4.2% of GDP, in line with the targets set in the adjustment programme (5.9% of GDP), though non-recurring operations were used, the most important of which being the transfer of part of the banks' pension funds to the state. In spite of these exceptional operations, the underlying structural adjustment in public finances was very substantial (around 3.5 pp of GDP). An adjustment of a similar size is expected for 2012 in order to meet the programme targets and help keep the sustainability of Portuguese debt on track. Unemployment rose at the end of the year (employment down 3% year-on-year) and the unemployment rate exceeded 14% of the population of working age. This unfavourable dynamic is expected to continue in 2012 in view of the forecast weakness of economic activity.

The fiscal consolidation necessary in 2012 (with objective effects on household incomes), the risk of slowdown in external demand and persisting major limitations on access to funding will condition spending and investment capacity, with negative impacts on production capacity, employment and the financial position of households and companies. Economic projections agree that there will be a drop in real GDP of around 3% in 2012. The performance of external demand and more attractive Portuguese products and services are crucial in this context in order to avoid a more negative scenario that hinders the current economic and financial adjustment process.

This background poses highly significant challenges to the banking business in terms of volumes of activity, business margins, quality of assets on the balance sheet and return, plus more demanding regulatory requirements in the deleveraging process and increase in solvency.

III. Legal and regulatory framework

This Activity Report includes three annexes setting out the legal and regulatory changes relevant to the activity of the APB Members in 2011. Annex A contains a chronological list of laws and regulations that came into force in Portugal. Annex B sets out the international initiatives regulating the financial system that had the highest relevance for the banking sector. Annex C completes this information with changes made to international accounting standards.

III.1. Laws and regulations in Portugal

The legal and regulatory framework governing banking activity underwent a number of changes in 2011. The new laws, which are listed and summarised in Annex A, came from authorities in Portugal, such as parliament (laws), the government (decree-laws, ministerial orders), Banco de Portugal (instructions, notices and circulars), the Portuguese Securities Market Commission (regulations and instructions) and Insurance and Pension Funds Supervisory Authority (regulatory standards). 2011 was particularly rich in profound changes, as it coincided with the implementation from May onwards of the European Union and International Monetary Fund Economic Adjustment Programme.

Two highly significant laws were introduced in Portugal even before the EAP. The first, Ministerial Order 121/2011, was published on 30 March and regulated the Levy on the Banking Sector. This levy is designed as an additional tax on the banking system and also to mitigate its systemic risks, in that the tax is only charged on highest-risk balance sheet liabilities (thereby excluding regulatory capital and deposits covered by the Deposit Guarantee Fund. The second was a Banco de Portugal notice on 5 April, which raised the minimum capital requirements for banks. The institutions affected were required to have a core Tier 1 ratio of 8% as of 31 December 2011, while the previous limit, also 8%, covered own funds in their entirety.[5]

After the EAP came into effect, there were three legal changes with a significant effect on the banks. They were related to minimum capital ratios, interest rates on deposits and the rules on liquidation of credit institutions.

The first change was made on 10 May, when Banco de Portugal (BdP) published Notice 3/2011 to replace that of 5 April, with another increase in minimum capital ratios. The banks were now required to have a core Tier 1 ratio of 9% by the end of 2011 and 10% as of 31 December 2012.

On 18 October, Banco de Portugal published Notices 7/2011 and 8/2011, which limited the growing trend in competition between the banks as they raised interest rates offered on deposits to attract more customer resources and make up for the shortage of other forms of funding. The notices also determined that excessive interest on deposits would be considered a negative element

[5] For prudential purposes, total regulatory capital (also called total own funds) is the sum of Tier 1 capital (original own funds) and Tier 2 capital (additional own funds). Tier 1 capital consists of core Tier 1 capital (core original own funds) and Additional Tier 1 (non-core additional own funds).

in calculating the core Tier 1 ratio. The technical details of this measure are set out in Banco de Portugal Instruction 28/2011 and establish a maximum spread of 300 basis points against Euribor.[6]

The third important change had to do with the review of the system for the reorganisation and winding-up of financial institutions. Law 58/2011 of 28 November authorised the government to revise it so that it was characterised by three different phases of intervention - corrective, provisional administration and winding up. The final law was only published in 2012.[7]

Only the first and third of these three measures represent stages set out in the EAP Memorandum of Understanding of May 2011. The establishment of a limit for interest on deposits was a Banco de Portugal measure seeking to respond to the credit institutions' over-aggressive efforts to attract deposits at the time. The deposit war broke out as a result of the banks' difficulty in arranging alternative sources of finance (e.g. on the interbank and/or capital market).

Finally, in view of the challenges facing the Portuguese banks in an adverse economic scenario, the Memorandum of Understanding reinforced two existing lines of support for the banking sector: an extraordinary state guarantee on the issue of bonds by banks in Portugal and a fund for recapitalisation[8] operations aimed at increasing the credit institutions' financial solidity. The former was designed to mitigate the problem of access to financing markets, and the EAP allowed the banks to issue state-guaranteed debt to a maximum of 35 billion euros. The guarantees approved in this regard totalled 11.825 billion euros in 2011. The latter stipulated that, of the 78 billion euros made available to Portugal in the EAP, 12 billion could be used to recapitalise the banks in order to ensure that they all complied the strictest core Tier 1 ratio. The actual conditions of access to this line were only made known in 2012, when the ministerial order was published.[9] Some banks announced in 2012 that they would be needing to resort to this assistance.

III.2. International initiatives regulating the financial sector[10]

The reform of the financial system made important advances on an international scale in 2011. In particular, in the European Union the new supervision architecture came into effect, important steps were taken towards strengthening the single rule book and implementation of the Basel III rules began. Elsewhere, the most significant progress occurred in the areas of systemic risk and shadow banking.[11]

[6] In 2012 an additional instruction was published making this decision even tougher by reducing the maximum spread for deposits of less than nine months.
[7] This revision was made via Decree-Law 31-A/2012 of 10 February, making the necessary adaptations to the Legal Framework on Credit Institutions and Financial Companies (RGICSF).
[8] Before the start of the EAP, although they involved different amounts, these two measures were introduced into the legal framework by Law 60-A/2008 of 20 October 2008 and Law 63-A/2008 of 24 November 2008, respectively.
[9] Ministerial Order 150-A/2012 was published in *Diário da República* on 17 May 2012.
[10] The APB website contains links to the international regulation initiatives on http://www.apb.pt/sistema_financeiro/reforma_do_sistema_financeiro. They are divided according to progress, i.e. approved legislation, draft legislation or public consultation phase.
[11] Parallel banking system.

1 January 2011 marked the start of the new supervision architecture in the European Union. It comprises a macro-prudential supervisory authority that monitors systemic risk in the financial system as a whole and three micro-prudential supervisory authorities that oversee the individual financial institutions in the banking, insurance and securities sectors. Unlike the old architecture, which had no macro-prudential aspect, the new micro-prudential supervisors have added powers, as they can issue binding technical standards that apply directly to the entire European Union. Furthermore, the micro-prudential authority responsible for the banking sector also conducts stress tests in the European Union. In 2011 it performed an exercise similar to the one conducted in 2010, although it was based on a different analysis approach.[12]

The new European Union supervisory architecture also reinforced the idea of a single rule book for the entire EU financial system. In 2011, great concern was shown for achieving this long-term goal, given the diversity of rules in the different Member States. A direct reflection of this concern was the simultaneous publication of a directive and a regulation in several regulatory initiatives. Since a regulation has the same immediate legal effects throughout the European Union, while a directive must be transposed into each country's law leaving leeway for some discretion and gold plating[13] by each member country, the joint publication of the two instruments shows a greater concern for defining common rules for all, as far as possible. Examples of the publication of a directive and regulation occurred in the areas of prudential capital regulation, financial markets, insider trading and rating agencies.

The European initiative that attracted most attention in 2011 was, however, the implementation and transposition of the new prudential regulation of banks, called Basel III. In July 2011, the European Commission published a Draft Directive (the fourth version of the Capital Requirements Directive,[14] first issued in 2006) together with a Draft Regulation (the Capital Requirements Regulation, or CRR). The European authorities are expected to approve the final versions of the CRD IV and CRR in 2012 and they should come into effect on 1 January 2013, in line with the Basel Committee on Banking Supervision (BCBS) plan for the start of Basel III.

There were two significant initiatives elsewhere in the world. The first resulted in a recommendation on additional capital requirements for more globally systemic banks from the BCBS and the Financial Stability Board (FSB). This new recommendation may result in an addition of 1% to 2.5%, with the possibility of going up to 3.5% in extreme cases in the core Tier 1 ratio. The addition is determined on the basis of a scoring system for each bank's systemic risk. The final document for this methodology was published in November 2011 and it now remains for each jurisdiction to transpose the requirement into law. As with Basel III, the BCBS and FSB wish this measure to be fully operational in January 2019 and it will be gradually implemented as of January 2016.

The second of these initiatives came from the FSB and concerns shadow banking. Its aim is to correct situations in which financial institutions with similar activities to banks are not covered by similar regulations. The lack of regulation of certain types of institution or operation is normally considered one of the shortcomings that helped trigger the global financial crisis in 2007/08.

[12] See sub-chapter VII.5 Stress tests and European Capital Exercise, p. 141 for more detail.
[13] Gold plating is when a national lawmaker uses the transposition of a directive to implement a legal regime or obligation that goes beyond the provisions of the directive in question.
[14] The latest version is usually referred to as CRD IV.

III.3. Amendments to international accounting standards[15]

The revisions and amendments to the international financial reporting standards that were endorsed by the European Union and came into effect on 1 January 2011 are detailed in Annex C. The most important changes were in IAS 24, IAS 32 and IFRS 1.

IAS 24 was revised so as to clarify and simplify the definition of related parties. The change to IAS 32 laid down that the rights issued for the acquisition of a fixed number of equity instruments must also be treated as equity instruments. The amendment to IFRS 1 allowed entities adopting the IFRS for the first time to enjoy the same transition regime as in IFRS 7, when comparative years begin before 31 December 2009.

The IASB also issued new interpretations (IFRIC Interpretations) introducing some matters that were omitted from the standards or required a more detailed explanation. There were also some changes to the IFRSs as a result of the Annual Improvement Project improving and clarifying their wording.

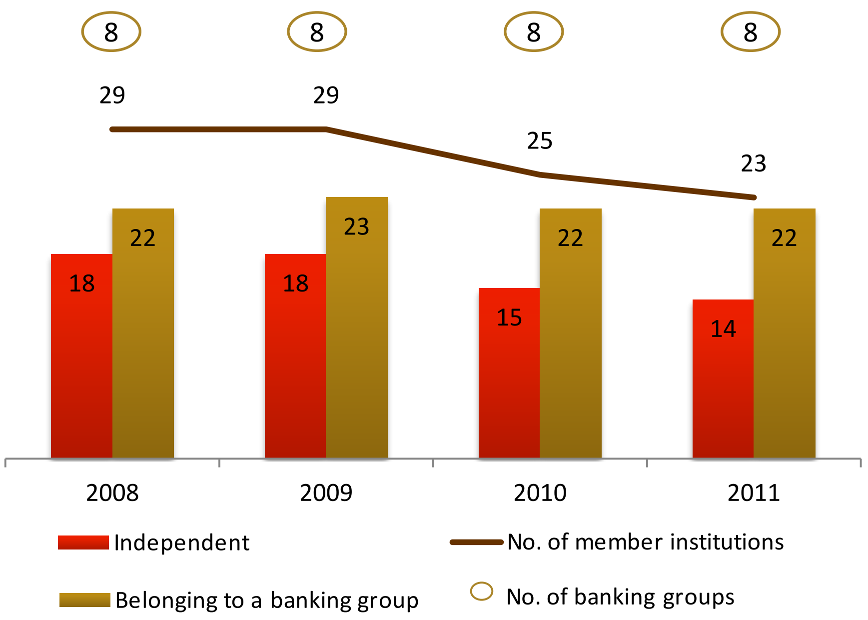
[15] The-international accounting rules comprise the International Accounting Standards (IAS) laid down by the International Accounting Standards Committee (IASC) and the International Financial Reporting Standards (IFRS) defined by the International Accounting Standards Board (IASB), which took over 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.

IV. Analysis of APB member institutions

IV.1. Number of institutions

Since it was founded in 1984, the Portuguese Banking Association's main concern has always been to represent the Portuguese banking sector in general and its Members in particular. The APB started out with only its 17 founding banks but over the years a growing number of financial institutions showed an interest in joining. Taking account of the changes that have taken place in its membership over time, at the end of 2011 the APB had 23 Members representing 36 financial institutions.[16] It is not practical to show all the changes that have taken place since the foundation of the APB, so there follows a brief summary of the events of the last four years.

Graph 1: Number of independent institutions and institutions belonging to banking groups, among the APB Members as at 31 December (2008 – 2011)



Source: FIs, APB.

At the beginning of 2008, the APB had a total of 29 Members comprising 40 financial institutions. Twenty-two of them belonged to the banking groups Banif, BCP, BES, BNP, BPI, BPN, BST and CGD, while the other 18 were independent institutions. There were no events affecting membership during the year (see Chart 2, p. 17), so it remained unchanged at the end of 2008 (see Graph 1).

On the other hand, 2009 witnessed a number of relevant events (see Chart 2, p. 17). First, in order to consolidate their presence in certain market niches and some geographical areas, two member banks acquired other financial institutions. Banif SGPS, S.A. acquired Tecnicrédito, S.A. (which included Banco Mais, S.A.), enabling it not only to step up its experience and business activity in motor finance but also to increase its international exposure. Banco Cetelem, S.A. acquired

[16] See Chart 1, p. 3.

Cofinoga (Portugal), SGPS, S.A. (which owned Credifin – Banco de Crédito ao Consumo, S.A.). The purpose of this operation was to form a company of reference in consumer credit in Portugal. In addition to these operations, BNP Paribas acquired Fortis Banque (Belgium) following difficulties experienced by the Fortis Group during the 2008 crisis. Although this event took place outside Portugal, it had an impact on the APB Members through Portuguese Fortis's branch office (taken over by the BNP Group). Secondly, the two incorporations in 2009 had the effect of reducing the number of member institutions. Finally, Banco BIC joined as a new Member only a year after going into operation. After this, the APB had 41 member institutions consisting of 18 independent institutions and 23 belonging to eight banking groups (see Graph 1, p. 15) on 31 December 2009.

As in the previous year, there were several changes in the APB's membership in 2010 (see Chart 2, p. 17). Montepio Geral – Associação Mutualista took over Finibanco Holding SGPS, S.A. The total number of member institutions was not affected, though the acquisition resulted in the creation of a new banking group and the cancellation of two independent institutions. Banco Santander de Negócios Portugal, S.A. was also incorporated into Banco Santander Totta, S.A. which had the effect of reducing member institutions to 40 and eliminating a banking group. A new institution, BNP SS, joined as part of the BNP group and another four left: the Royal Bank of Scotland (RBS), as it ceased to operate in Portugal, Banco Privado Português (BPP), as it was being wound up, and Cetelem (which included Credifin), by its own decision. As a result, the APB had 37 member institutions, 41% of which were independent, while the rest belonged to banking groups (see Graph 1, p. 15).

Finally, 2011 was a relatively stable year (see Chart 2, p. 17). Besides an acquisition that had no effect on the number of member institutions, there was a merger between Caixa de Aforros de Vigo, Ourense e Pontevedra (Caixanova) and Caja de Ahorros de Galicia, Branch office. As this event resulted in the loss of one institution, the APB represented 36 financial institutions at the end of the year (see Graph 1, p. 15). In line with previous years, most of them (approximately 60%) were institutions belonging to banking groups (Banif, BCP, BES, BNP, BPI, BPN, CGD and Montepio).

Chart 2: Changes in the number of member institutions (2008 – 2011)

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
2008	• Santander Consumer Finance, S.A. [e] acquires more 11.8% of Banco Santander Consumer Portugal, S.A.´s share capital [d]	-	-	-	-	-	40 [c]
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
	• 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

Year	Acquisitions	Integrations / Mergers	New Entry	Exit	Change in the No. of Financial Institutions		Total
					B.Group [a]	Indep. [b]	
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		-1	40
	-	-	-	Cetelem	-2 [i]	-	38
	-	-	-	BPP		-1	37
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. [j]	-	-	-	-	-	37
	-	Merger between Caixanova [d] and Caja de Ahorros de Galicia, Branch office [d] [k].	-	-	-	-2 +1 [l]	36 [m]

Source: FIs, APB.

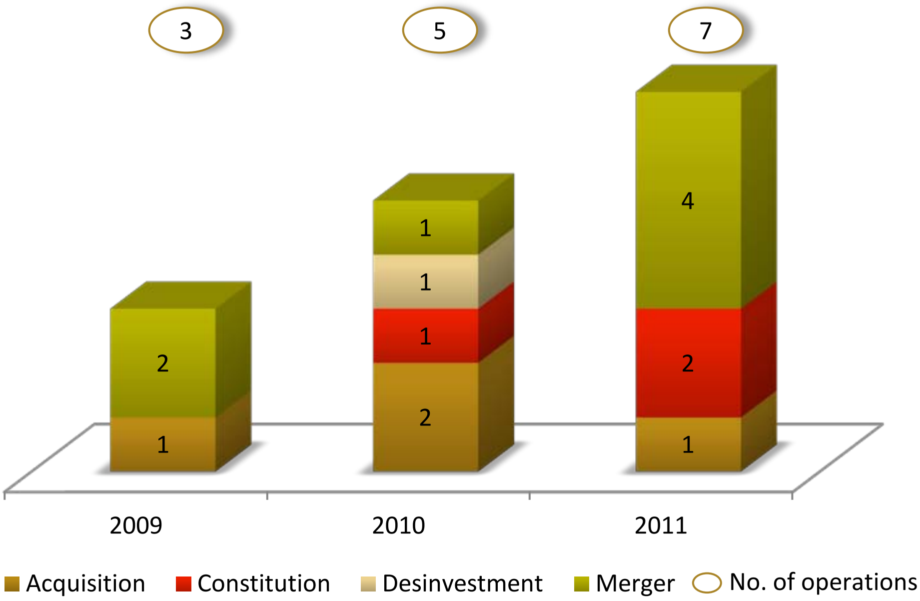
a) B.Group – Financial institutions integrated in banking group.
b) Indep. – Independent financial institution.
c) As at 31 December 2007 40 financial institutions constituted the group of APB members.
d) Member institution.
e) Non-member institution.
f) Tecnicrédito, S.A. owned 100% of Banco Mais, S.A. (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) Exit of Banco Cetelem, S.A. and of Credifin – Banco de Crédito ao Consumo, S.A.
j) This operation did not impact the total number of financial institutions, with both institutions being integrated in Montepio Group.
k) See Chapter I – Foreword, p. 1, for more details on this operation.
l) Two independent institutions no longer exist. Instead, only NCG Banco, S.A., Branch office in Portugal continues being independent institution.
m) For complete listing of 36 financial institutions integrated in APB Member Group as at 31 December 2011, consult Chart 1, p. 3.

IV.2. Restructuring and expansion operations

Restructuring and expansion operations are not only common but also occur in a wide range of industries, and the banking sector is no exception. Over the last three years, the member banks have proven this, as there were 15 operations between 2009 and 2011,[17] 46.7% of them in 2011 (see Graph 2).

Of the different reasons for member institutions to restructure or expand, the most important were international expansion and internal reorganisation (see Table 1, p. 21). The operations were of a different nature, but particularly took the form of mergers and acquisitions.

Graph 2: Number of restructuring and expansion operations by nature – acquisition, formation, disinvestment and merger (2009 – 2011)



Source: FIs, APB.

The value of the 15 operations totalled 1.391 billion euros,[18] with a particular contribution from disinvestment included in "Others", which refers to an operation during the sale of the insurance business by the group of a member institution. This operation was worth around 774 million euros (see Table 3 and Graph 3, p. 23). In individual terms, however, the amounts of each operation were small compared to the size[19] 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. 23).

[17] The restructuring operations analysed in this chapter were carried out by the 33 institutions in the sample on other financial institutions, in accordance with the following restrictions. Acquisitions may only include those resulting in a "percentage of capital held after the operation" of 20%, 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.
[18] This figure refers only to acquisition, constitution and disinvestment operations. Mergers were not included, as they are internal restructuring operations and their value has no impact in consolidated terms.
[19] Measured in terms of value of assets.

Table 1: Nature of restructuring and expansion operations by objective (2009 – 2011)

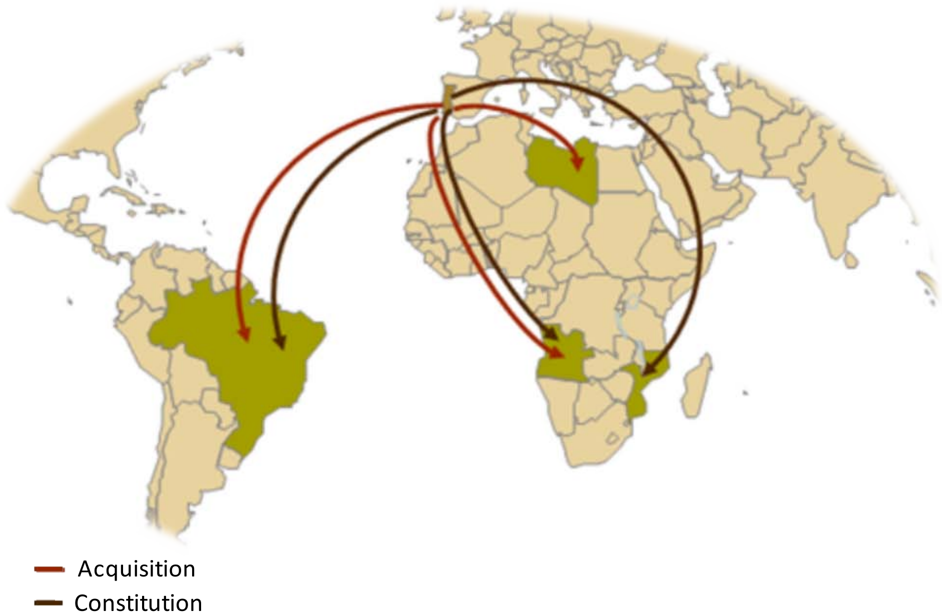
	2009	2010	2011	Total Nº	Total %
International expansion					
Acquisition	1	2	-	3	-
Constitution	-	1	2	3	-
Total	1	3	2	6	*40.0%*
Internal reorganisation					
Acquisition	-	-	1 [a)]	1	-
Merger	2	1	4	7	-
Total	2	1	5	8	*53.3%*
Other					
Disinvestment	-	1	-	1	-
Total	-	1	-	1	*6.7%*
Total	3	5	7	15	*100.0%*

Source: FIs, APB.

[a)] This operation relates to an acquisition made by APB member institution of another entity of its group. Consequently, the major part of the acquired institution was integrated in the acquiring institution.

Based on the available information, between 2009 and 2011 international expansion operations were of considerable relevance, given their increasing importance to growth in Portuguese banking activity, and accounted for 40% of the total (see Table 1). In the majority of these operations the member institutions entered or stepped up their presence in markets with cultural, economic or language ties to Portugal (see Figure 1).

Figure 1: International expansion by country and nature of operation (2009 – 2011)



Source: FIs, APB.

In 50% of the cases of internationalisation, expansion involved acquiring existing local entities, while the others entailed setting up operations from scratch (see Table 1, p. 21). In hardly any of these situations (except one acquisition and one constitution) did the member institutions or the group to which they belonged end up as the only shareholders of the entities acquired or set up. As a rule, by imperative of the country receiving the investment, the state and/or local private investors also maintained a holding in the companies. As a result, it was practically inevitable that the institutions had access to the knowledge and business relations of their local partners, which is decisive to the success of activities abroad.

In this internationalisation process, the member institutions have endeavoured to take advantage of the know-how that they have accumulated over the years, as they have expanded their networks of operations to business areas much the same as those in Portugal (see Table 2). Their expansion has therefore been motivated exclusively by geographical diversification.

These internationalisation operations totalled 275.701 billion euros. Each one is equivalent on average to only 0.1% of the member institution's assets (see Table 3 and Graph 3, p. 23).

Internal reorganisation operations accounted for 53.3% of the total (see Table 1, p. 21). The goal here was essentially to optimise the existing structure and available resources in the group, reduce costs and increase efficiency whenever possible.

Considering that the majority of these operations took place between institutions with similar business areas (see Table 2) and all involved total or partial incorporation[20] of the target institutions[21] into the member institution, we can say that, in this internal reorganisation, the groups focused on rationalisation of services and elimination of overlapping structures.

Table 2: Percentage of operations in member institutions´ identical business areas (2009 – 2011)

	Number of Operations	% of Operations in Member Institution´s identical business areas
International Expansion		
Acquisition	3	*100.0%*
Constitution	3	*100.0%*
Internal Reorganization		
Acquisition	1	*100.0%*
Merger	7	*85.7%*
Other		
Disinvestment	1	*0.0%*
Total	-	*86.7%*

Source: FIs, APB.

[20] Six mergers resulted in the total incorporation of the target institution into the member institution, while the other merger and acquisition resulted in partial, though almost total incorporation.
[21] The target institution means that which was acquired or merged.

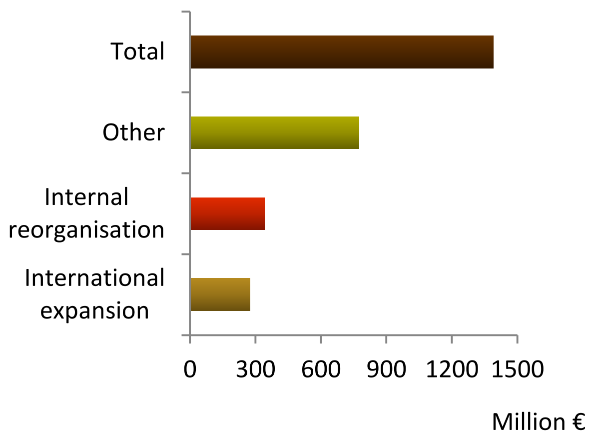
Table 3: Total amount and average weight of restructuring and expansion operations (2009 – 2011)

	Total amount (thousand €)	Average Weight of Each Operation
International Expansion		
Acquisition	91,655	*0.0%*
Constitution	184,046	*0.1%*
Total	275,701	*0.1%*
Internal Reorganization		
Acquisition	341,250	*1.4%*
Merger	-	-
Total	341,250	*1.4%*
Other		
Disinvestment	774,044	*0.8%*
Total	774,044	*0.8%*
Total	1,390.995	*0.3%*

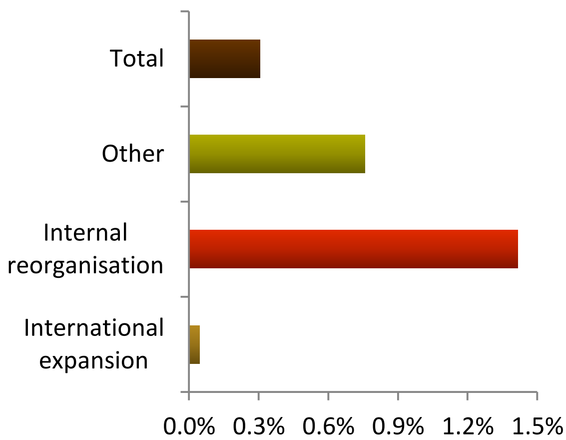
Source: FIs, APB.

Graph 3: Total amount and average weight of restructuring and expansion operations (2009 – 2011)

a) Total amount (million €)



b) Average weight of each operation



Source: FIs, APB.

IV.3. Representativity and characterisation of institutions

The Portuguese Banking Association consists of a group of monetary financial institutions that is highly representative of the joint activity of the Portuguese banking system (PBS). As at 31 December 2011, the 23 APB Members represented just over one fifth (21.9%) of the total number of banks in the PBS (105). They were, however, responsible for 96% of the sector's total business activity (measured as the value of consolidated banking activity) (see Table 4, p. 24).

As in 2010, this representativity was not homogenous between groups of different origins /type of legal structure.

As shown in Table 4, there were few domestic companies in the PBS that were APB Members in 2010 and 2011 (only 20.3% and 18.8% respectively). Nonetheless, they dominated almost all the activity in the domestic segment (their assets as a percentage of PBS assets represented 98.6% in both years).

Where branch offices were concerned, more than half the entities in the Portuguese banking system were represented in the APB (see Table 4). In spite of a lower percentage than in the case of domestic entities, member subsidiaries accounted for the lion's share of activity in the segment in the PBS (94.8% in 2010 and 93.8% in 2011).

Table 4: Representativity of the APB member institutions in the Portuguese banking system by origin/type of legal structure as at 31 December (2010 – 2011)

	Portuguese Banking Association (APB)		Portuguese Banking System (PBS)		APB as % of Total PBS	
	2010	2011	2010[22]	2011	2010	2011
Em No. of Entities[23]						
Domestic	14	13	69	69	*20.3%*	*18.8%*
Subsidiary	6	5	10	9	*60.0%*	*55.6%*
Branch office	5	5	31	27	*16.1%*	*18.5%*
Total	25	23	110	105	*22.7%*	*21.9%*
By Assets[24] (million €)						
Domestic	407,858	395,443	413,493	401,190	*98.6%*	*98.6%*
Subsidiary	74,380	64,444	78,495	68,733	*94.8%*	*93.8%*
Branch office	25,590[25]	32,628	39,718	43,246	*64.4%*	*75.4%*
Total	507,828	492,515	531,707	513,169	*95.5%*	*96.0%*

Source: BdP.

Finally, the number of branch offices in the APB in 2010 and 2011 was much lower than the segment's total in the PBS (16.1% and 18.5% respectively) (see Table 4). Even so, a substantial part of activity in this segment was represented by the APB (64.4% in 2010 and 75.4% in 2011).

In short, the APB represents most of the activity of the entities in the PBS. The average for the last two years was 98% for Portuguese companies (domestic and subsidiaries) and around 70% for branch offices.

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[22] The figures in this column for the number of entities and PBS assets do not coincide with those published in Activity Report 46 (2010), firstly because the method for calculating the number of entities was changed in 2011. 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. Secondly, the figures shown for the PBS were not estimated, unlike in the previous report; they were provided to the APB by Banco de Portugal. Furthermore, the total amount of assets for the PBS in 2010 does not coincide with that in the previous report due to a subsequent adjustment made by Banco de Portugal.

[23] In the case of the APB, the entities are its Members.

[24] 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 with head office in Madeira off-shore” published by Banco de Portugal (BP*stat*).

[25] This figure does not coincide with that in Activity Report 46 (2010) due to an adjustment made by Banco de Portugal to the data sent last year.

Table 5: Characterisation of member institutions as at 31 December 2011

	No. of Financial Institutions	As % of Total	Aggregate Assets (million €)	As % of Total
By origin/type of legal structure				
Domestic	21	*63.6%*	401,987	*80.2%*
Subsidiary	5	*15.2%*	68,367	*13.6%*
Branch office[26]	7	*21.2%*	31,124	*6.2%*
By size[27]				
Large	5	*15.2%*	369,495	*73.7%*
Medium-sized[28]	8	*24.2%*	103,359	*20.6%*
Small	20	*60.6%*	28,624	*5.7%*
By business area[29]				
Multi-specialised	23	*69.7%*	478,877	*95.5%*
Specialised	10	*30.3%*	22,601	*4.5%*
Total	33	*100.0%*	501,478	*100.0%*

Source: FIs, APB.

Referring exclusively to member institutions and not the 23 Members, the base sample of the report consisted of 33 institutions that owned assets (hereinafter referred to as aggregate assets) totalling 501.478 billion euros[30] (see Table 5) on 31 December 2011. The majority of the sample was domestic with multi-specialised activity.

As shown in Table 5, the domestic segment carried the most weight among the institutions (63.6%), with a market share of 80.2%. It was followed by branch offices, which accounted for 21.2% of all institutions in the sample. Curiously, in terms of aggregate assets, branch offices had the lowest (only 6.2%), while subsidiaries' volume of activity was twice as high (13.6%).

As mentioned above, where business area was concerned, the majority of the institutions in the sample were multi-specialised (69.7%), as also reflected in their total aggregate assets (95.5%).

With regard to size, the sample was relatively asymmetrical (see Graph 4, p.26). Although average assets totalled around 15.67 billion euros, only eight institutions (24.2%) had assets exceeding this figure. It is thus a biased sample dominated in number by smaller financial institutions (3rd quartile = 13.954 billion euros).

[26] In 2011, includes Deutsche Bank, which went from subsidiary to branch office.

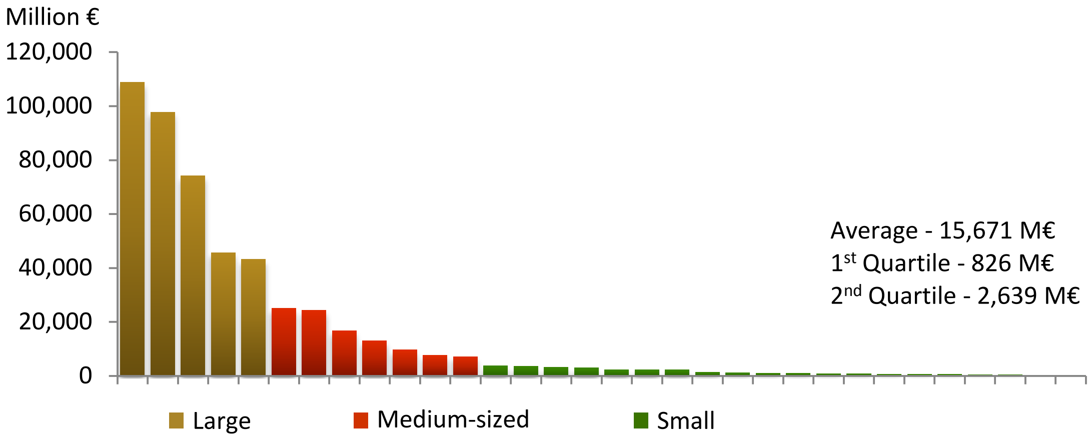
[27] Large financial institutions are those that represent 5% or more of aggregate assets, medium-sized institutions represent 1% to 5% and small account for 1% or less.

[28] In 2011, includes Finibanco, which went from small to medium-sized after acquisition by Montepio.

[29] 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.

[30] Aggregate assets are not comparable to total assets shown for the APB in Table 4, p. 24 (see footnote 24, p. 24), as they are the simple sum of the balances on the member institutions' separate balance sheets.

Graph 4: Aggregate assets by size das member institutions as at 31 December 2011[31]

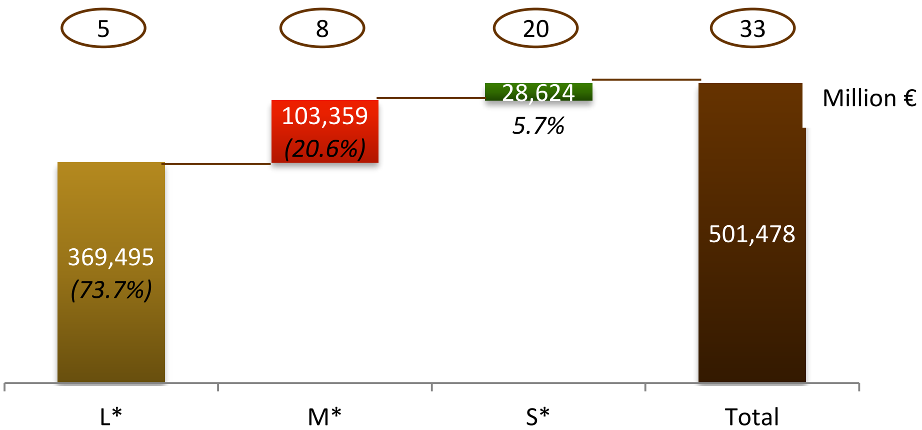


Source: FIs, APB.

As shown in Graph 5 and Table 5, p. 25, however, the 20 small institutions accounted for only a negligible part of the market in terms of activity (5.7%). On the other hand, the five large financial institutions dominated with 73.7% of activity in the sample.

It we combine the market share of the large and medium-sized institutions (94.3%), it is even clearer that banking activity is highly concentrated in a small number of entities (13, or 39.4% of the total) (see Graph 5). This does not, however, jeopardise the degree of competition, as the market shares in each segment (large and medium-sized) are fairly evenly distributed among the institutions (see Graph 4). This is reflected in the Herfindahl index,[32] as its score of 1303 indicates moderate market concentration.

Graph 5: Concentration of aggregate assets by size of member institutions as at 31 December 2011



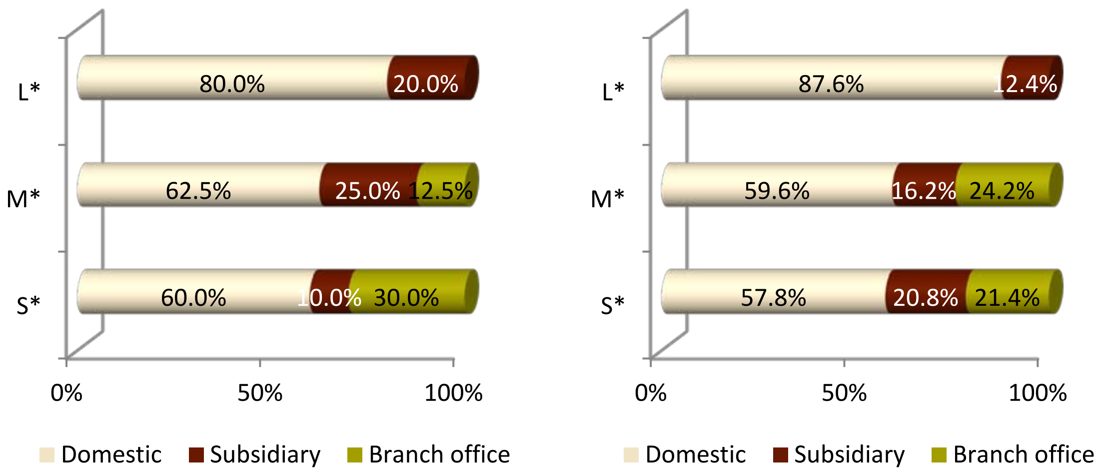
Source: FIs, APB.
Note: L* - large; M – Medium-sized; S – small
No. of member institutions

[31] In this graph, Montepio and Finibanco were considered a single institution.
[32] This figure was obtained by adding the square of the market shares of the 33 financial institutions in the sample measured in terms of assets. As a rule, a score of under 1000 indicates low concentration, 1000 to 1800 moderate concentration and above 1800 high concentration.

Graph 6 also shows that institutions set up under Portuguese law, especially domestic institutions, predominated in total number and value of aggregate assets in all size categories at the end of 2011. Branch offices were the least expressive in number, with none in the large institutions.

Graph 6: Characterisation of member institutions by size and origin/type of legal structure as at 31 December 2011

(a) In terms of total institutions **(b) In terms of aggregate assets**



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

Finally, if we cross-reference each segment's size and business area, we find that the large and medium-sized institutions were mainly multi-specialised. Multi-specialised institutions were in the majority in the small segment in terms of number, while specialised institutions were greater in terms of assets.

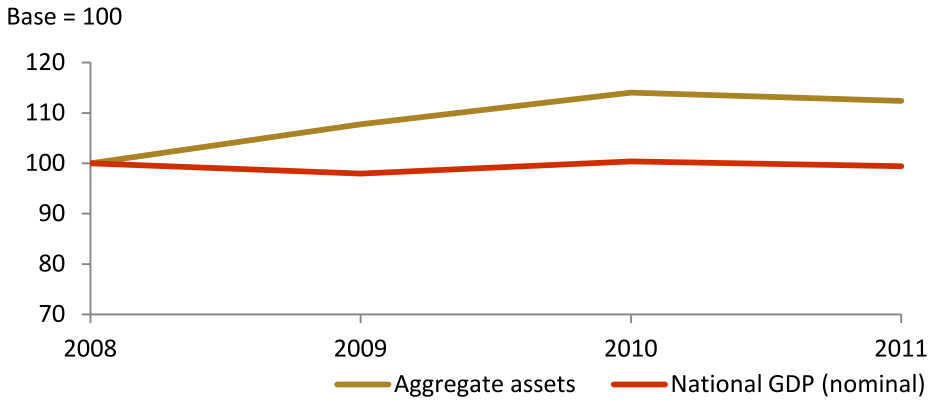
IV.4. Aggregate assets

As mentioned above, 2011 witnessed the exacerbation of the sovereign debt crisis in the euro area and a downward turn in global growth prospects. There was another important milestone in Portugal – the request for foreign financial assistance.

At the beginning of the year, there was a significant deterioration in Portugal's conditions of access to the international financial markets and in April the country had no other course but to request foreign financial assistance. The national economy then began a process of adjustment and correction of structural imbalances, mostly by means of more restrictive fiscal policies, deleveraging of the private sector and measures to guarantee the stability of the banking system.

As a result of this scenario, there was a decline in domestic demand in Portugal in 2011. Even though this was partially offset by growth in the export of goods and services, the final balance for the year was negative and the Portuguese economy contracted 1% in nominal terms (see Graph 7 and Table 6, p. 28).

Graph 7: Aggregate assets and national GDP (2008 – 2011)



Source: FIs, Statistics Portugal.

Table 6: Aggregate assets and national GDP (2008 – 2011)

	2008	2009	2010	2011	Average
Aggregate assets					
Total (million €)	445,346	479,771	507,799[33]	500,472	-
Annual growth rate	-	*7.7%*	*5.8%*	*-1.4%*	*4.0%*
National GDP (Nominal)					
Total (million €)	171,983	168,504	172,670[P]	171,016[P]	-
Annual growth rate	-	*-2.0%*	*2.5%*	*-1.0%*	*-0.2%*
Aggregate Assets as % of GDP	*258.9%*	*284.7%*	*294.1%*	*292.6%*	*282.6%*

Source: FIs, APB, Statistics Portugal.

Note: P – preliminary data

As was to be expected, the external and internal circumstances in 2011 had repercussions on the financial sector's activity. Firstly, while on the one hand the need to reduce the credit/deposits[34] ratio required an increase in efforts to attract customer deposits, on the other hand it placed pressure on the grant of loans. Secondly, the requirement to increase solvency[35] levels accentuated the need to deleverage banking activity, as difficulty in recourse to the capital markets on normal conditions mean that the financial institutions had to achieve this goal by selling non-core assets, reducing their credit portfolio and/or reducing the average risk of their assets.

Because of these limitations, the member institutions' volume of business activity contracted[36] 1.4% in 2011, going against the expansion trend of previous years (see Graph 7 and

[33] This figure for aggregate assets does not coincide with that in Activity Report 46 (2010) due to an adjustment made by Banif, S.A. to its accounts as at 31 December de 2010. This change resulted from a correction to the statement of bonds held in non-derecognised securitisation operations and was published in the bank's 2011 six-monthly report.

[34] The eight largest banking groups are expected to achieve a credit/deposit ratio of 120% by the end of 2014.

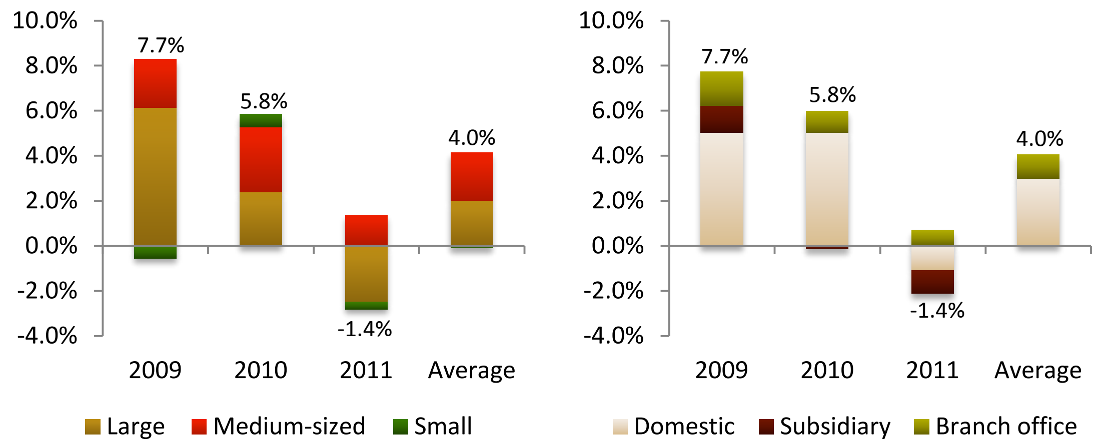
[35] The FAP required the banks to achieve a core Tier ratio of 9% and 10%, at the end of 2011 and 2012 respectively.

[36] Analyses over time (2008 – 2011) include 31 financial institutions out of the 33 institutions making up the sample in this report. BNP SS and Banco BIC were excluded as there was no historical information on them for 2008.

Table 6, p.28). As this decrease was greater than that in the country's GDP in 2011, the member institutions' weight in its economy went down 1.5 pp[37] from 294.1% to 292.6% (see Table 6, p.28).

Graph 8: Contribution from member institutions to growth in aggregate assets (2009 – 2011)

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



Source: FIs, APB.

Table 7: Contribution from member institutions to growth in aggregate assets by size and origin/type of legal structure (2009 – 2011)[38]

	2009	2010	2011	Average
By size				
Large	6.1%	2.4%	-2.5%	2.0%
Medium-sized	2.2%	2.8%	1.4%	2.1%
Small	-0.6%	0.6%	-0.3%	-0.1%
Total	7.7%	5.8%	-1.4%	4.0%
By origin / Type of Legal Structure				
Domestic	5.0%	5.0%	-1.1%	3.0%
Subsidiary	1.2%	-0.2%	-1.0%	0.0%
Branch office	1.5%	1,0%	0.7%	1.1%
Total	7.7%	5.8%	-1.4%	4.0%

Source: FIs, APB.

The fall in aggregate assets in 2011 was mainly due to contractions in the large institutions' balance sheets (see Table 7). Overall, the small institutions also contributed to the decrease in aggregate assets, though there was no homogeneous trend within the segment.

[37] Aggregate assets reflect the member institutions' domestic activity and business abroad (through branch offices and/or representative offices), which should be taken into account when comparing them with GDP figures.

[38] In 2011, the status of Deutsche Bank changed from subsidiary to branch office and Finibanco went from being a small to a medium-sized institution. For the sake of comparison, these institutions were reclassified retroactively into their new category so that growth in aggregate assets could be measured over time.

The large segment made a negative contribution for the first time compared to the previous two years. Nonetheless, it was one of the main groups responsible (2%) for the average growth in aggregate assets over the three years (4%). On the other hand, the small institutions have been the only ones to exert negative pressure (-0.1%) on average aggregate assets since 2009 (see Table 7, p. 29).

The medium-sized institutions were the only ones to make a positive contribution to aggregate assets last year. Even so, not all of them did so, and essentially two institutions contributed 1.4% (see Table 7, p.29). Historically, this segment is also the only one that has always favoured growth in aggregate assets, which has been reflected by its growing market share (against the small and especially the large institutions) (see Table 8). Nonetheless, 2011 witnessed a slowdown, as the 1.4% contribution was much lower than in 2009 and 2010 (see Table 7, p. 29).

Table 8: Aggregate assets by size and origin/type of legal structure as at 31 December (2008 – 2011)

	2008	2009	2010	2011	Average
By size					
Grande					
Assets (million €)	343,352	370,656	382,126	369,495	-
Annual growth rate	-	*8.0%*	*3.1%*	*-3.3%*	*2.6%*
Market share	*77.1%*	*77.3%*	*75.2%*	*73.8%*	*75.9%*
Medium-sized					
Assets (million €)	72,950	82,561	96,380	103,359	-
Annual growth rate	-	*13.2%*	*16.7%*	*7.2%*	*12.4%*
Market share	*16.4%*	*17.2%*	*19.0%*	*20.7%*	*18.3%*
Small					
Assets (million €)	29,044	26,554	29,293	27,618	-
Annual growth rate	-	*-8.6%*	*10.3%*	*-5.7%*	*-1.3%*
Market share	*6.5%*	*5.5%*	*5.8%*	*5.5%*	*5.8%*
By origin/type of legal structure					
Domestic					
Assets (million €)	360,026	382,414	406,519	400,989	-
Annual growth rate	-	*6.2%*	*6.3%*	*-1.4%*	*3.7%*
Market share	*80.8%*	*79.7%*	*80.1%*	*80.1%*	*80.2%*
Subsidiary					
Assets (million €)	69,010	74,311	73,616	68,367	-
Annual growth rate	-	*7.7%*	*-0.9%*	*-7.1%*	*-0.1%*
Market share	*15.5%*	*15.5%*	*14.5%*	*13.7%*	*14.8%*
Branch office					
Assets (million €)	16,310	23,046	27,664	31,116	-
Annual growth rate	-	*41.3%*	*20.0%*	*12.5%*	*24.6%*
Market share	*3.7%*	*4.8%*	*5.4%*	*6.2%*	*5.0%*
Total	445,346	479,771	507,799	500,472	-

Source: FIs, APB

Table 7 and Graph 8, p. 29 also show that the branch office segment was the only one that made a favourable contribution to aggregate assets (0.7%) in 2011. In historical terms, this contribution has been consistent (1.1% on average), in spite of the deceleration that began in 2010.

The negative contribution made by domestic institutions in 2011 (-1.1%) contrasts considerably to their input in 2009 and 2010, when they were the ones that most boosted aggregate assets (5%). Even so, over the three years, it was still this segment that contributed most to the member institutions' growth in overall activity (3%).

In contrast, subsidiaries had no impact at all on aggregate assets, on average. Their negative contributions in 2010 and 2011 (-0.2% and -1%) totally cancelled out their positive contribution in 2009 (1.2%). As a result, this segment has been losing market share, particularly in favour of branch offices (see Table 8, p. 30).

In short, the performance of aggregate assets in recent year has essentially been boosted by large and medium-sized institutions and institutions of domestic origin.

V. Human resources

V.1. Characteristics and changes

2011 was an exceptionally difficult year in economic and financial terms, especially in the banking sector and in Portugal in particular. In view of this scenario, cost reduction policies were mandatory, with effects on member institutions' workforces. As a result, last year the overall number of employees fell around 2.2% to 57,130[39] at the end of 2011 (see Table 9).

Nonetheless, the situation that led to this reduction in Portugal stimulated member institutions to seek growth alternatives abroad. As a result, the number of employees assigned to international activity increased substantially by 9.5%, partially offsetting the 2.6% fall in banking personnel in domestic activity. This reduction also consolidated the downward trend of 2009 and 2010. However, as it was very slight in these two years, it was not particularly relevant in relation to the increase in employees abroad.

This performance led to a reduction in the proportion of employees working in domestic activity in the total workforce. As of 2008 their representativity fell 0.9 percentage points to 96.1% at the end of 2011 (see Table 9).

Table 9: Number of employees as at 31 December (2008 - 2011)[39]

	2008		2009		2010		2011		Average
Global Number of Employees									
Total	58,194		58,277		58,412		57,130		-
Annual growth rate	-		*0.1%*		*0.2%*		*-2.2%*		*-0.6%*
In Domestic Activity									
Total	56,460	*97.0%*	56,427	*96.8%*	56,385	*96.5%*	54,911	*96.1%*	-
Annual growth rate	-		*-0.1%*		*-0.1%*		*-2.6%*		*-0.9%*
In International Activity									
Total	1,734	*3.0%*	1,850	*3.2%*	2,027	*3.5%*	2,219	*3.9%*	-
Annual growth rate	-		*6.7%*		*9.6%*		*9.5%*		*8.6%*

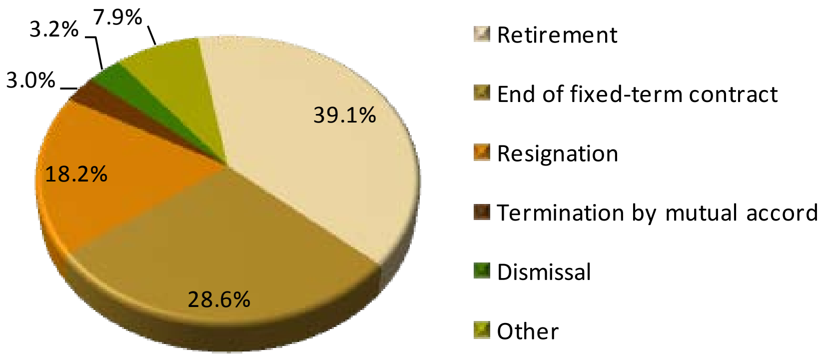
Source: FIs, APB.

The decrease in the number of employees in domestic activity in 2011 was caused by the replacement of just under 50% of the 2,742[40] employees who left, a policy resulting from the contraction in activity. Retirement was the main reason for these employees leaving, accounting for 39.1% of cases, almost 85% being due to early retirement however. The end of fixed-term contracts accounted for 28.6% of employees leaving, while resignations and termination by mutual accord were responsible for 21.2%. Dismissals accounted for only 3.2% (see Graph 9, p.34).

[39] The sample used for the analysis of growth (2008 - 2011) has been adjusted to 31 financial institutions by the additional exclusion of BNP SS and Banco BIC for the reasons pointed out in footnote 36, p.28.

[40] The sample used for analysis of the reasons for employees leaving has been adjusted to 32 financial institutions because Barclays did not provide the data and was therefore not included.

Graph 9: Reasons for employees´ leaving in 2011



Source: FIs, APB.

An analysis by size[41] shows that it was only in the small financial institutions that the variation in number of employees was different from the rest of the sample in 2011, as personnel in domestic activity grew 1.8% (see Table 10). Given the segment's weight in the sample, it made a minimal contribution to the growth rate in number of employees (only 0.1%) (see Table 10).

Although more modestly, this performance reflects a continuing trend towards growth in this segment since 2010 and contributed to an increase in its representativity in the sample in terms of the number of employees (see Graph 11 a), p. 36). A substantial contribution to this came from domestic institutions in the segment, via growth in specialised business areas and distribution channels, especially electronic and investment banking.

Table 10: Number of employees in domestic activity by size as at 31 December (2008 - 2011)

	2008	2009	2010	2011	Average
Large					
Total	39,272	38,737	38,383	37,504	-
Annual growth rate	-	*-1.4%*	*-0.9%*	*-2.3%*	*-1.5%*
Contribution to growth in the number of employees	-	*-1.0%*	*-0.7%*	*-1.6%*	*-1.1%*
Medium-sized					
Total	14,640	15,207	15,407	14,765	-
Annual growth rate	-	*3.9%*	*1.3%*	*-4.2%*	*0.3%*
Contribution to growth in the number of employees	-	*1.0%*	*0.4%*	*-1.1%*	*0.1%*
Small					
Total	2,548	2,483	2,595	2,642	-
Annual growth rate	-	*-2.6%*	*4.5%*	*1.8%*	*1.2%*
Contribution to growth in the number of employees	-	*-0.1%*	*0.2%*	*0.1%*	*0.1%*

Source: FIs, APB.

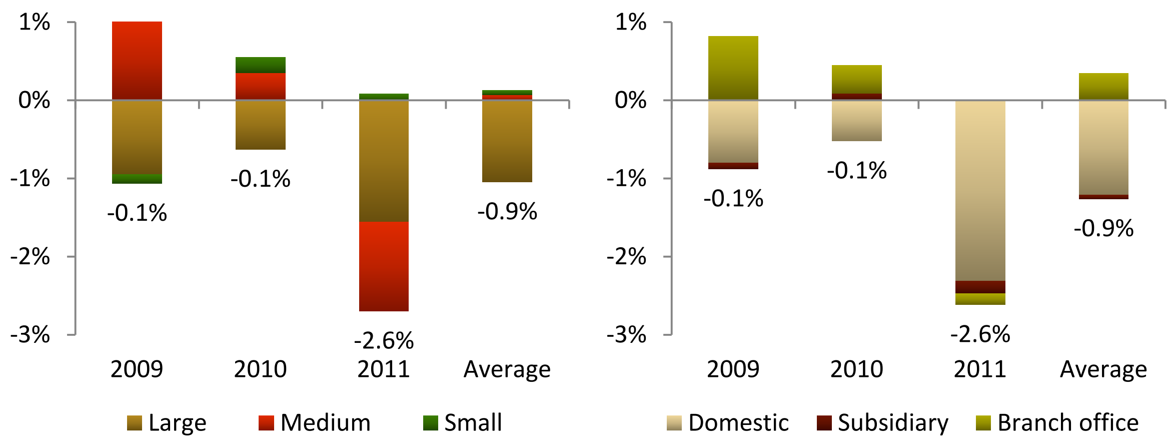
[41] This report has reclassified the sample with regard to the size of the member institutions for the reason given in footnote 28, p.25. The segments analysed here are therefore not directly comparable to those in Activity Report 46 (2010), as Finibanco, which was a small institution, was reclassified as medium-sized.

The large and medium-sized financial institutions showed decreases in their numbers of employees (-2.3% and -4.2%, respectively) and substantial contributions (-1.6% and -1.1%, respectively) to sector's performance (see Table 10, p.34) in 2011. Their development from 2008 onwards was very different, however. The performance of the large financial institutions in 2011 reflects a continuing trend towards the decrease in number of employees that began in the previous two years (-1.2% on average). The reduction in workforce of the medium-sized institutions occurred in 2011 for the first time in the three-year period, following ongoing growth that, although it was decelerating, enabled them to record a average positive annual growth rate (0.3%) (see Table 10, p. 34 and Graph 10a)).

A characterisation of the member institutions based on origin or type of legal structure[42] shows that all the segments contributed to the decrease in number of employees in domestic activity in 2011. The reduction in workforce was not, however, the same in all and was felt most among domestic institutions. The net decrease in number of employees of around 2.9% in 2011 accentuated the trend towards contraction that had been occurring, albeit on a smaller scale, since 2008 (see Table 11, p. 36). This was thus the segment that contributed most to the reduction in the number of employees in the sector in 2008-2011, with an average contribution of -1.2% to the annual average variation of -0.9% (see Graph 10 b)).

Graph 10: Contribution from member institutions to growth in the number of employees in domestic activity by size and origin/type of legal structure (2008 - 2011)

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



Source: FIs, APB.

The figures for the workforce of branch offices were substantially different from the above segment. The decrease in number of employees in 2011 (-2.6%) went against the high growth trend, although it was decelerating, since 2008. Even so, the branch offices achieved a fairly high annual average growth rate in the three-year period (7.8%) and were the only segment to increase (see

[42] This report has reclassified the sample with regard to origin and type of legal structure of the member institutions for the reason indicated in footnote 26, p. 25. The segments analysed here are not directly comparable to those in Activity Report 46 (2010), as Deutsche Bank, which was a subsidiary, is now included in branch offices.

Table 11). This performance shows these institutions' capacity for a rapid adjustment in human resource structure in the current scenario.

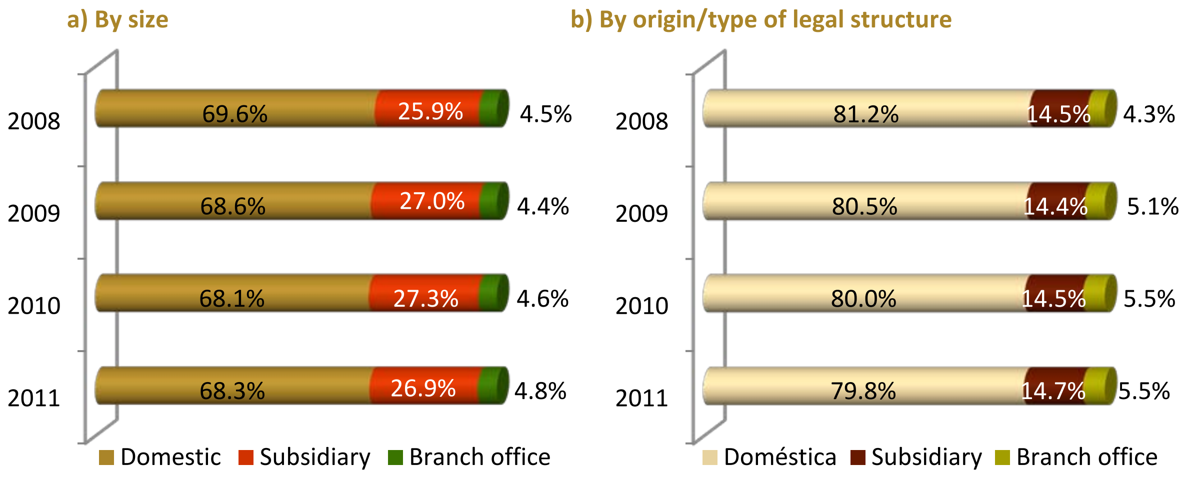
Table 11: Number of employees in domestic activity by size and origin/type of legal structure as at 31 December (2008 - 2011)

	2008	2009	2010	2011	Average
Domestic					
Total	45,872	45,419	45,125	43,820	-
Annual growth rate	-	*-1.0%*	*-0.6%*	*-2.9%*	*-1.5%*
Contribution to growth in the number of employees	-	*-0.8%*	*-0.5%*	*-2.3%*	*-1.2%*
Subsidiary					
Total	8,147	8,104	8,154	8,066	-
Annual growth rate	-	*-0.5%*	*0.6%*	*-1.1%*	*-0.3%*
Contribution to growth in the number of employees	-	*-0.1%*	*0.1%*	*-0.2%*	*-0.1%*
Branch office					
Total	2,441	2,904	3,106	3,025	-
Annual growth rate	-	*19.0%*	*7.0%*	*-2.6%*	*7.8%*
Contribution to growth in the number of employees	-	*0.8%*	*0.3%*	*-0.1%*	*0.4%*

Source: FIs, APB.

Due to the context described above, the proportion of domestic financial institutions in the number of employees in the sample has been decreasing successively, although they continue to account for most of the employment offered by the sector (see Graph 11b)). While in previous years it was the branch offices that took advantage of this reduction in representativity, in 2011, subsidiaries absorbed the percentage lost by domestic institutions (see Graph 11b), and Table 11).

Graph 11: Representativity of member institutions in terms of employees in domestic activity by size and origin/type of legal structure as at 31 December (2008 - 2011)



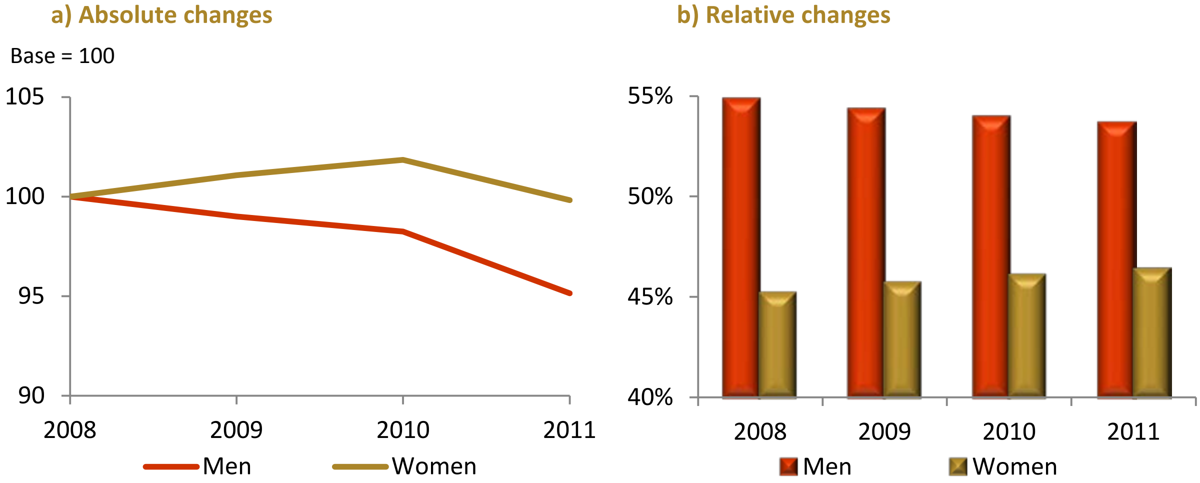
Source: FIs, APB.

At the end of 2011, the majority of the 55,485[43] employees in domestic activity at the member institutions were male (53.5%). More than half the banking population had degrees (51.7%) and was aged 30 to 44 (54.5%). A considerable part had been working in the sector for more than 15 years (40.5%). Where positions were concerned, the majority worked in specific jobs (39.4%) and commercial activity (65.2%). Most of them (97.1%) had indefinite contracts with the member institutions, while employees with fixed-term contracts made up a small part of the total (see Table 15, p. 45).

Male employees constitute the majority of the banking population, though their proportion fell by around 0.3 percentage points in 2011 as a result of a 3.2% decrease, as opposed to 2% in the number of females. The trend of previous years therefore continued, with an increase in the percentage of women in the sector (see Graph 12 and Table 16, p. 46).

This trend is common to all segments of member institutions irrespective of their size or origin/type of legal structure. Branch offices were the only segment with a majority of female employees in 2011 (see Table 15, p. 45).[44]

Graph 12: Number of employees in domestic activity and their representativity by gender as at 31 December (2008 - 2011)



Source: FIs, APB.

Specific jobs at the member institutions in Portugal were occupied by the largest part of the workforce (39.4%) in 2011 (see Table 15, p. 45). As mentioned in 2010, the proportion of employees in specific jobs tends to rise as the member institutions became smaller. The human resources at

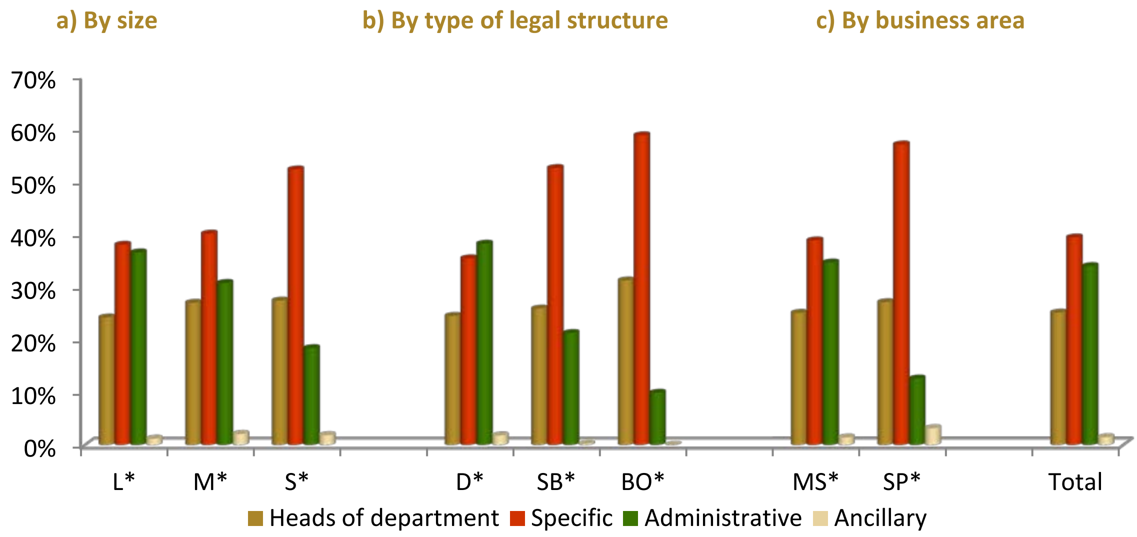
[43] This figure refers to the sample of 33 member institutions, which is why it is not the same as that in Table 9, p. 33 (54,911 employees), which refers to the sample adjusted for time purposes (see footnote 36, p. 28).
[44] In accordance with the segmentation by origin or type of legal structure of the member institutions in Activity Report 46 (2010) for the 33 institutions, branch offices already had a larger proportion of women employees that year. The retroactive reclassification of the sample meant that in 2010 branch offices had 50% women and 50% men).

institutions of foreign origin were more specialised, particularly at branch offices, again in 2011 (see Table 15, p. 45).

It is natural for the job distribution of human resources to differ on the basis of the institutions' size and origin or type of legal structure, as the large and medium-sized and domestic institutions and some subsidiaries operate essentially in more traditional business areas, such as retail banking. These areas offer a wide range of less complex products and services, which is why the proportion of highly specialised personnel is lower. On the other hand, small institutions and branch offices normally focus on less comprehensive business areas requiring more specialised staff.

The member institutions in specialised business areas tend to have a higher proportion of employees in specific jobs (see Graph 13). Once again, this effect can be explained by the fact that these institutions focus on products, services and markets with their own characteristics that require more specialised, technical knowledge from their human resources.

Graph 13: 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 2011



Source: FIs, APB.

Note: * (L) Large; (M) medium-sized; (S) small; (D) domestic; (SB) subsidiary; (BO) branch office; (MS) multi-specialised; (SP) specialized.

The predominance of specific jobs comes from the trend over time in the number of employees in this category compared to the others, particularly administrative jobs (see Table 16, p. 46).

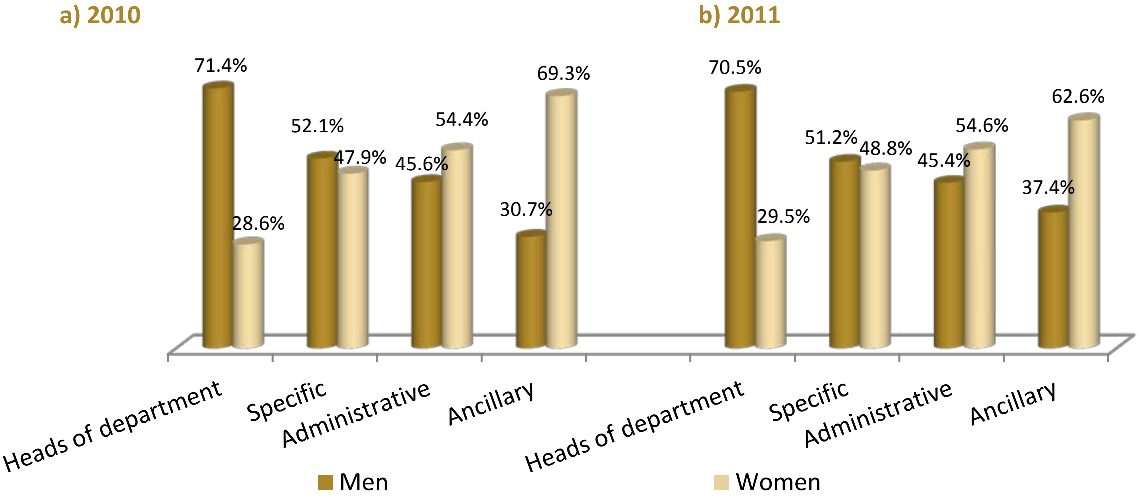
Between 2008 and 2010, the trend towards greater specialisation in the member institutions' workforces was essentially due to a considerable increase in the absolute number of employees with these jobs (1,401) and the simultaneous reduction in the others. This rise resulted essentially from the fact that the large and medium-sized and domestic financial institutions expanded their activity to more specific business areas, such as investment banking, and put a stake in unique products for highly specific market segments.

In 2011, the trend was accentuated not by an increase in the number of employees in specific jobs (indeed their number fell) but exclusively by a reduction in the number of administrative employees (-1,485), which was more than half (58.2%) of the net decrease of 2,552 in the category over the three-year period (see Table 16, p. 46). This performance is associated with the member institutions' general policies aimed at containing costs and rationalising workforces. Under these policies, specific jobs are usually those least affected, as they generate more value added and are essential to sustained business.

If we analyse the two previous variables together, we find that higher positions, i.e. heads of department and specific jobs, were occupied mostly by men[45] in 2011. The situation changed a little against 2010, with more women in more responsible positions requiring higher qualifications.

On the other hand, the majority of employees in administrative and ancillary jobs are still female, and the numbers of the former rose (+0.4 percentage points) but fell sharply in the latter (-13.4 percentage points) (see Graph 14).

Graph 14: Human resources by gender and position as at 31 December 2010 and 2011



Source: FIs, APB.

The trend towards more women as heads of department and in specific jobs in 2011 was common to all the member institution segments regardless of their size or origin/type of legal structure (see Table 12 and Table 13, p. 40).

[45] The sample has been adjusted to 32 institutions for a cross-analysis of job and gender variables in particular, as Barclays was excluded due to lack of data.

Table 12: Human resources by gender and position, by size of member institutions as at 31 December 2010 and 2011

	2010			2011		
	Men	Women	Difference (pp)	Men	Women	Difference (pp)
Large						
Heads of department	69.0%	31.0%	*38.0*	68.3%	31.7%	*36.6*
Specific	49.9%	50.1%	*-0.2*	49.4%	50.6%	*-1.2*
Administrative	45.0%	55.0%	*-10.0*	44.6%	55.4%	*-10.8*
Ancillary	36.2%	63.8%	*-27.6*	47.3%	52.7%	*-5.4*
Medium-sized						
Heads of department	77.7%	22.3%	*55.4*	77.3%	22.7%	*54.6*
Specific	56.4%	43.6%	*12.8*	55.3%	44.7%	*10.6*
Administrative	49.0%	51.0%	*-2.0*	49.4%	50.6%	*-1.2*
Ancillary	21.1%	78.9%	*-57.8*	19.7%	80.3%	*-60.6*
Small						
Heads of department	72.1%	27.9%	*44.2*	68.8%	31.2%	*37.6*
Specific	60.1%	39.9%	*20.2*	55.1%	44.9%	*10.2*
Administrative	38.4%	61.6%	*-23.2*	33.6%	66.4%	*-32.8*
Ancillary	53.1%	46.9%	*6.2*	55.0%	45.0%	*10.0*

Source: FIs, APB.

Table 13: Human resources by gender and position by origin/type of legal structure of member institutions as at 31 December 2010 and 2011

	2010			2011		
	Men	Women	Difference (pp)	Men	Women	Difference (pp)
Domestic						
Heads of department	70.7%	29.3%	*41.4*	69.8%	30.2%	*39.6*
Specific	51.8%	48.2%	*3.6*	51.0%	49.0%	*2.0*
Administrative	45.7%	54.3%	*-8.6*	45.5%	54.5%	*-9.0*
Ancillary	29.6%	70.4%	*-40.8*	36.6%	63.4%	*-26.8*
Subsidiaries						
Heads of department	75.3%	24.7%	*50.6*	75.0%	25.0%	*50.0*
Specific	53.0%	47.0%	*6.0*	52.7%	47.3%	*5.4*
Administrative	45.8%	54.2%	*-8.4*	45.2%	54.8%	*-9.6*
Ancillary	92.9%	7.1%	*85.8*	73.7%	26.3%	*47.4*
Branch offices						
Heads of department	70.5%	29.5%	*41.0*	63.1%	36.9%	*26.2*
Specific	52.1%	47.9%	*4.2*	46.0%	54.0%	*-8.0*
Administrative	42.6%	57.4%	*-14.8*	39.6%	60.4%	*-20.8*
Ancillary	0.0%	100.0%	*-100.0*	0.0%	100.0%	*-100.0*

Source: FIs, APB.

The small institutions and branch offices were the ones that made their human resource structure more egalitarian in terms of gender, for heads of department and specific jobs. This was certainly due in part to a net increase in the number of employees in this type of position in these two segments in 2011. Indeed, almost half the new head of department jobs created in net terms were occupied by women. This was even more notable in specific jobs, where around 60% of new employees were female.

As a result, the branch offices had the largest proportion of women as heads of department and in specific jobs compared to their peers at the end of 2011.[46] On the other hand, the medium-sized institutions and subsidiaries had the greatest inequality between genders in these categories (see Table 12 and Table 13, p. 40).

As in previous years, the vast majority of the member institutions' human resources worked in commercial activity (65.8%) in 2011. Indeed, the predominance of the commercial network remained quite stable from 2008 to 2011, when its representativity in the banking population rose only 0.7 percentage points and 0.1 in 2011 (see Table 16, p. 46).

Nonetheless, in absolute figures, the number of employees in commercial activity fell as of 2009 (-1,351), especially last year. In fact, in 2011, the reduction was almost 68% (i.e. 918 employees). The weight of commercial activity in the sample only did not decrease because, in relative terms, the reduction in personnel in other banking activities (central services) in 2011 was higher (-2.9% in the latter against -2.5% in the former against 2010) (see Table 16, p. 46).

This decrease in personnel in commercial activity in 2011 was certainly due in part to a reduction in the number of branches (-2.4% against 2010).[47] This explanation is backed up by the accentuated correlation (around 0.88) between the variations from 2010 to 2011 in the two variables. Indeed, this is not surprising, given that the branch network is still traditionally the dominant outlet for commercial activity in the banking sector.

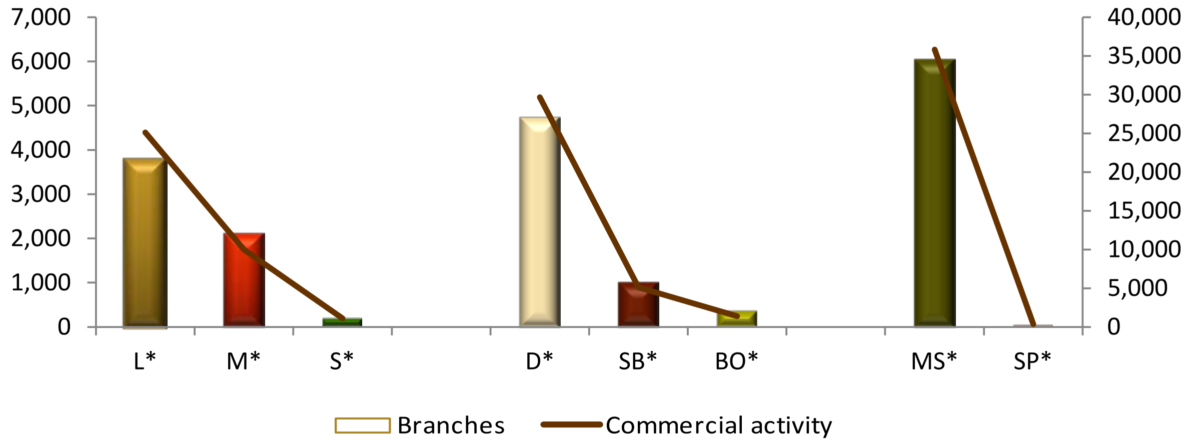
The positive relationship between size of branch network and the number of employees in the activity is also clear when we check it against any of the three criteria: size or origin/type of legal structure and business area (see Graph 15, p. 42).

[46] In accordance with the segmentation by size and origin or type of legal structure of the member institutions used in Activity Report 46 (2010), taking 32 institutions into account, branch offices already had the largest proportion of female heads of department compared to the other segments that year. The retroactive reclassification of the sample meant that in 2010 the large institutions had a more egalitarian gender distribution in this position.

[47] See Sub-chapter VI.1. Branch network in Portugal and Table 20, p. 53.

Graph 15: Comparison between the number of branches and the number of employees in commercial activity by size, origin/type of legal structure and business area as at 31 December 2011

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



Source: FIs, APB.

Note: Number of branches – left-hand scale; Number of employees in commercial activity – right-hand scale.

* (L) Large; (M) medium-sized; (S) small; (D) domestic; (SB) subsidiary; (BO) branch office; (MS) multi-specialised; (SP) specialized.

Meanwhile, an analysis of Table 16, p. 46 on variations in the number of employees in specific and administrative jobs in 2011 on the one hand and the number of employees working in commercial activity on the other suggests that it may have been the administrative jobs at branches that closed the ones that were penalised most in the decrease in commercial activity. On the other hand, and though we recognise that there may be some bias (given that we are dealing with net figures and some basic assumptions), the reduction in employees in commercial activity seems to have affected employees in specific sales jobs at those branches much less. Most of them seem to have been relocated to similar jobs in other branches and expanding distribution networks or direct customer sales.

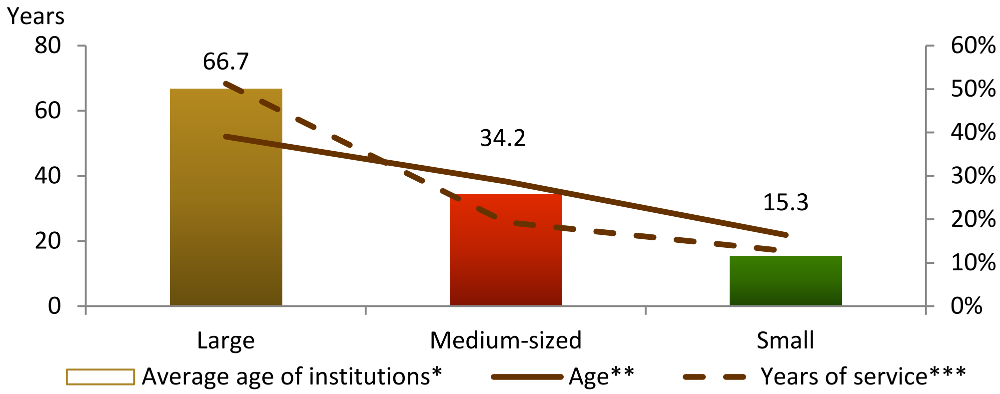
An analysis of the member institutions' human resources in terms of age group showed that the majority was aged 30 to 44 (54.5% of employees) (see Table 15, p. 45) in 2011. Performance since 2008 reveals that the percentage of employees in this age group was relatively stable, with only very small rises or falls from year to year. There was, however, a consecutive fall in the percentage of employees aged under 30 years and a concurrent rise in those aged 45 or over (see Table 16, p. 46).

At the same time, there was a substantial reduction in the percentage of employees with less than one year of service, going from 7% in 2008 to 2% in 2011. On the other hand, the representativity of employees working in the sector for more than 10 years rose considerably by around 6.9 percentage points to 62.6% at the end of 2011. Nonetheless, due to the high number of retirements in 2011, the representativity of employees with more than 15 years' experience in the sector decreased. This resulted in a slight decrease in average years of service in 2011, going against the upward trend before that. Due to its low expression, however, the decrease had no relevant impact on the performance over time of employees' years of service, which rose from 2008 to 2011.

All together, the context indicates progressive aging of the banking population, partly due to a reduction in recruitment in recent years, which fell 8.6%[48] in 2011. Furthermore, an ongoing decrease in the number of employees with fixed-term contracts, usually young people, also contributed to this trend. It is important to note that the number of employees with fixed-term contracts fell by an average of 29.1% over the three years and accounted for only 3% of the member institutions' workforce at the end of 2011.

The rise in the average age of the workforce was common to all the member institutions, regardless of their size or origin/type of legal structure. As was to be expected, however, and as in 2010, the relationship between the average age of institutions by size and the age of its employees was positive and the two variables rose side by side. This was also visible in the relationship with employees' years of service (see Graph 16).

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 2011



Source: FIs, BdP, APB.

Note: * Weighted average age of APB member institutions by number of employees assigned to domestic activity in each size category (left-hand scale)

** Age measured by % of employees aged 45 or over (right-hand scale).

*** Years of service measured by % of employees who have worked in the sector for more than 15 years (right-hand scale).

In spite of the aging of the banking population between 2008 and 2011, their level of qualifications has been rising. The percentage of employees who had completed the 9th and 12th grade fell in favour of those with degrees. The increase in the weight of specific jobs (requiring higher skills) in the member institutions' workforces certainly contributed to this. As a result, employees with degrees accounted for more than half (51.7%) of the member institutions' banking population (see Table 15, p. 45).

Finally, in 2011, the member institutions' human resources were mostly full-time employees (94.4%) (see Table 14, p. 44). As in previous years, very few had other type of work arrangement.

[48] The sample of data on hiring has been adjusted to 28 member institutions and excluded Banco BIC, BIG, Besi, Itaú and BNP SS due to lack of data

Table 14: Human resources by gender and type of work arrangement in domestic activity as at 31 December 2011

	Men	Women	Total
Full-time	28,436	23,959	52,395
Part-time	22	357	379
Flexi-time	1,149	1,349	2,498
Shifts	100	113	213
Total	29,707	25,778	55,485

Source: FIs.

In short, 2011 witnessed a reduction in the member institutions' workforce in domestic activity, in line with the contraction in the banking business in Portugal. This reduction was felt especially in the number of employees in administrative jobs and commercial activity, as a result of the decrease in the branch network. This context helped to accentuate the trend towards specialisation of human resources at banks since 2008.

The restructuring of the banking population in 2011 mainly took the form of early retirement and the termination of fixed-term contracts, which led to an increase in the average age of the banking population and a slight reversal of the upward trend in years of service in the sector.

Finally, the trend towards consecutive reductions in the percentage of men among banking sector employees continued in 2011, resulting in a greater balance between genders. This resulted essentially from more women in more responsible positions due to more admissions and fewer departures than among males.

Table 15: Characterisation of employees in domestic activity by size and origin/type of legal structure as at 31 December 2011[a)]

	Total		Large		Medium-sized		Small		Domestic		Subsidiary		Branch office	
Number of employees														
Total	55,485		37,504		14,765		3,216		43,904		8,066		3,515	
By Gender														
Men	29,707	*53.5%*	19,587	*52.2%*	8,354	*56.6%*	1,766	*54.9%*	23,379	*53.3%*	4,590	*56.9%*	1,738	*49.4%*
Women	25,778	*46.5%*	17,917	*47.8%*	6,411	*43.4%*	1,450	*45.1%*	20,525	*46.7%*	3,476	*43.1%*	1,777	*50.6%*
By Age														
Up to 30 years	5,845	*10.5%*	3,504	*9.4%*	1,691	*11.4%*	650	*20.2%*	4,283	*9.8%*	803	*10,0%*	759	*21.6%*
30 to 44 years	30,231	*54.5%*	19,364	*51.6%*	8,828	*59.8%*	2,039	*63.4%*	23,244	*52.9%*	4,614	*57.2%*	2,373	*67.5%*
45 years or over	19,409	*35.0%*	14,636	*39.0%*	4,246	*28.8%*	527	*16.4%*	16,377	*37.3%*	2,649	*32.8%*	383	*10.9%*
By Years of Service														
Up to 1 year	1,117	*2.0%*	586	*1.6%*	257	*1.7%*	274	*8.5%*	747	*1.7%*	169	*2.1%*	201	*5.7%*
1 to 5 years	11,740	*21.2%*	5,635	*15.0%*	4,539	*30.8%*	1,566	*48.7%*	7,578	*17.3%*	1,594	*19.8%*	2,568	*73.0%*
6 to 10 years	8,254	*14.9%*	5,069	*13.5%*	2,695	*18.3%*	490	*15.3%*	6,353	*14.5%*	1,593	*19.7%*	308	*8.8%*
11 to 15 years	11,902	*21.4%*	7,008	*18.7%*	4,417	*29.9%*	477	*14.8%*	10,197	*23.2%*	1,576	*19.5%*	129	*3.7%*
Over 15 years	22,472	*40.5%*	19,206	*51.2%*	2,857	*19.3%*	409	*12.7%*	19,029	*43.3%*	3,134	*38.9%*	309	*8.8%*
By Type of Employment Contract														
Permanent	53,856	*97.1%*	36,723	*97.9%*	14,166	*95.9%*	2,967	*92.3%*	42,795	*97.5%*	7,880	*97.7%*	3,181	*90.5%*
Fixed term	1,629	*2.9%*	781	*2.1%*	599	*4.1%*	249	*7.7%*	1,109	*2.5%*	186	*2.3%*	334	*9.5%*
By Academic Qualifications														
9th grade	4,394	*7.9%*	3,311	*8.8%*	1,004	*6.8%*	79	*2.5%*	4,104	*9.4%*	280	*3.5%*	10	*0.3%*
12th grade	22,393	*40.4%*	15,107	*40.3%*	6,349	*43.0%*	937	*29.1%*	17,611	*40.1%*	3,945	*48.9%*	837	*23.8%*
Higher education	28,698	*51.7%*	19,086	*50.9%*	7,412	*50.2%*	2,200	*68.4%*	22,189	*50.5%*	3,841	*47.6%*	2,668	*75.9%*
By Position														
Heads of department	13,933	*25.1%*	9,069	*24.2%*	3,983	*27.0%*	881	*27.4%*	10,748	*24.5%*	2,087	*25.9%*	1,098	*31.2%*
Specific	21,881	*39.4%*	14,266	*38.0%*	5,930	*40.2%*	1,685	*52.4%*	15,567	*35.5%*	4,248	*52.7%*	2,066	*58.8%*
Administrative	18,853	*34.0%*	13,721	*36.6%*	4,542	*30.7%*	590	*18.3%*	16,791	*38.2%*	1,712	*21.2%*	350	*10.0%*
Ancillary	818	*1.5%*	448	*1.2%*	310	*2.1%*	60	*1.9%*	798	*1.8%*	19	*0.2%*	1	*0.0%*
By Activity														
Commercial	36,178	*65.2%*	25,119	*67.0%*	9,978	*67.6%*	1,081	*33.6%*	29,680	*67.6%*	5,112	*63.4%*	1,386	*39.4%*
Other	19,307	*34.8%*	12,385	*33.0%*	4,787	*32.4%*	2,135	*66.4%*	14,224	*32.4%*	2,954	*36.6%*	2,129	*60.6%*

Source: FIs, APB.

[a)] Data from the sample of 33 member institutions.

Table 16: Number of employees in domestic activity as at 31 December (2008-2011)[a)]

	2008		2009		2010		2011	
Number of employees								
Total	56,460		56,427		56,385		54,911	
By Gender								
Men	30,952	*54.8%*	30,645	*54.3%*	30,407	*53.9%*	29,449	*53.6%*
Women	25,508	*45.2%*	25,782	*45.7%*	25,978	*46.1%*	25,462	*46.4%*
By Age								
Up to 30 years	8,500	*15.1%*	7,417	*13.1%*	7,070	*12.5%*	5,615	*10.2%*
30 to 44 years	30,728	*54.4%*	30,815	*54.6%*	30,642	*54.4%*	29,906	*54.5%*
45 years or over	17,232	*30.5%*	18,195	*32.3%*	18,673	*33.1%*	19,390	*35.3%*
By Years of Service								
Up to 1 year	3,962	*7.0%*	2,693	*4.8%*	2,199	*3.9%*	1,070	*2.0%*
1 to 5 years	10,072	*17.9%*	11,030	*19.5%*	11,423	*20.2%*	11,223	*20.4%*
6 to 10 years	10,968	*19.4%*	9,511	*16.9%*	7,852	*13.9%*	8,251	*15.0%*
11 to 15 years	8,764	*15.5%*	10,188	*18.0%*	10,916	*19.4%*	11,896	*21.7%*
Over 15 years	22,694	*40.2%*	23,005	*40.8%*	23,995	*42.6%*	22,471	*40.9%*
By Type of Employment Contract								
Permanent	51,853	*91.8%*	52,950	*93.8%*	53,776	*95.4%*	53,286	*97.0%*
Fixed term	4,607	*8.2%*	3,477	*6.2%*	2,609	*4.6%*	1,625	*3.0%*
By Academic Qualifications								
9th grade	5,621	*10.0%*	5,180	*9.2%*	4,842	*8.6%*	4,394	*8.0%*
12th grade	24,413	*43.2%*	23,702	*42.0%*	23,177	*41.1%*	22,323	*40.7%*
Higher education	26,426	*46.8%*	27,545	*48.8%*	28,366	*50.3%*	28,194	*51.3%*
By Position								
Heads of department	14,124	*25.0%*	14,012	*24.8%*	13,833	*24.5%*	13,855	*25.2%*
Specific	20,107	*35.6%*	21,497	*38.2%*	21,508	*38.2%*	21,418	*39.0%*
Administrative	21,372	*37.9%*	20,118	*35.7%*	20,305	*3.,0%*	18,820	*34.3%*
Ancillary	857	*1.5%*	800	*1.3%*	739	*1.3%*	818	*1.5%*
By Activity								
Commercial	36,771	*65.1%*	37,488	*66.4%*	37,055	*65.7%*	36,137	*65.8%*
Other	19,689	*34.9%*	18,939	*33.6%*	19,330	*34.3%*	18,774	*34.2%*

Source: FIs, APB.

[a)] The values of 2011 do not coincide with those in Table 15, p. 45, due to the fact that human resources growth over time imposed an adjustment to the sample of 31 member institutions.

V.2. Training

In 2011, employee training did not remain immune to the member institutions' general cost containment policy. A total of 50,423,[49] employees received training, a 4% reduction against 2010, which practically cancelled out the gains achieved in the previous two years. This performance resulted in a modest annual average growth rate of only 0.1% (see Table 17).

As the reduction in the number of trainees was greater than that in the total number of employees in domestic activity, the participation rate in training[50] fell 1.4 percentage points. This halted the trend towards growing involvement of the workforce in training since 2008 (see Table 17).

Table 17: Training at member institutions (2008 – 2011)

	2008	2009	2010	2011	Average
Number of Trainees					
Total	50,378	51,214	52,539	50,423	-
As % of number of employees in domestic activity	*89.9%*	*91.5%*	*93.8%*	*92.4%*	-
Annual growth rate		*1.7%*	*2.6%*	*-4.0%*	*0.1%*
Number of Participants in Training Courses					
Total	368,529	427,777	490,722	378,366	-
Annual growth rate		*16.1%*	*14.7%*	*-22.9%*	*2.6%*
Number of Training Hours					
Total	2,150.487	2,344.494	2,215.077	1,838.139	-
Annual growth rate		*9.0%*	*-5.5%*	*-17.0%*	*-4.5%*
Average Duration of Training Courses					
Average (hours)	11	14	15	10	-
Number of Training Courses					
Total	14,499	11,694	13,356	12,016	-
Annual growth rate		*-19.3%*	*14.2%*	*-10.0%*	*-5.0%*

Source: FIs, APB.

The number of participants in training courses fell 22.9% in 2011 (see Table 17). The average number of participations in training courses per trainee therefore also fell (from 9.3 to 7.5), returning to levels close to those in 2008 (see Graph 17, p. 48).

There was also an albeit less significant contraction in the amount of training[51] (-17%), which was why the average number of training hours per participant increased from 4.5 to 4.9 in 2011. This performance points to more time spent in training by each participant. This, combined with a reduction in the average duration of training courses, shows convergence towards greater

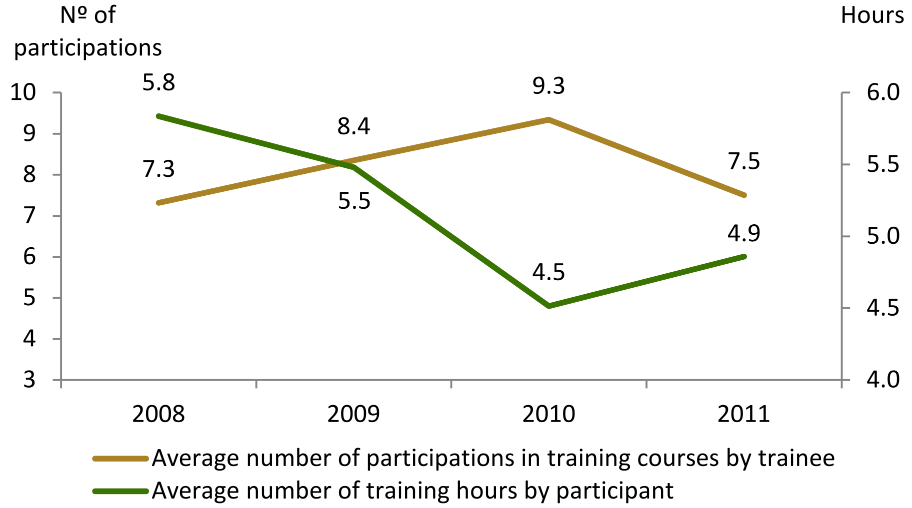
[49] Due to lack of data, all the indicators on training of human resources refer only to 26 of the 33 financial institutions in sample used in this Activity Report. Banco BIC, BAC, Invest, Banco do Brasil, BNP, BNP SS and BNP WM were excluded.

[50] The participation rate is calculated by dividing the number of employees attending training courses by the number of employees in domestic activity.

[51] The amount of training refers to the total number of hours of training given.

homogeneity in the duration of courses, with a more significant reduction in long courses and greater focus on medium-length courses.

Graph 17: Comparison between the average number of participations in training courses per trainee and the average number of training hours per participant (2008 – 2011)

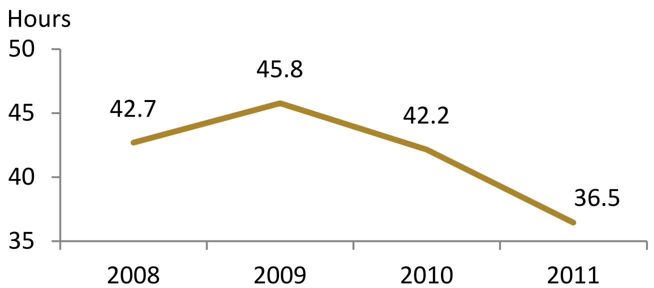


Source: FIs, APB.

The above scenario means that the average number of hours of training per trainee, calculated by multiplying the two indicators in Graph 17, fell in 2011, following the trend in 2010 (see Graph 18). While in 2010 the reduction in the ratio was due to a contraction in the average number of hours per participant, in 2011 the effect of the decrease in the average number of participations per trainee prevailed over the former.

This effect also helped to reduce the average number of participants in each training course, which went from 37 in 2010 to 31 in 2011. This may be due to less available time to attend training on the part of employees in 2011 because of an additional workload resulting from the difficult economic and financial scenario and new compliance requirements from a series of new national and international regulations imposed on the Portuguese banking sector.

Graph 18: Average number of training hours per trainee (2008 – 2011)



Source: FIs, APB.

Where the type of training courses attended by the member institutions' employees is concerned, the reduction affected the number of both in-house and external courses. Even so, this effect was felt more in the case of external courses, leading to an increase in the weight of in-house training, which had already represented the vast majority in previous years (see Table 18).

In spite of this performance, however, the number of participants in external training courses fell less than in internal courses (-17.6% vs. -23.2%). This resulted in a reduction in the average number of participates per in-house training course from 42.7 in 2010 to 36.3 in 2011 (-15%), while it fell only 5.8% in external courses from 10.3 to 9.7 (see Table 18).

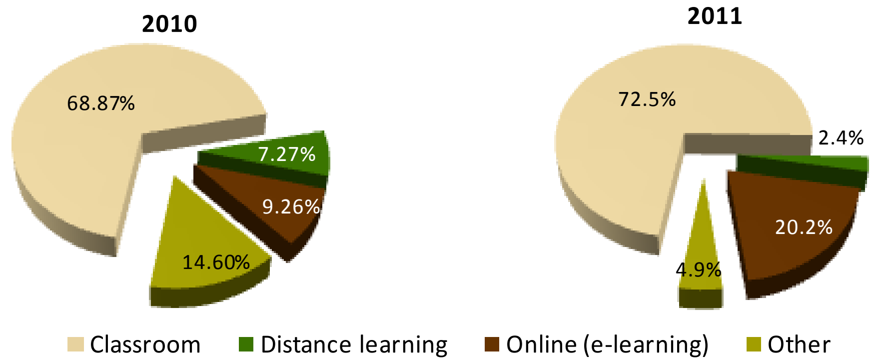
Table 18: Type of participation, training courses and corresponding methods (2008 – 2011)

	2008		2009		2010		2011		Average
Participations in Training Courses									
In-house	351,952	*95.5%*	405,615	*94.8%*	465,259	*94.8%*	357,390	*94.5%*	*94.9%*
External	16,577	*4.5%*	22,162	*5.2%*	25,463	*5.2%*	20,976	*5.5%*	*5.1%*
Type of Training Courses									
In-house	11,612	*80.1%*	9,342	*79.9%*	10,892	*81.6%*	9,846	*81.9%*	*80.9%*
External	2,887	*19.9%*	2,352	*20.1%*	2,464	*18.4%*	2,170	*18.1%*	*19.1%*
Training Methods									
Classroom	76.8%		65.7%		68.9%		72.5%		71.0%
Distance learning	3.5%		5.3%		7.3%		2.4%		4.6%
Online training (e-learning)	12.0%		22.1%		9.2%		20.2%		15.9%
Other	7.7%		6.9%		14.6%		4.9%		8.5%

Source: FIs, APB.

Regarding training methods, classroom training predominated in 2011, and even increased its representativity against 2010 (see Table 18). The main variation occurred in online training, as its weight rose substantially to 20.2% against distance learning and other methods (see Table 18 and Graph 19).

Graph 19: Training methods (2010 vs. 2011)



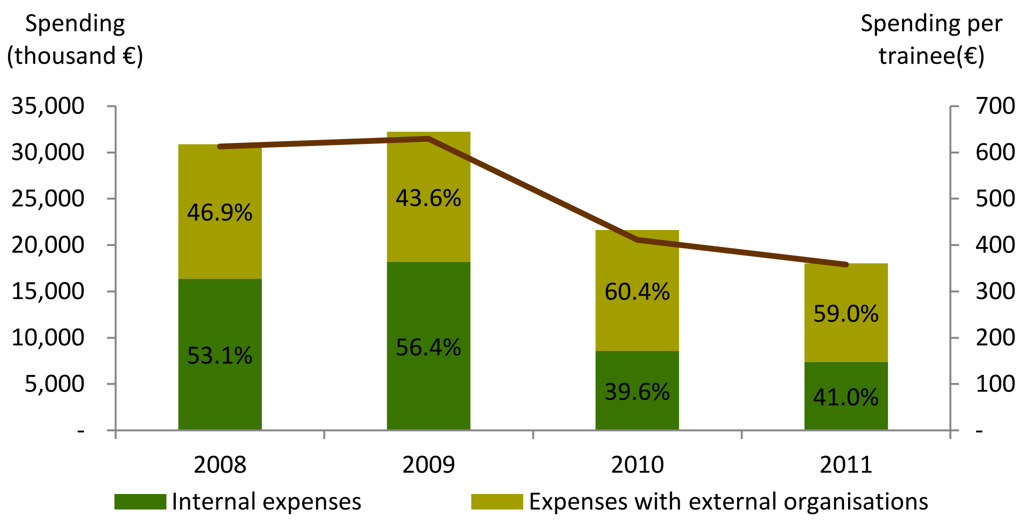
Source: FIs, APB.

In 2011, member institutions' spending on training totalled 18.04 million euros,[52] which is 0.9% of total general administrative expenditure. This was 16.5% less than in 2010, confirming the trend towards containment of costs that began that year (see Table 19, p. 51).

The containment of costs in 2011 came from spending on outside entities and in-house expenditure. It was more prominent in outside entities, which experienced a cut of 18.4%, as opposed to 13.8% in in-house spending. This scenario was influenced by a substantial increase in online training methods, which usually involve lower costs. The fact that there are fixed internal costs that are difficult to cut down by reducing training also exerted an influence.

Even so, the majority of the investment in training corresponded to costs of outside entities (59%), as was also the case in 2010 (see Graph 20). This scenario shows that the member institutions continued to choose to outsource training services and products to specialised entities rather than undertaking them in-house.

Graph 20: Spending on training (total and per trainee)



Source: FIs, APB.

Although there was a contraction in some member institutions' training indicators, such as the number of training courses (-10%) and number of trainees (-4%) in 2011, the cut in their costs was higher (-16.5%). As a result, the downward trend in average cost per course and per trainee continued, even though gains in efficiency were lower. In fact, the average cost per training course went down 7.2%, while in 2010 the reduction achieved was 41.3%. Much lower was the 13% fall in average cost per trainee, against 34.6% in 2010 (see Table 19, p. 51).

Nonetheless, in 2011 there was a loss of efficiency in cost per participant, which increased 8.2%. While this indicator had the highest gains in efficiency in 2009 and 2010, this trend was reversed last year due to a reduction in the number of participants, which was greater than the cut in

[52] Total spending on training (Table 19, p. 51) cannot be compared to that in Activity Report (2010). This analysis includes indirect internal costs attributable to training (such as associated structural costs) that were not taken into account in the previous publication.

costs (-22.9% vs. -16.5%). This indicator's performance was affected by a reduction in the average number of attendances per course (from 37 in 2010 to 31 in 2011)[53] and resulted in a loss of economies of scale.

Table 19: Spending on training (2008 – 2011)

	2008	2009	2010	2011	Average
Spending on Training					
Total (thousand €) [a)]	30,876	32,235	21,617	18,040	-
Expenses with external organisations	14,485	14,068	13,049	10,651	-
Internal expenses [b)]	16,391	18,167	8,568	7,389	-
Annual growth rate		*4.4%*	*-32.9%*	*-16.5%*	*-15.0%*
As % of general administrative expenses[d)]	*1.5%*	*1.6%*	*1.0%*	*0.9%*	*1.3%*
Costs per Training Course					
Total (€)	2,129.51	2,756.57	1,618.49	1,501.34	-
Annual growth rate		*29.4%*	*-41.3%*	*-7.2%*	*-6.4%*
Costs per Trainee					
Total (€)	612.88	629.42	411.44	357.77	-
Annual growth rate		*2.7%*	*-34.6%*	*-13.0%*	*-15.0%*
Costs per Participant					
Total (€)	83.78	75.36	44.05	47.68	-
Annual growth rate		*-10.1%*	*-41.5%*	*8.2%*	*-14.5%*

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)] Internal expenses as presented in Activity Report nº 47 (2011) are not comparable with those in Activity Report Nº 46 (2010) due to the reason explained in footnote 52, p. 50.

[c)] Annual growth rate of total spending on training.

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

[53] For the reasons indicated on p. 48

VI. Banking coverage indicators

VI.1. Branch network in Portugal

After several years of consolidation of a trend towards expansion, the number of branches in the member institutions' branch network fell by 152 in 2011. This reduction of around 2.4% in the number of branches in Portugal cancelled out the growth in 2009 and 2010 and resulted in an annual average growth rate of only 0.1% since 2008 (see Table 20).[54]

The need to reduce the branches' running costs, together with the fact that some of them overlapped in geographical terms and the restructuring of the branch network resulting from mergers between member institutions were the main causes.

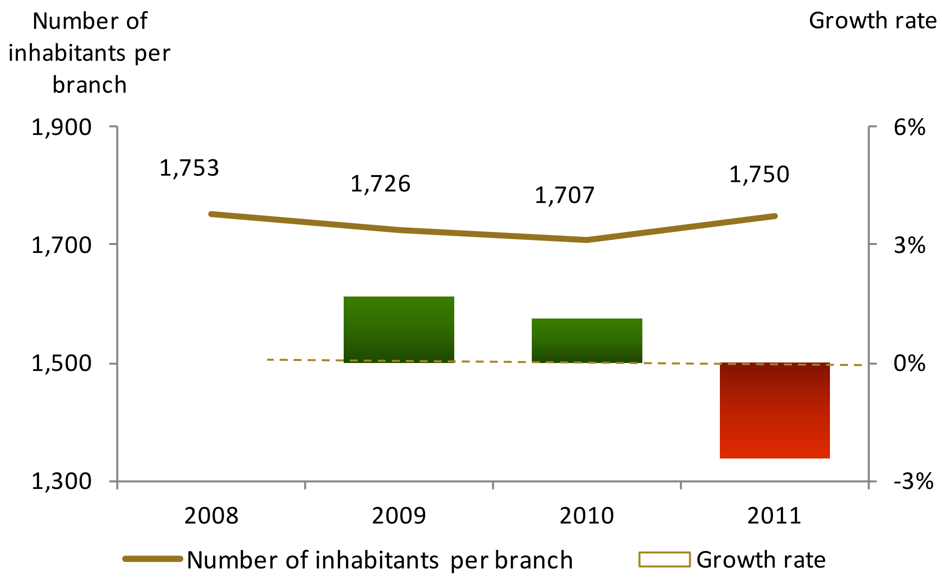
Table 20: Number of branches in Portugal as at 31 December (2008 - 2011)

	2008	2009	2010	2011	Average
Number of Branches in Portugal					
Total	6,062	6,162	6,232	6,080	-
Annual growth rate	-	*1.6%*	*1.1%*	*-2.4%*	*0.1%*

Source: FIs, APB.

The number of inhabitants per branch increased as a result of the contraction in the member institutions' branch network. This figure grew 2.5% against 2010 to 1,750 inhabitants per branch in Portugal in 2011[55] (see Graph 21).

Graph 21: Number of inhabitants per branch vs. branches´ growth rate (2008 – 2011)

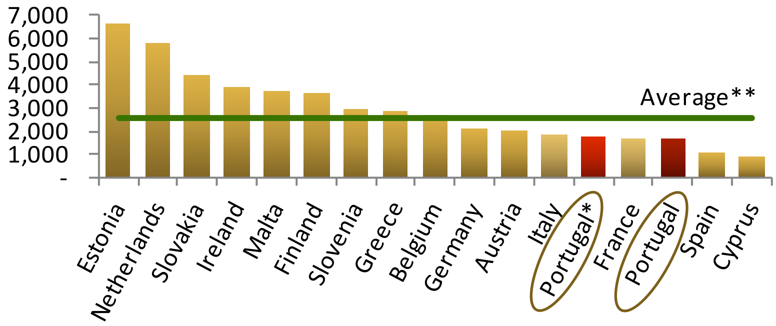


Source: FIs, APB.

[54] The sample used for the evolutive analysis (2008 - 2011) has been adjusted to 31 financial institutions, as BNP SS and Banco BIC were excluded for the reasons given in footnote 36, p. 28.
[55] As the data for the resident population in Portugal for 2011 are not yet available at Statistics Portugal, the figures for 2010 were used as an approximation.

Even so, at the end of 2011, the member institutions were well-positioned in relation to their peers in the euro area, as they had one of lowest figures for number of inhabitants per branch. As in 2010, Portugal was one the countries with the largest branch network in proportion to the population that it serves (see Graph 22).

Graph 22: Number of inhabitants per branch in the euro area



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.

Due to the fact that at the time this Activity Report was elaborated data for the number of branches at the end of 2011 in euro area countries was not available yet, the figures for 2010 were used as an approximation (except for the case of the number of branches of APB member institutions).

A more detailed analysis shows that all the large institutions reduced the number of their branches, while only 25% of the small ones did so. On the other hand, all the financial institutions that increased their branch network were small and mainly domestic. Nonetheless, the dominant trend (50%) among domestic institutions was towards a reduction in branch network (see Chart 3).

Chart 3: Changes in the member institutions´ branch network by size and origin/type of legal structure (2010 – 2011)

	Increase	Maintenance	Decrease
Large	0	0	5
Medium-sized	0	2	5
Small	6	9	5
Domestic	5	5	10
Subsidiary	0	3	2
Branch office	1	3	3

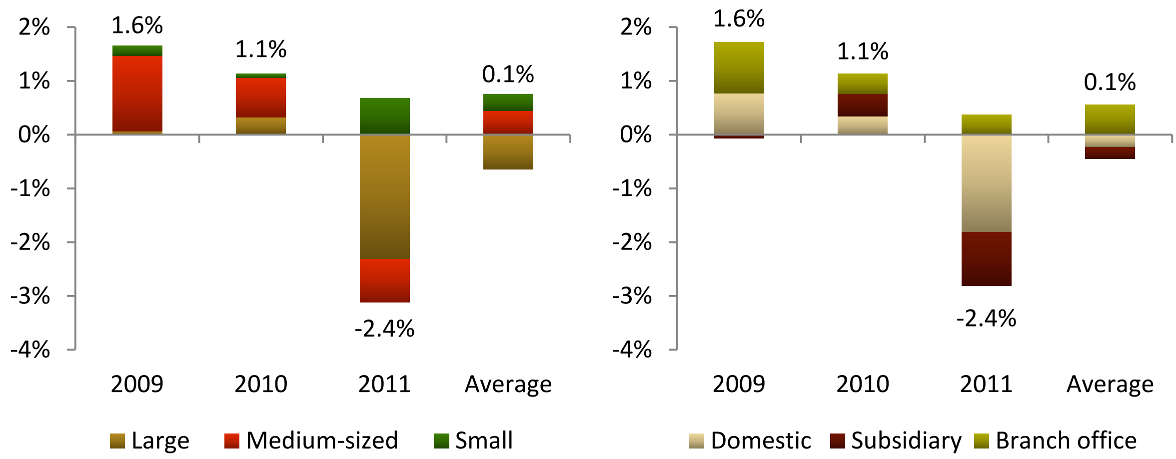
Source: FIs, APB.

Note: The chart demonstrates the number of financial institutions, in the sample of 33 that expanded, maintained or reduced their branch network in each segment. The sum up of the parcels result in 32 since Montepio and Finibanco were analysed conjointly.

It is therefore not surprising that, as large institutions traditionally have the largest branch networks (see Graph 26 a), p. 58), it was this segment that experienced the most substantial reduction in number of branches in absolute terms and as a percentage. These institutions were thus mainly responsible for the fall in the total number of branches in Portugal in 2011 with a contribution of -2.3% (see Graph 23a) and Table 21).

Graph 23: 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 (2009 - 2011)

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



Source: FIs, APB.

Table 21: Number of branches in Portugal by size as at 31 December (2008 – 2011)

	2008	2009	2010	2011	Average
Large					
Total	3,902	3,906	3,926	3,782	-
Annual growth rate	-	*0.0%*	*0.5%*	*-3.7%*	*-1,0%*
Contribution to growth in the number of branches	-	*0.1%*	*0.3%*	*-2.3%*	*-0.6%*
Medium-sized					
Total	2,035	2,120	2,165	2,115	-
Annual growth rate	-	*4.2%*	*2.1%*	*-2.3%*	*1.3%*
Contribution to growth in the number of branches	-	*1.4%*	*0.7%*	*-0.8%*	*0.4%*
Small					
Total	125	136	141	183	-
Annual growth rate	-	*8.8%*	*3.7%*	*29.8%*	*14.1%*
Contribution to growth in the number of branches	-	*0.2%*	*0.1%*	*0.7%*	*0.3%*

Source: FIs, APB.

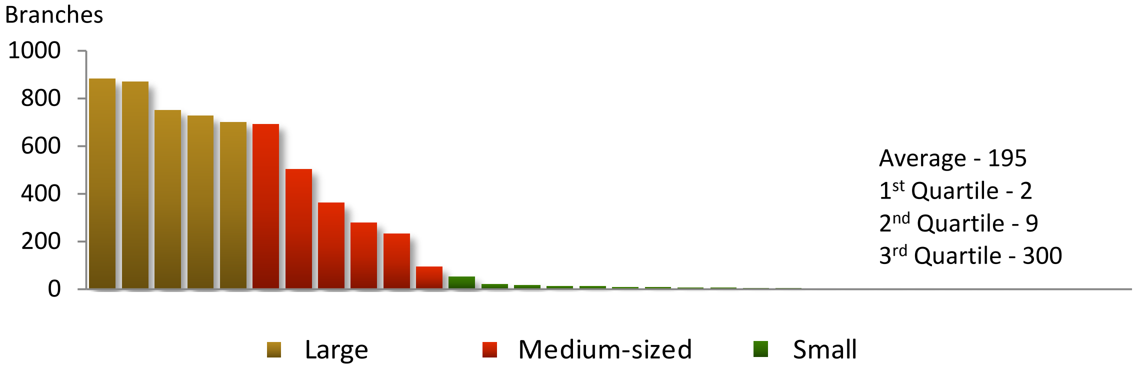
It is important to note that, at the end of 2011, it was only the large institutions' branch network that was reduced to figures a little below those for 2008, as those of the small and medium-sized institutions achieved annual average growth rates of 1.3% and 14.1% respectively. Furthermore, the small institutions were the only ones to show a net increase in their branch networks in 2011, actually quite high (29.8%), in a counter-cyclical performance (see Table 21, p. 55). This reflects the investment that they have been making essentially to expand their retail activity by attracting markets that have undergone disinvestment on the part of large and medium-sized institutions and offering innovative products and services that are unique in some way.

As a result, the representativity of the large institutions' branch network fell by about 0.8 percentage points in 2011, following the trend of previous years. Nonetheless, while in the past this reduction essentially favoured the medium-sized institutions, in 2011 it was the relative weight of the small institutions that increased most (see Graph 26 a), p. 58).

The opposite performance by the branch networks of the large and small institutions in 2011 contributed to greater homogeneity in the number of branches of each member institution (see Graph 24).

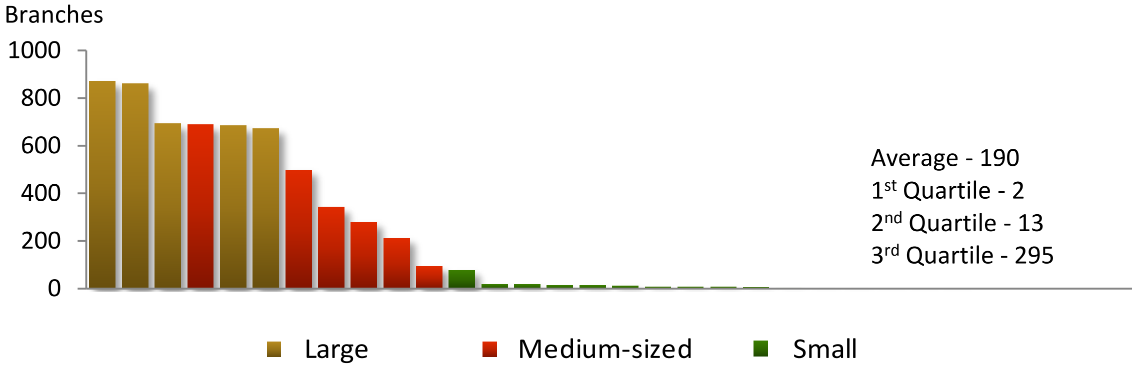
Graph 24: Number of branches of 33 member institutions as at 31 December (2010 – 2011)

a) 2010



Graph 24: Number of branches of 33 member institutions as at 31 December (2010 – 2011) (cont.)

b) 2011

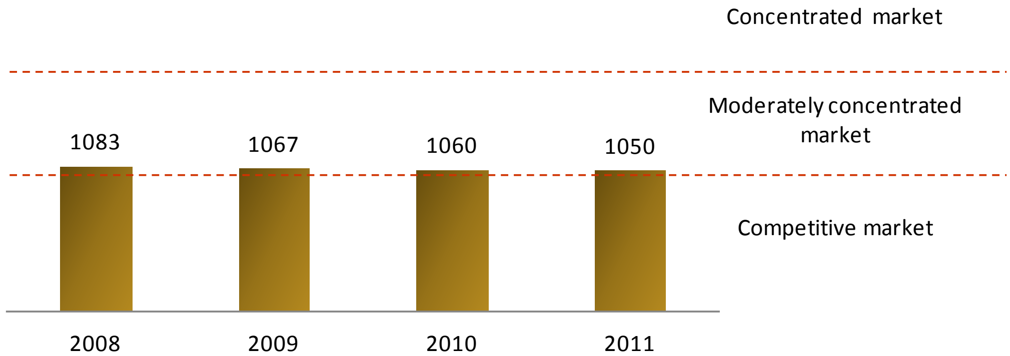


Source: FIs, APB.

This resulted in a reduction in market concentration and consequently a lower score in the Herfindahl index[56], which indeed had been falling since 2008 (see Graph 24 and Graph 25, p. 57).

[56] See footnote 32, p. 26.

Graph 25: Herfindahl Index (2008 – 2011)



Source: FIs, APB.

The degree of concentration measured by the Herfindahl index shows that the market is not very concentrated and is close to the threshold below which it could be described as competitive (see Graph 25). These results point to greater competition between member institutions in the retail banking market and commercial area for attracting business via the branch network as opposed to other types of banking activities, as market concentration is much higher when based on value of assets (see Graph 4, p. 26).

Table 22: Number of branches in Portugal by origin/type of legal structure as at 31 December (2008 – 2011)

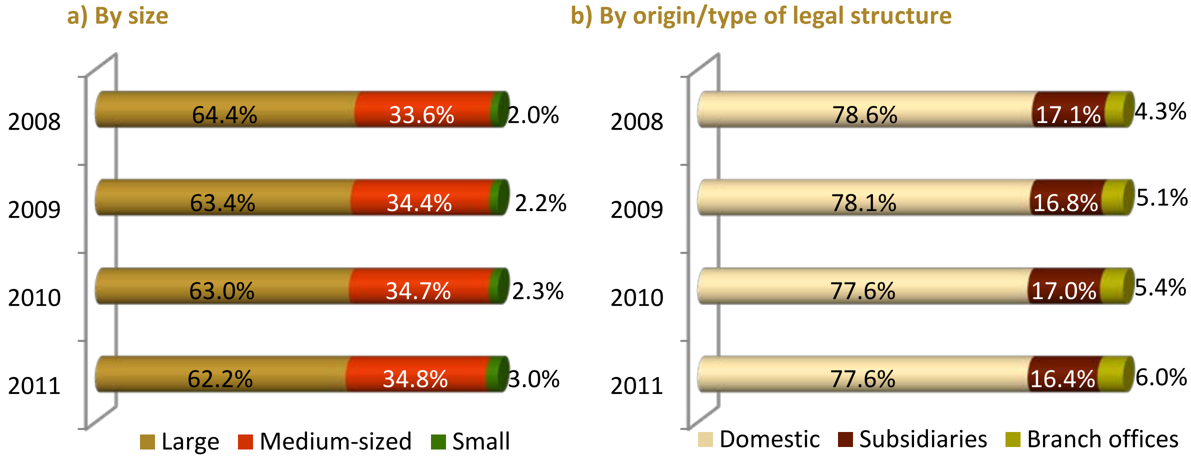
	2008	2009	2010	2011	Average
Domestic					
Total	4,766	4,813	4,834	4,721	-
Annual growth rate	-	1.0%	0.4%	-2.3%	-0.3%
Contribution to growth in the number of branches	-	0.8%	0.3%	-1.8%	-0.2%
Subsidiaries					
Total	1,037	1,033	1,059	997	-
Annual growth rate	-	-0.4%	2.5%	-5.9%	-1.2%
Contribution to growth in the number of branches	-	-0.1%	0.4%	-1.0%	-0.2%
Branch offices					
Total	259	316	339	362	-
Annual growth rate	-	22.0%	7.3%	6.8%	12.0%
Contribution to growth in the number of branches	-	0.9%	0.4%	0.4%	0.6%

Source: FIs, APB.

If we segment the member institutions by type of legal structure, the reduction in the number of branches in 2011 was common to domestic institutions and subsidiaries. On the other hand, there was net growth in the branch office networks (6.8%), as a single financial institution expanded its network and the others reduced them or remained the same (see Chart 3, p. 54). Although the growth rate slowed down in 2011 against previous years, branch offices were the only segment that enlarged their branch networks in the three-year period (see Table 22).

As a result, the representativity of branch offices in the member institutions' branch networks has become increasingly important and has risen around 1.7 percentage points since 2008 (see Graph 26 b).

Graph 26: Representativity of member institutions in term of number of branches in Portugal by size and origin/type of legal structure as at 31 December (2008 - 2011)



Source: FIs, APB.

Meanwhile, the member institutions' branch network was not evenly distributed in the country at the end of 2011 (see Graph 28b), p. 60). Generically, branches were more highly concentrated in the coastal districts, especially Lisbon and Porto, which had a highly significant part of the branches in Portugal (39.5% all together). On the other hand, the inland districts and islands had the lowest percentages of branches in the network.

As is to be expected, the number of branches in a particular district is related to its resident population (variables with a very strong correlation of around 0.98). It is also influenced to a lesser extent, by its area. Together, these two variables contribute considerably to determining how the member institutions' branch network is distributed. This is confirmed by the quite robust results of the significance test and adjusted coefficient of determination (adjusted R^2) of the regression calculated between these three variables.

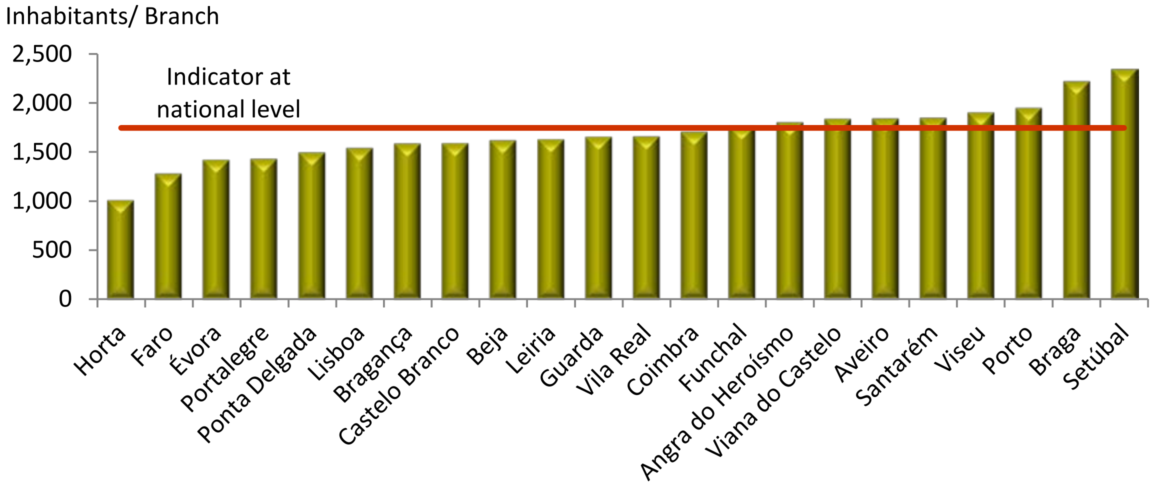
The reduction in the number of member institution branches in 2011 was not the same in the different districts (see Graph 28a), p. 60). The size of the branch network fell especially in the districts where it was the largest, especially the two biggest cities, Lisbon and Porto, where the number of branches fell around 3.6%. Setúbal and Funchal were also strongly affected, losing 16 (-4.1%) and 10 (-6.6%) branches, respectively. On the other hand, the branch network in three districts, Horta, Ponta Delgada and Vila Real, actually grew, albeit very modestly in absolute terms.

As a result, the branch network was more evenly distributed nationwide, as the differences in the percentage of branches in each district narrowed. This shows a reduction in the standard deviation of this variable from 5.4% in 2010 to 5.3%. This performance reflects efforts to reduce the costs of geographically overlapping branches while not affecting quality of service to customers or limiting their access to this channel.

In spite of the reduction in branches, the number of inhabitants per branch per district did not change significantly against 2010. The district with the smallest number of inhabitants per branch was still Horta, where it went down from 1,106 to 1,011 in 2011. At the opposite extreme, Setúbal remained the district with largest number of inhabitants per branch (2,340) (see Graph 27).

Figure 2, p. 61, shows the number of branches per district and the number of inhabitants per branch in three categories: under 1,600, 1,600 to 1,800 and over 1,800 on 31 December 2011.

Graph 27: Inhabitants per branch by district as at 31 December 2011

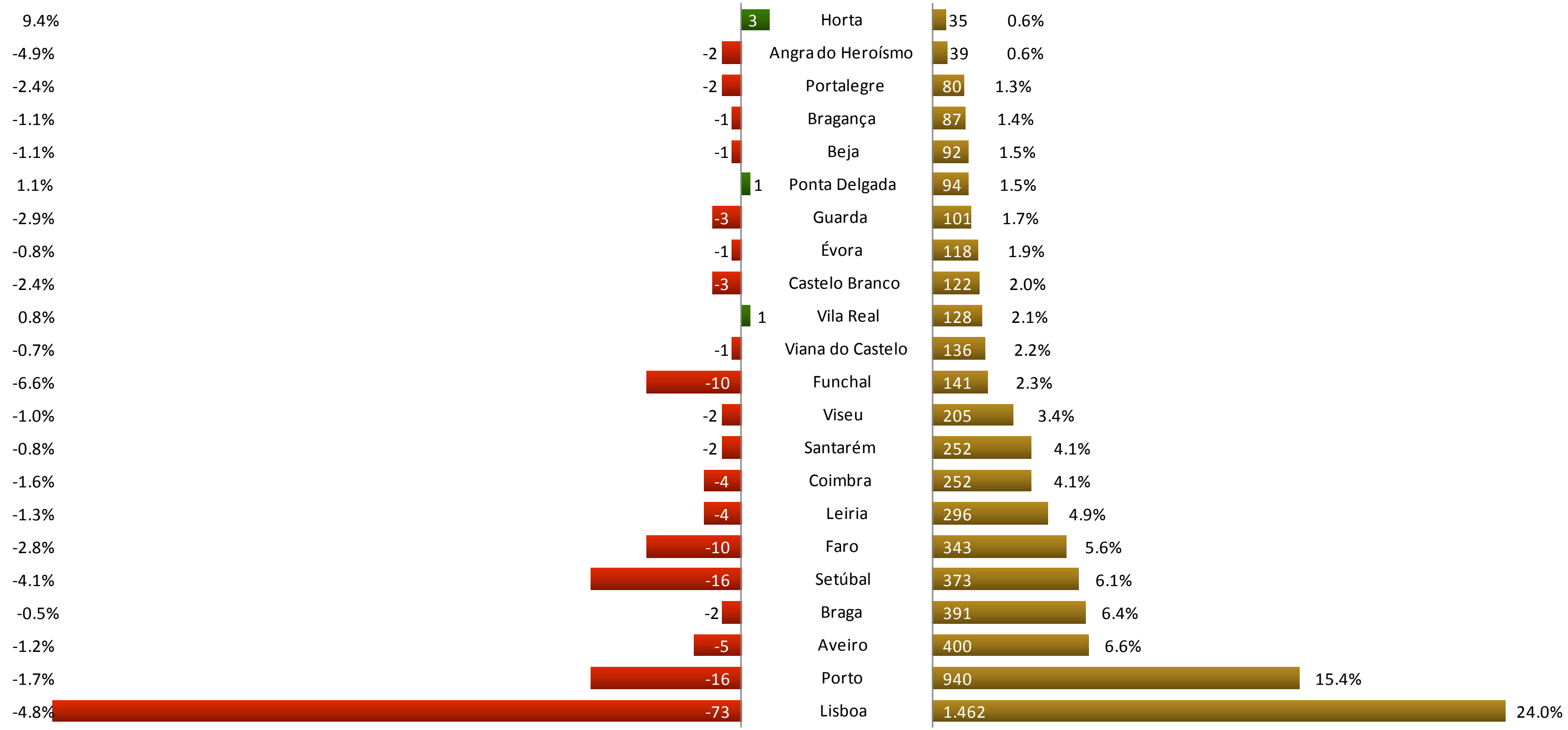


Source: FIs, APB.

Graph 28: Branch network per district in 2011 and respective changes against 2010

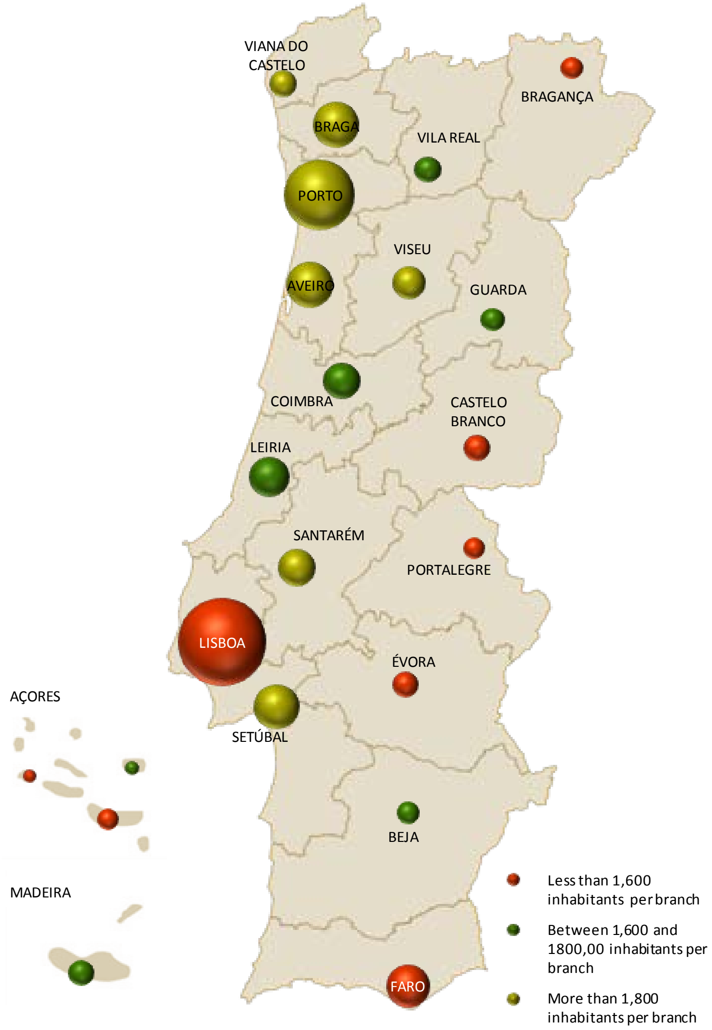
a) Absolute and percentile variation in the number of branches per district

b) Branch network in absolute and percentage terms per district, in 2011



Source: FIs, APB.

Figure 2: Branches and number of inhabitants per branch by district as at 31 December 2011



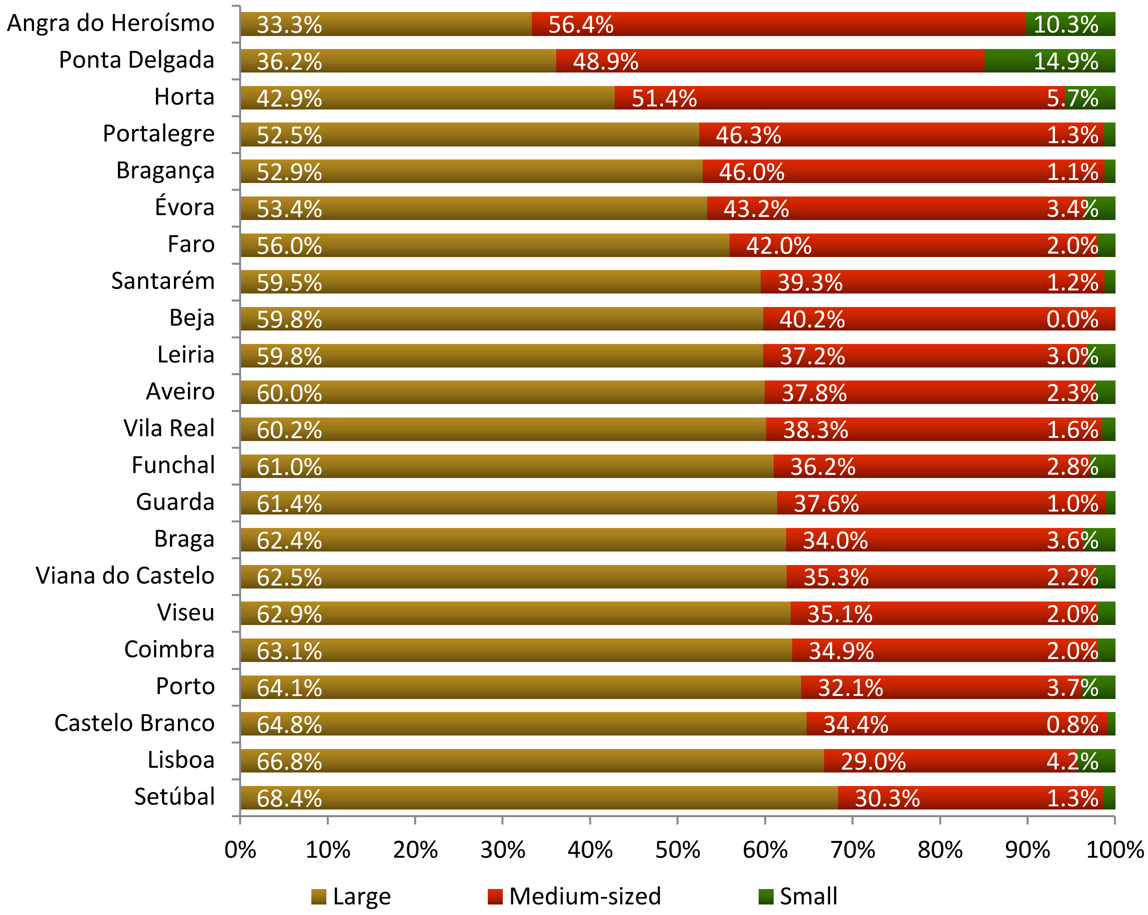
Source: FIs, Statistics Portugal, APB

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.

If we now analyse the geographical coverage of the branch network by size of member institutions, the large institutions continued to predominate in the majority of districts in Portugal in 2011. Their presence once again stood out from the others essentially in the districts with the most inhabitants. It was in the least populated districts that the weight of the large institutions was lowest, i.e. Horta, Angra do Heroísmo and Ponta Delgada (see Graph 29, p. 62).

There was a predominance of medium-sized institutions in these districts. The opposite situation was the case for the medium-sized institutions, as it was in the districts with the least inhabitants that had the largest proportion of branches. This segment's representativity in the total number of branches was lowest In the Lisbon, Setúbal and Porto districts, however, at 29%, 30.3% and 32.1%, respectively.

Graph 29: Percentage of branches by size and district as at 31 December 2011



Source: FIs, APB.

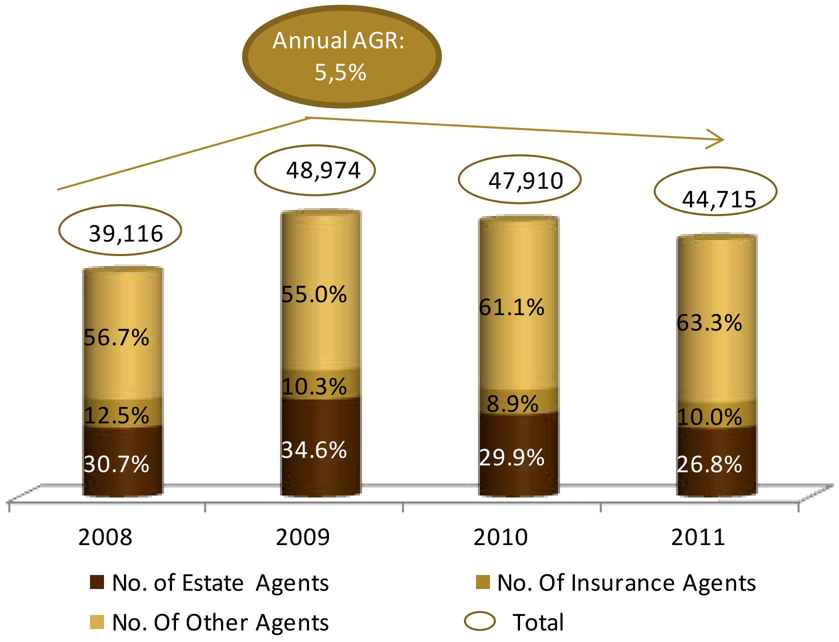
The small institutions' representativity in terms of branches increased against 2010 in 19 of the 22 districts in Portugal. This was the result of the combination to two effects: on the one hand a net increase in the number of branches in 13 districts and on the other hand a parallel reduction in the branch network in the large and medium-sized institutions.

In addition, in net terms the small institutions opened branches essentially in the districts where there was the largest reduction in the other segments' networks. Indeed, these two variables have a significant correlation of -0.84. This performance is in line with strategy of attracting markets that were the target of disinvestment by the large and medium-sized institutions.

The downward trend in the member institutions' branch network in 2011 was shared by external promoters as distribution channels. In 2011, they decreased by 6.7%, confirming the trend that began in 2010 (see Graph 30, p. 63).

These promoters include estate agents who facilitate placement of mortgages, insurance agents and other bodies directly involved in the sale of bank products and services, such as current accounts, cards, consumer credit, etc. At the end of the year, the member institutions had 44,715 external promoters, around 26.8% of which were estate agents and 10% insurance agents (see Graph 30, p. 63). The reduction in 2011 was particularly significant among estate agents (around -16.5%), so that their representativity went down 3.1 percentage points against 2010.

Graph 30: Number and type of external promoters as at 31 December (2008 – 2011)



Source: FIs, APB.

Table 23: Number of branches per district by size and origin/type of legal structure as at 31 December 2011

	Total		Large		Medium-sized		Small		Domestic		Subsidiary		Branch office	
Number of Branches														
Total	6,087		3,782		2,115		190		4,728		997		362	
Per District														
Aveiro	400	*6.6%*	240	*6.3%*	151	*7.1%*	9	*4.7%*	315	*6.7%*	65	*6.5%*	20	*5.5%*
Beja	92	*1.5%*	55	*1.5%*	37	*1.7%*	-	*0,0%*	83	*1.8%*	7	*0.7%*	2	*0.6%*
Braga	391	*6.4%*	244	*6.5%*	133	*6.3%*	14	*7.4%*	305	*6.5%*	62	*6.2%*	24	*6.6%*
Bragança	87	*1.4%*	46	*1.2%*	40	*1.9%*	1	*0.5%*	74	*1.6%*	10	*1.0%*	3	*0.8%*
Castelo Branco	122	*2.0%*	79	*2.1%*	42	*2.0%*	1	*0.5%*	98	*2.1%*	19	*1.9%*	5	*1.4%*
Coimbra	252	*4.1%*	159	*4.2%*	88	*4.2%*	5	*2.6%*	204	*4.3%*	39	*3.9%*	9	*2.5%*
Évora	118	*1.9%*	63	*1.7%*	51	*2.4%*	4	*2.1%*	102	*2.2%*	11	*1.1%*	5	*1.4%*
Faro	343	*5.6%*	192	*5.1%*	144	*6.8%*	7	*3.7%*	260	*5.5%*	60	*6,0%*	23	*6.4%*
Guarda	101	*1.7%*	62	*1.6%*	38	*1.8%*	1	*0.5%*	91	*1.9%*	8	*0.8%*	2	*0.6%*
Leiria	296	*4.9%*	177	*4.7%*	110	*5.2%*	9	*4.7%*	239	*5.1%*	41	*4.1%*	16	*4.4%*
Lisboa	1,462	*24.0%*	976	*25.8%*	424	*20.0%*	62	*32.6%*	1,044	*22.1%*	293	*29.4%*	125	*34.5%*
Portalegre	80	*1.3%*	42	*1.1%*	37	*1.7%*	1	*0.5%*	67	*1.4%*	10	*1.0%*	3	*0.8%*
Porto	940	*15.4%*	603	*15.9%*	302	*14.3%*	35	*18.4%*	698	*14.8%*	184	*18.5%*	58	*16.0%*
Santarém	252	*4.1%*	150	*4,0%*	99	*4.7%*	3	*1.6%*	200	*4.2%*	37	*3.7%*	15	*4.1%*
Setúbal	373	*6.1%*	255	*6.7%*	113	*5.3%*	5	*2.6%*	288	*6.1%*	63	*6.3%*	22	*6.1%*
Viana do Castelo	136	*2.2%*	85	*2.2%*	48	*2.3%*	3	*1.6%*	103	*2.2%*	24	*2.4%*	9	*2.5%*
Vila Real	128	*2.1%*	77	*2,0%*	49	*2.3%*	2	*1.1%*	105	*2.2%*	16	*1.6%*	7	*1.9%*
Viseu	205	*3.4%*	129	*3.4%*	72	*3.4%*	4	*2.1%*	176	*3.7%*	24	*2.4%*	5	*1.4%*
Funchal	141	*2.3%*	86	*2.3%*	51	*2.4%*	4	*2.1%*	116	*2.5%*	18	*1.8%*	7	*1.9%*
Angra do Heroísmo	39	*0.6%*	13	*0.3%*	22	*1,0%*	4	*2.1%*	37	*0.8%*	2	*0.2%*	-	*0.0%*
Horta	35	*0.6%*	15	*0.4%*	18	*0.9%*	2	*1.1%*	33	*0.7%*	2	*0.2%*	-	*0.0%*
Ponta Delgada	94	*1.5%*	34	*0.9%*	46	*2.2%*	14	*7.4%*	90	*1.9%*	2	*0.2%*	2	*0.6%*

Source: FIs, APB.

Table 24: Number of branches per district as at 31 December (2008-2011)[a)]

	2008		2009		2010		2011	
Number of Branches								
Total	**6,062**		**6,162**		**6,232**		**6,080**	
Per District								
Aveiro	401	*6.6%*	410	*6.7%*	403	*6.5%*	398	*6.5%*
Beja	93	*1.5%*	92	*1.5%*	93	*1.5%*	92	*1.5%*
Braga	379	*6.3%*	388	*6.3%*	392	*6.3%*	390	*6.4%*
Bragança	84	*1.4%*	88	*1.4%*	88	*1.4%*	87	*1.4%*
Castelo Branco	117	*1.9%*	117	*1.9%*	125	*2.0%*	122	*2.0%*
Coimbra	247	*4.1%*	246	*4.0%*	256	*4.1%*	252	*4.1%*
Évora	116	*1.9%*	119	*1.9%*	119	*1.9%*	118	*1.9%*
Faro	336	*5.5%*	345	*5.6%*	353	*5.7%*	343	*5.6%*
Guarda	98	*1.6%*	101	*1.6%*	104	*1.7%*	101	*1.7%*
Leiria	289	*4.8%*	293	*4.8%*	299	*4.8%*	295	*4.9%*
Lisboa	1,493	*24.6%*	1,514	*24.6%*	1,533	*24.6%*	1,461	*24.0%*
Portalegre	80	*1.3%*	79	*1.3%*	82	*1.3%*	80	*1.3%*
Porto	929	*15.3%*	945	*15.3%*	955	*15.3%*	939	*15.4%*
Santarém	250	*4.1%*	255	*4.1%*	254	*4.1%*	252	*4.1%*
Setúbal	373	*6.2%*	386	*6.3%*	389	*6.2%*	373	*6.1%*
Viana do Castelo	132	*2.2%*	137	*2.2%*	137	*2.2%*	136	*2.2%*
Vila Real	123	*2.0%*	126	*2.0%*	127	*2.0%*	128	*2.1%*
Viseu	201	*3.3%*	202	*3.3%*	206	*3.3%*	204	*3.4%*
Funchal	151	*2.5%*	153	*2.5%*	151	*2.4%*	141	*2.3%*
Angra do Heroísmo	43	*0.7%*	41	*0.7%*	41	*0.7%*	39	*0.6%*
Horta	32	*0.5%*	31	*0.5%*	32	*0.5%*	35	*0.6%*
Ponta Delgada	95	*1.6%*	94	*1.5%*	93	*1.5%*	94	*1.5%*

Source: FIs, APB.

[a)] 2011 figures do not coincide with those in Table 23, p. 64 and in Graph 28, p. 60, because the evolution of the branch network over time made it necessary to adjust the sample, as indicated in footnote 36, p. 28.

VI.2. Branch offices and representative offices abroad

The member institutions had 206 branch offices and representative offices abroad at the end of 2011. After stagnating in 2010, this distribution channel boosting international activity grew by an impressive 10.8% in 2011 (see Table 25).

This growth contrasts strongly with the reduction in branches in Portugal mentioned in the previous chapter. Portugal's particularly weak economic situation helped to increase the member institutions' focus on international activity as a way of mitigating its negative effects.

Table 25: Number of branch offices and representative offices abroad as at 31 December (2008 - 2011)

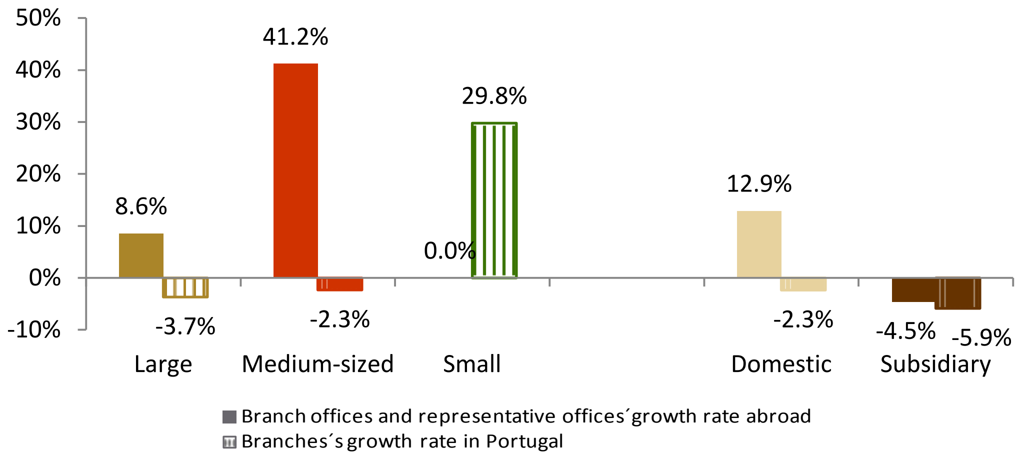
	2008	2009	2010	2011	Average
Branch offices and Representative Offices Abroad [a]					
Total	180	184	185	205	-
Annual growth rate	-	*2.2%*	*0.5%*	*10.8%*	*4.5%*

Source: FIs, APB.

[a] Includes foreign financial branch offices in the Madeira free-trade area.

The opposite performance by the number of branches and of branch offices and representative offices abroad occurred in practically all member institution segments, irrespective of their size or origin/type of legal structure. While there was a reduction in the large and medium-sized and domestic institutions' branches in Portugal along with an increase in their international network, this network stagnated in the small institution segment and they focused on opening branches in Portugal (see Graph 31).

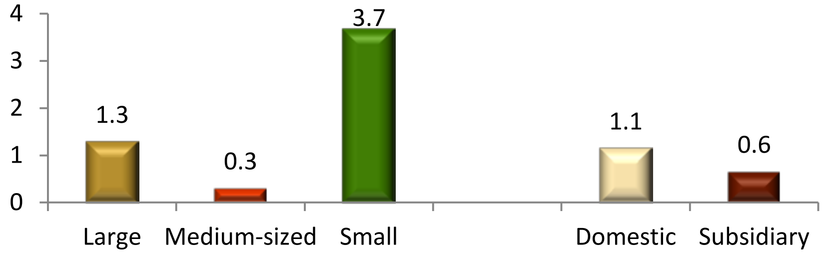
Graph 31: Changes in the number of branches, branch offices and representative offices abroad by size and origin/type of legal structure, 2011



Source: FIs, APB.

Even so, the internationalisation of the small institutions, measured by an indicator relating their average representativity in total branch and representative offices abroad to their average representativity in the whole branch network in Portugal,[57] is proportionally higher than that of the other institutions (see Graph 32 and Table 26). In absolute terms, however, the large institutions own the vast majority of branch and representative offices abroad (81%), along with domestic institutions (89%) (see Table 26).

Graph 32: Relative indicator of member institutions internationalisation by size and origin (2008 – 2011)



Source: FIs, APB.

Table 26: 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 (2008 – 2011)

	2008	2009	2010	2011	Average
Representativity in the Branch Network in Portugal					
Large	64.4%	63.4%	63.0%	62.2%	63.2%
Medium-sized	33.6%	34.4%	34.7%	34.8%	34.4%
Small	2.0%	2.2%	2.3%	3.0%	2.4%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Domestic	78.6%	78.1%	77.6%	77.6%	78.0%
Subsidiary	17.1%	16.8%	17.0%	16.4%	16.8%
Branch office	4.3%	5.1%	5.4%	6.0%	5.2%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Representativity in the Branch Offices and Representativity Offices Abroad					
Large	80.6%	81.0%	82.2%	80.5%	81.0%
Medium-sized	10.0%	9.8%	9.2%	11.7%	10.2%
Small	9.4%	9.2%	8.6%	7.8%	8.8%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Domestic	88.3%	89.7%	88.1%	89.8%	89.0%
Subsidiary	11.1%	10.3%	11.9%	10.2%	10.9%
Branch office	0.6%	0,0%	0.0%	0,0%	0.1%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

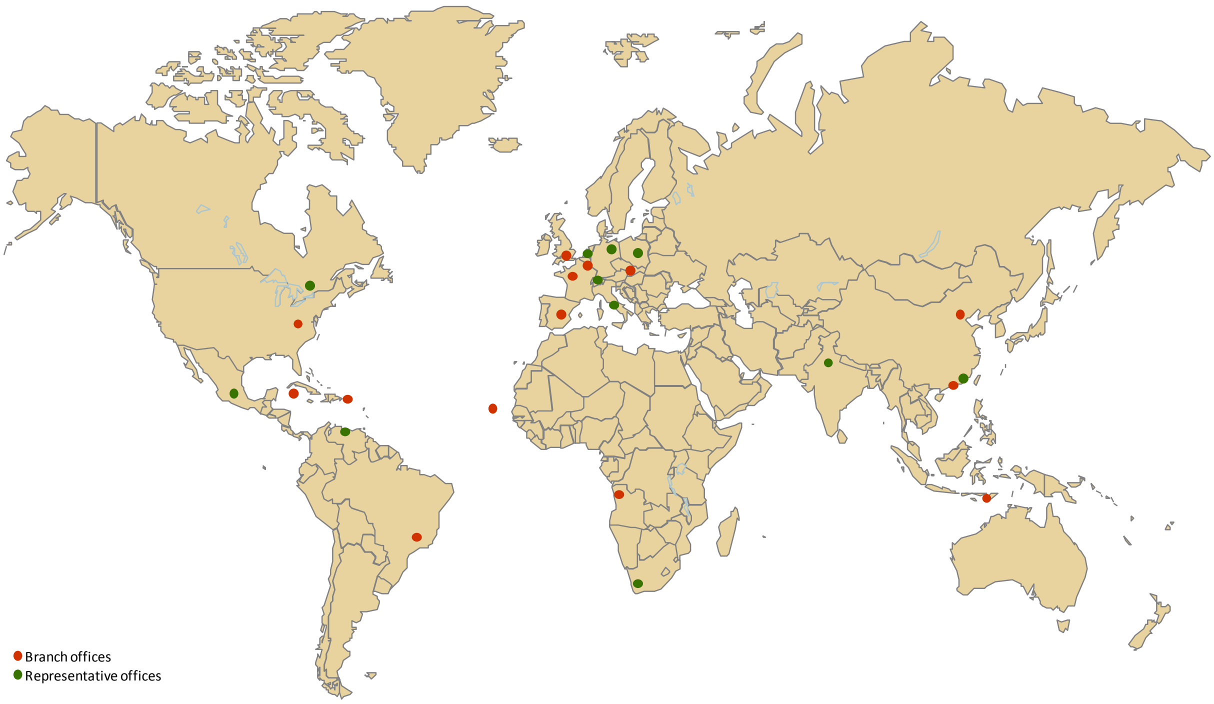
Source: FIs, APB.

As in 2010, the geographical distribution of the member institutions' branch and representative offices abroad was once again centred essentially in Europe in 2011. Nonetheless,

[57] This indicator is calculated by dividing the average representativity of a segment of financial institutions in total branch and representative offices abroad by their average representativity in the branch network in Portugal.

Europe's representativity in the total fell to 69.4% from 71.5%, which reflects the search for new markets as a solution to the difficult economic and financial situation affecting Portugal and other European countries (see Figure 3). In 2011, international expansion was particularly evident in South America and in Africa, where the number of branch and representative offices more than doubled.

Figure 3: Geographical distribution of branch offices and representative offices abroad as at 31 December 2011



Source: FIs, APB.

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

VI.3. ATMs and home banking[58]

In 2011, the member institutions' ATM network was reduced by 1.8% and totalled 17,676 machines at the end of the year. Around 74.5% of them belonged to the Multibanco network, while the remaining 25.5% were in their own networks (see Table 27, p. 69).[59] The closure of branches during the year was the main reason for this decrease, as the machines were removed from them.[60]

In spite of the reduction in their ATM network, the member institutions' prominent position in the Multibanco network remained constant against 2010 at about 94.6% (see Table 27, p. 69).

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[58] All the data on number and size of transactions refer to the sample of 33 member institutions.

[59] For the analysis of the ATM network, the sample is reduced to 28 institutions, as BIG, BAC, Invest, Santander Consumer and Barclays were excluded due to lack of data.

[60] For the sample of member institutions used here, the branch network lost 128 branches while the number of ATMs fell by 330. It is necessary, however, to consider that each branch has more than one ATM on average.

Even so, this did not prevent a modest increase in the number or amount of transactions. The number of transactions grew 0.1% while their amount increased 1.3% in 2011. This growth was essentially due to transfers and payment of services, since the number and amount of withdrawals fell due to the contraction in domestic spending (see Graph 33).

This shows that people in Portugal are increasingly skilled in using new technology that simplifies access to banking services when it comes to mandatory payments.

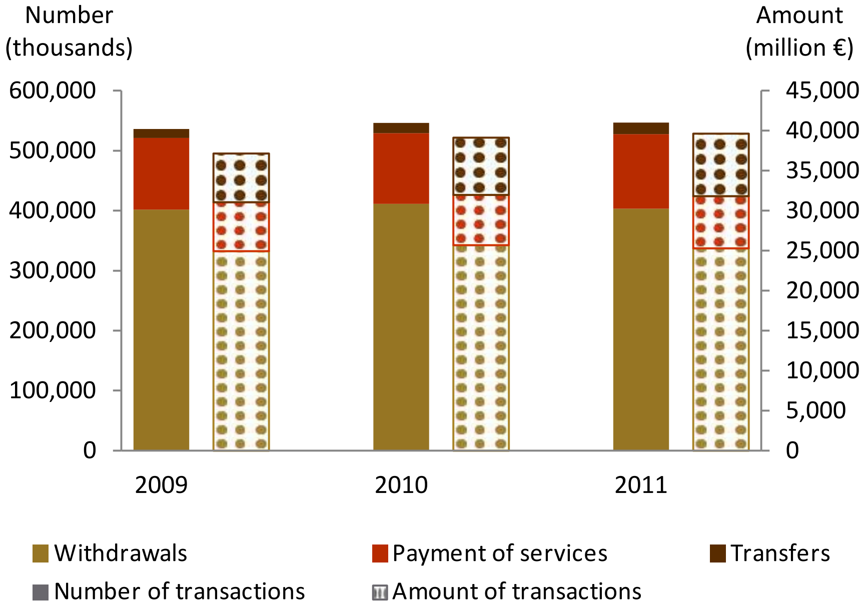
Table 27: Number of Member Institutions ATMs, including those belonging to the Multibanco network as at 31 December (2009 - 2011)

	2009	2010	2011	Average
Number of Member Institutions ATMs				
Total	16,197	18,006	17,676	-
Multibanco network	n.d.	13,364	13,165	-
Own network	n.d.	4,642	4,511	-
Annual growth rate	-	*11.2%*	*-1.8%*	*4.7%*
Number of ATMs belonging to the Multibanco [a] network				
Total	13,894	14,126	13,911	-
Annual growth rate	-	*1.7%*	*-1.5%*	*0.1%*

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).

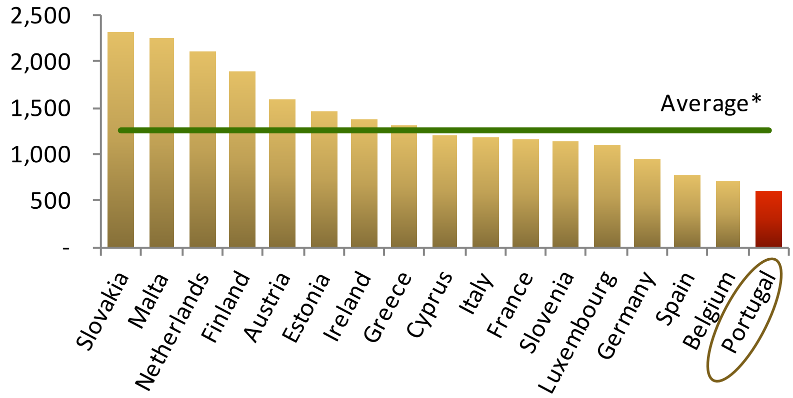
Graph 33: Number and volume of transactions in ATMs by type (2008 – 2011)



Source: SIBS.

In spite of this scenario, Portugal continued to occupy a highly favourable position in relation to the other euro area countries,[61] as it had the best figure for the number of inhabitants per ATM (see Graph 34). This confirmed the high investment made in recent years to achieve a vast ATM network and improve and extend the range of functions that it offers.

Graph 34: Number of inhabitants per ATM in the euro area as at 31 December 2010



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

Where the home banking service was concerned, the number of active users[62,63] fell considerably in 2011 (-7.1%). The member institutions had a total of 2,797,845 bank customers who used this distribution channel's services at the end of 2011 (see Table 28). This can perhaps be explained by a contraction in deposits from non-residents,[64] as this channel is mainly used by customers without easy access to the financial institutions' branch network.

Nonetheless, the number and amount of payments of services grew 10.8% and 15.3%, respectively (see Graph 35, p. 71).

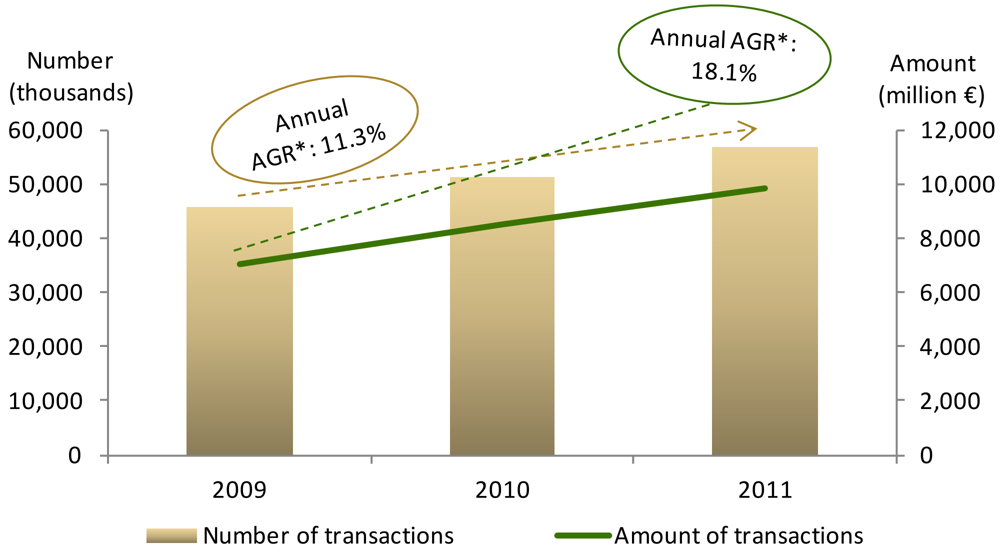
Table 28: Number of users of home-banking as at 31 December (2009 - 2011)

	2009	2010	2011	Average
Number of Users of Home-banking				
Total	2,967.812	3,012.138	2,797.845	-
Annual growth rate	-	*1.5%*	*-7.1%*	*-2.8%*

Source: FIs, APB.

[61] As the data on the number of ATMs in the euro area countries in 2011 are not yet available, this comparative analysis is based on information available for 2010.
[62] For the analysis of the number of home banking users, the sample only covers 24 institutions as BIG, BES, BAC, Invest, Santander Consumer, Banco do Brasil, Barclays, BNP and BNP WM were excluded for lack of data.
[63] Active home banking users are those who have accessed the system in the last three months.
[64] This contraction was mentioned by Banco de Portugal in its Financial Stability Report, May 2012.

Graph 35: Number and volume of service payments via home-banking (2008 – 2011)



Source: SIBS.

Note: TCM* - Average annual growth rate.

VI.4. Active accounts and cards and POSs

The number of active bank accounts[65] at member institutions at the end of 2011 went down to 13,314,366,[66] confirming, albeit more modestly, the downward trend in 2010. This progression was certainly due in part to the deterioration in the economic scenario in Portugal, which led to an increase in unemployment and number of companies declaring insolvency. The reduction in non-resident deposits also contributed to this contraction (see Table 29).

Table 29: Number of active bank accounts, credit and debit cards and POSs as at 31 December (2009 - 2011)

	2009	2010	2011	Average
Number of Active Bank Accounts				
Total	16,962.501	13,879.908	13,314.366	-
Annual growth rate	-	*-18.2%*	*-4.1%*	*-11.1%*
Number of Credit and Debit Cards				
Total	12,685.615	12,930.438	13,545.510	-
Annual growth rate	-	*1.9%*	*4.8%*	*3.3%*
Number of POSs				
Total	209,193	228,792	224,857	-
Annual growth rate	-	*9.4%*	*-1.7%*	*3.8%*

Source: FIs, APB.

[65] Active bank accounts are private and business accounts that have more than €125 in turnover on balance, a minimum of 10 debits or credits in the last three months or overdue credit.

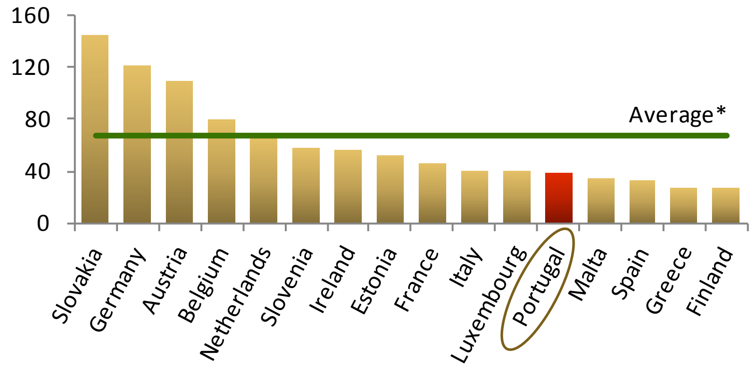
[66] For the analysis of the number of active bank accounts and POSs, the sample includes 27 institutions. BIG, Besi, BAC, Invest, Santander Consumer and Barclays were excluded due to lack of data.

The number of active cards[67] grew to 13,545,510 at the end of 2011[68] (see Table 29, p. 71). The majority, around 60.3%, were debit cards, while the other 39.7% were credit cards. Credit cards were probably responsible for the growth in the total number of active cards, as the reduction in Portuguese households' financial capacity meant that they used them more.

After strong 9.4% growth in 2010, the number of POSs fell 1.7% in 2011 (see Table 29, p. 71). This may be due not only an increase in cases of insolvency among businesses in Portugal but also to the start of a trend by retailers requesting payments in cash to avoid commissions.

The ratio of the number of inhabitants per POS in Portugal was below the average for the other euro area countries in 2010 [69] (see Graph 36).

Graph 36: Number of inhabitants per POSs in the euro area as at 31 December 2010

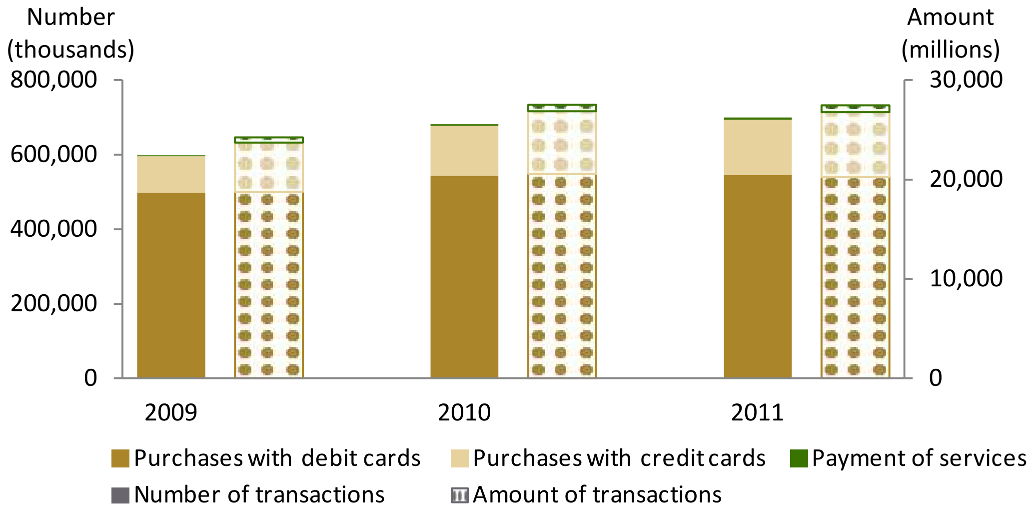


Source: Eurostat, ECB, APB.
Note: * Weighted average of number of inhabitants per POS by each country´s population.

In spite of a 2.6% increase in the number of POS transactions in 2011, there was a 0.2% decrease in the amount, which was undoubtedly related to the contraction of domestic demand, as was the case with ATM withdrawals (see Graph 37, p. 73 and Sub-chapter VI.3 ATMs and home banking, p. 68). This was due to a reduction in the amount of debit card purchases (accounting for 78% of the total number of operations in the period), as the amount of purchases with credit cards and payments of services rose (3.5% and 6.4%, respectively).

[67] Active debit and credit cards are those defined as such in the financial institutions' information systems and can therefore be used immediately by customers.
[68] For the analysis of the number of active cards, the sample was reduced to 26 institutions as BIG, BAC, Invest, Santander Consumer, Barclays, BNP e BNP WM were excluded due to lack of data.
[69] As the data for the number of POSs in the euro area countries in 2011 are not yet available, this comparative analysis is based on 2010 information.

Graph 37: Number and volume of transactions via POSs by type (2008 – 2011)



Source: SIBS.

VII. Performance analysis

VII.1. Balance sheet

VII.1.1. Structure

As at 31 December 2011, the aggregate assets of the financial institutions in this Activity Report totalled 501.478 billion euros (see Table 30), which was 7.395 billion euros[70] or 1.5% face less than on the same date in the previous year.

Table 30: Aggregate balance sheet (million €) as at 31 December 2011[71]

	2011	As % of Total
Assets		
Cash and deposits at Central Banks and other credit institutions	9,143	*1.8%*
Financial investments [a)]	115,905	*23.1%*
Loans and advances to credit institutions	56,798	*11.4%*
Loans and advances to customers	278,324	*55.5%*
Other assets [b)]	41,308	*8.2%*
Total Assets	501,478	*100.0%*
Liabilities and Equity		
Deposits from Central Banks and other credit institutions	132,431	*26.4%*
Deposits from customers	208,232	*41.5%*
Debt securities issued and other equity instruments [c)]	70,023	*14.0%*
Other financial liabilities[)]	56,871	*11.3%*
Other liabilities [e)]	12,298	*2.5%*
Equity	21,623	*4.3%*
Total Liabilities and Equity	501,478	*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.

Within their asset structure, loans and advances to customers were still the most significant item and represented 55.5% of total assets as at 31 December 2011. Financial investments continued to play an important role with a weight of 23.1%, followed by loans and advances to credit institutions, with 11.4% of the total (see Table 30).

[70] The total in the aggregate balance sheet as at 31 December 2010 was altered due to a correction made to the financial statements of Banif, S.A., as mentioned in footnote 33, p. 28. Therefore, including this correction, the balance sheet as at 31 December 2010 totalled 508.873 billion euros.
[71] At the end of the analysis of the balance sheet on pages 103 and 104, there is an annex with an aggregate for 2011 of off-balance-sheet operations of the financial institutions in the sample.

On the liabilities and equity side, deposits from customers are the member institutions' main source of funding and accounted for more than 40% of the total balance sheet at the end of 2011. They are followed, as a percentage of the total, by deposits from Central Banks and other credit institutions, which, together with the debt securities issued and other equity instruments, make up another 40% of the total balance sheet. Equity accounts for only 4.3% (see Table 30, p. 75).

In 2011, the international financial crisis and adverse macroeconomic background in Portugal resulted in an unfavourable context for the banking business. In addition, the EAP deleveraging policies imposed on the banks, the partial transfer of the sector's pension funds to Social Security, the Special Inspection Programme for the financial system and the difficult, prolonged lack of access to the international wholesale markets were behind the contraction in balance sheets.

Table 31: Aggregate assets structure as at 31 December (2008-2011)

	2008	2009	2010	2011	Average
Cash and Deposits [a]					
Total (million €)	10,418	10,485	7,225	9,039	-
Annual growth rate	-	*0.6%*	*-31.1%*	*25.1%*	*-1.8%*
As % of total assets	*2.3%*	*2.2%*	*1.4%*	*1.8%*	*1.9%*
Financial Investments					
Total (million €)	63,073	82,770	116,477	115,845	-
Annual growth rate	-	*31.2%*	*40.7%*	*-0.5%*	*23.8%*
As % of total assets	*14.2%*	*17.3%*	*22.9%*	*23.1%*	*19.4%*
Loans and Advances to Credit Institutions					
Total (million €)	56,638	65,300	56,891	56,239	-
Annual growth rate	-	*15.3%*	*-12.9%*	*-1.1%*	*0.4%*
As % of total assets	*12.7%*	*13.6%*	*11.2%*	*11.2%*	*12.2%*
Loans and Advances to Customers					
Total (million €)	281,739	286,619	288,211	278,068	-
Annual growth rate	-	*1.7%*	*0.6%*	*-3.5%*	*-0.4%*
As % of total assets	*63.3%*	*59.7%*	*56.8%*	*55.6%*	*58.8%*
Other Assets					
Total (million €)	33,478	34,597	38,995	41,281	-
Annual growth rate	-	*3.3%*	*12.7%*	*5.9%*	*7.3%*
As % of total assets	*7.5%*	*7.2%*	*7.7%*	*8.3%*	*7.7%*
Total Assets	445,346	479,771	507,799[72]	500,472	-
Annual growth rate	-	*7.7%*	*5.8%*	*-1.4%*	*4.0%*

Source: FIs, APB.

[a] At Central Banks and other credit institutions.

In the period in question, 2011 marked a turning point in the historic growth trend (even though it was slowing down) in the member institutions' aggregate assets. Due the item's weight in assets, loans and advances to customers best explain this performance. Last year, the stock of loans

[72] See footnote 70, p. 73.

and advances to customers fell 3.5% and lost 1.2 percentage points against 2010 in terms of representativity in the balance sheet aggregate (see Table 31, p. 76).

Table 32: Aggregate financing structure as at 31 December (2008-2011)

	2008	2009	2010	2011	Average
Deposits from Central Banks					
Total (million €)	13,398	17,503	44,958	46,985	-
Annual growth rate	-	*30.6%*	*156.9%*	*4.5%*	*64.0%*
As % of total in the balance sheet	*3.0%*	*3.7%*	*8.8%*	*9.4%*	*6.2%*
Deposits from other credit institutions					
Total (million €)	93,515	91,583	96,426	84,665	-
Annual growth rate	-	*-2.1%*	*5.3%*	*-12.2%*	*-3.0%*
As % of total in the balance sheet	*21.0%*	*19.1%*	*19.0%*	*16.9%*	*19.0%*
Deposits from customers					
Total (million €)	183,161	187,118	194,840	208,057	-
Annual growth rate	-	*2.2%*	*4.1%*	*6.8%*	*4.4%*
As % of total in the balance sheet	*41.1%*	*39.0%*	*38.4%*	*41.5%*	*40.0%*
Debt securities issued and other equity instruments [a]					
Total (million €)	79,483	101,382	81,819	70,023	-
Annual growth rate	-	*27.6%*	*-19.3%*	*-14.4%*	*-2.1%*
As % of total in the balance sheet	*17.9%*	*21.1%*	*16.1%*	*14.0%*	*17.3%*
Other financial liabilities					
Total (million €)	39,605	41,459	49,278	56,871	-
Annual growth rate	-	*4.7%*	*18.9%*	*15.4%*	*13.0%*
As % of total in the balance sheet	*8.9%*	*8.6%*	*9.7%*	*11.4%*	*9.6%*
Other liabilities					
Total (million €)	13,517	12,680	12,113	12,284	-
Annual growth rate	-	*-6.2%*	*-4.5%*	*1.4%*	*-3.1%*
As % of total in the balance sheet	*3.0%*	*2.7%*	*2.4%*	*2.5%*	*2.7%*
Total Liabilities (million €)	422,679	451,725	479,434	478,885	-
Annual growth rate	-	*6.9%*	*6.1%*	*-0.1%*	*4.3%*
As % of total in the balance sheet	*94.9%*	*94.2%*	*94.4%*	*95.7%*	*94.8%*
Equity					
Total (million €)	22,667	28,046	28,365	21,587	-
Annual growth rate	-	*23.7%*	*1.1%*	*-23.9%*	*0.3%*
As % of total in the balance sheet	*5.1%*	*5.8%*	*5.6%*	*4.3%*	*5.2%*
Total Liabilities and Equity	445,346	479,771	507,799	500,472	-

Source: FIs, APB.

[a] Includes subordinated liabilities.

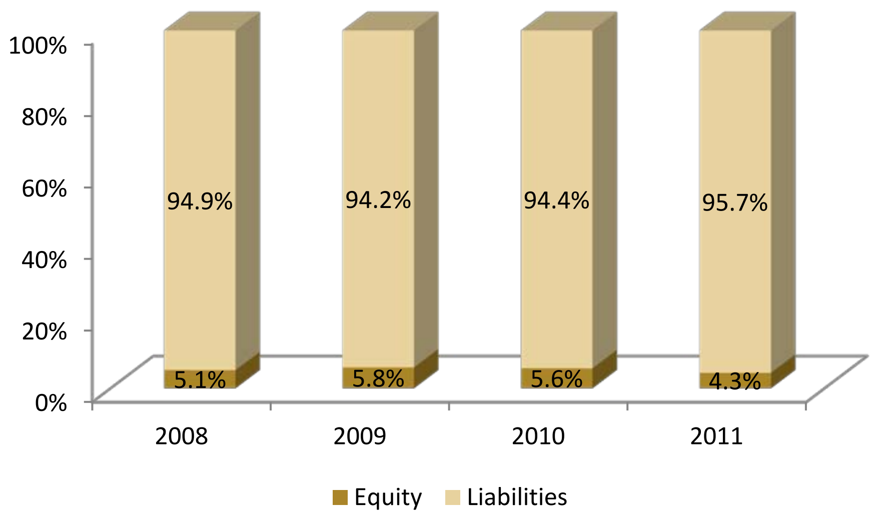
Difficult access to the international wholesale markets on the part of the member institutions and the need to meet more demanding solvency levels under the Economic Adjustment Programme led the financial institutions into an accentuated deleveraging process, which was reflected by a contraction in loans granted to the real sector of the economy. At the same time, the recession that took root in Portugal in 2011 resulted in a reduction in households' disposable income and a contraction in corporate investment, which in turn led to a reduction in demand for credit.

After highly substantial growth in 2009 and 2010, financial investments fell slightly by 0.5% in net terms in 2011 (see Table 31, p. 76). This performance resulted particularly from a sharp fall in share prices due to the highly unfavourable performance of the financial markets and an increase in impairment, especially that for available-for-sale financial assets. The deterioration in the risk premium of the sovereign debt of the peripheral European countries was certainly the main cause of losses recognised and associated with investment portfolios.

Between 2008 and 2011, the member institutions' financing structure was marked by a predominance of liabilities (an average of 94.8% of the total balance sheet as opposed to an average of 5.2% of equity) (see Table 32, p. 77, and Graph 38).

In 2011, however, the weight of the member institutions' liabilities was higher than the average calculated for the period analysed (0.9 percentage points higher), although they went down by 0.1% against 2010 (-549 million euros). This was due to a substantial reduction in absolute value of equity in the year (6.778 billion euros), which represented a decrease of 23.9% (see Table 32, p. 77). This performance was the result of: an aggregate net loss for the year (highly penalised by losses related to non-recurring impacts originating from higher-than-usual impairment for credit and financial investments and the partial transfer of pension funds to the state) and a decrease in fair value reserves and retained earnings. Increases in share capital by some member institutions in 2011 were not sufficient in aggregate terms to mitigate the decrease in reserves (resulting from the fall in debt and capital markets) or retained earnings (due to recognition of past actuarial deviations as a result of the change in accounting policy on pension funds).

Graph 38: Aggregate financing structure as at 31 December (2008-2011)



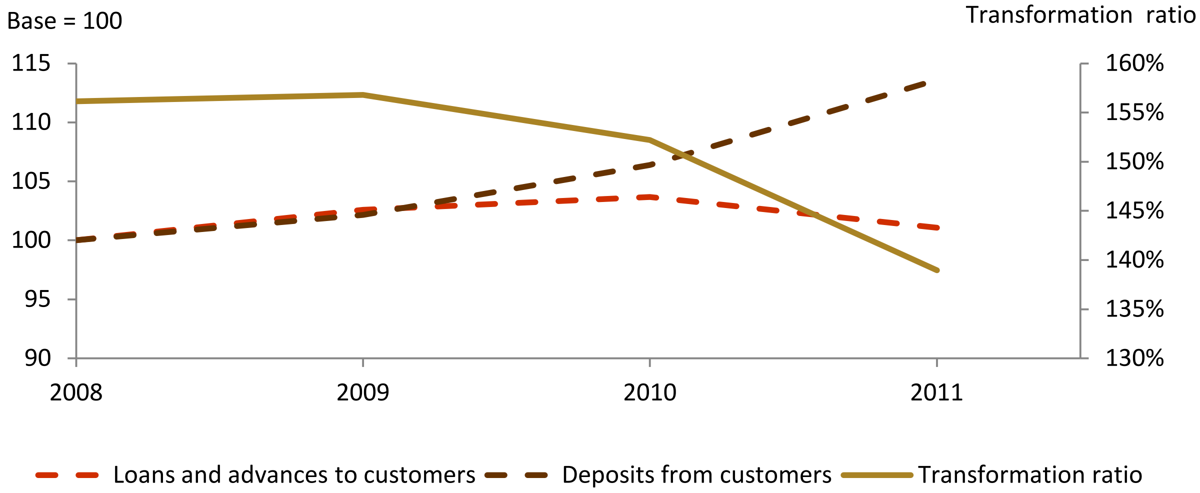
Source: FIs, APB.

Deposits from customers were the member institutions' main source of funding between 2008 and 2011 and represented 40% of the balance sheet structure on average (see Table 32, p. 77).

This item grew from year to year and exceeded 200 billion euros in 2011. Its annual average growth was 4.4%, which contrasts with an annual average reduction of 0.4% in loans to customers that year (see Table 31, p. 76). The divergent behaviour of these two balance sheet items, dictated mainly by their performance in 2011, was the result of a deleveraging process that began in 2010 and continued more intensely in 2011 under the monitoring of Banco de Portugal. Among other aspects, the financial institutions were advised to achieve a ratio of credit over deposits (transformation ratio) of 120% by the end of 2014.

The member institutions' efforts to this end resulted in positive developments in their transformation ratio, particularly in 2011, as shown by Graph 39 and Table 33, p. 82. The ratio went down from 156.8% in 2009 to 139% at the end of 2011.

Graph 39: Transformation ratio (2008-2011)



Source: FIs, APB.

Difficulties in accessing the international interbank and bond markets have been behind the financial institutions' efforts to attract customers' deposits by offering higher interest rates while bearing higher funding costs.

As a result of these circumstances, resources from the interbank market and bond markets have been shrinking (8.85 billion and 9.46 billion euros, respectively), an annual average decrease of 3% and 2.1% respectively in the period under analysis. In 2008, these two sources of funding together had almost the same representativity as deposits from customers, at just under 40%. In 2011, they accounted for only 30.9% of the member institutions' funding structure, while deposits from customers represented 41.5% (see Table 32, p. 77).

Deposits at other credit institutions, which are the financial institutions' second most important source of funding, underwent a net reduction[73] of 28.1% in 2011, as a result of the drying up of the interbank market, which was exacerbated last year by the Portuguese sovereign debt crisis and the country's request for outside assistance. The decrease in this item was more notable in interbank deposits and sale operations with repurchase agreements.

[73] Less loans and advances to credit institutions (see Table 31, p. 76).

While in 2009 the member institutions depended heavily on the issue of debt securities and other equity instruments as a source of funding, with a balance of over 100 billion euros and an annual growth rate of 27% (see Table 32, p. 77), in the last two years recourse to them has fallen considerably (19.3% in 2010, and 14.4% in 2011). The difficulty in placing new debt on the financial markets as result in the reduction in the rating of the country and the Portuguese banks explain the performance of this item, which lost 7.1 percentage points of representativity on the balance sheet between 2009 and 2011. The amount of bonds and other debt securities issued last year was lower than that of the bonds acquired by the institutions themselves.

Also important in the member institutions' aggregate borrowing structure were deposits from Central Banks. This item was the one that stood out most on the balance sheet in terms of annual average growth in the period, (64%), although its increase was moderate in 2011 (4.5%) (see Table 32, p. 77).

The member institutions' lack of access to the interbank market in 2010 and 2011 and to the bond markets in general and the monetary policy measures implemented by the European Central Bank to make up for the liquidity problems in the markets led to great dependency on the Eurosystem on the part of Portuguese financial institutions. It represented 9.4% of total bank funding in 2011, though, as mentioned above, it increased moderately during the year due to a contraction in banking activity and the institutions' active policies for attracting deposits (see Table 32, p. 77).

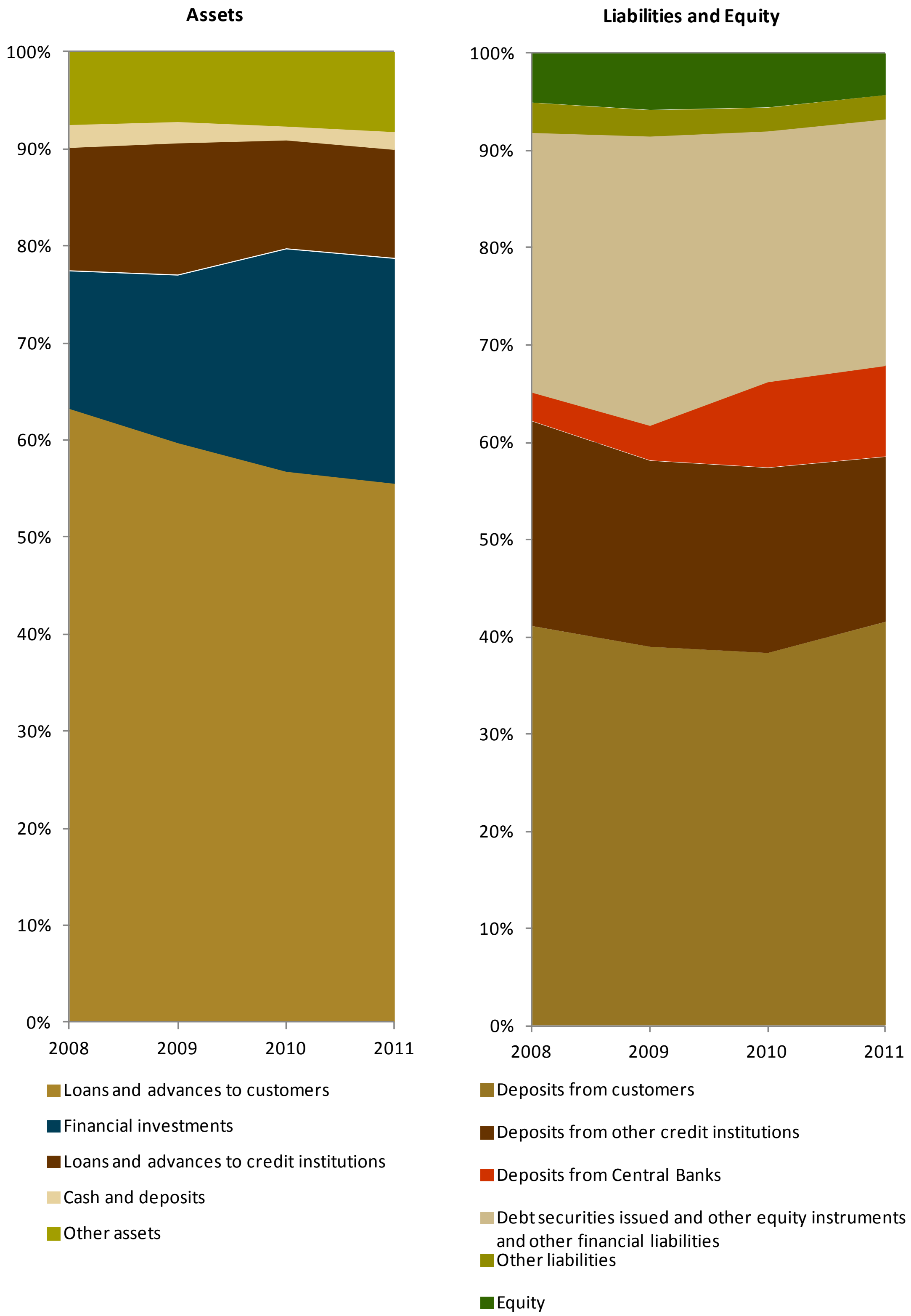
Other financial liabilities also showed significant average growth in the period (13%) (see Table 32, p. 77). This item consists mainly of liabilities for non-derecognised assets and is an accounting reflection of non-derecognised securitisation operations on the member institutions' balance sheets and has a similar performance to this item in assets.

Graph 40, p. 81 shows member institutions' aggregate assets and liabilities from 2008 to 2011.

As mentioned above, in the asset structure, in spite of the importance of loans and advances to customers, which have accounted for an average of 58.8% of the total balance sheet, their weight decreased during the period in analysis. The grant of loans is essential to the development of domestic demand and gross fixed capital formation, so it is crucial to business development and the country's economic growth. The current economic and financial scenario in Portugal has, however, hindered access to the international financial markets, restricting banks' liquidity and negatively affecting new funding. The requirements of the EAP have increased the need for deleveraging of credit. This contraction has been more significant in credit to companies and personal loans, especially consumer and other credit. In order to mitigate these difficulties, the financial institutions have made a considerable effort to attract deposits from their customers, mainly since 2010, by offering low-risk products at more attractive interest rates. This policy resulted in higher growth rates year after year and the stock of deposits from customers totalled 208.057 billion euros in 2011.

At the same time, Eurosystem financing operations, usually short term, were replaced by other, longer-term operations in 2011. This, together with high deposits from customers, especially term deposits, made the member institutions' aggregate funding structure more stable in terms of its maturity. As a result, in 2011 loans and financial investments were financed on a larger scale by liabilities with typically longer maturities than in 2010.

Graph 40: Aggregate balance sheet structure as at 31 December (2008-2011)



Source: FIs, APB.

Meanwhile, after a period of strong growth between 2008 and 2010, financial investments practically stood still in 2011. The deterioration in ratings of the sovereign debt and financial institutions of some European countries like Portugal and Greece required not only impairments and provisions, with a consequent effect on profits, but also the recognition of losses on the securities market values with an impact on the member institutions' equity. As a result, there was a reduction in the gross solvency ratio[74] (see Table 33) from 8.1% in 2010 to 6% in 2011. In fact, equity suffered in two ways: profits, due to provisions and impairment, and losses recognised in fair value reserves. Furthermore, losses from recognition in retained earnings of past actuarial deviations associated with pension funds, due to a change in accounting rules, contributed to the loss of weight of equity in the financial institutions' funding structure.

Table 33 shows the member institutions' aggregate balance sheet between 2008 and 2011.

Table 33: Indicators calculated on figures in the aggregate balance sheet as at 31 December (2008-2011)

		2008	2009	2010	2011
Quick Ratio	Cash and deposits at Central Banks / Financial liabilities [a)]	1.7%	1.6%	0.8%	1.1%
Transformation Ratio	Gross loans / Deposits from customers	156.2%	156.8%	152.2%	139.0%
Overall Lending Capacity	Gross loans / Financial liabilities	69.5%	66.6%	63.3%	61.8%
Finance of Financial Assets	Financial liabilities / Financial assets [b)]	99.3%	98.6%	99.6%	101.6%
Importance of Deposits from Customers	Deposits from customers / Financial liabilities	44.5%	42.5%	41.6%	44.5%
Relevance of Subordinated Debt	Subordinated liabilities / (Own funds + Subordinated liabilities)	40.1%	31.8%	30.4%	28.1%
Gross Solvency	(Own funds + Subordinated liabilities) / Assets	8.5%	8.6%	8.1%	6.0%

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.

VII.1.2. Loans and advances to customers

2011 was not an easy year for the member institutions, due to the recessive macroeconomic scenario in Portugal and the obligation to meet the prudential requirements imposed by the European Union and International Monetary Fund Economic Adjustment Programme.

On the one hand, stricter solvency levels required accentuated deleveraging of banking activity, given the Portuguese banks' difficulty in accessing the international financial markets on normal conditions to increase their capital. This deleveraging resulted in a reduction and/or changes in the composition of their balance sheet assets.

[74] Solvency in accounting terms, i.e. equity + subordinated liabilities.

This negative effect on assets was more accentuated on the grant of loans, as it has higher risk weights than more liquid assets. The need to reduce the transformation ratio placed additional pressure on the bank's credit portfolio.

If we add to these factors the natural contraction in demand for credit on the part of the non-financial private sector in 2011, due to the recession, it is no surprise that last year witnessed less credit channelled into the real economy or that its performance was in line with the decrease in gross domestic product.[75]

Table 34: Gross loans and advances to customers, provisions and impairments as at 31 December (2010-2011)

	2010	2011
Loans and Advances to Customers (Outstanding)		
Total (million €)	278,357	267,679
Annual growth rate	-	*-3.8%*
Loans and Advances to Customers (Overdue)		
Total (million €)	7,967	10,583
Annual growth rate	-	*32.8%*
Total loans and advances to customers (gross)	286,324	278,262
Annual growth rate	-	*-2.8%*
Provisions and Impairments		
Total (million €)	-7,987	-10,460
Annual growth rate	-	*31.0%*
Total loans and advances to customers (net)	278,337	267,802
Annual growth rate	-	*-3.8%*

Source: FIs, APB.

A more restricted but more detailed analysis over time of a sample of 31 member institutions (see Table 34),[76] shows that total gross loans and advances to customers fell 2.8% to 278.262 billion euros in 2011. This contraction resulted from the performance of outstanding loans and advances, which fell 3.8%, while overdue loans increased 32.8% against 2010. Due to the generalised rise in credit risk in 2011, the member institutions increased their provisions and impairments by 2.473 billion euros, 31% higher than 2010.

As a result of the Economic Adjustment Programme, Banco de Portugal developed its Special Inspection Programme (SIP) for the eight largest Portuguese banking groups as at 30 June 2011. The programme entailed assessing their credit portfolios on the basis of an analysis of impairment of a sample of credits and appreciating their impairment calculation models and associated policies and procedures. The process for calculating own funds´ requirements for the credit risk was revised and

[75] International Monetary Fund, "Report on Third Review of Economic Adjustment Programme to Portugal", April 2012 - www.imf.org/external/country/prt/index.htm

[76] This more detailed analysis of the last two years does not include Barclays or Finantia due to a lack of broken-down data. This is why the figures in Table 34 do not match those in Table 31, p. 76, due to adjustments in the sample.

the methods and parameters used in the groups' regular stress tests pursuant to the Economic Adjustment Programme were validated.[77]

According to Banco de Portugal[77], the first phase of the Special Inspection Programme resulted in estimated needs to increase impairments for the credit portfolios analysed by around 596 million euros (adjusted by the reallocation of impairments identified as available as at 30 June 2011). According to the information reported to the APB, as at 31 December 2011 there are currently 520 million euros in provisions and impairments resulting from the programme.

VII.1.2.1. Analysis of loans and advances to customers

As mentioned above, gross credit to customers, which includes loans,[78] non-derecognised securitised loans[79] and other loans and secured amounts receivable,[80] totalled 278.262 billion euros at the end of 2011. This amount is 8.062 billion euros, or 2.8%, lower than in 2010 (see Table 34, p. 83).

Table 35: Gross credit to customers by nature as at December (2010-2011)

	2010	2011	Average
Loans [81]			
Total (million €)	236,761	225,842	-
Change in absolute value (million €)	-	-10,919	-
Annual growth rate	-	*-4.6%*	-
As % of total	*82.7%*	*81.2%*	*81.9%*
Non-derecognised Securitised Loans			
Total (million €)	34,883	41,849	-
Change in absolute value (million €)	-	6,966	-
Annual growth rate	-	*20.0%*	-
As % of total	*12.2%*	*15.0%*	*13.6%*
Other Loans and Amounts Receivable (Secured)			
Total (million €)	14,680	10,571	-
Change in absolute value (million €)	-	-4,109	-
Annual growth rate	-	*-28.0%*	-
As % of total	*5.1%*	*3.8%*	*4.5%*
Total gross loans customers	286,324	278,262	-

Source: FIs, APB.

[77] According to a Banco de Portugal communiqué "The Results of Special Inspections Programme (SIP)" of 16 December 2011.
[78] Loans to the public administration, non-financial companies and private customers and overdue loans.
[79] 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.
[80] Including bonds and commercial paper not tradable on active markets with no intention to sell.
[81] Due to lack of detail in the information provided by Members, overdue credit was assumed to refer entirely to loans.

As also mentioned above, this reduction can be explained by a decrease in demand for credit from private customers and companies due to the fall in households' disposable income and the contraction in investment and by the supply side, as a result of the deleveraging process begun by the banks as they used more restrictive, selective risk assessment criteria and loan conditions, and also the sale of credit portfolios, especially loans to companies.

Specifically, loans, which accounted for 81.2% of total gross credit to customers in 2011, fell 4.6% against 2010 (see Table 35, p. 84). This decrease was particularly significant in loans to companies and, in the case of private customers, consumer credit (Table 38, p. 88). In spite of the reduction in new loans, the decrease also reflected the effect of the transfer of some loans to non-derecognised securitised credit. Securitisation operations in 2011 were essentially for loans to companies and private consumer credit (see Table 37, p. 87).

Meanwhile, the 20% growth (see Table 35, p. 84) in non-derecognised securitised credit obeyed the financial institutions' liquidity needs in 2011. As bonds issued in credit securitisation operations (recorded as financial investments) can serve as collateral for borrowing from the European Central Bank, the member institutions made high use of this possibility as an alternative source of funding.

After the increase in 2010, loans and other secured amounts receivable fell by 4.109 billion euros in 2011 (see Table 35, p. 84). This portfolio consists essentially of commercial paper and bonds that are not tradable on active markets with no intention to sell. This variation was essentially due to the sale of bonds to the parent companies of financial institutions that held them, plus a securitisation operation in 2011 to the amount of approximately 650 million euros.

Table 36: Gross credit to customers by borrower as at 31 December (2010-2011)

	2010	2011	Average
Loans to Companies and Public Administration			
Total (million €)	158,793	149,963	-
Change in absolute value (million €)	-	-8.830	-
Annual growth rate	-	*-5.6%*	-
As % of total	*55.4%*	*53.9%*	*54.7%*
Mortgages			
Total (million €)	107,807	109,561	-
Change in absolute value (million €)	-	1,754	-
Annual growth rate	-	*1.6%*	-
As % of total	*37.7%*	*39.4%*	*38.5%*
Consumer Credit and Other			
Total (million €)	19,724	18,738	-
Change in absolute value (million €)	-	-986	-
Annual growth rate	-	*-5.0%*	-
As % of total	*6.9%*	*6.7%*	*6.8%*
Total gross loans to customers	286,324	278,262	-

Source: FIs, APB.

According to Table 36, p. 85, gross loans to companies and the public administration represented on average more than 50% of total credit granted by the member institutions in the period. In 2011, however, the contraction of 8.83 billion euros in the stock of gross loans to companies and the public administration resulted in a 1.5 percentage point reduction in its weight in total credit against 2010.

Banco de Portugal[82] data indicate that privately owned companies were the most affected by the contraction in the grant of loans in 2011, particularly small companies.

The need to increase spreads due to more expensive funding for the banking sector and the need to abide by stricter risk assessment criteria and lending conditions resulted in greater difficulties in access to bank loans on the part of small and medium-sized Portuguese companies, which are generally highly decapitalised. At the same time, the pressure on the banking sector to meet state-owned companies' funding needs explains the growth in loans to them (and consequently the growth in larger loans[83]) to the detriment of the private sector.

Meanwhile, the stock of gross credit to private customers increased but by much less (only 768 million euros) than the decrease in gross credit to companies and the public administration in 2011. This modest increase reflects the different performance in stocks of gross mortgages and consumer credit in the year (see Table 36, p. 85).

Mortgages, which constitute the second largest item in gross loans to customers (38.5% on average in the last two years) and the largest slice of gross loans to private customers (85% on average in the period) grew almost 1.8 billion euros in 2011. Although this is only a 1.6% growth, it reflects their importance and the basic need that buying their own home represents for families, even in times of crisis (see Table 36, p. 85). Although the banks' conditions, such as higher spreads and the risk criteria followed, were largely responsible for the slowdown in mortgage growth rates, which tended to be high in the past, uncertainty about the current economic climate resulted in a fall in demand for mortgages against previous years.

The high unemployment rate in Portugal, tax increases and the resulting fall in households' disposable income had an adverse effect on the purchase of consumer goods. This is reflected in the 986 million euro reduction in gross loans to private customers for this purpose (see Table 36, p. 85).

Table 35, p. 84, which shows the composition and performance of gross credit, indicates that non-derecognised securitised credit represented 15% of total gross credit in 2011, 20% more than in 2010.

Banks' securitisation operations that are not derecognised in their balance sheets have traditionally been more important (in number and amount) in terms of mortgages. Indeed, in spite of the decrease in total non-derecognised, securitised mortgages in 2011, this type of loan continued to be even more significant, representing 55.5% of all securitisation operations (see Table 37, p. 87).

This trend can also be seen in each individual portfolio of non-derecognised securitised credit compared to total gross credit of each segment. Securitised, non-derecognised mortgages accounted for 21.2% of total gross mortgages at the end of 2011, while loans to companies and the public

[82] Banco de Portugal, "Financial Stability Report", May 2012.
[83] Banco de Portugal, "Financial Stability Report", May 2012.

administration and securitised, non-derecognised consumer and other credit represented 10.5% and 15.3%, respectively (see Table 36, p. 85 and Table 37).

Table 37: Non-derecognised securitised loans by borrower as at 31 December (2010-2011)

	2010	2011	Average
Companies and Public Administration			
Total (million €)	9,196	15,775	-
Change in absolute value (million €)	-	6,579	
Annual growth rate	-	*71.5%*	-
As % of total	*26.4%*	*37.7%*	*32.0%*
Mortgages			
Total (million €)	24,073	23,211	-
Change in absolute value (million €)	-	-862	
Annual growth rate	-	*-3.6%*	-
As % of total	*69.0%*	*55.5%*	*62.3%*
Consumer Credit and Other			
Total (million €)	1,614	2,863	-
Change in absolute value (million €)	-	1,249	
Annual growth rate	-	*77.4%*	-
As % of total	*4.6%*	*6.8%*	*5.7%*
Total non-derecognised securitised loans	34,883	41,849	-

Source: FIs, APB.

In 2011, however, it was essentially securitisation of loans to companies and the public administration and consumer credit that predominated (growing more than 70% against 2010), perhaps due to higher availability among these assets for this type of operation today (see Table 37).

An analysis of loans only (see Table 38, p. 88) confirms a preponderance of loans to companies in the member institutions' portfolio. As mentioned above, among private customers, mortgages were the main form of borrowing by Portuguese households, as it is a purchase of an essential good.

Table 38, p. 88 also shows that, excluding non-derecognised securitised credit, the variations between 2010 and 2011 in the loan portfolios analysed were greater than those in Table 36, p. 85. Consumer loans were clearly those that had fallen most in percentage by the end of 2011 (-12.3%) and loans to companies and the public administration contributed most in absolute value to the contraction in the member institutions' loan portfolios.

Table 38: Credit by borrower as at 31 December (2010 – 2011)

	2010	2011	Average
Companies and Public Administration			
Total (million €)	134,917	123,617	-
Change in absolute value (million €)	-	-11,300	
Annual growth rate	-	*-8.4%*	-
As % of total	*57.0%*	*54.8%*	*55.9%*
Mortgages			
Total (million €)	83,734	86,350	-
Change in absolute value (million €)	-	2,616	
Annual growth rate	-	*3.1%*	-
As % of total	*35.4%*	*38.2%*	*36.8%*
Consumer Credit and Other			
Total (million €)	18,110	15,875	-
Change in absolute value (million €)	-	-2,235	
Annual growth rate	-	*-12.3%*	-
As % of total	*7.6%*	*7.0%*	*7.3%*
Total loans	236,761	225,842	-

Source: FIs, APB.

VII.1.2.2. Quality of loans and advance to customers

The decline in the economic environment in Portugal in recent years, with the unemployment rate reaching all-time highs and a rising number of Portuguese companies declaring insolvency, explains why the deterioration of quality of credit is a reality in the member institutions' balance sheet, in view of high levels of borrowing by households and companies.

The materialisation of the credit risk resulted in 32.8% growth in overdue loans (loans overdue for more than 30 days) last year, which represents an absolute increase of 2.616 billion euros (see Table 34, p. 83 and Table 39, p. 89). Overdue loans represented 3.8% of the total gross stock of credit in 2011, one percentage point higher than in 2010.

Overdue loans to companies and the public administration, which accounted for more than 66% of total overdue loans in 2011, grew more than loans to private individuals (mortgages, consumer and other credit) in 2011 (43.3%) (see Table 39, p. 89). According to Banco de Portugal data,[84] the deterioration in credit quality indicators occurred in all sectors of the economy, but especially in construction, real estate, wholesale, retail and vehicle repairs. Shorter-term loans to smaller companies were those with the highest default rate.

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

Table 39: Overdue loans as at December (2010 – 2011)

	2010	2011	Average
Companies and Public Administration			
Total (million €)	4,928	7,064	-
Annual growth rate	-	*43.3%*	-
As % of total	*61.8%*	*66.7%*	*64.3%*
Mortgages			
Total (million €)	1,815	2,006	-
Annual growth rate	-	*10.5%*	-
As % of total	*22.8%*	*19.0%*	*20.9%*
Consumer Credit and Other			
Total (million €)	1,224	1,513	-
Annual growth rate	-	*23.6%*	-
As % of total	*15.4%*	*14.3%*	*14.8%*
Total loans overdue	7,967	10,583	-

Source: FIs, APB.

Overdue loans to private customers, which represented approximately 34% of total overdue loans in 2011, grew less in absolute and relative value (480 million euros or 15.8%) (see Table 39). Historically, overdue mortgages have grown less in percentage than consumer credit, considering the nature of the goods underlying the loans and 2011 was no exception (10.5% vs. 23.6%, respectively) (see Table 39).

In 2011, regarding the stock of gross credit, it was overdue consumer credit that was highest (8.1%) with the largest growth (1.9 percentage points) against 2010. It was followed by overdue loans to companies and the public administration at 4.7%, 1.6 percentage points up in the year. Overdue mortgages showed modest representativity and growth (1.8% and 0.1 percentage points, respectively) (see Table 36, p. 85 and Table 39).

In addition to the default ratio[85] traditionally reported by Banco de Portugal, in September 2011 it asked the financial institutions to present a new indicator on credit quality for better monitoring and ease of international comparison. The non-performing loans ratio[86] is now part of the minimum required indicators that Banco de Portugal requires whenever quantitative information on quality of credit is released.[87]

[85] 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.

[86] 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.

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

Table 40: Default and non-performing loans' ratios as at 31 December (2010 – 2011)

	2010	2011
Default ratio		
Total	3.3%	4.5%
Mortgages	2.0%	2.4%
Consumer credit and other	7.1%	9.4%
Credit to non-financial organisations	4.4%	6.1%
Credit to non-residents	1.9%	3.3%
Non-performing Loans Ratio		
Total	5.1%	7.1%
Mortgages	4.4%	4.7%
Consumer credit and other	9.9%	12.8%
Credit to non-financial organisations	6.3%	9.3%
Credit to non-residents	4.3%	6.7%

Source: FIs e APB.

The default and non-performing loans ratios show a similar pattern in 2010 and 2011 and they both deteriorated in all the segments analysed from one year to the other (see Table 40).

The total default ratio rose from 3.3% in 2010 to 4.5% in 2011 in the sample of financial institutions analysed.[88] The highest growth was in default rates in consumer credit,[89] as a result of the above-mentioned factors. The total non-performing loans ratio showed a similar trend, as it increased two percentage points to 7.1% in 2011. Consumer loans to private customers were the segment in which the non-performing loans were most disturbing (12.8%), although it was loans to non-financial companies in which the rise was greatest (three percentage points) (see Table 40).

In order to deal with the deterioration in quality of credit resulting from the above-mentioned increase in default rates, the member institutions increased their provisions and impairments by 2.473 billion euros in 2011 (see Table 34, p. 83). This increase was not sufficient to cover the entire rise in overdue loans however. The ratio of coverage of overdue loans by provisions fell from 100.3% in 2010 to 98.8% in 2011.

Considering this reduction in coverage of overdue loans by provisions, the member institutions can be expected to increase their provisions and impairments next year, due to the possible credit risk to the part of the portfolio identified as non-performing loans.

In short, the credit risk continues to increase and to be more significant in the case of credit to companies and private consumer credit. The exacerbation of the economic recession in Portugal, the rise in the unemployment rate and the sharp increase in the number of insolvencies are behind the deterioration in quality of credit.

[88] This analysis does not include the branch offices of foreign banks operating in Portugal as they are not obliged to prepare this information for Banco de Portugal.

[89] In addition to the institutions mentioned in footnote 88, the analysis of the details of overdue loans (including doubtful debt) and non-performing loans also does not include CGD, due to unavailability of information.

VII.1.3. Financial investments

After highly substantial growth in financial investment portfolios in 2010 due to strong acquisition of Portuguese public debt bonds and the issue of bonds resulting from credit securitisation operations, there was a slight contraction in these assets in net terms in 2011 (-453 million euros, representing an annual variation rate of -0.4%) (see Table 41, p. 92).

This contraction resulted not only from a significant reduction in the value of the portfolio of financial assets held for trading (almost 3 billion euros less) but also from an increase in impairments in portfolios of available for sale financial assets and investments held to maturity. This rise meant that the net increases in these portfolios were 2.5% and 4.8% respectively, while in gross terms the two items grew 3.1% and 7.2% respectively (see Table 41, p. 92).

As a result, the portfolio of financial assets held for trading lost representativity in net terms in the member institutions' financial investments (13.5% in 2011 against 16.1% in 2010) in favour of the other two portfolios (see Table 41, p. 92).

Overall, the performance of the financial investment portfolio was marked by the highly unfavourable performance of the international financial markets. The sovereign debt crisis in the peripheral euro area countries and the repercussions and uncertainties as to Europe's economic, financial and political future created great instability in share markets and particularly debt markets worldwide.

This context was responsible for profound depreciation in securities, which was reflected immediately in portfolios of financial assets recorded at market value (trading and available for sale portfolios) and indirectly, due to an increase in impairments, in portfolios of available for sale financial assets (520 million euros) and investments held to maturity (344 million euros) (see Table 41, p. 92). The main impact in terms of impairments was due to the carrying of losses from the restructuring of Greece's sovereign debt. Following the European authorities' measures to step up financial stability mechanisms in the European Union, an agreement was set up on voluntary involvement of the private sector in the restructuring of the Greek public debt. This resulted in acceptance of losses with the recognition of a 53.5% haircut in the debt's nominal value and the conversion of part of the debt into new securities with longer maturity.

The fall in the share market also resulted in recognition of impairments in shares held by member institutions, especially from PSI 20 companies. Furthermore, the performance of financial investments was also affected by a need for deleveraging, which resulted in the sale of a number of especially non-strategic assets in portfolios of available for sale assets.

Table 41: Financial investments portfolio as at 31 December (2010-2011)

	2010	2011	Average
Financial Assets Held for Trading and Other Assets at Fair Value through Profit or Loss			
Total (million €)	18,367	15,373	-
Annual growth rate	-	*-16.3%*	-
As % of net total	*16.1%*	*13.5%*	*14.8%*
Available-for-sale Financial Assets			
Gross amount (million €)	80,013	82,478	-
Annual growth rate	-	*3.1%*	-
As % of net total	*70.1%*	*72,6%*	*71.3%*
Impairment (million €)	-836	-1,356	-
Annual growth rate	-	*62.2%*	-
As % of net total	*-0.7%*	*-1.2%*	*-0.9%*
Held-to-maturity Investments			
Gross amount (million €)	14,316	15,344	-
Annual growth rate	-	*7.2%*	-
As % of net total	*12.5%*	*13.5%*	*13.0%*
Impairment (million €)	-50	-394	-
Annual growth rate	-	*688.0%*	-
As % of net total	*0.0%*	*-0.3%*	*-0.2%*
Other [a]			
Total (million €)	2,319	2,231	-
Annual growth rate	-	*-3.8%*	-
As % of net total	*2.0%*	*1.9%*	*2.0%*
Total of financial investments (gross)	115,015	115,426	-
Total impairments	-886	-1,750	-
Total of financial investments (net)	114.129	113.676	-
Annual growth rate	-	*-0.4%*	-

Source: FIs, APB.

[a] Assets with repurchase agreements.

An analysis of the structure of the member institutions' securities portfolios by type of instrument (see Table 42, p. 93) shows, however, that, in spite of a significant reduction in the bank's exposure to debt instruments (-1.494 billion euros) in 2011 these securities were still the most representative (91.8%), particularly debt securities from other issuers (67.7%). Their portfolios of shares and of other securities (which normally include investment fund units) accounted for the other 8.2%. Their performance was different during the year, however. While the share portfolio fell 1.9% (mainly due to the performance of the share market in 2011), the portfolio of other securities grew (9.8%), due to financial institutions' sale of loans to investment funds in return for purchasing units in these funds.

Finally, there was a sharp fall in the portfolio of public debt securities in 2011 (-1.481 billion euros), which absorbed practically all the variation in financial investments in the year.

Table 42: Structure of the securities portfolio by type of instrument as at 31 December (2010 – 2011)

	2010		2011		Change	
	million €	%	million €	%	million €	%
Securities Portfolio [a]						
Debt securities issued by public bodies [b]	26,390	*25.3%*	24,909	*24.1%*	-1,481	*-5.6%*
Debt securities issued by other bodies [b]	69,910	*67.0%*	69,897	*67.7%*	-13	*0.0%*
Shares	3,912	*3.7%*	3,839	*3.7%*	-73	*-1.9%*
Other securities	4,152	*4.0%*	4,558	*4.5%*	406	*9.8%*
Total	104,364	*100.0%*	103,203	*100.0%*	-1,161	*-1.1%*

Source: FIs, APB.

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

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

Table 43: Structure of financial investments [a] [b] by type of portfolio and instrument as at 31 December (2010 – 2011)

	2010		2011		Change	
	million €	%	million €	%	million €	%
Financial Assets Held for Trading and at Fair Value Through Profit or Loss						
Debt securities issued by public bodies [c]	5,031	*27.4%*	1,579	*10.3%*	-3,452	*-68.6%*
Debt securities issued by other bodies [c]	1,701	*9.3%*	704	*4.5%*	-997	*-58.6%*
Shares	1,149	*6.3%*	919	*6.0%*	-230	*-20.0%*
Other securities	2,154	*11.7%*	2,179	*14.2%*	25	*1.2%*
Derivatives	8,332	*45.3%*	9,992	*65.0%*	1,660	*19.9%*
Total	18,367	*100.0%*	15,373	*100.0%*	-2,994	*-16.3%*
Available-for-Sale Financial Assets						
Debt securities issued by public bodies [c]	15,438	*19.3%*	18,231	*22.1%*	2,793	*18.1%*
Debt securities issued by other bodies [c]	59,814	*74.8%*	58,948	*71.5%*	-866	*-1.4%*
Shares	2,763	*3.4%*	2,920	*3.5%*	157	*5.7%*
Other securities	1,998	*2.5%*	2,379	*2.9%*	381	*19.1%*
Total	80,013	*100.0%*	82,478	*100.0%*	2,465	*3.1%*
Held-to-Maturity Investments						
Debt securities issued by public bodies [c]	5,921	*41.4%*	5,099	*33.2%*	-822	*-13.9%*
Debt securities issued by other bodies [c]	8,395	*58.6%*	10,245	*66.8%*	1,850	*22.0%*
Total	14,316	*100.0%*	15,344	*100.0%*	1,028	*7.2%*
Total	112,696		113,195		499	*0.4%*

Source: FIs, APB.

[a] Gross amounts.

[b] Does not include assets with repurchase agreements.

[c] Includes bonds and other fixed-income securities.

It was in the trading and other assets at fair value through profit or loss portfolio (see Table 43) that the decrease in sovereign debt securities (-68.6%) and bonds from other issuers (-58.6%) was most accentuated. Indeed, both debt securities from public issuers and from other issuers (which represented 27.4% and 9.3% of this portfolio respectively in 2010) lost representativity in

2011 (10.3% and 4.5% do total, respectively). This loss was offset to some extent by investment derivatives, which went from 45.3% of the portfolio in 2010 to 65% in 2011, showing net growth of almost 20% or 1.66 billion euros.

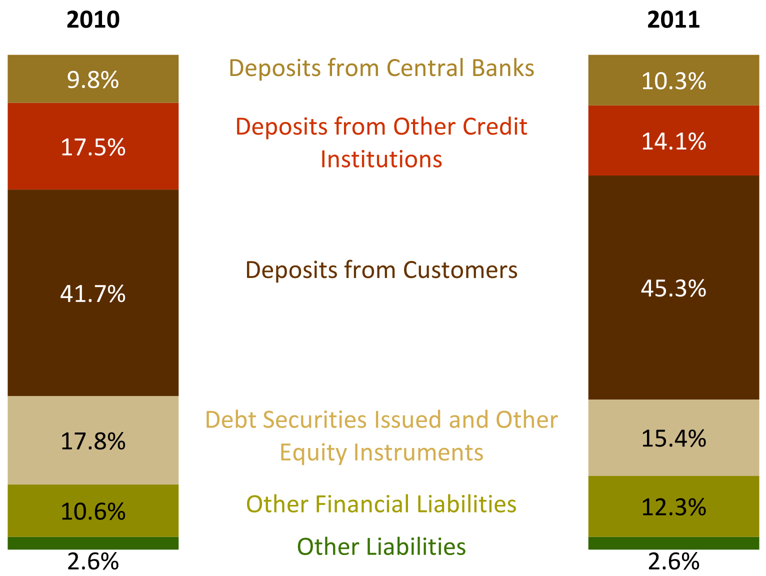
The 2.465 billion euro growth in the portfolio of available for sale financial assets (Table 43, p. 93) was mainly due to an increase in the balance of public debt securities (mostly Portuguese), which shows that, in spite of the depreciation in their market value, the financial institutions continued to provide funding to the Portuguese government. The reason that these securities are recorded in this portfolio is that variations in fair value are carried in reserves and not profit or loss (with the exception of recognised impairment and gains or losses when the securities are sold), which means that the profits or losses are not adversely affected by depreciation in the securities in this portfolio. At a prudential level, the impacts of the variations in value of debt securities in this portfolio have no effect, which explains the increase in it in recent years.

Finally, growth in investments held to maturity (7.2%) was the most significant in member institutions' total aggregate financial investments (Table 43, p. 93). This was the case in gross and net impairment values. Two different performances contributed to this, however, depending on whether the debt securities were from public or other issuers. The former fell (-13.9%) due to the maturity of the securities, while the latter rose 22%, mainly due to a financial institution's underwriting of bonds issued by its parent company.

VII.1.4. Funding structure[90]

In 2011, the member institutions' borrowing structure continued to be based on deposits from customers, which contributed more than 45% to their total borrowing. Debt securities issued and other equity instruments were in second place with a weight of around 16%. Deposits from other credit institutions and Central Banks proved to be of less importance, representing 14.1% and 10.3% of the member institutions' borrowing respectively (see Graph 41).

Graph 41: Aggregate borrowing structure as at 31 December (2010 – 2011)



Source: FIs, APB.

Last year, the substantial 7.4% rise in deposits from customers led to a considerable increase in their importance in the member institutions' borrowing structure (see Graph 41 and Table 44, p. 96). This performance was a result of the sizeable expansion in term deposits, with a growth rate 17.2%, corresponding to 20.173 billion euros. Current accounts and other deposits fell during the year (see Table 44 p. 96).

There were a number of reasons for this performance by deposits, though they consisted of those leading to an increase in customer investment and those allowing the financial institutions to attract more.

The former reasons include uncertainty in Portugal and the rest of Europe, which has generated preference for lower-risk alternatives on the part of consumers of financial products and services. The fact that deposits of up to 100,000 euros are covered by the Deposit Guarantee Fund is also an incentive for small investors.

The growth in deposits was also due in part to the member institutions' strong need to attract more stable funds, essentially because of two factors. One was the Banco de Portugal

[90] As in the previous sub-chapters, the analysis of funding was based on a sample of 31 financial institutions and did not include Finantia or Barclays for the reasons set out in footnote 76, p. 83.

recommendations under the EAP to reduce the transformation ratio to 120% by 2014, the other was the Portuguese financial institutions' difficulties in accessing the wholesale finance markets, which began in 2010 and worsened in 2011.

Inevitably, 2011 witnessed an intensification of competition to attract deposits between banks, which resulted in a high stake in diversification of savings products and a generalised increase in the interest offered on them.

It is important to point out, however, that the performance of interest rates on deposits was not regular during the year. While there were successive increases until the end of October 2011, rates on new operations fell sharply in the last two months as a result of intervention by Banco de Portugal. Using rules penalising the solvency ratios of financial institutions offering interest on deposits above a certain limit,[91] Banco de Portugal sought to end the spiralling increases in interest offered with potentially negative repercussions on the financial institutions' return.

Table 44: Deposits from customers as at 31 December (2010-2011)

	2010	2011	Average
Demand Deposits			
Total (million €)	56,085	52,984	-
Annual growth rate	-	*-5.5%*	-
As % of total	*29.4%*	*25.9%*	*27.7%*
Term Deposits			
Total (million €)	117,561	137,734	-
Annual growth rate	-	*17.2%*	-
As % of total	*61.6%*	*67.2%*	*64.4%*
Other Funds			
Total (million €)	17,196	14,216	-
Annual growth rate	-	*-17.3%*	-
As % of total	*9.0%*	*6.9%*	*8.0%*
Total deposits from customers	190,842	204,934	-
Annual growth rate	-	*7.4%*	-

Source: FIs, APB.

Meanwhile, the member institutions' added difficulty in accessing the wholesale finance markets had other impacts. Proof of this was a highly significant reduction in deposits from other credit institutions (-20.1%), debt securities issued (-11.3%) and subordinated liabilities (-32.1%) (see Table 45, p. 97 and Table 48, p. 100).

Restrictions on gross funding obtained through other credit institutions increased considerably in 2011, with a variation rate of -20.1%. If we consider these deposits in net terms, subtracting deposits at and loans and advances to other credit institutions from their gross amount,

[91] Banco de Portugal Notices 7/2011 and 8/2011 of 25 October and Instruction 28/2011 of 15 November - for more detail, see Sub-chapter III.1. Laws and regulations in Portugal, p. 11.

the deterioration of the member institutions' situation in relation to the interbank market is even more clearly visible, as this item showed a variation of -43% (see Table 46, p. 98).

Table 45: Deposits from other credit institutions as at 31 December (2010-2011)

	2010	2011	Average
Deposits			
Total (million €)	53,249	41,133	-
Annual growth rate	-	*-22.8%*	-
As % of total	*66.6%*	*64.3%*	*65.5%*
Interbank Money Market Funds			
Total (million €)	974	1,404	-
Annual growth rate	-	*44.1%*	-
As % of total	*1.2%*	*2.2%*	*1.7%*
Loans			
Total (million €)	5,799	7,707	-
Annual growth rate	-	*32.9%*	-
As % of total	*7.3%*	*12.0%*	*9.7%*
Sale Operations with Repurchase Agreements			
Total (million €)	12,347	7,534	-
Annual growth rate	-	*-39.0%*	-
As % of total	*15.4%*	*11.8%*	*13.6%*
Other Funds			
Total (million €)	7,633	6,177	-
Annual growth rate	-	*-19.1%*	-
As % of total	*9.5%*	*9.7%*	*9.6%*
Total	80,002	63,955	-
Annual growth rate	-	*-20.1%*	-

Source: FIs, APB.

In net terms, deposits from other credit institutions were essentially affected by sharp falls in deposits and sale operations with repurchase agreements. There was a 7.644 billion euro reduction in deposits, a fall of 30.7%. There was a substantial drop in sale operations with repurchase agreements to slightly over half the figure for 2010, resulting in a net reduction of 5.73 billion euros. Nonetheless, the large variation in this item in 2011 was due to its atypical performance in 2010, when its stock increased hugely, as at the time these instruments were an alternative able to offset the drying up of the interbank market, as they offered a greater guarantee to creditors.

On the other hand, both loans and the interbank money market proved to be sources of release of funds, as there was a reduction in the member institutions' net creditor position in these items (see Table 46, p. 98).

Table 46: Net resources from other credit institutions as at 31 December (2010-2011)

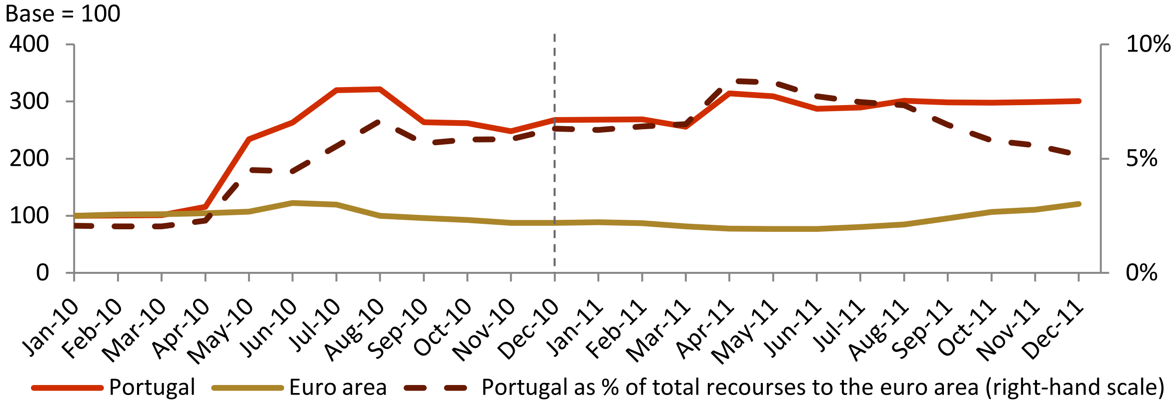
	2010	2011	Average
Deposits [a)]			
Total (million €)	24,893	17,249	-
Annual growth rate	-	*-30.7%*	-
As % of total	*88.3%*	*107.3%*	*97.8%*
Interbank Money Market Funds			
Total (million €)	-1,644	-241	-
Annual growth rate	-	*-85.3%*	-
As % of total	*-5.8%*	*-1.5%*	*-3.7%*
Loans			
Total (million €)	-5,304	-4,466	-
Annual growth rate	-	*-15.8%*	-
As % of total	*-18.8%*	*-27.8%*	*-23.3%*
Sale Operations with Repurchase Agreements			
Total (million €)	11,878	6,148	-
Annual growth rate	-	*-48.2%*	-
As % of total	*42.1%*	*38.3%*	*40.2%*
Other Funds			
Total (million €)	-1,635	-2,616	-
Annual growth rate	-	*60.0%*	-
As % of total	*-5.8%*	*-16.3%*	*-11.1%*
Total	28,188	16,074	-
Annual growth rate	-	*-43.0%*	-

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.

Funding from Central Banks rose in 2011 (1.856 billion euros) (see Table 47, p. 100), though still much less than in 2010 (see Table 32, p. 77). This demonstrates the member institutions' efforts to contain their borrowing from the Eurosystem, which actually resulted in a reduction in borrowing in some months of the year. Indeed, the monthly average growth rate in 2011 was around 1.2%, while that of the euro area countries was 2.9%. The weight of recourse to borrowing from the ECB by Portuguese financial institutions in the total Eurosystem therefore fell 1.2 percentage points against the end of 2010 (see Graph 42, p. 99).

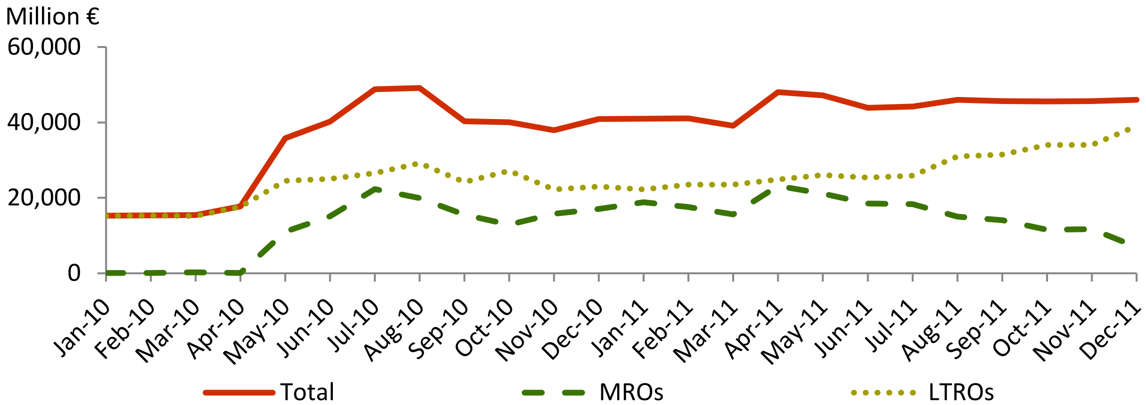
Graph 42: Recourse to funding from the European Central Bank by the national financial institutions against the euro area



Source: BdP, ECB.

Substantial subscription of an issue in a three-years long-term refinancing operation (LTRO[92]) as part of the ECB's non-conventional monetary policy measures last December was used almost entirely to reduce balances in other, shorter operations (MROs[93]), a practice that had been followed since the end of June 2011. As a result, there was a practical stagnation of the total debt to Central Banks and a significant alteration in its maturities, which became much longer (see Graph 43).

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



Source: BdP.

Furthermore, at the end of 2011, borrowing from Central Banks came essentially from Banco de Portugal (86.2%), which increased against 2010, as opposed to other Central Banks (see Table 47, p. 100).

[92] Long-term refinancing operation.
[93] Main refinancing operations.

Table 47: Deposits from Central Banks as at 31 December (2010-2011)

	2010	2011	Average
Deposits from Banco de Portugal			
Total (million €)	35,771	40,020	-
Annual growth rate		*11.9%*	-
As % of total	*80.3%*	*86.2%*	*83.3%*
Deposits from Other Central Banks			
Total (million €)	8,802	6,409	-
Annual growth rate		*-27.2%*	-
As % of total	*19.7%*	*13.8%*	*16.8%*
Total deposits from Central Banks	44,573	46,429	-
Annual growth rate	-	*4.2%*	-

Source: FIs, APB.

Table 48: Debt securities issued and other equity instruments as at 31 December (2010-2011)

	2010	2011	Average
Debt securities issued			
Total (million €)	69,120	61,339	-
Annual growth rate	-	*-11.3%*	-
As % of total	*84.8%*	*87.9%*	*86.4%*
Subordinated Liabilities			
Total (million €)	12,333	8,369	-
Annual growth rate	-	*-32.1%*	-
As % of total	*15.1%*	*12.0%*	*13.6%*
Equity Instruments			
Total (million €)	89	86	-
Annual growth rate	-	*-4.2%*	-
As % of total	*0.1%*	*0.1%*	*0.1%*
Total	81,542	69,794	-
Annual growth rate	-	*-14.4%*	-

Source: FIs, APB.

The lower growth in borrowing from Central Banks in 2011 may also have been favoured to a certain extent by the greater possibility of placing funding contracts guaranteed by Portuguese government on international markets.[94] The 11 debt issues performed under this scheme in 2011 totalled 10.825 billion euros in the form of bonds. This sum was approximately 30% of the total amount provided for the purpose by the Financial Stability Initiative and Economic Adjustment Programme.

Even so, there was a 11.7% decrease in the total amount of unsubordinated bonds recorded in balance sheets (7.35 billion euros), which contributed largely to the reduction in debt securities issued (-7.781 billion euros) (see Table 48 and Table 49, p. 101). In this item it was specifically the

[94] The State Guarantee Scheme is part of the Financial Stability Initiative.

percentage of certificates of deposit that fell the most in terms of balance sheet value against 2010, dropping to less than half.

In subordinated liabilities, which fell 3.964 billion euros, loans were the item with the highest reduction (-2.316 billion euros) (see Table 48, p. 100 and Table 49).

In 2011, the reduction in balance sheet value of the different items in subordinated liabilities (-3.964 billion euros) (see Table 49) was essentially due to debt repayments, especially loans whose maturity was reached but not renewed (-3.255 billion euros in net terms, or 82.1% of the total variation) (see Graph 44, p. 102). The acquisition of debt issued by the institutions themselves also contributed to this effect in that, in accounting terms, this type of operation cancels out the value of the instruments subject to them in the balance sheet. The institutions' acquisition of their own subordinated bonds totalled 709 million euros in net terms in 2011, explaining the remaining variation in the value of total subordinated liabilities.

Table 49: Debt securities issued and subordinated liabilities as at 31 December (2010-2011)

	2010		2011		Change	
	million €	%	million €	%	million €	%
Debt Securities Issued						
Certificates of deposit	1,871	*2.7%*	821	*1.3%*	-1,050	*-56.1%*
Bonds	62,799	*90.9%*	55,449	*90.4%*	-7,350	*-11.7%*
Other liabilities	4,450	*6.4%*	5,069	*8.3%*	619	*13.9%*
Total	69,120	*100.0%*	61,339	*100.0%*	-7,781	*-11.3%*
Subordinated Liabilities						
Loans	5,422	*44.0%*	3,106	*37.1%*	-2,316	*-42.7%*
Bonds	5,702	*46.2%*	4,976	*59.5%*	-726	*-12.7%*
Other subordinated liabilities	1,209	*9.8%*	287	*3.4%*	-922	*-76.3%*
Total	12,333	*100.0%*	8,369	*100.0%*	-3,964	*-32.1%*
Total	81,453		69,708			

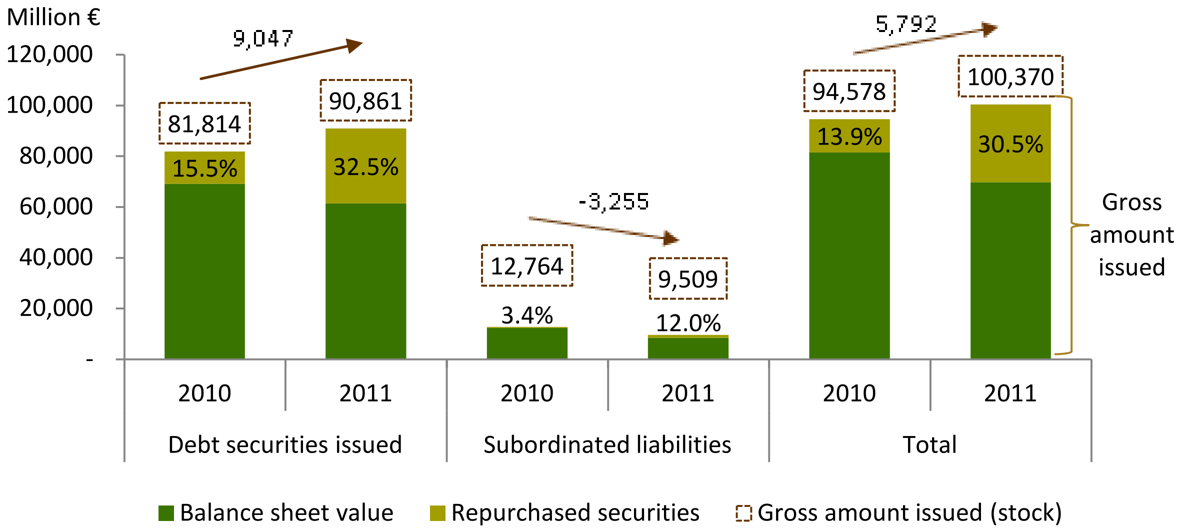
Source: FIs, APB.

Meanwhile, the decrease in the balance sheet value of debt securities issued resulted from considerable buying on the secondary market of debt instruments issued by the institutions themselves. Indeed, the gross stock of debt securities issued by the member institutions increased 11.1% in 2011 to 90.861 billion euros at year end (up 9.047 billion euros) (see Graph 44, p. 102).

Their portfolio of own securities acquired rose 16.828 billion euros (132.6%). This scenario indicates that the purchase of own debt securities was not limited to instruments issued last year. It also included securities issued before and traded on the secondary market, probably at favourable prices thanks to the generalised depreciation in the debt markets.

This performance may indeed have helped overcome the Portuguese financial institutions' difficult access to the wholesale finance markets, as it enabled them to increase their portfolios of available collateral to obtain funding.

Graph 44: Gross amount of debt securities and subordinated liabilities issued as percentage of repurchased securities as at 31 December (2010 – 2011)



Source: FIs, APB.

On aggregate terms, the debt securities portfolio (including subordinated securities) repurchased by the member institutions totalled 13.125 billion euros at the end of 2010 (13.9% of the total stock issued to date). In 2011, it totalled 30.662 billion euros, a net increase of 17.537 billion euros (see Graph 44).

The vast majority of these repurchase operations fall under unsubordinated bonds, which includes net repurchases during the year of 16.619 billion euros. As a result, the portfolio of repurchased unsubordinated bonds increased by a substantial 142% in 2011. It was mortgage-covered bonds that accounted for 43.6% of all repurchases of these bonds.

Annex

Table 50: Off-balance sheet aggregate items as at 31 December 2011

	2011 million €
Guarantees Given and Other Contingent Liabilities	**128,691**
Guarantees and sureties	37,324
Acceptances and endorsements	11
Transactions with recourse	18
Stand-by letters of credit	491
Open documentary credits	3,844
Sureties and indemnities (counter-guarantees)	1.401
Other personal guarantees given and other contingent liabilities	4,079
Real guarantees (assets pledged as collateral)	81,523
Guarantees Received	**481,079**
Guarantees and sureties	130,360
By acceptances and endorsements	163
By transactions with recourse	-
By stand-by letters of credit	663
By open documentary credits	35
By sureties and indemnities (counter-guarantees)	7,089
Other guarantees received	31,514
Real guarantees (assets received as collateral)	311,255
Commitments to Third Parties	**59,189**
Options on assets (sold)	150
Term operations	99
Term deposits contracts	568
Irrevocable credit lines	8,098
Securities subscription	4,819
Commitment for retirement and survivor pensions not yet received	21
Term commitment to make annual contributions to the deposit guarantee fund	444
Potential commitment to the investor indemnity system	115
Other irrevocable commitments	7,002
Revocable credit lines	33,626
Overdraft facilities	2,290
Other revocable commitments	1,957

Source: FIs, APB.

Annex (cont'd)

Table 50: Off-balance sheet aggregate items as at 31 D0ecember 2011 (cont'd)

	2011 million €
Commitments by Third Parties	**4.479.542**
Options on assets (bought)	56
Irrevocable credit lines	2,590
Securities subscription	20
Other irrevocable commitments	2,184,910
Revocable credit lines	95
Overdraft facilities	-
Other revocable commitments	2,291,871
Foreign Exchange Operations and Derivative Instruments	**609,786**
Spot foreign exchange operations	2,524
Forward foreign exchange operations – trading	4,743
Forward rate agreement - trading	723
Swap operations – trading	499,268
Futures and other forward operations – trading	10,301
Options – trading	19,528
Forward foreign exchange operations – hedging	348
Forward rate agreement - hedging	311
Swap operations – hedging	62,640
Futures and other forward operations – hedging	2,023
Options – hedging	850
Interest rate guarantee contracts (caps and floors) - hedging	6,527
Responsibilities for Services Provided	**371,633**
Deposit and safeguard of assets	321,142
Amounts for collection	11,914
Assets managed by the institution	37,013
Consigned funds	1
Other	1,563
Services Provided by Third Parties	**231,803**
Deposit and safeguard of assets	151,096
Amounts for collection	1,303
Assets managed	34
Other services	79,370
Other Off-balance Sheet Items	**-5,069,093**

Source: FIs, APB.

VII.2. Income statement

VII.2.1. Structure

In 2011, the member institutions operated in a particularly unfavourable scenario. This was not only due to the context in Portugal and in Europe in general, but also to the need for Portuguese financial institutions to adjust their balance sheets to the requirements of the Economic Adjustment Programme.

Table 51: Aggregate income statement (2011)

	2011	
	million €	**% NIBT**
+ Interest and similar income	21,121	
- Interest and similar expense	15,993	
Net Interest Income (NII)	**5,128**	***54.4%***
+ Fee and commission income	3,292	
- Fee and commission expense	603	
Net Gains from Fees and Commissions	2,689	*28.6%*
+ Net gains from assets and liabilities at fair value through profit or loss	-467	
+ Net gains from available-for-sale financial assets	1	
+ Net gains from foreign exchange differences	6	
Net Gains from Financial Operations	-460	*-4.9%*
+ Income from equity instruments	1,211	
+ Net gains from sale of other assets	156	
+ Other operating income and expense	697	
Other Results	2,064	*21.9%*
Operating Income (OI)	**9,421**	***100.0%***
Personnel costs	3,214	
General administrative expenses	2,067	
Depreciation and amortisation	447	
Operating Costs	5,728	*60.8%*
Gross Operating Results (GOR)	**3,693**	***39.2%***
Provisions net of reversals	-170	
Value adjustments relating to loans and advances to customers and receivables from other debtors (net of reversals)[95]	3,388	
Impairment on other financial assets net of reversals	1,438	
Impairment on other assets net of reversals	1,071	
Provisions and impairment	5,727	*60.8%*
Net Income before Tax (NIBT)	**-2,034**	***-21.6%***

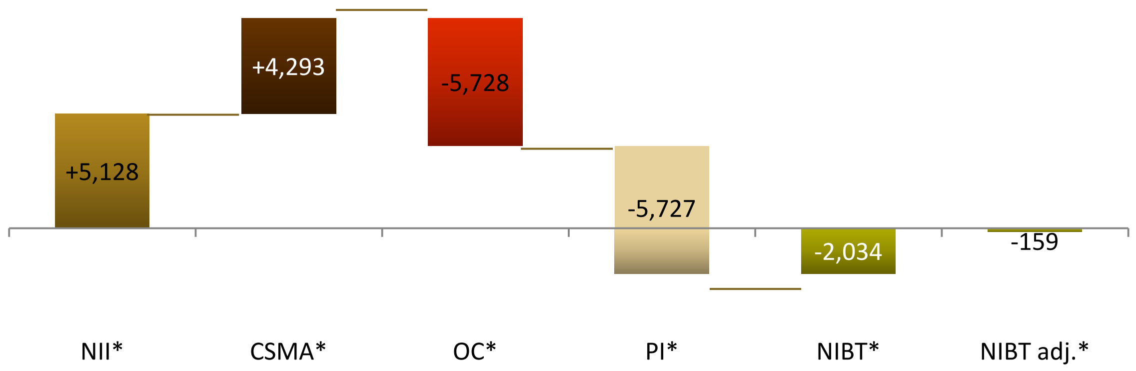
Source: FIs

[95] During the analysis, this item is also referred to as credit impairments.

As a result, the member institutions'[96] performance contrasted considerably with that of previous years, to such an extent that aggregate net income before tax fell to negative figures (see Table 51, p. 105), mainly due to extraordinary events, the majority of which were non-recurring.

As usual in the banking business, intermediation constituted the member institutions' main source of profit in 2011 and accounted for 54.4% of operating income. The remaining income came from customer services and market activities[97] (45.6%), with particular focus on fees and commissions (28.6%) and income from equity instruments (12.9%). All together, net income from banking activity totalled 9.421 billion euros (see Table 51, p. 105).

Graph 45: Aggregate earnings before tax formation (2011)



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; NIBT adj. – net income before tax purged from extraordinary events**.

** Extraordinary events refer to non-recurring events (credit impairment additionally accounted under Special Inspection Programme (SIP); recognised losses with an application of a haircut on Greek sovereign debt; and costs with banks´ partial transfer of the pension funds to the Portuguese state) and the Contribution of the Banking Sector (73 million euros) that was registered in "Other operating income and expense".

In terms of cost structure, operating costs were an important parcel and accounted for 60.8% of operating income (see Table 51, p. 105). Within these, personnel costs, with a weight of 56.1% in total costs, demonstrate the intensity with which the banking sector employs labour. Exceptionally, in 2011 this item included the partial transfer of the pension funds of some member institutions to Social Security (201 million euros).[98] The remaining 2.514 million euros in operating costs were mainly due (82.2%) to general administrative expenses.

Expenses of provisions and impairment, with a weight in operating income equivalent to operating costs (60.8%), were especially significant in 2011. The total of 5.727 billion euros was essentially due to credit impairment and impairment of financial assets net of reversals, the amount of which as at 31 December (3.388 and 1.438 billion euros, respectively) reflected two realities. The first was the deterioration in the quality of loans and advances to customers and tension in the financial markets. The second was the impact of two non-recurring events in the year: recognition of

[96] Considering the base sample of 33 member institutions used in this report.

[97] Income from customer services and market activities comprises net gains from fees and commissions, financial operations and other results (see Table 51, p. 105).

[98] Four institutions recorded these costs in other operating income and expenses rather than personnel costs (207 million euros), making a total of 408 million euros in expenses for the banks from the transfer.

more accentuated credit impairment following the Special Inspection Programme for the eight largest Portuguese banking groups (520 million euros) and the reporting of high losses on Greek sovereign debt securities in portfolios (874 million euros) (see Table 51, p. 105).

As a result of high operating costs, provisions and impairment in 2011 (11.455 billion euros), operating income (9.421 billion euros) was not sufficient to cover them (see Graph 45, p. 106). The aggregate net income before tax was therefore negative to the amount of 2.034 billion euros. It should be noted, however, that without the extraordinary events (totalling 1.875 billion euros), aggregate net income before tax would have involved a much smaller loss (-159 million euros).

Comparing the performance in 2011 with previous years[99] (see Table 52 and Graph 46, p. 108), it is clear that, although 2011 was the first year in which net income before tax was negative, this result follows on from a downward trend between 2008 and 2010, when it fell by an average of 36%. In 2011, net income before tax fell 302.8%, though largely as a result of the above-mentioned extraordinary factors. Net income before tax lost 44.3 percentage points during the period as a percentage of operating income, 32 of which were in 2011 alone (see Graph 46, p. 108). Extraordinary factors aside, this performance has been caused by growing difficulty in generating a level of income able to offset consistent rises in operating costs, provisions and impairment.

Table 52: Main items in the aggregate income statement (2008 – 2011)

	2008	2009	2010 [a]	2011	Average
Net Interest Income (NII)					
Total (million)	6,149	5,427	5,082	5,108	-
Annual growth rate	-	-11.7%	-6.4%	0.5%	-5.9%
Customer Service and Market Activities (CSMA)					
Total (million)	4,869	5,126	4,804	4,269	-
Annual growth rate	-	5.3%	-6.3%	-11.1%	-4.0%
Operating Income (OI) [b]					
Total (million)	11,018	10,553	9,886	9,377	-
Annual growth rate	-	-4.2%	-6.3%	-5.1%	-5.2%
Operating Costs (OC)					
Total (million)	5,592	5,622	5,783	5,698	-
Annual growth rate	-	0.5%	2.9%	-1.5%	0.6%
Provisions and impairment (PS)					
Total (million)	2,952	3,221	3,095	5,723	-
Annual growth rate	-	9.1%	-3.9%	84.9%	30.0%
Net Income Before Tax (NIBT) [c]					
Total (million)	2,474	1,710	1,008	-2,044	-
Annual growth rate	-	-30.9%	-41.1%	-302.8%	-

Source: FIs.

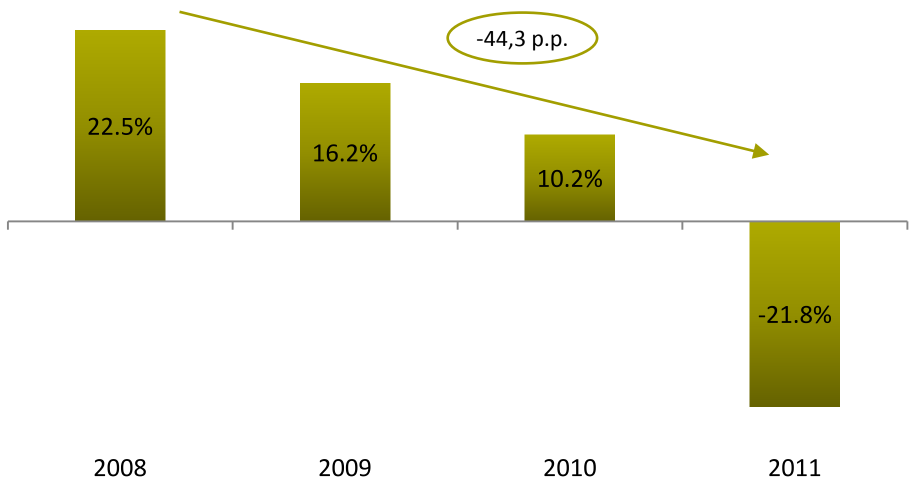
[a] The values in this column do not coincide with those in nº 46 (2010) due to data adjustment made two financial institutions after its publication.

[b] OI = NII + CSMA

[c] NIBTI = OI - OC - PS

[99] See footnote 36, p. 28.

Graph 46: Net income before tax as percentage of operating income (2008 – 2011)

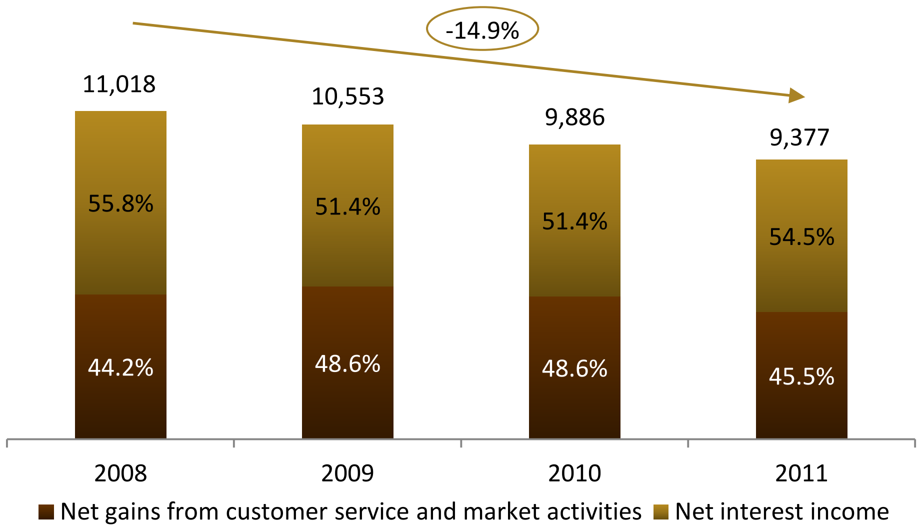


Source: FIs, APB.

Between 2008 and 2011, the member institutions' aggregate operating income fell on average 5.2% a year and 14.9% in the period (1.641 billion euros) (see Table 52, p. 107, and Graph 47). Losses in intermediation and customer services and market activities contributed to this performance. It has, however, been intermediation that has exerted most downward pressure on operating income (1.041 billion euros less since 2008, i.e. a drop of 16.9% in net interest income). Customer services and market activities recorded a loss of only 600 million euros in the period, a decrease of 12.3% against 2008 (see Table 52, p. 107).

Nonetheless, this did not alter the basic composition of operating income between 2008 and 2011, and intermediation dominated the banking business model (see Graph 47).

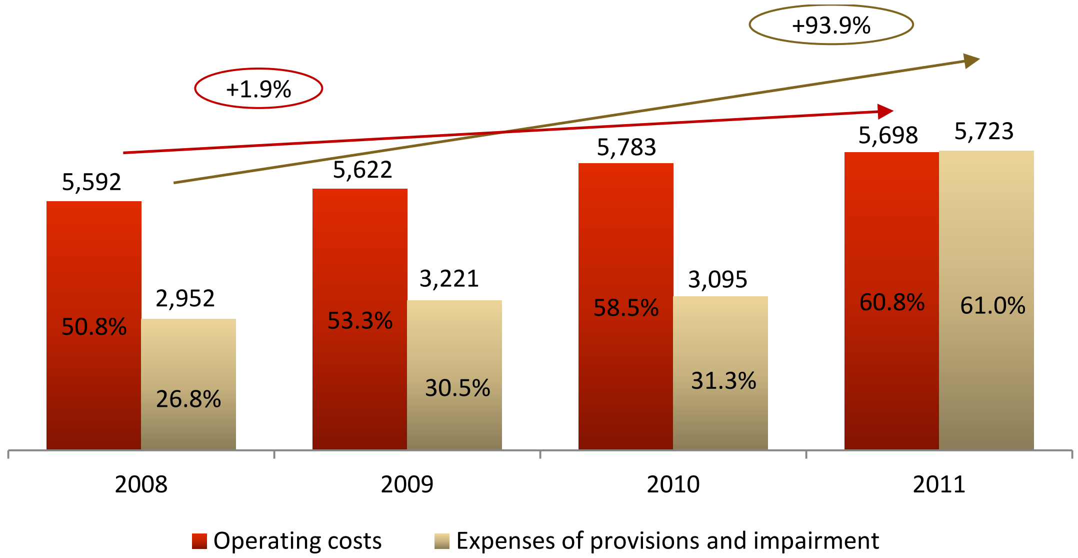
Graph 47: Net interest income and net gains from customer service and market activities as percentage of operating income (2008 – 2011)



Source: FIs, APB.

In the same period (2008-2011), together, operating costs, provisions and impairment grew 33.7% or 2.877 billion euros to 11.421 billion euros in 2011 (see Table 52, p. 107 and Graph 48). While operating costs showed a growth rate of 1.9%, however, provisions and impairment expenses rose 93.9%, serious affecting net income, especially in 2011.

Graph 48: Operating costs, provisions and impairment as percentage of operating income (2008 – 2011)



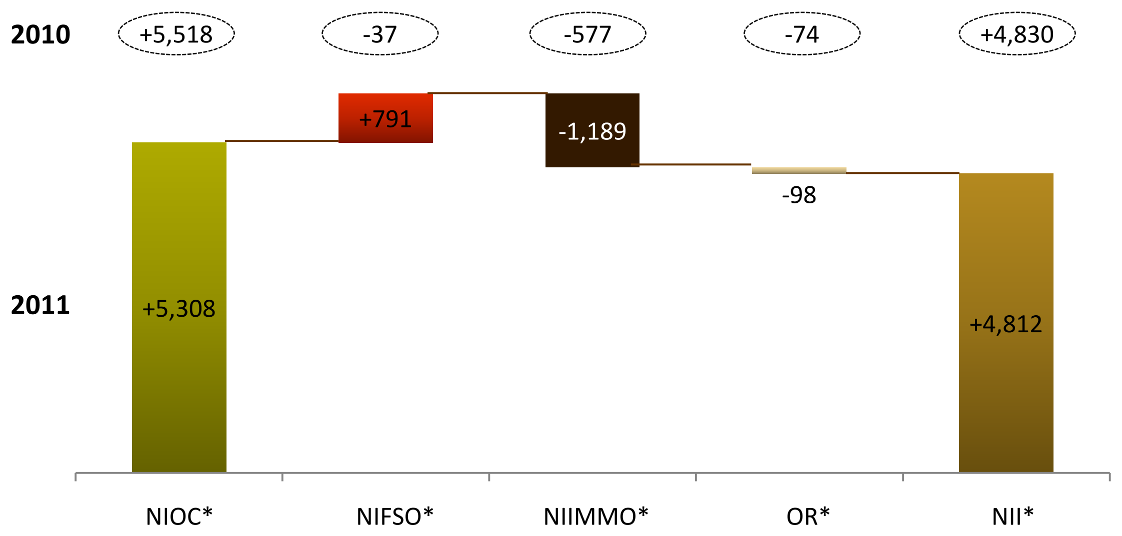
Source: FIs, APB.

The disparity in performance of these two types of cost, especially in 2011, explains the profound change in the banking sector's cost structure (see Table 52, p. 107 and Graph 48). While between 2008 and 2010, operating costs represented almost twice provisions and impairment and were the only item accounting for more than 50% of operating income, in 2011 the situation was radically different. Last year, both items reached very similar amounts and weights and together exceeded operating income by 21.7%.

VII.2.2. Net interest income

In 2011, the income from the member institutions'[100] intermediation totalled 4.812 billion euros (see Graph 49 and Table 57, p. 116). A positive contribution to this item came from net income from operations with customers[101] (5.308 billion euros) and net income from financial securities operations [102] (791 million euros). Net income from interbank money market operations[103] had a highly negative performance (-1.189 billion euros) (see Graph 49).

Graph 49: Breakdown of aggregate interest income (2010 - 2011) 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.

Year on year, net interest income fell slightly by 0.4% in 2011. With the exception of net income from financial securities operations, which improved by 828 million euros, the results in all other income were unfavourable. Within these, in particular, was the negative contribution from interbank money market operations (-612 million euros), which fell more than 100% (see Graph 49 and Table 57, p. 116).

[100] The sample considered in this analysis excludes Finantia and Barclays due to lack of detailed information, as mentioned in footnote 76, p. 83.
[101] Net income from operations with customers includes interest on loans and interest on customer deposits (see Table 53, p. 111).
[102] Net income on operations with financial securities comprises the following items: interest on financial assets held for trading and at fair value through profit or loss, interest on available for sale financial assets, interest on investments held to maturity, interest on hedging derivatives (income and expenses), interest on financial liabilities held for trading, interest on debt securities issued and interest on subordinated liabilities (see Table 55, p. 114).
[103] Net income from interbank money market operations comprises interest on deposits at and loans and advances to Central Banks, interest on deposits at and loans and advances to other credit institutions, interest on deposits at Central Banks and interest on deposits from other credit institutions (see Table 56, p. 115).

Table 53: Breakdown of aggregate results from operations with customers (2010 - 2011)

	2010	2011	Change	
	million €	million €	million €	%
Operations with Customers				
+ Interest on credit	7,854	9,718	1,864	*23.7%*
- Interest on deposits from customers	2,336	4,410	2,074	*88.8%*
Total	5,518	5,308	-210	*-3.8%*

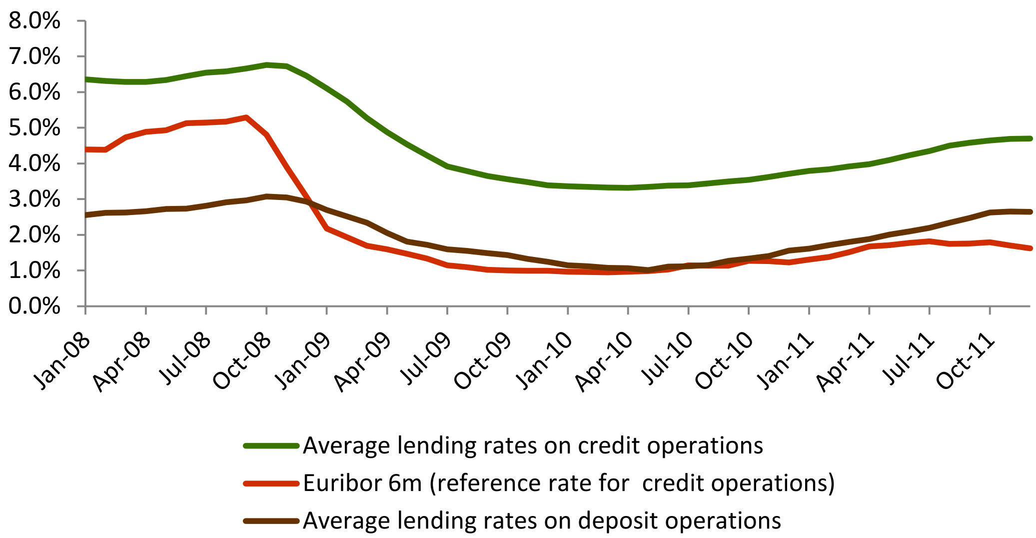
Source: FIs, APB.

According to Table 53, the main source of net interest income (on operations with customers) totalled 5.308 billion euros in 2011, 3.8% lower than in 2010.

This variation was the net product of efforts made by most of the member institutions to attract more stable funding by means of aggressive commercial policies offering more attractive interest rates on deposits and moderating the grant of loans104 by following stricter criteria and risk assessment conditions, including charging higher interest. Finally, the positive volume / price effect on borrowing operations with customers was not proportional to the volume / price effect on lending operations and so net interest income shrank in 2011.

Graph 50 shows the performance over time of average monthly rates on credit and deposit operations. Table 54, p. 112 completes this information with the average, maximum and minimum rates and six-month Euribor in 2010 and 2011.

Graph 50: Euribor (6m), average lending rates on credit operations and average interest rates on deposit operations (Jan. 2008 – Dec. 2011)



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 2012)).

[104] As part of the measures set out by the EAP for the banking sector.

As we can see, 2011 witnessed a generalised, very sharp rise in Euribor and rates on lending and borrowing operations with customers. The annual average lending rate in 2011 was 90 basis points above that of 2010 and the variation in average monthly lending rates over the year was also 90 basis points (against 34 in 2010). There was a similar but more pronounced pattern in the annual average borrowing rate – 100 basis points above that in 2010, and a variation in average monthly borrowing rates of 104 basis points (as opposed to 42 in 2010) (see Table 54). Furthermore, the figures for 2011 in either average monthly rate were always higher than in 2010 (i.e. the minimum figures in 2011 were the same as or even higher than maximums in 2010) (see Table 54).

Table 54: 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 credit operations (D)	D – E (pp)
2010					
Average	1.1%	3.4%	2.3	1.2%	0.1
Maximum	1.3%	3.7%	-	1.6%	-
Minimum	0.9%	3.3%	-	1.0%	-
Variation Jan. – Dec. (pp)	0.26	0.34	0.08	0.42	0.16
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

Source: BdP.

The performance of monthly average lending and borrowing rates with customers shows more accentuated growth in the latter in 2011. Even though their performance was accompanied closely by average monthly rates on credit operations, these operations' growth was lower. This was why the gap between them narrowed (from 2.2 to 2.1 percentage points on the basis of the annual average of both rates) (see Table 54). This had a negative price effect on net income on operations with customers.

In 2011, the pressure on the banking sector to reduce its transformation ratio, increase customer deposits and cut down its dependency on wholesale funding was behind the pronounced rise in the monthly average borrowing rate on deposit operations. The rise was not uniform over the year, however. While it grew continuously between January and October, it had not changed at the end of the year (2.7% in November and December). This stabilisation resulted from prudential intervention by Banco de Portugal, which issued Instruction 28/2011[105] in November to moderate the high deposit rates ("super deposits") that some financial institutions were offering[106].

This intervention was not, however, able to prevent a highly substantial rise in deposits from customers in the member institutions' aggregate balance sheets, largely due to the intensification of competition between banks' commercial policies. The volume effect thus reinforced the negative effect of price on deposit operations on net income from customer operations.

Meanwhile, the more moderate upward movement of average lending rate in the year can be explained by two effects. The first was the rise in Euribor,[107] whose average in 2011 was higher than in 2010, albeit by only 50 basis points (see Table 54, p. 112). The second was the increase in spreads in credit operations following less favourable perception of risk on the part of the financial institutions and an increase in the costs of funding and balance sheet restrictions".[108] The rise in spreads is visible in the increase in the difference between the annual average of the monthly lending rates and the annual average Euribor: 2.3 pp in 2010 to 2.7 pp in 2011 (see Table 54, p. 112).

It is important to note, however, that the increase in spreads did not have the same affect on the monthly average lending rate of all types of credit. In fact the most evident repercussion was in loans to non-financial companies, as they involve shorter contracts allowing the financial institutions to adjust more quickly to the required interest rate. The impact of the increase in spreads was not so great on personal loans, which are dominated by mortgages. As most mortgage contracts have longer maturities and fixed spreads for the entire period, the adjustment in the return on mortgage portfolios will only be visible at medium to long term. Even though there were higher spreads on new credit operations, their weight was insignificant in the total portfolio in 2011, which means that their contribution to the monthly average lending rate was small. Moreover, the positive effect (already more moderate) of the price (interest rate) of credit operations on net income on customer operations was offset in 2011 by the fact that loans fell in general and the overall balance of gross loans to customers went down in the year (negative volume effect).

Net income on financial securities operations improved by 828 million euros in 2011. This performance can be explained by a highly significant increase in income on the other operations, which absorbed all the reductions in income on trading and hedging operations (see Table 55, p.114).

[105] This Banco de Portugal instruction introduced penalties on own funds for institutions offering excessive interest rates on their deposits.
[106] The impact of this intervention on the annual average borrowing rate was insignificant because it only occurred at the end of the year and only affected new deposits. As they had little weight in the total stock of deposits in 2011, most of them term deposits, its repercussions were small in 2011.
[107] As most loans to private and business customers in Portugal are at variable rates indexed to Euribor, the indexer's performance is reflected in the average lending rate of credit operations. This impact is not immediate, however (there is a time lapse), because the interest rate on loans is not revised daily but at the same intervals as the indexer (six months in this case). See Banco de Portugal Circular 1/2008/DSB of 15 February.
[108] See Banco de Portugal 2011 surveys of banks on the credit market (January, April, July and October).

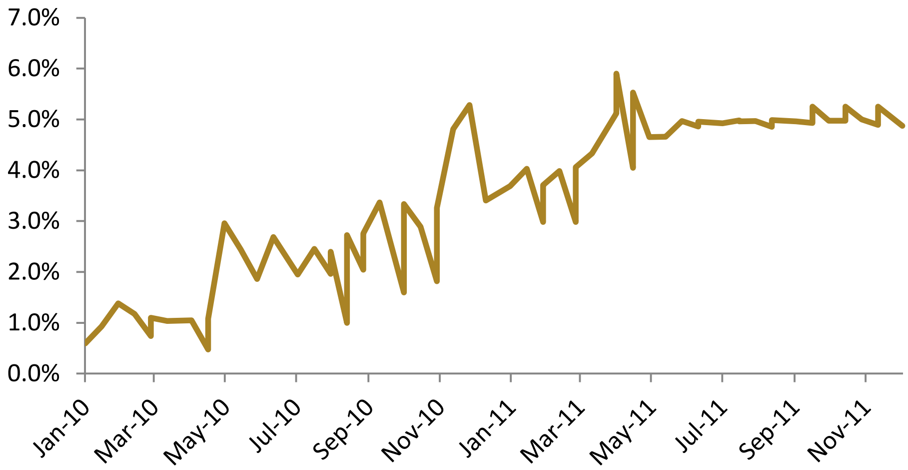
Table 55: Breakdown of net gains from operations with financial securities (2010 – 2011)

	2010	2011	Change	
	million €	million €	million €	%
Trading Operations				
+ Interest on financial assets held for trading and at fair value through profit or loss	3,692	3,720	28	*0.8%*
- Interest on financial liabilities held for trading	3,093	3,445	352	*11.4%*
Total	599	275	-324	*-54.1%*
Hedging Operations				
+ Interest on hedging derivatives	1,950	1,275	-675	*-34.6%*
- Interest on hedging derivatives	1,590	1,099	-491	*-30.9%*
Total	360	176	-184	*-51.1%*
Other Operations				
+ Interest on available-for-sale financial assets	1,380	2,445	1,065	*77.2%*
+ Interest on held-to-maturity investments	325	502	177	*54.5%*
- Interest on debt securities issued	2,286	2,246	-40	*-1.7%*
- Interest on subordinated liabilities	415	361	-54	*-13.0%*
Total	-996	340	1,336	*134.1%*
Total	-37	791	828	-

Source: FIs, APB.

All the items in question contributed to the 1.336 billion euro growth in net income on the other operations, but especially interest on financial assets available for sale. Its increase of 1.065 million euros was certainly related to a volume effect (the amounts in portfolio increased, essentially through acquisitions of Portuguese public debt), along with a positive interest rate effect (the Portuguese state obtained funding at higher rates in 2011 than 2010) (see Table 55 and Graph 51).

Graph 51: Weighted average rate on Treasury Bill auctions[109] (Jan. 2010 – Dec. 2011)



Source: IGCP.

[109] In 2011, after the EAP, the Portuguese state issued mainly Treasury Bills with no issue of Treasury Bonds.

The 612 million euro fall in net income on interbank money market operations in the period was due to a deterioration in the performance of operations with Central Banks and other credit institutions (these items varied -250 million and -362 million euros, respectively) (see Table 56).

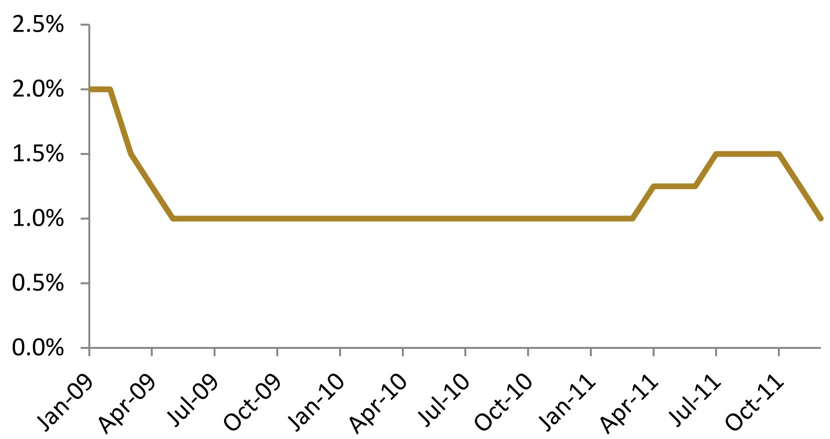
Table 56: Breakdown of net gains from monetary interbank market operations (2010 – 2011)

	2010	2011	Change	
	million €	million €	million €	%
Operations with Central Banks				
+ Interest on deposits to and loans and advances at central banks	47	53	6	*12.8%*
- Interest on deposits from central banks	348	604	256	*73.6%*
Total	-301	-551	-250	*-83.1%*
Operations with Other Credit Institutions				
+ Interest on deposits to and loans and advances at other credit institutions	726	1,061	335	*46.1%*
- Interest on deposits from other credit institutions	1,002	1,699	697	*69.6%*
Total	-276	-638	-362	*-131.2%*
Total	-577	-1,189	-612	*-106.1%*

Source: FIs, APB.

Following the almost total lack of access to wholesale debt markets, in 2011 the member institutions continued to fill their funding needs, albeit at a slower pace, with funds from the Eurosystem. Their stock in 2011 exceeded that in 2010 (see Table 47, p. 100). Combining this volume effect with the fact that the ECB annual average reference rate (see Graph 52) rose in 2011 (even though it remained low), interest on deposits from Central Banks rose 256 million euros, offset only by a minimal rise of six million euros in interest on deposits at and loans and advances to Central Banks (see Table 56).

Graph 52: ECB Refi rate (Jan. 2009 – Dec. 2011)



Source: Bloomberg.

The deterioration in the net income on operations with other credit institutions was the result exclusively of an interest rate effect. With the rise in the Euribor rate in 2011, both interest on deposits from other credit institutions and deposits at and loans and advances to other credit institutions increased. Nonetheless, given that the amount of deposits on the balance sheet is higher than that of deposits and loans and advances (debit position), even after the albeit unequal fall in both during the year (Table 46, p. 98), the impact of the variation in Euribor was necessarily greater on interest on deposits than on loans and advances. As a result, the net income on operations with other credit institutions fell 362 million euros in 2011 (see Table 56, p. 115).

Table 57: Breakdown of aggregate net interest income (2010 – 2011)

	2010	2011		Change	
	million €	million €	%	million €	%
Interest and Similar Income (ISI)					
Interest on credit	7,854	9,718	*48.2%*	1,864	*23.7%*
Interest on financial assets at fair value through profit or loss	3,692	3,720	*18.5%*	28	*0.8%*
Interest on deposits at and loans and advances to central banks	47	53	*0.3%*	6	*12.8%*
Interest on deposits at and loans and advances to other credit institutions	726	1,061	*5.3%*	335	*46.1%*
Interest on available-for-sale financial assets	1,380	2,445	*12.1%*	1,065	*77.2%*
Interest on hedging derivatives	1,950	1,275	*6.3%*	-675	*-34.6%*
Interest on held-to-maturity investments	325	502	*2.5%*	177	*54.5%*
Other interest and similar income	838	1,373	*6.8%*	535	*63.8%*
Total	16,812	20,147	*100.0%*	3,335	*19.8%*
Interest and Similar Expense (ISE)					
Interest on deposits from central banks	348	604	*3.9%*	256	*73.6%*
Interest on deposits from other credit institutions	1,002	1,699	*11.1%*	697	*69.6%*
Interest on debt securities issued	2,286	2,246	*14.6%*	-40	*-1.7%*
Interest on deposits from customers	2,336	4,410	*28.8%*	2,074	*88.8%*
Interest on hedging derivatives	1,590	1,099	*7.2%*	-491	*-30.9%*
Interest on subordinated liabilities	415	361	*2.3%*	-54	*-13.0%*
Other interest and similar expense	3,093	3,445	*22.5%*	352	*11.4%*
Total	912	1,471	*9.6%*	559	*61.3%*
Net Interest Income (NII)	11,982	15,335	*100.0%*	3,353	*28.0%*
Interest and Similar Income (ISI)	4.830	4,812	-	-18	*-0.4%*

Source: FIs, APB.

VII.2.3. Customer services and market activities

In 2011, net income from fees and commissions totalled 2.547 billion euros and, as in 2010, they were the main item responsible (62.1%) for the 4.104 billion euros in income from customer services and market activities (see Table 58). The remaining 1.557 billion euros were due to a highly-positive performance by other net income (2.01 billion euros), which more than absorbed the loss on financial operations (-453 million euros).

Net income from customer services and market activities was 546 million euros (-11.7%) lower than in 2010. This decrease was due to a reduction in net income from fees and commissions (-4.6%) and, particularly, a reduction in gains on financial operations (-251.5%). The only item that eased this trend was other net income, which grew 329 million euros, 19.6% (see Table 58).

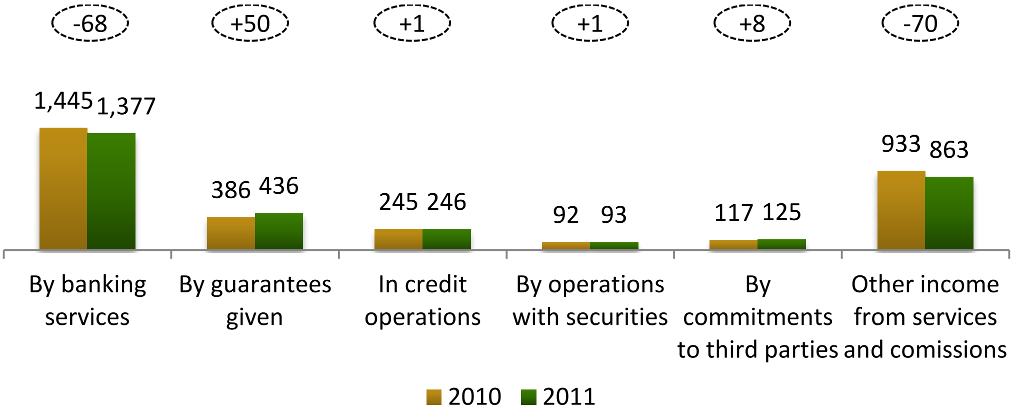
Table 58: Breakdown of net gains from customer services and market activities (2010 – 2011)

	2010	2011		Change	
	million €	million €	% NGCSM	million €	%
Net Gains from Fees and Commissions (NGFC)					
Fee and commission income	3,218	3,140	*76.5%*	-78	*-2.4%*
Fee and commission expense	548	593	*14.4%*	45	*8.2%*
Total	2,670	2,547	*62.1%*	-123	*-4.6%*
Net Gains from Financial Operations (NGFO)					
Net gains from assets and liabilities at fair value through profit or loss	-185	-459	*-11.2%*	-274	*-148.1%*
Net gains from available-for-sale financial assets	425	7	*0.2%*	-418	*-98.4%*
Net gains from foreign exchange differences	59	-1	*0.0%*	-60	*-101.7%*
Total	299	-453	*-11.0%*	-752	*-251.5%*
Other Results (OR)					
Income from equity instruments	1,375	1,164	*28.3%*	-211	*-15.3%*
Net gains from sale of other assets	-27	160	*3.9%*	187	*692.6%*
Other operating income and expense	333	686	*16.7%*	353	*106.0%*
Total	1,681	2,010	*48.9%*	329	*19.6%*
Net Gains from Customer Services and Market Activities (NGCSM)	4,650	4,104	*100.0%*	-546	*-11.7%*

Source: FIs, APB.

The 4.6% drop in net income from fees and commissions against 2010 reflects a reduction in income (-2.4%) not accompanied by a similar fall in expenses (8.2%) (see Table 58).

Graph 53: Breakdown of income from fees and commissions, million euros (2010 – 2011)

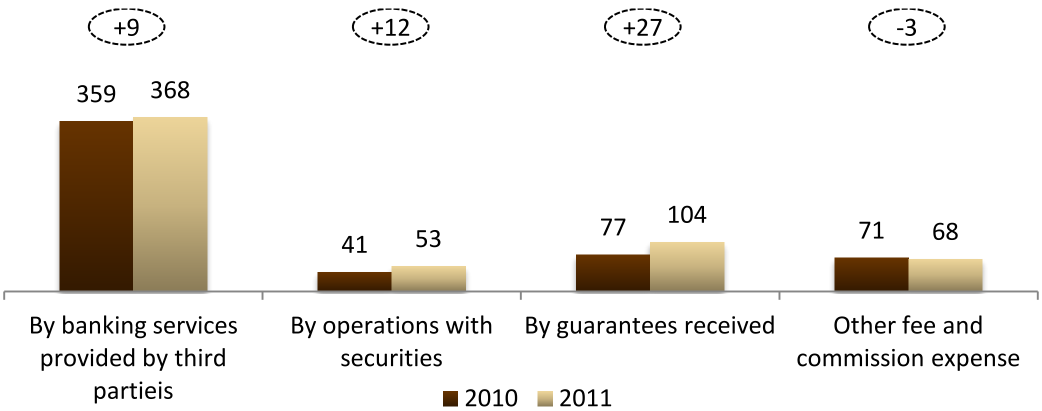


Source: FIs, APB.
Note: 2011/2010 change

The 78 million euro fall in income in 2011 was mostly due to other income and other income from banking services (see Graph 53). While the absence of greater detail makes it impossible to interpret other income further, for the second item, we know that there was a reduction in income from financial operations largely due to a fall in activity resulting from the climate of recession and instability in the financial markets.

The growth in expenses (see Graph 54) was mostly caused by an increase in the value of guarantees received, essentially due to commissions on bond issues guaranteed by the state.

Graph 54: Breakdown of expenses from fees and commissions, million euros (2010 – 2011)

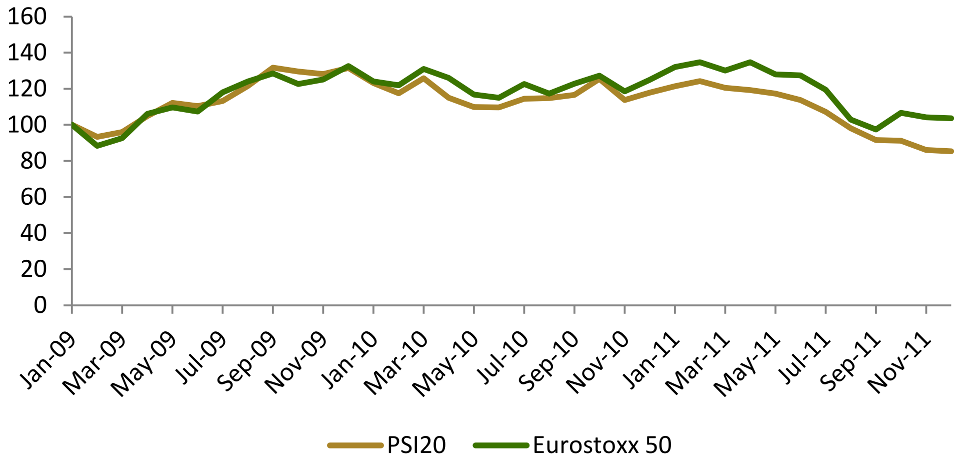


Source: FIs, APB.
Note: 2011/2010 change

The balance of net income on financial operations in 2011 was 752 million euros lower than in 2010. This situation can be explained by the unfavourable performance of all the items in this income, but especially by net gains from available-for-sale financial assets (-418 million euros) and net gains from assets and liabilities at fair value through profit or loss (-274 million euros) (see Table 58, p. 117).

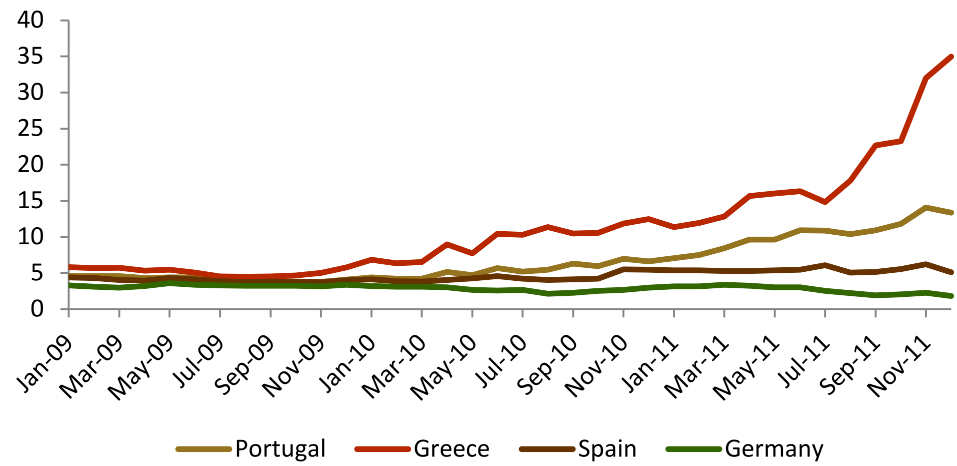
The performance of the former during the year was predominantly the result of losses on the sale of equity instruments on the share markets (see Graph 55). Furthermore, losses on sales of debt securities were also substantial (see Graph 56, and Graph 57, p. 120).

Graph 55: Main share indexes (Jan. 2009 – Dec. 2011)



Source: Bloomberg.

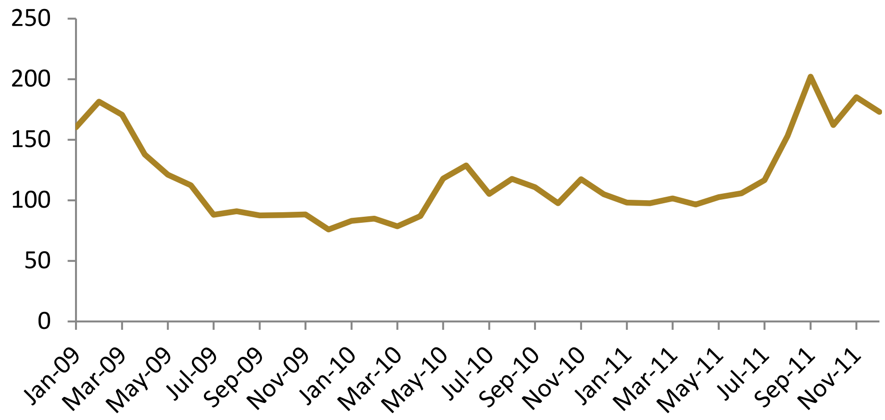
Graph 56: Yield-to-maturity for Portuguese, Greek, Spanish and German sovereign debt (Jan. 2009 – Dec. 2011)



Source: Bloomberg.

The variation in net gains on assets and liabilities at fair value through profit or loss essentially reflected recognition of losses in value in derivatives (mainly interest rate derivatives) and debt and capital securities, although they were mitigated by the gains in hedging derivatives. These losses were to be expected in a context in which the variable income markets fell substantially (see Graph 55) and the instability in the public and corporate debt markets led to higher yields-to-maturity and credit default swaps (Graph 56 and Graph 57, p. 120).

Graph 57: Credit default swaps of European institutions considered investment grade. 5-year bonds (Jan. 2009 – Dec- 2011)



Source: Bloomberg.

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

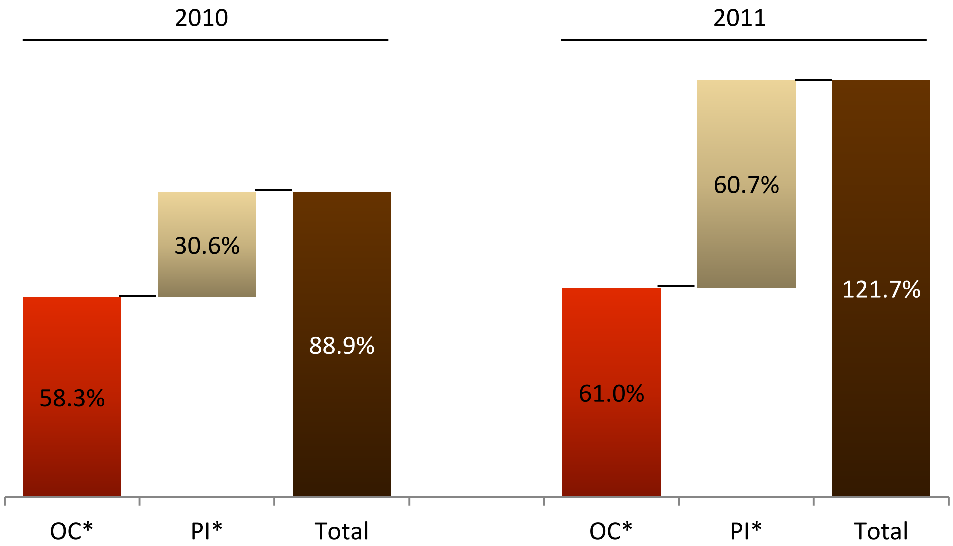
Finally, other results grew 19.6% (see Table 58, p. 117) in 2011 following a significant improvement in other operating income and expenses and net gains from sale of other assets. The growth in the former was due predominantly to recognition of gains in the member institutions' acquisition of their own debt issues. The positive performance by the latter was essentially thanks to the recording of gains on the sale of investments in subsidiaries, associates and joint ventures.

In spite of the fact that income from equity instruments (dividends) fell in 2011, it continued to be the most representative component in other results (see Table 58, p. 117).

VII.2.4. Operating costs, provisions and impairment

According to Table 60, p. 126, and as mentioned above, net income from intermediation and customer services and market activities was not sufficient in 2011 to bear operating costs and expenses of provisions and impairment. While on the one hand this can be explained by the reduction in income from intermediation (564 million euros), on the other hand, there was a highly significant impact from provisions and impairment, which rose 86.6% or 2.513 billion euros. Indeed, the weight (60.7%) of provisions and impairment in operating income in 2011 was almost double that in 2010 (30.6%) (see Graph 58). Operating costs fell 88 million euros, or 1.6%.

Graph 58: Breakdown of operating costs, provisions and impairments as percentage of operating income (2010 – 2011)



Source: FIs, APB.

Note: *OC – operating costs; PI – provisions and impairment.

In both 2010 and 2011, operating costs were mainly a reflection of personnel costs and general administrative expenses (see Table 59, p. 122). Personnel costs, with a weight in the total of around 56% and 57% respectively, showed how labour-intensive the banking sector is. General administrative expenses, which accounted for approximately 36% of operating costs in both years, demonstrate the importance of certain services, such as maintenance and repairs, communication and advertising and even rents in the functioning of financial institutions. Depreciation for the year carried a negligible weight in the two years when compared to other costs.

Operating costs decreased 1.6% in the period in analysis. As depreciation remained constant, the reduction was due to personnel costs, which went down 0.3%, and general administrative expenses, which fell 4% (see Table 59, p. 122).

Table 59: Breakdown of operating costs, provisions and impairments (2010 – 2011)

	2010		2011		Change	
	million €	%	million €	%	million €	%
Operating Costs (OC)						
Personnel costs	3,093	*56.0%*	3,085	*56.7%*	-8	*-0.3%*
General administrative expenses	2,011	*36.3%*	1,931	*35.5%*	-80	*-4,0%*
Depreciation and amortisation	424	*7.7%*	424	*7.8%*	0	*0.0%*
Total	5,528	*100.0%*	5,440	*100.0%*	-88	*-1.6%*
Provisions and Impairments (PS)						
Provisions net of reversals	-94	*-3.2%*	-198	*-3.7%*	-104	*110.6%*
Value adjustments relating to loans and advances to customers and receivables from other debtors (net of reversals)	2,342	*80.7%*	3,116	*57.6%*	774	*33.0%*
Impairment on other financial assets net of reversals	391	*13.5%*	1,426	*26.3%*	1,035	*264.7%*
Impairment on other assets net of reversals	262	*9,0%*	1,070	*19.8%*	808	*308.4%*
Total	2,901	*100.0%*	5,414	*100.0%*	2,513	*86.6%*
Total Costs (TC)	8,429	-	10,854	-	2,425	*28.8%*

Source: FIs, APB.

The eight million euro contraction in personnel costs (see Table 59) resulted from staff cuts in 2011 (see Chapter V, Human Resources, p. 33). The impact of this reduction would have been more visible, however, if some institutions had not had to bear the costs of the partial transfer of their pension funds to Social Security.[110]

In December 2011, under 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 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.[111] These differences totalled 201 million euros and so, without this extraordinary event, personnel costs would have been 2.884 billion euros, and 209 million euros or 6.8% lower (see Table 59).

General administrative expenses fell by 80 million. This essentially reflects the member institutions' efforts to contain costs of specialised services and advertising.

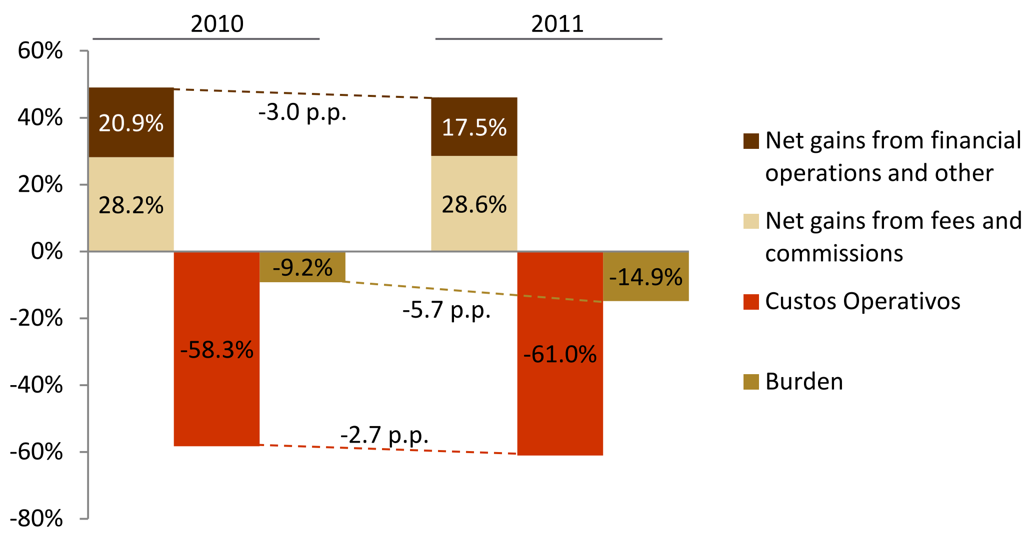
In terms of percentage of operating income, the fall in operating costs (1.6%) in 2011 was reflected by a 2.7 percentage point increase in their weight, due to the greater reduction (5.9%) in operating income. Meanwhile, the decrease in net income from customer services and market activities (11.7%) in 2011, much higher than the reduction in net interest income (0.4%), meant a loss of weight of the former in operating income (3 percentage points). As a result, capacity to cover

[110] For a list of the institutions covered by this programme, see Ministry of Finance Decree-Law 127/2011 of 31 December.

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

operating costs by net income from fees and commissions and financial operations deteriorated in 2010-2011 and the burden went from -9.2% to -14.9% of operating income (see Graph 59).

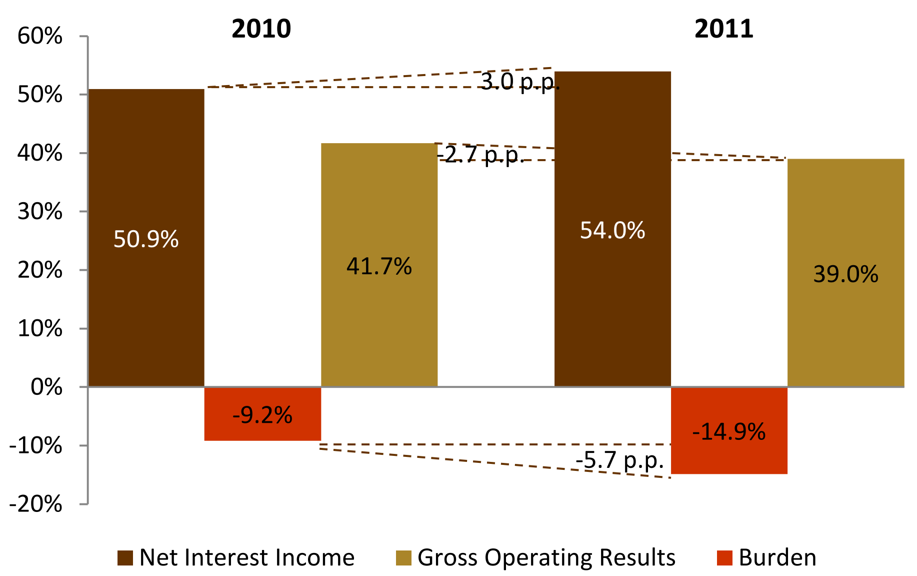
Graph 59: Burden as percentage of operating income (2010 – 2011)



Source: FIs, APB.

The three percentage point increase in the weight of net interest income in operating income lightened effect of the 5.7% increase in the burden and so together they resulted in a positive gross operating result that was still 2.7 percentage points lower as a percentage of operating income in 2011 (see Graph 60).

Graph 60: Gross operating results as percentage of operating income by comparison between net interest income and burden (2010 – 2011)



Source: FIs, APB.

In total expenses of provisions and impairment, credit impairment (80.7% in 2010 and 57.6% in 2011) and other financial assets net of reversals (13.5% in 2010 and 26.3% in 2011) were particularly important in the last two years. Impairment of other net assets net of reversals continued to be of lesser importance, even after its weight in the total increased 10.8 pp in 2011. Provisions net of reversals continued to record negative balances and were therefore the only item making a positive, albeit small (3.2% in 2010 and 3.7% in 2011) contribution to the total (see Table 59, p. 122).

Compared to 2010, provisions and impairment rose substantially in 2011 (2.513 billion euros). This increase was largely justified by the performance of impairment of other financial assets net of reversals. Its 1.035 billion euro rise was essentially due to impairment recognised in Greek sovereign debt securities following the support plan for Greece from the European authorities and private[112] (see Table 59, p. 122). The amount recognised in this extraordinary measure totalled 874 million euros in the entire sample. This item was also influenced by impairment recognised in Portuguese shares as a result of the considerable fall in the PSI 20 index.

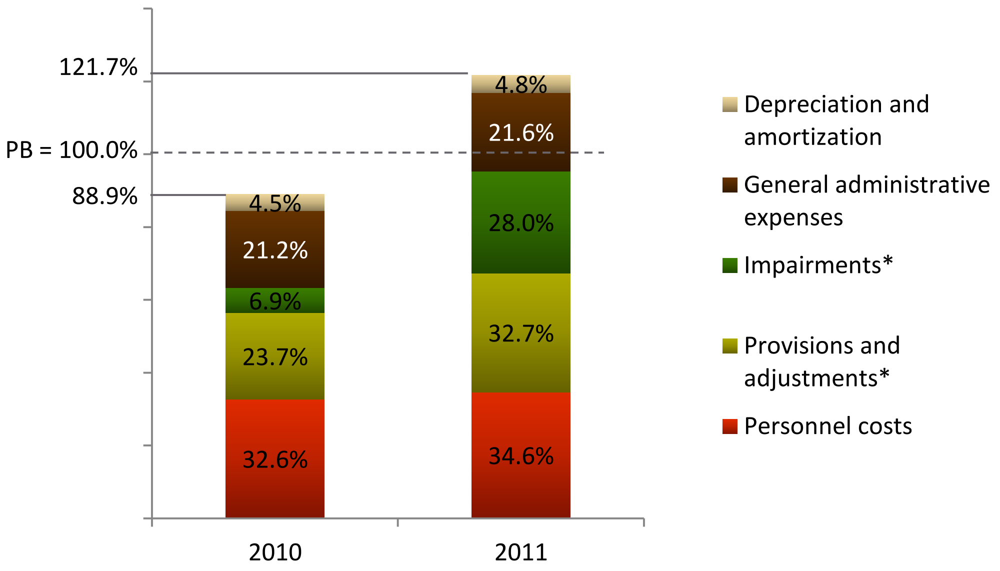
Another item that also contributed to the increase in provisions and impairment was credit impairment (774 million euros) (see Table 59, p. 122). Its 33% growth in 2011 was due to the recession in Portugal, which resulted in greater materialisation of the credit risk. There were also more significant allocations for impairment as a result of the Special Inspections Programme (SIP)[113] in 2011. According to the information provided by the member institutions, the programme entailed recognition of additional impairment to the amount of 520 million euros.

In short, provisions, corrections and impairment constituted a substantial expense for financial institutions in 2011 and absorbed approximately 30% of each one's operating income. Together, provisions and impairment penalised results almost as much as personnel costs, an item that usually has the highest impact on operating income (see Graph 61, p. 125).

[112] This support plan provided for recognition of a 53.5% haircut of the nominal amount of the Greek public debt and accounting of losses due to the conversion of 31.5% of the debt into new securities with longer maturities (Banco de Portugal, “Financial Stability Report”, May 2012).

[113] This programme involved assessing three aspects of the eight largest Portuguese groups: i) the banks' credit portfolios as at 30 June 2011, ii) the methods used to calculate own funds´ requirements for the credit risk and iii) the banks' methods and parameters in the stress tests (Banco de Portugal, “Financial Stability Report”, May 2012).

Graph 61: Weight of operating costs, provisions and impairments in operating income (2010 – 2011)

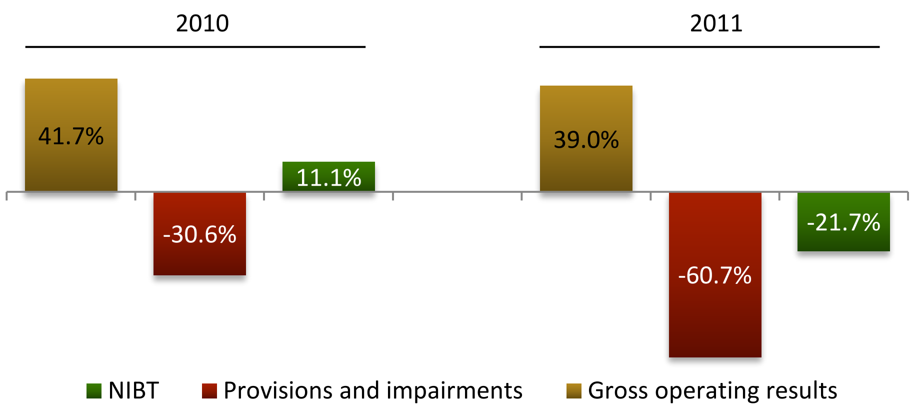


Source: FIs, APB.

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.

Graph 62 shows the profound change in the banking sector's performance in 2011, however. While in 2010, total operating costs, provisions and impairment did not fully absorb operating income and generated net income before tax of 11.1%, in 2011 these costs exceeded operating income by 21.7% and it was insufficient to cover them. This resulted in a loss before tax for the banking sector in 2011, although it was highly penalised by extraordinary measures (most of them non-recurring) imposed under the FAP. Without the recognition of the costs of the partial transfer of pension funds to Social Security, impairment from the Greek sovereign debt, additional credit impairment (SIP) and the levy on the banking sector, the member institutions' net income before tax would have been -63 million euros.

Graph 62: Net income before tax as percentage of operating income by comparison between gross operating results and provisions and impairments (2010 – 2011)



Source: FIs, APB.

Annex

Table 60: Aggregate income statement of the sample of 31 institutions for comparison between 2010 and 2011[114]

	2010		2011		Change	
	million €	% OI	million €	% OI	million €	%
+ Interest and similar income	16,812		20,147			
- Interest and similar expense	11,982		15,335			
Net Interest Income (NII)	4,830	*50.9%*	4,812	*54.0%*	-18	*-0.4%*
+ Fee and commission income	3,218		3,140			
- Fee and commission expense	548		593			
Net Gains from Fees and Commissions	2,670	*28.2%*	2,547	*28.6%*	-123	*-4.6%*
+ Net gains from assets and liabilities at fair value through profit or loss	-185		-459			
+ Net gains from available-for-sale financial assets	425		7			
+ Net gains from foreign exchange differences	59		-1			
Net Gains from Financial Operations	299	*3.2%*	-453	*-5.1%*	-752	*-251.5%*
+ Income from equity instruments	1,375		1,164			
+ Net gains from sale of other assets	-27		160			
+ Other operating income and expense	333		686			
Other Results	1,681	*17.7%*	2,010	*22.5%*	329	*19.6%*
Operating Income (OI)	9,480	*100.0%*	8,916	*100.0%*	-564	*-5.9%*
- Personnel costs	3,093		3,085			
- General administrative expenses	2,011		1,931			
- Depreciation and amortisation	424		424			
Operating Costs	5,528	*58.3%*	5,440	*61.0%*	-88	*-1.6%*
Gross Operating Results (GOR)	3,952	*41.7%*	3,476	*39.0%*	-476	*-12.0%*
- Provisions net of reversals	-94		-198			
- Value adjustments relating to loans and advances to customers and receivables from other debtors (net of reversals)	2,342		3,116			
- Impairment on other financial assets net of reversals	391		1,426			
- Impairment on other assets net of reversals	262		1,070			
Provisions and impairment	2,901	*30.6%*	5,414	*60.7%*	2.513	*86.6%*
Net Income before Tax (NIBT)	1,051	*11.1%*	-1,938	*-21.7%*	-2.989	*-284.4%*

Source: FIs, APB.

[114] See footnote 76, p. 83.

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[115])
- 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.[116]

The banking sector only receives favourable treatment in one concrete situation, which is 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

[115] 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.

[116] 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 does not apply to other companies with their head office and control in Portugal, is limited to 15% of the credit institution's taxable income. This substantially reduces its impact.[117]

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.[117]

An approximate aggregate amount of the corporate income tax payable to the state by member institutions was calculated [118] in order to confirm the above tax scheme analysis, (see Table 61, p. 129). This calculation considered the estimated tax base for 2010 and 2011 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[119] to the tax base calculated in accordance with current taxation rules.

On the basis of the results (see Table 61, p. 129), the corporate income tax payable to the state by member institutions is estimated at around 42 million euros in 2011 (as opposed to 124 million euros in 2010). This corresponds to an estimated corporate income tax rate of 26.4% (against 25.5% in 2010). According to statistics provided by Direcção Geral dos Impostos (DGI - Directorate-General for Taxation)[120] for 2009, the average effective corporate income tax rate for companies in the financial and insurance sector was 21%, which was above the national average of 19%.

[117] 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.*

[118] For the purpose of this calculation, and because of a shortage of or non applicable data, it was based on 28 of the 33 financial institutions from the sample in this report. It did not include Banco BIC, Barclays, CCCAM, Finantia or Montepio.

[119] In 2010 and 2011 this rate was around 25%.

[120] Statistics from the DGCI – IRC - Return form 22 –2007 to 2009 - Table 34 – Average effective rates - www.portaldasfinancas.gov.pt. – There is updated information for 2010.

Table 61: Approximate total amount of tax payable to the state in terms of corporate tax in 2010 and 2011. 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

	2010 million €	2011 million €
Net Income before Tax [a)]	**963**	**-2.023**
Adjustments for calculation of taxable income / tax loss		
Applicable to all taxpayers subject to corporate income tax:		
Capital gains and impairments in investments (net)	-326	256
Elimination of double taxation of distributed profits	-1,239	-958
Tax benefits	-48	-44
Non-relevant expenses and income for tax purposes	28	24
Provisions for other risks	321	911
Allocation of profits of non-resident companies subject to special tax schemes	214	342
Employment termination and retirement benefits and other post-employment or long-term benefits	-85	60
Impairments for credit-risk	482	846
Other [b)]	-290	266
Applicable to credit institutions and financial companies:		
Impact of the tax regime on financial branch offices' activity in the Madeira tax-free area	-19	-41
Taxable Income / Tax Loss	**1**	**-361**
Use of tax losses from prior years	-56	-360
Tax Base [c)]	**487**	**159**
Income tax	124	42
Income Tax Rate (%)	***25.5%***	***26.4%***

Source: FIs, APB.

[a)] Net income before tax of the 28 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 the state local taxes and are subject to autonomous taxation and the taxes levied in the foreign countries in which they operate. In 2010 and 2011, the member institutions paid around 68 and 40 million euros, respectively (see Table 62, p. 130).

Table 62: Approximate local taxes, autonomous taxation and income tax levied in foreign countries (2010 – 2011)

	2010 million €	2011 million €
Income tax levied in foreign countries net of the deduction of double taxation	36	11
Autonomous taxation	17	14
Local taxes [a]	15	15
Total Local Taxes, Autonomous Taxation and Income Tax Levied in Foreign Countries	**68**	**40**

Source: FIs, APB.
[a] Local taxes were calculated at 1.5% of taxable income in 2009 and 2010, plus an additional 2.5% for the state levy introduced under the Stability and Growth Programme.

Furthermore, in addition to the above-mentioned expenses, financial institutions are subject to other operating taxes, such as stamp duty, non-deductible VAT and municipal property tax (IMI). In Table 63, 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 original (Tier 1) and additional (Tier 2) own funds 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 63, the levy on the banking sector for the member institutions totalled 139 million euros in 2011.

Table 63: Tax and parafiscal burden (2010 – 2011)[a]

	2010 million €	2011 million €
Tax Burden		
Operating taxes [b]	277	290
Contributions on the Banking Sector	-	139
	277	429
Parafiscal Burden		
CAFEB	103	-
Single social rate	90	335
Pension expenses	441	415
Other expenses	157	137
Total	791	887
Total	**1,068**	**1,316**

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

Parafiscal levies consist of contributions to Social Security, SAMS (Medical and Social Service) and pension funds. In spite of the 5.9% reduction in 2011, contributions to pension funds continued to be the most significant parafiscal item and represented 55.8% of the total in 2010 and 46.8% in 2011. In 2010, parafiscal expenses also included contributions to CAFEB – Caixa de Abono de Família dos Empregados Bancários, which was closed down on 1 January 2011.

Parafiscal contributions rose 12.1% from 2010 to 2011. This growth was due to an increase in Single Social Charge (TSU) contributions, which, if we take account of CAFEB payments in 2010, accounted for 73.6%. On 1 January 2011, all bank employees who were CAFEB beneficiaries have been registered with Social Security and financial institutions pay the 23.6% single social charge.

VII.3. Return

The individual accounts on an aggregate level of the 31 financial institutions analysed here[121] showed a loss in 2011, with a return on equity (ROE)[122] before tax of -7.53%, as opposed to 3.85% at the end of 2010.[123] This sharp deterioration in return is due on the one hand to the adverse economic situation in Portugal in 2011 and on the other hand to extraordinary factors with a particularly negative impact on net income in 2011 (see Table 64, p. 132).

If we excluded the extraordinary impacts accounting for around 1.875 billion euros of the aggregate value of net income before tax (NIBT) in 2011, it would be -63 million euros, resulting in a minimal ROE of approximately -0.23%.[124]

These extraordinary impacts comprise four effects: the partial transfer of banks' pension funds to the state (408 million euros), recognition of credit impairments resulting from the Special Inspections Programme (520 million euros), a haircut on Greece's sovereign debt (874 million euros) and the levy on the banking sector (73 million euros). This last amount does not include contributions paid by some Members (66 million euros), which chose to account for them only after calculating net income before tax (i.e. 73 million euros only refers to cases in which the contribution was recorded as other operating results and not current tax). The rest of the analysis conducted in this chapter does not exclude these extraordinary impacts.

The deterioration in ROE was due to an almost three billion euro reduction in net income before tax and was actually negative in 2011 (see Table 64, p. 132). This variation can be explained mainly by a 2.513 billion euro increase in provisions and impairment as a result of the deterioration

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[121] See footnote 76, p. 83.

[122] 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.

[123] Please note that the 2010 figures shown here are slightly different from those in Activity Report 46 (2010), for two reasons: (i) differences in the universe of banks analysed and (ii) correction of some 2010 figures by an APB Member.

[124] This approximate figure was obtained by adding 1.875 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 in equity and also ignores the time lapse of some measures, which would affect the quarterly balance sheets differently.

in credit quality, especially in domestic business, and losses recognised in financial assets due to market devaluations and restructuring of the Greek sovereign debt. The 752 million euro decrease in gains from financial operations made a similar contribution. Net interest income remained relatively stable in aggregate terms, as interest received and paid increased by around 3.3 billion euros, reflecting more costly funding for banks and loans granted by them.

Table 64: ROA and ROE (2010 – 2011)

		2010	2011	Change
	Balance Sheet Average Values (Million €)			
ØTA	Average total assets	475,183	481,627	*1.4%*
ØFA	Average financial assets	441,232	443,929	*0.6%*
ØFL	Average financial liabilities	436,233	444,787	*2.0%*
ØE	Average equity	27,326	25,736	*-5.8%*
	Income Statement (Million €)			
	+ Interest and similar income	16,812	20,147	*19.8%*
	- Interest and similar expense	11,982	15,335	*28.0%*
	Net Interest Income	4,830	4,812	*-0.4%*
	+ Net gains from fees and commissions	2,670	2,547	*-4.6%*
	+ Net gains from financial operations	299	-453	*-251.5%*
	+ Other results	1,681	2,010	*19.6%*
	Operating income	9,480	8,916	*-5.9%*
	- Operating costs	5,528	5,440	*-1.6%*
	- Provisions and impairments	2,901	5,414	*86.6%*
NIBT	Net Income Before Tax	1,051	-1,938	*-284.4%*
	Return [a)]			
NIBT/ØTA	Return on assets before tax (ROA)	0,22%	-0.40%	
ØTA/ØE	x Financial leverage	17.39	18.71	
NIBT/ØE	Return on equity before tax (ROE)	3.85%	-7.53%	

Source: FIs, APB.

[a)] Values rounded to two decimal points.

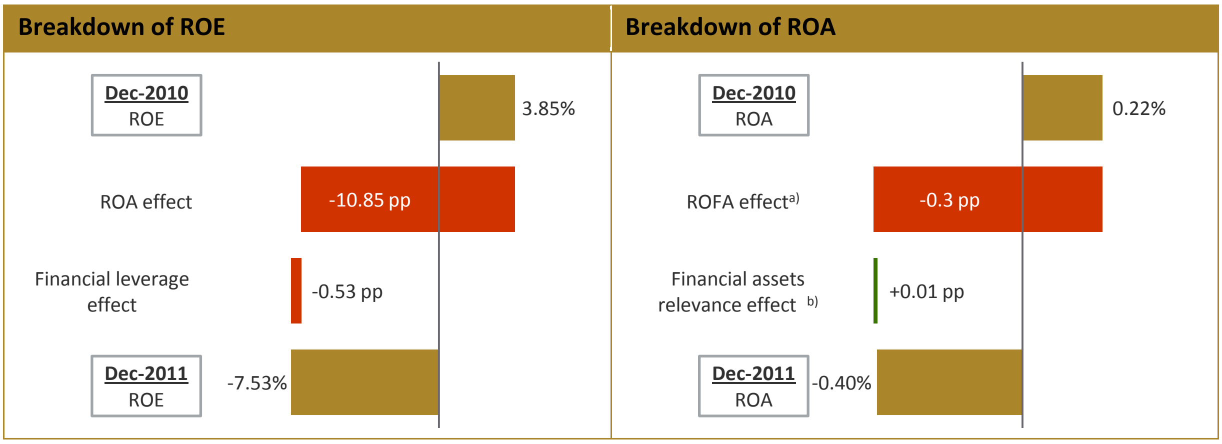
Note: Changes are measured in percentage.

According to Activity Report 46 (2010), the member institutions showed a slight trend towards financial deleveraging[125] in 2010. Nonetheless, in 2011 they were more leveraged once again, even though the Economic Adjustment Programme required a gradual reduction in assets of the Portuguese banking sector. Table 64 shows that this result was mainly down to two reasons. Firstly, based on average balance sheets, there was an increase in total aggregate assets from 2010 to 2011 (+1.4%), which was not the case at the end of the year (-2.3%). Secondly, the higher financial leverage was essentially due to lower average equity, which fell 5.8%. This was due to fair value reserves and net income for the year, the negative impacts of which superseded increases in share capital.

[125] In the measurements of return used here, financial leverage is the ratio between total average assets and average equity (see also the last part of Table 64).

Table 64, p. 132 and Chart 4 show the cause of the deterioration in ROE. Considering that ROE is the product between total return on assets (ROA) and financial leverage, we find that the reduction in ROE was mainly due to a decrease in ROA. A more leveraged balance sheet structure had only a marginal impact. In view of a reduction of 11.38 percentage points in ROE, the decrease in ROA to -0.4% accounts for 10.85 percentage points of this variation, while the remaining 0.53 percentage points can be explained by greater financial leverage. The preponderance of the ROA effect had already been observed last year, suggesting that changes in financial leverage in the sector as a whole were not very significant in 2011.

Chart 4: Breakdown of effect on ROE and ROA (2010 – 2011)



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.

Chart 4 also demonstrates that the deterioration in ROA, which went from 0.22% to -0.4%, was mainly due to lower return on financial assets (ROFA),[126] which fell to -0.44% in 2011 (see Table 65, p. 134) and contributed 0.63 percentage points to the total fall of 0.62 percentage points. The importance of financial assets, which are the main source of financial earnings, fell only slightly from 92.9% to 92.2% of total assets, which explains the positive but very small contribution (0.01 pp) to the variation.

Table 65, p. 134 shows the main income statement items as a percentage of average financial assets. As in the conclusions from an analysis of Table 64, p. 132, this table also shows that the main factors penalising return in 2011 were the increase in provisions and impairment (whose weight approximately doubled) and the reduction in income from financial operations (which went from positive to negative). Net interest income remained at 1.09% of financial assets, as the increases, measured in basis points, in interest received and paid were the same (73 bp) (see Table 65, p. 134).

[126] The balance sheet items included in financial assets are identified in Note b) of Table 33, p. 82.

Table 65: Return on financial assets (2010 – 2011)

		2010	2011	Change
	Income Statement as Percentage of Financial Assets [a)]			
	+ Interest and similar income	3.81%	4.54%	*73 bp*
	- Interest and similar expense	2.72%	3.45%	*73 bp*
	Net interest income	1.09%	1.09%	*0 bp*
	+ Net gains from fees and commissions	0.61%	0.57%	*-4 bp*
	+ Net gains from financial operations	0.07%	-0.10%	*-17 bp*
	+ Other results	0.38%	0.45%	*7 bp*
	Operating income	2.15%	2.01%	*-14 bp*
	- Operating costs	1.25%	1.23%	*-2 bp*
	- Provisions and impairment	0.66%	1.22%	*56 bp*
RAI/ØFA	Return on financial assets before tax (ROFA)	0.24%	-0.44%	*-68 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).

Our analysis of return is completed by a more detailed study of net interest income, in order to break down variations in the weight of interest, income and expenses into the composition effect vs. the interest rate effect.

If we match net interest income items with the balance sheet stock items, it is possible to assess whether variations are the result of rate of return / implicit cost (interest rate effect) or a change in the weight of the different financial assets/liabilities against total financial assets/liabilities (composition effect).[127]

It is necessary to mention some relevant aspects for an interpretation of the results shown here. In the interest rate effect, increases mean that the underlying interest rate has risen. In the composition effect, increases mean that the weight of the financial assets/liabilities item has increased in total financial assets/liabilities.[128]

The total 73 basis point increase in net interest income in 2011 resulted mainly from the higher weight of interest from loans and advances to customers and available-for-sale financial assets, with increases of 41 and 24 basis points, respectively (see Table 66, p. 135). Only interest on hedging derivatives fell, by a total of 15 basis points.

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

[128] If the sum of all the composition effects is positive, this tends to mean that financial assets/liabilities of lesser weight have increased to the detriment of those of higher weight, as the analysis here gives greater weight to variations in items of lower weight. For example, if the weight of two financial assets increases in total financial assets by 1 percentage point from 1% to 2% and 50% to 51%, the former will have a greater composition effect.

Table 66: Interest and similar income of net interest income (2010 – 2011)

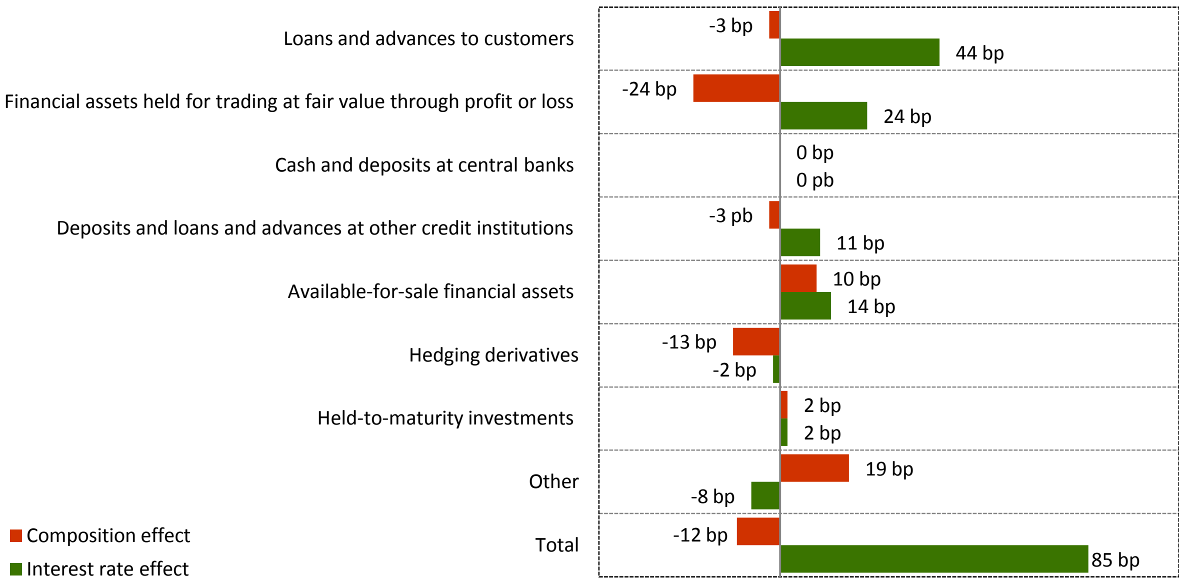
	2010	2011	Change
Interest and Similar Income as Percentage of Average Financial Assets			
Interest on credit	1.78%	2.19%	*41 bp*
Interest on financial assets held for trading at fair value through profit or loss	0.84%	0.84%	*0 bp*
Interest on deposits and loans and advance to Central Banks	0.01%	0.01%	*0 bp*
Interest on deposits and loans and advance to other credit institutions	0.16%	0.24%	*8 bp*
Interest on available-for-sale financial assets	0.31%	0.55%	*24 bp*
Interest on hedging derivatives	0.44%	0.29%	*-15 bp*
Interest on held-to-maturity investments	0.07%	0.11%	*4 bp*
Other interest and similar income	0.20%	0.31%	*11 bp*
Interest and similar income	3.81%	4.54%	*73 bp*

Source: FIs, APB.

Note: Change is measured in basis points.

The variations in Table 66 are then broken down by composition effect and interest rate effect (see Graph 63).

Graph 63: Breakdown of changes in interest and similar income of net interest income (2010 – 2011)



Source: FIs, APB.

Note: This graph breaks down the total variation shown in Table 66 by composition and interest rate effect.

The increase in the weight of interest and similar income within NII in terms of average financial assets in 2011 can be explained mainly by a positive interest rate effect (85 bp), though partially offset by a negative composition effect (-12 bp). Where items with the highest variations were concerned, interest on loans and advances to customers and available-for-sale assets increased their importance, essentially due to an increase in the interest rate charged. In terms of composition, however, these two categories showed opposing tendencies, as loans and advances to customers contracted, with a slightly negative composition effect (-3 bp). Available-for-sale assets showed a significant positive composition effect. The increase in the period in question can be explained by the purchase of Portuguese public debt.[129] On the other hand, the weight of financial assets held for trading and at fair value through profit or loss fell in total financial assets, which resulted in a negative composition effect (-24 bp) that was fully offset by a positive interest rate effect (24 bp), justifying a zero total effect.

Interest and similar expenses in net interest income as a percentage of average financial liabilities increased 70 basis points in 2011 (see Table 67). This can be explained largely by relative increases in interest on deposits from credit institutions and customers, which rose 15 and 45 basis points respectively, which reflects more costly funding for Portuguese banks. As in the conclusions on interest and similar income within NII, we find that the relative weight of interest on hedging derivatives fell in expenses of net interest income.

Table 67: Interest and similar expense of net interest income (2010 – 2011)

	2010	2011	Change
Interest and Similar Expense as Percentage of Average Financial Liabilities			
Interest on deposits from central banks	0,08%	0,14%	*6 bp*
Interest on deposits from other credit institutions	0,23%	0,38%	*15 bp*
Interest on debt securities issued	0,52%	0,50%	*-2 bp*
Interest on deposits from customers	0,54%	0,99%	*45 bp*
Interest on hedging derivatives	0,36%	0,25%	*-11 bp*
Interest on subordinated liabilities	0,10%	0,08%	*-2 bp*
Other interest and similar expense	0,92%	1,11%	*19 bp*
Juros e rendimentos similares [a)]	2,75%	3,45%	*70 bp*

Source: FIs, APB.

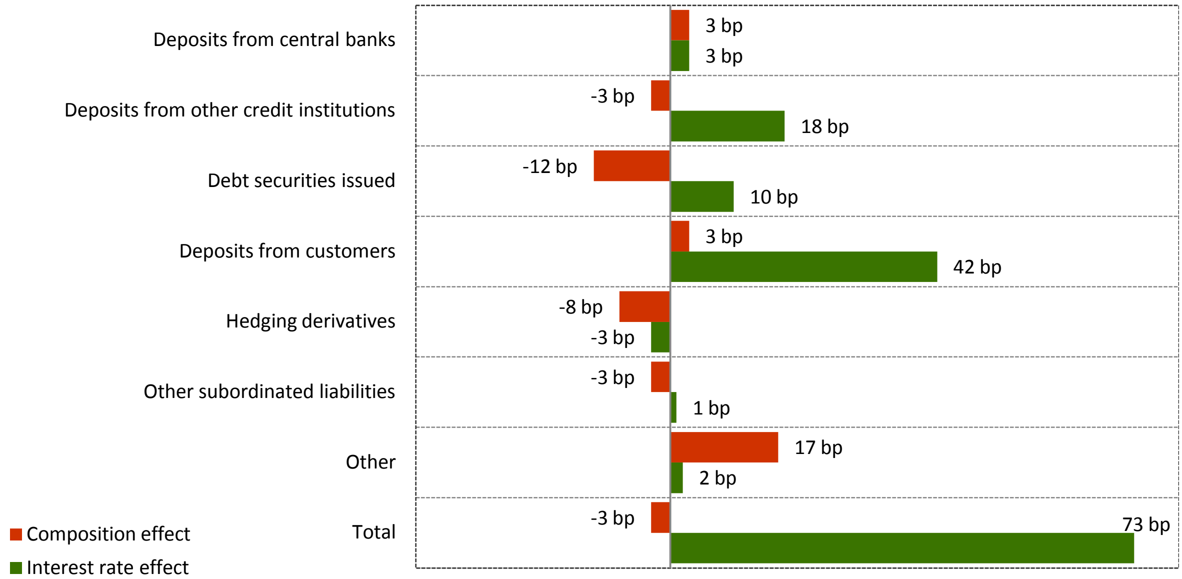
[a)] These figures are different from those at the beginning of Table 65, p. 134 since here they are measured in relative terms against average financial liabilities and not average financial assets.

Note: Change is measured in basis points.

A breakdown of these effects also shows the preponderance of a positive interest rate effect partially offsetting a negative composition effect (see Graph 64, p. 137).

[129] This increase is more accentuated in this analysis, which uses average balance sheet figures. There was a 28.1% increase in available-for-sale assets from 2010 to 2011. This increase was only 2.5% if we use only end-of-year balance sheet figures, however.

Graph 64: Breakdown of changes in interest and similar expense of net interest income (2010 – 2011)



Source: FIs, APB.

Note: This graph breaks down the total variation shown in Table 67, p. 136 by composition and interest rate effect.

The positive interest rate effect in the majority of items considered is a direct reflection of the deterioration of banks' funding conditions and was highest in deposits from customers, especially interest on deposits. There were positive composition effects in deposits from central banks and customers, whose weight in total financial liabilities increased from 7.6% to 10% and 42.3% to 44.6% respectively. These increases arose from difficulties in obtaining alternative sources of funding, such as access to international interbank or debt and capital markets.

VII.4. Solvency

The solvency of the financial institutions[130] analysed here improved in 2011,[131] with an aggregate core Tier 1 ratio of 9.4%. There were only two banking groups that did not exceed the minimum of 9% set for the end of 2011.

[130] This solvency analysis is different from last year's, as it does not focus on separate accounts. The decision to use the separate accounts in 2010 was due to our intention to ensure that this chapter was consistent with the rest of the Activity Report, which focused on individual accounting information, in order to analyse banking activity above all. This year, we used the 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 Grupo Rentipar Financeira 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 supervision.

[131] 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.

On average, the increase in core Tier 1 capital accounted for more than half the rises in core ratios, and overcame the impact of the contraction in total assets. The institutions with lower core Tier 1 ratios in 2010 were those that resorted most to increases in core capital. In general, reduction in the average risk of assets as a strategy for reducing core capital needs was of limited importance in 2011. There was, however, an increase in the average risk of assets at institutions with higher core Tier 1 ratios that basically had room to reduce their regulatory ratios.

The highest level of capitalisation in terms of core Tier 1 capital is a direct reflection of the stricter requirements imposed on the sector for this category of regulatory capital. On 5 April 2011, Banco de Portugal transposed the core Tier 1 capital concept into Portuguese law in Notice 1/2011 and required a minimum limit of 8% for the end of the year. Soon after, on 10 May, following on from the Economic Adjustment Programme, Banco de Portugal raised the limit to 9% to be met by the end of 2011. It also established that the limit would be changed to 10% from December 2012 on ward. Furthermore, the four banking groups that took part in the stress tests conducted by the EBA in 2011 have to achieve a core Tier 1 of 9% by 30 June 2012, using stricter criteria than those of Banco de Portugal and adding a temporary core capital buffer to handle exposure to sovereign debt securities.[132]

Table 68: Capital adequacy as at 31 December (2010 – 2011)

	2010	2011	Change
Total Assets (Million €)			
Total assets [a]	485,287	463,942	*-4.4%*
Own Funds (Million €)			
Original own funds (Tier 1)	28,094	27,013	*-3.8%*
Of which*:* Core elements	25,045	27,435	*9.5%*
Additional own funds (Tier 2)	7,143	4,643	*-35.0%*
Deductions from total own funds	-898	-1,015	*13.0%*
Total own funds	34,339	30,641	*-10.8%*
Risk-weighted Assets (Million €)			
Credit risk	278,430	266,357	*-4.3%*
Market risk	10,736	4,863	*-54.7%*
Operational risk	21,073	20,530	*-2.6%*
Total risk-weighted assets	310,239	291,750	*-6.0%*
Capital Ratios (%)			
Core Tier 1 ratio	8.1%	9.4%	*1.3 pp*
Tier 1 ratio	9.1%	9.3%	*0.2 pp*
Solvency ratio	11.1%	10.5%	*-0.6 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 member institutions made a substantial effort to meet these added supervision requirements. The core Tier 1 ratio of 9.4% as at 31 December 2011 represents a 1.3 percentage

[132] For more detail, see Sub-chapter VII.5. Stress tests and European Capital Exercise , p. 141.

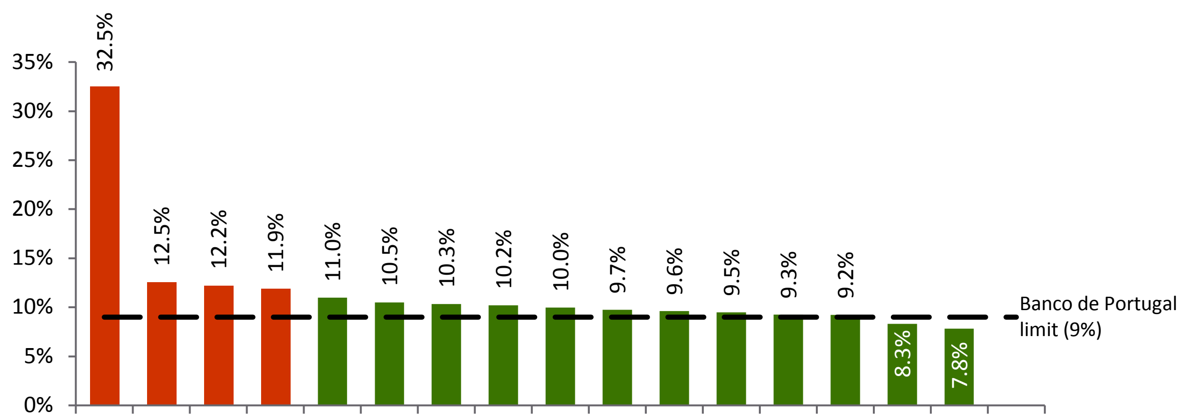
point increase on the same period in 2010 (see Table 68, p. 138). In the opposite direction, the solvency ratio, which takes account of total own funds, fell 0.6 percentage points to 10.5% in 2011. This last variation should not, however, be regarded as negative, as the prudential capital requirements focused mainly on the highest quality capital, i.e. core Tier 1 capital, while compliance with the solvency ratio played a secondary role.[133]

Where the absolute value of own funds was concerned, only the highest quality category, core Tier 1 capital increased (9.5%), while Tier 1 and Tier 2 fell 3.8% and 35%, respectively, resulting in a 10.8% reduction in total own funds. This trend shows that part of the increase in core Tier 1 capital was achieved by converting equity instruments belonging to other prudential categories. Furthermore, the increase in core capital was only not greater this year because of the need to recognise mostly losses in 2011. Nonetheless, the losses in the year did not have a more adverse effect on core Tier 1 capital as prudential filters were used by the supervisor and made it possible to postpone prudential recognition of greater losses. This was the case of amounts associated with the transfer of pension funds to Social Security and the recording of additional credit impairments following the Special Inspections Programme.

Graph 65 shows that, with the exception of two banking groups, all the Members exceeded the 9% minimum imposed for the core Tier 1 ratio in 2011. In addition, some institutions were already in a position to meet the 10% minimum that will be required after the end of 2012.

All the financial institutions that reduced their core Tier 1 ratio in 2011 belonged to the group of institutions with the highest figures and therefore had leeway to reduce their ratio without jeopardising compliance with capital requirements.

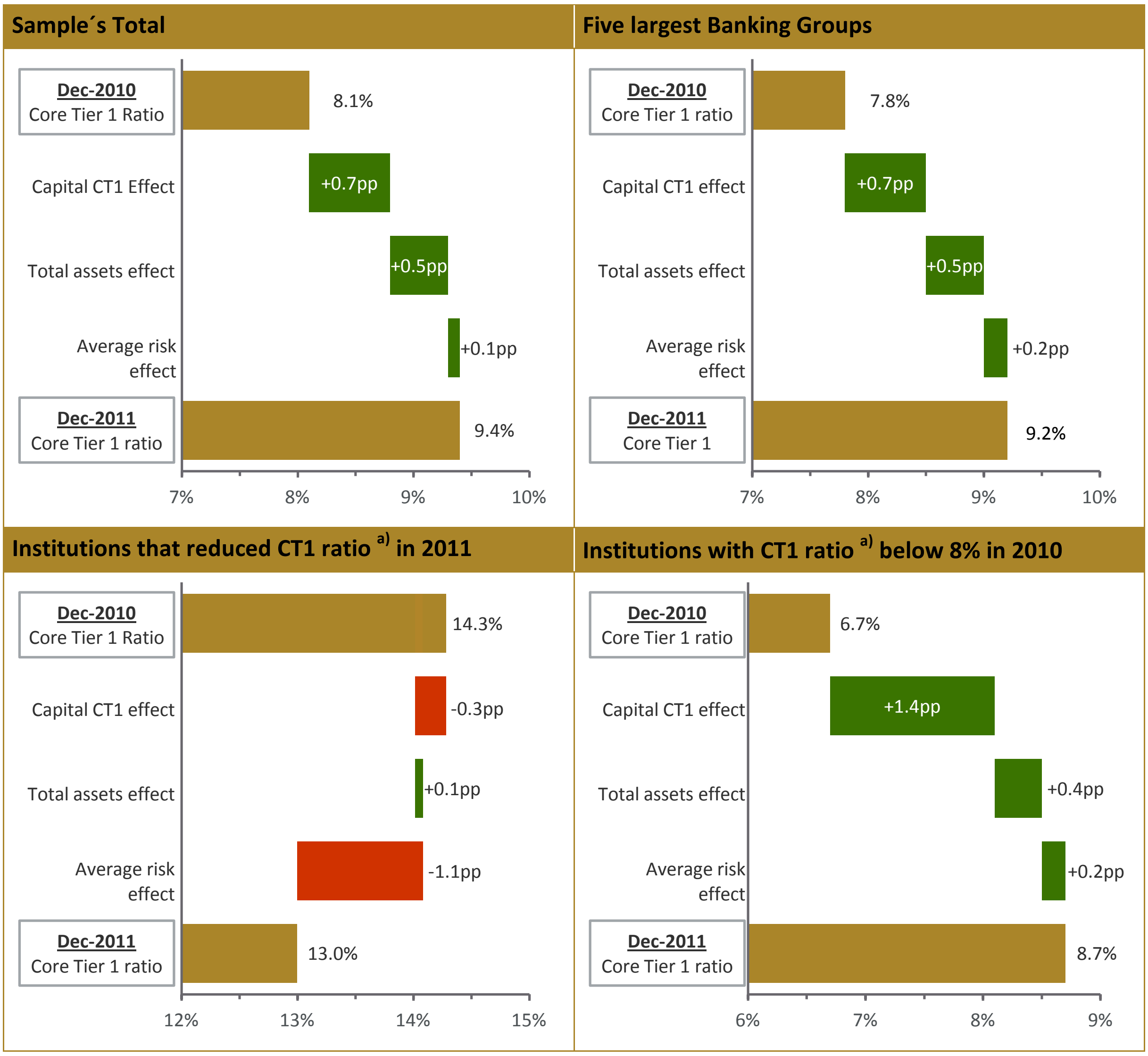
Graph 65: Core Tier 1 Ratios as at 31 December 2011



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 2010 e 2011.

[133] According to the international Basel rules, the minimum required solvency ratio is 8%, which should be automatically met if the core Tier 1 of 9% is achieved.

Chart 5: Breakdown of the Core Tier 1 ratio by subgroups (2010 – 2011)



Source: APB.

[a] CT1 – Core Tier 1.

Note: Subgroups of institutions that reduced CT1 ratio in 2011 and institutions with CT1 ratio below 8% consist of 4 financial institutions, oppositely to the universe of 16 financial institutions analysed in this chapter.

It is possible to characterise the different strategies used by the sample institutions to respond to higher prudential requirements. We can distinguish between the effects of increases in core Tier 1 capital, reductions in total assets and decreases in the average risk of assets[134] (see Chart 5). For all the sample institutions, the increase in their core Tier 1 capital was responsible for more than half the rise in their regulatory ratio. Nonetheless, the 4.4% reduction in total assets and a lower average risk, which went from 63.9% to 62.9%, made a positive contribution. If we analyse subgroups of institutions, however, we find that the trends are not uniform in the sample.

[134] 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.

On aggregate, the five largest banking groups had slightly lower core ratios than the total sample in December 2010 and 2011. Nonetheless, the effects that contributed to the 1.4 percentage point increase in the core Tier 1 ratio to 9.2% in 2011 were practically the same as those for the entire sample. The increase in core capital had a slightly greater impact than the contraction in total assets and the reduction in average risk had an insignificant impact.

There was a very different performance by the four sample institutions whose core Tier 1 ratio went down in 2011, with the average going from 14.3% to 13%. The average risk effect contributed more, showing a fall of 1.1 percentage points. This effect was caused by an increase in the average weight of risk of assets on the part of each one of the four institutions. The negative impact of 0.3 percentage points on the part of core Tier 1 capital was caused by an effective reduction in this item, which fell 2% for this subgroup in 2011.

There was a group of institutions that had a core Tier 1 ratio under 8% at the end of 2010 and therefore had to make a greater effort to achieve the required 9%. These four institutions essentially resorted to increases in core Tier 1 capital to fulfil the prudential ratio. A contraction in total assets (-4.6%) and a lower average risk also made a positive contribution to the core Tier 1 ratio, although to a lesser extent, and account for only 30% of the increase.

Finally, it is important to mention the nature of the variations explaining the performance of the core Tier 1 ratio, such as movements in core Tier 1 capital (numerator) and risk-weighted assets (denominator).

For the numerator, the conversion of non-core into core Tier 1 capital was the main source, although the conversion of Tier 2 instruments and increases in capital from the market were also somewhat important. The need to recognise 2011 results, which were negative for the majority of the institutions, also penalised core capital.

For the denominator, risk-weighted assets fell 6% in 2011, which exceeded the 4.4% contraction in total assets of these institutions, leading to a change in the composition of assets, with a lower average risk. The contraction in their balance sheet was not only a result of stricter regulatory capital requirements, which occurred when access to the capital market became more difficult for the banks. It was also a result of the poor economic scenario in Portugal and the deleveraging required of the banks as part of the Economic Adjustment Programme.

VII.5. Stress tests and European Capital Exercise

In July 2011, the European Banking Authority (EBA) and the European Systemic Risk Board (ESRB) undertook a stress test exercise to assess the resilience of 91 financial institutions in the European economic area, four of which were financial groups belonging to the APB, namely CGD, BCP, ESFG[135] and Banco BPI.

[135] The Espírito Santo Financial Group (ESFG) is a financial services holding company that includes Grupo Banco Espírito Santo and other companies working in banking, insurance and health in Portugal and abroad. As the stress tests were conducted at the highest level of consolidation and not all ESFG's banking activity is included in Grupo Banco Espírito Santo, it was ESFG that the EBA considered in them.

This tool is widely used by the supervisory authorities and financial institutions themselves to manage and mitigate risks that may jeopardise their solidity. The method consists of constructing severe but plausible scenarios and applying their shocks to different balance sheet and income statement items (including off-balance sheet) in order to calculate their impact on solvency.

The main focus of the stress tests in 2011 was credit and market risks. They included two different scenarios over a two-year period (2011 and 2012). In both cases the impacts on the financial institutions' solvency were calculated on the basis of the figures in their financial statements as at 31 December 2010 and the assumption that they would remain static in the future. The scenarios varied on the basis of each institution's country of origin in order to take account of the economy's specific characteristics.

The baseline scenario was constructed by the European Commission in cooperation with the EBA. It was based essentially on the Commission's projection models for different macroeconomic variables, such as GDP, interest rates, the unemployment rate and exchange and inflation rates, among others. The scenario for Portugal provided for a contraction in GDP in 2011 followed by a slight recovery in 2012.

The adverse scenario developed by the ECB and EBA comprised the baseline scenario to which shocks related to three main events were added simultaneously. The first was the continuation of the sovereign debt crisis in Europe, with special focus on the euro area. The second involved a reduction in overall demand originating in the USA. The third entailed a devaluation of the dollar against the other currencies, including the euro.

Consequently, the new scenario included changes in macroeconomic variables, with negative effects on the baseline scenario. For example, short-term interest rates (interbank rates) went up 125 basis points for all countries as a result of increasing tension in the money markets, which affected the cost of bank funding. Long-term interest rates also rose, though differently in each country depending of their specific circumstances.

This scenario also involved trading book shocks in the form of devaluations per instrument and sovereign exposure haircuts per country and maturity. The haircuts obliged institutions to recognise sovereign debt losses to the amount of the reduction in market value of the assets in their trading book.

Even so, considering the capital they held on 30 April 2012, the results of the Portuguese financial groups involved were satisfactory, as their core Tier 1 ratio for 2012 was above the 5% set as a threshold (see Table 69, p. 143) even in the adverse scenario. Furthermore, according to an explanatory note from Banco de Portugal,[136] the deterioration in the Portuguese banks' solvency after the shocks in the scenario occurred mainly because of an increase in impairment on their credit portfolio. The sovereign debt haircuts had small impacts, as most of the exposure was recognised under held-to-maturity investments and was therefore not included in the trading book.

Eight of the European financial institutions in the sample covered by the stress tests were not able to achieve the 5% limit for the core capital ratio. They were two Greek banks, one Austrian bank,

[136] Banco de Portugal, "EU-wide stress test: main results for the Portuguese banks", 15 July 2011 http://www.bportugal.pt/SiteCollectionDocuments/comunicado_EN.pdf

four Spanish *cajas* and one Spanish bank.[137] All together, the capital needed by these institutions totalled around 2.5 billion euros.

Table 69: Capital tests results for the Portuguese financial groups in question in June 2011

	CGD	BCP	ESFG	BPI
Core Tier 1 Capital [a)] (Million €)				
December 2010	6,510	3,521	4,520	2,133
Reference Scenario (Dec. 2012)	6,711	4,853	4,437	2,122
Adverse Scenario (Dec. 2012)	4,993	3,736	3,886	1,788
Risk-Weighted Assets [a)] (Million €)				
December 2010	76,989	59,562	71,122	26,036
Reference Scenario (Dec. 2012)	79,187	64,800	72,991	26,131
Adverse Scenario (Dec. 2012)	80,160	68,884	76,712	26,885
Core Tier Ratio				
December 2010	*8.5%*	*5.9%*	*6.4%*	*8.2%*
Reference Scenario (Dec. 2012)	*8.5%*	*7.5%*	*6.1%*	*8.1%*
Adverse Scenario (Dec. 2012)	*6.2%*	*5.4%*	*5.1%*	*6.7%*

Source: BdP, EBA, APB.
[a)] Values for capital core Tier 1 and risk-weighted assets used include listed measures contracted and executed until 30 April 2011.

Meanwhile, the worsening sovereign debt crisis in the euro area, especially in the peripheral countries, meant that it was later decided to implement stricter measures with regard to the capitalisation of the European banking system in order to reduce the systemic risk and restore confidence in the financial sector. These measures, which were introduced by the European Council and the EBA and must be fulfilled by 30 June 2012, include a 9% minimum core Tier 1 ratio and a temporary additional core capital buffer to deal with exposure to sovereign debt.[138] This buffer was calculated on the basis of the amounts of exposure of each institution or financial group on 30 September 2011. Unlike the stress tests, in which the haircuts of sovereign debt were limited to the trading book, the calculation of this new buffer was based on the market values of total exposure to sovereign debt, regardless of its accounting classification.

In December 2011, the EBA published a formal recommendation to guarantee compliance with these measures[139] and the results of the assessment made to calculate addition capital needs resulting from them[140] (European Capital Exercise). As a result of this exercise, the additional amounts of capital to fulfil the two requirements totalled 114.7 billion euros. Around 34.4% of this

[137] EBA, "European Banking Authority 2011 EU-wide Stress Test Aggregate Report", 15 July 2011 http://www.eba.europa.eu/EU-wide-stress-testing/2011/2011-EU-wide-stress-test-results.aspx
[138] Both measures apply only to the financial institutions that took part in the above-mentioned stress tests.
[139] 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
[140] 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

amount was the buffer against sovereign debt exposure, while the rest resulted from the increase in the minimum limit for the capital core ratio.

A need for core Tier 1 capital of around 6.95 billion euros was detected (see Table 70) in the case of the Portuguese financial groups, approximately 6.1% of the total amount calculated for the entire sample. It is important to note that a part of these needs was covered in 2011 in order to meet Banco de Portugal[141] requirements under the Economic Adjustment Programme.

Table 70: EU Capital Exercise results for the Portuguese financial groups in question in December 2011

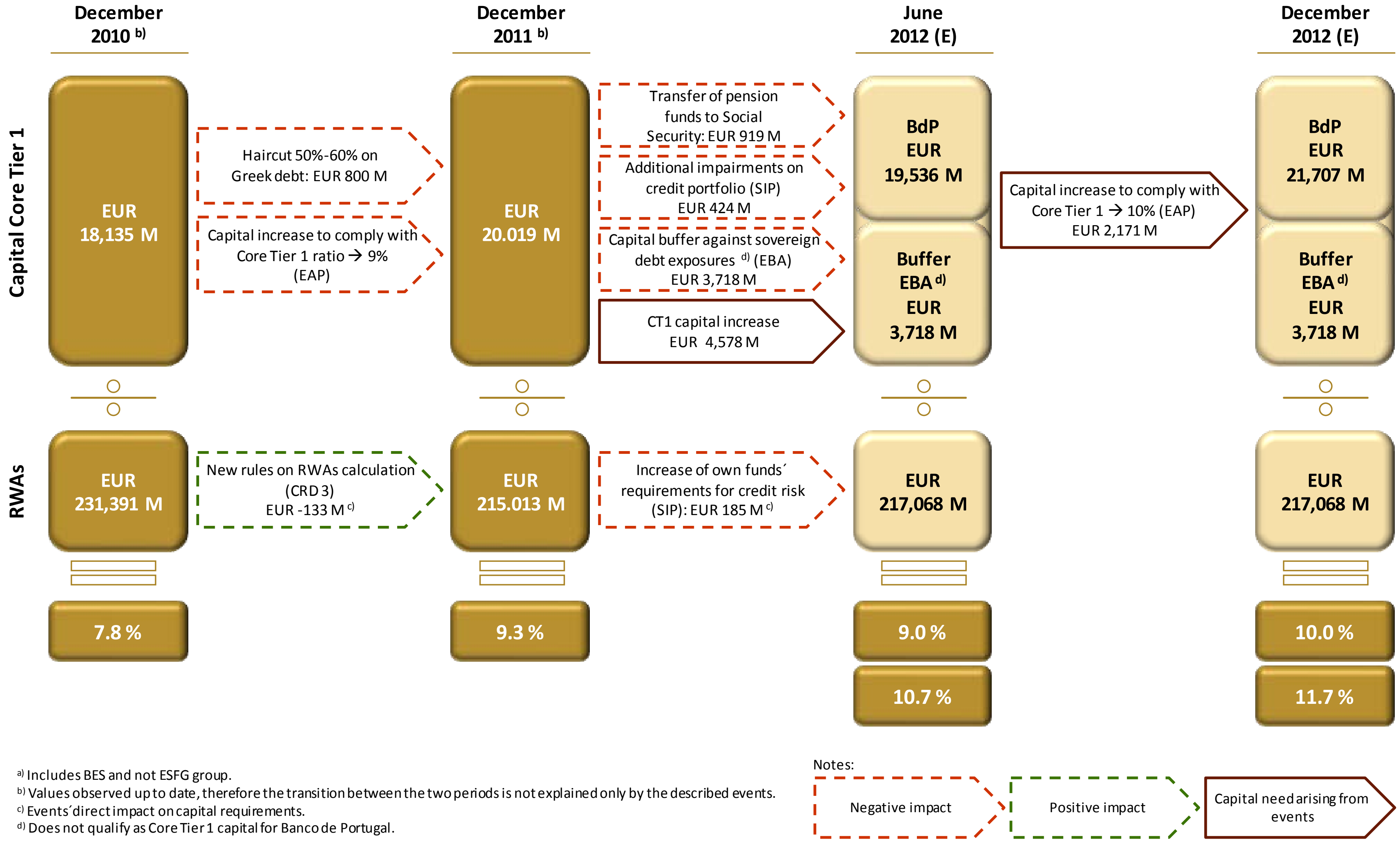
	CGD	BCP	ESFG	BPI	Total
Capital Core Tier 1 (September 2011)					
Million €	6,242	4,221	4,672	2,251	17,386
As % of risk-weighted assets	8.0%	7.3%	6.9%	8.9%	7.6%
Capital Buffer against Sovereign Debt Exposures					
Million €	1,073	1,165	121	1,359	3,718
As % of risk-weighted assets	1.4%	2.0%	0.2%	5.4%	1.6%
Need for Capital Core Tier 1 Reinforcement [a)]					
Million €	1,834	2,130	1,597	1,389	6,950
As % of risk-weighted assets	2.4%	3.7%	2.3%	5.5%	3.0%

Source: BdP, EBA, APB.
[a)] To comply with temporarily buffer and Core Tier 1 Ratio of 9%.

Even so, at the end of 2011, the negative impacts of some events will only be taken into account for prudential purposes in the first half of 2012 and will have to be covered then in order to comply with the above-mentioned EBA requirements by 30 June 2012. The transfer of part of the financial institutions' pension funds to Social Security and the extraordinary impairments resulting from the Special Inspections Programme[142]) will affect core Tier 1 capital by about 919 million and 424 million euros, respectively. On the other hand insufficiencies in the calculation of risk-weighted assets were detected during the programme, resulting in an increase of 2.056 billion euros in them, which reflects an extra need for core Tier 1 capital of 185 million euros. Consequently, the additional amount of capital calculated at the end of 2011 to meet EBA requirements on 30 June 2012 was 4.578 billion euros (see Chart 6, p. 145).

[141] See Sub-chapter VII.4 Solvency, p. 137.
[142] Special Inspections Programme

Chart 6: Estimates on evolution and impact on capital and risk-weighted assets for Portuguese financial groups involved in EU Capital Exercise [a)]



a) Includes BES and not ESFG group.
b) Values observed up to date, therefore the transition between the two periods is not explained only by the described events.
c) Events´direct impact on capital requirements.
d) Does not qualify as Core Tier 1 capital for Banco de Portugal.

Source: BdP, EBA, FIs, APB

VIII. Efficiency indicators[143]

VIII.1. Cost-to-income ratio

The cost-to-income ratio, also known as the efficiency ratio, is a measure that reflects financial institutions' capacity to generate operating profit from a certain flow of earnings generated by banking activity. In other words, this ratio assesses the financial effort necessary for financial institutions to do business, as it relates operating costs to operating income.

This ratio is particularly important for the banking sector and is used not only by institutions to set strategic goals and assessment criteria for their executives' performance, but also by different external agents, such as consultants, analysts and rating agencies. It is also an important benchmarking tool that positions financial institutions' operating efficiency against their peers.

Table 71: Operating costs, operating income and cost-to-income (2008 – 2011)

	2008	2009	2010	2011	Average
Operating Costs [a)]					
Total (million €)	5,592	5,622	5,783	5,698	-
Annual growth rate	-	*0.5%*	*2.9%*	*-1.5%*	*0.6%*
Operating Income [a)]					
Total (million €)	11,018	10,553	9,886	9,378	-
Annual growth rate	-	*-4.2%*	*-6.3%*	*-5.1%*	*-5.2%*
Cost-to-income					
Total	50.8%	53.3%	58.5%	60.8%	55.8%
Change (percentage points)	-	*2.5 pp*	*5.2 pp*	*2.3 pp*	-

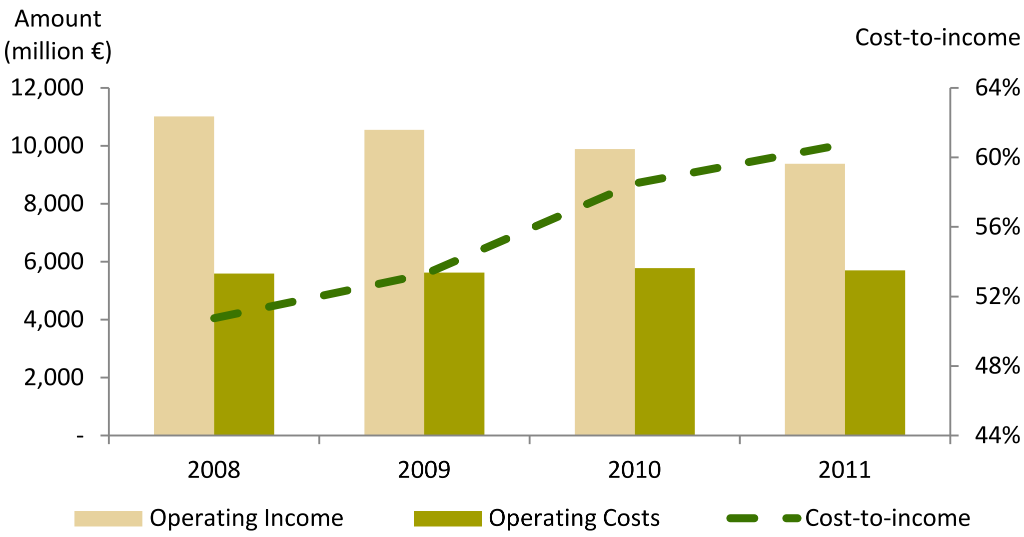
Source: FIs, APB.
[a)] See Table 52, p. 107.

The cost-to-income ratio rose by 2.3 percentage points to 60.8% in 2011. This rise followed the trend in effect since 2008, which resulted in a 10 percentage point deterioration in the ratio in the period (see Table 71).

The deterioration in the ratio in 2011 was, however, lower than in previous years. This was partly due to efforts to contain operating costs, which resulted in a reduction of 1.5%. Contrary to the scenario up to 2010, the increase in the ratio in 2011 was due solely to a highly significant fall in operating income, which was slightly over 5% (see Table 71 and Graph 66, p. 148).

[143] 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 36, p. 28.

Graph 66: Cost-to-income and its main components (2008 – 2011)



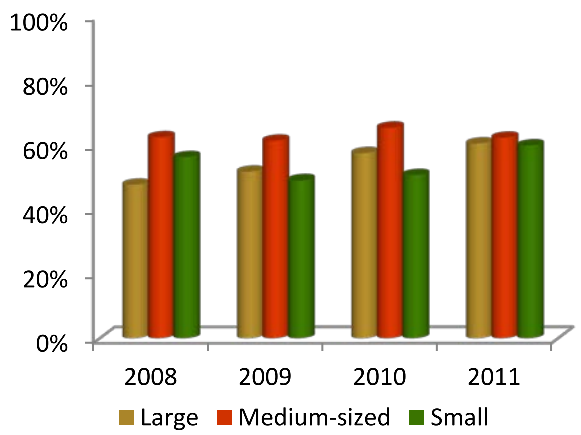
Source: FIs, APB.

Regarding the performance of the efficiency ratio in accordance with the member institutions' size and origin/type of legal structure, medium-sized institutions and branch offices were the only segments whose cost-to-income ratio fell in 2011. Even so the medium-sized institutions' ratio remained higher than that of its peers. The improvement in the branch offices' ratio combined with considerable deterioration of the subsidiaries' ratio meant that the subsidiaries had the highest efficiency level in the year (see Graph 67).

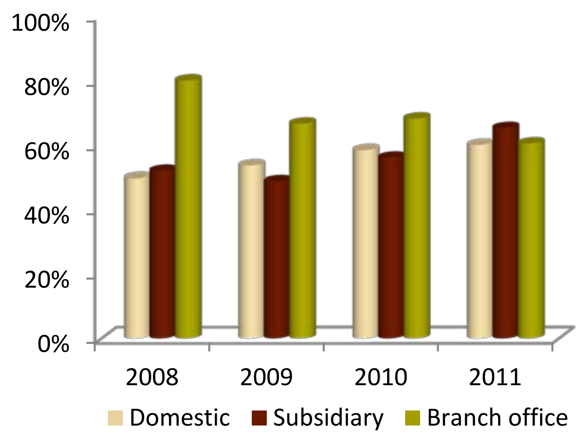
Due to this context, the cost-to-income ratio was fairly similar among the different segments of member institutions, both by size and origin/type of legal structure in 2011.

Graph 67: Cost-to-income by size and origin/type of legal structure of member institutions (2008 – 2011)

a) By size



b) By origin/type of legal structure



Source: FIs, APB.

VIII.2. Loans and deposits per employee and number of employees per branch[144]

The ratio of loans and deposits per employee analyses financial institutions' efficiency by relating aggregate value of the main services provided to the resources used to produce them. This ratio is especially important for the banking and financial sectors, as they are labour-intensive because human resources are their main production factor.

The loans and deposits per employee ratio is therefore indicative of financial institutions' performance in terms of efficient use of these resources to attract banking business.

Table 72: Credit and deposits, overall number of employees and credit and deposits per employee as at 31 December (2008 – 2011)

	2008	2009	2010	2011	Average
Credit + Deposits [a) b)]					
Total (million)	464,900	473,737	483,051	486,125	-
Annual growth rate	-	1.9%	2.0%	0.6%	1.5%
Overall Number of Employees [c)]					
Total	58,194	58,277	58,412	57,130	-
Annual growth rate	-	0.1%	0.2%	-2.2%	-0.6%
Credit and Deposits per Employee					
Amount (thousands €)	7,989	8,129	8,270	8,509	-
Annual growth rate	-	1.8%	1.7%	2.9%	2.1%

Source: FIs, APB.

a) Net loans to customers as shown in Table 31, p. 76.

b) Deposits from customers as shown in Table 32, p. 77.

c) See Table 9, p. 33.

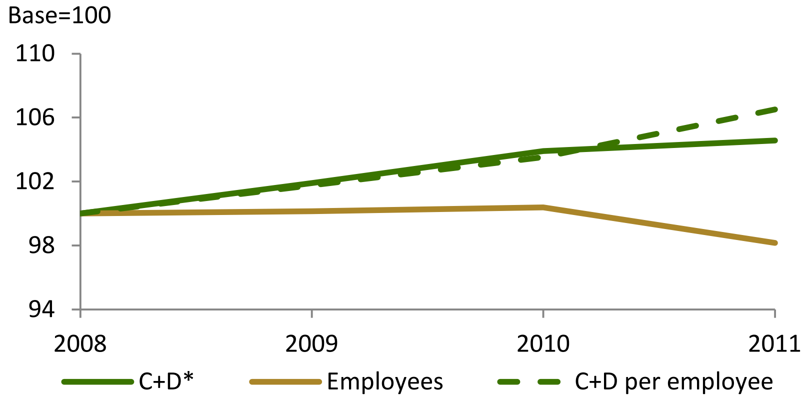
The loans and deposits per employee ratio increased significantly by 2.9% in 2011, which led to a reversal of the trend towards deceleration of growth up to 2010. As a result, , the amount of loans and deposits per employee rose around 6.6% from 2008 to 2011, thereby achieving an annual average growth rate of 2.1% (see Table 72).

Up to 2010, the ratio was driven only by an increase in loans and deposits, as the overall number of employees remained practically the same. The ratio was therefore very much in line with the total amount of loans and deposits (see Graph 68, p. 150).

This scenario changed in 2011, however. Combined with a slight increase in the amount of banking intermediation (due to opposing performances of deposits and loans), the reduction in member institutions' workforces led to an increase in the indicator's growth rate (1.7% to 2.9%) (see Table 72 and Graph 68, p. 150).

[144] 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).

Graph 68: Credit and deposits against overall number of employees as at 31 December (2008 – 2011)



Source: FIs, APB.
Note: * (C+D) Credit and Deposits.

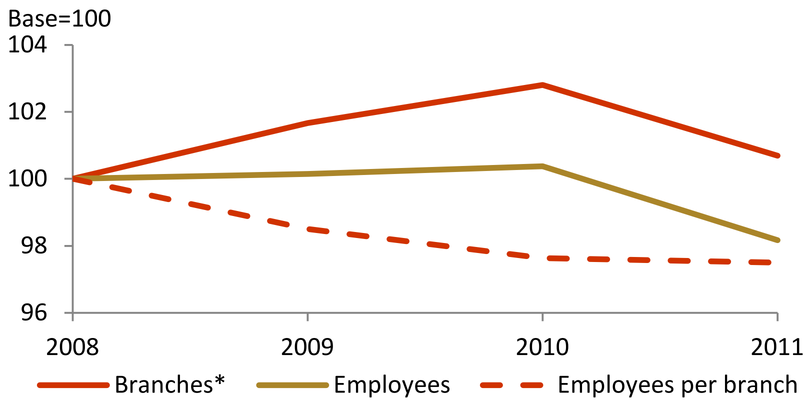
At the same time, the number of employees per branch stood still in 2011, thereby putting an end to gains in efficiency achieved since 2008 (see Table 73). While this ratio was marked by growth in the branch network up to 2010, as the workforce remained practically unaltered, in 2011 the stabilisation of the number of employees per branch resulted from similar reductions in its two components (see Graph 69).

Table 73: Number of branches and number of employees per branch as at 31 December (2008-2011)

	2008	2009	2010	2011	Average
Number of Branches [a)]					
Total	6,242	6,346	6,417	6,285	-
Annual growth rate	-	*1.7%*	*1.1%*	*-2.1%*	*0.2%*
Number of Employees per Branch					
Total	9.3	9.2	9.1	9.1	-
Annual growth rate	-	*-1.1%*	*-1.1%*	*0.0%*	*-0.7%*

Source: FIs, APB.
[a)] Including the number of branches in Portugal and branch offices and representative offices abroad.

Graph 69: Number of branches against overall number of employees as at 31 December (2008 – 2011)

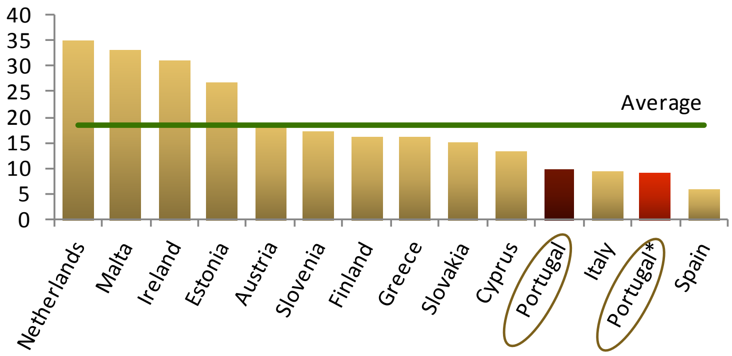


Source: FIs, APB.
Note: * Including number of branches in Portugal and branch offices and representative offices abroad.

Although the turnover per branch increased as a result of the restructuring in the member institutions' branch network in 2011, the number of human resources necessary for them to operate remained the same. This context was possible thanks to ongoing efforts to optimise available resources, which had already shown good results in previous years.

Furthermore, the member institutions' efforts to improve efficiency in terms of the number of employees per branch have placed them in a highly favourable position in relation to their peers in the euro area. Only the Spanish banking sector has a lower ratio (see Graph 70).

Graph 70: Number of employees per branch in the euro area as at 31 December 2010



Source: FIs, ECB, APB.
Note: * Includes only member institutions.
Due to lack of data for 2011, 2010 data was used for comparison of the indictor with other euro area countries.

VIII.3. Assets per employee

The assets per employee ratio relates the financial institutions' assets to their number of employees. An analysis of changes in this ratio provides an understanding of their performance in terms of operating efficiency (i.e. turnover), as it compares their main production factor (human resources) to the amount of business done (measured in terms of assets).

In 2011, the ratio grew by an insignificant 0.8%, as opposed to the highly positive 7.6% and 5.6% in 2009 and 2010. This is due to a 1.4% reduction in the amount of aggregate assets following the required deleveraging of the banking sector, which cancelled out most of the gains in efficiency that could have been achieved by rationalising resources (2.2%) (see Table 74, p. 152).

As a result, up to 2010, the increase in the assets per employee ratio was essentially driven by the growth in its first component, as the number of employees remained practically unchanged. In 2011, the latter component was responsible for the modest gains achieved in efficiency, as it fell more than aggregate assets (see Table 74, p. 152 and Graph 71, p. 152).

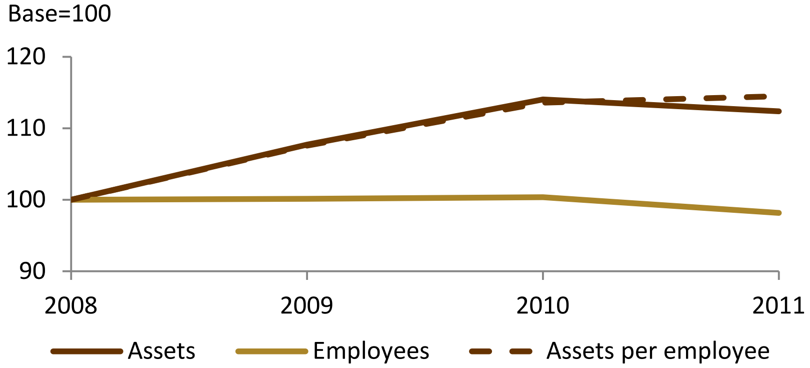
Table 74: Annual growth rates in aggregate assets and overall number of employees, and assets per employee as at 31 December (2008 – 2011)

	2008	2009	2010	2011	Average
Aggregate assets [a]					
Total (million €)	445,346	479,771	507,799	500,472	-
Annual growth rate	-	*7.7%*	*5.8%*	*-1.4%*	*4.0%*
Overall Number of Employees					
Total (million €)	58,194	58,277	58,412	57,130	-
Annual growth rate	-	*0.1%*	*0.2%*	*-2.2%*	*-0.6%*
Assets per Employee					
Amount (million €)	7,653	8,233	8,693	8,760	-
Annual growth rate	-	*7.6%*	*5.6%*	*0.8%*	*4.7%*

Source: FIs, APB.

a) See Table 31, p. 76.

Graph 71: Aggregate assets against overall number of employees as at 31 December (2008 – 2011)



Source: FIs, APB.

IX. International activity

The performance of international activity, which resulted from the internationalisation strategy pursued by a group of Members[145] in recent years, helped to mitigate extraordinary, highly negative impacts on domestic activity in 2011. This strategy of investing in expanding business abroad resulted in a 4.2% average annual growth rate in assets in international activity from 2008 to 2010.

Table 75: Consolidated balance sheet regarding international business activity as at 31 December (2008 – 2011)

	2008	2009	2010	2011	Average
Aggregate assets					
Total (million €)	67,575	74,681	73,079	71,611	-
Annual growth rate	-	10.5%	-2.1%	-2.0%	2.1%
Weight in total consolidated net assets	16.9%	17.4%	16.6%	17.2%	17.0%
Loans and Advances to Customers [a)]					
Total (million €)	39,991	42,702	45,591	44,733	-
Annual growth rate	-	6.8%	6.8%	-1.9%	3.9%
Weight in total consolidated loans and advances to customers	13.6%	14.2%	14.8%	15.3%	14.5%
Deposits from Customers					
Total (million €)	34,081	36,414	38,479	40,026	-
Annual growth rate	-	6.8%	5.7%	4.0%	5.5%
Weight in total consolidated deposits from customers	18.0%	19.0%	18.8%	18.4%	18.6%

Source: FIs, APB.
Note: [a)] Gross credit.

Nonetheless, the deleveraging process in separate activity [146] in 2011 also affected consolidated activity, including business abroad, albeit to a lesser extent. In spite of the contraction in international activity, its importance still grew in certain consolidate balance sheet items.

Assets in international activity therefore decreased 2% in 2011. Even so, this fall meant that their representativity in total consolidated assets increased from 16.6% in 2010 to 17.2% at the end of 2011. This contraction was largely due to a 1.9% reduction in gross loans to customers (see Table 75), which in turn were driven by the sale of credit portfolios from activity abroad.

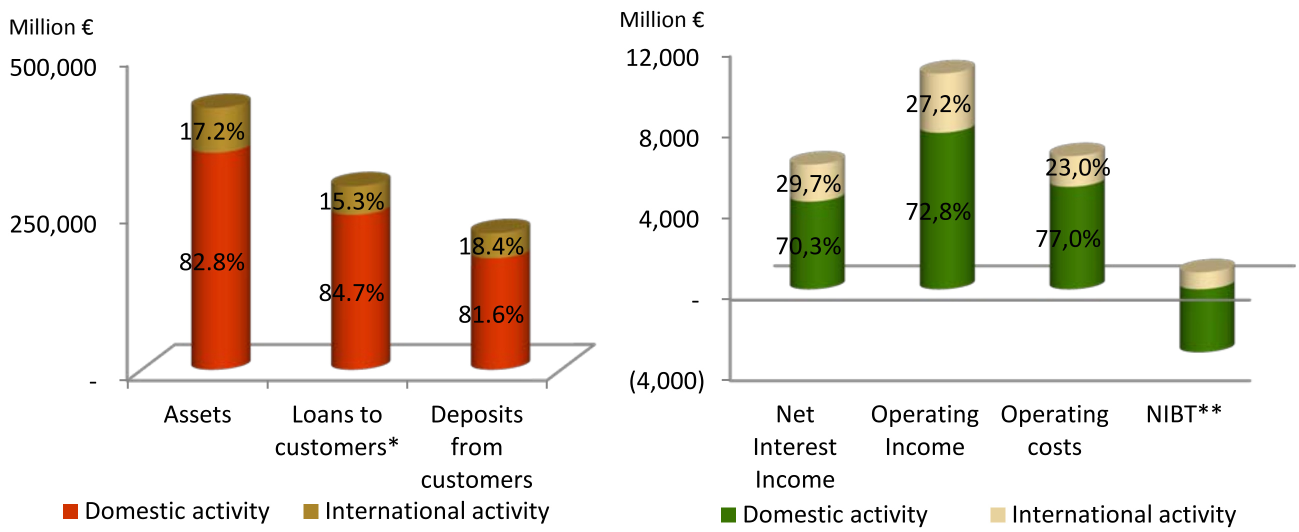
On the other hand, deposits from customers showed a growth rate of 4%, although they slowed down in relation to previous years. The resources attracted on the foreign market lost representativity in terms of total deposits from customers at consolidated level (see Table 75), as a result of strong growth in this item in domestic activity.

Due to a simultaneous decrease in gross loans to customers and a rise in deposits from customers, the transformation ratio for international activity fell 6.7 percentage points to 111.8% at the end of 2011.

[145] The analysis of international business was based on the consolidated activity of seven member banking groups (Banif, BCP, BES, BPI, BST, CGD and Montepio).
[146] See Sub-chapter VII.1 Balance sheet, p. 75

Graph 72: Weight **of international business activity in consolidated financial statements (2011)**

a) Balance sheet (as at 31 December) **b) Income statement**



Source: FIs, APB.
Note: * Gross credit.
** (NIBT) Net interest income before tax and minority interests.

Table 76: Consolidated income statement - international business activity (2008 – 2011)

	2008	2009	2010	2011	Average
Net Interest Income					
Total (million €)	1,339	1,314	1,809	1,835	-
Annual growth rate	-	-1.9%	37.7%	1.4%	12.4%
Weight in total consolidated net interest income	18.9%	21.3%	29.2%	29.7%	24.8%
Operating Income					
Total (million €)	2,156	2,347	2,718	2,905	-
Annual growth rate	-	8.9%	15.8%	6.9%	10.5%
Weight in total consolidated operating income	18.3%	20.5%	23.1%	27.2%	22.3%
Operating Costs					
Total (million €)	1,149	1,179	1,438	1,519	-
Annual growth rate	-	2.6%	22.0%	5.6%	10.1%
Weight in total consolidated operating costs	17.8%	18.3%	21.4%	23.0%	20.1%
Provisions and Impairments					
Total (million €)	324	578	580	546	-
Annual growth rate		78.5%	0.2%	-5.8%	24.3%
Weight in total consolidated provisions and impairments	11.2%	22.4%	21.2%	8.6%	15.9%
Net Income Before Tax and Minority Interests					
Total (million €)	683	590	700	840	-
Annual growth rate	-	-13.6%	18.6%	20.0%	8.3%
Weight in total consolidated NIBT [a)]	28.0%	24.3%	30.2%	-	-

Source: FIs, APB.
[a)] Net interest income before tax and minority interests.

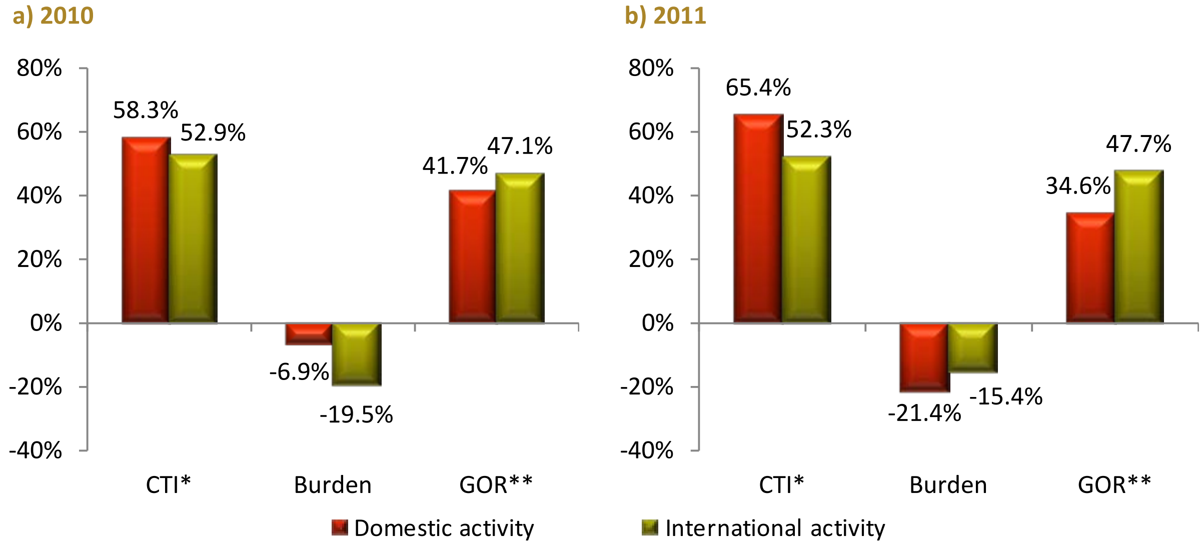
The consolidated member institutions' results in international activity grew considerably in 2011, partially offsetting a small part of the losses in domestic activity. Net interest income was the item pressured most, partly due to the considerable decrease in loans and advances to customers, and therefore showed very modest growth of 1.4% in 2011. Operating income had a more significant growth rate (6.9%), due in part to the results of financial operations and fees and commissions (see Table 76, p. 154).

Nonetheless, international activity stood out most for its net income before tax and minority interests, as it increased by a highly substantial 20% in 2011 (see Table 76, p. 154). This rise was much greater than those in income from banking activity (both net interest income and operating income), as it benefited considerably from the reduction in impairment against 2010.

If we combine the different factors mentioned above, the financial performance indicators for international activity were much more positive than in domestic activity in 2011. Furthermore, the change from 2010 to 2011 shows improvements in all the ratios analysed for business abroad and deterioration in them in domestic activity (see Graph 73).

In terms of the cost-to-income ratio and gross operating income as a percentage of operating income, the gap between the two activities was 13.2 percentage points in favour of international business. Where the burden was concerned, which showed a more unfavourable figure for international activity than domestic business in 2010, there was an inversion of this scenario last year. International activity therefore bested domestic business in its capacity to absorb operating costs through income from customer services and market activities in 2011 (see Graph 73).

Graph 73: Performance indicators for domestic and international activity in 2011



Source: FIs, APB.

Note: * (CTI) Cost-to-Income

**(GOR) Gross operating results as percentage of operating income.

In 2011 there were no major changes in terms of the geographical areas chosen for the member institutions' international activity against 2010. The main business areas were the countries with which Portugal has cultural and language ties, such as Angola, Brazil and Mozambique. They also still showed a preference for countries with particularly developed financial systems, such as the United States, and those that are important trading partners for Portugal, such as Spain.

The member institutions that stood out most in terms of growth in international activity were those whose operations abroad grew outside Europe, especially in the emerging countries.

The main business areas in international activity are retail and investment banking, venture capital and asset management.

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[147]

January

Inclusion of bank employees in general social security scheme

- Decree-Law 1-A/2011 of 3 January - Ministry of Labour and Social Solidarity

In this Decree-Law, the government included bank employees and other employees registered with Bank Employees´ Family Allowance Fund (CAFEB) in the general social security scheme for protection of parenthood and old age, thereby fulfilling the intentions set out in Decree-Law 54/2009 of 2 March, which decreed enrolment of new bank employees in the general social security scheme.

http://dre.pt/pdf1sdip/2011/01/00101/0000200003.pdf

Registration of members of boards of directors and supervisory bodies of institutions under Banco de Portugal supervision

- Banco de Portugal Instruction 30/2010, of 17 January 2011

The aim of this instruction is the convergence of rules on the registration of members of boards of directors and supervisory bodies of institutions under supervision of BdP and other financial supervision authorities.

http://www.bportugal.pt/sibap/application/app1/docs1/manual/textos/30-2010m.pdf

Microcredit companies

- Ministerial Order 59/2011 of 31 January – Ministry of Finance and Public Administration

This order fixes the minimum share capital of microcredit companies at no less than 1 million euros.

www.dre.pt/pdf1sdip/2011/01/02100/0062800628.pdf

[147] The Centre for Financial studies would like to thank the APB legal department for compiling the main legal and regulatory documents published in Portugal in 2011.

February

Securitisation operations

- Banco de Portugal Instruction 2/2011[148]

As a result of the changes made by Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 and Directive 2009/83/EC of the Commission of 27 July 2009, it amends points 3 and 4 of Instruction 13/2007 regarding respectively (i) the necessary conditions for the presumption of effective transfer of the credit risk of exposures by the originator and (ii) the possibility of recognising a significant transfer of the credit risk of exposures, even if the conditions for presumption of effective transfer of risk in point 3 are not met.

http://www.bportugal.pt/sibap/application/app1/docs1/historico/textos/2-2011i.pdf

Stress tests

- Banco de Portugal Instruction 4/2011, de 8 de February[149]

It changes the method requirements and implementation of stress tests for credit institutions and investment companies under Banco de Portugal supervision.

http://www.bportugal.pt/sibap/application/app1/docs1/historico/textos/4-2011i.pdf

http://www.bportugal.pt/sibap/application/app1/docs1/historico/anexos/4-2011i1.pdf

Concentration risk

- Banco de Portugal Instruction 5/2011 of 15 February

It sets out policies and procedures for identifying, assessing and mitigating concentration risks. They apply to credit institutions, and investment companies and the branch offices in Portugal of credit institutions, and investment companies with their head offices in non-EU Member States. It revokes Banco de Portugal Instruction 2/2010 of 15 February.

http://www.bportugal.pt/sibap/application/app1/docs1/historico/textos/5-2011i.pdf

http://www.bportugal.pt/sibap/application/app1/docs1/historico/anexos/5-2011i1.pdf

[148] Later revoked by Banco de Portugal Instruction 5/2011 of 15 February; see information below.
[149] Later amended by Banco de Portugal Instruction 14/2012 of 27 March

March

Lending of financial instruments

- Portuguese Securities Market Commission Instruction 10/2011 of 3 March

It defines the monthly information on lending to be provided by financial intermediaries to the Portuguese Securities Market Commission (CMVM), including lending of securities for the purpose of carrying out securities transactions as well as their form and frequency.

http://www.cmvm.pt/CMVM/Legislacao_Regulamentos/Instrucoes/2011/Documents/Instru%C3%A7%C3%A3o%2010-2011.pdf

Exemption from IMT on purchase of property by credit institutions to realise loans

- Directorate-General for Taxation Circular 5/2011 of 11 March 2011

The circular refers to the exemption from municipal real estate sales tax (IMT) granted in Article 8 (1) of the code on the subject (CIMT) to the acquisition of properties by credit institutions or companies in enforcement and/or insolvency proceedings, as a result of loans or guarantees.

It sets out the understanding that said acquisitions must be declared on IMT Form 1 resulting also in payment of stamp duty and issuance by the Directorate-General for Taxation (DGCI) of proof of exemption from IMT, if the competent judicial instances have not checked or declared said exemption. In these circumstances, the tax department shall automatically recognise it, provided that the taxpayer submits an application pursuant to the terms of the Article 36 (3) of the CIMT to the Head of Department of the tax authority.

The application shall be considered to have been submitted within the time limit if it is clear that the exemption had already been requested from the judicial instances.

http://info.portaldasfinancas.gov.pt/NR/rdonlyres/AC7304E5-E970-42D4-820E-BE6707836A02/0/Circular5-2011.pdf

Subordinated loans in own funds

- Banco de Portugal Circular 3/2011/DSP of 17 March

Article 7 (7) of Banco de Portugal Notice 6/2010 sets up a programme for gradual reduction of the amount of subordinated loans (including bonds with subordination clauses) that can be included in a borrowing institutions' own funds.

http://www.bportugal.pt/sibap/application/app1/docs1/circulares/textos/3-2011-DSP.pdf

Investment consulting companies and market, systems and service managers

- Portuguese Securities Market Commission Regulation 1/2011 of 21 March (published in *Diário da República IIª Série* on 30 March 2011).

It defines the elements and information that must accompany communications to the CMVM of plans to acquire, increase or reduce qualifying holdings and the information that must be sent to the

CMVM for the purpose of assessments of the qualification and suitability of members of the board of directors and supervisory body in investment consulting companies and market, systems and service managers.

http://www.dre.pt/util/getpdf.asp?s=diad&serie=2&iddr=63.2011&iddip=2011021677

Levy on the banking sector

- Ministerial Order 121/2011 of 30 March - Ministry of Finance and Public Administration [150]

It regulates the levy on the banking sector set out in the 2011 State Budget Law and sets out the conditions on which it will be applied.

www.dre.pt/pdf1sdip/2011/03/06300/0172801731.pdf

April

“Zero Licensing” initiative

- Decree-Law 48/2011 of 1 April – Presidency of the Council of Ministers[151]

This law, which is part of the “zero licensing” initiative, simplifies the licensing procedure for a number of economic activities by reducing expenses and administrative procedures. For example, it eliminates licences, permits, validations, authentications, certifications, acts issued following prior communications with deadlines, registrations and other authorisations that used to be required for specific activities or for the posting of advertising, replacing them by increased administrative supervision of these activities[152].

It also creates the Entrepreneurs' Desk, which is a single online service desk for all acts and formalities necessary for accessing and performing a service activity, including electronic means of payment.

www.dre.pt/pdf1sdip/2011/04/06500/0188201904.pdf

[150] Later amended by Ministerial Order 77/2012 of 26 March
[151] Later amended by Decree-Law 141/2012, of 11 July
[152] This law has been included in this annex as it deals with problems that broadly affect the functioning of credit institutions' branches.

Zero Licensing initiative / Entrepreneurs' Desk

- Ministerial Order 131/2011 of 4 April – Presidency of the Council of Ministers and Ministry of the Economy, Innovation and Development

It sets up the Entrepreneurs' Desk and its operation.

www.dre.pt/pdf1sdip/2011/04/06600/0198101982.pdf

Financial groups' ratios

- Banco de Portugal Notice 1/2011 of 5 April (published in *Diário da República IIª Série* on 14 April 2011) [153]

Pursuant to this notice, financial groups under Banco de Portugal supervision on a consolidated basis, including banks, savings banks and/or central agricultural savings banks, shall increase their Core Tier 1 ratios on a consolidated basis to no less than 8% by 31 December 2011. These ratios apply on a separate basis to the above entities not belonging to financial groups under Banco de Portugal supervision on a consolidated basis.

http://dre.pt/pdf2sdip/2011/04/074000000/1726117261.pdf

Court fees

- Decree-Law 52/2011 of 13 April – Ministry of Justice

It amends the Court Fees Regulations by reducing fees paid to banks for the bank accounts seizure services and makes the Chamber of Solicitors responsible for (i) receiving amounts owed to credit institutions for these services and (ii) redistributing only part of the fees paid by the enforcers to the credit institutions every quarter.

www.dre.pt/pdf1sdip/2011/04/07300/0226202268.pdf

Merger and demerger of companies – duty of information

- Decree-Law 53/2011 of 13 April

It transposes into Portuguese law Directive 2009/109/EC of the European Parliament and of the Council of 16 September regarding requirements of general meeting decisions approving mergers or demergers. The aim is to simplify the required information thereby reducing the financial and administrative costs of these operations to companies.

www.dre.pt/pdf1sdip/2011/04/07300/0226802270.pdf

Banking system's account database

[153] This notice was later repealed by Banco de Portugal Notice 3/2011 of 10 May, which sets minimums of 9% and 10% for the core tier 1 ratio to be achieved by 31 December 2011 and 31 December 2012 respectively. See information below.

- Banco de Portugal Instruction 7/2011 of 15 April

This instruction approves the Regulations on the Banking System's Account Database to be created and managed by Banco de Portugal in order to centralise information to be given to the judicial authorities at their request during criminal cases in compliance with the reporting duty set out in Article 79 (3) of the RGICSF[154].

Pursuant to this instruction, members of the banking system (credit institutions, financial companies and any other entities authorised to open bank accounts covered by the regulations) must provide Banco de Portugal with information on bank accounts in existence on 1 March 2011 or opened later, their holders and the persons authorised to use them.

http://www.bportugal.pt/sibap/application/app1/docs1/historico/textos/7-2011i.pdf

Optional cross-selling

- Banco de Portugal Circular 31/2011/DSC of 28 April

It sets out good practices for credit institutions in optional cross-selling, such as the sale to customers of financial products with no guarantee on principal invested in conjunction with deposits and credits.

It also lays down the information on financial products with no guarantee on principal invested that must be included in the standardised information sheet.

http://www.bportugal.pt/sibap/application/app1/docs1/circulares/textos/31-2011-DSC.pdf

[154] RGICSF – Legal Framework on Credit Institutions and Financial Companies.

May

Credit institutions' ratios

- Banco de Portugal Notice 3/2011 of 10 May (published in *Diário da República IIª Série* on 17 May 2011)[155]

Taking account of the new core Tier 1 ratio minimums of 9% and 10% to be achieved by 31 December 2011 and 31 December 2012 respectively, this notice lays down that Banco de Portugal may, on the basis of an assessment of financial institutions' risk profile and the results of its evaluation of solvency and deleveraging as part of the Economic Adjustment Programme, casuistically determine a higher core Tier 1 ratio and/or bring forward the dates for meeting them. It also revokes Banco de Portugal Notice 1/2011, which set the core Tier 1 ratio at 8% by the end of the year.

http://dre.pt/pdf2sdip/2011/05/095000000/2122921229.pdf

Unilateral amendments in interest rates

- Banco de Portugal Circular 32/2011/DSC of 17 May

It sets out good practices for credit institutions with regard to contractual clauses allowing them to unilaterally alter the agreed conditions such as the interest rate or other applicable fees in contracts with customers, pursuant to Decree-Law 446/85 of 25 October.

http://www.bportugal.pt/sibap/application/app1/docs1/circulares/textos/32-2011-DSC.pdf

Court fees

- Ministerial Order 202/2011 of 20 May – Ministry of Justice

It regulates the changes made to the Court Fees Regulation by Decree-Law 52/2011 of 13 April, such as (i) the form of payment of fees for services provided by credit institutions and database managers and (ii) the form of collection and distribution of revenue to the institutions providing the services.

www.dre.pt/pdf1sdip/2011/05/09800/0288002882.pdf

Minimum banking services

- Law 19/2011 of 20 May

It amends Decree-Law 27 -C/2000 of 10 March, which set up the minimum banking service system.

http://dre.pt/pdf1s/2011/05/09800/0282302826.pdf

[155] Later amended by Banco de Portugal Notices 8/2011 of 18 October (see information below) and 4/2012 of 10 January 2012

June

Pension funds

Insurance and Pension Fund Supervisory Authority Regulatory Standard 5/2011-R of 2 June (published in *Diário da República IIª Série* on 16 June)

It amends Article 18 of Regulatory Standard 7/2007-R of 17 May regarding pension fund governance structures. According to the new article, revaluation surpluses from intangible assets are not considered eligible for determining the available solvency margin or the elements making up the guarantee fund.

http://dre.pt/pdf2sdip/2011/06/115000000/2563625637.pdf

Payment systems, securities and financial guarantee contracts settlement

- Decree-Law 85/2011 of 29 June – Ministry das Finanças e da Administração Pública

It amends Decree-Law 221/2000 of 9 September (on payment systems), the Securities Code and Decree-Law 105/2004 of 8 May (on financial guarantee contracts), thereby transposing Directive 2009/44/EC of the European Parliament and of the Council of 6 May.

The aim of these changes is to simplify the law on the definitive nature of settlement in payment systems and of securities settlement systems.

Where financial guarantee contracts are concerned, it broadens the types of assets that can be given as a guarantee to include loans to third parties and adapts the law governing this alteration.

www.dre.pt/pdf1sdip/2011/06/12300/0380803819.pdf

July

Own funds and remuneration policy

- Decree-Law 88/2011 of 20 July – Ministry of Finance and Public Administration

Decree-Law 88/2011 transposes Directive 2010/76/EU of the European Parliament and of the Council of 24 November and amends the RGICSF, Decree-Law 104/2007 of 3 April and Decree-Law 103/2007 of 3 April on matters related to the employee remuneration policies of credit institutions and investment companies whose activity has a significant impact on their risk profile and to own fund requirements for re-securitisation operations.

www.dre.pt/pdf1sdip/2011/07/13800/0403204038.pdf

August

Minimum banking services

- Banco de Portugal Notice 4/2011 of 2 August (published in *Diário da República IIª Série* on 11 August 2011)

This notice regulates the disclosure of information required of the credit institutions that participate in the minimum banking service scheme as set out in Decree-Law 27-C/2000 of 10 March, as amended by Law 19/2011 of 20 May.

www.dre.pt/pdf2sdip/2011/08/154000000/3317733178.pdf

Mutual Agricultural Credit Guarantee Fund

- Banco de Portugal Notice 5/2011 of 9 August (published in *Diário da República IIª Série* of 17 August 2011)

Considering the amendments made to Article 14 of Decree-Law 345/98 of 9 November, which shortened the time limit for the Mutual Agricultural Credit Guarantee Fund to reimburse loans regarding deposits that had become unavailable, the notice obliges institutions participating in the fund to have an information system identifying deposits covered by and excluded from the guarantee at all times and the conditions by which it must abide.

http://www.dre.pt/util/getpdf.asp?s=diad&serie=2&iddr=157.2011&iddip=2011047919

September

Amendments to the framework law on privatisation

- Law 50/2011 of 13 September

It amends the framework law on privatisation approved by Law 11/90 of 5 April, making it no longer mandatory to reserve part of the capital for purchase by small subscribers, although it maintains the workers' pre-emption rights. It is also no longer mandatory to set limits on the percentage of capital purchased or subscribed by a single entity.

Finally, it eliminates the possibility of the reprivatisation law limiting the amount of shares held by foreign entities and the possibility of providing for golden shares or stipulating that decisions on certain matters require confirmation from a director appointed by the state.

The Portuguese Commission for the Follow-up of Reprivatisation is abolished and the formation of a special committee to monitor each reprivatisation is optional.

www.dre.pt/pdf1sdip/2011/09/17600/0437804383.pdf

Mandatory reporting of transactions in financial instruments

- Portuguese Securities Market Commission Instruction 12/2011, of 22 September

It revokes CMVM Instruction 2/2007 and extends mandatory reporting of transactions in financial instruments to cover not only transactions in financial instruments listed on a regulated market located or operating in a European Union Member State, but also operations in derivatives whose underlying asset is listed on a regulated market located or operating in an EU Member State.

http://www.cmvm.pt/CMVM/Legislacao_Regulamentos/Instrucoes/2011/Documents/Instru%C3%A7%C3%A3o-12-2011.pdf

Exposures to central governments or central banks

- Banco de Portugal Notice 6/2011 of 28 September (published in *Diário da República IIª Série* of 10 October 2011)

It amends Notice 5/2007 of 24 April, which sets out own fund requirements for credit institutions and investment companies.

Until now these institutions were free to adopt lower risk weights than those set by the BdP in matters of exposure to central governments or central banks when established by the competent authorities of a non-EU country. With this change, BdP reserves the possibility to determine a more restrictive weight in these situations.

http://dre.com.pt/util/getpdf.asp?s=udrd&serie=2&iddr=194.2011&iddip=2011059142

October

Deposits with high interest rates

- Banco de Portugal Notice 7/2011 of 18 October (published in *Diário da República IIª Série* of 25 October 2011)

It amends Notice 6/2010 of 31 December on the elements making up own funds of institutions under its supervision. In the new rules, the amount of deposits at a high interest rate is considered a negative element of original own funds.

www.dre.pt/pdf2sdip/2011/10/205000000/4228342284.pdf

Deposits with high interest rates

- Banco de Portugal Notice 8/2011 of 18 October (published in *Diário da República IIª Série* of 25 October 2011)

It amends Notice 3/2011 of 17 May on core Tier 1, in the part in which a referral is made to BdP Notice 6/2010 of 31 December with regard to its calculation.

The aim of this amendment is to reflect the inclusion in the list of negative elements of original own funds of the amount of high-interest deposits in accordance with the amendment to Notice 6/2010 of 31 December implemented by Notice 7/2011 of 25 October.

www.dre.pt/pdf2sdip/2011/10/205000000/4228342284.pdf

November

TARGET2 - PT Regulation

- Banco de Portugal Instruction 29/2011 of 21 November

This instruction makes the fifth amendment to Banco de Portugal Instruction 33/2007 of 15 January 2008 - TARGET2[156] - PT Regulation

According to the new wording, Banco de Portugal can reject an application or cancel or suspend participation in the TARGET2 - PT system on the grounds of a threat to general stability, solidity and safety of the system, adverse effects on its features or a prudential risk.

http://www.bportugal.pt/sibap/application/app1/docs1/historico/textos/29-2011i.pdf

Reorganisation and winding-up of institutions under Banco de Portugal supervision

- Law 58/2011 of 28 November

Law 58/2011 of 28 November authorises the government to amend the rules on the reorganisation and winding-up of institutions under Banco de Portugal supervision[157].

www.dre.pt/pdf1sdip/2011/11/22800/0508405091.pdf

December

New law on voluntary arbitration

- Law 63/2011 of 14 December

[156] TARGET – Trans-European Automated Real-time Gross Settlement Express Transfer System

[157] Using this legislative authorisation, in 2012 in Decree-Law 31-A/2012 of 10 February the government: (i) changed the provisions on the reorganisation and winding-up of credit institutions and the Deposit Guarantee Fund and set up the resolution fund in the legal framework on credit institutions and financial companies, (ii) changed the general law on the mutual agricultural credit guarantee fund, (iii) amended Decree-Law 199/2006 of 25 October, which regulates the winding-up of credit institutions and financial companies based in Portugal and their branch offices in other Member States and (iv) amended Banco de Portugal Statute.

It revokes the voluntary arbitration law approved by Law 31/86 of 29 August (except Article 1 (1), which remains in effect for arbitration of labour disputes) and lays down new rules on voluntary arbitration.

www.dre.pt/pdf1s/2011/12/23800/0527605289.pdf

Tax and Customs Authority

Decree-Law 118/2011 of 15 December – Presidency of the Council of Ministers[158]

It sets up the Tax and Customs Authority, which is the result of a merger between the Directorate-General for Taxation, the Customs and Excise Directorate-General and the Directorate-General of IT and Support for the Tax and Customs Services. The ATA went into operation on 1 January 2012.

www.dre.pt/pdf1sdip/2011/12/23900/0530105304.pdf

Deposit Guarantee Fund and Mutual Agricultural Credit Guarantee Fund

Decree-Law 119/2011 of 26 December – Ministry of Finance

This Decree-Law establishes a permanent maximum legal limit of 100,000 euros for the guarantee of reimbursement of each account holder's cash balances at credit institutions belonging to the Deposit Guarantee Fund and Mutual Agricultural Credit Guarantee Fund.

http://dre.pt/pdf1s/2011/12/24600/0540705408.pdf

Default interest rate on debts to the state and other public bodies

Treasury and Public Credit Management Institute Notice 24866-A/2011 of 26 December (published in *Diário da República Série IIª* of 28 December 2011)

This notice fixes the default interest rate on debts to the state and other public bodies at 7.007%, effective 1 January de 2012, replacing the previous rate of 6.351%.

http://dre.pt/pdf2s/2011/12/248000001/0000200002.pdf

[158] Later amended by Decree-Law 142/2012 of 11 July

2012 State Budget

- Law 64-B/2011 of 30 December[159]

It approves the 2012 State Budget.

http://www.dre.pt/pdf1s%5C2011%5C12%5C25001%5C0004800244.pdf

Transfer of pension funds to Social Security - banking sector

Decree-Law 127/2011 of 31 December – Ministry of Finance

This decree law sets out:

a) The transfer to Social Security of liability for pensions being paid on 31 December 2011 under the replacement social security scheme laid down in the collective labour instrument in effects in the banking sector

b) The transfer to the state of ownership of the assets of the bank employees' pension funds allocated to meeting liability for the pensions referred to in the previous paragraph, and

c) The terms of the state's funding of liability for said pensions

www.dre.pt/pdf1sdip/2011/12/250A00/0554005543.pdf

[159] Later amended by Law 20/2012 of 14 May

Annex B – International regulation of the financial sector

European supervisory authorities

On 1 January de 2011 the European System of Financial Supervisors, which consisted of the ESRB, an authority responsible for macro-prudential supervision, and the three European supervisory authorities in charge of micro-prudential supervision, which are the EBA, EIOPA[160] and ESMA[161].

The ESRB published three recommendations in the second half of 2011. These non-binding recommendations have to do with lending in foreign currency, US dollar denominated funding of credit institutions and macro-prudential mandates for national authorities in the EU Member States.

Where micro-prudential supervision is concerned, this annex only focuses on EBA initiatives, which are the most relevant to APB Members. In 2011 there were six public consultations, one of which was started at the end of 2010 by the CEBS[162], the authority that the EBA replaced in 2011. The purpose of the public consultations was to gather opinions on future guidelines and binding technical standards[163].

Related documents

ESRB Recommendation (21 September 2011)
On lending in foreign currency
http://www.esrb.europa.eu/pub/pdf/recommendations/2011/ESRB_2011_1.en.pdf?431cd89c2b29c6cab6ce6bf1e277cf04

ESRB Recommendation (22 December 2011)
On US dollar denominated funding of credit institutions
http://www.esrb.europa.eu/pub/pdf/ESRB_Recommendation_on_USD_Funding.pdf?d9f72e617dadd347f42e883268cde873

[160] European Insurance and Occupational Pensions Authority
[161] European Securities and Markets Authority
[162] Committee of European Banking Supervisors
[163] There are two types of binding technical standards: (i) regulatory technical standards and (ii) implementing technical standards, which differ in terms of how they are approved.

ESRB Recommendation (22 December 2011)
On the macro-prudential mandates of national authorities
http://www.esrb.europa.eu/pub/pdf/ESRB_Recommendation_on_National_Macroprudential_Mandates.pdf?87d545ebc9fe76b76b6c545b6bad218c

CEBS consultation CP45 (15 December to 15 March de 2011)
Draft guidelines on AMA changes
http://www.eba.europa.eu/Publications/Consultation-Papers/All-consultations/CP41-CP50/CP45.aspx

EBA consultation CP46 (28 July to 2 September 2011)
Guidelines on the remuneration benchmark exercise
http://www.eba.europa.eu/Publications/Consultation-Papers/All-consultations/CP41-CP50/CP46.aspx

EBA consultation CP47 (28 July to 2 September 2011)
Guidelines on the remuneration data collection exercise regarding high earners
http://www.eba.europa.eu/Publications/Consultation-Papers/All-consultations/CP41-CP50/CP47.aspx

EBA consultation CP48 (30 de November 2011 to 15 January 2012)
Guidelines to the Stressed Value at Risk (Stressed VaR)
http://www.eba.europa.eu/Publications/Consultation-Papers/All-consultations/CP41-CP50/CP48.aspx

EBA consultation CP49 (30 November 2011 to 15 January 2012)
Guidelines to the Incremental Default and Migration Risk Charge (IRC)
http://www.eba.europa.eu/Publications/Consultation-Papers/All-consultations/CP41-CP50/CP49.aspx

EBA consultation CP50 (20 December 2011 to 20 March 2012)
Draft Implementing Technical Standards (ITS) on supervisory reporting requirements for institutions
http://www.eba.europa.eu/Publications/Consultation-Papers/All-consultations/CP41-CP50/CP50.aspx

Macro-prudential regulation

Following the global financial crisis, the authorities realised the need for instruments and powers capable of containing systemic risk in the financial system. This risk is the danger of difficulties in one part of the financial system extending to other parts. The rules that safeguard the stability of the financial system as a whole are called macro-prudential regulation. The greater emphasis on macro-prudential regulation today is demonstrated by the recent foundation of authorities with a specific mandate for monitoring and mitigating the systemic risk in the financial system. On July 2010, the Financial Stability Oversight Council was set up in the United States, while European Union established the European Systemic Risk Board in January 2011.

The first and most profound macro-prudential initiatives began in 2011. On 27 October, the Financial Stability Board (FSB) published a report on macro-prudential policy instruments which took stock of different initiatives under way worldwide. At the same time, a number of countries implemented macro-prudential frameworks. For example, in December 2011 on the initiative of the Bank of England the United Kingdom released a discussion paper on a concrete set of instruments.

The most relevant initiative in 2011 was however, the requirement to set up an additional capital buffer for (G-SIBs[164]). It was prepared by the BCBS and the Financial Stability Board. The public consultations were held and the final report published in the second half of 2011. The document drafts a method for measuring the systemic risk of the largest banks worldwide so that each one can be given a systemic risk score based on five main criteria: size, interconnection with other banks, complexity, irreplaceability of services provided and geographical presence. Depending on their score, banks may be subject individually to a 1% to 2.5% additional buffer in their core capital ratio, though it may go as high as 3.5% in extreme cases. This method will initially only be used on banks, though there is a plan to extend its scope to other financial institutions, with the necessary adaptations.

In order to implement this method, the BCBS and FSB will set up a database of highly specific financial information on the world's largest banks. A sample of these banks will be used to choose a subset of more systemic banks that will be subject to the additional capital buffer. The final report submitted in November 2011 says that a simulation of the proposed method determined a need to impose this additional buffer on a subset of 29 systemic banks out of a sample 73 banks. The information to be included in the database was the subject of public consultations between 6 October and 8 November 2011.

There were two other important initiatives. Although they were not directly related to macro-prudential regulation, they are closely associated with it. The first came from the FSB in July 2011 in a public consultation and had to do with a new scheme for resolution of systemically important banks. The second had regard to shadow banking, which is governed by a more lenient regulatory framework. In this area, the FSB published the first document in April 2011 and recommendations on the subject in October 2011. The European Union began a consultation process in a Green Paper in March 2012[165].

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[164] Global systemically important banks
[165] More information on: http://ec.europa.eu/internal_market/bank/group_of_experts/index_en.htm.

Related documents

Financial Stability Board Report (12 April 2011)
Shadow Banking: Scoping the Issues
http://www.financialstabilityboard.org/publications/r_110412a.pdf

Financial Stability Board Consultation (19 July to 2 September 2011)
Effective Resolution of Systemically Important Financial Institutions
http://www.financialstabilityboard.org/publications/r_110719.pdf

Basel Committee on Banking Supervision Consultation (19 July to 26 August 2011)
Global systemically important banks: Assessment methodology and the additional loss absorbency requirement
http://www.bis.org/publ/bcbs201.htm

Financial Stability Board Consultation (6 October to 8 November 2011)
A Common Data Template for Global Systemically Important Banks
http://www.financialstabilityboard.org/publications/r_111006.pdf

Financial Stability Board Report (27 October 2011)
Macroprudential policy tools and frameworks
http://www.financialstabilityboard.org/publications/r_111027b.pdf

Financial Stability Board Recommendations (27 October 2011)
Shadow Banking: Strengthening Oversight and Regulation
http://www.financialstabilityboard.org/publications/r_111027a.pdf

BCBS Report (4 November 2011)
Global systemically important banks: Assessment methodology and the additional loss absorbency requirement.
http://www.bis.org/publ/bcbs207.htm

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

Banking system structure

On 16 June 2010, the British government appointed an Independent Commission on Banking, chaired by Sir John Vickers, to conduct an in-depth analysis of the United Kingdom's banking system and suggest reforms to increase its stability. The commission published an interim report in April 2011 followed by a final report in September 2011. Its recommendations included ring-fencing[166] and higher capital requirements for systemically important banks.

In 2012, the European Commission embarked on a similar EU project by appointing a working group tasked with drafting a report on the structure of the European banking system by the end of summer 2012.

Related documents

Independent Commission on Banking Interim Report (11 April 2011)
Interim Report – Consultation on Reform Options
http://s3-eu-west-1.amazonaws.com/htcdn/Interim-Report-110411.pdf

Independent Commission on Banking final report (12 September 2011)
Final report recommendations
http://bankingcommission.s3.amazonaws.com/wp-content/uploads/2010/07/ICB-Final-Report.pdf

[166] In which banks separate investment and retail activities to protect deposits and the payment system in times of crisis

Crisis management

The global financial crisis revealed a lack of appropriate, sufficient powers and instruments to liquidate an insolvent financial institution in a controlled manner. This gap entailed two important risks. One was the risk of a liquidation process that was too lengthy and uncoordinated with a potential contagion effect on other financial institutions. The other was the risk that it was so damaging to wind up a financial institution, that the government would be obliged to save it with public moneys (a bail-out). An example of the latter risk occurred in the United States, when the federal government decided to lend 85 billion dollars to prevent the failure of the country's largest insurance group American International Group (AIG) and took over control of it. This initial government aid for AIG was followed by more, once again demonstrating the problem of too-big-to-fail.

The European Union recognised a need to implement a **crisis management** framework in the financial system, also called the scheme for the recovery and resolution of financial institutions. This framework provides for a number of prevention, early intervention and resolution powers and instruments. Following an initial public consultation in 2009 and two communications in 2010, on 6 January 2011 the European Commission, through the Internal market and Services Directorate-General, published a public consultation on the technical details of a possible framework for the recovery and resolution of banks. This consultation was supposed to result in draft legislation in summer 2011, but it was postponed several times. One of the reasons for the delay was the fact that the crisis management framework regulated bail-ins, which means absorbing a financial institution's losses with its own debt instruments. In the sovereign debt crisis, with investors suffering high losses on public debt securities and instability affecting the behaviour of financial markets in general, bail-in became a sensitive matter, which seems to have contributed to the delay in the draft.

At a national level, Portugal is ahead of the European Union in terms of crisis management legislation, in that it has already reformulated the law on financial imbalances for credit institutions and financial companies. These changes were made by Decree-Law 31-A/2012 of 10 February 2012 in the framework of credit institutions and financial companies. It was necessary to take early action because of the European Union and IMF Economic Adjustment Programme for Portugal.

In July 2011 the Financial Stability Board held a public consultation on resolution schemes for systemically important financial institutions. This initiative, with the support of the G20 countries, is designed to increase cooperation between resolution entities worldwide by focusing first on large financial institutions. The FSB recommendations are not binding, however, and must be transposed to the law in each country to have any legal effect.

Related documents

European Commission Public consultation (6 January to 3 March 2011)
Technical details of a possible framework for bank recovery and resolution
http://ec.europa.eu/internal_market/consultations/2011/crisis_management_en.htm

Financial Stability Board Consultation (19 July to 2 September 2011)
Effective Resolution of Systemically Important Financial Institutions
http://www.financialstabilityboard.org/publications/r_110719.pdf

Capital and liquidity

In the area of **capital and liquidity**, the reform of the prudential regulation system called Basel III announced by the Basel Committee on Banking Supervision in late 2010 went ahead. One of the two documents in the Basel III framework on capital rules underwent a small revision in June 2011, while that on liquidity rules remained unchanged. The changes to the first had to do with the counterparty credit risk.

Basel III provisions must be implemented by each country´s national law in order to come into effect. In the European Union, it is up to the Commission, Parliament and Council to approve the laws.

Consequently 2011 witnessed the publication of a draft fourth version, called the Capital Requirements Directive IV or CRD IV in July 2011. This draft directive was accompanied by a draft regulation (CRR[167]). This means that when the final laws are published, the rules in the regulation will come into immediate effect in each member country, unlike the directive, which will first have to be transposed into each Member State's legal framework.

Finally, there were other capital and liquidity initiatives. There was a European Commission public consultation at the beginning of the year on the counterparty credit risk, which was also the issue that warranted the revision of the Basel III rules. The introduction of an additional capital requirement for systemically important banks proposed by the BCBS and FSB[168] was also discussed worldwide.

Related documents

European Commission public consultation (9 February to 9 March 2011)
Possible measures to strengthen bank capital requirements for counterparty credit risk
http://ec.europa.eu/internal_market/consultations/2011/credit_risk_en.htm

Basel Committee on Banking Supervision report (1 June 2011)
Basel III: A global regulatory framework for more resilient banks and banking systems (revised version).
http://www.bis.org/publ/bcbs189.htm

[167] Capital Requirements Regulation
[168] See part on macro-prudential regulation in this Annex B.

Draft Directive of the European Parliament and of the Council (20 July 2011)
On access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of 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:2011:0453:FIN:EN:PDF

Draft Regulation of the European Parliament and of the Council (20 July 2011)
On prudential requirements applicable to credit institutions and investment firms
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0452:FIN:EN:PDF

Regulation (EU) 883/2011 of the European Central Bank (25 August 2011)
Amends Regulation (EC) 25/2009 concerning the balance sheet of the monetary financial institutions sector (ECB/2008/32)
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:228:0013:0015:EN:PDF

Financial conglomerates

In November 2011, EU legislation on **financial conglomerates** [169] was altered by Directive 2011/89/EU, with regard to supplementary supervision of financial entities in a financial conglomerate. The directive is designed to increase consistency between different laws in effect and improve supplementary supervision in terms of identification of group risks and the way in which information is communicated to the competent authorities.

This European Union consultation occurred one month before the Joint Forum[170] published a public consultation aimed at revising its principles on the supervision of financial conglomerates dating back to 1999. The aim of the revision is to adapt the principles to cover a broader definition of a financial conglomerate.

Related documents

Directive 2011/89/EU of the European Parliament and of the Council (16 November 2011)
It amends Directives 98/78/EC, 2002/87/EC, 2006/48/EC and 2009/138/EC, with regard to supplementary supervision of financial entities in a financial conglomerate.
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:326:0113:0141:EN:PDF

Joint Forum Consultative Document (19 December 2011 to 16 March 2012)
Principles for the supervision of financial conglomerates
http://www.bis.org/publ/joint27.pdf

[169] 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 activity.
[170] The Joint Forum is an international organisation that handles matters concerning the banking and insurance sectors and the securities market, including the regulation of financial conglomerates.

Capital market

The **capital market** area was particularly rich in regulation initiatives in the European Union in 2011. They addressed a number of issues, such as securities, venture capital funds, social entrepreneurship funds and rating agencies.

A number of laws were passed on securities.

On 20 October, the European Commission formalised a revision of the MiFID[171]. This resulted in a draft directive and regulation aimed at responding to developments in the financial markets since the MiFID was approved in 2004, especially the growing fragmentation of markets and the appearance of new way of trading new complex financial products. The idea is also to comply with the G20 statements at the Pittsburgh Summit (2009) with a view to improving the transparency and supervision of financial markets. It also provides for the obligation to trade derivatives on organised markets and new rules for commodity derivatives, in order to make the financial markets more efficient, increase investor protection and ensure greater harmonisation of financial market regulation. The intention is also to improve access by small and medium-sized enterprises (SMEs) to capital markets by setting up a specific brand for SME markets.

At the same time, there was a similar process for the Market Abuse Directive with the publication of a draft directive and regulation. Their aim was to enforce stricter rules on combating and preventing market abuse (insider trading and market manipulation) by extending the scope of application and reinforcing the supervisory authorities' powers in order to respond to developments and new risks in the financial markets (such as risks of manipulation with derivatives like credit-default swaps). They increase EU harmonisation of the laws on market abuse (by approving a directly applicable EU regulation) and provide for criminal sanctions for more serious cases of market abuse. The Council negotiation process began in October 2011 alongside the MiFID revision.

The Transparency Directive was also the subject of a draft revision in 2011, announced on 25 October. The main aims of the draft directive are to make the capital markets more attractive to SMEs and guarantee greater transparency in acquisitions of holdings and economic rights in listed companies in order to increase investor confidence and improve access to information on companies at European level.

Another important development had to do with a public consultation on central securities depositories between 13 January and 1 March 2011.

A second set of initiatives in 2011 addressed venture capital and social entrepreneurship funds. Both matters were the subject of public consultations, which began on 15 June and 13 July respectively. On 7 December draft regulations were published for each type of fund. The drafts create a single European brand for venture capital and social entrepreneurship funds by establishing a European passport for fund managers using the brand. The idea is to revitalise the European venture capital market, increase the weight of this funding mechanism and improve access to funding for social entrepreneurship activities. The drafts also provide for the creation of a European

[171] Markets in Financial Instruments Directive

system to foster attraction of cross-border capital and the regulatory harmonisation of these funds (for professional investors) in the EU, including coordination rules on cross-border supervision.

There were profound changes where CRAs[172] were concerned. On 11 May 2011 the European Union issued a new regulation on credit rating agencies. Its main aims are to reduce conflicts of interest in the current funding model and the shareholder structures of CRAs (including the obligation to rotate CRAs), reduce overdependence on credit ratings, promote the independence of CRAs, increase transparency in disclosure of ratings and methods used, set out stricter rules for sovereign debt ratings and introduce European civil liability for CRAs.

The ESMA also opened public consultations on four documents on technical regulatory standards on CRAs[173]. On 15 November, the European Union issued a draft directive and regulation for legislation on CRAs.

Related documents

European Commission Public Consultations (13 January to 1 March 2011)
Consultation on central securities depositories (CSDs) and on the harmonisation of certain aspects of securities settlement in the European Union
http://ec.europa.eu/internal_market/consultations/2011/csd_en.htm

Regulation (EU) 513/2011 of the European Parliament and of the Council (11 May 2011)
Amending Regulation (EC) 1060/2009 concerning credit rating agencies
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:145:0030:0056:EN:PDF

European Commission Public Consultation (15 June to 10 August 2011)
A new European regime for Venture Capital
http://ec.europa.eu/internal_market/consultations/2011/venture_capital_en.htm

European Commission Public Consultation (13 July to 14 September 2011)
The Social Business Initiative: Promoting Social Investment Funds
http://ec.europa.eu/internal_market/consultations/2011/social_investment_funds_en.htm

Draft Directive of the European Parliament and of the Council (20 October 2011)
Concerning markets in financial instruments, revoking Directive 2004/39/EC of the European Parliament and of the Council
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0656:FIN:en:PDF

Draft Regulation of the European Parliament and of the Council (20 October 2011)

[172] Credit rating agencies
[173] All the ESMA documents on credit rating agencies are available on http://www.esma.europa.eu/page/CRA-documents.

Concerning markets in financial instruments, amending the Regulation [EMIR] on OTC derivatives, central counterparties and trade repositories
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0652:FIN:EN:PDF

Draft Directive of the European Parliament and of the Council (20 October 2011)
Concerning criminal sanctions for insider trading and market manipulation (market abuse)
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0654:FIN:en:PDF

Draft Regulation of the European Parliament and of the Council (20 October 2011)
Concerning insider trading and market manipulation (market abuse)
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0651:FIN:en:PDF

Draft Directive of the European Parliament and of the Council (25 October 2011)
Amending Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are listed on a regulated market and Commission Directive 2007/14/EC
http://ec.europa.eu/internal_market/securities/docs/transparency/modifying-proposal/20111025-provisional-proposal_en.pdf

Draft Directive of the European Parliament and of the Council (15 November 2011)
Amending Directive 2009/65/EC, which coordinates laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) and Directive 2011/61/EU on Alternative Investment Fund Managers in respect of the excessive reliance on credit ratings
http://ec.europa.eu/internal_market/securities/docs/agencies/COM_2011_746_pt.pdf

Draft Regulation of the European Parliament and of the Council (15 November 2011)
Amending Regulation (EC) 1060/2009 concerning credit rating agencies
http://ec.europa.eu/internal_market/securities/docs/agencies/COM_2011_747_en.pdf

Draft Regulation of the European Parliament and of the Council (7 December 2011)
On European Venture Capital Funds
http://ec.europa.eu/internal_market/investment/docs/venture_capital/act_en.pdf

Draft Regulation of the European Parliament and of the Council (7 December 2011)
On European Social Entrepreneurship Funds
http://ec.europa.eu/internal_market/investment/docs/social_investment/act_en.pdf

Corporate governance and social affairs

In the area of **corporate governance and social affairs** in 2011, there was a discussion in the form of a Green Paper on companies' governance in European Union, the articles in the draft Capital Requirements Directive IV and a Financial Stability Board report on good remuneration practices.

Firstly, the publication of the European Commission Green Paper on corporate governance in European Union in April 2011 began a general discussion on the actual functioning and composition of management bodies, shareholders' participation in corporate governance issues and better monitoring and enforcement of national legislation on corporate governance. For the discussion of how to improve corporate governance in the European Union, the European Commission held a public consultation that ended on 22 July 2011. A summary of the responses was published on 15 November. Then, in March 2012, the Legal Affairs Committee of the European Parliament issued a draft report on the framework for corporate governance for European companies, which was approved by the European Parliament on 29 March 2012.

Secondly, the draft CRD IV, which was submitted by the European Commission in July 2011, introduces corporate governance provisions (Articles 86 to 91): reinforcement of provisions on corporate governance and introduction of remuneration policies (principles on variable elements of remuneration and obligation to establish remunerations committees).

Finally, the FSB published a report on the Principles for Sound Compensation Practices[174]. It assesses the progress of national authorities and financial institutions in implementing FSB principles and standards. The report makes six recommendations on effective, lasting implementation of these principles and standards with a view to good remuneration practices at financial institutions.

Related documents

European Commission Green Paper (5 April 2011)
European Union corporate governance framework
http://ec.europa.eu/internal_market/company/docs/modern/com2011-164_en.pdf

[174] Released in September 2009, available on http://www.financialstabilityboard.org/publications/r_0904b.pdf

Draft Directive of the European Parliament and of the Council (20 July 2011)
Capital Requirements Directive IV – Articles 86 to 91
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0453:FIN:EN:PDF

Financial Stability Board report (7 October 2011)
Report on good remuneration practices under the Financial Stability Board's Principles for Sound Compensation Practices
http://www.financialstabilityboard.org/publications/r_111011a.pdf

Draft report of the Legal Affairs Committee of the European Parliament (8 March 2012)
On corporate governance framework for European companies
http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A7-2012-0051+0+DOC+PDF+V0//EN

Taxation

Directive 2011/96/EU, which amends Directive 90/435/EEC of the Council, sets out the **system of taxation** applicable in the case of parent companies and subsidiaries of different Member States. The substantive regime remains unchanged from the previous directive and only the annexes on taxes and types of companies covered by it have been updated.

The new directive sets out expressly that the Council will unanimously adopt the applicable standards after the effective entry in force of a common taxation system for companies, in accordance with a special legislative process after the European Parliament and Economic and Social Committee have been consulted. The Member States will transpose the directive into their law as of 18 January 2012.

Related documents

Directive 2011/96/EU of the Council (30 November 2011)
On the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:345:0008:0016:EN:PDF

Consumers

There were three relevant initiatives concerning **consumers** of financial services in Europe in 2011.

The first was a draft directive of the European Parliament and of the Council on credit agreements relating to residential property. This proposal establishes a common framework: (i) in credit agreements relating to residential property for consumers and (ii) in prudential and supervision requirements and requirements for credit intermediaries and creditors.

The second was a European Commission Recommendation on the general principles of basic payment accounts in the European Union, considering that essential payment services are not currently guaranteed by payment service providers in all European Union Member States. The European Commission states that consumers who are legally resident in the European Union and do not hold a payment account in that Member State should be in a position to open and use a basic payment account, regardless of their financial circumstances. At least one payment service provider in each Member State should be in charge of offering said accounts.

Finally, the third initiative is Commission Directive 2011/90/EU which provides additional assumptions for the calculation of the annual percentage rate of charge, in order to make them coherent with recent developments in the banking market. The annual percentage rate of charge is an indicator for which publication is mandatory and summarises the effective cost of a certain credit operation.

Related documents

Draft Directive of the European Parliament and of the Council (31 March 2011)
Concerning credit agreements relating to residential property
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0142:FIN:EN:PDF

European Commission Recommendation (18 July 2011)
Concerning access to a basic payment account
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:190:0087:0091:EN:PDF

Directive 2011/90/EU of the European Commission (14 November 2011)
Amending part II of Annex I of Directive 2008/48/EC of the European Parliament and of the Council and providing additional assumptions for the calculation of the annual percentage rate of charge
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:296:0035:0037:EN:PDF

Financial stability of the euro area

On 25 March 2011, following a draft submitted by the Belgian government on 16 December 2010, Article 136 of the Treaty on the Functioning of the European Union (TFEU) was altered to include a new paragraph 3, pursuant to which Member States whose currency is the euro may establish a stability mechanism to be activated in the event of serious financial difficulties. According to this paragraph, any financial assistance shall, however, be subject to the essential need to safeguard the stability of the euro areas as a whole.

As a result, Article 122 (2) of the TFUE shall no longer be used to request financial assistance. This decision comes into force on 1 January 2013 or on the first day of the month following receipt of all notifications from Member States that their national constitutions have been amended accordingly.

Related documents

European Council Decision 2011/199/EU (25 March 2011)
Amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for the Member States whose currency is the euro
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:091:0001:0002:EN:PDF

Annex C – Alterations to international accounting standards

IAS[175] 24 – (Revised) – Related party disclosures

In November 2009, the International Accounting Standards Board (IASB) issued IAS 24 (Revised) – Related party disclosures, with mandatory application for financial years beginning 1 January 2011.

This revision clarifies and simplifies the definition of a related party and eliminates the disclosure requirements for all transactions with the state or similar bodies by entities related to them.

IAS 32 – (Amendment) – Classification of rights issues

In October 2008, the IASB published an alteration to IAS 32 – Financial Instruments: Presentation – Classification of rights issues. The amendment was applicable for annual periods beginning on or after 1 February 2010.

The amendment alters the definition of financial liabilities. It classifies rights issues (and certain options and warrants) as equity instruments if the rights are offered pro rata to all holders of the same class of non-derivative equity instruments of the entity and are used to acquire a fixed number of equity instruments of that entity in exchange for a fixed amount in any currency.

IFRS[176] 1 (Amendment) – Limited Exemption from Comparative IFRS 7 Disclosures

In July 2009, the IASB published an amendment to IFRS 1 – First-time adoption of the International Financial Reporting Standards – Limited Exemption from Comparative IFRS 7 Disclosures, applicable for annual periods beginning on or after 1 July 2010.

This alteration gives first-time IFRS users the same transitional regime set out in IFRS 7 – Financial Instruments: Disclosures, when comparative periods begin before 31 December 2009.

IFRIC[177] 14 (Amendment) – Prepayments of a minimum funding requirement

The alteration of this interpretation must be applied for annual periods beginning on or after 1 January 2011 and is applied retrospectively to the first comparative period presented.

It corrects an unintentional implication of IFRIC 14 – IAS 19 - Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction. If this alteration had not been made, it would not be possible for an entity to recognise as assets voluntary payments of minimum contributions to a pension fund. This was not the intention when the IFRIC was first issued and the alteration corrects the original situation.

IFRIC 19 – Extinguishing Financial Liabilities with Equity Instruments

[175] IAS – International Accounting Standard
[176] IFRS – International Financial Reporting Standard
[177] IFRIC – International Financial Reporting Interpretation

In November 2009, the IABS issued IFRIC 19 – Extinguishing Financial Liabilities with Equity Instruments. This interpretation must be applied in annual periods beginning on or after 1 July 2010.

This IFRIC clarifies the accounting of settlement of liabilities by issuing equity instruments and the valuation criteria for these instruments.

Annual Improvement Project

In May 2008, the IASB published the Annual Improvement Project, which has been altering some standards. The standards altered effective for annual periods beginning 1 January 2011 were as follows:

- Alteration to IFRS 1 – First-time adoption of the International Financial Reporting Standards - effective for annual periods beginning on or after 1 January 2011

One of the alterations to this standard stipulates that first-time IFRS users that decide to change their accounting policies or use some of the exceptions set out in IFRS 1 after presenting interim financial statements in accordance with IAS 34 must explains the changes made and must reconcile the principles used before and the IFRS.

Another alteration to this standard sets out that a first-time IFRS user considers as a cost a fair value measured on a certain date (subsequent to that of transition to the IFRS) when events such as a privatisation or initial public offering occur, even if these events take place after the date of transition but before the first IFRS financial statements are issued. The resulting adjustments must be recognised directly in capital.

The alteration also allows entities that have regulated activities or hold tangible or intangible fixed assets that are or have been subject to regulated rate operations to use as a cost the amount carried in accordance with the previous accounting principles. This exception must be applied separately to each item.

- Alteration to IFRS 3 – Business combinations, for annual periods beginning on or after 1 July 2010

For each business combination, the acquirer must measure, on the date of acquisition, the components of interests that it does not control in the acquire, either at fair value or by the proportion that the ownership interest represent in relation to the amounts recognised for the acquiree´s identifiable net assets. These rights must constitute present ownership interests and entitle their holders to a proportional part of the entity's net assets in the event of liquidation. All the other components of the interests that they do not control must be measured at fair value on date of acquisition, unless IFRS require another measurement base.

It also clarifies that the alterations to IFRS 7 – Financial Instruments – Disclosures, IAS 32 - Financial Instruments: Presentation and IAS 39 – Financial Instruments: Recognition and Measurement, which eliminated the exception to contingent consideration arising from the revision of IFRS 3 in 2008, do not apply to contingent consideration that arose from business combinations whose acquisition dates preceded the application of IFRS 3 (revised in 2008).

- Alteration to IFRS 7 – Financial Instruments – Disclosures, effective for annual periods beginning on or after 1 January 2011.

This alteration highlights the interaction that must exist between qualitative and quantitative disclosures in order to help uses of the information achieve an overall view of the nature and extent of the risks resulting from financial instruments.

It clarifies disclosures on credit risk and guarantees and eliminates some disclosures of renegotiated credits.

- Alteration to IAS 1 – Presentation of Financial Statements, effective for annual periods beginning on or after 1 January 2011.

It clarifies that each entity must present an analysis of other comprehensive income per item in the statement of changes in shareholders' equity or notes to the statements.

- Alteration to IAS 27 – Consolidated and Separate Financial Statements, effective for annual periods beginning on or after 1 July 2010.

This alteration clarifies that an entity must apply the alterations to IAS 21 – The Effects of Changes in Foreign Exchange Rates, IAS 28 – Investments in Associates and IAS 31 – Interests in Joint Ventures arising from alterations to IAS 27 prospectively for annual periods beginning on or after 1 July 2010.

- Alteration to IAS 34 – Interim Financial Reporting, effective for annual periods beginning on or after 1 January 2011.

This alteration sets out guidelines on the application of IAS 34. More precisely, disclosures must be made in interim financial statements on updates of relevant facts and transactions that were presented in the last annual financial statements.

It also clarifies how to apply this principle to financial instruments and their fair value.

- Alteration to IFRIC 13 – Customer Loyalty Programmes, effective for annual periods beginning on or after 1 January 2011.

This alteration clarifies that an entity may estimate the fair value of award credits by reference to the fair value of the awards for which they can be exchanged. The fair value of award credits takes account of: the corresponding amount of discounts or incentives that would be offered to customers that did not win award credits in an initial sale and the proportion of award credits that are not expected to be redeemed by customers.

If customers can choose between a range of different awards, the fair value of the award credits will reflect the fair values of the range of awards available, weighted by the frequency at which each award is expected to be selected.

All the standards issued are available on www.ifrs.org.

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