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Acronyms

APB	Associação Portuguesa de Bancos (Portuguese Banking Association)
ATM	Automated Teller Machine
BCBS	Basel Committee on Banking Supervision
BdP	Banco de Portugal (Bank of Portugal)
BoD	Board of Directors
CAFEB	Caixa de Abono de Família dos Empregados Bancários (Family Allowance for Bank Employees)
CDS	Credit Default Swaps
CEBS	Committee of European Banking Supervisors
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CESR	Committee of European Securities Regulators
CIRC	Corporate Income Tax Code
CIRS	Personal Income Tax Code
CMVM	Comissão do Mercado de Valores Mobiliários (Portuguese Securities Market Commission)
CRD	Capital Requirements Directive
DGF	Deposit Guarantee Fund
DGI	Direcção-Geral dos Impostos (Directorate-General for Taxation)
E	Equity
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EIOPA	European Insurance and Occupational Pensions Authority
ESFS	European System of Financial Supervisors
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
FA	Financial Assets
FL	Financial Liabilities
FSB	Financial Stability Board
GDP	Gross Domestic Product
GOR	Gross Operating Results
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
ICS	Investor Compensation System

IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IMI	Municipal Property Tax
INE	Instituto Nacional de Estatística (National Statistics Institute)
ISE	Interest and similar expense
ISI	Interest and Similar Income
MiFID	Markets in Financial Instruments Directive
NFC	Non-financial Costs
NGCSM	Net Gains from Customer Services and Market Activities
NGFO	Net Gains from Financial Operations
NGFC	Net Gains from Fees and Commissions
NIBT	Net Income before Tax
NII	Net Interest Income
OC	Operating Costs
OI	Operating Income
OR	Other Results
PBS	Portuguese Banking System
POS	Point of Sale
PS	Provisions and Similar
RGICSF	Legal Framework of Credit Institutions and Financial Companies
ROA	Return on Assets before Tax
ROE	Return on Equity before Tax
SAMS	Serviço de Assistência Médico-Social (Medical and Social Assistance Service)
SIC	Standing Interpretations Committee
SIFI	Systemically Important Financial Institution
TA	Total Assets
VAT	Value-Added Tax

Executive summary

This Activity Report is the result of a decision by the Board of the Portuguese Banking Association (APB) to restructure APB's Annual Bulletin. The idea of creating a document with a new format was to provide a more analytical, detailed overview of the activity of the APB member institutions and make it more elucidative, informative and of greater interest to its readers.

As at 31 December 2010, 37 financial institutions belonged to the group of 25 APB Members. These institutions, which accounted for practically the entire Portuguese banking system, owned assets corresponding to around 95% of all the consolidated assets in banking in Portugal at the end of 2010.

Only 33 of the 37 financial institutions mentioned above make up the base sample of this report for the analysis of activity in 2010. On 31 December, the institutions in the sample owned total aggregate assets of 506.185 billion Euros. The majority of the market (measured in terms of these assets) was owned by domestic, large and multi-specialised institutions. Although large and medium-sized institutions (one-third of the sample) accounted for 92.5% of the market, with the five largest responsible for 75.5% of the aggregate assets, the banking market in the sample is actually only moderately concentrated, as shown by the Herfindahl index.

The activity of the APB member institutions in 2010 was mainly marked by the sovereign risk crisis in the euro area. The imbalance in Portugal's public finances resulted in a reduction in the country's sovereign debt ratings, which seriously hindered the state's access to finance from the international financial markets and, by contagion, that of the Portuguese financial institutions. This constituted a serious problem for the banks in obtaining liquidity and had repercussions on their intermediation activity and their growing dependence on liquidity operations in the Eurosystem.

Meanwhile, member institutions' business activity was also affected by a large number of international regulations for the financial sector seeking to find a solution to the financial crisis that broke out in 2008. The crisis revealed the need to increase the financial sector's resilience in order to prevent similar scenarios in the future. This resulted in the introduction of a package of measures by the political, regulatory and supervisory authorities, many of which were transposed into Portuguese law in 2010.

In spite of the adverse scenario in Portugal, firstly following the financial crisis, and secondly in the context of the Portuguese public debt crisis and unfavourable economic climate that began to take shape in 2010, the activity of the APB member institutions in terms of aggregate assets showed no signs of contraction. There was merely growth at more moderate rates as of 2008. This pattern was not shared equally by all the member institutions, however. It was the domestic institutions that contributed most to the average growth in aggregate assets from 2007 to 2010, even though their contribution slowed down considerably, particularly from the large institutions. Branch offices contributed modestly but always positively to this average growth mainly through the medium-size segment.

Indeed, overall growth was largely sustained by the international activity of branch offices or representative offices abroad. This is confirmed by the substantial growth in the number of employees working in international activities, who have been steadily increasing in number every year since 2007. This performance contrasts with the small reduction in the number of employees assigned to domestic business in the last two years. The number of branch offices and representative offices abroad has also been increasing albeit more modestly than the growth in the branch network in Portugal. However, while the rise in the former seems to show a trend towards acceleration, the growth in the latter demonstrates a slowdown.

The growing importance of the international presence of the APB member institutions to the expansion of their business and improvement in their performance is clearer in an analysis of consolidated data. In 2010, the contribution by international activity to member institutions' overall consolidated performance was highly significant, especially with regard to profits. In fact, business activity abroad contributed almost 25% to consolidated operating income and more than one third to consolidated net income before tax and minority interests. In terms of performance in 2010, the cost-to-income and transformation ratios in international activity were respectively 8.1 and 39.4 percentage points lower than the figures for domestic activity.

Returning to the aggregate analysis of individual data, the Portuguese public debt crisis triggered a reduction in the Portuguese banks' ratings in 2010. This rapidly affected their conditions of access to capital markets and international wholesale debt markets (interbank and securities), resulting in a generalised shortage of liquidity in the sector. This situation limited the supply of credit, whose growth rate had already been shrinking considerably since 2008, following the international financial crisis. The need for the financial institutions to abide by even stricter risk assessment policies and be more selective when granting new credit, combined with a fall in demand on the part of private and corporate customers due to the expected adverse economic climate, led to practical stagnation in the growth of loans and advances to customers in 2010.

Nonetheless, the APB member institutions continued to support the grant of home loans to private customers (which showed a somewhat favourable performance in 2010) and loans to companies and the public administration (which showed some, albeit modest growth). Only consumer credit suffered considerably. In a national economic scenario that was already unfavourable, the number of non-performing loans increased in 2010.

The overall performance of credit has been decisive to the deceleration in the APB member institutions' activity in the last two years. This slowdown, especially in 2010, was compounded by a reduction in their active involvement in the interbank market and a decrease in their most liquid funds (cash and deposits), once again due to the sector's difficulty in obtaining foreign finance.

Financial investments largely slowed down the scale of deceleration if not actual contraction in 2010 at member institutions as a result of the performance of credit and liquidity in the period. These investments were the balance sheet item that contributed most to the increase in aggregate assets. This rising growth was due to the purchase of Portuguese public debt securities, which grew in 2009 and particularly in 2010. The disparate performance in financial investments against loans and advances to customers was due to a lower appetite for risk on the part of member institutions and a greater preference for liquidity and assets that served as collateral on finance operations with the European Central Bank that also used up less regulatory capital. It was also certainly a result of a policy of sustaining finance to the public sector (especially by domestic financial institutions), to offset the lack of demand for Portuguese government debt instruments on the international markets. Finally, bonds underlying securitisation credit operations also contributed to growth in financial investments, because of their potential for rediscounting at the European Central Bank.

Following the performance of these different balance sheet items in recent years, investment became more important than traditional lending activity. However, credit continued to account for the largest percentage in the aggregate balance sheet structure and represented an average of more than 60% of member institutions' overall business activity. This reflects the importance of the banking sector to the national economy, and loans are the main source of finance for Portuguese companies. They are also a fundamental instrument in buying homes and other consumer goods.

Meanwhile, where the aggregate balance sheet structure is concerned, deposits from customers constitute the main source of finance for member institutions, accounting for close to 40%. All together, the solid deposit base and a large credit portfolio show the predominance of a traditional financial intermediation model.

However, the evolution over time of the transformation ratio shows some structural imbalance in the finance of credit, due to a trend over many years towards an increase in lending not duly accompanied by a similar ability to attract stable funds. This imbalance was particularly sustained by finance in the interbank market, which is volatile and of high systemic sensitivity.

In 2010, the contagion effect on the financial sector from the Portuguese sovereign debt crisis led to the above-mentioned lack of access to the international debt and capital markets and clearly exposed the fragility of the finance structure of banks' aggregate assets, which are highly vulnerable to the performance of the national economy and show high exposure to the Portuguese public debt. As a result, recourse to finance from the Eurosystem (reaching record highs in 2010) was inevitable as a way of offsetting the serious liquidity shortage in the Portuguese banking sector.

The unsustainability of this situation made it necessary to implement deleverage measures in 2010. They included an almost total credit freeze and a greater effort to attract new deposits from customers, mainly by increasing interest rates, especially in the last quarter.

The external constraints and the APB member institutions' investment and finance options naturally had repercussions on their profits. In three years, net income before tax fell by more than two thirds, dropping 41.0% in 2010 alone. The fall in this indicator in 2010 was the main reason for the reduction in return on equity (before tax), which fell to close to 4%. This sharp fall was due not only to a significant contraction in operating income but also a slight rise in operating costs. As a result, the cost-to-income ratio rose, with a consequent loss of efficiency. There was also a significant decrease in net interest income. Indeed, this indicator has been shrinking by general reference to operating income. Intermediation has therefore been gradually losing ground as a source of profit, as opposed to customer services and market activities. In 2010, however, net gains from these activities also contributed to the fall in operating income.

The reductions in operating income and net interest income in 2010 had an inevitable negative impact on their rates of return (calculated with reference to average financial assets). The fall in return on financial operations and other results contributed 16 basis points to the 29 basis points reduction in the rate of return of operating income, offset only by a good performance in return on services and commissions (+3 basis points). This reduction was due to highly significant drops particularly in the portfolio of assets and liabilities at fair value through profit or loss. The negative performance of this portfolio in 2010 was due to actual and/or potential losses in value of equity and debt instruments (especially Portugal's sovereign debt and from other Portuguese issuers), as a result of the fall in prices on stock markets (namely the PSI 20 index) and the increase in yields in the public debt market and Portuguesa corporate debt.

The remaining 16 basis points reduction in the rate of return on operating income lay in a decrease in the rate of return on net interest income, which in turn was determined by the sharp contraction in net interest income in 2010. This contraction was due to substantial reductions in interest received and paid. Nonetheless, the effect of the reduction in the former more than exceeded the effect of the same sign in the latter.

The reductions in interest and similar income were largely due to a negative interest-rate effect on different financial assets, particularly on interest on loans and financial assets at fair value through profit and loss. Where interest and similar expenses were concerned, the volume vs. interest rate relationship was less marked, with the exception of interest on deposits from customers and other credit institutions, where an interest-rate fall effect dominated.

While the problem of member institutions is essentially one of liquidity caused by lack of access under normal conditions to finance from the international financial markets, for reasons beyond their control, the situation with regard to solvency is very different. In this regard, the member institutions enjoy a comfortable soundness.

It is worth noting that the Portuguese banking system has shown great resilience to the financial crisis. Furthermore, in 2010 the member institutions, not only in aggregate though not consolidated terms but also in individual terms, showed solvency ratios above the minimums required by the supervisory authorities. Their capital in aggregate terms is also adequate in terms of other capital ratios, particularly the Core Tier 1 ratio. This ratio was 8.9% in the sample of member institutions at the end of 2010, very close to the 9% limit required for 2011 in the Memorandum of Understanding in the negotiations of the Programme of Financial Assistance to Portugal. However, this 9% limit will have to be met by each financial institution individually, which means that some will certainly have to reinforce their capital levels in 2011 or implement other strategies to improve their Core Tier 1 ratio.

As the banking business is a highly labour-intensive industry, human resources are regarded as important assets. The development of bank employees' skills is therefore still a priority in the sector. As a result, 93.8% of the total banking population received training in 2010. This goal was achieved while still reducing the cost of training per participant, not only by rationalising costs but also through more efficient use of available resources by increasing the number of participants per course. These two factors made it possible to absorb the growth in the number of trainees and offer each one a wider, possibly more diversified range of training of shorter duration and at lower total cost.

Finally, a brief reference must go to the member institutions' performance in terms of efficiency in 2010. With the exception of the cost-to-income ratio, which deteriorated for the reasons mentioned, the other indicators – credit and deposits per employee, assets per employee and employees per branch – showed improvements, having benefited from controlled growth in the number of employees against other items.

I. Foreword

This Activity Report is the result of a decision by the current Board of the Portuguese Banking Association to change its Annual Bulletin.

Until now, the Annual Bulletin contained financial and non-financial information on the APB member institutions for the year in question and some comments on the main factors that influenced the performance of banking activity in the period.

As of 2011, but starting with 2010, the Portuguese Banking Association will be issuing two different publications: the Activity Report and Statistical Bulletin. The former will focus on an aggregate analysis of each year's activity of the APB member institutions. The latter will compile periodical financial and non-financial information on each institution. The Activity Report will be published annually, while the Statistical Bulletin will be six-monthly as at 31 December and 30 June of each year.

The idea of publishing an Activity Report with a new format was to offer a more analytical, detailed vision of member institutions' activity in order to make it clearer and of more interest to readers. As a result, some substantial changes have been made to this first edition. They have to do with the matters addressed and their scope. The most important are as follows:

- Analysis focusing exclusively on APB member institutions on 31 December 2010 (see Chart 1, page 3) and, unlike the previous report, not including the following financial institutions, as they are off-shores or non-members:
    - BAI – Banco Africano de Investimento Europa, S.A.
    - BPG – Banco Português de Gestão, S.A.
    - Imibank – Sanpaolo Imi Bank (Internacional), S.A.
    - Rural – Banco Rural Europa, S.A.
- Description of the macroeconomic background affecting the sector's activity in 2010;
- Main legislation and regulations on the sector in Portugal and in the EU in 2010;
- Analysis of change, representativity and characterisation of member institutions;
- More detailed analysis of member institutions' performance thanks to a greater breakdown of their balance sheet and income statement items;
- Analysis of return on equity;
- Solvency analysis;
- Analysis of the performance of Members who performed European stress tests in 2010;
- A separate Statistical Bulletin containing Factsheets, annual separate and consolidated financial statements for each member institution and other additional information.

The Activity Report will therefore be essentially interpretative and cover APB Members' activity from a macroeconomic, legal and regulatory point of view in each year.

For analysis purposes, this Activity Report is based on aggregate financial and non-financial information on business activity in Portugal and abroad (through 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. Occasionally, the analysis will use consolidated aggregate information for comparative purposes, especially regarding the international activity of Members operating abroad. The information and details provided by the Members may condition broken down analyses to some extent and make it necessary to use a smaller sample or period. Finally, the Activity Report concentrates on member institutions' activity in the year to which it refers, though always viewed in a perspective of evolution over time.

On 31 December 2010, 37 financial institutions belonged to the group of 25 APB Members. These institutions[1] constitute the base sample for this Activity Report[2]. In order to guarantee the comparability of results of some time-series analyses, however, it was occasionally necessary to redefine the sample. These situations are clearly pointed out in the report or footnotes.

These are some of the events affecting Members in 2010:

- Change in name of Banco ActivoBank (Portugal), S.A. to Banco ActivoBank, S.A.;
- Integration of Banco Santander de Negócios Portugal, S.A. into Banco Santander Totta, S.A.;
- Closure in Portugal of The Royal Bank of Scotland, N.V., Sucursal em Portugal (formerly ABN AMRO Bank N.V.);
- Inclusion of BNP Paribas Securities Services, S.A. – Sucursal em Portugal in institutions analysed in the BNP group;
- Banco Cetelem, S.A. no longer included in institutions belonging to the BNP group;
- Withdrawal of licence of Banco Privado Português, S.A.;
- Acquisition by Montepio Geral – Associação Mutualista of 100% of share capital of Finibanco Holding, SGPS, S.A., although Finibanco, S.A. and Caixa Económica – Montepio Geral continued to be independent Members and were therefore analysed separately.

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 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.

[1] Excluding four –Caixa de Aforros de Vigo, Ourense e Pontevedra [Caixanova] and Caja de Ahorros de Galícia, Sucursal as they were merging and were unable to provide the information requested; BPN – Banco Português de Negócios, S.A. and Banco Efisa, S.A. as they had not sent the information by the 3 June deadline.
[2] The base sample therefore includes only 33 financial institutions.

Chart 1: Index of the APB Members and of the financial institutions that belonged to them as at 31 December 2010

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
	Banif Mais, S.A.	Banif Mais

[3] Even though 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[4]	Caixa Económica Montepio Geral	Montepio
Caixa Geral de Depósitos, S.A.	Caixa Geral de Depósitos, S.A.	CGD
	Caixa - Banco de Investimento, S.A.	CBI
Finibanco, S.A.[4]	Finibanco, S.A.	Finibanco

Financial institutions – Subsidiaries

Members	Financial Institutions	Acronyms
Banco Bilbao Vizcaya Argentaria (Portugal), S.A.	Banco Bilbao Vizcaya Argentaria (Portugal), S.A.	BBVA
Banco Itaú Europa, S.A.[5]	Banco Itaú Europa, 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
Deutsche Bank (Portugal), S.A.	Deutsche Bank (Portugal), S.A.	Deutsche Bank

[4] Although Caixa Económica Montepio Geral e do Finibanco, S.A. belonged to the Montepio Group on 31 December 2010, they remained separate Members.
[5] In February 2011, Banco Itaú Europa, S.A. changed its name to Banco Itaú BBA International, S.A.

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
Caixa de Aforros de Vigo, Ourense e Pontevedra [Caixanova]	Caixa de Aforros de Vigo, Ourense e Pontevedra [Caixanova]	Caixanova
Caja de Ahorros de Galícia, Sucursal	Caja de Ahorros de Galícia, Sucursal	Cx Galicia

Source: APB.

II. Macroeconomic background[6]

2010 witnessed the sovereign risk crisis in the euro area, mainly as a result of a substantial imbalance in Greece's public accounts and difficulties in the Irish financial sector, which had an impact on Ireland's public accounts. The need for financial assistance to these economies from the EU and IMF fuelled fears of contagion of other peripheral economies in the euro area, particularly Portugal and Spain, which adversely affected their finance conditions. The lowering of sovereign ratings in the peripheral euro area and fears about deterioration in credit quality (in terms of sovereign debt and mortgage loans) also adversely affected European banks' funding conditions. The spread on credit default swaps (CDS) in the Markit iTraxx Senior Financials 5Y index increased around 102 basis points to 177 at the end of 2010.

Reflecting a fall in investor confidence, the euro depreciated 6.7% against the US dollar in 2010, with an exchange rate of EUR/USD 1.336 at the end of the year. The share indexes CAC40, IBEX and PSI-20 fell 3.34%, 17.43% e 10.34% respectively. In contrast, the DAX rose 16.06%, reflecting the exceptionally favourable performance of the German economy.

In spite of fears of international financial instability, 2010 also witnessed growth in activity in the main economic areas, with the impact of stimulation from monetary and budgetary policy making itself felt on domestic demand and especially international trade flows at different times. After the negative figures in 2009, gross domestic product (GDP) grew 3.6% in Germany, 1.7% in the euro area and 2.9% in the United States. In this context, the US Dow Jones, NASDAQ and S&P500 indexes rose 11.02%, 16.91% and 12.78% respectively in 2010, also benefitting from the expansionist position of the Federal Reserve's monetary policy. The main emerging economies remained highly dynamic, with a 10.3% growth in China and 7.5% in Brazil.

In 2010, the euro area economy continued on the road to recovery in activity that had started in the second half of 2009. The 1.7% growth in GDP was thanks mainly to the strong performance of exports, which benefited from the revitalisation of international trade flows and especially demand from emerging economies, with a favourable impact on industrial production. The base of the recovery gradually widened and there was also an improvement in private spending. The fall in investment slowed down (and investment in equipment actually grew against 2009).

The recovery in business activity in the euro area as a whole was not uniform, however, and the different members' performance was heterogeneous. The German economy stands out, as it grew 3.6% over the year, its highest expansion rate since reunification, thanks particularly to exports and investment in equipment. This performance contrasts with the slowdown and even contraction in the peripheral Economic and Monetary Union economies. The Greek, Irish and Spanish economies contracted, Greece more than 4%, mainly due to considerable ongoing efforts at budgetary consolidation in these countries.

Where prices were concerned, the average annual inflation rate in the euro area was 1.4%, as opposed to 0.3% in 2009. This rise was largely due to energy, transports and food. Nonetheless,

[6] The Portuguese Banking Association would like to thank ES Research at Banco Espírito Santo, S.A. for drafting this chapter on the macroeconomic background.

the underlying inflation rate, which excludes these components, fell against 2009, reflecting the absence of inflationary pressure imposed by demand, which was somewhat visible in high unused installed capacity and an increase in the unemployment rate to 10% of the labour force.

In this context, the European Central Bank (ECB) kept its main reference interest rate at 1% throughout the year. At the same time, it provided the banking system with abundant liquidity and promoted unlimited three-month lending operations. In May, the ECB began to occasionally acquire public debt securities on the secondary market in order to reduce tension in the sovereign debt markets of some peripheral countries. Under this programme, the ECB purchased a total of 73.5 billion euro in debt securities. This amount was sterilised with short-term deposits by banks at the ECB so as not to increase the supply of money.

In Portugal, 2010 witnessed deterioration in financial conditions as a result of investors' higher aversion to risk with regard to the peripheral euro area countries. The turmoil in the markets and difficulties in obtaining finance worsened considerably following the lowering of Portugal's ratings. Over the year, the spread on 10-year Portuguese public debt securities against the German benchmark (bund) rose 296 basis points to 364 (reaching a high of 460 basis points in mid-November).

In April, Standard & Poor’s lowered Portugal's long-term rating two points to A- and its short-term rating to A2. This triggered a drop in the Portuguese banks' ratings and seriously affected their access to capital markets and particularly to short-term finance.

In spite of their sound solvency situation, the Portuguese banks were faced with an adverse external environment in access to liquidity and were forced to borrow more from the ECB and restrict their conditions for financing domestic economic activity.

Nonetheless, in spite of the resulting decrease in spending and investment in the second half of the year, the Portuguese economy benefited in particular from dynamic exports and recorded a 1.3% growth in 2010, which was higher than expected. This performance was also the result in part of the fact that domestic demand was not affected, as in other European economies, by the negative wealth effects of substantial corrections in the property market. According to the Confidencial Imobiliário index, housing prices showed a nominal year-on-year growth of 1% in December 2010.

In the context of the sovereign risk crisis in the euro area, the Portuguese government's budgetary policy, especially in the last quarter of 2010, entailed highly restrictive measures aimed at reducing the public deficit to 4.6% of GDP in 2011. These measures included an increase in income tax and VAT, the latter being raised from 20% to 21% in July and from 21% to 23% in January 2011. On the expenditure side, the government announced a reduction in salaries, a moratorium on admissions to the civil service and cuts in investment and social expenses.

The rise in the average annual unemployment rate from 9.5% to 10.8% of the labour force and the prospect of a fall in disposable income reduced consumer confidence and resulted in a slowdown in domestic demand towards the end of the year. Nonetheless, in 2010 as a whole, private spending rose 2%, mainly thanks to early purchases in light of the aforementioned increases in VAT. This effect was particularly evident in the purchase of durable goods (especially vehicles). The household savings rate fell from 10.9% to 9.8% of disposable income. Annual average consumer inflation went up from -0.8% to 1.4%. Prices rose faster in the last few months of the year, especially as a result of an increase in energy prices. Year-on-year inflation was 2.5% in December.

A deterioration in expectations as to domestic and foreign demand, high degrees of uncertainty and more restricted access to finance resulted in another decrease in investment (-5.6% in 2010, after -14% in 2009). There was a reduction in capital expenditure in all sectors – households, companies and public administrations.

Exports grew 8.7%, after an 11.6% drop in the previous year. This was due to exports of manufacturing sector goods and of services, benefiting from the recovery of global demand and from greater efforts at international expansion by Portuguese companies. The favourable performance of exports and progressive adjustment of domestic demand (pushing imports down) helped to reduce the external deficit. In 2010, the balance on current and capital accounts, which reflects the economy's net external finance needs, went down from 10.1% to 8.8% of GDP. The ongoing deleverage of the Portuguese economy was also visible in the reduction in net external liabilities from 111% to 108% of GDP.

Two main concerns will mark the overall economic scenario in 2011 and impact on the Portuguese economy. On the one hand, there is an apparent trend towards a slowdown in activity in the United States, the euro area and the main emerging economies, particularly China. On the other hand, the sovereign debt crisis will continue in the euro area. A number of factors will sustain a trend towards moderate growth. The rise in inflation, fuelled by the prices of raw materials, has adversely affected real disposable income and household spending. Monetary conditions will be less expansionistic in a number of economies. This concern is particularly important in the case of China, but is also relevant in the euro area, where the ECB is expected to gradually raise key interest rates in 2011 and 2012. These two years will also witness more restrictive policies in the United States and the euro area, which will limit short-term growth. Where the sovereign debt crisis in the euro area is concerned, attention will remain focused on efforts at budgetary and financial stabilisation in the peripheral economies, especially Greece, and on the risks of the spread of the crisis to the European financial system. In this context, taking account of the stabilisation programme agreed upon in the Financial Assistance Programme for Portugal, the economic scenario in Portugal should continue to be affected by the deleverage under way in the different sectors – public administrations, the financial sector, households and non-financial companies. Although this process is necessary for resuming sustained medium- and long-term growth, it will have negative short-term impacts on economic activity. Reductions in domestic demand are expected in 2011 and 2012 and they will only be partially offset by a greater contribution to growth from exports and net foreign demand.

III. Legal and regulatory framework

Three sets of initiatives were of importance to the activity of the APB member institutions in 2010. The first consisted of laws and regulations on banking, which came into effect in Portugal in 2010. The second was made up of regulations governing the financial sector at international level in 2010, which are expected to have short-term effects on the member institutions' business model. The third consisted of amendments to international accounting standards.

III.1. Laws and regulations

Following the financial crisis, there was a need to improve the legal framework covering financial institutions. In 2010 a number of laws and regulations therefore came into force or were amended in Portugal. Annex A contains a list of the most important amendments and new laws and regulations.

They encompass a wide variety of matters such as the prohibition of charges on ATMs, remuneration policy for members of credit institutions' managing and supervisory bodies, the investor compensation system, taxation of capital gains on securities, extraordinary state guarantees to financial institutions and the Deposit Guarantee Fund (DGF).

III.2. International regulations on the financial sector

The second set of initiatives was international and they were mainly designed to respond to the financial crisis. Annex B introduces a series of matters and, for each of them, lists public consultations, communiqués, draft legislation, directives, regulations and the most important rules published by international bodies in 2010.

The financial crisis that broke out in the United States in mid-2007 and spread to Europe in 2008 revealed a need to increase the financial sector's resilience in order to prevent future situations requiring new government guarantees or the injection of public funds to bail out financial institutions. In a communiqué on 20 October 2010, the European Commission (EC) calculated that the financial crisis had obliged European governments to provide aid of about 30% of the European Union's gross domestic product, while the funds actually used totalled 13%.

The wish to prevent this scenario from happening again resulted in a profound reform of the financial sector. It is being implemented via initiatives on the part of political authorities and regulatory and supervisory bodies, many of which were transposed into national law in 2010. These initiatives have been approved by global organisations for the different areas, such as the Basel Committee on Banking Supervision (BCBS) for oversight of banks and the Financial Stability Board (FSB) for general policy matters in the financial sector. G-20, which encompasses the ministers of finance and governors of central banks of the 19 largest world economies plus the EU, has also been involved in these processes and has defined and moulded the steps to be taken in these dimensions.

Discussions on financial reform took place in different countries at the same time, and so different courses of action were chosen worldwide, especially in the United States and the United

Kingdom. In the USA on 21 July 2010, President Obama ratified the Dodd-Frank Law, which provided for an in-depth reform of the financial system in a document of more than 2,300 pages. One of the central reforms had to do with the systemic risk, for which a new authority, the Financial Stability Oversight Council, was set up. This council's remit is to identify and mitigate pockets of systemic risk and so it has powers to supervise banks and other financial institutions. The reform also covered different aspects of the financial system in general, such as greater transparency in the capital market, especially with regard to derivatives and exotic financial products, and certain limitations on the activity of financial institutions, such as the Volcker Rule, which banned institutions that had deposits guaranteed by the deposit guarantee system from having their own trading portfolio (proprietary trading). The Dodd-Frank Law also established profound changes in the consumer protection system and financial institutions' governance structure, such as remuneration systems.

In the United Kingdom, taking the importance of its financial system into account, on 16 June 2010 the government appointed the 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's aim was to submit a final report in September 2011, and in April 2011 it published an interim report setting out its initial thoughts, which included a proposal that banks should separate their investment and retail activities to protect customer deposits and the payment system in times of crisis. Another measure put forward by the commission was an increase in capital requirements for banks considered systematically important.

2010 therefore witnessed the implementation of measures designed to respond to needs or fill gaps. In the European Union, in view of its political and economic reality, most of these initiatives took the form of public consultations, communiqués, preparation and publication of regulations and directives by the European Commission.

First, after the consultation process and definition of the Basel III reform aimed at increasing the financial sector's resilience by requiring more capital and liquidity in 2010, the measures are expected to be transposed into EU law in 2011 by means of a revision of the Capital Requirements Directive. The second concern on the part of the European authorities in 2010 was the discussion of the recovery and resolution of financial institutions in crisis, in that the insolvency of one financial institution can have serious repercussions on others, by contagion. This issue is particularly relevant for institutions considered systematically important. Thirdly, the recent financial crisis revealed shortcomings in legislation on deposit guarantee funds and investor compensation schemes in the EU requiring amendments to the directives in question. Fourthly, an in-depth reform was made in the financial system supervision architecture in Europe. In January 2011, new European authorities went into operation with powers to coordinate macro and micro-prudential supervision. This new model's first important task will be the stress tests in 2011. Finally, there were a number of initiatives with an impact on financial institutions' business activity in Europe in 2010, namely regarding the capital market, financial conglomerates, taxation and corporate governance in the financial system.

As these initiatives will soon have an impact on the activity of its member institutions, the APB has monitored and participated actively in several of the issues under discussion.

III.3. Amendments to the international accounting standards

Also in response to the financial crisis, amendments were made to the international accounting standards in order to correct practices that might have exacerbated the crisis. These standards consist of the International Accounting Standards (IAS), established by the International Accounting Standards Committee (IASC), and the International Financial Reporting Standards (IFRS), set out by the International Accounting Standards Board (IASB), which succeeded the IASC in 2001. The IAS and IFRS are currently in effect simultaneously, though it has been agreed that the IFRS take precedence over the IAS in the event of a conflict. International accounting standards also include interpretations from the International Financial Reporting Interpretations Committee (IFRIC), which succeeded the Standing Interpretations Committee (SIC) at the same time as the IASB took over from the IASC.

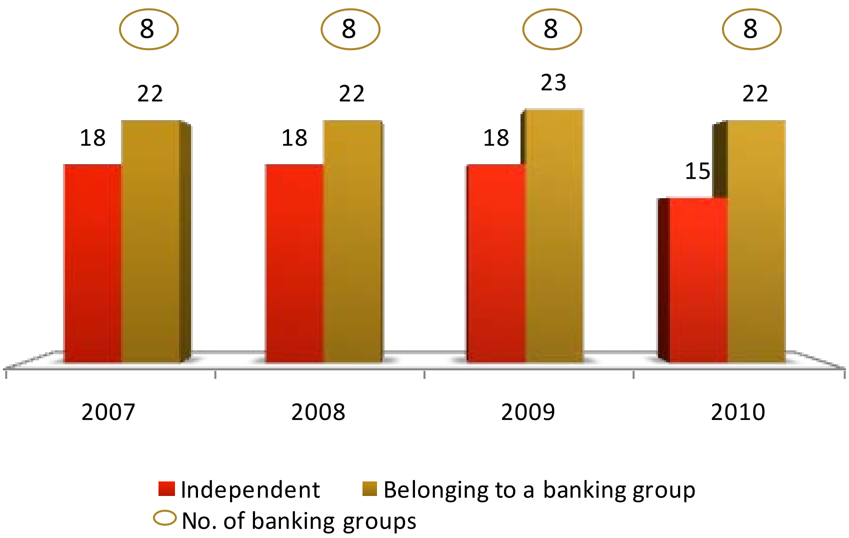
It is important to note that, although these standards are not specific to the banking sector or the financial system in general and cover all economic sectors, they do have an impact on banking activity. Annex C therefore summarises all the amendments to the international accounting standards made in 2010.

IV. Analysis of APB member institutions

IV.1. Number of institutions

As at 31 December 2007, there were 40 financial institutions belonging to the APB's Members. On 31 December 2010, as a result of increasing consolidation and occasional entries and exits, the Members included a total of 37 financial institutions.

Graph 1: Number of independent institutions and institutions belonging to banking groups, among the APB Members, as at 31 December (2007 - 2010)



Source: APB.

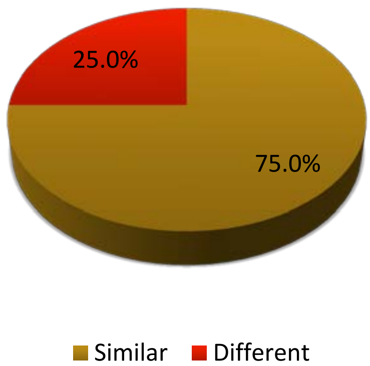
In 2007, the 40 APB member institutions consisted of 18 independent institutions and 22 others belonging to eight banking groups (see Graph 1) – Banif, BCP, BES, BPI, BPN, BNP, BST and CGD. The structure remained the same in 2008, though there were several acquisitions and integrations in 2009 (see Chart 2, page 17). A new Member, Banco BIC, also joined and therefore there were 41 member institutions at the end of 2009. They consisted of 18 independent institutions and 23 institutions belonging to eight banking groups (see Graph 1 and Chart 2, page 17).

In contrast to the preceding period, there was a slowdown in restructuring in 2010 and only one acquisition and one integration operation took place. On the other hand, there were a considerable number of financial institutions among the Members that left or joined. BNP SS joined the APB as an institution belonging to the BNP Group, while RBS left, after ceasing business in Portugal, as did BPP, since it was in liquidation, and Cetelem, by its own decision (see Chart 2, page 17). There were therefore 37 financial institutions (15 independent and 22 belonging to eight banking groups[7]) in the 25 APB Members on 31 December 2010 (see Chart 1, page 3).

[7] The eight groups on 31 December 2010 are Banif, BCP, BPI, BPN, BNP, CGD and Montepio.

As a result, excluding the financial institutions that joined or left, between 2007 and 2010 there was a trend towards consolidation among APB Members. This consolidation was even more significant because of the way in which it occurred, particularly where acquisitions were concerned. Indeed, the acquiring institutions not only took control of the institutions in question but most of them also decided to acquire institutions with similar business areas (see Graph 2).

Graph 2: Acquisitions by business area (2007 - 2010)[8]



Source: FIs, APB.

[8] This analysis does not include acquisitions by Santander Consumer Finance, S.A. in 2007 and 2008 (see Chart 2, page 17), as these operations were a continuation from previous years. If they were included, the 75.0% would change to 83.3%.

Chart 2: Changes in the number of member institutions (2007 – 2010)

Year	Acquisitions	Integrations	New Entry	Exit	Change in the No. of Financial Institutions		Total
					B. Group	Indep.	
2007	• Santander Consumer Finance, S.A. [b] acquires 28.2% of Banco Santander Consumer Portugal, S.A.'s [a] share capital.	• Santander Consumer Finance, S.A.'s [b] Portuguese branch offices integrated in Interbanco, S.A. [a] (later Banco Santander Consumer Portugal, S.A.).	-	-	-	-	40
2008	• Santander Consumer Finance, S.A. [b] acquires another 11.8% of Banco Santander Consumer Portugal, S.A.'s [a] share capital.	-	-	-	-	-	40
2009	• Banif SGPS, S.A. acquires 100% of Tecnicrédito, S.A.'s [b] [c] share capital. Banco Mais, S.A. now belongs to Banif Group.	-	-	-	+1	-	41
	• Banco Cetelem, S.A. [a] acquires 100% of Cofinoga (Portugal), SGPS, S.A.'s [b] [d] share capital. Credifin – Banco de Crédito ao Consumo, S.A. now belongs to Cetelem Group, which belongs to BNP Group.	-	-	-	+1	-	42
	• BNP Paribas [a] acquires 74.9% of Fortis Banque's (Belgium) share capital. Despite occurring abroad, this operation had no impact on Fortis' [a] [e] national branch office.	-	-	-	+1	-1	42
	-	• Banco Millennium bcp Investimento, S.A. [a] integrated in Banco Comercial Português, S.A. [a]	-	-	-1	-	41

Year	Acquisitions	Integrations	New Entry	Exit	Changes in the No. of Financial Institutions		Total
					B. Group	Indep.	
2009	-	• Banco Banif e Comercial dos Açores, S.A. [a)] integrated in Banif - Banco Internacional do Funchal, S.A. [a)]	-	-	-1	-	40
	-	-	Banco BIC	-	-	+1	41
2010	• Montepio Geral – Associação Mutualista acquires 100% of Finibanco Holding SGPS, S.A.'s share capital. Caixa Económica Montepio Geral [a)] and Finibanco, S.A. [a)] are no longer independent financial institutions and they became institutions belonging to Montepio Group.	-	-	-	+2	-2	41
	-	• Banco Santander de Negócios Portugal [a)], S.A. integrated in Banco Santander Totta, S.A. [a)]. They are no longer institutions belonging to a banking group, and Banco Santander Totta, S.A. [a)] becomes an independent financial institution.	-	-	-2	+1	40
	-	-	BNP SS	-	+1	-	41
	-	-	-	RBS Cetelem BPP	-2	-1 -1	37

a) Member institution.
b) Non-member institution.
c) Tecnicrédito, S.A. owns 100% of Banco Mais, S.A. (now Banif Mais, S.A.).
d) Cofinoga (Portugal), SGPS, S.A. owned 100% of Credifin – Banco de Crédito ao Consumo, S.A..
e) Fortis Bank – Sucursal em Portugal is no longer and independent institution, having become an institution belonging to a banking group – the BNP Group.

Source: FIs, APB.

IV.2. Representativity and characterisation of institutions

The Portuguese banking system (PBS) consists of a large number of monetary financial institutions of different origins and types of legal structure. Of the 73 institutions in the system at the end of 2010, 50.7% were APB member institutions (see Table 1). Nonetheless, the APB member institutions represented practically the entire Portuguese banking system and actually accounted for 95.1% of its total assets[9]. However, there were disparities in this representativity when the institutions were grouped by origin and type of legal structure (see Table 1).

Table 1: Representativity of the APB member institutions in the Portuguese banking system by origin/type of legal structure as at 31 December 2010

	Portuguese Banking Association (APB)	Portuguese Banking System (PBS) a)	APB as % of Total PBS
By No. of Monetary Financial Institutions			
Domestic	23	34	*67.6%*
Subsidiary	6	12	*50.0%*
Branch office	8	27	*29.6%*
Total	37	73	*50.7%*
	Portuguese Banking Association (APB) a)	**Portuguese Banking System (PBS)**	**APB as % of Total PBS**
By Assets[9] (million €)			
Domestic	407,858	418,981 b)	*97.3%*
Subsidiary	74,380	81,334 b)	*91.4%*
Branch office	24,862	32,946 b)	*75.5%*
Total	507,100	533,261 a)	*95.1%* a)

Source: BdP, ECB, APB.
a) BdP figures.
b) Figures estimated from ECB data.

In fact, the APB's Members represented the majority (67.6% in numbers) and almost the entire (97.3% in assets) Portuguese banking system in terms of domestic financial institutions. The representativity of APB Members, in terms of the monetary financial institutions registered with Banco de Portugal that consolidate abroad (i.e. subsidiaries and branch offices), was much lower (35.9% in numbers). Even so, this group owned 86.8% of the assets in this universe, particularly subsidiaries (91.4%).

In conclusion, the part of the Portuguese banking system not belonging to the APB at the end of 2010 was mostly of foreign origin (69.4%, 52.8% of which were branch offices), consisted on average of smaller financial institutions (average assets per institution of 726.7 million Euros)

[9] Assets defined pursuant to “Aggregate balance sheet of the banking system - consolidated activity”, Banco de Portugal (BPstat)

particularly in the branch office segment (where average assets were 425.5 million Euros), and was not highly representative of the system (around 5% of its assets).

In an analysis of member institutions only, the 33 institutions in the base sample in this report had total assets (referred to from now on as aggregate assets) of 506.185 billion Euros[10] as at 31 December 2010 (see Table 2). These assets were unevenly distributed among the 33 institutions on the basis of their origin/type of legal structure, size and business area.

Table 2: Characterisation of member institutions as at 31 December 2010

	No. of Financial Institutions	As % of Total	Aggregate Assets (million €)	As % of Total
By Origin/Type of Legal Structure				
Domestic	21	*63.6%*	404,899	*80.0%*
Subsidiary	6	*18.2%*	76,989	*15.2%*
Branch office	6	*18.2%*	24,297	*4.8%*
By Size[11]				
Large	5	*15.1%*	382,126	*75.5%*
Medium-sized	6	*18.2%*	86,223	*17.0%*
Small	22	*66.7%*	37,836	*7.5%*
By Business Area[12]				
Multi-specialised	23	*69.7%*	485,883	*96.0%*
Specialised	10	*30.3%*	20,302	*4.0%*
Total	**33**	***100.0%***	**506,185**	***100.0%***

Source: FIs, APB.

On 31 December 2010, around two-thirds of the APB member institutions were domestic and accounted for 80.0% of the market in terms of aggregate assets. The other third represented the remaining 20.0%. Meanwhile, there was a substantial difference in market share between subsidiaries and branch offices, although their number in the sample was the same.

In terms of size, small financial institutions predominated (representing 66.7% of the sample). On the basis of aggregate assets, however, they represented only 7.5% of the market, while large and medium-sized institutions (33.3% of the sample) accounted for 92.5%, with the five largest responsible for 75.5% of aggregate assets. The high concentration of aggregate assets in a small

[10] Aggregate assets are not comparable to total assets for the APB in Table 1 (see footnote 9, page 19), as they are the simple sum of the assets on the separate balance sheets of the member institutions.

[11] Large financial institutions are those that represent 5.0% or more of aggregate assets, medium-sized institutions represent 1.0% to 5.0% and small account for 1.0% or less.

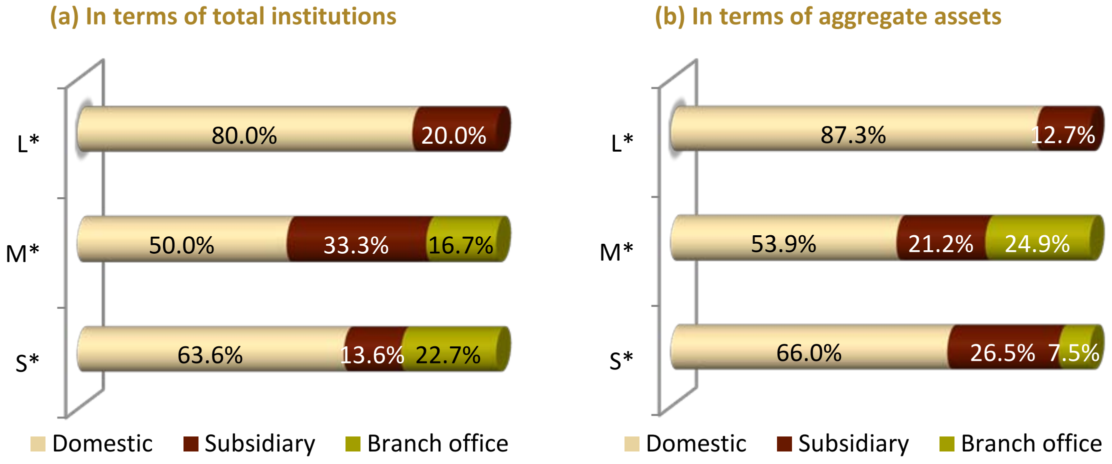
[12] A financial institution is said to be specialised if it devotes itself exclusively or mainly to one of the following activities: consumer credit, mortgage loans, car loans or investment banking. In all other cases, financial institutions are classified as multi-specialised.

number of large financial institutions is not entirely corroborated by the Herfindahl index[13] which showed a figure of 1,351. This figure points to a market concentrated in a few institutions (representing around 23% of the sample) of similar size, which results in a moderate degree of concentration. This index has remained stable since 2007.

Finally, it is worth mentioning the predominance of multi-specialised financial institutions in the sample, by reference to all the institutions (69.7%) and mainly to aggregate assets (96.0%).

A cross-analysis of the above characteristics shows that domestic financial institutions represented 50% or more in all size segments and it was particularly expressive (80% and more) among the large institutions (see Graph 3a)).

Graph 3: Characterisation of member institutions by size and origin/type of legal structure as at 31 December 2010



Source: APB.
Note: * (L) large; (M) medium-sized; (S) small.

This conclusion is even more accentuated if the criterion is type of legal structure. The financial institutions set up under Portuguese law (domestic and subsidiaries) accounted for 100% of the large-size segment and almost the entire small-size segment (92.5% of their aggregate assets). It was only among the medium-sized institutions that subsidiaries were of any relevance (24.9% of aggregate assets, although they only represented 16.7% of all the institutions).

Based on origin, with the exception of the large-size segment, the financial institutions that consolidate abroad (subsidiaries and branch offices) already had a relevant, balanced weight in 2010, both in terms of market share and percentage of all institutions, of around 46%-50% in the medium-sized segment and around 34%-36% in the small-size segment.

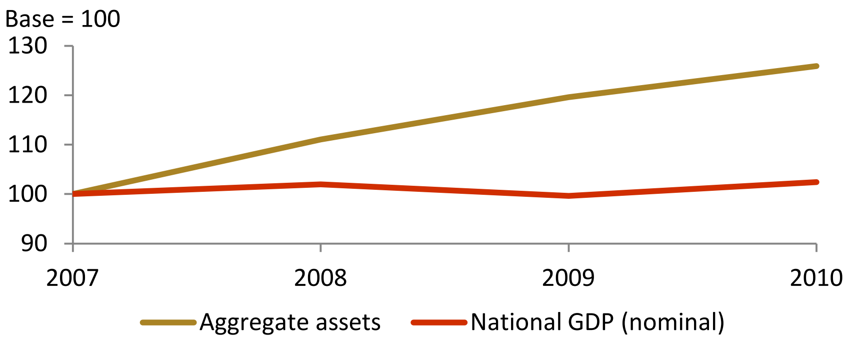
[13] This index was obtained by adding the square of market shares measured in terms of assets of the 33 financial institutions in the sample. As a rule, an index of less than 1,000 indicates low concentration, 1,000 to 1,800 moderate concentration and above 1,800 high concentration.

Finally, all the large and medium-sized financial institutions were multi-specialised, as opposed to the small ones, most of which were specialised (53.7% in terms of aggregate assets)[14].

IV.3. Aggregate assets

In spite of the adverse scenario in Portugal following the financial crisis and more recently a highly unfavourable context in the country, the business activity of most of the APB member institutions, measured in terms of aggregate assets, showed no sign of contraction. On the contrary, it demonstrated an upward trend between 2007 and 2010, which was reflected in an annual average growth rate of 8.0%[15]. Thanks to this growth, along with a GDP that practically stagnated in the period, the member institutions increased their importance in the national economy (see Graph 4)[16]. At the end of 2010, their aggregate assets accounted for 292.2% of Portugal's GDP (nominal values), as opposed to 237.7% at the end of 2007 (see Table 3).

Graph 4: Aggregate assets and national GDP (2007 - 2010)



Source: FIs, INE.

Table 3: Aggregate assets and GDP (2007 – 2010)

	2007	2008	2009	2010	Average
Aggregate Assets					
Total (million €)	401,104	445,346	479,771	505,111	-
Annual growth rate	-	*11.0%*	*7.7%*	*5.3%*	*8.0%*
National GDP (nominal)					
Total (million €)	168,737	172,022	168,074	172,837	-
Annual growth rate	-	*1.9%*	*-2.3%*	*2.8%*	*0.8%*
Aggregate Assets as % of GDP	***237.7%***	***258.9%***	***285.5%***	***292.2%***	***268.6%***

Source: FIs, INE.

[14] All the specialised financial institutions are in the small-size segment.

[15] The time-series analyses (2007 – 2010) include a total of 31 financial institutions rather than the 33 institutions that, as already mentioned, make up the base sample used in this Activity Report. BNP SS and Banco BIC were excluded as there was no historical information on them for 2007 and 2008.

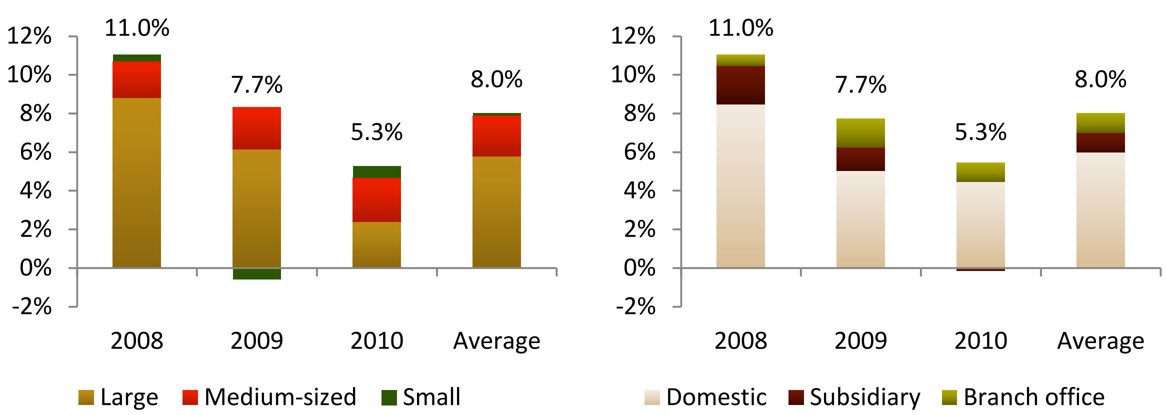
[16] The figures for aggregate assets reflect the domestic and foreign activity (branch offices or representative offices) of the member institutions and so their comparison with national GDP should take this into consideration.

This 8.0% growth rate was not constant throughout the period, however. While growth in aggregate assets was 11.0% in 2008, it was 7.7% in 2009 and 5.3% in 2010 (see Table 3, page 22). This shows a growing deceleration in aggregate activity in recent years.

The APB member institutions contributed diversely to this growth pattern. In particular, the average growth in the period was almost entirely sustained by the large and medium-sized financial institutions (5.8% and 2.1% respectively) (see Table 4 and Graph 5a)). However, while there was an accentuated slowdown in the large institutions' contribution to growth in aggregate assets (from 8.8% in 2008 to 2.4% in 2010), that of the medium-sized institutions increased (from 1.9% in 2008 to 2.3% in 2010). The contribution from the small institutions to average growth in aggregate assets in the period was practically nil (0.1%) (with the contraction in 2009 absorbing their low contributions in 2008 and 2010).

Graph 5: Contribution from member institutions to growth in aggregate assets (2007 - 2010)

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



Source: FIs, APB.

Table 4: Contribution from member institutions to growth in aggregate assets by size and origin/type of legal structure (2007 - 2010)

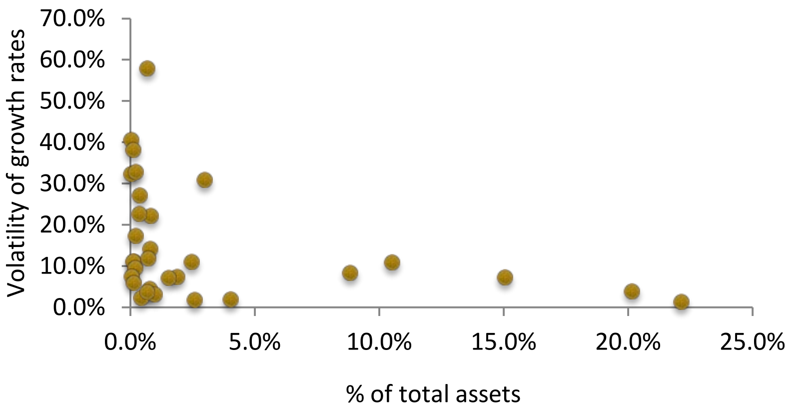
	2008	2009	2010	Average
By Size				
Large	8.8%	6.1%	2.4%	5.8%
Medium-sized	1.9%	2.2%	2.3%	2.1%
Small	0.3%	-0.6%	0.6%	0.1%
Total	11.0%	7.7%	5.3%	8.0%
By Origin/Type of Legal Structure				
Domestic	8.4%	5.0%	4.5%	6.0%
Subsidiary	2.0%	1.2%	-0.2%	1.0%
Branch office	0.6%	1.5%	1.0%	1.0%
Total	11.0%	7.7%	5.3%	8.0%

Source: FIs, APB.

Finally, irrespective of size, it was the domestic institutions that contributed most to average growth in aggregate assets in the period (6.0%) (see Table 4 and Graph 5b), page 23). Even so, their contribution slowed down between 2008 and 2010, especially among the large institutions.

Graph 6 also shows a negative relationship between size and volatility of growth rates. In particular, it points to very high sensitivity and exposure of small institutions to current circumstances due to their lower aggregate assets. On the other hand, the large institutions are more resistant to circumstantial fluctuations, for the opposite reason.

Graph 6: Volatility of growth rates (2007 – 2010)



Source: FIs, APB

It is also worth noting that the financial institutions that consolidate abroad (subsidiaries and branch offices) made an average contribution of 2.0% evenly distributed between both (see Table 4 and Graph 5b), page 23). However, while the contribution from subsidiaries fell from 2008 to 2009 and was negative in 2010 (net of the positive contribution of some medium-sized financial institutions), the branch offices, albeit with some instability, contributed positively, mainly through their medium-sized segment.

Annex

Table 5: Aggregate assets by size and origin/type of legal structure as at 31 December (2007 – 2010)

	2007	2008	2009	2010	Average
By Size					
Large					
Assets (million €)	308,069	343,352	370,656	382,126	-
Annual growth rate	-	*11.5%*	*8.0%*	*3.1%*	*7.5%*
Market share	*76.8%*	*77.1%*	*77.2%*	*75.6%*	*76.7%*
Medium-sized					
Assets (million €)	57,990	65,546	75,263	86,223	-
Annual growth rate	-	*13.0%*	*14.8%*	*14.6%*	*14.1%*
Market share	*14.5%*	*14.7%*	*15.7%*	*17.1%*	*15.5%*
Small					
Assets (million €)	35,045	36,448	33,852	36,762	-
Annual growth rate	-	*4.0%*	*-7.1%*	*8.6%*	*1.8%*
Market share	*8.7%*	*8.2%*	*7.1%*	*7.3%*	*7.8%*
By Origin/Type of Legal Structure					
Domestic					
Assets (million €)	326,009	360,026	382,414	403,832	-
Annual growth rate	-	*10.4%*	*6.2%*	*5.6%*	*7.4%*
Market share	*8.3%*	*80.9%*	*79.7%*	*80.0%*	*80.5%*
Subsidiary					
Assets (million €)	64,339	72,331	77,730	76,989	-
Annual growth rate	-	*12.4%*	*7.5%*	*-1.0%*	*6.3%*
Market share	*16,0%*	*16.2%*	*16.2%*	*15.2%*	*15.9%*
Branch Office					
Assets (million €)	10,756	12,989	19,627	24,290	-
Annual growth rate	-	*20.8%*	*51.1%*	*23.8%*	*31.9%*
Market share	*2.7%*	*2.9%*	*4.1%*	*4.8%*	*3.6%*

Source: FIs, APB.

V. Human resources

V.1. Characterisation and changes

At the end of 2010, the banking population represented by the 33 financial institutions making up the base sample for this report consisted of 58,871 employees, the vast majority of whom (96.6%) worked in domestic business activity.

Since 2007, the total workforce of the APB member institutions has grown only insignificantly and the annual average growth rate was 0.8%[17]. However, this scenario is a result not of constant growth over time, but of a moderate increase in 2008, followed by a slowdown in 2009 and a negligible recovery in 2010 (see Table 6).

These results were essentially due to strong growth in the number of employees working in international activity, whose annual growth rate has been rising progressively. On the other hand, the growth rates in the number of employees in domestic activity are much lower, even showing a trend towards a slight reduction in 2009 and 2010. Consequently, the proportion of employees in activities abroad in the total member banking population has been rising and went from 2.9% in 2007 to 3.5% in 2010. Even so, between 2007 and 2010, the vast majority of employees at member institutions continued to work in domestic business activity (see Table 6).

Table 6: Number of employees as at 31 December (2007 - 2010)

	2007		2008		2009		2010		Average
Global Number of Employees									
Total	57,025		58,194		58,277		58,412[a)]		-
Annual growth rate	-		*2.0%*		*0.1%*		*0.2%*		*0.8%*
In Domestic Activity									
Total	55,385	*97.1%*	56,460	*97.0%*	56,427	*96.8%*	56,385	*96.5%*	-
Annual growth rate	-		*1.9%*		*-0.1%*		*-0.1%*		*0.6%*
In International Activity									
Total	1,640	*2.9%*	1,734	*3.0%*	1,850	*3.2%*	2,027	*3.5%*	-
Annual growth rate	-		*5.7%*		*6.7%*		*9.6%*		*7.3%*

Source: FIs, APB.

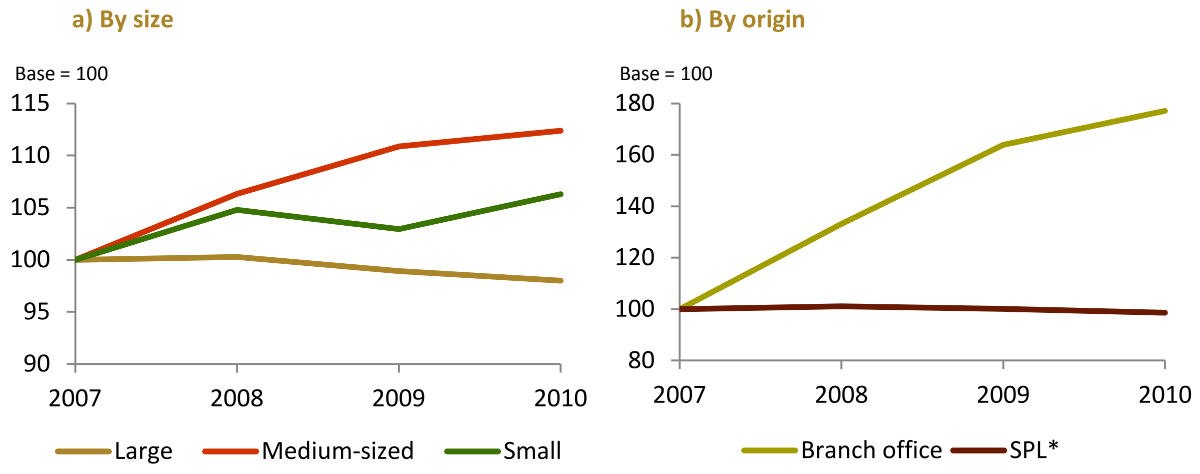
[a)] This figure does not coincide with that reported above (58,871 employees) because the evolution over time made it necessary to adjust the sample, as indicated in footnote 17.

The above-mentioned decrease in the number of employees in domestic activity in 2010 was not common to all segments of member institutions (see Graph 7, page 28, Table 7, page 29, and Table 8, page 30). In fact, it was the large financial institutions that fostered this scenario, as there was a 0.9% reduction in the number of their employees in the year, resulting in a contribution of -0.6% to the decrease (see Graph 8a) and Table 7, page 29). This performance follows the trend

[17]The sample used for the analysis of growth (2007 - 2010) has been adjusted to 31 financial institutions by the additional exclusion of BNP SS and Banco BIC for the reasons pointed out in footnote 15, page 22.

towards containment or reduction in the workforce in this segment in recent years. Indeed, the annual average growth rate in the number of employees in the large financial institutions' domestic activity was negative (-0.7%) between 2007 and 2010 (see Table 7, page 29).

Graph 7: Number of employees in domestic activity by size and origin as at 31 December (2007 - 2010)



Source: FIs, APB.
Note: * (SPL) set up under Portuguese law.

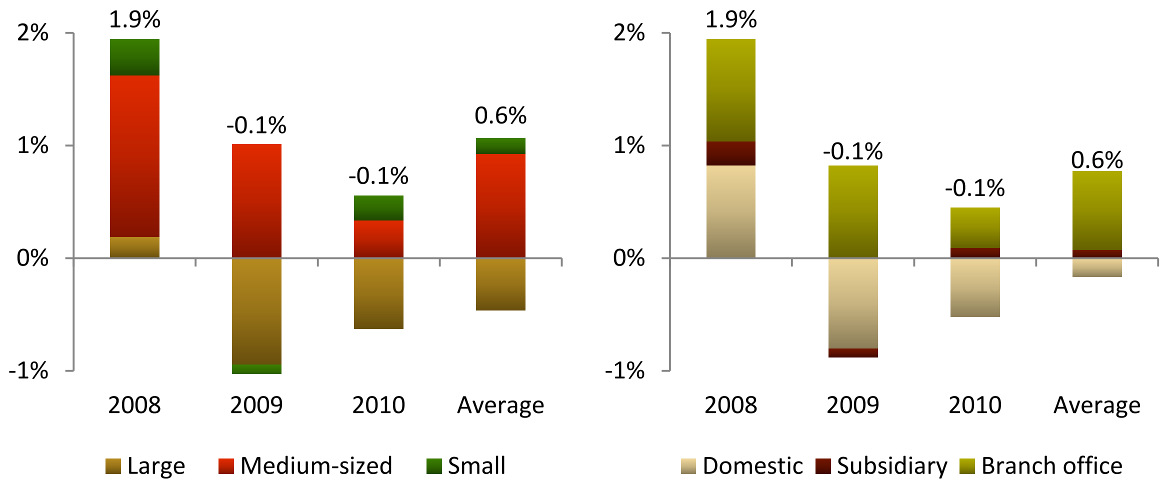
On the other hand, the medium-sized financial institutions showed the highest annual average growth (4.0%) in numbers of employees in domestic activity from 2007 to 2010 (see Graph 7a) and Table 7, page 29), mainly because of the expansion in activity of the branch offices in this segment. There is, however, a trend towards deceleration in this growth and in the contribution to the annual growth rate in the banking population from medium-sized financial institutions (see Graph 8a) and Table 7, page 29).

The number of employees in domestic activity at small institutions showed an annual average growth rate of 2.1%, although with a degree of volatility (see Graph 7a) and Table 7, page 29). However, it was these financial institutions that had the highest annual average growth[18] rate in terms of overall number of employees, due to considerable expansion in the workforce in international activity, especially among domestic institutions in the segment.

[18] Annual average growth rate of 4.9% in small financial institutions against -0.6% and 4.0% in large and medium-sized ones respectively.

Graph 8: Contribution from member institutions to growth in the number of employees in domestic activity by size and origin/type of legal structure (2007 - 2010)

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



Source: FIs, APB.

Between 2007 and 2010, domestic institutions generally reduced their numbers of employees, while foreign institutions showed annual average growth in their workforces, especially at branch offices (see Graph 7b), page 28, Graph 8b) and Table 8, page 30).

Table 7: Number of employees in domestic activity by size as at 31 December (2007 - 2010)

	2007	2008	2009	2010	Average
Large					
Total	39,167	39,272	38,737	38,383	-
Annual growth rate	-	*0.3%*	*-1.4%*	*-0.9%*	*-0.7%*
Contribution to growth in the number of employees	-	*0.2%*	*-0.9%*	*-0.6%*	*-0.5%*
Medium-sized					
Total	12,550	13,344	13,914	14,103	-
Annual growth rate	-	*6.3%*	*4.3%*	*1.4%*	*4.0%*
Contribution to growth in the number of employees	-	*1.4%*	*1.0%*	*0.3%*	*0.9%*
Small					
Total	3,668	3,844	3,776	3,899	-
Annual growth rate	-	*4.8%*	*-1.8%*	*3.3%*	*2.1%*
Contribution to growth in the number of employees	-	*0.3%*	*-0.1%*	*0.2%*	*0.1%*

Source: FIs, APB.

Table 8: Number of employees in domestic activity by origin/type of legal structure as at 31 December (2007 - 2010)

	2007	2008	2009	2010	Average
Domestic					
Total	45,416	45,872	45,419	45,125	-
Annual growth rate	-	*1.0%*	*-1.0%*	*-0.6%*	*-0.2%*
Contribution to growth in the number of employees	-	*0.8%*	*-0.8%*	*-0.5%*	*-0.2%*
Subsidiary					
Total	8,461	8,580	8,536	8,589	-
Annual growth rate	-	*1.4%*	*-0.5%*	*0.6%*	*0.5%*
Contribution to growth in the number of employees	-	*0.2%*	*-0.1%*	*0.1%*	*0.1%*
Branch Office					
Total	1,508	2,008	2,472	2,671	-
Annual growth rate	-	*33.2%*	*23.1%*	*8.1%*	*21.4%*
Contribution to growth in the number of employees	-	*0.9%*	*0.8%*	*0.4%*	*0.7%*

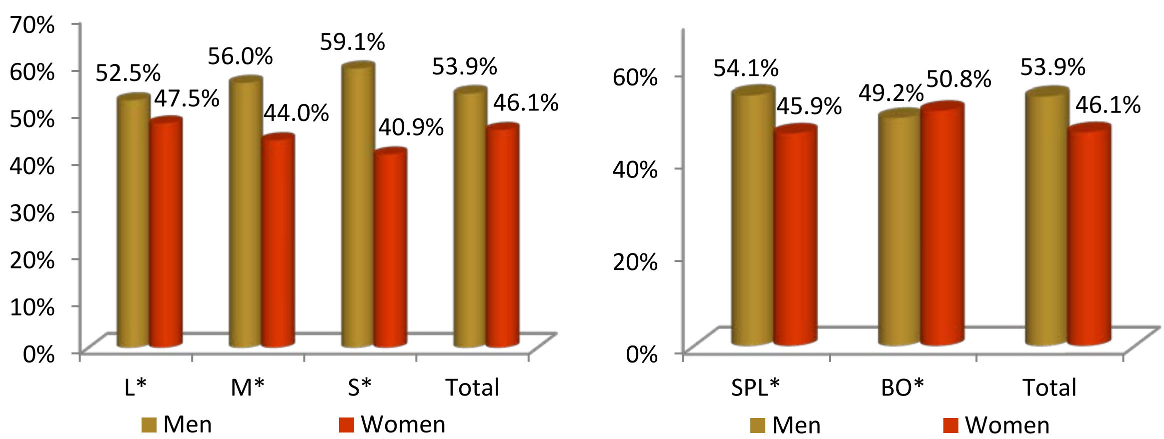
Source: FIs, APB.

At the end of 2010, the majority of the banking population working in domestic activity at APB member institutions (56,844[19] employees) were men (53.9%). Their average age was between 30 and 44 and a large part had been working in the sector for more than 15 years (42.2%). Around half of the employees had degrees. There was also a prevalence of employees in specific jobs and involved in commercial activity. There was a negligible number of employees with fixed-term contracts, while most employees had permanent employment agreements (see Table 12, page 38).

Graph 9: Characterisation of gender of the human resources in domestic activity by size and type of legal structure as at 31 December 2010

a) By size

b) By type of legal structure



Source: FIs, APB.

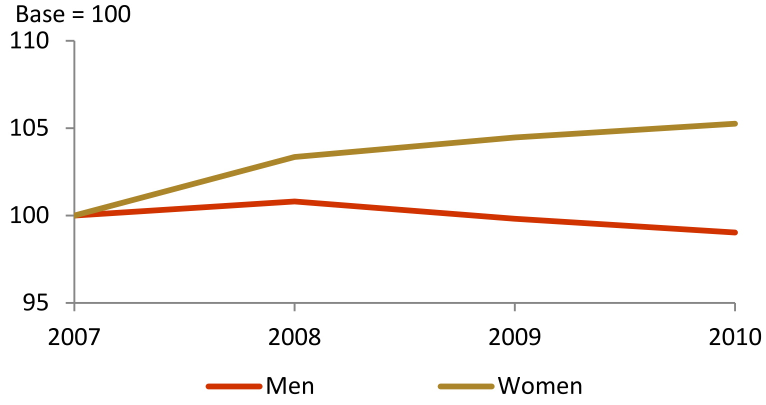
Note: * (L) large; (M) medium-sized; (S) small; (SPL) set up under Portuguese law; (BO) branch office.

[19] This figure does not match that shown in Table 6, page 27 (56,385 employees) because the evolution of human resources over time made it necessary to adjust the sample, as mentioned in footnote 17, page 27.

The predominance of male employees is a characteristic common to all the member institutions irrespective of their size. The scenario is the same at institutions set up under Portuguese law. The exception is branch offices, where the numbers of men and women are practically equal, though there were slightly more women in 2010[20] (see Graph 9, page 30 and Table 12, page 38).

In spite of the above-mentioned imbalance, in recent years there has been a significant increase in the number of women in the banking population, accompanied by a decrease in the number of male employees in 2009 and 2010. This resulted in a rise in the percentage of female employees in the total workforce in domestic activity from 44.6% in 2007 to 46.1% in 2010, which represents an annual average growth rate of 1.7% (see Graph 10 and Table 13, page 39)[21].

Graph 10: Number of employees in domestic activity by gender as at 31 December (2007 - 2010)



Source: FIs, APB.

A characterisation of the workforce in domestic activity at APB member institutions shows that the majority of employees occupied specific positions in 2010. In this context, the percentage of specific jobs among the employees working in domestic activity is in inverse proportion to the size of the institutions, as the former tends to increase when the latter decreases. This percentage was also higher in 2010 among the financial institutions consolidating abroad (see Graph 11, page 32 and Table 12, page 38). Indeed, 40.9% of total employees were in specific jobs in domestic activity at small financial institutions in 2010 (as opposed to 37.1% among large institutions) and 51.2% among the banks consolidating abroad (as opposed to 34.6% at domestic banks). This performance in 2010 continued the trend seen since 2007.

The member institutions' business area may have a major role in explaining this performance. Most of the small institutions focus on a small number of highly specialised business areas, resulting in a need for human resources to carry out highly specific jobs. At the same time, branch offices and subsidiaries began to address the Portuguese market in a small number of mainly

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[20] The parity between genders achieved at branch offices in 2009 is associated with their relatively recent installation and the gain in domestic market share by these financial institutions in recent years. This resulted in added needs for human resources, which were filled by recruiting a higher percentage of women. This has proved to be a dominant trend recently.

[21] See footnote 17, page 27.

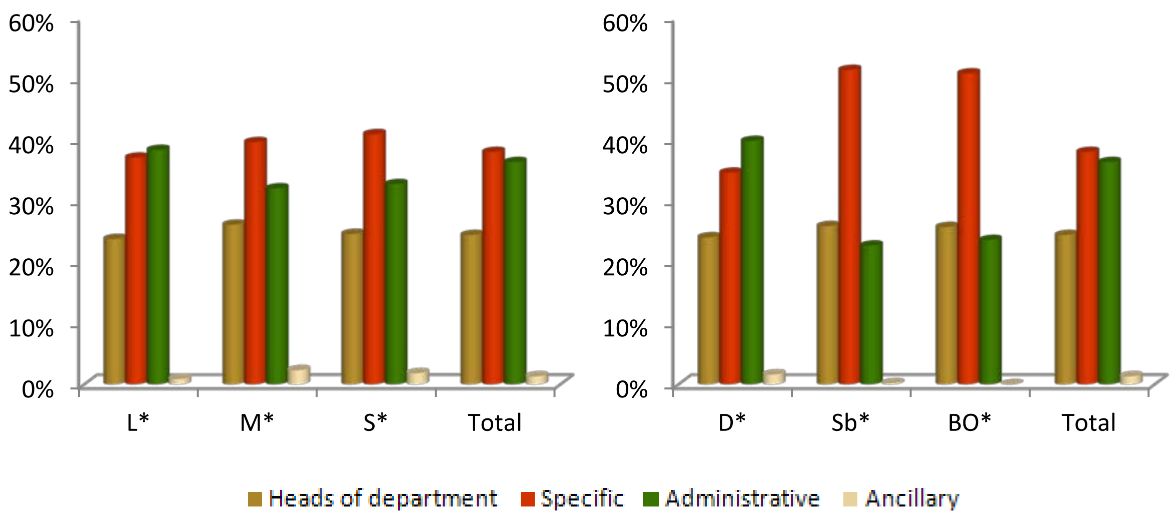
specialised activities. However, these institutions' growth and recent expansion to other less specialised business areas may account for the reduction in their percentage of employees in specific jobs in 2010.

On the other hand, the large and medium-sized financial institutions, especially the domestic ones, show a predominance of more traditional business areas (retail banking), which has resulted in fewer needs for specialised personnel than the other financial institutions. Even so, there is a growing trend towards specialisation in these cases, particularly in the large segment. This may be due to the recent, growing extension of their focus to more specialised business areas, such as investment banking and the resulting need to adapt their human resources to the new requirements.

Irrespective of the above comparisons, the growing specialisation of human resources between 2007 and 2010 is a fact and the number of employees in specific jobs grew at an annual average rate of 3.0% in the period. This increase occurred particularly at the expense of administrative jobs, as their weight in the total number of employees fell from 38.6% in 2007 to 36.0% in 2010. At the same time, the percentage of specific jobs rose 2.6 points (see Table 13, page 39)[22].

Graph 11: Characterisation of the positions of the human resources in domestic activity by size and origin/type of legal structure as at 31 December 2010

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



Source: FIs, APB.

Note: * (L) large; (M) medium-sized; (S) small; (D) domestic; (Sb) subsidiary; (BO) branch office.

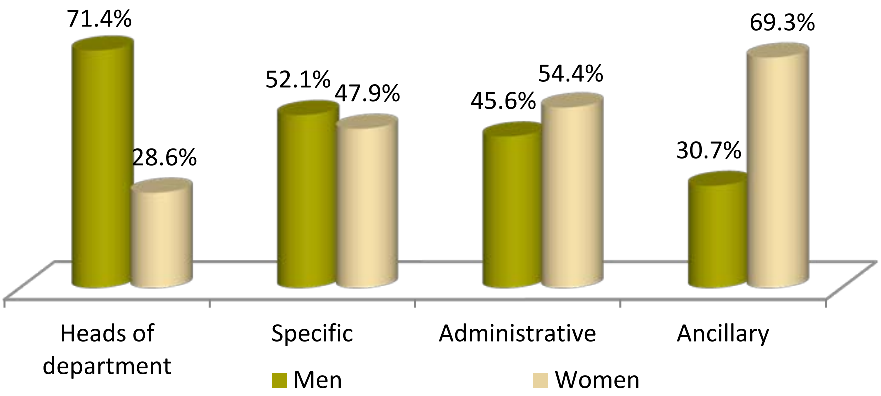
A cross-analysis of the above characteristics (gender and positions)[23] shows that the majority of heads of department were men in 2010 (see Graph 12, page 33). On the other hand, positions requiring lower academic qualifications (namely administrative and ancillary) were mainly occupied

[22] See footnote 17, page 27.

[23] For this particular analysis, the sample has been adjusted to 32 financial institutions, as Barclays was excluded due to lack of data. The number of employees considered still represents 95.6% of the total in 2010.

by women. This is a situation shared by other sectors of activity and is common in Portuguese society as a result of the fact that, historically, for a long time women were not employed in qualified jobs.

Graph 12: Human resources by gender and position as at 31 December 2010



Source: FIs, APB.

This phenomenon occurs in practically all the groups of APB member institutions, regardless of their size or origin/type of legal structure (see Tables 9 and 10, page 34). However, it is particularly visible in the large and medium-sized and domestic segments. The small financial institutions and subsidiaries are atypical when it comes to ancillary jobs, as men predominate. The branch office segment has the highest proportion of female heads of department (39.1%) and, along with the large financial institutions, the most balanced distribution between men and women in specific jobs.

Table 9: Human resources by gender and position and by size of member institutions as at 31 December 2010

	Men	Women	Total
Large			
Heads of department	69.0%	31.0%	100.0%
Specific	49.9%	50.1%	100.0%
Administrative	45.0%	55.0%	100.0%
Ancillary	36.2%	63.8%	100.0%
Medium-sized			
Heads of department	76.9%	23.1%	100.0%
Specific	55.4%	44.6%	100.0%
Administrative	48.6%	51.4%	100.0%
Ancillary	19.0%	81.0%	100.0%
Small			
Heads of department	76.4%	23.6%	100.0%
Specific	61.5%	38.5%	100.0%
Administrative	43.2%	56.8%	100.0%
Ancillary	55.7%	44.3%	100.0%

Source: FIs, APB.

Table 10: Human resources by gender and position and by origin/type of legal structure of member institutions as at 31 December 2010

	Men	Women	Total
Domestic			
Heads of department	70.7%	29.3%	100.0%
Specific	51.8%	48.2%	100.0%
Administrative	45.7%	54.3%	100.0%
Ancillary	29.6%	70.4%	100.0%
Subsidiary			
Heads of department	75.2%	24.8%	100.0%
Specific	53.0%	47.0%	100.0%
Administrative	45.2%	54.8%	100.0%
Ancillary	86.7%	13.3%	100.0%
Branch Office			
Heads of department	60.9%	39.1%	100.0%
Specific	50.5%	49.5%	100.0%
Administrative	44.3%	55.7%	100.0%
Ancillary	-	-	-

Source: FIs, APB.

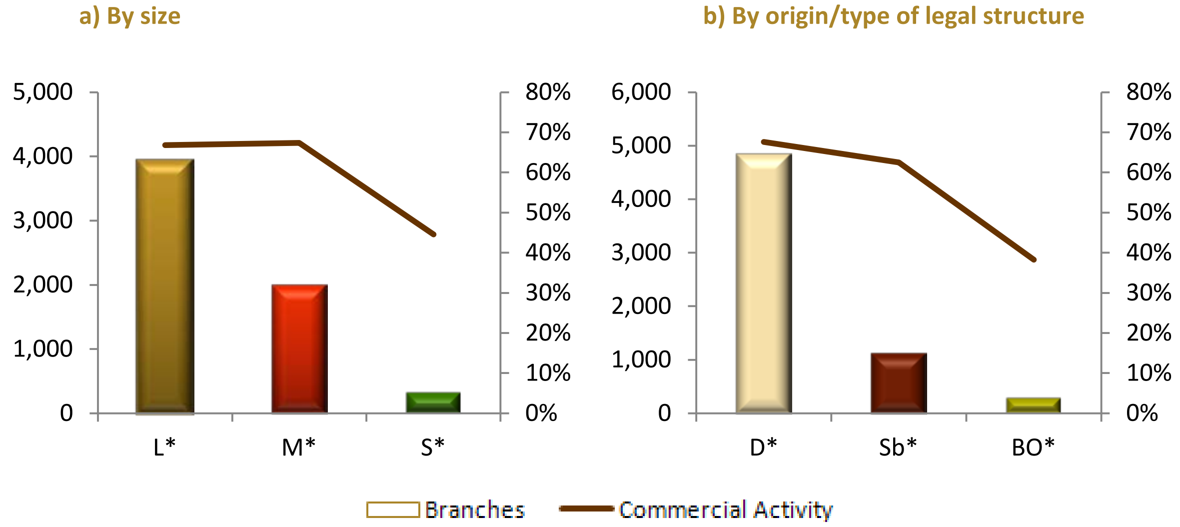
An analysis of the number of employees by nature of activity (commercial or other) shows a substantial predominance of employees working in commercial activity, who accounted for 65.3% of the total in 2010 (see Table 12, page 38).

This situation was accentuated between 2007 and 2009 (see Table 13, page 39) by the replacement of personnel working in other areas by employees working in commercial activity. Nonetheless, there was a slight change in this trend in 2010 as the number of employees working in commercial activity decreased in absolute terms and as a percentage of the total.

Even so, these employees showed an annual average growth rate of 3.4% against -3.7% among the others in 2007 - 2010. This is a result, on one hand, of rationalisation of resources by member institutions in order to improve their efficiency, especially of their administrative and central departments and, on the other hand, of the increase in the number of branches in Portugal. The member institutions whose commercial employees[24] account for the highest proportion of the total are also those with the largest branch networks. This applies especially to the large and medium-sized institutions and those set up under Portuguese law (see Graph 13, page 35).

[24] The group of commercial employees is broader than that of employees assigned to branches.

Graph 13: Comparison between the number of branches and the percentage of employees in domestic activity by size and origin/type of legal structure as at 31 December 2010



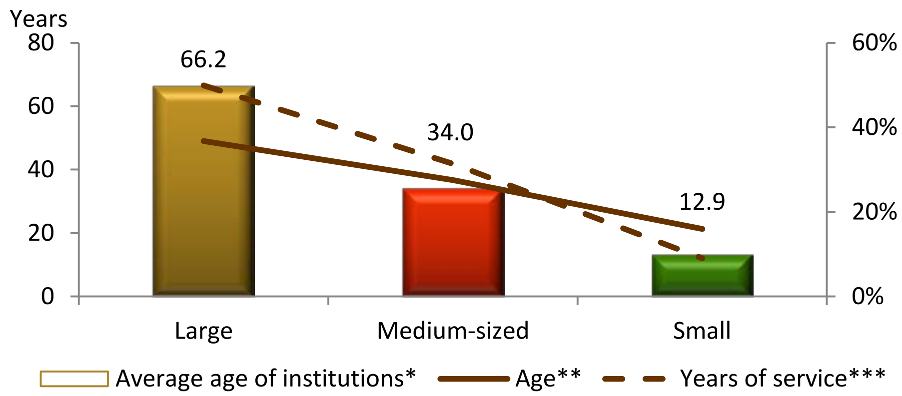
Source: FIs, APB.

Note: Number of branches - left-hand scale; percentage of employees in commercial activity– right-hand scale.
* (L) large; (M) medium-size; (S) small; (D) domestic; (Sb) subsidiary; (BO) branch office.

The average age of the human resources at member institutions was between 30 and 44 in 2010. Additionally, more than half the employees in all segments of financial institutions were in this age group, regardless of their size or origin/type of legal structure (see Table 12, page 38).

In spite of this apparent dominance, there is a direct relationship between the average age of each type of financial institution by size and the age of its workforce. This also applies to employees' years of service, as the three variables tend to increase simultaneously, as is to be expected (see Graph 14).

Graph 14: 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 2010

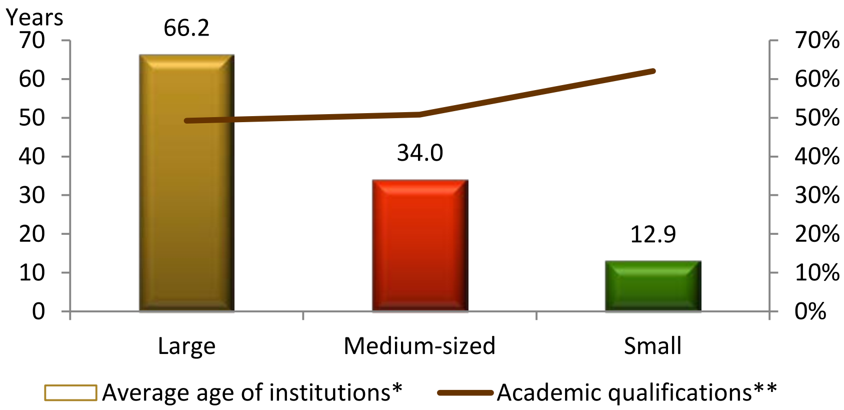


Source: FIs, BdP, APB.

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).

At the same time, the academic qualifications of member institutions' employees have the opposite relationship. As the oldest institutions are those that employ a higher percentage of older employees, they are naturally those with the lowest proportion of employees with degrees (see Graph 15).

Graph 15: Comparison between the average age of member institutions and the academic qualifications of their employees by size of member institutions as at 31 December 2010



Source: FIs, BdP, APB.

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

**Academic qualifications measured by % of employees with degrees (right-hand scale).

An analysis of the trend in the last four years shows that the number of employees aged over 45 and with more than 11 years of service in the sector has been growing significantly and gaining weight in the sample against the younger population (aged under 30), which has lost ground, particularly because of the accentuated reduction in temporary employees and fixed-term contracts in the period[25], which tend to be in the younger age groups (see Table 13, page 39).

The data therefore show that, in spite of a young banking population on average, the trend has been a bias towards a certain aging in the sector. At the same time, the trend in the last four years points to a banking population with higher academic qualifications (see Table 13, page 39).

Finally the vast majority of the banking population in domestic activity (94.4%) was working full time in 2010 (see Table 11, page 37). As in previous years, very few had any other type of work arrangement.

[25] Between 2007 and 2010, the number of temporary employees and those with fixed-term contracts showed an annual average reduction of 5.6% and 16.4%, respectively.

Table 11: Human resources by gender and type of work arrangement in domestic activity as at 31 December 2010

	Men	Women	Total
Full time	29,905	24,146	53,241
Part time	21	362	383
Flexi-time	1,160	1,332	2,492
Shifts	131	138	269
Total	30,407	25,978	56,385

Source: FIs.

Table 12: Characterisation of employees in domestic activity by size and origin/type of legal structure as at 31 December 2010

	Total		Large		Medium-sized		Small		Domestic		Subsidiary		Branch Office	
Number of Employees														
Total	56,844		38,383		14,103		4,358		45,202		8,589		3,053	
By Gender														
Men	30,611	*53.9%*	20,135	*52.5%*	7,902	*56.0%*	2,574	*59.1%*	24,208	*53.6%*	4,900	*57.0%*	1,503	*49.2%*
Women	26,233	*46.1%*	18,248	*47.5%*	6,201	*44.0%*	1,784	*40.9%*	20,994	*46.4%*	3,689	*43.0%*	1,550	*50.8%*
By Age														
Up to 30 years	7,296	*12.8%*	4,427	*11.5%*	2,012	*14.3%*	857	*19.7%*	5,520	*12.2%*	1,100	*12.8%*	676	*22.1%*
30 to 44 years	30,866	*54.3%*	19,857	*51.7%*	8,204	*58.2%*	2,805	*64.4%*	23,747	*52.5%*	5,073	*59.1%*	2,046	*67.0%*
45 years or over	18,682	*32.9%*	14,099	*36.7%*	3,887	*27.6%*	696	*16.0%*	15,935	*35.3%*	2,416	*28.1%*	331	*10.8%*
By Years of Service														
Up to 1 year	2,353	*4.1%*	1,179	*3.1%*	751	*5.3%*	423	*9.7%*	1,579	*3.5%*	293	*3.4%*	481	*15.8%*
1 to 5 years	11,728	*20.6%*	5,902	*15.4%*	3,987	*28.3%*	1,839	*42.2%*	8,188	*18.1%*	1,622	*18.9%*	1,918	*62.8%*
6 to 10 years	7,852	*13.8%*	4,829	*12.6%*	2,056	*14.6%*	967	*22.2%*	6,097	*13.5%*	1,490	*17.3%*	265	*8.7%*
11 to 15 years	10,916	*19.2%*	7,301	*19.0%*	2,879	*20.4%*	736	*16.9%*	9,034	*20.0%*	1,816	*21.1%*	66	*2.2%*
over 15 years	23,995	*42.2%*	19,172	*49.9%*	4,430	*31.4%*	393	*9.0%*	20,304	*44.9%*	3,368	*39.2%*	323	*10.6%*
By Type of Employment Contract														
Permanent	54,226	*95.4%*	37,075	*96.6%*	13,073	*92.7%*	4,078	*93.6%*	43,335	*95.9%*	8,246	*96.0%*	2,645	*86.6%*
Fixed term	2,618	*4.6%*	1,308	*3.4%*	1,030	*7.3%*	280	*6.4%*	1,867	*4.1%*	343	*4.0%*	408	*13.4%*
By Academic Qualifications														
9th grade	4,843	*8.5%*	3,585	*9.3%*	1,137	*8.1%*	121	*2.8%*	4,517	*10.0%*	323	*3.8%*	3	*0.1%*
12th grade	23,231	*40.9%*	15,896	*41.4%*	5,802	*41.1%*	1,533	*35.2%*	18,403	*40.7%*	4,168	*48.5%*	660	*21.6%*
Higher education	28,770	*50.6%*	18,902	*49.2%*	7,164	*50.8%*	2,704	*62.0%*	22,282	*49.3%*	4,098	*47.7%*	2,390	*78.3%*
By Position														
Heads of department	13,850	*24.4%*	9,105	*23.7%*	3,675	*26.1%*	1,070	*24.6%*	10,847	*24.0%*	2,219	*25.8%*	784	*25.7%*
Specific	21,598	*38.0%*	14,230	*37.1%*	5,585	*39.6%*	1,783	*40.9%*	15,638	*34.6%*	4,410	*51.3%*	1,550	*50.8%*
Administrative	20,657	*36.3%*	14,714	*38.3%*	4,517	*32.0%*	1,426	*32.7%*	17,993	*39.8%*	1,945	*22.6%*	719	*23.6%*
Ancillary	739	*1.3%*	334	*0.9%*	326	*2.3%*	79	*1.8%*	724	*1.6%*	15	*0.2%*	-	*0.0%*
By Activity														
Commercial	37,096	*65.3%*	25,653	*66.8%*	9,500	*67.4%*	1,943	*44.6%*	30,558	*67.6%*	5,370	*62.5%*	1,168	*38.3%*
Other	19,748	*34.7%*	12,730	*33.2%*	4,603	*32.6%*	2,415	*55.4%*	14,644	*32.4%*	3,219	*37.5%*	1,885	*61.7%*

Source: FIs, APB.

Table 13: Number of employees in domestic activity as at 31 December (2007-2010)

	2007		2008		2009		2010	
Number of Employees								
Total	55,385		56,460		56,427		56,385[a)]	
By Gender								
Men	30,704	*55.4%*	30,952	*54.8%*	30,645	*54.3%*	30,407	*53.9%*
Women	24,681	*44.6%*	25,508	*45.2%*	25,782	*45.7%*	25,978	*46.1%*
By Age								
Up to 30 years	8,571	*15.5%*	8,500	*15.1%*	7,417	*13.1%*	7,070	*12.5%*
30 to 44 years	30,243	*54.6%*	30,728	*54.4%*	30,815	*54.6%*	30,642	*54.3%*
45 years or over	16,571	*29.9%*	17,232	*30.5%*	18,195	*32.2%*	18,673	*33.1%*
By Years of Service								
Up to 1 year	4,933	*8.9%*	3,962	*7.0%*	2,693	*4.8%*	2,199	*3.9%*
1 to 5 years	8,458	*15.3%*	10,072	*17.8%*	11,030	*19.5%*	11,423	*20.3%*
6 to 10 years	11,910	*21.5%*	10,968	*19.4%*	9,511	*16.9%*	7,852	*13.9%*
11 to 15 years	9,608	*17.3%*	8,764	*15.5%*	10,188	*18.1%*	10,916	*19.4%*
Over 15 years	20,476	*37.0%*	22,694	*40.2%*	23,005	*40.8%*	23,995	*42.6%*
By Type of Employment Contract								
Permanent	50,787	*91.7%*	51,853	*91.8%*	52,950	*93.8%*	53,776	*95.4%*
Fixed term	4,598	*8.3%*	4,607	*8.2%*	3,477	*6.2%*	2,609	*4.6%*
By Academic Qualifications								
9th grade	5,955	*10.8%*	5,621	*10.0%*	5,180	*9.2%*	4,842	*8.6%*
12th grade	25,124	*45.4%*	24,413	*43.2%*	23,700	*42.0%*	23,177	*41.1%*
Higher education	24,306	*43.9%*	26,426	*46.8%*	27,547	*48.8%*	28,366	*50.3%*
By Position								
Heads of department	13,412	*24.2%*	14,124	*25.0%*	14,012	*24.8%*	13,833	*24.5%*
Specific	19,679	*35.5%*	20,107	*35.6%*	21,497	*38.1%*	21,508	*38.1%*
Administrative	21,400	*38.6%*	21,372	*37.9%*	20,118	*35.7%*	20,305	*36.0%*
Ancillary	894	*1.6%*	857	*1.5%*	800	*1.4%*	739	*1.3%*
By Activity								
Commercial	33,645	*60.7%*	36,771	*65.1%*	37,488	*66.4%*	37,055	*65.7%*
Other	21,740	*39.3%*	19,689	*34.9%*	18,939	*33.6%*	19,330	*34.3%*

Source: FIs, APB.

[a)] This figure does not coincide with that in Table 12 (of 56.844 employees) because the evolution of human resources over time made it necessary to adjust the sample, as indicated in footnote 17, page 27.

V.2. Training

The APB member institutions continue to set great store by developing the banking population's skills, since they regard their human resources as important assets. In 2010, 52,539 employees received training, i.e. 93.8% of the total banking population[26]. This performance confirmed the trends of 2008 and 2009, not only in a gross increase in the number of trainees but also in the growing involvement of the sample's employees in training (see Table 14).

Table 14: Training at member institutions (2007 – 2010)

	2007	2008	2009	2010	Average
Number of Trainees					
Total	48,419	50,378	51,214	52,539	-
As % of number of employees in domestic activity	*88.1%*	*89.9%*	*91.4%*	*93.8%*	-
Annual growth rate	-	*4.0%*	*1.7%*	*2.6%*	*2.8%*
Number of Participants in Training Courses					
Total	262,910	368,529	427,777	490,722	-
Annual growth rate	-	*40.2%*	*16.1%*	*14.7%*	*23.7%*
Number of Training Hours					
Total	2,550,779	2,150,487	2,344,494	2,215,077	-
Annual growth rate	-	*-15.7%*	*9.0%*	*-5.5%*	*-4.1%*
Average Duration of Training Courses					
Average (hours)	17	11	14	15	-
Number of Training Courses					
Total	12,085	14,499	11,694	13,356	-
Annual growth rate	-	*20.0%*	*-19.3%*	*14.2%*	*5.0%*

Source: FIs, APB.

The average number of participations in training courses per trainee (obtained by dividing the number of participants in courses by the total number of trainees) also increased from 5.4 in 2007 to 9.3 in 2010 (see Graph 16, page 41). The annual average growth in this indicator in the period was 20.2%, as a result of a greater relative increase in the number of participants than in the number of trainees.

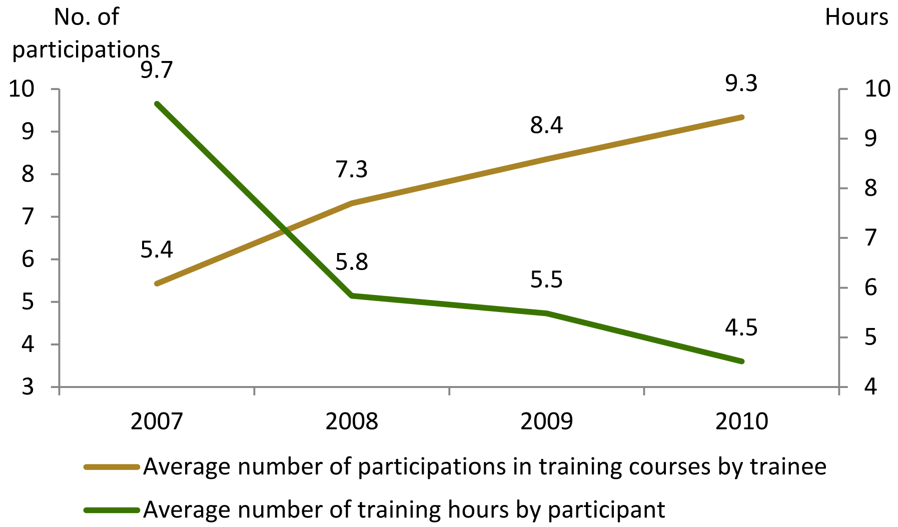
At the same time, the increase in the number of training courses was lower than that in the number of participants, as the former grew at an annual average growth rate of 5.0% while the latter at 23.7% between 2007 and 2010 (see Table 14). As a result, the average number of participants per course (obtained by dividing the number of participants by the number of courses held) increased significantly. While each course had an average of 22 participants in 2007, the number in 2010 was

[26] Due to lack of data, all the indicators on training of human resources refer only to 26 of the 33 financial institutions in the sample on which this Activity Report is based. BAC, BNP, BNP SS, BNP WM, Banco do Brasil, Banco BIC and Invest were not included.

37, an annual average growth of 20.4%. This was decisive in allowing each trainee to take more courses on average without it being necessary to increase the number of actual courses.

There was also a sharp reduction in the average number of training hours per participant (see Graph 16), which shows that the average duration of courses was shorter. Indeed, while each course lasted an average of 17 hours in 2007, the figure was 15 hours in 2010 (see Table 14, page 40).

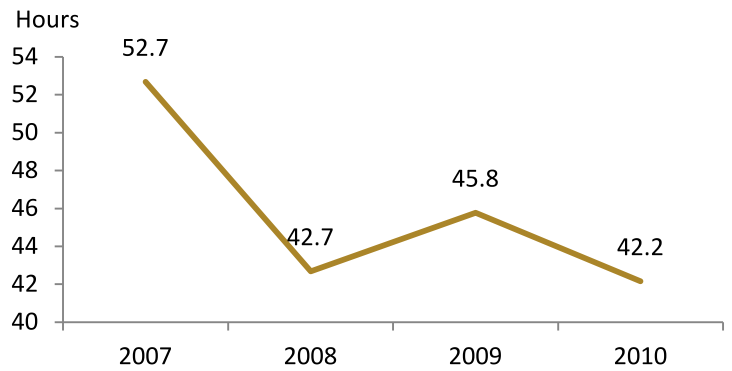
Graph 16: Comparison between the average number of participations in training courses per trainee and the average number of training hours per participant (2007 – 2010)



Source: FIs, APB.

The product of the two ratios shown in Graph 16 results in the average number of training hours per trainee, also calculated by dividing the total number of training hours by the number of trainees. The annual average reduction in this indicator was 6.5% (see Graph 17), due to the fact that the average number of training hours per participant went down more than the increase in the average number of participations in courses per trainee. The effect of the former thus overlapped that of the latter.

Graph 17: Average number of training hours per trainee (2007 – 2010)



Source: FIs, APB.

There was a predominance of in-house courses organised by the APB member institutions between 2007 and 2010. They accounted on average for 79.4% of the total (see Table 15) and were tailor-made for each institution to meet its specific needs.

Where teaching methods were concerned, classroom training has predominated since 2007 and represented on average 71.6% of the courses held in the period. Its proportion tended to go down all together (-5.7 percentage points) between 2007 and 2010. Even more important, the same was the case with online training (e-learning) which fell 11.3 percentage points (see Table 15).

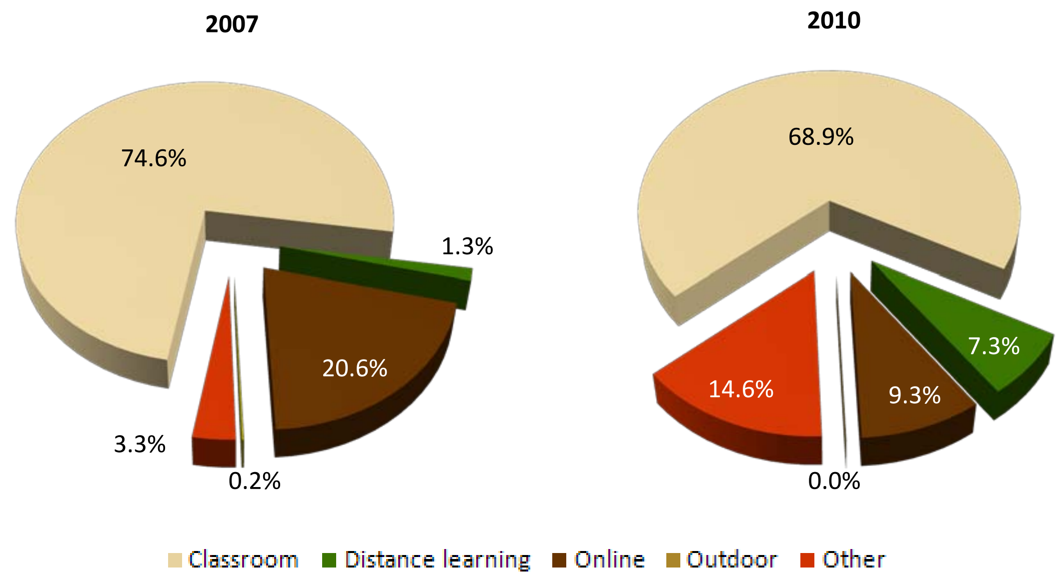
Table 15: Type of training courses and corresponding methods (2007 – 2010)

	2007		2008		2009		2010		Avg.
Type of Training Courses									
In-house	9,202	*76.1%*	11,612	*80.1%*	9,342	*79.9%*	10,892	*81,6%*	*79.4%*
External	2,883	*23.9%*	2,887	*19.9%*	2,352	*20.1%*	2,464	*18,4%*	*20.6%*
Training Methods									
Classroom	*74.6%*		*77.0%*		*65.8%*		*68.9%*		*71.6%*
Distance learning	*1.3%*		*3.5%*		*5.3%*		*7.3%*		*4.4%*
Online training (e-learning)	*20.6%*		*11.7%*		*22.0%*		*9.3%*		*15.9%*
Outdoor	*0.2%*		*0.0%*		*0.2%*		*0.0%*		*0.1%*
Other	*3.3%*		*7.7%*		*6.7%*		*14.6%*		*8.1%*

Source: FIs, APB.

On the other hand, other, less traditional training methods, such as distance learning and other, have been gaining in importance, which reflects a stake in innovation by the APB member institutions (see Graph 18).

Graph 18: Training methods (2007 vs. 2010)

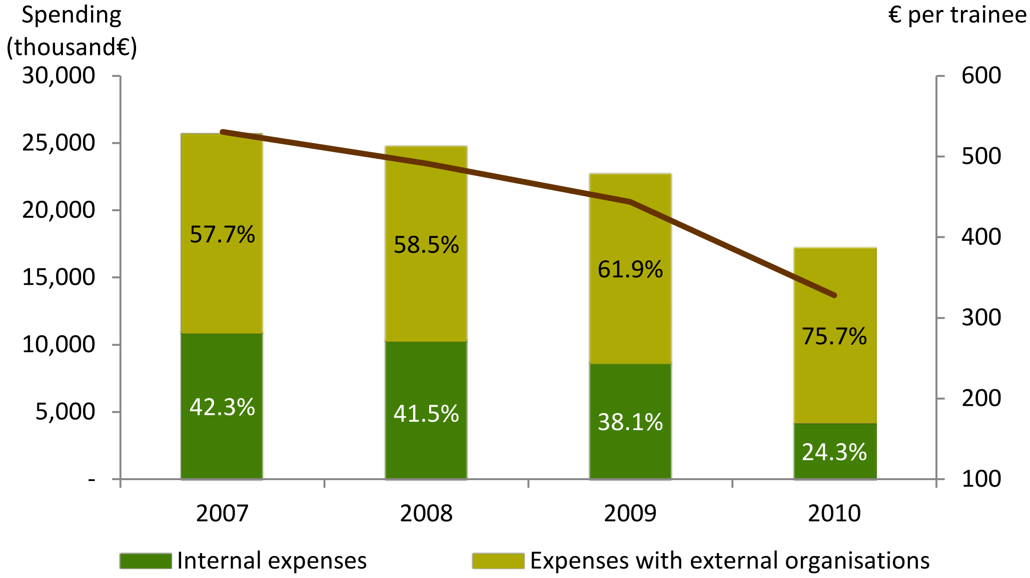


Source: FIs, APB.

Spending on training totalled 17.2 million Euros in 2010, which was 0.8% of the member institutions' total general administrative expenses that year. This item has tended to decrease since 2007 both in absolute value, which fell by an annual average of 12.0%, and as a percentage of general administrative expenses (see Table 16, page 44).

Between 2007 and 2010, most of the expenditure on training went to external organisations. The above reduction in costs was much greater in the case of internal expenses, which decreased by an annual average of 24.3%, as opposed to 4.1% for external organisations (see Table 16, page 44). As a result, the proportion of costs of external organisations in total costs incurred in training has tended to grow (see Graph 19), demonstrating a preference for outsourcing these services to specialised bodies on the part of the member institutions.

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



Source: FIs, APB.

The substantial cut in training costs by the member institutions in the period (an average of 12.0% a year) was accompanied by modest growth in the number of courses held (an average of 4.9% a year) (see Table 14, page 40 and Table 16, page 44). These two effects together brought down the average cost of training from 2,126 Euros in 2007 to 1,290 Euros in 2010, an annual average reduction of 13.2% (see Table 16, page 44). While the above considerable containment of expenses was the main determinant in the reduction in the average cost per course between 2007 and 2010, it was certainly partly due to a substantial decrease in the average duration of each course, as this reduced the amounts paid to trainers along with living expenses, accommodation and classroom rentals, among others.

The annual average fall in cost per trainee in the period is even more accentuated (14.4%), as the training was more comprehensive. It is, however, the cost per participant that really shows the gains in efficiency and efficacy achieved. This figure went down by an average of 28.7% a year between 2007 and 2010 (see Table 16, page 44).

This reduction was due not only to the above-mentioned rationalisation of costs but also to more efficient use of available resources resulting from a considerable increase in the number of participants per course. These two factors made it possible to absorb the growth in the number of trainees and provide each of them with a wider, possibly more diversified range of training at lower cost, even though it was shorter.

Table 16: Spending on training (2007 – 2010)

	2007	2008	2009	2010	Average
Spending on Training					
Total (million €)	25,688	24,753	22,715	17,226	-
Expenses with external organisations	14,815	14,485	14,069	13,048	-
Internal expenses	10,873	10,268	8,646	4,178	-
Annual growth rate [a]	-	*-3.6%*	*-8.2%*	*-24.2%*	*-12.0%*
As % of general administrative expenses [b]	*1.2%*	*1.2%*	*1.1%*	*0.8%*	-
Costs per Training Course					
Total (€)	2,126	1,707	1,942	1,290	-
Annual growth rate	-	*-19.7%*	*13.8%*	*-33.6%*	*-13.2%*
Costs per Trainee					
Total (€)	531	491	444	328	-
Annual growth rate	-	*-7.4%*	*-9.7%*	*-26.1%*	*-14.4%*
Costs per Participant					
Total (€)	98	67	53	35	-
Annual growth rate	-	*-31.3%*	*-20.9%*	*-33.9%*	*-28.7%*

Source: FIs, APB.

[a] Annual average growth rate in all spending on training courses.

[b] Total spending on training as a percentage of total general administrative expenses.

VI. Banking coverage indicators

VI.1. Branch network in Portugal

The branch networks of the 33 financial institutions in the base sample have grown in recent years and totalled 6,240 branches at the end of 2010. The number of branches in Portugal has increased 8.5% since 2007, which represents an absolute net growth of 490 branches. The annual average growth rate was 2.8%, although growth has tended to slow down in the last two years at an average of around 1.4% a year (see Table 17).

Table 17: Number of branches in Portugal as at 31 December (2007 - 2010)

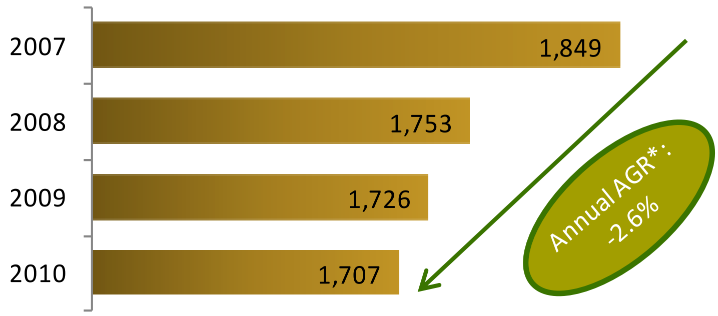
	2007	2008	2009	2010	Average
Number of Branches in Portugal					
Total	5,742	6,062	6,162	6,232[a)]	-
Annual growth rate	-	*5.6%*	*1.6%*	*1.1%*	*2.8%*

Source: FIs, APB.

[a)] This figure does not coincide with that reported above (6,240 branches) because the evolution in branch networks over time made it necessary to adjust the sample. See footnote 15, page 22.

The growth in the number of branches in Portugal between 2007 and 2010 was also reflected in a significant improvement in the number of inhabitants per branch[27]. While there was one branch for every 1,849 inhabitants in 2007, there was one for every 1,707 in 2010, reflecting an annual average decrease of 2.6% (see Graph 20). This trend shows that the branch network has been growing faster than the Portuguese population, thereby resulting in greater proximity and better service for customers but also reflecting greater competition between APB member institutions.

Graph 20: Number of inhabitants per branch in Portugal (2007 – 2010)



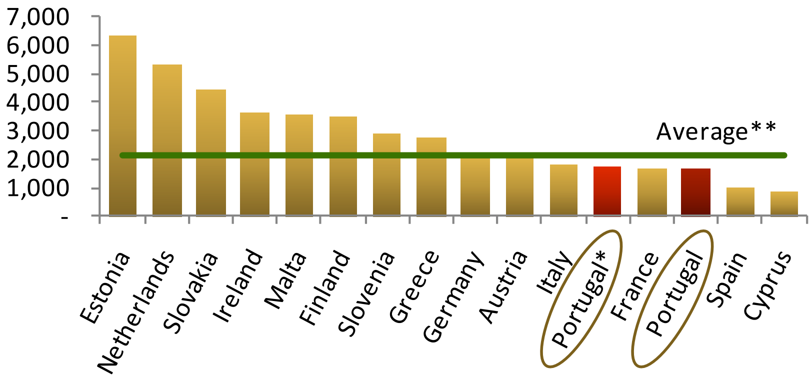
Source: FIs, INE, APB.
Note: *(AGR) annual growth rate.

The member institutions are well positioned in the euro area in terms of this indicator. Indeed, their large branch network places them below the average for these countries. Furthermore,

[27] As INE does not yet have data on the resident population in Portugal for 2010, the figures for 2009 were used instead.

Graph 21 shows that the member institutions own the vast majority of branches in Portugal, as the figure of all the monetary financial institutions registered with Banco de Portugal is very close to that of the sample.

Graph 21: Number of inhabitants per branch in the euro area as at 31 December 2009



Source: FIs, Eurostat, ECB, APB.

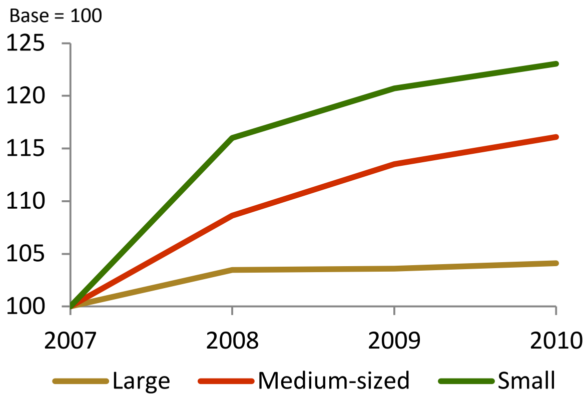
Note: * Includes only branches of APB member institutions.

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

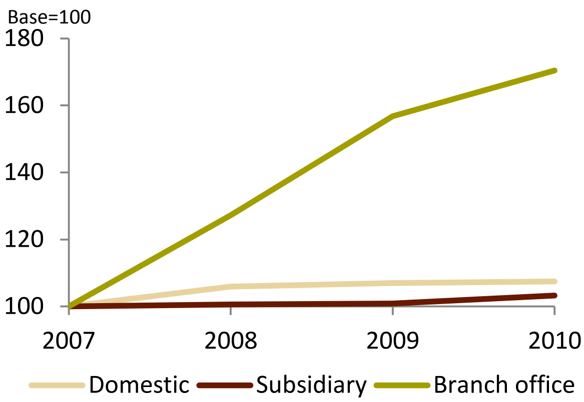
The slowdown in the expansion of the branch network that began in 2009 was common to all the segments of APB member institutions, regardless of their size and origin/type of legal structure. This was not the case in 2010, however, as the annual average growth rate in the subsidiaries and large financial institutions' branch networks increased, while that of the others continued the deceleration trend seen in 2009 (see Graph 22 and Tables 18 and 19, page 47).

Graph 22: Number of branches in Portugal by size and origin/type of legal structure as at 31 December (2007 – 2010)

a) By size



b) By origin/type of legal structure



Source: FIs, APB.

Table 18: Number of branches in Portugal by size as at 31 December (2007 – 2010)

	2007	2008	2009	2010	Average
Large					
Total	3,771	3,902	3,906	3,926	-
Annual growth rate	-	*3.5%*	*0.1%*	*0.5%*	*1.4%*
Contribution to the growth rate in branches	-	*2.3%*	*0.0%*	*0.3%*	*0.9%*
Medium-sized					
Total	1,715	1,863	1,947	1,991	-
Annual growth rate	-	*8.6%*	*4.5%*	*2.3%*	*5.1%*
Contribution to the growth rate in branches	-	*2.6%*	*1.4%*	*0.7%*	*1.6%*
Small					
Total	256	297	309	315	-
Annual growth rate	-	*16.0%*	*4.0%*	*1.9%*	*7.3%*
Contribution to the growth rate in branches	-	*0.7%*	*0.2%*	*0.1%*	*0.3%*

Source: FIs, APB.

Table 19: Number of branches in Portugal by origin/type of legal structure as at 31 December (2007 – 2010)

	2007	2008	2009	2010	Average
Domestic					
Total	4,498	4,766	4,813	4,834	-
Annual growth rate	-	*6.0%*	*1.0%*	*0.4%*	*2.5%*
Contribution to the growth rate in branches	-	*4.7%*	*0.8%*	*0.3%*	*1.9%*
Subsidiary					
Total	1,075	1,081	1,084	1,110	-
Annual growth rate	-	*0.6%*	*0.3%*	*2.4%*	*1.1%*
Contribution to the growth rate in branches	-	*0.1%*	*0.0%*	*0.4%*	*0.2%*
Branch Office					
Total	169	215	265	288	-
Annual growth rate	-	*27.2%*	*23.3%*	*8.7%*	*19.7%*
Contribution to the growth rate in branches	-	*0.8%*	*0.8%*	*0.4%*	*0.7%*

Source: FIs, APB.

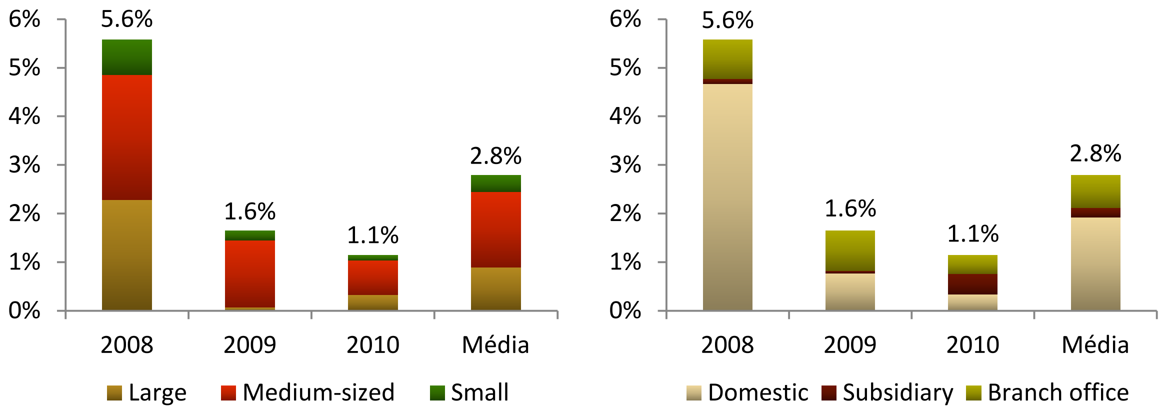
Between 2007 and 2010, the large and particularly the medium-sized financial institutions contributed most (0.9% and 1.6% respectively) to the overall average growth in the number of branches in Portugal (see Table 18 and Graph 23a), page 48). Even so, the large institutions own almost two-thirds of all the branches in the sample, although their proportion went down in the period (around 2.7 percentage points), especially in favour of the medium-sized institutions (see Table 18 and Graph 24a), page 48).

The networks of branch offices showed annual growth rates much higher than those of the other institutions, resulting in an annual average growth rate of around 19.7% between 2007 and 2010, as opposed to 2.2% in institutions set up under Portuguese law. This trend resulted in their making a 0.7% contribution to overall average growth in the branch network in Portugal, mainly thanks to medium-sized institutions in the segment (see Table 19, page 47).

The scenario is the result of the branch offices' strong commitment to expanding more to traditional business areas, with particular focus on retail banking, as mentioned above, hence the need to invest in opening new branches as they are the best distribution channel in retail. A financial institution's branch network allows it to attract more customers, build stronger relationships of trust and generally increase the target segment's awareness of the institution.

Graph 23: Contribution to growth in branches in Portugal by size and origin/type of legal structure as at 31 December (2007 - 2010)

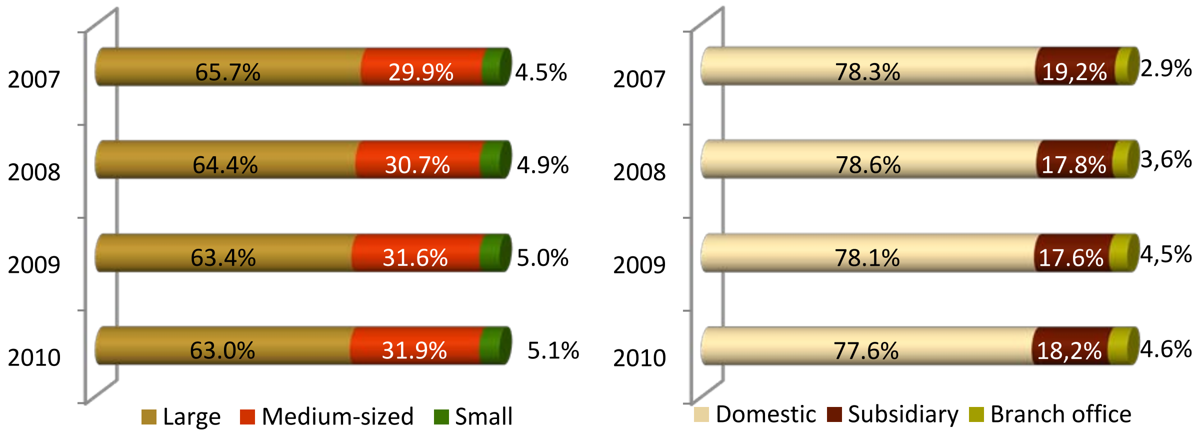
a) By size **b) By origin/type of legal structure**



Source: FIs, APB.

Graph 24: Representativity of member institutions in terms of number of branches in Portugal by size and origin/type of legal structure as at 31 December (2007 - 2010)

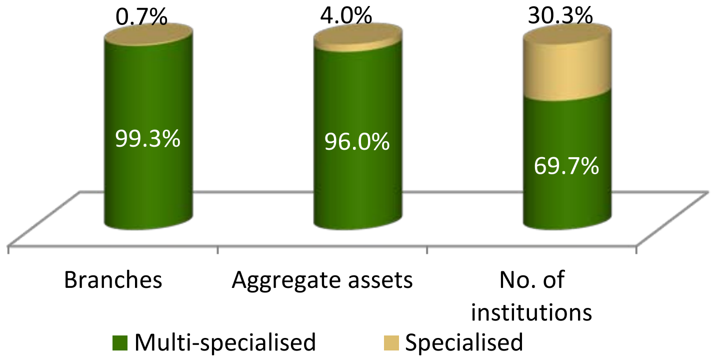
a) By size **b) By origin/type of legal structure**



Source: FIs, APB.

In spite of the considerable expansion of branch offices' networks, it was the domestic financial institutions that contributed most to the overall average growth (1.9%) in the branch network in Portugal (see Table 19, page 47 and Graph 23b)). This contribution was not, however, sufficient to cancel out their loss of proportion in terms of the number of branches (around 0.7 percentage points). The decrease, along with that in the subsidiary segment (1 percentage point) was transferred to the branch offices (see Graph 24b), page 48).

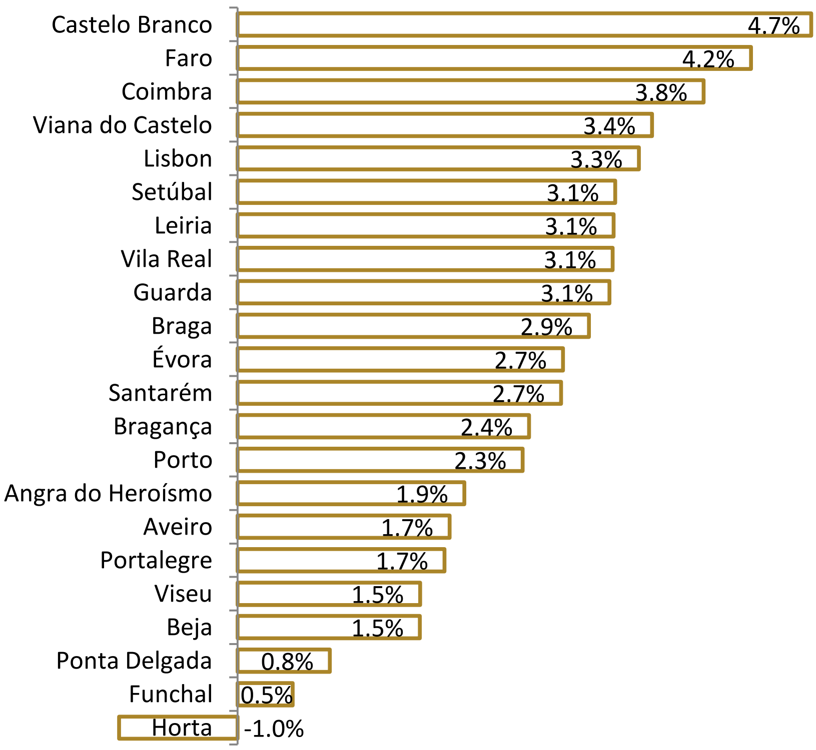
Graph 25: Number of branches, aggregate assets and number of member institutions by business area as at 31 December 2010



Source: FIs, APB.

Finally, as was to be expected, the multi-specialised financial institutions (which represent the majority of the sample in terms of aggregate assets and number of institutions) own practically all the branches in Portugal. In fact, specialised financial institutions own only 0.7% of all branches (see Graph 25).

Graph 26: Average annual growth rates in the number of branches by district (2007 – 2010)



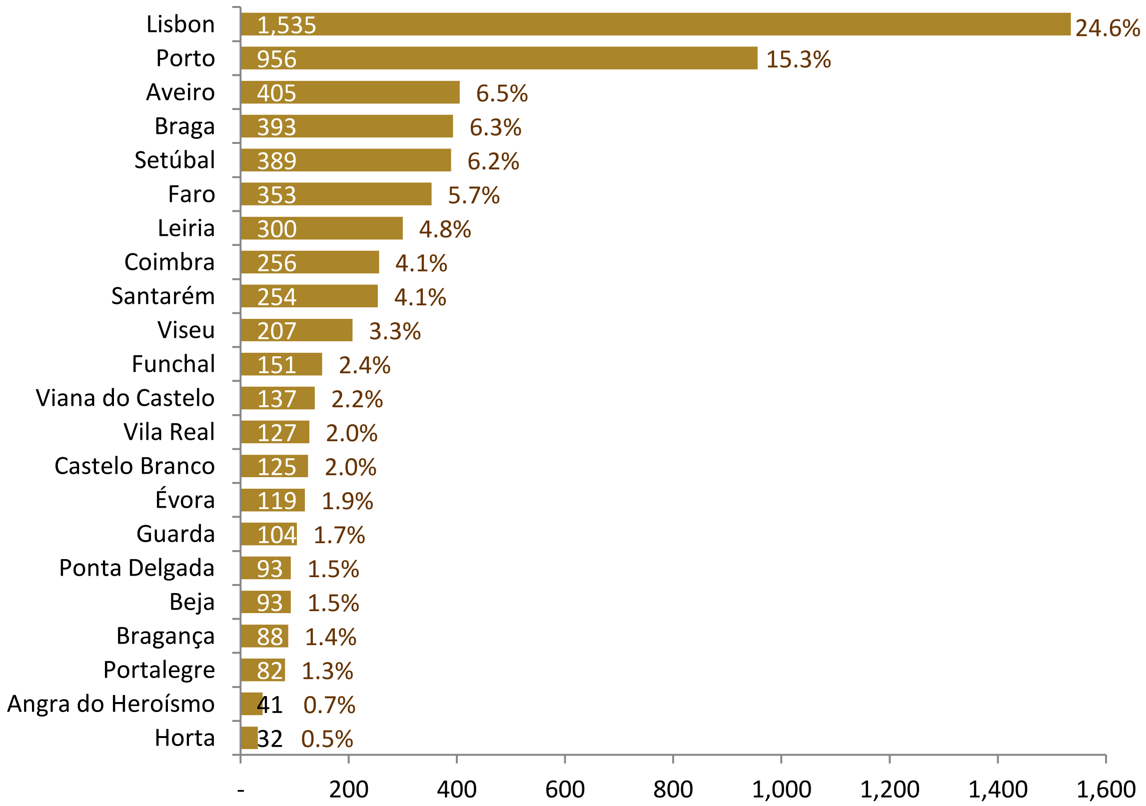
Source: FIs, APB.

The expansion of the branch network in the different districts of Portugal was not uniform on average in the timeframe in question. It was in Castelo Branco, Faro and Coimbra that the network grew most. On the other hand, Horta was the only district in which the number of branches fell, representing an annual average growth rate of -1.0% (see Table 21, page 55 and Graph 26, page 49).

In 2010, 19 more branches were set up in the Lisbon district (+1.3%) and 10 in Coimbra (+4.1%). The Castelo Branco district had the highest growth with 6.8% or eight branches. There were reductions in the number of branches in the districts of Aveiro, Santarém, Funchal and Ponta Delgada (see Table 21, page 55).

As was to be expected, the district of Lisbon was the one with the largest number of branches in 2010, followed by Porto (24.6% and 15.3%, respectively). As in previous years, this scenario applies to all APB member institutions, regardless of their size or origin/type of legal structure. Of the three districts with the fewest branches, two are in the Azores, i.e. Horta and Angra do Heroísmo (see Graph 27 and Table 20, page 54).

Graph 27: Number of branches and concentration index by district as at 31 December 2010

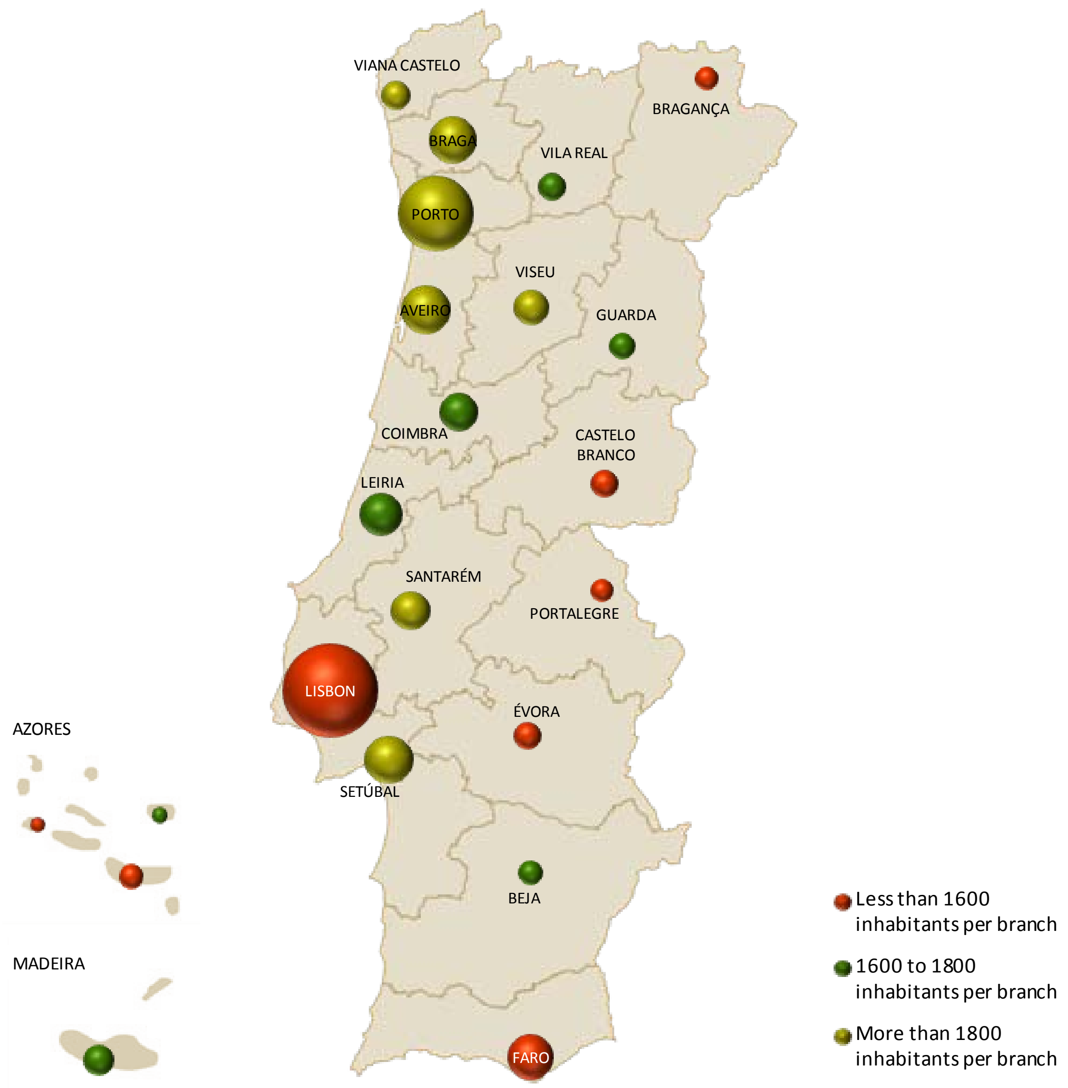


Source: FIs, APB.

Although the two largest cities, Lisbon and Porto, have a significant part of the branches in Portugal (39.9%), they are also the districts with the largest resident populations. As a result, the number of inhabitants per branch is 1,462 in Lisbon and 1,911 in Porto. The district with the smallest number of inhabitants per branch is Horta, with 1,101. In contrast, Setúbal is the one with the largest number of inhabitants per branch (2,228). Chart 3 shows the number of branches per district and the number of inhabitants per branch in three categories: fewer than 1,600, 1,600 to 1,800 and more than 1,800 on 31 December 2010.

Even though the number of inhabitants per branch shows some disparity between districts, in recent years the correlation between the resident population and the number of branches per district has been quite strong (around 0.98). Furthermore, the correlation between the annual average growth rate in the number of branches between 2007 and 2010 and the number of inhabitants per branch by district in 2007 was close to 0.41. This relationship shows a slight trend towards higher average growth in the number of branches in the districts with smaller branch networks, considering their number of inhabitants.

Chart 3: Branches and number of inhabitants per branch by district as at 31 December 2010



Source: FIs, INE, APB.

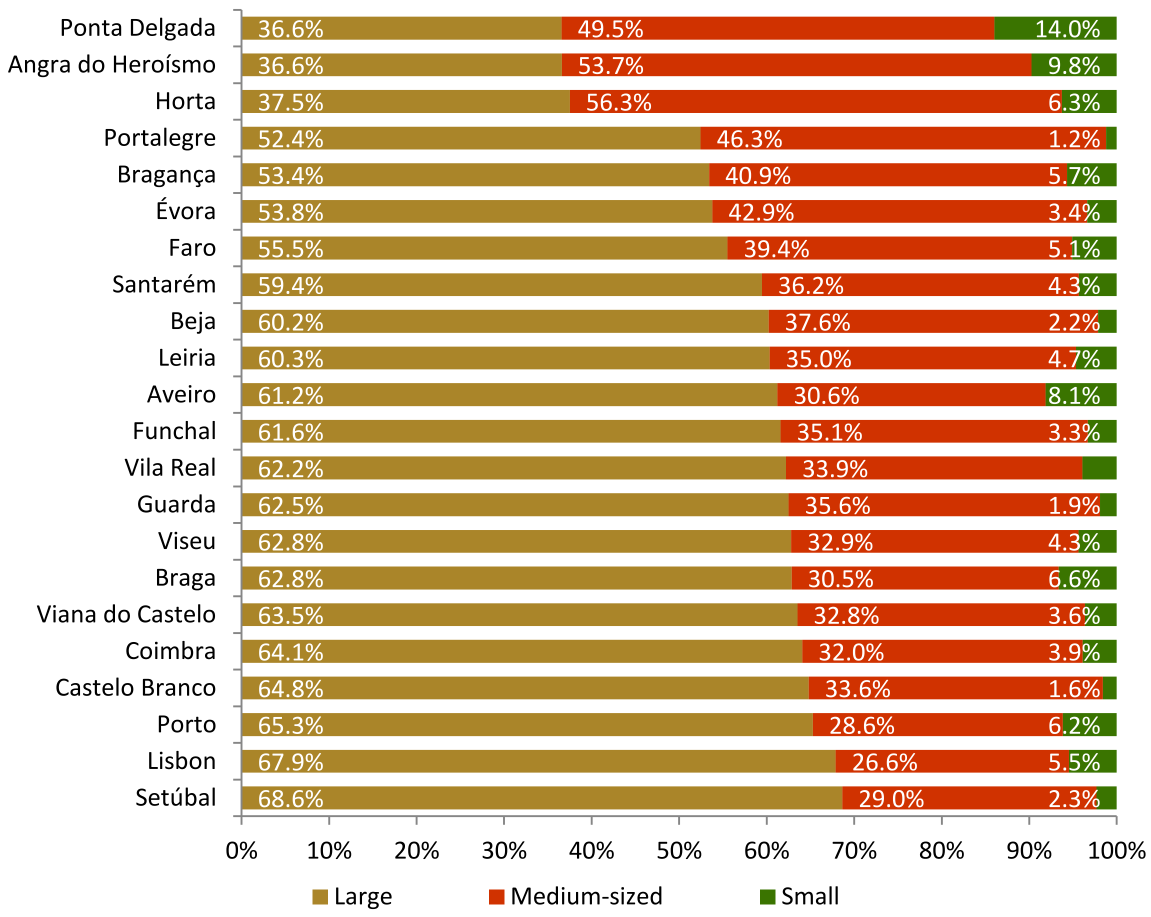
Note: The size of the bubbles indicates the absolute number of branches in the district, while the colour shows the number of inhabitants per branch.

There is a predominance of large APB member institutions in the majority of the districts in terms of geographical coverage of branches by size of institution. Even so, it is in the three districts with the most inhabitants (Lisbon, Porto and Setúbal) that these institutions stand out most. It is in the least populated districts that the large institutions have the smallest presence - Horta, Angra do Heroísmo and Ponta Delgada, where medium-sized institutions predominate (see Graph 28).

Indeed, it is precisely in the districts with the fewest inhabitants that the medium-sized institutions have the highest concentration. The proportion of branches belonging to this segment is lowest in the Lisbon, Porto and Setúbal districts at 26.6%, 28.6% and 29.0%, respectively (see Graph 28).

This trend towards concentration in the least populated districts also occurs among the small member institutions, though to a lesser extent. This is because this group also carries a particularly important weight in the five most populated districts, particularly Lisbon, Porto, Braga and Aveiro.

Graph 28: Percentage of branches by size and district as at 31 December 2010

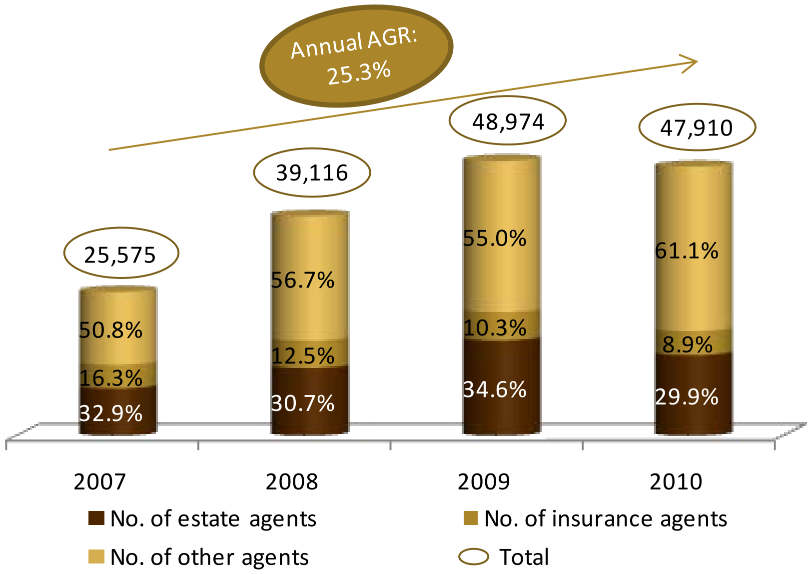


Source: FIs, APB.

In spite of the APB member institutions' commitment to augmenting their branch networks, the traditional channel for interaction with customers, they have also been trying to open alternative distribution channels, as demonstrated by the number of external promoters for attracting banking business, which has grown at an annual average rate of close to 25% since 2007. External promoters include estate agents, who place mortgages, insurance agents and other bodies directly involved in the sale of bank products and services, such as current accounts, cards, consumer credit, etc.

In spite of the growing importance of these agents, the expansion of the network of external promoters has slowed down in recent years and its annual growth rate actually fell, albeit only slightly in 2010. At the end of the year, the APB member institutions had 47,910 external promoters, almost 30% of which were estate agents and 9% insurance agents (see Graph 29).

Graph 29: Number and type of external promoters as at 31 December (2007 – 2010)



Source: FIs, APB.

Table 20: Number of branches by district, size and origin/type of legal structure as at 31 December 2010

	Total		Large		Medium-sized		Small		Domestic		Subsidiary		Branch Office	
Number of Branches														
Total	6,240		3,926		1,991		323		4,841		1,110		289	
By District														
Aveiro	405	*6.5%*	248	*6.3%*	124	*6.2%*	33	*10.2%*	317	*6.5%*	70	*6.3%*	18	*6.2%*
Beja	93	*1.5%*	56	*1.4%*	35	*1.8%*	2	*0.6%*	84	*1.7%*	7	*0.6%*	2	*0.7%*
Braga	393	*6.3%*	247	*6.3%*	120	*6.0%*	26	*8.0%*	307	*6.3%*	68	*6.1%*	18	*6.2%*
Bragança	88	*1.4%*	47	*1.2%*	36	*1.8%*	5	*1.5%*	75	*1.5%*	10	*0.9%*	3	*1.0%*
Castelo Branco	125	*2.0%*	81	*2.1%*	42	*2.1%*	2	*0.6%*	100	*2.1%*	20	*1.8%*	5	*1.7%*
Coimbra	256	*4.1%*	164	*4.2%*	82	*4.1%*	10	*3.1%*	205	*4.2%*	44	*4.0%*	7	*2.4%*
Évora	119	*1.9%*	64	*1.6%*	51	*2.6%*	4	*1.2%*	102	*2.1%*	13	*1.2%*	4	*1.4%*
Faro	353	*5.7%*	196	*5.0%*	139	*7.0%*	18	*5.6%*	267	*5.5%*	67	*6.0%*	19	*6.6%*
Guarda	104	*1.7%*	65	*1.7%*	37	*1.9%*	2	*0.6%*	92	*1.9%*	11	*1.0%*	1	*0.3%*
Leiria	300	*4.8%*	181	*4.6%*	105	*5.3%*	14	*4.3%*	243	*5.0%*	43	*3.9%*	14	*4.8%*
Lisbon	1,535	*24.6%*	1,042	*26.5%*	409	*20.5%*	84	*26.0%*	1,102	*22.8%*	337	*30.4%*	96	*33.2%*
Portalegre	82	*1.3%*	43	*1.1%*	38	*1.9%*	1	*0.3%*	68	*1.4%*	12	*1.1%*	2	*0.7%*
Porto	956	*15.3%*	624	*15.9%*	273	*13.7%*	59	*18.3%*	711	*14.7%*	203	*18.3%*	42	*14.5%*
Santarém	254	*4.1%*	151	*3.8%*	92	*4.6%*	11	*3.4%*	200	*4.1%*	41	*3.7%*	13	*4.5%*
Setúbal	389	*6.2%*	267	*6.8%*	113	*5.7%*	9	*2.8%*	297	*6.1%*	71	*6.4%*	21	*7.3%*
Viana do Castelo	137	*2.2%*	87	*2.2%*	45	*2.3%*	5	*1.5%*	105	*2.2%*	25	*2.3%*	7	*2.4%*
Vila Real	127	*2.0%*	79	*2.0%*	43	*2.2%*	5	*1.5%*	104	*2.1%*	18	*1.6%*	5	*1.7%*
Viseu	207	*3.3%*	130	*3.3%*	68	*3.4%*	9	*2.8%*	178	*3.7%*	25	*2.3%*	4	*1.4%*
Funchal	151	*2.4%*	93	*2.4%*	53	*2.7%*	5	*1.5%*	126	*2.6%*	19	*1.7%*	6	*2.1%*
Angra do Heroísmo	41	*0.7%*	15	*0.4%*	22	*1.1%*	4	*1.2%*	39	*0.8%*	2	*0.2%*	-	*0.0%*
Horta	32	*0.5%*	12	*0.3%*	18	*0.9%*	2	*0.6%*	30	*0.6%*	2	*0.2%*	-	*0.0%*
Ponta Delgada	93	*1.5%*	34	*0.9%*	46	*2.3%*	13	*4.0%*	89	*1.8%*	2	*0.2%*	2	*0.7%*

Source: FIs, APB.

Table 21: Number of branches by district as at 31 December (2007-2010)

	2007		2008		2009		2010	
Number of Branches								
Total	5,742		6,062		6,162		6,232 [a)]	
By District								
Aveiro	383	*6.7%*	401	*6.6%*	410	*6.7%*	403	*6.5%*
Beja	89	*1.5%*	93	*1.5%*	92	*1.5%*	93	*1.5%*
Braga	360	*6.3%*	379	*6.3%*	388	*6.3%*	392	*6.3%*
Bragança	82	*1.4%*	84	*1.4%*	88	*1.4%*	88	*1.4%*
Castelo Branco	109	*1.9%*	117	*1.9%*	117	*1.9%*	125	*2.0%*
Coimbra	229	*4.0%*	247	*4.1%*	246	*4.0%*	256	*4.1%*
Évora	110	*1.9%*	116	*1.9%*	119	*1.9%*	119	*1.9%*
Faro	312	*5.4%*	336	*5.5%*	345	*5.6%*	353	*5.7%*
Guarda	95	*1.7%*	98	*1.6%*	101	*1.6%*	104	*1.7%*
Leiria	273	*4.8%*	289	*4.8%*	293	*4.8%*	299	*4.8%*
Lisbon	1,392	*24.2%*	1,493	*24.6%*	1,514	*24.6%*	1,533	*24.6%*
Portalegre	78	*1.4%*	80	*1.3%*	79	*1.3%*	82	*1.3%*
Porto	891	*15.5%*	929	*15.3%*	945	*15.3%*	955	*15.3%*
Santarém	235	*4.1%*	250	*4.1%*	255	*4.1%*	254	*4.1%*
Setúbal	355	*6.2%*	373	*6.2%*	386	*6.3%*	389	*6.2%*
Viana do Castelo	124	*2.2%*	132	*2.2%*	137	*2.2%*	137	*2.2%*
Vila Real	116	*2.0%*	123	*2.0%*	126	*2.0%*	127	*2.0%*
Viseu	197	*3.4%*	201	*3.3%*	202	*3.3%*	206	*3.3%*
Funchal	149	*2.6%*	151	*2.5%*	153	*2.5%*	151	*2.4%*
Angra do Heroísmo	39	*0.7%*	43	*0.7%*	41	*0.7%*	41	*0.7%*
Horta	33	*0.6%*	32	*0.5%*	31	*0.5%*	32	*0.5%*
Ponta Delgada	91	*1.6%*	95	*1.6%*	94	*1.5%*	93	*1.5%*

Source: FIs, APB.

[a)] This figure does not coincide with that in Table 20 (6,240 branches) because the evolution of the branch network over time made it necessary to adjust the sample, as indicated in footnote 15, page 22.

VI.2. Branch offices and representative offices abroad

At the end of 2010, the APB member institutions had 139 branch offices and 53 representative offices abroad. They were mainly concentrated in Europe (see Chart 4), which accounted for 70.8% of the total. The Americas, especially North America, represented 17.7% of the total network.

Chart 4: Geographical distribution of branch offices and representative offices abroad as at 31 December 2010[28]

Source: FIs, APB.

The number of member institutions branch offices and representative offices abroad has also been increasing since 2007, although more moderately when compared to the branch network in Portugal (annual average growth rate of 2.0% as opposed to 2.8%) (see Table 22 and Table 17, page 45). This albeit modest growth accelerated in 2009 and remained unchanged in 2010, as opposed to the slowdown in growth in the branch network in Portugal in the same period.

Table 22: Number of branch offices and representative offices abroad as at 31 December (2007 - 2010)

	2007	2008	2009	2010	Average
Branch Offices and Representative Offices Abroad [a)]					
Total	181	182	187	192	-
Annual growth rate	-	*0.6%*	*2.7%*	*2.7%*	*2.0%*

Source: FIs, APB.

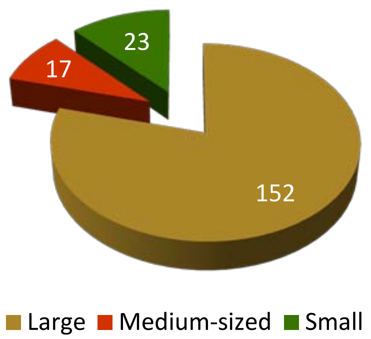
[a)] Includes foreign financial branch offices in the Madeira free-trade area.

[28] This chart shows the aggregate geographical distribution of member institutions on a separate, unconsolidated basis.

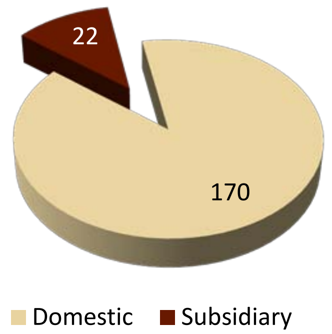
As with the branches, it is the domestic and large member institutions that have the vast majority of branch offices and representative offices abroad. The small institutions are, however, gaining ground in the total and overtook the medium-sized institutions in 2008 (see Graph 30 and Table 23, page 58).

Graph 30: Number of branch offices and representative offices abroad by size and origin as at 31 December 2010

a) By size



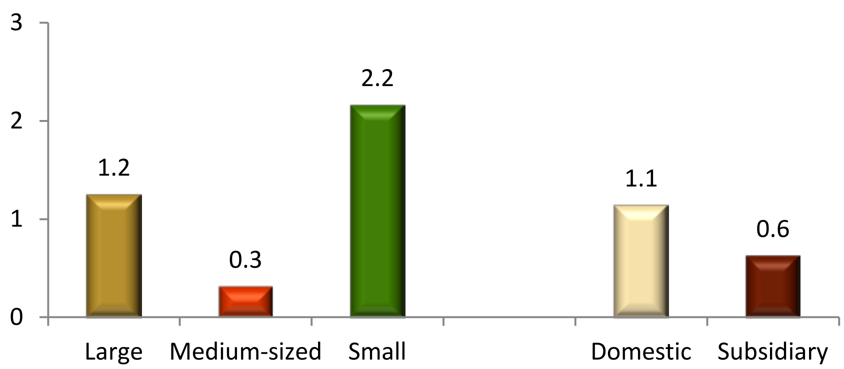
b) By origin



Source: FIs, APB.

The international expansion of the small institutions, measured by an indicator that relates their average proportion of the total branch offices and representative offices abroad to their average proportion of the entire branch network in Portugal, is higher than that of the other institutions (see Graph 31 and Table 23, page 58). In this context, the specialised institutions are particularly responsible for this trend. The fact that they operate essentially in specific business areas allows them to meet the needs of market niches abroad.

Graph 31: Relative indicator of member institutions internationalisation by size and origin (2007 – 2010)



Source: FIs, APB.

Table 23: 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 (2007 – 2010)

	2007	2008	2009	2010	Average
Representativity in the Branch Network in Portugal					
Large	65.7%	64.4%	63.4%	63.0%	64.1%
Medium-sized	29.9%	30.7%	31.6%	31.9%	31.0%
Small	4.4%	4.9%	5.0%	5.1%	4.9%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Domestic	78.3%	78.6%	78.1%	77.6%	78.2%
Subsidiary	18.7%	17.8%	17.6%	17.8%	18.0%
Branch office	3.0%	3.6%	4.3%	4.6%	3.8%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Representativity in the Branch Offices and Representativity Offices Abroad					
Large	81.2%	79.7%	79.7%	79.2%	79.9%
Medium-sized	10.5%	9.9%	9.1%	8.8%	9.6%
Small	8.3%	10.4%	11.2%	12.0%	10.5%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Domestic	88.4%	88.5%	89.8%	88.5%	88.8%
Subsidiary	11.6%	11.5%	10.2%	11.5%	11.2%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

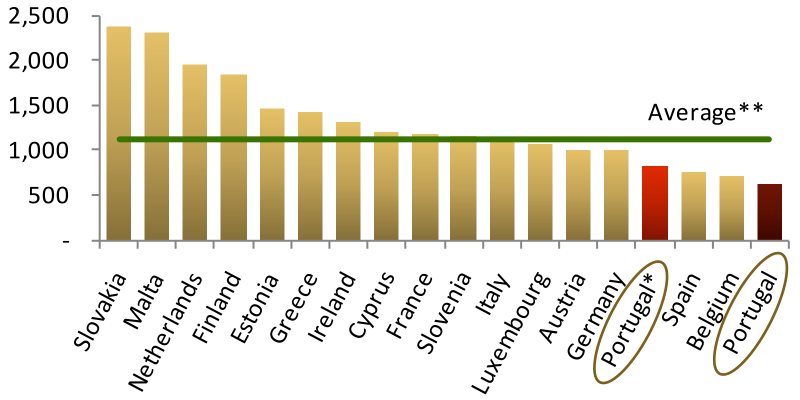
Source: FIs, APB.

VI.3. ATMs and home banking

Portugal's vast network of ATMs and the wide range of functions that it provides contribute to a better, faster, more diversified range of banking services for customers. It also makes the banking system more efficient, as it reduces the need for the branch network to expand and increase the size of its workforce by diverting a large number of simple, low-income banking operations to the outside. They are also available to customers at any time of the day and night.

Portugal is one of the most advanced countries in the euro area in terms of ATM coverage and has the lowest number of inhabitants per ATM (see Graph 32, page 59).

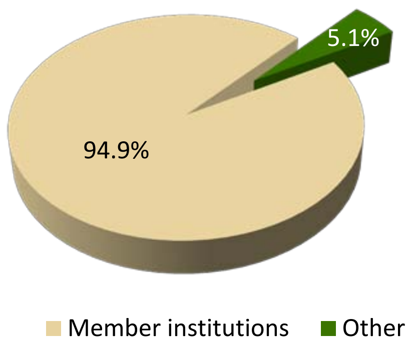
Graph 32: Number of inhabitants per ATM in the euro area as at 31 December 2009



Source: FIs, Eurostat, ECB, APB.
Note: *Includes only ATMs of the APB member institutions (excluding Barclays and BIG due to lack of data).
** Weighted average of number of inhabitants per ATM by each country's population.

On 31 December 2010, the member institutions[29] had 18,035 ATMs, 4,642 of which belonged to their own networks while the remaining 13,393 were part of the Multibanco network. The Multibanco network consisted of a total of 14,110 ATMs, which demonstrates the importance of member institutions in it (94.9%) (see Graph 33).

Graph 33: Number of ATMs belonging to the Multibanco network as at 31 December 2010



Source: FIs, SIBS, APB.

Active home banking users[30], i.e. those who had accessed the system in the previous three months, totalled 3,012,138 at the end of 2010, which was 1.5% more than in the previous year (2,967,812).

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[29] The sample consists of only 28 institutions as BNP SS, Invest, Barclays, BIG and Santander Consumer were not included due to lack of data.
[30] The sample is adjusted to 25 institutions for this information as BES, BAC and BB were also not included due to lack of data.

VI.4. Active accounts and cards and POSs

The performance of active bank accounts[31], active debit and credit cards[32] and the number of POSs was different from 2009 to 2010[33]. Bank accounts fell 18.2%, while the other items increased (see Table 24).

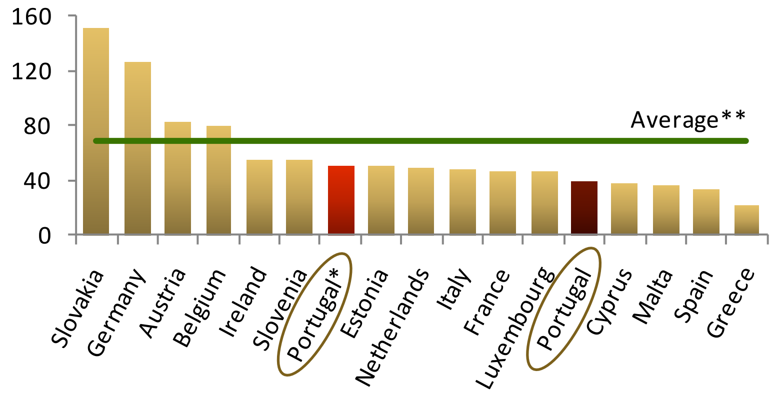
Table 24: Number of active accounts and cards and POSs as at 31 December (2009 – 2010)

	2009	2010
Active bank accounts	16,964,638	13,881,108
Active credit and debit cards	12,685,615	12,930,438
POSs	209,193	228,792

Source: FIs, APB.

POSs were the indicator that grew most in 2010, at 9.4%. This performance may accentuate the scenario in 2009, in which the entire banking sector and the member institutions were below the euro area average in terms of the number of inhabitants per POS (see Graph 34).

Graph 34: Number of inhabitants per POSs in the euro area as at 31 December 2009



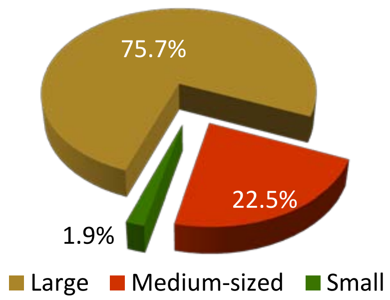
Source: FIs, Eurostat, ECB, APB.
Note: *Includes only POSs of APB member institutions.
** Weighted average of number of inhabitants per POS by each country's population.

As is to be expected, the domestic and large APB member institutions have the largest number of active accounts. The same applies even more to active debit and credit cards (see Graphs 35 and 36, page 61).

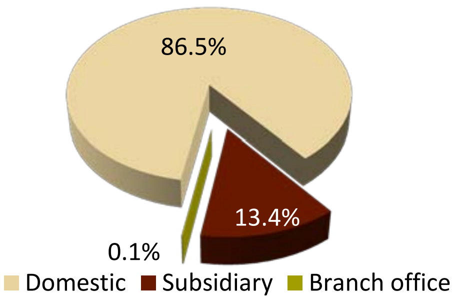
[31] Active bank accounts are private and business accounts that have more than €125 in turnover, on balance; have a minimum of 10 debits or credits in the last three months; or have overdue credit.
[32] Active debit and credit cards are those defined as such in the financial institutions' information systems and can therefore be used immediately by customers.
[33] The sample was reduced to 25 financial institutions for these indicators as BAC, BNP SS, BNP Paribas, BNP WM, Invest, Barclays, BIG and Santander Consumer were not included due to lack of data.

Graph 35: Active bank accounts by size and origin/type of legal structure as at 31 December 2010

a) By size



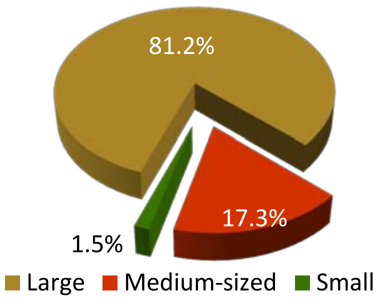
b) By origin/type of legal structure



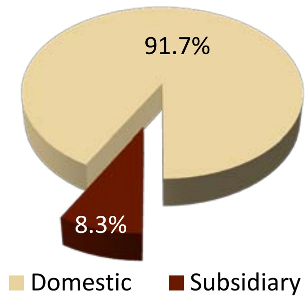
Source: FIs, APB.

Graph 36: Active credit and debit cards by size and origin as at 31 December 2010

a) By size



b) By origin/type of legal structure



Source: FIs, APB.

VII. Performance analysis

VII.1. Balance sheet

VII.1.1. Structure

The aggregate assets of the APB member institutions in this Activity Report[34] grew at a rate of 5.4% in 2010 and totalled 506.185 billion Euros as at 31 December (see Table 25).

Table 25: Aggregate balance sheet (million €) as at 31 December 2010[35]

	2010	As % of Total
Assets		
Cash and deposits at central banks and other credit institutions	7,275	*1.4%*
Financial investments [a)]	113,631	*22.4%*
Loans and advances to credit institutions	57,562	*11.4%*
Loans and advances to customers	288,668	*57.0%*
Other assets [b)]	39,049	*7.8%*
Total Assets	506,185	*100.0%*
Liabilities and Equity		
Deposits from central banks and other credit institutions	142,323	*28.1%*
Deposits from customers	194,936	*38.5%*
Debt securities issued and other equity instruments [c)]	81,819	*16.2%*
Other financial liabilities [d)]	46,590	*9.2%*
Other liabilities [e)]	12,125	*2.4%*
Equity	28,392	*5.6%*
Total Liabilities and Equity	506,185	*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 and held-to-maturity investments.
[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.

In assets, loans and advances to customers represent more than half of the aggregate balance sheet (57.0%), and financial investments, which were particularly important in 2010, accounted for over 20% of the total.

Where funding was concerned, deposits from customers were the main source of funding of the APB member institutions in 2010 and represented almost 39% of the total balance sheet, followed by deposits from central banks and other credit institutions (approximately 28%). Debt

[34] See footnote 2, page 2.
[35] There is an annex at the end of the balance sheet analysis on pages 85 and 86 showing aggregate off-balance sheet operations by the financial institutions in the sample.

securities issued, which includes subordinated liabilities, was the third source of funding on the balance sheet at around 16% of the total (see Table 25, page 63).

As mentioned in Chapter IV, the performance of aggregate assets between 2007 and 2010[36] shows that, in spite of the difficult situation in Portugal since 2008 as a result of the unfavourable global context and more recently a deteriorating national scenario, the APB member institutions' activity showed no signs of contracting, though its growth rates were more moderate (see Table 26).

Table 26: Aggregate assets structure as at 31 December (2007-2010)

	2007	2008	2009	2010	Average
Cash and Deposits [a]					
Total (million €)	11,710	10,418	10,485	7,225	-
Annual growth rate	-	*-11.0%*	*0.6%*	*-31.1%*	*-13.8%*
As % of total assets	*2.9%*	*2.3%*	*2.2%*	*1.4%*	*2.2%*
Financial Investments					
Total (million €)	49,156	63,073	82,770	113,549	-
Annual growth rate	-	*28.3%*	*31.2%*	*37.2%*	*32.2%*
As % of total assets	*12.3%*	*14.2%*	*17.3%*	*22.5%*	*16.6%*
Loans and Advances to Credit Institutions					
Total (million €)	61,072	56,638	65,300	56,891	-
Annual growth rate	-	*-7.3%*	*15.3%*	*-12.9%*	*-1.6%*
As % of total assets	*15.2%*	*12.7%*	*13.6%*	*11.3%*	*13.2%*
Loans and Advances to Customers					
Total (million €)	252,178	281,739	286,619	288,411	-
Annual growth rate	-	*11.7%*	*1.7%*	*0.6%*	*4.7%*
As % of total assets	*62.9%*	*63.3%*	*59.7%*	*57.1%*	*60.7%*
Other Assets					
Total (million €)	26,988	33,478	34,597	39,035	-
Annual growth rate	-	*24.0%*	*3.3%*	*12.8%*	*13.4%*
As % of total assets	*6.7%*	*7.5%*	*7.2%*	*7.7%*	*7.3%*
Total Assets	401,104	445,346	479,771	505,111	-
Annual growth rate	-	*11.0%*	*7.7%*	*5.3%*	*8.0%*

Source: FIs, APB.

[a] At central banks and other credit institutions.

The deceleration in business activity in the period mainly reflects a highly significant fall in the annual growth rate of loans and advances to customers as of 2008. This resulted in a 6.2 percentage point decrease in the weight of this item on the balance sheet in two years.

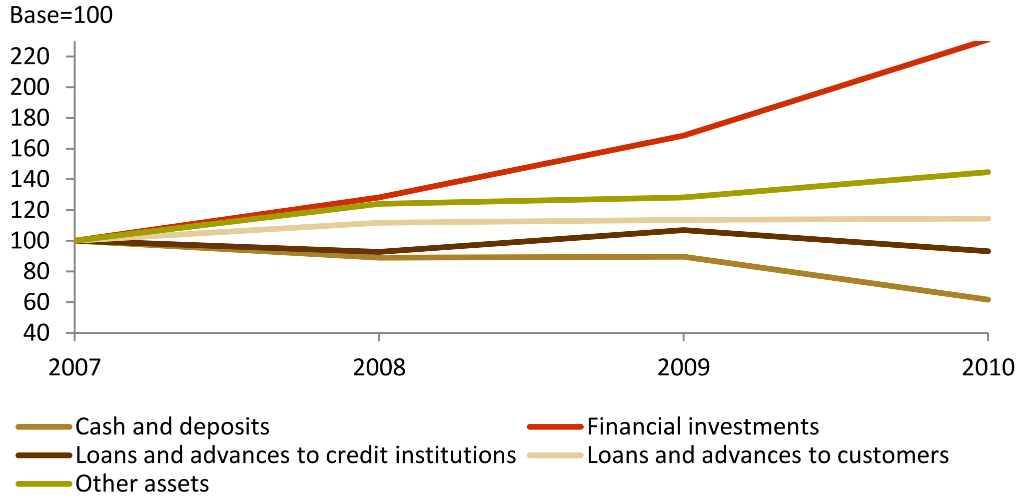
After the sharp 10 percentage point drop in 2009, the annual growth rate in loans and advances to customers practically stagnated (+0.6%) in 2010 (see Table 26). This situation is due, on one hand, to a fall in demand for loans among private and corporate customers because of the

[36] See footnote 15, page 22.

adverse economic climate that started at the time and that the country is now experiencing. Consumer credit in particular has been one of the most affected by the economic situation. On the other hand, credit granted by financial institutions was also restricted, as their ability to obtain finance in the international wholesale debt markets was drastically reduced in the period. This led to a need for more restrictive risk assessment policies and greater selectivity in granting new loans.

In spite of these limitations, the APB member institutions continued to provide finance to private and corporate customers and to the public administration, thereby contributing to albeit weak growth in credit to customers in 2010.

Graph 37: Aggregate assets structure as at 31 December (2007-2010)



Source: FIs, APB.

Reductions in the cash, deposits and loans and advances to credit institutions in last year's balance sheet also contributed to the deceleration in the member institutions' activity, in particular in 2010. Their active intervention in the interbank market fell significantly in 2010 (12.9%), while their most liquid funds went down 31.1%. All together, the two items decreased on average by 3.4% in the period under analysis and their weight in the balance sheet fell by around 5.5 percentage points since 2007 (see Table 26, page 64 and Graph 37). This was once again due to the banking sector's funding difficulties, which were especially acute in 2010 and a result of their lack of access to the international debt and capital markets.

On the other hand, financial investments were largely responsible for reducing the scale of the slowdown, if not contraction, that would have occurred in the member institutions' activity in 2010 as a result of the performance of credit and liquidity items. Financial investments were the balance sheet item that contributed most to growth in aggregate assets in the period, with an annual average growth rate of 32.2% (see Table 26, page 64 and Graph 37). The growth in 2010 (37.2%) was due essentially to the purchase of Portuguese public debt securities and ownership of bonds underlying credit securitisation operations during the year.

Furthermore, between 2007 and 2010, the balance sheet value of the APB member institutions' financial asset portfolio more than doubled and gained more than 10 percentage points in weight in the aggregate balance sheet. While in 2007, the balance for loans and advances to customers was five times more than that of financial investments, this difference went down to about half in three years (2.5 times), which reflects the importance that investment activity gained over traditional lending in the period (see Table 26, page 64). The different performance by loans and advances to customers and financial investments was the result of a lower appetite for risk on the part of the member institutions and a greater preference for liquidity and assets serving as collateral for finance operations with the European Central Bank, which also used less regulatory capital.

As is natural in banking, the member institutions' finance structure has entailed substantial borrowing (see Table 27 and Graph 38).

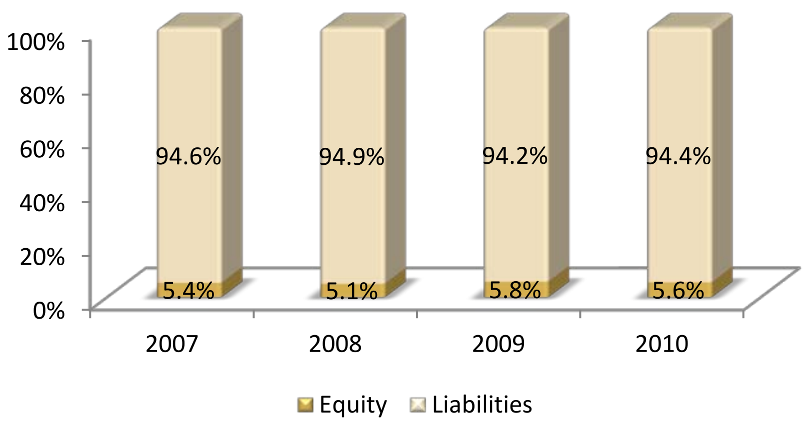
Table 27: Aggregate finance structure as at 31 December (2007-2010)

	2007	2008	2009	2010	Average
Liabilities					
Total (million €)	379,333	422,679	451,725	476,746	-
Annual growth rate	-	*11.4%*	*6.9%*	*5.5%*	*7.9%*
As % of total in the balance sheet	*94.6%*	*94.9%*	*94.2%*	*94.4%*	*94.5%*
Equity					
Total (million €)	21,771	22,667	28,046	28,365	-
Annual growth rate	-	*4.1%*	*23.7%*	*1.1%*	*9.6%*
As % of total in the balance sheet	*5.4%*	*5.1%*	*5.8%*	*5.6%*	*5.5%*
Total Liabilities and Equity	401,104	445,346	479,771	505,111	-

Source: FIs, APB.

During the period, liabilities maintained an average weight of 94.5% in the finance structure of the aggregate balance sheet, while equity varied between a minimum of 5.1% in 2008 and a maximum of 5.8% in 2009. This year, equity grew substantially (23.7%), thanks to a number of share capital increases, the issue of other capital instruments and increases in fair value reserves by some member institutions.

Graph 38: Aggregate finance structure as at 31 December (2007-2010)



Source: FIs, APB.

Deposits from customers carried considerable weight in the borrowing structure in aggregate terms (see Table 28 and Graph 39, page 69). Over the period, they represented an average of 42.2% of the total debt and liabilities on the balance sheet.

Table 28: Aggregate borrowing structure as at 31 December (2007-2010)

	2007	2008	2009	2010	Average
Deposits from Central Banks					
Total (million €)	5,492	13,398	17,503	44,958	-
Annual growth rate	-	*144.0%*	*30.6%*	*156.9%*	*110.5%*
As % of total liabilities	*1.5%*	*3.2%*	*3.9%*	*9.4%*	*4.5%*
Deposits from Other Credit Institutions					
Total (million €)	102,584	93,515	91,583	96,426	-
Annual growth rate	-	*-8.8%*	*-2.1%*	*5.3%*	*-1.9%*
As % of total liabilities	*27.0%*	*22.1%*	*20.3%*	*20.2%*	*22.4%*
Deposits from Customers					
Total (million €)	164,010	183,161	187,118	194,840	-
Annual growth rate	-	*11.7%*	*2.2%*	*4.1%*	*6.0%*
As % of total liabilities	*43.2%*	*43.3%*	*41.4%*	*40.9%*	*42.2%*
Debt Securities Issued and Other Equity Instruments [a)]					
Total (million €)	69,864	79,483	101,382	81,819	-
Annual growth rate	-	*13.8%*	*27.6%*	*-19.3%*	*7.4%*
As % of total liabilities	*18.4%*	*18.8%*	*22.4%*	*17.2%*	*19.2%*
Other Financial Liabilities					
Total (million €)	23,340	39,605	41,459	46,590	-
Annual growth rate	-	*69.7%*	*4.7%*	*12.4%*	*28.9%*
As % of total liabilities	*6.2%*	*9.4%*	*9.2%*	*9.8%*	*8.7%*
Other Liabilities					
Total (million €)	14,043	13,517	12,680	12,113	-
Annual growth rate	-	*-3.7%*	*-6.2%*	*-4.5%*	*-4.8%*
As % of total liabilities	*3.7%*	*3.2%*	*2.8%*	*2.5%*	*3.0%*
Total Liabilities	379,333	422,679	451,725	476,746	-

Source: FIs, APB.

[a)] Includes subordinated liabilities.

When the international financial crisis broke out and a growing feeling of insecurity set in, large amounts of savings that until then had been invested in higher-risk, more sophisticated products (such as security investment funds) were moved to safer but lower-income investments in 2008. This explains the atypical growth (11.7%) in the amount of deposits from customers[37] on the balance sheet in 2008. Since then deposits from customers have grown modestly (though still more

[37] Bank deposits have been covered by the Deposit Guarantee Fund up to an amount of 100,000 Euros since November 2008.

than loans and advances to customers, particularly last year). In 2010, in view of the growing difficulties in access to the international interbank, debt and capital markets as a result of the imbalances in Portuguese public finances and the simultaneous reduction in the rating of the national sovereign debt, the APB member institutions began efforts to attract new deposits from their customers, especially in the fourth quarter of the year. Marketing campaigns and more attractive, competitive interest rates explain why new deposits from customers almost doubled last year (7.722 billion Euros) and deposits grew 4.1% on the balance sheet against 2009 (see Table 28, page 67).

Meanwhile, it is worth noting that wholesale debt (interbank and securities market) had an average weight very similar (41.6%) to that of deposits from customers (42.2%) in total debt and liabilities in the aggregate balance sheet of the member institutions in the same period (see Table 28, page 67). All together, however, wholesale debt lost eight percentage points in weight in the liabilities structure between 2007 and 2010 (as opposed to 2.3 percentage points only in deposits from customers). Indeed, in 2008 wholesale debt began to lose its dominant position over deposits from customers in 2007.

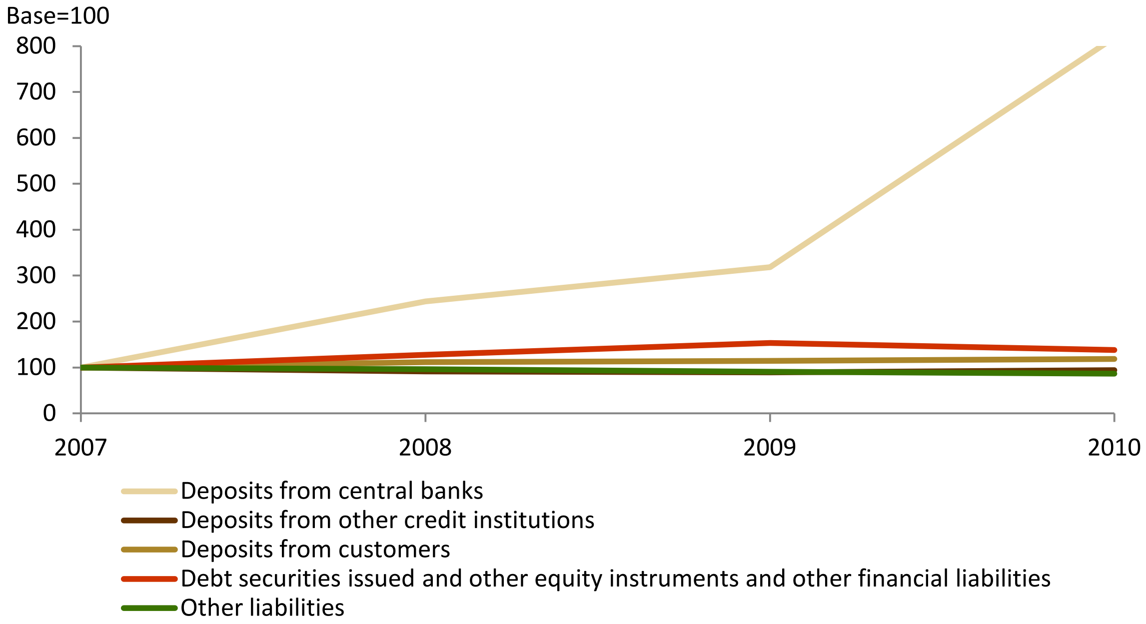
This loss was mainly due to the sharp drop in borrowing from the international interbank market in 2008 following the global financial crisis. After an almost normal period for most of 2009, the market once again closed under the adverse effect of the contagion of financial institutions from the Portuguese sovereign debt crisis. If deposits from other credit institutions grew in 2010 (5.3%), it was partly because of intra-group transfers (not cancelled out by the fact that the Activity Report is based on unconsolidated aggregate accounts) and especially a change in the composition of this item, with very significant growth in repos at the expense of loans and deposits (see Table 28, page 67).

Debt securities issued on the market also contributed to this loss in 2010, when it was responsible for 88.6% of the 19.3% drop in the balance sheet item (see Table 28, page 67). Once again, the same reasons for the international debt markets' perception of the deterioration in the quality of Portuguese financial institutions' credit following the country's sovereign debt crisis were behind the member institutions' inability to access these markets. The loss of weight of subordinated liabilities in total own funds was also a reflection of this inability[38], as demonstrated by the fall in value of the subordinated debt relevance ratio from 2009 to 2010 (see Table 29, page 72)[39].

[38] Own funds include equity and subordinated liabilities.

[39] The sharp drop in this ratio in 2009 was due to the increase in equity by some member institution that year.

Graph 39: Aggregate borrowing structure as at 31 December (2007-2010)



Source: FIs, APB.

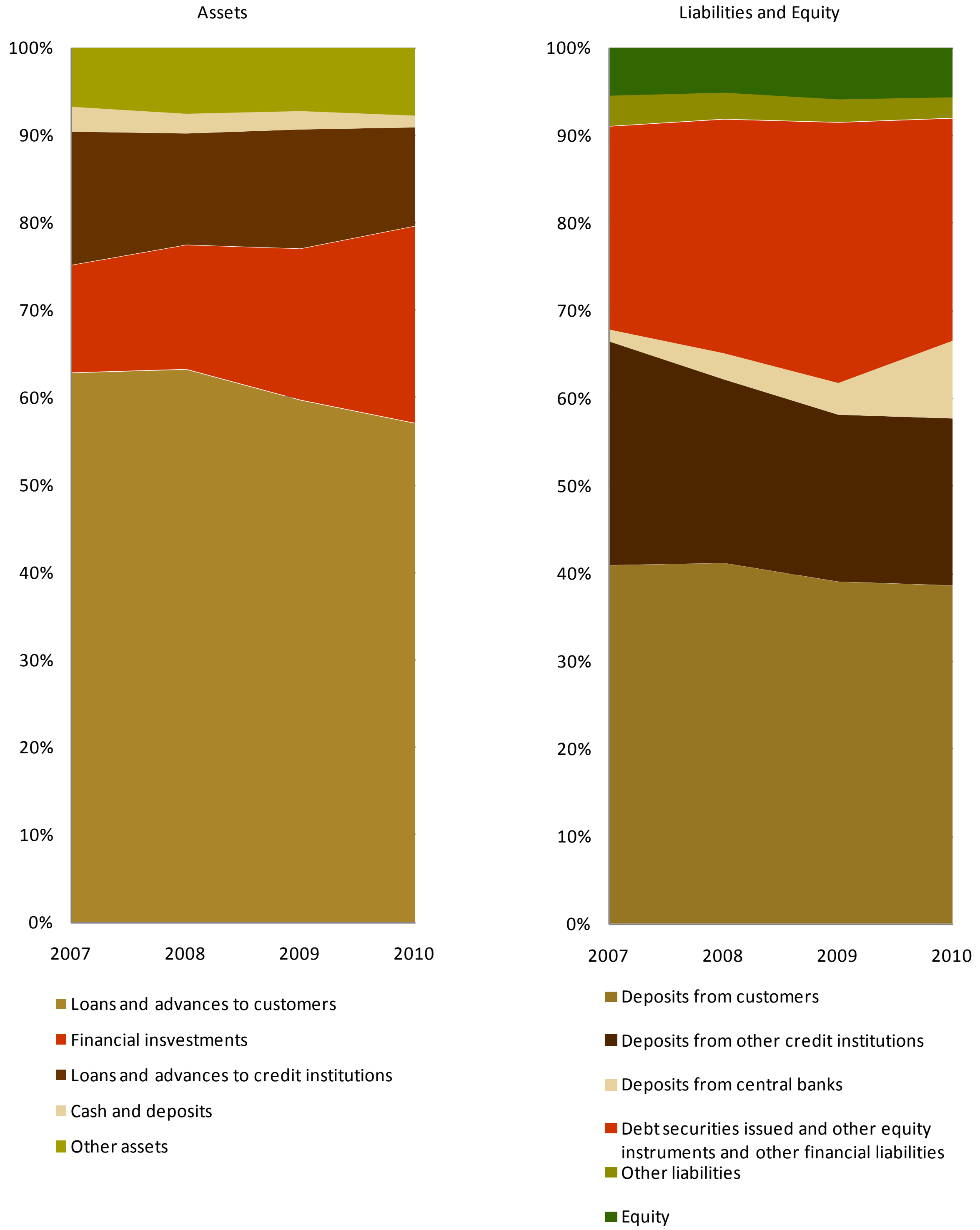
Finally, deposits from central banks are the liabilities item with the most significant growth throughout the period and increased at an annual average rate of 110.5%. As a result, their weight in the aggregate borrowing structure rose considerably from 1.5% in 2007 to 9.4% in 2010, although this weight is much lower in relative terms and against the previous items (see Table 28, page 67 and Graph 39). This was due to ever-growing recourse to funding from the European Central Bank by the APB member institutions. ECB intervention and use of this type of finance became inevitable as a way of offsetting the lack of normal access to the international financial markets and the resulting shortage of liquidity that affected the banking sector.

Graph 40, page 70, puts the structure of the assets portfolios of the member institutions and their funding structure from 2007 to 2010 into perspective by placing them side by side. This kind of analysis shows the choices made and limitations felt over time and aggregately by the member institutions with regard to their investment and funding policies.

From the point of view of assets, loans and advances to customers were especially relevant as they accounted for more than 60% of the member institutions' overall activity, on average terms in the period. This reflects the importance of the banking sector to the national economy, as borrowing is the main source of finance for the vast majority of Portuguese businesses and it is also essential and decisive in enabling households to purchase a home or consumer goods. At the same time, deposits from customers were also very important and were the member institutions' main source of funding, with an average weight of almost 40% on the aggregate balance sheet. A combination of a solid deposit base and intense lending activity by the member institutions shows that they essentially follow a traditional financial intermediation model.

A comparison of credit and deposits from customers based on an analysis of the performance of the transformation ratio over time shows some structural imbalance in the financing of loans, as the ratio's figures are too high (see Table 29, page 72).

Graph 40: Aggregate balance sheet structure as at 31 December (2007-2010)



Source: FIs, APB.

In 2007, following a trend towards expansion in lending not properly accompanied by a similar ability to attract stable funds as a result of fierce competition in the market from alternative savings products with much higher interest than bank deposits, around one-third of loans and advances to customers were sustained by funding from the interbank market, which is itself volatile and suffers from high systemic sensitivity.

When the international financial crisis broke out in 2008, the resulting paralysis of the interbank market and failure to reverse the expansionistic policy followed until then in lending to customers obliged the member institutions to seek liquidity from alternative sources, such as the international debt securities markets and the ECB.

In spite of the slowdown in growth of credit in 2009 and some reinforcement of equity and debt securities issued, the general lack of liquidity in the sample worsened and the member institutions had to obtain more finance from the ECB. The increasing importance of their financial investment portfolios in the aggregate balance sheet also contributed to this deterioration largely as a result of growing exposure to Portuguese public debt securities. This followed a demand for greater liquidity and lower risk and a policy to sustain the finance of the public sector, particularly by the domestic member institutions.

Even greater implementation of this policy in 2010 to offset the lack of demand for Portugal's debt instruments in the international markets proved particularly adverse when associated with the contagion of the national sovereign debt crisis to the financial sector, which led to the APB member institutions' inability to access the international debt and capital markets. A reduction in more liquid assets on the balance sheet and especially recourse to finance from the ECB at record levels became replacement sources of funding for the member institutions in 2010. Meanwhile, the unsustainability of this situation obliged them to starting taking some deleverage measures in 2010. These measures included an almost total freeze on loans and advances to customers and further steps to attract deposits from customers, especially in the fourth quarter. The measures had an effect on the transformation ratio, which went down for the first time since 2007 (almost four percentage points against the average for the last three years) (see Table 29, page 72). The 152.3% at the end of 2010 is too high and far above the target of 120% imposed on the banking sector in the Programme of Financial Assistance to Portugal.

In 2011, urgent, demanding decisions can be expected from the member institutions aimed at gradual deleverage of their activity and recovery over time of a more balanced, sustainable finance structure.

Finally, the indicators calculated on figures in the aggregate balance sheet as at 31 December in Table 29, page 72, reflect the structural changes in the member institutions' balance sheets from 2007 to 2010.

Table 29: Indicators calculated on figures in the aggregate balance sheet as at 31 December (2007-2010)

		2007	2008	2009	2010
Quick Ratio	Cash and deposits at central banks / Financial liabilities [a)]	2.0%	1.7%	1.6%	0.8%
Transformation Ratio	Gross loans / Deposits from customers	155.8%	156.2%	156.8%	152.3%
Overall Lending Capacity	Gross loans / Financial liabilities	69.6%	69.5%	66.6%	63.7%
Finance of Financial Assets	Financial liabilities / Financial assets [b)]	97.9%	99.3%	98.6%	99.6%
Importance of Deposits from Customers	Deposits from customers / Financial liabilities	44.6%	44.5%	42.5%	41.8%
Relevance of Subordinated Debt	Subordinated liabilities / Own funds [c)]	39.9%	40.1%	31.8%	30.4%
Gross Solvency	Own funds / Assets	9.1%	8.5%	8.6%	8.1%

Source: FIs, APB.

[a)] Financial liabilities include deposits from central banks and other credit institutions, deposits from customers, debt securities issued, other capital instruments, other financial liabilities and hedging derivatives.

[b)] Financial assets include cash and deposits at central banks and other credit institutions, financial investments, loans and advances to credit institutions, loans and advances to customers and hedging derivatives.

[c)] Own funds (accounting perspective) include equity and subordinated liabilities.

VII.1.2. Quality of loans and advances to customers

A more detailed analysis[40] for a smaller timeline (2009 and 2010) shows that although gross loans and advances to customers, and net loans and advances, did not decrease in 2010, its annual growth rate (0.8%) was very low among the financial institutions in the sample (see Table 30, page 73). As mentioned above, the weakness of the Portuguese economy, difficulty in accessing the international markets, lower demand for loans on the part of households and non-financial companies and more restrictive criteria in granting loans are reasons for this development.

Although the pattern of behaviour is similar, it is worth mentioning the higher annual growth rate in gross loans and advances compared to that of net (0.3%). The difference, which results from a much higher growth (23.1%) in the balance of provisions and impairments in the last year, points to an increase in defaults and/or risk of default. The gross credit coverage ratio by provisions and impairments increased from 2.3% in 2009 to 2.8% in 2010 (see Table 30, page 73).

Just as or even more important than the total value of loans and advances is their quality, which is measured by overdue loans, i.e. loans overdue for more than 30 days. Overdue loans totalled 7.967 billion Euros in 2010, i.e. 12.3% more than in 2009. This increase contrasts with insignificant growth in gross credit in 2010 and suggests an increase in defaults. As a result, the default ratio, which compares total overdue loans to total gross loans, deteriorated from 2.6% in 2009 to 2.9% in 2010.

[40] This more detailed analysis did not include BNP SS as it was not an APB Member in 2009, and Barclays, BIG or Finantia due to lack of aggregate data.

Table 30: Gross loans and advances to customers, provisions and impairments as at 31 December (2009-2010)

	2009	2010
Loans and Advances to Customers (outstanding)		
Total (million €)	277,028	278,515
Annual growth rate	-	*0.5%*
Loans and Advances to Customers (overdue)		
Total (million €)	7,097	7,967
Annual growth rate	-	*12.3%*
Total loans and advances to customers (gross)	284,125	286,482
Annual growth rate	-	*0.8%*
Provisions and Impairments		
Total (million €)	-6,489	-7,987
Annual growth rate	-	*23.1%*
Total loans and advances to customers (net)[41]	277,636	278,495
Annual growth rate	-	*0.3%*

Source: FIs, APB.

Lack of information from the sample institutions as to the amount of doubtful debts included in their balances of outstanding loans to customers in 2009 and 2010 makes it impossible to calculate a total default rate[42] and so the analysis is based on the data in Table 31 obtained from information in the Banco de Portugal Financial Stability Report (May 2011, pp. 78, 83 and 89).

According to this table, total default rates[43] have been higher in consumer and other credit (private customers) and loans to non-financial companies in the last two years, and both deteriorated in 2010. The indicator for mortgages remained stable in the period.

Table 31: Default rates in loans to private customers (homes and consumer goods) and non-financial companies

	2009	2010
Loans to non-financial private sector	2.7%	3.1%
Mortgages	1.7%	1.8%
Consumer credit	6.9%	8.6%
Loans to non-financial companies	4.2%	5.2%

Source: BdP.

The increase in defaults on consumer and other credit may be related to the increase in unemployment and very easy access to this type of finance prior to the financial crisis. The growth in

[41] The figures in Table 30 do not coincide with those in Table 26, page 64 because of adjustments in the sample. See previous footnote.
[42] Covering overdue loans and doubtful debts and including not only actual default but also the risk of default on future repayments.
[43] According to Banco de Portugal, a non-performing loan includes principal and interest overdue for more than 90 days and other doubtful debts.

defaults on the part of non-financial companies is essentially due to the deterioration in conditions in the Portuguese economy in the last two years which has adversely affected smaller companies.

Finally, where provisions are concerned, the ratio of coverage of overdue loans by provisions and impairments in the sample went from 91.4% in 2009 to 100.3% in 2010.

VII.1.3. Loans and advances to customers

For a more detailed analysis of outstanding loans and advances to customers, their balance in 2009 and 2010[44] has been broken down into loans (to non-financial companies, the public administration and private customers), non-derecognised securitised loans and other loans and amounts receivable (secured) (see Table 32). The second group includes loans that were securitised but for which the financial institutions keep all the risks and benefits associated with their ownership, meaning that they cannot be derecognised on the balance sheet. The last group includes bonds and commercial paper not tradable on active markets with no intention to sell.

As an absolute figure, the decrease in loans was practically offset by the growth in non-derecognised securitised loans, which may be a sign of a transfer effect between the two categories. Non-derecognised securitisation operations on banks' balance sheets are mainly intended to originate liquidity, as the bonds underlying securitised credit portfolios kept in financial investment portfolios can be offered as guarantees of borrowing from the European Central Bank (see Table 32).

Table 32: Outstanding loans and advances to customers as at 31 December (2009-2010)

	2009	2010	Average
Loans			
Total (million €)	235,678	228,752	-
Change in absolute value	-	-6,926	-
Annual growth rate	-	*-2.9%*	-
As % of total	*85.1%*	*82.1%*	*83.6%*
Non-derecognised Securitised Loans			
Total (million €)	28,143	34,883	-
Change in absolute value	-	6,740	-
Annual growth rate	-	*23.9%*	-
As % of total	*10.1%*	*12.6%*	*11.3%*
Other Loans and Amounts Receivable (Secured)			
Total (million €)	13,207	14,880	-
Change in absolute value	-	1,673	-
Annual growth rate	-	*12.7%*	-
As % of total	*4.8%*	*5.3%*	*5.1%*
Total outstanding loans and advances to customers	277,028	278,515	-

Source: FIs, APB.

[44] See footnote 40, page 72.

Meanwhile, growth in secured loans resulted essentially from the subscription of commercial paper issued by companies and, to a lesser extent, from the inclusion of assets from portfolios of available-for-sale financial assets. After the alteration to IAS 39 came into effect in October 2008, financial institutions were able to reclassify some non-derivative financial assets that were classified as held for trading or as available-for-sale financial assets to another category, such as the secured loans account.

The growth in this credit item, due essentially to the subscription of commercial paper, followed the trend for this particular type of funding for companies, not only because it is short term and therefore involves less risk, but also because it is a kind of asset that can sometimes be used as collateral in short-term operations with the European Central Bank.

From a different perspective, a breakdown of the balance of loans by borrower and purpose (see Table 33 and Table 34, page 76) shows that both loans to companies and the public administration and to private customers decreased in 2010 against 2009 (2.0% and 4.1% respectively). This decrease is not easy to interpret, in that it is distorted by the transfer effect of balances to non-derecognised securitised loans. The financial institutions in the sample performed a number of operations to securitise loans to companies and private customers (homes and consumer goods) in 2010.

Table 33: Loans as at 31 December (2009-2010)

	2009	2010	Average
Loans to Companies and Public Administration			
Total (million €)	132,636	129,980	-
Annual growth rate	-	*-2.0%*	-
As % of total	*56.3%*	*56.8%*	*56.5%*
Loans to Private Customers			
Total (million €)	103,042	98,772	-
Annual growth rate	-	*-4.1%*	-
As % of total	*43.7%*	*43.2%*	*43.5%*
Total loans	235,678	228,752	-

Source: FIs, APB.

In the absence of accurate, detailed information on the composition of the non-derecognised securitised loans balance, it is practically impossible to draw conclusions on developments in active credit per borrower in 2010.

By adding the balances of loans to companies and the public administration to those of other secured loans (see Table 34, page 76), it is perhaps possible to get an idea of developments in credit to this segment in 2010. The 0.1% reduction is negligible and points to stability in loans to companies and the public administration (or perhaps even an albeit modest increase, if we consider that there were securitisations of loans to companies in 2010 that have not been recognised in this aggregate).

Table 34: Outstanding loans and advances to companies and public administration (loans and secured loans) as at 31 December (2009 – 2010)

	2009	2010
Loans and Secured Loans		
Total (million €)	145,843	144,860
Annual growth rate	-	*-0.1%*

Source: FIs, APB.

Meanwhile, Table 35 attributes the reduction in mortgages (3.4%) and in consumer credit (7.8%) to the decrease in total loans to private customers (4.1%) in 2010 (see Table 33, page 75).

Table 35: Loans to private customers as at 31 December (2009-2010)

	2009	2010	Average
Mortgages			
Total (million €)	84,754	81,915	-
Annual growth rate	-	*-3.4%*	-
As % of total	*82.3%*	*82.9%*	*82.6%*
Consumer Credit and Other			
Total (million €)	18,288	16,857	-
Annual growth rate	-	*-7.8%*	-
As % of total	*17.7%*	*17.1%*	*17.4%*
Total loans to private customers	103,042	98,772	-

Source: FIs, APB.

Taking a similar approach to that used above for loans to companies and the public administration and adding mortgages to private customers balances to non-derecognised securitised loans balances (bearing in mind that most loan securitisation operations are for mortgages), the conclusion (with the necessary reservations) is that home loans to private customers must have shown a favourable performance (although slightly under the 3.5% in Table 36).

Table 36: Outstanding mortgages to private customers (loans and non-derecognised securitised loans) as at 31 December (2009 – 2010)

	2009	2010
Loans and Non-derecognised Securitised Loans		
Total (million €)	112,897	116,798
Annual growth rate	-	*3.5%*

Source: FIs, APB.

It was only in consumer credit that there must actually have been a reduction, as the value of securitisation operations for this type of credit in 2010 transferred to non-derecognised securitised loans was most likely not enough to warrant the 7.8% decrease in this item in the financial institutions in the sample. Greater selectiveness and strictness when approving consumer and other credit, associated with higher spreads and households' increasing economic difficulties, were most likely behind this reduction.

VII.1.4. Financial investments

Financial investments were the item that showed the highest growth (37.8%) in the balance sheet of the financial institutions in the sample[45] in 2010, totalling 110.498 billion Euros net on 31 December 2010 (see Table 37, page 78).

This growth occurred substantially due to the high (net) acquisition of public debt securities, in particular Portuguese ones. This considerably increased the APB member institutions' exposure to the national sovereign debt risk following the trend that began in 2009. This growth was also the result of a highly significant increase in other debt securities, mainly through ownership of bonds issued in credit securitisation operations in 2010. These bonds are eligible as collateral for borrowing from the European Central Bank.

Table 37, page 78, shows a 3.6% fall in the value of the trading portfolio and other financial assets at fair value through profit or loss representing 703 million Euros from 2009 to 2010. The drop occurred in spite of the net acquisition of sovereign debt securities, in particular Portuguese ones, to the amount of 1.663 billion Euros. This resulted in a 9.4 percentage point increase in the proportion of these securities in the portfolio (see Table 38, page 79). The reduction in value was essentially due to a 44.4% (1.355 billion Euros) drop in debt securities from other issuers and a 21.3% (636 million Euros) fall in other securities. Derivatives, which account for the largest proportion of this portfolio (around 44%), also suffered a decline that, although smaller in terms of percentage, resulted in a 412 million Euros reduction in absolute value. In general, the cause of the fall in value of this portfolio was gross acquisitions of securities that were more than offset by divestments and reclassification of securities to other portfolios, i.e. to those of available-for-sale financial assets and held-to-maturity investments.

As mentioned above, after the change to IAS 39 came into effect in October 2008, financial institutions were allowed to reclassify some non-derivative financial assets classified as for trading or as available-for-sale financial assets to another category of assets.

Table 37, page 78 shows highly significant increases in the value of portfolios of available-for-sale financial assets (43.5%) and held-to-maturity investments (99.2%) in 2010.

[45] See footnote 40, page 72.

Table 37: Financial investments portfolio as at 31 December (2009-2010)

	2009	2010	Average
Financial Assets Held for Trading and Other Assets at Fair Value through Profit or Loss			
Total (million €)	19,787	19,084	-
Annual growth rate	-	*-3.6%*	-
As % of total	*24.7%*	*17.3%*	*21.0%*
Available-for-sale Financial Assets			
Gross amount (million €)	54,103	77,621	-
Annual growth rate	-	*43.5%*	-
As % of total	*67.5%*	*70.2%*	*68.8%*
Impairment (million €)	-840	-522	-
Annual growth rate	-	*-37.8%*	-
As % of total	*-1.1%*	*-0.5%*	*-0.8%*
Held-to-maturity Investments			
Gross amount (million €)	7,186	14,316	-
Annual growth rate	-	*99.2%*	-
As % of total	*8.9%*	*13.0%*	*11.0%*
Impairment (million €)	-35	-50	-
Annual growth rate	-	*43.9%*	-
As % of total	*0.0%*	*0.0%*	*0.0%*
Other [a)]			
Total (million €)	-	49	-
Annual growth rate	-	-	-
As % of total	-	*0.0%*	*0.0%*
Total of financial investments (gross)	81,076	111,070	-
Total impairments	-874	-572	-
Total of financial investments	80,202	110,498	-
Annual growth rate	-	*37.8%*	-

Source: FIs, APB.

[a)] Assets with repurchase agreements.

The increase in the portfolio of available-for-sale financial assets (see Table 38, page 79) was due particularly to the acquisition of debt securities issued by other bodies (totalling 16.474 billion Euros, 43.4% more than in 2009). Bonds issued in credit securitisation operations stood out among these securities in 2010. Acquisitions and reclassifications of sovereign debt securities (to the amount of 6.203 billion Euros, more 68.5% than in 2009), with particular focus on Portuguese public debt securities, also contributed to growth in the portfolio of available-for-sale financial assets. All these acquisitions offset the losses in value of the portfolio in 2010 due to the devaluation of the PSI20, which affected the share component[46], and the sovereign debt market crisis, especially the public debt markets of the peripheral countries. This crisis led to increased risk and yields with negative repercussions on the price of fixed-rate securities.

[46] According to the Banco de Portugal Financial Stability Report (May 2011, p 55), the portfolio of equity securities held by Portuguese banks consisted mainly of shares in resident companies.

Table 38: Financial investments [a) b)] structure by type of portfolio and instrument as at 31 December (2009 – 2010)

	2009		2010		Change	
	million €	%	million €	%	million €	%
Financial Assets Held for Trading and at Fair Value through Profit or Loss						
Debt securities issued by public bodies [c)]	3,891	*19.7%*	5,554	*29.1%*	1,663	*42.7%*
Debt securities issued by other bodies [c)]	3,053	*15.4%*	1,698	*8.9%*	-1,355	*-44.4%*
Shares	1,107	*5.6%*	1,144	*6.0%*	37	*3.3%*
Other securities	2,992	*15.1%*	2,356	*12.3%*	-636	*-21.3%*
Derivatives	8,744	*44.2%*	8,332	*43.7%*	-412	*-4.7%*
Total	19,787	*100.0%*	19,084	*100.0%*	-703	*-3.6%*
Available-for-sale Financial Assets						
Debt securities issued by public bodies [c)]	9,056	*16.7%*	15,259	*19.7%*	6,203	*68.5%*
Debt securities issued by other bodies [c)]	37,917	*70.1%*	54,391	*70.1%*	16,474	*43.4%*
Shares	4,645	*8.6%*	5,926	*7.6%*	1,281	*27.6%*
Other securities	2,485	*4.6%*	2,045	*2.6%*	-440	*-17.7%*
Total	54,103	*100.0%*	77,621	*100.0%*	23,518	*43.5%*
Held-to-maturity Investments						
Debt securities issued by public bodies [c)]	2,004	*27.9%*	5,921	*41.4%*	3,917	*195.5%*
Debt securities issued by other bodies [c)]	5,182	*72.1%*	8,395	*58.6%*	3,213	*62.0%*
Total	7,186	*100.0%*	14,316	*100.0%*	7,130	*99.2%*
Total	81,076		111,021		29,945	*36.9%*

Source: FIs, APB.

[a)] Gross figures without impairment.

[b)] Not including assets with repos.

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

The value of the portfolio of held-to-maturity investments practically doubled from 2009 to 2010 (see Table 37, page 78). Once again, this was due to a substantial increase in investment in debt securities, especially from public issuers (the Portuguese state in particular), and some reclassifications of securities from the portfolio of available-for-sale financial assets to this one (probably those with the highest risk or longest maturity or both).

All together, in aggregate terms, financial investments tended to be dominated by the portfolio of available-for-sale financial assets, which accounted for a highly significant 68.8% of the total (see Table 37, page 78). This may have been due partly to the fact that, as this portfolio is recognised at fair value, variations in value of securities classified as available-for-sale are recorded in reserves and only have an impact on profit or loss if the securities are sold (capital loss or gain) or in the event of impairment. Furthermore, variations in value of debt securities in this portfolio have no prudential effect and so do not affect the financial institutions' regulatory capital.

Table 39: Structure of the securities portfolio by type of instrument as at 31 December (2009 – 2010)

	2009		2010		Change	
	million €	%	million €	%	million €	%
Securities Portfolio [a)]						
Debt securities issued by public bodies [b)]	14,951	*20.7%*	26,734	*26.0%*	11,783	*78.8%*
Debt securities issued by other bodies [b)]	46,152	*63.8%*	64,484	*62.8%*	18,332	*39.7%*
Shares	5,752	*8.0%*	7,070	*6.9%*	1,318	*22.9%*
Other securities	5,477	*7.5%*	4,401	*4.3%*	-1,076	*-19.6%*
Total	72,332	*100.0%*	102,689	*100.0%*	30,357	*42.0%*

Source: FIs, APB.

[a)] Not including assets with repos.

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

Finally, the securities portfolio is dominated by debt instruments as a whole, with an average weight of 86.7% of the total in the last two years (see Table 39). Practically 100% of the increase in the securities portfolio from 2009 to 2010 was due to debt instruments, in which around 39% was from the issue of public debt instruments. These instruments had the highest growth in percentage against 2009 (78.8%). The share portfolio is not very significant in the securities portfolio of the financial institutions in the sample and represented an average of only 7.5% of the total in the last two years.

VII.1.5. Funding structure

Deposits from customers stood out in the APB member institutions' funding of activity and accounted for an average of close to 40% of their aggregate balance sheet in the last four years.

A more detailed analysis of deposits from customers at the financial institutions in the sample for 2009 – 2010[47] shows that they grew 4.0% last year. This growth reflected net funds of around 7.4 billion Euros, which is all the more important because it is around double the funds attracted in 2009, as already mentioned (see Table 40, page 81).

An increase in interest on deposits offered by most of the member institutions in the fourth quarter of 2010 was decisive here and was able to attract considerable funds.

As deposits from customers are fundamental to the structural stability of the banking business, encouraging them is of vital importance to the survival of the sector today and an essential condition, along with other measures, for the recovery of investors' trust and a return to normal funding from the international debt and capital markets by the member institutions. Continued dependency on the European Central Bank as an alternative way of overcoming difficulties in obtain funding on the international wholesale markets is not sustainable.

[47] See footnote 40, page 72.

Table 40: Deposits from customers as at 31 December (2009-2010)

	2009	2010	Average
Demand Deposits			
Total (million €)	56,416	55,938	-
Annual growth rate	-	*-0.8%*	-
As % of total	*30.8%*	*29.4%*	*30.1%*
Term Deposits			
Total (million €)	106,503	117,387	-
Annual growth rate	-	*10.2%*	-
As % of total	*58.2%*	*61.6%*	*59.9%*
Other Funds			
Total (million €)	20,191	17,185	-
Annual growth rate	-	*-14.9%*	-
As % of total	*11.0%*	*9.0%*	*10.0%*
Total deposits from customers	183,110	190,510	-
Annual growth rate	-	*4.0%*	-

Source: FIs, APB.

Table 40 also shows that term deposits were the main component of deposits from customers (averaging practically 60% of the total in the last two years) and were the driving force behind growth in these deposits in 2010.

With regard to deposits from other credit institutions, Table 41, page 82, shows the difficulty in access to funding from the interbank market experienced by the financial institutions in the sample, essentially resulting from contagion of Portugal's sovereign debt crisis to its financial institutions.

The mere 0.8% growth in this item in 2010 shows the member institutions' inability to restore deposits and loans to 2009 levels, which was reflected by net reductions, which in the case of deposits was highly significant at 8.876 billion Euros. Only repo sale operations showed a favourable performance and grew around 7.339 billion Euros, or 146.5% in 2010 (see Table 41, page 82). The considerable importance of these operations in 2010 in view of the contraction in more traditional items shows the great dependency of the financial institutions in the sample on shorter-term money market operations for their borrowing. In a scenario in which access to longer-term funding on the interbank market is practically closed to Portuguese financial institutions because of its high cost, repo sale operations are an important alternative source of finance, as repos have a low credit risk and therefore a lower funding cost.

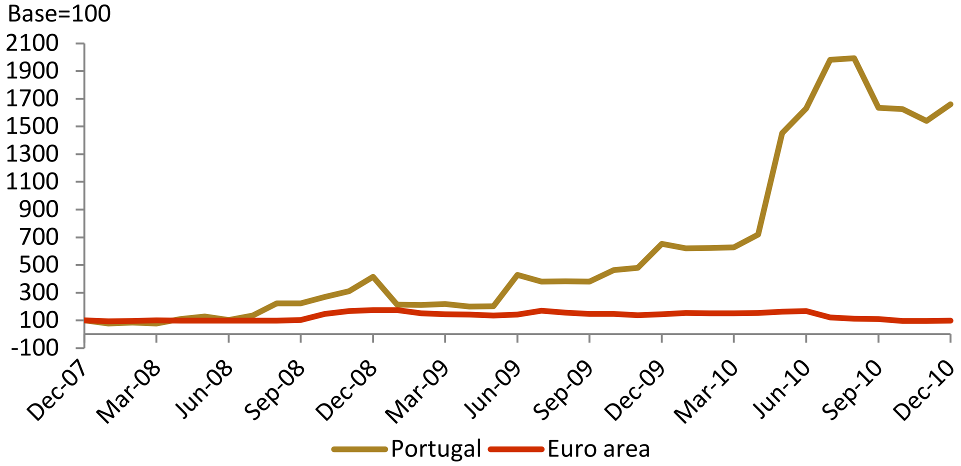
Table 41: Deposits from other credit institutions as at 31 December (2009-2010)

	2009	2010	Average
Deposits			
Total (million €)	62,116	53,240	-
Annual growth rate	-	*-14.3%*	-
As % of total	*78.3%*	*66.6%*	*72.5%*
Interbank Money Market Funds			
Total (million €)	701	974	-
Annual growth rate	-	*38.9%*	-
As % of total	*0.9%*	*1.2%*	*1.1%*
Loans			
Total (million €)	5,878	5,766	-
Annual growth rate	-	*-1.9%*	-
As % of total	*7.4%*	*7.2%*	*7.3%*
Sale Operations with Repurchase Agreements			
Total (million €)	5,008	12,347	-
Annual growth rate	-	*146.5%*	-
As % of total	*6.3%*	*15.5%*	*10.9%*
Other Funds			
Total (million €)	5,641	7,633	-
Annual growth rate	-	*35.3%*	-
As % of total	*7.1%*	*9.5%*	*8.3%*
Total	79,344	79,960	-
Annual growth rate	-	*0.8%*	-

Source: FIs, APB.

Meanwhile, 2010 was deeply marked by the member institutions' growing recourse to funding from the European Central Bank, a trend that had begun in 2009 (see Graph 41).

Graph 41: Recourse to funding from the European Central Bank by the national financial institutions against the euro area



Source: BdP, Banco de España.

This graph clearly shows how recourse to funding from the ECB by Portuguese financial institutions shot up in comparison to its growth in the entire euro area. In 2010 alone, borrowing from the ECB by the financial institutions in the sample increased 172.1% to 44.213 billion Euros, which represented 55.3% of the total accumulated borrowing by the sample from other credit institutions in the interbank market (see Table 42 and Table 41, page 82).

Table 42: Deposits from central banks as at 31 December (2009-2010)

	2009	2010	Average
Deposits from Central Banks			
Total (million €)	16,252	44,213	-
Annual growth rate	-	*172.1%*	-

Source: FIs, APB.

The intervention of the European Central Bank and access to borrowing from the Eurosystem on the part of the member institutions were decisive in dealing with Portugal's sovereign debt crisis, the subsequent fall in its rating and, by extension, the banking sector's crisis in obtaining funding from the international wholesale debt and capital markets.

The negative performance of debt securities issued and other equity instruments (a 19.494 billion Euros drop) was also a reflection of the restrictions on access to funding from the international markets (see Table 43). Meanwhile, most of the issues of securities, especially bonds, in this item in 2010 were placed with institutions belonging to the same banking group as the issuing institution.

Table 43: Debt securities issued and other equity instruments as at 31 de December (2009-2010)

	2009	2010	Average
Debt securities issued			
Total (million €)	86,385	69,120	-
Annual growth rate	-	*-20.0%*	-
As % of total	*85.5%*	*84.8%*	*85.1%*
Subordinated Liabilities			
Total (million €)	14,556	12,333	-
Annual growth rate	-	*-15.3%*	-
As % of total	*14.4%*	*15.1%*	*14.8*
Equity Instruments			
Total (million €)	95	89	-
Annual growth rate	-	*-6.3%*	-
As % of total	*0.1%*	*0.1%*	*0.1%*
Total	101,036	81,542	-
Annual growth rate	-	*-19.3%*	-

Source: FIs, APB.

With an average weight of 85.1% in the item, the debt securities issued (certificates of deposit, bonds and others) accounted for 88.6% of this negative performance in 2010 (see Table 44). In particular, certificates of deposit and other liabilities fell very sharply (10.387 and 5.594 billion Euros, respectively), which led to a substantial decrease in their proportion in the longer-term borrowing structure of the financial institutions in the sample. Bonds also experienced a net reduction in 2010 (2.0%), though they were still the most important long-term finance instruments.

Finally, subordinated liabilities showed a net decrease of 2.223 billion Euros in 2010 and contributed 11.4% to the reduction in debt securities issued and other equity instruments (see Table 43, page 83).

Table 44: Debt securities issued and subordinated liabilities as at 31 December (2009-2010)

	2009		2010		Change	
	million €	%	million €	%	million €	%
Debt Securities Issued						
Certificates of deposit	12,258	*14.2%*	1,871	*2.7%*	-10,387	*-84.7%*
Bonds	64,057	*74.2%*	62,773	*90.8%*	-1,284	*-2.0%*
Other liabilities	10,070	*11.6%*	4,476	*6.5%*	-5,594	*-55.6%*
Total	86,385	*100.0%*	69,120	*100.0%*	-17,265	*-20.0%*
Subordinated Liabilities [a]						
Loans	3,410	*26.8%*	2,477	*22.7%*	-933	*-27.4%*
Bonds	9,236	*72.7%*	8,412	*77.0%*	-824	*-8.9%*
Other subordinated liabilities	56	*0.5%*	34	*0.3%*	-22	*-39.3%*
Total	12,702	*100.0%*	10,923	*100.0%*	-1,779	*-14.0%*
Total	99,087		80,043			

Source: FIs, APB.

[a] Amounts calculated on the basis of information provided by only seven banking institutions. The totals therefore do not coincide with the value of subordinated liabilities shown in Table 43, page 83.

Annex

Table 45: Off-balance sheet aggregate items as at 31 December 2010

	2010 million €
Guarantees Given and Other Contingent Liabilities	**118,822**
Guarantees and sureties	42,466
Acceptances and endorsements	191
Transactions with recourse	18
Stand-by letters of credit	547
Open documentary credits	4,353
Sureties and indemnities (counter-guarantees)	312
Other personal guarantees given and other contingent liabilities	6,410
Real guarantees (assets pledged as collateral)	64,525
Guarantees Received	**462,642**
Guarantees and sureties	117,197
By acceptances and endorsements	162
By transactions with recourse	0
By stand-by letters of credit	906
By open documentary credits	13
By sureties and indemnities (counter-guarantees)	7,192
Other guarantees received	37,588
Real guarantees (assets received as collateral)	299,584
Commitments to Third Parties	**73,922**
Options on assets (sold)	66
Term operations	238
Term deposits contracts	1,001
Irrevocable credit lines	10,859
Securities subscription	5,968
Commitment for retirement and survivor pensions not yet received	22
Term commitment to make annual contributions to the deposit guarantee fund	437
Potential commitment to the investor indemnity system	109
Other irrevocable commitments	9,339
Revocable credit lines	40,368
Overdraft facilities	3,650
Other revocable commitments	1,865

Table 45: Off-balance sheet aggregate items as at 31 December 2010 (cont'd)

	2010 million €
Commitments by Third Parties	**4,770,852**
Options on assets (bought)	38
Irrevocable credit lines	2,849
Securities subscription	4
Other irrevocable commitments	2,365,351
Revocable credit lines	6
Overdraft facilities	0
Other revocable commitments	2,402,604
Foreign Exchange Operations and Derivative Instruments	**699,820**
Spot foreign exchange operations	3,214
Forward foreign exchange operations – trading	9,994
Forward rate agreement - trading	1,312
Swap operations – trading	545,630
Futures and other forward operations – trading	7,912
Options – trading	56,703
Forward foreign exchange operations – hedging	1,816
Forward rate agreement - hedging	62
Swap operations – hedging	50,560
Futures and other forward operations – hedging	9,988
Options – hedging	1,279
Interest rate guarantee contracts (caps and floors) - hedging	11,350
Responsibilities for Services Provided	**582,510**
Deposit and safeguard of assets	531,588
Amounts for collection	6,958
Assets managed by the institution	43,336
Consigned funds	1
Other	627
Services Provided by Third Parties	**279,849**
Deposit and safeguard of assets	209,924
Amounts for collection	1,906
Assets managed	34
Other services	67,985
Other Off-balance Sheet Items	**-5,004,516**

VII.2. Income statement

VII.2.1. Structure

In aggregate terms, intermediation was the main activity of the member institutions in this report[48] in 2010. Net interest income was the principal source of profit and represented 502.5% of net income before tax (NIBT). Nonetheless, customer services and market activities were almost as important, as their net gains represented 477.3% of NIBT, particularly fees and commissions (274.1% of NIBT).

Table 46: Aggregate income statement (2010)

	2010	
	million €	% NIBT
Interest and similar income	17,454	
Interest and similar expense	-12,359	
Net Interest Income (NII)	**5,095**	***502.5%***
Fee and commission income	3,326	
Fee and commission expense	-547	
Net Gains from Fees and Commissions	2,779	*274.1%*
Net gains from assets and liabilities at fair value through profit or loss	-200	
Net gains from available-for-sale financial assets	429	
Net gains from foreign exchange differences	70	
Net Gains from Financial Operations	299	*29.5%*
Income from equity instruments	1,418	
Net gains from sale of other assets	-29	
Other operating income and expense	373	
Other Results	1,762	*173.8%*
Operating Income (OI)	**9,935**	***979.8%***
Personnel costs	-3,211	
General administrative expenses	-2,151	
Depreciation and amortisation	-446	
Operating Costs	-5,808	*-572.8%*
Gross Operating Results (GOR)	**4,127**	***407.0%***
Provisions net of reversals	106	
Value adjustments relating to loans and advances to customers and receivables from other debtors (net of reversals)	-2,541	
Impairment on other financial assets net of reversals	-415	
Impairment on other assets net of reversals	-263	
Provisions and Similar	-3,113	*-307.0%*
Net Income before Tax (NIBT)	**1,014**	***100.0%***

Source: FIs, APB.

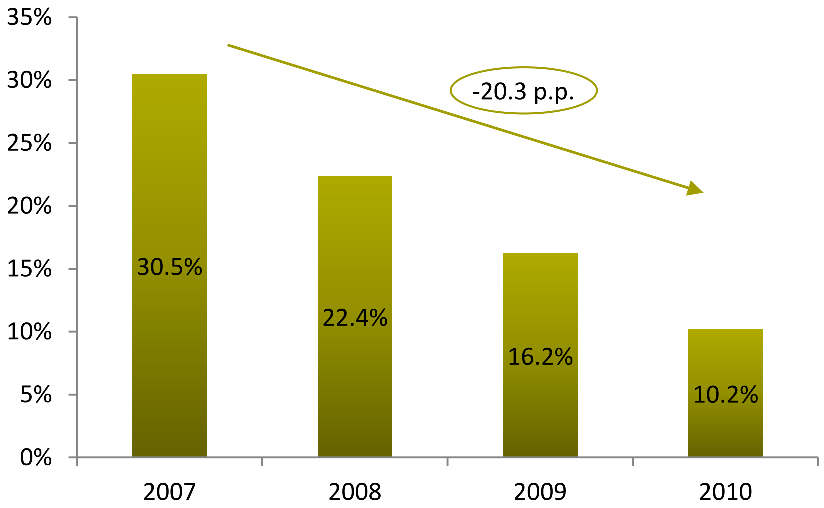
[48] See footnote 2, page 2.

Overall, operating income consisted of 51.3% intermediation margin and 48.7% net gains from customer services and market activities (see Table 46, page 87).

Meanwhile, more than half (58.5%) of operating income was absorbed by operating costs, particularly personnel costs and general administrative expenses. Although to a lesser extent, provisions and similar also constituted a comparable expense for the member institutions and absorbed 31.3% of operating income. As a result, net income before tax was around 10% of operating income (see see Table 46, page 87).

Between 2007 and 2010, the NIBT of the financial institutions in the sample[49] fell by more than two-thirds, at an annual average rate of 30.8% (see Table 47, page 90). This decrease represented a loss of 20.3 percentage points in NIBT, as a percentage of operating income (see Graph 42).

Graph 42: Net income before tax as % of operating income (2007 – 2010)



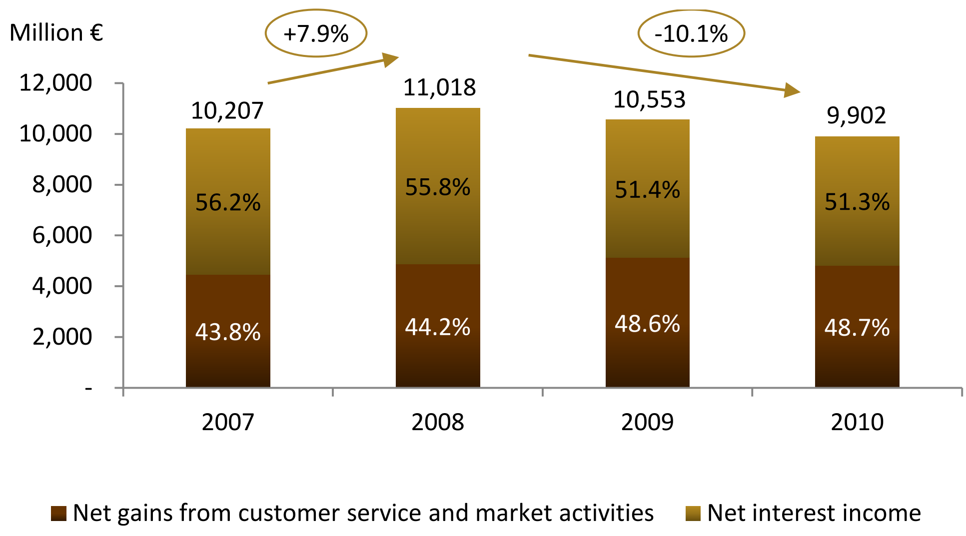
Source: FIs, APB.

The downward trend in operating income contributed to this substantial drop, as it fell by an average of 5.2% a year between 2008 and 2010 (see Table 47, page 90 and Graph 43, page 89).

This time-series analysis also shows the contraction in net interest income in the period as an absolute figure in the last two years and by reference to operating income as a whole. While the former fell by an annual average of 3.6% (9% between 2008 and 2010), the latter dropped only 0.8% (5.2% between 2008 and 2010) (see Table 47, page 90). Intermediation has therefore been gradually losing importance as a source of profit against customer services and market activities (in 2007 net interest income represented 56.2% of operating income while in 2010 it was only 51.3%). This loss was greater from 2008 to 2009 (see Graph 43, page 89).

[49] See footnote 15, page 22.

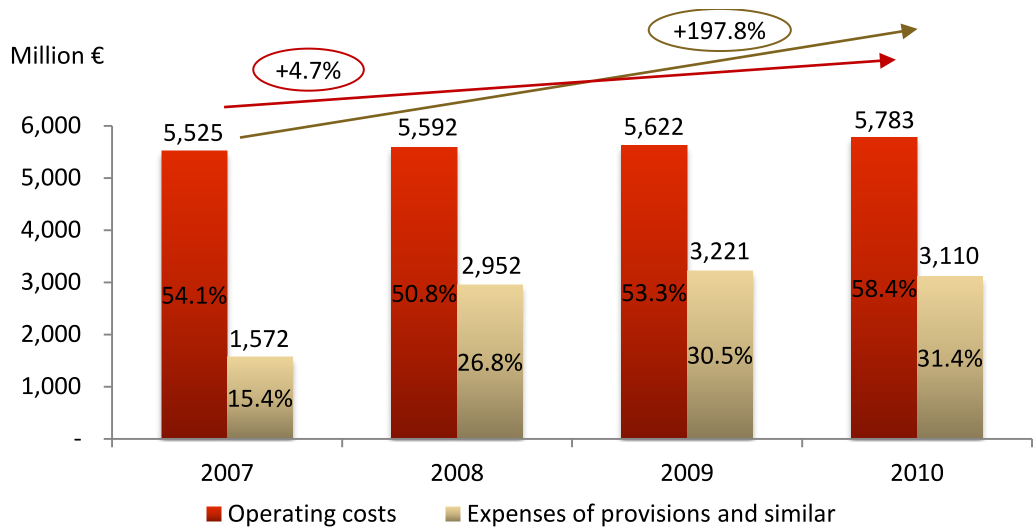
Graph 43: Operating income, net interest income and other results (2007 – 2010)



Source: FIs, APB.
Note: %s of operating income.

The albeit varying growth in operating costs and annual expenses of provisions and similar also contributed to the fall in net income before tax (see Table 47, page 90 and Graph 44).

Graph 44: Operating costs and annual expenses of provisions and similar (2007 – 2010)



Source: FIs, APB.
Note: %s of operating income.

Operating costs are traditionally the weightiest cost component in operating income. Between 2007 and 2010, they accounted for an average of 54.2% of this income. Their annual average growth was quite moderate in the period, however (around 1.5%), reflecting attempts at containing them (see Graph 44 and Table 47, page 90). The performance of annual expenses of provisions and similar was very different. These expenses grew substantially, particularly in 2008, having practically doubled in the period (in absolute value and as a percentage of operating income) (see Graph 44, page 89 and Table 47). Because they grew more than operating costs, annual expenses of provisions and similar gained importance in total expenses (22.2% in 2007 v. 35.0% in 2010).

Table 47: Main items in the aggregate income statement (2007 – 2010)

	2007	2008	2009	2010	Average
Net Interest Income (NII)					
Total (million €)	5,732	6,149	5,427	5,083	-
Annual growth rate	-	*7.3%*	*-11.7%*	*-6.3%*	*-3.6%*
Operating Income (OI)					
Total (million €)	10,207	11,018	10,553	9,902	-
Annual growth rate	-	*7.9%*	*-4.2%*	*-6.2%*	*-0.8%*
Operating Costs (OC)					
Total (million €)	5,525	5,592	5,622	5,783	-
Annual growth rate	-	*1.2 %*	*0.5%*	*2.9%*	*1.5%*
Provisions and Similar (PS)					
Total (million €)	1,572	2,952	3,221	3,110	-
Annual growth rate	-	*87.8%*	*9.1%*	*-3.4%*	*31.2%*
Net Income before Tax (NIBT)					
Total (million €)	3,110	2,474	1,710	1,009	-
Annual growth rate	-	*-20.5%*	*-30.9%*	*-41.0%*	*-30.8%*

Source: FIs, APB.

VII.2.2. Net interest income[50]

The reduction in net interest income from 2009 to 2010 was essentially due to a decrease in interest and similar income. Although interest and similar expenses fell more in relative terms (18.2% v. 15.5%), their decrease in absolute terms was not enough to offset that of interest and similar income (2,668 v. 3,072) (see Table 48, page 91). Several items contributed to the performance of this component, especially interest on credit, interest on financial assets at fair value through profit or loss and interest on hedging derivatives, given their weight in the total.

[50] This more detailed analysis was based on 29 member institutions. Barclays, BIG and Finantia did not provide broken down data and BNP SS was not a member institution in 2009.

Table 48: Breakdown of aggregate net interest income (2009 – 2010)

	2009	2010		Change	
	million €	million €	%	million €	%
Interest and Similar Income (ISI)					
Interest on credit	9,805	7,854	*46.8%*	-1,951	*-19.9%*
Interest on financial assets at fair value through profit or loss	4,545	3,692	*22.0%*	-853	*-18.8%*
Interest on deposits and loans and advances to central banks	59	47	*0.3%*	-12	*-20.3%*
Interest on deposits and loans and advances to other credit institutions	1,033	726	*4.3%*	-307	*-29.7%*
Interest on available-for-sale financial assets	1,074	1,360	*8.1%*	286	*26.6%*
Interest on hedging derivatives	2,168	1,950	*11.6%*	-218	*-10.1%*
Interest on held-to-maturity investments	179	323	*1.9%*	144	*80.4%*
Other interest and similar income	998	837	*5.0%*	-161	*-16.1%*
Total	19,861	16,789	*100.0%*	-3,072	*-15.5%*
Interest and Similar Expense (ISE)					
Interest on deposits from central banks	118	345	*2.9%*	227	*192.4%*
Interest on deposits from other credit institutions	1,557	1,003	*8.4%*	-554	*-35.6%*
Interest on debt securities issued	2,195	2,286	*19.1%*	91	*4.1%*
Interest on deposits from customers	3,266	2,332	*19.5%*	-934	*-28.6%*
Interest on hedging derivatives	1,859	1,590	*13.3%*	-269	*-14.5%*
Interest on subordinated liabilities	581	415	*3.5%*	-166	*-28.6%*
Other interest and similar expense[51]	5,067	4,004	*33.4%*	-1,063	*-21.0%*
Total	14,643	11,975	*100.0%*	-2,668	*-18.2%*
Net Interest Income (NII)	5,218	4,814	-	-404	*-7.7%*

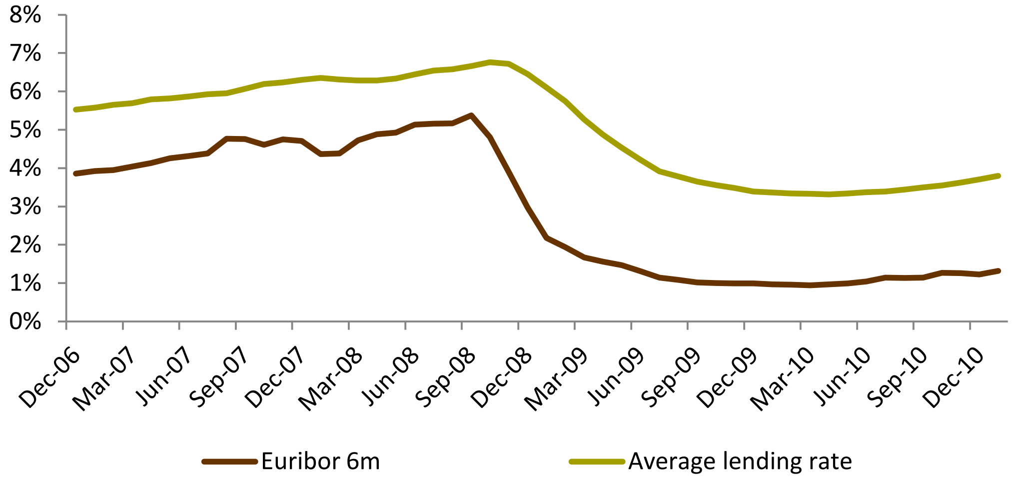
Source: FIs, APB.

Graph 45, page 92 shows changes in Euribor (6 months) and the average lending rate in the Portuguese banking system between December 2006 and 2010. It demonstrates that this rate tends to accompany Euribor (the rate normally used as an indexer in lending operations) although with some time lapses. This performance is expectable in view of the weight of loans to customers at variable rates and the importance of mortgages in total credit (where the spreads remain unchanged for the duration of the loan).

As a result of the ongoing fall in Euribor since September 2008 to all-time lows at the end of the first quarter of 2010, the average lending rate also began a downward trend, though only as of November 2008.

[51] This item includes interest on financial liabilities held for trading, which accounted for around 58.0% of all other interest and similar expense in 2010. As no breakdown was available for 2009, it was not possible to conduct an analysis of the performance of this item.

Graph 45: Euribor (6m) and average lending rate in the Portuguese banking system (2006 – 2011)



Source: Bloomberg, BdP, APB.

Note: The average lending rate was obtained by weighting monthly interest rates on balances of loans granted by monetary financial institutions resident in the euro area by the end-of-month balance (data from the Banco de Portugal Statistical Bulletin, May 2011).

It is, however, worth noting the wider difference between this average rate and Euribor after this date, which had to do with the simultaneous increase in spreads on lending[52]. The downward trend in the average lending rate was therefore not as pronounced as that of Euribor. The difference between the two rates widened particularly in 2009 (close to 302 basis points on average) due partly to the economic crisis, the general increase in risk and the need for greater selectiveness and restraint in granting loans, given the banking sector's growing borrowing difficulties. The difference narrowed in 2010, however (averaging 234 basis points), as a result of a reduction in higher-risk credit and competition factors[53] that mitigated the impact of higher spreads on new lending operations.

Even though the drop in the average lending rate was not so accentuated, for the reasons mentioned above, it still had an adverse effect on the return on lending by the APB member institutions in 2009 and 2010. After reaching its lowest in April 2010, the rate recovered again, though by the end of the year it had only reached a level close to that of September 2009. This recovery was not enough to offset the impact of the downward trend since the beginning of 2009, and the average rate on lending operations in 2010 was therefore around 94 basis points below the average for 2009. Considering that loans and advances to customers on the balance sheet remained practically unchanged from 2009 to 2010, the 19.9% fall in interest on credit in the year (see Table 48, page 91) was essentially the result of an interest-rate effect.

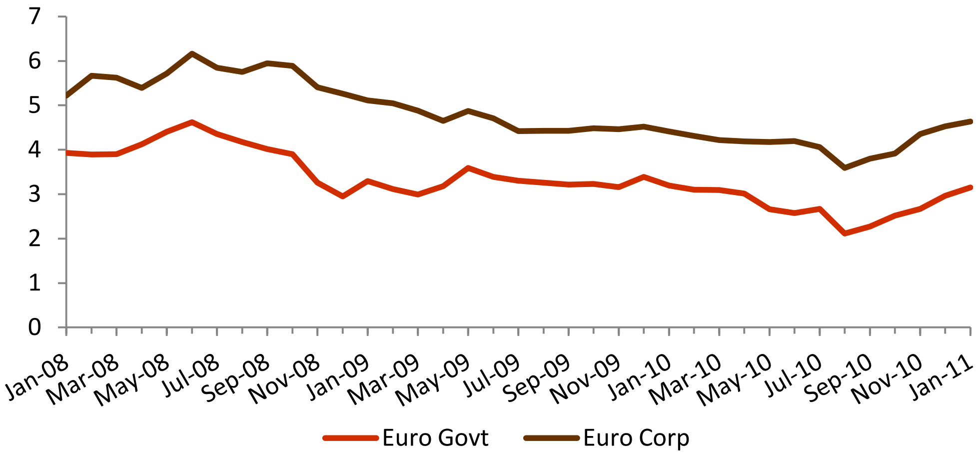
The 18.8% reduction in interest on financial assets at fair value through profit or loss seems to have come from a simultaneous price effect and a change in portfolio mix. Indeed, the considerable acquisition of public debt securities in 2010, particularly Portuguese public debt,

[52] With an immediate repercussion on loans to companies.

[53] Banco de Portugal Financial Stability Report (May 2011).

associated with the reclassification of securities from the same issuer (from the portfolio of assets held for trading to other investment portfolios) may be related to a change in maturity mix (i.e. an increase in the portfolio of shorter-term securities (such as T-bills) and an exit from longer-term ones (e.g. treasury bonds)), leading to a reduction in associated interest. Meanwhile, the absence of any further information on the aggregate composition and changes in the APB member institutions' trading portfolios from 2009 to 2010 makes it impossible to perform a more accurate analysis. Finally, the high turnover in the trading portfolio makes its return vulnerable to the performance of yields in the international debt markets, which have shown a general downward trend since 2008 (see Graph 46). This may also point to an accentuation of the price effect and help to explain the fall in interest in this portfolio in 2010.

Graph 46: Yields-to-maturity on European sovereign debt and bonds issued by European companies (10-year) (2008 – 2011)



Source: Bloomberg.

Note: Euro Govt refers to European sovereign debt.

Euro Corp refers to bonds issued by European companies.

The fall in interest on hedging derivatives in the period was largely caused by a volume effect. Due to the ongoing downgrade of Portugal's rating and that of Portuguese financial institutions, the risk involved in operations with these institutions increased (including the counterparty risk in hedging operations). As a result, the number of hedging operations or amounts traded fell and caused a reduction in the corresponding interest.

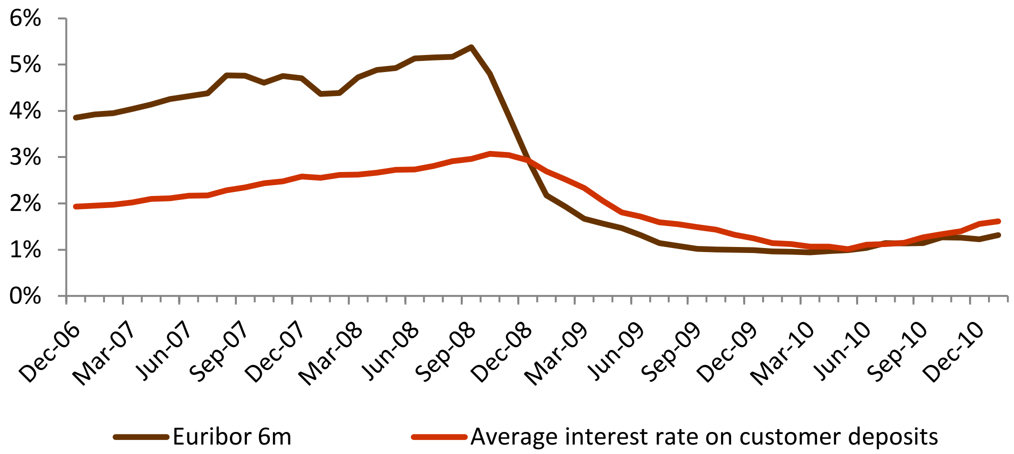
Also in the context of interest and similar income, it is worth noting the variation in interest on available-for-sale financial assets, on held-to-maturity investments and on cash and deposits at other credit institutions, despite their lower weight in the total.

The joint increase in interest on the above two investment portfolios (430 million Euros) (see Table 48, page 91) made a positive contribution to aggregate net interest income. The growth in interest on available-for-sale financial assets and held-to-maturity investments was largely the result of a volume effect, given the substantial increase in these portfolios in 2010, for the reasons given in Chapter VI.

Meanwhile, interest on deposits, loans and advances to other credit institutions fell 29.7% in 2010, representing a drop of 307 million Euros, which helped accentuate the total reduction in interest and similar income (see Table 48, page 91). This fall was due to a joint volume effect (because of the reduction in the balance on the balance sheet following growing liquidity difficulties in the banking sector) and price effect (due to the reduction in annual average Euribor from 2009 to 2010).

Interest on deposits from customers was decisive in the performance of the second component in net interest income, i.e. the fall in interest and similar expenses in 2010 (see Table 48, page 91). The joint performance of Euribor (6 months) and the average interest rate on customer deposits in the Portuguese banking system from December 2006 to December 2010 helps explain the performance of interest on deposits from customers in 2010 (see Graph 47).

Graph 47: Euribor (6m) and average interest rate on customer deposits in the Portuguese banking system (2006 – 2011)



Source: Bloomberg, BdP, APB.

Note: The average interest rate on customer deposits was obtained by weighting monthly interest rates on deposit balances with agreed maturity from residents in the euro area at monetary financial institutions by their end-of-month balance (data from Banco de Portugal Statistical Bulletin (May 2011)).

Traditionally, deposits from customers are the least costly source of funding for the banking system. The performance of the average interest rate on these deposits against Euribor between December 2006 and December 2008 confirms this (see Graph 47). The start of the very fast drop in Euribor in September 2008 had a practically immediate effect on the average interest rate on customer deposits, bringing it down continuously until May 2010. The fall was, however, much less accentuated than that of Euribor, thanks to the dominant weight of term deposits in the deposits from customers portfolio. This led to the atypical situation that has been felt since January 2009, characterised by average interest rates on customer deposits consistently higher than Euribor (see Graph 47). Meanwhile, the gap tended to close between the rates, and their proximity was highest in August 2010. After this, in spite of the reversal of the fall in Euribor, average borrowing rates took off and began a faster rise than Euribor. This has been caused by a rise in interest offered on new or renewed customer deposit operations in a bid by the banking sector to attract more stable funds.

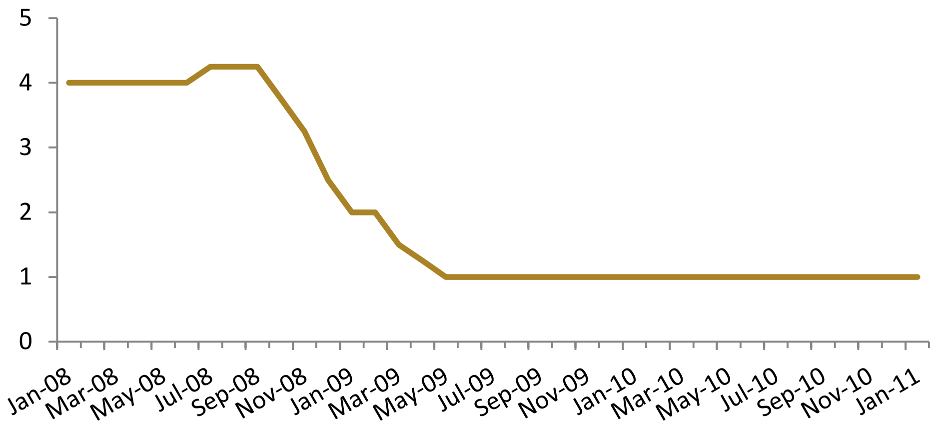
The fact that all the financial institutions are working towards the same goal and are therefore placing greater competitive pressure on interest rates on deposits has also contributed to the process.

In spite of the aforementioned rise in interest on customer deposits in late 2010, its value at the end of the year was only the same as that of August 2009. As a result, the annual average interest rate on deposits in 2010 was 61 basis points lower than that in 2009. As there was a 4.1% increase in deposits from customers on the balance sheet in 2010, the 934 million Euros reduction in corresponding interest during the year (see Table 48, page 91) can only be mainly explained by the reduction in these annual averages. The positive volume effect was not enough to offset the interest-rate effect.

The 554 million Euros variation in interest on deposits from other credit institutions was mainly due to a change in composition of the item. Selling operations with repos gained weight against deposits and loans. Repos have a low credit-risk and are therefore a cheaper alternative source of funding.

Even though the variation in percentage and as an absolute value of interest on debt securities issued was insignificant in 2010, it is important to remember the item's importance in total interest and similar expenses (19.1%). A price effect seems to be predominantly behind the 91 million Euros increase (see Table 48, page 91) in interest on debt securities issued. Indeed, the difficulties experienced by the APB member institutions in accessing the international wholesale finance markets, reflected by a higher cost of funding, led to a significant net reduction in these liabilities on the balance sheet. The 4.1% growth in corresponding interest is largely explained by the current prices asked in the international markets for any new funding operations entered into by the member institutions in 2010.

Graph 48: ECB Refi rate (2008 – 2010)



Source: Bloomberg.

Finally, in the above scenario of a serious reduction in access to the international wholesale debt markets, the member institutions sought to cover their liquidity needs by growing recourse to funding from the Eurosystem, particularly in 2010. Deposits from central banks on the balance sheet increased substantially from 2009 to 2010. As this funding is obtained at highly favourable interest rates and these rates have remained stable since mid-2009 (see Graph 48, page 95), the considerable increase in interest on deposits from central banks (+192.4%, or 227 million Euros) is exclusively due to the volume effect.

In short, net interest income fell 404 million Euros from 2009 to 2010 as a result of a decrease in interest and similar income. This performance was mainly due to the negative interest rate effect, which particularly affected interest on credit. On the other hand, the decrease in margin was partially offset by a reduction in interest and similar expenses, also due to an interest-rate fall effect (especially in interest on deposits from customers).

VII.2.3. Customer services and market activities

Banking services made the largest contribution to the total net gains from customer services and market activities by the financial institutions in the sample[54] in 2010 and represented 57.7% of those net gains (NGCSM) (see Table 49). Net gains from financial operations were of little importance (6.1% of NGCSM), while other results, coming essentially from income from equity instruments, accounted for 36.2% of the total.

Table 49: Breakdown of net gains from customer services and market activities (2009 – 2010)

	2009	2010		Change	
	million €	million €	% NGCSM	million €	%
Net Gains from Fees and Commissions (NGFC)					
Fee and commission income	3,008	3,324	*69.0%*	316	*10.5%*
Fee and commission expense	-525	-547	*-11.3%*	-22	*4.2%*
Total	2,483	2,777	*57.7%*	294	*11.8%*
Net Gains from Financial Operations (NGFO)					
Net gains from assets and liabilities at fair value through profit or loss	280	-200	*-4.2%*	-480	*-171.4%*
Net gains from available-for-sale financial assets	340	429	*8.9%*	89	*26.2%*
Net gains from foreign exchange differences	-22	67	*1.4%*	89	*404.5%*
Total	598	296	*6.1%*	-302	*-50.5%*
Other Results (OR)					
Income from equity instruments	1,450	1,418	*29.4%*	-32	*-2.2%*
Net gains from sale of other assets	289	-29	*-0.6%*	-318	*-110.0%*
Other operating income and expense	306	357	*7.4%*	51	*16.7%*
Total	2,045	1,746	*36.2%*	-299	*-14.6%*
Net Gains from Customer Services and Market Activities (NGCSM)	5,126	4,819	*100.0%*	-307	*-6.0%*

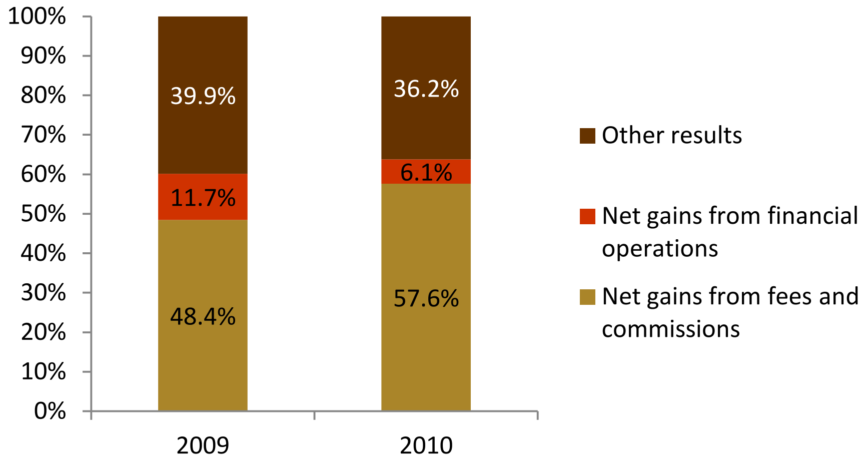
Source: FIs, APB.

[54] For the purpose of this subchapter, the sample comprises the same 31 financial institutions as the analysis for 2007 – 2010 (See footnote 15, page 22).

From 2009 to 2010, net gains from customer services and market activities fell 6.0% (307 million Euros), driven almost equally by losses on financial operations (302 million Euros) and other losses (299 million Euros). Only net gains from fees and commissions made a positive contribution (294 million Euros), though it was insufficient to offset the unfavourable performance of market activity (see Table 49, page 96 and Graph 49).

In the period in question, net gains from fees and commissions grew 11.8%, as income from them increased faster than expenses (see Table 49, page 96). The rise in this income was essentially related to an increase in income from banking services.

Graph 49: Net gains from customer services and market activities main items (2009 – 2010)

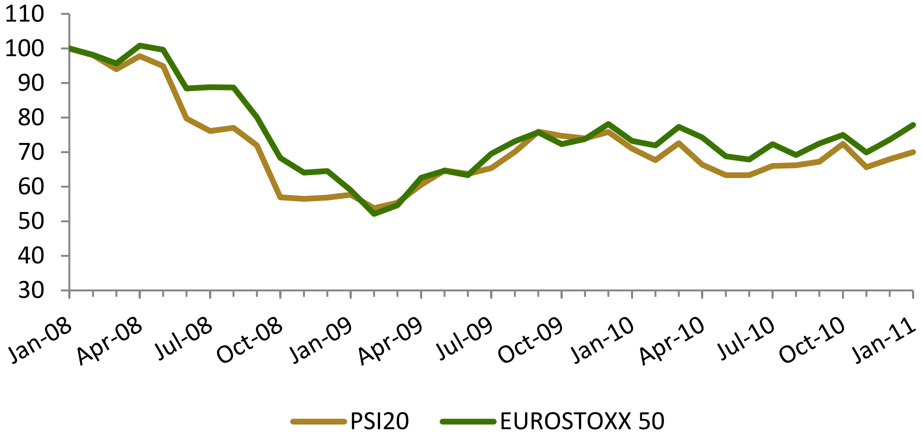


Source: FIs, APB.
Note: % of total net gains from customer services and market activities.

Between 2009 and 2010, net gains from financial operations benefited from the favourable performance of net gains on available-for-sale financial assets and net gains from foreign exchange differences (see Table 49, page 96). The growth in the former (89 million Euros) was the result of some capital gains on equity instruments, in spite of the instability in the PSI20 during the year (see Graph 50, page 98)[55]. The positive performance of net gains from foreign exchange differences (with an annual growth of 404.5%, also corresponding to 89 million Euros) reflected gains that resulted largely from the devaluation of the euro against the main currencies in 2010 (see Graph 51, page 98).

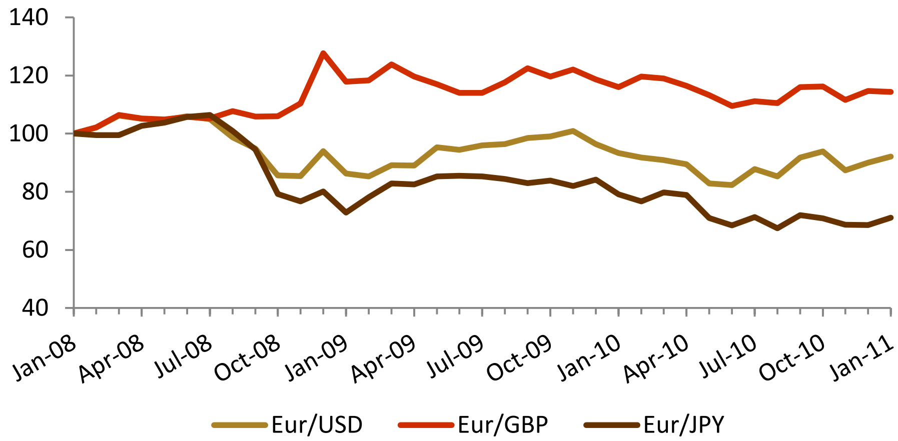
[55] See footnote 46, page 78.

Graph 50: Main share indexes (2008 – 2011)



Source: Bloomberg.

Graph 51: Main foreign exchange markets (2008 – 2011)

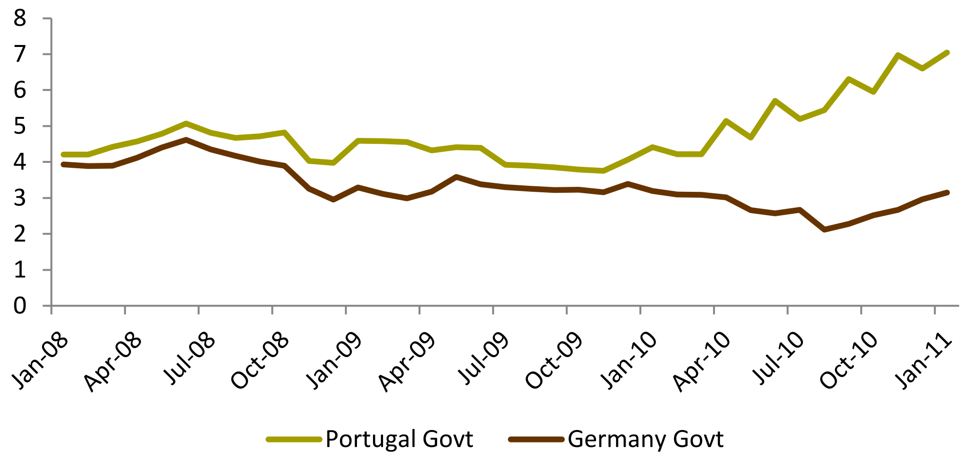


Source: Bloomberg.

While net gains from assets and liabilities at fair value through profit or loss made a positive contribution to net gains from financial operations in 2009, they were the only item in 2010 that brought it down and highly significantly (480 million Euros) (see Table 49, page 96). This sharp reduction was partly the result of recognition of (real or latent) losses in value of equity and debt instruments (especially Portuguese sovereign debt and from other Portuguese issuers), due to a fall in prices on the share markets (especially the PSI20 index) (see Graph 50) and an increase in yields in the Portuguese public debt (see Graph 52, page 99) and Portuguese corporate debt market (see Graph 53, page 99).

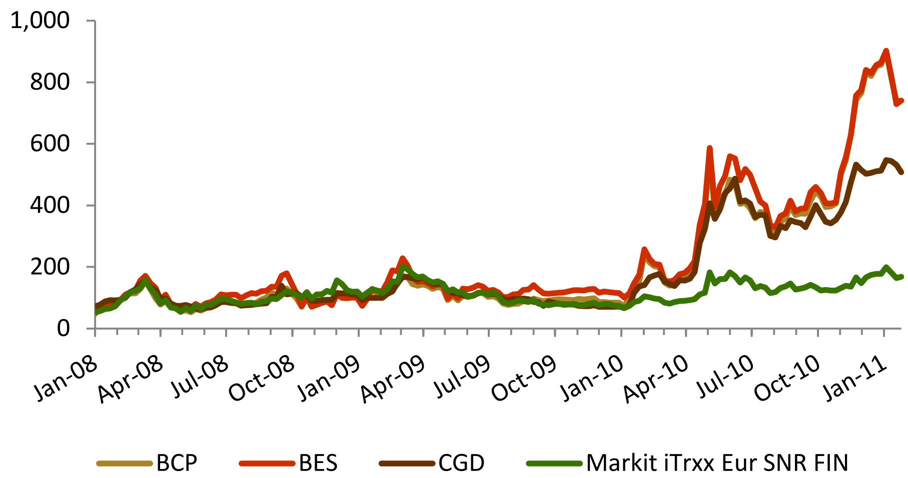
There may, however, have been capital gains recorded under this item from actual divestments of debt securities from other issuers (public or otherwise) during the year in view of the comments made above in the analysis of interest on the portfolio of financial assets at fair value through profit or loss. These capital gains were not, however, sufficient to offset the actual or potential capital losses from reductions in fair value recorded in this item.

Graph 52: Yields-to-maturity on Portuguese and German debt (10-year) (2008 – 2011)



Source: Bloomberg.
Note: Portugal Govt refers to Portuguese sovereign debt.
German Govt refers to German sovereign debt.

Graph 53: Credit default swaps of some member institutions vs. European institutions. Senior debt (5-year) (2008 – 2011)



Source: Bloomberg.

Finally the other results item was particularly important in net gains from customer services and market activities in both years, especially through income from equity instruments (81.2% of total other results), although there was a slight decrease in dividends received by the APB member institutions in 2010.

VII.2.4. Operating costs, provisions and similar[56]

In 2010, non-financial costs (operating costs and provisions and similar) absorbed 89.8% of operating income. Operating costs were the most important (58.4% of net interest income)[57], followed by provisions and similar (31.4%) (see Table 50).

Within operating costs, personnel costs stood out (55.3% of the total) and its importance reflects the highly labour-intensive nature of the banking business. These costs rose 2.2% in 2010 due essentially to pay rises and the hiring of new employees in international activity by some APB member institutions (see Table 50).

Table 50: Breakdown of operating costs, provisions and similar (2009 – 2010)

	2009	2010			Change	
	million €	million €	% Partial	% OI	million €	%
Operating Costs (OC)						
Personnel costs	3,129	3,197	*55.3%*	*32.3%*	68	*2.2%*
General administrative expenses	2,049	2,142	*37.0%*	*21.6%*	93	*4.5%*
Depreciation and amortisation	444	444	*7.7%*	*4.5%*	0	*0.0%*
Total	5,622	5,783	*100.0%*	*58.4%*	161	*2.9%*
Provisions and Similar (PS)						
Provisions net of reversals	-56	-107	*-3.4%*	*-1.1%*	-51	*-91.1%*
Value adjustments relating to loans and advances to customers and receivables from other debtors (net of reversals)	2,658	2,539	*81.6%*	*25.6%*	-119	*-4.5%*
Impairment on other financial assets net of reversals	360	415	*13.3%*	*4.2%*	55	*15.3%*
Impairment on other assets net of reversals	259	263	*8.5%*	*2.7%*	4	*1.5%*
Total	3,221	3,110	*100.0%*	*31.4%*	-111	*-3.4%*
Non-financial Costs (NFC)	8,843	8,893	-	*89.8%*	50	*0.6%*

Source: FIs, APB.

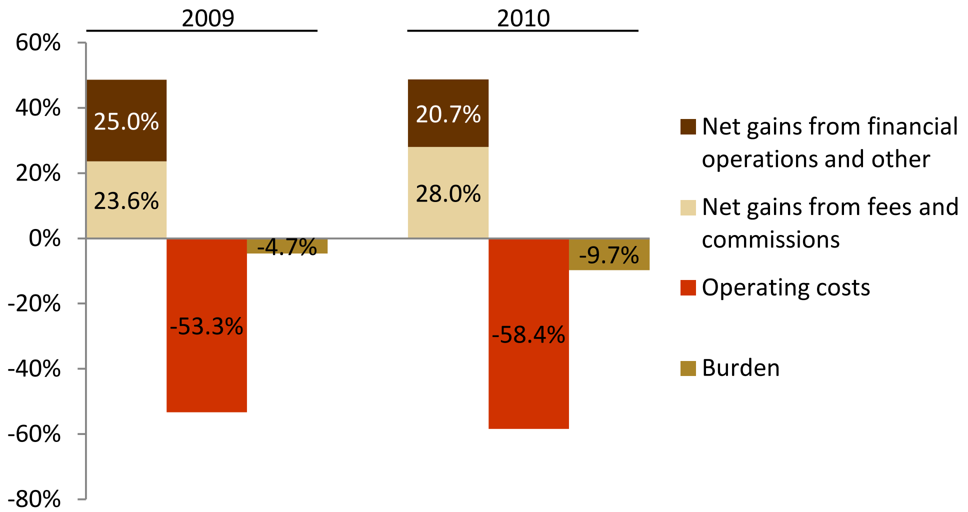
General administrative expenses were the second most important item and accounted for 37.0% of total operating costs. Compared to the previous year, these expenses were the ones that rose the most in absolute value and percentage, mainly as a result of an increase in outsourcing and self-employed work, rents and leases, advertising and IT services (see Table 50).

Considering that operating costs increased by 161 million Euros and net gains from customer services and market activities fell by 307 million during the period, there was an increase in the burden[58] borne by the member institutions (see Graph 54, page 101).

[56] For the purpose of this subchapter, the sample comprises the same 31 financial institutions as the analysis for 2007 – 2010 (See footnote 15, page 22).
[57] The underlying ratio is cost-to-income and indicates the percentage of income generated by intermediation and customer services and market activities absorbed by operating costs.

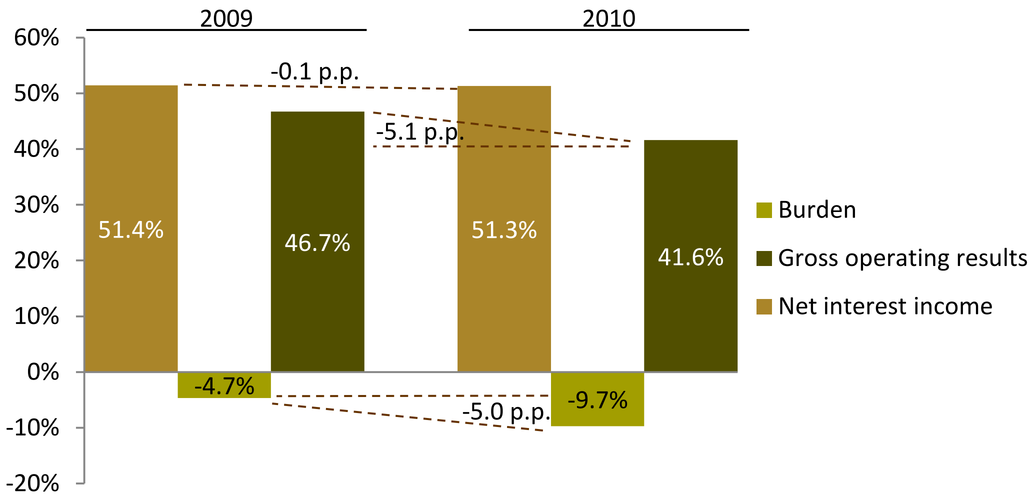
Operating costs consequently absorbed a larger percentage of net interest income. The combined effect of an increase in burden and decrease in net interest income in the year reduced gross operating results in 2010 (see Graph 55).

Graph 54: Burden (2009 – 2010)



Source: FIs, APB.
Note: As % of operating income.

Graph 55: Gross operating results by comparison between net interest income and burden (2009 – 2010)



Source: FIs, APB.
Note: As % of operating income.

[58] A comparison of net gains from customer services and market activities and operating costs shows the pressure of the latter on the former. As operating costs are usually higher, the difference between net gains from these activities and costs is called the burden.

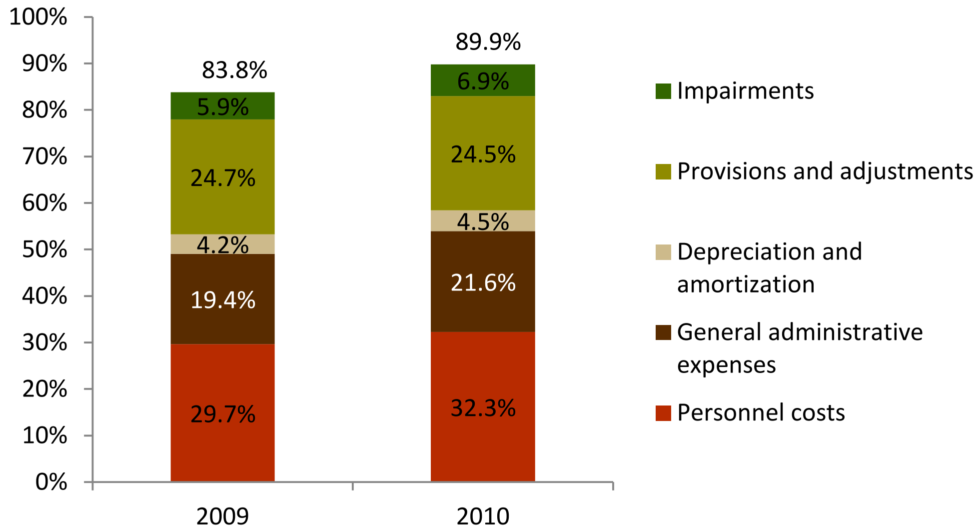
Provisions for value adjustments relating to loans and advances to customers and receivables from other debtors (net of reversals) were particularly important in provisions and similar in 2010 (81.6% of total). The other items were of little relevance, with the exception of impairment on other financial assets net of reversals (13.3%) (see Table 50, page 100).

Total provisions and similar went down 3.4% from 2009 to 2010 mainly as a result of a 4.5% reduction in charges for value adjustments relating to loans and advances to customers and receivables from other debtors (net of reversals) (see Table 50, page 100). In spite of this reduction, charges remained at similar levels to 2009 which, along with an increase in overdue loans, indicated some concern about the performance of default risk.

On the other hand, charges for impairment on other financial assets net of reversals increased (15.3%), mainly due to recognition of impairments on available-for-sale financial assets (see Table 50, page 100). Where these assets are concerned, impairment is only recognised when there is objective proof and the devaluation of the asset exceeds a certain percentage limit. The item in question therefore does not reflect all losses of value of available-for-sale financial assets. When devaluations are below this limit, they are recognised exclusively in reserves.

In short, in all the non-financial costs borne by the APB member institutions (see Graph 56), personnel costs absorb the largest percentage of operating income. This situation was exacerbated in 2010, more by a decrease in operating income (-6.2%) than by any significant growth in operating costs (only 2.9%) (see Table 47, page 90 and Table 50, page 100). Provisions and adjustments come in second and reduced operating income by around 25% in both years. Finally, general administrative expenses are also an important cost and their weight is similar to that of provisions and adjustments.

Graph 56: Weight of non-financial costs in operating income (2009 – 2010)



Source: FIs, APB.
Note: As % of operating income.

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[59])
- 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[60].

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 will be expiring on 31 December 2011. It is worth noting, however, that the tax exemption for income obtained by these branch offices, which does not apply to other companies with their head office and control in

[59] 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.

[60] 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).

Portugal, is limited to 15% of the credit institution's taxable income. This substantially reduces its impact[61].

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[61].

Table 51: Approximate total amount of tax payable to the state in terms of corporate tax in 2009 and 2010. 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

	2009 million €	2010 million €
Net Income before Tax [a)]	**1,533**	**955**
Adjustments for calculation of taxable income / tax loss		
Applicable to all taxpayers subject to corporate income tax:		
Capital gains and impairments in investments (net)	-490	-326
Elimination of double taxation of distributed profits	-1,346	-1,239
Tax benefits	-26	-48
Non-relevant expenses and income for tax purposes	20	27
Provisions for other risks	757	318
Allocation of profits of non-resident companies subject to special tax schemes	177	214
Employment termination and retirement benefits and other post-employment or long-term benefits	-175	-85
Impairments for credit-risk	779	481
Other [b)]	119	-292
Applicable to credit institutions and financial companies:		
Impact of the tax regime on financial branch offices' activity in the Madeira tax-free area	-61	-19
Taxable Income / Tax Loss	**1,287**	**-14**
Use of tax losses from prior years	-54	-56
Tax Base [c)]	**1,346**	**473**
Income tax	328	121
Income Tax Rate (%)	***24.4%***	***25.6%***

Source: FIs, APB.
[a)] Net income before tax of the 27 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).

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[61] 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.

In order to confirm the above tax scheme analysis, an approximate aggregate amount of the corporate income tax payable to the state by member institutions was calculated[62] (see Table 51, page 104). This calculation considered the estimated tax base for 2009 and 2010 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[63] to the tax base calculated in accordance with current taxation rules.

On the basis of the results (see Table 51, page 104), the corporate income tax payable to the state by member institutions is estimated at around 121 million Euros in 2010 (as opposed to 328 million in 2009). This corresponds to an estimated corporate income tax rate of 25.6% (against 24.4% in 2009). According to statistics provided by Direcção Geral dos Impostos (DGI - Directorate-General for Taxation)[64] 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%.

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 2009 and 2010, the amounts paid by the APB member institutions in this respect totalled around 37 and 68 million Euros, respectively (see Table 52).

Table 52: Approximate local taxes, autonomous taxation and income tax levied in foreign countries (2009 – 2010)

	2009 million €	2010 million €
Income tax levied in foreign countries net of the deduction of double taxation	12	37
Autonomous taxation	7	17
Local taxes [a)]	18	14
Total Local Taxes, Autonomous Taxation and Income Tax Levied in Foreign Countries	**37**	**68**

Source: FIs, APB.

[a)] Local taxes were calculated at 1.5% of taxable income in 2009 and 2010, plus an additional 2.5% in 2010 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 53, page 106, these taxes are grouped under the heading operating tax cost.

Parafiscal levies consist of contributions to the CAFEB, social security, SAMS and pension funds. Pension funds account for more than 50% of the total (55.1% in 2009 and 55.8% in 2010).

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[62] For the purpose of this calculation, and because of a shortage of or non applicable data, it was based on 27 of the 33 financial institutions from the sample in this Bulletin. It did not include Barclays, BNP SS, CCCAM, Finantia, Santander Consumer or Montepio.

[63] In 2009 and 2010 this rate was around 25%.

[64] Statistics from the DGCI – IRC - Return form 22 –2007 to 2009 - Table 34 – Average effective rates - www.portaldasfinancas.gov.pt

Table 53: Tax and parafiscal burden in 2009 and 2010[a)]

	2009 million €	2010 million €
Tax Burden		
Operating taxes [b)]	252	277
Parafiscal Burden		
CAFEB	111	103
Single social rate	66	90
Pension expenses	408	441
Other expenses	155	157
Total	740	791
Total	**992**	**1,068**

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 rose 6.9% from 2009 to 2010. This rise was due mainly to pension costs, not only because of the 8.1% growth in the year as a result of an increase in early retirements but also the weight of these costs in total parafiscal levies.

VII.3. Return

The financial institutions in this Activity Report[65] recorded a significant reduction, on aggregate, in return on equity before tax (ROE)[66], going from 6.59% in 2009 to 3.76% in 2010 (see Table 54).

Table 54: Breakdown of ROE (2009 – 2010)

		2009 million €	2010 million €
	Balance Sheet and Income Statement Figures		
ØTA	Average total assets	448,371	473,965
ØFA	Average financial assets	417,999	440,077
ØE	Average equity	24,891	27,227
	+ Interest and similar income	19,861	16,789
	- Interest and similar expense	14,643	11,975
	= Net Interest Income	**5,218**	**4,814**
	+ Net gains from fees and commissions	2,402	2,637
	+ Net gains from financial operations	554	278
	+ Other results	2,003	1,698
	= Operating Income	**10,177**	**9,427**
	- Operating costs	5,405	5,494
	- Provisions and similar	3,132	2,910
NIBT	**= Net Income before Tax**	**1,640**	**1,023**
	Breakdown ROE [a)]		
NIBT/ØTA	**Return on assets before tax (ROA)**	***0.37%***	***0.22%***
ØTA/ØE	x Financial leverage	18.01	17.41
NIBT/ØE	**= Return on equity before tax (ROE)**	***6.59%***	***3.76%***

Source: FIs, APB.

[a)] Due to rounding up or down to hundredths, the product between ROA and financial leverage is not the same as the ROE shown here.

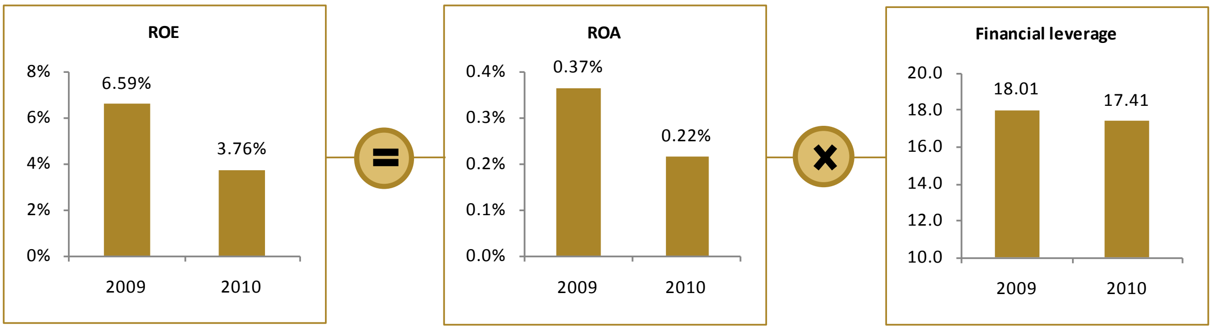
The fall in return on equity before tax in 2010 was due to two mutually increasing effects. On the one hand, there was a substantial increase in average equity, with a growth rate of 9.4%, which was higher than growth in average total assets (5.7%). On the other hand, there was a considerable drop in net income before tax, which went down 37.6% in 2010. This drop was mainly the result of reductions in net interest income, net gains from financial operations and other results and a rise in

[65] The sample used in this chapter is different from the others in this report due to lack of data on quarterly balance sheets and a breakdown of income statements, making it necessary to exclude Barclays, Finantia, BIG and BNP SS from the sample of 33 institutions, which resulted in a total of 29 in this analysis of 2009 and 2010.

[66] The figures for total assets and equity in the calculation of return are averages based on quarterly balance sheets (pursuant to Banco de Portugal Instruction 16/2004). The other balance sheet figures were also calculated on the basis of quarterly balance sheets. Readers should note the incomparability of these figures and those in previous bulletins, as this analysis of return uses net income before tax rather than net income for the year.

operating costs. The combined effect of these variations was greater than the improvements in net gains from fees and commissions and provisions and similar, the latter being mainly due to favourable adjustments in loans and advances to customers.

Graph 57: Breakdown of the effects on ROE

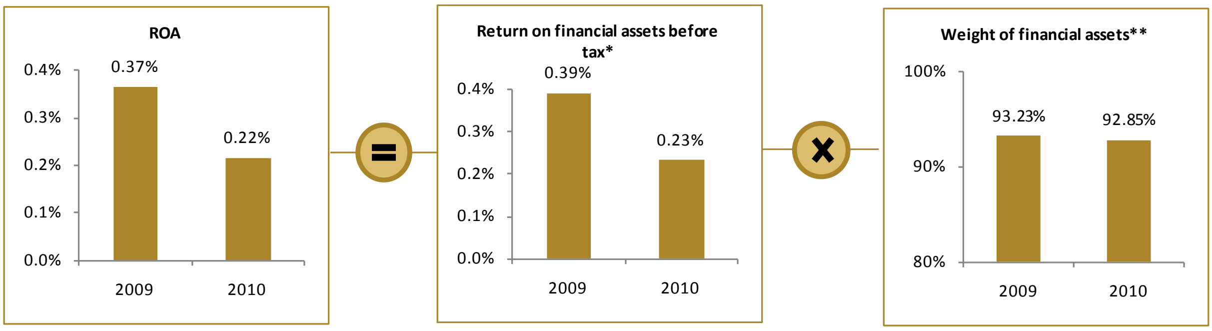


Source: FIs, APB.

It is also possible to break down the effect on return on equity into variations in an institution's return on assets and leverage ratio. The leverage ratio is the ratio between total assets and equity. The average figures for balance sheet variables show that the reduction in ROE was the result of decreases in return on assets before tax (ROA) and lower financial leverage in 2010 (see Table 54, page 107 and Graph 57). Nonetheless, the impact of the fall in ROA was much more decisive than the deleverage process in the reduction in ROE. If financial leverage in 2010 had continued at the 18.01 of 2009, the reduction in ROA from 0.37% to 0.22% would have caused a fall in ROE from 6.59% to 3.89%. The remaining 0.13 percentage point reduction was due to a slight tendency towards deleveraging in aggregate terms by the financial institutions in the sample.

As the reduction in ROA was the most decisive variable in the decrease in ROE, it is important to analyse this variable in more detail. The main items in the income statement as a percentage of average financial assets[67] are therefore shown in order to measure the relative importance of each item (see Table 55, page 109).

Graph 58: Breakdown of the effects on ROA



Source: FIs, APB.

Note: * Return on financial assets before tax = net income before tax / average financial assets.

** Weight of financial assets = average financial assets / total average assets.

[67] The balance sheet items in the definition of financial assets are shown in note b) of Table 29, page 72.

The last part of Table 55 shows that the reduction in ROA was due to two complementary effects: a decrease in return on financial assets before tax from 0.39% to 0.23% and a reduction in the weight of financial assets in total assets (see Graph 58, page 108). Nonetheless, the 0.38 percentage point fall in weight of financial assets had practically no effect on the reduction in ROA.

It is therefore worth conducting a more detailed analysis of return on financial assets in order to identify the reasons for its 16 basis points reduction. Firstly, this reduction was mainly due to a 29 basis points decrease in the rate of return on operating income, although it was partially offset by an improvement in provisions and similar, which contributed nine basis points, and operating costs, which contributed four basis points, although these costs rose 1.6% in absolute terms.

Table 55: Breakdown of ROA (2009 – 2010)

		2009 %	2010 %
	Return as % of Average Financial Assets		
	+ Interest and similar income	4.75%	3.81%
	- Interest and similar expense	3.50%	2.72%
	= Net interest income as % of financial assets	**1.25%**	**1.09%**
	+ Net gains from fees and commissions	0.57%	0.60%
	+ Net gains from financial operations	0.13%	0.06%
	+ Other results	0.48%	0.39%
	= Operating income as % of financial assets	**2.43%**	**2.14%**
	- Operating costs	1.29%	1.25%
	- Provisions and similar	0.75%	0.66%
NIBT/ØFA	**= Return on financial assets before tax**	**0.39%**	**0.23%**
ØFA/ØTA	x Weight of financial assets	93.23%	92.85%
NIBT/ØTA	**= Return on assets before tax (ROA)** [a]	**0.37%**	**0.22%**

Source: FIs, APB.

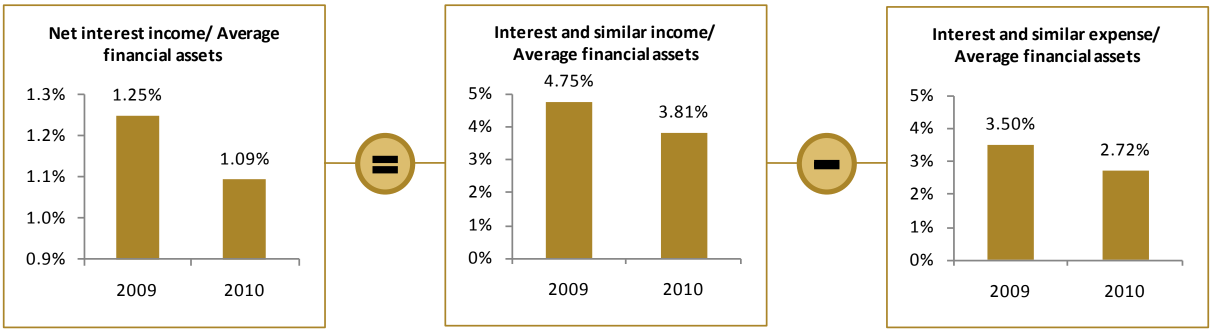
[a] Due to rounding up or down to hundredths, the product between return on financial assets before tax and the weight of financial assets is not the same as the ROA shown here.

Within the 29 basis points reduction in the rate of return on operating income, the decrease in net interest income contributed 16 basis points to the fall in return on financial assets. Net gains from financial operations and other results also contributed to this fall. The net gains from fees and commissions slightly mitigated these reductions, however (see Table 55).

VII.3.1. Breakdown of effects on net interest income

The institutions' financial intermediation underwent profound changes in 2010. Although the 7.7% fall in net interest income in absolute terms was significant, it concealed even more significant reductions in income and costs from interest, which were 15.5% and 18.2%, respectively (see Table 54, page 107).

Graph 59: Breakdown of the effects on net interest income



Source: FIs, APB.

Also in relative terms, as a percentage of average financial assets, it is clear that the APB member institutions experienced significant reductions in aggregate interest received and paid. The effect on income from interest was more pronounced, however, and resulted in a 16 basis points fall in the weight of net interest income in total average financial assets (see Table 55, page 109 and Graph 59).

The database also makes it possible to break down the effects on net interest income in more detail. Table 56, page 111 and Table 57, page 112 show the net interest income items as a percentage of average financial assets and liabilities respectively for 2009 and 2010. They also break down the variation into the composition and interest-rate effect from 2009 to 2010.

For the purpose of this breakdown a link was established between the balance sheet and income statement items. In financial assets (FA), concrete financial assets (FA_i) were associated with concrete items in interest and similar income (ISI_i) whenever possible:

$$\frac{ISI}{FA} = \frac{ISI_1 + ISI_2 + \cdots}{FA} = \sum_i \frac{ISI_i}{FA} = \sum_i \frac{FA_i}{FA} \cdot \frac{ISI_i}{FA_i}$$

The first ratio in the last sum can be interpreted as the weight of each FA_i asset in total financial assets (FA). Variations in this ratio are called the composition effect. Variations in the second ratio are to be interpreted as the interest-rate effect of financial asset FA_i.

It is also possible to identify an equivalent relationship between interest and similar expenses (ISE_i) paid by each financial institution and the items in financial liabilities[68] that originate them (FL_i):

$$\frac{ISE}{FA} = \frac{ISE_1 + ISE_2 + \cdots}{FL} = \sum_i \frac{ISE_i}{FL} = \sum_i \frac{FL_i}{FL} \cdot \frac{ISE_i}{FL_i}$$

Here, variations in the FL_i/FL ratio are interpreted as the composition effect, while variations in ISE_i/ FL_i are the interest-rate effect of the financial liability FL_i.

[68] For the purpose of this analysis, financial liabilities include the following balance sheet items: deposits from central banks, deposits from other credit institutions, debt securities issued, deposits from customers, hedging derivatives, other subordinated liabilities, financial liabilities held for trading, other financial liabilities at fair value through profit or loss, equity instruments and financial liabilities associated with transferred assets.

Table 56: Interest and similar income analysis (2009 – 2010)

	Weight of the Item in Average Financial Assets 2009 %	Weight of the Item in Average Financial Assets 2010 %	Total Change (09/10)	=	Composition Effect	+	Interest-rate Effect
Interest and Similar Income as % of Average Financial Assets [a]							
Interest on credit	2.35%	1.79%	-56 bp	=	-7 bp	+	-49 bp
Interest on financial assets at fair value through profit or loss	1.09%	0.84%	-25 bp	=	-3 bp	+	-22 bp
Interest on deposits and loans and advances to central banks	0.01%	0.01%	0 bp	=	0 bp	+	0 bp
Interest on deposits and loans and advances to other credit institutions	0.24%	0.16%	-8 bp	=	-3 bp	+	-5 bp
Interest on available-for-sale financial assets	0.26%	0.31%	5 bp	=	7 bp	+	-2 bp
Interest on hedging derivatives	0.52%	0.44%	-8 bp	=	-4 bp	+	-4 bp
Interest on held-to-maturity investments	0.04%	0.07%	3 bp	=	3 bp	+	0 bp
Other interest and similar income [b]	0.24%	0.19%	-5 bp	=	n.a.		n.a.
= Interest and similar income [c]	4.75%	3.81%	-94 bp	=	-7 bp		-82 bp

Source: FIs, APB.

[a] Total change, the composition effect and the interest-rate effect are measured in basis points (bp).

[b] It was not possible to break down the total effect for this item because this interest could not be associated with a certain type of financial assets.

[c] The problem in other interest and similar income justifies the fact that the sum of the composition and interest-rate effect is not the same as the total change.

Table 56 shows that more than half the reduction in the weight of interest and similar income was due to a fall in interest on credit, which reduced its weight in financial assets by 56 basis points. The second most significant reduction was in interest on financial assets at fair value through profit or loss. Going against these negative trends are interest on available-for-sale financial assets and interest on held-to-maturity investments, which improved slightly. It also shows that the reductions were largely due to an interest-rate effect of the different financial assets and not their lower weight. As in the total variation, the interest-rate effect is also concentrated mainly in interest on credit and on financial assets at fair value through profit or loss.

Table 57, page 112, contains a similar analysis for interest and similar expense and breaks down the variation in interest paid as a percentage of financial liabilities into the composition effect and interest-rate effect. On the cost side, financial intermediation also made a substantial contribution to the reduction found here. The loss of importance of interest on deposits from customers contributed almost one third to the total 85 basis points reduction.

Table 57: Interest and similar expense (2009 – 2010)

	Weight of the Item in Average Financial Liabilities 2009 %	Weight of the Item in Average Financial Liabilities 2010 %	Total Change (09/10)	=	Composition Effect	+	Interest-rate Effect
Interest and Similar Expense as % of Average Financial Liabilities [a)]							
Interest on deposits from central banks	0.03%	0.08%	5 bp	=	6 bp	+	-1 bp
Interest on deposits from other credit institutions	0.38%	0.23%	-15 bp	=	-4 bp	+	-11 bp
Interest on debt securities issued	0.54%	0.53%	-1 bp	=	-1 bp	+	0 bp
Interest on deposits from customers	0.81%	0.54%	-27 bp	=	-4 bp	+	-23 bp
Interest on hedging derivatives	0.46%	0.37%	-9 bp	=	-5 bp	+	-4 bp
Interest on subordinated liabilities	0.14%	0.10%	-4 bp	=	-2 bp	+	-2 bp
Other interest and similar expense [b)]	1.25%	0.92%	-33 bp	=	n.a.		n.a.
= Interest and similar expense/Average financial liabilities[c)]	3.61%	2.77%	-84 bp	=	-10 bp	+	-41 bp
x Average financial liabilities/Average financial assets	96.9%	98.9%					
= Interest and similar expense/Average financial assets	3.50%	2.72%					

Source: FIs, APB.

[a)] Total change, the composition effect and the interest-rate effect are measured in basis points (bp).

[b)] It was not possible to break down the total effect for this item because this interest could not be associated with a certain type of financial liabilities.

[c)] The problem in other interest and similar expense justifies the fact that the sum of the composition and interest-rate effects is not the same as the total change.

The weight of interest paid on deposits from other credit institutions also fell significantly. A reduction in other interest and similar expense contributed most to this drop. It cannot be broken down due to lack of data however. A breakdown by composition effect and interest-rate effect shows that the 84 basis points reduction in interest and expenses in terms of financial liabilities was mainly due to an interest-rate effect.

In short, it is possible to say that the reduction in return on equity in 2010 was largely the result of lower return on financial assets. The trend could not be reversed with lower weight of interest paid on financial liabilities. The relative and absolute reductions in operating income and net interest income were decisive to the fall in ROE.

VII.4. Solvency

This chapter gives an overview of the solvency of the financial institutions in the sample[69], analyses their situation at the end of 2010 and compares it to developments since the end of 2008.

[69] The sample used in this chapter is substantially different from the others in this Activity Report because branch offices are not subject to capital adequacy rules. This meant that the six branch offices had to be excluded from the sample of 33 financial institutions to make a total of 27 in the analysis of the 2010 data. Furthermore the time analyses (2008 – 2010) do not include Banco BIC or Finantia due to a lack of historical

This analysis is particularly important, as the Portuguese banking system is preparing to face considerable challenges, such as the introduction of Basel III, i.e. new rules on micro-prudential supervision, and the requirements of the Programme of Financial Assistance to Portugal agreed upon in the first half of 2011.

Where micro-prudential supervision is concerned, a financial institution's degree of solvency is called capital adequacy. The financial supervisors require an institution to meet minimum capital ratios, which are calculated by dividing its own funds by its risk-weighted assets. From a prudential point of view, the concept of own funds diverges from the accounting concept, while it recognises the existence of different categories of own funds, which are different in theory because of their capacity to absorb losses. From a prudential viewpoint, the supervision authorities therefore monitor different capital ratios.

The information used in this solvency analysis refers to the separate income statements of the financial institutions in the sample. As Banco de Portugal requires separate or consolidated accounts depending on the institutions' financial structure for supervisory purposes, the data from this analysis are not directly comparable to those from Banco de Portugal on the Portuguese banking system[70]. Nonetheless, the aggregation of the data on an exclusively separate basis does not show that the figures are significantly distorted in relation to those from Banco de Portugal. This is confirmed by the solvency ratio, which was 10.4% for the BdP in 2008 and 11.1% for the financial institutions in the sample. A similar conclusion can be drawn in 2010, when 11.1% was calculated for the solvency ratio at the BdP[71] and 13.1%[72] for the APB sample. Although there is a difference in these solvency ratios, both portray the same positive performance from 2008 to 2010.

VII.4.1. Solvency at the end of 2010

The Portuguese banking system showed great resilience to the financial crisis, in that no financial institutions had to be bailed out by the authorities[73], which was not the case in the United States and a number of European countries, such as the United Kingdom, Iceland or Ireland. No funds from the aid package that the Portuguese government provided to the financial system had been used for recapitalisation by the end of 2010. Some financial institutions used guarantees provided by the Portuguese government when issuing debt and chose to offer the government as guarantor of the debt in the event of default. It is important to note that there has been no default on any of these debts.

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data. Readers should also note that the Basel II new micro-prudential supervision rules introduced in 2008 required the time analysis to begin that year.

[70] According to Banco de Portugal, the consolidated activity of the Portuguese banking system is made up of the simple aggregation of (i) the consolidated balance sheets of financial groups that include in their consolidation perimeter at least one other monetary financial institution operating mainly in Portugal and (ii) the separate balance sheets of other monetary financial institution that are not consolidated in Portugal (see Supplement-1, 2001 in the Banco de Portugal Statistical Bulletin).

[71] The figures mentioned for Banco de Portugal come from its Financial Stability Report (May 2011) and refer to the case in which BPN and BPP were excluded from the sample, due to specificities of their financial situation.

[72] This figure refers to the 2010 analysis, which uses 27 financial institutions as a sample.

[73] BPN was taken over and nationalised, though for reasons other than the international financial crisis.

The financial crisis, which began to affect Europe more directly in 2008, particularly after the announcement that Lehman Brothers was filing for insolvency in September of that year, did not prevent the Portuguese banking system from improving its solvency levels after that, even without the injection of public funds. This improvement occurred in the different capital ratios (see Table 58).

The APB member institutions' own funds levels were above the minimums required by the authorities in 2010, in aggregate terms but on a non-consolidated basis.

Table 58: Capital adequacy as at 31 December 2010

			2010 million €
Own Funds and Risk-weighted Assets			
A.	**Own Funds Used to Calculate the Core Tier 1 Ratio**		**25,038**
	Preference shares		2,346
	Deduction of investments in financial institutions and other items		-670
B.	**Original Own Funds (Tier 1)**		**26,714**
	Additional own funds (Tier 2)		10,622
	Deductions from total own funds		-618
C.	**Total Own Funds**		**36,718**
D.	**Risk-weighted Assets**		**281,175**
	Credit risk		259,231
	Market risk		6,691
	Operational risk		15,253
Capital Ratios (%)			
	Core Tier 1 ratio	(A/D)	*8.9%*
	Tier 1 ratio	(B/D)	*9.5%*
	Solvency ratio	(C/D)	*13.1%*

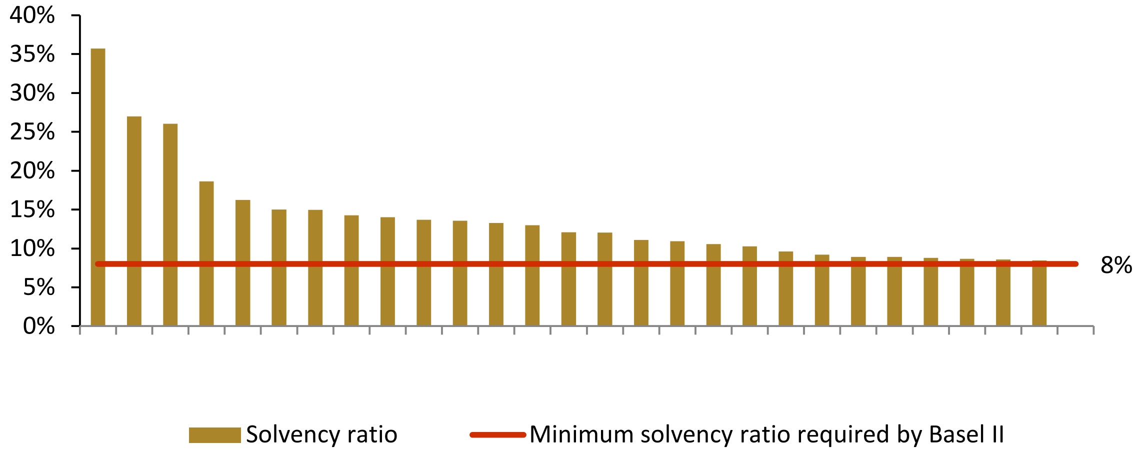
Source: FIs, APB.

The current agreement on capital adequacy, called Basel II, requires the institutions to which it applies to have a solvency ratio, for prudential purposes, of no less than 8% between total own funds and risk-weighted assets[74]. The solvency ratio of 13.1% for the financial institutions in the sample is more than five percentage points higher, which demonstrates a satisfactory level of capitalisation (see Table 58).

In 2010, in individual terms, all the institutions in the sample had a total capital adequacy above the minimum required by Basel II. The solvency ratio for all the 27 institutions in the sample was over 8% (see Graph 60, page 115).

[74] There are also additional requirements that will not be discussed here, such as additional own funds not being allowed to exceed original own funds or certain components of Tier 2 capital (lower Tier 2) not exceeding 50% of original own funds.

Graph 60: Individual solvency ratios by descending order as at 31 December 2010



Source: FIs, APB.

These financial institutions' capital adequacy in aggregate terms is also present in two other capital ratios. The 9.5% in the Tier 1 ratio is higher than the 8% recommended by Banco de Portugal in Circular 83/2008/DSB, although the document is not mandatory, meaning that failure to comply has no direct legal consequences. In aggregate terms, the financial institutions have a Core Tier 1 ratio close to the requirements expected in 2011.

The concept of the Core Tier 1 capital ratio was not provided for in Portuguese legislation until Banco de Portugal Notice 1 /2011. However, in line with the Basel III reform in prudential supervision at international level in 2009 and 2010, the concept of Core Tier 1 capital, which will cover higher-quality equity instruments within Tier 1 capital, will be playing an extremely important role[75]. At 8.9% in the sample analysed here, this Core Tier 1 ratio is very close in aggregate terms to the 9% limit required for 2011 in the Memorandum of Understanding – associated with the negotiations of the Programme of Financial Assistance to Portugal – with the European Commission, European Central Bank and International Monetary Fund[76]. Nonetheless, this 9% limit for the Core Tier 1 ratio must be met by each financial institution covered, which means that some institutions in the sample will have to increase their own funds levels or use other strategies to improve this ratio.

These temporary limits set in the Programme of Financial Assistance to Portugal place additional requirements on the Portuguese banking system. They are also stricter than the new Basel III agreement, which is designed to replace the current rules. One of the central points in the Basel III

[75] Another indication of the growing importance of the concept of Core Tier 1 capital is the fact that the stress testing scheduled for the European banks in 2011 measures compliance with a 5% minimum for the Core Tier 1 ratio.

[76] According to the Memorandum of Understanding, the financial institutions supervised by Banco de Portugal will have to achieve a Core Tier 1 ratio of 10% by the end of 2012.

reform is an increase in better quality capital, with a requirement of a Core Tier 1 ratio of 7% by the beginning of 2019[77].

Meanwhile, this sample can also be used to check whether there is a pattern in the level of solvency of the member institutions on the basis of their size or risk profile (see Table 59 and Graphs 61 and 62, page 117).

Table 59: Solvency ratios by size[78] as at 31 December 2010

	Number of Institutions	Weighted Average[a)]
By Size		
Large	5	*13.2%*
Medium-sized	5	*12.0%*
Small	17	*13.6%*
Total	**27**	***13.1%***

Source: FIs, APB.

[a)] The weighted average takes account of each institution's weight in terms of risk-weighted assets.

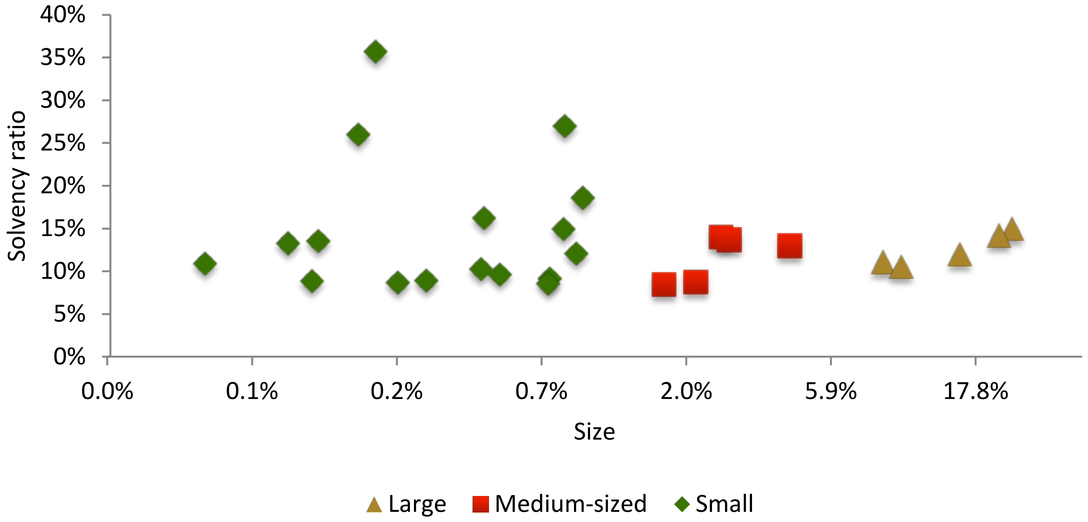
Table 59 shows that, on average, the smaller financial institutions have higher solvency ratios, while those of the medium-sized ones are the lowest. The five large institutions have an intermediate ratio. This conclusion remains the same for a simple average between the institutions in the sample or a weighted average based on their importance in terms of risk-weighted assets.

When considered jointly, the information in Table 59 and Graph 61, page 117, shows that there is no sign that the financial institutions systemically important to the financial sector and national economy in Portugal are benefitting from any “implicit subsidy”. This concept is based on the idea that, for some financial institutions in financial difficulty that may have significant contagion effects, the intervention of the authorities is inevitable in order to minimise the adverse effects on the real economy. This potential aid reduces incentives for these financial institutions to maintain high solvency levels, as possible assistance from the authorities makes it safer in the eyes of investors, resulting in more favourable funding conditions. This effect does not, however, seem to be happening in the sample. On the one hand, Table 59 shows that, on average, the large institutions, i.e. the potentially more systemic ones, have higher solvency ratios than the medium-sized ones. On the other hand, there is a positive relationship between size and solvency ratio within the medium-sized and large segments (see Graph 61, page 117).

[77] This minimum consists of a minimum ratio of 4.5%, plus a buffer of 2.5%. Failure to comply with this minimum ratio will mean that the financial institution will have to increase its capital or reduce risk-weighted assets, while failure to comply with the buffer will entail limitations on the distribution of profits.

[78] The concept of size is based on total assets (see footnote 11, page 20).

Graph 61: Relationship between solvency ratio and size[79] as at 31 December 2010

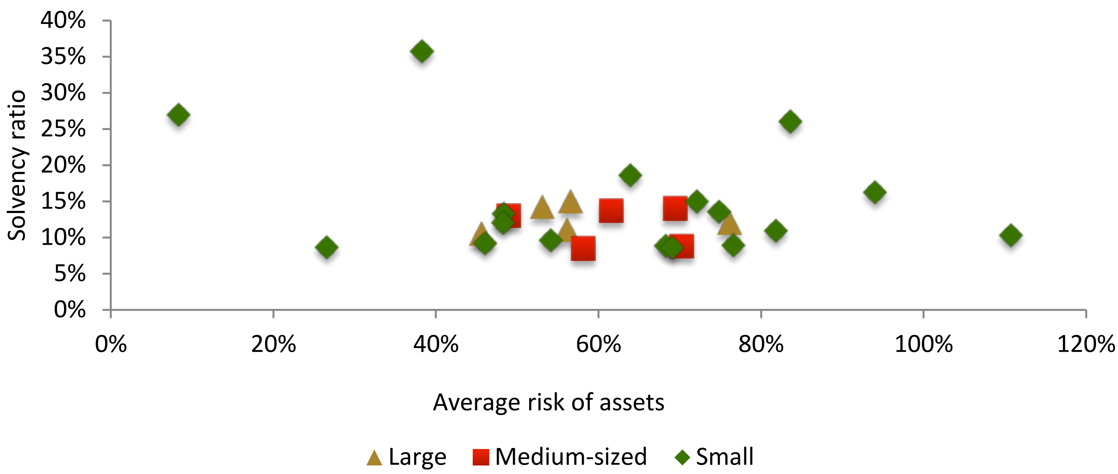


Source: FIs, APB.

Graph 61 does not show any relationship between solvency and size in the small segment. One reason for the absence of a pattern here has to do with the heterogeneous activity of these institutions, which is also reflected in their risk profile, as analysed below.

The available data also make it possible to create a simple measure of the risk profile of each financial institution in the sample and compare it with their solvency ratio (see Graph 62). This measure is the ratio between the value of risk-weighted assets and total assets. The relationship between these two aggregates indicates the average risk of an institution's assets.

Graph 62: Relationship between solvency ratio and average risk of assets as at 31 December 2010



Source: FIs, APB.

[79] Graph 61 uses a logarithmic scale for the horizontal axis.

What stands out immediately from this graph is the greater dispersal of the small institutions, which indicates that there is substantial heterogeneity among them in terms of risk profile and solvency ratio. There is greater homogeneity among the large and medium-sized institutions, with an average risk of 46% to 76% and solvency ratios between 8.5% and 15.0%. It is also interesting to note that the three highest solvency ratios (over 25%) belong to small financial institutions that have an atypical average risk of assets. This shows that these three institutions' higher solvency ratio may be related to structural differences in their business model. Indeed, among the small institutions with more extreme average risks, there is a high concentration of specialised institutions, as opposed to those with a multi-specialised business model.

VII.4.1. Solvency from end of 2008 to end of 2010

In terms of capital adequacy, the APB member institutions have shown favourable progress and managed to sustainably increase the three capital ratios in question in aggregate terms between 2008 and 2010 (see Table 60).

Table 60: Capital adequacy as at 31 December (2008 – 2010)

		2008 million €	2009 million €	2010 million €	Change	
					08/09 %	09/10 %
Own Funds and Risk-weighted Assets						
A. Own Funds Used to Calculate the Core Tier 1 Ratio		**19,238**	**23,394**	**24,791**	***21.6%***	***6.0%***
Preference shares		0	1,372	2,346	*0.0%*	*71.0%*
Deduction of investments in financial institutions and other items		-626	-651	-670	*4.0%*	*2.9%*
B. Original Own Funds (Tier 1)		**18,612**	**24,115**	**26,467**	***29.6%***	***9.8%***
Additional own funds (Tier 2)		13,635	12,739	10,507	*-6.6%*	*-17.5%*
Deductions from total own funds		-2,011	-1,156	-594	*-42.5%*	*-48.6%*
C. Total Own Funds		**30,236**	**35,698**	**36,380**	***18.1%***	***1.9%***
D. Risk-weighted Assets		**272,283**	**276,286**	**278,962**	***1.5%***	***1.0%***
Credit risk		249,326	251,988	257,107	*1.1%*	*2.0%*
Market risk		7,907	9,949	6,675	*25.8%*	*-32.9%*
Operational risk		15,050	14,349	15,180	*-4.7%*	*5.8%*
Capital ratios (%)					**08/09 p.p.**	**09/10 p.p.**
Core Tier 1 ratio	(A/D)	*7.1%*	*8.5%*	*8.9%*	*1.4*	*0.4*
Tier 1 ratio	(B/D)	*6.8%*	*8.7%*	*9.5%*	*1.9*	*0.8*
Solvency ratio	(C/D)	*11.1%*	*12.9%*	*13.0%*	*1.8*	*0.1*

Source: FIs, APB.

The Core Tier 1 ratio increased by 1.4 percentage points in 2009 and 0.4 in 2010 and its final figure in 2010 was 8.9%. This increase resulted mainly from growth in Core Tier 1 capital, which rose

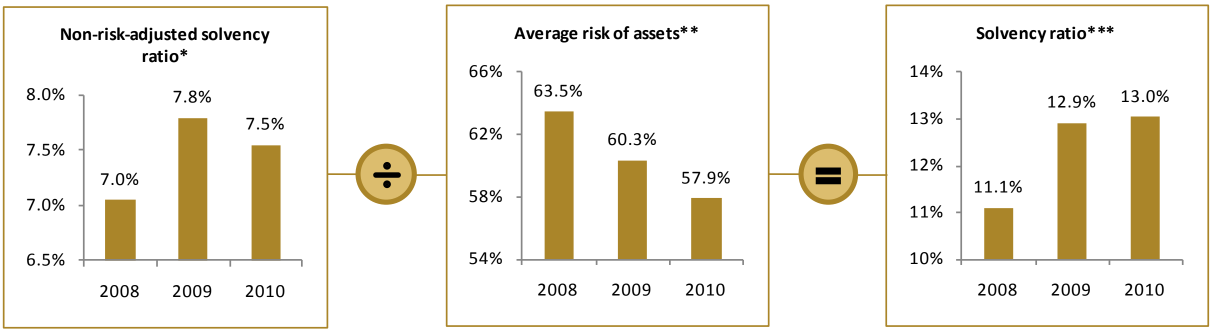
21.6% and 6.0% in the last two years, as the denominator of this ratio, risk-weighted assets, grew only 1.5% and 1.0% in the period.

There is a very similar trend in the Tier 1 ratio. This is not surprising, as increases in Core Tier 1 capital are also reflected in Tier 1 capital. Annual growth in original own funds (Tier 1) was higher, however, at rates of 29.6% and 9.8% respectively, essentially due to the issue of preference shares in 2009 and 2010. Only two member institutions issued preference shares in 2009, while four did so in 2010, one of which reinforced its 2009 issue. These capital increases resulted in considerable rises in the Tier 1 ratio, which went from 6.8% to 9.5% in aggregate terms in two years. Once again, as was the case for Core Tier 1 ratio, greater growth in the numerator, which was higher than the slight rise in the risk-weighted assets in the denominator, brought the Tier 1 ratio up in 2009 and 2010.

Finally, the solvency ratio grew by almost two percentage points in two years and totalled 13.0% at the end of 2010, although most of this growth occurred in 2009. Taking account of the fact that what distinguishes the solvency ratio from the Tier 1 ratio is additional own funds (Tier 2) and deductions from total own funds, its performance can be analysed in light of these two items. In 2009, the reduction in additional own funds (Tier 2) and in deductions from total own funds practically cancelled each other out for calculation purposes, meaning that the increase in the solvency ratio was very similar to that in the Tier 1 ratio. In 2010, the reduction in Tier 2 capital was higher than the reduction in deductions from total own funds, which explains why the solvency ratio rose only 0.1 percentage points in 2010, against the 0.8 percentage point increase in the Tier 1 ratio.

Analysing the solvency ratio in a different light, it is possible to determine whether its gradual increase in the last two years was the result of greater capitalisation, a reduction in the average risk of assets held by the financial institutions or a combined effect of the two. These effects can be broken down by analysing a non-risk-adjusted solvency ratio, i.e. one that uses the institutions' total assets as the denominator, and the ratio between risk-weighted assets and total assets. Once again, this last ratio can be used as a measure of the average risk of an institution's assets[80].

Graph 63: Breakdown of the effects on the solvency ratio



Source: FIs, APB.
Notes: * Non-risk-adjusted solvency ratio = total own funds / total assets.
** Average risk of assets = risk-weighted assets / total assets.
*** Solvency ratio = total own funds / risk-weighted assets.

[80] Division of these two ratios produces the solvency ratio exactly.

Graph 63, page 119, shows this breakdown from 2008 to 2010 and indicates that the sustained increase in the solvency ratio was accompanied by a significant reduction in the average risk of assets, which went from 63.5% to 57.9%. This means that, if the institutions had maintained their non-risk adjusted solvency ratio at its 2008 figure, i.e. 7.0% (which means assuming growth in total own funds similar to that of total assets), then only with a reduction in the average risk of assets in 2009 and 2010 would there have been a solvency ratio of 12.1% in 2010, one percentage point above the actual ratio in 2008.

The remaining 0.9% of the increase in the solvency ratio is justified by a rise in total own funds, which increased at a faster rate than the variation in total assets, thereby raising the non-risk-adjusted solvency ratio to 7.5% in 2010 and fixing the final solvency ratio at 13.0%. The modest 0.1 percentage point increase in the solvency ratio in 2010 is basically due to the fact that the lower growth in total own funds against total assets (taking the non-risk-adjusted solvency ratio from 7.8% to 7.5%) practically cancelled out the reduction in average risk of assets, which fell from 60.3% to 57.9% in 2010.

In short, the improvement in aggregate terms in the solvency ratio in the sample resulted from the joint, balanced effect of a reduction in the average risk of assets and an increase in coverage of assets by own funds.

VII.5. Stress tests

In July 2010, four Portuguese financial groups (CGD, BCP, ESFG[81] and Banco BPI) participated in stress tests coordinated by the Committee of European Banking Supervisors (CEBS) in cooperation with the European Central Bank. The exercise involved 91 financial institutions representing around 65% of the European banking system in terms of total assets.

Stress tests are designed to test bank's resilience to extremely adverse, but plausible scenarios and to assess the level of capital necessary to absorb hypothetical shocks to the scenarios, if they occur. The impacts of these shocks on solvency levels and income and costs for the period are calculated in each scenario. As these tests are an important risk management tool, the shocks included in the scenarios are based on severe assumptions that are unlikely to occur.

The stress tests conducted in 2010 were based on a two-year timeframe (2010 and 2011). All the projections of the institutions' accounting and prudential information were based on their consolidated accounts in December 2009. The main risks assessed were the credit and market risk, including exposure to European countries' sovereign debt.

Two scenarios were constructed for these tests (a reference and adverse scenario) in which shocks of different magnitudes were introduced in a variety of macroeconomic variables, such as GDP, the unemployment rate, property prices and interest rates. The scenarios represented a recovery from the 2008-2009 recession and its continuation for two more periods. The adverse scenario also included an additional country-specific shock reflecting the sovereign risk, which took the form of an increase in the interest rate spread on public debt securities.

The probabilities of default and losses due to default on the institutions' loan portfolio were also affected in these scenarios, along with the devaluation of equity instruments in their trading portfolios.

Where the overall results of the exercise were concerned[82], seven of the 91 financial institutions failed in the adverse scenario with a sovereign risk shock, as their Tier 1 ratio fell below the 6% set as the threshold by the CEBS. Five of them were Spanish *cajas*, one was a Greek bank and the other a German bank. It is also important to mention that the additional overall capital needs estimated for their Tier 1 ratio to reach the required 6% limit in December 2011 were calculated at around 3.53 billion Euros.

All the Portuguese financial groups passed, as their Tier 1 ratios were above 6% and showed adequate capital levels for the risks tested. Generically, as was to be expected, there were a significant reduction in solvency levels between the reference scenario and adverse scenario with the sovereign debt risk shock (see Table 61, page 122).

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[81] Espírito Santo Financial Group (ESFG) is a financial service holding company that includes Banco Espírito Santo Group and other companies operating in banking, insurance and health in Portugal and abroad. As the stress tests were conducted at the highest level of consolidation and not all the ESFG's banking activity is performed by Banco Espírito Santo Group, the ESFG was considered by the CEBS for the stress tests.

[82] **Summary report of the Committee of European Banking Supervisors** (23.07.2010)
Aggregate outcome of the 2010 EU wide stress test exercise coordinated by CEBS in cooperation with the European Central Bank (ECB)
http://stress-test.c-ebs.org/documents/Summaryreport.pdf

As the CEBS stress testing exercise was conducted at the highest level of consolidation, the business activity of Banco Espírito Santo Group and Santander Totta, SGPS[83] was included in that of their parent companies. These two groups eventually asked Banco de Portugal to perform the same exercise for their sub-consolidated activity[84]. The results were positive, as shown in Table 61, which contains the Tier 1 ratios for the tests for the six Portuguese financial groups in question.

Table 61: Stress tests results for the Portuguese financial groups in question in June 2010

	CGD	BCP	ESFG	BPI	BES	Santander Totta, SGPS
Tier 1 Ratio						
December 2009	8.4%	9.3%	7.7%	8.5%	8.3%	10.0%
Reference Scenario (Dec 2011)	9.1%	9.4%	9.2%	11.6%	9.3%	12.9%
Adverse Scenario (Dec 2011)	8.4%	8.4%	7.4%	10.3%	8.0%	12.9%
Adverse Scenario with Sovereign-risk Shock (Dec 2011)	8.2%	8.4%	6.9%	10.2%	7.5%	13.0%

Source: BdP, CEBS, APB.

In the report[85] on the main results for the Portuguese financial groups, Banco de Portugal mentioned the dominant factors causing the reduction in the Tier 1 ratio against the reference scenario. The weight of bank employees' pension funds in the financial institutions' assets means they are particularly exposed to fluctuations in share indexes. On the other hand, impairment losses grow significantly due to the high impact on default of interest and unemployment rates and the reduction in GDP.

Another stress testing exercise will be conducted in 2011. The European Banking Authority (EBA) (which replaced the CEBS in 2011) has announced that there will be two scenarios that will include not only world- and European-level shocks but also country-specific shocks, involving property prices and interest rates, for example. No euro area country is expected to fail.

The adverse scenario in this new test will entail a 15% reduction in share price indexes in the euro area. The macroeconomic variables in this scenario will include the assumption that GDP in the euro area will go down 0.5% in 2011 and 0.2% in 2012 and there will be a 4% depreciation of the dollar. Where the sovereign debt risk is concerned, there will be haircuts by country and maturity of the underlying instruments. Portuguese 10-year public debt securities will devalue around 20%. There will also be an increase in the cost of banks' funding as a result of a 1.25 percentage point rise in short-term interest rates. The measure used to assess the results in this test will be the Core Tier 1

[83] A subsidiary that consolidates the Santander Group's financial activity in Portugal, which was considered in the CEBS stress tests through the parent company in Spain.

[84] Their sub-consolidated activity is described in the APB Statistical Bulletin.

[85] **Banco de Portugal informative note** (23.07.2010)
Stress test in the European Union: Main results for Portuguese banks
http://www.bportugal.pt/pt-PT/Supervisao/Documents/EU_Stress_Test_Portugal%2022072010_PT.pdf

ratio, which is a stricter definition of capital than last year, and the criteria for calculating it will be standardised for all countries. This ratio's minimum limit for institutions to pass the tests will be 5%.

VIII. Efficiency indicators[86]

VIII.1. Cost-to-income ratio

The cost-to-income ratio is calculated from the quotient between operating costs and operating income. It is the indicator most commonly used by the financial sector to measure the efficiency of institutions' business activity. The ratio relates operating costs to banking operating income and therefore measures the percentage of this income absorbed by financial institutions' operating costs. A lower ratio therefore signifies greater efficiency.

This indicator is very useful in the financial sector as it is an important driver of its return. In practice, it is often a strategic goal at a lot of financial organisations. It is also very commonly used as a benchmark for the variable remuneration of executives working in the sector.

Table 62: Operating costs, operating income and cost-to-income (2007 – 2010)

	2007	2008	2009	2010	Average
Operating Costs [a)]					
Total (million €)	5,525	5,592	5,622	5,783	-
Annual growth rate	-	*1.2%*	*0.5%*	*2.9%*	*1.5%*
Operating Income [a)]					
Total (million €)	10,207	11,018	10,553	9,902	-
Annual growth rate	-	*7.9%*	*-4.2%*	*-6.2%*	*-0.8%*
Cost-to-income					
Total	*54.1%*	*50.8%*	*53.3%*	*58.4%*	*54.2%*
Change (percentage points)	-	-3.3 p.p.	2.5 p.p.	5.1 p.p.	-

Source: FIs, APB.

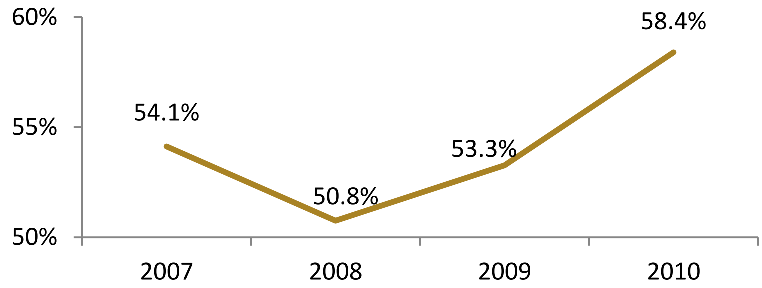
[a)] See Table 47, page 90.

The ratio for the sample was 58.4% in 2010, which was above the 54.2% average for 2007 to 2010. The performance of the cost-to-income ratio was not constant in the period, though it began successive deterioration in 2008. It increased 5.1 percentage points from 2009 to 2010 (see Table 62 and Graph 64, page 126).

This loss of efficiency was mainly due to a sharp drop in operating income (average of 5.2% in the last two years), not duly offset by an accompanying reduction in operating costs, in spite of efforts to contain their growth (average of 1.7% in the period) by the member institutions.

[86] As the analysis in this chapter was from an evolutive perspective, the sample is limited to 31 institutions, for the reasons given in footnote 15, page 22.

Graph 64: Cost-to-income (2007 – 2010)



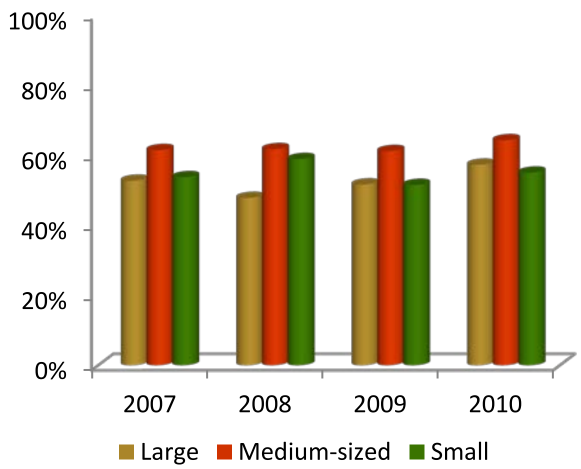
Source: FIs, APB.

An analysis of the member institutions' cost-to-income ratio by origin/type of legal structure shows a substantial improvement in the case of branch offices. In spite of a considerable fall in these member institutions' ratio (around 27.8 percentage points) against that of 2007 (approximately 96%), the branch offices' cost-to-income ratio was still much higher than that of the other institutions in 2010 (see Graph 65b)).

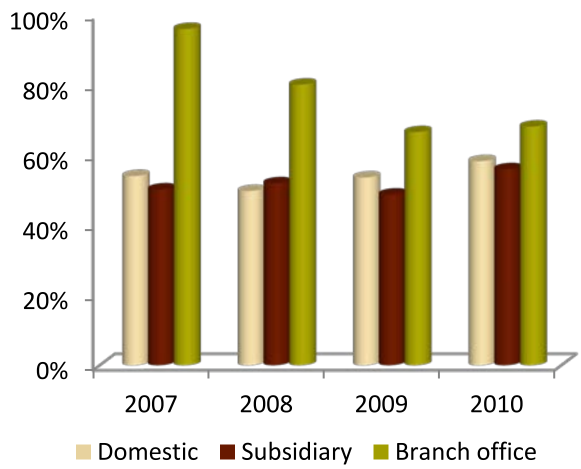
Stratification of the sample by size of institution shows that the small ones were the only segment in which the cost-to-income ratio improved between 2007 and 2010 (see Graph 65a)).

Graph 65: Cost-to-income by size and origin/type of legal structure (2007 – 2010)

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

Loans and deposits per employee is an indicator that evaluates banking institutions' productivity in terms of basic intermediation, which is reflected in attracting deposits from customers and channelling them into loans to the economy. It relates the volume of these activities to one of the resources used to generate them, i.e. the number of employees. Financial institutions' performance is therefore measured by their ability to create business by unit of production resource used.

Although this indicator increased in 2010 (1.8%), its growth was very low in the last two years compared to 2008. Its high growth rate in 2008 (9.5%) was the result of an expansionistic policy in granting loans to customers at the time and an atypical increase in the amount of deposits (as people moved savings from higher- to lower-risk investments). Meanwhile, the stagnation of loans to customers plus a modest increase in deposits in 2009 and 2010 (with a joint annual average growth rate of only 2.0%) resulted in a slowdown in the increase in productivity, although there were efforts to contain the workforce, in which growth practically stagnated in that period (see Table 63 and Graph 66).

Table 63: Credit and deposits, overall number of employees and credit and deposits per employee as at 31 December (2007 – 2010)

	2007	2008	2009	2010	Average
Credit + Deposits [a) b)]					
Total (million)	416,188	464,900	473,737	483,251	-
Annual growth rate	-	*11.7%*	*1.9%*	*2.0%*	*5.2%*
Overall Number of Employees [c)]					
Total	57,025	58,194	58,277	58,412	-
Annual growth rate	-	*2.0%*	*0.1%*	*0.2%*	*0.8%*
Credit and Deposits per Employee					
Amount (thousands €)	7,298	7,989	8,129	8,273	-
Annual growth rate	-	*9.5%*	*1.8%*	*1.8%*	*4.4%*

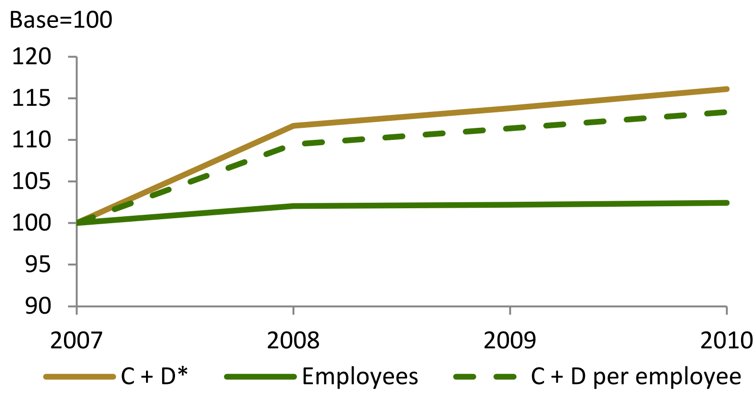
Source: FIs, APB.

[a)] Net loans to customers, as shown in Table 26, page 64.

[b)] Deposits from customers, as shown in Table 28, page 67.

[c)] See Table 6, page 27.

Graph 66: Credit and deposits against overall number of employees as at 31 December (2007 – 2010)



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

At the same time, there was an improvement in efficiency of the member institutions between 2007 and 2010, which was shown by the average number of employees per branch (see Table 64, page 128). This indicator makes it possible to analyse human resources used to sustain the financial institutions' branch network, which is their main channel of distribution. A reduction in this ratio, *ceteris paribus*, indicates a greater capacity for optimising available resources, as personnel costs per distribution unit will be lower.

While there was an average of 9.6 employees per branch in 2007, the average went down 5.2% to 9.1 in 2010 (see Table 64). This improvement in efficiency is the fruit of an increase in alternative channels for customers' banking operations, thereby reducing use of branches and staffing needs at each one. The growth in the ATM network, increasing use of financial institutions' home-banking services and greater investment in technology, which has helped automate operations and reduce back-office staff, have contributed to this trend.

Table 64: Number of branches and number of employees per branch as at 31 December (2007-2010)

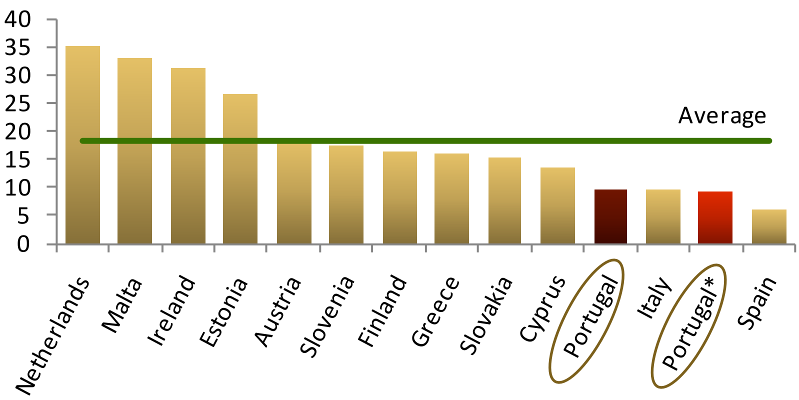
	2007	2008	2009	2010	Average
Number of Branches [a)]					
Total	5,923	6,244	6,349	6,424	-
Annual growth rate	-	*5.4%*	*1.7%*	*1.2%*	*2.8%*
Number of Employees per Branch					
Total	9,6	9,3	9,2	9,1	-
Annual growth rate	-	*-3.1%*	*-1.1%*	*-1.1%*	*-1.8%*

Source: FIs, APB.

a) Including the number of branches in Portugal and branch offices and representative offices abroad (see Table 17, page 45 and Table 22, page 56).

When measured by this indicator, the performance of the APB member institutions and the Portuguese banking sector as a whole stands out from other euro area countries. The number of employees per branch at member institutions is only higher than that in Spain (see Graph 67).

Graph 67: Number of employees per branch in the euro area as at 31 December 2009



Source: FIs, ECB, APB.

Note: * Includes only member institutions.

Finally, some caution is necessary when analysing these indicators, as they do not take business models into account and therefore the institutions' types of assets and liabilities. When institutions are being compared, the existence of higher ratios does not necessarily mean higher productivity or lower efficiency, as the business model in question may mean that the volume of activity requires fewer employees and branches. In spite of this limitation, these indicators' performance over time can help to understand how ability for optimising production resources has improved at member institutions.

VIII.3. Assets per employee

The assets per employee ratio evaluates financial institutions' efficiency by comparing net assets, which are associated with the volume of banking business, and resources used (measured by the number of employees assigned to it). Also in this case, some caution is needed with this indicator when comparing institutions. As this indicator does not consider their business models, it does not distinguish between types of activity and their specific human-resource requirements. Even so, it can show how financial institutions' efficiency has changed over time.

The member institutions' aggregate assets grew every year between 2007 and 2010, even though their growth showed a tendency to slow down[87]. This was also the case with the overall number of employees (see Table 65).

Table 65: Annual growth rates in aggregate assets and overall number of employees, and assets per employee as at 31 December (2007 – 2010)

	2007	2008	2009	2010	Average
Aggregate Assets [a)]					
Total (million €)	401,104	445,346	479,771	505,111	-
Annual growth rate	-	*11.1%*	*7.7%*	*5.2%*	*8.0%*
Overall Number of Employees					
Total	57,025	58,194	58,277	58,412	-
Annual growth rate	-	*2.0%*	*0.1%*	*0.2%*	*0.8%*
Assets per Employee					
Amount (thousands €)	7,034	7,653	8,233	8,647	-
Annual growth rate	-	*8.8%*	*7.6%*	*5.0%*	*7.1%*

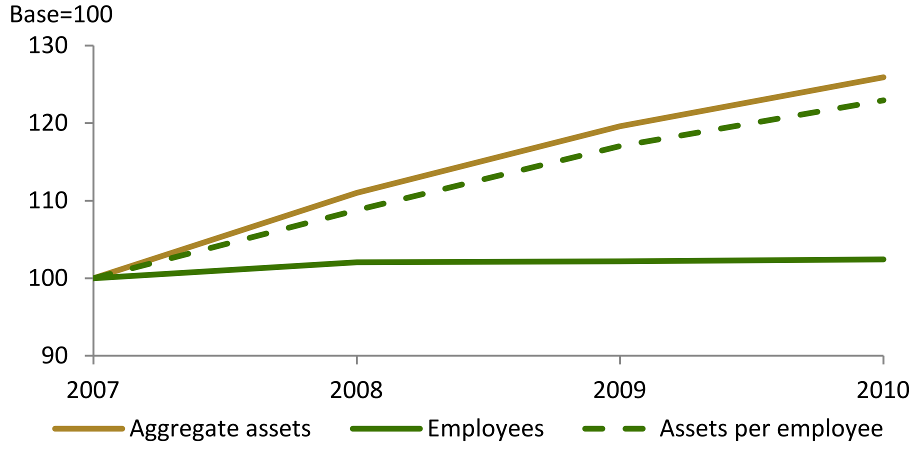
Source: FIs, APB.
[a)] See Table 3, page 22.

Nevertheless, the growth in the member institutions' aggregate assets in the period (average annual growth rate of 8.0%) was significantly higher than that in the number of employees (0.8%). This naturally resulted in highly positive progress in assets per employee (see Table 65).

[87] Chapter IV contains a more detailed analysis of the member institutions aggregate assets.

In spite of the above improvement in assets per employee, their growth rate has been falling due to lower annual growth rates. This trend was very similar to that in the member institutions' aggregate assets, as shown in Graph 68. This was due to the fact that the number of employees practically stagnated between 2007 and 2010, especially when compared to the substantial growth in aggregate assets.

Graph 68: Aggregate assets against overall number of employees as at 31 December (2007 – 2010)



Source: FIs, APB.

IX. International activity[88] [89]

The member institutions' internationalisation is an important alternative for expanding their business and improving their performance. In 2010, international activity made an important contribution to a number of their consolidated performance variables, especially in terms of income.

Although there was a 4.5% drop in 2010, net assets in international activity still accounted for 17.3% of the consolidated assets of the member institutions in the sample (see footnote 88). In spite of the unfavourable international juncture, the member institutions achieved an annual average growth in net assets abroad of around 4.5% in aggregate terms in the last two years (see Table 66).

Gross loans and advances to customers abroad rose at an annual average rate of 12.0% from 2007 to 2010, though it slowed down considerably in 2009 and 2010, but still in line with the international trend towards containment of loans and advances to customers. Nonetheless, the weight of gross credit granted abroad in total consolidated credit grew (2.4 percentage points between 2007 and 2010) and totalled 14.8% in 2010.

Table 66: Consolidated balance sheet regarding international business activity as at 31 December (2007 – 2010)

	2007	2008	2009	2010	Average
Net Assets					
Total (million €)	61,290	70,513	79,928	76,360	-
Annual growth rate	-	*15.0%*	*13.4%*	*-4.5%*	*8.0%*
Weight in total consolidated net assets	*17.5%*	*17.6%*	*18.6%*	*17.3%*	*17.7%*
Loans and Advances to Customers [a)]					
Total (million €)	32,649	39,991	42,707	45,591	-
Annual growth rate	-	*22.5%*	*6.8%*	*6.8%*	*12.0%*
Weight in total consolidated loans and advances to customers	*12.4%*	*13.6%*	*14.2%*	*14.8%*	*13.8%*
Deposits from Customers					
Total (million €)	28,338	34,081	36,628	38,479	-
Annual growth rate	-	*20.3%*	*7.5%*	*5.1%*	*11.0%*
Weight in total consolidated deposits from customers	*16.7%*	*18.0%*	*19.1%*	*18.8%*	*18.1%*

Source: FIs, APB.
Note: [a)] Gross credit.

Deposits from customers abroad also showed an upward trend in the same period, although their growth was slightly more moderate, resulting in an annual average growth rate of 11.0% in aggregate terms. It was, however, this balance sheet item that had the highest proportion in consolidated figures in the sample almost throughout the period, standing at 18.8% in 2010 (see Table 66). This scenario illustrates the growing importance of foreign markets as sources of funds for the member institutions.

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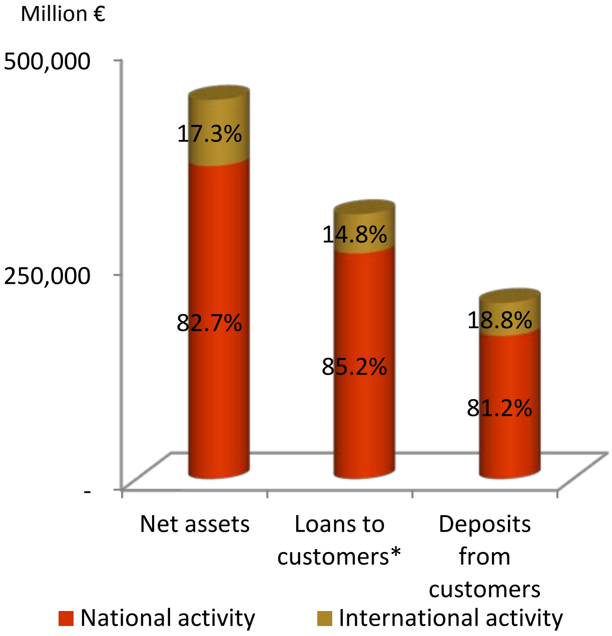
[88] This is the only chapter based on consolidated data.
[89] The analysis of international activity in this chapter is based on the consolidated operations of six member groups (Banif, BCP, BES, BPI, BST and CGD) and two member institutions (Finibanco and Montepio).

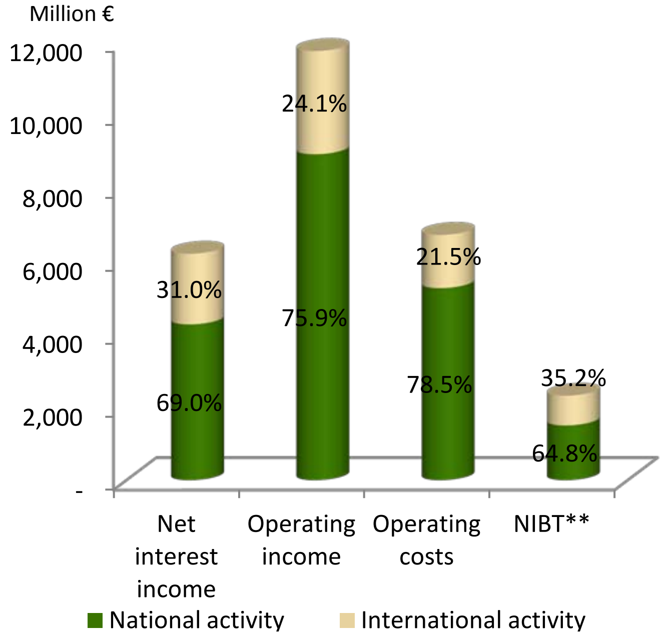
As a result of the higher growth in loans to customers than in deposits in the foreign market, the transformation ratio[90] for international business rose 3.3 percentage points between 2007 and 2010, when it was 118.5%. In spite of this growth, this ratio has been substantially lower than that of domestic activity, although the latter has been contracting. The difference between the two was 39.4 percentage points in 2010.

Graph 69: Weight of international business activity in consolidated financial statements in 2010

a) Balance sheet (as at 31 December)



b) Income statement



Source: FIs, APB.

Note: * Gross loans.

** (NIBT) net income before tax and minority interests.

Regarding the weight of the international activity of the member institutions in the sample in the main consolidated income statement items, the one that stood out most in 2010 was net income before tax and minority interests, to which foreign activity contributed around 35%.

On average, the contribution as a percentage of foreign business to the consolidated net interest income from 2007 to 2010 was higher than that to the consolidated operating income (see Table 67, page 132 and Graph 69b)). This gap widened substantially to 6.9 percentage points in 2010, due to a lower contribution by international activity to net gains from customer services and market activities, such as fees or results from assets other than loans and advances to customers.

[90] The transformation ratio is the result of the quotient between gross credit and deposits from customers.

Table 67: Consolidated income statement - international business activity (2007 – 2010)

	2007	2008	2009	2010	Average
Net Interest Income					
Total (million €)	913	1,500	1,473	1,922	-
Annual growth rate	-	*64.2%*	*-1.8%*	*30.5%*	*31.0%*
Weight in total consolidated net interest income	*14.2%*	*21.1%*	*23.8%*	*31.0%*	*22.6%*
Operating Income					
Total (million €)	1,770	2,317	2,507	2,834	-
Annual growth rate	-	*30.9%*	*8.2%*	*13.0%*	*17.4%*
Weight in total consolidated operating income	*15.4%*	*19.7%*	*21.9%*	*24.1%*	*20.3%*
Operating Costs					
Total (million €)	1,019	1,172	1,191	1,442	-
Annual growth rate	-	*14.9%*	*1.7%*	*21.1%*	*12.6%*
Weight in total consolidated operating costs	*16.4%*	*18.2%*	*18.5%*	*21.5%*	*18.6%*
Net Income Before Tax and Minority Interests					
Total (million €)	802	844	750	817	-
Annual growth rate	-	*5.2%*	*-11.1%*	*8.8%*	*1.0%*
Weight in total consolidated NIBT [a)]	*20.5%*	*34.6%*	*30.9%*	*35.2%*	*30.3%*

Source: FIs, APB.

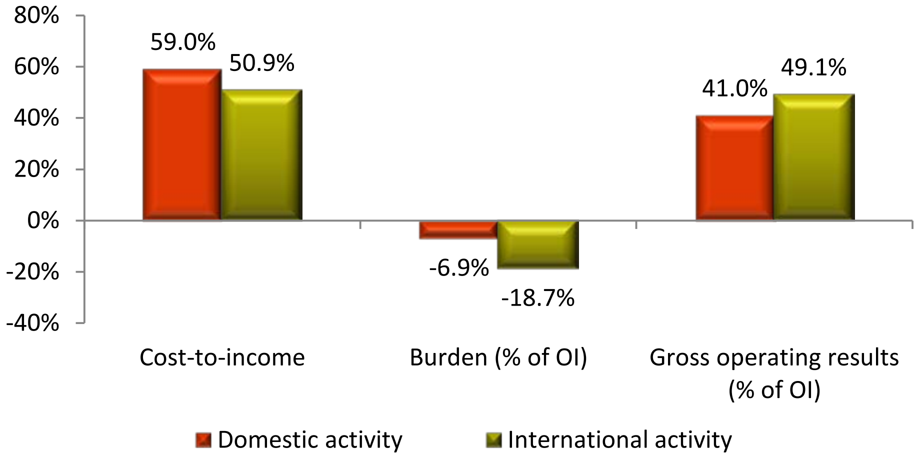
[a)] Net income before tax and minority interests.

In terms of performance, the figures for consolidated international and domestic activity were fairly similar in 2010. Even so, the performance of international activity was better in terms of the cost-to-income ratio (which was 8.1 percentage points lower) and gross operating income and expenses as a percentage of operating income. The opposite is the case with regard to the burden (also as a percentage of operating income), because, as mentioned above, the weight of net gains from customer services and market activities is lower for international business and therefore covers fewer operating expenses than domestic business (see Graph 70, page 134).

Factors that offer some kind of competitive advantage are particularly important in the choice of geographical areas for expansion on the part of APB member institutions. The cultural and linguistic ties that Brazil, Timor, Angola and Macao have with Portugal place them among the preferred destinations. There are also countries that traditionally have large Portuguese immigrant communities, such as France, Luxembourg and Switzerland. There is also a preference for countries with particularly developed financial systems, such as the United States and the United Kingdom. Finally, Spain is also a favoured market due to its proximity and intense business activity.

The most important international business areas are retail banking, investment banking, venture capital and asset management.

Graph 70: Performance indicators for domestic and international activity in 2010



Source: FIs, APB.

X. Annexes

Annex A – Laws and regulations

Annex B – international regulations on the financial sector

Annex C – Alterations to the international accounting standards

Annex A – Laws and regulations[91]

January

Charges on ATM operations

- Decree-Law 3/2010 of 5 January - Ministry of Finance and Public Administration

It prohibits charges by credit institutions on ATM operations (withdrawals, deposits or payments for services) and the beneficiaries of payment services using automatic payment terminals, subject to fines to the amounts and limits set out in Article 17(1) and (2) of Decree-Law 433/82 of 27 October in its current version, which regulates administrative offences and their procedures.

http://dre.pt/util/getpdf.asp?s=dip&serie=1&iddr=2010.2&iddip=20100020

Corporate governance

- Portuguese Securities Market Commission (CMVM) Regulation 1/2010, of 7 January (published in *Diário da República, 2nd Series* of 1 February)

It establishes the possibility of companies listed on regulated markets located or operating in Portugal using a corporate governance code different from that established by the CMVM on certain conditions, when they inform the CMVM in advance of the decision, with good reason.

http://www.cmvm.pt/CMVM/Legislacao_Regulamentos/Regulamentos/2010/Pages/Reg2010_01.aspx

CMVM Code of Corporate Governance

- New CMVM recommendations of 8 January 2010

The Board of the CMVM approved new recommendations on corporate governance.

http://www.cmvm.pt/CMVM/Recomendacao/Recomendacoes/Pages/default.aspx

Remuneration policy

- Banco de Portugal Notice 1/2010 of 26 January (published in *Diário da República, 2nd Series* on 9 February)

Banco de Portugal Notice 1/2010 of 26 January sets out the information that must be disclosed in statements on remuneration policy for the members of the board of directors and supervisory body of credit institutions, financial companies and branch offices of credit institutions and financial companies registered in third countries and of their employees who are not members of their board of directors and supervisory body but receive a variable remuneration and occupy the control

[91] The Centre for Financial Studies would like to thank the legal department of APB for gathering these main legal and regulatory documents published in Portugal in 2010.

positions set out in Banco de Portugal Notice 5/2008 of 1 July, i.e. they perform another job that may have a material impact on the institution's risk profile.

http://www.bportugal.pt/sibap/application/app1/aviso.asp?PVer=P&PNum=1/2010

February

Remuneration policy

- Banco de Portugal Circular 2/2010/DSB of 1 February

It makes recommendations on the remuneration policy for the members of the board of directors and supervisory body and for employees with duties that may have a material impact on the risk profile of credit institutions, financial companies and branch offices of credit institutions and financial companies with registered offices in third countries in order to align remunerative compensation mechanisms with prudent, adequate risk control and management.

http://www.bportugal.pt/sibap/application/app1/circular.asp?PVer=P&PNum=2/2010/DSB

Concentration risk

- Banco de Portugal Instruction 2/2010 of 15 February

In this instruction, Banco de Portugal recognises that the concentration of risks is one of the most important potential loss factors to which a credit institution is subject and sets out appropriate policies and procedures for identifying, assessing and measuring these concentration risks.[92]

http://www.bportugal.pt/sibap/application/app1/insthis.asp?PVer=P&PNum=2/2010

March

Payment system -TARGET2

- Banco de Portugal Instruction 5/2010 of 15 March

Following the publication of Guideline ECB/2009/21 on 17 September 2009 on the Trans-European Automated Real-time Gross Settlement Express Transfer System, Banco de Portugal issued Instruction 5/2010 of 15 March, which amends Instruction 33/2007 of 15 January 2008 and regulates the trans-operation of TARGET2-PT, the Portuguese TARGET2 system.

http://www.bportugal.pt/sibap/application/app1/insthis.asp?PVer=P&PNum=5/2010

[92] Its effect ceased on 15 March 2011 when it was revoked by Banco de Portugal Instruction 5/2011.

Investor compensation system (ICS)

- CMVM Regulation 2/2010 of 12 March (published in *Diário da República 2nd Series* on 23 March)

The CMVM approved Regulation 2/2010 of 23 March, which amended the regulation on the investor compensation system in conformity with the changes in applicable legislation made by Decree-Law 162/2009 of 20 July and Ministerial Order 1426-A/2009 of 18 August.

http://www.cmvm.pt/CMVM/Legislacao_Regulamentos/Regulamentos/2010/Pages/Reg2010_02.aspx

Duty of information in mortgage contracts

- Banco de Portugal Notice 2/2010 of 30 March 2010 (published in *Diário da República 2nd Series* on 16 April)

Pursuant to this notice, credit institutions must inform customers of the different features and costs to be borne under mortgage contracts and the costs that they will have to bear, providing a standardised factsheet during the simulation of the loan. Later, after the loan has been approved, but prior to signing, credit institutions must also provide the customers with a draft of the contract.

The notice also sets out the minimum elements on the financial conditions of the loan that must be included in the mortgage contract and establishes the obligation to provide periodic information on the loan for the duration of the contract.

http://www.bportugal.pt/sibap/application/app1/aviso.asp?PVer=P&PNum=2/2010

April

2010 State Budget

- Law 3-B/2010 of 28 April

This law approves the 2010 State Budget.

http://dre.pt/util/getdiplomas.asp?iddip=20100757

May

Credit institutions and investment companies

- Decree-Law 45/2010 of 6 May - Ministry of Finance and Public Administration

This decree-law amends Decree-Law 103/2007 of 3 April, which set out the capital adequacy requirements for investment companies and credit institutions, and Decree-Law 104/2007 of 3 April, which transposed Directive 2006/48/EC of the European Parliament and of the Council of 14 June, on the taking up and pursuit of the business of credit institutions.

"Country risk" is included in the calculation of credit institutions' capital coefficient and is no longer relevant only for the purpose of setting up provisions. It thus updates prudential rules on positions taken in relation to countries considered to be high risk, i.e. vulnerable to political, economic and social changes that may change the value of investments made there.

http://dre.pt/util/getpdf.asp?s=rss&serie=1&iddr=2010.88&iddip=20100828

Listed companies

- Decree-Law 49/2010 of 19 May - Ministry of Finance and Public Administration

It transposes Directive 2007/36/EC of the European Parliament and of the Council of 11 July on the exercise of certain rights of shareholders in listed companies into Portuguese law and establishes in national law the admissibility of shares with no nominal value in public limited companies.

http://dre.pt/pdf1sdip/2010/05/09700/0172201728.pdf

Holdings in financial sector companies

- Decree-Law 52/2010 of 26 May - Ministry of Finance and Public Administration

This decree-law approves the procedural rules and evaluation criteria for the prudential assessment of acquisition and increase of holdings in financial companies.

It transposes Directive 2007/44/EC of the European Parliament and of the Council of 5 September, which introduces maximum harmonisation in the EU. It does not allow the inclusion of stricter or more permissive rules in the Member States' laws, especially thresholds for notifying a proposed acquisition or a proposed sale of a qualifying holding in a financial institution and the relevant procedure and evaluation criteria.

http://dre.pt/util/getpdf.asp?s=rss&serie=1&iddr=2010.102&iddip=20100942

June

Undertakings for collective investments in the form of equity companies - investment companies and real estate investment companies

- Decree-Law 71/2010 of 18 June 2010 - Ministry of Finance and Public Administration

This decree-law amends and republishes the rules on collective investment undertakings approved by Decree-Law 252/2003 of 17 October and allows the establishment of undertakings for collective investment in securities and real estate investment funds in the form of equity companies. Although they are generically provided for in the original version of Decree-Law 252/2003, they are only now regulated under Portuguese law, following a number of European legal provisions.

http://dre.pt/pdf1sdip/2010/06/11700/0210002144.pdf

Income and withholding tax - approval of Form 39

- Decree-Law 72-A/2010 of 18 June and Ministerial Order 454-A/2010 of 29 June

This decree-Law amended the Personal Income Tax Code (CIRS) and established the obligation to submit a form on income subject to withholding tax or any other income subject to definitive withholding of tax. This obligation falls to those that owe said income or those that pay it to or place it at the disposal of the recipients.

http://www.dre.pt/util/getdiplomas.asp?iddip=20101131

Following this amendment, Ministerial Order 454-A/2010 approved official Form 39, which must be completed and submitted to Direcção-Geral dos Impostos (DGI - the Portuguese Directorate-General for Taxation) by the end of January for income and tax withheld in the previous year.

Additional measures to the Growth and Stability Programme

- Law 12-A/2010 of 30 June

This law approves additional budgetary consolidation measures aimed at reinforcing and speeding up the reduction in the excessive deficit and controlling growth in the public debt, as provided for in the programme.

These measures include:

- Increasing personal income tax rates and creating a new threshold for taxable income over €150,000;

- Increasing withholding tax on income in categories B, E and F;

- Increasing definitive withholding tax to 21.5%;

- Introducing a 2.5% state levy for companies with a taxable profit of over €2,000,000 on the part of the profit exceeding this amount;

- Raising VAT rates to a minimum of 6%, an intermediate rate of 13% and a normal rate of 21%;

- Levying stamp duty on the use of loans granted under Decree-Law 133/2009 (consumer credit).

http://www.dre.pt/util/getdiplomas.asp?s=sug&iddip=20101314

Duty to disclose relevant interests in short selling of shares

- CMVM Regulation 4/2010 of 24 June (published in *Diário da República 2nd Series* on 8 July)

It sets out the duty to disclose to the CMVM and the market relevant interests in short selling of shares admitted to trading on a regulated market or traded in a multilateral trading system located or operating in Portugal.

The basic aim of this regulation is to adopt the European rules on transparency on short positions on shares agreed upon by the members of the Committee of European Securities Regulators (CESR).

http://www.cmvm.pt/CMVM/Legislacao_Regulamentos/Regulamentos/2010/Pages/Reg2010_04.aspx

July

Taxation of capital gains on securities

- Law 15/2010 of 26 July 2010

This law amends the CIRS and the Tax Benefit Statute by introducing a personal income tax of 20% on capital gains on securities previously taxed at 10% or exempt from taxation - shares held by their owners for more than 12 months and bonds and other debt securities.

However, it establishes the tax exemption of capital gains from the sale of securities held by investment funds for over 12 months, provided that they are not mixed or closed private subscription investment funds, and also the exemption of capital gains on securities not exceeding €500 a year.

http://dre.pt/pdf1sdip/2010/07/14300/0282302824.pdf

August

Notification of transfers to offshore jurisdictions

- Banco de Portugal Instruction 17/2010 of 16 August

This instruction sets up mechanisms for credit institutions to disclose information to Banco de Portugal in compliance with Article 118-A Paragraph 3 of the Legal Framework of Credit institutions and Financial Companies (RGICSF) incorporated by Law 28/2009 of 19 June, which obliges credit institutions to register transfers to entities located in offshore jurisdictions if they exceed €15,000, regardless of whether the transfer is made in one or more interrelated operations.

http://www.bportugal.pt/sibap/application/app1/insthis.asp?PVer=P&PNum=17/2010

September

Exceptions to bank secrecy

- Law 36/2010 of 2 September

This law amends Article 79 of the RGICSF with regard to the exceptions to the obligation to maintain bank secrecy.

The two amendments are as follows:

(i) 2(d) sets out explicitly that the facts or elements of customers' relations with a credit institution may be revealed by it to "judicial authorities within the scope of a criminal procedure".

(ii) The article provides for the creation of a database at Banco de Portugal indicating all bank accounts in the banking system and the names of their holders.

http://dre.pt/pdf1sdip/2010/09/17100/0385803858.pdf

Extraordinary provision of personal guarantees by the state

- Ministerial Order 946/2010 of 22 September - Ministry of Finance and Public Administration

This ministerial order comes as part of Portugal's renewal of the law on state guarantees to the financial system, as in other EU countries, and amends Ministerial Order 1219-A/2008 of 23 October, which regulates extraordinary personal guarantees provided by the state under Law 60-A/2008 of 20 October.

http://dre.pt/util/getpdf.asp?s=rss&serie=1&iddr=2010.185&iddip=20102312

October

Disclosure Duty - obligation to disclose long positions on shares

- CMVM Regulation 5/2010 of 1 October (published in *Diário da República 2nd Series* on 11 October)

It makes the first amendment to CMVM Regulation 5/2008, which, along with the Securities Code, establishes the obligation to disclose information to the CMVM and the market.

The main purpose of the amendment to this regulation is to introduce the obligation to disclose long positions on shares and extend the obligations of transparency on qualifying holdings to these long positions. The CMVM believes that this equivalency is justifiable in that, even though they do not fall within the rule on ownership of shares in one's name but on behalf of others provided for in the Securities Code and do not grant direct access to voting rights, certain financial instruments create an economic effect similar to ownership of shares and are conducive to acquiring and exercising potential influence over a company. For example, owners of derivatives may indeed be able to influence voting rights formally held by their counterparties, who will endeavour to maintain a stable, lasting business relationship.

http://www.cmvm.pt/CMVM/Legislacao_Regulamentos/Regulamentos/2010/Pages/Reg2010_05.aspx

Deposit Guarantee Fund

- Banco de Portugal Notice 4/2010 of 18 October (published in *Diário da República 2nd Series* on 5 November)

This notice lays down that Banco de Portugal can use an instruction to establish an annual minimum contribution for credit institutions in the Deposit Guarantee Fund, irrespective of their volume of deposits covered by the guarantee.

http://www.bportugal.pt/sibap/application/app1/aviso.asp?PVer=P&PNum=4/2010

Qualifying holdings

- Banco de Portugal Notice 5/2010 of 16 October (published in *Diário da República 2nd Series* on 3 December)

This notice sets out information requirements for communication on the acquisition of an increase in qualifying holdings in credit institutions, financial companies and investment companies subject to Banco de Portugal supervision, and revokes Notice 3/94.

http://www.bportugal.pt/sibap/application/app1/aviso.asp?PVer=P&PNum=5/2010

December

Legal Framework of Credit institutions and Financial Companies

- Decree-Law 140-A/2010 of 30 December

It amends the Legal Framework of Credit institutions and Financial Companies and Decree-Law 104/2007 of 13 April and transposes (i) Directive 2009/111/EC of the European Parliament and of the Council of 16 September, which amends Directives 2006/48/EC of the European Parliament and of the Council of 14 June, 2006/49/EC of the European Parliament and of the Council of 14 June and 2007/64/EC of the European Parliament and of the Council of 13 November, (ii) Directive 2009/27/EC of the Commission of 7 April, which amends certain annexes of Directive 2006/49/EC of the European Parliament and of the Council of 14 June and (iii) Directive 2009/83/EC of the Commission of 27 July, which amends certain annexes of Directive 2006/48/EC of the European Parliament and of the Council of 14 June.

These amendments refer to banks that are affiliated to a central body, to certain elements on own funds, to great risks, to provisions on crisis supervision and management and technical provisions regarding risk management.

http://dre.pt/util/getpdf.asp?s=rss&serie=1&iddr=2010.252S02&iddip=20103216

Own funds and risk management of credit institutions

- Banco de Portugal Notice 6/2010 of 30 December (published in *Diário da República 2nd Series* on 31 December)

It sets out the elements that may make up the own funds of institutions subject to Banco de Portugal supervision and revokes Notice 12/92 of 29 December.

http://www.bportugal.pt/sibap/application/app1/aviso.asp?PVer=P&PNum=6/2010

- Banco de Portugal Notice 7/2010 of 30 December (published in *Diário da República 2nd Series* on 31 December)

This notice sets limits on the concentration of risks for a single customer or group of interconnected customers and revokes Banco de Portugal Notice 6/2007.

http://www.bportugal.pt/sibap/application/app1/aviso.asp?PVer=P&PNum=7/2010

- Banco de Portugal Notice 8/2010 of 30 December (published in *Diário da República 2nd Series* on 31 December)

It makes amendments and additions to the following Banco de Portugal notices: (i) Notice 5/2007 on credit institutions and investment companies' obligations with regard to own funds and credit risk limits, (ii) Notice 7/2007 on the treatment of positions taken by credit institutions in securitisation operations, (iii) Notice 8/2007 establishing provisions on the capital adequacy of investment companies and credit institutions for hedging market risks, (iv) Notice 9/2007 establishing the own fund requirements for hedging operational risks and (v) Notice 10/2007 regulating Article 29 of Decree-Law 104/2007 of 3 April, which transposed into Portuguese law Directive 2006/48/EC of the European Parliament and of the Council of 14 de June on the taking up and pursuit of the business of credit institutions, and reformulates Directive 2000/12/EC of the European Parliament and of the Council of 20 March.

http://www.bportugal.pt/sibap/application/app1/aviso.asp?PVer=P&PNum=8/2010

- Banco de Portugal Notice 9/2010 of 30 December (published in *Diário da República 2nd Series* on 31 December)

It updates the prudential regulations on securitisation operations following amendments made by Directive 2009/111/EC of the European Parliament and of the Council of 16 September.

http://www.bportugal.pt/sibap/application/app1/aviso.asp?PVer=P&PNum=9/2010

State Budget

- Law 55-A/2010 of 31 December

This law approves the 2011 State Budget.

http://dre.pt/util/getdiplomas.asp?iddip=20103231

Annex B – International regulation of the financial sector

Supervisory architecture

The work towards the implementation of the European Union's new **supervisory architecture** on 1 January 2011 was completed in 2010. The starting point of the reorganisation process was the de Larosière Report in February 2009. After draft legislation was submitted in September 2009, the final documents were eventually approved and published in November 2010.

The new supervisory system is divided into a macro-prudential and micro-prudential area. Macro-prudential supervision, which encompasses the financial system at aggregate level and not each individual financial institution, will be the responsibility of the European Systemic Risk Board (ESRB), whose main task will be to monitor financial stability in the European Union. The ESRB will not have any legislative powers and its job will be to issue alerts on possible situations of systemic risk to the EU and make any necessary recommendations. Micro-prudential supervision, which monitors financial institutions on an individual basis, will be performed by three European supervisory authorities (the European Banking Authority, European Securities and Markets Authority and European Insurance and Occupational Pensions Authority) together with national financial supervisory authorities. In January 2011, the three authorities replaced the three European committees that had been coordinating supervision of banking, the capital and insurance markets and pension funds in Europe[93].

The new architecture provides for close coordination between the macro-prudential and micro-prudential spheres. The ESRB will issue alerts and recommendations to the three authorities so that they can take timely action whenever it detects situations that may jeopardise the European financial system. The micro-prudential supervisors will also inform the ESRB of important developments so that it can include them in its analyses. The power to amend legislation will be on the side of micro-prudential supervision.

Along with this implementation of the new supervisory architecture, it was deemed necessary to make amendments to the law on the financial sector to make micro-prudential supervision possible. They were included in the Omnibus Directive.

Related documents

Regulation 1096/2010 of the Council (17.11.2010)
New tasks for the European Central Bank (ECB) relating to the European Systemic Risk Board (ESRB)
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:331:0162:0164:EN:PDF

[93] They were the Committee of European Banking Supervisors (CEBS), Committee of European Securities Regulators (CESR) and Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).

Regulation 1092/2010 of the European Parliament and of the Council (24.11.2010)
EU-level macro prudential oversight of the financial system and European Systemic Risk Board (ESRB)
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:331:0001:0011:EN:PDF

Regulation 1093/2010 of the European Parliament and of the Council (24.11.2010)
European Banking Authority (EBA)
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:331:0012:0047:EN:PDF

Regulation 1094/2010 of the European Parliament and of the Council (24.11.2010)
European Insurance and Occupational Pensions Authority (EIOPA)
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:331:0048:0083:EN:PDF

Regulation 1095/2010 of the European Parliament and of the Council (24.11.2010)
European Securities and Markets Authority (ESMA)
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:331:0084:0119:EN:PDF

Directive 2010/78/EU of the European Parliament and of the Council (24.11.2010)
Omnibus Directive – amending financial services sectoral legislation to ensure effective operation of the European System of Financial Supervisors (ESFS)
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:331:0120:0161:EN:PDF

Capital and liquidity

Where **capital and liquidity** are concerned, it is the Basel Committee on Banking Supervision (BCBS) that leads the international debate. Following the initial Basel agreement in 1988, which was revised in 2004, in December 2010 the BCBS published documents introducing a new reform of the prudential regulation system, called Basel III. These documents contain the BCBS's new prudential regulations. The aim of the Basel III package is to increase the financial sector's resistance by means of higher capital requirements for banks and to create transparent, uniform liquidity ratios.

The changes in capital requirements were made at four levels. Firstly, Basel III is designed to increase capital by raising minimum requirements, especially with regard to Core Tier 1 capital. Secondly, the reformed Basel agreement is intended to improve the quality of capital by means of stricter conditions for financial instruments to meet in order to be recognised as regulatory capital. Thirdly, the capital requirements are supplemented by a measure uncalibrated by risk, a leverage ratio. This ratio is expected to be calculated by dividing between Tier 1 capital and total assets (on and off balance sheet), though its final definition may be changed. It will undergo a test phase from 1 January 2013 to 1 January 2017. This prudential measure will presumably migrate to Pillar 1 on 1 January 2018. Finally, the BCBS also started public consultations on proposals to set up countercyclical buffers to add to the minimum capital requirements and the use of contingent capital to absorb losses.

Two liquidity ratios will be introduced in prudential supervision. They will first begin a calibration phase, after which they will come into force for the financial institutions covered. The short-term ratio, called the Liquidity Coverage Ratio, is intended to guarantee that a financial institution has sufficient net assets to cover its financial commitments for a 30-day period in the event of a severe liquidity shock. This ratio will be tested in 2011 and is expected to come into effect in 2015. The long-term ratio is called the Net Stable Funding Ratio and will complement the other. It is designed to encourage financial institutions to seek more stable forms of funding and avoid excessive use of short-term finance so that they are better able to resist liquidity shocks over the period of a year. Financial institutions must report this liquidity ratio as of 2012, for it to come into effect in January 2018.

As the BCBS has no legal power to enforce the rules that it proposes, their transposition into law depends on acceptance by each jurisdiction. In the EU, it is the European Commission (EC) that adopts the rules proposed by the BCBS and includes it in legislation in amendments to the Capital Requirements Directive (CRD).

In 2010 there were two amendments to the directive. The so-called CRD II refers to banks that are affiliated to a central body, certain elements on own funds, large exposures, supervisory arrangements and crisis management. The deadline for transposing it into each state's national law expired on 31 de December de 2010. CRD III covers own funds requirements for the trading portfolio and re-securitisation and the analysis of remuneration policies by the supervisory authorities. It was approved by Directive 2010/76/EU. CRD IV, which is already being prepared in a public consultation initiated on 16 July 2010 and should be published in the second quarter of 2011, will transpose the Basel III rules into EU law.

Related documents

Public consultation by the European Commission (16.07.2010)
Possible further changes to the Capital Requirements Directive (CRD IV)
http://ec.europa.eu/internal_market/consultations/docs/2010/crd4/consultation_paper_en.pdf

Public consultation by the Basel Committee on Banking Supervision (16.07.2010)
Countercyclical capital buffer proposal
http://www.bis.org/publ/bcbs172.pdf

Public consultation by the Basel Committee on Banking Supervision (19.08.2010)
Proposal to ensure the loss absorbency of regulatory capital at the point of non-viability
http://www.bis.org/publ/bcbs174.pdf

European Commission public consultation (22.10.2010)
Consultation on countercyclical buffers
http://ec.europa.eu/internal_market/consultations/2010/capitalbuffer_en.htm

Directive 2010/76/EU of the European Parliament and of the Council (24.11.2010)
CRD III
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:329:0003:0035:EN:PDF

Publication by the Basel Committee on Banking Supervision (16.12.2010)
Guidance for national authorities operating the countercyclical capital buffer
http://www.bis.org/publ/bcbs187.pdf

Rules of the Basel Committee on Banking Supervision (16.12.2010)
Basel III: International framework for liquidity risk measurement, standards and monitoring
http://www.bis.org/publ/bcbs188.pdf

Rules of the Basel Committee on Banking Supervision (16.12.2010)
Basel III: A global regulatory framework for more resilient banks and banking systems
http://www.bis.org/publ/bcbs189.pdf

Crisis management

It is the European Commission's intention to create a framework for **crisis management** in the financial system as soon as possible. One of the main concerns of this framework will be to guarantee that all financial institutions covered will be given appropriate liquidation treatment in the event of insolvency, in order to minimise contagion to the rest of the financial system. The framework therefore defines powers and instruments for prevention, early intervention and resolution.

In October 2010, the European Commission published a communication announcing that the future supervision matrix would not only focus on the banking sector but also apply to some types of investment company. It also set out a number of new powers and instruments to enable the authorities to manage a crisis in the financial system better. It presented a calendar of other challenges to be considered by the end of 2014, such as extending the framework to managing crises at other financial institutions (insurance companies, investment funds or central counterparties) and the review of the law on insolvency.

Meanwhile, the EC Internal Market and Services Directorate-General launched a new public consultation on 6 January 2011, following the European Commission's communication of October 2010, aimed at ascertaining the positions of the economic agents concerned and drafting a proposed law on the matter by summer 2011.

Linked to the issue of crisis management, on 26 May 2010 the European Commission published a communication on the setting up of crisis resolution funds. This initiative advocated the advance financing of a network of national resolution funds in EU Member States to provide funding for orderly resolution but not the rescue of the financial institutions themselves. The funds will be used to finance future crisis management mechanisms, such as the transfer of assets or the separation of an institution's business activities, among others.

Related documents

European Commission Communication (26.05.2010)
Bank crisis resolution funds
http://ec.europa.eu/internal_market/bank/docs/crisis-management/funds/com2010_254_pt.pdf

European Commission Communication (20.10.2010)
New EU framework for crisis management in the financial sector
http://ec.europa.eu/internal_market/bank/docs/crisis-management/framework/com2010_579_en.pdf

Systemic risk

Another topic under discussion on the vast agenda of the reform in the financial system is the treatment of **systemic risk**, i.e. situations in which difficulties in one part of the financial system may spread to other parts and jeopardise institutions or markets that themselves are economically healthy. There are a number of circumstances that could cause systemic situations, such as an adverse macroeconomic scenario, the freezing of certain financial markets or the similarity of business models leading to financial problems at several financial institutions. There is also a fourth case that can lead to systemic situations and that is a systemically important financial institution (SIFI). A SIFI is an institution that, due to its size or complexity, may place other parts of the financial system at risk if and when it faces financial difficulties or insolvency.

The Financial Stability Board (FSB) headed the debate on SIFIs in 2010 and published two documents with recommendations for the supervisory bodies. Its recommendations include a subgroup of SIFIs (G-SIFIs or global systemically important financial institutions), greater loss absorbance capacity by a SIFI, the principle that the resolution of a financial institution should be equally applicable to a SIFI (i.e. there are no institutions that are too big to fail) and reinforcement of the supervision and infrastructure of financial markets. In partnership with the BCBS, the FSB plans to use quantitative methods to analyse the systemicity of financial institutions in the economy.

Related documents

Communication from the Financial Stability Board (20.10.2010)
Reducing the moral hazard posed by systemically important financial institutions
http://www.financialstabilityboard.org/publications/r_101111a.pdf

Communication from the Financial Stability Board (02.11.2010)
Intensity and Effectiveness of SIFI Supervision
http://www.financialstabilityboard.org/publications/r_101101.pdf

Deposit guarantee fund

The existence of a well-organised **deposit guarantee fund** is essential for any banking system to work properly. On the one hand, it offers a guarantee to depositors that part of their wealth is protected even if their bank fails. On the other hand, it reduces the risk of a run on the bank in the event of news leading depositors to believe that their bank may be close to defaulting.

The recent financial crisis demonstrated the need to change the DGFs in the EU, as the current legal regime had only undergone minor changes in the last 16 years. The European Commission therefore published a proposal for a directive on deposit guarantee schemes in July 2010, which suggested some in-depth changes to the existing framework.

This amendment provides for the harmonisation and simplification of DGFs in the European Union, a reduction in the deposit reimbursement time, an improvement in the funding of DGFs and discussion of the possibility of mutual loans between the funds of Member States, if needed.

Related documents

Proposal for a Directive of the European Commission (12.07.2010)
Proposal for a directive on deposit guarantee schemes [reformulation]
http://ec.europa.eu/internal_market/bank/docs/guarantee/comm_pdf_com_2010_0368_proposition_de_directive_pt.pdf

Investor compensation scheme

The **investor compensation scheme** has a similar purpose to the deposit guarantee scheme. However, the ICS is designed to protect investors' assets in the event of a default by a financial institution resulting from insolvency, fraud or negligence in handling their customers' assets. The ICS is not intended to compensate investors for losses arising from investment risks they have taken.

The proposal for a directive published by the European Parliament and the Council in July 2010 provides for amending Directive 97/9/EC, which was adopted in 1997. The changes refer mainly to how Member States fund ICSs, reimbursement times, coverage and levels of compensation.

This proposal appeared at the same time as one published on the same date for deposit guarantee schemes, given their similarities.

Related documents

Proposal for a directive of the European Parliament and of the Council (12.07.2010)
Proposal for a directive on investor compensation schemes
http://ec.europa.eu/internal_market/securities/docs/isd/dir-97-9/proposal-modification_pt.pdf

Financial conglomerates

Financial conglomerates are business groups that operate simultaneously in several financial sectors, such as institutions that combine insurance and banking. The Financial Conglomerates Directive (2002/87/EC) was adopted in 2002 in order to prevent the double use of total own funds associated with each of these regulated activities (double gearing) and reduce the risks to the group structure, such as contagion within the group or conflicts of interest. A proposal for a directive made on 16 August 2010 alters the 2002 directive along with Directives 98/78/EC and 2006/48/EC, with regard to insurance and banking, respectively.

The law at the time laid down that, if a financial conglomerate reached a significant position in more than one regulated economic activity, the authorities would have to choose whether the banking or the insurance supervisor would oversee the conglomerate. As this imposition proved to limit supervision, the proposed directive is intended to correct the situation and lay down that both supervisors will continue their supervisory duties.

Related documents

Proposal for a Directive of the European Parliament and of the Council (16.08.2010)
Revision of the Financial Conglomerates Directive
http://ec.europa.eu/internal_market/financial-conglomerates/docs/com-2010-433_final_en.pdf

Capital market

The reform of the financial system has not been limited to the banking system. Many of the initiatives taken are also to amend legislation on the **capital market**. They include those related to securities, rating agencies and prospectus for public offerings of securities.

The European Union launched several public consultations on securities in 2010.

Between December 2010 and February 2011 there was a public consultation to review the MiFID – Markets in Financial Instruments Directive. This directive came into force in November 2007 and provided a framework for the activities of investment companies and set out rules for protecting investors. However, the constantly increasing sophistication of the financial markets made it necessary to review the MiFID. This review is expected to increase competition between the different financial institutions and further encourage the creation of a single capital market in the European Union. The European Commission expects to issue draft legislation on the matter in spring 2011.

The European Union also launched two initiatives related to short selling. One was a public consultation with a view to preparing a proposal for legislation for dealing with potential risks arising from short selling. The other was a draft regulation on short selling and credit default swaps (CDSs). This draft was designed to establish a harmonised framework that would increase the transparency and reduce the risks of short selling and CDS operations. If it is approved by the European Parliament and the Council, it will come into force on 1 July 2012.

The European Commission also held a public consultation on the review of the Market Abuse Directive (2003/6/EC) in June and July last year. The aim of this directive was to cover insider trading and market manipulation. The public consultation addressed aspects that needed to be corrected in the directive, such as loopholes in the regulation of certain markets and instruments that arose after developments in the financial markets, differences in the efficacy of execution of the directive and excessive costs to some economic agents, particularly small and medium-sized enterprises.

Finally, the European Commission held a public consultation on the transparency requirements for listed companies from May to August 2010. The aim was to check the need to modernise Directive 2004/109/EC and simplify and reduce the administrative costs of these requirements. In particular, it was designed to gather opinions from small companies, investors and consumers.

Rating agencies bore substantial responsibility in the unfolding of the financial crisis, as they gave low risk ratings to financial products that actually proved to have a very high risk. As a result, their activity has been the subject of particular attention from the authorities. The European Commission undertook two important initiatives in this area in 2010.

First, on 2 June it officialised a draft regulation to amend Regulation (EC) 1060/2009. It is designed to endow the new European Securities and Markets Authority, which went into operation in January 2011, with the necessary supervisory powers to register and control rating agencies. This measure will make it possible to monitor their activity more closely, as the de Larosière Report indicated as fundamental in 2009.

Then, there was a public consultation by the European Commission on rating agencies between November 2010 and January 2011. Its aim was to gather stakeholders' opinions in order to include new initiatives in future EC legislation. The issues discussed in the consultation were excessive dependency on rating agencies by participants in financial markets, the agencies' high degree of concentration, their absence of civil liability in the current regulation and conflicts of interest arising from the remuneration schemes used.

Where prospectuses in public offerings of securities were concerned, the European Parliament and the Council published Directive 2010/73/EU in November last year, amending Directive 2003/71/EC on prospectuses in the public offering of securities or their listing, and Directive 2004/109/EC on the harmonisation of transparency requirements with regard to information on issuers whose securities are listed on a regulated market. The new directive will reduce administrative costs and simplify the listing process by changing the requirements on information to be included in the prospectus for public offerings or listing.

Related documents

Public consultation by the European Commission (28.05.2010)
Consultation on modernisation of Directive 2004/109/EC (transparency requirements for listed companies)
http://ec.europa.eu/internal_market/securities/docs/transparency/directive/consultation_questions_en.pdf

Proposal for a Regulation of the European Parliament and of the Council (02.06.2010)
Amendment to Regulation (EC) 1060/2009 on rating agencies
http://ec.europa.eu/internal_market/securities/docs/agencies/100602_proposal_pt.pdf

Public consultation by the European Commission (14.06.2010)
Consultation on short selling
http://ec.europa.eu/internal_market/consultations/docs/2010/short_selling/consultation_paper_en.pdf

Public consultation by the European Commission (28.06.2010)
Consultation on the review of the Market Abuse Directive
http://ec.europa.eu/internal_market/consultations/docs/2010/mad/consultation_paper.pdf

Proposal for a Regulation of the European Parliament and of the Council (15.09.2010)
Proposal for a regulation on short selling and certain aspects of credit default swaps
http://ec.europa.eu/internal_market/securities/docs/short_selling/20100915_proposal_en.pdf

Public consultation by the European Commission (05.11.2010)
Public consultation on credit rating agencies
http://ec.europa.eu/internal_market/consultations/docs/2010/cra/cpaper_en.pdf

Directive 2010/73/EU of the European Parliament and of the Council (24.11.2010)
Review of the Prospectus Directive

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:327:0001:0012:EN:PDF

Public consultation by the European Commission (08.12.2010)
Consultation on the review of the Markets in Financial Instruments Directive (MiFID)
http://ec.europa.eu/internal_market/consultations/docs/2010/mifid/consultation_paper_en.pdf

Taxation

In 2010, EU rules were approved that were not aimed specifically at banking but were still relevant to its activity. The laws in question essentially addressed changes in VAT.

The changes were made by directives that amended others, namely that on optional, temporary use of a reverse charge mechanism in relation to supplies of certain services susceptible to fraud (Directive 2010/23/EU), that on VAT refund procedures (Directive 2010/66/EU) and that on the duration of the obligation to respect a minimum standard rate of 15% (Directive 2010/88/EU).

In addition, on 1 December 2010, the European Commission issued a green paper on the future of VAT in order to encourage discussion of the VAT system The issues suggested by the paper were a reduction in the system's complexity, the positive impact of perfecting the VAT scheme for the single market, a reduction in the system's vulnerability to fraud and its adaptation to technological changes.

Related documents

Directive 2010/23/EU of the Council (16.03.2010)
Amendment to Directive 2006/112/EC on the common VAT system
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:072:0001:0002:PT:PDF

Directive 2010/66/EU of the Council (14.10.2010)
Amendment to Directive 2008/9/EC on forms of VAT refund
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:275:0001:0002:PT:PDF

Green paper of the European Commission (01.12.2010)
About the future of VAT
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0695:FIN:PT:PDF

Directive 2010/88/EU of the Council (07.12.2010)
Amendment to 2006/112/EC on the common VAT system
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:326:0001:0002:PT:PDF

Corporate governance

There were two important initiatives in the area of **corporate governance** in 2010. The first was a green paper published by the European Commission, which began public consultation on possible measures to improve corporate governance in financial institutions. The deadline for answering the consultation is 1 September 2011. The second was a document from the Basel Committee on Banking Supervision setting out principles for improving governance of banks. These principles cover the role of the Board of Directors (BoD), its qualifications and members, the relevance of independent risk management, the importance of ongoing monitoring of business risks at consolidated and separate level, the BoD's monitoring of remuneration schemes and the in-depth knowledge that the BoD and senior management should have of the institution's operating structures and the risks of its activity.

Related documents

Green paper of the European Commission (02.06.2010)
Corporate governance at financial institutions and remuneration policies
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0284:FIN:PT:PDF

Principles of the Basel Committee on Banking Supervision (04.10.2010)
Principles for enhancing corporate governance - final document
http://www.bis.org/publ/bcbs176.pdf

Annex C – Alterations to international accounting standards

IFRS 1 (Altered) – First time adoption of the international financial reporting standards and IAS 27 – Consolidated and separate financial statements

The alterations to IFRS 1 – "First time adoption of the international financial reporting standards" and to IAS 27 – "Consolidated and separate financial statements" are effective for periods starting on or after 1 July 2009.

These alterations allowed entities adopting the IFRS (International Financial Reporting Standards) for the first time in preparing their separate accounts to use as the deemed cost of their investments in subsidiaries, joint ventures and associates their fair value on the date of transition to the IFRS or, alternatively, the balance sheet value based on the previous accounting reference.

IFRS 3 (revised) – Business combinations and IAS 27 (altered) - Consolidated and separate financial statements

In January 2008, the International Accounting Standards Board (IASB) issued IFRS 3 (Revised) – "Business combinations", which was mandatory for periods starting on or after 1 July 2009, though could be adopted earlier.

The main impacts of the changes to these standards are on: (i) the treatment of partial acquisitions in which non-controlling interests (previously called minority interests) can be measured at fair value (which also entails recognising goodwill attributable to non-controlling interests) or as a parcel attributable to non-controlling interests of the fair value of the equity acquired (as currently required); (ii) step acquisitions in which new rules require, during calculation of goodwill, the revaluation against profit or loss of the fair value of any non-controlling interest held prior to the acquisition leading to control; (iii) the recording of costs directly related to acquisition of a subsidiary that are directly imputed to profit or loss; (iv) contingent prices whose alteration in estimate over time is recorded in profit or loss and does not affect goodwill and (v) changes in the percentages of subsidiaries held that do not result in loss of control, which are then recorded as changes in equity.

In addition, the changes to IAS 27 also result in accumulated losses in a subsidiary being attributed to non-controlling interests (recognition of negative non-controlling interests) and, when a subsidiary is sold, involving loss of control, any non-controlling interests retained is measured at fair value on the date of sale.

IFRS 9 - Financial instruments

In November 2009, the International Accounting Standards Board issued IFRS 9 – "Financial instruments Part I: Classification and measurement". It is mandatory for periods beginning on 1 January 2013, though it may be adopted earlier.

This standard is part of the first phase of the overall IASB project to replace IAS 39 and addresses the classification and measurement of financial assets.

The main aspects considered are as follows:

– Financial assets can be divided into two categories: amortised cost or fair value. The decision is made when financial assets are first recognised. Their classification depends on how an entity reports these financial assets in its business management model and the contractual characteristics of the financial flows associated with each financial asset.

– Only debt instruments whose financial flows represent only capital and interest can be measured at amortised cost, i.e. if they only have basic debt characteristics, for which an entity's business management model carries these financial assets in order to attract only these financial flows. All other debt instruments are recognised at fair value.

– Equity instruments issued by third parties are recognised at fair value with subsequent variations recorded in profit or loss. However, an entity can irrevocably choose equity instruments for which variations in fair value and capital gains or losses are recognised in reserves at fair value. The gains and losses recognised there cannot be recycled by profit or loss. This decision is discretionary and does not mean that all equity instruments must be treated like this. Dividends received are recognised in profit or loss for the period.

IAS 39 (Altered) – Financial instruments: recognition and measurement – assets and liabilities eligible for hedging

The International Accounting Standards Board issued an alteration to IAS 39 – "Financial instruments: recognition and measurement – assets and liabilities eligible for hedging", which is mandatory for periods beginning on or after 1 July 2009.

This alteration clarifies compliance with the principles determining which risks or cash flows are eligible for inclusion in a hedging operation.

IFRIC 12 – Service concession arrangements

In July 2007, the International Financial Reporting Interpretations Committee (IFRIC) issued IFRIC 12 – "Service concession arrangements", which was mandatory as of 1 January 2008, though it could be adopted earlier. The European Union only adopted this interpretation in 2009, which is why it is mandatory as of 1 January 2010.

IFRIC 12 applies to public-private service concession arrangements and covers only situations in which the grantor (i) controls or regulates the use of the services provided by the operator and (ii) controls residual interests in the infrastructure at the end of the term of the arrangement.

IFRIC 17 – Distributions of non-cash assets

This interpretation clarifies the accounting treatment of non-cash dividends to shareholders. It is mandatory in periods beginning on or after 1 July 2009.

IFRIC 18 – Transfers of assets from customers

IFRIC 18 – "Transfers of assets from customers" came into effect for periods beginning on or after 1 July 2009.

This interpretation clarifies the accounting treatment of agreements in which an entity receives from a customer assets for its own use in order to connect the customer to a network or grant the customer ongoing access to a supply of goods or services.

The interpretation clarifies:
• the asset's position in the scope of this interpretation
• recognition of the asset and its initial measurement
• the identifiable services (one or more services in exchange for the asset transferred)
• recognition of earnings
• accounting for the transfer of money by the customer

IFRIC 9 and IAS 39 (amendments) – "Reassessment of embedded derivatives", which clarify the circumstances in which it is possible to subsequently re-appreciate the obligation to separate an embedded derivative for periods ending on or after 30 June 2009.

Annual Improvement Project

In May 2008, the IASB published the Annual Improvement Project, which altered certain standards. For the period beginning on 1 January 2010, the standard altered was as follows:

- Amendment to IFRS 5 – "Non-current assets held for sale and discontinued operations" is effective for periods starting on or after 1 July 2009. This amendment clarified that all assets and liabilities of a subsidiary must be classified as non-current assets held for sale, in accordance with IFRS 5, if there is a plan for the partial sale of the subsidiary involving loss of control.

All these standards are available on www.ifrs.org.

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