



EUROPEAN CENTRAL BANK

EU BANKING STRUCTURES

OCTOBER 2005

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LIST OF COUNTRY ABBREVIATIONS

AT	Austria
BE	Belgium
BG	Bulgaria
CH	Switzerland
CY	Cyprus*
CZ	Czech Republic*
DE	Germany
DK	Denmark
EE	Estonia*
ES	Spain
FI	Finland
FR	France
GR	Greece
HU	Hungary*
IE	Ireland
IT	Italy
JP	Japan
LT	Lithuania*
LU	Luxembourg
LV	Latvia*
MT	Malta*
NL	Netherlands
PL	Poland*
PT	Portugal
RO	Romania
SE	Sweden
SI	Slovenia*
SK	Slovakia*
UK	United Kingdom
US	United States
EEA	European Economic Area (18 countries; EU-15 plus Norway, Iceland, and Liechtenstein)
EU (EU-25)	European Union (25 countries, after enlargement on 1 May 2004)
EU-15	European Union (15 countries, before enlargement on 1 May 2004)
NMS	New Member States (10 countries, marked with *)



EXECUTIVE SUMMARY

Continuing with a practice that began in 2002, this is the fourth annual review of structural developments in the EU banking sector. The analysis is based on a wide range of indicators as well as on an exchange and assessment of qualitative information by the Banking Supervision Committee's (BSC) member organisations.

The report starts with a review of general trends in the banking sector, focusing on developments until mid-2005. Four short articles then look in more detail at the structure of and developments in EU syndicated lending markets, competition in EU mortgage markets, EU consumer lending, and the international activities of a sample of large EU banks.

The finalisation of the Basel II framework and the introduction of new International Financial Reporting Standards (IFRS), as well as the revision of some existing International Accounting Standards (IAS) were the most significant regulatory developments in 2004 and early 2005. Retail financial services and corporate governance also received some attention from regulators during the past year, as the European Commission set out its plans for the future of financial services policy in the EU and as part of amendments to governance frameworks in various countries.

Internationalisation and consolidation continued to shape developments in the banking industry in the review period, although, in recent years, this trend has been in decline. Whilst this consolidation process within and across borders and sectors may make individual institutions less reliant on any single region or product line – and hence contribute positively to financial stability in the longer-term – as institutions grow larger, so too will their systemic relevance. Also, the changing nature of banks' activities and their linkages to one another have an impact on the industry's long-term risk profile.

With regard to banking activities, these continued to focus on retail business – in

particular mortgage and consumer lending – and consequently represent a growing share of banks' profits. In addition, the business model followed by EU banks is slowly changing from being an integrated production and distribution platform for financial services into an increasingly open architecture. Furthermore, the funding structure of EU banks is being reshaped and is becoming more diversified and less reliant on deposits.

Overall, the EU banking system is becoming more integrated over time, and it is probable that competitive conditions will continue to intensify. Notwithstanding this, some important obstacles remain, the removal of which would effectively improve consumer welfare. This is particularly evident in consumer lending markets, as documented in this report.

Turning to the short articles, the chapter on syndicated lending shows that this activity has grown significantly over the last two decades and has reshaped banks' relationships with large corporations. Syndicated lending contracts have become more standardised and have contributed to financial integration, by creating wider and more liquid funding opportunities for borrowers and a level playing field for banks. Some notable developments have emerged in the EU syndicated loans market over the last decade, in particular relating to margins for investment-grade borrowers. The latter have narrowed owing to strong competition among banks in this segment, and a sharp rise of the leveraged market segment, where lower levels of risk compensation may have taken root. A careful assessment of the way in which this market segment is evolving and whether such developments signal potential risks is warranted.

The special focus on competitive conditions across the different EU countries' national mortgage markets reveals that these have intensified in recent years, albeit mostly within domestic markets. Although differences in

national rules and natural barriers such as culture, tradition and language play a central role, industry representatives have also identified different consumer protection standards and the lack of profit opportunities stemming from strong domestic competition as factors limiting foreign presence. More generally, intense competition in EU mortgage markets – should it result in a lowering of standards in credit risk assessment, too narrow margins or a greater exposure to markets that have shown some deviation of house prices from intrinsic values – could threaten financial stability. Comfort is provided by the relative security of mortgages and by the fact that risk management practices are generally assessed as being sound.

As regards consumer lending, the range of both products and providers appears to have expanded significantly during the past decade, whereas the funding has gradually shifted from deposits to capital market instruments. Cross-border integration is found to be relatively weak at present but may develop over time, supported by new EU proposals for regulations aimed at harmonising the various national consumer credit frameworks. However, some natural barriers such as language and cultural differences are likely to continue to uphold the importance of the supplier's proximity. As with mortgage products, intense competition in this market segment could raise concerns over financial stability were margins to be eroded or standards for credit risk assessment lowered.

The article on large EU banks that are internationally active compares their characteristics with those of a wider group of peers, as well as with each other. This group of around 40 large banks is typically better capitalised, more profitable, and less risky than its national competitors. However, when contrasted with one another, a higher foreign presence is positively associated with size, and negatively with provisions and capital buffers, possibly signalling some diversification benefits within the group from cross-border operations. Furthermore, several factors are

found to be conducive to a higher presence of foreign credit institutions in local banking markets. Where the local banking market is more profitable, has higher safety buffers (i.e., solvency and provisions) and is more concentrated, the foreign presence tends to be higher. Smaller and financially less developed banking markets are relatively more penetrated by foreign banks, and a stable environment tends to favour the development of larger domestic entities relative to foreign ones.



I OVERVIEW OF DEVELOPMENTS IN THE EU BANKING SECTOR IN 2004

This chapter provides an overview of general structural developments in the EU banking sector between 2004 and mid-2005.¹ General regulatory developments that have affected the banking sector, as well as developments in banking structures – i.e. consolidation, market structure, internationalisation and integration, intermediation, and funding – are discussed.

1.1 REGULATORY DEVELOPMENTS

Regulatory initiatives pertaining to the EU banking sector focused on three issues during 2004 and early 2005: the adoption of new international financial reporting standards, progress in the finalisation of the European Commission's Directive for the implementation of Basel II, and the presentation of the European Commission's Green Paper on Financial Services Policy (2005-2010) upon the completion of the Financial Services Action Plan (FSAP). Furthermore, corporate governance rules continued to be an important issue in some EU countries and international fora.

The main regulatory initiative under discussion in 2004 was the adoption of a new set of international financial reporting standards (IFRS) and the revision of some existing standards (IAS) issued by the International Accounting Standards Board (IASB). Discussion of this initiative has been particularly prominent in the EU given that the regulation in question² requires all listed European companies, including banks, to publish their consolidated financial statements in accordance with the IFRS from 1 January 2005.³ The policy discussion surrounding the IFRS has centred on some of their potential effects on financial stability in response to some studies which show that the adoption of the IFRS may result in greater income and balance sheet volatility relative to current accounting standards.

In June 2004 the Basel Committee published the final version of the new capital adequacy

rules (Basel II) and, one month later, the European Commission released its own proposals on new capital requirements for banks and investment firms in the EU. The new rules are more risk-sensitive than the existing rules (Basel I) as they require less capital for better quality loans and more capital for poorer quality loans. The introduction of the new rules could release some of the banks' current regulatory capital, which could translate into an estimated annual increase in profits of €10-12 billion for the EU banking sector as a whole.⁴

Under the Financial Services Action Plan (FSAP), which originally brought together 42 legislative measures to create a single market in financial services, 39 measures were adopted by mid-2005. Some important measures adopted in 2004 include amendments to company law to allow fair value accounting, modernisation of accounting provisions, communication and corporate governance, supplementary supervision of financial conglomerates, and the Directive on financial instruments markets.⁵

In its Green Paper on Financial Services Policy (2005-2010), the European Commission prioritised the simplification and consolidation of existing relevant financial regulations and the pursuit of further supervisory convergence as well as implementation of the outstanding FSAP measures. Moreover it aims at carefully assessing any new legislative action and giving relevant stakeholders sufficient time to adapt

1 A number of structural statistical indicators (SSIs) for the banking sector are collected each year from EU supervisory authorities and central banks and are listed in Annex 1. This year, the annex is expanded with data from the new EU Member States (NMS) that joined on 1 May 2004. As far as possible, historical data are also provided for the group of NMS.

2 Regulation (EC) No 1606/2002 on the application of international accounting standards.

3 See also the box on the financial stability implications of the new IFRS in the ECB (2005), *Financial Stability Review*, June, p. 76-77

4 Basel Committee on Banking Supervision, *Third Quantitative Impact Study*, July 2003, and national impact studies (QIS4) undertaken in 2004 and early 2005.

See also www.bis.org/bcbs/qis

5 See also europa.eu.int/comm/internal_market/finances/actionplan

to the changes these measures require.⁶ As regards the banking sector, regulatory interventions on retail banking as well as asset management will be considered.

New corporate governance rules have been introduced or strengthened in the past two years in many European countries, in line with a trend towards greater accountability and transparency.⁷ Good corporate governance will continue to be important for companies as a factor for accessing capital and for share price performance. For banks, adequate corporate governance is even more important, owing to their role as a financial intermediary and the comparatively higher risk of contagion in the banking sector.

These recent regulatory developments may affect some of the longer-term trends under way in the EU banking sector. They have the potential to enhance the EU banking sectors' competitiveness, facilitate the cross-border provision of services and promulgate a more integrated and diversified financial system.

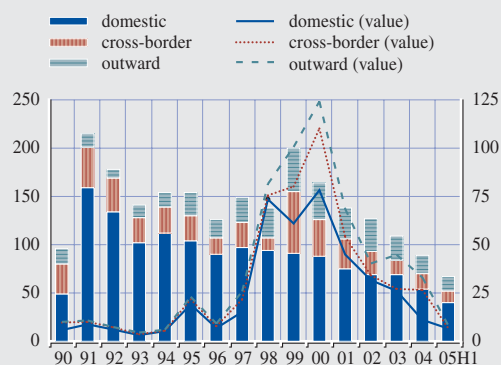
1.2 CONSOLIDATION

The number of credit institutions in the EU has been declining since 1997, and in 2004 it dropped by a further 2.8% (see Table 1 in the annex).⁸ In 2004 the total number of EU credit institutions stood at 8,374.

Mergers & Acquisitions (M&A) activity has been declining since 1999, and this trend continued in 2004 and the first half of 2005. This suggests that consolidation is proceeding, albeit at a decelerating pace (Chart 1 and 2). This decline can be explained mainly by a slowdown in domestic M&A activity. By contrast, cross-border M&As have increased relative to the period 1993-1998, both in absolute and relative terms, accounting for about 30% of the number and 24% of the value of all deals in the more recent period, up from 20% in the earlier period.⁹ Increased financial market integration, higher competition and

Chart 1 Number and value of banking sector M&As in EU-15

(1990-2005H1; number of deals = left-hand scale; value (EUR billions) = right-hand scale)



Source: Thomson Financial SDC.

Note: 2005 figures are annualised. Cross-border M&A refers to transactions in EU-15 involving a non-domestic acquirer. Outward M&A refers to non-EU acquisitions of EU-15 banks (only up to 2005Q1). The number of deals is shown on the left-hand scale. Value of deals is represented as stacked lines on the right-hand scale, but is missing for a number of deals.

limits to domestic concentration, as well as the introduction of the euro are seen as possible explanations for this development.

The high profile acquisition of Abbey National (UK) by Banco Santander Central Hispano (ES), as well as other recently announced M&A transactions¹⁰, have served to renew public debate on cross-border consolidation in the EU banking sector. Some claim that this may mark the resurgence of cross-border banking

6 European Commission, Green Paper on Financial Services Policy (2005-2010), COM (2005) 177, May 2005.

7 See also ECB (2005), "The evolving framework for corporate governance", Monthly Bulletin, May, 89-100. Also note that the BCBS is currently evaluating an update of the guidance on "Enhancing Corporate Governance for Banking organisations".

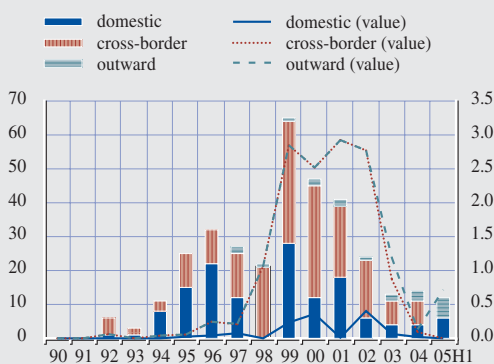
8 See also ECB (2005), "Consolidation and diversification in the euro area banking sector", May, Monthly Bulletin, 79-87.

9 However, cross-border M&As in other sectors of the economy generally account for around 45% of all M&A deals.

10 During the first half of 2005, two other large cross-border deals were finalised: the acquisition by Danske Bank (DK) of two Irish banking units and of Hansapank (EE) by Swedbank (SE). At the same time, three proposals for cross-border M&As that attracted wide public attention were those by ABN Amro (NL) and BBVA (ES) wishing to acquire Antonveneta (IT) and BNL (IT), respectively, and by Unicredit (IT) to acquire HVB (DE).

Chart 2 Number and value of banking sector M&As in NMS

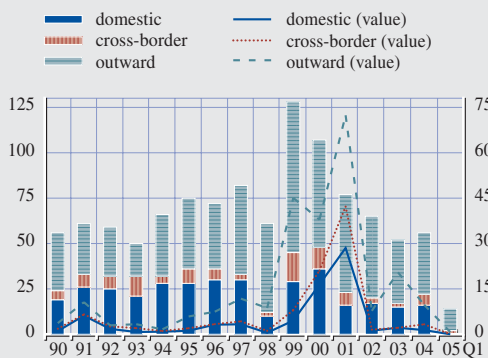
(1990-2005H1; number of deals = left-hand scale; value (EUR billions) = right-hand scale)



Source: Thomson Financial SDC.
Note: See notes to Chart 1.

Chart 3 Bancassurance M&As in the EU-25

(1990-2005H1; number of deals = left-hand scale; value (EUR billions) = right-hand scale)



Source: Thomson Financial SDC.
Note: Bancassurance refers to banks acquiring insurance companies and insurance companies acquiring banks. See also notes to Chart 1.

integration in the EU, as significant excess capital is currently being generated in the banking sector.¹¹ Recent changes in regulatory frameworks (the IFRS, Basel II, and the Financial Conglomerates Directive) could also stimulate moves towards bigger entities.¹²

The ongoing consolidation of the EU banking sector may change competitive conditions and further improve the efficiency and diversification of EU banks. On the other hand, cross-border deals are often more problematic in delivering synergies, as it is more difficult to quantify and realise the efficiency gains, and may involve a potentially larger overpayment to acquire a local branch network. Different rules and regulations make it difficult for financial services companies to expand into other EU countries and bank products tend to be specific to each country and thus cannot be easily sold across borders. This may affect the ability of EU banks to exploit economies of scale through operating at a pan-European level. Furthermore, there may be cultural and language barriers and labour market rigidities which act as an obstacle to cross-border M&As in Europe.¹³ In this context, Chapter 5 examines determinants of internationalisation strategies of large EU banking groups in more detail.

Cross-sector consolidation between banks and insurance companies remained low in 2004 relative to the peaks in deal value seen between 2000 and 2001, but was in line with the level of market activity seen in the last two years (Chart 3).¹⁴

11 According to a study by Morgan Stanley and Mercer Oliver Wyman ("European Banking Consolidation", February 2005), the EU banking sector will generate €74 billion of "excess capital" by 2006.

12 Other, more traditional arguments are, first, defensive reasons, which motivate other banks to look for cross-border M&A opportunities, or risk falling behind in international league tables. Second, cross-border mergers have the potential to reduce bank risk and may therefore be seen as a sound policy of geographic diversification and creation of synergies. Third, in local banking sectors that are already highly concentrated, international M&As seem the only possible way forward for growth.

13 A survey by KPMG conducted among 2,360 bank customers in March 2004 showed that 53% of the retail customers in 10 EU countries would prefer to deal with a local bank instead of a foreign bank and 46% would not want to see the emergence of a handful of pan-European "super banks", suggesting that people generally do not favour the idea of a few dominant players monopolising the market.

14 In terms of value, bancassurance deals during the period 1990-2005Q1 were mainly performed in North America. However, a large number of (low-value) deals were concluded in other European (non-EU) countries.

1.3 MARKET STRUCTURE

Many countries, especially smaller EU Member States, continue to be characterised by high concentration in the banking sector, as measured by the share of the five largest institutions in total banking sector assets (see Table 3 in the annex). However, concentration remained relatively low in DE, IT, LU and the UK.¹⁵ Similar evidence is conveyed by the Herfindahl index, which measures the sum of the squared market shares of the individual institutions.¹⁶

In recent years, a number of studies have attempted to measure whether a concentrated market structure adversely affects competitive market conditions. This would primarily be the case if the market were characterised as a monopoly or an oligopoly, as this

raises concerns over the exploitation of market power. Evidence for most EU countries shows that banking markets tend to be characterised by monopolistic competition. It is noteworthy that some studies show that a more concentrated banking system goes hand in hand with a more competitive structure.¹⁷ This may indicate that a

15 In DE and IT, this can among other things be attributed to a dual banking structure (with both commercial and cooperative banks), while in LU and UK, this is due to the presence of many foreign banks not directly providing services to residents, hence understating the level of concentration of banking services to residents.

16 According to US competition authorities, a number higher than 1,800 indicates a concentrated market.

17 See, for example, Bikker and Haaf (2002), "Competition, concentration and their relationship: An empirical analysis of the banking industry", *Journal of Banking and Finance* 26 (1), 2191-2214; Claessens and Laeven (2004), "What Drives Bank Competition? Some International Evidence" *Journal of Money, Credit and Banking*, 36, 563-584.

Table 1 EU banking sector capacity indicators relative to population (2004)

	CIs	Pop. per CI	Pop. per ATM*	Pop. per employee	Population density	Assets per employee
BE	104	100,173	1,468	146	315	12,818
CZ	68	150,031	4,000	264	129	2,238
DK	202	26,748	1,876	123	125	12,368*
DE	2,148	38,408	1,613	114	231	9,244
EE	9	150,667	2,096	304	30	2,020
GR	62	178,082	2,008	186	84	3,884
ES	346	123,238	785	173	84	6,981
FR	897	69,317	1,464	146	113	9397*
IE	80	50,702	2,070	114	58	16,130*
IT	787	74,021	1,490	173	193	6,753
CY	43	17,140	1,938	87	80	4,502
LV	23	100,557	2,681	240	36	1,157
LT	74	46,473	3,484	473	53	1,171
LU	162	2,794	1,161	20	175	30,826
HU	213	47,451	3,401	279	109	1,793
MT	16	25,094	2,674	120	1,255	6,081
NL	461	35,369	2,151	141	399	14,552
AT	796	10,270	1,078	112	97	8,720
PL	653	58,448	5,051	255	118	882
PT	197	53,329	871	199	114	6,547
SI	24	83,225	1,610	172	99	2,108
SK	21	256,303	3,571	295	110	1,590
FI	363	14,400	2,604	206	15	8,371
SE	212	42,425	3,344	230	20	14,878
UK	413	145,336	1,277	117	245	13,628
MU12**	6,403	48,689	1,347	142	121	10,226
EU25**	8,374	54,966	1,523	150	115	11,077

Source: Computations based on data in Annex 1 and ECB Blue Book.

Note: Population density is expressed as inhabitants per square kilometre. Assets per employee is measured in EUR thousands.

*: Data for the year 2003. **: Unweighted average.

concentrated market structure can be a consequence of economies of scale and scope, as larger players tend to be more efficient.

There also continues to be evidence of cost cutting and downsizing in some countries. However, this seems to pertain mostly to large banks and manifests itself in a reduction in staff levels, but less in a reduction of branch networks (see Tables 1 and 2 of the annex). Some banks also continued to re-position and sell non-core activities, ranging from investment banking to wealth management and insurance, mostly to concentrate on retail banking.

There continue to be significant differences in terms of banking market structures between EU member states. Table 1 describes the use of capital and labour in providing similar services in a sector that shares a common technology. If a country's banking sector is characterised by a dense network of banks, a high number of employees, and at the same time operates a dense network of ATMs, this may point to overcapacity in distribution channels.¹⁸

1.4 INTERNATIONALISATION AND INTEGRATION

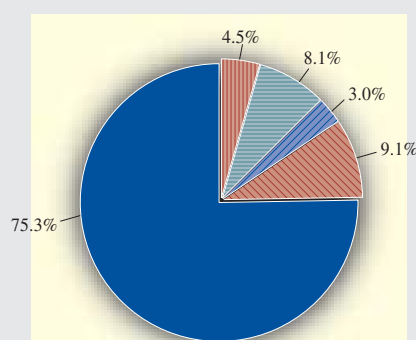
Although cross-border banking M&A has been relatively limited in the EU, some regional banking clusters especially in the Benelux, Nordic and Southern European countries have gradually emerged over the past decade. In Central and Eastern Europe clustering has also taken place, especially with banks from DE, AT, IT, SE and BE.

The market share of foreign branches and subsidiaries in the EU as a whole stood at 24.7% at the end of 2004 (see Chart 4), compared to 23.4% in 2003. The banking sectors of NMS, are particularly characterised by high levels of foreign ownership. On aggregate, 71% of the NMS banking sector is foreign-controlled (of which 63.5% is by EEA banks), compared to 15.5% in the euro area.

Chart 4 Share of foreign bank branches and subsidiaries in the EU

(2004; % total assets)

total domestic CIs
branches third countries
branches EEA countries
subsidiaries third countries
subsidiaries EEA countries



Source: Computations based on figures in Annex 1.

Around half of the foreign presence in EU countries is through subsidiaries, although under current EU banking legislation, branching can be easily performed, and a single corporate entity would facilitate the exploitation of economies of scale. However, the advantage of a subsidiary structure lies in the fact that loss in one office is not carried by another office ("ring-fencing"). In addition, a subsidiary structure can help to break local resistance to a merger and allows business units to be sold more easily. The fact that this structure is more flexible from the international corporate tax and deposit insurance perspectives may reflect some imperfections in the European integration process.¹⁹

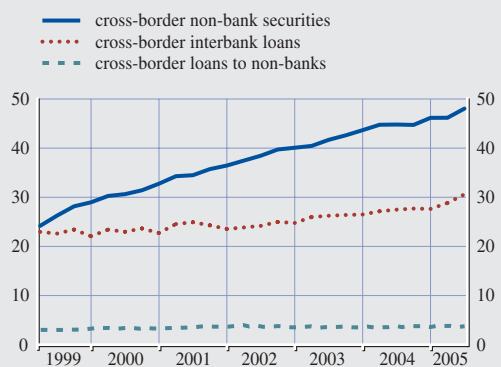
Another way in which banks have expanded their activities internationally is the cross-border provision of financial services. In 2004

¹⁸ However, it should be noted that less densely populated countries may need more branches to cover the same number of customers than more densely populated countries. Furthermore, high banking employment levels may not only reflect excess capacity, but also a financial sector that plays an important role as an international or off-shore financial centre.

¹⁹ See Dermine (2002), "Banking in Europe: Past, present and future", ECB: The transformation of the European financial system.

Chart 5 Cross-border provision of financial services in the euro area

(as a percentage of total)



Source: ECB.

Note: Figures express cross-border activity as a percentage of total euro area provision of financial services.

a large increase in the number of notifications for the cross-border provision of financial services in NMS was observed, especially from financial service providers in AT, DE and the UK. It should be noted, however, that the number of entities that eventually take up new business is usually much smaller than those making notifications.

Available data for euro area banks show that cross-border holdings of interbank loans and securities are very significant, amounting to more than 45% of total holdings, and continues the rising trend observed in the past few years (Chart 5). However, cross-border loans to the private sector as a percentage of the total loan book remain low, reflecting the importance of proximity of banks to their clients and relationship lending.

In 2004 a report commissioned by the European Commission identified the main barriers to further integration of EU mortgage credit markets and the impact of such barriers on the functioning of the Internal Market.²⁰ It revealed that, in mortgage lending, and in retail markets more generally, consumer protection legislation, choice of law, access to national land registers, and the liquidity of secondary markets and efficient funding were highlighted by the

industry representatives as the main challenges to further integration (see also Chapter 3).

Finally, internationalisation is also signalled by cross-border shareholding relations. In this respect, over the period 1995-2005Q1, nearly 60% of EU cross-border deals occurred through majority stakes, compared to around 80% of domestic EU-15 deals and 70% in NMS.

1.5 INTERMEDIATION ASPECTS

The alignment of different services and systems (including payment and settlement systems), centralisation, enhanced co-operation between institutions and outsourcing of IT and office services continued in 2004.²¹ This is consistent with the redesign of the value chain in banking from an integrated manufacturing towards an “open architecture” business model, separating origination, production, distribution and settlement of financial services. The increased focus on core functions over the past years and the more efficient operational management resulting from the sale and restructuring of business units has furthermore contributed to the improvement observed in the performance of EU banks in 2004.

In recent years, concerns have been raised about the price evolution of banking services. Comparing the increase in the cost of financial services with general consumer price inflation (HICP), Chart 6 shows that the increase in financial services prices has generally been lower than that of the HICP (as the regression coefficient is statistically lower than 1.0).²² Furthermore, cost increases have been uneven across countries, although this is largely

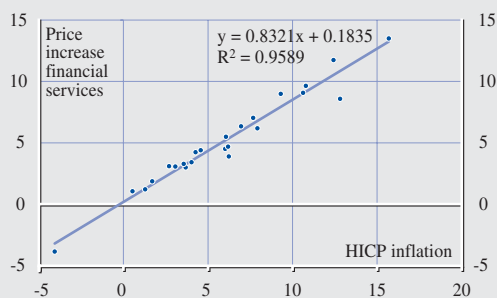
20 “The integration of the EU mortgage credit markets”, Report by the Forum Group on Mortgage Credit, European Communities, 2004.

21 See Outsourcing in the EU banking sector, Report on EU Banking Structures, November 2004, pp. 25-32.

22 The cost of financial services includes actual charges for the financial services of banks, post offices, savings banks, money changers and similar financial institutions, as well as the fees and service charges of brokers, investment counsellors, tax consultants and the like.

Chart 6 Increase in the general price level (HICP) and in costs of financial services

(1997-2004)



Source: ECB.
Note: The cost of financial services refers to COICOP class 12.6.2 of the HICP index.

attributable to differences in domestic HICP increases.

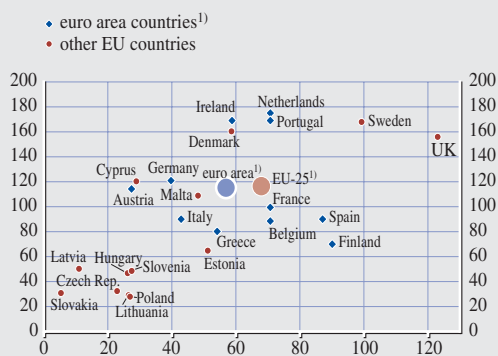
Anecdotal evidence also seems to indicate that many banks continue to focus on core activities, especially concentrating on retail, in particular mortgage and consumer lending, SME lending, and fund management.²³

Chart 7 shows that, for the EU as a whole, the domestic credit-to-GDP ratio stood at 116% in 2004 (120% in 2003), and stock market capitalisation reached 68% (against 70% in 2003). Nevertheless, with few exceptions, bank financing remains predominant in financial intermediation in the EU.

Direct market access by mostly large companies increased in several countries (see Table 7 of the annex), although it differed somewhat depending on the sector, with more rapid expansion in transport, technology, media and telecommunications (TMT) and manufacturing industries. These sectors have also played a prominent role in syndicated lending markets in recent years (see also Chapter 2).

Chart 7 Banking sector versus stock market

(as % of GDP; 2004; x-axis: stock market capitalisation; y-axis: domestic credit)



Source: IMF and World Federation of Stock Exchanges.
1) Excl. Luxembourg.

1.6 CHANGES IN FUNDING STRUCTURES

The funding structures of EU banks underwent substantial changes in recent years. This can be attributed both to structural trends (e.g., the increasing degree of private pension savings' schemes, the changing composition of household and firms' financial wealth, changes in preferences, shifts in EU banks' funding strategies) as well as cyclical developments (low interest rate environment and changing risk/return tradeoffs). Therefore, with a loan-to-deposit ratio of around 1.2 in the EU and limited growth of deposits, EU banks had to diversify their funding with other on and off-balance types of funding. At the same time, banks were drawn to compete more heavily in attracting deposits, by offering higher interest rates and introducing enhanced deposit products.

In many EU countries, the securitisation market has grown rapidly over the past couple of years. According to the European Securitisation Forum, issuance in the European securitisation market set a record in 2004 with €243.5 billion, compared with €217 billion in

²³ Specific attention is given to the evolution and competitive structure of EU mortgage markets (Chapter 3), and to developments in EU consumer lending markets (Chapter 4).

2003.²⁴ The issuance of residential mortgage-backed securities (RMBS) forms the largest segment (nearly 50% of total issuance in 2004), before securities backed by receivables (€32.5 billion) and collateralised debt obligations (€25.2 billion). The economic rationale for originating, issuing and investing in mortgage and asset-backed securities includes capital relief, funding and spread arbitrage.²⁵

EU banks are slowly changing their role as an intermediary between borrowers and lenders in risk transfer markets. While trying to maintain their position in traditional lending activities, EU banks are increasing their activities in credit risk transfer markets, whereby loans are granted but the respective credit risk is transferred to third parties. Furthermore, the importance of banks may change as corporate clients and governments become increasingly interested in originating securities which banks can sell on to investors.²⁶

1.7 CONCLUSION AND OUTLOOK

The role and importance of banks in Europe is slowly changing. Consolidation has been driven both by external factors, such as changes in regulations, and by sector-specific factors, including competitive strategies and the search for scale and scope effects. This has led to increased domestic concentration and a growing trend toward international expansion. The role of banks as intermediaries between borrowers and lenders is also slowly changing. While trying to maintain their position in traditional lending activities, EU banks are increasing their activities in risk transfer markets, whereby loans are granted and securitised or credit risk is transferred to third parties while loans remain on the balance sheet.

Structural differences between banking markets across the EU nevertheless continue to be significant. Characteristics such as ownership structures, market concentration, the size and importance of different delivery channels, and the presence of foreign banks

vary substantially across the EU. These differences may narrow in the future as business models become more aligned. This could have important consequences for financial stability in the longer term, as it affects profit and risk trade-offs and cost efficiency and ultimately has a bearing on the shock-absorptive capacity of the banking system.

²⁴ See also www.europeansecuritisation.com. Note that the statistics include some non-EU countries and multinational organisations, accounting for about €23 billion of the issuance in 2004 (the respective categories count for €7 and €16 billion).

²⁵ Securitisation allows banks to free up loan capacity and decrease the amount of capital they must hold, and receive cash funding from selling the collateral to a special purpose vehicle. It may also create arbitrage opportunities to originators (banks) and investors since it allows banks to minimise the weighted average cost of capital and investors to earn substantial spreads over debt securities or liabilities.

²⁶ ECB (2004), Credit Risk Transfer by EU banks: activities, risks and risk management. May.

2 THE EU SYNDICATED LOAN MARKET

This chapter examines several aspects of the EU syndicated loan market. Syndicated lending has grown significantly over the last two decades. Starting out as a sovereign business, it rapidly became a significant source of international funding and now accounts for a third of total funds raised internationally (including bond, commercial paper and equity issues).²⁷ It has contributed to reshaping banks' relationships with the large corporations and, as such, constitutes a structural development that deserves closer examination.

2.1 INTRODUCTION

Syndicated loans are loans granted to a borrower by a pool of banks, thereby spreading credit risk among several lenders. In a loan syndicate, the financing is typically arranged by one or more senior syndicate members acting as (mandated) arrangers. These senior banks act as investment managers and are in charge of bringing together a group of banks to participate in the transaction. They tend to keep a small fraction of the total financing (usually less than 10%) on their balance sheet and collect a loan origination fee (or arrangement fee) from the borrower for arranging the loan contract. The other members of the syndicate (a group of commercial and investment banks typically called managers or participant banks) are the providers of the bulk of the loan. Each member of the pool has a separate claim on the debtor and they retain the corresponding market and credit risk. The providers receive a commitment fee, proportional to the amount of their loan commitment, and a utilisation fee as soon as the facility is drawn.

The EU syndicated loan market appears to be fairly integrated. A recent BIS study²⁸ assesses the degree of integration of this market based on the share of loans arranged or provided by banks of the same country or region as the borrower. In the euro area, the percentage of funds provided via syndicated lending by banks where the nationality was the same as that of the borrower decreased from 43% (in 1993-

1998) to 38% (in 1999-2000). In addition, there have been signs that an increasing share of loans are arranged by euro area banks to borrowers located in another euro area country.²⁹

Foreign banks also have a strong presence in syndicates set up for EU Member State borrowers which remain outside the euro area. Figures are available for the UK, where around 60% of funds come from foreign banks and for the set of countries grouped under the heading "Eastern Europe" in the BIS study where, despite low volumes, the figure comes close to 80%.

2.2 THE GLOBAL AND EU MARKET

The global syndicated loan market experienced significant growth throughout the 1980s and early 1990s, stabilising thereafter (see Chart 8). On average, European borrowers were responsible for around a quarter of the total lending volumes over this period. In the first quarter of 2005, however, syndicated loans involving borrowers from the 25 EU Member States represented close to 40% of the global lending volume.³⁰

The ten new Member States continue to represent a small fraction (on average around 3%) of the EU volume of transactions (see Chart 9). The discrepancy between the volume of business for the EU-15 and that for the euro area mostly reflects the importance of UK borrowers in the syndicated credit market. However, due to the rise in non-UK borrowers, the share of loans to euro area borrowers has increased from around 50% on average to more than 70%.

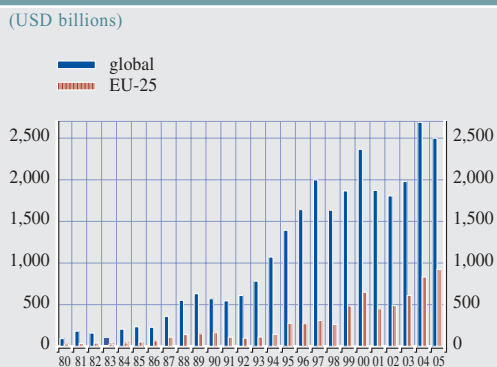
27 See "The syndicated loan market: structure, development and implications", BIS Quarterly Review, December 2004, pp. 75-89.

28 Ibid.

29 Unfortunately, similar computations are not available for the EU as a whole.

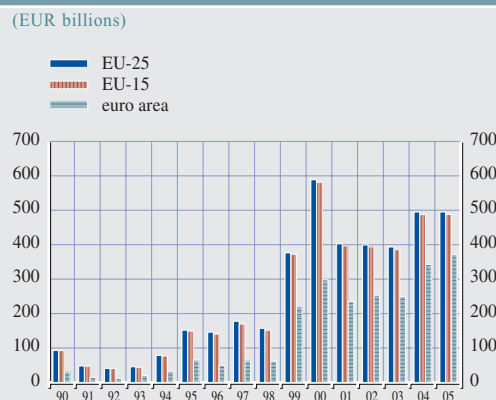
30 Throughout this chapter, given the significant level of integration in this market (with some large internationally active players present in a substantial fraction of the transactions), country-wide comparisons are defined based on the nationality of the borrowers.

Chart 8 Global syndicated loan market



Source: Loanware, Dealogic.
 Note: Data are aggregated for the set of EU-25 countries irrespective of the dates on which they joined the EU. Figures for 2005 until April, annualised.

Chart 9 Syndicated lending in the EU



Source: Loanware, Dealogic.
 Note: See also notes to Chart 8.

In the EU, new lending through the syndicated lending market peaked in 2000 (see Chart 9). The buoyancy of the market was mainly driven by increased borrowing on the part of the telecommunications sector to finance mergers and acquisitions and for the purchase of 3G licenses in Europe. In the euro area alone, syndicated lending to this sector reached €146 billion.

Syndicated credits have been particularly appealing for financing activities in the telecommunications sector for two main reasons. First, few or no banks were in a position to provide the large amounts of funds required by this sector or were willing to bear the market and credit risk alone. Second, especially in 2000, telecommunications firms faced significant uncertainty regarding the cost of licenses and the establishment of networks. The fee structure of a loan syndicate, where a distinction is made between banks' lending commitment and the actual portion of the credit drawn, also fitted the type of committed finance needed by telecommunications firms to participate in auctions.

Loan syndicates represent a small but significant fraction of total bank lending to non-financial corporations (see Chart 10). For the EU-15, the share of syndicated lending in

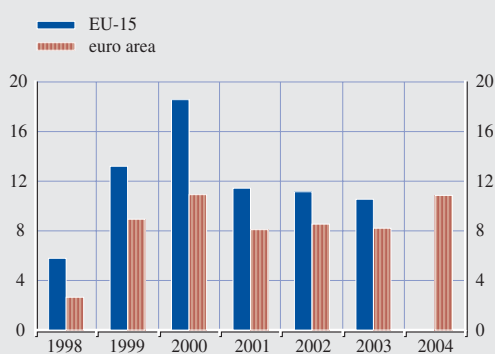
total lending to the non-financial corporate sector was close to 20% in 2000. In the euro area, syndicated credits as a percentage of total loans to corporates tripled between 1998 and 1999 to around 11%.

Syndicated loans in the EU have been characterised by a steady increase in the average amount of funds granted, combined with a stable average maturity which has mostly hovered between five and six years since 1980. Average maturities, however, vary widely across countries.³¹ The average loan size jumped from €135 million before 1995 to close to €320 million over the last decade (see Chart 11).

The growth of the secondary market for syndicated loans was supported by standardised trading arrangements and documentation produced by the Loan Market Association (LMA). According to the LMA, the secondary market for syndicated credits has become increasingly liquid, especially for the distressed loans segment. In Europe, secondary trading volumes increased by more than 50% between 2002 and 2003. However, in 2003, trading in the secondary market represented no

31 For some of the new Member States, for example, the average maturity is around one year.

Chart 10 Syndicated loans as a % of total loans to non-financial corporations



Source: Loanware and WGBD.
Note: For 1998-2002, total EU-15 lending to non-financial companies excludes DK and SE as these figures are not available. The 2004 figures for the EU are not available.

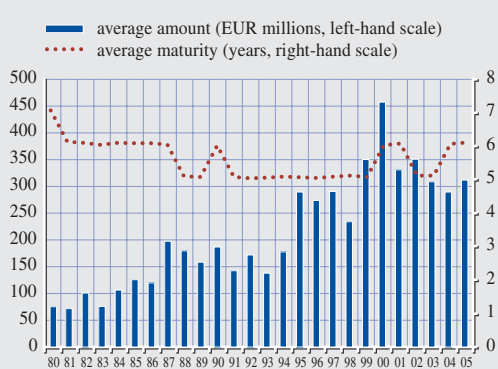
more than 11% of the primary market volume. In addition, only 10% of total syndicated loans originating in Europe were transferable in 2003.³²

2.3 PRICING OF SYNDICATED LOANS

In a loan syndicate, senior banks are mandated by the borrower to bring together the consortium banks and together with the borrower, to shape the terms of the loan (e.g. pricing, maturity, collateral, guarantees). Despite the low costs of obtaining a syndicated credit (see below), syndicated lending generated very high underwriting revenues for banks, especially in the 1990s. In some years this revenue exceeded that generated in the bond or equity markets. Besides earning the bulk of the fees, the senior banks which arrange the syndicated loans can meet borrowers' demand for loan commitments without bearing the corresponding market and credit risk alone.

Junior banks are mostly "price takers" in syndicated lending deals, since they have little influence on the terms of the loan. Fees and the loan margin (usually defined as a spread above Euribor or Libor in European deals) on the amount of funds provided do not represent a

Chart 11 Average amounts of syndicated loans and maturity



Source: Loanware, Dealogic.
Note: Data for 2005 until April.

large incentive for participation in this market as these sources of revenue tend not to be large. However, loan syndication allows junior banks to become involved in certain types of transactions with large borrowers, which allows them to gain exposure in different geographical areas or other industrial sectors that they might not otherwise be able to attain. In addition, junior banks can also benefit from more profitable cross-business with the large borrower (e.g. advisory business, corporate finance).

Average interest margins on all EU syndicated loans, irrespective of borrower credit worthiness (above Libor and Euribor), more than tripled from 1996 levels, reaching more than 200 basis points in 2004 and 2005. The widespread sharp increase in margins and fees did not result from changes in the structure of the syndicated loan market, but rather from an overall increase in credit risk. Indeed, in recent years there has been a substantial rise in the number and amount of leveraged syndicated credits. These are usually loans granted to non-investment grade companies when the ratio of debt to net worth is high. In addition, loans

³² Transferability, a measure of the tradability of loans, is determined by the consent of the borrower to transfer the claim from one creditor to another.

supporting leveraged buy-outs (LBOs), management buy-outs (MBOs) and acquisitions may often be considered as leveraged.

A decomposition of syndicated lending data according to the riskiness of the borrower reveals that margins on investment-grade deals have been falling since 2003 whereas margins on leveraged deals have steadily increased (see Chart 12). More importantly, the share of leveraged deals increased sharply over the last decade, jumping from 0.1% of total lending in 1996 to more than 25% in early 2005.

The significant fall in the cost of raising funds for investment grade companies reflects the high levels of liquidity that prevail around global banks and capital markets, as well as strong competition among banks. It has triggered some concerns about the adequacy of credit risk assessment and the possibility of under-pricing of risks in this segment of the market.

Such concerns may apply even more to the leveraged segment of the market, since there is evidence that for both highly rated and lower rated loans, credit terms have been relaxed over

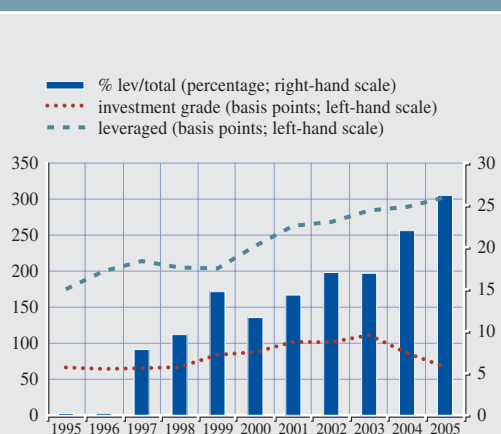
the last couple of years. For industrialised countries, for example, the share of syndicated loans with covenants fell from 24% in 1997-2000 to 19% in 2001-2004. A reduction in the share of collateralised syndicated loans was also observed.³³ The general picture appears to indicate that banks participating in the syndicated loan market may be accepting less compensation for holding risky loans.

The pricing behavior in the syndicated loan market appears to be in line with the recent compression of spreads across the credit quality spectrum of corporate bond markets. Improving fundamentals have certainly played an important role in supporting such prices. However, the low interest rate environment and abundant sources of liquidity may have led to a deterioration in the risk-return relation for banks and investors in general.

The reported findings concerning pricing behavior are not a particular feature of the EU. In fact, no significant differences in the average margins appear to exist on loans granted to borrowers in both the US and Europe (see Chart 13).

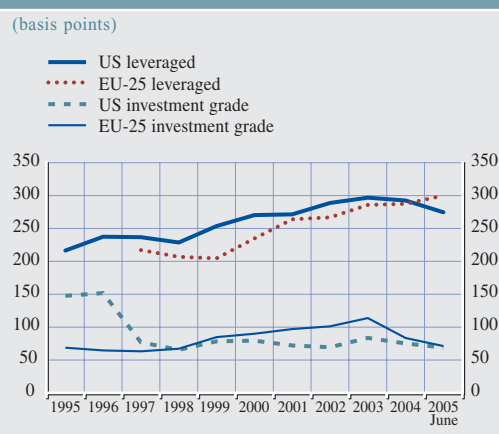
33 BIS Quarterly Review, December 2004, pp. 75-89.

Chart 12 Average margins on syndicated credits by quality of the borrower



Source: Loanware, Dealogic.
Note: Data for 2005 until April.

Chart 13 Average syndicated loan margins charged on US and EU-25 borrowers



Source: Loanware, Dealogic.
Note: Margins above US Prime, Libor and Euribor base rates. Average margins on EU-25 leveraged loans before 1997 are not reported given the insignificant number of loans granted in this category.

The main distinction between the two markets is based not on the prices charged, but rather on the loan volume, in particular regarding leveraged deals. The volume of leveraged or highly leveraged loans³⁴ in the US has been four to five times larger than that of the EU in recent years. As for investment grade loans, the disparity is not so prominent. EU volumes were equivalent to 60% of US volumes in 2004 and credits granted to EU borrowers in 2005 up to June 2005 almost match those granted to US borrowers.

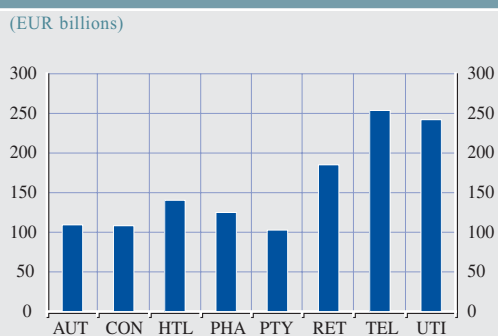
While banks are the predominant investor group in the primary and secondary leveraged loan market, especially in the EU, institutional investors (e.g. finance and insurance corporations, CDO managers, hedge funds) are becoming increasingly significant on both sides of the Atlantic. The broadening of the investor base in the leveraged loan market has promoted financial products, such as second lien loans or payments-in-kind (PIK) instruments³⁵, which are attractive to investors (including banks) looking for higher returns. It has also contributed to increased liquidity in secondary markets. The compression of spreads in the syndicated loan market may raise concern over whether these higher return products are sufficiently compensating investors for the increased risk taken. The development of these products in the leveraged segment of the market may contribute to reduce holding rates in the secondary loan market.

Turning to the borrowers' side, the recent pricing developments in the syndicated loan market have been positive. Growth and increased integration in this market may have channeled funding to highly leveraged borrowers that would otherwise probably not have been able to finance their activities.

2.4 MAIN BORROWING SECTORS

In addition to their importance in international financing, loan syndicates also provide interesting information on developments in the

Chart 14 Syndicated loans by EU borrowing sectors (outstanding volumes)



Source: Loanware, Dealogic.

Note: Sectors displayed are the automobile sector (AUT), composed of automotive and vehicle manufacturing; the construction sector (CON), including building materials and related heavy engineering; the real estate and property sector (PTY); the tourism sector (HTL), including hotels, leisure and services; the retail sector (RET), comprising retailing and distribution, foodstuffs and tobacco; the chemical-pharmaceutical sector (PHA), including healthcare, chemicals and plastics; the sector of utilities (UTI), including oil, gas, electricity, energy utility and water supply; and the telecommunications sector (TEL), including telecommunications and telecom equipment.

non-financial corporate sector. As opposed to typical bank loans – where loans to corporates are treated as a single category such as household and government loans – more information can be obtained from syndicated loans regarding their sectoral breakdown, contractual terms or pricing, given that not one, but a group of banks participate.

Chart 14 shows the eight most active sectors in the EU syndicated loan market (i.e. lending to EU borrowers). While the telecommunications and telecoms sector is no longer the largest borrower in terms of new business (gross signings), it still has the largest fraction of outstanding loans, as a result of loans signed in 2000.

³⁴ In the US market, leveraged is defined by pricing levels (e.g. 150bp or 250bp above the base rate for leveraged and highly leveraged loans, respectively) regardless of the purpose of the loan.

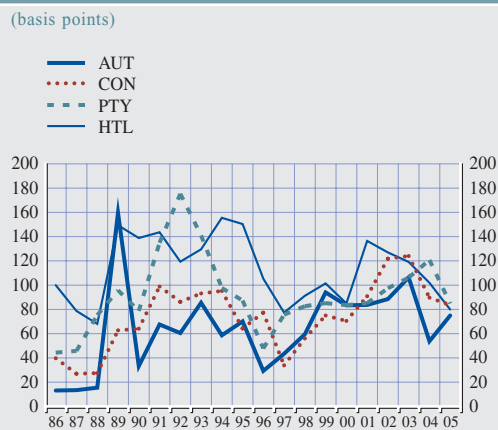
³⁵ Debt instruments in leveraged finance with significant levels of risk (roughly corresponding to the mezzanine and first lost tranche, respectively).

As regards pricing aspects, there have been significant discrepancies in the margins charged on investment grade deals over time with respect to the business sectors. In fact, after reaching differences of more than 100 basis points at the beginning of the nineties, margins are now at very low levels, hovering around 80 basis points for the relatively smaller borrowers (AUT, CON, HTL, PTY) and 60 basis points for the larger and older ones (RET,

PHA, UTI, TEL), as depicted in Chart 15 and Chart 16.

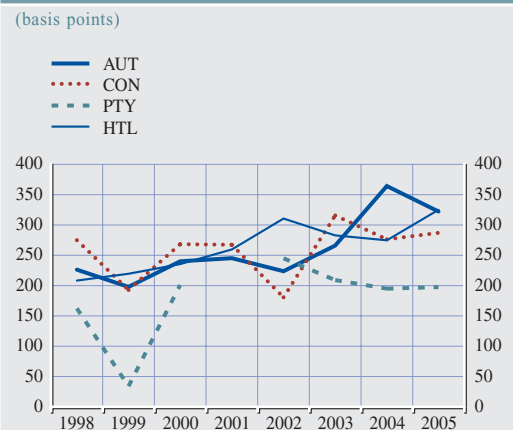
As described above, since 1995 leveraged loans to EU borrowers have steadily risen in size. The period starting in 1998 – when data starts being reliable – is characterised by large discrepancies across sectors. Prices have since converged, floating around 300 basis points, with the exception of the Property and Real

Chart 15 Margins on smaller investment grade borrowers



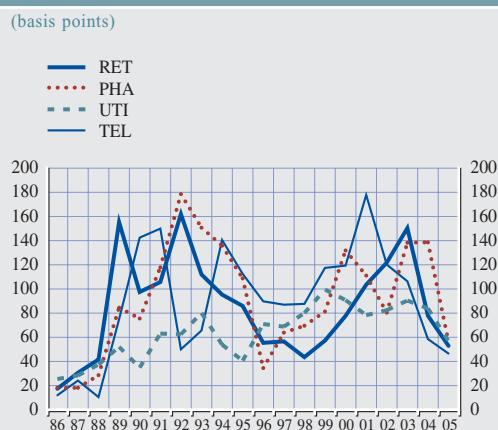
Source: Loanware.
Note: Margins are defined as spreads above Libor/Euribor on investment grade syndicated loans. Figures for 2005 until May. See notes to Chart 14.

Chart 17 Margins on leveraged loans to smaller borrowing industries



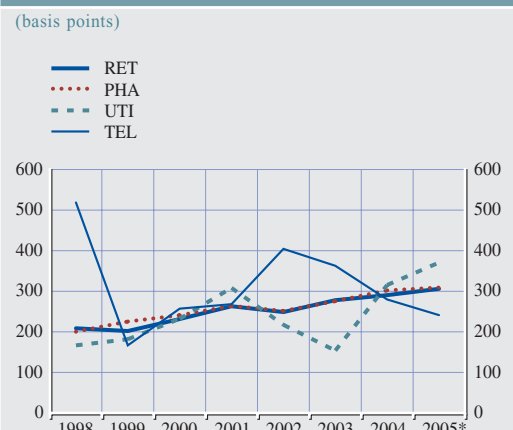
Source: Loanware.
Note: Margins defined as spreads above Libor/Euribor on leveraged syndicated loans. Figures for 2005 until May. Average margin on PTY loans not available for 2001.

Chart 16 Margins on larger investment grade borrowers



Source: Loanware.
Note: See notes to Chart 14.

Chart 18 Margins on leveraged loans to larger borrowing industries



Source: Loanware.
Note: See notes to Chart 17.

Estate sector (PTY), where significantly lower margins are seen – possibly reflecting its lower risk (see Chart 17).

It is also worth mentioning that, on average, non-investment grade loans to the utilities sector have recently been perceived as more risky, reflecting a growing trend since 2003, which is approaching a spread of 400 basis points above Libor and Euribor (see Chart 18).

2.5 CONCENTRATION

The amount of attention focused on banks' sectoral risk exposures has increased substantially following the problems in the telecommunications sector at the beginning of this decade. At present, exposures are still fairly concentrated on the lender side.³⁶

Credits granted from January 2004 to May 2005 can be seen as a lower bound to total loans outstanding.³⁷ Chart 19 relates the amount of credits granted over this period with the amount of total loans of each institution. It was found that syndicated credits represent roughly 20% of total loans on average. While the ratio does not exceed 10% for almost half of the sample, the upper tail of the distribution is

dominated by EU large banks (in terms of total assets).

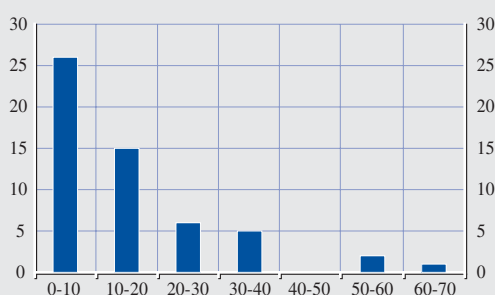
An assessment of the loans granted throughout the period under consideration with respect to banks' own funds reveals that, on average, current exposures are double that of total equity. In terms of distribution, Chart 20 shows that two-thirds of the sample loans signed from January 2004 to May 2005 exceed the level of own funds. Again, small banks tend to concentrate on the lower tail of the distribution where exposures do not exceed own funds, whereas the largest players in terms of assets are concentrated on the upper part.

³⁶ In this subsection the focus is on syndicated loans granted by EU banks irrespective of the borrowers' nationality or business. By combining the rank of EU credit institutions by gross signings of syndicated credits from January 2004 to May 2005, and by outstanding amounts, a group of 55 EU credit institutions were identified as significantly active in this market, accounting for 40% of current global lending. Individual bank exposures are subject to the "equal apportionment" rule under which, for each deal, the full amount of a loan is split in equal parts between participant banks. This is a crucial requirement of the banking industry for reporting the data to the provider.

³⁷ The analysis based on total amounts outstanding by institution proved to be inadequate due to some data inconsistencies when defining maturities. Together with the equal apportionment bias, this could significantly overstate the level of individual bank exposures.

Chart 19 Distribution of EU banks' ratio of syndicated loans to total loans

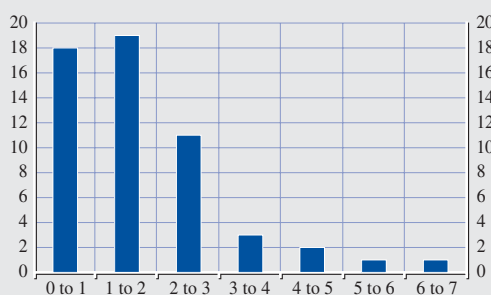
(x-axis: percentages; y-axis: number of banks)



Source: Loanware and Bankscope.
Note: Refers to a sample of 55 EU banks that are significantly active in this market and loans granted from January 2004 to May 2005.

Chart 20 Distribution of EU banks ratio of syndicate loans to equity

(x-axis: percentages; y-axis: number of banks)



Source: Loanware and Bankscope.
Note: See notes to Chart 19.

2.6 CONCLUSIONS AND FINANCIAL STABILITY IMPLICATIONS

The EU syndicated loan market has undergone substantial change in the recent past and evolved from a rarely used financing instrument, mainly involving domestic lenders, to a more mature financing instrument for major companies, benefiting from an increase in liquidity and market integration.

Syndicated lending, besides allowing banks to share credit risk, also allows them to diversify portfolios geographically and across sectors and activity types.

In addition, the creation of an integrated EU syndicated lending market not only creates deep and liquid funding opportunities for borrowers, but also creates a level playing field for banks across Europe, enabling them to increasingly secure mandates as mandated lead arranger outside their domestic market.

Both EU borrowers and EU lenders are significantly involved in this market in that they currently represent 40% of global borrowing and account for 40% of global lending. Nevertheless, EU banks face strong competition from the largest US and Japanese banks when granting loans to the EU corporate sector.

However, EU syndicated loans might have become more risky over the past decade, as the fraction of non-investment grade credits – almost non-existent before 1996 – is currently well above one quarter of all loans to EU borrowers. Spreads on investment grade loans are at record lows, reflecting high levels of liquidity and strong competition at this end of the rating scale. This is possibly reducing incentives for many banks to participate in this market. Although margins on leveraged loans have increased significantly over the last decade – showing that banks are pricing for the increased risk – whether they are adequately covering for the credit risks by maintaining commensurate capital buffers is a pertinent

question. Care needs to be taken when interpreting results relating to the risk this sector may represent for financial stability. For a more precise assessment, more information would be needed on the secondary loan market, where the risk exposures may be shed outside the banking sector to a wider pool of investors, and on the extent of banks' hedging of credit risks associated with such exposures by other means, such as structured finance instruments.

3 COMPETITIVE CONDITIONS IN EU MORTGAGE MARKETS

This chapter examines the evolution of competitive conditions in EU mortgage lending markets between 1998 and 2004.³⁸ Mortgage lending is a significant segment of bank lending, accounting for roughly 35% of total bank lending and two thirds of lending to households. It is also presently one of the areas under scrutiny from a financial stability perspective, in the light of concern in some EU countries over rising household indebtedness and high levels of residential property prices. Mortgage markets and, more generally, retail markets, which are among the least integrated components of the EU financial system, have attracted the attention of EU authorities.³⁹

3.1 INTRODUCTION

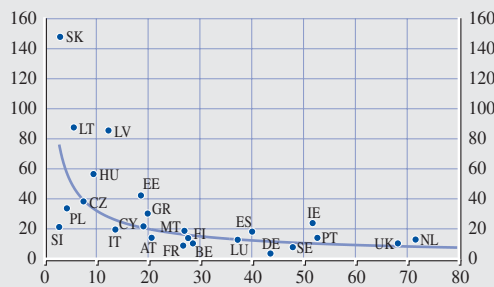
Mortgages represent a significant share of EU banks' retail lending activities. The total EU mortgage market stood at slightly more than €4 trillion at the end of 2004, or almost 40% of EU GDP. The largest national markets in terms of outstanding volumes were the UK, DE, FR, ES and NL, accounting jointly for nearly 80% of the outstanding total volume in the EU mortgage market in 2004.

In addition to their significant size, EU mortgage markets have been growing fast: the value of outstanding residential mortgages has risen by 8.8% per year in nominal terms over the period 1998-2004. This average, however, masks substantial differences across countries. Quite naturally, residential mortgage lending growth has been significantly higher in the NMS, rising nearly 9.4% on average per year over the period 1998-2004 (unweighted average is 55% per year), compared with 8.7% on average per year over the same period in the EU-15 countries (the unweighted average is 14% per year), reflecting a catching-up process as the former start from a sometimes very low base (see Chart 21).

Mortgage credit has a number of features that make it a relatively stable and secure source of

Chart 21 Catching-up in mortgage to GDP ratios and mortgage lending growth rate

(1998-2004, annualised %; y-axis: growth 1998-2004; x-axis: mortgage as % GDP)



Source: ECB.

Note: Figures from CY refer to 2002-2004, CZ and DE 1999-2004, SE 2003-2004, SK 2000-2004.

income for lenders: the average amount borrowed is high, it allows the establishment of long-term relationships with borrowers, and it offers scope for generating additional income on the basis of cross-selling. Mortgage lending is also among the least risky credit products in terms of both default risk and interest rate risk, although in the case of variable-rate loans, asset quality may be affected relatively more rapidly. Finally, this type of lending receives a very favourable treatment under solvency requirements, reflecting its low-risk nature.

3.2 INDICATORS OF COMPETITION IN EU MORTGAGE MARKETS

When surveyed about the competitive conditions reigning in their domestic mortgage lending markets, member authorities of the BSC have the widespread perception that they are highly competitive. Furthermore, there is a general notion of heightened competition in the

38 For the purpose of this chapter, mortgage lending is defined as any kind of lending to households for housing purposes. Mortgages used for purposes other than constructing, purchasing, or repairing a property, may also be considered as mortgage lending. Commercial real estate lending is not considered.

39 See the EU Commission Green Paper "Mortgage Credit in the EU", COM (2005) 327 final, 19.7.2005.

period between 1998 and 2004, supporting the view of an ongoing trend.⁴⁰

In general, the lower the degree of competition, the higher the spread between mortgage rates and banks' cost of funds. A lack of competition can be due to a restrictive regulatory framework, collusion or high entrance costs. Financial sector consolidation may also influence the degree of competition and result in less competitive loan pricing by banks.

3.2.1 PRICE AND PRODUCT DIFFERENCES

If the price exceeds the production cost by a substantial margin⁴¹, a key condition for perfect competition is violated. In the case of banking products, credit and other risks explain and justify a reasonable wedge between the interest rate on a mortgage loan and the cost of granting it. Therefore, it is important to consider information on loan-to-value ratios, debt-income ratios and other indicators of risk taken by creditors when assessing whether mortgage lending margins are indeed reasonable. Nevertheless, it is instructive to

observe developments in mortgage lending margins over time.

Chart 22 shows the distribution of margins across countries. While some markets still enjoy rather wide margins, in most EU countries margins on mortgage lending are generally below 200 basis points over the cost of funds (not risk-adjusted).

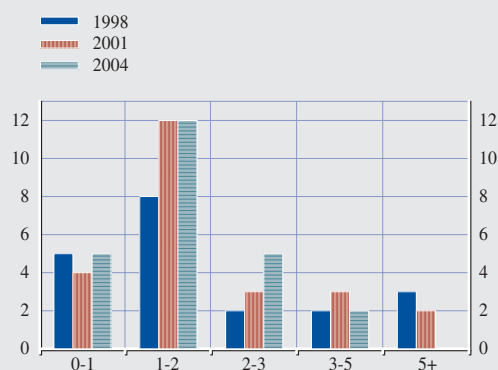
Chart 23 clearly shows that margins declined substantially across countries, owing mainly to the general decrease in mortgage and market

40 See also Mercer Oliver Wyman (2003), "Study on the financial integration of European mortgage markets". This study focused on eight European mortgage markets (DE, DK, ES, FR, IT, NL, PT, UK) and found that some markets are highly concentrated, that differences in mortgage rates between countries are largely due to product differences, and that mortgage profitability is driven by structural factors such as market size and structure, product cross-subsidies and regulation. Furthermore, market domination through branches and tied distribution makes it difficult for foreign competitors to enter the markets examined.

41 The margin on mortgage lending was calculated as the difference between the average or representative mortgage lending rate and the benchmark rate; the latter being that typically used to reprice the loan or that which corresponds to the average maturity of the loan or banks' cost of funds.

Chart 22 Distribution of EU mortgage lending margins (number of countries)

(x-axis: margin %; y-axis: number of countries)



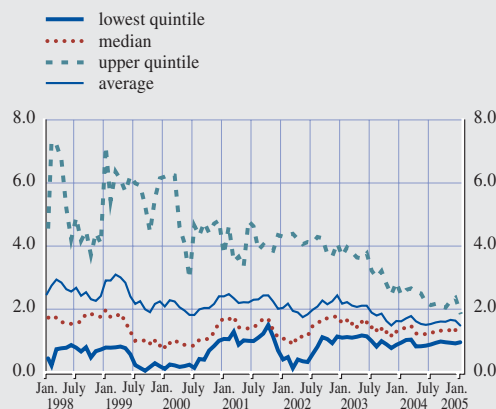
Source: ECB.

Calculations based on national retail interest rate data (before 2003) and, in the case of the euro area, the harmonised MFI interest rate (since 2003).

Note: the sample coverage varies between 19 countries in 1998, 22 in 1999-2001, and 24 thereafter. DK is omitted from the sample owing to the particular structure of its mortgage market.

Chart 23 Dispersion and convergence of EU mortgage lending margins

(%)



Source: ECB.

Notes: See Chart 22. Upper and lower quintiles depict the margins of countries at the 20% lower or upper end of the distribution.

interest rates and the introduction of the euro in 1999. Despite a certain convergence over time, mainly from the side of high-margin banking sectors, margins have remained substantially different across the EU.

In general, higher levels of competition may also be associated with higher and faster pass-through.⁴² Due to differences in the transmission of interest rate changes, households in countries with slow pass-through do not benefit as quickly from lower mortgage rates. Simulations with national interest rate data in slow pass-through countries, assuming the transmission process of the fastest pass-through country, point to potential gains for customers in the former, suggesting that imperfect pass-through rates are costly for bank customers during a period of declining interest rates.

Chart 24 shows the results from estimating a generic model of interest rate pass-through, using a general to specific modelling approach:

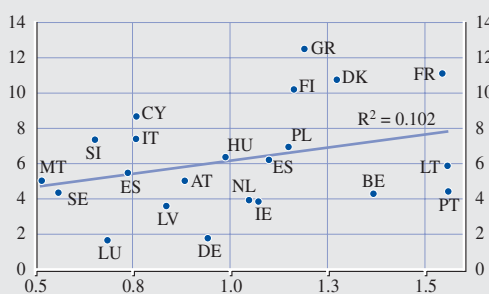
$$\Delta R_{m,t} = a_1 \Delta R_{m,t-1} + a_2 \Delta R_{c,t} + a_3 \Delta R_{c,t-1} + a_4 (R_{m,t} - a_5 - a_6 R_{c,t-1}) + \varepsilon_t$$

where R_m is the most typical mortgage rate (on new business), R_c is the reference rate corresponding to the most appropriate cost of funds, a_i is an estimated coefficient ($i=1, \dots, 6$), t is time and ε is the regression residual.

In the long term, the pass-through was found to be close to 1.0 for twelve EU countries and less than complete in just four countries. However, only in two countries were interest rate changes passed through more or less immediately (MT and SI). The speed of adjustment to a new equilibrium varies from less than two months to more than twelve months. Most banking sectors have adjustment periods between two and six months. Furthermore, banking sectors with a higher estimated pass-through typically have lower estimated margins (correlation 0.45), which also suggests some differences in competitive conditions between the different mortgage markets.

Chart 24 Relation between pass-through and speed of adjustment

(1998-2004; y-axis: speed of pass-through; x-axis: long-run pass-through)



Source: ECB estimations.

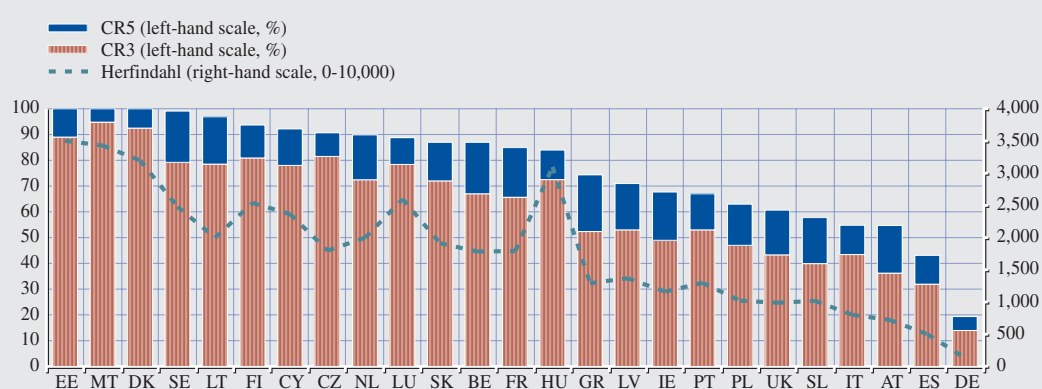
The chart shows the cross-country distribution of coefficient a_6 (x-axis) versus $1/a_4$ (y-axis) for all EU countries except DK and EE (no co-integration) and CZ (statistical outlier).

Differences in adjustments may be due to the time lag related to the review period for the reference rate or to adjustments in non-interest rate factors instead (e.g. shortening of loan maturity). These may also be partly explained by the importance of proximity to customers, which leads to price rigidities in the short run and fragmentation of mortgage lending along national borders.

Another frequently cited characteristic of EU mortgage markets is the widespread cross-selling of products linked to the granting of mortgage loans. In around 80% of the EU, cross-selling is a widespread practice which affects mortgage pricing. This may also possibly entail cross-subsidisation between different financial products. Similarly, although formally a conditional sale of products is legally forbidden, bank customers get better conditions if they for instance also opt for a related life, fire or employment insurance policy. Consequently, cross-subsidisation and cross-selling may have contributed to the perceived high level of competition in different EU mortgage markets

42 See, e.g., Heinemann and Jopp (2002), "The benefits of a working European retail market for financial services", Bonn: European Union Verlag.

Chart 25 Mortgage market concentration measures: CR3, CR5 and Herfindahl (2004)



Source: BSC.

Note: The correlation between Herfindahl and CR3 (CR5) is 0.920 (0.888). For LT, SE, UK, data are from 2003.

while simultaneously introducing potential distortions in competitive conditions. For example, cross-selling of mortgages and related products may limit competition from certain categories of providers that have limited cross-selling possibilities (e.g. on account of regulatory restrictions). Another possible type of cross-subsidisation, possibly introducing a market distortion, is between existing and new loans. If margins on existing fixed-rate loans are used to offset aggressive prices on loans to new customers and existing customers are unable to refinance at equal conditions, the latter are subject to discriminatory pricing and effective competition is compromised.

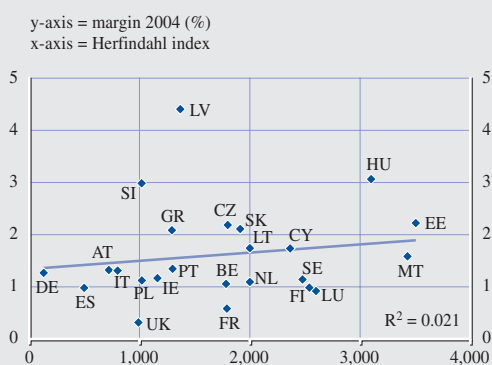
3.2.2 MARKET STRUCTURE AND ENTRY BARRIERS

A market without barriers to entry should exhibit a high level of competition between firms. Structural characteristics that may act as entry barriers in EU mortgage origination markets can take the form of high concentration, explicit use of market power, economies of scale or regulatory barriers to entry, such as limited transferability of mortgage products and different consumer protection rules.

If a small number of large firms are present on the market, they may behave as an oligopoly and wield substantial market power. Several measures of market power are put forward in the literature, which were found to correlate to some extent with market concentration ratios. The average CR3 concentration ratio in EU mortgage markets amounted to 66% in 2004 (50% in the euro area). According to the Herfindahl index, Chart 25 shows that 12 EU countries qualify as “very concentrated” (value larger than 1800), while mortgage markets in DE, ES, IT and AT do not appear to be concentrated, possibly owing to a dual banking structure of cooperative and regional banks competing with commercial banks.

Nevertheless, further evidence shows that, in a cross-country context, market concentration does not seem to be strongly associated with market power, as it does not result in higher mortgage interest rates or higher margins (Chart 26). Hence, notwithstanding the small number of providers present in a given market, their market power may be limited, possibly because of the threat of potential competition, i.e. other firms entering the market and undercutting prices, or because mortgages in a particular country are more or less perfect substitutes, which means that smaller players can lower interest rates and capture market

Chart 26 Mortgage margins and market concentration (Herfindahl) in 2004



Source: ECB and BSC.
See also notes to Charts 22, 23 and 25.

share if incumbents do not follow promptly. Alternatively, bigger players may be more efficient, which enables them to apply lower margins.

When analysing competitive conditions, it is also essential to pay attention to market entry and possible barriers to entry. One indicator of the absence of entry barriers is the actual commercial presence of foreign mortgage providers. Although there is a significant foreign presence of banks in many new Member States via branches and subsidiaries, it is limited in most other EU countries.⁴³ The evidence suggests that foreign intermediaries have succeeded in gaining market shares in some countries, possibly owing to wider product supply or their ability to process requests more efficiently, for example, through alternative channels such as the Internet. In general, however, the entry of foreign banks has not been a decisive factor in expanding the range of available mortgage products, due to various national rules and traditions and the fact that they adopt local pricing strategies.

The extent of cross-border origination of mortgage loans constitutes another indicator of market accessibility. Distant cross-border provision of mortgages however is only observed in some EU countries (FR, NL, IE,

ES, HU and UK), possibly owing to the importance of proximity between banks and their customers (i.e. the need to build up local knowledge).

Entry barriers may also be implicit in legal or regulatory requirements or plain customs and traditions. A study by the Forum Group on Mortgage Credit⁴⁴ shows that industry representatives consider differences in consumer protection rules or legal uncertainty about the applicable law as a factor that may hinder cross-border market provision and result in a distortion of competition in favour of national lenders. Banks offering cross-border mortgage services also tend to incur higher costs (e.g. because of language differences, the need to acquire expertise in local real estate practices, etc.), which could act as an effective entry barrier. Also differing standards for valuations and valuation-providers have been highlighted as a significant obstacle to enter the market.

Entry barriers may also be reflected in the degree of flexibility regarding the transfer and refinancing of mortgage loans, where in some cases there are still substantial elements standing in the way of the development of a more efficient origination and administration process.

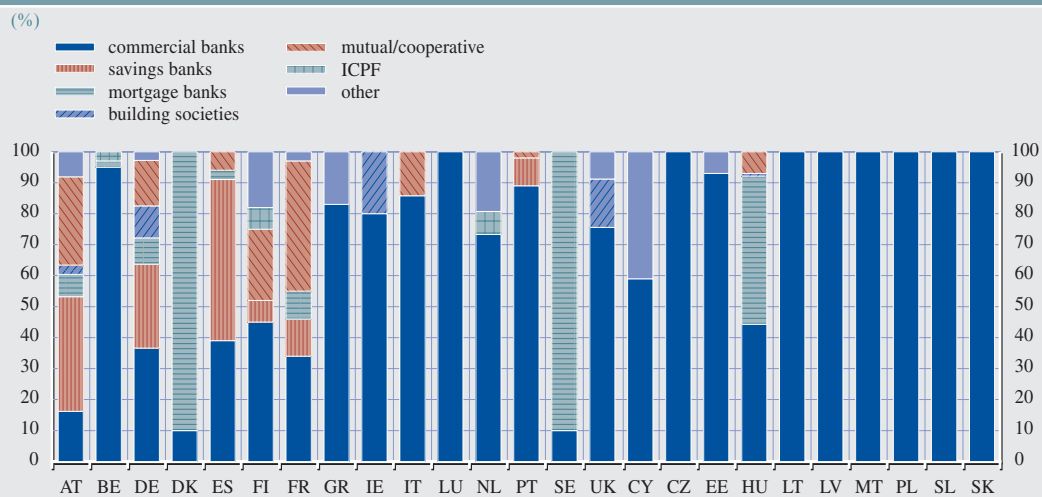
3.2.3 VARIETY IN DISTRIBUTION CHANNELS, INNOVATION AND SUBSTITUTION

The competitiveness of a given market is also affected by the variety of service providers, which increases consumers' choice of alternative financing channels and therefore increases the scope for competition. The possibility of using intermediaries and agents can help credit institutions to grant and administer more loans than they could via their

⁴³ It should also be noted that a lack of observed entry may reflect low incentives to enter a market (e.g. due to narrow margins and low profit opportunities) and may not necessarily be indicative of limited competition.

⁴⁴ Forum Group on Mortgage Credit, "The integration of the EU mortgage credit markets", December 2004

Chart 27 Different types of lenders in EU mortgage markets



Source: European Mortgage Federation and BSC.
 Note: Market share of different types of mortgage lenders across the EU. ICPF: insurance companies and pension funds.
 Data are for the year 2004 or 2003, depending on availability.

own distribution networks. Chart 27 shows that there is some variety in the types of mortgage lenders in EU countries. Commercial banks are clearly the most common type of mortgage providers (although in some countries they also tend to specialise in savings or mortgages): in 17 EU countries commercial banks have a market share of more than 50%. In countries such as AT, DE, ES, FI, FR, IE, IE and CY, savings banks, building societies and/or cooperative/mutual banks also enjoy a significant market share, providing a countervailing power to commercial banks in mortgage lending. In DK, SE and HU, mortgage banks are the most important mortgage providers, although in SE, they are part of big commercial banks. Also in AT, DE and FR, mortgage banks have a non-negligible market share in mortgages (around 10%). In a few countries insurance companies – including risk management specialists such as mortgage insurers that act as partners on high risk products – also appear to be significant mortgage players. Finally, in several countries, other intermediaries play an important role

Liberalisation and diversification of activities in the early 1990s led to an increase in the number of institutions providing mortgage

finance and an improvement in client selection and risk management practices. This resulted in a significant number of product innovations and an increase in competition between the different providers.

The most relevant developments in recent years relate to the increase in the amount lent in relation to the value of the property (increasing “loan to value” ratios), the lengthening of the average maturity, the heavy concentration in euro and other foreign currency-referenced floating-rate credit, and the use of mortgage loans for use other than house purchase (other consumer durables, life annuity income, etc.).

As regards prices there are floating-rate, fixed-rate and mixed products. Some products combine maturity and price flexibility⁴⁵, and there are second mortgages, off-set and current-account instruments, etc. In some countries loans are granted to a construction developer, and are then divided into as many loans as houses built and transferred to the buyer with the sale of the houses.

⁴⁵ For instance, loans with a fixed repayment instalment, or “accordion” loans, whereby the maturity is lengthened or shortened depending on the interest rate level at each point in time (offered in BE, IT, ES and MT).

One further element that has attracted some attention is the increase in the percentage of loans at floating rates throughout Europe. Structurally-high shares of floating-rate mortgages could be interpreted as an indication of some limitation in the supply of fixed-rate mortgage loans and hence deficiencies in terms of market completeness. Especially given the current interest rate environment, customers might want to lock in a very low interest rate in order to limit the risk of future interest rate increases. However, the macroeconomic environment and historical demand factors (preferences and traditions, a different understanding of the future interest rate evolution) seem to have a bigger explanatory power in some countries.

3.2.4 COMPETITION AT THE FUNDING SIDE

The funding strategies of EU banks have increased in importance as customer lending has in general grown more rapidly than deposits. This has led to increased competition to attract depositors and also to greater recourse to other types of funding.

If banks can easily acquire new funding or dispose of old loans by securitising them, they may use the excess funds to grant more loans and hence bolster their position on the mortgage market. The funding of mortgages has also become more crucial as interest rates and margins have declined, making the mortgage funding cost a determining factor in setting mortgage rates (see also the above discussion on pass through).

In addition, lenders are increasingly looking to diversify their funding and Europe's capital markets could serve to deepen liquidity and facilitate a smoother and cheaper transfer of risk between loan providers and investors. Thus, the diversification into different funding possibilities, in particular mortgage bonds and mortgage-backed securities, may offer mortgage lenders additional ways to better position themselves vis-à-vis competitors. However, access to the capital market often

implies costs that can make the risk transfer unprofitable compared with the funding advantage of deposits, especially if the issue size is small. Due to their significantly greater contractual liquidity, deposits are often a cheap funding option for banks.

The existence of effective funding mechanisms can also, in part, determine the characteristics of the mortgage loan product. It seems that the range of products broadly follows the funding models used. Long-term fixed-rate mortgages are more widely available in markets where mortgage bond funding is common and the mainly deposit-funded markets are generally able to provide more repayment structures and the flexibility of the core variable rate product.⁴⁶

3.3 CONCLUSIONS AND FINANCIAL STABILITY IMPLICATIONS

According to BSC member authorities, over the past five to ten years competition in mortgage markets has intensified significantly throughout most of the EU. This notwithstanding, significant structural differences prevail across the mortgage markets of the EU countries – owing to diversity in legal frameworks and consumption patterns, as well as differences in tax regimes, lender and intermediation structures, product characteristics and lending procedures. It appears that such differences, in addition to the lack of profit opportunities given the high level of competition, have effectively contributed to keeping mortgage markets national in character, while there is little evidence of cross-border mortgage lending taking place.

In the future, changes to the regulatory framework (Basel II and the implementation of IAS) may intensify competitive conditions in mortgage lending markets. For instance, banks using an internal ratings-based (IRB) approach

⁴⁶ Denmark is the only market that widely offers 25-30 year fixed rate products without early repayment fees, using the mortgage bond market to fund the loans via callable bonds.

may be able to price risks more efficiently, thus gaining a competitive advantage.

From a financial stability viewpoint, to the extent that the intensity of competition has led to easier access to credit through a lowering of standards in credit risk assessment, a reduction of lending margins and greater exposure to housing markets where prices in some countries may have departed from intrinsic values, risks may have risen. The risks for banks will also differ depending on whether fixed or floating rate mortgages are prevalent. In countries with a higher preponderance of floating rate mortgages, other things being equal, banks may face greater credit risk but lower interest rate risk. Where fixed-rate mortgages are more common, the opposite will usually be true. Furthermore, in countries where the majority of mortgage loans are denominated in foreign currency, a sharp currency depreciation – were it to occur – might constitute a source of vulnerability, as it would challenge households' debt servicing capacity. Finally, it should be noted that mortgages are – thanks to collateralisation – relatively secure financial products, and risk management practices are generally assessed as being sound.

4 THE STRUCTURE OF EU CONSUMER LENDING MARKETS

The aim of this chapter is to analyse the evolution and structure of the EU consumer lending market over the last five to ten years and highlight the role of integration of EU consumer credit markets.

4.1 INTRODUCTION

Consumer lending (CL) is one of the core banking activities that has changed significantly over the past ten years or so.⁴⁷ The main factors behind this evolution are the considerable change in consumer habits and the increase in household incomes. Other relevant factors include a substantial fall in interest rates in recent years, an increase in competition as well as technological and financial innovations (e.g. the use of credit scoring and customer relationship management tools). Changes in distribution channels (towards the use of the Internet, mobile phone technology, etc.) and in product offers (e.g. availability of higher amounts and more flexible payback conditions) have also contributed to the rapid increase in CL, as they have helped to reduce the administrative burden and accelerate approval rates.

Some banks have become highly specialised in CL at the European level, as part of a wider strategic focus on retail finance and as a result of the considerable expansion of this activity across the EU.

4.2 THE EVOLUTION OF EU CONSUMER LENDING MARKET

At the end of 2004, the total amount of outstanding consumer loans in the EU was nearly €900 billion, accounting for 17% of total lending to households and around 8.5% of GDP.⁴⁸ CL increased in 2004 by 6.7% compared with 2003 and has risen by 40% since 1998. Despite its relative low weight in total lending to households, CL is among the most attractive and profitable banking activities, as it provides a recurring and stable contribution

to earnings compared to investment banking activities, and offers higher interest rates than e.g. mortgage loans, although the higher risk profile of CL as compared to secured mortgage lending needs to be taken into account.⁴⁹ In December 2004, for the euro area (lacking a comparable breakdown for non-euro area countries), 40% of the outstanding CL was spread over 5 years or more, 37% had a maturity of between 1 and 5 years, and the remaining 23% was contracted over less than 1 year. The latter includes outstanding credit on credit cards, current account overdrafts and any postponed instalments on a purchase of primary goods.

The available data show that the EU-15 countries accounted for more than 98% of total CL in the EU. The largest markets are DE, UK and FR, accounting for 60% of EU consumer lending in 2004. Chart 28 shows that CL has increased significantly in all EU countries since 1998. Notable increases can be observed in NMS (HU, EE, MT, SK) and GR, IT and IE, which have all seen their total outstanding volume more than double since 1998. However, the initial level of CL was very low in these countries – with the exception of IT.

The per capita amount of CL reached around €1,935 in 2004 (€1,410 in 1998) but varies significantly across the EU. Along the same lines, SE has the highest ratio of CL to GDP (17% in 2004⁵⁰), followed by UK, AT, GR, MT, and IE, which has with ratios above or close to 10% (see Chart 29). From the chart, it can also be inferred that CL grew faster than GDP, most notably in GR, SE, UK and most NMS.

47 Consumer lending is defined as all credits and loans to households to buy consumer goods and services, the amount of credit granted to credit cards, advance payments on salary and, in general, any other finance given to households for consumer purposes (except for mortgages loans). It may comprise both lending by non-CIs and CIs. The latter is recorded in Annex 1 (Table 5).

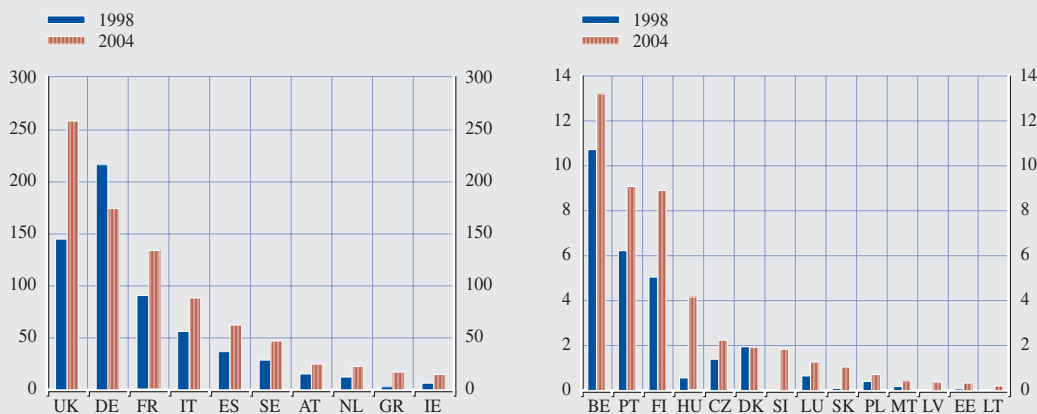
48 No data available in 2004 for CY.

49 Consumer credit margins in the UK are around 10%, 6% in FI, 4% in DE and ES. (ECB, 2002).

50 In case of SE, the high ratio of consumer lending to GDP is partly explained by the practice that top loans on mortgages can not be separated from consumer loans.

Chart 28 Outstanding volume of CL

(EUR billions)



Sources: BSC and ECB.

Notes: The above data refer to the global consumer lending market and may differ from the figures reported in Table 5 in the Annex (covering only credit institutions). In DE, a new reporting framework for consumer/other household lending was introduced in 2003, distorting comparisons with earlier years. For CZ, the figure for 2002 instead of 1998 is used. For PT, data refer only to MFIs reported in Annex 1 (Table 5).

4.3 PRODUCT MIX, COMPETITION, TECHNOLOGY AND FUNDING

The range of credit products offered by different providers includes various combinations of price, loan size and maturity. In recent years, new innovative types of credit have been added to the traditional range of products (e.g. credit instalments, consumer leases, personal loans and revolving credit). In some countries, general purpose mortgage loans have become an alternative for traditional personal loans, due to their relatively favourable pricing. These new products broadened the range of credit facilities available to consumers. The total amount and maturity of these loans has increased in some countries by more than 100% over the past five years.

Credit cards are considered to be one of the most important factors in the changing consumer lending landscape.⁵¹ Chart 30 illustrates the rise in credit card transactions per capita between 1998 and 2003. Credit card payments transformed CL by providing consumers with greater flexibility and autonomy over their purchasing and borrowing

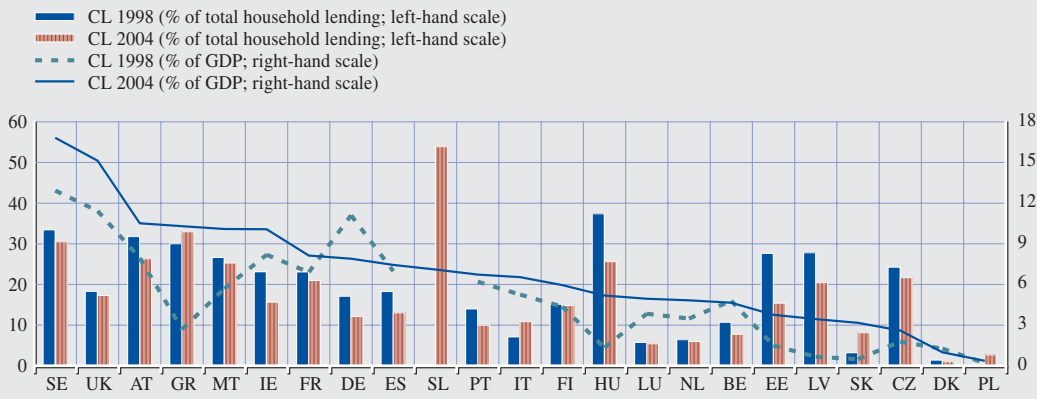
decisions. The UK is the leader in the use of credit cards as a payment instrument, with an outstanding amount of almost €80 billion in 2004, making up 30% of total CL in the UK, and has seen a growth of 134% since 1998. IT and NL have experienced the largest increase in the outstanding volume of credit card debt (€3.2 billion and €1.1 billion in 2004, respectively; increasing by nearly 500% and 400% since 1998), although payments with this instrument represent less than 5% of their CL market. Also ES has experienced a similar development (€9.8 billion credit card debt in 2004, +159% since 1998).

In addition, the number and characteristics of credit cards have changed in most EU countries. These changes include, inter alia, a large increase in credit limits (currently up to more than €12,000 per month), the possibility of splitting the instalments and the use of revolving facilities. Some credit institutions even offer discounts on the total monthly

51 In countries such as DE and UK, current account overdrafts also underwent significant changes, as the total amount of overdrafts increased substantially and the interest rate charged was reduced significantly. In DE, overdrafts are an important source of consumer credit.

Chart 29 Consumer lending in 1998 and 2004

(% household lending; % of GDP)



Sources: BSC and ECB.
Note: See also notes to Chart 28.

outstanding amount to stimulate the use of credit cards.

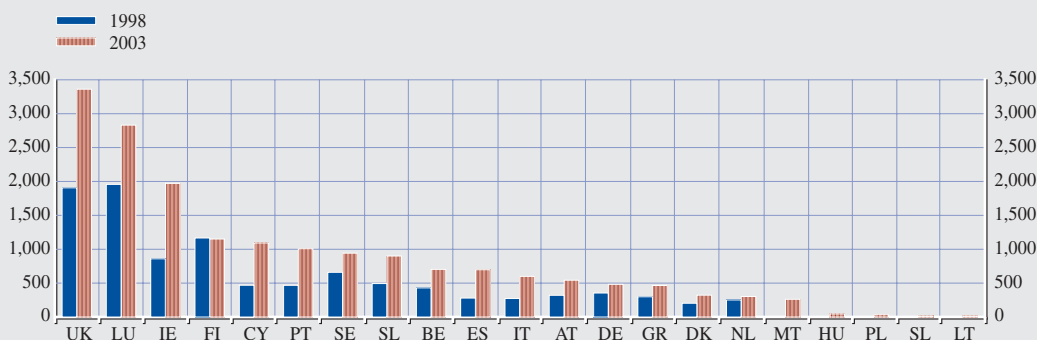
In parallel with credit institutions, non-regulated or less-regulated entities, including credit card issuers and large commercial enterprises, have also reacted to the increase in CL demand through aggressive campaigns aimed at providing new products, mainly linked to credit cards, at very competitive prices (in some cases offering close to 0% interest rate). In addition, these entities are increasingly offering personal loans with relatively long maturities (e.g. automobile

finance companies and retail outlets). Usually, non-bank entities act as an intermediary agent arranging consumer credits for their clients with cooperating banks. In response to increasing competition with these entities, credit institutions have reacted by offering joint packages of non-banking products and financing plans at competitive conditions and the offer of related insurance products.

In general, market concentration for consumer lending, as measured by the share of the five largest providers (CR5 ratio), is relatively high, especially in smaller EU countries

Chart 30 Credit card transactions per capita

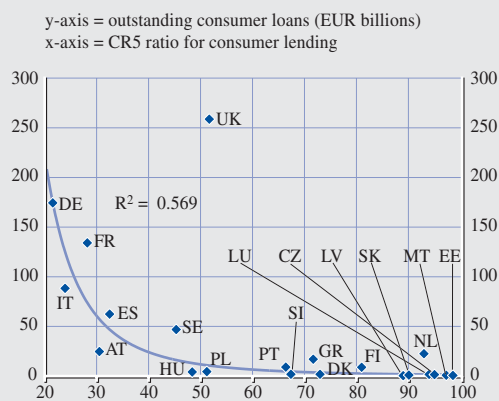
(in euro)



Source: ECB Blue Book.

Chart 31 Market concentration versus outstanding amount of CL

(2004)



Source: BSC and ECB.
Note: UK is an outlier to the fitted relation between CR5 and market size. Data are missing for BE, DK, IE, CY and LT.

(see Chart 31). The CR5 ratio is lower than 40% in only five countries (DE, FR, ES, IT, AT). This notwithstanding, there does not seem to be a relation between market concentration and the exercise of market power, as interest rates charged do not seem to be structurally different in more or less concentrated markets.

The favourable treatment of retail banking within the *Basel II framework*, as well as the growth in *e-commerce* are additional factors that are expected to help maintain the dynamism in consumer lending in the future. The former may influence banks' pricing strategy and increase their willingness to enter this market segment. To date e-commerce has not developed to the same extent in all EU countries and therefore offers additional growth potential.

Advancements in technology have also eased several processes related to consumer lending activities, such as fully automated underwriting and credit granting processes, on-line access to credit quality information on the borrower and improved risk management systems. This has helped banks to accelerate loan approval decisions and reduce the number of borrowers from defaulting.

Concerning funding, in many countries, deposits are the main source of funding for consumer lending. However, the rise in deposits does not keep pace with the growth of CL, exhibiting a growth of 29% and 36%, respectively, for the euro area countries, over the period 1998-2004. Consequently, credit institutions have had to use alternative funding sources such as interbank markets and capital markets.

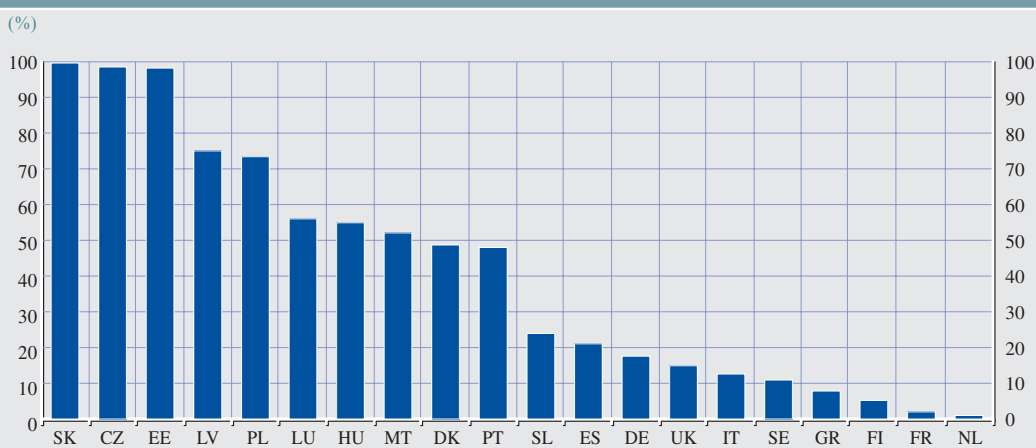
The securitization of CL is another source of finance that has expanded considerably in some countries over the last years. This source of funding has the advantage of being able to respond to a rapidly increasing demand for consumer lending by freeing up capital for new CL and therefore seems likely to grow significantly in the coming years. A wide range of assets have been securitised, including car loans, home equity and manufactured housing loans, credit card receivables and student loans.

4.4 THE INTEGRATION OF THE EU CONSUMER LENDING MARKETS

Potential benefits to be derived from the further integration in consumer lending markets in the EU include an enhancement of the information to consumers on different products, increase of the level of competition across providers and the expansion of the variety of products offered. Such potential benefits are at the core of a well functioning single market for financial services as they would directly and positively impact consumer welfare.

In spite of the ongoing integration of European financial markets, genuine cross-border consumer lending strictly defined is still very limited. If a wider definition of cross-border lending is adopted, however, in particular including the activity undertaken by foreign-owned branches and subsidiaries, cross-border consumer lending appears more significantly in some countries. According to available figures, CL by foreign branches and

Chart 32 Foreign presence in national CL markets via branches and subsidiaries



Source: BSC.

subsidiaries accounts for nearly 100% of outstanding CL in SK, CZ and EE in 2004. Also in LV, PL, LU, HU, MT, DK and PT, foreign providers, broadly speaking, have a market share above or close to 50% (see Chart 32).

Many efforts were made to support (genuine) cross-border activity.⁵² However, in the field of consumer protection, several national rules still remain and hinder cross-border operations in consumer lending. Consequently, work is being undertaken to identify genuine barriers and develop measures to remove them in favour of a single market for CL. At the same time, however, adequate levels of consumer protection should be maintained. For these reasons, a Proposal for a Directive on consumer credit is under discussion at EU level.⁵³ The proposal aims at improving transparency on products (costs, terms and conditions) and enabling comparisons of offers on a cross-border basis. It would allow lenders to assess borrower risk more easily. Harmonised consumer credit rules are believed to increase the protection of consumers across borders and increase their confidence and thus strengthen the functioning of the consumer credit market in the EU.

In addition to these legal barriers, natural barriers also limit market integration. These

mainly comprise language, cultural traditions, and proximity to the client. Despite these real barriers, lenders now have the possibility of offering (genuine) cross-border loans rather than establishing a multi-country presence. Examples include CL providers that have a local front-office delivery but centralised back-office operations organised on a pan-European basis. The use of multi-lingual call centres in one central location is part of their strategy to establish a leading position in the pan-European CL market. In this respect, the Internet can play a significant role in overcoming the effects of national boundaries.⁵⁴

Besides the above-mentioned legal and natural barriers, other factors may impede the growth of cross-border activities. The most significant

⁵² The implementation of the Second Banking Directive has been one of the key factors in eliminating legal barriers to cross-border banking integration. Note that it has been incorporated, together with some other Directives, into one law, the Consolidated Banking Directive 2000/12 relating to the taking up and pursuit of the business of credit institutions (OJ L126, 26.5.2000).

⁵³ Proposal for a Directive on the harmonisation of the laws, regulations and administrative provisions concerning credit for consumers, COM (2002) 443(01).

⁵⁴ One might argue that consumers may still be unwilling to provide sensitive personal data over the internet, having in mind prominent cases of theft of personal data. This might limit the possibilities of the internet as a distribution channel for consumer credit.

factors are difficulties in assessing the credit quality of a client for a bank from a different EU country and in accessing a client's account in another country to receive repayments through regular direct debit or credit transfer. Those difficulties would, however, be reduced by the integration of Credit Registers⁵⁵ (cross-border access) and Retail Payment Systems. A Single Euro Payment Area (SEPA) is now being developed for retail payments and there are also plans for a pan-European direct debit business.

Consumers generally still prefer to deal with local providers of consumer credit. Therefore, the need for a branch network seems to be a major entry barrier when penetrating another market. However, as this market is expected to benefit from further harmonisation of EU standards, cross-border activity may increase and potentially allow for a geographical diversification of EU banks' activities without having to establish a dense branch network abroad.

4.5 CONCLUSIONS AND FINANCIAL STABILITY IMPLICATIONS

Consumer lending is playing a growing role in many EU countries and is expected to increase in the coming years, as the level of CL remains relatively low in various EU countries. The growth of CL will depend on the level of consumer demand, income, prices and the overall macroeconomic situation. The possibility of a rise in interest rates may cause a temporary decline in CL growth.

Non-regulated or less-regulated entities (retail outlets and non-bank credit card issuers) are also increasing their presence in this market. This may lead to more intense competition between the different market players and may eventually lead to some concerns over financial stability, to the extent that CL margins are eroded or standards for credit risk assessment are lowered.

⁵⁵ A Memorandum of Understanding was signed by all EU central banks with Central Credit Registers which includes the exchange of information among Central Credit Registers (ECB, 22 March 2003).

5 INTERNATIONAL ACTIVITIES OF LARGE EU BANKING GROUPS

In 2001 and 2003, the Banking Supervision Committee conducted a mapping exercise of the geographical distribution of activities of major EU banking groups with a significant cross-border banking activity. Information on 43 major European banking groups from 15 EU countries was provided in the 2003 exercise, compared with 41 major banking groups from 14 EU countries in 2001.⁵⁶ Information was gathered on the number and assets of these banks' branches and subsidiaries in 30 countries (EU-25, BG, CH, RO, US and Japan), and also on the nature of the activities developed abroad and the legal form through which these activities are undertaken.

This chapter aims at gaining deeper insight into the motives underlying the extent of the internationalisation and geographical diversification of these banks by measuring their market share and relative importance in local banking systems.⁵⁷ The scope of the study is therefore focused on the banks within the sample and not on the wider population of banks. Therefore, the results cannot be easily generalised to cover the wider phenomenon of the internationalisation of all banking activities.

The specific aspects of internationalisation considered are outward reach (the degree to which banks in the sample have developed foreign activities) and inward attraction (the extent to which host countries have attracted the presence through assets and establishments of the large groups in the sample). In considering these two aspects, the study focuses on characteristics potentially underlying large EU banking groups' internationalisation strategies and host country characteristics that are potentially conducive to the formation of financial hubs. Accordingly, in the case of outward reach, the relationship explored is that between the standard balance sheet and operational characteristics of the large banking groups and the extent of the institution's foreign presence (measured in terms of *the share of foreign assets in the institution's total assets*). In the

case of inward attraction, the relationship explored is that between host country characteristics potentially related to banking activities and *the share of assets held by (foreign) major EU banks of the host country's total banking assets*.

5.1 CHARACTERISTICS OF THE GROUP OF MAJOR EU BANKS RELATIVE TO EU BANKS AS A WHOLE

Relative to the home country's financial systems, international banks are very important, together holding 40% on average of the home market share in 2003. Indeed, their importance has grown significantly compared with 2001. Relative to the host country's financial system, their importance varies from about 55% of banking sector total assets in the case of the New Member States to being almost absent in the large EU-15 countries. Interestingly, the EU-15 banking groups hold a much stronger market position in certain host countries than in their home country.

The sample of large internationally active banks covered in the study compares positively with the overall EU-25 averages in 2003 on a number of measures.⁵⁸ In particular, they show solid provisions, are well capitalised, and operate under favourable conditions.

⁵⁶ No data were reported for a number of countries, either because major domestic banking groups are foreign-controlled or because they do not have a significant cross-border presence. Further details of the coverage are provided in Annex 1. Furthermore, it should be noted that as UK figures for 2003 are missing, data on the five UK banks are not used in cross-temporal comparisons.

⁵⁷ A similar study on participation in the syndication of loans is by Yener Altunbas, Blaise Gadanecz and Alper Kara "Key factors affecting internationally active banks' decisions to participate in loan syndications", 2004, *Applied Economic Letters*, v. 12 no.4, p. 249-253. Unlike these authors, however, the present study does not aim to depict patterns in the population of banks as a whole, but instead uses the set of large banks as the reference population.

⁵⁸ Although care has been taken in producing comparable indicators, the comparison is only an approximation, as the source of the firm-level information and the EU-25 averages is different. Bankscope definitions apply to the firm averages and BSC definitions to the overall EU-25 weighted averages (on the basis of national aggregates).

The relatively lower asset quality – as denoted by the higher ratio of impaired (non-performing) loans to gross (outstanding) loans – of the banks' sample (3.25%) compared with the EU as a whole (3.10%) is also reflected by a higher ratio of loan-loss reserves to gross loans in the sample (2.71%) than the EU total (2.06%).

Both the average capital adequacy and equity over total assets ratios are more comfortable for the sample of large banks (12.99% and 5.17% respectively) than for the EU averages (12.35% and 4.20% respectively). This suggests that banks with a large international presence are comparatively better capitalised than other banks.

They also appear to be more profitable, as both net interest margins and cost-to-income ratios fair more favourably. While net interest income for internationally active banks represents 1.95% of earning assets, for the total population of banks it represents 1.38% of total assets (not fully comparable). Similarly, the cost-to-income ratio for the sample of banks stood at 61.21% in 2003 for the sample of large internationally active banks, whereas for the EU as a whole the level stood at 64.87%.

This brief comparison shows that internationally active banks rank high among their national peers, possibly underscoring a favourable role of lean and safe operations for international presence. This is also supported by comparing the asset-weighted expected default frequency of the sample of internationally active banks at the end of 2003 (0.13) with that for the EU as a whole (0.24), from which it is clear that markets assign relatively lower risk to internationally active banks.⁵⁹

The information collected, however, can be used to go one step further in analysing more specific conditions at the level of the banks themselves and their host financial systems, which are likely to underpin the extent of the foreign presence *within the set of*

internationally active banks. To this end, it is possible to compare firm-level characteristics of the internationally active banks in the sample and depict whether they are correlated with their profile of foreign presence. Likewise, the profile of host-market characteristics can be squared against the information collected on foreign presence in an attempt to unearth characteristics that appear to attract a foreign presence. These two aspects are dealt with in the sections below.

5.2 OUTWARD REACH AND BANK CHARACTERISTICS

“Outward reach” refers to the extent to which banks develop cross-border activities through foreign branches and subsidiaries. Both the assets and the number of branches and subsidiaries abroad of the sample of large banks are useful in quantifying their presence abroad. A broad observation that can be made based on these variables aggregated at the home country level, for instance, is that – despite large differences in the extent of outward reach across home countries – the degree of foreign presence did not develop significantly between 2001 and 2003.

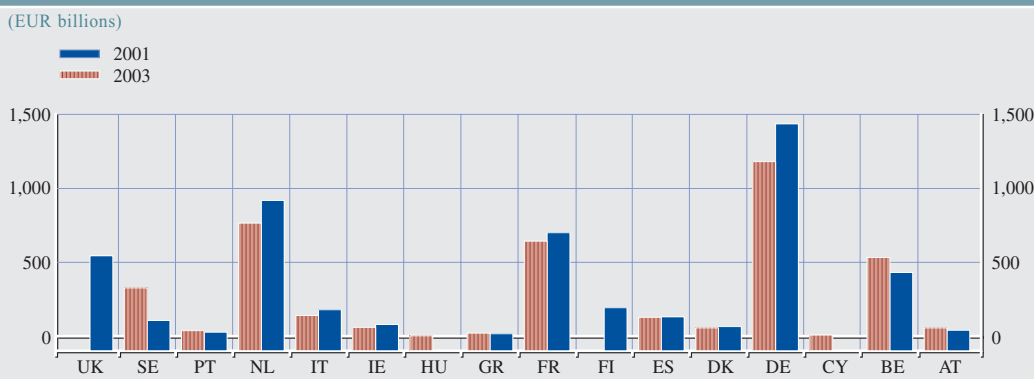
Some interesting nuances, however, appear at the level of institutions, where varying levels in outward reach are evident. This variation provides further motivation for the analysis of institutions' characteristics, with a bearing on the degree of outward reach within the sample.

ASSETS HELD OUTSIDE THE HOME COUNTRY

With regard to banking assets held abroad by the internationally active banks, there is a slight decreasing trend between 2001 and 2003. However, important differences across home countries are evident (see Chart 33).

⁵⁹ Moody's expected default frequency is a market-based measure based on equity price volatility and the institution's leverage depicting the probability of corporate default over a 12-month horizon.

Chart 33 Group's total assets of foreign branches and subsidiaries grouped by home country



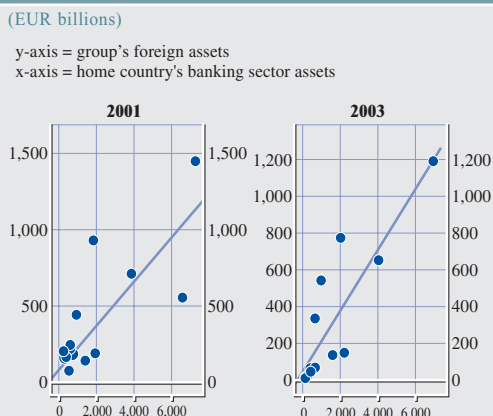
Source: BSC.

The large outward presence of German banks, for instance, is also the case for Dutch and French banks in the group and, to a lesser extent, Belgian banks. Likewise at the host end, the large presence of internationally active banks in London should be noted, providing evidence that London has become a major European (and global) financial hub.

Also, and as expected, internationally active banks from large countries tend to have greater outward orientation. Some exceptions are notable, however, as banks in some relatively small home countries have substantial foreign presence in terms of assets (see Chart 34).

Looking at the assets of large banks individually (not grouped by home country), some of the aggregated results prevail. For instance, the sample's median of large banks' foreign-to-total assets ratio decreased between 2001 and 2003 (see Chart 35).⁶⁰ At the same time, however, this indicator's dispersion across banks in the sample – as denoted by the wider inter-quartile range – widened, suggesting that some banks have increased and others decreased their presence abroad. This greater diversity across banks reveals a divergence from a representative distribution of domestic and foreign assets.

Chart 34 Foreign assets held by large banks against their home countries' total banking assets



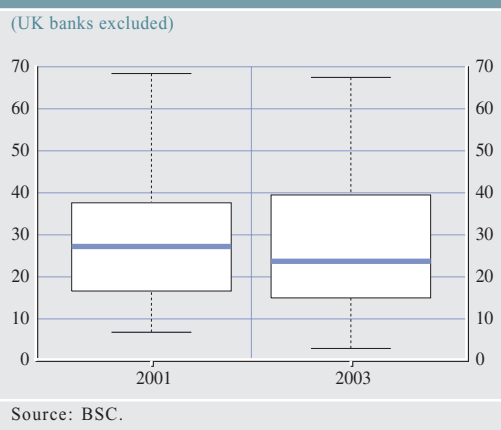
Source: BSC.

Furthermore, the highest and lowest values have both decreased, suggesting a falling share of outward activities across the sample of banks. Overall, therefore, the sample of major EU banking groups with significant cross-border banking activity shows greater diversity for the extent of their foreign presence, with a broad tendency to concentrate on domestic activities.⁶¹ This is consistent with the

⁶⁰ Boxplots summarize data succinctly by means of a 5 number summary. In between the maximum and minimum values (denoted by the lowest and highest whiskers – capped at a length of 1.5 times the box length), the box's borders denote the lower and upper quartiles, whereas the middle, thicker, line denotes the median. Possible outliers are denoted by points outside the whiskers.

⁶¹ Not shown, these developments are also evident with the home country aggregates, where there also appears to be a decreasing tendency in foreign presence.

Chart 35 Distribution across banks in the sample of the foreign to total assets ratio



observed trend for large banking groups to refocus on retail activities in home markets.

What factors underlie the internationalisation strategy of banks in the sample, and do these result from changes in the operating environment of the individual banks? Whereas there is insufficient information across time to answer this question fully, cross-section information available for banks in the sample may shed some light on the factors associated with the extent of their foreign presence. For example, it is conceivable that some characteristics of a large bank, such as its size, profitability, risk profile or operating environment may bear a relationship with its presence abroad.

In order to explore this issue, it is necessary to go beyond the mere description of correlations between the extent of this foreign presence and potentially related characteristics of banks within our sample. We thus look at the simplest possible method to statistically discriminate between significant and insignificant relationships, namely the 2-variable regression model. That is, we carry out simple regressions between the indicator of foreign presence and the banks' characteristics, with each of the latter being treated separately. The reader should not consider this a model, as it merely serves descriptive purposes and its objective is encouraging further exploration of the issues touched upon.

As discussed in the previous section, major EU banking groups with a significant cross-border banking activity are perceived by markets as having on average a lower risk profile – as denoted by the lower average expected default frequency for the banks in the sample. However, there is no statistically significant relationship between these variables across large internationally active banks. This notwithstanding, factors other than banks' risk profile could have a stronger relationship with foreign presence, as denoted by the foreign to total asset ratios of the institutions in the sample. In order to assess such a relationship, a number of typical ratios and balance sheet variables were collected from publicly-available information for internationally active banks in the sample.⁶² Slightly less than half of these variables show a statistically significant regression coefficient with the foreign presence indicator (see Table 5.1).

Clearly, the set of variables with the highest significance relate to the size of the group (total assets, as well as net and operating income and total expenses). Not only are larger groups naturally more active across borders but they moreover show a *higher share of cross-border activities*. Curiously, other variables also show a statistically-significant relationship with the indicator of foreign presence, notably measures on reserves for non-performing assets (2 out of 3 available measures), on capital adequacy (4 out of 11), on operating performance (5 out of 13), and on liquidity (3 out of 6). For these, the relation is typically negative, indicating that – within the sample of internationally active banks – those with a greater share of cross-border activities also have smaller provisions and lower capital buffers, operate under more competitive environments and have less excess liquidity.

Whilst it is conceivable that the various relationships stem from a correlation with size,

⁶² The variables are "typical ratios" and broad balance sheet measures available in Bankscope, including measures of activity (5 indicators), asset quality (6), capital levels (11) operating margins (13) and liquidity buffers (6).

Table 5.1 Bank-specific balance-sheet factors affecting EU banks' internationalisation strategies

	2001		2003	
	Estimated coefficient	Pr(> t)	Estimated coefficient	Pr(> t)
Loan Loss Reserve / Gross Loans (%)	-3.85001	0.05636	-4.72821	0.01816
Loan Loss Prov / Net Int Rev (%)	-0.34681	0.05665	-0.00340	0.98581
Equity / Dep & ST Funding (%)	-0.61541	0.37694	-1.00123	0.06914
Cap Funds / Tot Assets (%)	-2.38252	0.07909	-3.77809	0.00923
Cap Funds / Dep & ST Funding (%)	-1.09002	0.28705	-2.32413	0.00638
Capital Funds / Liabilities (%)	-1.65485	0.11466	-1.97292	0.07316
Net Interest Margin (%)	-4.29578	0.11344	-7.61162	0.02927
Net Int Rev / Avg Assets (%)	-4.73404	0.12059	-8.19946	0.03078
Non Int Exp / Avg Assets (%)	-6.62199	0.05912	-5.96144	0.11058
Inc Net Of Dist / Avg Equity (%)	1.09330	0.09756	0.12357	0.76399
Recurring Earning Power (%)	-3.44593	0.45472	-9.28609	0.08234
Net Loans / Total Assets (%)	-0.10012	0.58331	-0.30484	0.07546
Net Loans / Customer & ST Funding (%)	0.00762	0.94983	-0.18312	0.08408
Liquid Assets / Tot Dep & Bor (%)	0.14805	0.46472	0.31096	0.09938
Total Assets (mil EUR)	0.00003	0.00345	0.00003	0.00767
Published Net Income (mil EUR)	0.00335	0.02709	0.00321	0.06774
Total Expenses (mil EUR)	0.00037	0.02233	0.00074	0.00539
Operating Income (mil EUR)	0.00267	0.03991	0.00363	0.02825

Note: For each case, the table lists the coefficient of the linear regression of the indicator of foreign presence against the specific characteristic and its p-value for both 2001 and 2003 independently. The p-value denotes the significance of the relationship (regression coefficient) and the (increasing) 3 levels of greyness highlight the 10, 5 and 1% levels of significance. Only relationships with a statistically significant coefficient at (at least) 10% level are shown. In each case individually outliers were excluded to avoid leveraging of the relationship.

many are still significant when accounting for the institutions' size.⁶³ There is, therefore, some evidence that the extent of foreign presence is related to lower provisions and capital buffers. Since correlation is not sufficient to ascertain causality, one cannot establish whether the depicted relationship stems from diversification benefits from operations across borders.

ESTABLISHMENTS ABROAD

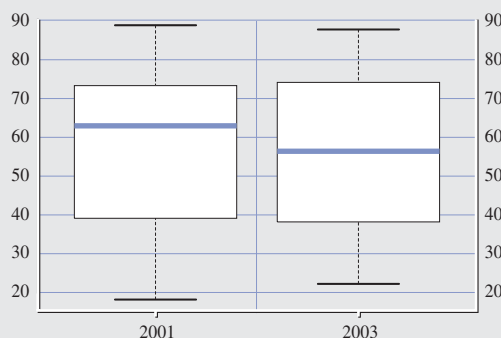
If instead of looking at assets one considers establishments (branches and subsidiaries) of internationally active banks abroad, some patterns of concentration are evident, notably in the EU-15, the NMS countries and the US. Only a handful of banks in the sample have a presence beyond this conclave. As for assets, an establishment-based indicator of foreign presence is constructed as the ratio of foreign to total branches and subsidiaries.

Considering first home country aggregated figures, the tendency towards scaling down cross-border activities is more clearly evident than for assets (not shown). The indicator's distribution across banks provides further insight into the nature of developments between 2001 and 2003. Whereas the median share decreased between 2001 and 2003, the overall distribution shows only a marginal wider dispersion in the middle and a narrower dispersion on the ends (see Chart 36).

63 The relationship between the group's foreign presence and the loan loss provisions indicators (not reported) are still significant in a bivariate regression with total assets included (which is also still significant). In addition, the two explanatory variables are not correlated, suggesting that the relationship does not stem from size. As for capital buffers, the statistically significant relationship remains for one of the four measures, with the significance weakened for the remaining three once total assets are included (which remains significant). This indicates that at least part of the relationship between foreign presence and capital buffers is driven by size considerations.

Chart 36 Distribution of the ratio of foreign to total establishments across banks in the sample

(UK banks excluded)



Source: BSC.

Therefore, information on establishments provides further evidence that banking groups with large cross-border banking operations appear to have concentrated on domestic activities between 2001 and 2003.

When considering the possible relationship between firm-specific factors and the share of establishments abroad, the results broadly resemble those for assets. In general, the broad groups of indicators with a statistically significant relation to the indicator of foreign presence (through establishments) are the same. The one exception is liquidity indicators, which have a positive relationship: more liquid banks tend to

have a greater share of their establishment outside the home country. Again, given that the causality cannot be established, it is not possible to assert that a greater share of establishments abroad necessitates larger liquid pools.

5.3 FOREIGN PRESENCE AND HOST COUNTRY CHARACTERISTICS

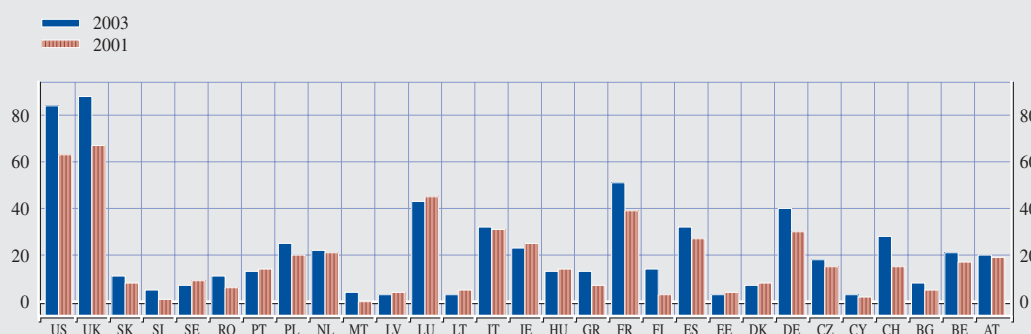
Inward attraction – the extent of foreign bank presence – is another important dimension revealed by the mapping exercise. The data show some interesting developments regarding both the number of foreign establishments in host countries and the assets held by them. As expected, larger banking markets appear more effective in attracting relatively more foreign establishments, supporting the idea of financial hubs serving as a magnet to large banking groups' activity.

Furthermore, although foreign presence (aggregated by host country) through establishments has markedly increased between 2003 and 2001 in the larger host countries, looking at foreign presence in terms of assets shows the opposite trend (see Chart 37 and Chart 38).

Large variation across countries is also evident when looking at the share of foreign assets in

Chart 37 Branches and subsidiaries of non-domestic banking groups by host country

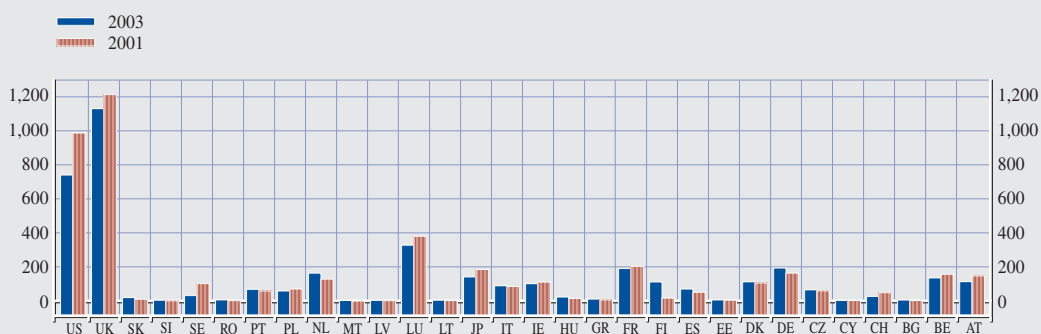
(y-axis: branches and subsidiaries of foreign group in host countries)



Source: BSC.
Note: Excluding banks resident in the UK.

Chart 38 Assets held by the non-domestic banking groups

(EUR millions; y-axis: assets of branches and subsidiaries in host countries)



Source: BSC.
Note: Excluding banks resident in the UK.

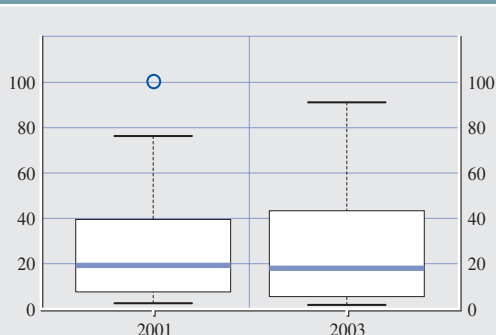
the host markets' total banking assets. The distribution of this share across host countries shows a wider dispersion in 2003 than in 2001 (see Chart 39). Indeed, no clear trend can be depicted, as both the inter-quartile range and the maximum and minimum values have widened, indicating greater polarisation among the host countries considered in the exercise. However, the wider move of the maximum and the upper quartile suggests that, overall, foreign banks represent a larger share of the activity of the host countries.

Furthermore, the presence of clusters attracting the presence of foreign groups is a salient result of both the 2001 and 2003 mapping exercises.

The elements that are catalytic to foreign groups establishing a local presence are likely to expand well beyond the economic domain, including legal aspects, the characteristics of local demand or local traditions. Nevertheless, it seems worth establishing which and to what extent some of the general and economic characteristics of the local markets are associated with high levels of inward attraction.

A number of country characteristics were collected on the sample of 30 host countries for which information is available in the mapping report. Of the 27 measures, only 9 do not show a statistically-significant relationship with the foreign presence indicator (see Table 5.2).

Chart 39 Distribution across host countries of cross-border assets as a percentage of total host country's assets



Source: BSC.

Measures showing a significant relationship can be broadly classified into seven groups: profitability of the host banking sector (positive relationship); the size of the market (negative relationship); the level of financial development (negative relationship); the liquidity of the local market (negative relationship); the level of competitiveness (positive and negative relationship); the safety buffers of the host banking sector; and the overall business/political environment.

Profitability, as measured by return on either assets or equity, is positively and significantly related to the extent of penetration of foreign

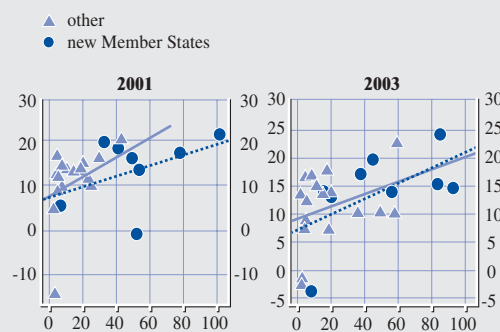
Table 5.2 Host country characteristics' relationship with foreign presence

	2001		2003	
	Estimate	Pr(> t)	Estimate	Pr(> t)
Bank Capital to Assets	3.456	0.071	5.184	0.016
Bank Nonperforming Loans to Total Loans	1.408	0.168	-1.654	0.375
Bank Provisions to Nonperforming Loans	-0.011	0.834	0.016	0.790
Bank Regulatory Capital to Risk-Weighted Assets	2.568	0.030	4.632	0.002
Bank Return on Assets	17.187	0.010	27.916	0.001
Bank Return on Equity	1.350	0.046	1.956	0.012
Total domestic credit of banking institutions (% of GDP)	-0.209	0.007	-0.322	0.000
Private domestic credit of banking institutions (% of GDP)	-0.236	0.006	-0.351	0.000
total.assets.eur	-0.004	0.059	-0.006	0.033
total.foreign.assets.EUR	-0.011	0.217	-0.014	0.182
foreign.percentage.total	0.282	0.387	-0.139	0.724
total.assets.usd	-0.005	0.059	-0.005	0.033
foreign.assets.usd	-0.013	0.217	-0.012	0.182
Bank liquid reserves to bank assets ratio	0.456	0.486	0.237	0.679
Domestic credit provided by banking sector (% of GDP)	-0.165	0.006	-0.312	0.000
Interest rate spread (lending rate minus deposit rate)	3.723	0.250	1.737	0.702
Liquid liabilities (M3) as % of GDP	-0.200	0.088	-0.430	0.026
Quasi-liquid liabilities (% of GDP)	-0.252	0.064	-0.647	0.010
Risk premium on lending (%)	-1.282	0.649	3.029	0.621
Number of local units (branches) of CIs per 100,000 inhabitants	-0.450	0.037	-0.643	0.018
Share of the 5 largest CIs in total assets (%)	0.407	0.072	0.467	0.077
Voice and Accountability	-24.506	0.095	-32.671	0.034
Political Stability	-20.507	0.053	1.832	0.896
Government Effectiveness	-10.351	0.080	-16.029	0.022
Regulatory Quality	-7.025	0.387	-13.423	0.254
Rule of Law	-13.214	0.023	-17.928	0.023
Control of Corruption	-11.662	0.020	-13.842	0.026

Sources: Banking Supervision Committee, IMF, World Bank and ECB calculations.
Note: See explanation in Table 5.1.

Chart 40 Foreign presence against host sector's return on equity

(x-axis: share of foreign assets in total assets; y-axis: return on equity)



Source: BSC.

groups. As made evident by the strengthening of this relationship between 2001 and 2003, both in terms of the size of the regression coefficient of the relationship and its significance, it is evident that the search for high levels of return is a catalyst for foreign presence (in terms of the foreign assets' share). Whilst this is clearly an important factor, since it has driven the substantial penetration of the New Member States banking sectors, the relationship is more general and possibly stronger for other host countries (see Chart 40).

Size (measured in terms of total assets in EUR and USD) is adversely related to the degree of

inward internationalisation. Although one would expect larger markets to be more attractive as hubs to foreign banks, the pure arithmetic effect of a larger market (the denominator) is clearly more dominant.

An interesting aspect is the negative relationship between the level of *financial development/depth* (as measured by the relative size of private and total domestic credit to GDP) and foreign presence. This unambiguous relationship seems to suggest that less developed markets tend to be more successfully penetrated by foreign groups. This may also be related to the profitability of such markets, with higher returns characterising less developed banking systems.⁶⁴

A negative relationship is also evident in both 2001 and 2003 for two out of the three *liquidity* measures: more liquid markets appear to have a lower share of foreign assets. Clearly, part of this relationship is derived from the sheer size of the host market – as larger banking sectors could well be characterised by higher liquidity.⁶⁵

Interestingly, *concentration* in the host market is also positively related to foreign presence. The larger shares of the largest five local institutions are associated with larger levels of inward internationalisation, suggesting at face value that less competitive markets are also attractive to foreign groups. However, some of this effect may capture a size-effect, as smaller markets are arithmetically characterised by larger CR5 values, as well as by a larger share of foreign assets (as the denominator is smaller).⁶⁶

Also measures of *safety buffers* show a significant relationship with the extent of foreign penetration, as hosts with deeper capital pools and larger provisions to non-performing assets also appear to exhibit greater foreign penetration – a relationship that was particularly significant in 2003.⁶⁷

Finally, the *overall political and business environment* is an important factor that drives

decisions regarding cross-border activities, as five of the six variables published by the World Bank show a significant negative relationship with foreign presence either in 2001 or 2003 or both. A stable overall financial and economic system appears to foster the development of domestic financial activity which is less reliant on foreign presence.

5.4 CONCLUSION

This chapter looks at the main characteristics of major EU banks with substantial international activities and the evolution of such activities between 2001 and 2003. Typically, these banks originate from and cluster into large financial centres (hubs). As such it is possible to refer to a core as well as a periphery in international banking. As a whole, internationally active EU banks rank high among their EU peers and markets assign relatively lower risk to them – likely underscoring a favourable role of lean and safe operations for international presence.

Of the broad trends that can be observed from the information on these banks, the extent of foreign presence in host countries (inward attraction) was lower in 2003 than in 2001. On the other hand, the degree of foreign reach

⁶⁴ The effect of financial development is still significant for 2003 in a bivariate regression with return on equity included (which is still significant, albeit at a lower level). Also, the two variables are not highly correlated, suggesting that the relationship of financial development with foreign presence is not fully channelled through profitability. Similar results also apply to bivariate regression with size indicators, where financial development is still statistically significant after conditioning for the size of the host market.

⁶⁵ This is not supported by a bivariate regression of foreign presence on both liquidity and size. Both size and liquidity are significant in 2003, but liquidity is no longer significant in 2001.

⁶⁶ Some support for this is evident from a relative evident negative correlation between the CR5 measure and the size of the host banking sector in terms of assets (-0.56). However, a bivariate regression fails to depict a more intricate relationship, as size is no longer significant in the bivariate regression, whereas the CR5 is then only significant in 2003.

⁶⁷ This relationship is still strongly significant – in particular in 2003 – even when conditioning for the size and the profitability of the host market (bivariate regressions).

of banks (outward reach) also exhibited a downward trend, with cross-border activity still characterised by regional champions in 2003, but with each of these large players showing a smaller presence abroad.

This chapter also looked in some detail at factors that may underpin the internationalisation strategies of large internationally active EU banks. Whilst it is clearly recognised that core elements underlying decisions to operate abroad include concepts that are not measurable or difficult to define, some basic analysis is possible using the information available. The reader should bear in mind, however, that this analysis is a first and very simple step beyond describing the data, and only aims to provide food for further thought.

Some interesting insights emerge from the cross-section analysis of the characteristics of both the internationally active banks themselves and the host markets in the degree of – respectively – outward reach and inward attraction. Such insights, however, only apply to the sample of banks in the study, and cannot accurately reflect patterns in the EU banking sector as a whole.

Part of the conventional wisdom regarding the nature of the presence abroad is supported: internationally active banks in our sample appear to benefit from the cross-border diversification of their assets and from more efficient operations. The size of both the home market and the bank is a relevant factor which affects the extensiveness of the international operations, as larger banks from larger home markets tend to have a greater proportion of assets abroad.

The exercise also points to factors in the host markets that are likely to influence and be influenced by foreign presence. Key among these, are the level of capital and profitability prospects, which are positively related to the host market's share of foreign assets. Factors negatively related are the level of financial development, available liquidity, the density of

branches and a myriad of stability measures, which suggests that favourable conditions in the host markets foster the development of the domestic institutions and diminish the reliance on foreign players.

ANNEX: SAMPLE COVERAGE

The 43 banking groups being examined have combined consolidated assets of nearly €12 trillion in 2003. The size of the institutions ranged between almost €800 billion and €12 billion. The size of the domestic banking markets for the EU as a whole amounted to €27 trillion. Hence, the sample covers nearly 45% of EU banking sector assets.

Banking groups with consolidated assets below €100 billion constitute around 30% of the sample, while the very large groups, with total assets in excess of €500 billion, represents slightly less than 20% of the sample (see Chart 41).

The growth of consolidated balance sheets amounted to 9% on average. However, differences between institutions appear to be quite large (see Chart 42). In particular, smaller banks appear to grow faster than larger ones, although there are exceptions to this rule.

Chart 41 Distribution of banks across different asset categories

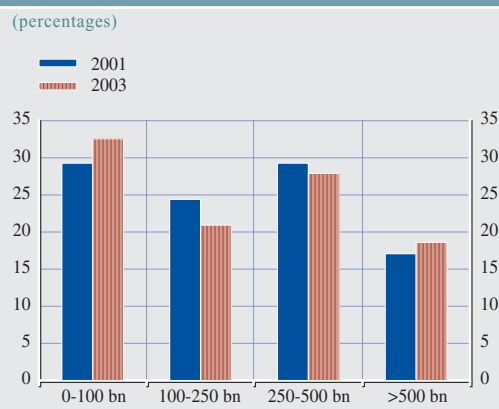
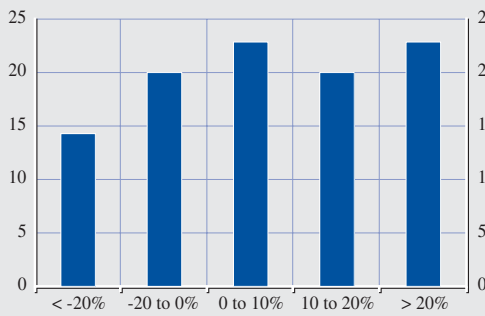


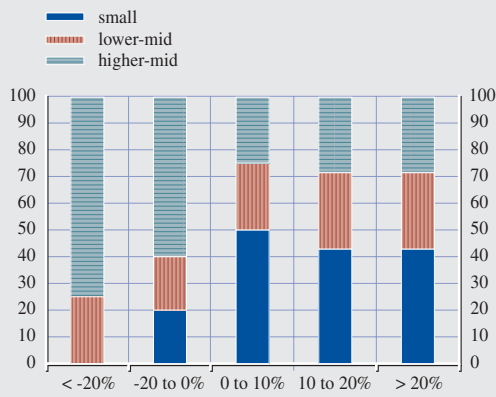
Chart 42 Distribution of balance sheet growth of banking groups

(percentages)

a. Distribution across growth categories



b. Distribution across size and growth categories



ANNEX I

STRUCTURAL INDICATORS OF THE EU BANKING SECTOR

Table I Number of credit institutions and local units (branches) of CIs

	Number of credit institutions				Number of branches			
	2001	2002	2003	2004	2001	2002	2003	2004
Belgium	112	111	108	104	6,168	5,550	4,989	4,837
Czech Republic	172	83	77	68	1,751	1,722	1,670	1,785
Denmark	203	178	203	202	2,376	2,128	2,118	2,021
Germany	2,526	2,363	2,225	2,148	53,931	50,868	47,351	45,505
Estonia	7	7	7	9	210	198	197	203
Greece	61	61	59	62	3,134	3,263	3,300	3,403
Spain	366	359	348	346	39,024	39,021	39,762	40,621
France	1,050	989	939	897	26,049	26,162	25,789	26,370
Ireland	88	85	80	80	970	926	924	909
Italy	843	821	801	787	29,267	29,948	30,501	30,946
Cyprus	43	46	47	43	528	521	506	500
Latvia	23	23	23	23	590	567	581	583
Lithuania	54	68	71	74	156	119	723	758
Luxembourg	189	177	169	162	274	271	269	253
Hungary	230	225	219	213	2,950	2,992	3,003	2,987
Malta	17	14	16	16	58	55	58	63
Netherlands	561	539	481	461	4,720	4,269	3,883	3,649
Austria	836	823	814	796	4,561	4,466	4,395	4,360
Poland	711	664	658	653	4,080	4,302	4,394	5,006
Portugal	212	202	200	197	5,534	5,390	5,440	5,408
Slovenia	69	50	33	24	717	721	720	706
Slovakia	20	20	21	21	1,052	1,020	1,057	1,113
Finland	369	369	366	363	1,571	1,572	1,564	1,585
Sweden	149	216	222	212	2,040	2,040	2,046	2,034
United Kingdom	452	451	426	413	14,554	14,392	14,186	14,001
MU12	7,213	6,899	6,590	6,403	175,203	171,706	168,167	167,846
EU25	9,363	8,944	8,613	8,374	206,265	202,483	199,426	199,606

Source: ECB.

Note: For SI, CIs include banks, savings banks and savings and loan undertakings (cooperative banks). Before 2004 the savings and loan undertakings did not have the Bank of Slovenia authorisation and were not obliged to report the number of employees and local units (branches) and hence, the former figures are without the savings and loan undertakings. For LT, the figure for CIs includes small credit cooperatives (61 in 2004) and the number of branches includes small non-registered local units (since 2003). For CY, data refer to domestic banks and international banking units but exclude cooperative credit institutions. For CZ, credit unions are excluded.

Table 2 Number of employees and total assets of CIs

	Number of employees of CIs				Total assets of CIs (EUR millions)			
	2001	2002	2003	2004	2001	2002	2003	2004
Belgium	76,104	75,370	73,553	71,334	776,173	774,330	828,557	914,391
Czech Republic	42,999	40,534	39,658	38,666	78,188	79,232	78,004	86,525
Denmark	48,538	47,613	45,994	43,877	454,328	506,694	546,468	607,107
Germany	772,100	753,950	725,550	712,300	6,268,700	6,370,194	6,393,524	6,584,388
Estonia	3,949	3,934	4,280	4,455	4,372	5,221	6,314	8,537
Greece	59,624	60,495	61,074	59,337	202,736	201,608	213,171	230,454
Spain	244,781	243,429	243,462	246,006	1,247,998	1,342,492	1,502,861	1,717,364
France	424,615	428,438	425,041	n.a.	3,768,943	3,831,610	3,994,237	4,415,475
Ireland	40,928	36,585	35,658	35,564	422,106	474,630	575,168	722,544
Italy	343,812	341,584	338,288	336,979	1,851,990	2,024,156	2,125,366	2,275,652
Cyprus	8,200	8,649	8,470	8,516	36,164	33,998	34,508	38,336
Latvia	8,172	8,267	8,903	9,655	7,279	7,250	8,482	11,167
Lithuania	8,796	8,420	7,557	7,266	4,361	5,010	6,425	8,509
Luxembourg	23,894	23,300	22,513	22,549	721,001	662,615	655,971	695,103
Hungary	34,376	35,232	36,014	36,246	39,343	46,477	52,565	64,970
Malta	3,584	3,459	3,401	3,353	13,644	15,543	17,803	20,391
Netherlands	131,230	125,911	120,539	115,283	1,265,906	1,356,397	1,473,939	1,677,583
Austria	74,606	74,048	73,308	72,858	573,384	554,528	586,459	635,347
Poland	165,225	158,697	151,254	149,610	133,476	116,044	103,659	131,904
Portugal	55,538	55,260	53,931	52,757	352,251	351,773	348,691	345,378
Slovenia	11,578	11,855	11,703	11,602	17,782	19,995	21,541	24,462
Slovakia	20,118	18,452	18,350	18,261	n.a.	21,527	20,883	29,041
Finland	26,733	27,190	26,667	25,377	163,416	165,661	185,846	212,427
Sweden	42,001	42,357	40,169	39,181	452,289	474,841	506,493	582,918
United Kingdom	506,278	501,787	500,656	511,455	5,830,158	5,854,355	6,175,244	6,970,009
MU12	2,273,965	2,245,560	2,199,584	2,175,385**	17,614,604	18,109,994	18,883,790	20,426,106
EU25*	3,177,779	3,134,816	3,075,993	3,057,528**	24,685,988*	25,296,181	26,462,180	29,009,982

Source: ECB.

* EU25 total excludes n.a., ** using 2003 figure for FR.

Table 3 Herfindahl index for CIs' total assets and share of the 5 largest CIs in total assets

(index ranging from 0 to 10,000 and in percent)

	Herfindahl Index for CIs				Share of the 5 largest CIs in total assets			
	2001	2002	2003	2004	2001	2002	2003	2004
Belgium	1,587	1,905	2,065	2,100	78.3	82.0	83.5	84.3
Czech Republic	1,263	1,199	1,187	1,103	68.4	65.7	65.8	64.0
Denmark	1,119	1,145	1,114	1,146	67.6	68.0	66.6	67.0
Germany	158	163	173	178	20.2	20.5	21.6	22.1
Estonia	4,067	4,028	3,943	3,887	98.9	99.1	99.2	98.6
Greece	1,113	1,164	1,130	1,069	67.0	67.4	66.9	65.0
Spain	551	529	521	482	44.9	44.3	43.9	41.9
France	606	551	597	623	47.0	44.6	46.7	44.7
Ireland	512	553	562	556	42.5	46.1	44.4	43.9
Italy	260	270	240	230	28.8	30.6	27.0	26.0
Cyprus	1,304	1,339	1,392	1,365	71.5	69.3	69.7	69.4
Latvia	1,053	1,144	1,054	1,021	63.4	65.3	63.1	62.4
Lithuania	2,503	2,240	2,071	1,854	87.6	83.9	81.0	78.9
Luxembourg	275	296	315	304	28.0	30.3	31.8	29.7
Hungary	892	856	783	795	56.4	54.5	52.1	52.7
Malta	2,163	2,390	2,199	2,015	79.6	82.0	79.3	78.7
Netherlands	1,762	1,788	1,744	1,726	82.5	82.7	84.2	84.0
Austria	561	618	557	552	44.9	45.6	44.2	43.8
Poland	821	792	753	692	54.7	53.4	52.3	50.2
Portugal	991	963	1,043	1,093	59.8	60.5	62.7	66.5
Slovenia	1,582	1,602	1,496	1,425	67.6	68.4	66.4	64.1
Slovakia	1,205	1,252	1,191	1,154	66.1	66.4	67.5	66.5
Finland	2,240	2,050	2,420	2,680	79.5	78.6	81.2	82.7
Sweden	760	800	760	854	54.6	56.0	53.8	54.4
United Kingdom	282	307	347	376	28.6	29.6	32.8	34.5
MU12	544	553	581	600	39.1	39.4	40.5	40.5
unweighted average	885	904	947	966	51.9	52.8	53.2	52.9
EU25	506	521	549	569	37.8	38.3	39.8	40.2
unweighted average	1,185	1,198	1,186	1,171	59.5	59.8	59.5	59.0

Source: ECB.

Note: Aggregate concentration figures display both weighted and unweighted averages.

Table 4 Loans of CIs to non-financial corporations and total loans of CIs for housing purchase

(EUR millions)

	Loans of CIs to non-financial corporations				Total loans of CIs for housing purchase			
	2001	2002	2003	2004	2001	2002	2003	2004
Belgium	94,247	90,840	86,850	86,459	58,006	63,609	71,710	80,440
Czech Republic	n.a.	13,820	13,340	15,133	n.a.	3,545	4,790	6,885
Denmark	n.a.	n.a.	83,458	89,536	n.a.	n.a.	151,820	163,450
Germany	844,235	840,675	813,746	786,844	901,839	921,822	937,379	949,457
Estonia	1,133	1,240	1,490	2,086	387	593	954	1,500
Greece	48,603	52,294	58,319	63,004	15,517	21,064	26,364	32,944
Spain	306,019	340,980	387,804	454,715	206,815	236,388	277,573	335,665
France	540,083	548,866	534,666	566,937	320,761	347,954	385,078	432,396
Ireland	52,830	54,912	64,952	85,555	34,710	44,126	55,012	73,739
Italy	520,856	546,559	588,676	615,688	107,711	131,660	154,374	185,014
Cyprus	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Latvia	1,993	2,230	2,639	3,545	221	390	722	1,311
Lithuania	1,640	1,944	2,811	3,609	n.a.	286	553	996
Luxembourg	45,391	40,159	36,625	33,741	6,533	7,052	8,291	9,335
Hungary	13,632	14,547	16,074	19,665	1,504	3,639	6,093	8,255
Malta	5,644	6,258	5,969	6,153	761	898	1,061	1,276
Netherlands	213,284	205,966	214,011	223,999	259,812	282,937	302,392	331,742
Austria	134,059	132,166	131,263	114,984	29,631	35,998	39,746	48,064
Poland	40,704	29,435	25,845	28,701	6,018	6,885	8,258	10,734
Portugal	72,597	78,715	82,717	84,079	57,448	64,954	66,485	71,139
Slovenia	5,608	5,929	6,784	8,086	390	457	557	732
Slovakia	5,625	5,502	5,975	5,642	n.a.	1,040	1,427	2,032
Finland	30,943	32,991	34,719	37,708	27,329	30,960	36,049	41,544
Sweden	124,804	127,352	124,953	128,341	72,554	81,219	84,129	96,086
United Kingdom	439,735	439,530	408,655	426,897	965,934	1,035,553	1,100,210	1,238,492
MU12	2,903,147	2,965,123	3,034,348	3,153,713	2,026,112	2,188,524	2,360,453	2,591,481
EU25*	3,543,665	3,612,910	3,732,341	3,891,107	3,073,881	3,323,029	3,722,676	4,123,180

Source: ECB.

Note: For euro area countries, DK and SE, figures comprise loans to domestic and (other) euro area country NFCs, households and individual enterprises, respectively. *: EU25 excludes n.a.

Table 5 Total loans of CIs for consumer credit and other household lending from CIs

(EUR millions)

	Total loans of CIs for consumer credit				Other household lending from CIs			
	2001	2002	2003	2004	2001	2002	2003	2004
Belgium	8,472	8,651	8,648	8,013	18,799	17,372	15,524	17,201
Czech Republic	n.a.	1,392	1,678	2,242	n.a.	807	862	1,220
Denmark	n.a.	12,590	13,357	14,214	n.a.	n.a.	17,200	21,655
Germany	223,380	225,187	174,919	174,448	282,928	274,380	319,502	313,494
Estonia	54	75	95	172	149	163	181	201
Greece	7,854	9,757	12,386	17,025	324	518	1,260	1,456
Spain	48,819	53,800	55,603	62,367	58,136	65,597	77,598	84,804
France	118,108	121,118	128,415	134,094	63,730	75,512	71,938	73,018
Ireland	12,991	14,485	12,310	14,725	1,472	1,343	4,300	5,567
Italy	23,895	28,386	33,012	38,117	126,929	122,174	122,864	128,138
Cyprus	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Latvia	117	136	203	295	88	163	178	258
Lithuania	n.a.	n.a.	n.a.	217	n.a.	n.a.	n.a.	235
Luxembourg	1,097	1,114	1,185	1,269	12,085	14,088	13,502	12,820
Hungary	879	1,193	1,840	2,549	1,344	1,461	1,116	1,615
Malta	121	106	113	190	216	240	277	246
Netherlands	13,903	18,647	20,442	23,480	21,366	22,364	22,641	22,505
Austria	24,043	22,886	21,525	24,752	8,138	6,638	7,015	21,224
Poland	11,460	10,319	9,066	11,965	n.a.	6,170	5,372	6,397
Portugal	8,156	8,161	8,720	9,089	10,511	10,534	9,817	10,806
Slovenia	n.a.	n.a.	n.a.	1,794	n.a.	n.a.	n.a.	732
Slovakia	n.a.	142	214	491	n.a.	n.a.	n.a.	n.a.
Finland	6,387	6,641	7,324	8,047	8,850	9,100	9,666	10,433
Sweden	n.a.	n.a.	9,528	10,420	39,822	43,252	44,716	48,732
United Kingdom	231,566	242,093	237,285	258,272	181,174	191,658	182,907	199,738
MU12	497,105	518,833	484,489	515,426	613,268	619,620	675,627	701,466
EU25*	741,302	786,879	757,868	818,094	836,061	863,534	928,436	982,457

Source: ECB.

Note: In 2003, DE amended the definition for the 'loans to households by purpose' (consumer credit, housing purchase, other) which caused a break in the time series (movement from 'consumer credit' to 'other lending'). Other household lending for PL is n.a. in 2001 because of reporting changes. For euro area countries, DK and SE, figures comprise loans to domestic and (other) euro area country households/individual enterprises.

*: EU25 total excludes n.a.

Table 6 Total loans and total deposits of CIs to/from non-CIs

(EUR millions)

	Total loans of CIs to non-CIs				Total deposits of CIs from non-CIs			
	2001	2002	2003	2004	2001	2002	2003	2004
Belgium	263,488	279,079	287,359	304,112	326,157	345,120	365,395	405,183
Czech Republic	n.a.	29,516	31,310	33,554	n.a.	53,941	53,869	60,030
Denmark	261,579	274,981	291,870	322,812	96,354	102,919	107,010	122,052
Germany	3,051,658	3,021,886	3,025,616	3,009,309	2,380,289	2,401,168	2,447,673	2,511,278
Estonia	2,602	3,194	4,421	5,916	2,728	3,115	3,415	4,138
Greece	81,779	95,084	110,018	127,637	135,732	133,850	140,029	159,855
Spain	683,862	759,698	862,851	1,010,453	707,472	752,902	806,803	874,008
France	1,336,505	1,370,384	1,431,686	1,531,434	1,051,456	1,076,587	1,196,253	1,268,439
Ireland	190,891	198,836	207,917	261,797	131,067	142,956	160,191	182,209
Italy	1,009,773	1,065,791	1,128,503	1,188,897	681,265	741,211	744,494	783,609
Cyprus	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Latvia	2,884	3,470	4,445	6,227	4,154	5,033	5,535	7,247
Lithuania	2,057	2,573	3,893	5,445	3,007	3,463	4,091	5,397
Luxembourg	148,113	131,989	118,528	119,919	218,233	198,935	205,909	220,556
Hungary	20,527	26,397	31,276	39,178	26,921	31,208	30,910	36,006
Malta	6,829	7,423	8,016	8,556	7,747	8,675	8,177	8,765
Netherlands	654,621	704,470	761,691	850,583	524,985	537,795	570,132	598,093
Austria	268,367	273,066	277,053	296,625	210,262	211,128	222,071	231,949
Poland	n.a.	61,000	57,000	68,000	n.a.	81,000	72,000	89,000
Portugal	170,615	183,214	185,829	194,798	134,370	133,804	137,421	145,574
Slovenia	8,649	9,317	10,461	12,372	12,724	13,910	14,154	14,812
Slovakia	n.a.	n.a.	n.a.	n.a.	4,232	4,726	5,833	7,181
Finland	81,058	85,991	94,137	103,944	68,977	71,534	75,632	79,666
Sweden	263,928	283,090	296,388	319,469	124,627	131,611	138,944	142,801
United Kingdom	2,124,785	2,195,037	2,223,517	2,438,156	1,851,098	1,819,959	1,847,372	2,016,793
MU12	7,940,730	8,169,488	8,491,188	8,999,508	6,570,265	6,746,990	7,072,003	7,460,419
EU25*	10,634,570	11,065,486	11,453,785	12,259,193	8,703,857	9,006,550	9,363,313	9,974,641

Source: ECB.

Note: For euro area countries, total loans are the sum of loans to government and other residents in the home country and the rest of the world. For euro area countries, total deposits are the sum of deposits from insurance companies and pension funds, non-financial corporations, households, other financial institutions and non-banks in the euro area.

*: EU25 total excludes n.a.

Table 7 Gross issues of long-term and short-term debt securities by non-financial companies

(EUR millions)

	Long-term debt securities by non-financial companies				Short-term debt securities by non-financial companies			
	2001	2002	2003	2004	2001	2002	2003	2004
Belgium	6,716	3,499	4,459	3,654	45,338	38,305	41,469	40,480
Czech Republic	126	382	389	250	0	0	0	0
Denmark	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Germany	6,948	15,850	21,513	26,111	123,476	116,629	197,864	237,986
Estonia	6	13	16	48	13	34	8	10
Greece	63	87	485	1,162	0	0	0	24
Spain	379	572	1,427	1,319	10,095	9,815	7,293	7,020
France	55,599	30,777	52,050	28,061	545,855	449,687	403,855	483,393
Ireland	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Italy	15,170	10,288	6,950	14,922	5	2	21	0
Cyprus	6,085	9,240	27,922	n.a.	0	0	0	0
Latvia	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Lithuania	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Luxembourg	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Hungary	n.a.	n.a.	128	0	n.a.	n.a.	0	0
Malta	4	119	58	24	n.a.	n.a.	n.a.	n.a.
Netherlands	15,725	3,931	7,315	2,212	1,263	1,703	3,452	550
Austria	1,955	1,913	5,251	3,545	18	370	778	784
Poland	n.a.	n.a.	322	588	n.a.	n.a.	7,792	11,108
Portugal	1,649	392	1,135	950	33,227	42,649	54,398	70,148
Slovenia	236	113	114	225	n.a.	n.a.	n.a.	n.a.
Slovakia	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Finland	1,938	1,236	1,722	1,842	58,481	57,940	62,860	68,116
Sweden	15,472	12,949	13,379	12,552	8,813	8,532	5,688	6,990
United Kingdom	54,376	30,808	18,006	13,231	-	-	-	-

Source: ECB.

Note: For UK, figures refer to net short and long term issues (2004: long-term issues only, with maturity above 1 year).

Table 8 Total investments of insurance corporations and total assets under management by investment funds

(EUR millions)

	Total investments of insurance corporations				Total assets under management by investment funds			
	2001	2002	2003	2004	2001	2002	2003	2004
Belgium	115,669	123,080	140,040	163,653	86,784	78,288	84,306	94,882
Czech Republic	4,891	6,496	6,977	8,109	2,740	3,714	3,341	3,712
Denmark	96,443	98,620	107,810	124,209	38,025	39,042	49,306	76,880
Germany	943,367	1,001,579	1,058,276	1,092,121	793,665	741,402	826,764	861,844
Estonia	152	182	233	311	57	104	158	313
Greece	12,175	9,036	10,132	12,071	17,392	14,742	14,342	15,908
Spain	148,847	168,196	184,567	203,744	158,249	144,150	178,858	207,570
France	836,635	868,444	942,562	n.a.	648,548	601,353	704,447	799,302
Ireland	56,393	61,592	74,171	n.a.	284,177	303,881	361,760	434,589
Italy	307,162	323,806	355,017	396,671	383,887	325,909	297,269	281,080
Cyprus	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Latvia	202	205	211	218	14	20	39	52
Lithuania	221	266	348	406	n.a.	n.a.	n.a.	n.a.
Luxembourg	28,631	28,941	33,448	39,503	854,000	725,781	818,462	974,685
Hungary	2,809	3,423	3,551	5,071	2,888	4,020	3,458	4,327
Malta	459	528	596	783	545	642	821	1,005
Netherlands	297,044	284,283	293,584	321,682	112,320	90,109	97,065	98,358
Austria	57,471	60,092	63,833	68,280	97,769	101,504	108,931	122,619
Poland	10,655	11,380	11,106	13,789	3,442	5,663	7,045	9,249
Portugal	26,550	29,559	32,471	35,014	25,588	25,421	28,456	31,261
Slovenia	1,318	1,699	1,980	2,316	2,542	2,249	1,856	2,085
Slovakia	1,313	1,500	1,939	2,371	n.a.	n.a.	887	1,641
Finland	32,362	32,576	34,965	38,109	12,300	11,573	15,429	21,517
Sweden	193	176	194	212	87,321	73,449	92,638	117,402
United Kingdom	1,740,000	1,557,000	1,509,000	1,629,000	362,155	347,219	376,195	424,751**
MU12	2,862,306	2,991,184	3,223,066	n.a.	3,474,678	3,164,113	3,536,087	3,943,616
EU25*	4,720,961	4,672,660	4,867,010	n.a.	3,974,407	3,640,235	4,071,831	4,585,033

Source: ECB.

*: EU25 total excludes n.a.

**: Estimate.

Table 9 Total assets under management by pension funds

(EUR millions)

Total assets under management by pension funds				
	2001	2002	2003	2004
Belgium	14,373	13,543	10,833	11,677
Czech Republic	1,613	2,238	2,577	3,200
Denmark	41,720	42,272	45,770	378,400
Germany	n.a.	100,077	142,000	260,000
Estonia	2	15	71	172
Greece	0	0	0	0
Spain	44,606	49,610	56,997	64,186
France	0	0	0	0
Ireland	51,149	44,810	53,060	62,334
Italy	6,653	8,393	11,594	12,122
Cyprus	n.a.	n.a.	n.a.	n.a.
Latvia	17	24	30	39
Lithuania	0	0	0	24
Luxembourg	n.a.	n.a.	n.a.	n.a.
Hungary	2,333	3,269	3,797	5,351
Malta	0	0	0	0
Netherlands	451,133	423,268	475,488	522,266
Austria	8,049	7,876	9,111	10,126
Poland	5,511	7,852	9,505	15,354
Portugal	14,826	15,552	16,283	15,191
Slovenia	206	241	339	529
Slovakia	n.a.	n.a.	n.a.	n.a.
Finland	n.a.	n.a.	n.a.	n.a.
Sweden	60	53	64	71
United Kingdom	1,180,000	951,000	1,023,000	1,107,000
MU12*	n.a.	663,129	777,757	957,902
EU25*	n.a.	1,670,093	1,862,910	2,468,042

Source: ECB.

Note: In GR and FR, all pension funds are state-owned (reported as 0). For SK, no data are provided because of a structural change in 2005 (social security reform). *: MU12 and EU25 total exclude n.a.

Table 10 Number of branches of CIs from EEA and third countries

	Number of branches of CIs from EEA countries				Number of branches of CIs from third countries			
	2001	2002	2003	2004	2001	2002	2003	2004
Belgium	35	36	38	36	11	10	10	9
Czech Republic	9	8	8	9	1	1	1	0
Denmark	9	8	15	16	1	1	1	1
Germany	59	64	65	64	21	19	19	19
Estonia	1	1	1	3	0	0	0	0
Greece	13	14	14	19	8	7	6	4
Spain	49	51	50	54	7	8	7	7
France	55	51	52	55	28	28	28	27
Ireland	32	31	31	31	1	1	1	1
Italy	94	91	75	90	16	15	15	14
Cyprus	5	5	5	4	16	19	19	19
Latvia	1	1	1	1	0	0	0	0
Lithuania	3	3	2	2	1	1	1	0
Luxembourg	55	48	43	40	8	7	7	7
Hungary	0	0	0	0	0	0	0	0
Malta	0	0	0	0	3	2	2	2
Netherlands	19	19	20	22	9	9	8	7
Austria	15	15	18	18	0	0	0	0
Poland	0	0	0	3	0	0	0	0
Portugal	23	21	22	26	2	1	1	1
Slovenia	1	1	1	2	0	0	0	0
Slovakia	1	1	2	3	1	1	1	0
Finland	18	19	18	20	0	0	0	0
Sweden	19	18	17	19	1	1	1	1
United Kingdom	87	85	84	84	115	105	97	91
MU12	467	460	446	475	111	105	102	96
EU25	603	591	582	621	250	236	225	210

Source: ECB.

Table 11 Total assets of branches of CIs from EEA and third countries

(EUR millions)

	Total assets of branches of CIs from EEA countries				Total assets of branches of CIs from third countries			
	2001	2002	2003	2004	2001	2002	2003	2004
Belgium	29,844	27,221	25,908	29,225	13,110	10,971	12,928	11,901
Czech Republic	9,359	7,674	7,350	8,268	*	*	*	0
Denmark	19,606	22,316	24,177	26,529	*	*	*	*
Germany	91,316	76,738	67,539	70,252	38,525	31,826	20,315	22,455
Estonia	*	*	*	806	0	0	0	0
Greece	8,934	11,489	12,769	22,634	8,911	5,881	6,383	394
Spain	49,454	61,713	85,993	122,030	2,684	3,911	2,502	2,984
France	119,647	118,053	99,917	110,543	21,112	13,701	11,351	12,591
Ireland	58,411	60,167	69,773	80,804	*	*	*	*
Italy	69,641	80,663	87,191	108,145	11,057	10,102	9,735	6,954
Cyprus	1,738	1,081	933	474	2,700	2,602	2,613	2,789
Latvia	*	*	*	*	0	0	0	0
Lithuania	213	233	*	*	*	*	*	0
Luxembourg	130,562	108,816	90,089	109,346	7,438	6,264	4,912	5,377
Hungary	0	0	0	0	0	0	0	0
Malta	0	0	0	0	2,973	*	*	*
Netherlands	27,626	26,600	26,091	30,283	2,107	1,795	1,582	1,198
Austria	4,458	3,242	3,363	4,298	0	0	0	0
Poland	0	0	0	828	0	0	0	0
Portugal	14,808	15,839	16,923	20,340	*	*	*	*
Slovenia	*	*	*	*	0	0	0	0
Slovakia	*	*	*	2,996	*	*	*	0
Finland	10,404	14,345	13,030	14,367	0	0	0	0
Sweden	23,245	27,581	33,281	43,369	*	*	*	*
United Kingdom	1,363,463	1,285,518	1,345,804	1,544,466	1,210,305	1,128,190	1,123,725	1,156,243
MU12	615,105	604,886	598,586	722,267	164,188	144,953	139,779	138,303
EU25	2,033,986	1,951,222	2,012,689	2,351,740	1,383,517	1,281,581	1,273,412	1,303,650

Source: ECB.

* If the number of branches is less than three, underlying data are not disclosed because of confidentiality reasons.

Table 12 Number of subsidiaries of CIs from EEA and third countries

	Number of subsidiaries of CIs from EEA countries				Number of subsidiaries of CIs from third countries			
	2001	2002	2003	2004	2001	2002	2003	2004
Belgium	22	22	20	20	7	7	6	6
Czech Republic	16	18	18	19	4	4	4	3
Denmark	7	8	7	7	2	2	2	3
Germany	21	22	20	20	32	27	25	22
Estonia	3	3	3	3	0	0	0	0
Greece	2	2	3	4	2	3	1	0
Spain	44	40	44	43	12	11	10	8
France	162	146	126	108	67	62	58	58
Ireland	25	26	21	22	10	11	10	10
Italy	7	6	7	6	2	2	2	2
Cyprus	7	10	9	9	2	2	2	1
Latvia	3	3	3	5	3	4	4	3
Lithuania	2	3	3	5	2	2	2	0
Luxembourg	90	85	83	82	36	33	32	29
Hungary	25	21	22	20	1	2	3	3
Malta	8	7	8	8	2	1	1	2
Netherlands	14	14	13	13	17	17	16	16
Austria	13	13	14	13	10	10	10	7
Poland	36	34	36	33	10	11	10	8
Portugal	9	9	11	9	3	4	4	4
Slovenia	4	5	5	5	0	0	0	0
Slovakia	8	9	11	14	3	4	4	1
Finland	3	3	3	5	0	0	0	0
Sweden	12	12	14	14	7	8	9	9
United Kingdom	17	17	15	20	76	78	76	75
MU12	412	388	365	345	198	187	174	162
EU25	560	538	519	507	310	305	291	269

Source: ECB.

Table 13 Total assets of subsidiaries of CIs from EEA and third countries

(EUR millions)

	Total assets of subsidiaries of CIs from EEA countries				Total assets of subsidiaries of CIs from third countries			
	2001	2002	2003	2004	2001	2002	2003	2004
Belgium	146,339	141,749	150,464	167,047	3,707	6,280	6,887	3,834
Czech Republic	43,441	63,468	64,240	66,886	3,684	4,505	4,340	4,295
Denmark	58,431	66,909	66,805	62,590	*	*	*	8,935
Germany	110,716	225,311	227,597	253,250	56,811	52,062	65,009	67,676
Estonia	3,985	4,698	5,622	7,557	0	0	0	0
Greece	*	*	27,730	34,134	*	1,927	*	0
Spain	49,426	52,897	63,731	67,405	15,397	14,436	14,310	5,237
France	298,786	301,275	287,559	303,941	74,947	54,801	46,503	74,472
Ireland	145,854	114,695	132,599	182,389	46,266	59,393	61,252	65,163
Italy	20,416	23,348	26,389	29,115	*	*	*	*
Cyprus	4,018	4,544	5,367	8,246	*	*	*	*
Latvia	1,718	1,580	1,853	4,400	1,264	1,237	1,690	455
Lithuania	1,821	2,554	3,300	6,309	*	*	*	0
Luxembourg	507,151	480,267	495,726	512,754	36,593	27,577	25,171	26,518
Hungary	21,535	24,655	29,430	36,293	*	*	1,643	2,028
Malta	6,685	6,502	7,050	7,970	*	*	*	*
Netherlands	96,588	94,456	126,420	151,287	16,809	16,421	19,119	19,733
Austria	102,813	112,152	107,755	116,482	4,070	3,454	4,108	2,603
Poland	80,653	68,980	61,535	76,713	11,212	10,752	9,398	11,422
Portugal	68,275	69,150	72,796	67,356	3,669	3,335	2,563	2,540
Slovenia	2,573	3,193	3,828	4,597	0	0	0	0
Slovakia	15,035	17,373	17,140	22,428	824	1,361	1,432	*
Finland	722	741	716	111,950	0	0	0	0
Sweden	2,290	2,614	3,491	4,495	1,802	2,051	2,372	2,604
United Kingdom	71,887	61,982	60,800	294,870	297,724	297,125	547,052	577,107
MU12	1,566,551	1,640,494	1,719,482	1,997,110	261,924	242,054	249,556	271,056
EU25	1,879,694	1,968,815	2,049,196	2,601,048	587,226	565,442	821,560	880,703

Source: ECB.

* If the number of subsidiaries is less than three, underlying data are not disclosed because of confidentiality reasons.

Table 14 Population and gross domestic product at market prices

	Population (thousands, number end of period)				Gross domestic product at market price (EUR millions)			
	2001	2002	2003	2004	2001	2002	2003	2004
Belgium	10,281	10,330	10,374	10,418	254,153	261,124	269,546	283,752
Czech Republic	10,224	10,201	10,202	10,202	67,960	78,388	80,254	86,239
Denmark	5,357	5,376	5,390	5,403	177,527	181,790	187,134	194,421
Germany	82,340	82,482	82,520	82,501	2,113,160	2,145,020	2,163,400	2,215,650
Estonia	1,367	1,361	1,356	1,356	6,676	7,472	8,138	9,043
Greece	10,950	10,988	11,024	11,041	131,769	142,369	154,153	167,169
Spain	40,721	41,314	42,005	42,640	679,848	729,004	780,557	837,557
France	61,044	61,426	61,800	62,177	1,497,184	1,548,555	1,585,172	1,648,369
Ireland	3,859	3,926	3,991	4,059	117,114	130,515	139,097	148,557
Italy	57,927	58,028	58,132	58,254	1,218,535	1,260,598	1,300,929	1,351,328
Cyprus	708	710	721	737	10,599	11,073	11,651	12,402
Latvia	2,355	2,339	2,325	2,313	9,227	9,792	9,861	11,024
Lithuania	3,481	3,469	3,454	3,439	13,505	14,928	16,271	17,926
Luxembourg	442	446	449	453	22,020	22,805	23,956	25,664
Hungary	10,188	10,159	10,130	10,107	57,874	68,902	72,584	80,816
Malta	393	396	398	401	4,204	4,257	4,195	4,277
Netherlands	16,043	16,147	16,224	16,305	447,731	465,214	476,349	488,642
Austria	8,043	8,084	8,118	8,175	215,878	220,688	226,968	237,039
Poland	38,248	38,230	38,205	38,167	207,128	202,497	185,226	195,205
Portugal	10,293	10,368	10,441	10,504	127,769	133,828	135,822	141,115
Slovenia	1,992	1,995	1,996	1,997	21,845	23,518	24,576	25,895
Slovakia	5,403	5,391	5,380	5,382	23,322	25,733	28,952	33,119
Finland	5,188	5,201	5,213	5,227	136,472	140,853	143,807	149,725
Sweden	8,896	8,925	8,958	8,994	245,178	256,840	267,250	279,008
United Kingdom	59,051	59,232	59,787	60,024	1,602,840	1,667,312	1,598,172	1,715,791
MU12	307,131	308,740	310,290	311,755	6,961,632	7,200,573	7,399,756	7,694,565
EU25	454,794	456,523	458,592	460,278	9,409,517	9,753,076	9,894,022	10,359,732

Sources: ECB and Eurostat.

Table 15 Number of mergers and acquisitions (M&As) in the EU banking sector

	Number of domestic M&As					Number of inter-EEA M&As					Number of M&As from third countries				
	2001	2002	2003	2004	2005h1	2001	2002	2003	2004	2005h1	2001	2002	2003	2004	2005h1
Belgium	1	1	2	1	0	0	0	0	1	0	0	0	0	0	0
Czech Republic	2	0	0	1	0	2	2	2	4	0	0	0	1	0	0
Denmark	3	0	1	1	0	1	1	1	3	0	2	0	0	0	0
Germany	9	8	14	11	6	2	5	2	0	1	1	0	1	0	0
Estonia	0	0	0	0	0	0	0	1	0	1	0	0	0	0	0
Greece	2	2	3	1	0	1	1	0	2	1	0	0	0	0	0
Spain	5	3	4	1	1	1	2	0	1	1	0	0	1	0	0
France	12	12	8	11	1	4	3	0	0	0	0	0	0	1	0
Ireland	0	0	1	0	0	1	1	0	0	1	0	0	0	1	0
Italy	24	23	22	13	5	3	3	0	2	1	1	0	2	0	0
Cyprus	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Latvia	1	0	0	0	1	0	1	0	0	0	1	0	0	2	0
Lithuania	0	0	0	0	0	3	0	0	1	0	0	0	0	0	0
Luxembourg	0	0	0	0	0	2	1	0	0	1	0	0	0	0	0
Hungary	5	1	2	1	0	3	1	3	0	0	0	1	0	0	0
Malta	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Netherlands	2	2	2	2	0	1	2	1	1	0	3	0	0	0	0
Austria	1	3	0	1	2	2	0	0	0	0	1	0	0	0	0
Poland	6	5	1	2	0	8	6	0	1	0	0	0	0	0	0
Portugal	2	0	1	0	1	1	1	4	2	0	0	1	0	0	0
Slovenia	3	0	1	0	0	1	3	0	0	0	0	0	0	0	0
Slovakia	1	0	0	0	1	3	1	0	1	0	0	0	0	0	0
Finland	0	2	0	0	0	0	1	0	0	0	0	0	0	0	0
Sweden	1	1	1	1	0	0	1	0	0	0	0	0	0	0	0
United Kingdom	13	12	10	13	4	0	1	1	2	1	4	0	2	1	0
MU12	58	56	57	41	16	18	20	7	9	6	6	1	4	2	0
EU25	93	75	73	60	22	39	37	15	21	8	13	2	7	5	0

Sources: Thomson Financial SDC Platinum and ECB calculations.

Note: M&A figures have been revised, compared to last year's publication, owing to adjustments in the selection criterion (commercial banks, credit institutions, mortgage banks, investment banks and merchant banks are considered) as well as to corrections in the classification.

ANNEX 2

METHODOLOGICAL NOTE ON THE STRUCTURAL INDICATORS

Data included in Annex 1 are derived from a variety of sources, using different statistical concepts, collection techniques, etc. This makes it difficult to compare series across indicators, countries and – perhaps to a somewhat lesser extent – over time as well. The reader should keep this caveat in mind when interpreting and possibly using the data any further. The set of indicators can be grouped according to the data source used, namely:

- indicators derived from data already available at the ECB;
- indicators that required a new data collection from the statistical departments of national central banks; and
- other sources, such as commercial databases.

The ECB's Directorate General Statistics was entrusted with establishing the second category of indicators. Guidelines for the compilation and transmission of these indicators are included in Annex VI of Statistical Guideline ECB/2003/2 (as amended).

NUMBER OF CREDIT INSTITUTIONS (TABLE 1)

Credit institutions are a subset of monetary financial institutions or MFIs, on which the ECB publishes more detailed information on its website (www.ecb.int) under "MFIs and Eligible Assets"/"Monetary Financial Institutions".

The number of credit institutions in each Member State includes the credit institutions under the law of that country, regardless of whether or not they are subsidiaries of foreign banks, as well as the branches of foreign banks in that Member State. If a foreign bank has several branches in a given country, then they are counted as a single branch. However, if the same bank has several subsidiaries, the latter are counted separately because they are considered to be separate legal entities.

In the case of credit institutions that depend on a central organisation (such as groups of co-operative banks), these may be counted separately, in accordance with Statistical Regulation ECB/2001/13 (as amended).

NUMBER OF BRANCHES OF CREDIT INSTITUTIONS (TABLE 1)

A local unit or branch is an unincorporated entity (without independent legal status) wholly owned by the parent. Only branches that belong to credit institutions are included. The indicator refers to the number of branches at the end of the reference period.

The set of credit institutions considered in the calculation of the local units is consistent with the definition used for the indicator in Table 1. If the same foreign bank has several branches in a given country, these are counted as a single branch. For additional information, please consult the above mentioned ECB Regulation.

TOTAL ASSETS OF CREDIT INSTITUTIONS (TABLE 2)

The set of credit institutions considered in the calculation of this indicator is consistent with the definition of the indicator in Table 1.

The total assets are calculated on a residential basis, meaning that for each Member State, the credit institutions under the law of that Member State are included (independent of whether or not they are a subsidiary of a foreign bank). However, the activity of the foreign branches of these credit institutions is not included, as this is reported by the host country. For additional information, please consult the above mentioned ECB Regulation.

NUMBER OF EMPLOYEES OF CREDIT INSTITUTIONS (TABLE 2)

The indicator refers to the average number of staff employed during the reference year by the credit institutions mentioned in Table 1. Employees of financial institutions which are

not themselves credit institutions are excluded, even if these institutions belong to the same group of the credit institution.

CR5 (TABLE 3)

The CR5 of a Member State is the percentage share of the five largest credit institutions, ranked according to assets, in the sum of the assets of all the credit institutions in that particular Member State. The set of credit institutions and the definition of assets used in the calculation are consistent with the definitions used for the indicators in Table 1. The set of five largest credit institutions may vary over time.

The ratio is calculated on the basis of a sub-set of the ECB list of monetary financial institutions (MFI) used for monetary policy purposes. The sub-set of the MFI list concern credit institutions only. This list follows a host country residence approach and a non-consolidated basis, meaning that banking subsidiaries and foreign branches of a particular credit institution are considered to be separate credit institutions resident in another EU Member State. Domestic banks' branches and subsidiaries resident outside the EU are not captured, while domestic branches and subsidiaries of credit institutions resident outside the EU are included.

HERFINDAHL INDEX (TABLE 3)

The Herfindahl index of a Member State is calculated as the sum of the squares of all the credit institutions' market shares, according to total assets. The set of credit institutions and the definition of assets used in the calculation are consistent with the definitions used for the indicators in Table 1.

The ratio is calculated on the basis of a sub-set of the ECB list of monetary financial institutions (MFI) used for monetary policy purposes. The sub-set of the MFI list concerns credit institutions only. This list follows a host country residence approach and a non-

consolidated basis, meaning that banking subsidiaries and foreign branches of a particular credit institution are considered to be separate credit institutions resident in another EU Member State. Domestic banks' branches and subsidiaries resident outside the EU are not captured, while domestic branches and subsidiaries of credit institutions resident outside the EU are included.

NUMBER OF BRANCHES/SUBSIDIARIES OF CREDIT INSTITUTIONS FROM EEA/NON-EEA COUNTRIES (TABLES 10 TO 13)

Two distinctions are made in these tables. The first is according to the entry mode of the foreign credit institution in the Member State, i.e. as a branch (which is not considered to be separate legal entity) or as a subsidiary (which is considered to be separate legal entity). If the same foreign bank has several places of business, the latter are counted as a single branch. The second is according to the nationality of the foreign credit institution, i.e. either EEA (European Economic Area) or non-EEA. The EEA as at end-2004 includes the 25 Member States of the European Union, plus Norway, Iceland, and Liechtenstein. The European banking directives also apply in the last three countries. Most Member States used the current composition of the EEA for the period 2001-2004. LV, LT and PL used the actual composition of the EEA at the end of the relevant period (until end-2003, this comprised the EU-15 plus Norway, Iceland and Liechtenstein), which may produce small differences.

The figures for a particular Member State only include the non-domestic component: the branches and subsidiaries of credit institutions under the law of that Member State are not included.

If less than three institutions are present, the underlying figures are not shown.

NUMBER OF M&AS (TABLE 15)

Data on the number of mergers and acquisitions (M&As) in the banking sector have been retrieved from a commercial database, Thomson Financial SDC Platinum Database and are aggregated according to the domicile of the acquired entity.

The authorities represented on the Banking Supervision Committee have expressed reservations about the completeness of the data, especially where small to medium-sized deals are concerned. Hence, the figures for M&As provide only a lower bound.

