European banks & Greek banks: Crossing new territory

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SUMMARY

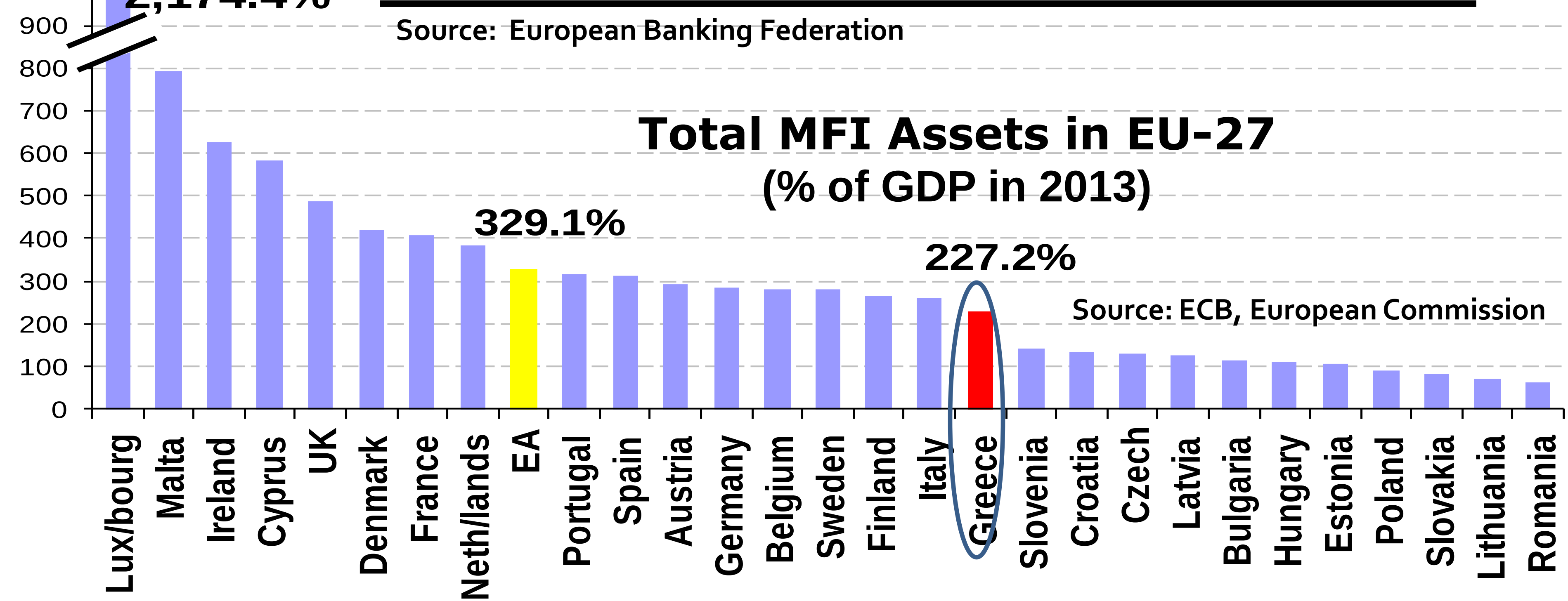
- **Banks are important for financial intermediation in Europe** and were hit hard by the international and subsequent EMU crisis
- EMU crisis has 3 inter-related legs: (a) Banking, (b) Sovereign Debt, (c) Competitiveness , complicating policy solutions
- EMU's piecemeal and delayed response to the multiple internal crises was driven primarily by the fear of instituting moral hazard, which allowed, among other items, the European banking problems to drag on
- **A Banking Union is necessary for EMU** survival, leading towards an Optimum Currency Area
  - The SSM should be complemented with SRM
  - Bank Recovery & Resolution Directive places emphasis on eradicating moral hazard through bail-ins; Cyprus was an early rehearsal
- In 2009, **Greece** suffered from **two legs** of the crisis only, the sovereign leg and the competitiveness leg, as it had **healthy banks**
  - Yet, PSI & length of recession have caused a Greek banking crisis as well
  - A **€50bn** injection of European funds have stabilized the Greek banking sector
  - **Four systemic groups** emerged in Greece with positive pre-provision profits
  - Greek Banks would return to health if the economy returns to growth

BANKING SECTOR IS LARGE IN EUROPE

EU, USA & Japan- banking sector (2011)

	EU	USA	Japan
Total Assets (€ tr.)	35.9	9.8	8.3
Total Assets (% GDP)	284%	90%	196%
Top 5 bank assets (€ tr.)	10.6	4.8	4.6
Top 5 bank assets (% GDP)	84%	44%	108%

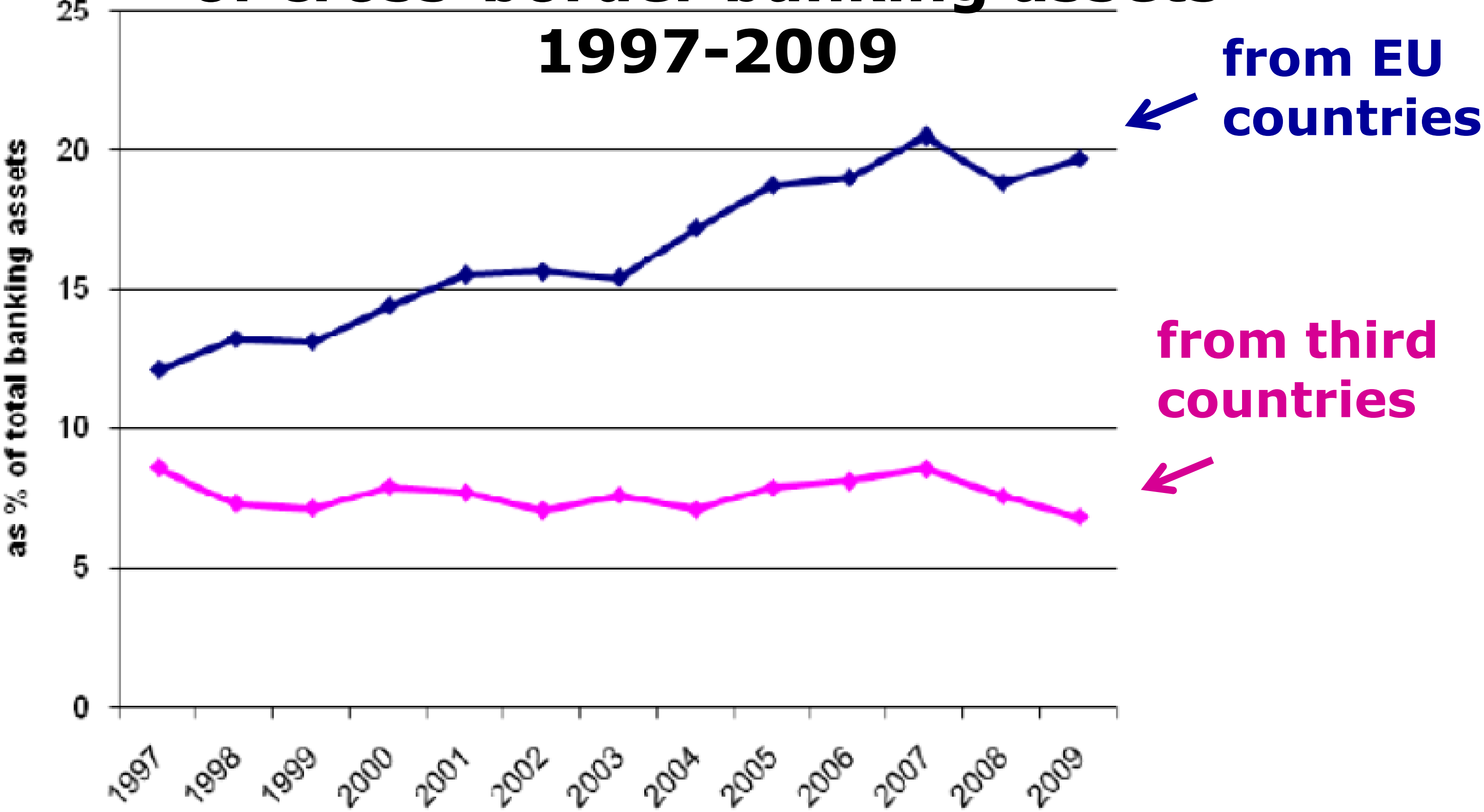
Source: European Banking Federation



Notes: Aug. 2013 data for total assets, EC estimations for 2013 GDP data

BANKING BECAME MORE INTEGRATED IN EUROPE

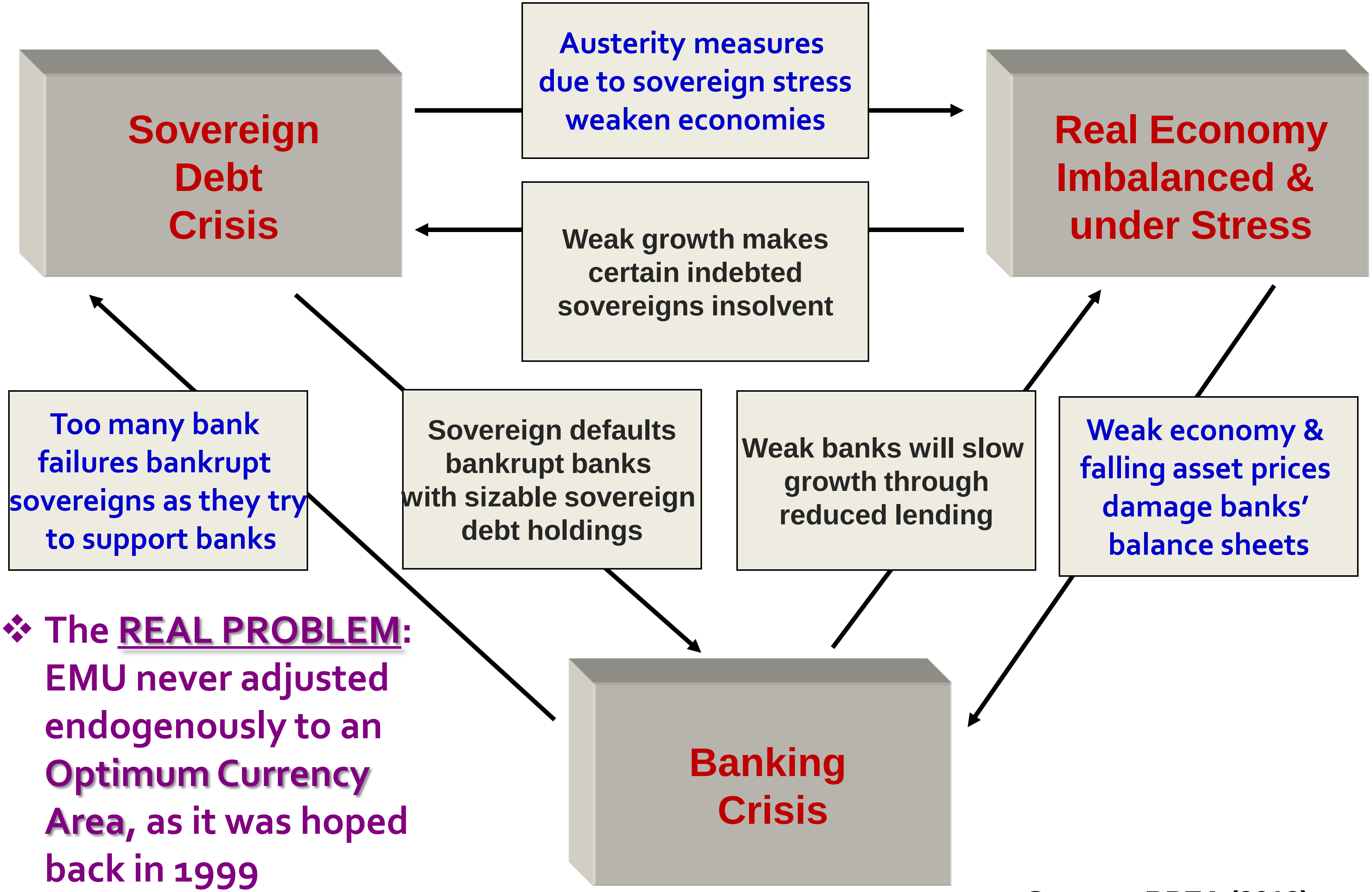
Share inside EU-27 of cross-border banking assets 1997-2009



Note: Share of assets of non-domestic subsidiaries and branches relative to total banking assets. Measured for EU-27. Data slightly differ from Table below.

Source: Liikanen Report, 2012, original source is ECB

THE UNHOLY TRINITY: THREE INTERELATED LEGS OF THE EMU CRISIS



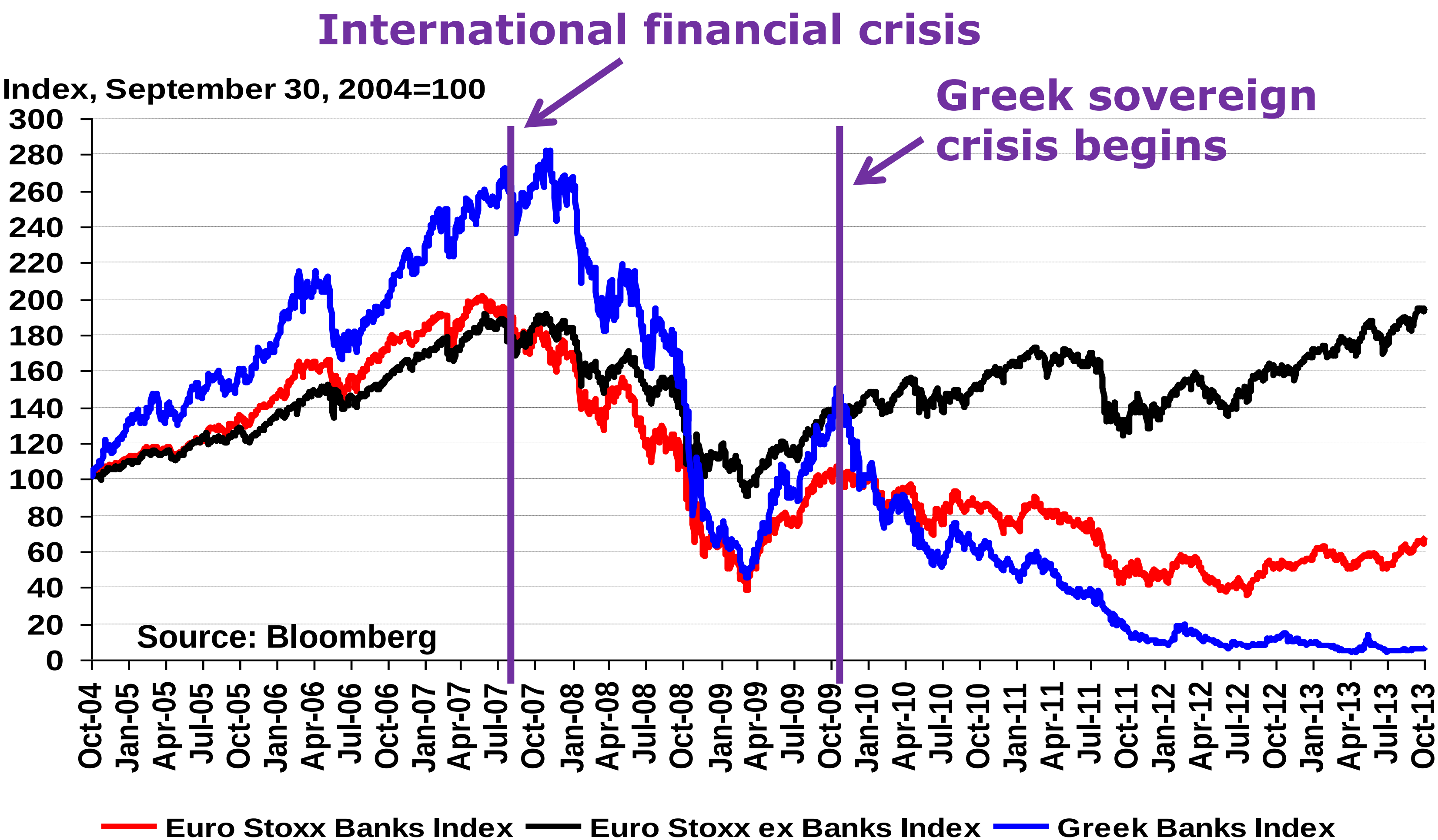
❖ The <u>**REAL PROBLEM**</u>: EMU never adjusted endogenously to an **Optimum Currency Area**, as it was hoped back in 1999

Source: BPEA (2012)

EUROPEAN BANK RISK REMAINS AT THE LEVELS OF THE LEHMAN EPISODE

- ✓ **Risk has declined after Mario Draghi's proclamation of doing whatever it takes, but is still at the level it was during the Lehman episode!**

FINANCIAL STOCKS HIT THE MOST



Note: Indices include dividends

- ✓ European financial stocks at 65% their Sept 2004 level, when remaining stocks at 195%
- ✓ Greek financial sector stocks almost completely wiped out

POLICIES TO RESOLVE THE EUROPEAN BANKING CRISIS

1. **Bank support & bank bailouts,** now **bail-ins**
   a) Support schemes in EU-27 (guarantees, capital injections, etc.) began in late 2008 (€3.5tr or 28%GDP) and by end-2011 were € 4.5tr or 37% GDP. Total aid used until 2011 was €1.6tr (€1.2 guarantees + €0.32 recap + €0.12 impaired asset relief)
      - Outliers: **Ireland**, with aid of 224% of 2011 GDP, **Denmark** with 64%

   b) Bailouts transferred the debt to tax-payers and caused sovereign crisis in Ireland
   c) Change of policy with Cyprus Bail-in, has given ammunition to hardliners in Europe
2. **Regulatory response**
   a) Basel III under the G-20 political umbrella, with grandfathering to 2019
   b) Establishment of **European Systemic Risk Board** (ESRB) plus the European System of Financial Supervisors (**ESFS**), composed of :
      i. European Banking Authority (**EBA**),
      ii. European Insurance and Occupational Pensions Authority (**EIOPA**)
      iii. European Securities and Markets Authority (**ESMA**)
3. **Stress tests did not work** (in contrast to US) – summer 2011 – because:
   a) They avoided to include the scenario markets were afraid off: A sovereign default
   b) No central backstop; Needed capital was supposed to be given by the local governments, hence too small for the task in some countries

POLICIES TO RESOLVE THE EUROPEAN BANKING CRISIS

4. In EMU, liquidity provision by the Eurosystem

a) SMP was too small (€187.7bn as of Sept 27, 2013) – the so-called "nuclear option"

b) LTROs (€670.2bn as of Sept 27, 2013) only after the Italian crisis in the summer of 2011. Even here ECB merely lends with collateral, it is not taking bad assets out of the system like the FED did in 2007-2009. LTROs can be used to fund the governments and increase the banks' dependency on the State

c) OMTs with strict conditionality

5. Preparation for a Banking Union

a) Single Supervisory Mechanism (SSM) – by Sept 2014, ECB supervises ≈130 banks or 85% of total asset size; UK dos not intend to join

b) Single Rulebook by EBA

c) Single Resolution Mechanism (SRM) - In June 2013, EU Council agrees on draft proposal for a Bank Recovery and Resolution Directive with BAIL-IN

d) Later on, either a common or a harmonized system for deposit guarantees

Liikanen High-Level Expert Group

Proposes separation of trading activities from deposit & retail banking

- For systemic banks (assets for trade > €100bn)
- Banks whose assets for trading & available for sale exceed 15-25% of total assets

THE BAIL-IN INNOVATION in BANK RESOLUTIONS

Proponents of bail-in strategy argue:

a) Allows the SRM to proceed without a huge central backstop

b) Breaks the link between a banking and a sovereign crisis

c) Minimizes distorted incentives of banks and distributes risk to those responsible for taking it, thus socially optimal and fair arrangement

BRRD proposes:

a) "Super-priority" of insured deposits (<€100K), "simple priority" for retail deposits of micros & SMEs (>€100K)

b) A minimum of "bail-inable" liabilities in order to avoid circumvention of bail-in rules

c) Stricter Staid-aid rules by DGComp as of Aug 1, 2013

Effects on Bank funding & lending behavior:

a) Cost of funds for systemically important banks ⇧as implicit tax-payer guarantee gone

b) An overall rise in funding costs as a function of bail-inable securities & deposits

c) Banks will try to game the regulation and their liability structure will be affected (more short-term debt?)

d) Contagion may still be present if significant portion of liabilities held by other banks

e) Lending rates will go up **unless** the higher cost of funding is counterbalanced by the lower risk of investing and lending though better discipline

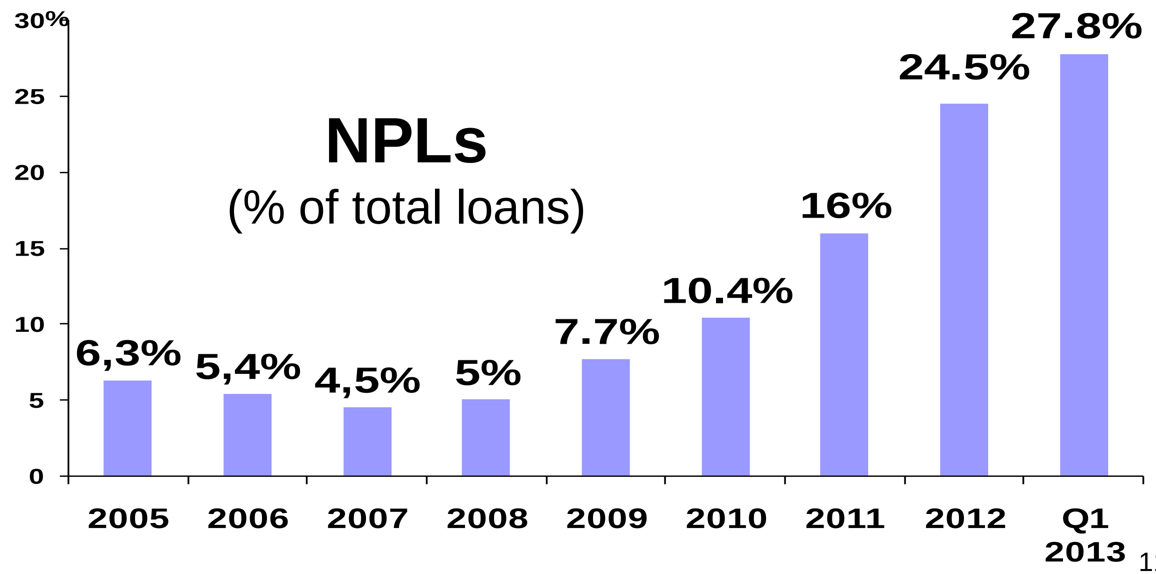
GREEK BANKS: NOT AFFECTED BY THE INTERNATIONAL CRISIS, VICTIMS OF THE GREEK CRISIS

Results - 6 Banking Groups

€ ml.	2008	2009	2010	2011	2012
Net Income	6.717	7.092	5.521	4.225	2.983
Provisions	3.383	5.786	5.915	7.044	7.963
PSI	**0**	**0**	**0**	**28.929**	**660**
Pre-tax profits	3.340	1.306	-393	-33.863	-6.526
Taxes	787	659	449	-4.229	-1.146
Profits	2.554	648	-843	-29.454	-5.380

Note: 2008-2010 all banking groups, 2011-212 publicly traded banking groups, the 4 systemic plus General Bank & Attikis

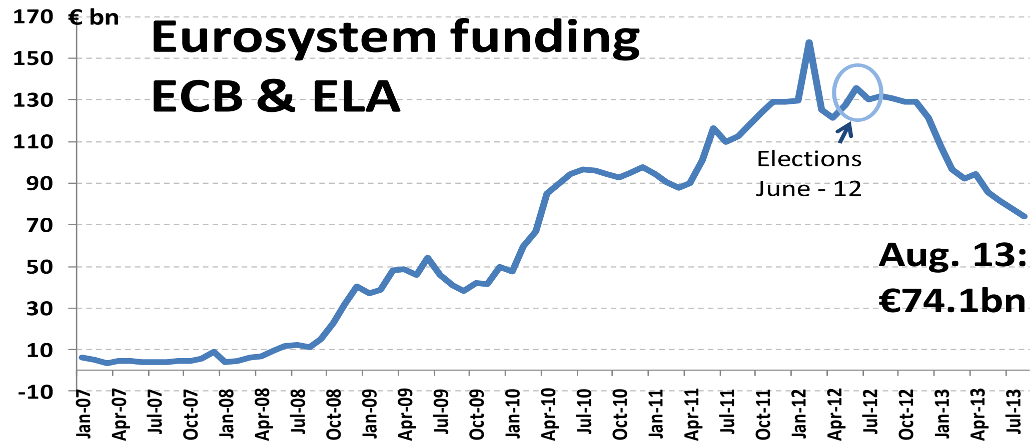
- **Today, Banks under two negative influences:**
  - **PSI**
  - **NPLs**



Source: BoG

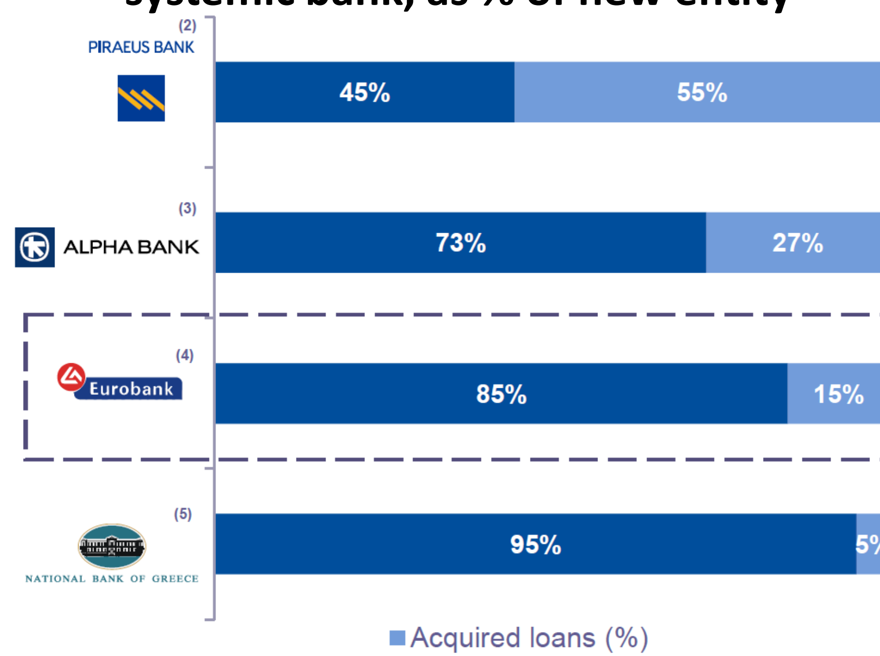
GREECE: RETURN OF CONFIDENCE IN THE BANKING SYSTEM

- Deposits flow back after June 2012 elections & there is room for more inflows
- Eurosystem funding declines, and so does the costly ELA funding
- Cost of deposits begins declining from unusually high levels
- Deceleration in new NPLs
- Provisions (i.e. cost of risk) are reaching their maximum in 2013
- Consolidation in the sector, as four systemic banks now own 91% of total gross loans
- Banks are fully capitalized: €42 bn of new capital injected via HFSF (€38.9) and private investors (€3.1)
- Pre-provision income improves
- A cushion of €8bn at HFSF to be used after Black-Rock Asset Quality Review & new stress tests



Loan portfolio expansion per systemic bank, as % of new entity

New size of Loans €



Greek Banking Groups

Pro-forma amounts

(30.6.2013)

	Group Assets €bn.	Group Net Loans €bn.	Group Deposits €bn.	Group Loans / Deposits	Employees World-wide	Greek-only Branches
NBG	110.4	62.1	60.8	102%	36,093	639
Piraeus	95.0	63.3	54.7	116%	24,743	1,280
Eurobank	82.1	48.3	41.7	116%	20,719	598
ALPHA	74.2	53.5	42.0	127%	17,673	733

Source: Announcements of 2013 H1 results

Thank you
for your attention

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I wish to thank my colleagues at Eurobank for their comments