



# European Financial Stability and Integration Report 2011

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# EFSIR 2011

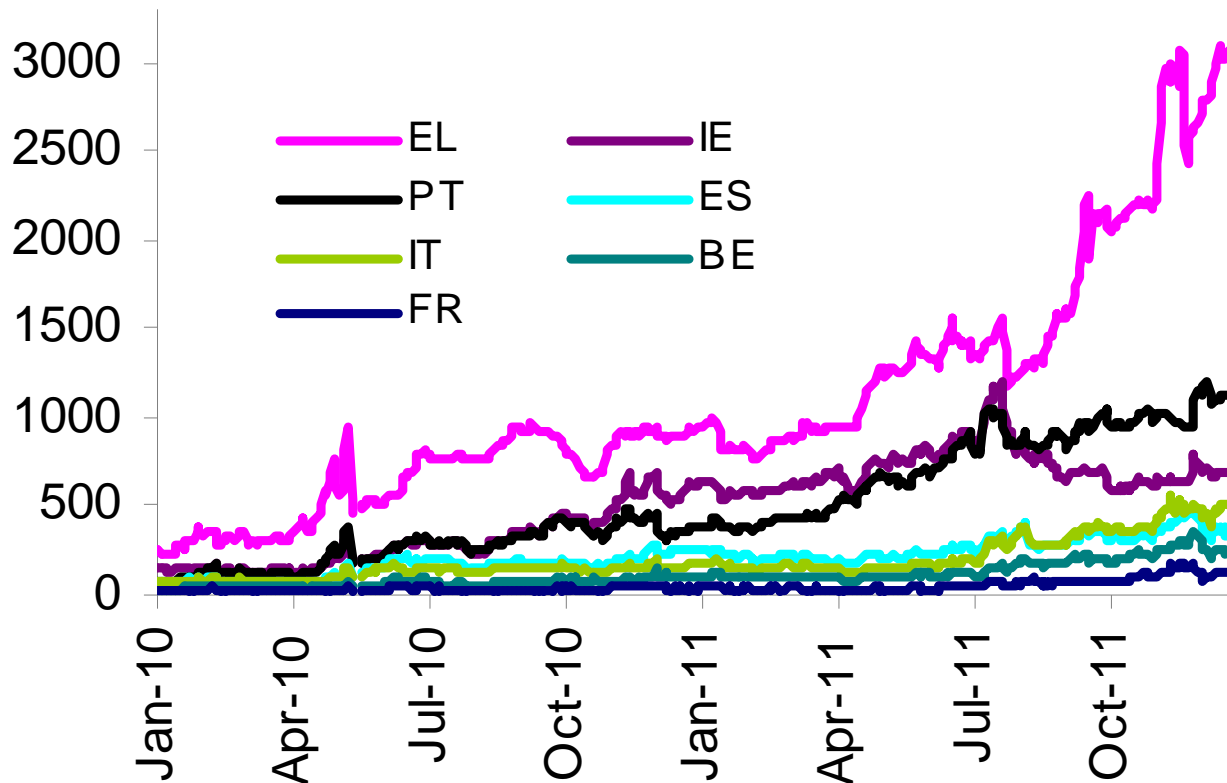
- **2011 – critical year in the financial and economic crisis**
  - complex feedback loops between sovereign debt crisis, financial markets and real economy
  - adoption of coordinated policies to resolve crisis and pave way for sustainable growth
- **reflected in 2011 report**
  - integration and stability
  - covers not only financial market reforms, but also economic governance reforms and other macro-financial policies
- **jointly drafted by DG MARKT and DG ECFIN**

# Structure of report

- **market developments**
  - sovereign debt markets, corporate capital markets, banking sector, insurance sector, market infrastructures
  
- **policy developments**
  - financial sector reforms, economic governance reforms
  
- **3 special features**
  1. Structural changes in the EU banking sector
  
  2. Changes in the EU insurance sector (based on survey of insurance companies)
  
  3. EU households and the financial crisis

# 2011 - Sovereign debt crisis at the centre of financial market tensions

Select government bond yields in euro area  
(spread vs German Bund, basis points)



# Sovereign debt crisis increased banking risks

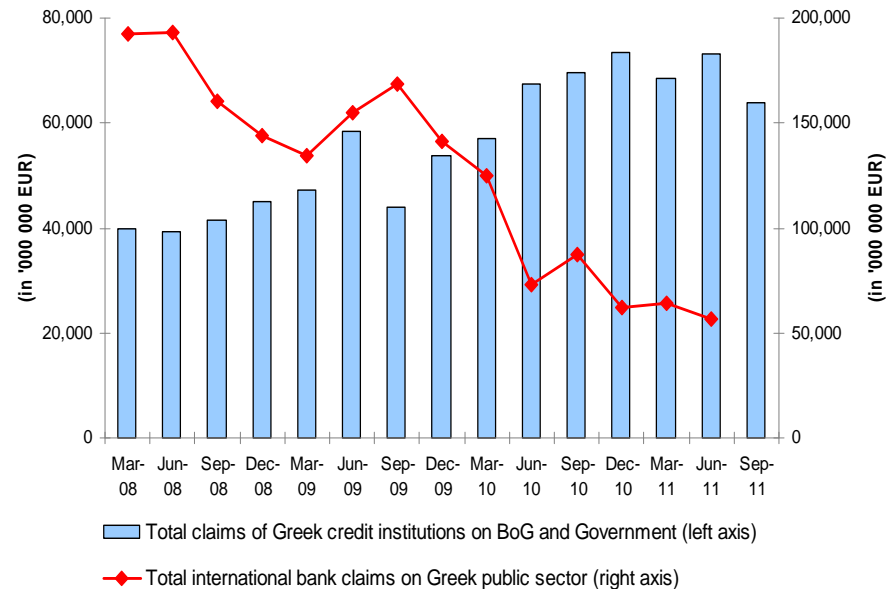
- **negative feedbacks to the EU banking sector - via**

- direct sovereign debt exposures (including impact of increased home bias, see chart)
- credit ratings
- state guarantees
- collateral, etc.
- ... 'sudden' market risk reassessment and related confidence losses

- **bank funding markets became increasingly impaired**

- interbank markets dried up; piling up of deposits at ECB
- significant concerns about banks' ability to refinance medium- and long-term debt

## Domestic and foreign bank holdings of Greek sovereign debt

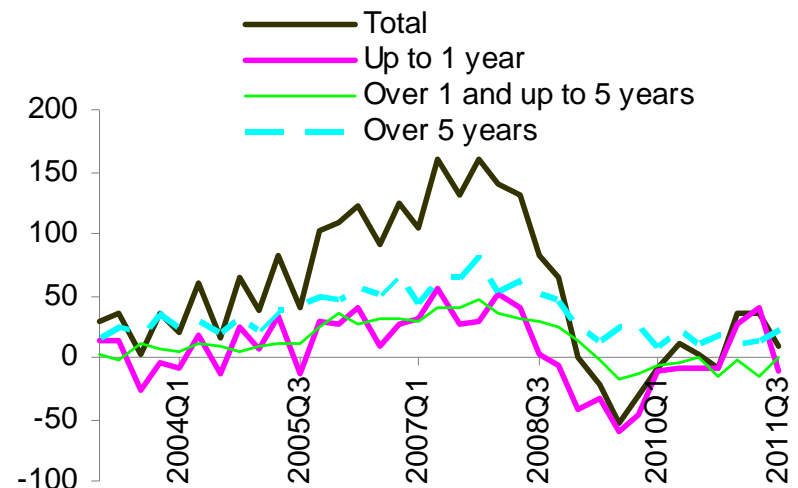


Source: Commission departmental calculations based on Bank of Greece, BIS, ECB and AMECO.

# Deleveraging and bank intermediation

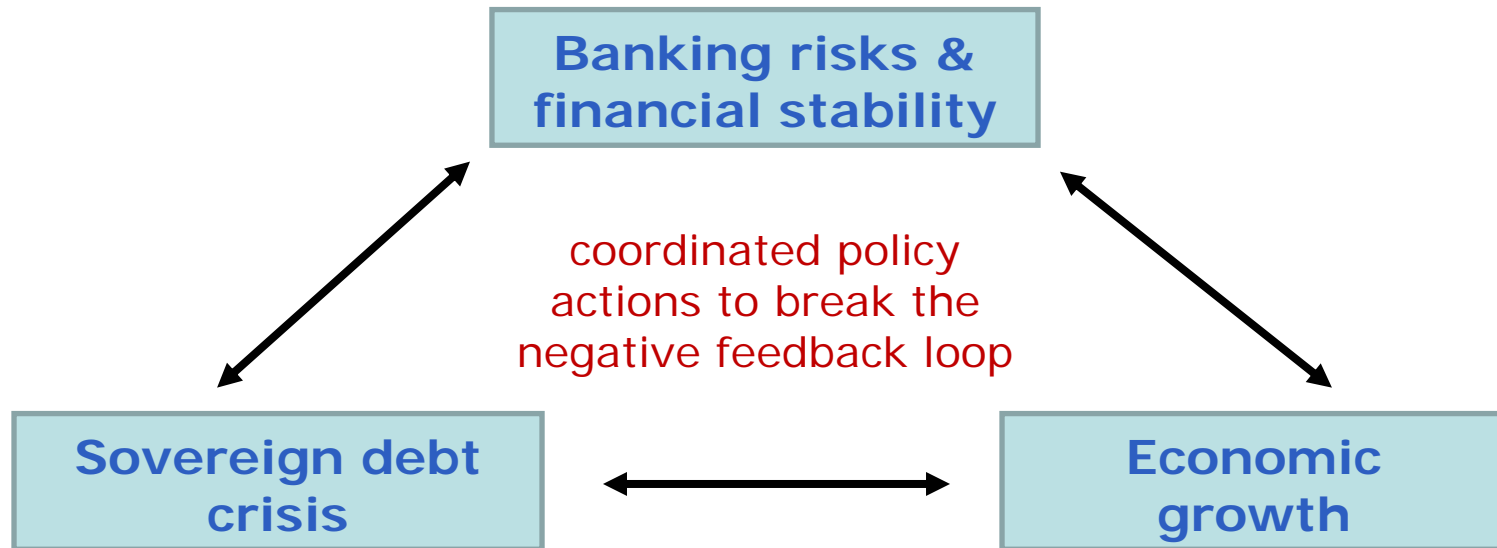
- **there is a need for deleveraging**
  - but risks that excessive or disorderly
- **tighter bank credit conditions and reduced flow of credit since Q3 2011**
  - due to increased funding strains on banks and weakened economic outlook
  - more significant impact on cross-border flows, in particular to CEE
- **the decline in credit flows partly reverses pre-crisis 'excesses'**
  - and also reflects lower demand
- **policy efforts to maintain bank lending to real economy**

Quarterly flows of MFI loans to NFCs in euro area (EUR bn)



Source: ECB

# Complex policy challenges since 2011

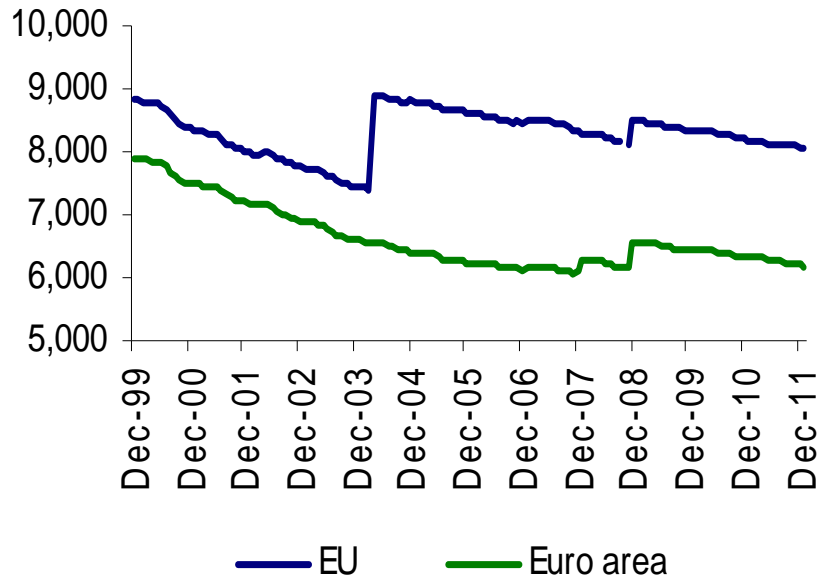


- Commission roadmap for stability and growth
  - policy agreements by European Council and Heads of State or Government
  - ECB long-term refinancing operations
- **improved market conditions since end-2011**

# Bank sector restructuring (1)

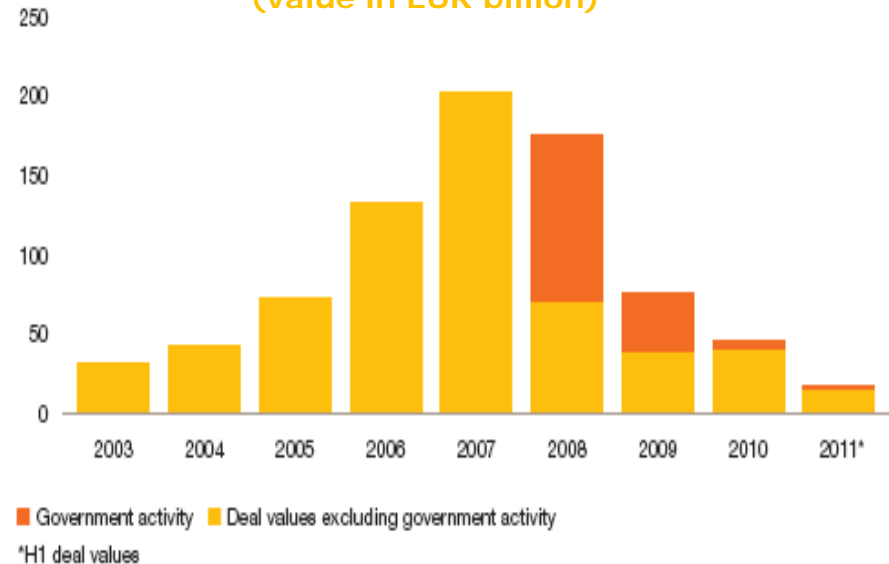
- restructuring has been relatively limited since the start of the crisis
  - lack of adequate bank resolution tools; thus bail-outs of ailing banks

Number of MFIs in Europe



Source: ECB

Financial services M&A in Europe (value in EUR billion)



Source: PwC



## State aid in banking sector

	Total approved amounts		Total used amounts	
	€ billion	% of GDP	€ billion	% of GDP
Recapitalisation	598	4.9	288	2.4
Guarantees	3,290	26.8	1,112	9.1
Asset relief	421	3.4	121	1.0
Other (liquidity)	198	1.6	87	0.7
<i>Total</i>	<i>4,506</i>	<i>36.7</i>	<i>1,608</i>	<i>13.1</i>

Notes: Approved (used) amounts for period Oct 08 – Oct 11 (Oct 08 – Oct 10). See Commission State Aid Scoreboard.

- **state aid control as a coordination tool**
- **need to return to 'normal' market functioning**
  - phase out of schemes
  - restructuring of banks
  - exit of state

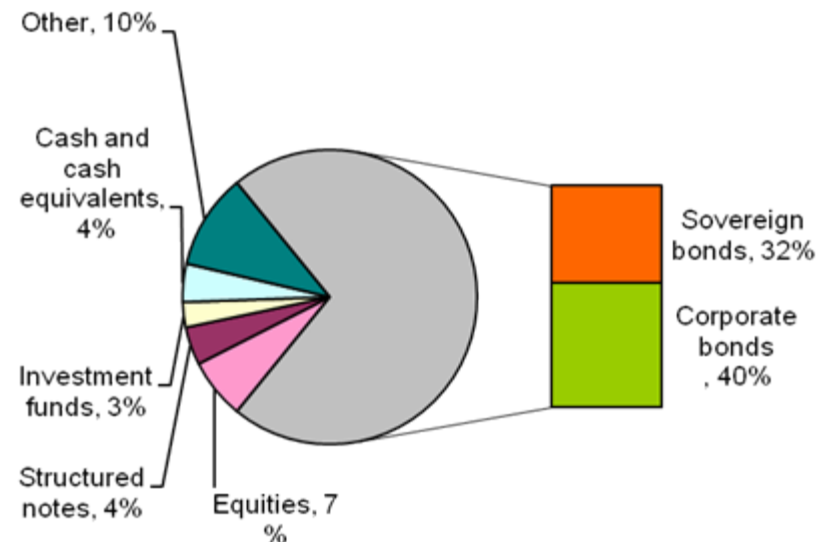
## Bank sector restructuring (2)

- **but structural changes will continue and intensify**
  - also as a result of state aid remedies and regulatory changes
- **this should shape bank sector resilience and integration**
- **the crisis (and the national responses to it) has put a hold on the integration process**
  - national (uncoordinated) bank resolution and restructuring efforts
  - however, banks have largely maintained their cross-border presence
- **there is a need for EU-wide coordinated policies to prevent further disintegration and enhance Single Market benefits**
  - EU crisis management and resolution proposals
  - Liikanen group on structural bank sector reforms

# Insurance sector

- **the insurance sector has been relatively crisis-resilient**
    - reflecting improvements made to risk management and ALM and the sale of non-core and unprofitable assets
    - global geographical diversification
    - preparations for Solvency II
  - **but it faces challenges from**
    - low interest rate environment
    - sovereign debt exposures (see chart), including increased home bias
    - weak economic growth and resulting effects on insurance demand
    - pressure on returns, which may increase high risk products/activities
- **this reinforces the importance of supervisory oversight and the implementation of Solvency II**

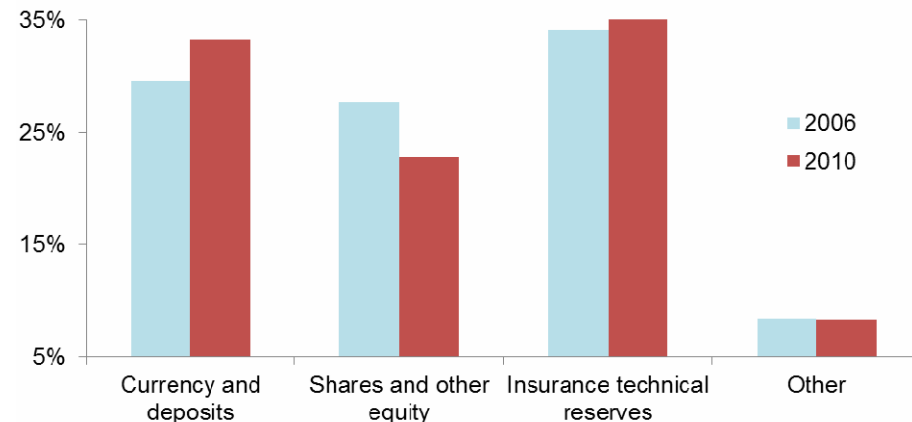
**Investment portfolio**  
(of insurers in EFSIR survey, 2010)



## EU households and the crisis

- **the crisis had a significant impact on the financial position of households**
  - in their role as savers, investors, insurees and borrowers (mortgagees)
- **at EU level, household financial assets and liabilities continued to grow, but there was a change in the composition**
  - more deposits, less equities (see chart)
- **at national level, changes in household deposits and problems in servicing debt had important ramifications for financial stability and economic recovery**
- **consumer protection is a key policy priority in 2012**
  - also to restore trust and confidence in the financial system

Composition of EU household financial assets (% of total)

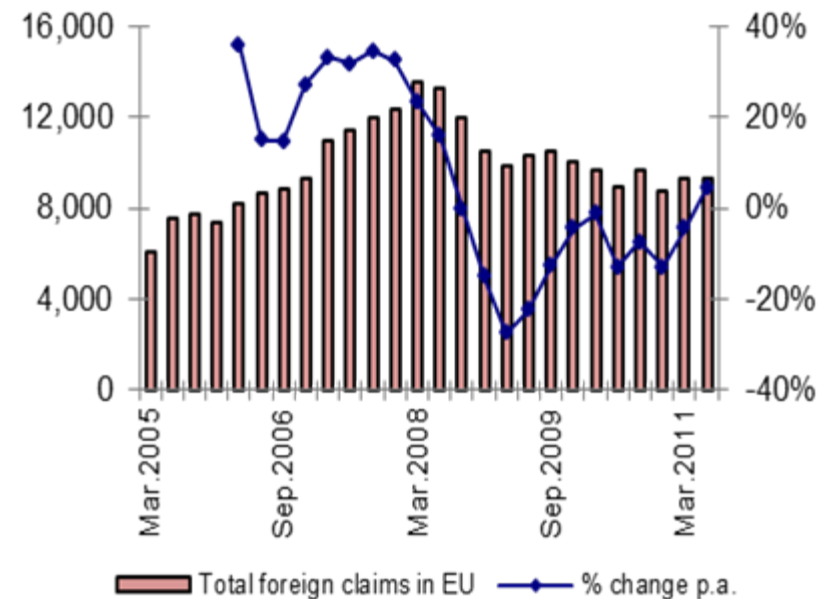


Source: Eurostat

# Financial stability and integration (1)

- **the crisis has put a hold on the integration process**
  - decline in cross-border bank exposures (see chart) and reversal of cross-border credit flows, in particular in interbank market
  - strategic focus on 'core' business/markets, domestic lending commitments
  - increased dispersion in financing costs, including retail interest rates
  
- **but financial institutions have largely maintained their cross-border presence**
  - and integration of market infrastructures progressed further (e.g. SEPA)

**EU bank exposures to other EU Member States**  
(in \$ billion and % change p.a.)



Source: BIS



## Financial stability and integration (2)

- **the crisis revealed shortcomings in the institutional framework to support the Single Market**
  - allowed large capital flows pre-crisis, resulting in unsustainable imbalances
- **the way forward is not less, but better and deeper integration - to facilitate:**
  - more coordinated crisis management and resolution
  - macro-prudential coordination to adjust policies in counter-cyclical manner
  - portfolio diversification and reduced home bias to break link between sovereigns and domestic firms
  - less fragmented, deeper and more liquid capital markets
  - risk-sharing to avoid sudden swings in market sentiment against some countries and institutions
  - open markets to allow efficient entry and exit of financial institutions
- **the Single Market remains the most powerful tool to stimulate growth as Europe comes out of the crisis**

# An ambitious financial reform programme

REFORMS PROPOSED BY THE EUROPEAN COMMISSION, ADOPTED & IN THE PROCESS OF BEING ADOPTED BY THE EUROPEAN PARLIAMENT AND THE COUNCIL OF MINISTERS			
	BANKS AND INSURANCE UNDERTAKINGS	FINANCIAL MARKETS	CONSUMERS
JULY 2010	CRD3 : NEW RULES ON REMUNERATION, PRUDENTIAL REQUIREMENTS AND GOVERNANCE OF FINANCIAL INSTITUTIONS *		REVISION OF DEPOSIT GUARANTEE SCHEMES *
			REVISION OF INVESTOR COMPENSATION SCHEMES
SEPTEMBER 2010	INTRODUCTION OF THE EUROPEAN SYSTEMIC RISK BOARD AND THE EUROPEAN SUPERVISORY AUTHORITIES FOR BANKING, SECURITIES AND MARKETS, AND INSURANCE *		
OCTOBER 2010		PROPOSAL ON OVER-THE-COUNTER DERIVATIVES *	
		PROPOSAL ON SHORT SELLING AND CERTAIN ASPECTS OF CREDIT DEFAULT SWAPS *	
		PROPOSAL ON HEDGE FUNDS AND PRIVATE EQUITY *	
DECEMBER 2010	REVISION OF FRAMEWORK ON CREDIT RATING AGENCIES REFORMS (PART 2) *		SEPA PROPOSAL (SINGLE EURO PAYMENTS AREA)
MARCH 2011			PROPOSAL ON MORTGAGE CREDIT
JULY 2011	REVISION OF THE CAPITAL REQUIREMENTS FOR BANKS (CRD4) *		RECOMMENDATION ON ACCESS TO A BASIC BANK ACCOUNT
PROPOSALS BEFORE END 2011			
OCTOBER 2011		REVIEW OF THE FRAMEWORK FOR MARKETS IN FINANCIAL INSTRUMENTS (MIFID) AND MARKET ABUSE *	
	REVIEW OF THE FRAMEWORK FOR RULES ON ACCOUNTING AND THE TRANSPARENCY		
NOVEMBER 2011	REVISION OF FRAMEWORK CREDIT RATING AGENCIES (PART 3) *		
		REFORM OF THE AUDIT SECTOR	
DECEMBER 2011		PROPOSAL FOR A VENTURE CAPITAL REGIME	
2012			
PROPOSAL FOR A FRAMEWORK FOR CRISIS PREVENTION AND MANAGEMENT FOR BANKS *			
		PROPOSAL FOR CENTRAL SECURITIES DEPOSITORIES	
	SOLVENCY II IMPLEMENTING MEASURES	PROPOSAL ON PACKAGED RETAIL INVESTMENT PRODUCTS (PRIIPS)	
	REVIEW OF THE INSURANCE MEDIATION FRAMEWORK	REVIEW OF THE UCITS FRAMEWORK (Undertakings for Collective Investment in Transferable Securities)	

Proposals adopted by the European Union<sup>(1)</sup>

(1) the indicated date is that of the Commission proposals

Commission proposals being discussed in the Parliament and the Council

Upcoming Commission proposals

\* G20 proposals



# Policy priorities for 2012

## 1. Finalizing implementation of the G20 agenda

- including crisis management and bank resolution proposal

## 2. Structural reforms for the EU banking sector

- based on conclusions of high-level expert group, chaired by Erkki Liikanen

## 3. shadow banking

- stakeholder consultation following Green Paper in March

## 4. consumer protection

- proposals for first consumer package (PRIPS, UCITS V and IMD) and on access to basic bank accounts;

## 5. financial regulation and economic growth

- ensuring long-term financing
- deepening the Internal Market