News release

Date	**Embargoed until 00.01 hrs GMT, Wednesday 25 February 2015**
Contact	Krishna Rao, PR Manager, Global Financial Services, PwC Tel: +44 207 804 3765 e-mail: krishna.c.rao@uk.pwc.com
Pages	3

PwC: EU Banks leaner and more liquid, but the end game still unclear

London, 25 Feb 2015 - Six years after the onset of the global financial crisis, EU banks are still busy shoring up their balance sheets to meet regulatory demands, finds a PwC/Economist Intelligence Unit (EIU) commissioned study. Analysis from the study suggests big banks will be reasonably well-positioned to take advantage when the economy does improve.

Titled '**That shrinking feeling: Tracing the changing shape of the European banking industry**', the report, based on published financial data for the period 2009 to 2013, attempts to shed light on how the size and shape of banks' balance sheets have changed since the announcement of the Basel III rules in 2010.

According to the report, EU banks are less bloated with assets than they were previously, with mean total assets at the largest European banks falling 11% from EUR 1,097bn in 2009 to EUR 1,064bn in 2013. The decline has been led by the shrinking of net loans and trading books.

In tandem with decreasing their assets, banks have, since 2011, significantly cut their exposure to adverse market movements. Most striking, says the PwC report, is the reduction in riskier corporate lending and corresponding rise in government bonds, most of which are safer and more liquid sovereign bonds.

PwC's report shows EU banks not only have smaller, less risky balance sheets resting on firmer capital foundations, they are also in a much stronger position to meet a liquidity crunch.

Chris Matten, PwC's Financial Services Risk Leader, Asia Pacific, said:

"Having passed their preliminary health check, EU banks are now in a stronger, more stable position, which will have more appeal to shareholders. They have come a long way in a short time. The journey to full health, however, is just beginning."

The report shows that between 2009 and 2013, EU Banks increased their holdings of cash and cash-equivalent assets by no less than 78%, grew the share of liquid assets from 9.2% of total assets to 11.6% and reduced their short-term borrowings by 38%.

“Thanks to the European Central Banks’ two long term refinancing operations, but also their having worked hard at extending term-funding maturities, banks at the end of last year held EUR 200bn more long-term than short-term debt. That is an astonishing turnaround: five years previously, short-term debt dwarfed long-term borrowing by EUR 875bn,” said Matten

According to PwC, this combination of reduced leverage, increased capital quality and a stronger liquidity position has led to a fitter and leaner banking industry. At the same time business models are changing, with banks turning away from more volatile activities. The past few years have seen some lenders move more towards a deposits-driven business. Similarly, commercial loans – many of which are believed to be unsecured – are shrinking faster than consumer loans.

PwC points out, however, that the Basel regulators are far from finished. The proposal for total loss- absorption capacity (TLAC) aims to ensure taxpayers do not have to pay the bill if a bank fails. Rule makers are recommending that banks issue enough subordinated debt and other securities that can be written down to cover resolution costs. Global systemically important banks could, as a result, have to hold capital and bail-in debt equal to as much as a quarter of their risk weighted assets, once various buffers are included.

Banks face uncertainty, not only over the size of the TLAC requirement, but also over the impact it would have on their liability stacks. All else equal, banks would have an incentive to issue more debt that can be bailed in and to rely less on deposits, which are partly insured and are more difficult politically to seize to pay for a bailout.

In addition to TLAC, policymakers have yet to finalise a host of other rules and requirements that will have a profound impact on banks’ balance sheet management and business practices. Many investors and analysts are convinced that regulators will keep increasing capital requirements to ensure banks take fewer risks and are never again, as in 2008, too big to fail. They reckon the minimum leverage requirement, in practice, will not be 3%, but at least 4% or 4.5%.

As a control, the report also looked at major banks in other jurisdictions which have to meet the same Basel standards, but some of which (notably Canadian, Japanese and Australian banks) were not really impacted by the global financial crisis. In other words, despite not having faced the same crisis, these banks still have to take the same medicine. To the extent that these banks have also changed the shape of their balance sheets, one can attempt to isolate the impact of global regulation (which affects every large bank) from the recovery efforts of those banks which were affected by the crisis. While the picture is not completely clear, it does appear that the Basel III rules have resulted in significant changes even at banks that were not affected by the financial crisis, leading to less risky, and more liquid, balance sheets.

Matten concluded:

When the economy does eventually improve, our analysis suggests that big banks will be reasonably well-positioned to take advantage. They will certainly look very different than before the crisis. Because of new regulations, risky activities such as proprietary trading, complex securitisations and over-the-counter derivatives deals are now either proscribed or prohibitively expensive because of additional capital charges. Instead, CEOs are stressing the importance of getting back to basics – regaining public trust by providing straightforward products that businesses and households genuinely need.

ENDS

Notes to Editors:

The PwC/EIU-commissioned report '**That shrinking feeling: Tracing the changing shape of the European banking Industry**' is based on a quantitative analysis of the European banking industry's aggregate balance sheet, which was performed by the EIU. It investigates how banks are adapting to profound changes in regulation.

The report outlines the space European banks are increasingly likely to occupy and attempts to shed light on how the industry has changed since the announcement of the Basel III rules in 2010.

The EIU gathered balance sheet data from 33 banks across the European Union (EU), Australia, Canada, Japan and the US; 17 of the banks were from Europe. The data covered the period 2009–2013.

About PwC
PwC helps organisations and individuals create the value they're looking for. We're a network of firms in 157 countries with more than 195,000 people who are committed to delivering quality in assurance, tax and advisory services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

© 2015 PwC. All rights reserved

PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.