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Executive summary

The ECB Report on Financial Structures (RFS) in the euro area reviews the main structural features of and developments in the broader euro area financial sector. Like the ECB Banking Structures Report (BSR), which was published until 2014 and can be seen as a predecessor of the RFS, the RFS has a clear structural focus, thereby serving as a complement to the biannual ECB Financial Stability Review (FSR) which focuses more on cyclical factors.1

The RFS has a much wider scope than the BSR, covering not only the banking sector, but also other financial intermediaries, in particular insurance corporations and pension funds (ICPFs) as well as non-bank and non-insurance financial intermediaries, often labelled the “shadow banking” sector. Parts of the non-bank financial sector have grown substantially over the past decade and sometimes perform bank-like functions. This calls for a more holistic approach to the structure of the euro area financial sector going forward.

The period covered in this year’s RFS is not uniform. As regards the banking sector, the period covered is 2008 to 2014, with special attention being paid to the changes that have occurred since the publication of the last BSR in 2014. This time period includes the beginning of the financial crisis. In addition, some euro area countries have entered into (and in some cases already concluded) EU/IMF financial assistance programmes.2 Not surprisingly, these developments have had, and in some cases are still having, a significant impact on developments in the euro area financial sector.

As regards ICPF and “shadow banks”, the availability of data is more heterogeneous and generally more limited than for the banking sector. This is reflected in the RFS chapters dealing with these parts of the wider euro area financial sector. In addition, given that this year’s RFS provides the first regular review of these parts of the financial sector, the focus is more on the general description of the ICPF and “shadow banking” sectors than on developments during the last year.3 This heterogeneity within the RFS is expected to gradually disappear in future editions of the report.

Chapter 1 presents the overall structure of the financial sector, looking at the relative importance of the different segments of the financial system in the euro area over

1 The RFS focusses on euro area/Single Supervisory Mechanism (SSM) countries. The report may contain, however, occasional references to the financial sectors of other EU countries. Lithuania is included in the report whenever comparable data are available, although it only became a member of the euro area on 1 January 2015.

2 At the time of publication of this report, EU/IMF financial assistance programmes were still in place for Greece and Cyprus. The programmes for Ireland, Spain (financial sector only) and Portugal were already concluded. Latvia also successfully concluded a programme during this period, but before entering the euro area.

3 Last year’s BSR contained a special feature article called “Structural features of the wider euro area financial sector” which provided the basis for a regular analysis of structural features in non-bank financial market segments appearing for the first time in this year’s RFS.
time. It then analyses interconnectedness across different parts of the financial sector in order to fully assess possible structural risks to financial stability in the euro area. Looking at direct exposures between various parts of the financial sector in the euro area as a whole, the analysis shows that banks and other financial intermediaries (OFIs) are the largest holders of loans, and OFIs are also the largest counterparties. For debt securities, banks are both the largest holders and the largest counterparties. Turning to individual Member States, it is found that in the largest euro area economies banks and ICPF tend to be exposed primarily to banks and OFIs in their home countries. The three most important locations for cross-country bank counterparties are Germany, France and – outside the euro area – the United Kingdom. More generally, geographic proximity and cultural background seem to matter for such cross-country links. Looking at exposures to common assets, the analysis shows that banks in the largest economies are particularly exposed to long-term debt, often issued domestically. Moreover, in countries with a large ICPF sector, the latter is heavily exposed to domestic investment fund shares.

Chapter 2 of the report presents structural developments in the euro area banking sector, providing the set of structural information that was previously discussed in the BSR. Section 2.1 primarily discusses statistics on an unconsolidated basis, including the annual structural financial indicators and monetary financial institution (MFI) balance-sheet indicators, which are available at a higher frequency. Section 2.2 primarily analyses consolidated banking data. In both sections, indicators will be examined from a cross-sectional (i.e. different banking types, business models) and a time perspective.

Section 2.1 reviews developments relating to the market structure of the euro area banking system, i.e. the capacity, consolidation and concentration of the banking sector over time. In 2014 the euro area banking sector continued its consolidation process, driven by continued pressure to achieve cost containment, deleveraging and restructuring. This process resulted in a further reduction in the total number of credit institutions in the euro area to 5,614 (down from 6,054 in 2013 and 6,774 in 2008). Market concentration continued to increase at the euro area level, reaching a historical maximum at the end of 2014. However, developments continued to be heterogeneous across countries. The rationalisation and resizing process in the euro area banking system suggests that the overall efficiency of the system continues to be enhanced. Merger and acquisition (M&A) activity, especially cross-border (intra-euro area) and outward transactions (with euro area banks as acquirers), has followed a declining trend in recent years, both in terms of number of transactions and in terms of total value. More recently, in 2014 and in the first half of 2015, M&A activity focused on the consolidation of the banking sector within the euro area and efforts to spread risks geographically, by diversifying into non-euro area EU countries and countries outside the EU.

Section 2.2 reviews changes in the balance sheet structure, financial performance, capital position and leverage of the euro area banking sector during the period 2008-2014, with a focus on developments during the last year. In contrast to the first part of Chapter 2, which mainly discusses unconsolidated banking data, the analysis here
is based on consolidated, domestic banking sector data. The analysis shows that growth in total assets and, to a lesser extent, lending resumed for euro area domestic banks in 2014. Total consolidated assets of the euro area banking sector, including foreign branches and subsidiaries, stood at €28.1 trillion at the end of 2014, reflecting an increase of 5% vis-à-vis 2013. On the liabilities side, the gradual shift towards deposit funding came to a halt in 2014, with the median share of customer deposits in liabilities hovering around 42%. The use of wholesale funding stagnated in 2014, although it was well below its peak of 38% in 2009, and banks continued to reduce their reliance on central bank funding. Capital increases resulted in an increase in solvency and a reduction in leverage ratios. More specifically, the median Tier 1 ratio increased to 14.4% in 2014 from 13.0% in 2013. Altogether, these movements indicate a continuation of the trend towards a more traditional banking business model for euro area domestic banks which has already been observed for a couple of years. The legacy of the crisis is, however, still visible in terms of structural deficiencies. Most importantly, a further increase in non-performing loans (NPLs) underlines the need in several euro area countries to take further steps to tackle this problem in order to free up bank capital and boost credit expansion. Cost-cutting efforts by euro area banks are continuing, but remain rather limited, in particular as regards staff costs for large euro area banks. As in previous years, structural developments in the euro area banking system continued to differ across countries in 2014, with the banking sectors of the euro area countries most strongly affected by the financial crisis generally also experiencing the most pronounced structural changes.

Chapter 3 of the report discusses structural developments in euro area insurance corporations and pension funds, mainly using publicly available data from the balance sheets of ICPFfs. The chapter first discusses the general market structure, before shifting its focus to sector-wide balance sheet items. The final section of the chapter focuses on the profitability and solvency of insurers. Assets of euro area ICPFfs have grown steadily in recent past years, with a strong concentration of total assets in a relatively small number of countries. Most insurance firms are active in the non-life sector. The high exposure to fixed income assets and the long-term nature of liabilities expose ICPFfs to the current low yield environment, but there is little evidence yet of a strong increase in unit-linked insurance and defined benefit pension products. Survey results indicate, however, other structural adjustments, such as diversification into non-life and asset management businesses, the lowering of guaranteed rates on new policies and the use of interest rate derivatives. The profitability of the insurance sector, and in particular the life-insurance sector, has been constrained in recent years by the low-yield environment and weak macroeconomic conditions. The solvency positions of the life and non-life insurance sectors are, however, well above the solvency requirements of Solvency I.

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4 The domestic banking sector comprises the consolidated accounts of banks that have their headquarters in a given country or economic area, including their foreign branches and subsidiaries abroad.

5 Whenever pertinent, data from other providers are used to provide additional information. In general, publicly available data are more limited for the insurance sector than for the banking sector. The forthcoming Solvency II regime is expected to improve the situation markedly.
Chapter 4 of the report reviews the structural features of the euro area non-bank financial sector, often also labelled the “shadow banking sector”. It examines both the broad measure of shadow banking (including all financial intermediaries except banks and ICPFs) and a more narrowly defined measure (investment funds, money market funds (MMFs) and financial vehicle corporations (FVCs) only). Structural features of key shadow banking sub-sectors for which balance sheet data are available are outlined in more detail, namely for non-money market investment funds (non-MMFs), MMFs, and FVCs. The shadow banking sector has continued to grow over the past year, driven primarily by non-MMF investment funds, which expanded owing to net inflows and rising valuations. The weakening of the euro vis-à-vis other currencies contributed to this, as the share of assets invested outside the euro area amounts to 40%. Euro area MMFs expanded as well, following a protracted period of decline, with net flows into these funds having stabilised since mid-2014. By contrast, euro area FVCs have continued to decline over the past year owing to continued weak loan origination and securitisation activity by euro area credit institutions.

The report makes use of a number of publicly available data sources. Aggregate banking sector statistics are compiled by the ECB with input from national authorities and are published on an annual basis. Individual bank-level data are derived from banks’ published accounts or market data providers.
Chapter 1 presents the overall structure of the financial sector, looking at the relative importance of the different segments of the financial system in the euro area over time. It then analyses interconnectedness across different parts of the financial sector in order to fully assess possible structural risks to financial stability in the euro area. Looking at direct exposures between various parts of the financial sector in the euro area as a whole, the analysis shows that banks and OFIs are the largest holders of loans, and OFIs are also the largest counterparties. For debt securities, banks are both the largest holder and the largest counterparties. Turning to individual Member States, it is found that in the largest euro area economies that banks and ICPFs tend to be primarily exposed to banks and OFIs in their home countries. The three most important locations for cross-country bank counterparties are Germany, France and – outside the euro area – the United Kingdom. More generally, geographic proximity and cultural background seem to matter for such cross-country links. Looking at exposures to common assets, the analysis shows that banks in the largest economies are particularly exposed to long-term debt, often issued domestically. Moreover, in countries with a large ICPF sector, the latter is heavily exposed to domestic investment fund shares.

In order to get a holistic picture of the wider financial sector, analyses of the structure of individual parts of the financial system (banks, ICPFs and OFIs, also often called “shadow banking institutions”) need to be complemented with an analysis of the interconnectedness among these different financial sector components in order to obtain a full picture of possible structural risks to financial stability in the euro area.

Against this background, this chapter first describes the structure of the wider euro area financial sector across countries, before looking at different aspects of interconnectedness within the financial system. More specifically, it looks at interconnectedness between financial institutions within and across the three main parts of the financial sector mentioned above. Interconnectedness is assessed from two angles: first, direct exposures between sectors and countries and, second, exposures to common assets, such as loans, securities, etc. The latter allows an assessment of whether risks are concentrated in certain instruments throughout the different parts of the financial system.
to below 100% of GDP (Lithuania). Other countries with a very large financial sector relative to GDP are Malta, Ireland, the Netherlands and Cyprus (Chart 1.1). At the other extreme, the financial sector is less developed in most central and eastern European countries in the euro area. The size of the wider financial sector in these countries was less than 200% of GDP at the end of 2014.

In terms of the evolution of the financial sector over time, the size of the wider financial sector exhibited heterogeneous dynamics across both the larger and the smaller economies in the euro area. The financial sector, measured as the ratio of assets to GDP, tended to contract slightly between 2008 and 2014 in two of the larger economies, namely Germany and Spain (Chart 1.1). It remained broadly unchanged in Italy, while it increased in France and the Netherlands. The size of the wider financial sector contracted over the same period in Austria, Belgium, Cyprus and Ireland, while it tended to increase slightly in Greece, mainly due to a significantly stronger contraction in GDP than in financial assets, and particularly in Finland. It remained broadly unchanged in the rest of the smaller economies.

Chart 1.1
Size of the euro area financial sector, 2008, 2013 and 2014

Turning to more recent dynamics, the size of the wider financial sector remained broadly unchanged between 2013 and 2014 in Germany, bringing the decrease observed since 2008 to a halt. It also remained broadly unchanged in Italy between

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Assets of the sectors in the financial system comprise monetary gold and SDRs, currency and deposits, debt securities, loans, equity and investment fund shares, insurance, pension and standardised guarantees, financial derivatives and employee stock options and other accounts receivable.

The decline in size of the financial sector in Germany between 2008 and 2013 was mainly the result of the reduction in the banks' balance sheets in response to stricter regulatory requirements developed since the beginning of the crisis. The balance sheets of the institutions in the other two categories did not decrease over time.
2012 and 2014, while it continued to contract slightly in Spain and continued to increase in France and the Netherlands.

Looking at the composition of the wider financial sector across euro area countries, banks represent the largest share in most of the countries, accounting for between 20% and 95% of total sector assets (Chart 1.2). The OFI sector is particularly developed in Luxembourg and Malta (where it represents 75% and 70% of total assets, respectively), but also in the Netherlands, Ireland, Belgium and Cyprus. In the remaining countries, the OFI sector accounts for less than about 30% of total assets. The insurance sector is particularly developed in France, Germany, Belgium, Ireland and Italy. Finally, the pension fund sector is particularly developed in the Netherlands, Slovakia and Estonia.

Looking at the evolution of the composition of the financial sector over the period from 2008 to 2014, the share of the banking sector tended to decline across most countries. Only in Spain, Portugal and Greece did it remain broadly unchanged or increase slightly over the period. By contrast, the OFI sector tended to increase in size across the board.

**Chart 1.2**
Composition of the euro area financial sector, 2008, 2013 and 2014

<table>
<thead>
<tr>
<th>Year</th>
<th>Pension funds</th>
<th>Insurance corporations</th>
<th>MFIs (excl. ESCB)</th>
<th>OFIs</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources: Quarterly Sector Accounts (QSA), MFI balance sheet items (BSI) and ECB calculations.
Notes: MFI total assets (excl. ESCB) are the difference between MFI total assets (including national central banks (NCBs)) from the QSA and NCB assets from the MFI BSI. Data for 2008 are not available for all the countries, and in such cases data for 2012 are used. EA is the sum of individual euro area countries and is therefore also a combination of data for 2008 and 2012 for the starting date. For readability, figures for LU and MT are not fully shown in the chart. Complete figures are available in Table 1 of the annex.

### 1.2 Approaches to assess interconnectedness

Two main approaches are used in the literature to identify interconnectedness across financial institutions and among sectors in the financial system. The first one is to identify structural risks arising from direct bilateral exposures across sectors, instruments and geographical regions. Direct bilateral exposures are the most direct mechanism of transmission of shocks within the system.
The second approach used to estimate interdependence among financial institutions consists in using price-based measures of interconnectedness (e.g. stock, bond, derivative or credit default swap (CDS) prices). A major advantage of this approach is that it captures interconnectedness arising from both direct and indirect spillover channels. The latter may arise, for example, from exposure to common assets, similar business models, common accounting practices, informational contagion and, perhaps more importantly, the market perception of coincident financial market stress. However, a main drawback of price measures is that they fail to identify the specific channels of contagion, given that they capture only co-movements in asset prices or risk. Another drawback is that such measures might not be available for a large fraction of the financial sector, particularly for those institutions which are not publicly traded or where stock prices are not reliable, owing to, for example, thin trading. Finally, as mentioned before, price-based measures tend to capture mainly the market perception of risk, which may not always reflect the true default probability of an institution.8

Against this background, the analysis in this chapter of the report will be based on the first approach to interconnectedness in the wider financial system, looking first at direct exposures across sectors and then focusing on the concentration of exposures towards particular instruments.

1.3 Interconnectedness arising from direct exposures

Understanding financial interconnectedness across sectors and countries is necessary in order to better understand the transmission of possible shocks and contagion throughout the various parts of the financial system. From a financial stability perspective, the analysis of interconnectedness can also help to inform measures that could make the financial system more resilient to shocks.

This chapter focuses on interconnectedness arising from direct exposures across different sectors in the euro area financial system as a whole and across different countries. In addition, it analyses exposures of MFIs located in different countries to non-residents.9

Many of the charts presented below are based on Securities Holding Statistics (SHS) data.10 These data have been collected by the European System of Central Banks (ESCB) since the beginning of 2014 and help to significantly improve the availability of information on securities holdings both within the euro area and between the euro area and the rest of the world. A main advantage of SHS data is that they provide information on securities holdings by main euro area financial sector, with the same

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9 Unlike other Chapters of the RFS, this chapter does not focus on changes in interconnectedness over time, given that most of the data used for the analysis is only available for 2014. As of next year, it will be possible to add a time dimension to the analysis.

sector on the issuer side, allowing for a thorough analysis of interconnectedness. However, the charts below should be interpreted with care, as the data cover only around 84% of the total outstanding amount of securities issued by euro area financial sectors (using euro area accounts data as a base of comparison).

1.3.1 Interconnectedness within the euro area

Tables 1.1 to 1.4 present the direct exposures across different sectors of the euro area financial system per instrument type in the last quarter of 2014. The tables allow the level of interconnectedness across sectors, and hence the strength of possible contagion channels across the different sectors of the financial system, to be assessed. The rows represent the lender (in the case of loans) or the holding sector (for other instruments), while the columns represent the borrower or the issuing sector, respectively. The last row and the last column report the total debt (for loans) or the total issuance (for other instruments) and the total exposure, respectively.

The scale of direct exposures of one euro area financial sector to another differs significantly according to the type of instrument. In absolute terms, the largest exposure is loans held by MFIs and OFIs, followed by debt securities held by MFIs and investment fund shares held by ICPFs and OFIs. Holdings of shares are comparatively smaller.

Looking at each instrument separately, MFIs are, unsurprisingly, the largest holders of loans to other parts of the financial system, followed by OFIs (Table 1.1). In terms of counterparties, OFIs are the largest counterparty to both MFIs and OFIs, representing 83% and 75% of the total loans granted by both sectors, respectively. MFIs are also an important counterparty to both MFIs and OFIs, accounting for about 9% of the total loans granted by both sectors. For MFIs, ICPFs are also a significant counterparty, accounting for 8% of the exposures.

Regarding debt securities, the largest holders are MFIs, followed by OFIs and ICPFs, the latter two holding similar, much smaller amounts (Table 1.2). MFIs are the main counterparty for all parts of the financial system, followed by OFIs. Securities issued by MFIs represent about 60% of the holdings in this sector, while securities issued by OFIs represent about 40%. For OFIs and ICPFs, holdings of debt securities issued by MFIs represent 53% and 64%, respectively, while holdings of debt securities issued by OFIs account for the rest.

Coverage also differs across sectors. For instance, SHS coverage tends to reach nearly 90% for MFIs, while it stands at 86% for OFIs and 77% for ICPFs.
Table 1.1
Cross-exposures among sectors of the euro area financial system: loans

( EUR billions; fourth quarter of 2014)

<table>
<thead>
<tr>
<th>Lender/Borrower</th>
<th>ICPFs</th>
<th>MFIs</th>
<th>OFIs</th>
<th>Total exposure</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICPFs</td>
<td>83</td>
<td>8</td>
<td>28</td>
<td>119</td>
</tr>
<tr>
<td>MFIs</td>
<td>101</td>
<td>97</td>
<td>986</td>
<td>1,184</td>
</tr>
<tr>
<td>OFIs</td>
<td>49</td>
<td>138</td>
<td>551</td>
<td>738</td>
</tr>
<tr>
<td>Total debt</td>
<td>234</td>
<td>243</td>
<td>1,564</td>
<td>2,041</td>
</tr>
</tbody>
</table>

Sources: Euro Area Accounts (EAA) and ECB calculations.

Table 1.2
Cross-exposures among sectors of the euro area financial system: debt securities

( EUR billions; fourth quarter of 2014)

<table>
<thead>
<tr>
<th>Holding sector/Issuing sector</th>
<th>ICPFs</th>
<th>MFIs</th>
<th>OFIs</th>
<th>Total exposure</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICPFs</td>
<td>17</td>
<td>566</td>
<td>313</td>
<td>917</td>
</tr>
<tr>
<td>MFIs</td>
<td>5</td>
<td>1,739</td>
<td>1,241</td>
<td>2,985</td>
</tr>
<tr>
<td>OFIs</td>
<td>17</td>
<td>536</td>
<td>459</td>
<td>1,012</td>
</tr>
<tr>
<td>Total issuance</td>
<td>38</td>
<td>2,862</td>
<td>2,014</td>
<td>4,914</td>
</tr>
</tbody>
</table>

Sources: Securities Holding Statistics (SHS), Euro Area Accounts (EAA) and ECB calculations. Notes: The ratio between the total outstanding amount from the EAA and the SHS for this instrument is used to rescale the exposures per sector obtained from SHS.

Turning to listed shares (Table 1.3), the largest holders are OFIs. MFIs and ICPFs hold much smaller amounts, representing about 30% and 16%, respectively, of OFI holdings. In terms of counterparties, OFIs are particularly exposed to MFIs, which account for slightly more than half of the total exposure. Equity issued by OFIs and ICPFs also represents large shares of total OFI exposure. MFIs appear largely exposed to equity issued by other MFIs, while ICPFs are largely exposed to equity issued by OFIs.

Table 1.3
Cross-exposures among sectors of the euro area financial system: listed shares

( EUR billions; fourth quarter of 2014)

<table>
<thead>
<tr>
<th>Holding sector/Issuing sector</th>
<th>ICPFs</th>
<th>MFIs</th>
<th>OFIs</th>
<th>Total exposure</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICPFs</td>
<td>5</td>
<td>15</td>
<td>34</td>
<td>54</td>
</tr>
<tr>
<td>MFIs</td>
<td>14</td>
<td>73</td>
<td>9</td>
<td>96</td>
</tr>
<tr>
<td>OFIs</td>
<td>56</td>
<td>170</td>
<td>103</td>
<td>328</td>
</tr>
<tr>
<td>Total issuance</td>
<td>75</td>
<td>258</td>
<td>145</td>
<td>479</td>
</tr>
</tbody>
</table>

Sources: Securities Holding Statistics (SHS), Euro Area Accounts (EAA) and ECB calculations. Notes: The ratio between the total outstanding amount from the EAA and the SHS for this instrument is used to rescale the exposures per sector obtained from SHS.

Table 1.4
Cross-exposures among sectors of the euro area financial system: investment fund shares

( EUR billions; fourth quarter of 2014)

<table>
<thead>
<tr>
<th>Holding sector/Issuing sector</th>
<th>ICPFs</th>
<th>MFIs</th>
<th>OFIs</th>
<th>Total exposure</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICPFs</td>
<td>88</td>
<td>2,257</td>
<td>2,345</td>
<td></td>
</tr>
<tr>
<td>MFIs</td>
<td>39</td>
<td>228</td>
<td>266</td>
<td></td>
</tr>
<tr>
<td>OFIs</td>
<td>130</td>
<td>1,239</td>
<td>1,369</td>
<td></td>
</tr>
<tr>
<td>Total issuance</td>
<td>257</td>
<td>3,723</td>
<td>3,980</td>
<td></td>
</tr>
</tbody>
</table>

Sources: Securities Holding Statistics (SHS), Euro Area Accounts (EAA) and ECB calculations. Notes: The ratio between the total outstanding amount from the EAA and the SHS for this instrument is used to rescale the exposures per sector obtained from SHS.

Finally, turning to investment fund shares (Table 1.4), the largest holders are ICPFs, followed by OFIs. MFIs tend to hold a much smaller amount of investment fund shares. In terms of counterparties, the major issuers of this instrument are OFIs, representing between 85% and 96% of the holdings of this instrument for the entire euro area financial system.

1.3.2 Interconnectedness across individual countries

This section looks at the structural interconnectedness across different parts of the euro area financial sector located in individual Member States. In particular, Chart 1.3 to Chart 1.5 show the exposures of MFIs, ICPFs and OFIs to their home country (domestic exposures) and the rest of the euro area (other EA exposures). Exposures
of each sector are computed for three instruments combined: debt securities, shares and investment fund shares. The charts are calculated on the basis of SHS data.

Chart 1.3
Exposure of MFIs to financial sectors located in the same country and in other euro area countries

(EUR billions; fourth quarter of 2014)

Sources: ECB (SHS sector) and ECB calculations. Underlying data are available on request.
Notes: Exposures of each sector are computed for three instruments combined: securities, shares and investment fund shares. Austria, Luxembourg and Malta are reported together for confidentiality reasons. DE domestic and EA non-domestic holdings of securities issued by ICPFs are aggregated for confidentiality reasons. PT domestic and EA non-domestic holdings of securities issued by ICPFs are aggregated for confidentiality reasons.

Reflecting in part the absolute size of their banking systems, exposures of MFIs tend to be sizable in the four largest economies of the euro area (Germany, France, Italy and Spain). They are, however, also large in the Netherlands, Ireland and Belgium, as well as in Austria, Malta and Luxembourg combined (Chart 1.3).\(^\text{12}\) In most countries, MFIs tend to be exposed primarily to financial sectors in their home countries. In Germany and France, domestic exposures amount to about 70% of the total exposures to these three sectors, while in the case of Italy and Spain the share is about 94%. In the Netherlands and Portugal, domestic exposures are also sizable, standing at 87% and 91%, respectively, whereas the domestic share for Belgium is somewhat lower at 65%. By contrast, MFIs in Ireland and in Austria, Luxembourg and Malta combined, tend to be exposed mainly to sectors located in other euro area countries.

Looking at the exposure to sectors, in Germany and France most MFI exposures are to other MFIs, mainly in the same country but also to a large extent in other euro area countries. In Italy, the largest MFI exposure is to domestic MFIs. MFI exposure

\(^\text{12}\) As mentioned in the notes to Charts 1.3 to 1.5, Austria, Luxembourg and Malta are reported together for confidentiality reasons. However, developments are likely to be driven mainly by Luxembourg and Malta, owing to the different financial structure of Austria.
to OFIs (at home or in other euro area countries) is, however, not negligible in Germany, France and Italy, and particularly large in Spain and the Netherlands.\(^{13}\)

**Chart 1.4** shows that the ICPF sector is particularly developed in France, Germany and the Netherlands. In other big euro area economies, such as Spain and Italy, it tends to be less than one fifth of the size of the sector in France, Germany and the Netherlands. In France, the ICPF sector is exposed particularly to French MFIs and OFIs, but also to other parts of the euro area. In Germany and the Netherlands, the ICPF sector is mainly exposed to the domestic OFI sector.

OFI exposures are particularly large in Austria, Malta and Luxembourg combined, as well as in Germany and France, followed by Ireland (**Chart 1.5**). Austria, Malta and Luxembourg combined and Germany are strongly exposed to OFIs and MFIs in other euro area countries, with non-domestic exposures representing slightly more than half of the total exposure. In France, where domestic exposures represent about 60%, these are concentrated mainly in domestic MFIs, followed by domestic and euro area OFIs. In Ireland, OFIs are mainly exposed to domestic and non-domestic OFIs and also to domestic and non-domestic MFIs. In the Netherlands, exposures tend to be concentrated in domestic OFIs. For Italy and Spain, the absolute value of exposures tends to be much smaller, with exposures being concentrated mainly in domestic MFIs and OFIs in other euro area countries.

### 1.3.3 Interconnectedness with non-residents

The third analysis performed in this chapter looks at MFI exposures to non-residents (non-domestic MFIs and non-domestic non-MFIs). In this sub-section, we include several non-euro area EU Member States, because they are large counterparties for many euro area countries. The main difference to the cross-country analysis presented above is the focus on each of the three largest counterparty cross-country exposures per country. The focus is on MFIs only, because the euro area is a largely bank-based economy. Exposures are computed for the sum of three instruments, namely loans, securities and MMF shares/units.

\(^{13}\) At least in the case of Spain, the large exposure of domestic MFIs to domestic OFIs reflects retained securitisations for collateral purposes, without implications for risk or contagion.
**Chart 1.6** and **Chart 1.7** report for each euro area country, the share of each of the three largest counterparty cross-country exposures relative to total assets for non-domestic MFIs and non-domestic non-MFIs.  

Regarding exposures of MFIs to non-domestic MFIs (**Chart 1.6**), the two countries with the largest exposures are Luxembourg and Ireland. For these two countries, the three largest exposures combined represent about 28% and 21% of total assets, respectively. Countries with sizeable, although much smaller exposures, are Malta, Belgium, Latvia, Finland and the Netherlands, where exposures to non-domestic MFIs vary between 7% and 11%. MFIs in the remaining euro area countries tend to be less exposed to non-domestic MFIs. As regards counterparties, the most important countries appear to be the United Kingdom, Germany and France. Proximity or cultural background matter as well. For example, Belgium is strongly exposed to the Netherlands, Cyprus to Greece, Portugal to Spain, Estonia and Finland are exposed to Denmark, Latvia to Finland and Slovakia to the Czech Republic.

**Chart 1.6**  
Three largest exposures of MFIs to non-domestic MFIs

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MFI exposures to non-domestic non-MFIs (**Chart 1.7**) tend to be smaller than those to non-domestic MFIs. The countries with the largest exposures are Greece, Luxembourg and Ireland, where the shares vary between 9% and 15%. In the remaining countries, the share of the three largest exposures to non-domestic non-MFIs represents less than 7% of total assets. The geographic distribution of counterparties appears to be more diverse than in the case of non-domestic MFIs. In particular, while the United Kingdom, Germany and France are major counterparties, the Netherlands also tends to be significant across the board and Greece appears to

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14 Unlike the cross-country analysis performed before, which is based on SHS data, this analysis is based on country-by-country MFI balance sheet items (BSI), which also contain information on non-euro area EU counterparty countries.
be particularly exposed to Luxembourg.\textsuperscript{15} Some clustering of countries is also present for non-domestic non-MFIs. For example, Austria and Slovenia are exposed to Hungary, Cyprus to Greece, Estonia to Latvia, Portugal to Spain and Slovakia to the Czech Republic.

**Chart 1.7**

Three largest exposures of MFIs to non-domestic non-MFIs

<table>
<thead>
<tr>
<th>Country</th>
<th>Exposure</th>
</tr>
</thead>
<tbody>
<tr>
<td>AT</td>
<td>15%</td>
</tr>
<tr>
<td>GR</td>
<td>14%</td>
</tr>
<tr>
<td>LU</td>
<td>13%</td>
</tr>
<tr>
<td>IE</td>
<td>12%</td>
</tr>
<tr>
<td>SI</td>
<td>11%</td>
</tr>
<tr>
<td>SK</td>
<td>10%</td>
</tr>
<tr>
<td>NL</td>
<td>9%</td>
</tr>
<tr>
<td>IT</td>
<td>8%</td>
</tr>
<tr>
<td>DE</td>
<td>7%</td>
</tr>
</tbody>
</table>

Source: MFI balance sheet items (BSI).

Notes: Exposures of each sector are computed combining MFI loans and holdings of debt securities. The non-MFI sector includes general government, financial corporations except MFIs, non-financial corporations, households and non-profit institutions serving households. For GR, LU, IE, FI, CY and BE, refer to the left-hand scale; for remaining countries, refer to the right-hand scale.

1.3.4 Interconnectedness from common exposures to assets

While the previous section focused on direct exposures across sectors and countries, this section assesses interconnectedness in the euro area financial sector arising from exposures to common assets. In particular, it analyses the exposures of financial systems of different countries to particular instruments, while distinguishing whether the instrument is held in the same country or in the rest of the euro area. This analytical angle is useful for assessing the possible transmission of stress in specific financial markets across sectors and countries. For example, if a sector of the financial system in a particular euro area country is largely exposed to listed shares, a sharp collapse in stock markets may have negative consequences for the sector in that country.

**Chart 1.8** to **Chart 1.10** show the exposures of MFIs, ICPF\s and OFIs located in euro area countries to different instruments, either issued in the same country (domestic exposures) or in the rest of the euro area. The focus is on short and long-term debt, shares and investment fund shares. Because the sources of the data are the same, these Charts are similar to **Chart 1.3** to **Chart 1.5** above, but the breakdown is by counterparty instrument, rather than by counterparty sector.

\textsuperscript{15} In the case of Greece, the large exposure to Luxembourg is due to large holdings of EFSF bonds as a result of Greek bank recapitalisation and restructuring in the context of the economic adjustment programme.
Regarding exposures of MFIs (Chart 1.8), in the countries with the largest exposures (namely Germany, France, Italy and Spain), domestic long-term debt tends to be the main counterparty instrument, accounting for between about 40% and 90% of the total exposure. However, in Germany and France, long-term debt issued in other euro area countries also tends to be significant (26% and 22% of total exposures, respectively). Germany and France are also exposed to some extent to investment fund shares and short-term debt, respectively, issued in the same country. MFIs in the Netherlands display a similar pattern, with most of the exposure being to domestic long-term debt. MFIs in Ireland hold a more mixed set of instruments.

As mentioned before, the ICPF sector is particularly developed in France, Germany and the Netherlands (Chart 1.9). In France, the ICPF sector is particularly exposed to domestic investment fund shares, but also to domestic and foreign long-term debt. In Germany and the Netherlands, most of the exposure is to investment fund shares issued domestically.
OFI exposures were already reported to be particularly large in Austria, Malta and Luxembourg combined, in Germany, France and Ireland (Chart 1.10).\(^{16}\) In these economies, the largest exposures are concentrated mainly in domestic investment fund shares, which represent about one third of the total exposure. OFIs in these economies are also exposed to long-term debt and investment fund shares issued by other euro area countries. In Spain and Italy, exposures tend to be concentrated in long-term debt issued by other euro area countries.

\(^{16}\) As mentioned before, Austria, Luxembourg and Malta are reported together for confidentiality reasons. However, developments are likely to be driven mainly by Luxembourg and Malta, due to the different financial structure of Austria.
The euro area banking system

2.1 The market structure of the euro area banking system

This chapter provides an overview of the structure of bank intermediation in the euro area. It reviews overall banking sector capacity by country, highlighting the main developments in 2014, i.e. since the publication of the last ECB Banking Structures Report, in the last year and in the seven years to the end of 2014. This time period includes the beginning of the financial crisis and the time when some euro area countries exited financial assistance programmes.

2.1.1 Banking sector capacity

The rationalisation process in the euro area banking sector which started in the late 1990s has continued. This consolidation of the banking sector is largely due to pressures to achieve cost containment and restructuring, in particular in a context of enhanced financial integration. In recent years, the financial crisis that erupted in 2008 has put additional pressure on banks to deleverage and consolidate, particularly in those countries that were more severely affected by the financial crisis.

On a non-consolidated basis, the total number of credit institutions in the euro area declined to 5,614 at the end of 2014 from 6,054 at the end of 2013 (see Chart 2.1). The net decrease of 440 credit institutions between the end of 2013 and the end of 2014 was the largest absolute fall since data started to be collected in the late 1990s. By comparison, between end 2012 and end 2013, there was a net decrease of 140 credit institutions. Taking a longer time perspective, the net decrease over the period from 2008 to 2014 is 1,160 credit institutions (-17.1%).

Looking at more recent dynamics in individual countries, all euro area countries except Belgium, Estonia, Lithuania and Slovakia experienced a decrease in the number of credit institutions between 2013 and 2014. The country that experienced the strongest absolute decline was France (-167), though strong declines were also recorded in Spain (61), Cyprus (44), Germany (40) and Finland (35). Taking a medium-term perspective, since the onset of the crisis, Greece, Cyprus and Spain have recorded the largest relative decrease, due to the restructuring and

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17 The figures reported in Chart 2.1 include all the countries that had adopted the euro by 1 January 2015.

18 MFI statistics are residence-based and compiled on an individual (as opposed to a consolidated) basis. Chart 2.1 thus refers to all credit institutions legally incorporated in euro area countries, which includes foreign subsidiaries and branches. Credit institutions account for the bulk of monetary financial institutions (MFIs) as defined in ECB Regulation ECB/2013/33 of 24 September 2013 concerning the balance sheet of the monetary financial institutions sector (recast).

19 In the case of France, the drop is largely due to a reclassification related to the adoption of EU regulations. In particular, the CRR defines credit institutions as those that grant credit and receive deposits. Under French law, by contrast, financial corporations that granted credit without receiving deposits were also classified as credit institutions until 2013.
consolidation of their banking sectors in the context of the crisis. Pronounced relative declines over that period were also noticeable in Finland, France, Italy, Portugal and the Netherlands.

Chart 2.1
Number of credit institutions and foreign branches in 2008 and 2014

Reflecting both the size and structural features of their countries, Austrian, French, German and Italian credit institutions accounted for around 69% of euro area credit institutions at the end of 2014, compared with 67% in 2008. The share of Spanish credit institutions in the euro area is relatively small, standing at about 3% in 2014.

Looking at the euro area as a whole, the share of foreign branches in the total number of euro area credit institutions increased from about 10% to about 13% between 2008 and 2014. More than half of this increase occurred between 2013 and 2014. This development is mainly due to the decline in the number of credit institutions incorporated in the euro area.

On a consolidated basis, the total number of credit institutions in the euro area amounted to 4,910 (domestic banks and banking groups) at the end of 2014, down from 6,069 in 2008 and 5,347 at the end of 2013. The number of foreign branches decreased to 704 on a consolidated basis at the end of 2014 from 705 in 2008 and 707 in 2013.

Focusing on the resizing process, total assets of the euro area banking sector, including foreign subsidiaries and branches, stood at €28.1 trillion on a consolidated basis at the end of 2014, reflecting a decline of 15.7% compared with 2008 and 4.8% compared with 2012. The largest reductions in the value of total assets since 2008 were recorded in Ireland, Estonia and Cyprus, amounting to drops of 69%, 40.7% and 39.8% respectively. On the other hand, Finland and Malta recorded an increase in the total value of banking assets of 48.5% and 17.6% respectively. The large reduction in the relative value of assets in Estonia was mainly driven by the restructuring of the ownership of a foreign banking group in 2011.

Source: ECB MFI statistics.
Note: Figures for Latvia include credit unions starting from 2013.
largest reductions in the value of assets in 2014 were observed in Ireland (36%) and Portugal (8%), followed by Slovenia (3.8%), Cyprus (2.6%) and Austria (1%).

At the end of 2014, France and Germany still had the largest banking sectors in the euro area, with total asset values of €7.2 trillion and €7.1 trillion, respectively. The banking sectors in Spain and Italy were a considerable distance behind, with total assets amounting to €3.6 trillion and €2.7 trillion respectively. At the other end of the spectrum, the assets of the Estonian and Lithuanian banking sectors amounted to €22 billion and €24 billion, respectively.

If the sizes of the different euro area banking sectors are measured in relation to GDP, the overall picture is radically different (see Chart 2.2). In terms of national GDP, Luxembourg stands out as the largest banking sector, with assets representing 1,618% of GDP, followed by Malta, Cyprus and the Netherlands with banking assets representing 656%, 432% and 382% of GDP respectively. It is worth mentioning that these percentages are still lower than at the end of 2012. Moreover, in Luxembourg, Malta and Ireland, the vast majority of banking assets are held by foreign-controlled subsidiaries and branches.

Chart 2.2
Total assets of domestic banking groups and foreign-controlled subsidiaries and branches in relation to GDP in euro area countries in 2008, 2013 and 2014

Banking sectors across euro area countries differ substantially when it comes to the presence of foreign banks (via bank branches or subsidiaries) and their relative weight with respect to domestic credit institutions (see Chart 2.3). When looking at medium-term dynamics over the period 2009-2014, the size of domestic banking assets increased somewhat in countries that were or still are subject to EU/IMF financial assistance programmes, such as Portugal and Cyprus, but particularly in Greece. The size of the domestic banking sector also increased in Malta and Estonia, the latter from a very low level. Other bigger economies that recorded smaller increases are France and Spain.
In terms of the composition of foreign banks, as measured by their share in euro area banking sector assets, bank subsidiaries prevailed over foreign branches in most countries. However, activity conducted through branches of banks from other EU countries is important in the Netherlands, Spain and Italy. Activity through branches has also increased since 2009 in Belgium, Slovakia and Estonia. It also increased slightly in Ireland and Cyprus.

As a result of the continued process of rationalisation and resizing in the euro area banking system, the number of local bank units (i.e. branches) in the euro area declined by 16% between 2008 and 2014. In absolute figures, the number of local bank units in the euro area declined by 29,394 between 2008 and 2014 and by 5,187 between 2013 and 2014. Almost half of the decrease in the number of local bank units since 2008 is accounted for by Spain. Other big economies, such as Germany, Italy, the Netherlands and France also contributed significantly to the decrease. As regards the smaller countries, there was a strong decline in the number of local units in Greece, particularly in 2014.

**Chart 2.3**
The composition of banking sector assets in euro area countries by type of credit institution (CI) in 2009, 2013 and 2014

The decline in the number of bank units in the euro area was reflected in the increase in two key banking system capacity indicators: population per local branch and population per banking employee (see Chart 2.4 and Chart 2.5). This increase was common to most euro area countries over the years from 2008 to 2014 and reflects the rationalisation process mentioned before. Compared with 2013, the increase in relative terms in the population per local branch was particularly noticeable in the Netherlands, Finland and Estonia, but also in Greece and Cyprus. As regards the population per banking employee, the increase since 2008 was particularly marked in Ireland, Greece, Spain and Latvia.
Table 2.1 displays additional capacity indicators for the euro area and individual countries as at the end of 2014, in which structural and cyclical factors play an important role. In the case of assets per employee, there has been an upward trend for the euro area as a whole since 2008. This upward trend was the product of different factors across countries, but it is mainly due to the consolidation process mentioned before that resulted in a substantial fall in the number of bank employees. This fall, more than offset the fall in assets due to the ongoing deleveraging process in several countries. By contrast, in some cases, such as Austria, Cyprus and Ireland, the effect of the deleveraging process outweighed the fall in the number of bank employees, leading to decreases in the ratio in recent years. In 2014 the ratio increased somewhat compared with 2013 owing to a faster decline in the number of employees than in total assets. The continued trend in these indicators suggests an increasingly efficient use of resources in the euro area banking sectors. This is in line
with trends in more conventional efficiency indicators (such as cost-to-income ratios) relating to the financial performance of banks, as discussed in the next section.

Table 2.1
Euro area banking sector capacity indicators in 2014

<table>
<thead>
<tr>
<th>Country</th>
<th>Population per credit institution</th>
<th>Population per branch</th>
<th>Population per ATM</th>
<th>Population per bank employee</th>
<th>Assets per bank employee</th>
<th>Population density</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>108,320</td>
<td>3,093</td>
<td>747</td>
<td>197</td>
<td>19,466</td>
<td>337</td>
</tr>
<tr>
<td>Germany</td>
<td>45,552</td>
<td>2,334</td>
<td>991</td>
<td>127</td>
<td>12,054</td>
<td>231</td>
</tr>
<tr>
<td>Estonia</td>
<td>35,562</td>
<td>10,785</td>
<td>1,712</td>
<td>271</td>
<td>4,415</td>
<td>29</td>
</tr>
<tr>
<td>Ireland</td>
<td>10,347</td>
<td>4,643</td>
<td>1,498</td>
<td>160</td>
<td>37,400</td>
<td>66</td>
</tr>
<tr>
<td>Greece</td>
<td>274,820</td>
<td>4,090</td>
<td>1,523</td>
<td>241</td>
<td>8,713</td>
<td>83</td>
</tr>
<tr>
<td>Spain</td>
<td>205,593</td>
<td>1,452</td>
<td>892</td>
<td>230</td>
<td>14,744</td>
<td>92</td>
</tr>
<tr>
<td>France</td>
<td>133,405</td>
<td>1,759</td>
<td>1,124</td>
<td>161</td>
<td>19,895</td>
<td>120</td>
</tr>
<tr>
<td>Italy</td>
<td>90,739</td>
<td>1,979</td>
<td>1,212</td>
<td>203</td>
<td>13,424</td>
<td>202</td>
</tr>
<tr>
<td>Cyprus</td>
<td>14,956</td>
<td>1,386</td>
<td>1,298</td>
<td>78</td>
<td>8,320</td>
<td>92</td>
</tr>
<tr>
<td>Latvia</td>
<td>33,816</td>
<td>6,254</td>
<td>1,710</td>
<td>213</td>
<td>3,292</td>
<td>31</td>
</tr>
<tr>
<td>Lithuania</td>
<td>32,909</td>
<td>4,801</td>
<td>2,346</td>
<td>327</td>
<td>2,847</td>
<td>45</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>3,772</td>
<td>2,573</td>
<td>1,185</td>
<td>22</td>
<td>37,297</td>
<td>216</td>
</tr>
<tr>
<td>Malta</td>
<td>15,819</td>
<td>3,883</td>
<td>1,956</td>
<td>96</td>
<td>11,909</td>
<td>1,335</td>
</tr>
<tr>
<td>Netherlands</td>
<td>77,358</td>
<td>9,096</td>
<td>2,275</td>
<td>179</td>
<td>26,078</td>
<td>413</td>
</tr>
<tr>
<td>Austria</td>
<td>12,085</td>
<td>2,012</td>
<td>994</td>
<td>115</td>
<td>11,874</td>
<td>102</td>
</tr>
<tr>
<td>Portugal</td>
<td>69,341</td>
<td>1,752</td>
<td>648</td>
<td>193</td>
<td>8,708</td>
<td>113</td>
</tr>
<tr>
<td>Slovenia</td>
<td>85,908</td>
<td>3,483</td>
<td>1,160</td>
<td>193</td>
<td>4,078</td>
<td>102</td>
</tr>
<tr>
<td>Slovakia</td>
<td>193,520</td>
<td>4,243</td>
<td>2,097</td>
<td>290</td>
<td>3,443</td>
<td>111</td>
</tr>
<tr>
<td>Finland</td>
<td>20,155</td>
<td>4,986</td>
<td>2,427</td>
<td>248</td>
<td>26,310</td>
<td>16</td>
</tr>
<tr>
<td>euro area</td>
<td>60,046</td>
<td>2,111</td>
<td>1,078</td>
<td>166</td>
<td>15,394</td>
<td>128</td>
</tr>
</tbody>
</table>

Sources: Calculations are based on figures in the Annex, the ECB Blue Book and United Nations data.
Notes: Assets per employee are measured in EUR thousands. Population density is expressed as inhabitants per square kilometre. Population per ATM refers to 2013.

2.1.2 Consolidation and merger and acquisition activity

Unlike the rest of this chapter, this section includes all EU Member States rather than only euro area countries in order to allow for a distinction between intra- and extra-EU merger and acquisition (M&A) activity. As emphasised in the previous section, consolidation of the euro area banking sector has continued since 2008, with the number of credit institutions declining at a steady pace for both the euro area and the EU as a whole (see Chart 2.6).

Total M&A activity in the EU banking sector has, however, declined since the high values recorded in 2007, especially in terms of the value of transactions, but also in terms of the number of transactions. Regarding the former, the decline was recorded across the board. Based on the trend observed in the first half of 2015, however, an increase in the value of M&A activity could be observed compared with the last three years. In terms of the number of transactions, M&A activity in the euro area banking sector has been falling almost continuously since 2000. Amid some volatility in recent years and rebounds in 2010 and in 2013, the number of M&A transactions is still much lower than observed pre-crisis and well below the peak of 2001. Cross-
border transactions (within the euro area) and outward transactions (with euro area banks as acquirers) were those most affected by this decline.

Chart 2.6
Number of credit institutions

Following the start of the crisis in 2008, the number of domestic transactions remained broadly unchanged until 2013, reflecting ongoing consolidation in the banking system, including intragroup transactions in Italy and Germany, and the restructuring of the banking sector in EU/IMF programme countries. As a result, the relative share of domestic M&As increased until 2013, but declined somewhat thereafter (see Chart 2.7).

The transaction value of M&A activity has decreased sharply since 2007 across all categories and continued to follow a downward path until 2014. In 2015, M&A transaction values seem to be recovering somewhat, as the volumes recorded in the first half of the year already accounted for about 70% of the total amount recorded in 2014 (see Chart 2.8).

From 2008 to 2014, the overall value of transactions decreased from about €39 billion to about €8 billion. In the first half of 2015, the value of transactions recorded was €5.5 billion.

M&A activity in 2014 and in the first half of 2015 appears to be dominated by consolidation of the banking sector within the euro area and by efforts to diversify risks geographically, both in non-euro area EU Member States and outside the EU.

Most domestic transactions recorded in 2014 and the first half of 2015 were relatively small, although one of them exceeded €1 billion (in Spain) and another one

21 “Domestic transactions” denote transactions that take place within national borders. In this report, transactions within the euro area are referred to as “cross-border M&As”.

22 The data assessed in this section do not cover participation by governments or special legal entities in the restructuring or resolution of credit institutions.

23 The peak in transaction values in 2007 reflected the acquisition of ABN Amro by the consortium of Royal Bank of Scotland, Fortis and Santander as well as the merger of Sanpaolo IMI and Banca Intesa.
exceeded €3 billion (in Finland). Cross-border (intra-euro area) transactions were also relatively small, with none exceeding €0.4 billion. Two large and several smaller transactions were recorded in which a euro area institution acquired institutions outside the euro area.

2.1.3 Concentration and competition

Market concentration, as measured by the share of total assets held by the five largest credit institutions or by the Herfindahl index, has broadly continued on an upward path both at the euro area and EU level since the pre-crisis period. The increase in market concentration reflects primarily the decline in the number of credit institutions mentioned before (see Chart 2.9). For the euro area, both indicators continued to rise until 2014, driven mainly by developments in Germany, Italy and Spain. For the EU, the share of total assets held by the five largest credit institutions stabilised at 2013 levels in 2014, while the Herfindahl index has continued to rise.

The Herfindahl–Hirschman Index (HHI) is defined as the sum of the squares of the market shares of all firms within the industry, where the market shares are expressed as fractions. As a general rule, an HHI below 1,000 signals low concentration, while an index above 1,800 signals high concentration. For values between 1,000 and 1,800, an industry is considered to be moderately concentrated. Note that these indicators are calculated on a non-consolidated basis, meaning that banking subsidiaries and foreign branches are considered to be separate credit institutions.
Taking a cross-country view, concentration indices reflect a number of structural factors. Banking systems in larger countries, such as France, Germany and Italy, are more fragmented and include strong savings and cooperative banking sectors, particularly in the latter two. Consequently, concentration levels tend to be lower in these countries. By contrast, banking systems in smaller countries tend to be less fragmented and more concentrated, such as in Cyprus, Estonia, Finland, Greece and Lithuania. The exceptions are Austria and Luxembourg, in the former owing to a banking sector structure similar to that of larger countries, in the latter due to the presence of a large number of foreign credit institutions. At the end of 2014, market concentration (measured by the share of assets held by the five largest banks) ranged from close to 95% in Greece, to just about 32% in Germany and Luxembourg (see Chart 2.10).

Regarding developments in the period from 2008 to 2014 in the share of assets held by the five largest banks, the banking sector structure tended to become more concentrated in a number of countries, in particular those undergoing deep banking sector restructuring processes, such as Greece and Spain, but also in other smaller economies, such as Malta and Lithuania. Concentration in other larger economies, such as in Germany and Italy, also increased over this period. On the other hand, concentration in countries like Estonia, Belgium and Slovenia decreased.

Market concentration indices, calculated by bank total assets on an individual basis, produce lower results than concentration indices calculated on a consolidated basis.
2.2 Structural developments in banking activity

Section 2.2 reviews structural changes in the balance sheet, financial performance, capital position and leverage of the euro area banking sector during the period 2008-2014, with a focus on developments during the last year. In contrast to the first part of Chapter 2, which mainly discussed unconsolidated banking data, the analysis here is based on consolidated, domestic banking sector data. Foreign branches and subsidiaries in a given country are included in the analysis or commented on in the text where relevant, in particular in relation to markets in which foreign presence is substantial, or where this is unavoidable owing to restrictions in data availability.

On the liabilities side, in 2014 the gradual shift towards deposit funding came to a halt, the use of wholesale funding stagnated and banks continued to reduce their reliance on central bank funding. At the same time, capital increases resulted in an increase in solvency and a reduction in leverage ratios. Altogether, these movements indicate a continuation of the trend towards a more traditional banking business model for euro area domestic banks which has already been observed for a couple of years. The legacy of the crisis is, however, still visible in terms of structural deficiencies. Most importantly, a further increase in non-performing loans (NPLs) underlines the need in several euro area countries to take further steps to tackle this problem in order to free up bank capital and boost credit expansion. Cost-cutting efforts by euro area banks are continuing, but remain rather limited, in particular as regards staff costs for large euro area banks.

2.2.1 Balance sheet structure

The total assets of the euro area banking sector, including foreign branches and subsidiaries, stood at €28.1 trillion on a consolidated basis at the end of 2014, reflecting an increase of 5% vis-à-vis 2013. The total assets of the domestic euro area banks also increased from €23.1 trillion in 2013 to €24.3 trillion in 2014. Exceptions from the rather broad-based increase were the Austrian, Cypriot, Irish, Portuguese and Slovenian banks, many of which continued to deleverage, in some cases as a condition for receiving state aid.

Growth has also resumed in total loans for the euro area, although at a slow pace. The median share of loans in total assets decreased slightly in 2014. At the same time, the cross-country heterogeneity of this indicator has increased (see Chart 2.11). Looking at country-level data, the turnaround in total loan growth has been driven mainly by strong growth in Germany, while lending has also grown in Estonia, Latvia, Luxemburg and Malta. In contrast, the negative trend continued in other countries.

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26 The domestic banking sector comprises the consolidated accounts of banks that have their headquarters in a given country or economic area, including their foreign branches and subsidiaries abroad.
The growth in the share of debt securities relative to total banking sector assets halted in 2014, with many countries seeing significant reductions in their relative importance (see Chart 2.12). However, strategies concerning debt securities holdings differ greatly across euro area banking sectors.

Chart 2.12
Share of debt securities in total assets of euro area banking sectors
(all domestic banks; percentage of total assets)

Sources: ECB/FSC consolidated banking data.

The breakdown of assets highlights large cross-country differences in the asset structures of euro area banking sectors (see Chart 2.13). For instance, the share of loans in total assets varies from 34% in Latvia to 77% in Greece. The share of financial assets held for trading is typically below 10%, with the high figures observed in Germany and France reflecting the presence of large banks with sizable investment banking activities. Including foreign branches and subsidiaries in the analysis would single out Finland as having a high share of financial assets held for trading, owing to the regionally concentrated investment banking and derivatives activities of large foreign banks present in the country.

The asset structure also differs by bank size. Trading assets feature most prominently in the balance sheets of large banks, whereas their share has decreased to almost non-existent in the aggregate balance sheet of the medium-sized and small domestic banks (see Chart 2.14). Medium-sized banks display a higher share of loans in total assets (67%) than large and small banks, indicating that banks in this size group tend to follow business models which are more geared towards traditional banking activities. The market share of the smaller banks in this market appears to be on the rise, following an increase in the average share of loans from 54% in 2012 to 59% in 2014.

27 It should be noted that the majority of domestic banks in Latvia – accounting for less than 50% of the banking sector – focus on non-resident business and do not have close links with the domestic economy. The share of loans in total assets for the banking sector, including foreign branches and subsidiaries, amounted to 58% in 2014.
As regards banks’ liabilities, the gradual shift towards deposit funding came to a halt in 2014, with the median share of customer deposits in liabilities hovering around 42% and thus demonstrating growth in line with assets (see Chart 2.15). The use of wholesale funding stagnated in 2014, with the median share of wholesale funding in total funding amounting to 26%, almost unchanged from the previous year but well below its peak of 38% in 2009 (see Chart 2.16). The cross-country dispersion of wholesale funding reliance continued to decrease.
Positive developments in retail deposits and only moderate extension of credit to the economy led to a further decrease in the median euro area loan-to-deposit ratio from around 121% in 2013 to 111% in 2014 (see Chart 2.17). The first quarter of 2015 showed, however, a slight increase compared with the last quarter of 2014, following increases in lending.

Chart 2.17
Loan-to-deposit ratios of euro area banking sectors

Sources: ECB MFI statistics and ECB calculations.

Chart 2.18
Share of central bank funding in total liabilities of euro area banking sectors

Sources: ECB BSI statistics, IMF International Financial Statistics (IFS) data and ECB calculations.

Banks continued to reduce their reliance on central bank funding in 2014, especially in the banking sectors at the high end of the distribution (see Chart 2.18). This indicates that new borrowing through the ECB’s targeted longer-term operations (LTROs) was offset by repayments of funds borrowed through the three-year LTROs in 2011 and 2012.

Looking at cross-country differences in the structure of banks’ liabilities, the share of financial liabilities measured at amortised cost — a category largely consisting of deposits — ranged from 92% in Latvia to 61% in France in 2014 (see Chart 2.19). Mirroring the business model related patterns on the asset side, the share of trading liabilities is largest for banks in Germany and France, accounting for more than 20% of total liabilities.

Chart 2.19
Liability breakdown for euro area banking sectors

(2014; all domestic banks; percentage of total liabilities)

Sources: ECB/FSC consolidated banking data and ECB calculations.
Notes: IFRS reporting banks only. Other liabilities include, for instance, deposits from central banks, financial liabilities associated with transferred financial assets, and tax liabilities.
2.2.2 Financial performance and cost structure

The subdued financial performance of the euro area banking sector observed since the onset of the financial crisis continued almost unchanged in 2014. However, cross-country differences decreased significantly during the year (see Chart 2.20 and Chart 2.21). A decrease in impairments in a subset of vulnerable countries from the very high levels seen in 2013 was the main contributor to this development. The positive factors included increases in net interest income and in gains on financial assets realised during the year. Negative contributions originated from restructuring costs and litigation charges, with increased provisions in some cases.

Chart 2.20
Return on assets of euro area banking sectors
(all domestic banks; percentages; maximum, minimum, interquartile range and median across national banking sectors)

Sources: ECB/FSC consolidated banking data.

Chart 2.21
Return on equity of euro area banking sectors
(all domestic banks; percentages; maximum, minimum, interquartile range and median across national banking sectors)

Sources: ECB/FSC consolidated banking data.

Chart 2.22 illustrates the decrease in impairments and provisions, particularly in the banking sectors belonging to the higher part of the distribution. Impairment charges and provisions sharply declined in countries such as Cyprus, Slovenia and Ireland. This resulted in a general improvement in profitability for most of these countries (see Chart 2.23). In contrast, increases in impairments and provisions were recorded in some other euro area economies, including Austria, Malta, Estonia and Greece.28 The resolution of a large Portuguese bank resulted in a substantial loss for the Portuguese banking sector, partly due to large impairments and provisions resulting from that event.

28 For Estonia, it should be noted that domestic banks form only 5% of the Estonian banking sector. Looking at the banking sector as a whole, impairments and provisions have decreased in 2013 and 2014.
Most of the impairment charges during 2014 were attributable to losses on loans and receivables (see Chart 2.24). In some countries, sizeable impairments were also incurred on other financial and non-financial assets. The latter mainly concern goodwill write-downs associated with divestments, restructurings and resolutions. The general increase in the prices of Irish assets resulted in a reversal of impairments in available-for-sale financial assets.

Deteriorating loan quality has resulted in a steady and broad-based increase in NPLs in many countries since 2008, with fairly pronounced further increases in some cases during 2014 (see Chart 2.25). Some of these increases are attributable to the adjustments made following the ECB’s 2014 comprehensive assessment, which used a simplified version of the EBA’s newly adopted common definition for non-performing exposures. The further increase in NPLs underlines the need in several euro area countries to take further steps to tackle this problem, which must be dealt with in order to free up bank capital and boost credit expansion.

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Banks raised sufficient provisions to compensate for the increase in NPLs, with the median euro area coverage ratio decreasing marginally to 47% in 2014 from 48% in 2013 (see Chart 2.26). Nevertheless, coverage ratios declined significantly in some countries, where profitability developments would have turned out less favourably if coverage ratios had been kept constant.
Operating profits across euro area banking sectors increased somewhat in 2014 (see Chart 2.27). Seven countries reported small falls in operating profits, whereas Ireland reported a significant surge.

Operating income remained subdued in 2014 owing to slightly decreased fee and commission income and other operating income. Interest rate and other asset price developments in 2014 resulted in gains on financial assets, especially in some vulnerable countries. The contribution of net interest income also increased for the first time since 2011 on account of more rapidly declining funding costs than asset yields in the vulnerable countries (see Chart 2.28).³⁰

The structure of operating income differs considerably across countries (see Chart 2.29). The share of net interest income, for example, ranges from 44% in Latvia to 86% in Slovakia. These cross-country differences can be explained by, among other things, the relative importance of non-bank financial intermediation and the business models of the domestic banks, including their cross-border outreach. For example, banks in countries with more mature corporate bond markets tend to earn more fee and commission income from bond underwriting activities.

³⁰ For an analysis on the interest spread and its drivers, see e.g. Financial Stability Review, ECB, May 2015.
Interest income from loans and receivables accounted for more than half of total interest income in all countries except Luxembourg and Finland in 2014 (see Chart 2.30). In some countries, interest income from other financial assets reported as available for sale and/or held for trading was also significant.

The median cost-to-income ratio for euro area banking sectors rose from 60% in 2013 to 61% in 2014, suggesting that cost-cutting efforts by euro area banks are continuing but remain rather limited (see Chart 2.31). Overall, operating costs decreased slightly relative to total assets in 2014 owing to a reduction in staff costs (see Chart 2.32). Cost cutting is more pronounced in small banks, where the ratio of staff costs to total operating income fell from 4.7% in 2013 to 3.1% in 2014. By contrast, staff costs continued to increase for large banks, amounting to 35% of total operating income in 2014.

The regulatory capital ratios of euro area banks continued to improve in 2014, with the median Tier 1 ratio increasing to 14.4% from 13.0% in 2013 (see Chart 2.33). In particular, the lower end of the dispersion moved upwards, with the minimum amounting to 11.4%, compared to 10.5% in 2013. The median phased-in common equity Tier 1 ratio amounted to 14%. The improved capital ratio resulted from capital increases, while risk-weighted assets (RWAs) increased slightly over the year. The
Implementation of the Capital Requirements Directive (CRD IV) and the Capital Requirements Regulation (CRR) as of January 2014 required banks to raise capital to comply with the new rules and the resulting higher average RWAs. In addition, many banks completed capital raisings during the year to address capital shortfalls identified in the ECB’s comprehensive assessment exercise.

Looking at the composition of risk allocation in banks’ balance sheets, credit and market risk-related RWAs gained in importance during 2014, while operational risk-related RWAs remained close to 10% of the total (see Chart 2.34). The increase in total assets and RWAs, together with the shift towards credit risk, give some tentative signs that a turning point in the deleveraging and de-risking trend may have been reached. Partly incentivised through regulation, banks may have started moving towards more traditional banking activities and lower complexity.

Chart 2.33
Dispersion of Tier 1 ratios across national banking sectors in the euro area

Chart 2.34
Breakdown of risk-weighted assets of euro area banks

Banks have also improved their balance sheet-based leverage ratios in most euro area countries (see Chart 2.35). The median equity-to-assets ratio for euro area domestic banks remained stable at 7.5%, as the impact of the increase in equity (9%) was counterbalanced by the growth in total assets (5%). The improvement in leverage ratios was broadly based across euro area countries, as indicated by the upward shift in the interquartile range of country values. However, dispersion across countries still remains significant, with equity-to-total assets ratios ranging from 5.1% to 14.7%.
In addition to capital issuance, the improvement in equity resulted mostly from improved profitability in 2014. At the same time, declines in retained earnings and revaluation reserves offset some of these increases. A decomposition of total equity at country level shows significant cross-country heterogeneity, although issued capital and retained earnings are typically the largest components (see Chart 2.36).
3 Insurance corporations and pension funds

This chapter discusses recent structural developments in the euro area insurance and pension fund sectors, mainly using publicly available data from the balance sheets of insurance corporations and pension funds (ICPFs). The chapter first discusses the general market structure, before shifting its focus to sector-wide balance sheet items. The final section of the chapter focuses on the profitability and solvency of insurers.

The assets of euro area ICPF have grown steadily in recent years, with a strong concentration of total assets in a relatively small number of countries. Most insurance firms are active in the non-life sector. The high exposure to fixed income assets and the long-term nature of liabilities expose ICPF to the current low yield environment, but there is little evidence yet of a strong increase in unit-linked insurance and defined contribution pension products. Survey results indicate, however, more widespread diversification into non-life and asset management businesses, the lowering of guaranteed rates on new policies and the use of interest rate derivatives.

The profitability of the insurance sector, and in particular the life-insurance sector, has been constrained in recent years by the low-yield environment and weak macroeconomic conditions. The solvency positions of the life and non-life insurance sectors are, however, well above the solvency requirements under the current Solvency I regime.

3.1 Market structure

In contrast to the developments in the banking sector, the assets of euro area ICPF have grown steadily in recent years (Chart 3.1). Looking at the country level reveals a strong concentration of total assets in a relatively small number of countries (Chart 3.2). Specifically, the bulk of the euro area insurance assets are located in France and Germany, whereas the Netherlands stands out for the size of its occupational pension funds. When related to the size of the economy, the largest insurance sectors can be found in Luxemburg and Ireland. Occupational pension funds are very significant players in the Netherlands, also relative to the size of the Dutch economy (Chart 3.3).

Where relevant, data from other providers are used to provide additional information. In general, publicly available data are more limited for the insurance sector than for the banking sector. The forthcoming Solvency II regime is expected to improve the situation markedly.
The significant heterogeneity in the importance of the occupational pension funds reflects to a large extent the institutional differences between the pension systems across euro area countries. In particular, many euro area countries are relying largely on public pension schemes, which are not included in the ICPF statistics.

Chart 3.4 and Chart 3.5 use data from the European Insurance and Occupational Pensions Authority (EIOPA) to shed more light on the insurance market structure. Most insurance firms are active in the non-life sector (56% for the euro area as a whole). This is followed by the life and reinsurance sectors. The presence of composite insurers, i.e. companies that offer both life and non-life insurance via subsidiaries, may be related to the use of a conglomerated business model of banking and insurance in a given market. Typically, conglomerates are large firms that, among other financial units, also incorporate both life and non-life insurance subsidiaries. Owing to their size, their significance is also more visible in the concentration ratio than in the number of firms.

Not surprisingly, insurance markets are typically more concentrated in smaller euro area countries than in larger ones. Among the large countries, Germany has a rather low concentration ratio in both life and non-life insurance. The French market, in contrast, is somewhat more concentrated owing to the dominance of the bancassurance model, where insurance is often located within financial conglomerates. The reinsurance market is very concentrated and dominated by a few companies in all the countries except Luxembourg and Ireland. This reflects the
fact that the global reinsurance market is itself very concentrated and dominated by a small number of large, mostly European, players. In contrast, Luxembourg and Ireland host a large number of captive reinsurers, making them the main European hubs for this type of specialised activity.\footnote{32}

### 3.2 Asset and liability structure

Euro area ICPFs are large investors in government and corporate bonds and in mutual funds, the shares of which continued to grow. Since 2008 more than 10% of total assets have shifted towards these positions (Chart 3.6). A corresponding proportional decline took place mainly in holdings of currency and deposits and in investments in shares and other equity. The latter decrease is partly attributable to value declines in equity holdings during the financial crisis, but also to a change in investment strategies with the aim of de-risking investment exposures, a development which had already begun before the financial crisis in 2008. Lately, insurers in particular are likely to have reallocated investments with a view to capital optimisation under Solvency II (Chart 3.7). Besides the higher capital charges for equities, investing in very long-term fixed income assets, which are typically government bonds, can reduce asset-liability mismatches, which require more capital. It is also likely, however, that yield developments in 2014 contributed to the asset distribution, as lower yields on fixed income assets have resulted in valuation gains in available-for-sale portfolios.

\footnote{32}{A captive insurer is a company that is established by its parents to cover specific risks that the parents are exposed to. In the EU, insurance captives are supervised in the same way as any other insurance companies and considered from a consolidated perspective in terms of group supervision.}
Direct lending by ICPFs remains small on aggregate and so far there is no indication of a large-scale, cross-country revision of insurance business models towards credit intermediation in search for yield (Chart 3.8).

Lending by ICPFs is, however, significant and increasing in the Netherlands and Germany. Belgian insurers have also strongly increased their lending activities to a significant degree recently, albeit starting from a lower level. More generally, lending by ICPFs has concentrated on households (in those jurisdictions where direct lending is allowed) and on governments.33

Technical reserves, i.e. obligations to the policyholders, constitute the bulk of the liabilities of ICPFs (Chart 3.9). The business model of insurance and pension provision implies that the average maturity of liabilities is typically longer than that of the corresponding assets, i.e. the maturity structure is inverted when compared to banking. This inverted maturity structure implies highly predictable, long-term outflows, in particular for life insurers and pension funds. For non-life insurers, the underwriting risks related to insured claims are typically limited to an acceptable level by the law of large numbers (e.g. for motor insurance) or, in the case of bulk claims (e.g. those related to natural catastrophes), through the use of reinsurance.

The high exposure to fixed income assets and the long-term nature of liabilities make ICPFs vulnerable to the protracted low-yield environment. First, low yields will hit investment income as the cash flows from paid premiums and maturing investments are gradually re-invested at lower rates (to the extent that they are not used for payments to policyholders). Second, a low discount rate implies an elevated value of liabilities. The valuation effect is typically larger on the liabilities side than on the assets side because the duration of the liabilities is often longer than that of the assets. A prolonged low-yield environment can thus ultimately affect the solvency of the ICPFs. Liquidity, in contrast, is rarely a problem for ICPFs, owing to the time lag between receiving premiums and making payments to policyholders, provided penalties are in place to deter policyholders from surrendering their policies easily.

The degree of vulnerability to low interest rates is dependent on the business model of individual firms. Small and medium-sized, non-diversified life insurers are typically more exposed (to the extent they have sold policies that are not unit-linked, possibly also with a high level of yield guarantees). For pension funds, the impact is large for defined benefits schemes, whereas policyholders tend to take the hit in the case of defined contribution schemes.

Despite the incentives for ICPFs to move towards policies where the policyholders bear the investment risk, Chart 3.10 shows that non-unit linked insurance and

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34 The EIOPA Insurance stress test 2014 showed that the low interest rate environment is particularly harmful for sectors which have large duration gaps and internal rate of return mismatches between their assets and liabilities. The stress test results are available at https://eiopa.europa.eu/financial-stability-crisis-prevention/financial-stability/insurance-stress-test

35 In the case of a unit-linked life insurance policy, the capital market risk is borne by the policyholder, not the insurance company. In a defined contribution plan, the participant’s contributions are determined in advance, but the level of pension payments is not. The contributions are invested in a portfolio and the participant bears all the investment risk. In a defined benefit plan, future pension payments are determined in advance, based on the wage history and years of service of a participant. The level of contribution may vary significantly over time, depending on the reserves or funding shortfall of the fund.
defined benefit pensions still constitute the bulk of the policies on the balance sheets of life insurers and pension funds. The low growth rates of the unit-linked and defined contribution policies may reflect their competitive disadvantage as an investment product in the current low yield environment, as expected returns to policyholders are low.

Other adjustment mechanisms available for ICPFs include diversification into the non-life and asset management businesses, the lowering of guaranteed rates on new policies and the use of interest rate derivatives. EIOPA’s Low interest rate environment stock taking exercise 2014 provides evidence that such adjustment mechanisms are indeed being used by the industry to a significant degree.36

3.2.1 Profitability and solvency of insurers

This section reviews structural changes in the activity of insurance companies since the end of 2009, with particular focus on changes in 2014, and the broad implications for their profitability performance and solvency position. The section relies on data provided by EIOPA which focus on a sample of large European insurance groups.

In recent years, the profitability of the insurance sector, despite having been solid in relative terms when compared with that of the banking sector, has been constrained by the low interest rate environment and weak macroeconomic conditions experienced by several euro area countries. Indeed, the median return on equity (ROE) for the total insurance business, including both the life and non-life sectors, declined from 10.8% in the second half of 2013 to 9.2% at the end of 2014 (Chart 3.11).

On the liability side, the insurance industry tried to shift towards products characterised by a more flexible yield structure. On the asset side, the industry engaged in reallocation of investments with a view to optimising the capital allocation under the forthcoming Solvency II regime (see Chart 3.7).

Growth in the life sector in 2014 remained subdued. Indeed, the life business recorded a median annual growth of life premiums of about 2.7% in mid-2014 and 2.2% at the end of 2014 (Chart 3.12).37 The development of the life sector exhibited a certain degree of heterogeneity across euro area countries, reflecting diverse social and economic

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37 According to Insurance Europe, total gross written premiums subscribed in Europe in 2013 were about €1,117 billion and life premiums accounted for about 60% of all premiums written in Europe. In the life sector, the three largest markets in the euro area were France, Germany and Italy.
conditions. However, at the end of 2014, there was a reduction in the degree of heterogeneity.

In many euro area countries, sales of products with guaranteed returns still represent the major source of income for life insurance firms. The sale of products with a more pronounced financial content, in particular unit-linked products, did not experience a uniform trend across the euro area (see Chart 3.10). While in some countries these products underwent sustained growth, resulting in a gradual replacement of more traditional products, in other euro area countries their growth remained much more limited.

The return on assets (ROA) of the life industry remained stable at relatively low levels in 2014. The median ROA for the large life-insurers in the sample has been hovering below 0.5% in recent semesters.

Most insurers in the sample exhibited low growth in non-life premiums in the second half of 2014 (Chart 3.13). On average, premiums in 2014 were generally stable (albeit at low levels) with growth at around 0%. The steadiness of this development can be explained by the mandatory nature of most non-life insurance policies.

At the same time, claims related to the non-life insurance business remained stable in 2014 owing to the moderate motor vehicle accident rate and the absence of “extreme” claims in connection with natural disasters.

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38 According to Insurance Europe, non-life premiums accounted for about 40% of all premiums written in Europe at the end of 2013. In the non-life sector, the three largest markets in the euro area were Germany, France and the Netherlands.
The non-life business is characterised on the investment side by a shorter duration than the life business. It also benefits from a faster “adaptation” mechanism to the current low interest rate environment. However, non-life insurance companies can also be exposed to the low interest rate environment as well as stock market and real estate developments.

**Chart 3.14** shows the development of the “combined ratio”. The median value in 2014 was about 95%. Overall, the combined ratio was stable in 2013 and 2014, but it has improved compared with the 99% recorded in 2010.

The solvency ratio for the life sector (**Chart 3.15**) marginally decreased in 2014, due to the increasing weight of existing commitments to policyholders. The median European company has a solvency ratio of around 200% which is well in line with the current Solvency I requirements.

**Chart 3.16** shows the development of the solvency ratio of the non-life sector. Unlike the life business, the solvency ratio of the non-life sector (**Chart 3.16**) increased at the end of 2014, exhibiting a median value of above 300%, which is the highest value recorded since 2009.

However, the EIOPA 2014 stress test found that 14% of the core stress participants (representing 3% of total assets in the sample) would not have met the Solvency II capital requirement ratio under the baseline scenario at the end of 2013. This demonstrates the weakness of the solvency ratios of some insurers according to market-based valuations.
4 Other euro area non-bank financial entities

This Chapter reviews the structural features of the euro area non-bank financial sector often also labelled the “shadow banking sector”. It examines both the broad measure of shadow banking (including all financial intermediaries except banks and ICPFs) and a more narrowly defined measure (investment funds, money market funds (MMFs) and financial vehicle corporations (FVCs) only). Structural features of key shadow banking sub-sectors for which balance sheet data are available are outlined in more detail, namely for non-money market investment funds (non-MMFs), MMFs, and FVCs.

The shadow banking sector has continued to grow over the past year, driven primarily by non-MMF investment funds, which expanded owing to net inflows and rising valuations. The weakening of the euro vis-à-vis other currencies contributed to this, as the share of assets invested outside the euro area amounts to 40%. Euro area MMFs expanded as well, following a protracted period of decline, with net flows into these funds having stabilised since mid-2014. By contrast, euro area FVCs have continued to decline over the past year owing to continued weak loan origination and securitisation activity by euro area credit institutions. Available data for the FVCs also suggest a notable decline in the relative share of liquid assets, while the issuance of short-term liabilities has remained constant over the past year.

4.1 Development of shadow banking aggregates

Over the past few years, growth in total euro area financial assets has been driven primarily by non-bank financial entities, while total banking assets have rebounded to levels last observed in 2008. Of the approximately €60 trillion of total financial system assets in the euro area, more than €23 trillion are now held by shadow banking entities. Using the broad definition of shadow banking of the Financial Stability Board (FSB), shadow banking entities have increased their share of the total assets of the financial sector from 33% to 38% since 2009, while – in parallel – credit institutions have seen their share shrink from 55% to 48%. Over the last year, the share of the shadow banking sector grew by 3 percentage points.

The broad shadow banking measure comprises MMFs, non-MMFs and FVCs (see Chart 4.1). In 2015 non-MMFs account for more than 40% of total shadow banking
assets. Smaller shares of total assets are held by FVCs (8%) and MMFs (4%). For more than 50% of the sector’s total assets, a breakdown is not available.\footnote{Following the recent reclassification under the ESA 2010, some limited information on the size, asset composition and geographical distribution of this “residual” has become available. Two-thirds of these residual assets are held in the Netherlands and Luxembourg. In the Netherlands, De Nederlandsche Bank estimates that special financial institutions (SFIs) account for two-thirds of the broad Dutch shadow banking sector. In the case of Luxembourg, the residual includes a significant proportion of holding companies and other entities not engaged in shadow banking activities that have very limited financial links to the banking sector.}

While FVCs and MMFs have struggled to cope with the collapse in demand for securitised products and the low interest rate environment respectively, the non-MMF investment fund industry has witnessed a rapid expansion amid an intense search for yield among global investors since the global financial crisis.

The shadow banking sector is an increasingly important provider of funding to the euro area economy. According to the narrow shadow banking measure (i.e. excluding other OFIs for which no breakdown is available), in 2015 these entities are providing €3.2 trillion of funds to the euro area non-financial sector in the form of loans, debt securities and equity financing (see Chart 4.2).

In addition, €3.5 billion are being provided to the euro area financial sector in the form of loans, debt securities and equity financing and approximately one third (€5 trillion) of assets are invested in non-euro area countries. The largest share of assets by the narrow aggregate are held by investment funds (about 79%), followed by FVCs (13%) and MMFs (8%).
Shadow banking entities also have an important and growing role in non-bank credit intermediation. Credit provision by the (narrowly measured) shadow banking sector to the euro area non-financial sector has increased by 6% over the past year to reach €2.3 trillion in the first quarter of 2015 (see Chart 4.3). €1.3 trillion of this credit is provided to non-financial corporates and households. The fall in securitisation activity has resulted in a decline in loan provision via FVCs since 2011. However, this dip in lending has been more than offset by the increase in debt securities held by the investment funds, which have become an important source of credit for non-financial corporates and governments, holding 27% and 12% of their outstanding debt securities respectively.

Euro area non-bank financial entities are also important providers of bank funding. The narrowly defined shadow banking sector currently holds around 10% of bank debt securities. Conversely, direct exposures of euro area banks to euro area non-bank financial entities amount to 8% of the aggregate balance sheet of MFIs. In addition to direct funding, banks can provide liquidity backstops, indemnification or credit lines to non-banks in times of stress. Further links between banks and shadow banking entities exist in the form of mutual contractual obligations in derivatives markets and securities financing transactions.

Box 1
Defining the shadow banking perimeter

Section 4.1 looks at non-bank financial intermediation in the broad shadow banking aggregate used by the FSB for monitoring purposes (MUNFI). The broad measure calculated for the euro area comprises MMFs, non-MMFs, FVCs and remaining other financial institutions (OFI). For the latter, the entity types cannot be identified on the basis of national accounts data. This broad measure is complemented by a narrow measure, which excludes remaining OFIs. The aggregation thus follows a pragmatic approach by taking important data limitations into account. However, the narrow measure in particular should not be understood as the more relevant aggregate for assessing systemic risk.

The ongoing academic and regulatory debate reveals some challenges in defining a uniform perimeter for shadow banking in light of its complexity and changing nature. Some emphasise the role of shadow banking entities in non-bank credit intermediation, others are concerned more generally with non-traditional activities such as securitisation or securities lending. Most think of

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shadow banking as entities or activities that exploit regulatory “boundaries” (Goodhart, 2008). The FSB takes a functional approach by defining shadow banking as “credit intermediation that involves entities and activities fully or partially outside the regular banking system”, which covers all non-bank and non-insurance entities. A narrower definition focuses more specifically on “entities that raise i) systemic risks […] and/or ii) regulatory arbitrage concerns”. Maturity and liquidity transformation, and leverage outside the regular banking system are seen as critical functions, especially when they involve close ties to the regular banking system.

The literature furthermore points to the role of banks and non-banks in creating money-like claims outside the traditional depository system (e.g. Adrian and Ashcraft, 2012). Mehrling, Pozsar, Sweeney and Neilson (2014) suggest having secured money-market funding at the core of the shadow banking definition. This view also stresses the importance of collateral markets, such as repo and derivative margins, in creating money-like claims (Pozsar, 2014; Claessens, Pozsar, Ratnovski and Singh, 2012), whereby the role of bankruptcy privileges is noted as a key feature of the secured funding model (Perotti, 2014). Others propose considering private and public backstops outside traditional banking, where the financial activities enjoying such backstops should be viewed as shadow banking (Claessens and Ratnovski, 2014).

A holistic approach to defining the perimeter of shadow banking would need to identify bank-like intermediation activities in addition to entities that perform bank-like functions outside the regulatory perimeter of banks. The activities covered under such an approach would encompass securitisation activities, but also securities financing transactions (SFTs) or economically equivalent functions e.g. through derivatives markets. There would be, however, no reliable estimates regarding the size of the shadow banking sector if such an approach were used.

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43 Shadow Banking: Scoping the Issues, Financial Stability Board, 12 April 2011, p. 3
4.2 Asset and liability structure of other non-bank financial entities

4.2.1 The investment fund sector

Assets managed by investment funds other than MMFs have expanded rapidly over the past few years. Since the end of 2009, total assets have almost doubled from €5.4 trillion to €10.5 trillion in the first quarter of 2015 (94%). Compared to last year, there has been 27% growth. Excluding valuation and reclassification effects, i.e. measured by the index of notional stock, the sector has grown by 30% since 2009. The net inflow of funds has accounted for around two thirds of this growth, with net inflows amounting to €2.1 trillion between the end of 2009 and the first quarter of 2015 and €0.5 trillion during the last year alone.

The expansion of the sector has been broad-based and all types of funds have contributed to growth. Since 2009, net inflows for bond funds and mixed funds amounted to €1.5 trillion overall, for equity funds €250 billion, for real estate funds €95 billion, and for hedge funds €33 billion. Last year was no notable exception from this diverse pattern.

The more recent acceleration in growth of total assets since the beginning of 2014 has been caused predominantly by valuation effects. Between the first quarter of 2014 and the first quarter of 2015, the average annual growth in total assets was close to 20%, partly due to a depreciation of the euro vis-à-vis other major currencies in that period. Excluding valuation effects, the sector has expanded at a relatively constant rate between 5% and 7% over the past year (see Chart 4.4).

Chart 4.4
Euro area investment funds – quarterly net flows and annual growth rates

(Q4 2009 – Q1 2015; EUR billions (left-hand scale); % annual change (right-hand scale))

Sources: ECB and ECB calculations.

Chart 4.5
Euro area investment funds – assets by location and fund type

(Q4 2009 (top row); Q1 2015 (bottom row); percentage of total assets)

Sources: ECB and ECB calculations.
Notes: The columns refer to fund assets by location and type. The first and second rows represent the situation in 2009 and 2015, respectively.
Concentration is high in the fund sector, with more than 90% of assets under management domiciled in Luxembourg, Germany, Ireland, France and the Netherlands (see Chart 4.5). The geographic concentration has further increased in 2014, with a more pronounced expansion in Ireland and Luxembourg. Funds in these two countries tend to hold a higher share of assets outside the euro area, which has contributed to the increase in holdings of non-euro area assets by the euro area fund sector.

As of the first quarter of 2015, investment funds domiciled in the euro area are providing €1.3 trillion in credit to euro area financials, €1 trillion to euro area governments, and €325 billion to other euro area non-financials (see Chart 4.6). They have also invested €2.4 trillion in euro area equities and €250 billion in euro area non-financial assets, including real estate. In addition, the investment funds hold €4.3 trillion of non-euro area assets,50 which is about 40% of total fund assets. This share has increased over the past year (from 38% in March 2014).

In recent years, euro area investment funds have kept their exposures to euro area MFIs broadly stable, but have increased their exposures to the non-financial sector. This mirrors the general expansion of market-based funding of the non-financial corporate sector, relative to bank-based funding. As a result, claims on the non-financial sector now account for a quarter of all investment fund assets in the euro area, compared to a fifth at the end of 2008. At the same time, the share of claims on MFIs has fallen from over 30% of total claims in the euro area at the end of 2008 to less than 25% in 2015.

### Chart 4.6
Euro area investment funds – assets by type

![Chart 4.6](chart.png)

Sources: ECB and ECB calculations.
Notes: Credit includes loans and debt securities; non-financial assets include real estate and other non-financial assets.

4.2.2 Money market funds

The euro area money market fund (MMF) sector expanded again last year following a protracted period of decline, which started in March 2009. The MMF sector added nearly €120 billion in total assets between the first quarter of 2014 and the first quarter of 2015, of which €34 billion were net inflows and the rest mainly due to valuation effects.51 Total assets measured in euro amount to more than €1 trillion in the first quarter of 2015.

Recent growth was driven predominately by MMFs domiciled in Ireland and Luxembourg, although the pace of growth declined in the first quarter of 2015 (see

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50 These include €1.9 trillion of debt securities, nearly €2.3 trillion of equities, €120 billion of deposits and loans, and €20 billion of non-financial assets.

51 More than 50% of MMF assets are invested in non-euro area assets because funds also operate in foreign currency; USD and GBP in particular.
During the first quarter of 2015, French MMFs also started to have positive net inflows, although annual growth remained negative.

The geographical concentration of the euro area MMF sector is high, with Ireland accounting for 43%, France for 30% and Luxembourg for 24% of total assets held by euro area MMFs in 2015. Other parts of the euro area account for less than 3%.

Many MMFs domiciled in the euro area operate in foreign currency markets; USD and GBP in particular. US MMFs have been a key source of US dollar funding for euro area banks, while Irish funds denominated in GBP have strong links to UK banks. 23% and 26% of MMFs total assets are denominated in GBP and USD, respectively.

Irish MMFs – and, to a lesser extent, also Luxembourgish MMFs – invest mainly in non-euro area debt securities or loans. The French funds invest predominantly in the euro area; although their share in non-euro area assets has increased over the past year from 11% to 17% in the first quarter of 2015 (see Chart 4.8). The investor base varies accordingly: while French MMFs are almost exclusively euro area investors, investors in Irish and, to a lesser extent, Luxembourgish funds are largely non-euro area residents.

There is a high degree of interdependence with the regular euro area banking sector, as more than 40% of MMF assets are either holdings of euro area MFI debt securities or loans to euro area MFIs (see Chart 4.9).
Bank debt securities remain by far the most important asset class held, accounting for three-quarters of the MMF balance sheet. In the first quarter of 2015, euro area MMFs held €327 billion of euro area bank debt (debt securities and loans) and €337 billion of non-euro area bank debt. The overall amount of bank debt remained constant compared to 2014, although the share in non-euro area bank debt increased relative to the euro area.

4.2.3 Financial vehicle corporations

Euro area financial vehicle corporations (FVCs) have continued to decline over the past year. Accumulated net flows between the first quarter of 2014 and the first quarter of 2015 amounted to minus €50 billion. Measured by total assets, FVCs have shrunk by 23% since the end of 2009, when reporting of the series started. The decline in FVC assets can be explained by a weakening of loan origination and securitisation activity by euro area credit institutions over the past few years, which in turn was largely driven by a reduced securitisation of loans to households. This trend also continued in 2014, albeit at a slower pace.

Much of the securitisation activity following the crisis has been in retained deals, i.e. deals that are not placed on the market but are used for collateral purposes – for example in central bank refinancing operations. Approximately 40% of outstanding FVC debt securities are held by euro area MFIs. This share rose after the global financial crisis, but has been gradually falling again since mid-2012 (see Chart 4.10).

With €1.8 trillion of total assets, FVCs remain an important channel for the intermediation of credit to euro area households. More than 10% of all MFI loans to euro area households are securitised through FVCs. In fact, in the Netherlands and Ireland, nearly a third of MFI loans to households are securitised through FVCs.

FVCs also have strong links with euro area banks. Loans originated by euro area credit institutions account for 51% (€930 billion) of the FVC balance sheet. Securitised loans originated by euro area non-MFIs amounted to €272 billion by the first quarter of 2015 (see Chart 4.11).

Approximately 75% of total FVC assets are longer-term (with an original maturity of more than one year) and this share has remained stable throughout the crisis. However, FVC balance sheets (€1.4 trillion) are also largely financed through the issuance of longer-term debt securities, so, on aggregate, the maturity mismatch of assets and liabilities on FVC balance sheets appears to be limited.
On the liabilities side, capital and reserves represent less than 2% of the FVC balance sheet; 8% of funding comes from loans, and the remainder from the issuance of debt securities, mostly with an original maturity in excess of one year. A large share of euro area FVCs tend to match the maturity of their assets and liabilities, but it cannot be ruled out that a growing proportion of the sector is engaging in maturity transformation. Available data point to a notable decline in the relative share of liquid assets, while the issuance of short-term liabilities has remained broadly constant over the past few years (see Chart 4.12).
### Statistical annexes

#### Table 1.1

Ratio of assets of MFIs (excl. ESCB) to GDP

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Sources: Quarterly Sector Accounts, MFI balance sheet items (BSI), Eurostat and ECB calculations.

Notes: Differences from Table 5 are primarily due to differences between locational (QSA) data and consolidated banking data. ESCB assets are subtracted using BSI data.

#### Table 1.2

Ratio of assets of other financial institutions to GDP

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### Table 1.3
Ratio of assets of pension funds to GDP (percentages)

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Sources: Quarterly Sector Accounts, Eurostat and ECB calculations.

### Table 1.4
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Ratio of assets of other financial institutions to total assets of the financial sector  
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Sources: Quarterly Sector Accounts, MFI balance sheet items (BSI) and ECB calculations.
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Sources: Quarterly Sector Accounts, MFI balance sheet items (BISI) and ECB calculations.

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Sources: ECB structural financial indicator, ECB list of financial institutions and Latvijas Banka.
Note: Figures for Latvia include credit unions starting from 2013.
## Table 4
Total assets of domestic banking groups and foreign-controlled subsidiaries and branches

**EUR billions**

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Source: ECB consolidated banking data statistics.
### Table 5
Total assets of domestic banking groups and foreign-controlled subsidiaries and branches in relation to GDP

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Source: ECB consolidated banking data statistics and ECB calculations.
Note: Differences from Table 1 are mainly due to differences between locational (QSA) data and consolidated banking data.
Table 6.1
Composition of banking sector assets by type of credit institution

(Percentages)

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<th>Domestic credit institutions</th>
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Sources: MFI balance sheet items (BSI), ECB structural financial indicators, Latvijas Banka, Eesti Pank and ECB calculations.

¹) Data for Malta are consolidated.
Table 6.2
Composition of banking sector assets by type of credit institution (cont’d)

(percentages)

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<th>Subsidiaries of credit institutions from EU countries</th>
<th>Branches of credit institutions from EU countries</th>
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Sources: MFI balance sheet items (BSI), ECB structural financial indicators, Latvijas Banka, Eesti Pank and ECB calculations.
1) Due to confidentiality reasons, data for Malta combines branches of credit institutions from EU countries and branches and subsidiaries of credit institutions from the rest of the world.
Table 6.3
Composition of banking sector assets by type of credit institution (cont’d)

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Sources: MFI balance sheet items (BSI), ECB structural financial indicators, Latvijas Banka, Eesti Pank and ECB calculations.

<sup>1</sup> Due to confidentiality reasons, data for Malta combines branches of credit institutions from EU countries and branches and subsidiaries of credit institutions from the rest of the world.
## Table 7
Population per credit institution and per local branch

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<th>Population per local branch</th>
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Sources: ECB structural financial indicators, Eurostat and ECB calculations.
### Table 8
Population per bank employee and assets per bank employee

(EUR thousands)

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Sources: ECB structural financial indicators and ECB calculations.
### Table 9
Herfindahl index for credit institutions and share of total assets of five largest credit institutions

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Source: ECB structural financial indicators and ECB calculations.

1) The Herfindahl index (HI) refers to the concentration of banking business. The HI is obtained by summing the squares of the market shares of all the credit institutions in the banking sector. The exact formula according to which data must be transmitted to the ECB is reported in the ECB Guideline on monetary financial institutions and markets statistics (recast) (ECB/2007/9). 2) Banking sector and individual figures are reported on an unconsolidated basis.
### Table 10
Total assets of other euro area insurance corporations and pension funds

**(EUR billions)**

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Source: Statistics on euro area insurance corporations and pension funds.
## Table 11
Total assets of other euro area non-bank financial entities

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Sources: ECB MFI balance sheet items (BSI), investment funds balance sheet statistics, ECB financial vehicle corporation assets and liabilities statistics, quarterly sector accounts, ECB calculations
Note: "Remaining OFIs" excludes FVCs from the OFI sector accounts series S12O.
Table 12.1  
Total assets of other euro area non-bank financial entities

(EUR billions)

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<td>Malta</td>
<td>0.2</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2.5</td>
</tr>
<tr>
<td>Austria</td>
<td>3.8</td>
</tr>
<tr>
<td>Portugal</td>
<td>0.0</td>
</tr>
<tr>
<td>Slovenia</td>
<td>1.6</td>
</tr>
<tr>
<td>Slovakia</td>
<td>1.6</td>
</tr>
<tr>
<td>Finland</td>
<td>12.3</td>
</tr>
<tr>
<td>euro area</td>
<td>1,280</td>
</tr>
</tbody>
</table>

Sources: ECB statistics on balance sheet items (BSI), investment funds balance sheet statistics, ECB calculations.
Table 12.2
Total assets of other euro area non-bank financial entities (cont’d)

(EUR billions)

<table>
<thead>
<tr>
<th>Financial vehicle corporations (FVCs)</th>
<th>Remaining OFIs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
</tr>
<tr>
<td>Belgium</td>
<td>76.5</td>
</tr>
<tr>
<td>Germany</td>
<td>-</td>
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<tr>
<td>Estonia</td>
<td>-</td>
</tr>
<tr>
<td>Ireland</td>
<td>538.2</td>
</tr>
<tr>
<td>Greece</td>
<td>-</td>
</tr>
<tr>
<td>Spain</td>
<td>487.9</td>
</tr>
<tr>
<td>France</td>
<td>151.4</td>
</tr>
<tr>
<td>Italy</td>
<td>386.5</td>
</tr>
<tr>
<td>Cyprus</td>
<td>-</td>
</tr>
<tr>
<td>Latvia</td>
<td>-</td>
</tr>
<tr>
<td>Lithuania</td>
<td>-</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>110.9</td>
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<tr>
<td>Malta</td>
<td>-</td>
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<tr>
<td>Netherlands</td>
<td>479.8</td>
</tr>
<tr>
<td>Austria</td>
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</tr>
<tr>
<td>Portugal</td>
<td>50.4</td>
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<td>Slovenia</td>
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<tr>
<td>Slovakia</td>
<td>-</td>
</tr>
<tr>
<td>Finland</td>
<td>-</td>
</tr>
</tbody>
</table>

| euro area                            | 2,369         | 2,359         | 2,298         | 2,062 | 1,918 | 1,849 |      |

Note: "Remaining OFIs" excludes FVCs from the OFI sector accounts series S12O.