



cutting through complexity

Banking Executive Survey 2012

Austria, Czech Republic, Hungary,
Poland, Romania, Slovakia

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Contents

Preface	3
Introduction	4
Summary	6
Current Situation in the Banking Sector	8
Drivers of Financial Performance in the Banking Sector	14
Handling Risk	16
Financing and General Attitude to Investment	18
Trends in Banking	20
Development Investments	21
Contacts	22

Preface

The global financial crisis has affected most areas of business for six years now. Nowhere has its impact been greater than in the banking sector. How do bankers themselves perceive this, and what do they see as the future for their firms and for the industry?

The Banking Executive Survey was first conducted among Czech and Slovak banks in 2010. This time we broadened the scope and surveyed the sector's leading banks from Austria, the Czech Republic, Hungary, Poland, Romania and Slovakia. In cooperation with the top management of more than 100 respondent banks, we mapped their current state, the situation in which they found themselves in the same period of the previous year, and the outlook for the future, including measures that need to be taken to increase financial performance.

In the present economic situation, and with the high regulatory pressure approaching, banks are generally not very optimistic in their assessment of the current and future state of their industry. The fact that they see their own industry slightly better than the rest of the economy can be seen as either a first sign of light at the end of the tunnel or as calculated optimism. Nevertheless they are focusing mainly on further cost-cutting measures and do not have great faith in growing revenues and profits or planning substantial investments. Fortunately, not all banks bear such a gloomy outlook, and some positive trends have emerged.

This and much more detailed information is contained within this study. We hope that you find this unique insight into the views of the region's finance industry leaders beneficial and inspiring.

We would like to thank all who participated in the survey, submitted their data and helped provide a full picture of the situation in the banking sector.



Zdeněk Tůma
Head of Banking
KPMG in the Czech Republic



Introduction



The countries of Central and Eastern Europe have seen a significant economic transformation in the previous decade, with the privatisation and substantial restructuring of local banking sectors. The share of foreign ownership is now above 80 percent for all countries except Poland. Austria's banks played a major role in this transformation, which is why Austrian banks are now present in all the markets we surveyed; also for this reason, we have included Austria in the survey.

The countries in our study have much in common, although there are also some interesting differences among them:

- Poland is a large and attractive market with the volume of loans growing steadily. Total deposits, however, fell slightly year-on-year (2010/2011). The average return on equity has been stable at about 14 percent for the last couple of years. Average capital adequacy ratios have increased and remain high. The ratio of credit risk cost to banks' assets has stabilised and fortunately has not been affected by the decline in GDP growth. The banking sector's earnings rose and reached a record high in 2011, in nominal terms. The presence of PKO Bank makes the situation in the Polish banking market somewhat unique, as this is a state-owned bank which holds a market share of nearly 14 percent.
- The Hungarian banking sector has been perhaps worst affected by the crisis – many of the problems there stem from high unemployment and a large volume of loans in foreign currencies (61 percent of all loans, in particular mortgages in Swiss francs). Exchange rate risk hit hard with a negative effect on financial stability. The government passed a law allowing early repayment of mortgages in foreign currencies at administrative exchange rates and the banks had to bear the loss. The value of bank assets has been falling for three years, total loans have dropped by more than 10 percent year-on-year (2010/2011), and return on equity was negative last year (-1.7 percent). Another cause for concern among bankers is the new tax on all banking transactions (0.3 percent in case of money withdrawal and 0.2 percent for any other type of transaction). The banking sector still faces the risk of non-performing loan portfolios not being managed effectively and this risk is becoming increasingly pronounced in the corporate sector. On the other hand, as a result of capital injections by parent banks, the capital position of the domestic banking sector has strengthened.
- The Czech banking sector was highly resilient to external risks in 2011. Return on equity dropped to just below 20 percent in 2011. The volume of both loans and deposits continues to grow slightly, and the loan-to-deposit ratio remains very conservative (below 80 percent). Unlike in Hungary, the volume of foreign currency loans is minimal in the Czech Republic (15 percent). Two major risks for Czech banks are the not fully stabilised situation in other EU countries and a potential increase in credit losses should the real economy take a turn for the worse.



- Conditions for financial stability in Slovakia deteriorated in 2011, mainly due to external developments. Nevertheless, the Slovak economy proved to be relatively resilient to heightened tensions in the external environment. This was also related to factors conducive to the country's macro-financial stability (relatively low indebtedness of households, firms and the public sector, and the sound financial position of the banking sector). Slovak banks did well in 2011, generating historically the highest profits (EUR 674 million); return on equity is still below pre-crisis levels, at 14 percent. As in the Czech Republic, the loan-to-deposit ratio is low (90 percent), which enhances the stability of the local banking sector. Perhaps the only cause for concern is the special banking tax of 0.4 percent which is significantly reducing banks' profits. According to the Slovak central bank the most significant risk in the domestic environment is that the fiscal consolidation plan will not be implemented.
- The Romanian banking sector is rather stable, despite showing minor losses for two years now. Financial results of the banking sector were negative in 2010, but returned to positive territory in 2011. Risks to the banking sector were countered by credit institutions' own efforts, which translated into consolidation of solvency, provisioning and liquidity levels amid the National Bank of Romania's measures to address prudential regulation, supervision and adequate management of risks faced by the banking system. By volume, nearly two-thirds of loans are in foreign currency, and the loan-to-deposit ratio has stabilised at 111 percent. Austria's involvement is substantial, with banks under Austrian control accounting for 30 percent of the banking sector.
- The situation in the Austrian banking sector differs from the other markets in the survey in a number of ways. The market share of foreign-owned banks is minimal, at only around 5 percent. The loan-to-deposit ratio is quite high, reaching 130 percent. However, the total ratio of loans to GDP has been falling slightly, and now stands at 86 percent. Return on equity is on average 1.6 percent. For Austrian banks, foreign subsidiaries in the region remain an important source of income; despite some losses, they show a positive trend overall. The threats of abrupt deleveraging from CEE were not proven right till now but Austrian bankers are still very cautious of the CEE development. At the local level there is a pressure leading towards greater consolidation of the Austrian banking market, and the Austrian government is pushing the banking sector towards early adoption of prudent regulatory measures. The banks will have to prepare restructuring and recovery plans which aim towards greater stability and resolvability.



Summary

The assessment of the overall economic situation in the banking sectors is generally not so optimistic for the current period, but is slightly improving for next year.

Expected revenues are lower for 2012 and do not seem to improve much in 2013; the same goes for profitability, where banks obviously already exploited benefits of their cost-cutting measures.

The consolidation of the banking markets is mostly over, but still expected in some countries (Hungary, Austria, Romania).

The financial market leaders clearly indicate that the economic recovery is dependent chiefly on boosting confidence in the market, both on the part of investors as well as on the part of consumers and other companies.

There have been changes in the banks' approach to risk as most of them improved methodologies and increased management focus. Credit risk is considered the most significant of all the risks surveyed.

The ability to raise capital seems to have increased a bit overall while the ability to obtain financing decreased.

As far as future strategic plans are concerned, companies are leaning more towards cost-cutting rather than to investment aimed at long-term growth. The areas for savings were mainly in marketing spending and employee headcounts. Outsourcing and the sale of non-core activities is often in their plans. If banks do invest, then the biggest investments go into risk management, compliance with regulations, employee development and ICT solutions.

The next five years will be influenced mainly by increased regulation, new simple banking products and product optimisation.





Current Situation in the Banking Sector

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2012 was so bad that in 2013 things can only get better

– CEO, CEE banking group

The global financial crisis has had an impact on most economic sectors. The economic outlook of the participating countries can be seen in the following Eurostat GDP growth rate estimates:

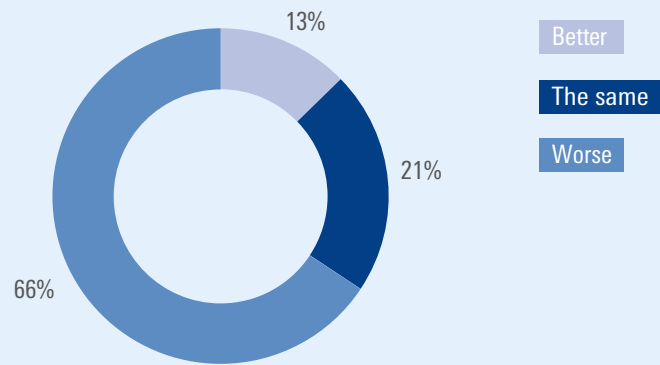
Real GDP growth rate – volume

Percentage change on previous year	2011	2012	2013
Czech Republic	1.9	-1.3	0.8
Hungary	1.6	-1.2	0.3
Austria	2.7	0.8	0.9
Poland	4.3	2.4	1.8
Romania	2.5	0.8	2.2
Slovakia	3.2	2.6	2.0

The results of our survey show that the banking sectors' situation is very much in line with the economic outlook of the respective countries. No clear trend for the future has emerged and only short-term planning is taking place; long-term prospects are very diverse.

Survey respondents rate the current condition of the banking sector rather negatively in comparison with the previous year. Approximately 66 percent of respondents rate the economic situation as worse than last year's. Only 13 percent of respondents reported an improvement in the situation. On the other hand, expectations for the future are slightly better than the assessment of the current situation (with 29 percent rating 2013 positively).

Current business conditions in the banking sector compared to a year ago



Czech banking executives gave the most positive ratings to the current business conditions in the banking sector.

The Czech banking sector has remained profitable even through the crisis and has sufficient capital to cover potential losses. The banking sector in the Czech Republic is one of the most stable in Central Europe, which is why current business conditions are rated most positively by the Czech bankers: 56 percent perceive the situation as the same or better.

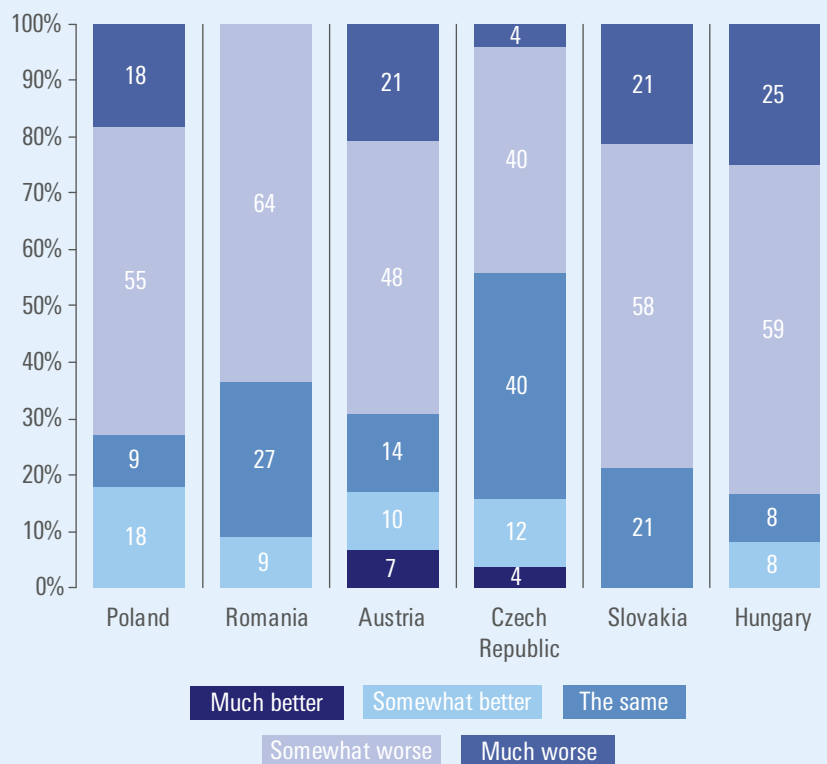
Polish bankers also report an improvement – 18 percent consider the situation better compared to one year ago.

Even though Austria's fiscal position faces considerable external risks, such as Austrian banks' continued high exposure to Central and Eastern Europe, and political and economic uncertainty, we can see almost the same positive assessment, with 17 percent of respondents rating current business conditions as better.

On the other hand, Slovak (79 percent) and Hungarian (83 percent) banking executives describe the current situation as worse than one year ago. In the Hungarian case, the wider economic situation may be to blame – Hungarian debt was recently relegated to junk status by the major credit rating agencies as a result of long-standing doubts raised about the independence of the Hungarian National Bank following government decisions on the financial sector.



Ratings of current business conditions in the banking sector compared to one year ago



Most respondents described 2012 as worse than last year and banking executives expect 2013 to be similar.

Despite overall expectations, a positive development is predicted for the sector in Romania, Austria, the Czech Republic and Hungary; in contrast, Slovakia and Poland expect business conditions to worsen in 2013.

Respondents from Slovakia are the most sceptical about the development of the overall economic situation: 85 percent of Slovak banking executives expect 2013 to be worse. Polish banking executives are also rather sceptical, with 73 percent expecting worse to come in 2013. Romania's outlook is the most positive, with all respondents believing the situation will be the same or better.

Specific differences between countries

A comparison of expectations between Slovakia and Poland and the remaining countries shows large differences.

Slovakia faces an increase in the level of debt and strong regional imbalances (regional differences in GDP per capita range from 178 to 49 percent of the EU average), which is predominantly the reason why Slovak bankers are rather sceptical about the economic situation. Despite Poland's stable market of banking institutions and the fact that the country represents a stable, large and significant Central European economy, there is apprehension over the future development of its economic situation.

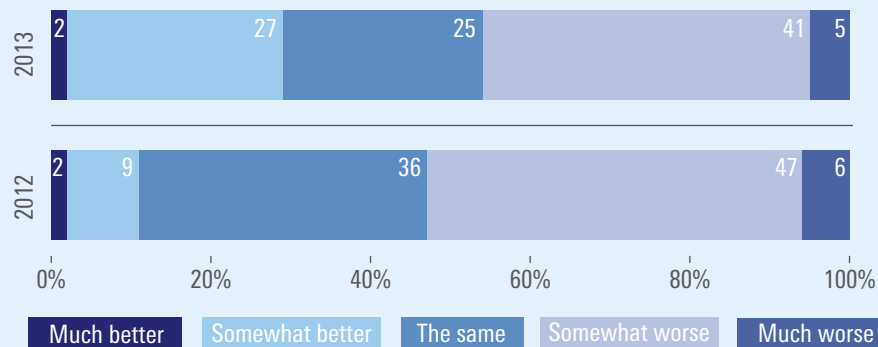
Overall, the perception of the current situation and outlook for the future depends on the specific institution and the national economy itself. Nevertheless, there is generally a clear tendency towards a negative assessment in the perception of the current situation. Regarding the future, a slightly more optimistic outlook for 2013 can be seen among respondents.

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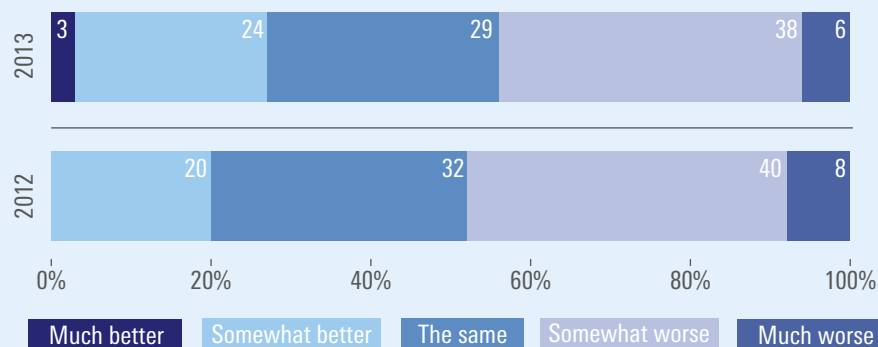
The situation in 2013 will be worse because we have not yet fully felt the deteriorating effects of the economy

– CEO, major Czech bank

Development of the economic situation in 2012 and 2013



Development of revenues in 2012 and 2013



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Flat revenues and increasing costs, together with high regulatory pressure, pose a serious threat to our profits

– CEO, major Czech bank

Only 27 percent of respondents expect better revenues next year.

We found a similar range of expectations regarding future revenues across the countries surveyed. Bankers quite often express significant uncertainty over future development which is why they are quite conservative in terms of their long-term expectations.

Forty-eight percent of respondents report lower revenues in 2012 and 44 percent of respondents predict a very similar trend in 2013.

Polish and Slovak banking executives in particular are negative in their expectations, with 82 and 71 percent, respectively, forecasting a decline in revenues.

On the other hand, Romanian and Hungarian respondents report a more positive outlook (55 and 33 percent, respectively).

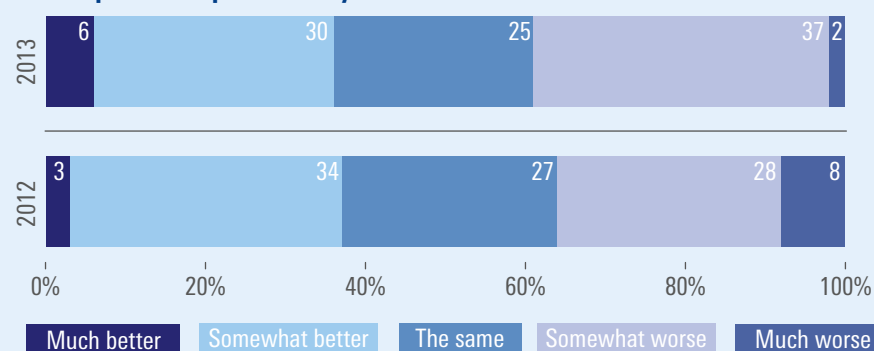
The Czech Republic and Austria show rather a similar range of results, with no clear trend in future expectations.

Banks' expectations about revenues development have changed little compared to last year, although they are inclined to have a slightly more optimistic outlook for 2013.

Thirty-nine percent of respondents expect profitability to worsen next year.

No major differences were found between profitability expectations for 2012 and 2013. The results from Austria and the Czech Republic show particularly consistent expectations. Despite consistent expectations in both countries we have to take into account that the actual results in terms of RoE (Return on Equity) are significantly different in the Czech Republic than in Austria.

Development of profitability in 2012 and 2013



“

Current interest rates
jeopardise profitability

– CEO, Austrian regional bank

Expectations for profitability are particularly low among executives in Poland and Slovakia (64 percent of Slovak banks predict a drop in profitability in 2013, which is somewhat more pessimistic than the expectation for 2012, when 57 percent predicted a drop in profitability compared to 2011). Romania has the most positive outlook, with 73 percent expecting profitability to grow (which may be attributable to the weak development in recent years).

In line with their assessment of the overall economic situation, Polish and Slovak banking executives remain the most sceptical regarding the future development of revenues and profitability. Despite this negative sentiment, the current situation in those countries remains much better compared to Romania.







Drivers of Financial Performance in the Banking Sector

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Monetary policy is stable in the long term. The situation of the real estate market still seems to be underestimated; the actual prices of real estate outside the capital are low and residential real estate is almost unsellable

– CEO, major Czech bank

Strengthening companies' and investors' confidence is the most important factor for economic efficiency.

Respondents regard strengthening companies' and investors' confidence as the most important factor driving financial performance in the banking sector.

The following factors were rated as the most important:

- Strengthening companies' and investors' confidence – 26 and 25 percent respectively
- Effective regulation – 24 percent
- Monetary policy – 17 percent

Poland, Romania and Hungary all rated effective regulations as the most significant factor, unlike Austria, which placed no emphasis on this.

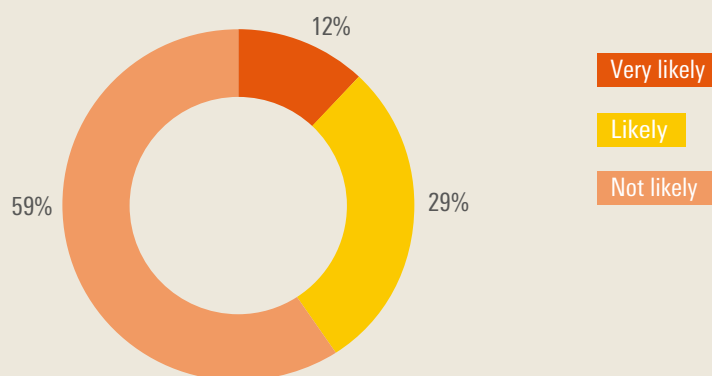
In Poland, Romania and Hungary monetary policy has emerged as a significant factor; other factors were also highlighted as important: more job opportunities in Hungary, increased customer spending in Slovakia and improved consumer confidence in Romania.

The importance of factors in respect of economic performance in banking sector





Expectations of greater consolidation of the financial market



The following factors were rated as least important:

- Government stimulus spending (except for Hungary and Romania, all countries place this factor in the last place)
- Greater availability of consumer credit
- Stabilisation of the automotive industry (this factor highly depends on country specific development)

Almost all countries regard government efforts to regulate the financial market as the least important factor.

Despite the fact that the real estate market was worst affected by the financial crisis, stabilisation of the construction industry is almost as important as real estate market stabilisation according to banking executives from the selected countries. On the other hand, stabilisation of the automotive industry was not considered important in stabilising the economic situation in the banking industry.

The development of new services, products and markets appears to be of moderate importance for the monitored countries. Banking executives commented that in the area of banking products it is very difficult to differentiate products because competitors can copy them in up to six months. Therefore, any particular competitive advantage is not sustainable for very long. However, differentiation is possible in the areas of pricing and services.

The development of new services, products and markets is considered most important in Slovakia and Poland, with 29 and 18 percent of respondents, respectively, rating this as the most important factor.

“

Further consolidation in the CEE banking markets is not very likely

– CEO, major CEE banking group

Most respondents do not expect further consolidation of the financial market.

More than half of the banking executives who took part in the survey confirmed that they do not expect further consolidation of the financial market. In fact, this factor actually depends on the current level of fragmentation/consolidation in each market, rather than at the regional level. In the Czech Republic, consolidation is not expected by 92 percent of respondents. Poland and Slovakia also regard consolidation as unlikely. Nevertheless, respondents in Austria (63 percent), Romania (64 percent) and Hungary (58 percent) expect to see further consolidation.



Handling Risk

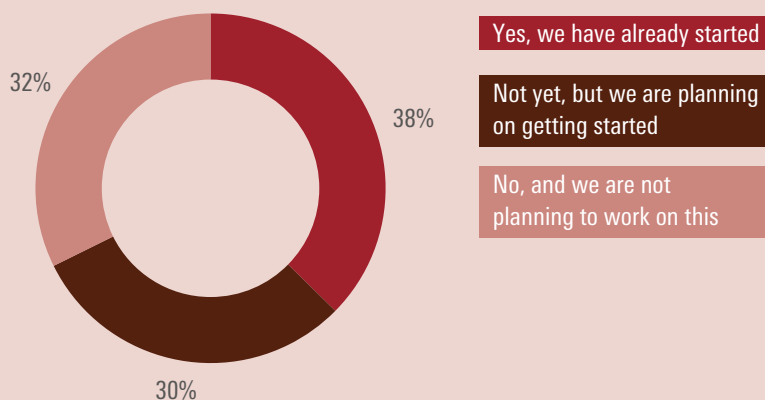
The vast majority of banks – 94 percent – have made specific changes in their approach to risk management (only 6 percent reported no changes). Most banks have already improved methodologies and increased management’s focus on risk management. Roughly half of respondents also expanded the resources they put into risk management.

In all the countries in our analysis, credit risk is considered the most significant of all the risks surveyed. In response to the economic crisis, banks have rediscovered the importance of certain risk factors – factors which were somewhat underestimated before the crisis (e.g. liquidity risk, which now ranked 3.02 on a scale of 1-10, where 1 is the most important). Regulatory risk is viewed as very important in almost all countries surveyed, and particularly in Slovakia and Hungary; on the other hand, Romania sees it as least important.

The mutual distrust among banks has not dissipated, and interbank money market remains constrained, primarily limited to short-term lending. Most European banks rely on liquidity provided by the European Central Bank.

Only one-third of banks do not plan to have a recovery and resolution plan in place. Czech banks most often responded that they do not have a recovery and resolution plan in place or under preparation. The situation in Austria is unique – all banks either already have such a plan or they will be obliged to prepare it in the near future. Banks with a strong influence on European and local markets should already be preparing such a plan.

Situation regarding RRP (Recovery and Resolution Plan)





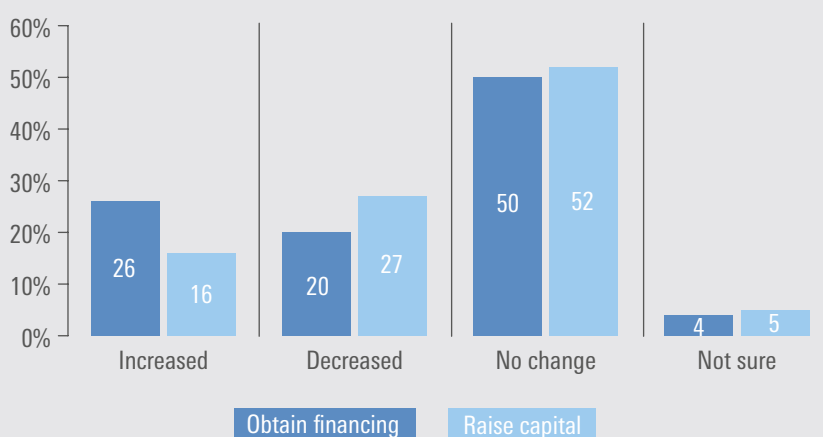
Financing and General Attitude to Investment

Half of respondents report that their ability to obtain financing has remained unchanged. Increased ability to obtain financing was seen mainly in the Czech Republic and Slovakia; access to finance decreased in Hungary, where no respondents reported an improvement. The ability to raise capital decreased for 27 percent of banks (almost half of Austrian and Romanian banks contribute to this number); more than half of banks reported no change. An increase was seen only in the Czech Republic and Slovakia.

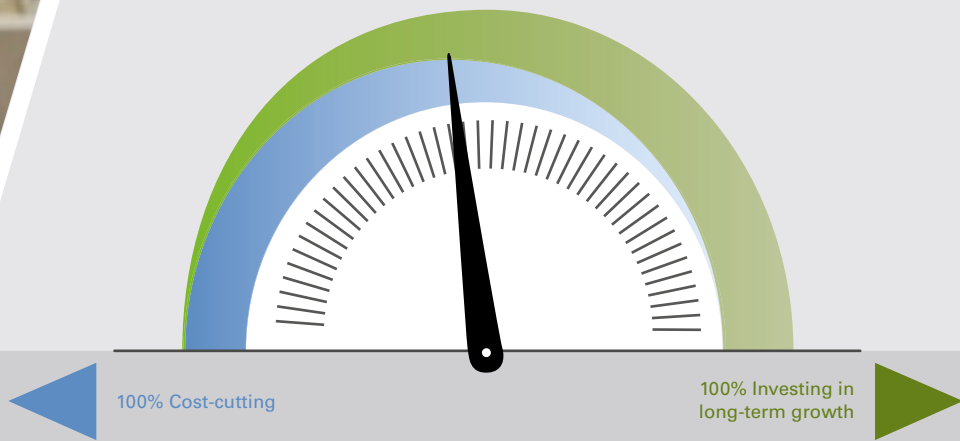
Concerning their strategic focus for the future, banks seem to favour cost-cutting over investing into long-term growth. This trend, however, varies by country – Czech banks are more focused on investing (a trend that was also identified in our previous survey), while Hungarian and Polish banks are mostly focused on cost-cutting. Austrian and Slovak banks are also slightly more focused on cost-cutting than investing. It is obvious from the results that banks are divided into those that opt for cost reductions and those that are relatively stable in this regard.

Most banks have already placed restrictions on marketing spending, reduced the number of employees and created or modified their risk management plan. Measures currently being taken by a majority of banks include steps to increase the efficiency of internal operations and IT solutions to reduce operating expenses. Banks also plan to implement or increase the use of outsourcing and get rid of unprofitable or less key business activities. Government support is widely considered irrelevant (except in Austria), as is debt restructuring.

Ability to obtain financing and/or raise capital



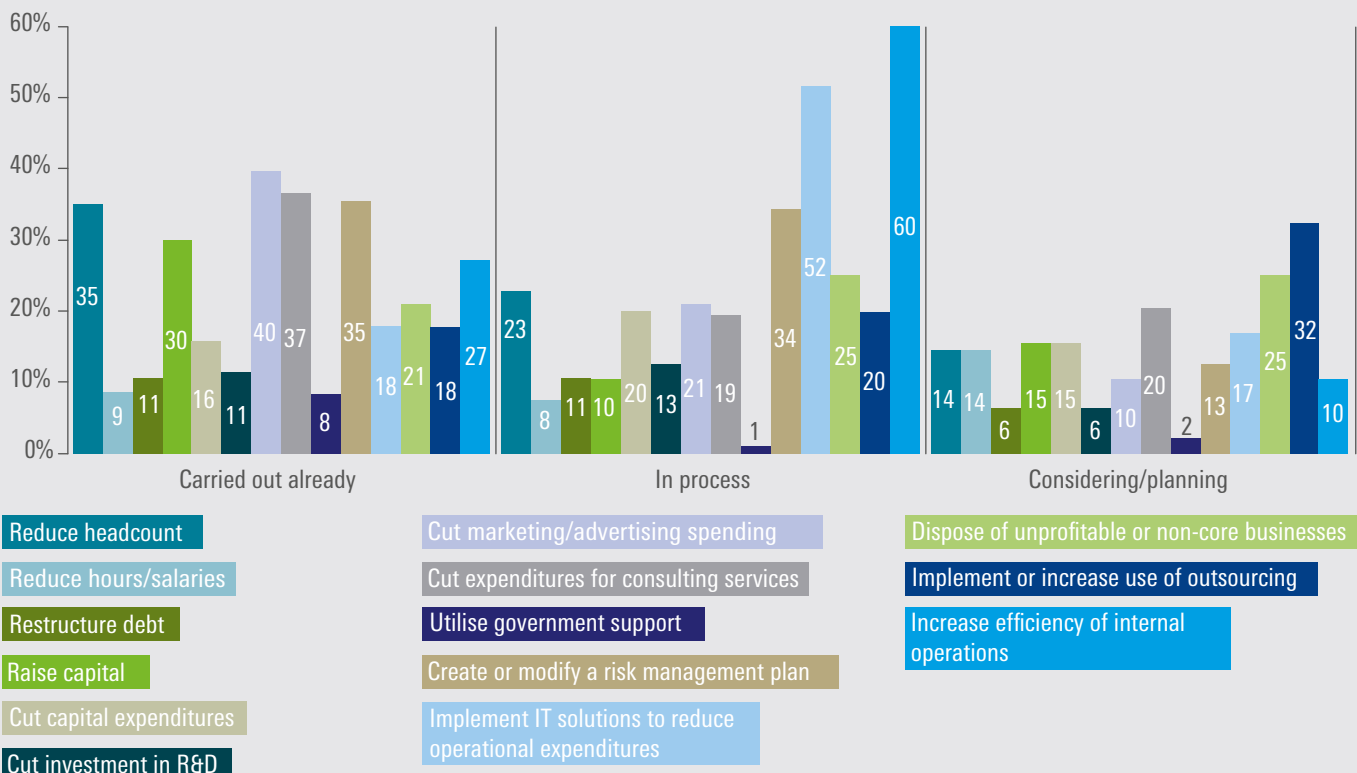
Strategic focus of companies in terms of costs



- Forty-five percent of Polish banks have raised capital; 30 percent of Czech banks have done the same.
- Most banks in Romania are making an effort to increase the efficiency of internal operations.
- Eighty-two percent of banks in Romania have either reduced their number of employees already or are planning to do so; similar measures have been taken by many Austrian and Hungarian banks.
- The question of government support is most relevant for Austria.
- Some banks also plan to start insourcing activities previously outsourced.

Respondents regard the vast majority of their own measures as successful.

What measures has your company already taken, and what is it considering or planning in order to increase the economic performance?



Trends in Banking

Uncertainty regarding social media is reflected in the following comments from Czech CEOs:

“

Yes, our PR people argue it is important, but I am not sure why

“

Social media may be relevant in five years, but currently it is not affecting business models

Regulation is widely expected to have a significant impact on the banking sector over the coming years. Two-thirds of bankers (66 percent of respondents) rated this among the most important factors. Other factors with a significant, though less severe impact on the future of the banking sector in the region are: service customisation, locally-oriented banking, creation of simple banking products and the effect of an ageing population. The areas of franchising and co-branding are perceived as least relevant.

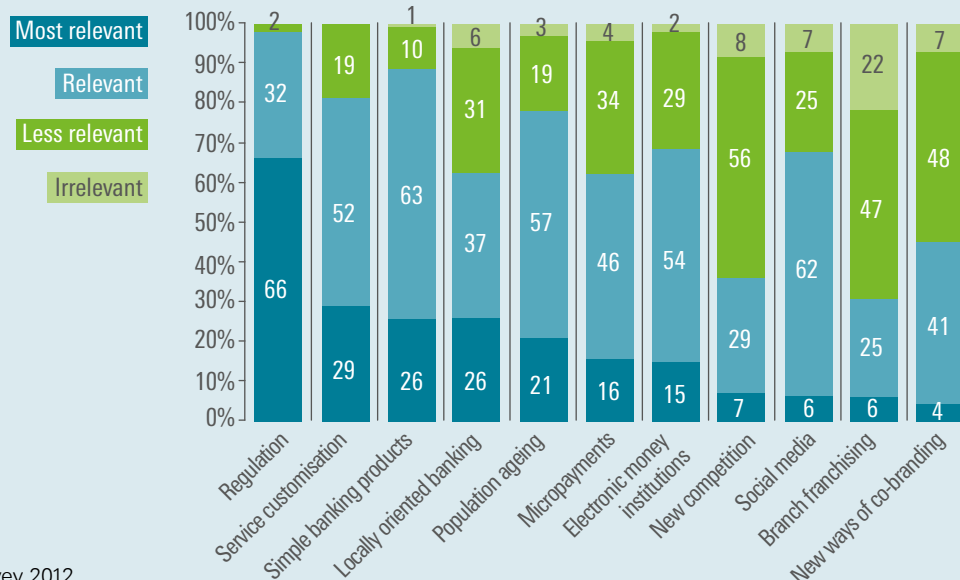
Banks also do not fear new competitors; this is considered the fourth least important factor.

Here are some specifics that emerged at the level of individual countries:

- Poland and the Czech Republic see a higher importance for micropayments than others. Poland specifically expects a rapid growth in the acceptance of contactless cards, which are used mainly for low value payments. Based on a MasterCard study*, 3 million transactions per month are already done via contactless MasterCard cards in Poland and 15 percent of merchants have already adopted the required infrastructure. The Czech Republic is catching up quickly with 15,000 acceptance points expected to become available in 2013.
- Romanian and Slovak banks perceive electronic money institutions as more important than the other countries.
- Austria is especially focused on the factor of population ageing. This, of course, is also a crucial factor in other countries, but more as a long-term issue.

*Source: MasterCard cleared transactions data 2010, 2011, 2012

What developments will influence the banking sector in the next five years?





Development Investments

Investments in regulatory compliance and in risk management are considered the most important investment areas for the coming year, both in terms of the size of investment and the number of banks that are investing. Employee development is also of key importance, though more concerning investment frequency rather than the amount. Other major investment areas include core banking systems and mobile technologies. Most banks are also investing in the digitisation of business processes and documents – in communication with the client, as well as customer experience management. Cloud computing is now a frequently discussed area, but only a small proportion of banks (6 percent) are investing in it.

Country specifics include the following:

- Ninety percent of Romanian banks are investing in mobile technologies and loyalty.
- Two-thirds of Austrian banks are investing in core banking systems.
- Seventy-four percent of Czech banks are investing in customer experience management, with investments in employee development being the second most common investment area. One Czech bank mentioned a specific investment area – an IT system for HR management.
- The country with the greatest number of banks investing in social media is Austria – 63 percent.
- A significant number of Polish banks (64 percent) are investing in business process and document digitisation – in communication with clients.

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