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THE EVOLUTION OF BANKING SYSTEM IN GREECE AFTER 1975

DISSERTATION THESIS
BY

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CHAPTER 1. INTRODUCTORY CHAPTER

Chapter 1

1. Introduction

The purpose of the study is the analysis of some aspects of the Greek Banking System after 1975. I am going to present the evolution of the banking system in our country. Over the past two decades, the Greek banking and financial system has undergone significant transformation. The banking and financial sectors have been liberalized considerably since 1987, primarily because of directives from the EU and are now basically free of state control. In short , for years the Greek economy and the Greek Banking System was under the close ownership, management and control of government. In the late 1990s deregulation changed the situation. With a few exceptions, Greek banks are no longer under government ownership, management and control and must compete the one against the other and against the European counterparts.

1.1The research questions to be investigated

To analyse the evolution of banking system in Greece we should make a research about the historical background of the banking system. We should understand the role of the Central Bank of Greece , the structure of the banks, the main characteristics of the Greek Banking market and the credit institutions operating in Greece. Furthermore it is important to understand the role of the bank as an intermediary and the financial services provided by the commercial banks in Greece. An other question which I have to investigate is the profitability of the banks and the uses of funds.

1.2 The aims of the dissertation

The main aim of the dissertation is to understand the evolution of the banking system. To investigate the reasons of changes and the new banking sector in Greece. In parallel to report the current regulatory challenges in European financial system which affecting the Greek banking sector. Also an other objective is to mention the global economic crisis and the influence in the Greek banking system.

1.3The basic methodology

For the accomplishment of objectives of the dissertation I made bibliography review (literature review). I studied authors outlooks and opinions who did research with the same case. The theoretical approach of the study about the evolution of banking system in Greece is based in the contemporary bibliography , articles, academic journals and internet sites ,in order to write with the best way the new banking environment and the basic changes.

1.4The action plan of the dissertation

In the chapter 2 I am going to present the literature review. I am going to report authors opinions about the commercial bank as an intermediary and the role of the central bank. Also there will be a brief historical review about the banking system in Greece.

In the chapter 3 there is a theoretical analysis of banking theory. This includes the elements that comprise banking functions and how banks are affected by changes that

occur on them. There is an extensive reference in interest rates and exchange rates, banking risks, international and domestic competition, as well as the imperative need of regulating banks.

In chapter 4 (which is the practise part)I am going to present what happen in the banking system of Greece. The recent developments in banking sector, the main characteristics, the credit institutions operating in Greece. I will present the profitability of banks , money and capital markets, the current regulatory challenges and I will conclude with the global crisis and the stability of banking system.

Finally I will end the dissertation with the conclusion and the indicative references.

CHAPTER 2 THE ROLE OF THE BANK IN GREECE

2.1.A BRIEF HISTORICAL REVIEW

To represent a historical background, the Greek banking system evolved in parallel with the modern Greek state. According to director Gika Hardouveli the country's oldest and largest commercial bank, the National Bank was established in 1841, and several banks followed in due course. In 1928, the Bank of Greece was established as the country's central bank. During the booming 1920s many new commercial banks were established, only a part of which, however, survived the economic crisis of the 1930s.

In the post-war period, the Greek banking system was assigned the pivotal role of financing the country's economic development and industrialization. According to director Karatza and the Greek Banking System, as in many other European countries, a detailed framework of financial interventionism gradually developed, through which banks were required to provide low-cost credit for industrial development. A complex system of quantitative and qualitative credit controls and banking restrictions was established, under the protective umbrella of the Breton Woods system. For the particular circumstances of a developing country in the post-war era, these interventionist institutions may have had an overall positive role to play in assisting capital accumulation and investment. However, financial interventionism in Greece continued after the collapse of Breton Woods. Over the 1970s and much of the 1980s, interventionism degenerated into high inflation and large deficits, keeping failed industries artificially alive, and channelling negative real interest-rate credit to various favoured socioeconomic groups.

As with other European countries, the liberalization of the financial system in the 1980s was deemed indispensable for the overhaul of the entire economy. The deregulation of interest rates, allowing them to rise to market levels at the end of the 1980s, and the liberalization of the capital account by the first half of the 1990s, paved the way for macroeconomic stabilization. Liberalization ended a whole period of subsidized credit,

which had led to an inefficient allocation of scarce capital as well as high inflation. It also subjected Government to the discipline of international markets, from which it now had to raise financing.

As with many other instances of structural modernization, the European Union provided a crucial external force for financial liberalization. The single market program in the second half of the 1980s offered the first impetus in the arduous process of rendering Greek banks competitive to withstand international competition. The EMU convergence program in the 1990s provided a framework of discipline that allowed conditions of monetary stability to be restored, for the first time since 1973. (KARATZAS THE GREEK BANKING SYSTEM)

- Freedom to provide cross-border financial services within the EU
- Minimum harmonization of Greek legislation to European standards
- Enhancement of prudential supervisory measures (capital requirements, large exposures, corporate governance)
- Creation of deposit guarantee scheme
- Enactment of money laundering legislation
- Enactment of extensive legislation on the operation of capital markets and financial intermediaries providing services in them
- Enactment of extensive legislation in the field of consumer protection law
- Adoption of International Accounting Standards

In this context, the financial sector has led the way in the transformation of the Greek economy and it can claim a large share of the progress achieved. Greek banks are now seen as comprising among the most dynamic part of the Greek economy.

Since the 1990s, Greek banks have taken advantage of liberalization to strengthen their portfolios and capitalization. The boom of the Greek capital market between 1997 and 1999 accelerated financial system development, further strengthening Greek banks, which expanded into a wide range of financial services.

2.2 A COMMERCIAL BANK AS AN INTERMEDIARY IN GREECE – WHAT IS AN INTERMEDIARY?

Most people do not enter financial markets directly but use intermediaries or middlemen. Commercial banks are the financial intermediary we meet most often in macroeconomics, but mutual funds, pension funds, credit unions, savings and loan associations, and to some extent insurance companies are also important financial intermediaries. According to Professor Sioki F and his lecture notes 2009(for banking system), when people deposit money in a bank, the bank uses the funds to make loans to home buyers for mortgages, to students so they can pay for their education, to business to finance inventories, and to anyone else who needs to borrow. A person who has extra money could, of course, seek out borrowers himself and bypass the intermediary. By eliminating the middleman, the saver could get a higher return. Why, then, do so many people use financial intermediaries?
Financial intermediaries provide two important advantages to savers. (SIOKIS FOTIOS LECTURE NOTES 2009).First, lending through an intermediary is usually less risky than lending directly. The major reason for reduced risk is that a financial intermediary can diversify. It makes a great many loans, and even though some of those loans will be mistakes, the losses will be largely offset by loans that are sound. In contrast, an average saver could directly make only a few loans, and any bad loans would substantially affect his wealth. It insures its depositors from substantial losses.

Another reason financial intermediaries reduce risk is that by making many loans, they learn how to better predict which of the people who want to borrow money will be able to repay. Someone who does not specialize in this lending may be a poor judge of which loans are worth making and which are not, though even a specialist will make some mistakes.

A second advantage financial intermediaries give savers is liquidity. Liquidity is the ability to convert assets into a spendable form quickly. A house is an illiquid asset; selling one can take a great deal of time. If an individual saver has lent money directly to another person, the loan can also be an illiquid asset. If the lender suddenly needs

cash, he must either persuade the borrower to repay quickly, which may not be possible, or he must find someone else who will buy the loan from him, which may be very difficult. Although the intermediary may use its funds to make illiquid loans, its size allows it to hold some funds idle as cash to provide liquidity to individual depositors. Only when a great many depositors want to withdraw deposits at the same time, which happens when there is a crisis on the institution, will the financial intermediary be unable to provide liquidity. Unless it can obtain help from the government or other institutions, it will be forced to suspend payments to depositors.

In addition to lending money to individuals and groups, there are other ways in which banks are part of financial markets. Banks borrow and lend funds among themselves in the federal-funds market. They buy and sell foreign exchange. They buy and sell government and commercial debt. And finally, one form of bank debt serves as money in modern economies, and banks create this debt as a result of their financial transactions.

According to director Siklo Pirre (2001) Economists are concerned that financial intermediaries can be a source of shocks to the economy, bumps that can disrupt the normal flow of economic life. This concern arises for at least two reasons. First, bank debt serves as money, so disruptions to banks can affect the amount of money in circulation. Second, financial intermediaries are tied together through chains of debts and assets. Because of these linkages, the failure of one financial intermediary can weaken others, increasing their chances of failure. As a result, there is the possibility that if a key financial intermediary fails, that failure can create a domino effect that could cause other financial institutions to fail, ultimately causing the financial sector to stop functioning. Serious disruption of the financial markets will disrupt the rest of the economy.

2.3 WHICH IS THE ROLE OF THE CENTRAL BANK ?

I) BANK'S HISTORY

The Bank of Greece is the central bank of the country. According to Pr. Gortso Christo and The Greek Banking System it was established in 1927, by an Annex to the Geneva Protocol of 15 September 1927, a few years after World War I and the Asia Minor Disaster. In the 80 years of its existence, the Bank has had 16 Governors, of whom three have been elected Honorary Governors, and 28 Deputy Governors.

The Bank began operations on 14 May 1928, under the first Governor Alexandros Diomidis.(www.centralbankofgreece.gr) Its 25th and 50th anniversaries (under Governors Georgios Mantzavinos and Xenophon Zolotas, respectively) were celebrated with pomp and circumstance. The 75th anniversary occurs at a time when the Bank, under Governor Nicholas C. Garganas, is a member of the European System of Central Banks.

The Bank's Head Office is located in the centre of the city of Athens, at 21 El. Venizelou Str., opposite the three historical buildings of the Academy, the University and the National Library. The building was designed by architects K. Papadakis and N. Zoumpoulidis and its foundations were laid in 1933. The official inauguration took place in 1938, under Governor Emmanouil Tsouderos, and was accompanied by the publication of an album with photographs of the new building.

II) INSTITUTIONAL FRAMEWORK

The regime that governs the operation of the Bank of Greece is laid down in its Statute. The Statute of the Bank of Greece was ratified by Law 3424/7 December 1927[1] ratifying the Legislative Decree of 10 November 1927 re: "Ratification of the agreement dated 27 October 1927, regarding waiver by the National Bank of Greece of

[1] Government Gazette A 298

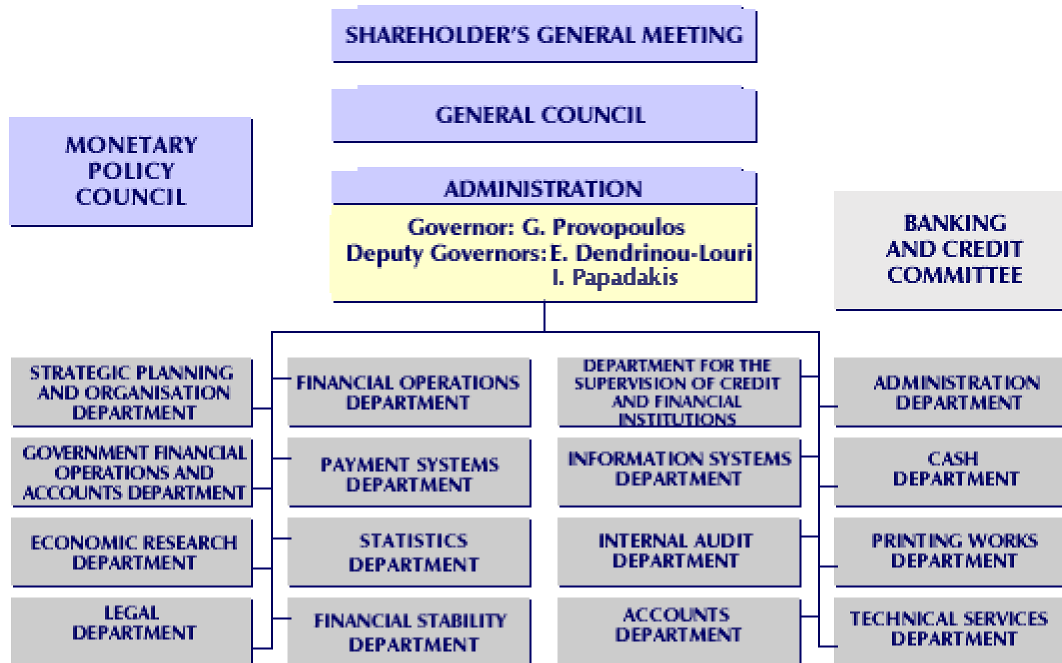
its privilege of issuing banknotes and establishment of a new bank under the name "BANK OF GREECE", and the Statute of the Bank of Greece annexed thereto".[2] Since then, the Statute of the Bank of Greece has been repeatedly amended. The most substantial amendments were approved by the decisions of the General Meeting of Shareholders of the Bank of Greece on 22.12.1997 and 25.4.2000, ratified by Laws 2609/1998 and 2832/2000 respectively. By those amendments the operational framework of the central bank was modernised and brought in line with the provisions of the Treaty on European Union and the Statute of the European System of Central Banks. More specifically the Statute, as amended:

- explicitly states that the Bank' s primary objective is price stability;
- safeguards the Bank' s independence towards the government or any organisation and its accountability to Parliament;
- recognizes the Bank' s legal integration into the European System of Central Banks

Moreover, the Statute provides that, as from the adoption of the euro as the currency of Greece, the Bank of Greece, is pursuing its primary objective and in exercising its main tasks, shall be an integral part of the European System of Central Banks (ESCB) and shall act in accordance with the guidelines and instructions of the European Central Bank (ECB).

[2] Article 1 paragraph b of the legislative decree of 10 November 1927 explicitly states that the provisions of the Statue have the force of law.

THE ORGANISATIONS' CHART



III) CENTRAL BANKS' INDEPENDENCE (CBI)

Independence indicates the absence of political interference and implies the widest possible room of manoeuvre in the conduct of the policies delegated to the central bank. (SIOKIS FOTIOS LECTURE NOTES 2009) CBI is advocated mainly in the conduct of monetary policy, leaving aside other important central bank functions, such as lender of last resort, oversight of the payment systems, management of the official foreign reserves and monopoly on note issuing.

There are arguments for independence, the economic and the political argument.

The economic argument describes the fear that government and parliament will be tempted to succumb to monetary expansions to meet their financial need, therefore neglecting the risks and detriments of inflation.

The political argument: An independent bank, operating without regards to day-to –day business of politics, can be a guarantor of continuous stabilization policy.

Politicians tend to focus on the near future and they are subject to the pressure of public opinion and special interest groups and tend to exhibit an inflationary bias when elections approach. Also, political authorities may have an interest in maintaining CBI as it allows them to blame the central bank for unpopular policies.

All these arguments (economic and political) collapse into one: today's on CBI centre on how the central bank's non-political , non-partisan positions can contribute to the credibility and long-sightedness of a monetary policy geared towards price stability.

IV) CENTRAL BANKS' ACCOUNTABILITY

Accountability requires that the central bank, at the very least , explain and justify its policies or actions and give account for the decisions made in the execution of its responsibility. (SIOKIS FOTIOS LECTURE NOTES 2009) An independent central bank needs to be accountable to another authority. This authority may be executive, legislative or judicial. An important factual dimension of accountability is the support of public opinion. A central bank needs the support of financial and non financial community for maintaining its status of accountability. Transparency in the operation of monetary policy is another form of accountability, generally supported by countries such as US and UK, which encourage strong financial market discipline and transparency. Another key form of accountability is performance which is generally measured with relation to the statutory goals to be achieved. The governing bodies of the central bank, particularly the governor, should be held accountable for failing to achieve such objectives.

CHAPTER 3 BANKING THEORY

3.1 Banking theory

The banking world is changing rapidly. The strategic priority has shifted away from growth and size alone towards a greater emphasis on profitability, performance and 'value creation' within the banking firm. But let us try to do determine the first existence of the banks.

The traditional role of banks in the economy, is to act as intermediaries between depositors and borrowers.[3]

Banks are normally distinguished from other types of financial firms in that they provide deposit and loan products. The deposit products pay out money on demand, or after some notice. Thus, banks are in business of managing liabilities, and, in the process, banks also lend money, thereby creating bank assets. Alternatively, one can argue banks are in the business of managing assets, which are funded by deposits or other liabilities.

In modern banking systems, there exists a whole range of specialist banks, which focus on niche markets, and generalist banks, which offer a wide range of banking and other financial products, as diverse as deposit accounts, loan products, real estate services, stock broking, and insurance.[4]

[3] The economics of money banking and financial Markets (Serletis , Mishkin)
[4] Modern banking in Theory and Practise (Heffernan Shelagh)

3.2 Interest Rates

Interest is a fee paid on borrowed assets. It is the price paid for the use of borrowed money or, money earned by deposited funds. Assets that are sometimes lent with interest include money, shares, consumer goods through hire purchase, major assets such as aircraft, and even entire factories in finance lease arrangements. The interest is calculated upon the value of the assets in the same manner as upon money. Interest can be thought of as "rent of money". When money is deposited in a bank, interest is typically paid to the depositor as a percentage of the amount deposited; when money is borrowed, interest is typically paid to the lender as a percentage of the amount owed. The percentage of the principal that is paid as a fee over a certain period of time (typically one month or year), is called the interest rate.[5]

Interest is compensation to the lender for the risk of not being paid back, and for forgoing other useful investments that could have been made with the loaned asset. These forgone investments are known as the opportunity cost. Instead of the lender using the assets directly, they are advanced to the borrower. The borrower then enjoys the benefit of using the assets ahead of the effort required to obtain them, while the lender enjoys the benefit of the fee paid by the borrower for the privilege. The amount lent, or the value of the assets lent, is called the principal. This principal value is held by the borrower on credit. Interest is therefore the price of credit, not the price of money as it is commonly believed to be[6]

[5] A history of interest rate (Sidney Hom, Richard Sylla)
[6] The theory of interest (Kellison Stephe G)

3.2.1.Fixed and floating rates

Commercial loans generally use simple interest, but they may not always have a single interest rate over the life of the loan. Loans for which the interest rate does not change are referred to as fixed rate loans. Loans may also have a changeable rate over the life of the loan based on some reference rate (such as LIBOR and EURIBOR), usually plus (or minus) a fixed margin. These are known as floating rate, variable rate or adjustable rate loans.

Combinations of fixed-rate and floating-rate loans are possible and frequently used. Loans may also have different interest rates applied over the life of the loan, where the changes to the interest rate are governed by specific criteria other than an underlying interest rate. An example would be a loan that uses specific periods of time to dictate specific changes in the rate, such as a rate of 5% in the first year, 6% in the second, and 7% in the third.[7]

3.2.2.Reasons for interest Rate change

Deferred consumption. When money is loaned the lender delays spending the money on consumption goods. Since according to time preference theory people prefer goods now to goods later, in a free market there will be a positive interest rate.

Inflationary expectations Most economies generally exhibit inflation, meaning a given amount of money buys fewer goods in the future than it will now. The borrower needs to compensate the lender for this.

Alternative investments The lender has a choice between using his money in different investments. If he chooses one, he forgoes the returns from all the others. Different investments effectively compete for funds.

[7] A history of interest rate (Sidney Hom, Richard Sylla)

Risks of investment There is always a risk that the borrower will go bankrupt, abscond, or otherwise default on the loan. This means that a lender generally charges a risk premium to ensure that, across his investments, he is compensated for those that fail.[8]

Liquidity preference People prefer to have their resources available in a form that can immediately be exchanged, rather than a form that takes time or money to realise.

Taxes Because some of the gains from interest may be subject to taxes, the lender may insist on a higher rate to make up for this loss.

3.2.3. Market interest rates

There is a market for investments which ultimately includes the money market, bond market, stock market and currency market as well as retail financial institutions like banks.

Exactly how these markets function is a complex question. However, economists generally agree that the interest rates yielded by any investment take into account:

- The risk-free cost of capital
- Inflationary expectations
- The level of risk in the investment
- The costs of the transaction

This rate incorporates the deferred consumption and alternative investments elements of interest.

[8] The theory of interest (Kellison Stephe G)

3.3 Exchange Rates

In finance, the **exchange rates** (also known as the **foreign-exchange rate**, **forex rate** or **FX rate**) between two currencies specifies how much one currency is worth in terms of the other. It is the value of a foreign nation's currency in terms of the home nation's currency.[9]

If a currency is free-floating, its exchange rate is allowed to vary against that of other currencies and is determined by the market forces of supply and demand. Exchange rates for such currencies are likely to change almost constantly as quoted on financial markets, mainly by banks, around the world. A movable or adjustable peg system is a system of fixed exchange rates, but with a provision for the devaluation of a currency.

The explosion in trading of financial assets (stocks and bonds) has reshaped the way analysts and traders look at currencies. Economic variables such as economic growth, inflation and productivity are no longer the only drivers of currency movements. The proportion of foreign exchange transactions stemming from cross border-trading of financial assets has dwarfed the extent of currency transactions generated from trading in goods and services.

The asset market approach views currencies as asset prices traded in an efficient financial market. Consequently, currencies are increasingly demonstrating a strong correlation with other markets, particularly equities.

Like the stock exchange, money can be made or lost on the foreign exchange market by investors and speculators buying and selling at the right times. Currencies can be traded at spot and foreign exchange options markets. The spot market represents current exchange rates, whereas options are derivatives of exchange rates.

[9]Money and banking (Luckett Dudley)

3.3.1.Fluctuations in Exchange Rates

A market based exchange rate will change whenever the values of either of the two component currencies change. A currency will tend to become more valuable whenever demand for it is greater than the available supply. It will become less valuable whenever demand is less than available supply (this does not mean people no longer want money, it just means they prefer holding their wealth in some other form, possibly another currency).

Increased demand for a currency is due to either an increased transaction demand for money, or an increased speculative demand for money. The transaction demand for money is highly correlated to the country's level of business activity, gross domestic product (GDP), and employment levels. The more people there are unemployed, the less the public as a whole will spend on goods and services. Central banks typically have little difficulty adjusting the available money supply to accommodate changes in the demand for money due to business transactions.[10]

The speculative demand for money is much harder for a central bank to accommodate but they try to do this by adjusting interest rates. An investor may choose to buy a currency if the return (that is the interest rate) is high enough. The higher a country's interest rates, the greater the demand for that currency. It has been argued that currency speculation can undermine real economic growth, in particular since large currency speculators may deliberately create downward pressure on a currency in order to force that central bank to sell their currency to keep it stable (once this happens, the speculator can buy the currency back from the bank at a lower price, close out their position, and thereby take a profit).

[10] Money ,banking & economic activity (Lloyd Thomas)

3.4 Banking Risks

3.4.1.What is RISK?

Is a danger that a certain unpredictable contingency can occur, which generates randomness in cash flow .Risks may be described using probability analysis (business cycle, company failures), while events subject to uncertainty cannot (financial crises, wars etc.)[11]

Variability alone may not entail risk as long as known for sure ex ante.

The nature of qualitative asset transformation gives rise to risks because of mismatched balance sheet.

3.4.2. Main forms of risk

-Credit risk – risk that party to contract fails to fully discharge terms of contract

-Interest rate risk – risk deriving from variation of market prices owing to interest rate change

-Market risk – more general term for risk of market price shifts

-Liquidity risk – risk asset owner unable to recover full value of asset when sold (or for borrower, credit not rolled over)

-Market liquidity risk – risk that a traded asset market may vary in liquidity of the claims traded

[11] Commercial bank risk management , an analysis of the process (Anthony Santomero)

Other risks

o operational risk

o risk of fraud

o reputation risk

Systemic risk – that the financial system may undergo contagious failure following other forms of shock/risk[12]

[12] Commercial bank risk management, an analysis of the process (Anthony Santomero)

3.5 Competition

In recent years we have witnessed a substantial convergence of research interest and the opening of a debate on the economic role of market competition in the banking industry. The need for such a debate may seem unjustified at first. The common wisdom would hold that restraining competitive forces should unequivocally produce welfare losses. Banks with monopoly power would exercise their ability to extract rents by charging higher loan interest rates to businesses and by paying a lower rate of return to depositors. Higher lending rates would distort entrepreneurial incentives toward the undertaking of excessively risky projects, thus weakening the stability of credit markets and increasing the likelihood of systemic failure. Higher lending rates would also limit firms. investment in research and development, thus slowing down the pace of technological innovation and productivity growth. Lower supply of loanable funds, associated with higher lending rates, should also be reflected in a slower process of capital accumulation and, therefore, in a lack of convergence to the highest levels of income per capita.[13]

These are some of the conventional effects that market power in the banking industry is commonly thought to generate. However, in more recent years, researchers have begun analyzing additional issues in the matter of bank competition, highlighting potentially negative aspects and so raising doubts regarding the overall beneficial welfare impact of bank competition on the economy. The research effort devoted to this issue has picked up noticeably, a sign that the time is ripe for an open debate regarding the costs and benefits of bank competition.

[13] Banking competition , risk and regulation (Wilko Bolt & Alexander F Tieman)

3.5.1.Theoretical arguments

The most common theoretical arguments used to identify positive and negative economic effects of bank competition. In a stylized model of economic growth, Pagano (1993) showed that market power, by allowing banks to charge higher loan rates and compensate savers with lower deposit rates, does indeed reduce the equilibrium quantities of funds available for credit, hence generating a direct negative effect on the rate at which the economy can grow. Guzman (2000) confirms this negative effect of market power in a general equilibrium model of capital accumulation. He compares two identical economies, one with a monopolistic bank and the other with a competitive banking sector, and shows that the monopolistic bank produces an unequivocally depressing effect on capital accumulation for two possible reasons. If the conditions exist for credit rationing, quantities are rationed more with a monopolistic bank than within a competitive setting. Without credit rationing, monopoly power in banking is still inefficient because it leads to excessive monitoring. As Guzman argues, this is due to the fact that with monopoly power loan rates are higher, and with higher rates the likelihood of default also increases (moral hazard). Consequently, the monopolistic bank has to sustain a higher cost to monitor entrepreneurs, thus diverting resources that could otherwise be available for lending. In perhaps the most widely cited article about this issue, Petersen and Rajan (1995) focus on the role banks play in financing new businesses. In a stylized theoretical model, the authors show that young firms with no record of past performance may actually receive more credit, and at better rates, if they are in a market where banks have monopoly power. The intuition is the following. Lenders facing a pool of risky (because yet unknown) borrowers should incorporate an appropriate premium in their lending rates to cover a likelihood of default potentially higher than that among already established entrepreneurs. Consequently, lending rates for this category of borrowers should be high and credit partially rationed. However, in such a scenario, a bank with market power has an alternative lending strategy. It can charge introductory lower rates, attract more and possibly on average better young entrepreneurs, and establish a lending relationship

with them, with the prospect of extracting rent (charging higher rates) in the future from those who are eventually successful. This strategy of initial .subsidization and subsequent participation in successful firms. profits is feasible if the bank has market power. The bank relies on the fact that the successful firms will not be bid away by competitor banks in the future. On the other hand, in a competitive market, a bank sustaining the initial cost of offering credit at a lower rate could not count on its ability to retain the successful customers.[14]

[14] Banking competition, risk & regulation (Wilko Bolt ,Alexander F Tieman)

3.6 Regulation

3.6.1.Regulatory restrictions

An additional route of exploration should focus on the impact of regulatory restrictions on banks activities.

For example, in some countries banks have historically been authorized to own and control nonfinancial firms and nonfinancial companies have been able to hold equity positions in commercial banks. In addition, banks have been able to operate in other markets through insurance underwriting and selling or through the underwriting and brokering of securities. The economic role of banking market power may be affected by the regulatory environment in which banks operate. For example, the mechanism proposed by Petersen and Rajan (1995) through which market power is needed for banks to establish lending relationships assumes that banks fund firms with traditional debt rather than equity finance. If a bank were authorized to finance via equity, the bank would participate in future profit sharing regardless of whether the firm maintains a lending relationship. Therefore, it is possible that competitive banks allowed to provide equity finance would have the incentive to establish lending relationships. In such a world, the positive effect of bank concentration for firm growth identified in the empirical analysis described earlier may be less important.[15]

Moreover, in an environment where banks are authorized to operate in multiple markets (such as securities, real estate, and insurance), one could argue that, facing cross-market competitive pressures, banks in concentrated markets may be less able to extract rents. Therefore, in economies where banks are less restricted in their activities, the negative effects of bank market power may be of lower magnitude.

[15] Bank regulation and supervision, what works best? (J. Barth, G. Caprio & R. Levine)

3.6.2.Objectives of bank regulation

The objectives of bank regulation, and the emphasis, varies between jurisdiction. The most common objectives are:

1. Prudential -- to reduce the level of risk bank creditors are exposed to (i.e. to protect depositors)
2. Systemic risk reduction -- to reduce the risk of disruption resulting from adverse trading conditions for banks causing multiple or major bank failures
3. Avoid misuse of banks -- to reduce the risk of banks being used for criminal purposes, e.g. laundering the proceeds of crime
4. To protect banking confidentiality
5. Credit allocation -- to direct credit to favored sectors[16]

3.6.3. General principles of bank regulation

Banking regulations can vary widely across nations and jurisdictions. This section describes general principles of bank regulation throughout the world.[17]

-Minimum requirements

Requirements are imposed on banks in order to promote the objectives of the regulator. The most important minimum requirement in banking regulation is maintaining minimum capital ratios.

-Supervisory review

Banks are required to be issued with a bank license by the regulator in order to carry on business as a bank, and the regulator supervises licensed banks for compliance with

[16] Regulation in banking (Matutes Carmen Vives Xavier)
[17] Lecture notes in banking system 2009 (Siokis F)

the requirements and responds to breaches of the requirements through obtaining undertakings, giving directions, imposing penalties or revoking the bank's license.

- Market discipline

The regulator requires banks to publicly disclose financial and other information, and depositors and other creditors are able to use this information to assess the level of risk and to make investment decisions. As a result of this, the bank is subject to market discipline and the regulator can also use market pricing information as an indicator of the bank's financial health

3.6.4.Instruments and requirements of bank regulation

-Capital requirement

The capital requirement sets a framework on how banks must handle their capital in relation to their assets. Internationally, the Bank for International Settlements' Basel Committee on Banking Supervision influences each country's capital requirements. In 1988, the Committee decided to introduce a capital measurement system commonly referred to as the Basel Capital Accords. The latest capital adequacy framework is commonly known as Basel II. This updated framework is intended to be more risk sensitive than the original one, but is also a lot more complex.

-Reserve requirement

The reserve requirement sets the minimum reserves each bank must hold to demand deposits and banknotes. This type of regulation has lost the role it once had, as the emphasis has moved toward capital adequacy, and in many countries there is no minimum reserve ratio. The purpose of minimum reserve ratios is liquidity rather than safety. An example of a country with a contemporary minimum reserve ratio is Hong Kong, where banks are required to maintain 25% of their liabilities that are due on demand or within 1 month as qualifying liquefiable assets.

Reserve requirements have also been used in the past to control the stock of banknotes and/or bank deposits. Required reserves have at times been gold coin, central bank banknotes or deposits, and foreign currency.

-Corporate governance

Corporate governance requirements are intended to encourage the bank to be well managed, and is an indirect way of achieving other objectives. Requirements may include:

1. To be a body corporate (i.e. not an individual, a partnership, trust or other unincorporated entity)
2. To be incorporated locally, and/or to be incorporated under as a particular type of body corporate, rather than being incorporated in a foreign jurisdiction.
3. To have a minimum number of directors
4. To have an organizational structure that includes various offices and officers, e.g. corporate secretary, treasurer/CFO, auditor, Asset Liability Management Committee, Privacy Officer etc. Also the officers for those offices may need to be approved persons, or from an approved class of persons.
5. To have a constitution or articles of association that is approved, or contains or does not contain particular clauses, e.g. clauses that enable directors to act other than in the best interests of the company (e.g. in the interests of a parent company) may not be allowed.

-Financial reporting and disclosure requirements

Banks may be required to:

1. Prepare annual financial statements according to a financial reporting standard, have them audited, and to register or publish them
2. Prepare more frequent financial disclosures, e.g. Quarterly Disclosure Statements
3. Have directors of the bank attest to the accuracy of such financial disclosures

4. Prepare and have registered prospectuses detailing the terms of securities it issues (e.g. deposits), and the relevant facts that will enable investors to better assess the level and type of financial risks in investing in those securities.

-Credit rating requirement

Banks may be required to obtain and maintain a current credit rating from an approved credit rating agency, and to disclose it to investors and prospective investors. Also, banks may be required to maintain a minimum credit rating.

-Large exposures restrictions

Banks may be restricted from having imprudently large exposures to individual counterparties or groups of connected counterparties. This may be expressed as a proportion of the bank's assets or equity, and different limits may apply depending on the security held and/or the credit rating of the counterparty.

-Related party exposure restrictions

Banks may be restricted from incurring exposures to related parties such as the bank's parent company or directors. Typically the restrictions may include:

- Exposures to related parties must be in the normal course of business and on normal terms and conditions
- Exposures to related parties must be in the best interests of the bank
- Exposures to related parties must be not more than limited amounts or proportions of the bank's assets or equity

CHAPTER 4.(PRACTICAL PART)THE GREEK BANKING SYSTEM

4.1. A BRIEF NOTE ON RECENT DEVELOPMENTS IN THE GREEK BANKING SYSTEM.

The structural changes in the Greek banking system were initiated in the early 1980s when the role of the Bank of Greece in conducting quasi-independent monetary policy was enhanced[18]. The Report of the Karatzas Committee in 1987 set the stage for an extensive deregulation process of the market, motivated by the internationalization of competition and the establishment of the single European market for financial services. Following this report, most controls on the operation of financial markets and institutions were relaxed by the mid-1990s. The main changes included, among others, the liberalization of interest rate determination, the free movement of short and long-term capital and the abolition of various rules regarding the operation of credit institutions.

In addition, the Single European Act and the First and Second Banking Directives have further intensified cross border competition, by allowing banks from other Member States to do business in Greece. Finally, the domestic banking system faces competition not only from its European counterparts, but also from markets. The growth of national and European markets for various financial instruments (bonds, equities, derivatives, etc.) allows corporate and retail clients to choose from alternative sources of finance.[19]

The Greek banking landscape has been changing rapidly as a result of this deregulation and liberalization process. Since the mid-1990s, Greek banks have entered a phase of

[18] Law 1266/1982

[19] Institutions, political system and economic policy in Greece (P. Kapopoulos)

M&As[20] dictated by (a) government measures of privatization of previously state-owned banks, and (b) market discipline, i.e., the need for banks to achieve the necessary critical mass to reap economies of scale and scope, and to share the high information technology costs. The first step towards the restructuring of the Greek banking system took place in 1992 when Commercial Bank absorbed Investment Bank. The big explosion in consolidation activity occurred in the late 1990s and early 2000s, leading to the creation of large banks by Greek standards. Furthermore, Greek banks have been expanding in regional markets (mainly in the Balkans), and have been promoting strategic cooperation with well-known international credit institutions in order to take advantage of synergistic effects and know-how transfers, to expand distribution networks and to secure a position in major international financial centres (London, New York, etc.).

The further integration of the Greek banking sector should not be precluded, considering the ongoing restructuring of the financial sector in Europe and worldwide.

[20] Mergers and acquisitions

4.2.THE MAIN CHARACTERISTICS OF THE GREEK BANKING SYSTEM.

a)subject to monetary and foreign exchange policies conducted at the European level

b)full integration into the single European financial market

c)universal banking prototype (banks may engage in-house in both commercial banking and investment banking services- they can also provide bank assurance services)

d)segmentation of supervisory authorities
-Bank of Greece
-Capital market commission
-Private insurance supervisory committee[21]

4.3. CREDIT INSTITUTIONS OPERATING IN GREECE

a) 19 commercial banks incorporated in Greece (with a steadily increasing participation of foreign institutional investors in their capital basis)
b) Branches of 30 commercial banks incorporated in other member states of the European Union
c) Branches of 6 commercial banks from third, non-EU countries
d) 1 specialized credit institution
e) 16 cooperative banks

[21] The greek banking system (Gortsos Christos)

Number of bank branches and employees end-2008

	No. of Banks		**No. of Branches**		**No. of Employees**	
	2007	**2008**	**2007**	**2008**	**2007**	**2008**
Greek commercial banks	19	19	3431	3640	56773	57842
Foreign banks	27	30	300	327	6451	6665
Specialized credit Institutions	1	1	4	4	436	454
Cooperative banks	16	16	115	126	1060	1204
Bank of Greece			87	65	2763	2494
Total	**63**	**66**	**3937**	**4162**	**67483**	**68659**

Source: financial stability report , June 2009 Bank of Greece

Number of ATMs end 2008

	2007	2008
Greek commercial banks	6653	6906
Foreign banks	413	441
Cooperative banks	204	228
Total	7270	7575

Source: Banks

LISTED CREDIT INSTITUTIONS

- Bank of Greece S.A.
- National Bank of Greece S.A.
- Alpha Bank
- EFG Eurobank-Ergasias
- Emporiki Bank (Commercial Bank of Greece S.A.).(acquired by Credit Agricole)
- Piraeus Bank
- ATE Bank (Agricultural Bank of Greece)
- Marfin Popular Bank — formed after a merger of Marfin Bank, Egnatia Bank and Cypriot Laiki (Popular) Bank

- Bank of Cyprus
- TT Bank
- Attica Bank
- Geniki Bank (acquired by Societe Generale)
- Pro Bank
- Millennium Bank (Member of the Millennium BCP (Banco Comercial Portugues) Group, now conformed with its international trademark), formerly NovaBank
- Aspis Bank
- Citibank (Member of Citigroup)
- HSBC Bank plc
- Proton Bank
- Omega Bank (absorbed by Proton Bank)
- Ioannina Bank

SOURCE CENTRAL BANK OF GREECE

4.4. OWNERSHIP

Greek commercial banks can be classified in two groups according to their ownership status, to state controlled banks and to private commercial banks, including bank subsidiaries of foreign financial conglomerates.[22]

i) state-controlled banks

There are commercial banks controlled by the Greek state either directly or indirectly through public pension funds, municipalities and other funds:
National bank of Greece, Agricultural bank of Greece, Bank of Attica, Bank of Central Greece.

ii) private commercial banks

These are commercial banks owned by private institutional or individual investors resident in Greece and abroad. They are classified according to whether or not a foreign institutional investor resident abroad has o dominant participation in them:

-Greek private commercial banks
-Greek bank subsidiaries of international financial conglomerates.

All the private commercial banks, some of which are the largest and most innovative Greek credit institutions (e.g, Alpha bank, EFG Eurobank) operate within the same legal framework as the state owned commercial banks. The main differences between them derive from the continuity of their managements and a higher degree of flexibility in the decision taking process. In addition, those incorporated after the deregulation of financial system have a more flexible portfolio, since they could pursue and implement rational investment policies from the beginning.

[22] The Greek banking system in 2006 (Gikas Hardouvelis)

In addition to the above mentioned Greek credit institutions, several credit institutions incorporated in other EU member states or third countries have branches in the Greek banking market. Thirteen EU commercial banks are operating in Greece according to the principles of the single market program (Barclays Bank , ING Bank, HSBC, Midland Bank, Societe Generale e.t.c).[23]

All these branches are in direct competition with Greek commercial banks. They adapted to local conditions while also being innovative, contributing to the operational and technical modernisation of the Greek financial market.

[23] Financial markets and economic growth (George Hondroyiannis)

[24]4.5. FFINANCIAL SERVICES PROVIDED BY COMMERCIAL BANKING GROUPS IN GREECE.

a) Traditional commercial banking services
i) deposit
ii) granting of commercial, housing, consumer loans, credit cards, fund transfer services.

b) Other financial services
i) leasing, factoring

c) Fund management services
i) on a private basis
ii) on a collective basis

d) Insurance brokerage

e) Investment services
i) securities underwriting and related services
ii) brokerage of stocks and stock-related derivatives
iii) dealing in stocks and stock-related derivatives for own account
iv) brokerage of bonds
v) brokerage of interest rate and foreign exchange related derivatives
vi) dealing in bonds for own account
vii) dealing in interest rate and foreign exchange related derivatives
viii) financial advisory services
ix) safekeeping of securities

[24] The Greek Banking System (Gortsos Christos)

4.6. THE COST OF FINANCING

i) ASYMMETRIC INFORMATION

In economics and contract theory, asymmetric information deals with the study of decisions in transactions where one party has more or better information than the other. This creates an imbalance of power in transactions which can sometimes cause the transactions to go wrong. Two problems rise from information asymmetry:

a. **adverse selection**
b. **moral hazard**

a. Adverse selection

_It is a situation where those who are most likely to produce an adverse outcome are the most likely to be selected by the less informed party in a transaction. (problem or cost that occurs before the transaction)

b. Moral hazard

It is a hazard that the more informed borrower will engage in activities that are undesirable from the less informed lender's point of view.(problem or cost that occurs after a transaction.

ii) SOLVING ASYMMETRIC INFORMATION PROBLEMS

Banks by managing credit risk can reduce adverse selection. They can screen out bad credit risks, collecting financial information about potential borrowers before the transaction. Banks have the knowledge of particular credit markets and particular borrowers. After the transaction the lender monitors the activities of the borrower to be sure that he is not engaging in risky activities. The banks use loan commitments and collateral (especially in mortgage loans).

4.7. SOURCES AND USES OF FUNDS

Traditionally Greek commercial banks have been dominant among all depository and credit extending institutions operating in the Greek financial market. They are incorporated as limited liability companies by shares,, authorised by the Bank of Greece under a single license valid throughout the European Union and supervised by the Bank of Greece according to internationally accepted rules of prudential supervision.

I. DEPOSIT TAKING AND CREDIT EXTENSION

Primarily commercial banks link collecting savings with supplying credit through traditional commercial banking services such as the following:
- soliciting and accepting retail and wholesale deposits in Euro and other freely convertible foreign currencies. Deposit taking is effected through checking, saving and time accounts, the performance of which is enhanced by financial engineering
- repurchase agreements[25]
- short-term and long-term business loans to large corporations as well as to small and middle size enterprises
- financial services connected with corporate mergers and acquisitions as well as dept and equity placements
- consumer loans and credit cards under conditions which still are partly determined by the Bank of Greece
- shipping finance.

[25] Repos

II. OFF-BALANCE-SHEET ACTIVITIES

Commercial banks undertake considerable off-balance sheet activity including services linked to:

-import and export finance through commitments and financial contingencies

-transactions in financial derivatives, particularly forward rate agreements, interest rate swaps, currency options and foreign exchange swaps. The volume of transaction in exchange-traded financial and commodity derivatives is limited.

iii. PAYMENT SERVICES

- the real-time gross settlement system[26] for the euro, offered by the Eurosystem. It is used for the settlement of central bank operations, large-value euro interbank transfers as well as other euro payments. It provides real-time processing, settlement in central bank money and immediate finality. The current system went live on 19 November 2007. As from 19 May 2008, only the Target 2 system has been in operation.
- the ACO[27] is a multilateral net settlement paper-based cheques Clearing system , which settles in the books of the Bank of Greece
- DIAS payment systems are used mostly for low value payments, namely card payments, credit transfer payments (salaries, pensions e.t c), direct debits (telecommunications, electricity, water bills, taxis e.t.c) and cheque clearing.
- SEPA is an area in which consumers, companies and other economic actors will be able to make and receive payments in euro, whether between or within national boundaries under the same basic conditions, rights and obligations, regardless of their location. SEPA aims to create an integrated, competitive and innovative euro area retail payments market, where non-cash euro payments can be effected using as a single bank account and a single set of payment instruments. SEPA has the full support of the European Commission and the Eurosystem and is being developed on the initiative of

[26] Target 2
[27] The Athens Clearing Office

the banking sector. Banks focus on the development of SEPA payment instruments (credit transfers, direct debits, credit/debit cards) that will replace the correspondent national payment instruments. Besides banks, SEPA implementation involves clearing systems, companies, consumers, public authorities and the public administration. The Greek banking community acknowledges the need to migrate to SEPA and for this purpose it has set up the appropriate organisational structure body. The time plan consists of three phases: a) the design phase, which started in 2004 and has been completed, b) the implementation phase, which started in mid 2006 and was concluded by the end of 2007 and c) the migration phase, which started in January 2008; the goal is that a critical mass of transactions will have migrated to SEPA by the end of 2010. More specifically, banks have developed the SEPA products, which they have been offering to the public since January 2008 onwards. It should be noted that the launch of cross-border SEPA direct debits cannot be eeffected before the transposition into national laws of the Payment Services Directive which has to take place by 1 November 2009 Association. SEPA requires the use of common pan-European standards and business practices for the fully automated and efficient processing of payment instruments. Indicatively, the following standards shall be used in SEPA payments: The IBAN[28] which is used to define the bank and the account number of a beneficiary. In SEPA, the use of IBAN is a prerequisite for the automated processing of payment orders. BIC[29] is the unique identification code of a specific bank and/or bank branch, registered by the provider of electronic messaging services SWIFT.

[28] International Bank Account Number
[29] Bank Identifier Code

iv. CORE AND SUPPLEMENTARY INVESTMENT SERVICES

Through their dealing rooms and private banking departments, commercial banks provide a variety of core and supplementary investment services. These services are defined in the law transposing the provisions of the EU Council Investment Services Directive into Greek legislation. The list of core investment services provided by banks includes:

- the reception and transmission of investors orders with regard to financial instruments ,money, market instruments, bonds, equities and financial derivatives.
- trading in the market making of government notes and bonds
- discretionary financial portfolio management in the course of private banking.
- dept and equity securities underwriting

The main supplementary investment services provided by the majority of Greek commercial banks are the safe-keeping and administration of physical financial instruments, custody services, as well as investment advisory services and services related to underwriting.

4.8. THE PROFITABILITY OF GREEK BANKS

The Greek Banking System, in its effort to prepare itself for the changeover to the EURO, have face some initial costs. Being the basic institution of money distribution, this changeover impose a heavy burden on banks. In addition to the costs that banks will sustain, they will derive new benefits. The impact of the EURO on Greek Banks is explained through a cost-benefit analysis, by providing a perspective of the anticipated costs, benefits and outcome.

BALANCE SHEET

In the 2007 the growth rate of Greek commercial Bank's and banking groups' profitability improved clearly in comparison to 2006. Banks' after tax profits rose by 46,1% to 2.758 million euro and groups after tax profits increased by 55% to 4.216 million euro. At the end of September 2007 the share of gross income from operations in South Eastern European countries approached 18%, almost 6% higher than in 2006 and more than 10% higher tan in 2005. In Q3 2008 the growth rate of Greek commercial banks and banking groups' profitability further improved in comparison to Q3 2007. This performance reflects continued growth in the banking business in Greece and the markets of Southeast Europe, even while the global banking sector in general is under unprecedented pressure.

PROFITABILITY AND EFFICIENCY RATIOS OF BANKS AND B.G

	Banks 2008 – 2007	Banking groups 2008 - 2007
-Net interest rate margin	2,2 - 2,5	2,9 - 3,o
-Return on risk-weighted assets after tax ROA	0,3 - 1,5	1,0 - 2,1
-return on equity after Tax ROE	3,0 - 14,7	10,1 - 17,9
-efficiency ratio	60,9 - 52,9	56,0 - 52,7

Source: Bank of Greece Annual Report 2008

4.9. MONEY AND CAPITAL MARKETS IN GREECE

Money and capital markets developed rapidly during the years after the deregulation of the Greek financial system and the liberalisation of cross-border movements. Banks are active players in these markets by providing, either directly or through subsidiary brokerage firms or other specialized investment firms, investment services related to financial instruments. Money market and the Athens Stock Exchange are the major markets for short and long-term borrowed funds.[30]

The Greek money market is an over-counter interbank market for short-term transactions in euro and foreign exchange. Domestic and foreign credit institutions operating in Greece participate regularly in this market in order to manage their liquidity position, while the Bank of Greece intervenes to achieve its monetary policy objectives. The reference interbank interest rate is the ATHIBOR.[31]

i. THE ATHENS STOCK EXCHANGE

The ASE is a limited liability company by shares for the trading of corporate stocks as well as bonds issued by the Greek government, banks, other private or public corporations and international organizations. Stocks are listed either on the main or the parallel market of the ASE upon fulfillment of specific requirements. Bonds are listed and traded in the ASE's so called Fixed Income Securities Market. Transactions are conducted through brokerage firms.

ASE operates under the supervision of the Capital Market Commission which is the body primarily responsible for ensuring the protection of investors and the compliance of market participants with the capital markets legislation.

[30] Developments of Greek Economy in the 19th century (Petmezas & Kostis)

[31] Athens Interbank Offered Rate

ii. THE ATHENS DERIVATIVES EXCHANGE S.A (ADEX)

The main purpose of ADEX is the organization and support of trading in the derivatives market, the organization of the trading system as well as any other similar activity.

iii. THE MARKET FOR GOVERNMENT SECURITIES

The Bank of Greece has developed an electronic secondary securities market (HDAT) and a settlement system (BOGS) for trading and settling Greek government securities in book entry form.

4.10. CURRENT REGULATORY CHALLENGES IN THE EUROPEAN FINANCIAL SYSTEM

Regulatory reforms in Greece began later than in many countries, but Greece has now launched itself on the road to market liberalisation. Today, the Greek government is moving further and faster on regulatory and other structural reforms than at any time in the post-war period. Though most regulatory reforms are very recent, a few are already contributing to the country's economic success. Good progress has been made, particularly in such areas as telecommunications, the tax system and public administration, and benefits are beginning to appear.

According to a report just published by the OECD,[32] Greece's economic benefits of regulatory reform may be as high as 9-11% of GDP if reforms are sustained over several years. The confluence of positive elements - growing social consensus for reform, macroeconomic and political stability, and healthy economic growth that will ease the pain of transition - suggests that the next few years will be decisive years of reform in Greece.

The report notes that:

- In the telecommunications sector, services and prices have improved after reform.
- Modernisation of the tax system has improved transparency and tax revenues, although major reform is needed to establish a level playing field for enterprises and to simplify the tax code.
- Reducing red tape and regulatory uncertainties for firms is underway, and formalities are being visibly reduced. This should boost entrepreneurship and investment.
- The Greek government has launched a series of reforms to improve the efficiency and effectiveness of its public administration. The culture of the Greek

[32] Regulatory Reform in Greece available on the OECD password protected website, online bookshop

public administration is moving away from legalism and formalism to focus on service to citizens.

Nevertheless, the OECD report observes, poor regulatory practices still reduce economic growth and job creation in Greece. Moreover, although most Greeks will benefit from regulatory reform, the resistance of many protected groups to needed change is hard to overcome. The major challenges now are to systematically unwind the extensive state involvement in the economy and to ensure the sustainability of strong growth at low inflation by establishing regulatory policy regimes and institutions that support investment, innovation, and vigorous competition.

Burdensome regulations through the whole of the Greek economy are still slowing structural adjustment and job creation, discouraging market entry and foreign investment, encouraging work in the informal sector, and reducing public sector effectiveness. Public enterprises, particularly state-controlled banks, have performed poorly. Public enterprises account for 6% of employment and 27% of investment, yet almost all are inefficient. Continued privatisation is a high priority. Competition policy is ineffective, although improving, and tight labour market legislation has slowed job creation. Further, Greece has a poor record in attracting foreign investment. Greece has moved to open its markets, but domestic regulations still fall short on transparency and unnecessarily restrict trade.

The OECD report makes a number of recommendations:

- Further reforms of the Greek civil service are needed to create the capacity for an efficient and transparent regulatory system.
- Competition policy should be reinforced. Greece should intensify efforts to reduce administrative barriers to businesses.
- A government-wide strategy for regulatory quality and a framework of quality standards should be adopted to speed up reform.
- Despite recent improvements, regulatory transparency can be improved through systematic use of public consultation and development of a comprehensive database on regulations.

- Use of regulatory impact analysis can improve understanding of costs and benefits of regulatory actions within the Greek public administration, and guide the appropriate use of regulation.
- Market openness should be promoted by reducing discrimination in domestic regulation, and Greek competitiveness enhanced through the use of international standards and quality certification.
- Regulatory quality controls should be strengthened in local governments.
- More attention is needed to market access in the electricity sector to open the markets to new entrants. Resources and regulatory powers must be placed in a regulatory body, independent of the Ministry and the regulated companies.
- The domestic ferry sector is crucial in Greece and has been highly regulated. Reforms are now underway to improve the regulatory framework. As part of these reforms, modernisation of regulatory institutions to reduce concerns about the influence of ferry operators has begun, and should be continued.
- Greece reformed its telecommunications sector later than most OECD countries, and competition is relatively undeveloped. With the right reforms, Greece could quickly build a sound regulatory framework. Regulation of prices through government authorisation is not appropriate for current competitive circumstances.

The OECD report recommends sustained and consistent reforms in the coming years, in order to drive convergence with other European countries. If the measures proposed are effectively implemented, the OECD concludes that regulatory reform can be among the most effective tools available today to boost living standards through sustained economic performance, international competitiveness, innovation and investment, and job creation.

Regulatory Reform in Greece covers thematic subjects and specific sectors: government institutions and processes; competition policy and enforcement; enhancing market openness; and electricity, domestic ferries, and trucking. It also assesses the macroeconomic context for reform.

4.11. THE CURRENT REGULATORY CHALLENGES AFFECTING THE GREEK BANKING SYSTEM

i) IMPLEMENTATION OF THE PAYMENT SYSTEM DIRECTIVE (PSD)

The European Payment Services Directive also known as PSD, applies to payment transactions in euro or in other currencies of the European Union/European Economic Area (including the CHF), within the internal market between Member States of the European Union/European Economic Area. The incorporation of the PSD directive is also imminent in the Greek legislation, setting the frame to conduct payment transactions in the Greek market.

New, added benefits for customers

The PSD is a piece of legislation which applies to all Member States of the European Union/European Economic Area and introduces new, beneficial payment transaction terms which safeguard the rights of citizens and businesses:

- making payment transactions in any Member State currency (including the CHF) reliable, cost-effective and easy;
- reducing transaction execution time to the shortest time possible between Member States of the European Union/European Economic Area;
- enabling funds to be refunded if transactions are disputed, under certain conditions;
- setting the valeur for the purpose of calculating the interest to be charged or credited to accounts as appropriate.

ii) SEPA PROJECT (EXTERNAL ANALYSIS IN PAYMENT SYSTEM)

iii) TARGET 2- SECURITIES PROJECT TARGET2 SECURITIES

Is a project of the Euro system launched in 2006 aimed at creating a single IT platform for the settlement of securities in euro central bank money. The settlement platform would be operated by the Euro system with the objective of reducing the cost of cross-border securities settlement within the euro area. The idea of the ECB is to use the TARGET 2 platform for cash payments as the technical basis for the new settlement engine.

The user requirements phase, launched in May 2007, is running until April 2008. In early 2008, the ECB Governing Council will take a final decision on whether to go ahead with the project and launch the development phase. The platform should not be operational before 2013.

In July 2009 the official Memorandum of Understanding was signed by most CSDs in Europe·

iv) IMPLEMENTATION OF DIRECTIVE 2008/48/EC ON CREDIT AGREEMENTS FOR CONSUMERS (CONSUMER CREDIT DIRECTIVE)

The Consumer Credit Directive was adopted by the European Commission in May 2008, with an ensuing date for completing the transposition set for June 2010 for all member states. This Directive replaces the 1986 Consumer Credit Directive and amendments made to this Directive. The new CCD takes a maximum harmonisation approach and is intended to harmonise key aspects of consumer credit legislation in Member States as part of the objective of creating a common credit market across the European Union. At the same time, the Directive is also intended to maintain high levels of consumer protection.

v) OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

a. ECOFIN roadmap
b. European Commission public consultation on possible changes to the Capital Requirements Directive
c. Committee of European Banking Supervisors (CEBS) :Technical advise of liquidity risk management

vi) MARKETS IN FINANCIAL INSTRUMENTS (MIFID)

vii) POST FSAP INITIATIVE (2005- 2010)

viii) INVESTMENT MANAGEMENT

- Revision of UCITS directive
- European Parliament's discussions on hedge funds, private equity and transparency of institutional investors
- EU framework for private placement
- European Commission feedback statement on its call for evidence on substitute retail investment products

4.12. THE GLOBAL FINANCIAL AND ECONOMIC CRISIS

The global economy is in the midst of its most severe financial and economic crisis since the 1930s. The strong turbulence that started in the United States in August 2007 and spilled over to the rest of the world is continuing for the second year running, with occasional episodes of intensification. The persistence of the financial turmoil has caused the global outlook for output, employment and trade to deteriorate rapidly, especially during the last few months. At the current phase, developments in the financial and the real sectors of the global economy form a negative feedback loop, whereby the dysfunction of financial markets squeeze activity and, in turn, the fall in economic activity further undermines the capital position of the financial sector and its ability to finance enterprises and households. Exit from this vicious circle will not be easy or fast. The global crisis has negatively affected the Greek economy, especially since the intensification of the crisis in September 2008. The growth rate of the Greek economy, which had been steadily high since the second half of the 1990s, decelerated markedly in 2008, while economic activity is projected to stagnate in 2009.
The financial crisis is affecting economic activity in Greece in two ways:[33] on the one hand, the tightening of banks' credit standards for lending to enterprises and households is restricting the supply of loans and, on the other hand, the significant weakening of consumer and business confidence and the resulting lower propensity to consume and invest in housing and the higher risk aversion are causing credit demand by both households and enterprises to decline as well. The world economic crisis also has a direct impact on the Greek economy, since the ongoing contraction in global economic activity and the decrease in world trade volumes have hit Greek exports of goods as well as services, notably shipping and tourism. The financial and economic crisis has made the macroeconomic imbalances and structural weaknesses of the Greek economy more visible. First of all, the favourable factors that had supported strong growth rates for a number of years, fostering complacency with regard to the economic outlook, have lost their momentum. In addition, market concerns have heightened, as indicated by the yield spreads between Greek government bonds and the

[33] Annual report of central bank of Greece

corresponding German securities. In particular, markets are concerned about Greece's fiscal deficit which has been well in excess of 3% for two consecutive year, as well as about the country's high public debt-to-GDP ratio (over 95% in 2008[34]) and the failure of successive governments to achieve a sustainable fiscal adjustment, despite the strong growth performance seen since the mid-1990s. Another source of concern are the extremely high levels of the current account deficit, attributed, to a large extent, to the insufficiency of structural measures taken at the time with a view to reforming the public sector and enhancing the production base and productivity. As pointed out in the latest Report on Monetary Policy of the Bank of Greece (February 2009), there is an urgent need for a credible medium term plan that will include bold but necessary reforms, with fiscal consolidation being the top priority.

As for the key aggregates of the Greek economy, annual GDP growth fell from 4.0% in 2007 to 2.9% in 2008 (and 2.4% in the fourth quarter[12]). According to Bank of Greece estimates, economic activity will stagnate in 2009 and even negative annual rates of change cannot be ruled out in the course of the year, while developments could turn out even worse if global economic conditions deteriorate more than expected (causing a stronger than expected drop in Greek exports). However, Greek GDP increased more than the euro area average in 2008 and, though projected to stagnate in 2009, would fare better than area-wide GDP which is expected to decrease significant -.

[34] Source Annual report of Bank of Greece

4.13 The Monetary Policy of the ECB and the Interventions of the Eurosystem in the Euro Money Market Area

The Governing Council of the ECB determines the level of key interest rates with a view to achieving the Eurosystem's primary objective of price stability in the euro area over the medium term, defined as an annual inflation rate of below but close to 2%. The progressive withdrawal of monetary accommodation, which had started in December 2005 and involved nine increases in key interest rates by 25 basis points each, lasted until the third quarter of 2008. Since October 2008, the Governing Council of the ECB, taking into account the gradual easing of inflationary pressures, has lowered its interest rate on main refinancing operations on six occasions, bringing it to 1.25% on 2 April 2009[35]. Several other central banks also proceeded to a gradual monetary easing during the same period . Underlying the decisions to reduce the key interest rates was the assessment of the ECB Governing Council that the intensification of the financial turmoil since mid-September 2008 has had considerable negative effects on aggregate demand over an extensive period of time, and has thus contributed to containing inflationary pressures. In addition, declining commodity prices also contribute to the easing of inflationary pressures, while inflation has been on a downward path since August 2008. At the same time, the growth rates of monetary and credit aggregates continue to decline. Regarding the outlook for price developments, the Governing Council expects that, after the recent reductions in key interest rates, price stability will be maintained over the medium term.

Throughout 2008, the euro area interbank market experienced tensions and disruptions, which accentuated after the bankruptcy of Lehman Brothers. Among other developments, the spread between the Euribor and the expected EONIA[36] rate widened

[35] Source annual report of Bank of Greece

[36] Euro OverNight Index Average

significantly, while the volume of interbank transactions contracted. The Euro system addressed these developments with interventions in the money market that intensified after mid-September. The aim of these interventions was to provide liquidity to credit institutions which, albeit solvent, faced difficulties in tapping the interbank market due to the prevailing tensions. Lately, however, these disruptions have subsided and tensions in the euro area interbank market are gradually easing. The Eurosystem's interventions have been decisive in mitigating disruptions and easing tensions. In particular, in October 2008, the Governing Council of the ECB decided, on a temporary basis and until the normal functioning of the interbank market is restored: a)to conduct liquidity-providing operations as fixed rate tenders with full allotment, b) to increase the frequency of longer-term refinancing operations, c) to enlarge the set of eligible collateral accepted in Euro system credit operations and d) to broaden the set of eligible counterparties in quick tender operations.

Moreover, the Eurosystem continued, in cooperation with the Federal Reserve and other central banks, to provide liquidity in US dollars to euro area credit institutions through standard tenders and against assets eligible for monetary policy operations.

Through these interventions, the Eurosystem effectively substituted banks in the interbank market, providing ample liquidity. This development is reflected in the impressive increase in the Eurosystem's total assets by 42% between mid-September 2008 and theend of the year. The higher assets were initially in line with a rise in the outstanding amounts placed in the context of the deposit facility, associated with the temporary narrowing of the corridor formed by the interest rates on the Eurosystem's two standing facilities (i.e. the marginal lending and the deposit facilities) from early October 2008 until late- January 2009. When the narrowing of the corridor was reversed in late January 2009, the outstanding amounts under the deposit facility declined. Finally, after early October 2008, with the provision of ample liquidity, the EONIA rate fell below the rate on the main refinancing operations. More generally, the monetary policy of the ECB and the provision of liquidity by the Eurosystem have been key to addressing the risk of inflation falling below the level that is consistent with price stability, to supporting economic activity and to stabilising the financial system.

4.14 BANK LENDING AND DEPOSIT RATES - THE INTEREST RATE SPREAD

In 2008, interest rates on deposits by households with a maturity of up to one year rose substantially, while interest rates on households' overnight deposits remained broadly unchanged. Developments in deposit rates in the course of 2008 were associated with the fact that Greek banks offered high interest rates for deposits with longer maturities in order to strengthen their deposit base. By contrast, in the first two months of 2009 the interest rates on both categories of deposits declined, as funding conditions for banks improved. During 2008, the larger rise in the interest rate on time deposits relative to other categories of deposits encouraged a shift from more liquid deposits to time deposits. Thus, although the growth rate of time deposits moderated, it remains high; as a result, the share of these deposits in M3 increased. By contrast, overnight deposits continued to decline, which reduced their share in M3.
Developments in interest rates on bank loans to the private sector in Greece were not uniform in 2008. Interest rates on new loans showed a broadly-based decline in the last two months of 2008, which continued into the first two months of 2009. This, however, masked divergent developments in individual components, as interest rates on new loans to households were higher in December 2008 than in December 2007 and those on loans to non-financial corporations were lower. The overall decline in the interest rates of loans to businesses in 2008, which fell short of the decline in interbank market rates, was offset by an increase in interest rates in all categories of loans to households. Thus, the average interest rate on total new loans rose marginally in 2008. The above developments mainly reflected the fact that banks, facing difficulties in tapping the interbank market, sought to secure liquidity by offering high interest rates on time deposits, which implied that they had to keep their lending rates high as well. Also, the credit conditions faced by Greek banks were negatively affected by an increase in the yield spread of Greek government bonds vis-à-vis German bonds. The cuts in the key ECB rates and the fall in interbank market rates did not translate into

significantly lower interest rates on new loans, as their impact was partly offset by the higher risk premier required by Greek banks in the context of increased non-performing loans. By contrast, a marked debt reduction was achieved in the case of existing loans carrying floating rates. In the euro area, interest rates on bank loans to households at the end of 2008 stood at a lower level than at the end of 2007, by contrast with the respective Greek rates. During the same period, interest rates on most categories of bank loans to non-financial corporations declined more strongly than in Greece. Due to these developments, the interest rate spread between Greece and the euro area widened in both categories and increased further in January 2009, primarily in loans to non-financial corporations and, to a lesser extent, in loans to households. In general, interest rates in Greece remain higher than the euro area average due to structural factors, with the largest differentials observed in the rates on consumer loans, which nevertheless are not among the highest in the euro area.

The interest rate spread, i.e. the difference between the weighted average interest rate of new bank loans and the corresponding rate on new deposits in Greece, narrowed by 70 basis points in 2008 (December 2007-January 2009: 75 basis points[37]), because of a larger increase in the deposit rate than in the lending rate. The corresponding spread contracted by 45 basis points in 2008 in the euro area. The interest rate spread in Greece, despite falling more than the average figure for the euro area, remains at a higher level than the euro area average. This situation is attributable to some inherent characteristics of the domestic banking system, e.g. the relatively large number of small depositors and borrowers, the higher borrowing costs of Greek banks in the interbank market, the higher ratio of non-performing loans to total loans and the longer time needed for the realisation of collateral. Another important factor is the different composition of both deposits and loans in Greece and in the euro area.

[37] Source Annual Report of Bank of Greece

4.15 THE STABILITY OF GREEK BANKING SYSTEM

The dysfunction of international money and capital markets throughout 2008, which led to deterioration in the international and domestic macroeconomic environment in particular after September 2008, has had a negative impact on the determinants of the stability of the Greek banking system. At end-2008, banks' profitability and capital adequacy ratios were lower than at the end of 2007, but still stood higher than those of banks in the EU as a whole. In addition, there was a small decline in the quality of banks' portfolios and in liquidity ratios during 2008. However, the relevant ratios remain at satisfactory levels, above the regulatory minimums, while the tightening of banks' credit standards and the intensive supervisory controls by the Bank of Greece have helped maintain the soundness of the key aggregates of the Greek banking system. Specifically, after tax profits of banking groups dropped substantially in 2008 (by 42.8%) to 2.6 billion euro, excluding the non-recurrent profits recorded in 2007, the decline in profits was 34.6%15. Underlying this drop in profits were the more than doubling of provisions for credit risk, the increased cost of funding and lower profits from financial operations and from investment portfolios. These developments inevitably affected return on risk-weighted assets (2008: 1%, 2007: 2.1%)[15], return on equity (2008: 10.1%, 2007: 17.9)[15] and the efficiency ratio (2008: 56%, 2007: 52.7%). The net interest rate margin deteriorated only slightly (2008: 2.9%, 2007: 3%[15]). However, Greek banking groups performed better in terms of these ratios than their large euro area counterparts, which saw a sharper deterioration. Declines were also seen in the capital adequacy ratio (2008: 9.5%, 2007: 11.2%)[38] and the Tier I ratio (2008: 7.9%, 2007: 9.2%)[16]. These ratios were affected by valuation losses recognised in own funds, purchases of own shares by banks, write downs on participations held by Greek banking groups due to foreign exchange valuation differences, the calculation for the first time—under the "Basel II"[39] framework— of

[38] Source Annual Report of Bank of Greece
[39] **Basel II** is the second of the Basel Accords, which are recommendations on banking laws and regulations issued by the Basel Committee on Banking Supervision.

capital requirements for operational risk, and an increase in credit risk-weighted assets, which more than offset a decline in market risk weighted assets. Nevertheless, the leverage ratio of Greek banking groups remained relatively low (2008: 17.6, 2007: 13.2)[16]. Furthermore, capital adequacy remains higher than the supervisory minimum level and is expected to improve, mainly through the issuance of preference shares under Law 3723/2008 and through capital injections to subsidiaries of foreign banks in Greece by their parent banks. Regarding the quality of bank loan portfolios in Greece, the ratio of non-performing loans (NPL) rose to 5.0% at end-2008, from 4.5% at end-2007[16]. This development stemmed exclusively from loans to households, with increased NPL ratios for both housing and consumer loans. A small improvement was seen in the NPL ratio for loans to businesses. The NPL ratio increased with respect to loans to the countries of South Eastern Europe (including Turkey), especially in the second half of 2008. At the same time, the provision coverage ratio (i.e. the ratio of accumulated provisions for credit risk to non-performing loans) in Greece fell to 48.9% in 200816, compared with 53.4% in December 2007[16], the coverage ratio was unchanged, at about 100%, for Greek banks' branches and subsidiaries abroad. The above coverage ratios and the maintenance of capital adequacy above the supervisory minimum level are expected to largely offset the impact on the quality of Greek banks' portfolios from the deterioration of the macroeconomic environment in the domestic and foreign markets where Greek banks are active. The lower availability of funding sources and the high cost involved caused banks' liquidity ratios to deteriorate. Despite increased volatility in international money and capital markets, market risk-weighted assets declined at bank and banking group level, mainly because of partial unwinding of positions entailing market risk.

4.16 THE LIQUIDITY SUPPORT PLAN

The above factors need to be viewed in the context of emerging developments and prospects, as well as of policy measures taken at both the national and the international level aimed to restore confidence and absorb shocks from the slowdown in economic activity. In this respect, the Greek plan to support liquidity in the economy (Law 3723/2008) is gradually being implemented and is expected to further strengthen the liquidity and capital adequacy ratios of banks. It should be recalled that Law 3723/2008 includes three measures:

• a recapitalisation scheme, whereby an amount of up to 5 billion euro will be injected to eligible banks, in exchange for preference shares to be acquired by the Greek State;
• a guarantee scheme (up to 15 billion euro), covering against remuneration new debt with a maturity between three months and three years, issued by 31 December 2009 at the latest and
• a securities scheme, i.e. the issuance, by 31 December 2009, of special government bonds (up to 8 billion euro) to be provided to eligible credit institutions enabling them to enhance their access to liquidity, in particular through financing from the Eurosystem or from the interbank market.

By an amendment to the above-mentioned law it was stipulated that, for as long as the support measures are in place, beneficiary institutions may not purchase own shares. Also, any dividend to be distributed by institutions benefiting from the recapitalisation/issuance of preference shares scheme may only be in the form of shares. The total amount corresponding to the above measures, namely 28 billion euro, represents 11.5% of Greek GDP in 2008[40]. This percentage is lower than that of the euro area as a whole (26.5% of GDP in 2008)[18] and of the EU-27 (around 23% of GDP in 2008)[18], where significant variations are observed across countries and where many banks faced serious problems, which was not the case in Greece.

With regard to the implementation of this law so far, the shareholder meetings of twelve banks have approved the issuance of preference shares totalling 4.1 billion

[40] Source Annual Report of Bank of Greece

euro, eight banks have raised 4.4 billion euro through the issuance of special Greek government securities (while an amount of 1 billion euro has been approved for another three banks) and two banks have made use of the government guarantee scheme for loans totalling 1 billion euro. The full exploitation of the possibilities offered by the plan is expected to mitigate the impact of the financial crisis on the real economy (contributing, along with the cuts in ECB rates, to a gradual reduction in banks' funding costs and supporting the supply of credit to households and businesses) and to bolster the stability of the banking system, in conjunction with the implementation of corresponding measures at the EU and South Eastern Europe level. The pace of implementation of the plan is similar to the one observed in the euro area as a whole, where by late March only one third of the commitments for capital injections had been used and about 12% of the commitments to guarantee new bank debt had been called upon. In the ECB's view, the limited use of these guarantees may reflect a decline in credit demand or banks' desire to continue deleveraging their balance sheets. However, there are certain disincentives associated with the provision or pricing of these debt guarantees, which need to be addressed, so as to help banks finance additional lending to the private sector. In view of the increased risks associated with the weak economic environment, the high uncertainty in money and capital markets and the prevailing conditions of low liquidity and reduced profitability, the Bank of Greece continues to call upon banks to pursue appropriate policies for promoting financial stability. In this respect, banks are encouraged to make use of the liquidity support plan in order to strengthen their capital base and prevent a credit crunch. At the same time, the Bank of Greece is closely monitoring developments on a consolidated basis (i.e. taking into account subsidiaries operating abroad) and has recommended that Greek banks with activities in the countries of South Eastern Europe (including Turkey), which are currently facing increasing risks, should carefully assess local economic conditions and the possibility of finding themselves exposed to both credit risk and exchange rate risk. Finally, the Bank of Greece has, in a timely manner, pointed out the need for increased loan loss provisioning and restraint on manager bonuses.

CONCLUSION

The bulk of the financial flow in the Greek economy always has moved through the banks. The banking system consists of three kinds of institutions. One is the central bank (the Bank of Greece), which manages and controls the country's money supply and its exchange rate with other currencies. The bank accomplishes these tasks mainly by regulating the liquidity of other banks and by direct interventions in money markets (including the foreign exchange market). It is also the main supervisory agency for the quality of commercial bank portfolios, and the protection of the monetary system against bank failures. In line with requirements of the 1992 Maastricht Treaty, which standardized the financial organizations of EU member countries, the Bank of Greece must become independent of the government, and the bank must enforce strict limits on government use of the money supply as a source of loans. European central banks also will be jointly responsible for the management of the projected European common currency.

Commercial banks are a second type of financial institution in the Greek system. They are deposit institutions that traditionally have engaged in commercial and industrial lending. More recently, Greek commercial banks have expanded their operations to provide a wide range of wholesale and retail banking services. Their loans include commercial, industrial, consumer, and mortgage credits. They issue credit cards and travelers' checks, buy and sell foreign exchange, and issue letters of credit. They directly engage in securities underwriting. Through their subsidiaries, they also offer brokerage services and own mutual funds of Greek and foreign securities.

A third class of institution is the "specialized credit institution" such as investment banks, mortgage banks. The traditional role of these institutions was to offer credit in specifically designated areas. However, banking liberalization and European policies on a unified banking market have forced specialized institutions to diversify their operations.

Commercial banks operating in Greece include both domestic and foreign institutions. The number of such institutions is constantly increasing. The foreign banks, which operate in Greece through locally established branches, control about 10 percent of assets and deposits in the Greek banking market. Among Greek banks, the Bank of Greece is by far the largest institution.

The major assets of commercial banks traditionally included credits and loans to the private sector. Since the late 1980s, however, the heavy borrowing requirements of the state have altered the portfolios of bank assets. Roughly one-third of their assets now are made up of government securities, equal to the share devoted to loans and security holdings of the private sector. The liabilities of commercial banks continue to be dominated by private deposits.

Since 1987 the Greek banking system has undergone almost complete liberalization. Interest rates are now set by market conditions, quantity controls on credit have been long abolished, foreign-exchange transactions and capital movements have been deregulated, and restrictions on entry into banking have been removed. In the implementation stage were EU directives on the freedom of bank establishment among member countries, on the free provision of financial services across frontiers, and on common standards for capital adequacy. In short, banking is becoming a modern and very competitive business in Greece.

Over the past decade, a remarkable transformation has occurred in the financial sectors of the accession countries. Considerable progress has been made in restructuring and consolidating the banking sector though the liberalisation of markets, privatisation of state-owned banks, and the opening of the banking sector to foreign ownership. These broad developments parallel changes that have been taking place in Greece.

In these circumstances, and in view of the key role of the banking system in invigorating and broadening economic growth and improving welfare, it seems crucial that Greece complete a number of structural reforms, including the implementation of a well-functioning regulatory and legal framework, corporate restructuring, and

improvements in corporate governance. Ongoing reforms in the euro area make such changes in Greece all the more necessary, because they increase the gap between current practices in the country and in the euro area.

In conclusion, developing the size, depth, and efficiency of the banking sector will help Greece to develop its full growth potential. The resulting increase in competition, combined with sound supervisory practices, will lead to lower costs of funds and financial services, higher rates of return to investors, and a wider array of financial products.

The Greek experience illustrates the effects of European integration on a national banking system. The most notable effect has been the increase in competition, whether through privatisation, the rationalisation of bank's expenses, or the restructuring of their balance sheets to make bank's financial position sounder. Through its supervisory functions, the Bank of Greece play a vital role in maintaining the soundness of the banking system, helping to ensure the ability of Greek banks to reap the full potential benefits of participation in Europe's single currency area.

The Greek banking sector continues to undergo change as it adapts to the regime of the euro zone. Despite the substantial progress made in recent years, its financial sector will need to undergo further significant changes in the future. By so doing, financial sectors will be able to fully support economic growth, and, hence, the process of real convergence to euro-area levels.

Further more there must be policies that can foster not only an exit from the current crisis as soon as possible but also a return to sustainable growth rates.

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