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The Trieste Eastern Europe Investment Forum
Investment and Finance for the Post-Covid Recovery
DRAFT FOR DISCUSSION

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PART 1
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EXECUTIVE SUMMARY

This report provides an analysis and evaluation of the financial service sectors of the South-Eastern European (SEE) countries over the period 2002-2018. It is mostly based on the individual countries' reports officially launched by their relevant national institutions, such as central banks and financial supervisory authorities, and the survey of the banking and insurance associations. Its first part is consisted of the comparative analysis, in terms of the SEE region countries' macroeconomic indicators, key determinants of their bank and insurance businesses as well as other financial institutions, and an essay on sustainable (socially responsible) investments, with special regard on the SEE countries and their energy sectors' transformation. Detailed reports of the particular countries' financial service sector can be found in the second part of this (overall) report.

Analysing the data on the financial intermediaries operating in the financial service sectors, results reveal, among other findings, the following:

❖ Some SEE countries are the EU member states (that is, Greece, Slovenia, Romania, Bulgaria, and Croatia) and the other are at different stages of the EU integration process (Turkey, Serbia, Montenegro, Albania, and North Macedonia have the candidate status, while Bosnia and Herzegovina and Kosovo are the potential candidate countries). Ukraine, which geographically is not a part of the SEE region, but it is included in the report, has recently announced that it will apply for the EU membership in 2024. A major contribution to both the population and the total nominal GDP continuously comes from Turkey (in 2018, 44,2% and 46,7%, respectively). However, the current trend of depopulation in the region could be explained by plenty of reasons, such as demographic aging, persistence of high unemployment (youth in particular), corruption, consequential migrations to the Western European countries, etc. Also, the average GDP per capita for the SEE region is still far below the EU (approximately four times smaller).

❖ Since the financial service sectors in the SEE region is highly bank-centric, the financial soundness of the banking sector has extreme importance for financial service sector and real sector of economy, their stability and growth. The SEE countries have had relatively high capital adequacy as well as liquidity in their banking sectors. Bearing in mind that the legal and institutional framework for the banks is designed in accordance with the Basel Committee standards, the resilience of the banking sectors will be strengthened by full implementation of Basel III requirements. Although reductions of NPLs ratio were reported across all SEE countries in 2018, mainly by those with higher previous ratio, NPLs remain unevenly distributed (from 2,7% in Kosovo and 2,8% in Slovenia to 28,3% in Ukraine and 45,4% in Greece) and elevated for some SEE countries.

❖ Considering selected indicators on the SEE insurance markets we could gain a knowledge and understanding of their diversity, for example regarding insurance density, which varied from EUR 36,8 in Ukraine to EUR 1,133 in Slovenia (also in 2018, in the Insurance Europe members it was EUR 2,169,4), as well as mutual characteristics. A key common determinant of the markets is undoubtedly its general underdevelopment compared to the Insurance Europe member states. Nevertheless, considering the volume of the SEE economies, banking sectors as their inherent parts in particular, there is a serious potential for the insurance markets growth in future.
With regard to other financial institutions in the SEE countries’ financial structures in 2018, it is important to recognize that there is a wide spectrum of various types of financial institutions other than banks and (re)insurance companies, such as voluntary pension funds, investment funds, leasing companies, micro-credit organizations (or microfinance institutions), credit unions, saving and loans associations, factoring companies, brokerage houses, etc. However, as before, their share(s) in 2018 ranged from 3.1% in both Montenegro and Serbia to 25.3% in Croatia and 30.9% in Kosovo. Due to bank centricity of the financial service sectors, the investment potentials of other relevant financial institutions in the SEE region countries are still far below the banks.

As far as sustainable or socially responsible investments (like investments in companies that are engaged in social justice, environmental sustainability, and alternative energy) are concerned, how much money investors, especially institutional ones, will indeed invest in sustainable investments primarily depends on the expected financial return. They principally prefer stocks with high upside or dividend yield potential and only if ( supra)national legislators and regulators as well as various stakeholder group through collaborative efforts support the whole process (for example, through information disclosure and transparency, including environmental, social and governance factors into investment decision making process, increase sustainability awareness among both assets owners and professional asset managers, financial education for both retail investors and financial advisors/intermediaries shall be essential, etc.), sustainable investments can be found with a greater share of their portfolios and make them a truly mainstream among investors. Moreover, it should increasingly be recognized that sustainable investment is good for business and that investors do not necessarily have to choose between returns and positive impacts. Specifically, SEE has substantial, largely untapped renewable energy potential. Some countries in the region have begun to exploit these resources, but the renewable energy sector in SEE is still at its primordial stage – except for the large hydropower capacity, most of which was constructed several decades ago. Bearing in mind the EU 2030 Climate and Energy Framework, a transformation of the SEE countries’ energy sectors from fossil fuels towards renewable sources of energy (solar, wind, geothermal, etc.) has no alternative.

Some identified areas of weakness of this kind of the analysis and evaluation are related to a lack of more unified reporting on aggregate bank balance sheet items or sporadic changing in the reporting across countries. Furthermore, data on the other relevant financial institutions are mainly unstructured or uncompleted and a regularity of the reporting misses. In that regard, recommendation to the relevant national institutions (central bank and/or financial supervisory authorities) and bank and insurance associations can be proposed.

A main limitation of the report refers on the usage of the historical data. For that reason, this year’s report encompasses an additional part, “After the Report: Pandemic Crisis and Its Possible Impacts”, through which we will give a brief discussion about the current situation caused by pandemic of Covid-19 and some possible impacts on the SEE financial service sectors.
INTRODUCTION

The following report on 'Investment in South Eastern Europe (SEE)' is the fifth issued based on the contribution provided by several financial associations from SEE countries at the Trieste Eastern Europe Investment Forum (the zero report was made in 2015, but with focus only on the insurance sector).

In Part I of this Report we will shortly present the basic performances of the main segments of the financial service sector in the countries of South-Eastern Europe, including Turkey and Ukraine.

The entire Report, Part I and Part II, with Individual Country Reports of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Greece, Kosovo, Montenegro, North Macedonia, Romania, Serbia, Slovenia, Turkey and Ukraine, will be available at our web page shortly (www.febaf.it).

Trieste's Forum, as a permanent venue and opportunity to strengthening dialogue and cooperation among the financial communities of the area, promotes the development of local, national, and regional markets. It aims at relaunching infrastructure and SME financing, integrating capital markets, and above all supporting stability employment and growth in the region and in wider Europe.

The program of this year has been reviewed considering the recent events related to health and economic emergency. We are strongly committed to give a positive sign of continuity holding FeBAF’s Forum even in this unprecedented season.

Modern developed and sophisticated banking and insurance sectors are required for encouraging domestic production, innovation, investments, and trade. Banks, moreover, channeling funds and their other typical financial intermediary activities, in the initial years of transition in these countries, relied on relatively low expertise and made up a tiny share of economic activity.

To the other side, insurance companies reduced the investment risk faced by private sector companies, and the state. Insurance thereby facilitates access and reduces costs of raising the capital needed by firms, particularly small and medium-sized ones. This is especially important in emerging markets, as a shortage of capital, and particularly in this tragic season, is common there and represents one of the major disincentives to investment and economic growth. By reducing the investment risk, insurance can also encourage companies to think more long-term and increase their risk absorption capacity.

This document aims to stimulate a debate among all participants and stakeholders. After the discussion, we plan to publish a book with short extracts from speakers’ remarks, as we do every year.

Franco Delneri

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PART I – THE FINANCIAL SERVICE SECTOR IN SOUTHEASTERN EUROPE ECONOMIES

Safet Kozarevic

In the first part it will be briefly represented and interpreted the main macroeconomic indicators of South-Eastern European (SEE) countries, that is Albania, Bosnia and Herzegovina (BiH), Bulgaria, Croatia, Greece, Kosovo, Montenegro, North Macedonia, Romania, Serbia, Slovenia, Turkey, and Ukraine. After macroeconomic environment, the features of bank and insurance businesses in these countries will be explained as well as specifics of the other relevant (existing) financial institutions. The data for this part and the report in general was mostly collected from the official reports and via the survey of banking and insurance associations, central banks, national statistics offices, and financial supervisory authorities in the SEE countries. Database for the previous years, back in 2002, provides the trends; in other words, long-term dynamics of the economy, especially financial service industry, of the SEE region and its particular countries.

Considering its increased importance, the first section of the publication also includes an essay about sustainable and responsible investments (SRIs), based on using numerous literature units. A special emphasis was placed on the SEE region and its financial intermediaries as well as its energy sector and the necessary transformation from fossil fuels towards renewable sources of energy (solar, wind, geothermal, etc.).

ECONOMIC LANDSCAPE OF THE SOUTHEASTERN EUROPE IN 2018

In the first section of this part we are going to shortly overview the main macroeconomic indicators and associated parameters of the SEE to situate the research issue, i.e. the financial structures of the SEE region countries, in the wider European context. Although the subsequent comparative analysis over the period 2002-2018 provides an overview of the trends in the indicators, we will put the accent on significant changes in the macroeconomic environment of the SEE countries in 2018 compared to the previous year.

Figure 1 illustrates the trends of the population changes, where we can generally notice a continuity of the population reduction (that is, depopulation) in almost all the countries, except Turkey. While Montenegro noted stagnation, North Macedonia and Slovenia registered a slight increase of the population (for two and four thousands, respectively) in 2018.

Hence, unlike other SEE countries, Turkey continued its population growth over the period, reaching 82 million in 2018. The total population of the SEE region for the corresponding year was 185,5 million and it was 36,1% of the EU-28 population, which reached 513,6 million (the

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3 From geographical point of view, Ukraine is not a part of the SEE, but in this survey the SEE will include data for Ukraine too.
same fraction/percentage was noted in 2017 compared to the previous year). Bearing in mind their EU membership, Greece (since 1981), Slovenia (2004), Bulgaria (2007), Romania (2007), and Croatia (2013) are included in the EU population too.

In 2018 Turkey’s contribution to the SEE population was 44.2%, while in 2017 it was 43.7%, which supports the thesis of the continued growth of its population. Owing to this growth of the Turkish population, the total population of the SEE region increased by 8.3% since 2002 or by 5.2% in the last ten years. However, the data for Ukraine dating back to 2010.

Figure 1. Total population of the SEE countries over the period 2002-2018 (in thousands)

Compared to the previous year, in 2018 the total population in the SEE region grew by only 0.4%, slowly decreasing in most of the countries. There is a plethora of reasons that could

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explain the current trend of depopulation in the region – demographic aging, persistence of high unemployment, corruption, consequential migrations to the Western European countries, to name but a few.

As far as the total nominal GDP of the SEE countries is concerned, it was EUR 1.407,5 billion in 2018 and it declined by 2,6% compared to 2017 (in absolute term). In that regard, it needs to be emphasized that Turkey’s supreme share in the SEE GDP in 2018 was 46,7% (in absolute term, EUR 657,1 billion), less than in the previous year (52,3%). When we compare the SEE GDP of EUR 1.407,5 billion to the EU GDP in 2018 of EUR 15.909,0 billion, we can conclude that the SEE countries generate only 8,8% of the EU GDP.

The data regarding the total GDP of the particular SEE countries from 2002 to 2018 is presented in Figure 2.

Figure 2. Total GDP of the SEE countries over the period 2002-2018 (EUR millions)
All SEE countries registered the real GDP growth, as it is shown in Figure 3. The highest rate of real GDP growth was recorded in Montenegro (5.1%), followed by Romania and Serbia (4.4%), and then Albania and Slovenia (4.1%), while other countries had the rate of real GDP growth between 2% and 4%. Only Greece had the rate less than 2% (i.e. 1.9%). By comparison, an average real GDP growth in the EU in 2018 was 2.0%. In addition, among the SEE countries, the largest drop in the rate of real GDP recorded Turkey, from 7.5% in 2017 to 2.8% in 2018.

Figure 3. Real GDP growth of the SEE countries over the period 2002-2018 (%)

Moreover, average GDP per capita for the SEE region was EUR 7,588 in 2018 and it declined by 2.6% compared to 2017. It was still far below the EU average of EUR 30,980; descriptively, even 4.1 times smaller. Also, while GDP per capita in the SEE region decreased by 2.6%, the EU GDP increased by 3.2% in 2018 compared to the previous year.
More analytically, when it comes to the SEE region, Slovenia was repeatedly the SEE country with the highest GDP per capita and reached 71.3% of the EU average in 2018 (that is, in absolute term, Slovenian GDP per capita was EUR 22,083). Ukraine was the poorest among the observed countries, with GDP per capita EUR 2,656 (by 26.7% higher than in 2017, but still the second lowest in Europe, after Moldova). Additionally, except Slovenia – Greece, Croatia, and Romania were the countries with GDP per capita above EUR 10,000. On the contrary, except Ukraine – Kosovo, Albania, and BiH had the amounts below EUR 5,000. Turkey, Bulgaria, Montenegro, and North Macedonia were “in the middle”, with GDP per capita between EUR 5,000 and 10,000 (see Figure 4). Interestingly, Bulgaria had the lowest level of GDP per capita in the EU in 2018 (more specifically, at one quarter of the EU average).

Figure 4. GDP per capita of the SEE countries over the period 2002-2018 (EUR)

The EU member states of the SEE region (that is, Greece, Slovenia, Romania, Bulgaria, and Croatia) are trying to be more competitive members, while other countries are at different
stages in the EU integration process. Turkey, Serbia, Montenegro, Albania, and North Macedonia have the candidate status (Turkey as of 1999), while BiH and Kosovo are the potential candidate countries. Recently, Ukraine has announced that it will apply for the EU membership in 2024. It is clear that the progress in the EU integration process depends on economic and, much more, political issues. Nevertheless, there are still many structural reforms related to business climate and governance that need to be implemented, such as a fundamental reform of the pension schemes, reduction of the shadow (informal) economy and elimination of corruption, the rule of law, consolidation and reduction of the number and costs of parafiscal charges and burdens, etc.

Thanks to the trend of economic growth, foreign direct investments (FDI), as a source of economic activity, in the SEE countries boosted in 2018, especially for those countries making efforts to join the EU. For example, the Western Balkan countries – Albania, BiH, Kosovo, Montenegro, North Macedonia, and Serbia – achieved its highest greenfield FDI inflows in a decade in 2018, attracting 147 greenfield FDI projects, mostly by Serbia. Most of the FDIs is a result of interregional cooperation, while other investors come from the EU, China, the Middle East, and the Russian Federation. From the interregional perspective, the largest investor in the region is Turkey. The investors are mainly interested in energetic and financial sectors, but there is also an increasing interest in the manufacturing industry, such as automotive industry and organic food and beverages production, as well as infrastructure, tourism, etc.

As a result of these mostly underdeveloped economies, which are substantially behind EU member states, probably the biggest economic problem for most of the SEE countries is chronically high unemployment rate (Figure 5), in particular of the youth. For example, while the general unemployment rate in SEE countries such as Kosovo and North Macedonia was above 20% in 2018, the youth employment rate was around 50% (54,9% and 47,6%, respectively). For the purpose of comparison, in Germany, as one of the leading EU economies, the general unemployment rate in the same year was only 3,4% and for the young people 6,4%. Therefore, the migration trend of the young, unemployed, and well-educated population to the EU is becoming more evident and, consequently, a major threat for the SEE countries in the future, as the EU labour market opens. Moreover, working-age population is decreasing as the result of unfavourable demographics and, thus, many SEE countries have unfavourable relationship between the number of employees and retired individuals. This creates additional difficulties to their social pension and health insurance systems.

Regarding the (general) unemployment rate in the SEE countries in 2018, the lowest unemployment rate continued to have Romania (4,2%), less than in 2017 (4,9%). Kosovo had the highest unemployment rate (29,6%), but also less than in 2017 (30,5%). Except Kosovo, North Macedonia also had the unemployment rate above 20%; more precisely, 20,7%, which means that around a fifth of labour force in the country was out of a job in 2018. However, because of intensified emigrations and presence of the shadow economy, we should have doubt in official statistics about real picture of unemployment in some SEE countries. In order to make comparison to the EU countries, in the same year an average unemployment rate in the EU was 6,8%.
In 2018 the inflation rate was between 0.6% and 4.6%, excluding Turkey and Ukraine with the inflation rates as high as 20.3% and 10.9%, respectively (shown in Figure 6). In order to make comparison, in the same year an average inflation rate in the EU was 1.9%. 

Figure 5. Unemployment rate in the SEE countries over the period 2002-2018 (%)
More specifically, the lowest inflation rate, of 0.6%, was noticed in Greece, as the Economic and Monetary Union (EMU) member since 2001. Greece was followed by Kosovo that unilaterally adopted EUR in 2002, with the inflation rate of 1.1%, and then BiH that had a currency board system based on EUR as anchor currency since 2002 (earlier was used DEM), with the rate of 1.4%. Unlike in previous years, no cases of deflation were registered for the second consecutive year.
BANK CENTRICITY OF THE FINANCIAL SERVICE SECTORS

In all SEE region countries the financial service sectors are dominated by commercial banks. Hence, their financial service sectors are considered as being bank-centric. Banks (commercial) have been playing a decisive role for the economic stability and development for a long time.

The data on the SEE countries’ banking sectors was collected from the official reports of their relevant national supervisory institutions and with support of central banks and banking associations of some countries. After a brief introduction to the legal and institutional framework, a comparative analysis of the banking sector indicators among these countries will be done as well as their comparison to the developed European countries.

BASEL III REGULATORY FRAMEWORK AND BEYOND

Although the selected countries belong to the same region, South-East Europe, they are hardly comparable because of different level of their economic development, their political and historical background and, especially, different relations to the EU. As we have already mentioned, some are the EU member states, while others are in the process of accession.

SEE countries have different monetary policy regimes implemented. For example, Bulgaria and BiH have currency board arrangements, Kosovo and Montenegro have unilateral use of the euro, since 2001 Greece and since 2007 Slovenia have been the EMU(19) members, Croatia and Macedonia apply flexible but managed monetary policy regimes, etc. Despite that diversity the main goal of the central banks remains unique – maintenance of monetary and financial stability.

The banking supervision is generally assigned to the central banks. Exceptions are BiH, where the entities’ agencies (Banking Agency of the Federation BiH and Banking Agency of Republic of Srpska) supervise the bank activities, and Turkey, where Banking Regulation and Supervision Agency (BRSA) is in charge of supervision of banking sector.

In the case of all SEE countries, Basel Committee on Banking Supervision (BSBC) documents and the EU directives serve as the basic guidelines for designing the legal and institutional framework. However, while the SEE countries that are the EU member states fully implemented Basel III (Capital Requirements Directive IV/Capital Requirements Regulation - CRD IV/CRR package) until the beginning of 2019, the SEE countries that are non-EU member states are in the various stages of the process of adopting Basel III standards.

For example, in the case of Albania and Kosovo, in the process of the implementation of Basel III much need to be done. In BiH, the banking agencies, in collaboration with the experts of the International Monetary Fund (IMF) and the World Bank (WB), renamed the “Strategy for the Introduction of the ‘International Convergence of Capital Measurement and Capital Standards’” into the “Strategy for the Implementation of Basel III” and focused on the gradual transition to the new regulatory framework before Basel II was fully implemented. In 2017 in Serbia and then in 2018 in North Macedonia, banks successfully met the challenge of complying with the requirements that relate to the capital component of Basel III. Montenegro intends to fully adopt of Basel III requirements in 2020. Turkey’s banking regulatory and supervisory framework is in line with international standards. In conjunction with the IMF, the WB, the European Commission (EC), and other international financial institutions, Ukraine also works on implementation Basel III standards and the EU laws.
Moreover, the implementation of the Basel standards is a dynamic process, leading to continuous revisions and suggestions. Future changes of the legal and institutional framework will be a result of the EU improvement of the CRD/CRR regulatory package. In February 2019 EU ambassadors endorsed the full package of risk-reduction measures, which represent a more robust framework to regulate and supervise banks aimed at reducing risks in the EU banking sector. The package involves enhancing the framework for the resolution of banks, strengthening capital requirements for lenders, and improving banks' lending capacity and giving them a larger role in capital markets as well as a framework for information-sharing among regulators responsible for supervision and resolution of cross-border lenders. It also introduces changes aimed at improving cooperation between competent authorities on matters related to supervision of anti-money laundering activities.

Comparative Analysis of the Banking Sector Indicators

The size of the banking sector relative to GDP, in terms of total banks' assets as % of GDP, in the particular SEE countries indicates its great importance for the SEE's economies, as shown in Figure 7. Therefore, it is critical to assess the stability and resilience of the banking sector and to identify the most sensitive areas.

The total banks’ assets as a percentage of GDP in the SEE region countries was 96,8% in 2018. More specifically, while Greece recorded the largest share of banks’ assets in GDP (158,1%), Romania recorded the lowest share of banks’ assets in GDP in 2018 (51%). Apart from Greece, other SEE countries with the share of banks’ assets in GDP above the region average in 2018 were Croatia (106,8%), and Turkey (103,8%).

The amount of total assets held by EU banks expanded in 2018 after few years of consecutive contraction. This time enlarged by around EUR 500 billion from the previous year amounting to EUR 43,4 trillion (EUR 30,9 trillion in euro area and EUR 12,5 trillion in non-euro area). The expansion came basically from gain in the total assets in the euro area countries (1,6%). Total banks' assets in relation to the EU GDP in 2018 (EUR 15.909,0 billion, as we mentioned earlier) was 272,8%; in other words, it was 2,8 times higher compared to the SEE region's average. This indicator for the euro area was 267,3% (EUR 30,9 trillion to EUR 11,6 trillion). However, it differed significantly among the member countries (from slightly below one times GDP in Lithuania to almost 250 times GDP in Luxembourg).

As Figure 8 illustrates, over the period 2012-2018 the size of the banking sector increased in all countries except in Greece, Slovenia, and Ukraine. In 2018 Greece continue to decrease, while Slovenia and Ukraine are increasing, but still below the level in 2012. After the first drop of the

5 An asterisk (*) in the graphs means that the data for 2018 was not available and the data for the previous year was used.


size of the banking sector in 2017, Turkey continued to decrease significantly, but it is still above level from 2012. In the other SEE region countries there is significant increase in Romania, while the other countries increase slightly in comparison to 2017.

Figure 7. Total banks' assets as % of GDP in 2018

Figure 8. Total banks' assets over the period 2012-2018
The number of banks per SEE countries, represented in Figure 9, varied from 10 in Kosovo to 77 in Ukraine in 2018. It did not change significantly since 2012, except in Ukraine, where it dropped from 176 to 77, Greece, where it dropped from 52 to 37, as well as Croatia, where it dropped from 31 to 21.

While the downward trend in the number of EU credit institutions, which started in 2009, continued in 2018, consolidation in the banking sector continued helping to reduce overcapacity and aiming for enhancing profitability. According to the ECB’s the Consolidated Banking Data (CBD) with reference to end-June 2018, the EU banking sector consisted of 381 banking groups and 2.824 stand-alone credit institutions (including foreign subsidiaries and branches). Like in the SEE region, the number differed significantly among the EU member states.

Figure 9. Number of banks in 2018

The size of banks in 2018 measured as average assets per bank also varied significantly among the SEE countries, traditionally from the lowest level in Montenegro, EUR 293,8 million, to the highest in Turkey, EUR 11.637,3 million (see Figure 10). However, while this size increased in the case of Montenegro by 5,4%, in Turkey it declined by 11,7% in 2018 compared to the previous year.

The average assets per bank in the SEE region countries in 2018 was EUR 3.713,1 million (total bank’ assets in the SEE region countries, EUR 1.362,7 billion, divided to the overall number of banks, 367). For the purpose of comparison, the average assets per credit institution (i.e. banking group and stand-alone credit institution, including foreign subsidiary and branch) in the EU in 2018 was EUR 13.525,7 million and it was 3,6 times higher than the SEE region average.
If we compare the size of banks measured as average assets per bank in 2018 to 2012 (see Figure 11), we can clearly notice that the average assets per banks decreased only in Greece, by 7,1%, and Turkey, by 10,4%. On the contrary, it increased by more than 50% in BiH (70,8%), Bulgaria (58,8%), Albania (58,1%), Croatia (53,5%), and North Macedonia (52,1%), while in other countries it increased by less than 50% (in Serbia, by 49,5%; Romania, by 38,2%, Kosovo, by 33,1%, Ukraine, by 28,8%, Slovenia, by 15,8%, and Montenegro, by 15,1%).

In 2018 the market concentration measured as the share of five largest banks in the total banking assets, as shown in Figure 12, was the highest in Greece (96,8%), although it was much lower in 2012 (79%).

The lowest market concentration in 2018 was reported in Serbia (53,5%). Due to missing data, for Kosovo was used the share of three largest banks in the total banks’ assets.
Figure 11. Average assets per bank over the period 2012-2018

Figure 12. Market share of five largest banks in 2018 (%)
Figure 13 reveals that inasmuch as we observe the market share of the largest bank, it was the highest in Albania (29.4%), followed by Greece (29.1%), Croatia (27.4%), BiH (27.2%), and North Macedonia (22.7%). The other countries had the share of the largest bank around a fifth of the market or slightly less. The lowest share was noted in Turkey (15.0%).

Figure 13. Market share of the largest bank in 2018 (%)

Figure 14 shows that in all countries, except Turkey and Ukraine, there was a high share of foreign ownership in the total banking assets. It varied from 62% in Slovenia to 90.2% in Croatia.

As far as Turkey and Ukraine are concerned, their banking sectors were dominated by domestic banks (more precisely, 31.5% and 31.1% of the total assets were held by domestic banks, respectively). Due to missing data, the presented share for Greece referred to 2015.

Bearing in mind the underdevelopment of the SEE financial markets and, as a consequence, the banking orientation to a conservative (core business) approach, in terms of operating in a sphere of attracting deposits and lending money, in all countries net loans undoubtedly had the highest share in the banks’ assets, as shown in Figure 15.
Figure 14. Share of banks with majority foreign ownership in the total assets in 2018 (%)

Figure 15. Composition of banks’ assets in 2018 (%)
On the other side, Figure 16 illustrates the structure of total banks’ liabilities in 2018. In spite of quite different forms of reporting, we can conclude that in all countries, except Albania, Montenegro, and Ukraine, households and corporation deposits had the highest share in total banks’ liabilities. Albania and Montenegro are also dominated by deposits, but government deposits. While presented deposit share for Greece referred to “non-financial corporations and other than non-financial corporations deposits”, in the case of BiH it was presented “all deposits”, because of such reporting.

Figure 16. Composition of banks' liabilities in 2018 (%)
As far as the maturity structure of loans in 2018 is concerned, the share of long-term loans was significantly higher than the share of short-term loans in all countries, except Romania (Figure 18). In Romania, the share of short-term loans (83.6\%) was much higher than the share of long-term loans (16.4\%), similar to the structure of deposits by maturity.

The highest share of long-term loans in total loans was noted in Croatia (87.3\%), followed by Kosovo (86.8\%), North Macedonia (81.4\%), Montenegro (78.1\%), and BiH (78\%), which indicated to much or less mismatch between maturity structure of deposits and loans in those countries.

The currency structure of deposits in 2018, shown in Figure 19, reflects presence of a major part of deposits (more than 50\%) in the local/domestic currency, including Montenegro, where euro is local currency. The exception was Serbia, with the higher share of euro-denominated deposits (61\%) than deposits in dinar (33\%).

For some countries, such as North Macedonia and Turkey, deposits in euros were included in “deposits in other currencies”. Also, official data on currency structure of deposits as well as loans for Slovenia was not available.
As far as the currency structure of loans in 2018 is concerned, shown in Figure 20, we can notice that loans in the local currency were dominating in the loan currency structure, including...
Montenegro, where euro is local currency. Only countries with the shares of loans in the local currency less than 50% were Serbia and Albania (more precisely, with the shares of 31% and 48.9%, respectively).

While the highest share of loans in euros, where euro is not local currency, was registered in Serbia (66%), the highest share of loans in other currencies was recorded in Ukraine (38.8%). Like for deposits, data on Turkey’s currency structure of loans contained local and other currencies, without separation of euro currency.

Figure 20. Currency structure of loans in 2018 (%)

Considering the basic features of the banking sectors in 2018, concretely capital adequacy ratio in Figure 21, we can notice that the ratio in the countries varied between 15.6%, in Montenegro, and 23.1%, in Croatia, above the international standard of 8% or the rates required by national legislatives (10% or 12%).

Over the period 2012-2018 movements in the ratio showed a stagnancy or even positive trend, for example in Slovenia, where it increased from 11.9% in 2012 to 19.8% in 2018, and Greece, where it increased from 9.7% in 2012 to 16.6% in 2018. However, a rare decrease was recorded in Ukraine, where the ratio dropped from 18.1% in 2012 to 17.7% in 2018, which was still far from the minimum of 10% set by the National Bank of Ukraine.

In order to make comparison to the developed European countries, all capital ratios for the group of significant institutions in the eurozone, i.e. the banks supervised by the ECB, slightly
increased in June 2018 compared to the same period of the previous year. The Common Equity Tier 1 (CET1) ratio stood at 14,2%, the Tier 1 ratio at 15,5% and the total capital ratio at 18,4%.

Figure 21. Capital adequacy rate in 2018 (%)  

Additionally, the highest ratio of non-performing loans (NPLs) was recorded in Ukraine (52,9%), followed by Greece (45,4%). In Greece, the ratio of NPLs in total loans increased significantly from 31,3% in 2012 to 48,5% in 2016, and then fell in 2017 to 47,2% and in 2018 to 45,4%. In regard to Ukraine, the ratio of NPLs in total loans steadily increased since 2012, from 8,9% in 2012 to 35% in 2017, and then to 52,9% in 2018.

While in Romania the ratio of NPLs decreased from 18,2% in 2012 to 5% in 2018, in Serbia and Albania this ratio decreased from 18,6% and 22,5% in 2012 to 5,7% and 11,1%, respectively. In other countries like Turkey the ratio was relatively stable over the period. The lowest NPL ratio, 2,7%, was recorded in Kosovo (see Figure 22).

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Figure 22. Ratio of non-performing to total loans in 2018 (%)

Figure 23 represents that return on equity (ROE), a key indicator to assess the bank sector’s attractiveness for investors, was negative only in Greece (-0.3%), which was a continuum since 2014. The highest ROE in 2018 was registered in Kosovo (20.4%), followed by North Macedonia (16%) and Romania (14.9%). Interestingly, after four consecutive years of negative ROE, in 2018 Ukrainian banks recorded ROE of 11.4%.

The global financial crisis, 2007/08, has seen a strong uptake in NPLs in banks’ balance sheets, leaving policymakers worldwide concerned by this challenge. This trend has been exacerbated for some countries by the eurozone debt crisis, 2011/12, particularly in the SEE region, resulting in an EU-wide peak NPL ratio of 7.5% in 2012 (for example, before global financial crisis the ratio in Turkey was 2.5, while in BiH was 3%. But in the time of crisis the ratio increased at the level 5% and 12%, respectively).

However, NPL ratio trajectories point to a significant decline across the EU which can be mostly attributed to NPL sales and securitizations. In 2018 the ratio for the EU has stood below the world average of 6.88%, at 3.2%, which suggests that NPLs are no longer a specific European problem.  

With the ECB maintaining its ultra-low interest rates, profitability remains a key challenge facing European banks and the ROE has been slowly recovering. The ROE of European banks was 6.1% in 2018 for EU-28, up from 5.8% in 2017. While this is still far from the 10.6% registered in the

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9 The world average of NPLs as a percentage of all bank loans for 2018 was based on 121 countries, with the highest value in San Marino, 53.0%, followed by Ukraine and Greece. The lowest value of NPLs was registered in Monaco, 0.2% (https://www.theglobaleconomy.com/rankings/nonperforming_loans/, Accessed: May 2, 2020). The EU average of NPLs ratio at the end of 2018 was taken from the European Banking Authority’s (EBA) Report on NPLs (https://www.eba.europa.eu/file, Accessed: May 2, 2020).
burst of the financial crisis, it is the highest since 2007. The ROE across the EU countries diverged after 2007, signaling growing fragmentation, particularly across the eurozone. After reaching a peak in 2013 (25.8%), the dispersion around the average ROE has substantially decreased falling to 8.3% in 2014, 7.4% in 2015, 5.7% in 2016, 5.1% in 2017 and further into 2018 to 3.5%, for the first time, less than the 4.5% seen in 2007 before deviation started.10

Figure 23. Return on equity in 2018 (%)

As Figures 24 and 25 illustrate, like in the previous year, in 2018 Romania and Ukraine recorded both the highest ratio of liquid assets to total assets (53% and 49.9%, respectively) and the highest liquid assets to short-term financial liabilities ratio (180% and 93.5%, respectively), which were far above the observed group's average.

Also, liquid to total assets were repeatedly the lowest in Slovenia (12.2%), followed by Turkey (13.7%). The low liquid assets to short-term financial liabilities in 2018 were recorded in Greece and Turkey (26.5% and 26.8%, respectively).

However, in this liquidity analysis were included only countries with available data, that is, Kosovo, Serbia (missing ratio of liquid assets to short-term financial liabilities), and Slovenia were missing. Liquidity issues were highlighted in new capital accord and we can expect further improvement in this field of banking business.

Figure 24. Liquid to total assets in 2018 (%)

Figure 25. Liquid assets to short-term financial liabilities in 2018 (%)
Since the financial service sectors in SEE the region is highly bank-centric, the financial soundness of the banking sector has extreme importance for financial service sector and real sector of economy, their stability and growth. As we can conclude from the graphs, the SEE countries have had relatively high capital adequacy and, also, liquidity in their banking sectors. The resilience of the banking sectors will be strengthened by full implementation of Basel III requirements. Although reductions of NPLs ratio were reported across all SEE countries predominantly by those with higher starting ratio, NPLs remain unevenly distributed (from 2,7% in Kosovo and 4% in Slovenia to 45,4% in Greece and 52,9% in Ukraine) and elevated for some SEE countries.

KEY DETERMINANTS OF FUNCTIONING THE INSURANCE MARKETS

The data on insurance markets of the SEE countries was collected from the official reports of the countries’ relevant national supervisory institutions and with support of certain insurance associations. As a consequence, we could do a comparative insurance market analysis among the observed 13 countries using different parameters and, which is also important, comparison to the parameters for the Insurance Europe (IE), the European (re)insurance federation that represents the developed part of the European insurance market.

In order to illustrate the trends, we used the data from the reports since 2002, but descriptive analysis was focused on 2018 compared to the previous year and a deep market review will be presented. Additionally, in Part II of this publication, a detailed report of particular country insurance market indicators is provided for all countries. We collected the main market indicators for all countries as well as the other relevant data necessary for a comparative analysis for 2018 from their annual reports published by the relevant national institutions, as mentioned before.

Regarding the functioning of the SEE region insurance markets in 2018, we can assert that most markets continued to grow as in the previous years. However, an overall outlook of the region insurance markets would be much less remarkable without Turkey’s involvement.

TOWARDS MORE RISK-ORIENTED REGULATORY REGIME

In 2016 new regulatory regime, that is, Solvency II, has started to apply in the EU insurance and reinsurance businesses. As it is known, similar to Basel II and then Basel III in banking, Solvency II is based on a structure of following three pillars: (a) risk evaluation (quantitative requirements), (b) risk management (qualitative requirements or supervisory review process), and (c) transparency of risk (market discipline via disclosure requirements).

Bearing in mind at least six-year transition period, implementation of Solvency II did not cause many problems for most of the EU member states, in spite of a significant change of their legal and institutional framework. However, the SEE countries that are non-EU member states (that is, Albania, BiH, Kosovo, Serbia, Montenegro, North Macedonia, Turkey, and Ukraine) are still implementing regulatory regime Solvency I and their insurance markets are taking the appropriate steps in the preparation for Solvency II. Some of them are focusing on further liberalization of motor third-party liability (MTPL) insurance, a key line of the insurance business, while others are struggling with plenty of burdens, trying to provide a better supervision process and improve market discipline.
In the targeted year, 2018, the SEE countries that are the EU members (that is, Greece, Slovenia, Romania, Bulgaria, and Croatia) continued to focus on further meeting Solvency II requirements and establishing the related reporting process. The other countries continued to improve the regulation regarding MTPL insurance as well as popularize risk management practices in the insurance undertakings. Throughout the process of joining the EU, SEE countries that are non-EU member states will have the opportunity to use the technical support and projects to establish the EU’s Solvency II regime.

But, generally speaking, during 2018 most SEE countries did not make noticeable preparations for the new regulatory regime in their insurance sectors. Unlike in the developed part of Europe, insurance is still not perceived as an important factor of financial stability as well as economic development in these countries. In the following chapter we will find out why.

**THE INSURANCE MARKETS OVERVIEW**

The following comparative insurance market analysis among SEE countries as well as their comparison to the Insurance Europe members reveals a diversity concerning different criteria.

While in 2016 the SEE insurance market reached the largest growth since 2012 (at a rate of 11.1%) and in 2017 decreased by 1.5%, the total premium of the SEE region countries was EUR 24.082 million in 2018. This meant the further fall by 2.7% and it was mostly caused by similar trends of Turkish market in 2017 and 2018.

On the contrary, the total insurance premium of the Insurance Europe members was EUR 1.311,5 billion and it continued to increase, by 5.7%. The previous increase was 2%, in 2017 compared to 2016. Because of the introduction of the new regulatory regime, the comparability of the Insurance Europe members data with those of the years before 2016 is not plausible due to the changes in the methodology of data collection.

To put things in a perspective, the total insurance premium of the Insurance Europe members in 2018 was 54.5 times higher than the premium of the SEE countries. Because of the recent changes in the insurance premium volumes, the spread became even bigger compared to the previous year (50,1). In other words, from the perspective of the insurance premium volume, the SEE insurance markets fell from the very small level of 2% of the share in the Insurance Europe members’ premium in 2017 on the even smaller level, 1,8%, in 2018. It indicates on, among others, a primordial stage in the insurance culture development of the SEE region.

As Figure 26 shows, the total insurance premium of the SEE region in 2018 decreased because the country with the largest contribution to the region insurance landscape, that is, Turkey, as we mentioned at the beginning of the section devoted to the insurance, registered decline in the premium. The total premium volume of Turkey was EUR 9.643 million, 40% of the SEE insurance premium, and fell by 14.7% compared to 2017. Apart from that, since 2002, Turkey's insurance premium declined in 2004 by 25,1%, 2014 by 6,8%, and 2017 by 6,7% compared to the previous year. Hence, we can state that the decline in 2018 was moderate. The reason for the decrease in the last two years is a high level of inflation, since the premium amounts in the Turkish lira are increasing for both years.

The region country with the lowest insurance premium in 2018 was Montenegro, as the smallest country, with the premium of EUR 87 million (for EUR 5 million less than Kosovo, as the country
with the second smallest premium). Except Turkey, all countries registered a three-year continuity of premium increase.

Figure 26. Total premium of the SEE insurance markets over the period 2002-2018 (EUR millions)

By two following figures, Figure 27 and Figure 28, we can explain the trends in insurance penetration and insurance density in the region or, descriptively, the trends in the share of insurance premium in GDP and the insurance premium per capita, respectively. While an average insurance penetration for the region stayed at the level of 1,7%, the same as in 2017, insurance density of the SEE region in 2018 followed the trend of the total insurance premium. Namely, insurance density for the region in 2018 was EUR 129,8 and it was less by 2,4% than in 2017.

In the Insurance Europe members in 2018, insurance penetration was 7,5% (4,4 times higher than in the SEE region) and insurance density was EUR 2,169,4 (16,7 times higher than in the SEE region). As we can assume, both parameters, the insurance penetration and the insurance density, increased in the case of the Insurance Europe members in 2018 compared to the previous year – from 7,3% and EUR 2,048,8, respectively.
Specifically, by the comparative analysis of the countries, we can conclude that the largest level of insurance penetration was expectedly noted in Slovenia (5.1%) and that is the closest to the Insurance Europe average (7.5%, as mentioned earlier). Also, Slovenia had by far the best indicator of insurance density (EUR 1,133). All other countries of the region, except Greece (EUR 377), Croatia (EUR 325.1), and Bulgaria (EUR 185.2), continued to have features of poor insurance markets with insurance density less than EUR 150 (for example, EUR 140 in Montenegro, fifth largest penetration, and the lowest in Ukraine, only EUR 36.8).
As far as the structure of insurance premium of the SEE insurers is concerned, a situation with life insurance stayed almost unchanged. More precisely, the average share of life insurance in total premium of the SEE region in 2018 was 22.3%, while in 2017 was 22.8%. Simultaneously, when it comes to the Insurance Europe members, a situation with life insurance changed slightly, in a positive way. The average share of life insurance in the total premium in 2018 was 58.3%, while in 2017 was 57.9%.

Figure 29 confirms that the largest share of life insurance in 2018 was registered, as usual, in Greece (46.3%, by 1% less compared to 2017). Additionally, Croatia (31.8%), Slovenia (30.6%), Serbia (23.8%), Romania (20.7%) and BiH (20.1%) were the countries, among the remaining ones, that had the share of life insurance above 20%, that is, a fifth of the premium or more. The country with the smallest share of the life insurance in the total premium in 2018 stayed Kosovo (3.3%), but with a slight increase compared to the previous year (2.9%).
The further data about insurance markets of the SEE region in 2018 confirmed diversity among the countries regarding various criteria. Through the following figures we will analyze specific market indicators, starting with the market size data shown in Figure 30.

The total premium of EUR 24.082 million in 2018, where Turkey’s contribution was EUR 9.643 million or, in relative terms, 40%, made the SEE region as one of the least developed parts of Europe when it comes to insurance. Like in the previous three years, apart from Turkey, Greece (EUR 4.050 million), Slovenia (EUR 2.341 million), and Romania (EUR 2.179 million) were the only countries with the amount of the insurance premium above EUR 2.000 million in 2018. Nevertheless, considering the volume of the SEE economies, banking sectors as their inherent parts in particular, one of the mutual characteristics refers to a serious potential for insurance market growth in future.
While the total number of insurance and reinsurance undertakings conducting business in the Insurance Europe members was 3.236 in 2018, Figure 31 reveals that this parameter for the selected 13 markets of the SEE regions was 595. With only 1.8% of the share in the Insurance Europe members’ premium, having the share of 18.4% in the total number of companies operating there suggests that most countries of the SEE region had a disproportionately large number of companies in a relation to market’s premium.

As it is shown in Figure 32, this is most evident in Kosovo, where an average premium per company was EUR 6.1 million, 26.2 times less than in Turkey, as the country with the largest average premium per company (EUR 160.7 million), and, especially, the Insurance Europe members, 66 times (EUR 405.3 million). In other words, although Ukraine generated only 6.5% of the total insurance premium in the SEE region, with overall 281 insurance companies it participated with 47.3% in the total number of companies operating on the observed 13 markets.

The average premium per company for the observed markets in 2018 was EUR 40.5 million, that is 10 times less than the average premium of the Insurance Europe. Except Turkey (EUR 160.7 million), only Slovenia had an average premium per company above EUR 100 million (precisely, EUR 117.1 million). Bearing in mind the upcoming regulatory requirements set by Solvency II, these parameters indicate that further mergers and acquisitions or even liquidation of the insurance undertakings can be expected.
Figure 31. Number of companies on the SEE insurance markets in 2018

Figure 32. Average premium per company on the SEE insurance markets in 2018 (EUR millions)
The selected indicators of the market concentration are shown in Figures 33-36 (the data for Kosovo was not available). Figure 33 illustrates that Montenegro continued to have the highest market share of the largest company in 2018 (35.4%), which was the successor of the monopolistic state company that existed in the earlier country's economic and political system. Regarding this criterion, Montenegro was followed by Serbia (27.6%), Slovenia (27%), Croatia (26.5%), and Albania (24.1%), while in other countries the largest insurance company covered between 4.1 and 14.8% of the market.

Figure 33. Market share of the largest company on the SEE insurance markets in 2018 (%)

Moreover, Figures 34 and 35 refer to market shares of three and five largest companies, respectively. We can notice that in all analyzed countries three largest companies covered more than 25% and five largest companies covered more than 40% of the total markets. The exception was Ukraine.

The parameters linked to the market share of the three and five largest companies in the case of Ukraine were 11.8% and 17.7%, respectively. These shares were far less than the SEE average shares, which will be mentioned below.
Figure 34. Market share of three largest companies on the SEE insurance markets in 2018 (%)

Figure 35. Market share of five largest companies on the SEE insurance markets in 2018 (%)
The participation of small companies in the markets can be approximated by the number of companies with market share less than 3%, as shown in Figure 36. The total number of companies with the market share less than 3% in the observed countries was 454. Ukraine had the largest number of these companies (277), followed by Turkey (49) and Greece (39). The number of these companies declined over the last years as a consequence of mergers and acquisitions as well as bankruptcies.

![Figure 36. Number of companies with market share less than 3% on the SEE insurance markets in 2018](image)

Additionally, the average share of the largest company for the 12 observed markets was 14.5%, while the average share of the three largest companies was 38.1% and the five largest companies 47.4%. In order to make comparison to the Insurance Europe member states, the average share of the largest company in the last ones was 7.3%. The parameters regarding the three and five largest companies were 18.4% and 25.5%, respectively. Hence, the selected indicators of the market concentration and their comparison to the Insurance Europe members point to more concentrated insurance markets in the SEE region than in the developed part of the Europe.

Figure 37 represents the structure of the insurers according to the type of insurance they were focused on. In general, we can notice well-known dominance of nonlife insurers (434) over life and composite insurers (101 and 54, respectively). Exceptions were Slovenia and Croatia, where composite insurers had a prevalence. However, a composite type of insurers is prohibited in some countries, in other words, life and nonlife insurance have to be separated. As a consequence, it is easier for small domestic insurers to conduct their activities in the nonlife than life insurance lines of business. That is why the life insurance business on the SEE insurance markets is mostly "in the hands" of the insurers that come from the EU.
On the one hand, a low level of capacity competition of the domestic companies in life insurance business forced them to focus on less profitable – nonlife insurance business. On the other hand, efficiency of foreign insurers was reduced by the lack of insurance culture and predominant interest of the insurers in auto insurance, especially in mandatory MTPL insurance. Figure 38 illustrates the shares of life, MTPL, and other types of nonlife insurance on the selected markets in 2018.
Figure 38. Share of life, MTPL and other types of nonlife insurance premium on the SEE insurance markets in 2018

The share of life insurance in the total premium of the SEE insurance markets was 22.3%, while MTPL covered 26.5% and other nonlife 51.4%. More specifically, a high share of MTPL insurance on the market was evident in Albania (63.6%), Kosovo (59.7), and BiH (50.9%), while a contribution of the MTPL to the total premium in the other SEE countries was less than 50%, as we can see from Figure 39.

For comparison, an average share of the MTPL insurance in the total premium of the Insurance Europe members was only 5.2% and the share of the other nonlife insurance was 36.6% in 2018. The share of life insurance in the total premium of the Insurance Europe, as mentioned, was 58.3%.

The final figures regarding the introductory (general) considerations of the SEE insurance markets represent the numbers and market share of companies with the majority of domestic and foreign ownership for the seven countries with available data – BiH, Croatia, Kosovo, Montenegro, North Macedonia, Serbia, and Turkey. Except in the case of BiH, foreign insurers were prevalent in all observed markets (see Figure 40). As far as the foreign insurers are concerned, there were many examples of insurers from one SEE country, such as Slovenia and Croatia, operating on the markets of other countries of the region, like BiH.
Figure 39. MTPL shares on the SEE insurance markets in 2018

Figure 40. Number of companies with majority of domestic and foreign ownership on the SEE insurance markets in 2018
As Figure 41 reveals, foreign insurers were covering more than a half of the total premium in the observed markets with the available data – BiH, North Macedonia, Serbia as well as Turkey. The largest market share of foreign insurers was repeatedly registered in North Macedonia, where foreign insurers covered 89,5% of the market.

Figure 41. Market share of companies with majority of domestic and foreign ownership on the SEE insurance markets in 2018

Considering all aforementioned about the SEE insurance markets we could gain a knowledge and understanding of a diversity as well as mutual characteristics of the SEE insurance markets. A key determinant of the markets is undoubtedly its general underdevelopment compared to the Insurance Europe members states, while on the other side there is a huge potential for their growth.

OTHER RELEVANT FINANCIAL INSTITUTIONS IN THE FINANCIAL SERVICE SECTORS IN 2018

Based on the previously mentioned reports related to the banks and/or insurance companies, the contributions of the other relevant financial institutions to the financial service sectors in all SEE region countries, except Greece and Ukraine (for which data was not available), over the period 2007-2018 can be illustrated as shown in Figure 42. The shares on the most selected markets were increased or were relatively stable. On the contrary, BiH was continuously recorded the decrease, while Montenegro recorded the same trend like BiH until 2018, when it increased like in most other SEE countries.
More detailed data on the other financial institutions in the SEE countries’ financial service sectors in 2018 was collected from the official reports published by their relevant national supervisory institutions. The PART II of the report included the segments related to these institutions consisting of data for these institutions for several years. Since the reporting on the country levels for these institutions is not well organized and data is not well structured, like in case of banks and insurance companies, for some countries there is missing data for 2018. Nevertheless, below we will give an overview of other relevant financial institutions by each country in order to shed some lights on this part of the sectors, much smaller than banking share. In fact, it will be highlighted specifics of other financial intermediaries and the range of their activities in the SEE financial service sectors.

When it comes to Albania, the share of other relevant financial institutions in the overall assets circulated in the financial system was 7.8% in 2018 and it slightly decreased compared to the 2017 (8.1%). There were three voluntary pension funds and they invested mostly in government securities (e.g. treasury bonds and bills). Also, four investment funds operated on the market. According to the official data, in 2018 they invested 61.3% of their assets in government bonds, 17.5% in treasury bills, 13.1% in cash and cash equivalents, 3% in corporate bonds, 3.9% in other investments, and 1.1% in other assets. In 2016 through the mergers, by absorption, the process of the reorganization of 98 existing saving and loans associations.
finished. At the end of 2017 there were 13 saving and loans associations and one union savings and loan associations and no new licenses were granted until 2019, when one new saving and loans association was licenced. Micro-credit organizations (or microfinance institutions) as well as leasing companies operated on Albanian financial market. Regarding the object of the leasing, in 2018 the leasing portfolio was dominated by financing for personal transport vehicles (58,8%) and working transport vehicles (24,8%).

The share of other relevant financial institutions in BiH financial system was 6,1% in 2018 and it did not change compared to the previous year. Despite the entities’ strategies for pension reforms created in conjunction with the WB experts and adopted in 2007, the pension fund reform in BiH is still not over and in practice it has actually been stopped. However, in 2017 the first voluntary pension fund management company was founded and the first voluntary pension fund (“European Voluntary Pension Fund”) started to operate. Investments funds are mostly closed-end, as a result of legally permitted transformation from privatization investment funds in the 2000s. Regarding the investment structure of 35 BiH investment funds, they invested the main part of the assets in stocks and shares (63,7% the investment funds located in the Federation BiH and 60,6% the investment funds in Republic of Srpska). The micro-credit sector of BiH has played a significant role in reducing poverty and supporting the development of entrepreneurship among the socially vulnerable parts of the population, which have no access to financial resources at traditional banks. The results achieved for the period since the establishment of the micro-credit sector rank BiH among the countries of the world that have gone further in the development of this area of financial offer. In 2018 on the BiH market 25 micro-credit organizations were functioning, out of which 14 operated as micro-credit foundations and 11 as micro-credit companies. They invested mostly in the net loans (in Federation BiH 78% of their assets and 81,6% in Republic of Srpska). When we consider the portfolio of 7 BiH leasing companies, 88% of all arrangements were financial and 12% operational leasing. The object of the leasing were mainly vehicles for business purposes and, expectedly, the users were mainly legal entities. There also were 8 brokerage houses in the financial structure of BiH in 2018.

The share of other relevant financial institutions in the financial service sector of Bulgaria was significantly higher than in Albania and BiH, at the value of 16,7% in 2018 and it slightly declined compared to the previous year (17,2%). Unlike BiH, in 2015 Bulgaria adopted the WB three-pillar model with a mandatory state pillar, a mandatory funded pillar and a voluntary supplementary third pillar. The supplementary pension insurance was implemented by participation in mandatory universal and/or professional pension funds, supplementary voluntary pension funds and/or supplementary voluntary pension funds with occupational schemes, which were established and managed by pension insurance companies licensed by the Financial Supervision Commission. At the end of 2018, the structure of the pension insurance market remained unchanged compared to 2017 as well as 2016, in terms of the number of licensed pension companies (9) and the number of pension funds (28). They invested dominantly in debt securities, issued or guaranteed by the EU member states or by their central banks (46,2%). Investment funds in Bulgaria can be classified into two broad groups – resident and non-resident. As far as their portfolio structure is concerned, it is interesting that the funds mainly invested in shares and other equity (39,6%), then securities other than shares (24,9%), and then deposits (23,2%). Moreover, in the portfolio of Bulgarian leasing companies the highest share had loans (85,5%). Much more leasing was financial (94,4%) than operational (5,6%), on
the observed three-year continuity. The object of both leasing contracts were usually cars, transport and commercial vehicles as well as machinery and industrial equipment.

In 2018, almost a quarter of the financial service sector (25.3%) in Croatia was made up of other relevant financial institutions, such as pension and investment funds, credit unions, and leasing companies. The share stayed almost unchanged compared to the previous year (25.5%). Similar to Bulgaria, there were mandatory pension fund (12), which may belong to the one of the three categories (A, B or C), and voluntary pension funds, which may be of an open-end (8) or closed-end type (21). Mandatory pension funds invested 96.6% of their assets in securities and deposits, out of which the most in domestic government bonds (68.4%). Also, while voluntary open-end investment funds had 90.5% of the investment structure in securities and deposits (out of which 56.2% in domestic government bonds), voluntary closed-end funds had 88.1% in the same items (out of which 51.2% in domestic government bonds). There were many investment funds of two types in Croatia in 2018 – 96 open-ended investment funds with public offering (UCITS) and 35 alternative investment funds. UCITS funds predominantly invested in government bonds (58.8%), then deposits (16.3%), money market instruments (11.3%), shares and global depositary receipts (9.5%), UCITS funds (2.6%), and corporate bonds (1.7%). With regards to the country of the origin of issuers, these funds continued to invest the most in domestic securities (83.6% in 2018). Moreover, credit unions nowadays play the role of micro-credit organisations in Croatia. As a result of the initiative of nine credit unions, the Croatian credit unions association was established on July 1, 2011, in order to achieve mutual interests. Besides, the majority of leasing companies in Croatia belong to the group of financial institutions and they traditionally offer financial as well as operational leasing services/products. In 2018, the most of the leasing contracts referred to passenger cars, commercial vehicles, plants, machinery, transport machines and equipment. The most frequent users were non-financial institutions (i.e. companies).

Despite the fact that in Greece there are also three pillars of the pension system, the first pillar on the social security accounts for more than 99% of its whole system. Voluntary occupational and private pension plans existed in 2018, but they still were of minor importance. Greek UCITS included two basic types of collective investment undertakings – mutual funds and variable capital investment companies. Both fund types were open-end. According to type, in 2018 out of 316 mutual funds, 78 were funds of funds, 76 bond and equity each, 45 balanced, 31 money market, and 10 specialized. The existing Banking Law requires a minimum capital of EUR 18 million to carry out financial or credit activities. A partnership with a licensed bank is required by all legal entities such as NGOs (including associations, foundations, etc.) that are interested in serving the micro-credit market. Among other relevant financial institutions, in 2018 in Greece operated leasing as well as factoring companies.

Pension funds, micro-credit organizations and leasing companies as other relevant financial institutions in Kosovo participated with the share of 30.9% in the financial structure in 2018, slightly less than in the previous year (31.3%) and not far away from the share of other relevant financial institution in Croatian financial structure. "Kosovo Pension Savings Trust" ("Trusti") was established in August 2002 to administer and manage mandatory and voluntary pension contributions of Kosovo’s employers and is supervised by the Central Bank of Kosovo (CBK). Since 2008, there were two pension fund management companies – "Trusti", with an exclusive mandate to administer compulsory pension contributions (second pillar), and the "Slovenian Kosovo Pension Fund", licensed also by the CBK to administer only voluntary pension funds.
Pension funds mostly invested abroad (89.8%). The vast majority of microfinance institutions in Kosovo has non-governmental organization (NGO) status. They are supervised by the CBK. The leasing sector in Kosovo is at early stage of development and the Raiffeisen Leasing Kosovo was still the only financial institution that offered this kind of financial services in the country in 2018. The main activity of this leasing company was to provide financial leasing for vehicles, equipment or machinery as well as real estate.

When it comes to Montenegrin financial service sector, we can state that the role of the third group of financial institutions – other relevant financial institutions – has still not been recognized. Their contribution was only 3.1% in 2018, which was a slight increase compared to the share in 2017, of 2.4%. Since 2002 it has been relatively stable or even in decline. Two voluntary pension funds operated in Montenegro in 2018, out of which one mostly invested in deposits (58.5%) and the other one in the investment funds (65.4%). Four closed-end and open-end funds each operated in the industry of the investment funds. They invested 86.1% of their assets in securities. Seven micro-credit organizations invested 61.4% of the assets in loans, out of which 96.4% to loan to citizens. Moreover, in 2018 four leasing companies continued to conduct their businesses, while 77.6% of the leasing activities referred to financial leasing and 22.4% to operational. The main object of the leasing contracts were passenger cars (88.9%).

In North Macedonia 13.9% of the assets in the financial service sector referred to other relevant financial institutions in 2018, which was a slight increase from 13.5% registered in the previous year. The fully funded pension insurance included two pension companies. Both companies managed one mandatory pension fund and one voluntary pension fund. They mostly invested in bonds of domestic issuers (54.7%). Investment funds continued to have small contribution among institutional investors (that is, 1%, while the pension funds had the share of 10.8%, and the insurance companies contributed with 3.5%). In 2017 (the last available data) there were 15 open-end funds and not a single closed-end fund. The existing funds invested 48.5% of the assets in deposits. In 2017, the number of leasing companies remained seven, unchanged compared to the previous year. Unlike the previous years, when the scope of activities of this sector was continuously decreasing, in 2017, the total assets of the leasing companies increased by 20%. All companies were with 100% foreign capital but the leasing market was still underdeveloped. Also, there were two saving houses and four financial companies on the market, relatively small according to the volume of their activities.

In Romania 20.6% of the financial assets were possessed by other relevant financial institutions in 2018, just like in the previous year (20.2%). There were 17 pension funds, out of which 10 voluntary and seven mandatory, which functioned on the market. They invested 63.8% of the assets in government securities. Apart from pension funds, 154 investment funds operated in Romania in 2018, out of which 130 were open-end and 24 were close-end. The number of the non-bank financial institutions in the General Register increased from 177 in 2016 to 183 in 2017 and then decreased to 178 in 2018. Their primary activities were multiple lending activities, more precisely, 83.7% of the non-bank financial institutions in 2018.

Just like in Montenegrin financial service sector, 3.1% was the share of other relevant financial institutions in Serbian financial structure in 2018 and it stayed unchanged compared to the previous year (3%). The pension reform finished in 2006, since only voluntary pension funds have been operating. Four companies managed seven voluntary pension funds, one custody bank and five agent banks. As far as the investment structure of the pension funds is concerned,
they invested 83,1% of their assets in the government debt securities in 2018. Besides, there were two types of investment funds on the market – open-end investment funds with public offering and alternative investment funds. In total, 21 investment funds on the market in 2018 mostly invested in short-term and cash deposits (69,7%), more in domestic currency (54,0%) than euro (36,0%). Micro-credits in Serbian financial system are approved exclusively by banks, and money control is carried out by UNHCR donors and tax authorities. Moreover, 17 leasing companies operated on the market and at the end of 2018 their financing of commercial vehicles, minibuses and buses continued to account for the largest share of financial lease (41,2%) as well as to the financing of passenger vehicles (35,1 %).

When we analyse the financial structure of Slovenia, we can notice that 11,2% of the structure related to other financial institutions in 2018, which was a slight decline compared to the previous years (11,8%). The “First Pension Fund” (PPS) represents a special type of a pension fund designed to cover for payments of pension annuities from insurance policies under supplementary pension insurance and is managed by “Modra Zavarovalnica” d.d., which activities are defined by the law and the Company’s Articles of Association. Regarding the investment funds, at the end of 2017, seven management companies operated, which managed six umbrella funds with 96 sub-funds and four mutual funds. The Leasing Committee, established as a leasing office within the Bank Association, represents the leasing industry in Slovenia. Related to the leasing activities, there were relevant trends in 2017 such as the sale of the portfolios of the leasing companies, the sale of certain leasing companies, the specialisation of the member institutions, the changes in business models, etc. As it was the case in the previous years, in 2018 the leasing business grew only in the segment of automotive and equipment financing.

The contribution of other relevant financial institutions in Turkey’s financial service sector was 7,5% in 2018 and it decreased from 8,9% in 2017. The number of active pension investment funds as of the end of 2017 (the last available data) was 299, which were managed by 18 pension companies. Moreover, in 2018 on the market operated 489 investments funds. The funds mostly invested in private sector debt securities. Also, there were 23 leasing companies on the market in 2018. While the share of financial leasing receivables in the aggregate leasing companies balance-sheet was 88,6%, a main object of the leasing contracts were heavy equipment and construction machinery (21,5%). However, the supply of microfinance services in Turkey is still very limited, both in terms of the numbers of citizens served and the range of services offered.

Other relevant financial institutions in Ukraine involve pension funds, investment funds, credit unions as well as leasing companies. Pension reform was introduced in October 2017. This reform has been one of the IMF’s key demands for Ukraine in order to release an USD 8,4 billion tranche of finance, part of its USD 17,5 billion loan program. However, according to a survey, 49% of Ukrainians do not support the pension reform. In 2018, 1,436 investment funds operated on the market and 40,2% of their assets was invested in equities. Like in Turkey, microfinance in Ukraine is not developed and the microfinance segment is mostly served by banks or credit unions, though NGOs are present on the market. Credit unions are the main non-bank financial institutions serving the financial needs of small and medium enterprises. The overall size of the credit union segment is very small, relative to the financial system. Similarly, the leasing market has been developing slowly. In 2000, the overall contribution of the leasing assets was registered at the level of 1,0% (the lowest in Europe). Vehicles (cars, trucks, LCV) were still
the main subject of leasing in Ukraine, comprising more than 70% of all items leased during 2017. Ukrainian leasing market is rebuilding slowly after a sharp drop of 42% in leasing agreements in 2015. Lessor were mostly interested in the leasing of equipment that is highly liquid and can be easily repossessed and resold.

Summa summarum, considering the other financial institutions in the SEE countries’ financial structures in 2018 we can conclude that there was a wide spectrum of various types of financial institutions other than banks and (re)insurance companies, such as investment funds and voluntary pension funds, leasing companies, micro-credit organizations (or microfinance institutions), credit unions, saving and loans associations, brokerage houses, factoring companies, etc. Their share(s) ranged from 3.1% in both Montenegro and Serbia to 25.3% in Croatia and 30.9% in Kosovo and it has been relatively stable in recent years. Knowing the fact about bank centricity of the financial service sectors, as we could assume, the investment potentials of other relevant financial institutions in the SEE region countries are still far below the banks.

SUSTAINABLE INVESTMENTS, FINANCE AND ENERGY SECTOR

**INTRODUCTORY CONSIDERATION OF SUSTAINABLE INVESTMENTS, STRATEGIES AND RETURN ISSUE**

The common meanings of *investment* include “giving one’s capital a new form” and “to endow with a quality or characteristic” (Haigh, 2012). **Sustainable investing**, also known as socially responsible, values-based, ethical, and impact investing, refers to the process of incorporating environmental, social, and governance (ESG) factors, both positive and negative, into the context/account of portfolio securities selection and management, investment analysis and decision-making.

In this regard, those who invest sustainably choose to invest in companies as well as investment funds in order to generate not only economic effects (i.e. financial returns) but also measurable environmental and social outcomes (i.e. intrinsic returns). Sustainable investing involves the practice of investing money, aligned with values and personal priorities of the investors, in companies and funds that generate positive social and environmental impacts, while staying focused on pursuing long-term competitive financial returns. What is very important, the impacts are spread across multiple areas – from renewable energy and climate change to health, safety, community development, gender balance, biodiversity, etc.

From a broader historical standpoint, socially responsible investing is not a novelty. Its basics lay even in the holy books, in term of investing aligned with ethical and moral values (Nuhanović, Kozarević, 2020). In general, we can state that sustainable investments mean eschewing investments in companies that produce and/or sell addictive substances (like illicit drugs, alcohol, and tobacco), gambling industry, pornography, weapon manufacturing, coal mining industry as well as companies involved in animal testing and genetically modified products in favour of seeking out companies that are engaged in social justice, environmental sustainability, and alternative energy (i.e. companies involved in clean/green energy or other technologies that balance the interaction between humans and the environment, supporting underserved individuals or communities in areas such as mortgages or small business credit, investment products geared towards advancing women, etc.). However, because there are many
different viewpoints on what constitutes the proper values to seek in companies, it is difficult to provide a universally accepted definition of sustainable investments, that is, of companies suitable for this kind of investments. For some investors, being socially responsible means not investing in companies involved in wine production (and commerce); while for others, wine production is quite acceptable. The most commonly negatively screened companies are those involved in tobacco and tobacco-related products business, because tobacco is almost universally seen as detrimental.

The terms sustainability and responsibility are mutually connected. Sustainability means taking responsibility for preserving the stock of wealth a society might lay claim to (including facilitating networks or social capital) and ecological systems. At its base, sustainability always concerns temporality and, in particular, longevity (Costanza, Patten, 1995).

According to Global Sustainable Investment Alliance (GSIA, 2012) as well as the European Sustainable Investment Forum (Eurosif, 2020), sustainable investment involves the following seven strategies:

1) Negative (exclusionary) screening;
2) Positive (best-in-class) screening;
3) Norms-based screening;
4) Environmental, social, and governance (ESG) integration;
5) Sustainability-themed investing (investment in themes or assets linked to the development of sustainability);
6) Impact (community) investing, and
7) Corporate engagement and shareholder action (engagement activities and active ownership through voting of shares and engagement with companies on ESG matters).

As the oldest and extremely popular sustainable investment strategy, negative screening systematically excludes specific investments or classes of investments from the investible universe/market such as companies, sectors or countries that are involved in certain activities, based on specific criteria. The criteria usually include weapons, tobacco, animal testing, and pornography. Exclusions can be applied at individual fund or mandate level, but increasingly also at asset manager or asset owner level, across the entire product range of assets. This approach is referred to as ethical- or values-based exclusions too, as exclusion criteria are usually based on the choices made by asset managers or asset owners.11

Positive screening can be defined as an approach where leading or best-performing investments within a universe/market, category or class are selected or weighted based on ESG criteria. This approach involves the selection or weighting of the best performing or most improved companies or assets as identified by ESG analysis, within a defined investment universe/market. This approach includes best-in-class, best-in-universe, and best-effort.

Norms-based screening is actually screening of investments according to their compliance with international standards and norms, or their combinations, covering ESG factors.

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11 There is an opinion that exclusion strategy, when practiced alone, does not constitute real sustainable and responsible investments (SRIs). The protagonists argue that for everyone who divests from an industry, there will be another investor willing to buy such that the investee company suffers no impact. Therefore, for a negative screening to be meaningful, it needs to be applied together with some attempt at engagement and voting.
International norms on ESG are those defined/issued by international bodies such as the United Nations (UN), United Nations International Children’s Emergency Fund (UNICEF), Organization for Economic Co-operation and Development (OECD), and International Labour Organization (ILO).

**ESG integration** means the explicit inclusion by asset managers of ESG risks and opportunities into traditional financial analysis and investment decisions based on a systematic process and appropriate research sources. This type of the strategy, with growing popularity, covers explicit consideration of ESG factors alongside financial factors in the mainstream analysis of investments. The integration process focuses on the potential impact of ESG issues on company financials, both positive and negative, which in turn may affect the investment decision (see Table 1).

Table 1. ESG factors

<table>
<thead>
<tr>
<th>ESG issues/concerns</th>
<th>Content/aspects</th>
<th>Examples</th>
</tr>
</thead>
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| **Environmental issues** | Any aspect of a company’s activity that affects the environment in a positive or negative manner | - Renewable energy  
- Energy efficiency  
- Greenhouse gas emissions  
- Chemical pollution  
- Resource depletion  
- Water management  
- Waste management  
- Impact on biodiversity… |
| **Social issues** | Vary from community-related aspects, such as the improvement of health and education, to workplace-related issues, including the adherence to human rights, non-discrimination, and stakeholder engagement | - Labour standards (along the supply chain, child labour, forced labour)  
- Relations with local communities  
- Talent management  
- Controversial business practices (weapons, conflict zones, …)  
- Health standards  
- Gender balance  
- Freedom of association… |
| **Governance issues** | A quality of a company’s management, culture, risk profile, and other characteristics; the board accountability and their dedication towards, and strategic management of, social and environmental performance; accent on principles such as transparent reporting and the realization of management tasks in a manner that is essentially free of abuse and corruption | - Corporate governance issues (executive remuneration, shareholder rights, board structure, …)  
- Bribery  
- Corruption  
- Stakeholder dialogue  
- Lobbying activities… |

**Sustainability-themed investing** means investing in themes or assets specifically related to sustainability, for example clean energy, green technology or sustainable agriculture. In other words, this approach focuses on specific or multiple issues related to ESG. Sustainability-themed investments inherently contribute to addressing social and/or environmental challenges such as climate change, eco-efficiency, and health. Thematic funds are required to have an ESG analysis or screen of investments in order to be counted in this approach.

**Impact investing** refers to investments aimed at solving social or environmental issues alongside a financial return. Community investing, whereby capital is specifically directed to traditionally underserved individuals or communities, is included in this category as well as
financing that is provided to businesses with an explicit social or environmental purpose (e.g. microfinance, community investing, social business/entrepreneurship funds, etc).

**Engagement and voting** is a long-term process, seeking to influence behaviour or increase disclosure. In its base, this approach involves the use of shareholder power to influence corporate behaviour, including through direct corporate engagement (i.e. communicating with senior management and/or boards of companies), filing or co-filing shareholder proposals, and proxy voting that is guided by comprehensive ESG guidelines. However, engagement and voting on corporate governance only is necessary, but not sufficient to be counted in the latest sustainable investment strategy. More general, sustainable investment strategies are not all mutually exclusive as investors could do both corporate engagement and ESG integration, for example.

A very important question in this regard is whether the investors have to sacrifice returns in favour of ESG impacts when deal with sustainable activities. Several surveys have been conducted worldwide. The results of the empirical analysis in the Norwegian stock market indicated that one does not have to sacrifice return for investment opportunities that are in line with their personal values (Fiskerstrand et al., 2019). The results of one German study, which took into the account both strong bear and bull market, underlined that investors in sustainability funds do not have to sacrifice financial performance (Mervelskemper, Kaltofen, Stein, 2014). Rong Ang (2015) found that the performance of SRI in Korea does not exhibit additional instability than what occurs in the behaviour of conventional indices during crisis and non-crisis periods and thus can be an alternative investment opportunity for investors to consider for international diversification purpose.

Interestingly, Arslan-Ayaydin et al. (2016) compared *sukuk* (Islamic bonds) and conventional bonds, bearing in mind that Islamic finance just like SRI has a social value component. They learnt that, after correcting for risk, the returns on *sukuk* are significantly higher than those of conventional bonds. It meant that investors are not paying for being ethical, but issuers of *sukuk* bear a higher cost of debt compared to issuers of conventional bonds.

Considering the aforementioned, we can conclude that sustainable investments are good for business as well as society and investors do not necessarily have to choose between returns and positive impacts.

**GLOBAL SUSTAINABLE INVESTMENT REVIEW**

As far as global dispersion of sustainable and responsible assets is concerned, in 2018 Europe managed the highest proportion of the assets, 46%, followed by the United States, 39% (shown in Figure 43). Nevertheless, the fastest growing region over the period 2016-2018 was Japan, followed by Australia/New Zealand, and Canada.
In **Europe**, total assets committed to sustainable and responsible investment (SRI) strategies grew by 11% from 2016 to 2018, to reach **EUR 12.300 billion (USD 14.100 billion)**, but their share of the overall market declined from 53% to 46% of total professionally managed assets. The slight drop may be due to a move to stricter Eurosif standards and definitions. Although **negative screening** remained the dominant strategy at EUR 9.500 billion, this was down from the EUR 10.200 billion reported under this strategy in 2016. Corporate engagement and shareholder action was the second most widely practiced strategy, up from third place in 2016, with the assets involved in this strategy growing 14%. Norms-based screening, which was the second most widely practiced strategy in 2016, ranked in fourth place. Meanwhile, ESG integration moved from fourth place to third place; the assets managed under this strategy grew 60% from 2016 to reach EUR 4.200 billion in 2018; notably this growth occurred after Eurosif adopted a stricter definition of ESG integration for its 2016 study.

From 2012 to 2014 in the **United States**, sustainable investments grew 107,4% per year and in 2014 accounted for 18% of USD 36.800 billion (EUR 30.300 billion) in the assets under management in the wealth and asset management industry, *i.e.* USD 6.570 billion or EUR 4.700 billion (US SIF Foundation, Ltd., 2014). Simultaneously, the number of sustainable investing funds increased by 28,5% or, compared to 2008, nearly tripled (Table 2).12

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12 One of the first open-end investment funds to incorporate socially responsible screening was the **Pioneer Fund (PIOX)**, which has avoided the stocks of companies whose primary business has been alcohol or tobacco since 1950 (https://www.investopedia.com/articles/07/clean_and_green.asp, Accessed: January 8, 2020).
Table 2. Growth in sustainable investing funds

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<tr>
<td>Number of funds</td>
<td>200</td>
<td>231</td>
<td>338</td>
<td>493</td>
<td>720</td>
<td>925</td>
</tr>
</tbody>
</table>

Source: Ernst & Young LLP, 2017

From 1995, when the US SIF Foundation, Ltd., first measured the size of the US SRI market, to 2018, the sustainable, responsible and impact investing universe/market has increased more than 18 times, a compound annual growth rate of 13.6%. According to latest available data, sustainable, responsible, and impact investing in the United States has continued to expand at a healthy pace. The total US-domiciled assets under management using SRI strategies grew from USD 8.700 billion (EUR 8.250 billion) at the start of 2016 to USD 12.000 billion (EUR 10.000 billion) at the start of 2018, an increase of 38%. This represents 26% – or 1 in 4 dollars – of the USD 46.600 billion (EUR 40.700 billion) in total US assets under professional management (US SIF Foundation, Ltd., 2018). The dominant sustainable investment strategy in the United States in 2018 was ESG integration and it was used across an estimated USD 9.500 billion (EUR 8.300 billion) in the assets. Negative screening was in the second place.

In Japan, sustainable investing assets quadrupled from 2016 to 2018, growing from just 3% of total professionally managed assets in the country to 18%. The growth has made Japan the third largest centre for sustainable investing after Europe and the United States, with the amount of JPY 232.000 billion (EUR 1.900 billion). The leading sustainable investing strategy in the country is corporate engagement and shareholder action, deployed by assets totaling JPY 141.000 billion, followed by ESG integration, which is practiced across JPY 122.000 billion. In the last few years, a number of developments have driven the significant expansion in the sustainable investment market in Japan. The first is Shinzo Abe administration’s continuing encouragement of private sector investment as part of its economic growth strategy as well as initiatives by various government bureaus. Adding to the growing awareness of sustainable investing in Japan were the decisions by two major institutional asset owners to become signatories to the Principles for Responsible Investment – the giant Government Pension Investment Fund in 2015 and the Pension Fund Association in 2016.

From 2016 to 2018, assets managed with responsible investment strategies in Canada grew by 42%. The growth was even more impressive in terms of market share. Responsible investments accounted for just over 50% of professionally managed assets in the country or, in absolutely terms CAD 2.100 billion (EUR 1.500 billion), up from 38% in 2016. This marked a major milestone in the history and development of responsible investing in Canada. The most prominent responsible investing strategy practiced in Canada, in asset-weighted terms, continued to be ESG integration, with corporate engagement in second place. The most rapidly growing strategy was negative screening; assets managed with this strategy grew 64% over the two-year period. Impact investing continued to be a small category, but one that experienced rapid growth, by 60%, since 2016.

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13 Reports on US Sustainable, Responsible and Impact Investing Trends have been making on the biennial basis.

14 Money managers reporting in more detail said that climate change was the leading ESG issue for them in asset-weighted terms.
The 2018 survey by the Responsible Investing Association of Australasia (RIAA) revealed that a responsible approach to investing – one that systematically considers environmental, social, and corporate governance and/or ethical factors across the entire portfolio – represented 63% of the assets managed professionally in the region of Australia and New Zealand or, in absolutely terms, **AUD 1.000 billion (EUR 600 billion)**, up from 51% in 2016. In Australia, 78% of the responsible investing assets were managed through what RIAA terms a "broad" strategy that emphasized **ESG integration and corporate engagement**, while 22% were managed through the “core” responsible investment strategies of screening, sustainability-themed investing or impact investing. Broad responsible investing approaches accounted for 53% of responsible investing assets in New Zealand (GSIA, 2018).

**European market of SRIs**

In Europe, where sustainable investing has long been practiced, there are signs that the market is maturing. The reduction in the share of the European investment market in part stems from the intense **debate over defining sustainable investing**. Since the end of 2016 the European Commission was considering action points to finalize its sustainable finance policy.¹⁵ The main elements that will influence and guide investors refer to the development of a common taxonomy or wide classification system for sustainable investing and the definition of a **green bond standard**¹⁶ and an **ecolabel**¹⁷.

In March 2019, the European Parliament adopted rules under the European Commission **Action Plan on Sustainable Finance** to require asset managers to use a common reporting standard to disclose how they consider ESG factors and to prevent them from “greenwashing”, in terms of overstating their commitment to sustainable investing.¹⁸ In fact, the majority of the recommendations set out by the European Commission are in line with adding a much-needed layer of transparency on what sustainable finance is and guide investors in the right direction.

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¹⁵ In December 2016 the European Commission established the High-level expert group on sustainable finance (HLEG) and then, in July 2018, the Technical Expert Group on sustainable finance (TEG).

¹⁶ Although they represent a tiny fraction of the overall debt market, green bonds have grown rapidly over the last six years. Issuance totaled EUR 141 billion in 2018 (Chaudhry, Laidlaw, 2019). By **EU Green Bond Standard** (GBS), green bond – debt that finances environmentally friendly projects such as wind farms or solar power – is defined as “any type of listed or unlisted bond or capital market debt instrument issued by a European or international issuer, defined as meeting the following requirements:
- Green bond framework,
- Proceeds to green projects,
- External verification.”


¹⁷ Established in 1992 and recognised across Europe and worldwide, the **EU Ecolabel** is a label of environmental excellence that is awarded to products and services meeting high environmental standards throughout their life-cycle: from raw material extraction, to production, distribution, and disposal. The EU Ecolabel promotes the circular economy by encouraging producers to generate less waste and CO2 during the manufacturing process. The EU Ecolabel criteria also encourages companies to develop products that are durable, easy to repair, and recycle (https://ec.europa.eu/environment/ecolabel/, Accessed: January 13, 2020).

¹⁸ In other words, “greenwashing” means the process of conveying a false impression or providing misleading information about how a company’s products are more environmentally sound.
The Action Plan, which is expected to clarify characteristics and standards for SRI products and to expand the amount and the quality of information available on ESG aspects of investments as well as foster sustainable corporate governance, outlines reforms in the three following areas:

- Reorient capital flows towards sustainable investment, in order to achieve sustainable and inclusive growth;
- Mainstreaming sustainability into risk management, and
- Foster transparency and long-termism in financial and economic activity.\(^\text{19}\)

Additionally, in December 2019 the European Parliament ratified the **EU taxonomy for sustainable activities**, what represented the first time a global (or supranational) regulator has produced a comprehensive labelling system for what can be classified as a sustainable financial product. The new rules were formally **adopted in January, 2020, and need to be implemented in December, 2020**. Engagement with credit rating agencies is the next step for the integration and broadening of the taxonomy into the global institutional investor base.\(^\text{20}\)

Furthermore, Eurosif’s "European SRI Study 2018” results show clear signs of **consolidation** in the industry. The data suggests there are now two “essentials” for sustainable investors in Europe. One is that investors cannot do without at least some form of ESG integration, which grew 60% in Europe from 2016 to 2018 based on the assets affected and was the fastest growing strategy in 2018. Second, there is a trend to more active management underlined by strong growth in assets deployed for corporate engagement, which grew 14% from an already high base over the two-year period. Owners and producers increasingly feel they need to be more vocal and show their engagement through their ownership rights.

Top ten **exclusion criteria** as a part of negative screening at European level in 2018 are presented in Figure 44. The greatest percentage of the exclusion from portfolios had weapons (all, especially controversial) and tobacco.

**Figure 44. Top exclusion criteria at European level**

![Exclusion Criteria Graph]

Source: Eurosif, 2018

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\(^\text{19}\) More details in: (European Commission, 2018).

Observing the **themes** in sustainable investing, it can be concluded that investors were mainly focused on climate change (18%), water (17%) and renewable energy-themed funds (12%), as shown in Figure 45.

Figure 45. Overview of European sustainability-themed investments

![Figure 45](image)

Source: Eurosif, 2018

Regarding norms-based screening, the **norms** refer to focus on areas such as environmental protection, human rights, labour standards, and anti-corruption principles and are set out in international initiatives and guidelines. The most common norms-based screen at European level in 2018 was the UN Global Compact (42%), followed by ILO Conventions (26%) and the OECD Guidelines (25%), as shown in Figure 46.

Figure 46. Application of norms as a part of European norms-based screening

![Figure 46](image)

Source: Eurosif, 2018
The Eurosif’s reports encompass characteristics of SRI markets in Belgium, Denmark, France, Italy, the Netherlands, Norway, Poland, Spain, Sweden, and the United Kingdom. Hence, Italy is included in Eurosif’s SRI reports. A total annual sum of its individual SRI strategies is presented via Table 3.

Table 3. SRI investments in Italy, by strategies (in EUR millions)

<table>
<thead>
<tr>
<th></th>
<th>Negative screening</th>
<th>Engagement and voting</th>
<th>Norms-based screening</th>
<th>ESG integration</th>
<th>Positive screening</th>
<th>Sustainability-themed investing</th>
<th>Impact investing</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>496.561</td>
<td>54.372</td>
<td>351.754</td>
<td>-</td>
<td>3.917</td>
<td>1.094</td>
<td>2.003</td>
</tr>
<tr>
<td>2015</td>
<td>569.728</td>
<td>43.303</td>
<td>565.607</td>
<td>45.008</td>
<td>4.058</td>
<td>2.064</td>
<td>2.927</td>
</tr>
<tr>
<td>2017</td>
<td>1.449.554</td>
<td>135.729</td>
<td>105.842</td>
<td>70.425</td>
<td>58.137</td>
<td>52.861</td>
<td>51.960</td>
</tr>
</tbody>
</table>

Source: Eurosif, 2018, 2016

Traditional strategies such as negative screening and engagement and voting have the leading share in Italian SRI market. Impact investing has registered a substantial increase mainly due to the rising interest in environmental and social effects of finance, reflected by several opportunities of intervention such as investments in social housing.\(^{21}\) The positive trend in engagement and voting has driven by the increased activism of pension funds and other institutional investors interested in playing an active role to affect companies’ sustainability policies. Positive screening has confirmed and consolidated its highly positive trend and ESG integration has continued to grow to signal the relevance of sustainable criteria in investment products.

The market research on Italian retail investors, conducted by Forum per la Finanza Sostenibile (Italian Sustainable Investment Forum) and Doxa S. p. A. in 2017, confirm the ever-increasing awareness about the importance of ESG issues in financial activities and 45% of retail investors declared their willingness to invest in SRI. Respondents trust in banks, insurance companies, and financial advisors. However, the SRI industry has to make further efforts to focus and improve their offer and advising services on SRI.

The Italian regulatory framework has changed significantly in the last three years, both for the transposition of EU Directives and for the initiatives of the legislature. For example, the legislative decree No. 254/2016 transposed the EU Directive 2014/95, regarding non-financial reporting.\(^ {22}\) The intervention requires large companies to disclose non-financial and diversity

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\(^{21}\) As its base, social housing involve houses and flats that are owned by local government and by other organizations that do not make a profit, and that are rented to people who have low incomes.

\(^{22}\) Non-financial reporting provides information on corporate social responsibility, that is, sustainable development. Articles on non-financial reporting regularly emphasize the need for businesses to begin this form of reporting as soon as possible. Out of the 250 largest companies in the world, 90% publish sustainability reports and most apply GRI standards (these are standards developed by the Global Reporting Initiative). However, there is a lack of consistency in reporting metrics, reflecting the lack of internationally recognized standards in sustainability reporting. This is in part because, unlike financial reporting, which uses a common unit (i.e. money), many factors included in sustainability reporting (e.g. tons of recycled waste, use of natural resources, gender balance) are difficult to express in
information on their activities in order to help SRI investors. Certainly, the European Commission Action Plan on Financing Sustainable Growth, as well as the EU taxonomy for sustainable activities, is also going to affect Italian SRI market in the years ahead.

**South-Eastern Europe in the SRI Market and the Energy Sector**

Considering the road ahead of the South-Eastern Europe (SEE) region, in its 2016 regular economic report (which include Albania, BiH, Kosovo, North Macedonia, Montenegro, and Serbia), the World Bank Group’s Macroeconomics and Fiscal Management highlighted, among other urgent areas of reforms, „**ensure sustainable use of energy and natural resources and stewardship of the environment**“. Actually, addressing energy, economic, and environment security is a pressing challenge for nations across the globe. Global energy demand is projected to increase by 45% during the next 20 years, with the fastest growth in developing and transition countries (Dixon, Scheer, Williams, 2011).

SEE has substantial, largely untapped renewable energy potential. Some countries in the region have begun to exploit these resources, but the renewable energy sector in SEE is still at its primordial stage – except for the large hydropower capacity, most of which was constructed several decades ago.

Much of the region’s vast and unexploited potential could already be cost-competitive for power generation, as indicated in the International Renewable Energy Agency (IRENA) report, “**Cost-competitive Renewable Power Generation: Potential across South East Europe**“. SEE policy makers are poised to continue scaling up renewables in line with the EU 2030 Climate and Energy Framework’s goal of deriving 32% of energy from renewables by that year. The region has already attracted large-scale investment in renewables, but ensuring a successful energy transition requires more. Thus, IRENA established the South East Europe Regional Initiative in 2017 and specified its commitment to the region in the Communiqué23 on accelerating the uptake of renewables in SEE. The support for policy makers and investors is provided in the six following areas:

- Mapping renewable energy resources;
- Long-term planning for renewable deployment;
- Socio-economic benefits of renewable energy;
- Enabling frameworks – technical, policy, regulatory, institutional;
- Access to finance for renewable energy projects;
- Integration of variable renewable energy sources to power system.24

Renewable energy investments need to advance demonstration and deployment of solar thermal heating, solar thermal power, photovoltaics, wind power, geothermal energy, small hydropower, biomass, combined technologies, etc. Energy efficiency, renewable energy, and urban transport investments will contribute to the direct reduction of greenhouse gas emissions.

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23 The IRENA’a **Communique** outlined the key action areas for collaboration with **IRENA**.

24 For more details see: (IRENA, 2018).
A growing number of SEE countries, both EU- and non-EU members, use renewable energy policies. Different support policies (e.g. capital grants, feed in tariffs, feed in premium, auctions) focus on power sector. Heating, cooling, and transport lag behind. For example, the decarbonization of the transport sector is a huge task that requires a change in the nature of transport demand, improvements in efficiency and changes in the energy mix, which all require major policy push.

Patterns of energy and resource use and waste outputs are imbedded in an economy’s capital stock, which includes everything from buildings, factories and manufacturing equipment, appliances and vehicles, to transportation, water, energy and power infrastructure. Creating a green, low-carbon economy will require comprehensive investments over many years to transform the capital stock so that it provides economic services with far greater energy efficiency and wiser resource use, and far less generation of wastes, greenhouse gas emissions, environmental impact and depletion of natural capital. This is a tremendous, long-term, systemic challenge. Capital stock is inherently capital intensive. Furthermore, virtually every item of capital stock has investment and financial system analogs; that is, financial products and finance delivery mechanisms, whether they be commercial loan products, leases, bond financing, mortgages, consumer credit, or microcredit, that enabled the capital purchase. To make the green economy transition, it needs to develop and implement investment programs that target and deliver financing with financial products adapted for green economy projects, including prominently energy efficiency and renewable energy projects, wherever these projects are located (MacLean, 2012).

According to the Regional Cooperation’s „South East Europe 2020: Annual Report on Implementation for 2018“, despite evident progress, especially under the energy and transport dimensions, to progress towards meeting the SEE 2020 Sustainable Growth objectives, as far as the energy sector is concerned, SEE countries still need to the following:

- Pursue the development of integrated energy networks;
- Accompany the infrastructure developments with reinvigorated efforts to implement the regulatory and connectivity reform measures;
- Continue efforts aimed at creating single energy market while ensuring protection of the environment and shift to resource efficient and low-emission economy;
- Complete full transposition and enforcement of the Third Energy Package and full market liberalization;
- Pursue transformation of the energy market in line with growing contribution of intermittent renewable sources together with implementation of smart measures;

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25 Corruption also remains one of the major obstacles for sustainable development in the SEE countries. Together with the related malfunctioning of the judicial systems, it is seen as a significant obstructive factor for the accession and integration of the complete region into EU.

26 In 1995, GDP per capita in Central, Eastern and SEE countries was at EUR 8,150, which represented around 43% of the EU average. In 2017, GDP per capita rose to EUR 17,550 or 66% of the EU average (European Commission & European Investment Bank, 2018). According to the EIB regional study, most countries in this region are regarded as modest or moderate innovators.

27 An integrated energy network encompasses following evolving infrastructures: (a) producing cleaner energy, (b) using cleaner energy and electrification, and (c) integrating energy sources.
• Exploit the huge energy efficiency potential and intensify efforts in order to ensure achievement of 9% energy saving targets by the end of 2018;
• Make additional efforts and introduce framework for placing biofuels on the market;
• Continue efforts towards providing affordable, sustainable and safe access to energy (primarily produced from “green” sources) and energy services for all Western Balkans citizens and creating conductive environment for investments in the energy sector;
• Improve energy statistics and provide timely preparation of energy balances;
• Continue with implementation of infrastructure projects supported by the Connectivity Agenda.

THE ROLE OF FINANCIAL INSTITUTIONS IN THE SRI MARKET

Regulators have assumed that “ethical”, “environmental”, “social”, “responsible” or “sustainable” investment means to incorporate considerations of the environment, basic human rights, and workplace concerns in the investment process. For example, information disclosure regulations in Europe, Australia, New Zealand, and South Africa require financial institutions holding out investment products to disclose that how they take environmental and social considerations into account. However, sanctions have not been brought for “non-compliance” because there is very little in the way of compliance and, consequently, minimal levels of monitoring (Haigh, 2012).

In investment and finance sustainability and responsibility requires an ethics. By ethics is not meant ethical investment but a telos of awareness of the social interconnections forged by financing activity. Institutional conflicts are inherent to socially responsible investment, for example, financial intermediation in which fiduciaries rely on non-fiduciaries whose purposes are independent of the best interests of beneficiaries; the commonplace lending of ethically selected securities to custodians, whose use of the securities is unmonitored; and the use of quarterly profit announcements to assess investments continuously held by “patient capital” such as pension funds (Haigh, 2012).

Investments managed by professional asset managers are often classified as either “retail” or “institutional”. Retail assets are personal investments by individuals in professionally managed funds purchased in banks or through investment platforms with relatively low minimum investment levels, while assets classified as institutional are managed on behalf of institutional asset owners such as pension funds, universities, foundations, and insurance companies through investment products with higher minimum investment levels. Although institutional investors tend to dominate the financial market, interest by retail investors in sustainable and responsible investing has been steadily growing since 2012. At that time, institutional investors held 89% of assets compared with 11% held by retail investors. At the start of 2018, the retail portion had grown to one quarter (see Figure 47). Moreover, in its „Financing for Sustainable Development Report 2019” the UN reported that 84% of asset owners said they are pursuing or actively considering pursuing ESG integration in their investment process.
According to latest available data, sustainable investments have extended across the range of asset classes commonly found in diversified investment portfolios. A majority of assets (51%) has been allocated to public equities. The next largest asset allocation (36%) has been in fixed income (shown in Figure 48).

As far as European market of sustainable investments is concerned, in spite of the fact that European households’ savings represents over 40% of total financial assets in the European Union, there is growing evidence that retail investors like to invest in a sustainable manner. Since 2013 the demand of the retail sector for SRI assets has increased by nine times, as represented in Figure 49.
SRI asset allocation in Europe is presented in Figure 50. Equities and bonds have the highest shares in the market, 46% and 40%, respectively.

Regarding the financial intermediaries upcoming business activities in this context, it is imperative that they recognize the changing client demographics (e.g. millennial investors’ preferences, values, and personal priorities) and mobilize quickly to serve an increasing client base (e.g. millennial investors are nearly twice as likely to invest in companies or funds that target specific social or environmental outcomes, compared to non-millennials28). Financial institutions most adequately prepared to address sustainable investing and the intergenerational wealth transfer together will not only capitalize on the acquisition of new clients, but also effectively serve their current client base. For example, the Royal Bank of

28 More details about distinctions between habits of millennial and non-millennial investors see in: Ernst & Young LLP, 2017.
Canada invested EUR 15 million into an impact strategy in 2012 and that was the first step for directing funds to sustainable projects, initiatives, and corporations. Vancouver City Savings Credit Union provides also a good example, as it has started to transform its lending portfolio into a social finance portfolio (Wiek, Weber, 2014).

As we can notice at European level, the retail sector has the potential to become one of the corner stones of sustainable finance. However, current national legislation on the role of financial advisers, still not contains specific requirements to embed sustainability as part of the investment preferences discussed with the client. Financial advisors could play a key role in promoting ESG considerations into investment preferences of retail investors. Moreover, to this purpose, financial education could be essential for both financial advisors and retail investors.

Because of that, financial institutions’ legislators and regulators on national level need to amend or continue to amend the legislative/regulatory framework in favour of sustainability as well as disclose information regarding sustainability potential of financial/investment product and/or services. In that way, asset managers will get incentives to create and launch sustainability-oriented financial products and/or services, emphasizing their positive trade-off with financial returns as well as intrinsic returns. The work on the definition of a green label for financial products is an important step in this direction.\(^{29}\) Also, the clear sustainability taxonomy not only for Europe but across the international markets will help determine the activities which are compatible with sustainable investments, while defining impact indicators on environmental issues.

**Perspectives of Sustainable Investments**

Sustainable investments will continue to rise over the coming years and decades. A growing number of investors, financial institutions, and investment professionals are deploying and managing capital to build a more global sustainable and equitable economy.

Considering the global trends, especially an estimated addition of two billion people by 2050, global demand for food, water, and energy will drive the need for innovative improvements in infrastructure to address the resource demand associated with a growing population (Ernst & Young LLP, 2017). At the global level, food production will have to double in order to feed a world population of nine billion people in 2050. Moreover, clean water and sanitation, innovations linked to energy generation and distribution, reducing emissions, improved health care, more efficient transport network, global warming and climate changes as well as sustainable management of natural resources, etc., provide a pool of potential for sustainable investment growth.

\(^{29}\) At European level, there is a series of labels for SRI denominated products, whose aim is to inform investors of the features of the products and what they can actually deliver. The majority of the labels available today are based on the Eurosif Transparency Code, which is the first European framework for sustainable investment products, first launched in 2008. The Code has undergone a series of revisions in the past years and the latest one came at the end of 2017, and delivered an updated version which takes into account some of the key major developments in the sustainable investment space, these being mainly considerations from the French Article 173, the work of the Task Force on Climate-related Financial Disclosure TCFD and HLEG recommendations (Eurosif, 2018).
In its 2018 survey, Eurosif identified key SRI market drivers and pointed up that a good mix of legislative push, coupled with the possibility to link sustainability targets to financial outcomes and other examples of soft law, continue to represent the main drivers for SRI demand (Figure 51) and will certainly continue to be so in the years ahead.

Figure 51. Drivers for SRI demand

Source: Eurosif, 2018

On the supply side, drivers as well as barriers for SRI strategies (Eurosif, 2018) can be summarized as illustrated in Table 4.

Table 4. Pros and cons of SRI strategies

<table>
<thead>
<tr>
<th>Pros</th>
<th>Cons</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial opportunity</td>
<td>Performance concerns</td>
<td>17%</td>
</tr>
<tr>
<td>Risk management</td>
<td>Risk management</td>
<td>18%</td>
</tr>
<tr>
<td>Looking for stable long-term return</td>
<td>Lack of viable products/options</td>
<td>16%</td>
</tr>
<tr>
<td>Responsibility to client/fiduciary duty</td>
<td>Lack of qualified advice/expertise</td>
<td>18%</td>
</tr>
<tr>
<td>Address climate change and other environmental issues</td>
<td>Mistrust/concern about “greenwashing”</td>
<td>24%</td>
</tr>
<tr>
<td>Generational transfer of wealth</td>
<td>Other</td>
<td>7%</td>
</tr>
<tr>
<td>Contribute to local community development</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td>3%</td>
</tr>
</tbody>
</table>
In a nutshell, considering what practice has proven, how much money investors, especially institutional ones, will invest in sustainable investments still depends primarily on the expected **financial return**. Empirically, investors prefer stocks with high upside or dividend yield potential. Only if (supra)national **legislators and regulators** as well as various stakeholder group through collaborative efforts support the whole process, e.g. through information disclosure and transparency, including ESG factors into investment decision making process, increase sustainability awareness among both assets owners and professional asset managers, financial education for both retail investors and financial advisors shall be essential, etc., sustainable investments can be found with a greater share of their portfolios and make them a truly mainstream among investors. Last but not least, it should increasingly be recognized that sustainable investment is good for business and that investors do not necessarily have to choose between returns and positive impacts.

**AFTER THE REPORT: PANDEMIC CRISIS AND ITS POSSIBLE IMPACTS**

The World Health Organization (WHO) announced the **coronavirus COVID-19 (or SARS-CoV-2) pandemic** on March 11, 2020. The term “pandemic” does not reflect the severity or mortality rate of a disease, but its geographical spread. Due to both the worlds’ population growth (7.7 billion people) and higher than ever global mobility of people, for a couple of months the rapid spread of the virus became noticeable worldwide, prompting the authorities to act quickly in order to fight the pandemic. Social distancing and isolation became common preventative actions for most countries. According to the Worldometer’s report, at the time of this writing, the pandemic affected 212 countries and territories worldwide, which reported a total of 4,115,625 confirmed cases and a death toll of 280,594 deaths.30

Authorities in the affected countries have faced a completely new and largely unprecedented risk and many hesitated in taking a swift action. Some took a relaxed and ignorant approach and were swiftly punished with deadly outbreaks. Instead of assessing and managing the risk, some resorted to precautionary measures, primarily by suspending ("pausing") high-risk economic activities. The common preventative action – social isolation or, more precisely, physical distance – has proven to be an effective measure, although the structure and implementation could be open for a debate. From the aspect of economic consequences (once health and safety elements are addressed), the necessity of suspension and isolation by the principle of universality should be re-examined, and perhaps compared to the principle of individualism. In particular, the necessity of suspending such a significant number of occupations should be examined, especially the cases within a non-endangered or risk-free segment of the population. This gives the opportunity for timely identification and isolation of people infected, which would prevent the spread of the virus in a completely different way. In other words, analysis should be conducted where possibly to precisely evaluate the relation between the costs of the proposed procedures and the costs as a consequence of the procedures already performed, that is, at the heart of the question whether to take and manage the risk or, as a precautionary measure, eliminate the risk that is now visible, and generate some new ones, on a possibly unimaginable scale.

However, risk management in this context could benefit the so-called ALARA approach,\textsuperscript{31} but with a very important note that the mentioned approach, in this case "isolation without stopping the economy", must be the first point, not the last, that is, if there is no other, "precautionary measures" should be approached when the victim must sacrifice and "the victim are financial losses". Even the existing measures are not effective to the extent planned, the mass spread of the virus has not been avoided. It is incredibly difficult for decision-makers to weigh whether they want to risk the lives of senior citizens and, in turn, save the working-age population from a potentially long recession or save lives and then take care of the economy. In both cases, people will die, now from viruses, later from poverty and comorbidities caused by stress due to poverty, unpaid loans, lost jobs and real estates, etc. Although the virus does not make a difference and we are all equal, the time of the pandemic (which is still ongoing) did not show sufficient unity in the way of thinking or in the strategic orientation of countries (for example, China, Italy, Sweden, Great Britain, USA, etc.).

The coronavirus COVID-19 pandemic is first and foremost a public health threat, but it is also, and increasingly, an economic threat. It is undeniable that a pandemic is, above all, a threat to public health, but it is also an increasing threat to the economy (UNCTAD, 2020, p. 1). In a broader sense, pandemics force individuals to change their usual patterns of behaviour, people change how and when they consume goods and services, and how and when they participate in the labour market. Insecurity and fear are the main drivers of how and why people change their normal behaviour during a pandemic. In extreme cases, businesses and households may lose confidence to the point of panic in financial markets, with investors overreacting, resulting in falling property prices (KPMG International, 2020, p. 5). The spread of fear, the feeling of personal and financial insecurity, the withdrawal of deposits and pension funds,\textsuperscript{32} the increase in risk aversion, the issue of salary payments and other problems, are caused by a rapidly spreading "infodemic", in terms of lack of correct information.

Increasing aversion to the risk of so-called COVID-19 shock and the usual flight to liquid assets due to uncertainty have already begun to have impacts on financial markets (UNCTAD, 2020, p. 4). Stock markets around the world have responded to the pandemic with worrying volatility as traders panicked out of fear. As a result of the recent turmoil, trade disruptions have been introduced throughout the market, in hopes of preventing panic trading. Existing guidelines provide for a 15-minute break in trading on all US stock exchanges if the S&P 500 falls more than 7% before 3:25 p.m.\textsuperscript{33} On the other hand, when it comes to gold, which is traditionally considered a "safe haven" for investment in times of uncertainty, from the beginning of January to the very end of February this year, the price followed an upward trajectory, after which there was a sharp break in growth and a sudden drop at the end of the first half of March 2020 (at the

\textsuperscript{31} ALARA (As Low As Reasonably Achievable) promotes a continuous process of improvement. The discussion is not about whether something is safe or not, but the question is what, given the risks, costs and benefits, is rationally possible to achieve (https://risk-monger.com/2020/03/20/covid-19-a-failure-in-risk-management/, Accessed: March 24, 2020).

\textsuperscript{32} For example, Australia has allowed AUD 20,000 to be withdraw from the pension fund for each individual who is unemployed or has a reduced income during this pandemic.

time of the "invasion" of authorities' decisions). Further, the second half of March 2020 was marked by a sharp rise in the price of gold, returning to an almost approximate value from the beginning of the month. Additionally, at the beginning of March 2020, oil prices on world markets fell by more than 30%, to the lowest levels since 1991. The original cause has been the dispute between the Organization of the Petroleum Exporting Countries (OPEC) and Russia, and the fear of investors has additionally "inflamed" the already tense situation. Demand for oil has all but dried up as lockdowns across the world, forced by the novel pandemic, have kept people inside. At the beginning of May 2020, the WB announced that the oil market entered the biggest crisis in the history and an average price per barrel was USD 35.

The COVID-19 shock will trigger a recession in some countries and a deceleration of global annual growth to below 2.5% – often taken as the recessionary threshold for the world economy. The resulting hit to global income compared with what forecasters had been projecting for 2020 will be around the trillion-dollar mark; the bigger question is could it be worse? (UNCTAD, 2020, p. 1). Thus, according to OECD reports, the slowest growth of the world economy since 2009 is forecast. Moreover, the IMF predicts worst downturn since the Great Depression because it expects that the global economy will shrink by 3% this year. The duration and depth of the crisis will depend on three variables – how far and fast the virus spreads, how long before a vaccine is found, and how effective policy makers will be in mitigating the damage to our physical and economic health and well-being. The uncertainty surrounding each of these variables is adding to people’s sense of anxiety, which is a fourth variable that will shape crisis outcomes.

What is happening in the sphere of production, turnover, and consumption, for the first time in this way in a broad sense is transformed into what is called the domino effect. Sudden interruptions in production activities in the most vulnerable regions will cause bottlenecks in global value chains. The concern is that exports of final products will start to weaken sharply, which further affects earnings and employment. The consequences of supply-side disruptions can, therefore, contaminate aggregate demand. On the demand side, a combination of declining incomes, mood swings (fear of infection), and the absence of vaccines can be expected to negatively affect private consumption, especially in the services sector, with tourism and hospitality being significantly affected. Shortened working hours, working remotely and possible layoffs (for example, over 33 million people lost their jobs in the USA since the pandemic was announced) could very easily, among other conditions, reduce household consumption and increase economic insecurity for those who do not have access to social assistance programs.

The increase in uncertainty about the effects of the COVID-19 shock will also delay private investment, but government demand can go up in many countries, to fight contagion through emergency health-assistance initiatives (UNCTAD, 2020, p. 3). Thus, the traffic sphere in all its manifestations will be destroyed, and the domino effect will not be able to be stopped.

36 An additional issue for the USA is related to the civil unrests. For example, in April 15, 2020, thousands protested to show their displeasure with the governor’s order to keep people home and business lockdown during the coronavirus COVID-19 outbreak.
“isolation” of the Chinese economy has caused a significant impact on the supply chains of large manufacturing companies such as JCB and Nissan, and the decline in demand for cars in the transport sector has created additional problems. Sales of Chinese cars fell 92% in the first half of February, and more carmakers, such as Geely or Tesla, are selling online, due to quarantine. With the outbreak of the pandemic, the weakness and dependence of the world’s logistics chains on China “surfaced”, looking both geographically and through activities, leaving them without credible replacements, and the world must think carefully about its dependence on China. In other words, disruptions to production, initially in China, have now spread to supply chains across the world.

An effective response to the economic consequences of the COVID-19 will require not only active and targeted macroeconomic measures, but a series of remedial policies and institutional reforms needed to build a robust, sustained, equitable, and climate-friendly growth trajectory that would reduce the chances of a subsequent economic breakdown. If the COVID-19 crisis has negative impacts on household and corporate spending, governments can avoid a slump further deepening of the crisis by increasing their own demand, especially for goods and services that are not in short supply, such as construction and social services (UNCTAD, 2020, pp. 1-8). Moreover, funding the funds needed for increased health services, such as virus tests, respirators, protective masks, visors, accommodation facilities, etc., will generate an additional challenge for governments (KPMG International, 2020, p. 6).

Due to the coronavirus pandemic, the USA, EU, and Germany have already approved billions of euros/dollars in loans and aid, primarily to areas of the economy and society affected by the pandemic. EU members will even be able to deviate from the current limits of economic and monetary union and exceed the allowed budget expenditures for subsidies. After weeks of debates between Republicans and Democrats, on March 25, 2020, the American Congress approved a package of aid of as much as USD 2 trillion. The package includes direct payments of aid to Americans and a USD 500 billion fund to help American corporations. The activities of many central banks around the world are aimed at lowering referent interest rates and injecting additional amounts of “fresh” money, in order to improve the liquidity of the economic system.

However, a special aspect of interventions should be focused on the industries most affected by the current health crisis, which de facto poses the greatest threat to the global economy since the latest global financial crisis, such as tourism, transport and manufacturing as well as the small and medium-sized enterprises, which in European countries employ 60-70% of the overall workforce. What is mentioned as a necessary government intervention in order to prevent mass layoffs (“dismissal pandemic”) is to subsidize salaries and employee contributions in proportion to previous earnings during the epidemic crisis as well as postponing deadlines for settling tax obligations, communication with bank associations regarding a several-month moratorium credit payments for legal entities as well as individuals, financial support to domestic producers of scarce food products, ensuring uninterrupted supply and distribution of goods in domestic and foreign trade, continuous communication and mutual cooperation between government representatives, unions, and employers, etc.37

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37 In the midst of a massive work-from-home experiment, most companies are now looking for the way to reduce the number of people in offices, maintenance expenses, and rent for the time after the pandemic. Our future ways of working maybe will never be the same again and that also could have a big impact on the economy. For example, in cities, many companies make a living by “feeding” people in offices.
When it comes to the impact of the pandemic crisis on financial service sector in general, and in particular the SEE region countries’, we can expect the following, among other things:

- Many countries introduced the moratorium on credit payments to banks and other financial institutions such as leasing companies and micro-credit organizations (or micro-finance institutions) during the state of emergency or, even, until the end of 2020. During that period debtors are obliged to pay interests, which increase their total cost of debt. However, the moratorium is optional for debtors.

- Due to the fact that many small and medium-sized enterprises, such as restaurants, bars, gyms, salons, etc., have been forced by the pandemic to shutter their businesses, there is a possibility of their loan quality deterioration in banks’ balance sheets.

- Decline in purchasing power and living standards due to mass layoffs could cause a declining demand for additional types of insurance, apart from mandatory insurance. Consequently, it could lead to a fall in sales revenue as well as profitability of insurance companies.

- Demand for other financial institutions’ services by individuals, which implies both consumption and investment, could also decline. According to PWC (2020, p. 5), private consumption is reduced leading to a 0.5% increase in savings. Indeed, as people around the world are blocked from leaving their homes, they generally no longer need luxury goods, while their demand for office as well as sports equipment, online education, online shopping and delivery, etc., has increased.

- Because of job losses, fear or, even, panic, etc., to some extent deposits could be withdrawn from banks, which could generate an additional problem in terms of reduction of funds for placements and increase in capital prices. All this will further affect the standard of living and the economy will face serious challenges.

- There is likely to be a slowdown in banks’ lending activities due to increased credit risk, which will mean lower credit volume and a further slowdown in economic activity, as in the case of the global financial crisis, which has grown into a global recession. With that difference now that the global epidemiological crisis, unheard of in the new history, leads to a new global recession, disruption of global value chains, drastic decline in many economic sectors such as aviation, tourism and hospitality industries, etc.

- An additional problem facing banks is low interest rates. For example, the ECB has kept interest rates at record lows since the peak of the 2011 debt crisis. Monetary policies of low interest rates per se encourage banks to compensate low interest rates and the decline in net interest income by taking on a higher level of risk, on the contrary to the aforementioned.

- This pandemic has led to a situation where the global economy is experiencing a slowdown and certainly goes to the new global recession. Hence, it is important for

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If 1/3 of the people are in the offices after the pandemic and the rest work from home, and then they switch, it will also hit those businesses. Maybe this will reshape whole services industry, public transport, etc.
countries to have a stable banking sector and sufficient credit demand to prevent negative fluctuations within the business cycle. What is already known is the fact that indirect consequences are possible in terms of issues with access to international money markets, which have already led to a slight rise in interest rates and tightening lending conditions.

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