

Regulatory Debates Impacting Bank Strategy

Risk Minds, December 2016

ALVAREZ & MARSAL



A&M Rethinking Banking

Last year's panel debated bank strategies to better answer investor expectations while complying tougher regulatory restrictions



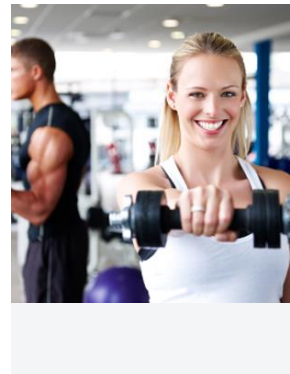
Crisis

2008-2010



Regulatory Compliance

2010-2015



Business Model Fitting

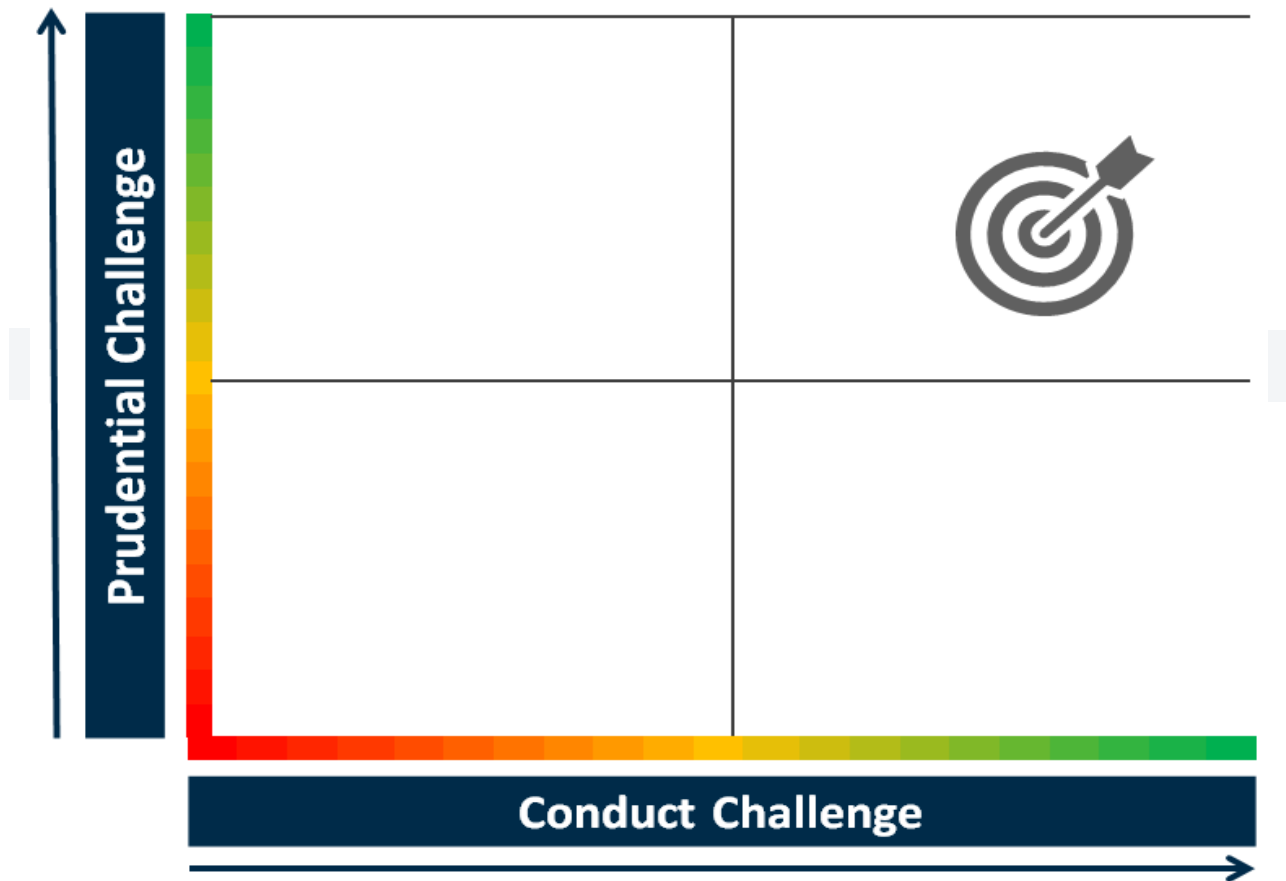
Beyond 2015



**2016 Recap
Top Debates
Way Forward**

A&M Rethinking Banking

With continued regulatory change banks are still transforming business models in search to become a profitable franchise





Recap 2016



2016 Market Developments



Prudential




- 3 stress tests (US, UK, EU)
- Pillar 2G
- Basel IV
- MREL and TLAC

Conduct





















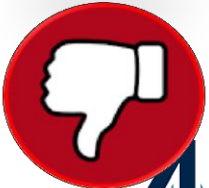


- Conduct losses
- Declining bank reputation
- CEO changes in G-SIBs
- Market reform



	Price-to-Book	Chg. 15-16
	0.76	→ 1 pps
	0.64	↓ 9 pps
	1.17	↑ 13 pps

Regulatory Uncertainty and Convergence

	Regulatory Uncertainty	Drivers	Convergence
 Capital & Leverage	2016   2015  2014 	<ul style="list-style-type: none"> + Split of P2R & P2G - Basel IV - Ongoing TRIM - EU IHC plans 	
 Liquidity	2016  2015  2014 	<ul style="list-style-type: none"> + NSFR Calibration + ILAAP implementation 	
 Resolution	2016  2015  2014 	<ul style="list-style-type: none"> + Calibrated TLAC + MREL/TLAC + Bail-inable debt - MREL letters 	
 Risk Profile	2016  2015  2014 	<ul style="list-style-type: none"> - Business Model - NPL & IFRS 9 - Risk culture, fit & proper - Conduct & IT risk rules 	

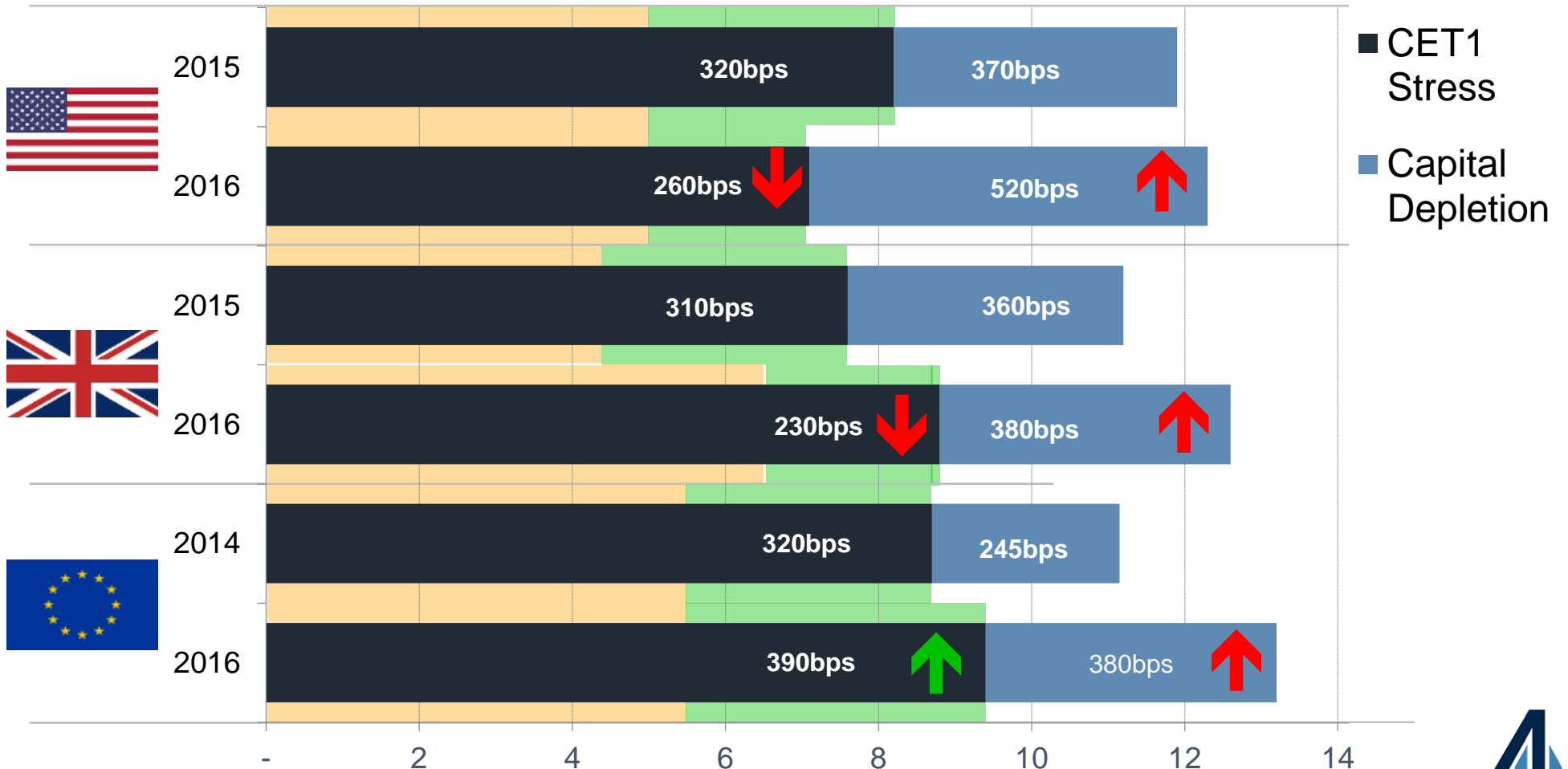
3 concurrent stress tests in 2016

% T1C (US)

% CET1 (Europe)

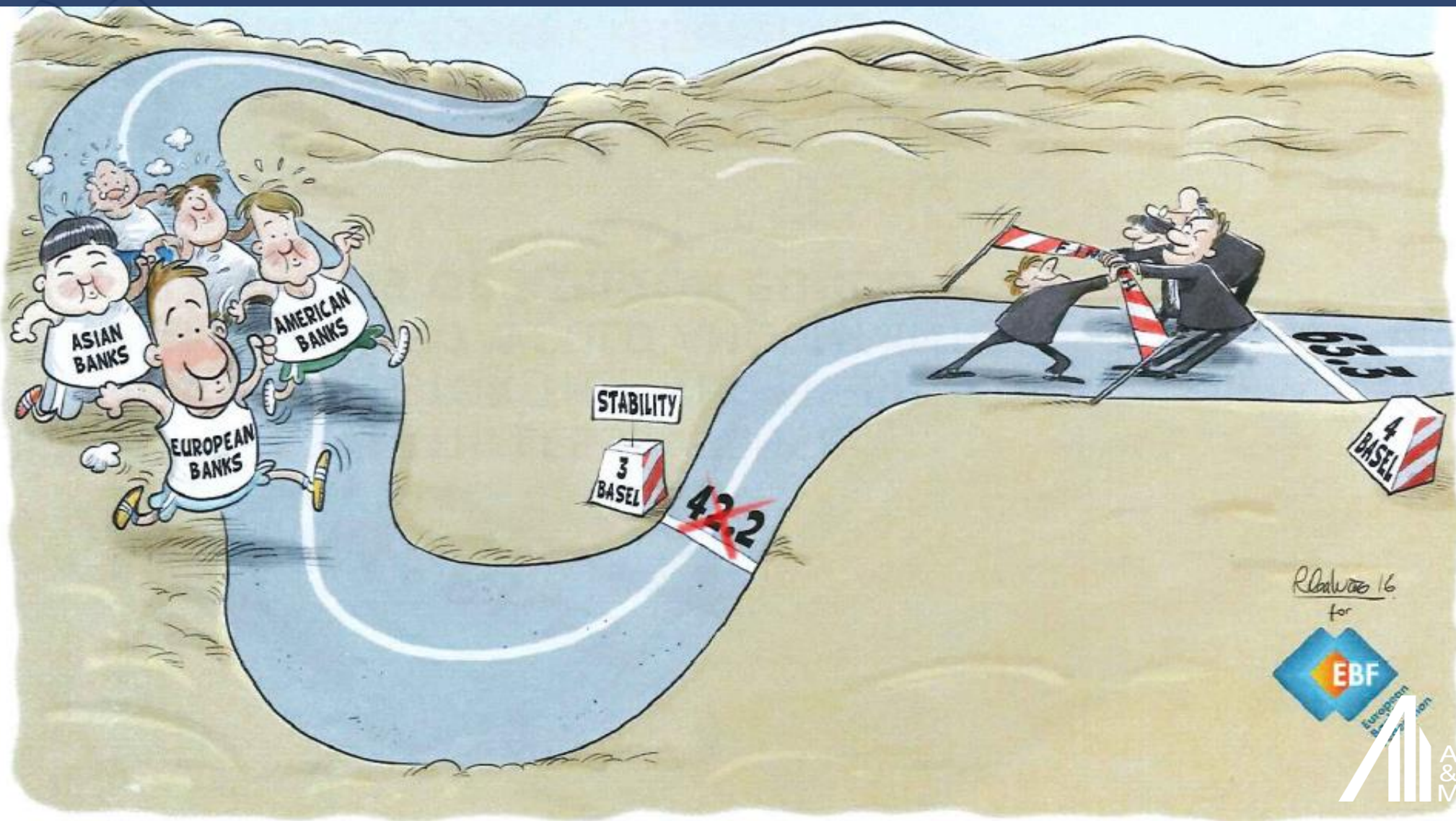
Minimum

Capital Flexibility



Recap 2016

Continued Regulatory Uncertainty and Increasing Fragmentation





Top Debates

1 | Business Models

2 | NPLs

3 | Culture & Reputation

4 | Smart Compliance

Lagging Profitability of Business Models



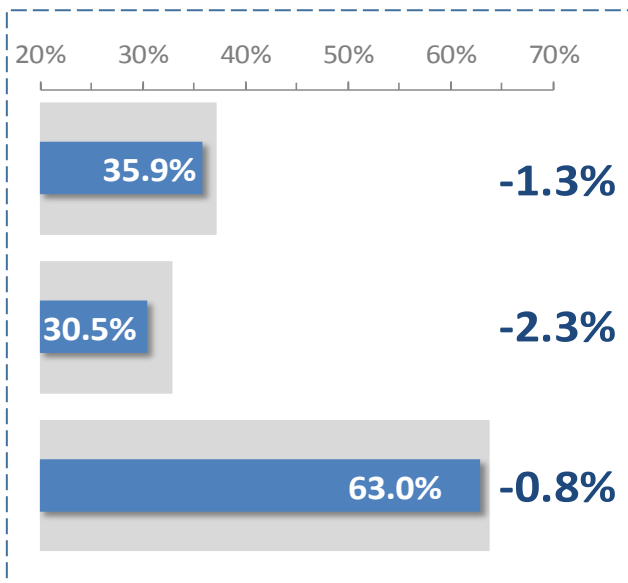
Compliance		Current Status	Vs '15
Capital & Leverage	CET1	12.3% ●	👍
	CET1 FL	11.9% ●	👍
	CET1 FL ST	8.7% ●	=
	Total Capital	17.4% ●	=
	Leverage FL	6.3% ●	👍
Liquidity	LCR	126% ●	=
	NSFR	115% ●	👍
Resolution	TLAC Shortfall	-96bps ●	=
	MREL	Assumed convergence to TLAC	
Risk	NPL	2.0% ●	=
	Coverage	57% ●	=



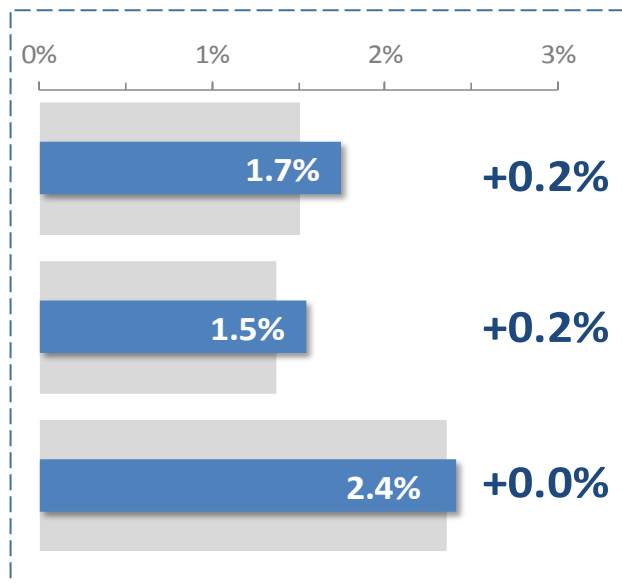
Fitting		Current Status	Vs '15
Capital & Leverage	RWA Density	35.9% ●	=
	K Generation	+20bps ●	=
	RORWA	1.7% ●	=
	Dividend Yield	4.0% ●	=
	Econ. Profit	-1.5% ●	=
Liquidity	NIM	1.1% ●	=
	Funding Cost	0.6% ●	=
	G-SIB Buffer	1.0% ●	=
Resolution	Resolvability Ease	n.a. ●	=
	Risk	Conduct Cost	? ●
Diversification		83 ●	=

Lagging Profitability of Business Models

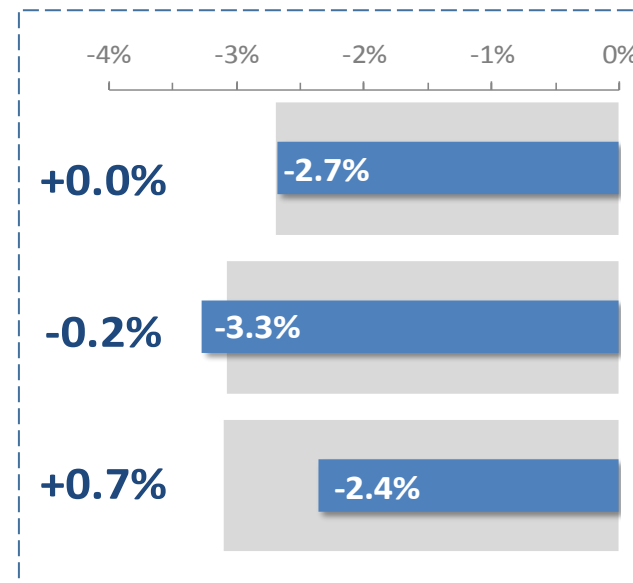
RWA Density



RORWA



Economic Profit



Higher profitability among US banks while RWA density doubles in comparison to EU banks. Shortage of economic profit still an issue for all G-SIBs



Lagging Profitability of Business Models

Organic Growth

M&A

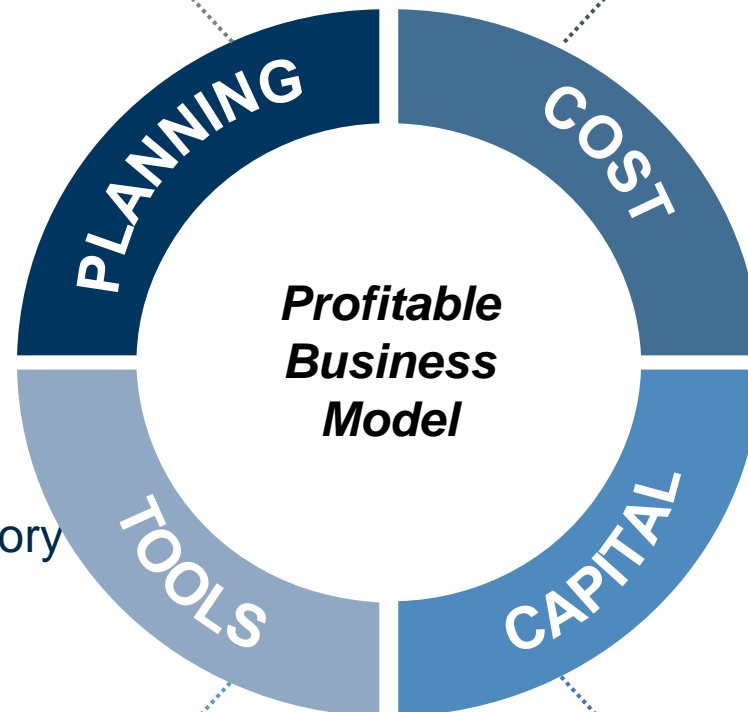


- Comprehensive LOB Budgets

- RWA
- Funding
- Leverage
- Stress Test
- TLAC / MREL
- RoRWA



- Interactive regulatory optimizer
- New pricing and portfolio tools



- Cost synergies

€80bn

vs.

- Compliance & Integration Costs

- G-SIB Add-on

€210bn

vs.

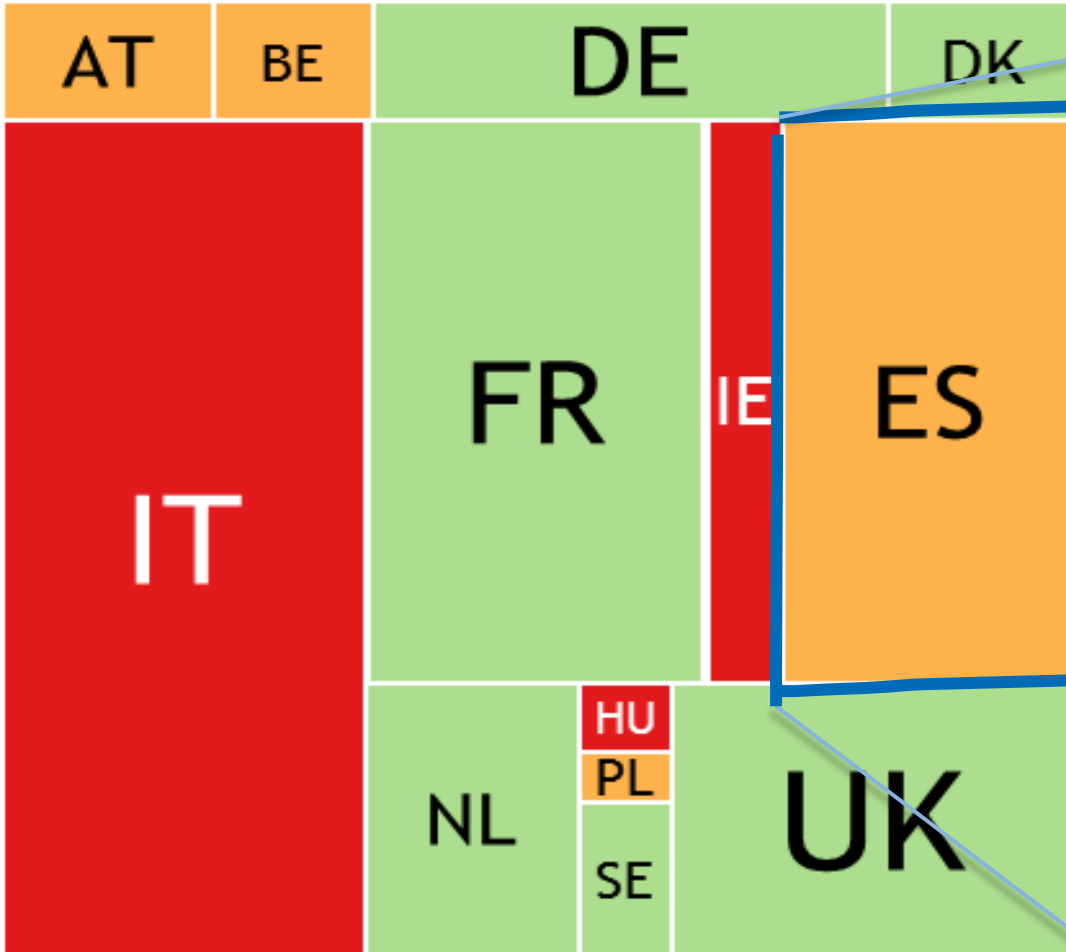
- Diversification Benefits

€165bn

NPLs and their CET1 and Profitability drag

Stock of NPLs

€760bn



Stock of Non-Productive Assets (NPA)

€257bn

18%



Capital & Profitability Drag Impact

-384 bps
in CET1

-11 pps
annually in ROE

NPL ratio %

■ <5%
 ■ <10%
 ■ >15%

NPLs and their CET1 and Profitability drag

NPL ACTION PLAN



Bank Culture and Impact in Reputation

Reputation

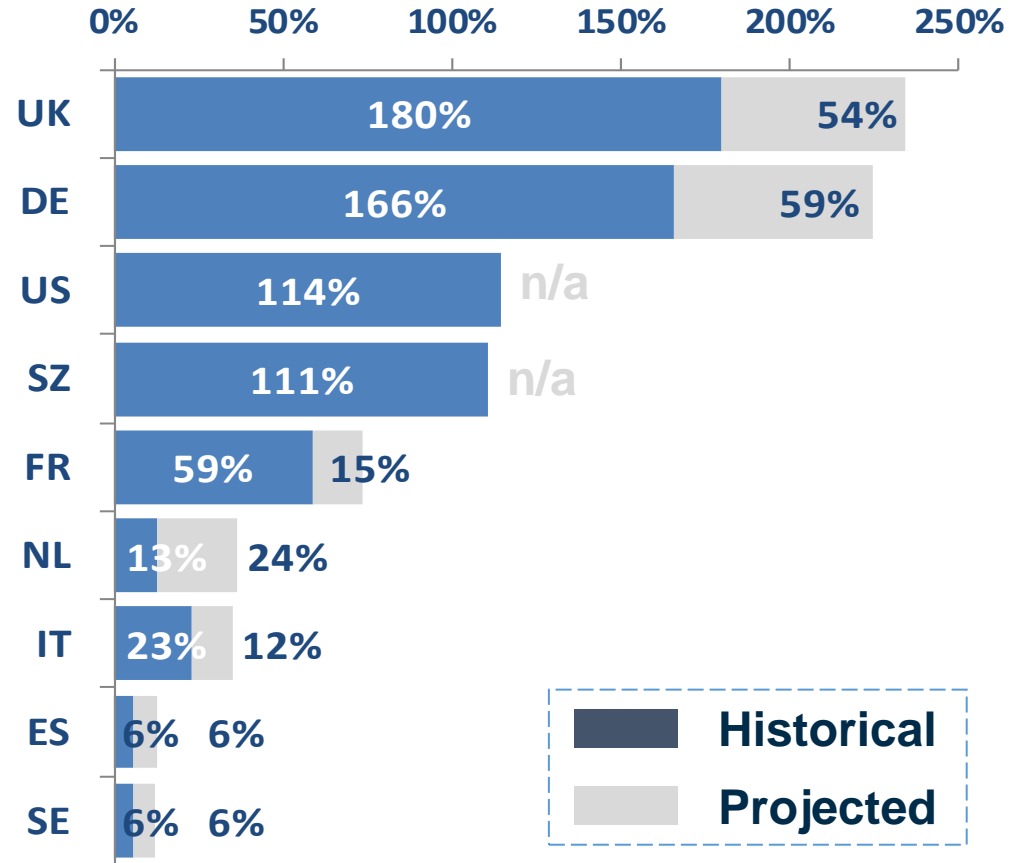
0 banks in top 30 global brand

5 banks in top 100 global brands

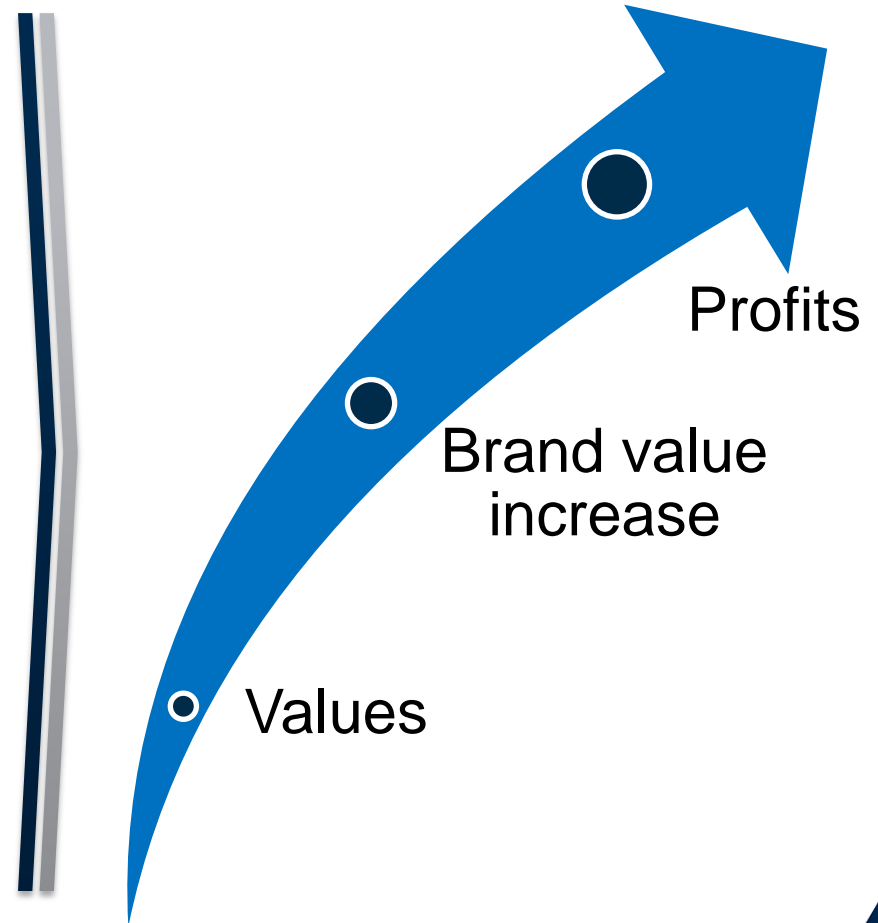
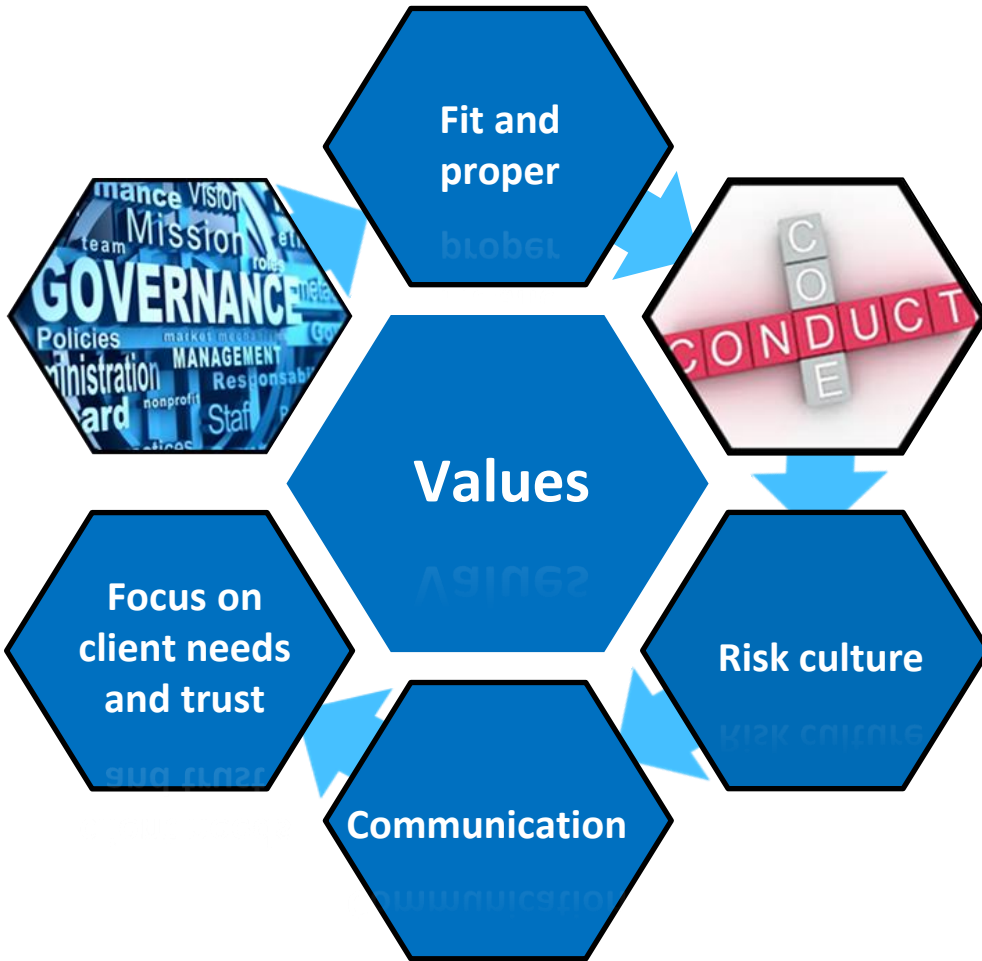
\$235 bn in fines from top 20 banks since 2008

- Payment Protection Insurance (PPIs)
- LIBOR and Euribor scandals
- Foreign exchange manipulation
- Interest rate swaps to corporates
- Financial crime
- ...

Cumulative Conduct Losses as % of Brand Value



Bank Culture and Impact in Reputation





Smart Compliance



Operational Challenges

Holistic approach towards risk assessment to overcome **regulatory requirements overlap** (i.e. MiFID II & PRIIPs)

Identify at an **early stage** the type of **data/information** needed to develop a comprehensive operational framework

Migration of banks' technological landscape to eliminate data systems redundancy and reduce costs in the long run

Better use of technology in conduct compliance (i.e. regulatory reporting and monitoring of employee conduct risk)



Organizational Challenges

Horizontal approach towards new rules when identifying key risk areas within a bank

Vertical approach towards conduct compliance internally, i.e. from board to trading desk

Policies and processes incorporating **incentives** that foster **right behaviours and risk culture**

Good behaviours and incentives to be **'owned' by the management**

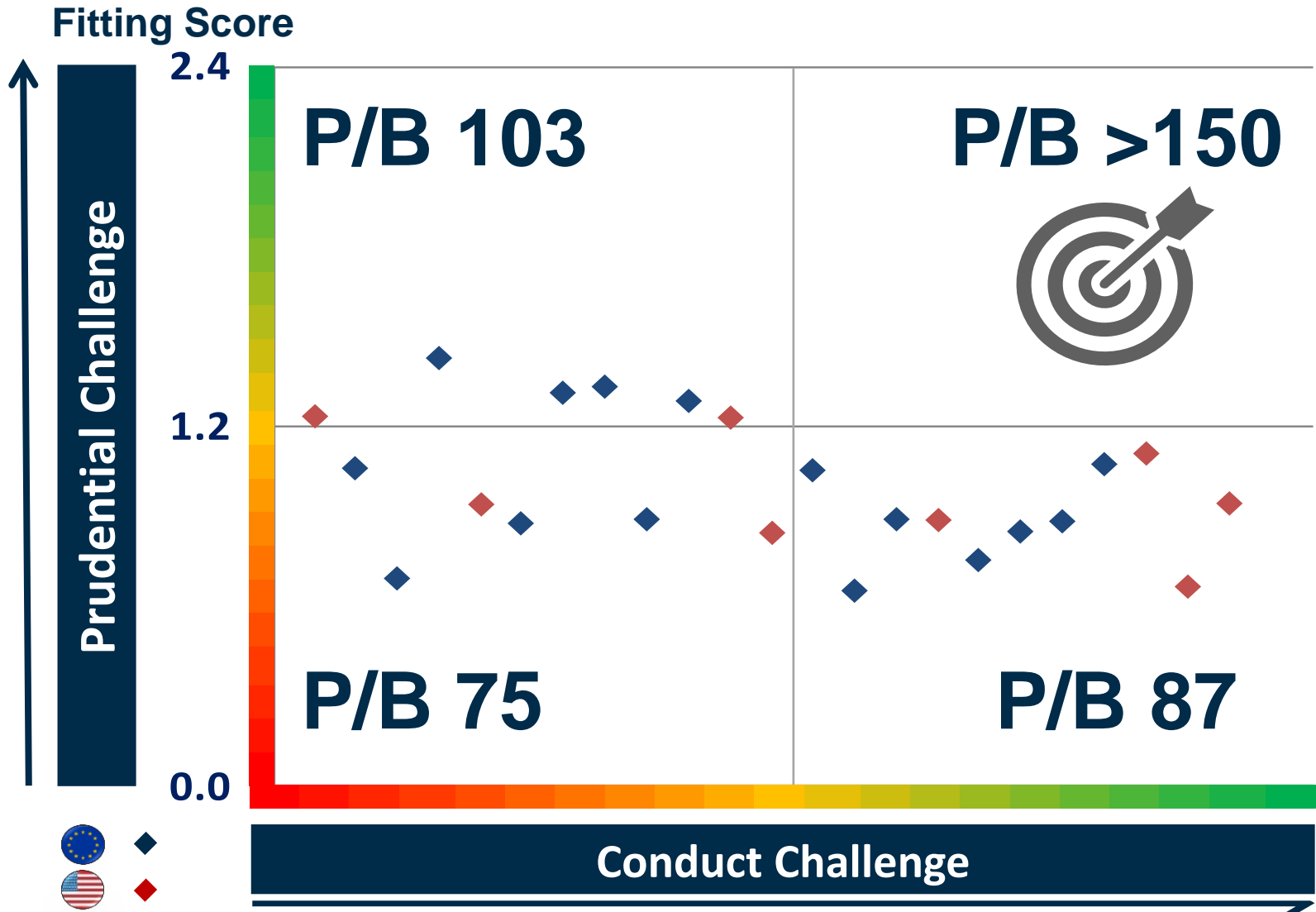


Way Forward

The path to a Profitable Franchise



A&M Scorecard



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