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Future-Proofing the Bank Risk Agenda BCG Global Risk Report 2018

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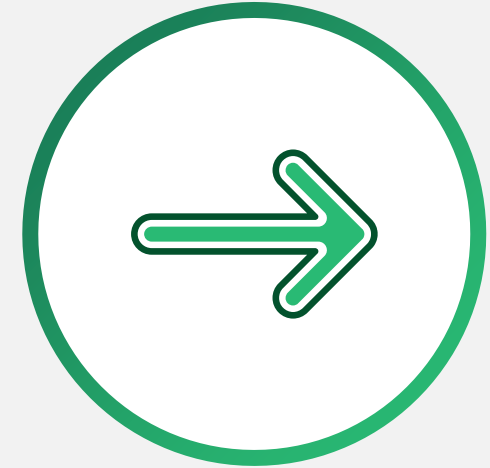
Summary: Future-Proofing the Bank Risk Agenda



Global banking industry has stalled on the road to recovery—still wide variation by region



Broad elements of most top-level regulatory reforms are established—focus of banks must shift to implementation and adaption of processes to remain efficient



Modern CRO must transform risk function's role beyond regulatory compliance to more directly support bank's business growth

Summary: Future-Proofing the Bank Risk Agenda



Global banking industry has stalled on the road to recovery—still wide variation by region



Broad elements of most top-level regulatory reforms are established—focus of banks must shift to implementation and adaption of processes to remain efficient



Moving forward from “Staying the Course in Banking”, the modern CRO must transform risk function’s role beyond regulatory compliance to more directly support bank’s business growth

European banks continue their struggle to recover, still burdened by high volumes of non-performing loans

North American banks with weaker results due to a sharp decline in trading income for previously top-performing banks

Middle East and Africa slowing down, Asia-Pacific on a two-year decline and South America back on track

Flow of regulatory revisions persists—average of 200 revisions per day

Europe is expected to witness a convergence of national regulations, driven by increased ECB attention to national issues

In the US some degree of banking deregulation is likely, but its extent and pace remain unclear

Continue to monitor and manage compliance with existing matrix of regulations and detect new emerging risks

Expand and leverage data and analytics capabilities to enhance internal decision making and to extend commercial opportunities and client service

Digitize the bank’s risk management function

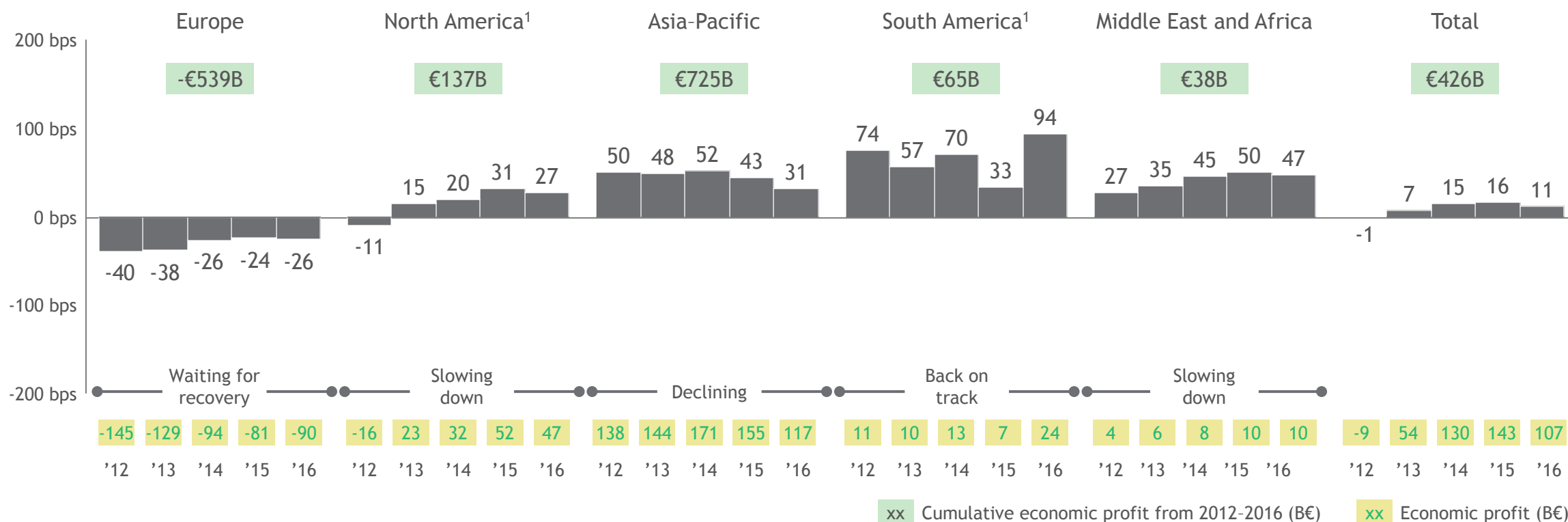
Adopt cutting edge technologies through collaboration with regtechs and other fintechs

Agenda

- State of industry—global banking recovery stalls
- Regulations—mastering the matrix of regulatory change
- Outlook—CRO's agenda for optimizing risk management

The Banking Recovery Has Stalled, with Slower US Profit Growth and European Banks Still Struggling

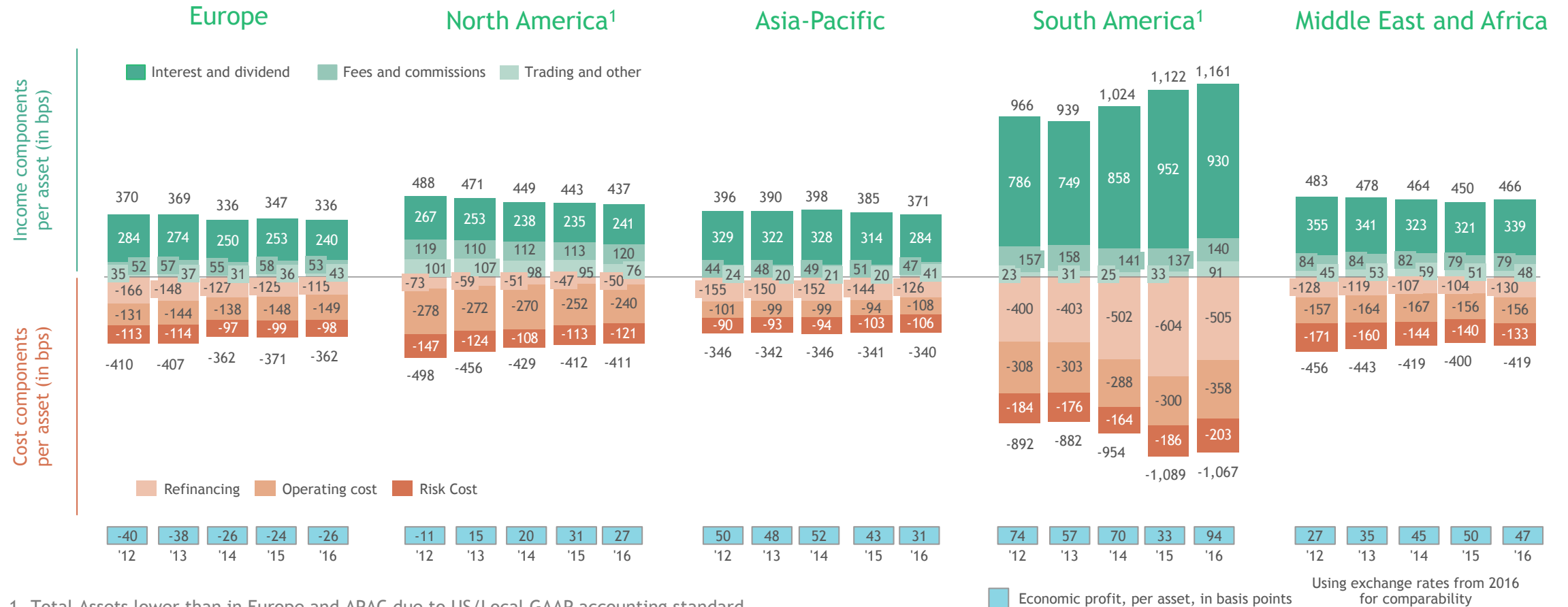
Economic profit generated by global banks, relative to total assets, 2012-2016 (basis points)



1. Total assets lower than in Europe due to US/local GAAP accounting standard
 Note: Using exchange rates from 2016 for comparability; values may not add up to totals due to rounding
 Source: Bank Scope; Annual reports; BCG Risk team database; Bloomberg; BCG analysis

The components of economic profit varied widely by region in 2016

Components of economic profit generated by global banks, relative to total assets, 2012-2016 (in basis points)



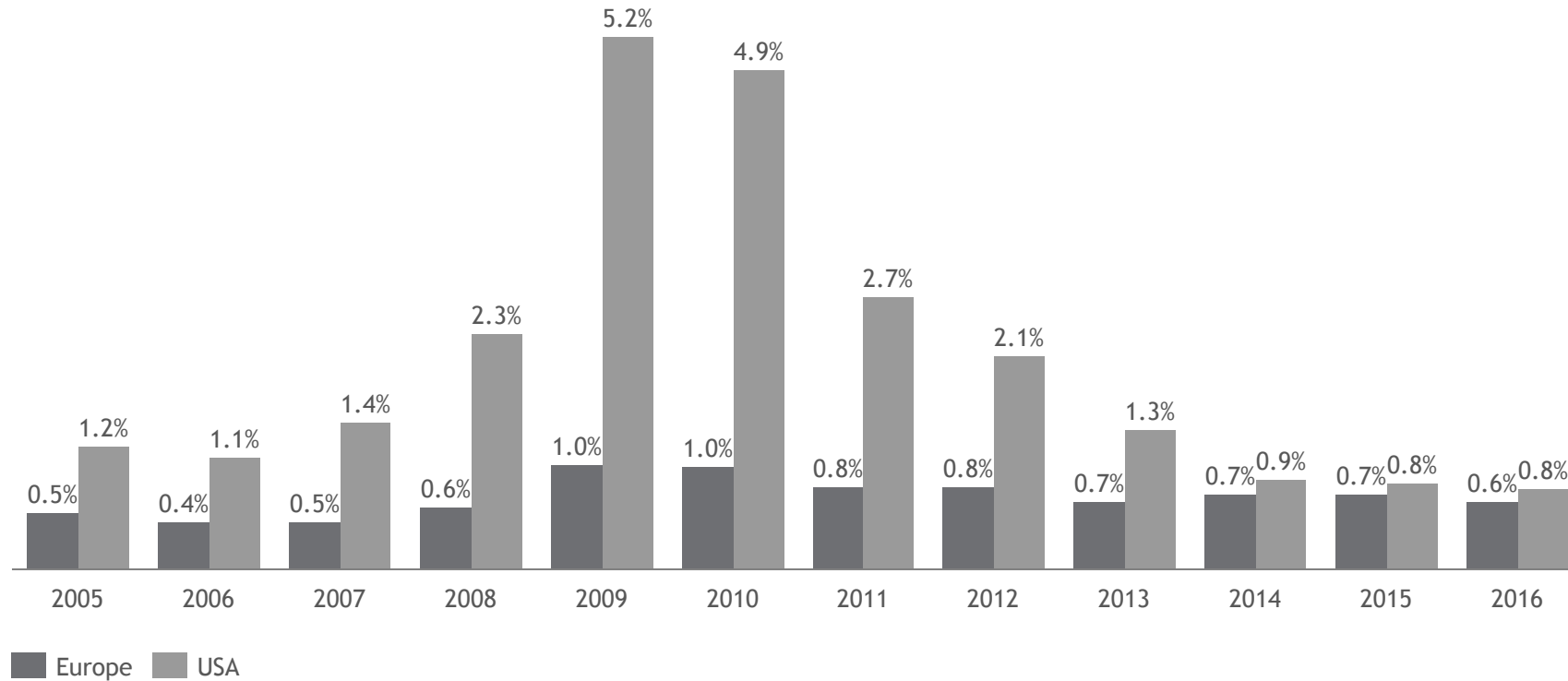
1. Total Assets lower than in Europe and APAC due to US/Local GAAP accounting standard

Note: All values are per asset, i.e., total € value divided by total € assets, then expressed in basis points; Values may not add up to totals due to rounding; order of regions with focus on Europe and North America, remaining regions sorted according to total assets

Source: Bank Scope; annual reports; BCG Risk Team database; Bloomberg; BCG analysis

Deep Dive: European Banks Wrote Off NPLs More Slowly than US Banks and Remain More Vulnerable to a Downturn

Average write-offs relative to loan volumes (%)



Note: The total number of banks considered in 2005 was 88; in 2016 it was 115. NPL = nonperforming loan.
Source: SNL Financial

Comments

European banks doubled loan write-offs following the 2008 financial crisis—but retained NPLs on their balance sheets

US banks, in contrast, nearly quadrupled write-offs and thus considerably reduced their NPL exposure early. Beginning in 2014, they have even been able to reduce write-offs below pre-crisis levels

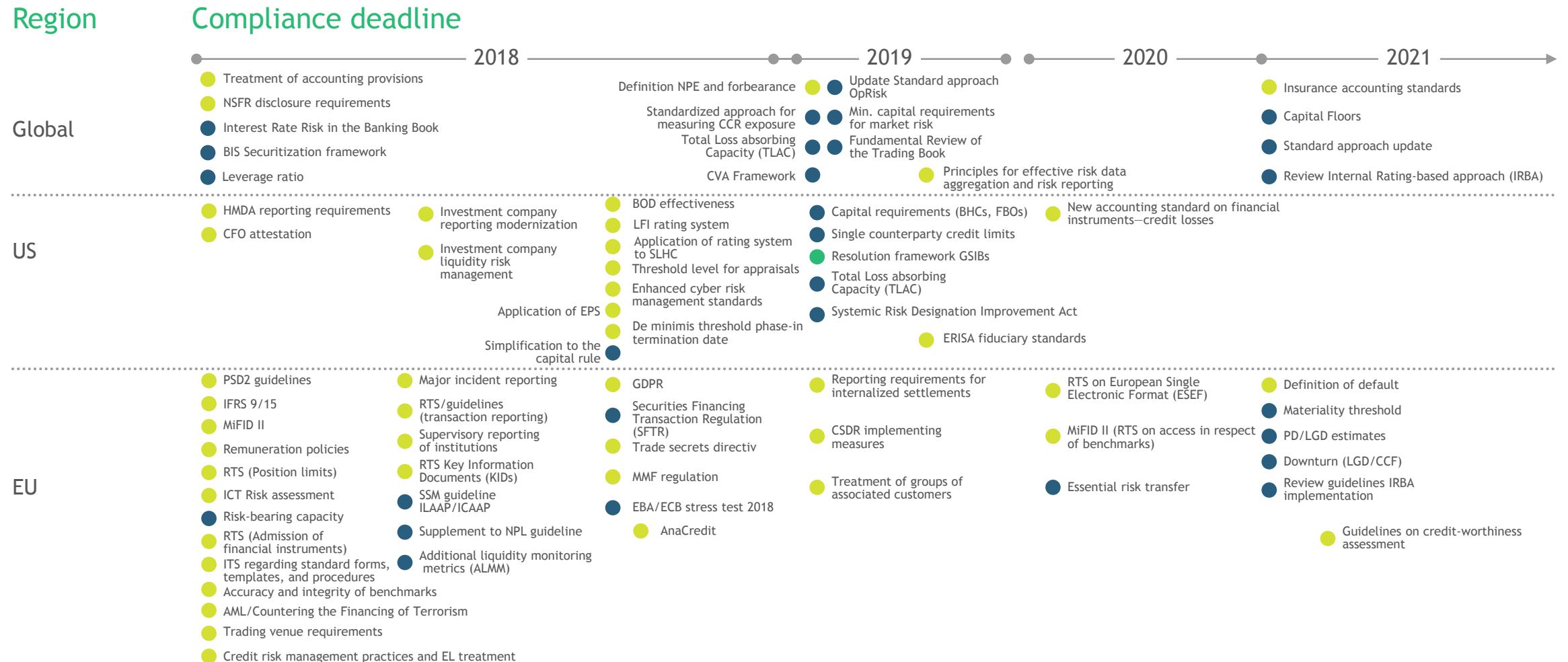
Agenda

State of industry—global banking recovery stalls

➤ Regulations—mastering the matrix of regulatory change

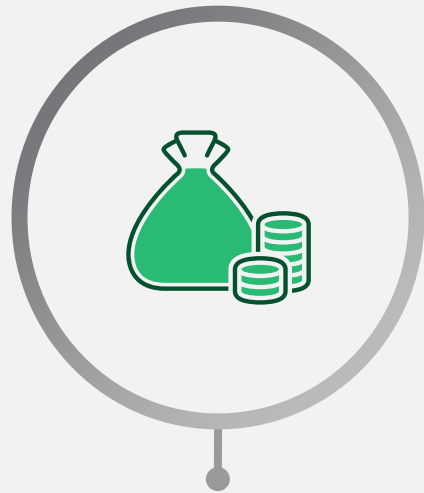
Outlook—CRO's agenda for optimizing risk management

Banks Face Substantial Work to Comply with a Host of Regulatory Deadlines by 2021



Note: compliance deadlines partly estimated
 Source: BCG Regulatory Database; BCG analysis

Regulatory topics can be structured along three main clusters



Financial stability

Basel IV with impact on capital ratios, TRIM with strong focus on internal models



Prudent operations

Cumulative penalties rose to \$345B—strict penalization continues



Resolution

Resolution remains least developed area of reform



TRIM is the biggest single project investment of the ECB Banking Supervision history

**2017-
2019**

Execution phase for on-site investigations from 2017 until beginning of 2019

15%

15% of total SSM budget in 2017 for TRIM

6
Investigators

At least 6 investigators per on-site investigation

68
Banks

Covering 68 banks in 15 countries



TRIM comprises a holistic view on all major risks



General topics

- Governance
- Validation
- Model Use
- Data quality



Credit Risk

- Scope
- Data
- PD/LGD/CCF



Market Risk

- IMA
- Backtesting
- Methodology
- Validation



Counterparty CR

- Trade coverage
- Margining
- Model calibration
- Validation

CCAR: Comprehensive Capital Analysis and Review

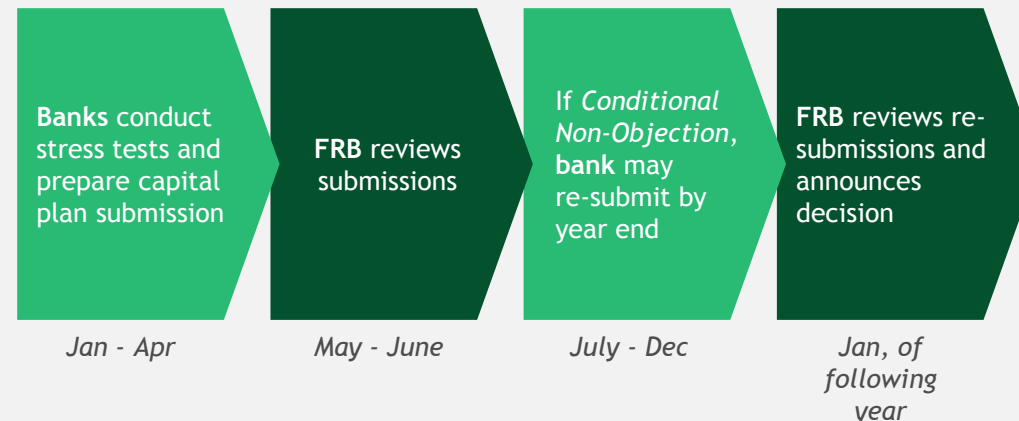
Purpose

CCAR is an annual exercise by the Federal Reserve (FRB) designed to assess the largest banks':

- Capital adequacy under normal and stressed conditions ("Stress Test")
- Robustness of internal risk management and capital planning processes
- Feasibility of proposed capital actions

Overview of CCAR Annual Cycle

- 1 FRB releases CCAR instructions & scenarios (January)
- 2 Banks submit capital plans to FRB (April)
- 3 FRB announces objection / non-objection decisions (June)
























Banks must demonstrate robust, forward-looking capital planning processes commensurate with their unique risks

CCAR Scope: List of in-scope banks by category

Application Scope	Number of Institutions ³	In-scope Institutions	
Large Financial Institutions > \$50B (US) assets	Large & Complex	LISCCs ¹ Domestic 8	JPMorganChase, citi, Goldman Sachs, BNY MELLON, Wells Fargo, Bank of America, Morgan Stanley, STATE STREET
		LISCCs ^{1,2} (Foreign) 4	BARCLAYS, CREDIT SUISSE, UBS, Deutsche Bank
	Non-LISCCs 6	Capital One, usbankcorp, HSBC, PNC, TD Bank, RBC	
	Large & non-complex 21	BB&T, SUNTRUST, FIFTH THIRD BANK, REGIONS, ally, CIT, KeyBank, Citizens Bank, M&T Bank, DISCOVER, Huntington, AMERICAN EXPRESS, BANCWEST BNP PARIBAS GROUP, BBVA, Compass, BMO Financial Group, ZIONS BANK, BNP PARIBAS, Comerica, MUFG, NORTHERN TRUST, Santander	

1. Large Institution Supervision Coordinating Committee 2. Non-public for newly formed IHC's in 2017 3. As of January 2017
Source: SR 12-17 / CA 12-14

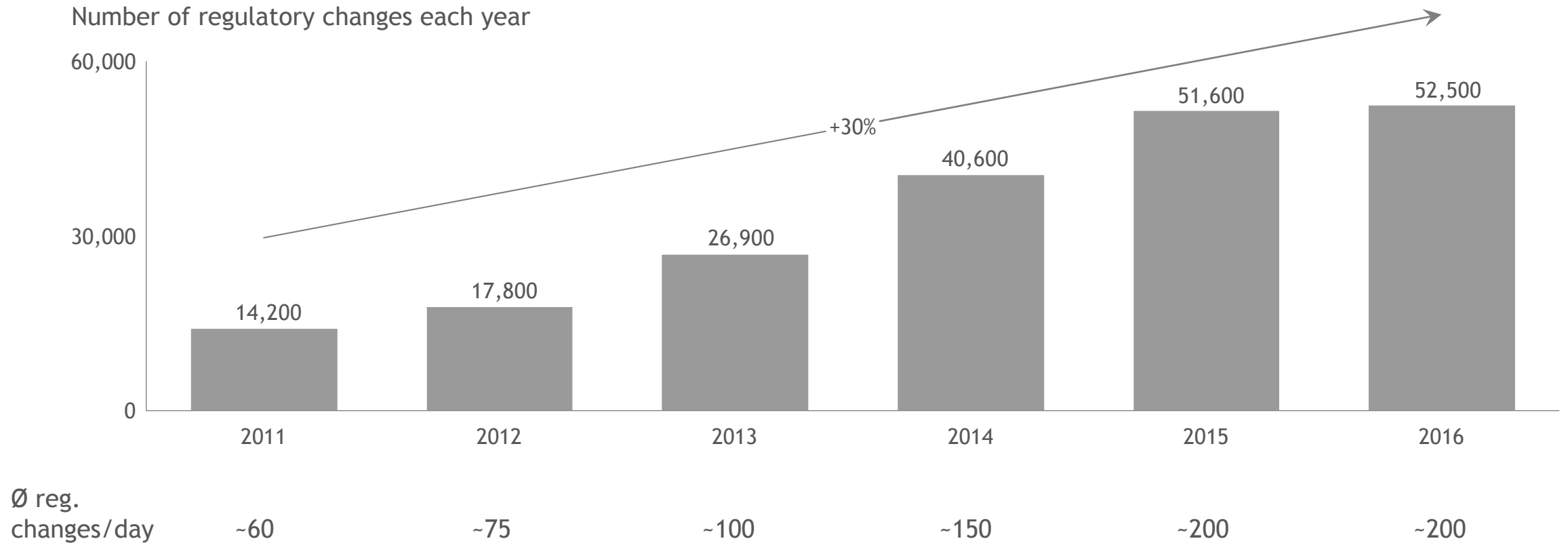
CCAR results: Some early quantitative objections, but recent objections have all been for qualitative reasons

		2011	2012 ¹	2013 ²	2014	2015	2016	2017	2018	
Objection	Quantitative		   							
	Qualitative	Results not publicly available			   	 	 	Foreign BHC not publicly disclosed		
Conditional Non-objection				 						

1. MetLife was a bank holding company in 2012 but it had completed its deregistration in Feb 2013. Large & non-complex firms were subject to a qualitative stress test in 2013
 Source: The Fed's CCAR result announcement, Press search



The era of constantly evolving and increasing regulatory requirements persists

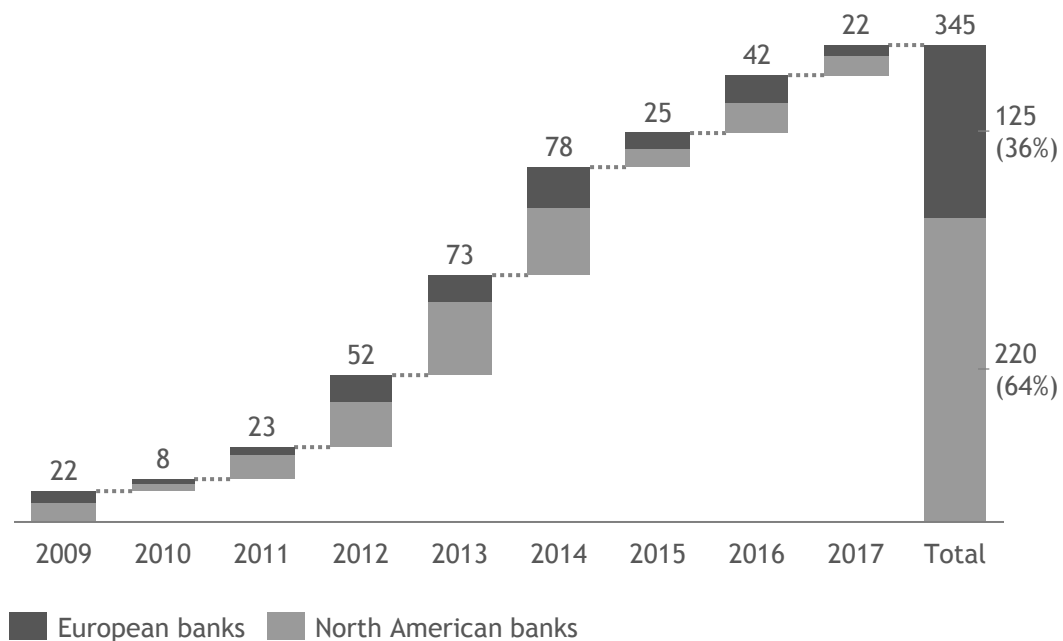




Prudent operations: Regulators Continue to Impose Financial Penalties on Banks for Noncompliance, but at a Slower Pace

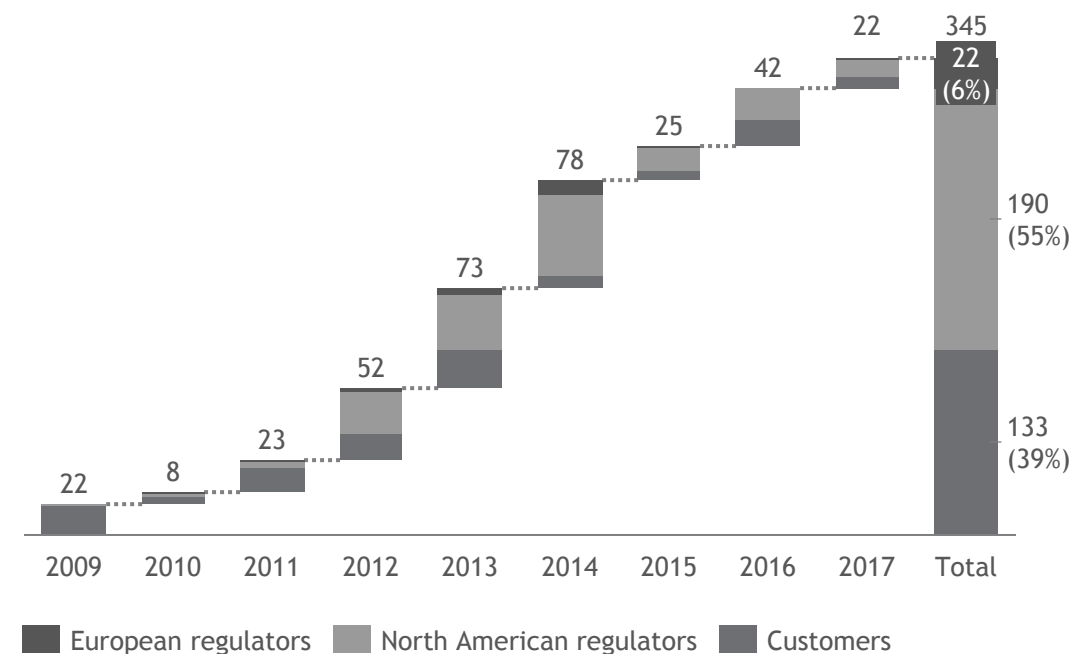
Penalties paid by banks, by region

Penalties (B\$)



Penalty recipients

Penalties (B\$)



Note: The sample covers the 50 largest European and US banks. Data through 2015 includes only the penalties, fines, and settlements that surpass \$50M; data since 2015 includes only the penalties, fines, and settlements that surpass \$20M. Values may not add up to totals shown because of rounding.

Source: Annual reports; Press reports; BCG analysis

Agenda

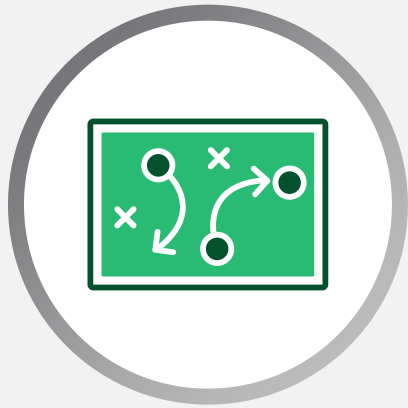
State of industry—global banking recovery stalls

Regulations—mastering the matrix of regulatory change

➤ Outlook—CRO's agenda for optimizing risk management

Outlook: CRO's agenda for optimizing risk management

Relevant agenda topics



1. Ensure regulatory compliance strategically



2. Make risk a source for competitive value



3. Digitize the risk function



4. Collaborate with regtechs for innovation and advantage

A close-up photograph of a lit sparkler against a dark background. The sparkler is the central focus, with numerous bright, golden-yellow sparks radiating outwards in all directions. The sparks vary in length and intensity, creating a dynamic and celebratory atmosphere. The background is dark, making the bright sparks stand out prominently.

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