KPMG

cutting through complexity

Impact of regulatory requirements

Study

Munich 12 September 2014

IUHF

BUILDING THE FUTURE

1914 100th Anniversary 2014

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Agenda

1. Introduction

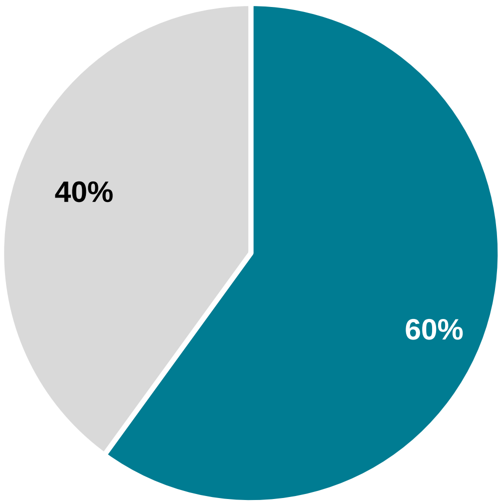
Background of the study

- The study was initiated by KPMG in order to examine the aggregated overall impact of the various regulatory measures introduced as a response to the financial crisis as well as the European sovereign crisis
- It presents results of a survey among major German banks on the impact and associated costs of regulatory requirements from 2010 to 2015
- The survey was carried out in cooperation with the Federal Association of German Banks (BdB) and the Federal Association of Public Banks in Germany (VOEB)
- 20 banks participated in the survey, representing 60% of the German banking market (as measured in balance sheet total). The pool of participants included Tier 1 as well as Tier 2 banks

bankenverband
BUNDESVERBAND DEUTSCHER BANKEN

VÖB Bundesverband Öffentlicher Banken Deutschlands

- Survey participants' share of German banking market (balance sheet total, 2012)



Source: KPMG; Bundesbank

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1	Introduction
2	Costs resulting from Regulatory Initiatives
3	Banking Market and Bank Business
4	Banks’ POV on Regulation
5	Conclusion and Outlook

Direct costs: Project budgets and administrative expenses

- Participants were asked to state one-time investment costs as well as ongoing administration costs for the implementation of regulations over the past 3 years and estimates for the following 3 years
- Total direct costs amount to EUR 5.2 bn over the period of 2010-2015 for banks in the survey pool

Direct costs of the regulation		
	2010–2012	2013–2015
Required project budgets/ Investment costs from regulations	EUR 1.9 billion	EUR 2.5 billion
Additional ongoing administration costs from regulations	EUR 0.4 billion	EUR 0.4 billion
Direct costs of the regulation among the study participants in total	**EUR 2.3 billion**	**EUR 2.9 billion**

Source: KPMG, 2013

- Regulatory costs claim **up to 61%** of project budgets of individual areas:
  - High shares especially in Risk controlling/Risk management and Compliance (54-61%)
  - Low share in IT/Organisation (21-27%) although highest absolute amount (EUR 1.8 bn from 2010 to 2015)

Operational costs of the regulation – implementation of supervisory requirements – percentages of the project budget of individual areas		
	2010–2012	2013–2015
Risk controlling/risk management	57%	56%
Compliance	61%	54%
Internal auditing	42%	32%
Accounting/Finance	47%	52%
IT/Organisation	21%	27%

Source: KPMG, 2013

2. Costs resulting from Regulatory Initiatives
Total costs of regulation

- 2010-2015: **EUR 8.6 bn** direct implementation and administration costs from regulatory measures for all German banks
  - **EUR 2.0 bn p.a.** including bank levy of EUR 0.6 bn
- Main focus of operational expenses in the following fields:
  - Basel III and CRDIV/CRR
  - Increased reporting requirements, e.g. COREP and FINREP
  - New international accounting standards
- 2010-2012: **EUR 9.0 bn total costs p.a.** for all banks due to direct costs (EUR 2.0 bn) and indirect costs of opportunity from increased capital and liquidity requirements (EUR 7.0 bn)
  - Increased capital, liquidity and margin/collateral requirements as main drivers of indirect costs

Direct costs of the regulation at German credit institutions in total

2010–2012	2013–2015
approximately EUR 3.8 billion	approximately EUR 4.8 billion

Source: Bundesbank banking statistics (balance sheet total "Monetary financial institutions") in relation to the balance sheet total indicated by the participants in each case (reference 2011), calculation of aggregation pursuant to the bank survey "impact of regulatory requirements" 2013.

Change in the return of equity before tax

2010–2012	2013–2015
minus 2.4 percentage points	minus 2.4 percentage points

Source: KPMG, 2013

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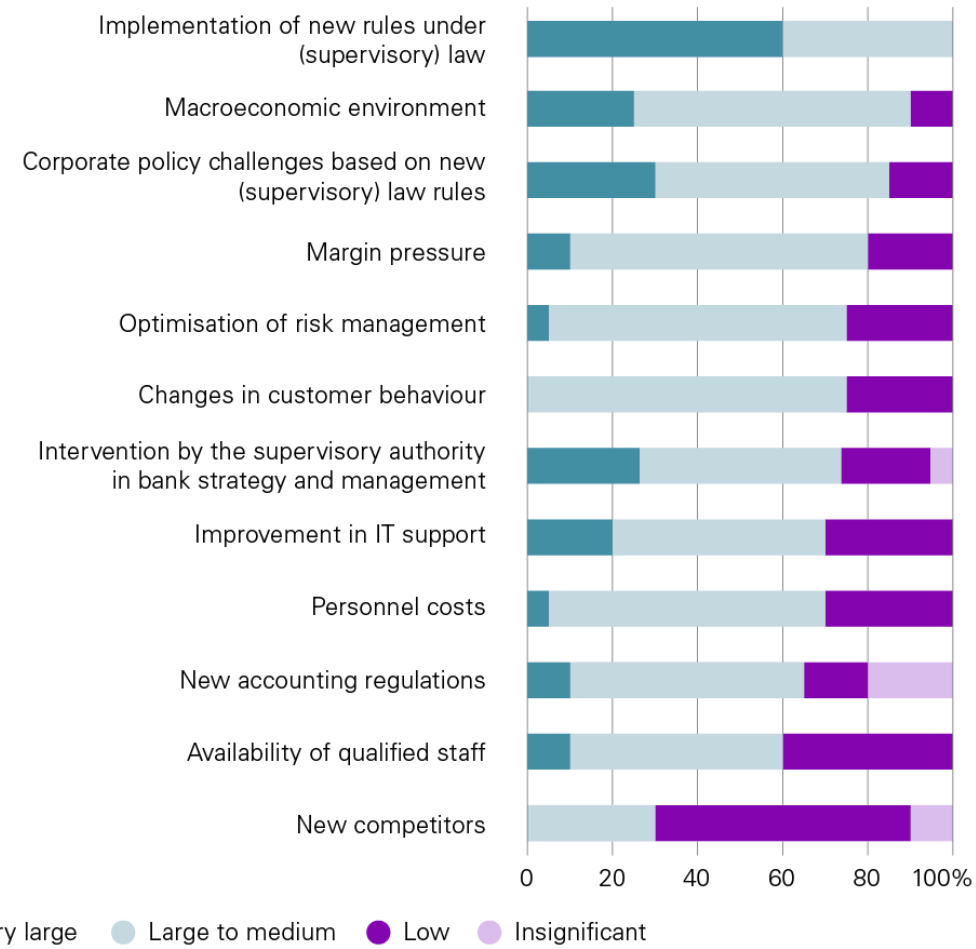
Current challenges and perspectives

- The effects of the regulation are seen by the banks as the **central challenge** for the mid-term company success, even before new competitors, customer behaviour or margin pressure
- Consequently, projects to improve **capital and liquidity management** are seen as highly important for mid-term success by participants
- Improvements in **risk management** are also ranked as important although a large number of projects have already been completed or at least started and hence may be seen as less relevant for the medium term

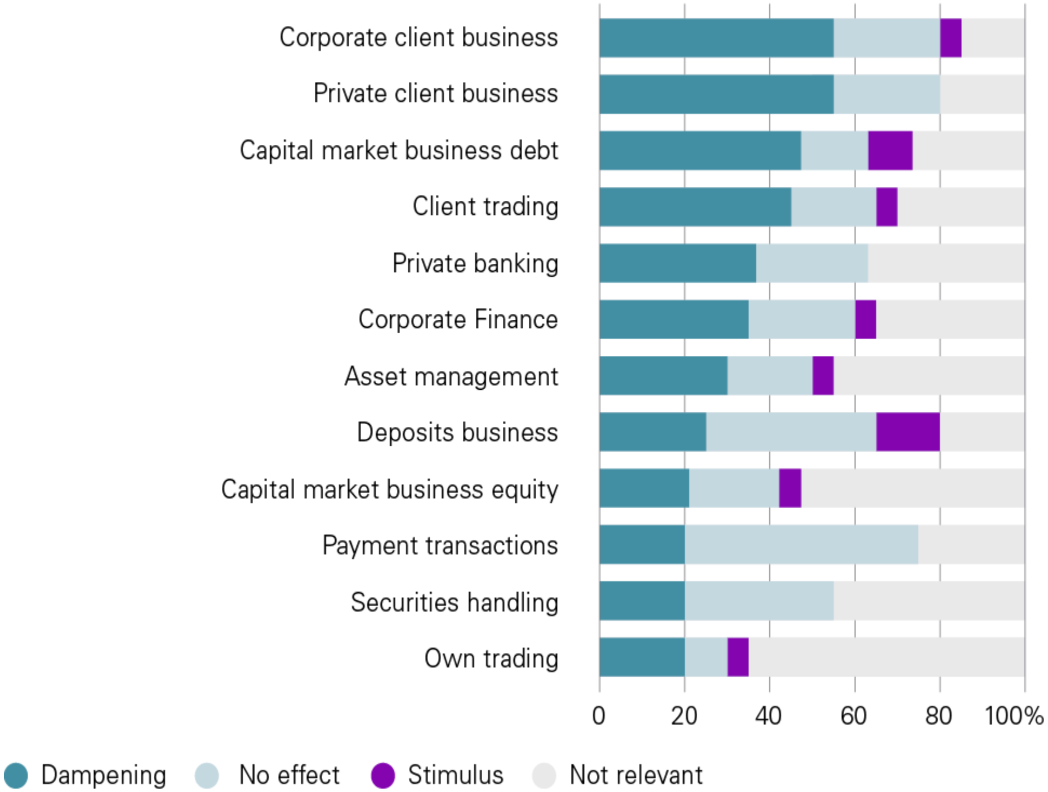
Challenges with regard to the medium-term (2013–2015) corporate success



Impact on business opportunities

- Banks considerably shift their business model focuses to **corporate client** and higher-level **private client business**
- At the same time, participants see business opportunities in these fields as **strongly dampened** by regulatory measures
- A relatively high share of participants see a **positive stimulating effect** of regulatory measures on **deposit business**, partly due to competitors withdrawing from the business
- The significance of **proprietary trading** has highly decreased as a result of regulation. Most institutions have already partially or even completely **suspended trading activities**

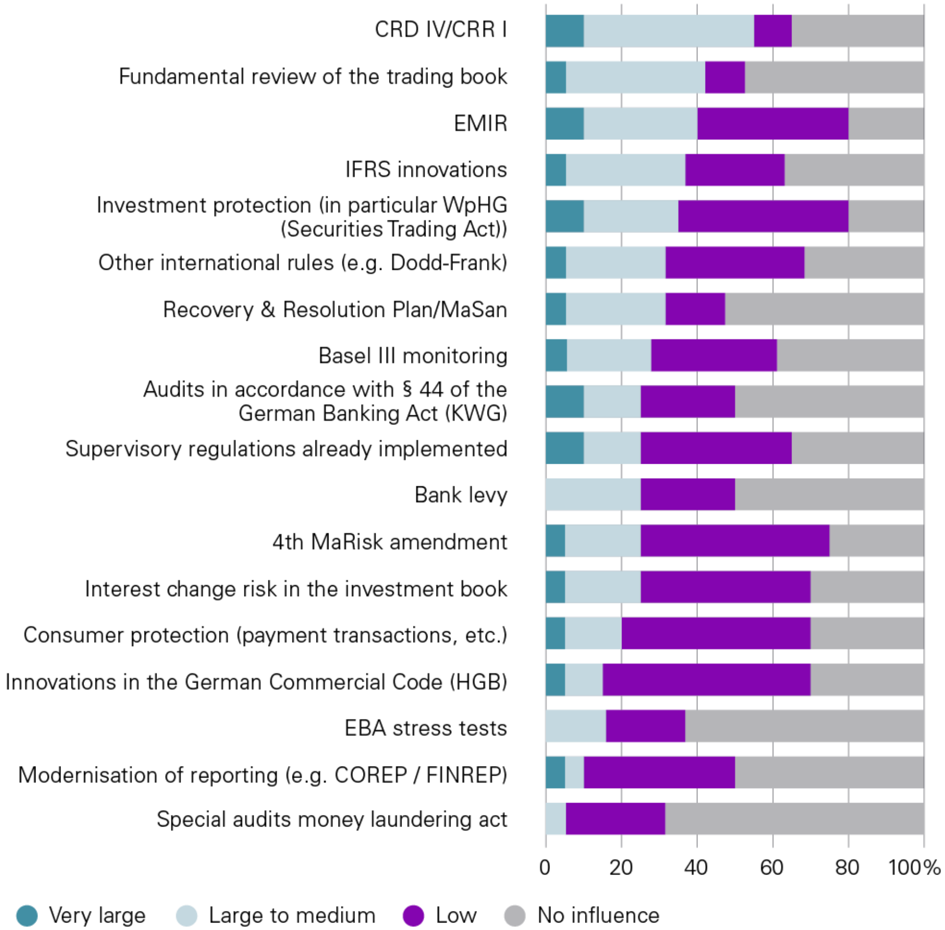
Effect of new regulations on growth potential of the banking business



3. Banking Market and Bank Business
Impact on business models and bank organization

- A majority of banks does not question their **general business model** with regard to regulatory initiatives
- However, **adjustments within the business models** take place in line with regulatory goals: Higher capital and liquidity endowments combined with a reduction of higher-risk business activities, e.g. due to withdrawal from trading activities
- According to the participants, the **business organization** and **bank management** units belong to the most impacted areas within the institutions
- The regulatory initiative with the most significant impact is **CRD IV/CRR**, followed by EMIR and investor protection measures

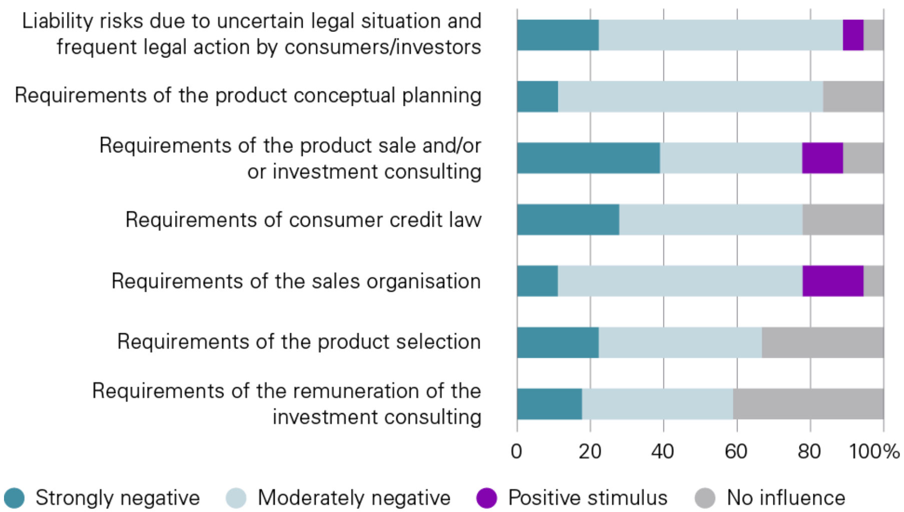
Influence and/or need for adjustment due to individual regulations on the business model



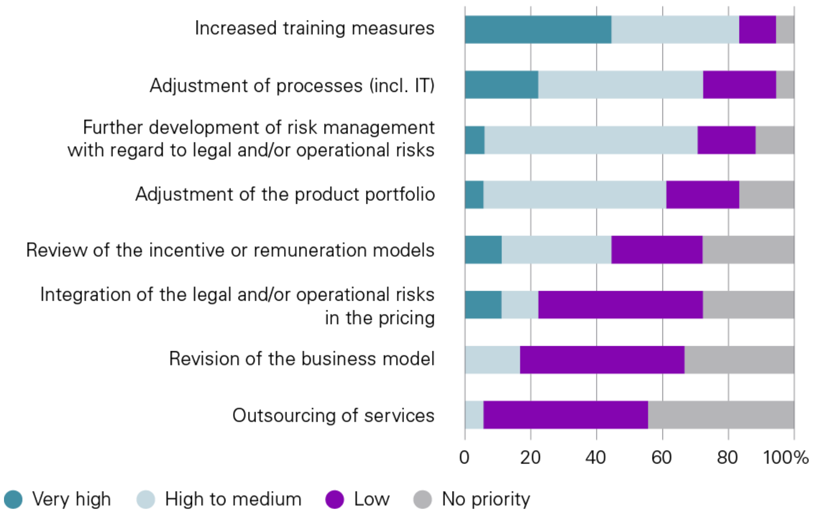
Spotlight: New challenges in Private client business

- Focus on **consumer protection** and **investment advisory**:
  - Higher documentation requirements seen as costly and negatively influencing business activities (counterproductive, overburdening, creating uncertainty)
  - No influence seen due to shift from commission-based to fee-based advisory
  - Institutions see only little possibility to roll over the increased costs of legal and operational risk to customers

Influence of the regulations (or legislation) on business success in the field of consumer and investor protection



Prioritisation of measures to limit the costs due to new rules on consumer protection



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Purpose and process of regulation

- The participating institutions do not generally question the new regulatory regime. Necessity and course of the regulations are **generally appreciated**
- However, some initiatives appear **especially costly** in relation to the regulatory purpose, such as new reporting requirements, FATCA, EMIR, automated trading regulation, and Financial Transaction Tax
- **Positive effects** from regulatory measures are seen among other in the
  - OTC regulation due to higher transparency and standardization of trading
  - Single rule book (CRR) due to greater clarity and internationally harmonised interpretation of rules
- Participants demand a **higher degree of coordination** of regulatory initiatives (nationally and internationally) as
  - Differing interpretation of rules, “gold plating” and “front running” in different jurisdictions lead to multiplication of requirements as well as complication of cross-border business activities and intra-group coordination
  - Short-term amendments of regulations often result in costly follow-up projects in the institutions
- At the same time, smaller and only nationally active banks require **greater differentiation** between institutions and increased **proportionality** in the design and implementation of regulations
- High effort to implement new regulations requires **extended implementation and transitional periods**

Banks generally appreciate new regulation but demand increased coordination, higher proportionality and more time

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5. Conclusion and Outlook

- The implementation of the new regulations and their application create **significant costs** for the industry. Banks experience total direct and indirect costs of EUR 9.0 bn p.a., largely driven by higher capital and liquidity requirements
- Our survey participants regard the effects of the new regulations as the **greatest challenge** for achieving their business targets in the intermediate term
- The institutions **adjust** their business models towards the target compassed by the regulators while **maintaining** their general business model. Banks now focus more on the business with **Private and Business clients** and reduce high-risk exposure
- Although new regulations are largely appreciated, institutions are also keen to limit the overall costs of the regulation
  - First of all, institutions ask for **longer implementation periods**
  - Secondly, they would appreciate **higher levels of coordination** between the different regulators and between different regulations
  - And thirdly, the participants are demanding **improved relation** between efforts of implementation and regulatory purpose

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