

# ESE Conference 2017

Challenges ahead for business models – what is the role of the financial supervisor?

Jan Sijbrand, DNB Executive Board, 28 September, 2017

DeNederlandscheBank

EUROSYSTEEM

# Business models of financial institutions

## Agenda

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- 1** Challenges ahead
- 2** What role for the supervisor
- 3** How does it work in practice
- 4** Wrap-up

# 1 Challenges ahead

- Low interest rates
- Fintech
- Reaction to new regulation
- Country-specific factors

Capacity for change is needed

# Low interest rates

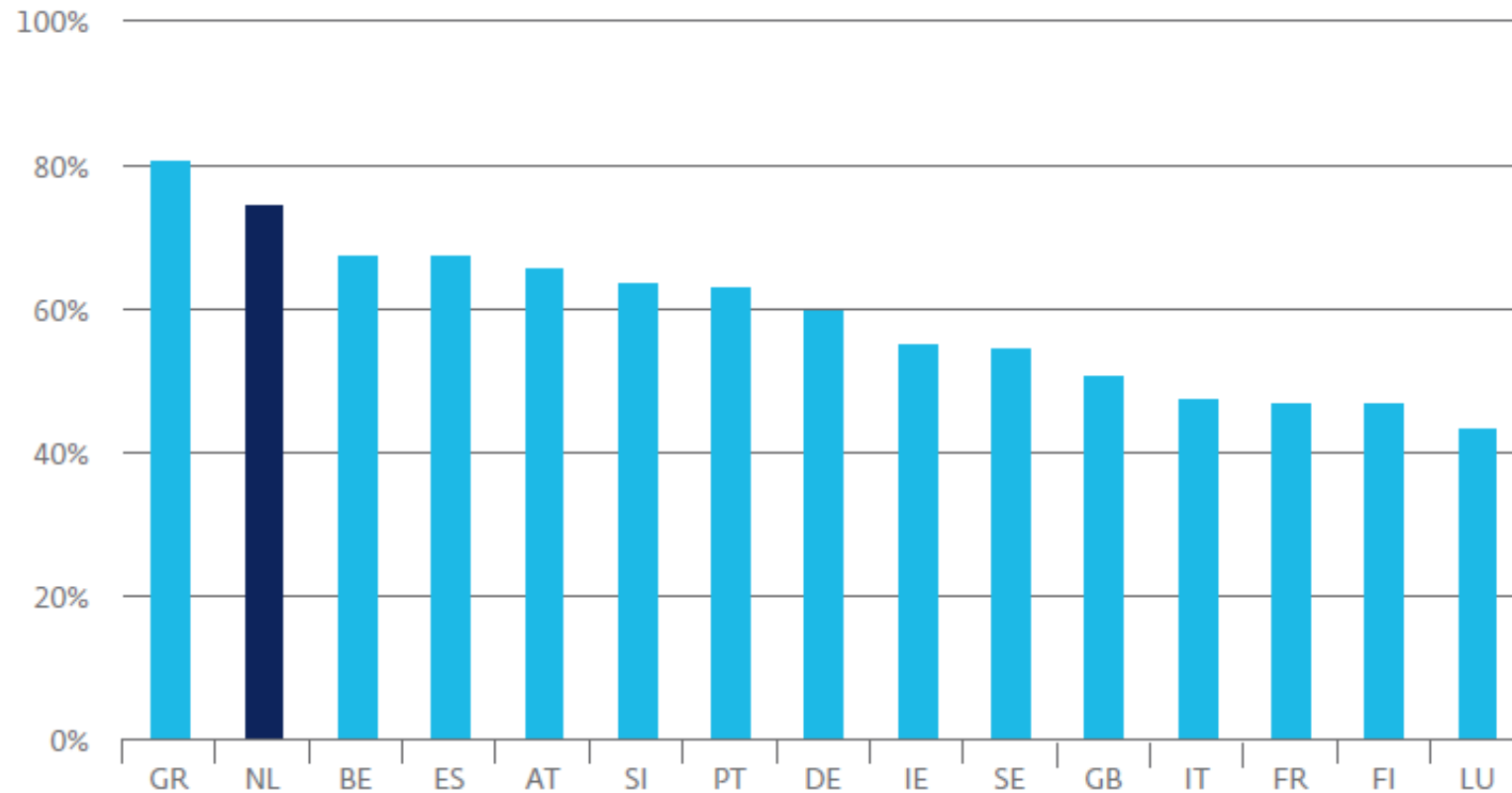
- Risks for the financial sector and the real economy
- Bank profitability under pressure
  - Savings rates approaching their lower bounds
  - Compressing net interest income
- Solvency of insurance companies and pension funds under pressure
- Incentives for risk taking



# Low interest rates

## Banks depend on net interest income

*Net interest income as percentage of total income; 2016 Q3.*



Source: ECB.

# Fintech



# Fintech impact



# Reaction to new regulation

Changes in regulation may impact business models.

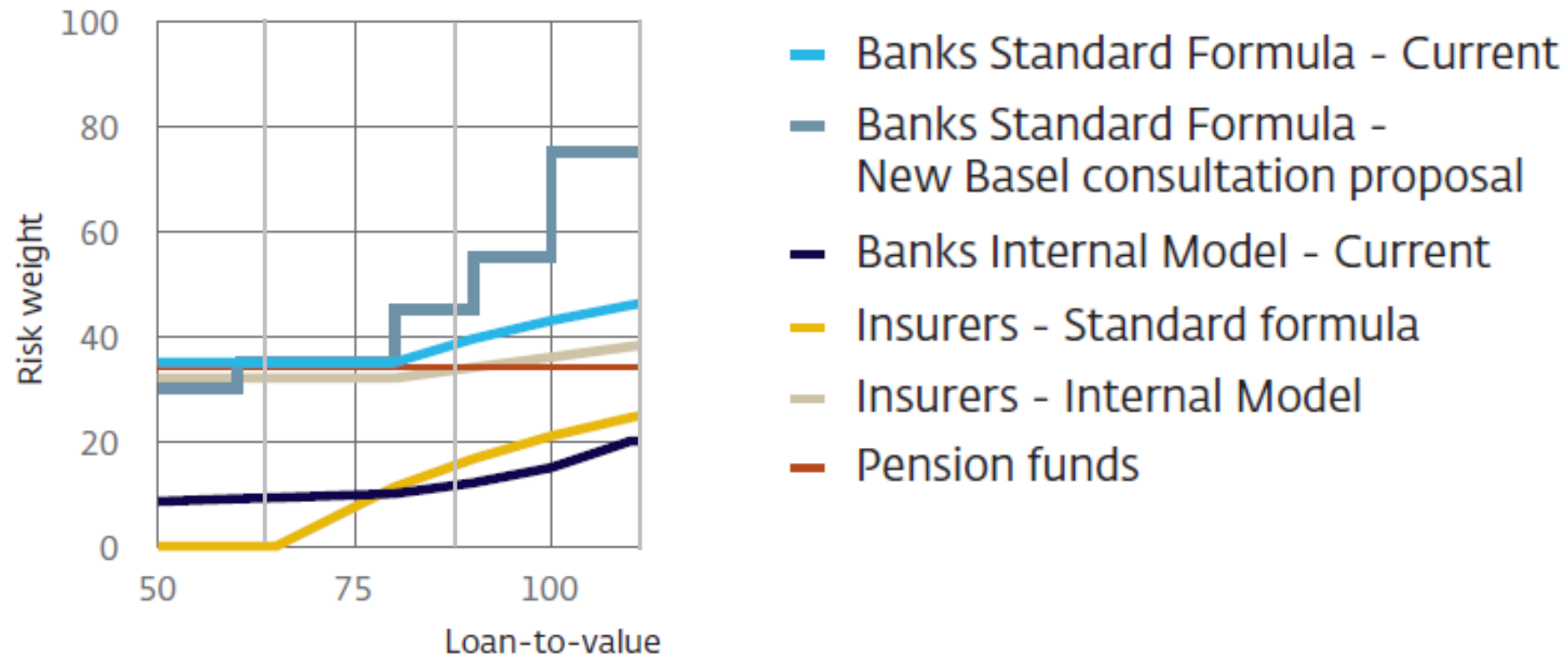
- MREL
- IFRS9
- Basel 3.5



# Reaction to new regulation

Capital requirements of non-securitised mortgages for banks, insurers and pension funds

Percentage

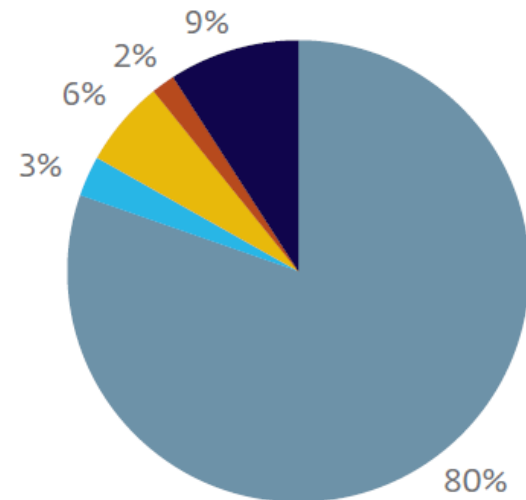


Source: DNB.

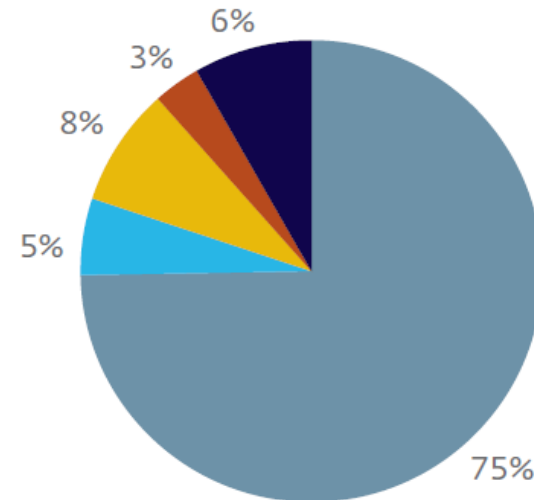
# Country-specific factors

For example: Non-bank lending in the Dutch mortgage market is on the rise ...

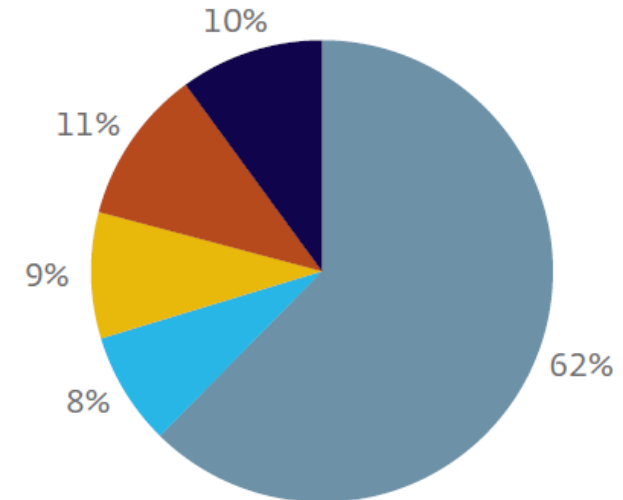
2010 Outstanding debt  
(Total: EUR 647 billion)



2016 Outstanding debt  
(Total: EUR 662 billion)



2016 New loans  
(Total: EUR 33 billion)



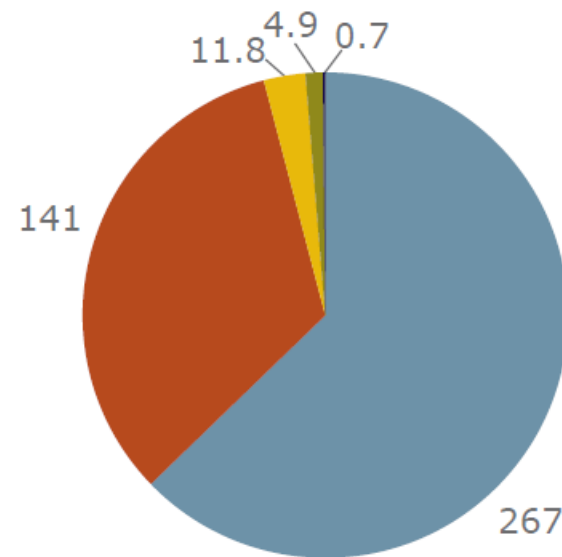
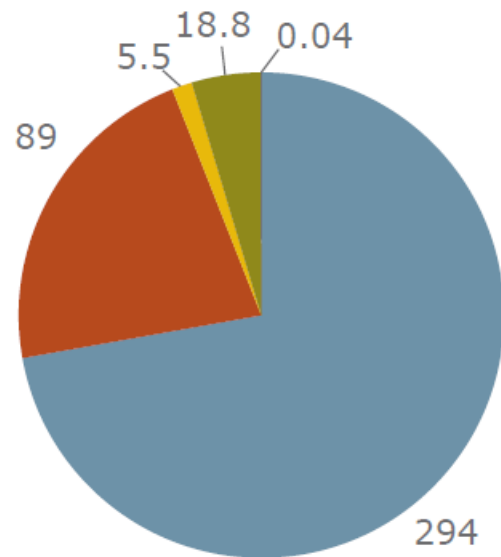
Source: DNB.

# Country-specific factors

... the same trend is visible on the Dutch corporate market

Outstanding debt in 2010 in EUR billions

Outstanding debt in 2016 in EUR billions



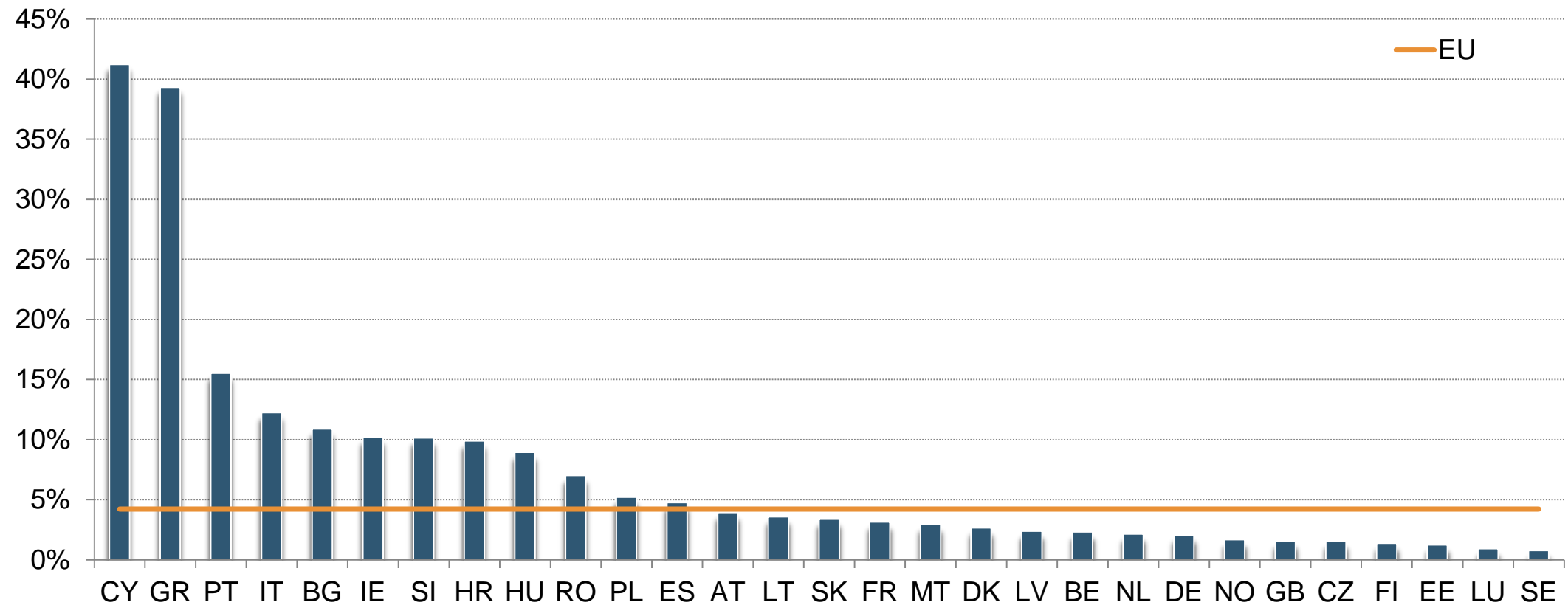
- Bank loans
- Corporate bonds
- Private placements

- Securitisations
- New alternatives

Source: DNB, CBS, Dealogic, Douw & Koren, NPEX, Qredits and VSK/VKN.

# Country-specific factors

For example: Non performing loans, as the NPL ratio is highly dispersed across Europe



Source: EBA Risk Dashboard (Q1 2017)

## 2 What role for the supervisor?

- Business model assessment
- Added value of business model supervision
- Examples of typical business model related risks
- Some of the results of business model supervision



# Business model assessment

- Usually starts from a business plan submitted by the institution or from changes within the internal or external business environment
- Business model risk relates to **scenarios** in which a bank's course of business is impaired
- Business Model Supervision is therefore by nature **forward looking**

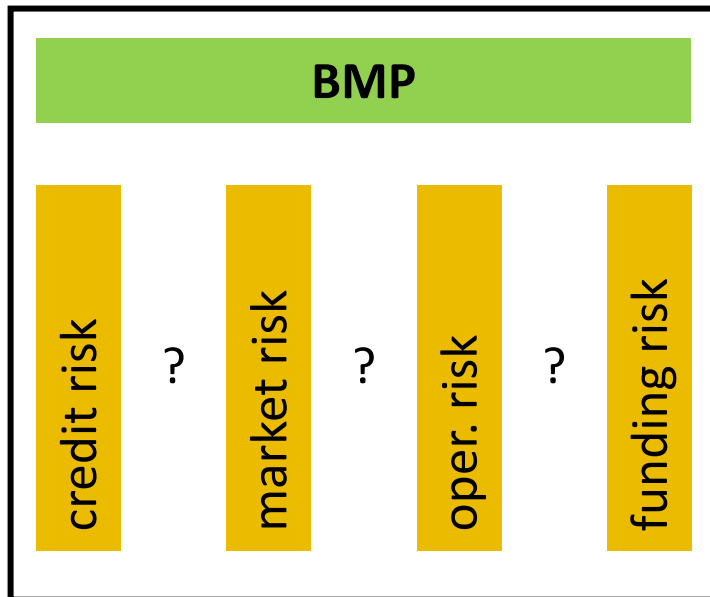
# Business model assessment

It is NOT: 

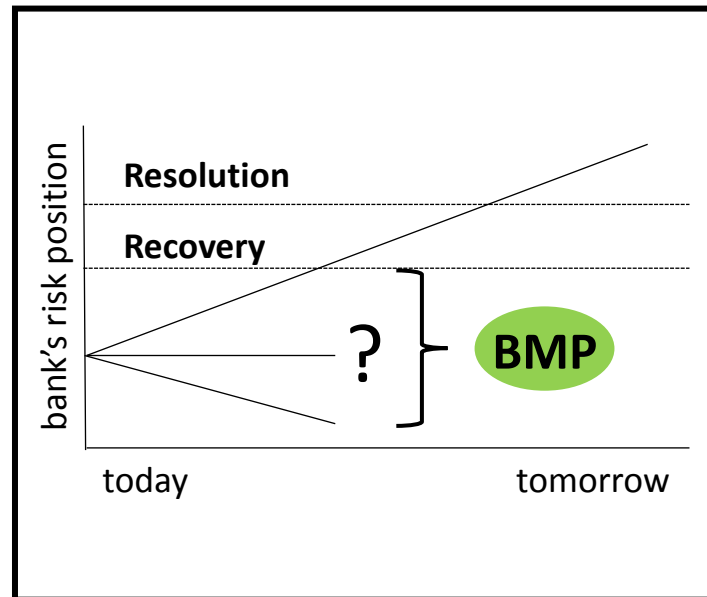
- Repeating the work of external auditors
- Backward-looking analysis (as done by external auditors)
- A conclusive view about the future of the institution
- Defining or pushing towards the “right” BM for an institution

# Added value of business model supervision

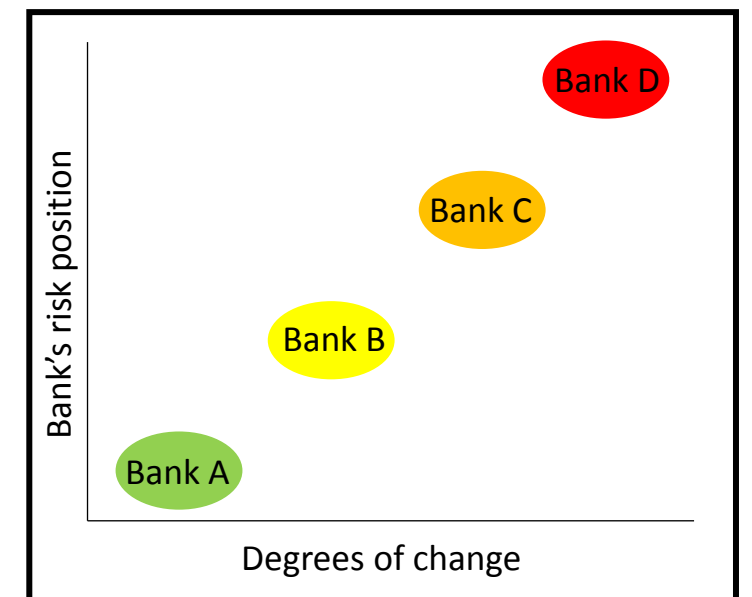
## Holistic tool



## Forward-looking tool



## Peer benchmark tool *(e.g. thematic reviews)*



Bron: DNB



# Examples of typical business model related risks

- Incomplete management information
- Cost cutting
- Not factoring in all costs
- All or nothing strategies (gambling for resurrection)
- These risks are not always covered by regulations!

# *Pitfalls of business model analyses*



*Entrepreneurial versus a more risk sensitive/supervisory mind-set*

# *Sources of profitability are sometimes surprising*

Two practical examples to illustrate wrong decision making: are return drivers really driving returns?



# Some of the results of business model supervision

- Convince bank management to **not pursue** a certain strategy
- Put in place extra demands on **funding / liquidity**
- Decide on initial **level of equity** with new bank
- Require an **exit plan**
- Move bank towards creating **partnership** scenario
- Activate **alert status** after a business model assessment
- Lead to **improvement of key financial policies**

# 3 How does it work in practice?

- Business model assessment building blocks
- Thorough understanding of the business model
- Business model assessment within the SSM SREP

# Thorough understanding of the business model ...

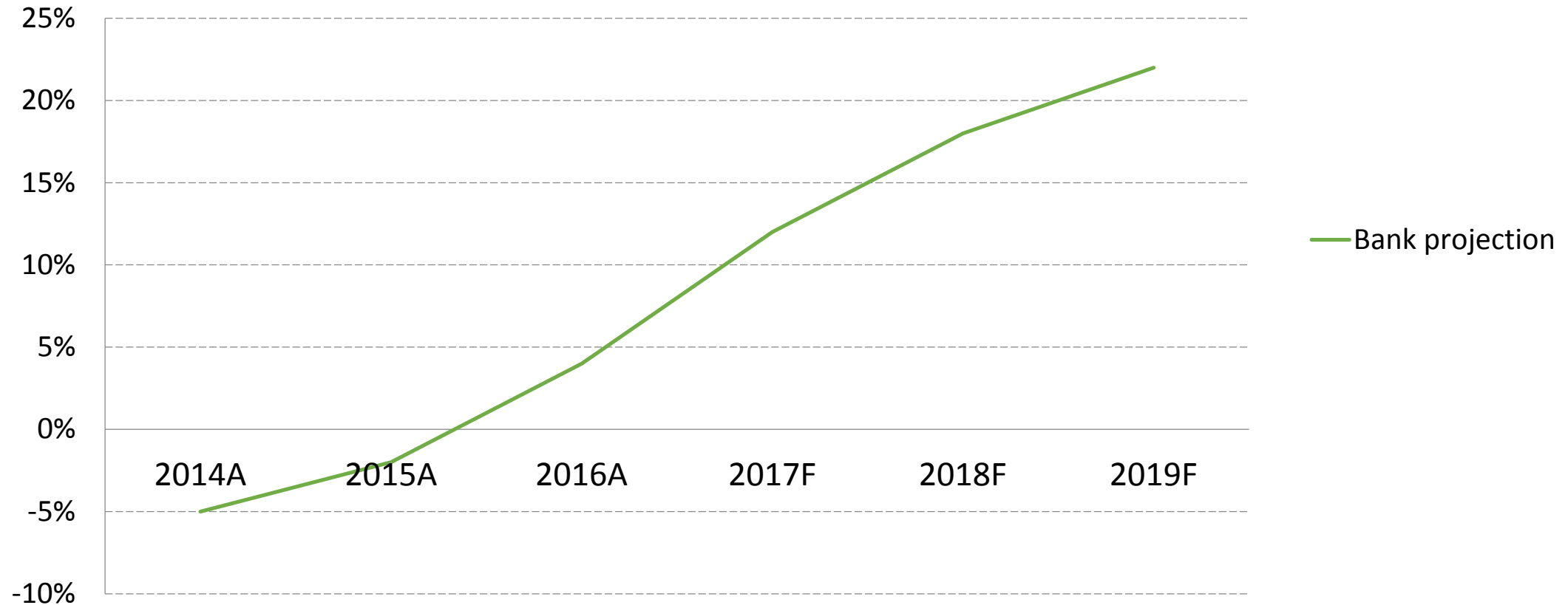
...is essential to identify the key drivers of profitability and challenge senior management on those drivers.

# Thorough understanding of the business model

- Combatting 'wishful thinking'
- Helping to identify more plausible scenarios
- Identify key dependencies

# Thorough understanding of the business model

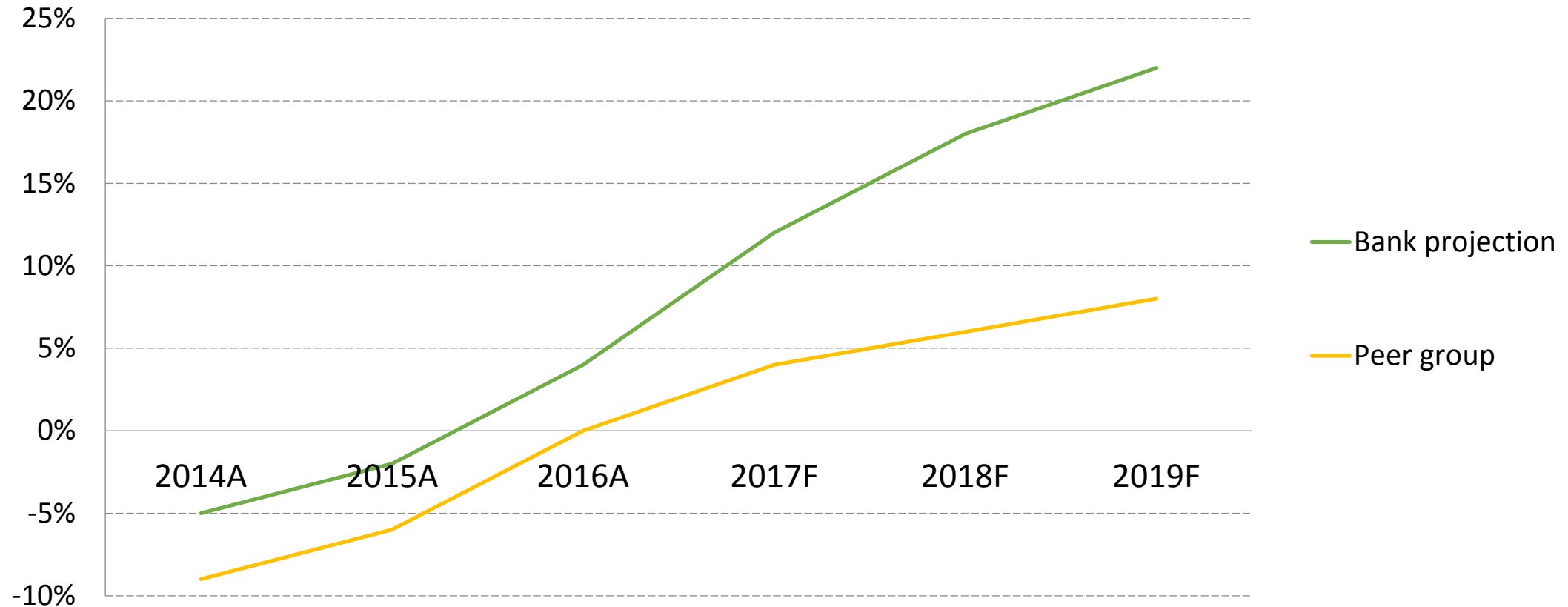
Example: optimistic asset growth of private banks





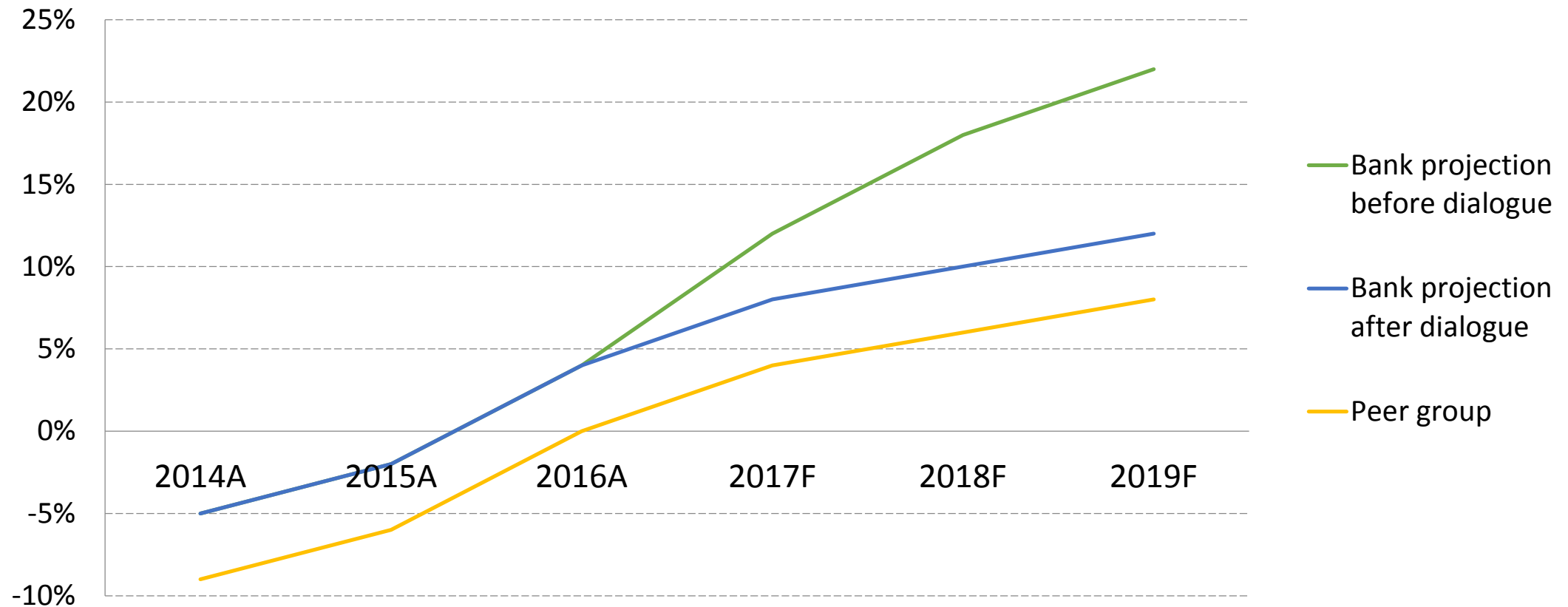
# Thorough understanding of the business model

Example: optimistic asset growth of private banks

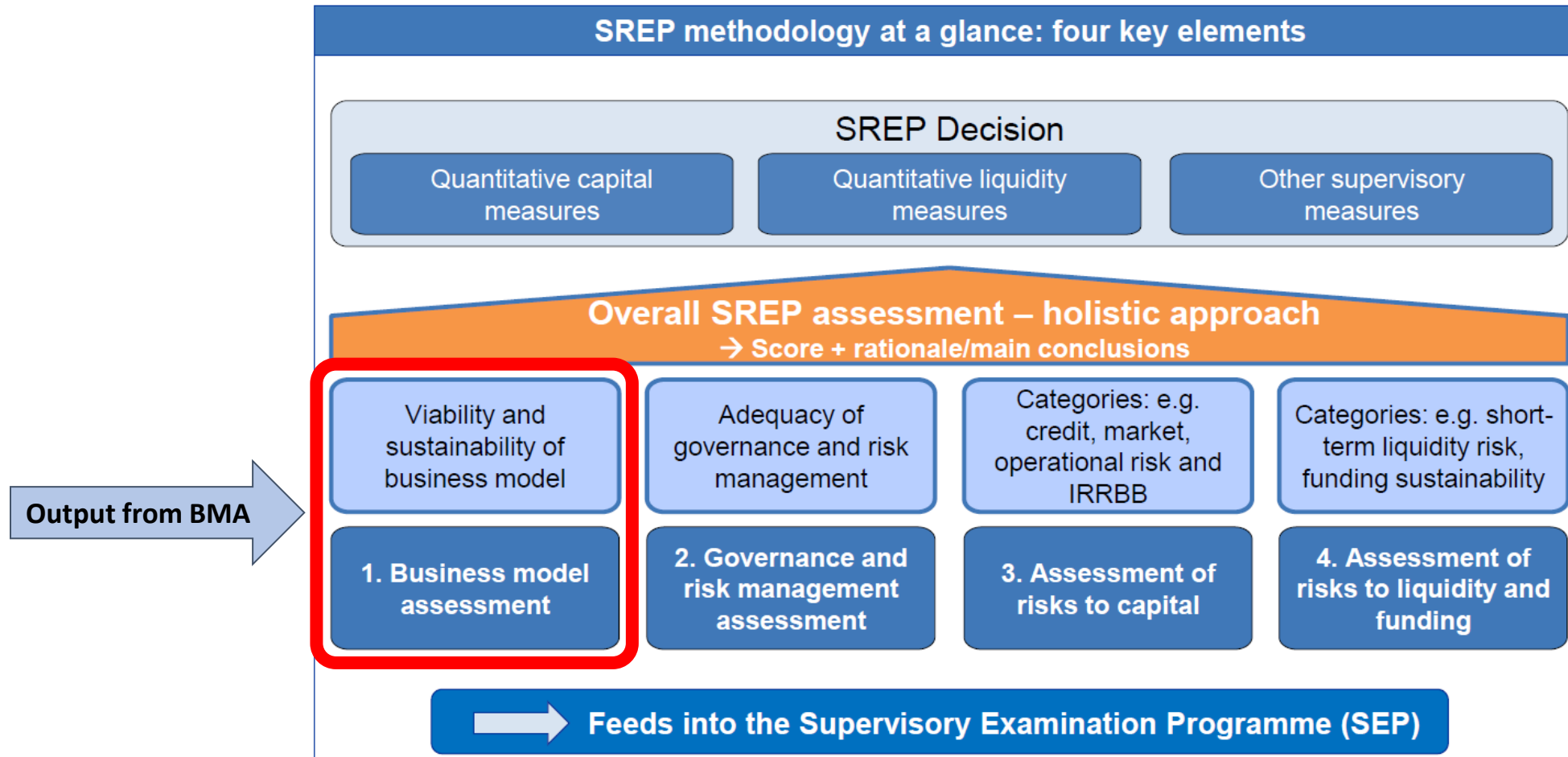


# Thorough understanding of the business model

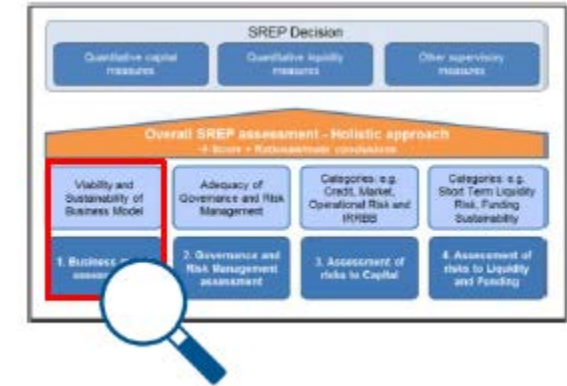
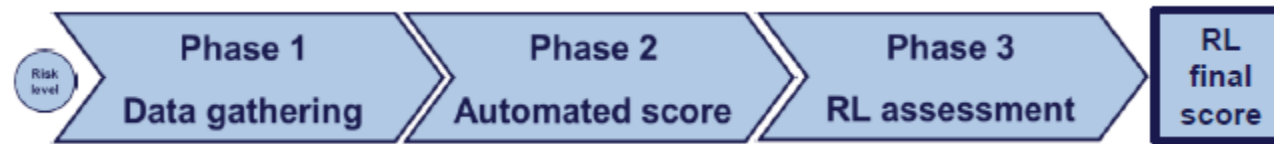
Example: optimistic asset growth of private banks



# Business model assessment within the SSM SREP



# Business model assessment within the SSM SREP



## Phase 1

- Information gathering and understanding materiality of business areas

## Phase 2

- Automated anchoring score based on indicators, such as ROA, cost-to-income ratio, etc.

## Phase 3

- Comprehensive analysis
- Used to adjust Phase 2 score taking into consideration the bank's specificities

# 4 Wrap-up

- Multiple challenges for financial institutions business models ahead
- Role of the supervisor
  - Identification of these challenges
  - Discussion of implications with supervised entity
  - Assessment of possible impact on supervised entity's business model

Business model supervision and associated methodological framework helps the supervisor in making their own “forward looking” assessment on the institution's business model and identify whether supervisory action is required

# Q&A