European Banking Supervision – Business model analysis

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Business Model Analysis

1. Why we analyse business models
2. How we analyse business models
3. The results for Europe
4. The results for Spain
1. Why we analyse business models

Business model analysis reveals a bank’s key vulnerabilities and the sustainability of its strategic plans

- Banks in the euro area are highly diverse in terms of their business models.

- Supervisors need to understand the diversity and its implications for banking supervision and financial stability.

- This is particularly important given the challenges banks are facing, including …
  - a macroeconomic environment with a prolonged period of low interest rates,
  - increasing competition,
  - tighter regulation.

- Business model analysis is a supervisory priority in 2016 and an integral part of the annual Supervisory Review and Evaluation Process (SREP).
2. How we analyse business models

**Key components of the assessment**

- Identifying the areas of focus (e.g. main activities of the banks)
- Assessing the business environment
- Analysing the forward looking strategy and financial plans
- Assessing the business model:
  - viability (within 1 year)
  - sustainability (within 3 years)
  - sustainability over the cycle (more than 3 years)
- Assessing key vulnerabilities

In line with EBA SREP Guidelines, § 55-57
2. How we analyse business models II

### 3-phase approach

<table>
<thead>
<tr>
<th>Phase 1</th>
<th>Phase 2</th>
<th>Phase 3</th>
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<tbody>
<tr>
<td><strong>Purpose:</strong> gather information and understand materiality of business areas</td>
<td><strong>Purpose:</strong> Evaluate the bank’s capacity to generate profits</td>
<td><strong>Purpose:</strong> Comprehensive analysis – supervisory judgement</td>
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<td>Contribution of business areas to revenues, profits and risks</td>
<td>Generate automated anchoring score, mainly based on ROA and Cost Income ratio</td>
<td>Used to adjust phase-2 scores taking into consideration the bank’s specificities</td>
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<td>Which business areas are significant drivers of risk?</td>
<td>Compare results to pre-defined thresholds, and aggregate scores</td>
<td>More than 60 indicators based on standard regulatory/supervisory reporting allows for comparisons between banks</td>
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<td>Quarterly ITS reporting</td>
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3. The results for Europe

**Profitability of Significant Institutions improved in 2015**

- The average Return on Equity for Significant Institutions increased in 2015 to 4.5% on average from 2.8% in 2014

- **No need to worry about profitability?**
  - Aggregate figures conceal rather diverse developments across institutions
  - Decreasing impairments and non-recurring revenues were the main drivers of improved profitability: credit losses are expected to keep easing but positive one-off items will also decrease
  - Growth in fee income played a role, but it remains to be assessed to which extent it can keep growing
  - Low interest rates will take their toll in the coming quarters: high yielding assets come to maturity or are prepaid; decrease of interest expenses is limited by the zero lower bound on deposits

Dynamic sample of banks (95 before 2013, 102 thereafter): main trends are confirmed on an identical sample of banks
4. The results for Spain I

**Profitability of Spanish banks above average ...**

- Higher RoE of Spanish banks with respect to the SSM average, partly due to international diversification of large banks
- Funding costs for Spanish banks improved significantly in 2015
- Spanish banks remain more cost-efficient than the euro-area average
4. The results for Spain II

... but business models quite dependent on interest income

Income structure of Euro Area SIs by country

- Net interest income
- Net fee and commission income
- Trading and other operating income