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European Banking Supervision – Business model analysis

CEO/CFO/CRO-Roundtable
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Business Model Analysis

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 I

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

3-phase approach

Phase 1

- **Purpose: gather information and understand materiality of business areas**
- Contribution of business areas to revenues, profits and risks
- Which business areas are significant drivers of risk?
- Quarterly ITS reporting
- Any relevant internal or external information

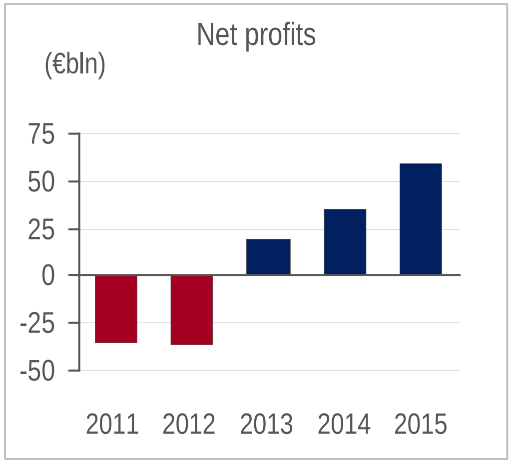
Phase 2

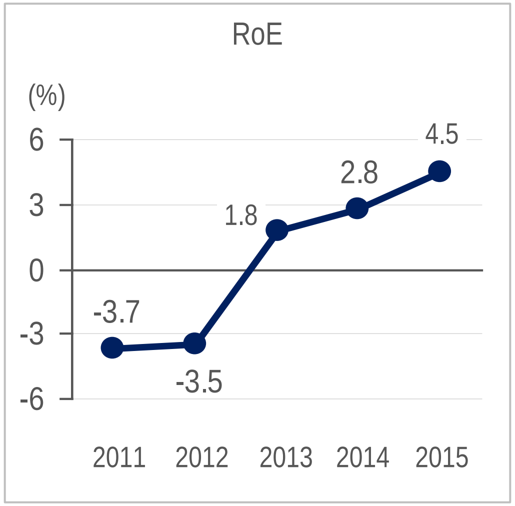
- **Purpose: Evaluate the bank's capacity to generate profits**
- Generate automated anchoring score, mainly based on ROA and Cost Income ratio
- Compare results to pre-defined thresholds, and aggregate scores

Phase 3

- **Purpose: Comprehensive analysis – supervisory judgement**
- Used to adjust phase-2 scores taking into consideration the bank's specificities
- More than 60 indicators based on standard regulatory/supervisory reporting ➔ allows for comparisons between banks

Profitability of Significant Institutions improved in 2015





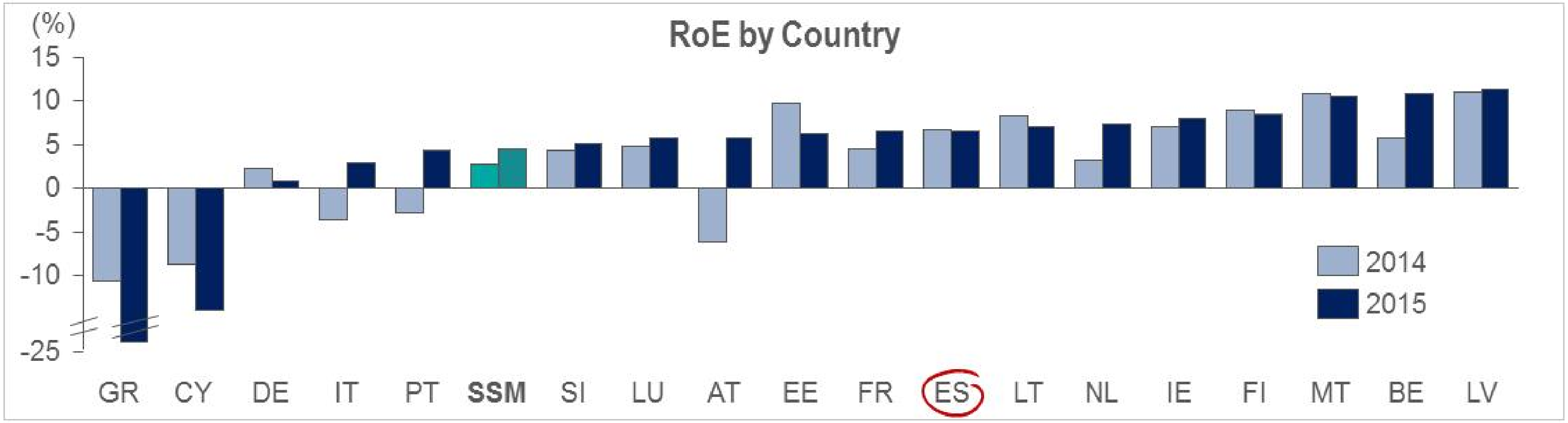
- **The average Return on Equity for Significant Institutions increased in 2015 to 4.5% on average from 2.8% in 2014**

- **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

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



… but business models quite dependent on interest income