Major French banks: results, solvency, liquidity

Banking regulation, some challenges

NATIXIS

ROADSHOW
London – 09 March 2016

ACPR
BANQUE DE FRANCE

London – 9 March 2016 Frédéric VISNOVSKY Deputy Secretary General

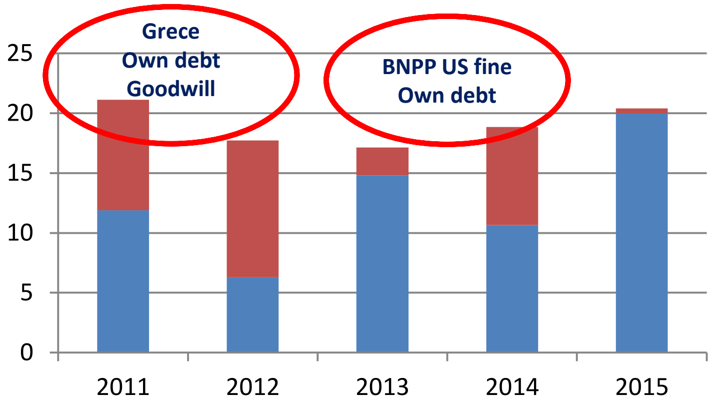
Major French banks: results, solvency, liquidity

1. Profitability has increased
2. Net interest income in retail under pressure and higher cost to income ratio compared to European average
3. Cost of risk at a moderate level
4. Appropriate capital level
5. TLAC to imply issuance of new eligible debt
6. Increased liquidity reserves

1 – Profitability has increased for the 4 largest French banking groups (BNPP, BPCE, GCA, SG)

Source : ACPR – financial disclosure

1. Published income / Non exceptional income



Income for the 4 largest groups (in billion euros)

Billion euros	2012	2013	2014	2015	
Revenues	115,2	115,7	116,2	124,3	+ 7%
Cost to income ratio	68,9 %	67,8 %	67,2 %	66,2 %	
Cost of risk	14,7	14,2	11,4	11,7	
Ordinary income	21,1	23,1	26,8	30,3	+ 13,1 %
Net income	5,7	14,8	10,7	20,0	+ 87 %
Revenues without own debt	120,0	118,5	117,7	122,8	**+ 4,3 %**
Cost to income ratio without own debt	66,1 %	66,1 %	66,3 %	66,9 %	
Non exceptional net income	17,7	17,2	**18,9**	**20,4**	**+ 8,2 %**

2 – Retail banking/specialized businesses with good performance and increased contribution from asset management/insurance

Retail banking/specialized businesses

Billion euros	2012	2013	2014	2015	
Revenues	79,2	80,0	78,1	80,5	+ 3,1 %
Cost to income ratio	61,9 %	60,4 %	61,5 %	61,8 %	
Cost of risk	11,9	11,8	10,3	9,1	
Ordinary income	18,3	19,9	19,8	21,7	+ 9,6 %

Asset management/insurance

En milliards d'euros	2012	2013	2014	2015
% of revenues without own debt	13,6 %	13,9 %	14,7 %	14,8 %
% of insurance in revenues without own debt	4,0 %	4,3 %	4,3 %	5,1 %

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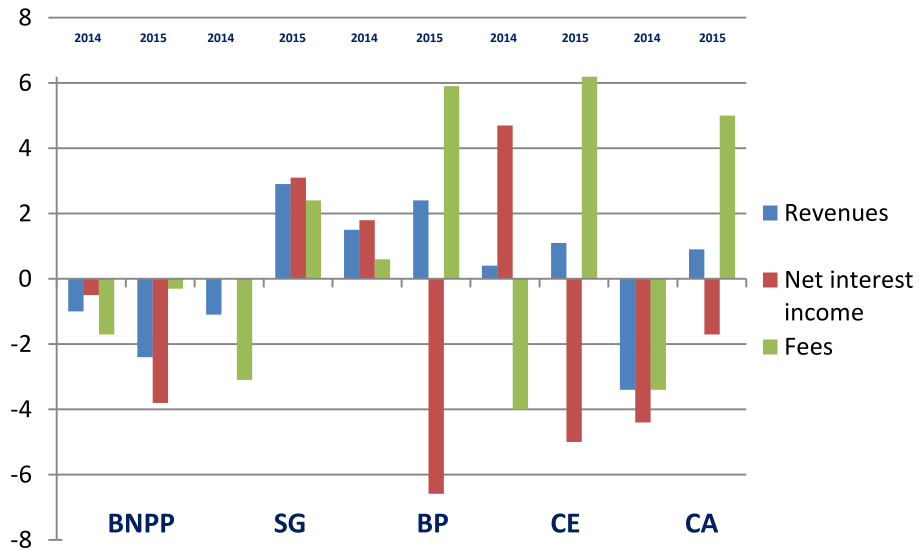
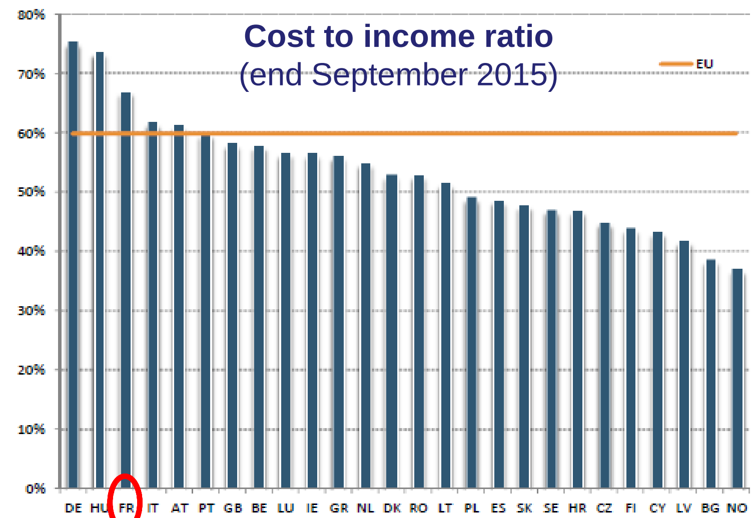
2 – Net interest income in retail banking under pressure with low interest rate environment and French banks with cost to income ratio higher compared to European average



Retail banking in France

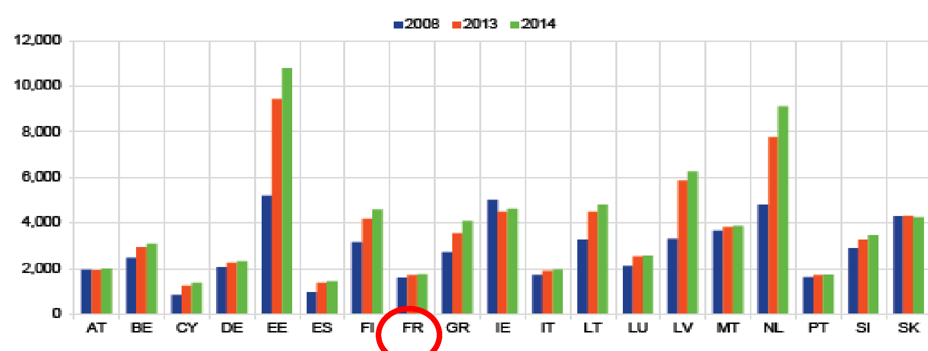
Source : ACPR – financial disclosure



Source : EBA – Risk dashboard – end September 2015

Low population per local branches

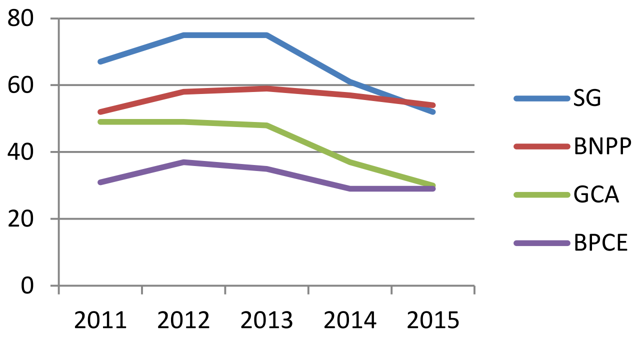
Population per local branch in euro area countries in 2008, 2013 and 2014



Source: EU structural financial indicators and ECB calculations.
Notes: Branches refer to the local units of credit institutions.

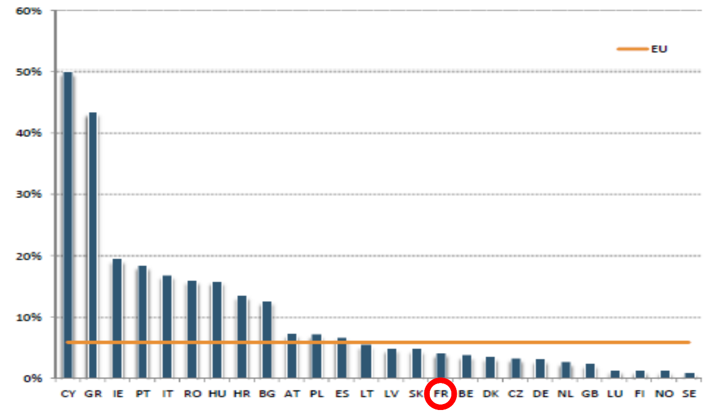
3 – Cost of risk at a moderate level compared with other European countries

Cost of risk (in % of total loans)



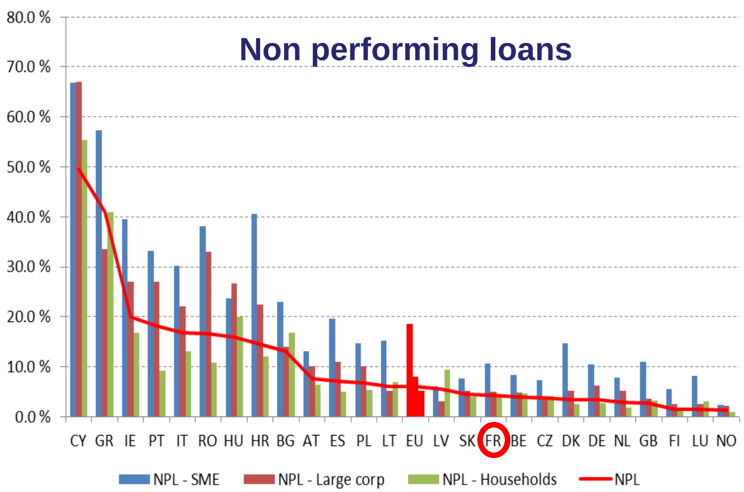
Source : financial disclosure

Non performing loans

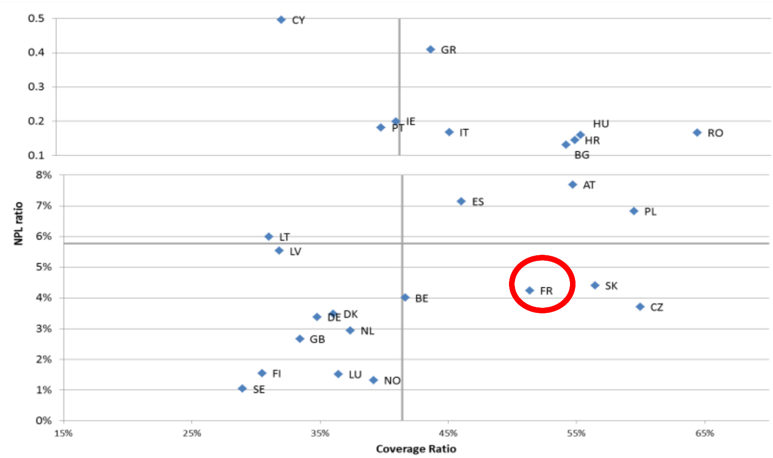


Source : EBA – Risk dashboard – end September 2015

Non performing loans



Non performing loans and coverage



Source : EBA – Risk assessment of the European banking system – December 2015

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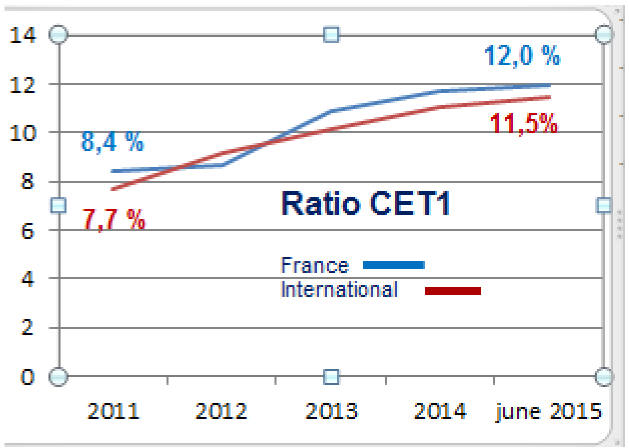
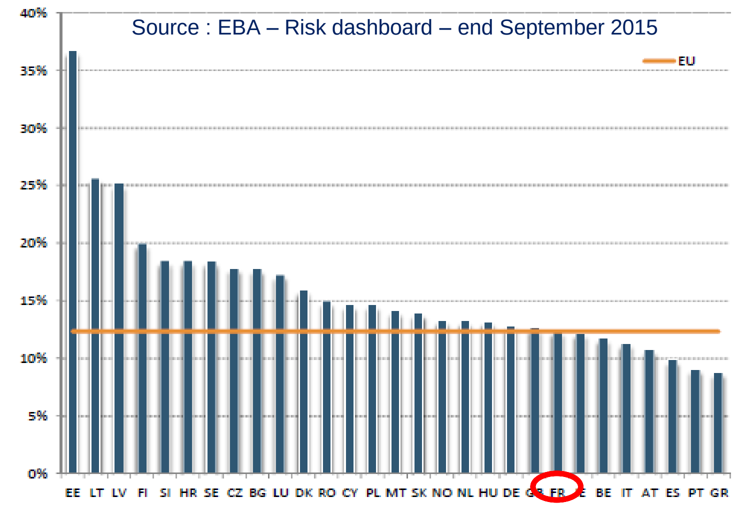
4 – Appropriate capital level even if challenges remain

1 - CET1 fully loaded



Source : Basel Committee

2 – CET1 – European banks



3 - SSM Minimum requirements

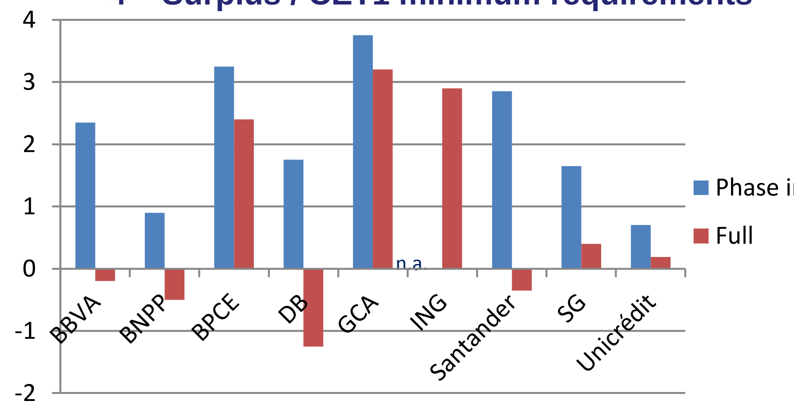
Systemic buffer

Pillar 2 + conservation buffer

Pillar 1

CET1 minimum	Pillar 2 + CB	Phase in (2016)	Full (2019)
BBVA	5 %	9,75 %	10,5 %
BNPP	5 %	10,0 %	11,5 %
BPCE	5 %	9,75 %	10,5 %
DB	5,75 %	10,75 %	12,25 %
GCA	5 %	9,75 %	10,5 %
ING	5 %	9,75 %	10,5 %
Santander	5 %	9,75 %	10,5 %
SG	5 %	9,75 %	10,5 %
Unicrédit	5,25 %	10,0 %	10,75 %

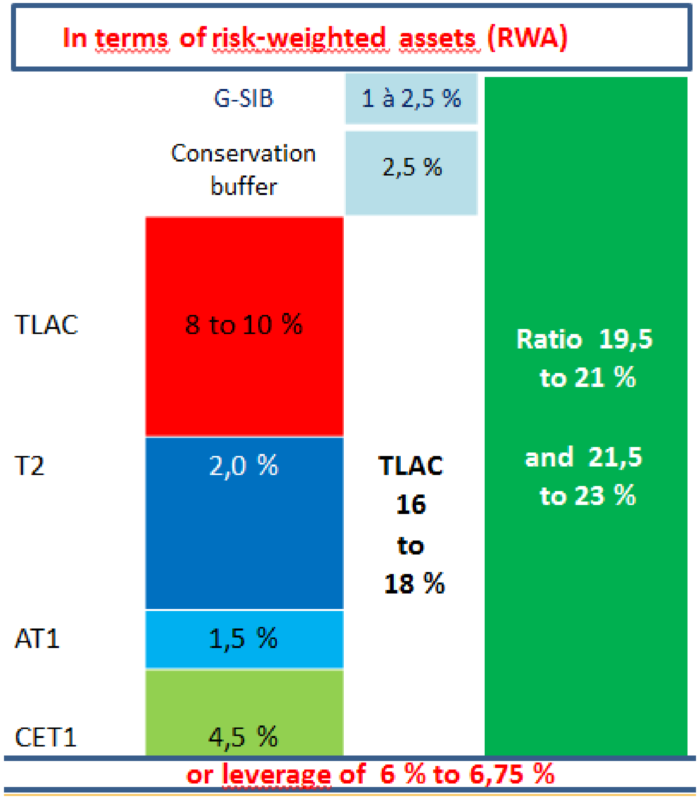
4 – Surplus / CET1 minimum requirements



Source : ACPR – financial disclosure

5 – TLAC (*Total Loss Absorption Capacity*) to imply issuance of new eligible debt

1. **For systemic banks (G-SIBs), agreement on a minimum capacity of loss absorption in resolution, as approved at the G20 November summit**



2. **Different situation across French banks**

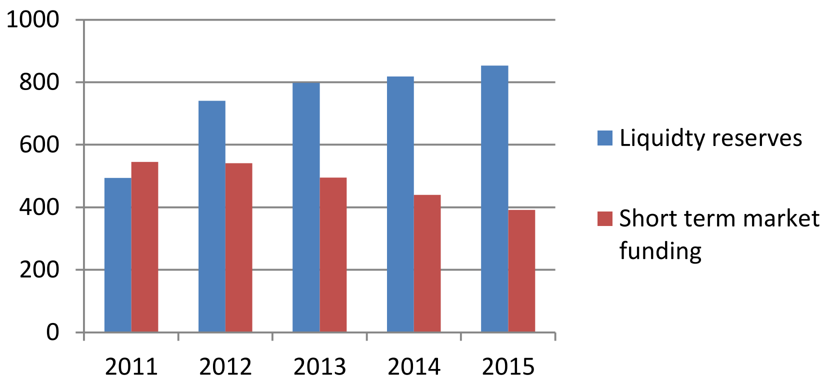
Draft French law to be adopted soon with a new category of debt TLAC eligible

- a new category of senior debt ('non preferred senior debt'), subordinated to deposits/derivatives/structured notes and senior to T2/AT1/CET1

- no retroactivity on outstanding senior debt

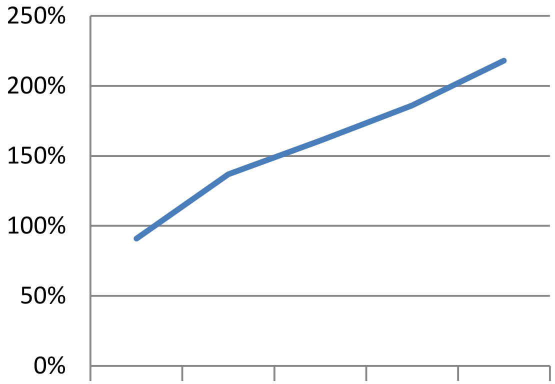
6 – Increased liquidity reserves

1. **Liquidity reserves increased by 359 billion euros since end 2011 with short term market funding decreased by 153 billion**



Source : financial disclosure

2. **Liquidity reserves compared to short term market funding from 91 % to 218 %**



Source : financial disclosure

3. **Improved leverage ratios** (source : financial disclosure)

	BNPP	SG	GCA	GBPCE
December 2014	3,6 %	3,8 %	5,2 % (4,2% CASA)	4,5 % (>3% Natixis)
March 2015	3,4 %	3,7 %	5,4 % (4,4% CASA) *	4,6 % (3,6% Natixis)
June 2015	3,7 %	3,8 %	5,4 % (4,3% CASA) *	4,8 % (3,9% Natixis)
September 2015	3,8 %	3,9 %	5,5 % (4,4% CASA) *	4,8 % (3,9% Natixis)
December 2015	4,0 %	4,0%	5,7 % (4,6% CASA) *	5,0 % (4,3% Natixis)

4. **Compliance with the Liquidity Coverage Ratio (LCR)**

	BNPP	SG	GCA	GBPCE
December 2014	114%	118%	> 110 %	> 100 %
March 2015	nc	132%	> 110 %	> 100 %
June 2015	nc	128 %	> 110 %	> 100 %
September 2015	nc	144 %	> 110 %	> 110 %
December 2015	124%	124 %	> 110 %	> 110 %

Banking regulation, some challenges

1. Risk and vulnerabilities
2. SREP and Pillar 2 decision by the ECB
3. Harmonization of national discretions
4. EBA EU-wide stress test 2016: back to business as usual
5. To be prepared for the implementation of the new accounting standard IFRS 9
6. To be prepared for the revision of risk weighted
7. To be prepared for the leverage ratio and the new interest rate risk framework
8. SSM priorities 2016

1 – Risks and vulnerabilities

		Bank risk	Risk drivers	Level of risk – Last quarter (memo) – Level	Level of risk – Last quarter (memo) – Expected Trend	Level of risk – Current quarter – Level	Level of risk – Current quarter – Forward Trend
Capital	Pillar 1	Credit risk	Asset quality, emerging markets, China, commodity markets	High	Stable	High	Stable
Capital	Pillar 1	Market risk	Risk from negative changes in market sentiment and market liquidity	Medium	Increasing	Medium	Increasing
Capital	Pillar 1	Operational risk	Information & communication technologies, cyber attacks	High	Stable	High	Stable
Capital	Pillar 2	Concentration risk, IRRBB and other	Real estate markets, sovereign exposures, EM country exposures at some banks	Medium	Stable	Medium	Stable
Capital	Pillar 2	Reputational and legal	Misconduct, litigation costs	High	Decreasing	High	Stable
Capital	Pillar 2	Profitability	Interest margins, impact of deteriorating asset quality, conduct cost	High	Stable	High	Stable
Liquidity & Funding		Access to funding and maturity distribution	Volatile spreads, need to issue BRRD / MREL compliant instruments	Medium	Stable	Medium	Stable
Liquidity & Funding		Funding structure	Reliance on secured funding	Medium	Stable	Medium	Stable
Environment		Regulatory and legal environment	MREL, structural reforms	Medium	Stable	Medium	Stable
Environment		Fragmentation	Funding, asset quality, profitability, supervision	High	Stable	High	Stable
Environment		Sovereign risk	Debt overhang	High	Stable	High	Stable

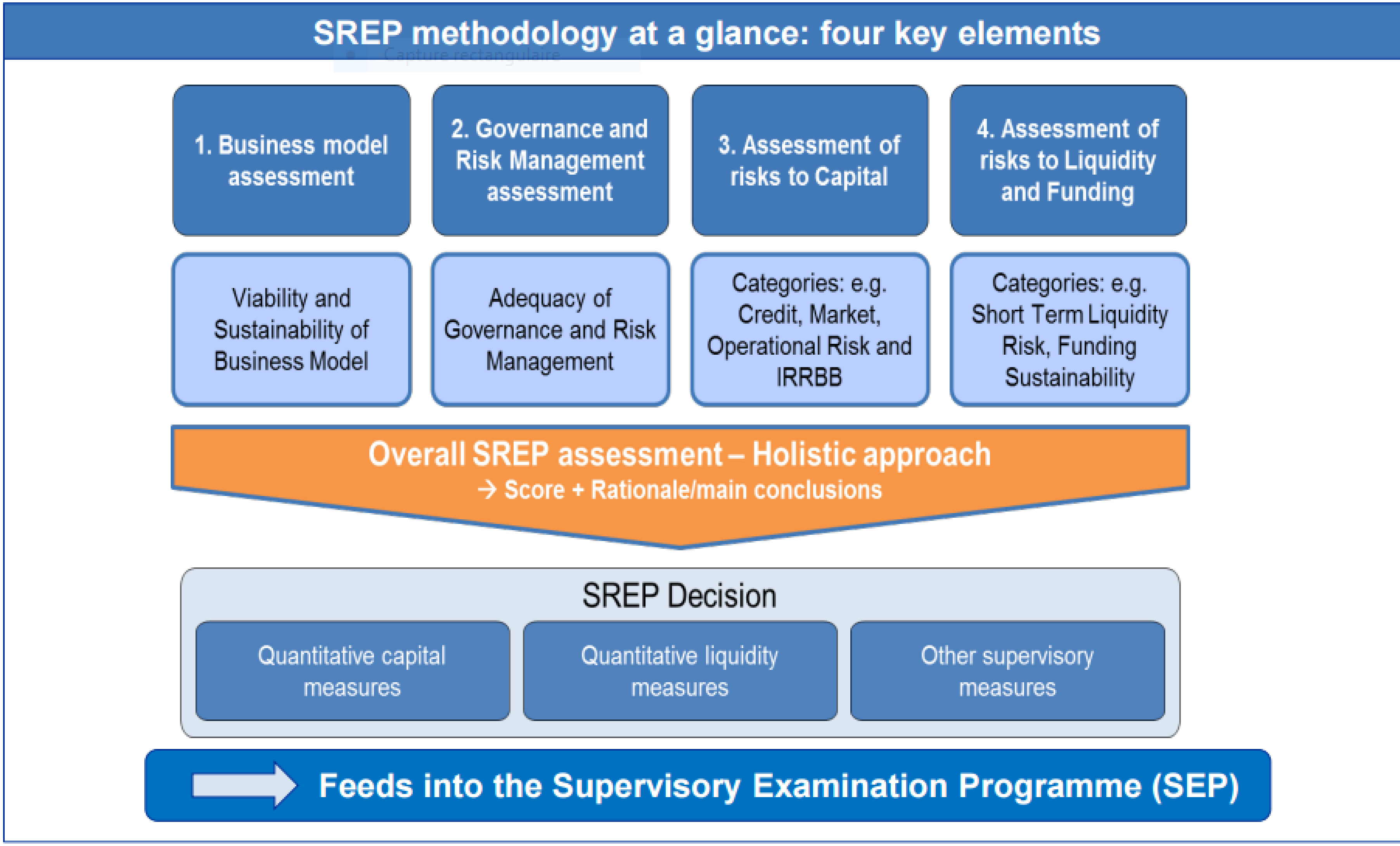
Level	High	Medium	Low
Trend	Increasing	Stable	Decreasing

Source : EBA – Risk dashboard – end september 2015

3 challenges

- technology challenge with new actors
- low interest rates with retail banking under pressure
- finalization of Basel III

2 – SREP and Pillar 2 decision by the ECB (1/3)



Source: SSM SREP Methodology Booklet

2 – SREP and Pillar 2 decision by the ECB (2/3)

SSM Pillar 2

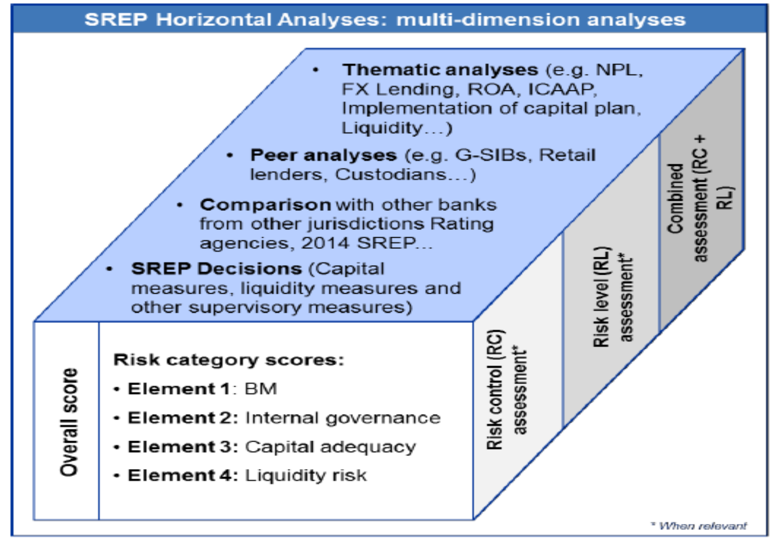
Consistent and fair treatment

Risk Level (RL) vs. Risk Control (RC)

	1. Business model	2. Internal Governance and RM	3. Assessment of Capital risks	4. Assessment of Liquidity risks
RL	✓	n/a	✓	✓
RC	n/a	✓	✓	✓

Combined score (RL + RC)

n/a: not applicable



Pillar 2 decisions take into account

- risks related to economic conditions and market that banks face in the euro area, as the credit and liquidity risks;
- the goal of a transition to « full Basel 3 » requirements in 2019;
- the equal competition within the SSM and with other major areas.

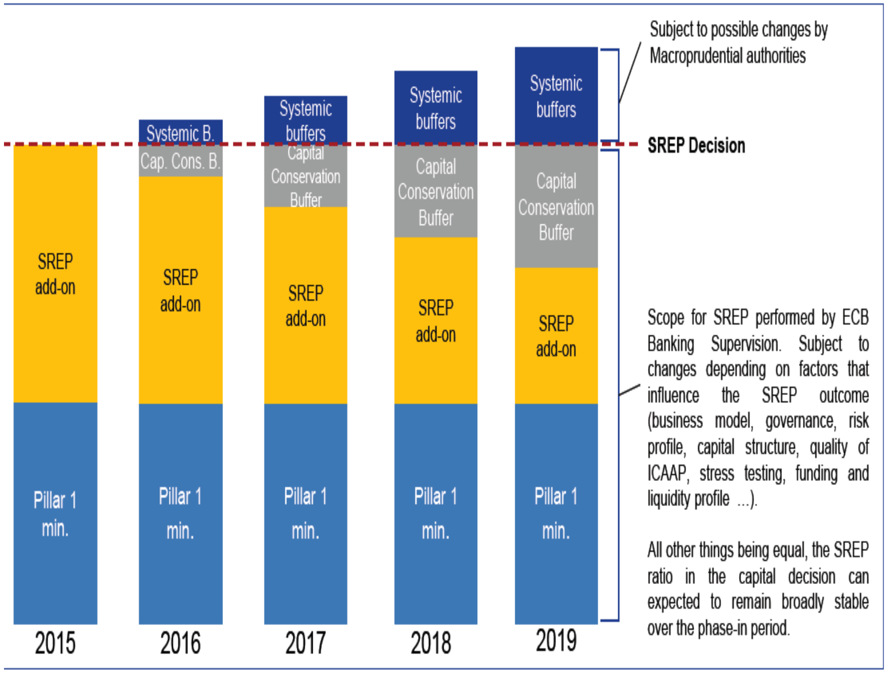
SREP decisions finalized end year 2015

- Pillar 2 requirements for 2016 are slightly higher than for 2015, with an increase of 30 bp in average
- Are added about 20 bp of requirements related to the phase-in of the buffers

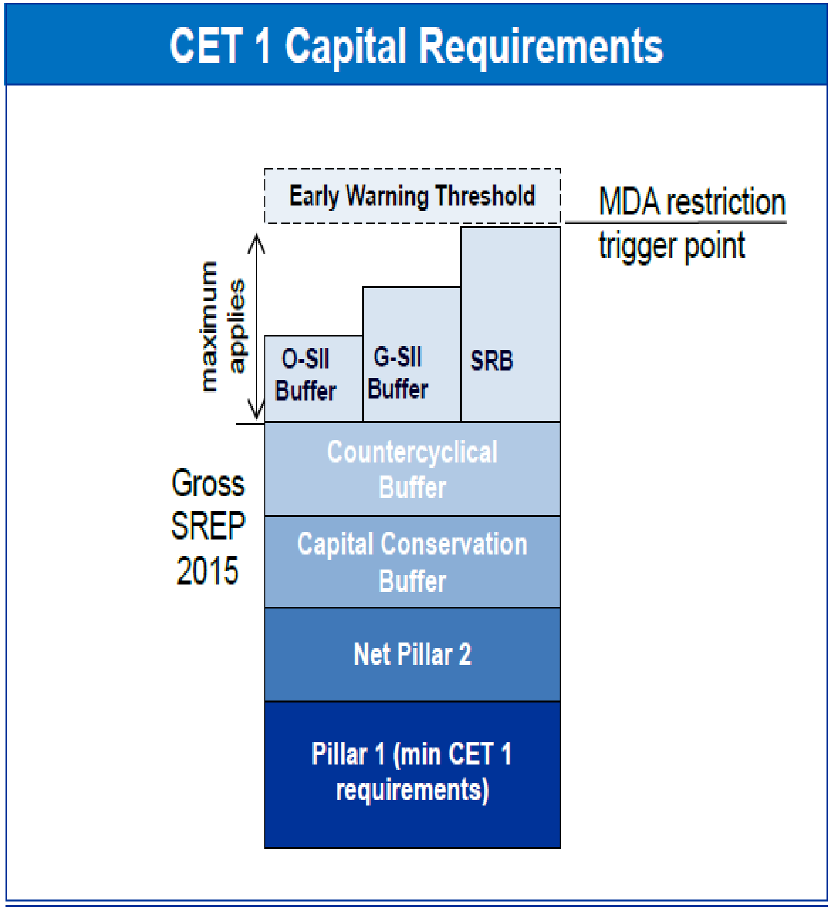
2 – SREP and Pillar 2 decision by the ECB (3/3)

SSM Pillar 2

All things being equal, the Pillar 2 requirements set out in the SREP 2015 decisions also provide an indication for the future; especially the capital conservation buffer will phase-in by 2019 with the Pillar 2 net requirement reducing in equal fashion.



Excludes Countercyclical Buffer and reduces the three different systemic buffers to one for simplicity

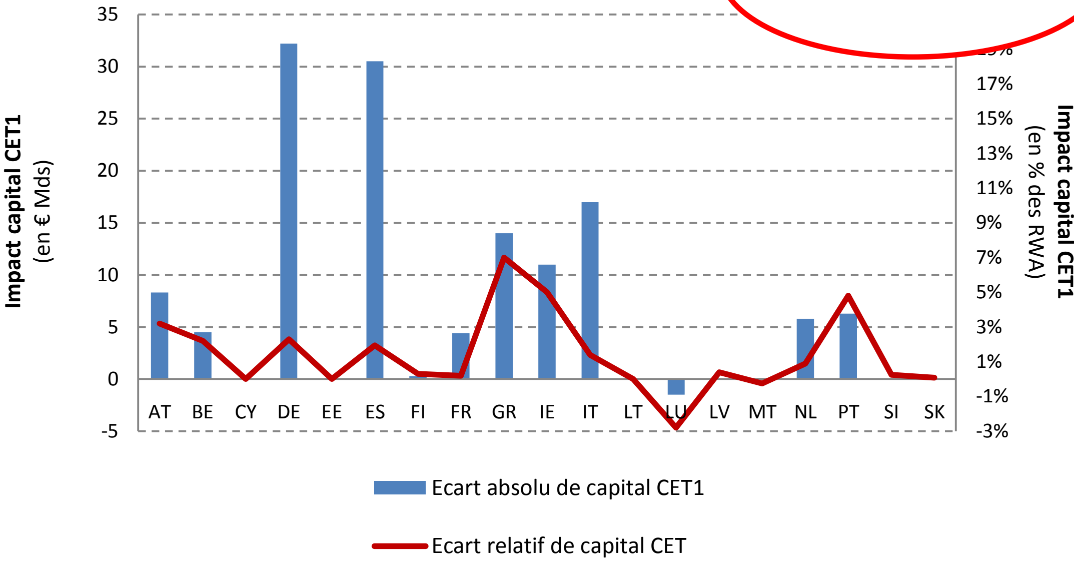


Source: SSM SREP Methodology Booklet

3 – Harmonization of national discretions

2016

The 2014 Asset Quality Review (AQR) has highlighted the impact of national discretions on CET1 and important differences between member States including the application of transitional measures



167 options identified in CRD4/CRR

122 options « by hands » of the ECB have been revised

July 2015 : recommendations approved by the *Supervisory Board*

11 November 2015 : public consultation on a draft regulation on the exercise of national discretions and guidelines for the exercise of the individual character options

Final document to be published in **March 2016**

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4 – EBA EU-wide stress test 2016: back to business as usual (1/2)

The European Banking Authority (EBA) released 24th February the methodology and macroeconomic scenarios for the 2016 EU-wide stress test.

– to provide supervisors, banks and other market participants with a common analytical framework to consistently compare and assess the resilience of EU banks to economic shocks;

– no single capital thresholds have been defined as the results will inform the 2016 round of Supervisory Review and Evaluation Processes (SREP) under which decisions are made on appropriate capital resources;

– sample of 51 EU banks covering 70% of the banking sector in the EU and stress test to be run at the highest level of consolidation.

Results to be published in early Q3 2016.

4 – EBA EU-wide stress test 2016: back to business as usual (2/2)

<u>Key features of the methodology and the scenario</u>

- covers all main risk types including: credit risk and securitization, market risk, sovereign risk, funding risk and operational and conduct risks
- static balance sheet assumption, which precludes any mitigating actions by banks, and a series of caps and floors, for example on risk weighted assets (RWAs) and net trading income
- the adverse scenario, designed by the European Systemic Risk Board (ESRB), reflects the four systemic risks that are currently assessed as representing the most material threats to the stability of the EU banking sector:

  i) an abrupt reversal of compressed global risk premia, amplified by low secondary market liquidity;
  ii) weak profitability prospects for banks and insurers in a low nominal growth environment, amid incomplete balance sheet adjustments;
  iii) rising of debt sustainability concerns in the public and non-financial private sectors, amid low nominal growth;
  iv) prospective stress in a rapidly growing shadow banking sector, amplified by spillover and liquidity risk.

5 – To be prepared for the implementation of the new accounting standard IFRS 9

1 of january 2018

1. From IFRS 39 to IFRS 9

- Application date on 1 of january 2018
- New classification

2. Technical issues (modelling, implementation), steering (what impact on the prices of products) and financial issues

- EBA decided to make a qualitative and quantitative impact
- Need to consider the prudential impacts

IAS 39	IFRS 9	
▪Individual provisions on non performing loans	▪From **incurred losses** (IAS39) to **expected losses** (IFRS 9)	**Provisions**
▪Collective provisions on assets non individually impaired	▪Triple segmentation :	
	➢ credit risk has not deteriorated significantly or it is low ➡	On the expected loss in 12 months
▪Sectoral provisions on fragile portfolios	➢ credit risk has deteriorated significantly ➡	On the expected loss at maturity
	➢ portfolio is non performing ➡	individual

6 – To be prepared to the revision of risk weighted

- Methods were not revised after the crisis (except on market risks)
- General objectives of simplicity, comparability and sensitivity to risks
- Excessive variability of risk weighted assets between banks not justified by the risks

2019/2020 ?

Credit, market and operational risks		
Revised standard approaches	**Internal model more framed**	
Credit risk	Consultative document in December 2015	QIS
Operational risk	Consultative document in Q1 2016	in
Market risk	Final document final in January 2016	February 2016

Which calibration ?

Which floor for internal systems ?

Standard Approach

Internal system

Current requirements

Revised standard approach

Internal system

New requirements

The Committee will focus on **not significantly** increasing overall capital requirements

7 – To be prepared for the leverage ratio and the new interest rate risk framework

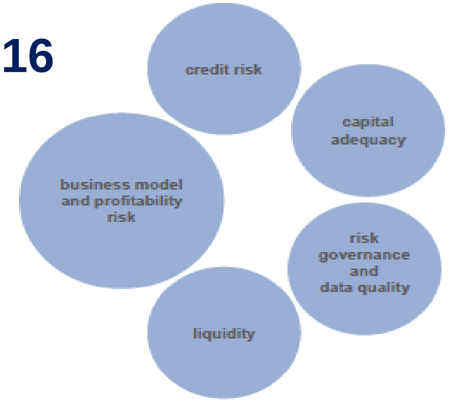
- Introduction of a **leverage ratio** to complement the risk weighted approach
  - Fixed at minimum of 3 % (measure based on Tier 1)
  - Possible additional requirements for GSIBs
  - Final calibration in 2016
  - Move to a Pillar 1 requirement

1 of January 2018

- Standard measurement of **interest rate risk**
  - Capital requirement
  - Alternative approach in Pillar 2
  - What treatment of non mature liabilities?

To be decided mid 2016 ?

8 – SSM priorities 2016



Business model and profitability risk	▪ Thematic review of banks' profitability drivers
Credit risk	▪ Task force on NPLs ▪ Thematic review to assess potential impact of IFRS 9
Capital adequacy	▪ Quality and consistency of banks' Internal Capital Adequacy Assessment Processes (ICAAP) ▪ Targeted review of banks' internal models over several years
Risk governance and data quality	▪ Clarify supervisory expectations to banks' boards ▪ Thematic review of banks' compliance with BCBS 239 (effective data aggregation and risk reporting)
Liquidity	▪ Dialogue on banks' Internal Liquidity Adequacy Assessment Processes (ILAAP)

Thanks for your attention

and find ACPR analysis on our website: www.acpr.banque-france.fr