

Key Developments in the Banking Sector

Update following recent regulatory and South Africa specific changes



QUANTIFYING RISK, ENABLING OPPORTUNITY

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Enterprise Risk Management Seminar

18 August 2013

Agenda

Macro Changes

Structural Reform

Resolution regime

New style capital instruments

African Bank case study

Key Developments in banking - Agenda for discussion

- Macro Changes impacting the industry
- Structural Reform and regulatory changes
- Resolution planning
- New style capital instruments
- African Bank case study

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Macro Changes



Rating Agency outlook

- Rating agencies have recently downgraded the outlook for South African to negative, one notch away from sub investment grade.
- Banks robust but Moody's have downgraded micro lending following ABIL resolution.

FITCH RATINGS – 17 July 2014

PEER ANALYSIS	Barclays Africa Group	Standard Bank Group	FirstRand	Nedbank Group
National				
Short-term	F1+ (zaf)	F1+ (zaf)	F1+ (zaf)	F1+ (zaf)
Long-term	AAA (zaf)	AA (zaf)	AA (zaf)	AA (zaf)
Outlook	Stable	Stable	Stable	Stable
Local Currency				
Long-term	A-	BBB	BBB	BBB
Outlook	Stable	Negative	Negative	Negative
Foreign Currency				
Short-term	F2	F3	F3	F3
Long-term	A-	BBB	BBB	BBB
Outlook	Negative	Negative	Negative	Negative
Viability Rating	bbb	bbb	bbb	bbb
Support Rating	1	5	3	2

¹ FirstRand Group credit ratings relate to Bank

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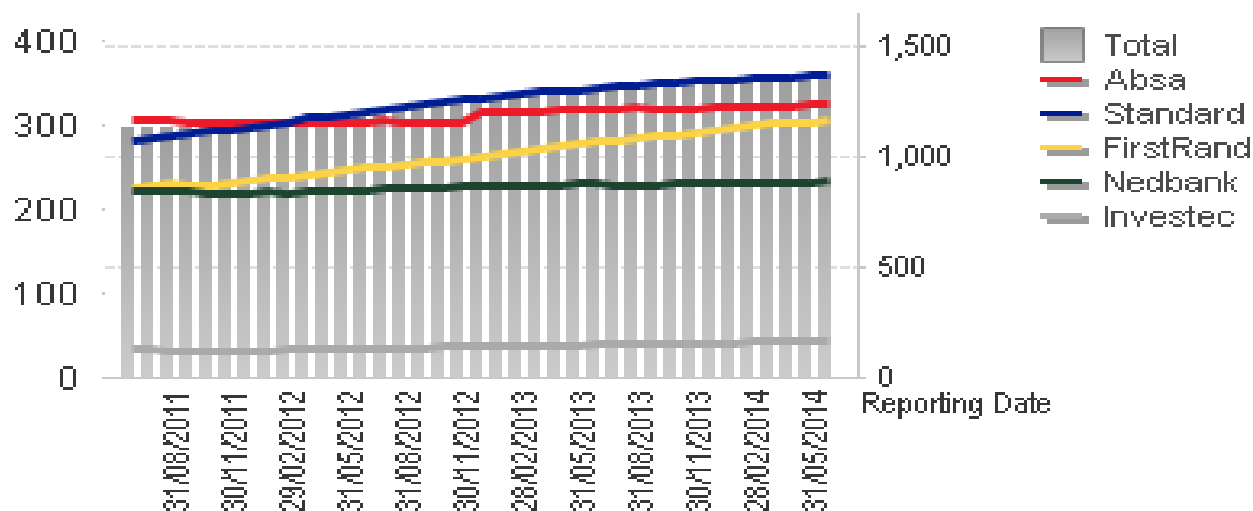
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Balance Sheet Changes

- Retail advances growth is currently below inflation following sluggish economy and strike action.
- Micro lending growth has slowed significantly as risk appetite reduces.
- Impairment increases expected.



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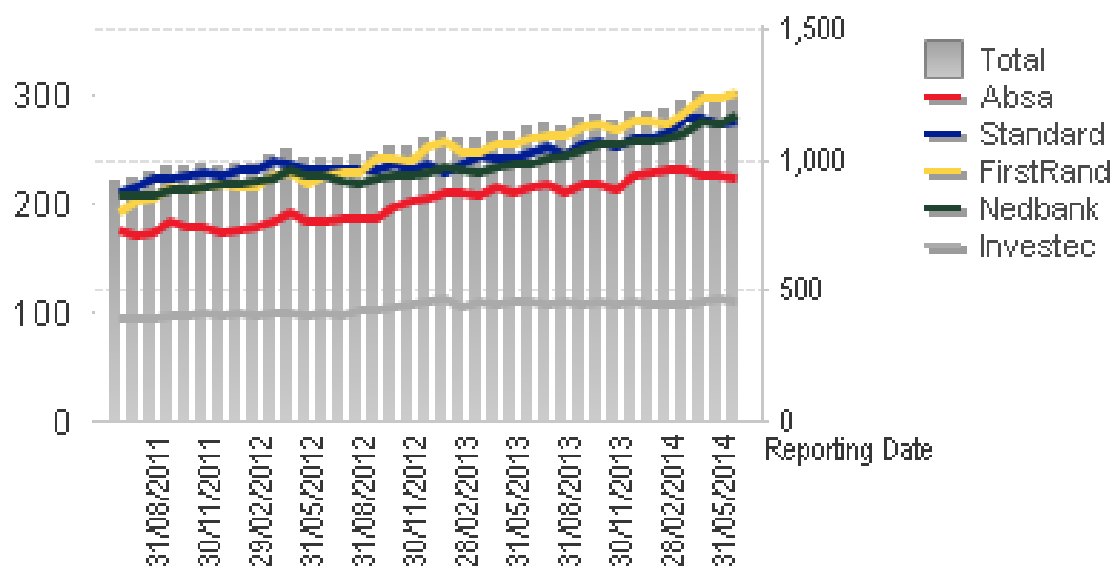
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Balance Sheet Changes

- Corporate advances growth remains strong (c6% above inflation)
- Market share per bank fairly stable.



Source: South African Reserve Bank BA900

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Capital and Returns

	ROE	CET ratio	RWA Rbn	Reporting
 Standard Bank <small>Also trading as Stanbic Bank</small>	12.7%	12.2%	876	Q2 14
 BARCLAYS	16.1%	11.8%	595	Q2 14
 FIRSTRAND	23.4%	13.7%	535	Q4 13
 NEDBANK	16.5%	12.1%	422	Q2 14
 Investec	10.1%	9.4%	248	Q1 14
 CAPITEC BANK	23.0%	31.7%	30	Feb 14

Source: Financial statements and Capital disclosures

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The industry has seen mixed fortunes

- Different strategies have resulted in varying fortunes for shareholders over the last 3 years.
- Stronger regional focus going forward



Source: Google Finance share price change excluding dividends
Note: The market cap of largest bank is FirstRand cR240bn
BAGL excluded due to Barclays Absa transaction

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Structural Reform



Structural Reform

- Various initiatives to split commercial and investment banking from retail banking specifically to protect retail depositors:

A stylised comparison of selected structural reform proposals Table 1

	Volcker	Liikanen	Vickers
Broad approach	Institutional separation of commercial banking and certain investment activities	Subsidiarisation: proprietary and higher-risk trading activity have to be placed in a separate legal entity	Ring-fencing: structural separation of activities via a ring fence for retail banks
Deposit-taking institution may:			
- deal as principal in securities and derivatives	No	No	No
- engage in market-making	Yes	No	No
- perform underwriting business	Yes ¹	Yes	Restricted
- hold non-trading exposures to other financial intermediaries	Unrestricted	Unrestricted	Restricted (inside the group)
Holding company with banking and trading subsidiaries	Not permitted	Permitted	Permitted
Geographical restrictions	No	No	Limitations for ring-fenced banks in the UK to provide services outside the European Economic Area

¹ Underwriting in response to client/counterparty demand.

Structural Reform Implications

- Ring fence retail exposure on a legal entity basis and strengthen recovery and resolution plans for banks.
- Implementation is progressing – departing from universal bank structures

Less Risk

- Will proposals enhance financial stability?
 - Will protect ring fenced entities
 - Will reduce systemic cross subsidisation
 - Will potentially reduce complexity and too big too fail



More Risk

- Will proposals introduce more risk?
 - Shadow banking development (i.e. Non deposit funded banking activities are less regulated
 - Structural bank regulation vs international bank regulation
 - bank vs non-bank regulation as is already the case.
 - Bank business models will change
 - Friction in frequent resolution
 - Some reversal of globalisation

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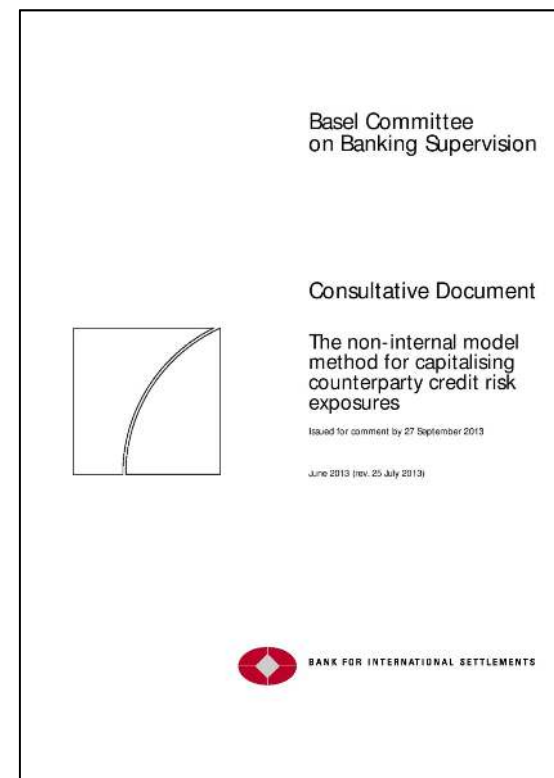
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NIMM (BCBS 254)

- To replace exposure calculation methods
- To coincide with Basel leverage ratio reporting
- Simplified
- Incorporates hedging /netting



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NIMM Design Considerations

- Suitable for a wide variety of derivative transactions (margined and unmargined, bilateral and cleared)
- Comparatively simple and easy to implement
- Address the known deficiencies of CEM and the Standardised Method
- Draw on prudential approaches already available in Basel
- Minimise national discretion
- Improve supervisory understanding of banks' risk profiles on derivatives
- Significantly improve risk sensitivity without adding undue complexity

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Other Regulatory Developments

- The scope of regulatory development is vast and all the elements of change cannot be addressed in this discussion.
- IFRS 9
- BCBS 239 (risk data aggregation & reporting)
- Foreign Account Tax Compliance Act
- Protection Of Personal Information
- Anti Money Laundering

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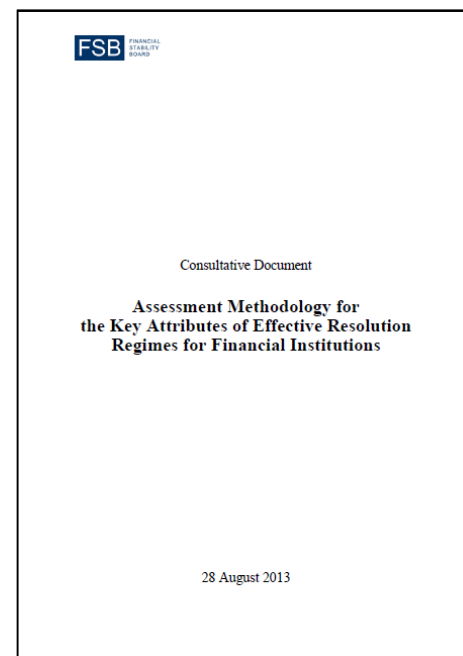
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Resolution Regimes

- Any financial institution that could be systemically significant or critical in the event of failure is subject to a resolution regime.



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Resolution Regimes

- Point of non viability – who decides?
- Hierarchy of claims
- Loss absorbing capital / bail in
- Depositor preference and guarantee

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BIII capital instruments

- New style AT1 and T2 introduced January 2013.
- Replacing existing instruments.
- Includes PONV clause.
- Issuance out of group rather than bank.
- Significant compression of yields since introduction.
- Local market dynamics i.e. a hunt for yield in a compressed global yield environment.

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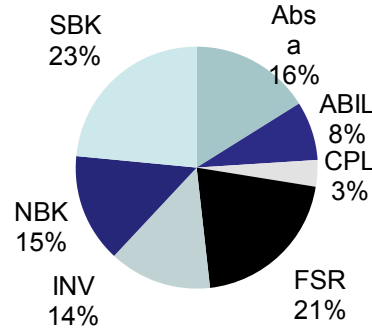
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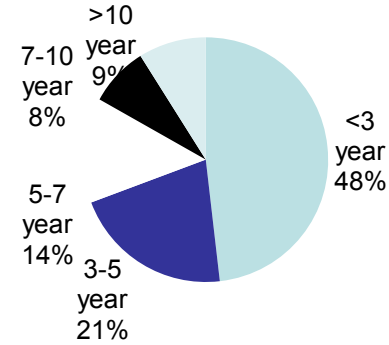
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R205bn in total Bank Outstanding

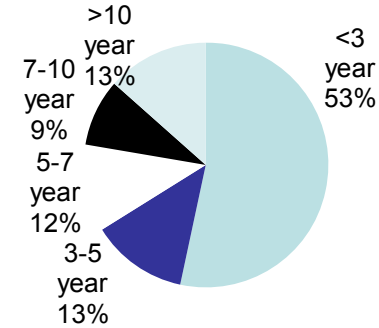
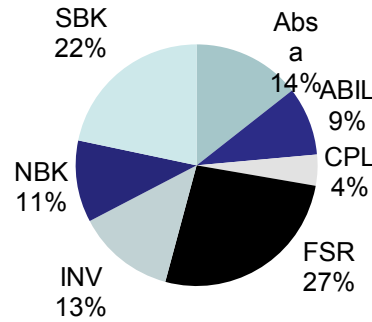
Total Outstanding



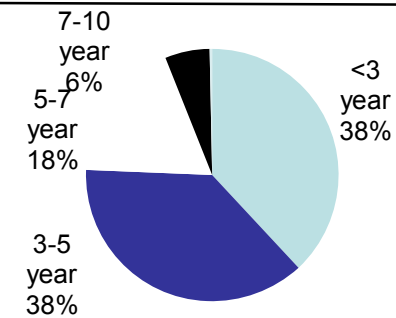
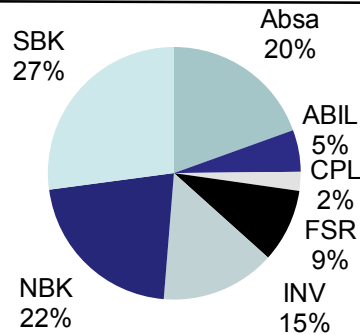
Tenor



Senior Unsecured R136bn

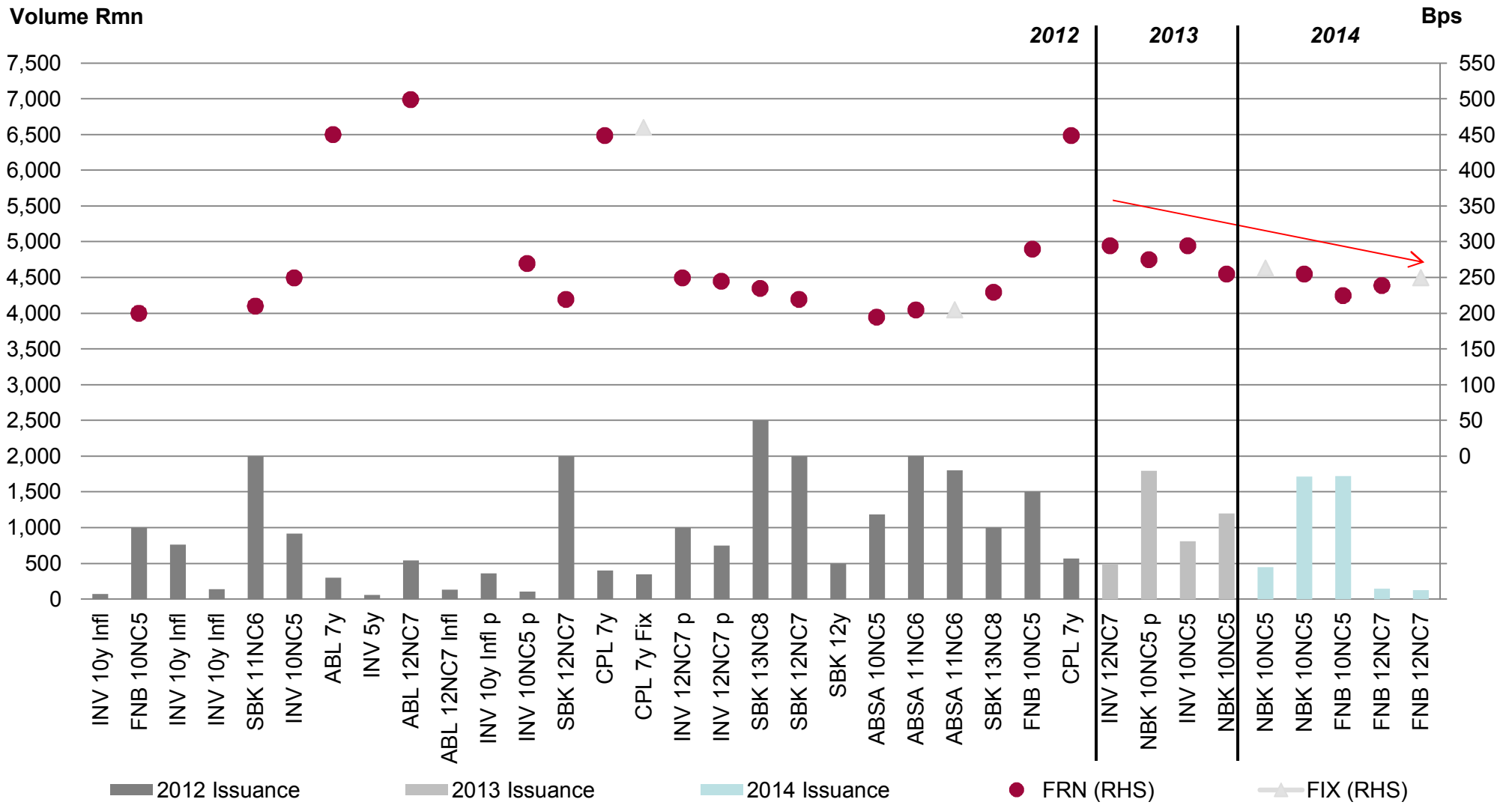


Sub-ordinated R69bn



Source: JSE Bond Data File, Barclays, February 2014. Excludes CLNs, Secured Notes, ABS & Conduit Issuance. Subordinated maturities reference the call date.

2012 – 2014 Subordinated Issuance



Source: JSE, Absa, May 2014
 "p" denotes private placement

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African Bank Resolution



Source: Google Finance share price change excluding dividends

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African bank resolution

- The resolution was announced 10 August 2014.
- The SARB provides support of R7bn for a bad-loan book with book value of R17bn.
- R10bn capital will be raised to support the good book of R26bn.
- A 10% haircut for senior debt instruments and wholesale deposits that are to be transferred to the good bank. Retail paid in full.
- No creditor should be worse off than in liquidation.
- The five largest banks have small exposures.

Source: SARB, Fitch

Conclusion

- The global and local economy remains fragile.
- The only source of lasting prosperity is a stronger supply side. It is essential to move away from debt as the main engine of growth.
 - 84th BIS annual report.
- Peak resources pose a serious challenge for a stronger supply side and therefore risk management in future.

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