Konsekvenser af krisen
og ny finansiel regulering
-
"Financial Crisis, Banking Union and New Financial Regulation"

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Copenhagen, 27 May 2013

Agenda

- Messages
- The Banking Industry in 2013
- New Regulation during the Crisis
- The New Capital Regime
- Consequences of the Crisis and new Regulation
- Strategic considerations

Messages

Messages

1

A number of banks have changed their capital structures, their business models and their risk appetite sufficiently to be well prepared for future crises – the new regulation therefore supports the behaviour already implemented

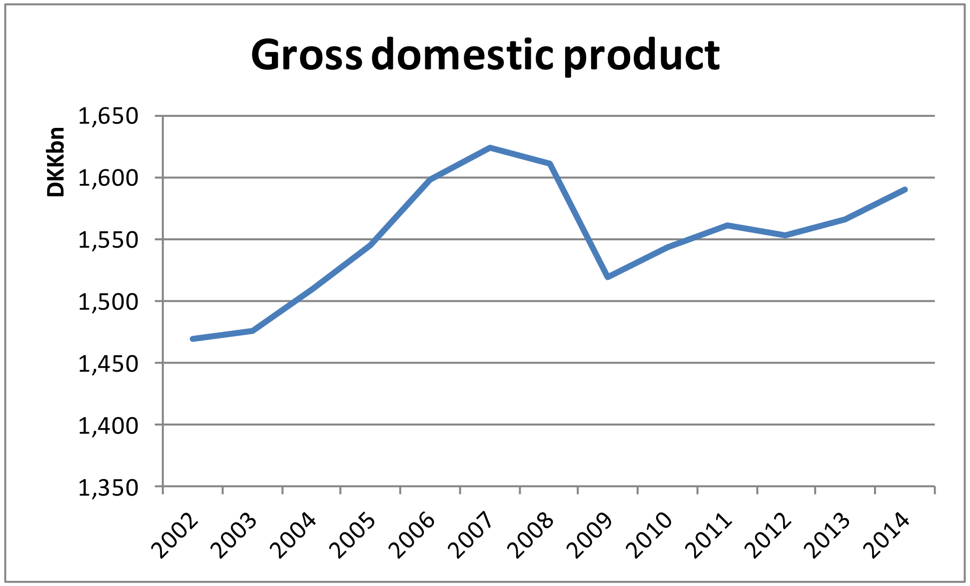
2

The consequences are:

- Conservative and Risk Averse Banks
  – conservative risk and liquidity profile
- Fewer and larger banks
  – M&A will continue
- Price and risk more aligned
  - greater differentiation in pricing of risk of customers
- Long-term ROE under pressure
  - New capital regime and new awareness of risk

The Banking Industry in 2013

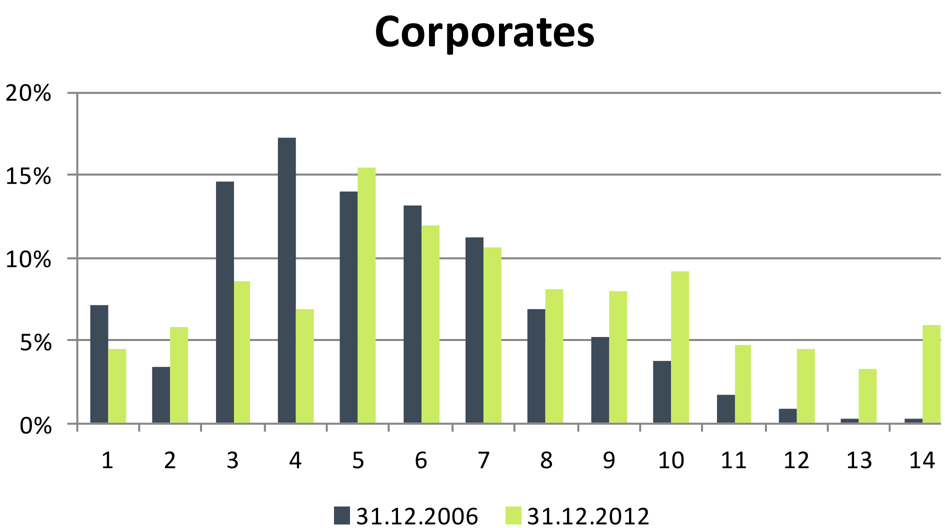
Still below pre-crisis GDP level

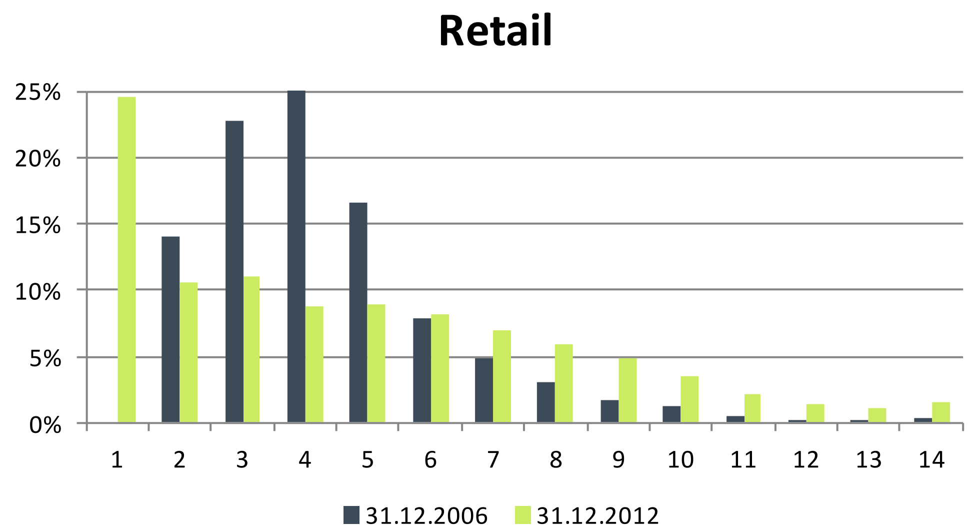


1

- Danish Banks still operate in a risk-averse market with low activity
- Pre-crisis GDP level will be reached in 2015 at the earliest

Historically high Credit Risk





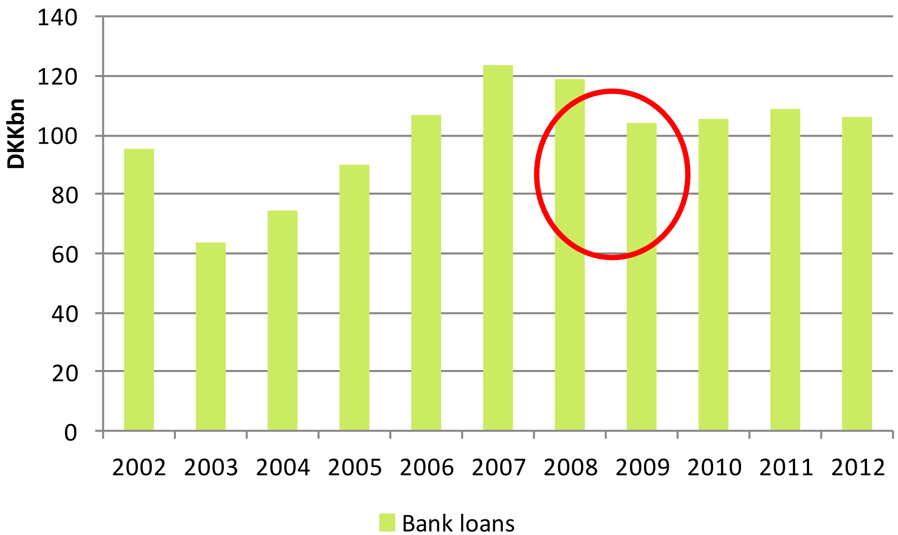
2

- Danish Banks operate with historically high credit risk in their portfolios
- Risk in corporate portfolios approx. double as high as in retail portfolios

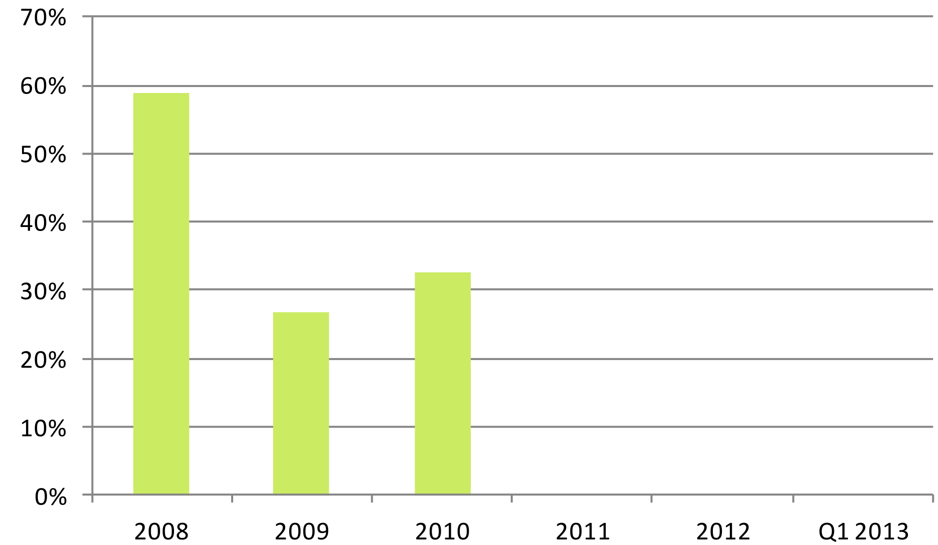
Investment grade (level 1-5)		
%	**2006**	**2012**
Retail	80	64
Corporate	56	41

Deleveraging

Bank loans
DKKbn



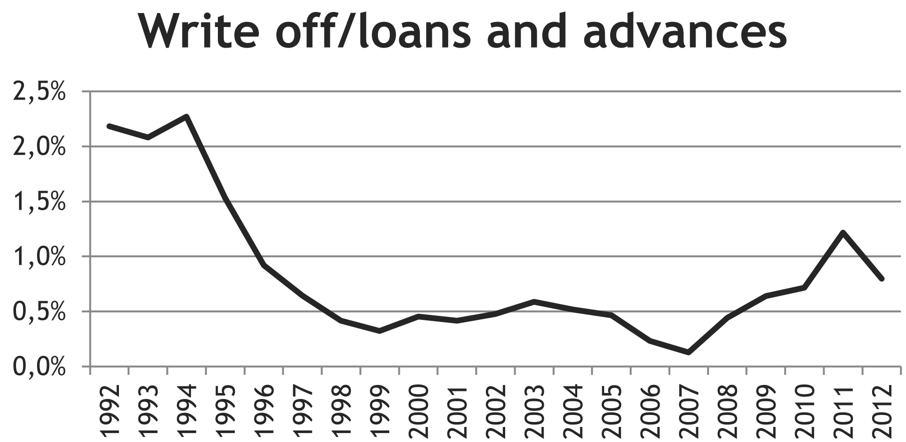
Large exposures
per cent of capital base



3

- Deleveraging driven by the crisis (for some banks) – not by the regulator
- Lower concentration risk (long-term strategy)
- Jyske Bank 2013: No shipping and aeroplane exposure, no exposure towards large real-estate developers
- Voluntary deleveraging narrows funding gab (loan to deposits)
- Forced deleveraging (by the market or FSA) may widen funding gab

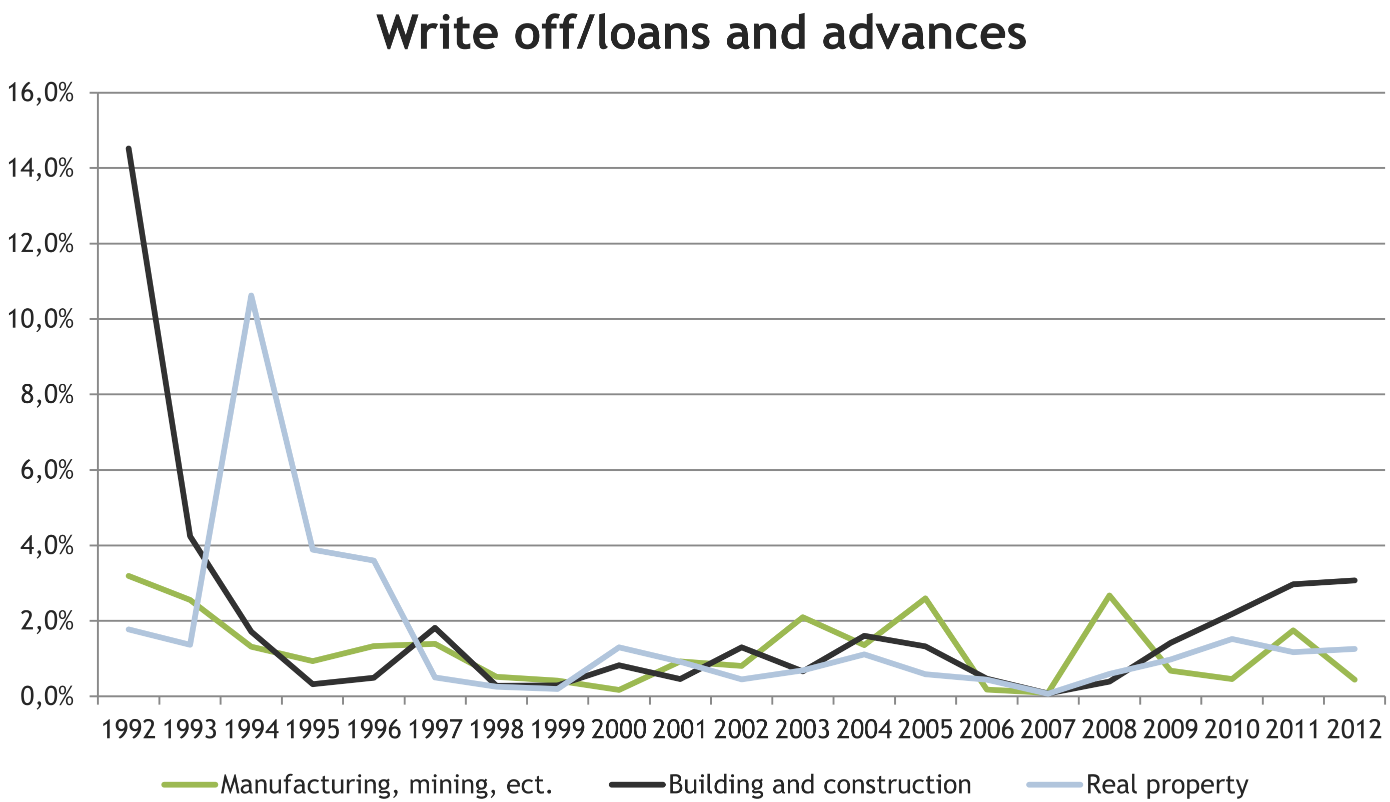
Credit squeeze is not an issue in large banks (apparently)



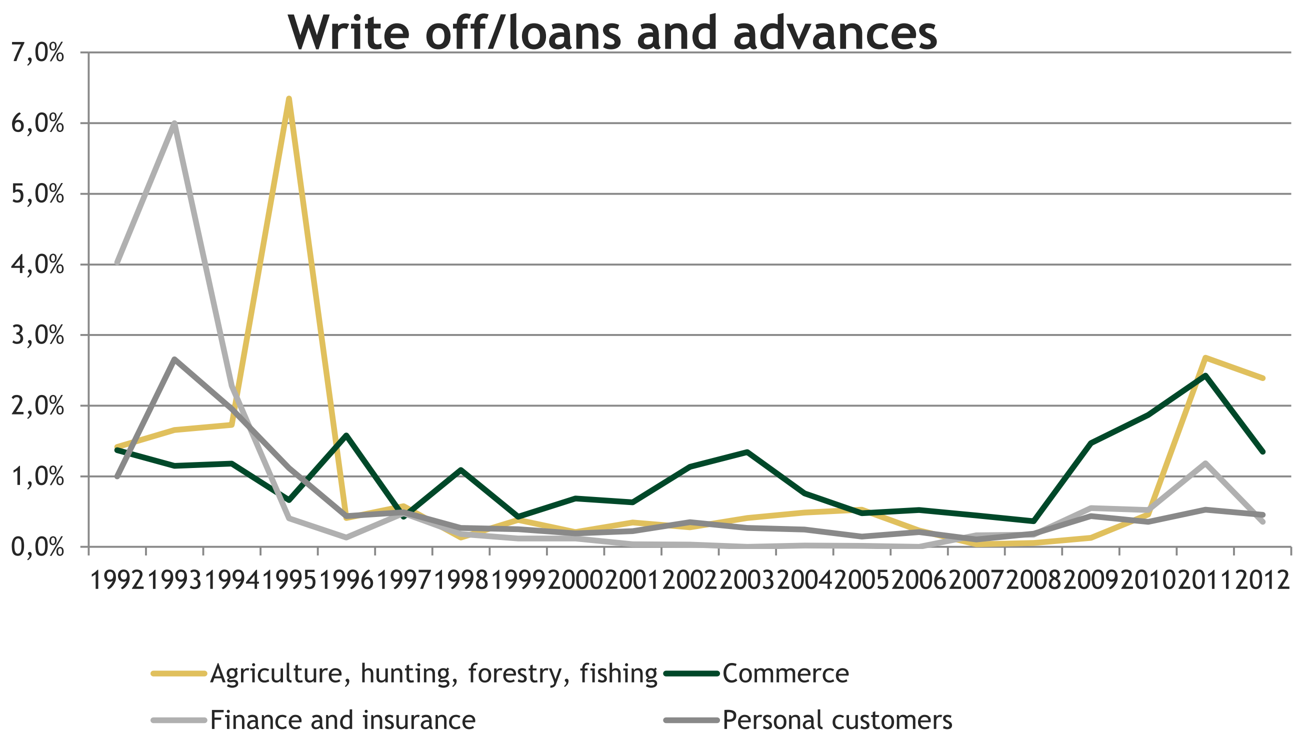
- Many small banks need to deleverage further – large number of banks but low market share; 4% of loans according to survey by Danish FSA have increased internal capital requirements significantly according to 8+ model
- Performance in large banks demonstrates the capacity to enlarge credit risk
- Risk assessment changed, leading to higher prices
- New companies have doubled up risk of default compared to existing companies
- High uncertainty attached to long-term budgets
- Pre-crisis: loan to all industries and very different companies; during crisis: large corporates quickly restructured leading to a risk-skewed loan demand from many fragile minor companies
- Credit policy is gradually changed before and on the outset of the crisis (reallocation by sector)
- Don't confuse access to credit (credit squeeze) with quality of borrower (price and economic cycle)
- The supply of credits is available to the right customers but at higher prices

- # 4
- Credit squeeze is not an issue in large banks (apparently)

Volatile sectors are scaled down

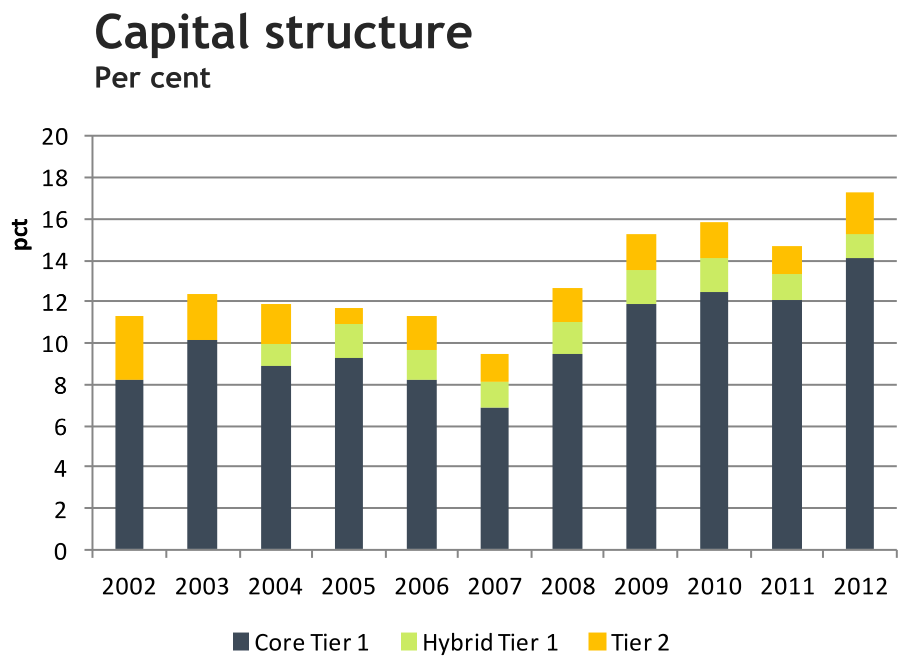


Personal customers are solid!



- Less intrinsic risk in personal customers than corporates
- Jyske Bank: 15% of balance of impairments are related to retail, 85% to corporates
- Average write off retail/corporates: 0.4%/0.9% in 2008-2013

Procyclical Capital Management



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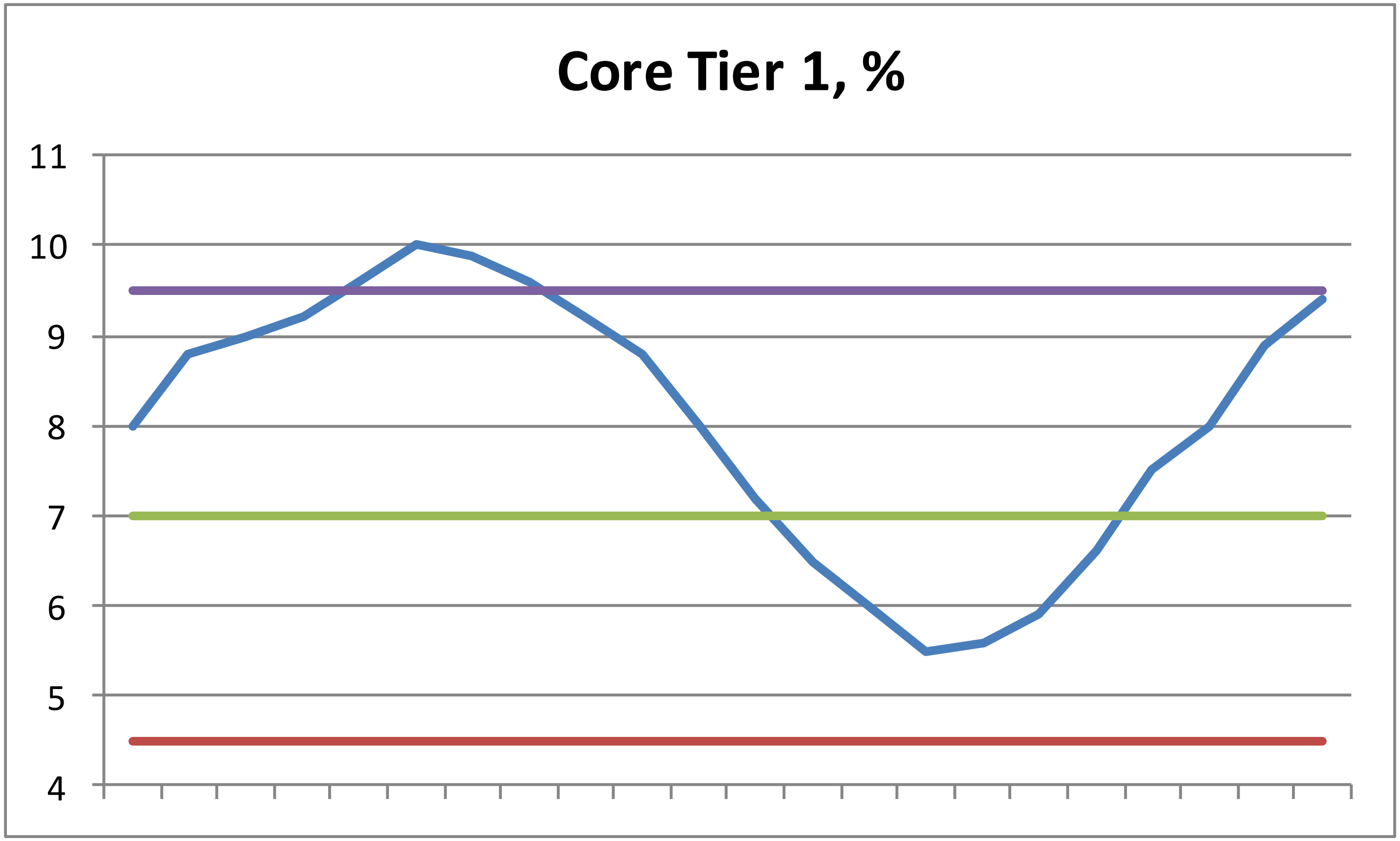
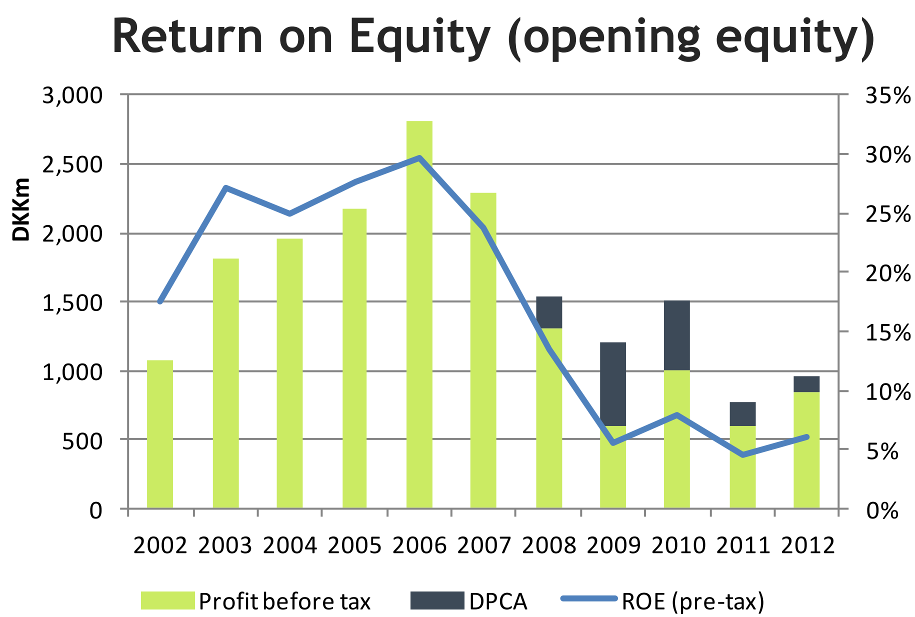
- Gearing high pre-crisis due to expected capital relief in 2008 (approx. 20%, Basel II)
- Historic recapitalization 2008-2012
- Capital restructuring completed and aligned with CRD IV/Basel III – but at the wrong time (procyclical)

CRD IV breaks procyclicality!



Upturn Downturn Upturn

ROE - from two digits to one digit



6

- ROE from two digits to one digit:
  - Historically high credit risk
  - Low activity
  - High risk aversion
  - Strong equity base
  - Historically low interest rates

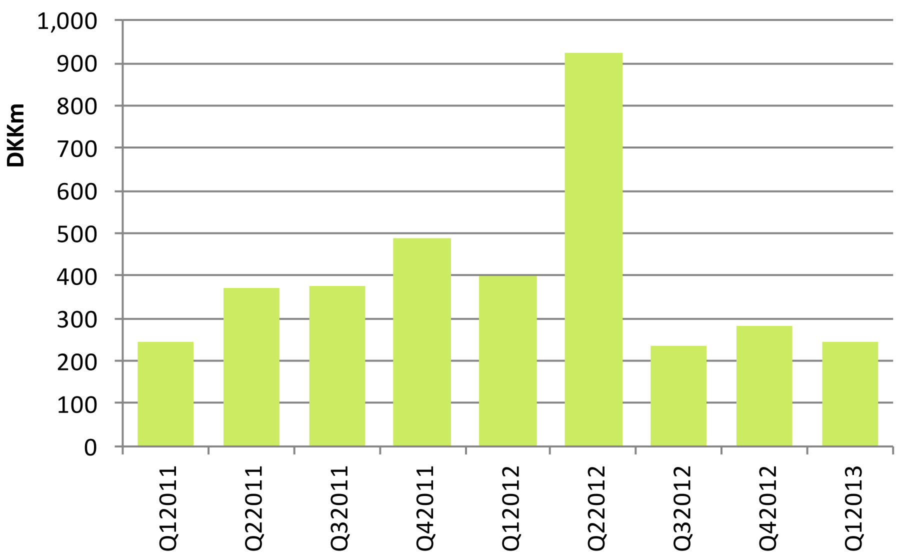
The Banking Industry in 2013

- # 1
- Danish Banks still operate in a risk-averse market with low activity
- # 2
- Danish Banks operate with historically high credit risk in their portfolios
- # 3
- Deleveraging driven by the crisis (for some banks) – not by the regulator
- # 4
- Credit squeeze is not an issue in larger banks (apparently)
- # 5
- Procyclical Capital Management
- # 6
- ROE from two digits to one digit

New domestic regulation during crises

New domestic regulation during crises

- Q2 2013: More stringent guidelines for loan-loss provisions - risk assessment not changed



- Q1 2013: Capital reservation method to assess internal capital requirements (Pillar II) - higher charges for especially minor institutions

The New Capital Regime

The New capital regime

- Basel II –
  defined an internal calculator to advanced risk assessment and risk management

- Basel III –
  defines a set of rules for especially capital and liquidity to ensure the stability of the financial markets

New capital regime

- Double-up of capital requirements
  - from 8% to 16%

- Dramatic restrictions on capital structure
  – equity is king! – SIFI-rules put further pressure on Danish institutions

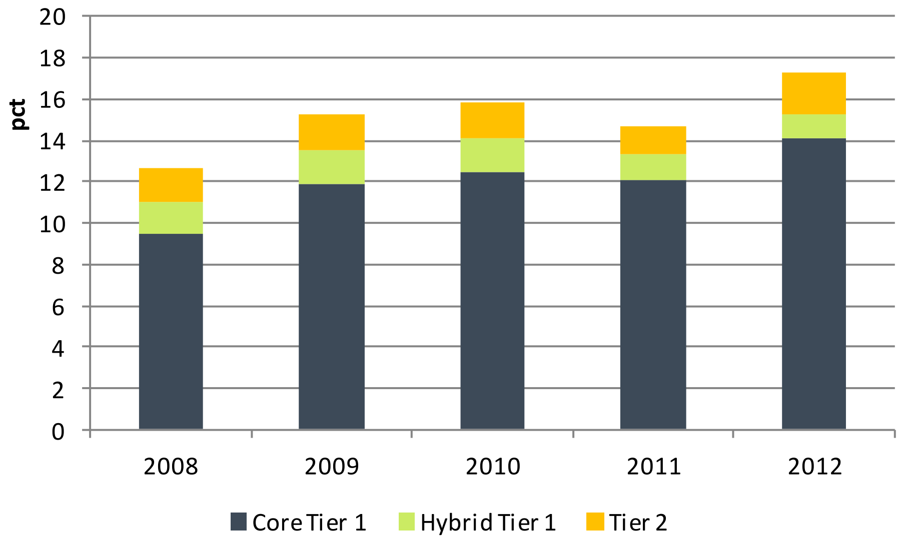
- Non-risk sensitive cap on leverage
  - pressure on low-risk portfolios (e.g. covered bonds)

- New liquidity ratios
  - demanding/securing long-term liquidity management

- FSA behaviour opposite experiences during crises
  - countercyclical behaviour

Consequences of the Crisis and new Regulation

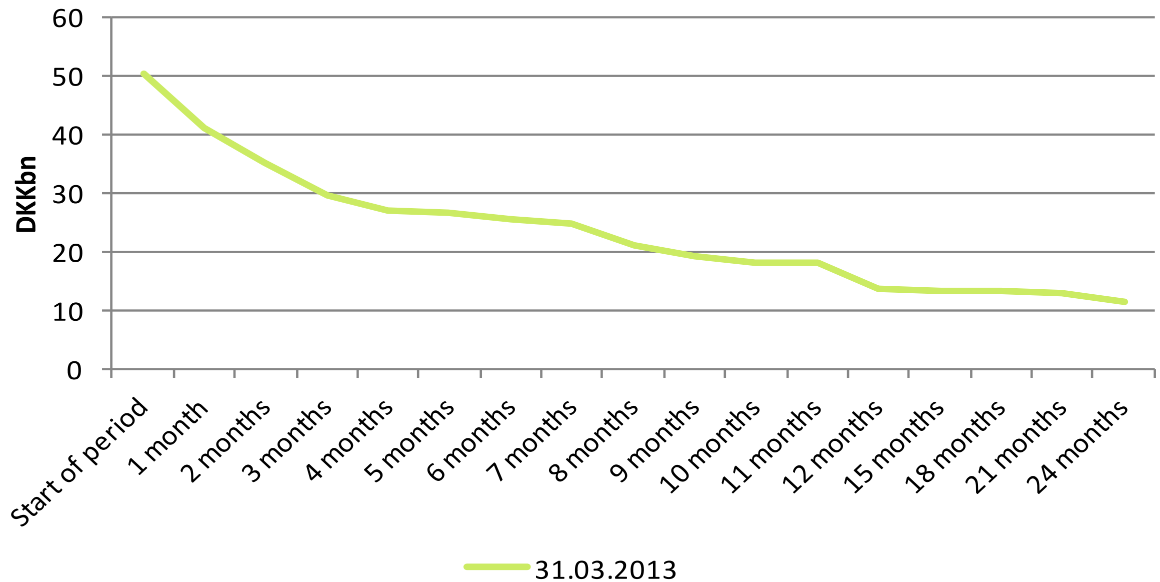
1 Capital structure points only towards equity



SIFI:
Normal year: 15%-18%+
Upturn: 17%-20%+
Tier I (hyb)+Tier II: max. 3.5%

- In Denmark, CRD IV is an issue about capital the ”numerator” and to a lesser extent risk-weighted assets
- Capital buffer under pressure due to 8+ model
- Tier II instruments expire massively in 2013-2014
- New capital (hybrid Tier I or Tier II) is (prohibitively) expensive or impossible to attract
- Banks can’t rely on capital markets funding to the previous extent
- Earnings capacity and expansionary potential in the Industry are limited
- Breach of ”soft limits” may lead to significant market reactions
- Jyske Bank P/L surplus every year and raised capital during the crisis
- Models are re-estimated and validated every year and approved by FSA; models are valid and used in pricing of products.

2 Conservative liquidity profile



Liquidity and run-off

- Access to international liquidity impossible for banks below A-level due to Bank Package III
- ”Loans and savings bank” model reinvented
- Response: More diversified funding solutions (e.g. Jyske Bank’s funding via BRFKredit)
- More differentiated pricing for credit and liquidity in fixed-income instruments (LCR)
- Focus on longer term capital markets funding and long-term commitments from customers

- Liquidity profile points towards conservatism (duration) and high-quality assets

3 No rating benefits from CRD IV/SIFI

- no level playing field in the Nordics (EU)

Moody's

- Moody's Investors Service said that March proposals naming Denmark's systemically important financial institutions and their capital requirements won't prompt rating upgrades.
- The banks will continue to get only one notch in Moody's systemic support analysis. Swedish banks enjoy three notches.
- Moody's assumptions regarding the willingness and ability of the Danish government to impose losses for bank creditors in a crisis are unchanged. An assumption, which has limited the support factor since 2011 (Bank package III).
- ”A lot of Danish institutions have improved their capital and coverage ratios and a further significant improvement is unlikely. Therefore the effect of the SIFI proposals is limited."

SIFI committee

- "The committee felt that the state shouldn't give a guarantee, binding for all future, completely independent of the situation," Michael Moeller, chairman of the SIFI committee, said in an e-mailed response to questions. "As far as I remember, Sweden is the only country that has given such a strong guarantee."

3 No rating benefits from CRD IV/SIFI – no level playing field in the Nordics (EU)

- Rating agencies have defined and calibrated a new capital-normal i.e. no changes
- Bank package III was devastating
- Rating agencies focus at least as much on earnings capacity as on capital levels and quality of capital structure

4 M&A activities will continue

Pushed by the crisis and CRD IV – the industry has received artificial respiration:

- Deposit and senior bond guarantees (Bank package I and II)
- 3-year LTRO from Central Bank
- Government hybrid capital (Bank package III)
- Funding of real-estate customers and agricultural customers (Bank package V)

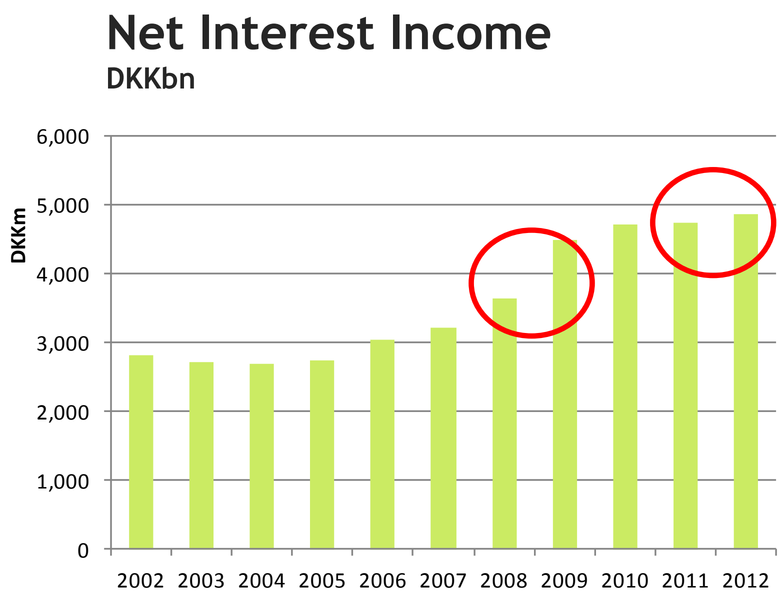
at prices below market level relative to Basel III requirements

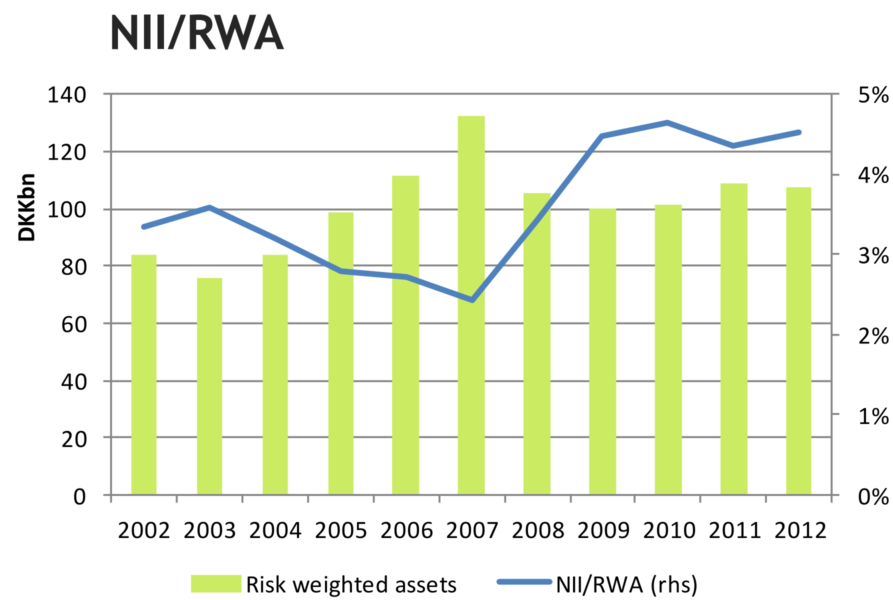
Minor banks still fragile:

- Weak earnings capacity plus skewed capital structure (significant amount of Tier II loans)
- Higher administrative burdens
- Higher capital charges (CRD IV, 8+)
- More stringent guidelines from FSA for loan-loss provisions

- Consolidation is absolutely necessary and desirable to create a banking industry which to a larger extent supports financial stability

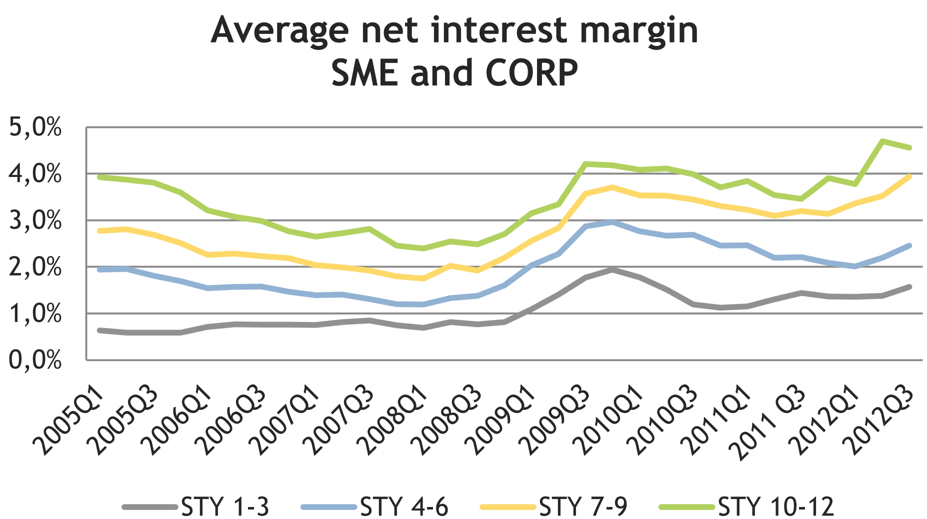
5 Prices aligned with higher risk & capital charges

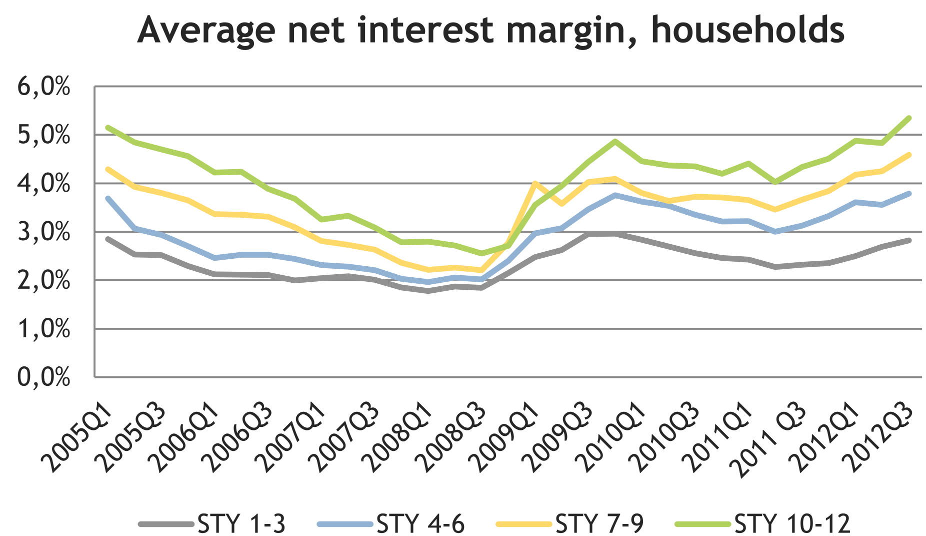




- Risk/price relationship eroded from 2003 to 2007 due to market conditions
- More focus on risk management due to crisis and CRD IV
- Loan prices are primarily driven by quality of customers, portfolio allocation, local market conditions and internal ROE requirements

5 Higher price differentiation



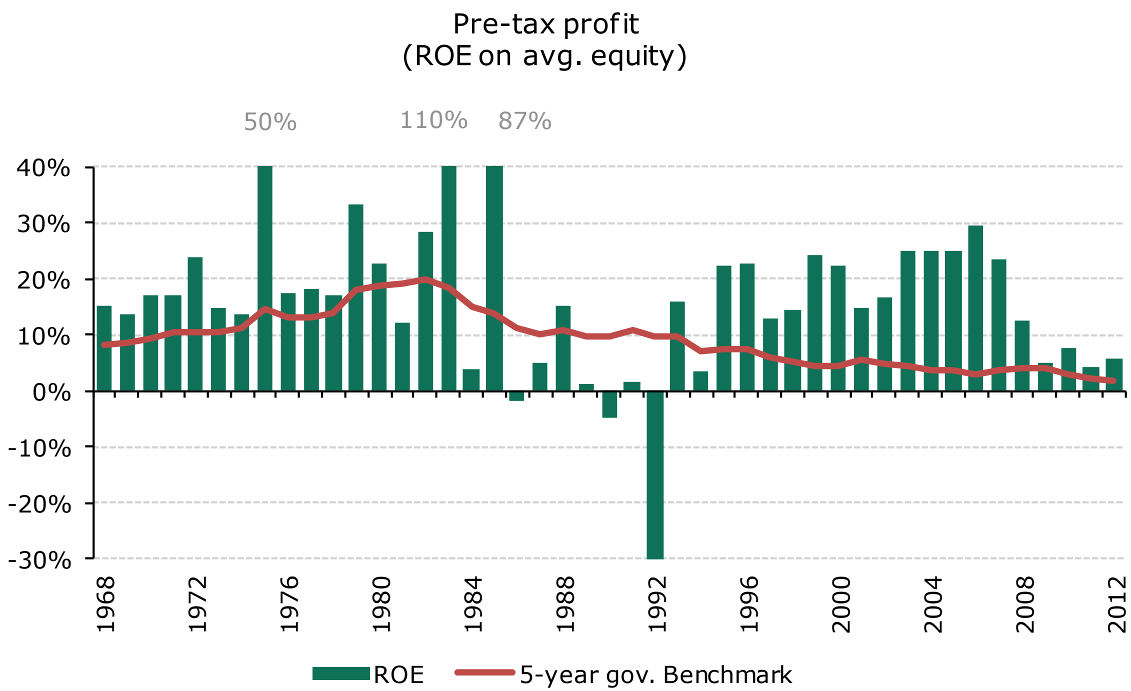


Rating models fully support greater differentiation after the crisis:

- Risk of weak customers can't be priced (expected and unexpected loss)
- Need for higher price differentiation (2008 vs. 2012)
- Risk distribution is more polar, especially for private customers

But prices are also cyclical and not only driven by consistent risk assessment

6 Lower ROE long term



Average: 19%

- New capital regime
- Lower risk profile and risk appetite
- Changed risk assessment
- Bank-specific ROE targets
- Not fully efficient market: double capital requirement doesn’t lead to a symmetric cut in ROE expectations
- Investors invest in sectors with difference in regulation and capital requirements
- Interest-rate level extraordinarily low in a long period of time

Consequences

Conservative and risk-averse banks

- # 1 Capital structure points only towards equity
- # 2 Conservative liquidity profile
- # 3 No rating benefits from CRD IV/SIFI – no level playing field in the Nordics (EU)

Fewer and larger banks

- # 4 M&A activities will continue

Price and risk more aligned

- # 5 Higher price differentiation and alignment with higher risk & capital charges

Long-term ROE under pressure

- # 6 Lower ROE long term

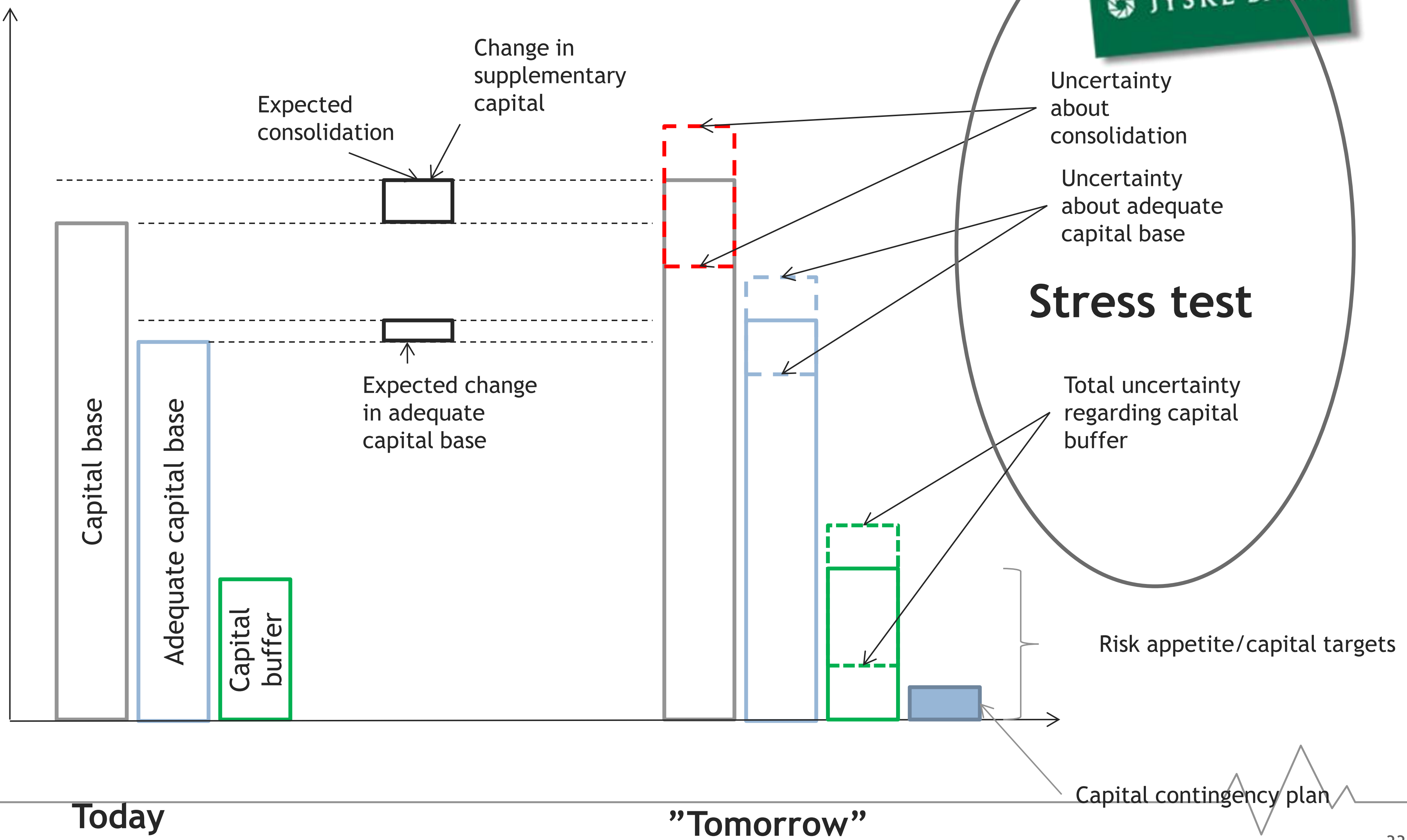
Strategic considerations

Strategic consequences and considerations for banks

Basel III/CRD IV
&
Banking industry 2013

- M&A activities continue
- Basel II incentives downplayed/ removed
- More liquid market for corporate bonds
- Procyclicality amplified until equilibrium is achieved
- Lower risk profile in banks
- Align price and risk i.e. structural pressure for higher prices/fees
- Lower ROE
- More conservative capital and liquidity planning
- Higher capital charges
- Business model under pressure (deposits, loan-diversification etc.)

Capital buffer & stress test (Pillar II)



Questions