



## Business Model Analysis (BMA) – The challenging SREP element

Deloitte Romania  
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# Agenda

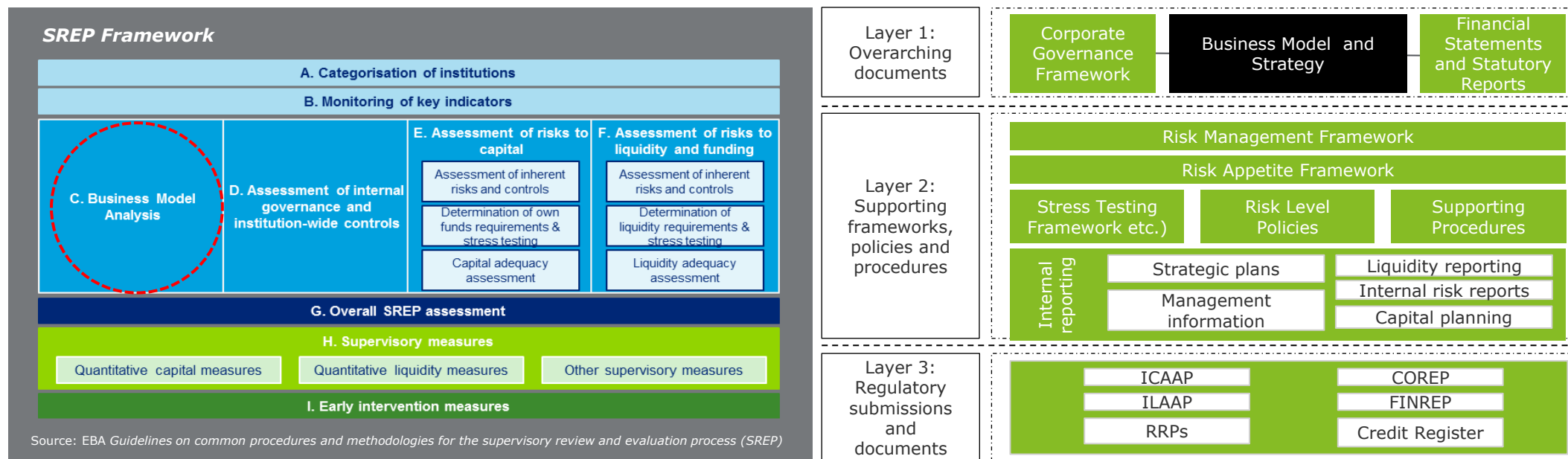
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# Supervisory approach to BMA

# BMA is evaluated as part of its SREP assessment

BMA has wide reaching implications, interacting with both ICAAP/ILAAP frameworks as well as with the Recovery plan framework.







- Business model covers the entire organization
- Business model ensures the interconnection and consistency of frameworks.
- Banks need to take a holistic approach to ensure that all components are aligned and support each other
- Align business strategy, risk strategy and appetite and key reports (regulatory, external and internal)
- Need to define business model through the identification of key resources, operational procedures, market conditions and stakeholder expectations

# What is the approach used by supervision to evaluate the BMA?

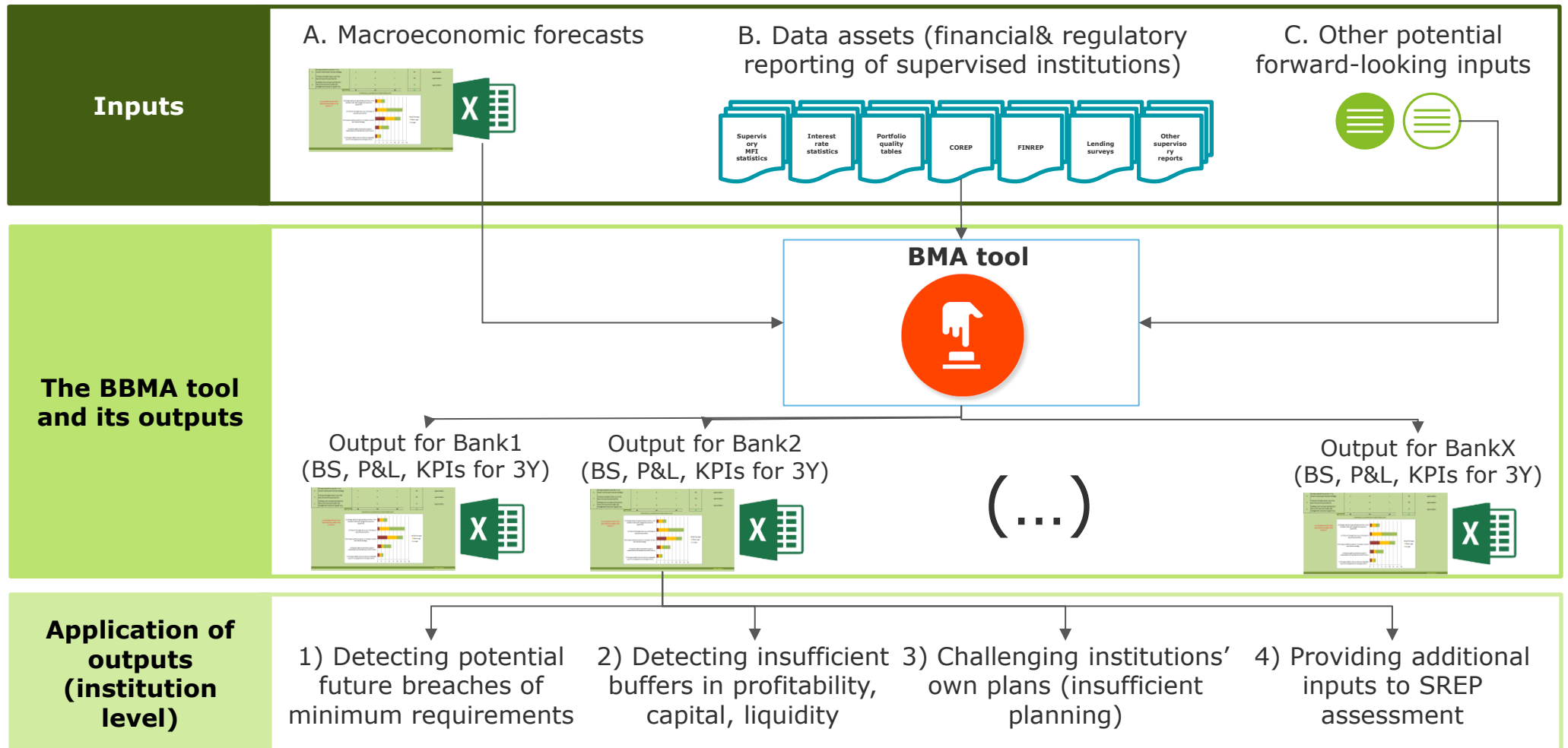
## Key Methodology aspects of BMA

- The BMA Methodology consists of a number of areas which target a demonstration of the **ability to generate an adequate level of profitability over the short (1 year) and medium-to-long term (3 years)**.
- The regulator will assess **performance in light of risk appetite, in the context of the business environment, and against banks' peers**

 <p><b>Assessment of business environment</b></p> <ul style="list-style-type: none"><li>• Key trends that may impact the business model and strategy (e.g. technology, regulatory);</li><li>• Assessment of key macro-economic variables relevant to major products and geographies;</li><li>• Assessment of where the market is heading.</li></ul>	 <p><b>Analysis of key vulnerabilities</b></p> <ul style="list-style-type: none"><li>• Poor financial performance;</li><li>• Unrealistic strategy;</li><li>• Excessive concentrations or volatility</li><li>• Excessive risk taking;</li><li>• Significant external problems (for example, legislative threats such as the provision of a "blockade" of operational units).</li></ul>	 <p><b>Quantitative and qualitative analysis of business model &amp; strategy</b></p> <ul style="list-style-type: none"><li>• Assessment of historical and projected performance;</li><li>• Reasonableness of assumptions underlying projections;</li><li>• Profitability vs risk appetite;</li><li>• Execution capabilities and track record of management;</li></ul>	 <p><b>Peer group analysis</b></p> <ul style="list-style-type: none"><li>• Identification of peers based on criteria such as size, business model, ownership structure and risk appetite;</li><li>• Analysis of identified peer group.</li></ul>
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# BMA Tool NCA exemplification

Tool to detect unsustainable business models and challenge banks' own forecasts



# How is the supervision assessing the business models?

To reach an unbiased, holistic and forward-looking conclusion, the supervisor assess business models by combining information and data with their own experience.

**ICAAP and ILAAP, Risk Appetite, Strategy and Forecasting**



**The analysis of complex data**



**The judgement of experienced supervisors**



**SREP: Business Model Analysis (BMA)**

**On-site Inspections (OSI)  
Thematic reviews of business models and profitability drivers**

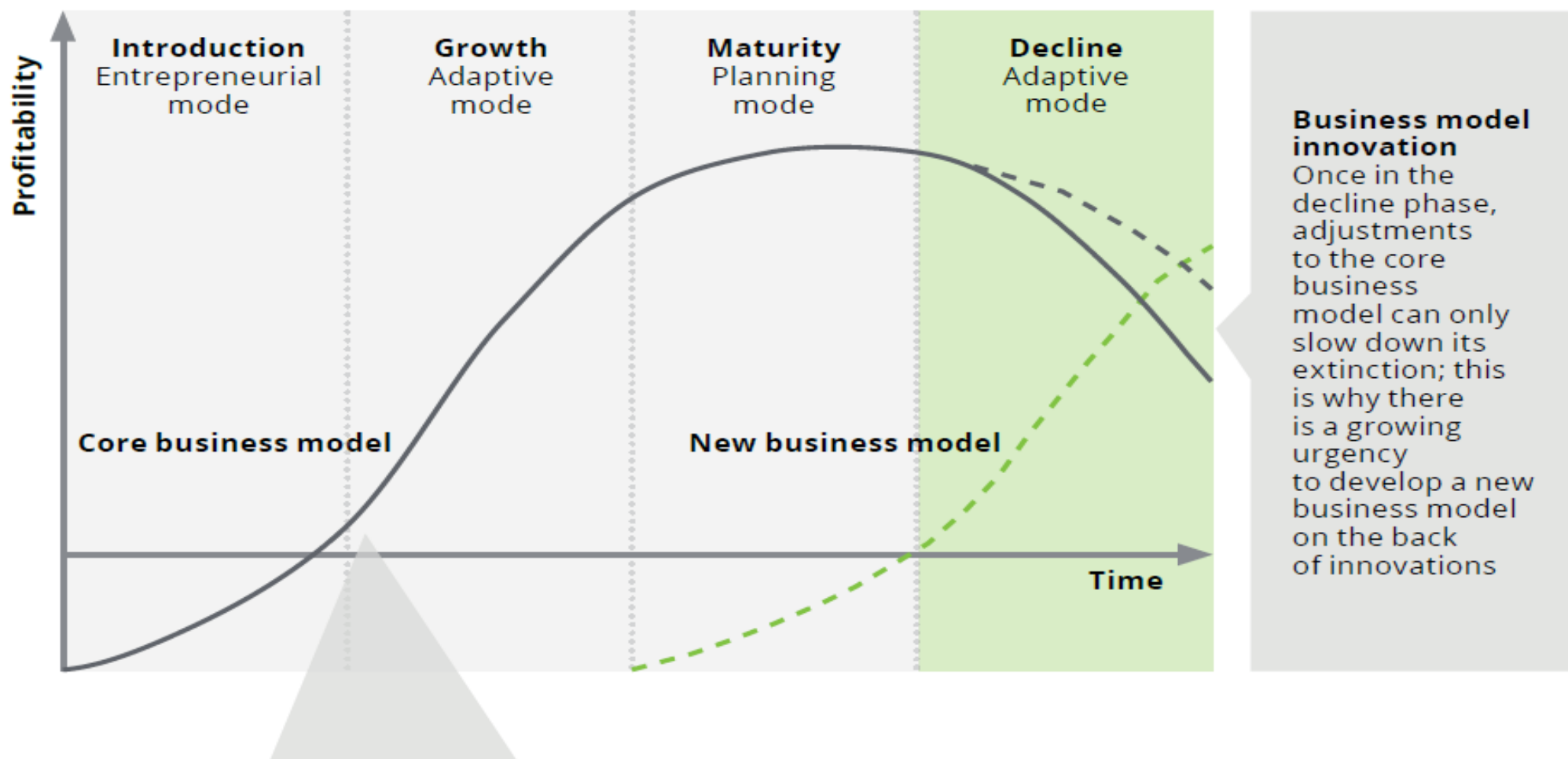


# What challenges do Banks face in relation to BMA?



# Business Model life cycle - and implication on strategy

The first step in the process of banks' business model adaptation should be **fixing their strategy**. This should take into account **interest rate environment**, the pace of **cleaning up of their balance sheets**, the **implementation of Basel prudential rules** and **the new resolution framework**.



# What are the challenges faced by Banks in relation to BMA?

How can we deal with them?

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What challenges do banks face as part of Supervisory Business Model Analysis?

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Where should ownership of Business Model Analysis sit within an organization?

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What are the key challenges facing Boards in Business Model Analysis?

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How can firms best define their approach to business model analysis to stakeholders?

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What factors should firms consider when looking to improve the analysis of their business model?

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How can banks incorporate technology threats into their business model analysis?



# BMA Framework

## How to balance the right BMA Framework?

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### Forward-looking

- Focus on the consequences of actual business and risk profile
- Includes planned amendments in strategy
- Takes into account expected / potential changes in the external environment
- Consequent projection of financials

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### Flexible

- Enables the inclusion of all important information
- Override is regulated and possible
- Detailed and up to date documented



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### Objective

- Methodology set up in advance
- Relies on objective metrics (quantitative or qualitative)
- Replication is possible
- Same inputs results in the same assessment

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### Integrated

- Takes into account all relevant information
- Interconnected with the assessment of other risk aspects (ICAAP, stress testing, etc.)
- Values consistency

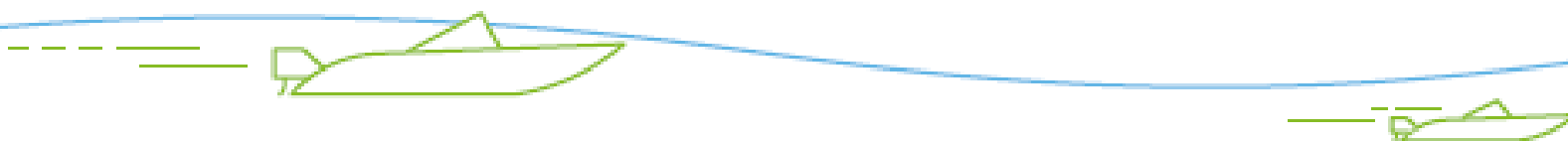
## Continuous improvement

The business model and strategy of the Bank should be continuously re-assessed for improvement opportunities

Mapping out the business model provides an opportunity for the Board to challenge whether improvements can be made in relation to any aspects of the business model and strategy.



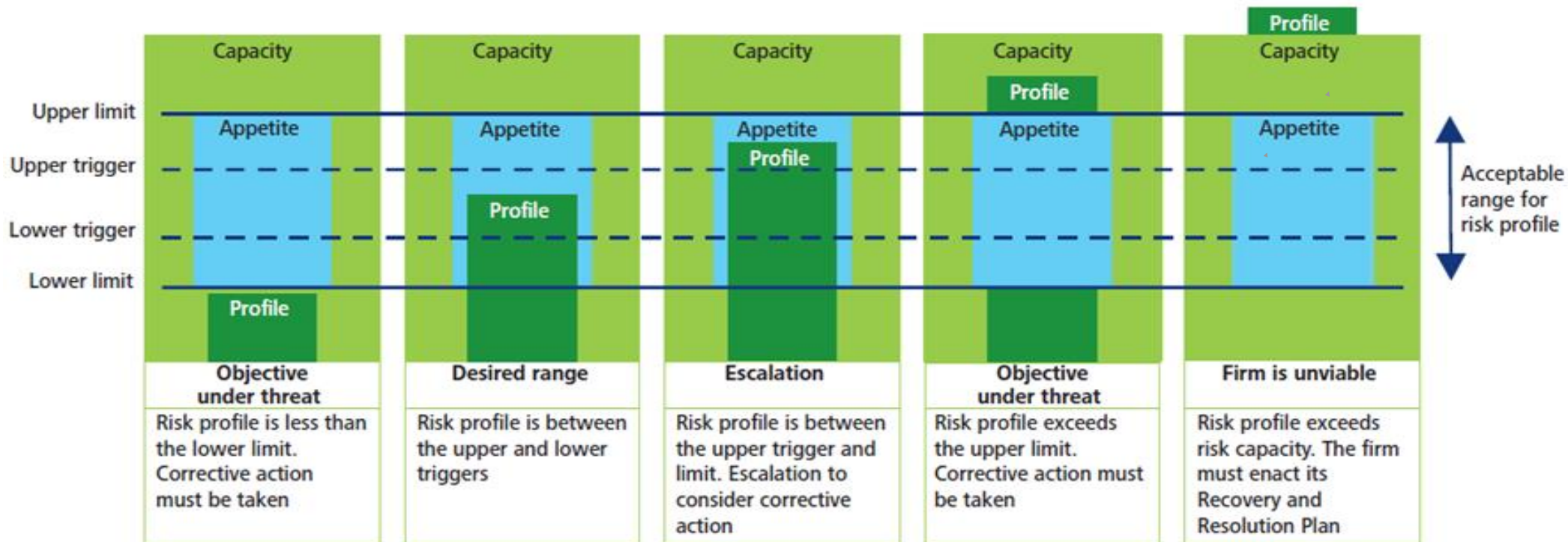
- Should the business model and strategy be transformed in the future to ensure that the Bank remains competitive in light of industry developments, including new competitive forces?
- Is the Bank organised in a manner that allows a quick reaction to market and industry developments?
- Does the Bank focus on customer experience enough?



# **BMA consistency and integration with the Risk framework**

# Risk Appetite Framework as the core of BMA

The development of an appropriate risk culture is highly dependent on the effectiveness of the RAF.



## BMA consistency and integration with the Risk Management Framework



**Standardize RAF and align to financial forecast**



**Link RAF to Risk Management Framework with the use of KRIs**



**Benchmark internal control architecture vs. business model**

# **BMA's interaction with profitability and pricing**



# Profitability important in the BMA context?

What is the bank in the future environment?

## Market environment

### Regulatory Environment

- Increasing **regulations**, e.g.:
  - CRD4 package (additional capital and liquidity)
  - Bank Guarantee Fund Act
  - MiFID2
  - Basel IV: IRBA, FRTB, IRRBB, NSFR and other typically affected areas
- New regulations might cause down swings, e.g., IFRS 9 and LCR

### Economic environment

- **Interest rate** environment
- Rising interest rates with negative short-term effects on PnL seem to be approaching
- Significant **economic imbalances**, e.g., real estate valuations, and increased risk appetite
- Increased consumption and indebtedness
- **Rising global economy**

### Business environment

- **Digitalization**: Need for significant infrastructure investments
- Banks' **profitability is very low** in Europe, stopping all „dangerous“ business is not an option
- **Few very promising business opportunities** in the market
- Most banks have significantly **capital and funding constrained**

## Holistic Balance Sheet Management Approach



Improve RoE



Enhance capital effectiveness



Reduce operating costs by revealing further efficiencies

# BMA & Asset Quality

# The burden of non performing loans

How compatible is the financial plan and operational model of the bank with its NPL strategy?

## Asset Quality

### NPL strategy

- **Legacy vs. new NPLs** key drivers
- Link between **NPL generation and commercial strategy**
  - Risk matrix (product, customer)
  - Early warning indicators (stage 2)
- **Financial and operational impact** of NPL and non-core portfolio divestments
  - Pricing
  - Transaction expenses
  - Operational capacity

### Workout strategy

- Alignment between **workout strategy and operational plan**
  - Organizational capacity
  - Recovery efficiency
  - Operational expenses

### Collateral management

- Alignment between **operational model and repossessed collateral management**
  - Organizational knowhow and capacity

## Suitability / Feasibility assessment required with typical goals:



**Reconcile NPL strategy and financial forecast**



**Reconcile workout strategy and operational plan**

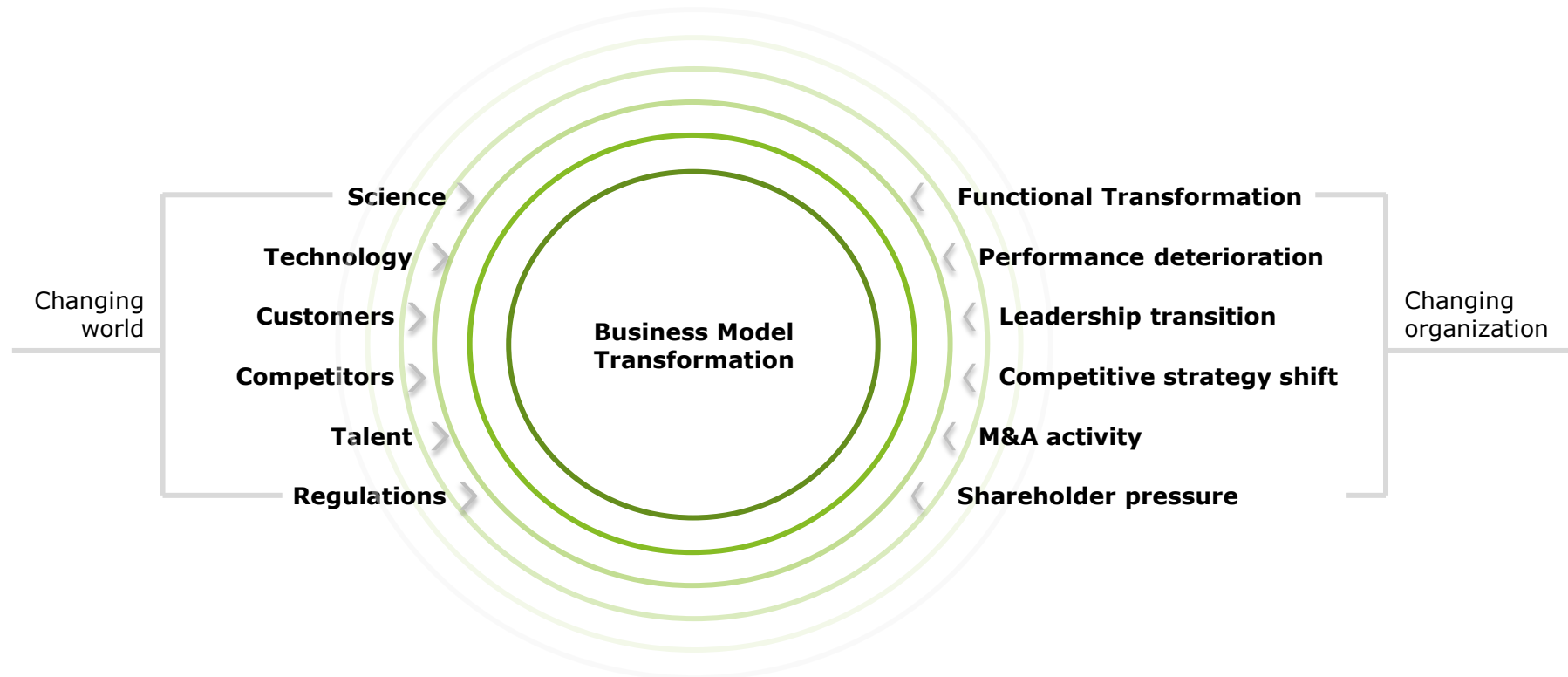


**Reconcile collateral management obligations to operating model capacity**

# BMA & Technology Innovation

# As tech advances, traditional banking models become less viable

Banks' business models need to adapt to new technology for establishing an efficient and sustainable business



Based on the last EBA risk assessment report, most banks signal the rapid growth of firms impacting their business:

- The most disrupted business line is payments and settlement which is perceived as an opportunity for banks to either increase revenues or reduce costs. FinTech firms appear to be particularly dominant in the provision of payments, clearing and settlement services.
- Retail banking is the second most disrupted business line while the EBA mapping exercise indicates disruption also in other financial-related activities (e.g. credit reference services, compliance services etc.).

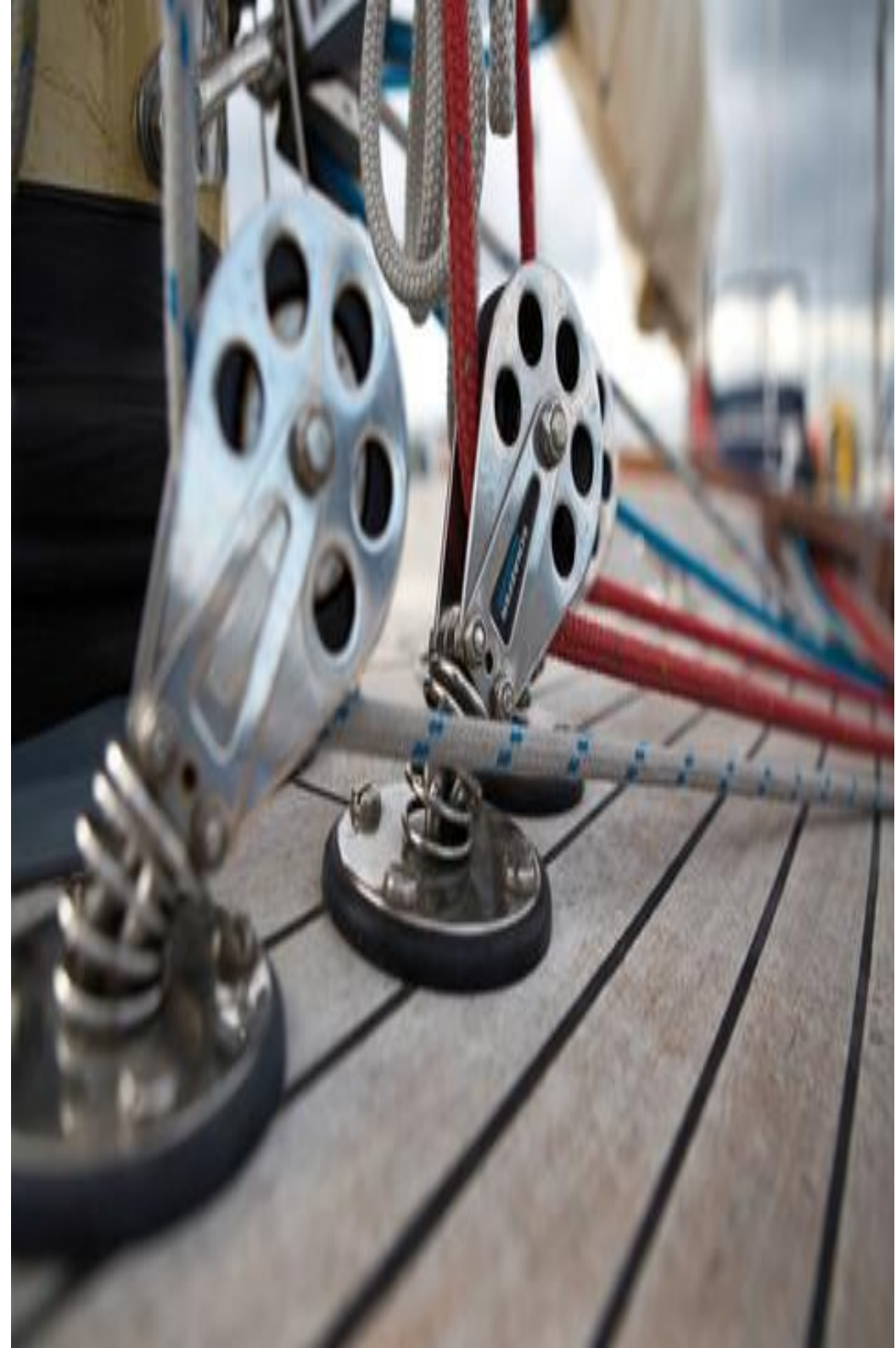
“We should not forget a basic truth: **good times never last.** Banks should take this chance to make themselves shipshape before the choppy waters return. Otherwise, it might be too late.”

“**Adapt** business models to remain profitable”

“**Improve** risk management to remain stable.”

“Deal with **legacy** assets to free balance sheets”.

Speech by Danièle Nouy, Chair of the Supervisory Board of the ECB, European Banking Federation Boardroom Dialogue, Frankfurt, 24 January 2018.





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