EURO GROUP CONSULTING

/ SUMMARY

STATE OF THE NATION p. 3

THE BANKING INDUSTRY IN PORTUGAL p. 5

INTERVIEW WITH FABRICE SEGUI - CEO FOR BNP PARIBAS PORTUGAL p. 7

ESG INVESTING: WHAT, WHY AND WHO FOR? p. 9

ABOUT THE AUTHORS p. 11

/ STATE OF THE NATION

By Dipen Patel

European CIBs are facing one of their most resilient periods since the financial crisis whilst trying to compete with the dominance of the US banks in their back-garden, dealing with complicated economic and political environments, managing the deterioration of their share prices and complying with regulatory requirements imposed on them. Survival in these conditions requires drastic changes to their business model to help alleviate these pressures.

Over the last 10 years, CIB revenue pool in EMEA have decreased by -28%, whilst over the same period in AMER they had only fallen by -8% and APAC benefited from an increase of +10%. By 2021, it is forecasted that EMEA revenues will fall a further -4% whilst both AMER and APAC will see increases of +4% and +11% respectively[1]. Many factors have contributed to this decline for the EMEA region since 2009, however this decline has been recently driven by the prolonged negative interest rates in the eurozone, saturation of the market by local lenders and tighter regulations on capital.

In September, Mario Draghi, the outgoing president of the European Central Bank, cut its key deposit rate to -0.5%, putting further pressure on banks' net interest income. Given that many of the European institutions are built upon deposits and deposits income, if the negative rates continue for the foreseeable future, these institutions would need to redefine their business model to counteract for these conditions.

The negative rates are not the only factor threatening revenues, the saturation of the market by local lenders is also having a huge impact on the larger CIBs. Domicile banks can offer uneconomically cheap loans as they are less vulnerable to overhead costs or dividend payments which force the larger CIBs to write low-margin business to compete with them[2].

Basel IV, the new capital requirements CIBs will face in the next 3 years will put additional pressure on banks and their investors. If the regulation were in place today, large European banks would need €130bn ($153bn) to comply with the regulation . A recent study conducted by the European Banking Authority, illustrates that Basel IV would reduce the core equity tier one capital ratios of Europe's eight largest banks by 27% and a separate study estimates the impact on US banks will be around 5%-6%[3].

All these factors contribute to decreasing revenue pools resulting in increased pressure on European CIB's profitability and Return on Equity. Consequently, many have focused on cost reductions programmes to shore up profitability. The results have varied from bank to bank, with some CIBs exiting entire business lines whilst others have reduced their variable costs.

The analysis detailed in our recently published CIB Outlook 2019, illustrates that European CIBs should be pro-active and look at cost reduction via structural change to substantially decrease costs. Focusing on short-term solutions such as reducing variable costs is no longer the answer as exhaustive measures have already driven variable cost to a low point. It is now time to target fixed costs which are impacting the various business lines[4].

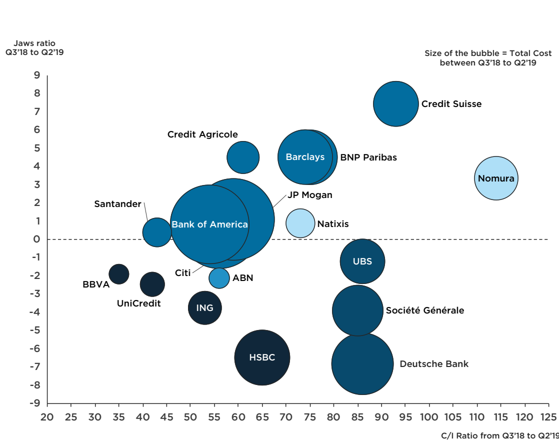
[1] "Searching for Growth in an Age of Disruption", Morgan Stanley
[2] "European Banks Face $153 Billion Capital Hole Under Basel Rules" Bloomberg
[3] "Can European banks strike back", Euromoney
[4] "CIB Outlook 2019", Eurogroup Consulting

/ STATE OF THE NATION

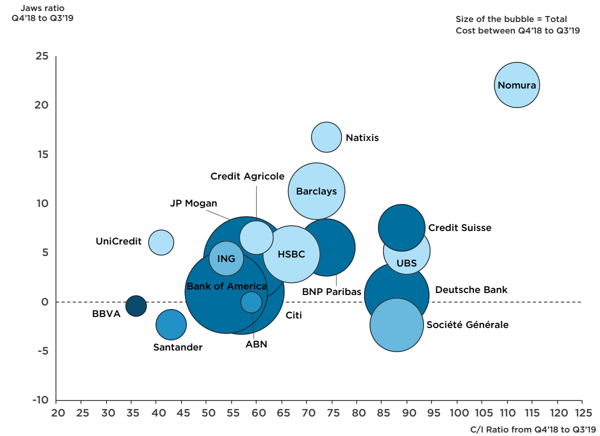
By Dipen Patel

The Q3’19 results of our sample of CIBs illustrated that many had started to reap the benefits from restructuring programmes despite cost stickiness.

	Revenue has decreased whilst expenses have increased
	Increase in expenses is more than the increase in revenue
	Increase in revenue is more than the increase in expenses
	Decrease in revenue is more than the decrease in expenses
	Decrease in expense is more than the decrease in revenue
	Revenue has increased whilst expenses have decreased



Our Jaws analysis[5] indicates over Q3’18 to Q2’19 (4Q) there was a mixed bag of results, some CIBs benefited from their expenses decreasing and revenues increasing however, many CIBs experienced increases in their revenue but also increases in their expenses. The average Cost-to-Income ratio for our sample of CIBs was 65.2%.



In comparison to the period Q4’18 to Q3’19 (4Q), where many of the CIBs had shifted to having positive Jaws benefiting from decrease in expenses and increase in revenue. Interestingly the average Cost-to-Income ratio for our sample of CIBs increased ever so slightly to 65.5%

As many CIBs are now benefiting from decreases in their cost base, the question remains how much elasticity is left in their variable and fixed costs and how they can start disrupting these without adversely impacting day-to-day operations. We believe CIBs need to industrialise their operating model and focus on redefining their business model by measuring the profitability of product offerings against diversification of coverage.

[5] The Jaws ratio is the difference between growth rate of revenue and growth rate of expenses

/ THE BANKING INDUSTRY IN PORTUGAL

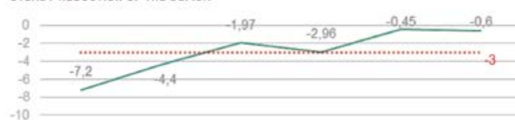
By José Manuel Azevedo

In October 2019, Portugal held legislative elections. With a record abstention rate of close to 51%, the Portuguese public voted for the Socialist Party allowing it a second 4-year term in power. There is no doubt that the former "coalition" between socialists and two other left-wing parties can evidence remarkable progress to the Portuguese economy, benefiting from a favourable external environment and from the efforts the previous government had during the Troika period. As from 2015, Portugal's Gross Domestic Product (GDP) grew year-on-year, the public spending deficit reduced, and unemployment decreased. However, debt to GDP growth, also declining, is still the weakest point for the economy, averaging approximately 120% of GDP. This is alarmingly high compared to the other European countries.

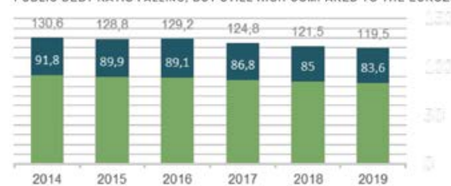
A STEADY AND UNDENIABLE RECOVERY

Gross Domestic Product (YoY variation %)
EXPECTED TO INCREASE 2% YOY UNTIL 2020

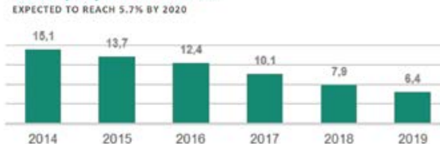
Portuguese deficit (% of GDP)
STEADY REDUCTION OF THE DEFICIT



Debt to GDP Ratio (%)
PUBLIC DEBT RATIO FALLING, BUT STILL HIGH COMPARED TO THE EUROZONE



Unemployment Rate (%)
EXPECTED TO REACH 5.7% BY 2020



Sources: Pordata, IMF, OECD

The decrease in the public spending deficit was celebrated by the governing parties, however this achievement was through continuous decrease in public investments leading to a significant degradation of both Public Health System and Transportation infrastructure. The decrease in public investments by the government meant the private sector had to support ongoing and future investments, this being mainly financed by the Financial Services (FS) industry.

A report issued by Associação Portuguesa de Bancos in Q3'19[6] illustrates that the FS industry is now more resilient and prepared to handle adverse potential shocks from the economy. Significant progress has been made by the institutions on efficiency, liquidity, asset quality and solvency. A more in-depth analysis of the report allows us to conclude that the total credit to clients had reduced, but at a residual pace. Recently, non-performing loans (NPLs) have decreased drastically, from the maximum in June 2016: NPL's have decreased by €26bn and the NPL ratio has decreased by -9% to 8.9% at the end of Q3'19. An increase in the number of deposits has been the main source of income for banks and despite the low interest rates, profitability has been positive. The funding gap has progressively been reducing, a -71% compared to the maximum in June 2010 and the liquidity coverage ratio is considerably higher than the required 100%. Solvency has also recorded improvements, reflecting the reinforcement of the institutions'

[6] Portuguese Banking Sector - Associação Portuguesa de Bancos

/ THE BANKING INDUSTRY IN PORTUGAL

By José Manuel Azevedo

own funds, the favourable evolution of risk weighted assets and the improvement of profitability. The points mentioned by the report highlight the strengths of the Portugal FS industry, however, when looking at the banking industry and more specifically how the credit market has evolved, the results have been less positive. A study conducted by Banco de Portugal[7] illustrates that as the credit granting policy goes unchanged, credit supply to corporates and individuals has practically remained the same. However, there has been an increase in competition which has helped spreads to be less restraining in average risk loans to corporates. Regarding the demand from consumers, the situation is very similar, the exception being for home mortgage loans, which have slightly increased due to favourable interest rates. Banks and consumer credit companies do foresee a steady increase for personal loans, particularly for cars and home appliances.

Retail and wholesale banking in Portugal Q3'19 showed insignificant changes to the previous quarter. Even though, there was a small improvement of such access through medium to long term debt securities, as well as through the capacity for transferring credit risk off balance sheet. The European Central Bank (ECB) asset purchase program reported no impact on the balance sheet nor the profitability for banks in H1'19. Until the end of the financial year, the expectations are for overall terms of financing to improve. As far as the impact of negative interest rates are concerned, banks in Portugal have reported a significant impact on their financial margin. Simultaneously, such interest rate applicable to the permanent deposit facility has contributed to the decrease of interest rates applied on corporate and private loans. For corporate and home mortgage loans, Portuguese banks have reported an increase in commissions and other charges not related to interest rates. This increase was far bigger than those reported by other banks within Europe.

Overall, one can say that the last 1.5 years showed us that Portuguese financial institutions are continuing their short-term cost reduction programmes through notably branch closures and headcount reductions whilst attempting to invest in two key areas, compliance and digital. Overall, Q3'19 reports indicate growth in profit and market capitalisation (except for Novo Banco, due to Banco Espírito Santo's bankruptcy – leading to huge levels of impairments that are still being recorded in their balance sheet).

[7] Survey to Portuguese banks on the credit market – Banco de Portugal

INTERVIEW WITH FABRICE SEGUI - CEO FOR BNP PARIBAS PORTUGAL

By José Manuel Azevedo

Portugal has several banking institutions, ranging from local providers to global conglomerates. BNP Paribas has been heavily investing within the country and evidently has benefited from a remarkable pace of growth since the financial crisis.

1. BNP Paribas is present in Portugal since 1985, that is, 34 years of activity in the country. In your view, what were the main cornerstones that made BNPP such a relevant institution in the Portuguese market?

We were one of the first foreign banks to operate in the country. Over the last 34 years, we have been gradually consolidating our presence in Portugal, offering both our corporate and individual clients a wide range of integrated financial solutions to support them in their day-to-day lives and businesses.

We have proved ourselves and gained the local market's trust by always putting our clients and their business needs at the heart of our operation. And by providing each one of them with world-class opportunities that only a global player with such a balanced and integrated business model as BNP Paribas could offer.

FABRICE SEGUI

Fabrice Segui is the Chief Executive Officer of BNP Paribas in Portugal. Having joined the BNP Paribas Group in 1996, he has held several managing positions in Paris, Brussels and London. Fabrice is also the Head of BNP Paribas Securities Services in Portugal, since 2008. In this capacity, he was responsible for building up and developing the Lisbon International Operations Centre – which now serves many of the Securities Services locations of the Group. As CEO of BNP Paribas in Portugal, he is fully committed to the talented people that help transform the banking industry from within the bank in this ever-changing world.

Fabrice Segui explains in an exclusive interview with Eurogroup Consulting why the BNP Paribas group had decided to install the Lisbon International Operations Centre during the financial crisis and how it now services many of the other locations of the Group.

2. BNP Paribas' business stems from providing services to local/domestic retail and CIB clients, where the operations have started, to six competency centres servicing clients worldwide. Which factors or circumstances made BNPP to elect Portugal as one of the countries where these competency centres would be launched? Can you share details on those businesses involved?

«Why Portugal?» was never a difficult question for us. And don't forget that we already had, at the time, more than 20 years of experience with some of our local business activities, in Portugal. Therefore, in a way, we knew that establishing our competency centres in the country was something that could definitely be done.

BNP Paribas' competency centres are part of the bank's European platform of specialized services that supports the Group's activity. They are paramount to the bank's operating model by providing worldwide clients with high-valued services, which go beyond simply providing them with administrative or technical support.

This part of our operation relies on a multitude of activities – which range from services to specific business lines and their clients (e.g. securities services) to many diverse functions that serve the Group in itself (e.g. compliance or finance).

/ INTERVIEW WITH FABRICE SEGUI - CEO FOR BNP PARIBAS PORTUGAL

By José Manuel Azevedo

3. Specifically on CIB, one could say that Securities Services business is a landmark for the Group's activities in Portugal. SS international operations centre started in 2008, in the very beginning of what would be a very tough period for the world's economy. That was a very courageous decision! Why did BNPP choose to do so in such adverse conditions? And how did BNPP overcome the challenge of launching this during the financial crisis?

Every business decision of this magnitude takes time to be planned and properly executed, as you very well know. When the first signs of a world crisis hit us, arrangements were already being made to establish the Lisbon International Operations Centre.

Having said this, in my opinion, the first and right question one should make is «why did BNP Paribas decide to do it despite the crisis?". And the answer to this question is a very straightforward one: because we saw huge potential in this country. Portugal is a safe, politically stable and culturally relatable country with highly trained and talented people. Backing out was simply not something we were willing to do.

This is also the «secret» of how we managed to be as successful as we were. We knew we were right. We kept investing, hiring and training more talented people to help us serve our clients; always knowing that Portugal had the potential for a full economic recovery. Thanks to this investment and our commitment to the country, BNP Paribas in Portugal consists today of a 6,000 people workforce (our estimate for the end of this year), who works hard to provide our clients with the best solutions to their business needs.

4. The growth of BNP Paribas in Portugal has been by all means outstanding. Will you please share some numbers of that growth with us?

The human side of our path is always a very interesting way of assessing our growth in Portugal. In the year 2000, we were just 400 people...

5. In your opinion, what are/have been the key success factors for such growth for BNPP in Portugal?

In my personal experience, it all adds up to the talent and amazing qualities of the Portuguese people. And to their unique way of adapting their skill set to almost every professional situation – good or bad – combining a high-quality formal education to a number of soft skills that usually prove themselves invaluable to get the job done.

6. Finally, for the future, how will you see the Group's activity evolve in Portugal? What are the main challenges you foresee for BNPP to continue their success in Portugal? And which are the areas where you think a significant leap will have to occur in the way business is done?

Our ambition is to continue to grow our local footprint, while actively contributing to the transformational journey of BNP Paribas worldwide. How? By continuously improving our operating model and by integrating and continuing to be an active part of the bank's 2020 transformation plan.

ESG INVESTING: WHAT, WHY AND WHO FOR?

By Louise Garampon and Estelle Goullioud

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG) IS BECOMING A BUZZ WORD; WHAT DOES IT REALLY REFER TO AND WHY IS IT SO COMPLEX?

Understanding Environmental, Social and Governance (ESG) has now become an important part of a robust investment process. A survey conducted by LGT Capital partners[8] illustrated that 75% of investors would integrate ESG into their investment decision. Banks have now taken this onboard and started to report on their ESG initiatives to differentiate themselves from their competitors. ESG reporting has slowly been replacing the reporting of Corporate Social Responsibilities (CSR) initiatives however, as each institution reports on their ESG initiatives differently, it has become misleading to investors as to which is of more value.

SO, WHAT IS THE DIFFERENCE BETWEEN CSR AND ESG?

CSR represents an institution's effort to have a positive impact on its employees, consumers, the environment and wider community. It's a form of self-regulation, encouraged by the United Nations Global Compact network that most large companies such as banks, UN agencies, labor & civil society and governments report on annually. ESG, on the other hand, attempts to reach a more precise assessment of a company's actions in terms of social and environmental impact, treatment of employees, management styles and innovative initiatives in production and after-sales care.

In early 2015, the United Nations (UN) introduced its 17 Sustainable Development Goals (SDG) to be achieved by 2030, they act as a blueprint to achieve a better and more sustainable future. On the back of these goals, the United Nations Environment Programme Finance Initiative (UNEP FI) established a partnership between the UN and private financial institutions to help create a financial sector that serves people and the planet whilst delivering positive impacts. To do this, the UNEP FI established 3 frameworks:

- Principles for Responsible Banking (PRB)- launched with more than 130 banks from 49 countries;
- Principles for Sustainable Insurance (PSI)- currently applied by one-quarter of the world's insurers;
- Principles for Responsible Investment (PRI)- currently applied by half the world's institutional investors.

For Corporate and Investment Banks (CIBs), of the three frameworks established, the PRB and PRI frameworks are most relevant as their activities simultaneously involve banking and assets management. These frameworks have now become the key pillars for many banking institutions thanks to the shift in the way investors are today investing. A survey conducted by the Thinking Ahead Institute[9] highlighted that, at the end of 2018, traditional investments had decreased by -3% whilst assets in ESG investments had increased over 23%.

SO HOW DOES AN INVESTOR KNOW WHETHER AN ORGANISATION SUCH AS A BANK IS ESG COMPLIANT?

As mentioned, many banking institutions have implemented the Principles for Responsible Banking (PRB) framework. This framework is dependent on the following 6 principles; Alignment, Impact and Target setting, Clients and Customers, Stakeholders, Governance & Culture and Transparency & Accountability.

Once the bank has fulfilled these pillars defined by the UNEP FI, they will be acknowledged as Principles for Responsible Banking followers.

MANY INVESTORS LIKE TO CONSIDER IMPACT INVESTING SO HOW IS ESG INVESTING DIFFERENT TO IMPACT INVESTING?

ESG focuses on the operations of an institution, while Impact Investing is taking the focus back on the products and services the institution is offering. CIBs are considered as both impact investors and ESG promoters due the service and products they offer. Differentiating one from the other is simple:

- ESG is embedded in the daily running of the organisation. It is a methodology implemented in the operations and management ecosystem of the company.

- Whereas, Impact investing relates to investors choosing to place their capital into purpose-driven businesses whose products or services follow several Key Performance Indicators (KPIs) that are compliant with the UN's global guidelines. These KPIs can be used to measure a bank performance on impact investing and ESG initiatives.

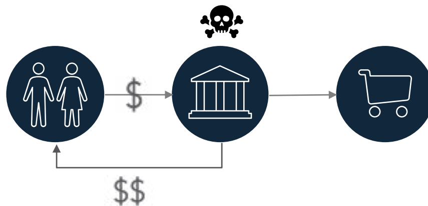
Organisations can influence their social footprint using both dimensions (ESG investments and Impact Investing). The way they offer or manufacture products and services, as well as the way the organisation is run are KPIs which can be measured.

[8] ESG to SDGs: The Road Ahead, LGT Capital Partners
[9] The world's largest fund managers 2019 – Thinking Ahead Institute

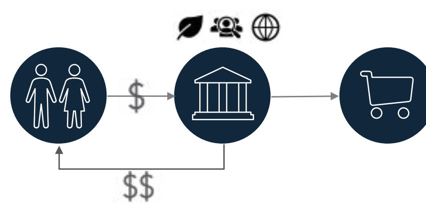
/ ESG INVESTING : WHAT, WHY AND WHO FOR?

By Louise Garampon and Estelle Goullioud

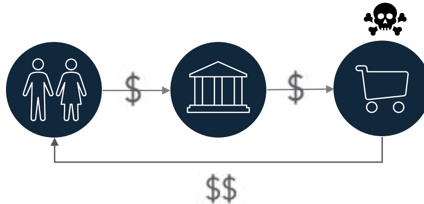
Traditional Investing
Investing in non-ESG compliant companies that trigger short-term ROI and no visible positive impacts



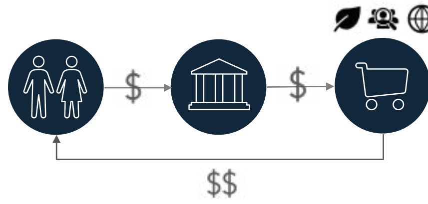
ESG Investing
Investing in ESG compliant companies that trigger ROI but also potential positive impacts that are visible in the long-term



Traditional Investing
Investing in non-ESG compliant products that trigger short-term ROI and no visible positive impacts



Impact Investing
Investing in ESG compliant products that trigger ROI and positive impacts in the long-term



CAN A BANK OPERATE AS AN ESG INVESTOR WHILST OFFERING 'IMPACT INVESTING' PRODUCTS?

Impact investing is estimated to be over $20 trillion in AUM or around a quarter of all professionally managed assets around the world[10] and with this, CIBs involvement is also increasing as they are finding interesting offsets to take part in and better engage in their ESG investments. This has a knock-on effect on the organisations themselves as they become ESG promoters as well as offering products that are ESG friendly enabling them to attract impact investors.

CIBs in recent years have been focusing on the environmental aspect of ESG and impact investing, this has mainly been driven by the wider social concern for the environment today. The benefit of this is that banks are developing new climate friendly products and for current products, climate impact is integrated as a financial risk on investments. For example, products such as transition bonds are being launched which aim to develop new technology to drive cleaner energy initiatives for organisations.

The following four types of products are sufficiently mature to comply with UN standards:

1. Bonds- As of October 2019, there are 4 different markets of ESG bonds that can be found: Green Bonds, Social Bonds, Sustainable Bonds and Thematic Bonds (such as Transition Bonds).

2. Exchange-traded fund (ETF)- In addition to CIBs, brokerage firms and mutual fund institutions have also begun to offer ETFs and other financial products that follow ESG criteria.

3. Sustainability Linked Loans (SLL)- The SLL market has also seen significant growth since 2017, growing from $5bn to over $40bn in 2018[11].

4. Equities - there is a growing demand for investing in shares or indexes of companies which are fully focused on ESG. Examples of such index include; Calvert Balanced A (CSIFX), iShares ESG MSCI EM ETF (ESGE), SPDR MSCI EAFE Fossil Fuel Free ETF (EFAX), JPMorgan Emerging Markets Equity A (JFAMX), and RBC Emerging Markets Equity A (REEAX)[12].

Demand for ESG products is clearly increasing and echoes with all generations: even if seniors and generation-X are much more represented in the wealth gap, millennials (generations Y & Z) seem to be the most eager to invest in ESG funds and products. They are increasingly aware of climate change consequences and the risks it poses to their future. They are moreover willing to act with the available resource and are capable of envisioning new potential to existing resource.

Banks now need to further question their roles in the impact investing value chain whilst complying with their regulatory environments and remain competitive in a fast-moving and uncertain economy. Still, a few remaining questions need attention when building win-win ESG strategies to maximise their impact, notably with regards to a consistent framework to independently rate and assess ESG product performance.

[10] The Remarkable Rise Of ESG, Forbes
[11] According to Environmental Finance
[12] ESG funds identified by the investment management firm Charles Schwab

AUTHORS

José Manuel AZEVEDO
Senior Advisor | Eurogroup Consulting Portugal

José Manuel has a wealth of experience in strategic project management, products and services portfolio valuation, process optimisation and market studies for Corporate, Investment and Retail Banking institutions. He is a pragmatic leader who shares the values of challenging and empowering his teams, encouraging innovation in every aspect of the initiatives he conducts. José Manuel graduated from ISCTE in Corporate Organisation and Management.

josémanuel.azevedo@eurogroupconsulting.pt

Dipen PATEL
Senior Consultant | Eurogroup Consulting UK

Dipen has extensive experience in delivering large scale transformation programmes focusing on operating model assessment and design. He has vast experience in delivering transformation in an Agile environment and has supported numerous leading financial services institutions in Europe with optimising their operating model. He holds a BA in Accounting and Finance and a Business Accounting Certificate for CIMA.

dipen.patel@eurogroupconsulting.com

Louise GARAMPON
Consultant | Eurogroup Consulting UK

Louise is a London based consultant with experience in leading strategic projects for institutions in multicultural environments. She has a proven track record of high-quality delivery and has developed her critical judgement regarding technology, sustainability and people management practices through her extensive work on benchmarks and international market researches. Louise holds a double master's degree from Sciences Po and ESCP Europe.

louise.garampon@eurogroupconsulting.com

Estelle Goullioud
VIE Consultant / Eurogroup Consulting UK

Estelle has been specialised in strategic and market intelligence for financial goods and services through her past experienced in the banking industry. She has been working for a year in the Paris and London offices of Eurogroup Consulting, doing M&A projects for banks and strategic researches about innovation or digitization in financial services and cross-industry. She is also in charge of the international Digital Business Community and Leadership & Innovation Management laboratory of Nextcontinent.

estelle.goullioud@eurogroupconsulting.com

Matthieu PRIEURET
Partner | Eurogroup Consulting UK

matthieu.prieuret@eurogroupconsulting.com

Nextcontinent consists of 15 consulting firms which are leading in their countries of origin: Germany, England, Argentina, Belgium, Chile, Spain, France, Ireland, Italy, Luxemburg, the Netherlands, Portugal, Singapore, whereby offices in South and North America, Africa and Asia are affiliated with Nextcontinent.

www.eurogroupconsulting.com
Eurogroup Consulting
@EurogroupFR
Eurogroup Consulting
www.nextcontinent.net