Global Structural Reform: Establishing a New-Era Response to Business Restructuring

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In Short

Major Pillars of Structural Reform

- Scrutiny from domestic regulations: Institutions have less jurisdictional flexibility and need to solve for each set of requirements in the countries where they operate.
- Governance of legal entities: Institutions need to consider how legal entities will be governed in the jurisdictions where they operate.
- Stricter stress testing: Institutions must demonstrate comprehensive and effective risk management, with comprehensive risk reporting by legal entity.

Regulations

- MiFID II
- Trading book review
- US GAAP
- DFA
- HKMA
- Liikanen
- IPV
- MMRS

Six Core Components of a Restructuring Plan

- Transfer Mechanics
- Capital, Liquidity and Funding
- Clients, Products and Business Model
- Operational Data and Configuration
- Processes, Systems and Infrastructure
- Organization, People and Property

Investment bank restructuring presents a strategic opportunity to transform, optimize capital and satisfy the bottom line, while aligning with global regulations.

The financial crisis has resulted in widespread bank restructuring driven by cost reduction, business optimization, competition and regulation. Initially, investment banks focused on immediate cost reduction and simplification programs; however, subsequent macroeconomic developments, coupled with the ensuing market and regulatory pressures, have triggered the need for structural change in business and operating models.

Rule-makers have been prolific in recent years, with individual jurisdictions seeking to reshape financial institutions and enhance their operational resilience. Since this persistent wave of regulation shows no signs of abating, banks can no longer rely on traditional ways of working and are being forced to make hard choices about their post-crisis business models.

Recent events revealed numerous weaknesses in global regulatory frameworks and banks’ risk management practices. Regulatory authorities are now considering new measures to increase financial market stability, including requiring each bank to provide a consolidated view across all businesses and types of risk (e.g., market, credit and liquidity risk). For example, the fundamental review of the trading book (FRTB) restricts banks’ capital, limits positions and curtails principal trading. As such, banks are faced with a new approach to market risk management.

Accenture sees seven major pillars of structural reform that are forcing change across each jurisdiction in which financial institutions operate:

1. Scrutiny from domestic regulations: Institutions have less jurisdictional flexibility and need to solve for each set of requirements in the countries where they operate.
2. Governance of legal entities: Institutions need to consider how legal entities will be governed in the jurisdictions where they operate.
3. Stricter stress testing: Institutions must demonstrate comprehensive and effective risk management, with comprehensive risk reporting by legal entity.
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4. **Capital and liquidity adequacy**: Local and global regulations are forcing institutions to operate in a more capital-restrained environment.

5. **Recovery and resolution planning**: Regulators are taking steps to ensure the stability of banking operations, including establishing provisions for state takeover in the event an institution becomes insolvent.

6. **Separation or cessation of activities**: These rules help prevent the failure of one legal entity or business line from causing systemic failure across the enterprise.

7. **Geography-focused finance**: Institutions need to consider reorienting their financial ledgers, performance management and reporting to support financial operations at the jurisdictional level.

Unlocking the potential of global structural reform

Investment banks are now prepared to face the reality of this task—whether they have had time to digest their position or are playing catch-up with competitors. UBS was one of the first banks to announce a major shake-up in 2011. More recent examples include Barclays, which announced a rightsizing and refocusing in May 2014, and Deutsche Bank, which announced plans to shrink investment bank operations and product scope in April 2015 and recently closed its Russian investment bank. In October 2015, Credit Suisse announced a new strategic direction under CEO Tidjane Thiam, which included a deep restructuring and Asian expansion.

Banks must synchronize their regulatory and strategic business planning and make restructuring in response to regulation part of their business strategy toolkit. Looking at the regulatory landscape holistically can help banks identify inter-regional synergies to leverage (see Figure 1).

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**Figure 1: Inter-regional synergies across the regulatory landscape**

Source: Accenture Research
Evaluating the business mix

As investment banks look to tackle the restructuring challenge, five core considerations must be reviewed against business priorities. These considerations can help banks optimize capital and satisfy the bottom line, while adhering to regulations.

1. **Business activities**: Shifting and streamlining core investment banking activities can help banks align specific activities with specific regions for business benefit. For example, concentrating broker-dealer licenses in a single jurisdiction may be cheaper than having licenses in multiple jurisdictions, particularly in low-volume situations. Activities such as securities trading, securities financing, securities warehousing, derivatives management, cash management and clearing can be analyzed for streamlining opportunities. Further examples include shifting from principal to agency business models, or leveraging the opportunities provided by trading venue development (i.e., systematic internalizer).

2. **Geography**: Tailoring propositions to geographic markets can help banks use scarce capital more efficiently. For example, the Royal Bank of Canada expanded its US wealth presence by acquiring City National Corporation.6

3. **Product mix**: Developing a targeted set of offerings can help banks allocate capital to business lines that generate appropriate returns on equity and potentially discontinue other products. Barclays’ recent group strategy update highlighted similar themes, including plans to reallocate capital to growth businesses.7

4. **Client mix**: Targeting profitable client segments and exiting relationships that have a high cost of service can help banks improve their client mix. According to various news articles, Bank of America Merrill Lynch has parted ways with a large number of hedge fund clients in an effort to reduce costs.8

5. **Financial optimization**: Focusing on a combination of the factors listed above with a clear goal of optimizing capital, liquidity, funding or taxation can help banks reduce costs and increase net capital or revenue gains.

Investment banks should examine business lines at a regional level, choosing which ones to maintain locally, which ones to move elsewhere and which ones to gradually phase out. Key factors to consider include regulatory maturity in each market or asset class, the level of inter-regional homogenization and opportunities for delocalization (see Figure 2).

### Figure 2: Optimization of business mix choices by asset class

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Regulatory Maturity</th>
<th>Regulatory Homogenization</th>
<th>Regulatory Pressure</th>
<th>Geo Opportunities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Securities</td>
<td>High, Globally</td>
<td>Medium</td>
<td>Growing</td>
<td>n/a</td>
</tr>
<tr>
<td>OTC Derivatives</td>
<td>High, Globally</td>
<td>High</td>
<td>High</td>
<td>Differences in central clearing requirements across geographies</td>
</tr>
<tr>
<td>Funds</td>
<td>High, US &amp; EU, Growing</td>
<td>Low</td>
<td>High</td>
<td>Differences in taxation regimes</td>
</tr>
<tr>
<td>Collateral Transaction</td>
<td>High, US, EU</td>
<td>Growing</td>
<td>Medium</td>
<td>Differences in collateral accepted and cross-margining possibilities across regions</td>
</tr>
<tr>
<td>Money Market</td>
<td>Low, Globally</td>
<td>Growing</td>
<td>Low</td>
<td>Repo accounting</td>
</tr>
<tr>
<td>Commodity</td>
<td>High, Growing</td>
<td>Low</td>
<td>High</td>
<td>Different regulatory pressures in US and EU</td>
</tr>
<tr>
<td>Credits</td>
<td>High</td>
<td>High</td>
<td>High</td>
<td>n/a</td>
</tr>
<tr>
<td>Proprietary Trading</td>
<td>High, US &amp; EU</td>
<td>Low</td>
<td>High</td>
<td>Fewer regulatory constraints in emerging markets</td>
</tr>
</tbody>
</table>

Source: Accenture Research
A structured framework to deal with restructuring

Restructuring exercises require banks to consider a number of factors—a potentially cumbersome process if the bank has a particularly complex organizational structure. Without a logical framework, it can be challenging to determine the robustness and completeness of a restructuring plan. Typically, investment banks will need to consider six core components (see Figure 3).

These components should be considered at each stage of the restructure, from due diligence to legal close, and accompanied by stringent regulatory and program management.

A structured framework is not a one-size-fits-all solution. Rather, such frameworks can help banks increase certainty and speed when conducting certain initiatives. In addition, calibration of local and global regulations can help frame implementation programs.

New business and operating model, new mindset

Against this backdrop, a “consolidation” operating model is starting to emerge. Investment banks are looking for ways to simplify their structures by streamlining their business activities and ultimately “thinning out” their legal entity structures to support consolidation and net capital benefits.

Regardless of what shape the business restructuring takes—for example, disposals or exits, acquisitions, transfers to improve capital and funding positions, transfers to improve resolvability or wind-downs—there is no single solution for responding to this challenge. Each institution’s response should reflect its strengths, weaknesses and future expectations. Banks can begin by taking the following steps:

1. Organize a long-term response. Institutions need to think end-to-end across regulations and geographies, and holistically assess and communicate impacts across their business and operating models—to streamline the change response and identify smart investments.

2. Aim for market-driven specialization. Institutions can address competitive challenges by focusing resources and attention on certain customer, product or geographic market segments. They need to consider the type of business they want to conduct in each location and the practical operations required to sustain those businesses.

3. Focus on compliance and efficiency. Reputation may be a competitive advantage in the future, with clients and customers drawn to firms with strong ethical reputations that are capable of meeting their needs efficiently.

4. Demonstrate value to stakeholders. Value can only be realized if planning is adopted effectively throughout the business. Further tuning of the new operating model will be required to help retain engagement and support from internal and external stakeholders.

Figure 3: Core components of investment banking restructuring

<table>
<thead>
<tr>
<th>Transfer Mechanics</th>
<th>Includes the design and execution of legal mechanisms to effect the transfer, and associated client/market communication, rebooking, hedging and funding activities in the sending and receiving entities.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital, Liquidity and Funding</td>
<td>Involves managing the transfer within the constraints imposed by the balance sheet and capital position of sending and receiving entities.</td>
</tr>
<tr>
<td>Clients, Products and Business Model</td>
<td>Includes managing the transfer of “live” revenue strategies, critical client relationships and trades. Corporate structure and assets may need adjusting to maintain the viability of the transferring business.</td>
</tr>
<tr>
<td>Operational Data and Configuration</td>
<td>Includes managing the definition, remediation and setup of client, instrument, price, hierarchy and calendar data in the receiving entity, and making any adjustments within the sending entity.</td>
</tr>
<tr>
<td>Processes, Systems and Infrastructure</td>
<td>Involves the extension of receiving execution and control infrastructure by enhancing existing or integrating transferring capability. Will address business process and information, application functionality and technical services.</td>
</tr>
<tr>
<td>Organization, People and Property</td>
<td>Involves consulting with staff bodies and organizational restructuring. Also involves the provision of premises and third-party services and associated contract novation.</td>
</tr>
</tbody>
</table>

Source: Accenture Research
About Accenture

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