



**Investment Banking
current and future
challenges and changes**

Don't react to change
Create it.

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Current and prospective industry challenges, changes, disruptions

The challenge for the investment banking industry revolves around higher capital charges, market electrification & digitalisation, stuck cost base, inflexible and layered technology with increased complexity of regulation and reporting.

1. Regulation drives business behaviour

Banks are already fully engaged in meeting the IFRS 9 requirements and the resulting changes to their business model with specific focus on provisioning. Pressure to build appropriate models and data requirements only leads to greater complexity.

Basel III has increased focus on maintaining core liquidity and leverage ratios with pressure on reducing short-term funding, holding more liquid assets, raising long-term wholesale funding, while reducing leverage both on and off balance sheet.

2. Capital is scarce

The effect of Basel III has resulted in fundamental shifts in product profitability. Structured derivatives and long dated transactions pre-crisis & Basel 3 in many cases are now a drag on ROE. This has resulted in the shift towards the creation of non-core divisions to dispose of unprofitable transactions & portfolios. Commoditised exchanged traded OTC products has resulted in a fundamental change in margins and capital management.

3. Pressure on costs as suboptimal ROE bites

Investment banks face significant pressure to reduce their cost base as regulation has bitten. Industry experts predict only 5 to 6 investment banks

will be successful as “transformational” cost initiatives fail to deliver results on the back of complex infrastructure and governance hurdles.

4. Banks are required to utilise their customer knowledge to not only retain but grow their customer returns through more effective cross sell.

The ability to measure and cross sell products has become increasingly important to a company's ability to remain competitive, while best servicing all bank customers with an eye on capital returns.

5. The emergence of Fintech companies creates a disruptive marketplace

The African financial services market is expected to be one of the most receptive FinTech markets globally, opening the door to disruption across the end to end investment banking value chain. Blockchain is rapidly seen as changing the face of cross-border lending activity.

6. Outdated, inflexible physical infrastructure restricts movement and growth in the current digital age

The traditional infrastructure of banks (both physical and technical) has proven to be inflexible to change and this renders their ability to survive “as is” in a disruptive marketplace potentially unlikely.



7. Increasing complexity of reporting and responding to new and evolving regulation with focus on data optimisation

The evolving demand for reporting compliance including governance outlined in BCBS 239 & Pillar 3 poses new challenges to all banks. This increases the pressure on data optimisation through accuracy, timelines & granularity of risk & financial reporting requirements.

8. The client onboarding conundrum

The increased pressure for banks to both historically clean up their adherence to AML and KYC and remediate & streamline their current procedures. The cost of compliance continues to rise with higher capital requirements resulting in the review of existing business model both geography and client segments.

9. Disruption is ripe in all financial markets

Disruption in markets such as foreign exchange is reshaping the banking landscape and how the traditional players exist in the ever-changing landscape with decreased market share and margins.

10. Market Place Lenders

Securitising consumer debt as the challenge to raise funding to match new lending activity with 90% of fees from new loans with increased financing from Institutional investors. Regulators push for greater transparency indicating disclosures. A bubble in the making in the current low interest-rate environment?

11. Cyber Security

Number of cases of digital theft from Banks through bypassing risk controls within Swift. Swift processes \$6tn transfers daily with 11 000 members. EBA to stress test financial institutions to assess vulnerability to hackers & Swift to implement "two factor" authentication.

12. Regulators get tough on BCBS 239

A number of regulators globally are now seeing adherence to meeting BCBS239 as a compliance requirement as opposed to set of principals. This has resulted in considerable investment cost to meet the current deadlines. Watch this space.

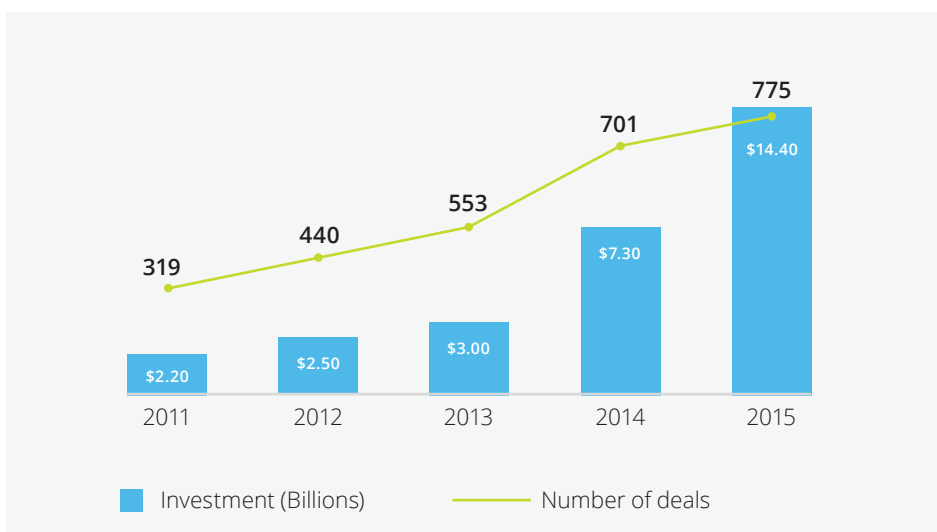
The Financial Services industry catches FinTech fever

“FinTech heralds the dawn of narrow banking and portfolio optimisation. It will change the nature of money, shake the foundations of central banking and deliver nothing less than a democratic revolution for all who use financial services.” **Mark Carney, governor of the Bank of England**

Annual global investment in the FinTech industry has grown by a factor of 6.5 multiples in the past 5 years, representing a compounded annual growth rate of 45%. Goldman Sachs, Citi and Santander were the most active investors among the large banks. Central banks have also entered the fray with the Singaporean central bank funding a Blockchain-based record-keeping system as part of a five-year \$225m

investment, the Canadian Central Bank announcing it is working with the country's largest banks to develop an electronic version of the Canadian dollar and the Bank of England's intent to use Blockchain and a digital central bank currency to widen access to its real-time gross settlement system (RTGS), which processes £500bn worth of transactions each day.

Annual Global VC Investment in FinTech



Source: Deloitte analysis on CB insights data



The future of the investment banking landscape

The changes and evolution of the financial services landscape that we have seen to date is just the beginning of an ever-developing eco-system. Success in this new environment will force changes in the way financial institutions see themselves and their customers, the way in which they tailor and channel pioneering products, and the innovative strategies they use to combat new disruptors.

- **Decreased customer profitability and increased competition**

Customer profitability and measurement of capital has become an increased focal point as banks continue to operate in an ever competitive market. As competition grows, margins will be squeezed and ultimately only the most efficient companies will survive.

- **Continued development and optimisation of data sources as duplicate demand for information and reporting continues to increase**

Leveraging data sources will provide institutions with a more granular view of the marketplace and the existing risk. This ability will offer new firms a competitive advantage as they are able to tailor their risk and business model strategy. Existing competitors will also benefit from leveraging this information to identify untapped opportunities within the marketplace. Investment banks are set to utilise this data to raise profitability, map out markets and company exposures and ultimately - win more deals. The analysis will boost profitability by promoting a better understanding of the customer and placing the institution in a better position to understand and meet their client's needs.

- **Volume driven profitability (rather than margin driven)**

Margin driven products and profitability are set to make way for volume drive operations as the competitive landscape continues to develop

- **Major focus on cross sell of products with eye on capital returns**

Financial institutions will continue to develop their need to ensure effective cross-selling of products and services to maximise capital returns

- **Compensation subject to balanced independence risk score-cards assessment**

In years past, excessive risk-taking was driven by the potential for excessively large rewards, this is set to be a thing of the past driven mainly by the expected increase in use of developed independent risk score-cards assessment for financial institution leadership

- **Continuing development of regulations such as Twin Peaks will force transparency**

Regulations such as Twin Peaks encourages transparency and enhances the integrity of the banking market by placing equal importance on market and prudential conduct supervision

- **Structured derivatives are set to become the domain of a small number of investment banks**

Structured product's ability to offer customised exposure, including to otherwise hard-to-reach asset classes and subclasses, are set to make structured products important as a complement to these other traditional components of diversified portfolios

- **Financial engineering requirements become a vital part of any successful banking structure**

As reporting complexity and maturity continues to develop, financial engineering requirements are set to be limited to specialised and well capitalised financial institutions

- **Independent pricing vendors are set to be used by all financial institutions**

As competition in the financial institutions landscape continues to strengthen, independent pricing vendors forcing transparency and equilibrium are set to be key

- **Confluence of Disruptors**

Blockchain is forcing Financial Services transactions can be digitised and securely distributed – will impact F2B lending, Syndication & Trade Finance

- **Bitcoin Stability Risk**

Financial Stability Oversight Committee has warned that like most new technologies certain risks & operational vulnerabilities with such systems until they are deployed at scale. Dramatic increases in transaction delays & failures as new Bitcoin transactions exceed the speed they can be added to the Blockchain

- **New Digital Currency to clear & settle trades**

Four of the world's largest banks combine resources to develop a new form of digital currency to clear & settle financial transactions which is estimated to cost the industry \$65bln to \$80bln annually. Based on Blockchain technology to speed up settlement & freeing up billions of pounds of capital by creating utility bitcoin that are directly convertible into cash at central banks, cutting the time and cost of post-trade settlement and clearing.

- **The continued evolution of FinTech means flexibility becomes crucial to survival**

Understanding, regulating and maximising the benefit of FinTech is set to be a critical means of not only success, but also survival in the investment banking landscape of the future

- **Intelligent Risk Culture**

Becomes a key competitive advantage by shifting from overnight to real time. This requires a significant shift in Technology & Organisational capability

- **Optimising Collateral**

The increased cost of capital has resulted in the need to optimise collateral assets and obligations. Increased sophistication with the use of algorithmic methodology with haircuts, concentration requirements and eligibility are major considerations

- **Service Centres of the future**

Increased use of robotics will result in a significant shift in size and structure of current service centres run by financial institutions leading to greater efficiencies and improved control environment

- **Standard Initial Margin Model for Non-Cleared Derivatives**

The push to develop and implement a standardised methodology for OTC derivatives not settled through clearing houses eliminating collateral disputes in a market of 170th % national value

- **European Stress Testing Lessons for Africa**

While the EBA's stress testing results for European Banks was largely positive it stressed emphasis on the need for strong CET1 capital to avoid additional capital raising

Linking our unique African integrated offerings

Strategy and Innovation

We help our banking and investments clients deal with changing operating model structures, business and finance transformations, evolving customer expectations and changes to the ecosystem which redefine the rules of financial services.

Capital Markets

We proactively assist banks and corporates to implement risk management, capital and funding (incl. liquidity) frameworks. We also assist clients to leverage their systems to better manage their balance sheets, while providing regulatory and accounting expertise and advisory.

Deloitte Digital

We help clients reimagine how profits are generated, and how relationships with your customers are created and managed. We reshape how work gets done, and rewire the competitive fabric of entire industries. That's the power of driving disruption.

Risk and Analytics

We maximise the performance of internal business operations by identifying, predicting, resolving and mitigating imminent threats and obstacles as well as enhancing the value of these operations.



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