Global Banking Outlook 2017

Uncertainty is no excuse for inaction
2017 must be the year that banks move decisively to improve their profitability.
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Innovation is necessary to drive meaningful improvements in performance.
Executive summary

The year ahead is one of uncertainty for many banks, with the implications of Brexit for the UK and the European Union (EU) unclear, the election of Donald Trump as President of the United States raising questions about the future direction of banking regulation in the US and European pushback on so-called “Basel IV” regulations driving delays in finalizing those rules.

The last year has highlighted weak and eroding profitability for many banks around the world. Even in emerging markets, profitability has been squeezed as global economic growth has weakened. Profit trends may strengthen in 2017 – particularly for US banks, which are positioned to benefit from higher interest rates and the recovery in consumer and business confidence that followed the US election. However, the sustainability of improved trends in the operating environment – and how transferable these improvements are to banks in other advanced economies and the emerging markets – remains uncertain.

But uncertainty cannot be an excuse for inaction

EY 2017 global banking outlook survey – a survey of senior executives at almost 300 banks across the globe – shows that only 11% of respondents expect their banks’ financial performance to improve significantly in the next 12 months. And while the survey indicates that the risk and regulation agenda will continue to dominate the attention of management and decisions about spending over the next year, our research shows that many of the world’s largest banks are starting to think about how to improve financial performance by growing or optimizing their businesses.

While the challenge for banks is how, in a year of uncertainty and with little cash to invest, they can improve their financial performance, we expect the shift from “keeping safe” to “making things better” to gather pace over the coming year. We believe there are short- and medium-term steps banks should take in five specific areas to help them address both a “keep safe” and “make things better” strategic agenda.

- **Reshape:** Rethink basic organizational structures, consider M&A strategies and find new ways to grow profitably in response to regulatory and market pressures.
- **Control:** Ensure that financial risk and financial performance are singularly sourced, measured, validated and reported.
- **Protect:** Holistically address threats to business continuity from both external and internal actors, including cyber and financial crime.
- **Optimize:** Use new operating models and technologies to address the challenges of margin pressure, customer experience and compliance.
- **Grow:** Regain profitable relationship growth in an era of heightened customer expectations and nontraditional market entrants.

The successful execution of strategies in each of these areas, will require banks to think and operate differently. Innovation will be necessary to drive meaningful improvements in performance.
2016 was a year of surprises and transition. 2017 must be the year that banks move decisively to improve their profitability.

2016 started on a wave of anxiety, as commodity prices tumbled and concerns about global growth escalated sharply. The first quarter of the year – typically the strongest for capital markets revenues – was historically weak. Conditions stabilized in the second quarter, but then came a pair of political surprises – the outcomes of the UK referendum vote to leave the EU and the US presidential election. While markets largely took the vote surprises in stride, both may have significant long-term implications for banks.

Against the challenging operating environment, banks in developed markets continued to struggle to deliver ROEs that were higher than their cost of equity. ROEs also disappointed in the emerging markets, reflecting the impact of slowing economies. In terms of transition, the prudential regulatory framework is now well established and the program of policymaking for capital, liquidity and resolution rules is coming to a close, with many major reform decisions now in place.

But, while 2017 will see a shift toward implementation and supervision, this will not necessarily translate into a natural profit tailwind for banks.

Instead, in 2017, we expect that the shift from setting policies to implementing rules will demand a significant compliance effort – and investment – that is unlikely to be offset by a surge in revenue growth. In addition, the introduction of total loss-absorbing capacity (TLAC) as a resolution tool brings an explicit recognition that investors will be “on the hook” if things go wrong; the associated implications of this for credit ratings and cost of capital will likely exacerbate banks’ challenges in improving profitability.

Equally, in terms of conduct, recent fines and discoveries of past misconduct show there is still a need for banks to clear up legacy issues and change their culture. Although significant progress has been made on this front, there remains a major challenge in implementing mechanisms to prevent a recurrence of problems. Institutions cannot allow large fines to continue to destroy their capital bases.

**Figure 2**

No signs of recovery: return on average equity for world’s 200 largest banks (%)

Source: SNL Financial, EY analysis
We also expect that banks will continue to shrink their footprints in certain businesses in 2017 – for example, correspondent banking – where the risks of breaching increasingly stringent regulation are exceptionally high. While this will make them safer, it will also reduce their future opportunities.

And finally, although regulators may be coming to the end of setting policies related to prudential supervision, we anticipate that they will turn their focus to the implementation of these rules, as well as consumer protection and cybersecurity reforms, all of which will demand greater management attention and capital investment.

Our 2017 global banking outlook survey confirms these trends and reveals that risk and regulation will continue to dominate management attention over the next 12 months.

According to the survey, the top five strategic priorities for banks in 2017 are:

1. Managing reputational risk, including conduct and culture risks
2. Meeting regulatory compliance and reporting standards
3. Enhancing data security and cybersecurity
4. Meeting capital, liquidity and leverage ratio requirements
5. Recruiting and retaining key talent

Notably, four of the five priorities in this list are aligned with the “keeping things safe” agenda.

Despite this, we expect 2017 to also be the year that banks increasingly look for ways to improve their ROE. According to our analysis of the publicly stated strategies of 30 major banks around the world, while their strategic priorities vary across regions, many are focused on “making things better” by growing and optimizing their business (see Figure 3). We believe it is possible for banks to reconcile conflicting priorities to improve their financial performance, while also enhancing their control and protection agenda.

- **Reshape the business:** Banks must clearly articulate a core strategy – do they want to dominate local markets, be regional champions or establish themselves as universal super banks that provide a full range of services to a global customer base? They will need to identify their strengths and then restructure operations to reflect them, while also being more mindful of their legal entity structure and the danger of ignoring innovation.

- **Control the business:** As compliance and risk management remain a priority, banks must also enhance their application of the three lines of defense to nonfinancial issues, strengthen their focus on vendor management and simplify their supply chains to manage associated risks. At the same time, banks must improve the efficiency of the risk management function, using technology or centers of excellence to scale down testing and surveillance teams.

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**Figure 3**

Banks’ strategic focus differs by region

Source: Company reports, EY analysis
Protect the business: Banks must rebuild trust. The right organizational culture will be a key differentiator for leading banks. In addition, given the ongoing – and extensive – threat of cyber- and financial-crime, banks must make their systems secure, use technology to maximize the coverage of internal protection and adequately train and supervise their staff. In addition, banks must embed a focus on cybersecurity in their digital and FinTech agenda.

Optimize the business: Banks must develop new operating models that take advantage of technology and partnerships to improve service and reduce cost. Over the medium term, we expect utilities to play an increasingly significant role in driving efficiency. In addition, banks will need to do more to optimize their balance sheets in the face of multiple market and regulatory constraints.

Grow the business: To regain profitable growth, banks must determine the clients they want to serve and harness the power of analytics to serve those customers better. They must also define their product portfolios and the geographic footprint of the organization.

Our analysis also revealed that the maturity of strategic actions banks are taking to keep safe and make things better varies significantly. Looking at growth, for example, some banks are simply seeking to protect their existing market positions, while others are ambitiously investing in new technologies and customer segments. There is a similarly divergent approach to “reshape,” with some banks maintaining their current business structures while exiting selected non-strategic markets, and others actively building alliances with FinTech companies in an effort to find new ways to grow profitably.

To drive meaningful ROE improvements banks will need to innovate. They must look for new ways to operate their business and deliver against client expectations. Doing this alone will be challenging, and we believe they will likely become increasingly dependent on an ecosystem of providers to help them drive innovation and implement change.
Banks will become increasingly dependent on an ecosystem of providers to drive innovation and implement change.
Reshape: set clear strategy and consistent structure

Most banks have undergone at least one post-financial crisis strategic review in response to regulatory reforms and the challenging operating environment. Many of these reviews resulted in difficult decisions about exiting noncore businesses, customers and geographies, rationalizing product offerings and, in some cases, replacing top management. Some banks now have a good idea of the future business model that they are working toward.

For those that have less certainty about their strategic path, however, the time to act is now. It is time for these banks to stop doing what they don’t do well and start focusing more on their competitive advantages. Reshaping with a forward-looking perspective will require them to act on three things: defining a business model, embedding consistency in their operating model and identifying how to drive innovation by participating in an ecosystem of providers.

First, banks must determine what they want to become. We see the industry coalescing around four primary business models: local boutiques, global boutiques, regional champions and universal super banks (see Figure 4). In addition, a new category of challenger banks and innovative disruptors is emerging. These firms have the agility to use technology to exploit the evolving industry landscape and could pose a competitive threat, offer opportunities for collaboration or both.

Simultaneously, banks must refine their legal entity structures, especially as they seek to address recovery and resolution planning requirements. We believe the defining characteristic of a transparent, efficient and compliant operating structure is consistency. This is especially important in the current (and likely permanent) environment where domestic regulators have taken a super-equivalent approach to implementing global capital and liquidity rules and where a consistent structure across countries and segments can facilitate resolution planning and minimize systemic risk. For some banks, establishing an intermediate holding company may address these objectives and also yield other benefits, such as greater efficiency in raising and allocating funding, a more logical alignment of legal entities with business lines and reducing the complexity of processes across the group.

Finally, to grow profitably, banks must embrace and accept innovative ideas — from both internal and external sources. According to our 2017 global banking outlook survey, not enough banks have prioritized this imperative. While, for example, 68% of Global systemically important banks (G-SIBs) see partnering with FinTech firms as a critical activity over the next year, just one-third of Non-global systemically important banks (non-G-SIBs) do. We believe that as banks reshape their business model and legal entity structure, they will also need to ensure that they are establishing the infrastructure, culture and network necessary to participate in a rapidly evolving ecosystem of innovative competitors and partners that will allow them to develop and adopt potentially revolutionary advances in technology.
Figure 4
Four potential future business models

1. **Local boutiques**
   - Small and mid-sized domestic banks serving retail and business customers with their home country, state or province; also represents banks that have a core focus on a particular product or service, such as credit cards, mortgages, niche investment or wealth management.

2. **Regional champions**
   - Built on local expertise and a targeted customer base; represents banks that operate major business lines across multiple countries or provide a full-service offering in their home markets.

3. **Global boutiques**
   - Provide selected services and products to global clients (e.g., leading M&A advisory internationally).

4. **Universal super banks**
   - Truly international in coverage and depth; provide a full range of services to a global customer base.
Figure 5
The reshape agenda: strategic priorities for banks in 2017*

Top three reshape priorities - all banks

- 43% Simplifying/restructuring business operations or legal entities
- 39% Developing partnerships with industry disruptors/FinTech companies
- 24% Developing partnerships or joint ventures with other financial organizations

G-SiBs
- Developing partnerships with industry disruptors/FinTech companies: 68%
- Simplifying/restructuring business operations or legal entities: 64%
- Collaborating with peers to develop industry utilities: 41%

Non-G-SiBs
- Simplifying/restructuring business operations or legal entities: 40%
- Developing partnerships with industry disruptors/FinTech companies: 33%
- Developing partnerships or joint ventures with other financial organizations: 24%

Source: EY 2017 global banking outlook survey

*Percentage of respondents ranking strategic initiatives 8, 9 or 10 on a scale of 0 (not at all important) to 10 (very important).
An action plan for reshaping the bank

- **Identify core strengths and define preferred business model.** We advocate that banks use big data to support their decision-making as they determine what they want to become. When detailed information such as a time series of returns aligned to the current and future regulatory environment is simply not available, strong leadership will be required to overcome the data gap.

- **Deliver preferred business model.** Once a business model has been decided, banks must answer a series of critically important questions related to purpose, target customers, core products and services, distribution model and innovation strategies. The answers to these questions and the steps taken to implement them will determine whether individual banks emerge as industry leaders, recede into irrelevance or fail altogether.

- **Implement a plan of action.** Once the preferred state is defined, banks should identify a course of action to get them there organically (special projects, launches, campaigns, wind downs); inorganically (disposals, acquisitions); or ecosystem change (working with partners, alliances, suppliers, joint ventures, etc., in different ways).

- **Reshape the legal entity structure.** The growing focus on recovery and resolution planning is making it more difficult for banks to move capital, funding and liquidity across jurisdictions. As a result, banks must embed consistency into their legal entity structures and if feasible, move to a global holding company structure that oversees discretely regulated businesses.

- **Set a “tone at the top” to drive an innovative culture.** The top levels of management must make it clear that innovation is an expected trait of leaders throughout the bank. Banks should establish a governance framework to support efficient innovation, set a zero-tolerance policy for anti-innovative behaviors and, crucially, develop internal talent who can successfully engage external ecosystem partners.

- **Define an innovation operating model.** Banks should consider what type of innovation operating model – centralized, decentralized or hybrid – they want to adopt. A hybrid model could make the most sense as it integrates the experts who know how to innovate with the business units that know where innovations are needed. At the same time, a hybrid model may provide banks with the flexibility needed to drive innovation through external partnerships and collaborations.
Control: enhance three lines of defense

Regulators are approaching the end of prudential regulatory policy setting and the key components of the new framework are now well-defined. However, this does not mean that banks can relax their focus on compliance; instead, they face a daunting implementation effort in the years ahead. Additionally, global regulators are expected to increase their scrutiny on consumer protection and nonfinancial risks in the years ahead, which means new rules in those areas are likely to emerge. Furthermore, in the domain of tax, now that a system of global information exchange has been established on customer tax data, banks can expect a new phase during which tax authorities start to use this new data source to identify areas of non compliance.

Despite banks’ aspirations to shift their strategic efforts to an agenda focused on optimization and growth, EY 2017 global banking outlook survey shows that in the short term, compliance will continue to be the primary priority of banks around the world. Indeed, meeting regulatory compliance and reporting standards is one of the top overall priorities for banks around the world in 2017. (See Figure 6.)

Where historically banks have focused on delivering ROE targets against one regulatory constraint – capital – today, ROE generation is contingent on first meeting an array of requirements for capital, funding, liquidity, leverage and tax reporting. In addition, the world’s largest banks have to demonstrate that their business can be resolved easily and in a timely manner without an adverse impact on the financial system. And this level of accountability is even harder in an era where regulators are scrutinizing vendor risk management more thoroughly.

According to EY 2016 global banking risk management survey, banks have meaningfully improved their risk management processes in the years since the financial crisis, but there is more work to do. Now is not the time to be complacent about their progress. Instead, banks must continue to strengthen the three lines of defense risk management model, seek ways to better manage nonfinancial risks and remain poised to develop a sustainable response to changing regulatory demands and timelines.

Figure 6
The control agenda: strategic priorities for banks in 2017*

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An action plan for enhancing controls

- Increase first-line accountability and change culture and incentives. Banks must strengthen first-line accountability for financial and nonfinancial risks, realign control functions, train the front line on risk and devolve risk appetite further down into business lines. Bank boards and executive management teams must act now to change the culture of their firms by embedding a risk management and control mindset in day-to-day business decisions, processes and procedures.

- Clarify responsibilities across lines of defense. A critical component to enhancing three line model effectiveness is clarifying and communicating the roles of the first and second lines. There is no industry standard as to which controls should sit in the first or second line. For example, while most banks have their first line perform business-line activity controls, with the second line owning key risk policy, performing control testing and designing the control framework, the industry is split on who performs control monitoring.

- Adopt firmwide processes and tools. The adoption of common firmwide risk-and-control tools and processes across the three lines of defense is a key component of success. While many firms have processes in place for identifying, assessing and reporting risks, issues management processes and the underlying technologies remain a challenge. Effective implementation of risk appetite frameworks will play a crucial role in properly reinforcing the three-lines-of-defense approach.

- Improve balance sheet management. Banks must develop tools and processes to manage and optimize their balance sheets across a range of market and regulatory constraints. In addition to product and customer segments, legal entity and jurisdiction will become important dimensions.

- Tighten ecosystem management. As banks outsource tasks previously done in-house to vendors, partners and utilities, they will need to take steps to hold these counterparties to the same standards as their own employees. However, banks will need to work with their counterparties and regulators to develop and agree on appropriate models for sharing risk.

- Enhance crisis management capabilities. Banks must improve their crisis management and recovery and resolution planning capabilities so that in the event of stress, the organization has an effective toolkit, contingency action plan and clear communication protocols that can be deployed in a timely and effective manner. Banks will continue to be under pressure to demonstrate that their business models and growth strategies do not lead to systemic risks or the need for a bailout.

- Invest in data and analytics and optimize risk management. Banks must make significant investments to enhance their legacy data and technology architectures to pre-emptively detect potential breaches of controls and limits (e.g., trade surveillance). Testing and surveillance teams should be scaled down while banks make greater use of robotics and centers of excellence to manage risk more effectively.

- Search for the blueprint for strategic success. In the short term, the ongoing implementation of the global capital and liquidity agenda will make tactical and strategic adaptation the name of the game. Regulatory uncertainty, due to new proposals, changing implementation deadlines and differences across jurisdictions, will be with banks for a while. Ultimately, however, banks will need stable, sustainable business models appropriate for the demanding regulatory environment.
Protect: minimize internal and external threats

The post-crisis era has been characterized by a wide range of banking scandals, including claims of Libor manipulation, sanctions and tax violations, improper sales of mortgage securities and payment protection insurance, and more. Resolving these matters resulted in steep fines and legal settlements – aggregate conduct costs for 20 large global banks from 2011-15 were more than US$370b – which wiped out earnings and also shattered trust in the banking industry.

While many banks have responded by hiring compliance officers, implementing new codes of conduct and changing incentive structures, more must be done to rebuild the trust of clients, regulators and investors; a culture change and greater investment in cyber and data security and technology are needed.

For example, while in a functional area like tax, technology has traditionally been seen as a cost and efficiency play, the rapid adoption of new and more powerful technologies by tax authorities will change that paradigm. As tax authorities move towards collecting underlying transaction data and applying analytics to whole data sets we expect that to shine a light on underlying data quality and robustness of tax controls. Accordingly, banks should look to apply technology in tax not to simply automate tax return processing but to protect the bank against increasingly data rich audit challenges by tax administrations. More strategically, tax administrations are actively engaged in understanding the potential for block-chain to transform the tax environment, as well as the use of technology, strengthening the role of banks in the operation of tax systems within national economies.

As banks seek to restore their reputations, they must put legacy issues behind them, demonstrate that they have systems in place to prevent money laundering and financial crime, and also fulfill the remediation plans agreed to with supervisory authorities. Even more difficult, they must prepare for and protect against potential future system outages and cyber attacks.

Our 2017 global banking outlook survey found that, along with managing reputational risks, one of the top priorities for banks in the coming year is enhancing cybersecurity, while managing the threat of financial crime is emerging as a major concern for globally systemically important banks (see figure 7.)

The challenge for banks is to holistically address threats to business continuity from both external and internal actors and failures to comply with regulations.

Figure 7
The protect agenda: strategic priorities for banks in 2017*

*Percentage of respondents ranking strategic initiatives 8, 9 or 10 on a scale of 0 (not at all important) to 10 (very important).
An action plan for protecting the bank

- **Establish governance and decision-making frameworks to better manage conduct risk and protect against the threat of financial crime.** They must also establish a decision-making framework that enables them to rapidly understand issues and escalate them.

- **Embed cybersecurity in all new digital and FinTech initiatives.** With pressure to improve ROE, there is a risk that speed to market overrides protection when banks are developing new digital tools or services. Banks must embed cybersecurity considerations in all new initiatives.

- **Industrialize cybersecurity safeguards.** Even in an era of cost-cutting, banks cannot skimp on cybersecurity. Artificial intelligence (AI) and advanced analytics offer the ability to analyze and potentially prevent cyber attacks by identifying patterns of activity. Critically, we believe the industry will be stronger when it can collaborate to share information about cyber threats.

- **Address the cybersecurity skills shortage.** With cyber skills in short supply, banks must move to cultivate the cyber workforce of the future. Hiring and retaining people with the right cyber skills will be the first step. Helping these people develop business and risk skills will be a crucial next step.

- **Establish standards and training.** The industry should develop norms of behavior and codes of conduct for its employees, as other professions have. Banks should establish a conduct academy where employees need to demonstrate they are well drilled on decision-making and on the standards and behaviors required, both when they enter the industry and certainly before they take leadership roles in a bank.

- **Invest in RegTech.** Banks can use technology to do things more efficiently and make things safer. In some countries, banks have begun working with authorities to develop RegTech solutions that can make compliance more cost-effective. With the cost and effort of compliance radically increasing in recent years, many banks are struggling to find the right talent to support regulatory programs. We see a key role for analytics and AI in reducing the cost and manual effort required to monitor activity across the bank, spotting poor behaviors much more quickly and identifying patterns of behavior that predict where failures will happen.
Optimize: harness technology to drive next-generation efficiency

For almost a decade, banks – particularly in developed markets – have touted expense management as one of the primary levers that they could pull to improve profitability. Numerous efficiency programs have been launched and completed. These have focused largely on tactical measures such as:

- Reducing staff costs
- Optimizing physical footprints
- Controlling discretionary expenses
- Simplifying processes

While such efforts drove a 6% reduction in operating costs between 2011 and 2015, the savings achieved were offset by a 6% drop in revenues.

Meanwhile, expenses for emerging-market banks actually increased 21% over the same period, as stronger economic growth provided a revenue tailwind that gave them the luxury to invest in geographic expansion and revenue initiatives and decreased the urgency to optimize costs. As economic growth trends in these markets have slowed, however, emerging-market banks are coming to the realization that cost management is a lever they need to pull.

Our 2017 global banking outlook survey found that banks are focused on optimizing customer channels, driving strategic cost reductions and using new technologies such as robotic process automation (RPA) to improve efficiency. (See Figure 9.)

Another profit lever available to banks is capital optimization. By allocating capital to the highest-return businesses and carefully managing risk-weighted assets (RWA), banks have the opportunity to improve capital efficiency and profitability. However, since 2011, total RWA for the top 200 global banks has increased by nearly US$8t, yet there has been no improvement in the total RWA/total assets ratio. While this may partially due to regulatory impacts in areas such as operational risk, it also suggests that the industry has not focused sufficiently on this part of the equation.

Banks must reassess their tactics for managing both cost and capital efficiency since efforts thus far have fallen short. It is past time for banks to shift from a near-term triage approach to managing their resources to a decisive, forward-looking effort to harness and embrace technology to meaningfully reduce costs and risks and improve agility. Some technologies are mature enough to be used immediately and others are a little further off, but it is time to start planning for them now.

Figure 8
Limited efficiency improvements: operating costs/total assets of top 200 global banks

<table>
<thead>
<tr>
<th></th>
<th>FY11</th>
<th>FY12</th>
<th>FY13</th>
<th>FY14</th>
<th>FY15</th>
</tr>
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<tbody>
<tr>
<td>Value</td>
<td>1.68%</td>
<td>1.67%</td>
<td>1.66%</td>
<td>1.60%</td>
<td>1.61%</td>
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Source: SNL Financial, EY analysis
Figure 9
The optimize agenda: strategic priorities for banks in 2017*

<table>
<thead>
<tr>
<th>Priorities</th>
<th>G-SiBs Percentage</th>
<th>Non-G-SiBs Percentage</th>
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<tbody>
<tr>
<td>Optimizing customer channels</td>
<td>74%</td>
<td>62%</td>
</tr>
<tr>
<td>Rationalizing physical footprint</td>
<td>63%</td>
<td>62%</td>
</tr>
<tr>
<td>Strategic efficiency and cost reduction</td>
<td>62%</td>
<td>56%</td>
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*Percentage of respondents ranking strategic initiatives 8, 9 or 10 on a scale of 0 (not at all important) to 10 (very important).

Source: EY 2017 global banking outlook survey
An action plan for optimizing the bank

12 months

- **Invest in robotic process automation (RPA).** RPA can be integrated into existing interfaces without requiring changes to systems and can reduce the cost of high-frequency manual operations by 40% or more. At the same time, RPA improves quality of service. Importantly, RPA technology is self-funding and ready to implement now. Immediate savings from RPA can be reinvested in other cost-efficiency measures.

- **Use big data and technological advancements to improve modeling capabilities and support business decisions.** Advances in the ability to collect and analyze big data can make it easier for banks to improve their internal RWA models and evaluate the profitability of various business activities. Big data can provide the information necessary to both support tough decisions about business exits and drive further savings of 15%-20% of RWA.

- **Identify a strategy to replace or renew core banking systems.** While total replacement of a core banking system may be too expensive, time-consuming and daunting to consider, there are other approaches banks can take to renew their systems: build a parallel core, replace modules gradually or surgically replace parts. The need to make legacy systems more agile and fit for purpose cannot be ignored, but banks must not delay decisive action.2

36 months

- **Embrace the utility model.** The banking industry has a significant opportunity to gain economies of scale by working together on common external platforms for meeting such requirements as know your customer and anti-money laundering or by pooling resources to manage back-office processes common across the industry. While care must be taken in entering such arrangements to safeguard customer data and privacy, such cooperation could meaningfully improve the efficiency of individual banks and the industry as a whole.

- **Actively invest in blockchain.** Distributed ledger technology could have a profound impact on the banking industry once issues related to scalability, resilience and security are resolved. While banks can start developing and testing applications in the near term, in the longer term they should be looking for opportunities to help build the public blockchain ecosystem by collaborating with large IT multinationals, participating in industry consortiums and teaming with traditional and non-traditional competitors.3

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2 “Surgically replacing core banking platforms”, EY, 2016.

3 “Blockchain: the hype, the opportunity and what you should do”, EY, 2016.
Grow: invest in staff and technology to support innovation

In recent years, banks have had little control over their revenue growth trajectory due to significant macroeconomic, geopolitical and regulatory headwinds. Between 2011 and 2015, aggregate revenues at the top 200 global banks grew only 4%, and even emerging markets banks were not immune from slow growth trends. The top emerging-market banks saw their revenues decline by 4.9% in 2015, compared to growth of 10.9% the previous year.

The outlook in 2017 may be improving for some banks – particularly in the US – as monetary policy normalizes and capital markets respond with increased resiliency to geopolitical events.

However, just as uncertainty is not an excuse for inaction, the industry is now passing the point where it can blame external factors for lack of growth or rely on them to drive growth. It is time for banks to focus on their customers, invest in innovation and talent and leverage their competitive advantages to compete effectively.

According to EY 2016 Global Consumer Banking Survey, banks have some advantages over non-traditional competitors. They remain the preferred provider for products such as primary checking accounts and mortgages and they are trusted – approximately 93% of consumers have some degree of trust in their primary financial services provider.

However, our research also suggests that these advantages are increasingly at risk. Consumers are becoming more willing to get these products from non-traditional providers and those that do bank with new players trust them as much those who use traditional banks as their primary financial services provider. This means banks must act now to defend their existing market share and use their competitive advantages as a springboard to growth. Investment banks face a similar issue – while demand for investment banking services remains strong, the market share of the major traditional players in certain businesses is diminishing. Before this erodes further, investment banks must move to protect their existing client bases.

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**Figure 10**

Slow growth environment: revenues (in US$b) at the top 200 global banks have only grown 4% since 2011

<table>
<thead>
<tr>
<th></th>
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<th>FY12</th>
<th>FY13</th>
<th>FY14</th>
<th>FY15</th>
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<tr>
<td><strong>Net interest income</strong></td>
<td>1,448</td>
<td>1,510</td>
<td>1,518</td>
<td>1,609</td>
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<td><strong>Non-interest income</strong></td>
<td>972</td>
<td>1,004</td>
<td>1,029</td>
<td>1,072</td>
<td>1,013</td>
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</table>

Source: SNL Financial, EY analysis
Figure 11
The grow agenda: strategic priorities for banks in 2017

Top three growth priorities - all banks

- 63% Recruiting and retaining key talent
- 60% Investing in new customer-facing technology
- 40% Developing new products

G-SIBs
- Investing in new customer-facing technology: 62%
- Recruiting and retaining key talent: 59%
- Developing new products: 35%

Non-G-SIBs
- Recruiting and retaining key talent: 64%
- Investing in new customer-facing technology: 60%
- Developing new products: 41%
An action plan for growing the bank

12 months

• **Preserve customer trust.** Banks must promote transparency in all transactions and proactively protect their customers from data, privacy and cybersecurity threats.4

• **Understand customers better.** Both retail and investment banks need to decide who they want to serve. Simple demographic information is no longer sufficient to segment customers. Banks must use big data and advanced analytics to gain a deeper understanding of their targeted customers. Once target segments have been identified, banks should leverage analytics to better understand customers’ expectations and to design service or product propositions that specifically meet their needs.

• **Invest in talent.** Banks must invest in their front-line staff, particularly in their skills, culture, incentives and toolkits, to enable them to put customers’ interests first. Banks also need to hire technologists to interpret big data and help design targeted products and services.

36 months

• **Make and execute informed decisions about products and channel strategy.** Banks must leverage data to shape their channel strategies. Our 2016 Global Consumer Banking Survey found that 60% of consumers globally value a bank with a physical presence and 66% value a bank with a digital presence. This suggests that banks must balance digital and branch investments and develop a clear design for future cross-channel customer interactions. Similarly, investment banks must focus on which products they want to offer and how they distribute them. These choices are not always clear-cut, and investment banks may have to choose between offering only high-return products and maintaining a relationship with a major customer.

• **Embed an innovation mindset.** Banks must adopt innovative practices to deepen customer relationships by offering solutions that address all aspects of important stages of customers’ lives and grow customer-centric digital platforms. They must also leverage market and customer insights to build personalized products and pricing that are delivered seamlessly across all channels.

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4 The relevance challenge, EY, 2016.
The key to success will be building a better ecosystem, not a bigger bank.
Building a better ecosystem

In 2017, banks in most regions anticipate limited improvement in their financial performance, and management focus is expected to continue to be dominated by the risk and regulation agenda.

We believe management must carve out time to re-examine and reshape their businesses to determine new ways to grow and be more efficient. But as banks rebuild, they must also meet the demands of regulators. In our experience, this means innovation and the execution of change will be critical.

One thing is clear: banks are currently ill-positioned to do all this alone. We believe the key to success will be building a better ecosystem, not a bigger bank. Institutions must look for alternative ways to be organized and to operate.

In our view, this means banks must do less. Bank operating models need to have a much thinner spine than they have today, making extensive use of industry utilities and a diverse range of partners to deliver better services, drive out cost, manage risks and help protect the organization.

We believe banks will see meaningful benefits from this more flexible (and more experienced) model:

- From improved risk management to better compliance, and from better resolvability to greater trust, these institutions will be safer than ever before.

- From lower costs – with a diminished legacy estate, expenses could be more than 30% lower than they are today – to greater efficiency, from lower capital requirements to a stronger employee proposition, and from an enhanced client experience to smarter revenue acquisition, banks will be better optimized and better able to grow than ever before.

However, building this ecosystem will also require substantial engagement with regulators, which increasingly expect banks to be able to guarantee that third-party providers can offer the same level of resilience and assurance of processes as banks themselves. (See Figure 12.)

The challenge to banking leaders is to be bold and move beyond incremental adjustments to broader transformation. Success will depend on the effectiveness of implementation and execution of innovation, as well as the quality of the ecosystem banks build with their partners.

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**Figure 12**

A better ecosystem not a bigger bank

![Diagram showing a bank ecosystem with collaborating competitors, financial institutions, and end users of finance. The diagram illustrates the role of venture capital funds, vendor platforms, and managed service providers in the ecosystem.]
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The EY 2017 global banking outlook survey asked senior executives at almost 300 banks across 29 markets about the outlook for their sector, their bank and their bank’s strategic priorities for the next 12 months. The survey was conducted between November and December 2016.
Further reading

Capital Markets: building the investment bank of the future

A set of blueprints for success
Seventh annual global EY/IIF bank risk management survey

Leading through innovation
The future of banking in emerging markets

Global banking outlook 2016
Transforming talent
The banker of the future
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