Regulatory Revolution and New Normal in the Banking World

- **Capital Rules restrict lending capacity and put pressures on returns**
- **Liquidity Rules determine a shortage of eligible liquid assets**
- **Leverage requirements make certain assets less desirable on a bank's balance sheet**

Capital

More and better capital

- Minimum common equity of 3.5% which will increase to 4.5% by 2019
- Capital conservation buffer of 2.5% by 2019
- Deductions from CET1 phased-in from 2014 to 2019
- Minimum total capital ratio of 8.0%

Higher RWA

- Charge for mark-to-market losses
- Account for bank correlation risk (+30% RWA)
- Higher charge on trading books
- Increase counterparty risk charge

Liquidity

Liquidity Coverage Ratio (LCR)

- Buffer to be held against short term liquidity shortages (30 days)
- Planned implementation in 2015 of 60% LCR, gradually increasing to 100% by 2018

Net Stable Funding Ratio (NSFR)

- Promote longer horizon resilience
- Observation period begins in 2012
- Minimum standard to be introduced in 2018

Disclosure to start in 2014

Leverage Ratio

Introduction of general leverage ratio

- Max. leverage = 33.3x Tier 1 capital
- Final calibration in 2017 for implementation in 2018
- Disclosure to start in 2015
- Not risk based
- On and off balance sheet positions
- Broadly in line with IFRS accounting with add back for certain off balance sheet exposures
- Harmonised internationally across accounting standards
- Derivative exposures can be netted

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Impact of New Regulatory Requirements for Global Banking

Basel III (CRD IV, CRR)

- Capital
- Liquidity
- Leverage

Other regulation

- EMIR / Dodd Frank
- Financial Transaction Tax
- Ring Fencing
- Resolution Plan
- IFRS 9
- MIFIR

Cumulative impact on Banking Industry

Estimated impact of increased Requirements*

CT1 capital shortfall	**€ 474bn**
Funding gap long term (NSFR)	**€ 2.8trn**
Unencumbered Liquid Assets (LCR)	**€ 1.8trn**
B/S Structure	**Deleverage**
RoE	**– 2/3%**
Collateral**	**4.5-5.5trn**

?

Where Banks stand today

Banks have increased their capital by retained earnings, new issues and balance sheet downsizing

Most banks are **long liquidity** and deposits **helped by ECB** and depositors

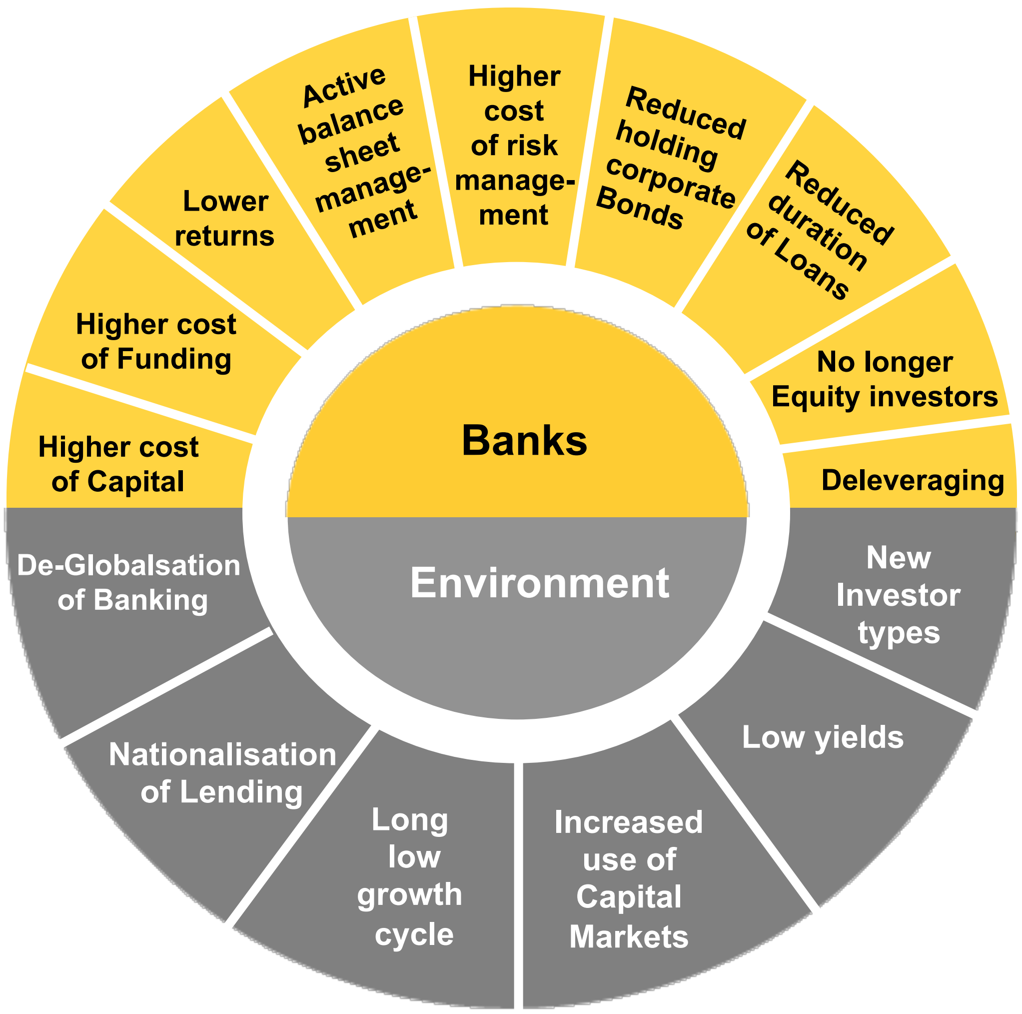
Low new Loans generation especially in the peripheral due to low demand and profitability

ECB looking to support SMEs but focus on cheap finance rather than incentives to invest

Banks sale of assets is stagnating due to low loss absorbing capacity

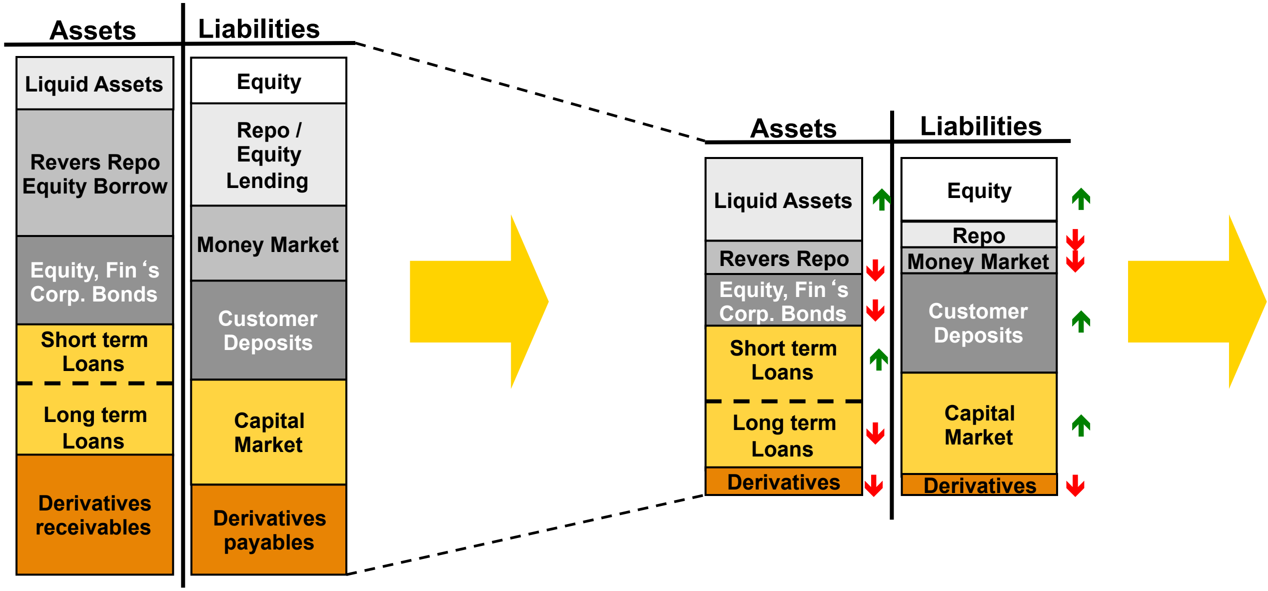
*Sources: McKinsey Working paper on Risk, No 41 "Between deluge and drought Mar 2013; Morgan Stanley & Oliver Wyman "Wholesale & Investment Banking Outlook" Apr 2013; BCG Risk Report "An Inflection Point in Global Banking" Dec 2012
** OTC reform incl. CCP, etc.

The New Normal



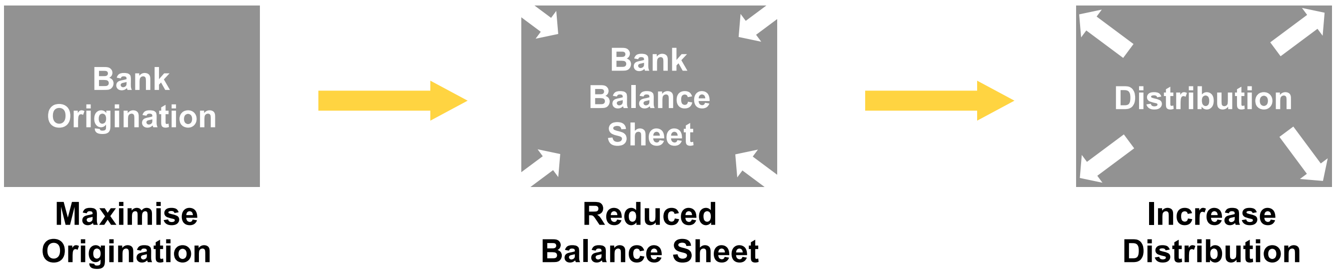
Source: Commerzbank – Corporates & Markets

How are Banks responding?

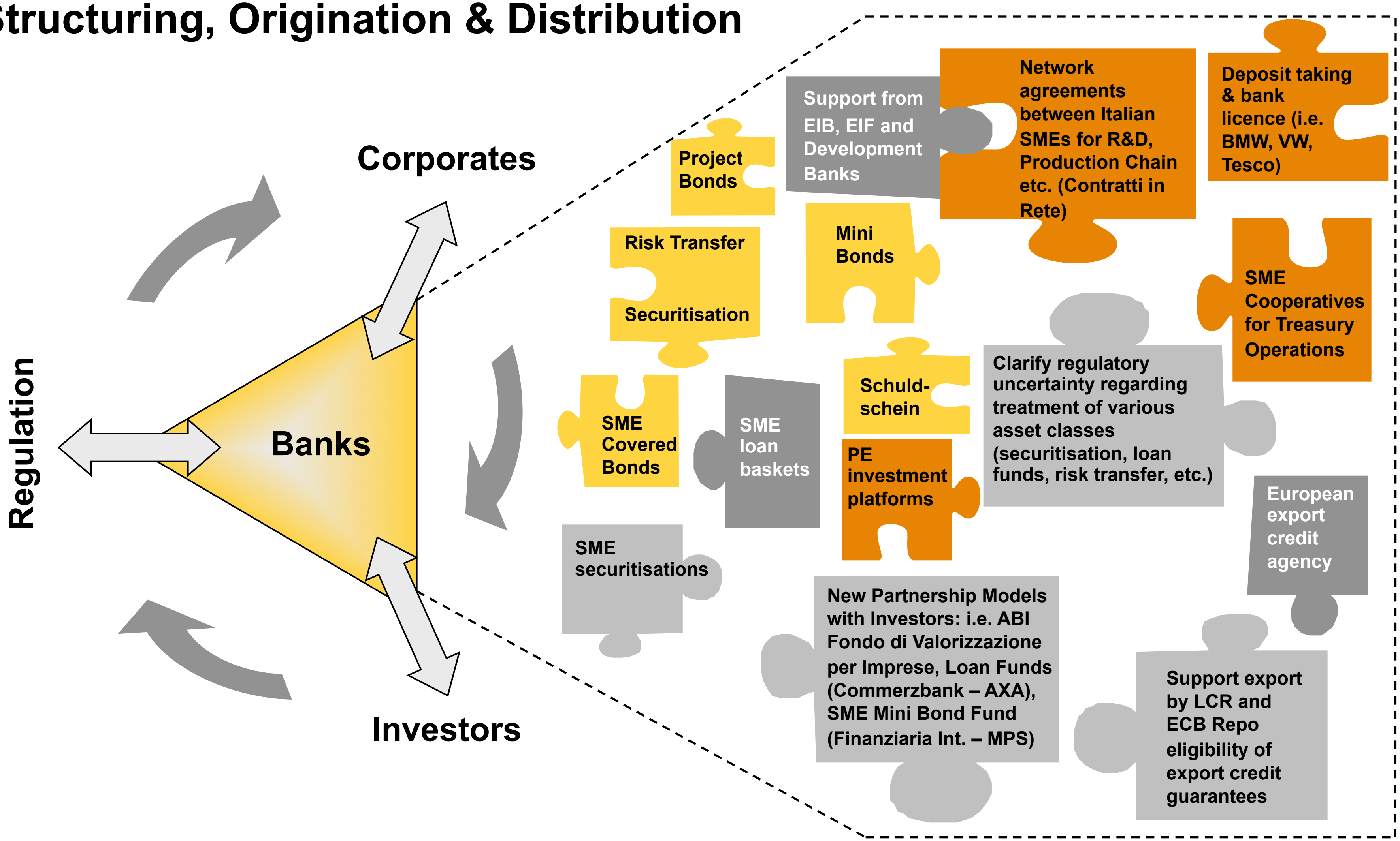


- ↓ long term loans
- ↓ equity & corporate bonds investments
- ↑ equity capital
- ↑ capital markets refinancing
- ↑ customer deposits

› **Banks are changing business models & looking for alternative balance sheets**



The New Focus of Banks in Financial Intermediation: Advisory, Structuring, Origination & Distribution



Transaction Examples for Banks

High Grade SME Structured Covered Bonds

Risk / Rating	➢ AAA to A
Tenor	➢ 3 – 5 years
Overview	➢ Support to SME ➢ Efficient refinancing instrument for SME banks ➢ Dual-recourse to the Bank and a pool of SME loans ➢ Committed minimum OC
Assets	➢ Corporate loans from the banks core business ➢ Eligibility standards to meet the rating agencies requirements ➢ Other assets may be considered
Investors	➢ Diverse investor base seeking high grade paper with enhanced yield ➢ ECB eligible, included in key indices
Return	➢ + 40 to +100 bps
Examples:	➢ Commerzbank SME Structured Covered Bond ➢ Potential in Italy, Holland, Spain

High Yield Mezzanine on Europe Portfolios

Risk / Rating	➢ Mezzanine or Equity Risk – No rating required
Tenor	➢ Depends on asset and jurisdiction
Overview	➢ Sell mezzanine Risk funded or unfunded ➢ Reduce RWA improving capital ratios ➢ Assets could be granular or non-granular depending on allowable name disclosure ➢ Portfolios can be existing but also can be participations in new originations
Assets	➢ Lease ➢ Mortgage ➢ SME ➢ Infrastructure
Investors	➢ Bespoke – 1 to 8 investor
Return	➢ 10% to 15% but currently under pressure to tighten given high demand
Examples:	➢ Synthetic securitisation of non-granular infrastructure assets ➢ Whole loan sale of new mortgages or leases

Conclusion

- **Banks are less balance sheet intensive and focus more on Client oriented Advisory, Structuring, Origination and Distribution**
- **Investment Banks can help Corporates and Banks to develop alternative Financing and Capital raising channels accessing new Investors**
- **Corporates need to adapt quickly to the new Bank Intermediation model**
- **Banks will sell assets in various forms: an opportunity for Investors**
- **A virtuous circle should be created leveraging Italy's key strengths: the SME system and high private savings**
- **All of this needs new Channels, Platforms and Products, the development of which is hindered by Regulatory uncertainty and limited transparency for International Investors**
- **To overcome this obstacles an exceptional cooperation effort is needed between Corporates, Banks, Investors, Regulators, Associations and Public Authorities**

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