The Future-Ready Bank requires a Future-Ready Treasury

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Agenda

"The post-GFC environment has proved extremely challenging for banks worldwide, and arguably is still evident in a continuing slow growth and negative interest-rate environment. Banks have to address multiple challenges including: onerous regulatory compliance, intense competition and restoring customer satisfaction.

"To meet these requires bankers to adopt fit-for-purpose systems, processes and governance structures. At the heart of this is the Treasury function. This presentation addresses the needs of the Future-Ready Treasury and the evolution of the bank asset-liability management (ALM) function."

Current issues in Balance Sheet Risk Management

- Ensuring effective stewardship of the balance sheet as the bank expands business activities, in a highly competitive and resource-constrained environment
- Need for a single owner of balance sheet risk – capital, liquidity, funding, interest-rate and FX risk – with effective 2nd Line of Defence (Risk) segregation
- Effective interaction between the balance sheet risk management "Triumvirate" of Treasury, Finance and Risk, and between it and the Business Lines
- "Optimising" the balance sheet across the Group
- Making more effective use of the Treasury function, with respect to:
  - Group ALCO reporting
  - Integrating the origination process for assets and liabilities at legal entity level
  - Improving NII/NIM at legal entity level
    - HQLA, Cash management
- Data analytics
  - Leveraging currently unstructured data, a genuine resource, into a structured form as part of an analytics toolkit that will improve Customer relationship, Risk analytics, and scenario / stress testing process

Managing the impact of Basel III

Increased Balance Sheet Resource Requirement

- Increased holdings of Liquid Assets (HQLA)
- LCR; NSFR
- Intra-day liquidity
- Increased Capital
- MREL
- More drivers of capital
- (IRRBB)

Constraints on capital and liquidity and higher cost

- Increased efficiency of operation and customer acquisition demanded
- Higher cost of hedging (CCP)
- Exit business lines that are no longer viable

Re-Design Customer Offering

- Restructure transactions with customers
- Re-design products
- Review product pricing
- Exit business lines that are no longer viable

Manage Balance Sheets more efficiently

- Restructure and/or Collapse legal entities
- Improve data collection and data analytics processes
- Balance sheet structure
- Optimisation

Balance Sheet items: what’s the optimum mix?*

- Credit cards
- Asset management
- Term Loans
- Broking (Securities Intermediation)
- Insurance
- Corporate Finance
- Fixed rate bonds
- Factoring – receivables finance
- Mortgages
- Project Finance
- Leveraged Loans
- Asset Finance
- Trade finance
- Instant Access Savings accounts
- Overdrafts
- Wealth solutions and financial planning
- Syndicated loans
- Interest Bearing Current Accounts
- Notice deposit accounts
- Investment Management
- Financial Advisory
- Trusts and Estate Planning
- Alternative Investments
- Leasing
- Custody Services
- Foreign Exchange and derivatives

** The answer depends on which stakehokder viewpoint one is considering this from…*

Strategic ALM and Risk Management

- A single, integrated approach that ties in asset origination with liabilities raising. The two parts of the business process – assets and liabilities – are integrated and aligned
  - No more “silo’d” organisation
- *A business strategy approach at the bank-wide level driven by balance sheet ALM considerations*
- Asset type is relevant and appropriate to funding type and source…
- ….and funding type and source is appropriate to asset type
- An explicit, articulated liabilities strategy that looks to optimise the funding mix and align to asset origination
- A high-level, strategic discipline driven from the top down…
- A high-level, strategic discipline driven from the top down…
- *It addresses the 3D optimisation problem:*
  - *Regulator requirements*
  - *Customer franchise requirements: ARE YOU A “FULL SERVICE” BANK?*
  - *Shareholder requirements*

Which means…

- Proactive balance sheet management (BSM)…
- …not the "reactive" balance sheet management philosophy of traditional banking practice
- Consider the process by which ALM is undertaken at banks…
  - Business lines – which at the large banks are many and varied and geographically dispersed – go out and originate business according to a supposed high level strategy that is often not clear even to the line head
  - This creates the balance sheet exposure that is then "risk managed" by the risk triumvirate of Treasury, Finance and Risk
- Proactive BSM means the asset-side product line is managed by a business head who is closely aligned (in strategic terms) with the liabilities-side product line head
- To be effective the process needs to look in granular detail at the product types and how they are funded / deployed
- ONLY THEN can the bank start to think in terms of optimising the balance sheet ***Proactive not reactive***

Implementing strategic ALM

- A strategic ALM integrated balance sheet origination process will increase the likelihood of arriving at a balance sheet shape and structure that maximises the desired outcomes for each of the 3 stakeholders
- From an ALM perspective, it means integrating the following processes into one:
  - Capital planning and management (inc the ICAAP process)
  - Liquidity risk management (inc ILAAP process)
    - ***Call it "ICLAAP" – merge into one process***
  - IRRBB
  - FTP
  - Internal curve construction process
- …within the "triumvirate" of Risk, Finance and Treasury, overseen by Treasury – and this requires a developed Treasury function

Why we need "Strategic ALM"

"…. as far as possible a bank's balance sheet should aim to maximise those assets and liabilities that hit the yellow-shaded 'sweet spot' shown in the Venn diagram, where the requirements of all three stakeholders are served"

"Strategic ALM is a single, integrated approach that ties in asset origination with liabilities raising. It works to break down "silos" in the organisation …

We define it as follows: A business strategy approach at the bank-wide level driven by balance sheet ALM considerations …

Strategic ALM addresses the three-dimensional optimisation problem of meeting with maximum efficiency the needs of:

- the regulatory requirements, in particular on capital and liquidity resources
- the NII (P&L) requirement
- the customer franchise requirements

and must be a high-level, strategic discipline driven from the top down. It is by nature proactive and not reactive."

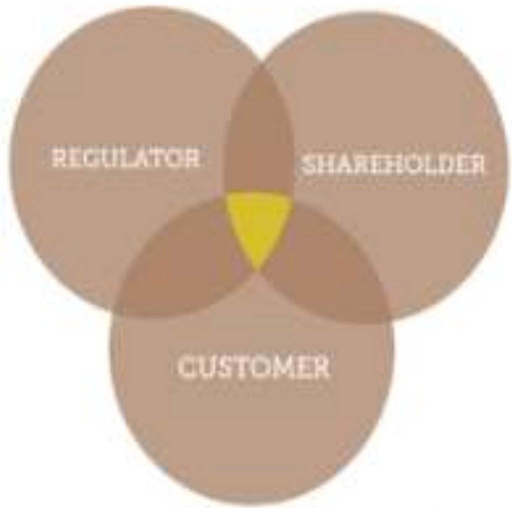

Figure 5: Product mix optimisation
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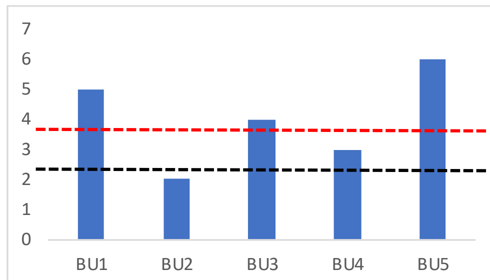
How do we make "Strategic ALM" work?

- Question:
- *How do we make the process of Strategic ALM work, in a way that makes origination of customer loans and assets produce an optimised balance sheet?*

  Answer:
- 1- ensure ALCO has the requisite authority to have effective control and direction of the strategic and annual budget setting process
- 2- ensure the Board RAS is in place that identifies the KRIs and KPIs that the bank wishes to optimise
- 3- at the planning stage, move beyond the traditional hub-and-spoke bilateral budget setting process involving Finance and Business Lines with an integrated one, where every business line sees every part of the budget and Strat Plan, and the forecast balance sheet impacts on the KRIs and KPIs is noted. If these are not deemed optimum, iterate the process again, reviewing the revised KRIs and KPI values, and when these are deemed optimum, that forecast balance sheet is the one to move forward with
- 4- send this annual plan and new Strat Plan for ALCO and Board approval

How do we make "Strategic ALM" work…

Design Workflow	Setting Pricing Origination >> Transaction	Managing Banking Book Risk Post-deal >> Risk modelling / Data analytics	Regulation and Reporting IFRS9 Provision >> ALCO Reporting
Performance Management Enterprise Wide Platform Service	Liquidity / Funding Costs Capital Customer Behaviour Additional Strategic Considerations → Risk-based Pricing	 Optimisation Hurdle Rate	> Optimisation under regulatory compliance constraints > Automated operations > AI (Maching Learning)-based customer behaviour prediction > Enhanced customer service > Personalised financing options from the bank

Stakeholder

Front Office

Treasury / ALM

Finance and Risk (2LoD)

Evolution of the future-ready Treasury function

BTRM
The Certificate of Bank Treasury Risk Management

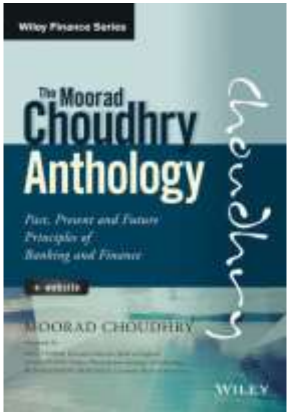
Stage 1 *Pre-2008*	Stage 2 *Post-2008*	Stage 3 *Today*	Stage 4 *Tomorrow*
Capital markets Treasury	Separation from Markets	Treasury owns liquidity risk and capital management	Treasury owns the balance sheet under delegated ALCO authority
or	*or*		
Middle Office Treasury	Separate function from CFO office		
Limited number of liquidity risk metrics	More appropriate set of liquidity metrics	Managing Liquidity Risk and IRRBB on long-term horizon	Fully integrated KRIs and alignment to RAS
Limited (flat term structure) FTP	More apprpriate FTP regime	Integrated management of capital and liquidity ratios	Automated real-time balance sheet MI reporting
Limited visibility of "Treasury" position in the front office system	Formal HQLA Policy	Greater transparency of KRIs and P&L attribution, assisted by transparent FTP regime	Firm-specific one touch simulation and stress testing ability for one or more KRIs
Steering reactive, P&L / RoC driven	Recognition of data analytics constraints for IRR, FTP and Liquidity Risk (inc stress testing)	Collateral management part of Treasury and collateral costs incorporated in hedging / pricing	AI systems used as part of BAU balance sheet management and stress testing process to aid understanding of balance sheet
		Proactive steering driven by regulator and customer drivers as well as RoC/P&L	Robots (eg., "trading bots") as part of Treasury op model

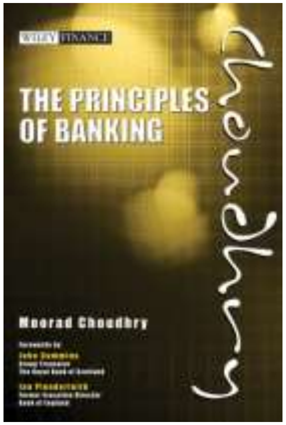
Conclusions

- The operating environment for banks in the EU will only become ever more competitive and restricted
- An ability to manage the balance sheet efficiently - and achieve genuine optimised balance sheet structure - is a real USP for any bank as it strives to maintain margin, market share and customer franchise in the face of FinTech and non-bank FIs
- Optimisation starts at the planning stage and continues to the customer product origination stage…
- …and the role and ability of the Treasury function is crucial as part of the optimisation process
- In the Basel III era, to meet the "3D" stakeholder challenge one must seek to achieve balance sheet optimisation, and that calls for Treasury to undertake proactive ALM processes
- This is now the modern approach to "risk management" in banks
- Without this approach, it will be difficult to optimise the A-L mix that addresses the 3D challenges of meeting regulatory compliance, NIM enhancement and customer franchise satisfaction
- Banking and finance is a commoditised product space. Creating and maintaining an optimised balance sheet provides an edge and "USP" that will be observed through keener prices and above-average customer service

Reading

- *The Moorad Choudhry Anthology: Past, Present and Future Principles of Banking and Finance,* Singapore: John Wiley & Sons Ltd., 2018, chapters 9, 10, 11, 12
- ***The Principles of Banking***, Singapore: John Wiley & Sons Ltd., 2012, chapters 6-15, 18





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