

# Banks in the changing world of financial intermediation

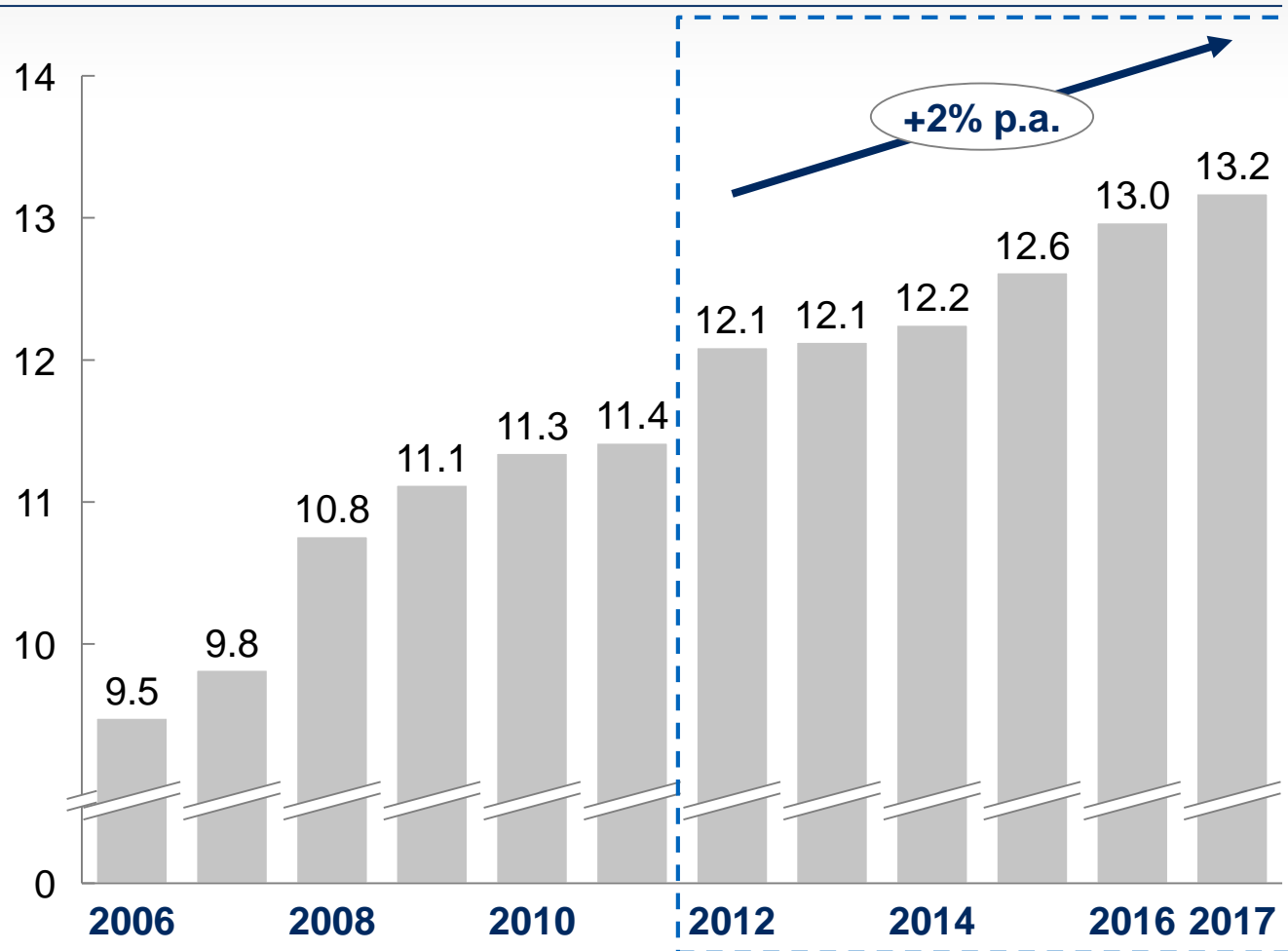
AAB CONFERENCE

May 14<sup>th</sup>, 2019

# The Tier-1 capital ratio has risen consistently over the last years, increasing the level of safety and stability of the banking system

Tier-1 capital ratios<sup>1</sup>, %

Global, 2006-17



## Developed world

North America

12.6



13.1

Western Europe

13.0



15.9

Other Developed

11.0



12.4

## Emerging markets

China

10.2



10.8

Emerging Asia

11.6



13.2

Latin America

10.5



12.9

EEMEA

14.4

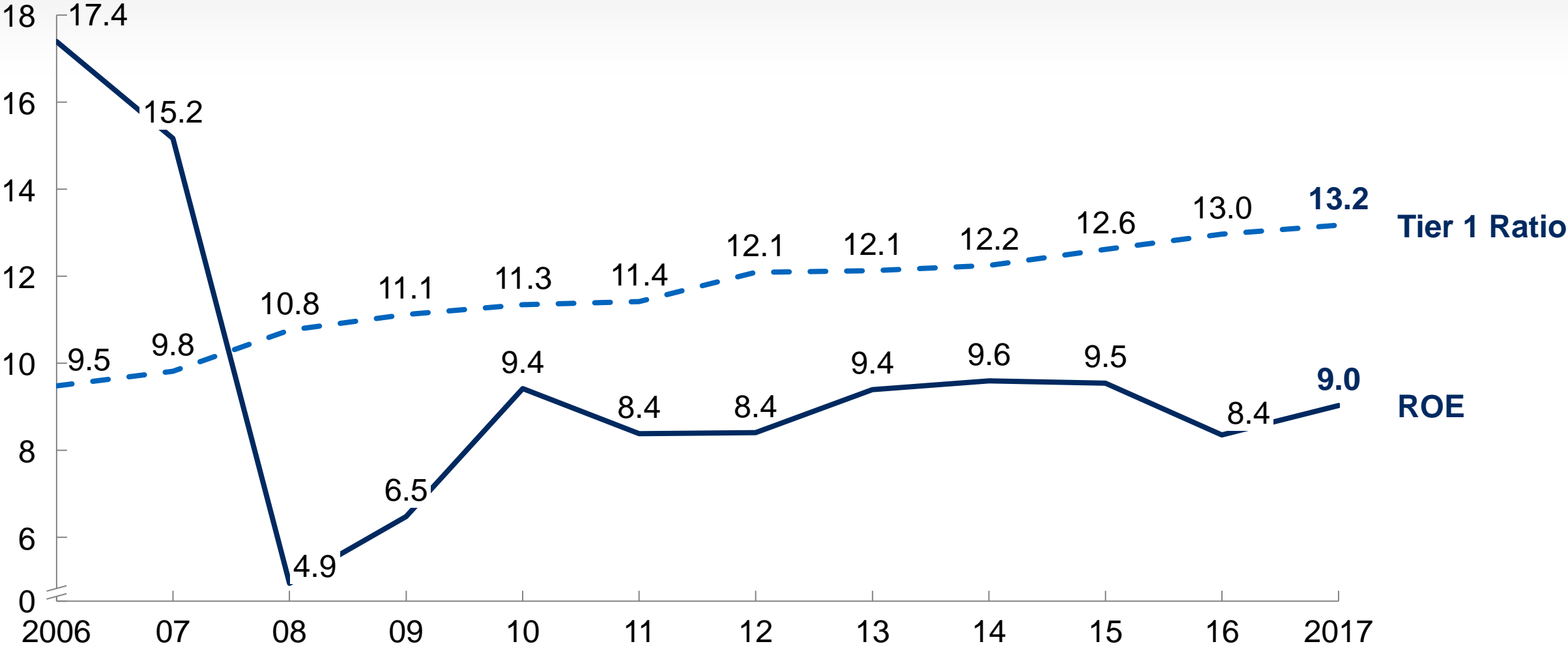


14.2

<sup>1</sup> Based on a sample of ~1,000 largest banks globally in terms of assets

# Banking returns on equity have remained stable despite a steady increase in the Tier-1 ratio

## Global ROE & Tier 1 Ratio<sup>1</sup>, %

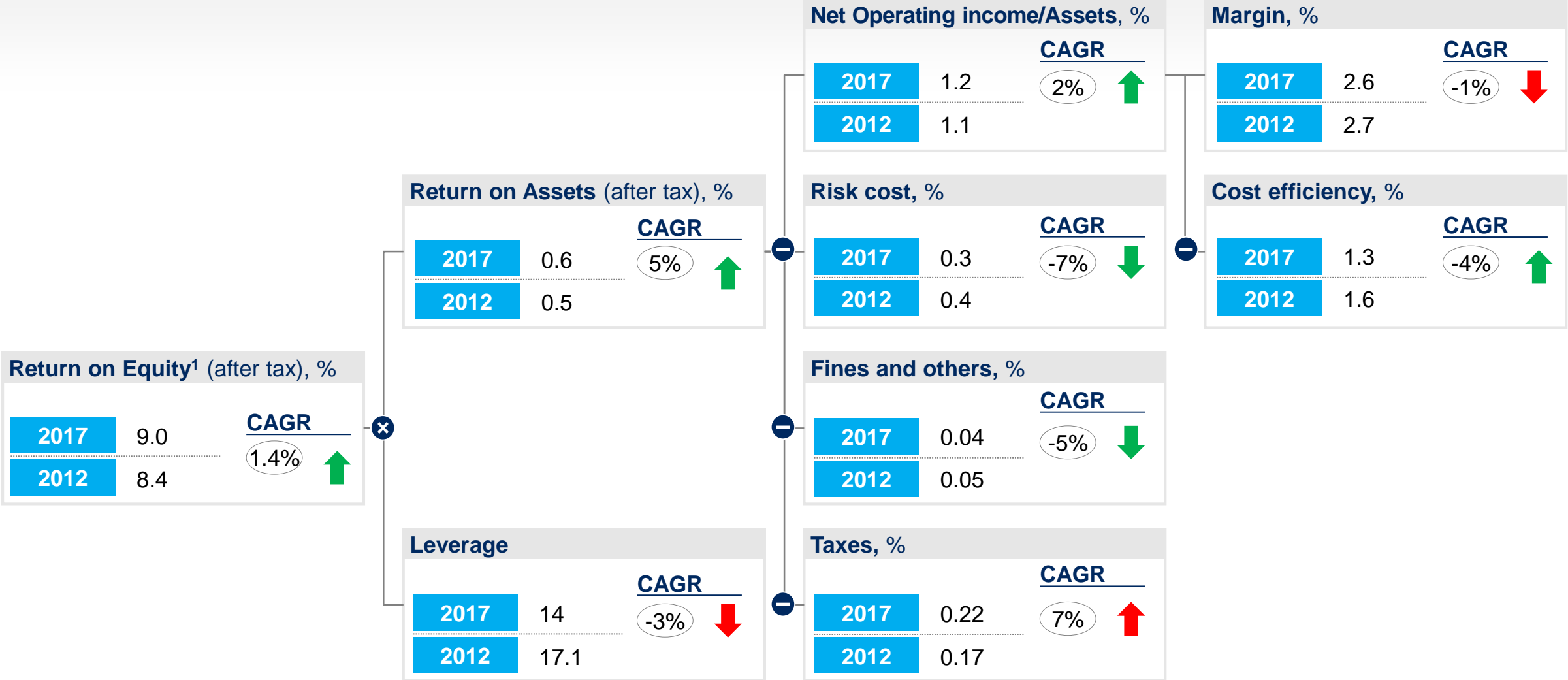


<sup>1</sup> Based on a sample of ~1,000 largest banks globally in terms of assets

SOURCE: SNL; Thomson Reuters; McKinsey Panorama

# Global banking ROE has hovered in a narrow range between 8 and 9 percent since 2012

Global banking ROE tree, 2012-2017



<sup>1</sup> Based on a sample of ~1,000 largest banks globally in terms of assets.

# Global banking margins are declining in most geographies, but cost efficiency is rising

**Levers impacting ROE, 2012–17<sup>1</sup>,**  
Percentage points

■ Change in lever increases ROE  
■ Change in lever decreases ROE

	Margin <sup>3</sup>	Cost efficiency <sup>5</sup>
<b>Global</b>	-3.3	4.7
North America	-3.5	5.0
Western Europe	-6.5	4.6
Other developed <sup>2</sup>	-6.9	3.7
China	-10.3	7.4
Emerging Asia	-1.8	0.4
Latin America	2.5	0.6
EEMEA	-10.2	7.2

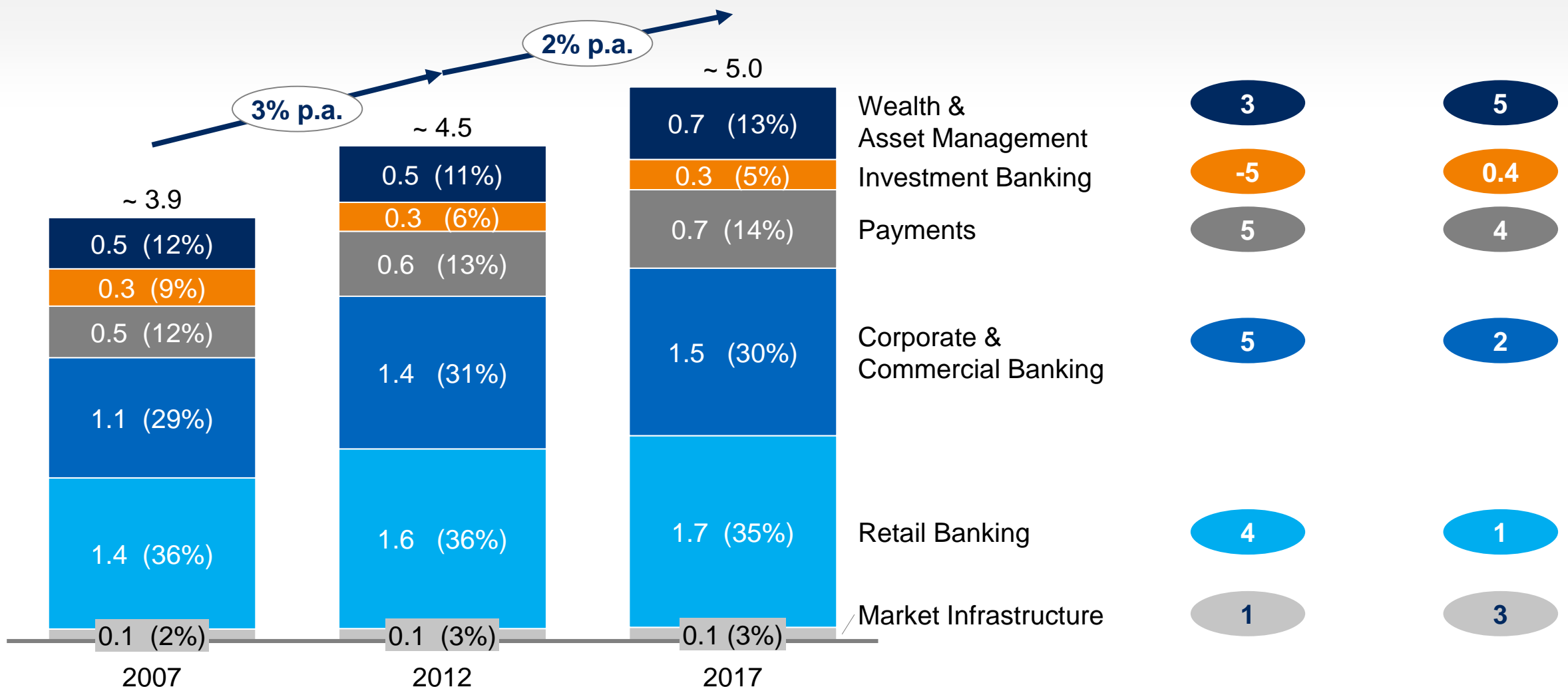
**Decreasing margins and improved cost efficiency consistent across geographies**

<sup>1</sup> Based on a sample of ~1,000 largest banks in terms of assets    <sup>2</sup> Australia, Hong Kong, New Zealand, Singapore, South Korea, Israel & Taiwan.  
<sup>3</sup> Operating Income/Assets    <sup>4</sup> Impairments/Assets    <sup>5</sup> Operating Cost/Assets    <sup>6</sup> Income tax expenses/Assets    <sup>7</sup> Includes regulator fines, customer redress, impairment of goodwill, gains/losses from discontinued operations and restructuring charges  
<sup>8</sup>. Numbers may not add up due to rounding

# Global revenue growth rate slowed to 2% in the last 5 years

ESTIMATES

Global Industry Revenues, USD trillion



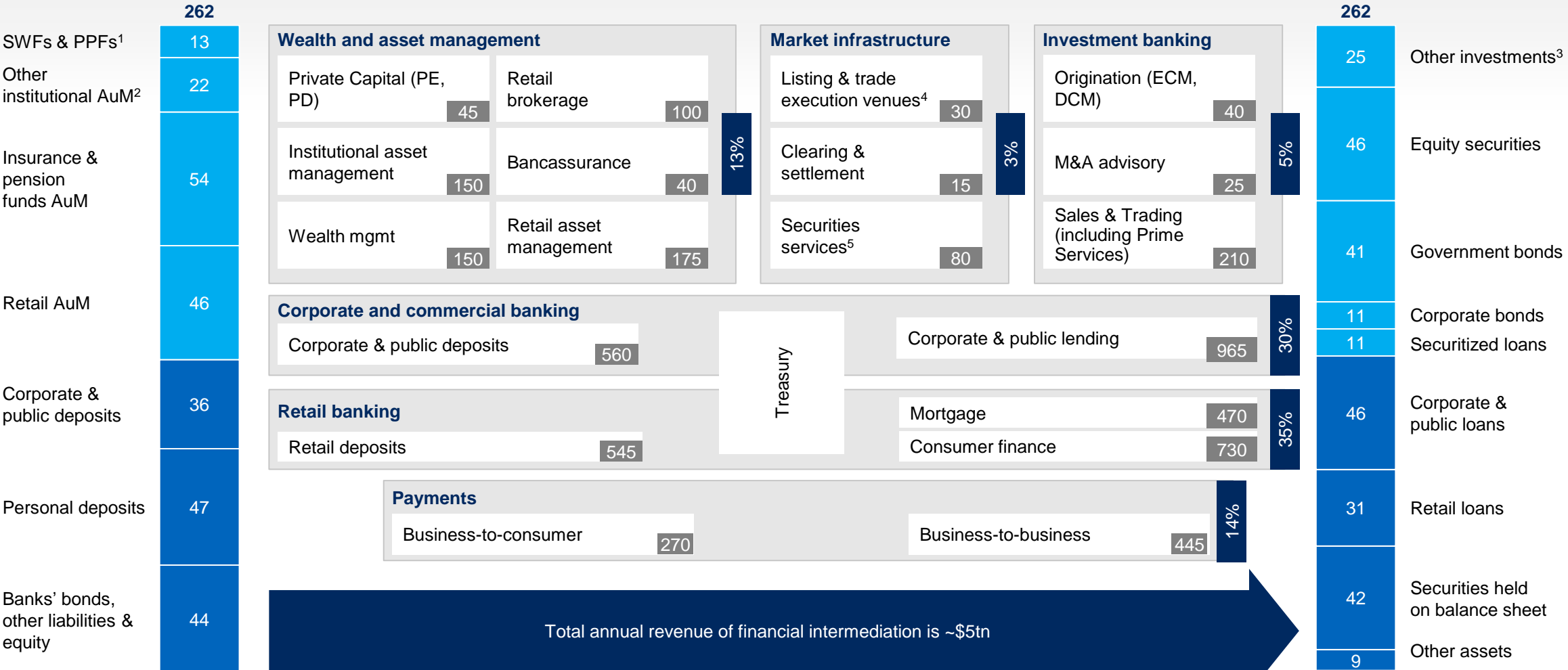
SOURCE: McKinsey Panorama - Global Banking Pools, McKinsey Capital Markets Infrastructure Providers & Securities Services practice

# The current financial intermediation system remains highly complex and generates ~\$5 trillion of revenue, equivalent to ~190 bps

■ On banking BS   ■ Off banking BS   ■ Annual revenue in 2017, USD billion   ■ Share of total revenue in 2017, %

Sources of funds: USD trillion

Uses of funds: USD trillion



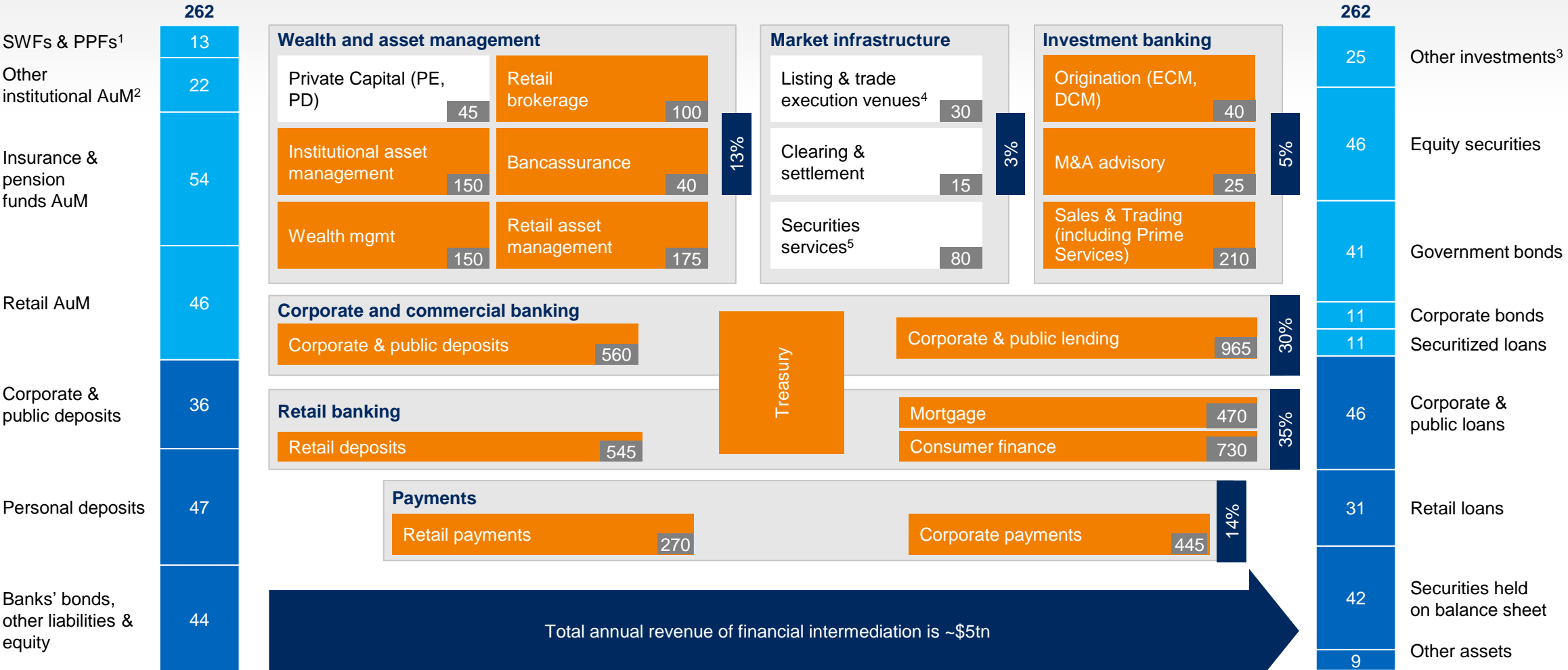
1 Sovereign wealth funds, and public pension funds; 2 Endowments and foundations, corporate investments, etc.; 3 Real estate, commodities, private capital investments, derivatives, etc.; 4 Includes exchanges, inter dealer brokers (IDBs), and alternative venues (e.g., ATS and MTF), but excludes dark pools; 5 Custody, fund administration, corporate trust, security lending, net interest income, collateral management, and ancillary services provided by custodians

# Banks perform most of activities in the financial intermediation system today

■ On banking BS   
 ■ Off banking BS   
 ■ Core activity for banks   
 ■ Annual revenue in 2017, USD billion   
 XX% Share of total revenue in 2017, %

Sources of funds: USD trillion

Uses of funds: USD trillion



1 Sovereign wealth funds, and public pension funds; 2 Endowments and foundations, corporate investments, etc.; 3 Real estate, commodities, private capital investments, derivatives, etc.; 4 Includes exchanges, inter dealer brokers (IDBs), and alternative venues (e.g., ATS and MTF), but excludes dark pools; 5 Custody, fund administration, corporate trust, security lending, net interest income, collateral management, and ancillary services provided by custodians

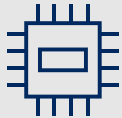


# Technology and data advancements and shift in regulatory environment are the two driving forces of change in the financial industry



## Key driving forces

### Technology and data



- Radical increase in **data availability**
- **Technological advancements to store and process data**
- Declining cost of **data storage**

### Regulation



- **Higher transparency** on fees, trading book, open access to customer data
- **Greater competition** leveling playfield between incumbent banks and other firms

## Impact

### Reinforcing the scale impact

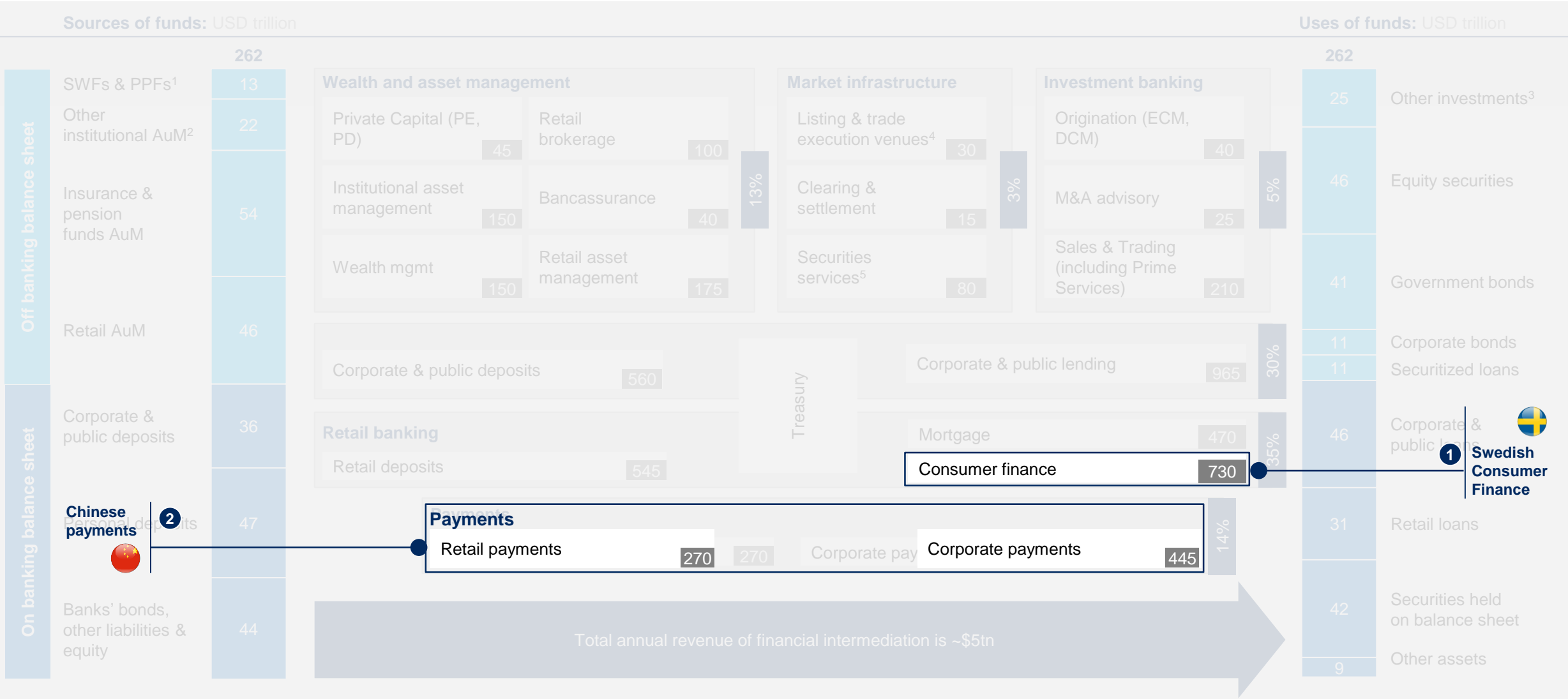
- Increased difficulty of **differentiation** for individual players
- Reduced differentiation generating **increased cost pressure** environment
- Incumbents have rapidly grown their size, **creating barriers to entry** for smaller newcomers

### Creating pathways for new entrants

- **Democratization** of information and expanded accessibility of technology
- New entrants can proactively avoid areas with **costly regulation** or take advantage of lower capital requirements tied to specific activities

# 2 example case studies to highlight the impact that these two forces are having on the financial intermediation ecosystem

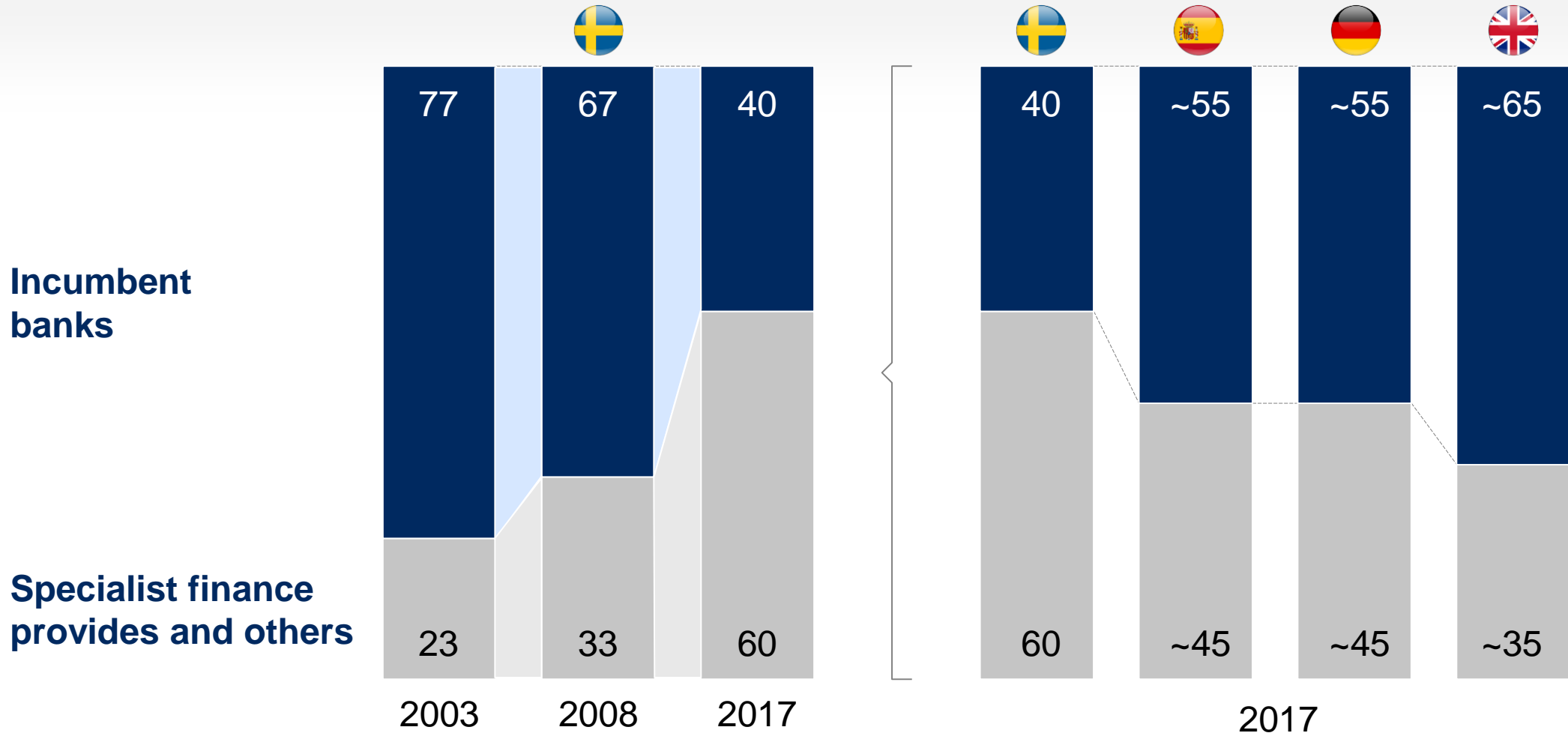
■ Annual revenue in 2017, USD billion



1 Sovereign wealth funds, and public pension funds; 2 Endowments and foundations, corporate investments, etc.; 3 Real estate, commodities, private capital investments, derivatives, etc.; 4 Includes exchanges, inter dealer brokers (IDBs), and alternative venues (e.g., ATS and MTF), but excludes dark pools; 5 Custody, fund administration, corporate trust, security lending, net interest income, collateral management, and ancillary services provided by custodians

# 1 SWEDISH CONSUMER FINANCE - Specialist finance providers have captured a significant share of Sweden's consumer finance market

Market share by firm type, % of total outstanding consumer finance volumes



NOTE: Incumbent banks include direct consumer finance activities of traditional retail banks, and consumer finance divisions of universal banks. Specialist finance providers and others include independent consumer finance specialists, captives, pan-European consumer finance monoliners, balance aggregators, online credit providers as well as peer-to-peer lenders.

SOURCE: National statistics and company filling; McKinsey analysis

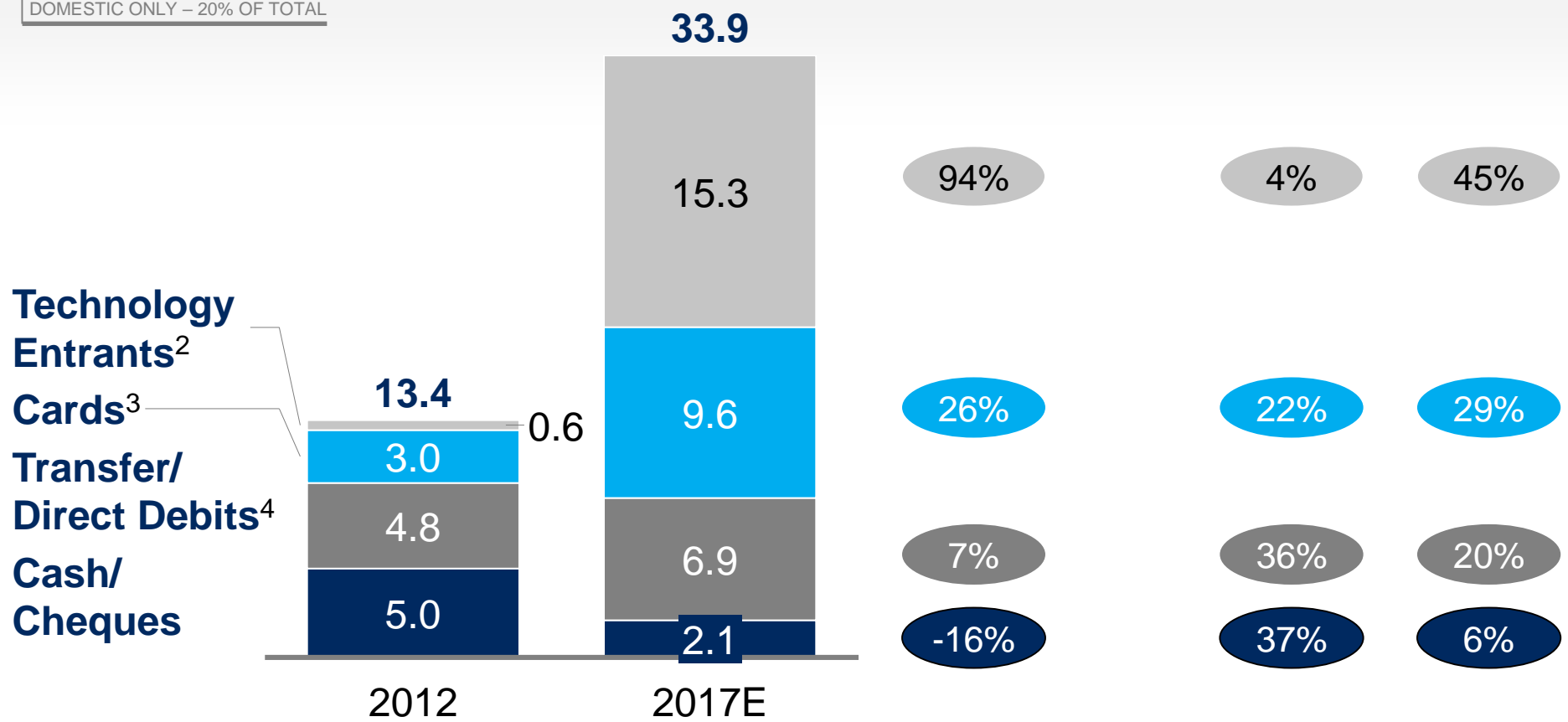
## ② CHINESE PAYMENTS - Technology giants, such as AliPay and WePay, now account for nearly 50% of domestic retail payments volume in China

China Retail Payments<sup>1</sup>,  
\$ Trillions

12-17  
CAGR, %

2012 value, 2017 value,  
% of total % of total

DOMESTIC ONLY – 20% OF TOTAL

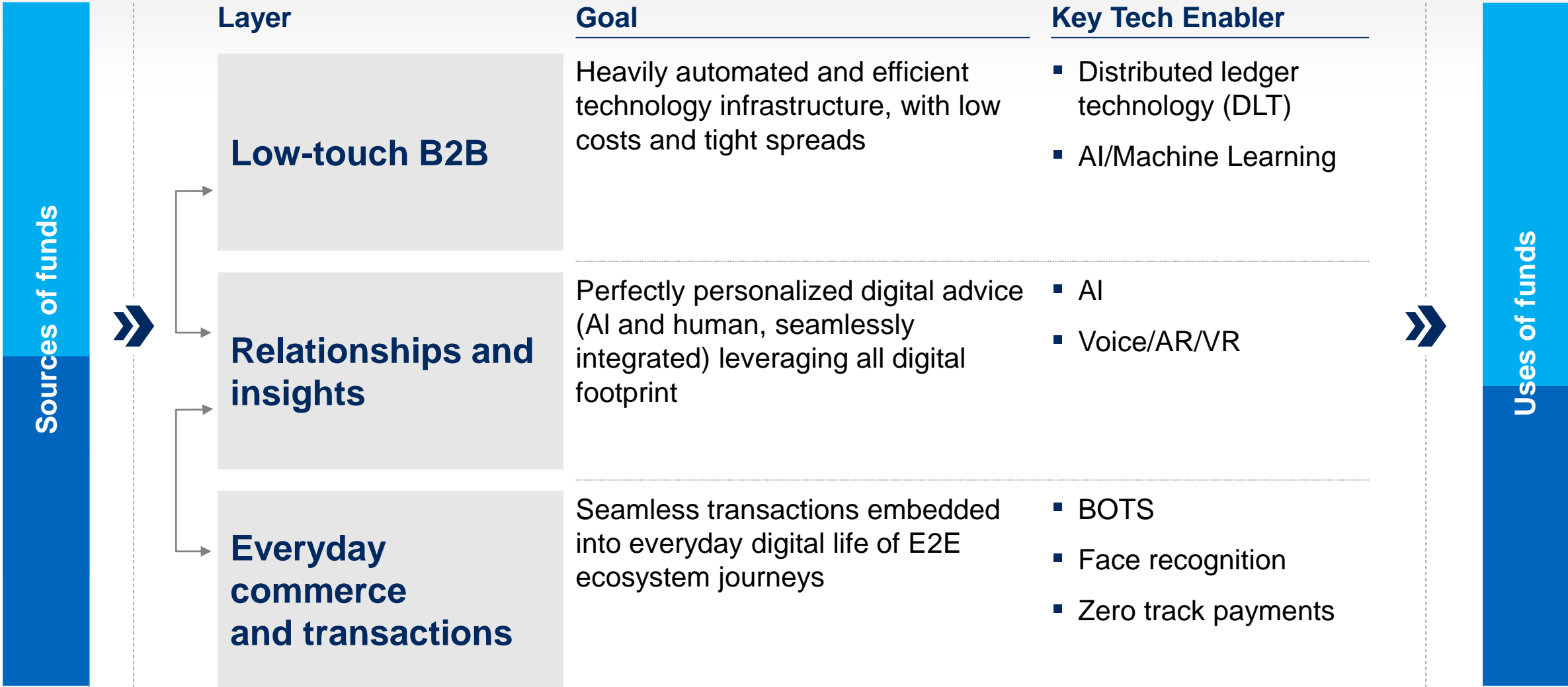


- Almost half the domestic payments flow via 3rd party platforms
- Alipay and WeChat Pay have ~75% share

1 All retail transactions done by domestic Chinese customers, by domestically issued cards and domestic bank accounts across all sectors and use cases  
 2 Includes pure pass-through wallets and pass-through and staged wallets  
 3 Includes only transactions done locally by locally issued credit cards  
 4 3PP transaction volume includes both consumption-related and non-consumption related

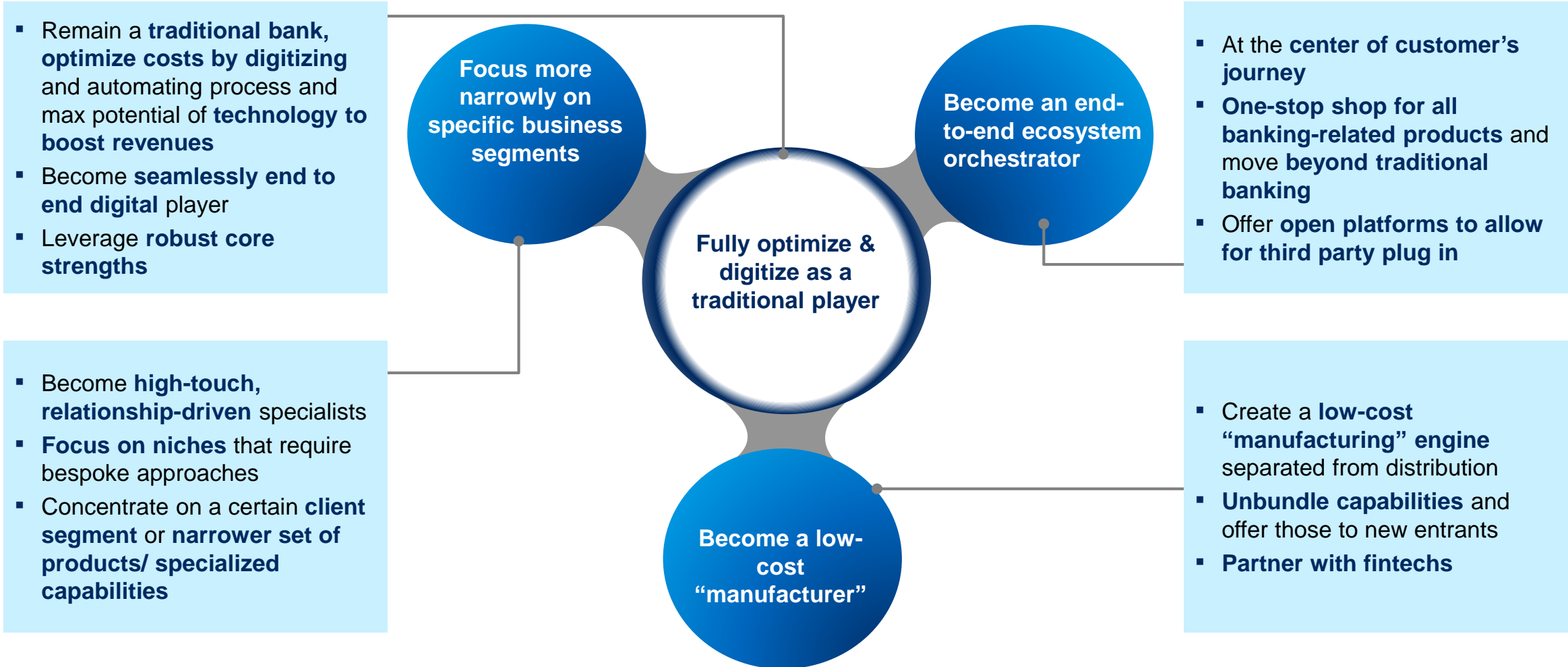
# A faster, smarter, and lower-cost, set of layers will likely replace the current complex system as a conduit for global funds

10 year + endgame scenario



# The question that matters most: how should banks respond to this disruption?

*Each bank must assess how the coming transformation will impact its businesses in specific segments and geographies, its particular strengths and vulnerabilities, and the nature of competition it will face in future—and then make choices about its core offer and other aspects of its strategy*



# The three “MUST DOs” for banks to compete in the new world of financial intermediation



## Reinforce Trust

- **Make a visible commitment to create value for both shareholders and other stakeholders**
  - Take an **expansive view of relationship with customers**
  - **Be mindful of the social and environmental impact**



## Reset Cost Base

- **Accelerate end-to-end digitization**
  - Migrating transactions and **sales from physical to digital channels**
  - Make **services seamlessly available** on digital channels
- **Improve front-line productivity**
  - **Leveraging analytics** and data
  - **Specialists to support front-line staff** in selling more sophisticated products
  - **Reducing the number of branches (and tellers)**



## Renew Talent

- **Transform how to acquire, manage, and deploy talent**
- **Harness the full power of women’s participation**