Building a better working world

Global Banking & Capital Markets

Key themes from the 1Q 2017 earnings calls

June 2017

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Top 10 themes: a year-over-year comparison

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Main topics discussed in the 1Q 2017 earnings calls

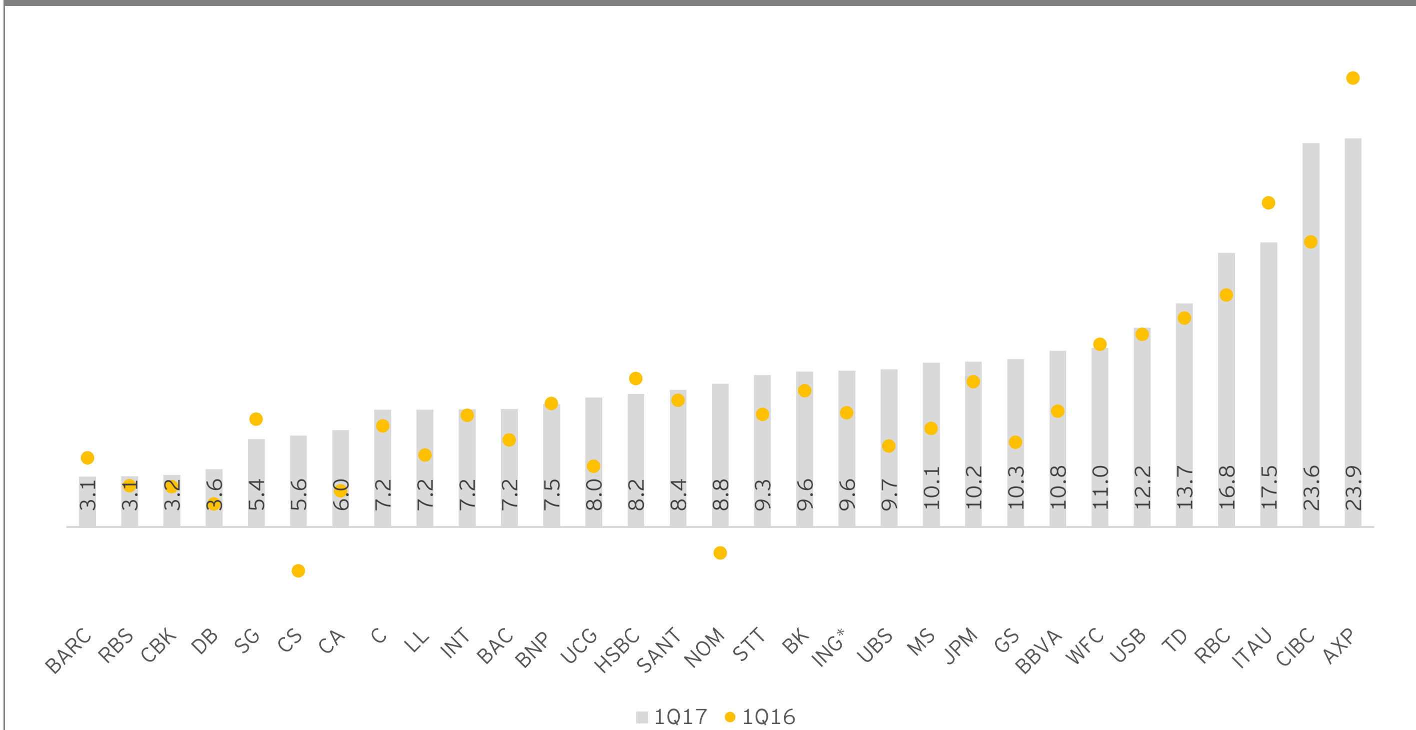
A recovery in revenues from weak 1Q 2016 levels contributed to improved profitability in 1Q 2017.

"In the first quarter, we achieved CHF 5.5 billion of adjusted net revenues, reflective of constructive markets and of stronger levels of client activity. This represents an 18% increase vs. the same period last year, which we acknowledge was a particularly challenging quarter, but also an 8% increase sequentially from 4Q 2016, which enjoyed a more supportive market. So that's a good progression in revenue."

— Tidjane Thiam, CEO, Credit Suisse

- Financial performance in 1Q 2017 generally improved from 1Q 2016, however, results were somewhat flattered by the weakness that characterized the start of last year.
- Only four banks included in this analysis* reported a decline in revenues from 1Q 2016.
- Revenue growth was primarily driven by strong performance in fixed-income trading, which benefited from a more constructive market environment and a surge in investor confidence following the US presidential election.
- Revenue trends were sufficiently positive to generate efficiency improvements at 21 banks. In addition, 23 banks reported positive operating leverage (revenues grew more than expenses).
- Higher revenues also contributed to better earnings performance, with return on equity (ROE) improvements at all but 7 banks and an increase in net income at 27 banks.
- With strategic plans on track and delivering, and efficiency programs generating savings, banks are starting to shift their focus to transformational investments.

Return on average equity (ROAE), 1Q 2017



Source: SNL Financial
*ING data is from company reports

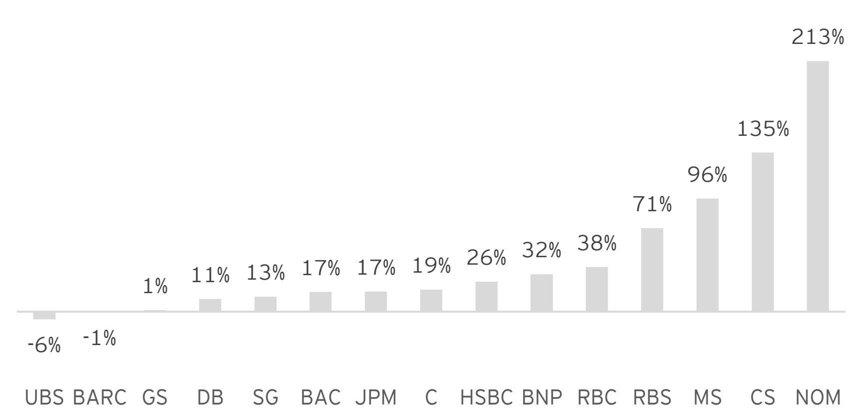
In 1Q 2017, only four banks — American Express, Deutsche Bank, HSBC and Wells Fargo — reported a decline in revenues from 1Q 2016.

- American Express faced challenges from currency translation and the sale of the Costco portfolio. CFO Jeff Campbell noted that excluding these factors, revenues would have increased 7%.
- Deutsche Bank's €722 million revenue decline reflected a negative impact from valuation adjustments. CFO Marcus Schenck noted, "*Let me highlight once again that the desired reduction on our own credit spreads has cost a swing in reported revenues year-over-year to the tune of €0.7 billion*."
- At HSBC, reported revenue fell 13% from 1Q 2016. However, when adjusted to exclude significant items such as the 1Q 2016 benefits from the sale of Brazil operation and own credit spread, revenues actually grew 2%.
- At Wells Fargo, fee income was impacted by a 23% drop in mortgage banking revenue.

For many quarters, revenue growth trends have been muted, with banks reporting only single-digit increases, if any at all. In 1Q 2017, it was notable that 11 of the banks included in this analysis generated double-digit revenue growth when compared to 1Q 2016. The primary driver of higher revenues was the recovery in banks' wholesale businesses and in particular, fixed income, currencies and commodities (FICC) trading. Most of the 15 major participants in FICC trading saw significant revenue gains in this business, as a post-US election surge in investor confidence and expectations for higher US interest rates resulted in higher global activity levels, particularly in credit and rates products. Even banks outside this group of traditionally dominant investment banks cited wholesale banking or trading revenues as a key revenue driver in the quarter.

- Victor Dodig, CEO, Canadian Imperial Bank of Commerce: "Our Capital Markets business also reported a record quarter, with adjusted earnings of CA$371 million, which is up 50% from a year ago. These earnings are supported by a combination of a well-diversified and client-driven trading revenue business, cost discipline and strong credit quality."
- Carlos Torres Vila, CEO, BBVA: "High net trading income with strong performance of our corporate and investment banking unit, including here some portfolio gains but also very strong performance in global markets."
- Jérôme Grivet, CFO, Crédit Agricole: "If we go now to the large customers division, we have had again a significant growth in revenues, nearly 24%, with all business divisions contributing to this increase. Capital markets [were up more than] 17%, in particular in credit and foreign exchange."

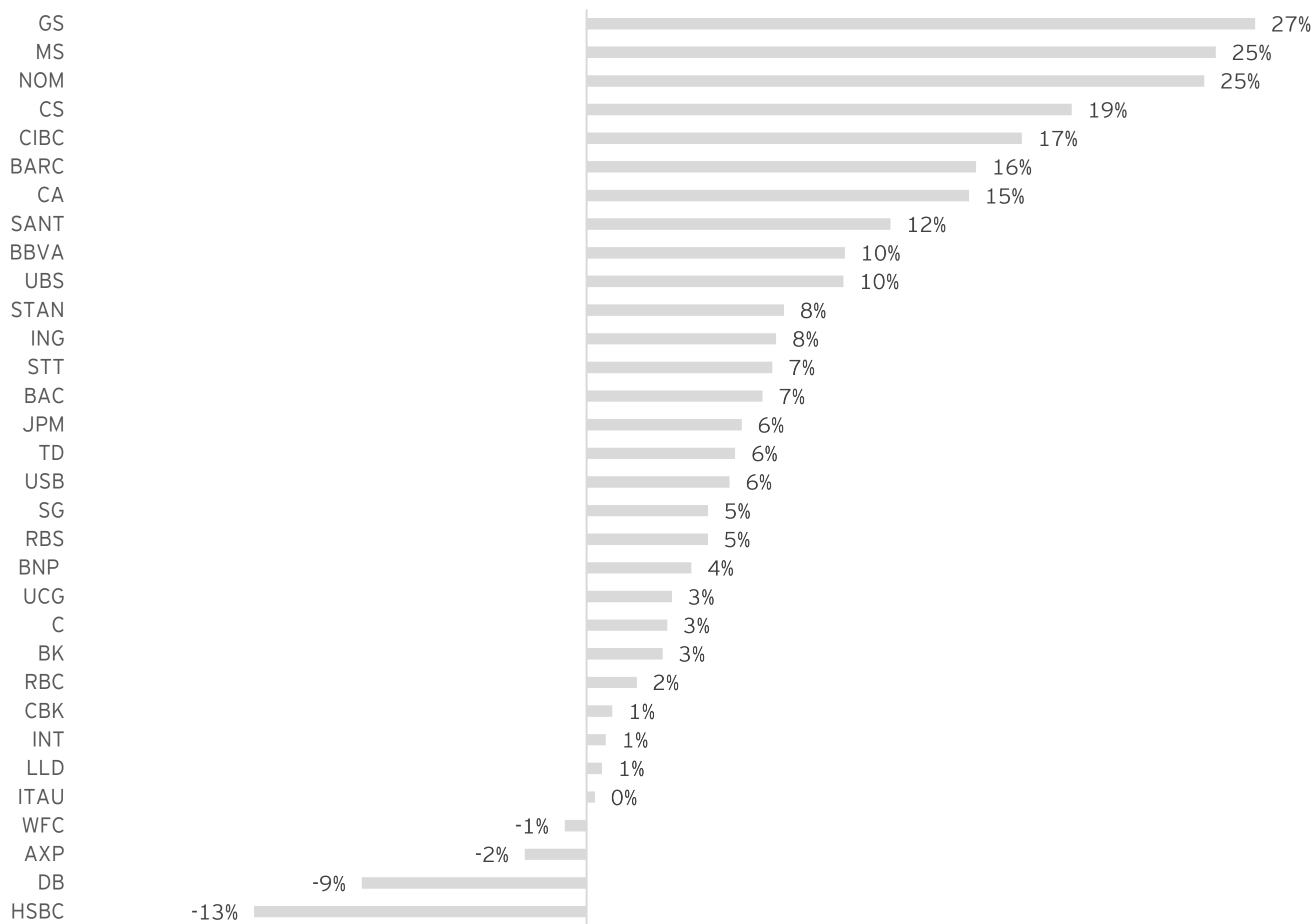
Percentage change in FICC trading revenue from 1Q 2016 in reported currency, selected banks



Source: Company reports

Revenue growth also contributed to improved profitability across the industry, easily offsetting an increase in performance-related costs in the quarter. ROAE was in positive territory for all the banks included in this analysis. In addition, 11 banks — 10 of which are based in the Americas — reported double-digit returns. This regional outperformance underscored the advantages of higher interest rates and stronger business and consumer confidence. Unfortunately, European banks have not experienced the same benefit, as observed by UBS Group CEO Sergio Ermotti: "*We have clearly seen improved investor sentiment in the first quarter, particularly in the US, but this hasn't yet translated into a sustained increase in activity levels globally and may not, given macro and geopolitical uncertainties*."

Percentage change in revenues from 1Q 2016



Source: Company reports, EY analysis

Positive revenue momentum is expected to continue this year, but may be impacted by geopolitical uncertainties.

"In recent weeks, we've seen increased geopolitical risks in elections in Europe and the situation in North Korea and the market stance remains cautious in preparing for any surprises."

— Takumi Kitamura, CFO, Nomura Holdings

Improved performance in 1Q 2017 was welcomed by banks and analysts alike, however, there are two important caveats to the recovery in revenues and profits. First, 1Q 2016 was challenged by an unusually weak market environment and the resulting dismal performance provided a flattering comparison. Second, positive trends in 1Q 2017 were driven by expectations that global economic growth will accelerate and that pro-growth policies such as tax reform will be implemented in the US. Further evidence will be necessary to demonstrate that either of these drivers actually materializes and is sustainable. Nevertheless, management comments reflected optimism about economic prospects:

- Marcus Schenk, CFO, Deutsche Bank: "The revenue outlook is broadly better than it was a year ago and that clearly has been reflected in market sentiment. The macro economic outlook has improved, reflecting an expectation of accelerated economic growth and likely increases in interest rates. Obviously, there is no certainty on this outlook and, in particular, there remains substantial geopolitical risk."
- António Horta-Osório, Group CEO, Lloyds Banking Group: "UK economic performance remained strong in the first quarter and continued to benefit from low unemployment and reduced levels of indebtedness. We continue to expect GDP growth in 2017, similar to the level seen in 2016, of around 2%."

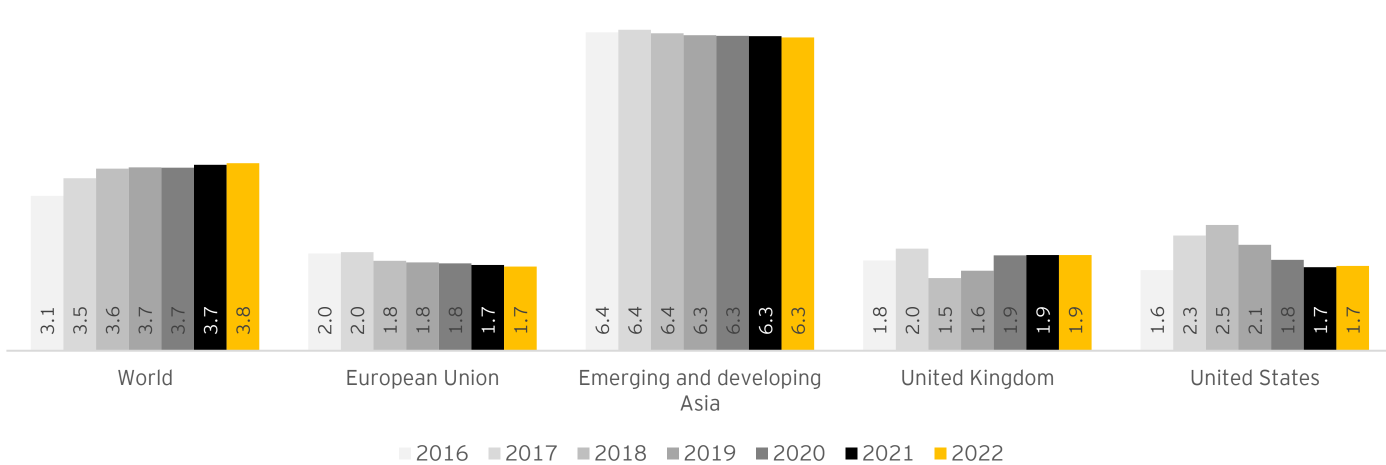
- Andy Cecere, CEO, U.S. Bancorp: "The US economy continues to improve. Interest rates are finally on an upward trajectory, and customer sentiment reflects optimism for potential actions by the new administration. So there is a lot of change and potential opportunity on the macro front, much of which could be to the benefit of the banking industry."

At the same time, however, the operating environment continues to be framed by significant geopolitical uncertainties that could easily derail economic growth. While the outcomes of recent elections in Europe have calmed market unease, concerns about when — and how easily — the Trump administration's US policy agenda will be implemented escalated in late March and early April.

- Frédéric Oudéa, CEO, Société Générale: "In March, we've seen the return of political uncertainties leading to a more 'wait-and-see' mood in the markets."
- Jon Pruzan, CFO, Morgan Stanley: "Questions around timing and achievability of the new administration's policy initiatives resulted in more sporadic client activity toward the end of the first quarter. This was consistent with the broader theme that began to crystallize in late March — the contrast between the strength of the global economy and the unease around US policy outcomes and potential geopolitical strains. We're cognizant that uncertainty can weigh on market psychology and activity levels."

For more information on the impact of the Trump administration's agenda on the banking industry, please watch EY's webcast, The first 100 days: impact on financial services

GDP growth forecasts



Source: IMF World Economic Outlook, April 2017

Areas of strategic focus are shifting as legacy issues are resolved, restructuring nears completion and banks are on a firmer capital footing.

"For years, we have stayed focused on growing responsibly, including staying within our risk and client frameworks and making our growth more sustainable by simplifying the company and improving efficiency. … These results tell us that responsible growth is working with more to come as the economy continues to improve."

— Paul Donofrio, CFO, Bank of America

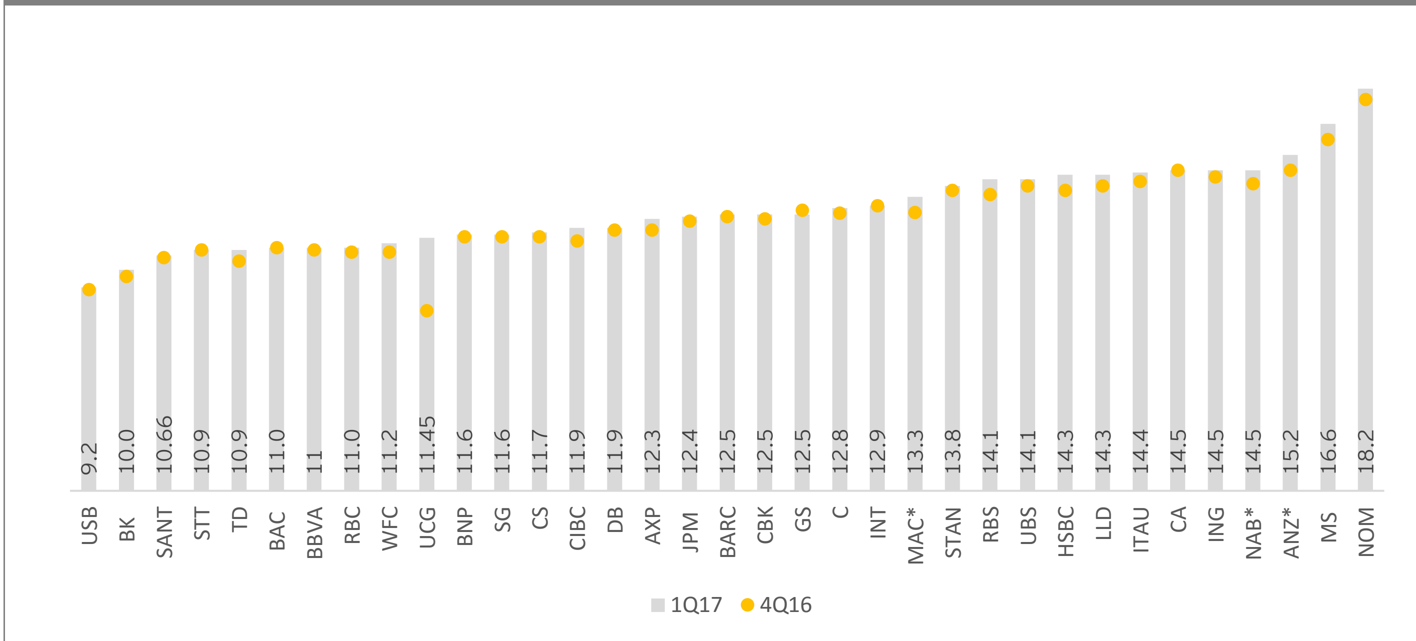
In recent years, banks around the world have put considerable effort into reshaping their businesses, building capital, adjusting their strategies to respond to new regulations and the persistently difficult operating environment and getting positioned to succeed under "normalized" conditions. While there remain too many macro uncertainties to definitively assert that 1Q 2017 represented a sustainable and normalized environment, management at a number of banks appeared to believe that the recovery of revenues — albeit from the unusually low base set in 1Q 2016 — validated their strategic choices and demonstrated the successful execution of their priorities.

Société Générale CEO Frédéric Oudéa even asserted that the European banking sector was moving beyond legacy issues into a new and more proactive period. "*After the first years where we were all firemen between 2008 and 2012, dealing with either specific crises, or the Lehman, the bankruptcy or the Eurozone crisis, I think the major banks, at least in Europe, are going to end what I'm calling the remediation phase in 2017. … The idea is to enter into a third phase, in 2018 and beyond, where the energy and the focus will be 100% on industrial and structural transformation, which is very significant*."

- Jes Staley, Group CEO, Barclays: "The performance we have reported today represents a period of strong progress against our strategy, and it's the clearest evidence so far of what this company is capable of delivering once our restructuring is complete. We are now just two months away from finishing that work, a restructuring that is creating a simplified transatlantic consumer, corporate and investment bank that has the means to produce high-quality returns for our shareholders and on a sustainable basis. Looking at each of the priorities we set out in March of last year, we have cause for confidence in achieving our objectives."
- Jeff Campbell, CFO, American Express: "Our 1Q 2017 results showed the steady progress we are making on the range of growth and cost initiatives that we have put in place over the last couple of years and that we reviewed at our Investor Day last month. These initiatives have been supported by the spending that we did over the last two years. We expect that these efforts will all come together to help us produce steady results during 2017 and position us well for the longer-term."
- Marcus Schenk, CFO, Deutsche Bank: "Behind us was a quarter of progress. We completed our capital raise, announced strategic steps to strengthen our German home base and better position the bank for future growth. Although numbers might not show this all yet, we see momentum across the bank as we're overcoming the headwinds we faced in 2016."
- António Horta-Osório, Group CEO, Lloyds Banking Group: "Finally, I am pleased to see that the hard work undertaken in the last six years to transform and simplify the business has allowed the UK government to recover their investment in Lloyds. As the government announced last Friday, £20.4 billion has now been returned to date, including dividends, on its original £20.3 billion investment, with further proceeds to come as UKFI completes its divestment."

For more information on banks' strategic priorities, please see EY's 2017 Global Banking Outlook: Uncertainty is no excuse for inaction

CET1 ratios, 31 March 2017*



Source: Company reports
*Fully loaded Common Equity Tier 1 ratios, with the exception of Nomura, for which the ratio is transitional; harmonized CET1 ratios for ANZ, NAB and MAC

Savings from efficiency initiatives and strategic cost programs is being redeployed into investments.

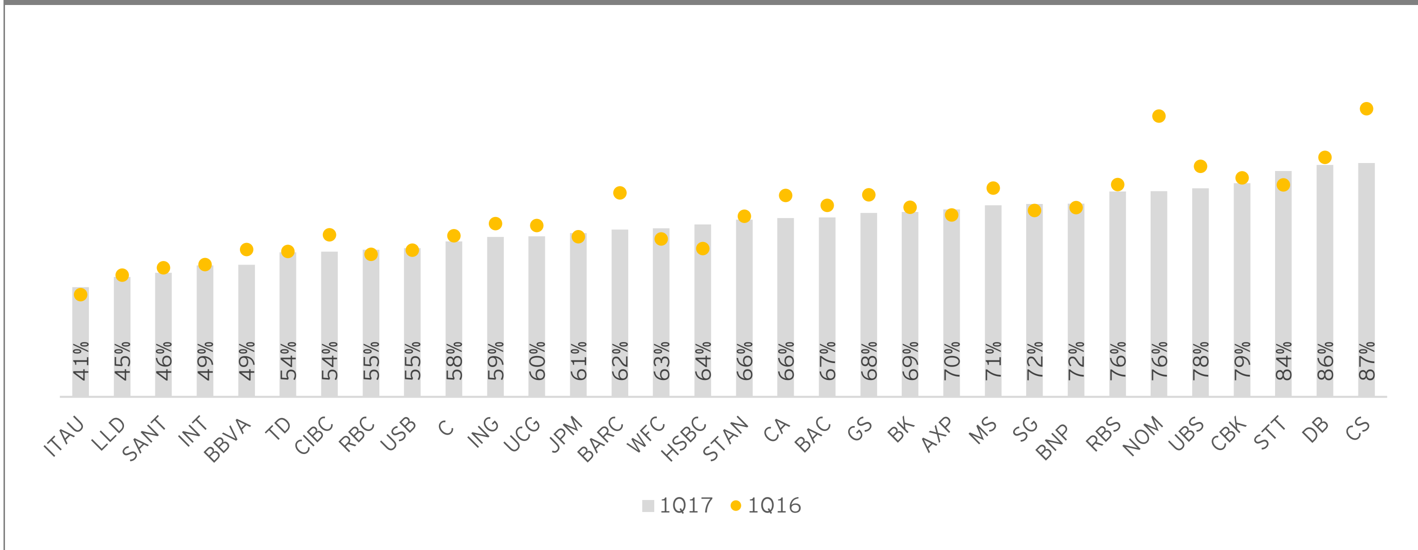
"The benefits of simplification are already evident, and they provide financial and executive bandwidth to invest more heavily in digitization and growth."

— Shayne Elliott, CEO, Australia and New Zealand Banking Group

A key pillar of the reshaping that has taken place in recent years has been the focus on simplification and efficiency. Many banks are now reaching the point where they have either met targets for absolute cost reduction or identified further opportunities to improve their expense base. In addition, 23 banks generated positive operating leverage, or "jaws," in 1Q 2017 as revenues grew faster than expenses. This trend is expected to continue, however, as BBVA CEO Carlos Torres Vila acknowledged, "*The 'jaws' will continue to be positive for the rest of the year, although this large gap between the rate of growth of revenues and costs will not likely be as large going forward.*" Even if revenue growth weakens, comments during the 1Q 2017 earnings season seemed to indicate that banks' investment flexibility has increased, as management detailed plans to invest in business growth and technology initiatives.

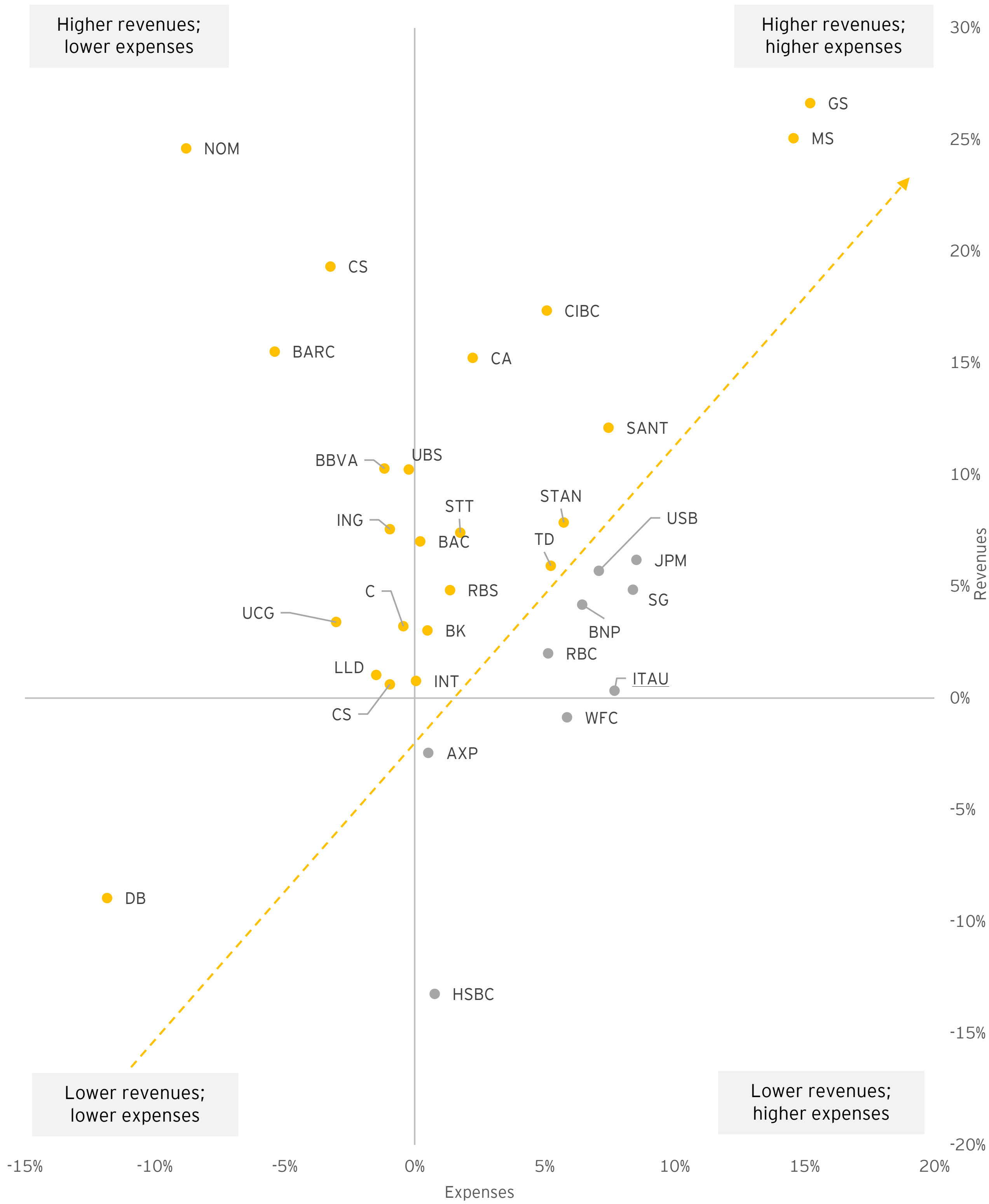
- Kirt Gardner, Group CFO, UBS: "As we continue to complete our net cost-reduction program, you should see a benefit to the net non-compensation cost baseline as we focus on areas like consulting cost, like contractors, like what we're doing with our technology platform to modernize it. … On the other hand, we do continue to invest. We're investing in technology. Sergio highlighted what we're doing in digital. …We would hope on that line to be able to fund our investments without having a significant increase in our non-comp line as we go forward."
- Bharat Masrani, CEO, Toronto-Dominion Bank: "This quarter, you saw us deploy strong earnings growth and savings generated from our productivity program into additional investments, and you can expect that to continue. It's an exciting time to be in banking. Rapidly changing technologies are opening up new frontiers and we are well situated to seize the resulting opportunities. We will continue to make investments to advance our digital transformation, deliver a more connected customer experience and simplify the way we work. Our spending is purposeful, pragmatic and aligned with our strategy to build a better bank, a bank of the future."
- John Shrewsberry, CFO, Wells Fargo: "We've been working on a number of initiatives that we expect will reduce expenses by approximately US$2 billion annually by year-end 2018, with the full year benefit starting in 2019. However, there will not be a bottom-line impact as these savings will be reinvested in the business."
- José Antonio Álvarez, CEO, Banco Santander: "We're investing quite heavily in Mexico to improve our operations, process systems and digital proposition for customers. And you see the cost growing according to that … and you see the cost falling accordingly in Spain, in Portugal, in Poland and in the Corporate Centre, due to the restructuring we did last year."

Efficiency ratios, 1Q 2017



Source: Company reports

Percentage change in revenues and expenses from 1Q 2016



Source: Company reports; banks above the yellow line with yellow markers had positive operating leverage (revenues grew at a higher rate than expenses)

Methodology

The purpose of this review is to examine the key themes discussed among 35 global institutions operating within the banking and capital markets (BCM) sector during the 1Q 2017 earnings reporting season.

Acronym key

ANZ –Australia and New Zealand Banking Group
AXP – American Express Company
BAC – Bank of America
BARC – Barclays
BBVA – Grupo BBVA
BK – Bank of New York Melon
BNP – BNP Paribas
C – Citigroup
CA – Crédit Agricole
CBK – Commerzbank
CIBC – Canadian Imperial Bank of Commerce
CS – Credit Suisse
DB – Deutsche Bank
GS – Goldman Sachs
HSBC – HSBC Holdings
ING – ING Groep
INT – Intesa Sanpaolo
ITAU – Banco Itaú
JPM – JPMorgan Chase
LLD – Lloyds Banking Group
MAC – Macquarie Group
MS – Morgan Stanley
NAB – National Australia Bank
NOM – Nomura Holdings
RBC – Royal Bank of Canada
RBS – Royal Bank of Scotland
SANT – Banco Santander
SG – Société Générale
STAN – Standard Chartered
STT – State Street
TD – Toronto-Dominion
UBS – UBS Group
UCG – Unicredit Group
USB – U.S. Bancorp
WFC – Wells Fargo

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