

The Global Banking Industry

A Challenged Future

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First Avenue Investment Management Conference
Johannesburg, South Africa
May 15th, 2014

I. Financial Crisis 2008: Why? How?

II. Economic Consequences: US & Sovereign Stress / Economic Downturn 2009-2011

III. Consequences: Political & Regulatory Backlash

IV. The Regulatory Landscape

- *Systemic Risk & Capital Buffers, Customer & Markets, and Governance & Supervision*

V. Future Challenges

Questions

I

I. Financial Crisis 2008: Why? How?

As a Result of...

- **MBS/ CDO**
- **IMPROPER and DEFICIENT CREDIT ANALYSIS/ GREED**
- **COMPROMISED “NEUTRAL AUTHORITIES”
RATING AGENCIES**
- **INSUFFICIENT / LAX REGULATORY OVERSIGHT**
- **LIQUIDITY CRISIS**

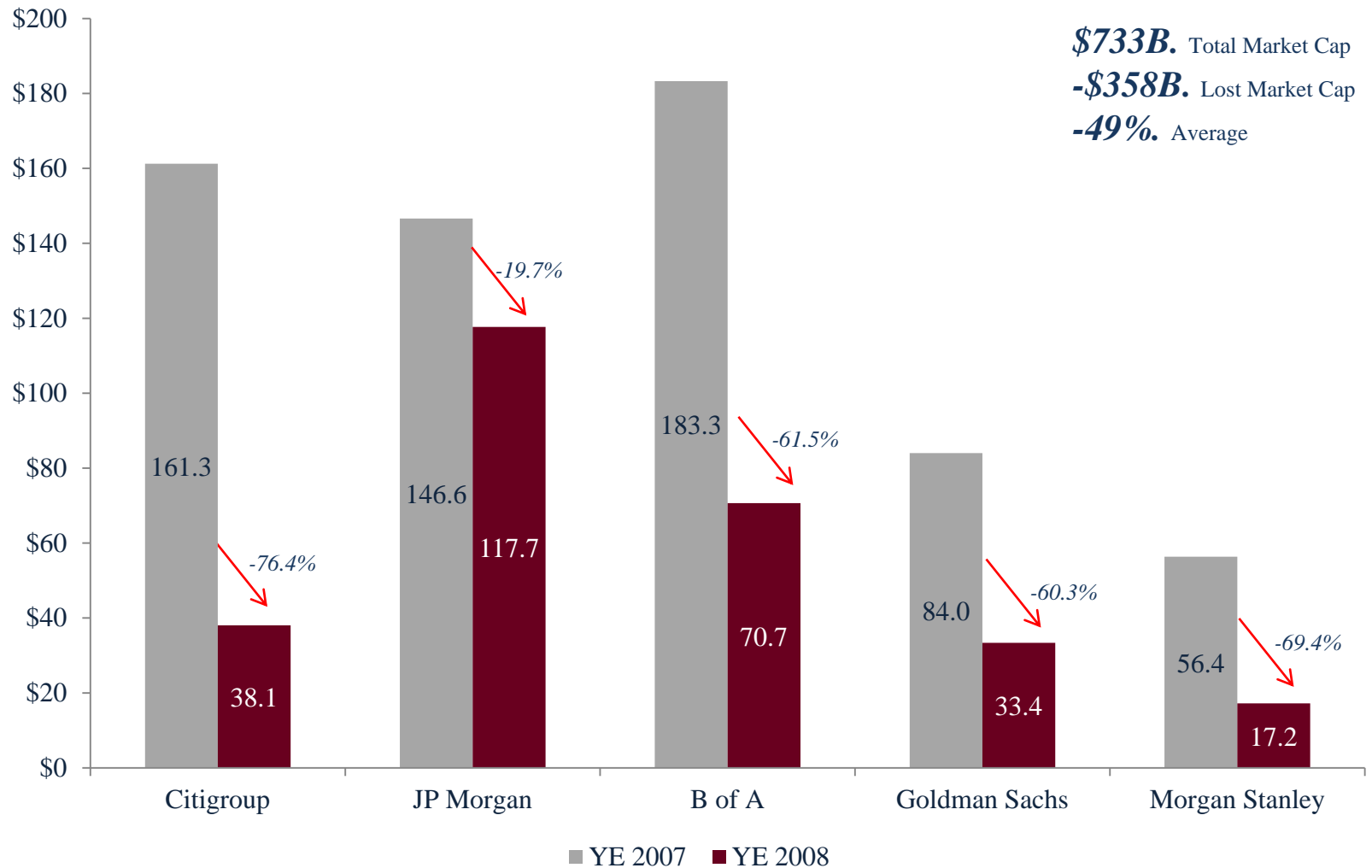
Facilitated by...

- **GLOBALIZATION OF THE FINANCIAL SYSTEM**
- **CLINTON ERA COMMUNITY REINVESTMENT ACT (1995)**
- **GLASS STEAGALL REPEAL (1999)**
- **FREDDIE MAC & FANNIE MAE;**
\$130B in Bailout + \$187 in Liabilities (CBO)
- **BEAR STERNS EFFECT (3/08)**
- **LEHMAN BANKRUPTCY (9/08)**
 - Merrill Lynch → B of A

I

Impact on Market Capitalization | US Global Banks

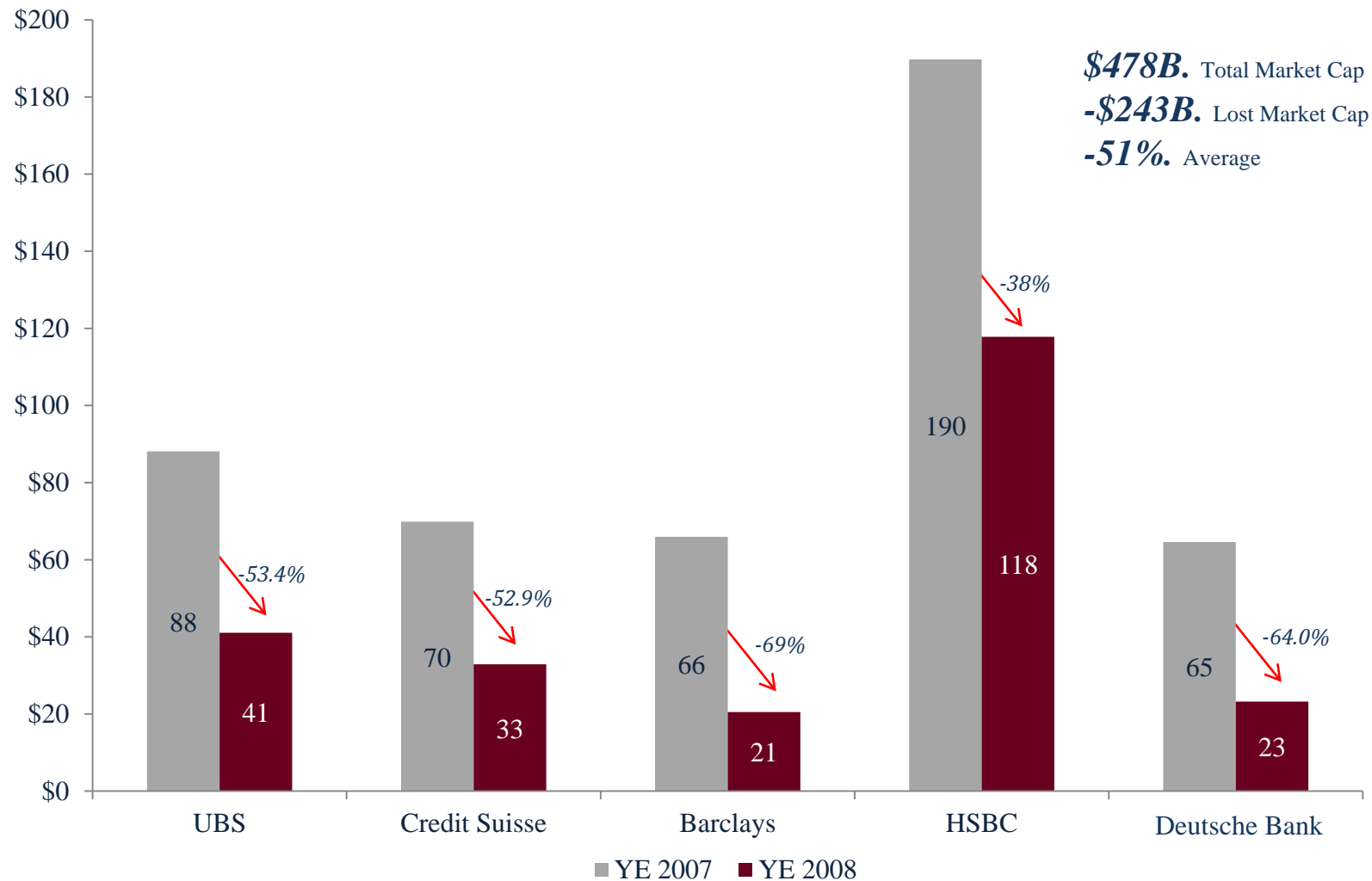
Estimated Losses in Market Capitalization (US\$ B, 2007-2008)



I

Impact on Market Capitalization | Non-US Global Banks

Estimated Losses in Market Capitalization (US\$ B, 2007-2008)



Over \$600 billion in lost market capitalization between 2007-08

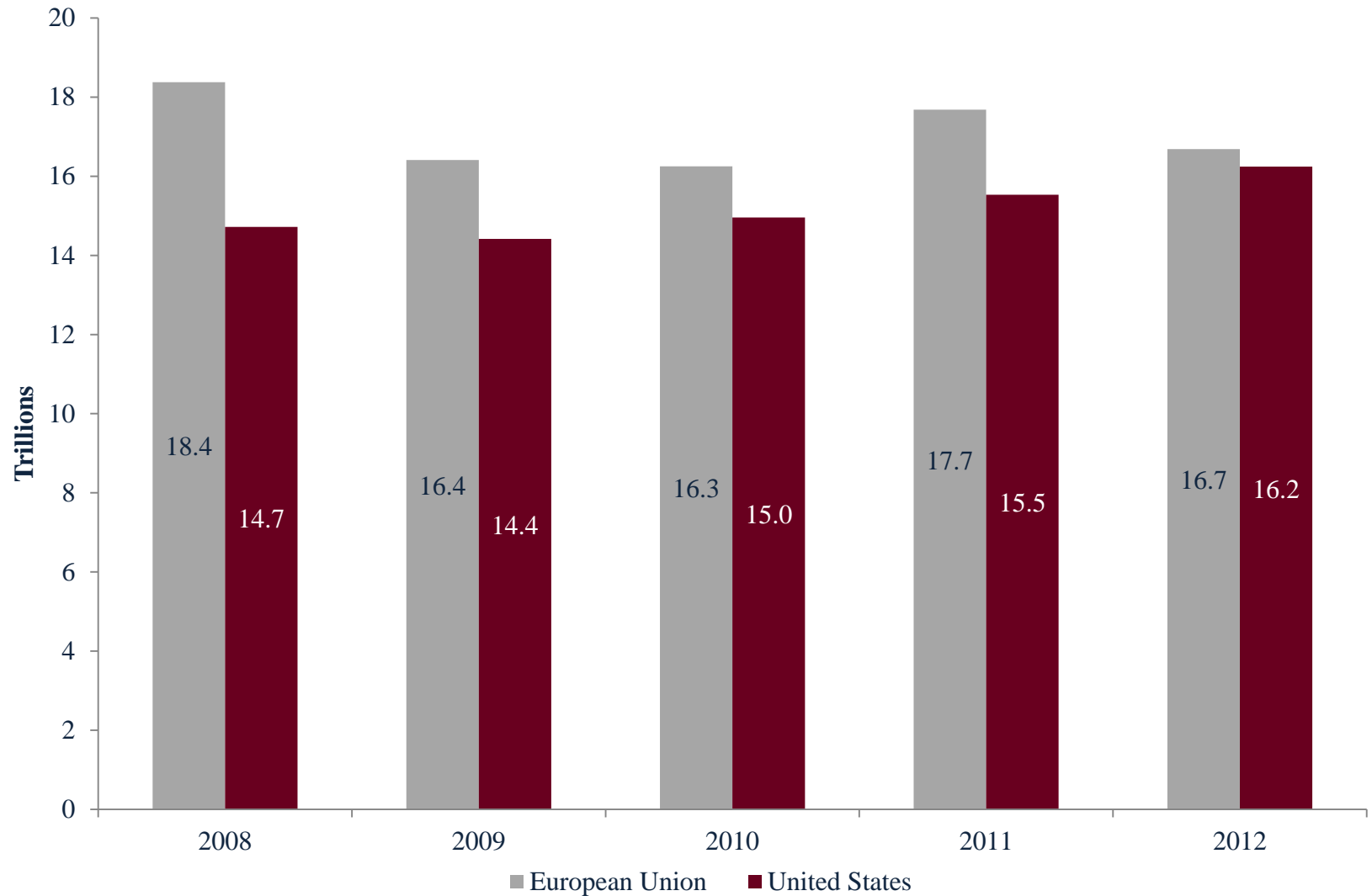
II

II. Economic Consequences: US & Sovereign Stress / Economic Downturn 2009-2011

- **LIQUIDITY STRESS in the FINANCIAL SYSTEM**
- **GLOBAL ECONOMIC CONTRACTION**
- **QUANTITATIVE EASING (US FED/ECB)**
- **REGULATORY and LEGAL INITIATIVES (Phase 1)**
 - **COMPENSATION LIMITS / POLITICALLY MOTIVATED**
 - **DODD-FRANK**
 - **BANK OF ENGLAND / PRUDENTIAL STANDARDS**
 - **ECB & BROADER OVERSIGHT**
 - **VOLKER RULE – DEBATE STARTS**

II

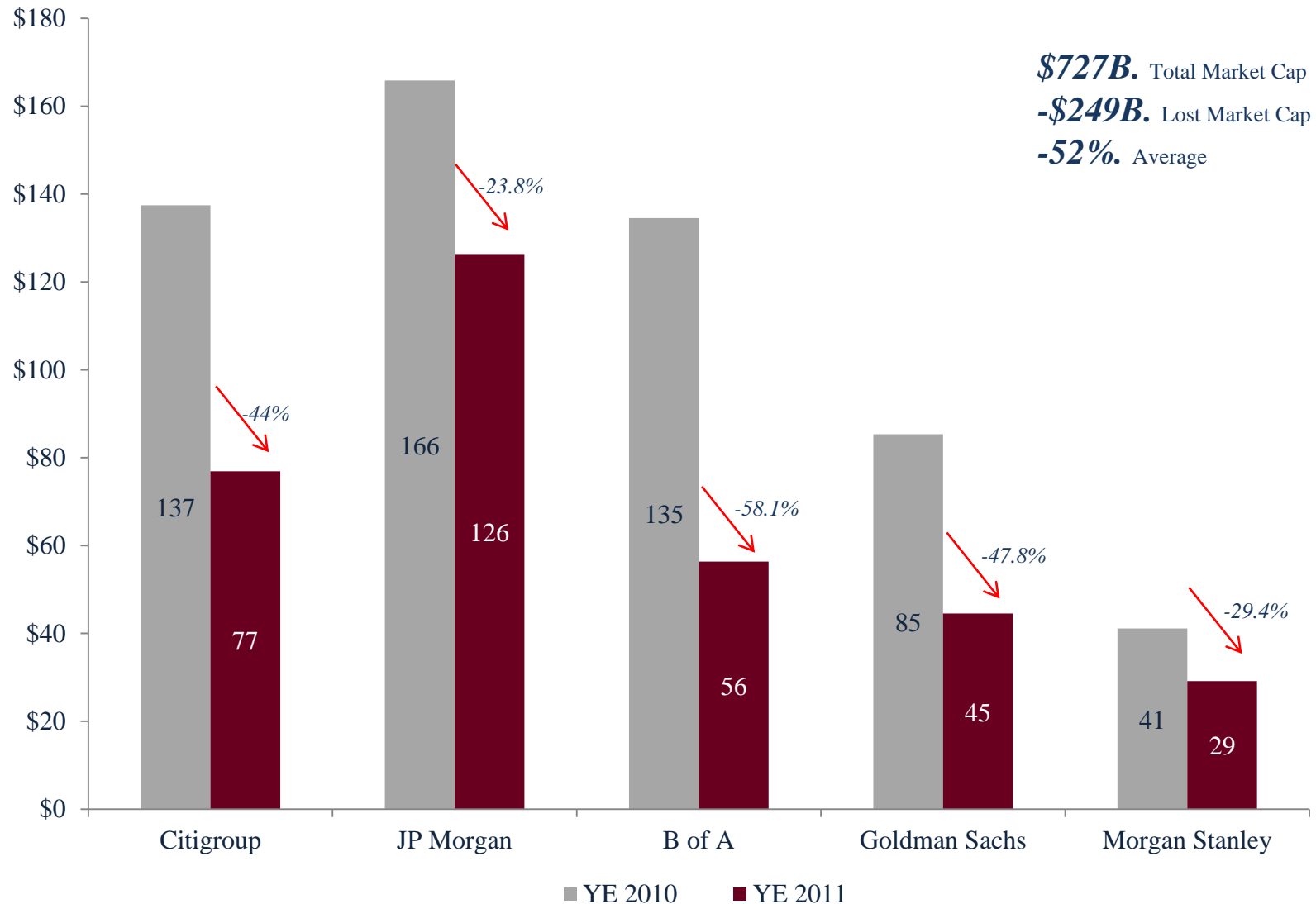
Sovereign and Economic Stress



II

Impact on Market Cap. (2010-11) | US Global Banks

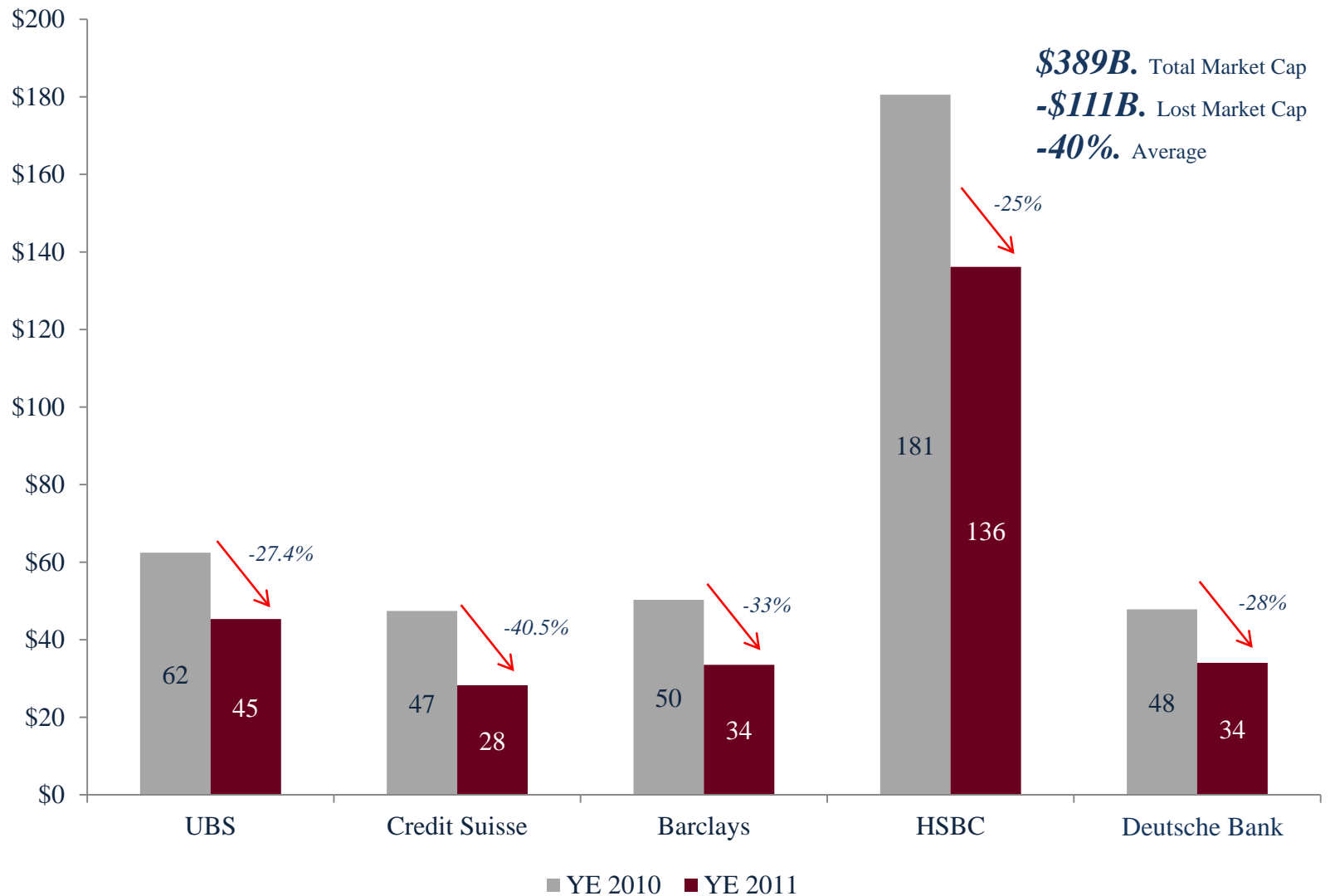
Estimated Losses in Market Capitalization (US\$ B, 2010-2011)



II

Impact on Market Cap. (2010-11) | Non-US Global Banks

Estimated Losses in Market Capitalization (US\$ B, 2010-2011)



II

Top 10 Global Bank Market Impact

Over \$360 billion in lost market capitalization between 2010-11

III. Consequences: Political & Regulatory Backlash

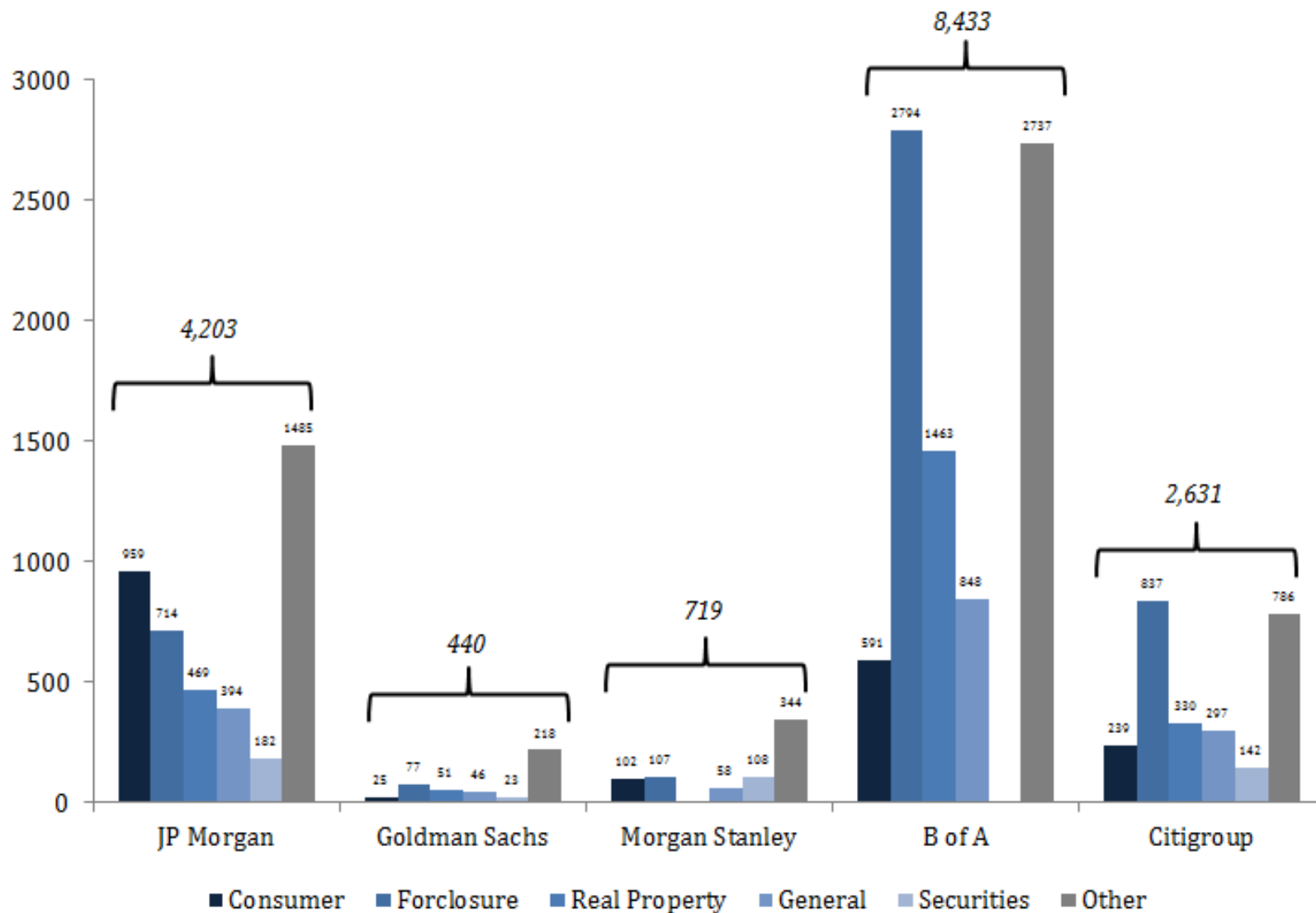
- **PUBLIC OUTCRY**
- **POLITICS** → [MILLIONAIRES / BILLIONAIRES = WALLSTREET]
- **CULTURAL SHIFTS/ PRESSURES**
“MARGIN CALL” – “TOO BIG TO FAIL”
- **CALL FOR REFORM**
 - CONGRESSIONAL HEARINGS (GS/MS/JPM)
 - CONSUMER PROTECTION BUREAU / FED (NEW)

- **CONTINUED BALANCE SHEET STRESS**
- **LOSS OF FEE INCOME/ SHRINKAGE OF ISSUANCE VOLUMES, DEBT & EQUITY**
- **FED/ECB OVERSIGHT INTENSIFIES**
- **CONSUMERS DISINTERMEDIATE THE BANKING SYSTEM**
 - **HIGH LIQUIDITY ON BALANCE SHEETS/ CORPORATES**
 - **CREDIT CONSTRAINTS ON CONSUMERS**
- **RETRIBUTION ENVIRONMENT/POLITICAL PRESSURES INCREASE**

III

Consequences | Lawsuits US Global Banks (2011-14)

Total Number of Filed Cases Against US Global Banks (2011-2014)

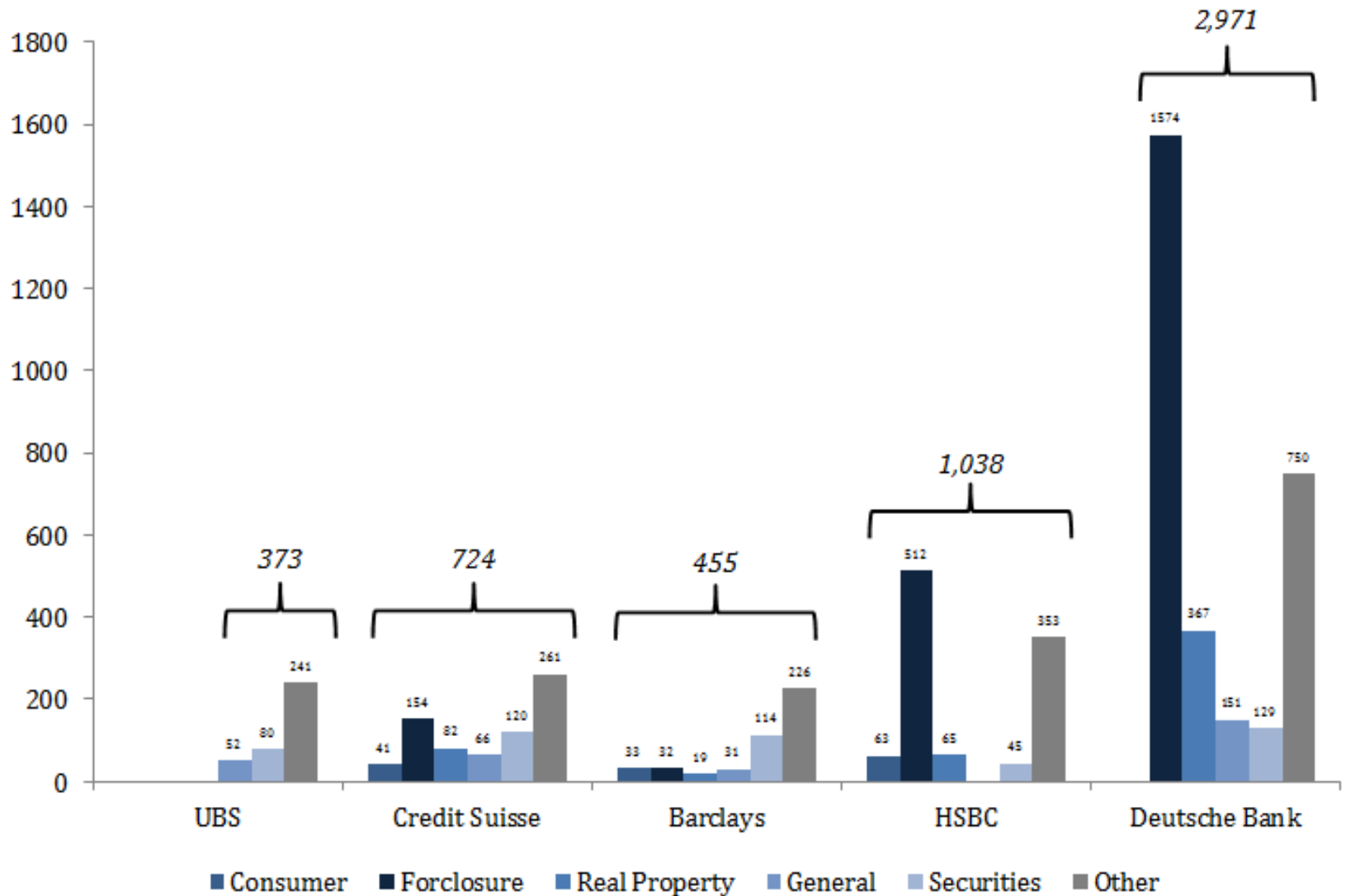


16,426
Total Filed
Cases
Including
Subsidiaries

III

Consequences | Lawsuits Non-US Global Banks (2011-14)

Total Number of Cases Filed Against Non-US Global Banks (2011-2014)

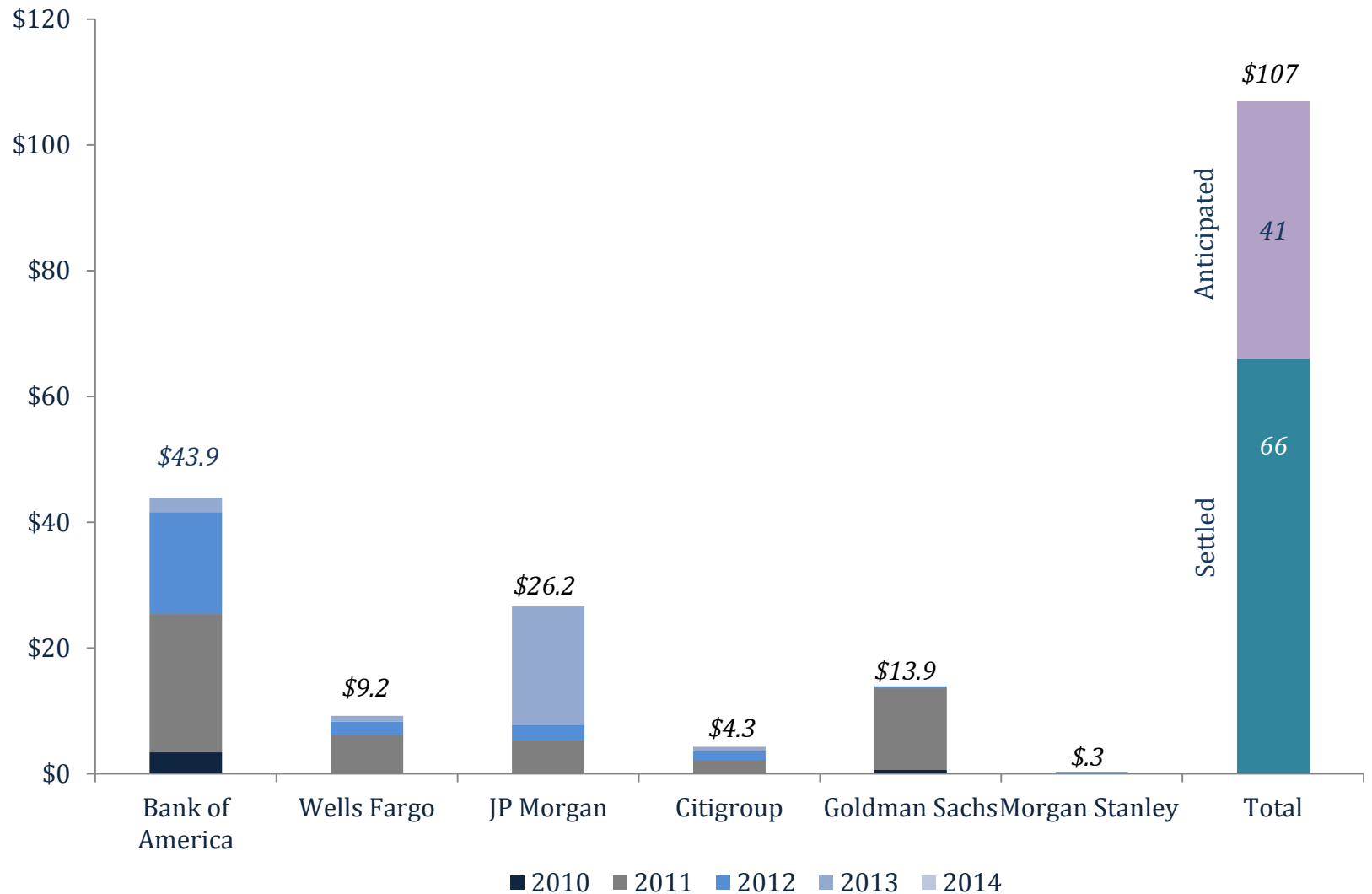


5,561
Total Filed
Cases
Including
Subsidiaries



Estimated Legal Settlement Costs | US Global Banks

Estimated Total Settlement Cost (US\$ B, 2010-2013)



Over 22,000 total cases filed between
2011-2014

III

Additional Costs Not Considered

- **LEGAL COSTS**
- **FORENSIC ACCOUNTING**
- **DISGORGEMENT**
- **RECISION**
- **OPPORTUNITY COST**
- **ADDITIONAL COMPLIANCE COSTS (i.e. monitoring, C/D order)**
 - JPM hires 8,000 employees for anti-money laundering (2014)
 - HSBC hired 1,600 compliance employees in 2013



Select Lawsuits | US Global Banks

Citigroup

- **2000-2012 Fannie Mae Repurchase Claims**
(US \$968M settlement 2013)
- **2006-2008 Subprime Mortgage Toxic Assets (Bondholders)**
(US \$730M settlement in 2013)
- **2007-2008 Class Action, Common Stock Holders, Hidden Risks**
(US \$590M settlement 2012)
- **2007 CDO/CDO Housing Market Lawsuit**
(US \$285M settlement 2011)
- **(?) Force Placed Insurance Lawsuit**
(US \$110M settlement 2014)
- **2005-2008 Securities Claims**
(US \$1.13B settlement in 2014)

Goldman Sachs

- **2007 Subprime Mortgage CDO**
(US \$550M settlement 2010)
- **2005-2007 Massachusetts Subprime Mortgages**
(US \$60M to end investigation 2009)
- **2008 (?) Supervisory Failures (Trading & Research)**
(US \$22M settlement 2012)

JP Morgan

- **2005-2008 MBS Settlement with US Government**
(US \$13B settlement 2013)
- **2005-2008 MBS Settlement with institutional Investors**
(US \$4.5B settlement 2013)
- **2005-2008 Subprime Mortgage Settlement (Defrauding)**
(US \$614M settlement 2014)
- **2007-2008 Madoff Settlements**
(US \$2.0B settlement 2014)
- **2012 London Whale**
(US \$900M pending)
- **2010-2012 Manipulation of Energy Markets**
(US \$410M settlement 2013)
- **2005-2012 Refunds to Credit Card Customers**
(US \$389M settlement 2013)

Bank of America

- **2005-2007 Mortgage Settlement (Fmae /Fmac)**
(US \$9.3B settlement 2014)
- **2008 Merrill Lynch Acquisition**
(US \$2.43B settlement 2012)
- **(?) Assured Guaranty Settlement on Bonds**
(US \$1.6 B settlement 2011)
- **2004-2007 Countrywide Discrimination/Pension Suits**
(~US \$1B settlement 2010-2011)
- **2008 SEC Settlement over Merrill Acquisition**
(US \$150M settlement 2010)
- **2011-2012 Misleading Customers in Credit Card Products**
(US \$772M settlement 2014)

Morgan Stanley

- **2005-2007 Mortgage Securities Settlement**
(US \$1.25B settlement 2014)
- **2007 SEC Probe into Bond Trades**
(US \$275M to resolve investigation)



Select Lawsuits | Non-US Global Banks

Barclays

- **2005-2009 Libor Probe (Manipulation)**
(US\$ 453M settlement)
- **2006-2008 Gaming US Energy Markets (on hold)**
(US\$ 488M pending 2014)
- **2000 Subprime Mortgage (Securitization) to Italian Bank**
(US \$36.1M settlement 2013)
- **Mid-1990's – 2006 Settlement of Client Payments (Opaque)**
(US\$ 298M settlement 2010)
- **2002-2012 FINRA fines over Record Retention**
(US \$3.75M settlement 2013)

Credit Suisse

- **2005-2007 Mortgage Lawsuit (Fmae and Fmac)**
(US\$ 885M settlement 2014)
- **(?) Evading US Taxes (could reach)**
(US\$ 800M may accept settlement 2014)
- **2005-2010 Misleading Investors on RMBS**
(US \$120M settlement with SEC 2012)
- **2002-2013 Non-Compliance; Cross-Border Advisory**
(US\$ 196M settlement 2014)
- **Mid-1990's-2006 Secret Financial Transactions**
(US\$ 536M settlement 2009)

HSBC

- **2009-2010 Wrongful Foreclosure (US Homeowners)**
(US \$249M settlement 2013)
- **2007-2008 Money laundering allegations with Mexico**
(US \$1.9B settlement 2013)
- **2005-2009 Libor Scandal (Still pending)**
(US \$? Pending)

UBS

- **2012 (news breaks) Libor Probe (Manipulation)**
(US\$ 1.5B settlement 2012)
- **2005-2010 Manipulation, False reporting**
(US\$ 700M settlement 2012)
- **2004-2007 Mortgage Settlement (Fmae and Fmac)**
(US\$ 885M settlement 2013)
- **2002-2007 Fine for Helping Americans Avoid Taxes * NB**
(US\$ 780M settlement 2009)
- **2007-2008 Misleading Investors on Lehman Notes**
(US\$ 120M settlement 2013)
- **2007 Misleading Mortgage Securities**
(US \$50M Fed settlement 2013)

Deutsche Bank

- **2005-2007 Mortgage Suit (inadequate disclosure)**
(US \$1.9B settlement 2013)
- **2012 (news breaks) Libor Rigging Scandal**
(US\$ 633M fine 2013)
- **1990's Management of Embezzled Funds; Brazil**
(US \$20M settlement 2014)

- **PUBLIC HUMILIATION**
- **CONGRESSIONAL HEARINGS**
(B of A, GS, JP Morgan, Morgan Stanley, Lehman)
- **COMPENSATION: NEW STRUCTURE/ON-GOING**
- **VALUE DESTRUCTION**
 - EMPLOYEE DISLOYALTY
 - CLIENT DISLOYALTY
 - SHAREHOLDER STRESS





Bank of America to pay \$9.3 billion to settle mortgage bond claims

JPMorgan agrees to \$13 billion mortgage settlement



Citigroup to Pay \$1.13 Billion to Settle Securities Claims



UBS \$1.5 Billion Libor Settlement Signals More to Come

MARKETS

Bank of America to Pay \$772 Million Over Credit-Card Practices



Payment Would Settle Allegations Brought by U.S. Regulators and Will Include Refunds to Customers



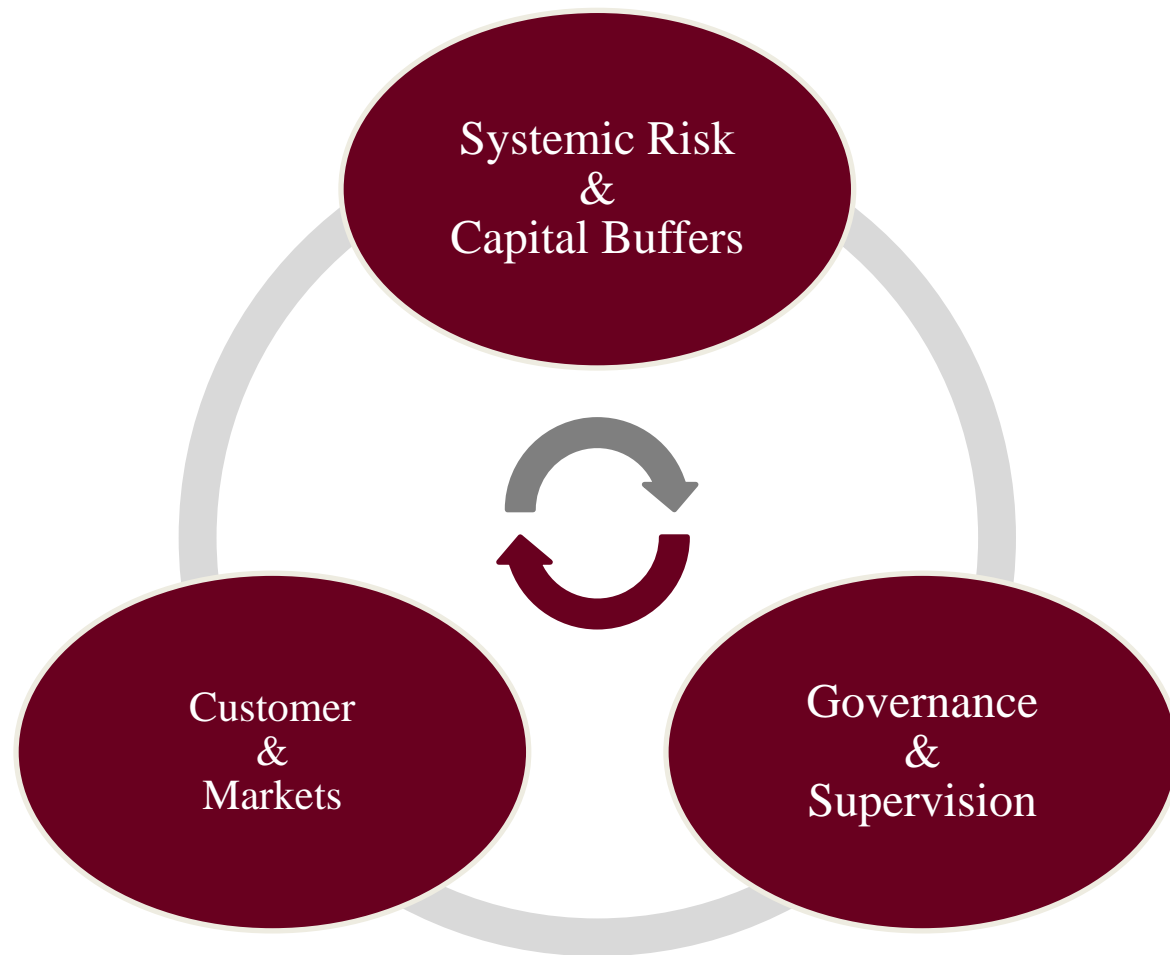
HSBC's \$1.9 Billion Money Laundering Fine

IV

IV. The Regulatory Landscape

IV

New Regulatory & Compliance | Management Process

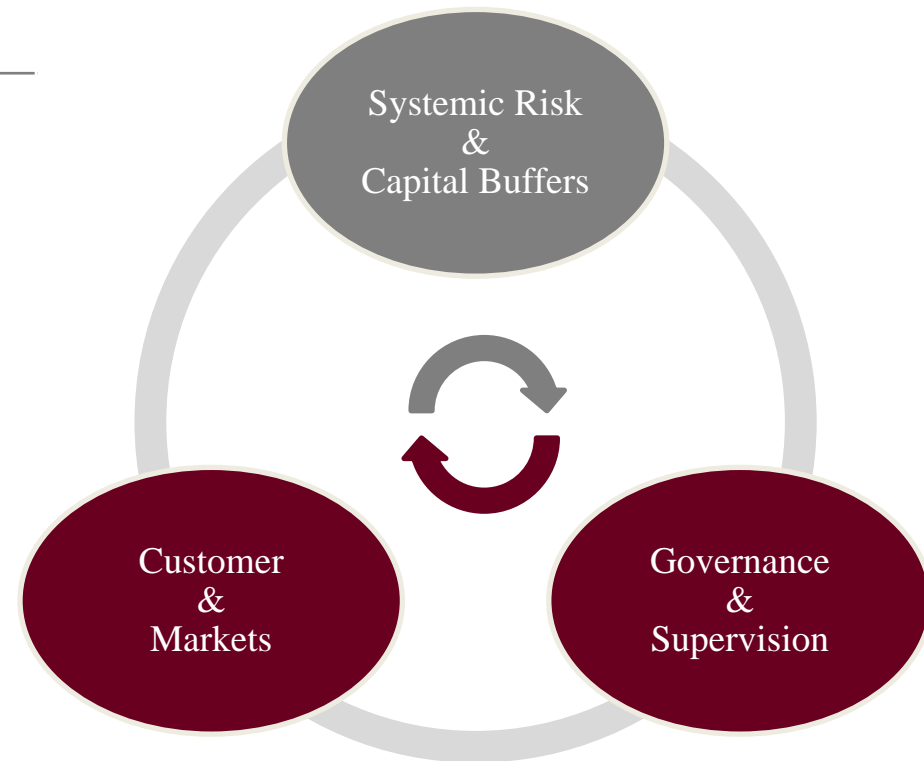


IV

Systematic Risk & Capital Buffers

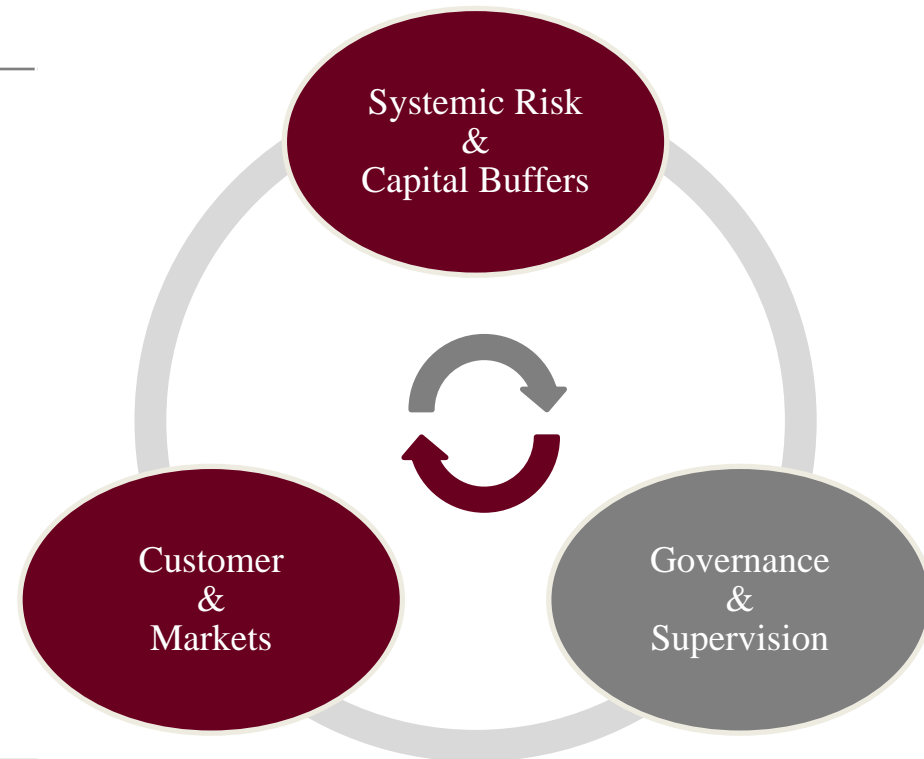
SYSTEMIC RISK & CAPITAL BUFFERS

- **Basel II/III (in process)**
- **Dodd Frank (in process)**
 - *2009 → ?*
 - *Volcker Rule*
- **Prudential Regulatory & Environmental Criteria**
- **FED New Prudential Standards**
- **Political Influences/Shareholder Activism**
 - *Controlling Pay*
 - *Changing Boards*
 - *Industry Consolidation (Potentially forced)*



GOVERNANCE & SUPERVISION

- **Enforcement of Existing and New Banking Laws**
 - *More proactivity*
 - *Permanent – i.e. Bank Examiner Floor*
- **Board Accountability High → to increase**
- **Bank Management Accountability**
- **Securities Regulators**
 - *Political pressures*
 - *Improve enforcement/proactivity*
- **Media Pressure**
- **Reputation Risk -> Ongoing**



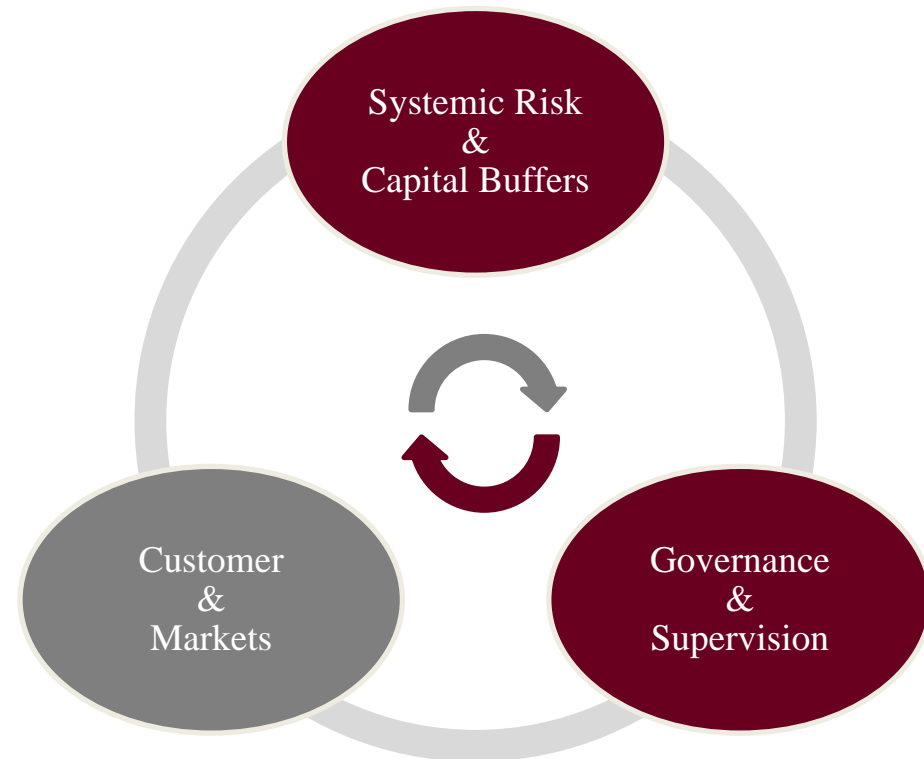
CUSTOMER & MARKETS

- **Counterparty Risk**
 - *Increases as universe shrinks*
 - *Haircuts / trading limits*
 - *Constricting liquidity flows*

- **Sovereign Debt Limitations**
 - *Debt Ratings*
 - *i.e. Portugal, Greece, Spain, others*

- **Liquidity**
 - *Lower volumes*
 - *What value to local sovereign exposure*

- **Economic Stress- Absence of Credit**



V

V. Future Challenges

- **CONTINUED REGULATORY OVERSIGHT**
 - **MULTI-AGENCY**
 - Federal Reserve / Extraterritorial Reach
 - Federal Deposit Insurance Corporation
 - Securities & Exchange Commission
 - Office of Comptroller of the Currency
 - Commodities Futures Trading Commission
 - Financial Industry Regulatory Authority
 - FINCIN, FATCA, Others
 - **JURISDICTIONAL (GLOBAL, REGIONAL, LOCAL)**
 - European Central Bank (9/14)
 - Bank of England
 - Prudential Regulatory Authority/FCA

- **POLITICAL RISK CONSIDERATIONS**
 - SANCTIONS (RUSSIA?)/OTHERS
 - GOVERNMENT POLICY
 - ABML (INTERNATIONAL ANTI-CRIMINAL COOPERATION)
 - PATRIOT ACT
 - PAYMENT SYSTEM/ STRESS
 - CYBER THREATS

1Q 2014 Earnings Net Earnings

- **JP MORGAN CHASE**

1Q 2014 Net Income \$5.3B | 1Q 2013 Net Income: \$6.5B  -19%

- **BANK OF AMERICA**

1Q 2014 Net Income (-276 M) | 1Q 2013 Net Income: \$1.5B  -118%

- **CREDIT SUISSE**

1Q 2014 Net Income 859M | 1Q 2013 Net Income: \$1.3B  -34%

- **CITIGROUP**

1Q 2014 Net Income 3.9B | 1Q 2013 Net Income: \$3.8B  +4%

- **BARCLAYS**

1Q 2014 Net Income 2.85B | 1Q 2013 Net Income: \$3.02B  -5.6%

- **UBS**

1Q 2014 Net Income 1.25B | 1Q 2013 Net Income: \$1.1B  +11.3%

B of A incurred \$6B of litigation expenses

Barclays to revamp investment banking

UBS to focus on Wealth Management

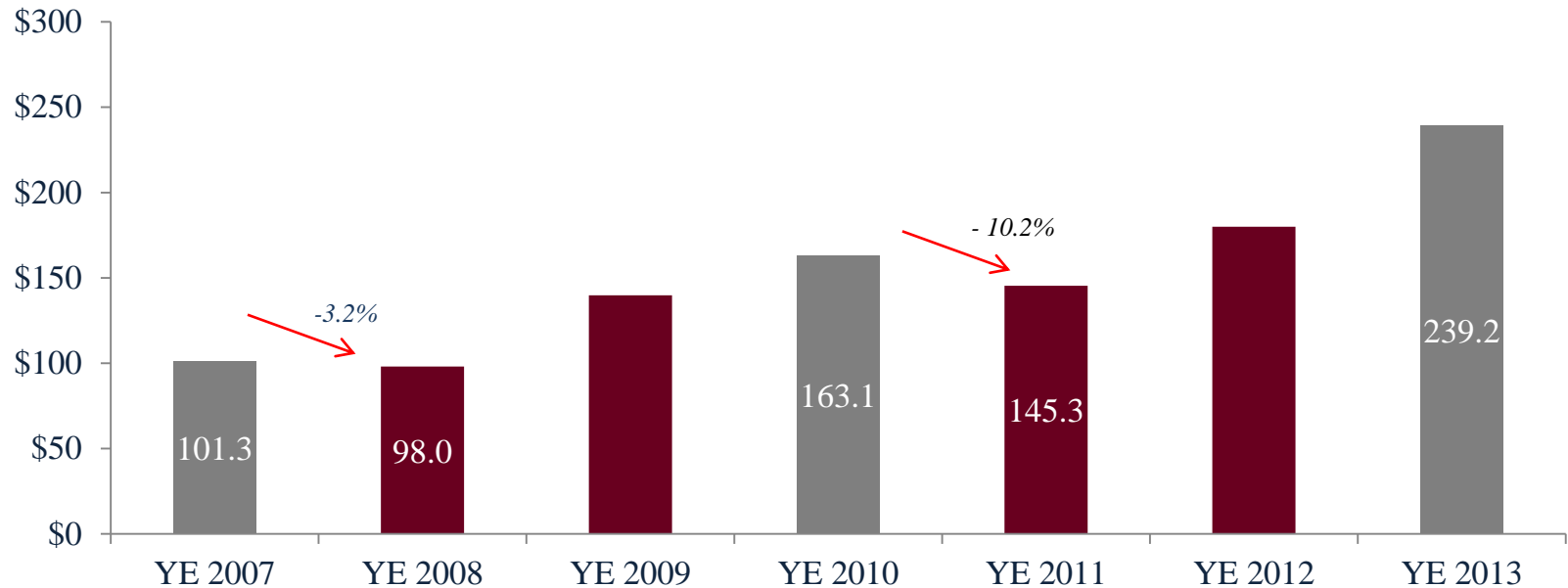


Wells Fargo | A Case Study

No meaningful
investment banking
activities

No global footprint

Wells Fargo Market Capitalization (US\$, B 2007-2013)



Legal Costs/Settlements

Wells Fargo has incurred \$9.2B in legal costs between 2010-2013. This pales in comparison to B of A, MS, and JPM.

Earnings Net

1Q 2014 Net Income \$5.9B
1Q 2013 Net Income: \$5.2B
+14% ↑

How will the investor community rate and value financial institutions in the future?

- National Regulatory Realities
- Capacity to balance business objectives within greater external scrutiny
- Management capacity/capability to be held accountable?
- New public utilities?
- New actors in the crosshairs
 - Hedge Funds
 - Asset Managers
 - Private Equity
 - Insurance companies
 - Broker – Dealers
 - Credit Unions

V

Questions?