RWA dynamics FY11-FY14E

- European banks included in this note reduced their RWA much more aggressively than their US peers, and have enjoyed a far greater improvement in FY11-FY14E revenue/RWA, largely due to their faster adoption of Basel 3.
- In securitisation, credit and commodities, the key driver of RWA returns for US banks was revenue; Europeans, by contrast, relied somewhat more on RWA. European banks have outperformed in equities; their area of focus in recent times.

Scope and methodology

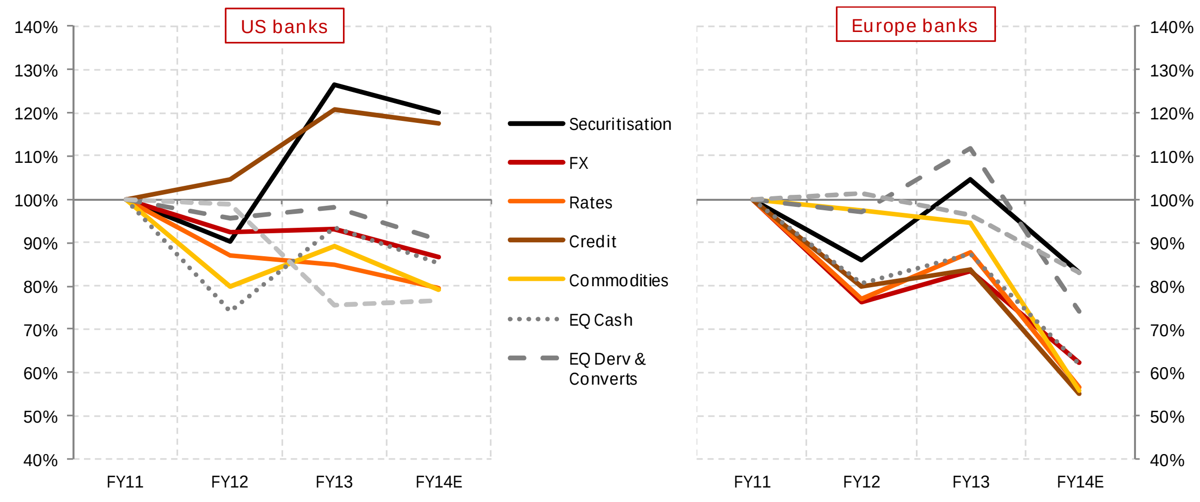
- We modelled product-level RWA data[1] to Basel 2.5 and 3 standard. Underwriting and M&A/advisory fees are excluded (largely due to their low RWA requirement), as are dedicated prop trading units. All financial data is reconciled against banks' published financial statements.
- The peer group comprises nine of the top 14 capital markets players[2] - five from the US and four from Europe.

RWA dynamics

Banks needed a few years after the original 'Crunch' to stabilise their businesses – which, in many cases, included the establishment of legacy/'bad bank' units - and for regulators to define (and subsequently, refine) their response to it. In our view, banks have only firmed up their commitment to RWA reductions in recent years, as the incoming regulation loomed closer and 'stress tests' gained in popularity with regulators. During this period, the US banks' overall RWA base declined much less than that of their European peers, due the slower timetable for the adoption of Basel 3, but most of this divergence took place from mid-2013.

The US and European banks cut their RWA by c.25% in FY12, but then saw these cuts reversed with the introduction of Basel 3 (rather than Basel 2.5) calculations. Since mid-2013, the main difference (aside from Europe's persistent economic difficulties) between the two peer groups was at the product level. The US banks were generally better capitalised and less immediately threatened by new regulations (chiefly, the introduction of Basel 2.5/3) and favoured RWA-heavy securitisation, credit and commodities, while European banks focused on profitable and comparably RWA-light equity products. As the pressure from EU regulators (both at the national and EU level) increased, European banks adjusted their strategies - which, in many cases, meant closing down RWA-heavy units.

RWA (indexed to FY11, Basel 2.5 FY11 and FY12, Basel 3 FY13 and FY14E, US$m)



Source: Tricumen analysis. Notes: (1) DCM, ECM, M&A, dedicated proprietary trading units and 'bad banks' are excluded. (2) FY11 and FY12 normalised to Basel 2.5; and FY13 and FY14E normalised to Basel 3; (3) FY14E is based on Tricumen's analysis of 6m14 and 9m14 RWA. (4) Tricumen product definitions apply throughout.

[1] Our full product-level dataset comprises market risk (mRWA), derivative counterparty risk (dRWA), credit risk (cRWA), equity risk (eRWA) and operational risk (opRWA), normalised to Basel 3 standard from FY13 and provided on named basis. SVaR and equity/capital analysis complements the dataset.

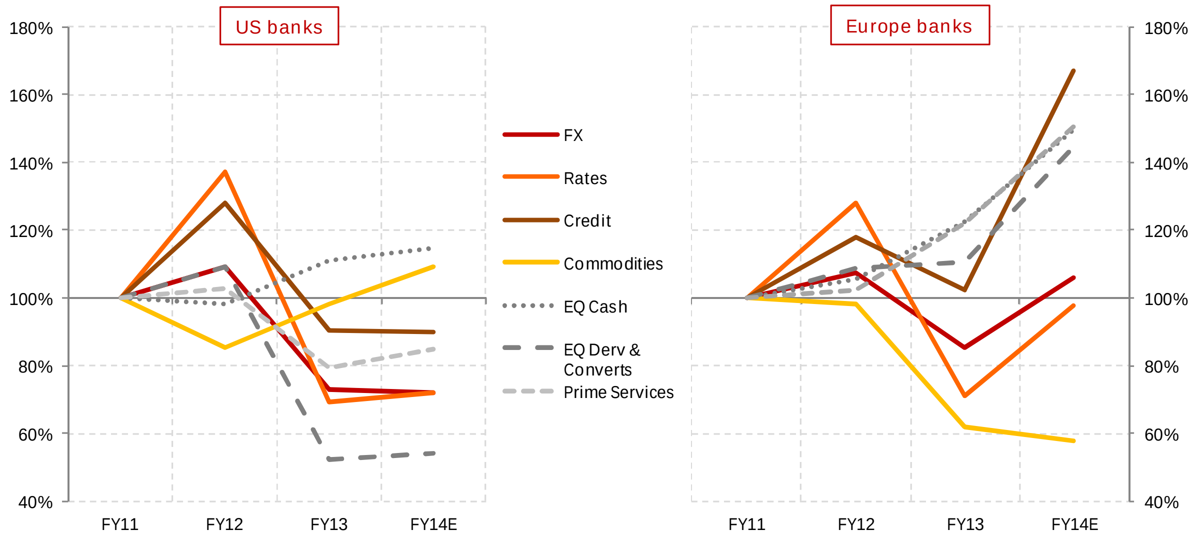
[2] 'Top 14' are global capital markets units of Bank of America Merrill Lynch, Barclays, BNP Paribas, Citi, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, J.P.Morgan, Morgan Stanley, Royal Bank of Scotland, Societe Generale, UBS and Wells Fargo.

Revenue / RWA dynamics

Revenue/RWA jumped in FY12, especially in FICC. At first, the US banks did better in FX, rates, credit and equity derivatives but, after a difficult FY13, European banks surged ahead in most product areas.

Our analysis suggests that FY14E revenue/RWA for European banks will be 23% ahead of FY11 for all the products shown here, compared to a 33% decline for the US banks. In FICC (excluding securitisation) and Equities, we expect European banks to show 13% and 43% advance, compared to the reduction of 27% and 32% for their US peers. The only area where the US banks have a firm lead is in Commodities (FY14E/FY11: +9% vs -42%), which European banks have largely deserted.

Operating Revenue / RWA (indexed to FY11, Basel 2.5 and 3, US$m)



Source: Tricumen analysis. Notes: (1) DCM, ECM, M&A, dedicated proprietary trading units and 'bad banks' are excluded. (2) FY11 and FY12 normalised to Basel 2.5; and FY13 and FY14E normalised to Basel 3; (3) FY14E is based on Tricumen's analysis of 6m14 and 9m14 RWA and post-writedown revenue. (4) We excluded securitisation from the charts above, as heavy US emphasis skews the overall result. (5) Tricumen product definitions apply throughout.

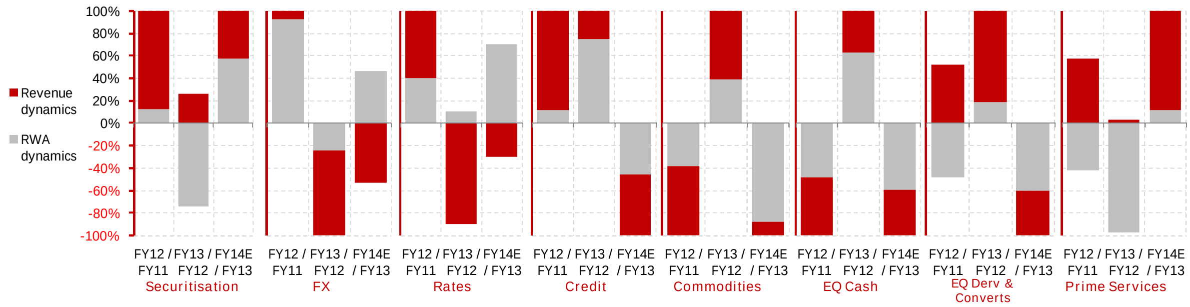
(continued overleaf)

We also considered whether the revenue/RWA returns were led by revenue growth (which, to us, suggests a more sustainable future returns) or a reduction in RWA. The charts below plot the relative contribution of revenue and RWA dynamics to RoRWA over the past four years, in each of the eight product areas in the scope. Each bar compares one year's revenue/RWA relative to the previous year. Positive values indicate a positive contribution, either from the growth in revenue or a decline in RWA; conversely, negative values indicate a negative impact.

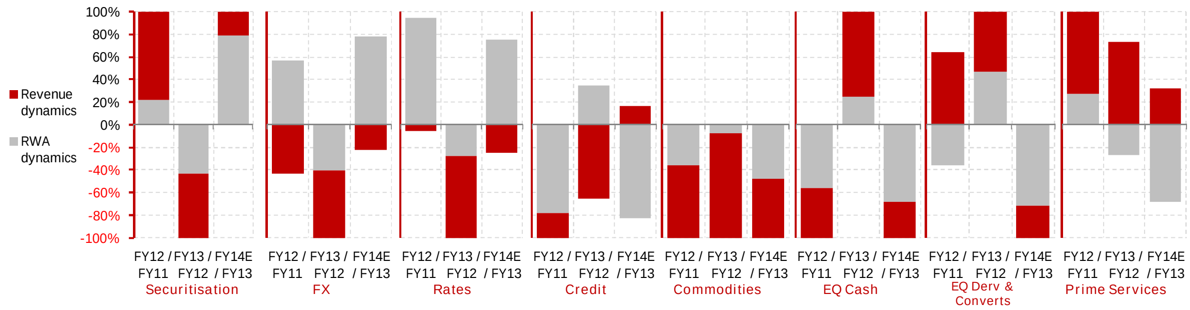
In FICC, US banks' revenue growth-vs-RWA cuts is more evenly distributed, especially in securitisation, credit and commodities; European banks, on the other hand, have a slightly better profile in equities and prime services. In FX and rates, European banks' superior revenue/RWA dynamics in FY12/11 and FY14E/13 was largely due to the reduction in RWA, rather than revenue growth.

Revenue / RWA drivers (Basel 2.5 and 3, US$m)

US banks



Europe banks



Source: Tricumen analysis. Notes: (1) DCM, ECM, M&A, dedicated proprietary trading units and 'bad banks' are excluded. (2) FY11 and FY12 normalised to Basel 2.5; and FY13 and FY14E normalised to Basel 3; (3) FY14E is based on Tricumen's analysis of 6m14 and 9m14 RWA and post-writedown revenue. (4) Tricumen product definitions apply throughout.

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Tricumen was founded in 2008. It quickly became a strong provider of diversified market intelligence across the capital markets and has since expanded into transaction and corporate banking coverage. Tricumen's data has been used by many of the world's leading investment banks as well as strategy consulting firms, investment managers and 'blue chip' corporations.

Situated near Cambridge in the UK, Tricumen is almost exclusively staffed with senior individuals with an extensive track record of either working for or analysing banks; and boasts what we believe is the largest capital markets-focused research network of its peer group.

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