Positioning for a new financial landscape

Contents

Foreword

The future of the global financial services industry remains uncertain. While the worst of the financial crisis and economic downturn appears to be past, the competitive landscape remains in flux and the debate about regulatory change continues, with few of the final details agreed upon.

What *is* certain is that the global financial services industry is experiencing a period of transition, leaving behind many of the practices and products of the pre-crisis era, and moving towards a new financial landscape. However, there are questions as to what preparations institutions are making to position themselves for success in this new landscape.

To shed some light on these questions, Deloitte conducted a survey of over 200 financial services executives from around the world, the results of which are presented in this report. These executives revealed the impact of the crisis – the relationships damaged, the performance curtailed, and the strategies disrupted – and highlighted their future focus around customers and products, strategy and operations, risk and regulation, capital and liquidity, and talent and technology.

> "It's tough to make predictions – especially about the future."

Yogi Berra
U.S. Baseball Legend

As this industry transition continues, Deloitte's Global Financial Services Industry network is committed to providing continued thought leadership, surveys and studies on the issues most important to global financial institutions. Deloitte's aim is to help guide clients through these challenging times and provide them with insights useful in preparing for a new financial landscape.

I hope you find this report of interest.

Regards,

Jack Ribeiro

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The damage done

After every catastrophe there is a strong desire to rebuild bigger and better than before. However, there is also an acknowledgment that the first task is to clear away the rubble and assess the damage, before any reconstruction can begin.

The catastrophe of the global financial crisis and economic downturn initially threw many institutions into survival mode. Institutions scrambled to access liquidity, de-risk their assets, and slash operating costs. Carefully constructed strategies and operational activities were thrown into chaos, and executives recoiled at the thought of the damage done to relationships with customers, employees, shareholders, regulators, rating agencies and, of course, the general public.

However, as the dust settles and the rubble is cleared, 89 percent of survey respondents indicate that they have survived the crisis and economic downturn as well as, or better than, expected [figure 1].

Figure 1. How do you think your organization has survived the financial crisis and economic downturn so far?

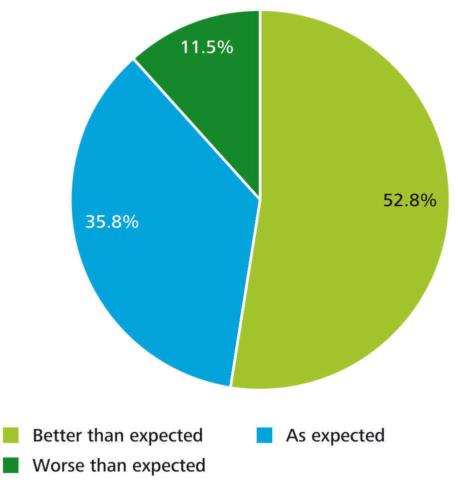
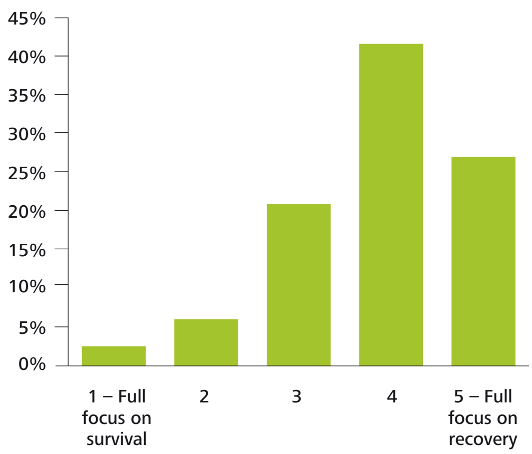


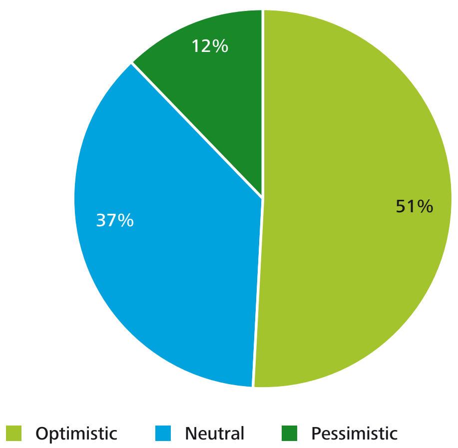
Figure 2. What is the current balance of effort in your organization between surviving the downturn and preparing for the recovery?



As a result, their focus is continuing to shift from survival mode to recovery mode [figure 2]. However, there remains a significant element of caution within this shift. The industry, and the global economy, is still being sheltered by government support in various forms of guarantee, both implicit and explicit, and other forms of protection. In addition, the continued low-interest rate environment means it is difficult to tell how durable the recovery has become, and how the global economy would fare if that low-rate environment were to change.

While over half of survey respondents indicated that they were optimistic about the prospects for their industry over the coming year, the remaining 49 percent point to the uncertainty that exists within the industry and the broader economy [figure 3].

Figure 3. What is your sentiment about the prospects for your industry over the next 12 months?



Relationships

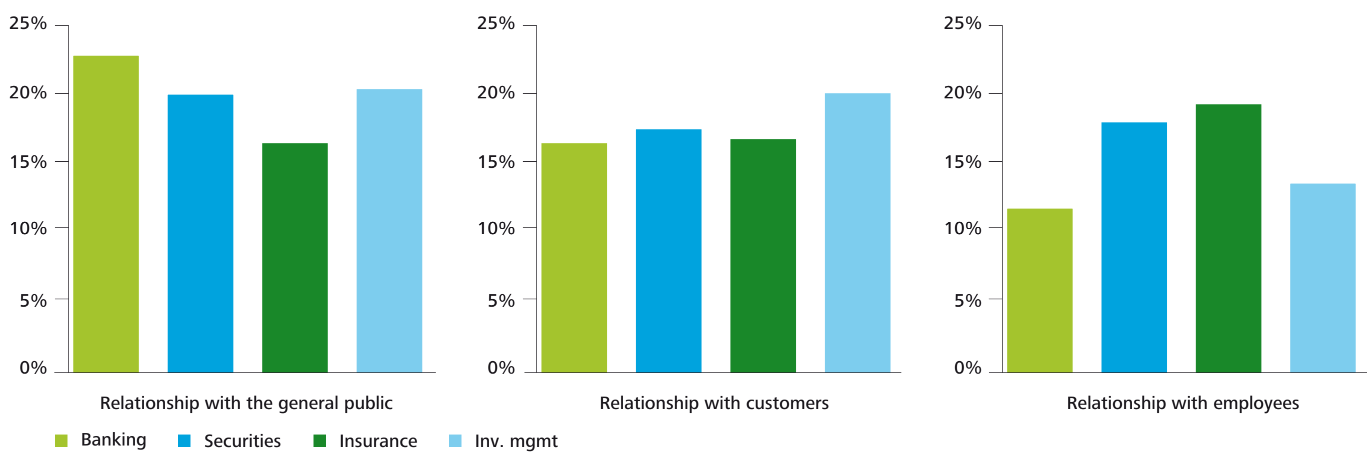
When respondents considered the damage that the financial crisis and economic downturn inflicted on their business relationships, there was a difference between the various sectors [figure 4].

The banks led the sectors most concerned about the damage done to their relationship with the general public. Considering that media attention about the crisis has been heavily focused on the banks – a term loosely used by the media to describe everything from mortgage originators to 'Wall Street' traders and hedge fund managers – it is not surprising that public perception is high on the banks' list.

Respondents from the investment management industry led the sectors in worries about damage to customer relationships. While not publically painted as villains quite to the same extent as the banks, there is no doubt that there was damage done each time a customer opened a shrinking investment statement during the period of the crisis.

Surprisingly, the insurance industry respondents led the votes for damage done to employee relations. However, this might be explained by the inclusion of producers and agents in their perception of the broad term 'employees'. As the individuals caught in the turmoil between customers and the insurance companies, it is perhaps not surprising that respondents felt that these producer and agent relationships had been damaged.

Figure 4. What *relationships* within your business do you think have experienced the most long-term damage from the financial crisis and economic downturn?



Performance

Respondents indicated that the greatest damage done to the performance aspects of their business, as a result of the financial crisis and economic downturn, was that it left them with less ability to generate top line revenue [figure 5]. This response reflects the shrinking or disappearance of a wide range of revenue generating activity. Clearly as mortgage originations ground to a halt there was a corresponding drop in the fees banks expected to make from those transitions. In addition, the drop in demand for policies to insure those houses also impacted the insurance industry. Furthermore, the freeze in structured products that packaged many of those mortgages into asset-backed securities also had an impact on the fees generated by the industry.

Banking respondents also indicated an additional area of performance damage, leading the sector votes on the issue of weakened balance sheets [figure 6].

This is recognition of the damage done by the historic drop in equity prices at many institutions, along with the significant write-down banks were required to make against many assets that had a mortgage element to them.

Figure 5. What *performance* aspects of your business do you think have experienced the most long-term damage from the financial crisis and economic downturn?

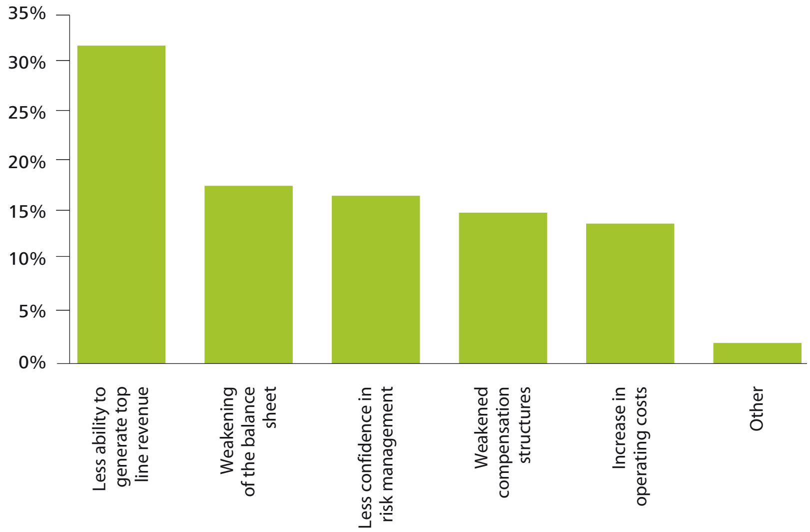
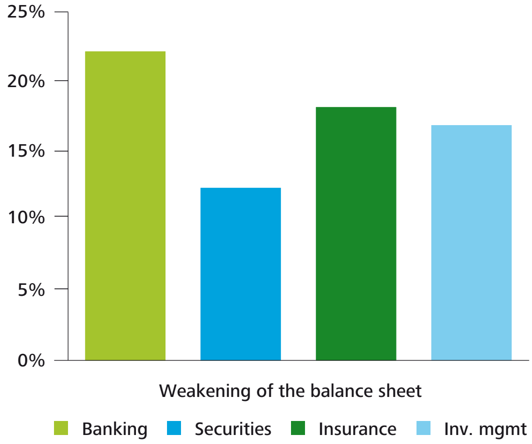


Figure 6. What *performance* aspects of your business do you think have experienced the most long-term damage from the financial crisis and economic downturn?



Strategy

The final area of damage indicated by survey participants was in relation to disrupted strategic goals. The majority of respondents indicated that their plans to expand into other sectors had to be put on hold as a result of the crisis, with the second and third ranked areas of damage being related to new product development and the sustainability of business models [figure 7].

Figure 7. What *strategic objectives* of your business do you think have experienced the most long-term damage from the financial crisis and economic downturn?

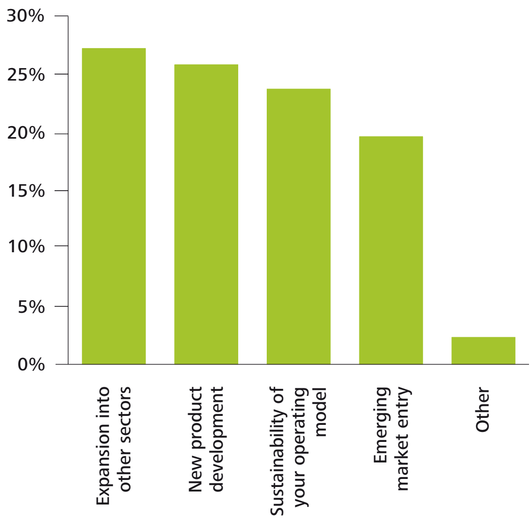
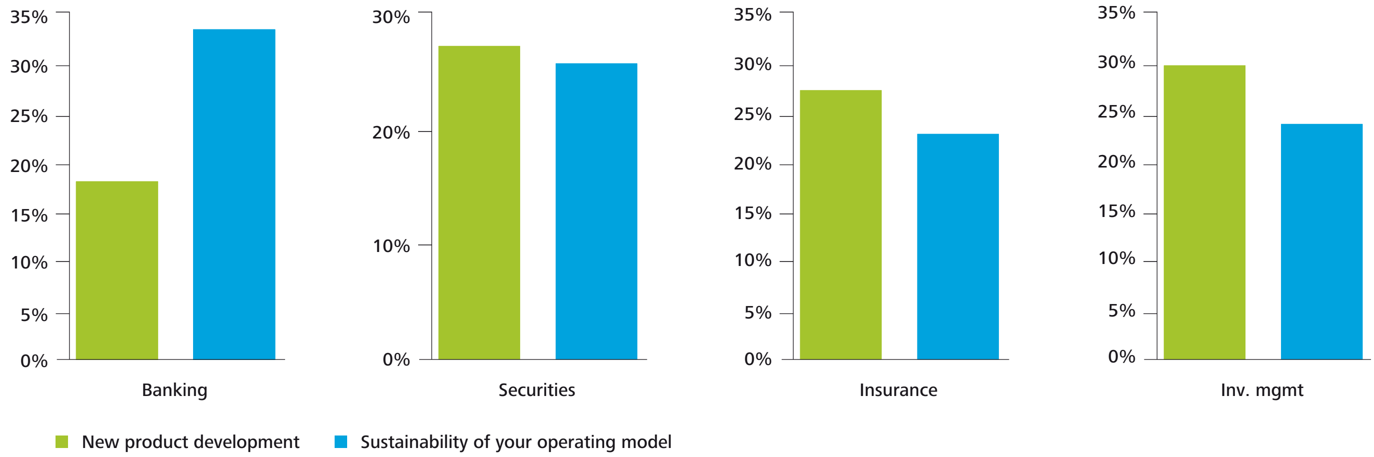


Figure 8. What *strategic objectives* of your business do you think have experienced the most long-term damage from the financial crisis and economic downturn?



Performing a sector analysis of those second and third ranked answers reveals a difference in response between the banks and other sectors. While insurance, securities and investment management respondents rated their ability to develop new products as having been more damaged than their business model sustainability, the banks voted the opposite, highlighting doubts about the durability of existing bank business models [figure 8].

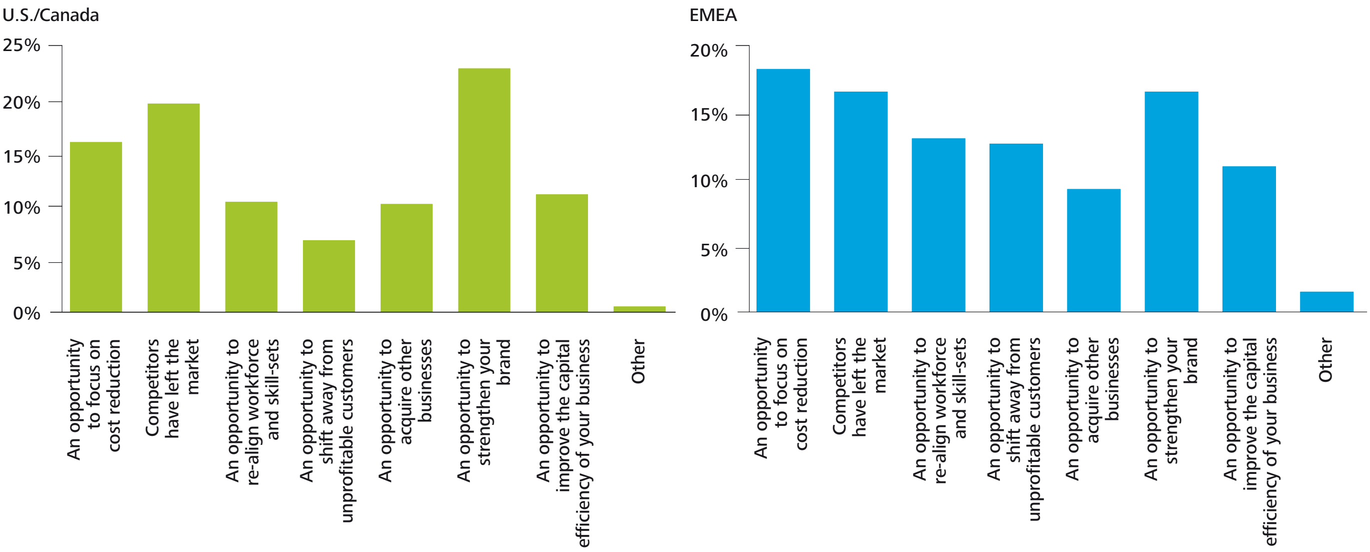
This is a theme that reveals itself across the entire survey, where banking respondents recognize the need to rethink their business models, particularly as we enter a new financial landscape where cost pressures and the potential for revenue generation have changed significantly.

The silver lining

Of course, every crisis generates not only danger but also opportunity, and so the survey asked respondents to identify what positive aspects may have resulted from the financial crisis and economic downturn. Many institutions have used the crisis as an opportunity to rationalize their business, by controlling costs, trimming talent and cutting customers who have been persistently unprofitable.

Interestingly, respondents based in the European, Middle East and Africa region (EMEA) indicated that a focus on cost reduction was the most positive outcome, while the majority of respondents from North America voted for the opportunity to strengthen their institution's brand [figure 9]. Perhaps this might be explained by the disproportionate number of institutions in North America that failed or were acquired during the crisis, leaving a thinner competitive landscape in which the survivors can further establish their brand.

Figure 9. What *positive opportunities* have resulted from the financial crisis and economic downturn?



Certainly the response around competitors leaving the market was dominant in the banking and securities sectors [figure 10], with insurance respondents leading the sector vote when it came to the opportunity to acquire other businesses [figure 11].

This is likely to reflect the trend for insurance consolidation that pre-dated the financial crisis and economic downturn, now accelerated by increased capital requirements and the opportunity to make acquisitions at an attractive price.

Figure 10. What *positive opportunities* have resulted from the financial crisis and economic downturn?

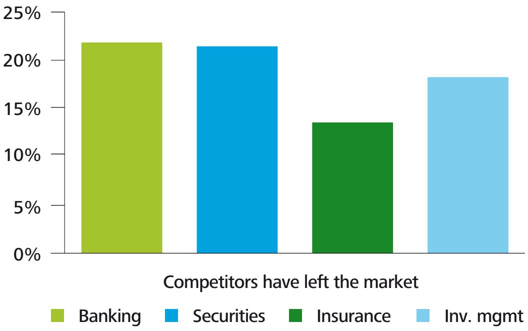
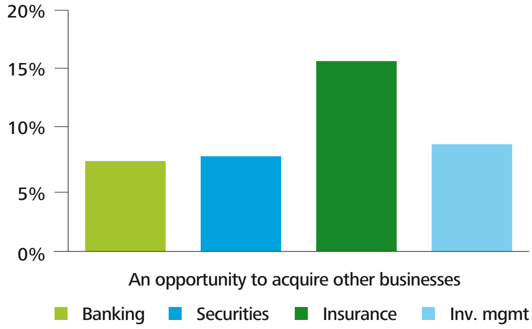


Figure 11. What *positive opportunities* have resulted from the financial crisis and economic downturn?



Against this backdrop of damaged relationships, performance and strategy – and the opportunity to cut costs, strengthen brands and make acquisitions – what should institutions be focusing on as they position for the new financial landscape? These intentions are revealed in the rest of the survey data, reviewed in the next section.

Positioning for a new financial landscape

The disruption caused by the financial crisis presents a very rare opportunity for institutions to gain competitive position. However, to take advantage of that opportunity, institutions will need to adjust their approach to take account of all the changes that have occured.

It is hard to think of a single aspect of the financial services industry that won't be changed as a result of the financial crisis.

Customer perceptions and attitudes are changing. Methods for managing risk are changing. Decisions for the deployment of capital are changing. Compensation strategies are changing. And the local regulations by which the financial system is governed are also soon likely to change.

The challenge for financial institutions is how to begin adapting to this new environment long before the fine detail has been confirmed. The Deloitte survey provides some insights to where financial institutions are focusing their efforts.

Customers and products

It has been said that trust is like a flower vase. If broken, it can be fixed, but it will never be the same vase again. Working in a service industry that relies so heavily on trust and reputation, financial executives are likely to be concerned about the damage done to customer trust and relationships as a result of the crisis.

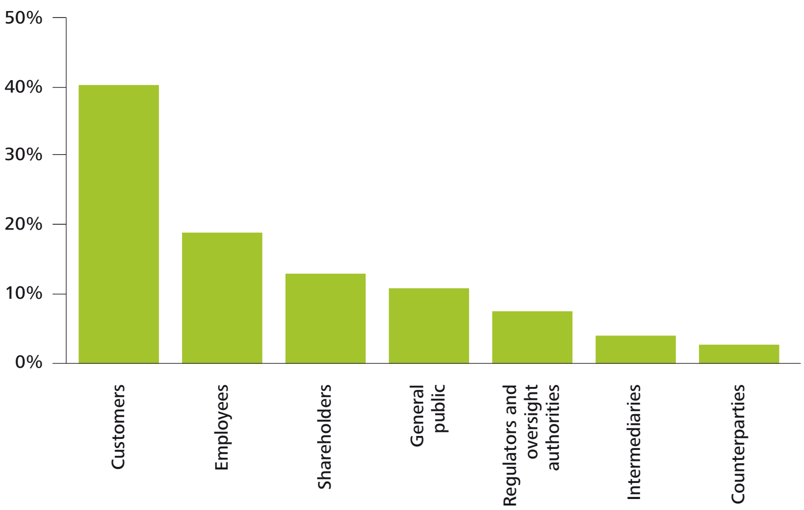
Confidence in financial products and services was almost certainly eroded during the crisis, as customers saw the value of their properties and investments plummet. Despite the fact that investment advisors and financial planners didn't cause this drop in value, it is probable that customers feel aggrieved that their advisors didn't steer them away from such a crash in value, and may feel distrustful of advice offered by these parties in future.

Customer confidence was likely also eroded by the perception that financial institutions were responsible for the crisis that damaged so much wealth. Customers, after all, are also members of the general public, and the media frenzy that accompanied the crisis will certainly have impacted this group's perception of the industry.

However, this spotlight on the industry has also created opportunities for institutions. Customers now have an increased appreciation about the complexities of the industry that serves them, and a greater understanding of the innovation necessary to create the products they rely upon. As a result, there is likely to be a greater engagement by customers when selecting products and service providers in future.

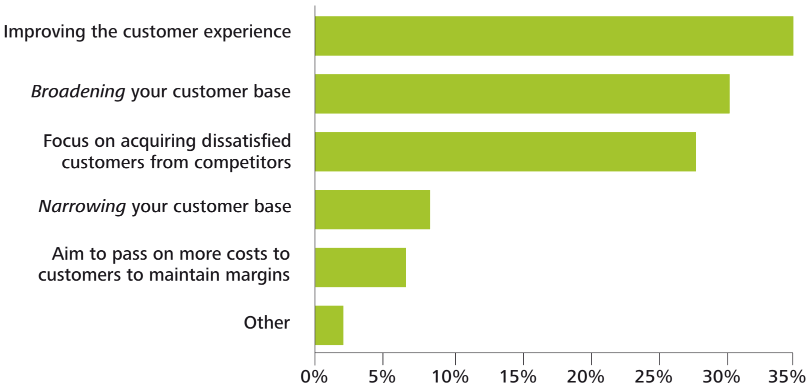
To leverage this opportunity, and to repair any damage done to relationships, institutions are focusing great energy on customers across the industry [figure 12]. This seems like an appropriate focus, since customers were the group that respondents identified as having endured the greatest relationship damage as a result of the crisis.

Figure 12. Which of the following groups will your institution focus on in order to rebuild *trust and reputation*?



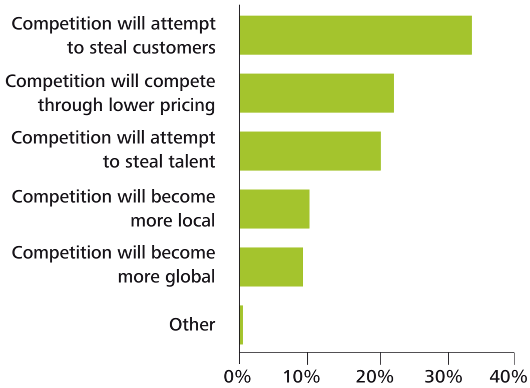
A large part of this focus is centered on improving the customer experience during their interactions with institutions [figure 13]. These improvements include better communications with customers, as well as more efficient levels of service, particularly in branches. These steps not only repair some of the damage done to existing customers, but can also be a key factor in attracting new customers.

Figure 13. What will be your institution's focus regarding *customers* as you prepare for the recovery?



The survey confirms this, with evidence that institutions are focusing energy on acquiring dissatisfied customers from their competitors [figure 13]. Convincing customers to switch financial providers is always a difficult task. There is a certain inertia that comes from the 'hassle factor' of having to change financial arrangements, such as scheduled payments or premiums. Therefore, a disruptive event like the financial crisis is a rare opportunity for institutions to acquire customers, who are either so disillusioned with their current provider that they are willing to accept the 'hassle factor', or are customers of an institution that failed or was acquired.

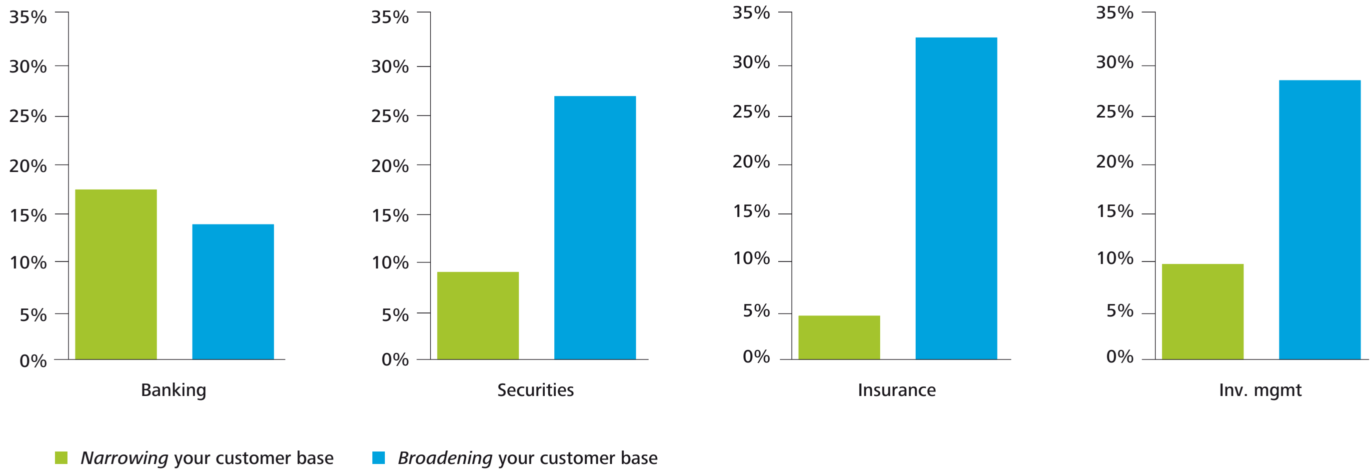
Figure 14. How do you expect your *direct competition* to respond to the recovery?



However, if institutions are trying to steal customers away from their competitors, it should come as no surprise that they are also expecting their competition to target their customers in return [figure 14]. Institutions therefore need to carefully balance their efforts between acquiring new customers, and preserving existing customers that are in the sights of their competitors.

> Institutions therefore need to carefully balance their efforts between acquiring new customers, and preserving existing customers …

Figure 15. What will be your institution's focus regarding *customers* as you prepare for the recovery?



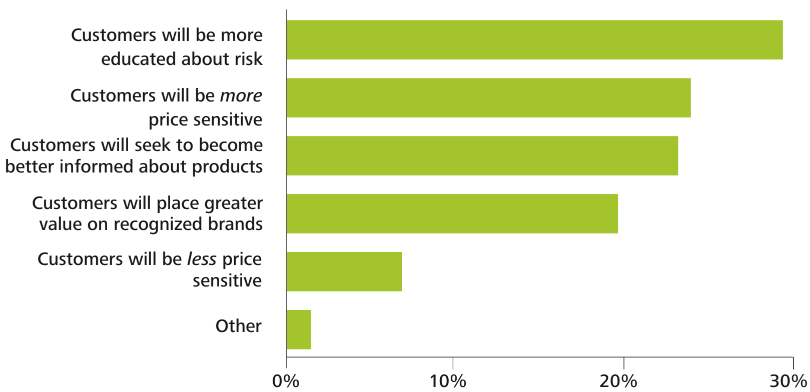
However, the survey indicates that banks are being more selective in the types of customers they are attempting to capture [figure 15]. This appears to reflect the naturally shrinking number of mortgage customers, but also a deliberate resurgence of *caveat venditor* – 'let the seller beware'. Banks are taking steps to separate customers now recognized as high-risk, the additional capital costs for which have made them unprofitable (if they weren't unprofitable before the crisis). For example, J.P. MorganChase recently revealed that it will no longer offer credit card services to 15 percent of its customers now rated as having too high a risk.[1]

If the doctrine of *caveat venditor* has returned to the industry, then executives also expect there to be a comeback of *caveat emptor* – 'let the buyer beware'.

When asked about changes to customer behavior, survey respondents indicated that they expected customer to be better educated about their buying choices in future.

In particular, respondents expected customers to be more educated about the risk they were taking on, as well as becoming better informed about financial products [figure 16].

Figure 16. In your opinion, what do you anticipate will be the most pronounced change in *customer's* behavior as we move into recovery?



1 Tomoeh Murakami Tse, "J.P. Morgan's Dimon says new laws have hurt his company," *The Washington Post,* April 2, 2010

This increased diligence by customers is likely to have an impact on the innovation and design of future financial products. Many products that rely upon promotional rates or other incentives may now actually find it harder to secure a market, as customers become wiser about the total cost and risk of each package. Conversely, products that are competitive but difficult to promote due to their complexity might now find favor with a more educated customer base.

This shift in customer engagement sets the scene for a new period of product innovation in the industry, as institutions seek to realign their product portfolio with changing customer expectations. These new products might offer the customer greater control at selecting products based on their own risk profile, and could even be created in a way that allows customers to build and combine elements of existing products into something more in line with their needs.

This resurgence of product innovation is also likely to be driven by the unexpected situations customers find themselves in. Many customers are now playing 'catch-up' on their retirement portfolios, or no longer have access to the types of product and level of returns they were relying on at retirement. These customers will be looking for new products, innovated to help with this 'catch-up'.

Strategy and operations

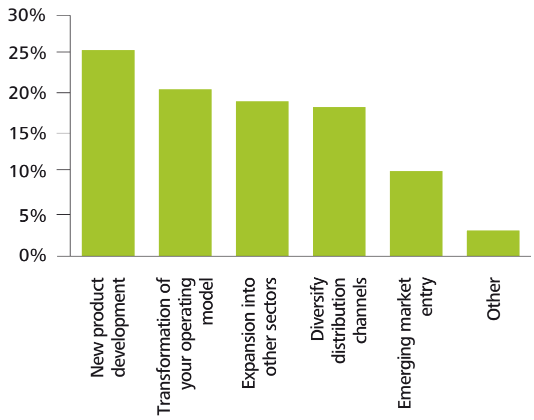
During the height of the financial crisis thoughts of strategy were set aside, as the industry embraced a short-term focus in order to navigate the stresses and shocks that continued to appear in the market.

However, as some form of stability returns to the industry, institutions are re-examining their growth strategies to determine which parts remain relevant in the new financial landscape, and which will have to be revised.

While the uncertainty around regulatory reform and the strength of the recovery make this strategy review a difficult task, it is also a great opportunity for institutions to exploit the disruption and find ways to jump ahead of the competition. To do this, institutions will need to identify which attributes may have emerged as a competitive advantage in the new environment, and to re-align their strategic focus to leverage these attributes before the competition can re-orientate themselves to do the same.

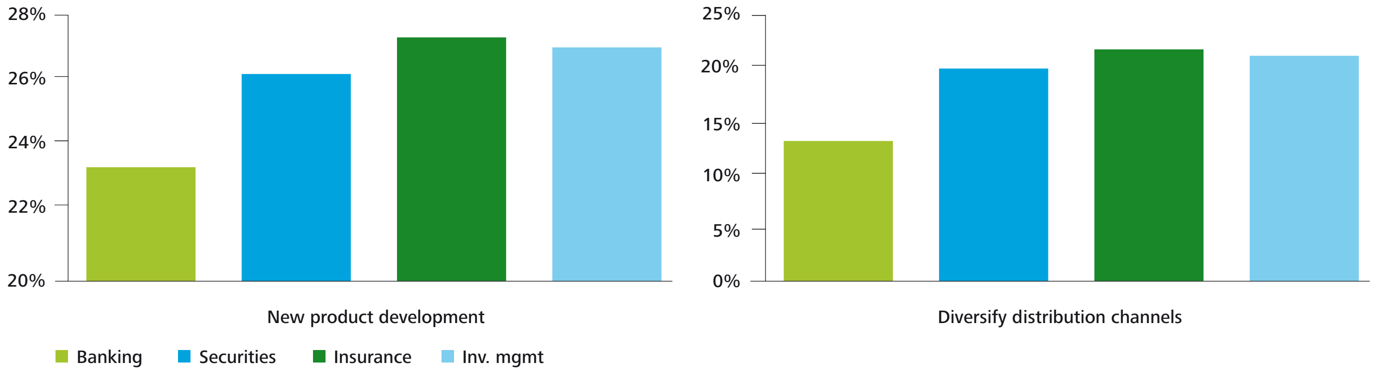
Interestingly, the survey reveals that the majority of respondents are focusing this strategic re-alignment on product development [figure 17]. This is surprising, as survey respondents earlier indicated that sector expansion, not product development, was the aspect of their strategy most damaged by the financial crisis and economic downturn.

Figure 17. What will be your institution's focus regarding *strategic growth* as you prepare for the recovery?



However, this re-focus on new products can perhaps be explained in part by the changing customer behavior mentioned above, with customers now examining products and risk in a more diligent way. However, the product focus may also be a function of the fact that the economic basis that made many products profitable before the crisis has now vanished. For example, products that relied on an ongoing supply of cheap liquidity to ensure their profitability will need to be redesigned or retired in the new era of increased liquidity premiums.

Figure 18. What will be your institution's focus regarding *strategic growth* as you prepare for the recovery?

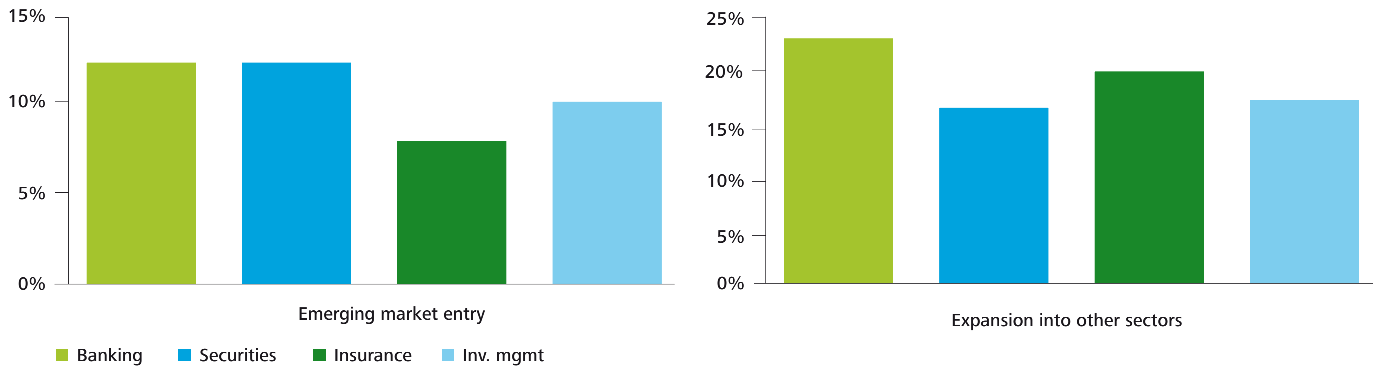


Comparing the sectors represented in the survey, investment management and insurance lead the way in the focus on new product development. Interestingly these sectors also lead the way in their strategic focus on diversifying their channels by which they distribute these products [figure 18]. This diversification should deliver two major advantages to institutions. Firstly, a broader mix of channels is likely to help them capture additional customers, some of whom may not have been touched through previous distribution models. Secondly, this diversification should reduce the risk to institutions in the event that one of their distributors, such as a retail bank, comes under stress or experiences failure.

While the survey suggests that the investment management and insurance sector strategies are focused heavily on growth through product expansion, the survey suggests that the banking sector has more of a split focus in terms of strategy.

While they also have a declared focus in growth through product development, compared to the other sectors the banking respondents have a stronger focus on emerging market entry and sector expansion as growth strategies [figure 19]. This focus has several probable explanations.

Figure 19. What will be your institution's focus regarding *strategic growth* as you prepare for the recovery?



As mentioned in the previous section, the financial crisis left many banks with weakened balance sheets, making them vulnerable. This has made for some attractively priced acquisition opportunities for those banks that emerged stronger from the financial crisis and economic downturn, which may explain the expansion focus.

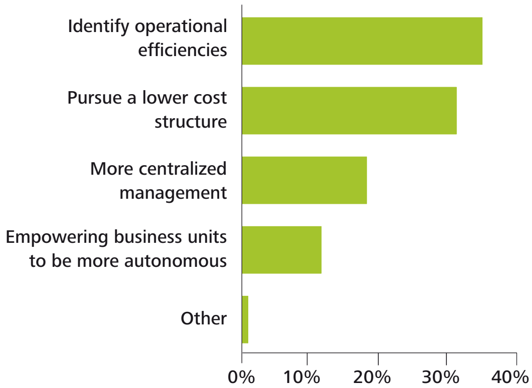
Another explanation might lie in the wide-ranging predictions that the emerging markets will make a stronger return to economic growth than the more traditional economies. The International Monetary Fund (IMF) has forecast that growth in emerging and developing economies should top 6.3 percent this year, while reaching only 2.3 percent in more advanced economies.[2] These forecasts might have been enough to convince banks to refocus on the emerging market plans and ambitions that were in place before the financial crisis and downturn.

On the operational side, the survey indicates that institutions continue to focus on the issue of cost, as the industry tries to preserve areas of profitability. Respondents are primarily focused on finding ongoing operational efficiencies, while also taking long-term steps to shift to a lower cost structure [figure 20]. This pursuit of a lower cost structure is a response to the expectations of a lower revenue environment going forward, driven by the 'commoditization' of some previously higher-margin activities, as well as the expected increase in costs related to new regulation. Analysts at J.P. Morgan have predicted that if all the proposed regulations were enacted it would require banks to add an additional $221billion in capital.[3]

In addition, only 6.1 percent of survey respondents expect to be able to pass these additional costs onto customers [figure 13]. Almost 23 percent of executives expect customers to be more price sensitive [figure 16], and over 23 percent expect their competition to try to undercut them with lower priced offerings [figure 14].

Finally, the survey indicates that institutions in all sectors are focusing more on centralizing their management than they are empowering local business units. The data suggests a slight reverse of this trend in Asia-Pacific respondents, where institutions perhaps recognize the need for a more local approach due to less mature markets for some of their products.

Figure 20. What will be your institution's focus regarding *operations* as you prepare for the recovery?



Regulation and risk

The ongoing regulatory debate, taking place between governments, regulators and industry, has a lot in common with popular horror movies; you know that something dramatic is going to occur – you just don't know when it will happen, or what it will look like.

The regulatory debate began with what appeared to be a strong global consensus to take action. However, as the discussions proceeded, concerns emerged about whether governments could ensure that any regulatory action was consistent across the globe, and this began to slow the pace of action.

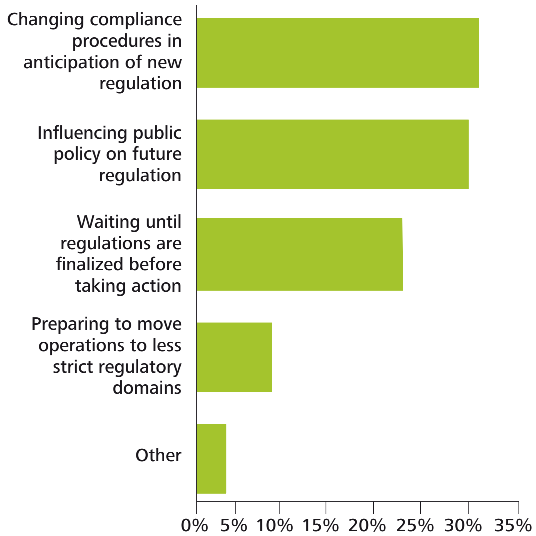
Almost 23 percent of executives expect customers to be more price sensitive, and over 23 percent expect their competition to try to undercut them with lower priced offerings.

2 Lesley Wroughton and Emily Kaiser, "IMF nudges up world GDP view," *Reuters*, April 21, 2010

3 Steve Slater, "Bank reform may have $220bln capital hit," *Reuters*, February 17, 2010

This concern over consistency was an acknowledgement of the skill with which some financial institutions had navigated the global regulatory environment in the past. Politicians appear fearful of the return of 'regulatory arbitrage', in which institutions abandon certain countries and move their operations to jurisdictions with more convenient regulatory regimes. However, survey respondents indicate less of an appetite to make such a move than politicians might fear [figure 21].

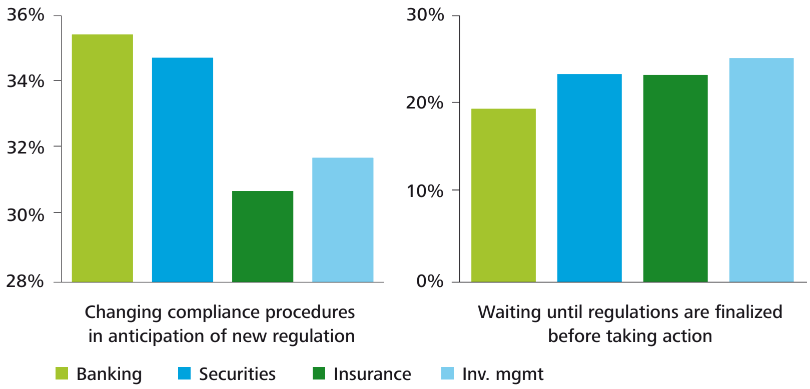
Figure 21. What will be your institution's focus regarding *regulatory compliance* as you prepare for the recovery?



This lack of action has left financial institutions in a kind of regulatory 'limbo'. Despite increasingly detailed proposals emanating from bodies such as the Financial Stability Board (FSB), there remains uncertainty about what final version of the proposals will be ratified by the G20 countries – particularly as the early unity between members appears to have weakened. However, the survey reveals that the majority of respondents are not waiting, and are already changing compliance procedures in anticipation of new regulation [figure 21].

It is likely that many of these procedure changes will focus on increasing each institution's compliance flexibility, such as broadening the data sets reported for each transaction, so that the institution will have that information available should new regulations require it. This flexibility will be critical in adapting to the new regulations, as they are likely to have a staggered arrival.

Figure 22. What will be your institution's focus regarding *regulatory compliance* as you prepare for recovery?



However, the survey shows a difference between the sectors in their willingness to make compliance changes prior to any new regulations being finalized. While the banking sector appears the most proactive in its compliance changes, the investment management sector appears more willing to wait until the regulations are finalized before taking action [figure 22].

The survey also shows that institutions are not simply monitoring this regulatory debate – they are also trying to influence it.

When asked what their current focus is around regulatory compliance, the second highest answer related to influencing policy decisions. These influence attempts have led to some tensions with politicians. U.S. President Obama recently warned the financial services industry about the "the furious efforts of industry lobbyists"[4], and the 2010 World Economic Forum meeting in Davos was notable for the tension between the politicians and industry executives.

4 Peter Baker, "Obama Issues Sharp Call for Reforms on Wall Street," *The New York Times*, April 22, 2010

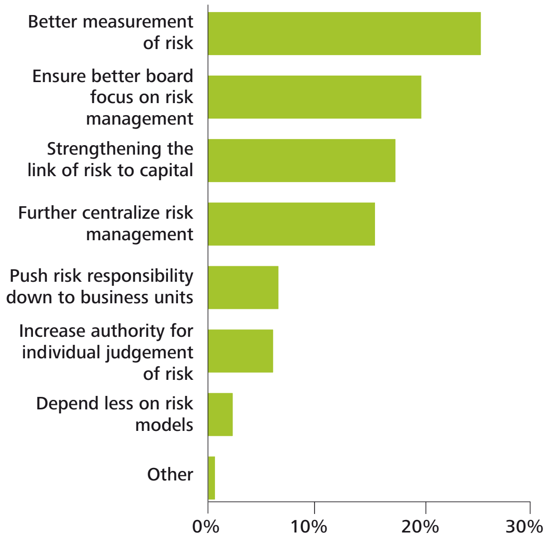
In Davos, many industry executives expressed fears that regulatory changes might be too extreme, as a result of politicians responding to popular demands for action. However, the politicians made clear their continuing determination to keep control of the regulatory agenda. "The big banks, if they think they're in a position to stop the regulation, they're deluding themselves." said Barney Frank, Chairman of the U.S. House of Representatives Financial Services Committee.[5]

One area of focus almost certain to be included in any final regulations will be risk management. In particular, there is recognition of the need to develop better techniques for understanding and managing systemic risk within the industry.

Prior to the crisis, the industry had recognized the risk of counterparty failure, and many institutions had processes in place to try and mitigate that risk. However, few people could have imaged the scale of the *systemic* risk that existed. The interconnectivity of the industry was revealed to be greater than previously thought, with complex financial instruments linking institutions together in a truly systemic way. The result of this was that institutions were vulnerable to not only failures of direct counterparties, but failures of institutions across the world to which no direct business relations existed.

Armed with these experiences, institutions have been examining ways to refine and improve their risk management practices, so that they will be more robust in the new financial landscape. The survey reveals that the top priority for institutions in this area is to find better ways to measure risk [figure 23].

Figure 23. What will be your institution's focus regarding *risk management* as you prepare for the recovery?

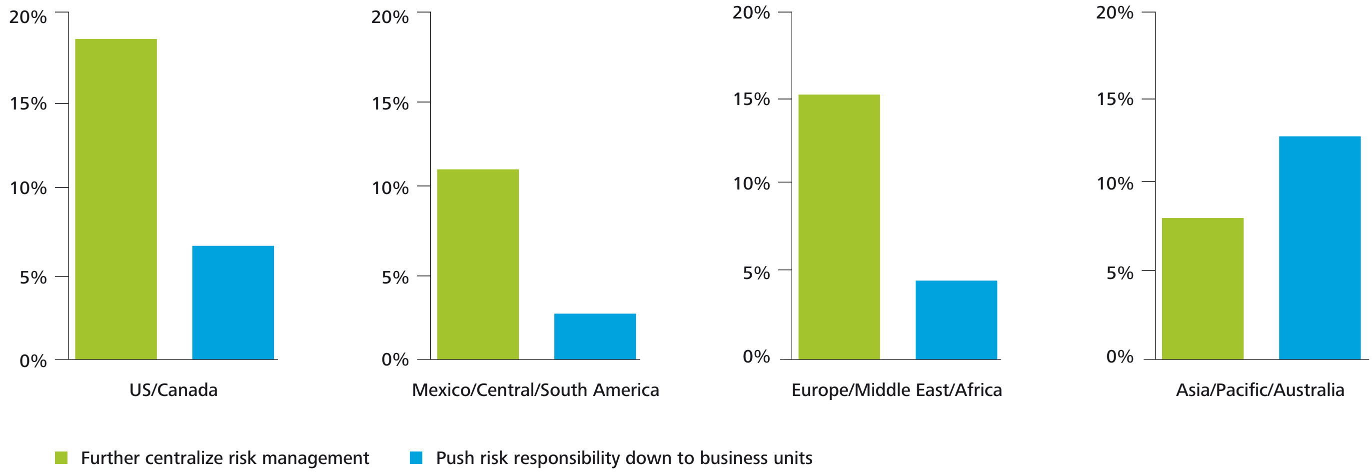


These measurement improvements are likely to include an expansion of existing risk models to include more robust variables related to liquidity and systemic risk, which were perhaps missing from previous models. Institutions are also likely to increase the frequency of their model validation testing, with some institutions aiming to validate their pricing models on a daily basis. Institutions are also likely to increase the standardization of risk measurement across their global business, so that this risk information can be compared and trends identified. To achieve this many institutions are aiming to further centralize their risk management processes.

The interconnectivity of the industry was revealed to be greater than previously thought, with complex financial instruments linking institutions together in a truly systemic way.

5 Simon Kennedy and Christine Harper, "Davos Dispute Escalates as Policy Makers, Bankers Square Off," *Bloomberg Businessweek*, Jan 29, 2010

Figure 24. What will be your institution's focus regarding *risk management* as you prepare for the recovery?



The survey indicates that further centralizing risk management, including ensuring a better board level focus on risk, is a higher priority than pushing risk responsibility down to business units, again with a slight reverse for Asia-Pacific respondents [figure 24]. However, these actions are not mutually exclusive, and it is clear that while institutions are working to improve their board level understanding and management of risk, this will also require individual business units to take a greater role in managing and measuring that local level of risk.

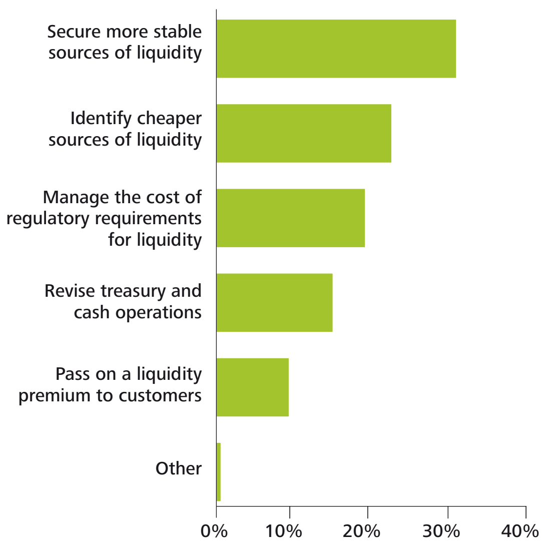
Capital and liquidity

Benjamin Franklin, one of the founding fathers of the United States, once said, "If you want to know the true value of money, just try to borrow some".

The financial crisis revealed the dependence that many institutions had developed for easily available liquidity. Some institutions were so dependent on access to this liquidity, that when credit markets froze it dealt a catastrophic blow to their solvency and operations. As we move into the new financial landscape, institutions have developed a greater focus on liquidity management, and are recognizing the true value of liquidity.

Survey respondents indicate that their top priority is securing more stable sources of liquidity [figure 25]. Many institutions have boosted their cash holdings, and have increased the balance of their capital held in a more liquid form, accepting lower returns in exchange for more stable liquidity. Banks have also focused attention on deposit accounts as a more diverse and stable source of liquidity.

Figure 25. What will be your institution's focus regarding *liquidity* as you prepare for the recovery?



Prior to the crisis deposit accounts were viewed largely as a gateway for drawing customers into an institution, with the aim of selling additional services or charging overdraft fees. However, the financial crisis has reminded the industry of the liquidity benefits of insured bank deposits. As Michael Carpenter, CEO of GMAC Financial Services, highlighted in his testimony to the U.S. Senate, "Insured bank deposits offer a stable and reliable source of liquidity to fund our business. Previously, GMAC was a wholesale funded finance company, and as demonstrated by the capital market disruption, that model is risky in a financial crisis and needs to be balanced with access to more stable sources of funding".[6]

The cost of these increased liquidity 'buffers' will be significant for many institutions, particularly those that are active internationally and are therefore likely to be subject to recent requirements proposed by the Bank of International Settlements (BIS).

A notable finding is the lower response from survey participants about the ability to pass on a liquidity premium to customers [figure 25]. This is in line with the other survey responses indicating the difficulty in passing on additional costs to the customer. As a result it is likely that this increased cost of liquidity will have to be borne by the institutions themselves. It should therefore be no surprise that survey participants indicated that their second priority was to identify cheaper sources of liquidity [figure 25].

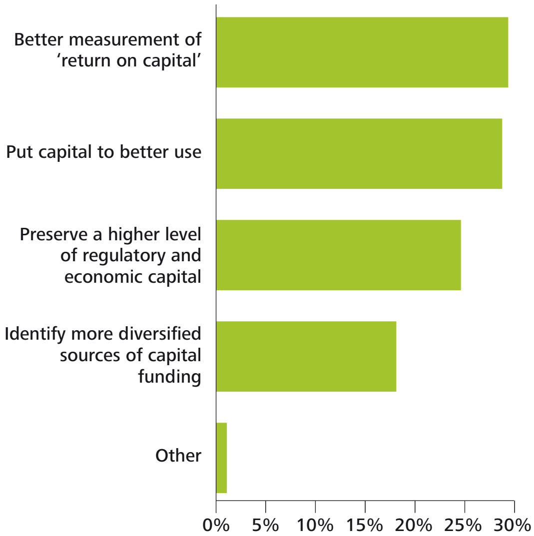
While cheap liquidity appeared to be a contributing factor to the crisis, the weakness was that the majority of this liquidity came from the wholesale market, creating a concentration risk. Moving forward institutions will likely want to balance the efficiency of liquidity with a more diverse range of sources of that liquidity.

Efficiency was also the theme revealed in participants' answers to questions about capital.

When asked about each institution's priority focus around capital the top two answers were better measurement on the return on capital, and putting capital to better use [figure 26]. Clearly the answers are linked, as an institution can't be sure it is putting capital to better use unless it is confident in its measure of the capital return.

6 Written Statement of Michael A. Carpenter, GMAC Chief Executive Officer GMAC Financial Services Before the Congressional Oversight Panel, February 25, 2010

Figure 26. What will be your institution's focus regarding *capital* as you prepare for the recovery?



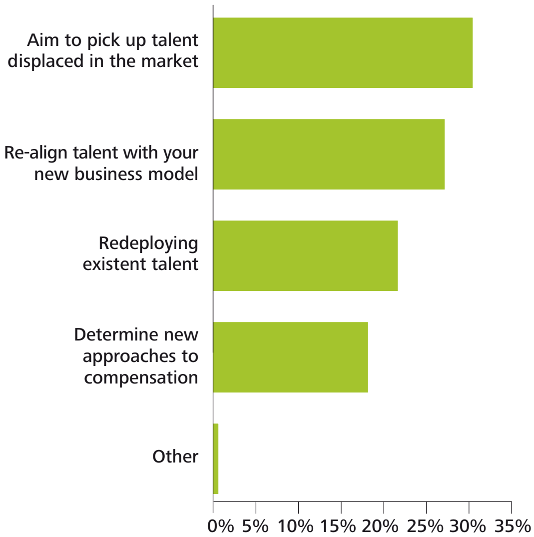
The methods for measuring the return on capital have evolved over the last several decades to become complex models, which calculate the risk-adjusted rate of return on capital. The various methodologies for calculating 'value at risk' and economic profit have enabled institutions to compare risk across the organizations activities, and therefore enabled them to measure which activities resulted in a better return on the capital employed.

However, as the financial crisis demonstrated, some of the risk assumptions built into these models were understated, and the true 'value at risk' of investing capital in some activities – such as complex financial instruments – was greater than previously thought. As we move into the new financial landscape these measurement models will need to be adjusted using the data and experience collected during the market disruption.

Talent and technology

As the financial crisis continued to inflict damage on the industry, institutions were focused on rapidly cutting costs and a large part of that effort involved cutting headcount. However, now that the industry has stabilized and there are signs of economic recovery, it seems that institutions have switched their focus once again to retaining and recruiting talent [figure 27].

Figure 27. What will be your institution's primary focus regarding *talent* as you prepare for the recovery?

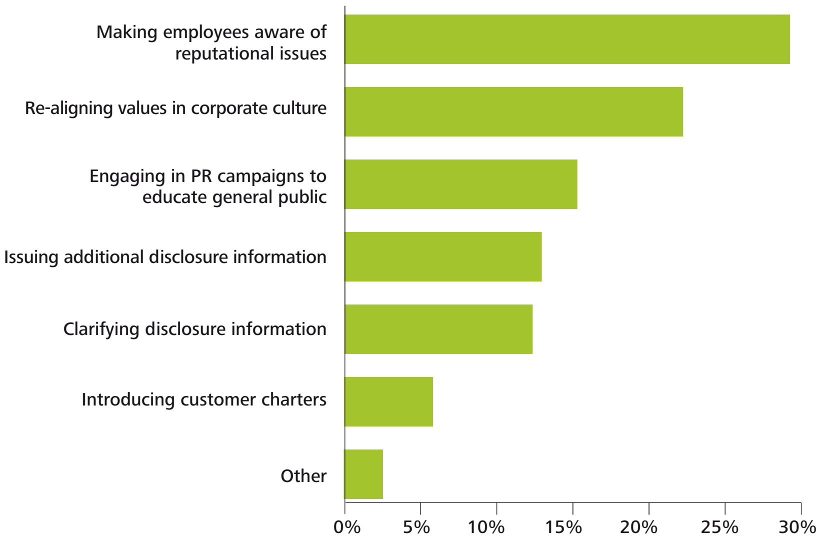


However, for many institutions, *retaining* talent as the recovery develops will be a significant challenge. There is likely to be a pent up desire by people to change jobs that, while dormant when the industry was in the crisis, could well become a reality as the recovery continues. In addition, the compensation tools traditionally used by institutions to hold onto their top talent have been changed by new rules around bonus payment, with many institutions now having to defer their bonuses for several years, and to ensure that a certain percentage of that bonus is awarded in non-cash forms. However, it is interesting that survey respondents didn't place as high a priority on developing new compensation approaches as might be expected.

In terms of *recruiting* talent, institutions may have brighter prospects. In a similar way that respondents indicated that their institution was picking up customers displaced in the market, they also indicate a similar approach for picking up displaced talent. However, institutions will have to be strategic in executing these hires, to ensure that they align with their changing business models.

Finally, institutions also indicate that they are expecting talent to play a key role in rebuilding trust in the marketplace. The survey finds that the two priority focus areas for rebuilding trust and reputation were to make employees more aware of reputational issues and to re-align the values of their corporate culture [figure 28].

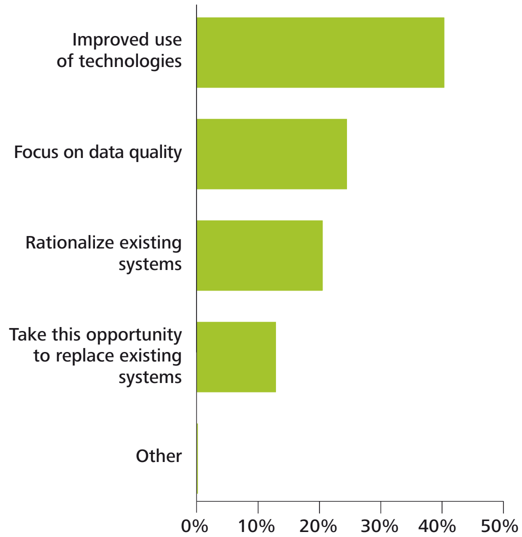
Figure 28. What key steps will your institution focus on in order to rebuild *trust and reputation*?



This will be critical as financial institutions continue to work to change the public perception of the value that they add, as the day to day actions of employees will need to be in line with the values that each institution is promoting.

On the technology side, institutions are focused on improving their use of technology [figure 29]. In large part this is being done in search of efficiencies as the industry enters a period of significant cost pressure. While institutions are focusing their efforts on gaining efficiency through the rationalization of existing systems, a sector split of the responses shows a higher proportion of banks also taking the opportunity to replace existing systems. This may be due to the increased level of transactions that have taken place within that sector, as banks absorbed struggling competitors, and are now overhauling the systems of the newly formed group. Or it could also be a further indication that banks have decided that it is not enough to update or mend their existing practices, but instead are focused on re-inventing their operating models at a more fundamental level.

Figure 29. What will be your institution's focus regarding *technology* as you prepare for the recovery?



Conclusion

Navigating the journey into the new financial landscape will require delicate and decisive decision making on the part of financial executives. If institutions wait until the landscape becomes clear, they risk trailing those competitors who have marched boldly ahead. However, if they move forward too quickly, their efforts could be undermined by the still shifting landscape.

For some financial executives, this navigation will appear as a significant challenge, as they attempt to steer their institutions through the uncertainty. However, for others this uncertainty will present a rare opportunity to take bold action, and perhaps even transform the competitive environment.

This survey provides clues to the areas in which institutions have made that head-start, and where they are waiting patiently for more detail before moving forward. It highlights the different approaches being pursed between the sectors and geographies, and it provides a snapshot of what institutions are doing to position themselves for the new financial landscape.

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