

NAVIGATING THE NEW MONETARY ORDER

IACPM Conference

Umit Kaya, Partner

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CONTEXT

The financial sector was transformed between 2008 and 2021, primarily by shifts in monetary policy and tightened banking regulations

“Low for Long” rates and abundant liquidity shaped not only the financial sector’s structure and business models, but also the mindset and behavior of broader stakeholders

Low for Long has ended, giving rise to a “New Monetary Order”, and the sector is slowly adapting



WHY IS THE PARADIGM SHIFT CRITICALLY IMPORTANT?

The financial sector is a key determinant of economic functioning due to its role in credit provision and the optimal allocation of capital

The new policy environment is likely to trigger another evolution of the financial sector

This evolution will alter the sector’s growth, composition, profitability, risk, and the nature of winning and losing business models



FOUR KEY TAKE-AWAYS FOR WHAT HAPPENED DURING LOW FOR LONG AND WHAT IT MEANS FOR THE NEW MONETARY ORDER

ANEMIC PRIVATE SECTOR CREDIT GROWTH

- Major slowdown in private sector credit growth during Low for Long
- Higher interest rates and economic uncertainty under the New Monetary Order will likely hinder reversion of this trend

1

COMPETITION FOR HIGH-QUALITY DEPOSITS

- Increased reliance on deposits and securities for banks during Low for Long
- Going forward, optimizing ALM will be important; the ability to retain higher-quality deposits will be a key competitive differentiator

3

MARKET SHARE DYNAMICS SHAPED BY INTEREST RATES AND REGULATORY PRESSURES

- Segment-level shifts among banks and non-banks and GSIBs and large non-GSIBs due to relative regulatory differences and the rate environment
- Bank and non-bank regulatory gap likely to widen due to Basel 3 Endgame, and likely to narrow for GSIBs and non-GSIBs for various reasons

2

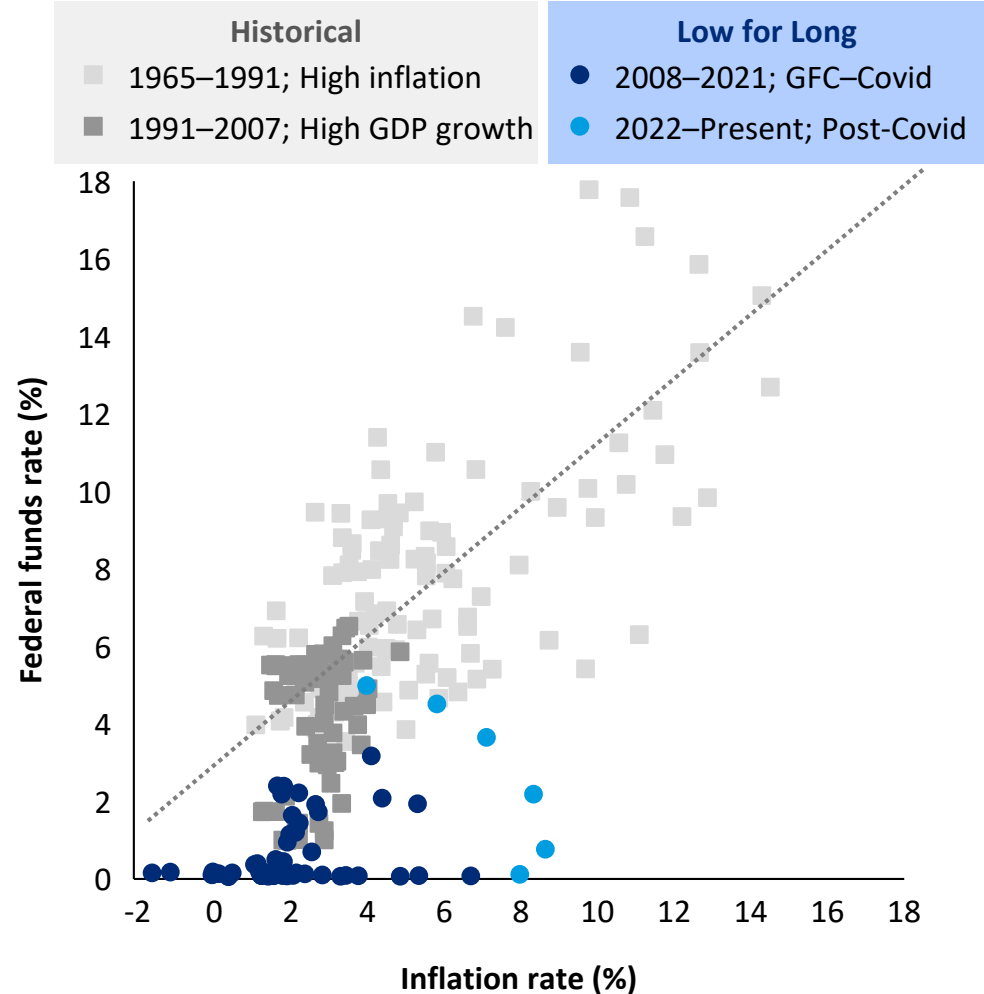
THE VALUE OF OPTIONALITY DUE TO THE RETURN OF VOLATILITY AND UNCERTAINTY

- Firms with entrenched Low for Long “habits” suffered in past two years
- Given the significant uncertainty surrounding the financial sector, firms should make contingency plans, invest in cheap optionality, and proactively manage risk

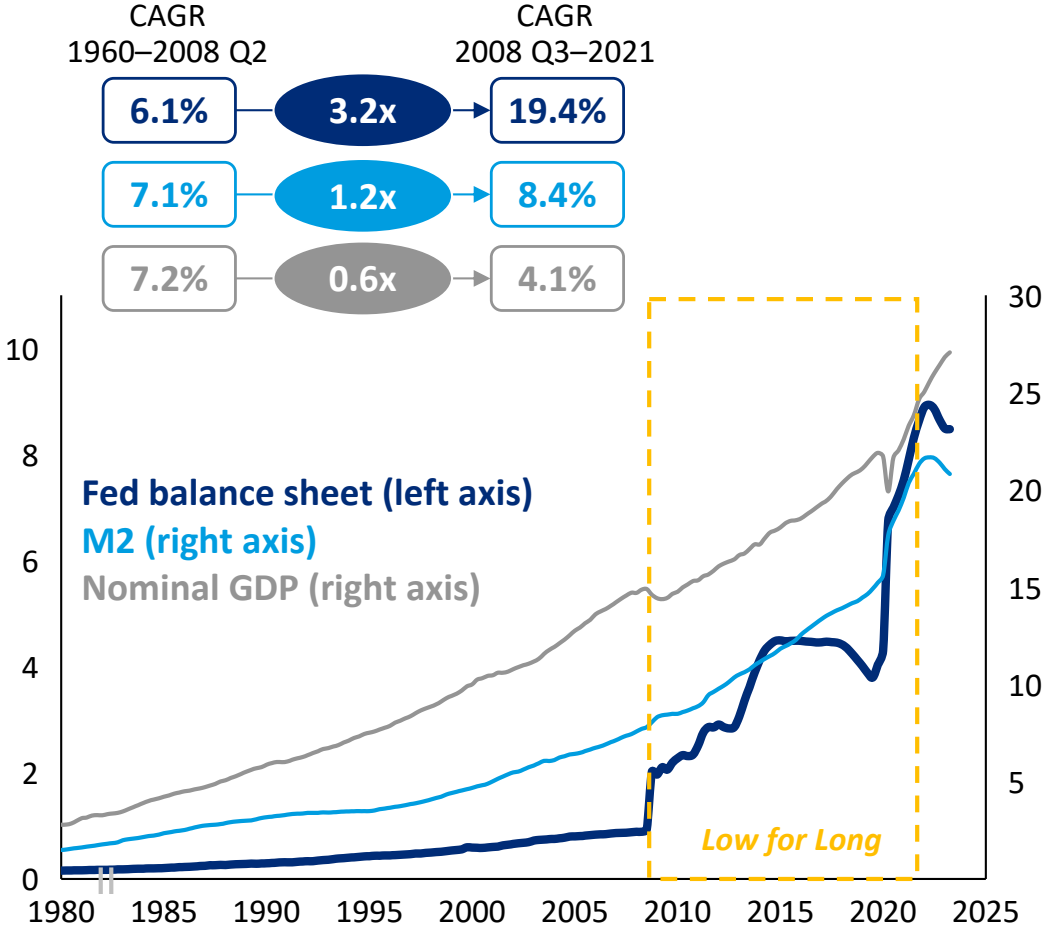
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POST-GFC, RATES WERE HISTORICALLY LOW AND DEVIATED FROM THEIR RELATION TO INFLATION AND THERE WAS A LARGE INCREASE IN THE FED'S BALANCE SHEET

Effective federal funds rate vs. inflation
%, Quarterly, up to Q2, 2023



Federal Reserve balance sheet, money supply (M2), and nominal GDP
\$ Trillion, Quarterly, up to Q2, 2023

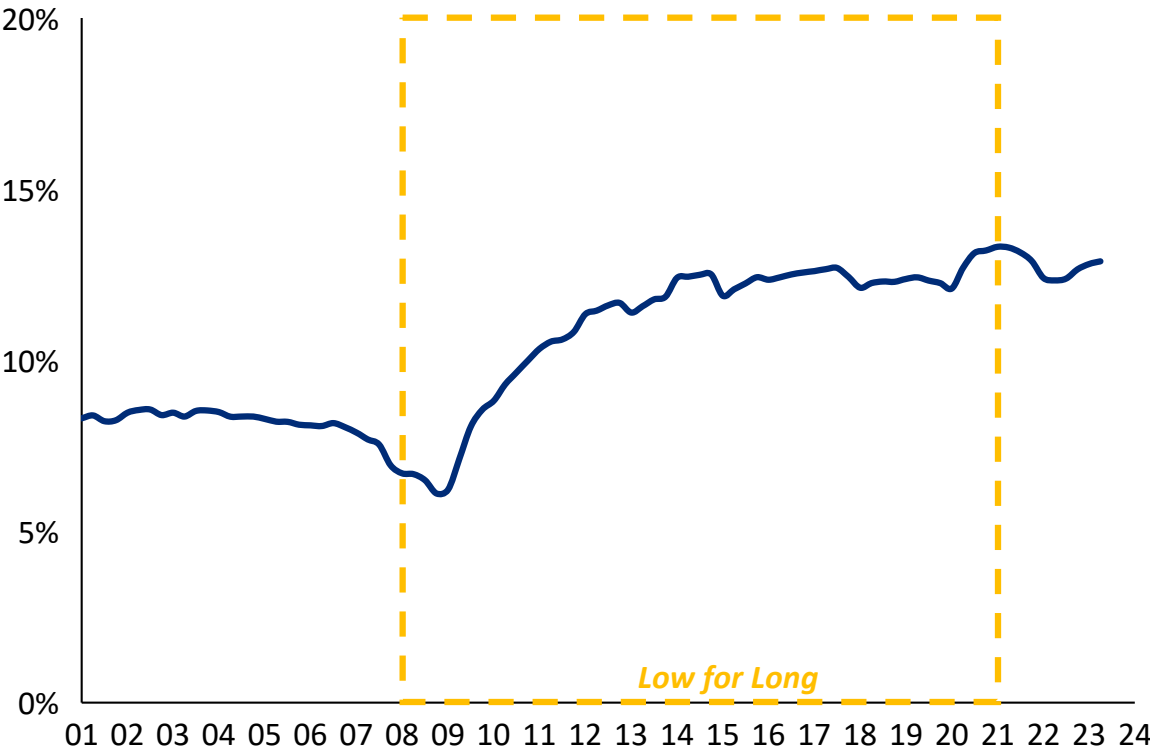
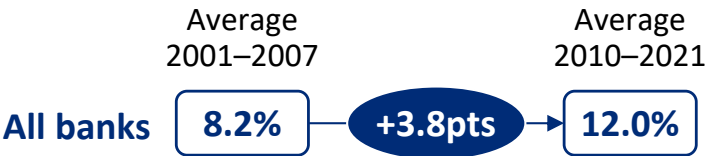


Source: FRED, OECD, OW Analysis. Federal funds rate values are quarterly averages.
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DURING THE SAME PERIOD, NEW BANK REGULATIONS LED TO HIGHER CAPITAL AND LIQUIDITY POSITIONS...

CET1 ratio for banks

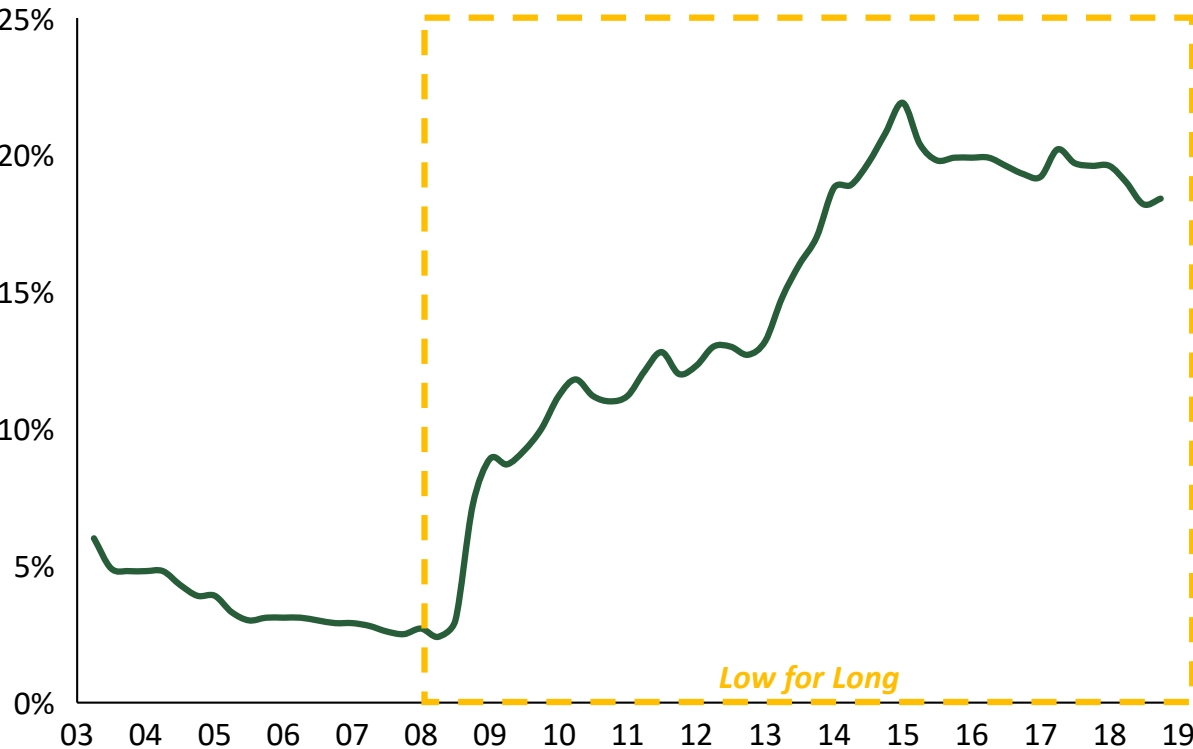
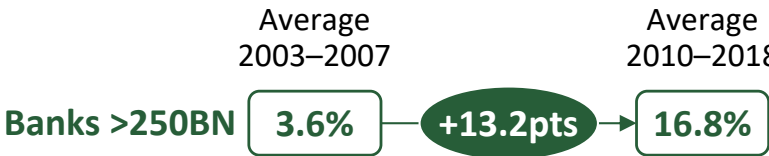
%, Common Equity Tier 1 as a percentage of RWAs



Source: Federal Reserve, FDIC, OW Analysis

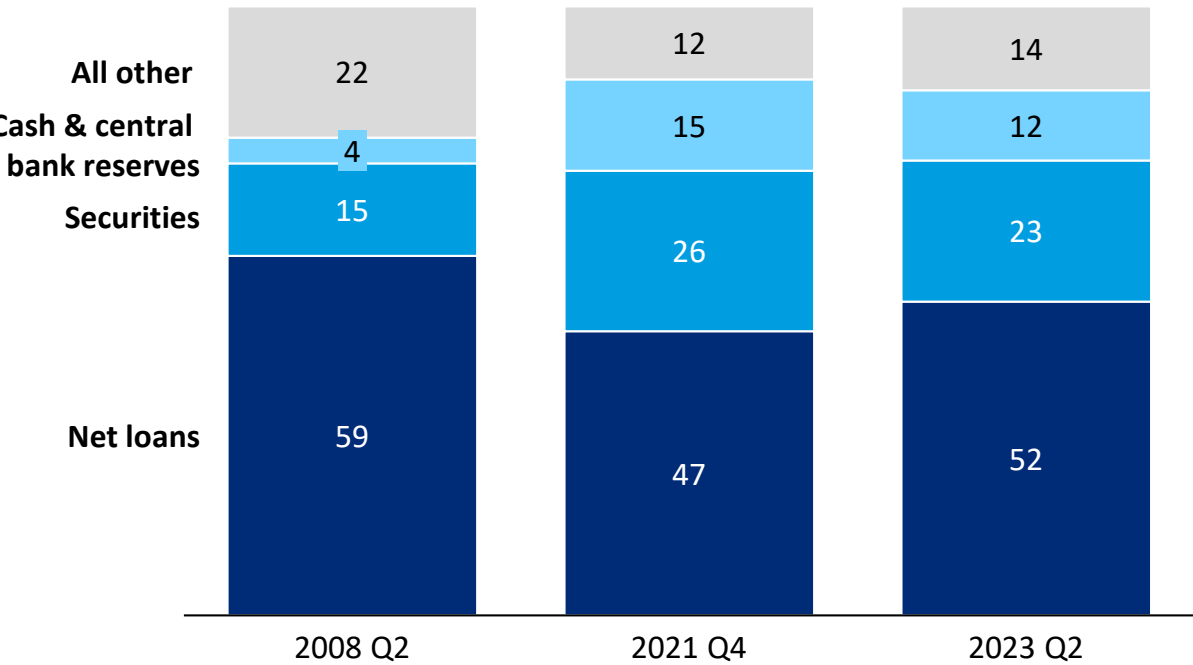
High-Quality Liquid Assets (HQLA)-to-assets ratio

% of assets, banks with total consolidated assets >\$250 billion

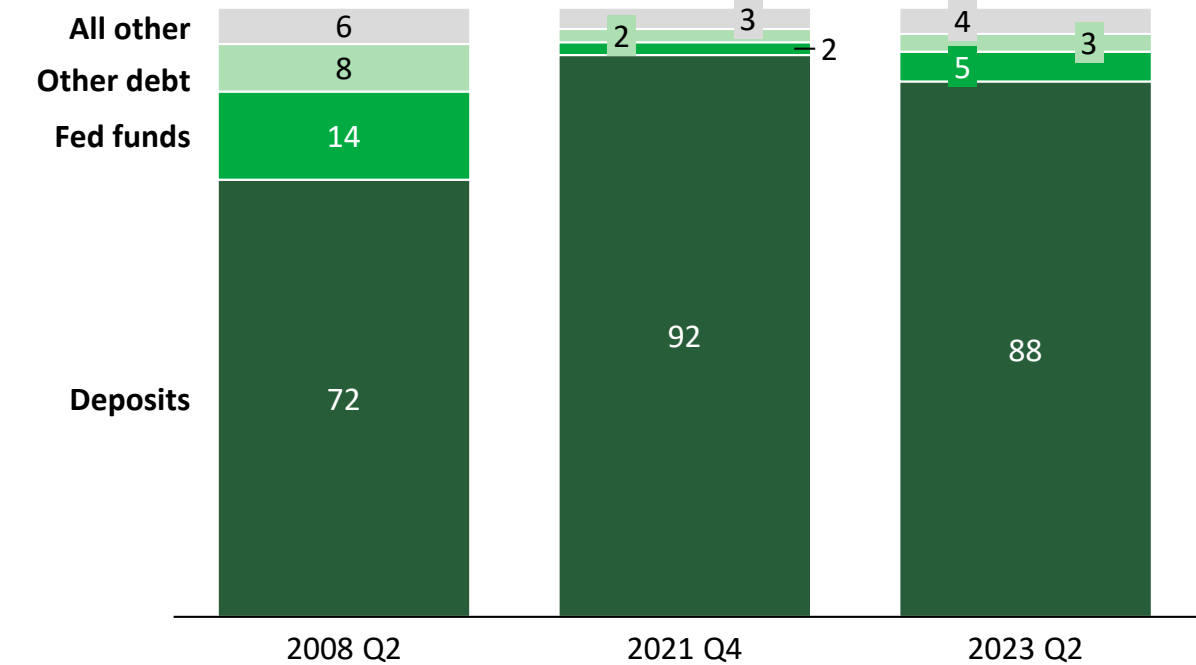


...TRANSFORMING BANK BALANCE SHEETS TO HOLD MORE SECURITIES & CASH ON THE ASSET SIDE AND GENERATE AN INCREASED RELIANCE ON DEPOSIT FUNDING

Total bank assets
% of total



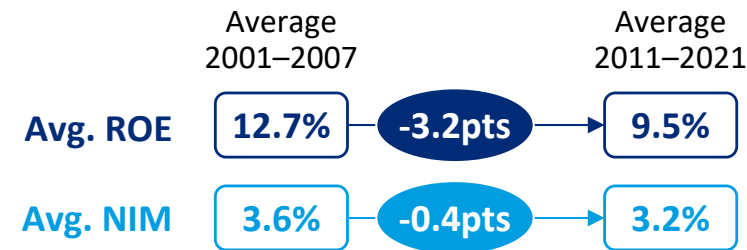
Total bank liabilities
% of total



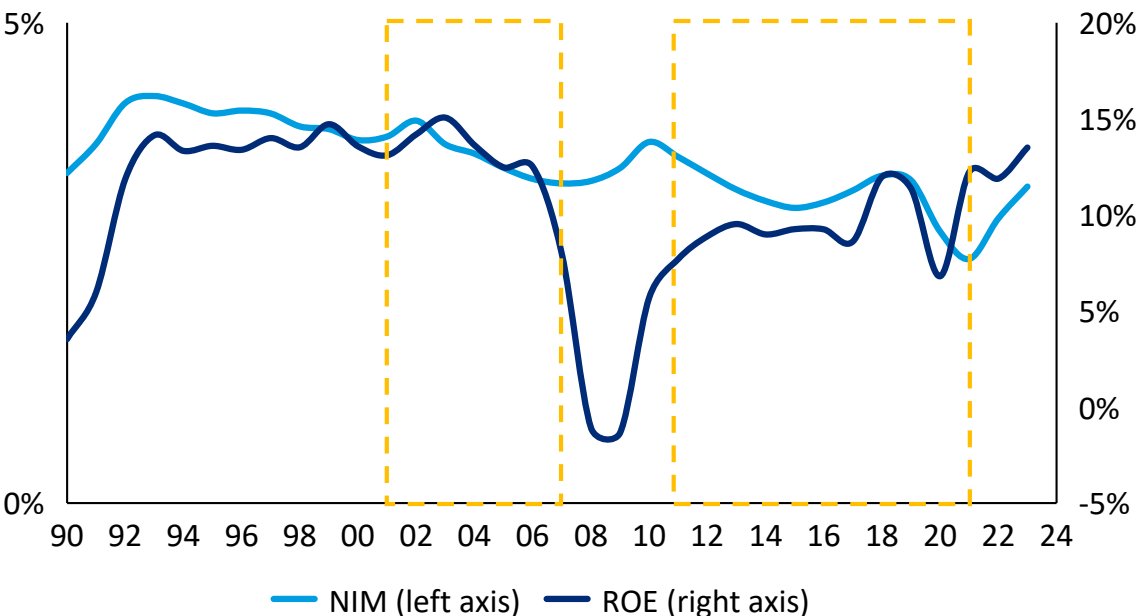
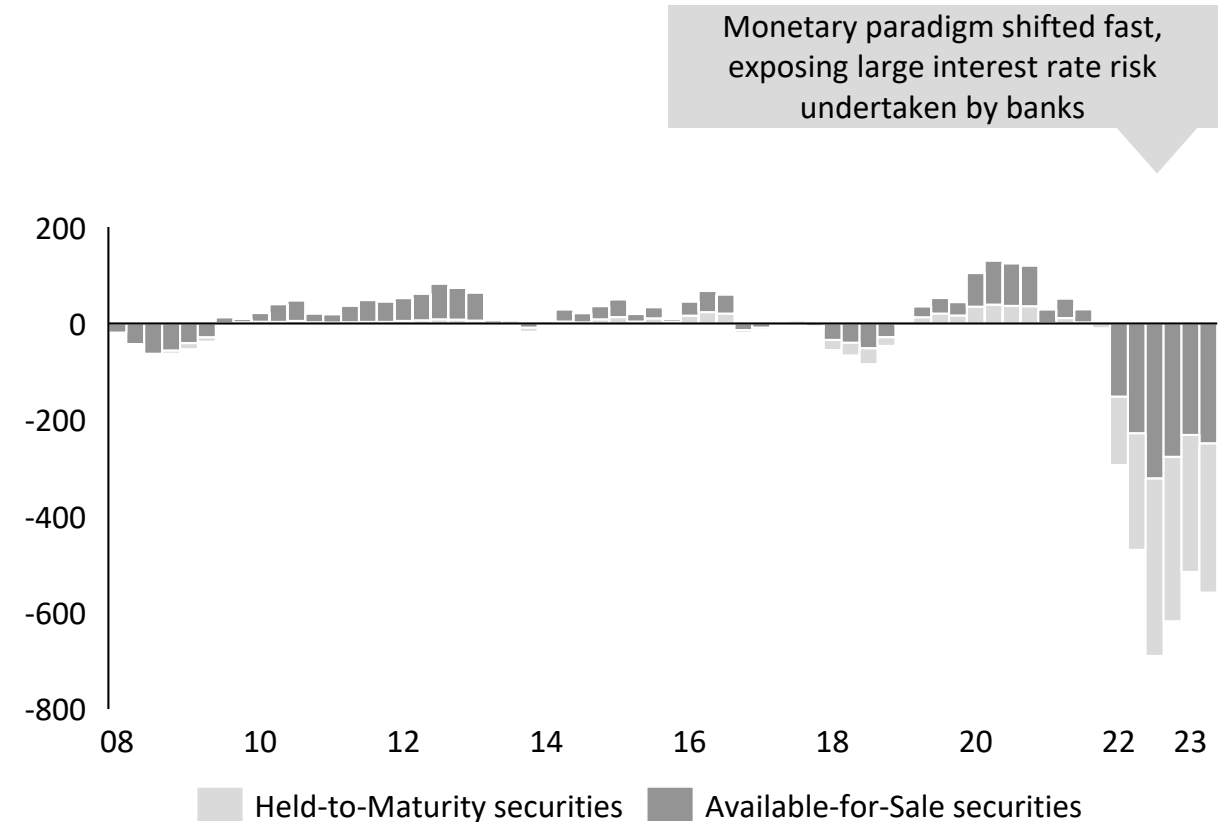
Source: FDIC, OW Analysis

INTEREST RATES AND REGULATORY PRESSURE PUT DOWNWARD PRESSURE ON PROFITABILITY, TRIGGERING A SEARCH FOR YIELD WHICH HAS RECENTLY BEEN FOREFRONT

Bank return on equity (ROE) and net interest margin (NIM)
%, quarterly data annualized, up to Q2, 2023



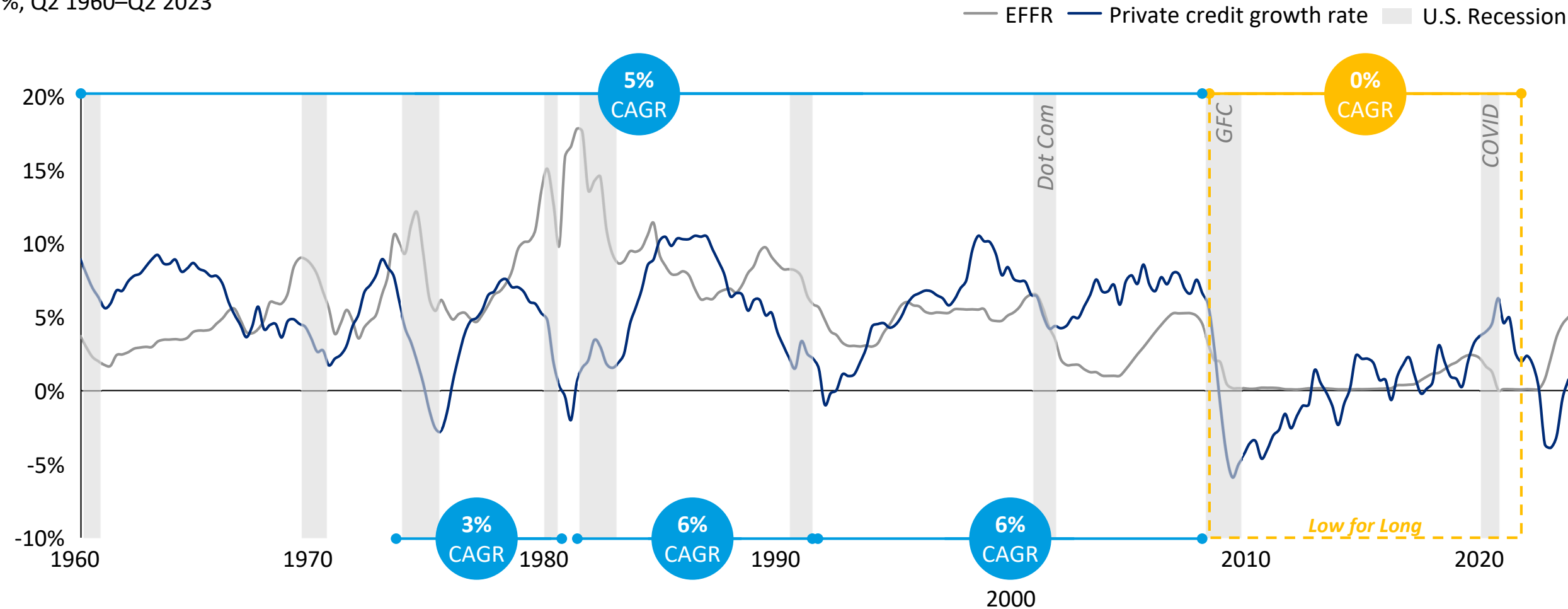
Unrealized gains/losses on investment securities
\$ Billion, quarterly, up to Q2, 2023



Source: FRED, Federal Reserve Board Financial Accounts of the United States (Z1 tables), FDIC, OW Analysis

A MAJOR CHARACTERISTIC OF THIS PERIOD HAS BEEN THE SCREECHING HALT OF THE MULTI-DECADE REAL GROWTH IN PRIVATE SECTOR CREDIT

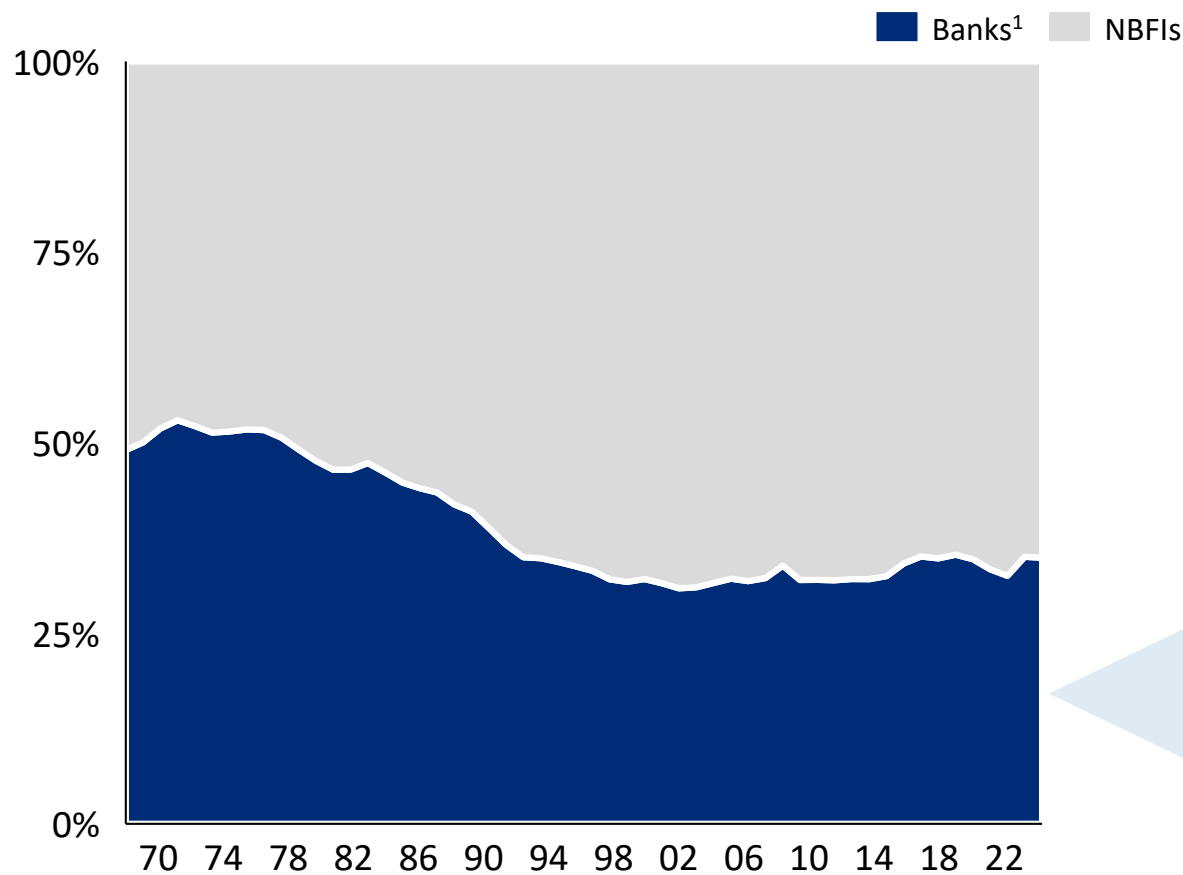
Private sector credit real growth rate¹
%, Q2 1960–Q2 2023



1. FRED's seasonally adjusted quarterly GDP implicit price deflator with an Index of 2017=100
Sources: Federal Reserve Board Z1 Tables, FRED, OW analysis

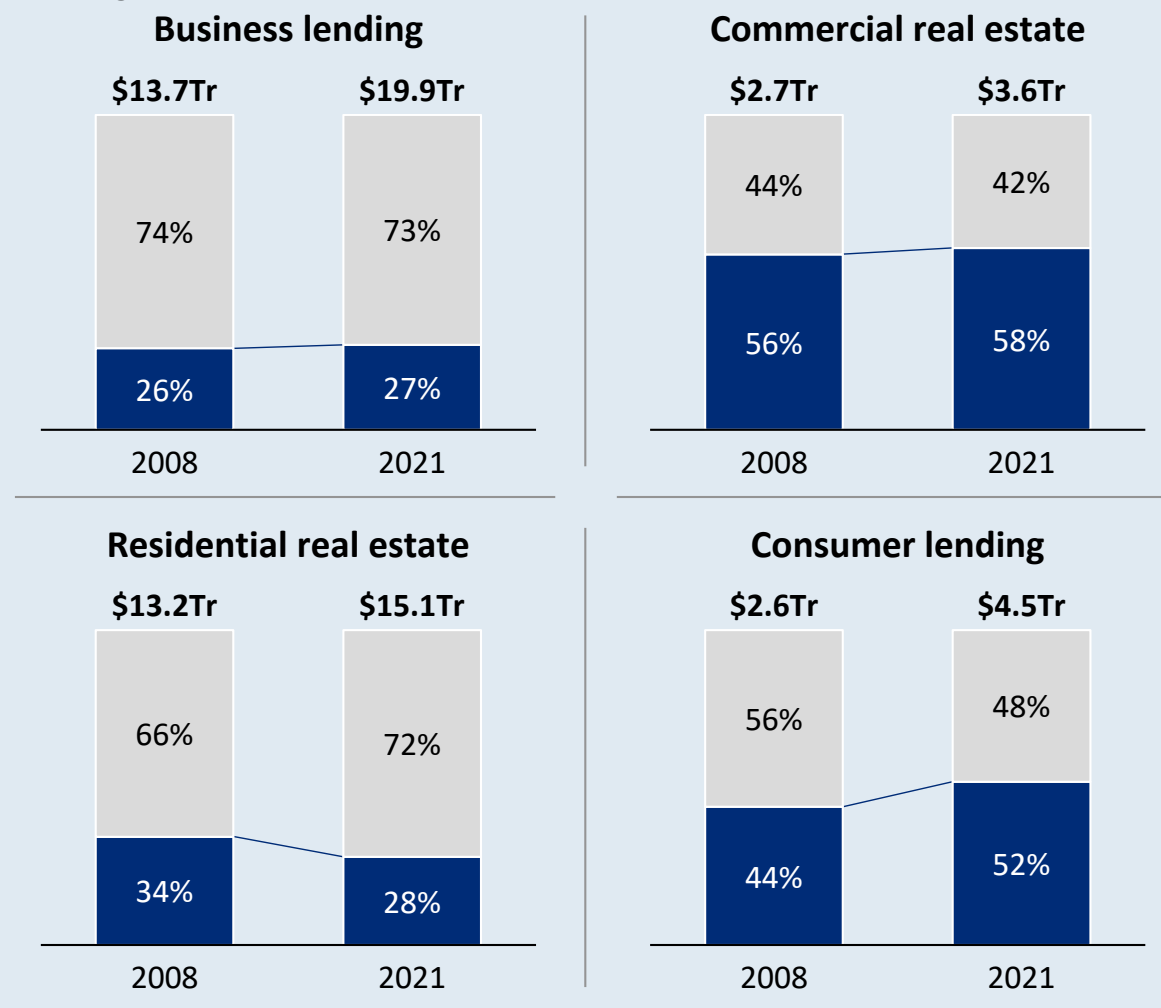
IN THIS LOW GROWTH ENVIRONMENT, BANKS OVERALL HELD ONTO THEIR MARKET SHARE — OFFSETTING LOSSES IN MORTGAGE MARKET SHARE WITH GAINS IN CONSUMER LENDING

Total private sector credit market share
%, annually, up to Q2, 2023

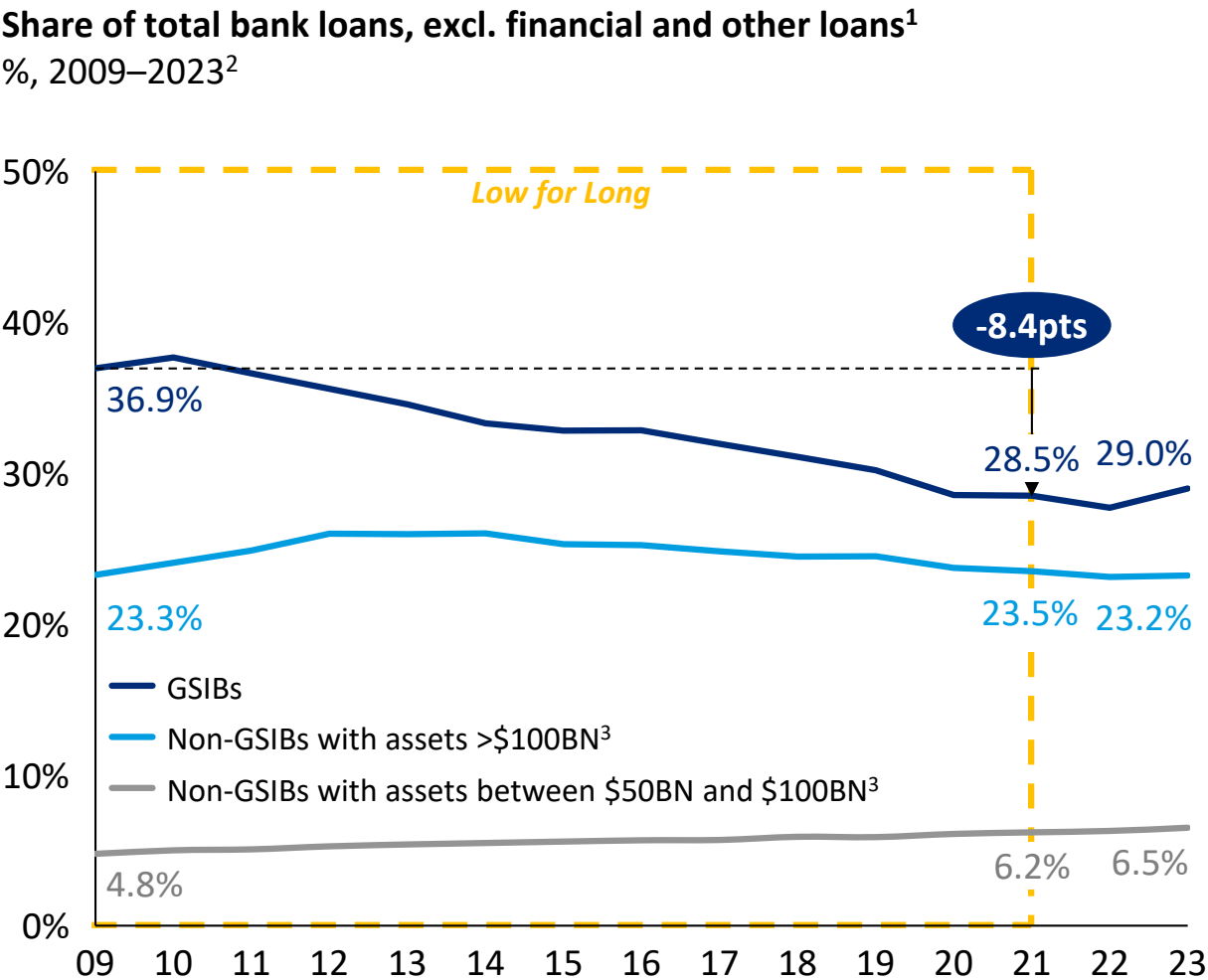


1. Data excludes bank lending to non-bank financial institutions
Source: Federal Reserve Board Financial Accounts of the United States (Z1 tables), OW Analysis

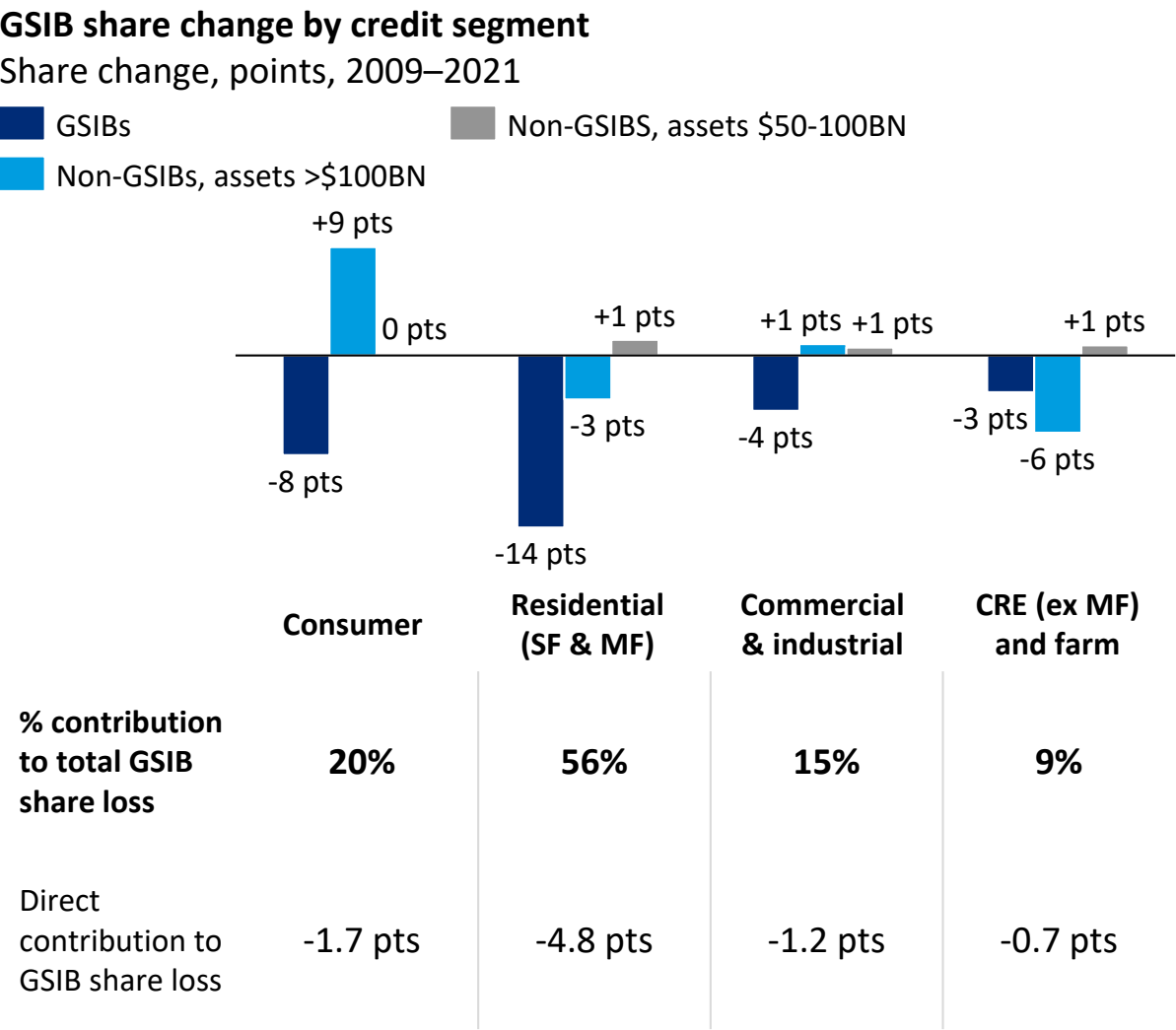
Bank share of private sector credit by segment
% of segment total



AMONGST BANKS, DIFFERENTIAL REGULATIONS RESULTED IN GSIBS LOSING SIZABLE SHARE TO SMALLER BANKS ACROSS ALL SEGMENTS IN THE REAL ECONOMY

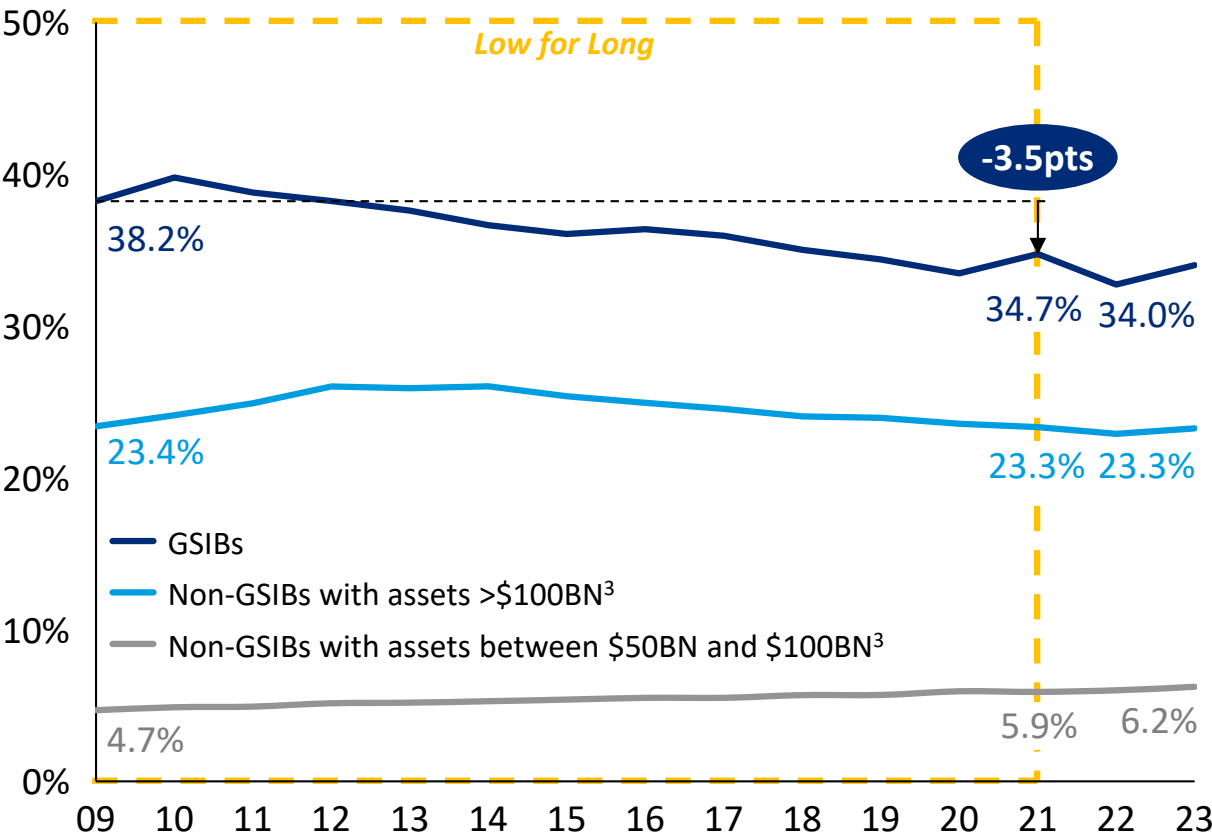


1. Other loans refers to loans that are not classified as consumer, residential, C&I, CRE, or financial lending.
2. 2023 values are as of Q2 2023, other values are from EOY.
3. Asset values as of EOY 2021.
Source: S&P Capital IQ, FDIC, OW Analysis



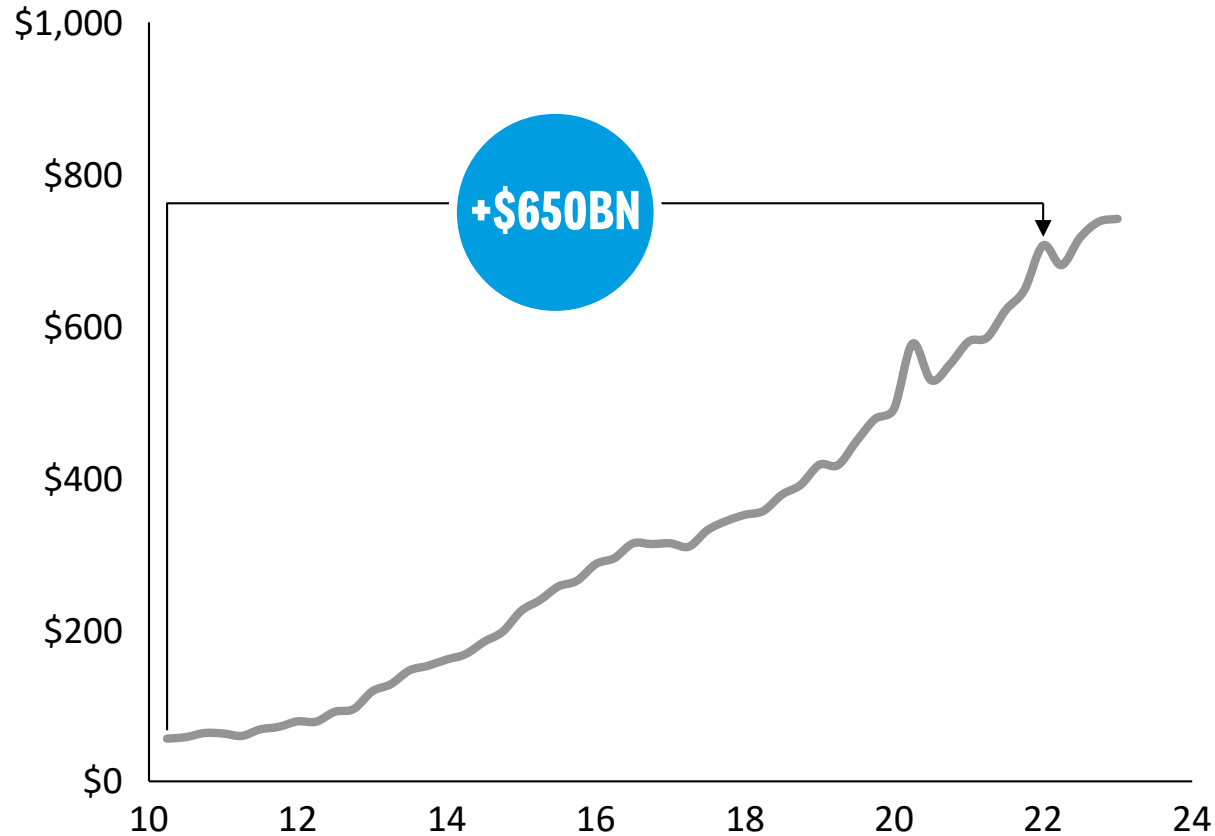
THIS PERIOD WITNESSED SKYROCKETING BANK LENDING TO NON-BANKS, MOST OF WHICH CAME FROM GSIBS, WHICH OFFSET GSIBS' MARKET SHARE LOSS IN REAL ECONOMY LENDING

Share of total bank loans, incl. financial and other loans¹
%, 2009–2023²



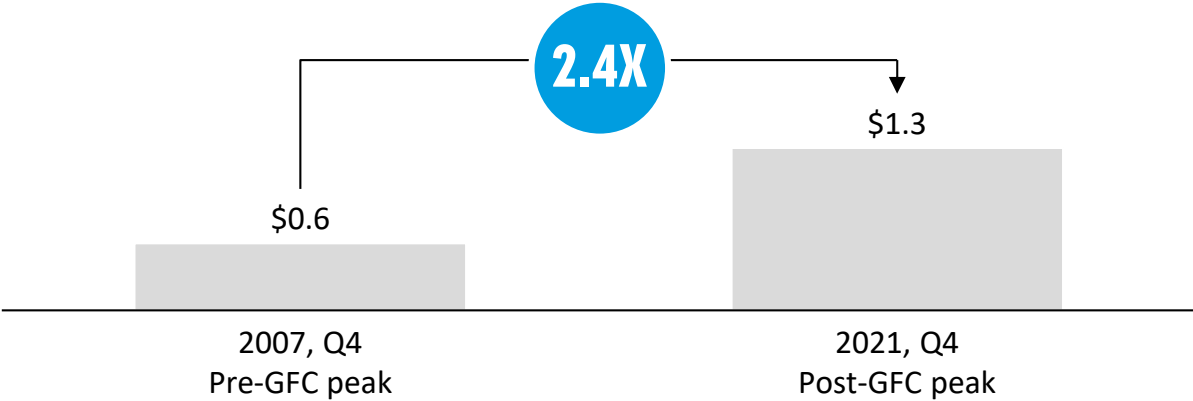
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Source: S&P Capital IQ, FDIC, OW Analysis

Bank lending to NBFIs
\$BN, Q1 2010–Q4 2022

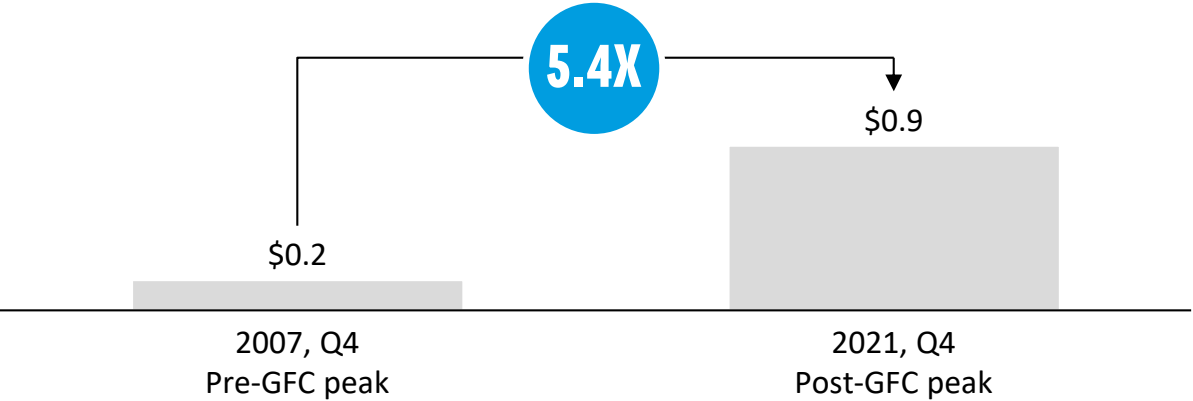


AT A MICRO LEVEL, THE STORY IS EVEN MORE NUANCED: NBF1 BUSINESS LENDING DURING LOW FOR LONG SHIFTED TOWARDS HISTORICALLY RISKIER TYPES OF CREDIT

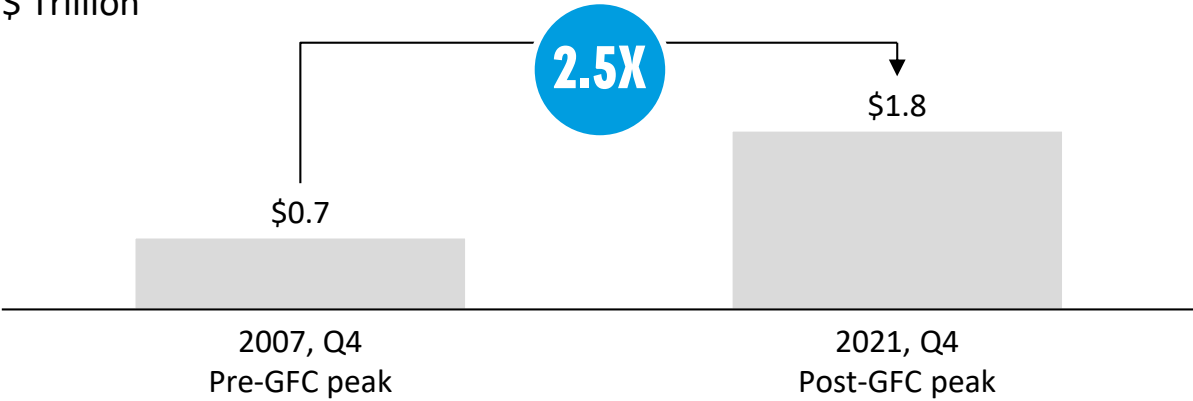
Leveraged loans outstanding
\$ Trillion



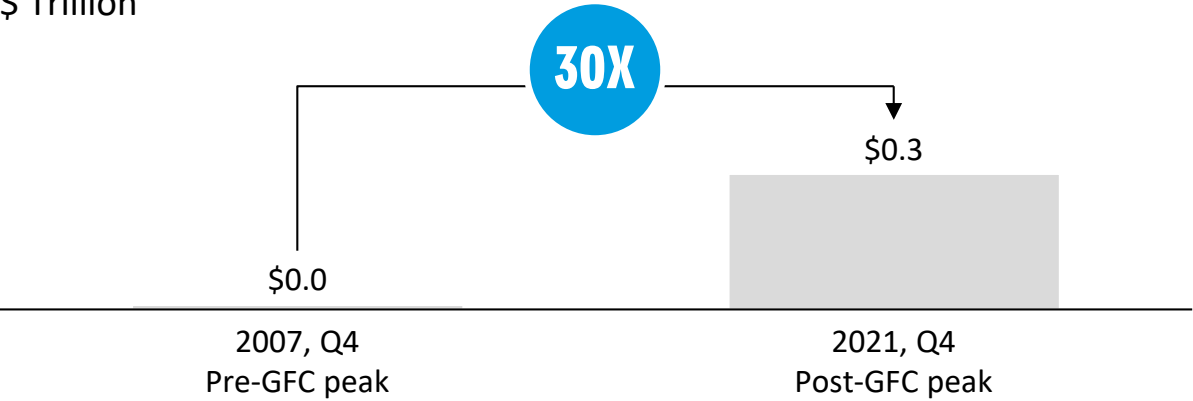
Non-bank private debt AUM¹
\$ Trillion



High-yield bonds outstanding
\$ Trillion






Direct lending private debt AUM
\$ Trillion



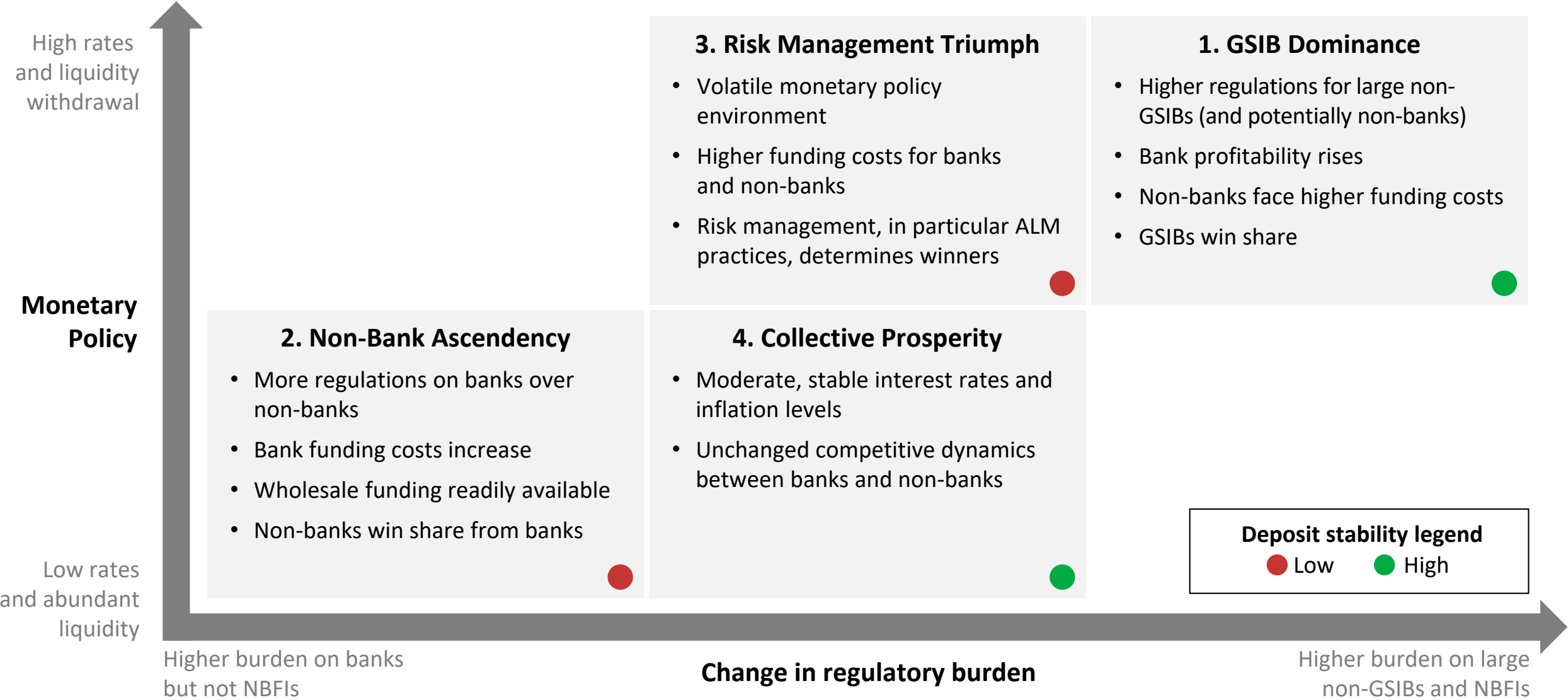
1. Private debt refers to debt finance to companies from alternative asset manager funds, rather than banks, bank-led syndicates, or public markets; Source: Pitchbook | LCD, Preqin, OW Analysis

LOOKING AHEAD: KEY FINANCIAL SYSTEM DRIVERS WILL LARGELY DETERMINE THE IMPLICATIONS OF THE NEW MONETARY ORDER

Scenario Driver	 MONETARY POLICY	 FINANCIAL REGULATION	 DEPOSITOR BEHAVIOR
	Oliver Wyman Conjecture <ul style="list-style-type: none">• Higher interest rates than during Low for Long• May be steady or volatile; however, in either case uncertainty is likely to be high• Central banks aim for QT, but market conditions will determine the pace and magnitude	<ul style="list-style-type: none">• Heightened regulation, but not to the same level as post-GFC• Greater effect on large non-GSIBs than GSIBs• Stricter NBFi regulation remains an open and difficult question	<ul style="list-style-type: none">• Lessened deposit stability and heightened segment-level divergence due to cyclical and behavioral shifts• With higher rates and heightened uncertainty, betas likely to squeeze banks not actively managing their deposit base

Source: OW Analysis

WE HAVE IDENTIFIED FOUR SCENARIOS TO SERVE AS GUIDES IN FUTURE DECISION-MAKING



Q&A

APPENDIX

PRESENTER BIO



UMIT KAYA

Partner
Financial Services

Umit Kaya is a Partner at Oliver Wyman's New York office, primarily advising CEOs, CROs, CCOs, CFOs, and Treasures of financial institutions on risk management, treasury, and finance topics.

His expertise covers the full spectrum of risk management, including overall financial system and its regulation, credit risk, market risk, treasury and balance sheet management, enterprise risk management, risk governance, model risk management, and modeling.

Umit's clients include almost all types of financial institutions. Umit advises his clients on establishing industry leading approaches in these areas, addressing supervisory feedback while pursuing management goals.

Umit also founded and leads an internal group at Oliver Wyman to build analytical tools for internal use at Oliver Wyman and external use by our clients, including using advanced techniques and tools. He has published on various topics, including strategic finance, credit markets, LIBOR transition, treasury practices, and model risk management.

Umit holds a Ph.D. in Economics from Princeton University, and a B.A. in Economics from Koç University in Istanbul, Turkey.

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