Finance for Europe

Association for Financial Markets in Europe

Press release

New AFME/PwC report examines the impact of post-crisis regulation on banks' capital markets activities

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The Association for Financial Markets in Europe (AFME) and PwC have today published a new *ex-post* study on the impact of regulation on banks' capital markets activities.

While there have been many forward-looking studies examining how banks may respond to regulatory reforms, this latest study is the first that examines how banks have *actually* responded to regulations 10 years on from the global financial crisis.

At a point where global supervisors have finalised the post-crisis reform programme, AFME commissioned PwC to assess the role played by regulation in motivating changes to banks' capital markets activities.

Simon Lewis, Chief Executive at AFME said: "*While the benefits from the post-crisis regulatory framework are clear, now is the right moment to examine how this framework has influenced banks' capital markets activities. Our study finds that since the crisis, there has been a significant decline in banks' global capital markets assets with regulation being by far the largest single driver of these changes. This clear link between regulation and its impact on banks' capital markets activities strongly argues for EU and global authorities to commission further studies of the potential effects of these rules on the provision of primary and secondary market services to end users, such as corporates and investors, before undertaking any further major regulatory changes."*

Nick Forrest, Director at PwC, said: "*Our study shows that since the global financial crisis, regulation has had a key impact on the shrinkage of banks' balance sheets - with a bigger effect than other economic and market trends. Banking regulations have contributed to a particularly substantial reduction in banks' balance sheet capacity to support the issuance, marketing and secondary trading of corporate debt, equity and related hedging products. This can ultimately lead to reduced access and higher cost of borrowing for corporate borrowers.*"

The study draws upon data across a selection of 13 global banks - which in aggregate represent 70% of global capital markets activities - covering three years of data: 2005, 2010 and 2016 as the latest full year of data available.

Among the key findings from the study are:

- The aggregate annual regulatory cost that applies to capital markets activities across the 13 banks in our sample is estimated to be approximately **US$37bn, representing 39%** of total capital markets expenses in 2016.
- **Capital and leverage requirements are the most substantial drivers of regulatory cost** and account for almost 90% of the total regulatory impacts.
- **Regulation drove a 14 percentage point reduction in (pre-tax) capital markets return on equity (ROE)** from 2010 to 2016 (from 17% to 3%) before banks' mitigating actions via deleveraging, cost reductions or repricing. Following such actions, overall ROE (excluding one-off charges) recovered to 11% by 2016.
- **Rates and credit activities** have been most impacted by regulation in ROE terms.
- Higher regulatory costs and low returns have been significant drivers of assets deleveraging in banks' capital markets activities.

- **Regulation alone accounted for about two thirds of the net 39% decline** in capital markets assets across the sample of banks between 2010 and 2016, with pronounced falls in **rates, credit, commodities and equities assets.**
- Macroeconomic trends and non-regulatory factors also explain some of the movement in assets.
- Broad trends of deleveraging across regions suggests these are global in nature, and not limited to individual firms or regions.

The PWC/AFME study captures information up to 2016. It therefore does not incorporate data on the impacts from the recent introduction of MiFID II/MiFIR or banks' responses to the forthcoming implementation of NSFR and the remaining Basel III capital reforms. Taken together with banks' 2017 capital markets results, this strongly suggests that the trends seen in the study are likely to continue.

AFME recommends that European and global authorities undertake further *ex-post* cumulative impact studies. These should specifically examine how regulation impacts the economics, for providers of primary and secondary market capital markets products and their incentives and capacity to continue offering them to end-users, such as corporates and investor users of financial services. Particular attention should be given to the provision of market making services in impacted asset classes.

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About AFME:
AFME (Association for Financial Markets in Europe) advocates for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society. AFME is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues. AFME aims to act as a bridge between market participants and policy makers across Europe, drawing on its strong and long-standing relationships, its technical knowledge and fact-based work. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website: www.afme.eu.
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