Brexit 2.0
Lessons Learned & Challenges Ahead –
The PwC Viewpoint

PwC – Financial Services – Capital Markets
June 2020
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We had a rough idea what to expect ... at the end, too rough ...

Chief Risk Officer
Brexit Bank
Background
The Brexit negotiations are ongoing and “final exit” of UK is scheduled for end of 2020, with no further transition period envisaged. Capital Markets clients face a number of challenges as their legal entities have been set up in order to provide “markets access” whilst regulators expect a sustainable and standalone legal entity.

Survey Content
We conducted structured interviews clients and set-up to get an overview of the main challenges across the capital markets (Brexit) industry. Whilst we see a number of technical topics, it can be observed that risk and regulatory requirements are the cornerstone of each banks challenge universe.

Timeline
Brexit is expected to happen until the end of 2020 and regulators expect incoming banks to be ready. Whilst some banks have made progress, we see even increased concerns across regulators that the current challenges will become even more severe.

Executive Summary
- A number of banks are working their way towards regulatory compliance.
- It can be observed that governance as well as processes are not yet well established.
- Over 71% of the current challenges will require substantial investment.
- Almost the entire Management Board (within their remit) is affected, although on a different severity level as well as different number of challenges.

PwC recommendation
Even though Covid-19 puts additional pressure on banks, don’t underestimate the impact Brexit will bring and how severe the post-Brexit situation will be.
The Brexit maturity ladder
Incoming banks face similar challenges across the journey, but on a different maturity scale

Legal Entity Setup
Operations Running
Reg. Compliance & Governance
Local Excellence & Global Integration
Depending on the level of “legal-entity-maturity” there will be significant effort on the road to regulatory compliance.

71% of challenges require significant or material effort to comply with either regulatory requirements or with envisaged legal entity setup.
Common Pitfalls & Root-Causes
Whilst different challenges can be observed, a holistic approach towards the root-causes is even more important

It was important for us to not only focus on regulatory items, but to develop an overall picture of our challenges and roadmap ...

Chief Executive Officer
Brexit Bank

Risk & Regulatory Challenges

- Controls not in place
- Controls not designed correct or operating effectively

- Data not available to legal entity
- Data delivery not in time
- IT systems not adequate for purpose

- Roles & Responsibilities within the Entity not defined
- Interaction between Group and Legal Entity not clear

- Quantity of people not sufficient to conduct operations
- No sufficient knowledge and skills within the legal entity

- Processes not defined
- Processes not transparent

Control
Data & IT
Governance
People
Process

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June 2020
There is a consistent trend across our capital markets clients regarding the root-cause of their challenges

5 material “root-causes”
Reflecting the themes and topics from our clients, although a number of different technical topics have been identified, performing a root cause analysis results in the following categories and results:

- Governance: 44%
- Process: 25%
- Controls: 21%
- Data & IT: 7%
- People: 2%
Different board members face a different number of challenges and “efforts to comply”

The Management Board view
All Management Board Members are affected by the current challenges. Whilst we can observe that for some Board Members the severity of challenges is comparable, divergency can be seen with regard to the number of challenges. We do see that CRO’s and COO’s face substantial work and effort to ensure a sustainable and regulatory compliant legal entity setup.
CFO’s have to develop a playbook especially in the area of regulatory reporting – a high priority for regulators.
On the strategic side, the more mature the legal entity will become, a viable and strategic business model reflecting group wide targets will be essential for CEO’s.
Technical Topics & Themes
Overview of selected topics & challenges per Management Board Member

CEO
- Legal entity Strategy
- Legal entity Governance

CFO
- Liquidity & Funding
- Regulatory Reporting
- Capital Planning

CRO
- Enterprise Risk Management
- Credit Risk Management
- Compliance Framework
- Operational Risk Framework

COO
- IT-Framework & Governance
- Governance Processes and Controls
- Outsourcing Framework
- Other

Bus.
- Front Office Framework & Controls
- Middle Office Processes & Controls
The Chief Executive Officer View

Root-causes per Management Board

- Governance: 75
- Process: 13
- People: 13

Number and Severity per area

<table>
<thead>
<tr>
<th>Area</th>
<th>Severity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal Entity Strategy</td>
<td>F4 13</td>
</tr>
<tr>
<td>Legal Entity Governance</td>
<td>F2 13</td>
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</tbody>
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Legal Entity Strategy
- Missing or unclear Business Strategy
- Limited view on Legal Entity specific strategy and how to add more value to group targets
- Insufficient strategy process & documentation
- Development of business strategy in the light of Day-2 readiness

Legal Entity Governance
- Missing documentation on internal governance framework
- No final legal entity governance established and how interaction with internal and external stakeholders
The Chief Financial Officer View

Root-causes per Management Board

- Governance: 42
- Process: 8
- Control: 17
- Data & IT: 8
- People: 5

Number and Severity per area

- Capital Planning: F4
- Regulatory Reporting: F3
- Liquidity & Funding: F2

Liquidity & Funding
- Contingency Funding Plan not tested for effectiveness
- Inadequate number of scenarios as part of the Stress Testing
- No sufficient funds transfer pricing concept for the legal entity

Regulatory Reporting
- Regulatory Reporting software does provide data for legal entity
- Regulatory Reporting (extended reporting capacity due to expected increased business volume)
- Outsourcing KPI, Controls
- Data sources, Data flows, Controls unknown
- No Policies & Documentation
- Onshore Knowledge

Capital Planning
- ICAAP – Capital planning, Scenarios not adequate
Enterprise Risk Management

- Insufficient documentation on legal entity ICAAP
- Models & Methodology not approved for legal entity
- Risk Appetite & Limit Framework does not reflect local portfolios
- Risk Culture-Framework not established
- New Product Approval & Documentation
- Recovery & Resolution measures not available - other than parental support
- Risk Inventory not documented or not available

Credit Risk Management

- Credit Risk – insufficient processes around new regulatory requirements (e.g. NPL, LT)
- Credit Risk, stress test for leveraged transactions not sufficient
- Models & Methodology – Documentation of assumptions not specific for legal entity
- Models & Methodology – Granularity of assumptions not adequate enough to reflect local portfolios
- Risk Appetite & Limit Framework – Credit Risk determined outside the legal entity

Compliance Framework

- Compliance risk assessment not documented
- MaRisk Compliance Reporting not available

Operational Risk Framework

- Models & Methodology not adequate for legal entity
- Policies not established and Onshore Responsibilities not clear
- Operational Risk Self assessment framework not finalized
- Operational Risk limits not calibrated from legal entity perspective

Root-causes per Management Board

- Governance: 58
- Process: 22
- Control: 19

Number and Severity per area

- Credit Risk Management: F4, F3, F2, F1
- Compliance Framework: F4, F3, F2, F1
- Enterprise Risk Mgt.: F4, F3, F2, F1
- Operational Risk Mgt.: F4, F3, F2, F1
The Chief Operating Officer View

Root-causes per Management Board

- Governance: 39
- Process: 17
- Control: 17
- Data & IT: 28

Number and Severity per area

- Outsourcing Framework: F4
- IT-Fram.: F3
- Governance, P&C: F2
- Other: F1

IT-Framework & Governance
- Business Continuity Plan does not address legal entity needs
- IT-Data processing not sufficient for local deadlines
- IT-Strategy not available
- IT-Policies not available

Governance, Processes & Controls
- OpRisk Risk Control Self Assessment not conducted
- Remote Booking controls not in place
- Booking Model – Framework not available
- Booking Model Governance & Processes not defined

Outsourcing Framework
- Outsourcing Risk Assessment not clear
- Outsourcing processes and controls not established
- Documentation, Onshore Responsibilities for Outsourcing Framework not available
- Outsourcing inventory & Service Level Agreements not available
- Outsourcing Policy not yet finalized

Other
- Policy Framework not yet established for legal entity
- Market Conformity Check no sufficiently designed

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The Business View

Front Office Framework & Controls
- P&L Attribution & Sign Off not conducted
- Mandatory Time Away not in line with MaRisk requirements
- Product Catalogue & Inventory not updated and documented

Middle Office Processes & Controls
- Governance of monitoring, escalation, confirmation, settlement etc, not established
- Timely capture of off hour trades not ensured

Root-causes per Management Board

Number and Severity per area
Mastering the Journey
In order to prepare for the challenges ahead, it is essential to take another perspective, whilst leveraging existing building blocks.

We have observed a common pattern across the ‘Brexit Industry’, and we are currently seeing a number of clients that have already adjusted their viewpoint and taken specific actions.

Stephan Lutz
Head of Capital Markets PwC

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**Unsuccessful Peers**

- Headquarter
  - „What we have”
- Local Entity
  - „What you can leverage"

**Successful Peers**

- Headquarter
  - „What we would like to leverage”
- Local Entity
  - „This is what we need”

**Benefits**

- Deeper integration into existing processes
- Stronger governance and accountability within the legal entity
- Better ‘legal entity business case’
- Clear regulatory roadmap and compliance
We have supported key clients with the development of their local legal entity...and the journey continues

1. Legal Entity Strategy
   Definition of target model based on existing and envisaged building blocks
   • Business & risk strategy
   • Regulatory Roadmap
   • Group Targets & KPI’s
   • Benchmarking view
   • Products & Customer
   • Supervisory Roadmap & Expectations

2. Workshop based assessment
   A workshop based assessment with material legal entity departments will result in a self-assessment accompanied by PwC’s external view
   - Business Management
   - HR
   - Strategy
   - Risk
   - Compliance
   - Controlling
   - IT & Operations
   - Business Risk
   - Project Management
   - Finance
   - Accounting
   - Regulatory Reporting

3. Benefits & Outcome
   PwC will issue a legal entity maturity report outlining the key observations and potential strategic options
   - How transparent is the legal entity strategy & vision
   - What are my peers doing in order to cope with the increasing requirements
   - Do we have the right skillset for the future and what are my biggest challenges (Governance, IT, Processes etc.)
   - How can I leverage group processes in the most efficient way without negatively affecting my regulatory roadmap
   - ...

Legal Entity Strategy - Questionnaire
- Transparency
- Regulatory Expectations
- Skillset
PwC Capital Markets – Your Contacts
Your Contacts

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Thank you.