

Dealing with underperformance

Deal Advisory BANKING



Tightening regulation, reduced liquidity and the continued challenging economic conditions have all led to banks looking more closely at their operations, the risks affecting those operations and the regulatory capital required commensurate with those risk assessments.

These reviews, coupled with ongoing assessment by regulators and supervisory bodies, have brought underperforming parts of a bank's business into much sharper focus. When combined with the increased appetite to improve capital buffers that can be seen across most markets, a proactive approach to addressing underperformance is necessary. KPMG's member firms' clients are increasingly demanding strategic responses to deal with the value destruction. This may take the form of a rapid cost reduction exercise, dealing with growing levels of non-performing loans, or around governance and control processes. Frequently, however, it is caused by an underperforming market/line of business (LOB) where a rapid, dynamic and robust process around the decision to fix, sell, or close a business is required.

A multi-disciplinary approach

Underperformance is often a result of complex dynamics, requiring multi-disciplinary teams to identify and effect solutions. Banking turnarounds and transformations may often involve a mix of selling operations, establishing non-core operations for later sale or run-off, and portfolio sales (see separate service sheets) in conjunction with cost-base rightsizing, improving governance and dealing with underperforming credits. Implementing such comprehensive change across multiple LOB's and jurisdictions cannot be achieved effectively without appropriate program management, internal sponsorship by

senior management, and robust stakeholder management. Regulator scrutiny, the public eye and short-term liquidity management issues can further increase demands on management. Where appropriate, we can provide senior individuals in decision-making executive support capacity to advise and work alongside senior executives, guiding them through the fix/sell/close evaluation and deal with both internal and external stakeholder management issues.

Fixing the cost-base: footprint and headcount reduction

The shift from high-street to online retail banking, increased technology adoption in back-office functions, and shrinking corporate lending due to liquidity constraints are rapidly reducing both property footprint and headcount requirements across most banking organizations. Financial underperformance is often reflective of the weaker pace of delivery or ineffective implementation, of major cost reduction programs. Banks, especially those operating in multiple jurisdictions, will need to deal with many challenges along the way including unionization or local labor law issues; employee resistance to change and insufficient management bandwidth that provide multiple opportunities for underperformance. Higher performing institutions have identified that developing and effectively communicating a robust case for change is vital to retaining critical skill-sets, maintaining staff morale and ensuring a smooth transition to the new business model.

Addressing the balance sheet – 'working out' non-performing loans

The prolonged economic downturn has resulted in growing levels of non-performing loans in



many leading and periphery Eurozone nations. The early identification, intervention and dedicated management of underperforming and non-performing loans, thereby avoiding borrower insolvency and improving loan recovery prospects, is critical to maintaining loan portfolio and net asset value. Local regulators are increasingly requesting that banks establish dedicated specialist work-out functions to effectively manage non-performing loans and minimize the risk of bank failure. Many banks, as part of their overall portfolio sale or exit strategies, are seeking to work-out non-performing loans prior to their sale in order to maximize disposal value.

Loan work-out is a relatively new concept in many jurisdictions and securing the employees with the right skills and experience can prove problematic for banks in the short-term. However, transferring loan management to independent teams with specialist restructuring knowledge early in the non-performing loan cycle can make the difference between recovering loans at par or achieving low cent in the dollar insolvency returns. Typically such loans will be transferred to new relationship teams responsible for examining the underlying reasons for non-performance, identifying possible restructuring solutions, negotiating solutions with customers, implementing and monitoring such solutions.

KPMG: hands on support where it's required

With a large pool of experienced turnaround, transformation and loan work-out professionals, KPMG member firms are able to bring the requisite skills sets to rapidly help stabilize underperforming, stressed or distressed banks, identify the route to business as usual, improve stakeholder management, potentially help reduce cost and address non-performing loan books. KPMG firms can bring in the right people from the global network of firms to give clients the critical mass that they need in the areas where needed. A proven track record of working in cross border stressed and distressed situations, coupled with extensive experience of working-out distressed loans in both capacity as banker and advisor to banks, means our firms are uniquely placed to make an immediate impact. Our teams frequently work with other transaction and restructuring professionals to deliver comprehensive fix/sell/close alternatives through to execution.

Our firms can help you:

- assess, identify and manage underperformance across markets and lines of business
- provide decision-making executive support and advice working alongside board members
- exit underperforming or non-core divisions or lines of business through sale or managed wind down to release capital
- manage complex stakeholder situations including regulators, bank and other creditors and shareholders
- rapidly right-size headcount and property portfolios
- take action on common governance issues
- establish industry best practice functions to manage the work-out of non-performing corporate loans
- develop appropriate Management Information (MI) for the monitoring and reporting of non-performing loans
- provide hands-on support for the management and restructuring of large non-performing loans.

Activities our member firms support:

- **strategic reviews** of underperforming business units
- **exit planning and implementation** of underperforming or non-core business
- rapid **cost reduction**
- **operating model change** and operational restructuring
- work-out of **non-performing loans**
- **contingency planning**
- **dealing with stressed and distressed subsidiaries**
- **business planning and liquidity management**
- **stakeholder management.**

Case studies

Management of a complex restructuring project and negotiation of a settlement with stakeholders

A sovereign debt crisis precipitated a sharp decline in the value of government bonds and, very quickly, a number of large and systemically important banks that held these bonds became technically insolvent. One immediate consequence was intense concern from international bank creditors and demands for information. At very short notice we assisted a major bank to establish an informal moratorium with more than 100 international bank creditors. Working closely with the bank's senior management team, who had no experience of dealing with such a crisis, we produced information packs for creditors, managed multiple channels of communication, developed a robust model to run forecast restructuring scenarios and produced a proposal. In a hostile environment with cross-border litigation and pressure from regulators and creditors, we helped the bank negotiate a settlement that was accepted by all stakeholders and approved by the courts. This was the first such precedent in that country.

Assistance in establishing a work-out function and hands-on management of non-performing loans

Following a severe economic contraction, bail-in of the local banking sector and subsequent growth of its non-performing corporate loan book, KPMG in the UK developed and implemented the restructuring of a banks most acute non-performing loans. They assisted with establishing a new work-out team, including developing and implementing a new team structure, governance framework and key reporting and management tools. Working alongside senior management and existing loan officers, the team provided hands on advice on the development of loan restructuring strategies on a case by case basis, deal negotiation and execution support. This was complemented by formal and informal training sessions and stakeholder management support, including the reporting of progress to regulators.

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