

The adaptable survives #6

- The effects of increased regulation of banks

Report on the 2020 survey

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Foreword

This is the sixth annual report on the effects of change in banking regulations that started with a thesis written in 2015 at Stockholm Business School Executive MBA program.

The purpose of the annual reports is to do a limited follow up of trends and results based on an annual survey within the banking industry in the Nordic countries.

I want to give a special thanks to the Bankers Associations in Denmark, Finland, Norway, and Sweden, as well as the Swedish Savings Bank Association (*"Sparbankernas Riksförbund"*), for making this annual survey possible and to all colleagues in the banking industry for dedicating their time to answer.

Also, thanks to Viktor Elliot, Ph.D. Senior Lecturer, at the School of Business, Law and Economics at University of Gothenburg for all cooperation and support.

The results of this survey have been used in the PhD thesis "Bank Funding Strategies; Time for change: The role of professional self-esteem in relation to industry support of banking reforms in Sweden" (Natalia Kostitcyna, University of Gothenburg) and the book "Finansiell Reglering och Tillsyn" (Studentlitteratur). Both these publications have benefitted from the survey results.

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About the author:

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The author is a frequent speaker at conferences and educator at several universities. He was a finalist of the Swedish award GRC profile of the year 2016.

Executive summery

It is impossible to write a study today without reflecting on the Covid-19 pandemic, so this report will also address that. The result of the 2020 survey shows that the early actions taken by regulators was well received. Half of the respondents indicated increased risk levels on capital and liquidity and four out of ten on cyber risk and operational risks. Future studies are needed to understand if this early indication on increased risk continues.

The next hot topic in the banking industry is sustainability and ESG risk requirements. Some new questions were added to this survey relating to how well the banks processes are adapted to the ESG requirements. The result is that bank employees believe more in the process than the group Others. Same results as the digitalization five years back. If the results develop the same way, will the bank employee respondents be more self-critical in the coming years, as they understand that there is more to do within the ESG area?

The second-year result relating to communication with the national FSAs together with the questions of the regulations clarity and certainty in follow up, etc, show no improvement. The results are still that the regulators do not make it easy to understand the regulation.

The annual survey examines the effects of regulatory change in banking. So far, the survey results are primarily concentrated on Swedish banks but from 2018, also Norwegian, Danish, and Finnish banks are included. The survey focuses on three areas: regulation, competition, and processes & leadership. In 2020, there were an increased number of participants from Swedish savings banks.

The aim of the survey, and the related studies, is to understand the ongoing change in the regulatory environment and its implication for the banking industry. The survey also includes questions about digitalisation, especially focusing on how competition is changing in the banking industry. New for 2020 is also questions relating to the Covid-19 pandemic and ESG requirements. The response rate in the sixth annual recurring survey was 22 percent, 225 replies of which 215 was in Sweden. Unfortunately, the number of answers from the other Nordic countries is not sufficient for a separate analysis this year.

Stricter and persistently changing regulations is a major topic in banking and has been for many years. The regulations aim to promote financial stability and a single rulebook both globally and within the European Union. The regulations have moved from local regulation to Basel and EU over the past ten to fifteen years. These supranational regulatory institutions primarily focus on large international banks, but the regulatory frameworks cover banks of all sizes. This means that banks of all sizes need to stay up to date with multiple regulators, alas is consuming large resources. The annual Nordic banking survey shows that it is still difficult for banks to analyse and fully comprehend all the regulations.

The conclusion stands even after analysing this sixth survey: "Banks are risking a myopia; they see the changes but are unable to implement the necessary adjustments to new business conditions" - The adaptable survives.

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1. Introduction

The focus of this report is like previous years: the increased regulatory effects and the risk of a bank¹ myopia. Myopia here refers to failure to detect important changes in the outside world and thus, in time, failure in adapting the business model to changing customer behaviour. The study has three focus areas.

- 1. How the regulation is interpreted, implemented, and adapted in banks*
- 2. Competition between banks and other financial actors² that do not fall under the same regulation*
- 3. Influence of regulation on banks' processes and leadership.*

The results will be compared to the results in previous years' surveys.

1.1. Banks and its regulation

For readers who do not themselves work in the banking industry, it is recommended to read the author's thesis "Den anpassningsbare överlever" (The adaptable survives) (2015) for background information relevant to understand this report. The thesis is available in full and as an executive version at www.jacobsson.se. The thesis is in Swedish.

Appendix 1 – "The bank regulation" contains a description of bank regulation.

1.2. Limitations

The report:

- Only includes a casual review of bank regulation outside the risk management area.
- Do not focus on the effects of regulation on other financial institutions, finance companies or shadow banks, collectively named other financial actors.
- Do not to analyse the consequences of non-compliance with the regulation and subsequent regulatory measures.
- Only casually discusses technological change and other environmental factors.

The limitation is made as the above areas are nearby but are nevertheless deemed not to be essential for the analysis.

Furthermore, this report does not contain a theory review as the thesis did.

¹ With bank means in this report also credit market companies "kreditmarknadsbolag" that is regulated under the same regulation as banks.

²Other financial actors – for example IT-companies, service companies and shadow banks that compete with banks without being under the same regulation. Shadow banks is financial companies that conduct banking like services.

2. Method

The author studies the questions with qualitative method. The 2020 survey is somewhat developed compared with previous years. The survey is sent to a wide group of professionals active in the banking sector. The survey contains both predefined answer options and open response questions.



2.1. Survey formation

The data collection is done with an empirical study through a survey verified by an expert panel (2015), a survey design expert (2016) and a researcher at the School of Business, Law and Economics at University of Gothenburg (2018-2020). The Web-based surveys consists of two versions, one for bank employees and one for other banking professionals. Both surveys contain the same questions, the difference is how the questions are formulated. It is an empirical study based on the knowledge of the author and respondents about banks and banking regulation.

2.2. Identifying recipients

The survey recipients consist primarily of persons who are members of a committee in the Swedish Bankers Association relating to capital adequacy, liquidity, legal, compliance or operational risks, or within the equivalent committees with the Swedish Savings Bank Association, Finance Denmark, Finance Finland or Finance Norway, and persons with whom the author has a professional relationship with. The selection has been made on the basis that they are expected to provide a comprehensive view of the questions based on the banks' internal perspective. The recipients are categorized in Bank employees or Others. The group Others consist of persons employed at consultancy companies, universities, authorities, or independent board members.

2.3. Distribution

The survey is conducted via the web where recipients receive a link sent by e-mail together with information about the survey. The information contains a description of the purpose, scope, volunteering of answering the questionnaire and guaranteeing anonymity. The associations in each country have distributed the email to their members as from 2019.

2.4. Analysis

The data collection is analysed by comparing the results with previous year's results and predefined answers with open response answers. Using the background information, comparisons can be made between larger and smaller banks, as well as between respondents with good insight into the regulation and the less involved. Any differences in response patterns between respondent categories are made between those who are or are not members of any committees and between those with and without employee responsibility.

3. Result and analysis

The 2020 survey received a 22 percent response rate, 254 replies. This report will focus on three areas: first the new questions regarding the pandemic, secondly the new questions regarding ESG and thirdly last year's new question on communication with the national FSA.

This year the number of responses in Norway, Denmark and Finland decreased. This is a direct result of the pandemic because it has been difficult to get the survey out and prioritized. Due to that, this year's report contains limited comparisons between countries. See Table 1 - Respondents by country and year.

New findings are:

- The respondents are finding the actions taken relating to the Covid-19 pandemic relevant.
- The respondents need to put focus on the ESG requirements.
- There is an improvement in how regulatory guidelines and information on the webpage helps in the compliance process.
- The regulatory guidelines do not reduce any advisory costs for banks.

The results of the 2020 survey might be affected by the increased number of recipients (+45%) and respondents (+30%). The increase stems primarily from Swedish savings bank respondents. Response rates for all five surveys are reported in Table 1 - Respondents by country and year. This is the third year that the survey was submitted outside Sweden and, as shown in Table 1, most recipients (87 percent) and respondents (96 percent) are from Sweden.

Table 1 - Respondents by country and year

Country	2019			2018			2017			2016			2015		
	Received	Answer	Rate	Received	Answer	Rate	Received	Answer	Rate	Received	Answer	Rate	Received	Answer	Rate
Sweden	546	154	28%	457	169	37%	341	122	36%	301	125	42%	126	89	71%
Norway	94	17	18%	66	12	18%									
Finland	48	6	13%	20	1	5%									
Denmark	103	19	18%	35	8	23%									
Total	791	196	25%	578	190	33%	341	122	36%	301	125	42%	126	89	71%
Change YoY	37%	3%		70%	56%		13%	-2%		139%	40%				

Appendix 2 – Respondents, contains a more comprehensive description of the respondents.

For the further analysis, we separate between large (>500bn SEK - 50bn EUR in total assets), medium (50-500bn SEK – 5-50bn EUR in total assets) and small (<50bn SEK or 5bn EUR in total assets) banks.

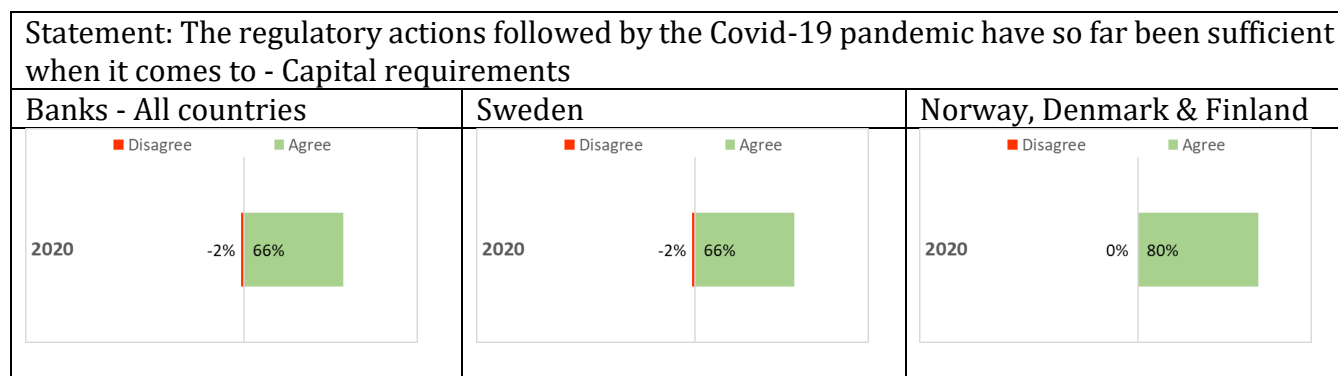
Appendix 3 – Comparison 2020 with 2018-2019 shows that the results did not change much to 2020, and the reader can further analyse these numbers. Instead, the focus here is on “what’s new”: for example, areas with clear trends, major differences between countries or between bank employees and the group of others (“Others”).

3.1. The Covid-19 pandemic

The respondents are generally positive to the actions that took place in the regulatory landscape because of the covid-19 pandemic. Half of the respondents indicate an increased risk due to the pandemic.

This was a new question in the 2020 survey, and respondents answered it circa six months after the initiation of the pandemic. Ten questions were added relating to the regulatory actions that was taken because of the Covid-19 pandemic.

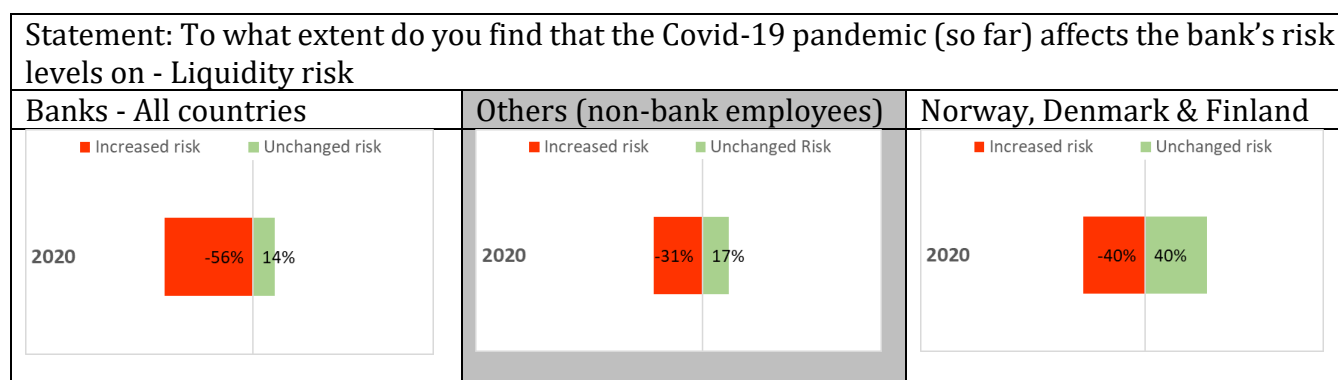
Figure 1 – Regulatory actions



The response was the same on Liquidity and from the group Others.

Relating “Reporting requirements”, “Implementation and/or change of regulation” or “Governmental support actions to the public via the financial sector”, the response was slightly less positive with 7% - 10% disagreeing and 48-54% agreeing with the statement.

Figure 2 – Risk levels due to the Covid-19 pandemic



The response was the same on Capital risks.

Related to “Market risk”, “Operational risk” or “Cyber risk”, the respondents were slightly less negative with 38% - 44% for increased risk and 17-22% for unchanged risk. The lowest numbers on increased risk were for Cyber risk.

The group Others selected unchanged risk to a much larger degree than the bankers, the highest number on Cyber risk where 48% indicated unchanged risk.

3.2. ESG risks

The answers here shows that banks must step up to be on top of ESG requirements. The group Other is much more critical than bank employee respondents.

This was a new question in the 2020 survey, and it was added to better understand how the respondents view the ESG (Environmental, Social & Governance) risks. From a regulatory and political perspective, the financial industry including banks have an important role in the ongoing change towards more sustainable societies. The questions are therefore on top of agendas and the questions was added to better understand how banks are preparing in this area.

The bank respondents generally responded in the middle, equal parts agreeing and disagreeing to the statements. The group Others are clear in that the banks are not quick to adjust and have a long way to go within this area. The group Others also rate their knowledge higher than the bank employees.

Figure 3 - Knowledge on implications of the ESG requirements for banks

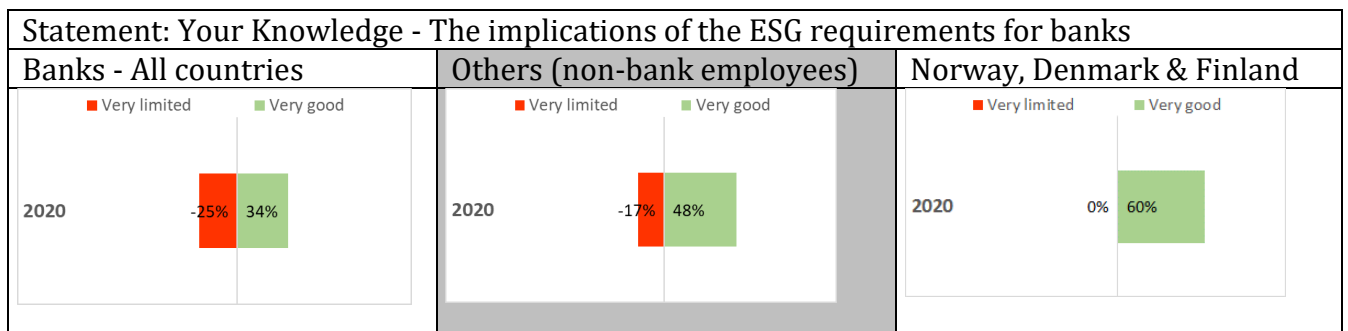
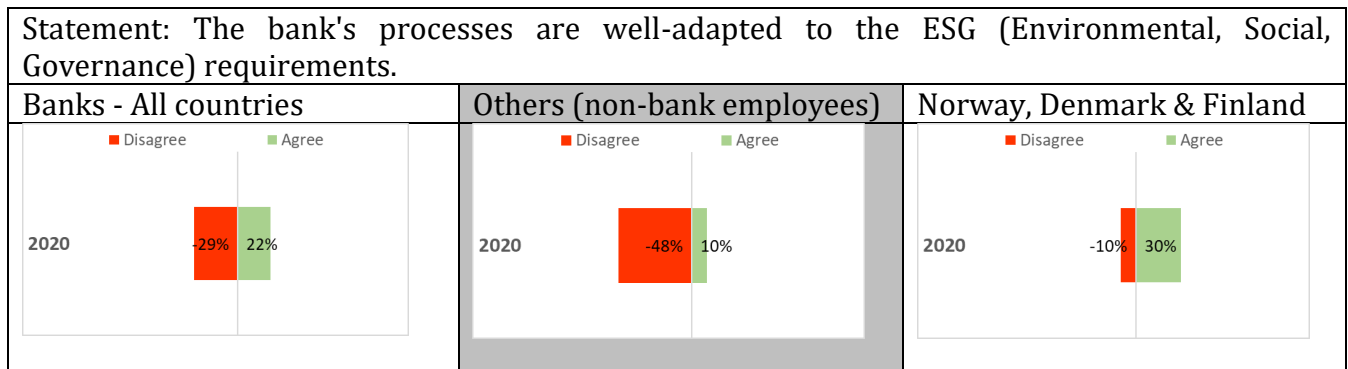


Figure 4 – Well-adapted processes to ESG requirements



The response on “My bank is quick to adapt its business models to the ESG (Environmental, Social, Governance) requirements” was almost the same as above on how well-adapted the processes are.

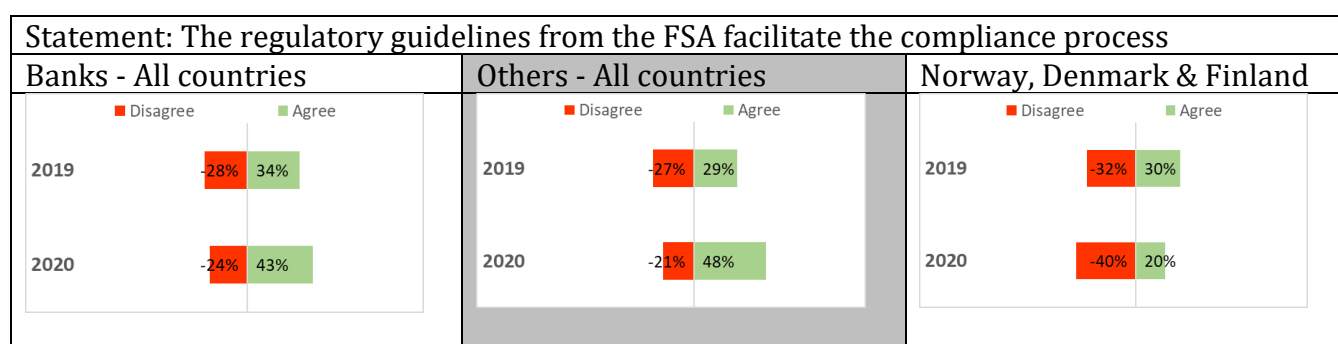
3.3. Communication with national FSA

The answers still confirm the general critique of the regulatory framework, but most respondents seem to find the guidelines helpful. The advisory costs are not reduced.

This was a new question in the 2019 survey, and it was added to better understand how the respondents view the communication with/from the FSA. Based on previous surveys more than 40% reported that the regulation isn't clear and over 50% that regulators are not sufficiently clear in their instructions. These results have remained stable for several years and are not improving.

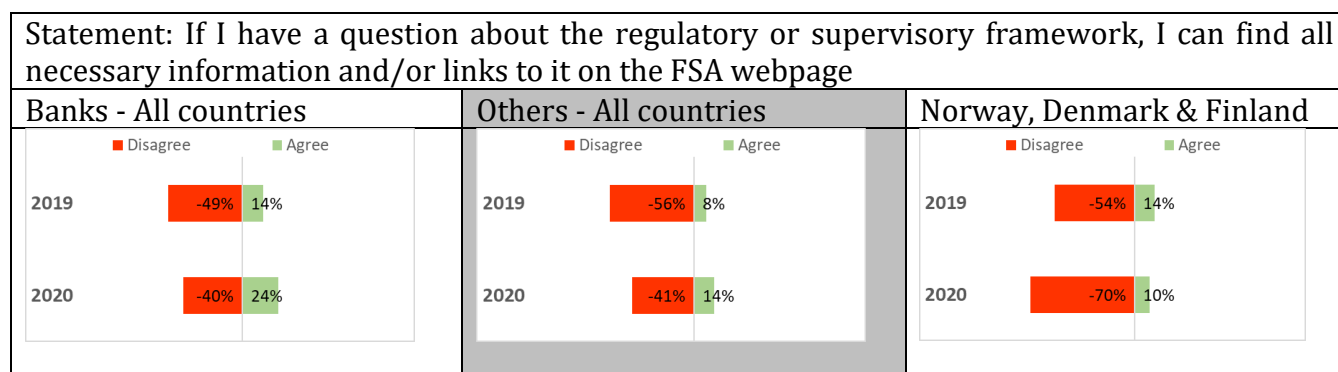
The bank respondents generally agree with the statement that the guidelines are facilitating the compliance process. The development is that the guidelines are improving. The group Others and the Swedish bank respondents agree to a greater extent this year compared to last year.

Figure 5 - Guidelines from the FSA



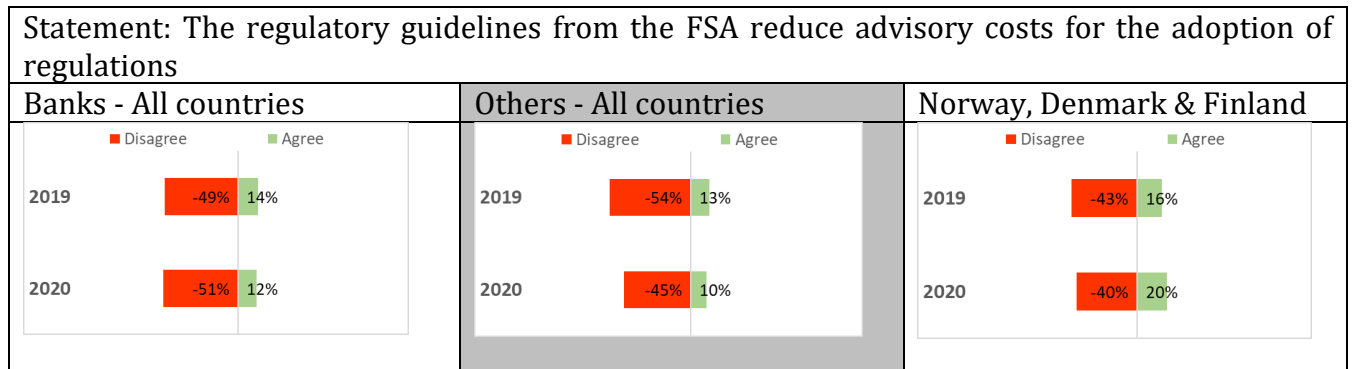
Still banks find it difficult to locate the necessary information on the webpage, a result that has slightly improved from last year in Sweden, but not in the other countries.

Figure 6 – Finding information



The bank respondents do not report that they can reduce any advisory costs because of regulatory guidelines. Opposite to the bank respondents, the Others are a bit more positive. Still almost 50% disagree, which indicate that the guidelines still are unclear and difficult to understand for the bank employees.

Figure 7 – Reducing advisory costs



4. Conclusions

The conclusions stand year by year, "the effects of increased regulation on Nordic banks are still extensive".

The respondents are positive to the actions taken from the regulatory authorities relating to the Covid-19 pandemic. Authorities was quick in action to support banks and the general economy. These actions seem to be well received in the banking industry, at least after six months of the Covid-19 pandemic.

At the same time, more than 50% indicates the increasing risk in capital and liquidity. It is interesting that the lowest increased risk is Cyber risk. When many employees work from home, or from other places, the exposure to cyber risk should increase. The survey was made six months in to the Covid-19 pandemic. After one more year it will be interesting to see how the bank employees understand the increased risks and if the risk has gone up in general.

ESG (Environment, Social, Governance) risk requirements is quickly moving to become a top priority for the banks. The respondents within the banks estimate their capacity to adapt processes higher than the group Others. In comparison to the results of the 2015 and 2016 surveys with respect to regulation, the ESG-result show some similarity in the tendency among respondents to display some overconfidence in their ability to manage change.

The respondents maintain that it is difficult to comprehend the entire regulatory framework, and that the supervisor is not sufficiently clear. Combining the results on communication with the FSA and perception of the regulation shows a rather daunting result for the regulators. The regulation is:

- unclear,
- difficult to understand,
- there is a significant uncertainty in how the FSA will follow up on the regulation and instructions.
- the guidelines help but after spending money on advisors to understand them.
- the communication with the FSA does not help.

During 2020, the FSA in Sweden have done some changes to become more transparent and give more guidance to the industry. It can be a result of what the survey reflects, and the coming year surveys will show if the actions improve the results.

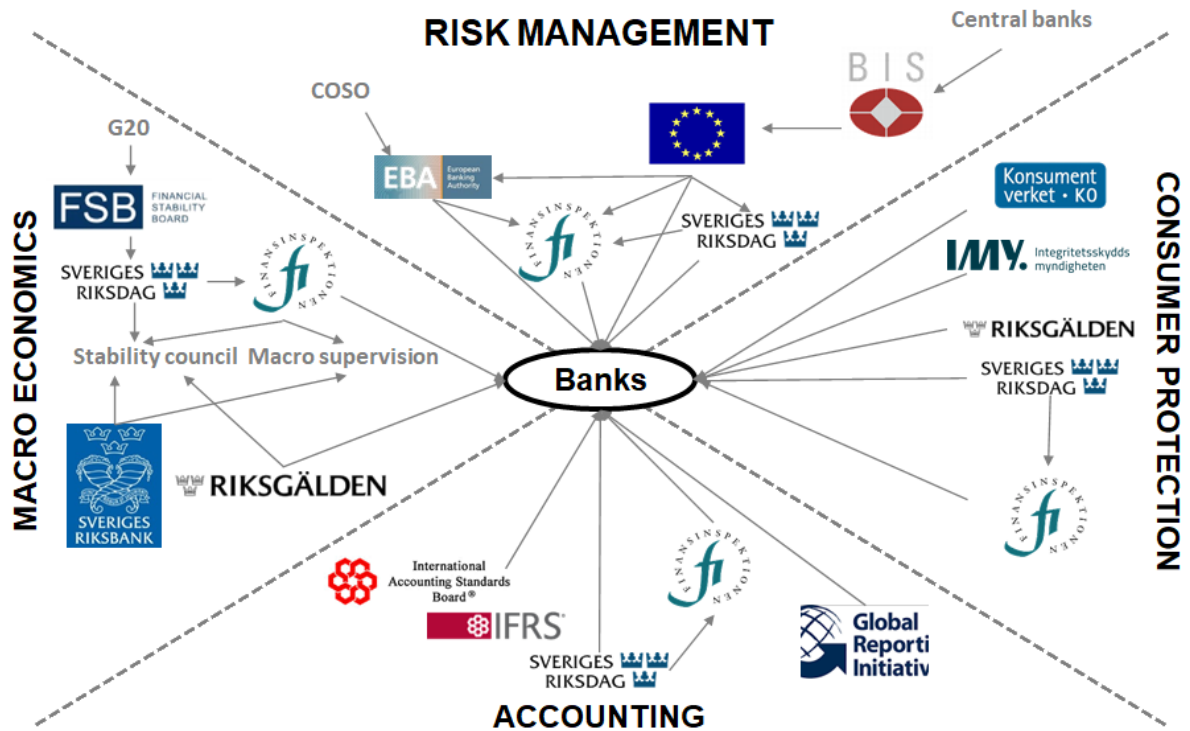
The title of the thesis and the reports, the adaptable survives, is by this conclusion as relevant now for the Nordic banks as it was in 2015.

Appendix 1 – The bank regulation

Banks are regulated to protect some stakeholders in particular, depositors and the state. Four main areas of regulation have been identified from the different perspectives of stakeholders: 1) Risk management, 2) Macroeconomics, 3) Accounting and 4) Consumer protection.

The bank regulation was in deep described in the thesis “The adaptable survives” (2015). An update has been made of Figure 8 – Swedish regulators.

Figure 8 – Swedish regulators



The different regulators above are here shortly described together with a reference to their respective homepage for more information.

1) Risk management

Basel committee (bis.org/bcbs)

Provides international standards for bank regulation, focus on large international banks. For the EU is Basel committee a sort of advisor, the regulation is implemented via EU directives and/or regulations.

COSO - The Committee of Sponsoring Organizations of the Treadway Commission (coso.org)

Provides framework and guidelines around ERM (Enterprise Risk Management), internal control and fraud.

EU (ec.europa.eu/finance/bank)

Implementing the Basel Committee's standards through regulations (direct acting) and directives (through national implementation).

EBA – European Banking Authority (eba.europa.eu)

Issues technical standards and guidelines based on EU regulations and directives. EBA is the interpreting authority of the Common Rule Book for Europe.

Finansinspektionen (fi.se)

Swedish financial supervisory authority (SFSA) issues regulations, guidelines, general advice and supervises Swedish banks. In major European banks, the ECB, European Central Bank, is the supervisor, (www.ecb.europa.eu).

Sveriges riksdag (riksdagen.se)

Decides on legislation for implementing EU directives as well as specific Swedish laws including mandate to Swedish authorities.

2) Macroeconomics

FSB (financialstabilityboard.org) / G20 (g20.org)

Created by the G20 Group, the twenty richest countries in the world, and shall identify systemic risks in the financial sector, develop policies and monitor the policy implementation to reduce systemic risks.

Riksbanken (riksbank.se)

Sweden's central bank is part of the Stability Council and has the task of being responsible for monetary policy with the aim of maintaining a fixed monetary value as well as promoting a safe and efficient payment system. This means that all payments between different banks in Sweden will be thru the Riksbank.

Riksgälden (riksdagen.se)

The Swedish national debt office handles consumer protection in the form of deposit guarantees for the state and the recovery plans within the crisis management.

3) Accounting

GRI – Global reporting initiative (globalreporting.org)

Provides global standards for sustainability reporting.

IFRS/IASB (ifrs.org)

Provides international standards for financial reporting. These standards are direct acting on banks as they must have IFRS as accounting standard.

4) Consumer protection

Integritetsskyddsmyndigheten (imy.se)

The Swedish Authority for Privacy Protection is supervising the banks data protection and dept collection.

Konsumentverket (konsumentverket.se)

Swedish Consumer Agency executes supervision of the banks' communication and relationship with consumers, such as its marketing and contractual terms.

Appendix 2 – Respondents

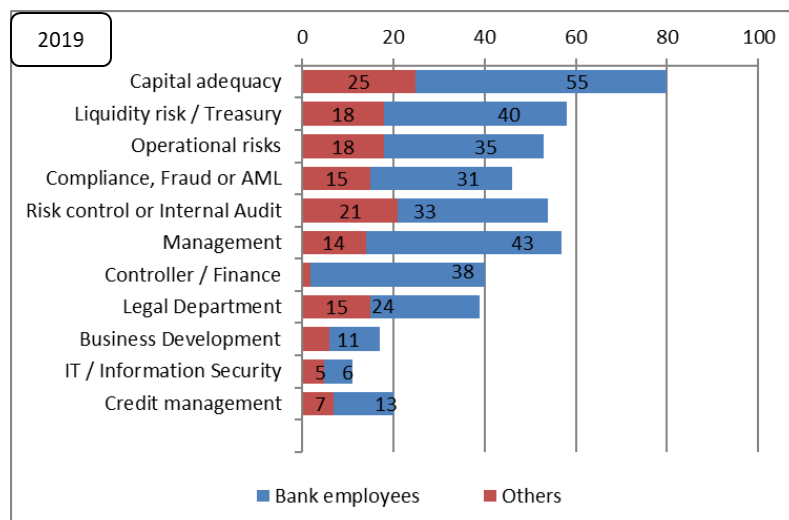
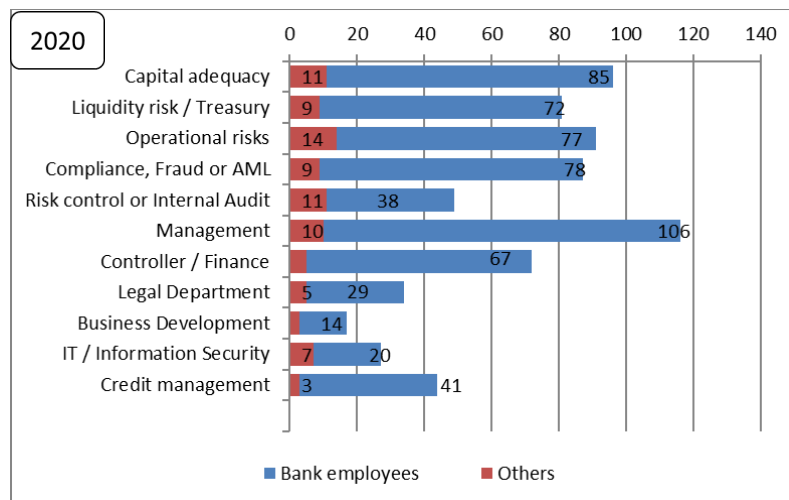
Most of the respondents, 89 percent, is found in banks, see Table 2 - Size of bank and category of respondent. The distribution has an overweight from smaller banks, with large banks being defined as more than SEK 500 billion in total assets, mid-sized banks SEK 50 - 500 billion and small banks have less than SEK 50 billion in total assets.

Table 2 - Size of bank and category of respondent

Category - respondent			Very large bank		Large bank		Small bank		Other	
	No.	Share								
Employees in bank	225	89%	31	14%	31	14%	163	72%	0	0%
Others	29	11%							29	100%
Total	254	100%	31	12%	31	12%	163	64%	29	11%
<i>Survey 2019</i>	<i>196</i>	<i>100%</i>	<i>38</i>	<i>19%</i>	<i>31</i>	<i>16%</i>	<i>78</i>	<i>40%</i>	<i>49</i>	<i>25%</i>
<i>Survey 2018</i>	<i>190</i>		<i>31</i>	<i>16%</i>	<i>39</i>	<i>21%</i>	<i>76</i>	<i>40%</i>	<i>44</i>	<i>23%</i>
<i>Survey 2017</i>	<i>122</i>		<i>29</i>	<i>24%</i>	<i>20</i>	<i>16%</i>	<i>44</i>	<i>36%</i>	<i>29</i>	<i>24%</i>
<i>Survey 2016</i>	<i>125</i>		<i>27</i>	<i>22%</i>	<i>22</i>	<i>18%</i>	<i>49</i>	<i>39%</i>	<i>27</i>	<i>22%</i>
<i>Survey 2015</i>	<i>89</i>		<i>23</i>	<i>26%</i>	<i>13</i>	<i>15%</i>	<i>25</i>	<i>28%</i>	<i>25</i>	<i>28%</i>

Respondents have identified which areas they are active in, where several responses have been possible, see Figure 9 - Area of activity.

Figure 9 - Area of activity



In general, respondents have been active in banking, finance and insurance industry for more than 10 years, more than half have worked with a regulator, half have personnel responsibility and almost half are member in any committee of the bankers organisations, see Table 3 - Time of activity in the industry, with regulator, Personnel responsibility or committee member.

Table 3 - Time of activity in the industry, with regulator, Personnel responsibility or committee member

Time in the industry	More than 20 years		15 to 20 years		10 to 15 years		5 to 10 years		2 to 5 years		< 2 years		
Employees in banks	225	108	48%	40	18%	32	14%	22	10%	16	7%	7	3%
Others	29	19	66%	6	21%	2	7%	1	3%	0	0%	1	3%
Total	254	127	50%	46	18%	34	13%	23	9%	16	6%	8	3%
<i>Survey 2019</i>	196	78	40%	46	23%	40	20%	26	13%	5	3%	1	1%
<i>Survey 2018</i>	190	74	39%	37	19%	43	23%	29	15%	3	2%	4	2%
<i>Survey 2017</i>	122	46	38%	28	23%	24	20%	19	16%	4	3%	1	1%
<i>Survey 2016</i>	125	47	38%	28	22%	22	18%	20	16%	7	6%	1	1%
<i>Survey 2015</i>	89	n/a		n/a		66	74%	17	19%	5	6%	1	1%

Time at regulator	More than 20 years		15 to 20 years		10 to 15 years		5 to 10 years		2 to 5 years		< 2 years		No time		
Employees in banks	225	27	12%	7	3%	28	12%	14	6%	14	6%	22	10%	113	50%
Others	29	8	28%	2	7%	4	14%	3	10%	3	10%	3	10%	6	21%
Total	254	35	14%	9	4%	32	13%	17	7%	17	7%	25	10%	119	47%
<i>Survey 2019</i>	196	11	6%	11	6%	22	11%	30	15%	17	9%	18	9%	87	44%
<i>Survey 2018</i>	190	16	8%	11	6%	18	9%	19	10%	14	7%	20	11%	92	48%

Personnel responsibility	Yes		Yes, before		No		
Employees in banks	225	118	52%	37	16%	70	31%
Others	29	9	31%	11	38%	9	31%
Total	254	127	50%	48	19%	79	31%
<i>Survey 2019</i>	196	105	54%	33	17%	58	30%
<i>Survey 2018</i>	190	99	52%	36	19%	55	29%
<i>Survey 2017</i>	121	61	50%			60	50%
<i>Survey 2016</i>	124	61	49%			63	51%
<i>Survey 2015</i>	86	38	44%			48	56%

Committee member	Yes		Yes, before		No		
Employees in banks	225	44	20%	17	8%	164	73%
<i>Survey 2019</i>	148	50	34%	18	12%	80	54%
<i>Survey 2018</i>	146	50	34%	12	8%	84	58%
<i>Survey 2017</i>	93	42	45%			51	55%
<i>Survey 2016</i>	98	46	47%			52	53%

The regulatory knowledge is generally assessed out of position and area of responsibility, both generally and in three specific areas: Governance, Risk and Control³, Operational Risks, Information Security, and IT⁴, and Capital Coverage and Liquidity (CRR⁵). The assessed level of knowledge is lowest about Operational Risks, Information Security and IT, see Table 4 - Regulatory knowledge.

Table 4 - Regulatory knowledge

Regulatory knowledge	Very limited				Very good				2019	2018	2017	2016	2015		
	Count	%	Count	%	Count	%	Count	%							
Regulation in general	1	0%	13	5%	40	16%	124	49%	74	29%	34%	34%	32%	22%	27%
Governance, Risk, control	1	0%	13	5%	52	21%	104	41%	81	32%	35%	39%	36%	40%	34%
Operational risk, IT ...	9	4%	38	15%	81	32%	89	35%	35	14%	12%	21%	18%	23%	24%
Capital adequacy	26	10%	27	11%	55	22%	94	37%	52	20%	25%	34%	27%	24%	36%
Liquidity	26	10%	31	12%	63	25%	86	34%	44	18%	17%	21%	27%	24%	36%

³ Sweden: Finansinspektionens föreskrift FFFS 2014:1

⁴ Sweden: Finansinspektionens föreskrifter FFFS 2014:4 och 2014:5

⁵ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions

Appendix 3 – Comparison 2020 with 2018-2019

Here are the figures from the 2018-2019 report that led to the conclusions in the report compared with the same figures for 2020. As the results are more or less the same has, I chosen not to comment all of them.

Regulation

Figure 10 - The rules are clear

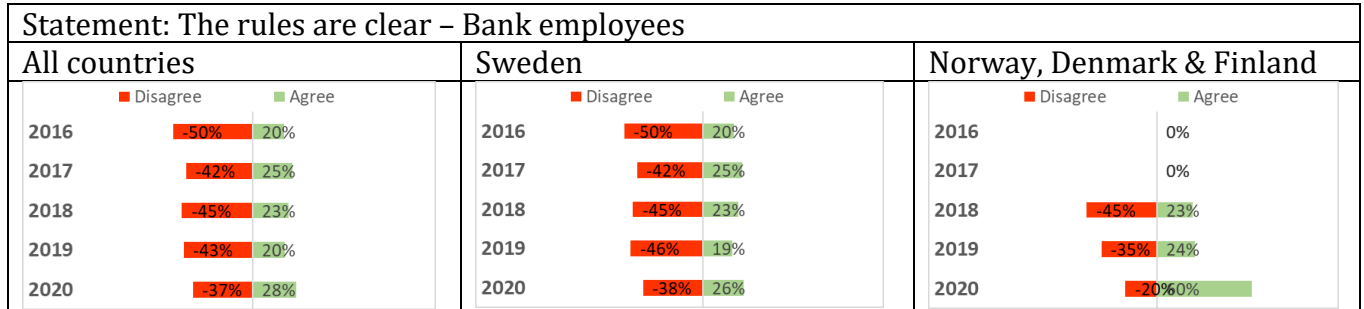


Figure 11 - Regulators are sufficiently clear...

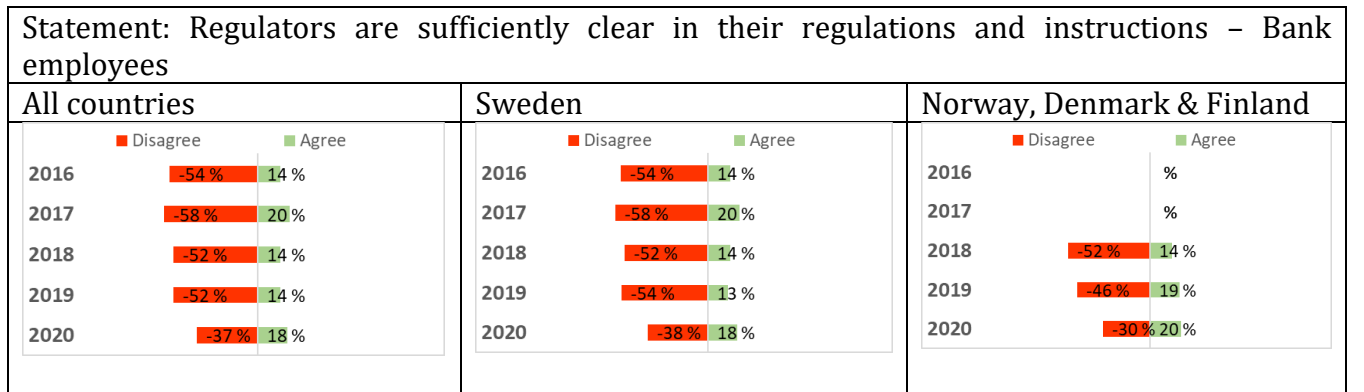
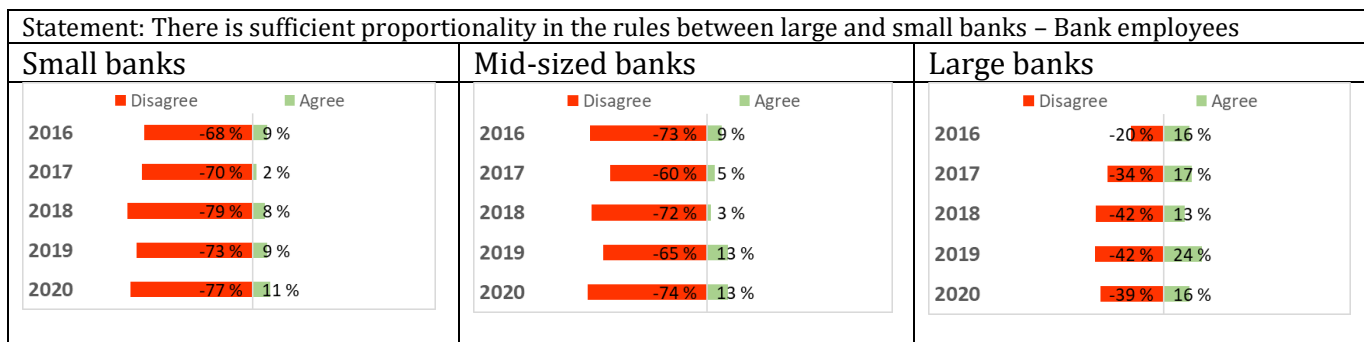


Figure 12 - Proportionality



Competition on the banking market

Figure 13 - Other actors increased regulation

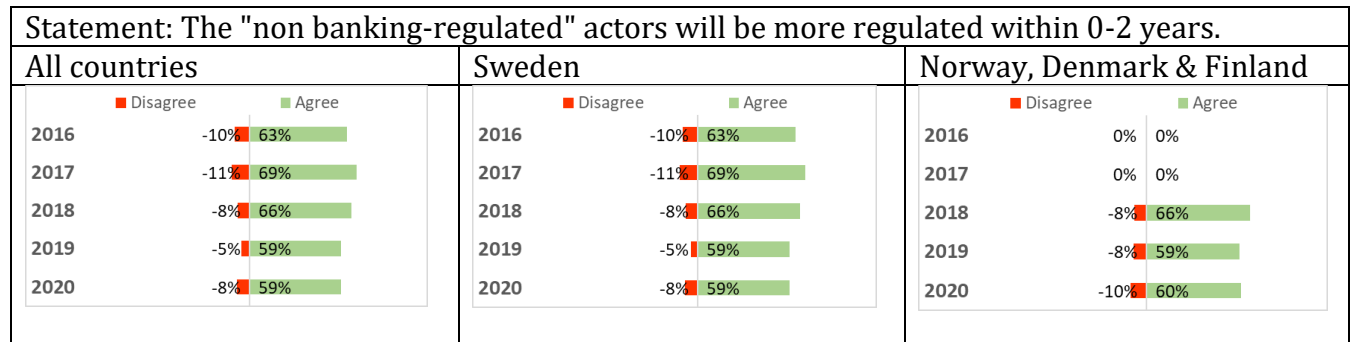


Figure 14 - Difficulty to distinguish products.

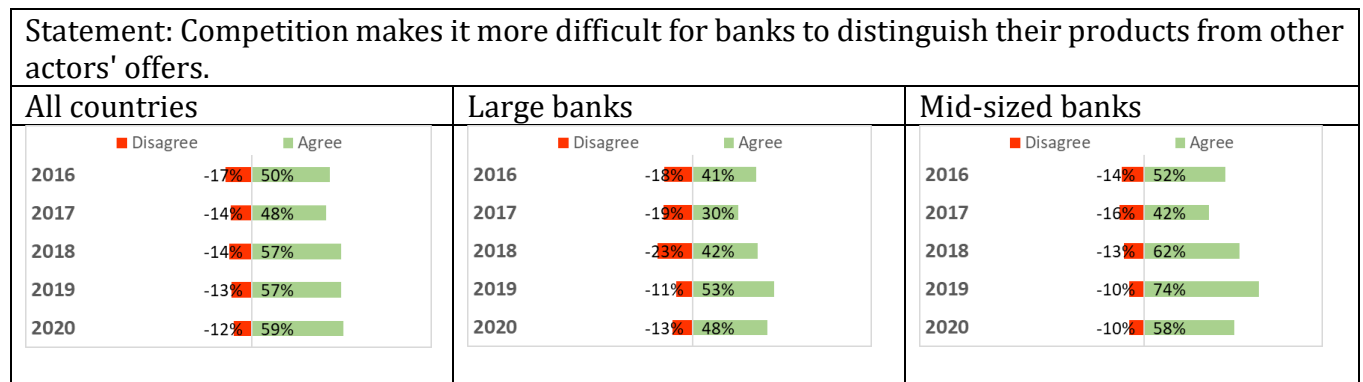
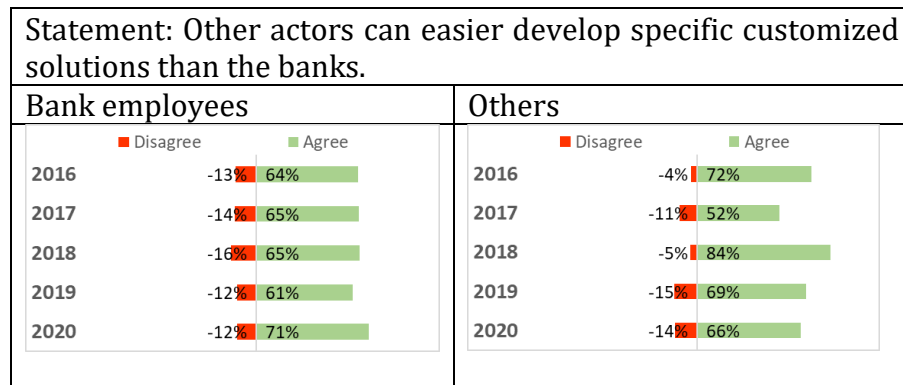


Figure 15 - Other actors, development capacity



Banks processes and leadership

Figure 16 - Unique processes

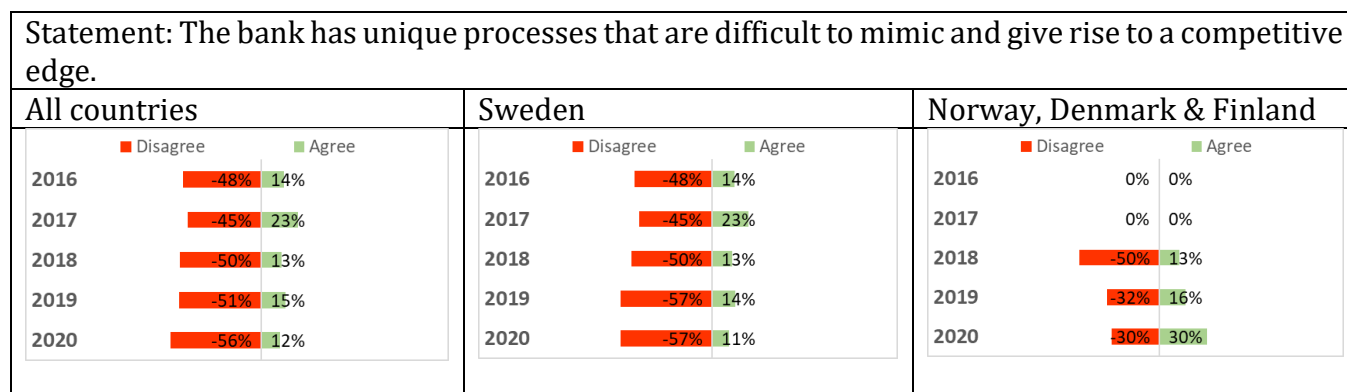


Figure 17 – Regulatory change is positive for clear and systematic processes

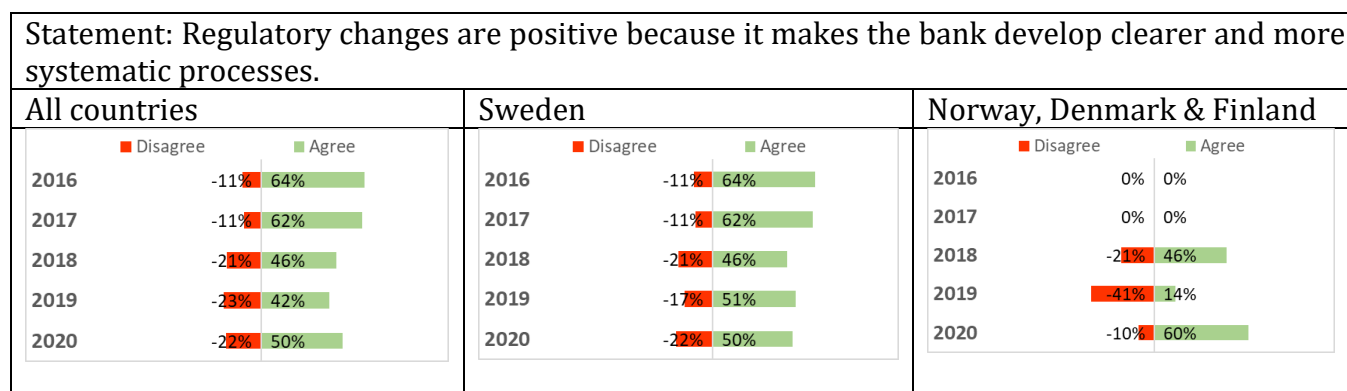


Figure 18 - More difficult to recruit managers

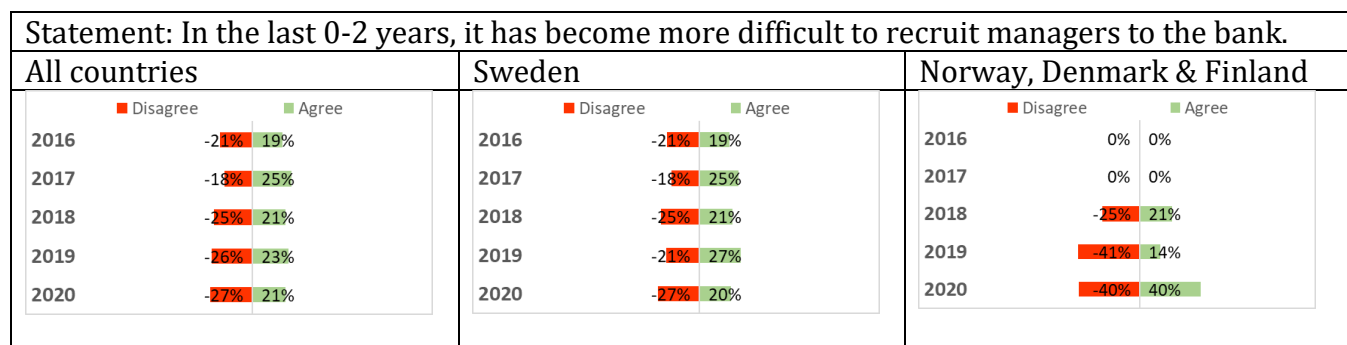


Figure 19 - More difficult for managers recruited outside the banks

