

# Deloitte.

## Financial Services in Uncertain Times

Is your business  
shaping up?



# Soft Collection

## Context

- The previous good economic situation encouraged increased debt granting.
- The current economic context is causing a worsening of loan portfolios. The reasons are twofold:
  - Decreasing portfolios due to tightened loan granting policies.
  - Worse repayment due to customers' worse financial standing.
- Lower quality loan portfolios may cause an increase in capital requirements – meeting increased capital requirements may be challenging in these uncertain times.

## Risks and Challenges

- How to recover debts and motivate borrowers to payment of liabilities without taking legal action?
- How to ensure that the bank is first in the “creditors’ line”?
- How to collect debts most efficiently?
- How to combine all information on the customer and use it to collect debts as soon as possible?

### How Deloitte can help

Increasing collection efficiency through:

- 1) Defining quickly implementable improvements in existing collection processes.
- 2) Remodelling collection processes according to market best practices.
- 3) Defining an overall customer collection approach (instead of a product approach).
- 4) Supporting implementation of modern IT collection solutions.

# Non-Performing Loan Portfolio Services

## Context

- NPL portfolio transactions can assist banks.
- Improved liquidity position: freeing up funds for new lending and investment.
- Better capital & debt market perception and improved ratings.
- Improved capital adequacy position—particularly in light of Basel II requirements for weighting on NPL's.
- Immediate and future positive impact on P&L via possible provision write backs, utilisation of tax assets, accelerated recoveries and savings on human resource costs.
- Overcoming resource constraints to manage problem loans in-house effectively.
- Freeing up management time to focus resources on more profitable activities/collections.
- Transaction can be focused on single contracts or a portfolio of loans.

## Risks and Challenges

- The market for all assets including NPLs has changed dramatically since mid 2008 and as a result realising a portfolio transaction requires more planning and more careful management than it did previously. There are new players in the market with new requirements.
- The current rapid deterioration in credit quality in some markets in the last 12 months makes valuation more difficult, as does predicting developments in collateral markets.

### How Deloitte can help

Knowing the market improves results. Advisors who have contact with, and knowledge of, market players in the field of stressed and distressed loan portfolio investors and/or investors in stressed or distressed companies will help to improve and predict recoveries.

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Tried and tested transaction experience—based on Deloitte's global NPL portfolio network and deep regional expertise.

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# Liquidity and Economic Capital

## Context

- The financial difficulties of banks and other financial institutions have resulted in a lack of trust between them, and significantly decreased the availability of financing.
- Hence, financial institutions have been forced to secure missing interbank financing from other sources such as retail deposits. In this fight for liquidity, banks became involved in a “deposit war” that forced them to offer rates significantly higher than interbank rates.

## Risks and Challenges

- Have you analysed the profitability of certain business lines, products, organisational units?
- Have the outcomes of the check been implemented into business activity?
- Have you optimised the capital management strategy?
- Have the economic capital principles been encompassed in day-to-day management?
- Is the cost of risk adequately reflected in the pricing of products and services?

## How Deloitte can help

Deloitte offers a wide range of services in the area of economic capital and liquidity management:

- 1) Setting up the economic capital principles and policy (material risk catalogue, capital management, strategies for liquidity positions management).
- 2) Development and implementation of the RAPM methodologies e.g. RAROC, RORAC, tailored to the institution's constraints and limitations.
- 3) Development of liquidity management strategies and plans.

# Independent Business Reviews

## Context

- The current downturn is marked by rapid and unpredictable changes in credit quality caused by unpredictable market and business developments.
- The bank as a key stakeholder needs to be appraised of the true situation.
- An independent, objective and credible source of this appraisal is an independent business review that provides the bank with an up-to-the-minute evaluation of the debtor's situation and an evaluation of the options available to the bank to work out or exit the exposure.

## Risks and Challenges

- Stakeholder behaviour – specialist teams need to be able to extract the relevant information from the target entity without conflict or disruption. Occasionally banks need to put pressure on their corporate customers to increase consent. Understanding and recognising management or shareholder behaviour is the key to success and can only be developed through many years' experience of similar situations.
- Market context and industry expertise – the trading performance of the entity needs to be assessed in the context of the wider market, including underlying industry-relevant or/and economic assumptions.

## How Deloitte can help

To support the client decision-making process by:

- Giving an accurate picture of the company's current debt status – debt summary, debt providers, covenant analysis, repayment profile, collateral packages and hedging exposures.
- Giving a realistic estimate of the company's ability to meet its immediate and mid-term financial obligations.
- Giving an accurate picture of the company's operations and in particular their ability to generate cash flow.
- Outlining the risks related to the recoverability of assets in the balance sheet, sufficient levels of provisioning and contingent liabilities.

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Analyse the quality of the client's collateral / collateral provided to other lenders and the extent to which there is collateral that has not yet been encumbered.

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# Early Warning Systems

## Context

- In recent years, financial institutions have built their loan portfolios in conditions of long-term economic growth. This has abruptly changed and the banks are exposed to a sharp increase of non-performing loans.
- A key prerequisite for maintaining a healthy loan portfolio is Early Warning - early problem identification, facilitated by a system solution – Early Warning System (EWS).
- An EWS proactively and systematically seeks potential problem indicators on the portfolio level as well as on the level of individual borrowers, to ensure that required steps are taken promptly and losses from problem loans are prevented or minimised.
- The current practice of annual reviews does not identify the problems early enough. Many banks have already recognised the value of Early Warning and have started to implement them as a response to the economic crisis.

## Risks and Challenges

- How to identify problems early using internal and external data based on financial and non-financial indicators.
- How to identify the root cause of the problem.
- How to identify problems before they impact our borrowers.
- How to evaluate and analyse large amount of potential problems in a short time.
- How to improve collateral value monitoring.
- How to identify early problems in the real estate projects portfolio.

### How Deloitte can help

Implementation of models for the evaluation of Early Warning and credit risk triggers and its prioritisation.

Collect and organise customer data from external and internal sources relevant for evaluation by an EWS.

Implement a technology solution for Early Warning process monitoring.

Educate existing staff on EW and Early warning indicators' impact on existing processes and their roles.

Assign EW responsibilities to existing and/or new staff.

# Distressed M&A

## Context

Distressed M&A services aim at stabilising the financial situation of a distressed company by attracting an investor with the capacity to refinance and reorganise the distressed entity. By employing distressed M&A processes—rather than focussing on the liquidation of assets—companies, or parts of companies, retain higher valuations as ongoing concerns.

## Risks and Challenges

- Frequently, stakeholders must accept the risk of supporting the company during the time of the distressed M&A process. This amounts to “stand-still” behaviour from financial backers, and sometimes includes the provision of interim financing.
- The situation requires an experienced and dedicated team of advisors who can deal with the immediate stabilisation measures of the company and the moderation of interest of stakeholders, while at the same time attracting the interest of potential investors and negotiating an optimal transaction.

### How Deloitte can help

Swift creation of a competitive tender. It is key to be able to rely on an advisor who can set up the M&A process under severe time pressure in order to stem the most significant liquidity drain.

International footprint and contact network, and knowledge of the investment rationales of investors willing to step into distressed situations. The major success factor for maximising valuations is creating competitive momentum by attracting more than one interested party.

Alignment of stakeholder strategies and expectations by creating trust in the process. Transparency of the process, reliability of financial data, and predictability of project steps and results in total, create a sufficient level of trust for the stakeholders in the process and trigger supportive behaviour in stakeholders.

# Collateral Management and Asset Recovery

## Context

Following a real estate boom in 2006-2008, Central European real estate is currently facing price decreases. Coupled with a significant portion of mortgages granted in CHF, EUR, USD and depreciation of local currencies, the situation has resulted in a considerable LTV ratio increase.

## Risks and Challenges

- Have you checked the credit portfolio vulnerability to under-collateralisation?
- What is the efficiency of your soft collection process?
- What is the efficiency of the debt collection process? How long does it take to recover collateral?
- What is the cure rate on particular portfolios?
- Have you performed a review of the portfolio of collateral in terms of its liquidity, legal situation, eligibility?

## How Deloitte can help

Deloitte has long-lasting relationships with many financial institutions in the area of measurement, modelling and monitoring of credit risk, among others:

- 1) Modelling PD, LGD and CCF.
- 2) Design and implementation of the debt collection process.
- 3) Design of credit risk portfolio management policies and models.
- 4) Design of collateral monitoring and reporting procedures.

# Collateral Management and Asset Recovery – Tax Angle

## Context

- One of the main prerequisites to maintain a healthy loan portfolio is early problem identification. Financial institutions are developing internal systems to continuously monitor the loan portfolio and quickly identify any deterioration of the client's financial situation that could result in failure to meet obligations.
- Monitoring and assessing relevant tax information can be a very useful tool for the evaluation of client's financial situation and/or forthcoming insolvency. Taking a post tax approach for early identification will deliver a competitive advantage.

## Risks and Challenges

Omission of tax information may bring significant risks because:

- Taxes reflect the client's true financial position.
- Certain taxes, for example VAT and payroll, reflect real time economic activity.
- The principles of taxation are not always the same as accounting.
- The client's tax position is becoming subject to increasing levels of control by the respective state authorities.

### How Deloitte can help

Our team brings a wide range of expertise, including corporate tax, indirect taxation and personal tax and social security. Tax professionals work closely with you to understand your organisation's global goals. At Deloitte, experts in various disciplines form one team, taking a 360° view of your situation.

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We can provide you with assistance in debt assignment transactions such as:

- Analysis of tax consequences and optimisation of the sale of a loan portfolio and other receivables.
- Analysis of the tax effectiveness of debt assignment (deduction of tax losses incurred in relation to the sale of receivables).
- Analysis of the deductibility of bad debts.
- Analysis of tax consequences arising from receipt and sale of underlying collateral.
- Legal support in formatting/restructuring the debt portfolio for the purpose of subsequent sale.
- Legal support in acquisition/sale of debt obligations.

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In addition, for business restructurings we can provide:

- Assistance in tax and legal business restructuring to reduce the overall tax burden as well as enhance flexibility, liquidity and business valuation.
  - Comprehensive tax and legal support of M&A deals, including due diligence services, tax planning of the deals, drafting transactions documents, etc.
  - Legal analysis of effective agreements to determine the possibility and the consequences of deferral/restructuring of contractual liabilities.
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# Cash Flow Review

## Context

There are many factors influencing the performance of corporate clients and thus reducing the level of comfort in the FSI sector. Among them, the following can have the highest negative impact on working capital in companies:

- Increased pressure from creditors, resulting in reduced credit days outstanding.
- Reduced visibility of demand, which makes manufacturing planning more difficult and may significantly impact the level of stock in the company.
- Higher pressure from debtors to delay payments and increased level of debtors in the balance sheets of corporate clients. Increased margin pressures as a result of balancing between payment terms and early payment discounts.
- Reduced resources due to headcount reductions and other matters, which makes it more difficult to control operations including, managing the effective implementation of a credit policy.

## Risks and Challenges

The following are the main risks companies may face:

- The risk of insolvency or inability to finance the company's short-term operations caused by lack of cash funds.
- The risk of running low on cash, which increases stress, delays payments and increases internal pressures on management and staff.

The challenges FSI clients might face are:

- To quickly monitor and identify working capital deficiencies.
- To manage positive business relationships with debtors while enforcing credit control.
- To improve just-in-time planning principles to optimise performance of inventories.

### How Deloitte can help

Deloitte can help by delivering quick and long-term improvements through two phases:

*Phase 1.* Quick diagnostic review in the scope areas with the aim of identifying the level of pressure on cash, and the key factors influencing this pressure.

*Phase 2.* Devising a quick-hit improvement implementation plan, and implementing those improvements. We assist clients in quantifying the potential benefits of implementing improvements in the identified areas, and in developing a programme to realise those benefits.

# Growth and revenue protection



# Product Optimisation

## Context

- Bank customers expect real value for money.
- Banks have so many products in their portfolio that it makes it almost impossible to monitor and manage.
- The costs of maintaining this kind of product portfolio can be excessive (e.g. IT costs, sales costs, customer service costs, product maintenance costs).
- Pricing of the products can be significantly handicapped due to the number of existing product options and non-standard solutions.
- Entering the market with new products is very time consuming and may lead to missed market opportunities.

## Risks and Challenges

- Which products can be aggregated?
- What should the target product matrix look like?
- How to create the perception of tailored-made services while having harmonised products?
- What about the quality of management information about products?
- How to decrease churn, and at the same time decrease the number of offered products?

## How Deloitte can help

Product simplification and harmonisation.

- 1) Supporting the organisation with better prices and income control.
- 2) Preparing a business case supporting product optimisation.
- 3) Preparing product mapping to the target product grid.
- 4) Identifying changes in IT systems, procedures, processes and resources.
- 5) Providing support during the implementation.

# Cost efficiency enhancement



# Triggering the Tax Advantage

## Context

Tax is embedded in all aspects of the business of financial institutions. Management of taxes should be performed with a clear strategy, fully aligned to corporate goals. Ensuring a strategic approach to tax management will support optimising the efficiency of the business and deliver stakeholder value.

## Risks and Challenges

- In the current economic climate, tax payers should pay increased attention to every area of tax to:
  - Increase or speed up tax repayments;
  - Reduce or defer tax outgoings;
  - Maximise cash flow benefit connected with limited possibility to claim input VAT;
  - Manage effective tax rate; and
  - Optimise employment taxes.
- Tax opportunities are valuable, support the business goals and should be an integral part of financial institutions' delivery.

## How Deloitte can help

Our dedicated team of tax professionals works closely with you to understand your organisation's global goals and strategies. The team, including both direct and indirect tax specialists, analyses business issues and identifies relevant tax opportunities.

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Look at non-deductible expenses:

- Detailed analysis of incurred non-deductible expenses to minimise tax liabilities. Recommendations on effective tax planning in relation to such expenses.

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Forex issues:

- Ensuring that all valid currency exchange losses are deducted for tax purposes.
  - Analysis of the agreements to limit forex exposure.
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- Possibility to link a contract price to changes in currency exchange rates.
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#### Deferral of tax payments:

- Analysis of transactions with respect to timing of recognition of income and expenses.
  - Adjustment of contractual terms to increase tax efficiency.
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#### Optimise the VAT deduction right:

- Improving the VAT pro-rata by performing a detailed review of methodology for valuing supplies.
  - Investigate other deduction methods, such as direct allocation of expenses incurred to the VAT-able operations which result in full VAT recovery for the respective expenses.
  - Structuring of real estate transactions.
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#### Tax audits:

- Review of tax audit reports to conclude on the possibility to challenge additional charges imposed by the tax authorities.
  - Assistance in the preparation of tax and court claims.
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#### Bad debts provisions:

- Review of implemented provisioning methodology and the tax treatment of provisions.
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#### Transfer pricing:

- Review of existing transfer pricing methodology. Recommendations on maximisation of tax efficiency of intercompany transactions.
  - Advice on efficient cost allocation within the group of companies from the tax perspective.
  - Assistance in mitigation of transfer pricing issues applicable to the financial services industry.
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#### Managing labour relations:

- Structuring of severance payments.
  - Analysis of accounting policies and labour agreements to maximise the tax deduction of related expenses.
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# Enterprise Cost Management

## Context

- Deloitte is convinced that cost cutting can be embedded in the corporate structure and culture. In that way it does not cause a major disruption every time another programme is introduced. But companies need to think of cost-cutting as a core capability and entrench it into everyday management attitudes.
- Enterprise cost management incorporates a scalable and sustainable approach to creating value through transformational cost reduction opportunities. It is a strategic imperative that requires both vision and operational discipline, with a value-oriented mindset and a bias for execution.

## Risks and Challenges

- Have you decided how much cost reduction is needed?
- Do you know where to identify your possible savings?
- Have you taken full advantage of all the cost levers at your disposal?
- What about your project portfolio?
- Have you balanced short-term and long-term?
- Does your cost cutting strategy take into account maintaining full operational efficiency?

### How Deloitte can help

Deloitte can help by identifying enterprise-wide cost reduction opportunities, delivering a stress test to the organisation and managing cost reduction programmes.

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Our programs can focus on the identification of cost cutting opportunities in all cost areas (e.g.: HR, real estate, telecoms, IT and procurement).

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Additionally, we design and implement sustainable improvements to underlying cost structures, such as streamlining infrastructures, adjusting service delivery models and redesigning business models that help organisations prosper during an economic downturn by helping protect margins, capitalise on opportunities and capture market share.

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# Strengthen governance, risk & compliance in the business



# Revisiting Risk Governance

## Context

- The prosperity and the economic boom made many banks too loose with their credit policies.
- Belief that the “constant” growth would never end resulted in a stronger focus on the sales side, underestimating the risk side. In some cases this has led to non-compliance with policies (e.g. breaching the product and client limits).
- In some institutions credit risk was underestimated, especially in terms of derivative instruments—there was no clear risk ownership. The management board and senior management were not adequately informed about the risk to which the company was exposed.

## Risks and Challenges

- How is the risk bearing capacity transformed to limit systems?
- How does risk exposure relate to risk bearing capacity?
- Who is responsible for setting and updating the exposure/clients limits?
- What are the responsibilities of the Internal Audit Department in terms of the review of the internal capital adequacy assessment process (e.g. adequacy of the limit system)? Who reviews the process of the post-audit recommendations implementation?
- How do you assign the risk cost to the sales forces?

### How Deloitte can help

Deloitte is experienced in setting up enterprise-wide risk management frameworks and a risk governance culture. The scope of services covers design, implementation and optimisation of a risk governance culture.

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Deloitte helps with the design and implementation of the integrated capital management framework (especially the limit system and risk adjusted performance measurement).

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# Ensure Adequate Capability and Compliance in Risk Management

## Context

- The crisis has put more focus on the completeness and accuracy of procedures, policies, models and processes.
- Management Board, Senior Management, Internal Audit and Compliance Departments have to implement a forward-looking proactive approach for enterprise-wide risk management.
- Companies focus on implementing regulatory best practices and streamline the enterprise risk management.

## Risks and Challenges

- How is the cooperation and SLA between “sales” and “risk” forces set?
- What is the degree of automation of the processes in the institution, especially for the credit process?
- What models are used for the purposes of valuation of illiquid assets? Is the counterparty risk embedded in financial instrument valuation?
- What are the Compliance and Internal Audit departments’ roles in setting the corporate principles?

### How Deloitte can help

Deloitte offers a full range of services in terms of set up, redesign and optimisation of credit processes and valuation models (including IT systems).

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Deloitte offers help with design, set up implementation and assessment of internal control systems.

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