



2023 Irish Banking &
Capital Markets Outlook

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Irish retail and international banks can look towards 2023 with some confidence despite the looming clouds of recession, war, volatile markets and the cost of living crisis. Rising interest rates, consolidation in the retail banking market, diversification of offerings through acquisition, better cost management, and executive teams that have overcome more than a few crises mean that Irish retail banks are very well placed to weather the storms ahead. Their international equivalents have grown consistently and substantially since Brexit and have become a central and strategic part of their parent's EU plans. Nonetheless we continue to see some key trends that banks must track and manage over the course of 2023.



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All Banks

Sustainability

The energy crisis has made the case for a move to net zero all the more compelling, yet any reduction in discretionary spend caused by the cost of living crisis may create challenges for retail banks. On the wholesale banking side this is likely to have a knock-on effect in manufacturing and consumer industries reducing their ability to fund investment in sustainability. The transition of customers to a low-carbon economy, however, continues to offer significant opportunities for the sector; among them the opportunity to establish Ireland as a prime hub for sustainable finance in the coming years.

Banks, in their intermediary role, are central to this move, yet the integration of sustainability practices and considerations into the existing bank operating model are not straightforward. The availability of real expertise and appropriate resourcing are also creating

challenges to adoption. The sooner banks can make this a core competency and integrate it fully into their operating models the sooner they can gain real competitive advantage. Regulators will continue to monitor the situation carefully and there will be capital consequences and other implications for banks that fail to hit transition milestones.

People and Culture

People and Culture remains a critical consideration for the success of Irish banks, yet it is one that seems to have slipped down the priority list in recent years with the obvious exception of remote working considerations. This may be in part due to competing challenges or because it is such a difficult topic to address, yet the battle for talent remains hotter than ever. Identifying the resource and skill sets of the bank of the future coupled with maintaining the appropriate culture despite new acquisitions and remote working should be key focus areas for the banks over the

coming months.

With a more condensed banking ecosystem following the departure of Ulster Bank and KBC, the potential impact of poor culture is heightened and we suspect regulators will give this some focus as the Individual Accountability Framework finally comes into effect. While we are likely to see some spare capacity across the banking sector in 2023, there is likely to continue to be high demand in areas like risk, financial modelling, cyber, transformation, ESG, data and financial crime.

Transformation

Almost all banks have been investing in digital transformation for some years. Pressure to transform is likely to increase in 2023 as banks not only need to achieve new efficiencies in the face of increasing competition but must also adapt how they serve their customers and operate their businesses in future.

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Moving from digital frontend to digital at core as well as focusing on corporates and SME are some key trends for the coming year.

While transformation has been a key priority for some time, legacy systems, competing priorities, budget constraints, business silos, and weak embedding can all contribute to a reduction in the pace and quality of execution. As the level and frequency of change increases, banks are putting more and more focus on agility and flexibility in everything they do but particularly execution capability. A focus on project outcomes and quality of output over the coming year will be central to improving banks' transformation capability.

The cloud will also play a major and disruptive role in 2023. Many banks are rethinking their IT infrastructure to prepare for the future. This is likely to open up new opportunities for innovation. There are regulatory

concerns about the cloud but developing a clear strategy, risk mitigation and diversification plans will be key to putting some of those concerns to rest.

Data will remain a key focus for banks. There are signs that they are leveraging data assets not only to drive cost efficiencies but also to identify and meet changing customer needs and requirements. If banks are to avail of the opportunities uncovered, they will need to get closer to their customers and alter the nature of their relationships with them. Regulatory demands in respect of data continue to increase adding to complexity and the level of investment required in this space.

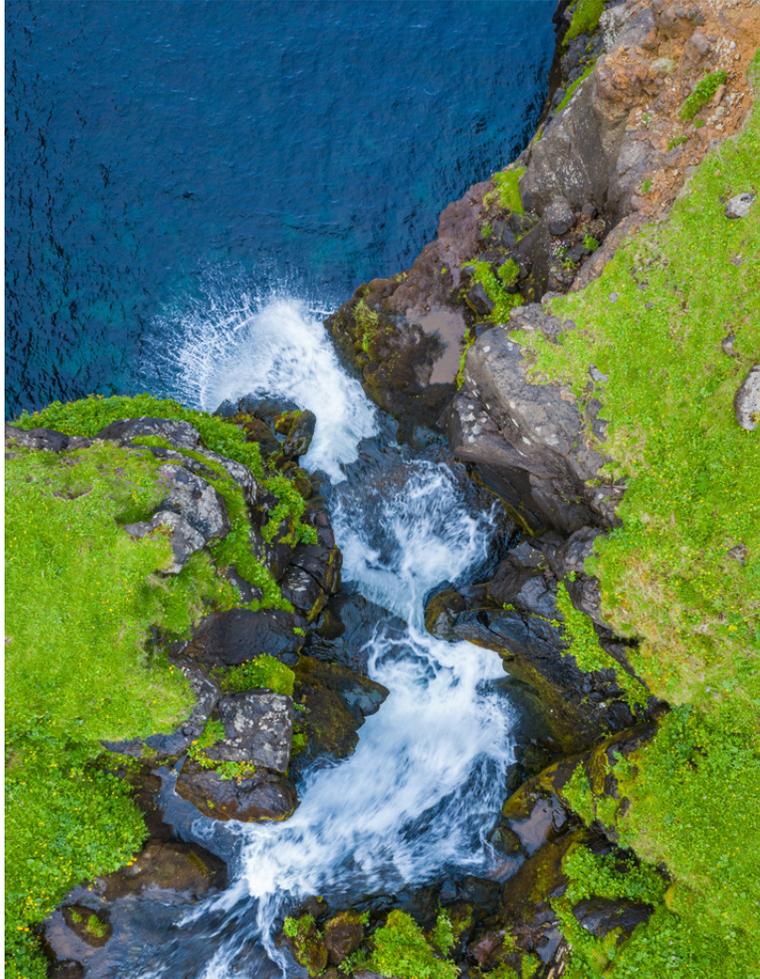
Regulatory

Banking will continue to face regulatory challenges in 2023 and beyond. The EU Digital Operational Resilience Act (DORA) is particularly relevant in this regard. Its core aim is to prevent and mitigate

operational risks in the financial services sector by creating a regulatory framework on digital operational resilience whereby all firms need to make sure they can withstand, respond to, and recover from all types of ICT-related disruptions and threats.

Banks will need to comply with this new legislation at the same time as they are playing catch-up in terms of their technology infrastructure and digital strategies. The European Artificial Intelligence Act will also have profound implications for Irish banks as they continue to invest in digital transformation.

In addition, the implementation of Basel 3.1 will make significant changes to the way firms calculate risk weighted assets at the same time as the banks have to deal with enhanced EU-wide stress testing. Regulators will place a strong emphasis on bank asset quality and credit risk as we enter into a potential downturn.



There will also be an increased focus by the European Banking Authority on the battle against money laundering and the financing of terrorism.

Retail Banks

Economic Environment

The changed interest rate environment should have a positive impact on banks' net interest income. The era of cheap money is over, and the European Central Bank is likely to raise rates to 2% by the end of 2022 and possibly to 3% during 2023. Lending margins will receive a boost as deposit rate increases are likely to lag lending rate rises.

That boost could be offset by the economic slowdown. There is strong international evidence to suggest a direct correlation between economic growth and the performance of banks, and 2023 looks challenging in that respect on both the domestic and global fronts. Non-performing loans are likely to raise their head

again as the cost of living crisis deepens. Banks will need to act quickly and decisively but sympathetically, remobilising arrears structures early and engaging with customers proactively.

The impact on SMEs is also unclear but we can estimate that the sector will be affected more severely than during COVID-19. A lot will depend on the length of any downturn and the supports that are put in place. Irish banks have identified SMEs as a key growth area so potential impacts on the upside and downside will need to be considered.

New challengers

The entry of challenger neo-banks such as Bunq, Revolut, and N26 in recent years has shaken up the Irish market somewhat but they have yet to materially challenge the core business model of the Irish retail banks. Nonetheless they have managed to amass a large customer base and if the flip to everyday banking

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occurs, the speed of change is likely to increase exponentially. There is therefore increasing pressure on Irish retail banks to become more innovative and provide new products and services which meet the expectations of today's banking consumer.

It should be noted that the banks have already responded with Synch, the new mobile payments platform jointly owned by Bank of Ireland, AIB, and Permanent TSB. The new venture was cleared by the Competition and Consumer Protection Commission in June but has yet to be launched on the market.

Cost

In the current volatile market, cost effectiveness continues to be a key priority for organisations. In addition, the transformation of group functions such as finance and HR continues to be a prime objective. In line with this, staffing and workforce optimisation

along with new forms of workplace organisation are expected to become top agenda items in 2023.

International Banks and Capital Markets Life post-Brexit (and COVID-19)

The international banks will continue to execute their post-Brexit strategy focusing on growing the services provided and EU countries covered. We are likely to see greater regulatory focus as COVID-19 accommodations are removed, regulatory divergence furthers, and life under the SSM becomes more pronounced. Booking models are likely to form part of the regulatory conversation but are also featuring more in efficiency conversations. IRB approvals are also likely to come back on the agenda. Finally, there is likely to be a continued emphasis on right-sizing the entity and embedding an operating model that is fit for purpose. This may involve obtaining new licences and/or legal entity restructuring.

Markets Business

Ireland is likely to see a continued inflow of markets business across the international banks. This creates some great opportunities but will also require some controlled acceleration particularly across front and middle office skills, risk management, resourcing, and board experience. There is likely to be a greater focus on self-reliance and less dependence on group. Firms will also need to consider the implications of IFR/IFD on local and EU-based markets businesses and the potential requirement to convert to a Credit Institution and the implications of that for the banking group.

Conclusion

Banks are facing into a range of challenges over 2023 including rising inflation, economic uncertainty, increased competition from nimble new market entrants, and an increased regulatory burden. They are however healthier and more hardened than in the past. While there is much change, banks will need to remain focused on growth and diversification over the coming year. Executing on strategy, embedding new business, and delivering acquisition KPIs will be key. Payments and technology will be central to success as will the development of a purpose-driven organisation built around an appropriate culture and with the customer at its heart.



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