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Background

In Part 1 of this series, we highlighted the 12.5% deterioration in the Return Of Assets (RoA) for the 9 key Saudi Banks within the reference years 2019 and 2023. While in Part 2 of this series, we revealed that the collective income of the same banks is centered around interest income (78% share of operating income) and lending (66% of total assets).

We hypothesized that should Saudi Banks reclaim their 2019 (pre-Covid 19) RoA levels then, they can generate SAR 2 B of additional operating income.

In this article, we introduce a management tool to help executives sweat their assets and seize the SAR 2 B opportunity.

We call this tool "*The Asset Maturity, Price and Fee Model – MPF*". It's an adaptation of the industry renowned asset maturity analysis model tailored to the challenge at hand.

How To Build An MPF?

The model breakdowns the asset base of a bank into several buckets driven by their maturity (i.e. when will the outstanding loan amount be paid back by means of contractual expiry or modeled customer premature settlement). The buckets are represented by the light grey columns where the length of the column is proportionate to the size of the bucket in billions of dollars.

The model then proceeds by tagging each bucket with five (5) metrics, namely- "Asset Price", "Asset CoF", "Market Price", "Cost Of Risk" and "Fee Wallet Share".

First, the "*Asset Price*" is the average weighted credit interest charged to the clients of the bucket.

Second, the "*Asset Cost Of Funding - CoF*" is the internal transfer price used fund this asset as established by the Treasury department.

Third, the "*Market Price*" reflects how much the fixed income or debt markets are willing to pay for such an asset given the prevailing market conditions.

Fourth, the "*Cost Of Risk*" reflects what this bucket is costing us in terms of credit losses and provisions taking into account present exposures, haircuts and probability of defaults.

Fifth, the "*Fee Wallet Share*" reflects what fee, commission and trading income are we generating from the clients of those assets compared to those clients' overall wallet or business size.

The model can be applied across a line of business, a product portfolio, a customer segment or a geography. The decision on when to apply this model, across what parts of the business and in what frequency highly depends on the challenges faced and the corporate governance structure in place.

How To Use An MPF?

Once all the asset buckets are plotted and tagged, the model suggests a series of remedial actions to take to improve the returns of each asset bucket.

We are deliberate in our use of the phrase "*suggested remedial actions*"! Seasoned bankers know too well that asset re-structuring requires further due diligence in terms of specific clients and contracts.

Withstanding the above, the MPF model delivers tangible benefits in terms of providing a uniform, standard way of analyzing and re-structuring assets in a balanced way taking into account global and local market dynamics.

Now, let's consider few examples of suggested remedial actions-

Action [A] – stipulates that assets of long maturity that are currently underpriced should be re-negotiated with the client, scaled down, or exited by means of securitization. In corollary, the cost of funding should be continuously optimized.

Actions [B] – stipulates that assets of very short maturity that are priced above the market should be renewed promptly and extended to preserve favorable income.

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Action [C] – stipulates that assets of low Fee Wallet Share should trigger cross-sell and up-sell campaigns of cash management, trading, custody, trade finance and/or advisory services.

Action [D] – stipulates that risky assets should trigger "Exposure At Default – EAD" optimization actions in terms of- increased collateral coverage, higher rates, prepayment and decreased limits.

Action [E] – stipulates that asset buckets of small size that are priced above market should be expanded.

Action [F] - stipulates that reducing the cost of funding should be a flagship priority for all management team.

Wish you an exciting and rewarding asset re-structuring journey.

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