THE CHANGING LANDSCAPE: HOW REGULATION AFFECTS BANKING RELATIONSHIPS

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Operator: Please stand by. We're about to begin. Good day and welcome to the BNY Mellon, The Changing Landscape, How Regulation Effects Banking Relationships conference. Today's conference is being recorded. The statements and opinions expressed by the panelists during this webcast are those of the panelists as of today's date and do not necessarily represent the views of BNY Mellon or any of its affiliates. This webcast will be videotaped and the video will be made available to the general public on our Web site and social media channels. By participating in this webcast you consent to the recording of any statements you would like to make or submit during the webcast. At this time, I would like to turn the conference over to David Cruikshank. Please go ahead sir.

David Cruikshank: Thank you and good morning. I'm David Cruikshank with BNY Mellon and thank you for joining our panel discussion on The Changing Landscape, How Regulation Effects Banking Relationships. I'll start by briefly introducing our panelists. First we have Ioana Barza who is the Director of Analysis at Thomson Reuters. We have Todd Gibbons, Vice Chairman and Chief Financial Officer of BNY Mellon. We have Kathy Hoffman, Vice President and Assistant Treasurer at Prudential. And we have Peter Hong, Vice President and Treasurer of Alcoa. Before I begin, I'd like to just make everyone aware that there is the option of sending in questions during the course of the panel discussion. There is an email address on the screen. Please feel free to send your questions in at any point.

So to begin, coming out of the financial crisis from 2008, regulators worldwide have been determining how best to reduce risk in the financial markets. Specifically focusing on banks and financial institutions, they've been instituting measures to help ensure that banks have sufficient capital and liquidity to cover loan losses and cash outflows in the event of another market tailspin. These new or revised regulations and ratios are focused at the heart of the banking institutions, their balance sheets. As we've begun to see, this has direct consequences on the types of business that an institution will focus on, the type of lending activity that a bank is able to participate in, which liquid deposits the institution has an appetite for and ultimately how a bank might measure the value of a corporate relationship.

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Two such regulatory requirements aligned with the new guidelines under Basel III are the supplemental leverage ratio or SLR and the liquidity coverage ratio, LCR. The SLR measures the capital cushion that would cover the bank's leverage if loans go into default or lose value. And unlike a typical measure of risk adjusted return on capital, the SLR does not consider the risk weighting of assets. The LCR is focused on ensuring that the bank has enough high quality liquid assets to meet all assumed cash outflows during a 30 day period of financial stress. Those outflows are focused on both the asset and liability side of the bank's balance sheet and include easily withdrawn deposits as well as draw downs on credit facilities.

There are rules as to what qualifies as high quality liquid assets and very often the high levels of non-operational corporate cash deposits would not earn that designation which will impact a bank's appetite for such deposits. With this as a background, I'm going to direct my first question to Todd Gibbons, CFO of BNY Mellon. Todd, the LCR and SLR are just two components of the new regulatory environment that have an impact on a bank's liquidity, balance sheet, long term business strategy. To set the stage, can you provide perspective on where the banking industry is along this continuum of change and perhaps a comment on the role of the Federal Reserve.

Todd Gibbons: Okay thanks David. Hello everyone. Well where we are on the continuum is hard to say. I would say the pendulum for more and more regulation has been swinging. So I probably predicted that it's close to the end three or four times so far. So I'm not sure we're there. But these I think are two critical changes to the capital and liquidity management of banking firms and I'm sure they have knock on effects to not only our businesses but also of course our clients. So one is a measure of liquidity. The other is a measure of capital. The difference - the leverage ratio is a bit blunt. It's just related to the size of the balance sheet. And what - I think what the regulators believed during the crisis is the institutions that came out best were the ones that had relatively high leverage ratios not just the highest risk based ratios.

Now as we - as I talk amongst my peers I think there's another element that - to the regulatory framework - that's really changed and that is the importance of stress testing and the CCAR test, the comprehensive capital assessment regime if you will. And that is a - that, in combination with the SLR and the other risk based ratios, is what's really driving business decisions for us and where we're allocating capital. And I must admit, it's extremely challenging. So I look at your businesses and it can probably be a little bit more straightforward because we don't know exactly how the government is going to conduct a stress test every year. So as a result, we don't really know exactly what the capital consumption in our businesses are going to be. We have to guess that. It's a black box for us. So we're just estimating what the results are going to be.

The SLR, which is a supplemental leverage ratio, which applies to the large banks, is becoming a constraining factor and since it's not risk based, what's really driving it is just the size of the balance sheet and how that's computed. And the balance sheet is not just the GAAP balance sheet, it includes potential draws on the balance sheet like what could go on with the - with derivative portfolios or unfunded commitments as David had indicated. So the cost of the balance sheet is increasing. That we know. And I think that will start to be reflected and the cost of an unfunded commitment could potentially be increasing at least to the banks.

So bank models - bank CFOs are looking at their strategic plans and they're making some assessment of activities that are less capital consuming or more capital consuming because of the rules. And you're starting to see, for example, a lot of investment in wealth management activities because they're pretty friendly to these rules and a drawback in some of the trading activities, drawbacks in some of the liquidity provisioning, drawback in commitments because of the intense capital consumption there. We'd much rather make a funded loan now than we would to make a commitment for a future funding because not only does that impact our capital ratio, we also actually have to hold the liquidity in place as a permanently and which then grows our balance sheet even more if you want to think about it that way.

So there really are two drivers. One is liquidity and so we've been forced to rethink how we price liquidity in the institution whether as a potential user of it or as a potential provider of it. And we have to differentiate deposits as David had indicated, especially wholesale deposits or institutional deposits into what is known as operational or non-operational. And if they qualify as operational, that means that we can make loans with those assets. If they qualify as non-operational that means we have to hold what they call high quality liquid assets that we could liquidate quickly to meet any potential demands on that.

So what's happening internally is banks are changing their transfer pricing schemes. So they're changing the - what they would pay for a deposit because certain deposits have more value than others. You can imagine how challenging that is to the businesses to operate because one year I come to them. I say well this deposit is worth X. This year it's worth Y because it no longer has the same characteristics under this new regime. So that's the liquidity profile. What that is doing is it's making some deposits non grata. Some deposits are actually quite expensive for us to hold. It sounds strange but if we were to simply take a deposit and leave it at the Federal Reserve Bank no risk to us. It's riskless income. We still have to hold substantial capital against that and that could be a real losing proposal for the - for an ROE model. So you're going to see more and more if you will pinging of - pushing away of certain types of non-operational deposits.

Getting back to the SLR, what I want to link that to that's not the only binding constraint but for many institutions it could be the binding constraint. But the real driver now of the capital regime is stress testing. So it's not so much are we meeting our spot capital ratios today. It's through a stress test that we don't really know what the outcome is going to be because it's a bit of a black box. Are we going to have adequate capital at - through that stress test. So that's the real capital regime. It's not what I call a spot ratio. It is what is the expected ratio, which is I believe an appropriate way to look at any capital - any risk based institution.

And but there's a fair amount of uncertainty to that. So as a result, certain businesses are falling into favor and certain businesses are falling out of favor and you're seeing the large banks start to change in very much, for example, their activity with hedge funds, their prime brokerage activities, their use of commitments and their taking of deposits. And that - it's starting to fit together. We start - I think we're starting to see the light at the end of the tunnel. I don't think there are going to be a lot more acronyms coming at is in the future. We still have the NSFR and the TLAC and I can throw a few more at you but we pretty know what they are now. They haven't been perfectly described and the framework is probably not going to change too much from what we've just discussed with those first two ratios so. Hopefully that answers your question.

David Cruikshank: Yes that's great Todd. Thank you. And it's interesting to hear how these new rules, regulations and ratios are actually impacting a bank's strategic decisions as they look long term. Kathy I'll turn to you. Can you share a little bit about your company as a starter and then specifically in terms of your business mix maybe tell us the main themes you're hearing from your bank partners today, particularly around this new regulatory environment. What are you hearing?

Kathy Hoffman: Sure. Sure. So just a little background on Prudential Financial. PFI and its subsidiaries we provide a range of insurance, investment management and other financial products and services to both individual and institutional customers in both the U.S. and around a host of countries around the world. Our principal products include life insurance, annuities, retirement services, mutual funds and investment management products. Pru as we like to call ourselves has been around for 140 years. We have 48,000 employees around the world and we have - just a little over $1.2 trillion in assets under management in 43 countries and territories. So that's where I come from and really where I think my comments will be based in.

The themes I think what Todd has said so the banks don't want to lend. They don't want your cash and anything that's going to be more expensive. So how's that?

David Cruikshank: That's pretty good.

Kathy Hoffman: That's a good summary.

David Cruikshank: We're trying to figure out what we want to do but.

Kathy Hoffman: Yes. Let us know. And I think what we've actually been hearing for several years and I think probably starting with our European banks. Initially I think they were a little bit faster to the gate with Basel III and but that credit will likely be tougher to get. It will be more expensive, although we haven't seen that yet. But I think everybody assures us that it's coming at some point. I joked about the cash but more recently we are starting to hear that, we - the banks don't want certain types of cash. So, the operating balances that's one thing but things that don't fall in that bucket are much less - they're of much less interest.

And as you said, we are hearing from certain banks that they're getting out of certain businesses. So you did a really nice summary. So certainly making a lot of very targeted decisions about what makes sense for where the banks want to continue. As I mentioned, really purely from a credit perspective probably four years ago we were hearing from the European banks. There was a lot more uncertainty as to how they were going to deal with regulations and their capital requirements. I actually think we've seen them stabilize and actually start to ramp up in their activities specifically around credit and maybe the U.S. banks are a little bit further behind and they're at a place where they're - there's a little less certainty. So those are some of the things that I think we've been seeing recently.

David Cruikshank: Good. Peter same question to you, a little bit about Alcoa and are you hearing consistent themes from your banks?

Peter Hong: We're a global leader in lightweight metals technology, engineering and manufacturing. We innovate multi-material solutions that advance our world. Our technologies enhance transportation. So that covers automotive, commercial transport and air and space travel. We also enable smart buildings, sustainable food and beverage packaging and high performance defensive vehicles and more efficient power generation. We pioneered the aluminum industry about 125 years ago which happens to coincide with how long our relationship is with the bank. We are 59,000 people scattered in 30 countries around the world and we make products made of titanium, nickel and aluminum and we produced best in class bauxite, alumina and aluminum. We're $24 billion in annual revenues, whether you look at 2013 and 2014 and typically most firms - most individuals on this call might think of us as the firm that reports earnings first after - at the end of each quarter.

Going back to your question about themes we hear from banks, very much like what Kathy's already discussed and obviously what Todd's alluded to. We hear the themes about regulatory impacts, higher capital requirements and I will tell you there's absolutely a sharpened focus on relationship profit and the whole concept of RAROC or return on risk adjusted capital comes into play. We hear the same comments about again the acceptability or desirability of deposits and the like. So again very much the same themes coming from the large group that we actually bank with.

David Cruikshank: Since we talked a little bit about deposits, Todd I'm going to turn it back to you. From your perspective, can you give examples of what might be bank preferred deposits giving these new capital rules?

Todd Gibbons: Most of what Peter and Kathy can't bring us actually. But the real preferred deposits right now are retail deposits. And so if a most retail clients are deemed - most of those deposits are deemed to be stable. And the implication with that is if you think about the deposit base, you bifurcate it under this new liquidity rule into one that is stable or one that is, for want of a better term, not stable. And most retail flows and is stable. From an institutional side, depending on who the depositor is, if for example it's a hedge fund it can't flow anywhere other than it's not a stable fund. Certain types of investment managers can be considered what we call operational.

So for the institutional deposits they have to be classified as operational or non-operational. If they're operational, it implies that they're kind of frictional. So that, for example, if you're in the payments business and you need to leave some level of cash in your payments account or otherwise you may overdraw it and that tends to correlate with activity in the account that can be qualified as operational. Some percentage of that, the maximum that could qualify would be 75%. The other 25% you'd have to categorize as not. If we saw a onetime spike, for example, at the end of the quarter if one of our clients wanted to leave a lot of money because they had nowhere else to put it and this is happening more frequently because monetary - money market funds have fewer and fewer assets to invest in because you guys are relying less and less on short term financing, less commercial paper outstanding, that type of thing.

And those monies get dropped temporarily into the accounts. Those have to be considered non-operational and therefore they can't be put to use in making loans even though there tends to be a fair amount of that that flows through the accounts. So all deposits get bifurcated. If it's an institutional deposit at least 25% of it is considered non-operational. It can be more based on who the depositor is and the nature of the deposit whether it's unusual or in the normal course of operational activity.

David Cruikshank: Peter, recognizing that some banks obviously won't find all cash deposits attractive and also seeing potential changes due to money market reform on the horizon, can you share your views on how this might impact a company's cash and liquidity strategies as we look into the future?

Peter Hong: Sure. We need to improve our forecasting and anticipate volatility of cash flows. We strive to do that better and better and not surprisingly that flows, of course, into a volatility of earnings which again addresses a different question here. But the impact to us is we think about carrying generally more cash which then exacerbates the problem that Todd's referred to. We think hard about deposit allocation and I'll tell you some banks are more vociferous about the desirability of deposits. Some actually are fairly silent about it. We focus in on aligning in fact the deposits to operating services, again to what Todd's referred.

In our case, we've historically put money into again basically demand deposit accounts. We by definition have to look at alternatives and we have put monies into government money market funds as an example. I'm sure over time we'll look at SMAs and the like. We have banks that obviously have talked about longer term deposits. We see I would say differing interpretations of what constitutes a longer term deposit. So we'll be approached by some firms about having deposits where we basically intend to keep it a long period. Once you get to that threshold period, 30 days, all of a sudden it becomes more freely available but they just want some level of - the bank might want some level of stability.

The final thing that it actually causes us to think about, again very perverse, it's not a - it's a downstream effect and if you think about having to carry more credit because our cash deposits become less available. We start to think about pushing out the deposit. We offset that by saying we want potentially more credit. Then if you think a little further down that path, in terms of how we deal with our banks it means in the past historically we would have been as treasury professionals very focused on access to credit which meant that we would know the credit chain very well. We need to know not only the credit chain but the portfolio allocators within the firms so that when we come to your institution or other institutions for credit line renewals, in my case I personally I'll use the word appeal but market to not just the credit professional but again the portfolio allocation teams.

Todd Gibbons: Can I ask a follow up question to...

David Cruikshank: Yes please.

Todd Gibbons: It's - Peter one of the points that you made is that banks are looking at the deposits a little bit - not necessarily completely consistent although there's probably a general framework. One of the things that we're faced with at this point is the definitions that I went through around operational and non-operational, they're still subject to interpretation, quite a bit of interpretation. So the regulators have not even come in and looked at how individual institutions are modeling to see whether there is a consistency. Are you seeing any inconsistent where somebody might like one type of activity over another?

Peter Hong: The interpretation has generally been around the deposit itself. I mentioned we operate in 30 countries. So we have transaction services literally in every - in all parts of the world. We can better probably allocate some of our deposits to those banks. We just happen to be in an unusual situation.

David Cruikshank: Picking up on your earlier comment about how deploying cash for longer may actually drive additional credit needs, I'll turn to Kathy on that. From your perspective, have these changes, these regulations driven changes in your company's financing strategies? Is there anything there that you might want to be able to comment on?

Kathy Hoffman: I don't think we've - so far we've seen an impact to our financing strategies but I think significantly Prudential - in 2013 Prudential was designated as a significantly important financial institution, a SIFI. So, our interaction with the Fed is certainly ramping up and with the Fed and various regulators. And that's clearly where we're going to see our financial or financing strategies I think be affected. Also the insurance industry while it's been highly regulated for a number or years I think you're seeing a lot of changes now and potential challenges around captive reinsurers and redundant reserves and AG48. And all of those things are going to have I think a significant impact on the insurance industry. So that's - again that's an area I think we'll see it.

You know, going back to our credit facility which is really used for liquidity backup for our commercial paper programs, general purposes as well as contingent capital. We've seen that, as I mentioned earlier, pricing is going up. Pricing is going up. We haven’t seen that but I'm sure at some point that is likely to happen. Clearly so credit will become more expensive but also suspect - and we recently just refinanced our corporate purpose facility - that the terms will become more onerous and we're starting to see that a little bit. So that, again I think that will have some impact down the road to at least that source of liquidity.

David Cruikshank: That's a great segue and Ioana I've not forgotten about you. So this is a great opportunity to turn to perspective from you and from Thomson Reuters. The SLR doesn't consider the risk weighting of assets as we've talked about anywhere in the calculation. A bank with mostly triple A loan commitments has to set aside the same amount of capital as a bank with mostly triple B loans all other factors being equal. Meanwhile, the triple A commitment fees tend to be a bit lower than the triple B fees. So one possible outcome as we've just talked about is that there could be a higher cost to this lending activity felt by a corporation. Is that reality or myth?

Ioana Barza: Well I think that it could be a reality but maybe more with regard to the terms and conditions as Kathy said. We're seeing some changes around the margin. And just as background, so my role at LPC is to talk to all the banks that are active in the different lending spaces, so leveraged lending, investment grade, middle market. We do surveys which I'm going to share some of the findings with you today as well. So from a macro picture, we start to look at where does pricing move. Where do terms and conditions start to change? You know, where do we see changes and what's happening?

So I think the reality is that terms and conditions are starting to change. As Kathy said, we're not really seeing a move in pricing. I don't get the sense that capital availability is changing. That will probably be an impact down the road as Todd you talked about. And there are a couple of things I wanted to share with you. So we asked the investment grade lenders, you know, about what some of these impacts could be and everybody came back and said investment grade lending is relationship lending and it always has been. And we actually asked them will this model change? Do you expect to change? You know, are you going to look at investment grade assets differently? And pretty much everybody said it's always been a relationship model and for now, you know, that's what it'll be.

So along those lines we asked them well let's say you have a challenging lending opportunity, meaning that it looks challenging in this new environment maybe to recommit to this issuer. What might help you get over that hump? And only 6% said a shorter tenor would make a difference. So we haven't seen a change in tenor. It's really a five year market. Thirteen percent said having more access to the borrower. So sort of more opportunity for relationship down the road. Thirty eight percent said if pricing goes up, that would help maybe because we're working with new models, with new hurdles. And, you know, if we can move that pricing up that might help. And really the largest group said maybe if we can reduce our commitment size and it goes back to what Todd said. So commitments are a very different issue than taking on a funded term loan. And, you know, for example and putting that capital to work today versus making these commitments down the road.

The other one I wanted to share is we asked about cross sell since it's a relationship business. How has that changed? So we said do you need more or less cross sell? How has it changed in the past year? And they were completely split, the banks. And just as background so the banks we talked to are global. So it's Asian banks, you know, Taiwanese, Japanese banks, Chinese banks, U.S. regional banks, U.S. money centers, U.K. banks, European banks, so the whole gamut. They were completely split. Half said I don't need more cross sell but the amount of cross sell I've been asked to rationalize I - it's consistent. The other half said I need more cross sell today. So I think things are shifting and changing but at the margin not in a great - not a big sea change.

Todd Gibbons: Well I can make a comment on that?...

David Cruikshank: Yes please.

Todd Gibbons: You know, that - I think that makes complete sense. When you think through the - what's happening is because there's still - we're still uncertain around what the stress test is going to look like and what our binding constraint might be, to make knee jerk reactions to business models or client service or anything like that is probably not the smartest thing for us to do as banking institutions. So I think people are still and certainly many of my colleagues in the bank would like me to be a lot more specific where we think we should be on certain things. But it could change next year a little bit. We're moving toward the end of the - toward the ninth inning but we're not there. So I think most institutions will want to protect their franchises, not make a knee jerk reaction and may - and you'll start to see then developing of those relationships and making sure that there's enough of a - enough revenue to support the commitments and the deposit taking.

Kathy Hoffman: In your survey...

Ioana Barza: Sure.

Kathy Hoffman: Did you see any difference or did you get data on the large corporate markets versus the middle market or smaller institutions and?

Todd Gibbons: Good question.

Ioana Barza: Yes. So what I'm - what I was sharing with you is just the investment grade lenders. We also survey the middle market. That's completely separately. What's interesting there and in the leveraged broad syndicated market is leveraged lending guidance is really the big driver. So the banks are being limited in what kind of deals they can take on given where the leverage is and there are a lot of different modeling issues so the way you're modeling how much leverage there is and adjusting the EBITDA and all these other issues. And that seems to be the bigger regulatory issue. But in the middle market you have all these non-banks specialty finance lenders that have been serving as banks for a long time originating deals, distributing deals, doing the syndication process.

So even though banks are pulling back and saying I can't lead this deal, maybe I can't even co-lead with you because it's just too highly leveraged for me. It can't go in my portfolio. You've got five other lenders behind them that are originators of loans. In investment grade space we don't have that because you've got these huge commitments. So I think that's why we may feel the impact differently and I agree that we will on the middle market space. And I don't know Todd if you.

Todd Gibbons: Oh no I - we're not in the middle market space. We're a lesser extent to the large base. Middle market and the lower investment - lower than investment grade tend to be funded assets versus what you see in the investment grade space as well...

Ioana Barza: Yes.

Todd Gibbons: So that changes things since the asset, whether it's a commitment, whether it's funded or not, has similar liquidity requirements and capital requirements. So it's much more attractive because there's more yield if it tends to be funded.

Ioana Barza: Yes.

David Cruikshank: And as you mentioned earlier, that's obviously on the new regulations that's more attractive to banks at the upper end of the market in the investment grade space as well. And it makes me curious Ioana have you seen an uptick in the aggregate amount of term loans as a percentage of syndicated volume over the past couple of years?

Ioana Barza: That's a great question. We've seen more term loans but not significantly more. So we track issuance, you know, of - in every market and term loan issuance has gone up. It's been about $10 to $15 billion every quarter for the last maybe eight, nine quarters. So it's a little bit higher than normal. But overall issuance each quarter is about $200 to $250 billion. So you're not seeing term loans take up a much larger percentage of what the loans generally look like. We're not seeing that shift. But I do want to share that in our surveys. So you're not seeing it. Issuers seem to be relying on term loans for the event driven transactions. We're not seeing a major shift in structures there or in going, you know, switching out bonds or anything like that.

But the banks as Todd said are very interested in term loans. So we've actually started to asking a question every quarter since we surveyed we have opportunity to ask. And we ask what is your lending preference? Is it an unfunded revolver, a funded term loan or nothing depending on the relationship? So we say well there's a weak relationship. So your bank doesn't have much relationship with this investment grade issuer. What would you do based on how the regime is changing? And 1/3 of the banks said we would not lend at all. At this point we probably can't rationalize it. And then most of the remainder said we prefer a funded term loan and it's echoing exactly what you said.

Then we asked what about a strong relationship where you've got long history and there's ancillary business. Seventy five percent of the banks said I would prefer you fund a term loan, you know, in the high grade space which isn't surprising based on Todd's comments but it's surprising when you look at structures because historically we've not seen that. The other 25% as Kathy you talked about is largely European banks and some U.S. money centers. And they're saying we've adopted these models and now that looks fairly expensive for us because that capital is competing against a lot of other areas. And so I'd rather have the unfunded commitment and then use that capital somewhere else. So it's a real bifurcation in the lending preferences right now.

David Cruikshank: I’m going to ask you to be a visionary. From your vantage point, what do you envision that the new banking landscape wants all of these regulations before fully taking place?

Ioana Barza: And you all have talked about it. We think probably fewer banks as some banks are going to shed less profitable businesses and say, you know, we're just out of that business. We might see smaller bank groups because you've got this focus on wallet and relationship. We might also see ((inaudible)) talking about more funded debt. And, you know, we don't see it yet in the data. It's really more on the event driven side. The other thing is I wanted the banks to be the visionary. So we asked them as well. So we said in the next two to three years, who's going to grow their loan book and who will shrink? You know, who's going to retrench? And this is just not, you know, any particularly bank, just regionally.

So 40% of the banks said they see the most growth from U.S. regional. About a third of them said it'll be from Chinese banks. And this was kind of a yes/no. So it's not going to add up to 100% for each type. For Japanese types about 20% said we think more growth will come from them. Only 10% expected more growth from non-bank investors. Now on the flip side, who will re-trench? And 75% of all the banks surveyed said U.K. and European banks. They expect retrenchment there. Everything else was pretty much in the minority. So nobody really selected in any of the other geographies. So I think in a way that's good news because it shows that we don't expect too much retrenchment and actually probably more growth.

But I think it's going to look a little bit different. So we asked - I'll add a couple other questions. We said what's the future of the investment grade landscape? What's it going to look like? Three fourths said we're going to see probably same number of players as today which kind of matches what I just shared. Twenty percent said we're going to have fewer investors. About 10% said more banks coming in. Syndicate structures, we said are we going to see fewer tiers and consolidation or about the same. They were evenly split on that. And what about sizes of revolvers? A share - a fair amount of the banks said revolvers will probably shrink and I think that goes back to commitments. You know, how big do these commitments need to be and especially when banks are looking at the kind of variables they have to consider today. This was kind of a long answer.

David Cruikshank: No that's a perfect answer.

Ioana Barza: I can't sum that up.

David Cruikshank: You also made a comment before about the expectation of banks whether they'd be looking for more cross sell, less cross sell.

Ioana Barza: Yes.

David Cruikshank: So the results of that sounded interesting to me. But I'm going to turn it to the experts on this. So Kathy I'll start with you. Balancing non-credit services among your banking partners has - it's not exactly a new topic but it's becoming more complex in this environment. Has this caused you to rethink how you manage bank partner relationships and if so how or how do you envision that it might?

Kathy Hoffman: Well I would like to think that I am a visionary but I think probably I just got lucky. A number of years ago at Prudential we sort of developed this mantra of smaller more meaningful bank relationships. So we significantly reduced the number of banks that we were actively dealing with and, particularly starting with our credit facility. That was really more driven out of I don't want to keep meeting with banks that, you know, there's really no opportunity to do business. So it was a little selfish. But I think and what you're just - what you just said as well I think that is going to become increasingly important that you have to have a relationship and there has to be business backing that particularly if you are looking for - we are looking for credit.

So I think we're going to continue to - we have a fairly decent size facility and a fairly small number of banks that are participating in that. And, you know, we've told our relationships consistently that we are very thoughtful about the allocation of fees and hopefully almost 100% of it if not 100% of Prudential's fees are going to that relatively small group of banks. So we continue to be successful in the credit support but I think that's because, you know, we - the bankers aren't always happy with the allocation and these bankers aren't really ever happy, right...

Ioana Barza: Yes.

Kathy Hoffman: Just kidding. But I think that with kind of the ongoing dialogue that they recognize at least we're very thoughtful about it. I think the other thing that you kind of mentioned is having a very good understanding of what's important to the bank. So where - what products do they want to play in? What's important from a return for them? And how to make that work. We focus on having a mix of banks. So not everybody with Bank of New York Mellon does is different from, what some of the other banks do. And so to make sure that there's a good diversity of products and services represented in our bank group and understanding like I said who wants to get paid for what services. And then working through that.

One of the other things that we do that I find is helpful and gets pretty good feedback from our bank group is we have an annual relationship review meeting and it's really not to talk about so much what we do with one another. It's really to talk about the treasurer and his directs sit around a table with the bankers, and we do this with each of our banks, and talk about what our objectives are for the year. What are the things that we're going to be focusing on? And then try to identify where it makes sense to further the dialogue and to have those connections and to try to do business together. So we try to be as transparent as possible about those things that we're working on. And we want to continue to further the relationship and we love the advice and the help and all that from our bank groups so. I think more and more communication is going to be important.

David Cruikshank: Great. Peter what would be the most effective way for your banking partners to be communicating all of these client impacts or potential client impacts coming out of these regulations.

Peter Hong: Sure. So in many ways it's going to echo the themes that Kathy's alluded to. And again as I thought about this question in the prep phase, I thought be careful for what I ask. If you all adopt it, it's probably going to make our job tougher. But when you think about what do and think about, we think about again transparency on the relationship profitability. We want to understand from the perspective of the bank, not just the banker but the bank, what's important to the relationship. We track our financial services spend. You refer to - you use the term wallet. We look at financial services not just spending, not just what we spend at the banks. And in fact, we very much make a concerted effort to drive spending into the lending group. And so what we do is not by accident but by very deliberate moves because we're very concerned about having a long term access to bank capital.

We know what we can deliver. So therefore again we ask that the bankers be more precise, be more transparent as I said earlier about its expectations. It's also critical to have clarity on what I'll call high impact business from that institution's perspective. We deal with roughly 30 banks from around the world and you can imagine the bankers that come and knock on the door. They ask for the entirety of the wallet. So it's not just treasury operation services of foreign exchange or investment banking and on and on. But a lot of them can only deliver some of these products very well and a lot of those services not very well.

It's important to be very clear as to what that firm values because we can manage that flow so that the impact to the relationship is supportive of the banker's role as an advocate within his or her institution. Now on our behalf as you go up for credit renewals and obviously portfolio allocation, I think very much about again the wallet - something that Kathy's alluded to. I think about what I'll call the reasonableness of request. So again it is not always - it's the banker needs to have a good expectation of what he or she can deliver well and therefore can advocate or rather request from our side to deliver.

I would add to it the concept of better knowledge about us as a firm from a credit perspective. Having been a former banker I understood the concept of credit very well. And not as manifesting itself in the price of CDSs. It's become so much of “what's the price of it?” We've stepped away from the question of “can this firm by itself support the credit?” And I think that's important because that understanding has now become I think more and more of a lost art. It helps the bank understand better as it advocates for credit and whether it is truly a desirable business from their perspective. Again the commitment that we end up making to the banks that are part of our bank group is we want the relationships to be profitable because we want long term access to bank capital.

Kathy Hoffman: Can I just make one comment on the communication idea? I would say yes a lot and often and I think where that comes from is, Todd you mentioned that the formulas are all there I guess but how each bank implements some of these regs is still unraveling and unfolding. And some of these things can have a dramatic impact on our operating infrastructure. As an insurance company we have very complex structure tied with our asset management, our investment accounting folks and so some operating changes we may have to make in treasury are going to trickle down and could potentially be significant. So I would say and to your point be sorry what you ask for but as heads up if things are unfolding. As even if you're not sure but let us know what's potentially going to happen so we can start thinking about it too and start preparing and managing expectations across the firm.

David Cruikshank: So keeping an open dialogue.

Kathy Hoffman: Yes absolutely.

David Cruikshank: Well I don't want to lose the comment Ioana that you made about wishing the banks were being visionaries. So I'm actually going to take that as an opportunity to turn again to Todd and ask you to be the visionary now Todd. Tell us what you envision as the new banking landscape once all of these regulations have taken effect.

Todd Gibbons: You know, I think we're going to be holding more capital. I think there's going to be a little more cost to the balance sheet. I think there will be some rearrangement of the businesses but ultimately I think it is not going to be - I think there will be a role for the capital markets that's quite important. I don't think from the lending and credit and relationship side of it if anything the trends that we've been seeing over the past few years are - I think are going to continue. One element that might change a little bit is around the cash management side and where cash might go and what the alternative is. And Peter you alluded to that and maybe it'll be in a separately managed account or maybe you'll look at something at, you know, treasury money market funds or things that you might not have looked at in the past.

And I - at this point I think there's a little uncertainty how that is going to evolve because we don't know how the Fed is going to execute monetary policy going forward once we do come out of a zero rate environment. But so I'm afraid to say my vision isn't - never is it clear. That's why I wear glasses. But it's - unfortunately I can't say there's anything striking or shocking that I see - shocking that I see developing. I think relationship is going to be absolutely critical. I think the trends that you've seen and the way we measure that, the way we measure. I mean the questions you raise are great ones. There might be a little tweaking around that risk based return. I think we've over focused this morning on the leverage ratio. There is a risk based ratio also and some institutions will be constrained by one versus the other. So you might hear a little bit of a different message. But I think that move towards - that continued move toward relationship banking can't change especially at the - in the investment grade - in the large institutions.

Ioana Barza: I just want to add. Do we know that as you said earlier the variables you kind of know what the pieces are. Maybe there aren't too many more surprises. But what I think for me what's interesting to watch is that the banks are in such different stages and phases of dealing with this. So I - when I surveyed them every month we also speak to a lot of them on the phone and kind of say what worries you. What excites you? What's - where's the opportunity? And between the U.S. regionals, the Europeans, the U.K., you know, banks out of the U.K., the money centers, you hear such different commentary as to how they're adopting this and where they are.

So within each institution you get a lot of different inputs and answers because they're in different phases of adopting this. And so they have different clarity and they'll say are my colleagues, you know, doing this because we're only looking at this variable right now. You know, in three months from now and I guess it goes back to the communication. As long as you're keeping open communication you'll see those things, you know, as ((inaudible)). But I think it's a somewhat uneven playing field because some banks have adopted some of these regulations a lot earlier than others.

Peter Hong: I'll add one thing. The concept of pricing credit is very mystifying because I know that the - that a credit line is a loss leader. And then it's the ancillary business that makes up - offsets it and hopefully makes the whole relationship profitable. And again it - under the "be careful what I ask for" model - mantra rather it would be clear if we understood what is the kind of cost of capital, rather credit, becomes or you price credit more fairly, more representatively. Then you can allocate the ancillary business in a slightly different way. But today you end up having to use the ancillary business to offset the credit loss associated with the commitment. And it most manifests itself most clearly when you ask a banker, and again it's not any particular institution, what if I wanted literally to have this credit line priced at full cost and I want to disassociate the transaction banking and the like, you can't get there. You can't get there.

Todd Gibbons: That's a challenge, right.

David Cruikshank: Well as we head to the top of the hour, I do want to take an opportunity to take a few of the questions that have come in online. And the first question is directed to Ioana. I'm going to pass this one over to you.

Ioana Barza: Okay.

David Cruikshank: Ioana I'm sorry. Have you identified shifts in the composition of lender groups on a macro scale in the past year or so?

Ioana Barza: Yes this is like we - I actually survey about this as well because as an analyst I'm always looking to see how is the market changing. And we haven't seen a lot of changes in lender groups and we asked going forward do you expect to see changes. Given all this it would make sense. And about half the lenders in our survey the last time we took it said we don't expect any change. A third said maybe on the margin. You know, as some banks - there are always some banks who exist but then there are always banks behind them willing to come in. So I would say there's no discernible pattern for any type of institution or geography. And a few years ago Kathy alluded to we saw it very clearly with European banks. So basically you can kind of point to almost deal and see that European banks were exiting. They were being very selective about their commitment. So it was a clear pattern. Today we have on the margin banks do kind of exit deals and but there are always banks willing to come in and be issuers themselves or making those decisions. So we don't expect any big changes.

David Cruikshank: Great. Thank you. And the next question is directed to Todd. How does the regulation vary between the U.S. and Europe? We haven't talked about that yet. And does this give some banks an advantage over others?

Todd Gibbons: Sure. So the way the regulation is adopted especially for the SIFIs is the Basel committee puts out a rule and then the local jurisdictions interpret that rule and in the U.S. some - for the most part it's been what we call gold plated. So the standards have been raised from the minimums. Not worth really - not that big of a difference in the liquidity side of the house. And the capital side of the house fairly consistent for risk based capital. For the leverage ratio that we just talked about, the SLR, is at this point it's - it appears to be not completely unique but a little bit higher for the large institutions in the U.S. So I don't think it's made the playing field terribly uneven but maybe perhaps a little bit uneven for just pure balance sheet usage.

David Cruikshank: Okay. And the next question to I guess either Kathy or Peter. We've talked a little bit about some of this already I think but what do you see as options upon the implementation of the floating NAV on prime money market funds? And could rotating to government funds be considered a new option or a different option or the option? What are your thoughts?

Peter Hong: Yes so you just mentioned rotating of the government funds. The fact of the matter is, the market for government securities is dropping. There's less and less - there are less and less securities out there so that makes it difficult for corporates to go and to play into that market. And you think about all the things that Todd earlier talked about in how a bank deploys its assets. Again we get to that point where you're actually being forced in some ways to compete against us to get those liquid assets. We want those same liquid assets too. So that just means that we're going to be chasing after I think a lot of the same things. That just makes that a tougher challenge for us.

Kathy Hoffman: I think this may present an opportunity for the banks or private groups to start to come up with some innovative ideas. We - at a recent insurance industry conference a bunch of treasury folks were sitting around saying well at the end of the day if I've got cash and you need cash and we start more bilateral or establish sort of our own facilities together pool. So I don't - so I think some creative innovative ideas might come out of this and I expect the banks will step up and fill the void to somehow I think they always do.

David Cruikshank: Well these are the changes that should bring about opportunities for new vehicles, new products, new services. So we're getting to the top of the hour. I'll just ask the panelists any final comments? Any points that you'd like to raise or put forward? No. Well then I'll say thank you to all of my panelists for participating and thank you everyone for joining the webinar. Again this is the BNY Mellon webinar on the changing landscape around regulations and the impact on bank relationships. Thank you.

Operator: That does conclude today's conference. Thank you for your participation.

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