Cost reduction in the European Banking sector

Presentation

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Leveraging its industrial consulting roots, Roland Berger is a recognized leading practitioner in cost management.

**ROLAND BERGER’S OPERATIONAL EFFICIENCY OFFERING**

<table>
<thead>
<tr>
<th>Targeted cost savings</th>
<th>Long Term Transformation Program</th>
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</thead>
<tbody>
<tr>
<td>&gt;20%</td>
<td>Orga. streamlining</td>
</tr>
<tr>
<td>10 à 20%</td>
<td>Outsourcing/offshoring</td>
</tr>
<tr>
<td>5-10%</td>
<td>Shared service centers</td>
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<tr>
<td></td>
<td>Process simplification</td>
</tr>
<tr>
<td></td>
<td>IT Turnaround</td>
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</tbody>
</table>

**FIT OPERATIONS (Fast Impact Transformation)**

**BUDGET CUTS**

**LEAN / CONTINUOUS IMPROVEMENT**

<table>
<thead>
<tr>
<th>Saving realization timeframe</th>
<th>2010</th>
<th>2012 ytd</th>
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</thead>
<tbody>
<tr>
<td>Short term (6-18 months)</td>
<td>32%</td>
<td>57%</td>
</tr>
<tr>
<td>Long Term (24-36 months)</td>
<td>68%</td>
<td>43%</td>
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</table>

**COST MANAGEMENT IS THE MAIN ACTIVITY FOR OUR FS CC**

Financial Services Competence Center Revenues

- **2010**: 32%
- **2012 ytd**: 57%
- **2010**: 68%
- **2012 ytd**: 43%

Efficiency enhancement projects

Source: Roland Berger Strategy Consultants
> **Industry inflexion point on cost**: from cost adaptation to cost transformation

> **Starting point**: Not all banks equal … but too many still unprepared

> **New frontier**: Performance from simplicity
   - Axis 1: Fit operations to remove local inefficiencies
   - Axis 2: Simplify and delayer organization for stronger accountability
   - Axis 3: Simplify business model (offer / manufacturing) for greater agility

> **Two-tier approach**
   - Accelerate/Amplify/Align traditional levers
   - Re-invent post-crisis cost models

> **Implementation challenges**
   - Challenge 1: attacking front-office cost-reduction
   - Challenge 2: mastering social engineering
   - Challenge 3: addressing each bank's governance and leadership issue
   - Challenge 4: rooting a culture of frugality

> **Banks ability to prepare cost model for tomorrow will differentiate winners from losers**
Agenda

1. From cost adaptation to cost transformation
2. It's time for simplicity in banking
3. Make it happen: key lessons learnt and success factors
1. From cost adaptation to cost transformation
Cost reduction is a key driver for restoring ailing profitability

Average ROE of main Western European Banking groups

Source: Annual reports, 2011 results presentation, Roland Berger Strategy Consultants analysis
2 scenarios were projected

**BASE SCENARIO**

- Gradual recovery of the banking environment
  - Gradual recovery of economic growth
  - Progressive implementation of new regulation
  - Limited political impact on taxation and activity constraints
  - Return to a more stable and fluid funding environment

**STRESS SCENARIO**

- Persistence of a deteriorated banking environment
  - "Lost decade" of economic growth
  - Rigid implementation of new regulation
  - Multiplication of political initiatives with Finance seen as the "enemy"
  - Persistence over time of market stress

Source: Roland Berger analysis
Announced plans reflect a turnaround from cost containment to active cost reduction

Evolution of European Banks Cost: Income Ratio

In a different top line growth context!

NBI growth/year 3 to 5% +/-1%

Cost growth/year 2 to 4% -0.5 to -2.5%

Base case: -10% COSTS OVER 2012-2016
-40 Bn EUR

Stress case: -17% (-68 Bn EUR)

Source: Bloomberg, Broker reports, Annual reports, Roland Berger Strategy Consultants analysis
Many banks have announced cost reduction plans…

Cost income ratio performance overview & cost reduction objectives

CIR evolution
[pts; 2010; 2011]

- BBVA
  - > 6% headcount reduction
  - > By end of 2012

- BBVA
  - > 2.5-3.5 Bn USD by 2013

- ING
  - > 800M€ by 2015 (300 M€ from purchasing)
  - > Targeted CIR: 50%-53% by 2015

- Nordea
  - > 1.5 bn€ by 2013-15 (560 M€ from mass lay-offs)
  - > Targeted CIR: 50% by 2015

- HSBC
  - > 3.5 bn€ (2009-2011)
  - > Targeted CIR: 55% by 2013

- RBS
  - > 2 bn GBP by 2013

- Intesa
  - > 770 M€ by 2013
  - > 8 000 FTE
  - > Targeted CIR: 43% by 2015

- Barclays
  - > 1,6 Bn€ achieved in 2011
  - > Additional 1.3 Bn€ gains through integration

- DB
  - Ø 1.8pts

Source: Annual reports, Roland Berger analysis
… yet not all banks are equally prepared

# of banks amongst European Top 25 European Banks

- **PREPARED**
  - Ambitious cost transformation plan announced
    - 6-7 pts reduction target in CIR
    - Medium-term vision (2014-15)

- **NOT CLEAR**
  - Short term cost adaptation plan announced end 2011
    - 2 pts reduction target in CIR
    - Short-term vision (2012-13)

- **PREPARED / WILL IT BE ENOUGH?**
  - Modest cost transformation plan announced
    - ~2-5 pts reduction target in CIR
    - Medium-term vision (2014-15)

Source: Annual reports, Roland Berger analysis
Target cost reduction varies by country depending on stress level of each domestic banking system as well as social constraints.

### Target Cost Reduction Per Country

**Social constraint** (Proxy: OECD Employee Protection Index)

- **-5 / -10%**
  - (196; 2.4)
  - Germany
  - Low
- **-10 / -15%**
  - (338; 2.9)
  - France
  - Medium
- **-15 / -20%**
  - (441; 3.0)
  - Spain
  - High
- **-15 / -20%**
  - (547; 2.4)
  - Greece
  - Very high

### Key Levers Per Country

- **Concentration**
  - Low
  - Restructuring, mergers, branches closure
  - 10 / -15%
  - Mergers, outsourcing, organizational integration
  - 10 / -15%
  - Organizational integration, carve-outs/outsourcing, branches closure
  - 10 / -15%
  - Offshoring, out-sourcing, Front-office productivity in the City of London
  - 10 / -15%
  - Productivity, carve-out/outsourcing, interbank alliances

### Stress Level (Proxy: 5Y CDS)

- Low
- Medium
- High
- Very high

### Cost Reduction Target to be Achieved

(XXX; x.xx) Average CDS 5Y by country base on Banks' headquarter / OECD Employee Protection Strictness Index (0-6 scale)

Source: Roland Berger analysis
Cost reduction targets and main efficiency levers to activate vary according also to business line.

**POSITIONING OF BUSINESS LINES DEPENDING ON THE ENVIRONMENT**

**Social constraint**

- **Retail**: $-5/-10\%$
- **Asset & Wealth Management**: $-10/-15\%$
- **Support functions**: $-15/-20\%$
- **SFS**: $-10/-15\%$
- **CIB**: $-10/-15\%$
- **Support functions**: $-15/-20\%$

**Stress level**

- **X/Y\%**: Cost reduction target to be achieved

**KEY LEVERS PER BUSINESS LINE**

- **Retail**: > Delayering, carve-outs/JVs, branch closing
- **SFS**: > Offer simplification, IT consolidation, merger
- **CIB**: > Front Office productivity, offshoring/carve-outs, front-to-back process streamlining
- **Asset & Wealth Mgt**: > Front Office productivity, BO outsourcing, industrialization
- **Support functions**: > Renunciation, organizational consolidation and shared services, offshoring
Pressure will be primarily put on support functions and external suppliers

Source of savings and relative effort by cost nature

<table>
<thead>
<tr>
<th>Cost Nature</th>
<th>% of Cost Base</th>
<th>Effort 1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>HR - Support</td>
<td>10%</td>
<td>15% -15% (-20%)</td>
</tr>
<tr>
<td>HR - BO/FO</td>
<td>48%</td>
<td>35% -7% (-15%)</td>
</tr>
<tr>
<td>IT</td>
<td>15%</td>
<td>19% -12% (-20%)</td>
</tr>
<tr>
<td>Real Estate</td>
<td>12%</td>
<td>10% -8% (-12%)</td>
</tr>
<tr>
<td>External expenses</td>
<td>15%</td>
<td>22% -15% (-20%)</td>
</tr>
</tbody>
</table>

1) % of cost base – Base Scenario (Stress Scenario)

**BANK HR COSTS: 50% OF SAVINGS**
- (-55% in Stress Scenario)
- vs. 58% of cost base

**EXTERNAL COSTS: 50% OF SAVINGS**
- (-45% in Stress Scenario)
- vs. 42% of cost base
2. It is time for simplicity in banking
In many other industries, the reduction of complexity has been a major performance enhancer.

INCREASING COMPLEXITY IN FINANCIAL SERVICES

> Successive phases increasing complexity
  – Before 2008: "Growth" (new products, new geographical areas, new activities)
  – After 2008: "Regulatory Response" (staked initiatives, budget cuts, increasing resources)

> Internal organization more and more complex
  – Additional standards
  – Matrix form of organization
  – Stack of managerial levels (HQ, activities, entities, business units, …)
  – …

EXAMPLE OF A COST TRANSFORMATION JOURNEY - TELECOM

1. Productivity
2. Simplify
3. Spin-off

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>&gt; OPEX savings</td>
<td>&gt; OPEX savings</td>
<td>&gt; OPEX savings</td>
</tr>
<tr>
<td>EUR 2 bn</td>
<td>EUR 1.8 bn</td>
<td>EUR 3 bn</td>
</tr>
<tr>
<td>&gt; Headcount</td>
<td>&gt; Headcount</td>
<td>&gt; Spin-off of</td>
</tr>
<tr>
<td>reduction</td>
<td>reduction</td>
<td>45,000 FTE</td>
</tr>
<tr>
<td>26,400 FTE</td>
<td>20,000 FTE</td>
<td></td>
</tr>
</tbody>
</table>

OPEX: Operating Expense; FTE: Full-Time Equivalent.
New frontier: The quest for simplicity to reach the next level of structural cost performance

Performance from simplicity

1. Fit Operations
   - Renunciation
   - Productivity
   - Skills alignment

   EFFICIENT

2. Streamline Organization
   - Delaying
   - Suppressing overlaps
   - Eliminating “embedded support”

   ACCOUNTABLE

3. Refocus Footprint
   - Reduction of Product / Channel variety
   - Carve-outs and outsourcing
   - Consolidation & shared services

   AGILE

Source: Roland Berger Strategy Consultants
FIT Operations: high level of cost inefficiencies remaining at a "shop floor" level

**KEY FIT SPECIFIC LEVERS**

- Renunciation: > Not doing it
- Streamlining: > Doing it once
- Standardization: > Doing it one way
- Simplification: > Doing it simpler
- Skills alignment: > Doing it cheaper
- Self care: > Let the user / customer do it

**ILLUSTRATION - FIT OPERATIONS PROJECT**

Illustration - Source of savings of a FIT Operations project (%)

- Automation: 26
- Mutualization: 6
- Renunciation: 33
- Process simplification / Standardization: 18
- Skills adjustment: 16
- TOTAL: 100

1/3 with classic levers (18-36 months)
2/3 with FIT specific levers (6-18 months)

17.4% cost savings
Many banks are now flattening their structure

MANAGEMENT WEIGHT FOR SUPPORT FUNCTIONS

Span of control [# of employees per manager]

Average ratio = 5.1
Targeted ratio= 7 - 9

HIERARCHICAL LEVELS WITHIN SUPPORT FUNCTIONS

Width of hierarchy [# of hierarchical level]

Workforce : 2020
Weighted average= 4.4

Simplification by removing one hierarchical level

20%+ of potential reduction in # of managers

Source: Roland Berger Strategy Consultants experience
Product portfolio simplification: reducing the complexity of the offering to slim down the value chain

MAKING PRODUCTS EASY TO EXPLAIN FOR EMPLOYEES...

- Products are clearly distinguished and have little overlap
- Employee is able to give the customer good advice

Example: strong reduction in mortgage offering complexity by looking at all parameters

...AND EASY TO CHOOSE FOR CUSTOMERS

- Product characteristics and differences between products are easy to understand
- Customer can make an independent choice when desired

Example: ABN AMRO

Reduction from 10% to 90% across product silo's will be achieved

Source: Producten Anno Nu presentation, March 2011
Expect off-shoring, outsourcing, carve-out, spin-off to be high on CEO agenda

## Type of carve-out model

<table>
<thead>
<tr>
<th>MODEL</th>
<th>DESCRIPTION</th>
<th>COMMERCIAL PURPOSE</th>
<th>BUSINESS COMPLEXITY</th>
<th>EXAMPLE</th>
</tr>
</thead>
</table>
| Competence sharing Sourcing  | > A bank leverages technical knowledge of an IT vendor partner  
> Industrial JV with access to cheaper resources                                                                                                                                                        | ☀️ ☀️               | ☀️ ☀️               | > IT Infrastructure  
> Retail banking services                                                                                                                   |
| optimization                 |                                                                                                                                                                                                             |                    |                     |                                                                                                                                   |
| Outsourcing to a Third Party | > A bank sells its assets and teams to a provider benefiting from scale effect  
> Costs variabilization and access to best of breed systems and processes                                                                                                                                | ☀️ ☀️               | ☀️ ☀️               | > Investor Services (SS, AM, Insurance)  
> Support functions  
> IT Maintenance                                                                                                                               |
| Volume Consolidation         | > Two banking groups joint forces to share large volumes  
> Scale effect / Investment sharing                                                                                                                                                                       | ☀️ ☀️               | ☀️ ☀️               | > Investor Services  
> Payment (post-paid)  
> Consumer Finance  
> Structured Finance                                                                                                                              |
| Commercial JV                | > A bank carves-out a BO with a service provider that markets the service to banks  
> Banks brings business competence, partner provides industrialisation and commercial knowhow                                                                                                        | ☀️ ☀️               | ☀️ ☀️               | > Capital Markets  
> Payment (pre-paid)                                                                                                                              |

Monte Paschi di Senna just announced the outsourcing of its entire Back-Office.
3. Make it happen: lessons learnt and success factors
### BANKS HANDICAPS

<table>
<thead>
<tr>
<th>DIMENSIONS</th>
<th>Handicap</th>
<th>Neutral</th>
<th>Accelerator</th>
</tr>
</thead>
<tbody>
<tr>
<td>COST CULTURE</td>
<td>€</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SOCIAL FACTORS</td>
<td>€</td>
<td></td>
<td></td>
</tr>
<tr>
<td>COST VARIABILITY</td>
<td>€</td>
<td></td>
<td></td>
</tr>
<tr>
<td>COST OF REGULATION</td>
<td>€</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LEVEL OF STRESS</td>
<td>€</td>
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#### BANKS FACE A GREAT COST TRANSFORMATION CHALLENGE

- High cost reduction ambitions (60/72% of banks with CIR decrease targets more than thrice/twice past 15 years achievements)
- Starting point with many handicaps compared others
- Limited time / High market pressure

Source: Roland Berger Strategy Consultants analysis
Think ahead: from cost adaptation to cost transformation

ARE YOU WELL PREPARED?
Review of cost-related announcement of top 25 European banks

WELL PREPARED

UNPREPARED?

PREPARED BUT WILL IT BE ENOUGH?

DESIGN A 3-STEP COST TRANSFORMATION JOURNEY

- Reinvent the cost model
- Accelerate / Amplify / Align (AAA) conventional levers
- Remove local inefficiencies

Savings

Low

High

25%

15%

Time
Execution is king: The effective delivery of cost savings will differentiate post crisis winners from losers.

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**POST-MORTEM OF A COST PROGRAM ONE YEAR AFTER LAUNCH**

- Initial target: 100
- Additional target: 5
- Savings to be validated by business units: 27
- Delay: 14
- Adjusted target: 64

**KEY SUCCESS FACTORS**

- Relentless sponsoring from the top management
- Mobilization of middle managers around a long term vision and clear action plans/priorities
- Well designed social engineering to realize savings
- Change management to instill a cost culture
- Rigorous program management and savings tracking

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**Source:** Roland Berger experience
Front Office won't be "sacred cows"

**PERSPECTIVES BY ACTIVITY**

**CIB**
- Pressure on compensation
- Front office delayering

**Retail**
- Branch network optimization
- Leverage of remote channels

**SFS**
- Acquisition costs decrease
- Service level adjustment for partners

**W & AM**
- Productivity of front-office
- Review of external distribution value sharing scheme

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**ILLUSTRATION: BRANCH NETWORK PER MILLION INHABITANTS IN WESTERN EUROPE [#]**

1. Based on total of ~240,000 branches in 2010 in Western Europe

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**> 15-20,000 potential branch closures by 2016 in the base case or -6/8%**

1) vs. -30-35,000 closures in stress case or -12/14%

- Inflexion point versus historic trend (+1.2% between 2000/10)

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Source: ECB, EFMA, Febelfin, Roland Berger analysis
A complex social equation

BANKS WORKFORCE IN WESTERN EUROPE [’000 EMPLOYEES]

- 1.1% p.a.
- 0.7% p.a.
- Base case: -1.0% p.a.

<table>
<thead>
<tr>
<th>Year</th>
<th>Workforce</th>
</tr>
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<tbody>
<tr>
<td>2004</td>
<td>2.988</td>
</tr>
<tr>
<td>2005</td>
<td>2.983</td>
</tr>
<tr>
<td>2006</td>
<td>3.027</td>
</tr>
<tr>
<td>2007</td>
<td>3.084</td>
</tr>
<tr>
<td>2008</td>
<td>3.072</td>
</tr>
<tr>
<td>2009</td>
<td>3.021</td>
</tr>
<tr>
<td>2010</td>
<td>2.994</td>
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<td>2011</td>
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<tr>
<td>2014</td>
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<tr>
<td>2015</td>
<td></td>
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<tr>
<td>2016</td>
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</tbody>
</table>

COMMENTS

> Pressure on compensation
  - Bonus pool
  - Base salary evolution

> Pressure on suppliers
  - IT providers
  - Consultants
  - Facility/service providers
  - Employment agencies/Temps

> Social engineering
  - Recruiting slowdown / Non replacement of retirements
  - Internalization
  - Internal mobility promotion
  - Carve-out / Spin-off
  - Social plans

> Workforce will decrease back to early-2000 level
> Indirect job losses at suppliers should be in the same range
> Stress-scenario would double the projected impact

1) 380,000 bank employees in France, 18% 55+ years old in 2010

Source: European Banking Federation, Roland Berger analysis
Which obstacles for change now?

"What makes us hesitate is not the difficulty of things, but things are difficult because we hesitate to tackle them"

Senèque

"Social cohesion is done at the expense of truth"

Jeff Bezos, Amazon CEO
Our advice for European banking executives as they are starting their cost transformation journey

> In the midst of a crisis, doing nothing is the worst possible choice

> If you are in a bad situation, the right decisions often make things worse before they get better

> Navigating out of a crisis requires courageous, non-consensus leadership

> Once you have addressed the issue, things invariably get better more quickly than you expect

> If you prepare for the worst, surprises will generally be positive
It's character that creates impact!