Roland Berger Focus

June 2017

A sustainable comeback?
Belgian bank profitability since the crisis.

Roland Berger

50 YEARS navigating complexity

Management summary

We analyzed the performance of 13 Belgian banks since the crisis. For each bank, a balanced set of European peers was constructed to benchmark their performance. Peers were selected based on size, type of activities, type of ownership, level of internationalization and balance sheet structure.

Belgian banks have returned to profitability since the crisis, but their recovery should not be taken for granted. Threats on the revenue side will require concerted action in the coming years. Priorities on the CEO agenda will be a shift to fee business and controlling distribution costs, costs of innovation and costs of regulatory compliance.

Contents

Section 1:

Approach and summarized findings

Belgian banks have been quite successful in restoring profitability and now outperform their EU peers on ROE.

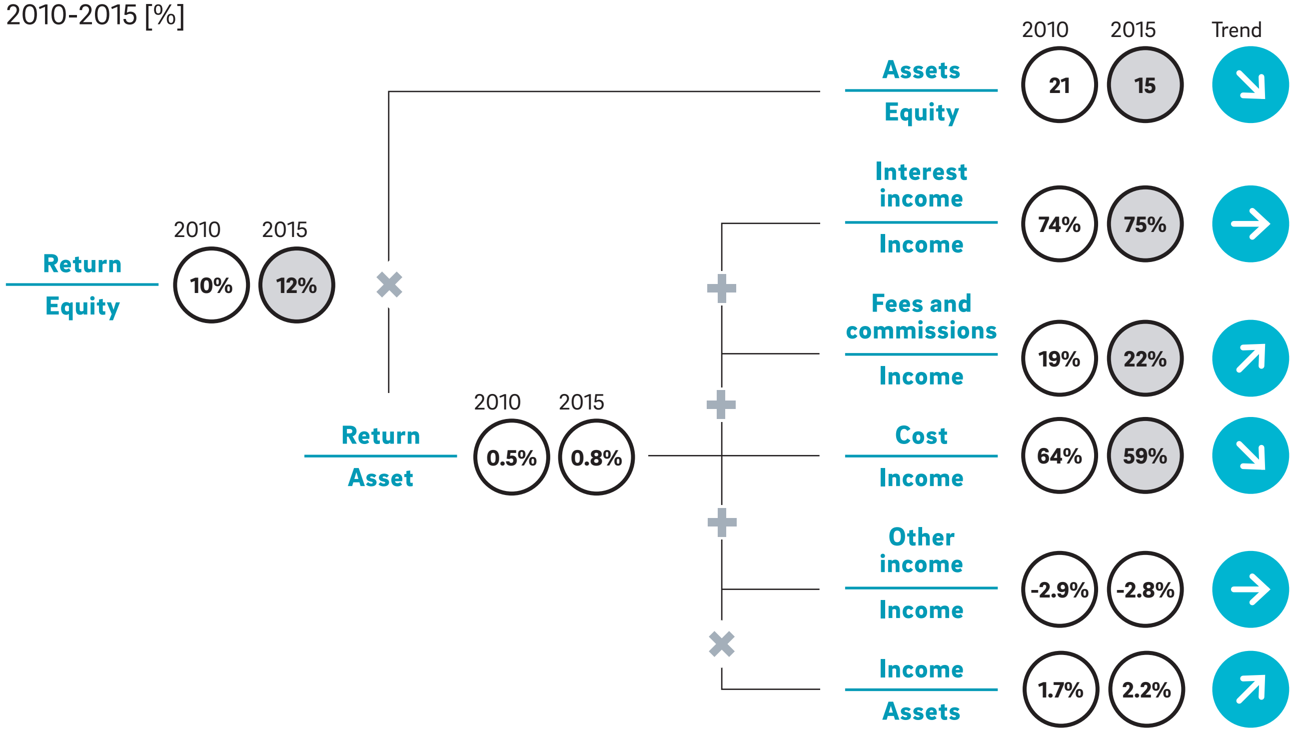
1. BLACK SWANS AND STORMY WEATHER

Between 2007 and 2011, the global banking landscape went through the greatest turmoil it had seen since the 1930s. Belgian banks were hit very hard, resulting in the bail-out of two of the country's largest banks and government recapitalization of several other financial institutions. In the wake of this crisis, Belgian banks were reporting severe drops in profitability, mainly related to losses in their asset portfolios, and leading to a negative or almost negative return on equity (ROE). Since then, restoring profitability has been a key priority for Belgian banks.

2. A REMARKABLE COMEBACK

Starting from an unfavorable position compared to other EU banks, Belgian banks have been quite successful in restoring profitability and now outperform their EU peers on ROE. As we can see across the three Belgian bank clusters[1] we analyzed (→ 1 Big universal banks, → 2 Locally anchored banks, → 3 Niche players), there has been strong performance with double-digit ROEs as of 2014/2015. Our DuPont analysis on the Belgian banking sector, which is dominated by Big universal banks, indicates that several factors come into play to explain this performance). → A

A: Belgian Bank performance – DuPont-analysis
2010-2015 [%]



Source: Roland Berger

1 For a zoom on the split in three clusters, see p. 13

Section 2:

Key findings in detail

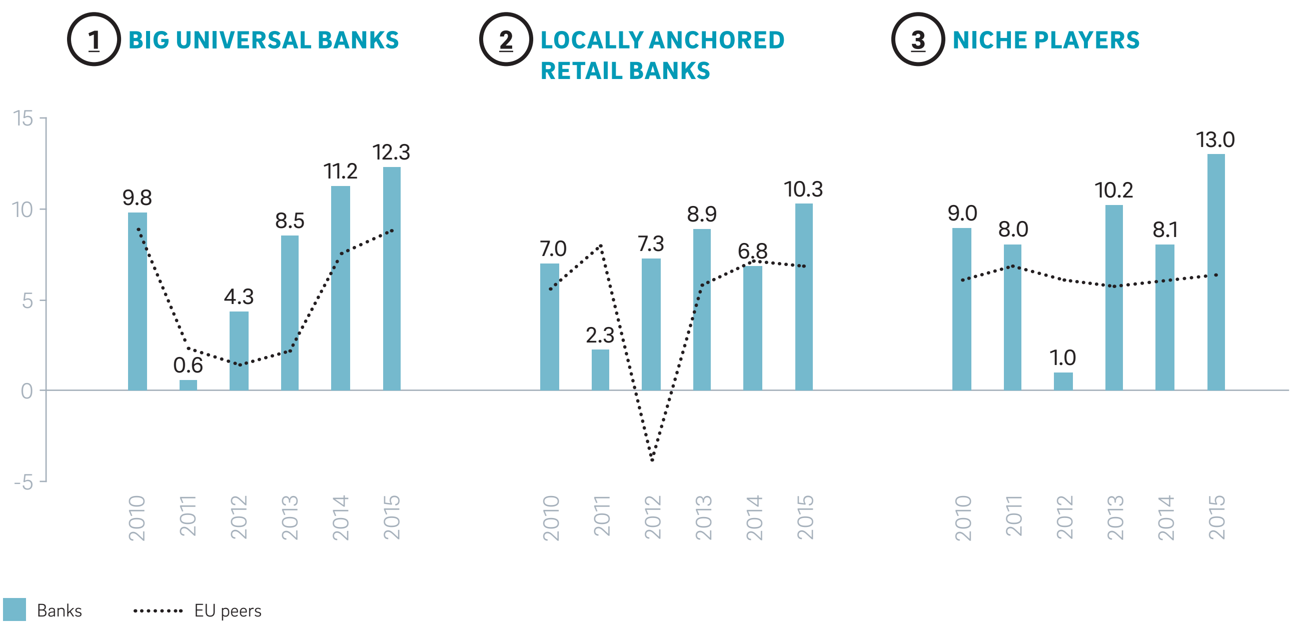
Factors that come into play to explain the strong performance of Belgian banks.

1. REVENUE

The major driver in restoring profitability has been an increase in revenues (both interest and non-interest income) and this has been seen across all clusters. First of all, Belgian banks have managed to keep their **interest margin** sufficiently high, as falling interest rates had a bigger impact on the average rate paid on funding (which is more short-term financed) than on the average rate earned on the asset portfolio (which is more longterm invested). In addition to this, banks initiated the shift to **fee-based business** (now good for 22% of income). It is apparent that especially big universal banks have made the shift to fee-based business (up by EUR ~890 m since 2010 for the whole cluster).

Looking forward, the question is, however, how sustainable the current level of interest income will be once market rates are rising again (or even stabilizing, as we're currently experiencing). While the average funding rate will stabilize, the average return on the loan portfolios will further decrease, resulting in a shrinking margin. This will put severe pressure on interest income (still by far the largest source of revenues, at 75% of income). → B

B: Profitability per bank cluster.
Return/Equity 2010-2015 [%].

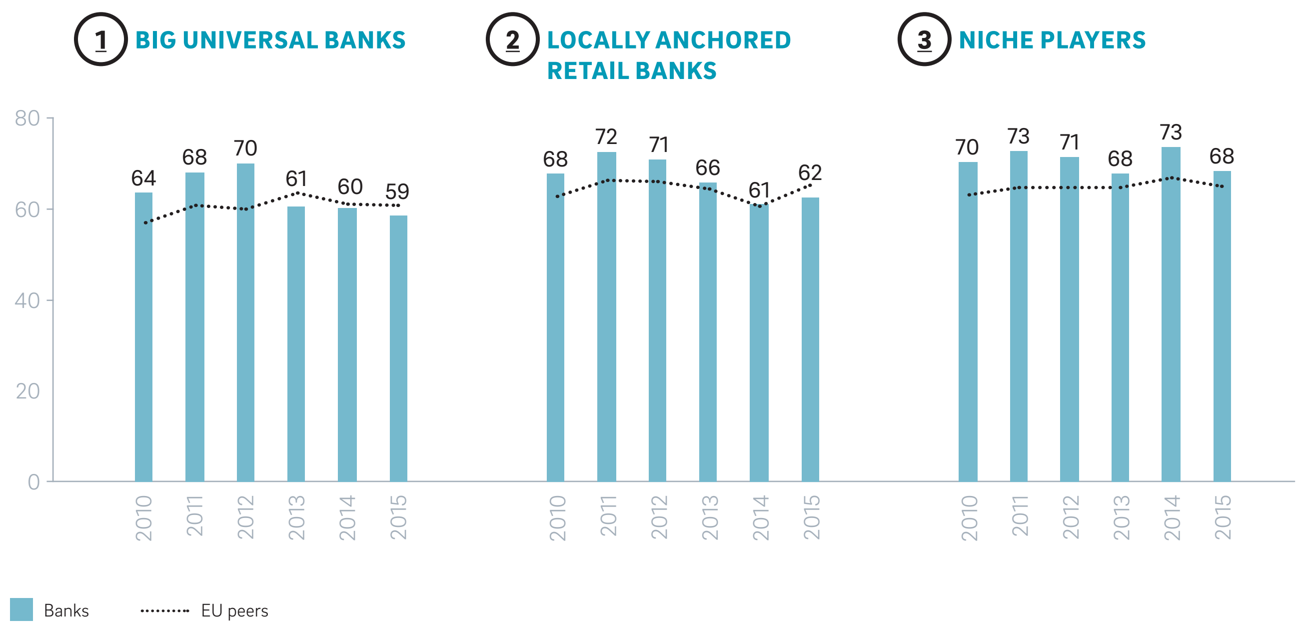


Source: Roland Berger

2. COST STRUCTURE

The cost-to-income ratio (CIR) of Belgian banks decreased by 5% pt. between 2010 and 2015, reflecting the increasing income but also the efforts made to control costs. The big universal banks, who have been working on rationalizing their distribution model and reducing overhead costs, performed very strong here (-5% pt. since 2010, good for a combined reduction by EUR ~275 m). Compared to their EU peers, whose CIR increased over the same period, their performance appears even more remarkable. Locally anchored retail banks have also exhibited an improvement in their CIR, but remain less cost competitive versus the big universal banks. Niche banks costs remained roughly stable, both in absolute terms and measured in CIR. → C

C: Cost structure – Peer group analysis
Cost/Income 2010-2015 [%].

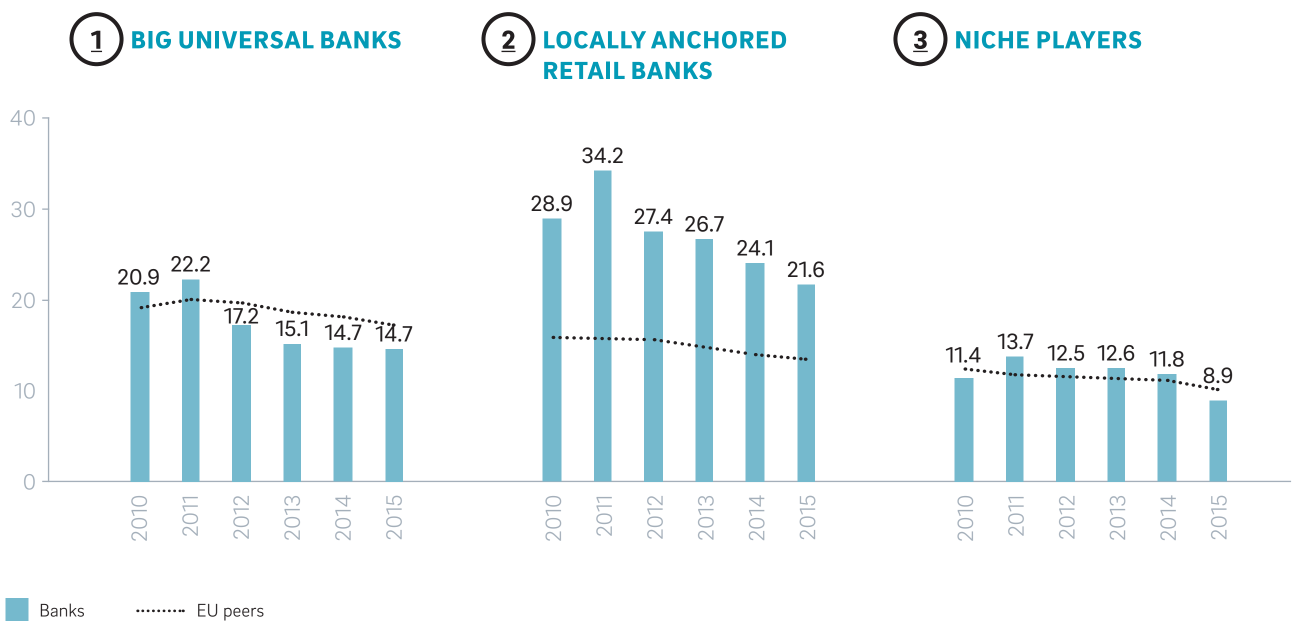


Source: Roland Berger

3. LEVERAGE

Given the higher regulatory pressure (mainly Basel III) and risk awareness present in the market, Belgian banks have been deleveraging their balance sheets in recent years: While big universal banks had assets equivalent to 21x their equity in 2010, the figure was down to 15x their equity in 2015. On a standalone basis, such deleveraging would normally decrease profitability but clearly the increase in revenues and reduction in costs have been strong enough to compensate for this effect. That said, the individual clusters perform very differently: While the big universal banks with a leverage of 15x in 2015 are roughly on a par with their peers, locally anchored retail banks have been reducing leverage on their balance sheets to "only" 22x in 2015, significantly above their peers, who are at 13x. If they were to deleverage further in the coming years, this would come at the expense of profitability or require additional efforts on the revenue or cost side. → D

D: Leverage per bank cluster
Assets/Equity 2010-2015 [%].



Source: Roland Berger

Section 3:

Priorities for 2017 and beyond

Strategies to generate more fee-based revenues will have to go beyond conventional paths.

PRIORITIES FOR 2017 AND BEYOND

Our analysis of the profitability drivers of Belgian banks in comparison to their EU peers shows that the current profitability levels should not be taken for granted, and helps to determine some clear priorities that should be high on the CEO agenda.

1. SHIFT TO FEE BUSINESS

An increase in fee-based revenues will be key for the following reasons: 1) It can compensate for the expected high pressure on interest income; 2) It further decreases the riskiness and volatility of revenues and of the overall banking model; 3) The relatively low level in Belgium compared to other European countries suggests that there is scope for increase.

Strategies to generate more fee-based revenues will, however, have to go beyond conventional paths, as simply increasing the price of banking services clearly comes with a first mover disadvantage. It might raise churn rates in an environment marked by increasingly price-conscious customers. Therefore, strategies to generate more fee-based revenues will require banks to rethink their existing offers to customers or look for alternative sources of revenues. We see some banks taking their first steps in this direction already, with new private banking offers or partnerships with non-financial firms among the options being launched.

2. COSTS, COSTS, COSTS

Although substantial efforts have been made, the difficulties on the interest income side will require ongoing discipline from big universal banks and strong efforts from locally anchored retail banks in the coming years. The challenge is threefold:

Be a cost champion in distribution – Currently, digitization is not (yet) generating meaningful savings, and in fact creates additional costs as a parallel distribution channel to the physical channel. However, with consumers increasingly shifting to digital channels, underinvesting in digital is not an option. Being able to offer a strong digital channel while keeping the combined distribution costs low will therefore be a key competency.

Be a cost champion in innovation – We are seeing innovation in areas like products, customer interface or business model speeding up and becoming a more important driver of business. In many banks, however, innovation is a time-consuming and costly activity, with big legacy IT systems, complex governance and a strict regulatory framework to contend with. The ability to innovate at low cost will therefore be a key competency for banks in the coming years.

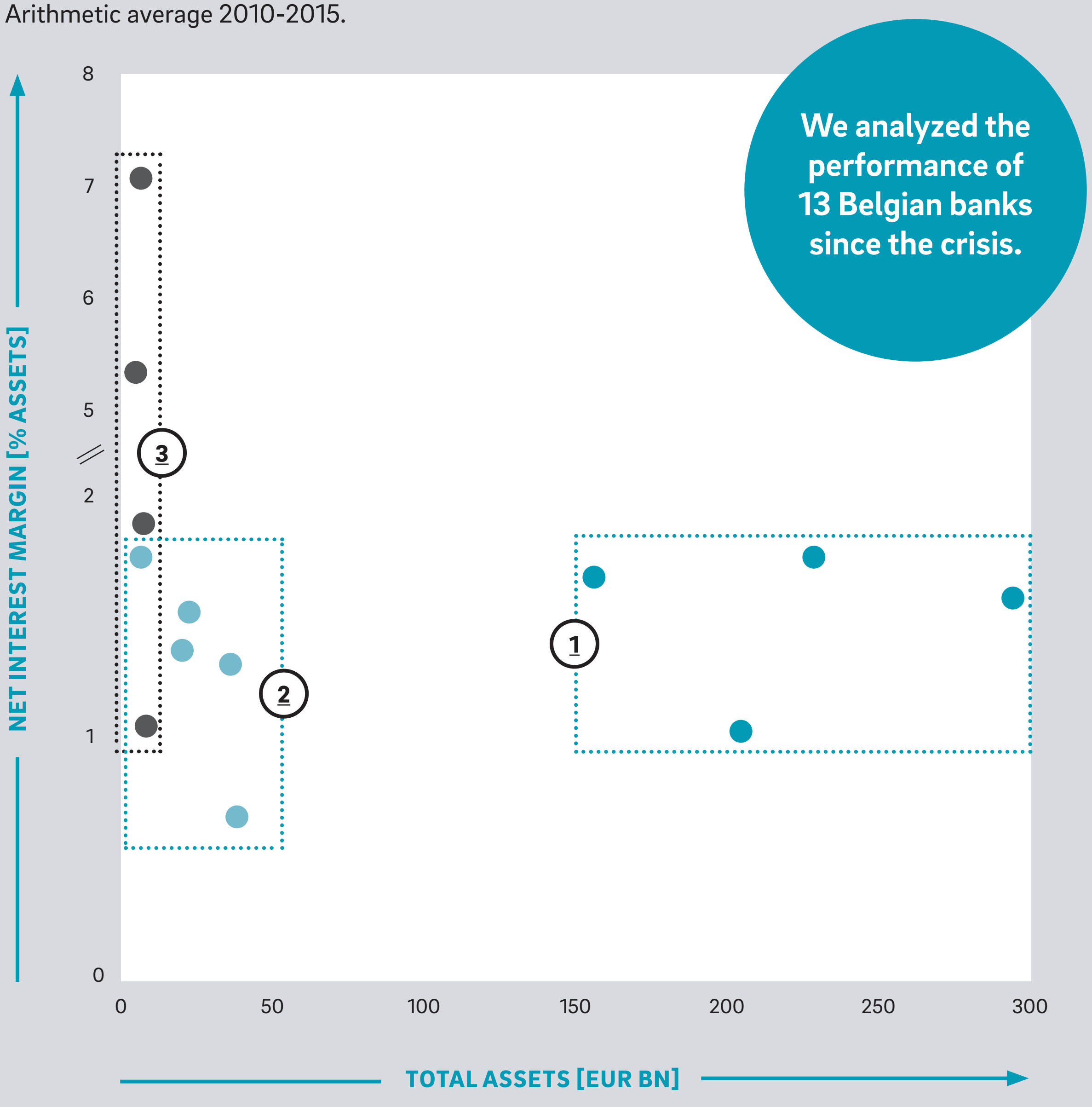
Be a cost champion in regulatory compliance – Over recent years, an increasing number of regulatory measures have been taken (including CRD/CRR IV, FATCA, EMIR) and additional costs are expected to arise in the coming months and years from MiFID II, PSD II and the General Data Protection Regulation, among others. Consequently, the cost of complying with regulatory changes has been significantly on the rise. Locally anchored retail banks and niche banks are even more concerned, given that there are substantial economies of scale related to many of the regulatory initiatives. In order to control these costs, some banks are pursuing an active agenda of increasing the effectiveness of regulatory implementation. It is clear that against the backdrop of the increasing regulation this could be an important competency.

About this study

For this study, we analyzed the performance of 13 Belgian banks between 2010 and 2015. For each bank, a balanced set of European peers was constructed to benchmark their performance. Peers were selected based on size, type of activities, type of ownership, level of internationalization and balance sheet structure.
In our analysis, we distinguish between three bank clusters to account for the differences in business model and exposure to macroeconomic developments.

	1 BIG UNIVERSAL BANKS	2 LOCALLY ANCHORED RETAIL BANKS	3 NICHE PLAYERS
DESCRIPTION	**Tier-1** banks with activities in **wide range of businesses** that traditionally have a dense distribution network	Banks with an **exclusive focus on retail** customers, served mostly through **independent agents** with high proximity to the clients	**Small banks** with activities in specific niches (e.g. private banking, consumer finance, liberal professions, …) that position themselves as **specialists**
BANKS INCLUDED	BNP Paribas Belfius Bank ING KBC Group	Argenta AXA Crelan Record Bank VDK Spaarbank	Bank J.Van Breda & C° Beobank Delta Lloyd Europabank

Bank clusters
Arithmetic average 2010-2015.



Source: Roland Berger

Imprint

WE WELCOME YOUR QUESTIONS, COMMENTS AND SUGGESTIONS

AUTHORS

Grégoire Tondreau
Managing Partner
+32 478 979725
gregoire.tondreau@rolandberger.com

Stephan Janssens
Partner
+32 470 213 660
stephan.janssens@rolandberger.com

Frederick Van Gysegem, PhD
Project Manager
+32 476 44 63 74
frederick.vangysegem@rolandberger.com

CONTRIBUTORS

The authors would like to thank **Cédric Faché**, **Adeline Burms** and **Laura Smets** for their valuable contribution to this study.

About us

Roland Berger, founded in 1967, is the only leading global consultancy of German heritage and European origin. With 2,400 employees working from 34 countries, we have successful operations in all major international markets. Our 50 offices are located in the key global business hubs. The consultancy is an independent partnership owned exclusively by 220 Partners.

For half a century, Roland Berger has helped its clients manage change. Looking at the next 50 years, we are committed to supporting our clients conquer the next frontier. To us, this means navigating the complexities that define our times. We help our clients draft and implement responsive strategies essential to success that lasts.

Publisher

ROLAND BERGER
Vorstlaan | boulevard du Souverain 100
B-1170 Brussels | Belgium
+32 2 661 03 13