



EUROPEAN RETAIL BANKING

AN OPPORTUNITY FOR A

# RENAISSANCE

# INTRODUCTION

The challenges facing the European banking sector as a whole are significant. The issues of regulatory intensity, cost excesses, and troubled assets are serious. And the required restructuring path for the industry remains a complex one.

In this context the underlying profitability of many European retail and small business banking markets looks surprisingly solid. The UK, Swedish, French, and Swiss markets are all generating over 15% RoE. The German market is also generating double-digit RoE. In Southern European economies, returns are lower - both the Spanish and Italian markets both posted single-digit RoEs - yet given the macroeconomic situation, these results also can be seen as something of a success. And in some of the larger markets outside the EU (e.g. Turkey, Russia), RoEs are also strong, driven by a mix of stronger growth, wider margins, and in some cases notable innovations in distribution and customer management.

Looking forward, there are observable pressures on this profitability picture. Regulation is likely to simultaneously increase capital requirements and erode the revenue base through consumer protection and bank conduct interventions. Further macroeconomic challenges could easily result in more credit loss damage, particularly in parts of southern Europe. New competition is emerging, particularly in the cards and payments space, which may drive down returns through lower pricing or disintermediation of traditional retail banks.

However, we believe that many retail banks now have the potential to deliver powerful improvements in the performance of their own operating models that can offset the above pressures. The benefits from using digital channels more broadly, reshaping branch networks, adjusting customer propositions in small business and affluent segments, and making real changes in conduct and customer-centricity have yet to be fully realised. The sector as a whole may also realise further financial benefits from future interest rate rises. And after many years of seeing less attention, and less investment, than their corporate and investment banking counterparts, retail banking management teams are now seeing this reversed. In short, we believe the stage is set for an unprecedented phase of dynamism in retail banking.

This report provides an overview of the underlying economics in the largest European retail banking markets today, our views on likely future trends, and the agenda for retail bank management teams.

The report is structured as follows:

- 1. Current profit dynamics:** a country-level review of revenue, cost, risk, and RoE
- 2. Market trends:** a review of the thematic trends in European retail banking and their application in individual countries
- 3. Suggested agenda for retail bank management:** a proposed to-do list in the light of the above

# 1. CURRENT PROFIT DYNAMICS

## 1.1 MARKET DEFINITION AND REVENUE GENERATION

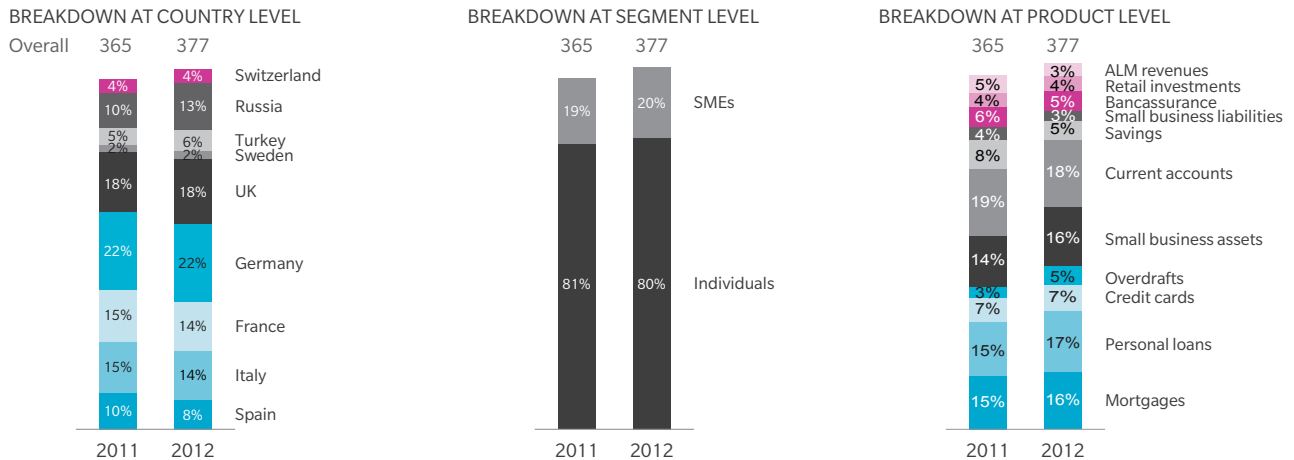
This report uses a broad definition of European retail and small business banking:

- **Customers:** including both individuals and small businesses (less than €25 MM turnover companies), excluding private banking
- **Products:** core banking products (current accounts, mortgages, loans, savings and cards), bancassurance and investment products

**Countries:** focus on the largest European markets: namely Spain, Italy, France, Germany, UK, Sweden, Turkey, Russia and Switzerland

More detailed definitions are given at the end of this document. This market represents a 2012 revenue pool of ~€380 BN – the breakdown of this is shown in Exhibit 1.

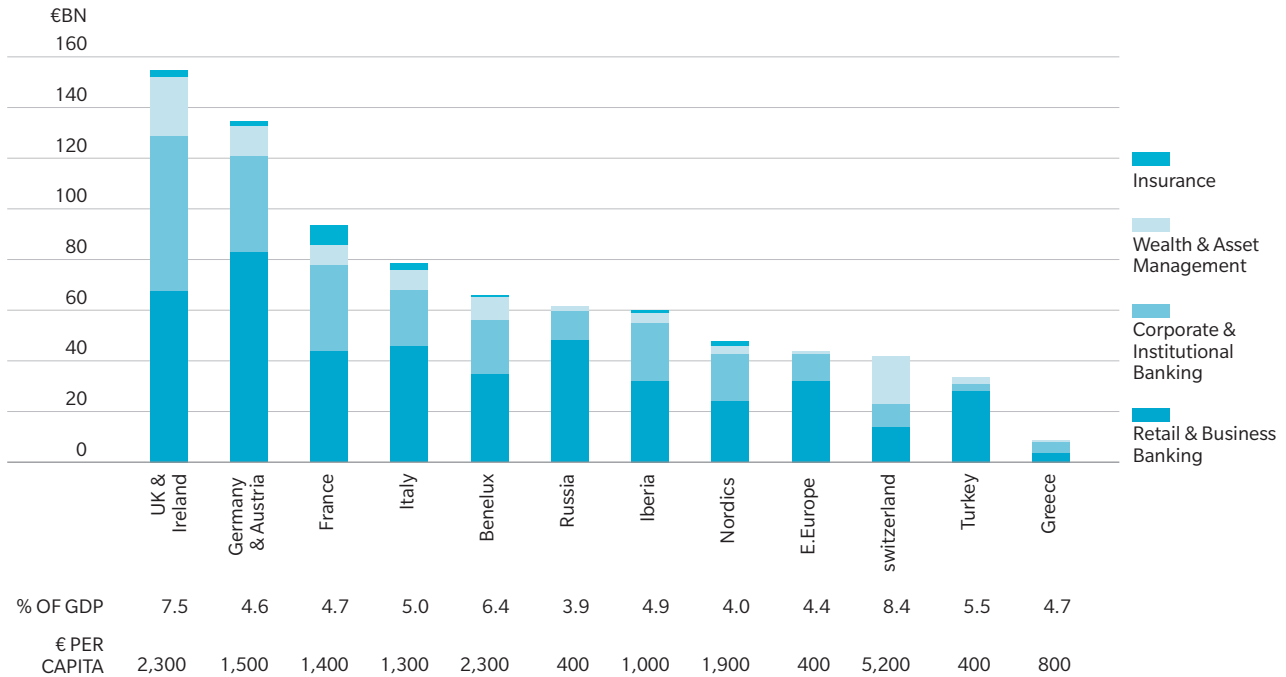
### EXHIBIT 1: EUROPEAN RETAIL BANKING REVENUES €BN, 2011 – 2012



The above represents the single largest segment of the European banking market as a whole – over 50%

of overall aggregate banking revenues across the countries analysed.

EXHIBIT 2: BANK REVENUE BY SEGMENT AND REGION, 2012, €BN

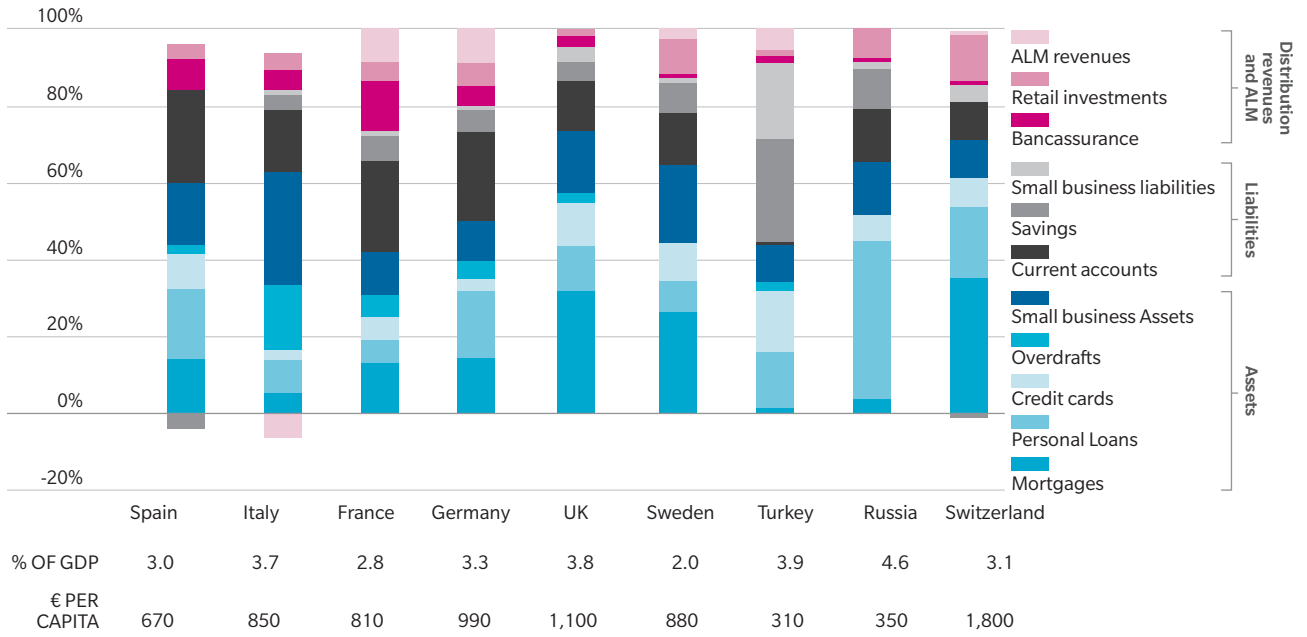


Note: Definition of the Retail & Business Banking segment in the European Banking report excludes a proportion of HNWI distribution revenues and retail investments distribution revenues allocated to the asset management segment and bancassurance revenues accounted for in Insurance.  
 Source: Oliver Wyman European Banking Report (October 2013), International Monetary Fund (IMF), Eurostat, Central Intelligence Agency (CIA) fact book

The product revenue mix differs significantly at the country level. Several markets can be defined as asset-driven: the UK, Sweden, Russia and Switzerland all fit into this category, with the retail banking revenue pool led by contributions from mortgages, personal loans, cards and small-business lending. Others are driven more by liability and investment products. In Spain,

France, Germany and Italy revenues are skewed more towards current accounts, deposits, bancassurance and retail investment products. ALM margin (defined here as the value generated by duration mismatch between assets and liabilities) is generally small and has a contribution which ranges from -10% to +10%.

EXHIBIT 3: REVENUE MIX PER COUNTRY, 2012



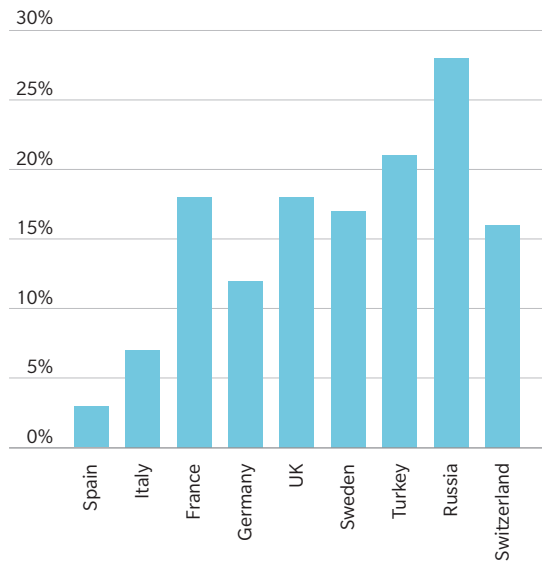
## 1.2 MARKET PROFITABILITY

Across the markets profiled underlying RoE is solid at 14%, albeit slightly down from 2011, confirming a

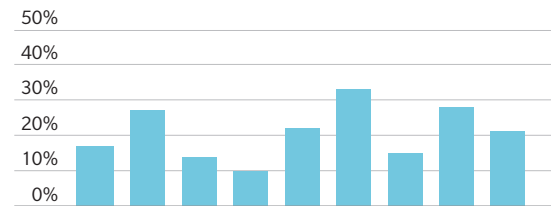
surprising state of health. This naturally differs strongly at the country level, as shown in Exhibit 4.

EXHIBIT 4: ROE, POST TAX %, 2012

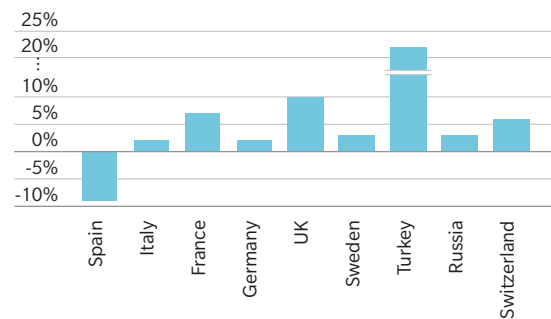
### BY COUNTRY



### INDIVIDUALS



### SMALL BUSINESS



Note: RoEs normalised with capital calculated as a percentage of RWAs, represented by the average of the Top 5 banks Core Tier 1 ratio in each country. RoE figures include regulatory provisions whose 2012 increase has varied significantly across European countries. ALM margin has been included in the total RoE calculation but not at segment level. UK figures excluding PPI redress.

Four sets of profit dynamics can be observed at the country level:

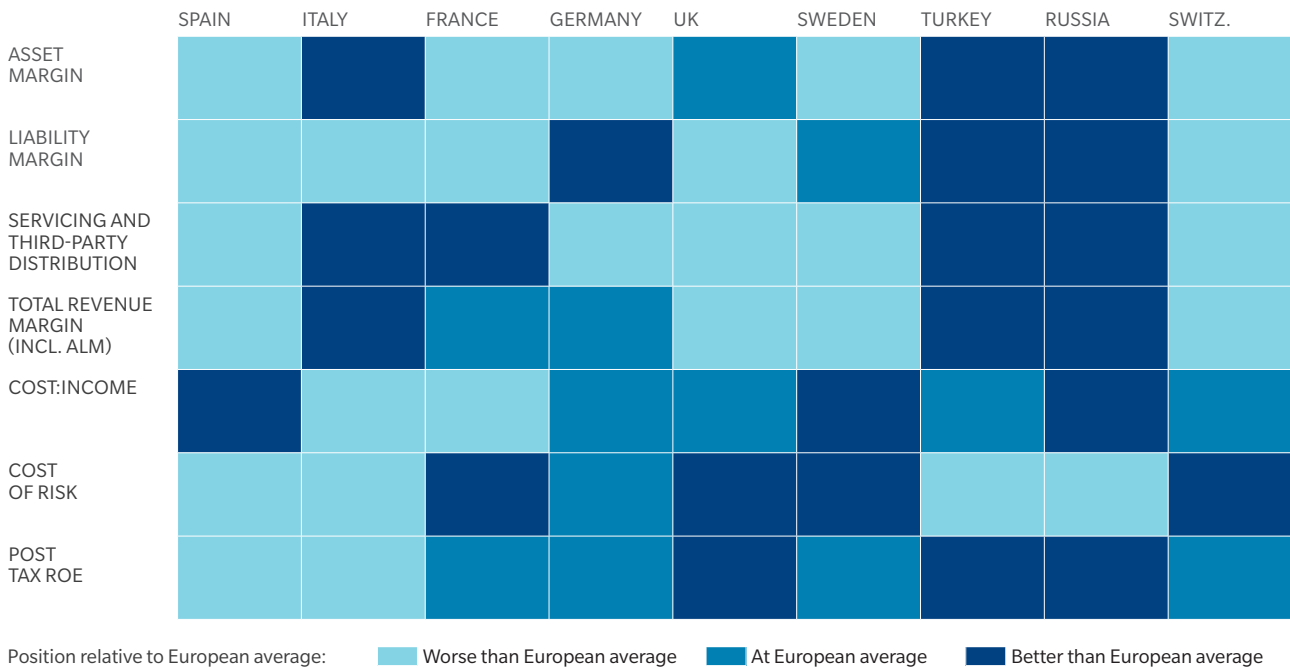
- **UK and Sweden:** asset-driven revenue streams, smart pricing, leaner physical distribution, emerging multichannel capabilities, lighter macro crisis and therefore lower NPL impact. High RoE
- **Spain and Italy:** revenue streams more driven from the liability-side, heavier physical distribution, many banks lagging in multichannel capabilities, heavier macro-economic crisis, higher NPL impact. Low RoE

- **Germany and France:** liability-driven revenue streams, heavier physical distribution; but NPL issues naturally less pressing. Medium RoE
- **Turkey and Russia:** following more of the Sweden/UK pattern (retail asset-driven, leaner physical distribution, direct channels) but in the context of very different macro-economic climates

The drivers of profitability shows that many of the differences in RoE dynamics, such as Non-Performing Loan (NPL) rates, asset margins, liability margins, cost/revenue ratios vary considerably across countries.



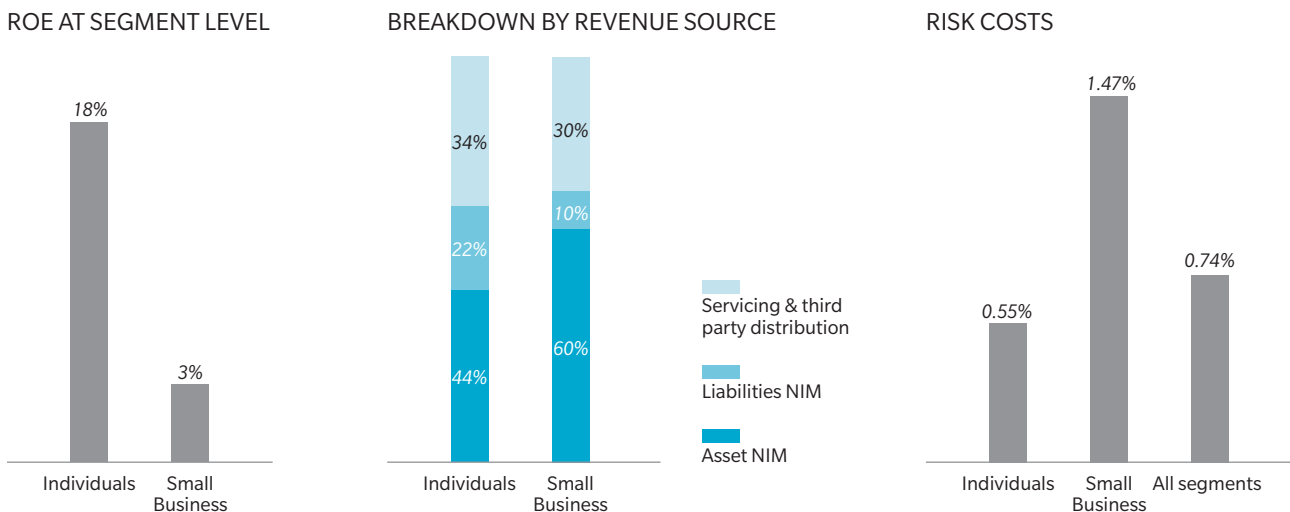
EXHIBIT 5: PROFIT DYNAMICS BY COUNTRY



There are notable differences in profitability between the retail and small business banking markets. Small business banking markets in general have weaker profit margins. Compared to retail banking markets, small business banking markets suffer from

higher impairment rates (and lower levels of loan collateralisation) and often less clean operating models and organisation on the supply-side. They also tend to have less management science around pricing, customer selection/prioritisation and marketing.

EXHIBIT 6: THERE ARE ALSO NOTABLE DIFFERENCES BETWEEN RETAIL AND SMALL BUSINESS PROFITABILITY



Note: ALM margin has not been allocated at segment level.

## 2. MARKET TRENDS

The profitability of European retail banks over the next five to 10 years will be heavily influenced by the way they respond to five major developments.

The first is **regulation**, an unavoidable consideration in all parts of the banking market. In retail and small business banking, regulation creates a mix of pressures: increasing capital, structural changes (e.g. ringfencing, price caps) and erosion of the revenue base through consumer protection and conduct interventions. The last point is most progressed in the UK, but is increasingly a consideration across other European economies.

The second is **NPL management**. The continued workout and resolution of retail NPLs in the most stressed economies will be the single biggest driver of profitability. And even in some of the healthier European economies, there is a growing collections and NPL management challenge to be met.

The third is adjustments to **customer sales and servicing** models. New digital technologies and changing consumer behaviours are providing banks

with an opportunity to generate benefits for all stakeholders simultaneously – lower costs and higher profits for the banks, happier customers, a more secure infrastructure model and satisfied governments and regulators.

The fourth is **new forms of competition**. Even as retail banks evolve to capture the benefits of changes in technology and customer behaviour, others are plotting a revolution. Some of these new competitors remain small in scale compared to the large incumbent banks, but others can match and exceed banks in terms of customer base, brand value and satisfaction.

The fifth is the possible medium term **change in the macroeconomic cycle**. Upward movements in interest rates tend to benefit the retail and business banking sector, as the proceeds of rate gains are shared between customers and the banks. If and when interest rate movements occur, realising these benefits – at levels and through methods acceptable to regulators and customers – will be a major driver of industry profitability.



## 2.1 REGULATION

Today, European retail banks face a wide range of regulatory and government pressures.

### EXHIBIT 7: REGULATORY PRESSURES ON RETAIL BANKING

CATEGORY	REGULATION	ELEMENTS
BASEL 3	<b>Capital</b>	<ul style="list-style-type: none"> <li>Improve quality of tier 1 capital, reduce leverage</li> <li>Improve counterparty credit risk requirements</li> </ul>
	<b>Liquidity</b>	<ul style="list-style-type: none"> <li>Leverage ratio</li> <li>Liquidity coverage ratio</li> <li>Net Stable Funding Ratio</li> </ul>
CONSUMER PROTECTION	<b>Conduct risk</b>	<ul style="list-style-type: none"> <li>Implementation of Treating Customers Fairly and Know Your Customer (KYC) principles or equivalents</li> <li>Reporting/focus on handling of customer complaints</li> <li>Division of fees between sales and advisory for investment products (e.g. Retail Distribution Review (RDR) in UK)</li> <li>Reforms of Mortgage lending/borrowing, distribution and disclosure (e.g. MMR in UK)</li> </ul>
	<b>Consumer credit</b>	<ul style="list-style-type: none"> <li>EU Consumer Credit Directive has laid out principles on transparency, creditworthiness, right of withdrawal and early repayment</li> </ul>
	<b>Deposit insurance</b>	<ul style="list-style-type: none"> <li>Revision of deposit insurance limits, coverage and increase in awareness post-crises</li> </ul>
	<b>Debt management</b>	<ul style="list-style-type: none"> <li>Regulatory initiatives that impact ability to collect consumer debt e.g. limitations on time to recover, data protection</li> </ul>
	<b>Retail investment products</b>	<ul style="list-style-type: none"> <li>Consistent and effective standards for investor protection, ensuring a level-playing field for distributors &amp; providers</li> <li>“Packaged Retail Investment Products” (PRIPs) definition in Europe covers a wide range of products</li> </ul>
REGULATORY INTERVENTION	<b>Provisions/arrears/losses</b>	<ul style="list-style-type: none"> <li>Stressed markets have already undertaken detailed tests around provisions, arrears and losses</li> </ul>
	<b>Authorisation</b>	<ul style="list-style-type: none"> <li>Regulators have tightened criteria around approval of deposit-taking banking licenses</li> <li>Impacts cross-border deposit-taking opportunities</li> </ul>
	<b>Compensation</b>	<ul style="list-style-type: none"> <li>Compensation regulation on deferrals, clawback, and instruments for payment e.g. G20, (FSB)</li> </ul>
	<b>Supervisory approach</b>	<ul style="list-style-type: none"> <li>Increased regulator scrutiny and intervention post-crises</li> <li>Increased disclosure requirements following financial crises</li> </ul>
STRUCTURAL REFORM	<b>Competition</b>	<ul style="list-style-type: none"> <li>Regulation to increase competition e.g. ease of current account switching in UK</li> <li>EU competition commission have ruled on state aid, requiring divestments</li> </ul>
	<b>Ring-fencing</b>	<ul style="list-style-type: none"> <li>Proposals for separation of retail and corporate/investment bank activities</li> </ul>
REDUCING SYSTEMIC RISK	<b>Supervisory oversight</b>	<ul style="list-style-type: none"> <li>Create Financial Stability Oversight Council in US; access to financial data through new Office of Financial Research, ability to demand higher prudential requirements</li> <li>Create European Systemic Risk Board in EU; identify risks, issue warnings via national regulators</li> </ul>
	<b>G-SIFIs</b>	<ul style="list-style-type: none"> <li>Institutions with global systemic importance (G-SIFIs) to have additional capital requirements</li> </ul>
	<b>Living wills</b>	<ul style="list-style-type: none"> <li>Create resolution and recovery plans; ringfence certain businesses</li> <li>UK, US propose Living Wills arrangements, France, Germany &amp; Switzerland considering</li> </ul>

Within this overall regulatory landscape, we highlight increased regulatory scrutiny on consumer protection issues as a major consideration for the business. And beyond the regulatory requirements, adjustments to historical practices within banks are needed in order to maintain the confidence and trust of customers. This issue is most pronounced in the UK, with “conduct” the number one issue for most retail banks, and for the newly created Financial Conduct Authority. But the issue is also growing in importance in almost all other EU countries.

## EXHIBIT 8: CONDUCT AND CONSUMER PROTECTION ISSUES

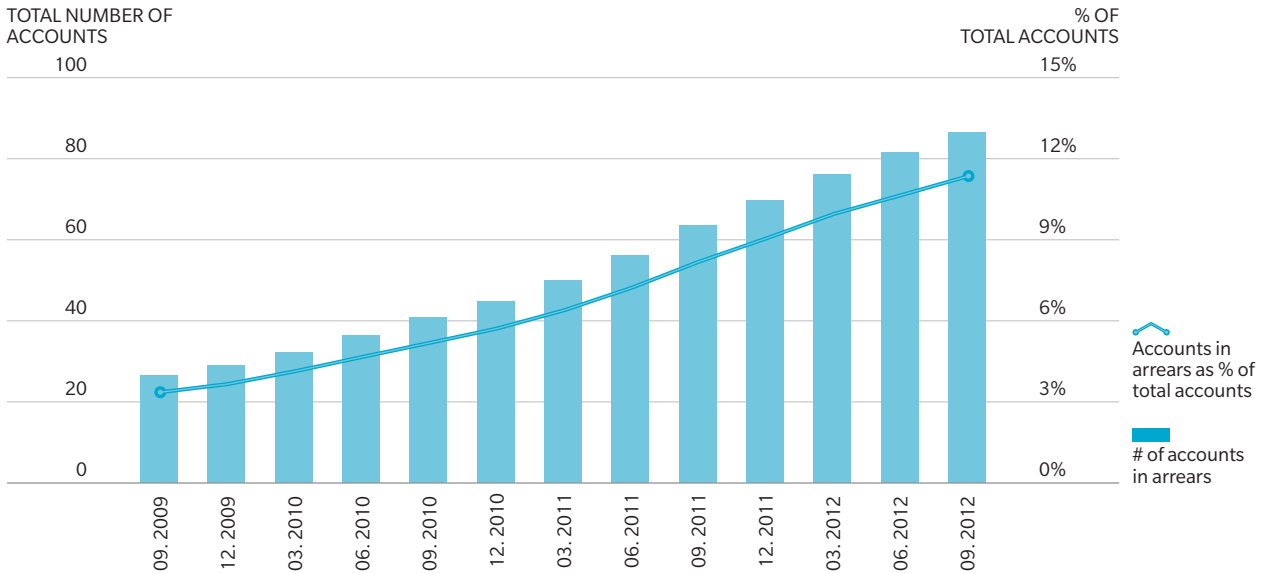
AREA	LIKELY IMPACTS	EXAMPLES
PRODUCT	<ul style="list-style-type: none"> <li>• Migration to simpler, more standardised product offering</li> <li>• Increased transparency of pricing to allow comparison across banks</li> <li>• Application of pricing caps</li> <li>• Safeguards for capital at risk products</li> <li>• Rebalancing of pricing to reduce skews between customers (e.g. front vs. back book)</li> </ul>	<ul style="list-style-type: none"> <li>• Loi Chatel and “Pauget-Constans” rapport (France)</li> <li>• PattiChiari – transparency pact (Italy)</li> <li>• Trasparenza bancaria (Italy)</li> <li>• Sergeant Review of Simple Financial Products (UK)</li> </ul>
DISTRIBUTION	<ul style="list-style-type: none"> <li>• Split of fees for financial planning products between advice and execution</li> <li>• Removal of broker conflicts of interest (e.g. limitations on commissions charges)</li> <li>• Tightened rules on financial advertising</li> <li>• Limitations on sales incentives schemes</li> <li>• Improved monitoring and governance</li> </ul>	<ul style="list-style-type: none"> <li>• Retail Distribution Review (UK)</li> <li>• Implementation of EU Consumer Credit Directive (Germany)</li> <li>• “Delmas-Marsalat” rapport (France)</li> <li>• Amendments to legislation (Germany)</li> <li>• FSA incentives review (UK)</li> </ul>
CONSUMER CREDIT	<ul style="list-style-type: none"> <li>• Additional restrictions on providing consumer credit <ul style="list-style-type: none"> <li>– Stricter creditworthiness assessment (in particular around evidencing affordability)</li> <li>– Raising qualification requirements for intermediaries</li> <li>– Minimum capital requirements for specialist lenders</li> </ul> </li> <li>• Incentives for small business lending</li> <li>• Cap on rate rises or penalties due to payment delinquency/early repayment</li> </ul>	<ul style="list-style-type: none"> <li>• EU Consumer Credit Directive (EU, France, Italy)</li> <li>• Loi Lagarde (France)</li> <li>• Loi Brunel (France)</li> <li>• Consumer Credit Act (UK)</li> <li>• Consumer Credit Act Review (UK)</li> </ul>
DEBT MANAGEMENT	<ul style="list-style-type: none"> <li>• Introduction of new generation of forbearance measures</li> <li>• Partial debt forgiveness for those with unaffordable debt burdens</li> <li>• Re-writing of rules governing relative priority of different forms of debt (e.g. mortgage vs. unsecured)</li> </ul>	<ul style="list-style-type: none"> <li>• Loi Lagarde (France)</li> <li>• Personal Insolvency Bill (Ireland)</li> <li>• MARP programme (Ireland)</li> <li>• Risk limitation act (Germany)</li> <li>• Debt management acts (Italy, Spain)</li> <li>• Consumer Credit act (Switzerland)</li> </ul>
DEPOSIT PROTECTION	<ul style="list-style-type: none"> <li>• Higher requirements for acquiring banking license – reduced market competition</li> <li>• Increased moral hazard: higher deposit guarantee to lower banks’ cost of funding</li> <li>• Increased public “firepower” to be used in a stabilisation and/or resolution process</li> <li>• Increased barriers to cross-border business</li> </ul>	<ul style="list-style-type: none"> <li>• Deposit Guarantee scheme review (France, Germany, Switzerland, EC)</li> <li>• Sector-specific deposit guarantee schemes (Germany)</li> <li>• Bank levies/liability tax (Germany, Sweden)</li> <li>• Retail bank ring-fencing (UK)</li> </ul>

## 2.2 NPL MANAGEMENT

In stressed economies, NPL levels will remain the single largest driver of profitability not just of retail banking, but of the entire banking sector over the next few years. Over and above the natural impacts of the

macroeconomic health of any individual country, we observe significant differences in the effectiveness of NPL practices across banks.

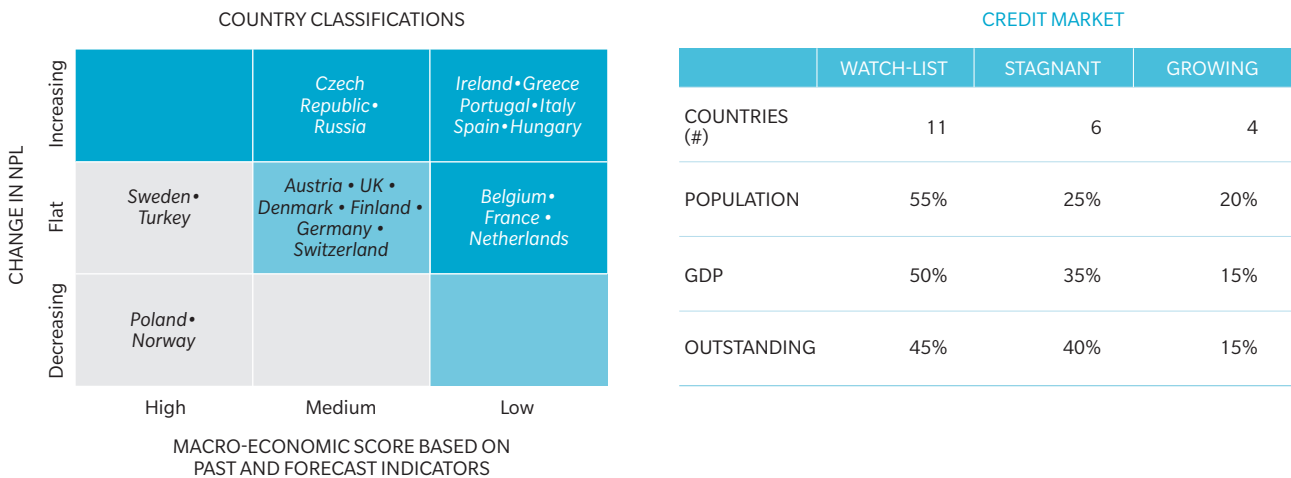
## EXHIBIT 9: CASE STUDY ON RETAIL NPLS: RISING IRISH MORTGAGE 90+ ARREARS, VOLUME AND RATIO



Source: Central Bank of Ireland

Classifying countries into three distinct segments captures the degree of differentiation that exists within the European retail credit market.

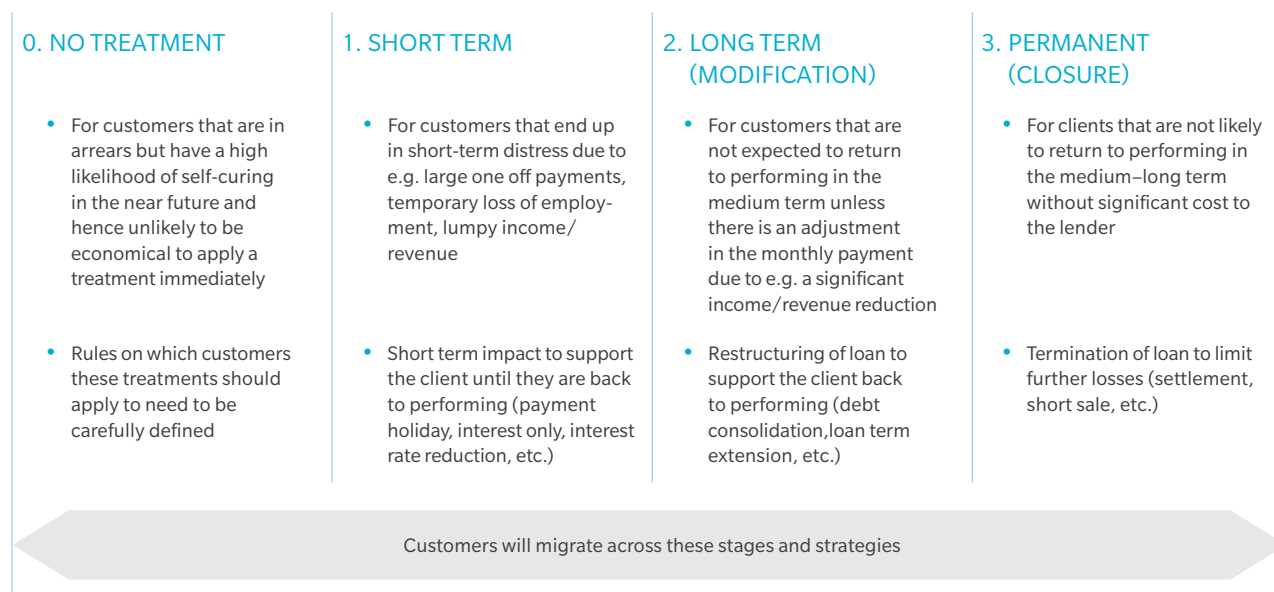
## EXHIBIT 10: DIFFERENCES IN EUROPEAN RETAIL QUALITY



Source: Oliver Wyman Retail Credit Survey (June 2013), NPL data taken from ECB 2011 data, except for CZR, Ireland, and Russia which are taken from Central Banks, Oxford economics, Oliver Wyman analysis

Formulating and executing realistic resolution strategies will be essential to working through these issues, not just in the most stressed parts of the continent, but also elsewhere (e.g. UK interest-only mortgage workouts).

## EXHIBIT 11: EXAMPLES OF RESOLUTION STRATEGIES ACROSS ARREARS STAGE IN THE MOST STRESSED MARKETS

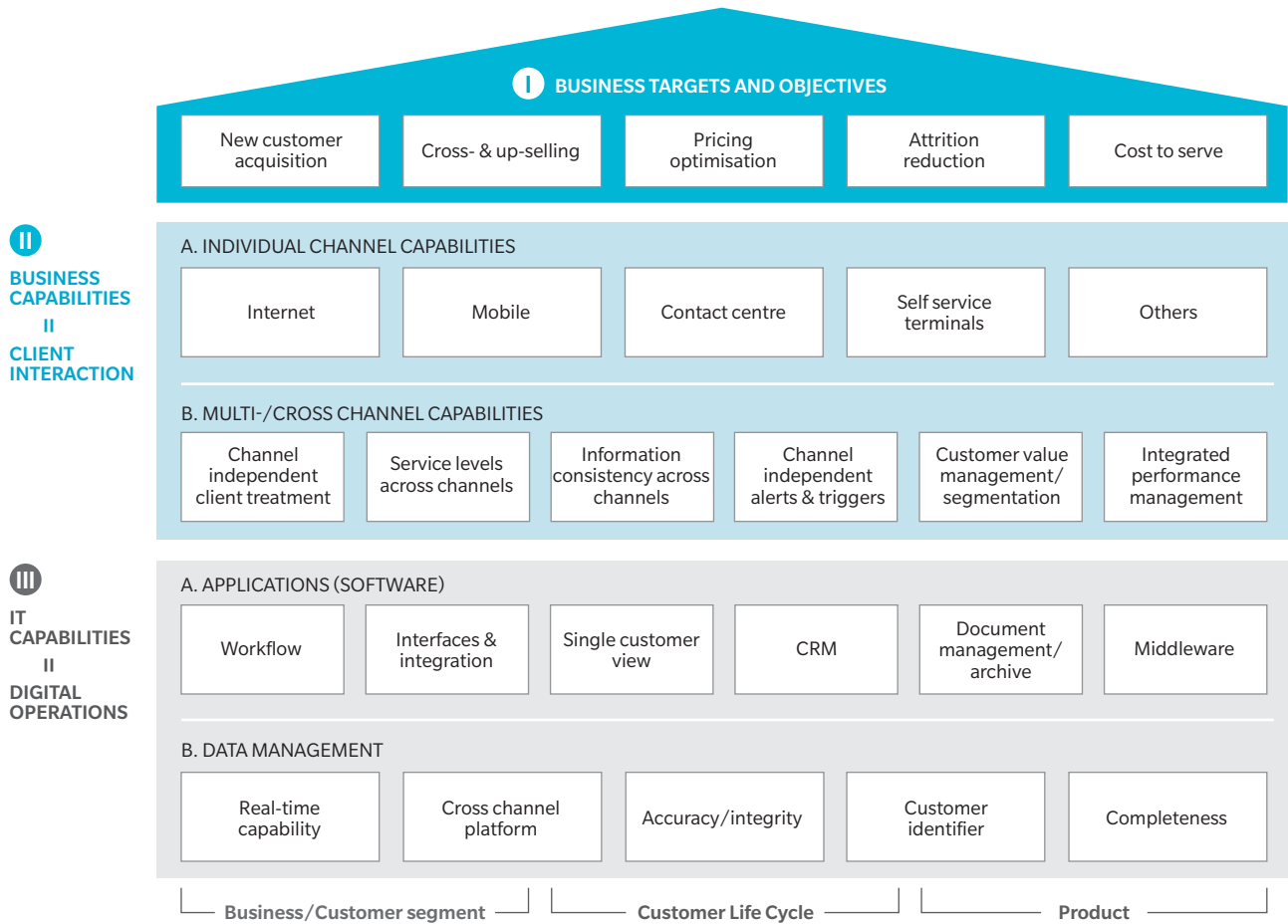


## 2.3 ADJUSTING UNDERLYING CUSTOMER SALES AND SERVICING MODELS

The industry needs to deliver wholesale change in this area. Starting with the customer, propositions and promises need to be tightened, channels rationalised and consequent investments in infrastructure made. And the value of customer information needs to be clarified and appropriately monetised.

This will require an understanding and prioritisation of change across a broad front within retail banks. To date, most banks have failed to recognise the scale of change required, and simultaneously failed to apply sufficient economic discipline in prioritising the suite of digital investments that have been made.

EXHIBIT 12: A TAXONOMY FOR DIGITAL INVESTMENTS

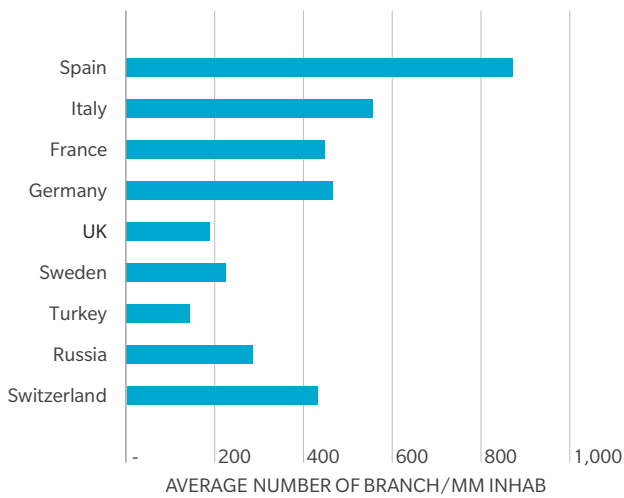


Experience from the last wave of technology-led innovation suggests that, if badly managed, the result could easily be poor if new service offerings and channels are simply layered on top of old ones, if existing channels and infrastructure are not rationalised and if legacy operating models are not addressed.

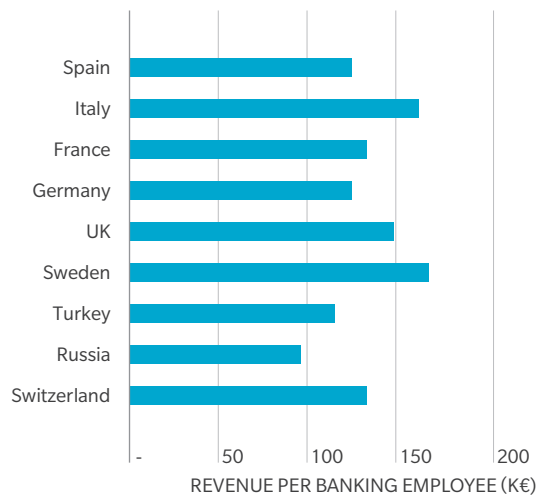
On this point, the role of the branch will be a major debate in all European banking markets over the next cycle. Though branch density and usage patterns differ significantly across countries, almost all face pressures to evolve away from the current position in the direction of fewer, more customer friendly and more efficient branches.

## EXHIBIT 13: BRANCH DENSITY

NUMBER OF BRANCHES PER MM INHABITANTS



RETAIL BANKING REVENUES PER BANKING EMPLOYEE



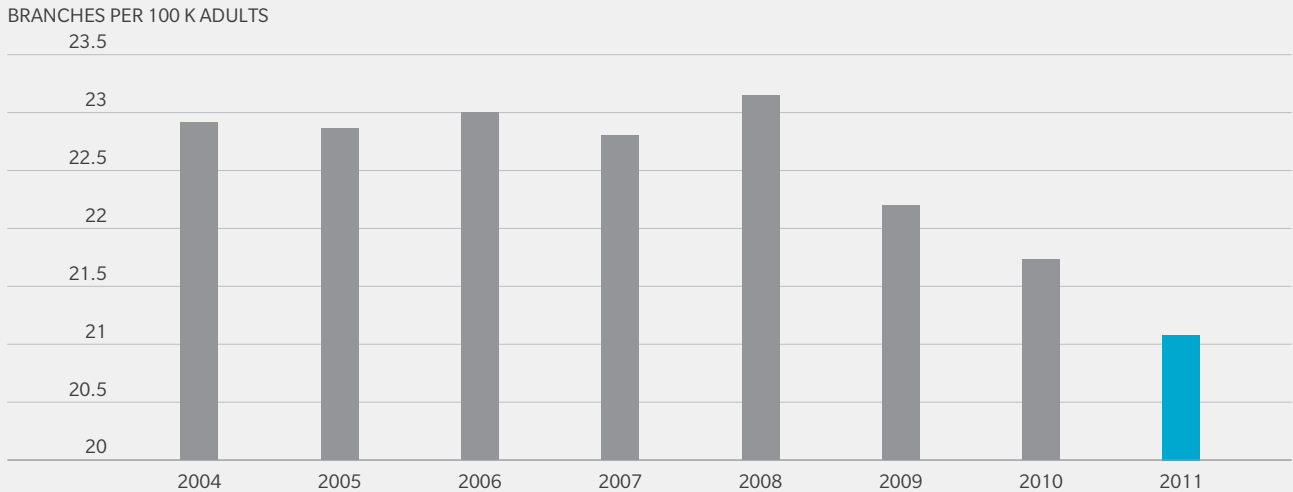
Source: ECB 2011

Customer propositions are in need of attention in some areas of retail banking, most notably in the small business and affluent segments. The small business segment remains a low-profit part of the overall business, in most countries facing the challenges of bloated costs in sales and servicing, growing

government pressure around lending levels and often poor levels of product innovation. The affluent segment remains poorly defined and poorly served at many banks, with many showing an inability to provide meaningful and cost-effective services or product access beyond that offered in the mass market.

# CASE STUDY: SWEDISH BRANCH TRANSFORMATION

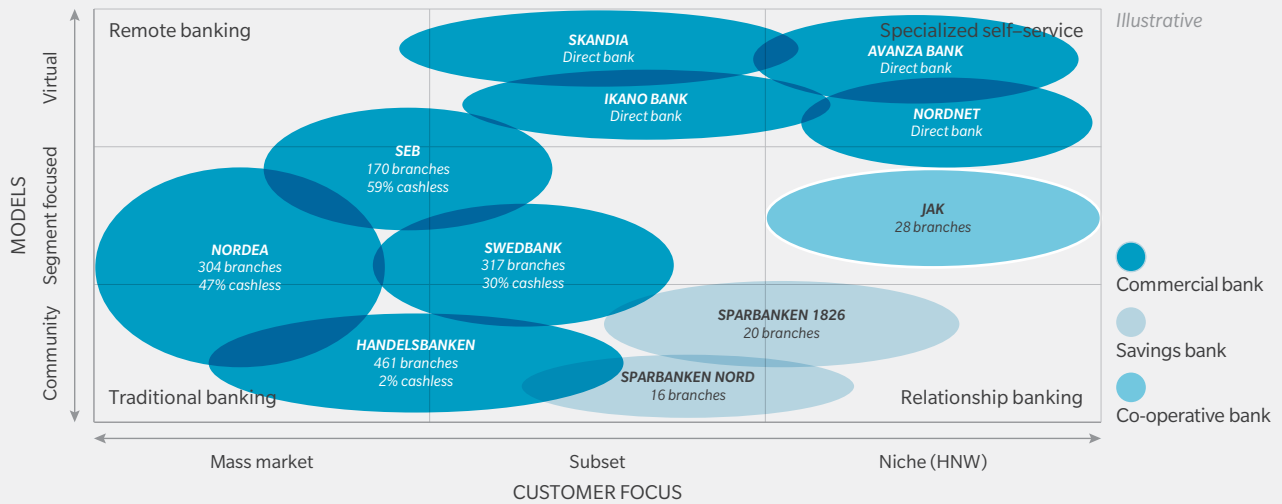
## EXHIBIT 14: SWEDISH BRANCH NETWORKS CONTRACTED MATERIALLY FROM 2008



Source: Swedish Bankers' Association, 2012 American Bankers Association Guide, FDIC, OECD, IMF FAS 2012

## EXHIBIT 15: YET TRANSFORMATION DOES NOT MEAN COMMODITIZATION

SWEDEN STILL MAINTAINS A DIVERSITY OF BRANCH MODELS



Note: Data from 2011

Source: Swedish Bankers' Association



## 2.4 NEW FORMS OF COMPETITION

In what has historically been a relatively slow-moving supply-side we are beginning to see meaningful new forms of competition emerging. Three are of particular relevance:

- **Payments players:** some are established (e.g. PayPal); hundreds of others are still start-ups. The payments market is ripe for change as physical tokens of value (cash, cheques) and security mechanisms (plastic cards, signature) are giving way to virtual tokens and cloud-based identity management. Non-bank competitors are reinventing ways of providing services to consumers in ways that offer higher value and lower costs to both parties. Regulation (e.g. on credit interchange) is accelerating the disruption levels in this space
- **Non-financial services firms:** in many countries, retailers, internet giants and telecoms companies have aspirations in the banking business, either as a whole or in specific parts (e.g. credit cards).

These competitors have many notable advantages: trusted and untainted brands, potential for a much more efficient physical distribution network and often better access to and usage of customer data. Unencumbered by incremental thinking and structural inertia, they have the potential to deliver for fast movements in market share, particularly in markets that are quickly digitalising

- **New banks:** several markets now have a rich diversity of small, often newly formed banks – usually with very low market shares today. These banks offer consumers with increased choice and add further to competitive pressures faced by incumbents. Despite the barriers to entry inherent to banking (such as customer stickiness and benefits of scale), new banks derive competitive advantages from their lack of legacy infrastructure (in particular IT systems and branch networks), lack of legacy bad loan exposures and less well known but untainted brand positioning.

## 2.5 CHANGE IN THE MACROECONOMIC CYCLE

Retail banking has natural macroeconomic dependencies: notably national creditworthiness and the interest rate environment. For the former, a clear risk of spikes in credit losses remains; but medium-term we would still see slow improvements in creditworthiness as the most likely outcome as economies gradually recover.

On the latter point, interest rates are currently at historic lows. Although central banks seem committed to low

rates for the time being, rates will surely rise over the medium term. When they do, the profitability of deposits will improve, as benefits are shared between banks and customers. Whilst lending margins will narrow, we would expect them to move disproportionately, and slowly, relative to base rate movements given duration and stickiness. The net effect is therefore likely to be positive, with larger gains to industry profitability in higher base rate rise scenarios.

### 3. SUGGESTED AGENDA FOR RETAIL BANK MANAGEMENT

The rapid regulatory, technological and economic changes described above create threats and opportunities for European retail banks. How should management teams respond? Below, we list the most important items on the management agenda.

- a. Respond proactively to regulatory pressures, particularly around consumer protection and conduct.** Consumer protection and conduct is not just a regulatory issue, it is an issue of customer trust and will be a competitive advantage for banks (or new entrants) that are genuinely proactive. The response requires not just technical adjustments in governance models and processes but real, customer-facing adjustments in product structures and pricing. Be brave and take these issues on before regulatory attention forces change; you will see the medium-term benefits and can afford the short-term costs.
- b. Embrace changes in the structure and role of the branch network.** Managing the different interests of governments, staff, shareholders and customers will not be easy; but the direction of change required is clear. The branch, as a physical location for sales and servicing, is in permanent decline as customer preferences shift to remote, mobile interaction. Develop a holistic view of branch restructuring requirements – a mix of closures, new staffing models, machining, sales/service rebalancing, digital and service model investment and improved in-branch experience. Challenge the old idea that branch cost reduction trades-off against customer service quality.
- c. Broader than the branch network, take on the cost base.** Many banks still suffer from significant inefficiencies in operations, infrastructure and head offices. It is time to take on these inefficiencies and share the benefits with shareholders and customers. The same approaches you take to re-engineering the front office can be employed to radically change core processes and costs.
- d. Commit to digital.** Digital customers, offerings, service propositions and operations are imminent. Customer data and information is going to be a substantial source of value. Yet there is uncertainty regarding which of the many competing technologies and customer approaches will win. While some argue that you should simply accept the need to invest without clear direct payback, think through carefully how to maximise the required investments across future market and competitor scenarios. Approach the future not with the mind-set of an incumbent, but of a challenger and re-shaper of the business.
- e. Prepare today for interest rate rises tomorrow.** In a rising rates environment, product profitability dynamics will change and the business being written now will still be here. Test your business mix and structure today against tomorrow's macro environment and reconsider your product pricing and volume levels in this context. Develop a clear plan for how you will react on pricing when rates rise and how this will change in reaction to different competitive moves.
- f. Manage the NPL challenge.** Whether in a highly stressed economy or a more healthy economy, NPL management will be vital. Define your strategy in a way that accepts the need for a sharing of the burden between banks and borrowers in stressed areas. Ensure collections standards are consistent with the conduct and customer-centric aspirations that you state. And approach government and regulatory engagement positively.
- g. Question foreign market participation and the home-market regional mix.** Sub-scale retail/small business foreign operations should be under the microscope: some exits or radical restructuring are likely to be needed. The target in-home-market regional mix is also an open question for many banks given regional economic divergences in-country; look to evolve and optimise this rather than simply live with historical regional biases.
- h. Sharpen customer segmentation and proposition delivery.** Retail banks can do better in many areas here – particularly the small business and affluent segments. Take a fresh look at product design, distribution, servicing and segment definitions.

\* \* \*

In conclusion, retail and small business banking saw insufficient attention from regulators and many bank management teams over the last five years. Business models have not changed sufficiently. Much of this has been for understandable reasons given the nature of the financial crisis and the limited capacity for investments to drive change.

But over the next five year cycle, we anticipate a new, more dynamic phase in the European retail banking markets. Banks that recognize the need to adjust their old ways, and who respond quickly, smartly and effectively, have an opportunity to thrive.

## REFERENCE MATERIAL – METHODOLOGIES

Oliver Wyman has created a proprietary database on European retail and small business banking measures the size of this market in nine European countries and across all retail and small business products and services.

Since creating this database in 2010, we have calculated profit pools annually as a performance benchmark for European retail banks.

The database includes all key components of a profit and loss (P&L) statement: volumes, net interest income, fees and commissions, operating costs, provisions, tax and profit.

It also provides a vision on normalised RoE at country and segment levels (individuals and small business) with capital calculated as risk-weighted assets multiplied by average Core Tier 1 ratio in each country (weighted average of the top five banks).

The profit pool analysis encompasses all products and services offered by a retail bank: mortgages, personal loans, credit cards, overdraft and revolving lines, current accounts, instant-access deposits, notice deposits, term deposits, other country-specific saving products, bancassurance, investment products, loans to small business, small business deposits. It also includes related treasury asset and liability management (ALM).

In the database, we only account for products and services provided by retail banks, as a consequence, insurance companies and private banking are excluded. For example, if a retail bank offers an insurance product such as property and casualty (P&C) manufactured by an insurance company, we consider the distribution commission paid to the bank for selling the product only in the revenue pool.

The data provided at country level covers the total retail and small business banking activity in that specific country, either offered by a national or a foreign bank.

## REFERENCE MATERIAL – TERMINOLOGIES AND SCOPE

### COUNTRY SCOPE

The database includes nine European countries and we continue to extend the perimeter of European countries covered each year. The countries covered are:

- France
- Germany
- Italy
- Russia
- Spain
- Sweden
- Switzerland
- Turkey
- United Kingdom

### PRODUCTS & SERVICES

The database includes all typical products and services offered by a retail bank:

- Mortgages: loans issued to finance home purchases/upgrades
- Personal loans: unsecured loans, used for a variety of reasons including durable goods, or as a cheaper borrowing alternative than overdrafts/credit card borrowing
- Overdrafts and revolving lines: revolving facility attached to current accounts
- Credit cards: form of unsecured credit offered in most retail banking markets. We consider two forms, delayed debit cards and revolving credit cards
- Loans to small business: used for different purposes (investments, invoice, factoring, leasing, etc.) by small business enterprises
- Current accounts: principal banking account used by individuals or small business and services attached, providing instant-access to funds (e.g. through electronic transfers, withdrawals or a linked debit card)
- Instant-access deposits: non-current account deposits which are immediately accessible, yet are more frequently used for savings; these accounts often receive a small rate of interest
- Notice Deposits: deposits with a pre-agreed period of notice; early withdrawal leads to loss of interest
- Term deposits: locked in deposits for an agreed period of time; early withdrawal will incur a penalty
- Other country-specific savings: French regulated and unregulated livrets, bonds issued to retail customers
- Bancassurance: commission-driven products distributed through the retail banking channels; main products include Payment Protection Insurance (PPI), P&C and life insurance
- Investment products: commission-driven products distributed through the retail banking channels; products include mutual funds and other collective investment schemes, direct holdings in listed stocks and shares and direct holdings in government and other bonds

## PROFIT & LOSS (P&L) COMPONENTS AND ROE

All components of the P&L statement have been analysed and gathered:

- Net interest income: difference between customer interest rates paid/received and funding cost based on matched duration market rates
- Fees and commissions: non-interest income received from customers or third parties to distribute insurance or investment products
- Operating costs: all operating costs calculated based upon the market-observed cost/income ratio
- Provisions: calculated based upon the industry-observed weighted average
- ALM margin: revenue value generated by duration mismatch between assets and liabilities
- Risk-weighted assets (RWAs): including credit risk and operational risk RWAs; amount is calculated based on a percentage of asset balances, which vary product by product to reflect the risk of each asset class appropriately
- Capital ratio: typical weighted average Core Tier 1 ratio or target ratio in that country
- Equity: risk weighted assets and capital ratio
- RoE: based on total profit after tax/equity segment/equity

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