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Retail Banking Monitor 2021

June 2021

A decade of change ahead

2020 marked a year of concern for retail bankers amidst the Covid-19 pandemic. Some industry observers put drastic outlooks of double-digit revenue losses forward – our own April 2020 scenario for Europe saw up to a 9% reduction. Although we have been pretty close: In the end we were all wrong – the worst expectations have not materialized.

Less travelling cut into foreign exchange and card revenues. Increasing savings, deposits and investments, unbroken appetite for real estate, a move to cashless and notably government programs to curb insolvencies and unemployment have worked well – so far.

Perhaps most notably, last year put the spotlight on the fundamental transformation agenda in retail banking: a rethinking of everything related to sales and marketing (beyond branch models), the need to uplift product and pricing capabilities, a positioning in and for an ecosystem play, as well as the dawn of a new wave of industry consolidation on a pan-European level.

This year, we expect to see more profit improvements as more cost savings become visible in run rates, and from a rebound to growing economies – and hopefully without major fall-out effects on the business banking side. A year to stay alert, and accelerate on the transformation agenda.

Our 2021 Retail Banking Monitor covers the performance of ~50 European, Australian and US-based retail banks and banking groups across 15 individual countries. We hope you find this segment-specific performance comparison – both across countries and years – helpful and informative for your tactical and strategic decisions. The study team stands ready to discuss and support, and please do not hesitate to reach out.

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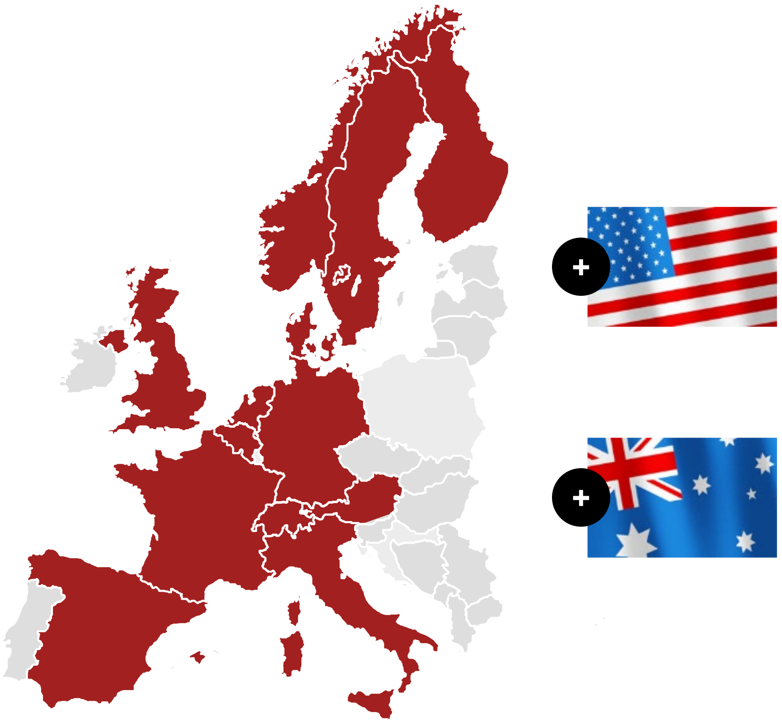
Comprehensive performance analysis of European retail banking augmented with global context

Our methodology

Countries in sample



- **Relevant set:** Comprehensive analysis of European, North American and Australian retail banking across key performance dimensions:
  - ~50 retail banks/ banking groups across 15 countries covered
  - Market share coverage per country ranges from close to 50% to above 90%
  - ~690 million customers and ~€18 trillion business volume (i.e. on balance sheet deposit and loan volume) covered
  - Sample includes traditional branch-based banks as well as direct banks of relevant size and P&L
- **Reported segment performance**: Country-specific retail banking business was extracted based on annual reports, investor relations material and press releases, and subsequently submitted to 4-eyes quality review
- **No normalization**: Country-/ bank-specific biases remain (from economic across regulatory context to the segment cut in each bank) and are highlighted, yet not normalized
- **Sample continuity**: 2020 sample was consistently carried forward; updated for relevant changes in bank reporting, and excluding banks in analysis where their reported data does not allow for a like-for-like comparison

Note: Currency conversion to EUR using year-end exchange rates
Source: Strategy& Retail Banking Monitor 2021

The big picture: 2020 financial results are better than expected

State of play – geographical perspective

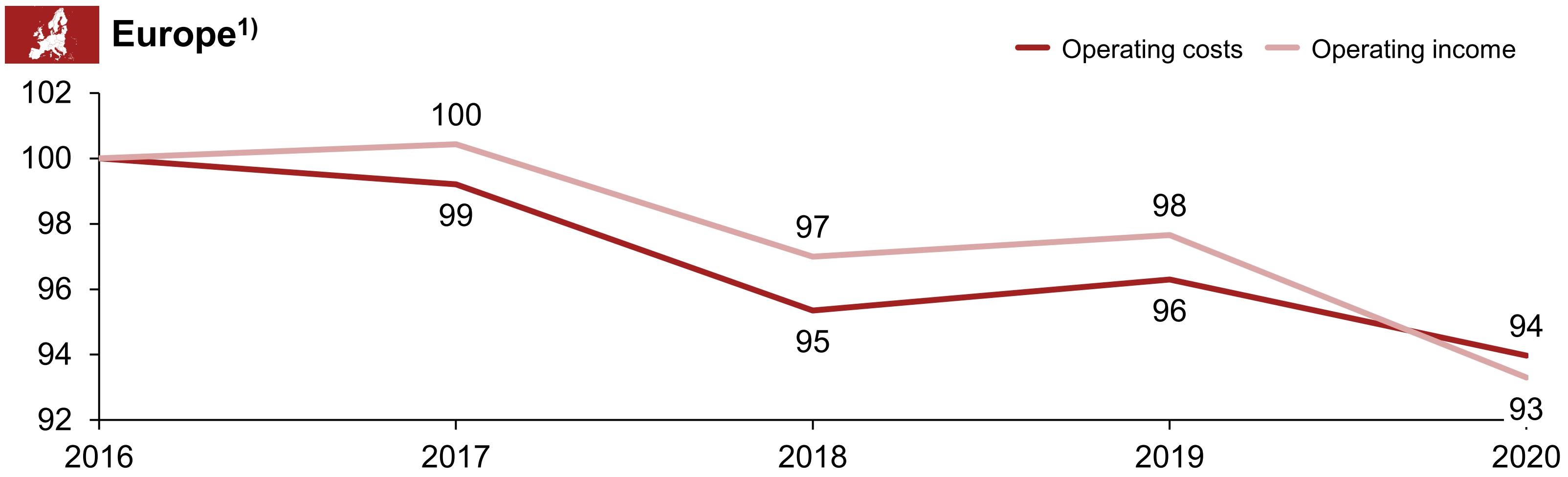
Globally, retail banks have suffered from fewer international and credit card transactions as well as partially lower consumer finance appetite. Continued mortgage lending and growing deposits and investments boosted returns, but could not offset the lost revenue from less transactions.

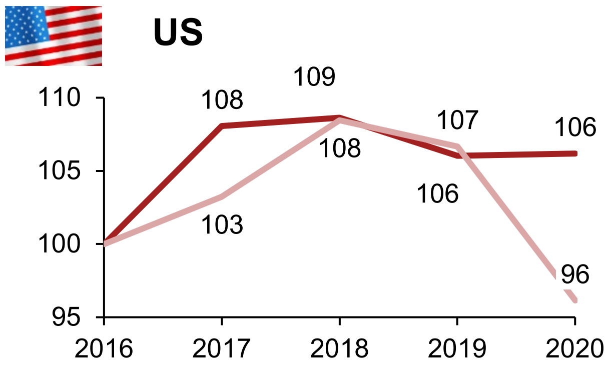
Overall, European banks have managed to lower costs in line with shrinking revenues consistently over the past years.

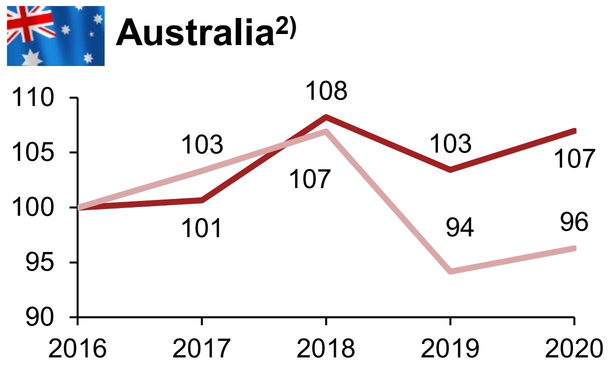
This however is symptom of a worrying development: European banks – as opposed to their US- and Australian counterparts – suffer from a structural decline in their top lines and have not managed to create a positive gap between revenue and cost development in recent years.

Differently put, CIR ratios remain an area of concern in a number of markets like Austria, Germany, Belgium, France & Italy.

Operating costs and income per customer in percentage points (indexed: 2016 = 100)



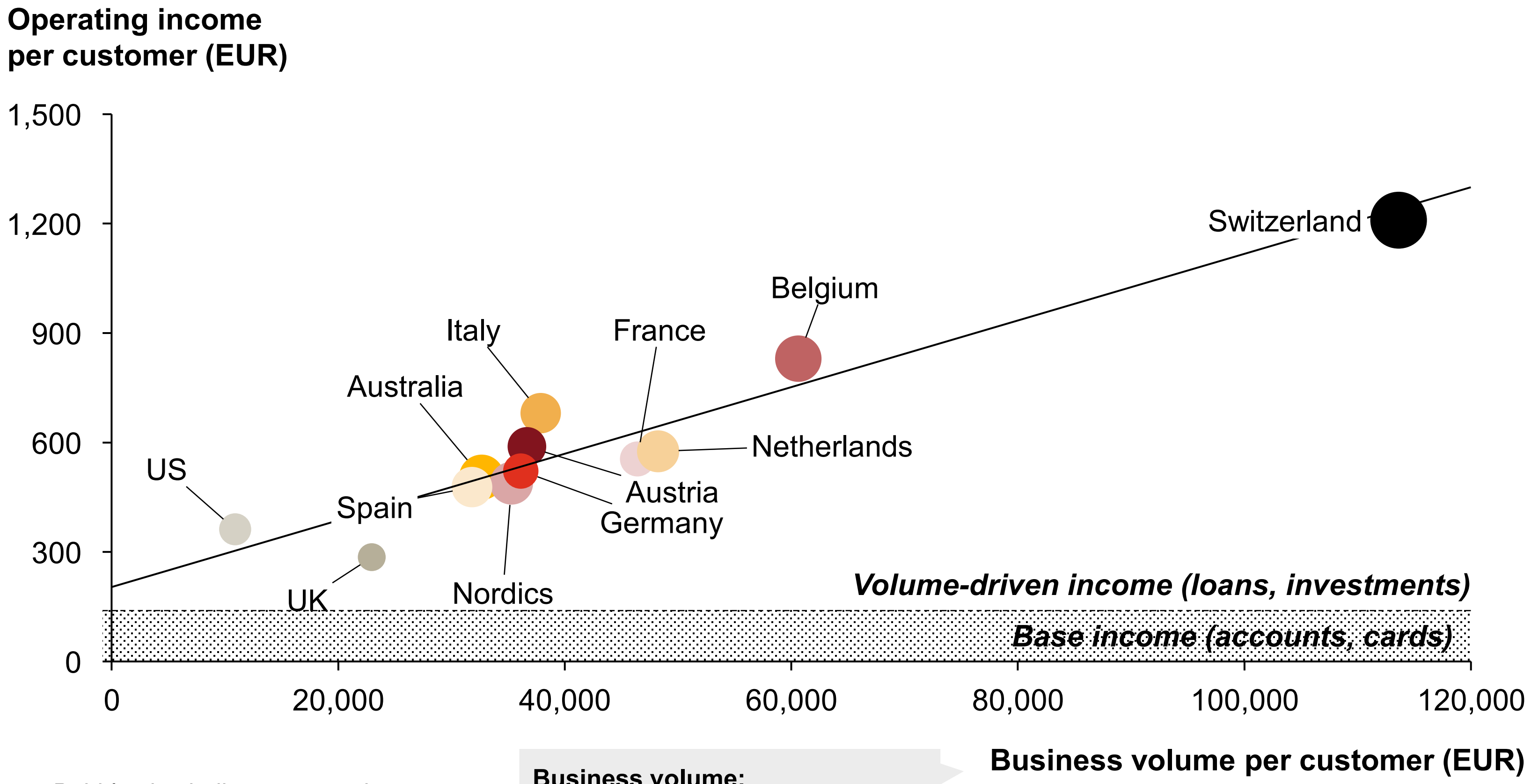




Note: Operating income and cost per customer as weighted total average in local currency (EUR in Europe); 1) European countries included are AT, BE, DE, DK, ES, FI, FR, IT, NL, NO, SE and UK; 2) 2019 structural impact of underlying segment changes in reporting
Source: Strategy& Retail Banking Monitor 2021

Business volume is the biggest driver for operating income

Business volume impact on operating income and profit per customer (2020 data, weighted averages)



Bubble size indicates operating profit per customer

Business volume:
Sum of loan and deposit volume

Key insights

Above all, revenue capture in retail banking is a business volume driven game.

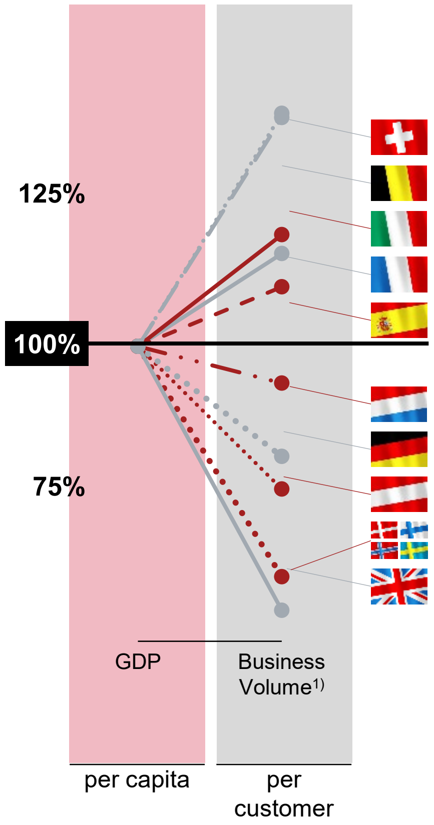
Next to business volume, pricing on base products (e.g. accounts, cards) is highly relevant.

European banks operate out of different market contexts determined e.g. by macroeconomics, regulations and customer behaviors.

Source: Strategy& Retail Banking Monitor 2021

Market contexts are different, and similarly how banks maneuver within them

Different market contexts…

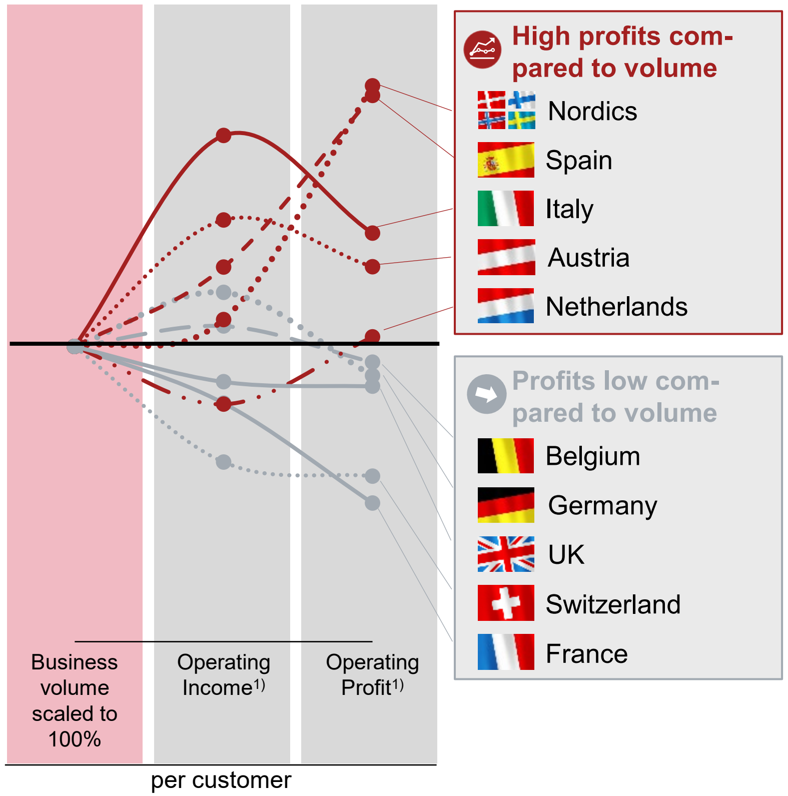


Business volumes are one of the strongest influencing factors for banks ability to make profits.

GDP as a measure of wealth is, however, not equally translating into business volumes.

Other market context is relevant, e.g. intensity of competition (Germany) or tax regimes (Switzerland).

… with different capture of potential



Nordic banks realize comparatively high operating profits per customer, boosted by fee income.

Italian and Spanish banks well leverage on-balance business, though absolute income levels are much lower.

Balance sheet and interest dependency, combined with free checking, continue to pose structural challenges to e.g. UK, German lenders.

Swiss banks rank high in absolute terms, but not relative to their business volumes.

French banks still suffer from commission income below historical levels.

1 Methodology: Calculation of unweighted average per KPI; calculation of relative distance to average per KPI; standardization of distances to average on GDP per capita = 100% for business volume and to average Business volume per customer = 100% for operating income and operating profit
Source: Strategy& Retail Banking Monitor 2021

Four key drivers of 2020 in European Retail Banking

Income decline

-4%

…income squeeze – accelerated by Covid-19, yet less than expected

2020 also a turning point in account and deposit pricing

Flight to deposits

+9%

…deposit volume in 2020 driven by decreased consumer spending

Transforming of deposits into fee income as imperative

Continuous cost focus

-2%

…operating costs in 2020 – cost cutting programs already started pre-covid-19

More radical measures to come

Cushion and caution

+110% [1)]

…Loan loss provisions in 2020 and government interventions as cushion

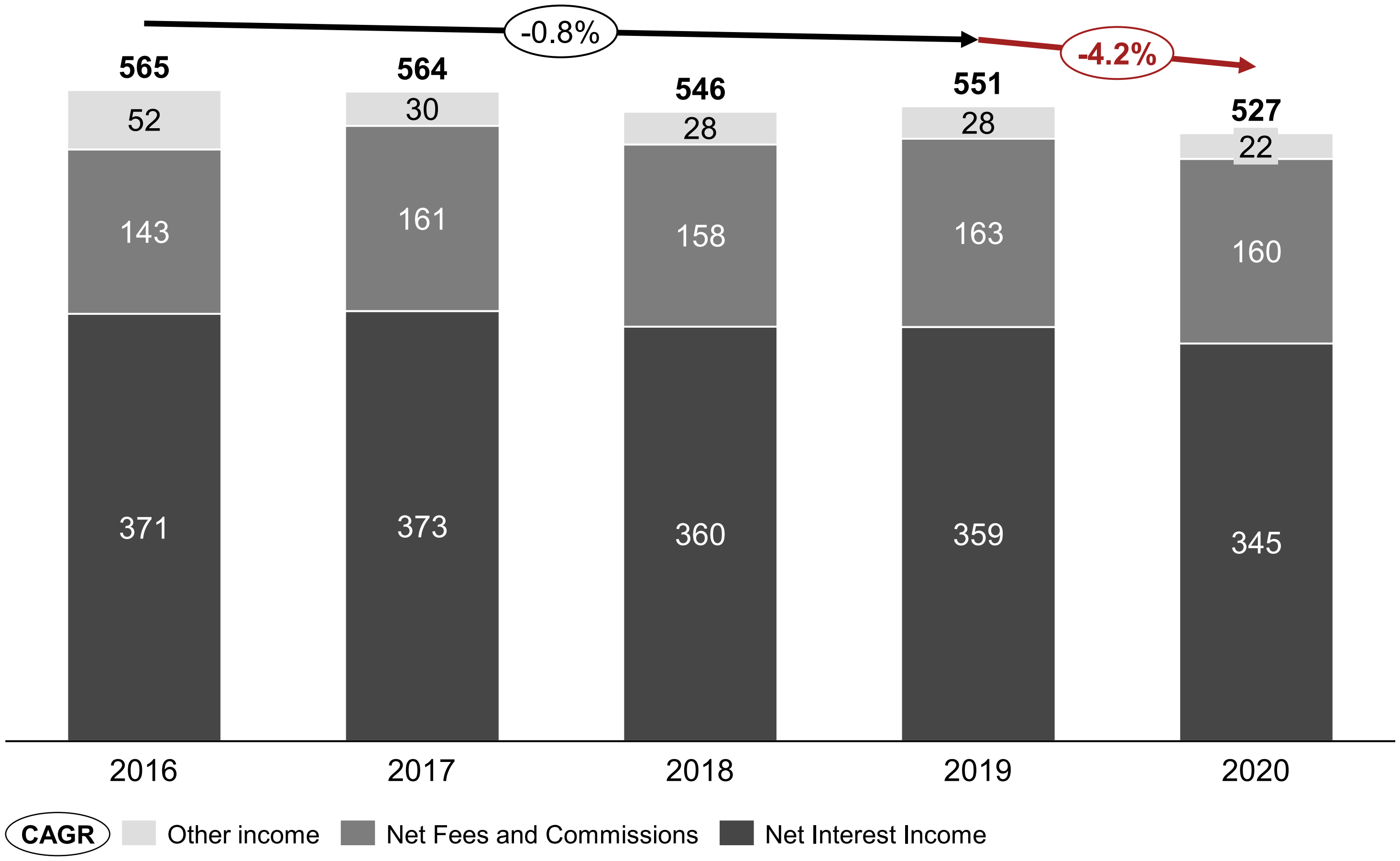
Pending insolvencies and heightened unemployment

1) Based on the development of loans provisions of the 25 largest banks in Europe, not restricted to retail banking
Source: Strategy& Retail Banking Monitor 2021

Bank's 2020 topline results suffering, yet less than expected

Operating income per customer

(European sample, weighted average in EUR)



Top line is down by 4 percent in 2020. This is a substantial decline and in continuation of a past trend amongst the banks in our sample.

It is less dramatic than expected by many industry observers – ourselves included. Increased consumer savings rates and government measures against unemployment and insolvencies – so far – are paying off.

Banks in countries with an emphasis on the current account relationship, and less on more volatile (and fee-generating) lending and card products as in the UK, for instance, have been more resilient throughout Covid-19.

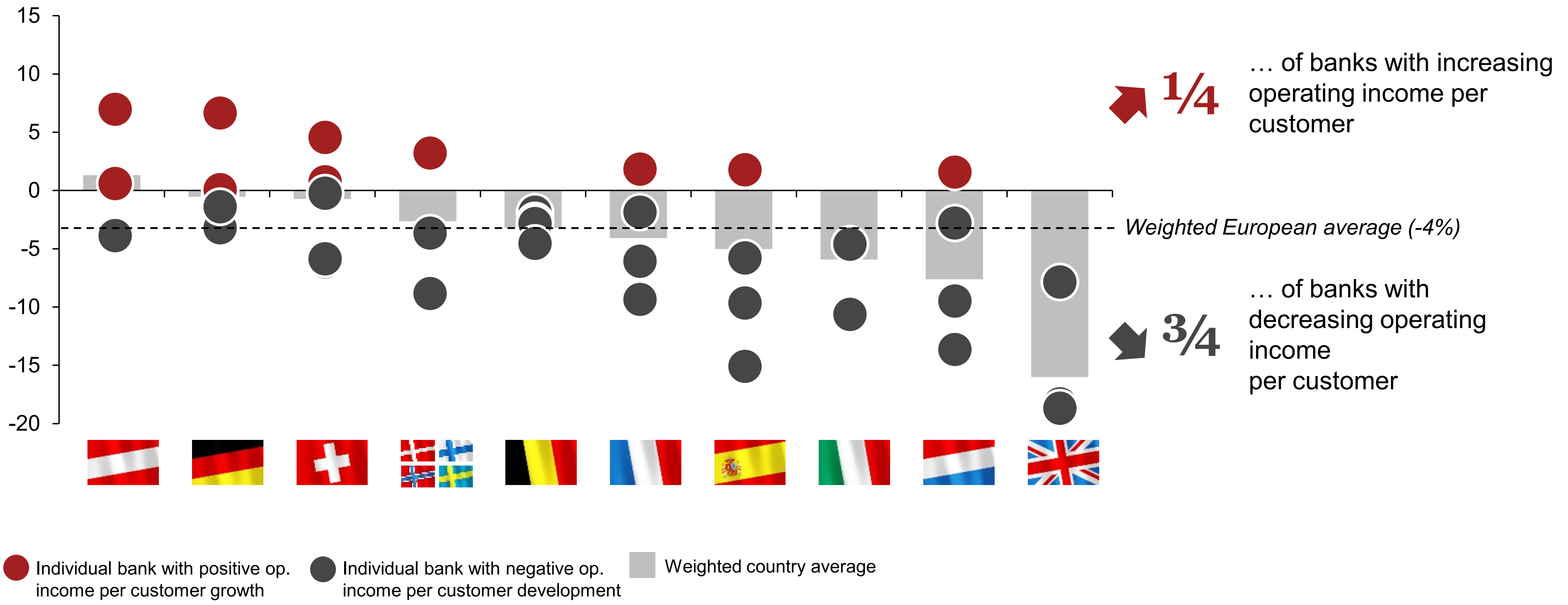
With business, personal consumption and travel patterns normalizing, banks in markets like the UK or Switzerland should see more dynamic top line uplift than others on the continent.

Broadly, we expect to see uplift from ongoing (account and card) fee increases, and a shift in focus on developing existing customer relationships rather than spending on new ones.

Source: Strategy& Retail Banking Monitor 2021

A quarter of banks have even increased top line, within an overall context of declining income

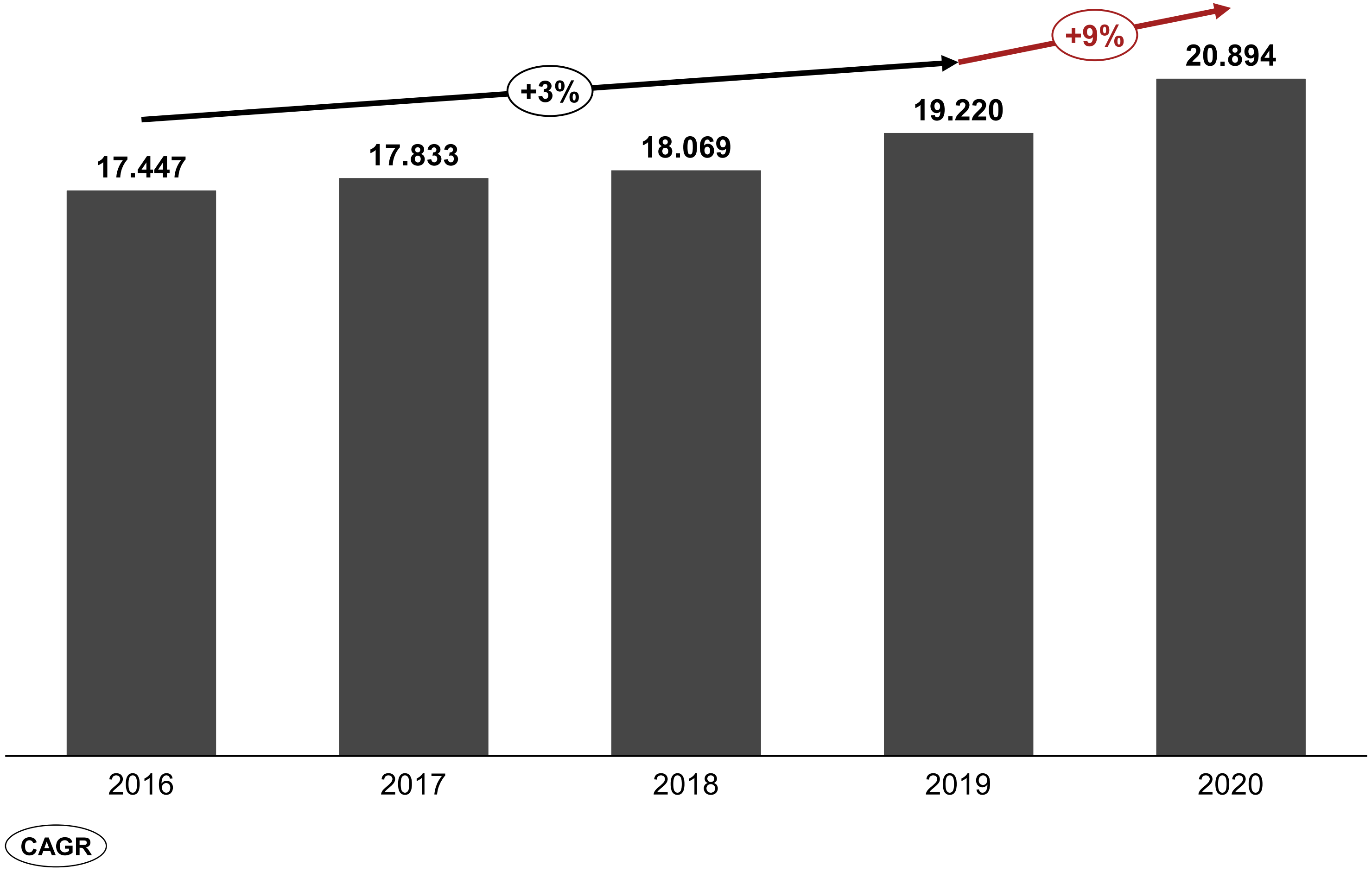
2020 y-o-y growth of operating income per customer (in %)



Source: Strategy& Retail Banking Monitor 2021

2020 marked a notable increase in savings and deposits

Deposits per customer (European sample, weighted average in EUR)



Deposit growth tripled in 2020 from 3 to 9%, mainly fueled by lower consumption. Together with stock markets recovering quickly and renewed interest in brokerage, savings, deposits and investments became the theme of 2020.

Not all of this 'flight to deposits' will stay. In 2020, household spending dropped by ~6-7% in Germany and France, and by more than 10% in Italy and Spain. Some consumption will only be postponed.

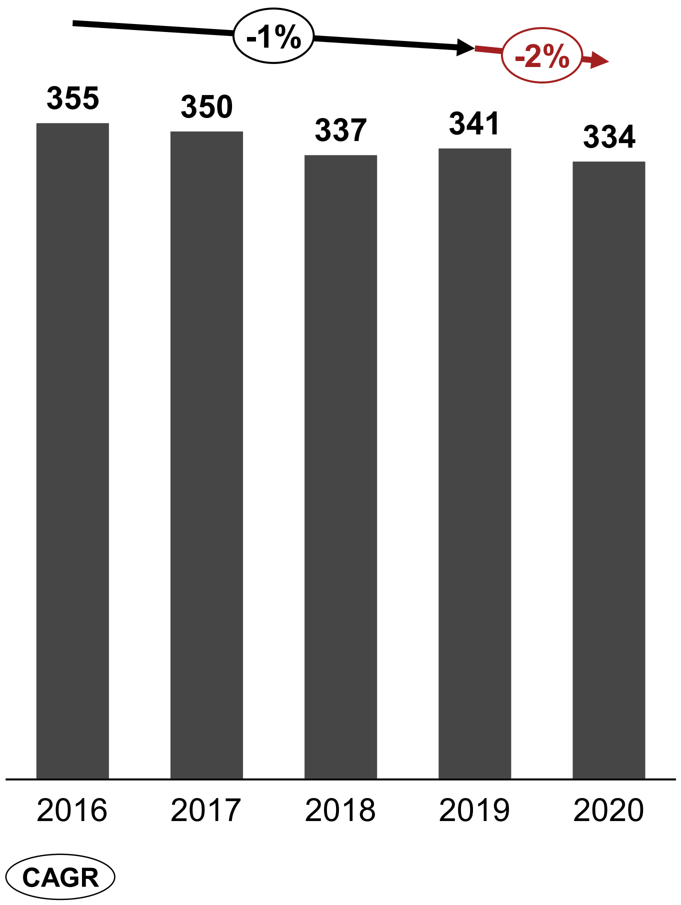
Three priorities for retail banks have emerged and require action in 2021:

1. Redeploying deposits in a profitable way despite negative interest rates
2. Supporting a new generation of equity investors into longer-term wealth generation, and optimization
3. Responding to a shift to zero-fee brokerage across the US and Europe, a new class of investors, and volatility

Source: Strategy& Retail Banking Monitor 2021

Banks are doubling down on their (so far moderate) cost efforts

Operating costs per customer (European sample, weighted average in EUR)



HSBC – **35,000 jobs cut** by 2022 with **$4.5bn cost savings** (BBC, August 2020)	Santander with **~4,000 job cuts** and more than $20bn in digital investments to reduce **CIR below 45%** (Reuters, November 2020)
Commerzbank to **cut 10,000 jobs** (Bloomberg, January 2021)	Société Générale **closing 600 bank branches** in profitability push – **expected ~€450mn cost saves** in 2025 (Reuters News, December 2020)
6,000 job cuts and **450 branches** to be closed at UniCredit (Reuters, February 2020)	**18,000 jobs cut** and up to **$17bn cost savings** by 2022 at Deutsche Bank (Bloomberg, October 2019)
KBC with ~**2000 jobs cut** and $0.3bn in digital investments to reduce **CIR below 54%** (Reuters, September 2019)	Phasing of investments to control spending, reduction of **CIR below 60%** at Barclays (Annual results, 2020)

Outlook (exemplary)

Operating costs have been coming down across European retail banks for a while – at a very moderate pace, in line with income development

Covid-19 has focalized the need to step up efforts, and take action on long-term trends: the demise of branches, another level of instant delivery and customer centricity, and digital at scale

There is hardly a retail bank that has not announced massive restructuring programs. Whilst 2020 saw some acceleration of cost decreases, the run rate effects of the programs announced is yet to come.

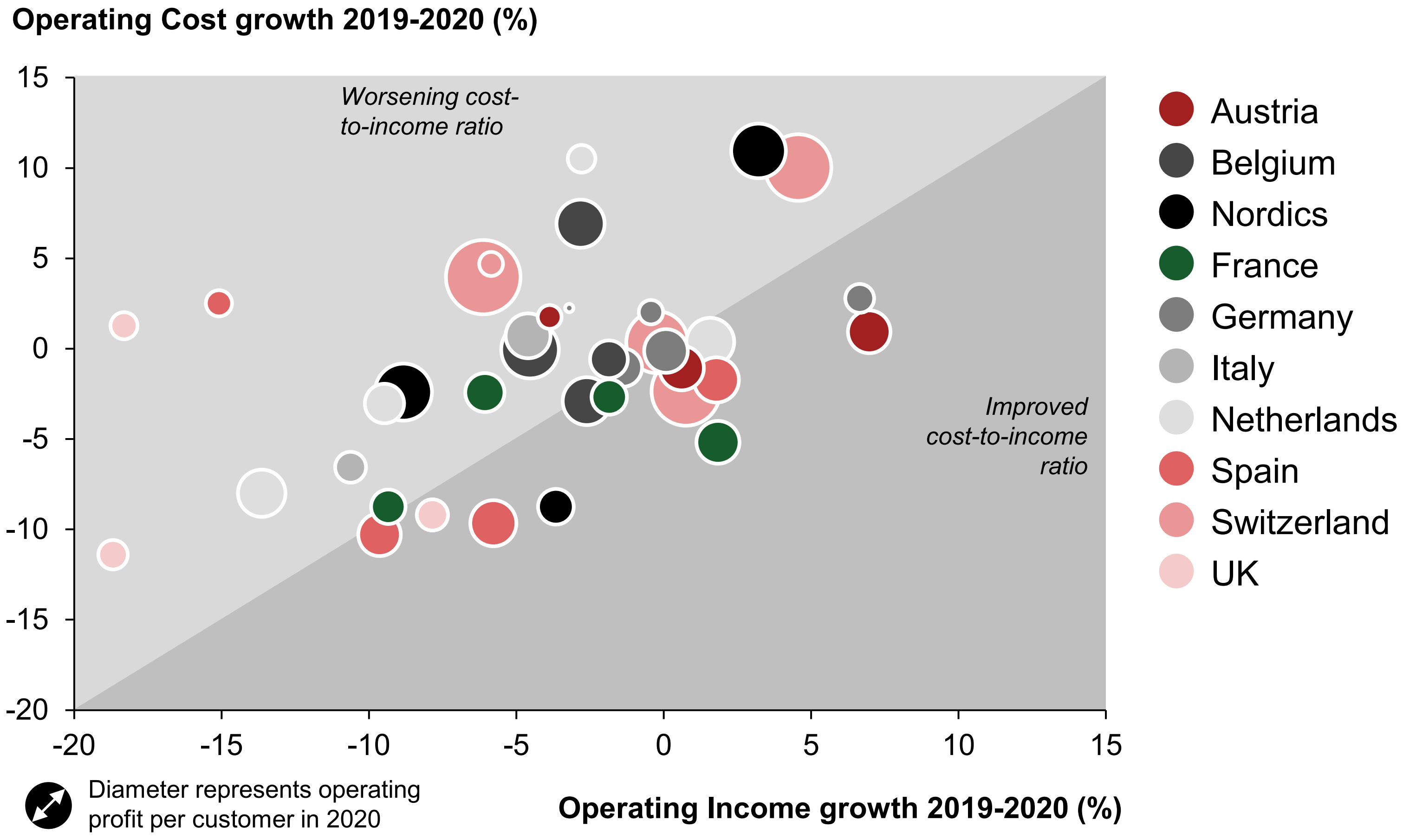
We expect 2022 / 23 to be the first years where the 2020 announcements will truly become visible in a new 'European retail banking run rate'.

The biggest challenge now is not in the savings, but in taking customers – old and new – with them. A disruption with opportunities for those getting it 'more right' than others.

Source: Strategy& Retail banking monitor 2021, BBC, Bloomberg, Financial News, Reuters, press releases

Increasing profitability despite decreasing costs – not impossible

Operating income/ cost development (per customer, weighted average)



Dealing with the unavoidable is also separating the wheat from the chaff. Structurally there are two lenses:

1. Are banks able to reduce costs? In 2020, almost half of the banks surveyed have not managed to do so.
2. Are banks improving in efficiency? Three out of four banks exhibit worsening cost-to-income ratios in 2020

2020 is only a prelude and should not be overinterpreted, as transformation programs only have started. There are some (soft) country observations though:

- British, Belgian and Dutch lenders almost all worsened their positioning
- French (and Spanish) banks kept costs mostly in line with income
- Germany, Switzerland show the highest degree of 'inertia'

Certainly a picture we will see change substantially over the next 2-3 years.

Source: Strategy& Retail Banking Monitor 2021

A more detailed look into the size of banks reveals that it is mostly smaller lenders suffering from cost increases

Operating cost development by bank size

Mid-sized and larger European Banks managed to decrease their cost bases or keep them stable.

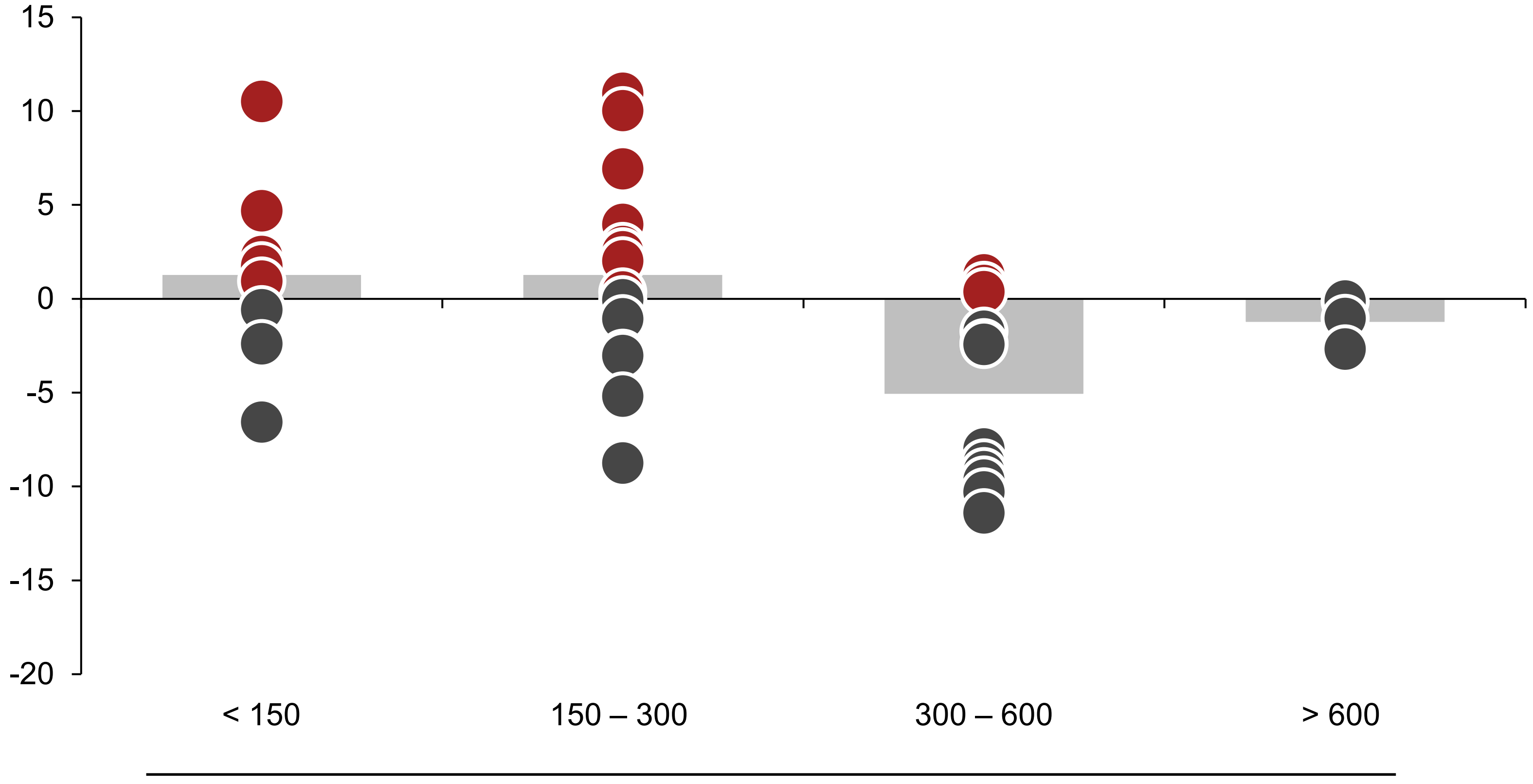
This particularly applies to banks with a business volume between 300 to 600 €bn, which decreased their costs by 5% on average.

Main driver for this are large banks from Spain and UK – the latter country was hit particularly hard by declining incomes.

Hence, the cost reductions only partially translated into an increased profitability

The cost trajectory of smaller Banks varies widely – between -10% and +10%

Average change of operating costs per customer 2019 – 2020 (%)



Total business volume (€bn)

Source: Strategy& Retail Banking Monitor 2021

Operating profits – expectedly – declined substantially, with large spread across banks in sample

Operating profit development 2019 to 2020

Overall declining profitability…

Development 2019 → 2020, European weighted average

-8%

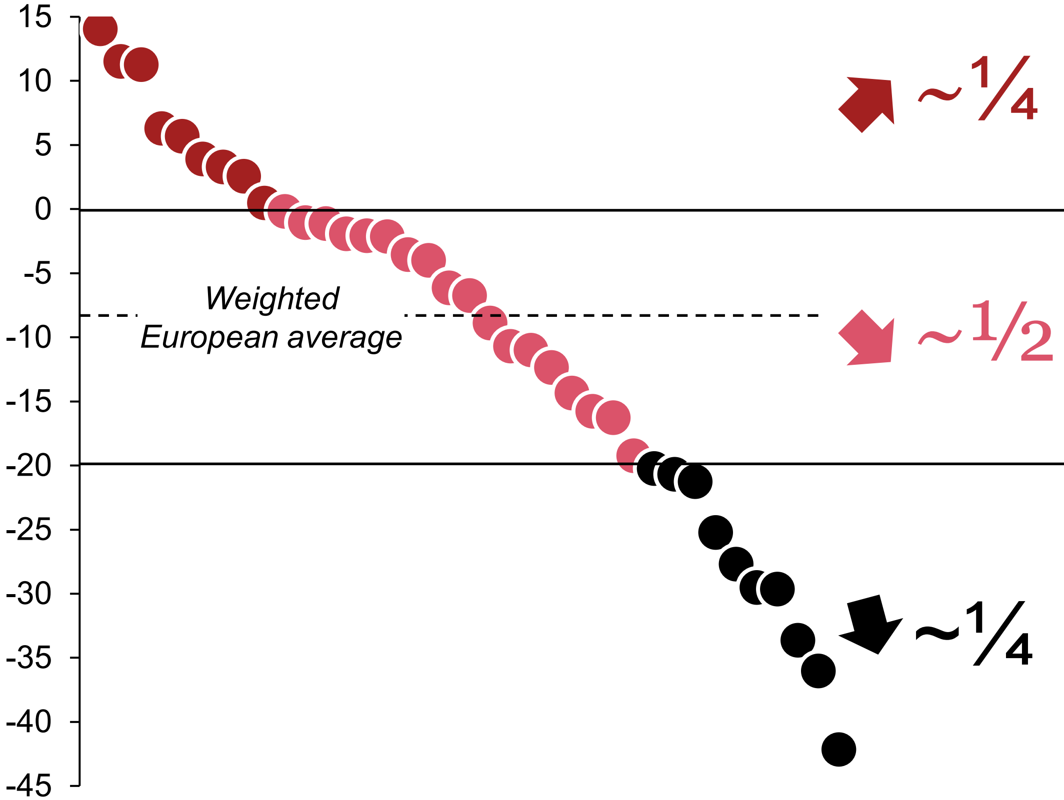
Operating profit per customer
(210 € → 193 €)

+1.4pp

Cost-income-ratio
(61.9% → 63.3%)

…with significant spread in operating profit change between European banks

Development of operating profit per customer of individual banks



…of banks with increasing profitability – mainly driven by growing top line despite Covid-19

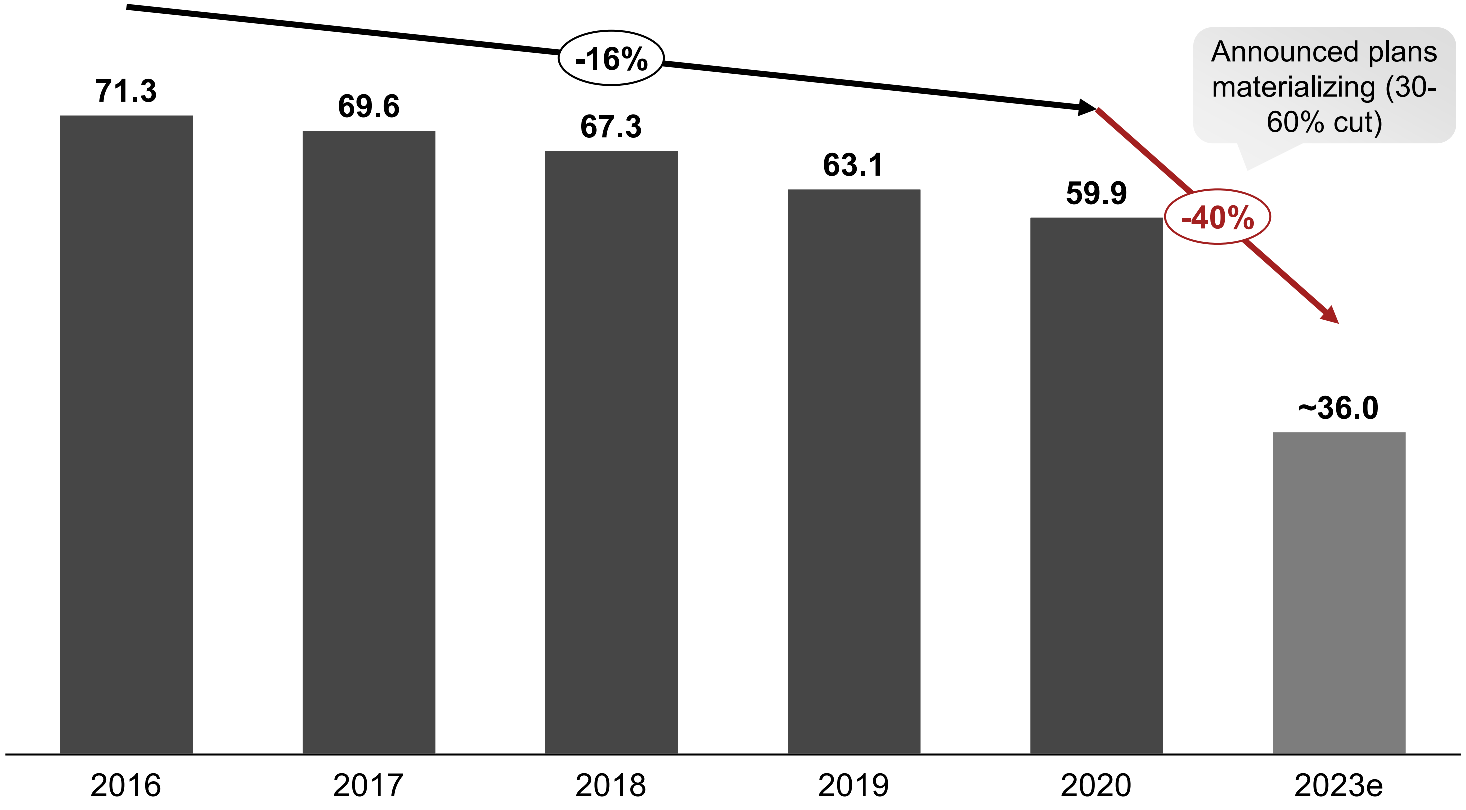
…of banks with decreasing profitability by up to 20% – mainly driven by declining top line by up to 10%

…of banks with decreasing profitability by up to ~40% – partially despite cost reductions of up to ~10%

Source: Strategy& Retail Banking Monitor 2021

Shrinking of branch networks to reduce costs – further radical measures ahead

Number of branches (European sample, in thousands)



Despite all press reports and many banks closing branches during the first lock-down in 2020 particularly, branch networks only slightly accelerated their decline.

More substantial effects lie ahead – we expect a further rationalization of branch networks of up to 40% in the next years.

- Lock-downs have shown to customers and decision makers in banks that drastic cuts are feasible
- Like the move to cashless payments, a new set of customers is now banking online and mobile

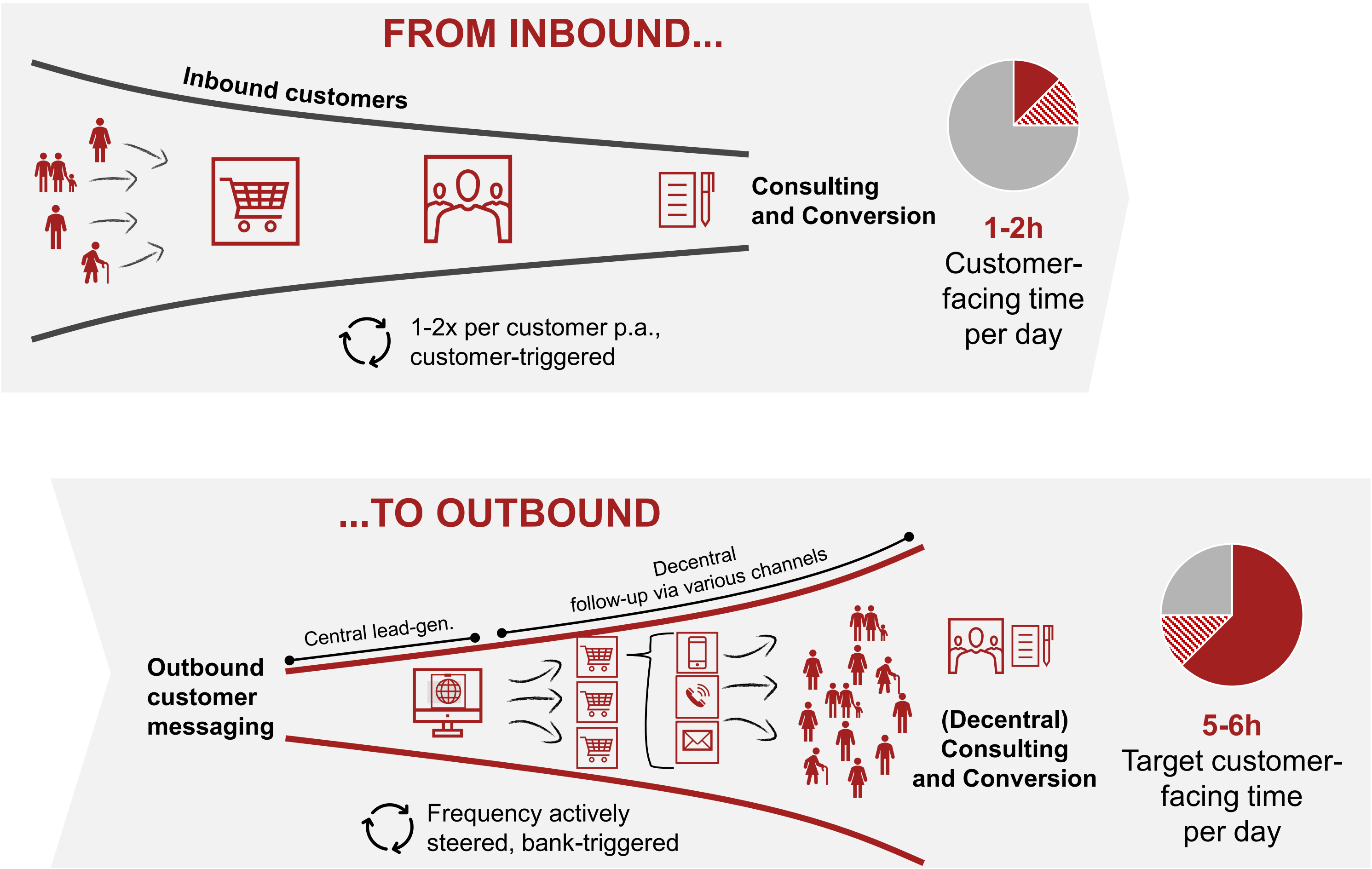
The branch model in itself – an inbound sales model, waiting for customers to step by and in, requires a fundamental overhaul.

The biggest change is not about the number of branches and density of the network. **It is about retail banks' ability to embed physical outlets into a digitally-driven outbound sales model** – everything challenger banks master plus fueling superior conversion in outlets.

Source: Strategy& Retail Banking Monitor 2021

Less branches does not do the trick; a new 'outbound' sales model is coming

Future sales model



Challenger and branch bank models are converging.

Neither a 'foot on the street' nor a location optimization will do the trick for traditional lenders. Advisors waiting for customers to pop in, spending a mere 15-25% of their time facing customers and making 1 sell per day is not sustainable.

The future role of branches looks different:

- Digital banks engage in content marketing and digital targeting techniques
- They interact digitally and personally, with instant 'experience management' driving needs discovery and customer satisfaction
- Leads are automatically classified for different follow-ups. As in online mortgages already, advisors in outlets can play a critical role in picking up leads and converting

Such models can drive customer facing time up to 75%, and provide a new future to sales staff in a slimmed down network.

Source: Strategy& Retail Banking Monitor 2021

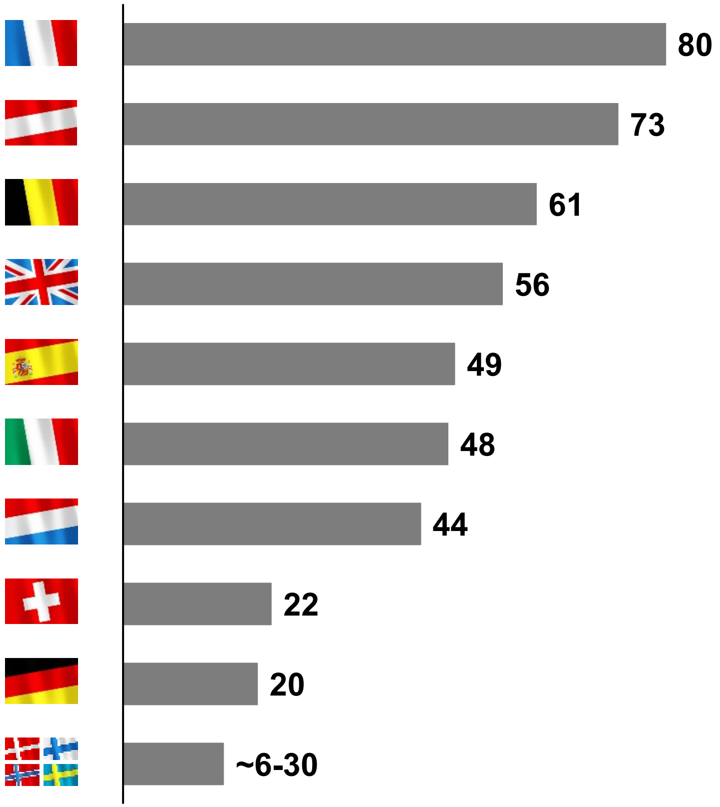
2021: Staying on the cautious side from a risk perspective

Cushion and caution

Government interventions preventing business failures in 2020

“Without government intervention, including billions in state-backed loans and subsidized payrolls, European business failures would have almost doubled last year, according to a study by the National Bureau of Economic Research.“

Insolvency growth forecasts 2021
(%y-o-y)



The aftermath of Covid-19 on retail banking is lingering on – even though capital markets enjoyed a quick rebound for now.

European business failures would have almost doubled last year without governments interventions, according to the National Bureau of Economic research.

Looking forward into 2021, insolvency rates are forecasted to grow significantly; e.g. by 80% in France. Particularly threatened are small businesses and companies in heavily impacted industries

The 2010 Euro crisis showcased how European Banks and their national economies are tied together, bringing the risk of a “doom loop”.

Unemployment rates peaked during the pandemic, with a slow recovery expected over the next few years.

Loan-loss provisions are not heavily impacted so far however, insolvencies are likely to make their impact on European banks’ results in 2021.

Source: NYT, Atradius, Strategy& Retail Banking Monitor 2021

Substantial strategic transformations are only starting – with many key challenges left largely unaddressed

Key challenges ahead

Convergence of models

Digital offerings and distribution models are required irrespective of branch network

Inbound to outbound marketing

Reversing funnel and role of outlets (new branch operating model)

New role for segmentation

Away from organizing coverage to building the profit cohorts of the future

Product and pricing excellence

Playing full spectrum from bundles across subscription services to advanced pricing tactics, and periodical reviewing

Ecosystem positioning

Embedding in key ecosystems (mobility, health, etc) beyond the current product partnering/ channel perspective in a world of open finance

Consolidation

Increasing pressure for industry consolidation on a pan-European level

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