Excerpt from the World Retail Banking Report 2009

Key Findings

09 WORLD RETAIL BANKING REPORT

Capgemini
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Principal Findings

- The average price of basic banking services for the local active user fell 2% from last year, to €70.3, with average prices ranging from €54.3 in Asia-Pacific to €76.6 in Europe Non-Eurozone.
- Except for Europe Non-Eurozone (up 1.6%), all regional area prices decreased, down 6.1% in Europe Eurozone and 1.4% in North America.
- The downward trend in prices since 2005 continues: the compound annual growth rate (CAGR) for all regions, 2005 to 2009, was (-1.2%).
- The primary cause of this decrease was the decline in Europe Eurozone, mostly due to the introduction of packages in Ireland (down 33%).
- The secondary cause was the development of differentiated pricing per distribution channel: Internet active users paid €9.5 less per year than active users, and €31 less than branch active users.
- The fee structure parallels our 2006 findings, with payments accounting for about 50% of retail bank revenues, and account management for 25%.
- The SEPA (Single Euro Payments Area) effect on prices continues its downward trend: the price of electronic payments fell by nearly €4 in Europe Eurozone (to €57, down from €60.9).
- Prices continue to converge in Europe Eurozone and North America, while we recorded large discrepancies in Asia-Pacific and Europe Non-Eurozone.
- Overall, Europe Eurozone prices decreased by 6.1%, a phenomenon largely explained by drastic declines in Ireland (down 33%) and, to a lesser extent, Spain (down 7.2%); but, excluding Ireland, Europe Eurozone prices actually rose by 0.8%.
- In Europe Non-Eurozone, prices increased by 1.6%, despite price declines in the Nordic countries and Poland, resulting from pricing incentives to push clients towards Internet banking.
- North America's varying fee structures can be explained by Canada's reliance on cash revenues, while the US relies on payments fees.
- Asia-Pacific remains extremely heterogeneous, containing countries with very different fee structures and pricing levels; the region's overall price decrease (down 2.3%) was caused by a decline in payments revenues and a drastic price cut in India (down 34.7%).
- Prices should continue to decline as Internet use increases, especially in less mature markets such as Central European countries.

MANAGING MORTGAGE PROFITABILITY

RETAIL BANKS AT A CROSSROAD IN 2009

Principal Findings

1. The Booming Mortgage Market, 2001-2007

- Mortgage was a growth engine for retail banks worldwide from 2001 through 2007, with some markets exceeding reasonable limits, especially in the ratio of mortgage debt to gross domestic product.
- Although most mortgage markets experienced this boom, huge discrepancies could be observed between these markets.
- Within each of these markets, retail banks developed similar commercial and economic strategies. Depending on the country, mortgage was used either as a *stand-alone* product (it has to be profitable by itself), a *hook* product (it is used primarily for customer acquisition and is sold with low margins), or a *hybrid* product (it serves customer acquisition objectives, but with margins that aim at a profitable return).

2. Mortgage Unit Profitability: A Widespread Decline until 2007, Partly Mitigated by Growth

- Unit profitability declined from 2003 through 2007, primarily as a result of the decrease in net interest income (down by around 50 basis points [bps] in major markets) due to intense competition between retail banks.
- Initiatives to generate additional revenues and reduce costs could not compensate for the loss in interest revenues.
- This decline in global unit profitability was partly mitigated by the rise in volume during this period, but value creation remained questionable.

3. The Year 2008: A Downward Turning Point in the Mortgage Market

- In 2008 the subprime crisis marked a clear stop to positive trends in the mortgage market, with an explosion in funding costs having a dramatic impact on mortgage profitability.
- In the five years to come, retail banks will need to prepare for a significant decline in mortgage activities due to three main factors: the general slowdown of the world economy, the asset crisis with its impact on the cost of funding, and the threat of an increasing cost of risk.
- The general trend towards regulations protecting consumers (for example, limits on loan prepayment penalties and ceilings on total customer rates) is likely to continue, and will have an impact on mortgage unit profitability.

4. How Can Retail Banks Respond to the New Market Situation?

- Banks are looking for key opportunities and activities to address the challenges related to this new market situation over the next five years.
- For marketing and sales:
  - Improve mortgage sales productivity and capabilities by enhancing cross-selling and, where there is critical mass, developing a specialised sales force.
  - Develop new products and services by focusing on higher margin services linked to mortgages and by creating packages with other financial products.
  - Use remote channels by reinforcing their position as pre-sales and sales channels.
- For pricing and risk-management issues:
  - Optimise pricing strategies by developing customer-based pricing, aware that any of today's customer spreads would not even cover the cost of funding.
  - Manage risk by improving customer selection processes and tools, and by enhancing approaches to monitoring the loan portfolio (early-warning and watch-portfolio approaches, customer category-related actions, etc).
- For middle/back office and information technology (IT) optimisation:
  - Optimise origination and servicing by speeding up the loan origination processes and by lowering the breakeven point, notably through geographic consolidation.
  - Optimise IT, also mainly by geographic consolidation.
- Among these key opportunities, the most critical are improving mortgage sales productivity and capabilities, and optimising pricing strategies.

5. Moving Forward over the Next Five Years

- In 2009, retail banks are at a crossroad and will have to make major changes to remain successful over the next five years:
  - Rather than relying exclusively on cost reduction, the best retail banks will continue to develop sales, particularly by improving cross-selling capabilities, product bundling, and customer-based pricing.
  - Top-performing retail banks that once relied on *hook* or *stand-alone* strategies will have to alter their approaches in favour of the *hybrid* strategy.
  - Retail banks will also have to rethink their business models and revert to their historic deposit-based approach, leaving behind the credit-based model of the past few years.
- In this crisis context, mortgage specialists' ability to survive on their own is weak, due to the lack of access to deposits and direct cross-selling opportunities.
- Managing mortgage profitability by developing excellent profitability models is the clear way forward, although today it is an under-used practice. We believe it is the best way for retail banks to ensure they are prepared for the daunting challenges they will face in the years ahead.

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