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Lunch'n Learn
Mutualization and outsourcing trends:
From competition to cooperation

March 3rd, 2021



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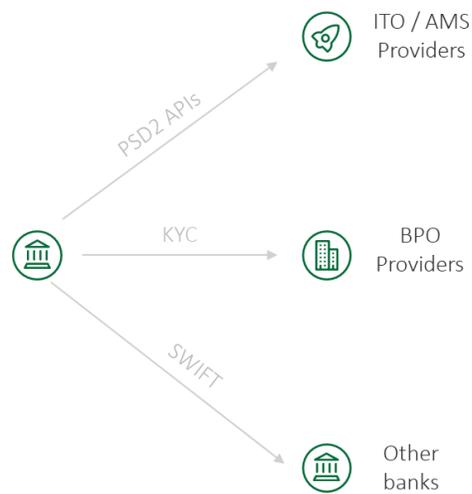
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A global banking context suitable for outsourcing and mutualization

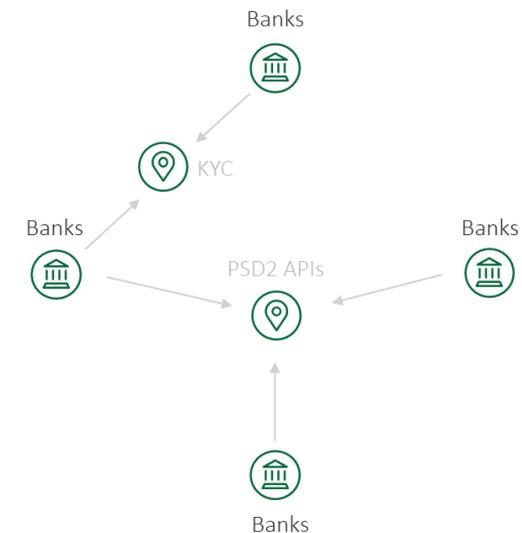
Outsourcing and mutualization: why are they interesting?

Outsourcing



“Outsourcing can be defined as use of a service provider by the bank to contract out part of its day-to-day banking activities to reduce its cost of operation, enhance customer satisfaction, utilize specialized skills, and reap other strategic/operational benefits.”

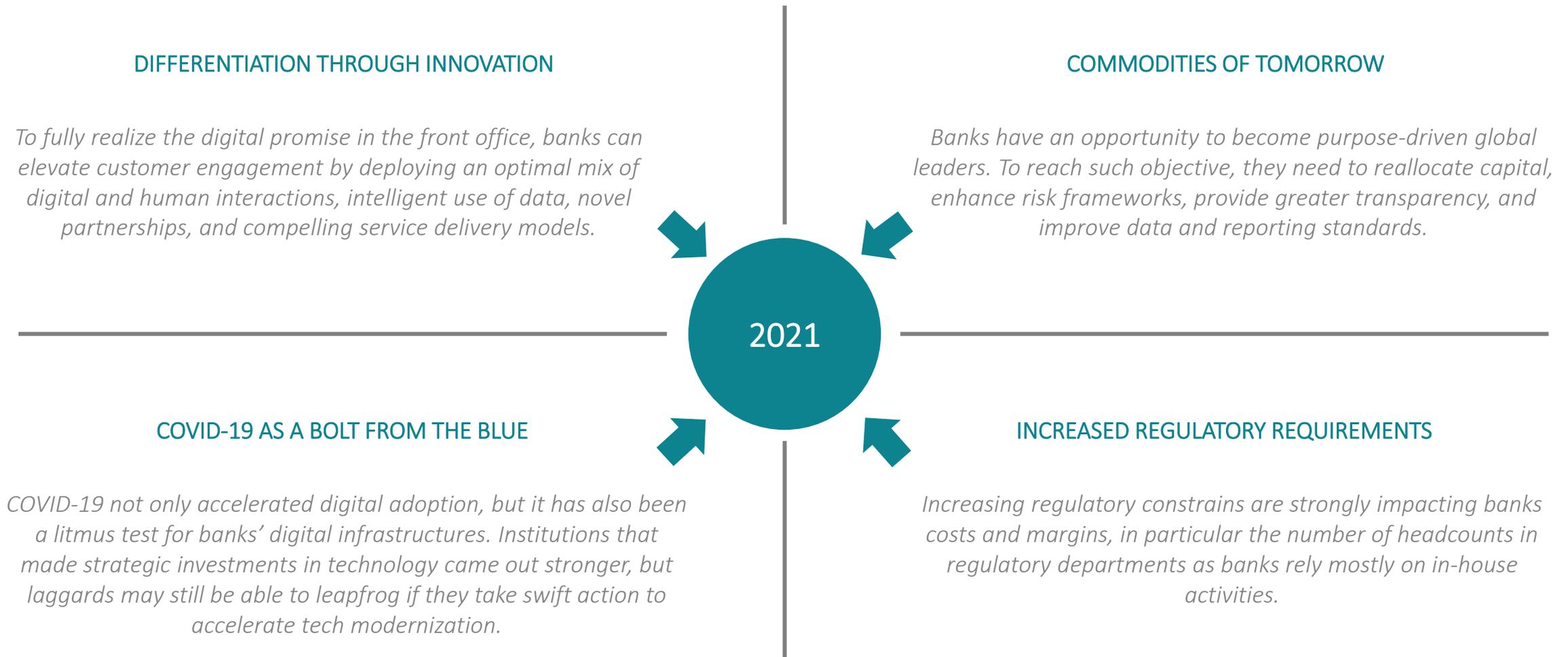
Mutualization



“Mutualization refers to a situation where financial institutions, together with other partners such as technology providers, law firms, consulting companies, pool their resources in order to set up a separate utility or a hub that could provide its services that were previously internal business functions.”

Global context and megatrends

Banks' traditional business model is currently challenged by multiple factors. Thus, the pursuit of innovative and digital solutions has become crucial, while non-differentiating activities are becoming commodities



How COVID-19 has affected megatrends globally

Levers to elevate customer engagement can include creating an optimal mix of digital and human interactions, using data intelligently, and deploying compelling service delivery models



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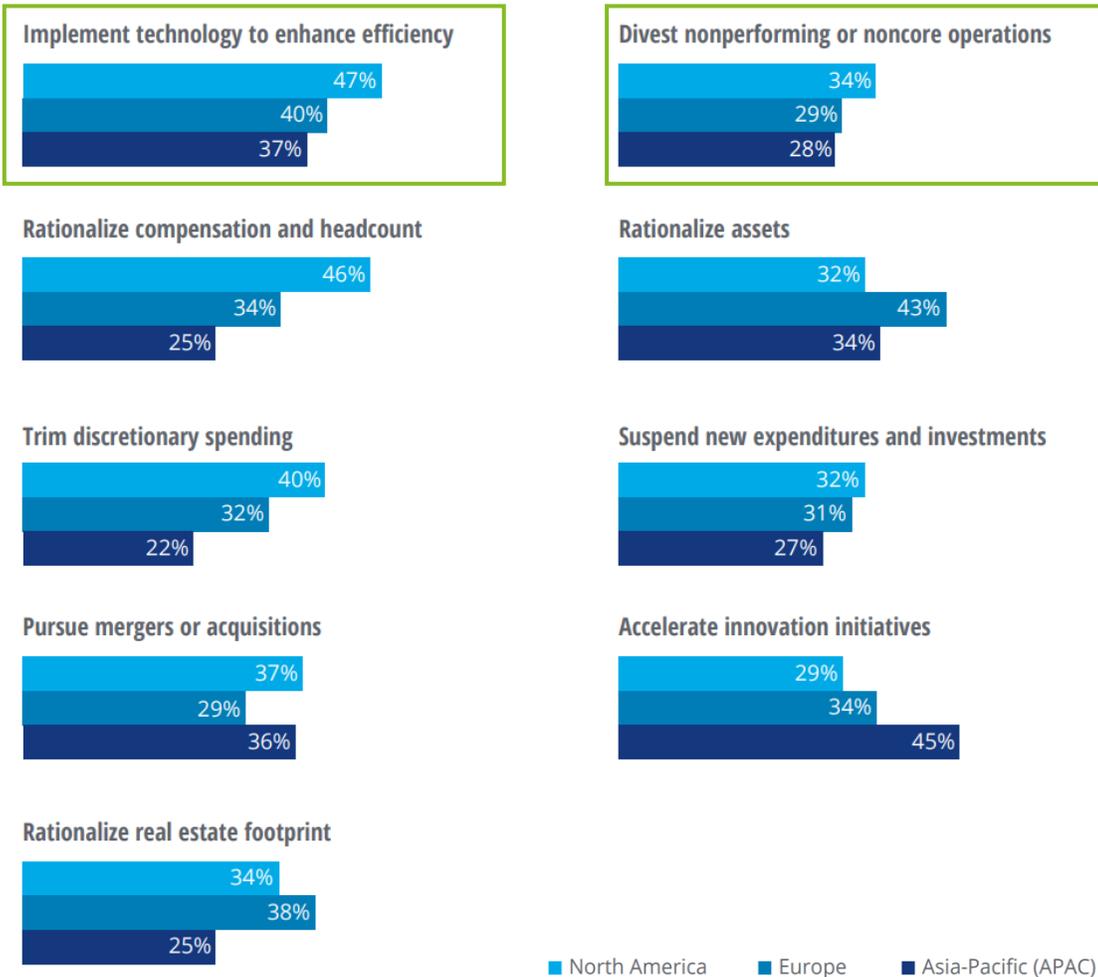
COVID-19 has demonstrated that banks must strengthen resilience and accelerate transformation in the following areas: digital customer engagement, talent, operations, technology, risk, finance, M&A and sustainable finance.

For instance, maintaining resilience may pose a challenge if employee productivity declines from the myriad effects of the pandemic. Our survey of 200 global banking executives revealed that this challenge is particularly acute in Europe, where almost 60% of survey respondents indicated that employee fears of returning to work will hamper their ability to succeed after the pandemic. Interestingly, respondents in North America (35%) and Asia-Pacific (38%) were not as pessimistic.

”

Banks plan to take a variety of actions to support financial and operational stability

Many banks could also pursue a structural cost transformation initiative to bolster operational efficiency. Undoubtedly, agility goes hand in hand with resilience.



“

Some banks could also be conducting layoffs to rationalize costs. One-third of respondents indicated their firms are planning to do so

Concurrently, banks should continue to explore how technologies, such as cloud, machine learning, and robotic process automation can simultaneously contribute to significant cost savings, while also helping increase speed, improve accuracy, and provide scalability.

Chief operating officers may also need to challenge cost management orthodoxies, such as outsourcing noncore activities or using technology to do traditional manual tasks.

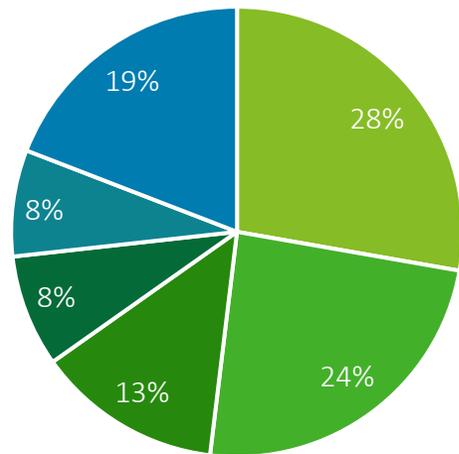
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Today's main banking trends in Luxembourg

Mutualization and outsourcing have significantly accelerated in Luxembourg in 5 years...

93% of Luxembourg financial institutions agree on the mutualization of certain functions

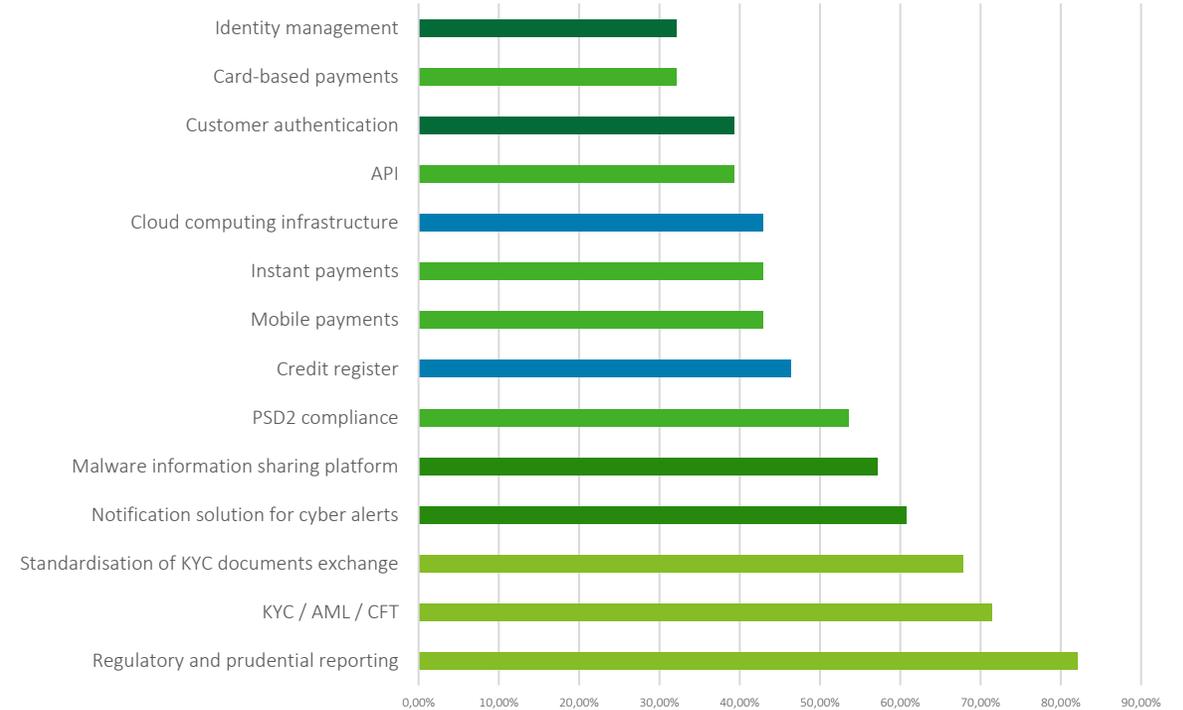
In a survey conducted on 28 respondents, five main mutualization areas have been identified as competitive advantages of banks in Luxembourg:



- Compliance
- Payments
- Cybersecurity
- Authentication
- Investment and funds
- Others*

*Others include Loans, Distributed Ledger Technology, Document Access and Management, Procurement and Specific Technologies.

Functions and services requiring mutualisation are considered by banks as non-differentiating activities and perceived as commodities to provide clients with banking services:



...while in the same period, the number of regulations applicable to banks has surged!

New regulations impose additional requirements on stakeholders and their business models. The below regulations create new burdens on the financial services industry.

Regulation	Scope & description	Potential impacts & risks
AML Directive	<ul style="list-style-type: none"> • Ensure soundness, integrity and stability of financial institutions • Allow greater consistency of rules across the European Union • LU law transposing new AML directive • Creation of a central payment accounts register 	<ul style="list-style-type: none"> • Requirement to assess and take appropriate measures to identify and assess the risk of exposure to Money Laundering/Terrorist Financing (incl. trustees register) • Mandatory reporting on ML/TF risks • AML IV grants greater sanctioning powers to competent authorities
FATCA / CRS / DAC6	<ul style="list-style-type: none"> • Identification and reporting of cross-border investors and arrangements • On-going evolution of reportable jurisdictions • Additional KYC burden with higher degree of sophistication 	<ul style="list-style-type: none"> • Constantly evolving law and related circulars in Luxembourg • Penalties in case of non-compliance, even partially • Complex reporting schemas to be maintained over years
GDPR	<ul style="list-style-type: none"> • Strengthen and unify data protection for all individuals in the EU • Entitles Data Protection Authorities (DPA) with investigative, corrective, advisory and authorization powers • Effective as from May 28, 2018 	<ul style="list-style-type: none"> • Set-up of sufficient mechanisms to allow for proper personal data <ul style="list-style-type: none"> – Governance – Internal control – Accountability • Significant enforcement fines possible (up to 4% of annual revenues or € 20M)
MiFID II / MiFIR	<ul style="list-style-type: none"> • Strengthen investor protection • Improve the functioning of the financial markets • Make markets more efficient, resilient and transparent • Application as from January 3, 2018 	<ul style="list-style-type: none"> • Target investor base and markets have to be clearly defined and monitored • Full transparency on fund costs and charges becomes mandatory • Ban on inducement fees • Oversight on distributors is compulsory
SFTR	<ul style="list-style-type: none"> • Transparency towards regulators on the use of Securities Financing Transactions • Transparency towards investors 	<ul style="list-style-type: none"> • Mandatory monthly and annual reports to regulators and investors on SFTs • Stricter conditions on the reuse of instruments already provided as collateral • Investor consent on re-hypothecation
PSD2	<ul style="list-style-type: none"> • Promote innovation towards new payment institutions • New reporting obligations related to payments services (fraud, incidents, risks) for banks 	<ul style="list-style-type: none"> • Recurrent and consolidated reports to be sent to the competent authorities within a short timeframe • Increased risks on electronic channels available to initiate clients operations

Key trends | Luxembourgish banking sector

Banks face efficiency pressure while working on more client centricity and servicing through technology developments

KEY TRENDS OBSERVED IN TODAY'S BANKING MARKET IN LUXEMBOURG



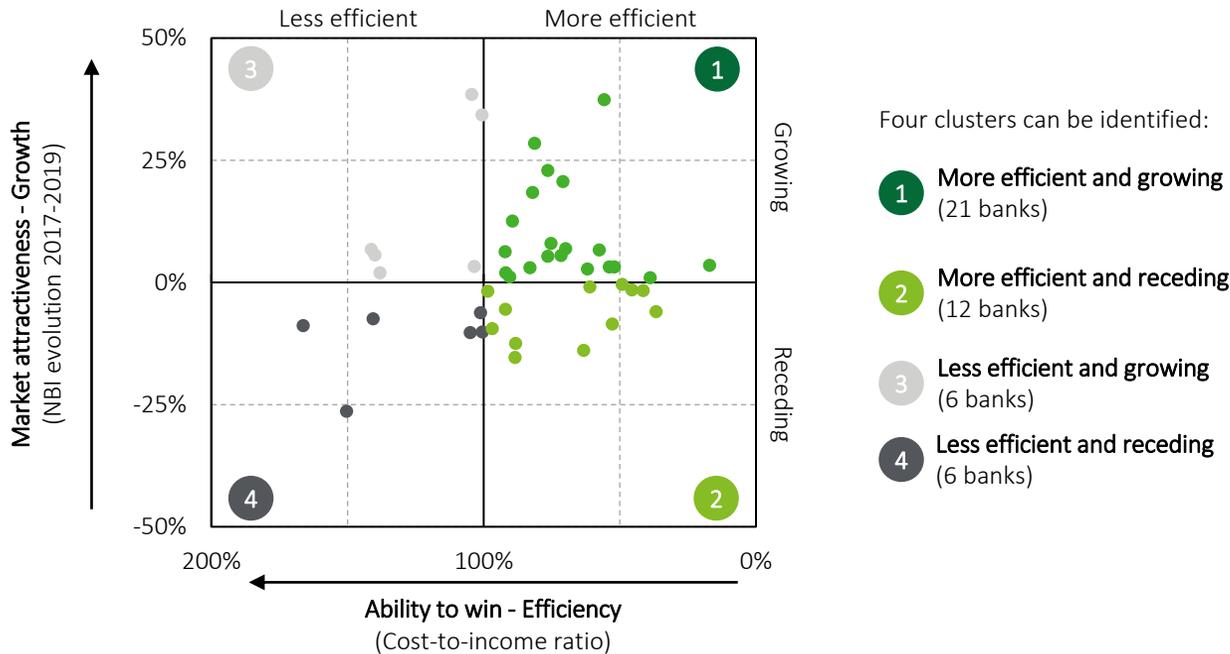
Source: Deloitte analysis; Deloitte project experience and private banking know-how

Key trends | Luxembourg private banking market

The overall market attractiveness is rather low with negative revenue growth and efficiency under-pressure

MARKET OVERVIEW

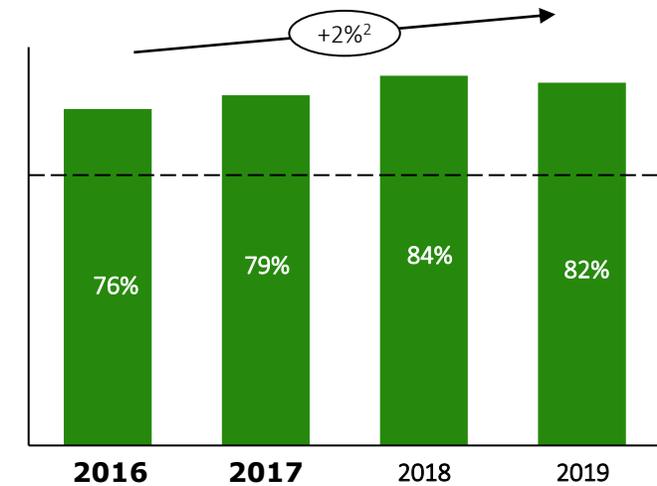
More than half of the banks (24 banks out of the 45) with private banking activities in the benchmark are either **not efficient, receding or both**. Overall median cost-to-income ratio of 82% and overall median of NBI evolution 2017-2019 of 2.8%.



ZOOM-IN EFFICIENCY DRIVERS

Less efficient

Private Banks' cost-to-income (%)²



Key: ■ Median cost-to-income ratio (%)

Cost-to-income ratio for 2019 players shows an increase from 2017 to 2019 with a CAGR of 2%

Luxembourg Private Banking market is experiencing the same efficiency pressure, with difficulties to grow revenues, while technology developments are becoming concrete.

As for the rest of Europe, the outsourcing of non core / non differentiating activities is hence fully applicable to Luxembourg Private Banking market.

The case for outsourcing and mutualization

What do mutualization and outsourcing bring?

Overview of the main opportunities driven by cost reduction and the concentration on core capabilities

1



Increased efficiency

By leveraging on the partner's IT and human capital.

3



Enhanced service offering

By leveraging on the activities of the partner, allowing to strengthen the bank's market position.

5



Risk transfer

Operational risks are shared with the partner.

2



Increased flexibility

Outsourcing transforms many of the fixed costs into variable costs, thus providing more flexibility for the business.

4



Enhanced service quality

By leveraging the knowledge and expertise of the partner, thus increasing the quality of the output.

6



Favorable regulatory framework

Strong legal framework created by the European financial industry regulators, ensuring that outsourcing providers are regulated to the same extent as financial institutions.



Cost reduction

By leveraging the partner's economies of scale, whilst reducing the headcounts.

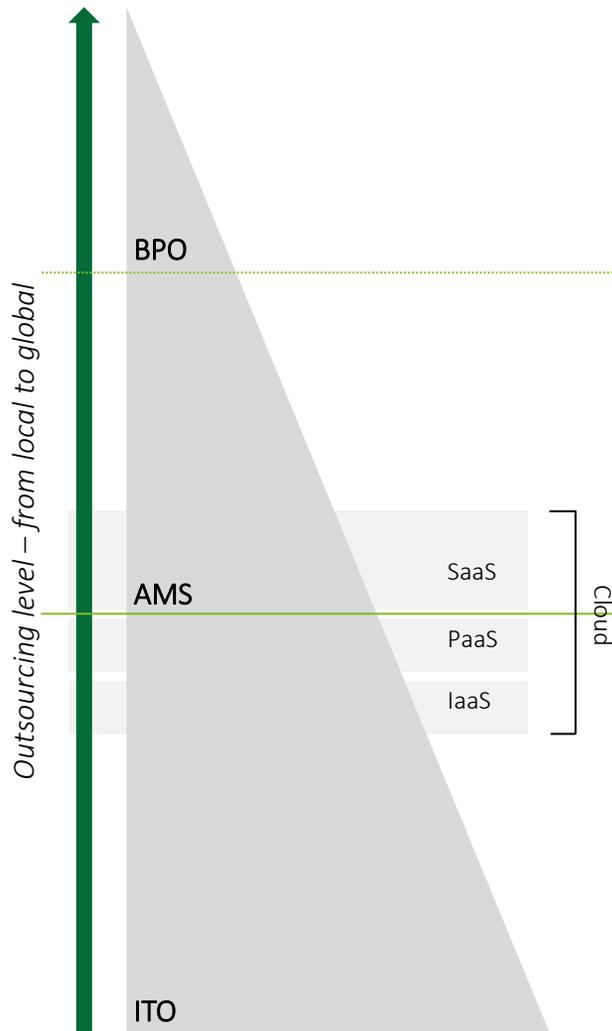


Concentration on core capabilities

Refocusing both efforts and financial resources on core business activities, thus delivering additional value to the customer.

Specific outsourcing & mutualization types per organization level

Three levels of services



Business Process Outsourcing

BPO involves the contracting of the operations and responsibilities of specific business functions (or processes) to a third-party service provider.

Most services provided by BPO vendors are offered on a fee-for-service basis.

Application Management Services

AMS includes, among other things, Software as a Service (SaaS):

SaaS is a software distribution model in which applications are hosted by a service provider and made available to customers over a network. The development, maintenance and trouble-shooting of the modules is undertaken by the service provider.

Information Technology Outsourcing

Contracting with outside consultants, or software vendors to perform systems analysis, programming and data center operations.

- Data Center /Facilities and services (e.g. Hosting, housing, DRP).
- Infrastructure Management (e.g. Infrastructure reception, installation, decommissioning, network management, security management, monitoring, etc.).
- Managed Services / IaaS (e.g. Open servers, workstations management, server provisioning (Cloud), storage services, online backup, Business Continuity Planning, etc.).
- Platforms (PaaS) (e.g. Licenses upgrade management, database, operating systems, virtualization, Virtualized Desktop Infrastructure (VDI), web hosting, etc.).

ITO providers

There are 4 types of ITO service providers that will bring different areas of expertise and benefits

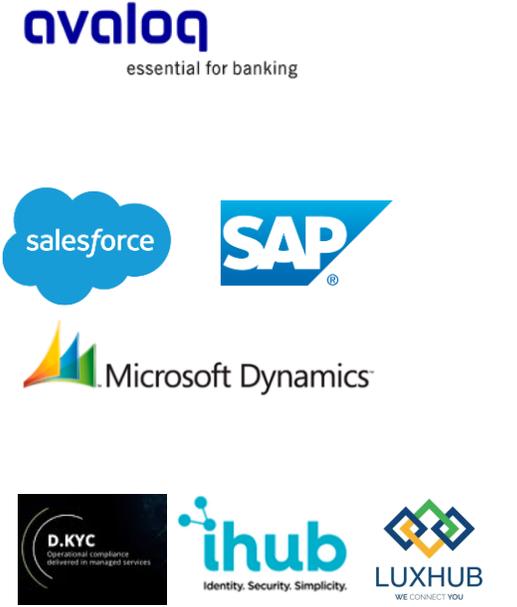
Different types of ITO providers	Description	Strengths/Weaknesses	Examples of providers with relevant offerings
Banks	Banks offering their in-house built successful solutions, sometimes created as a spinoff of their IT department	<ul style="list-style-type: none"> • Build solution and services based on deep understanding of the business and day to day issues 	
Software providers	Technology companies specialized in developing software solutions for different industries including banking	<ul style="list-style-type: none"> • Provider/developer of the solution adjusted to the market needs • Limited regulatory knowledge, can require consulting support 	
Integrator / consulting providers	Consulting companies and integrators, knowledgeable about products and solutions on the market with capacity of implementing various solutions	<ul style="list-style-type: none"> • Can help with selection of best fit solution • Deep knowledge of the market and offerings 	
New players / FinTechs	New technology players specialized in specific areas, with innovative solutions and low costs, bringing enhanced user experience	<ul style="list-style-type: none"> • Innovative and specialized solutions • Competitive pricing • Limited experience and client base in banking 	

European market (incl. Luxembourg)

Depending on client context, internal IT and business operations size and complexity, some providers will likely be more suitable

AMS providers

3 functions can be outsourced by banks to AMS providers

Functions	Description	Strengths/Weaknesses	Examples of providers with relevant offerings
Core banking system solutions	Back-end system handling all banking transactions. A typical core banking system comprises deposit, loan, credit processing and securities activities	A bank can decide to outsource all three listed functions. Ultimately, it all comes down to the risk appetite and the accepted loss of control, while adopting customer-oriented solutions adapted to the latest market trends.	
Customer Relationship Management systems	Solutions helping businesses manage all company's relationships and interactions with customers		
Regulatory solutions	Complete solutions aiming at helping banks be compliant with European and local regulations		

European market (incl. Luxembourg)

BPO functions

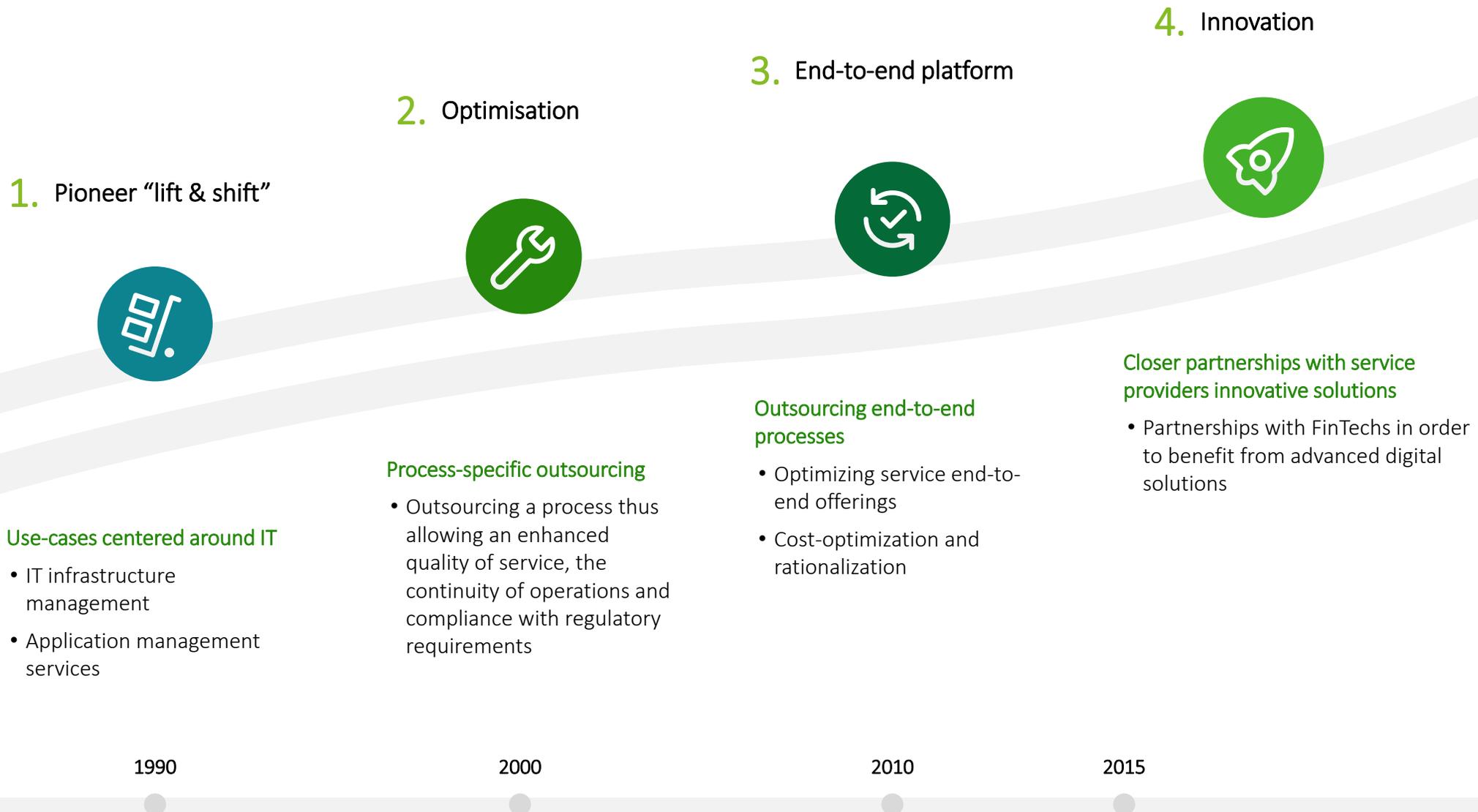
2 main functions can be outsourced within BPO according to banks' needs

Functions	Description	Strengths/Weaknesses	Examples of providers with relevant offerings
Back Office functions	Internal business functions: finance, accounting, human resources, compliance. These functions do not directly generate revenue	<ul style="list-style-type: none">Historically BO functions were mostly outsourced. External providers thus have the necessary experience to perform such activitiesLow risk of outsourcing or mutualizingReduction in operating costs	 <p>European market (incl. Luxembourg)</p>
Front Office functions	Revenue-bringing functions such as Sales, M&A, Trading and Advisory. Partnerships between banks and third-parties such as FinTechs, especially in order to benefit from specific digital capabilities	<ul style="list-style-type: none">Strategic partnerships are more interesting in this caseThe risks of not having these functions in-house are higher<ul style="list-style-type: none">Possible loss of customer relationships	

Outsourcing can be an alternative to any new service a bank intends on launching.

Scope of outsourcing and mutualization

Evolution as per industry requirements



Business case: collaboration

LUXHUB - PSD2 compliance



Problem

Under PSD2, banks have to allow third-party providers (TPPs) to access payments accounts of their customers (when consent is provided). This access must be done through “XS2A” (access to accounts), an API that must be ISO20022-compliant. Additionally, banks will have to support TPPs with the API documentation and a dedicated sandbox.

Solution

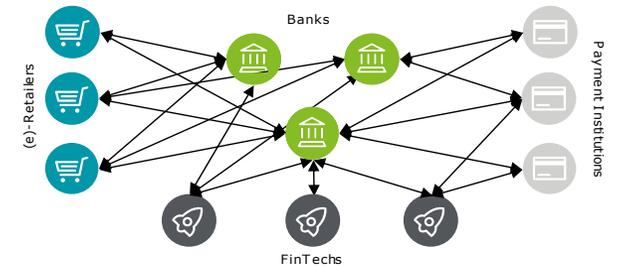
A consortium of banks in Luxembourg decided to work together to build a solution (LUXHUB) able to centralize all these requirements into a single platform (technical requirements of PSD2 and requirements such as supporting TPPs, managing their onboarding, etc.)

Benefits

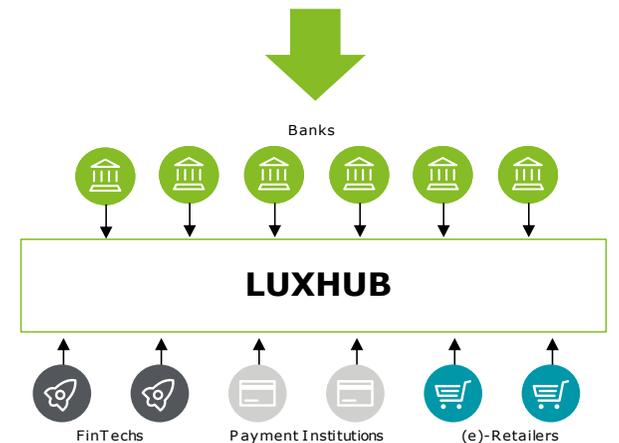
Compliance costs, as well as hardware and infrastructure are mutualized between LUXHUB and the banks. Banks are compliant with PSD2 requirements and can provide their clients with a complete up-to-date solution. Additionally, banks benefit from LUXHUB’s expertise in connectivity and standard interfaces, who is also the single point of contact with TPPs.

Limits

Oversight requirement must be enforced by banks.
Loss of knowledge and expertise.



From a non-organized model where each bank has to provide an XS2A solution to comply with PSD2...



... to a solution where a central platform enables banks to mutualize operational & technical challenges to allow third-party providers to access their accounts and propose new services!

Business case: outsourcing

I-Hub – KYC process automation

Problem

KYC processes require a significant initial investment, as well as important maintenance costs and a strong infrastructure.

Solution

Digital and secure storage solution: banks can thus, -by subscribing-, outsource their KYC tasks to I-Hub, in order to benefit from a complete KYC solution for the management and digital storage of their clients' data.

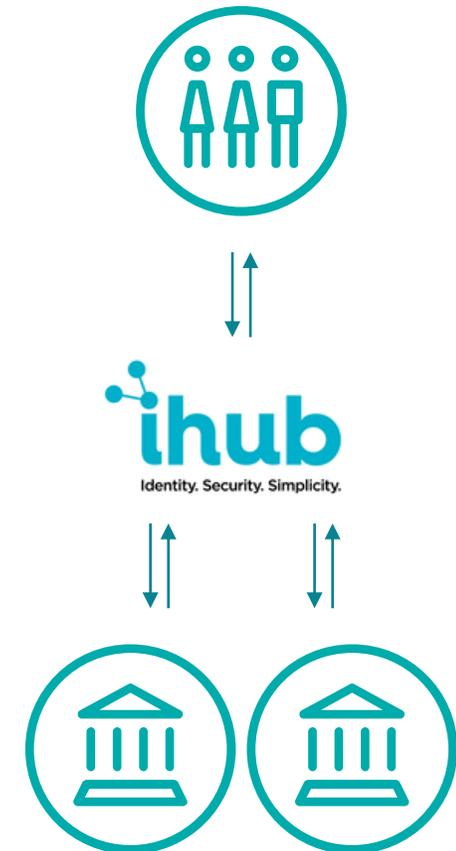
Benefits

Mutualized solution leading to a reduction in costs. Additionally, operational efficiency is optimized.

Improved client experience.

Limits

Creation of an important dependency vis-à-vis I-Hub with a control loss, that can become an important risk if not managed correctly.



Business case: outsourcing

Digicash – Mobile payment solution



Problem

Transferring money to other banks takes several days, thus delaying important payments.

Solution

Digicash (via Payconiq) offers a complete solution for instant money transfers, online paying, bills paying and in-shop paying in the BENELUX countries.

Benefits

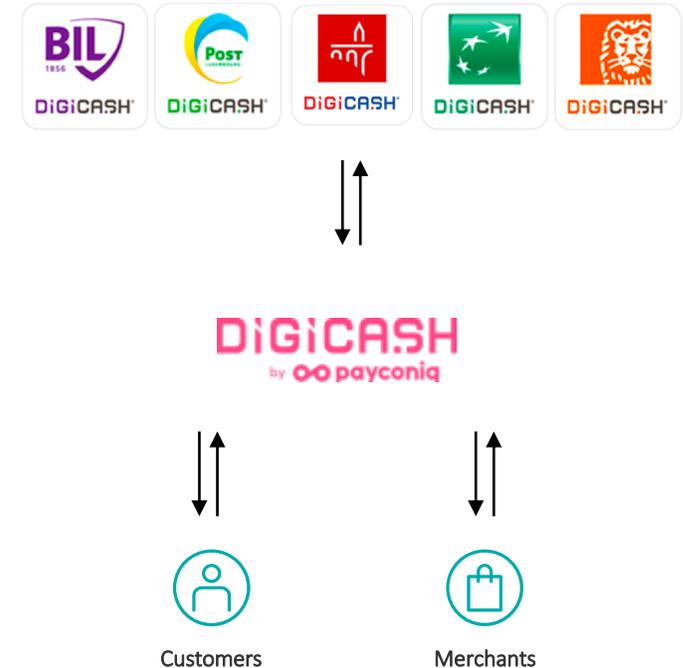
Digicash offers an easy-to-use solution allowing instant payments and transfers, with high security and encryption standards.

The user experience is enhanced, thanks to the use of smartphones only, through the scanning of QR codes.

Additionally, fees for card schemes are eliminated.

Limits

Not all banks within BENELUX are Digicash partners. No interoperability with other similar solutions.



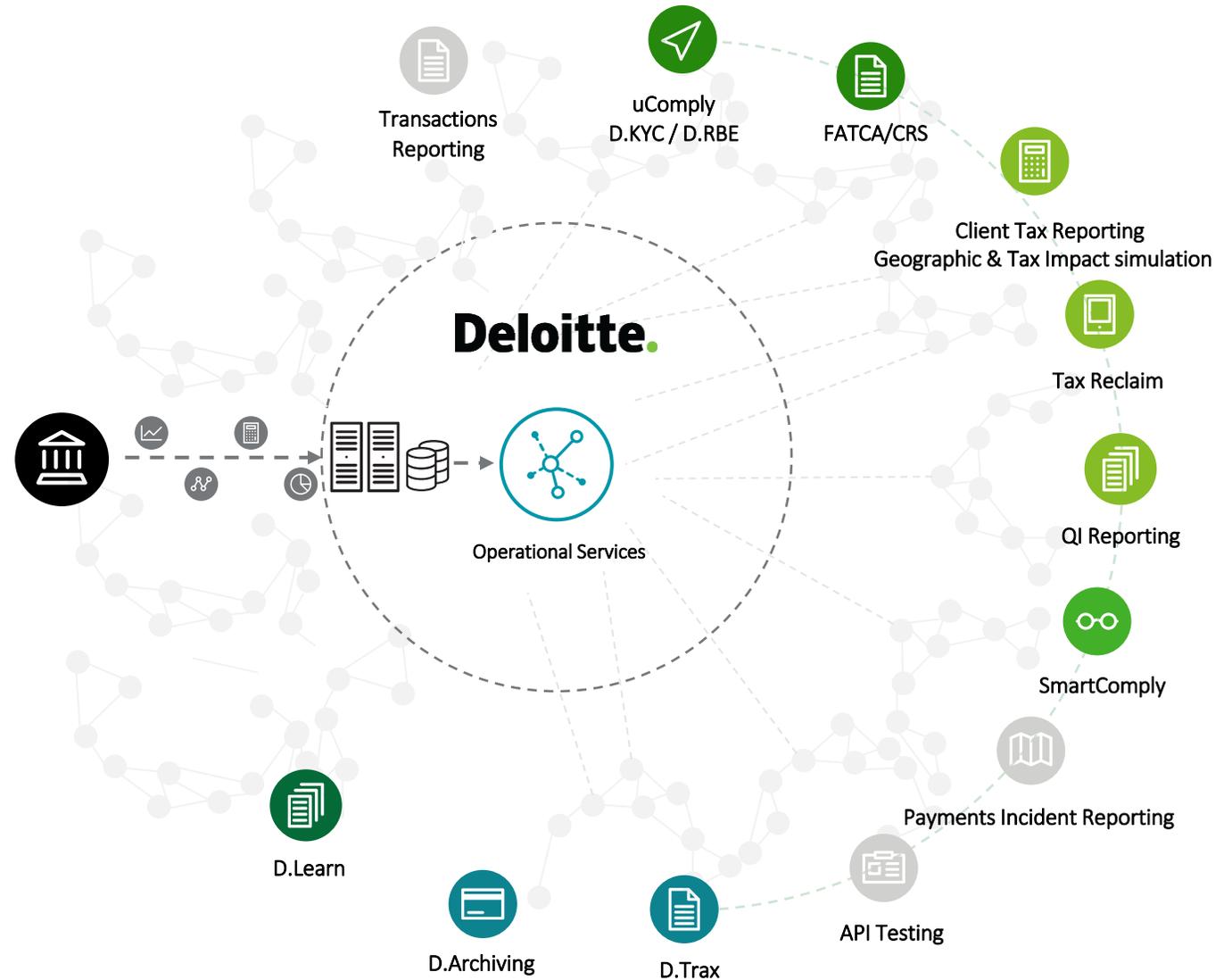
Other examples of broader outsourcing

Our range of services help banks deal with current market concerns

The below list of operational services evolves constantly to fit with banks activities and ensure a smooth integration in their ecosystems

The typical services that our clients are willing to outsource given their

- Low-added value for their day-to-day business,
- Or high-level of technicity or requirements in terms of technology.



Thank you for joining
today!



› Time for questions



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