Darling, do you want to marry me?

Business process outsourcing, a shared future together.

A possible new business in Luxembourg?
Business Process Outsourcing will prove compelling!

- Financial institutions in Luxembourg will have to consider business process outsourcing options in the next years
- The demand is increasing in Luxembourg while the supply side is lagging behind
- There is a clear market in Luxembourg
- There are important opportunities, but also challenges related to BPO
Why financial institutions may consider business process outsourcing as an option?

When is it worthwhile for customers to outsource certain processes?

Based on experience, which processes qualify for outsourcing and which do not?
Financial institutions in Luxembourg have to face substantial challenges independently of their business model:

**Pressure on profitability**
- Low level of ROE, especially for smaller institutions
- Increased CIR due to lower revenues and higher cost of compliance
- Decreasing pretax profit margins

**New markets and new client types**
- From local to global - Growing importance of emerging countries, in particular Asia Pacific region
- New client typology – new clients from emerging countries and new connected generation in all regions (digital)
- Focus on the customer side – customer retention and acquisition

**Regulatory pressure acceleration**
- Global and local regulations seeking:
  - Tax transparency
  - Customer protection
  - Prevention of financial crime
  - Market stability
  - Tax compliance and disclosure

**Outdated technology legacy and digitalisation**
- High technological legacy costs
- High complexity
- Lack of flexibility
- No adapted to fit digital needs
- Technology as a "must" and "competitive advantage"
- Increasing importance of digitalisation

---

**Need to develop a sustainable operating model**

Source: Deloitte analysis

© 2015 Darling, do you want to marry me? - Business process outsourcing, a shared future together
According to a recent Deloitte European survey, the focus of private banks is changing to a more and more customer oriented approach.

To focus on **client relationships** rather than executing my back-office processes and activities in-house.

79% Agree
17% Neutral
4% Disagree

Today the question is not anymore how well you can run your back-office functions with internal resources.

The question is to consider whether running those functions internally is actually part of the core strategy of your business.

Source: Deloitte analysis
To adapt to their new challenges, financial services institutions will need to identify the right approach for the transformation of their operating model - External sourcing and especially BPO will prove compelling!

CoE: entity providing leadership, best practices, research, support and knowledge
SSC: entity responsible for the execution and the handling of specific operational tasks

There is an important first mover advantage for large institutions, especially in terms of HR

© 2015 Darling, do you want to marry me? - Business process outsourcing, a shared future together
What should be outsourced?
Strategic categorisation of functions is required to design the target operating model

- Business relationship entry
- Loan origination support
- Business analysis
- Premium collection
- Litigations management
- etc.

- Fund administration/investor services joint-ventures
- Credit cards management
- Some ongoing discussions with some large banking groups for back-office functions

Source: Deloitte analysis
Some functions can be outsourced while other should be kept internally or shared within the group – a clear split between commodity and value added services/products is key.

Subject to outsourcing
Partly outsourced
Bank (local, SSC, CoE)

**Banking**

- Subject to outsourcing
- Partly outsourced
- Bank (local, SSC, CoE)

**Life insurance**

- Subject to outsourcing
- Partly outsourced
- Bank (local, SSC, CoE)

Source: Deloitte analysis
There are three options for a financial institution to outsource its operations and IT

1. Transformational outsourcing
2. Creation of a joint venture as first step towards outsourcing
3. Internal/progressive transformation and an outsourcing in a second step

The majority of BPO service providers were created as a result of initiatives from the financial institutions (carve-outs)

Source: Deloitte analysis
Are we meant to be together?

What is the current state of the demand side?

What is the current state of the provider side? And how does it look in terms of future developments?
About 30% of financial institutions will consider outsourcing in BeNeLux in the next 5 years

Market potential of different geographies

Today for the financial industry
IT and business process outsourcing global market of 150 EUR bn, 7% CAGR

Types of potential customers and their characteristics

1. **Small to mid size private banks**
   - Need for specialization, skills, replacement of legacy platforms, cope with regulatory requirements & new functional needs (e.g. digital)

2. **Small universal banks**
   - Need for an offering able to cope with breadth of their service, size and digital requirements

3. **Wealth management companies**
   - Need for specialization, skills, replacement of legacy platforms, cope with regulatory requirements & new functional needs (e.g. digital)

4. **New banks**
   - Time-to-market & variable costs

**Insurance undertaking with run-off portfolios**
- Need for basic service offering, flexibility, decreasing volumes, costs management, replacement legacy platforms

**Insurance undertakings with new business**
- Need for new platform, time-to-market

Source: Deloitte market study
Outsourcing for the financial industry has evolved during the last years and will continue to evolve.

**Pioneer – “lift & shift”**
- IT infrastructure management, application management, and project-based IT related professional services mostly structured around wages arbitrage

**Optimisation**
- Process-specific outsourcing
- Optimisation and continuous improvement of existing outsourcing
- Some selective inclusion of innovation

**End-to-end process**
- Outsourcing of end-to-end processes
- Platform-based BPO – standardised platforms and processes (Modelbank concept)

**Innovation**
- Increased value add, innovative solution architectures and much closer partnerships between clients and service providers

**Type of outsourcing**

- **Horizontal**
  - E.g. IT infrastructure

- **Vertical**
  - E.g. data management & pricing

- **Full**

- **Multi-Sourcing**

Source: Deloitte analysis

© 2015 Darling, do you want to marry me? - Business process outsourcing, a shared future together
The BPO market has developed further and is composed of different types of offerings but it is far from being a mature product in Luxembourg.

- **Niche BPO providers**
  - Deloitte
  - SIX
  - BNP PARIBAS Securities Services
  - Clearstream
  - BBP
  - Société Générale

- **End-to-end BPO providers with increasing global reach**
  - Avaloq
  - Lombard Odier
  - Credit Agricole
  - Xiangning
  - Weggelin & Co.
  - Finanz Logistik
  - Sab
  - Wegelin & Co.
  - Opexia
  - Swisscom
  - Pro Capital

- **End-to-end local BPO providers**
  - MONTBEL
  - SAB
  - Wegelin & Co.
  - Ipsii

**INSURANCE:**
- The regulatory and legal framework has been created recently allowing outsourcing as a sourcing option for insurance undertakings.
- The first PSA has been created in 2014 in Luxembourg.
- In Ireland some offerings already exist, e.g., Ipsii, Percana.

Source: Deloitte analysis
Do I really want to get engaged?

What are the advantages for financial institutions to outsource?

Can the customer save costs on the one side while the provider makes money on the other?
The BPO provider must offer a better alternative to financial institutions in order to make it worthwhile!

The BPO provider must offer to its customers

• Economies of scale with the goal of cost reduction

• Transformation of fixed into variable costs

• A state of the art platform and the continuous maintenance of the platform in the future (digital)

• The opportunity to focus on the core business banking, time-to-market and customers

• The opportunity to build international activities

• Increased quality & control

• Standardised processes

Source: Deloitte analysis
Depending on the starting position, it is challenging to create a cost advantage for the client and a margin for the provider.

**Efficiency gains to be realised by the provider** by new/improved levels of automation and by the onboarding of additional clients – pulling volumes together and sharing the fixed costs on a larger number of clients.

<table>
<thead>
<tr>
<th>Cost base of outsourced services</th>
<th>New overhead/retained organization</th>
<th>Cost savings client</th>
<th>VAT</th>
<th>Margin provider</th>
<th>Provider allocated cost base</th>
</tr>
</thead>
</table>

*Optimisation potential to mitigate VAT impacts*

*Source: Deloitte analysis*
What do we have to do to make it work?

What have been the experiences so far?
What are the difficulties for the outsourcing business model?
BPO customers and service providers find themselves facing a major task (1/2)

The detailed definition of the scope and business case are key in a BPO project

There will be important implications in terms of indirect and direct taxes

Carefully evaluate the implications for your employees and initiate a change management strategy early on in the process when considering BPO. This will avoid issues and ensure commitment from all employees

BPO can represent major risks both during the transition and in the long run for an organisation which will have to be managed properly

The parent company, government, regulatory authorities and trade unions will have to be involved
BPO customers and service providers find themselves facing a major task (2/2)

Third parties will potentially be involved in the new relationship

An in-depth due diligence, structured contracting negotiations and execution are the baseline for a successful project

Collaborative governance is key for the success of the outsourcing

A strong transition & transformation partner will facilitate the project
Do we need a wedding planner?

How to organise once the decision to outsource has been made?
The use of an external partner will help you to ensure that you stay focused throughout the project on where you want to go while managing all the elements and stakeholders.

1. Assess general strategic interest for the BPO opportunity and build a high-level business case
2. Provider selection (RfP) and refine the business case
3. Transition and transformation preparation
4. Transition and transformation execution
Contacts

**Technology & Enterprise Application**

Patrick Laurent  
+ 352 451 454 170  
palaurent@deloitte.lu

**Strategy, Regulatory & Corporate Finance**

Pascal Martino  
+ 352 451 452 119  
pamartino@deloitte.lu

**Operations Excellence & Human Capital**

Lisa Sophie Kleiss  
+ 352 451 452 713  
lskleiss@deloitte.lu
Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see [www.deloitte.com/lu/about](http://www.deloitte.com/lu/about) for a more detailed description of DTTL and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries and territories, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte’s more than 200,000 professionals are committed to becoming the standard of excellence.

In Luxembourg, Deloitte consists of 83 partners and about 1,600 employees and is amongst the leading professional service providers on the market. For over 60 years, Deloitte has delivered high added-value services to national and international clients. Our multidisciplinary teams consist of specialists from different sectors and guarantee harmonised quality services to our clients in their field.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the “Deloitte Network”) is, by means of this communication, rendering professional advice or services. No entity in the Deloitte network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.