



Private banks' securities processing in Germany

Is Business Process Outsourcing the right strategy and which BPO provider fits best?

Key results from a market analysis

Munich, March 2008

THE MARKET ANALYSIS

Securities processing is commonly considered as a back office activity with a distinctive suitability for Business Process Outsourcing (BPO). Due to its non-strategic nature an outsourcing of securities processing normally does not affect the banks competitive advantages and offers the possibility to benefit from significant economies of scale. However, *private banks* – defined as banks specialised on portfolio management and investment advisory services for wealthy individuals – have to consider additional aspects when taking their “make or buy” decision (e.g. product and process flexibility, confidentiality of customer and transaction data, individualisation of customer reporting).

In order to better understand the sourcing strategies of *private banks* in Germany and to evaluate the outsourcing services offered by BPO providers, METIS conducted a market analysis (including market survey and a series of explorative interviews) in Jan/Feb 2008:

- Initially, the sourcing strategy of 54 *private banks* was surveyed with particular consideration of two criteria, assumed to be of substantial importance for the BPO decision: The bank’s size (i.e. annual transaction volume) and its business model (i.e. target customer segments).
- Subsequently, expert interviews were conducted to evaluate the business models of BPO providers and to assess their strengths and weaknesses.
- Finally, conclusions were drawn under which conditions a *private bank* will take advantage of an outsourcing strategy and which BPO provider fits best for its strategy.

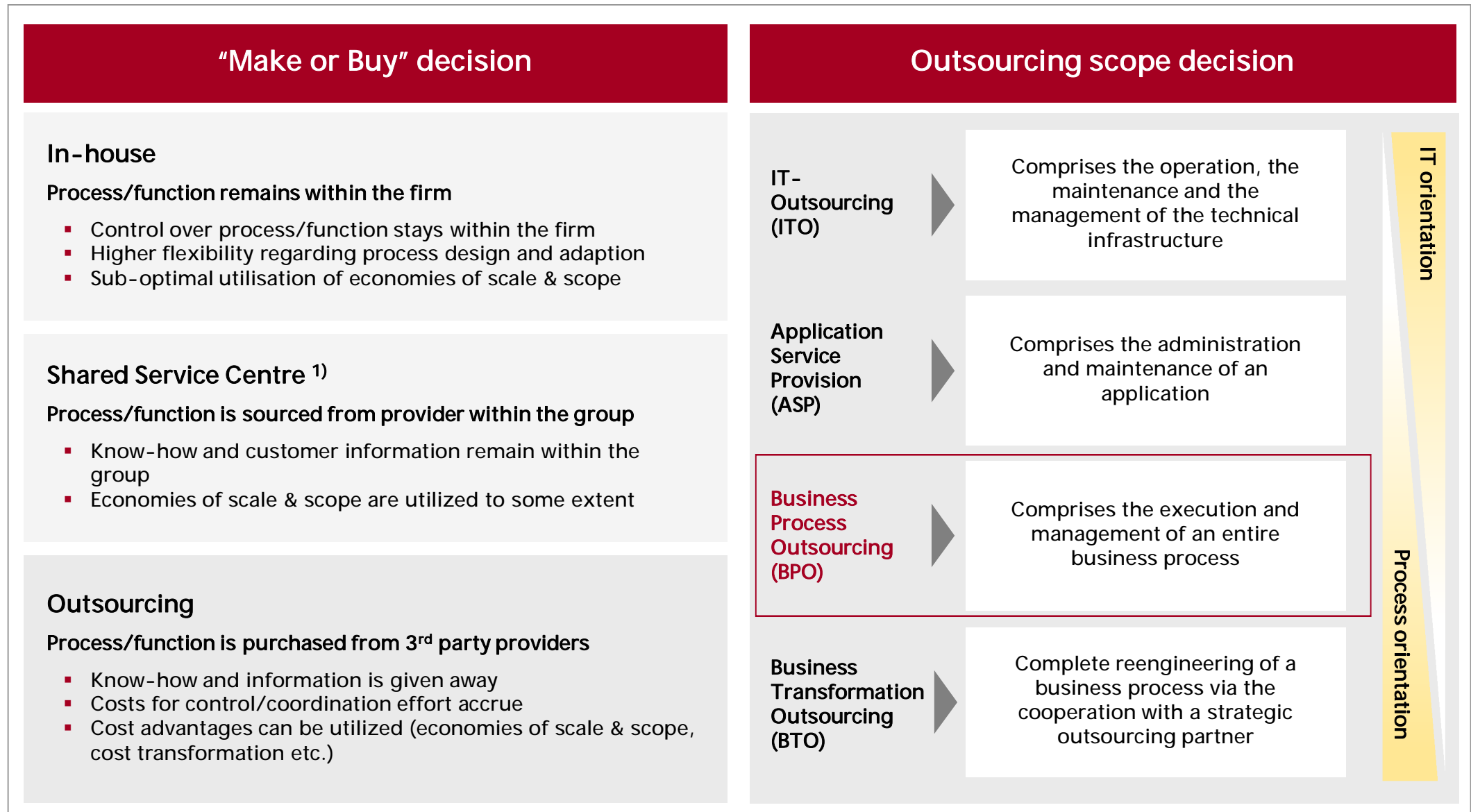
This document summarizes the key findings of the analysis.

METIS MANAGEMENT CONSULTING

METIS Management Consulting is a Munich-based consulting boutique specialised in the Financial Services Industry. Established by former partners of leading international management consultancies (e.g. Ernst & Young, Mitchell Madison Group, A.T. Kearney), METIS can draw on comprehensive project experience in the areas of Private Banking, Securities Services, and Business Process Outsourcing.

1.	Introduction
2.	Sourcing strategies at private banks
3.	BPO providers for securities processing
4.	Conclusions

Business Process Outsourcing (BPO) is one of the strategic options in the context of a bank's sourcing decision



1) Sourcing strategy is only applicable for a company within a group

To take advantage of BPO's key benefits, the relevant bank processes need to fulfil certain preconditions

Business Process Outsourcing (BPO)

Process preconditions

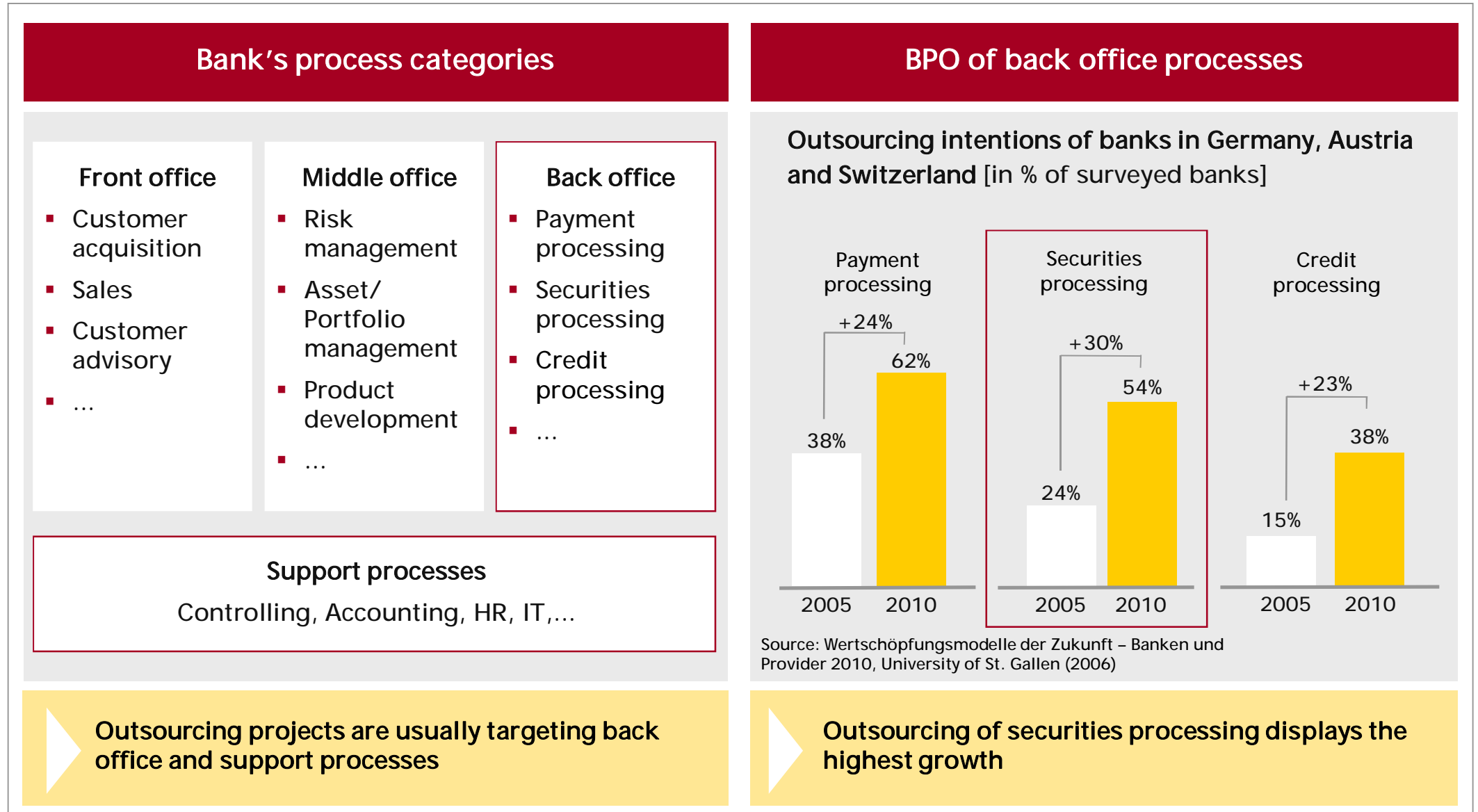
- *No source of differentiation*
Processes must not be source of competitive advantage (i.e. they must not belong to the core competency of a company)
- *Suitability for standardisation*
Only standardised processes will provide outsourcing benefits in terms of cost and quality improvements



Key benefits

- *Positive cost effects*
The outsourcing bank's cost can potentially be reduced by certain outsourcing effects
 - BPO provider's economies of scale and experience curve effects
 - BPO provider's reduced input costs
 - Cost transformation (fixed into variable)
- *Quality improvements*
Through specialisation effects and know-how bundling, BPO providers potentially offer better quality
- *Other benefits*
Complexity can be reduced and risk transferred by the outsourcing bank

In general, securities processing is suitable for BPO and becomes increasingly popular among banks in Germany, Austria and Switzerland



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In the context of this analysis, *private banks* are defined as financial services institutions with clear focus on private banking services

Subject of the analysis and research questions

Definition

Private banks in the context of this analysis are defined as all financial services institutions...

1. ... which are licensed by the German "Bundesaufsicht für Finanzdienstleister" (BaFin) ¹⁾
2. ...with focus on onshore private banking services (i.e. discretionary portfolio management and/or investment advisory) ²⁾

Key characteristics

- *Customer base & bank size*
Less customers compared to retail banks
- *Core values*
Confidentiality and independence are often perceived as core values
- *Business model & target customers*
Service offers range from highly individualised services ("family office") to rather standardised service packages ("mass affluent")

Research questions

Based on the key characteristics of private banks, the following research questions were formulated:

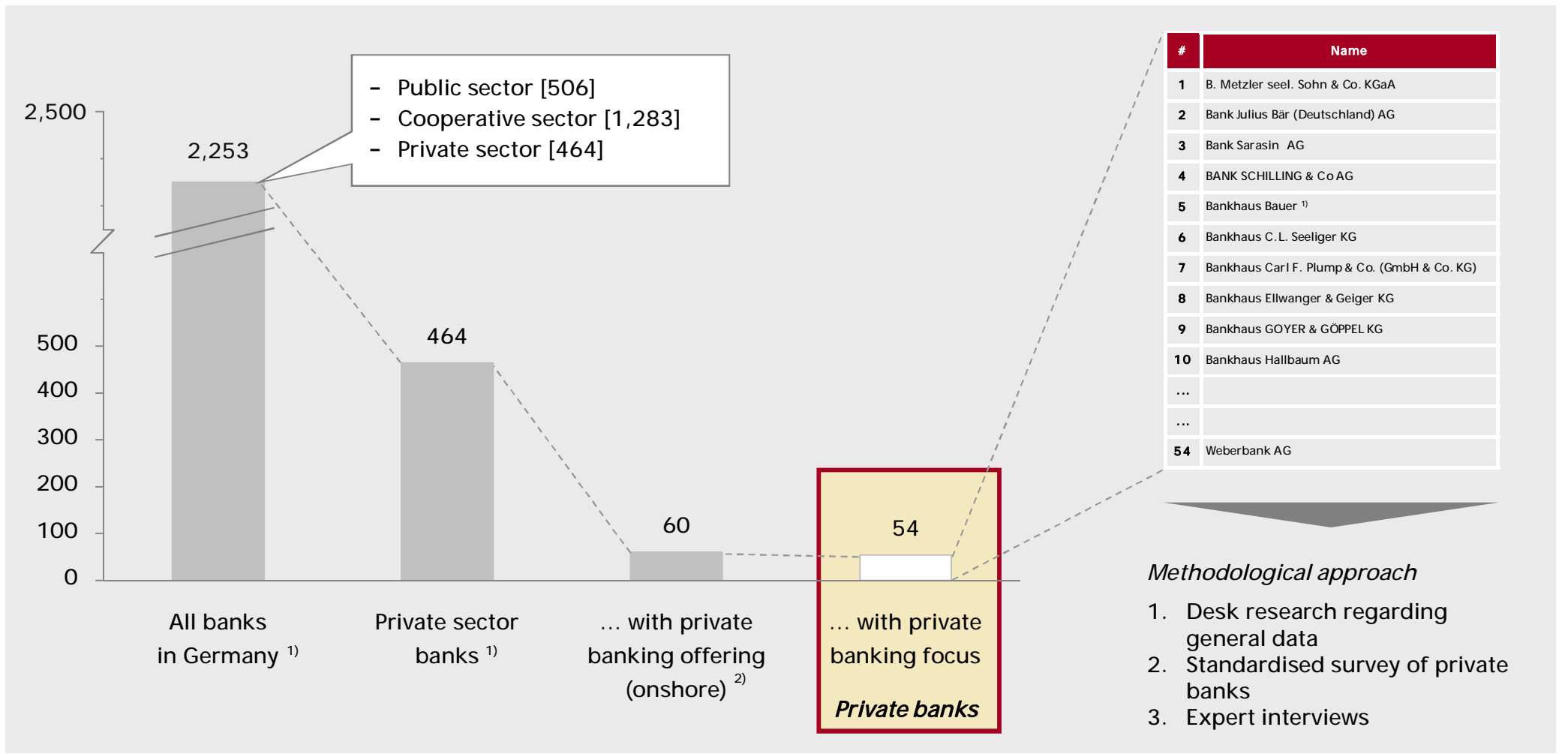
1. How does the bank's size ³⁾ relate to its sourcing decision?
2. How does the business model and the process requirements affect the outsourcing decision?
3. If securities processing is outsourced, which BPO providers are chosen?

1) Or an equivalent license from an EWR country 2) Universal banks are excluded since they have no particular private banking focus

3) Size in terms of transaction numbers

According to the private bank definition, a total number of 54 banks was included in the survey

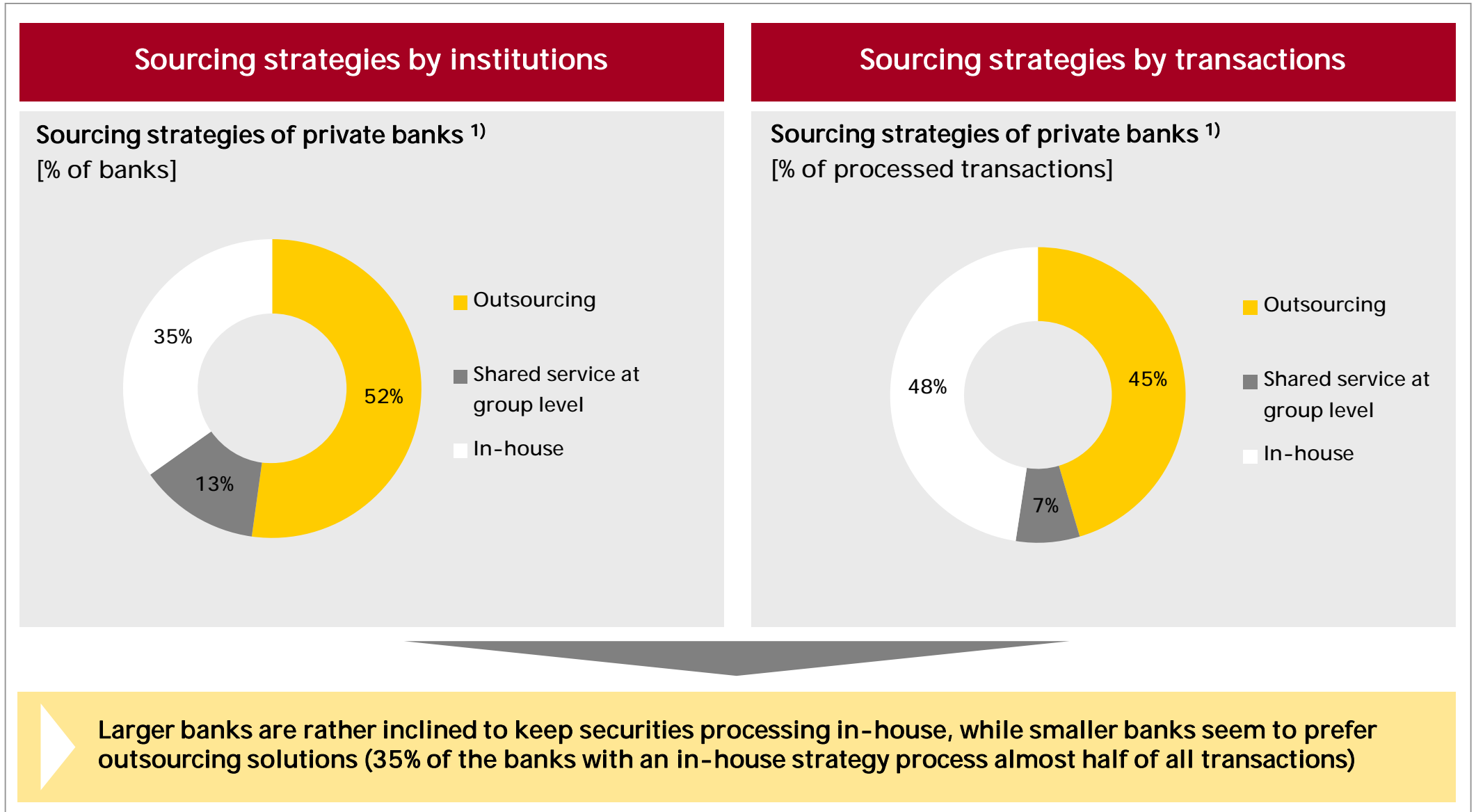
Private banks in Germany



1) Including 173 branches of foreign banks licensed via EU passport
Source: BaFin, company information, market interviews, METIS analysis

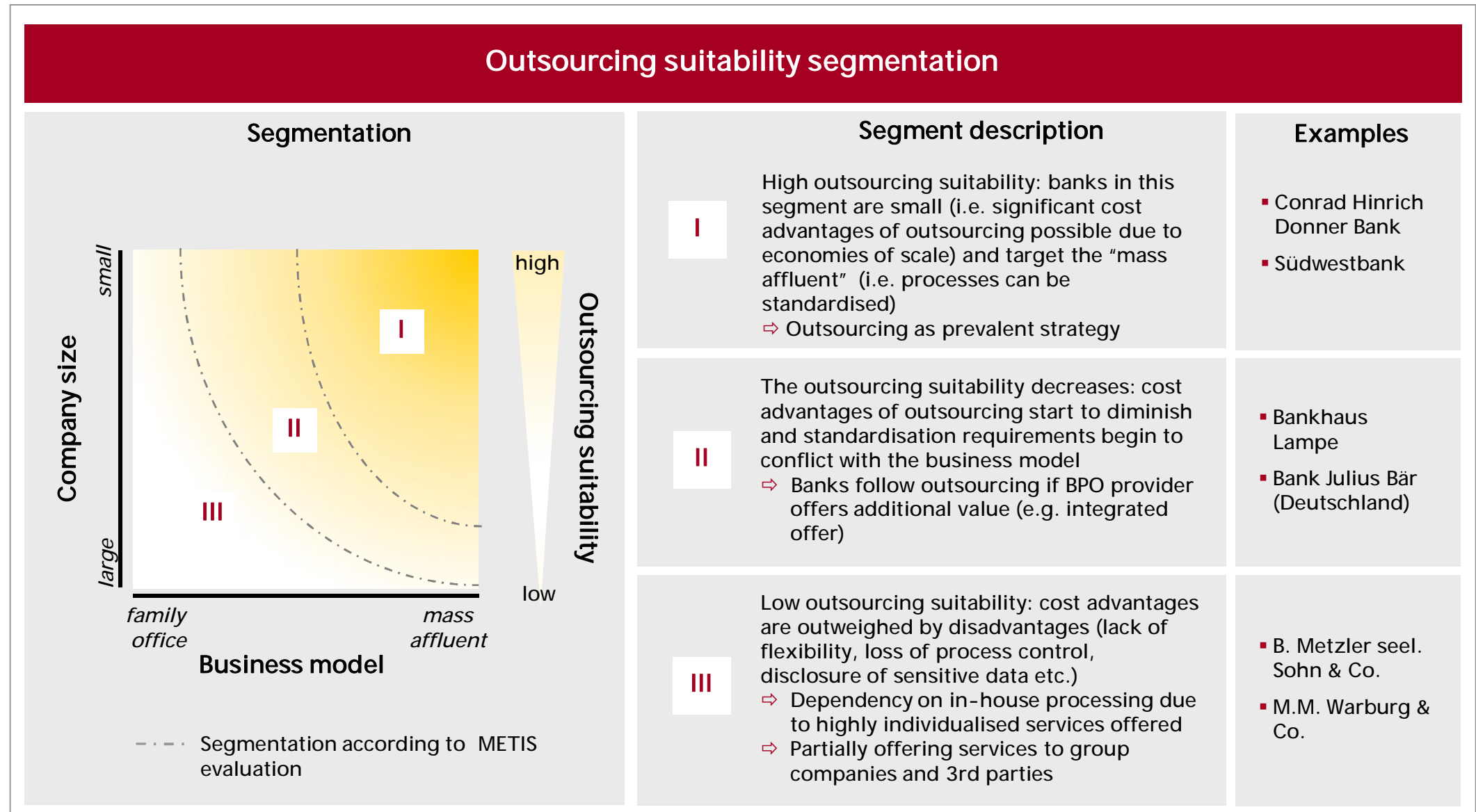
2) Including six major banks: Commerzbank, Deutsche Bank & Dt. Bank PGK, Dresdner Bank, HVB, SEB

Some 50% of the 54 banks have outsourced their securities processing, another 13% use shared services solutions within the group



1) Information available for 85% of the banks
Source: company information, market interviews, METIS analysis

For small private banks with focus on “mass affluent” customers, outsourcing is the prevalent strategy



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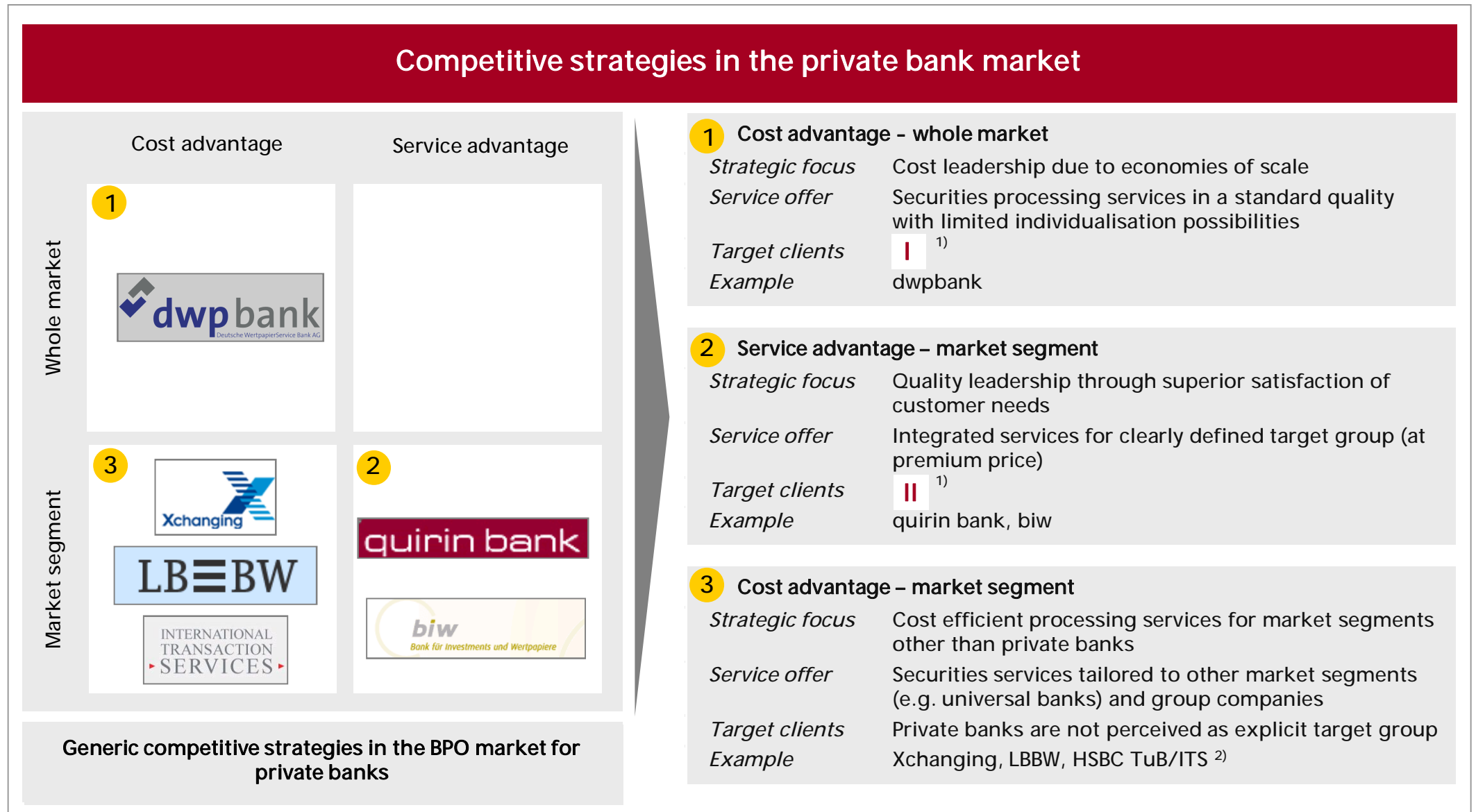
Currently, six BPO providers target private banks in Germany – dwpbank clearly dominates the market

Provider	Systems employed	Private bank clients ¹⁾	Trx ²⁾ p.a. [m]	Securities accounts [m]	Service offer ³⁾			Client portfolio
					SP	CB	PMS	
dwpbank	WP2 (WVS, BSV, WP-Kette)	20	~48 ⁴⁾	~8.8 ⁴⁾	✓	-	-	<ul style="list-style-type: none"> Cooperative financial services network 360 "Sparkassen" and 8 "Landesbanken" 40 private banks (incl. Dresdner Bank, Postbank)
quirin bank	ITREXS	2	~0.3 ⁵⁾	~0.02 ⁵⁾	✓	✓	✓	<ul style="list-style-type: none"> Sachsen LB Tradegate Bank Julius Bär (Deutschland) AG Vontobel (migration phase)
Xchanging	euro-engine2 (DB Trader)	1	~29	~3.4	✓	-	-	<ul style="list-style-type: none"> Deutsche Bank Sal Oppenheim jr. & Cie Sparda-Bankengruppe Citibank Deutschland
biw Bank	XCOM	1	~3 ⁵⁾	~0.05 ⁵⁾	✓	✓	(✓) ⁶⁾	<ul style="list-style-type: none"> E*TRADE Flatex Bankhaus von der Heydt
LBBW	BOS /DIS	1	~3	~0.85	✓	-	-	<ul style="list-style-type: none"> "Sparkassen" (BW & RLP) Bankhaus Ellwanger & Geiger
HSBC TuB/ITS	GEOS	0	45	1.4	✓	-	-	<ul style="list-style-type: none"> HVB Online brokers (DAB, fimatex, sBroker), "Makler"

1) Number of BPO 3rd party "private bank" clients 2) Trx: transactions 3) SP: Securities Processing, CB: Core Banking; PMS: Portfolio Management System 4) Incl. TxB and Dresdner Bank 5) Estimate 6) Provided via third party software

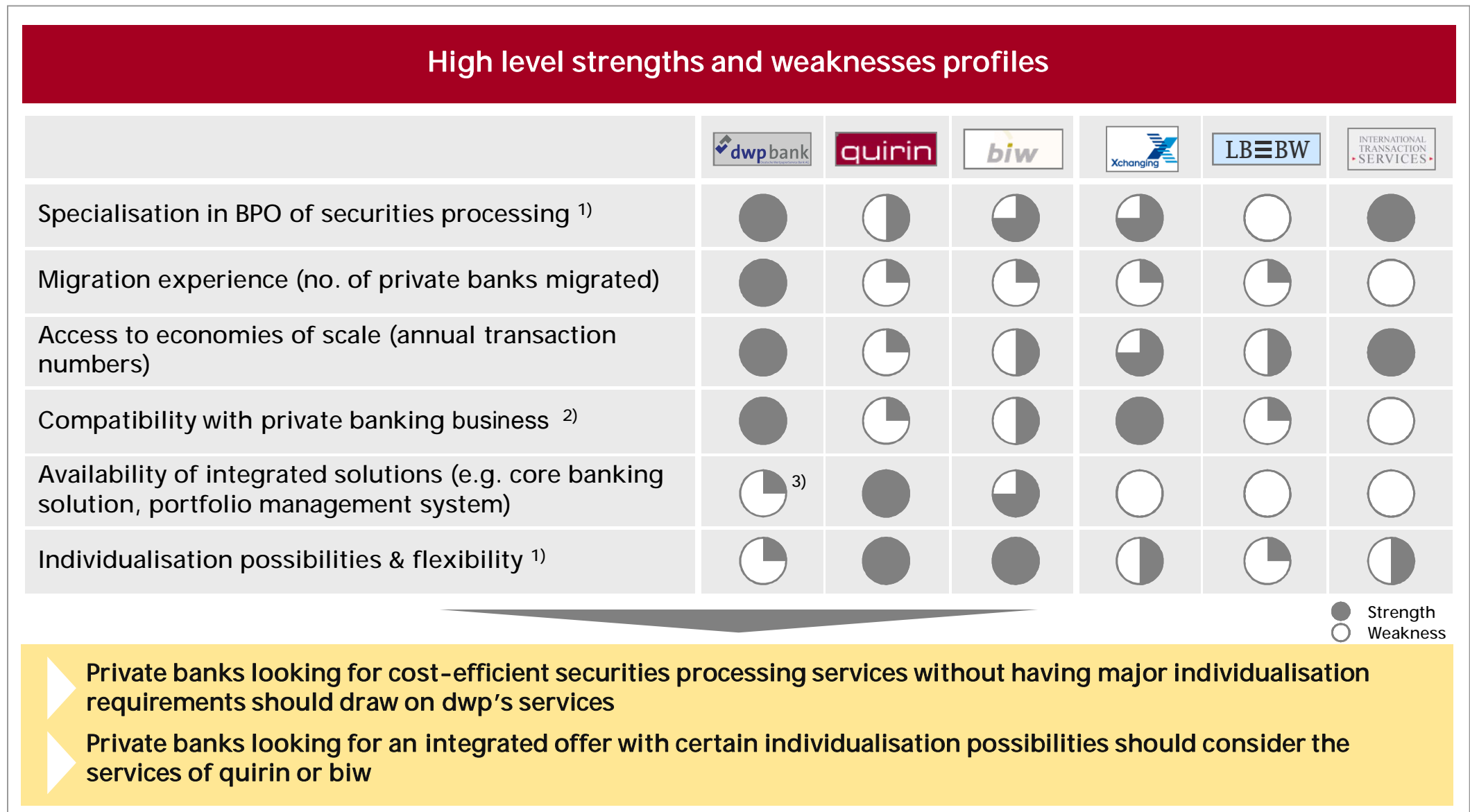
Source: company information, dwpbank, market interviews, METIS analysis

With regard to the private bank market, the business models of BPO providers can be classified into three main categories



1) According to segmentation model (page 11) 2) HSBC TuB/ITS have not served private banks in the past but are supposed to actively target this segment

According to their business models, BPO providers have characteristic strengths and weaknesses



¹⁾ Based on expert interviews ²⁾ If a BPO provider (or the group) offers private banking services itself, the compatibility is assumed to be low (weakness) ³⁾ dwp does not offer an integrated solution; however, core banking solutions within the cooperative financial services network are provided by FIDUCIA/GAD

Source: company information, market interviews, METIS analysis

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Aim of the analysis was not only to gain insights into sourcing strategies of private banks in Germany but also to derive implications for future sourcing decisions of private banks. Based on the analysis results the following conclusions can be drawn:

1. A certain number of private banks is not eligible for outsourcing due to their strategic positioning. On the one hand, this segment includes banks which consider securities processing as part of their core competencies and offer processing services as "Shared Service Centre" for group companies or external clients. On the other hand, it comprises banks for which outsourcing contradicts their "family office" business model where confidentiality of customer data, process flexibility and full process control is of overriding importance.
2. All other private banks have to examine the impacts of BPO carefully in order to choose the right sourcing strategy. Against this background, process requirements regarding flexibility and individualisation have to be analysed since they will considerably determine the expected disadvantages of an outsourcing strategy: The more individualised the business processes and the higher the quality expectations of the customers, the more disadvantages will be associated with outsourcing. After having evaluated the possible disadvantages of outsourcing, the expected advantages have to be specified. The analysis of the internal cost structure will provide the bank with an indication for the dimension of potential cost savings through outsourcing. Furthermore, there might be some quality advantages of an outsourcing strategy which have to be considered as well (e.g. higher process stability and speed).
 - 2.1 For certain private banks this cost-benefit-analysis will yield unambiguous results: Particularly for small private banks with low transaction volumes and rather standardised business models, outsourcing will be an advantageous strategy. These banks should draw on the services of large BPO providers following a cost advantage strategy. Similarly, foreign banks entering the German market should opt for an outsourcing strategy since building up own processing capabilities is associated with significant costs and additional complexity (e.g. tax and regulatory requirements). BPO providers following a quality service advantage strategy are first choice for those foreign banks.
 - 2.2 For other private banks, the result of the analysis will not be that clear. In case the cost-benefit-analysis leads to a positive evaluation of the outsourcing option - despite of a rather individualised business model -, two different implementation scenarios are possible: either the bank can outsource its securities processing services to a BPO provider which follows a service strategy (and which subsequently further customises its service portfolio) or a partial outsourcing solution can be implemented with a BPO provider following a cost advantage strategy. In the latter case, the bank will outsource its standardised sub-processes (e.g. clearing & settlement) only and keep its individualised sub-processes in-house (e.g. customer reporting).

The authors of this analysis can draw on profound experience in the areas of private banking and securities processing



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