

# Inside

Triannual insights  
from Deloitte

Issue 18  
June 2018

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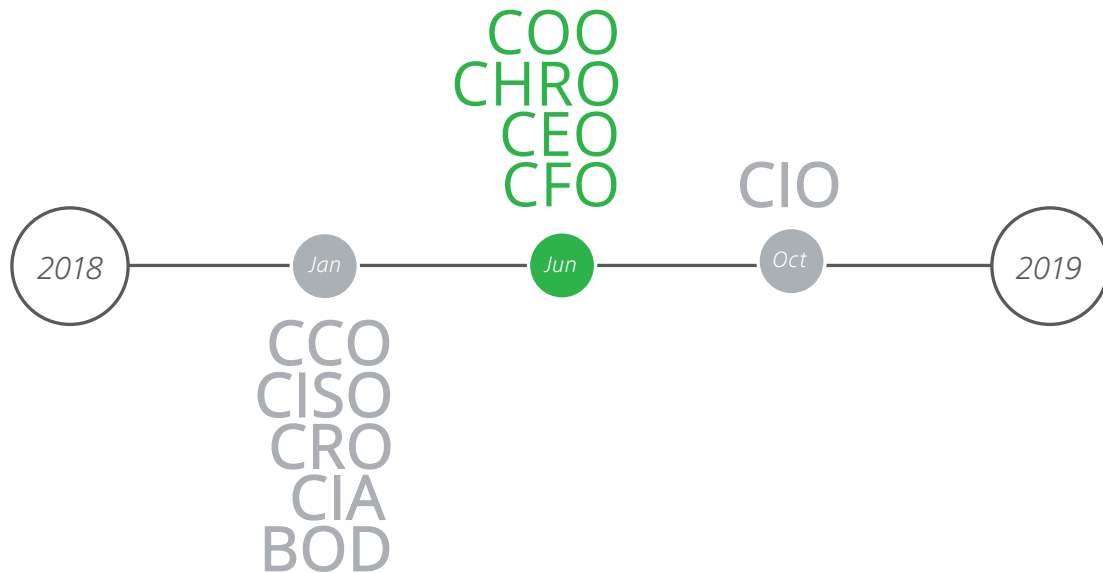
**Deloitte.**

COO  
CHRO  
CEO  
CFO

EDITION  
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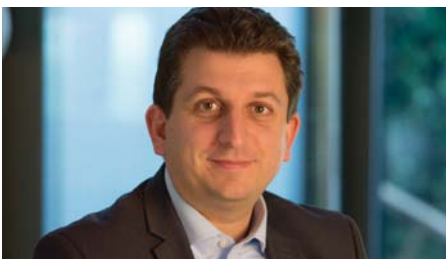
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**Increasing regulatory training requirements in the banking and financial industry**

A burden or an opportunity?

# Foreword



Dear readers,

Welcome to the eighteenth edition of Inside magazine. Inside is Deloitte's quarterly magazine that offers an exclusive insight into best practices, trends, and opportunities that market players in the financial services are currently facing or will face in the near future. Each quarter, we address hot topics related to a specific "C-level" function exploring their corresponding challenges in the current and future business climate. There are three editions over the course of the year: the January risk edition addressed to the Chief Compliance Officer (CCO), the Chief Risk Officer (CRO) and the Governance Body; the June strategic and operational edition (scope of this issue); and the October digital edition addressed to the Chief Information Officers (CIO).

For six years now, the June edition has been dedicated to the Chief Executive Officer (CEO), the Chief Financial Officer (CFO), the Chief Operating Officer (COO), and the Chief Human Resources Officer (CHRO). Thus, we are proud to provide you with the sixth issue that combines our experts' analysis on key areas for leaders responsible for strategic, financial, operational, and human capital decisions.

We would like to draw your attention to the distinct external contributions obtained during the Horizon Conference organized by Deloitte. The 2018 Horizon Conference, held on 3 May, brought together for the

eight time senior industry professionals and internationally renowned keynote speakers with a message to share on the future of the financial industry. A few highlights include, the opportunity to ask Mr. Anders La Cour, CEO of Saxo Payments Banking Circle, his view on the future of Banking and the future of Luxembourg, as well as Mr. Herman Van Rompuy, former President of the European Council, further details on Brexit's impacts. We are confident these interviews will spark your interest.

In addition, we would like to highlight the remarkable analysis from an unprecedented EMEA Digital Banking Maturity study where more than 800 functionalities in more than 200 entities throughout 38 markets have been benchmarked, Luxembourg amongst them. The breadth of this study has been possible thanks to the close collaboration of all the Deloitte member firms in Europe led by Deloitte Central Europe. The results have successfully identified the digital champions in Europe's banking industry, key challenges, opportunities, and much more. We encourage you to dive into this article and contact us should you require further details.

We hope you will enjoy reading this 2018 CEO/CFO/COO/CHRO edition of Inside magazine as much as we enjoyed preparing it. As always, we look forward to receiving your views and comments.

**Joël Vanoverschelde**  
Partner  
Advisory & Consulting Leader

**Pascal Martino**  
Partner  
Digital & Banking Leader

**Andrea Alcaraz Villodre**  
Analyst  
Strategy Regulatory & Corporate Finance

# Editorial

Dear readers,

It is often the case that people overestimate what will happen within the next two years, but always underestimate what will happen within the next ten. The pace of change faced by the economic environment accelerates in time, regardless of the industry we are looking at; it took 62 years for the car industry to reach 50 million users, but only 28 years for the credit card industry, 12 years for the smartphone industry, and 2 years for Twitter. No matter how each of us conceives the speed of the financial industry transformation, we cannot deny that we are in a fast changing environment, and that future success will be dependent on the ability to embrace the challenges of today's world.

Therefore, in this edition, we focus on some of the disruptive trends that capture our attention, and on how firms can capitalize on their strategy and their people to better evolve and build foundations for the future. Market game-changers and technical innovations as well as regulatory perspectives will continue to affect your daily activities and results. Achieving full digital transformation requires new technologies, new processes, and a transcendent change. We hope the vision you will find in the following pages will give

you the necessary overview to position yourself and to conduct the needed shift. Simultaneously, despite low interest rates, market volatility, and client sophistication, firms will see new regulations (and above all, MiFID II) as an opportunity instead of a threat. You will find some concrete and meaningful examples present in this edition.

However, at the end of the day, organizations that will succeed are those that triumph in combining the best of the digital and the best of the human. Firms must hence implement a cultural shift that is as important as the innovation shift. Whether that is strategy, added value, or questioning, it is all about people; staff education, training, as well as management practices have never been as critical as today in adding value to your business.

There is no single technology or approach that will enable your organization to move into the digital age and remain up to speed with continuously evolving regulations. Conversely, firms must engage in an ongoing process of identifying how they can adapt to the disruptive trends and new regulations through their workforce and strategy. This will be the necessary key possessed by the leaders of tomorrow.

We hope you will enjoy reading this issue.



**Deloitte Luxembourg**  
560, rue de Neudorf  
L-2220 Luxembourg  
Grand Duchy of Luxembourg

Tel: +352 451 451  
[www.deloitte.lu](http://www.deloitte.lu)

**Benjamin Collette**  
Partner  
Clients & Industries Leader

**Basil Sommerfeld**  
Partner  
Operations Excellence  
& Human Capital Leader

**François Bade**  
Senior Manager  
Strategy Regulatory  
& Corporate Finance





# Part 01

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From market  
game-changers &  
tech innovations  
perspectives ▶

# THE **FUTURE** OF EUROPE



## *An interview with **Herman van Rompuy**, former President of the European Council*

Elected as the first full-time President of the European Council in November 2009, Herman Van Rompuy took office when the Lisbon Treaty came into force on 1 December 2009. In 2012, he was re-elected for a second (and last) term starting the 1 June 2012 and running until 30 November 2014.

At the time of his first election, Herman Van Rompuy was Prime Minister of Belgium. Prior to that, he had served in Belgium as Speaker of the House of Representatives (2007-2008) and in several government positions, including Vice-Prime Minister and Minister of Budget (1993-1999).

Awards: Nobel Peace Prize 2012, reception on behalf of the EU.

On the 3 May 2018, Deloitte's annual Horizon conference took place under the theme of "The Horizon—reimagined". During the conference, we were lucky to welcome Herman Van Rompuy, former President of the European Council as one of our speakers and were able to ask him a few questions about how he sees the future of Europe after Brexit. [➤](#)

**Deloitte: Currently the EU and UK are negotiating the future model after Brexit. What model are we heading towards in your view?**

**Herman van Rompuy:** Once the United Kingdom is no longer part of the customs union and the single market, they would like to negotiate a free-trade agreement. The free-trade agreement will represent a very big change and will need to be negotiated sector by sector, thus the negotiation may be complicated. A unilateral withdrawal is still possible although there is no majority in the Parliament for supporting that decision.

One of the most difficult issues in the upcoming weeks will be how to avoid a hard border between Ireland and the northern (UK) part of the island. It is not only an economic matter, but peace is at stake, bearing in mind the tragic past and the 3500 people killed. In the absence of an innovative proposal for how to avoid a hard border between the two parts of the island, the UK is confronted with a dilemma.



**D: Commentators often highlight the negative sides of Brexit. Do you also see positive sides/ opportunities of Brexit (e.g. for member states, financial services firms)?**

**HvR:** In my view, there are no advantages of Brexit for Europe and the United Kingdom. Brexit is the most serious setback in the history of the Union, a political amputation and the biggest British mistake of the last hundred years—but nothing in life is irreversible, not even Brexit.

Brexit is not in the interest of the UK, they will be worse off. 45 percent of British exports of goods and services have the continent as their destination; for the EU, only 8 percent are exported to the UK. For specific companies there may however be some advantages. In some areas, a void may be left by the exit of Britain from the European Union, which they may fill. While these opportunities may exist at an individual level, from a macro-perspective I see only disadvantages.

**D: There are currently discussions ongoing to propose a transition period up to the first of January 2021. Do you think that this transition period will be approved? What are the risks for financial services companies, who rely on the approval of this transition period?**

**HvR:** The United Kingdom has asked for a transition period and an agreement was reached. I hope we will find a negotiated divorce and a stable future framework for trade, research, and security during this period. In any case, a long transition period is unavoidable between Brexit (29 March 2019) and the ratification of a Free Trade Agreement. During this transition, few things will change because Britain will remain a member of the single market and of the customs union.

In my view, it will last longer than the agreed 21 months, because we will not be ready with the Free Trade Agreement negotiations by the end of 2020.

Financial services will feature prominently in these negotiations, as the industry is strategically important for the UK and the EU27. The use of the European passport will not be possible after Britain leaves the EU, possibly with the benefit of a transitional period. The London based financial institutions have to comply with the existing EU rules.

The concept of “equivalence” was raised as a solution. The EU allows some financial services to be provided by businesses in jurisdictions based outside the EU if their regulatory regimes are deemed equivalent to those of the EU. The equivalence arrangements cover only a fraction of financial services, but are at the discretion of the Commission and can be withdrawn at virtually no notice. For financial services firms, this means that there is a prolonged period of uncertainty.

**D: In the current negotiation, the remaining EU Member States appear highly aligned, what could derail this unity?**

**HvR:** So far, the EU27 have indeed shown a remarkable sense of unity in the negotiations with the UK, for example concerning the Irish position that there should be no hard border. However, problems may come up when the negotiations for a free-trade agreement come up. As this free-trade agreement will be negotiated sector by sector, each country’s individual interests will come to the forefront and trade-offs will need to be made. This may create tensions, but the European Union has negotiated many such agreements in the past.

**D: We see a rise of separatist movements across the globe and in the EU. In this respect what are your views on the risk of another Brexit for another member state?**

**HvR:** Britain and Brexit are not a template for other countries. On the contrary, the support for EU membership increased dramatically in the other countries after Brexit. People do not want to add instability to an already unstable world. The paradox is that the Union is more united after Brexit and the United Kingdom less so.

The French elections among others marked a big change. One of the last big debates between President Macron and Mrs. Le Pen centered around the EU. When President Macron defeated Marine Le Pen, it became visible that France and the French people do not want an exit from the European Union, so I do not think this will be an issue. By now we also see that other populist parties outside France (e.g. Italy and Austria) have changed their stance on exiting the EU and the Eurozone as a response to public feeling—remember populists want to be popular!

Brexit is not in the interest of the UK, they will be worse off. 45 percent of British exports of goods and services have the continent as their destination; for the EU, only 8 percent are exported to the UK.



DESTINATION

✈ STATUS

LUXEMBOURG

ON TIME

PARIS

ON TIME

BERLIN

ON TIME

ROME

ON TIME

BRUSSELS

ON TIME

AMSTERDAM

ON TIME

COPENHAGEN

ON TIME

DUBLIN

ON TIME

LONDON

BREXIT

# Get ready for the EU 27 single market

**Simon Ramos**

Partner  
Operations Excellence  
& Human Capital  
Deloitte

**Marco Lichtfous**

Partner  
Operations Excellence  
& Human Capital  
Deloitte

**Francesca Messini**

Director  
Operations Excellence  
& Human Capital  
Deloitte

**Sandrine Leclercq**

Principal  
D.Law  
Deloitte

**Benoit Sauvage**

Senior Manager  
Strategy Regulatory  
& Corporate Finance  
Deloitte

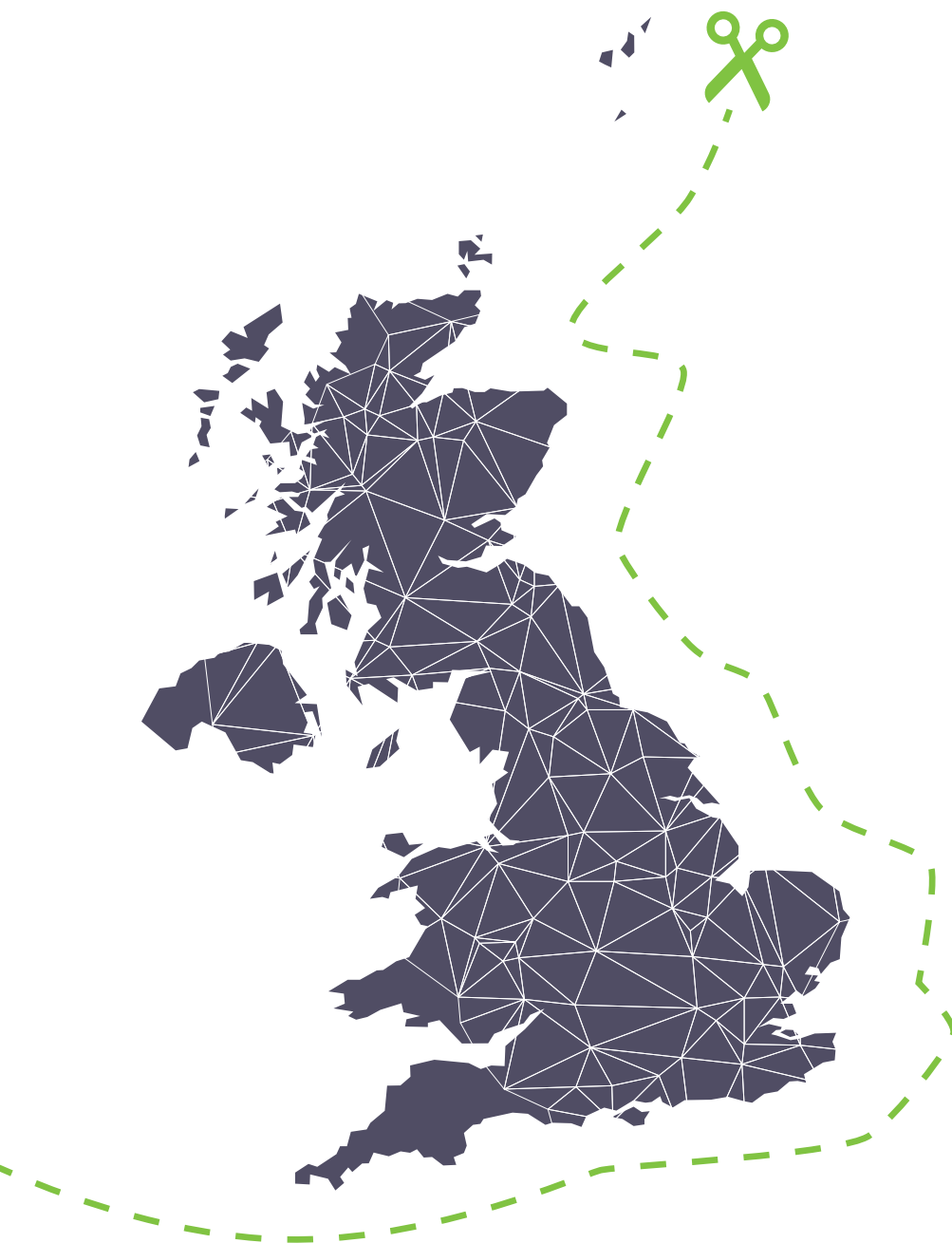
**Virginie Etienne**

Manager  
Operations Excellence  
& Human Capital  
Deloitte

**Stuart Hayter**

Senior Consultant  
Financial Industry  
Solutions  
Deloitte

On 30 March 2019, in less than a year's time, the EU single market will shrink overnight from 28 to 27 member states when the United Kingdom leaves the union, initially to embark upon a transition period running until 31 December 2020. Now that an agreement on a limited transition period has been reached, the focus of negotiations can shift to the permanent future relationship between the UK and the EU. However, it is important to bear in mind that, as the saying goes, nothing is agreed until everything is agreed. With uncertainty still looming about the precise details of Brexit, financial institutions and businesses are facing unprecedented challenges as they seek to prepare themselves and their clients for the UK's departure from the European Union.



### The impact of Brexit on your business

With the UK leaving the European Union, financial institutions in the UK will no longer benefit from “passporting” rights under EU Directives such as MiFID, CRD IV, PSD, AIFMD, and UCITS V. As a direct consequence, a market of 446 million people with GDP of €13 trillion is likely to move out of reach overnight. Whether you have a UK-based business targeting the EU, or an EU-based business dealing with UK clients and counterparties, it is vital that you have the clearest possible understanding of the impact Brexit will have on your company.

As matters stand currently, the loss of the EU passport would mean that UK investment firms are no longer authorized to offer their services in the EU. In contrast, EU-based subsidiaries could continue to operate in the single market if authorized, for example, under MiFID 2. In any case, the business model and structure of such subsidiaries will have to be reviewed by the relevant national authority to ensure sufficient substance and independence from the group. Brexit is also expected to affect established commercial activities, particularly with regard to instruments subject to the MiFID II trading obligation and the possibility of offering direct electronic access to clients. In the case of EU-based branches of UK firms, it is highly likely that they will be required to apply for a new license or an extension of their current license. ➔



The fund industry will also face its share of challenges. The loss of their EU passports will mean that UK UCITS management companies and AIF managers will have to be treated as third-country AIF managers. They will no longer be allowed to manage and market funds in the EU. Unless targeted member states decide to allow such activities under a discretionary national private placement regime, local authorization will have to be obtained. And as the UCITS and AIFs authorized or registered in the UK will be non-EU AIFs, this also means that EU 27 management companies managing them will have to seek specific authorization to manage this type of fund.

**Identification of your target structure: two sides of the same coin**

9 months before the end of the negotiating period, what appears clear is that there will be consequences not only for firms in the UK and firms from the EU 27 delivering services or products in the UK, but also for EU 27 firms dealing with other EU 27 firms. From a legal perspective, it seems highly likely that access to services, products, and/or competencies will be curtailed,

meaning that EU-regulated products or services may be stripped of their rights unless a company has a physical presence on both sides of the Channel.

Preparing for withdrawal should be on everyone’s agenda, as the wait-and-see approach could turn out to be costlier than setting up a new entity in an EU country.

**There are two sides to the coin when reorganizing the geographic and product footprint of a business:**

01. EU financial companies engaged in cross-border activities with the UK or that have a UK-based entity will have to seek authorization from the prudential regulation authority. Additionally, they may need to review their connections with financial market infrastructure such as stock exchanges, lead arrangers, trading venues, etc.
02. In contrast, UK entities will only have to set up a (light) presence in the EU 27 or move to a dual presence in the UK and in the EU 27. By only requiring the fulfilment of the minimum substance requirements, this solution should

be understood as a contingency plan independent of the final scenario yet to be negotiated between the UK and the EU, whereas the transfer of a significant share of your operations would constitute a pragmatic response to the current uncertainty that Britain’s financial institutions face today

In designing the future operating model, there are two common causes for concern to consider.

Preparing for withdrawal should be on everyone’s agenda, as the wait-and-see approach could turn out to be costlier than setting up a new entity in an EU country.



# DEPARTURE

# ARRIVALS

**First is the rather stern stance adopted by the ESMA on the topic of outsourcing arrangements. The EU authority has issued opinions highlighting that:**

- A thorough due diligence procedure should be followed to ensure that service provider selection is based on an objective reasoning process aimed at identifying the most suitable counterparty to provide outsourced functions or services. In particular, the ESMA stresses that the selection of an entity within the same group should entail a higher level of scrutiny to ensure that the choice was based purely on objective reasoning and despite the potential conflicts of interest this outsourcing structure could have
- In any event, enough substance should be kept in the EU entity, and outsourcing of certain key functions and services will either be more strictly regulated or simply not allowed

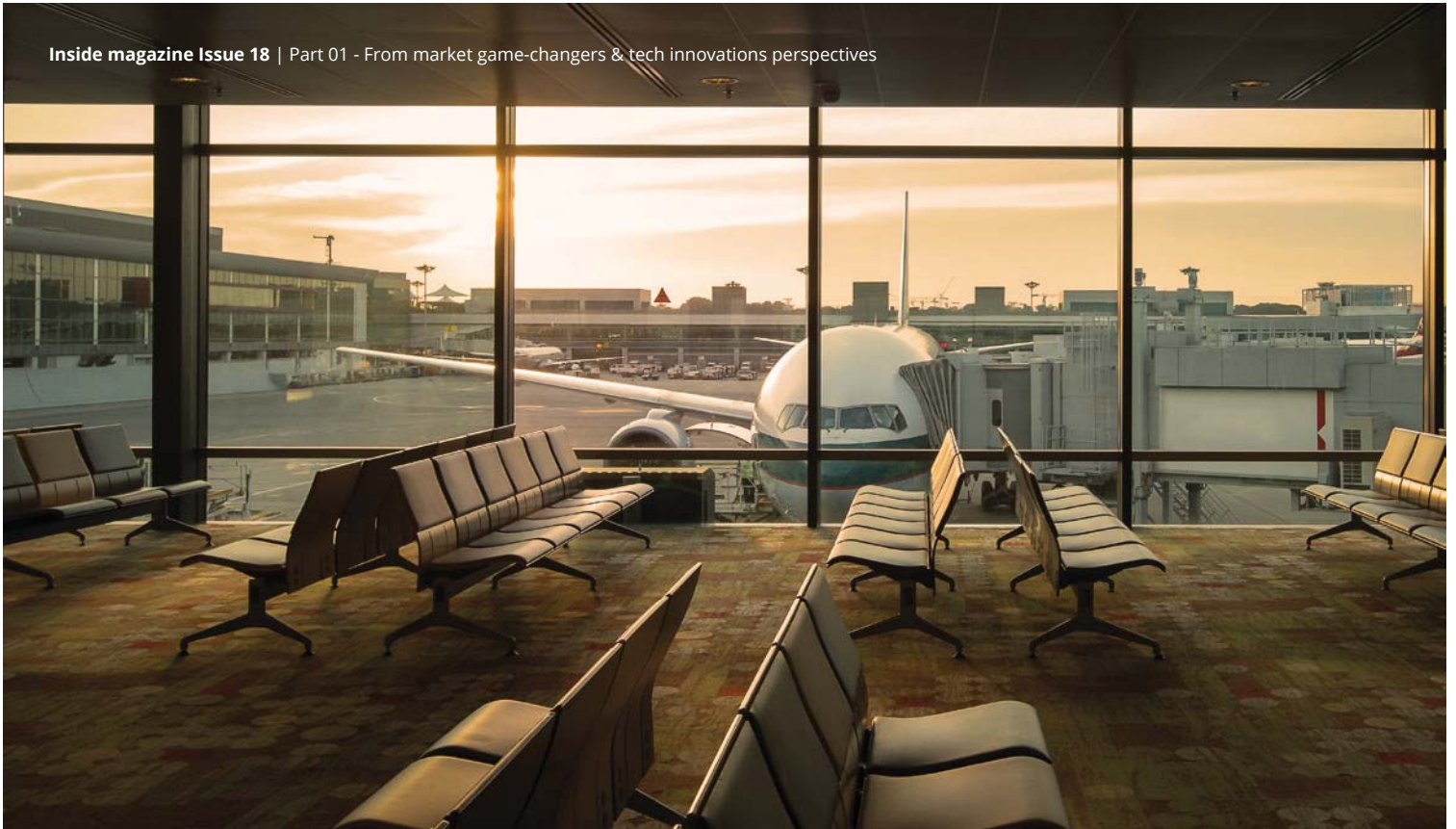
The EBA highlighted this need for substance as well and expects an EU 27 entity to be able to carry out its business

independently from its third-country group entities. All other EU authorities (EU Commission, ECB, etc.) plan to follow this strict line, believing it to be the best way to ensure a regulatory level playing field.

**Second** is the back-to-back booking model that new entities may implement to optimize hedging efficiency and market risk capital consumption. The authorities expect new local entities to have adequate resources to assess, govern, and manage part of all risk locally and not transfer all their market risks to a third-country entity via back-to-back transactions or comparable booking practices.

Luxembourg is the leading financial center in the Eurozone and is ranked second in the world behind the USA for asset and fund management. Last year alone, five banks decided to establish or expand their presence in Luxembourg and more than a dozen leading global asset managers as well as 10 insurance players made a similar decision. Further moves are expected in the coming months in the insurance, fund management, banking and FinTech sectors. ➔

Luxembourg represents the natural asset administration hub in the EU to perform certain activities.



### Opportunity #1

#### **The asset management and fund industry:**

Luxembourg funds are the vehicle of choice for cross-border distribution.

If Luxembourg is the EU's leading fund domiciliation center, London currently remains its leading center for fund management activities, with UK fund managers being "delegated" the management of assets domiciled elsewhere in the EU.

Unless a political agreement is reached, the possibility to delegate the management of EU-domiciled funds will be negatively affected by Brexit. EU-based operations as well as operational transformation will therefore be required in order to protect the management of EU-domiciled funds and serve EU-domiciled investors.

Luxembourg has long specialized in structuring, marketing and distribution, transaction reporting, and the administration, custody and risk management aspects of the asset management lifecycle. For those reasons, it is already used by 80 percent of the top 30 asset managers as their primary EU platform for distribution, and it is a leading fund center for real estate, private equity funds, onshore hedge funds and funds of hedge funds.

### Opportunity #2

#### **Private banking and wealth management:**

Thanks to its toolbox, Luxembourg is one of the leading global centers for private banking and wealth management. After March 2019, this trend may be reinforced by the MiFID II requirement stating that firms must have an EU presence if they wish to access EU clients via passporting, or else firms may have to rely on "equivalence determination"—a process that is likely to take some time. Otherwise, access to clients may be dependent on receiving authorization in each individual member state. Hence, it is advisable for firms to consider expanding or establishing a presence for themselves now in an EU 27 member state. Time will be of the essence; the process could take up to 12 months with some regulators.

Home to the EU headquarters of key global private banks and investment firms, Luxembourg is widely recognized as the European hub for private banking and the wealth management business. This is as a result of its international cross-border business configuration and experience, the opportunities offered by its wealth management toolbox, and the benefits derived from its tax optimization practices. As a financial center, Luxembourg offers a comprehensive range of services to both European and international private and institutional investors.

### Opportunity #3

#### Digital banking & payment

**solutions:** Luxembourg offers a thriving ecosystem in which to develop increasingly compelling digital solutions, which are set to revolutionize the future of finance.

The EU regulatory banking framework (CRD IV) allows banks to accept deposits from and provide lending solutions to all EU customers, either through a branch or directly on a cross-border basis, and the payment service directive (PSD) provides a similar passport in relation to payment services throughout the EU. With the loss of such passports post-Brexit, financial companies will face the choice of either being compelled to comply with each individual EU 27 country's national laws, or requesting to set up an authorized EU subsidiary in one of the member states in order to serve the single market from an EU-located hub. This question is even more crucial at present, given the recent introduction of PSD II in January, aimed at sparking new opportunities in the payment value chain.

Should you choose Luxembourg as your future EU hub, you would gain a base from which to provide banking and payment services to the entire EU 27 single market as well as access to favorable conditions for the development of digital banking and payment solutions. Luxembourg's strengths include being a leading cross-border financial center, and a major European e-commerce and e-payment hub, being innovation-friendly and having a responsive financial regulator with a dedicated FinTech division and excellent information technology infrastructure. The country also offers easy access to some of the fastest-growing and best technologies in the world.

#### Market dynamics

More than 310 FinTech companies have already made the choice to base their EU operations in Luxembourg, supported by a total of 10 accelerators and incubators managed by top financial players (such as ING and BIL).

According to public announcements, roughly 26 institutions are planning to relocate their operations to Luxembourg; some of them will establish a brand-new entity, while others will build upon their

existing presence in the country. Big insurance groups such as AIG, Tokyo Marine, Hiscox, etc., as well as management companies (e.g., M&G Investments, Columbia Threadneedle, etc.) are relocating their activities to Luxembourg; similarly, investment banks such as JP Morgan are relocating part of their business by leveraging their existing presence here.

Should you choose Luxembourg as your future EU hub, you would gain a base from which to provide banking and payment services to the entire EU 27 single market as well as access to favorable conditions for the development of digital banking and payment solutions.

### Conclusion

The UK's decision to leave the European Union fundamentally calls into question the cross-border distribution of financial and banking services from UK-based actors to the European Union, as well as the relationship of EU 27-based financial entities with UK financial counterparties and funds.

Although no withdrawal agreement has yet been reached, the effects and implications for the single market will nevertheless affect both the activities and the operating models of financial institutions, management companies and AIF managers. As a consequence, a thorough impact assessment of the consequences of Brexit for your business activities should be conducted, from which you can identify and define your post-Brexit model. Key changes such as the restructuring of cross-border groups and additional license applications will need to be considered in advance and should therefore be carefully planned in order to "stay ahead of the curve".

With less than a year left before Brexit, and in light of continuing uncertainties regarding the scope and length of the transition period, the focus should now be on the definition of your future European operations and the identification of the right EU hub for your activities. In that regard and as described in this article, Luxembourg offers key competitive advantages in the asset management and fund industry, private banking and wealth management services, as well as digital banking and payment solutions. ●

# Are EMEA banks prepared for the new world of banking?

## Benchmarking of 248 financial institutions

### **Grzegorz Cimoichowski**

Partner  
FSI Leader  
& FSI Strategy  
Deloitte

### **Ronan Vander Elst**

Partner  
Technology &  
Enterprise Application  
Deloitte

### **Daniel A. Majewski**

Manager  
FSI Strategy  
Consulting  
Deloitte

### **Pascal Martino**

Partner  
Strategy Regulatory  
& Corporate Finance  
Deloitte

### **Xavier Turquin**

Senior Manager  
Strategy Regulatory  
& Corporate Finance  
Deloitte





"Digital" is an oft-repeated mantra in banking that in the space of a few short years has progressed from the fringe to the core of banks' strategic agendas.

This shift is visible in the annual reports of Europe's 20 biggest financial institutions, where "digital" was mentioned an average of once per report in 2011 but 55 times per report in 2016. The reasons for this shift are clear: changing consumer preferences driven by technological advancement, competition from FinTech start-ups, and changing regulations, with the European Union's Payment Services Directive (PSD2) coming into force in January 2018.

**Many banks consider themselves to be leaders when it comes to digital, but what is the reality?**

All banks have been forced to invest in digital capabilities, but they are at differing

stages of development. What has been lacking until now is objective data. That's where the Deloitte Digital Banking Maturity project comes in, providing information on the position of each bank with respect to its digital offering, comparing apples to apples by reviewing the full spectrum of products and functionalities, mapped against consumer preferences in each market.

The Deloitte Digital Banking Maturity project, a joint effort on the part of Deloitte member firms across EMEA, is a comprehensive and objective assessment of financial institutions' digital maturity in three critical areas. **A functionality review** was conducted of 248 financial institutions across 38 countries. A team of 136 "mystery shoppers" opened current accounts and evaluated each bank's internet and mobile banking channels to map their offering against 826 functionalities. In parallel, **a customer survey** was conducted, of more

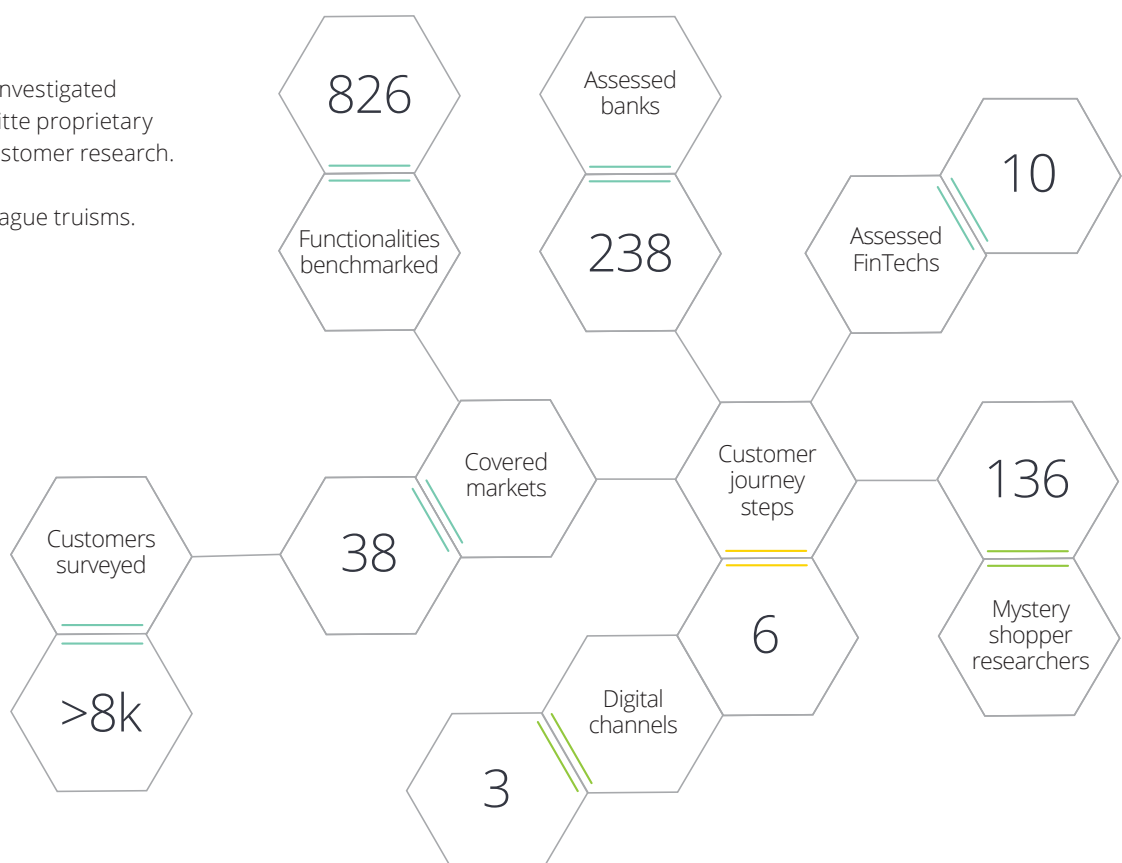
than 8,000 clients of banks in the same 38 countries, to understand customer needs and preferences for each market, and to be able to map each bank's functionality against consumer expectations in their market. These findings were supplemented by an **evaluation of mobile user experience (UX)** by customers according to the User Experience Questionnaire (UEQ) framework.

The results of this study—to our knowledge the most comprehensive of its kind for the banking sector, consisting of over 197,000 data points—provide a wealth of nuanced information about each bank and each country's banking sector.

**Size Matters**

**Real** current accounts investigated thoroughly via the Deloitte proprietary framework based on customer research.

**Real** insights, without vague truisms.



### What makes a digital champion?

Following this methodology, we were able to **separate the true digital champions from smart followers, adopters, and digital latecomers.**

Digital champions are banks which

- 01** provide a broad variety of digital functionalities to their customers
- 02** meet or exceed customer preferences in their market
- 03** deliver a modern and intuitive mobile UX. These banks score in the upper range of each of our three assessments

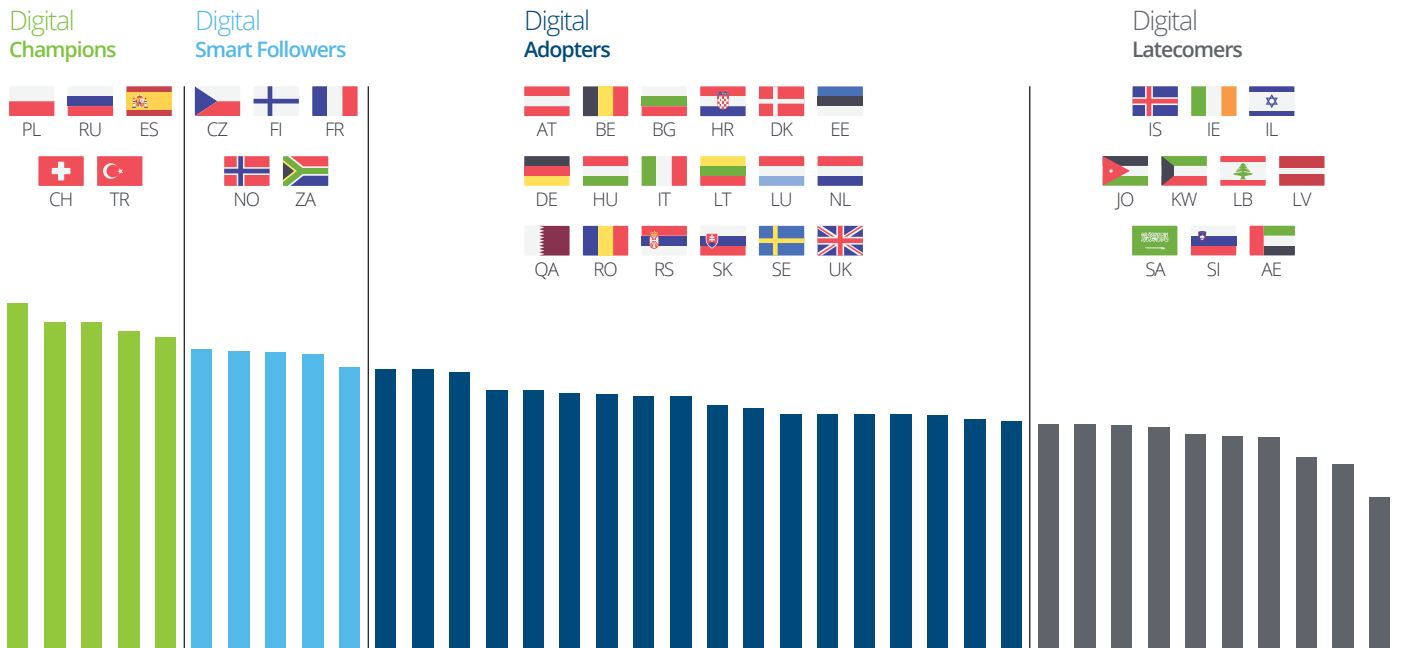
### Which country's banking sector is the most digitally mature?

To provide a snapshot of the results and identify some broad trends in digital banking, we compared the five largest banks by asset size of each country.

Interesting patterns emerge in this EMEA view that allow us to make some qualified statements about what drives digital banking development. 

To provide a snapshot of the results and identify some broad trends in digital banking, we compared the five largest banks by asset size of each country.

### Benchmarked markets can be divided in 4 groups in terms of digital banking maturity



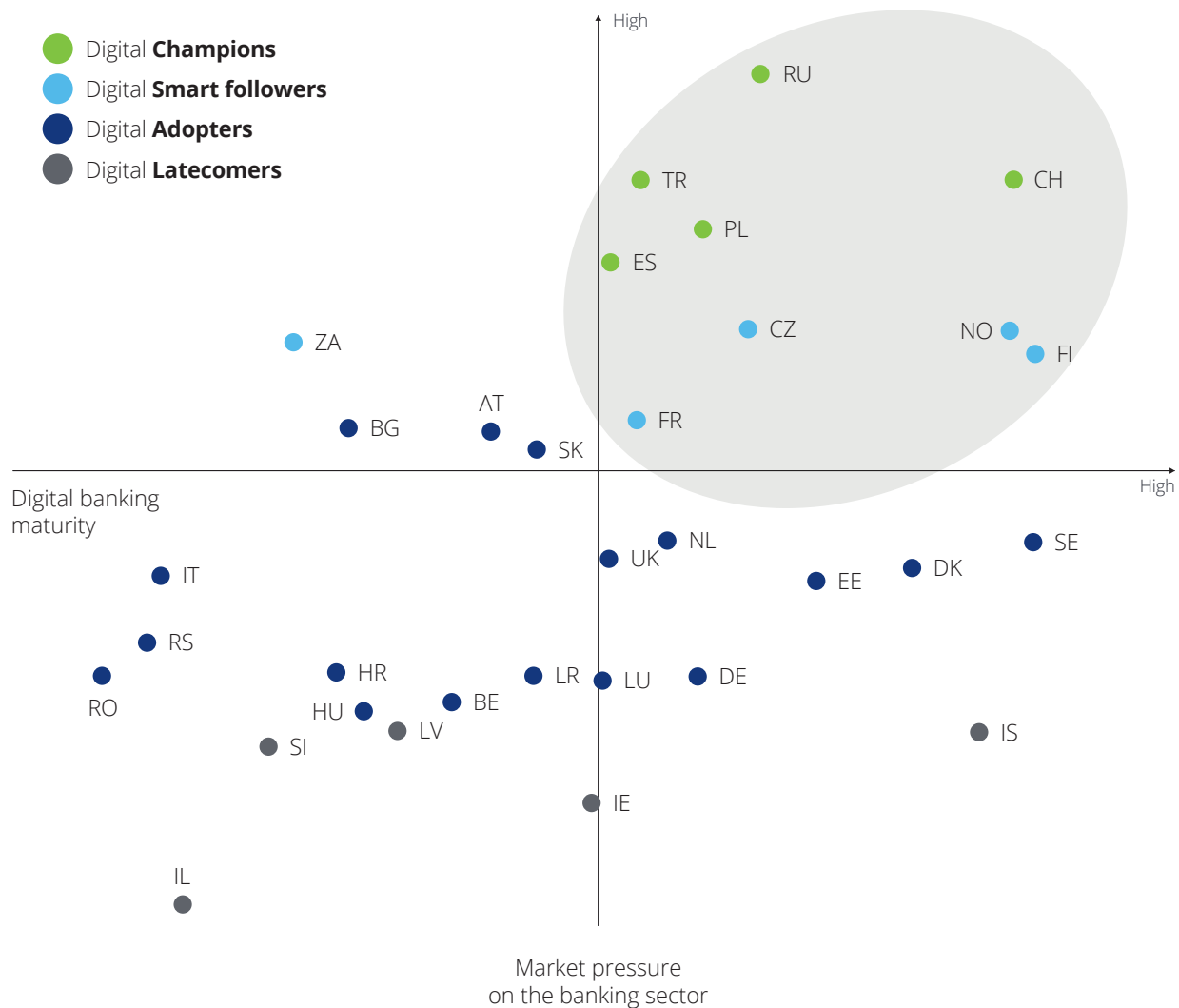
**EMEA's digital banking leaders are a product of their environment**  
**The two key environmental factors driving digital banking maturity are:**

**01. Customer preferences:** When customers expect digital and omnichannel functionality from their banks, it becomes a competitive factor, which compels banks to deliver it.

**02. Market pressure:** When other banks in the market make the move into digital and leverage it as a key differentiator or area of competence, it puts pressure on competitors to keep up.

These factors are often correlated, but not always. In some countries (e.g., Poland), market pressure has driven banks to develop digital capabilities at a faster rate than customers expect. These banks are investing in their future competitiveness, under the belief that customer preferences will inevitably catch up.

**Digital Banking maturity**





**From digitization to the new world of Open Banking and Beyond Banking**

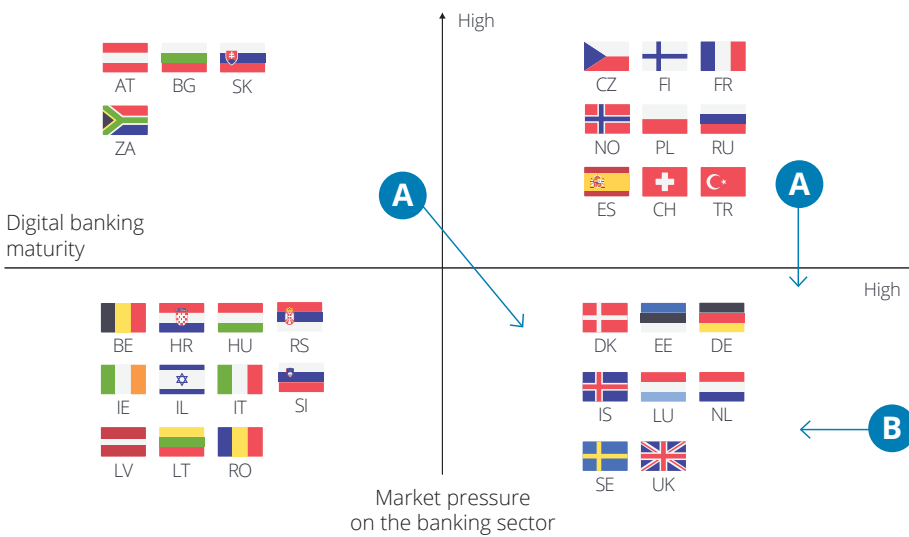
While the survey focuses on digitization—the transformation of traditional banking products and services from brick-and-mortar into internet and mobile—there is growing pressure on banks to enter a new world of banking, as a result of changing regulations (mainly PSD2) and competition from FinTechs. The digital champions identified in the survey are also leaders in both **Open Banking** (expanding traditional banking products and services

with new value-added services, mostly delivered by third parties) and **Beyond Banking** (introducing non-financial value-added services delivered by third-party providers into their banking digital channels).

Maintaining a competitive edge in **Open Banking and Beyond Banking will be critical to determining the digital champions of the future.** PSD2 will change the dynamics of competition in many markets by removing boundaries

and allowing both banks and FinTechs to compete for incumbents’ customers in their home markets. PSD2 is creating an environment in which digital champions have an opportunity enter and capture market share in neighboring markets, particularly those where there is a gap between customer expectations and incumbents’ digital capabilities. This creates a risk for incumbents that have not kept pace with their customers’ preferences for digital services.

**PSD2 and FinTechs will increase market pressure**



**A Foreign digital champions as attackers**  
 Competition between digital champions for highly demanding clients will be increased by the implementation of PSD2

**B FinTechs as challengers of the status quo**  
 Banking sectors that fail to withstand market pressure will face competition not only from other countries, but also from FinTechs

**What should banks and FinTechs be doing now?**

Digital banking maturity has become a lynchpin for the medium-term development of the EMEA banking landscape as it evolves toward Open Banking and Beyond Banking. For banks, surviving and thriving in this new era will necessitate a complete understanding of their competitive landscape, encompassing how their functionality compares to their competition as well as how they measure up to customer preferences.

**For digital latecomers, now is the time to move out of the comfort zone of the traditional banking status quo and start transforming** into a service platform if they do not want to be left behind by more digitally mature incumbents and FinTechs. However, the significant investment required for this transformation may steer some banks to focus on providing only a

few banking products and services as a specialized banking provider.

**Digital champions should leverage their strong current position to expand from a banking platform** into an exponential platform before other incumbents and FinTechs fill this space. To achieve this, they will need to work closely with financial and non-financial service providers as the level of complexity of this strategic shift will require deep integration with external partners.

FinTechs offering everyday banking services will face pressure from two sides: in order to not be left behind by digital champions, they will need to develop further in the direction of exponential platforms; to meet customer demand for more complex banking products, they will need to expand their services in the area of traditional banking. Collaboration with both

incumbents and other specialized FinTechs will be a critical success factor. The recent examples of N26 and Revolut demonstrate that FinTechs have these capabilities. It will be critical to maintain flexibility while scaling up their business—an issue which has been a stumbling block for the digital maturity of many incumbents.

**Strategic decisions need to be informed by data**

For EMEA banking executives who want to seize the opportunity presented by PSD2 and Open Banking, reliable information is essential to create a game plan. Deloitte’s EMEA Digital Banking Maturity study provides a comprehensive picture of their market and where banks stand relative to their competitors in the digital space. As such, it is an essential ingredient for any bank’s strategic planning in the post-PSD2 world of Open Banking.

# Disruption and innovation in financial services

## Banking innovation series

**Lorraine Barnes**

Partner  
Banking & Insurance  
Deloitte

**Tom Mullally**

Manager  
Banking & Insurance  
Deloitte

**Louise Mewett**

Senior Consultant  
Banking & Insurance  
Deloitte

**James Buckhalter**

Consultant  
Dublin  
Deloitte



There has never been a more exciting or a more challenging time to be leading a financial services organization. We are living in a period of unprecedented change. That change is coming from all directions, some familiar and some less so. In financial services, that change is resulting in some unexpected threats as well as some surprising opportunities. Here, we will look at some of those sources of disruption, as well as the recent major trends in innovation as financial organizations try to capitalize on it. ➤

### Sources of disruption

There are four familiar sources of disruption: regulation, new technology, changing customer expectations, and competitors. These sources are nothing new, and they have long worked in isolation to affect the financial services industry incrementally. Now, in 2018, these four factors are converging, multiplying the force of their impact. Regulation has been a persistent driver of change in banking for the last decade,

although the introduction of GDPR and PSD2 in 2018 are perhaps unusual in their scope for disruption and, in the case of GDPR, the scope for enormous fines for malpractice. This is forcing FS firms to rethink their approach to managing and sharing data. Digital technology in particular mobile phones, automation, and biometrics, has been re-shaping the way we interact with our financial services institutions for several years now, too.

We'll look at some of the ways AI is moving beyond automation and into something far more powerful later in this article.

However, the most unfamiliar catalysts for massive disruption in the last year have come from two sources: a new breed of competitors ranging from the start-up to the tech giant, and customer expectations being set by organizations that have nothing to do with financial services.

### Competitors

#### Challenger banks

Major financial services institutions have been a stable cohort for decades, and in some regions for centuries. To set up a new bank, the barriers to entry have always been prohibitively high, and, as a result, incumbents have faced little threat.

Digital technology has drastically lowered those barriers, and EU regulators have worked to make the process of getting a banking license significantly easier. Some regions are seeing a huge rise in so-called "challenger banks". These are small, nimble, mostly app-only retail banking propositions with scalable IT architecture, almost zero front-end costs, and fast, paperless turnaround for account opening.

Banks in Europe such as N26, Monzo, and Starling that were not even possible just a decade ago are beginning to gain market share and pose a serious threat to the status quo, staking their business model on the belief that customers want to interact with their finances but not with their bank.





### Product specialists

It's not just full-scale challenger banks that threaten the incumbents. Disaggregated product specialists are also contenders. The payments market has seen TransferWise gain widespread adoption. Moneybox, Nutmeg, and Acorns are providing a simple, low-fee way to invest modest sums of money. Habito and Blend are re-shaping the mortgage market by proactively seeking better deals for customers and linking existing financial accounts to shorten the offer process. All these previously high-reward, low-effort revenue streams for banks are being eroded by tech-savvy specialists, offering better rates and a simpler interface thanks to recent advances in technology and a regulator that has encouraged competition.

Even if your money is where it always was, new specialists are coming between you and your bank to offer a

simpler, more versatile interface. Plum and Cleo are both chatbots working through Facebook messenger to provide intelligent AI feedback on your spending, data aggregation from multiple sources, and even payment services through the bot. Yolt and Blend are PSD2-ready aggregators offering a single view of multiple bank, credit card, and savings accounts.

### Non-financial services players entering the financial services arena

There are countless new companies like these nibbling away at the incumbents' advantage. But we are also seeing something different: non-financial services giants taking advantage of their dominance in other industries to offer financial services. Chinese retail giant Alibaba and communications behemoth Tencent between them or their respective payments companies, Alipay and WeChat Pay in 2016 made up 92 percent of the

Chinese mobile payments market, in total worth around US\$9.3 trillion. In the US, Venmo, now owned by PayPal, is doing something similar. Apple, previously known for its gadgets, provides a thin layer on top of your payments with Apple Pay, facilitating online and at-till transactions, whilst using the opportunity to harvest data it can monetize elsewhere.

As PSD2 comes into force in Europe, there is less reason than ever for customers to make payments via their banks, particularly when abroad, as they can avoid punitive foreign transaction fees by using services outside of the incumbents' orbit. The consequence of technology's lowering of barriers is that customers now have a far broader choice when they make their payments, and they are not necessarily choosing incumbent financial institutions. ➔



### Customer expectations

To understand what's fueling the ever-increasing expectations of customers in financial services and a rise in the adoption of challenger banks and alternative providers, we need to understand the way customers are consuming other services and how this has changed.

The latest and most successful companies, usually fueled by digital technologies, provide a frictionless, mobile-centric proposition. We call an Uber with a tap and expect it to know where to pick us up and drop us off without a word being exchanged, at a reasonable price, without delay, and without having to produce cash or a card. When abroad, we can book an Airbnb in the city we find ourselves in and have the details taken care of automatically.

When we order something on Amazon, we expect to receive it the next day and to pay no postage.

Customers are not interested in whether these are platform business models, whether these companies are disproportionately advantaged by having been born in the internet age, or how (or even whether) such firms are turning a profit. From a customer perspective, this is how services, from buying clothes to selling your house, are provided, and it sets their expectations. Banks must deal with cumbersome legacy IT architecture, huge fixed costs, impending regulation, and the inertia of any large organization. So how can they meet these customer expectations, stay ahead of their nimbler competitors, meet the requirements of regulation, and make the most of the possibilities afforded by the latest technology?

## Innovation

Large financial institutions are going to need to innovate to avoid lagging behind nimble start-ups and powerful non-financial services players. Whilst there are benefits to being small, the incumbents have some serious advantages when it comes to innovating if they know how to exploit them.

First, incumbents have resources start-ups can only dream of. Whether in terms of funding, staff, or equipment, major financial institutions will always have a better supply of finite materials than even a VC-backed young company. Then, there is expertise. Large companies have at their disposal not only cumulatively millions of hours of experience of their industry, but also of the various technologies, techniques, and connections inherent in the people who work for them. They can also provide a safe sandbox environment with realistic data and scenarios in which to experiment, and the power of a huge existing customer base.

There will, of course, be disadvantages. Large organizations suffer from inertia, resistance to change, bureaucracy, a risk-averse culture, and individuals still

having a day job and their concerns about the impact of experimentation on their promotion and reward prospects.

C-suite leaders need to know how to incentivize experimentation and innovation. That will sometimes mean rewarding those who try something bold and fail but learn from the experience, instead of those who repeatedly try something safe and succeed.

## The latest trends

We can track the latest trends and try to keep up with what's going on in the market. As the four forces above converge, here are our picks for 2018.

### Cryptocurrency and blockchain are going mainstream

The past year has seen bitcoin move from the fringes of conversation to front-page news. As barriers to the acquisition of bitcoin were lowered thanks to more user-friendly platforms, late 2017 saw a flurry of buying, pushing prices to extraordinarily levels before the inevitable crash in early 2018. Although it's been easy to sneer at the get-rich-quick traders, enjoy some schadenfreude as the prices plummeted, and mutter to ourselves about the South Sea Bubble

and Tulip Mania, it's hard to deny the progress cryptocurrencies have made in the last 12 months. Every newspaper now has an opinion about blockchain, bitcoin, and the hottest new cryptos.

But it's not just investors. Customers are paying for daily services, from sandwiches to train journeys, in cryptos, and, partly by design, banks are excluded from these transactions. **Revolut** now offers in-app currency exchange from 25 traditional currencies into three cryptos (Bitcoin, Ether, and Litecoin). **KFC**, perhaps tongue-in-cheek, but genuinely is offering to take bitcoins in exchange for a more reliable commodity: buckets of chicken. And cryptos aside, blockchain and distributed ledger technology is being used in all sorts of arenas, from cross-border payments (**Veem**), to ship certificates (**Deloitte** and **DNV GL**), and diamond tracking (**Everledger**).

Bitcoin may have been overvalued. In fact, it may still be overvalued. But we can no longer take seriously suggestions that cryptocurrencies are a temporary blip on our financial services radar. Together with blockchain, they are going mainstream. ➔



### AI cognition is becoming useful at last

Narrow AI has been around for a long time. Even a pocket calculator counts. But recently, we've heard a lot about cognitive AI. We may be a long way still from artificial intelligence that is in any way human, but useful applications are finally emerging within financial services.

Chinese internet search giant **Baidu** is partnering with China Citic Bank to launch an AI-based banking service called aiBank. **Nordea** has begun using AI to triage incoming queries from email or text channels and direct them automatically to the right department, in a move that reduces customer wait time and cuts operating costs.

**Skandiabanken** is investing in robotics and AI, and **MasterCard** have bought Brighterion, a firm creating technology that uses AI to observe spending habits and provide an early warning system in the event of credit card fraud.

The next challenge for banks is going to be combining solving back-office process automation with AI whilst simultaneously improving the customer experience through empathic, intuitive AI. That way, banks can save money on expensive humans in call centers and shift the demand onto sophisticated artificial intelligence.

### Mortgages and other lenders are catching up on innovation

Mortgage lending has not changed significantly over the last decade whilst other areas of financial services have been utterly transformed. Payments, spending tracking, AI assistants, and car insurance have all seen huge improvements not just in terms of channels and products, but also in service and business model. Coupled with the fact that some of the worst experiences anyone seems to have had with a bank have been in applying for a mortgage or loan, it's about time mortgages and other lending caught up.

The most common complaints about the mortgage process are the time and documentation involved, and a lack of transparency around the process.

**Rabobank** have introduced gamification to make it easier for customers to learn about the process, coupled with a beautiful UX to make uploading endless documents a pleasure rather than a chore. **Blend** is a software provider currently working with some major US banks which allows applicants to link their existing financial accounts, reducing both effort and the time for approval by five days.

**Instabank** is using Provenir's technology to approve loans instantly, in much the same way that insurance company

Lemonade are reducing the time it takes to approve a claim (their record, for a stolen coat, standing at three seconds).

Although time and effort are concerns, so too is the size of the interest payments reaped by banks on relatively low-risk homeowners. Loan Dolphin is an Australian platform business that sets up auctions in which banks and brokers bid to provide the cheapest loan to customers, offering savings of up to 60 percent on the regular fees.

And if legacy mortgage providers weren't already on guard, **Trussle** is a mortgage comparison site with a twist: it promises to contact you proactively if it thinks it has found you a better deal.





### Conclusion

We're starting to see evolution in the industry from largely peripheral disruption of products and services to wholesale change in how customers interact with banks.

Data, computation, and connectivity are combining, resulting in effects far greater than the sum of their parts. This process will take time but will change the industry beyond recognition.

The big question against a backdrop of radical change is this: what will happen to banks in the next financial crisis? Things are very different now from how they were in 2008, but have those changes made banks more or less prepared? Perhaps, in fact, it is the FinTechs that will struggle, given that very few of them have figured out a sustainable business model. A downturn could see start-ups flail in the market, and banks move to purchase their capabilities and bring them in-house at a knock-down price.

Consumers will continue to benefit from better, cheaper, more innovative services and offerings in the financial services space. ●

Data, computation, and connectivity are combining, resulting in effects far greater than the sum of their parts. This process will take time but will change the industry beyond recognition.





***A perspective from Anders La Cour,  
Speaker at the Annual Deloitte Horizon conference***

Anders La Cour is co-founder of Saxo Payments Banking circle, designed to provide FinTech businesses and banks with the crucial “utility” needed to deliver core-banking services to their clients efficiently and cost-effectively.

Anders is not just a figurehead: he is a hands-on leader for the Saxo Payments business. Over the last 22 months, the business has grown at a tremendous pace, achieving US\$50 billion volume growth. Under his leadership, Saxo Payments Banking Circle has received industry wide recognition, winning five awards in 2016 and four awards in 2017.



# LUXEMBOURG AND THE BANKING INDUSTRY OF TOMORROW

We sat down with Anders La Cour, CEO of Saxo Payments Banking Circle, to discuss what banking looks like now and how that could change in the future. We also asked him why he chose to bring the company to Luxembourg and whether he would recommend it for other players. Read on for more.

**Deloitte:** In today's age, digital technologies are fundamentally disrupting the banking business. What are the main impacts on the value chain and profitability?

**Anders La Cour:** Traditionally the banking industry has owned both the client relationship and the corresponding banking network. In industries, which face a deregulation, a separation of the value chain is often observed and the banking industry is no different. As it faces deregulation, the value chain is split into different parts, with the upper part creating value for clients and being supported by what we may call the "pipes and plumbing".

For banks, this has a significant impact on profitability. FinTechs will battle for consumers alongside "relationship banks", which will likely have third-party handling, non-core functions in the future. They will strive to maintain the client relationship with the aim of retaining a position on top. Only very few very large banks will be able to continue serving the whole value chain. Particularly smaller banks with legacy systems will need to consider focusing on the upper part of the value chain, whilst letting someone else handle the "pipes and plumbing". ➔

**D: In a time where many actors may be doubting the future of banking as we know it, why did the banking circle decide to apply for a banking license?**

**ALC:** In ten years, banks will still exist, but in a different way than we know today. They will differentiate themselves to the consumer. With this shift, many of them will no longer focus on providing what we can describe as utility services, as scale is essential.

As a result, providing utilities only to their own customers on legacy systems will become costly for these banks placing them in an unfavorable position. As with the right scale and no legacy systems, providing utilities can be a profitable business, this can create a win-win situation for the provider and banks. These banks require stability from their partners and by having a banking license, they can assure our clients this stability.

**D: You chose Luxembourg as a location for your bank. Could you explain why?**

**ALC:** At the beginning, we were mainly focused on the United Kingdom and Denmark, given that we had already established offices in both London and Copenhagen. With the result of the referendum in the UK in 2016, we started exploring other options given the uncertainty.

As a global company, we wanted internationality and stability, so the pool of shortlisted countries included the Netherlands, Ireland and Luxembourg. Luxembourg was then our final choice. This was due to a number of elements, including its membership of the European Union, high innovation performance and support from an innovation-friendly government with a stable regulator.

Furthermore, its location, but also its family-friendly environment with high quality education and multi-cultural and multi-lingual environment were important. Especially the availability of a Danish track in the European School was an attractive factor for Luxembourg.

**D: There has been much discussion around Brexit over past few months. How can Luxembourg improve its value proposition to be an interesting location for financial services players looking for a home?**

**ALC:** Luxembourg is special, and it is not the same as London or New York, so Luxembourg must find its own positioning. Today Luxembourg is not very diversified, but very specialized and may need to broaden the access to different financial services. I see three key dimensions on which Luxembourg could work in order to develop the financial place further:

In ten years, banks will still exist, but in a different way than we know today. They will differentiate themselves to the consumer.

01

**Embracing access to funding**

is a major part of the ecosystem (e.g. VC funding), but today in Luxembourg there is a lack of access to this type of funding. I myself co-founded two companies and while Luxembourg was an appropriate choice for Saxo Payments Banking circle, I would ask myself more questions before moving my other company to Luxembourg, as the limited access to VC funding may be prohibitive.

03

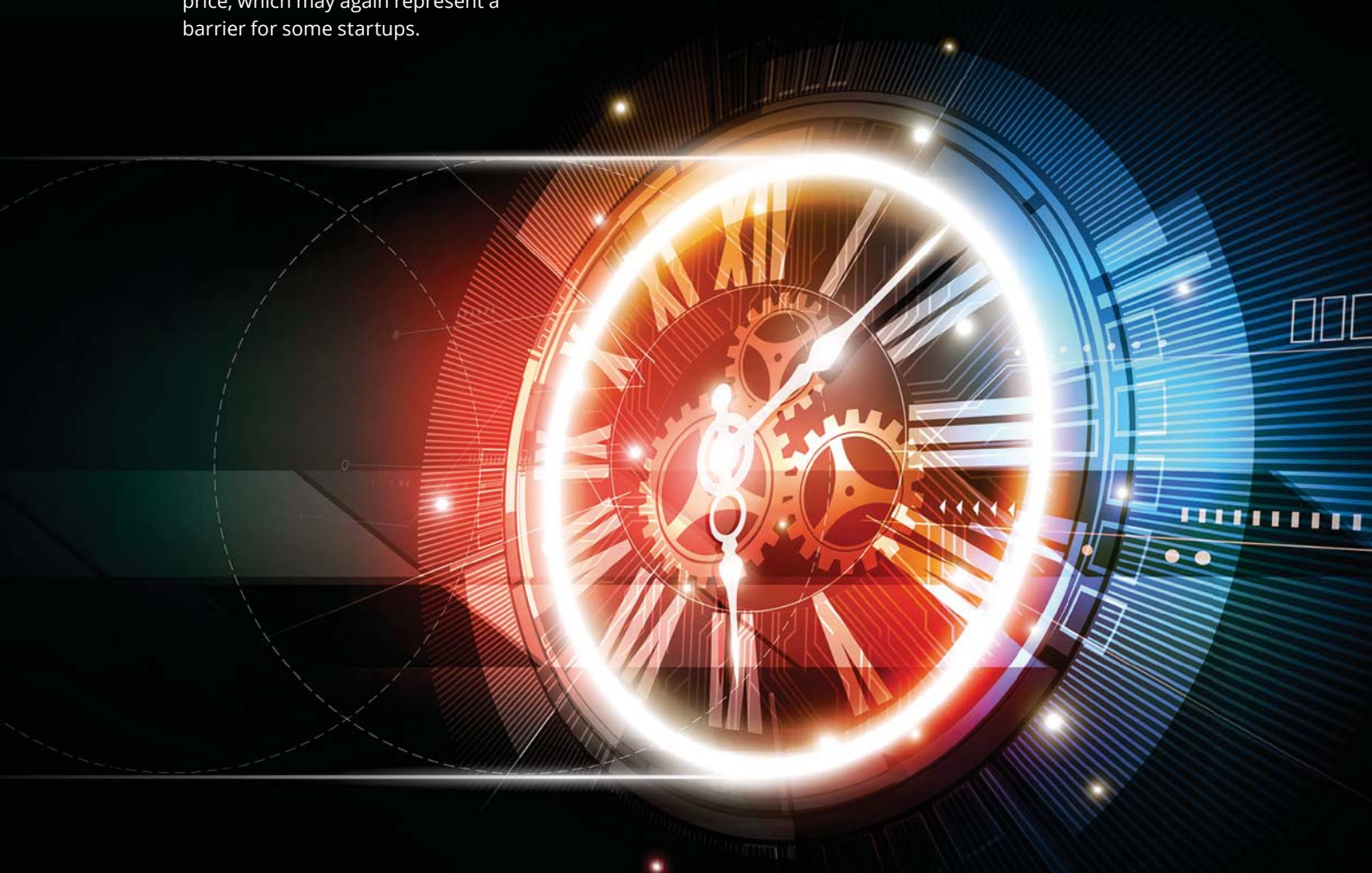
**Supporting early stage startups**

in order to create the right environment will also be important. In other cities, such as London and Berlin, I see many schemes to support early-stage startups and I think Luxembourg could benefit from similar schemes. For example, Luxembourg could provide financial incentives or tax advantages for startups hiring local staff. ●

02

**Investing in universities and developing the overall attractiveness**

of Luxembourg to attract highly-skilled workers. For some types of companies, and especially startups it is important to have very specific skills available. In Luxembourg, I feel that there is a shortage of engineers at a reasonable price, which may again represent a barrier for some startups.



# EU cross-border payments

## An evolving concept

### **Petra Hazenberg**

Partner  
Strategy Regulatory  
& Corporate Finance  
Deloitte

### **Fabrizio Dicembre**

Director  
Strategy, Regulatory  
& Corporate Finance  
Deloitte

### **Jordan Cattaruzza**

Analyst  
Operations Excellence  
& Human Capital  
Deloitte





Since the introduction of the euro, a major ambition of the European institutions has been to eradicate the concept of “cross-border payments” within the European Union. While this has been done in the Eurozone thanks to the introduction of the euro as a single currency, the development of a fully integrated payment market remains a challenge in the countries that have not adopted the single currency. Indeed, today, nine countries of the European Union still have their own currencies and domestic payment systems. The resulting market fragmentation leads to higher costs for consumers and for banks. This article discusses the impact this has on the European Union payment market. Out of the nine, Sweden is an exceptional case, as it has adopted the regulation while keeping its own currency. Is Sweden an early example of what the European Commission is hoping to achieve as it acts to eliminate the concept of cross-border payments in a unified market? [➤](#)

# Despite the EU’s efforts, the concept of domestic versus cross-border payments is still present in the European Union.

## The European single market

Since its construction, the European Union has devised and implemented multiple initiatives aimed at achieving one of its ultimate goals: creating a single EU territory devoid of borders and regulatory hurdles. This concept, known as the European single market, guarantees the free movement of goods, capital, services, and labor to more than 500 million customers in all participating states. It is argued that developing an integrated market within the EU would help to deliver real improvements to people’s lives in the EU by enabling companies to offer their services throughout the block, improving choice and lowering prices for consumers, as well as fostering competition and innovation.

The European Commission is taking the same approach when it comes to the financial market, including payment and retail financial services.

## The fragmented EU payment market

Despite the efforts made by the European Commission to integrate the payment market in the European Union, the concept of domestic versus cross-border transactions is still present today. Indeed, **the market is segregated into three groups of actors:**

01. 19 countries in the Eurozone have integrated payment systems within which the notion of “cross-border payments” no longer exists
02. 8 countries of the European Union have kept their domestic currencies, meaning that payment systems are not integrated or standardized (Box 1) and the notion of “cross-border payments” still exists
03. 1 country (Sweden) still has its local currency but has adopted European cross-border rules, meaning that the notion of “cross-border payment” with Eurozone countries no longer exists

### Box 1: Illustration of lack of harmonization in the European payment market—Clearing system operating hours

The table below shows the operating hours (GMT+1) of the clearing systems in Europe, demonstrating that the operating hours of the various clearing systems have not been harmonized across European Union countries. As a consequence, it is possible that a payment processed at the same time in two different currencies will be received by the beneficiary on different business days. This example illustrates the lack of harmonization in the European payment market and represents a difficulty European authorities must overcome if they are to implement a single European payment system.

Country	Clearing house	Currency	System	Operating hours (for consumers)	Operating hours (for interbank)
<b>Eurozone countries</b>	TARGET2	EUR	RTGS	7 a.m. – 5 p.m.	7 a.m. – 6 p.m.
<b>Bulgaria</b>	RINGS	BGN	RTGS	7 a.m. – 2.45 p.m.	7 a.m. – 2.45 p.m.
<b>Croatia</b>	CLVPS	HRK	RTGS	7.30 p.m. – 6 p.m.	7.30 p.m. – 6 p.m.
<b>Czech Republic</b>	CERTIS	CZK	RTGS	12 p.m. – 4 p.m.	12 p.m. – 4 p.m.
<b>Denmark</b>	KRONOS	DKK	RTGS	n/a	7 a.m. – 3.30 p.m.
<b>Poland</b>	SORBNET	PLN	RTGS	7 a.m. – 5 p.m.	7 a.m. – 6 p.m.
<b>Hungary</b>	VIBER	HUF	RTGS	7 a.m. – 5 p.m.	7 a.m. – 6 p.m.
<b>Romania</b>	REGIS	LEI	RTGS	7 a.m. – 4 p.m.	7 a.m. – 4 p.m.
<b>Sweden</b>	RIX	SEK	RTGS	8 a.m. – 5 p.m.	8 a.m. – 5 p.m.
<b>UK</b>	CHAPS	GBP	RTGS	7 a.m. – 7 p.m.	7 a.m. – 7 p.m.



**The expensive charges for cross-border transactions outside of the Eurozone**

As the notion of “cross-border transactions” no longer exists within Eurozone countries, the fees charged to consumers for euro payments in the Eurozone have decreased to a few cents. However, this is not the case for consumers from other EU member states in which the notion of “cross-border payments” still exists. Indeed, in these countries, **the fees for cross-border transactions in euro are well above the level of fees paid for national transfers in the local currency.** Figure 1 provides an extract of Deloitte’s study on the fees charged by banks to consumers. This illustrates, for Deloitte’s sample, the lowest and highest fees charged by banks to a consumer in Croatia (an EU non-euro country) for a domestic local-currency transaction and for a euro cross-border transaction.

High fees also apply for consumers in EU countries (i.e., Eurozone and non-Eurozone) who want to transfer credit in the currency of an EU member state other than the euro. Figure 2 illustrates an example, from Deloitte’s study, of the transaction price charged by a bank to a consumer in France (an EU country) both for a domestic local-currency transaction and for a non-euro cross-border transaction.

The high fees charged for cross-border transactions are one of the main complaints consumers have with regards to payments in the European Union. This hinders the free movement of goods in the European Union and discourages small and medium-sized enterprises from operating in the various countries of the European Union. Consequently, consumers favor large and rare payments or increasingly

turn to online payment service providers that can offer cheaper alternatives for cross-border payments.

**The bank costs behind the fees Euro transactions**

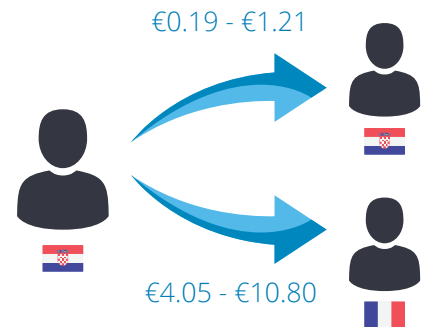
Eurozone banks are able to offer low prices for euro transactions because processing these payments is fairly inexpensive for them. Indeed, processing euro transactions is lean and efficient due to the vast volumes processed and the simplicity of the models: single format, single clearing system, and certainty of time and costs. In addition, straight-through processing (i.e., a processing system that allows information to be transmitted between parties electronically) and access to a common European processing platform (TARGET2) considerably reduce the complexity for banks when processing these payments. These developments have significantly reduced the typical costs in relation to transactions, enabling banks to offer higher discounts to their clients.

**Cross-border non-euro transactions**

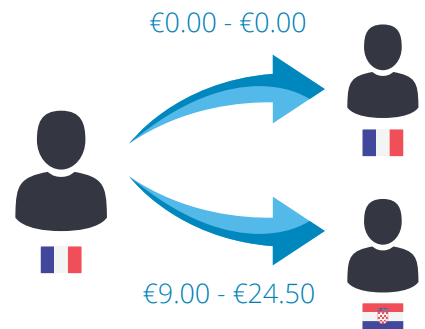
While the fees charged for euro transactions in the Eurozone are low, banks are now facing growing pressure to decrease their prices for cross-border non-euro transactions in the European Union as a consequence of the emergence of cheaper online payment service providers, consumer complaints, and the intervention of European institutions. This poses a serious challenge for banks as the cost per transaction for processing payments in non-euro currencies is high. Indeed, processing payments in these currencies requires manual intervention to account for various local specificities such as discrepancies in payment information format, different settlement procedures, and inconsistent regulations related to

AML and KYC. In addition, while banks can easily process payments in euro thanks to the European payment platform TARGET2, no such common platform exists for non-euro currencies. Processing these currencies requires the intervention of a correspondent bank, which is a partner bank that has the capabilities to process local transactions by having access to local clearing systems. As illustrated in figure 3, transferring a payment in an EU non-euro currency involves more actors than a payment in euro and therefore increases the overall cost. ➔

**Figure 1: Illustrative customer fee for transferring €10 equivalent from Croatia to Croatia in Kuna and €10 to France**



**Figure 2: Illustrative customer fee for transferring €10 from France to France in Euro and €10 equivalent in Kuna to Croatia**

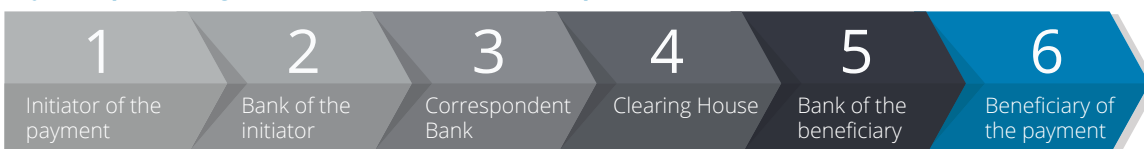


**Figure 3: Intermediaries involved in a payment transaction**

**Payment processing in euro**



**Payment processing in other currencies of the European Union member states**





## Processing payments in non-euro currencies is approximately 40 times costlier for Eurozone banks than processing a euro credit transfer executed on TARGET2.

From Deloitte's interviews with European banks, it appears that most banks prefer to use a correspondent banking system rather than requesting access to the local clearing system, which can be complex and very costly on a per-transaction basis. Indeed, the number of cross-border transactions in EU non-euro currencies is marginal for banks. In 2015, cross-border transactions accounted for around 2 percent of total transactions in the EU<sup>1</sup>. In addition, from Deloitte's study sample, it appears that less than 1 percent of the retail cross-border transfers processed by Eurozone banks are cross-border transactions in an EU non-euro currency.

Overall, in comparison to euro payments, lower levels of automation and the extra players involved in processing payments in non-euro currencies lead to a transaction cost for banks that is, according to interviewed banks, approximately 40 times higher than a euro credit transfer executed on TARGET2. While automating the clearing of these currencies would reduce the costs per transaction for banks, the investments needed for such automation are not justified due to the marginal volume of transactions processed in these currencies by Eurozone banks.

<sup>1</sup> Data retrieved in July 2017 from European Central Bank statistics.

### What to expect

To respond to the issues outlined above, the European Commission is looking at a range of possible solutions. In this context, the European Commission has announced, as part of the Regulatory Fitness program (REFIT), its plan to review Regulation 924/2009.

This aims to reduce the fees charged for cross-border transactions in EU non-euro currencies and in euro initiated from EU non-euro countries. This would improve consumers' experience by decreasing fees and offering more choice as well as fostering competition among retail payment providers.

The European Commission has announced that several options could be considered for extending the regulation. Based on this declaration, Deloitte has performed a study that considers the impact for banks and consumers according to the various extension options.

#### Option 1: Align cross-border and domestic local-currency transaction prices

The first option is to require banks to charge similar fees for all transactions in the European Union. In this context, a bank's customer would pay the same price for a domestic local-currency or a cross-border transaction in a currency of another EU member state.

#### The advantages

This option would have the advantage of positively benefiting consumers and small and medium-sized businesses, as this would lower the fees for cross-border transactions throughout the European Union.

In addition, owing to single tariffs for different transactions, this would make the fees charged by banks more transparent and improve consumers' trust in the financial system.

#### The challenges

While this option has several advantages, such an extension would have a significant impact on banks' profits. Based on current

conditions, processing these currencies is expensive for banks as it requires manual intervention. Due to the low number of transactions processed in these currencies, the investments needed to automate the processes are not justified. To make such an extension of Regulation 924/2009 viable, European institutions and central banks would need to set up a central multi-currency infrastructure that would allow banks to benefit from an integrated and less costly system.

#### Option 2: Align cross-border euro transaction prices with domestic local-currency transaction prices

A second option is to require banks to align cross-border euro transaction prices with domestic local-currency transaction prices. This already applies in Sweden, where the notion of "cross-border payments" with Eurozone countries has been eradicated. Indeed, in 2002, the government notified the European Commission that it would apply equal charges for domestic payments in Swedish krona and cross-border payments in euro. The Swedish Ministry of Finance argued that this regulation extension would favor Swedish integration into the European Union as well as putting pressure on the Swedish banks to develop payment functions that are competitive and automated.

#### The advantages

This option would make all transactions in euro less expensive for consumers, which would mostly favor non-Eurozone bank customers, who are currently charged high fees for such transactions.

While the vast majority of EU payments are already in euro, this regulation extension could further increase the number and volumes of euro transactions; further strengthening the euro as a pivotal currency of the European Union.

#### The challenges

As for option 1, extending Regulation 924/2009 by implementing this option would negatively affect non-Eurozone banks' profitability.

In order to limit this negative effect, European institutions would have to ensure that EU non-Eurozone are also granted equal access to euro clearing systems such as TARGET2. Today, not all central banks in the EU have access to TARGET2, which would enable them to benefit from STP processing and therefore to have lower operations costs. The European Central Bank offers two pricing schemes for using TARGET2:

- Option A: €0.80 flat fee per transaction on top of a monthly fee of €150
- Option B: Volume-based transaction fee ranging from €0.60 to €0.125 per transaction on top of a €1,875 monthly fee

To lower their fees, banks could also use a sub-participation agreement rather than direct access. Furthermore, if we consider the ownership structure of the market leaders in the non-euro area, most of the banks are part of groups of banks with headquarters in the Eurozone, reinforcing the option of easy and economical access to those platforms. In addition, the increase in the number and volume of transactions following the adoption of the regulation would help banks to mitigate the negative impact on their profits per transaction. ➔



## Conclusion

It is apparent today that the European Union is acting to further integrate the various markets and industries to improve consumers' satisfaction and strengthen the European Union's image as a single market. Concerning the payment, the challenge for European institutions is to adopt new regulations that will enhance citizens' experience without affecting banks' profitability. A potential option for European institutions is to extend Regulation 924/2009 as per option 2, which would force banks to align cross-border euro transaction prices with domestic local-currency payment fees. If EU non-Eurozone banks are granted equal access to euro clearing systems, this would limit the impact on banks' profitability and would have the advantage of lowering cross-border fees, encouraging consumers to buy more products abroad, therefore offering them greater choice, better quality, with lower prices. ●

## Possible extensions of Regulation 924/2009

### 1. Align cross-border and domestic local-currency transaction prices

#### Pros:

- Fee reduction for a large number of customers
- Increased transparency in banks' fee schemes

#### Cons:

- Large impact on banks' profits
- No current central multi-currency payment infrastructure

### 2. Align cross-border euro transaction prices with domestic local-currency transaction prices

#### Pros:

- Fee reduction for customers of non-Eurozone banks
- Large volumes of euro transactions initiated from non-Eurozone EU countries
- Strengthening of the euro as central currency of the European Union

#### Cons:

- Fees for domestic euro and cross-border non-euro transactions are not aligned
- Access to TARGET2 is not mandatory for central banks of non-Eurozone countries







# Instant payments

## Embarking on the payment transformation journey

### Pascal Eber

Partner  
Operations Excellence  
& Human Capital  
Deloitte

### Alexandre Havard

Senior Manager  
Operations Excellence  
& Human Capital  
Deloitte

### Amit Bhalerao

Manager  
Operations Excellence  
& Human Capital  
Deloitte

### Margaux Bauwens

Consultant  
Operations Excellence  
& Human Capital  
Deloitte

**“A race against time”**—We live in a time-constrained world where we expect services at our fingertips. Our lives are dominated by organizations providing us with the convenience of instant messaging, online books 24/7, “pay-per-view” movie streaming, real-time holiday reservations, online shopping experiences, and the list goes on. Although payment is an intrinsic part of every transaction, it has not been able to keep pace with the digital revolution in the social and commercial space.

The service providers of the future expect instant access and reuse of funds for services rendered, even during non-business hours. As a result, instant payments is likely to be a new standard, touching every aspect of modern consumer lifestyle 24/7. ➤

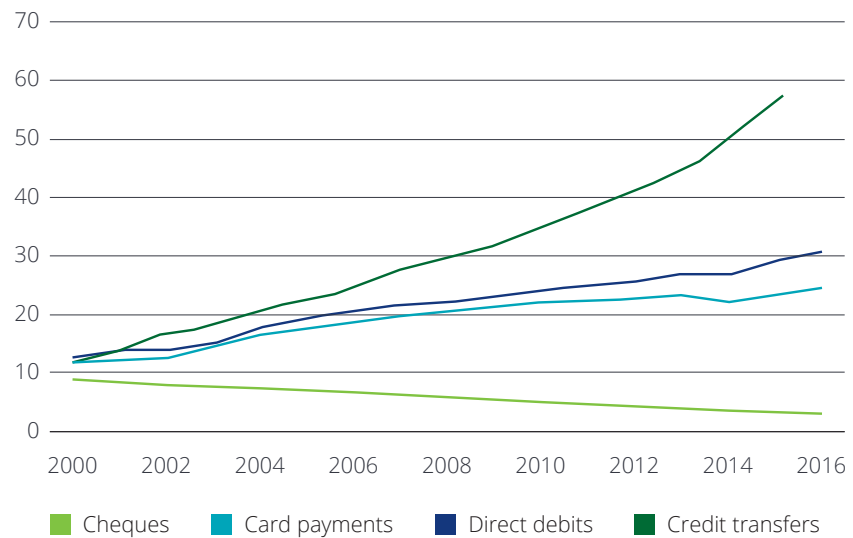
Constant changes and increasing speed are the cornerstones of modern society. The last few decades have seen the emergence of disruptive technologies (i.e., the PC in the 1980s, the internet in the 1990s, and social media and mobile devices in the 2000s) that have overthrown existing market leaders such as Remington, Yellow Pages, and Nokia. The current decade is witnessing the rise of a few innovative technologies with the potential to influence customer behavior and alter the existing landscape. The Internet of Things, biometric authentication, blockchain, and robotic process automation are just some of the disruptive technologies with the potential to enhance delivery models and provide services in a flash. Increasingly, companies are looking to reinvent their service offering to meet customer needs “Anytime, Anywhere, Instantly”.

Firms like Amazon (e-commerce), Uber (transportation) and AirBnB (accommodation) are transforming the industry by providing customers with services that are cheaper, easily accessible, and available 24/7. Though payment is an integral part of the value-chain, it has struggled to keep pace with the technological advancements achieved in other industries. Today it takes a minimum of one business day for a payment in euro to reach the beneficiary, whereas Amazon can provide same-day delivery of physical goods. Likewise, Uber can help customers to book a taxi in matter of seconds with real-time tracking of the driver. The inertia in the current payment ecosystem exposes the service provider to a risk of payment default. Furthermore, lack of real-time visibility on the payment status has aggravated the problem for stakeholders.

In the years to come, instant/real-time payments will be the new normal, substituting traditional payment methods like cash, check, credit transfer and card. Banks have to develop new products and services around instant payment to keep up with the changes occurring in other industries and meet customer expectations. It is imperative for banks to take advantage of the new open banking

### Use of the main payment services in the EU

(Number of transactions per year in billions, partially estimated)



Source: ECB

ecosystem in order to develop unique value propositions for their customers and create new business opportunities.

#### A request for a new payment journey

In 2017, the European Central Bank published statistics on non-cash payment and its evolution over time. The study highlighted the fact that European consumers are steadily moving away from paper-based transactions to electronic methods. Card payment is still a dominant payment method across Europe accounting for 50 percent of transactions.

The following payment methods are commonly used to transfer funds in the market:

**Cash:** Cash is a universally accepted payment instrument and most commonly used in developing or third-world countries by those without a bank account. Cash protects the privacy of the user and is most suitable for face-to-face transactions. However, it is the most expensive instrument, with significant cost incurred around production, distribution, management, and security. In 2016, India banned 86 percent of its currency to neutralize the threat of counterfeiting and the shadow economy created by cash transactions.

**Checks:** Though usage of checks is steadily declining around the world, consumers still use them as an alternative to cash for peer-to-peer and consumer-to-business transactions. However, the recipient is exposed to default risk due to a lack of instant validation of funds and the possibility that the issuer will place a stop payment order on the check.

**Card (debit & credit):** Card is the most suitable instrument for retail payment since the card infrastructure provides quick payment execution with real-time positive fund verification. Nevertheless, these payment instruments incur high processing costs due to inefficient infrastructure, chargeback, and fraud. Moreover, card usage is dependent on beneficiary acceptance and the transaction amount is restricted by a daily credit limit.

**Credit transfer:** Credit transfer is the electronic payment method predominantly used by businesses for the domestic transfer of funds. It is frequently used by corporations for business-to-business and business-to-consumer payments because of lower cost of processing and faster speed of execution.



**Direct debit:** Direct debit is most suitable for recurring payment such as utility bills and insurance premiums due to batch processing and the low cost of execution. However, the payer has limited control over the payment lifecycle. A direct debit authorizes the recipient of funds to initiate the payment on behalf of the payer.

However, the evolution of the service delivery model and changing consumer preferences are putting pressure on traditional payment products. Existing payment methods do not match the immediacy and ubiquity of new digital processes in commerce and social life. All payment instruments with the exception

of cash have inherent weaknesses in that the transfer of value cannot be achieved outside standard business hours.

**Suitability and comparative assessment of existing payment products**

The table below presents the suitability and a comparative assessment of existing payment methods based on the preferences of modern consumers

Payment instrument	Payment suitability					Customer preferences			
	Face-2-Face	Bill payment	Retail	E-commerce	M-commerce	Convenience	24/7 availability	Speed of execution	Cost to make payment
Cash	✓	✓	✓	✗	✗	●●●●	●●●●	●●●●	●●●●
Check	✓	✓	✓	✗	✗	●●●●	●●●●	●●●●	●●●●
Card	✗	✓	✓	✓	✓	●●●●	●●●●	●●●●	●●●●
Credit Transfer	✗	✓	✗	✓	✓	●●●●	●●●●	●●●●	●●●●
Direct Debit	✗	✓	✗	✗	✗	●●●●	●●●●	●●●●	●●●●

**Convenience:** Ease of carrying and suitability of payment instrument for different type of transaction (e.g., peer-2-peer, bill payment, retail, e-commerce, m-commerce)  
**24/7 availability:** Flexibility to use payment instrument during non-business hours and reuse funds  
**Speed of execution:** Total time required to finalize the transaction including initiation, clearing, and settlement  
**Cost to make payment:** Total cost for processing the payment transaction (e.g., logistics cost, printing, transaction processing, clearing and reconciliation)

**Rocket fuel for the launch of Instant Payments**

The psychology of instant gratification is defining the characteristics of modern society. The expectations of the tech-savvy generation and digitalization have resulted in greater “speed” in all areas of life. Furthermore, regulations are opening up the banking ecosystem, fueling the development of real-time payment platforms by FinTech firms.

**Changing customer preferences:**

“Power of Now”— The demand for instant services has forced the customer to look for real-time solutions in social and commercial spaces. Consumers increasingly expect convenience, 24/7 availability, and money that moves as fast as an email. Furthermore, the adoption of mobile for daily activities and the use

of digital wallet solutions such as Apple Pay or Google Pay to transfer funds have increased drastically due to ease of use.

**Market demand:** Changing customer preferences have given rise to a new service delivery model. The last decade witnessed the emergence of firms focused on providing services that are instant, easily accessible, and available 24/7. Likewise, there is increasing pressure from the market for instant payment for services rendered at lower processing costs.

**Digitalization and technological advancement:** The adoption of new technology (e.g., biometric authentication, distributed ledger, wearables, digital wallet) has drastically transformed the payment landscape over the past few years. The emergence of virtual currencies as Bitcoin

and Ripple with near real-time settlement has provided organizations with a cheaper alternative to traditional payment methods. Leading money transfer services and online retailers are increasingly looking to provide virtual currency as an additional payment option to its consumers.

**Regulatory pressure:** Open Banking (UK) and PSD2 (Europe) regulations will create a new banking ecosystem allowing third parties to access customer bank account data and initiate payments. Agile FinTech firms are in a better position to disrupt the payments market and create innovative digital solutions and new business models. FinTech firms are likely to be at the forefront, taking control of the customer experience. ➤

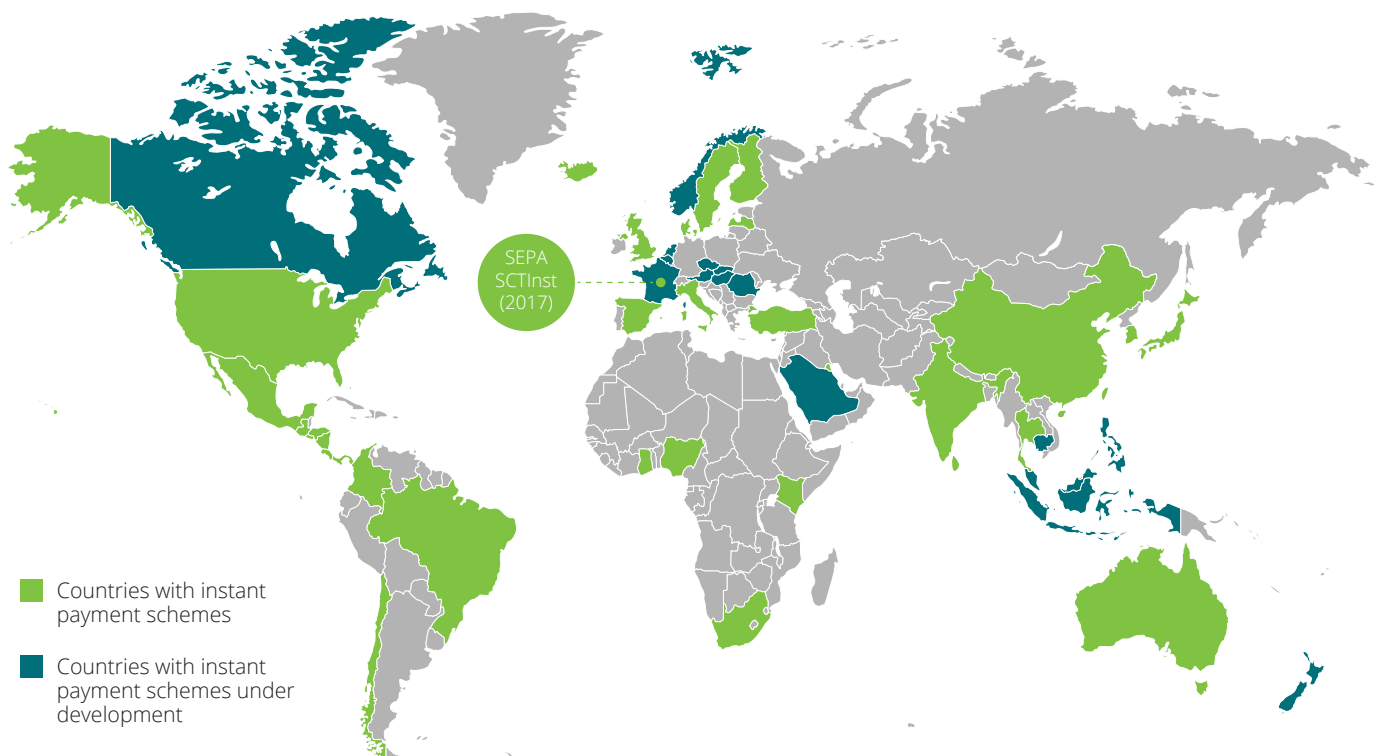
### Countdown to the worldwide launch of instant payment

The concept of instant payment is not new. The first instant payments scheme was launched in 1973 in Japan. The mass movement to instant payments is quickly gaining traction globally. Led by the various central banks in close collaboration with market participants, real-time payment infrastructure for domestic payment is currently being rolled out in many countries around the world. Australia recently went live with its New Payments Platform (NPP), enabling customers to send money via a service called PayID.

By the first quarter of 2018, there were more than 44 active domestic instant payment schemes around the globe and a further 13 schemes planned or under development. Europe has also been at the forefront of this change with some country-driven instant payment initiatives such as SIC in Switzerland (1987), FPS in the United Kingdom (2008), BIR in Sweden (2012), and Elixir in Poland (2012). However, these instant payment schemes only operate within the borders of a country, or among the customers of the same payment service provider.

To avoid fragmentation, the European Payment Council launched the pan-European SEPA Instant Credit Transfer scheme (SCT Inst) on 27 November 2017. The SCT Inst scheme will increase the speed of euro payments within the European Union. The scheme has the potential geographical scope to cover 34 European countries and territories.

### Instant Payment initiative across world - Q1 2018



### Countries with live instant payment schemes

- |                         |                             |                              |                             |
|-------------------------|-----------------------------|------------------------------|-----------------------------|
| Australia - NPP (2017)  | Ghana - GhIPSS (2016)       | Nigeria - NIP (2011)         | Sri Lanka - SLIPS (2013)    |
| Bahrain - EFTS (2015)   | Hong Kong - FPS             | Poland - ELIXIR (2012)       | Thailand - PromptPay (2017) |
| Brazil - SITRAF (2002)  | India - IMPS (2010)         | Singapore - FAST (2014)      | Turkey - BKM (2013)         |
| Chile - TEF (2008)      | Italy - Jiffy (2014)        | South Africa - RTC (2006)    | United Kingdom - FPS (2008) |
| China - IBPS (2010)     | Japan - Zengin (1973)       | South Korea - HOFINET (2001) | United States - RTP (2017)  |
| Colombia - CENIT (2014) | Kenya - PesaLink (2017)     | Spain - Bizum (2016)         |                             |
| Denmark - NETS (2014)   | Latvia - ZIBMAKSĀJUMI(2017) | Sweden - BIR (2012)          |                             |
| Finland - Siirto (2017) | Mexico - SPEI (2004)        | Switzerland - SIC (1987)     |                             |

## Instant Payments takes off in Europe

The SCT Inst scheme was primarily launched to strengthen the single market and to bring around 500 million people into a single scheme for euro transactions. More than 600 PSP across Europe have enrolled in the SCT Inst scheme.

The key features of the SCT Inst Scheme are:

### Key features of the SCT Inst Scheme

#### Currency

- SCT Inst scheme will cover Credit transfer in euro
- Currency-agnostic solution

#### Transaction Limit

- €15,000 can be transferred
- PSP can bilaterally or multilateral agree to increase the transfer limit
- The scheme has provision to increase transaction limit in future

#### Scope

- 34 European countries
- Service availability 24x7x365

#### Processing Time

- Maximum 10 secs to transfer fund from originator to beneficiary account
- Real-time gross settlement
- Payments settlement are non-revocable
- No cut-off time

#### Compliance

- Optional scheme
- PSP can adhere as receiver only or both receiver and originator

#### Framework & Pricing

- Based on existing SEPA Credit transfer scheme
- ISO 20022 XML payment standards
- Both originator and beneficiary charged separately as decided by individual participants



**A universe of possibilities for the future**

Instant payment has potential applications in a variety of customer segments. Banks will have to develop a value proposition taking into consideration the existing use case, solutions available in the market, and the characteristics of the service made available to target customers.

The following section highlights the various use cases and the likely candidate for instant payment in future:

**Peer-2-Peer (P2P)**

Instant payment is likely to replace cash and checks for everyone with a bank account. The most suitable use case for instant payment in the P2P segment includes: emergency money transfer, remittance, rent payment, restaurant bill split, and payment for second-hand goods during non-business hours. Banks

and FinTech firms can provide secure and anonymous payment mechanisms by developing a mobile-based service around instant payment (e.g., Pay to Mobile No. or Facebook ID). Likewise, banks can achieve significant cost savings by reducing cash costs arising from the distribution of cash, ATM maintenance, and security costs<sup>7</sup>. Increased usage of instant payment solution in the P2P segment will ultimately lead to a cashless society.

**Consumer-2-Business (C2B)**

A merchant can provide consumers with an alternative payment instrument to cards for e-commerce/bricks-and-mortar retail transactions. This will lower the payment cost for merchants and reduce credit risk for e-retailers on the sale of digital content such as music, movies, and books. The merchant can then pass the cost savings to consumers in the form of loyalty rewards. Likewise, instant payment also provides

consumers with the convenience of paying bills at the last minute without incurring a penalty. Other notable use cases in the C2B segment include “pay-on-delivery” of physical goods and “pay-per-use” services.

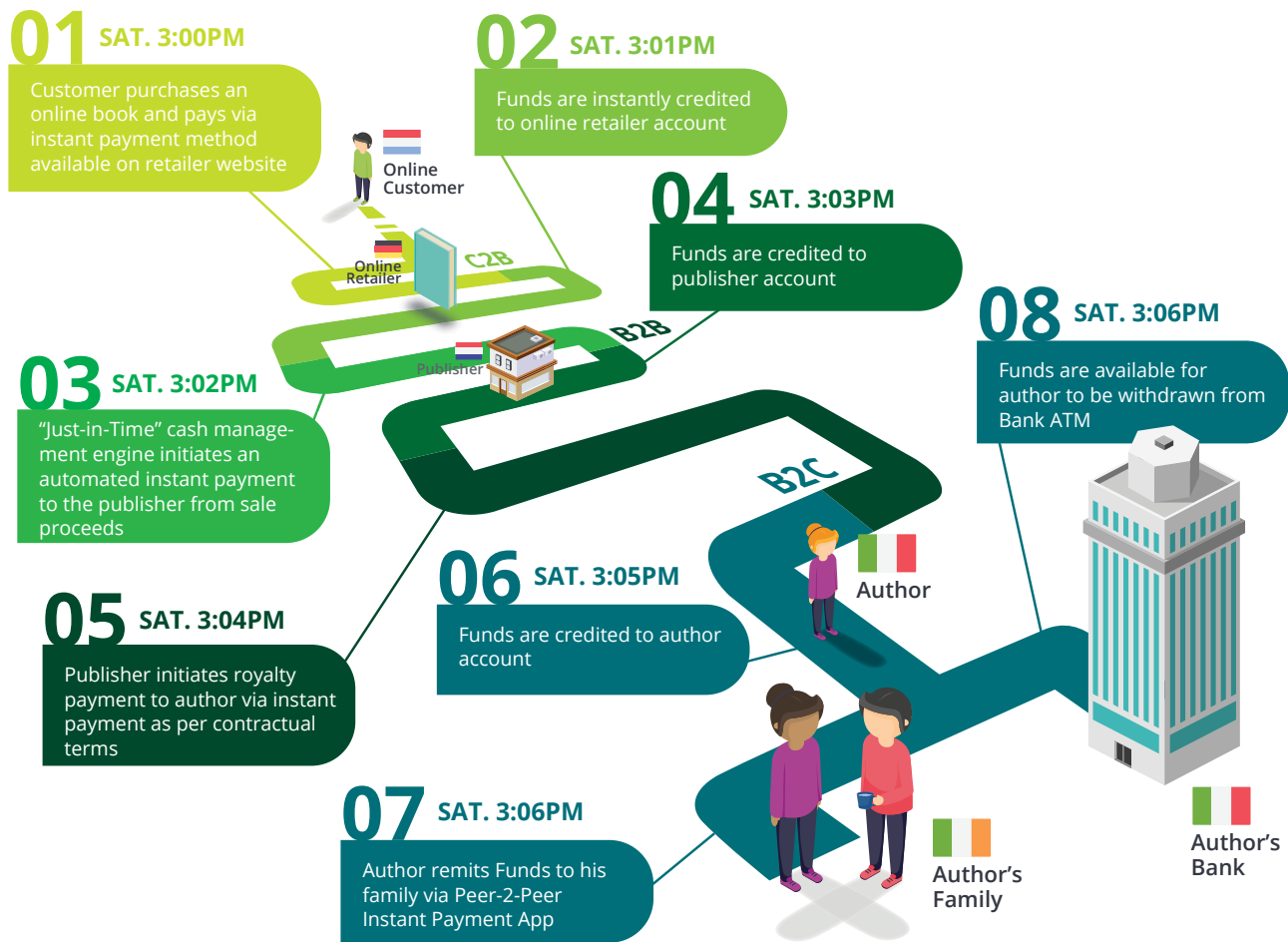
**Business-2-Business (B2B)**

Instant payment will be more widely accepted for corporate payments if the transaction limit is increased (>€15,000). Banks can develop overlay services around B2B invoice payment for corporates to implement “Just-in-Time” cash management practices. Firms can achieve cost saving by efficient use of cash and the streamlining of the reconciliation process.

**Business-2-Consumer (B2C)**

An organization can also use instant payment for salary and pension payments. This would provide the recipient with faster access to funds.

**Sneak-peak into Instant Payment Journey**



### Conclusion

"A chain is only as strong as its weakest link". Organizations around the world are constantly enhancing the service delivery model to provide a seamless experience to its customers. Payment being integral part of the ecosystem can no longer afford to be the weak link. Industry demands a payment product, which is instant, secure, cheap and available 24\*7 across multiple channels.

Instant Payments is likely to be a new normal for retail transactions and potential substitute to Cash for Peer-to-Peer transactions. The Instant payment solution may find wider adoption beyond retail transactions if banks can further reduce the processing time (<10 sec) and increase the transaction limit (> €15,000). Instant Payment scheme is likely to bring a paradigm shift in European Payment landscape.

Organizations will have to adapt and embrace the change brought by Instant Payment. Firms have opportunity to disrupt the business model or alter the value-chain by aligning finance supply chain with physical supply chain. Instant Payment can help firms to implement "Pay-per-use" service model or "Just-In-Time" cash management practices.

In the new open banking ecosystem, Banks will have to define their strategic positioning from being an "Early Adopter" or "Wait & See Approach". With wider acceptance, Instant Payment is likely to impact existing revenue for Banks from Cards, Wire payments or Credit Facility. Banks can choose to collaborate with Fintech to create next-gen payment / Cash management services over Instant Payment infrastructure. In years to come, Banks will be required to offer instant payment solution to its customer similar to ATM services. ●







# The new virtual workforce

**Benjamin Collette**

Partner  
Tax & Consulting  
Deloitte

**Bernard Lecaillon**

Senior Manager  
Operations Excellence  
& Human Capital  
Deloitte

**Andrej Hocevar**

Consultant  
Operations Excellence  
& Human Capital  
Deloitte

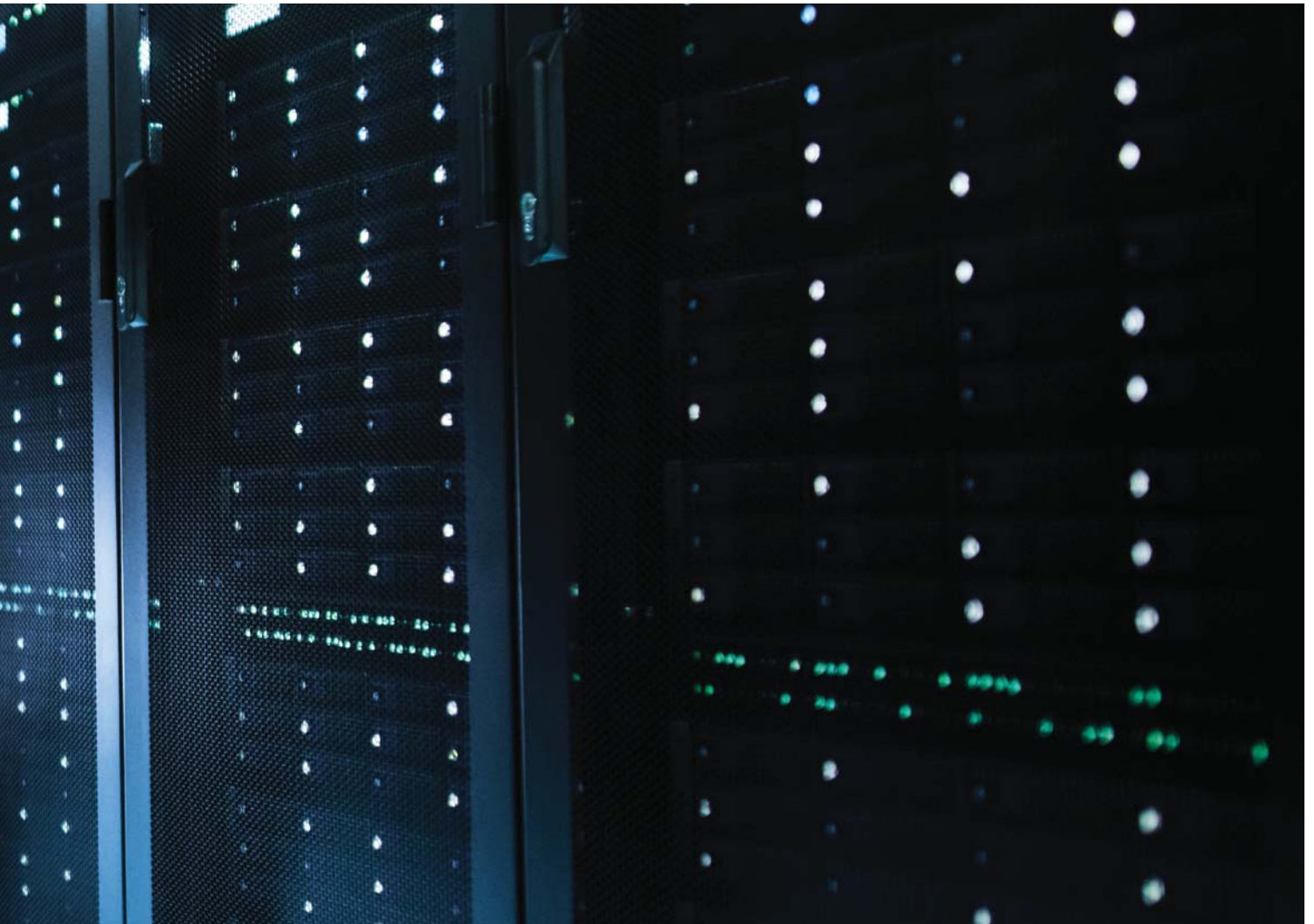


In 2018 and beyond, the financial industry will face multiple challenges linked to regulations, cyber risk, disruptive technologies, new competitors, and a well-informed customer base. Furthermore, expensive and outdated legacy systems in the financial industry have contributed to the inflexibility and rigidity of established actors.

In this rapidly changing environment, CEOs and COOs must address these emerging challenges and opportunities. Specifically, they should adapt their approaches to drive the transformation of their organizations into more strategically focused, technologically oriented, and operationally agile institutions.

Today, the ability to drive a business forward is largely dependent on having a clear digital strategy supported by leaders who foster a flexible and innovative culture. Innovations and customer expectations have brought a broader spectrum of technologies into the scope of digital transformation. Advanced analytics, blockchain, artificial intelligence, and virtual workforce are just a few notable examples. In this paper, we focus on robotic process automation—a solution that enables organizations to effectively balance long-term goals with short-term performance pressures.





**Robotic Process Automation (RPA)—  
The new virtual workforce**

IT Sloan Management Review, an annual survey published in collaboration with Deloitte, (fourth annual survey including more than 4,800 business executives, managers, and analysts from leading organizations around the world) found that increased efficiency (e.g., automation) is, together with improved customer experience, highest on organizations’ digital agendas. Similar findings emerged from Deloitte’s 2017 3<sup>rd</sup> Annual Global Robotics Survey (hereafter “RPA Survey”). Continuous improvement and automation remain top priorities for CEOs seeking to enhance their cost income ratios, and even more so in administrative functions and shared-service operations.

Robotic process automation, or RPA, is one of many optimization enablers alongside core system transformation and lean methodologies. It enables organizations to

automate repeatable, manual, rules-based tasks across the organization (back-office activities have proven some of the most suitable).

Organizations are currently in the process of trialing automation with robots performing routine processes that mimic the actions a human would perform when interacting with core applications. Examples of activities often performed by RPA include opening, sorting, and sending emails, extracting structured data from documents, logging into web/enterprise applications, interacting with databases, filling out official forms, reporting, etc.

Whereas robotics can be applied to many different processes, not all of them are equally suitable. A clear diagnosis of processes together with consideration of other available efficiency solutions constitute the first step of your automation journey. Other solutions, such as

automation within the core system or the use of macros, should be considered to determine the best approach and avoid further complicating the landscape.

The second step that needs to be taken prior to investing in RPA is determining the objectives that RPA will be used to achieve. RPA can be deployed as a tactical solution, or as a temporary patch prior to a future larger IT transformation. Features such as fast implementation, non-interference with applications/systems, and ease of use (and maintenance) make RPA an attractive short-term solution. On the other hand, strategic and long-term consideration of RPA allows organizations to achieve many other benefits rapidly and without extensive investment, making the service more attractive than traditional solutions especially for multi-system and fragmented manual tasks. ➔



### Why RPA?

The main benefits sought by executives from the automation of processes are freeing up resources for critical initiatives, rapidly streamlining processes, and driving a competitive pricing advantage. In that respect, robotic process automation also improves operational excellence through increased capacity, and improved efficiency and quality, as well as enabling scalability by deploying a “virtual workforce” with numerous advantages:

- Robots perform tasks faster, with a higher degree of accuracy and can operate 24/7
- Processes can be automated and scaled quickly, reducing resource needs for workload spikes
- RPA enables insourcing of processes, providing greater control over service delivery
- RPA can be used as a support for analytics—RPA includes various features that can interpret the data it processes

and generate reports for the audit trail and to improve decision making

- RPA has a short payback period since robots drive existing applications with low integration costs

Zooming in on the financial benefits of RPA, there are a number of factors that directly or indirectly contribute to high ROI, making it an attractive investment. The Deloitte RPA Survey has indicated an average payback of investment of under 12 months, and cost reductions ranging from 20 percent to 60 percent. Several factors converge to improve efficiency. Starting with velocity, we have observed increases from 20 percent to more than 100 percent depending on the type of process. Our experience has shown that execution time for high-volume processes (e.g., central bank reporting, cash reconciliation) can be reduced by as much as five times. And of course, productivity is enhanced “naturally” as the robots operate 24/7.

Non-financial benefits are even further outperforming expectations. A total of

85 percent of respondents to the survey stated that RPA has exceeded their expectation on areas such as quality, compliance, timelines, and flexibility.

Output quality (measured in terms of number of errors) after RPA deployment can reach up to a 100 percent reduction; robots cannot deviate from their designed process path, and as long as the input data is correct, it does not make any mistakes. Improved compliance with laws, regulations, and rules (compliance criteria) can be configured in the robot decision tree. The robots will not allow anything to pass a specified decision point unless set compliance criteria are met.

However, to derive maximum benefit from the factors outlined above, companies will typically need to implement RPA throughout their organization. Robots bring scalability and 78 percent of the respondents who had already implemented RPA expected a significant increase in investment in RPA over the next three years.

### RPA journey

The corporate RPA journey should be strategically delivered through three stages: think big, start small, and scale up.

Organizations need to clearly define a vision and a strategy on why, where, and how to set up the RPA program. The introduction of robots will affect numerous domains of the organization such as governance, human resources, processes, controls, and technology; therefore, it requires the involvement of all the relevant stakeholders from the beginning and at every stage thereafter.

Once the strategic vision is defined, companies should start small by performing a proof-of-concept or a pilot to familiarize themselves with the new technology and build awareness within the organization. Proving the compatibility of RPA with existing teams, applications, and IT infrastructure will encourage functions to take ownership of the process. RPA may even serve as a catalyst for cultural change and will garner widespread support as teams start to realize that more of their time is spent on controlling activities rather than on tedious processing tasks. After delivering a pilot, organizations should be in a position to develop, test, and refine their approach (methodology) and prepare to scale up RPA across the enterprise. Scalability will determine the size of the impact and benefits of the RPA technology.

### Governance

For a successful launch and integration into the organizational DNA, the RPA program requires clearly defined governance under a senior RPA leader/sponsor. Ideally, the person appointed should be someone with the ability to promote the new technology, approve future financing, and be able to involve and mobilize all of the relevant stakeholders.

Appointing a person from the C-suite or a functional leadership group as a sponsor has proven to be the most successful choice, as these stakeholders are usually the most supportive of RPA and have the appropriate means.

The main benefits sought by executives from the automation of processes are freeing up resources for critical initiatives, rapidly streamlining processes, and driving a competitive pricing advantage.

Setting up a dedicated RPA team under the leadership of the sponsor is the next step. The core team, consisting of the business analysts and developers, should have cross-organizational support and implement continuous communication with the stakeholders in order to achieve quick results. It is key to ensure that employees beyond the core team dedicate enough of their time to helping to identify and select appropriate processes for RPA consideration.

The successful involvement of the IT department is critical for successful deployment of RPA—system selection, access rights definition, credentials, and application maintenance are just a few of the factors crucial to RPA.

### Talent

The introduction of a virtual workforce will affect various departments and people within the organization. To fully embrace and benefit from this new technology, companies should engage with all affected employees as early as possible. It is crucial that organizations design the new roles and responsibilities of each affected employee and train them to be able to work alongside


the robots and, more importantly, control their performance and output. One of the key benefits of implementing RPA is that humans are freed up to work on activities with greater potential to add value.

### RPA as an entry point into the cognitive sphere

RPA offers an initial stepping-stone into the cognitive automation sphere, which includes much more advanced and powerful technologies and functionalities.

Due to its relative simplicity and high impact, it is an appealing technology with which to familiarize yourself before you consider introducing cognitive automation.

The importance of cognitive solutions in organizations is increasing. Of the organizations that have implemented RPA, 44 percent have already started to identify new solutions as candidates for the further expansion of the spectrum of suitable-for-automation processes.

Furthermore, 28 percent have started implementing cognitive automation. 



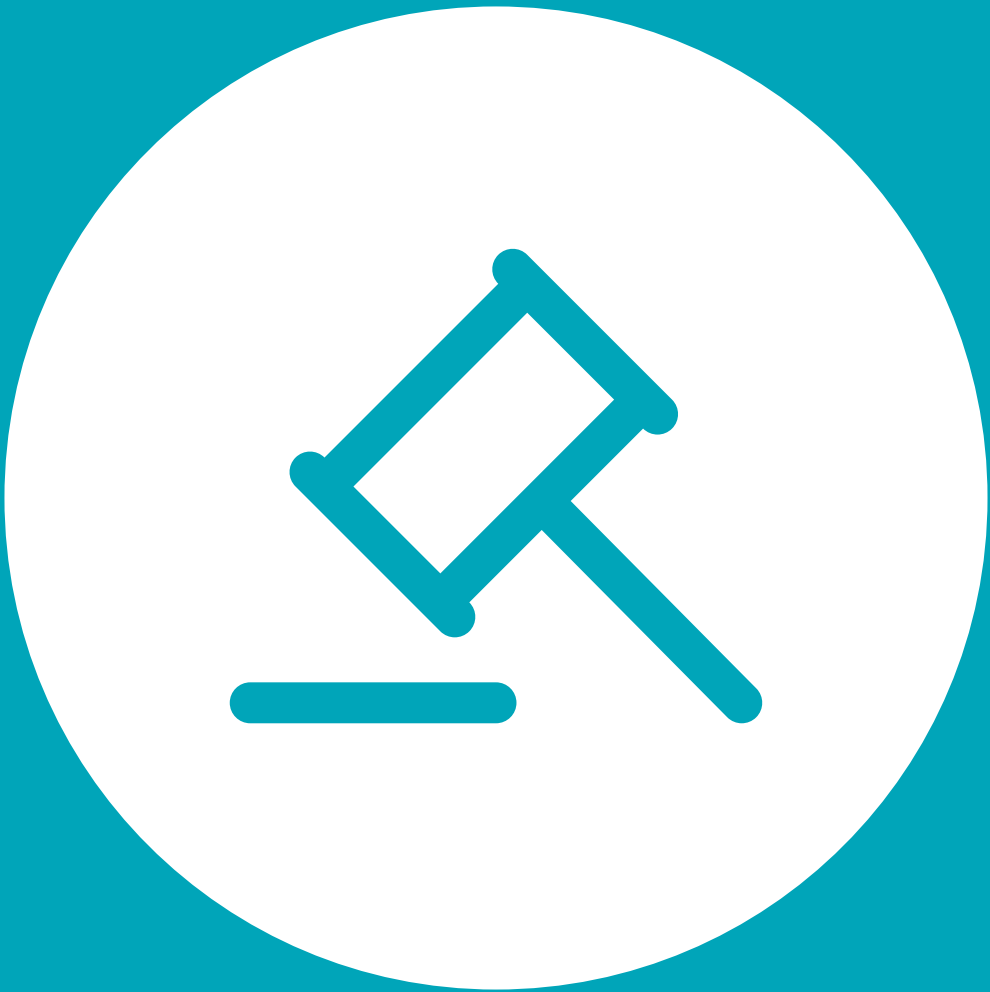


### Conclusion

RPA technology has proven a valuable solution used by numerous organizations not only from the financial industry but also from various other sectors. The adoption of RPA technology is becoming an increasingly important competitive advantage enabling companies to compete on a cost and quality basis.

Many organizations have already embarked on the RPA journey (53 percent of RPA survey respondents) but not all of them have achieved their initial objectives yet. Scaling up RPA success is the current focus for many in the financial industry as only 3 percent of organizations have successfully scaled RPA to a level of 50 bots or more. Robotic and cognitive automation is clearly one significant disrupter in the future world of work that needs to be understood, and responded to, as part of a much wider transition to new ways of working.

HR departments—HR being the most important consideration—should be given an opportunity to realize and acknowledge the empowerment brought by RPA (enabling employees to concentrate on value-added tasks), to contribute to the acceptance of and successful collaboration with the virtual workforce. ●



# Part 02

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From a regulatory  
perspective ▶







## When the going gets tough, the tough gets going...

Level of readiness, strategic responses and major trends for 2018 in the wake of MiFID II

**Simon Ramos**

Partner  
Operations Excellence  
& Human Capital  
Deloitte

**Pascal Martino**

Partner  
Strategy Regulatory  
& Corporate Finance  
Deloitte

**Julie van Cleemput**

Director  
Strategy Regulatory  
& Corporate Finance  
Deloitte

**Erika Bourguet**

Director  
Strategy Regulatory  
& Corporate Finance  
Deloitte

**Benoit Sauvage**

Senior Manager  
Strategy Regulatory  
& Corporate Finance  
Deloitte

Investment firms can no longer live off the fat  
MiFID II entered into force on 3 January 2018. Affected entities in Luxembourg took very different approaches to the MiFID II regulation in 2017, and the regulatory, strategic, and operational consequences are likely to take up a lot of their time in 2018 as well. [➤](#)

With both of these technical challenges, as well as operational challenges, most investment firms have opted to work with external providers.

**They have broken the back of the beast and are starting to see light at the end of the tunnel**

**Investment firms' level of readiness**

In 2017, most firms dedicated significant time, resources, and (in most cases) IT manpower to being MiFID II ready by the start of 2018. As a result, significant progress has been made regarding the level of regulatory compliance and communication to clients and staff.

**1) Level of regulatory compliance of MiFID firms**

The level of coverage of the regulatory constraints seems to be very high in Luxembourg.

However, given the strict deadline and the fact that high-level guidelines are often issued late, investment firms have had to take some operational shortcuts to ensure compliance, but not always efficiency. Firms will need to upgrade these shortcuts in the course of 2018. In particular, due to very late guidelines, product governance, and the infamous "target market" concept, reporting obligations related to transactions and training programs have been the most difficult topics to tackle for most actors in Luxembourg.

As expected, given their greater financial, operational, and organizational resources, it seems that larger investment firms, especially those that are members of a group, have a higher overall level of readiness.

**2) Client communication and staff**

Most actors view ensuring that clients and staff understand all of the strategic and operational changes in the context of MiFID II as a key element of MiFID II implementation. However, given the very tight deadlines, and the fact that parts of

the regulations were only finalized during the summer and some as late as December, not all investment firms have been able to properly communicate with clients in a timely and comprehensive manner.

In this context, investment firms have again taken different approaches in their client communications: some have provided concise, high-level information, while others have gone into (maybe too many?) details, and a third group of firms have not even communicated to their clients at all.

Regarding staff competencies and skills assessment, the degree of training delivered or to be delivered varies across the industry. Some have been organized and embarked on structured programs well in advance of any regulation being formally released. Meanwhile, others are still devising an implementation process so as to comply with CSSF Circulars 17/665 and 17/670, requiring, inter alia, at least 60 hours of training in the various areas of MiFID services or products if training sessions are to be delivered by external providers. For most investment firms, this means that training will have to continue in 2018 if they are to be able to certify their staff as MiFID II compliant.

**A shared ordeal**

**Market impact is not to be underestimated**

One area in which firms have been struggling to meet the deadlines is related to transparency and the reporting of transactions. With both of these technical challenges, as well as operational challenges, most investment firms have opted to work with external providers. Nevertheless, accurate and timely reporting have necessitated a painstaking trial and error approach to making improvements.



Additionally, in some instances, the aforementioned late communication and information requests to clients led to some client-related data, such as LEIs and national ID codes, not being available at the beginning of 2018. This created issues at least as regards regulatory transaction reporting, where the providers of LEI codes were simply unable to keep up with requests. In response to this development, ESMA provided some breathing room late in December 2017 to ensure the smooth introduction of the LEI requirements. This was achieved by allowing a six-month period during which transactions could be executed on behalf of clients, while waiting

for the LEI providers to process the backlog of requests.

**Regulators' level of readiness**

In terms of MiFID II readiness, both investment firms and regulatory authorities are under a similar level of pressure. Indeed, MiFID II has not yet been enacted in the national legislation of all EU countries. In Luxembourg, implementation guidelines were published and drafted in the form of circulars very late in the game on topics such as staff competence and skills certification (13 October 2017) and transaction reporting (1 December 2017).

The reporting of daily transactions is an example of the Herculean tasks facing national competent authorities. Transaction reporting has been a huge challenge for national regulators, while many financial industry players doubt their capacity to efficiently and meaningfully process this immense flow of data. As a confirmation, ESMA, the EU Supervisory authority, published an instrument-level report on 9 January 2018, stating that only 2 percent of instruments that should have been subject to reporting had been adequately processed by the beginning of March. ➔



Transaction reporting has been a huge challenge for national regulators, while many financial industry players doubt their capacity to efficiently and meaningfully process this immense flow of data.

**Some investment firms are going beyond “mere” regulatory readiness to review their strategic positioning**

With the increase in regulatory constraints and the partial ban on inducements, MiFID II has forced investment firms to take action to mitigate the increased costs and compensate for lost revenue.

**1) Investment value proposition reshuffle**

MiFID II has introduced the notion of independent advice. While some investment firms were unsure how to position their advisory services a year ago, lack of interest from clients regarding independent positioning and the additional regulatory burden led the majority of firms to opt for non-independent positioning. For example, if we focus on banks, a benchmark shows that all 15 banks benchmarked in Luxembourg opted for non-independent positioning.

Alongside their non-independent positioning, banks also had to position themselves regarding the treatment of inducements.

**Banks had three options:**

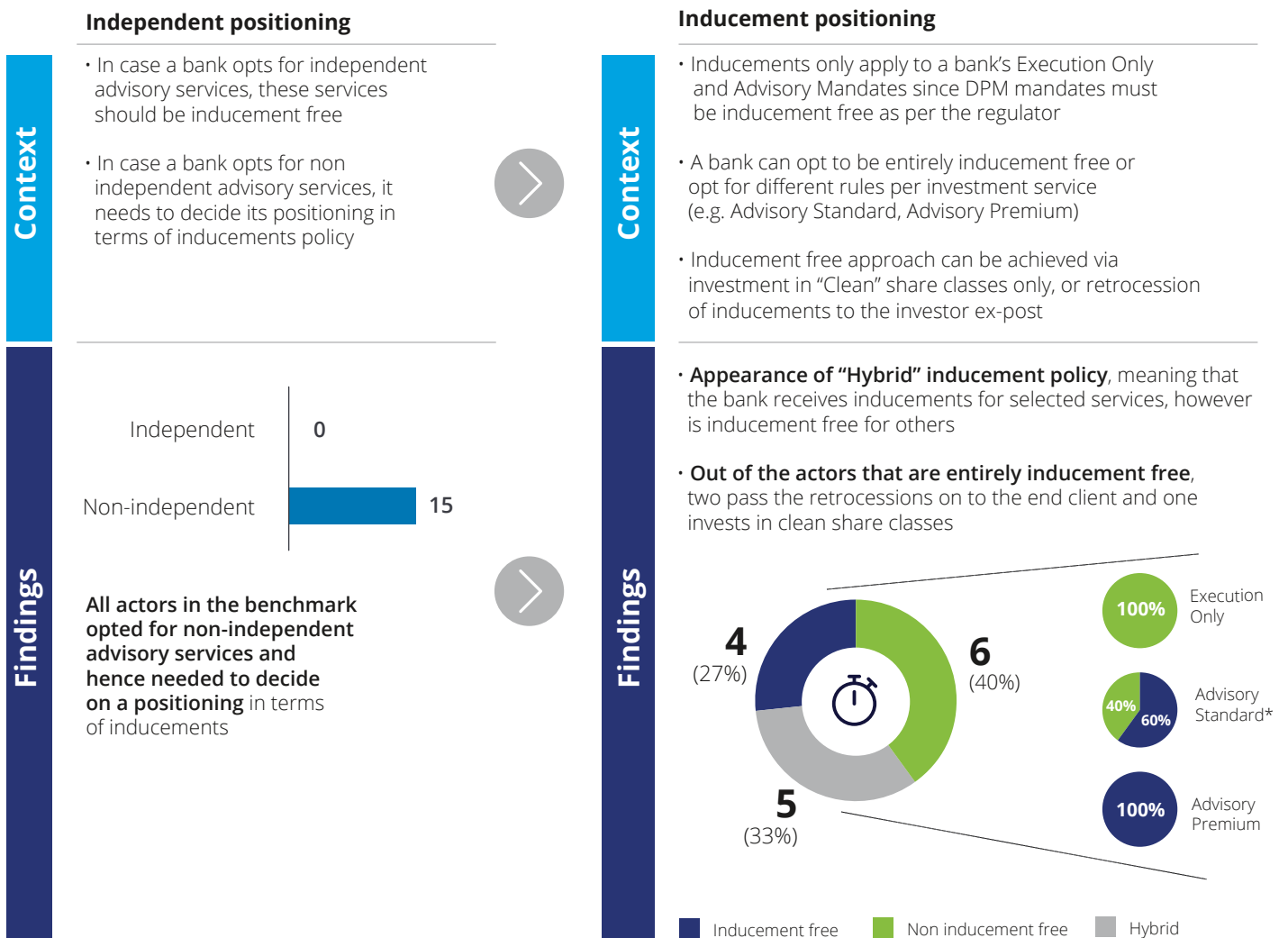
- 01. To be totally inducement-free (i.e., not receiving and/or not keeping received inducements related to any investment services offered). A minority (a quarter) of banks have chosen to be fully inducement-free. These banks clearly marketed this positioning to their clients.
- 02. To retain inducements related to their investment services (except for discretionary portfolio management services where doing so is forbidden by the regulation). Almost 40 percent of banks have chosen this option.

03. To be partially inducement-free. One third of banks have chosen a hybrid model. These banks all offer premium advisory services that are inducement-free, and all are keeping inducements on their execution-only offering while having different positioning on their standard advisory offering.

MiFID II also incentivized investment firms to position their execution-only offering as a real (packaged) offering to distinguish it clearly from advice and to launch a premium advisory offering to enable a distinct inducement positioning on advisory services. ➔

### MiFID II has forced Banks to position themselves regarding inducements

Benchmark performed in Luxembourg on 15 Private Banks



\* One actor that keeps inducements on existing Advisory mandates, however follows an inducement free policy for new mandates is shown in graph as inducement free

## 2) Investment pricing: “each service has price, transparency has a cost”

On top of reviewing their value proposition, some banks have also worked on the pricing strategy of their investment offering.

To compensate for the partial loss of inducements as well as the increased costs related to client reporting and monitoring, most banks have amended their overall pricing. Not all banks have overhauled their prices entirely; some have just tweaked existing fees or added a new MiFID II related fee. Others have exhaustively reviewed their pricing list, and this might lead to some unwelcomed surprises by the end of 2018.

Two thirds of the banks from our benchmark published new price lists in the last quarter of 2017 to benefit from the pricing change as of the first quarter of 2018. Others are still working on it or have adopted a wait-and-see approach to see how the clients will react to the price change. It should be noted that the pricing review was carried out at the same time as a review of discount policies and procedures so as to have stricter rules to avoid losing the compensation benefits of the new pricing.

## 3) Launch of new products

In addition to reviewing their current value proposition and pricing, some banks have also looked at launching new products to compensate for the impacts of MiFID II.

In particular, banks mainly positioned as funds distributors, which have most to lose as a result of the partial ban on inducements, are aiming to improve their position as fund producer. This launch/increase of the share of in-house funds will, of course, take time to produce positive effects, but may have a long-term impact on the Luxembourg fund industry.

## What's next?

### Trends and outlook

#### 1) Many “first times” in terms of readiness

Investment firms will have to manage their “first times” in 2018.

- Inter alia, the first round of quarterly client reporting, the first round of reporting on the top five execution venues, the launch of the systematic internalize role and the first round of yearly post-trade costs and charges reporting are on the agenda for 2018.
- Investment firms are also providing further training and official certification to their workforce.
- Processes will need to be reviewed to correct operational shortcuts taken in 2017 in the context of MiFID II but other processes will also have to be improved in order to save commercial time that has been taken up by MiFID II.
- Investment firms will also probably have to manage MiFID II on-site inspections from the regulator in 2018.

#### 2) MiFID II is only a stepping-stone and strategic considerations should reflect this

A trade-off was found under MiFID II with a partial ban on inducements, but this situation will not last forever. What is not yet clear, however, is who (the client or the regulator) will demand a full ban on inducements and when it will happen. In any case, we can expect to see inducements disappear in the long term. This ban will force investment firms to look at other strategic mitigation actions. In parallel, it may also be in the fund industry's best interests to reconsider its pricing schemes.

Brexit implications will also have to be closely monitored as the United Kingdom represents a major share of the European banking industry. In particular, all “market” related measures will have to be amended and considered by investment firms once Brexit occurs. ●





To compensate for the partial loss of inducements as well as the increased costs related to client reporting and monitoring, most banks have amended their overall pricing.





# To cook or to be cooked —that is the question

## Stirring up the perfect investment offering and pricing in a post-MiFID II world

### Pascal Martino

Partner  
Strategy Regulatory  
& Corporate Finance  
Deloitte

### Erika Bourguet

Director  
Strategy, Regulatory  
& Corporate Finance  
Deloitte

### Esther Bauer

Manager  
Strategy Regulatory  
& Corporate Finance  
Deloitte

### Vera Josten

Analyst  
Strategy, Regulatory  
& Corporate Finance  
Deloitte

### What do restaurants and private banks have in common?

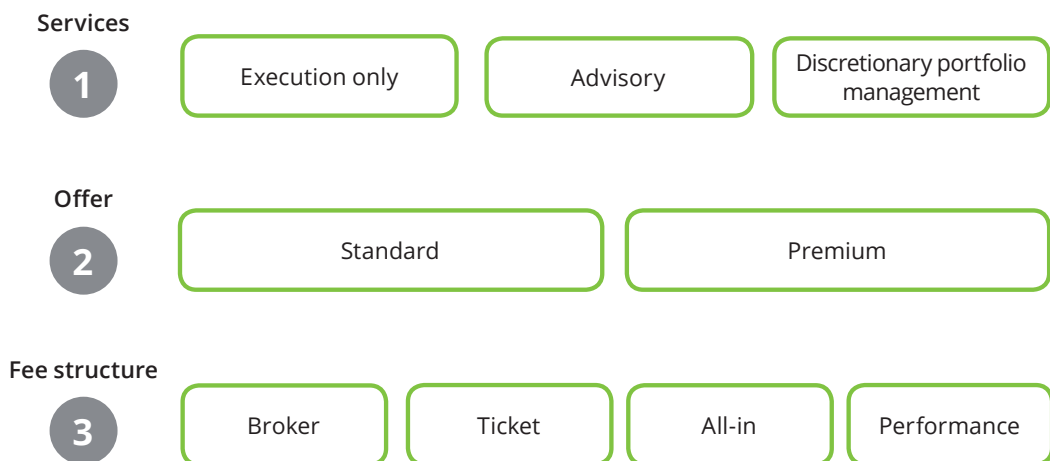
More than you might think... Changing ingredients and shifting customer behaviors are compelling banks to review existing recipes and make strategic choices regarding the future of their business models. The private banking market has undergone significant changes in recent years as external pressures such as an evolving economic environment and regulatory challenges take their toll. The provisions of MiFID II have fundamentally challenged their existing business models and forced banks to react. While many banks seem to have been unsure of how to respond until recently, the entry into force of the new regulation has prompted the majority of banks to review their menu, introducing a new service offering and pricing. 

# Banks are spicing up the menu with a new value proposition

To provide an overview of these redefined offerings, Deloitte has analyzed almost 15 private banks in Luxembourg, including pure player private banks and universal banks with a private banking department. The results of this analysis show that the services on offer continue to range from execution only to advisory and discretionary portfolio management, but the range of ancillary services has become more diversified.

**Luxembourg private banks can set themselves apart from the competition on three main aspects: service, offer and fee structure.**

In this changing environment, banks are reacting in a relatively homogenous way. As MiFID II enters into force, we observe that the majority of banks have decided on a new value proposition for their investment services, reviewing the range of services that they provide to customers and adapting their fee structures accordingly. Consolidating the pricing grids submitted by the 15 individual banks on a voluntary basis allows us to provide a market overview of private banks in Luxembourg, especially in terms of investment offering. We looked at services, offers, and the proposed fee structure, as well as fee levels for the proposed investment offering.





**1. Three different types of services are typically offered to clients based on their requirements.**

	1 Execution Only	2 Advisory	3 Discretionary portfolio management
Definition	<p>Clients manage their own investment.</p>	<p>Clients receive advice on their investment strategy from the bank professionals, but take the final investment decisions themselves.</p>	<p>Clients choose an investment strategy that reflects the level of risk they are willing to accept and entrust the management of their portfolio to bank experts.</p>

**2. For each of these services, banks may choose to provide their clients with a standard offer only or with both a standard and a premium offer.**

A premium offer usually includes additional features, such as a more active and individualized advisory approach.

	1 Execution Only	2 Advisory	3 Discretionary portfolio management
Level of service offering	 <ul style="list-style-type: none"> <li>Consists in the execution of transactions requested by clients and on their sole initiative</li> </ul>	<ul style="list-style-type: none"> <li>Less active management</li> <li>Reactive/on demand advisory by RM</li> <li>More general investment advisory</li> <li>Less frequent portfolio reporting</li> </ul>	<ul style="list-style-type: none"> <li>Standard service offering</li> <li>Mostly dedicated investment advisor</li> <li>More general investment strategy (often through funds)</li> </ul>
	 <ul style="list-style-type: none"> <li>Consists in the execution of transactions requested by clients and on their sole initiative through a direct access to trading room</li> </ul>	<ul style="list-style-type: none"> <li>More active advisory approach/ ongoing contact with dedicated financial advisor</li> <li>Personalized recommendations</li> <li>More frequent portfolio revenue reporting</li> </ul>	<ul style="list-style-type: none"> <li>Tailored service offering</li> <li>Dedicated investment advisor</li> <li>Tailored investment management</li> </ul>



**3. There are four different fee structures within each service and offer category: ticket fees, broker fees, all-in fees, and performance fees.**

Some fee structures are applicable to all types of services and offers, whereas others are particularly well-suited to specific service offerings. Ticket fees, for example, exist solely for execution only services, while broker fees can be charged for all three services.

	1 Ticket fees	2 Broker fees	3 All-in fees	4 Performance fees
Definition	<ul style="list-style-type: none"> <li>Ticket fees <b>generally include</b> the administration fees and custody fees</li> <li>Ticket fees <b>do not include</b> transaction fees</li> </ul>	<ul style="list-style-type: none"> <li>Broker fees <b>generally include</b> the administration fees and custody fees</li> <li>Broker fees <b>do not include</b> transaction fees</li> </ul>	<ul style="list-style-type: none"> <li>All-in fees <b>generally include</b> administration fees, custody fees, transaction fees, and advisory or discretionary management fees</li> </ul>	<ul style="list-style-type: none"> <li>Performance fees are <b>generally</b> a variation of classic all-in fees, with lower rates than all-in fees but with a performance fee that may be applicable in case of good performance</li> </ul>
Standard calculation	<ul style="list-style-type: none"> <li>Ticket fees are calculated based on a fixed amount applied per transaction (hence, independent of the transaction amount and of the financial instrument category)</li> </ul>	<ul style="list-style-type: none"> <li>Broker fees are calculated based on a percentage (<b>generally</b>, depending on the transaction amount and the financial instrument category) applied to the transaction amount</li> </ul>	<ul style="list-style-type: none"> <li>All-in fees are calculated based on an annual rate (<b>generally</b>, depending on the level of assets) applied to the total assets in portfolio</li> </ul>	<ul style="list-style-type: none"> <li>Performance fees are calculated based on an annual rate (<b>generally</b>, depending on the level of assets) applied to the total assets in portfolio and with a performance fee added in case of good performance (calculation differs)</li> </ul>

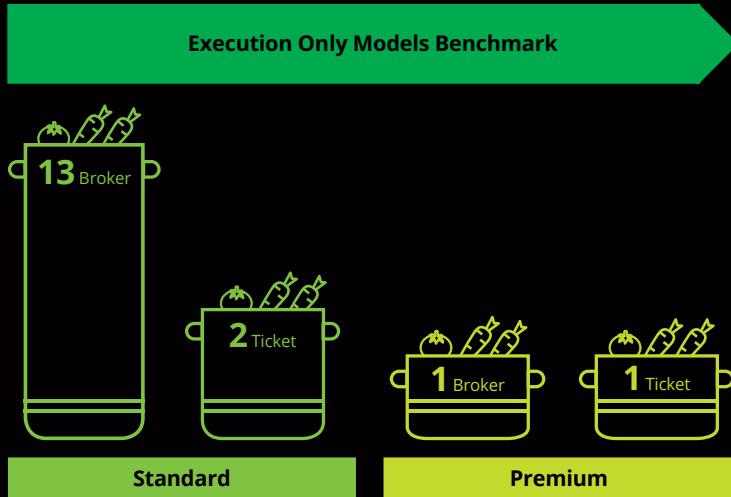
**In summary, the new bank menu has the following key features:**

**Execution only is becoming a staple.** In a break with the past, execution only services are increasingly emerging as a packaged offering for a number of banks. In particular, banks whose clients typically have lower total net worth are using packaged execution only offers to attract clients and eventually upsell toward advisory or discretionary services.

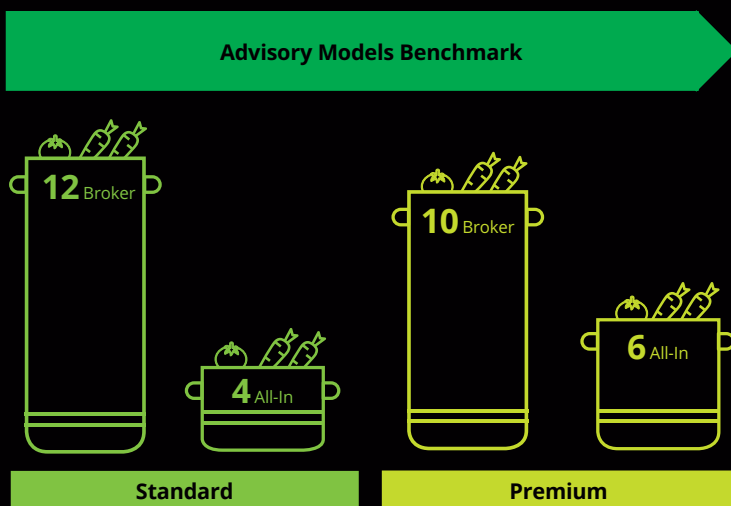
**Novelty is shaking up the menu.** Clients are being proposed newer and more innovative pricing models than in the past, as banks respond to the changes they face. Discretionary portfolio management clients, for example, can now choose more traditional fee structures, such as broker and all-in fee structures, or more innovative performance-related all-in fees.

**A premium menu is on offer if clients are willing to pay.** Banks are increasingly differentiating between standard and premium offers; while some banks continue to propose only one type of offer for each service, a large number of banks are attempting to respond to the changing structure of the Luxembourg private banking market by creating a more segmented offer tailored to the needs of individual clients.

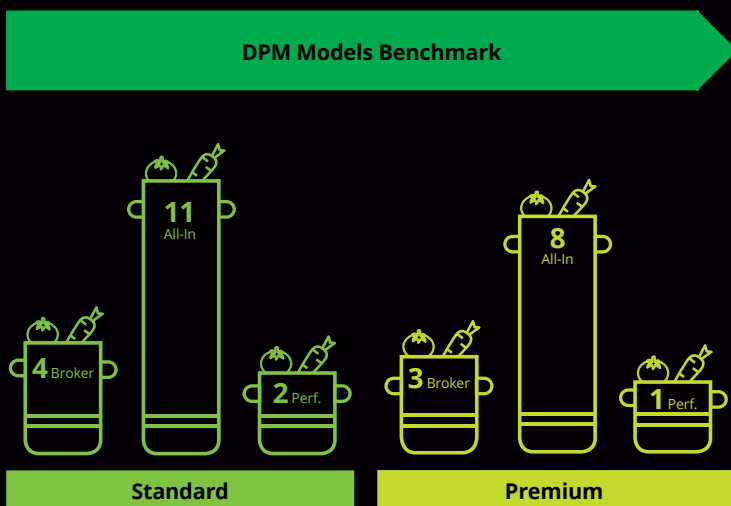
Broker models are the predominant fee structure for execution only and advisory models, while all-in models are most common for DPM (all numbers out of 13)



- **All actors offer execution only broker services and premium services are rare.** Only one actor provides premium execution only services
- **Specific ticket models are limited.** They are mainly available for execution only and here are only offered by a few actors
- **Entry thresholds are not commonplace.** Only one actor has an entry threshold for the standard offer of €250,000



- **Broker models are predominant for advisory models and premium models are commonplace.** Nine actors offer premium models
- **All-in models vary in terms of services included.** For example, out of six actors offering an all-in structure for premium advisory, only three actors offer a "real" all-in model, while the other two offer a hybrid model (i.e., account management and custody fees come on top of all-in management fees)
- **Approximately one-third of actors have an entry threshold.** For standard offers ranging between €125,000 and €1 million, and for premium between €1 million and €5 million



- **All-in models are the prime fee structure for discretionary portfolio management.** Eleven actors offer an all-in model for a standard DPM offer
- **A majority of actors only present standard DPM mandates in their official pricing grid**
- **Only two actors provide performance models.** There is one for both the standard and premium DPM



# Not all prices are adapted to the menu and clients

The majority of private banks have a clear strategy regarding the services and clientele they want to target. However, by applying the pricing grids of the actors analyzed to 10 different simulated investor profiles<sup>1</sup>, it is clear that not all actors have actually aligned their pricing with the strategy that they have defined.

The 10 profiles encompass a wide array of services and investor behaviors, ranging from a smaller client with €600,000 in execution only and not very active to a large client, investing €20 million in a discretionary portfolio management mandate. These sample clients are based on classic portfolios and the related transactional behaviors. More information on each of the profiles can be found in the table below.

## Selected information on profiles included in the pricing benchmark

N°	Sample Client Profile	Strategy	AuM (mio €)	Turnover rate
1	Standard Execution Only Broker		0.6	20%
2	Standard Execution Only Broker / Ticket I		0.8	44%
3	Standard Execution Only Broker / Ticket II		1.0	59%
4	Standard Advisory Broker		0.6	35%
5	Standard Advisory All-in		1.5	60%
6	Premium Advisory Broker		2.6	46%
7	Premium Advisory All-in		2.6	88%
8	Standard DPM All-in		2.6	85%
9	Premium DPM All-in I		5	94%
10	Premium DPM All-in II		20	-

 Balanced     High

<sup>1</sup> Representing a diversity of investors in terms of services required (execution only, advisory, discretionary portfolio management), investment strategy, assets under management and turnover.

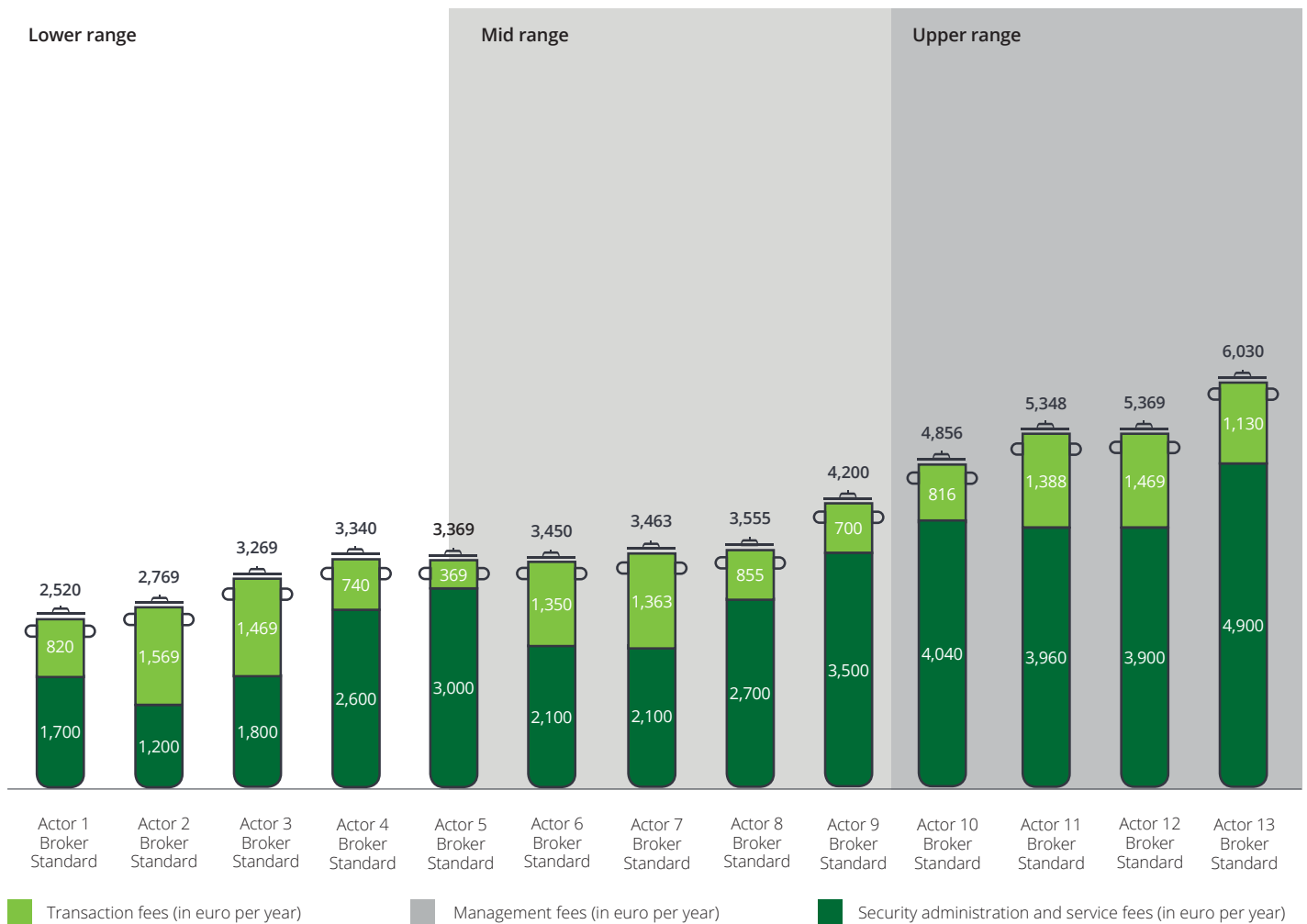
# The extent to which strategic positioning and pricing are aligned varies significantly between banks

The results show that the market is fragmented regarding the degree to which banks' pricing is aligned with their strategy. Some actors seem to have carried out significant analysis and definition work resulting in pricing grids that are aligned with their strategy, attracting target clients and dissuading non-target clients. By contrast, other banks' pricing is actually attracting clients that do not belong to their target segment, often resulting in a high cost to serve and low margins, or they

are pitching prices too high, and thereby dissuading clients in their target segment. Let's take a look at the example of execution only broker pricing for a client with €600,000 performing three transactions for €120,000. The levels of fees charged to the client differ significantly among banks, with the cheapest actor pricing its services at approximately €2,500 per year and the most expensive actor pricing them at approximately €6,000 per year. ➔



Amount of fees paid per year in EUR<sup>2</sup>



If we consider the extremes, it is interesting to note that both actors are private banks targeting mainly advisory and DPM clients with AuM of at least €2 million. One actor clearly aligns its pricing to its strategy, while the other is attracting clients it does not desire:

- The least expensive actor (Actor 1), in contrast, attracts clients that do not belong to its core target market by pricing its execution only services for a client with €600,000 of AuM lower than the private banking departments of universal banks
- Private banking departments of universal banks are intentionally pitching their prices at relatively low levels as they actively target these clients as part of their efforts to move affluent clients from retail banking to private banking and encourage upselling
- The most expensive actor (Actor 13) aligns its pricing to its strategy by charging a high security, administration, and service fee, which is prohibitive to less desirable clients

<sup>2</sup> Does not include fees charged by third parties on financial, expressed excluding VAT and excluding trailer fees or rebates



**Conclusion**

As banks are reviewing their menus, offering new dishes based on new recipes, they need to ensure that they adapt their prices accordingly. We have observed that two-thirds of banks have reviewed their pricing grids in the wake of MiFID II. Pricing should not be underestimated but should instead be seen as a key contributor to the implementation of the bank’s strategy, which can lead to a significant increase in profitability by driving the RoA of each individual customer.

As in the case of a restaurant, banks need to take a strategic approach to defining their pricing strategy, looking both at the revenue side—identifying the clients that they want to target, their willingness to pay, and their perception of different pricing models—but also the cost side. From the revenue side, a very simple calculation shows this; should Actor 1 increase its pricing by €1,000 to €3,520 (e.g., by increasing its security administration and service fees), it would position itself in the mid-range of execution only services for a client with €600,000. As a result, the RoA for this individual client would increase from 0.49 percent to 0.59 percent<sup>3</sup>.

From the cost side, the wrong pricing will attract non-target customers, which may have a negative impact on the bank’s bottom line by acting on both drivers for a number of reasons, including a diluted brand image, a potential inability to serve these clients adequately, or a high cost to serve.

In contrast, having a tailored pricing model will ensure that margins are safeguarded and increase the profitability of individual clients. ●



<sup>3</sup> This RoA calculation is particularly simplistic, as it does not reflect sources of revenue other than transaction fees, management fees, and custody and security administration fees. While it is not comprehensive, it provides an indication of the potential impact of a coherent pricing strategy.



# IM industry

## The MiFID II paradigm shift

### Simon Ramos

Partner  
Operations Excellence  
& Human Capital  
Deloitte

### Julie van Cléemput

Director  
Strategy Regulatory  
& Corporate Finance  
Deloitte

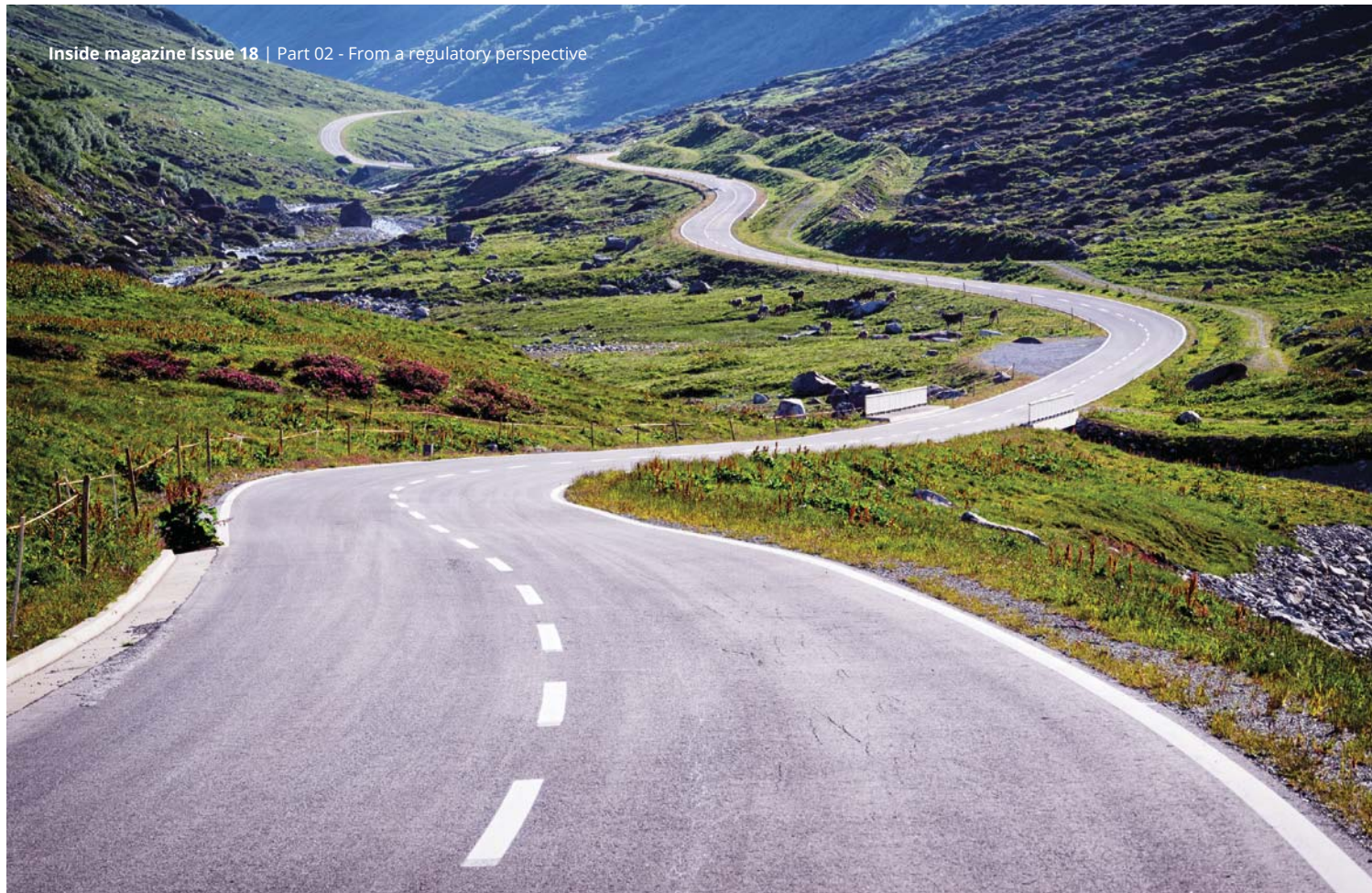
### Gerard Lorent

Director  
Strategy Regulatory  
& Corporate Finance  
Deloitte

### Benoit Sauvage

Senior Manager  
Strategy Regulatory  
& Corporate Finance  
Deloitte

Despite the fact that MiFID II is not directly legally applicable to investment management companies or AIFMs, a brief overview of the asset management industry after MiFID II implementation demonstrates beyond doubt that **the new rules will have a profound influence on its products, structures and future**. As instruments, funds are subject to MiFID II and are therefore affected by the MiFID II framework on every possible level. >



### MiFID II: one era ends and another begins

Although the entry into force of MiFID II and MiFIR (hereafter referred to as “MiFID II”) on 3 January 2018 affected all entities in Luxembourg, it is clear to us that institutions have approached MiFID II very differently. Specifically, when we consider asset management, despite the fact that MiFID II is not directly legally applicable to fund industry management companies or AIFMs—thanks to an explicit exclusion in the regulation—the **products, structures and future of the industry will be heavily influenced by the new MiFID II rules**. As instruments, funds are subject to MiFID II and are therefore affected by the MiFID II framework at every possible level.

Until now, as is often the case at the start of a trend, the changes have not necessarily been obvious to asset managers, oftentimes because of their focus on their large institutional clients, which obscures the fact that these clients are themselves intermediaries to retail clients.

**We believe that MiFID II marks the start of a new era of transparency at three levels: pre-trade, trade and post-trade.** The new transparency rules affect all stakeholders, and none more so than product managers and manufacturers.

#### 01. Before the trade

Pre-trade information will cover performance and risk information, as well as costs and charges, and information on the target market

#### 02. During the trade

The market transparency requirement implies that more firms will look at “auditable” solutions with public prices (often via trading platforms), as these will facilitate compliance

#### 03. After the trade

Clients will be informed about the quality of execution and costs, including the amount of any retrocessions charged by their financial institutions

Another key element to factor in is that advice will no longer be free of charge in most cases, and this may prompt clients to monitor performance even more closely.

### The direct consequences of MiFID II for the IM industry



#### Distribution

Many in the UCITS/AIF communities seem to have been caught by surprise, barring a few—albeit notable—exceptions. In fact, although nearly everyone had heard of MiFID II, it was not at the center of the fund industry’s radar. The IM industry is drawn to MiFID II for commercial reasons rather than legal imperatives: they are looking to facilitate distributors’ lives under MiFID II. Even though, from a legal perspective, MiFID II does not apply directly to UCITS or AIF management companies/AIFMs, the fact that their products fall within the scope of the directive has dragged them into the MiFID II maelstrom.

In the short term, for reasons of product governance (and costs/charges) including the availability of KIID/PRIIPS, many products were set aside or simply dropped from retail offerings at the beginning of the year and will not be reintroduced

until they produce adequate information. However, while this short-term impact is significant for some product providers, they are in a position to mitigate its effects over the course of the year by providing the requisite information. Nevertheless, the potential difficulty of re-entering the distribution circuit should not be underestimated. As difficult as this might be, we expect that more important longer-term consequences will challenge the entire industry.

In the medium and longer term, the new approach to inducements will provide a major impetus for restructuring the industry. At present, whereas the “independent adviser” status is not extensively used, the paid-for advisory management and DPM (discretionary portfolio management) models have become entrenched.

**Coupled with price transparency, these models will be game-changers, because:**

- Clients will be more aware of the costs (as stipulated by the EU Commission) as financial institutions will have to disclose their cost structure
- On top of this, financial firms will push in the same direction. Their support might come from less direct factors falling into two broad categories, one of which will be related to business imperatives: why pay high fees for a product that negatively affects portfolio performance, then legal and compliance incentives to switch from off market execution to on market trades (with ETFs)

The end of retrocessions from independent advice, DPM or paid-for advice will make performance even more of a priority within the industry. In this scenario, only top performers will attract attention and a steady flow of business. This trend has an additional potential consequence for portfolio management, in that there may be a shift towards defining the strategic allocation of assets and considering

products as a pure commodity from the current stock or instrument-picking perspective.

The way services will evolve at distributor level represents a challenge for the IM industry. Funds under DPM and independent advice will not be able to pay retrocessions, hence selection and product appraisal will have to rely on a new set of factors, chiefly service and performance. For good but undifferentiated products, the new norm will definitely be for passive and index-linked funds to be managed cheaply. There are difficult times ahead for funds whose investment strategies do not stand out from the crowd, because they will not be able to justify their pricing; conversely, commoditization will be a boon for top performers, which might even be in a position to increase their management fees in response to increased demand (access to top managers will be even more sought after). This trend is rooted in a basic tenet: “why pay X basis points for a fund when the firm can buy an ETF for a fraction of the cost?” In addition to the pricing difference, ETFs (for example) have the additional benefit of being easier to manage from a compliance perspective, since they are traded in real time on public stock exchanges with public prices.

At present, many funds managers are still simply considering their basic needs to ensure compliance with MiFID II rules. Among the most MiFID II remote communities of PERE funds, the notions of costs and charges and/or product governance come as surprises. One reason for this is that these funds target large private banks or insurers, sometimes overlooking the fact that they do not invest for themselves but for end clients. Because the MiFID II definition of “retail client” encompasses high-end private banking clients, prime end targets for these products, distributors and intermediaries (the entities doing business with these PERE funds) also have to meet product governance requirements (KIID/cost and charges).

In addition, in terms of the impact on management, anecdotal evidence for the trend comes from the robo-advice segment of the market. The driving forces behind this new breed of advisers are real-time, personalized, and efficient, cost effective products that are easily traceable and tradable, not “obscure” retrocession arrangements, and this might offer new drivers for the industry.

From a pure policy perspective and in the longer term, the evolution of inducements might lead member states to converge upon a Netherlands/UK-style ban (or a cap as envisaged in Poland), which would change the industry dynamic. Interestingly, the impact on the fund industry might only be half that seen under MiFID II. Funds are offered via banks and other managers, but a large proportion of distribution services are provided by insurers that will undergo similar changes to those seen under MiFID II (with IDD) by the autumn. This may deal yet another blow to the industry before the end of the year, coming at the same time as cost and charges disclosure. ➤

The new transparency rules affect all stakeholders, and none more so than product managers and manufacturers.



### Management

As we have seen, MiFID II will change the dynamic of distribution, and there are also direct implications for the asset management industry. The cost of trading may increase because of regulations (MiFID/MIFIR and EMIR); as these force market participants to use exchanges or clearing platforms, fund managers may be required to place more collateral, margins, etc. with their intermediaries. This stems from the fact that more products will become both clearable and tradable with the interaction of MiFID II and EMIR.

On the positive side, funds stand to benefit from best execution information about trading venues, listing, quality of execution, etc.

One key new factor is that MiFID II greatly enhances the tools at the regulator's disposal to influence products, from suspension to outright bans. In January, ESMA conducted a consultation on CFDs (contracts for difference)/binary options in order to restrict their use or fully ban them for retail investors across the entire EU. This new supervisory power triggers naturally a question: "what's next?"

There are many gray areas at the juncture between MiFID II and fund management. For example, from a UCITS/AIFMD perspective, product governance is not a requirement, and yet MiFID II requires ex-post reporting of trades for each product, coupled with management of the "negative target market" and potential sanctions. At this moment, these ex-post sales reports are still closer to myth than reality for many providers, but that leaves the product manager responsible for when products are sold outside of a target market or—worse—offered without checking for such a target market.



### Investment pricing: "each service has price, transparency has a cost"

This maxim perfectly summarizes the implementation of MiFID II and its consequences for the IM industry. At the beginning, MiFID II proponents had a very clear picture of their objectives, which included putting **pressure on the fee level across the financial industry and specifically in the funds/structured products arena**. What we see now is that the trend seems to be following the desired trajectory.

Products without governance or target markets aside (at least for retail investors), costs have increased to cover the massive compliance burden, and in many cases MiFID firms have opted for paid-for advisory contracts. That leads to two consequences:

- Leaving the world of free advice means that clients will be more demanding,

hence putting pressure on firms to improve their product/service offering and the performance of their investments

- To demonstrate that they have chosen the optimal product, firms will have to rely on demonstrable/auditable and public information, which might lead to clients opt for a trading platform

Finally, price increases implemented by distributors are primarily a reflection of increased costs. These costs are easily justified as compliance investments, but it is harder to make this argument in the IM industry.

### Case study: management company A

Management company A offers some MiFID II services, including managing direct client accounts. As a result, it must fully comply with MiFID II requirements, such as reporting and the processing of investment research. If management company A has both a MiFID license and "management company" status, it will face organizational challenges stemming from the fact that it is partly under MiFID II but some of its activities are not covered by the directive. Clear and strict barriers will therefore have to be put in place, and this will make the overall structure costlier to manage.

### Conclusion

MiFID II paves the way for new asset management industry drivers

**Product governance, the pressure on retrocessions and transparency requirements are reshaping the asset management industry,**

forcing the commoditization of more standardized products. In light of MiFID II, the IM industry needs to fundamentally rethink its:

- Cost drivers
- Real-time performance
- Distribution model

The start of this year only brought the first stage of change, with the removal of products from distributors' lists of available instruments.

For the IM firms that have not yet woken up to these profound changes, action must now be taken urgently, since MiFID II will be closely followed by the IDD regulation for the insurance industry, which will restrict access to the insurance sector. Not complying with MiFID II requirements is a very bad path for meeting IDD. Providers should consider what would happen if these two types of client were to become inaccessible.

The areas to address in the IM industry are based on commercial and client requirements, and not necessarily only from regulations. In fact, we are at the **outset of a new era, not at the end of MiFID II. On 3 January, we witnessed the arrival at the starting line for departure, not the finish line.** ●

# The AML/CTF compliance transformation



**Pascal Eber**

Partner  
Operations Excellence  
& Human Capital  
Deloitte

**Bastien Collette**

Director  
Operations Excellence  
& Human Capital  
Deloitte

**Adrien Chiariello**

Senior Consultant  
Operations Excellence  
& Human Capital  
Deloitte

**Sarah Audrey Samou**

Consultant  
Operations Excellence  
& Human Capital  
Deloitte

Over the last few years, the compliance function has had to cope with heightened regulatory pressure. Compliance departments have grown in size, at increased cost to organizations. In addition, compliance departments must improve their efficiency and play a key role in implementing regulatory changes.

The time has come to transform the compliance function so that it can fulfil its primary roles, which include the oversight (monitoring and testing) of a company's activities. The corporate governance and culture of institutions need to change and this will involve making changes to the tools and services they use (technology, enhanced collaboration with external specialists, etc.).

Some institutions have already embarked upon this transformative journey by searching for efficient solutions and services so as to be compliant with all applicable rules.





The concept of compliance is frequently overlooked because it is seen as lacking any positive impact on business activities. Given that compliance is an *absolute* (i.e., it cannot be partially achieved), it is also seen as an overwhelming regulatory mountain to climb. In fact, since the concept of compliance is so pervasive, the best way to achieve compliance is to ensure compliance in every business activity and not consider it as a stand-alone topic or goal.

While hefty fines for regulatory misconduct far exceed the cost of efforts to ensure compliance, beyond the financial loss, non-compliance often has the following deeper impacts on businesses:

First, reputational risk: broadcasting a positive image has never been as hard as it is today. Ever since the emergence of now-ubiquitous communication technologies, customer awareness and protection have been growing in importance. On the top of that, fines and sanctions are now made public, which weighs heavily on the scales of public opinion.

Next, we have corporate culture impairment: bosses favor motivated employees united under one flag and one business purpose. This is what corporate culture is all about. Nevertheless, corporate misconduct, when detected, is usually an attempt at personal enrichment to the detriment of the company's wealth. When committed by senior executives, the cultural damage felt deeply by those on the bottom rungs of the ladder.

Avoiding regulatory misconduct requires more than mere procedures and well-trained compliance teams. The involvement of senior management is essential. Investing in compliance and the regulatory framework is no longer a box ticking exercise. It requires more dedication and qualitative resources to set up a process to ensure efficient and accurate compliance with constantly changing and increasingly stringent regulatory provisions.

Regulators do not expect financial institutions to merely comply with the rules; instead, they are called upon to be pro-active. This new challenge should motivate financial institutions to re-think how they go about investing in compliance.

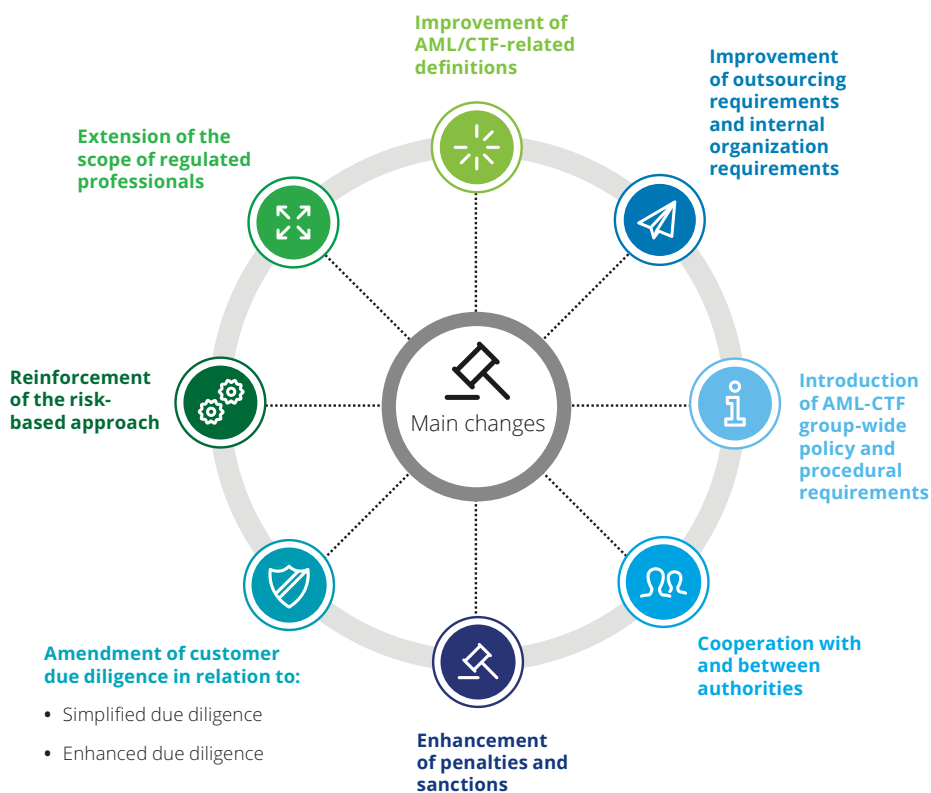
**Obstacles to full compliance**  
**Ever-increasing regulatory pressure**

It would be impossible to argue that financial institutions have not faced a rising tide of regulatory pressure over the past 10 years. One of the reasons why this pressure can sometimes become unbearable is that these regulations rapidly evolve over time and expand in scope with every update. In the last 24 months alone, new acronyms have entered the lexicon of every compliance officer: AMLD IV, MiFID II, GDPR, etc.

Compliance departments must constantly adapt their policies, procedures, controls, and processes. AML/CTF laws and regulations are the perfect example of rapidly expanding scope. For instance, the Luxembourg law of 12 November 2004 relating to AML/CTF, as amended most recently in February 2018, follows on from the partial implementation of AMLD IV into Luxembourg law (which began with the tax reform and joint circular 17/650 of 17 February 2017 making tax crimes a predicate tax offence to money laundering). ➔



The main changes brought in by this law are:



In this era of digital transformation, organizations that are slow to invest in proper IT infrastructure are denying themselves access to valuable data.

AMLD IV's full transposition into national law will be achieved when the national UBO registries for trusts and legal entities currently subject to separate transpositions (bills of law N°7216 and N°7217) become legally applicable Luxembourg.

**AMLD V and VI are already being discussed at EU-level, and this is just the beginning**  
**Face the real-IT-y**

It has become difficult, if not impossible, to dissociate the increasing need for digital tools from the stricter requirements introduced by the new regulations. Financial institutions are used to investing vast sums in tools that serve the business—i.e., the departments that “create” money. FinTech has overwhelmed the financial market over the past decade with countless innovations revolutionizing the banking

profession. The most recent wave of innovation has finally paved the way for technology dedicated to the regulatory framework itself. RegTech, as it is known, is technology created to enable financial service providers to fulfil their compliance obligations. Time will tell, but we may now be on the brink of a new era in terms of the digitalization of regulation.

The UK Financial Conduct Authority is considering developing machine-executable regulatory requirements to reduce the compliance burden on financial firms. Other jurisdictions including Singapore and Hong Kong are also taking the lead, encouraging companies to develop products in response to new financial regulatory requirements. The reality is that while RegTech is still growing, a lot of financial entities have yet to adopt compliance-friendly technology. Financial services companies may be reluctant to properly invest in such technology, as it is perceived as having the dual disadvantage of both costing money and not bringing in any income. In this era of digital transformation, organizations that are slow to invest in proper IT infrastructure are denying themselves access to valuable data. From an AML/CTF standpoint, this not only considerably hampers the detection of relevant alerts (“know your transactions”)—also, in most cases, the quality of data drives resource allocation.

It is noticeable that data is often collected and stored purely for the sake of complying with regulations but rarely exploited once it has been buried in servers for years. Additionally, customer relationship management (CRM) and KYC systems typically require a significant amount of KYC information (“data”) that is rarely embedded in the best way, leading to a disappointing front-end user and customer experience, as well as the risk of having, for instance, incorrect AML client risk scoring attributed, incomplete client and related-party information used for name screening, etc.

### The brain shortage

Despite the regulators' strenuous efforts to make AML/CTF a serious subject, organizations are facing difficulties in hiring and retaining talented professionals, as evidenced by the plethora of job vacancies for AML/CTF specialists (we recommend that you check this on your favorite job search engine). If financial institutions have got the message, civil society has yet to catch on, since very few academic institutions seem to be providing a specialized AML curriculum or even teaching AML as a subject in its own right. Why are compliance officers not making a career out of their jobs? Well, maybe in part because when they are hired they currently have to struggle with outdated systems or spend a considerable amount of their time convincing other business lines and management of the importance of a new procedure from a compliance point of view. Down the road, the best talents seek new challenges in front-office positions or move to competitors offering higher salaries.

Compliance teams are often left frustrated by the challenge of performing their duties without the appropriate tools. This is compounded by the growing regulatory burden and the fact that, all too often, they are not properly integrated into the company's culture.

### Streamlining the compliance framework

In light of these obstacles on the pathway to full compliance, organizations must undertake several essential steps<sup>1</sup> to initiate their compliance transformation.

### Mind the gap

Few of us would be willing to set out on a long and important trip without getting our vehicle checked beforehand. A similar analogy could be applied to the compliance/AML journey. Moreover, it is twice as important because, in many cases: some chief compliance officers (CCOs) do not have the opportunity to be involved from the beginning in the construction of their own department, but instead have to manage a structure left by a predecessor or an interim CCO. Such situations can lead to inefficiencies in many ways: e.g., confusion between the responsibilities of the various lines of defense, poor coordination and reporting of exceptions, and even duplication of control activities or a failure to ensure proper oversight. Hence, asking independent third parties to perform a sanity check on a regular basis may reveal valuable information and eventually help an organization to usefully redistribute resources to what actually matters. ➤

Compliance teams are often left frustrated by the challenge of performing their duties without the appropriate tools. This is compounded by the growing regulatory burden and the fact that, all too often, they are not properly integrated into the company's culture.



1 Non-exhaustive list

### Empower the first line of defense

How many times have we heard compliance officers, when investigating a suspicious case, complain that if they had known all the facts from the outset they would not have allowed such a business relationship in the first place? This kind of event teaches us that the quality and timeliness of the information collection process is of paramount importance in the fight against money laundering. Thus, at the very beginning of the process, the front office must bear full responsibility for ensuring that, at the end of the chain, compliance gets the right information at the right time. Ideally, this communication stream should be a two-way street, with compliance providing regular, measurable feedback to front-office teams so that the latter have a clearer understanding of the importance of their actions. Unfortunately, this does not happen overnight. At times, we see that the front office and compliance do not have the best possible patterns of communication for the simple reason that they only have to talk to each other when something goes wrong. Changing this pattern may be arduous but it is an essential step towards continuous improvement.

### Empirically biased

Compliance departments have a lot to gain from setting up adequate and accurate KPIs to monitor their activity and performing efficient sample testing. KPIs are part of the prudential control setup in most compliance departments, but there is ample scope to question their effectiveness. As mentioned earlier, relevant data will provide key insight into the efficiency of controls, and it will also serve as a basis for arguments to present before the board of directors and authorized management bodies regarding the provision of additional resources to ensure the compliance of the organization as a whole. To achieve this, compliance could present management with specific metrics that are important from a decision-making perspective, including sufficient details on the various business lines and client types, as well as on matters not directly linked to the business. In essence, a good KPI should



pinpoint where the issue is coming from so that it is easier to take corrective action. The difficulty in identifying the right KPIs for compliance teams stems from how hard it is to quantitatively evaluate the full scope of their tasks. Establishing the right KPIs is no easy or short task, and no KPI should be set in stone over time, but successful KPI implementation will sharply increase the relevance and timeliness of compliance activities. Moreover, the growing number of (sometimes unpredictable) reports requested from regulators significantly adds to compliance departments' workload in a way that is not always measurable.

### Prioritize the exceptions

On any given day, a compliance officer receives on average 200 alerts<sup>2</sup>. While this may sound like a crushing workload for anyone, we believe that only one fifth of these alerts actually deserve attention. The causes of this distortion include the aforementioned factors:

- Poor quality of data initially input because of inefficient systems and quality, and insufficient exhaustivity of information and documents received from the first line of defense.
- The first line of defense is not sufficiently held accountable or trained to detect missing or improper information during the on-boarding process.

That said, not all items in the vast swathes of data and alerts are equal or even require a due date. Considering the sheer volume of alerts to take care of, simply categorizing them could be a job on its own. Along with other broader considerations, this is why a risk-based approach to AML/CTF makes complete sense. Systems featuring embedded algorithms to sort through such a dataset are suitable for this, assuming they have been accurately configured in the first place and consider, for instance, the ML/TF risk attributed to each customer. The importance of having adequate KYT scenarios is essential. Compliance has to think ahead when deciding how best to design and implement effective AML/CTF detection rules based on scenarios rather than just thresholds. The growing interest in RegTech makes this the perfect time to refocus the prioritization of compliance duties. Embedding machines and tools would help reduce the number of false positives, for instance in the case of transactions monitoring, and it would enable compliance to focus on value-added analysis of false negative cases that previously went undetected.

### Monitor, monitor, monitor

Many organizations have officers whose role it is to monitor the regulatory calendar and thereby ensure that the entity is thinking ahead. This is indeed highly important. However, how many organizations have set up a monitoring

structure to detect the potential failures and inefficiencies, regardless of tax regulations, of the compliance program itself? As a matter of fact, the most straightforward ratios are the best allies. For a minute, why not roughly estimate these metrics?

Take, for instance, the evolution of your customer portfolio ML/TF risk level, which will tell you a lot about your AML risk scoring. Or the staff attendance and success of AML-related training, which will probably give you an idea of the number of people you still need to inform of their AML/CTF obligations. How about the number of positive alerts (name screening, transaction monitoring and filtering) versus the number of items screened that could prompt a rethinking of the setup of transaction monitoring, name screening, and filtering systems. You could even

estimate the size of the backlog of pending alerts, so as to allocate the right amount of resources to it.

**As organizations move towards a full compliance program, there are ways to reduce the hassle of implementing all of the solutions needed to prevent money laundering.**

- Leverage top-notch systems: this has become so trendy that RegTechs have made an industry of it, with solutions that are generally cheaper than developing in-house workarounds
- Take advantage of the experiences of industry experts: if you have faced a suspicious transaction, chances are that you are not the first potential victim, nor the only one. In many cases, even if the perpetrator is not the same, industry

experts know of other cases with similar fact patterns, and hence are best placed to provide the right course of action

- Train your compliance staff regularly: on-the-job training is the best way to truly get to grips with what you should know. Nevertheless, eventually compliance officers will need to get a little taste of what they do not know, so that they are better equipped to handle new fact patterns as they arise
- Perform a data cleansing of your database and full monitoring of all tasks
- Outsource some of your AML/CTF activities to third parties so that your compliance officers can focus on their main oversight tasks ●

**Compliance blossom**



- 01 Compliance focus**
  - Reduce time on low value-added tasks
  - Focus on main oversight
- 02 Accurate monitoring**
  - Monitoring of compliance duties
  - Monitoring of non-compliance staff on regulatory matters
- 03 Efficiency of the capital**
  - Human capital (training, competencies of compliance staff)
  - Financial capital (technology tools)
- 04 Strengthening regulation**
  - Growing and specific expectations from regulators
  - Wider scope

## IFRS: Mission accomplished?

Ten years after the financial crisis, how have IFRS changed the role of the CFO within organizations?

### **Martin Flaunet**

Partner  
Audit - Banking  
& PSF  
Deloitte

### **Baptiste Guionnet**

Director  
Strategy Regulatory  
& Corporate Finance  
Deloitte

### **Jérémy Pages**

Manager  
Audit - Banking  
& PSF  
Deloitte

Since the inception of IFRS—the somewhat idealistic project of creating an internationally recognized accounting framework—IFRS have changed the paradigm for financial analysis and the use of financial information. The collective impact of individual new standards (IFRS 9, IFRS 15, IFRS 16) is an accounting evolution prompted by the fallout from the 2007 financial crisis. However, in conjunction with the need for a combined financial and risk dataset, IFRS have also sparked a revolution for the CFO function that goes far beyond accounting alone. ➔







**B**ack in 2008, less than a year after US subprime mortgages triggered widespread disruption to the global financial system, the balance sheets of financial institutions were burdened by assets that suffered rapid and major declines in value.

In reaction, financial institutions and/or governments often created “bad banks” to isolate such toxic assets, reduce leverage, and respond to increased demand for liquidity, thus hindering access to credit and draining liquidity out of the market.

To re-establish confidence in the soundness of capital markets and financial institutions, both international and national authorities took emergency steps to facilitate an adjustment to credit access and dampen the impact on the real economy.

These measures included monetary and fiscal stimuli, central bank liquidity operations, policies to promote asset

market liquidity, and regulatory action to resolve specific situations. As part of these measures, financial institutions had to take steps to rebuild capital and liquidity cushions, forcing their clients, whether large corporates or SMEs, to adapt their working capital and debt management processes to this new environment.

The common objective of these reforms was to avoid a recurrence of the financial crisis. In order to be comprehensive, the recommendations included a set of changes to accounting practices—at least in terms of those that were most widely used—US GAAP and IFRS. Aside from the convergence of these two accounting frameworks, the most significant changes were aimed at decreasing the pro-cyclicality of the accounting frameworks used at the time of the financial crisis.

In 2018, 10 years since the reform began, the time has come to assess the current and future effects of the new IFRS in terms of restoring the robustness of financial institutions’ balance sheets.

Aside from this primary objective, these new standards have also had significant ripple effects within organizations and more specifically on the role of the CFO. And given the fact that we are at an early stage in the implementation of these changes, we could expect the consequences to continue in the future.

The most significant changes were aimed at decreasing the pro-cyclicality of the accounting frameworks used at the time of the financial crisis.



**The purpose of IFRS and effects on the Economy**

With the public interest in mind, IFRS were originally designed to develop “high-quality, transparent and comparable information in financial statements to help investors, participants in the world’s capital markets and other users of financial information make economic decisions”<sup>1</sup>.

The objective of adopting IFRS<sup>2</sup> for use in the European Union was to improve the efficiency of EU capital markets.

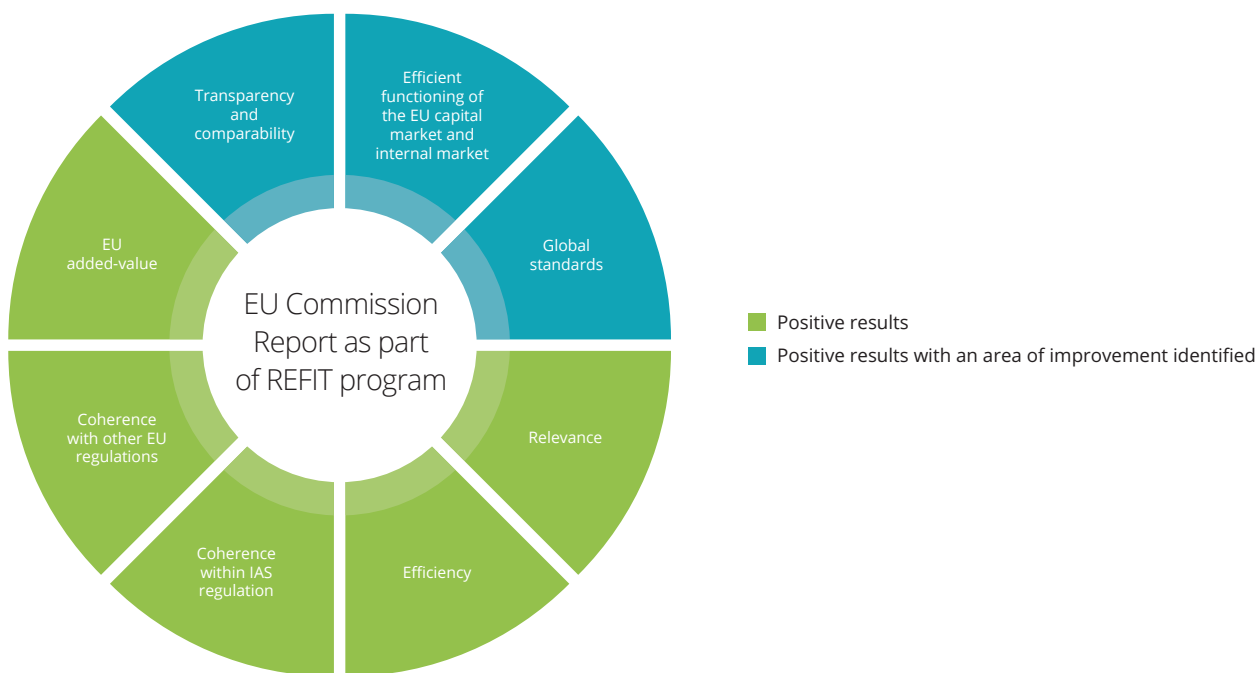
In 2014, the European Commission decided to assess whether it had achieved its goals as part of the Regulatory Fitness and Performance Program (REFIT).

As we can see from the figure below, the conclusions of this assessment were fairly positive. IFRS provide benefits for: (i) EU integration, by reducing cross-border barriers via a common international accounting language, and (ii) the strength of the EU, by creating a consolidated voice. While there is still work to be done

on the transparency and comparability objective (one of the three items identified as potential areas for improvement), IFRS have increased transparency and led to greater comparability between financial statements within and across industries or jurisdictions. ➔

IFRS have increased transparency and led to greater comparability between financial statements within and across industries or jurisdictions.

The assessment, published in 2015, considered the following topics:



1 Preface to International Financial Reporting Standard

2 Regulation EC 1606/2002 of the European Parliament and of the Council of 19 July 2002

## IFRS adoption worldwide:



- IFRS required (for all or most of the companies)
- IFRS required (for Financial institutions only)
- IFRS authorized (option)
- Local Gaap required

In addition to that, while more and more countries are using IFRS, the United States still does not permit its domestic companies to use IFRS.

By contrast, IFRS are also seen as complex, and the sheer volume of disclosure may be perceived as having a negative effect on the ability of readers without specific training to understand the information provided, and therefore on the take-up rate. Some

feedback also suggests that recent and frequent changes to these standards have adversely affected the cost/benefit trade-off.

In addition to that, while more and more countries are using IFRS, the United States still does not permit its domestic companies to use IFRS. Of course, this will significantly hamper international adoption the discrepancies that have emerged between IFRS and US GAAP, despite the initial intention to ensure convergence.

However, the EU has concluded that the benefits of implementing IAS/IFRS outweigh the costs and other drawbacks. A report published in 2017 by the IASB<sup>3</sup> about the worldwide adoption<sup>4</sup> of IFRS supports this positive stance.



Region



Number of jurisdictions profiled in the region



Of which requiring IFRS standards for all or most domestic publicly accountable entities

Region	Number of jurisdictions profiled in the region	Of which requiring IFRS standards for all or most domestic publicly accountable entities
Europe	44	98%
Africa	23	83%
Middle East	13	100%
Asia-Oceania	33	73%
Americas	37	73%
<b>Total</b>	<b>150</b>	<b>84%</b>






**Of the 150 jurisdictions profiled, the IASB observed that 126 jurisdictions required IFRS for all or most companies (84 percent), as shown in the table on the left.**

Source: IASB 2017

3 Pocket Guide to IFRS – The global Financial Reporting language

4 For domestic reporting by listed companies and for financial institutions

The adoption of IFRS in most jurisdictions around the world for domestic reporting, at least by listed companies and financial institutions, is seen as a real success.

Key Jurisdictions					
<b>Financial Institutions</b>	<b>IFRS</b> Mandatory if listed (if not listed, mandatory at least for FINREP and optional for statutory accounts)	<b>IFRS</b> Mandatory if listed (if not listed, mandatory at least for FINREP and optional for statutory accounts)	Prohibited (US GAAP is required)	Prohibited (only local GAAPs, but convergences with IFRS)	<b>IFRS</b> Allowed
<b>Listed (non-financial) companies</b>	<b>IFRS</b> Mandatory for consolidated accounts, and allowed for statutory accounts	<b>IFRS</b> Mandatory for consolidated accounts, and allowed for statutory accounts	Prohibited for domestic companies  <b>IFRS</b> Allowed for foreign companies only	Prohibited (only local GAAPs, but convergences with IFRS)	<b>IFRS</b> Allowed
<b>Unlisted companies &amp; SMEs</b>	<b>IFRS</b> Allowed (Either full IFRS or LuxGAAP with certain IFRS options or Fair value option. However, the IFRS for SMEs Standard is prohibited)	<b>IFRS</b> Allowed (Full application. However, the IFRS for SMEs Standard is prohibited)	Prohibited (However, the IFRS for SMEs Standard is neither required nor expressly permitted)	Prohibited (only local GAAPs, but convergences with IFRS)	Prohibited

### Different interpretations/translations of IFRS:



While most countries have enforced IFRS, some differences in implementation can be observed across jurisdictions. This may take the form of different interpretations/translations or simply modular/optional adoption in local law, introducing complexity for CFOs with companies in different countries.

A study conducted in 150 jurisdictions around the world by the IASB in 2017 highlighted this diversity across the IFRS environment (see graph for the proportion of each interpretation/translation of IFRS in the world). [➤](#)

- IFRS as issued by IASB
- IFRS as issued by EU
- IFRS as locally adopted
- IFRS as issued by IASB or EU



### **A quick review of the most recently adopted IFRS—what, if anything, did it solve?**

Since the last public consultation in 2014, the IASB has issued and the EU has adopted three major standards (IFRS 9, IFRS 15, and IFRS 16) with a view to increasing the efficiency of the EU capital market, and promoting transparency, comparability, and efficiency. Were these initial goals achieved?

### **Example #1: IFRS 15 (Revenue from contracts with customers) aimed at harmonizing revenue recognition policies among market participants**

This standard, issued in May 2014, with an equivalent under US GAAP (ASU 2014-09), entered into force on 1 January 2018.

The IFRS 15 model's core principle can be summarized as follows: to recognize revenue so as to document the transfer of promised goods or services to customers in an amount that reflects the performance obligations as described in the contract. Based on a scope decision tree, five steps are clearly defined in this revenue recognition framework, leading to a complete decorrelation with the cash records and with the invoicing process, fewer judgmental areas, and more guidance to align revenue recognition across countries, industries, and entities within the same sector.

### **Undoubtedly, IFRS 15 improves the consistency and comparability of revenue recognition practices, and the usefulness of disclosures, but does it imply changes in the role of the CFO?**

As a result of a closer link with contracts and less scope for interpretation, the

CFO may encounter more (or new) difficulties during audits. More supporting documentation may be required and, in some cases, contracts with customers are not explicit enough in their definition of performance obligations, leading to judgmental areas.

The CFO will therefore need to be part of upstream discussions on the (re)engineering of client contracts in order to prevent downstream flaws during the preparation of financial statements and audits, emphasizing the need for clarity in the description of performance obligations to clients. This is a clear indication of the increasingly important role of the CFO in providing business partnering in today's companies.

This may also accelerate the adoption of new technologies like smart contracts in the Blockchain coming at managing this types of constraints in a STP<sup>5</sup> way.

5 STP: Straight Through Processing

**Example #2:**

**IFRS 9 (Financial instruments) aimed at reducing cyclical effects on systemic risk and avoiding “too little too late” risk**

The former standard (IAS 39) was roundly criticized during the financial crisis for the pro-cyclical nature and lagging effect of its credit risk impairment model, the volatility affecting the income statement. This standard was also perceived as flawed in terms of comparability since it allowed some arbitrage in the classification and measurement rules on financial instruments, regardless of their complexity (some might say “toxicity”). Thus, the new IFRS 9 standard that has been in force since 1 January 2018—after a decade of back-and-forth discussions and amendments—aims to neutralize these negative effects.

**Better comparability:**

- The classification and measurement method under IFRS 9 is now strictly based on:
01. The nature of the financial instrument (derivative or funded, equity or debt)
  02. The contractual cash flows (complexity of the financial instrument, basic vs complex)
  03. The business model (strategy envisaged by the entity for holding these instruments)

This leads to a stricter use of the amortized cost as measurement method for financial reporting, as opposed to Fair Value that is promoted. Depending on the level of complexity for the products held on the balance sheet, some banks may already have experience of transferring some assets from fair amortized to value cost (or the other way around). Where IAS 39 allowed the same instrument to be accounted for under various measurement methods, under IFRS 9, the options available have been narrowed in order to ensure greater comparability.

However, it is worth to mention that having a larger part of the asset measure at Fair Value can lead to higher volatility and procyclicality except with a proper ALM and accounting policies.

For the CFO, this increased robustness in the classification process comes at the cost of greater involvement in the front-to-reporting process. Thus, the CFO now has an additional supervisory role (level 2) over the business lines and over the middle-office in charge of trade capture (or control). The purpose of this additional task is to ensure an acceptable level of alignment between IFRS 9 requirements and product classification in the information system, as well as monitoring its subsequent management.

**Reduction of the “too little too late effect”**

The most significant change introduced by the new standard relates to impairment accounting. IFRS 9 requires entities to estimate and account for ECL (expected credit loss) for all relevant financial assets and commitments no later than at initial recognition.

Expected loss provisioning was already required under the previous standard, often under the name of “incurred but not reported” loss allowance (IBNR reserve under IAS 39). However, the requirements on how to assess this loss allowance have changed considerably.

**When designing the loss allowance (ECL), IFRS 9 promotes and requires:**

- The “point-in-time” feature to ensure that ECL is sensitive to the economic cycle and to remove smoothing effects via the “through-the-cycle” rule used for regulatory capital. Consequently, the same asset (product) will have a different book value if reported at different points in the economic cycle (i.e., riskier assets are less valuable when macro-economic factors are below their long-term average, and a fortiori in the event of an economic meltdown).
- The “forward-looking” feature to avoid the lagging effects that are often caused by moving average methods and to ensure that asset values start to change before it is already obvious that they cannot be sold anymore at the book value (for instance).

**For the CFO, there are two possible approaches to managing these new requirements:**

- Stick to pure accounting responsibilities and take the ECL figures as they come, then rely heavily on other experts working for the institution, usually in risk teams
- Start to build a more comprehensive skillset within finance teams to monitor ECL figures, be in a position to challenge models or parameters, and explain variations on the balance sheet and in terms of profit and loss (sensitivity analysis, also called income attribution). While those charged with governance and the auditors are obvious clients, the business heads must also be included in the reporting line in order to ensure that they have the information they need to reach timely business and strategic decisions in line with changes in economic environment

At present, the finance-risk convergence is probably one of the hottest topics to address in banking organizations. Aside from providing accurate and sufficiently well-articulated information to ensure that financial statements can be understood by their intended readership, it is also a matter of managing talent within finance teams. IFRS 9 is encouraging clarity and providing a common language that the finance, treasury, and risk functions and the CFO can use to better communicate financial performance to investors, as well as internally to business line managers and to the Board of Directors.

In addition, the new standard requires (following the amendments to IFRS 7) that reporting entities make all useful public disclosures about credit risk exposure, credit risk management practices, provisioning, and related matters to bring about a higher degree of transparency. It is obvious that IFRS 9 bridges the gap between accounting and risk management—at least in theory. The real situation on the ground will depend on how the CFO (and the CRO) jointly reshape the organization in response to this challenge. ➔

**Example #3:**

**IFRS 16 aimed at increasing transparency with regard to commitments and avoiding arbitrage between owning an asset and having a long-term lease**

Leasing is an important financing activity for large corporate and financial institutions with the majority not reported on the balance sheet under IAS 17. That is because a significant part of the leases to date have been categorized (under the former standard for lessee) as “operating leases” (disclosed only in the income statement and in the notes to the financial statements as proposed to "Finance lease" reported on balance sheet).

This somewhat arbitrary distinction made it difficult for investors to compare companies. There was also criticism from investors that balance sheets provided a misleading picture about the leverage and leased assets used. This meant that investors (and other market participants) had to estimate the effects of a company's off-balance sheet lease obligations, which in practice often led to an overestimation of the liabilities arising from those obligations.

The new leasing standard removes the distinction between finance and operating leases for lessees, and enhanced guidance is introduced on identifying whether a contract contains a lease in order to increase the comparability of financial information (lessor accounting will not change significantly).

The new standard will have an impact on the monitoring of financial performance by the CFO as companies that have material off-balance sheet leases will report higher assets and lower equity when applying IFRS 16. As a company will present lease assets arising from leases of property, plant and equipment as tangible assets, this could affect the regulatory capital of lessees that are financial institutions. In addition, as higher liabilities will be presented, the CFO will have to closely monitor (and/or renegotiate) agreements if the company has loan covenants.

## Standards and their contributive effects

Standard	Contributive effect		
IFRS 9			
IFRS 15			
IFRS 16			

- Transparency and comparability
- Efficient functioning or EU capital market
- Global standard

### Conclusion

The reaction of legislators/ standard-setters after the 2007 financial crisis has been to provide stakeholders, regulators, stock exchanges, rating agencies, and ultimately taxpayers with a greater level of transparency as regards financial information related to banking institutions. However, the amount of information currently disclosed has probably hindered rather than helped transparency and made IFRS understandable only for a limited number of specialists. The CFO is one of these rare specialists who can play a role in ensuring the correct degree of clarity in the financial reporting process.

While the new standards described above are making the reporting process more of a burden, they are also transforming the finance function from an end-user to a data setter either at the inception of the products/ services of the institutions or during their lifecycle through proper risk data aggregation. Implementing the right process for identifying criteria for recognition, classification, measurement, and disclosure, and maintaining the best possible related data warehouse, is the critical path for the next generation of CFOs. ●







# Part 03

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From corporate  
strategies & people  
perspectives ▶





# It's harvest time!

## Sowing the seeds of a fruitful 2019 through benchmarking

### Pascal Martino

Partner  
Strategy Regulatory  
& Corporate Finance  
Deloitte

### Erika Bourguet

Director  
Strategy Regulatory  
& Corporate Finance  
Deloitte

### Esther Bauer

Manager  
Strategy Regulatory  
& Corporate Finance  
Deloitte

The noun “harvest” comes from the Old English word “haerfest”, meaning autumn, and it describes the activity of reaping, gathering, and storing grain and other produce. It also represents the moment in which a farm or farmer reviews the past year, understands how successful it was, and makes detailed plans for the next year, planting the seeds for the following year’s harvest.

As the end of the year approaches, banks also embark upon their own harvest process. They consider the past year, evaluate what went well or less well, and anticipate future cycles as they outline their strategic plans for the year to come. Confronted with the ongoing challenges of regulatory recalibration, a low interest environment, new technologies and FinTechs, as well as a changing workforce, banks need to continue their journey of transformation in this harvest period. 2018 and 2019 may prove to be pivotal years for banks in terms of considering the macro trends requiring particularly detailed planning. Evaluating past and current performance and comparing it to benchmarks will highlight the areas in which banks need to act and how they can sow the seeds of a successful harvest in 2019. ➔



### Was it the weather or was it me?

As the harvest approaches, farmers evaluate the quantity and quality of their crop and compare it to other years and to their expectations. If it is better or worse than previous years' crops or the crop the farmer was expecting, it will be essential for the farmer to understand why this was the case. Was the weather better or worse than in past years? Did unexpected events occur? Or was it maybe something the farmer did themselves? To understand the answers to these questions, farmers must compare their crop harvest to that of farmers in the same area—i.e., engage in benchmarking<sup>1</sup>.

In a similar way, by the third quarter of the year, banks are able to have an overview of the general trend of results and understand whether they are likely to be above or below expectations in terms of overall bottom line. They are also in a position to understand the specific drivers of their bottom line. In the majority of cases, however, a bank's insights into the reasons behind its performance are at best hypothetical and unclear, and

at worst completely obscure. This is the point at which the benchmarking becomes particularly valuable for banks, as it helps them to understand the reasons for divergences. For example, a bank could be aiming to improve its operational efficiency in order to decrease its costs by a certain percentage. During the year, the bank realizes that it is lagging behind its expectations<sup>2</sup>, but does not understand why. Are poor results due to the increasing regulatory burden across the board, or are they specific to the bank?

Of course, the number of benchmarks that could be considered to gain a better understanding of the situation is extremely large. To select a quality benchmark with a clear taxonomy, the bank needs to define the problem further. It is here that artificial intelligence (AI) can support companies. AI-based benchmarking tools enable a huge amount of data crunching based on public data in a very short time, allowing initial conclusions to be drawn as input for a more detailed benchmark and a detailed root-cause analysis. Let us look again at our bank seeking to improve its operating margin.

<sup>1</sup> Benchmarking is defined by the APQC as the process of comparing and measuring your organization against others, anywhere in the world, to gain insights into measures, performance, and practices in a way that can rapidly improve the journey to world-class performance

<sup>2</sup> Fictional actor. Any resemblance to a real Luxembourg actor should be considered as coincidental

Deloitte's AI-based benchmarking tool, Smart Report, creates an initial benchmark based on companies' operating margins as stated in their annual reports by looking at the following topics:



**Improve customer interaction efficiency**

- Customer service & support
- Marketing & advertising
- Order fulfilment & billing
- Sales interaction



**Improve development & production efficiency**

- Materials
- Product development
- Production



**Improve logistics & service provision efficiency**

- Logistics & distribution
- Merchandising
- Service delivery



**Improve shared service efficiency**

- Business management
- Financial management
- Human resources
- IT Telecom & networking
- Procurement
- Real estate

The results show that, overall, the bank considered above is extremely focused on improving its operating margin<sup>3</sup>. Turning to its annual statement, 40.6 percent of the strategies and initiatives mentioned in its annual report pertain to this, while only approximately 30 percent of the strategies and initiatives mentioned by companies in the financial and insurance activities sector in general relate to this subject. Delving further into the details, however, the benchmark generated by AI highlights some interesting findings. While more than half of the industry actors assessed mention HR strategies, this bank makes no references at all to HR strategies, and it may therefore want to take a closer look at this angle.

**In order to do this, the bank may, for example, want to benchmark elements linked to HR. The bank might consider:**

- **The overall workforce:** Size and composition of the workforce compared to other comparable actors in Luxembourg and abroad, etc.
- **Individual departments:** Size, composition, skills, and efficiency of

different departments, compared to other comparable departments within the bank or similar departments in other comparable banks in Luxembourg or abroad, etc.

- **Training:** Training time and expenditure within the bank and compared to other banks in Luxembourg or abroad, efficiency gains following training, etc.

Collecting data related to these questions and regularly validating it before compiling the data on itself and its competitors allows the bank to draw and present conclusions, which will then enable the bank to identify areas in which anomalies may exist. Once these positive and negative anomalies are identified, a deeper qualitative analysis needs to be carried out to understand any reasons or specificities that may exist. As an article by Harvard Business School states: "Numbers in a vacuum are dangerous. Or another way to look at it: in benchmarking, context is king". In the right context, however, these numbers can be extremely valuable. The bank may realize, for example, that its current training expenditure compared to the training time

that its employees are receiving is extremely low and want to consider reviewing its training plan and program. ➔

Was the weather better or worse than in past years?  
Did unexpected events occur?  
Or was it maybe something the farmer did themselves?

Results and an understanding of how these results were achieved will enable organizations to use the collected data to prioritize initiatives based on expected return on investment.

**The grass is always greener...**

**Should I use my neighbor's fertilizer?**

But let's get back to our farm. Farming is a traditional business, where know-how is passed down through the generations and acquired over lengthy years of experience. A farmer will have tips and tricks on how to make sure that their crops grow best and are resistant to external influences. However, from time to time, the farmer needs to make changes to stay competitive in the market. Currently, for example, the digital value chain is influencing the entire value chain of agriculture, and a farmer can only stay competitive by "combining the power of a farmer's instinct with cutting-edge technologies ..., [so that] a farmer can make better informed choices that lead to higher yields". Farmers must therefore look at what other farmers are doing and understand whether they can apply their ways of working to their own business.

This is not so dissimilar to banking. Banking is a traditional industry. The financial crisis, more stringent regulation, new entrants and technology have shaken up the industry, and these disruptive trends represent an opportunity for banks. By selecting a few local competitors, as well as some best-in-class examples and benchmarking what they are doing, banks can gain insight into the opportunities that may exist for them.

So, let us look again at the example of our bank in Luxembourg that would like to review its training plan based on the AI-based initial benchmark and a detailed quantitative benchmark focusing on HR KPIs. How can it use benchmarking to improve what it is doing? At this stage of the process, benchmarking will become more explorative and executives need to be open-minded. While each organization is special, it can still benefit from seeing the advantages of another organization's way of doing things.

Best performers identified during the quantitative benchmark process can provide a good starting point. Different methods of data collection, such as carrying out desk research, in-depth interviews with experts, and even mystery shopping or asking the organization for further information exist. By using these, it is possible to establish an overview of the different best practices that exist on the market. Results and an understanding of how these results were achieved will enable organizations to use the collected data to prioritize initiatives based on expected return on investment and fit with the organization creating actionable input for the strategic planning process for the upcoming year.



## Conclusion

### Let the harvest begin

Over the course of 2018, banks should take inspiration from the farming industry and the harvesting ritual. In a pivotal period for banking, re-evaluating one's actions in the quest for continuous improvements is a crucial driver of competitiveness and transformation. As a result, benchmarking is an essential component of banks' strategic planning processes, with the potential to significantly bolster the improvement of the bottom line if banks remember the following:

- **Take advantage of new technologies**

Especially in the initial stages of the root-cause analysis, new technologies can support the analytical process.

- **Context is king**

Isolated numbers can be dangerous, and can distort essential specificities of the organization. Understand the organization and the situation before drawing conclusions.

- **Adopt a learning mind-set**

Although each organization is special, each organization can learn from every other. Have an open mind and be prepared for change.

- **Collaborate**

Benchmarking is a valuable tool. Contributing to market benchmarks can provide you with access to valuable data. ●





# Driving growth through Business Process Outsourcing (BPO)

Financial institutions (FIs) have long considered Business Process Outsourcing (BPO) as an instrument for improved cost efficiency. The market has reached maturity and best practices established over time by vendors and advisors have increased the success rate of BPO relationships.

Some domains of the financial industry such as investment management and asset management have already opted for outsourcing certain processes and nowadays include it as part of their business models. However, other industries such as private banking and retail banking are not yet versed in outsourcing. It may be that outsourcing could provide the solution for banks' evolution in their highly competitive climate.

Moreover, BPO does not only offer a greater cost efficiency. As market conditions and technologies have evolved, outsourcing has followed suit to offer new adapted solutions, answering many challenges faced by banking industry actors. From increasing the level of digitalization to offering new value-adding services, how can your organization drive growth through outsourcing? ➤

## **Pascal Martino**

Partner  
Strategy Regulatory  
& Corporate Finance  
Deloitte

## **Patrick Laurent**

Partner  
Technology & Enterprise  
Application  
Deloitte

## **Umit Misirli**

Senior Manager  
Operations Excellence  
& Human Capital  
Deloitte

## **Sahra Nassiri**

Manager  
Strategy Regulatory  
& Corporate Finance  
Deloitte

## **Kevin Schiavitti**

Senior Consultant  
Operations Excellence  
& Human Capital  
Deloitte

## **Guillaume Lucchi**

Analyst  
Operations Excellence  
& Human Capital  
Deloitte



### **Banks are racing on a slippery track**

Banks evolve in turbulent context and are facing several challenges that need to be addressed in order to ensure future profitability.

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#### **Bad weather on race day**

In the wake of the financial crisis, the low interest rate environment has greatly narrowed the bank's margins. In the meantime, European financial institutions need to comply with an increasing number of regulations, many of which come at a cost. The increased governance and compliance expenditure is especially hard for small banking organizations to absorb, as they lack the economies of scale.

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#### **The public expects a great show**

They are paying the price to attend the race and will back the winner. Banks' customers have rising expectations and higher customer experience standards. Banks are no longer solely compared to their industry peers, but also to GAFA (Google Apple Facebook Amazon), who offer best in class user experiences and customer centric services that can be accessed anytime and anywhere. Banks must get up to speed and meet these new standards of services.

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#### **New racers with improved engines**

There are new competitors that take the form of FinTechs. They are built from the bottom up, using the latest technology, with customer care at their core. They are also able to leverage data analytics to bring additional value to the customer. These new entrants are agile because they are free from legacy technologies and can therefore offer highly competitive rates to the customer as they benefit from low operational costs.

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This context creates lagging growth in the financial industry and builds up the need for strategic decisions to drive more cost efficiency and identify new streams of revenue.



52 percent of investors are willing to change their current wealth management provider if they continue to fail to meet their current expectations<sup>1</sup>.

**Focus on piloting: outsourcing the mechanical work to third parties and increasing cost efficiency**

With margins being squeezed on all fronts, banks need to find ways to increase their cost efficiency. Outsourcing of back office and non-core functions permits significant reduction in operating costs. Outsourcing business processes to external partners helps to free up time, financial resources and managerial efforts. These can be reallocated to value-generating business processes.

**Advantages of outsourcing**

- **Reduced costs:** cost reduction is the main driver for BPO; it is achieved by leveraging the partner's economies of scale, whilst reducing the headcount
- **Increased flexibility:** outsourcing transforms many of the fixed costs into variable costs, thus providing more flexibility for the business. Likewise, whether your business is growing or decreasing in size, the BPO partner will scale accordingly in order to meet your business requirements

**What is Outsourcing?**

Outsourcing is the contracting out of the management and enhancement of business function to an external partner that can involve the transfer of people, processes, assets, and definitely responsibilities.

- **Refocus on core business activities:** BPO allows to refocus both efforts and financial resources on core business activities, and to deliver additional value to the customer
- **Enhanced service quality:** By leveraging the knowledge and the expertise of a partner, the quality of the outsourced process' output increase
- **Favorable regulatory framework:** The European financial industry regulators keep creating legal frameworks that ensure that the outsourcing providers are regulated to the same extent as financial institutions. Such a practice reduces the regulatory risk associated with outsourcing and prevents customers' data mishandling ➤

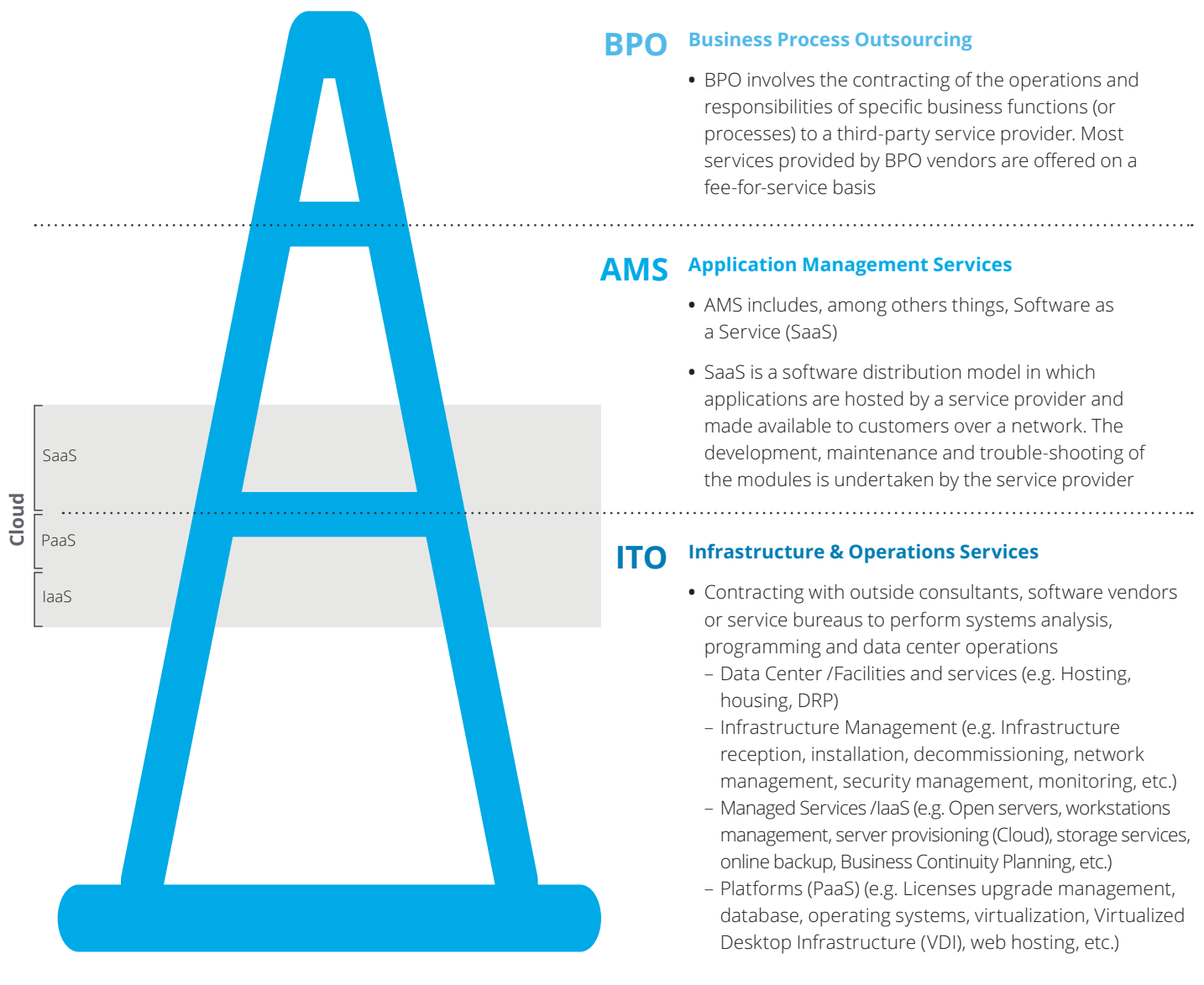
<sup>1</sup> Roubini, Wealth and AM 2021



### Identify the parts to outsource

According to the individual situation of the bank and its goals, improvements can be targeted through various types of outsourcing, such as the IT Outsourcing (ITO), Application Management Services (AMS), and Business Process Outsourcing (BPO).

Figure 1: Types of outsourcing



There are multiple examples of banks looking for a BPO provider that is also able to offer ITO and AMS. We can see some factors steering towards this type of global outsourcing, such as the continuous regulatory changes that require sophisticated IT process remodeling on the one hand and the maintenance of applications and renewal of IT licenses on the other hand.

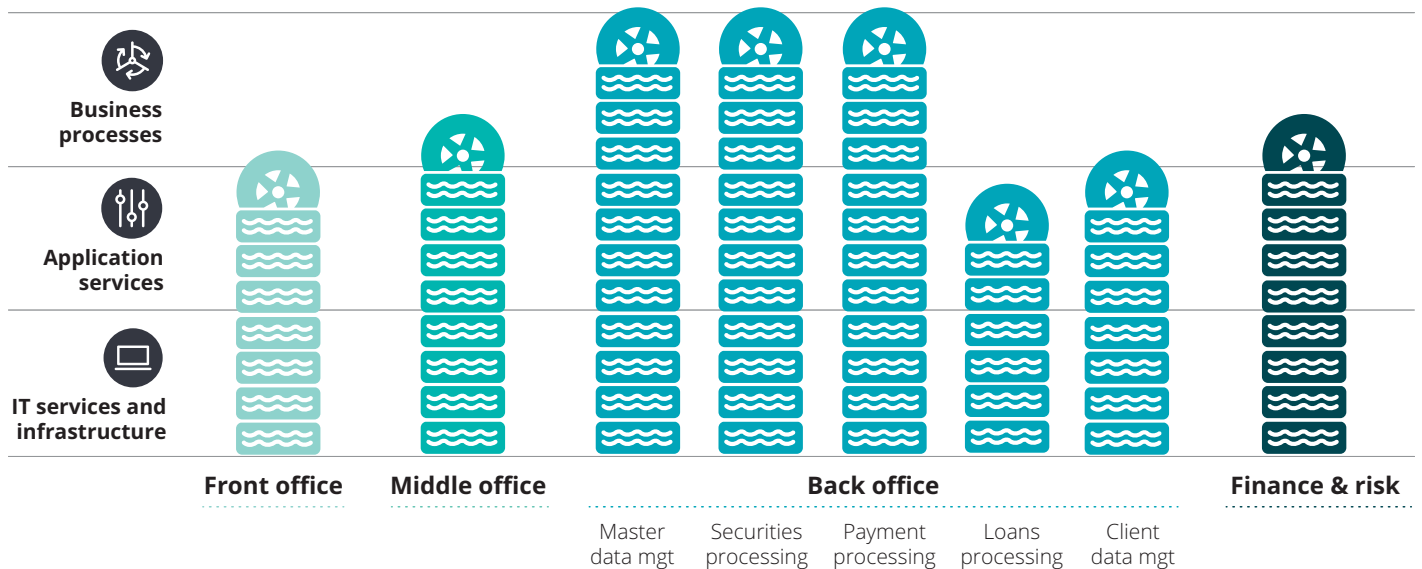
There are different levels of outsourcing as we can see in Figure 2 and the selection is among generic functions as opposed to strategic or knowledge based functions. The latter should be retained in-house in order to remain in control. Nevertheless, it is part of best practice to establish more centralized or mutualized service centers (Center of Competence, Center Of Excellence). ➔

**Commonly outsourced functions:**

In the financial industry, outsourcing has reached great maturity for all back office and IT processes. The decision makers that have not carried out, or at least considered, outsourcing some internal functions are rare. BPO is not limited only to back office perimeter anymore but outsourcing also reaches the front office.

BPO is not limited only to back office perimeter anymore but outsourcing also reaches the front office.

**Figure 2: BPO/Outsourcing scope**





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## Most commonly outsourced functions:



### Private banking

Master data management, case processing, securities processing, loan processing, client data management, regulatory and client reporting, trading, dealing processing, credit scoring, AML/KYC and invoicing, tax reclaim.



### Asset management

Valuation and accounting, custody and settlement, client servicing and reporting, treasury and cash management, compliance and regulatory reporting.



### Retail Banking

Procurement, Payment, Mortgage, Accounting.

### Activate your cruise control: let the robots do the work

Emerging technologies are expected to drive the cost of outsourcing down. Indeed, many of the outsourced processes are rule-based and highly repetitive. These tasks are costly because they have the tendency to be time-consuming. Moreover, they are tedious and provide low job satisfaction to the person executing them. The solution therefore lies in automation. BPO vendors that plan to automate their processes will gain competitive advantage, by offering more competitive prices, and reducing both error rates and time to deliver. Thus, your pit-stops will be faster, better, and cheaper.

## What criteria to investigate when selecting a BPO partner

As BPO contracts typically span over five years, it is essential to choose the right partners. Depending on the business process to be outsourced, criteria may vary, but we have selected seven key areas to look into when selecting a BPO provider.



### Level of expertise and service offering

One of the main advantages of setting up a BPO partnership is the value that will be derived from the BPO vendor's knowledge and expertise. Building on that knowledge will permit an increase in the quality of the outsourced functions' output and in the time to deliver the desired output. Therefore, when choosing a partner, it is important to assess their level of experience, inquire about their other clients, and the nature of their existing BPO partnerships



### Flexibility

If your business expects a growth or a decline in the quantity of output required, it is important to ensure that your partner will be able to keep up with your requirements. Does the provider's pricing models allow for flexibility? Are they capable to support a rapid growth in demand?



### Strategic development plan

Your partner's strategic development plan for the next five years should be assessed. Does it seem achievable? Is there any chance that the level of services provided will decrease over time because of the vendor's decision to free up resources to focus on other strategic projects?



### Financial health

What is the potential partner's financial health? The risk of bankruptcy faced by the potential partners should be evaluated. Do they have important debt ratio, are they profitable, do they have liquidity problems? Is the partner part of/backed by a big group that could provide financial help if threatened by bankruptcy?



### Compliance/security

As the chosen partner will most likely gain access to protected data, it is vital to ensure that the partner is compliant in all aspects. A non-compliant partner will put your whole organization at risk. Is he well aware and prepared for incoming regulations? What is his timeline to implement them?



### Digitalization/innovation and the inherent risk of disruption

Besides the need to investigate the vendor's current technologies, it is also crucial to investigate the vendor's future development plans in terms of technology and capability. This is especially important since BPO contracts span on several years. Thus, at a time of such rapid technological shift it is important to scrutinize the market, looking for potential disruptors.



### Location

What are the partner's current location? Is he present in the country where you operate? The impact will be on his capability to understand and comply with your regulatory obligations. ➔



## Outsourcing digital transformation is about adding digital capabilities, by implementing out-of-the-box solutions, developed by third parties.

### **BPO: helps you stay on the track**

New technologies, evolving market conditions, and pressure from clients have paved the way for the development of a completely new branch in the outsourcing field. It now provides an answer to pressing strategic challenges faced by Banks. From the digitalization of services to the addition of new capabilities, outsourcing can help drive your company's growth.

Regardless of their size, financial institutions will have to embrace the digital turn in order to keep thriving. While the bigger incumbents may choose to develop digital capabilities internally, or even lead their transformation through acquisitions, it is not an option for the smaller players lacking the resources and expertise to lead such transformation strategies. Their best alternative is therefore to outsource their digital transformation. Indeed, new players have emerged, proposing agile modern and scalable solutions built with the customer's needs at their core. Successful

FIs are those that will team up with them to build the right network of partners. These partners will provide the technology, take care of the maintenance, and let the financial professionals focus on what they do best—providing the best services to the customer.

Outsourcing digital transformation is about adding digital capabilities, by implementing out-of-the-box solutions, developed by third parties. This permits great cost savings (R&D and hiring costs) and shorter time-to-market, which is mostly determined by the time of implementation. Consequently, it is a particularly good solution for companies that have made limited efforts to digitalize their offerings, as it permits them to catch up quickly on their delay. In fact, a global asset manager survey found that 40 percent of the digital laggard asset management companies plan to outsource their digital development work .

Due to the strategic considerations involved in outsourcing digital transformation, the decision to outsource should not be assessed through the sole lens of cost reduction; it should be considered as an investment, on which a return is expected. The real currency here is the amount of additional value brought to the customer, which through increased satisfaction and increased customer loyalty, leads to greater revenue.

Thus, outsourcing allows banks to lead their digital transformation with a very short time to market, while staying cost efficient.



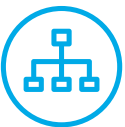
## Understand the associated risks

Although the outsourced processes are usually non-core business activities, they are vital to the organization. Moreover, FIs must control and mitigate their reputational risks: delegating responsibilities to a third party does not free the FIs from their duties towards clients. Therefore, there are always risks involved in BPO, and they must be properly assessed and managed.



### Control loss

Control loss is more of a consequence than a risk, but it becomes a risk when mismanaged. When outsourcing processes to a third party, you inevitably lose some control over the carrying out of the process. To mitigate this risk, the right Service Level Agreements and the right governance model must be established.



### Dependency

Relying on a partner to carry out some of your business processes can make your organization dependent on the partner. Outsourcing may lead your organization to lose its knowledge and expertise regarding the outsourced processes. This creates a certain dependency, as your organization is no longer able to take over the process, or it lacks the expertise to assess the quality of the output provided.



### People risk

During the transformation phase, in-house employees in charge of the processes to be outsourced are unsure what a BPO means for them and their jobs. This uncertainty can lead to demotivation and productivity losses. To mitigate this risk, it is important to ensure clear communication with the employees who will be affected by the BPO, to listen to them and to take their concerns into account.



### Risks of disruption

In a BPO strategy, where contracts span over five years, the increasing speed of innovation and the growing role played by technology paves the way for the risk of disruption. It is costly and complicated to renegotiate a BPO contract in place. Therefore, there is a risk that a new player disrupts the way one of the processes is carried out by our BPO partner, offering to do it at a much lower price.



### Unforeseen costs

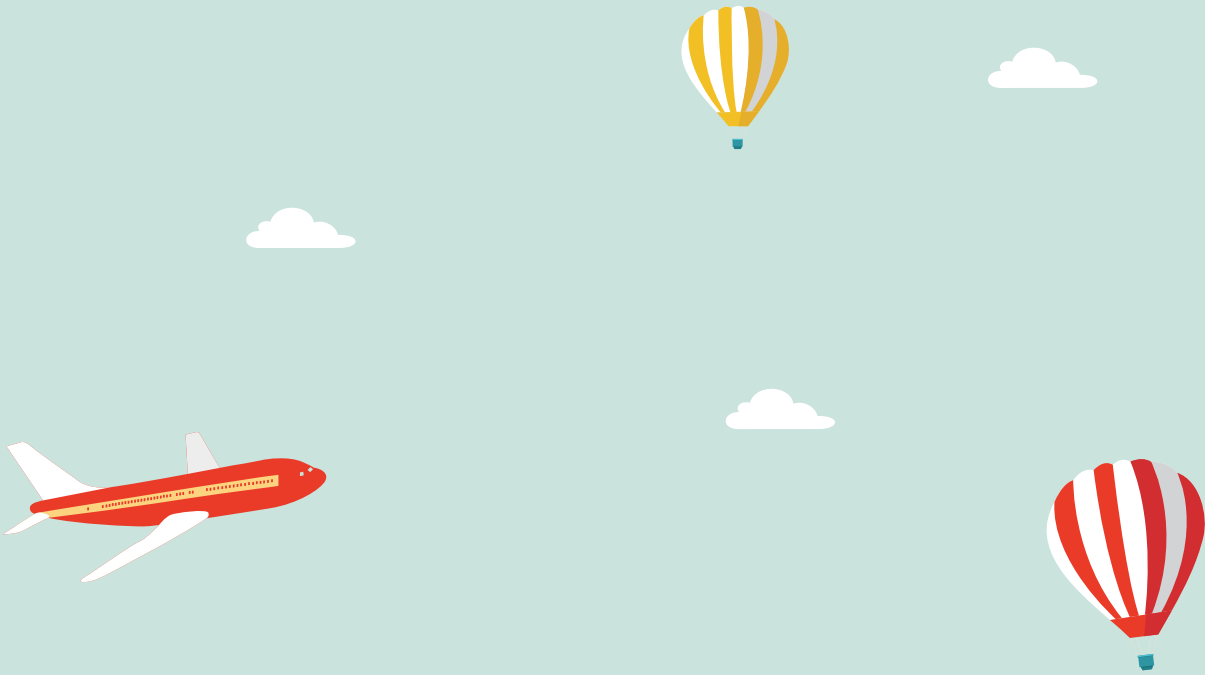
When building the business case, two aspects must be taken into account. On the one side, there is the cost of transformation, and on the other side, the cost of operations. Discrepancy in either one of these cost forecasts often arises due to overly optimistic projections.

### Conclusion

BPO can offer organizations a new-found flexibility, external insights, and not to mention the benefit of reduced costs. It is however important to remain informed and aware, with a view to mitigating any possible risks, as mentioned above. With this formula, collaboration between FIs and their outsourced counterparts will no doubt lead to a fruitful end result. ●

# M&A benefits for the banking sector consolidation





**Joachim Heukmes**

Partner  
Strategy Regulatory  
& Corporate Finance  
Deloitte

**Baptiste Guionnet**

Director  
Strategy Regulatory  
& Corporate Finance  
Deloitte

In a low interest rate environment and stringent regulatory context, the profitability of banks is in question more than ever before. In Europe, this trend is further exacerbated by the relatively low level of consolidation of the market in comparison to the US. However, M&A in the banking sector has risen recently, driven not only by scale issues but also by technology or geographical considerations. Given current market momentum, acquisitions and disposals will remain at the forefront of banking group priorities in the coming months. ➤

Following the introduction of the single currency in 1999 and the lifting of legal barriers to European banking unification, financial integration in the euro area has accelerated.

The period prior to the international financial crisis saw an increasing number of cross-border M&A activity in Europe.

However, since the start of the crisis in 2008, M&A activity in the European

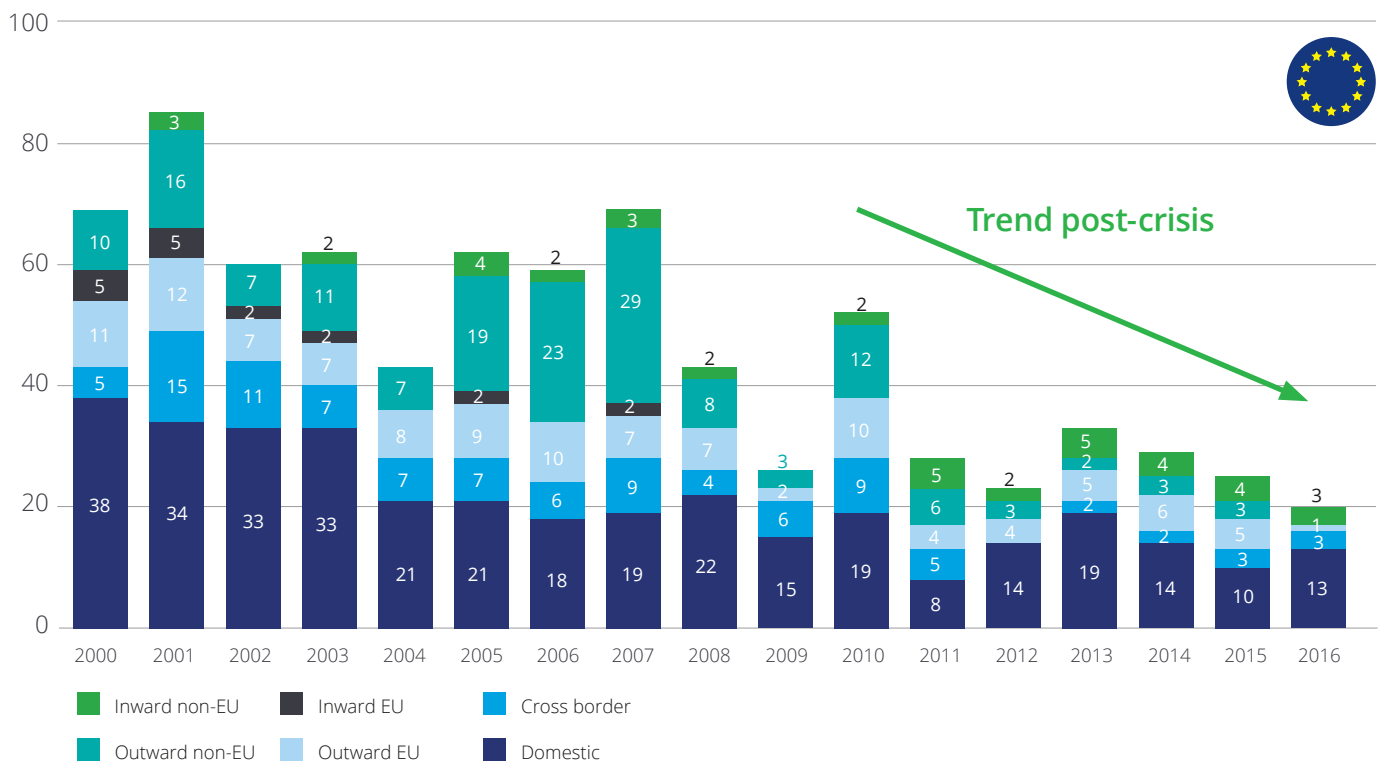
banking sector has declined significantly. Indeed, even if other causes can be identified, the entire post-crisis regulatory framework was partly designed to alleviate potential too-big-to-fail concerns in the banking industry in general.

As a result, the euro area banking sector still appears to be considerably more fragmented than in the United States, for example.

In the current economic context and given the challenges faced by banks, we observe that the number of M&A transactions rose recently and that the drivers underlying these transactions have, to some extent, changed in relation to the pre-crisis era. ➔

**Observation #1: Historical trend (especially after 2009) shows insufficient consolidation movements in Europe compared to the US**

**Figure 1: Banks M&As in the euro area - Number of transactions**



Source: Dealogic.

Notes: "M&As" refers to transactions where the acquired stake is more than 20% of the target bank. The data do not cover participation by governments or special legal entities in the restructuring or resolution of credit institutions. Transactions whose amounts are not reported are excluded. "Domestic" refers to transactions that take place within the national borders of euro area countries. "Cross-border" M&As involve euro area targets and non-domestic euro area acquirers. "Inward" refers to M&As by non-EU or non-euro area EU banks in the euro area, while "outward" indicates M&As carried out by euro area banks outside the euro area.

As a result, the euro area banking sector still appears to be considerably more fragmented than in the United States.

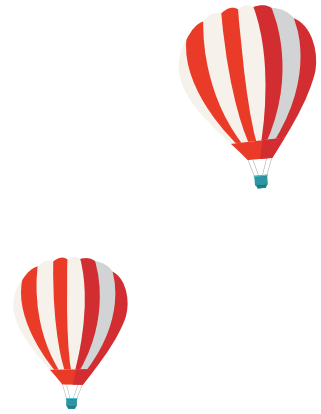
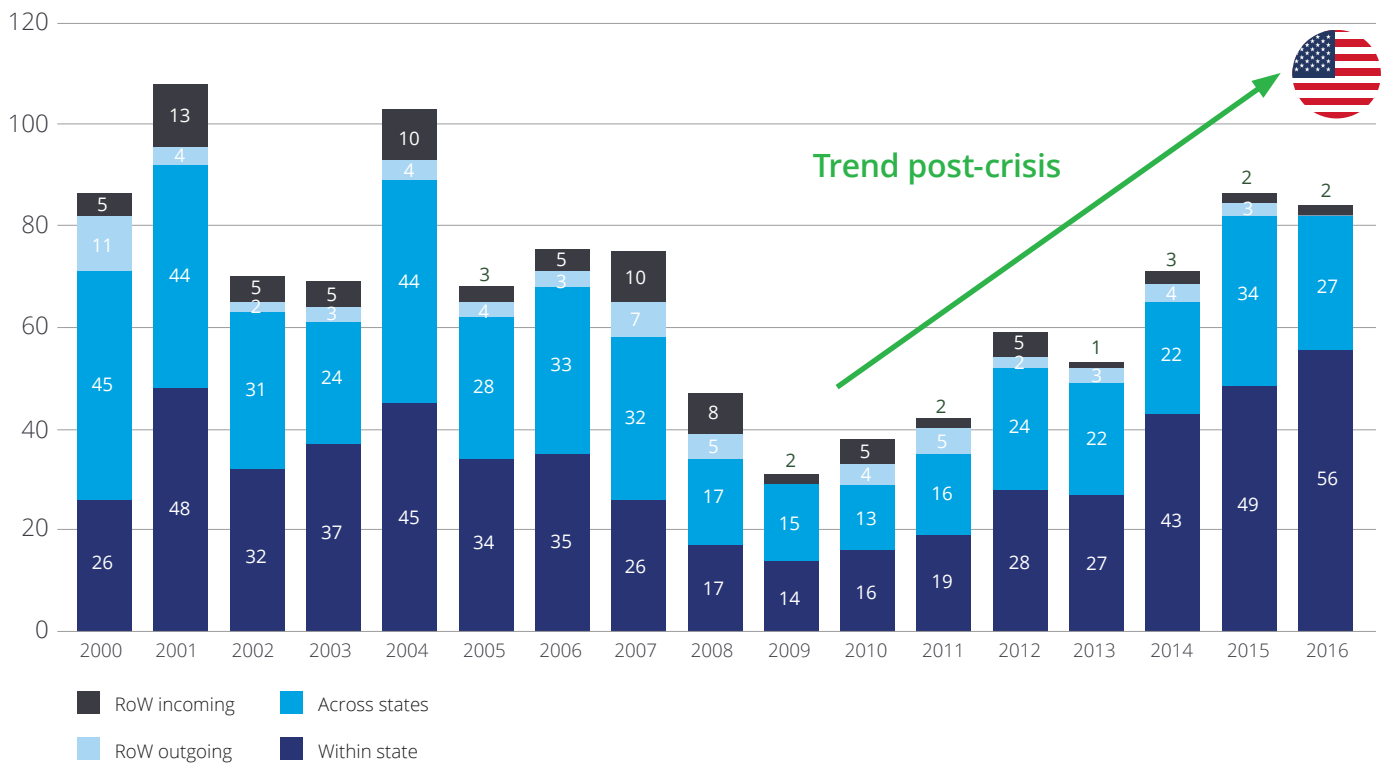


Figure 2: Banks M&As in the US - Number of transactions



Source: Dealogic.

Notes: "M&As" refers to transactions where the acquired stake is more than 20 % of the target bank. The data do not cover participation by governments or special legal entities in the restructuring or resolution of credit institutions. Transactions whose amounts are not reported are excluded for consistency. "Within state" M&As are transactions within the same state. "Across states" refers to M&As between states. RoW stands for "rest of the world". "RoW outgoing" indicates M&As carried out by US banks outside the United States while "RoW incoming" refers to banks outside the United States acquiring shares in banks in the United States.

Bank consolidation in the EU has made limited—and mainly domestic—progress in recent years compared to other mature markets like in the US. European market is still fragmented and EU banks could reach for a larger scope to be more efficient without creating issues in the competitive landscape. In terms of financial stability, cross-border M&As could make a valuable contribution to improve diversification of risk and increase the size and profile of client bases.

**The different patterns between the EU and the US in terms of the volume of M&A transactions can be partly explained by:**



The time-lag in the European economic cycle and interest rates central banks' policies compared to the US



More heterogeneous markets in Europe where the specifics of each country remains a key consideration preventing certain cross-border transactions

## European market is still fragmented and EU banks could reach for a larger scope to be more efficient without creating issues in the competitive landscape.

Recently, it appears that the perspective of Brexit or announcements addressing potential protectionism measures have been overridden by attractive M&A opportunities.

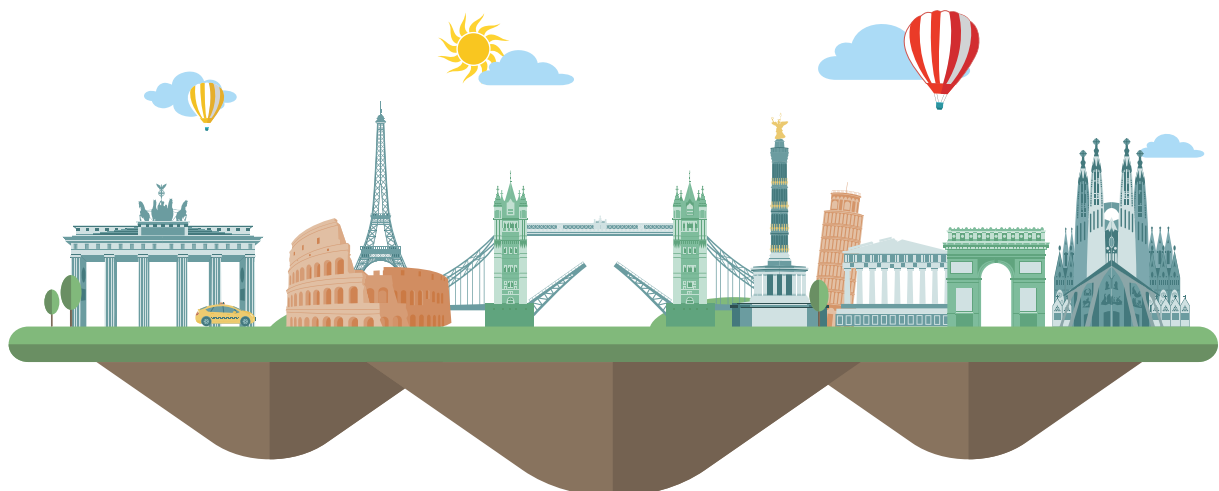
**Over the last few quarters, we noted that the number of M&A transactions showed a sharp increase globally, but also in Europe.**

- **Globally:** during the first quarter of 2018, more than US\$1,200 billion in M&A transactions were announced, which correspond to a 60 percent increase compared to 2017, and—even more surprisingly—a 30 percent increase compared to the historical peak registered in 2007.
- **In Europe:** we see a significant increase of 50 percent in the first quarter of 2018 compared to the same period in 2017.

**This trend is corroborated by a recent survey<sup>1</sup> showing that:**

01. CFOs' optimism continues to improve, especially in the Eurozone
02. There is now a shift from defensive to an expansionary mindset at the top management level

In 7 out of the 19 countries surveyed, expansion by acquisition or expansion to new countries is coming in the CFOs' top three priorities for 2018. More globally, expansionary strategies outnumber defensive ones in 11 of the 19 countries surveyed. ➔

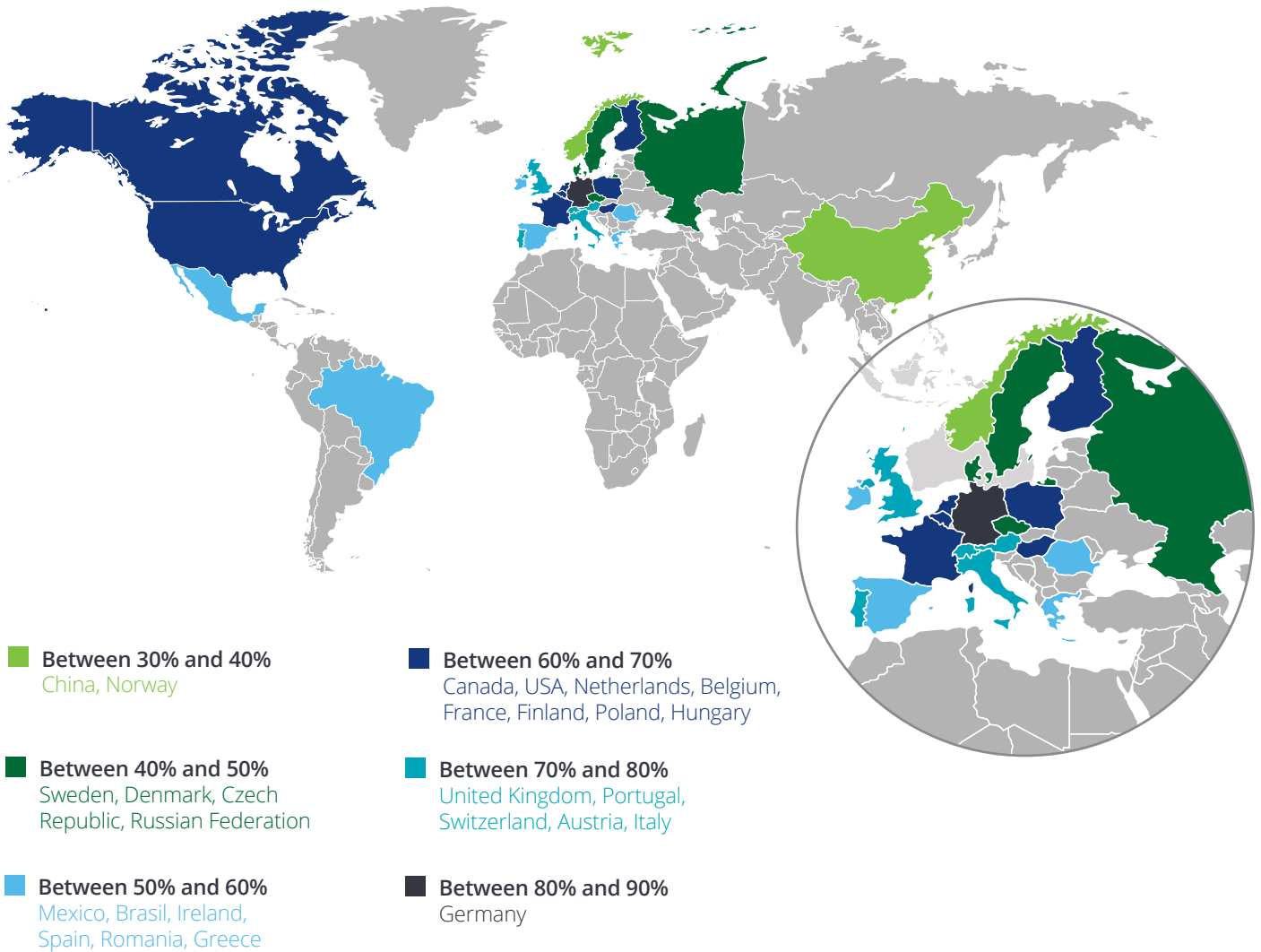


1 Deloitte European CFO Survey Q3 2017

**Observation #2: A higher level of profitability is more likely to occur only in a consolidated financial sector**

When looking at a simple KPI like the cost-to-income ratio, we see significant distortions across organizations in the banking sector (see illustration below).

**Figure 3: Cost to income ratio of banks (average by country)**

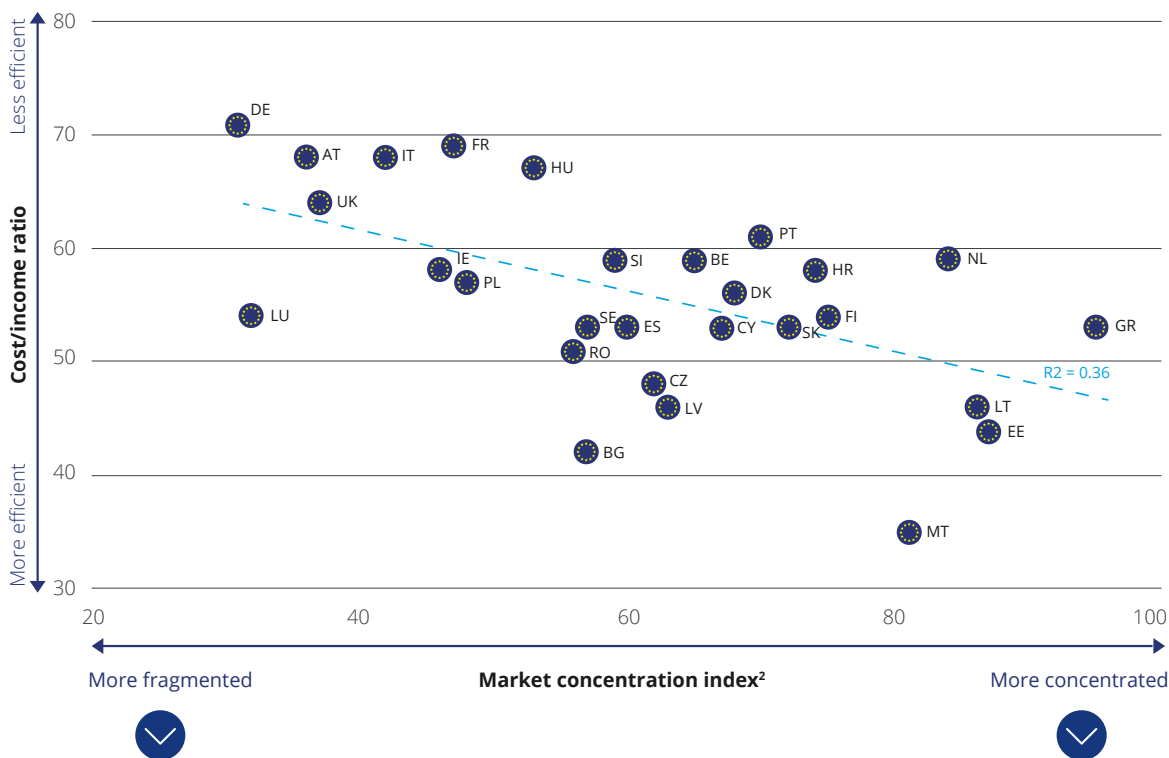


Source: S&P Global Market Intelligence

**Observation #3: The more consolidated the industry, the more profitable**

The chart above shows the correlation between the concentration index, measured by the aggregated market shares of the top five banks (measured in terms of asset size) and the average cost-to-income ratio of the banks in this country. We observe that the more concentrated the banking sector in a given jurisdiction, the lower the CTI ratio, and therefore, the higher the return on equity. EU member state banks are evolving under the same overall regulation exhibit—notwithstanding a large spectrum in the level of their comparative performance. It is worth noting that some banks manage to report strong profitability despite a heavy regulatory context.

**Figure 4: Cost to income ratio vs market concentration**



Banks evolving in fragmented environments (left part of the chart: Luxembourg, Germany, Austria, etc.) could be seen as the most fertile ground for M&A transactions and could probably grow on the short-term and obtain a better long-term profitability thanks to consolidation.

Banks evolving in an already-concentrated domestic market (right part of the chart: The Netherlands, the Baltic countries, etc.), have lower incentive to merge (already relatively low CTI ratio), but will need to prioritize cross-border alliances or acquisitions in order to achieve further growth.

2 Source: Banking structural statistical indicators (ECB) and Consolidated Banking Data (ECB). Data on cost/income ratios relate to the third quarter of 216, except those of Croatia, which are from the fourth quarter of 2015. The shares of the five largest credit institutions per country in total assets (CR5) relate to 2015.

Notes: Market concentration is based on unconsolidated data, whereas cost/income ratios are based on consolidated data that include foreign subsidiaries. Market concentration can differ if measured at the consolidated level (as in the case of cost/income ratios), which could therefore affect the correlation shown in the chart above. In the case of France, its position on the chart would be different if both indicators were to be measured at the same level of consolidation: when using consolidated data, it can be observed that in relation to the share of the five biggest banks, the French banking system is fairly concentrated, as the market share of the top five banking groups is close to 80 percent instead of the less than 50 percent reported by the chart when using unconsolidated data. The cost/income ratio is defined as total operating expenses divided by total operating income. The underlying profitability data are annualised.





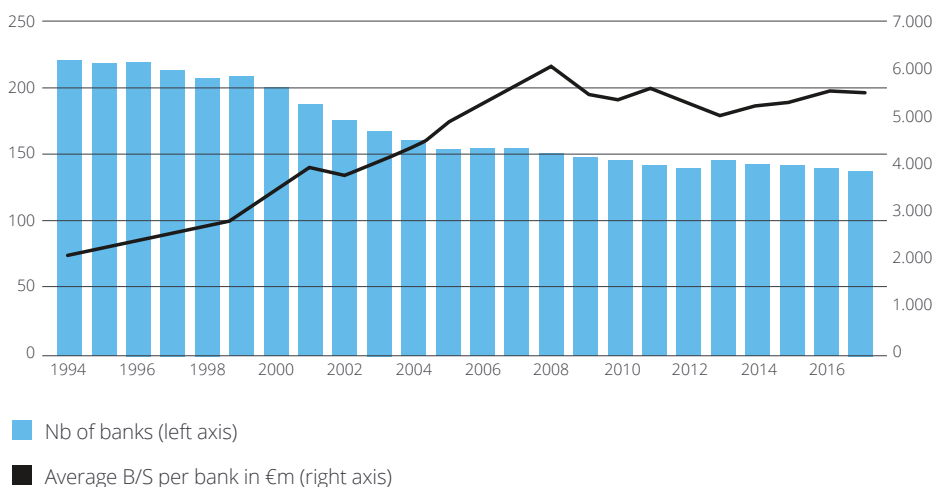
**To be successful in such context, each bank needs to design a robust strategy to sustain growth and improve profitability. Such strategies typically include:**

- 01 The implementation of internal efficiency measures and organic growth prospects
- 02 Divestment of part of their non-core/non-profitable portfolios or activities (i.e., where the banks do not have a competitive edge or sufficient scale)
- 03 Acquisitions in core/strategic markets providing scale to absorb regulatory and other fixed costs, which should in turn drive long-term profitability ➤

### Focus on Luxembourg market

When looking at the banking industry in Luxembourg, we see a fragmented market but still a strong CTI (see previous chart). We should however interpret this statistic with caution given the specific nature of the Luxembourg market (one of the highest GDP per capita in the world, high proportion of funds and private banking business).

**Figure 5: Consolidation trends in the Banking sector (Luxembourg)**

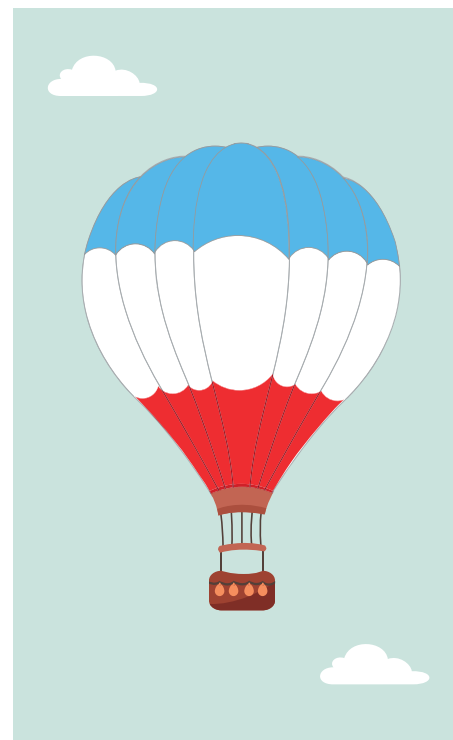


With 139 banks<sup>3</sup>, the country is indeed hosting branches or subsidiaries of many international groups in addition to local banks. In comparison to the population of European banks forming part of our CTI benchmark, the Luxembourg market is heavily leaning toward investment management and private banking activities exhibiting different revenue profiles and cost structures than those of traditional retail banks with their costly network of brick and mortar branches as main distribution channels.

Despite achieving a good CTI ratio overall, Luxembourg banks have recently faced some significant headwind resulting from regulatory changes such as the end of

the bank secrecy, the enforcement of the Common Reporting Standard (CRS), the implementation of MiFID II, etc.

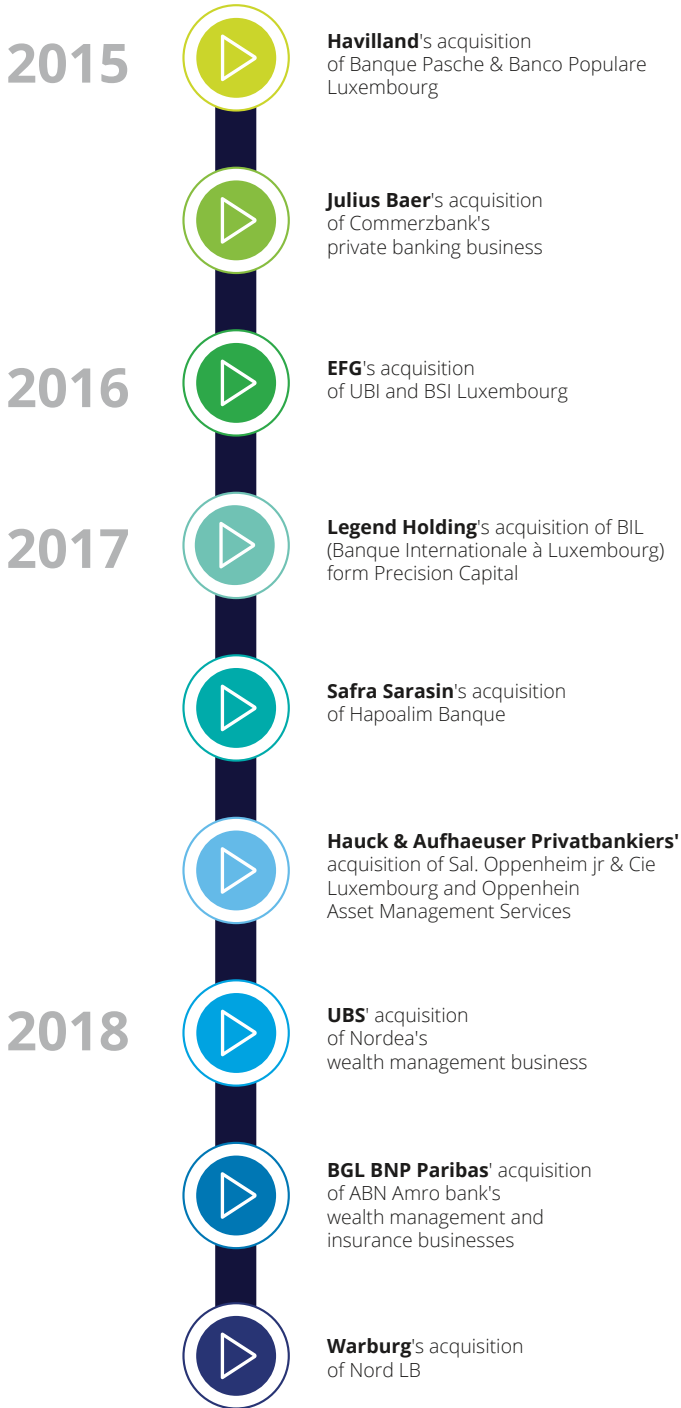
These changes led to certain client outflows (volume effect) and lower margins on services provided (price effect) associated with an increase of compliance costs and investments required to keep up with regulators' requirements. These effects resulted in declining profitability and ROE leaving subscale entities in difficult positions. These trends have pushed some banking groups to consider selling their subsidiary, and consequently, M&A activity spiked in Luxembourg, with this trend expected to continue in the coming months.



Other transactions are about to occur in 2018, supporting an undeniable takeoff for M&A activity in Luxembourg, especially in the Banking sector but also in the asset management and servicing industry.

<sup>3</sup> Source CSSF monthly statistics (as of 31-Dec-2017)

**Figure 6: Key M&A transactions in Luxemburgish Banking sector (2017 and 2018Q1)**



On the buy-side, M&A activity is also supported by the appetite of banking players affected by Brexit and looking for a “fall-back” onshore solution, active acquisition strategies implemented by players from Switzerland, the Middle East, or Asia to set foot in Europe and finally by large European banking groups desiring to strengthen their footprint in certain markets.

As illustrated in the chart on the left, we observe a series of significant transactions in 2017 and Q1 2018. Others are about to occur in 2018, supporting an undeniable takeoff for M&A activity in Luxembourg, especially in the Banking sector but also in the asset management and servicing industry. ➔

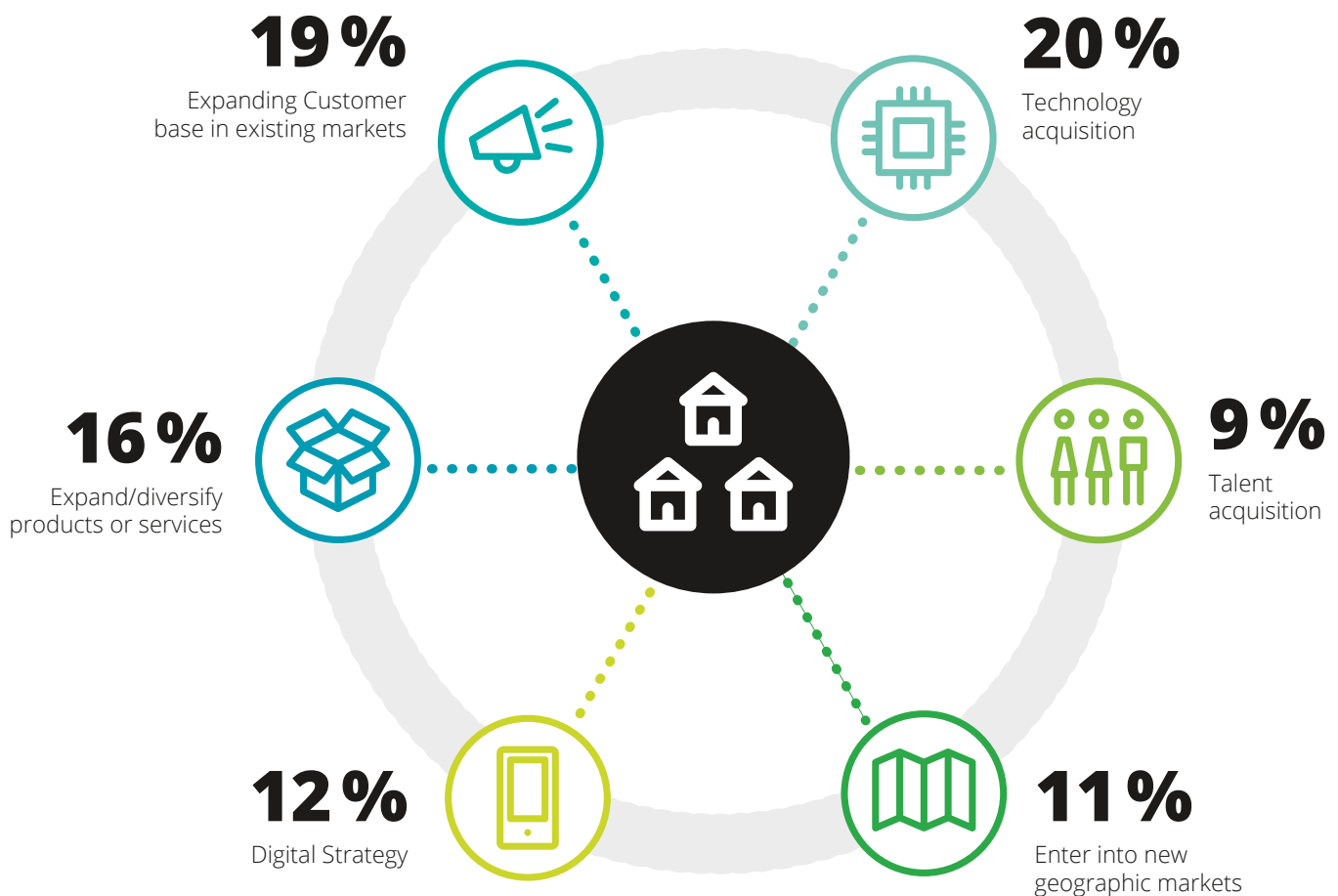
Sources: CSSF, Merge and Market

**Observation #4: Size is not always the main M&A driver**

According to a recent survey<sup>4</sup>, acquiring technology assets now ranks number one as a strategic driver of M&A deals (see figure below). In total, almost one third of executives involved in M&A activities quote the acquisition of technology assets (20 percent) or the digital strategy (12 percent) as the principal reasons behind deals, up from 6 percent compared to previous survey.

Half of financial services firms say they expect to engage in a joint venture with a FinTech in the next two years.

**Figure 7: Main drivers for considering an acquisition**



4 Deloitte M&A trends 2018

On recent M&A transactions, where we observed that the potential acquirers were having a very close look at the targets' IT setup (Core Banking System, Web-based platform, etc.) as a key transaction driver. Inadequate IT setups or the insufficient scalability of certain IT platforms has also been considered as important showstoppers on certain transactions.

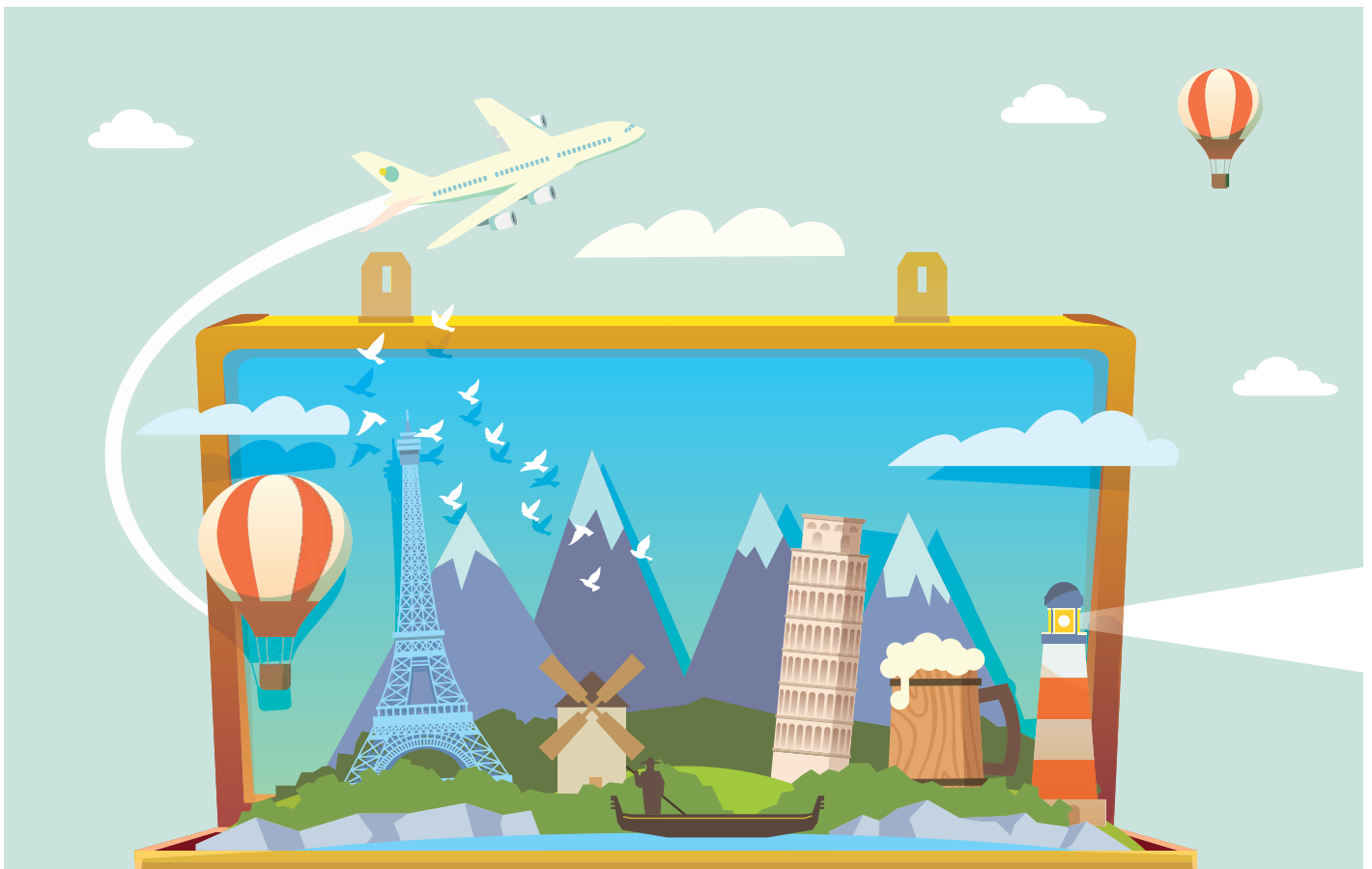
FinTechs offering innovative financial services are also becoming central in the acquisition strategy of financial groups:

- Half of financial services firms say they expect to engage in a joint venture with a FinTech in the next two years
- One-third say they expect to acquire a FinTech firm over the same period<sup>5</sup>.

However, in the context of a bullish equity market, promising FinTechs have already raised a significant amount of capital and are becoming relatively expensive.

Furthermore, mature banks typically encounter troubles when assessing FinTechs' future profitability, and many still find that there may not be a cultural alignment with traditional bank culture. Technology solutions are indeed viewed by many as "disruptors," not always suiting the highly regulated environment faced by large institutions. ➤

Inadequate IT setups or the insufficient scalability of certain IT platforms has also been considered as important showstoppers on certain transactions.



<sup>5</sup> Source: MergerMarket

Despite the importance of the technologic angle, a significant portion of M&A activity remains driven by size with the objective to reach an adequate cost-income ratio. According to a recent survey, recent acquisitions were also largely driven by the acquisition of a client base:

- Expand the customer base in core markets of the acquirer (19 percent of respondents)
- Enter into new geographic markets (11 percent of the deals)

Investing in a bank that has clients in multiple jurisdictions implies some risks due to regulatory obstacles

and stringent compliance rules. The trend for banking players is therefore often to re-focus on fewer core jurisdictions. Accordingly, we observe a certain number of asset deals through which only selected client portfolios and corresponding client relationship manager are acquired.

The banks in Luxembourg might be seen as potential interesting targets, with an international client base and still good profitability, but the countdown has started; if they are not growing enough, private banks might become non-profitable going forward.

The banks in Luxembourg might be seen as potential interesting targets, with an international client base and still good profitability, but the countdown has started; if they are not growing enough, they might become non-profitable going forward.



Given the recent peak in M&A activity and strong market momentum, timing seems about right to look for an answer those these strategic questions.

**Conclusion**

**Investing or divesting?**

Low interest rates in Europe together with a constantly evolving regulatory framework continue to put pressure on banks revenue streams while increasing their compliance costs. As a result, the cost-to-income ratio of banks remains under pressure, in particular for smaller businesses not benefiting from economies of scales nor a diversification of their activities.

In this context, market participants should carefully consider their strategic options, the rationale, and sustainability of their footprint in certain jurisdictions.

Accordingly, beyond the implementation of internal restructuring measures, banking groups typically consider M&A routes to bring an answer to the strategic questions with which they are currently confronted:

- **BUY strategy:** Has the entity reached the critical size required to be profitable? Is the return on equity adequate given the risk profile of the activity? Are further

organic growth opportunities available? Does the entity need to acquire specific technologies to complement its service offer or remain competitive?

- **SELL strategy:** Is the entity performing a core activity for the group? Is it active in a core jurisdiction? Could another player derive more value from the ownership of the business? Is the business undersized or has limited growth opportunities in the future?

While notifying the market of the willingness to perform acquisitions generally constitutes a positive sign, divesting might be perceived as a sign of weakness. This perception together with a certain resistance to change prevents groups from taking the difficult decision to dispose of an asset, thus resulting in some sub-scale assets or entities being sold too late to generate an acceptable return. Given the recent peak in M&A activity and strong market momentum, timing seems about right to look for an answer those these strategic questions. ●



# A strategic approach to real estate management





**Jean-Pierre Lequeux, MRICS**

Partner  
 Strategy Regulatory  
 & Corporate Finance  
 Deloitte

**Didier Fritzsche, MRICS**

Senior Manager  
 Strategy Regulatory  
 & Corporate Finance  
 Deloitte

**Buyanzaya Batbileg, CFA**

Analyst  
 Strategy Regulatory  
 & Corporate Finance  
 Deloitte

The real estate industry appears to be straightforward at first sight, but in reality, it is a complex and ever-changing landscape. Strategic real estate management involves many different dimensions for different stakeholders.

Indeed, the real estate business is currently experiencing a shift in demand away from the traditional business operating model and towards more flexible solutions, such as co-working spaces. Sustainability—though far from being a new consideration—is another key driver of change in the real estate domain. Among other factors, sustainability and new practices in operating/developing real estate are having a positive impact on the wellbeing of employees and leading to further efficiency gains in portfolio management in general. In today's search for value creation, there is a clear need for greater efficiency in standardized solutions, and digitalization could be the answer.

From an investor's perspective, efficiency begins with a successful asset/portfolio acquisition process. A key success factor for this is having an independent and transparent transaction process from A to Z. Key risks must be identified and mitigated from the outset, preventing unpleasant surprises at a later stage.

**The best ways of using real estate  
 New trend: co-working**

“Co-working space” is not merely a real estate operating model that has experienced rapid growth in recent years—more importantly, it creates “a community of people” who share similar needs and interests. The concept of co-working has arisen from fundamental changes in lifestyle and ways of working. Typical users of co-working spaces include startups, SMEs and independent professionals such as freelancers, contract workers, and remote workers. The rise of co-working spaces is being driven by the influence of “millennials”, who prefer to work on their own and be in control of their own time. ➔

Among other factors, sustainability and new practices in operating/developing real estate are having a positive impact on the wellbeing of employees and leading to further efficiency gains in portfolio management in general.

The percentage of independent workers is set to increase in the coming years, boosting this trend. In countries like the United States, where co-working spaces are the most trendy and have been most successful to date, this percentage is as high as 35 percent and expected to reach 40 percent of the total workforce by 2020.

Thanks to rapid technological progress, it is becoming easier and more efficient to organize remote working solutions. As a result, large corporates are increasingly offering employees the freedom to work remotely. Luxembourg is following this trend. Studies show that it is a “win-win” arrangement for both the employer and the employee. Working from remote areas, particularly in modern and innovative places like co-working spaces alongside other professionals, fosters employees’ productivity and creativity.

From a corporate RE management perspective, membership of co-working spaces allows for:

- Flexibility in terms of RE commitment (less office space rented on a fixed term) leading to cost reductions since corporates can pay for it only when needed

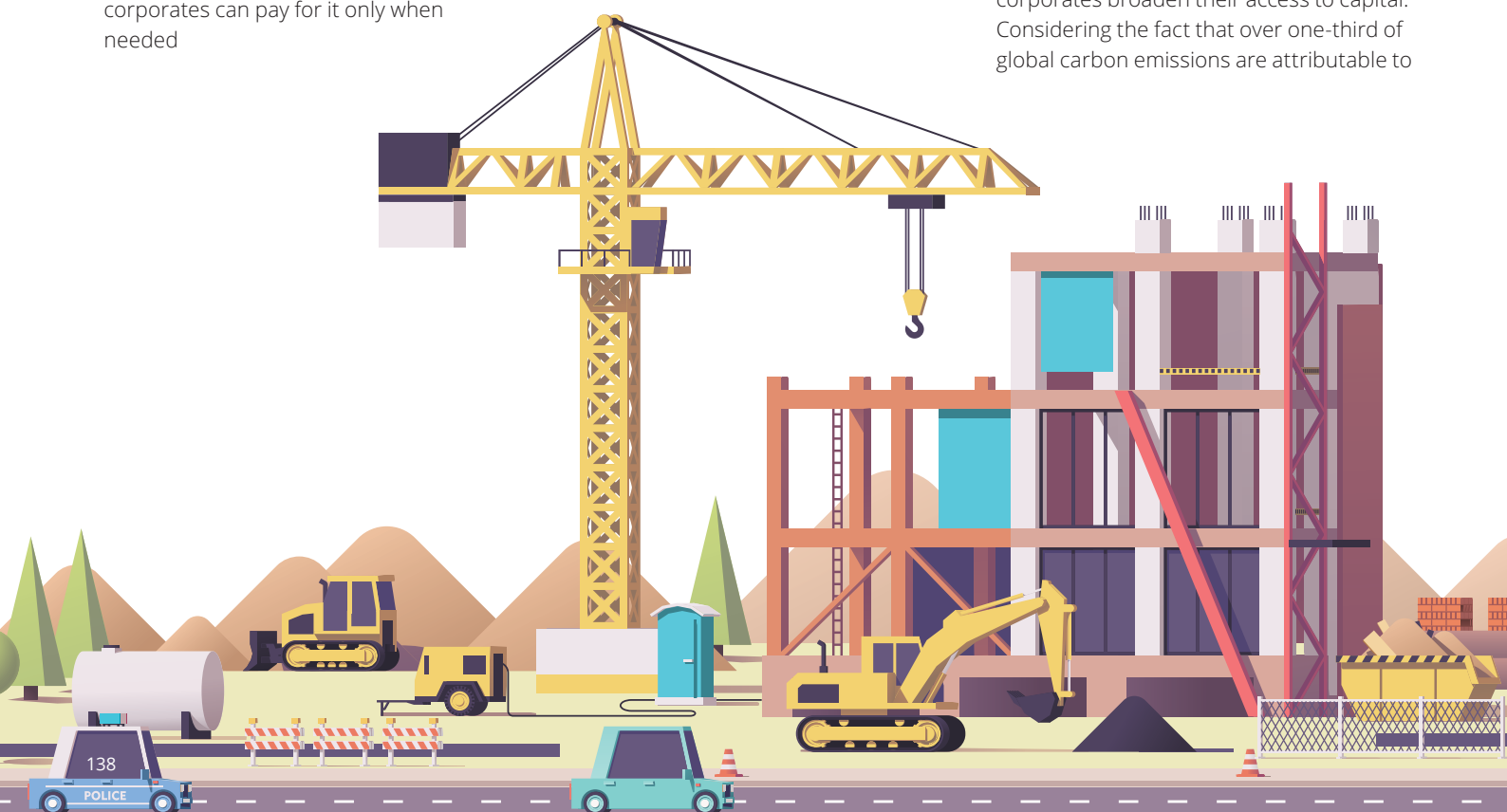
- Increased efficiency of lettable area resulting in lower square meterage per employee.

What could be better than having happier and more productive employees while reducing the overall RE cost and operational work related to RE management? From the perspective of the operator of a co-working space, providing shared space, desks, internet, necessary office supplies, a comfortable environment, and other facilities it is not necessarily enough to attract and maintain customers. As mentioned in the beginning, co-working spaces are a place in which to build a community of people who wish to connect and collaborate with like-minded peers, to exchange ideas and be inspired by one another. Therefore, it is important to actively organize events and programs to effectively boost the engagement of all members and create a positive environment in the co-working space.

From a risk management perspective, the co-working business model seems to be vulnerable to downturns in the economic cycle due to the characteristics of the main users (startups, SMEs, and freelancers). In addition, operators of this kind of business model tend to have weaker covenants than traditional commercial real estate. A high fixed cost and variable-income business model requires greater scale for an operator to be profitable and sustainable. As a result, there is vertical consolidation happening among operators and bigger scale/multiple location operators have proven to be successful.

#### Sustainability and real estate

Encouraging sustainability has many positive impacts in terms of creating long-term value for the community, businesses, and shareholders. Sustainability helps corporates attract and retain talented employees and therefore increases efficiency and profitability. It also brings in new customers by boosting brand reputation. Moreover, thanks to the new concept of “green financing”, stemming from growing awareness of global warming, sustainable practices are helping corporates broaden their access to capital. Considering the fact that over one-third of global carbon emissions are attributable to



buildings, corporates are increasingly willing to consider how their sustainable business practices can be adapted to their real estate. Besides contributing to corporate social responsibility (“CSR”), it also has proven economic value.

Once you decided to build a smart and green building, it is actually not that difficult to implement it considering all the technological and innovative solutions that are already available in the market, including wind and solar energy systems, smartphones and apps, big data, and IoT technology.

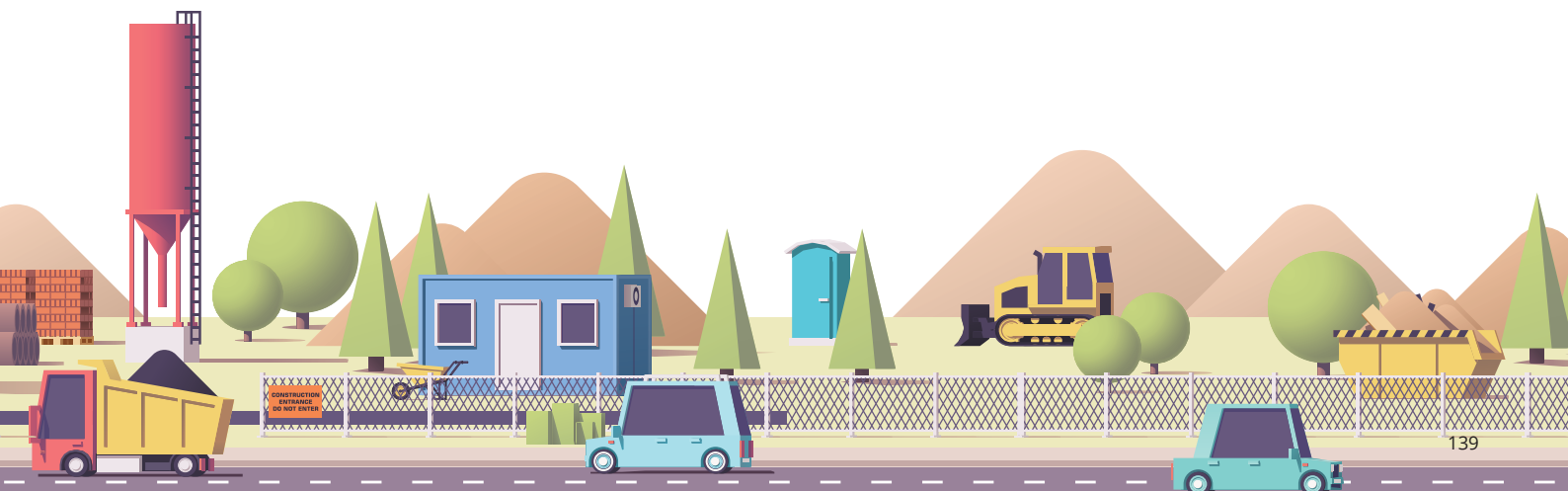
A perfect example of this is our Deloitte Amsterdam office building called “The Edge”. The office was recently named as the greenest and smartest building in the world, scoring 98 out of 100 on the BREEAM authority scale. It has its own smartphone app that delivers information collected through thousands of small sensors installed in the building, allowing users to adjust their custom preferences in the rooms and spaces they are using (lights, temperature, etc.). The televisions can instantly connect to smartphones, the availability of parking spaces can be checked through the app, and electric car charging points are available on-site.

On the roof, the building has its own solar panels that provide a self-sufficient energy source for the building. The building’s operational solutions have increased space efficiency significantly by implementing a “hot-desk” policy, meaning that working spaces are arranged (standing desk, sitting desk, meeting room, concentration room etc.) to be best suited to the needs of each individual based on their schedule for that day. Compared to the previous office, The Edge building hosts the same number of employees with half the number of desks and workstations previously used, while also improving the quality of the working environment.

A key strength of smart buildings is the ability to effectively collect, control, and analyze big data to solve inefficiency problems in relation to real estate. Even cleaning costs can be optimized by monitoring and determining cleaning needs by checking via pre-installed office sensors to see whether or not an area was used during the working day. It is all about boosting efficiency!

Finally, health factors for employees in the office building are monitored through air quality, automatic windows, etc. ➔

## Sustainability helps corporates attract and retain talented employees and therefore increases efficiency and profitability.



Luxembourg is among the European nations that are leading the way in terms of sustainable construction practices. The latest research shows that about 110 buildings in Luxembourg have been certified as sustainable buildings by BREEAM International. Out of the total amount of office properties, that number is impressive compared to other European capitals.

### **Wellness in the workplace**

According to recent studies, future workplace environments will be increasingly focused on health and wellbeing. An appropriate wellness offering is a crucial factor for employees when choosing their prospective employer. From the employer's perspective, a healthy environment increases productivity at work and reduces various opportunity costs, such time lost to as sick leave. Attracting and retaining skilled and talented employees and keeping them healthy and satisfied by providing a good environment is key to competitiveness for any business. The design of the office building is an important part of the corporate wellness program including, but not limited to, lightning and hydration systems, relaxation areas, and a fitness center offering.

### **Asset/portfolio optimization**

#### **Value creation in RE**

There are two sources of value creation in RE: i) increasing income and ii) reducing cost. Optimizing the trade-off between these two sources requires analysis and expertise. An important question when choosing between the various RE portfolio management approaches (active vs passive) is whether or not the investor has the necessary knowledge, skills, time, and incentives to effectively take care of all

aspects of their real estate portfolio. Before making an investment decision, a pre-deal analysis must be carried out thoroughly and with proper due diligence. Some people might consider an under-rented letting situation with a reduced weighted average lease term ("WALT") to be a key risk, while others might view this as a clear opportunity to re-let at market conditions.

After the transaction is completed, efficient property and tenant management becomes crucial to optimize both sources of value. Digital is currently having a considerable impact on efficient real estate portfolio management tools, which are being transformed from standardized reporting solutions to cloud-based platforms that are accessible from anywhere in the world. This is even more important for diversified asset managers who have a global footprint. The industry has seen many new players, namely startups, who have identified the need in the RE market, given the lack of digitalization in the RE industry, and are providing new solutions to their customers. Naturally, moving away manual processes to fully embrace digital is a process that will take time to mature.

### **Independence in the real estate transaction process**

The real estate market in Luxembourg is a vibrant market characterized by limited supply, a low vacancy rate and continuously growing demand. Challenges are more on the buy-side, in "finding the right property". In this kind of competitive market, independence in the transaction process is crucial. Ensuring independence in the transaction process prevents conflicts of interest and reputational damage and provides a strong base for legal and

litigation cases. Independent transaction advisors will identify the key risks linked to a transaction, from a financial, tax, technical, and legal perspective. Once identified, management should consider mitigating these risks, unless they are considered deal breakers. Risks should be quantified and qualified (i.e., level of risk), in order to provide a strong rationale for any potential price adjustments. An independent advisor will support the client throughout the transaction process, providing guidance and ensuring that the process runs smoothly, thereby limiting day-to-day business disruption. Overall, an independent advisor will provide comfort, add value throughout the process, and outweigh the time and monetary costs involved.

### Conclusion

The real estate landscape is changing rapidly and facing many new challenges and opportunities. From new ways of working to new places of work (smart buildings), real estate is disrupting many traditional concepts. Given technological advancements and changes in users' lifestyles, strategic real estate management now requires a greater level of adaptability. Investors are becoming ever-more demanding, and rightly so since the business model has evolved over recent years. We expect the business model to become even more disruptive, in light of recent trends towards digitalization.

Many corporates will need to adapt to this new environment in order to sustain their position, whether through greater efficiency in portfolio management or transaction process optimization. Employees are becoming more demanding as well, requesting greater flexibility and healthier working environments, creating challenges for employers to find and retain talents.

All these market trends may seem complex at first glance, but they are creating new opportunities and can be rewarding for market players that are willing to adapt. ●





# Increasing regulatory training requirements in the banking and financial industry

## A burden or an opportunity?

### Paul Schilling

Director  
Operations Excellence  
& Human Capital  
Deloitte

### Sonia Ben Abdelhafidh

Manager  
Operations Excellence  
& Human Capital  
Deloitte

### Nicolas Neymann

Analyst  
Strategy Regulatory  
& Corporate Finance  
Deloitte

Financial industry players are increasingly subject to regulations. Employees of banks, investment funds or other financial institutions are required to go through extensive training to understand, apply, and ultimately comply with the regulatory requirements. This regulatory inflation has not only multiplied the complexity and cost of compliance but has also made compliance training a vital topic for banks. This situation might sound challenging, but compliance training can in fact be much more than a financial burden. It should instead be seen as an opportunity to refresh the financial institution's overall corporate training approach, reduce costs, and help financial institutions to enhance their services as part of a customer-oriented strategy. ➔



The European regulatory framework is constantly growing and increasing in complexity. The long-term influence of regulations naturally leads to more onerous training obligations and higher expectations in terms of staff knowledge and competencies. As the aforementioned requirements affect a large set of employees across the whole organization, they represent a substantial challenge for banks and financial institutions. In practice, the HR and Compliance departments of banks and financial institutions are tasked with managing implementation, change, and cost. While this seems like a burden to most organizations, these new regulations can represent an astonishing opportunity to renew corporate training strategies, innovate, reduce costs, and increase employer attractiveness.

In 2008, the world faced its second global financial crisis in under 10 years. The court of public opinion convicted bankers of underhandedness and a presumed incompetence in terms of ethics, business

conduct, and technical skills such as knowledge of the financial markets and risk management. At the time, Joseph Stiglitz stated: “the financial crisis [...] is the fruit of a pattern of dishonesty on the part of financial institutions, and incompetence on the part of policymakers”. According to the 2001 Nobel Prize laureate, if we consider the causes of the crisis, bankers’ mismanagement of risk and policymakers’ failure to act are equally deplorable. As a reaction, after the crisis, both European and American policymakers embarked upon a new cycle of regulations. They emphasized knowledge and competence requirements in order to achieve a higher level of staff professionalism and to ensure a better framework for consumer protection.

Today, most new regulations thus include strict requirements in terms of staff knowledge and competence and the ability to properly inform clients. For instance, article 25 of the second Markets in Financial Instruments Directive (MiFID II) requests that Member States take appropriate action


to ensure that “natural persons giving investment advice or information about financial instruments, investment services or ancillary services to clients [...] possess the necessary knowledge and competence to fulfil their obligations”. Similarly, article 9 of the Mortgage Credit Directive (MCD) is fully dedicated to “knowledge and competence requirements of the staff” and requires that “Member States ensure that creditors, [...] require their staff to possess and to keep up-to-date an appropriate level of knowledge and competence in relation to [...] credit agreements [...] or the provision of advisory services”. And this list of examples could be much longer, including the AML IV Directive, IDD, GDPR, and MAD II.

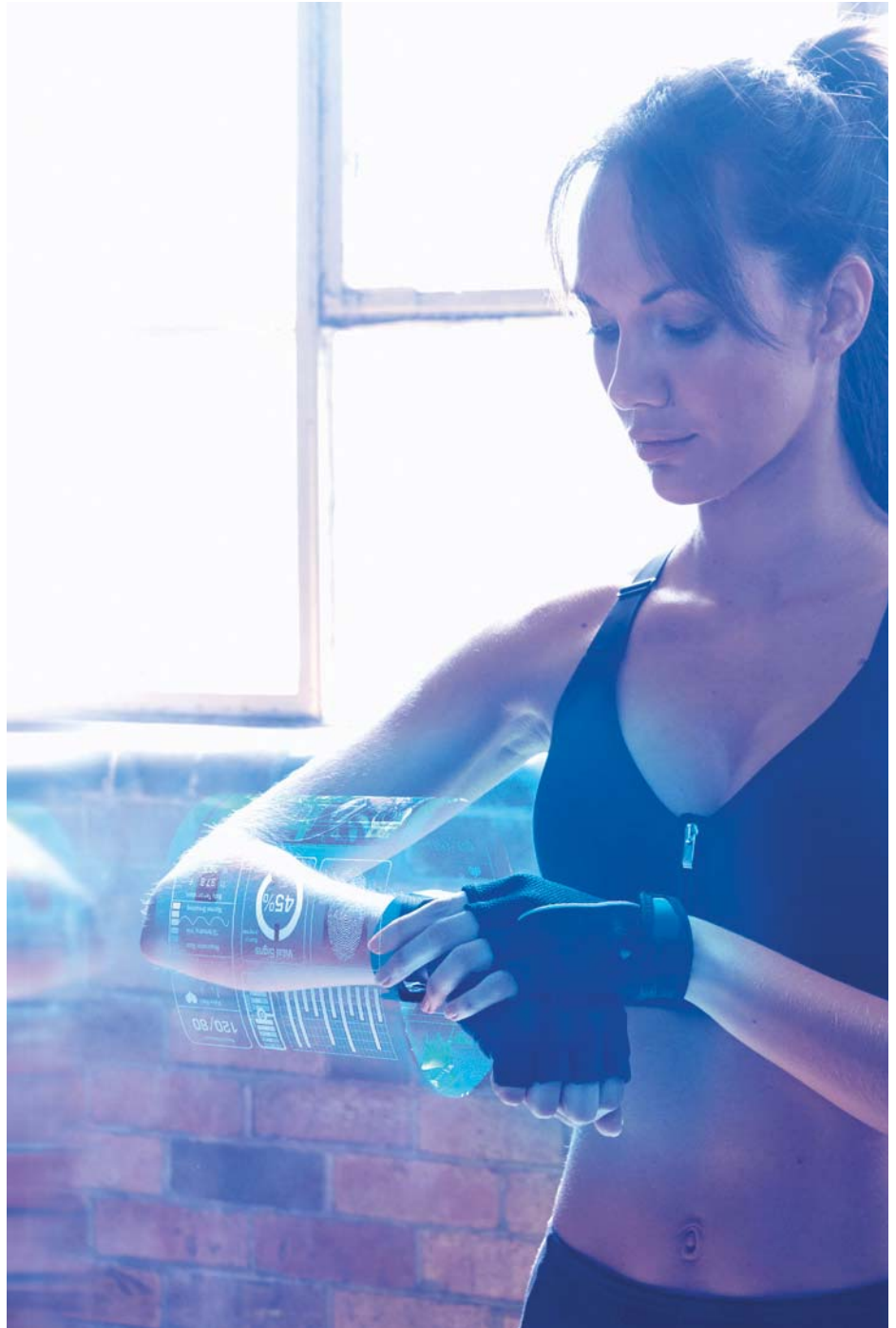
Requirements in terms of knowledge and competence now go beyond a simple instruction that relevant employees must possess and keep up-to-date a certain level of knowledgeability. As regards MiFID II, the ESMA published new guidelines in August 2017 on the assessment of knowledge and competence, which “set important

The long-term influence of regulations naturally leads to more onerous training obligations and higher expectations in terms of staff knowledge and competencies.



standards to assist firms in meeting their obligations to act in the best interest of their clients". In particular, the guidelines list the elements about which staff should be knowledgeable, i.e., understanding investment products, costs and charges, market structures, valuation principles, and portfolio management. To further increase the complexity of the situation, it is also important to note that European directives are not at the same stage in terms of adoption in member states' national legislation. Some countries' requirements regarding knowledge and competence are significantly stronger than others: in Spain for example, banking employees providing advisory services need to follow up to 150 hours of training on MiFID II. Similarly, CSSF Regulation 12-02 on AML/CTF states among other requirements that new employees must receive awareness training on their professional obligations and AML legal requirements. The Luxembourg MCD adoption law defines the minimum requirements for compliance in terms of knowledge and competence, including knowledge of the Code de la Consommation, knowledge of the market, understanding of the code of conduct, a grasp of how creditworthiness is assessed, etc. In France, there is even a decree that is almost fully dedicated to the aforementioned requirements.

This short sample of the new regulatory requirements in terms of knowledge and competence demonstrates the scale of the unprecedented challenges faced by banks and financial institutions, which must implement thorough procedures to document their compliance with these legal provisions. Sometimes, proving several years of professional experience is enough, but in other instances a robust process 



needs to be put in place. In Luxembourg, this is the case for MiFID II, as the CSSF, through circulars 17/665 and 17/670, has stated that it expects to see a formalized procedure for ensuring compliance in terms of staff knowledge and competence, covering everything from the assessment logic of learning needs to record-keeping obligations in relation to the relevant training sessions.

These recent developments have compelled banks' compliance departments to spend more and more time on training-related activities. It is not surprising that training accounts for some of the highest levels of expenditure within compliance departments, just after the salaries of the various teams. Specifically, in 2015, in the banking and financial services industry, a non-management staff member followed on average 8.1 hours of compliance training per year. The rise in compliance costs, which are forecasted to increase from 4 to 10 percent of banks' resource allocation by 2022, is directly linked to the increased compliance training expectations.<sup>1</sup>

That said, compliance training is not only about responding to regulatory requirements and should not be viewed purely as an additional cost—in fact, this is far from the truth. It is above all about shaping a culture of ethics and respect within an organization, enhancing its services, and ultimately strengthening its market positioning. Over the long term—

contrary to what one might expect—a well-designed training pathway allows a rationalization of costs, and especially costs related to risk mitigation.

In practice, banks and financial institutions should seize the opportunity to innovate in various ways to transform their legal training obligations into an opportunity to create value. For example, the high rate of repeatability of some annual awareness training sessions opens doors to smart digitalization of training content and, more generally, to an efficient blended learning approach. Digitalization is particularly appropriate for training with a broad target audience e.g., on AML/CTF, conflicts of interest or policies. This, in return, allows organizations to use their classroom training for real learning experiences rather than for delivering theory that could be assimilated remotely. In addition, through a diligent assessment of learning needs, organizations can better target and tailor relevant content to the respective audiences, ensuring a tangible impact on participants' daily tasks. Finally, yet importantly, the latest training methods building on the key tenets of adult learning theory apply disruptive learning design to minimize attention loss and maximize the knowledge retention rate.

In practice, banks and financial institutions should seize the opportunity to innovate in various ways to transform their legal training obligations into an opportunity to create value.

<sup>1</sup> Source: Nave Global 2015



### Conclusion

In conclusion, regulatory training should be at the top of each organization's learning strategy agenda. Regulatory requirements in terms of staff knowledge and competencies no longer need be perceived as a constraint but rather as an opportunity to enhance the image of the organization as perceived by clients, and current and future employees.

Well-trained employees have higher levels of motivation, a better knowledge of their clients' expectations, the market, and common traps and risks. As a matter of fact, clients themselves, when made aware of this investment in the banking staff's development, see the training of their advisors as a positive step towards quality, safety, and trustworthiness. This is where regulatory compliance, employee development, and customer service excellence converge. ●

# Being a CFO today



**Pierre Masset**

Partner  
Corporate Finance  
& CFO Services  
Deloitte

**Laurent Gateau**

Director  
Corporate Finance  
& CFO Services  
Deloitte

**Camille Presa**

Consultant  
Corporate Finance  
& CFO Services  
Deloitte

## Being a CFO today

1,000—4—1

In this article, we use three numbers to show why it's no longer all about the figures.

**W**hat does it mean to be a CFO today? Every CFO would have his or her own answer to this question.

It would depend on their backgrounds, past positions and the environment in which they are working. It is easy to argue that CFOs from, for instance, an international food and drink company, a universal bank, a FinTech start-up and a family business have very little in common.

This is all the more the case since answers to this question may change over time as more and more enquiries and responsibilities are heaped on CFOs.

Yet, as CFOs grow in stature and gain new responsibilities, they can sketch similar patterns in the way they tackle business challenges and issues. Regardless of their differences, what unites them is the key role they play within and for their company.

Ultimately, it all comes back to the same critical issue that sits at the top of their agenda: how to add value to the business? [▶](#)

## The CFO role now requires incumbents to focus on what matters both inside and outside of the field of pure finance and gain an understanding of the company's business model and industry.

### The 1,000 faces of CFOs

A CFO's responsibilities go well beyond financials alone to span an ever-widening range of topics.

In addition to traditional accounting, supervision and reporting, CFOs now also play a crucial role in the organization and operational setup of the finance function, the training and management of their teams, IT systems selection and implementation, identification of risks and implementation of mitigating measures, and controls for finance and accounting activities.

They and their team are involved every time a corporate project is launched to provide an accurate financial analysis of the impact these initiatives will have on the business. It goes without saying that other examples of this shift will come to mind as you read this.

The broadening and diversification of areas of responsibility and scrutiny require new skills beside the old-fashioned (and now insufficient) analytical mindset and a "love for figures".

The CFO role now requires incumbents to focus on what matters both inside and outside of the field of pure finance and gain an understanding of the company's business model and industry.

Strong leadership skills have become necessary for CFOs as their role and responsibilities continue to expand.

### The 4 roles of CFOs

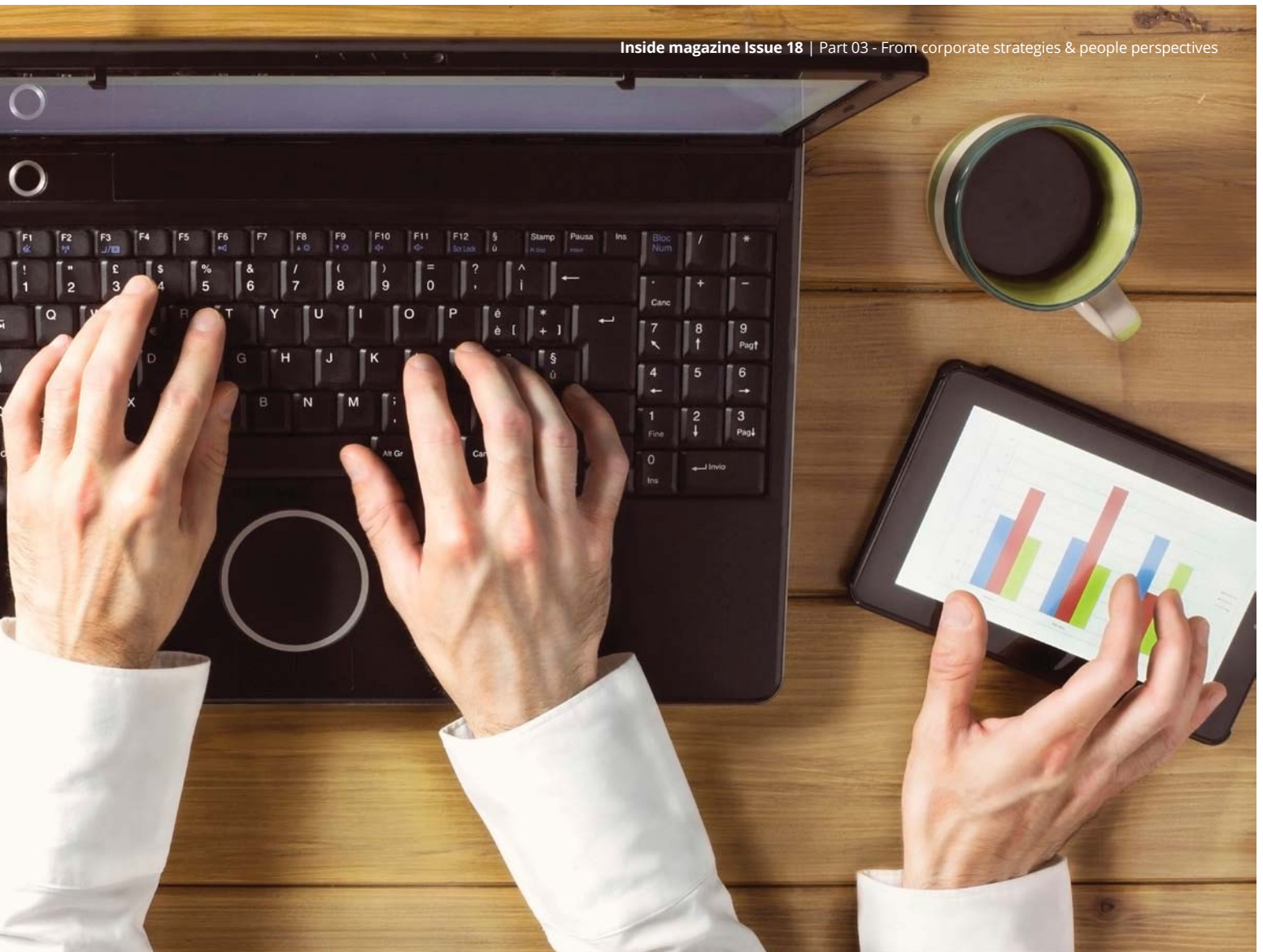
Regardless of their differences, their responsibilities are what make CFOs part of a common club. These responsibilities stem from four main roles: operator, steward, catalyst, and strategist.



### 01. The role of operator is the cornerstone of the finance function

It requires the balancing of capabilities, talent, costs, and service levels to ensure that the finance function is performing its core responsibilities and duties effectively. To that end, CFOs must ensure that finance and accounting organization, processes, and operational activities are in place and allow attention to be focused on value-added activities.

Typically, this encompasses duties such as developing the finance operating model and talent management processes and keeping these up to date as the business model and environment evolve, while ensuring that they remain effective and efficient. The aim here is to allocate limited human and IT resources so as to drive the greatest return on investment while managing risk.



Thus, the management, development, and training of finance talents and profiles are key aspects of this element of CFOs' role as they seek to ensure that the finance function's structure and activities are adequate and sustainable in the context of the business, competitive, and legal environments.

This role, often perceived as a necessary evil, has the potential to become a competitive advantage for best-in-class finance departments. Nevertheless, it is a must to ensure that enough time and resources are allocated to the other roles of CFOs and their team.

**02. CFOs must be the steward that ensures accuracy and provides insight on the strength of the business**

In this role, CFOs focus on upstream activities and factors that may adversely

affect the timely and reliable production, analysis, and disclosure of financial figures and information. The goal should be to manage business complexity while minimizing operational risk linked to finance and accounting activities and initiatives.

This leads to increased scrutiny on areas such as information and data quality, management of risks and controls and—depending on the company's footprint and activities—on the implementation of robust and streamlined processes and the enforcement of procedures across multiple locations and operations (markets, businesses, local and global finance activities, etc.).

This will enable finance functions to safeguard the critical assets of the organization and allow for accurate reporting of financial positions and

operations to both internal and external stakeholders.

This wide span of control requires CFOs to regularly assess and ensure the alignment of the finance function's activities and organization with new accounting standards (such as the new IFRS 9, 15 and 16) and increasingly granular and extensive regulatory requirements (such as FinRep, CoRep, BCL, and country-to-country reporting).

**03. CFOs and their teams act as a catalyst for the emergence and protection of the financial culture within the organization**

CFOs foster behaviors across the organization in order to achieve strategic and financial objectives while at the same time creating a risk-intelligent culture. ➔

CFOs now serve as people-managing, technology-fluent, risk-assertive, and business-driven financial coaches and mentors to internal stakeholders, and key contacts for external parties and investors. The main pitfall for CFOs is the lack of focus that may result from this evolution.

CFOs serve as the business partners of other executives such as sales, production, risk, information technologies and infrastructures, legal, etc. They (or their team) also have to liaise with professionals from their own department to explain the main concepts at stake within finance and their impact on or from their activities, and to coach them during projects and business initiatives.

From an operational perspective, this requires the implementation of a process to define optimal targets and to measure the performance of business activities and strategic initiatives through a balanced scorecard and/or KPI framework disclosed to, and adapted to, the various internal stakeholders.

It also requires CFOs to ensure optimal business alignment so as to successfully identify, evaluate, and execute strategies by partnering with senior management to gain a competitive advantage over competitors as well as optimized investor relationships and interactions with regulators and public stakeholders.

#### **04. Ultimately, CFOs should aim to be strategists**

This is where CFOs step into a leadership role: together with their company's senior management, they deliver the financial

information and scenarios used to determine strategic business direction, M&A, financing, and capital market and longer-term strategies.

Decisions stemming from these activities are vital to the future performance of the company as they shape the factors that will put them ahead of and set them apart from competitors. They also affect the very core of the business in which the company is engaged and are in most cases irreversible. Indeed, such decisions are likely to influence major investment and financing decisions (the launch or interruption of new activities related to services, products or markets, acquisitions and joint ventures, diversification of activities, etc.) that result in organizational changes, or even the redefinition of the company's target operating model and structure.

#### **Only 1 focus: bringing added value to the business**

All the roles discussed above are interconnected and often overlapping. CFOs and the finance function do not have the luxury of gradually honing their skills over time—all of these roles are equally vital, and CFOs must excel in each of these areas to remain "best in class". This implies that being a CFO requires a wide array of varied and complementary skills, knowledge, and awareness.

Nowadays, this diverse skillset must be applied to a plethora of new business topics that fall under the responsibility of CFOs and their team: digital finance, GDPR, BEPS, the US tax reform, blockchain, robotic process automation, payments and PSD2, cyber criminality, and the management of professionals from Generation Y.

Admittedly, being a subject-matter expert on finance and accounting topics remains essential. Yet, the role requires more and more competencies not directly linked to figures. CFOs now serve as people-managing, technology-fluent, risk-assertive, and business-driven financial coaches and mentors to internal stakeholders, and key contacts for external parties and investors. The main pitfall for CFOs is the lack of focus that may result from this evolution. They should fight against becoming corporate jacks of all trades but masters of none.

The growing number of topics under the responsibility or scrutiny of the finance function is an ever-increasing concern for CFOs. The more they deal with activities on the fringes of their traditional area of responsibility and the higher the number of stakeholders with whom they interact, the higher the risk of blurring the focus on finance.





### Conclusion

CFOs should stick to the pattern that has made them successful: focus on finance.

This may seem paradoxical and a step backwards, but it is not. Indeed, CFOs should take responsibility for their operations, and the insight and information they provide via financial business figures, and delegate or drop their other ancillary activities or responsibilities (while continuing to oversee them).

In doing so, they will continue to generate added value for their business in an accelerating and ever-expanding business environment. ●

# Contacts

## Editorial committee



**Joël Vanoverschelde**  
Partner – Advisory  
& Consulting Leader  
+352 451 452 850  
jvanoverschelde@deloitte.lu



**Pascal Martino**  
Partner – Digital  
& Banking Leader  
+352 451 452 119  
pamartino@deloitte.lu

Please do not  
hesitate to contact  
your relevant experts  
in the magazine.

## CIO services



**Patrick Laurent**  
Partner – Technology Leader  
+352 451 454 170  
palaurent@deloitte.lu



**Steve Hauman**  
Partner – Technology  
& Enterprise Application  
+352 451 453 352  
shauman@deloitte.lu



**Michael Holzmans**  
Partner – Technology  
& Enterprise Application  
+352 451 453 283  
miholzmans@deloitte.lu



**Jean-Pierre Maissin**  
Partner – Technology  
& Enterprise Application  
+352 451 452 834  
jpmaissin@deloitte.lu



**Hervé Marchand**  
Partner – Technology  
& Enterprise Application  
+352 451 452 292  
hmarchand@deloitte.lu



**Ronan Vander Elst**  
Partner – Technology  
& Enterprise Application  
+352 451 454 322  
rvanderelst@deloitte.lu

## CCO/CISO/CRO/CIA/BOD services



**Laurent Berliner**  
Partner – Risk Advisory Leader  
+352 451 452 328  
lberliner@deloitte.lu



**Roland Bastin**  
Partner – Information  
& Technology Risk  
+352 451 452 213  
rbastin@deloitte.lu



**Eric Collard**  
Partner – Forensic, AML  
& Restructuring  
+352 451 454 985  
ecollard@deloitte.lu



**Thierry Flamand**  
Partner – Insurance Leader  
+352 451 454 920  
tflamand@deloitte.lu



**Stéphane Hurtaud**  
Partner – Cybersecurity Leader  
+352 451 454 434  
shurtaud@deloitte.lu

## CEO & CFO services



**Benjamin Collette**  
Partner – Strategy, Regulatory  
& Corporate Finance Leader  
+352 451 452 809  
bcollette@deloitte.lu



**Jean-Pierre Lequeux**  
Partner – Strategy, Regulatory  
& Corporate Finance  
+352 451 453 598  
jlequeux@deloitte.lu



**Laurent Collet**  
Partner – Strategy, Regulatory  
& Corporate Finance  
+352 451 452 112  
lacollet@deloitte.lu



**Frank Lichtenthäler**  
Partner – Strategy, Regulatory  
& Corporate Finance  
+ 352 451 454 387  
flichtenthaeler@deloitte.lu



**Annick Elias**  
Partner – Strategy, Regulatory  
& Corporate Finance  
+352 451 454 386  
aelias@deloitte.lu



**Pascal Martino**  
Partner – Digital  
& Banking Leader  
+352 451 452 119  
pamartino@deloitte.lu



**Petra Hazenberg**  
Partner – Strategy, Regulatory  
& Corporate Finance  
+352 451 452 689  
phazenberg@deloitte.lu



**Pierre Masset**  
Partner – Strategy, Regulatory  
& Corporate Finance  
+352 451 452 756  
pmasset@deloitte.lu



**Joachim Heukmes**  
Partner – Strategy, Regulatory  
& Corporate Finance  
+352 451 452 037  
jheukmes@deloitte.lu



**Simon Ramos**  
Partner – Advisory & Consulting  
Investment Management Leader  
+352 451 452 702  
siramos@deloitte.lu

## COO & CHRO services



**Basil Sommerfeld**  
Partner – Operations Excellence  
& Human Capital Leader  
+352 451 452 646  
bsommerfeld@deloitte.lu



**Marco Lichtfous**  
Partner – Operations Excellence  
& Human Capital  
+352 451 454 876  
mlichtfous@deloitte.lu



**Michael Cravatte**  
Partner – Operations Excellence  
& Human Capital  
+352 451 454 758  
mcravatte@deloitte.lu



**Arnaud Willems**  
Partner – Operations Excellence  
& Human Capital  
+352 451 453 309  
awillems@deloitte.lu



**Pascal Eber**  
Partner – Operations Excellence  
& Human Capital  
+352 451 452 649  
peber@deloitte.lu



**Michael JJ Martin**  
Partner – Forensic, AML  
& Restructuring  
+352 451 452 449  
michamartin@deloitte.lu



**Jean-Philippe Peters**  
Partner – Business Risk  
+352 451 452 276  
jppeters@deloitte.lu

### Financial Industry Solutions



**Vincent Gouverneur**  
Partner – Financial Industry  
Solutions Leader  
+352 451 452 451  
vgouverneur@deloitte.lu



**Sylvain Crepin**  
Partner – Financial Industry  
Solutions  
+ 352 451 454 054  
screpin@deloitte.lu



**François-Kim Hüge**  
Partner – Financial Industry  
Solutions  
+352 451 452 483  
fkhuge@deloitte.lu



**Lou Kiesch**  
Partner – Financial Industry  
Solutions  
+352 451 452 456  
lkiesch@deloitte.lu



**Xavier Zaegel**  
Partner – Financial Industry  
Solutions  
+352 451 452 748  
xzaegel@deloitte.lu

### Audit & Assurance



**Christiane Chadoeuf**  
Partner – Audit  
& Assurance Leader  
+352 451 452 065  
cchadoeuf@deloitte.lu

### Tax



**Raymond Krawczykowski**  
Partner – Tax Leader  
+352 451 452 500  
rkrawczykowski@deloitte.lu

### Banking



**Pascal Martino**  
Partner – Digital  
& Banking Leader  
+352 451 452 119  
pamartino@deloitte.lu

### Deloitte Private



**Pierre-Jean Estagerie**  
Partner – Deloitte Private  
Industry Leader  
+352 451 454 940  
pjestagerie@deloitte.lu

### EU & Supranational



**Jean-Pierre Maissin**  
Partner – EU & Supranational  
Industry Leader  
+352 451 452 834  
jpmassin@deloitte.lu

### Insurance



**Thierry Flamand**  
Partner – Insurance  
Industry Leader  
+352 451 454 920  
tflamand@deloitte.lu

### Investment Management



**Vincent Gouverneur**  
Partner – Investment  
Management Industry Leader  
+352 451 452 451  
vgouverneur@deloitte.lu

### Large and Listed Industry



**Bernard David**  
Partner – Large & Listed  
Industry Leader  
+ 352 451 452 799  
bdavid@deloitte.lu

### LaCo Industry



**Christophe de Sutter**  
Partner – LaCo Industry Leader  
+352 451 453 503  
cdesutter@deloitte.lu

### LSCP Club



**Benjamin Lam**  
Partner – LCSB Club Leader  
+352 451 452 429  
blam@deloitte.lu

### Non FSI



**Georges Kioes**  
Partner – Non FSI Leader  
+352 451 452 249  
gkioes@deloitte.lu

### Private Equity



**Nick Tabone**  
Partner – Private Equity  
Industry Leader  
+352 451 452 264  
ntabone@deloitte.lu

### Public Sector & Healthcare



**Luc Brucher**  
Partner – Public Sector  
& Healthcare Industry Leader  
+352 451 454 704  
lbrucher@deloitte.lu

### Real Estate



**Lize Griffiths**  
Partner – Real Estate  
Industry Leader  
+352 451 452 693  
lizgriffiths@deloitte.lu

### SME



**Jean-Philippe Foury**  
Partner – SME Industry Leader  
+352 451 452 418  
jpfoury@deloitte.lu

### Technology, Media and Telecommunications



**David Osville**  
Partner – TMT Industry Leader  
+352 451 452 941  
dosville@deloitte.lu

Our expert authors, who are brimming with excitement about these disruptive topics, have written articles to help decision-makers to apprehend the new paradigms—if not to understand them all.

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