Covid crisis: Are efforts up to the mark? Optimisation versus turnaround of the French Retail Banking Industry

Analysis of French Retail Banks' profitability in 2020

April 2021

Alvarez & Marsal

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Contents

Covid crisis: Are efforts up to the mark?
Optimisation versus turnaround of the French Retail Banking Industry

Executive Summary (1/2)

Alvarez & Marsal has been conducting a comprehensive analysis of French Retail Banks profitability for 3 years, confirming that the economic model is under pressure, emphasized by the effects of the Covid crisis. This study is based on the 2020 results of French Retail Banks.*

Losses of revenues have continued and accelerated (- € 1.5 billion, down 3% compared to last year) with a cost of risk that more than doubled (+ € 3.8 billion additional provisions, +121%) ; in the same time, expenses have only decreased by €1 billion (-2%)… Cost out efforts are real, but still insufficient to maintain the profitability of French Retail Banks; as a result, the sector's cost/income ratio stagnated at 70% and net operating income collapsed by 29%, down €4.4 billion from last year.

In this context, a key challenge for French Retail Banks is to move from a model optimisation to a turnaround logic, through four key points.

1. The pressure on the retail banking business model is confirmed and is intensifying

- The profitability deterioration of interest margin products has been ongoing for several years: with mortgage loan rates that have decreased by 13.6% per year on average since 2015 and outstanding loans that have increased by 6.3% per year, the income/asset ratio declined from 2.9% to 2.0% (-7.2% / year). Similarly, in the context of the massive issuing of State-guaranteed loans (€130 billion), institutions have committed themselves to limit interest rates and fees.
- Additional threats have appeared or are being confirmed: online banks increasing their customer base are spreading the (false) impression that basic banking services are for free, increased competition (fintechs, GAFAs), ESG (environmental, social and governance) criteria that are gaining more and more weight in clients' investment choices (leading to a commercial risk), inclusion of the most fragile clients by limiting commissions on payment incidents, changes in consumption habits (e-commerce) leading to jeopardizing historical revenues for traditional banks, etc.
- As an illustration, the digital shift in consumer usage can potentially impact retail banking revenues by more than €1 billion (acceleration of the changeover of payments from traditional banks to e-merchants' PSPs would deprive banks of commissions, and development of split payment actors gaining market shares to consumer credit and overdraft traditional actors).

2. After having massively increased in 2020, banks must anticipate a very likely cost of risk stabilization instead of reversal of provisions

- After a steady decline since 2015 in provisioning levels (the cost of risk/outstandings ratio decreased from 26 bp in 2015 to 17 bp in 2019), the massive provisioning in 2020 is more akin to a return to normal with a cost of risk/outstandings of 33 bp.
- Short-term unemployment schemes, large number of aids for individuals and measures for businesses (guaranteed loans, moratoria, aid, tax deferrals) have avoided massive bankruptcies in 2020 for both retail clients and SMEs. As proof, the number of bankruptcies in 2020 is below the 2019 level by about 37%. For this reason, the cost of risk rise is almost exclusively due to anticipation ("forward-looking") and not to proven risks. Beware of the (sudden or gradual) stop of the aids, which could cause the cost of risk to explode, with little room for manoeuvre for the banks given a 70% cost/income ratio!
- So how to manage this impact in the coming years? The regulator is extremely attentive to these loans, which are described as "non-performing" (Non Performing Loans – NPL), and whose increase immediately raises the alarm. Historically, French banks have never (or in very small proportions) sold these lesser-quality loans portfolios, whereas in other European countries (Spain, Italy in particular) divestments can be massive to relieve regulatory pressure as well as the very high capital cost. In the absence of divestments, the cost of risk will continue to be borne by French banks with the induced capital impact.

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* Crédit Agricole, Caisse d'Epargne, Banques Populaires, Crédit Mutuel, Société Générale, BNP Paribas, LCL

Covid crisis: Are efforts up to the mark?
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Executive Summary (2/2)

3. The costs reduction initiatives must be massive and long-term oriented to – at least – return to 10-years-ago profitability levels

- In the past two years, retail banks have implemented savings of €1 billion in 2020 (-2% compared to 2019). It partially offset the loss of revenues and the increase in provisioning at €4.4 billion (instead of 5.4 billion). However, banks has not communicated on the sustainability of these savings: are these effects linked to the crisis (wage cuts in the case of partial unemployment, empty premises during successive lockdowns, etc.) or will they be maintained in the coming years?
- Moreover, the ambition of cost reductions, whether recorded or announced by banks this year, are not yet up to the challenge, especially given the strong social pact in a sector that is otherwise dominated by mutual banks. Cost/income ratios are among the highest in Europe, at 70%, and have been stable for several years, despite efforts initiated by all banks. So, how much room remains for credit risk and profitability to additionally finance investments, particularly digital ones? A fall of cost/income ratio by 10pt to reach 60% would offset 2020 revenue losses and credit risk increase.
- More ambitious cost reductions for retail banks is bound to require more significant downsizing, with staff costs accounting for more than half of the cost base. Between 2012 and 2019, “only” 16,000 jobs have disappeared (based on AFB data), a decrease of 7.5%... By comparison, Spanish banks cut 120,000 jobs between 2008 and 2020 and will not stop there. Over the next two years, they have planned to launch massive downsizing plans (more than 20,000 job cuts, above 10%) and network “rightsizing” plans (more than 25% of agencies).
- Will the economic model be sustainable in the coming months in a context of cost of risk evolution and threats on revenues? Additional efforts will be a challenge but must be done even if the social pact is to be jeopardized in a context where age pyramid and natural flows will be less and less favourable.

4. What are the future challenges for the retail banking model: optimisation or turnaround ?

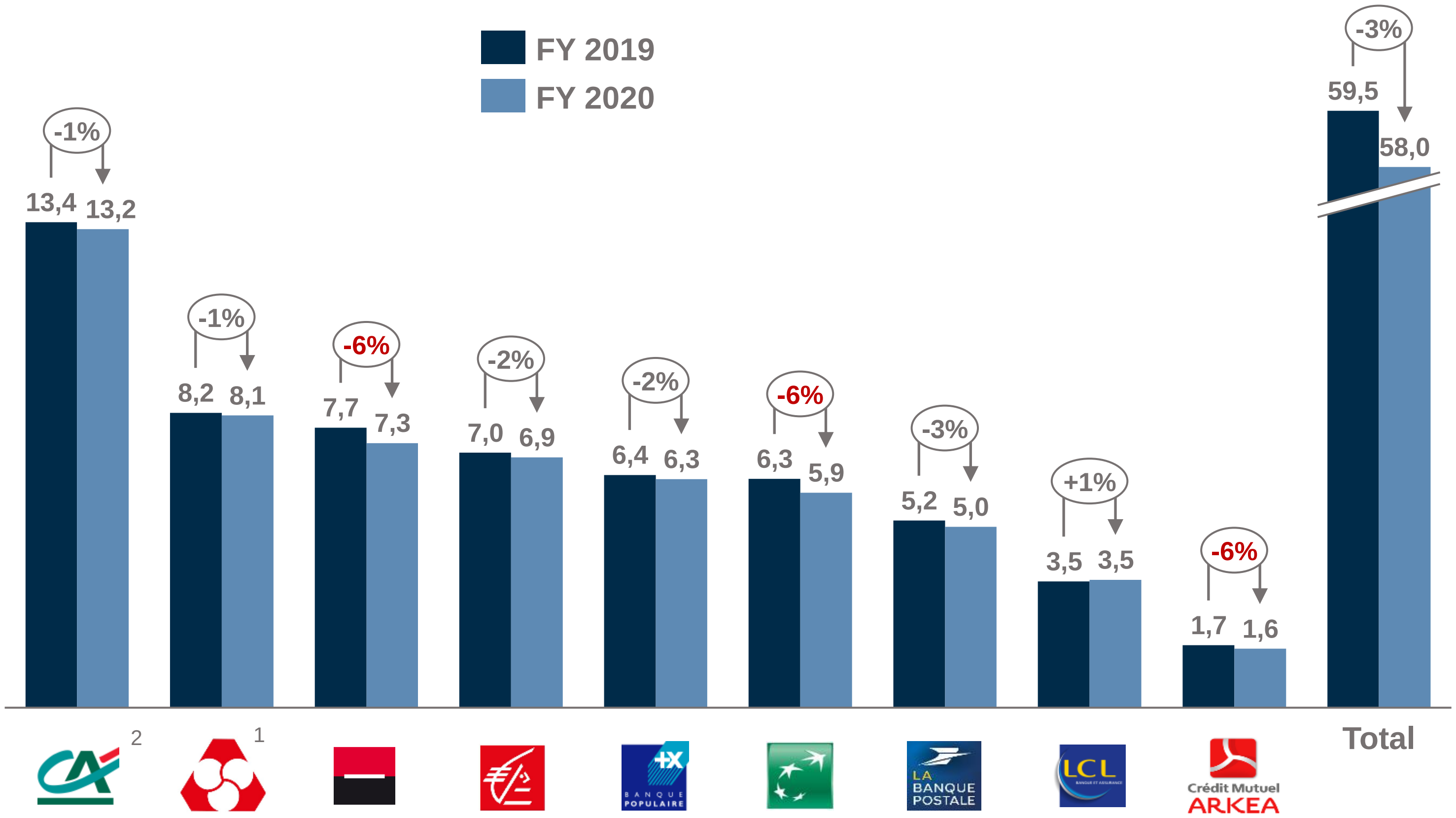
- In this tough environment, banks must transform their model. Several major projects must be amplified, accelerated or simply initiated: (i) full potential for intra-group pooling, (ii) joint approaches between institutions, (iii) further outsourcing.
- For illustrative purposes:
  - Network of branches: accelerate ongoing rationalization, and anticipate, through the rise of millennials, a model where branches will be a marginal place of contact, mutualisation of branches between networks…
  - Back offices: further develop outsourcing with development of credible servicing providers on all or part of the value chain (e.g. servicing of real estate loans, recovery)
  - Support functions: full potential of work-from-home to decrease occupied surfaces, optimisation of compliance functions and risks through the intensive use and development of technology and tools
  - IT: in line with outsourcing and the maturity of market service providers (software package), sharing of platforms between institutions, leveraging of the technology of intra-group online banking platforms to generate more scale effects in an industrial logic
  - Product offer: rationalization of the offer (simplification like low cost approach)
  - Financial Management: proactive approach in the sale of Non Performing Loans (NPL)

Analysis of EoY 2020 FRB Financial Statements

Overall, revenue loss is accelerating, decreasing by almost 3% mostly due to the impact of the health crisis on SMEs and Midcaps

Universal model banks more exposed to corporates faced more losses than mutualists ones

Comparison of FRB's NBI: 2019 vs 2020 ***(EUR bn)***

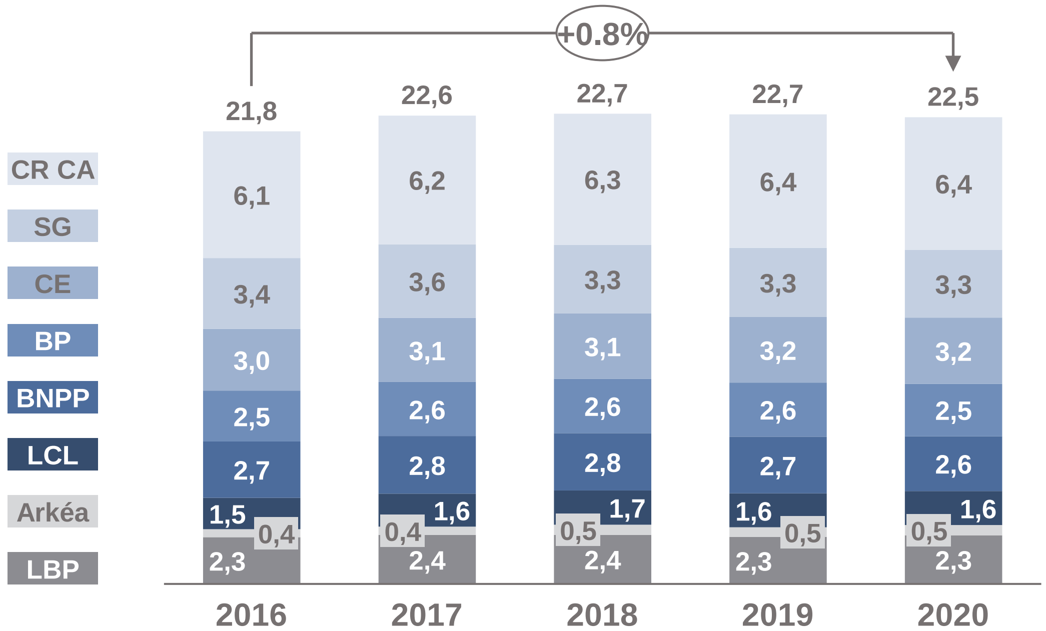


- Heterogeneity amongst peers can be induced by the difference of **proportion of corporate customers within client base** (facing more difficulties due to successive lockdowns and restriction measures which lowered transaction volumes):
- **BNPP and SG and are more exposed to SMEs and Mid-caps than others** (other banks are highly exposed to professionals and micro-businesses).
- The NBI[3] split between NIM and net commissions did not significantly change during FY 2020: 54.5% of NIM and 45.5% of Net Commissions

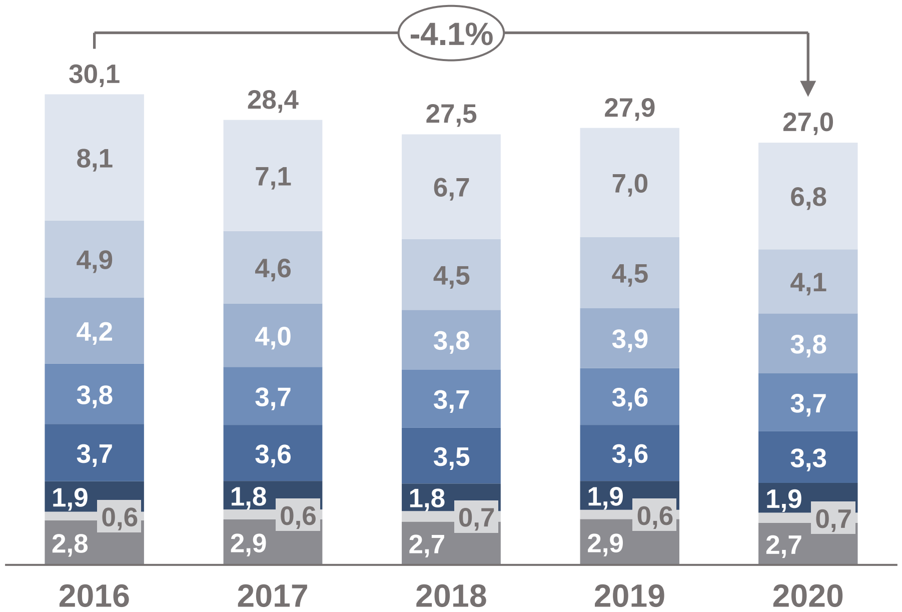
(1) Crédit Mutuel Alliance Fédérale; (2) Crédit Agricole Caisses Régionales; (3) Excluding Crédit Mutuel Alliance Fédérale and items other than net interest margin and net commissions

This drop in NBI is due to the decline in NIM (continuous decline of interest rates) not offset by commissions which have also decreased in 2020

Revenues from commissions[3] (€bn)



Revenues from NIM[3] (€bn)



- Decrease in commissions in 2020 especially related to the cap on payment incident fees[1] for financially fragile individuals (due to the health crisis).
- This cap further penalizes retail business, which had already suffered from successive caps between 2007 and 2014:
  - Capping of overdraft fees[2] as of 2014.
  - Capping of commissions applicable to payment incidents (cheque or direct debit rejection) as of 2007.

- The share of NIM in NBI[4] continues to decline and is close to 54% on average (compared to almost 58% 4 years ago).
- This decline in NIM is due to **persistently low interest rates combined with a flattening of the yield curve.**
- **Decrease in NIM not offset by the increase in loan outstandings (excl. State-Guaranteed Loans for which banks commit to limit the cost for their clients).**

Sources: annual reports, financial presentations, A&M analyses
(1) Since November 1, 2020, financially fragile people (private individuals) have benefited from a cap on payment incident fees of €25 per month for a period of 3 months (2) Capping of overdraft fees for private individuals not acting for professional purposes; (3) Excluding Crédit Mutuel Alliance Fédérale and items other than net interest margin and net commissions

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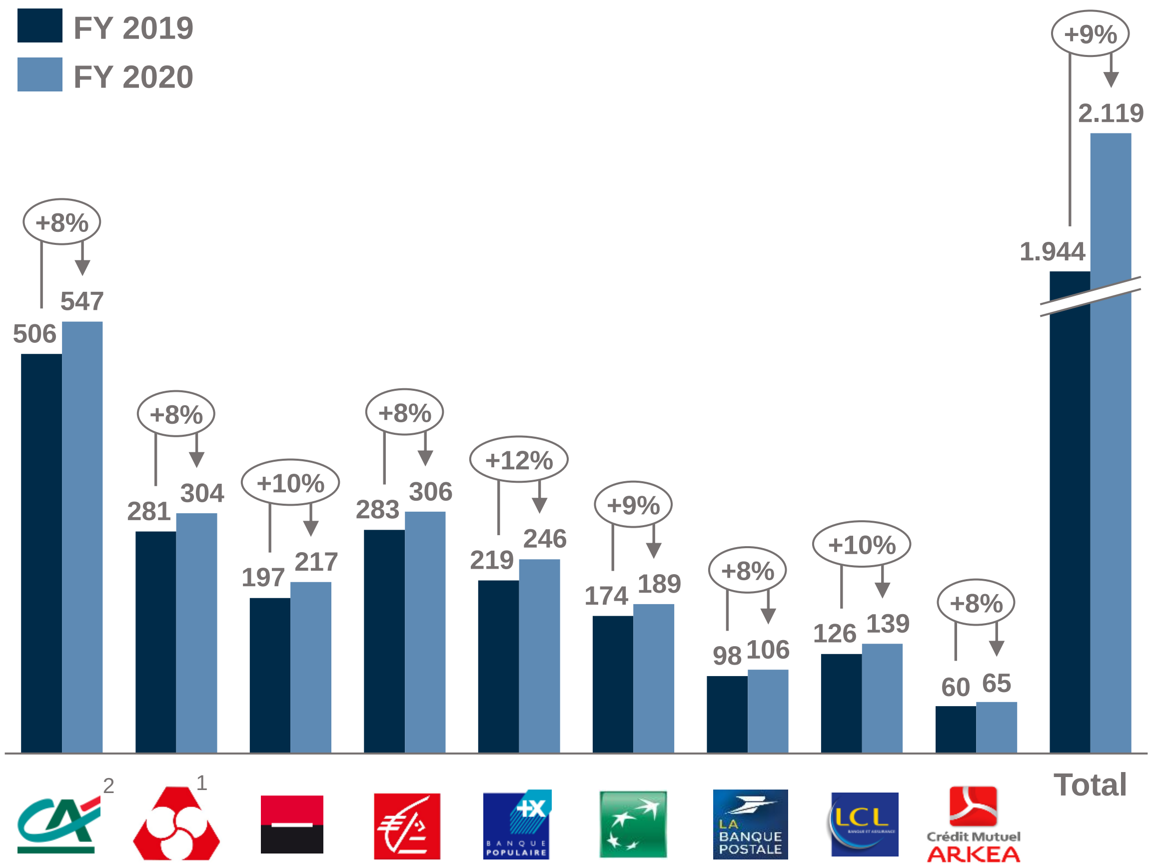
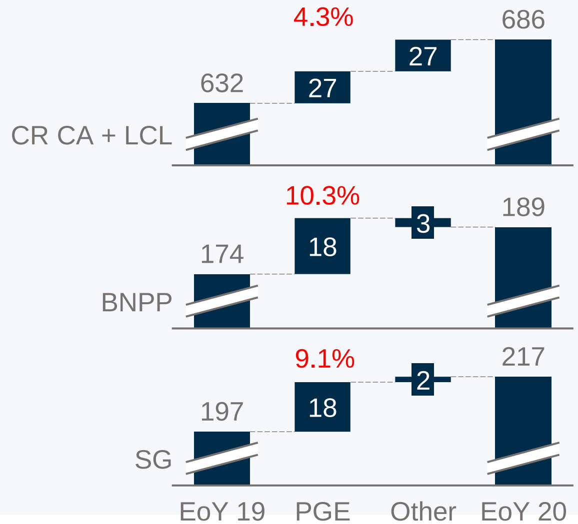
In 2020, the business was driven by a large 9% increase of loans exposures, notably due to the increase of guaranteed loans

All FRB faced similar increase in the panel, largely driven by the EUR 129 bn guaranteed loans

Comparison of FRB's loan exposures[5]: 2019 vs 2020 *(EUR bn)*



- **Large proportion of the increase is due to guaranteed loans** weighing almost EUR 129 bn at EoY 2020, for an initially planned budget of EUR 300 bn
- The increase in loans outstanding is **in line with the trend of the past few years**: in this context of **health crisis**, the loans normally taken out by companies (investment loans for most of it) have been **exceptionally and partly replaced by SGLs[3]** (acting as operating loans) to avoid bankruptcies. At the same time, the **NIM[4] has been steadily declining** under the influence of low interest rates.
- Examples of PGE ponderation in loans increase:

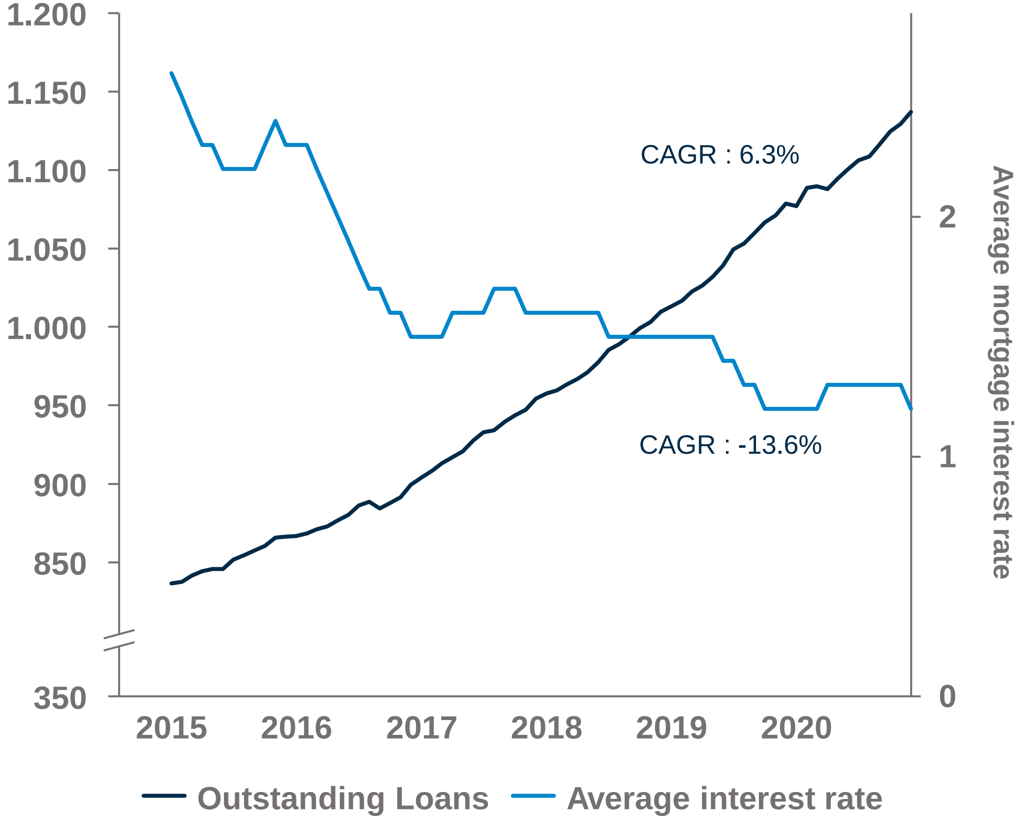


(1) Crédit Mutuel Alliance Fédérale; (2) Crédit Agricole Caisses Régionales; (3) State-Guaranteed Loans; (4) Net Interest Margin; (5) Average of loans outstanding of year n and year n-1

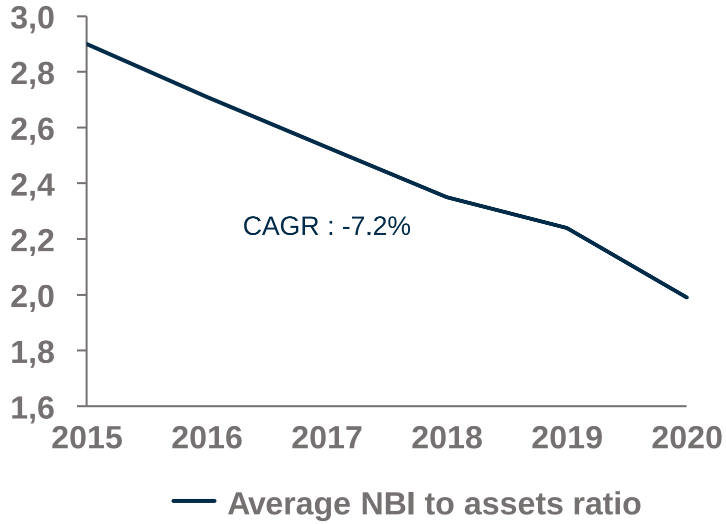
Over the last years, FRB managed to maintain revenues through increased volumes, yet mortgage interest rate fell down which dragged down NBI to assets ratio by 7% / year since 2015

Whilst mortgage interest rates have decreased by 13.6% since 2015, volumes increased by 6.3%

Evolution outstanding mortgage loans & interest rates
(in EUR bn and in %)



Source: *Banque de France*



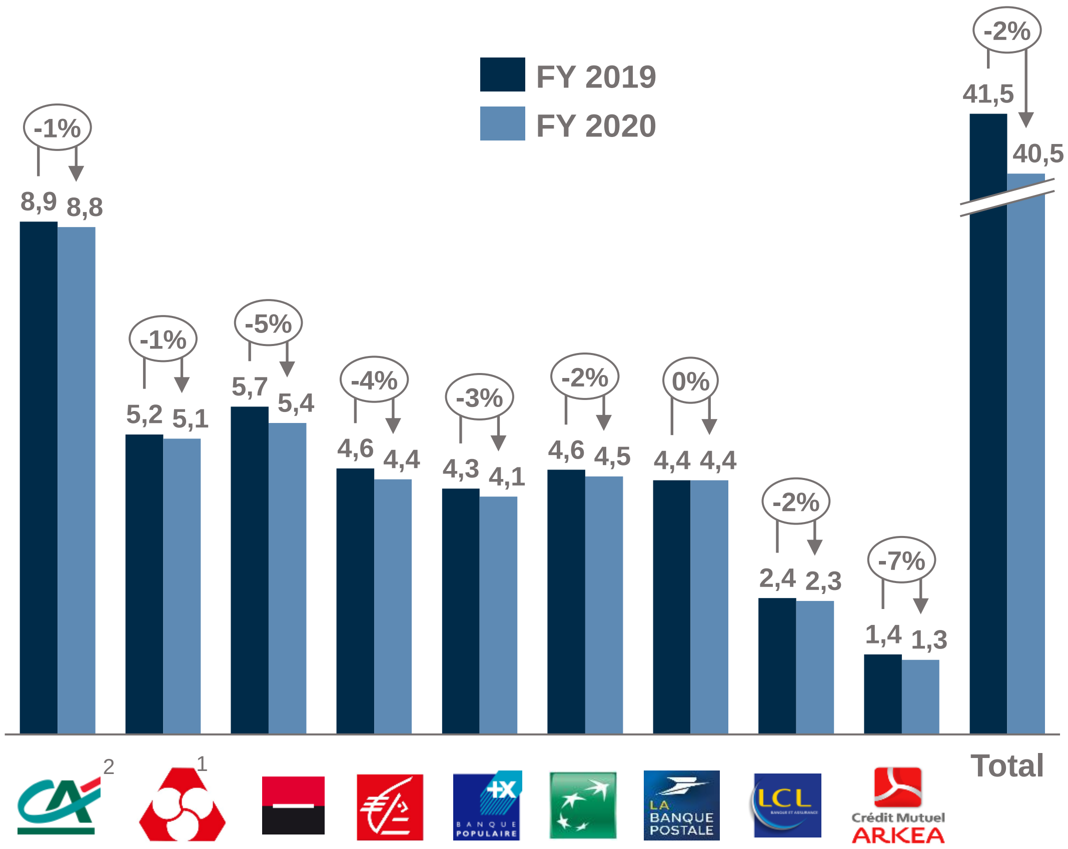
Source: *Individual financial statements, A&M analysis*

- Outstanding mortgage loans have **increased by 5.6% / year since 2010**, and **accelerated since 2015** with an annual **6.3% increase**.
- Meanwhile, **interest rates have fallen by 10.8% since 2010** and similarly **accelerated to reach 13.6%** annual decrease **since 2015**.
- As a consequence the **NBI to assets ratio has fallen from 2.9% in 2015 down to 2% in 2020**.

Operating expenses' decrease by 2% is not enough to offset revenue loss

Almost all banks have developed long-term cost reduction plans

Comparison of FRB's operating expenses: 2019 vs 2020 *(EUR bn)*



- **The decrease in expenses is partly due to the drop in activity** (health crisis), but for many banks, **cost-saving measures have been implemented to generate new sustainable savings**
- BNPP completed its 2020 strategic plan with cost-saving measures that have been revised upwards in 2020, due to the pandemic (EUR 1.4 bn vs EUR 1.0 bn originally announced).
- SG has initiated a cost savings plan of EUR 450 m by 2025, the effects of which will only be felt in 2024.
- BPCE completed its 2018/2020 strategic plan[3] with a cost reduction target of EUR 1 bn (rationalization of its organization & purchases including a reduction of at least 5% in the number of its regional retail banking branches).
- LCL launched a new project to upgrade its network by 2022: closure of almost 250 points of sale (15% of the network).
- CM 2019-2023 strategic plan: increased efforts to share and pool resources + industrialization of AI[5] and OCR[6].
- In 2020, LBP[4] continued its 2023 operational excellence programme: acceleration of digitalization (especially for day-to-day management and customer information) and automation of end-to-end processes. 2030 strategic plan: industrialization of low value-added operations, development of ATMs and selfcare… with the aim of reducing the C/I by 10 pts by 2025.

(1) Crédit Mutuel Alliance Fédérale; (2) Crédit Agricole Caisses Régionales; (3) Including a group program (excluding Natixis) of EUR750m and a EUR250m transformation and operational excellence plan for Natixis; (4) La Banque Postale; (5) Artificial Intelligence; (6) Optical Character Recognition

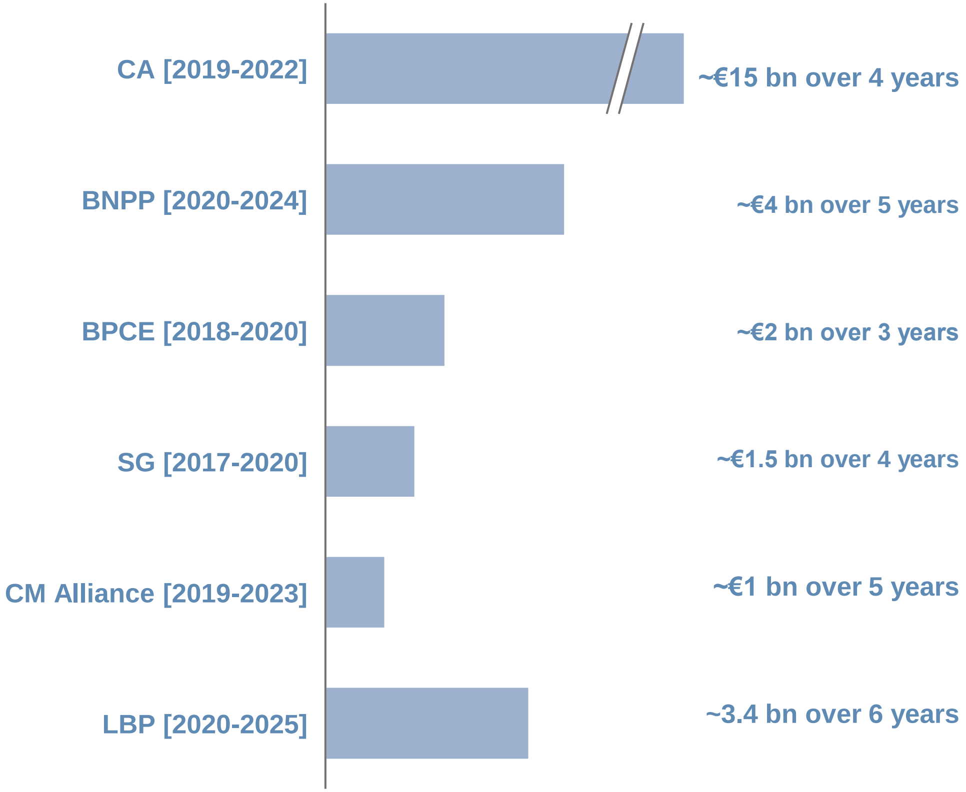
Even if efforts have already been undertaken or announced, banks have to go way further with disruptive measures

	Commercial Network	Operations	Support functions	Financial Management
Measures already initiated or undertaken	▪ Rightsizing of the branches network ▪ Merger of different networks within single banks	▪ Specialization of Ops teams to gain efficiency ▪ Development of IT tools allowing a more efficient treatment of operations	▪ Rationalization of support functions by improving processes and outsourcing / nearshoring when possible	-
Examples of disruptive measures	▪ Limit branches to a minor role of ad hoc contacts with customers to embrace Millenials behaviours ▪ Turn online banks into distribution channel instead of pure banking actors ▪ Full mutualization of ATM network ▪ Rationalization of product range	▪ Further develop outsourcing of operations when providers available ▪ Mutualization of IT costs by sharing platforms with other banks, or using online banks platforms	▪ Mutualization of purchasing functions with other banks (critical size effect) ▪ Further develop work-at-home to minimize occupied surfaces ▪ Streamlining of compliance teams by further developing technological tools	▪ Proactive approach to divest credit portfolios (NPL) to limit regulatory cost of capital

However, cost reduction efforts are not enough to fund investments required to streamline and digitalise FRB

Cumulative annual Investments *(in EUR bn)*

Investment Envelopes – Group level



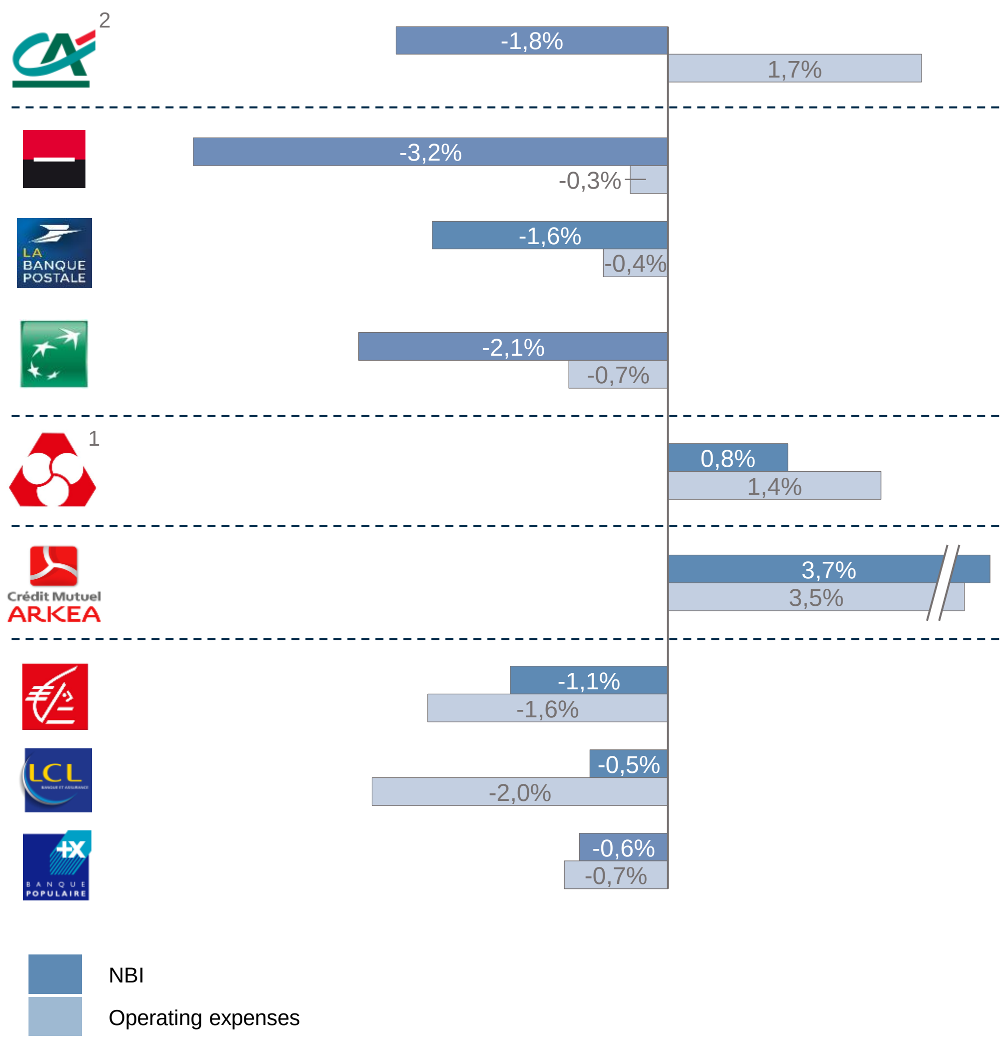
Main investment areas for the FRB

- Digitalisation of banking operations (acceleration of mobile usage & development of self-care functionalities), processes (end-to-end approach) and offer (new relationship, subscription of consumer credit or real estate products)
- Specialization of remote platforms (closing or specialization of Back Offices)
- Optimisation of the network (branch closures or reorganisations, simplification of the steering system)

Note: Group data, the FRB share not being systematically detailed in financial communications
Source: investor presentations and press releases, A&M analyses.
NB: SG and BPCE are about to communicate new strategic plans therefore ambition of investments are not available yet

Profit model of retail banks is still under pressure: revenue decrease is still not offset by cost reduction

2015-2020 CAGR of NBI and Operating Expenses



Increase in operating expenses and decrease in NBI (negative jaw effect)

Decline in operating expenses lower than the decline in NBI

Increase in NBI lower than the increase in operating expenses

Deterioration of C/I ratio

Increase in operating expenses lower than the increase in NBI

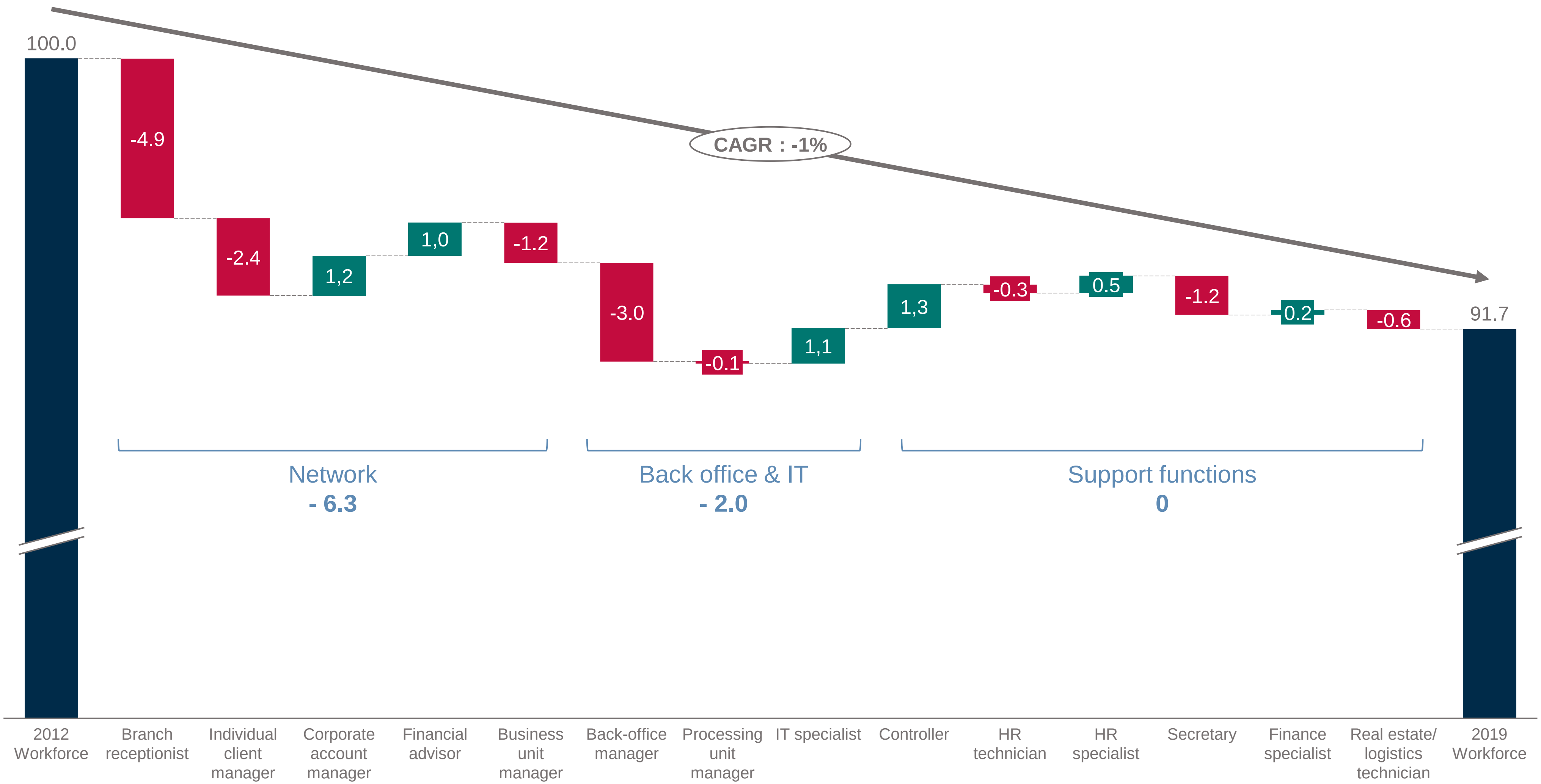
Decline in NBI lower than the decline in operating expenses

Improvement of C/I ratio

Sources: annual reports, financial presentations, A&M analyses
(1) Crédit Mutuel Alliance Fédéral; (2) Crédit Agricole Caisses Régionales

As a consequence, to align efforts with Covid agenda, retail banks will have to go beyond staff adjustment, challenging social pact if necessary

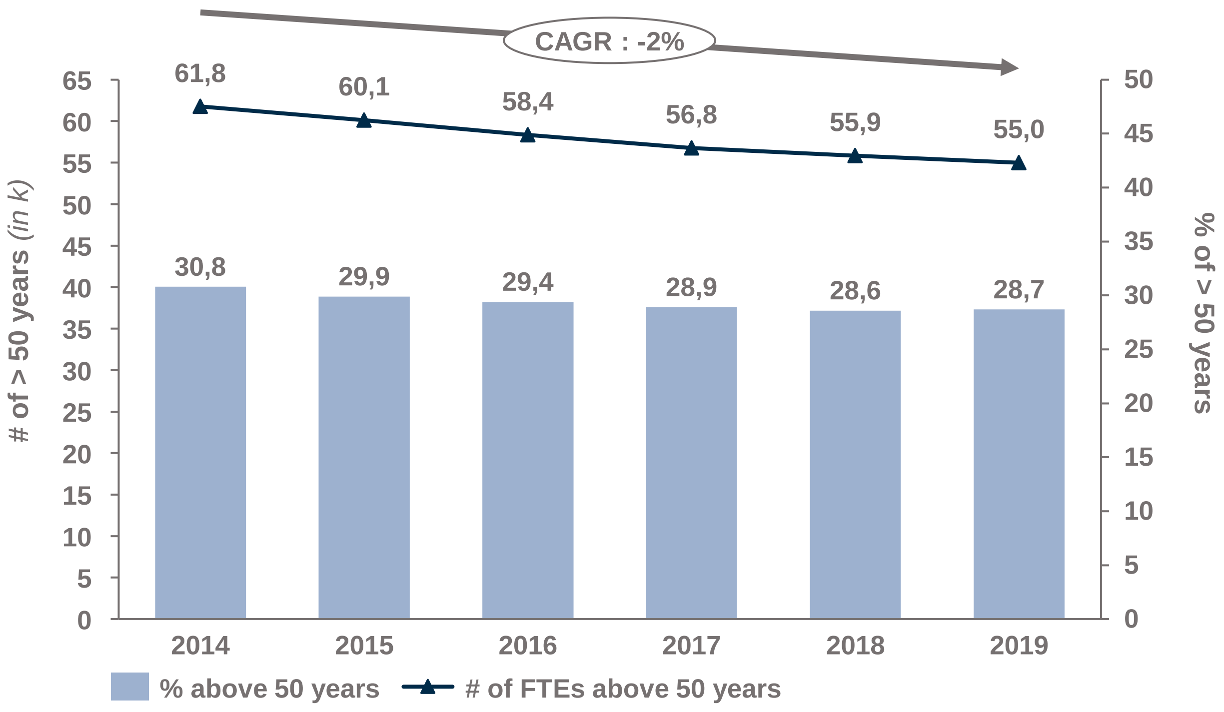
Evolution of retail banking staff (2012-2019, 2012 base 100)



of employees above 50 years has significantly decreased since 2014 from 61.8k to 55k preventing natural attrition to further decrease costs

Yet, turnover rate has increased to reach 12% / year, o/w retirements are weighing 19% only

Evolution of the > 50 years population over 2014 - 2019
(in k FTEs and in %)



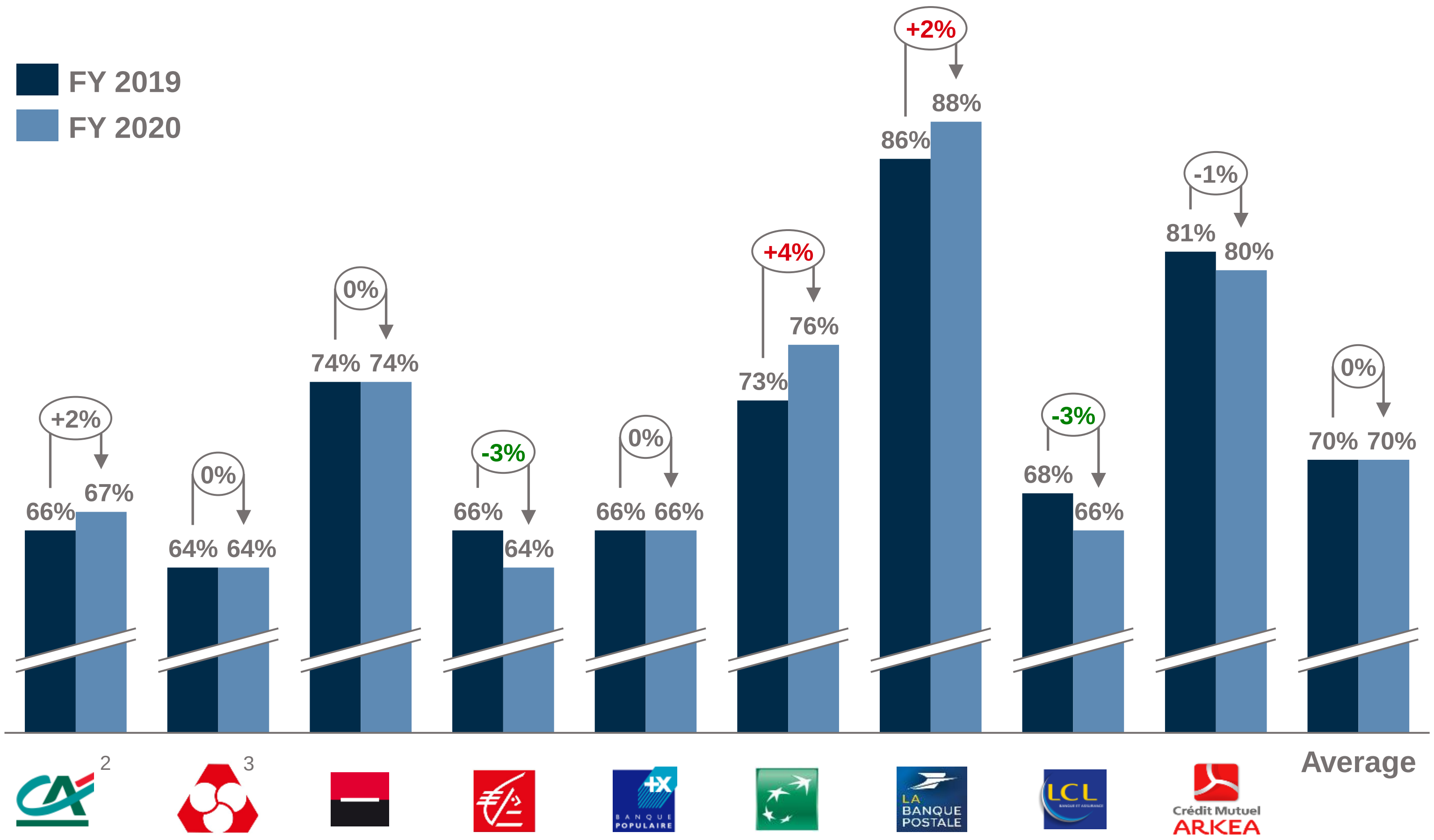
- After several years of large number of retirements, the **proportion of employees above 50 only weighs 28.7%** (- 7% in 5 years) of a decreasing population, leading to a **number of employees above 50 years of 61.8k vs 55k** (-11% in 5 years).
- However, the **turnover rate has increased from 10.1% to 12.3%** in 5 years, o/w the proportion of retirements has felt to 19.2% vs 41.2% 5 years ago.
- As a consequence, the **banks cannot rely on retirements** anymore to generate significant cost reduction and **complementary efforts** will have to be made.

Sources: AFB, A&M Analyses

As a result, the C/I[1] ratio of French retail banks remains high and flat at 70%

The loss of NBI for BNPP and LBP was too important to maintain their C/I ratio that rised by 4pt

Comparison of FRB's C/I ratio: 2019 vs 2020 ***(EUR bn)***

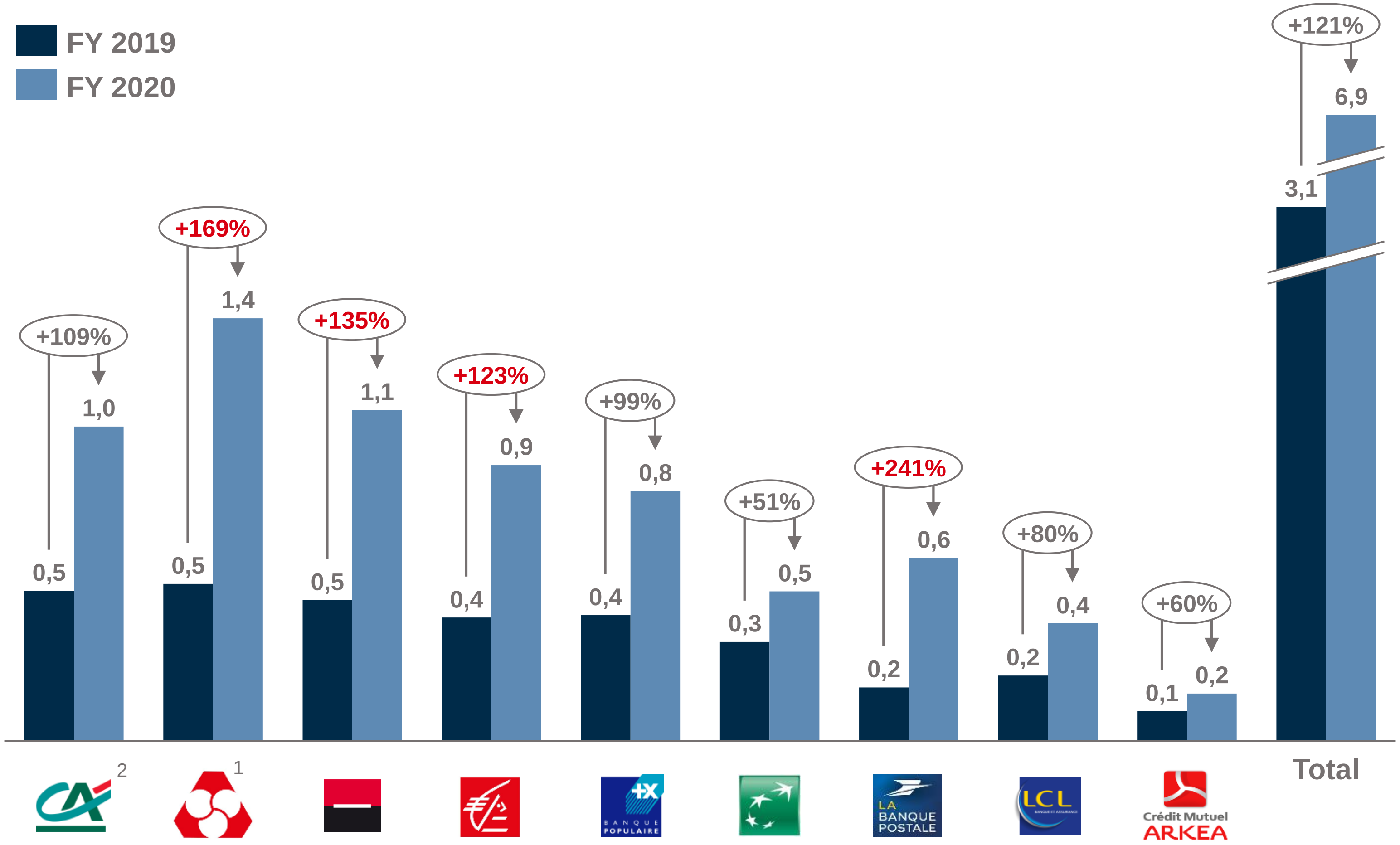


- **BNPP and LBP[4] suffered a large 4pt increase of C/I ratio whilst other peers maintained their ratios** (apart from CE[5] and LCL which decrease their ratios by 3pt).
- **The C/I ratio has been generally stable for several years** but very **heterogeneous depending on the bank** (mutualists vs non-mutualists).

(1) Costs (including depreciation, amortization and impairment of property, plant and equipment and intangible assets) / Net Banking Income
(2) Crédit Agricole Caisses Régionales; (3) Crédit Mutuel Alliance Fédérale; (4) La Banque Postale; (5) Caisse d'épargne

In this context, profit model is more than ever under pressure as immediate impact of Covid crisis results in the doubling of cost of risk

Comparison of FRB's CoR: 2019 vs 2020 *(EUR bn)*

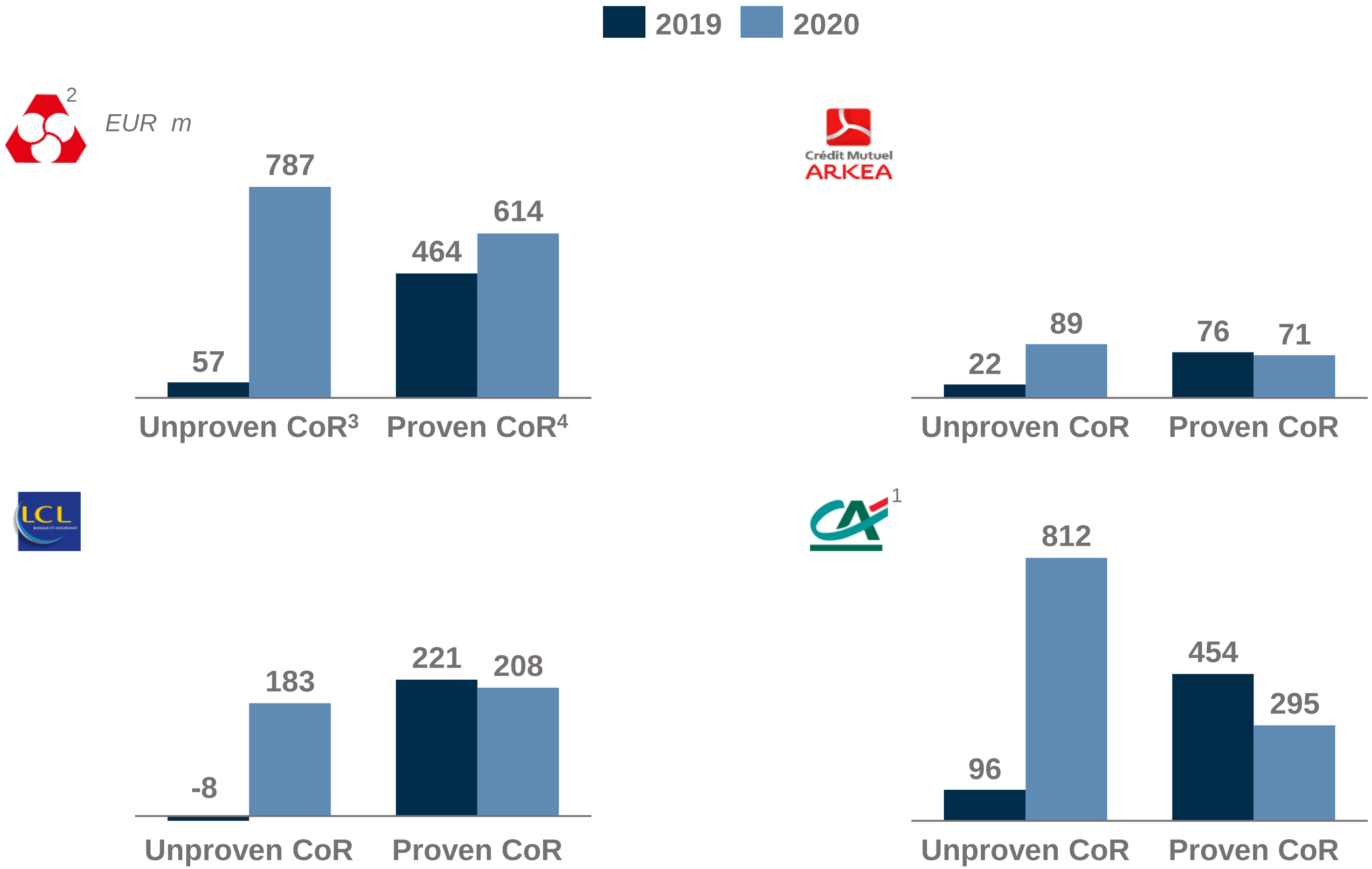


- **Overall increase in the Cost of Risk:** very strong increase in the CoR for La Banque Postale, Crédit Mutuel, Société Générale and Caisse d'Epargne (respectively 241%, 164% 135% and 123% vs 2019).
- Increase contained for BNPP (+51% between 2019 and 2020) and LCL (to a lesser extent).
- **The average CoR in basis points is 33bp for FRB peers (i.e. +98% vs 2019)** with 52bp for SG and 46bp for LBP[3] at the top of the range and 19bp for CA CR[2] at the bottom.

(1) Crédit Mutuel Alliance Fédérale; (2) Crédit Agricole Caisses Régionales; (3) La Banque Postale

This widespread increase in the CoR is linked to a prudent provisioning policy on performing loans

A rising unproven CoR largely due to the deterioration of macroeconomic scenario assumptions



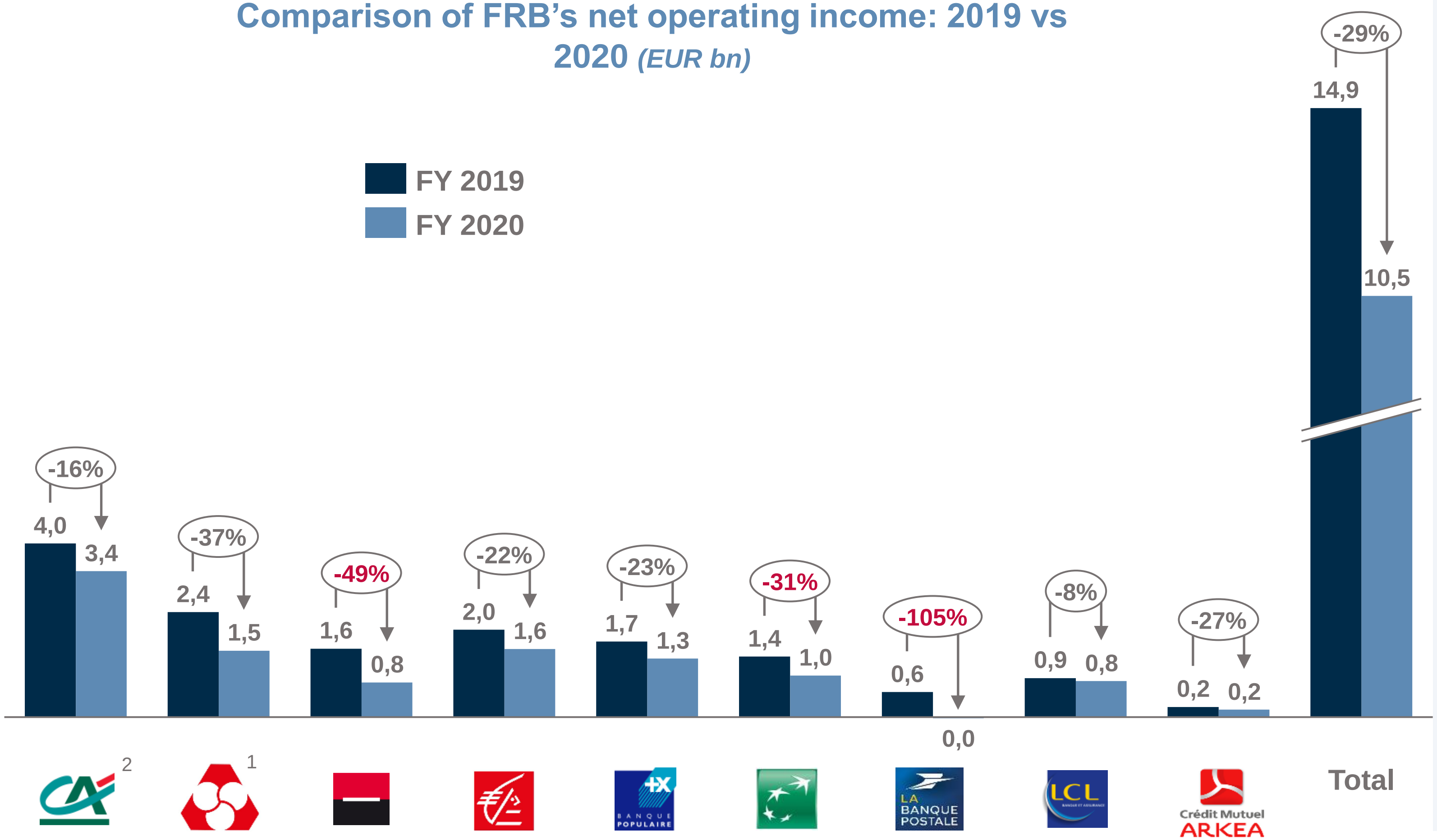
- For all FRB peers, the **increase in the unproven CoR** largely stemmed from the **deterioration of macroeconomic scenario assumptions** (in accordance with IFRS 9).
- For example, at Crédit Mutuel Arkéa, 72% of the increase in the cost of unproven risk is linked to the (pessimistic) updating of macroeconomic scenario assumptions, while only 28% is linked to the deterioration of the credit risk parameters (probability of default and loss given default) of the bank's clients.

(1) Crédit Agricole Caisses Régionales; (2) Crédit Mutuel Alliance Fédérale; (3) Buckets 1 & 2 (Performing Loans); (4) Bucket 3 (Non-Performing Loans)

Thus, FRB net operating income on FY 2020 period shrinked by 29%

The impact for Retail Banking activities of Universal model banks is more important than for mutualist ones

Comparison of FRB's net operating income: 2019 vs 2020 ***(EUR bn)***



- As a consequence, the loss of NBI was partially offset by **the decrease of operating expenses**, however the latter was **not sufficient to compensate for the CoR doubling.**
- Thus, FRB peers will have to **reduce operating expenses in order to compensate for the loss of NBI and the rise in the CoR.**

(1) Crédit Mutuel Alliance Fédérale; (2) Crédit Agricole Caisses Régionales

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Cost reduction effort can be estimated at least above EUR 5 bn for French Retail Bank to keep current profit model

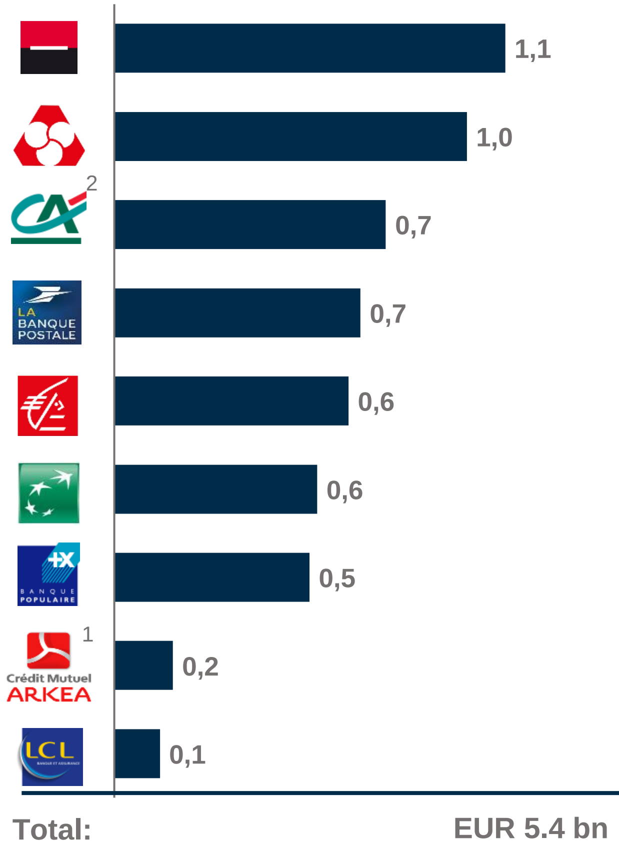
However, the decrease in operating expenses has only been EUR 1 bn in 2020

Decrease of Operating Income *(in EUR bn)*

In EUR bn		Net Banking Income		
		-2%	-4% (-2.6%)	-6%
Cost of Risk	50%	**2.8**	3.9	5.1
	100%	4.3	**5.5**	6.7
	150% (+121%)	5.9	7.1 (5.4)	**8.3**

According to FY 2020 evolution of NBI and CoR, FRB peers banks will suffer **a lower operating income** of **EUR 5.4 bn** (2.6% fall in NBI and 121% increase of CoR)

Breakdown of cost-out need *(in EUR bn)*



Cost-out need (EUR bn)	% of decrease vs 2019 Op. Exp.	Current C/I ratio	Targeted C/I ratio
1,1	-19%	74%	60%
1,0	-18%	64%	52%
0,7	-8%	67%	61%
0,7	-15%	88%	75%
0,6	-14%	64%	55%
0,6	-12%	76%	66%
0,5	-12%	66%	57%
0,2	-11%	80%	70%
0,1	-5%	66%	62%
Total: EUR 5.4 bn	-13%	70%	60%

Sources: annual reports, financial presentations, A&M analyses

(1) Crédit Mutuel Alliance Fédérale; (2) Crédit Agricole Caisses Régionales

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Benchmark of top French Retail Banks and chronological sequence

Analysis of 2020 operating income to assets highlights large heterogeneity amongst FRBs and divergent strategies

BNPP, LCL and CRCA are best in class when Arkea and LBP are the less profitable when considering their assets

CMAF is penalized by higher cost of risk

CE geographic footprint implies low NBI / assets whilst maintaining low costs

NBI / branch for **LBP** suffers from the very large number of branches, as well as from very high CI ratio

LCL enjoys the highest profitability of the panel thanks to high NBI / assets and low costs due to cost reduction measures already undertaken

Bank	NBI / branch (in EUR M)	NBI / assets	Costs / assets	Cost of risk / assets	Op. Income / assets	Cost / NBI
CR CA	2.00	1.77%	-1.18%	-0.14%	0.45%	66.70%
CMAF	2.10	2.21%	-1.41%	-0.38%	0.42%	63.64%
SG	2.94	2.86%	-2.12%	-0.43%	0.31%	74.07%
CE	1.74	1.59%	-1.02%	-0.21%	0.36%	64.13%
BP	2.16	1.79%	-1.17%	-0.23%	0.38%	65.53%
BNPP	3.40	2.91%	-2.20%	-0.24%	0.47%	75.54%
LBP	0.34	1.78%	-1.57%	-0.22%	-0.01%	88.40%
LCL	2.21	2.04%	-1.34%	-0.22%	0.48%	65.56%
Arkéa	3.76	1.55%	-1.24%	-0.15%	0.16%	79.89%
Worst in class	*0.34*	*1.55%*	*-2.20%*	*-0.43%*	*-0.01%*	*88.40%*
Best in class	*3.76*	*2.91%*	*-1.02%*	*-0.14%*	*0.48%*	*63.64%*
Average	*1.51*	*1.98%*	*-1.39%*	*-0.24%*	*0.36%*	*69.85%*

CR CA has a strong territorial grid and its assets have generated low revenues, yet they have a low cost base and risk

SG's profitable assets are impacted by its large cost base and credit risk

BP managed to preserve its profitability thanks to low costs per assets

BNPP's footprint is mainly located in large cities with a strong corporate customer base, generating high revenues (but low risk) per assets, yet dealing with an important cost base

Arkea is mainly focused on corporates, thus best in class regarding NBI / branch. However their assets have a low margin.

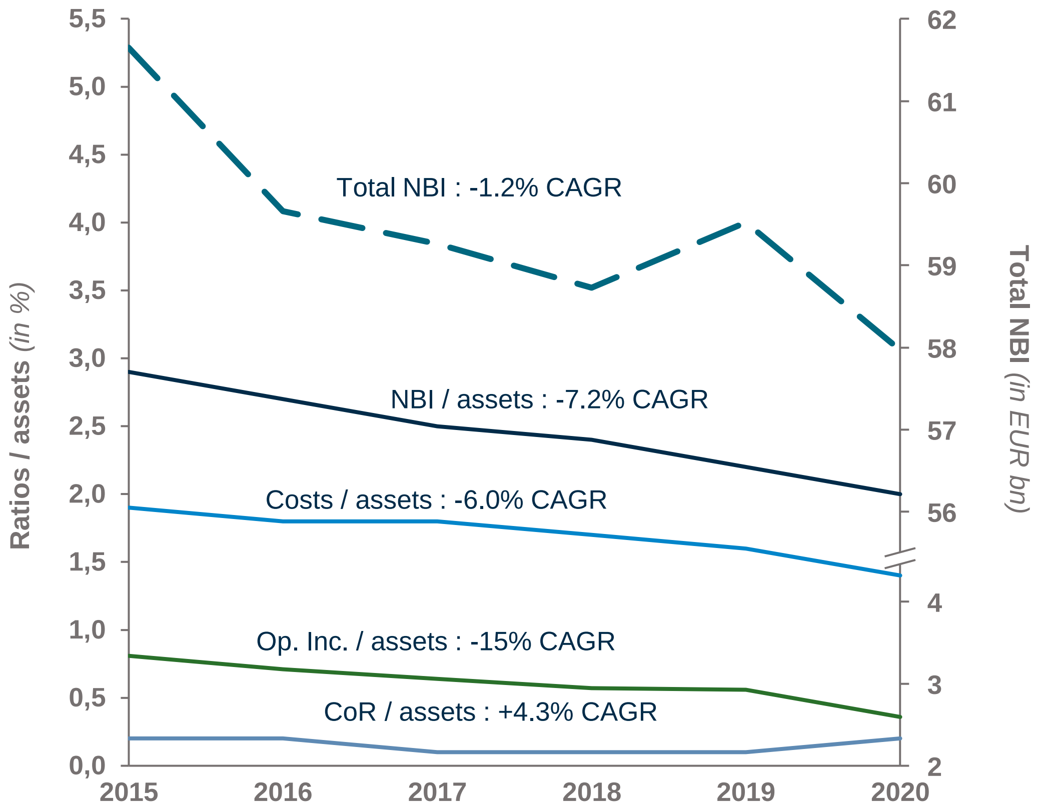
Selected peers

Crédit Agricole · *Crédit Mutuel Alliance Fédérale* · *Société Générale* · *Caisse d'Epargne* · *Banque Populaire* · *BNP Paribas* · *La Banque Postale* · *LCL* · *Crédit Mutuel Arkea*

Sources: FY 2020 figures - annual reports, financial presentations, A&M analyses

Whilst NBI has decreased by 1.2% / yr since 2015, the operating income / assets has plunged by 15% / yr

Profitability has been impacted by the large increase of assets (+6.5% / yr since 2015)

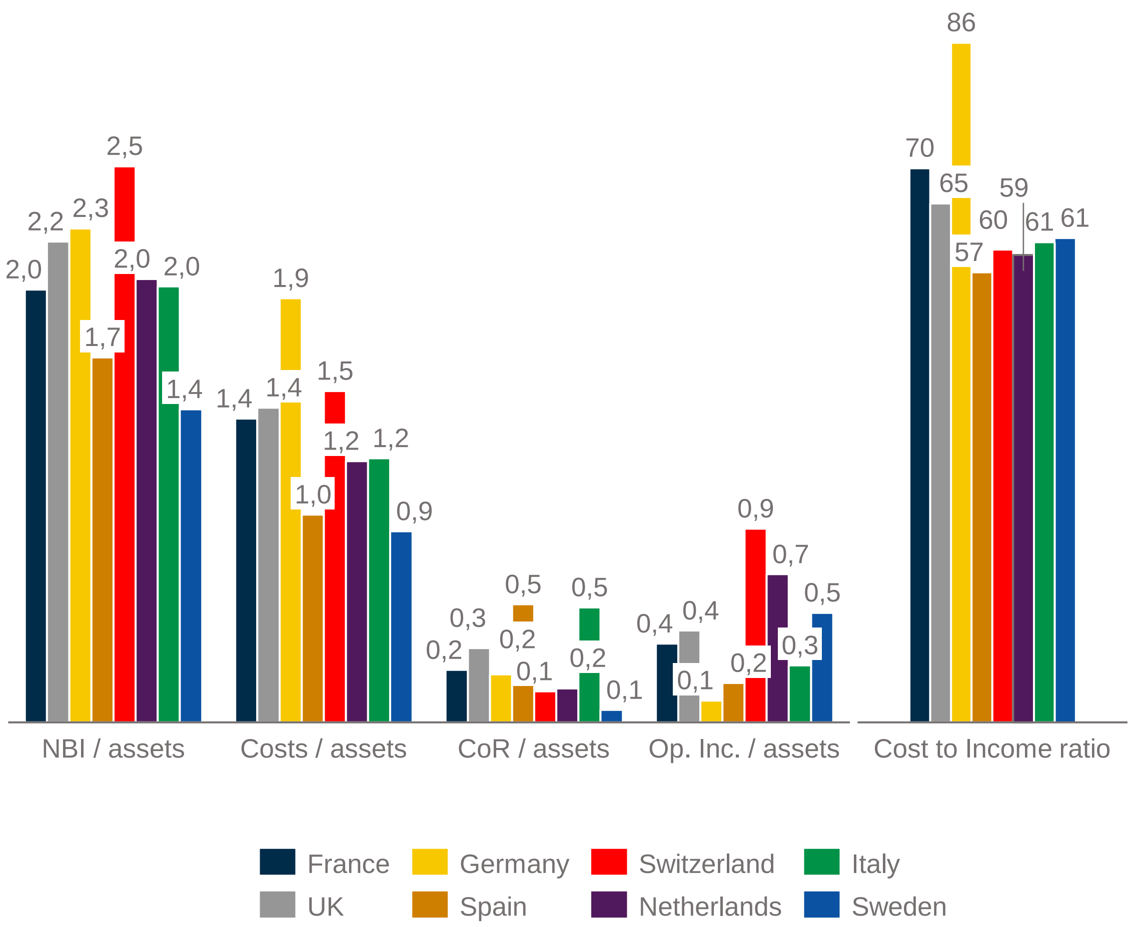


- Total **NBI has declined since 2015** (-1.2% / year) with a large decrease between 2019 and 2020 mainly due to the pandemic (-2.6% YoY).
- In the same time total assets have increased by 6.5% / year, higher volumes compensating ever lower interest rates. Between 2019 and 2020 **increase in volumes has accelerated to reach +10%.**
- As a consequence, NBI / assets have plummeted (-7.2% / year), **with a -11% fall over the last year.**
- In spite of several measures taken by FRB, costs / assets ratio has decreased (-6% / year), yet **those efforts did not offset the revenue decrease.**
- CoR / assets has **doubled in 2020 vs 2019** bearing in mind that it had **continuously decreased between 2015 and 2019** (-11.5%) ; yet, the current level of provisions remains at **quite low level** (33 bp).

Sources: annual reports, financial presentations, A&M analyses

In spite of high C/I ratio, French Retail Banks have preserved their operating income / assets ratio thanks to a lower CoR

Comparison of 2020 main KPIs for European Banks *(in %)*



- UK banks have been beneficiating from **better market conditions on their domestic market** (mortgage interest rates are > 2x than France), **limited costs** in spite of their high labour costs (massive restructuration efforts already undertaken) and low risk (despite bankruptcy risk for 250k SMEs), leading to the **best operating income / assets** ratio amongst peers.
- German Retail Banks have the **lowest operating income / assets** ratio, mostly due to the **lack of profitability of retail banking activity for Deutsche Bank for which retail banking segment is not the priority** (cost to income ratio has reached 93% to be compared to 88% two years ago).
- Due to **massive efforts already undertaken** on cost base and low labour costs, Spanish banks have managed to con**tain their gross operating income**, however they are **strongly impacted by a large Cost of Risk** due to consequences of economic crisis (16% unemployment rate, 40% of Spanish firms are facing strong financial issues).
- Swiss and Netherlands banks **overperform the panel** due to **high revenues / assets** and **lowest costs of risk** whilst **maintaining their costs base**.
- Italian banks are penalised by **high cost of risk** (similar to Spanish Banks).
- If Swedish banks have **relatively low revenues / assets**, they strongly beneficiate from **lowest costs and risks**.

Sources: annual reports, financial presentations, A&M analyses
See selected peers in Appendix 6.

Main risks faced by FRB in the coming years

However several drivers could push for further and accelerated cost reduction initiatives

Most of the risks will affect revenues, and others regulatory capital or cost base

Main risks faced by French Retail Banking

Regulatory
- Cap of banking fees (overdraft, poor clients, refused cheques and direct debits)
- Increasing cost of regulatory framework (IT, people, processes etc.)
- Regulatory costs of Basel IV implementation for standard method approach

ESG
- Recent & strong client awareness on ESG topics and transition to ESG products (commercial risk if not sufficiently anticipated)

Macro-economic context
- Low interest rates compromising NMI (rates halved in 5 years, historical low, no increase expected in short to medium term)

Competition

New pure banking competitors
- Increasing competition from Fintechs / Insurtechs and increasing role of GAFA 's in financial services
- Increasing market shares of neobanks that disseminate the idea that basic banking services are for free

E-commerce
- Increasing cash-flow capture and revenues for PSP instead of FRB (up to EUR 700 M)
- Increasing substitution of personal credits by BNPL (c. EUR 400 M)

Focus on e-commerce: see next slides

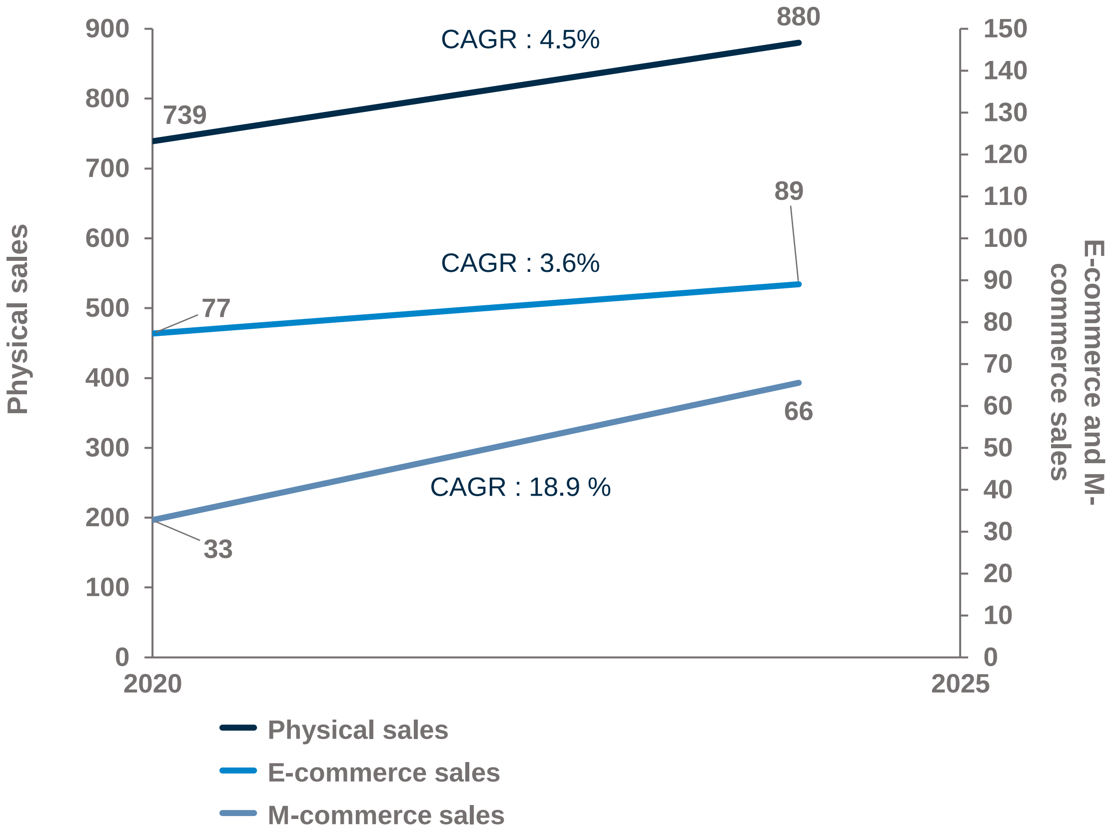
Intermediation/Brokers
- Development of brokers that are becoming a leading distribution channel for banking products (mortgage, consumer credits, insurance etc.) and thus eroding margins

Legend
- *Magnitude*
- *Probability*

E-commerce boom is disrupting customer behaviors and threatening retail banks revenue model ~ EUR 1 bn

The growth potential will notably be on mobile e-commerce

Evolution of physical / e-commerce sales in France
(in EUR bn and associated CAGR in %)



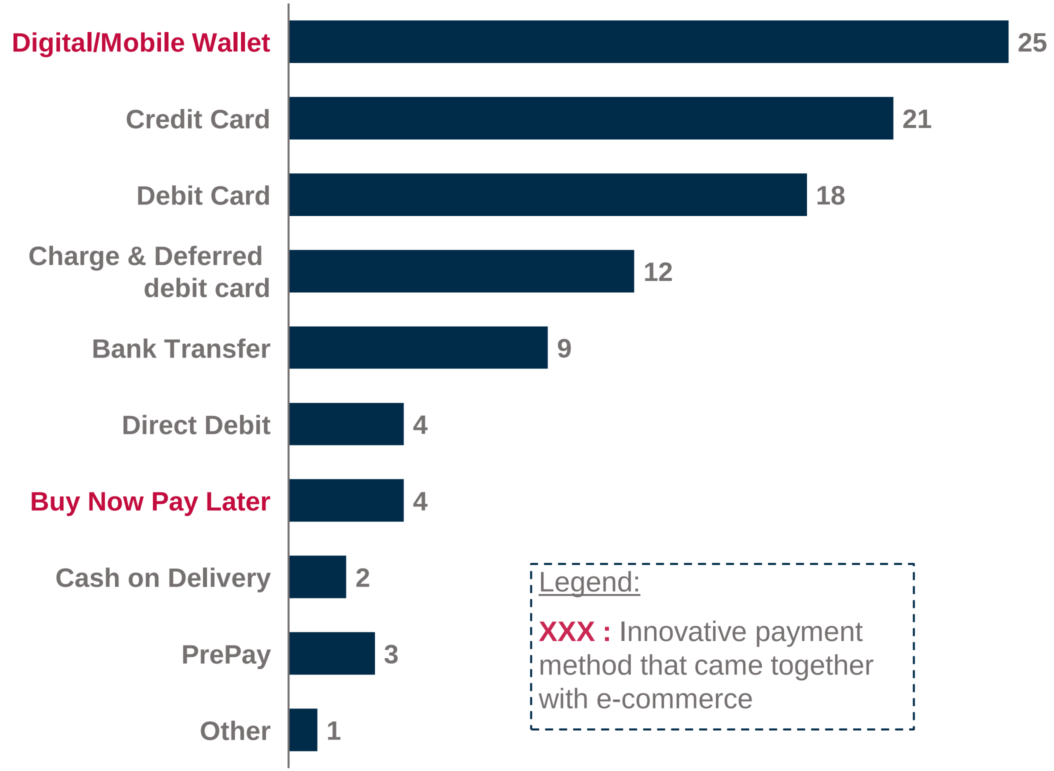
- **E-commerce** from both computers and mobiles represents **13% of total sales in France** in 2020.
- It is **expected to reach 15% in 2024**, yet the impact of the health crisis on those figures has not been considered, which could lead to **accelerated change in habits and larger proportion**.
- If the **e-commerce from laptops may have hit a plateau** (CAGR over 2020 – 2024 is limited to 3.6% when physical growth will increase by 4.5% over the same period), the **growth potential of mobile e-commerce is more important** (19% CAGR over 2020 – 2024) and will drive the whole e-commerce.

Source: 2020 Global Payment Report, Worldpay

2 consequences for banks: payment and consumer finance shifts to digital/mobile wallet and Buy Now Pay Later (BNPL)

Digital/Mobile Wallet and BNPL account for c.30% in 2020 and expected to reach 45% in 2024

E-commerce payment method in 2020 *(in %)*

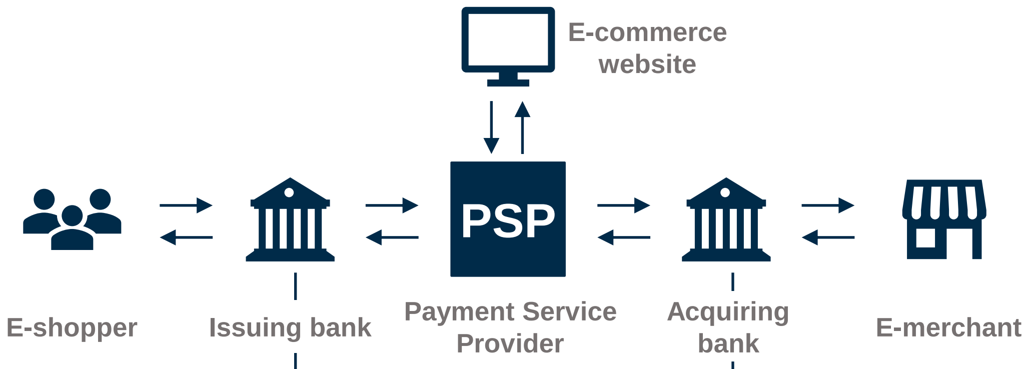


- New payment methods now **represent circa 30% on total e-commerce payments**
- **Buy Now Pay Later** accounts for 7.4% in Europe in 2020 and is expected to almost double to reach 13.6% in 2024 leading to a **large improvement in the ecommerce payment method mix in France** (expected CAGR over 2020 – 2024 : 35.8%)
- Evolution perspective for **Digital/Mobile wallet** are **positive** yet **more** limited to reach circa 30% in 2024 (expected CAGR over 2020 – 2024 : 4.7%)

Source: *2020 Global Payment Report, Worldpay*

New Payment Services Providers (PSP) jeopardize revenues for traditional issuing and acquiring banks

Split of the e-commerce payment value chain



30% of e-commerce sales are no longer captured by issuing banks but by innovative payment methods (exp. 45% in 2024)

Volumes of e-commerce sales @ risk = EUR 23 bn

Revenues @ risk = up to EUR 100 M

Revenues generated by traditional acquiring banks are estimated to 800 MEUR, ow 25% are already captured by digital wallets. Risk of income loss if traditional banks are bypassed by new PSP.

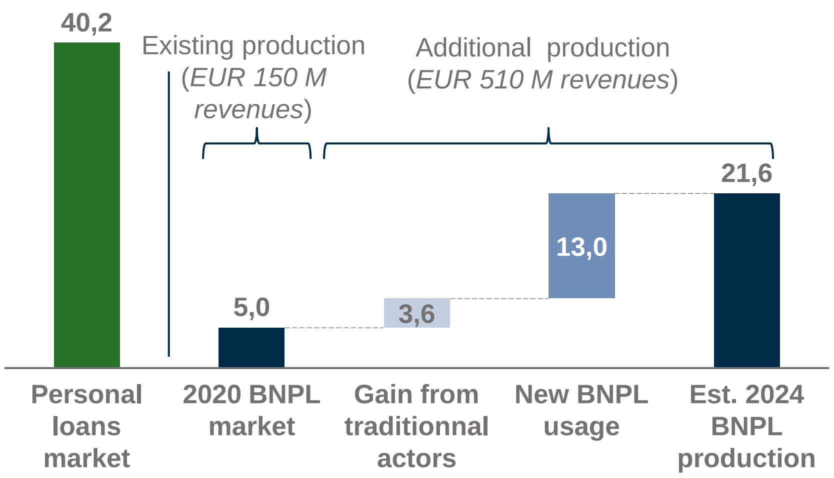
Revenues @ risk = up to EUR 600 M

- Many Payment Service Providers (“PSP”) have been developed along with e-commerce expansion.
- Choosing the adequate PSP is more a question of providing the most innovative payment methods and a perfect integration in the buying journey than low pricing.
  - The **absence of the client favourite payment method** induces **35% of purchase cancellation**.
- Therefore if traditional banks were originally the first choice for e-merchants to collect sales cash-flows, **many other services were developed** to provide **better guarantees of finalizing purchasing projects** generating **income losses for acquiring banks**.
- In addition, the **fast development of innovative payment methods** at the expense of traditional payment cards (debit & credit) has been generating **loss income for issuing banks**.
  - For instance, **digital / mobile wallets are used in 25%** of e-commerce sales and are expected to reach **30% in 2024**.
  - Similarly, **BNPL accounts for 4%** of e-commerce sales as of 2020 and is excepted to reach circa **14% in 2024**.

BNPL is expected to gain EUR 3.6bn from traditional actors and create a new EUR 13bn market leading to a EUR 380M revenues market

Traditional actors will be excluded of the new market created by BNPL usage

Evolution of BNPL 2020 – 2024 *(in EUR bn)*



Synthesis of loss for traditional actors

- Existing BNPL market of EUR 5 bn = **EUR 150M**
- Substitution risk on EUR 3.6 bn *(1)* = **EUR 110M**
- Exclusion of a new market of EUR 13 bn *(2)* = **EUR 400M**

TOTAL losses for traditional actors : EUR 660M

TOTAL losses for FRB (@57% *(3)*) : EUR 380M

Source: (1) : A&M analyses, (2) Worldpay from FIS – Global Payment Annual Report, (3) Banque de France

- Personal loans market has reached an annual production of EUR 40.2 bn in 2020, **11.5% below 2019 production,** drastically **impacted by the decrease of households consumption** and the **delay of investments.**
- Out of this annual production EUR 3.6 bn (9%) **may face a substitution risk toward split payment actors**.
  - This reflects the proportion of small amount credits allowing a fast repayment (**maturity below 90 days** (4-time payment) are **not considered as personal loans**, thus **outside of the prudential regulation framework** (main slot for BNPL actors).
  - Split payment is a good opportunity for customers **both in terms of pricing and convenience** by avoiding the painful process of granting loans.
- This EUR 3.6 bn loss of production would **induce a loss of NBI for traditional consumer credit actors** that is estimated to reach **EUR 110 M per year**, representing **3% of annual revenues in France.**
- Additionally to this substitution risk, traditional personal loans issuers **will be outside of a BNPL market** that is expected to quickly go up to reach **14% of total e-commerce payments in 2024** with **EUR 16.6 bn annual additional production** and a **grand total of EUR 660 M** revenues / year ow EUR 380 M for banks.
- An **overperformance** of BNPL market in France (annual growth rate of e-commerce of **12%** instead of 8.7% and a utilisation rate of **17%** instead of 13.6% would lead to a **EUR 30 bn production** and **EUR 900 M revenues** in 2024.

A&M Competencies

A&M can help Financial Institutions improve their Operating Income

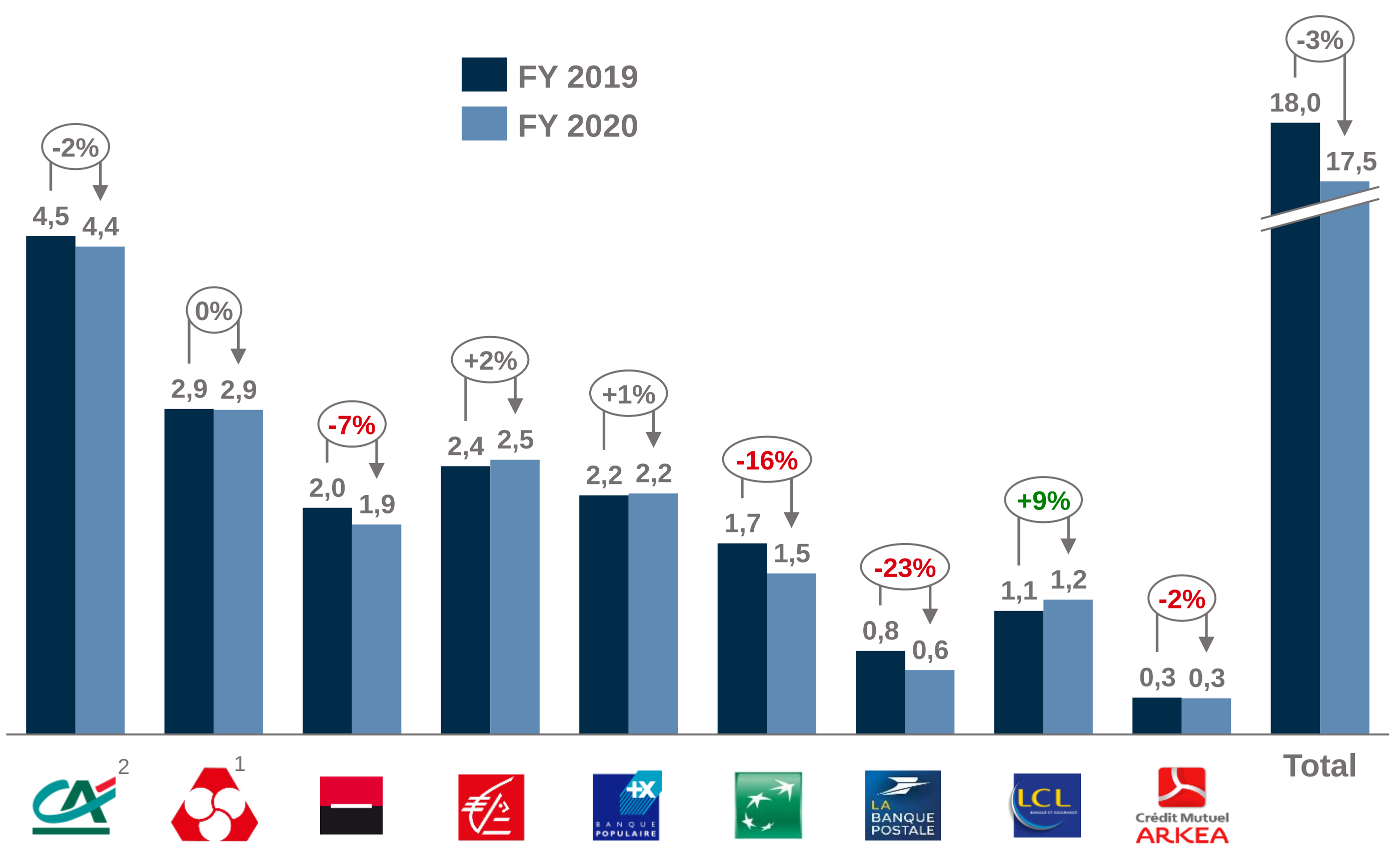
Main area		A&M expertise	Project examples
Revenue enhancement	1	Revenue growth	New business model, strategic plan review, commercial effectiveness
	2	Corporate social responsibility	New business mode, green finance
	3	Cost to serve optimization	Chanel mix optimization, pricing review, product offering simplification
Cost take out	4	HQ rightsizing and filiere synergies	Zero Based Budget, cross business/region synergies, layers & span of control
	5	Branch network optimization	Branch network redesign, branch ZBB, revenue at risk mapping
	6	Procurement	Direct and indirect cost optimization, procurement function transformation, Joint Ventures
	7	Real estate	Real estate strategy (location, flex office), space usage optimization, facility management and utilities contract
	8	BPO (offshoring, outsourcing)	BPO strategy, support to contract management, captive efficiency
Risk & Regulatory	9	Capital & liquidity	Capital planning, Basel IV impacts, EBA ST 2020 optimization
	10	Credit risk optimization	Credit function efficiency, EBA credit loan origination implementation & guidelines, upgrading IFRS9 provisioning
	11	Non-Performing loan	NPL sale process, evaluation, servicing model
	12	Compliance and non-financial risks	Cyber security, compliance function efficiency, climate risk management
Merger & Integration	13	PMI/Integration	Merger and integration process, Due Diligence
	14	Carve out	Carve out of non-core assets, Due Diligence
	15	Joint Ventures	JV design and implementation

Appendix

Appendix #1: Impact on gross operating income is limited due to lower costs that partially offset lower revenues

However, the evolution has diverged between groups more exposed to corporate than others

Comparison of FRB's gross operating income: 2019 vs 2020 *(EUR bn)*

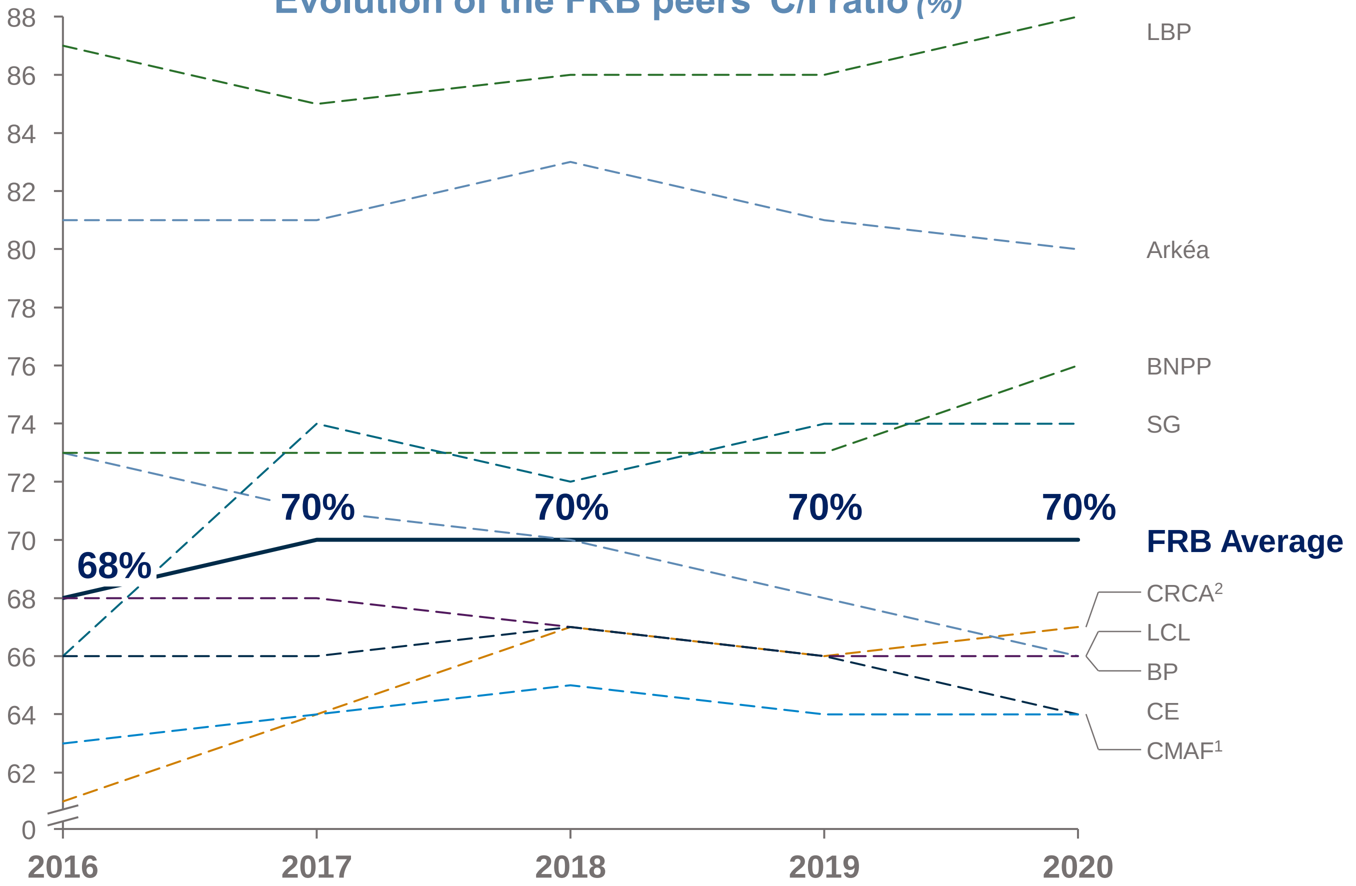


- LBP[3] suffered the most important losses due to the **drop in NIM** (low interest rate environment) partially offset by a **4% increase in commissions** (increase in financial commissions, development of diversification activities…). **Costs have remained stable in 2020.**
- BNPP faced important losses due to **the important NIM and commission loss** (respectively -8% and -4%) that was **not offset by the decrease of operating expenses** (-2%).
- Similarly, SG faced important losses due to the **important NIM and commissions loss** (respectively -9% and -2%) that was **not offset by the decrease of operating expenses** (-5%).
- LCL stands out by a large 9% increase of gross operating income due to the **increase of NIM and commissions and 2% decrease of operating expenses.**

(1) Crédit Mutuel Alliance Fédérale; (2) Crédit Agricole Caisses Régionales; (3) La Banque Postale

Appendix #2: A generally stable C/I ratio for several years but very heterogeneous depending on the bank (mutualists vs non-mutualists)

Evolution of the FRB peers' C/I ratio *(%)*



FRB peers	C/I 2016	C/I 2020
[2]	61% ↑	67%
[1]	63% ↑	64%
	66% ↑	74%
	66% ↓	64%
	68% ↓	66%
	73% ↑	76%
LA BANQUE POSTALE	87% ↑	88%
LCL	73% ↓	66%
Crédit Mutuel ARKEA	81% ↓	80%

Change in the C/I ratio between 2015 and 2020

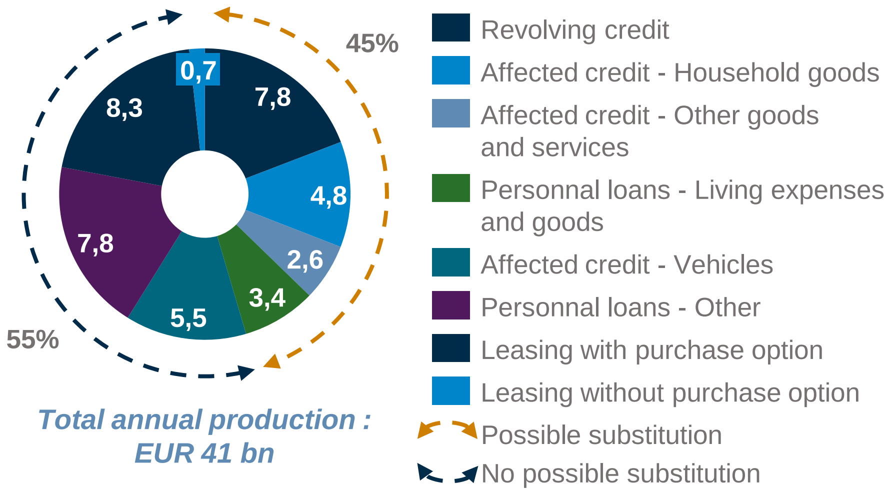
- ↑ Increase in the C/I ratio between 2015 and 2020
- → Change in the C/I ratio of less than 1 point between 2015 and 2020
- ↓ Drop in the C/I ratio between 2015 and 2020

Sources: annual reports, financial presentations, A&M analyses
(1) Crédit Mutuel Alliance Fédéral; (2) Crédit Agricole Caisses Régionales

Appendix #3: 9% of personal credits production may be substituted by BNPL products inducing a 5% income loss (same for FRB)

BNPL usage will create a new market that is estimated to reach EUR 430 M complementary revenues / year in 2024 that traditional personal credit providers won't enter in

Split of consumer credit annual production by nature *(in EUR bn)*



Total annual production : EUR 41 bn

Out of the **45% for which a substitution risk exist**, we estimate that **20% of loans are below 2Y** and therefore on BNPL slot.

➔ Total production @ risk : EUR 3.7 bn

- Overall, **9% of consumer credit annual production may face a substitution risk toward split payment actors**.
  - This reflects the proportion of small amount credits allowing a fast repayment (**maturity below 90 days** (4-time payment) are **not considered as consumer credits**, thus **outside of the prudential regulation framework** (main slot for BNPL actors).
  - Split payment may be a good opportunity for customers **both in terms of pricing and convenience**, jeopardizing credit production for specialised actors and leading to potential loss of revenues.
  - Remaining 91% are **large affected loans** (car, motorcycle, renovation etc.) or revolving / personal loans that are greater than 2 years preventing substitution.
- **45% are personal loans that are relatively short maturity** and amounts (exl. Auto / moto / refurbishment), ow **20% are estimated to be below 2Y** and therefore potentially substituted, leading to the 9% production @ risk.

Source: ASF report « L'activité des établissements spécialisés en 2020 », March 2021 and A&M analysis

Appendix #4: Sensitivity analysis of BNPL growth – based on e-commerce evolution

2020 Global Payment Report from Worlpay is expecting a 8.7% annual growth rate and a 13.6% utilisation rate as of EoY 2024

BNPL production in 2024 based on e-comm CAGR and BNPL utilisation rate (in EUR bn)

BNPL utilisation rate on e-commerce sales	E-commerce CAGR over 2020 - 2024: 6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%
11%	12.9	13.4	13.9	14.5	15.0	15.6	16.1	16.7	17.3	17.9	18.6
12%	14.1	14.7	15.2	15.8	16.4	17.0	17.6	18.2	18.9	19.5	20.2
13%	15.3	15.9	16.5	17.1	17.7	18.4	19.1	19.7	20.5	21.2	21.9
14%	16.5	17.1	17.7	**18.4**	19.1	19.8	20.5	21.3	22.0	22.8	23.6
15%	17.6	18.3	19.0	19.7	20.5	21.2	22.0	22.8	23.6	24.4	25.3
16%	18.8	19.5	20.3	21.0	21.8	22.6	23.4	24.3	25.2	26.1	27.0
17%	20.0	20.8	21.5	22.4	23.2	24.0	24.9	25.8	26.7	27.7	28.7
18%	21.2	22.0	22.8	23.7	24.5	25.5	26.4	27.3	28.3	29.3	30.4
19%	22.3	23.2	24.1	25.0	25.9	26.9	27.8	28.9	29.9	31.0	32.0
20%	23.5	24.4	25.3	26.3	27.3	28.3	29.3	30.4	31.5	32.6	33.7
21%	24.7	25.6	26.6	27.6	28.6	29.7	30.8	31.9	33.0	34.2	35.4

BNPL market total revenues based on e-comm CAGR and BNPL utilisation rate (in EUR M)

BNPL utilisation rate on e-commerce sales	E-commerce CAGR over 2020 - 2024: 6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%
11%	388	403	418	434	450	467	484	501	519	538	557
12%	423	440	456	473	491	509	528	547	566	586	607
13%	459	476	494	513	532	551	572	592	614	635	658
14%	494	513	532	**552**	573	594	616	638	661	684	708
15%	529	549	570	592	614	636	660	683	708	733	759
16%	564	586	608	631	655	679	703	729	755	782	809
17%	600	623	646	671	695	721	747	774	802	831	860
18%	635	659	684	710	736	764	791	820	849	880	911
19%	670	696	722	749	777	806	835	866	897	929	961
20%	706	733	760	789	818	848	879	911	944	977	1,012
21%	741	769	798	828	859	891	923	957	991	1,026	1,062

Appendix #5: Selected peers for European Benchmark

Selected European peers

HSBC | BARCLAYS | LLOYDS BANKING GROUP | NatWest Group

Deutsche Bank | COMMERZBANK

Santander | BBVA | CaixaBank

UBS | CREDIT SUISSE

Rabobank | ING

UniCredit | INTESA SANPAOLO

Nordea