ACCELERATION OF COST REDUCTION

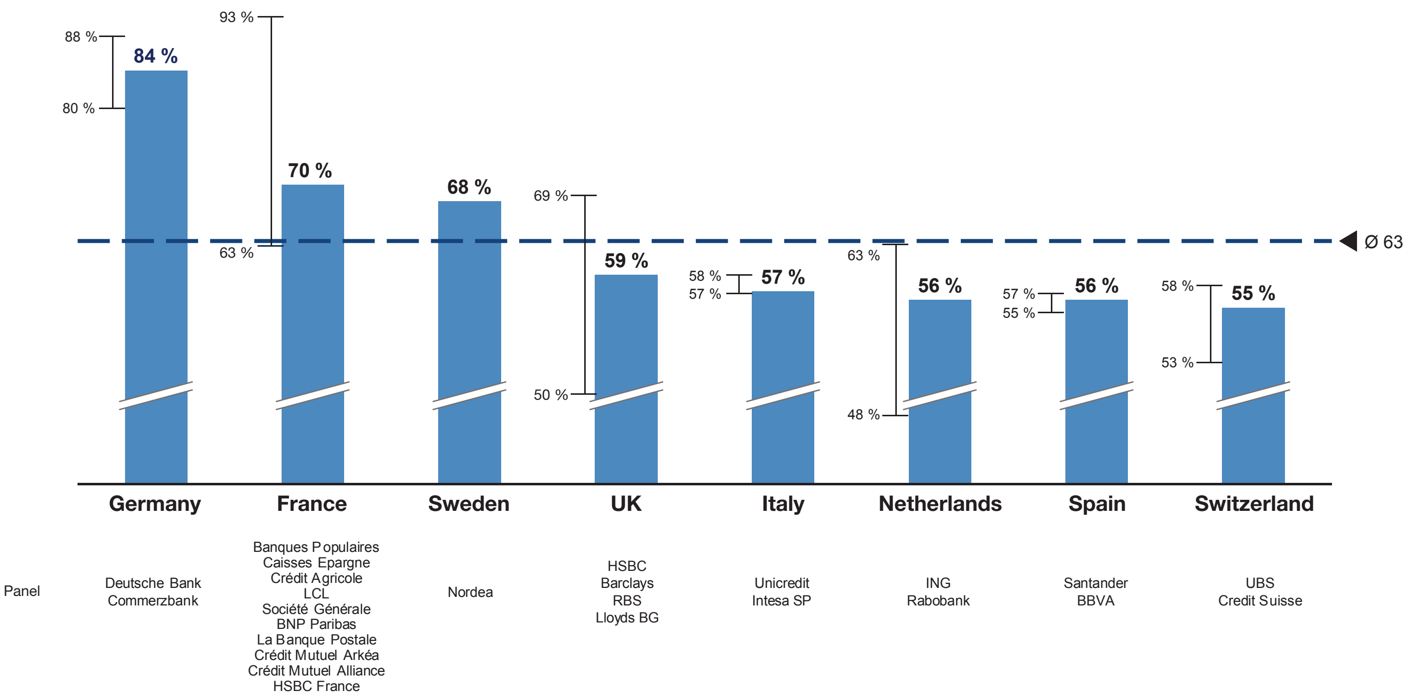
IN THE FRENCH RETAIL BANKING, THE NEED FOR DISRUPTION

French retail banks are currently facing an increasing pressure on their business model, which requires a new approach to transformation; fortunately, they have many opportunities to reduce their costs in a context of income pressure that is likely to continue but pending on several initiatives from banks.

Today, French retail banks (together with their German counterparts) have the highest cost/income ratios (operating expenses as a percentage of NBI) in Europe. This is a fundamental trend since 2016, as banks of these two countries are the only ones in Europe to have seen their cost to continue to deteriorate, while players from other countries have seen their banks undertake major cost reduction projects to optimise their cost base.

FRENCH BANKS HAVE ONE OF THE MOST SIGNIFICANT COST TO INCOME RATIO IN EUROPE

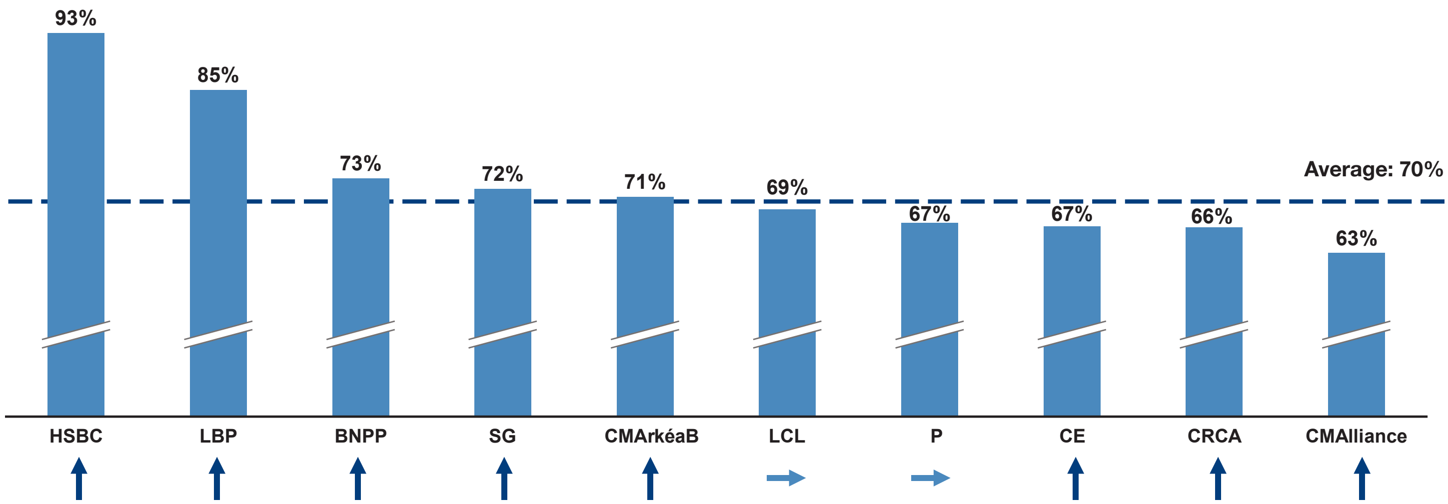
C:I (2018) – Average by country



It should be noted that this trend is widespread across all French retail banks: the average cost/income ratio is 70%, up for almost all players in the sector over the 2014-2018 period.

C:I INCREASE IS A GLOBAL TREND AMONG FRENCH BANKS

C:I ratio French Retail banks –2018



C:I evolution between 2014 et 2018

C:I increase between 2014 et 2018

Flat C:I (variation below 1 pt between 2014 et 2018)

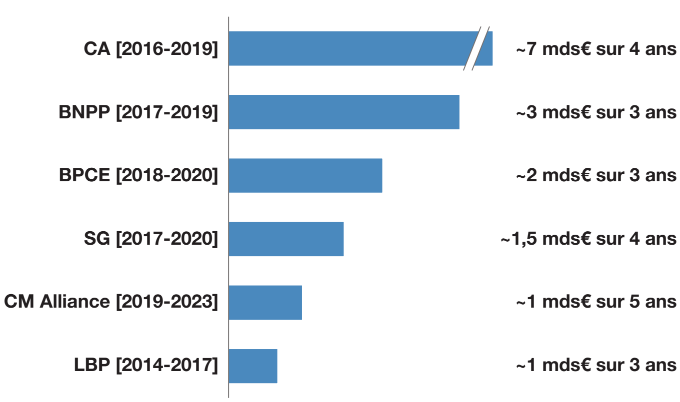
These figures show one thing: French banks continue to see their revenues remaining flat or even fall, while costs continue to rise, creating a profitabiliy squeeze; all this in a context of historically low cost of risk, which leaves no room to improve the profitability of retail banking in France.

The challenge to face is huge, but not overwiming for French banks; moreover, they have no other choice given the rise of the millennials, the new uses driven by neobanks, the regulatory pressure on revenues that is confirmed, the need to continue financing digital transformation (nearly 15 billion invested over the period 2014 to 2010 by French banks).

DIGITAL TRANSFORMATION REQUIRES SIGNIFICANT INVESTMENTS THAT NEED TO BE FUNDED

Digital investments (€ Bn)

Investments by Banks



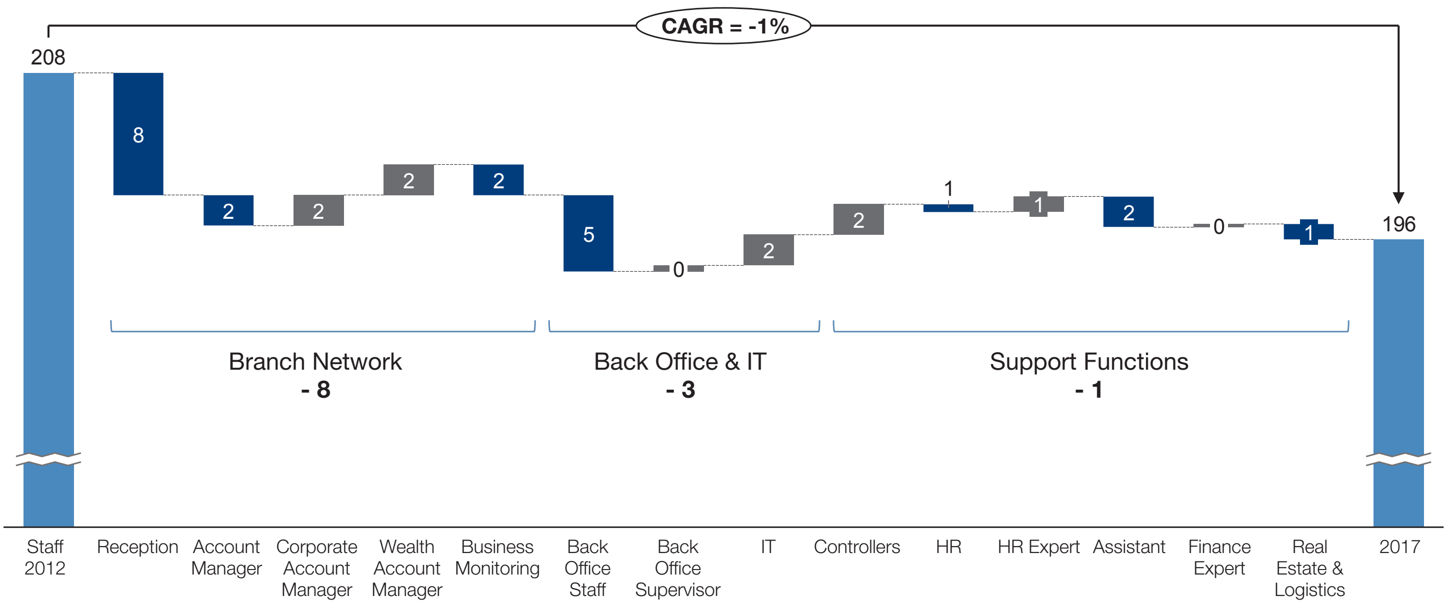
Comments

- Digitalisation / dematerialisation of banking operations (mobile usage & development of self-care functionalities acceleration), processes (end-to-end approach) and the offer (relationship building, subscription of products such as consumer credit or real estate)
- Specialization of remote platforms (closure or BO specialization)
- Optimisation of the network (branch closures or relocations, simplification of the monitoring system, etc.)

Time is running out, a new concept for retail banks in their transformation agenda. Their staff numbers have only decreased by 1% on an annual basis over the past 5 years because banks have mainly focused on staff reallocations to adapt to the new context. We are convinced that it is only by taking strong measures that banks will be able to face the challenges of the new transformation agenda. This will require ambitious and proactive social engineering, given an age pyramid that offers few opportunities in the coming years, in line with their social pact; it will also be necessary to find internally the leaders of this transformation beyond top management.

STAFF ARE NEARLY FLAT OVER THE LAST 5 YEARS IN FRENCH RETAIL BANKING, BANKS HAVE FOCUSED ON STAFF REALLOCATION

Staff evolution in French retail banks (2012-2017, in '000)



Sources : AFB, analyses A&M

The potential cost reduction for French retail banks can be estimated at €8 billion. These savings can be split between the network (60%), back offices, IT and support functions (40%). While the amount may seem significant, in a context of increased pressure on revenues, it is an essential condition for achieving cost/income ratios in line with the new, unfortunately more "low-cost" economic model of retail banking in France.

COST SAVING POTENTIAL IS ESTIMATED AROUND €BN.8

		Potentiel gains (Md€)
Branch Network	▪ Branch closure, reduction in formats ▪ Layers, span of control aligned with branch consolidation ▪ Pooling of ATMs between banks, cash transport (JV)	~ 5
Back Office	▪ Automation (RPA, AI) ▪ BPO (credit servicing crédit, collection) ▪ Back office shared service (Regional hub)	~ 1
IT	▪ Banking core system software, API ▪ IT provider optmisation ▪ IT Development agile models ▪ MOA/MOE merger	~ 1,5
Support Functions	▪ HQ consolidaton ▪ Zero Based Budget approach by function ▪ External spend optimisation	~1

Sources : analyses A&M

The measures that French banks will have to take are essential, but in this context, French banks will be able to rely on the attractiveness of banking profiles on the labour market (allowing very high reclassification rates, sometimes reaching up to 70%), the dynamism of the managerial staff market and the recent measures put in place since September 2017, in particular the collective bargaining break.

SOCIAL ENGINEERING CAN LEVERAGE NEW OPPORTUNITIES

Social Engineering

Strengths

- Expertise developed by bank employees sought by other sectors (financial culture, rigour, etc.)
- Good replacement rate on the various voluntary redundancy plans set up by banks (~70%), or even over-subscription

Weaknesses

- Few natural flows to be expected due to an unfavourable age pyramid over the next few years
- Perception of the sense of urgency not yet fully aligned with economic pressure (strong social pact, caution towards the social partners)

Opportunities

- New legislative framework ('Lois Macron') put in place 2 years ago to facilitate social management
- Overall dynamism of the executive labour market offering opportunities for banking executives (> 60% of the workforce)

Threats

- Continued decline in incomes, which requires intensifying and accelerating staff reductions, with partial or total questioning of the social pact
- Pressure from the public authorities to leave a local network through the branch network

FRENCH BANKS HAVE RECENTLY ACCELERATED INITIATIVES THROUGH SOCIAL ENGINEERING

Bank	Levers	Date	Scope	FTE's
SOCIETE GENERALE	▪ External mobility ▪ Dismissals ▪ Reclassifications, natural and retired staff, end-of-career adjustments, external mobility assistance	▪ 2012 ▪ 2019-… ▪ 2016-2020	▪ CIB ▪ CIB ▪ Retail	▪ 880 ▪ 700 ▪ 3 450,
GROUPE BPCE	▪ Turnover, retirements	▪ 2018-2020	▪ Retail	▪ 3 600-4 000 (~5% total FTE)
BNP PARIBAS	▪ Turnover, retirements	▪ 2016-2019 ▪ 2017-2020	▪ CIB ▪ Retail	▪ 675 (out of 6000, = 11%) ▪ 640 (out fo 28000, = 2%)
BANQUE DE FRANCE	▪ Turnover, retirements ▪ Redundancy plan	▪ 2017-2020	▪ Réseau de succursales	▪ 2 400 (out of 11000, = 22%)
MILLEIS BANQUE		▪ 2019-2020	▪ Back office ▪ HQ	▪ 350 (out of 1000, = 35%)
LCL BANQUE ET ASSURANCE	▪ Turnover, retirements ▪ Redundancy plan ▪ Lay-offs	▪ 2014-2018 ▪ 2017-2019	▪ Retail ▪ HQ ▪ Back office	▪ 1 658 (c.300 back-office, c.1350 branches) (out of ~17000, = 10%) ▪ 750-850
CRÉDIT FONCIER	▪ Internal transfer	▪ n.c	▪ Group	▪ 1 400
CRÉDIT IMMOBILIER DE FRANCE	▪ Redundancy plan	▪ n.c.	▪ Group	▪ 491 (out of 957)

Note : 50% des employés quittant la SG sortent du secteur bancaire, selon le DRH BDDF

Source: Revue de presse, Analyses A&M

This vision of the stakes in the management of the transformation is shared by French bank CEO's. However, depending on the specific contexts, in particular the social pact, the perception of the sense of urgency, the responses in terms of both intensity and speed will remain different according to the institutions; independently, it is now that we must act because banks can rely on profitability levels that are still very satisfactory to finance the investments, particularly social investments, required by this transformation.

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