Post-Brexit: cost optimization for Banks

Minds made for transforming financial services

November 2019

Building a better working world

Building a better financial services industry

At EY Financial Services, we train and nurture our inclusive teams to develop minds that can transform, shape and innovate financial services. Our professionals come together from different backgrounds and walks of life to apply their skills and insights to ask better questions. It's these better questions that lead to better answers, benefiting our clients, their customers and the wider community. Our minds are made to build a better financial services industry. It's how we play our part in building a better working world.

Minds made for building financial services

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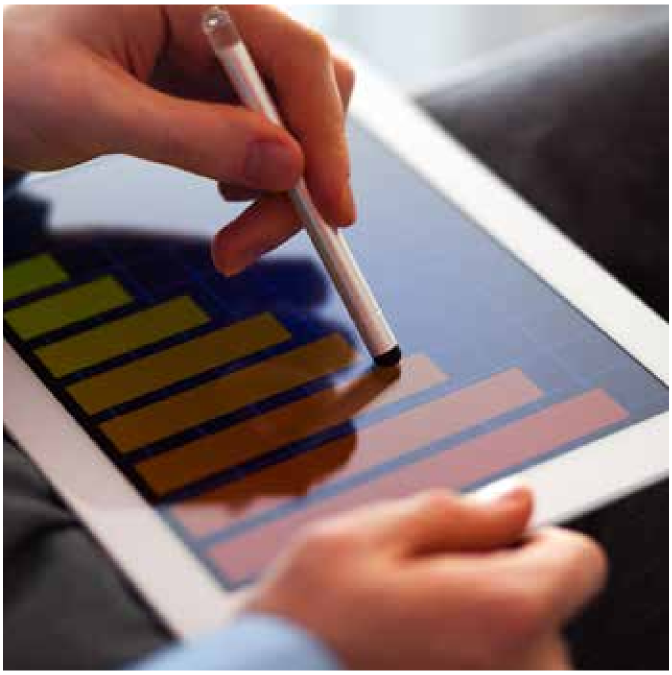
Banks face increased costs as a result of the implementation of Brexit plans

To negate the risks of a no-deal Brexit and ensure business continuity many banks have already implemented their Brexit plans. However, this has typically led to increased costs and banks should now re-assess their operations to optimize cost and gain competitive advantage.

Banks should evolve following the implementation of their Brexit plans

- In the face of unprecedented political uncertainty banks have raced to implement plans to enable them to continue in operation in the event of a no-deal Brexit.
- Organizations have adopted various approaches to prepare, choosing to establish or expand European entities to maintain access to European markets. Most banks now have to maintain both their UK and European entities.
- Furthermore, short-term tactical solutions largely replicating the as-is operating model have often been implemented to secure business continuity. This is typically the case where timeframes have not permitted more strategic solutions or uncertainty has resulted in delayed decision making.



- Consequently, many banks now have inefficiencies embedded within their organizational construct and operating model including:
  - More complex legal entity structures, resulting in increased costs without the benefit of additional revenue.
  - Increased capital, funding and liquidity costs arising from the maintenance of more legal entities.
  - More extensive governance and internal and external reporting requirements.
  - Increased complexity of regulatory reporting portfolios.
  - Duplicative processes and controls across legal entities and the front-to-back operating model, driving increased operational costs.
  - Increased Financial Market Infrastructure (FMI) costs including exchange and clearing fees.
  - Sub-optimal sales and relationship management coverage models, resulting in increased costs and potentially reduced revenues.
  - Shared service centres required to provide services to more customers across more locations, increasing the burden of maintaining service catalogues.
  - Increased infrastructure spend required to maintain operational resilience across new entities.
  - Use of short-term solutions to resource new entities, compounded by uncertainty surrounding Brexit.
  - Increased tax costs due to the inability to rely on directives which prevent withholding tax.
- In addition to Brexit, banks also face increased spend and costs relating to IBOR transition, EU Intermediate Parent Undertaking (EU IPU) proposals, resolvability and on-going supervision of recently implemented regulations.
- The change agenda, declining trading revenues, challenging macro-economic environment and potential recession, necessitates banks to critically assess their operations.
- Banks that act now will position themselves for future growth and first movers will gain leadership advantage.

Business benefits

- **Banks that successfully optimize and transform beyond Brexit can expect to benefit from:**
  - **Increased profitability from reduced capital costs and improved capital management.**
  - **A streamlined operating model, resulting in reduced costs and an enhanced control environment.**
  - **Improved shareholder confidence in the effectiveness of cost management.**
  - **Improved regulator confidence.**

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Cost optimization is key if banks are to thrive and gain competitive advantage in the post-Brexit world

With the vast majority of banks now prepared for a no-deal Brexit, there is an opportunity to strategically review the business, legal entity construct and the supporting operating model to ensure that return on equity is maximized.

1. Legal entity rationalization

- Brexit has increased the complexity of legal entity structures and banks should now strategically review their entities with a view to rationalizing them through the:
  - Elimination of surplus, dormant or non-trading entities.
  - Amalgamation of regulated entities or entities undertaking similar business functions or activities.
  - Alignment of legal entity structure to the business operating model.
- Legal entity rationalization is a key driver in reducing overall operating costs and could result in several benefits including:
  - Increased capital and liquidity through the release of trapped capital and cash.
  - A reduction in entity FMI costs, financial control costs, inter-company administration and audit fees.
  - Improved transparency which in turn will lead to increased board and shareholder confidence and simplified regulatory interactions and reporting.

2. Front-to-back processes and controls

- Banks should review and simplify their front-to-back processes and controls, eliminate duplicate processes and transform inefficient processes which may have been "lifted and shifted" into new legal entities.
- Furthermore, banks should determine whether innovative technologies could be utilized to optimize costs whilst simultaneously enhancing controls. Manual, repetitive processes should be automated and robotic process automation deployed to deliver processes faster and cheaper, driving immediate and significant cost benefits. In addition, artificial intelligence solutions should be considered for streamlining and improving more judgement-based processes, enabling existing resources to be re-assigned to more value adding activities.
- Blockchain technology could also be implemented to deliver improved efficiency across a number of areas including securities settlement, payments and intercompany reconciliations.

3. Governance

- Banks should review governance frameworks to ensure that they are not disparate and unnecessarily onerous, thereby driving increased costs.
- It is also critical that governance mechanisms and protocols are effective and constructively challenge business decisions, driving the right behaviors and optimizing the use of scarce financial resources across the entire organization.

4. Coverage model

- Banks should review their sales and relationship management operating and support models in light of Brexit related changes. This will support banks in focusing on more profitable clients, products and locations.
- The coverage model should also be rebalanced away from one which has a high trader footprint to one which increases client digital penetration and increases efficiency and profitability.

5. Shared services & third party vendors

- The creation or expansion of legal entities generates increased demand for shared services. To minimise the possibility of duplicate processes and people, banks should define and document their outsourcing policy and framework as per the European Banking Authority (EBA) outsourcing guidelines.
- In addition, detailed service catalogues should be documented, which will not only provide clarity on services provided, but also improve transparency of costs, which in turn will drive a more commercial mindset across the business.
- Banks should also assess the mapping of third party vendor contracts to the operating model to determine whether they are optimal and ensure that any volume changes are reflected in contract costs.

6. Capital and liquidity

- Multiple new legal entities created to support the post-Brexit operating model will all attract minimum prudential capital and liquidity requirements. Banks should review their booking models for transactions to ensure this is structured to minimise the need for incremental capital and liquidity.
- The fragmentation of portfolios across multiple legal entities will also lead to the loss of netting benefit for capital purposes. The review of the booking model should also look to minimise this impact and banks should also maximise the usage of trade compressions and other mechanisms to reduce the impact on capital and leverage ratios.
- Banks should look for technical optimization opportunities in their portfolio, improving data quality and maximizing the usage of internal models to reduce capital usage. Although leverage ratio does not allow the usage of internal models, banks should review their methodology to ensure calculations are as accurate as possible.

7. Operational resilience

- Banks should establish and document a global operational resilience strategy and framework with clear, common and consistent triggers for escalation and decision making. This will ensure that any additional costs arising from operational disruptions due the fall out from Brexit will be minimized as banks are appropriately prepared.
- Resiliency by design should be included in all new systems and processes to avoid additional and inconsistent infrastructure spend.

8. Tax

- Banks should ensure tax efficiency in their post-Brexit operating models, in particular, analysis should be undertaken to optimize cross-border transfer pricing and value-added tax (VAT).
- Tax implications should be also be considered in relation to legal entity rationalization, as the elimination of unnecessary corporate entities will require complex analysis to enable profits to be allocated to jurisdictions in an appropriate manner for tax purposes.

9. People

- Banks have typically focused on more short-term resource planning to ensure they have the required resources in place ahead of a possible no-deal Brexit. Banks should now shift focus to their long-term workforce strategy to align roles with the skills needed in a post-Brexit operating model. A key part of the strategy should be to focus on ways to maintain access to vital EU talent in the future. Therefore, optimizing the cost of recruitment, mobility & immigration support, and having associated spend analysis available for the business, will be key for firms looking for competitive advantage.
- Banks must consider how to optimize their spend through strategic immigration planning in relation to the UK's new immigration system. This will help to ensure access to talent is maximized, whilst the impact of additional application fees, health and skills charges is neutralized as far as possible.

The implementation of Brexit plans demands that banks re-assess their operating models to ensure costs are optimised. A holistic approach is required to maximise success.

Assess

Assess the post-Brexit legal entity structure and operating model

Outcomes

- Design principles & assessment criteria
- Prioritised opportunity hypotheses

Optimize

Identify optimization opportunities and determine the target operating model

Outcomes

- Opportunities & cost savings
- Target operating model

Transform

Define the path and secure change

Outcomes

- Roadmap & planning
- Change management & enablement

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How EY can help

EY teams have extensive experience of assessing and transforming operating models to optimize cost.

We are able to assemble multidisciplinary teams that possess in-depth subject matter knowledge and are able to provide strategic solutions.

We possess numerous toolkits, techniques and enablers to help accelerate projects and deliver improved operations and sustainable cost savings.

In particular, we can help you with:

Sustainable cost optimization

- Assessing the operating model post-implementation of Brexit plans, to identify inefficiencies and cost optimization opportunities.

Operating model definition and implementation

- Defining and implementing the future strategic operating model to position banks for growth and address inefficiencies embedded as a result of Brexit plans.

Technical advice

- Providing tax, accounting, risk, legal, regulatory, capital, technology and knowledge to deliver optimal solutions and cost savings.

Legal entity rationalization

- Strategically reviewing and rationalizing legal entity structures to optimize capital and liquidity, and minimise associated operating costs.

Execution support

- Supporting programme execution including transition planning, analysis of potential road blocks and management of material risks.
- Managing change and benefits realization, utilizing our robust methodology and supporting tools.

Contacts

For a confidential conversation on post-Brexit cost optimization, please contact EY professionals today.

We can bring together professionals from across services, ranging from Risk and Regulatory, Transaction Services, Tax, People Advisory Services to CFO Advisory Services.

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