



World Retail Banking Report 2004

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ERNST & YOUNG

Preface



In an effort to clarify the dynamics of today's retail banking industry, ING, Cap Gemini Ernst & Young, and the European Financial Management & Marketing Association have joined forces to conduct an annual in-depth study of the variables governing global retail banking. This initial effort seeks to understand the structure and nature of pricing for core retail banking products and services across national markets, and to highlight the implications for banks and their customers.

Within domestic markets, pricing data is readily available, generally comparable, and relatively consistent. Between countries, however, only scant data has been collected and compared prior to this report, and what little there is has not been widely circulated. We suspect this is partly due to the complex nature of the various national pricing mechanisms, but

also because relatively few customers have held retail bank accounts in more than one country. Until now, therefore, neither customers nor banks have felt any great need for cross-border comparisons.

The advent of the euro is one signal that these information needs are changing. With the single currency, comparing pricing data across national borders becomes easier and takes on added importance. Another factor is the accelerating consolidation of retail banks in large markets such as the U.S. and the U.K., and their simultaneous internationalization. Pricing is at the core of any retail bank's strategy, and customers have more than a passing interest in the fees banks charge them. Clearly, having comparative cross-border pricing data is increasingly essential to a thorough understanding of today's retail banking marketplace.

Collecting the data has not been easy. This report is the result of eight months of research covering eleven countries and seventy-three banks. It included in-depth desk research, more than thirty personal interviews, and three workshops with industry experts. Eleven separate national teams conducted the research in their respective countries, and a core team synthesized their extensive output to highlight the key findings and create the international pricing index presented here.

We are delighted to publish this first annual report, which we hope will stimulate discussion and help retail banks make more effective strategic pricing decisions and better serve their customers around the world.

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Summary of Major Findings



- Most institutions in a given country apply some combination of four basic pricing models: account-based, transaction-based, package-based, and indirect revenue-based.
- Pricing within domestic markets varies far less than pricing across countries; the difference between lowest and highest local price ranged from €9 to €133 a year.
- No apparent direct link exists between pricing and efficiency; countries with high cost/income ratios do not necessarily have high prices, or vice versa.
- Interest rate spreads and other indirect charges have no apparent impact on pricing.
- We found no direct causal relationship between the major macroeconomic indicators of each country and its pricing level.
- Regulators have long played an important role in shaping retail banking practices, and a link exists between the degree of regulatory pressure and pricing in national markets.
- Prices of core retail banking products and services in 2003 varied enormously across countries—e.g., from €31 a year for the average customer in the Netherlands to €501 in Italy.
- Cross-border comparisons by consumers and regulators could eventually promote international harmonization on price, which could fuel a trend toward the commoditization of core retail banking products and services.
- As a more integrated global market emerges, retail banks that take a global perspective on pricing could enjoy a first-mover advantage.



Pricing in a Global Market

Despite an increasingly global economy, the introduction of a single European currency, and a rising tide of cross-border and in-market mergers and acquisitions, the price of core day-to-day banking varies to a surprising extent across western countries. The average price a typical customer paid in 2003 for a year's core banking products and services was €167. This figure fluctuated widely across our survey group, however, ranging from a low of only €31 a year in the Netherlands to a high of €501 in Italy (see Figure 1). Even in economically similar neighboring countries, such as the United States and Canada or France and Belgium,

the price of core banking services varies by 30% or more. This is a remarkable and somewhat counterintuitive finding given the pace of globalization.

Prices of individual products within core banking products and services also vary substantially across national boundaries. Swedish and U.K. banks, for instance, do not charge customers for account management; instead, fees are generated by payments and exceptions handling. In contrast, as noted in Figure 2, German annual account management fees make up more than half the cost of core banking products and services in that country.

Figure 1: *International Pricing Index, 2003 (€ per year)*

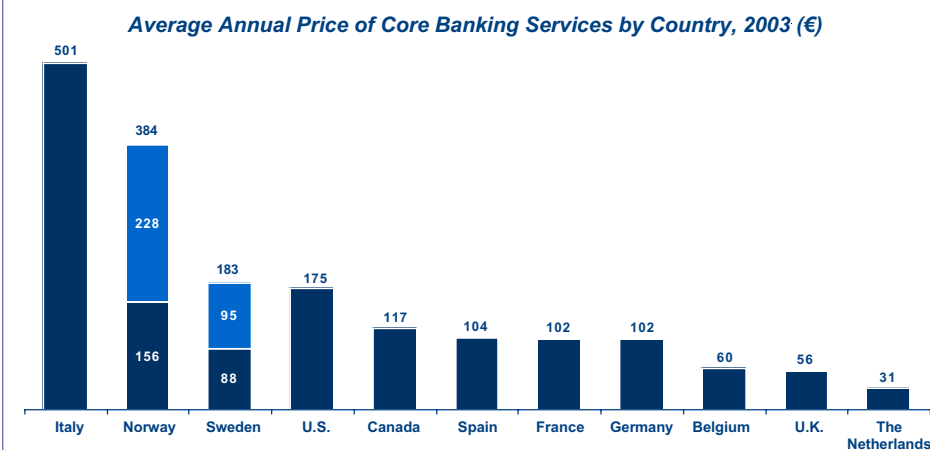


Figure 2: *Sources of Fees for Core Banking*

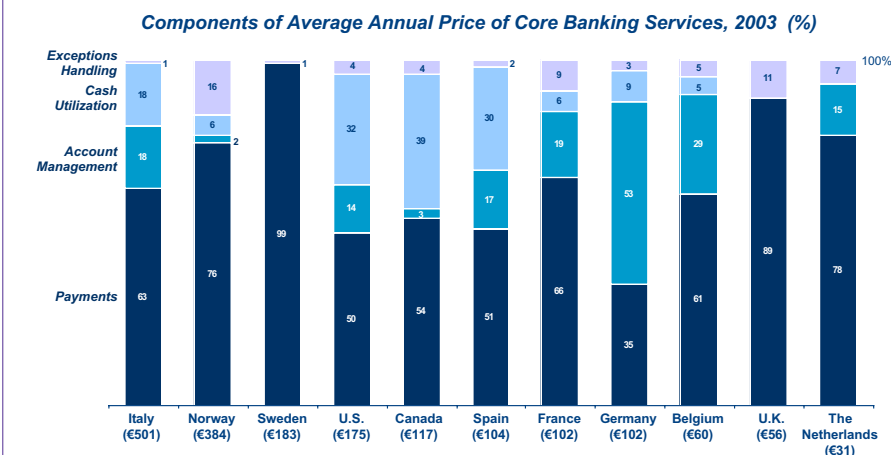
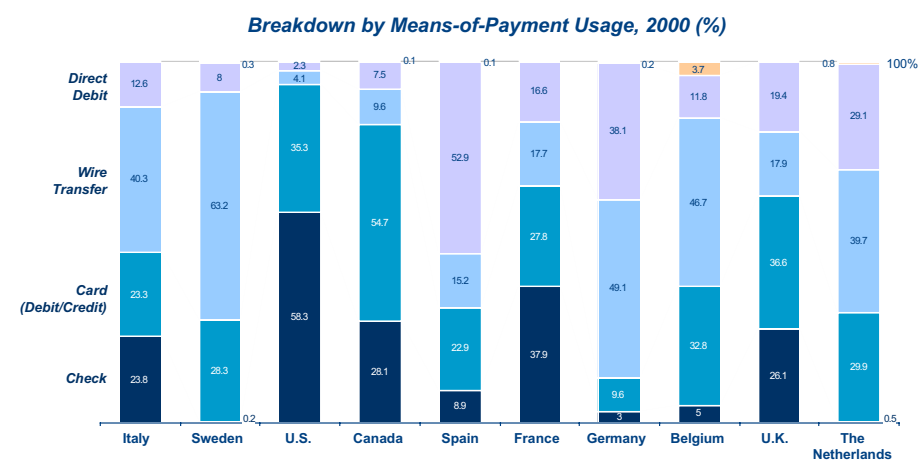


Figure 3: *Cross-Country Variations in Means of Payment*



Local pricing reflects usage and custom. For example, while Norwegians and Swedes use checks only for big-ticket items, such as buying a house, most Americans would not think twice about making out a check for \$5. As shown earlier in Figure 2, when we break down the components of the pricing index into the four product families that make up core banking services, the primary source of fees in every case is payments—accounting for a high of 99% in Sweden.

As Figure 3 illustrates, however, the products behind the payments category differ substantially in each country. In Canada, France, and the United States, payments are dominated by checks and credit cards, while in Spain, it is direct debits, and in Belgium, Germany, and Sweden, it is wire transfers.

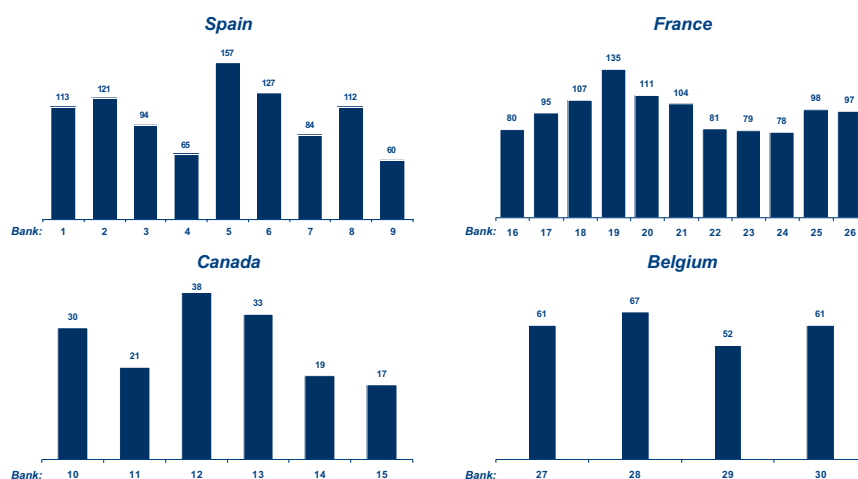
Pricing Models

While prices vary enormously across countries, most institutions within a country adopt a broadly consistent pricing model, so pricing differences within a given country are smaller, ranging from €9 to €133 (see Figure 4 for examples).

Our study across the survey group identified four “pure” approaches to charging for core banking services: account-based, transaction-based, package-based, and indirect revenue-based (see Figure 5). While none of the banks in our study used one of them to the complete exclusion of the others, all banks had applied some combination of them.

In the account-based pricing model, a range of fees is applied annually to the general management of the account. The fee level is often determined by the account balance, and individual transactions are provided free up to a certain limit. In contrast, the transaction-based model charges fees based on the number of individual transactions (“You only pay for what you use”), and no annual fees are charged for the account. The package-based pricing model is similar to the account-based model, except that the bank charges an annual fee for a suite of services, rather than just an account. Finally, in the indirect revenue-based pricing model, most day-to-day banking services are free

Figure 4: *Domestic Pricing Variations in Four Countries, 2003 (€)^a*



Source: CGE&Y analysis, 2003–2004.

a. Average annual price of core banking services, by bank, 2003 (scales vary).

Figure 5: *Four “Pure” Approaches to Pricing*

Account-Based	Transaction-Based
<ul style="list-style-type: none"> • A range of fees is applied to account management: <ul style="list-style-type: none"> – Could be based on balance to ensure relative stability or increase non-interest-bearing deposits • All other P&S are linked to the current account: <ul style="list-style-type: none"> – Must open a current account before getting day-to-day banking products and other financial products (savings, credit, mortgages) • P&S pricing is based on current account balance 	<ul style="list-style-type: none"> • Fees are applied to transactions, often including any form of: <ul style="list-style-type: none"> – Debit (check, money transfer, point-of-service purchase, ATM withdrawal) or credit (deposit at desk, deposit at an ATM, etc.) • Fees consist of a fixed amount per transaction, a percentage of the transaction amount, or both: <ul style="list-style-type: none"> – A free-of-charge limit may exist: transactions across service channels are aggregated for each statement cycle, and when the transaction limit is exceeded, the customer is charged accordingly.
Package-Based	Indirect Revenue-Based
<ul style="list-style-type: none"> • Similar to account-based model, except that the bank charges an annual fee for a suite of services, rather than just an account: <ul style="list-style-type: none"> – Fees/commissions are directly linked to the bank's ability to increase cross-selling rates 	<ul style="list-style-type: none"> • A majority of day-to-day banking is free of charge • Income is generated by other types of products, such as credits and savings: <ul style="list-style-type: none"> – Interest spread on credits, as well as a commission to set up credit – Interest spread on savings, as well as fees to manage savings account

of charge, and the bank generates revenues from other sources, such as overdrafts, revolving credit, and value dates.

Banks in most countries adopt a pricing model that is a hybrid of two or more of the four pure approaches. U.S. banks, for example, typically adopt a mixture of account-based and transaction-based pricing, while banks in France tend to use a combination of the account-based and package-based models. Most Swedish banks, meanwhile, favor the indirect revenue-based model (in which most of the day-to-day banking is free), adding a touch of the transaction-based model to the mix.

Understanding Pricing Differences

Business Models

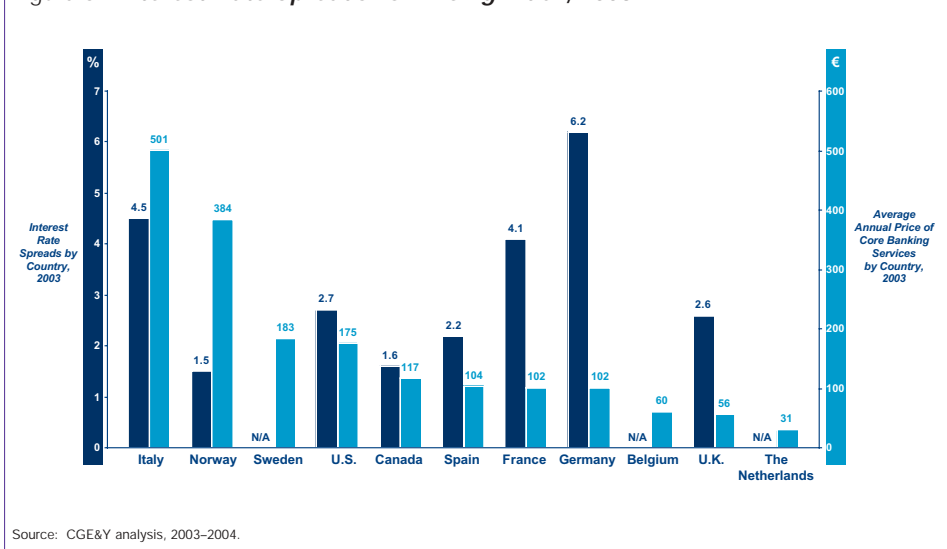
In many countries, core banking is a loss-making activity. It is often positioned as a loss-leader to attract clients, and banks then expect to turn a profit through high interest margins and the cross-selling of other, profitable products, such as deposits, overdrafts, and insurance. Once with a bank, customers tend to stick with it, partly because switching is not seen as an easy process.

New entrants seldom choose to enter a market by offering low-priced current accounts. They more often focus on

attracting clients by offering high interest rates on deposit accounts, and differentiate themselves on the basis of better service.

In countries where the price of core banking products and services is relatively high, we looked for reasons for their higher rates, including, for example, the extent to which they might be compensating for lower sources of income from other areas, such as interest rate spreads between savings and loans or pricing for small businesses. But we found no evidence that this was the case. On the contrary, Italy—which comparatively has the most expensive core banking services—has one of the largest interest rate spreads (see Figure 6). It quickly became clear that the

Figure 6: *Interest Rate Spreads vs. Pricing Index, 2003*





determinants of pricing are not as obvious as we expected, and our research would lead us to investigate many other factors that might affect the pricing of retail banking products and services in various countries.

Macroeconomic Factors

The average price of a comparable set of core banking services across different countries varies by as much as a factor of fifteen, and other, noncore banking charges outside the scope of our survey explain only part of this difference. Macroeconomic factors such as local income, labor costs, market size, and competitive environment would be expected to be major contributing factors to price, along with less quantifiable influences such as behavioral factors and the degree of regulation in a particular market. We focused considerable attention on these areas to assess the accuracy of this assumption.

Local Income. In countries with higher incomes, banks might be expected to charge more for their core products and services. Yet we found no evident link between pricing and country incomes or purchasing power parity. Gross domestic product (GDP) is very similar across many European countries. GDP per capita in France, for example, was €28,859 in 2002, while in the U.K. it was only slightly higher at €29,708.¹ Nonetheless, the average price of core banking services in France at that time, €102, was almost twice the U.K.'s €56.

Labor Costs. Finding no obvious links between income and pricing, we turned to domestic labor costs, which definitely influence a bank's cost base. Surely this would affect local pricing. In fact, no evidence emerged to support this hypothesis. While unit labor costs and productivity vary considerably across the survey group, higher unit labor costs do not necessarily lead to higher prices for core banking services. Again counterintuitively, the opposite proved to be more common. In the U.K., which

has some of Europe's highest labor costs, the price of core banking services is relatively low. The reverse is also true—Italy's labor costs are below Europe's average, yet the average core banking charges for an Italian customer are relatively high.

Market Size. We also examined the impact of market size on pricing, seeking to test the logical hypothesis that in a market with large numbers of customers (such as the United States), scale economies might enable banks to offer lower prices; or, conversely, that in a geographically dispersed market, banks would have a higher cost base and might of necessity charge their customers more. Once again, no obvious relationships surfaced, whether measured by volume, value, or geographic area.

Competitive Environment. Assessing the impact of the competitive environment on pricing practices in national markets was a more difficult task. In most countries we studied, banking is a concentrated industry with a few large, local players (see Figure 7).

We analyzed and weighted several variables, such as the number and size of players and the number and diversity of new entrants in each country. When we compared this data to our pricing index, no clear link emerged between these two variables. Countries with highly consolidated markets (such as Benelux) or with many new entrants (such as the U.K.) offer the lowest prices.

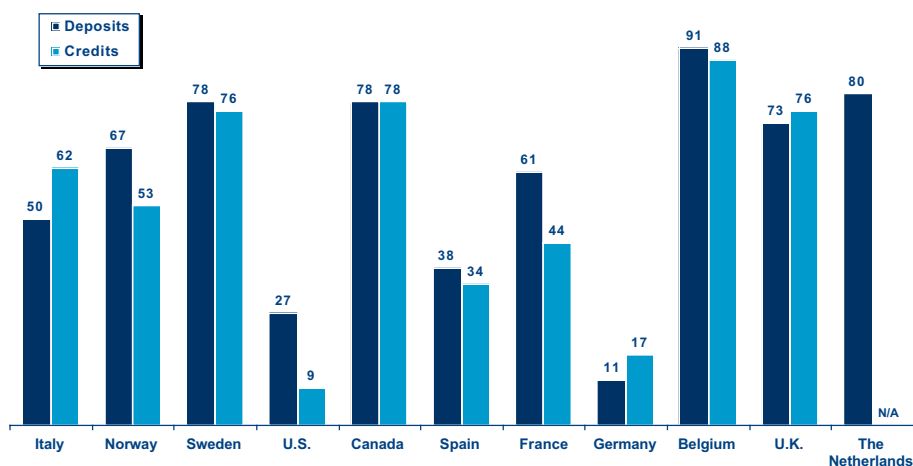
As a result of these findings, we concluded that high prices cannot be attributed to a single macroeconomic variable, and we turned our attention to less quantifiable sources of potential pricing drivers—regulation and customer behavior.

Regulation

Regulators have long played an important role in shaping retail banking practices, and we soon found there is a link between the degree of regulatory pressure and pricing in national markets. Retail banking is a heavily regulated industry,

¹OECD data for 2002, www.oecd.org/dataoecd/48/5/2371372.pdf, and [55/63/18624791.pdf](http://www.oecd.org/dataoecd/55/63/18624791.pdf), 24 February 2004.

Figure 7: *Market Share, Top Four Retail Banks, by Country, 2002 (%)*



Source: CGE&Y analysis, 2003–2004.

and a government's priority is to ensure a stable and reliable banking system.

To begin with, citizens must have confidence in their banks. It is not in the public interest to liberalize banking to the point where banks struggle to survive. In France, for example, banks may not pay interest on deposits, and in Germany, interest rates are capped to limit the competitive possibilities they might create.

All western governments regard certain banking services as an essential element in everyday economic life. In France and Sweden, for instance, you cannot rent living space unless you present a bank statement, and partly as a result, bank accounts are free by law. However, although we found evidence in Spain and Italy that the role of government has decreased over the past few years, we also found evidence to the contrary in Canada and the U.K., an example being the Universal Banking Act legislated by the U.K. government in 2003.

Regulators also influence pricing by mandating the use of certain products and services. France is a case in point—certain transactions in that country must be made by check. Issuers of bad checks face severe legal penalties, merchants that accept checks receive tax breaks, and most important, banks are required to offer free checking to all their customers.

Customer Behavior

Some observers believe that differences in customer behavior across national boundaries are the primary reason for the offering and pricing differences across countries, and this belief has apparently deterred many organizations from making cross-border comparisons. Customer behavior no doubt plays a role at the local market level, and it has a significant influence on pricing models. Customer dissatisfaction with limited banking hours, for instance, has forced banks in many countries to open on Saturdays and provide 24-hour call center services. And when a U.K. bank decided to close its unprofitable rural branches in 2000, a vociferous public outcry and unfavorable media attention convinced the bank to cancel this plan. Customers undoubtedly have power.

Conversely, bank pricing strategies can encourage customers to change their behavior. In the Nordic countries, banks demanded premium prices for branch transactions, and concurrently offered free Internet and call center access. Customers soon turned away from branches toward direct channels. As a result, Sweden and Norway have comparatively few branches and ATMs per capita, which have high maintenance costs, and both countries boast an exceptionally high ratio of remote transactions per customer.





Summing Up

Our initial research on the pricing of core banking services led us to a perplexing finding: the pricing of core banking varies enormously across developed countries and varies less within domestic markets. The second half of our research—on pricing drivers—brought us to several conclusions. First, the pricing of core banking services in a particular country is apparently a purely domestic decision that seldom factors in how banks in other countries are setting their prices. Second, many local structural factors that have developed over time combine to influence a particular domestic market's pricing, which all local market players apply.

This pricing, in many cases, is not consistent with that in other countries, even next-door neighbors. It has developed over the years and is the result of a delicate balance between regulators' efforts to maintain a stable system, consumer associations' and governments' pressures to cap prices, and banks' determination to influence customer behavior away from the most costly services to more cost-efficient alternatives.

Customers rarely investigate the price of banking outside their home country, as they have little interest in comparing the price of banking services in a country where they do not have an account, and making such comparisons would not be a simple task. Banks, meanwhile, use the

local market model as a given, despite the wide gulf between prices from one country to another (see Figure 8). Like their customers, they have thus far regarded serious comparisons across borders as difficult and unnecessary. The impact that the single currency in Europe will have on these prevailing attitudes remains to be seen.

A Changing Landscape

We are undoubtedly heading toward a new landscape of closer cross-border integration and larger players with significant scale. Given the trend toward globalization, integration across borders looks inevitable, despite the pressure established local players might exert to maintain the status quo.

Two scenarios would be likely to trigger major change and drive toward international pricing harmonization. Each would shake the foundation of existing pricing in any country where it occurred.

The intensifying interest that regulatory bodies are focusing on pricing issues might trigger the first scenario. As the European Commission becomes increasingly aware of pricing differences across borders, it could decide to accelerate the process of retail banking harmonization through directives that streamline retail bank pricing policies. The impact of such a decision would be huge, and would not only upset the local pricing equilibrium but also challenge banks' existing business models.

Figure 8: *Price-Range Disparity between Domestic and International Markets*

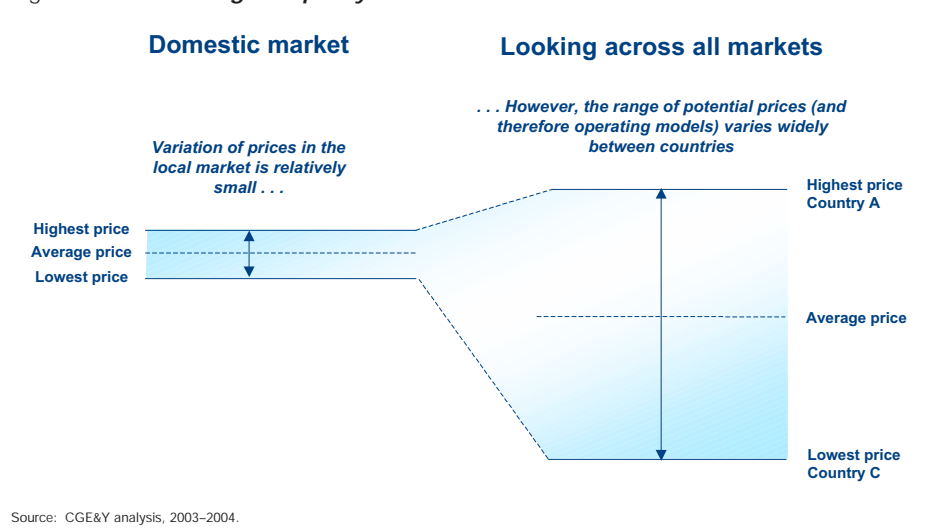
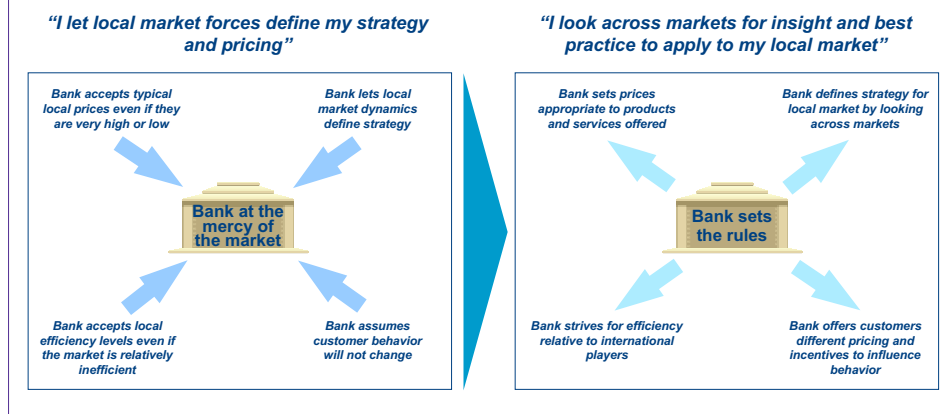


Figure 9: *The Local-Global Paradigm Shift*



We call the second scenario “The ants move the tree.” In this case, several focused niche players independently enter a particularly interesting domestic market with different products and pricing strategies, putting additional pressure on interest rates and other variables that today bring profitability to the established local banks. Their combined actions could break the domestic pricing pattern.

The impact of these and other scenarios on retail banking incumbents depends on how they react. Some might choose to stand and fight for perpetuating the status quo, lobbying with regulators to keep restrictions in force to maintain stability. In many markets this might sustain current profit margins for some time to come, but players that choose this option will face increasing risk from inevitable competitive threats.

Taking the Next Step

To thrive in this environment, in which major change seems imminent, some retail banks will consider shifting from a local to a global pricing strategy (see Figure 9).

In today's local pricing strategy, banks follow their local counterparts, accepting domestic market dynamics and efficiency levels as given. They assume they have little power to influence customer behavior and that market composition will change only slightly in the future.

In a global pricing strategy, in contrast, a bank strives to maximize efficiency compared to its international counterparts, defining and applying a pricing strategy for each market while taking a global perspective on profitability. The strategy is driven by careful segmentation and the belief that customers can be moved away from costly transactions to more efficient alternatives by increasing the value for money the bank delivers to each customer.

The scene is set for change. Major players, consumers, and regulators can readily make cross-border price comparisons, and it is only a matter of time before a more integrated global market emerges. As this change progresses, forward-looking banks with a global perspective toward pricing strategies might well enjoy a first-mover advantage.





Methodology

We have taken the consumer standpoint to benchmark the pricing of core retail banking products and services across eleven countries. As shown in Figure 10, our analysis is based on a representative sample of seventy-three major retail banks in nine European and two North American countries. For this first edition, we limited the scope to core, day-to-day banking products and services—account management, means of payment, cash utilization, and exceptions handling (Figure 11).

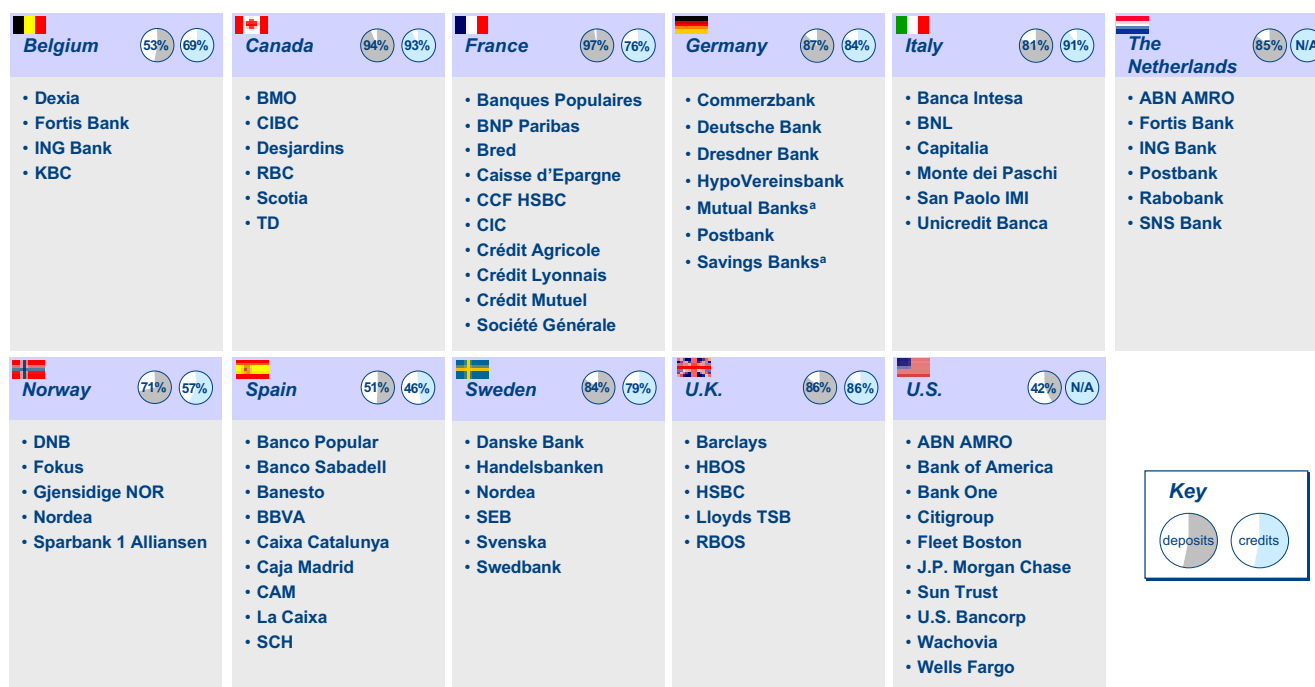
Eleven country teams completed the research in three stages over eight months. First, we scanned the entire domestic banking environment of each country, and mapped it in a detailed dashboard format (see Figure 12). Second, we analyzed the pricing schemes of the seventy-three selected retail banks, ranked each country's average on a common pricing index, and completed a

correlation analysis of the key variables. Finally, the core team validated the findings through focus interviews with banking experts and economists.

The dashboards provided a comprehensive view of the banking environment in each country. Competition in each country was studied first to identify the major players based on market shares (using total deposits and total credits as the metrics). The market analysis enabled us to select in each country a group of retail banks representing a significant market share. To be consistent across countries, we only included retail banking activity.

To build the pricing index, we grouped basic banking into the four families highlighted in Figure 11, and broke them down into products and services. We then defined three customer profiles based on frequency of use of each

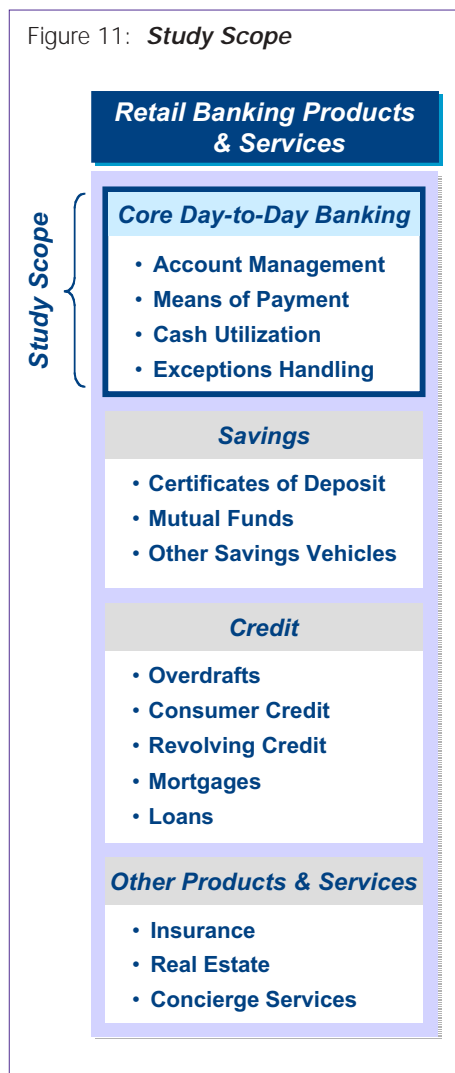
Figure 10: *Our Representative Sample: Seventy-three Retail Banks in Eleven Countries*



Note: Pie charts indicate share of domestic market selected banks hold.

a. Savings banks are linked to the Savings Banks Group (Sparkassen Finanzgruppe) in the public sector, and total about 700 banks owning 13 central institutions; mutual banks are those in the Cooperative Federation (Genossenschaftlicher Verband), which comprises about 1,500 banks, with DZ-Bank and WGZ-Bank as central institutions. The combined groups account for more than 60% of the retail banking market (deposits and credits) in Germany.

Figure 11: **Study Scope**



product in each family: very active, active, and less active. In the first stage of the analysis, these two sets of data (basic needs and frequency-of-use profiles) were identical for all countries in order to enable cross-country comparisons. For each bank, the local teams collected the standard unitary prices as they were broadly advertised by banks in readily available media, such as brochures and websites. To gather the basic prices, we assumed that the prices were for a current bank customer, excluding special conditions granted to new customers.

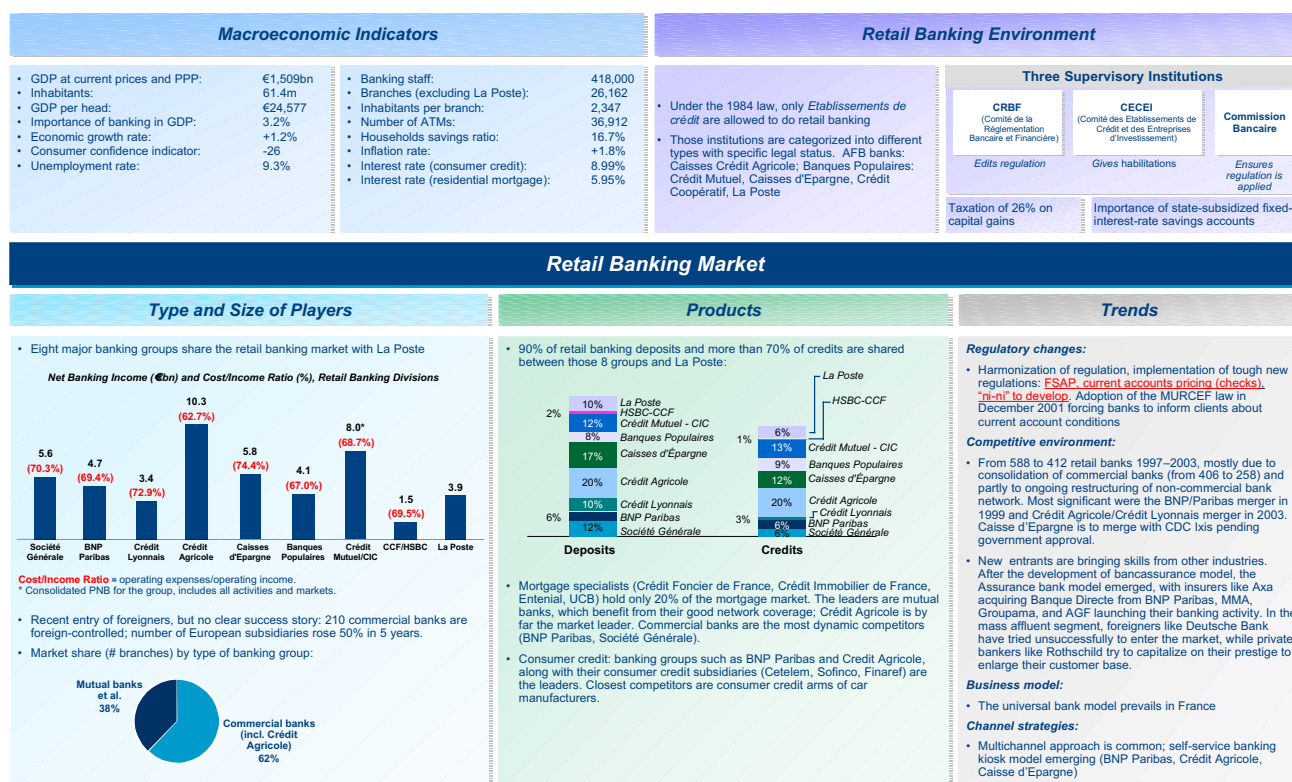
The local teams then developed a pricing index for each country, translating the four basic needs into local offerings of products and services, and noting frequency of use, to better understand local pricing mechanisms and behavioral patterns.

We ultimately compared the ranking of each country's average pricing with its ranking on three types of variables: macroeconomic (GDP per head, purchasing power parity, unit labor cost, interest rate spreads, number of customers, size of the banking sector, competitive environment, regulation, and

extent of market fragmentation), performance indicators (cost/income structure, productivity ratio, cross-selling, number of branches/ATMs), and behavioral patterns (type and number of operations).

In subsequent years we expect to build on this methodology, and generate increasingly accurate data across a broadening spectrum of countries.

Figure 12: **Example of a Country Dashboard – France, 2002**



Source: INSEE, Banque de France, Commission Européenne, annual reports, OECD, CIA ; all figures are 2002, except when otherwise specified.

ING: *the difference in financial services*

ING was created in 1991 from the merger between the largest insurance company in the Netherlands, Nationale-Nederlanden, and one of the largest banks, NMB Postbank Group, thus combining insurance, banking and asset management under one roof.

ING now serves some 60 million customers in more than 50 countries with around 115,000 employees worldwide. In Europe, ING is one of the largest financial services providers. The Group aims to serve each customer to the best of its abilities, whether the customer needs a

savings account, life insurance, mutual fund, pension, starter's credit or complex corporate finance. ING distributes its products and services through branches, the Internet, call centers or insurance intermediaries: it is up to the customer to choose.

In performing its activities, ING seeks the right balance between the interests of all its stakeholders: customers, shareholders, employees and society at large. ING's corporate values are entrepreneurship, integrity, professionalism and teamwork. The Group is also committed to



demonstrating its corporate social responsibility.

ING Group's special skills are ING Direct, insurance in emerging markets and pensions. ING Direct sells simple savings products via the telephone and the Internet in eight large countries. ING offers insurance in various emerging economies in Asia, Latin America and Central Europe. ING also provides pensions, thus responding to the needs of an aging population.

The European Financial Management & Marketing Association

The European Financial Management & Marketing Association is a not-for-profit association with a membership uniquely composed of banking and financial services organizations in Europe.

EFMA seeks to promote innovation in the banking and financial communities by fostering debate and discussion in a setting removed from the pressures of commercial competition. Through meetings and an open exchange of

information, EFMA facilitates dialogue and collaboration among its members, creating a forum for the recognition and study of best practice.

EFMA is funded by membership fees and income earned from events and services. The fees paid by members finance an array of services strictly reserved for members. The income earned from supporting activities enables the association to reduce these fees. This



original arrangement maintains EFMA's neutrality, protecting programs and activities from commercial pressures and ensuring a standard of program quality that is highly valued by members.

The loyalty of EFMA members, representing over two-thirds of the largest banking organizations in Europe, is a testament to its effectiveness in performing this mission.

Cap Gemini Ernst & Young

The Cap Gemini Ernst & Young Group is a world leader in management consulting and IT services. We are dedicated to helping our clients improve the economics of their business through cost-reduction and revenue-growth initiatives that offer an immediate return on investment.

The Group employs more than 52,000 people throughout Europe, North America, and the Asia-Pacific region, and reported global revenues of approximately 5.4 billion euros in 2003. We offer local and international clients in

35 countries a range of services, including management consulting, systems transformation, and systems management.

The Cap Gemini Ernst & Young Group has developed extensive expertise in retail banking over 30 years. Our professionals cooperate in the firm's global network, serving the world's leading financial services organizations. Through this highly skilled network, our consultants share knowledge, create leading-edge ideas, and establish industry-wide competencies that ensure our clients

receive the best possible advice and assistance.

The Group's Retail Banking practice helps clients develop leading innovative strategies. We work side-by-side with our clients to implement successful solutions, including customer relationship management; Internet-based, self-directed, and full-service offerings; front- and back-office systems; straight-through processing; project management; and outsourcing.



