Global Sourcing
Market Update: October, 2007 – Preview Deck

Topic: Bank of the Future – The Emerging Operating Model
Industry trends are transforming the operating models of U.S. banks

**Implications for banks’ operating models**
- Increasing use of outsourcing and offshoring as levers to achieve highly efficient and sophisticated back offices
- Transformation in banks’ operating models, driven by outsourcing and offshoring, requires fundamental changes
  - Managing people to managing outcomes
  - Managing by service levels
  - Implementing new governance models and capabilities
  - Changing risk profile
- Given the significant benefits of outsource/offshore-centric models, this trend is here to stay and likely to accelerate
- Regulators are taking note of above and will try to manage macro-level risks
- Suppliers need stronger capabilities to manage new complexities and risks

**Banking industry drivers**
- Continuing consolidation at regional and national level
- Technology playing an ever increasing role – both in back office and front office
- Increasing cost and effort required to comply with regulatory requirements
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Banking outsourcing trends

- The revenues of Tier-1 ITO and BPO suppliers in the financial services domain have registered growth rates of 42.3% and 37.1% respectively from 2002 to 2006
- Offshore delivery of services has entered the emerging rapid growth phase of the outsourcing cycle
- Financial services firms account for 45% of the offshore imports (US$16 billion) – by far the largest industry
- India is the largest destination for offshore spending by U.S. financial services firms, accounting for 57% of offshore spend
- In addition to sourcing from third-party suppliers, banks have used captive centers and partnership-based models like Joint Ventures (JV) and Build Operate Transfer (BOT)

Operating model transformation

- The transformation underway currently will result in an operating model in 2010 that is significantly different from the one today
- Banks are utilizing global communication links to build a physically distributed network of service providers and captives
- As a result, complications arise along the following dimensions:
  - Geographic dispersion (e.g., risks, regulatory environment)
  - Geographic distance (e.g., working around time zones)
  - Multiple sourcing models (e.g., third-party suppliers, captives)
- This complexity impacts all stakeholders (i.e., employees, customers, shareholders, and regulators)
Key messages (page 2 of 2)

Emerging risks and benefits

- Firms have realized value beyond cost savings in areas such as delivery quality and timeliness
- The savings realized by offshore outsourcing transactions are of the magnitude of 30%. We expect labor arbitrage, the driver of the cost savings from offshoring, to last for several decades
- Risk analysis of the new operating model of banks should include the following dimensions: financial, operational, organizational, legal, and strategic

Regulatory implications

- The pioneering companies’ rapid adoption of offshoring has led regulators to study the implications of this trend in the following areas: financial, operational, jurisdictional, security, and law enforcement
- The two areas where new risk-related issues emerge at the system level are concentration of risk and the management of risk

Success factors

- Shaping the bank of the future will involve taking decisions on six key design points:
  - Which functions should be outsourced or offshored?
  - Should processes be outsourced individually or as full-service BPO?
  - Should technology be bundled with outsourced processes?
  - Is it better to outsource or offshore to a captive center?
  - What should be the destination for offshored operations?
  - What governance and risk-management actions are required?
Use of captive centers has enabled banks to leverage offshore service delivery for a variety of functions...

### EXAMPLES

<table>
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<tr>
<th>Organization</th>
<th>IT¹</th>
<th>BPO²</th>
<th>CC³</th>
<th>KPO⁴</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>HSBC Holdings</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>HSBC uses its captives to provide customer support, transaction processing, software development and solutions for the HSBC Group companies</td>
</tr>
<tr>
<td>JPMorgan</td>
<td></td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>JPMorgan’s captive operations include data processing, transaction processing, contact center, risk analysis, and other fairly advanced derivative transaction support work</td>
</tr>
<tr>
<td>American Express</td>
<td></td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>F&amp;A back-office HR processing, voice- and data-based customer services, fraud and risk modeling, and financial processing to Amex customers worldwide</td>
</tr>
<tr>
<td>Standard Chartered</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td>Banking operations, global HR processes, finance and accounting services, software development and maintenance, support for global treasury operations and providing IT helpdesk support</td>
</tr>
<tr>
<td>Citigroup</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td>Finance and processing of loans, contact center</td>
</tr>
<tr>
<td>ABN AMRO</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>ABN AMRO central enterprise services provides processing services for ABN AMRO banks worldwide. Select contact center and IT functions are also provided</td>
</tr>
</tbody>
</table>

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¹ IT includes application development, maintenance, testing, infrastructure management, software product development, etc.
² BPO includes transaction processing, F&A, HRO, industry-specific back-office processes (e.g., banking, insurance), etc.
³ CC includes voice and non-voice customer service, sales & marketing support, order processing voice support, etc.
⁴ KPO includes business research, analytics, knowledge management, etc.

Source: Everest Research Institute (2007)
Our research suggests that banks in 2010 will look very different from banks in 2007, which are a far cry from those in 1990

<table>
<thead>
<tr>
<th>Bank of 1990</th>
<th>Bank of 2010</th>
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<tbody>
<tr>
<td>Local competition and service base</td>
<td>Consolidating industry with a number of national and multi-local banks</td>
</tr>
<tr>
<td>Largely local operations</td>
<td>Operations spread nationally and internationally</td>
</tr>
<tr>
<td>IT moderately important to business</td>
<td>IT critical to business</td>
</tr>
<tr>
<td>Some outsourcing of business processing (e.g., check processing, card processing)</td>
<td>Substantial outsourcing of IT and other business processes to multiple suppliers</td>
</tr>
<tr>
<td>No offshoring of jobs</td>
<td>New organizational models to accommodate offshore staff and suppliers providing outsourced and offshore services</td>
</tr>
<tr>
<td>Straightforward organization model</td>
<td>New organizational models to accommodate offshore staff and suppliers providing outsourced and offshore services</td>
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Along with multiple benefits, the new model also raises some unique risks for banks

<table>
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<tr>
<th>Dimensions of risk</th>
<th>Description of risk</th>
<th>Examples of risk</th>
</tr>
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</table>
| **Financial**      | A risk that would change the expected financial outcome of a solution | - Total charges/savings  
- Pricing  
- Productivity  
- Inflation  
- Currency fluctuations  
- Local taxes  
- Liabilities |
| **Operational** (including technical) | A risk that would prevent the solution from meeting current or evolving business requirements | - Quality  
- Process control  
- Buyer adaptability to offshoring  
- Transition management and knowledge transfer  
- Geopolitical  
- Infrastructure |
| **Organizational** | A risk that hinders the organization’s (i.e., buyer, supplier, or governance) ability to enable the desired outcomes | - Attrition  
- Cultural fit and communication  
- Stakeholder backlash  
- Governance |
| **Legal** | A risk that puts the relationship sufficiently out of legal conformity (i.e., contract, regulations, enforceability) | - Regulatory compliance  
- Termination  
- Data security and privacy  
- Intellectual property  
- Limits on immigration |
| **Strategic** | A risk that the solution would not support or would fall out of alignment with the strategy of the organization | - Fit with strategic imperatives  
- Control  
- Illegal transfer of funds  
- Money laundering |
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ERI-2007-2-PD-0169