fs viewpoint

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May 2012

2012: The Revenue Is Not Coming Back:
It's Time to Manage Costs Differently

Point of view

There is widespread agreement in the financial industry that a "new normal" exists. With increased regulation and capital requirements as well as limited revenue leverage, we believe that significant business-model change will be needed going forward.

"Battered by a weak economy, the nation's biggest banks are cutting jobs, consolidating businesses and scrambling for new sources of income in anticipation of a fundamentally altered financial landscape requiring leaner operations… In response, bankers are turning to the one area that is easiest to control—costs. They have begun programs aimed at cutting operating expenses, which have risen almost 13 percent since 2008."
— The New York Times [1]

"Have paradigm shifts in economic conditions, regulatory requirements, and customer needs created a 'new normal' in the environment in which we will operate?… All told, the sum of these changes to the banking landscape suggests that a 'new normal' does exist, perhaps not permanently for all conditions, but for most changes at least on a protracted basis for some time to come. Not only must bankers overcome the fatigue associated with operating under these difficult conditions for an extended period, they must understand how their bank fits within this new environment."
— ABA Banking Journal [2]

1 Eric Dash, "Profits Falling, Banks Confront a Leaner Future," *The New York Times*, August 28, 2011.

2 Joseph H. Cady and Nichole Jordan, "Remaking Your Bank in the New Normal," *ABA Banking Journal*, March 9, 2011.

Given the macroeconomic forecast, financial institutions can no longer grow their way out of their problems. Instead, they must make difficult choices regarding their operating models.

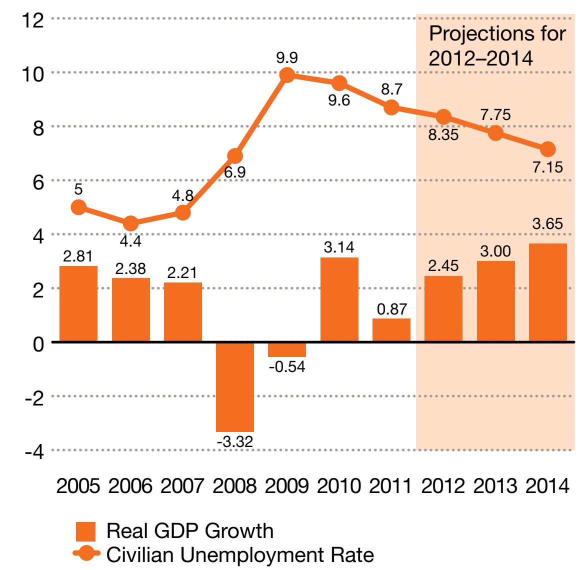
The current economic environment, both in the United States and abroad, continues to prove challenging.

In his press conference on January 25, 2012, Federal Reserve Chairman Ben Bernanke remarked, "Incoming information suggests that the economy has been expanding moderately, notwithstanding some slowing in global growth. The Committee expects the pace of economic growth to be… moderate over coming quarters, reflecting ongoing drags from the housing sector and still-tight credit conditions for many households and smaller businesses. Specifically, participants' projections for the growth rate of real gross domestic product in 2012 have a central tendency of 2.2% to 2.7%. Strains in global financial markets continue to pose significant downside risks to that outlook."[1] (See chart.)

"For advanced economies, the International Monetary Fund estimates growth of only 1.9% in 2012 compared with a historical average of about 3%."[2]

"The European sovereign debt crisis has worsened the economic growth problem. And the uncertainty over how far the crisis will spread in Europe is bound to drive down takeover volume."[3]

Federal Open Market Committee (FOMC) projections for real GDP growth and civilian unemployment rate



Note: Unemployment rate and GDP projections are central tendencies (mean)

Sources: Federal Reserve Board and Haver Analytics

1 Ben Bernanke, Federal Open Market Committee Press Conference, January 25, 2012. Transcript available from: www.federalreserve.gov. Accessed February 9, 2012.

2 Steven M. Davidoff, "As the Economy Goes, So Go Takeovers, Even Though Bargains Abound," *The New York Times*, October 18, 2011.

3 Ibid.

Business areas that traditionally provided revenue growth for financial institutions are not growing sufficiently to overcome new capital and regulatory requirements.

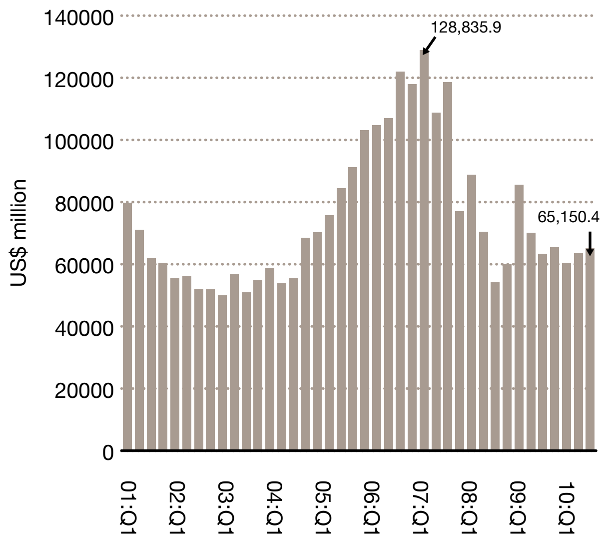
Activity levels of several major financial sector businesses are flat or declining.

Total revenue for US domestic broker-dealer operations as of Q4 2010 were approximately half their high of $128,835 million in Q4 2007.

Mortgage loan applications for purchases have declined steadily since January 2005.

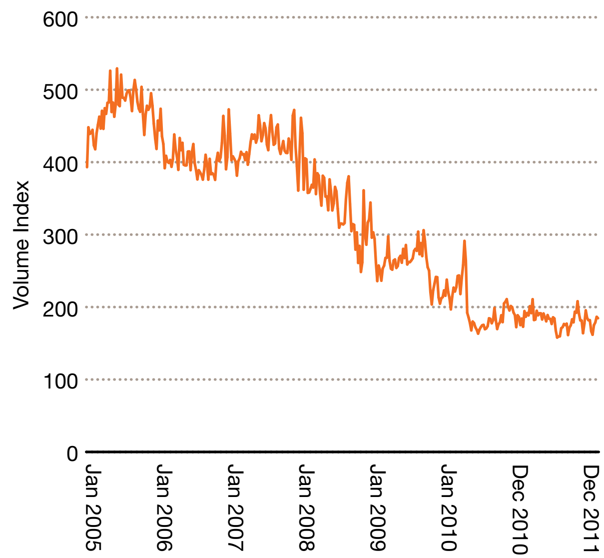
Commercial and industrial lending were 15% lower in February 2012 than the high in October 2008.

US Securities Industries Total Revenue



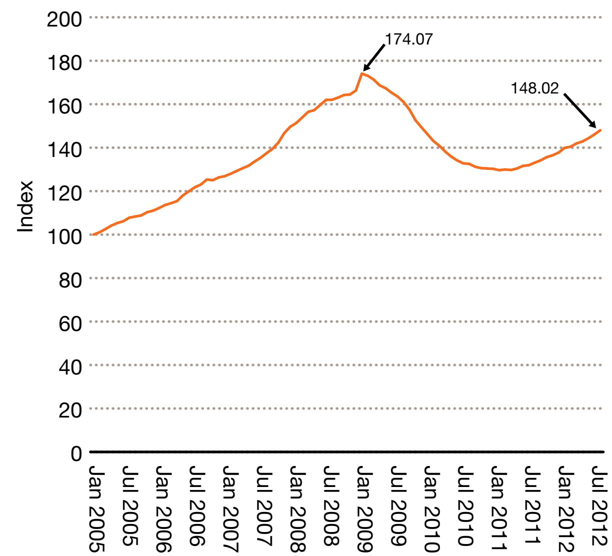
Source: SIFMA. US domestic broker-dealer operations of all NASD and NYSE member firms. www.sifma.org. Accessed January 26, 2012.

Mortgage Loan Applications for Purchases, Seasonally Adjusted



Source: Mortgage Bankers' Association / Haver Analytics. March 16, 1990 = 100.

Commercial & Industrial (C&I) Loans in Bank Credit: All Commercial Banks, Seasonally Adjusted

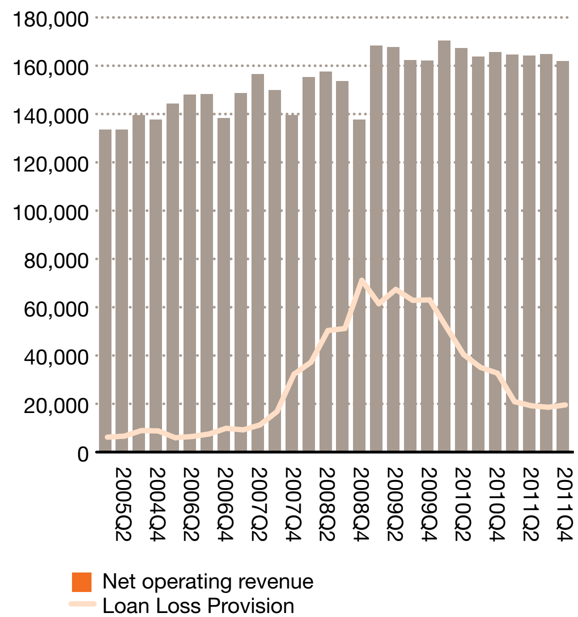


Source: Federal Reserve Board, Haver Analytics, and PwC calculations. January 1, 2005 = 100.

The "new normal" is providing a wake-up call to financial institutions.

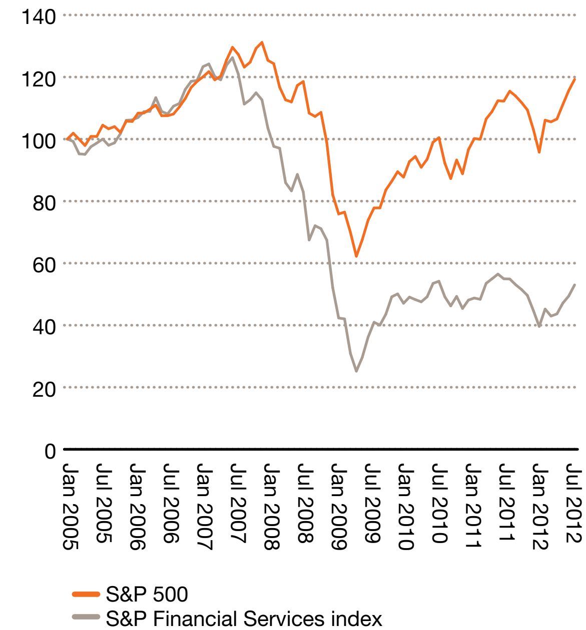
With increased regulatory capital requirements, lower trading volumes, shrinking balance sheets, more conservative risk appetite, cost-cutting, and declining profits, finding new ways of doing business has become critical.

Provisions Continue to Decline, but Revenues are Not Growing



NOTE: Net operating revenue = net interest income + non-interest income
Source: FDIC. Quarterly Banking Profile Second Quarter 2011, Chart 3. www.fdic.gov

S&P 500 Index versus S&P Financial Services Index



Source: Wall St. Journal, Standard & Poor's, Haver Analytics, and PwC calculations. January 1, 2005 = 100.

Key Metrics for S&P Financial Services Index 2005-2012

Open	Jan 2005 = 401.56	Close	Mar 2012 = 212.84
High	May 2007 = 506.99	Low	Feb 2009 = 101.15

Capital is now a key driver in all strategic business decisions. Amount, usage, and return on capital are dictating business-model decisions. Financial institutions are waking up to the following needs:

- Divest non-core businesses.
- Eliminate underperforming businesses.
- Extract the maximum return on equity (ROE) from their core performing business.

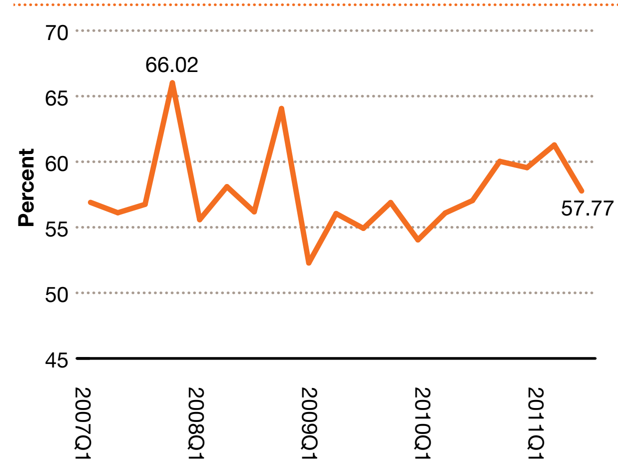
Given the dismal outlook, many financial institutions are seeking to reduce their cost base. However, many of the approaches taken have not been fully effective.

Common short-term cost-cutting measures		Limitations
Headcount reductions, hiring freezes, and bonus reductions	By September 2011, nearly 100,000 planned and actual layoffs had been announced by banks in the US and Europe.[1]	Causes morale to drop; headcount and compensation usually drift upward as focus on cost reduction wanes.
Elimination of non-core businesses	Many financial institutions are divesting non-core businesses to reduce costs, strengthen management focus, and comply with new regulatory requirements.	"Stranded costs" related to divested assets, such as shared services or technology expenses, often remain after a divestiture.
Policy changes	Many financial institutions are tightening their policies for expenses, such as first-class travel, events, non-client entertainment, and meals.	Employees may become cynical when policies are seen as being dictated by changes in P&L.
System and process reviews	Institutions are expanding existing outsourcing initiatives and exploring new ones in areas such as finance, research, operations, and front-end business support. Large technology spends are also being assessed for their potential ROI. Internally sponsored programs, such as leadership, diversity, advertising, and corporate philanthropy, are being scrutinized as well.	An institution's operations and morale can be significantly impacted. Projects take a long time to bear results.

Financial institution stock prices are a reflection of the new normal.

Banks have not become more efficient despite their cost-cutting efforts.

Efficiency Ratio (%) for US Commercial Banks



Source: SNL Financial data

1 Sarah White and David Hulmes, "Nomura axe hangs over 5 pct of European staff," *Reuters News*, September 13, 2011, www.reuters.com.

Going beyond individual, one-time cost-cutting programs, leading institutions are breaking down historical barriers to better manage costs in a more sustainable way.

Traditionally, when normal business cycles start to take hold, institutional expenses start to creep up again

However, with financial institutions being unlikely to grow their way out of their current problems, new tools are needed to enable financial institutions to maintain expense discipline enterprise-wide. Leading institutions are strategically approaching this challenge by implementing a continuous expense management process as opposed to short-term cost-reduction initiatives.

Our definition of continuous expense management:

- Ensuring that the organization's use of resources matches its ability to generate a sufficient return to shareholders.
- Elevating the management of costs to the same relentless focus as revenue and customer service.
- Maintaining a permanent, integrated focus on organizational efficiency—not a project-related response to market conditions.

We have observed that approaches to expense management undertaken by financial institutions vary across the following spectrum.

Key actions/Steps	Common obstacles	Historical cost-reduction approach	Continuous expense management
Engage the board of directors and the CEO, and hold them accountable	• Cost focus has typically been "point-in-time" and in the nature of a relatively short-term program. This view needs to change.	• The CEO talks about the need for cost-cutting initiatives. • Cost-reduction targets are communicated to the organization. • Progress reviews are held quarterly.	• The CEO involves the board in strategic decisions regarding expense management and reports progress to the board monthly. • Expense management initiatives are reviewed weekly by the CEO. • Cost-reduction targets are communicated and clearly understood by the entire enterprise.
Utilize rewards and incentives	• Strategic goals around expense management will need to be built into performance scorecards for relevant management.	• The institution focuses on cost-cutting initiatives and dollars saved, but may overlook individuals who drive cost-cutting results. • Employees are not given meaningful incentives or rewards for their cost-management efforts.	• Employees at all levels are given expense management responsibilities and held accountable. • Benchmarks and metrics are agreed upon and communicated to all employees. • Results are evaluated and communicated frequently, not just annually, so employees are rewarded for their efforts and results in a timely manner.

Going beyond individual, one-time cost-cutting programs, leading institutions are breaking down historical barriers to better manage costs in a more sustainable way. (continued)

Key actions/Steps	Common obstacles	Historical cost-reduction approach	Continuous expense management
Build a cost management and productivity function	• Such structures are typically temporary to support the cost-reduction program.	• A cost czar is appointed. • Ad hoc committees are formed to focus on cost-cutting ideas. • Senior executives are given dual responsibilities for handling full-time positions and cost-cutting committees.	• A cost and productivity function is headed by a senior executive. • The executive maintains a matrix relationship to other key employees throughout the organization to manage costs. • The newly built function provides tools, metrics, and support to the entire organization, both for managing expense and measuring productivity. • The appropriate expense management specialists are involved in real-time expense decision making.
Review current cost-allocation procedure and develop relevant allocations and mapping	• Institutions typically do not have a transparent understanding of their costs. It can take time and investment to reengineer that process.	• Few efforts are made to educate current business owners about cost-allocation methodology. • There is little understanding of the true drivers of costs and limited or no transparency into the cost-allocation process.	• Allocation is based on cost drivers that reflect the true consumption of resources. • Legacy cost-allocation processes are updated to reflect current operations and to measure the cost of servicing particular products and customer segments. • Business owners are provided with support to understand the allocation process. This allows revenue generators to assist in identifying areas for cost reduction.

Going beyond individual, one-time cost-cutting programs, leading institutions are breaking down historical barriers to better manage costs in a more sustainable way. (continued)

Key actions/Steps	Common obstacles	Historical cost-reduction approach	Continuous expense management
Deepen understanding of costs through multiple lenses	• Superficial understanding of costs leads to "GL-based" cost cutting exercises.	• Businesses and functions hack away at costs until they meet headline cost reduction targets. • Necessary strategic discretionary spend is often a casualty.	• A "GL view" of cost, with a transparent understanding of the cost drivers, helps to achieve line item cost improvement. • An "investment view" considers whether the expense will justify the return, for example, in terms of building capability/capacity or launching a new function. • A "business view" looks at the costs as part of a business metric or business process. This highlights opportunities such as improving productivity, combining business functions, and restructuring operating models.
Assess need for business- and operating- model changes	• Demanding exercise requiring broad senior executive support and top-down focus.	• Business and operating model reviews have not traditionally been associated with cost-management efforts.	• Emerging business models, delivery channels, customer needs, and technological innovations are assessed to identify ways to manage/alter operational cost models. • Examples include: leveraging digital channels to attract, service, and retain customers; establishing shared-service utilities; realigning geographic footprint to business; and assessing market needs.

Going beyond individual, one-time cost-cutting programs, leading institutions are breaking down historical barriers to better manage costs in a more sustainable way. (concluded)

Key actions/Steps	Common obstacles	Historical cost-reduction approach	Continuous expense management
Conduct broad and ongoing review of investment portfolio	• Inability to identify and categorize investments. • Inadequate structure, tracking, and governance.	• Typically, businesses have not used a portfolio view to assess how and where cost-management initiatives should be focused.	• Portfolio view of all investments is developed; strong processes and governance mechanisms are instituted to ensure that investments can be tracked and categorized into groups such as "option creating" and "stay in business." • Ongoing portfolio review is conducted to ensure balance between investment categories. This avoids stifling innovation while also preventing a single-minded focus on break-fix activities.
Evaluate productivity and efficiency of existing processes/functions	• Lack of buy-in to evaluate processes, functions, and technologies that are working or have worked in the past.	• Historically, firms have not focused on efficiency and/or productivity as a means to driving cost reduction.	• Material processes, functions, and enabling technologies are evaluated for productivity/efficiency opportunities. • Necessary adjustments are then enabled to drive cost savings through improved processes, functions, and technologies. • Example changes may include automation, labor arbitrage, establishing center of excellence, among others.
Update and refresh analytical tools and reports	• Organizations typically have developed sophisticated analytic reporting on the revenue side, not on the expense side. Investment will be needed for sustainable process.	• Detailed expense reports are created outside the traditional reporting environment. • Reports are used as indicators of performance, but not as predictors of behavior.	• Flexible and detailed analytical tools and expense reports are available for scenario modeling and comparative analytics. • Monthly expense reports are detailed, relating businesses, geographies, and expense-line performance to budget, prior years, and rolling three months. • Reports are in a relevant format and provide a comparison of the institution's expenses against industry benchmarks. • Reports incorporate productivity metrics that can also be measured against peer performance.

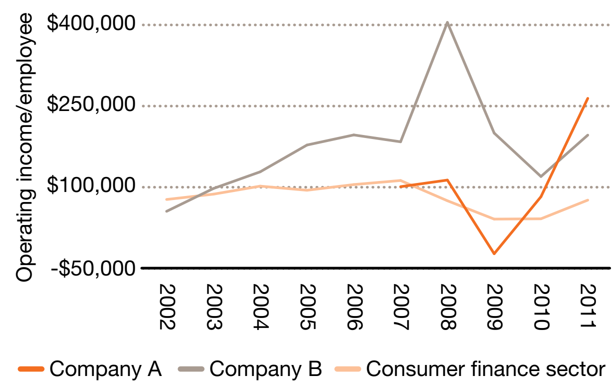
As part of their continuous expense management programs, leading financial institutions also utilize productivity metrics to quantify results and measure success.

Peer-group comparisons of productivity metrics provide a useful benchmark for tracking continuous progress, as shown in the illustrative examples below. This not only quantifies results, providing clear support for business cases and highlighting areas of focus, but also helps institutionalize expense management as an ongoing process.

Retail productivity comparison (2006-2011)

	Consumer finance	Company A	Company B	Sector average
Productivity	Revenue per employee	$437,000	$593,000	$245,000
	Change in revenue per employee	108%	-4%	8%
	Operating income per employee	$260,000	$190,000	$73,000
	Change in operating income per employee	307%	-2%	-25%
Growth	Revenue growth	39%	32%	30%
	Operating income growth	183%	41%	-10%
Profitability	Operating margin	48%	39%	31%
	Change in operating margin	22%	4%	-9%

EBITDA per employee (2002-2011)



Productivity CAGR: '08-11	Share price CAGR: '08-11
124.0%	4.3%
-48.0%	-32.1%
-3.1%	-57.3%

Competitive intelligence

Our observations of industry practices.

Many recent and current programs show aggressive senior management involvement, but still lack critical elements to drive sustained improvement in the cost structure.

	What we observe in the industry		
Success factors	Financial institution A	Financial institution B	Financial institution C
Overall senior executive engagement	CEO reviews cost initiatives monthly, with sole focus on savings rather than details of program. No board review of progress on cost initiatives. Senior business leaders conduct monthly meetings and take ultimate accountability.	CEO gives updates of the cost-reduction project to finance committee of the board every month. Committee consisting of CEO, COO, CFO, and CAO monitors the project biweekly. Agreement on budgets, goals, and action plan (including timeline) on items across the firm.	Group CEO leads a high-profile initiative; rapid progress is being made both globally and in the US on cost reduction. From a project standpoint, senior oversight committees have been formed. However, these will likely stand down once cost-reduction goals have been met.
Strategic business-model changes	Strategic review of all global product market shares and plans for which products should receive investment dollars. Key decisions regarding geographic footprint based on resource needs, business, and competitive advantage. Significant focus on off-shoring all support group functions. ▲	Enhancement of project management monitoring processes, particularly those projects where costs exceed certain thresholds. Stricter rules on "exit strategy" (such as risk-adjusted return on capital efficiency ratio targets) for lagging business lines. No exception to application of cost-management process to any (profitable) businesses (no sanctuary policy).	Standardization of core businesses across every region. Aggressive elimination of non-core businesses in specific regions (including large high-profile businesses) and laser focus on hurdle-rate return on equity. Simplification and de-layering of regional structures to drive productivity.

Leading On Par Lagging

Many recent and current programs show aggressive senior management involvement, but still lack critical elements to drive sustained improvement in the cost structure. (continued)

	What we observe in the industry		
Success factors	Financial institution A	Financial institution B	Financial institution C
Ownership of cost-cutting initiatives	Subject matter experts develop action plans and goals, with every major expense bucket having an owner. Transparent budget and action plan are managed jointly with business and cost-control organization. Every expense in the organization is subject to review. No area is considered off-limits. Drivers of cost-cutting initiatives come from a specialized expense management group.	Each line of business develops an action plan. Special Program Management Office handles financial data on the cost reduction. Transparent budget and action plan shared with all owners.	Little understanding and consistency/ transparency as to how costs are allocated within the organization. This has not delayed or slowed down aggressive cost-reduction efforts. Aggressive project plan, managed top-down. Targets for cost reduction clearly set and understood by all.
Cost allocation and mapping	Cost allocation is reviewed, but there is no strong effort to change existing methodology; would rather give transparency to existing process.	A common set of financial indicators has been agreed upon to evaluate and identify businesses that should be exited. The cost allocation and mapping methodology is mostly project-related rather than a framework for understanding/ managing costs in the future.	Despite rationalization of businesses, little formal work on stranded cost elimination due to lack of transparency and understanding as to how costs are really allocated.

Leading On Par Lagging

Many recent and current programs show aggressive senior management involvement, but still lack critical elements to drive sustained improvement in the cost structure. (continued)

	What we observe in the industry		
Success factors	Financial institution A	Financial institution B	Financial institution C
Analytical tools and reports	Elements of a continuous process starting to emerge through monthly business reviews, quarterly reporting, metric and goal analysis. Budgeting process reflects saves from cost-cutting initiatives. Use of cross-business metrics to incentivize better performance.	Biweekly business review/progress check on big-ticket items; all mainly associated with project progress. Benchmarking to competitors. Solicit small ideas from employees and adopt them to maintain motivation.	Global reporting on cost reduction initiated; however, due to project-based nature, reporting will likely cease once the project is completed. Top-down targeting of cost base and efficiency ratio targets.
Entire firm-wide approach	All businesses and support groups dedicate a team or individual to own savings ideas and be accountable for expense results. No savings initiative embarked on until it is thoroughly understood in a business context. Firm-wide agreement on budgets, goals, and action plan.	Top-down approach on enterprise-wide reorganization initiatives. No area is off-limits for cost reduction.	All businesses affected and all transformation programs are under review. Multiple approaches and work-streams are evident, including rationalization of “spans and layers” and review/ disposition of non-critical businesses.

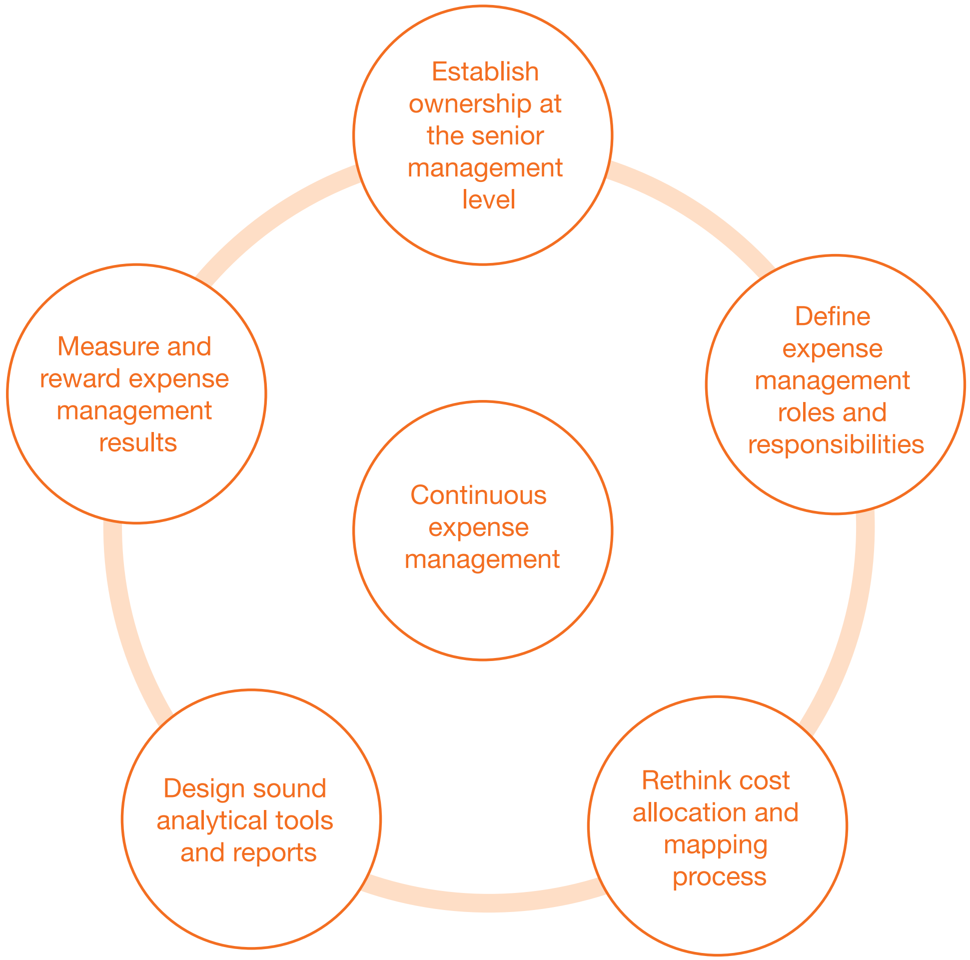
Leading On Par Lagging

A framework for response

Our recommended approach to the issue.

Institutions need effective, continuous expense management to extract value from business-model changes. Productivity improvements become the barometer for success of continuous expense management.

A properly designed expense management process increases the transparency of costs throughout the organization and strengthens the tools designed to analyze them.



With top-down support, expense management should become a leading practice and be perceived as a key success factor.

To achieve this, adopt a top-down approach by engaging the CEO and senior executive management. Their attitudes and actions toward expense management shape the environment and focus of the organization.

An organization sends an important message about the priority of expense management based on:

- Holding cost performance and productivity to the same rigor as revenue performance.
- The place of expense management functions on an organizational chart.
- The utilization of expense reporting and metrics to manage costs.
- The rewards implemented for effective expense management.
- The inclusion of expense management input in relevant decision making.

Define roles and responsibilities

The CEO should appoint an officer responsible for expense management who drives the expense management strategy.

A senior executive—ideally a business unit leader or finance executive—should be appointed to the role of "cost and productivity officer."

This executive is responsible for the entire expense management agenda, including procurement, outsourcing and off-shoring, and major reengineering and transformation projects. This executive should also own the entire "cost-capture and allocation" process as well as the cost side of the planning and forecasting processes. In addition to reporting to the CFO/COO, the cost officer should periodically report the status and results of initiatives to the board so that they can align the input they provided to the results being obtained.

Responsibilities include:

- Engages all aspects of firm with relevant expense information/action plans to impact business decision making.
- Creates multiple forums for enterprise-wide "out-of-the-box" ideas.
- Creates firm-wide matrix cost organization: major expense owners, who manage large expense buckets.
- Builds a small team of expense and productivity experts, who partner with the organization to provide timely information, deep dive analysis, competitive information, and savings ideas.
- Rethinks and reenergizes expense and productivity reporting to make them relevant to business owners.
- Is accountable for crisp execution of all expense plans.
- Partners with finance to make expense budgeting, forecasting, and performance a dynamic exercise.
- Rethinks the cost-allocation methodology.

The cost and productivity officer should have a small team of skilled senior business executives who are responsible for the cost agenda.

Each major expense category, whether it is functional expense such as legal or the total direct expenses of a business unit, should have an owner. In addition to their "normal" reporting lines, these executives will report all expense management-related business to the cost and productivity officer. Traditional cost-center structures are likely to be a casualty.

Rethink cost allocation and mapping process

The cost and productivity officer should develop robust processes to capture costs and allocate them based on measurable consumption by the business.

Understand the costs	Rationale for allocation	Capture costs by category	Allocate and report
• Why are costs consumed, and who is consuming them? • How do unit costs vary by demand volumes? How fixed or variable are the costs, and who is responsible (the demand side or the supply side)?	• What are the cost drivers for different categories of expense and for different consumers of cost (for example, transaction volumes, number of employees, or square footage)? • Is this readily available and measurable? Can it be transparently automated into the allocation and reporting process?	• Does the cost-center structure clearly reflect the services provided and consumed? • Do cost-center "owners" own whole processes, and are they rewarded and capable of driving efficiency?	• Does the business get prompt itemized reports on costs allocated to them? • Does the business only pay for service consumed or capacity provided? Is there a "corporate tax"? • Is there any "negotiation" involved, for example, during the annual budget setting process?

Additionally, solving the questions above addresses the issue of stranded costs.

As organizations continue the process of deleveraging and become more disciplined with their capital, divestitures are becoming more common. Increased transparency illuminates the costs that have become stranded and allows management to assess if and when those costs can be reduced in a more timely manner.

Key principles of cost allocation

- Design cost centers in line with what you want to measure.
- Analyze and allocate based on true cost drivers.
- Have transparent documentation of cost allocation in place.
- Continuously review allocated costs to identify those that do not add value.

Design sound analytical tools and reports

Reports should be timely, easy to use, and serve as the business template for expense discussions.

Once cost-capture and allocation processes are in place, the cost and productivity officer requires flexible analytical tools that enable scenario modeling and comparative analytics across business units and geographies. These tools should adapt easily to changes in the performance management framework. As expenses are incurred infrequently, such as at year-end only, it is important for the institution to understand trends and anticipated expenses when performing modeling and analytics. Reports should also include external metrics for individual expenses to allow for industry benchmarking. Results should be communicated in a timely manner to all users.

Reports generated are detailed at various levels, including business unit, geography, division, and support area; this detail should be available in a timely manner.

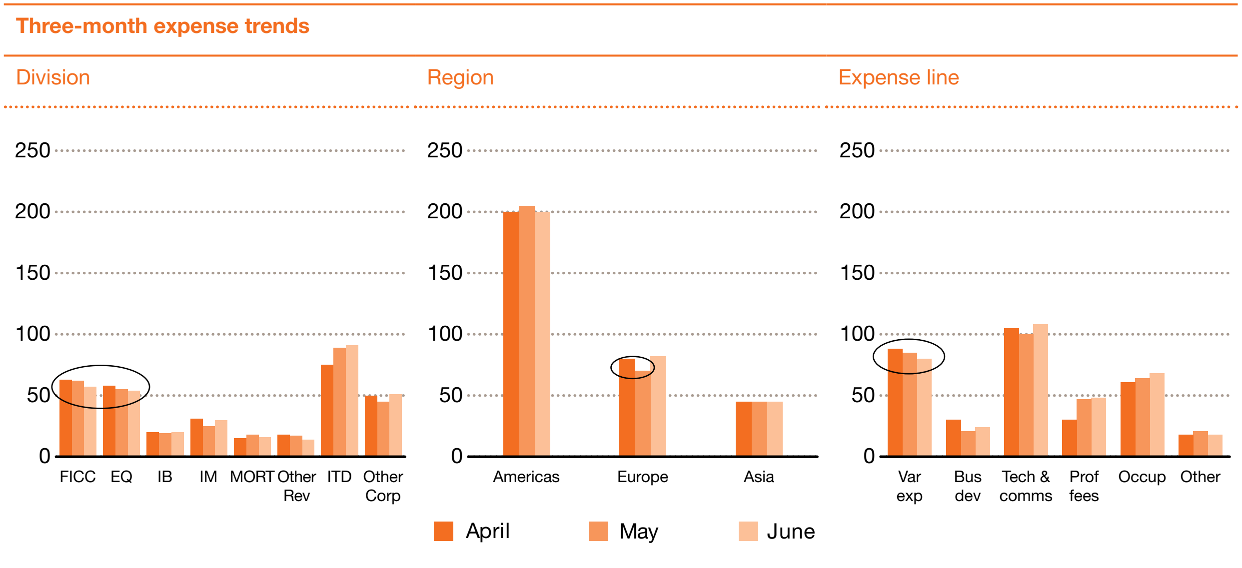
Actual performance results can be compared against the previous year and rolling three months.

	Trailing 3 Months					Variance		YTD		Variance
	Apr 2011 Actuals	May 2011 Actuals	Jun 2011 Actuals	Jul 2011 Forecast	Jul 2011 Actuals	Jun 2011 Actuals	Jul 2011 Budget	Jul 2010 Actuals	Jul 2011 Actuals	Jul YTD 2010 v. Jul 2011 YTD
Divisions										
Business Development										
T&E	5.0	3.5	3.1	2.9	3.6	(0.5)	(0.7)	27.0	24.9	2.1
Corporate Events	1.3	0.9	1.1	0.8	0.3	0.8	0.5	8.5	7.5	1.0
Total Business Development	6.3	4.4	4.2	3.7	3.9	0.3	(0.2)	35.5	32.4	3.1
Tech & Comm										
Mail, Print	0.7	0.7	0.6	0.5	0.6	-	(0.1)	0.6	0.7	(0.1)
Market Data	4.9	4.7	4.3	2.8	4.3	-	(1.5)	30.3	25.7	4.6
Technology	0.3	1.1	0.8	0.6	0.7	0.1	(0.1)	4.2	4.0	0.2
Total Tech & Comm	5.9	6.5	5.7	3.9	5.6	0.1	(1.7)	35.1	30.4	4.8
Geographies										
Asia										
China	17.1	16.6	15.7	14.6	14.7	1.0	(0.1)	97.8	93.8	4.0
Japan	9.6	9.3	9.5	9.3	9.3	0.3	0.1	63.9	62.5	1.4
Singapore	5.6	5.4	4.7	4.5	4.7	0.0	(0.2)	28.1	25.0	3.1
Total Asia	32.3	31.2	29.9	28.4	28.6	1.3	(0.2)	189.7	181.2	4.5
Europe										
France	15.0	17.4	15.3	12.6	12.7	2.6	(0.1)	89.5	90.6	(1.1)
Germany	7.5	10.1	7.2	9.7	9.7	(2.5)	0.1	57.4	54.6	2.8
Switzerland	3.5	6.2	5.1	4.2	4.4	0.7	(0.2)	28.5	23.6	4.9
Total Europe	26.0	33.7	27.6	26.5	26.7	0.9	(0.2)	175.4	168.8	7.7

Design sound analytical tools and reports

The appropriate use of dashboards and analysis helps firms embed continuous expense management into their operations.

Going forward, financial institutions should embed continuous expense management into their strategic business models. When supported by robust processes, this will help end the cycle of cutting costs when revenues fall, and boosting spending when revenues rise. Using the right reports and analysis will help institutionalize the concept of continuous expense management.



The above example illustrates how one leading institution uses enhanced expense data to get a multi-dimensional, time-sequenced view of its enterprise-wide spending. This enables targeted, deep-dive analysis of unexpected trends where appropriate.

Measure and reward results

Executives should be held accountable for achieving expense management goals by linking compensation and rewards with realization of those goals.

In partnership with human resources, the CCO should lead an effort to include enterprise expense management goals and reward individual staff efforts to drive sustainable cost savings as part of an enhanced performance review process. Performance reviews should include measurable performance against expense targets similar to revenue or other individual goals.

The CCO should focus on the following:

Communicate to major expense owners that expense management results will be integrated into their performance review.

Ensure that responsibilities are clear and controllable. For example, if a manager budgets for a 5% increase in a commodity price but it unpredictably rises by 10%, this should not reflect poorly on the manager.

However, if the same manager requests 50 man-hours of shared-service support but only utilizes 30 man-hours, any associated cost incurred by the shared service should be allocated back to that manager.

Develop and monitor key performance metrics continuously. In a timely manner, review actual results against that executive's goals.

Encourage a forum or culture in which not only those executives responsible for expense management can be rewarded. All staff levels should be encouraged to follow sustainable cost reduction. For example, iPlace is PwC's internal Web forum for sharing revenue-generating or cost-saving ideas.

Compensation levels in 2011 were down as much as 30%, driving changes to compensation practices going forward.

- Pay has to be linked to performance.
- Pay must correspond to return on equity.
- The compensation rate must allow for an adequate return to shareholders.
- Not everyone gets a bonus.

How PwC can help

Our capabilities and tailored approach.

It is time for a different approach. Institutions benefit when cost-reduction, expense management, and control processes are put in place to support transformational activities.

Institutions that leverage PwC's organizational-change processes, tools, and concepts to identify and remediate areas for improvement can position themselves to effect sustainable change and reap the value. Throughout our engagement, we transfer our knowledge to your staff—increasingly empowering them to lead change efforts going forward.

Realized benefits across these areas:		**Clients—Reaping the value**
Cost-reduction	• Operations-spend savings from cost-driver and activity-level definition • Discretionary-spend savings from non-critical, contingency, or unsupported balances • Headcount-reduction savings via functional benchmarking analysis • Contract-leakage savings and other invoice-control savings via a forensic contract analysis	On average, our clients… • Save $5 to $20 of cost savings for every dollar spent in fees • Achieve approximately 5% to 10% in cost-reduction opportunities identified via forensic contract reviews • Realize cost reductions ranging from 20% to 30% of the in-scope cost base as a result of productivity improvements, reductions in cycle time and lead time, and working capital reductions
Strategic expense management and controls	• Strong budget ownership, discipline, and accountability established • Outline of critical expense management and control deficiencies identified via gap analysis • Meet cost-reduction demands of regulators, boards, and other stakeholders in this sensitive area	
Transformation	• Improvements to organizational structure, capabilities, and behaviors • Performance-measurement and management-process improvements • Development of productivity metrics and peer-group benchmarking • Waste elimination	
Cost-capture and allocation methodology design	• Improved cost-capture and allocation processes to support the strategy of the organization and what it wishes to measure	
Financial systems implementation	• Advanced financial systems architecture to facilitate and meet regulatory, management reporting, accounting, and tax requirements	

PwC can partner with you on continuous expense management without losing focus on the future health of the business.

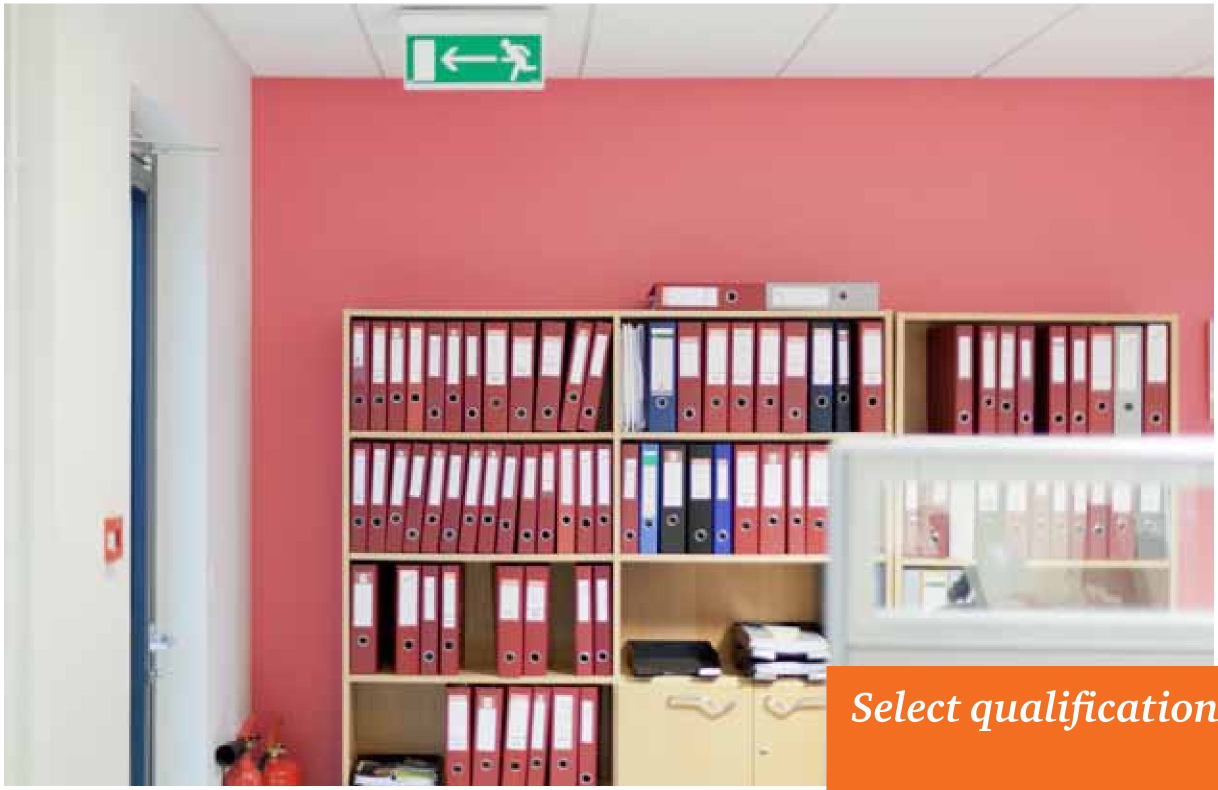
We look across the entire organization—focusing on strategy, structure, people, process, controls, and technology—to help our clients improve business processes, transform organizations, and implement technologies needed to run the business.

Client needs	Issues we help clients address
Reduce costs	• Driving efficiency through shared services • Redesigning Finance to realize efficiency and competitive advantage • Taking control of cost through effective spend management and cash forecasting practices • Driving sustainable cost reduction
Build effective organizations	• Rethinking strategy in terms of markets, geographies, channels, and clients • Restructuring organizational models in terms of structures, policies, and roles • Establishing effective strategic sourcing and procurement • Realizing competitive advantage through effective sales operations inventory planning • Transforming the close and consolidation process to work for, rather than against you
Innovate and grow profitably	• Reshaping the IT function into a source of innovation • Transforming business information to drive insight and fact-based decision making • Evaluating acquisition and divestiture strategies to position for the future • Realizing deal synergy and value • Developing sustainability programs that add value
Leverage talent	• Defining and implementing an effective HR organization • Rethinking pivotal talent
Manage risk and regulation	• Building a risk-resilient organization • Managing Enterprise Resource Planning investment and project execution risk • Safeguarding the currency of business; keeping sensitive data out of the wrong hands • Affirming capital project governance and accountability • Assessing and mitigating corruption risk in your global business operations • Accounting and financial reporting • Third-party assurance • Taxation

What makes PwC's Financial Services practice distinctive.

Integrated global network	PwC US helps organizations and individuals create the value they're looking for. We're a member of the PwC network of firms with 169,000 people in more than 158 countries. We're committed to delivering quality in assurance, tax, and advisory services. Tell us what matters to you and find out more by visiting us at www.pwc.com/us.
Extensive industry experience	PwC serves multinational financial institutions across banking and capital markets, insurance, asset management, hedge funds, private equity, payments, and financial technology. As a result, PwC has the extensive experience needed to advise on the portfolio of business issues that affect the industry, and we apply that knowledge to our clients' individual circumstances.
Multidisciplinary problem solving	The critical issues financial institutions face today affect their entire business. Addressing these complexities requires both breadth and depth, and PwC service teams include specialists in strategy, risk management, finance, regulation, operations, and technology. This multi-disciplinary approach allows us to provide support to corporate executives as well as key line and staff management. We help address business issues from client impact to product design, and from go-to-market strategy to operating practice, across all dimensions of the organization. We excel at solving problems that span the range of our clients' key issues and opportunities, working with the heads of business, risk, finance, operations, and technology.
Practical insight into critical issues	In addition to working directly with clients, our practice professionals and Financial Services Institute (FSI) regularly produce client surveys, white papers, and points of view on the critical issues that face the industry. These publications—as well as the events we stage—provide clients new intelligence, perspective, and analysis on the trends that affect them.
Focus on relationships	PwC US helps organizations and individuals create the value they're looking for. We're a member of the PwC network of firms with 169,000 people in more than 158 countries. We're committed to delivering quality in assurance, tax, and advisory services.

Appendix



Select qualifications.

Streamlined and reenergized expense management through targeted initiatives to achieve greater gains—Global investment bank

Issues	A global investment bank with a long record of successful cost management found that its expense results lagged behind the industry in recent years. The firm decided to replace the group's senior management and needed direction to get back to "best-in-class" performance compared to its peers. The bank also strongly desired to reenergize its cost control effort throughout the entire firm.
Approach	The project was executed in three phases. First, a diagnostic was performed on the existing products and services offered by the cost-management group. Results showed that the group had lost its credibility with the larger organization because of overly aggressive budgeting, poorly thought-out cost-control recommendations, and an inadequate skill set within the members of the cost-control group. Second, extensive interviews with key internal customers identified the need for a partnership between internal customers and the cost control group. Finally, based on the client's decision to reduce the size of the cost-control group, PwC developed a roadmap for transition, as well as roles and responsibilities for the cost-control group and its internal customers. This solution allowed the client to rethink the role of the cost-management group. The bank developed new tools and business-relevant cost reporting, and initiated a major technology revamp of the cost group's infrastructure. The leadership of the cost-management team was replaced with business-knowledgeable, customer-friendly professionals. The cost group's mission was clearly communicated throughout the firm.
Benefits	Over an 18-month period, the cost-management group returned to "best-in-class" performance compared to its peers, and US$600 million of run rate saves were taken out of the firm's operating expenses. With more than 60 positions removed, the headcount of the cost-management group dropped by one-third.

Delivered sustainable cost reductions across the business—Super-regional US financial institution

Issues	A multi-billion dollar banking institution with fully diversified lines of business sought to significantly reduce bottom-line costs in a manner that would cause the least disruption and business risk. Only limited capital was available for any "spend-to-save" investment. This initiative required multiple skill sets and subject matter expertise across both institutional and retail businesses, and the institution's management team needed a service provider that could marshal all of these capabilities to help minimize communication and implementation risks. The institution sought a partner that could execute in a manner that were wholly consistent with its corporate culture, particularly given the sensitivity and likely staff impacts of the engagement.
Approach	PwC delivered a proprietary, sustainable cost-reduction methodology through a cross-line-of-service team, which allowed for specific subject matter expertise to appropriately align with all in-scope divisions and lines of business. The team also performed a cross-business analysis to identify opportunities that spanned multiple divisions, business lines, and areas of management control. Highlights of our assistance included: • Stressing "intelligent business-model changes" instead of simple performance-based headcount reductions to drive savings and limit required investment. • Providing targeted external market analysis and peer and competitor points-of-comparison where required. • Helping to ensure that all recommended changes advanced the organization toward a leading-practice profile. • Risk managing the process so that corporate communications and HR considerations were effectively planned and incorporated throughout. The collective capability of the cross-line-of-service team enabled PwC to provide a seamless, integrated solution as well as the necessary subject matter expertise, leading-practices perspective, and detailed cost-analysis skills required for success.
Benefits	As a result of this engagement, PwC identified cost savings of more than 10% of the total cost base, and the client was able to prioritize and capture these savings in a manner that fully met its requirements for sensitivity to the business and its staff. PwC identified additional savings opportunities in excess of the initial US$200 million goal.

Improved net profits with better strategic initiatives based on accurate understanding of costs—Fortune 500 financial services institution

Issues	In a tough economic environment, the financial institution was losing accounts and profits were declining. Management's vision for recovery involved providing investors with access to low-cost securities, acknowledging that this move would require strict cost control. The institution's home-grown profitability system was incapable of delivering accurate and timely cost metrics. Executives needed a more robust expense management system that would enable them to respond more quickly and to make effective strategic decisions.
Approach	PwC's approach involved an activity-based costing program on a company-wide scale, beginning with the study of the existing organizational structure, employee data, workflows, and expense reports. From this point, PwC was able to determine cost objects and the level at which they should be assigned. PwC next outlined and defined cost drivers. Working with cost-center managers, the finance team, and business consumers, PwC was able to redefine the activity drivers. With this methodology, and an updated reporting system in place, the institution was better able to calculate costs and attribute them to their proper owners in quick fashion.
Benefits	The process resulted in improved efficiency-delivering profitability reports within two days versus eight weeks under the old system with a greater level of information but using half the number of employees. PwC uncovered stranded costs and excess IT capacity, which allowed the company to renegotiate its contracts with outside vendors, freeing up capital. Most importantly, PwC's process provided accurate insight into operational costs, allowing the client to reduce fees and recapture lost customers. The strategic initiatives developed using this process helped to reduce overall costs and improve net profits by US$600 million annually.

Accelerated a cost reduction initiative to create a cost-conscious culture and achieve targeted savings—Fortune 100 multi-line insurer

Issues	The client sought to identify cost-savings opportunities to support an external commitment to shareholders of a significant run-rate expense reduction of US$250 million by year-end.
Approach	PwC performed a rapid assessment of the client's expense base and current cost-reduction program in seven functional areas through interviews, comparison of leading industry practices, high-level data analysis, and benchmarking. Steps involved included: • Performance and spend analysis to define operational cost drivers; peer and benchmarking analysis to identify key "eligible" areas, priorities, and quick hits; and gathering enterprise financial data from internal and public sources. • Meetings with all functional areas to become familiar with existing cost-reduction opportunities and performance relative to industry leading practices and trends. • Creation and documentation of potential cost-reduction strategies mapped by cost, complexity, and benefit. • Assessment of current program progress and individual cost-reduction ideas based on complexity and value. • Development of an implementation roadmap.
Benefits	PwC established the cost baseline through benchmarks and comparisons to industry leading practices, provided targeted cost-reduction ideas to accelerate the planning process, and created a roadmap for functional and enterprise-wide savings. Projected cost savings exceeded the corporate mandate by more than US$150 million. Our project team set in motion a process to create a cost-conscious culture for the client to create a sustainable cost advantage.

Performed a comparison assessment in line with industry best practices to achieve greater cost savings—Major European/American investment bank

Issues	After engaging in an initial analysis of the institution's cost structure, a major European/American investment bank identified areas within its investment banking and private banking operations as opportunities for improvement.
Approach	After obtaining the baseline data, PwC was able to refine target opportunities outlined in the institution's plans for restructuring operations functions. Through an assessment of the cost data and comparisons to industry best practices and alternative solutions, PwC outlined a solution that would maintain quality while reducing costs. This solution benefitted the client by examining the effects of the individual initiatives on a standalone basis and in combinations before proposing an optimal strategy. This strategy involved a major redesign of the organization's staffing pyramid, management layers, and spans of control.
Benefits	An overall headcount reduction of 15% in targeted areas led to an associated cost benefit of 30% in those key areas. Major outsourcing across the business units resulted in additional cost reductions of 15%.

Redesigned and rebuilt the shared services cost-capture and allocation process—Large regional bank

Issues	The client's performance struggled in the early days of the financial crisis. Business was shrinking, yet cost allocations were remaining stubbornly high. Business unit heads did not understand why costs allocated to them were so high and lamented the absence of transparency in the process. The shared service centers' costs were not captured according to the services provided, but rather were based on the organizational and hierarchical construct within the center. Accordingly, each cost center's allocation was viewed as rather meaningless to the business.
Approach	PwC worked with senior management, shared service center leaders, and the cost consumers (the functions and business units) to understand the needs of the users and the services that were required or provided. We were able to categorize the shared service centers into 88 different services and reached agreement on these categories with shared service centers and consumers. Not all services were readily understood by users, prompting us to prepare a service dictionary describing each service, explaining why it was required, and identifying the likely drivers of that service. Based on agreed cost drivers, we worked with the technology group to capture driver information in an automated and seamless manner and to use it to drive cost allocation within the engine we developed for that purpose. Where necessary, proxy drivers facilitated allocation. The design was built out into a new cost-capture, allocation, and reporting model, overlaid with a simple invoicing system itemizing all the allocations for the cost consumers.
Benefits	The new tools and processes were quickly and successfully implemented and provided a sound basis for the expense management activities the institution implemented after 2009. Senior management acknowledged that they now had a reasonable and transparent process to allocate costs, as well as levers to manage costs. When the organization divested a major subsidiary, the new processes and transparency allowed it to develop a plan to eliminate 88% of "stranded" cost associated with the divestiture (a previous divestiture had failed to achieve 40%).

Reengineered the finance and risk infrastructures to meet new business goals—Leading global investment bank

Issues	The institution was undertaking a major initiative to realign its performance management infrastructure with a new strategic business model. There were numerous challenges, including a legacy information delivery system and a highly complex business structure. The client wished to enhance its management information systems, establish a firm-wide methodology to prioritize across competing requests for firm resources, and provide the framework and transparency necessary to manage performance on a consistent basis across the institution.
Approach	PwC worked with management, business users, and the finance organization to define the new management reporting framework that identified key areas of executive focus, as well as the performance metrics to support that focus. This involved the development of a business case, communication, and implementation of leading financial institutions' practices in the finance organization. To enhance data quality and provide management with a better understanding of overall financial performance, the PwC team converted three legacy activity-based costing (ABC) models into a single model that improved cost attribution and increased transparency. Finally, PwC created a strategy for information systems integration that focused on increasing data quality.
Benefits	Cost-allocation enhancement improved data quality and IT efficiency, which resulted in lower costs. As a result, management was able to view critical business and financial information and a standardized set of performance metrics, which enabled better decision making. PwC's recommendations for the finance organization allowed the CFO and other finance executives to form a strong business case and achieve buy-in from other members of senior management. This elevated the stature of the project within the organization.

Designed new operating model for customer service contact centers that lowered costs and enhanced competitiveness—Global payments company

Issues	The institution was facing increasing operating costs associated with customer service contact centers as a result of limited technology investment and ballooning salaries of long-tenured employees. The contact centers had evolved over time, from merely providing issuers with required services that they were unable to provide themselves, into entities that provided value-added services as well. As a result, the contact centers could not accurately report their impact on client profitability to senior management.
Approach	PwC defined a best-cost operation model for the client, which assessed the key value and cost drivers associated with labor, facilities, technology, and telecommunication expenses for the customer contact centers. The PwC team then developed a tool using this data, which provided scenario analyses examining a range of strategic initiatives ranging from complete insourcing to complete outsourcing of technology solutions.
Benefits	The PwC future-state operation reduced bottom-line expenses, positioned the contact centers to become more agile in the competitive landscape, and enabled the capture of increased top-line revenue. The PwC-designed future state also is expected to deliver ongoing annual benefits of US$6 million to US$10 million per year, with a return on investment of 20% to 40%.

Achieved cost reductions through a targeted integration of governance, risk, and compliance operations—Top-ten US bank

Issues	The client identified its corporate governance, risk, and compliance-related (GRC) activities as areas to achieve cross-functional cost efficiencies and effectiveness opportunities. Management believed that, by employing greater cross-functional leverage and clarifying roles and responsibilities, it could achieve these goals.
Approach	PwC performed proprietary diagnostics to assess the people, processes, and technology capabilities that were central to capture the costs for each of the GRC activities. The costs associated with each function were then captured and analyzed to determine their attributions across the business units. Combining these studies, PwC identified opportunities for greater efficiency and developed action plans, timelines, and business cases for each initiative.
Benefits	The institution identified US$15 million to US$30 million in potential annual cost reductions and agreed to executive-level action plans and business cases for pursuing further improvement opportunities.

Streamlined and restructured an anti-money laundering monitoring practice to improve efficiency and lower costs—Investment bank

Issues	The client was experiencing difficulty in maintaining consistent and adequate anti-money laundering (AML) monitoring practices, and was concerned about potential regulatory discipline due to insufficient monitoring filters and compromised data integrity. After an internal study, the financial institution believed that the costs of running AML services in the United States were significantly higher than if the services were placed in Europe or Asia.
Approach	The PwC response focused on two areas: • Improving the AML technology systems • Restructuring and relocating the monitoring team PwC replaced the single-filter AML process initially in place at the financial institution with an eight-scenario filter, which greatly improved data quality and efficiency. Additionally, PwC helped migrate the bank's AML process to two global monitoring hubs in Europe and Asia. The PwC team worked with the client at those locations to reengineer the processes and procedures that would drive more sophisticated AML monitoring.
Benefits	The client realized approximately 60% labor cost savings as a result of relocating its AML processes. The dual hub approach allowed the client to provide services to all its non-US based locations, and reduced the cycle times required to respond to issues, eliminating many of management's regulatory fears.

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