Operations Strategy At Major European Bank: Outsourcing To Achieve Service Enhancements And Risk/Cost Reduction In A Post-Merger Banking Environment

The Challenge: A major European bank had recently completed a merger with one of its main rivals. At the outset, it was agreed that US Dollar clearing operations should be kept in-house for the first 6 months after the merger. Now the 6-month time period had elapsed and management was ready to consider long-term alternatives to the in-house processes in place. While Euro-clearing operations were considered strategically important to the bank, US Dollar clearing was not. Management felt that there was potential to benefit from outsourcing some or all of this activity and asked for our back-office process expertise to help them evaluate the costs, benefits, and risks of the possible alternatives.

The Partnership:
Analysis: Divisional managers from the US Dollar clearing area were guaranteed positions within the bank regardless of the outcome and were memebers of our project team along with managers from the 3 largest internal client groups. Because some managers felt it might be best to outsource only select parts of clearing activity, our team decided to consider a complicated array of alternatives.

We split our team into 3 groups: one focused on current costs, one on client requirements, and one working with potential external suppliers to understand the solutions available. Over a month-long period, the 3 groups combined findings to develop a conclusive economic picture of the annual costs and risks of various outsourcing scenarios.

- Investigation of the in-house clearing department evidenced a highly fragmented patchwork of processes with poorly connected computer systems and a high reliance on manual intervention. Much of the software used was 20 or 30 years old. Excessive manual intervention, caused by poor software interfaces and exception handling for poorly input instructions, required the attention of multiple operators for security and quality control reasons. Our team's analysis showed that to raise in-house systems to the level of process robustness desired by management would require an immediate investment of $1MM and $2MM per year thereafter.
- The client requirements group found that dollar clearing transaction volume, even after the merger, was the smallest amongst its peers. Of all clearing activity, 90% of transactions and 99% of dollar volume were for internal customers, such as FX trading and real estate lending. Because so much activity was for internal customers, controls were very lax, often resulting in considerable excess balances left in US dollar positions. In some cases, these amounts reached $600MM, representing significant lost interest and currency risk exposure.
- The external supplier group scheduled visits to banks that specialized in such clearing activity to learn about the level of service available in the marketplace. Through our research, it became clear that there was a battle for market share taking place in the marketplace that was driving the cost to outsource down significantly.

Our team concluded that, to meet client and managment requirements, costs would have to increase under any scenario. While the annual cost increase for options ranging from partial to no outsourcing would be between $2.0-3.3MM, outsourcing all activity would only increase annual cost by $1.8MM. In addition, outsourcing all activity would place process risk with a third party and would force internal clients to keep closer tabs on their excess balances and exposure to US currency risk.

Strategy: Because US Dollar clearing was not a strategic capability for the client, a significant investment in strengthening this capability was not considered justifiable. The team recommended contracting US Dollar clearing activities out to a bank that had made this activity a specialty. Now that management had a solid understanding of the in-house cost structure and all client requirements, an RFP could be written and an outsourcing partner selected. Candidates for the business would be chosen from the group of banks that already had close business relationships with the client.

Execution: Over a 2-week period, our team drafted, circulated internally, and finalized an RFP to handle all US Dollar clearing activities. Simultaneously, we began to create a first-draft transition plan. The RFP was released, and within 2 weeks, bids were received from potential partners. From the first two bids, it was clear that the external cost would be even lower than first estimated.

The Results: Once a partner had been selected, the divisional managers took over responsibility for migrating clearing activities to the new partner. Within 6 months, the outsourcing of all clearing activity was successfully completed, the service levels and costs were beating initial projections, exceptions and service issues had decreased significantly, and the bank asked us to help them investigate customer service across all divisions.

575 Lexington Avenue, 24th Floor • New York, NY 10022 • Tel: 212.497.9200 • Fax: 212.497.9210 • www.gcpny.com