Since the global financial crisis, banks have faced increased regulatory burdens. The pressure to reduce risk and complexity, and to enhance resolvability, is forcing banks to rethink their operational structures. Already, some banks have reduced their global footprint. However, increased pressure to grow revenues means many banks will remain committed to offering diverse services and operating across multiple markets. To overcome the operational and regulatory challenges this will create, banks need to ensure they have structures and operating models that are lean and flexible.
Operating across multiple markets

Before the financial crisis, cumbersome and complex legal and operational banking structures grew up as by-products of overseas expansion, acquisitions, changing tax legislation and the development of new banking products.

The traditional approach of banks to operating diverse businesses across the confused landscape of divergent regulatory regimes has been to match complexity with complexity. However, we believe the tide is turning, and leading banks will be those that simplify their structures. In fact, the introduction of Recovery and Resolution Plans (RRPs) in key jurisdictions will compel some banks to reappraise and simplify their entity structures, but we believe that, even when not mandatory, there are benefits in doing so.

The pre-crisis period was one of legal entity proliferation (Figure 1). It is now time to rethink current structures that may no longer fulfill their intended purpose and may magnify risks, lead to inefficient use of resources and unnecessary costs and, ultimately, erode value. Before the financial crisis, one global bank had in excess of 5,000 legal entities across the globe. Such a structure is expensive to maintain. We estimate that the average “carrying cost” of a single legal entity can range from US$90,000 a year for a small entity to over US$600,000 a year for a large entity. Even more troubling, our experience suggests that few at board level truly understand these structures.

Banks that take the opportunity to simplify their structures will benefit from increased operational efficiency, cost savings and compliance benefits. They will also be better positioned to operate and grow in a world where regulatory boundaries are less clear, regulatory demands are increasing and regulators are increasingly assertive and less tolerant of excessively complex organizations.

We also believe that, regardless of business model or geographic footprint, many banks have sub-optimal operational footprints. They must overhaul their operating models. Their core is inefficient and overly complex (also see “Defining the new core of a bank”). Many banks operate business lines supported by their own separate support functions. We believe that, by breaking out these functions and reshaping them to serve the broader organizations, institutions will be able to drive greater efficiency. They will also build institutional resilience and give regulators greater confidence around their resolvability.

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**Figure 1:** Complex and costly – illustrative example of a global bank’s legal entity structures
As banks redefine how they operate, they will need to redefine where they operate. We believe that the offshore footprint of global and regional banks is often sub-optimal. In our experience, there has been an optimistic bias among banks (and other institutions) when making outsourcing and off-shoring decisions. The expected cost savings are, often, initially lower than expected. Furthermore, it typically takes longer than originally anticipated to deliver those savings and to ensure robust processes. In fact, for many banks that have offshored activities, the price of achieving lower costs has been unexpectedly high. Many emerging markets have seen wage inflation that has reduced labor arbitrage benefits. Furthermore, many customers and employees have been disappointed by the quality of offshored services.

Finding the right combination of near-shoring and off-shoring will be critical to banks’ expansion plans. They need to look beyond pure cost factors to develop operations that support competitiveness, innovation, growth and flexibility across back-, middle- and front-office functions.

Regulation will clearly play a part in deciding where to locate operations and activities. Banks must consider global and local regulatory environments – including concerns about how control of data and activities in an RRP world will evolve in the future.

Furthermore, they must be confident about the resilience of local infrastructure and inflation expectations, as well as political and country risks. The availability of talent will also be critical to location decisions.

Our recent discussions with banks across a range of emerging markets have identified shortages of skilled staff as a frustration to their growth ambitions. Such shortages will also become an increasing problem in developed markets, where fewer high-quality graduates want to work in finance. Banks across the world must find new ways to attract leading talent and deploy it where it is most needed.

As banks rethink the markets in which they want to do business over the next decade, so too must they re-examine their operational footprint. It is clear that banks need to simplify their structure, but they must do so in a way that helps achieve efficient growth.
Over the coming months, our Transforming banking series will explore how banks can establish a structure that meets different regimes and secure the talent required to build their business.

To contact a member of the banking team or to keep up to date with EY’s insights and analysis, go to ey.com/transformingbanking.