

Stability and Profitability in Banking: The Handelsbanken Model

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My involvement with Handelsbanken and other banks

McKinsey&Company

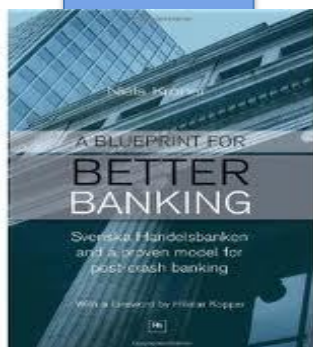
Management consultant in Financial Institutions Group (1999-2006), working with a handful European banks

BARCLAYS

Director of Group Strategy & Planning

AKO Capital

Partner and Senior Financials Analyst, responsible for \$150m stake in Handelsbanken, frequent CEO/CFO/... interviews with Handelsbanken as well as numerous other banks in Western and Eastern Europe



Transformed in depth know-how into 2009 book about Handelsbanken (Harriman House)

EUROPEAN
UNIVERSITY AT
SAINT-PETERSBURG

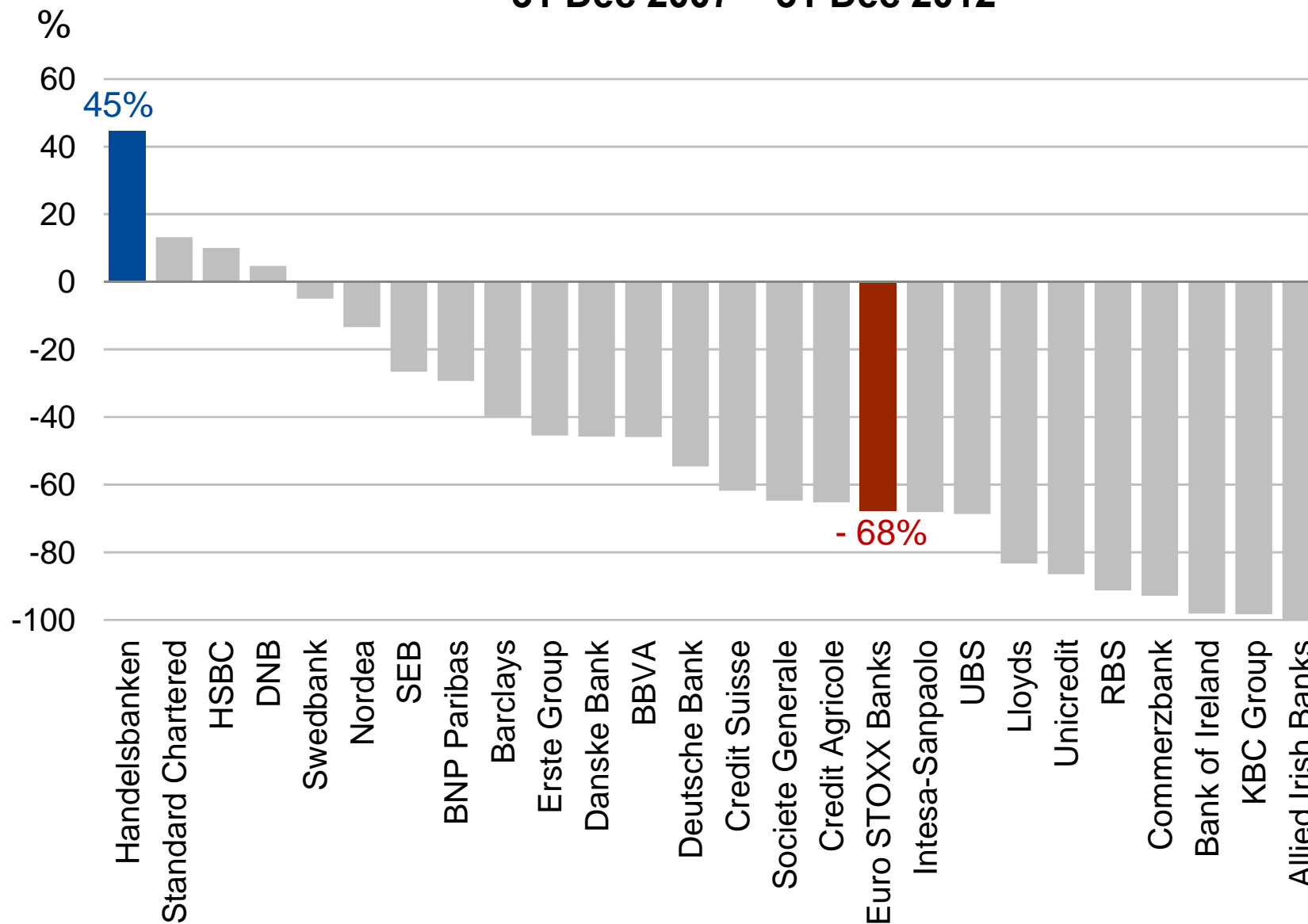
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Dual position: 1) Barclays Capital Professor of Applied Finance at European University at St. Petersburg, 2) Executive Chairman of AEE Renewables (a Handelsbanken client...)

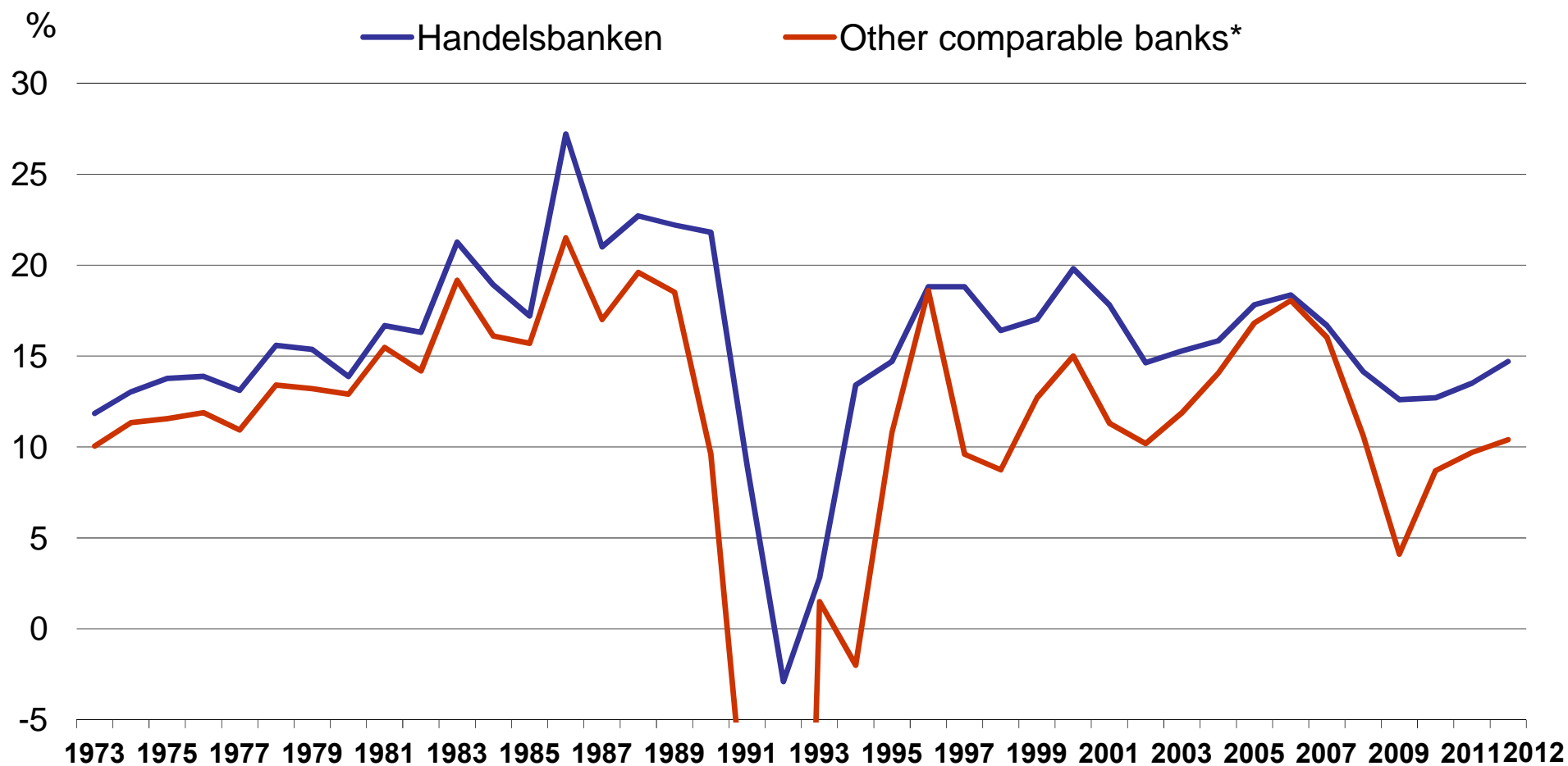
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- **Is Handelsbanken a model of profitability and stability?**
 - How does Handelsbanken's model work compared to other banks?
 - What aspects of its model could / could not be applied to Iceland?
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Handelsbanken delivers superior shareholder returns

European banks' total return, 5 years 31 Dec 2007 – 31 Dec 2012



Outperformance is financially driven by consistently higher and less volatile return on equity



Return on shareholder's equity after tax (1973-2008: standard tax). Adjusted for one-off items.

* Comparable banks: SEB, Nordea, Swedbank and since 2003 also Danske Bank and DNB.

Handelsbanken is one of the few European banks that have eschewed government support, rights issues and reliance on ECB funding since 2007

SEK bn **	Handelsbanken	SEB	Swedbank	Nordea	DNB	Danske Bank
Dividends 2007 - 2012	34.5	17.8	17.7	54.2	28.3	12.8
Proposed dividend 2013 *	6.8	6.0	10.9	12.1	2.2	0.0
Rights issue(s)		-14.7	-27.5	-21.5	-16.2	-31.4
Repurchase of shares	2.2		6.2			
Total						
transactions with shareholders	43.5	9.1	7.3	44.8	14.3	-18.6
As % of market cap. 31 Dec 2006	33%	6%	6%	17%	10%	-9%

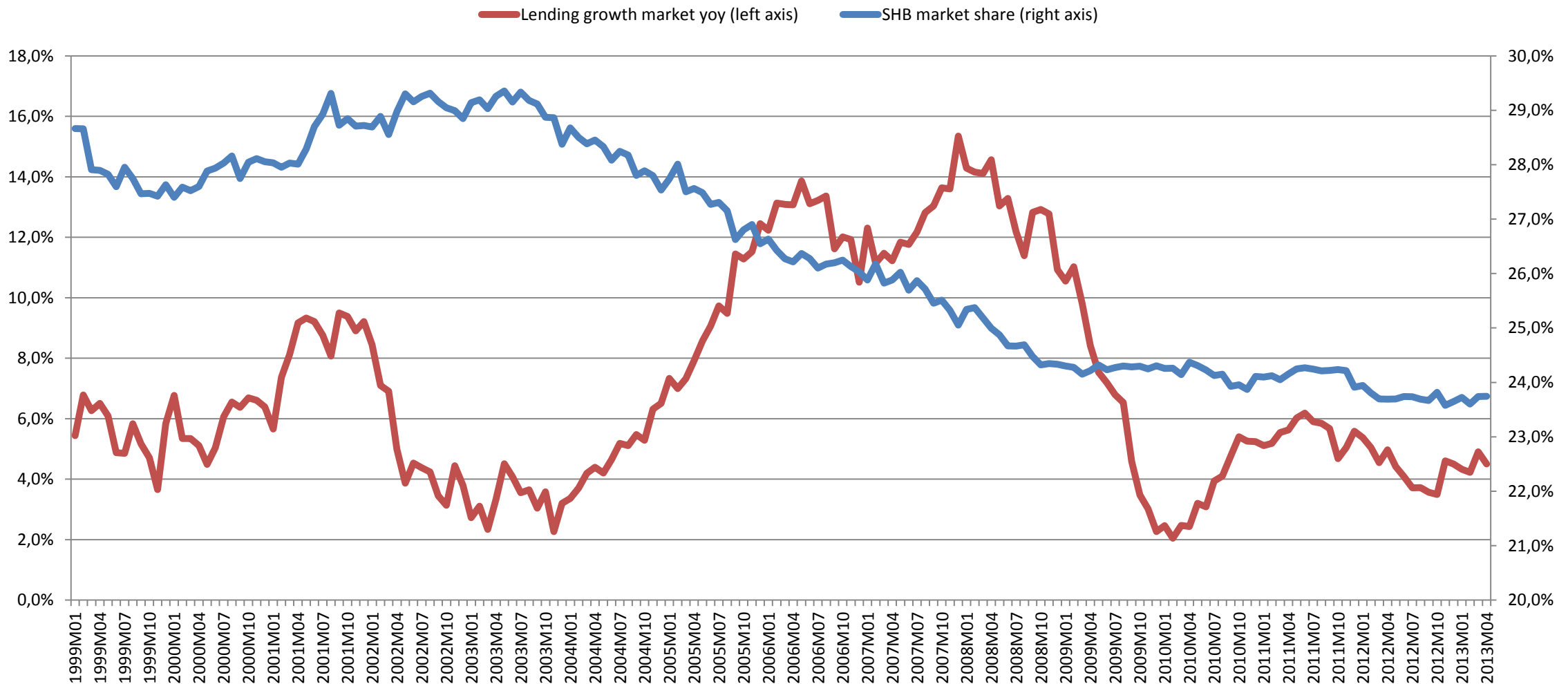
* Analysts consensus for DNB. Danske Bank as communicated in Q3 report.

** For Nordea, DNB and Danske exchange rates to SEK as at 31 Dec 2012

Source: Handelsbanken, Morgan Stanley

Constant credit policy over the cycle leads to countercyclical lending behaviour and provides lending to the economy when most banks retreat

Sweden lending to non-financial corporations



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How do they do it?

Handelsbanken

Recipe one: use branch model and unique credit approach to keep loan losses low

Recipe two: transform conservative risk stance into funding cost advantage

Recipe three: use branches to achieve outstanding customer satisfaction and transform it into higher margins

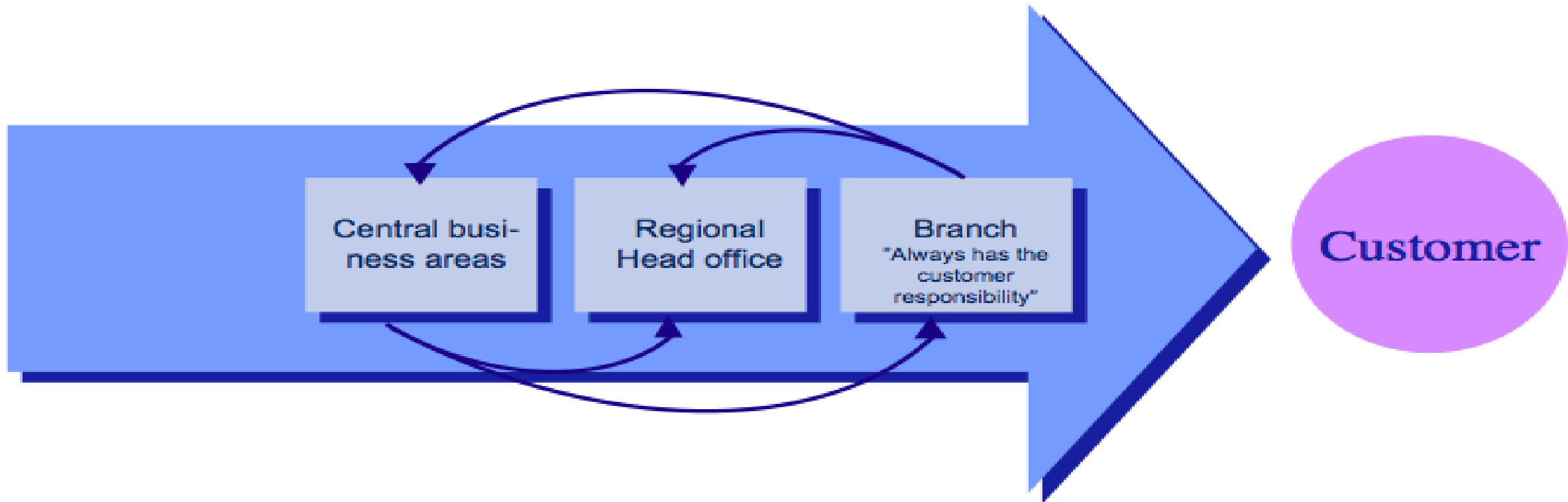
Recipe four: use customer selection and branch model to become cost leader

Consistent, steady growth

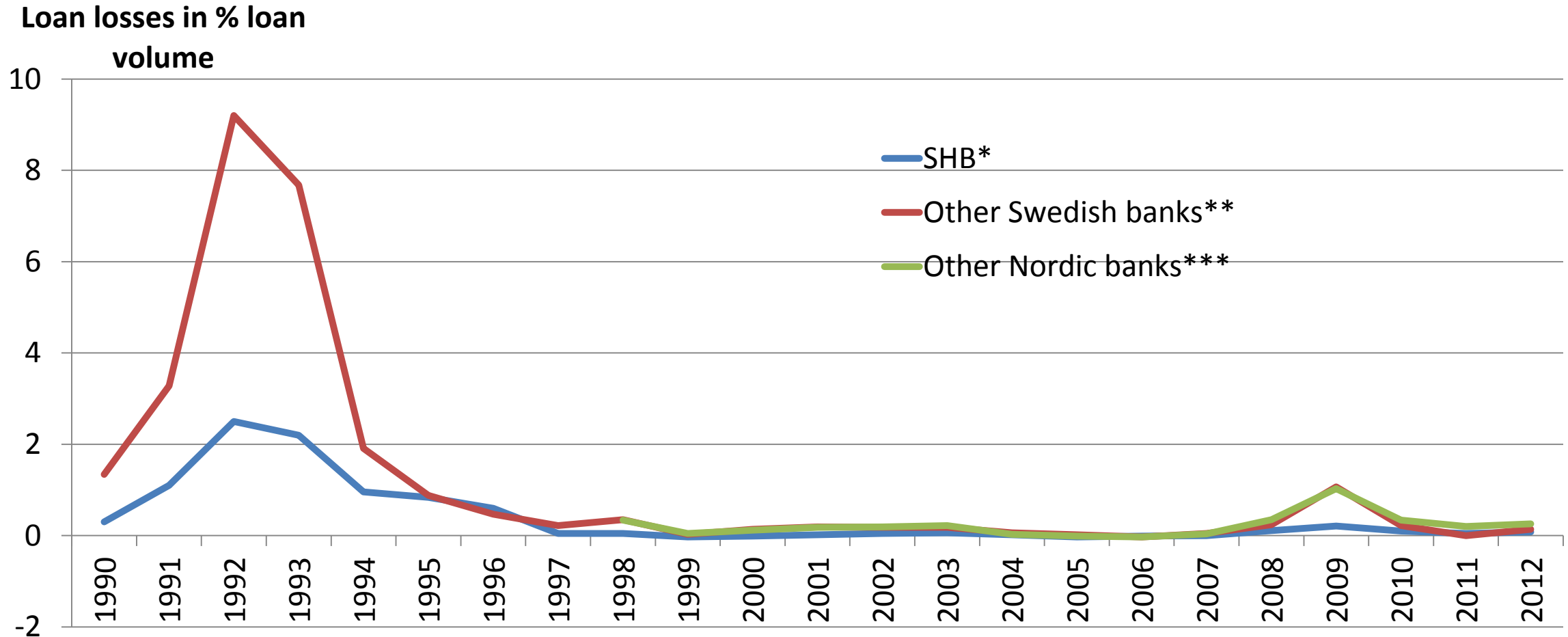
Sustainable superior profitability

Stable business model

The branch is the centre of Handelsbanken's philosophy
("The branch is the bank")



Recipe one: use branch model and unique credit approach to keep loan losses low



* From 1997 incl. Stadshypotek

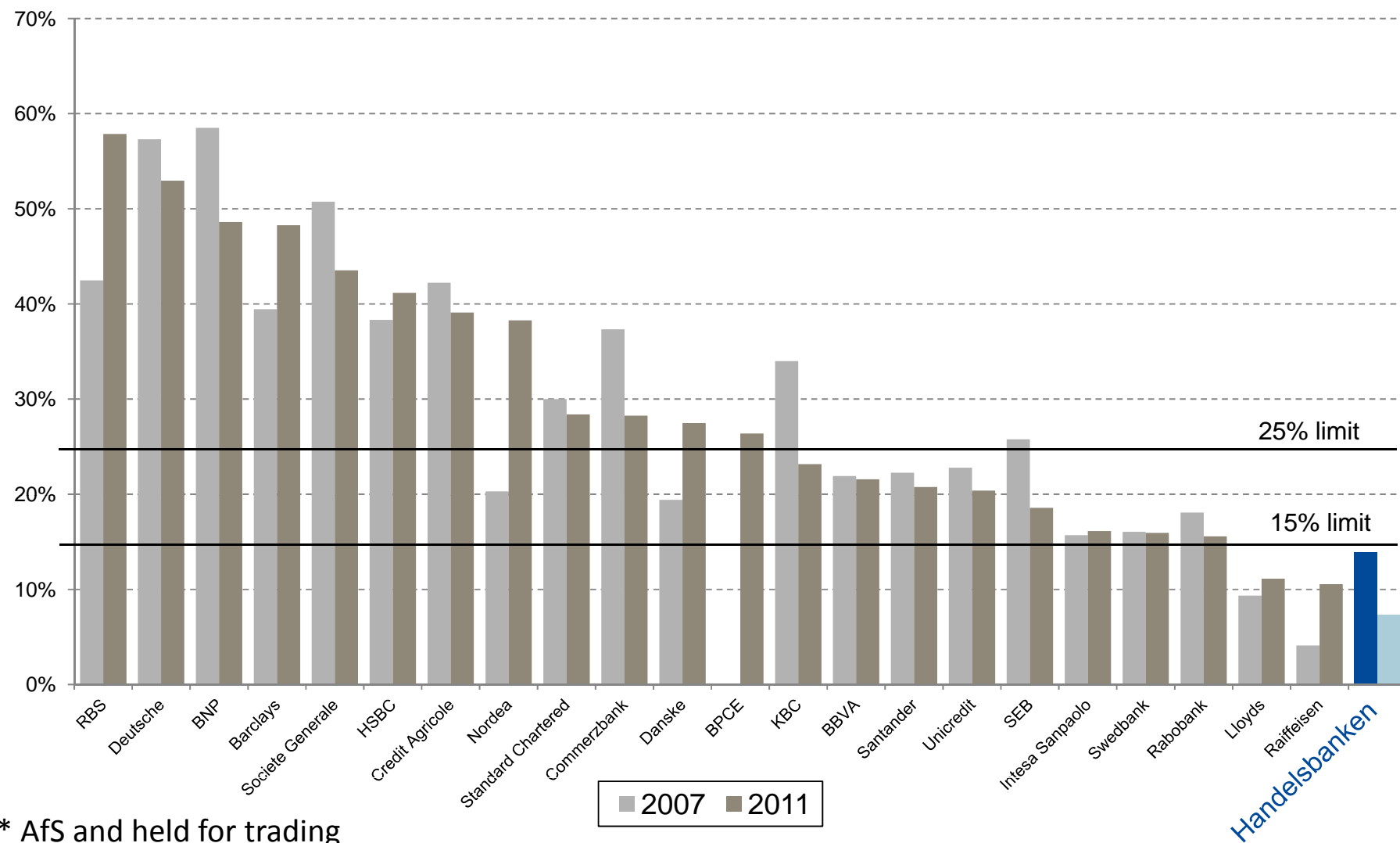
** SEB, Nordea (Nordbanken nationalised 1992, Gota Bank nationalised 1992) and since 1995 Swedbank

*** SEB, Nordea, Swedbank, Danske Bank, DnB Nor

Core elements of the Handelsbanken model: a differentiated perspective on risk

Macro risk categories with no informational advantage = manage down / avoid	Risk categories with informational advantage for banks = carefully accept
Sectoral / country credit risk	Customer credit risk
Interest rate risk	
FX risk	
Trading risk	
Investment risk	

What risks not to take: Handelsbanken has one of the lowest proportions of trading asset* of total balance sheet



* AfS and held for trading

Source: Liikanen report, Handelsbanken

Basic principles of the credit process at Handelsbanken

Credit policy

- Same across markets
- Specific to each customer – no portfolio approach (e.g., no “good” or “bad” industries)
- Unchanged over the business cycle (no tightening or relaxation of lending rules)

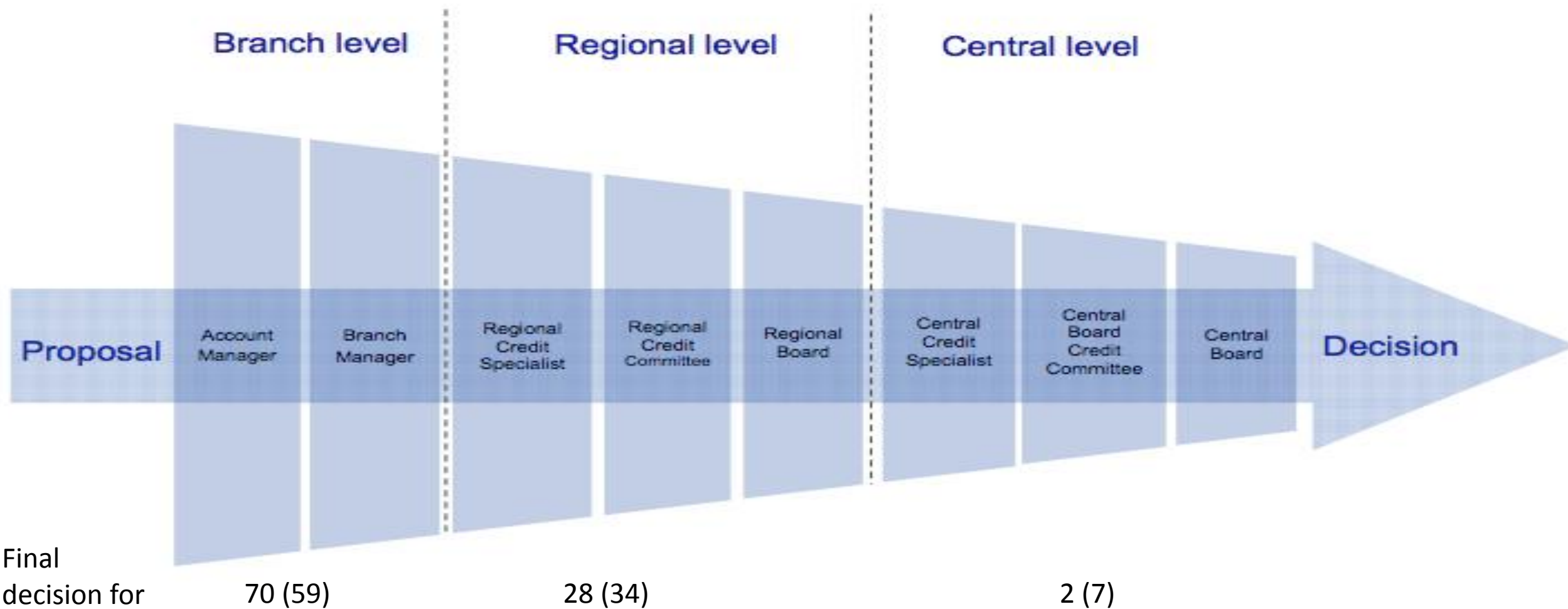
Organisation

- Branches are responsible for all credit decisions and bear full economic responsibility
- Lending only to customers with substantive presence near the branch
- Region and headquarters merely review larger credit decisions
- No separation of roles (e.g., no separate workout unit, no split between sales and credit book management, no split between relationship and lending authorisation capacity)
- Strong credit culture (e.g., loan losses are bad)
- Focus not just on initial decision but also ongoing management (documentation, early restructuring)

Credit guidelines

- Individual assessment of repayment capacity (no automation of credit scoring etc.), equal emphasis on quantitative and qualitative criteria
- Credit is only granted to customers that have the ability to repay (no loans based on collateral alone, no relaxation of credit standards in return for market share growth or high margin loans), pricing follows on market levels if they are sufficiently attractive to the bank
- Usually looking for collateral (e.g., 55% of corporate exposure and 86% of retail exposure collateralised) and very clean documentation

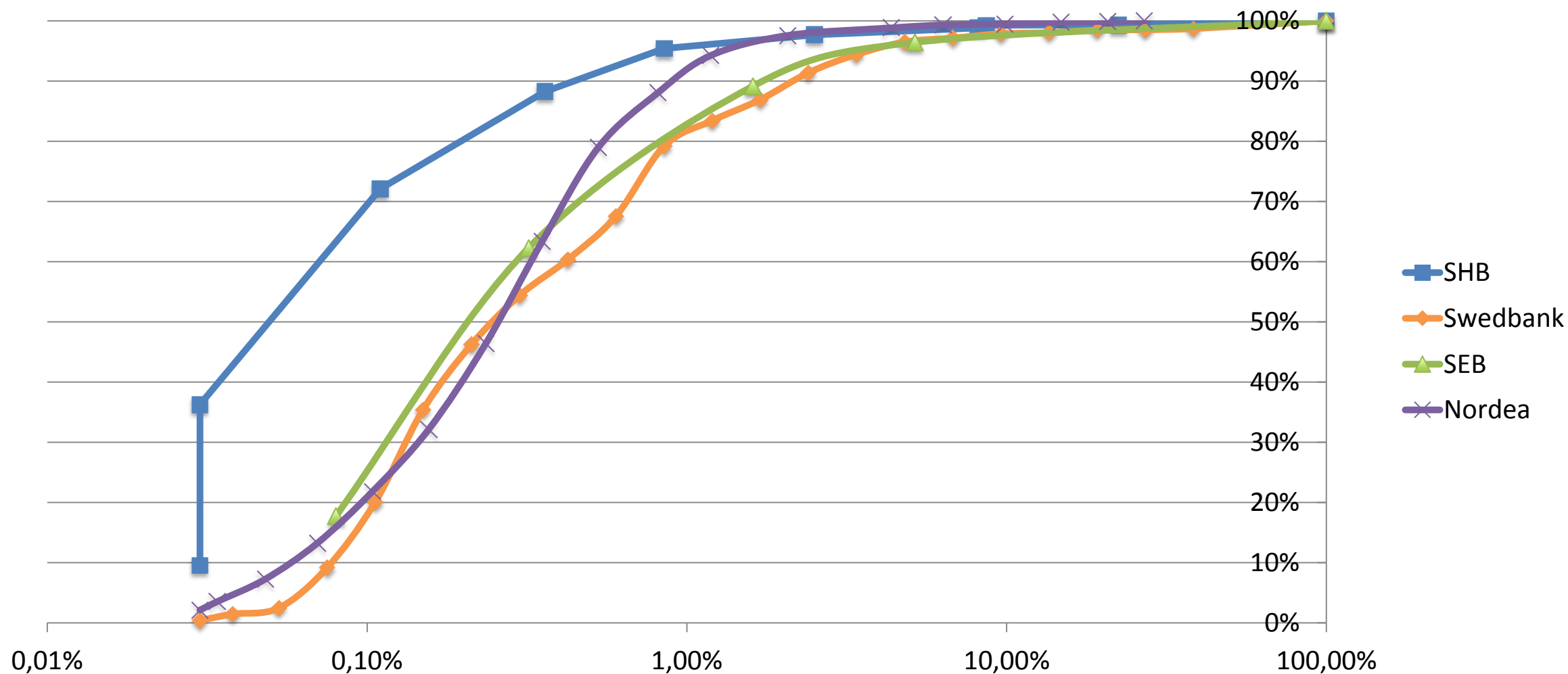
Credit organisation at Handelsbanken



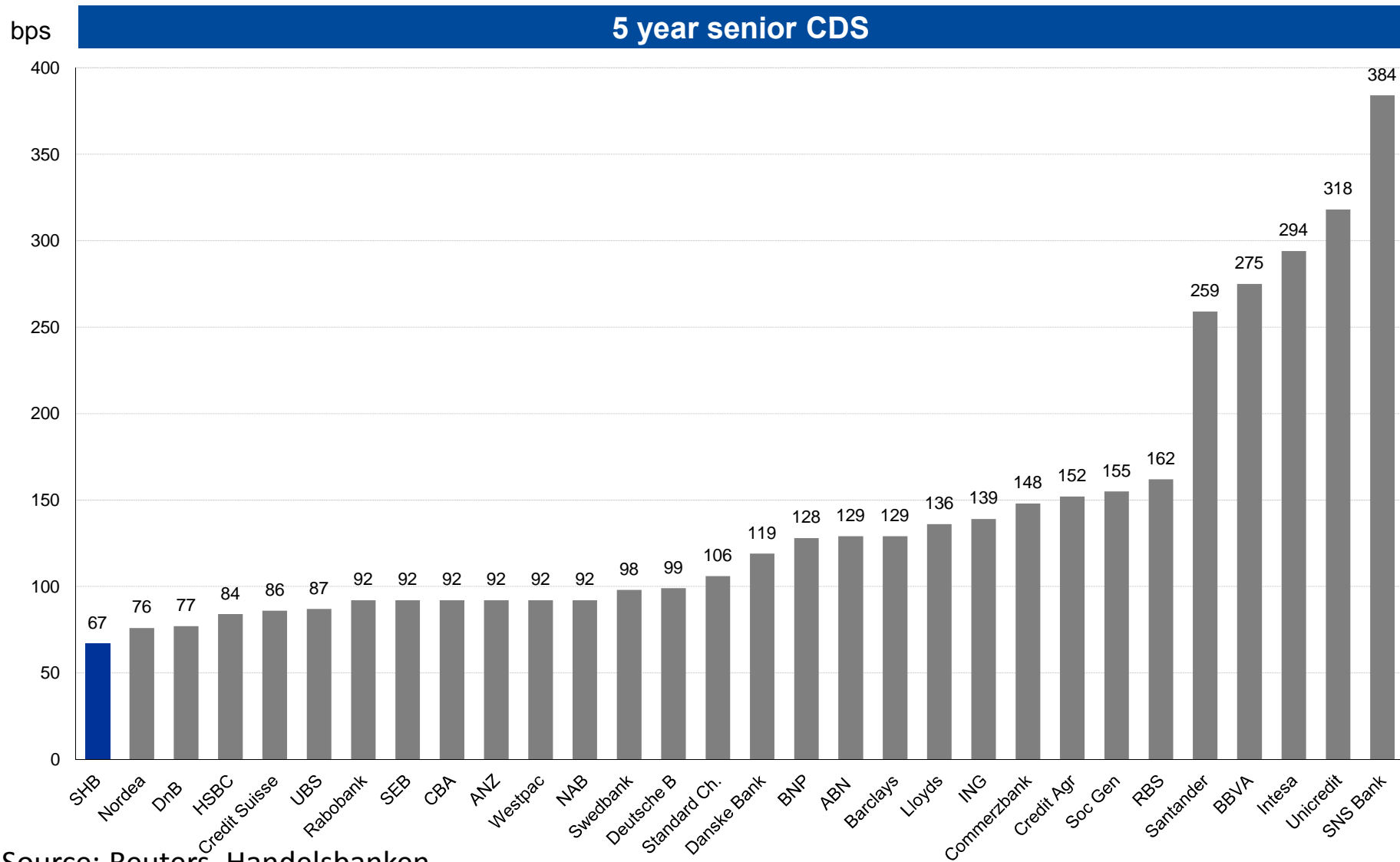
Final
decision for
...% loans
2012 (2007)

Branches tend to make safer credit decisions

IRB corporate exposure distribution by PD classes 2012



Recipe two: transform conservative risk stance into funding cost advantage



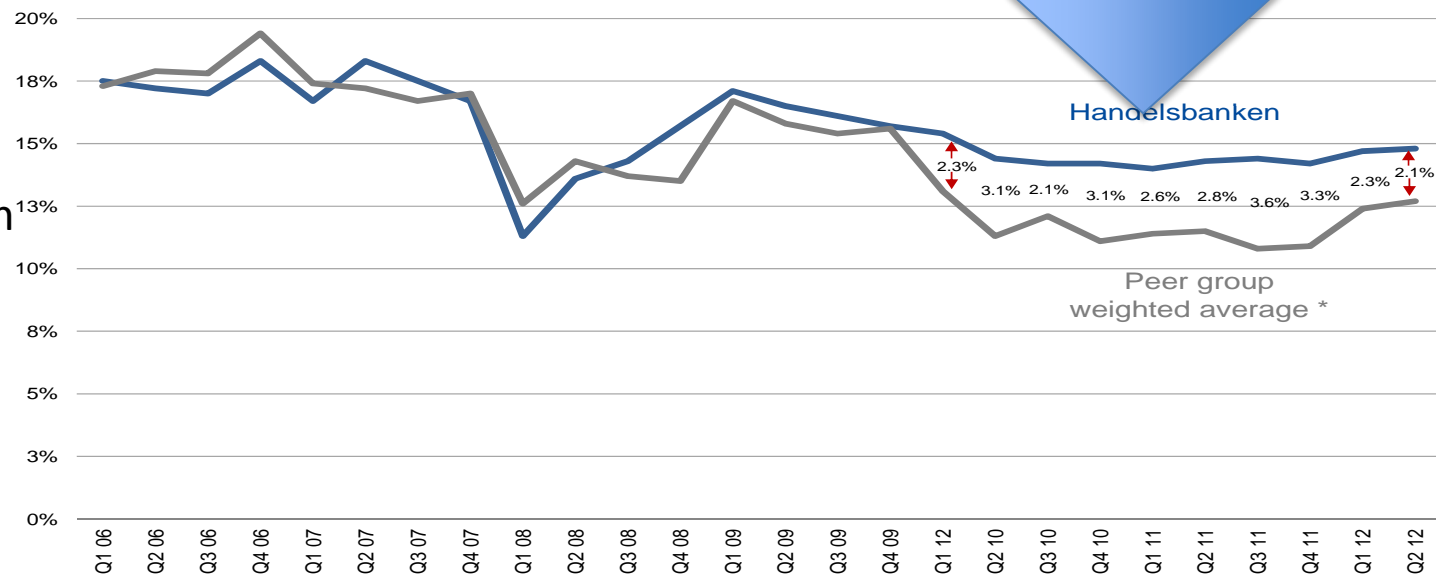
Source: Reuters, Handelsbanken

Recipe two: transform conservative risk stance into funding cost advantage

5yrs CDS spread

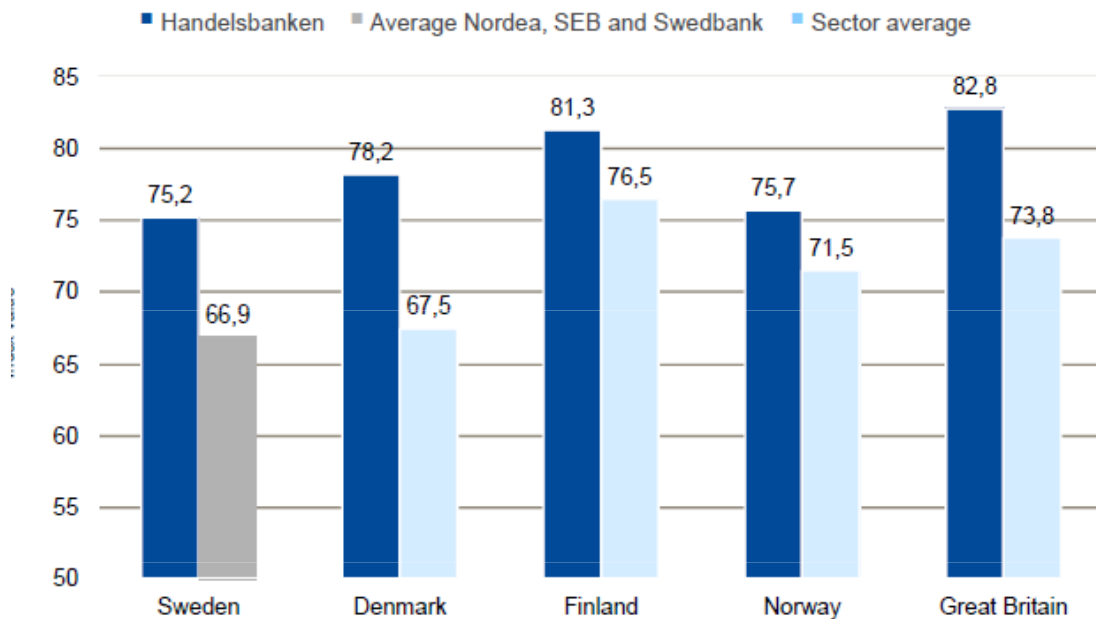


RoE before loan losses

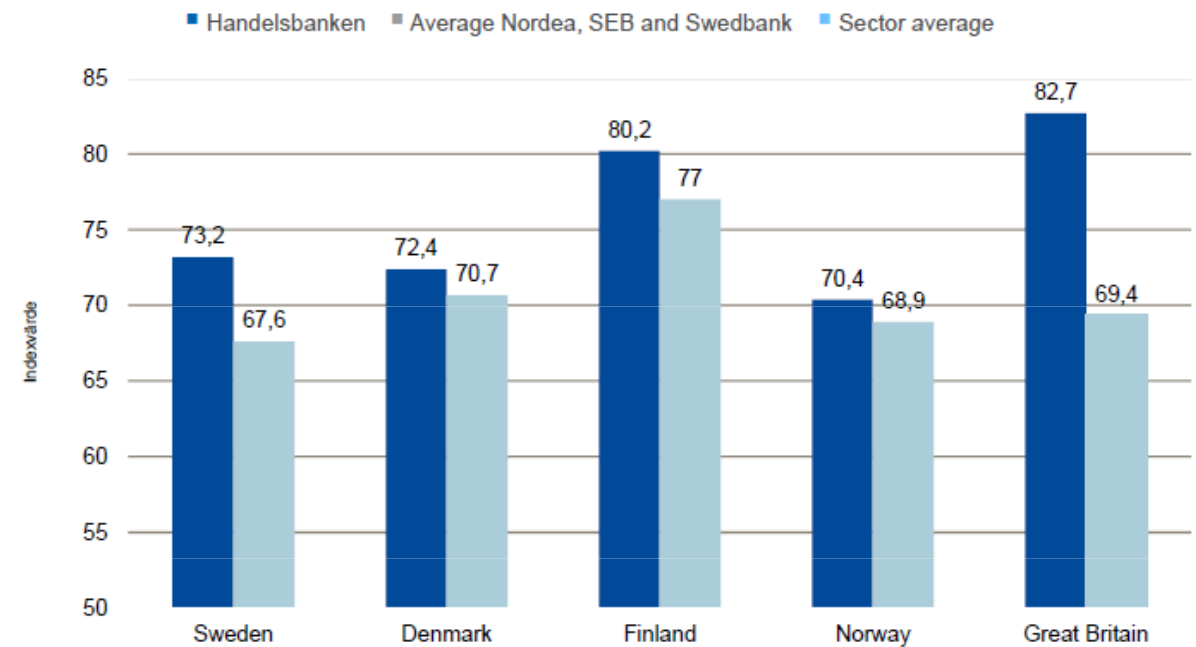


Recipe three: use branches to achieve outstanding customer satisfaction and transform it into higher margins

Customer satisfaction – Private customers, 2012



Customer satisfaction – Corporate customers, 2012



Source: EPSI

Handelsbanken's branches have much wider decision-making powers than at most other banks – closer to franchise model

“Best practice”

- Branches are sales channels with very limited decision making powers
- Products are designed and priced centrally
- Marketing is done centrally
- Branches gather information for loan decisions, which are then taken elsewhere
- Primarily managed via sales targets

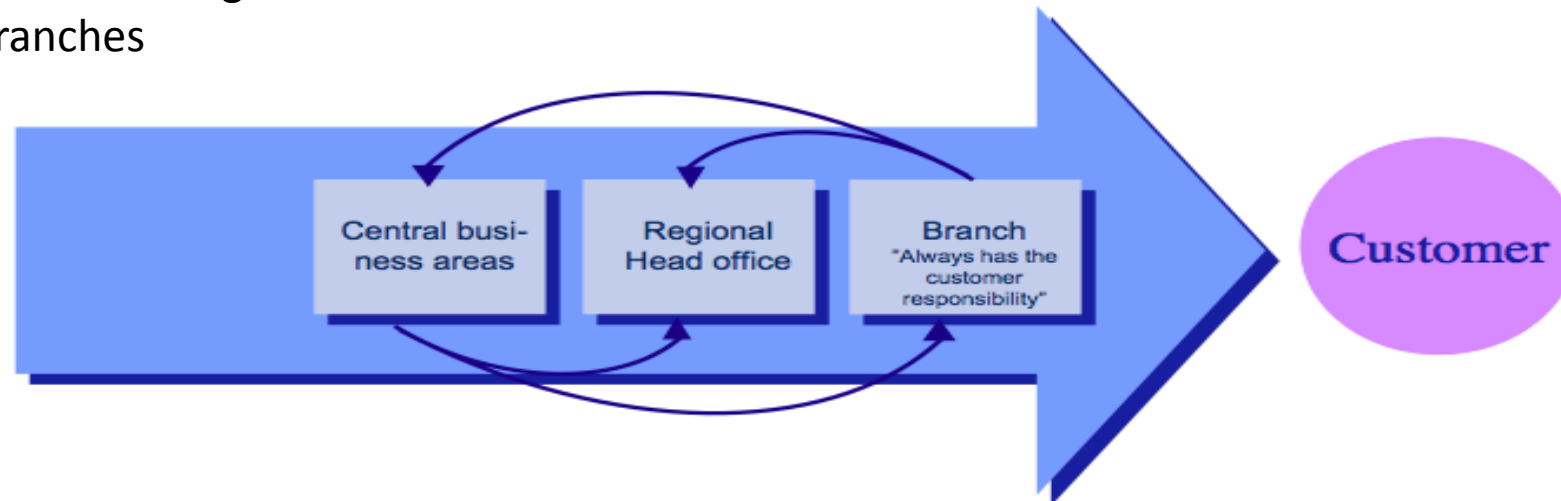
Handelsbanken approach

- Branches act like independent little banks with broad discretion on business plans – a new branch starts with the branch manager's business plan
- There is no "Handelsbanken business plan"
- Banks are free to decide customer selection, product offering, local marketing, pricing...
- ...and without their say no loan decision is made
- Primarily managed via profitability targets (cost/income ratio, loan losses) and customer satisfaction
- Only difference to independent bank: tied into bank-wide IT system and Treasury

What is the role of the regional head office and central business areas?

Regional head office

- Credit review (but 70% of loans decided on branch level only)
- Coaching and benchmarking of branches
- Establish new branches



Centre

- Product areas (mutual funds, life insurance products, mortgages) provide products and sales support, can be called into customer meetings by the branch
- Credit decision review and annual audit of branches
- IT/Operations: bank-wide uniform systems and processes, aim to support branch operations (e.g., reduce workload, suggest opportunities)

Example of a Handelsbanken branch (1/2)

Branch office operations in Great Britain – example of a newly-opened branch

Profile of a newly-opened branch (Scarborough):

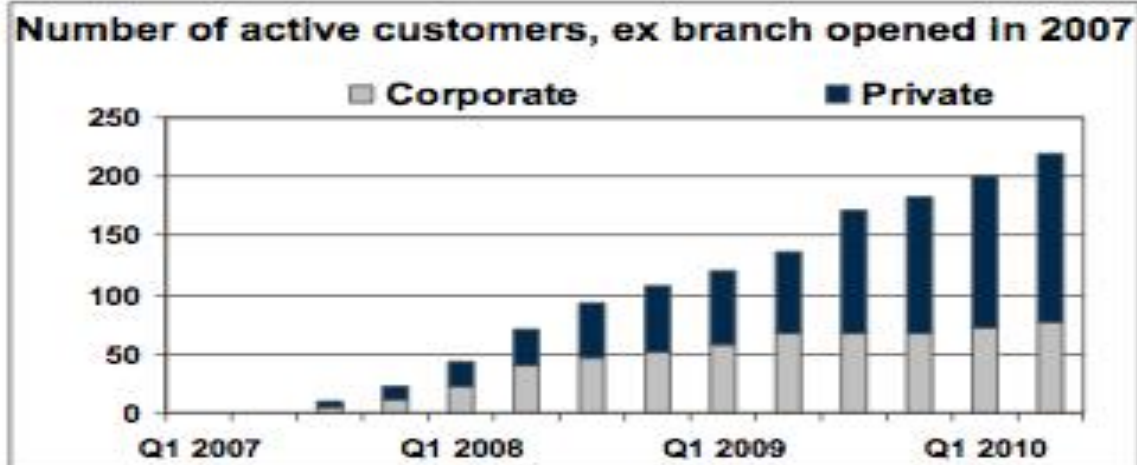
Four employees with a total of 145 years of banking experience, 85 of them in the town

Each of them has only had one previous employer

All the employees live locally

Area: "Small and medium business' town"
with a population of 140,000

The branch broke even after 17 months



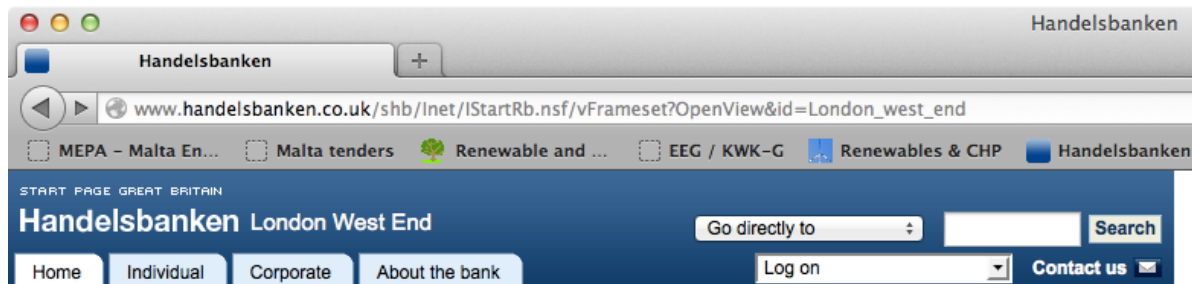
Example of a Handelsbanken branch (2/2)

- Karlavägen is an old branch (founded 1924) in an affluent area in Stockholm
- It serves 2300 private customers and 450 corporate customers in a tiny area that covers just a few blocks
- The branch has a different structure from the one in Scarborough

Scarborough (1)	Karlavägen (2)
Branch manager	Branch manager, deputy manager
Corporate banking manager	Two corporate banking managers
Two product specialists (Trade Finance, Asset Finance)	
Individual bank manager	Two managers working with housing associations and mortgage loans
Account manager	Two tellers



Branch focus survives in the internet age



Contact information
Customer testimonials
Deposit protection
Meet the team
New cookie policy

Handelsbanken London West End



Modern banking - traditional values

Founded in Sweden in 1871, Handelsbanken specialises in providing highly personalised, bespoke banking services to corporate and personal customers. Please feel free to contact us by phone or e-mail and experience "the Handelsbanken way".

[Read more about Handelsbanken](#)

Need a mortgage or re-mortgaging?



Whether you need a mortgage or are looking to review your current arrangements we have a solution for you.

[Read more](#)

Satisfied customers for a fourth year running



For the fourth year running Handelsbanken has been ranked top by both Corporates and Individuals in terms of customer satisfaction and loyalty in an independent survey.

[Read more](#)

Online services

[Log on Individual](#)
[Log on Corporate](#)
[Log on GlobalOn-Line](#)
[Log on TradePath](#)

[About Online Banking](#)
[Activate Online Banking](#)

Interest rates and Treasury commentary

[Handelsbanken's current and historic interest rates](#)

[Daily round up of FX, interest rate and commodity markets](#)

[Macro forecast](#)

Meet the team



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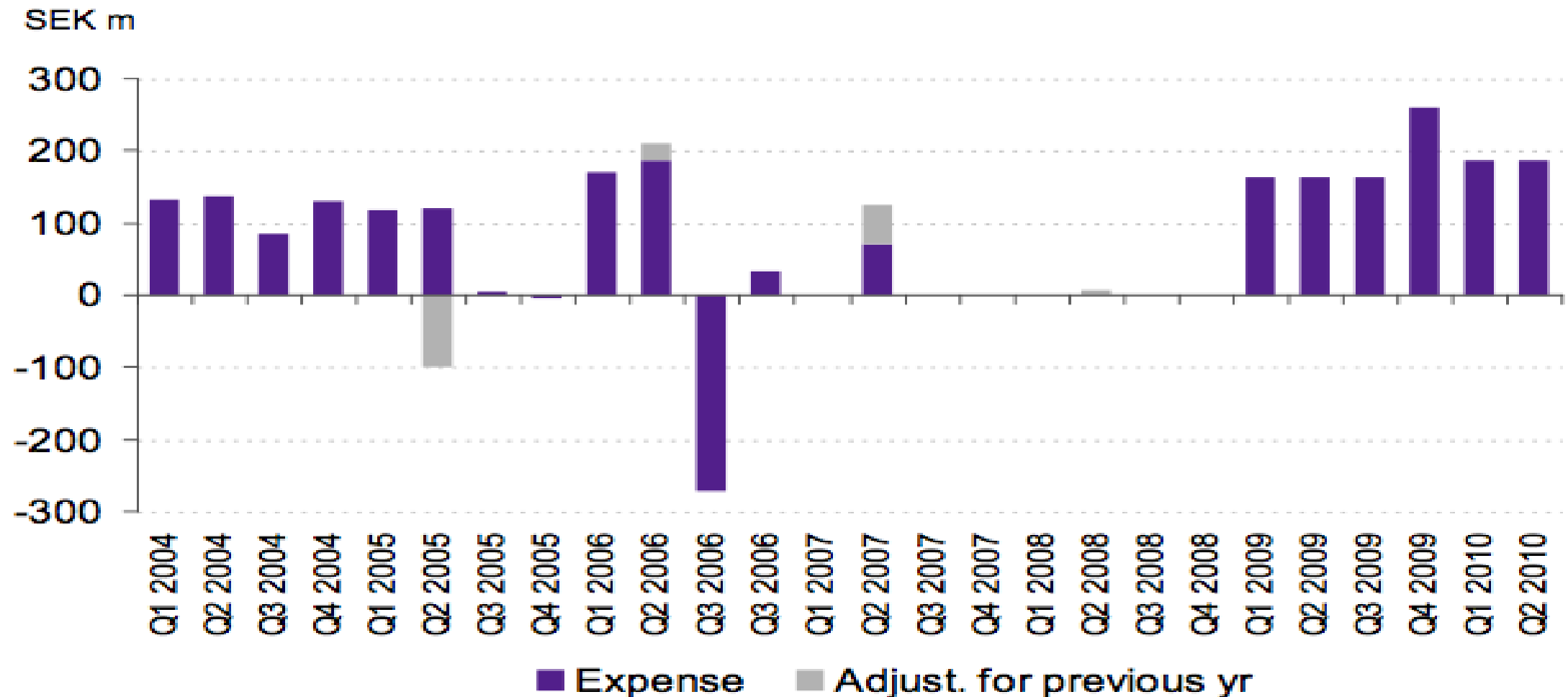
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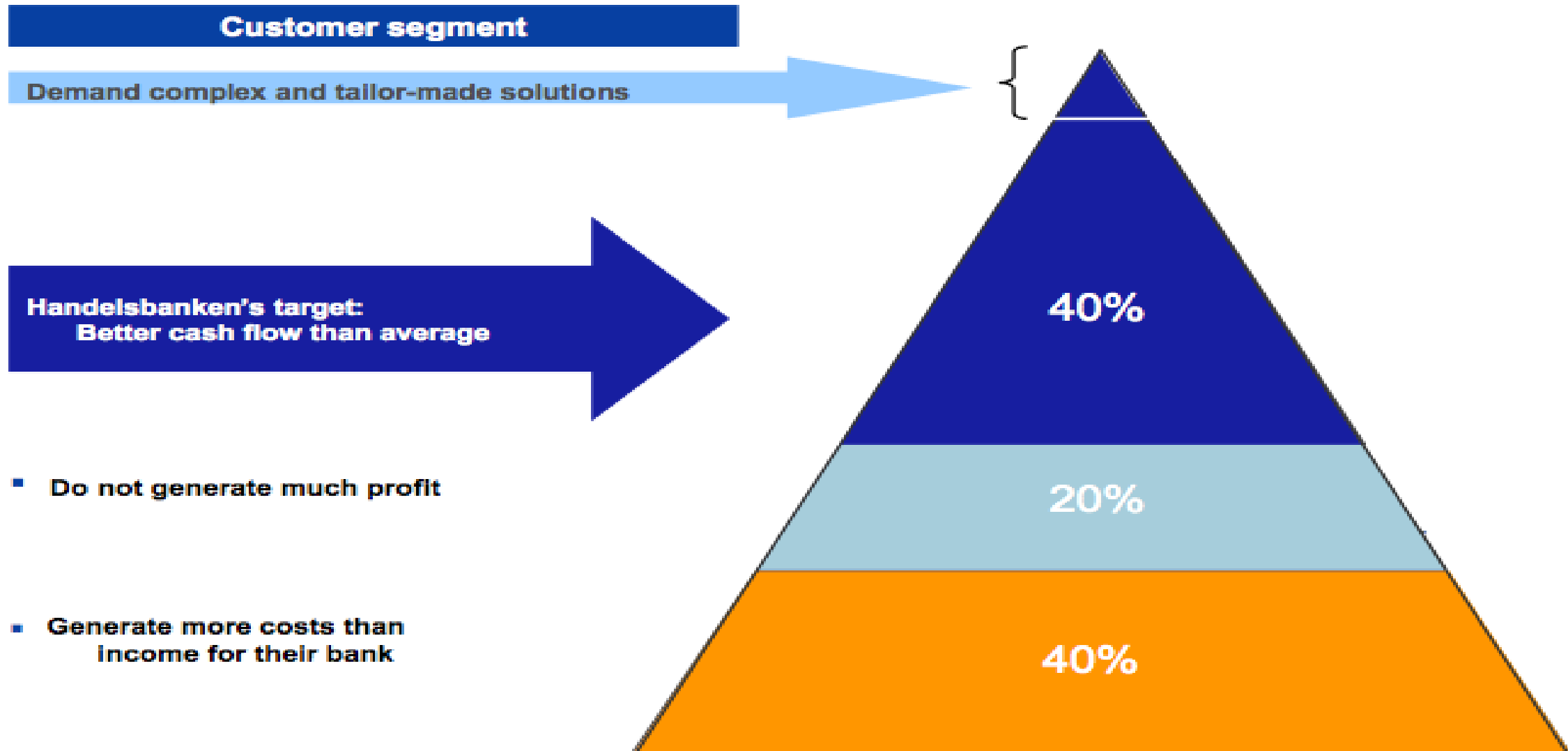


Handelsbanken's unusual incentive system without bonuses

Oktagonen quarterly 2004 – 2010



Recipe four – customer selection



Handelsbanken's approach to customer selection and acquisition is very different to "best practice"

"Best practice"

- Bank-wide customer segmentation
- Uniform service model
- Active nationwide marketing
- Special offers to attract new clients
- Product pricing decided centrally
- Staff have sales targets
- Branches are sales outlets

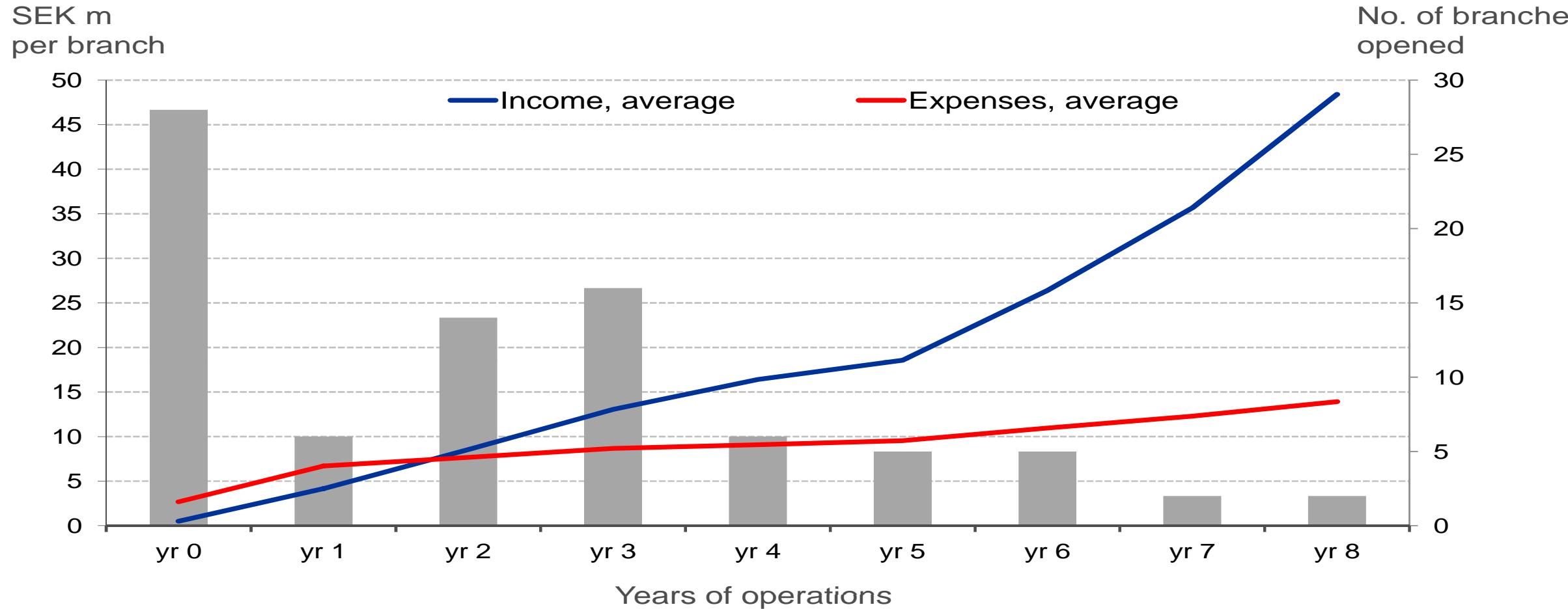
Handelsbanken approach

- Branch decides if and how to segment customers and which customers it wants to target (new branches: business plan by branch manager, taking into account local specifics)
- Branch decides service model
- Only very limited, local marketing
- Customers acquired by introductions and work of mouth
- No hook product offers (compete on service, not price)
- Branch decides on pricing
- No sales targets (but branch benchmarking)
- Branches are entrepreneurial franchises

Branch model not just good for *profitability* but also for *growth*

Income and expenses trend, new opened branches in Great Britain

Refers to the average of 80 branches opened in Great Britain 2000 – 2011:Q1



Lack of overhead and good margins create attractive cost position even in small markets

FY 2012 - branch numbers and cost/income ratio

	Handelsbanken		Local peers		
Sweden	461	35.1%	310	46.1%	Swedbank Retail (Sweden)
			231	50.7%	Nordea Retail Sweden
			169	58.5%	SEB Retail Sweden
			44	49.5%	Danske Bank Retail Sweden
UK	133	50.6%	3000	53.3%	Lloyds TSB Core business
			2200	47.9%	RBS UK Retail and UK Corporate
			1593	86.8%	Barclays UK Retail and Business Banking
			n/a	n/a	HSBC
Denmark	54	54.6%	228	54.4%	Danske Bank Retail Denmark
			207	55.6%	Nordea Retail Denmark
Norway	49	35.8%	185	53.4%	DnB Nor Retail
			43	42.0%	Nordea Retail Norway
			35	59.5%	Danske Bank Retail Norway
Finland	45	48.4%	235	61.6%	Nordea Retail Finland
			93	85.5%	Danske Bank Retail Denmark
Netherlands	13	67.8%	408	67.6%	ABN Amro overall bank
			826	65.6%	Rabobank overall bank

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-

Considerations for Iceland

Positive aspects



- Model is inherently local through branch focus
- Intl. operations demonstrate that model does not require any large scale
- Low risk profile and low reliance on sovereign bailouts desirable for Iceland
- Balanced funding model on branch level would have avoided wholesale-driven credit boom of Icelandic banks
- Alignment of long-term interests between stakeholders

Problematic aspects



- Model works as universal banking model in Sweden but even better in other countries where SHB can cherry pick only affluent customers
- Low risk appetite appears incompatible with existing loan books / established banking products in Iceland (e.g., inflation-linked mortgage, FX loans to private customers)