HARVARD | BUSINESS | SCHOOL

115-018
JUNE 24, 2015

AMAR BHIDÉ
DENNIS CAMPBELL
KRISTIN STACK

Handelsbanken: May 2002

Introduction

Pär Boman, Head of Handelsbanken Markets, wondered where and how Handelsbanken, one of Sweden's big four banks, should expand abroad. Handelsbanken had enjoyed decades of profitable, uninterrupted growth at home. Now saturation of domestic banking was spurring large Swedish banks to look for opportunities abroad. Boman's own position had been created just a few months ago to suggest to the board of directors how Handelsbanken should grow internationally.

Boman and his team thought three options abroad merited consideration. One was to increase market share in the neighboring Nordic countries, namely Norway, Denmark and Finland. Handelsbanken had previously declared each as a "home market" with branches offering a full range of banking services. A second option would be to declare the United Kingdom, where Handelsbanken now operated six branches, as a fifth full service home market. The UK market, like Sweden's, was considered to be over-banked, but customer dissatisfaction with UK banks was much higher. Third, Handelsbanken could invest in Baltic states (Estonia, Latvia and Lithuania) that had been part of the Soviet Union until 1990. Handelsbanken now operated just one branch in the Baltics where other large Swedish banks were leading the development of a West-European style banking system.

"Our Way"

Svenska Handelsbanken (SHB, Handelsbanken) started as a local bank in Stockholm in 1871. By 1919, it grew to a national bank in the country with over 200 branches, many acquired through mergers. Like other Swedish banks, Handelsbanken suffered from substantial loan losses during the financial crises of the 1920s and 1930s[1] requiring it to take over several borrowers. The borrowers were then rolled into an independent holding company, Industrivarden, which was taken public in 1945 and which then became one of the major shareholders in Handelsbanken, with about 10% ownership.[2]

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[1] *History of Svenska Handelsbanken,* Svenska Handelsbanken corporate brochure, p. 4

[2] *Kroner (2009 p. 60)*

Amar Bhidé, HBS Professor Dennis Campbell; Professor Amar Bhide (Tufts University, The Fletcher School); and Research Associate Kristin Stack prepared this case. It was reviewed and approved before publication by a company designate. Funding for the development of this case was provided by Harvard Business School and not by the company. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

Rebounding from the crisis, Handelsbanken grew along with the Swedish economy in the 1950s and 1960s, opening about 150 new branches in the country[3].

Questionable foreign exchange transactions lead to the replacement in 1970 of Handelsbanken's CEO by Jan Wallander, described in a book by Kroner as a "strong, if slightly eccentric, character"[4] who had previously headed Sundsvallsbanken a regional bank in northern Sweden. Wallander had started his career as an economics researcher (after securing a PhD in 1949) before joining Sundsvallsbanken in 1961.

As Wallander later recalled, he found in Handelsbanken a bank that, following US management methods, had adopted a functional centralized organization with the view that credit decisions made at high levels and involving many people were better. Thus in 1968 more than 2,400 loan decisions had been made either by the bank's top management committee or its board of directors. On average, the bank took two month to accept or reject a loan application.[5]

Wallander asked for and received approval from Handelsbanken's board for a sweeping restructuring. Under a plan that drew on how the bank Wallander had previously worked in was organized, as well as the ideas of a new executive team comprising many individuals who did not have traditional banking backgrounds[6], all of Handelsbanken's branches in Sweden were placed under one of eight newly created regional banks. Considerable decision making authority was transferred from headquarters in Stockholm to regional and branch managers. Wallander scrapped top-down budgets and targets -- the bank would have no goal for overall profit or revenue growth. Rather it would focus on earning a higher return on equity than its large competitors. At the same time, the detail and dissemination of reports on actual performance, especially of branches and regions, was expanded considerably (see page 6).

Wallander became the non-executive Chairman of the bank's board of directors after eight years as CEO. Three successive chief executives, including current CEO Lars O. Gronstedt who took the position in 2001, sought to keep the bank on the path that Wallander had established. Handelsbanken managers credited the approach, laid out in an internally published document called "Our Way", with the bank's resilience in the Swedish banking crisis of the early 1990s when Handelsbanken was the only large bank in the country to not ask for government assistance) and its 30 year record of achieving its goal of earning a higher return on equity than the average of its peers (see **Exhibits 1-4** for information on Handelsbanken financial performance).

"The Branch is the Bank"

Handelsbanken expected that shareholder value would naturally follow from the value it provided customers[7] and that branch managers and local staff were best equipped to serve customers. These beliefs were represented by the "Arrow" pictograph displayed in the bank's offices (see figure 1) and encapsulated in the motto "The Branch is the Bank."

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[3] *History of Svenska Handelsbanken*, Svenska Handelsbanken corporate brochure, p. 3

[4] *Kroner (2009 p. 78)*

[5] *Kroner (2009 p. 60) citing Wallander (2004 p. 3)*

[6] *Kroner (2009 p. 88) citing Wallander (2004 p. 3)*

[7] *Handelsbanken, 2001 Annual Report*

Figure 1 "The Arrow", Representing Handelsbanken's Customer-Focused Organizational Structure

Source: Svenska Handelsbanken 2001 Annual Report, p. 13.

Maps demarcating the territories branches could serve followed the "Church-Spire" principle: branches were not supposed to serve customers who could not been "seen" from the top of the spire of the local church (traditionally located in the town center). Moreover, the principle stipulated that all customers were the primary responsibility of a single branch. This included large companies, who would be matched with a branch nearby their headquarters.[8]

Handelsbanken gave branch managers broad authority. Rates on deposits and loans suggested by headquarters weren't binding –- branches could offer better rates to customers who used (or might be expected to use) a broad range of the bank's services for instance. Similarly, reported Kroner, branch managers could "decide how many people to hire at the branch and how much their salaries should be." Customer segmentation was "left entirely to the branches" and the "customer service model for two similar clients in adjacent towns [could] be very different." And, of the 400,000 credit decisions made in 2001, about two thirds had been made entirely at the branch level.

Branch managers were in turn encouraged to delegate responsibility to individual staff responsible for customer relationships ("relationship managers"). In the 1970s, according to Wallander, managers who were keen on having powers devolved from the center to them had resisted delegating their own authority, claiming that staff at lower levels did not want responsibility or lacked the necessary experience.

Handelsbanken had started offering on-line banking in 1997 and had enrolled about half a million users by 2001[9]. Initially internet banking had been seen as a threat, according to Kroner: "If a customer did his or her banking on the internet, what relationship would be left with the branch?" Handelsbanken's solution was "charmingly quaint: each branch got its own website." Although the base "technology platform" was centrally developed and maintained, customers who logged on to Handelsbanken's main internet page would be redirected to the website of their local branch where they could see photos and contact information of branch staff. Branches could also modify the design and some of the functionality of their web pages.[10] At the same time, Handelsbanken had not opened any call centers that might make relationships with customers impersonal, although it did operate a round-the-clock help desk to serve urgent or after-hours requests.

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[8] Exceptions to the rule of forbidding branches from serving remote customers required permission of the branch's regional bank. And, according to bank managers no more than 4-5 such exceptions were granted each year.

[9] Handelsbanken, 2001 Annual Report, p. 26.

[10] Svenskt Kvalitetsindex's customer survey reported as much satisfaction with the bank's internet services as they did with other channels whereas customers of other banks reported less satisfaction. Handelsbanken, 2001 *Annual Report,* p. 28.

Branches also used IT in a manner that was not directly visible to customers. One banker reported for instance that the first thing she did every morning was to log on to review all the transactions of all her commercial customers. Similarly, branches used IT to communicate with credit staff and to send and receive information about branch performance. Effective and nearly "real time" IT use for such purposes was in turn attributed to having branches do much of the back office and administrative work that would normally be done centrally. Therefore, Kroner reported, branches could immediately tell customers when their mortgage had been approved or their payments had been executed.[11]

Handelsbanken executives believed that its branch-centered model had produced high customer satisfaction. The bank had secured the top place every year since 1989 when Svenskt Kvalitetsindex had started its annual customer satisfaction surveys.[12] Surveys also showed high levels of employee satisfaction. Kroner, who "talked to numerous branch managers as well as staff" reported that they found it "motivating" to be "self-directed and entrepreneurial." Bankers enjoyed "broad responsibility" for "doing whatever a customer situation call[ed] for." Work was "personalized." There was no "division of labor" that assigned staff "repetitive tasks" and few "hard and fast procedures." [13]

Assessing creditworthiness

The absence of many hard and fast rules was especially noteworthy in lending decisions, an area in which branch staff interviewed by Kroner saw their bank as "conservative but fact-based and rational." Branches were never required to reduce lending to borrowers in a sector because top management had decided that the bank was overexposed to that sector. Similarly there were no rules capping property loans to say 75% of property values: a branch could accommodate a wealthy client who wanted a loan for 120% of the price of a property if "taking everything into consideration" it was happy making such a loan.[14]

At the same time, branch-based lenders *were* expected to take everything into consideration. Handelsbanken rejected "check box" or formulaic lending that had become commonplace in other banks especially in consumer credit and residential mortgages (See Appendix A). According to the bank's CFO, lending officers did use computerized models to screen applications for consumer loans but only "as input in the decision process. In the overwhelming majority of cases, the case-by-case reviews confirm the results of the model. For large loans however, statistical models play no role in credit decisions."

A branch manager noted:

> "We never make a loan without meeting the borrower. For larger loans or new customers we have several meetings.
>
> "We review about 5 to 10 variables for individual borrowers and for a corporation up to 20 variables. We don't have any "minimums" or "threshold" values for any of the variables – we look at the total picture. For example if a borrower doesn't have a long employment

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[11] Kroner, Niels, *Blueprint for Better Banking* (Petersfield, Hampshire, UK: Harriman House Ltd), p. 74.

[12] Handelsbanken, 2001 Annual Report, p. 28.

[13] Kroner, Niels, *Blueprint for Better Banking* (Petersfield, Hampshire, UK: Harriman House Ltd), p. 93-94.

[14] Kroner, Niels, *Blueprint for Better Banking* (Petersfield, Hampshire, UK: Harriman House Ltd), p. 93-94.

history but has a wealthy relative willing to cosign, we will seriously consider making the loan. As a result we can make loans that banks using check boxes will reject.

"Lending officers and branch managers are given the authority to approve loans up to limits set according to their experience – more experienced staff have larger limits. An experienced branch manager will also generally know which large loans are likely to be turned down and won't submit them for approval. We know for instance that the bank usually does not like complex, difficult to understand transactions. Similarly while we will naturally demand more collateral and tougher terms from relatively weaker borrowers we cannot use tough terms to make loans to borrowers that fall below our standards. In fact we only think about or discuss terms after we have decided that a borrower is creditworthy.

Other large banks in Sweden and Europe followed different credit practices in the discretion provided to branch-based lenders and in their reliance on statistical scoring models. (See Appendix A).

Scoring credit risks

Although credit assessment remained holistic, starting in the early eighties, Handelsbanken had instituted a numerical scoring scheme. Corporate borrowers were rated on two 1-5 scales (with one being best), namely "risk of financial strain" and "financial power of resistance." The former was intended to reflect the likelihood that the borrower would face a period of financial hardship and the latter the borrower's financial capacity to continue making loan payments during that period. For example, a corporate could be a "2-3", indicating that its risk of financial strain was ranked a 2 and its financial power of resistance was ranked a 3.

Individual borrowers were ranked only on risk of financial strain, also on a 1-5 scale.

Handelsbanken would not make loans to borrowers whose score would fall below 3-3. However the scores were periodically reviewed, so a score could fall below levels that would have been unacceptable when the loan was first made.[15]

Controlling loan losses

Although Handelsbanken tracked its loan losses, its target for loan losses was zero, because according to Pär Boman, a non-zero target might encourage a culture of tolerance that could lead to higher than the targeted loss. Boman further credited the bank's low loan losses to its personalized approach:

"It is possible that a computer would make fewer bad loans than a human – in the first year of the loan. But you can best learn about lending by making mistakes. And our analyses suggest that only 30 percent of avoidable loans losses result from the initial decision to make

[15] The scoring system would later help Handelsbanken satisfy Basel 2 rules specifying how much capital it had to hold as a cushion against losses. Earlier rules had required banks to hold more capital for categories of loans that regulators deemed to be more risky (e.g. more capital for commercial real estate than for residential mortgages). The new rules encouraged banks to develop their own models to predict the probability that particular borrowers would default. If a bank could satisfy regulators that its models were accurate predictors of default, it could use its "internal" scores to calculate its capital cushions. Handelsbanken's scoring system, which had not been designed for this purpose, turned out to provide good predictions of default.

a loan. The rest seem to be the result of insufficient intervention after a borrower's creditworthiness had started to deteriorate. A good lender knows when and how to intervene. Furthermore, unlike some other banks we don't have a workout department. Whoever made the loan remains responsible so there is an extra determination to avoid defaults."

A branch manager elaborated on how lenders monitored corporate borrowers:

"We schedule meetings with borrowers at least once a year and with larger corporate borrowers at least once every three months.

"And even when there is no meeting scheduled, we like borrowers to call us if something significant happens.

"And we constantly watch for red flags: an overdraft, a missed loan payment, a decreasing cash balance – it helps when we provide multiple services so we see the full picture – or even an unexpected "For Sale" sign on a borrower's property. A red flag will cause us to have a conversation with the borrower. Sometimes there is nothing serious – a loan payment may have been missed because the borrower was traveling and had forgotten to arrange to pay before leaving. But borrowers may also tell us that they have lost their jobs or a court case. Then we have to discuss the appropriate next steps.

Accountability

Along with the unusual decision making authority Handelsbanken gave branch managers, it also held them accountable for their branch's Statement of Profit and Loss (P&L). Some of the costs (for instance, salaries and rent) included in the Statement (see **Exhibit 5)** were under the direct control of the branch manager. Others costs reflected the legacy of prior branch choices and outcomes. "Depreciation Expense" was for instance charged on assets that might have been purchased by a previous branch manager.

Branch managers had partial control over the profitability of deposits taken in and of the loans made by their branch. As mentioned, branches had discretion over the cost of securing deposits, namely the interest paid to depositors. The revenues earned by a branch from deposits were largely outside local control however. As was common in large banks, all customer deposits had to be sent up to a centralized Treasury function (which effectively served as an internal bank for local branches). And, the centralized Treasury paid all branches identical and non-negotiable rates for the funds (although branch managers could collectively protest unreasonably low rates).

Similarly with the profitability of loans. Branches had significant control on loan revenues because they controlled the interest they charged borrowers and had considerable discretion over who they lent to. But branches were also charged by the Treasury department – the internal bank – for the entirety of the funds they advanced to borrowers, regardless of the deposits taken in by the branch and the interest paid on these deposits. And, since the bank as whole extended more credit than it had customer deposits, the internal bank passed on to the branches Handelsbanken's total cost of borrowing the difference in the capital markets. Branch managers obviously had little control over this cost.[16]

Virtually all the expenses incurred at the regional or headquarter level (including the CEO's salary) were allocated to branch P&Ls. And, while branch managers had no direct control over such expenses, they could influence their magnitude and allocation through annual planning committee meetings. For instance, headquarters-based IT staff would present their projects to the planning committee and have to persuade its members (which included representatives of branch managers) that they were worthwhile. At a recent planning committee meeting, UK representatives challenged the appropriateness of their charges for Handelsbanken TV, a network that Handelsbanken owned in Sweden. Since Handelsbanken in the UK did not get the benefits of the network, they were no longer charged for its cost. "For every centralized function at Handelsbanken," Boman observed, "there is a group of branch managers scrutinizing it."

Branch managers also monitored each other's' performance, competing to deliver the best results. Cost to income (C/I) ratios on P&Ls were the primary financial measure of a branch's success, and branch managers were provided monthly reports listing the C/I ratios of all branches in the region. The bank's reporting system also encouraged competition between branches and regions along dimensions outside the items found on P&L statements such as internal market shares and uptakes of voluntary staff incentive programs. And, observed Kroner, "the main topics for boasting – within the bounds of Scandinavian egalitarianism and modesty" weren't about "how much money one has made personally or for the bank, but how much money one has not spent (low cost: income ratio) and how much money one has not lost (good loan quality)." Conversely "the transparency of internal rankings and benchmarking [could] quickly become the court of shame for someone who made a loan to a shaky customer." [17]

While its reporting system encouraged internal competition, Handelsbanken also expected its use to promote the internal dissemination of effective practices. For instance if a branch manager noticed her C/I ratio was below average, she could dig into his Statement of Profit and Loss to find out why. If, for example, she noticed she had virtually no credit card income, she could ask for advice from the branch manager with the highest credit card income.

Hiring, Advancement and Compensation

Branch managers who were responsible for recruiting branch staff said they favored hiring young people who had not previously worked at other banks, who were likely to fit the culture, and who would make their career at the bank. Most branch managers in Sweden themselves had started in entry level positions and most senior executives had made their careers within the bank (See **Exhibit 6**) including service as branch managers.

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[16] Branches could however partially influence funding costs by varying the maturities of their loans. Just as Handelsbanken's overall cost of borrowing varied with the "duration" of its debt (in normal circumstances, longer term bonds cost more than short term deposits) the price the "internal bank" charged branches depended on the duration of the loans made by a branch. A branch that made long-term fixed rate loans would therefore face a higher rate than a branch that made short term (or adjustable rate) loans. Branch level lending choices acquired further influence in later years when a capital charge was levied on all loans made by branches to reflect the implicit cost of the capital held by Handelsbanken as a cushion against loan losses. This capital cost was calculated from the implied cost of regulatory capital that each individual loan gave rise to (as described in the footnote on page 9).

[17] Kroner, Niels, *Blueprint for Better Banking* (Petersfield, Hampshire, UK: Harriman House Ltd), p. 97.

Promotions within the bank did not follow a traditional climb up the corporate ladder. One Handelsbanken executive observed:

> “The bank encourages employees to move "back and forth along the arrow", more than once. For example, a successful lender in a branch may transfer to a regional credit team to gain expertise in the credit review system. Thereafter, she may be promoted to a branch manager at a small branch, then a branch manager at a larger branch and then an area manager in the regional head office.
>
> “But, while staff can expect good performance to be rewarded with promotion offers – and the salary increases that come with promotions – there is nothing which requires an individual to seek executive positions. There is no embarrassment in retiring from the same branch in which you start. Longtime branch managers are respected in the bank and within their local communities.

Although, managers were accountable for their P&Ls – and competed with each other to show the best results – their compensation was not linked to performance. In fact no one in a branch, no regional manager and no headquarters executive was paid a bonus or other form of incentive compensation.

Employees did have a stake in the financial success of Handelsbanken through a retirement scheme called “Oktogonen.” In the years in which the bank paid a dividend and achieved its goal of better-than-average ROE, it contributed some of the “excess” profit to Oktogonen. And, Oktogonen only invested in Handelsbanken’s shares, making Oktogonen the Bank’s largest shareholder.[18] But employee shares in Oktogonen weren’t distributed either by position or individual performance – all employees were awarded identical interests. And employees did not receive any payouts from Oktogonen until at the earliest when they reached 60 years of age.

Explaining the absence of a “bonus culture,” Kroner observed that the bank paid “competitive salaries and generous pensions” to “talented and moderately ambitious people who are motivated to do what is right because it is right, not because it earns them a financial reward… the system has the great attraction of entrepreneurial autonomy [and] a more interesting and satisfying job though at the expense of more limited financial rewards.”

Kroner further noted that the bank did not “employ people who only do their job in order to be promoted to something else.” Nonetheless, “apart from job satisfaction the key motivation for doing well is that good performance will be rewarded with promotions within the bank [with] clear rules about what constitutes good performance… so that the unwritten contract between the bank and the employee is credible.” Moreover change at Handelsbanken was “moderate and evolutionary” with “no large-scale restructuring. The lack of restructuring or of shifts in corporate strategy forms the cornerstone for the system of internal promotion. You cannot have competition as the main motivational tool in an organization that frequently changes its structure and management. If staff know that there is a high likelihood that the rules and the jury will change over the next five years they will demand more immediate and tangible reward than an implicit promise for future promotion.”[19]

[18] Handelsbanken, 2001 Annual Report, p. 18.

[19] Kroner, Niels, *Blueprint for Better Banking* (Petersfield, Hampshire, UK: Harriman House Ltd), p. 100-102.

Roles of regional banks

Regional banks (represented on the immediate left of branches in "The Arrow") provided oversight and counselling to the branches within their purview in two main ways.

One was through the review of decisions or recommendations made by the branches about loan applications. As mentioned, larger loans had to approved by regional managers (and, sometimes, by headquarters executives). All loans approved at the branch level – and their numerical scores – were also subject to review by credit staff in the regional offices.

A bank executive commented:

> "Not all loans, especially small loans, are actually scrutinized in detail, but lenders in the branches do not know which loans will receive detailed scrutiny and they have to submit complete credit files for all their loans. And these files have to be convincing because credit staff had no contact with borrowers and base their reviews entirely on the documentation provided by branches.
>
> "Lenders responsible for the loans prepare the credit files, but branch managers also have to sign off before they are submitted.
>
> "Reviews by credit staff can cover anything relevant, such as the decision to grant the loan, the numerical rating that was assessed, the collateral taken and its value, and the documentation. If the loan decision has already been taken and communicated to the customer by the branch, then that cannot be changed. Numerical scores can be changed after a review, however."[20]
>
> "Similarly when credit staff review loans, they often contact the lender who prepared the credit report for additional information or clarification. This is expected to be a cooperative dialogue rather than a challenge to make sure that the correct rating has been assigned, that all the assumptions in the credit analysis have been included in the loan file and that the loan documentation is in good order."
>
> "The review process also serves as an important learning tool for new lenders about our credit policies and more generally "Our Way."

Annual audits of branches provided a second oversight and counselling mechanism. According to Kroner's account:

> "An internal audit team visits each branch and examines everything from branch appearance to HR practices at the branch. The audit also focuses closely on the quality of documentation, as Handelsbanken have found that proper documentation can be key to recovering the loan. The branch gets a grade between one and five from the audit team. The audit report is an

[20] The bank also levied a "capital" charge (over and above a "funding charge") on the branches with higher capital charges levied on loans with worse scores. Since scores were "confirmed" after branches had committed to a rate to their customers, this created the possibility of a decline in profitability if the credit staff insisted on a worse score than the branches. The possibility in turn encouraged branches to consult with regional credit staff about a score before make a rate commitment to their customers.

> important basis for the discussion between the branch manager and the regional bank. Having a bad audit grade for several years is likely to end a career as branch manager." [21]

Regional managers were responsible for managing credit staff and providing HR support to branches. They also assessed the potential for new branches in their geographic area and helped select branch managers for new and existing branches. They were accountable for the overall profitability of branches in their region, and (like branch managers) received reports comparing the performance of their regions with other regions.

Headquarters functions

Some of the roles and responsibilities of the executives and staff at Handelsbanken headquarters in Stockholm paralleled the roles at regional offices: They evaluated the extension of very large loans, selected and counseled regional managers and assessed opportunities in new markets. Headquarters also provided some distinctive centralized functions.

One was the operation of an "internal bank" through the Treasury function. As mentioned, Treasury financed the difference between the deposits customers maintained with Handelsbanken and the funds Handelsbanken lent out. As a rule, the Treasury function sought to (through its borrowing and internal pricing policies) to limit the risk and profit of maturity transformation (using cheaper short term deposits and borrowing to make higher yielding longer-term loans). Historically, according to Kroner, about half the treasury staff had engaged in "taking bets on different interest rate scenarios with the aim to make an additional profit for the bank."[22] By 2002 however, bond trading beyond what was necessary to fund the bank had been reduced.

The need to use capital markets to finance Handelsbanken in turn made communications with investors an important Headquarters function. The CEO and CFO therefore visited investors in cities such as London and New York several times a year. However, according to Kroner, the executives "put enormous emphasis on not giving any guidance" about future performance to investors, sounding "as though they would rather have their tongue cut out than make a forward looking statement."[23]

Headquarters housed a capital markets (investment banking) division that was "one of the biggest players in Scandinavia" in "advisory, bond and equity underwriting, syndicated lending and offering clients equities, debt and commodities trading." [24] Although it operated mainly as customer driven and a "flow" business the capital markets division, like the treasury function, also engaged in some trading for profit. And, asset management and insurance subsidiaries reported to corporate headquarters. This structure sometimes lead to disagreements about how the profits of investment banking and asset management would be shared between the branches that provided the customers and the headquarters based staff that serviced them.[25]

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[21] Kroner, Niels, *Blueprint for Better Banking* (Petersfield, Hampshire, UK: Harriman House Ltd), p. 89-90.

[22] Kroner, Niels, *Blueprint for Better Banking* (Petersfield, Hampshire, UK: Harriman House Ltd), p. 110.

[23] Kroner, Niels, *Blueprint for Better Banking* (Petersfield, Hampshire, UK: Harriman House Ltd), p. 127.

[24] Kroner, Niels, *Blueprint for Better Banking* (Petersfield, Hampshire, UK: Harriman House Ltd), p. 66.

[25] Staff in the capital markets division and in the asset management subsidiary were exempted from Handelsbanken's policy of not paying bonuses..

Handelsbanken did not have a centralized marketing department[26]and virtually no media or advertising budget. Similarly, according to Kroner, "the effort other banks might put into strategic planning and budgeting" was devoted to "refining control and reporting tools so that all levels have the right information on a timely basis." [27]

Expansion outside Sweden

Small home markets had long encouraged many Swedish businesses (including Volvo, LM Ericson, ASEA, Swedish Match, Ikea and H&M) to expand abroad. However until the mid-1980s Swedish banks, including Handelsbanken did not have the same incentives or opportunities: Banking and foreign exchanges rules limited competition and entry in domestic banking -- and the opening of overseas branches.

Banking deregulation started in 1985 drastically changed the structure of Swedish banking. It permitted new entry, increased competition and triggered a massive lending boom. Loans to the private sector grew from 85% of GDP to 135% of GDP from 1985 to 1990 while real estate prices more than doubled. In the bust that followed many banks became insolvent. Nordbanken and Gotabanken were nationalized and merged into a new entity, Nordea, which (after further mergers) became the largest bank in Sweden (in terms of assets, but not branches). Restrictions on entry were further reduced after Sweden joined the European Union in 1995 and banking licenses had to be granted to more foreign banks entering the Swedish market.[28]

Capital controls had also been eased when banking had been deregulated in 1985 allowing Swedish banks to expand abroad. Handelsbanken, like other Swedish banks, had taken advantage of the opening in two ways. First, it opened branches in various locations including New York, London, and Singapore mainly to serve Swedish clients.[29] It also gradually expanded in neighboring Nordic countries, starting local retail oriented business in Norway in 1990, in Finland in 1994 and in Denmark in 1996 to provide a full range of banking services to local customers, rather than just Swedish "expatriates."

Opening full service branches outside Sweden had entailed changes to Handelsbanken's model, notably in the selection of branch managers because appointing someone from the existing Swedish branches had proven infeasible. Most branch managers in countries outside Sweden had been recruited from other banks or promoted from the local staff through a process that had evolved over the years.

Quo Vadis, 2002

Sweden continued to be Handelsbanken's largest market however, accounting for 80% of the banks loans, made through 458 branches operating under seven regional banks but opportunities for further growth seemed limited. The Swedish banking market was one of the most concentrated in the world,[30] with four major banks controlling 85% of the sector's total assets (see **Exhibits 7** and **8),** although

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[26] Handelsbanken, 2001 Annual Report, p.12.

[27] Kroner, Niels, *Blueprint for Better Banking* (Petersfield, Hampshire, UK: Harriman House Ltd), p. 98.

[28] McKinsey&Company, "Sweden's Economic Performance: Recent Development, Current Priorities", p. 11.

[29] *History of Svenska Handelsbanken,* Svenska Handelsbanken corporate brochure, p. 19

[30] Consolidation in the Swedish banking sector: a central bank perspective, p 27

competition had kept the "spread" between rates paid to depositors and the rates on loans made to borrowers narrow. Handelsbanken had succeeded in gaining market share in the previous year (in household deposits, household credits, mortgage loans, corporate loans, and mutual funds) but significant further increases – without sacrificing profitability – seemed unlikely. Handelsbanken like its large Swedish competitors had to look outside Sweden for growth opportunities.[31] And abroad, Handelsbanken was a laggard: more than half the assets of the other large Swedish banks were already outside Sweden[32], in considerable measure because they had acquired banks and loan portfolios abroad (see **Exhibits 9 and 10** for information on Handelsbanken operations outside Sweden).

Expansion in the other Nordic countries offered one opportunity for international growth (see **Exhibits 11, 12,** and **13** for economic data on the Nordic banking market). By 2002, Handelsbanken had 27 branches in Norway, 28 in Finland and 32 in Denmark, with branches in each of the three countries operating under a self-standing regional bank. Although Handelsbanken had become the fifth largest bank in Norway (after purchasing loan portfolios from other banks and acquiring Bergensbanken in 1999) its share of Norwegian banking assets was under 5%[33]. Similarly Handelsbanken was just the number five bank in Denmark (in terms of assets) after acquiring Midtbank in 2001. And in Finland, Handelsbanken was the fourth largest bank in assets.[34] Yet, the Handelsbanken model had been tried and tested in all three countries, the bank had high name recognition, and a reputation for good service.[35]

The Baltic countries – Estonia, Latvia, and Lithuania – that had been under Soviet rule after the Second World War until they became independent in 1990 – offered another opportunity (see **Exhibit 14** for economic data on the Baltic banking market). These countries had been heavily influenced by Scandinavian culture, although they were not "Scandinavian." For instance, Western Estonia had been controlled by Denmark in the late 16th century and northern Estonia by Sweden.

All three countries had switched from a closed to a market economy after 1990 and had relied on foreign banks to create modern credit systems. Handelsbanken's Swedish competitors, SEB and Swedbank, had taken the lead controlling (by 2002) 84% of the Estonian loan market, 46% of the Latvian loan market, and 63% of the Lithuanian loan market[36]. In total (according to a European Central Bank report) foreign capital, controlled over 80% of banking assets in Baltics – 90% in Estonia, 85% in Lithuania, and 70% in Latvia."[37]

Handelsbanken had virtually no presence in the Baltics – it operated one branch in Estonia and that wasn't a full service branch. Yet the Baltics remained underbanked. Domestic credit amounted to less that 50% of GDP compared to approximately 160% for the Euro area. Under-banking in turn had

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[31] The Riksbank, "Financial Stability Report 2/2002: Swedish banks' international expansion", p. 72.

[32] The Riksbank, "Financial Stability Report 2/2002: Swedish banks' international expansion", p. 69. Note that one reason that other large Swedish banks had higher shares of their assets abroad was that they had made significant acquisitions of banks abroad.

[33] Handelsbanken, 2001 Annual Report, p. 29

[34] Handelsbanken, 2001 Annual Report, p. 29.

[35] Handelsbanken, 2001 Annual Report, p. 29.

[36] Martin Adahl, "Banking in the Baltics—The Development of the Banking Systems of Estonia, Latvia, and Lithuania since Independence," European Central Bank, p. 112, accessed June, 2015.

[37] Martin Adahl, "Banking in the Baltics—The Development of the Banking Systems of Estonia, Latvia, and Lithuania since Independence," European Central Bank, p. 112, accessed June, 2015.

supported nearly 30% annual increases in deposit and loan growth after 1999[38] but this rapid growth had also caused Swedish regulators to be concerned about the exposures of Swedish banks operating in the Baltics.[39]

The UK was a third option. Like Sweden, the UK had deregulated its financial sector in the mid-1980s, sparking radical changes.[40] Banks began offering untraditional products and services, relying increasingly on non-lending sources of income and, according to some observers, creating a sales culture that put performance incentives and bonuses on the minds of employees at all levels.[41] An independent review commissioned by the UK government had reported in 2000 that the "Big Four" High Street banks (Lloyds, HSBC, Barclays, and RBS) overcharged their customers,[42] exaggerated the difficulty of switching banks and overcomplicated products to confuse customers. The report also accused the UK government of impeding entry into the banking market, noting that the Big Four banks had 68% of the market share of current accounts. The report called for a 'culture change' in the banking industry and in banking regulation[43]. The report changed little however; the market share of the Big Four banks actually increased from 68% to 73% in the two years after it was released (see **Exhibits 15** and **16**).

Unlike its Swedish competitors whose UK operations were not focused on domestic retail banking, Handelsbanken had opened a full service branch (to serve British rather than Swedish) customers in 1999. By 2002 it had expanded to six full service branches. Handelsbanken believed that UK customers were "overwhelmingly sympathetic to the local way we run a bank, focusing on personal service and rapid response." Likewise "good UK banking staff" seemed "genuinely interested in working Our Way."[44] But while the Handelsbanken model had found validation in the UK that was on par with its experience in Scandinavia – the Baltics were untested in this regard – the British market was also the most saturated. Moreover, given the overall banking culture in Britain, the potential for finding the staff to scale up from six branches (in London, Manchester, Birmingham, Nottingham, Leeds and Reading) remained uncertain.

Commit or hedge?

As Boman thought about Handelsbanken's international options therefore he also wondered about the merits of making large commitments to any one market. The bank could potentially expand incrementally opening new branches as attractive opportunities arose. But while incrementalism would leave resources available for expansion in other parts of the world meaningful growth might be helped by a serious, focused commitment. Capable staff in the UK for instance might find careers at Handelsbanken more attractive if the bank declared the UK to be a "home market" or made

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[38] Martin Adahl, "Banking in the Baltics—The Development of the Banking Systems of Estonia, Latvia, and Lithuania since Independence," European Central Bank, p. 118, accessed June, 2015.

[39] Sveriges Riksbank, "Financial Stability Report 2001:2", p. 45.

[40] The Cass Business School, "A Report on the Culture of British Retail Banking", p. 17.

[41] The Cass Business School, "A Report on the Culture of British Retail Banking", p. 17.

[42] Russell-Walling, Edward, "Balancing Act," *New Statesmen,* September 18, 2000.

[43] Donald Cruickshank, "Competition in UK Banking, A Report to the Chancellor of the Exchequer," March, 2000.

[44] Handelsbanken, 2001 Annual Report, p. 6.

acquisitions as it had in other Scandinavian countries. Similarly, continued caution while the Baltics remained underbanked could make later expansion problematic.

As a rule, Boman and his colleagues favored incremental improvements over "big bang" solutions.[45] Did international expansion merit a bolder commitment?

[45] Kroner, Niels, *Blueprint for Better Banking* (Petersfield, Hampshire, UK: Harriman House Ltd), p. 131

Exhibit 1 Handelsbanken Income Statement, 1997-2001

	Y 2001	Y 2000	Y 1999	Y 1998	Y 1997
Interest Income	57,667	66,308	58,048	60,138	57,209
Interest Expense	-43,141	-55,024	-46,540	-48,986	-46,040
Net Interest Income	**14,526**	**11,284**	**11,508**	**11,152**	**11,169**
Dividends received	309	504	245	139	150
Commission income	5,894	6,048	4,693	4,077	4,024
Commission expense	-1,038	-770	-715	-669	-687
Net result on fin. Operations	1,577	3,049	969	1,520	593
Other operating income	219	343	356	618	566
Total income	**21,487**	**20,458**	**17,056**	**16,837**	**15,815**
General Admin Expenses					
Staff costs	-5,909	-5,300	-4,888	-4,579	-4,150
Other admin expenses	-3,345	-2,928	-3,030	-3,543	-2,926
Depreciation and write-down in value of tangible and intangible fixed assets	-805	-753	-750	-685	-617
Total expenses before loan losses	**-10,060**	**-8,981**	**-8,668**	**-8,807**	**-7,693**
Profit before loan losses	**11,427**	**11,477**	**8,388**	**8,030**	**8,122**
Loan losses, net	-160	66	203	330	231
Change in value of repossessed property	8	1	16	-11	71
Participations in result of associated companies	82	32	N/A	N/A	N/A
Result of Banking Operations	**11,206**	**11,576**	**8,607**	**7,711**	**7,820**
Result of Insurance operations	-149	107	N/A	N/A	N/A
Operating Profit	**11,208**	**11,683**	**8,607**	**7,711**	**7,820**
Minority interests	N/A	N/A	N/A	-22	-19
Appropriations	306	797	603	505	532
Profit before taxes	**11,514**	**12,480**	**9,210**	**8,194**	**8,333**
Taxes	-3,202	-3,353	-2,525	-2,168	-2,326
Minority interests	-22	-22	-22	N/A	N/A
Profit for the year	**8,290**	**9,105**	**6,663**	**6,026**	**6,007**

Source: Company Documents

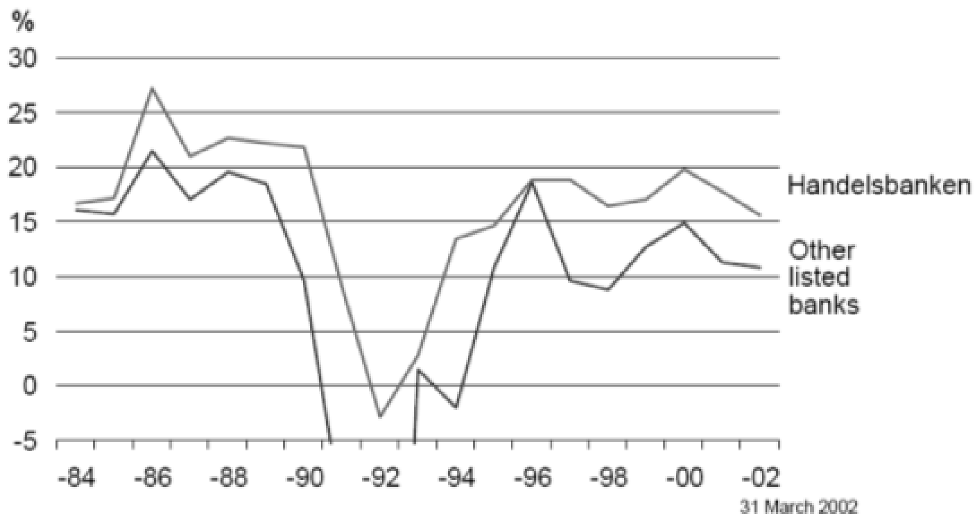
Note: In 1997 and 1998, "Minority interests" were subtracted before "Profit before taxes", and in 1999-2001, "Minority interests" were subtracted after "Profit before taxes".

Exhibit 2 Handelsbanken Balance Sheet, 1997-2001

	Y 2001	Y 2000	Y 1999	Y 1998	Y 1997
ASSETS					
Cash and cash balance with central banks	10,614	5,258	6,285	4,054	3,025
Instruments eligible as collateral w/ c. banks	23,796	12,662	13,187	34,032	13,298
Lending to credit institutions	70,857	94,677	98,859	139,823	134,472
Lending to the general public	800,068	689,106	626,206	587,405	586,824
Bonds and other interest-bearing securities	104,551	75,600	80,104	73,794	52,657
Shares and participations	13,769	13,883	9,350	3,107	2,007
Shares and participations in associated co's	300	271	266	47	45
Shares and participations in Group co's	4,419	247	247	247	247
Assets in insurance operations	20,429	17,762	13,731		
Intangible fixed assets					
Goodwill	6,587	4,970	5,171	4,645	4,770
Tangible Assets					
Equipment	767	744	785	693	721
Buildings and land	1,699	1,014	1,074	1,087	8,608
Other assets	109,623	95,073	71,295	67,695	44,920
Repayments and accrued income	7,042	9,086	9,697	9,821	7,872
Total assets	**1,174,521**	**1,020,353**	**936,256**	**926,450**	**859,466**
LIABILITIES, PROVISIONS, & SHAREHOLDER'S EQUITY					
Liabilities to credit institutions	220,126	155,414	186,503	261,146	241,436
Deposits and funding from general public					
Deposits	225,750	191,016	185,294	168,006	138,371
Funding	57,942	64,334	36,189	38,518	66,376
Issues securities, etc					
Issued debt instruments	440,981	401,489	359,540	299,378	284,051
Liabilities in insurance operations	17,535	17,276	13,649		
Other liabilities	119,532	109,391	80,339	85,304	57,504
Accruals and deferred income	10,017	14,720	11,583	12,663	12,272
Provision for deferred taxes	5,289	4,920	4,478	3,608	3,595
Subordinated liabilities	28,976	19,066	19,850	23,135	23,231
Total liabilities and provisions	**1,126,148**	**977,626**	**897,425**	**891,758**	**826,836**
Minority interest in shareholder's equity	**261**	**261**	**261**	**261**	**268**
Share capital	2,859	2,859	2,859	2,605	2,605
Other reserves					
Statutory reserve	2,748	2,748	2,754	3,007	3,169
Reserve for unrealized profits	205	425	633	22	21
Other restricted reserves	14,369	10,541	8,263	6,393	5,319
Profit brought forward	19,641	16,788	17,398	16,378	15,241
Profit for the year	8,290	9,105	6,663	6,026	6,007
Total Shareholder's Equity	**48,112**	**42,466**	**38,570**	**34,431**	**32,362**
Total liabilities, provisions, and shareholder's equity	**1,174,521**	**1,020,353**	**936,256**	**926,450**	**859,466**

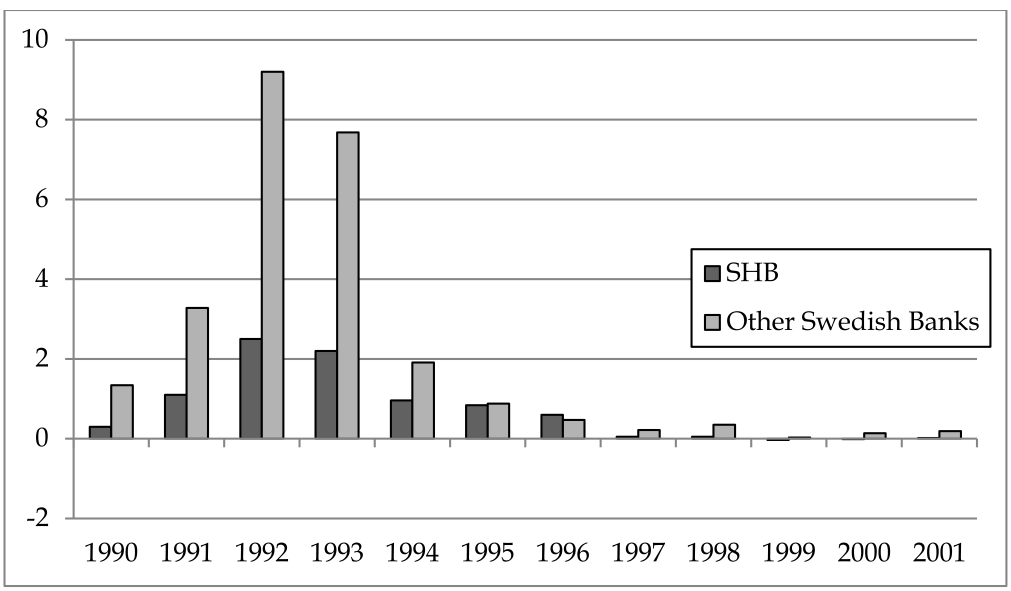
Source: Company Documents

Exhibit 3 Handelsbanken Performance: ROE after standard tax versus peers over time



Source: Company Documents

Exhibit 4 Handelsbanken Performance: Loan losses as a percentage of lending versus Other Swedish banks



Source: Company Documents

Note: "Other Swedish Banks" includes SEB, Nordea, Gota bank (nationalized in 1992), and Swedbank (since 1995).

Exhibit 5 Sample Quarterly Branch Profit and Loss Statement

Quarterly Income Statement, thousands of SEK	
Net Interest Income	7,160
Net Commission Income	2,624
Net gains on financial transactions	124
TOTAL INCOME	**9,908**
Staff Costs	-1,639
Other administrative expenses	-494
Depreciation	-36
Internal Costs (net)	-2,507
TOTAL COSTS	**-4,676**
PROFIT BEFORE CREDIT LOSSES	**5,232**
Credit Losses	-31
OPERATING PROFIT	**5,201**

Source: Company Documents

Note: Net interest income included funding costs for funds borrowed from the treasury. Net interest income also included a capital charge for loans extended by the branch based on Handelsbanken's internal risk ratings. In the external accounting, this capital charge was not part of the interest cost. The internal costs were a net flow based on various costs and some income that the branch would pay (or be paid) to (or from) internal sources. The internal costs is debited to the branches for basically everything that is done centrally ,for instance management, risk & financial control, IT-systems, product development etc.

Exhibit 6 Handelsbanken Senior Management Profiles

President and Group Chief Executive

LARS O GRÖNSTEDT, * 1954
Employed: 1983
Shareholding: 600, options 80 000

Executive Vice Presidents at the Central Head Office

BJÖRN C ANDERSSON, * 1946
Head of Handelsbanken Asset Management
Employed: 1985
Shareholding: 12 500, options 40 000

GÖRAN BJÖRLING, * 1942
Head of Handelsbanken Markets
Employed: 1977
Shareholding: 0, options 40 000

BJÖRN BÖRJESSON, * 1951
Head of Central Credit Department
Employed: 1981
Shareholding: 0, options 40 000

LENNART FRANCKE, * 1950
Head of Central Control and Accounting Department
Employed: 1972
Shareholding: 1 284, options 40 000

ANDERS JOHANSSON, * 1955
Head of Central IT Operations
Employed: 1999
Shareholding: 0, options 5 000

BJÖRN G OLOFSSON, * 1950
Head of Central Business Development Department
Employed: 1986
Shareholding: 0, options 10 000

ANNA RAMBERG, * 1952
Head of Human Resources
Employed: 1971
Shareholding: 909, options 40 000

PEHR WISSÉN, * 1951
Head of Central Treasury Department
Employed: 1983
Shareholding: 0, options 18 000

Executive Vice Presidents at the Regional Banks

STEFAN NILSSON, * 1957
Head of Northern Norrland Regional Bank
Employed: 1980
Shareholding: 0, options 40 000

HÅKAN SANDBERG, * 1948
Head of Southern Norrland Regional Bank
Employed: 1969
Shareholding: 509, options 40 000

MAGNUS UGGLA, * 1952
Head of Stockholm City Regional Bank
Employed: 1983
Shareholding: 30 000, options 40 000

MICHAEL ZELL, * 1950
Head of Central Sweden Regional Bank
Employed: 1978
Shareholding: 2 000, options 40 000

HANS-OLOF HARRISON, * 1943
Head of Eastern Sweden Regional Bank
Employed: 1964
Shareholding: 10 336, options 40 000

M JOHAN WIDERBERG, * 1949
Head of Western Sweden Regional Bank
Employed: 1972
Shareholding: 3 540, options 40 000

THOMMY MOSSINGER, * 1951
Head of Southern Sweden Regional Bank
Employed: 1982
Shareholding: 0, options 25 000

PÄR BOMAN, * 1961
Head of Denmark Regional Bank
Employed: 1991
Shareholding: 0, options 40 000

PETRI HATAKKA, * 1962
Head of Finland Regional Bank
Employed: 1990
Shareholding: 0, options 20 000

BJÖRN-ÅKE WILSENIUS, * 1944
Head of Norway Regional Bank
Employed: 1961
Shareholding: 2 310, options 40 000

Source: Handelsbanken 2001 Annual Report

Notes: Year next to each executive's name indicates year of birth. "Employed" year denotes the year the executive first joined Handelsbanken as an employee in any capacity. Shareholdings and options reflect purchases by management on market terms and were not awarded as part of any compensation package. Pär Boman was appointed head of Markets shortly after the 2001 Annual Report was published.

Exhibit 7 Sweden's General Economic and Banking Performance Indicators, 1997-2001

Sweden	Units	1997	1998	1999	2000	2001
General economy						
GDP per capita	$	24,510.6	25,546.7	27,167.8	29,327.3	29,765.8
Real GDP (% change)	%	3.1	4.1	4.3	4.9	1.7
Population	m	8.8	8.9	8.9	8.9	8.9
Internet Users	'000	2,099.4	2,963.3	3,671.5	4,058.3	4,611.9
Banking Market						
Banking Assets	$M	265,965.9	298,306.3	291,088.4	314,693.8	302,150.1
Capital and Reserves	$M	15,386.4	15,891.8	16,607.6	16,864.1	17,103.0
Bank Loans	$M	109,769.9	123,160.7	125,270.2	134,938.8	132,013.1
Bank Deposits	$M	117,983.0	120,312.1	121,126.3	125,457.8	121,314.0
Net Interest Income	$M	4,528.2	4,169.9	3,891.2	3,588.1	3,753.9
Net Financial Worth of Households	$M	210,515.1	229,127.1	284,335.0	248,141.6	215,465.3

Source: Economist Intelligence Unit, SE Country Data, accessed June, 2015.

Note: "GDP per capita" referred to Nominal GPD divided by the population, "Population" was an end-period estimate, "Bank Performance Indicators" refer to banks' domestic and foreign transactions, except for "Net Financial Worth of Households" which included the domestic market only, and "Bank Deposits" excluded deposits with other banks.

Exhibit 8 Comparison of the Big Four Swedish Banks – Key Figures, 2001

2001	Handelsbanken		SEB		Nordea		Swedbank	
Loan Losses	-152	SEKm	-574	SEKm	-373	EURm	-1,337	SEKm
Operating Profit	11,208	SEKm	6,151	SEKm	1,928	EURm	8,039	SEKm
Total Assets	1,174,521	SEKm	1,163,315	SEKm	242,000	EURm	960,000	SEKm
EPS	11.99	SEK	7.17	SEK	0.53	EUR	9.86	SEK
Return on Equity	18.40	%	11.90	%	13.80	%	14.70	%
Capital Ratio %	9.90	%	10.84	%	9.10	%	7.10	%
Cost/Income Ratio *(before loan losses)*	47.50	%	75.00	%	58.00	%	60.00	%
Loan Loss %	0.02	%	0.09	%	0.29	%	0.20	%
Branches (#)	545		675		268		951	
Employees	9,239		19,618		39,700		16,068	

Source: Handelsbanken, SEB, Nordea, and Swedbank Annual Reports for 2001.

Exhibit 9 Distribution of Handelsbanken Branch Banking Operations

9a. Nordic Countries

Source: Handelsbanken Annual Report for 2001.

9b. Non-Nordic Countries

Source: Handelsbanken Annual Report for 2001.

Exhibit 10 Key Figures - Handelsbanken's Branch Operations Outside of Sweden

	2001	2000
Number of branches	87	52
Number of customers, private 1,000s	170	102
Number of customers, corporate 1,000s	29	19
Internet penetration %, private	23	28
Average number of employees	1,091	758
Total assets, SEK bn	141	117
Lending to the general public, corporate SEK, bn	74	57
Lending to the general public, private, SEK bn	31	20
Deposits from the general public, SEK bn	39	28
Mutual funds volumes, SEK bn	5	4
Income, SEK m	2,193	1,561
Expenses, SEK m	-1,929	-769
Operating profit, SEK m	264	792

Source: Handelsbanken 2001 Annual Report

Exhibit 11 Norway's General Economic and Banking Market Performance Indicators, 1997-2001

	Units	1997	1998	1999	2000	2001
General economy						
GDP per capita	$	36,491.4	34,658.8	36,224.1	38,001.8	38,454.9
GDP (% real change)	%	5.3	2.7	2.0	3.2	2.0
Population	m	4.4	4.4	4.5	4.5	4.5
Internet Users	'000	N/A	N/A	N/A	N/A	N/A
Banking Market						
Banking Assets	$M	129,116.1	139,384.8	146,715.1	151,633.1	161,766.9
Capital and Reserves	$M	8,841.5	9,629.0	10,474.8	10,645.4	10,935.2
Bank Loans	$M	101,715.2	110,774.9	115,237.8	119,814.8	129,322.1
Bank Deposits	$M	73,425.0	75,861.5	80,511.6	80,311.0	86,806.5
Net Interest Income	$M	3122.3	3351.2	3380.5	3427.9	3685.5
Net Financial Worth of Households	$M	34,900.7	33,302.1	42,524.5	41,262.0	36,398.1

Source: Economist Intelligence Unit, NO Country Data, accessed June, 2015.

Note: "GDP per capita" referred to Nominal GPD divided by the population, "Population" was a mid-period estimate, "Bank Performance Indicators" refer to banks' domestic and foreign transactions, except for "Net Financial Worth of Households" which included the domestic market only, and "Bank Deposits" excluded deposits with other banks.

Exhibit 12 Finland's General Economic and Banking Market Performance Indicators, 1997-2001

	Units	1997	1998	1999	2000	2001
General economy						
GDP per capita	$	24,432.9	26,175.7	26,216.1	24,325.4	24,935.0
GDP (% real change)	%	6.3	5.4	4.4	5.6	2.6
Population	m	5.1	5.2	5.2	5.2	5.2
Internet Users	'000	N/A	N/A	N/A	N/A	N/A
Banking Market						
Banking Assets	$M	137,055.4	143,193.6	133,345.6	130,212.8	142,935.1
Capital and Reserves	$M	9,144.5	9,609.0	8,508.0	8,336.0	15,470.3
Bank Loans	$M	66,081.8	76,719.9	71,226.1	72,299.7	70,571.5
Bank Deposits	$M	57,713.6	62,489.4	56,804.4	54,396.0	55,460.3
Net Interest Income	$M	2451.1	2779.7	2310.5	2470.7	2385.6
Net Financial Worth of Households	$M	57,790.9	77,969.9	94,399.2	92,580.3	83,617.7

Source: Economist Intelligence Unit, FI Country Data, accessed 06/2015.

Note: "GDP per capita" referred to Nominal GPD divided by the population, "Population" was a mid-period estimate, "Bank Performance Indicators" refer to banks' domestic and foreign transactions, except for "Net Financial Worth of Households" which included the domestic market only, and "Bank Deposits" excluded deposits with other banks.

Exhibit 13 Denmark's General Economic and Banking Market Performance Indicators, 1997-2001

Denmark	Units	1997	1998	1999	2000	2001
General economy						
GDP per capita	$	32,885.8	33,400.9	33,458.2	30,752.7	30,773.3
GDP (% real change)	%	3.3	2.2	2.9	3.7	0.8
Population	m	5.3	5.3	5.3	5.3	5.4
Internet Users	'000	N/A	N/A	N/A	N/A	N/A
Banking Market						
Banking Assets	$M	279,953.8	338,333.9	315,648.0	322,725.2	349,070.6
Capital and Reserves	$M	15,633.1	18,222.7	16,364.8	18,442.0	18,378.0
Bank Loans	$M	175,739.2	198,563.0	194,120.0	201,997.6	219,952.9
Bank Deposits	$M	102,453.4	114,427.8	106,501.0	98,842.1	99,975.6
Net Interest Income	$M	5,988.4	6,516.7	5,792.7	5,654.8	6,067.9
Net Financial Worth of Households	$M	124,639.4	132,198.9	138,891.0	129,998.8	112,652.6

Source: Economist Intelligence Unit, DK Country Data, accessed June, 2015.

Note: "GDP per capita" referred to Nominal GPD divided by the population, "Population" was a mid-period estimate, "Bank Performance Indicators" refer to banks' domestic and foreign transactions, except for "Net Financial Worth of Households" which included the domestic market only, and "Bank Deposits" excluded deposits with other banks.

Exhibit 14 Baltic States' General Economic Performance Indicators, 1997-2001

	Units	1997	1998	1999	2000	2001
Estonia						
GDP per capita	$	3,618.0	4,051.1	4,148.5	4,069.0	4,478.1
GDP (% real change)	%	11.7	6.8	-0.3	10.4	6.2
Population	m	1.4	1.4	1.4	1.4	1.4
Latvia						
GDP per capita	$	2,508.2	2,781.3	2,770.8	2,642.9	2,832.6
GDP (% real change)	%	8.8	6.3	2.2	5.3	7.2
Population	m	2.4	2.4	2.4	2.4	2.4
Lithuania						
GDP per capita	$	3,711.0	4,100.5	3,836.4	3,515.9	3,658.7
GDP (% real change)	%	8.1	7.6	-1.0	3.6	6.7
Population	m	3.6	3.6	3.5	3.5	3.5

Source: Economist Intelligence Unit, EE Country Data, LV Country Data, and LT Country Data, accessed 06/2015.

Note: Banking Market information not available for Baltic States.

Exhibit 15 The UK's General Economic and Banking Market Performance Indicators, 1997-2001

The United Kingdom	Units	1997	1998	1999	2000	2001
General economy						
GDP per capita	$	24,684.0	26,164.7	26,554.5	26,347.4	25,877.6
GDP (% real change)	%	2.6	3.5	3.2	3.8	2.7
Population	M	58.3	58.5	58.7	58.9	59.1
Internet Users	'000	4,306.8	7,993.5	12,496.0	15,794.3	19,791.8
Banking Market						
Banking Assets	$M	2,199,978.7	2,331,343.7	2,482,378.7	2,851,627.4	3,025,546.2
Bank Loans	$M	1,782,706.9	1,870,197.1	2,069,494.2	2,315,531.8	2,402,792.0
Bank Deposits	$M	1,404,008.0	1,475,158.3	1,559,250.7	1,707,384.4	1,767,274.4
Net Interest Income	$M	63,198.5	67,605.8	70,491.9	68,302.0	72,691.0
Net Financial Worth of Households	$M	3,157,830.3	3,402,362.4	3,931,997.5	3,542,655.7	3,091,231.6

Source: Economist Intelligence Unit, UK Country Data, accessed June, 2015.

Note: GDP referred to Nominal GPD divided by the population, "Population" was a mid-period estimate, "Bank Performance Indicators" refer to banks' domestic and foreign transactions, except for "Net Financial Worth of Households" which included the domestic market only, and "Bank Deposits" excluded deposits with other banks.

Exhibit 16 Comparison of the Big Four UK Banks

2001	HSBC		Barclays		Lloyds		RBS	
Provision for Bad and Doubtful Accounts	-2,037	$m	-1,149	£m	-747	£m	-984	£m
Operating Profit	8,000	$m	3,619	£m	3,521	£m	4,275	£m
Total Assets	695,877	$m	356,649	£m	236,539	£m	368,782	£m
EPS	0.59	$	148.2	p	45.2	p	67.6	p
Return on Equity	11.4	%	17.5	%	29.1	%	41.1	%
Capital Ratio	13.0	%	12.5	%	9.2	%	11.5	%
Cost/Income Ratio *(before loan losses)*	56.4	%	53.0	%	42.9	%	46.9	%
Branches (#)	7,000		2,652		2,300		3,265	
Employees (#)	180,000		78,600		81,000		105,700	

Source: Annual Reports

Note: HSBS and Barclays ROE (Return on average shareholders' funds). Of HSBC's 180,000 employees, 59,000 work in the UK. HSBC Loan Loss % (Customer bad debt charge as a percentage of closing gross loans and advances).

Appendix A: Practices for mortgage and consumer lending in other European banks

Using credit bureau scores to assess the creditworthiness of applicants for residential mortgages and credit cards had become standard practice in large US banks. US regulators also discouraged "discretionary overrides" of credit scores by bank lending staff. Large US banks also used credit scores to extend small business loans – or encouraged small business borrowers to secure credit through "business" credit cards rather than through loans.

A survey of large banks headquartered in France, Iceland, Italy, Germany, the Netherlands, Spain, Sweden, Switzerland, and the UK revealed a different approach, one in which standardized credit bureau scores were not widely used. Only three banks (in the UK, the Netherlands, and Germany) used bureau-provided scores – and even then only as one of several variables in their own scoring models. Non-users (and even two users – in Germany and the UK – that used bureau-provided scores) offered unfavorable comparisons of European bureau scores to US bureau scores.

However, all of the banks surveyed used "negative" credit bureau data (on previous defaults and delinquencies) to screen out borrowers with bad payment histories. In fact, Icelandic and Spanish bankers said they did not get any other data from bureaus. The use of "positive" information secured from credit bureaus (where this was available) varied however. Swedish bureaus provided the broadest range: an interviewee said that income, wealth, tax, and other financial data that would be considered private elsewhere was in the public domain in Sweden and his bank used credit bureaus as a convenient conduit for this data. Bankers outside Sweden did not mention such use. A French banker also said that positive bureau information was incomplete, as lenders were not required to provide positive information.

Although "generic" bureau scores were not widely used, "proprietary" (i.e. non-bureau) credit scoring was widespread in the banks surveyed: all used automated credit scoring for unsecured consumer loans. Models typically played a less important role in mortgages, however. For instance, a banker from one of Handelsbanken's leading Swedish competitors said the only "model" his bank used was to set minimum loan-to-value and loan-to-income ratios. Instead, his bank relied on manuals and underwriting rules established by the bank's board of directors.

Where US banks commonly offered credit cards and mortgages to individuals with whom they had no prior relationships (often using mailing lists provided by credit bureaus), European banks strongly favored lending to existing customers and avoided blind solicitations. One reason was that lending to existing customers gave banks easy access to the transactional and banking data they used for credit scoring. And, according to interviewees, privacy laws restricted access to credit bureau data – which was less comprehensive and reliable than in the US to start with – about non-customers. For instance, a German banker said that German banking rules stipulated that no credit could be extended to a new customer without "proper" analysis. But proper analysis required pulling a credit report and this could not be done without the borrower's prior consent. Therefore, "German banks cannot flood consumer mailboxes with solicitation offers." UK lenders did solicit borrowers by mail (through lists obtained from list brokers rather than bureaus) without analyzing creditworthiness, but unlike US banks, they did not make "firm offers" of credit. Rather, the mailings were meant to solicit applications.

Bankers also expected bundling with other products to help control risks. An Italian banker observed that "clients are less likely to default on loans from their primary bank where their pay accrues." Similarly, a banker from one of Handelsbanken's large competitors in Sweden said that individuals who used their credit cards as a source of credit, rather than as a convenient way of making payments, were usually individuals who face liquidity constraints "between paychecks." And although rates charged on card balances were high, so were defaults and cases of fraud. The bank therefore strongly preferred extending cards to existing customers and required credit card borrowers to either open an account into which the borrower's salary was deposited or to maintain a savings account. Balances in these accounts were monitored against the draw against the credit card limit.

Regulators did not discourage European bankers from overriding the results of credit scoring models as they do in the US, but the degree to which banks permitted their staff to override varied considerably. An Icelandic banker said, "The model only provides a suggestion. Models are used as a tool not an oracle – so a lot of qualitative assessment is done after the model has been run."

One German bank did not require reviews but encouraged them. "Branches have credit discretion," the banker interviewed said, "and are expected to question model scores when they think this is necessary. I love models but I don't fully trust them. Also, model challenges help us constantly fine-tune and refine our models."

A Spanish banker said that discretionary review was built into the scoring system: the models produced "auto-decisions" for high-scoring and low-scoring customers, whereas "grey zone" scores were adjudicated by a centralized underwriting group. Branch staff also could choose to send an "auto-reject" case to the underwriting group for review. Underwriting groups took branch referrals seriously because they believed that branches had "deep knowledge" of their customers.

Other banks, however, tried to limit discretionary overrides. An Italian banker said that branches could override model results, but the branch manager had to take responsibility. A Netherlands-based bank capped overrides by branches to 2% of the total. A French banker said overrides depended on how the loan application originated. Some loan applications come in through retailers helping their customers buy appliances. In such instances the bank will allow retailers to override about 5% of automated rejections. Rejection of applications made over the web could not, however, be appealed. Swiss bank executives similarly said there was "no possibility" of overrides for mortgage applications, while credit cards overrides required a "hierarchy-specific approval process." In contrast, a UK banker said that overrides are more common for mortgages than for credit cards; in either case, branches did not have the authority to overrule models. Challenges to model decisions were reviewed centrally.

Source: Bhide, Amar V., (January 2015) Formulaic Transparency: The Hidden Cost of Mass Securitization. Columbia University Center on Capitalism and Society Working Paper No. 79. Available at SSRN: http://ssrn.com/abstract=2206996 or http://dx.doi.org/10.2139/ssrn.2206996