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2020

WORKFORCE PRODUCTIVITY IN THE NORTH AMERICA BANKING SECTOR

SUMMARY REPORT ON THE IMPACT OF TALENT ON MARKET VALUE AND COVID-19 RECOVERY

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The Business Impact of Workforce Value and Risk

ABOUT THIS REPORT

This summary report is a high-level workforce productivity and return on workforce benchmark analysis that includes historical performance trending and benchmarking of the workforce productivity of 41 of the top 50 Banks listed in North America between 2012 to 2019. *To order the full report with detailed category segmentation, individual bank performance, and on-line database access contact Anh.Tran@hcmi.co.*

BACKGROUND ON WORKFORCE PRODUCTIVITY METHODOLGY AND MEASURES

Multiple studies have shown that intangible assets including patents, trademarks and ideas created by the workforce are responsible for more than 80% of company Market Value*. Research by *McKinsey* indicates that a bank's value is centered around its current and future talent and that there is enormous potential for improvement in this area**. And for most banks, while CEOs state that people are their most valuable asset, labor costs are also the single largest operating expense driving the cost-to-income-ratio (CIR) banking metric.

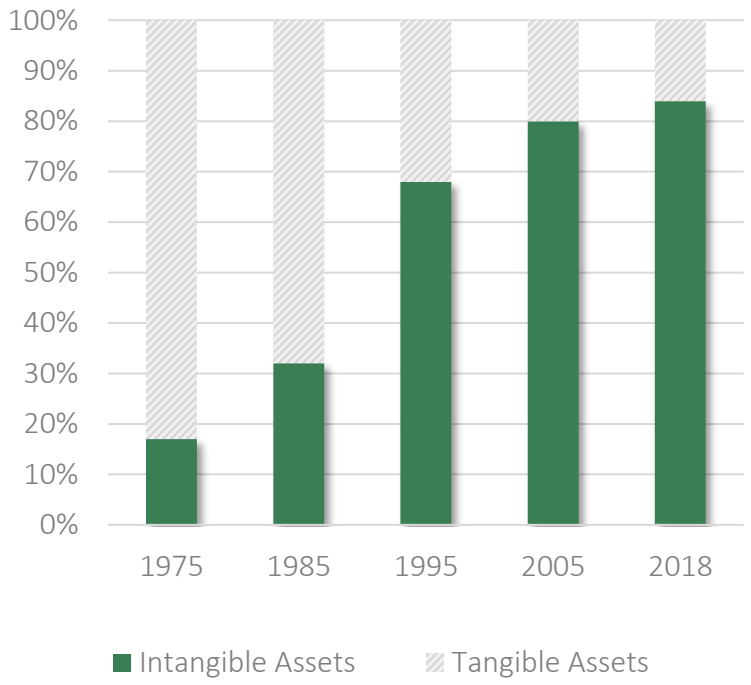
For these reasons, understanding and quantifying the impact of human capital value and risk on the business is critical for evaluating business performance and competitive advantage as the banking sector looks to emerge from the uncertainly of COVID-19.

Traditional financial reporting contains minimal information on an organization's talent management effectiveness and productivity in relation to revenue and profit. The recently released **ISO #30414 Human Capital Reporting Standard** addresses this deficiency with recommendations for disclosing certain advanced workforce productivity metrics. **The U.S Securities and Exchange Commission** Chairman also has stated that he *"would like to see more disclosure from public companies on how they think about human capital."* (see page 16 for details).

This study incorporates advanced workforce productivity metrics that solve the financial linkage challenge by quantifying overall changes in major expenses such as total labor costs to outputs such as revenue. The result is an output and input sensitive return on a series of cost-based workforce productivity metrics.

(See appendix for metric calculations)

Tangible vs. Intangible Assets for S&P 500 Companies*
(1975 – 2018)



** Source: Aon and Ponemon Institute (2019)*
*** Source: McKinsey & Company's "Talent in wholesale banking: Building a sustainable competitive advantage"*

Report Highlights

KEY FINDINGS

While the performance of individual banks and bank categories varied, significant trends emerged over the seven-year study period revealing the following insights:

- Top 5 bank 'Winners' grew in market cap by $20.5 billion* per bank on average vs flat market value for the others
- Top 5 bank 'Winners' increased their productivity on average 5.4% annually
- Bottom 5 bank 'Laggards' lost (- 9.1%) in productivity return per dollar invested annually
- Workforce productivity of the largest banks stagnated, falling (- 0.4%) annually, despite revenue growth
- Top quartile** banks improved on average 1.7% productivity per year annually, all other banks stagnated (- 0.4%)

The above findings when combined with previous studies by HCMI's "Linking Human Capital to Business Performance", further supports the power of selected human capital metrics to predict market valuation.

CONCLUSION

While the average productivity of the 41 banks was stagnant from 2012 to 2019, a select group of 5 high performing banks effectively increased revenue 4.4% annually with flat headcount while keeping labor and operating expense increases to 2.0% or less. Many of these 'Winners', were mediocre performers in 2012 but by 2019 became top banks measured via human capital productivity and have separated themselves from the competition.

Overall, Top Performers Outpaced 'Laggards' by

$20.5 Billion

In Market Capitalization

Top Banks Increased Human Capital ROI annually

5.4% ↑

7 Year Compound Annual Growth (CAGR)

* Compared to bottom 5 banks ranked by HC ROI ratio growth. Top 5 saw 7.6% average yearly market growth while bottom 5 saw only 0.2%
** Ranked by single year HC ROI score

Banking Industry Performance Summary

Study Scope: 41 of the largest North America listed banking and financial services companies from 2012 to 2019

The North America Banking industry overall has seen large increases in revenue and headcount-based productivity metrics over the last decade, this has not translated to cost based measures of workforce productivity.

On average, the top 41 banks have not improved on advanced productivity measures, with an average (- 0.4%) CAGR rate over the last 7 years.

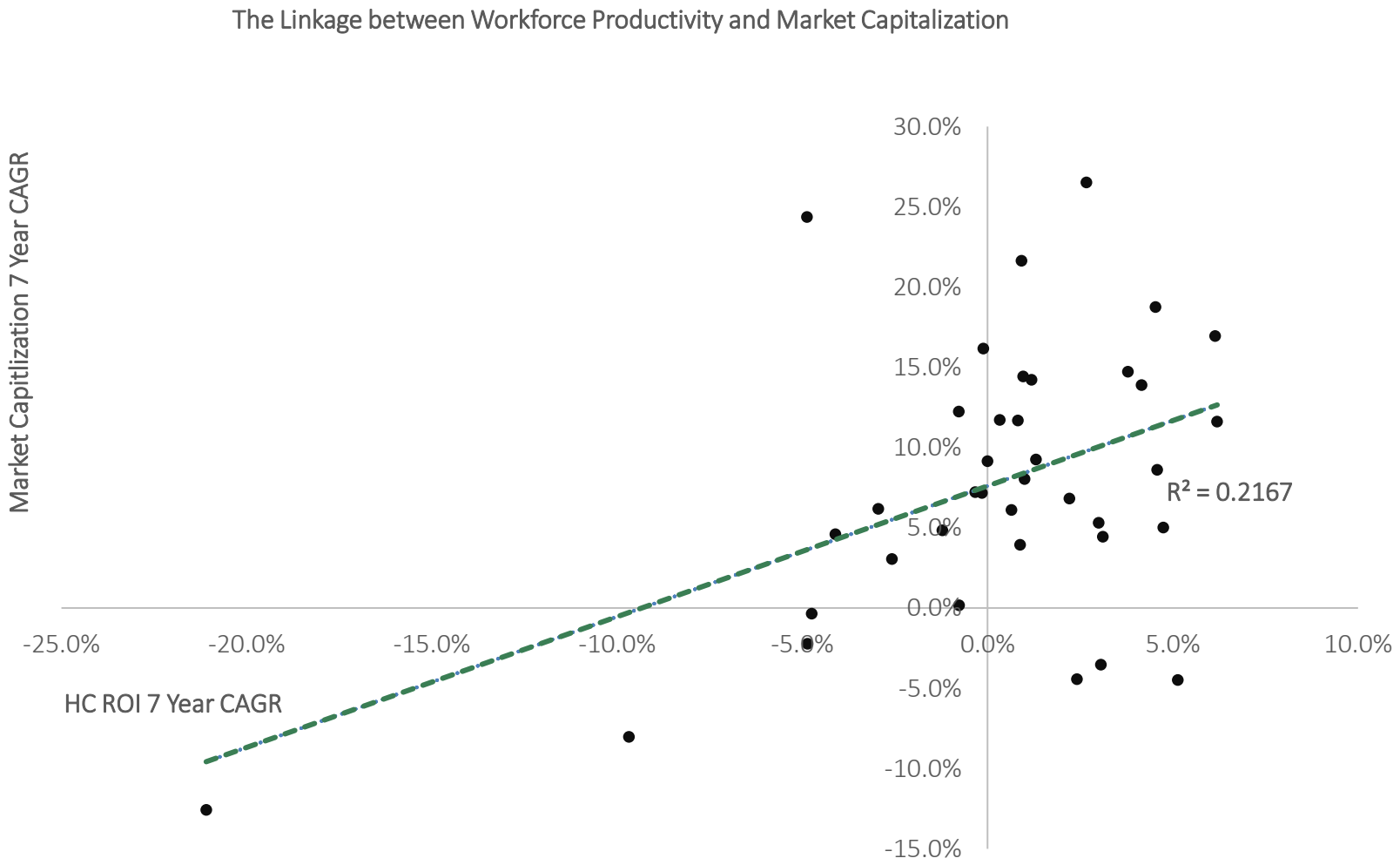
Within the study group there was significant variation from the average in annual productivity improvement. Industry 'Winners', the 5 banks with the largest productivity gains, saw an average of 5.4% in workforce productivity gains each year, while the 'Laggards', the 5 banks with the largest productivity losses, saw a (- 9.1%) average loss each year.

Some banks ('Laggards') with very high productivity (Human Capital ROI Ratio) in 2012 were shown to be unsustainable as their productivity dropped on average (- 46.0%) over 7 years. Other banks ('Winners') started from a lower productivity score and consistently improved year over year, climbing an average of 12 ranks compared to the other 41 banks in workforce productivity.

'Winners' held headcount steady **(- 0.5%)** while growing revenue **4.4%** annually, keeping workforce costs and operating expenses to less than **2.0%** growth.

'Laggards' increased staff **3.3%** annually but revenue only **2.8%** while workforce and operational costs grew by **6.5%** and **9.7%**, respectively.

Linking Workforce Productivity to Stock Market Value



INSIGHT

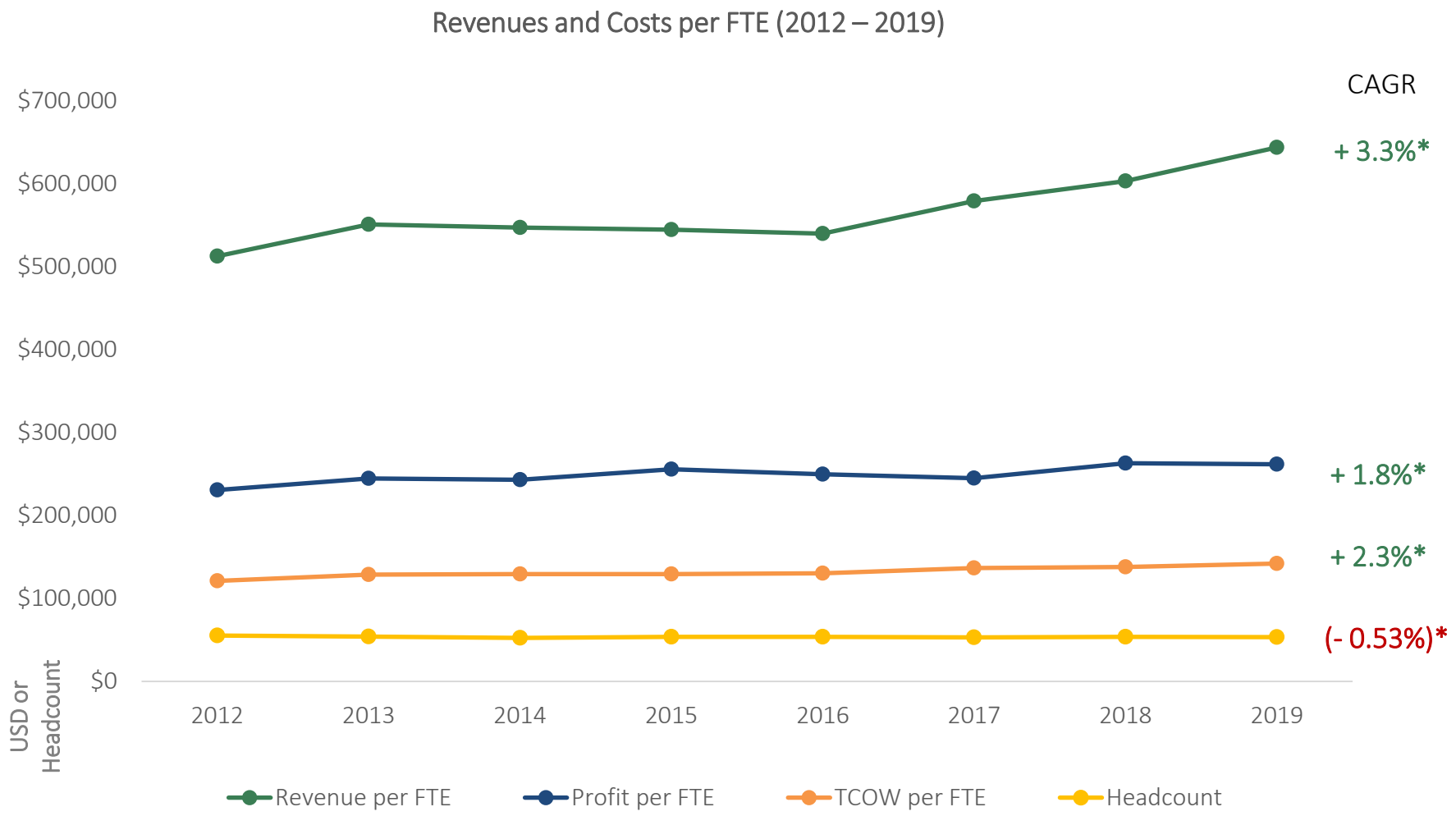
On average, banks that saw an increase in workforce productivity saw higher increases in Market Capitalization.

This matches previous findings by Higgins and Atwater (2013)* that advanced productivity metrics were more predictive of market value growth compared to established measures such as Profit and Revenue per FTE.

Metrics utilizing workforce costs rather than headcount have **10x** the predictive power in terms of future stock price, market valuation and of Human Capital Return on Investment (HC ROI).

** For further reading, see HCMI's white paper "Linking Human Capital to Business Performance"*

Productivity Trends: Basic Metrics



Note: Headcount is not in USD but # of employees

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WINNERS

'Winners' saw yearly **4.9%*** gain in Revenue per FTE, with the top performer seeing a **11.1%** growth rate.

LAGGARDS

'Laggards' saw a yearly **(- 1.5%)*** loss in Revenues per FTE, with the bottom performer seeing a **(- 9.5%)** average yearly loss.

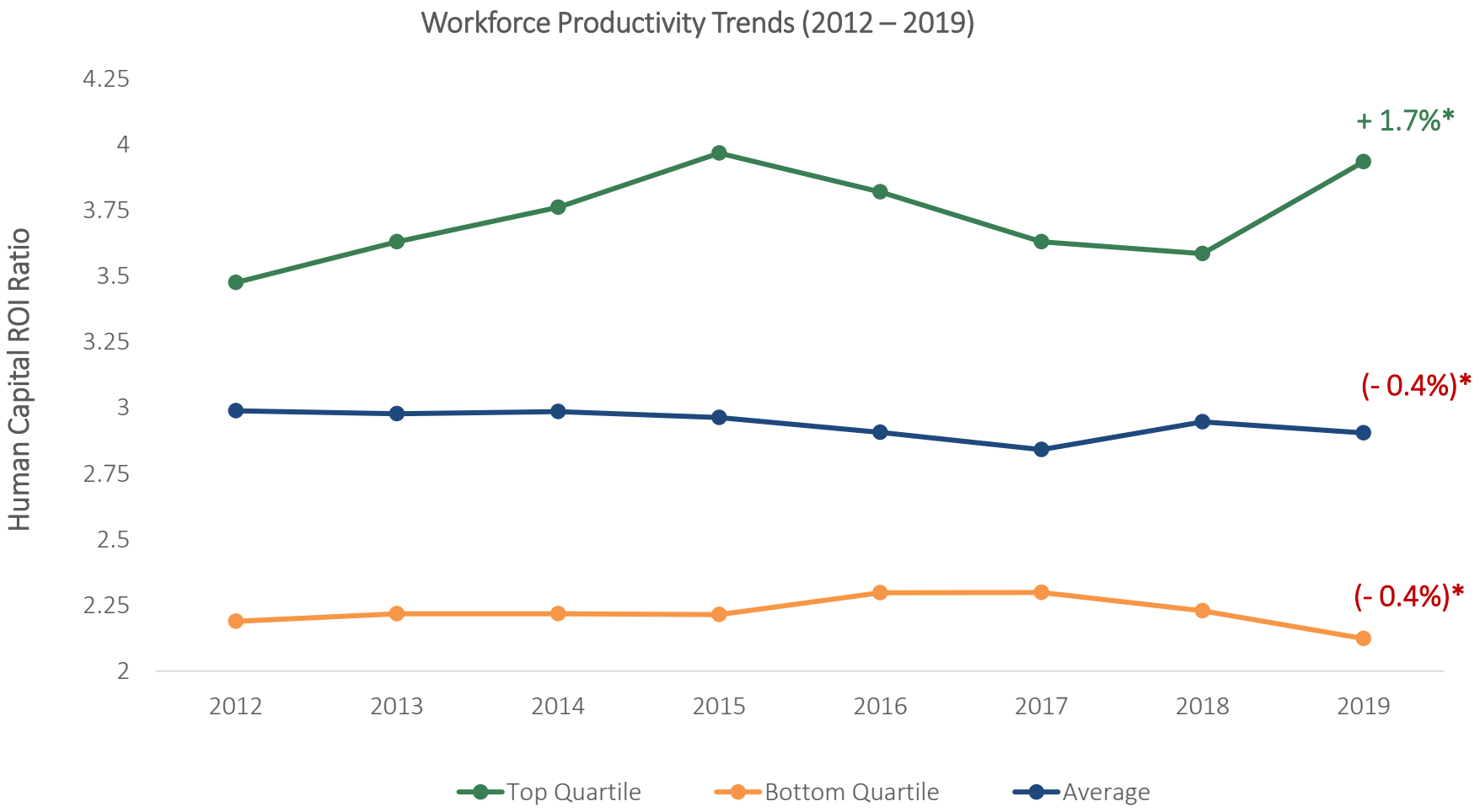
INSIGHT

Basic productivity measures improved, but advanced productivity measures tell a different story.

(See next slide)

**Presented as 7-year CAGR*

Productivity Trends: Advanced Metrics



Productivity reflects the amount of ROI for every $1 spent on workforce

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WINNERS

Top banks saw yearly workforce productivity growth of 5.4%*, using the workforce cost based metric HC ROI Ratio

LAGGARDS

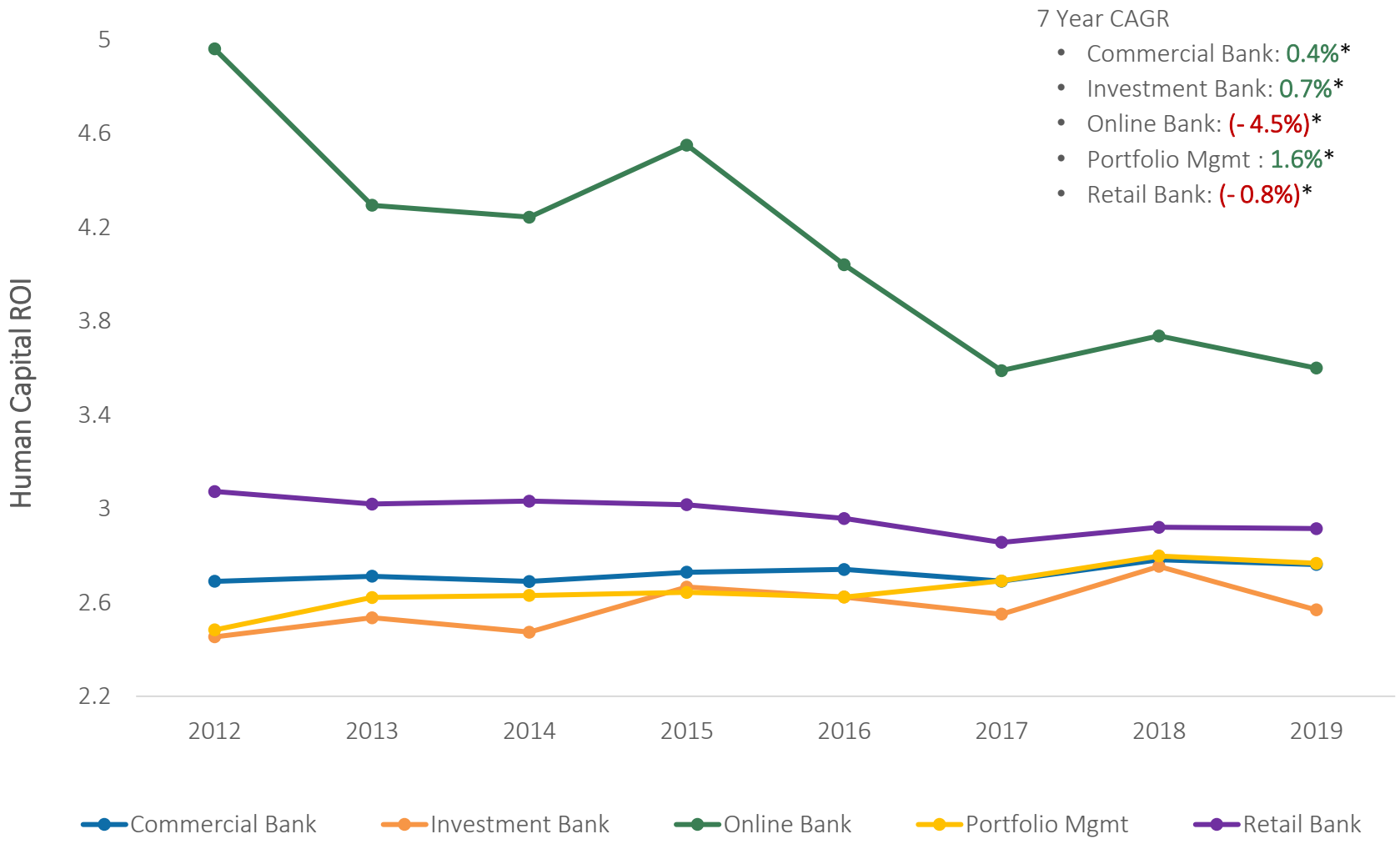
Advanced productivity among all banks down (- 0.4%)* yearly despite increases in revenue

INSIGHT

In 2019, the **gap between the top and bottom** quartile banks increased by **33%**.

**Presented as 7-year CAGR*

Productivity Trends: By Bank Category



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WINNERS

Portfolio Management banks have seen a 1.6%* rise in employee productivity over the past 7 years.

LAGGARDS

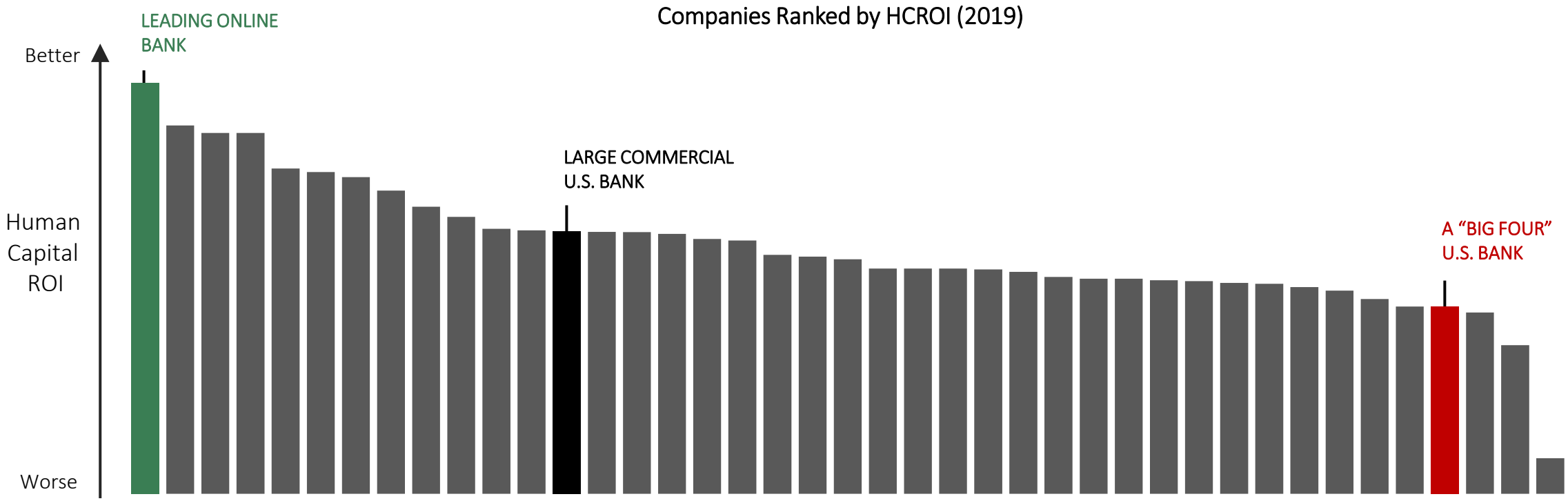
Online Banks saw a yearly **(- 4.5%)*** loss in productivity. Although this is likely a market correction for inflated productivity from earlier years.

INSIGHT

Online Banks, with perceived competitive advantages, showed perhaps unsustainably high productivity in 2012 but have slowly moved **closer to average over time**.

**Presented as 7-year CAGR*

Productivity Trends: 2019 Human Capital ROI Ranking



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WINNERS

Climbed an average of 12 ranks in HC ROI ratio compared to other banks from 2012-2019

LAGGARDS

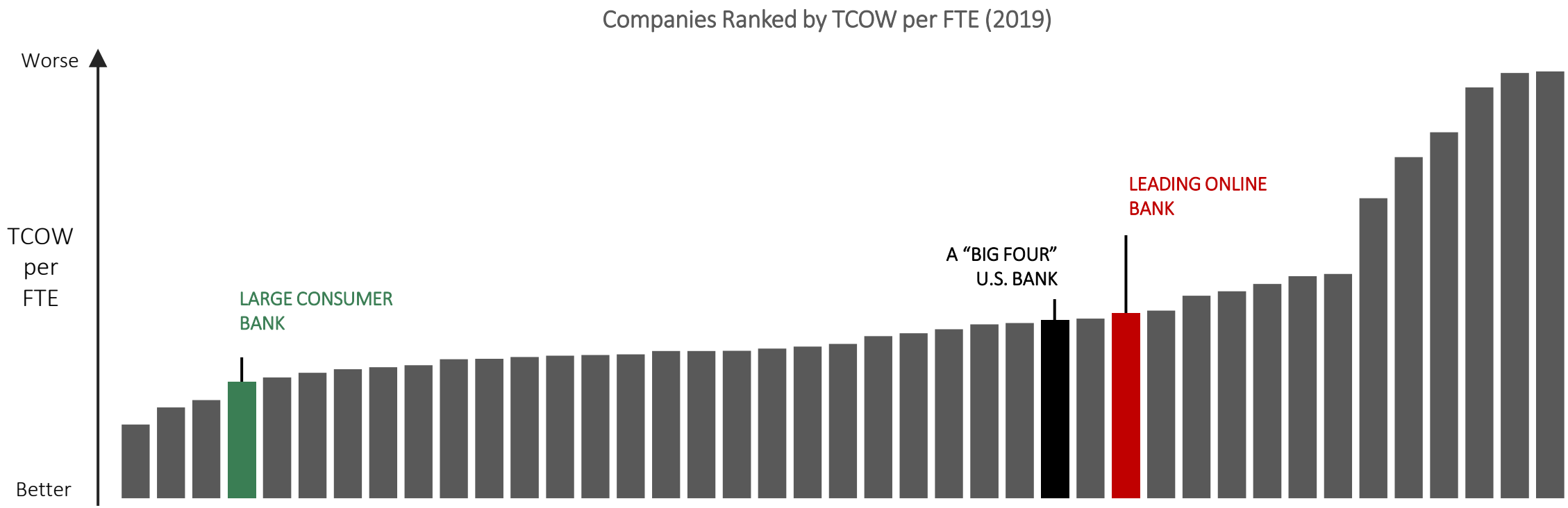
Fell an average of 10 ranks in HC ROI ratio compared to other banks from 2012-2019

INSIGHT

- Productivity high performers are found in all categories
- Industries low on costs have higher average results

For complete list of all companies see appendix

Productivity Trends: 2019 Total Cost of Workforce Ranking



WINNERS

Increased TCOW per FTE about as much as 'Laggards', but kept headcount steady to control costs

LAGGARDS

Per FTE Workforce costs increased 2.0% annually, but with 3.3% headcount increases total TCOW rose 5.5% per year

INSIGHT

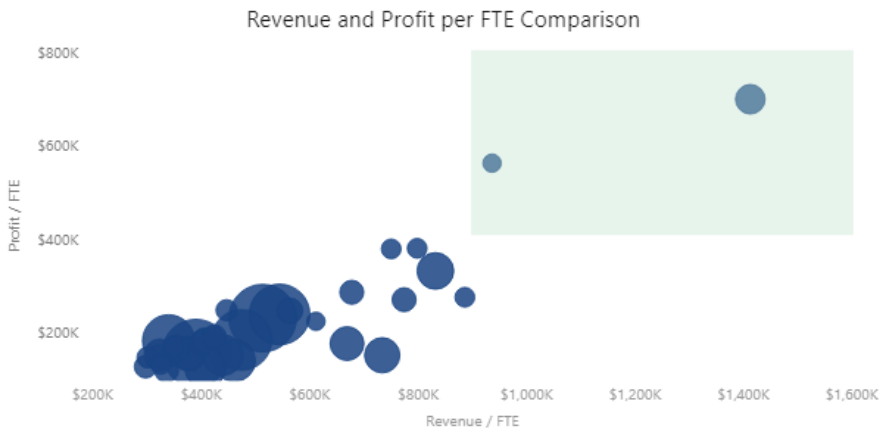
- Investment banks have higher workforce costs, but higher revenue
- Online and Consumer banks have lower workforce costs, on average

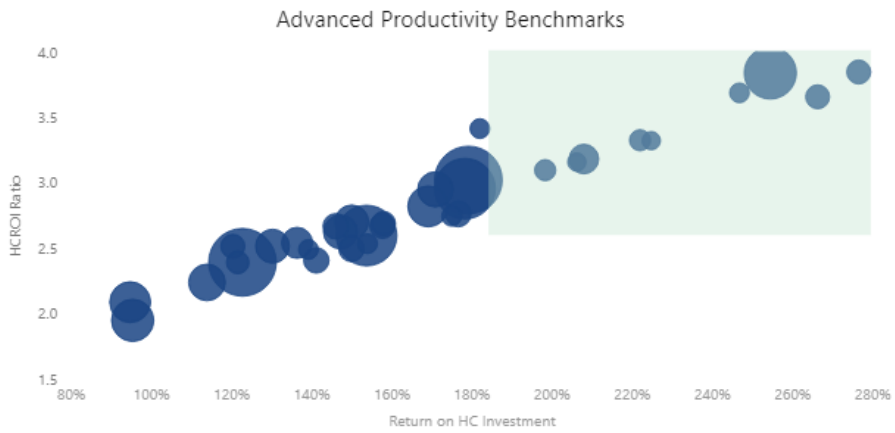
For complete list of all companies see appendix

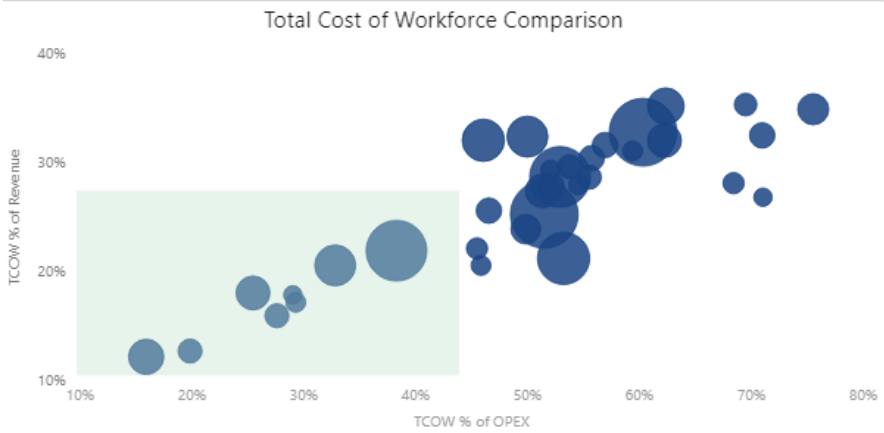
SOLVE™ Workforce Productivity Benchmarking

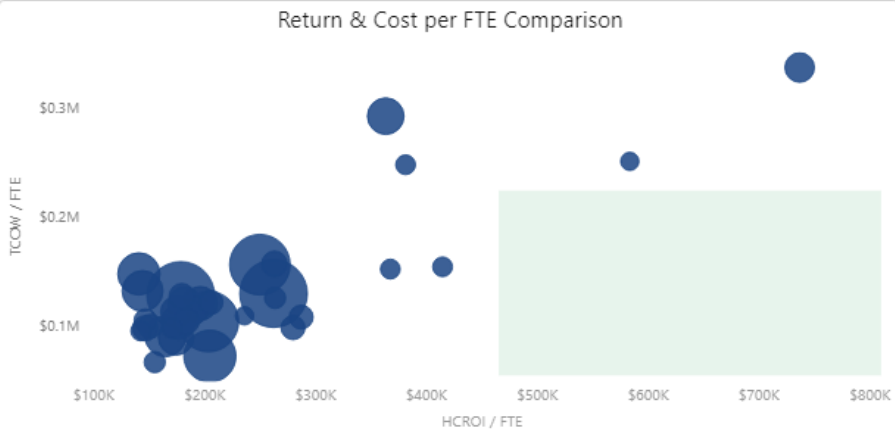
Basic Metrics

Advanced Metrics









INSIGHT

In SOLVE™'s productivity benchmark analyses (shown to the left), companies are plotted by both traditional and advanced measures of workforce productivity. The top right chart uses the metrics focused on in this report.

Each bank in the study is represented by a bubble with the bubble size representing headcount. The "green zone" provides a simple guide on the ideal score range.

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Looking Ahead: Emerging from COVID-19 Uncertainty

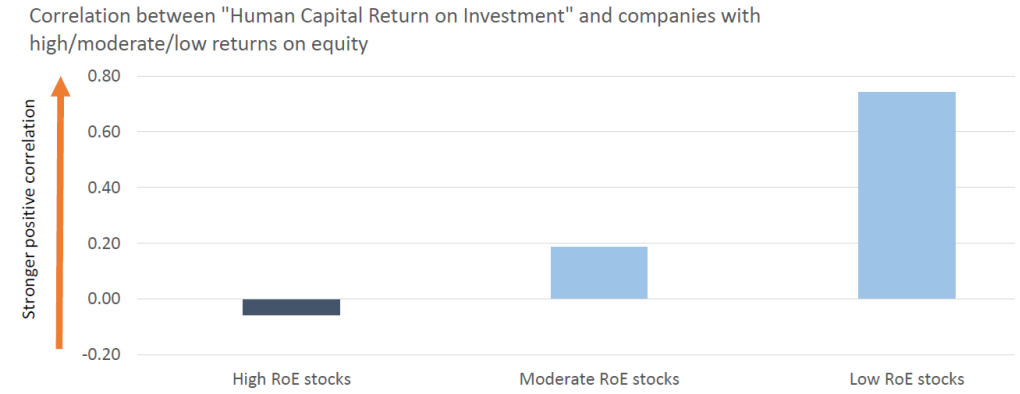
Reflecting on Prior Recessions

While the COVID-19 economic uncertainty and previous financial crises have many differences, there are relevant findings across prior recessions regarding the improved likelihood of recovery for organizations that make better strategic and long-term oriented talent decisions.

2008 Financial Crisis: Strategic Staffing Decreases led to Quicker Recoveries

A May 2020 Deutsche Bank study found that S&P 500 companies who strategically invested in talent while minimizing staff cuts during the 2008 financial crisis saw their subsequent revenue, market share, and profits grow at almost double the rate of peers who rushed major staff cuts.

As the chart to the right shows, companies with low Return on Equity and high labor costs stand the most to gain by improving their talent management capabilities.



Source : Company reports, Factset, Deutsche Bank

Business Performance Following Recessions: Winners Reduce Costs through Operational Efficiency Rather than Slashing Headcount

A study published in the Harvard Business Review** analyzed strategy selection and corporate performance during the prior three global recessions: the 1980 crisis, the 1990 slowdown, and the 2000 bust. Key findings:

- 17% of the companies didn't survive a recession and 80% of the survivors had not regained their prerecession growth rates within 3 years.
- Only 9% flourished after a slowdown, doing better on key financial parameters than they had before it and outperforming rivals.
- The post recession winners cut costs mainly by improving operational efficiency vs slashing the number of employees relative to peers.

As the Banking industry looks to emerge from the COVID-19 pandemic, those banks with higher workforce productivity and a strategic talent focus supported by the right data and metrics to surgically invest in talent while controlling overall workforce costs will be well positioned to outperform those who do not or cannot.

* Source: Deutsche Bank's "Furloughs, layoffs and recovering from Covid-19"
** Source: Harvard Business Review's "Roaring Out of Recession"

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PRE-ORDER SOLVE™ PREMIUM PRODUCTIVITY REPORT & DATABASE

Reserve your copy of the detailed report that includes access to the SOLVE™ proprietary Financial Services workforce productivity database. Highlights include:

- ✓ Ranking detail for all 41 banks in the study
- ✓ Industry sector cuts
- ✓ Additional discussion on productivity metrics
- ✓ Example of an ISO compliant report
- ✓ On-line access to SOLVE™ with data for all 41 banks for:
  - ➢ Benchmarking
  - ➢ Filtering by sub-sectors
  - ➢ Multivariate forecasting

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ABOUT US

SOLVE™ is HCMI's advanced business analytics platform for human resource management that drives competitive advantage through higher workforce productivity, smarter workforce spending and better talent management.

SOLVE™ applies over 1,000 machine learning algorithms and natural language processing to integrated sets of HR, financial and operational data to quantify the value of the workforce, link people investments to business outcomes, and identify key drivers of productivity, costs, turnover, retention, engagement, leadership, and performance to improve talent management.

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APPENDIX

Banks Included in the Analysis

ALLY FINANCIAL INC
AMERICAN EXPRESS CO
BANK OF AMERICA CORP
BANK OF NEW YORK MELLON CORP
BARCLAYS PLC
BBVA
BNP PARIBAS
CAPITAL ONE FINANCIAL CORP
CIT GROUP INC
CITIGROUP INC
CITIZENS FINANCIAL GROUP INC
COMERICA INC
DEUTSCHE BANK AG
DISCOVER FINANCIAL SVCS
E TRADE FINANCIAL CORP
FIFTH THIRD BANCORP
FIRST REPUBLIC BANK
GOLDMAN SACHS GROUP INC
HSBC USA INC
HUNTINGTON BANCSHARES
JPMORGAN CHASE & CO
KEYCORP
MITSUBISHI UFJ FINANCIAL GRP
MORGAN STANLEY
NEW YORK CMNTY BANCORP INC
NORTHERN TRUST CORP
PEOPLE'S UNITED FINL INC
PNC FINANCIAL SVCS GROUP INC
POPULAR INC
REGIONS FINANCIAL CORP
SANTANDER HOLDINGS USA INC
SCHWAB (CHARLES) CORP
SIGNATURE BANK/NY
STATE STREET CORP
SVB FINANCIAL GROUP
SYNCHRONY FINANCIAL
SYNOVUS FINANCIAL CORP
TORONTO DOMINION BANK
U S BANCORP
WELLS FARGO & CO
ZIONS BANCORPORATION NA

The ISO and SEC on Human Capital Standards

ISO HUMAN CAPITAL REPORTING STANDARD 30414

The ISO Human Capital Reporting Standard (ISO 30414) is the first-ever guideline for human capital reporting released by the International Organization for Standardization (ISO). The main purpose is to make the contribution of human capital to the business more transparent to both management and investors. The U.S. Securities and Exchange Commission (SEC) also is evaluating potential human capital disclosure requirements that likely will leverage the ISO guidelines.

WHY IT MATTERS

The investment community has been actively seeking additional HR insights to assess how companies are managing their most important asset - their talent. They are now pointing to the ISO standard as a guideline for information. As noted in a February 2019 research brief by Deutsche Bank: “The value of employees will now be calculated under the new-released ISO standard on Human Capital reporting” and “Our stock screens detail those stocks in a strong and weak Human Capital position.”

WORKFORCE PRODUCTIVITY RECOMMENDED

ISO 30414 recommends advanced workforce productivity metrics including Human Capital ROI as well as EBIT/Revenue/Turnover/Profit per FTE to be included disclosure. The template provided here can be calculated with just a few base metrics, with the most complex being Total Cost of Workforce (see appendix for calculations).

Source: ISO Technical Committee 260

Human capital areas		External reporting	
		Large organizations	Small and medium organizations
Compliance and ethics	Number and type of grievance filed	x	
	Number and type of concluded disciplinary action	x	
	Percentage of employees who have completed training on compliance and ethics	x	x
Costs	Total workforce costs	x	x
Diversity	Workforce diversity with respect to		
	a) age	x	
	b) gender	x	
	c) disability	x	
	d) other indicators of diversity	x	
	Diversity of leadership team	x	
Leadership	Leadership trust	x	
Organizational health, safety and well-being	Lost time for injury	x	
	Number of occupational accidents	x	x
	Number of people killed during work	x	x
Productivity	EBIT/revenue/turnover/profit per employee	x	x
	Human capital ROI	x	x
Recruitment turnover and mobility	Average length		
	a) time to fill vacant positions	x	
	b) time to fill vacant critical business positions	x	
	Percentage of positions filled internally	x	
	Percentage of critical business positions filled internally	x	
	Turnover rate	x	x
Skills and capabilities	Total developing and training costs	x	x
Workforce availability	Number of employees	x	x
	Full-time equivalents	x	x

Why Workforce Productivity Metrics

WHAT'S WRONG WITH TRADITIONAL MEASUREMENTS?

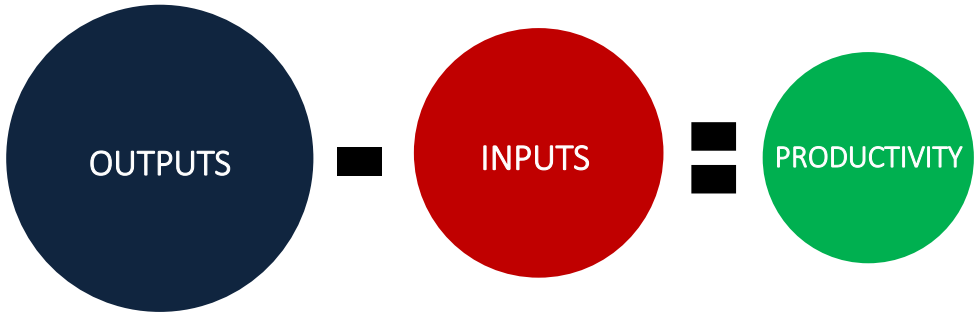
The Bureau of Labor Statistics defines productivity, as output per hour, or average output. However this type of productivity measurement does not recognize the influence of human capital involvement, or improvement overtime*. It also doesn't take accounts of other workforce costs outsides of wages and salary such as hiring cost, training time and onboarding cost.

This is why we need another robust measure for workforce productivity that account for workforce costs in relation to company output (revenue/profit).

OUR METHODOLOGY

The methodology used for this study included a series of advanced metrics which measure workforce productivity in terms of dollar-based outputs such as revenue together with labor costs.

These inputs integrate into a series of measures quantifying a cost-based return on workforce costs. Specifically, the recommended measures solve the financial linkage challenge by quantifying overall changes in major expenses such as total labor costs to outputs such as revenue. The result is an output and input sensitive return on a series of cost-based workforce productivity metrics.



Outputs	Inputs	Productivity
• Revenue (Budget) • Units of Production • New Products • Inventions/IP • Technology/Assets	• Labor Costs • Material Costs • Time/Speed • Overhead • Technology	• Profit • Quality • Efficiency • Satisfaction

ADVANCED PRODUCTVITY METRICS

Human Capital ROI

Descriptions: Net operation profit impact of each dollar invested in human capital or the total cost of workforce

Total Cost of Workforce

Descriptions: Net operation profit impact of each dollar invested in human capital or the total cost of workforce

(See page 18 for metric calculations)

* BLS Productivity and Cost News Release, USDL 13-1101, June 5, 2013.

Key Input Metric: Total Cost of Workforce

Total Cost of Workforce =

Total workforce direct business costs + HR, including:

+ Employee compensation (salaries/wages, incentives, overtime, equity & other pay)
+ Contingent temporary / contract labor (costs)
+ Employee benefits and perks (costs)
+ HR function (costs e.g., recruiting, training & support)
+ Retiree or inactive workforce costs* (costs)

BACKGROUND

Normally companies only track salary and wages which on average only represents 60% of all workforce expenditures. Bonus, recruiting cost, contingent workforce and many other costs that made up the remaining 40% are often forgotten and subsequently ill-managed. Total Cost of Workforce (TCOW) attempts to capture all these expenditures to give management a much better insights into workforce costs.

WHY TCOW?

- Workforce costs are large (average 70% of operating expenses)
- What gets poorly measured, gets poorly managed
- In growth, TCOW is a tool to control budgets, requisitions and position control leaves gaps
- In decline, TCOW shows how much to cut or control at a granular level
- Need for a metric to manage the complexity of the workforce

Advanced Productivity Metric: Human Capital ROI Ratio

Human Capital ROI

$$= \frac{\text{Total Operating Revenue} - (\text{Total Operating Expenses} - \text{Total Cost of Workforce})}{\text{Total Cost of Workforce}}$$

Descriptions: Net operation profit impact of each dollar invested in human capital or the total cost of workforce

INTEPRET HUMAN CAPITAL ROI

This metric reflects the return on investment in people in terms of the incremental Revenue an organization would be able to generate from $1 additional investment into the workforce.

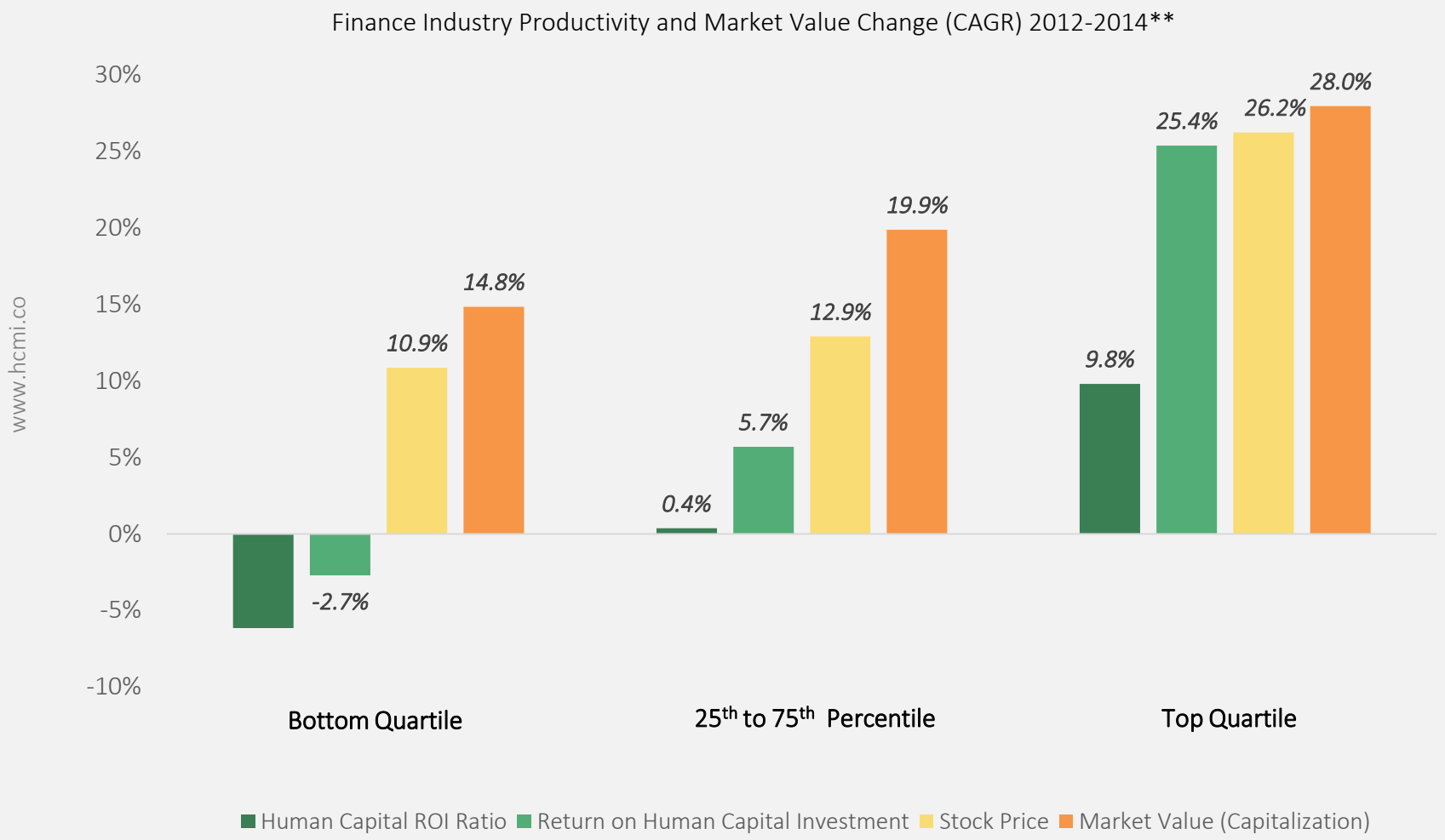
For example, a 2.5 Human Capital ROI ratio means that if an organization were to invest an additional $100,000 into the workforce, they should expect this investment to be able to generate an additional $250,000 in revenue.

OTHER ADVANCED PRODUCTIVITY METRICS

Advanced productivity metrics are more robust and account for workforce costs in relation to company output (revenue/profit). The top advanced metrics include:

- Human Capital ROI (HCROI)
- Return on Human Capital Investment (%)
- TCOW per FTE

Prior Workforce Productivity Study



** BLS Productivity and Cost News Release, USDL 13-1101, June 5, 2013.

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INSIGHT

Our prior multi industry and finance focused research* found that cost-based workforce productivity metrics predicted improvements and losses in overall market value, even controlling for market factors.

- 2013 study on data from 1996 to 2011. Sample size = 22,000 (link below)
- 2015 follow-up study on the finance industry from 2012-2014. Sample size = 169

These findings held in the periods of recession, growth, and overall market stagnation.

** For further reading, see HCMI's white paper "Linking Human Capital to Business Performance"*

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