



**TEMENOS**  
The Banking Software Company

## Case Study Metro Bank

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### Breaking the Mould but Breaking the Malaise?

An assessment of whether Metro Bank,  
with its distinct model, can bring about a  
cultural revolution in the UK banking market



As the first new entrant in the UK banking market for over 100 years, Metro Bank is generating plenty of headlines....



UK's Metro Bank beats target on new accounts



Metro Bank works magic on customers



Does the first new British bank since the 1800s herald the start of new competition for your money?



the established players, despite blotted copybooks, are deeply entrenched ... the barriers to entry are formidable



Metro Bank a fascinating case study in what customers really want



Metro Bank model backed by banking commission



Metro bank opens on Sunday as battle for high street heats up



Metro Bank Speeds Growth



The UK's newest bank must show a genuinely creative side beyond the promotional gimmicks dispensed at the opening of the first branch



Banking revolution or the emperor's new clothes?



... a challenge to the tarnished incumbents is long overdue. But its American-style "fun" marketing may not be enough to win over jaded British account holders



Metro: first bank for 100 years opens its doors. Metro Bank has promised to revolutionise the British banking experience.



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# METRO BANK

reams  
Wedding Bed Specialist



## Executive Summary

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Market share in the UK retail banking market is highly concentrated. This is not a new phenomenon – as far back as 1918, the four largest clearing houses held 67% of all deposits<sup>1</sup> – but the concentration has been growing over time. Moreover, an unintended consequence of the recent financial crisis has been to increase concentration further, as several banks, unable to tap the wholesale markets for funding, have been forced into the arms of competitors. *In extremis*, the UK government even had to contravene competition rules to bring about the merger of HBOS and Lloyds TSB. The result: a market for current accounts that in 2010 is 85% held by the “big five” banking institutions<sup>2</sup>.

High concentration has permitted anti-competitive behaviour culminating in high bank profitability at the expense of customers. Several reports commissioned over the last decade<sup>3</sup> draw the conclusion that weak competitive pressures, coupled with excessively ‘light touch’ regulation, allowed banks to pursue a policy of profit maximisation that – at its most extreme – negatively impacted consumer welfare and – at best – largely ignored consumer welfare and satisfaction levels. Moreover, a predilection among bankers to drive their lending businesses produced an unhealthy reliance on wholesale funding and helped fuel an asset bubble in the last decade, the unwinding of both of which may weigh on economic growth for years to come.

However, the ingredients for change are forming. Consumer dissatisfaction with their banks is not new. But, public anger over the many well-publicised cases of excessive or opaque pricing, over the role of banks in creating the economic downturn and over the need for the taxpayer to fund a bank bail-out – particularly when banks are ostensibly little reformed (paying large bonuses, making fewer loans to businesses) – is galvanising consumers to consider switching banking providers in numbers not seen before. Add to this a new-found political desire for change – already evidenced, for example, in the UK banking levy – and the conditions for long term change would seem to be materialising.

Metro Bank, the first new bank to enter the UK banking market for more than 100 years, represents a timely antidote to public and political misgivings about existing banking practices. Metro Bank’s mission is to take retail and commercial banking back to its basics – to offer a personalised service based on the provision of transparent, fairly-priced products. In so doing – and through its emphasis on customer service – Metro Bank aims to restore the customer to the heart of banking. What is more, because loans are made out of deposits, the bank is not dependent on wholesale funding and so represents the kind of safe, well-capitalised new entrant that the governing bodies might wish to encourage to foster a sustained increase in competition<sup>4</sup>.

The Metro Bank model is based on a highly successful antecedent – Commerce Bank in the US – and is being brought to the UK by the same founder, Vernon Hill. Hill started Commerce Bank in 1973 with a single branch, but was able – by sticking resolutely to its winning model of transparent branch-based banking and superior customer

service (“wowing” the customer) – to turn itself into one of the largest banking groups in the US.

Metro Bank is clearly breaking the mould, but there are doubts that it can really make a lasting difference and break the UK banking malaise. Two principal challenges are cited. The first concerns Metro Bank’s ability to overcome market forces – the economies of scale and other factors that favour the large incumbents and have produced such a concentrated market. And the second questions whether a model which continues to place importance on face-to-face branch banking still appeals in a world where alternative banking channels have become so prevalent.

As regards overcoming market forces, Metro Bank – as Commerce Bank did as well – is neutralising many of the scale advantages enjoyed by large banks by operating a highly efficient IT platform. Metro Bank is using T24 from Temenos as its core banking system: a modern, integrated and fully upgradable solution that affords the bank a complete and real-time view over its business and its customers and across all channels – and that does so at a fraction of the cost of running legacy or other third-party applications<sup>5</sup>. Furthermore, Metro Bank has taken the application on a hosted, pay-per-use basis – minimising the level of upfront IT investment needed (which the Office of Fair Trading (OFT) estimates to account for two-thirds of a start-up bank’s initial costs<sup>6</sup>) and rendering IT a variable cost which flexes with account numbers and transaction volumes. Not only can Metro Bank operate at a significantly lower IT cost base and so achieve minimum efficient scale sooner, but its IT infrastructure facilitates its superior customer service – by enabling it to open a customer account and issue a new debit card in 15 minutes, for instance.

As regards whether the model is still relevant for current times and outside of the US, the early evidence would seem to offer a resounding endorsement of its continued validity. Market data reveals that customer preferences in the UK are very similar to those in the US – customers value service above all else – giving no *prima facie* reason for why Commerce Bank’s success in the US could not be replicated by Metro Bank in the UK. And, initial trading has been highly robust; in fact, in its first month of operation Metro Bank exceeded its target for the whole of 2010 in terms of account openings.

As to whether market share gains can be defended over the long term – another concern raised – we point to several sources of sustainable competitive advantage. Metro Bank’s branches (stores) would be hard to copy, for example: they have a very distinct look and feel and are found in the most convenient locations. But, the most profound advantage the bank has is that everything – from the core banking application to the employee training – is built around the customer. To achieve the same customer satisfaction scores as Metro Bank is already achieving would require big banks to change their people, their IT systems, (the negative associations of) their brands and their facilities. So, in short, no easy feat – or to cite Vernon Hill: “the big banks can imitate our model, but they can’t copy it.”

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### Sources

- 1 UBS Investment Research, “Regulatory moderation, perhaps”, 12 July 2010
- 2 “Review of barriers to entry, expansion and exit in retail banking”, Office of Fair trading, November 2010
- 3 Such as HM Treasury, ‘Competition in UK Banking: A Report to the Chancellor of the Exchequer’, March 2000, ‘Personal current accounts in the UK: An OFT market study’ July 2008 and ‘Personal current account banking services in Northern Ireland market investigation’, May 2007
- 4 The fragmentation in the UK mortgage market earlier in the decade, for example, was achieved through higher lending from players like Northern Rock dependent on wholesale funding, and has not endured.
- 5 Research carried out by Temenos, using data from The Banker – Top 1000 banks, showed a clear and statistically significant discrepancy between the performance of banks using Temenos core banking software and banks using other third-party or home grown applications. The results showed that banks running Temenos enjoy a 54% higher return on assets, a 62% higher return on capital and a cost/income ratio that is 7.2 points lower than non-Temenos customers. A follow-up customer survey revealed as a key source of these better metrics that Temenos customers on average spend 5.6% of total costs on IT compared to 14.3% on average for the industry as a whole (source: Boston Consulting Group)
- 6 ‘Review of barriers to entry, expansion and exit in retail banking’, Office of Fair Trading November 2010

# “The OFT believes that the Personal and Current Account market as a whole is not working for consumers”

## History and Background of the UK Banking Market

This section serves to describe, chiefly through reference to third party reports and market share data, the current competitive situation in the UK banking industry. It also sets out some of the conditions – such as light-touch regulation – that gave rise to the financial crisis in the UK, as well as examining some of the consequences of the crisis and high levels of consolidation on consumer satisfaction and welfare.

## The Market Today

Since the early 20th century, the banking sector in the UK has been dominated by a handful of large universal banks. In 2010, the five leading players are namely Barclays, HSBC, Lloyds Banking Group, Royal Bank of Scotland Group and Spanish-owned Santander, which are known collectively as the “big five”<sup>7</sup>.

These five banks, four of which operate more than one brand in the UK, together hold significant market share. In 2009, the “big five” held 83% of the personal current accounts market, 68% of the deposits savings market and 77% of the mortgage market. As regards the market for SMEs, the latest data show the “big four” had an 83% market share<sup>8</sup>.

### For some time, there has been concern about the high level of concentration in the UK market and its consequences...

Concerns about the negative effects of limited competition on business and retail customers were already widespread a decade ago. A flurry of M&A activity at the end of the nineties (e.g. Lloyds’ takeover of TSB) prompted the UK government to order a review of the British banking market in November 1998. The resulting study, conducted by Don Cruickshank and published in 2000, concluded that the current account and SME-lending markets were too concentrated and that the absence of competition was allowing banks to charge higher prices and earn higher profits than would otherwise have been the case<sup>9</sup>. Amongst its many recommendations to increase competition, it urged the government to lower entry barriers to allow new and overseas entrants into the market and to improve the supply of information to consumers, so that they could make better informed decisions about what products and services they consumed<sup>10</sup>.

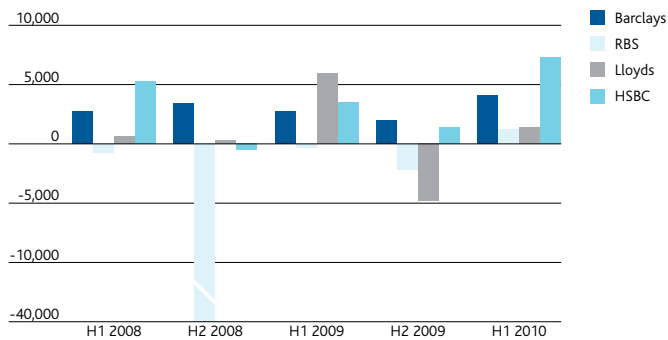
Follow-on studies from the OFT and the Competition Commission into the competitiveness of the personal current account (“PCA”) market reached similar conclusions<sup>11</sup>. These studies were commissioned by the government since the PCA market is such a large source of profits to the industry (more than savings and credit cards combined<sup>12</sup>), because basic banking services are essential for consumers to participate in the economy and because current accounts provide a gateway for banks to sell other products and services. Their findings point to the typical market failings of an oligopolistic market, where rivalry is high but competition low:

“the OFT believes that the PCA market as a whole is not working well for consumers. A combination of complexity and a lack of transparency means that consumers and competition are focused almost exclusively on more visible fees, and not on the less visible elements such as insufficient funds charges and foregone interest – despite the fact that these make up the vast bulk of banks’ revenues<sup>13</sup>.”

Among the OFT’s recommendations were measures to increase consumers’ confidence to switch banking suppliers and to increase transparency, in particular over overdraft fees.

### “Big four” profits are recovering ...

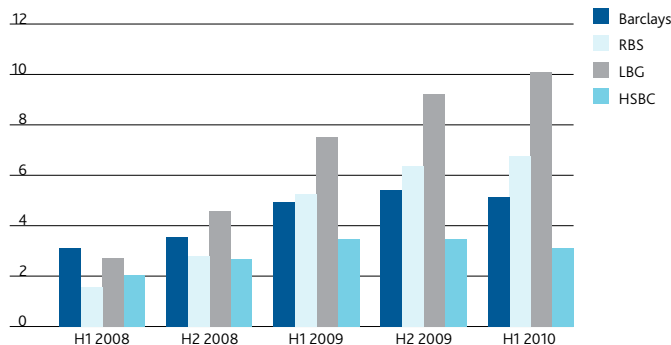
Statutory Profit/Loss Before Tax (million GBP)



Source: KPMG LLP (UK) 2010

### ...even though for some, impairments are still rising

Impaired loans compared to gross loans and advances to customers (percentage)



Source: KPMG LLP (UK) 2010

#### Sources

7 Note that Santander has been present in the UK since its 2004 acquisition of Abbey National, but it has only become a truly leading bank – with more than 10% of the market for personal accounts, for example, – since its acquisitions of Alliance & Leicester and the savings business of Bradford and Bingley, both of which took place in the second half of 2008. As such, we make reference in this report to both the “big five” and the “big four” – that is, the “big five” less Santander and particularly for the period before 2009

8 All of the figures are taken from the Future of Banking Commission report, 2010

9 A follow-up study in 2002 by the Competition Committee into the SME market estimated that the return on equity by banks serving this market was 21 points higher than would have otherwise been the case with effective competition: at 36%. See ‘SME Banking: Review of the undertakings by banks following the 2002 Competition Commission report’

10 See HM Treasury, ‘Competition in UK Banking: A Report to the Chancellor of the Exchequer’, March 2000

11 See ‘Personal current accounts in the UK: An OFT market study’ July 2008 and ‘Personal current account banking services in Northern Ireland market investigation’, May 2007

12 ‘Personal current accounts in the UK: An OFT market study’ July 2008

13 *idem*



## ...yet concentration has been increasing – particularly in the last decade...

Since the time of the Cruickshank report in 2000, concentration has increased significantly. For example, the combined share of personal accounts held by the “big four” has increased from 68% to 71% in 2009<sup>14</sup> and, as already noted, the “big five” hold 83%. The “big four” concentration of the deposit savings accounts market rose from 19% to 59% in 2008<sup>15</sup>. Their combined market share in mortgages increased even more dramatically, from 17% in 2000 to 67% in 2009<sup>16</sup>.

## ... and regulation has failed to prevent further consolidation...

The many recent studies into the UK banking market have recommended tougher regulation to prevent further consolidation, to increase competition and to promote more open competition. Yet, regulation not only failed to prevent further consolidation – as evidenced above – but it also failed to prevent a severe banking crisis in the UK.

The lack of rigorous regulation in the UK banking and financial markets is often viewed as a legacy of the gentlemanly system of self-regulation which prevailed in the City of London even prior to Margaret Thatcher’s “Big Bang” deregulation in 1986.

Nonetheless, in 1997 – partly in response to the collapse of Baring Brothers and the pensions mis-selling scandal earlier in the decade – the new Labour government set up the Financial Services Authority (FSA) to tighten up regulation<sup>17</sup>.

However, the FSA’s way of regulating became known as ‘principles-based’ or ‘light touch’, and did not encourage prudential self-regulation. It was heavily influenced by the self-regulatory, market-based approach preached by the US Federal Reserve Chairman Alan Greenspan<sup>18</sup>. Crucially, this approach assumed that players in the banking and financial markets operated with good corporate governance and the market was capable of pricing risk correctly. The FSA had no remit for, or practice of, reviewing or sanctioning banks’ strategies or business models.

And, as the developments of the last decade – culminating in bank bailouts and nationalisations – showed, the principles-based approach allowed some banks to turn liberty into licence.

## By 2008, British banks were lending out £800bn more than they had on deposit

## ...or avert the Banking Crisis...

The widespread use of wholesale funding for loans was a relatively recent phenomenon in the UK and could have been kept in check by tougher regulation. In the UK, the low-risk basic savings and lending banking model was widespread until as late as the end of the twentieth century, keeping loan-to-deposit ratios below 100%. However, by 2008, British banks were lending out £800bn more than they had on deposit<sup>19</sup>, signifying a heavily reliance on the wholesale funding markets. In the UK, the use of securitisation, to fund mortgages for instance, increased from some \$200 billion in 1995 to \$2.3 trillion in 2006<sup>20</sup>. Many observers believed that the increase in securitisation activity would reduce the risk within the financial system, but they were proved wrong in 2007. Risk had been transferred and concealed, not reduced.

This overreliance on the wholesale market caused several banks to experience funding difficulties at the end of 2007, even before the economic downturn began to cause impairments to rise. In September 2007, the Bank of England was suddenly forced into action to provide emergency funding to Northern Rock, a bank whose funding depended largely on wholesale markets that had frozen as the US subprime mortgage crisis unravelled. In early 2008, following a couple of failed private sector bids, the Banking Special Provisions Act was passed which allowed the government temporarily to nationalise the bank.

The government was forced to intervene several more times in the banking sector to ensure its continued health (and the supply of credit to the economy). After Northern Rock, Bradford & Bingley, a bank specialised in self-certified mortgages, was the next to experience funding problems, leading in September 2008 to the sale of its retail network and deposit base to Santander’s Abbey (and nationalisation of the rest of the business). Then, in October 2008, the UK government launched a Special Liquidity Scheme of up to £500bn of interbank short-term loans and guarantees. At the same time, it set up a Recapitalisation Fund, making capital available to eight of the UK’s largest banks and building societies in exchange for shares. As a result of the latter, the UK government took a significant stake in RBS: it injected £20bn, to which it later added a further £22.5bn the following year in respect of the bank’s participation in the Asset Protection Scheme (and which took the government stake to 84%).

The government also engineered the merger of Lloyds TSB and HBOS, which has added considerably to the degree of consolidation in the UK retail banking market. It is one of the unintended, yet ironic consequences of the banking crisis that the government, concerned that concentration had allowed market abuse, actually contributed to further consolidation – and in this case it was necessary to invoke a national interest clause to bypass competition law since jointly the banks held nearly one third of the UK’s savings and mortgage market. Nonetheless, the government believed that HBOS – which was suffering significant impairments in its mortgage loan book – could not have survived on its own. In fact, even the combined HBOS/Lloyds TSB entity was not even able to continue without government assistance – it was partly nationalised in late 2008 when the government injected £17 billion in exchange for 44% ownership.

The role of the regulator in failing to avert the banking crisis was acknowledged by the FSA itself when, in 2008, a review by its internal audit division into its supervision of Northern Rock concluded that there was an urgent need for a supervisory enhancement programme<sup>21</sup>. In April 2010, the UK government also acknowledged culpability: Gordon Brown admitted that the UK government had bowed to pressure from the banking industry in the 1990s and failed to regulate banks properly<sup>22</sup>.

### Sources

14 Future of Banking Commission report, 2010

15 *idem*

16 *idem*

17 The FSA was set up with five statutory objectives: to promote market confidence, public awareness, financial stability, consumer protection and the reduction of financial crime

18 Greenspan was even awarded an honorary knighthood by the UK in 2002 “for the benefit that the UK has received from the wisdom and skill with which he has led the US Federal Reserve Board”

19 Financial Stability Report, Bank of England, June 2009

20 Future of Banking Commission report, 2010

21 “The Supervision of Northern Rock: a lessons learned review”, FSA internal audit division, March 2008

22 Gordon Brown made this admission in a television interview on 14 April 2010

## Consumer Trust, Satisfaction and Welfare Have Suffered Because of High Levels of Concentration

As the various official studies into the UK banking market cited in this report have shown, the biggest four banks in the UK hold a level of market share that allows them to make profits well in excess of the cost of capital by charging higher prices for products and services (transparently and non-transparently) than would have been possible in a more highly contested market.

A more recent report, included within the Bank of England's Q3 2010 Quarterly Bulletin, suggests that the increased levels of consolidation that have resulted (inadvertently) from the banking crisis – and which have caused the "big four" to become the "big five" – may be the reason why banks are not passing on lower base rates to consumers. As the report notes, "During the recent financial crisis Bank Rate was reduced sharply, but in general the interest rates charged on new lending to households did not fall by as much and indeed some interest rates rose." While the banks choosing not to pass on these lower rates to customers might be motivated by the prudent desire to increase capital adequacy levels ("may reflect a need to build higher capital levels"), the point is that this is possible because of the "reduction in the degree of competition within the banking sector following consolidation." And, it represents a transfer of welfare from consumers to banks.

So, the increase in consolidation over the last decade has been consistent with consumer welfare losses. Moreover, consolidation and the recent banking crisis have also adversely affected levels of customer trust and satisfaction in the UK, to levels not seen before.

## Just 7% of Britons have complete trust in their bank

### Customer Trust Has Been Eroded

Just 7% of Britons have complete trust in their bank<sup>23</sup>. As a recent Deloitte YouGov poll showed, consumers are much more cognizant of, and prepared to take action about, issues like the perceived safety of their bank and the level of fees charged than at any time in the recent past.<sup>24</sup>

Furthermore, consumer resentment against banks for their perceived role in the crisis is intense and widespread. The results of a 2009 survey by the UK consumer watchdog Which? showed the extent of ill feeling towards the sector: two thirds of people were still very angry with banks for causing the financial crisis; three quarters believed that banks were not genuinely sorry for their role in the crisis; sixty percent felt that banks had not learnt their lessons from the crisis; eighty percent believed that senior bankers had managed to avoid paying the price for their mistakes. Because of this, a third of people thought that, in future crises, banks should not be bailed out by government<sup>25</sup>.

#### Sources

- 23 YouGov poll, [www.money.co.uk](http://www.money.co.uk), 2009
- 24 Poll dates from Oct 2009 and results published in "Opportunity Knocks: Considerations for new entrants in UK retail banking" by Deloitte
- 25 "Britain Needs Better Banks", Which? research, October 2009
- 26 "Customer Priorities: What customers really want", UK Institute of Customer Service, 2007
- 27 "Barking Up the Wrong Tree", Anita Chakrabarty, International Journal of Applied Marketing, 2004
- 28 "Best Practices in Retail Banking Sales and Service Channels", Booz Allen & Hamilton, 2007
- 29 2010 Industry service rankings, [www.moneysupermarket.com](http://www.moneysupermarket.com)

### The Customer Satisfaction Crisis

Before looking at customer satisfaction levels among banking customers in the UK, it is useful to understand how customers define satisfaction. A landmark UKCSI survey published in 2007 identified the top ten drivers of customer satisfaction across all sectors as being, in order of importance: overall quality of the product or service, being treated as a valued customer, speed of service, friendliness and helpfulness of staff, handling of problems and complaints, handling of enquiries, competence of staff, ease of doing business, being kept informed<sup>26</sup>.

Retail banking-specific research has found that in-branch factors, particularly the quality of staff, branch location and convenience are the most significant factors influencing customer satisfaction in the UK<sup>27</sup>. In addition to this, having access to transparent financial products and not feeling pressured to buy financial products are two factors which have been cited over and over again by retail banking consumers in the past years.

On many of these accounts, retail banks have fared quite poorly in the UK compared to other developed economies. A study by Booz Allen of 100 retail banks in 17 countries showed that UK banks lagged behind all surveyed European countries except the Netherlands in quality of service in branches, call centres and online operation. The main criticisms were the difficulty of accessing humans, lack of information, failure by bank staff to have customer information at hand, and long waiting times in branches<sup>28</sup>.

Also, within the UK, customer satisfaction is low relative to other sectors. In a recent survey by [moneysupermarket.com](http://moneysupermarket.com) of UK consumers' perception of the level of service, the banking industry came 14th out of 16 sectors, beating energy suppliers and estate agents, while building societies were in 12th place<sup>29</sup>. The main issue raised was that banks have moved to increasingly automated service, depriving customers of personal interaction.

### 2010 Industry Service Rankings By [moneysupermarket.com](http://moneysupermarket.com)

- 01 Hairdressers
- 02 Hotels
- 03 Beauty salons
- 04 Restaurants/coffee shops
- 05 Garden centres/florists
- 06 Supermarkets
- 07 Department stores
- 08 Clothes stores
- 09 Entertainment centres (e.g cinema/bowling)
- 10 Travel agents
- 11 Gyms
- 12 Building societies
- 13 Mobile/broadband companies
- 14 Banks**
- 15 Energy companies
- 16 Estate agents

Source: [www.moneysupermarket.com](http://www.moneysupermarket.com)





## Only 22% of customers said they would recommend their bank

Looking at the UK retail banking sector in isolation, it is also evident that satisfaction levels are low. A dearth of consistent research prior to the 2008 crisis makes it difficult to track accurately the evolution of retail banking customer satisfaction over the past decades. However, in the most recent JD Power survey of UK high-street banks, only 22% of customers said they would recommend their bank<sup>30</sup>. The report also identified key issues as being long service times, unexpected customer fees, and inefficiency in resolving problems within the branch.

Other research showed that average customer satisfaction in retail banking fell between 2009 and 2010 (no data available for prior years),

and that the largest year-on-year negative variations occurred at the largest banks and their acquired brands<sup>31</sup>. The principal causes of dissatisfaction felt by consumers are the lack of personalisation of services, the scarcity of "helpful, courteous, knowledgeable, skilled" people in branches, poor complaint management, and the excessive complexity of financial products sold. A very clear pattern in this research is that larger banks provide the worst customer experience, while smaller banks, cooperatives, and building societies, have managed to keep their customers much happier across the full range of products:

Financial Provider	Mortgage Satisfaction %	Savings Satisfaction %	Current Account Satisfaction %	Credit Card Satisfaction %	Overall Score %
First Direct	87	74	88	78	82
One Account	78	n/a	88	n/a	81
Smile	n/a	n/a	85	83	79
Co-operative Bank	74	70	86	76	76
Coventry BS	69	64	n/a	n/a	71
Cahoot	n/a	58	71	n/a	68
Nationwide BS	67	57	72	74	67
Tesco Bank	n/a	58	n/a	74	66
Saga	n/a	55	n/a	74	65
Yorkshire BS	64	59	n/a	n/a	64
Britannia	71	50	n/a	n/a	64
Yorkshire Bank	65	58	63	n/a	64
Egg	n/a	54	n/a	71	63
Intelligent Financea	64	55	66	n/a	63
HSBC	65	52	58	65	60
Marks & Spencer	n/a	44	n/a	76	59
Skipton BS	56	55	n/a	n/a	59
Clydesdale Bank	65	50	53	n/a	58
Sainsbury's Finance	n/a	47	n/a	68	57
Standard Life Bank	51	56	n/a	n/a	57
Alliance & Leicester (Santander)	52	48	57	n/a	54
Barclays/Woolwich	59	48	53	57	54
Lloyds TSB	56	48	54	54	53
Natwest (RBS)	55	48	54	56	53
RBS	53	47	55	n/a	53
CITI	n/a	45	n/a	57	51
C&G (Lloyds TSB)	56	40	n/a	n/a	50
Northern Rock	43	49	n/a	n/a	49
Santander/Abbey	48	39	47	57	47
Halifax (Lloyds TSB)	43	42	48	54	46
Bank of Scotland (Lloyds TSB)	38	42	45	n/a	43
<b>Average</b>	<b>60</b>	<b>52</b>	<b>61</b>	<b>66</b>	<b>59</b>

"big five"

"big five" subsidiaries

Source: Which? Money research, 2010

Sources

30 2008 UK Retail Banking Customer Satisfaction Study", J.D. Power and Associates  
31 People's Choice poll, Which? Money, 2009 and 2010

**“Potential conflicts of interest are rife. Pricing is opaque. Competition appears not to work. Customers are dissatisfied. Shareholder value has been eroded. Damage has been caused to the real economy. These issues are systemic, not just confined to a few badly run banks.”**  
*(Future of Banking Commission, 2010 report)*

## Why the Current Environment Might be Conducive to New Entrants

A Money Saving Expert poll conducted in August 2010 also highlighted the correlation between larger size and poor customer service:

### Worst customer service uncovered (% of customers who rate service)

Provider (no. sampled)	Poor	OK	Great
Santander/A&L (3,388)	62%	24%	14%
Hbos (2,044)	48%	33%	19%
Lloyds TSB (2,322)	41%	36%	23%
Barclays (2,091)	41%	34%	25%
Natwest/RBS (2,416)	38%	33%	28%
HSBC (1,954)	36%	34%	30%
Nationwide (1,423)	28%	32%	39%
Co-op (842)	10%	15%	75%
First Direct (1,195)	6%	9%	85%

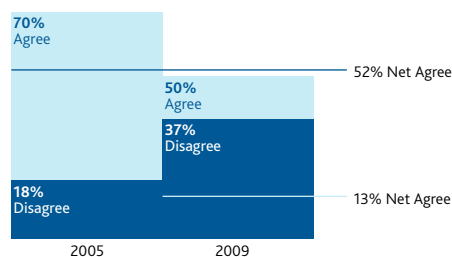
Total sample: 17,675. Percentages may not reach 100% due to rounding

Source: Money Saving Expert, August 2010

The very high volume of complaints made by banking customers in the UK in the first half of 2010 is a powerful indicator of low service quality. Data from the six largest banks shows that 1.4 million complaints were received in just the first six months of 2010, equating to more than 11,000 every day<sup>32</sup>. Worse still, complaints management is very weak; up to 90 percent of complaints were dismissed without even an apology from the bank. Yet about 50 percent of complaints were upheld when assessed independently. Large banks perform particularly badly in complaint management. For instance, of the 103,686 complaints to Lloyds about bank accounts, only 12% were upheld. Worse, its Bank of Scotland subsidiary only upheld 7% of complaints.

As a result of the poor overall customer experience, the proportion of UK retail banking customers who felt that they are treated fairly by the banking industry shrank significantly between 2005 and 2009, according to a 2009 MORI poll<sup>33</sup>:

“On the whole, banks treat customers fairly”



Source: MORI

The prognosis for new banks is especially benign today because, for the first time in a long time, the demand for fundamental and radical change in banking is not only economic, but also social and political. The issues that have created the need for change cannot only be blamed on the big, dominant banks, but on the banking system as a whole. Fresh blood – in addition to greater oversight – will be needed to generate and lead systemic change in the UK banking industry.

### Society Wants Change

Society has lost trust in banks which have become too large, too diversified and too complex because it has suffered the consequences of “moral hazard” where it hurts most – in the purse. So far, the rescue cost to the British taxpayer has amounted to £131bn in cash injections, and publicly funded guarantees of £850bn<sup>34</sup>. Even though taxpayers had made a paper profit as of mid 2010 on their rescue investments, the economic consequences of the banking crisis in terms of, for example, growth foregone are deeply resented and the social and economic benefits of large banks have been put into question by society at large. As the recent Future of Banking Commission (“FBC”) survey has clearly shown, “trust and confidence in the banking system has been severely shaken over the last couple of years.” In contrast, new banks will not present as much moral hazard as their survival is deemed less critical (at least until they become dominant forces). Furthermore, the regulators are unlikely to allow new entrants unless they operate transparently, display good governance and are sustainably funded – and this being the case, they are likely to be viewed as more socially acceptable than large established banks.

**“Current regulatory arrangements do not allow financial institutions to fail without serious consequences for the economy. If institutions can’t fail, then market discipline – an essential element of competition – cannot be brought to bear on the incentives and conduct of financial institutions.”**

*(Future of Banking Commission, 2010 report)*

**“Putting more capital into the banks, and then returning to ‘business as usual’ is not enough. We need to build a sustainable banking sector, focused on delivering value to the economy outside its own financial world. To do this requires significant reform to the structure, regulation, governance and culture of the industry.”**

*(Future of Banking Commission, 2010 report)*

In the midst of the post-crisis trauma, some people have questioned the very relevance of banks, whether big or small, whether old or new, and have dismissed new banks as a wrong solution. But extensive research stresses the “profound importance” of having “a sustainable banking system which serves the needs of society efficiently and effectively”<sup>35</sup>. This is especially true of the UK where the financial services industry employs over one million people and has contributed between 5% and 8% of national output since 2000<sup>36</sup>. New, healthy banks will be an important ingredient in revitalising and restructuring the UK banking system.

**Sources**

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 33 “What do we really think about the GB Retail Banking industry?”, IPSOS MORI poll, October 2009  
 34 Future of Banking Commission report, 2010  
 35 Future of Banking Commission report, 2010  
 36 *Idem*



## There is Political Will for Change

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In a market where scale economies favour large players and these large players have scope to leverage their positions to reinforce their dominance, the much-needed increase in competition cannot happen without a regulatory framework to support it. So far, the calls for regulatory change in this direction have been loud and clear, and support ideas which would not only foster increased competition in general but also strongly benefit the emergence of new banks specifically. For instance, the FBC has proposed that the regulator have the remit to ensure that customers can easily transfer products and accounts from one bank to another. The OFT has also publically committed itself to “encouraging competition within retail banking that benefits consumers through cheaper and better products or services”<sup>37</sup>, and in May 2010 launched a review of barriers to entry, expansion and exit in retail banking, to identify any barriers to new entrants and smaller banks seeking to expand in the UK.

Similarly, in October 2010, the newly-formed Independent Commission on Banking (ICB) confirmed it was looking at ways to increase competition and choice among high street banks, possibly by breaking up large banks and encouraging new entrants; suggestions for which the Governor of the Bank of England has expressed his support. Further, even though it did not ultimately result in any transfer of market share outside of the “big five” players – since the branches were bought by Santander - the EU’s decision to force the sale of 318 RBS branches has shown a willingness on the part of the authorities to act for the benefit of competition.

**“Consumer protection regulation should have a primary duty to promote effective competition so that competition provides market discipline where possible. Where it is not possible the regulator would intervene so as to mimic the beneficial effects of competition.”**  
*(Future of Banking Commission, 2010 report)*

## New Entrants Can Display Clear Vision...

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New banks with a strong focus on customer experience and better transparency will likely have the strongest resonance with the banking consumer base and are therefore the mostly likely to be successful. A recent survey by Deloitte shows that customers place more value on a bank’s treatment of customers than they did two years prior<sup>38</sup>. Clearly, it will be much easier for new banks to offer a truly customer centric service than for established banks which have strayed off this course and in which non-customer centric cultures have become entrenched over time. Furthermore, traditional banking models, and in particular product as opposed to customer-centricity, are often reinforced by existing and intractable processes, systems and reporting lines. New entrants have a blank canvass with which to form their customer proposition and have the opportunity to take advantage of advances in technology to make this real.

## ...and Differentiate Effectively

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Besides the quality of customer-facing employees, channels, and complaints management, a central part of customer experience is of course the quality and appropriateness of the product. However, as was shown above, many banks have been trying to sell products which are far too complicated for their customers or which address artificial needs, often in the sole aim of meeting ever greater profit targets. This widespread conviction that customers “are repeatedly being mis-sold or [...] mis-buying products”<sup>39</sup> is based on perceived unfairly steep or “surprise” charges, “sneaky” small print, and irresponsible lending to vulnerable customers<sup>40</sup>. The ongoing consumer and regulatory campaign against the inappropriate selling of payment protection insurance is also a testimony to how consumers were often encouraged to buy products they simply did not need. Research shows that 65% of retail banking customers are more concerned about the fees charged to them than they were five years ago<sup>41</sup>. New banks will be able to create simple and transparent product offerings which appeal to customers who are weary of mis-selling and tired of not being able to compare products easily.

## It is Not Just Retail Customers Who are Dissatisfied, But Commercial Customers Too

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The potential market for new banks is large because private individuals are not the only consumers displeased with poor service from established banks. In the UK, where 83% of small and mid-sized enterprise lending is done by the “big four”, SMEs have lost patience with their traditional finance providers and are among the most eager proponents of change. State-backed RBS and Lloyds Banking Group missed their government-assigned targets for extra lending to small business in 2009. The Bank of England figures show that lending to SMEs continued to shrink in June 2010, by £3.5 billion, and has dismissed banks’ explanations that this is due to little demand for credit. Clearly, SMEs do not believe that established banks are ready to mend relationships, as warned by John Wright, chairman of the Federation of Small Business: “I think the banks have got a big job to actually try and restore the confidence of small businesses in their service, without any shadow of a doubt, and they have to work much harder than they are at the present time”<sup>42</sup>. New banks will therefore be able to capitalise on SMEs’ pressing need for more stable banking relationships.

The bottom line is that retail banking in the UK needs a cultural reform. New entrants who manage to differentiate themselves on grounds other than price are likely to be successful and profitable agents of change.

**“It shouldn’t be about treating customers fairly because the FSA says so, [treating customers fairly] should be in the DNA of your business”**

Neville Richardson, CEO, Co-operative Financial Services

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### Sources

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“If you talk to our customers, they don’t like us, they love us.”<sup>43</sup>



Manning - Employee Trainer - Commerce Bank

# Metro Bank – Love Your Bank at Last

## The Origins of Metro Bank – Commerce Bank in the US

Metro Bank is not Vernon Hill’s first attempt at bringing the customer back to the heart of banking. In 1973, at a time when US retail banking was focusing on aggressive growth and cost-cutting, Hill founded Commerce Bank with happy customers as the top priority. He was convinced that overinvesting in the customer experience relative to cost-cutting competitors would allow Commerce Bank to outperform its rivals and gain market share (and, in turn, would fund continued overinvestment).

At the centre of Commerce Bank’s business strategy was the branch, in stark contrast to other banks which were generally steering customers away from their branches to cheaper-to-serve channels by offering incentives to use ATMs or limiting the number of charge-free teller visits per month. Commerce Bank’s customers were served through a network of consistently replicated, welcoming “stores” which stayed open from 7:30am to 8:00pm and in which coffee and newspapers were available to waiting customers. The higher costs incurred by staffing branches better and longer were considered a plus, not a minus, and did not prevent branches from breaking even within 12-18 months versus three years for the average US bank.

Hill also understood that revamping the customer experience would not be possible unless his bank was infused with a culture of customer centricity. All new employees underwent an intensive induction programme at Commerce Bank University on the bank’s “wowing” culture, a cult to systematically exceeding customers’ expectations. Compensation and recognition were intricately linked to quality assurance. One of Commerce Bank’s main challenges was managing the efficiency needed to wow its customers. The bank instantly created ATM cards at the time of account opening, reduced the number of keystrokes required for routine teller transactions, and scanned customers’ signatures into the computer system so as to appear automatically when a teller entered an account number (reducing the time it took to cash a check to 20 seconds). Nevertheless, long lines occasionally formed at high volume stores, and the bank had to count on its employees’ common sense and creativity to manage such issues.

Commerce Bank’s business model was not built on a hunch. Research by the ABA banking Journal showed that 62% of consumers picked a bank for service and convenience whereas only 3% did so for the highest rates. Commerce Bank confidently left all the other banks to compete over the 3% of rate-seeking consumers, and focused on capturing deposits which came for non-rate reasons.

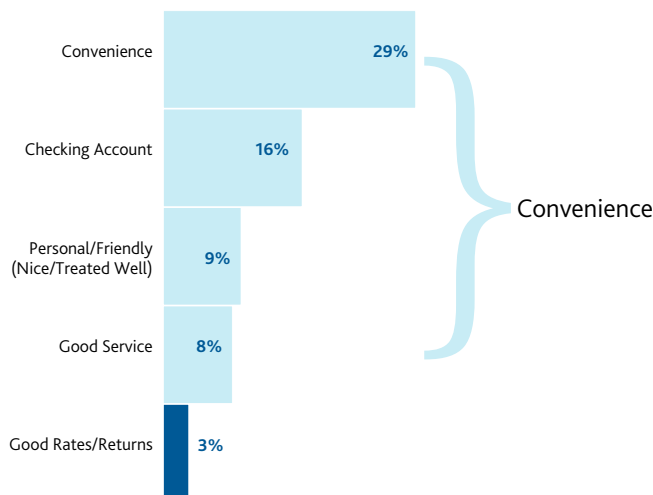
Rapidly, the bank was generating a much larger share of its deposit base from private individuals than most banks (50% vs. 35%) despite generally being one of the lowest ratepayers in its markets. Commerce Bank was also careful to not saddle its customers with inappropriate or overly complex products, mostly limiting its product offering to no-frills checking, savings accounts and loans. Loans were considered very carefully, and, as a result, the bank’s loan-to-deposit ratio was much lower than the sector average. The level of risk was kept in check and customers never felt mis-sold to.

# 48,000

The average no of visits to Commerce Bank stores in 2001 compared to 25,000 at McDonald’s

Despite the rise of internet banking in the 1990s, Commerce Bank stuck to its credo and refused to push consumers out of the branch, instead offering the best of every channel. The bank was rewarded for this strategic decision. While more than half of Commerce Bank’s customers were active online banking users (which compared favourably with the US average<sup>44</sup>), its customers continued to use (and value) the branch channel. As of 2001, its stores were getting on average 48,000 visits a month<sup>45</sup>, compared with 25,000 at McDonald’s fast food outlets<sup>46</sup>.

### US Banking Customer Preferences



Source: ABA Banking Journal

“People buy our products because they trust our brand.”

Vernon Hill - Founder - Commerce Bank

#### Sources

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- 44 According to Michigan Surveys of Consumers, the average rate of regular internet banking usage in US was much lower: at around 20% in 2006
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- 46 “Commerce Bank” case study, Harvard Business School press, October 2006

## “If you have the right model, people can’t compete”

Vernon Hill - Founder - Commerce Bank

Analogous to sales per store in the retail environment, Hill believed that the bank that secured the highest deposits per branch would be more profitable. Hill’s reasoning was that once deposits per branch hit the USD30-40 million mark, costs stabilised and marginal profit exploded. And he was right: by carefully using the massive influx of cheap deposits, Commerce Bank was able to double its net income from 1998 to 2001, compared to 20% for the industry<sup>47</sup>. The total return on Commerce Bank stock during the ten years to 2000 was 2,048%; the compound annual return during the 20 years to 2007 was 23% per annum<sup>48</sup>.

# 2,048%

The total return on Commerce Bank stock during the ten years to 2000

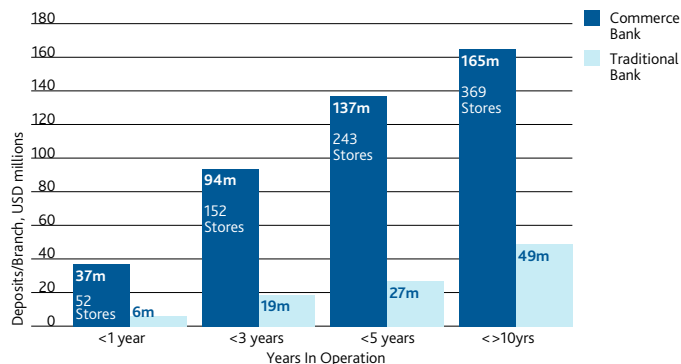
These impressive financial results were of course underpinned by exceptionally high customer satisfaction levels. Consistently throughout the years, Commerce Bank received consumer awards for the consumer bank most loved by American banking customers, and was repeatedly voted the best bank in America by JD Power for its absolute commitment to customers, outperforming its competitors on all aspects of convenience and transparency (of fees, statements, etc.). In 2006, Commerce Bank topped Satmetrix’s first financial services industry Net Promoter Score<sup>49</sup> study: 64% of Commerce Bank’s existing customers were willing to recommend Commerce Bank to a friend or colleague.

Crowded markets were never an issue for Commerce Bank, as illustrated by Commerce Bank’s foray into New York City which was generally believed to be the most overbanked market in the US. Hill actually felt it was the most underbanked market in the country and decided to enter it with a bang in 2001. He increased the bank’s marketing spend by five times to support a high-visibility, street-based campaign which was hugely successful and enabled the NYC stores to break-even in half the time usually needed, despite the much higher operating costs in the city.

In 2007, Commerce Bank was purchased by Toronto-Dominion Bank for US\$8.5 billion. All of its banks and stores were given the TD Bank logo. That year, Commerce Bank still ranked number one in the 2007 J.D. Power banking customer satisfaction survey, and Hill featured in the influential Forbes’ 20-20-20 Club as the fourth highest performing public company CEO over 20 years (just behind Warren Buffet) with a 23% annual compounded shareholder return.

The lessons from Commerce Bank’s success are manifold. Perhaps the most powerful one is that service quality is more important than price for the vast majority of consumers, and that there will always be space for growth for financial service providers who think like retailers, even in seemingly crowded markets. What is more, the extra costs incurred and profits foregone to create a great customer experience generate sustained organic growth in core deposits and, ultimately, generate higher returns. And, last but not least, zealously nurturing a customer centric culture within the bank ensures that price cutting from the competition will never be a problem. As Hill likes saying: “If you have the right model, people can’t compete”.

### Deposits Per Store – Commerce Bank versus peers (as of 31 March 2007)



Source: First Manhattan Consulting Group Branch Database 2005

#### Sources

- 47 “Commerce Bank” case study, Harvard Business School press, October 2006
- 48 20-20-20 Club, Forbes, September 2007
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“Commerce Bank was the number one rated bank for service in America, and that is what is going to happen here.”

Vernon Hill - Founder - Metro Bank

## Metro Bank – a Novel Model in the UK

Anthony Thomson, Chairman of the UK Financial Services Forum, had written a lot about Commerce Bank and started suggesting in 2000 that the Commerce Bank model would work really well in the UK. When Commerce Bank was sold in 2007, Thomson called Hill and said that there was no longer any excuse not to open a similar bank in Britain. After spending 3-4 months talking to the FSA, the decision was made in December 2007 to launch the new project. Armed with his experience and reputation, Hill set out across the Atlantic to bring the customer back to the heart of banking in the UK. Metro Bank’s “Love your bank at last” motto illustrates well the gusto with which the bank has set out to bring consumers back to face-to-face, branch-based dealings.

Hill’s business model was clearly differentiated and the timing of the venture so opportune in terms of tapping into a desire for change that he attracted immediate attention and had no trouble raising £75 million in initial capital from a pool of investors, including Fidelity and Wellington Capital. He and Thomson assembled a management team of highly experienced professionals, mostly from the established banking industry. Craig Donaldson, managing director at the Royal Bank of Scotland, was hired as CEO. He had an impressive track record, having been made a senior management member of RBS at 36. For Donaldson, the opportunity to start up a new bank with Hill who he had studied and who he greatly admired, was too interesting a proposition to ignore. And, in his view, Hill possessed three things which, together, look like a recipe for success: inside-out knowledge of banking, a zeal for the customer, and the ability to keep things simple.



“You don’t often get the chance to set up a new bank in the UK.”

Craig Donaldson - CEO - Metro Bank







## “Why should banks have their own holidays? Metro Bank will be open on bank holidays”

Anthony Thomson - Chairman and Founder - Metro Bank

Being exactly the kind of new entrant that the FSA must want to encourage thanks to its simple, fully deposit funded model with transparent pricing and products, Metro Bank received its banking licence from the FSA in March 2010, around 18 months after the founding team was assembled. Metro Bank became the first entrant in the UK banking market for over 100 years.

An examination of Metro Bank’s business model reveals that Metro Bank really is a transplant to the UK of the keys to Commerce Bank’s success, on all levels. Further, there are no *prima facie* grounds to think that the venture would not be successful in the UK.

The results of surveys on why customers pick their bank shows that the reasons are very similar if not exactly the same between British customers and American customers: in both countries, many more banking consumers value convenience than good rates. Also, the founders believe that London has very similar characteristics to New York where Commerce Bank was very successful and had 250 stores in Manhattan alone.

Just like at Commerce Bank, a customer ‘wowing’ culture permeates Metro Bank’s people and processes. Metro Bank staff are inculcated with an appropriately Europeanised version of Commerce Bank’s culture of exceeding customers’ expectations: customer-facing employees are trained to say “yes” as much as possible, and cannot say “no” to customers without having asked a colleague for a second opinion first. Employees are also incentivised to put an end to any stupid rules, for instance only one form of identification is required to be able to open an account (vs. two usually). Finally, staff bonuses are based on both profit and customer service results.

Supported by Temenos technology, Metro Bank’s exceptional people strive to achieve exceptional service delivery. Thanks to its state of the art systems, Metro Bank has made customer switching fast and easy: in the space of 15 minutes, new customers can open an account, receive their debit card and PIN number as well as a chequebook. Extra customer-facing staff are put on duty during peak times, especially lunchtimes, to ensure fast service. Finally, the telephone banking call centre is neither offshored (located in London) nor outsourced to ensure high quality levels, and promises that all calls be answered on the third ring at the latest, 24 hours a day, 7 days a week.

“Our proposition is local bankers making local loans. Small and medium-sized companies in particular want one person who knows their whole business.”

Vernon Hill - Founder - Commerce Bank

As at Commerce Bank, the stores are modelled on retail outlets, and are the cornerstone channel, although telephone and internet banking are available. Vernon Hill’s conviction that the Commerce Bank model can work in the UK has been supported by research. According to a survey by Deloitte, UK retail depositors place a high value on branches and service levels when choosing where to place their current account or savings. Metro Bank stores are larger and airier than traditional banking branches, and more welcoming; the ceilings are always high and cashier desks do not have protective screens. The stores are open 361 days a year, seven days a week, from 8am to 8pm on week days, which amounts to twice as many hours as other banks, to the great convenience of the vast majority of workers. They are located in high-visibility areas in London where rival bank branches are already present, and will also target retail parks in later stages of expansion. Everything has been planned to encourage consumers to visit the stores: the free use of coin-counting machines and lavatories, free dog biscuits and lollipops. By pre-launch estimations, the first stores will need an estimated £40m in savings deposits and 12-18 months to break even.

Metro Bank is targeting non-rate seeking depositors by offering rates it describes as “fair” but not market-leading rates. This decision is based on findings similar to those on which Commerce Bank’s strategy was founded: although nearly all banks in the UK compete on rates, research by the OFT shows that rates are the most important thing to only 7% of customers<sup>50</sup>. This finding was reinforced by a MORI poll in 2009 which showed that 70% of retail banking consumers in the UK agree that banks all offer very similar rates and that, therefore, customer service is more important to them<sup>51</sup>. The bottom line is that customers are willing to pay more - or, in this case, earn less interest - because they like the experience, just like Starbucks customers.

# 7%

Proportion of customers for whom rates are the most important factor in selecting a bank

Also in line with Commerce Bank’s model, Metro Bank’s products are ‘simple, transparent and fair’ and are designed to protect not only its customers but also the bank. The offering includes current accounts (no monthly service charges), instant access savings (£100 minimum balance), fixed term savings (with ISAs coming soon), as well as simple loans and mortgage products. All fees are detailed in documentation made easily accessible in the stores and on the website. Last but not least, the staff in the Metro Bank stores are not rated on their ability to generate product sales, but rather on customer service levels, which should preclude the emergence of an aggressive selling culture.

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<sup>50</sup> ‘Personal current accounts in the UK: An OFT market study’, July 2008

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## Metro Bank aims to capture at least 5% of the estimated £700 billion market

### Metro Bank's Ambitions

Metro Bank's number one target are London-based account holders because, according to research, they are the most dissatisfied customers in the UK and are therefore likely to be tempted by the promise of better customer service<sup>52</sup>. Metro Bank also plans to reach out to businesses, especially SMEs which have seen their credit supply from large banks dwindle since the crisis, and forecasts that corporates will eventually constitute 50% of its customer base.

Metro Bank aims to capture at least 5% of the estimated £700 billion<sup>53</sup> London deposit market within 10 years. Research has estimated the size of Metro Bank's target customer base to be seven million people, of which four fifths come from London<sup>54</sup>.

To support its growth, Metro Bank plans to expand its network of stores organically to reach 200 in Greater London and its environs ("we want stores where people travel to and from in Greater London") by 2020. So far, four stores have been opened. The number is planned to increase 10-fold to 40 by the end of 2014.

In the post-crisis context, Metro Bank's growth targets appear ambitious, even aggressive, which raises the question of whether

such growth can be achieved while keeping risks under control. As the crisis has shown, strong growth in banking often meant taking too many risks and therefore often came at an unacceptably high cost. Metro Bank is determined to avoid such a fate by keeping its loan-to-deposit ratio below 100%: "Our model of a pure deposit-funded bank fits into [the FSA's] new view of life." It has also vowed that its core tier one ratio will "never drop below the high teens". Finally, high quality growth is being achieved thanks to the real-time and granular risk management supported by the TEMENOS T24 (T24) core banking system.

Metro Bank's founders have talked about floating the bank on the London stock market before 2013 in order to raise approximately £260m. The exact timing will be driven by the pace of growth.

These are ambitious objectives. But, Metro Bank and its founders are determined to achieve them, and are certain that their T24 core banking system will be key to Metro Bank's success.

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52 "What's love got to do with it", GfK Financial, March 2010

53 Metro Bank estimate

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**"Programmers have no place on a bank's payroll. Banks should specialise in banking and leave software development to the experts."**



Vernon Hill - Founder - Metro Bank

## How Temenos is Helping Metro Bank

Because Metro Bank has pledged to deliver the ultimate customer experience through exceptional service delivery, Vernon Hill knew that selecting and establishing the right IT platform would be critical to the bank's success. The founders also understood that Metro Bank would never have the opportunity to start up again and that, even if it could build a heavily staffed IT department very quickly and with all the specialist skills, it "had the opportunity to go out, get best of breed and ensure we had the platform for the future<sup>55</sup>."

In mid 2009, Temenos was selected from a group of half a dozen potential suppliers because T24 was the only fully integrated, out-of-the-box solution for the UK, and because Temenos lowered the entry barriers by offering a flexible and massively scalable delivery model which reduced capital outlay and operating costs to a bare minimum.



**"Today marks the start of a British banking revolution. T24 gives us a competitive advantage by delivering functionality we need to support our UK business model on a single software platform, which keeps costs low and delivers a single customer view that allows us to deliver superior service to our clients. We want to build fans not customers; with Temenos we have a world class software provider which will help us achieve this and significantly contribute to our success in this market"**

Vernon Hill - Founder - Metro Bank

## Lowering the Barrier to Entry – the First Software as a Service ("SaaS") model in the UK

By OFT estimates, the IT investment normally accounts for up to two-thirds of a start-up bank's costs. Aware of this, Metro Bank's founders immediately ruled out the possibility of building up a heavily staffed IT department and purchasing expensive software and hardware. Determined to achieve a return on their investment commensurate to the risk taken and well aware that Metro Bank would not be able to compete on economies of scale (traditionally a major barrier to entry), Metro Bank's founders were particularly intent on minimising the size of the initial capital outlay and carefully managing the bank's cash flow and profitability from the outset.

**"A proprietary system is, in a sense, obsolete the day it is built. We needed to outsource to someone with an economic model that worked for a very small bank, with the potential to grow into a very big bank."**

Anthony Thomson - Chairman and Founder - Metro Bank

Therefore, a key requirement was that the core banking solution underpinning the bank's operations be supplied on an outsourced basis. Yet, for Hill, who needed a cost effective solution, finding an out-of-the-box IT platform operating on a paid-per-account-per-month basis was the single biggest challenge in setting up Metro Bank because this model had never existed in the UK when Metro Bank was conceived.

As it does in several countries, Temenos was able to offer T24 to Metro Bank on a Software as a Service (SaaS) model – where a vendor (in this case using a third-party) hosts an application on behalf of a customer and provides access through the internet, normally in exchange for a monthly or quarterly rental. Temenos was able to construct a flexible, low cost and low risk model in partnership with NIU. Metro Bank's usage of T24 is charged according to an account-based pricing model and is therefore intricately linked to the bank's business plan – meaning that Temenos shares the business risk with Metro Bank and that Metro Bank only pays for what it uses. Furthermore, a monthly payment model for all T24-related charges allows Metro Bank to better control its cash flows.

**"We have state-of-the-art IT systems that are infinitely scalable. Temenos probably spends more updating their system every year than any bank could ever afford to spend. If you build a system, it is obsolete the day you start, whereas ours will constantly be updated due to this partner investment."**

Anthony Thomson - Chairman and Founder - Metro Bank

Metro Bank's investments and spending on IT software, hardware and staff have all been reduced to the bare minimum. Metro Bank's branch staff employees do not have desktops and instead use Wyse thin-client equipment. Furthermore, the unlimited scalability of T24's SaaS model will ensure that Metro Bank can deliver exceptional service to its customers regardless of its size or rate of growth. The branches are connected via secure IP which means that adding extra branches to the system will be effortless.

Metro Bank does not foresee the need for more IT staff to meet the bank's future growth requirements. Currently, it employs only three IT staff whose main function is to manage third-party service delivery.

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55 Aisling Kane, COO, Metro Bank in Computer Weekly, August 2010

The IT systems in the British banks are worse than in any other G7 country. I have often said British bankers must actually be the best in the world to run banks with the IT systems they have.”

Vernon Hill before he discovered Temenos and T24 Model Bank for Start-Ups

## The Need for Speed – Out-of-the-Box

Metro Bank’s founders also required an out-of-the-box solution with a strong delivery track record because it knew that it could not afford a lengthy implementation which would drain financial resources and delay the granting of the banking licence and, therefore, the launch of revenue-generating operations.

Temenos’ T24 Model Bank, a pre-configured version of the software, coupled with its process-led implementation allows the software to be implemented quickly, with minimal customisation. In this case, the level of fit between Model Bank and the functionalities needed by Metro Bank was over 80%, enabling Metro Bank to deploy the application in nine months.

## More than 80% – out-of-the-box fit between Metro Bank’s needs and T24 Model Bank

Fulfilling the project in such a short timeframe was a feat given that the duration of the implementation was 50% shorter versus comparable projects and that Metro Bank was able to operate as a full-service retail bank from the very first day of operations.

The Model Bank for the UK includes several strategically important functions like a real-time single customer view across all products and services consumed - something very few UK banks can boast and, in these cases, only available using middleware, rendering the single customer view expensive to maintain and not real time, as it is with Metro Bank.

“[banking] will become more demanding as banks get back to the business of focusing on their customers – the emphasis will be on relationships, not products<sup>56</sup>.” (Boston Consulting Group)

“Banks have been organized by product lines and channels, which may even compete for the customer’s attention rather than supporting each other<sup>58</sup>.” (Deloitte)

## The Single Customer View



“The most important thing for us is the ability to have a single customer view. It was essential to be able to look at the entirety of a customer’s relationship with us wherever they are... that was our absolute prerequisite.”

Anthony Thomson - Chairman and Founder - Metro Bank

Traditionally, the most important metric of success for banks has been the number of products sold. As seen above, this has led banks to pursue this objective at the expense of other goals, notably customer satisfaction.

However, banks are changing their priorities – not just because dissatisfied customers are demanding it, but because the recent financial crisis has proved the need to build long term customer relationships to secure profitable growth with acceptable risk.

The problem that many banks will face, and which Metro Bank was so keen to avoid from the outset, is that so many processes and systems have been built around products that making the change to customer- as opposed to product-centricity will be difficult. Take software applications, for instance – these have been built over decades in response to tactical and strategic needs, including new product launches. As such, the information is siloed and not organised in a way that allows management to gain a quick and complete view of a customer relationship across all products and services consumed – the same customer information is commonly duplicated for every product the customer holds. As a consequence, unless systems are replaced, becoming more responsive to customers is likely to be a slow and expensive endeavour. Consider for example the estimated cost of the government-proposed changes to the Financial Services Compensation Scheme, which would see banks having to provide depositor information within 48 hours to speed up the refund process in the event of another banking failure: “the set up and maintenance costs of new IT systems for quick claims processing are estimated at £891.8m over five years<sup>57</sup>.”

In contrast, Metro Bank has sought to reinforce its customer-centric model with systems and processes that reflect it. In choosing its core banking system, for instance, a key criterion for Metro Bank’s founders was that the core banking system have a proven ability to provide the bank with a real-time single view of the customer across all channels, which would permit employees to deal with customer requests seamlessly and efficiently – without asking the customer, for example, to provide the same information again and empowering employees to be able to answer questions about all the products and services taken.

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56 Boston Consulting Group, “Living with New Realities: Creating Value in Banking in 2009”, February 2009

57 ‘FSA consults on changes to financial compensation scheme’, 7 January 2009

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## The Absolute Platform for Seamless, Customer-centric Delivery

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For CEO Craig Donaldson, seamless integration between systems was another absolute prerequisite. In his previous jobs in large banks, he had dealt with a lot of technology and experienced the lack of integration first hand.

Many senior executives at large banks have also spoken out about how they have to rely on lots of different systems producing conflicting numbers in order to perform critically important tasks. As put by a former executive at RBS: "The reality was you could never be certain that anything was correct. Reported numbers for the bank's exposure were regularly billions of dollars adrift of reality; finding the source of the error was hard<sup>59</sup>."

Metro Bank knew that it could not afford to expose itself nor its customers to this sort of experience. Most importantly, it knew that its customer-facing employees needed to be supported by a completely integrated system in order to deliver seamless service. COO Aisling Kane was adamant that Metro Bank's branch staff "[won't] need to worry about IT, just about servicing customers".

Besides supporting seamless service across Metro Bank's main front-to-back operations - Personal and Commercial Business, Current Accounts, Savings and Deposits, ISAs, Personal and Commercial Loans, Mortgages, Debit and Credit Cards, Internet Banking (TEMENOS ARC-IB) and providing the Single Customer View - TEMENOS T24 also acts as the hub for 23 systems which cover all of Metro Bank's requirements - everything from IVR (Interactive Voice Response functionality), to the card printing capability, to security at front office level.

The resulting process seamlessness is the source of one of Metro Bank's most powerful differentiators: the account opening process which is designed to last 15 minutes at most for customers. The account process is done through flow-enhancing sequential screens with short cuts for joint-account holders, a simplified customer application form, and the efficient capture of documents, images and UK compliance data. All standard anti-money laundering and credit check processes are also done within this tight time frame. The new customer's debit and credit chip cards are printed using a fully integrated instant issuance system and a desktop instant issuance printer. Mastercard data is instantly generated after receiving the card production order from the TEMENOS T24 account opening screen via Vocalink, and the card is fully personalised within three minutes. This is truly revolutionary in the UK where customers are used to waiting at least 5 working days to receive new or replacement cards. Finally, once the opening process is complete, the customer has immediate and full access to their account.

TEMENOS T24's strength as a hub for seamless service delivery has been independently validated: the research agency Keyfact which specialises in walkthrough testing has rated Metro Bank's account opening process as "the best it has encountered".

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**"Integration is the key, but the integration with the single view is the most important part, it's the biggest advantage."**

Vernon Hill - Founder - Metro Bank

**"The account application systems worked quickly and efficiently and customers have to supply less information than at other UK banks when opening an account. It is obvious Metro Bank is not using legacy systems stitched together."**

*(Keyfact report, August 2010)*

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### Sources

59 "Computer says no", The Economist, 22 July 2010

## Process Expertise in an Inherently Uncertain Environment

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At the outset of the project, Metro Bank's senior management was very experienced in running banks but not in building a bank from nothing. Therefore, it realised that it would need to leverage Temenos' knowledge and experience to implement best practice processes within tight deadlines and a tight budget in the inherent uncertainty of a start-up environment. Temenos' process expertise brought a high level of certainty to the Metro Bank project, as its experience across more than 600 projects worldwide is distilled into a proven, safe and well-documented implementation methodology.

### Temenos' Management Consulting Services provided a clear view of the end-to-end process design at the start of the project

Concurrently, Temenos' Management Consulting Services (MCS) provided a clear view of the end-to-end process design at the start of the project, focusing its efforts on effecting business change as opposed to just technology change. While it endeavours to minimise changes to the standard T24 Model Bank, MCS has deep expertise in managing change requirements and knows how to focus on areas which deliver most business value. Quantifiable and qualitative benefits are identified before the customisation effort commences, leading to better informed decisions on prioritisation.

Adding new requirements in the course of the project rather than having a full, clear scope from the beginning was a challenge at Metro Bank because the bank's leadership team was assembled in parallel to the implementation project. New people brought new ideas at all stages of the project which required additional or re-engineered interfaces. MCS was instrumental in expressing the detailed requirements to support Metro Bank's extreme focus on service delivery, for example changes to teller screens in order to enhance the transaction flow.

Metro Bank's specific requirements, such as fast account opening, also created challenges, both on the technology and practical sides, such as determining what Know Your Customer (KYC) procedures had to be carried out on the spot. Yet, from the outset of the project, MCS emphasised change control by clearly explaining the costs, risks and benefits of changes throughout the process. MCS also rigorously set the limits of the numerous vendor systems interfacing with the T24 hub in order to deliver the full functional breadth required by Metro Bank. Ultimately, this approach enabled T24's timely delivery at Metro Bank.

Overall, Temenos and T24 have provided Metro Bank with a sustainable strategic advantage by enabling the delivery of market-leading customer experience at very low operating costs. The low costs incurred will, in turn, allow Metro Bank to over-invest in customer service and therefore continue capturing market share.

**“The instant issuing of debit/credit cards and cheque book was seamless – other banks could only dream of an adviser apologising it took 5 minutes to print off a cheque book because she had to go to the safe for more paper.”** *(Keyfact report, August 2010)*

**"You have to look at everything differently. You have to think like a retailer. I went from 0 to big like this. Price cutting from the competition has never been a problem."**



Vernon Hill - Founder - Metro Bank

## Can Metro Bank Achieve Its Ambitions? (Can it Break the Malaise?)

Metro Bank sceptics normally set out four misgivings about the bank's prospects: 1. that the bank will struggle to achieve scale and, given the cost of achieving superior customer service, will be unable to compete on rates 2. That people simply won't switch in great enough numbers to make the venture work 3. That a model based chiefly on branch banking is no longer relevant for the modern age and 4. That, even if the venture is successful, the established banks can easily change their models to compete effectively and thus any market share gains will prove temporary. We address each point in turn.

### Big Banks Will Be Able To Offer More Competitive Rates

Not only are technological changes making it easier for new entrants to achieve critical scale sooner, but the real battleground is unlikely to be rates.

Technological spending is one area where complexity precludes some of the biggest banks from extracting significant scale economies, either organically or through acquisition. Several studies, covering the both the US and Europe conclude that there exists a "productivity paradox" in banking, where increased spending on IT does not translate into higher productivity (and in some cases the reverse)<sup>60</sup>. So it is not axiomatic that economies of scale continue to manifest themselves the bigger a bank gets, but instead that there are sources of diseconomies of scale, particularly at the central level.

Thus, lower absolute technology spending as result of having a modern, integrated system offers Metro Bank not just the opportunity to achieve a minimum efficient level of scale with lower volumes, but also a source of enduring economies of scale and competitive advantage – which it could choose to invest in higher deposit rates.

Nonetheless, rates are unlikely to be the chief focus of competitive pressures. Market data show that customers place significantly more importance on customer service than rates. In fact, only 7% of customers consider rates to be the most important factor compared to 70% who rate service as the most important<sup>61</sup>.

When asked if he thought the costs associated with providing market-leading customer service would become a drag on the business, Vernon Hill gave this response:

"If you believe your business is not growing, then you have to cut costs. If, however, you run a growing business, then you can invest more. We therefore have a very different mindset. I give you an example: free coin counting machines. They cost \$25,000 dollars each with no return. You'd never get that past the capex committee of a big bank. You can only justify free machines if you think differently and you want to build fans, not customers."

**"We want to build fans, not customers"**

Vernon Hill - Founder - Metro Bank

**"I'd never seen minus [net promoter] scores until I came here... I mean Brits really hate their banks"**

Vernon Hill - Founder - Metro Bank

### Customers Won't Switch

Customer inertia is often cited as one of the biggest barriers to entry into a market where 66% of consumers have always banked with the same institution<sup>62</sup>. Despite their millions of complaints each year, only roughly 6% of banking customers in the UK switch accounts each year<sup>63</sup>.

Prior to launch, Vernon Hill was under no illusions that overcoming customer inertia would be a significant challenge: "we're going to make it easy, but typically people don't switch banks very often."

Metro Bank is making it easy for customers by operating a dedicated switching team, who handle all of the administration (by transferring all of a customer's direct debit instructions), and giving peace of mind by guaranteeing payment of all direct debits and standing orders in the unlikely event one is missed or not processed in time.

**"As banks, we still like to think that we can dictate the terms of how and when customers work with us, but increasingly our customers are realising they have a myriad of options. No longer will customers stay with us just because we are the first bank they ever took a deposit with, or because it is too hard to change. These protections will no longer be afforded to a service organisation that doesn't serve their customers."**<sup>64</sup>

However, the prospect of getting customers to switch appears better than ever before. That so few customers have switched, or are considering switching, accounts does not reflect brand loyalty, but much rather misperceptions about how difficult the process is<sup>65</sup> – and to even greater extent "the high levels of apathy and disengagement with financial services which consumers are displaying in the UK"<sup>66</sup>.

By offering a dedicated and guaranteed switching service, Metro Bank is reassuring customers concerned about the complexity of switching. And, concerning apathy, the timing of the venture coincides with new lows in terms of consumers' satisfaction with their banks, as well as widespread anger at the banks' role in the financial crisis, their taxpayer bailout and their lack of contrition since – and these may well provide the conditions for significant customer migration from the big banks. In fact, according to the OFT, the potential number of customers considering switching is significantly greater than the 6% who typically switch each year – according to their poll, 24% of consumers are considering switching while a further 8% have "not got round to it" but are presumably open to switching<sup>67</sup>.

If customers do decide to switch providers, Metro Bank is likely to be a significant beneficiary since its brand is untarnished either by the financial crisis or historic dissatisfaction. As Craig Donaldson says, "if you wanted to switch before, you could only go from one 'big five' bank to another. It was just a protest vote. Metro Bank offers a true and very appealing alternative to banks dissatisfied with the 'big five'."

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- 62 Financial Services Consumer Insight Survey, Datamonitor, 2009
- 63 'Personal current accounts in the UK: An OFT market study' July 2008
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- 67 'Review of barriers to entry, expansion and exit in retail banking', Office of Fair Trading November 2010 – a survey of Scottish SME customers

95%

Proportion of young people who believe the branch will continue to act as an important channel

## A Model with a Primary Focus on Branch Banking is No Longer Valid

**“It’s not unusual to hear proponents of branch banking telling us that “the branch is back”, and that the winning strategy is to be investing in more real estate and variations of the branch... The problem is [customers] don’t assign a higher value or priority to the branch; they just view it as one of the many channels they can choose to do their banking. In fact, many customers these days choose not to go to the branch because they don’t want to stand in line, or they find it troublesome to get to the branch during operating hours<sup>68</sup>.”**

A clear threat to Metro Bank’s branch-centric model is the rise of internet and mobile banking which, in Europe more than in the US, have caused the branch to become less relevant since the 1990s. Some believe that the higher online and mobile banking penetration rates in the UK may cause Metro Bank’s branch-based growth to be slower than Commerce Bank’s was in the US. A Booz Allen study in 2007 showed that UK bank customers were already much more amenable to buying and using bank services through online and other channels, as opposed to branches, than the global average<sup>69</sup>.

However, Metro Bank – and Vernon Hill in particular – are unconcerned. “People raised exactly the same concerns with Commerce Bank and the model never stopped working. I agree that the branch is dead if you offer nothing different. But no-one in the UK has comparable branches.”

What is more, market data continue to show that customers value the branch. A recent report by the OFT shows that the number one factor in choosing a retail bank in the UK is – and by a very wide margin - the proximity of the branch<sup>70</sup>: 29% of respondents said they chose their bank based on the proximity of the branch to their work, while the factor ranked second - recommendations by friends and family – was only cited by 11% of respondents. Similarly, a recent piece of research undertaken by Temenos into the attitudes of young people about banks found that, in the UK, 95% of respondents believe that the branch will continue to act as an important channel in the future and that branch location and service continue to be important factors for why people choose their banks – ranked second and third respectively, after where their parents banked<sup>71</sup>.

Plus, Metro Bank is not jettisoning other channels just because it places so much emphasis on the branch. Like Commerce Bank, it aims to offer the best of all channels and its customer ethos permeates them all. Take the 24 hour call centre, for example, it is manned by the same people who work in the store and is operated from the bank’s headquarters in Holborn in London. Clearly, this is comparably a much higher cost service than offered by most other banks, but as Vernon Hill says: “we would never outsource or offshore any aspect of customer service.”

### Sources

- 68 “Bank 2.0: How customer behaviour and technology will change the future of financial services”, Brett King  
 69 “UK banks shamed by overseas rivals’ customer service”, The Sunday Times, June 2007; referring to “Best Practices in Retail Banking Sales and Service Channels”, Booz Allen & Hamilton, 2007  
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87%

Proportion of Metro Bank customers who would recommend the bank to a friend



## Any Market Share Gains Will Not be Defensible Over the Long Term

The possible imitation of Metro Bank's customer centric model is another commonly cited threat. But, as Metro Bank's founders are keen to point out, the Metro Bank model is not easily copied.

Assuming Metro Bank is successful at gaining market share in London, the incumbent players are likely to respond by adopting many of Metro Bank's practices, like extended opening hours.

However, what will be much harder to copy wholesale will be the customer centricity of the organisation. Everything about Metro Bank – the people they hire, the staff training, the systems they run, the facilities, the branch locations – is built around customer service; customer satisfaction is paramount. Thus, even if incumbent banks improve their branches, put more emphasis on customer service and upgrade their systems, they are still unlikely to arrive at the same level of customer experience that Metro Bank has built from the bottom up. Or, as Vernon Hill puts it, "The big banks can imitate our model, but they can't copy it"

**"Metro Bank's retail banking model works and will pose a real threat to other retail banks in the London area. It has a strong brand, a decidedly retail approach, and its customer service philosophy strikes a chord with many people disillusioned by other UK banks".**

*(Keyfact report, August 2010)*

**"The big banks can imitate our model, but they can't copy it"**

Vernon Hill - Founder - Metro Bank

## So, Is it Working?

More time will be needed to test Metro Bank's resilience to some of its challenges and threats, and the biggest challenge in the long-run may come from within: that of preserving the revolutionary spirit and customer service zeal as Metro Bank grows. As the CFO of Commerce Bank said so well: "The hardest thing about becoming a big bank is not becoming a big bank"<sup>72</sup>.

But, so far, the response to Metro Bank in the UK has been overwhelming – even better than the response to Commerce Bank when it launched in Manhattan. In its first month of operations alone, Metro opened more accounts than it had targeted for all of 2010. As foreseen, the majority of Metro Bank's customers are coming from the big established retail banks.

With four stores open before the end of 2010, Metro Bank is well on track with its expansion plans. Yet, with only four stores, Metro Bank is generating a significant amount of coverage and excitement: the rate of recognition of the Metro Bank brand had reached nearly 70% in London within a few of months of the launch<sup>73</sup>.

As to whether the early momentum can be sustained, independent research and initial customer feedback both indicate a highly differentiated and superior customer service. In August 2010, Keyfact carried out a mystery shopper visit to the Metro Bank Holborn store and qualified the overall branch experience as "exceptionally good" and confirmed that it is a very effective differentiator. Furthermore, and more importantly, the first survey undertaken by Metro Bank into customer satisfaction revealed that 87% of customers would recommend the bank to a friend – dramatically higher than the 22% average score achieved by other retail banks in the UK and higher even than the scores achieved by Commerce Bank<sup>74</sup>.

Clearly, with Temenos' support, Metro Bank is planting the seeds of a cultural revolution in British retail banking.

**"Metro Bank has succeeded in differentiating itself from other banks. The customer service ethos is evident everywhere"**

*(Keyfact report, August 2010)*

### Sources

<sup>72</sup> Douglas Pauls, 2002

<sup>73</sup> Research by Opinium Research in August 2010 showed 68% of Londoners had heard of Metro Bank

<sup>74</sup> In a 2008 study carried out by JD Power and Associates ("2008 UK Retail Banking Customer Satisfaction Study"), only 22% of customers said they would recommend their bank. In 2006, 64% of Metro Bank customers said they would recommend their bank

## Authors

**Thomas Krommenacker** is a Senior Manager in the Strategic Planning Department, based out of the Geneva Headquarters. He can be contacted by email at [tkrommenacker@temenos.com](mailto:tkrommenacker@temenos.com)



**Ben Robinson** is Director of Strategic Planning at Temenos, based out of the Geneva Headquarters. He can be contacted by email at [brobinson@temenos.com](mailto:brobinson@temenos.com)



## Further contact

### [Temenos](#)

For more information about Temenos' products or to arrange a product demonstration, please contact [salesteam@temenos.com](mailto:salesteam@temenos.com)

For information regarding re-use of this publication or to obtain other recent studies, please contact [marketing@temenos.com](mailto:marketing@temenos.com)

For general enquiries, please visit our website: [www.temenos.com](http://www.temenos.com)

### [Metro Bank](#)

Claire Haylock  
Metro Bank PLC  
One Southampton Row  
London, WC1B 5HA

Mobile: +44 (0)7956 331 056

Email: [claire.haylock@metrobank.plc.uk](mailto:claire.haylock@metrobank.plc.uk)

## About Temenos

Founded in 1993 and listed on the Swiss Stock Exchange (SIX: TEMN), Temenos Group AG is a global provider of banking software systems in the Retail, Corporate & Correspondent, Universal, Private, Islamic and Microfinance & Community banking markets. Headquartered in Geneva with 67 offices worldwide, Temenos serves over 1100 customers in more than 120 countries. Temenos' software products provide advanced technology and rich functionality, incorporating best practice processes that leverage Temenos' experience in over 600 implementations around the globe. Temenos' advanced and automated implementation approach, provided by its strong Client Services organisation, ensures efficient and low-risk core banking platform migrations. Temenos is top of the IBS Sales League Table 2009; winner every year since its launch of the Best Core Banking Product in Banking Technology magazine's Readers' Choice Awards and ranks 26th in the American Banker top 100 FinTech companies. Temenos customers are proven to be more profitable than their peers: data from The Banker – top 1000 banks shows that Temenos customers enjoy a 54% higher return on assets, a 62% higher return on capital and a cost/income ratio that is 7.2 points lower than non-Temenos customers.

## About Metro Bank

Metro Bank was co-founded by Vernon Hill and Anthony Thomson. It is based on the successful Commerce Bank model that was established by Vernon Hill in the US in 1973. A UK management team worked with Vernon Hill to help bring this model to the UK market.

Metro Bank operates retail hours, not banking hours. It will be open seven days a week (8am- 8pm Monday to Friday, 8am - 6pm Saturday, 11am - 4pm Sunday and bank holidays), every day of the year apart from Good Friday, Easter Sunday, Christmas Day and New Year's Day.

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Temenos Headquarters SA

18 Place des Philosophes  
CH-1205 Geneva  
Switzerland  
Tel: +41 22 708 1150  
Fax: +41 22 708 1160

[www.temenos.com](http://www.temenos.com)

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