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### **To: Our Clients and Friends**

The CBM Group will soon celebrate its tenth year in business. We would like to take this opportunity to thank you for your continued support and friendship.

We thought it appropriate to devote this “annual report” to a 10-year retrospective and summary of our activities.

Below we outline our client franchise, our key practice areas and our professional team.

#### Our client base

During the past ten years we have completed some 120 specific assignments for 40+ different clients. Most of our clients are leading global financial institutions or other organizations with financial services activities or interests. They include:

- Banks (12 of the global top 100 banks)
- Securities firms (7 of the top 20 securities firms in the US, a leading European investment bank)
- Derivatives product companies (2 of the top US-based firms)
- Interdealer brokers (2 of the top 5 in the US, 2 of the top 5 in Europe)
- Exchanges and clearing organizations (8 of the top 20 world-wide exchanges, 2 of the top 10 clearing organizations)
- Monoline financial guaranty insurers (5 leading monolines, 3 aspiring new entrants in the industry)
- Life insurers (leading US life insurance company, subsidiary of global French life insurance group)
- Property casualty insurers
- Asset managers (leading US and European assets management firms)
- Technology vendors to financial institutions
- Regulators (a Finance Ministry)

We have worked for our clients around the globe. Looking back over the last ten years, we spent:

- About 50% of our time in the United States and Canada
- About 25% in Europe – in the UK, Spain, France, Germany, Italy, Netherlands, Belgium, Switzerland and Greece
- About 20% in Latin America – in Brazil, Argentina, Mexico and Chile
- About 5% in Asia – Japan, Hong Kong, Singapore, Taiwan

We are proud to maintain strong and long-term relationships with our clients.

- Our relationships with our top 5 clients have spanned periods from 3 to 10 years.
- Every year, repeat business with existing clients has averaged about 65%.

### **Our Practice Areas**

Our consulting practice has focused on the following major areas or “themes”:

#### **Capital Markets**

Based on experience from some two dozen assignments, we have developed (and are constantly refining) a diagnostic methodology for trading and sales activities for over-the-counter instruments such as fixed income, equities, FX.

The methodology, which is based on statistical analysis of large samples of trade tickets, quantifies key factors which drive trading P&Ls, such as market liquidity/volatility, market share by instrument, trading style, sales franchise, tier position with clients, quality of research. It provides management with a comprehensive diagnostic of profitability differentials across trading desks, salesforces and counterparties and suggests profit improvement actions. We have successfully applied this methodology in over a dozen assignments.

We have also worked with several international banks on strategies for building global investment banking and capital markets businesses. This has provided us with sharp insight into the key success factors in these businesses, in the context of different financial systems.

#### **Risk Management**

Our risk management practice has, since the early 1990s, spanned market risk management, credit risk management and operational risk management.

- We helped a leading European bank develop a market risk management system for its dealing rooms, incorporating an early version of Value-at-Risk analysis, including emerging markets instruments with limited liquidity.
- We helped a leading Japanese bank introduce modern credit risk management techniques in its overseas units.

- We helped a major European bank develop its procedures for using credit derivatives as a hedge to its specialty lending activities.
- We helped several monoline financial guarantors with their credit risk modeling challenges.
- We helped derivatives clearinghouses refine their credit risk measurement and management approaches
- We helped a leading European bank evaluate the benefits and costs of outsourcing its treasury back office in order to reduce operational risk.
- Recently we have been conducting a comprehensive credit risk management project for one of the largest Brazilian banks. Together with this bank, we are developing internal credit rating models for various businesses, including large corporate, middle market, small business, agribusiness, financial institutions, consumer finance. We learned that in emerging markets, data quality challenges are enormous and that many of the sophisticated risk models proposed in the last few years fail to perform. We focused therefore on developing simple but robust scoring models – which we discovered can work extremely well in emerging markets – and “reverse engineering” agency ratings.

### Exchanges / Clearing and Settlement

Since 1995, we have had a strong practice focused on derivatives exchanges, stock exchanges and clearing and settlement organizations.

- We developed comprehensive strategies for several leading exchanges (in the US, Canada, Europe and Latin America) dealing with issues such as: transition to electronic trading, new product development, market data service policies, strategic alliances and mergers, international expansion, governance and de-mutualization, as well as running the exchange as a profit-seeking corporation.
- We also focused on the topic of exchange consolidation, in particular in Europe, where European integration and the common currency have greatly stimulated the exchange consolidation process.
- More recently, as many of exchanges have done their Initial Public Offering (IPO) they are now asking us to focus on post-IPO challenges, in particular delivering shareholder value in an intensely competitive space. This will clearly require exchanges to reinvent themselves, in terms of products, business model, alliances etc.
- Several years ago, we correctly predicted a value shift from exchanges – the trading function- to clearing and settlement organizations – the “plumbing” of capital markets. We worked with several clearinghouses and depositories, in the US, Brazil and Europe to identify strategic opportunities related to this shift.
- We worked in particular on the concept of clearing over-the-counter products, such as repo and swaps, which we feel is a promising new frontier for clearinghouses. We are advocating, in particular, clearinghouse services for over-the-counter credit derivatives.
- We also looked at the opportunity of “networking” clearinghouses in order to achieve benefits such as enhanced risk management, cross-margining and increased financial solidity
- We helped a government agency evaluate the impacts of exchange and clearinghouse restructuring plans

## Payment Systems and Electronic Commerce

We also acquired substantial expertise in the wholesale and retail payment processing through working with banks, central banks, technology providers and non-bank financial services companies in the US, Europe and developing countries.

- Firm members played a key role in designing and overseeing the implementation of one of the most advanced real time gross settlement systems in the extended G-10 countries
- We also played a key role in helping a leading European global bank assess the full economics, including operational and credit risks of maintaining direct access to the US dollar clearing system including CHIPS, Fedwire and the ACH
- We developed the Euro settlement strategy for the treasury and trading businesses of a leading UK wholesale bank to maximize their ability to leverage their cash liquidity and eligible collateral across European payment systems while minimizing costs, including risk costs.
- We developed a post-Euro correspondent banking strategy and market positioning for the same bank
- We assessed the business case for commercialization of electronic checks developed the FSTC and Federal Reserve for two leading US commercial banks.
- We advised a leading German bank on e-commerce and Pan-European electronic banking strategy options.
- We developed the business model, value proposition and business case for an innovative invoice management and settlement service sponsored by leading banks and venture firms
- We continue to advise a surviving player in the e-procurement/ sourcing space

## Financial guaranty insurance and credit derivatives

As a firm, we have significant experience in the monoline bond insurance business. We have worked over the years for several leading players in the industry as well as several aspiring new entrants.

Since the early 1990s, we have been developing comprehensive strategies for these clients, covering topics such as: strategic market focus, underwriting process re-engineering, line-of-business profitability, etc.

- We examined a company's risk profile, marketing, underwriting and risk management processes, investment management activity, new business opportunities, pricing models and line-of-business profitability in preparation for a spinoff as an independent entity.
- We advised a major European firm in its entry into the US market through a strategic alliance.

- We developed a diagnostic and strategic vision for another firm, re-engineered its underwriting and surveillance processes and assisted in its re-organization along product and customer segment lines
- We developed economic models of monoline bond insurance companies, including deal pricing models, capital adequacy and risk management models.
- We assessed the European market for securitization and financial guarantees for a leading European institution – in relation to a major acquisition in the US
- We performed a strategic evaluation of the financial guaranty business in emerging markets for a leading US firm.

We also are particularly active in the rapidly growing credit derivatives business. In particular:

- We developed procedures for utilization of credit derivatives for a major European bank in the US.
- We performed a strategic analysis of the credit derivatives business and developed a pricing algorithm for credit default swaps for a new entrant to the market.
- We looked at the feasibility of introducing exchange-traded credit derivatives for a leading US-based derivatives exchange.

### Globalization

As a firm with strong international experience and outlook, we have a strong interest in the globalization of the financial services industry.

- We worked with several leading global banks on their strategies for global redeployment – what businesses to enter or exit in various geographies, ranging from developed economies, such as Europe, Japan, North America to emerging markets, such as Latin America
- We have in particular developed a view on the evolution of financial systems as economies develop: from commercial bank-dominated financial systems to market-based financial systems in which investment banks and asset management firms become the key intermediaries.
- We have modeled and quantified this evolution in over 20 different geographies (US, Canada, UK, Germany, France, Spain, Italy, Belgium, Sweden, Greece, Japan, Taiwan, Korea, Hong Kong, Singapore, Brazil, Argentina, Mexico, Chile, Venezuela, Central America and Caribbean), using national flow-of-funds statistics. We discovered it is possible to anticipate the evolution of national financial systems reasonably well and provide a strong basis for strategy development for global financial institutions.

### Consumer Wallet Evolution

In the context of the above work on globalization, we have analyzed in particular depth the evolution of “consumer wallets”, i.e. “household financial assets”, in the flow-of-funds terminology.

We have developed insightful analyses of the historical shifts in consumer wallets (e.g. stagnation/erosion of bank deposits, their substitution by mutual funds, annuities and retirement savings products in a variety of countries. This wallet evolution is driven by a variety of factors, such as the emergency of an equity culture and especially the need to fund retirement.

We estimate that a developed economy with a typical aging population should accumulate dedicated savings of around 3 X GDP in order to cover 100% of its retirement needs. A few countries, such as the UK, the US, Canada have started this process a long time ago, but the vast majority are way behind. We estimate that annual growth rates in retirement-oriented “assets-under-management” should be around 15-20% for the next 20-30 years, if the retirement challenge is to be met. This is clearly one of the top growth areas in the financial services industry for the foreseeable future.

We have helped several clients position their businesses in this context.

### Distribution

Distribution represents the expense of many financial services firms. For retail-oriented firms, such as large brokerage firms (“wire houses”), large life insurance companies, financial planner networks and the like, distribution strength is the key competitive advantage they can build.

From years of experience with clients in the brokerage, insurance and financial planning sectors, we have developed a unique methodology for improving the performance of large-scale salesforces and enhancing the effectiveness and efficiency of their distribution effort.

We have in particular developed comprehensive “distribution metrics”, analytics and scorecards to enable management to monitor, diagnose and manage the distribution effort.

The basis for our analyses comes from a “lifecycle” view of the producer, from which we developed a brand new metric – the producer caliber - that allows management to predict accurately a producer’s future performance based upon his/her early track record on the job. Caliber thus becomes a useful tool to identify, early on and accurately, those trainees that will become good producers and those that will in all likelihood remain substandard performers throughout their career. It can also be used as the basis for a rational recruiting program for experienced producers, in particular the design of sign-on bonus or “super-payout” programs.

We also have been working on the “marriage” of electronic distribution of investment products with financial planning oriented salesforces. We anticipate that, with the increasing acceptance of the Internet, consumers will prefer to perform most of their financial transactions on-line, using increasingly sophisticated yet user-friendly software tools and with occasional contact, in-person

or most likely by phone, with their financial planner/personal banker or a call center. We believe that this combination of technology and human touch will provide the most effective and cost-efficient future method of distribution of financial services.

### Our Team

As a professional services firm, our people are our assets. We believe that building a stable and seasoned team of professionals is essential to our effectiveness as consultants.

Our professionals have an average of 13 years of experience, with an average tenure at CBM of over 5 years. Our staff turnover has generally been under 10% per year on average.

Most recently, in July 2001, we added Kevin Mellyn to our senior ranks. Kevin brings over twenty years of experience in banking and consulting to financial institutions.

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As we begin our second decade, we look forward to continue working with you and your firms.

To keep in touch with our activities, please visit our web site at [www.thecbmgroup.com](http://www.thecbmgroup.com)

If you have any questions, do not hesitate to contact us:

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