White Paper:

FINANCIAL SERVICES

ARE YOU TRANSFORMING OR JUST TRANSACTING?

THE MODEL FOR THE 21ST CENTURY RETAIL BANK

BearingPoint®

Business and Systems Aligned. Business Empowered.™

Are You Transforming or Just Transacting? The Model for the 21st Century Retail Bank

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The dramatic events ushering in the new century—from globalization and a final crescendo of consolidation to regulatory changes and technology breakthroughs—are compelling banks to turn their focus toward efficiency and customer relationship development. How will banks adjust to a rapidly changing landscape as the first decades of the 21st century unfold? BearingPoint contracted with Datamonitor to interview technology executives at leading global retail banks, find out how banks are transforming their operations for the new century, and articulate a vision of how they can succeed in the new century's challenging environment. This global research report explores the direction of the global banking industry over the next five to 10 years. The observations of industry leaders presented here provide a vision of what the 21st century bank may look like and how IT is being used to achieve that vision.

Introduction

Transformation is not a new notion to banks. Over the past two decades, bankers have explored an array of approaches to capturing new markets, streamlining operations and redefining customer relationships.

Ambitious and occasionally successful, these efforts largely have fallen short of expectations for a variety of reasons. Customer demand wasn't accurately predicted. Hoped-for synergies failed to materialize. Supporting technologies proved inadequate.

That could all be about to change, however. Banks may have struggled with transformation efforts, but they cannot afford to do so in the years ahead. The dramatic events ushering in the new century—from globalization and a final, major wave of consolidation to regulatory changes and technology breakthroughs—are compelling banks to turn their focus toward efficiency and customer relationship development.

How will banks adjust to a rapidly changing landscape as the first decades of the 21st century unfold? To find out, BearingPoint contracted with Datamonitor to interview technology, operations and line-of-business executives at leading global retail banks. The goal of this qualitative research was to find out how these banks are transforming their operations for the new century and to articulate a vision of how they can succeed in the new century's challenging environment.

Is real bank transformation likely to take place? Three converging forces appear to make it unavoidable.

One is the sheer growth of leading banks. With the most recent wave of mergers and acquisitions, the assets of today's largest global banks now dwarf those of several banks combined 10 years ago. In the years ahead, size and the accompanying economies of scale will largely dictate which institutions secure access to capital. In order to compete in the 21st century, banks must find ways to continue growing while transforming into efficient management organizations with a range of expertise and resources beyond those traditionally found among retail banks. This efficiency play will lead to financial institutions that are more data brokers than bankers. Organizations with world-class data storage, management and analytical capabilities will differentiate themselves by rapidly developing and introducing the next logical product.

This transformation from banker to data broker is lowering traditional barriers to entry and is opening the banking arena to new players. Witness Wal-Mart's recent attempts in three U.S. states and Canada to enter the banking business, ostensibly to process debit, credit and electronic check transactions for cost-reduction purposes. The banking industry's continued resistance to this move by Wal-Mart is clear indication of banks' concern over an entirely new wave of nontraditional competitors entering the marketplace.

Second, financial transactions, the traditional core of the banking business, are fast becoming commoditized. Looking to the future, banks must view their business as one of securing, servicing and maintaining customer relationships. A deeper understanding of the customer will be imperative for retention and revenue growth.

Finally, regulatory demands are unprecedented. Banks will have transparent systems and processes required to meet rigorous compliance standards in disparate geographies, as well as establish more effective and predictable means for collecting, storing and manipulating information. At the same time, they must be positioned to address new requirements as they emerge.

For these reasons, the 21st century bank, unlike its 20th century predecessor, will need a new approach to IT that places a premium on flexibility, adaptability and leveraging the best elements of previous strategies.

This global research report explores the direction of the global banking industry over the next five to 10 years. The observations of industry leaders presented here provide a vision of what the 21st century bank may look like and how IT is being used to achieve that vision.

FIGURE 1. BANKING STRATEGY FROM THE 20TH TO 21ST CENTURIES

STRATEGY AREA	20TH CENTURY	21ST CENTURY
CUSTOMER SEGMENTATION	• Customer relationship understood in relation to products held • Limited understanding of customer profitability	• Customer-oriented/structured institution providing full range of financial product on customer-defined basis (transaction to full-service) accessible to customers on their terms and requirements and with focus on customer service
CHANNEL	• Siloed channel with limited process or data integration • Employee interaction focused on servicing	• Multichannel delivery with human relationships/sales focus and automated servicing/support • Branch as retail and/or advisor function • Channel-integrated rather than siloed
SERVICE	• Priority on sales/efficiency rather than satisfaction • Disparate service between channels and products and disjointed problem resolution	• Enterprise service platform across channels with combination of automated and human service support based on customer preference, but with design to incentive automation
SALES	• Reactive/mass market sales focus • Focus on direct mail • Product focus, sales campaigns in branch • Uncoordinated between channels • Open loop between marketing and sales	• Development with sales/service role for all front-office staff with human resources/training/compensation linked to both customer satisfaction/sales • Automated origination to improve customer service (processing time) • Integration/coordination of marketing and sales process
PRODUCT	• Product differentiation focused on pricing • Slow time-to-market for new products	• Ability to bundle/wrap products with rapid time-to-market for new products and ability to offer customizable products
COMPLIANCE/ RISK	• Regulation-specific reporting • Manual/spreadsheet-based data analysis/ collection • Business-level risk systems	• Enterprisewide compliance-consistent processes/data management platform with automated reporting that can meet evolving compliance requirements and provides benefits to other functions • Consistent/top-down manageable process for sales (for risk management/compliance)
PAYMENTS	• Siloed payment systems by product • Manual processing	• Minimal paper/human interaction in payment and process (exceptions management) across checks and existing electronic payments, with access to payments across all channels
OPERATIONS	• Multiple points of data re-entry • Manual processes • No consolidation/central view of processes • Separation of operations center and channels	• Single point of capture/data entry • Automated processes • Enterprise content management allowing multisite processing • Consolidation view of operations/site/workforce optimization/workload balancing

Source: Datamonitor

CHANGES IN GLOBAL BANKING

Global retail banking is currently experiencing a period of fundamental change driven by a host of social, economic and technological developments. Worldwide market deregulation, the emergence of an affluent class in Asia, the maturity of the Internet as a service channel and the prevalence of new networking technologies are creating the potential for true transformation by retail banks. However, the "moving targets" of customer behavior, coping with regulatory legislation and establishing IT governance procedures remain obstacles for global retail banks. Figure 1 depicts the evolution of banking strategies across key operations.

21ST CENTURY BANKING

Our conversations with banks revealed several assumptions about the 21st century banking environment. The next five to 10 years will be defined by:

- **Accelerated expansion.** The cost of compliance, cost of capital and need for processing scale will further accelerate cross-border expansion already underway in the United States and Europe. Global industry deregulation caused a spate of mergers and acquisitions in the past five to seven years, and its effects will reverberate in IT for some time. According to Mr. Nemoto, the executive director and general manager of IT at Bank of Tokyo-Mitsubishi, deregulation in the Asian banking industry will have the greatest impact on IT spending and planning among Asian banks in the near term. One of Bank of Tokyo's goals in the next five years is to become one of the top five banks in the world. Deutsche Bank confirmed that it will invest an increasing portion of IT spending over the next five years on revenue generation, including setting up businesses in new countries, extending some smaller businesses and opening up new markets in existing countries. If the banks in this research are correct, the largest banks of the 21st century will control far more assets and deposits than those of the 20th century.

- **Process efficiency.** In the 21st century, process efficiency will be as important a competitive driver as acquisition. Automation, aimed at reducing human intervention in processes, will allow banks to devote more resources to customer retention and acquisition efforts. Improved risk management and unit-processing scale will allow them to compete with lower margins. Retail banks will begin to establish better data-storage and data-management techniques to leverage and manipulate an ever-growing pool of information about customers, products and competitors. Organizations with the most efficient operations and most comprehensive market and customer data will be able to develop new products and services faster, speeding them to market for competitive advantage.

- **Greater customer sophistication.** The changes to customer expectations brought about by the Internet will occupy a considerable amount of a bank's strategic thinking in the next five to 10 years. Virtually every bank we spoke with indicated that numerous customer-centric projects, including redevelopment of the branch, the establishment of a "parallel channel" strategy and

Our conversations with banks revealed several assumptions about the 21st century banking environment. The next five to 10 years will be defined by:

- Accelerated expansion
- Process efficiency
- Greater customer sophistication
- Emergence of new competitors
- More intense regulatory demands

the advent of sophisticated customer analytics, are being undertaken in an attempt to paint as complete a picture of the customer as possible in relation to a bank's products and services. The key for the 21st century bank is to understand a customer's evolving needs in the context of technology and consumer patterns, including 24-hour service, online origination, electronic bill presentment and payment (EBPP), and their potential as buyers of new products.

- **Emergence of new competitors.** The factors creating the 21st century banking environment—consolidation, technology maturity, customer demand and even bank branch renewal—will make it easier for nontraditional players to establish financial services operations. Already, retailers such as Wal-Mart, Tesco and Starbucks are offering checking and payments services, often in conjunction with regional banks that can offer branding and processing support, although regulation has stymied further expansion. However, as transactional banking services become more commoditized and banking strategies are more centered on customer preference, nonbanking retail organizations with large, underserved target markets will naturally see retail banking as too lucrative to ignore. This will certainly mean some erosion of deposit and transactional income at retail banks and could even lead to the establishment of huge, low-cost megaretailers in industry deposit markets. The current strategy of focusing on perfecting online banking platforms, integrating channels and establishing higher value advisory services is clearly aimed at retaining deposit bases that support value-added investments such as loan operations. While this may help banks maintain higher-value customers, it may do little to keep transactional customers on board, particularly if lower cost alternatives emerge. Wachovia's Cece Sutton, head of operations, stated that while product innovation is important, "retail banking customers don't look at banks and go, 'I want an innovative bank'; they say, 'I want a bank or company that is convenient and easy to do business with.' "

- **More intense regulatory demands.** While the past several years have been characterized by market deregulation, allowing banks to offer more services across more markets, including attempts at the "one-stop shop" in financial services, regulations such as Sarbanes-Oxley and Basel II are exacting an onerous toll on IT cost and planning requirements. IT managers are currently occupied with the initial stages of multiyear efforts devoted to bringing internal systems and governance into compliance. For companies involved in enterprisewide data integration efforts, including the establishment of an information life cycle management system, changes implemented now to deal with short-term compliance may, in the next five to 10 years, pay dividends in the form of increased employee productivity, lower operational costs, shorter cycle times and better risk management.

These conditions will require banks to adopt flexibility, speed and transparency across their operations. The globalization of banking will force poor performers to respond because national borders and regional bases may no longer provide the same barriers to entry. The leading banks are beginning to understand the role technology can play in aligning operations horizontally. Banks now understand that technology can help them achieve a better competitive position, primarily as a means of enabling organizations to leverage information across business lines and units.

For example, mortgage operations, card and payment operations, global treasury, and document imaging, which may have operated independently in the 20th century, are now being envisioned as components in a holistic, customer-centric operating environment. One of the overarching technology goals of the

FIGURE 2. 21ST CENTURY ALIGNMENT OF BUSINESS AND TECHNOLOGY

STRATEGY AREA	TECHNOLOGY
CUSTOMER	• Multichannel transaction/origination/data management platform servicing across all products with integration of customer information • Customer satisfaction monitoring
CHANNEL	• Integrated platform across servicing/origination/customer information that services branch/other channels across all products • Development of voice/kiosks channel and full range of servicing/product sales for online channels • Platform allows rapid integration of new channels (e.g., wireless)
SERVICE	• Enterprise problem/service platform with automation of core servicing demands to allow customer reps to focus on value-added/sales identification
SALES	• Consistent incentive compensation management and workforce optimization • Analytical and operational customer experience management • Common operations function with automation (business process management/workflow/exceptions management)
PRODUCT	• Centralized core systems with modifiable business rules to create products without code modification servicing all channels
COMPLIANCE/ RISK	• Integrated information life cycle management platform with consistent data management across enterprise (for compliance, customer and products) • Automated reporting and data analysis with management information system capabilities
OPERATIONS	• First entrance imaging/data point of capture • Automation/business process management/integrated real-time fraud analysis

Source: Datamonitor

bank is to make operations more horizontal—allowing for the capture of information across areas and business lines to enable more profitable customer service relationships, more accurate and comprehensive data and risk management, more efficient processes, and fool-proof regulatory compliance.

In implementing new models, however, banks must ensure that initiatives not only reduce costs, but increasingly meet long-term objectives, improve efficiency, and generate revenue and customer growth. The bank of the 21st century will consider technology to be far more important in achieving these goals than their 20th century counterparts. While banks displayed adaptability and execution as competitive advantages in the 20th century, these characteristics will be necessary for survival in the 21st.

TECHNOLOGY: ENABLING BUSINESS STRATEGY

While factors such as global economic expansion and networking technology maturity are providing banks with both the cause and enablers to reach far more people, only the right technology strategy will allow companies to execute. Figure 2 illustrates how 21st century technology can impact key business strategies.

Technology overhaul could prove to be the transforming agent in the next five to 10 years. The move to standardization across hardware, platforms, databases and application development, together with a move to modular architectures and Web services, is poised to transform a bank's ability to integrate, maintain

FIGURE 3. THE STRATEGIC VISION

	20TH CENTURY		21ST CENTURY
CUSTOMER MANAGEMENT	• Data organized by business/product • Fragmented channel • Online account statement	→	• Data organized by customer (single-view) • Integrated/multiple channel • Online account origination/multiple product
PROCESS	• Manual processing of imaged documents • Re-entry of data • Siloed operations	→	• Automated image processing (Check 21) • Single data entry • Uniform operations
ENTERPRISE ARCHITECTURE	• IT maintenance • Application-specific architecture • Product-/process-driven	→	• Business maintenance • Application-agnostic architecture • Services-driven/event-driven
INFORMATION	• Isolated marketing and sales efforts • Disparate operational and analytical systems • Manual feedback	→	• Integrated analytical and operational intelligence systems for risk, customer data and business analytics/management
PAYMENTS	• Checks/cash dominant (U.S.) • Siloed payments operations • External security • Contact/presence for transactions	→	• Card (Chip/PIN) dominant • Uniform payments strategy • Embedded security • Contactless payments
COMMUNICATIONS	• Phone • Fax • Mail • Siloed channels and operations	→	• E-mail • Wireless LAN/mobile sales • Voice over Internet Protocol—integrated call center, branch and online
SOURCING	• Internal dominant—tactical • Long-term outsourcing contracts	→	• Best sourcing—strategic • Centralized procurement • Standardized
IT/BUSINESS ALIGNMENT	• Decentralized budget discretion • IT-driven • Lines of business independent/federated • "Change the bank/run the bank" spending = 30%/70%	→	• Centralized budget discretion • Business-driven • Lines of business federated/integrated • "Change the bank/run the bank" spending = 70%/30%

Source: Datamonitor

and expand its operational capabilities. These will significantly reduce the IT cost base through use of competitive, low-cost technology and allow institutions to replace application modules rather than to tackle the risk of full-scale system replacement.

Banks are also moving toward electronic processing, yet paper-based processes remain embedded, causing significant manual intervention and duplication of effort. The 21st century bank will move toward fully automated processes with a single point of capture at presentment for any external paper-based transactions or communications and gradually develop electronic origination across the branch, contact center, broker and online channels. Check and document imaging will increasingly ensure that paper processing will be the exception rather than rule. At a more tactical level, the 21st century vision will be enabled by a number of key technology developments and strategies (see Figure 3).

THE ROAD AHEAD

While banks are still several years away from realizing many of the attributes of the 21st century bank, there are several areas where the application of technology has begun to enable long-term transformation.

CUSTOMER MANAGEMENT

The maturity of transactional banking services in the 21st century will place downward pressure on interest income/transaction fees, driving the need to understand customer profitability and risk more accurately, as well as raise customer satisfaction and loyalty. Wachovia's Sutton believes that, in the next five to 10 years, "this will separate the great banks from the good banks." For retail banks, strengthening the relationship with the customer is clearly the most important objective today. This includes improving the look and feel of the branch (or store, as it is increasingly known), adding banking hours, improving promotions and, occasionally, getting creative with pricing. The end result of such "customer experience" efforts will be the establishment of an analytic-enabled "e-bank" by the end of the next decade.

Failed attempts at creating the e-bank in the past several years may have given institutions pause, but have not caused them to scrap the idea of direct channels with sophisticated analytics applications. In fact, a single view of the customer, enabled by analytical customer relationship management (CRM) and supported by online product acquisition, remains very much a part of the long-term customer servicing functionality.

"We want to be able to leverage our channels first, and this means getting one view of a customer across all channels. When you talk about integrating channels, it's better for the customer and it's a win for us," says Bank of America. Deutsche Bank considers the e-bank a "breakthrough" technology aspect of 21st century consumer banking and is currently planning a total revitalization of its online banking channel. Currently at the infrastructure replacement stage, the bank is preparing for the next stage—the completion of Deutsche's "Branch of the Future" initiative is scheduled for completion in 2007 and will feature a redevelopment of the Internet bank, CRM analytics, performance management tools and advisory services.

While the goals of a 21st century customer experience are quite common across all the banks, the steps banks are taking to get there vary. ABN AMRO is currently concentrating on the front end, including a redesign of the Internet bank and customer delivery, while Handelsbanken plans to add new functionality to its Internet applications in the next two to three years. Today, Deutsche Bank's initiative is largely centered on infrastructure improvements. The key at the senior executive level is establishing measurable, successful initiatives. This involves a more comprehensive approach to technology, putting people and processes, both internally and externally, at the heart of the solution. According to Bank of America, "The technology is largely in place, so the human aspect is the most crucial aspect in this strategy."

Some banks we spoke with admitted to already having a heavy reliance on customer analytics in cross-selling applications. Wachovia's strategy is to enable the back office to collect customer information and model, track and measure it as the seller conducts business directly with the client. The key is enabling ease of use on the front end, which will allow for the human element to make the best use of the complexity that will ultimately reside behind the scenes. "We don't try to cross-sell five products for every client. We want every client to transact, borrow or save/invest with us. When they do all three, they do not leave."

With these elements in place, banks will be able to focus on more revenue-generating aspects of customer service — the ultimate objective over the next five to 10 years.

PROCESS

Despite the industrywide shift from cost savings to revenue-generating IT initiatives, such as branch and single customer view strategies, the reduction of paper-based and manual processes remains an important long-term priority for the largest global banks.

Currently, process automation efforts in the United States are primarily centered on transferring documents to electronic images, a process that has gotten a boost from Check 21 legislation, which allows for the substitution of check images in place of checks in settlement. Several of the large U.S. banks we spoke with already enable branch image capture and are prepared to support image exchange once a critical mass in the industry is established. Wachovia believes that image capture will represent enormous cost savings to the industry, while Bank of America stated that electronic imaging is "revolutionary" because it removes cost in a way that is transparent to the customer, unlike outsourcing or other changes to service: "Although image was introduced five years ago, banks have not capitalized on it yet as an efficiency play."

Automation has tremendous potential within the banking industry to streamline a host of business processes, not only removing paper, which would reduce administration costs and eventually enable greater data integration, but removing people as well, potentially freeing them up to pursue revenue-generating activities such as cross-selling. The Nordic banks are among those at the forefront of branch automation. Handelsbanken's approach to branch staffing is to "eliminate all non-value-added work."

> Of all the long-term projects cited by our banks, there was one that virtually all banks believed would be essential to fulfill the vision of a 21st century bank: an enterprise architecture.

This means automating "wherever and whenever possible," according to Danske Bank, whose branch automation efforts are not only leading to significant cost savings and better revenue generation in the branches, but also enabling new customer analytics functionality as information is used across systems more efficiently and more rapidly.

The move to straight-through processing (STP) is the ultimate objective for the 21st century bank because it reduces the need for people in administrative functions, reducing cost and error and improving cycle times. Following efforts to remove paperwork in its bank branches, Societe Generale is currently in the process of consolidating platforms and automating credit-scoring functionality to achieve STP in its loan application processes. Meanwhile, the success of ABN AMRO's mortgage operations in the United States is a justification for revamping of the bank's mortgage servicing systems to process more loans, more quickly and accurately.

Business process management (BPM) software is increasingly being used in the banking industry to reduce the manual tasks in any number of processes, from servicing customers to processing applications to credit scoring. Business rules and workflow engines also reduce administrative complexity within the overall systems, as they allow non-IT staff to integrate changes to the system easily or apply rules for reuse in other areas. Banks believe these will be critical technology areas in the next five to 10 years, complementing the establishment of enterprise architecture.

ENTERPRISE ARCHITECTURE

Of all the long-term projects cited by our banks, there was one that virtually all banks believed would be essential to fulfill the vision of a 21st century bank. An enterprise architecture satisfies many of the requirements necessary to establish a flexible, adaptable, business-driven IT strategy. In the response to the question “what is the breakthrough technology in retail banking?” the response “service-oriented architecture” (SOA) was given by over half of our banks, and nearly all have either implemented some elements of SOA or are planning to do so. ABN AMRO, which has implemented SOA for Internet banking in the Netherlands, says that SOA will be a key feature, to be “built in with each new application.”

Enterprise architecture, particularly a service-oriented one, establishes an open, enterprisewide IT framework built on business tasks, or services, rather than a hodgepodge of proprietary IT code. The key for banks is that it provides for theoretically simple integration of both internal and external applications, allowing for far easier and faster changes to the business. This approach is already well underway at Bank of Tokyo, where enterprise application integration combined with “quasi-SOA, based on hub and spoke messaging,” will link operations, including international banking, domestic banking and the trading business. According to Mr. Nemoto, this is the essential technology project for the next five years. BBVA called it a breakthrough and will begin planning stages in its mortgage systems in the next year. “SOA sets up infrastructure to prepare for the future and is an enabler of change for the business.”

The point-to-point architectures that still dominate in global financial services are notoriously inefficient, and banks are well aware of the limitations they have in reusing services and transferring data across an organization. In fact, SOA as a concept of applications as components has existed for some time. Only lately with the development of Web services has this become a feasible and practical proposition for banks. The presence of a more flexible enterprise architecture will also allow banks to reduce the dependence on legacy systems, often the byproduct of aggressive mergers and acquisitions activity. According to Deutsche Bank, such a development could “eliminate the legacy problem—the redundancy due to previous M&A, which soaks up the overall IT spend.”

Nevertheless, our research indicated that while banks may be sold on the notion of SOA, there may be some skepticism around the technology and the hype. Although Bank of America has made “a directional commitment around the notion of SOA,” it makes the bank “think of CRM. I think a lot of companies spent a lot of money and didn’t really see the return on investment.” Such architecture overhauls are expensive, time-consuming and potentially risky, particularly the migration from a legacy environment to a completely componentized one. HVB, which is considering SOA as a next-generation architecture following a legacy replacement, believes that “while a dramatic change is needed, we will have to proceed in steps. We can’t do it all at once.”

The most common approach for those who have engaged in early SOA establishment appears to be a go-slow approach—beginning in one line of business and gradually expanding from there. HSBC is attempting such an approach with its “HUB” architecture, an open, centralized banking system architecture. According to the CIO, “HUB will be ready to support from next year, but total completion is at least three years away, when we will include the major countries. The bank is looking to convert 63 small countries to HUB first before moving on to the big three.”

INFORMATION

The establishment of enterprise architecture can enable the integration of formerly siloed business operations and allow IT decisions to reflect business strategy more easily. However, the development of enterprise architecture alone does not provide the necessary components for complete horizontal integration. Evolving business strategies that place the customer rather than the product at the center of the banking transaction and the increasing need for regulatory compliance will require a seamless integration of information across product and business lines.

Regulatory compliance spending is an increasing percentage of overall IT budgets of banks today. Basel II, Sarbanes-Oxley and anti-money laundering provisions are driving the need to lower operational risk and increase overall control. The impact of these regulations is that retail banks are now evaluating their data retention requirements, including data integrity, storage, accessibility and retrieval.

Societe Generale believes that consistency of data across the enterprise will be imperative to meet the current and future demands imposed by regulatory authorities and is currently implementing an external package application at the group level. "Coordinating efforts and making sure things are consistently defined and the right data is accessed" is the biggest challenge in regulatory reporting. The bank is currently looking to impose consistent data feeds, particularly consistency in finance data.

To provide enterprisewide presentation of this data, banks must be able to identify, classify, access and store data residing in multiple applications and on multiple platforms. In such a framework, all tasks coming into the organization are managed in real time, and the data is stored and reused for core banking operations, risk assessment and customer management.

The lack of uniformity across the enterprise is a tremendous impediment to effective and repeatable processes in regulatory reporting. Business analytics applications can address the business intelligence needs of the entire enterprise, including regulatory reporting. They contain the necessary technology to integrate data from enterprise systems, combine it into an integrated view across the organizational value chain, and deliver real-time information to employees across the organization.

Leading banks now realize that an integrated data management framework has clear benefits beyond regulatory reporting. Regulatory compliance in both European and North American banking is considered an opportunity for improving the overall data management capabilities within an organization, rather than a short-term imposition. Because regulatory compliance is mandatory, the source of spending is often from the non-discretionary IT budget and often at the group level. This is enabling many IT departments to take a strategic rather than tactical approach to their data management capabilities—focusing on an enterprisewide initiative without pulling resources from the long-term IT projects.

PAYMENTS

When thinking of 21st century banking, perhaps no example of the future financial services has become more rooted in the mind of banking executives and the general public alike as the progression toward a "cashless" society. Card-based electronic payments have, in fact, become the dominant vehicle for monetary transactions in the developed world, and retail banks are focusing greater attention on their capacity to capitalize on this area of consumer banking. The notion of "contactless" payments, which eliminate the need for card presentment at the point of sale, is already becoming a reality in Europe and Japan, where payment networks are more sophisticated than in the United States. Evolving biometrics applications, including fingerprint scanning, retinal scans and voice recognition, offer promise for substantially reducing identity theft and consumer fraud.

The likelihood is that consumers will continue to choose plastic over paper when making transactions, while banks will implement increasingly more complex detection systems to combat ever-more sophisticated acts of fraud. However, the 21st century vision of full-scale, global implementation of smart cards or chip cards and biometrics systems is likely years away. These technologies currently face significant obstacles to implementation, including acceptance of industry standards on card types—such as personal identification numbers or chips—patent rights, customer acceptance and industry debates over their efficacy. Most importantly, before this vision can be realized, banks must develop the internal systems to process the growing number of card payments while maintaining their capabilities in declining areas, such as checks.

Compliance, mergers and acquisitions activity, and cost reduction are all driving the overlap in back-office systems. The leading banks currently see payments as a back-office issue, with several of our respondents looking to develop a unified and integrated payments infrastructure, which would essentially blur distinctions between various payment types: check, cash, debit, credit and mobile payments. Payments will need to be seen as transparent to the organization and the consumer.

Societe Generale is currently implementing a unified system for its Visa and MasterCard transactions on an existing platform. Handelsbanken lists the integration of its payments platforms as one of its top two priorities, along with Basel II. HVB has chosen to maintain its payments systems as it focuses on branch renewal in the next two years, but intends to integrate its payments as part of a major rationalization effort in the next two years. However, banks with large payment operations remain cautious of combining various payment types, citing competitive differentiation in "high-value" payments. While a unified payments strategy is clearly seen as a competitive advantage in retail banking, the need to distinguish internally between retail and commercial payments will be critical, as the latter provides substantial competitive advantage. Deutsche Bank seeks to merge payments systems while differentiating between payment types in the back office to retain what it considers to be a competitive advantage. "We would not want to compromise this by merging the systems; however, where there are clear benefits, such as in small market enterprises and retail, we are merging payments systems."

> Perhaps the most important aspect of a 21st century bank, from a CIO's point of view, is the presence of a sophisticated governance system. Virtually all of the leading banks in this research indicated that a greater degree of top-down IT governance is essential to establishing the enterprisewide changes necessary for execution on a more flexible long-term business plan.

COMMUNICATIONS

The communications systems of the 21st century will rely on the key communications technology of the late 20th century. In the next five to10 years, most major banks will have some level of communications based on Voice over Internet Protocol (VoIP). Large banks, with the size and clout to negotiate lower communications costs, were, until recently, reluctant to place telecommunications on a new technology platform, especially considering the high network replacement costs involved with such a move. However, the potential benefits for branch efficiency and customer service are causing most banks to incorporate VoIP into their plans.

SOURCING

The success with which the largest outsourcers have established themselves as an essential part of a bank's IT strategy may well transform into an opportunity for core banking operations, as opposed to noncore functions, down the road. In the 21st century, economies of scale and expertise among major outsourcers could result in the creation of shared service utilities capable of managing virtually all processes of retail banking, effectively separating the administration and management of core banking from the strategy. This is certainly the vision of outsourcers for the next five to 10 years, and, indeed, of many banks.

Part of the overall IT strategy at HSBC is to increase its usage of low-cost development centers, particularly in offshore locations. The firm is looking to increase its off-site developers by roughly 30 percent in the next three years in low-cost areas such as India and China. HSBC stated that it will continue to outsource "as long as the IT cost-to-revenue ratio improves" so that it can focus internally on revenue growth—reflecting the more popular current strategy among banks with significant outsourced operations. The bank believes this cost-intensive approach to staffing is a logical first step in the eventual rationalization and integration of all its operations. The current attitude is to "offshore first, then automate."

This approach, however, is not shared by several of our participants, suggesting that the future for outsourcers is less than certain. Attitudes among several of the European banks reflect a significant amount of skepticism toward outsourcing. Some banks are even doubtful of the true amount of cost savings, regardless of the potential loss of intellectual property and competitive differentiation, which can result in lost revenue even as costs decrease. Societe Generale "doesn't see huge savings" from outsourcing and is particularly put off by "the loss of the control element." Citing its own scale advantages, the bank believes that rather than turn over operations to a third party, it makes more sense to leverage the size and scale of the bank, devoting resources to improving the internal efficiency through rationalization and integration efforts. The bank has managed to realize significant cost reduction due to internal head count reduction, operational standardization and potential overlap with other business areas, such as asset management.

> It is imperative for banks to shed the transactional orientation of the past and focus on improving the efficiency and customer-centricity of their operations by embracing long-touted technologies that now appear ready to deliver on their promise.

In the opinion of Handelsbanken, the dominant trend suggesting growth in outsourcing in the next five to 10 years may be "going the other way" among some Scandinavian banks. Handelsbanken is currently re-evaluating its outsourcing agreements because many have not delivered on "quality or cost." The current plan is to bring some operations in house, especially where scale advantages have been created. This suggests that as global banking becomes more consolidated, concentrated and competitive, many banks will continue to see the business case for outsourcing as hard to prove if cost savings are minimal. At least for the next five to 10 years, banks will continue to view the outsourcing of many operations as risky. Until a significant number of reference sites can be established, outsourcing will likely be limited to areas that do not offer a competitive difference, such as IT or some processing areas.

IT/BUSINESS ALIGNMENT

While the benefits of these initiatives—structuring organizations around customers' needs, establishing enterprise architectures and implementing STP—have been understood by IT and business professionals for years, the industry has long grappled with exactly how it can reliably execute on them. Many of the technologies cited by these banks have been in place for several years now, not to mention the understanding of benefits and risks. However, there remain in place forces that have prevented banks from achieving these goals. The vagaries of the business cycle, market forces and a means of effectively proving the return on technology investment have stymied organizations in their attempts to align IT and business objectives. This fact is a source of great frustration for the managers in our research, and virtually all of the surveyed banks indicated the importance of IT/business alignment and establishing governance procedures in the management of technology projects. It can be seen as a foundational necessity in the successful completion of 21st century initiatives presented earlier. To achieve this, banks must align IT with business needs, define IT within the context of the overall strategy, and track and measure projects to make sure they meet both short- and long-term objectives in an ongoing and iterative process. Multigenerational planning under the IT strategy is paramount.

Perhaps the most important aspect of a 21st century bank, from a CIO's point of view, is the presence of a sophisticated governance system. Virtually all of the leading banks in this research indicated that a greater degree of top-down IT governance is essential to establishing the enterprisewide changes necessary for execution on a more flexible long-term business plan. Handelsbanken considers governance, as part of a unified IT and business strategy, to be the key characteristic of a 21st century bank, noting "IT will not be seen as separate from the business function as it is now, but integrated as an aspect of solving business needs." Deutsche Bank considers IT and business alignment to be among the most important overall objectives over the next five years. According to Clemens Jochen, CIO of infrastructure, and Michael Reinicke, CIO of personal banking, "DB's biggest five to 10 year changes will be in the area of IT governance, which will make it easier for rapid technology implementation. The plan is to evaluate the synergies that can be achieved through a joint IT and operations strategy." This will be the second phase of a plan that will begin with an evaluation of cost-saving opportunities and end with a synchronization of overall organizational strategy.

Most importantly, the structure will increasingly be determined by business needs, not IT. This has not always been the case, even among some of the largest global banks. Far from its ideal position, technology in the 20th century was often isolated from the business, with a focus strictly on IT infrastructure and integration. IT strategy remained disjointed and often an inhibitor, rather than enabler, of business strategy. For example, the failure of significant investment in CRM is now widely considered a cautionary tale in the financial services industry, and several of the banks in our research considered this largely a failure of IT and business to understand the benefits and limitations of the technology fully.

Particularly with respect to customer servicing, perhaps the most important area of focus among our banks, a "business-led" IT strategy will enable a better understanding of evolving customer behavior. Bank of America's consumer CIO credits its approach, in which "technology enables the strategy, rather than drives the strategy," as the reason for the company's industry-leading online retail banking. "Some banks came out with the bank of the future and it was technology-driven. I think a lot of our stuff has been process-driven, with technology enabling that to happen."

CONCLUSION

The observations presented in this global research report reveal the breadth and urgency of the transformation efforts underway in banks as the 21st century unfolds. Banks today face both greater regulatory constraints and the challenge of achieving growth as new competitors threaten traditional markets and mergers and acquisitions activity slows. In this environment, it is imperative for banks to shed the transactional orientation of the past and focus on improving the efficiency and customer-centricity of their operations by embracing long-touted technologies that now appear ready to deliver on their promise.

Going forward, banks must address several key issues:

Go horizontal. The first is how to make the transition from traditional banking operations to an integrated organization. Banks are beginning to align functionality across vertical areas. For example, billing or customer-records functionality previously located within each business area will increasingly be consolidated and used across multiple lines and products. This applies to the underlying knowledge base of a bank, too. Leading banks will increasingly look outside the industry for expertise. For statement rendering, they're turning to the worlds of manufacturing and high-speed printing. For cash and check movement, they're capitalizing on the superior logistics capabilities of leading courier and delivery companies.

Balance objectives in IT strategy. The need to balance the use of technology resources to support revenue growth with the ongoing need to control costs and retain existing customers will drive the use of technology across the enterprise. New, customized products that generate additional revenue are inherently high in cost, requiring coding of systems and creation of new processes. How many types of deposit accounts are worth the cost to attract new customers? Alternatively, should investment be made in customer analytics to identify how to prevent attrition?

Focus on governance. IT also must align with business strategy to improve returns on IT spending. Leading banks recognize the role IT governance will play in this effort. It is crucial to understand that any dollar spent on technology must be evaluated in terms of the needs of the enterprise, not a single line of business. If the credit card, mortgage and retail banking operations all are doing their own content management or image solutions, precious resources will be wasted.

Long-term, comprehensive technology strategies addressing enterprise architecture, process automation and customer analytics will be key to bridging the gap between the 20th and 21st centuries. Still, to realize the benefits of these projects, industry leaders must first recognize their limitations and properly understand their potential impact on meeting business objectives.

Encouragingly, technologies such as open-source computing and SOA are reaching the stage of maturity at which they can contribute to project success. Perhaps not far off is the coveted "universal bank," a single sales and service platform that crosses all lines of business, from retail banking to wealth and investment management to corporate and private banking.

It is an ambitious vision, but one that banks can, and must, pursue to thrive in the century ahead.

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