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FINACLE CONNECT

CONNECTING THE BANKING WORLD

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A Quarterly Journal From

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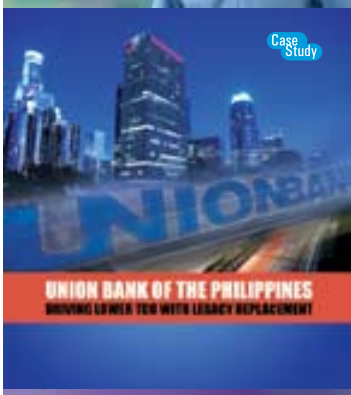

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Voice from the Desk

Emphasis On Compliance

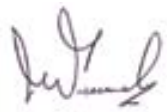
The financial services industry is arguably the most regulated with financial institutions today required to comply with a whole host of regulations ranging from Basel II and MiFID to Sarbanes Oxley and Solvency II. Not surprisingly, regulation is often regarded as among the key challenges facing the banking industry today. In fact, regulatory overkill was identified as the greatest risk facing the financial sector for the second year running by the annual 'Banana Skins' survey conducted by the CSFI (Centre for the Study of Financial Innovation), a London based non-profit think tank, in association with PricewaterhouseCoopers. Over 450 respondents from 60 countries said that too much regulation was endangering the financial health of banks with its cost burden and distractions, as they did in the 2005 survey.

Arthur Amos, head of IT planning and governance at Nationwide Building Society in the UK, who we have interviewed in this issue of FinacleConnect, too lists regulation as among the biggest challenges facing banks and building societies in UK today. Over the past two years, regulations for the mortgage sector, general insurance and those such as Basel II have created a big overhead for the financial industry in the UK, says Amos, adding that this will only grow in the future. And while not all regulations impact every firm, Amos states that the financial industry is as such seeing an overall increase in the emphasis on corporate, operational and IT governance and risk management. This is good. For while there are valid concerns about the cost of compliance and about the impact compliance requirements has on innovation, there is no denying that regulation is essential for the smooth running of the financial industry. This issue's cover story, Compliant on Compliance, discusses the main regulatory issues faced by banks today and also explains that for banks to be successful in their efforts to overcome the compliance challenge it is necessary to evolve a holistic strategy and framework, to invest in the right technology and skilled personnel. The topic of compliance and regulation is also dealt with in considerable depth in Modern Banking, the book that is reviewed in this issue. Written by Shelagh Heffernan, a professor of banking and finance at the Cass Business School in City University, London, Modern Banking is among the rare books that manages to provide a wholesome perspective of the banking industry right from theoretical concepts to more practical and relevant aspects of banking.

Along with compliance, another key challenge faced by the financial industry today, says Arthur Amos in his interview is that of obsolete technology and legacy infrastructure, a topic that we have dealt with in depth in previous issues of FinacleConnect. In this issue we look at how Union Bank of Philippines is achieving agility and business growth by replacing their legacy core banking system. Justo Ortiz, Chairman of the bank says that by migrating its legacy systems the bank will be able to cut technology costs by 15 percent. Apart from reduced costs, he says, the solution will also help the bank move from being a product-centric bank to a customer centric bank.

This issue of FinacleConnect covers a variety of topical issues and I am sure you will enjoy reading them. Please continue sending us your valuable feedback.

Till next time!



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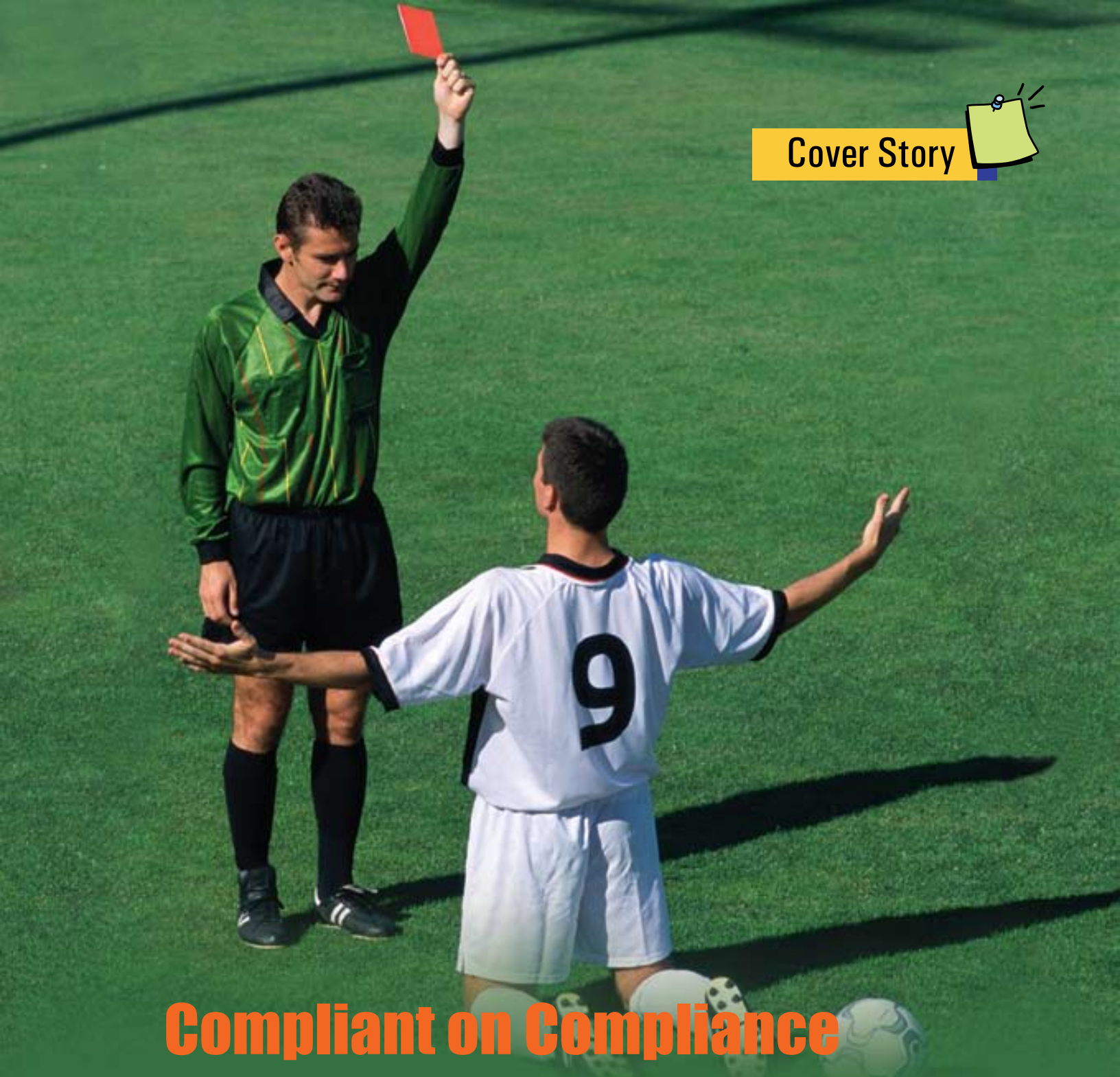

Compliant on Compliance

Recent years have seen the financial services industry being bombarded with a host of regulatory requirements, ranging from anti-money laundering and Sarbanes Oxley, to MiFID (Markets in Financial Instruments Directive) and regulations regarding the SEPA (Single European Payments Area). While some are focused on the global financial industry, others are domain-centric and applicable only if a bank operates in certain geographies. However, each regulation comes with its own set of complex requirements with non-compliance proving not only extremely costly, but also leading to a loss of reputation and goodwill in the industry.

Recently Dutch banking giant, ABN AMRO agreed to pay $75 million in fines and its board members agreed to repay EURO 1 million in executive bonuses after admitting to serious flaws in compliance controls at its Dubai branch and US dollar clearing centre in New York. A report found that between 1997 and 2004, employees of ABN AMRO in Dubai developed procedures that modified US dollar payment instructions sent to the bank's clearing centre in New York on behalf of Libyan and Iranian clients. They excluded

country and client-specific information from the relevant payment instructions so that the payments would pass through the New York branches' OFAC filter without being detected and blocked. Rijkman Groenink, ABN AMRO chairman says, "As a global financial organisation, nothing short of the highest standards of compliance is acceptable. We regrettably recognise that, in the past, our compliance in certain areas did not meet this standard. Further improving our compliance is the highest priority of the bank."

Banking Banana Skins 2006

(2005 position in brackets)

- Too much regulation (1)
- Credit risk (2)
- Derivatives (4)
- Commodities (14)
- Interest rates (12)
- High dependence on technology (8)
- Hedge funds (5)
- Corporate governance (3)
- Emerging markets (15)
- Risk management techniques (9)
- Fraud (6)
- Equities (18)
- Currencies (7)
- Macro-economic trends (10)
- Political shocks (22)
- Conflicts of interest (-)
- Banking market overcapacity (20)
- Money laundering (13)
- Merger mania (27)
- Legal risk (17)
- Business continuation (19)
- Retail sales practices (23)
- Insurance sector problems (11)
- Back office (26)
- Environmental risk (28)
- Management incentives (21)
- Rogue trader (24)
- Competition from new entrants (29)
- Payment systems (25)
- Too little regulation (30)

In another case, Wall Street bank, Morgan Stanley agreed to pay a record $15m fine to the US Securities and Exchange commission (SEC) for its failure to archive emails to the SEC's satisfaction. The fine will be the largest ever levied by the SEC for inadequate record-keeping. In 2004, Bank of America had set a record by agreeing to pay $10m fine to the SEC for failing to retain documents.

Not surprisingly, regulation is often regarded as among the key challenges facing the banking industry today. In fact, regulatory overkill was identified as the greatest risk facing the financial sector for the second year running by the annual 'Banana Skins' survey conducted by the CSFI (Centre for the Study of Financial Innovation), a London based non-profit think tank, in association with PricewaterhouseCoopers. Respondents from 60 countries said that too much regulation was endangering the financial health of banks with its cost burden and distractions, as they did in the 2005 survey. But this time, many of them added their concern about growing political interference by governments seeking to influence banks' behaviour and obstruct free markets. John Hitchins, UK Banking Leader at PricewaterhouseCoopers LLP, said, "The financial sector is again throwing down a challenge to the regulators as to whether they have the right balance of cost and benefit."

According to a report published by the UK Financial Services Authority (FSA), the UK financial services industry spends about £600 million a year dealing with regulatory red tape. The study which was commissioned in response to growing business complaints about the rising tide of regulation found that money laundering rules account for by far the largest single set of administrative burdens on the UK financial services industry, accounting for around 40 percent of the total estimated cost. Regular reporting rules were also found to be a significant drain on management time and resources.

Regulatory snapshot

Despite ongoing concerns about the bugbear of regulation and the subsequent costs imposed on the financial industry, it is universally acknowledged that regulation is essential in today's world. Some drivers for regulations include the rise of global terror links, accounting scandals and other operational issues. The following section highlights some of the key areas of regulation faced by the banking industry.

Ensuring macro-economic stability

With memories of the economic meltdown in countries like Japan, Indonesia, Mexico and Brazil still fresh, one of the main rationales that regulatory agencies use to justify intervention in markets is prevention of market failure. Many banks as a result of this meltdown suffered heavily which resulted in some of these banks either being wound up or become targets for cheap acquisition and mergers. The entire episode helped emphasize the importance of good lending norms, a reliable customer base and proper mix of different segments in the lending portfolio. These norms along with stringent risk management policies are often mandated by most central banks globally.

Risk management is a key factor in assessing the future performance and condition of a bank and management effectiveness. In this regard, disclosures may include discussions of overall

risk management philosophy, risk methodologies, sources of risk, risk identification, risk quantification, risk management, and risk control. It may also be useful to discuss the risk management structure, risk measurement and monitoring, performance testing, use of risk-mitigating tools, online limits monitoring and tracking and review of exposures.

Countering terrorism

The Financial Action Task Force on Money Laundering (FATF), is an inter-governmental body founded in 1989 by the G8. The purpose of the FATF is to develop policies to combat money laundering and terrorist financing. The primary policies issued by the FATF are the Forty Recommendations on money laundering and the Special Recommendations on Terrorist Financing which set the international standard for anti-money laundering measures and combating the financing of terrorism. Both sets of FATF Recommendations are intended to be implemented at the national level through legislation and other legally binding measures.

"Risk management is a key factor in assessing the future performance and condition of a bank and management effectiveness."

The current (2003) Forty Recommendations require states, among other things, to implement relevant international conventions, criminalise money laundering and enable authorities to confiscate the proceeds of money laundering, implement customer due diligence (eg: identity verification), record keeping and suspicious transaction reporting requirements for financial institutions and designated non-financial businesses and professions, establish a financial intelligence unit to receive and disseminate suspicious transaction reports, and cooperate internationally in investigating and prosecuting money laundering.

One of the regulations targeted at countering terrorist money networks is the USA PATRIOT Act. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, commonly known as the USA PATRIOT Act is one of fastest executed Acts in US history. The Act was passed in the aftermath of the September 11 attacks in 2001, and places responsibility on banks and financial institutions to take utmost care in carrying out banking transactions. Further, the regulation requires financial institutions covered by this Act to share information to deter money laundering and terrorist activity, maintain financial records and report currency and foreign transactions, institute anti-money laundering programs and conduct due diligence programs for correspondent accounts of foreign financial institutions and private banking accounts for non-US persons.

Customer identification

Know Your Customer (or 'KYC') is the due diligence and bank regulation that financial institutions and other regulated companies must perform to identify their clients and ascertain relevant information pertinent to doing financial business with them. Typically, KYC is a policy implemented to conform to a customer identification program mandated under FATF and USA PATRIOT Act. Know your customer policies have in fact become increasingly important globally to prevent fraud, money laundering and terrorist financing. One aspect of KYC checking is to verify that the customer is not on any list of known fraudsters, terrorists or money launderers. Beyond name matching, a key aspect of KYC controls is to monitor transactions of a customer against their recorded profile, history on the customers account(s) and with peers.

Ensuring transparency

In response to major corporate and accounting scandals such as Enron and WorldCom, there is a growing need for transparency and greater disclosures. In the US, the Sarbanes Oxley (SOX) Act was instituted which established new or enhanced standards for all U.S. public company boards, management, and public accounting firms. SOX is also applicable to banks and financial institutions that have raised funds from the US capital markets or have branches or representative offices within the US. Some of the key features of SOX are the requirement of certification of financial reports by CEOs and CFOs, real-time disclosure by public companies and audit independence.

To ensure transparency for banks, the Bank for International Settlements (BIS) has also identified six broad categories of information, each of which should be addressed in clear terms and appropriate detail. This includes financial performance; financial position (including capital, solvency and liquidity); risk management strategies and

practices; risk exposures (including credit risk, market risk, liquidity risk, and operational, legal and other risks); accounting policies; and basic business, management and corporate governance information.

Role of technology in managing regulatory requirements

To comply with the ever increasing set of regulatory requirements, banks need to effectively increase their effort and make investments in both skilled personnel and technology to reduce any potential risks that may arise because of non-compliance. They also need to develop mechanisms to assess and analyse compliance requirements such that they can reduce their risk exposures and to protect themselves from potential losses.

"Banks need to effectively increase their effort and make investments in both skilled personnel and technology to reduce any potential risks that may arise because of non-compliance."

- To meet KYC norms, every customer acquired by a bank should be analyzed for the background, nature of business, credit rating, customer's previous financial records, financial history, and relationship with existing customers in the bank. The system capturing such information should be able to trigger and guide the user and the concerned persons about such information and raise alarms and alerts to handle the same. It should support customer identification, provide alerts for black-listed customers and defaulting customers and monitor customer accounts for abnormal behavior.
- Technology has a major role to play when it comes to addressing the requirements of 'anti money laundering' and 'preventing terrorist financing' as suggested by FATF. The systems should be able to analyze and report all suspicious transactions and there should be controls to prevent such transactions. The system should be able to detect and report on a continuous basis so that the banks can take corrective actions accordingly.
- Areas such as credit risk and default risk can be effectively managed by technology solutions that monitor and track all borrowed accounts. These systems should provide support for online and real-time monitoring of funds utilization and the real-time valuation of collateral along with report overdues. The system should also support automatic classification of assets based on the bank guidelines. Once classified as non-performing, the system should keep track of all transactions in that account, further the system should support prudent income recognition norms prescribed by the regulatory authorities.
- Though it is considered as one of the risk management tool and many central banks have placed greater importance for an effective Asset Liability Management (ALM) system within banks, not many banks have realized the importance of an ALM system. It is impossible to manually keep track of all the inflows and outflows in any bank, the size also adds to the complexity which necessitates a proper system to be in place for managing liquidity risks, interest rate risks. Technology has proved very effective in this area since banks are thrown with many choices. Today ALM systems not only handles the required cash flows, but are also capable of analyzing the trends in such flows, alerts on mismatch and triggers on stressed buckets among others.
- Solutions to ensure operational risk management are essential in any bank today. There are many instances to show how organizations have collapsed due to the absence of better operational risk management tools. Operational risk management takes on greater significance since banks deal with public money. To control operational risk, your banks should maintain a system of comprehensive policies and a control framework designed to provide a sound and well-controlled operational environment. The technology solution should be based on a recognized and approved internal controls framework and help track important risk management metrics▪

Rajashekara V. Maiya
Product Manager
Finacle

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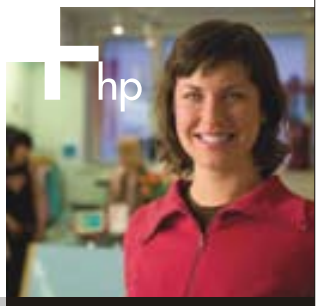

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Inside Talk

Technology Enabled Business Excellence

Nationwide is a mutual building society* owned by its members and a major provider of financial services in UK. Its total assets exceed £120 billion, making it the world's largest building society and among UK's top 10 retail banking, savings and loan organizations. Notably, Nationwide, which provides services through around 870 outlets, is the fourth largest mortgage lender and the third largest savings provider in Britain. In 1997, Nationwide pioneered internet based retail banking in the UK and today has over 2 million registered customers. It is also rated highly for its employee commitment and focus. The firm has consistently been ranked among the top in the Best Big Companies to Work For list produced by The Sunday Times newspaper and the UK Department of Trade and Industry.

In a wide ranging discussion with Rekha Menon, FinacleConnect's research and contributing editor, Arthur Amos, Nationwide's head of IT planning and governance, talks about the key challenges facing financial institutions in the UK, impact of regulation and Nationwide's technology strategy. A financial industry veteran, Amos has been with Nationwide for nearly 30 years. Prior to his current role, he was head of technology infrastructure at Nationwide.

Arthur Amos
Head of IT Planning and Governance at Nationwide

*A **building society is** a financial institution, owned by its members, that offers banking and other financial services, especially mortgage lending. The term building society first arose in 19th century Britain from working men's co-operative savings groups: by pooling savings, members could buy or build their own homes. In the UK today, building societies actively compete with banks for most "banking services" especially mortgage lending and deposit accounts. There are currently 63 building societies in the UK with total assets exceeding £260 billion.

"We have always had a strong IT function, and it is becoming increasingly apparent how key IT is to overall business success."

Q **What are the main challenges facing banks and building societies in the UK today?**

A The challenges faced by building societies are similar in nature to that faced by high street banks today. Essentially, any financial institution targeting the retail customer needs to offer services, round the clock, 365 days a year. As customers become increasingly sophisticated, they need to be serviced through a variety of delivery channels in a real-time mode. At Nationwide for instance, we offer banking services through the ATM, telephone, branches, and the Internet.

The challenge today is to move commoditized transactions from branches to self-service channels. This is difficult because in the UK we have a history of face-to-face interaction with customers. We also need to tailor products to each customer's specific requirements and develop new products quickly to meet customer demands. Other issues facing the industry today are legacy systems and regulation.

Q **What key regulatory requirements do banks need to focus on?**

A Over the past two years, regulations on the mortgage sector, general insurance and those such as Basel II have created a big overhead for the industry. And this will only grow in the future. Also, while regulations like Sarbanes Oxley does not affect us directly, we are seeing an overall increase in the emphasis on corporate, operational and IT governance and risk management for all financial institutions.

Q **How much do you estimate is the overall cost of regulation for financial institutions?**

A While it is difficult to put a straight figure on the cost of regulation, I can say that today virtually every part of our business, from IT to retail banking, is impacted by regulations. In the normal course of business, even without the current regulatory diktats, we would have deployed some of the processes and tools we are implementing now, but there are certain areas where we have had to specifically invest in due to the regulations. Obviously, the IT budgets get affected because of this. For instance, a couple of years ago, most financial institutions we spoke to, had focused all their discretionary IT budgets on Basel II and mortgage regulations.

Q **Do you see the burden of regulation obstructing innovation?**

A Not really, but it certainly makes our work more complex. Additionally, we need to balance compliance requirements with it not becoming too difficult to do business for our customers.

Q **You mentioned obsolete technology being a challenge for the industry. How can the problem of legacy applications be resolved?**

A Most high street banks and building societies in the UK suffer from legacy applications. The problem is exacerbated in the case of mergers and acquisitions. Legacy applications are inflexible, less agile and not suited to dynamic changes. With these applications it becomes more difficult to meet regulatory requirements and since they were mostly developed in-house, there are often fewer people who know the system inside out.

Financial institutions therefore need to simplify their complex IT infrastructures. Complexity leads to errors and higher costs. Additionally, they need to partner with third party vendors to assist in deploying new-age technology.

At Nationwide, we have long used third party packages, now we are partnering with system integration firms for support and migration purposes. However, some of our systems are still very old. Like most financial institutions, our core systems were built in the 1970s. We are in the process of evaluating options to modernize and replace them.

Q **What is Nationwide's technology strategy?**

A At Nationwide, we have a relentless desire to automate as much of our customer interfaces and in-house administrative work. This is important to meet our growth plans. For example, if we want to grow our mortgage business, rather than utilizing more people, technology should scale up to help us manage the growth in business volumes.

Our strategy also focuses on technology enabled business excellence. While our systems work very well, some are not very user friendly. Our new systems need to be designed so that they are easy to use for both our employees and customers.

Technology is critical to Nationwide's future plans. We have always had a strong IT function, and it is becoming increasingly apparent how key IT is to overall business success▪

UNION BANK OF THE PHILIPPINES
DRIVING LOWER TCO WITH LEGACY REPLACEMENT

UNION BANK OF THE PHILIPPINES (UBP) - A PROFILE

UnionBank is a partnership among the Aboitiz Group, Insular Life and Social Security System. It started operations in 1981 and became a commercial bank by January 19, 1982. In July 1992, UnionBank was granted the license to operate as a universal bank. The bank acquired the International Corporate Bank (Interbank) in 1994. In the Philippines, it is ranked amongst the top 10 banks and stands out for its strategy, execution and performance. While many banks went for size and market share via large balance sheets, UnionBank has followed a highly focused differentiation strategy that emphasizes innovation and service. It has put technology at the heart of its business. Information and network access are at the core of UnionBank offering. As of 2005, it had 111 branches and handled about 250,000 transactions a day.

Case Study

"The project was envisaged to be the first 'big bang' implementation in the Philippines market, in which all 111 branches would go live in around 11 months from the start of implementation."

KEY BUSINESS DRIVERS

Business agility and speed of innovation

The key drivers for UBP to initiate this migration from legacy systems to a new-generation technology was to attain business agility and become more responsive to its ever demanding customers. The new system was expected to help them innovate rapidly in a highly competitive market place and differentiate themselves.

Need to grow

UBP wanted to increase its market share and acquire new customers more rapidly than before. And the only way to achieve this was by offering differentiated products and services, at attractive overall costs.

Lower costs

UBP realized that while migration is very critical, it cannot be at a very high cost. TCO was a very important factor and the cost of moving to the new technology had to be lower than continuing with the mainframe-based legacy system.

UBP - FINACLE PARTNERSHIP

UBP was the first amongst the top tier banks in the region to move from a legacy mainframe platform to open standard UNIX platform and a new-generation core banking solution. The earlier back-office engine was Systematics, running on refurbished mainframes. UBP chose Finacle core banking solution from Infosys to replace its mainframe based legacy system. The project was envisaged to be the first 'big bang' implementation in the Philippines market, in which all 111 branches would go live in around 11 months from the start of implementation. The complete retail operations were to be handled out of Finacle (CASA, Loans, Deposit and GL) from day one. In a market, which has generally seen a phased out implementation of these retail modules, this project was a milestone that was certainly one of the most watched out for.

Highlights of the project

- The first "Big-Bang" Finacle core banking implementation for over 111 branches in the Philippines.
- A bank-wide consolidation of general ledger in Finacle from other systems like Opics treasury system, TFS trade finance system, CardPAC credit card system, home-grown trust system etc.
- Finacle had an interface with all delivery channels of the bank like ATMs (Base24), Corporate and Retail Internet Banking and Megalink inter-bank ATM network.
- Highly transacted with 700 users logging on to Finacle, concurrently, every day.
- 40% of all daily transactions were utility bill payments, handled through a customized bill payment module in Finacle.
- Highly user-friendly system with 90% of front-office operations done through Finacle, using a browser.
- A high degree of efficiency with End of Day (EOD) brought down to less than 3 hours.

SOLUTION OVERVIEW

Infosys identified all the applications on the mainframe and proposed viable alternatives for all the existing systems. This was a key component of the proposed solution, which gave the bank an investment proposal that would clearly justify a case for moving out of the mainframe with a clear TCO advantage over a five-year period. Finacle's architecture also enabled the bank to completely do away with the branch IT infrastructure which proved to be a big advantage. The evaluation process also comprised of a detailed solution walk-through that helped highlight the limitations of the existing legacy system and bring out the key solution benefits of Finacle in the following areas:

- Unified Customer Information File (CIF)
- Integrated front office and back office system
- 24X7 banking
- Integrated channel connectivity
- Time-to-market advantage

> *"With the replacement of its legacy solution with Finacle, the bank would be able to get, over a five-year horizon, an estimated 15% reduction in overall costs."*

Over a brief five-day gap analysis, Infosys was able to bring out key process improvements in the areas of CIF, accounts management, limit monitoring, tracking and collection of charges, customer services and a host of new product offerings, besides the standard USPs. This along with significant process improvements over their current practices and a clear advantage in terms of ROI presented the bank with a very strong business case to go ahead with replacement of their legacy system.

Finacle solution highlights

- Localization of the solution
- Interface to the clearing house - prompt payment discount, bill payment at the branches, withdrawal tax collections etc.
- Local signatures without going for local branch server
- Product enhancements & customization
- For clearing purposes, auto loans and parri passu loans
- Customization to support utility bill payments for various types of billers
- Customization in the area of payroll accounts
- Strategy to support both dollar and Peso bookkeeping
- Xtensibility tool kit used to ensure easy account opening and maintenance purpose
- 120 central bank reports designed and included into the solution which the bank has been able to use effectively from day one

REAPING THE BENEFITS

TCO

Total cost of ownership was a clear driver for the bank to go ahead with the core banking replacement. With the replacement of its legacy solution with Finacle, the bank would be able to get, over a five-year horizon, an estimated 15% reduction in overall costs. The Bank is projected to be able to reduce its hardware maintenance costs by 46% over a five-year horizon.

Process efficiencies - enhancing ease of doing business

The migration helped UBP achieve many process efficiencies and helped streamline its business enabling it to be more responsive to its customers. Processes which were earlier manually done were transformed to an online mode, thus saving on effort and time on charges, reconciliation between GL to sub-GL, limits monitoring, clearing etc. One of the major enhancements in process efficiency was the reduction in time-to-market for new products.

The joint project coordination between Infosys and Union Bank's core team helped to streamline processes, and ensured ease of doing business with the customers of Union Bank. This joint effort ensured that project timelines were on-track and deliverables were adhered to, strictly making this challenging implementation a success in the budgeted timeframe▪

View from the Top

"With this migration from legacy to the Finacle solution, we will be able to cut our technology costs by about 15%. The solution itself will reduce the overall costs of scaling up and as we grow larger, costs will come down. Apart from reduced costs, the solution will also help us focus on individual needs of our target customers. Union bank will move from being a product-centric bank to a customer-centric bank with this migration"

"Our old mainframe technology had prevented us from offering new products and services because it was proprietary, hence, could not run other applications from other vendors unlike the present open-systems based solution Finacle from Infosys"

Justo Ortiz
Chairman
Union Bank of the Philippines

View Point : UK Banking Industry

The UK banking sector, which is the third largest in the world after the US and Japan and the largest in Europe, is regarded among the most efficient and dynamic in the world with UK banks having a higher return on capital than most other advanced economies. Currently the banking sector cost-effectively services nearly 95 percent of the population and employs over 1 million people, around 3.5 percent of the total UK workforce. The past decade has been a period of rapid growth. At the end of 2005, assets and liabilities of the UK banking sector touched £5526 billion, over three

times the total in 1995. Bank lending in the same period more than doubled to reach £3284 billion, while the outstanding value of deposits in UK banks reached £4984 billion at end-2005, more than double the 1997 total. It is estimated that the financial sector's productivity is increasing at a rate of three times to that of the UK economy and accounting for a steadily increasing share of the UK economy and GDP growth. Last year, banks and financial services contributed £70 billion to the country's national output, which is equivalent to nearly 7 percent of the country's GDP. This is a 100 percent jump from 2003, when the UK banking industry contributed around £35 billion to the economy. Further, along with having one the largest commercial banking industries, the country is a major international centre for investment and private banking. It is the world's largest centre for cross-border banking, accounting for one-fifth of global international lending last year, and banks in London handle a third of the world's total foreign exchange business.

Top 10 Industry Facts

- Banks and financial services provide over 1m jobs
- Banks and financial services contribute £70bn to the UK's national output (6.8% of GDP)
- Banks and financial services provide 25% of total corporation tax (£8bn) to the UK Government
- The main retail banks provide over 125m accounts, clear 7bn transactions a year and facilitate 2.3bn cash withdrawals per year from its network of over 30,000 free ATMs
- Banks provide cost-effective banking services to 95% of the UKs population
- In 2005, 24m personal customers registered to access their bank accounts online, while 42 million are registered to access their accounts by telephone
- Since April 2003, banks have opened a net total of 1.8m Post Office-accessible basic bank accounts
- Banks in the UK contribute well over £100m per year to charities and local community initiatives
- Five UK banks are in the top 15 firms listed in the DTI's recent 2006 Value Added Scoreboard of Wealth Creating Companies
- The value of foreign exchange business passed through London every day is £560bn ($1 trillion)

Source: British Bankers Association (BBA)

Deregulation, Competition and Consolidation

The past few decades have seen a radical transformation in the UK banking industry. Before the 1980s, banks, building societies, insurance companies and other financial firms operated in discrete silos. While building societies dealt with mortgages and banks offered deposit and money transmission services, insurance companies focused only on insurance products. However, deregulation has ensured that the boundaries between financial institutions have been redefined. The Building Societies Act of 1986, for instance, permitted building societies to offer a much wider range of financial services, including insurance and allowed building societies to convert into banks. Abbey and Halifax are examples of building societies that demutualised into banking entities as a result of this legislation. Life insurance firms too moved into banking and banks in the meanwhile diversified into other domains such as mortgages and insurance. More recently retailers like Tesco and Sainsburys have entered the banking space.

Market liberalisation has therefore ensured intense competition in the UK retail banking space. While on the one hand it has enabled retail banks to develop into financial supermarkets offering a vast range of financial products outside their core deposit and lending activities, it has allowed erstwhile building societies, insurance firms and retailers to develop banking products that compete with the banks.

Mergers and acquisitions has been the other transformational force in the UK banking industry. Till the late 1960s, retail banking in England was dominated by the 'big-five' of those days, Barclays, Lloyds, Midland, National Provincial and the Westminster Bank. Only two of those names are visible today, the others have either merged or been acquired. While Midland Bank was acquired by Hongkong and Shanghai Banking Corporation to create the current HSBC, National Provincial merged with National Westminster and was later acquired by Royal Bank

of Scotland. In the meanwhile Halifax and the Bank of Scotland merged to form HBOS. Recently, in Europe's biggest cross-border banking deal, Abbey was acquired by Santander Central Hispano of Spain. Further, banks diversification into new product areas has resulted in a number of cross- sector mergers, where banks are beginning to acquire life insurers. Examples of cross-sector mergers include the acquisition of Scottish Widows by Lloyds TSB and of Scottish Provident by Abbey National.

All this has ensured that while the total number of UK owned banks has declined (out of the 400 odd banks operating in the UK, less than 100 are UK-owned, a 40 percent drop compared to a decade ago), there has been an increase in the average size and financial strength of banks in the UK. The number of building societies, which account for around a fifth of personal deposits and mortgages in the country, too have decreased primarily due to mergers and also because a number of the larger building societies converted to banking entities. In 2005, there were 63 building societies, down from 80 in 1995 and 167 in 1985.

The largest banks in the UK are currently the major high-street banks, namely HSBC Holdings, Royal Bank of Scotland, HBOS, Barclays Bank and Lloyd's TSB Group. These banks dominate the UK current account market and account for over half of credit cards and personal loans. Building societies on the other hand account for around half of the mortgage market.

Technological Developments

As with other parts of the world, technology has had a tremendous impact on the UK banking industry. According to research firm Datamonitor, UK leads Europe in IT spending in banking and will maintain its lead until at least 2008. The research firm suggests that spending on technology by banks in the country will hit USD 23 billion in 2006 alone. From 2004 through 2008, the compound annual growth rate (CAGR) of IT spending by UK banks is 8.1%, it adds. Datamonitor analyst William Conner, says the emergence of e-banking technology is the biggest single factor driving the growth in European banks' IT spending and the online channel will remain the top channel in terms of IT investment growth in 2006. Over half of British adults now use online banking services to manage their finances, according to research commissioned by the UK's Alliance and Leicester. A survey of 2395 UK adults conducted by research firm YouGov found that two thirds (61percent) are using Internet banking a lot more than they did two years ago, with 12 percent using the services once a day.

Most banks prefer to follow a multi-delivery channel strategy providing customers access through the internet, ATM and call centres. Between 1994 and 2004, the ATM network in the UK has doubled to reach over 50,000. Branches too continue to remain in fashion. A study released by Forrester Research last year shows that over half of UK customers still visit a bank branch each month and British consumers are among the most frequent branch visitors in Europe, with 55 percent of the 2000+ customers surveyed visiting a branch monthly, mainly for routine tasks like depositing cheques and withdrawing cash. And while there has been an overall decrease in bank branches over the past decade, banks like Abbey are planning to open new branches, and several banks are investing in upgrading their existing branches both in terms of redesigning them and investing in new branch technology. According to news reports, Abbey is planning to open 100 new bank branches over the next 10 years, Barclays Bank is currently undertaking a major revamp of 1500 of its UK branches while Alliance and Leicester (A&L) is introducing a number of new concept branches which are designed to encourage customers to use direct banking services in the branch.

Along with delivery channels and branch automation, areas that are seeing an increase in technology investments are multi-channel integration, regulation, security, risk management and customer relationship management. Core banking however is an area where technology investments have been lacking till date. Most banks and building societies in the UK are saddled with legacy core banking systems that were developed way back in the 1960s and 70s. And despite the fact that such obsolete core banking systems reduce the

overall agility and flexibility of banks and pose a risk as well, banks have been reluctant to upgrade their age old solutions due to the inherent complexity of a core banking replacement exercise. As a result, one of the biggest challenges faced by banks in the UK is speed of launching new products. Industry experts estimate that banks can take anywhere upwards of 9 months to design and launch a new product – far too long by any standard.

However, the situation is expected to improve. Over the past 12 months or so, there has been an increase in urgency and effort amongst UK banks to evaluate potential solutions to resolve the issue of legacy systems. While the increasing global awareness of the risks posed by legacy solutions has certainly contributed to this, competition too is playing a key role. After acquiring Abbey, Spain's Banco Santander is in the process of replacing Abbey's exisiting legacy systems with its own modern Partenon core banking platform. Recently Abbey announced that it has hit the first milestone in the rollout of Partenon with the launch of new corporate Intranet and Internet services. The Partenon platform is being introduced at Abbey in phases through 2006 and 2007. Abbey says there are a number of further developments coming later this year, including the introduction of a single customer database.

In stark contrast to legacy core systems, a modern core banking solution provides banks with a flexible, componentized solution that can enable them to launch new products within a matter of days. There are other obvious benefits that are difficult to ignore. Francisco Gomez-Roldan, CEO, Banco Santander, says: "We're introducing better analysis and information on product profitability, sales capacity and productivity by channel, region and branch. This approach is enabling us to focus our efforts on reducing under-performance, targeting incentives and managing performance across the business more rigorously."

Conclusion

The UK banking industry has been experiencing rapid growth over the past decade and is poised to grow further. In an era of mergers and acquisitions, competition is much more intense today than even a few years back. This is only going to increase in the coming years. A 2005 study by AT Kearney predicts that the 20000 banks currently operating in Europe will decline by about one-third within the next five years and by more than two-thirds within the next 10 years. To compete successfully, meet regulatory requirements and satisfy customer needs, banks need to invest in technology not only in deploying peripheral applications, but also in modernizing obsolete core solutions.

Sanat Rao
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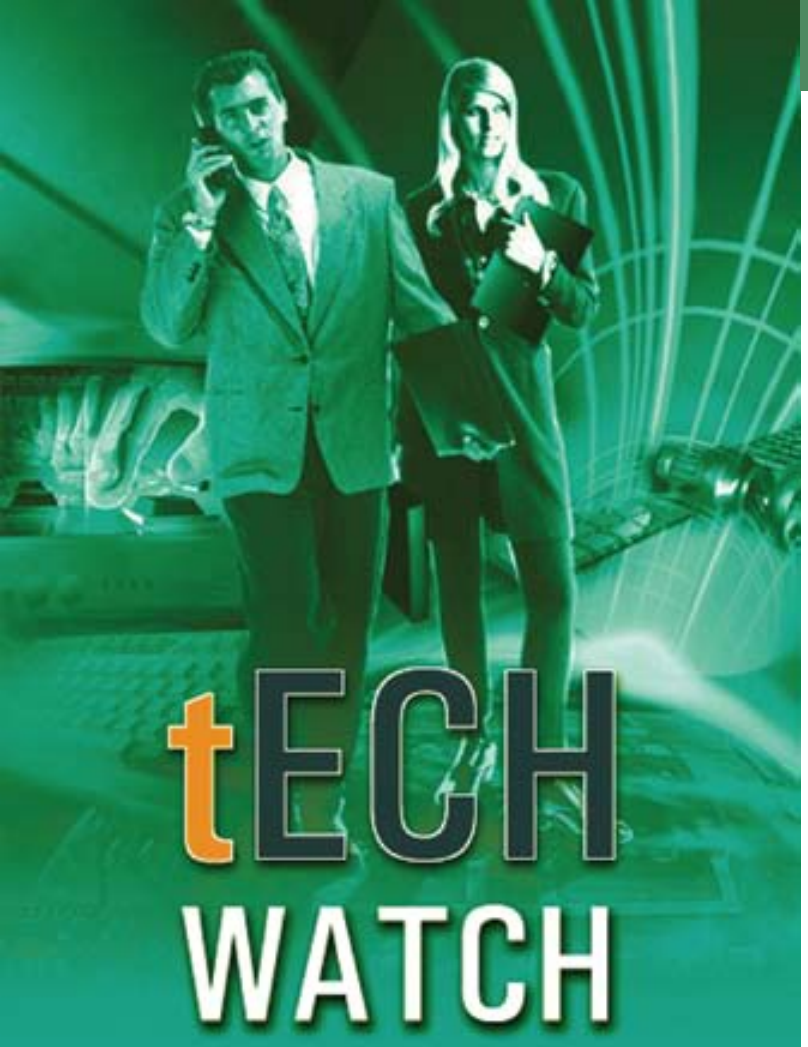

OPERATIONAL DATA STORE

ODS : CONCEPT TO REALITY

Growing competition and the search for niche markets for optimal return on shareholder's funds have forced banks to undertake multiple levels of analysis on their operations. These detailed analytics, be it on customers, transactions or financial information, have forced banks to look for software tools and applications beyond their core operational data processing engines.

Initially, it was felt that implementing large data warehouses could solve the problems of data analysis and analytical reporting at banks. Major banks therefore started investing heavily in technologies and developing enterprise wide data warehouses to capture and store data from their multiple legacy operational systems. But these data warehouses were mostly non-integrated and worked like 'information spider webs'.

Challenges of an Enterprise Data Warehouse

After the initial euphoria of having an enterprise wide data warehouse settled down, banks felt that these big data warehouses should be broken into small subject oriented data marts that could provide business users with focused and easy to use applications. Additionally, these data marts could help ensure security and maintain the confidentiality of data. However, the main requirement was lost in the process since most major banks either invested too heavily in big enterprise wide data warehousing projects where the turn around time was very long or focused on business division/sector wise small data marts to solve specific analytical problems. The whole approach was implemented either at a mega scale or with a siloed focus without the provision to get a fully integrated picture.

The need of an integrated metadata and data storage structure was felt very strongly.

Another concern, which emerged, was the long time it was taking to process, analyze and generate reports on a daily basis of the data extracted from the OLTP (online transaction processing) systems. It was therefore becoming very difficult to convince business managers to wait an entire week to get reports, which were critical to interact with the customers on a real-time basis and ensure quick decision making.

Operational Data Store (ODS)

In recent years, data warehouses have started becoming operational in nature with a flavor of warehouse data that is both current or almost current and static as well. Banks are trying to maintain data in two ways. One is more static in nature for daily reporting requirements, while the other, also called an operational data store (ODS), is more dynamic, offering a current view of data for immediate reporting and analysis requirements.

Since this ODS lies within the enterprise wide Data Warehouse (DWH), it is very easy to integrate it with the other components of the warehouse. Essentially, an ODS is required to store transactional level data in the most granular form for any application. Wherever transaction level data is not readily available; the application should be able to create pseudo transaction data to build balances if required. Also, to ensure better querying and reporting requirements, this transactional data can be stored in a dimensional way. Figure 1 shows the basic structure of an ODS.

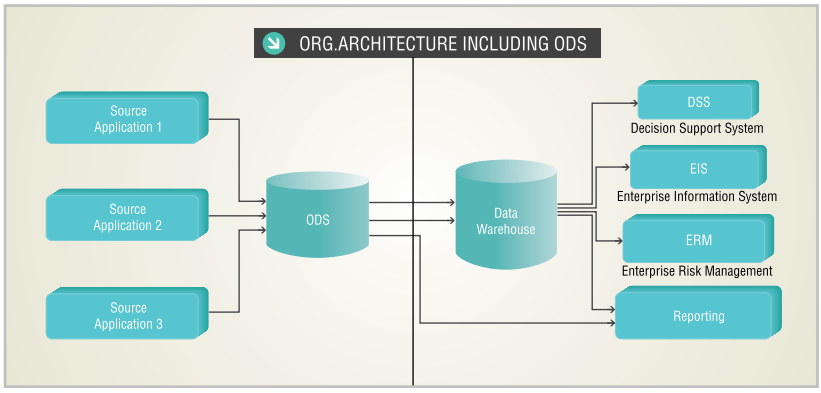

Fig1: Basic structure of an ODS

Difference between ODS and DWH

One of the key challenges in a data warehouse is to extract data from multiple non-integrated systems to a defined single space, all the while ensuring linkages between data elements such as customer, transaction, account and other dimensional data. By providing a foundation to integrated operational results, the ODS easily helps resolve this challenge and is often regarded as a common link between banks' operational systems and the data warehouse. However, it is always advisable to have a clear distinction between the ODS and the DWH decision systems. While the DWH should store only historical data, the ODS needs to be more current in nature. It should be designed to rapidly update data so as to provide snapshots in an online, real-time environment.

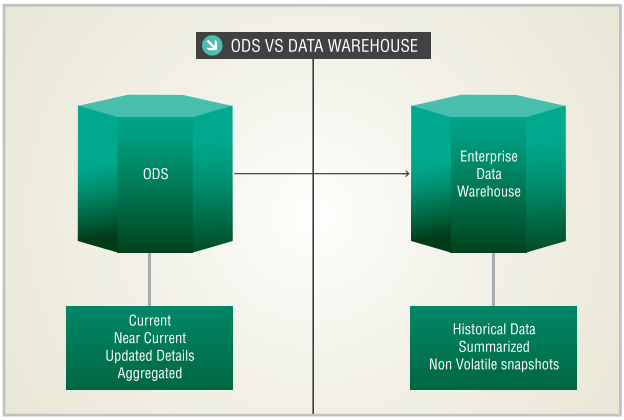

Fig2.: The Different Environments of ODS and DWH

There is also a marked trend towards keeping both the ODS and warehouse in the same place as the interchangeability is very thin. Often, to avoid investing in technology to develop an ODS, banks end up using the old warehouse for operational reporting requirements as well. However, it needs to be remembered that at the technology front, both the ODS and DWH need different architectures. While the ODS needs 'update and record' oriented functionality, the warehouse requires a 'load and access' oriented functionality.

An important recent trend is of keeping some functionalities of a DWH in the ODS, such as summary or aggregated data for easy and fast query. Although it is very difficult to have both current and summary data stored in an ODS, this helps to meet quickly and easily, different requirements from the same place. However, as the ODS data gets regularly updated, it is important to realize that the accuracy of the summary data in an ODS is only for the specific point when it is accessed. So compared to a DWH, the reconstruction of same balances in an ODS will be difficult.

Essentially, the ODS derives some of its essence from

that of a data warehouse with certain key differences. An ODS can be defined as an application that enables any institution to meet its operational data analysis and processing needs. The key features of an ODS are as below:

- Subject oriented
- Integrated
- Volatile - updated data
- Near time or current time data

Notably, it is the last two points that differentiate an ODS from a warehouse.

When we say an ODS needs to be subject oriented, it means that the basic design should cater to specific business areas or domains for easy access and analysis of data. It will be easier to store data in sub segments like customer, transaction and balance with an inter linkage between all the segments. That brings the requirement of using a common key for all data files to establish the linkage. Along with using the key, aggregation of data for certain time blocks as discussed above, it will also be helpful for easy and fast recovery of query results.

The following key functions are generally required for a successful ODS

- Converting data
- Selection of best data from multiple sources
- Decoding/encoding data
- Summarizing data
- Recalculating data
- Reformatting data and many more.

Apart from changes in the structure of an ODS in terms of handling large volume volatile transactional data from multiple sources with a scope of aggregating them as well, there are also infrastructure related changes happening today. While the basic technology of loading and processing high volume data remains the same, when the system of records changes a little, the impact on the ODS can be very significant and has to be managed very carefully. Therefore, even if the system of records may comprise a very small portion of the system, it should be ensured that the underlying infrastructure is able to handle high volumes at all times.

Metadata

Though commonly defined as "data about data", metadata is an integral part of any data warehouse. The usage of metadata in an ODS is also increasingly being used for ease of use by the business user. It allows the user to look in the correct place for the required data thereby reducing query times and increasing performance to some extent. Metadata in the ODS identifies the following,

- The system of records in ODS
- The data elements in ODS
- The transformations made to the data
- Relation between multiple ODS

How to start building an ODS

It is advisable to start building a subject-oriented small ODS in the first place with customer centric activities and transactions. Later, with integration in mind, other subject areas can be added.

Conclusion

Although there are many similarities between a data warehouse and an ODS and it is often difficult to differentiate between them, there is a specific need for an ODS in banks today where large volume of data is required to be processed in a fast and accurate manner to support the operational data reporting and analytical needs of the organization. As ODS contains specific data required for a set of business users, it helps in reducing the time to source information and with the added functionality of summary or aggregated data, it will definitely be an important element in any large bank's IT systems infrastructure▪

Basudev Banerjee
Senior Consultant- Product Management Group
Finacle

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TDWI Articles on ODS

"There is a specific need for an ODS in banks today where large volume of data is required to be processed in a fast and accurate manner to support the operational data reporting and analytical needs of the organization."

Infosys in the news

Infosys celebrates 25 years

Infosys celebrated its 25th Anniversary Celebrations on July 30 with a spectacular event at its Mysore campus. Inspiring speeches by the Finance Minister of India, Mr. P. Chidambaram, and Infosys Chief Mentor Mr. Narayana Murthy made this a truly memorable occasion. On Monday, July 31, Infosys became the first company in Asia to remotely ring the NASDAQ Opening Bell from India, in celebration of its 25th anniversary. The event was telecast live on the NASDAQ Market Site Tower in Times Square, New York.

Infosys first quarter revenues up 38.7%

Infosys Technologies Limited announced financial results for its first quarter ended June 30, 2006. Revenues for the quarter aggregated $ 660 million, up 38.7% from $ 476 million for the quarter ended June 30, 2005. Net income was $174 million ($ 122 million for the quarter ended June 30, 2005). 38 new clients and 8097 new employees were added during the quarter.

Waters ranks Infosys among top three outsourcing services providers

Infosys is among the top three outsourcing services providers to the financial services industry, according to the fourth annual Waters rankings. More than 500 readers from six continents voted for this year's winners in 23 categories, including "Best Outsourcing Provider". Interestingly, Infosys is the only offshore player in the list which includes Accenture, IBM and EDS.

Finacle – The Universal Banking Solution from Infosys

Recent Wins

- **United Bank of India** headquartered in India licensed Finacle to power its centralized core banking initiative. The Bank has chosen to deploy Finacle core banking solution and aims to leverage new generation technology to differentiate its value proposition in retail banking and manage the rapid growth in scale of operations.
- **One of the largest financial institutions in the Caribbean** has selected Finacle as they embark on leveraging electronic delivery channels aggressively. The bank will deploy Finacle consumer e-banking and corporate e-banking solutions.

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Finacle achieved a significant milestone in this quarter with State Bank of India (SBI) completing the roll out of Finacle across all its international branches. This quarter, its operations in China, US and Oman have also gone live. With this, Finacle has been successfully deployed across SBI foreign offices in 20 countries within 24 months.

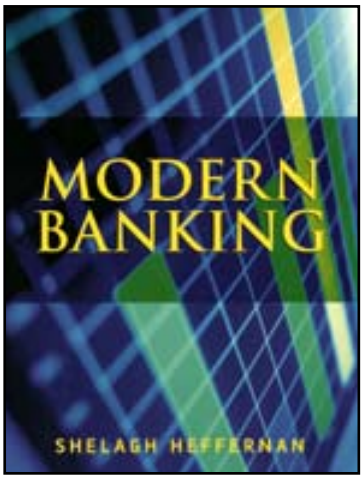
Customer Speak:

"We have chosen Finacle because we believe that it offers a new generation platform and the lowest risk to us in this strategic initiative. We are delighted to partner with Infosys and look forward to growing our customer base and enhance our productivity leveraging Finacle. "

Andy Deller,
CEO - Dunbar Bank
A Part of Zurich Financial Services Group

Shelagh Heffernan

MODERN BANKING



The banking industry is so vast and complex that most books on banking usually restrict themselves to specific banking disciplines or key trends. It is therefore a welcome event to see a book focused on the entire banking industry as such. *Modern Banking,* authored by Shelagh Heffernan, a professor of banking and finance at the Cass Business School in City University, London, is among the rare books that manages to provide a wholesome perspective of the banking industry right from the theory to more practical and relevant aspects of banking.

Modern Banking begins with a review of fundamental concepts like what differentiates a bank from other financial institutions, the various types of banks within a banking structure, commercial banks, merchant banks, investment banks and the role of central banks. According to Heffernan, a bank undertakes two core functions which singles it out from other financial institutions, the provision of intermediary and liquidity services. A bank offers loans and deposit products on the market and caters to the changing liquidity needs of its borrowers and depositors. Often, a by-product of these core functions is the provision of payment services. And given that banks' core activities involve money, it also means that banks play a special role in the monetary economy with their activities affecting the overall money supply in the countries where they operate. The book then goes on to discuss the diversification of banks into non-banking financial activities, their growing reliance on non-interest income and the development of new financial methods like securitisation and derivatives. Outlining the key challenges facing banks today in an increasing globalizing world Heffernan also looks at how banks can cope with rapid advances in technology. The banks most likely to survive, he says, are those which embrace the rapid progress of information technology, consolidation of the banking/financial services sector and for European banks, the advent of the Euro together with a single European financial market.

Modern Banking looks at bank failure, reporting on quantitative methods used to identify the precise determinants of bank failure, and at the issue of financial crises, what contributes a financial crisis and how it can be managed. It also dwells at length on risk management. As Heffernan puts it, the central intermediary role played by a bank is evolving through time, from the traditional intermediation between borrowers and lenders through to more sophisticated intermediation as risk managers. A discussion on the management of different risks invariably leads to an analysis of one of the primary challenges facing banks today - prudential regulation. Not only does the book focus on international regulation such as Basel I & II, it also covers the structure and regulation of banks in developed economies that host the key global financial centres namely US, UK, Japan and EU. Significantly, unlike several banking books that focus almost entirely upon developed countries, *Modern Banking* reflects the growing impact of emerging economies on the global financial landscape today. It covers banking in emerging markets in depth and also provides an overview of Islamic banking.

Taking into account the criticality of being competitive for banks around the globe, Heffernan covers some of the main factors that govern bank competitiveness such as productivity, scale and efficiency. While this section is extremely relevant to the overall theme, unlike the rest of the book, it is overtly technical in its treatment with a preponderance of econometric models. In addition, some key ideas such as the importance of customer service and customer retention have been completely overlooked. Other than this inexplicable lacuna in an otherwise excellent treatise, *Modern Banking* offers a much needed overview of the banking industry. Further, to illustrate the main ideas and themes covered throughout the book, Heffernan has also included a few interesting case studies towards the end.

At 800 odd pages, *Modern Banking* is not for the faint hearted. As Heffernan states, it is primarily designed for courses in banking and finance at Masters, MBA programs or undergraduate programmes. But given the nature of its contents which effectively capture the true essence of banking in the modern world today, the fluid prose and clarity of ideas, Modern Banking is highly relevant to banking practitioners wishing to deepen their understanding of banking, and would make an excellent reference book▪

Rekha Menon
Research and Contributing Editor
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