



The Innovator

The Impact of Dodd Frank on IT and Operations in the Financial Services Industry

- [*BITS & BYTES: The Impact of Dodd Frank on IT and Operations*](#), by Dan Schutzer, BITS
 - [*Cumulative Weight of Dodd-Frank*](#), by Abigail Martin McCloskey, The Financial Services Roundtable
 - [*Dodd-Frank Stimulates Financial Industry Transformation – Again!*](#) by Rohit Verma, Oracle Financial Services Software
 - [*The Dodd-Frank Act: Preparing Your Organization for the Information Technology Impact*](#), by Anoop Singh, PricewaterhouseCoopers
 - [*Managing Revenues and Customer Value with Predictive Analytics*](#), by Carl Snyder, SAP
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We value your opinion. Please contact Dan Schutzer, Dan@fsround.org, if you have comments about this edition of *The Innovator*.

Disclaimer: The views and opinions expressed in the enclosed articles are those of the authors and do not necessarily reflect the official policy or position of BITS or The Financial Services Roundtable.

BITS and BYTES: The Impact of Dodd Frank on IT and Operations

By Dan Schutzer, Chief Technology Officer, BITS

Our industry is facing significant change brought on by the financial crisis and the regulatory response to that crisis, with the Dodd-Frank Wall Street Reform and Consumer Protection Act significantly impacting the U.S. financial services community. Surrounding these regulatory changes, yet to be fully defined, are changes in the way our industry is viewed by the public, and the loss of trust and growing resentment most recently displayed by the Occupy Wall Street protests.

In this issue, Abigail McCloskey of The Financial Services Roundtable gives a good overview of how the financial crisis created the motivation for financial reform, and a discussion of Dodd-Frank and unintended consequences likely to come out of it. She provides caution regarding possible undesirable outcomes if we do not carefully consider the impact of the resulting rules and regulations.

Her article is followed by three others that focus on the likely impact of regulatory reform to IT and Operations. Rohit Verma of Oracle outlines key areas of regulatory change that are in process and highlights how IT infrastructure must be transformed to adapt. Annop Singh of PricewaterhouseCoopers discusses how Dodd-Frank will result in increased reporting to regulators and transparency to customers that will put an increased burden on IT and operations, highlighting among other things the need for a Data Governance program¹. Carl Sydner of SAP discusses how regulatory reform is causing the financial services industry to lose billions of dollars in revenue, and how the use of data, business-intelligence and optimization tools will be important to help accurately predict the actual impacts of decisions such as changing fees or adding features that cost more for the customers. Carl, Rohit and Annop all agree that the resultant changes to IT and operations, if appropriately executed, can be turned into a strategic opportunity to generate revenue, streamline operations, and limit negative cost impacts.

One take away message from these articles is clear – the aftermath of the financial crisis and Dodd-Frank will require our industry to:

- Adjust to an increasingly transparent world;
- Work to regain trust;
- Meet the challenge of increased regulatory and compliance requirements without making customer interaction more complex and time-consuming; and
- Re-examine its business strategy and make hard decisions regarding how to allocate scarce resources without sacrificing profitability, customer service or innovation.

¹ See the October 2011 *CTO Corner: Good Data – A Key to Competitiveness*, <http://www.bits.org/publications/home/CTOCornerOct2011.pdf>

This means that now more than ever, IT and operations will become a full partner of your enterprise's business team contributing to your company's transformation in these challenging times, while coping with tremendous shifts in the IT industry with its increased movement to mobile and the cloud, a growing cyber threat, and the growth of social networking and the consumerization of IT, including the introduction of consumer IT devices into the workplace.²

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Thanks and happy reading.

² See the November 2011 *CTO Corner*, *Consumer Devices and Applications in the Workplace*, <http://www.bits.org/publications/home/CTOCornerNov2011.pdf>.

Cumulative Weight of Dodd-Frank

By Abigail Martin McCloskey, Director of Research, The Financial Services Roundtable

The Dodd-Frank Act (DFA) initiated many needed reforms given the excessive risk-taking that contributed to the financial crisis. It was like the speed limit on financial activity had been increased. Financial activity kept going faster and faster until it hit 100 miles per hour, and eventually the system crashed. There was too much risk in the system, and changes were needed to bring the pace of financial activity back down to 60 or 40 miles per hour.

Many of the rules mandated by DFA will accomplish this goal. They will reduce risk in financial markets, bring greater transparency to financial transactions, and consolidate consumer protection. Because of DFA, and related Basel reforms, there has been a massive increase in the amount of capital banks are holding on their balance sheets. Because of DFA, there is a broader perception that some firms are no longer “too big to fail.” Because of DFA, the Federal Deposit Insurance Corporation now has the authority to resolve troubled holding companies and other systemic firms.

Yet, other rules mandated by the DFA create new weaknesses in the system. For example, the derivatives rules will severely disadvantage U.S. banks if they are applied internationally. The same goes for the Volcker Rule, which regulates proprietary trading even though proprietary trading had nothing to do with the financial crisis. Moreover, the Basel liquidity standards that have been proposed would have an enormous impact on lending and economic growth—much more so than the proposed capital requirements. The DFA also included provisions designed to benefit small banks that have ended up placing them at a competitive disadvantage. The Durbin Amendment is a chief example.

Additionally, the sheer *volume* of rules to be implemented in a three-year time span is perhaps the most immediate concern for regulators and policymakers. As of June 2011, of the 385 new rules mandated by the DFA, federal agencies have proposed 115, finalized 24, and missed statutory deadlines on 28. In other words, only 6% of the rules have completed the comment process and are final.

According to the Davis Polk law firm, “many agencies will have no choice but to miss deadlines in an increasing number of instances.” Trade associations and individual financial firms have been working overtime to keep up with this wave of new rules. The Roundtable has filed over 100 comment letters since the passage of the DFA, which may be found at www.fsround.org. This compares to an average of 12-14 comment letters in the years preceding the DFA.

Ultimately, financial firms and financial markets can and will adapt to the new rules. They have done so in the past.

What is less clear is if financial firms and financial markets will be able to adapt to the cumulative weight of these new rules and the unforeseen interactions that they may have. The potentially toxic interaction of the rules may be compared to drug interactions. Consider someone taking stomach medication, heart medication, blood medication, and antibiotics. Separately, these medications may work, but their combined effects may negate each other, or worse.

Former Comptroller of the Currency, Gene Ludwig addressed the potential cumulative impact of rules mandated by the DFA at a recent Senate Banking Committee Hearing:

The cumulative impact of the entirety of the Dodd Frank Act reforms will have an immense, and not entirely predictable, impact. It is critical to take a thoughtful approach to the implementation of all of these reforms – domestic and international – with an eye towards maintaining the balance of the financial system and allowing the economy to recover and provide Americans with much needed jobs and opportunity.

--Former Comptroller of the Currency, Gene Ludwig, August 2011.

In an effort to try to understand the cumulative weight, the Financial Services Roundtable has collected nearly 100 reports and other public statements that provide a window into the weight of new rules on the economy, consumers, businesses, and international competitiveness. This research is by no means comprehensive. Yet, the following themes emerge:

1. The Dodd-Frank Act reduces risk in our financial system – but at a cost.
2. The cumulative weight of the rules mandated by the DFA will restrict economic growth;
3. The cumulative weight of the rules mandated by the DFA will restrict the availability of credit;
4. The cumulative weight of the rules mandated by the DFA will put U.S. financial institutions at a competitive disadvantage internationally; and,
5. The cumulative weight of the rules mandated by the DFA will increase the cost of financial services.

These themes are built out in the Roundtable's white paper on cumulative weight, (see below). A selection of these facts reported in the paper from various sources include:

- GDP will decline 2.6% from regulatory changes;
- 4.6 million jobs will be lost from regulatory changes;
- 75% of surveyed economists expect a negative impact on credit availability;

- \$1.25 billion of budgetary costs will be incurred by next year;
- Bank lending rates will increase by about 193 basis points by 2014;
- Regulatory changes will reduce earnings by roughly \$20 billion annually for largest banks;
- Compliance costs for small property-casualty insurance companies have already increased by 36%;
- The industry will need to spend 2,260,631 labor hours per year to be in compliance with new rules;
- No other industrialized countries plan to enact provisions that parallel the U.S. restrictions;

At this critical time in our nation's economic recovery, we must carefully analyze the impact of each new rule and the cumulative weight of all these rules on the economy. We must preserve those parts of the DFA that make our system safer and stronger, while re-examining the provisions and combination of provisions that restrict economic growth, limit credit, make our companies less competitive internationally, and result in higher costs and reduced access to services for consumers.

View the white paper here:

http://www.fsround.org/fsr/publications_and_research/files/CUMULATIVEWEIGHTWHITEPAPER.pdf

View the entire cumulative weight database here:

<http://www.fsround.org/fsr/fsic/files/EconomicImpactRegulatoryReform.xls>

View Fast Facts on cumulative weight here:

http://www.fsround.org/fsr/publications_and_research/fast_facts.asp

View what thought leaders in Washington said about Dodd-Frank at the Roundtable's Annual Anniversary Dinner here: [One Year Later: The Dodd-Frank Act](http://www.fsround.org/fsr/publications_and_research/files/WhitePaper-AnniversaryDinner.pdf),

http://www.fsround.org/fsr/publications_and_research/files/WhitePaper-AnniversaryDinner.pdf

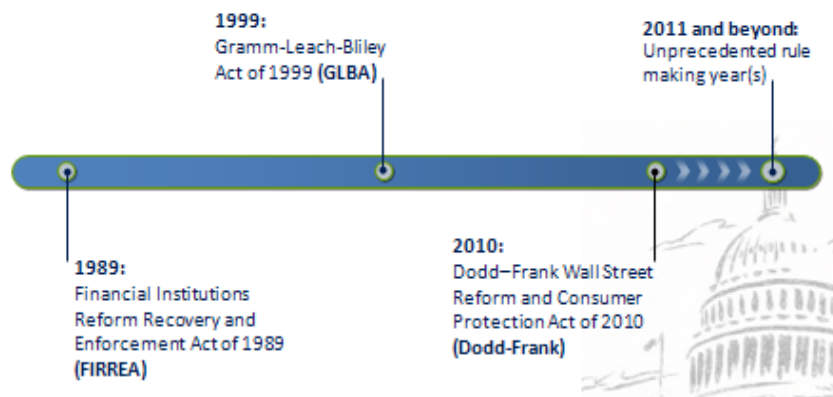
Dodd-Frank Stimulates Financial Industry Transformation – Again!

By Rohit Verma, Senior Director, Product Management and Strategy, Oracle Financial Services Software

Here we go again! From the Financial Institutions Reform Recovery and Enforcement Act (FIRREA) of 1989, Gramm-Leach-Bliley Act (GLBA) enacted in 1999, to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, we've seen a trend of regulatory overhaul in each of the last three decades.

Regulatory change is not new to the industry, but the sheer scale and scope of reform today is unprecedented.

Industry Transformation, Again!



We're just starting to experience the aftermath of Dodd-Frank and watch with a wary eye for what's still to come in the rule-making years of 2011 and beyond. Call it a maze, tsunami, or storm of new financial regulations, but the bottom line is that every financial institution is facing a compliance challenge to address and prepare for right now. These new compliance mandates affect consumer financial products and services, income, operating expenses, and risk management throughout the institution.

Dodd-Frank's Effect on Financial Institutions

Leaders of financial institutions will be accountable for understanding and complying with over 23,000 pages of regulatory change from Dodd-Frank. It's a huge undertaking to ascertain the true effect on customers, products, services, and day-to-day operations. The number of changing regulations will require a forest of trees to print; but how many new rules, directly affecting the institution, will be put forth in the next 12 to 18 months?

An estimated 214 new or changing regulations will trickle down from Dodd-Frank. Approximately 194 regulatory updates and 20 “new” rules will directly affect financial institutions. Whether the number is 214, 194 or 20, it is still a massive undertaking for bank and credit union leaders to address. Additionally, these new compliance readiness demands must be added to the work required from the dozen or so regulatory updates that happen each year already.

How does the institution’s management team even begin to assess, identify, and take action on the steps required to comply with new mandates? At the foundation of preparedness is the need to update and streamline the existing way of doing things—including programs, services, software, data normalization, and technology—in order to adapt and survive.

This article outlines key areas of regulatory change that are in process and highlights how IT infrastructure must be transformed to adapt. It also presents a best practices view to assist in beginning the journey of transforming IT infrastructures to successfully ride the wave of regulatory reform.

Key Areas of Transformation

Financial institutions should pay close attention to the rules and statements that come from the regulatory banking agencies and newly created Consumer Financial Protection Bureau (CFPB) regarding the following key categories of reform:

1. Capital adequacy
2. Mortgages
3. Liquidity
4. Stress testing
5. Other considerations

All of the new compliance mandates will affect consumer financial products and services, and risk management throughout the institution. They will require institutions to collect, analyze and report more detailed data to consumers, management, auditors, and regulators.

Institutions can more easily begin to identify and plan for this regulatory wave by breaking the elements down into the above five categories. This will enable a better, less overwhelming approach to management that will help assign resources, assess the effects on existing operations and practices, and execute strategy.

Capital Adequacy

The Dodd-Frank Act requires financial institutions to raise the quality, consistency, and transparency of capital in order to ensure that the banking industry is able to absorb losses. All

institutions will be required to hold additional capital. Due to the difficulty involved with raising new capital, many institutions are meeting the new ratio requirements by adjusting balance sheets, thus reducing net income during a time when high costs, weak spreads, and lower fees are a reality.

The Federal Reserve Board (FRB), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) adopted a final rule that establishes a floor for the risk-based capital requirements applicable to the largest, internationally active banking organizations. The rule is consistent with the requirements of Section 171 of the Dodd-Frank Act. In addition, it authorizes the FFIEC to impose a 15-1 leverage requirement on a company if necessary to mitigate a grave threat to the financial system. It also mandates changes to make capital requirements countercyclical. This means that during downturns, banks would be in a better position to absorb increased losses while sustaining lending to support economic growth.

The Collins Amendment (i.e., Section 171) will drive significant changes in how capital is accumulated for all institutions. However, it remains to be seen how much more capital regulators will require with the new countercyclical policy. Every bank, regardless of size, should have a Capital Plan and a Capital Contingency Plan in place if additional capital is needed.

Dodd-Frank also tightens the capital standards for bank holding companies by placing limits on trust preferred securities. Institution holding companies with total consolidated assets of less than \$15 billion as of December 31, 2009, may continue to include preferred securities that were issued prior to May 19, 2010. Further, depository institutions with more than \$15 billion in total consolidated assets will be required to phase-out – over a period of three years – trust preferred securities issued before May 19, 2010, that are presently included in regulatory capital.

Mortgages

New regulations on mortgage originators, and new disclosure requirements as a result of amending the Truth in Lending Act, amplify the compliance reporting and documentation requirements for financial institutions. The new amendment restricts the provision of incentives for steering consumers into higher-cost mortgage loans, and sets minimum underwriting standards. The act also increases the amount of information that financial institutions will need to report in accordance with the Home Mortgage Disclosure Act of 1975 (HMDA).

Overall, the mortgage reform changes alone will impose a significant effect on operations.

Dodd-Frank specifies that institutions must prohibit:

- Mortgage originators from steering a consumer to a residential mortgage loan that the consumer lacks a reasonable ability to repay or has predatory characteristics.

- Steering a consumer from a qualified mortgage which the consumer is qualified to a non-qualified mortgage.
- Abusive or unfair lending practices that promote disparities among consumers of equal credit-worthiness but of different race, ethnicity, gender, or age.
- Mortgage originators from mischaracterizing credit history of a consumer, mischaracterizing the appraised value of the property, or discouraging a consumer from seeking a loan from another mortgage originator.

Liquidity

Funds management and proper liquidity planning is essential to all institutions to compensate for expected and unexpected balance sheet fluctuations. The risk of not being able to obtain funds at a reasonable price within a reasonable time period to meet obligations as they become due, could affect the ongoing viability of an institution. Regulatory agencies have stated that many financial institutions need to improve liquidity policies and contingency funding plans as part of the overall asset and liability management function. For example, monitoring ratios are many times limited to a static analysis and only provide a point-in-time snapshot of the liquidity position. A near real-time comprehensive liquidity program is necessary.

Stress Testing

The regulatory agencies emphasize the importance of stress testing as a tool for assessing risk and addressing a range of potential adverse outcomes.

Stress testing is an important aspect of Dodd-Frank. Stress testing requirements for interest rate risk (IRR) and for other variables on commercial loan portfolios are now required. Institutions must now assess liquidity and sustained operations under “worst case” conditions. These conditions may include downgrades in asset quality, depleted capital, net reductions in deposit balances, or loss of funding support. Financial institutions are called upon to use stress testing to evaluate risk of assets and funding concentrations.

Other Considerations

There are other provisions that will challenge the need to establish real-time visibility, analysis and reporting of enterprise-wide data. These include:

- A loss of interchange fee income under the Durbin amendment. Institutions are looking for alternative sources of income such as bundling of products, increased account servicing fees, charging fees for previously free services, and many more.

- New disclosure and reporting requirements. The CFPB carries the authority to require disclosures to ensure that customers understand the “costs, benefits and risks associated with the product.” It also mandates 20 new HMDA reporting obligations.
- Providing proof to CFBP that banks are offering fair, equitable and non-discriminatory access to credit for customers.

Transforming the IT Infrastructure is Key to Compliance and Success

All of these new and updated regulatory requirements will require institutions to transform their IT infrastructure to update and streamline the existing way of doing things in order to adapt and profit in this new environment.

Banks cannot take a “wait and see” approach in identifying how the Dodd-Frank Act will affect IT operations. There is much to evaluate and prepare. Rather than reacting on a rule-by-rule basis, institutions must formulate a well-coordinated plan to transform the IT infrastructure and its operations to provide the visibility, analytics, and reporting that is required to facilitate compliance.

The right IT infrastructure can enable an institution to drive down the time and cost of compliance efforts, while expanding resources, expertise, intelligence, and real-time visibility across the enterprise.

To ensure compliance, financial institutions require an IT infrastructure that will normalize data to enable:

- A logical data model based on deep domain experience
- End-use driven and pre-defined physical data model for sourcing and provisioning, ready for immediate deployment and use across the enterprise
- A unified and conformed reporting data model to provide fast query performance across all functional domains
- Shared data, metadata, computations, calculations, business rules and controlled access that enable organizations to meet emerging or changing cross-functional business and regulatory mandates quickly and with reduced expense
- Thousands of pre-built data quality checks contextualized to the institution’s analytical end use that enable financial institutions to eliminate accuracy and consistency issues
- A formal and centralized general ledger reconciliation process, for accurate and fully-auditable reporting that eliminates inconsistencies across ledgers, books and marts

- The capability to handle high volume, “what-if” computations across business domains to support enterprise level stress testing and scenario analysis
- Analytical applications that can combine results from multiple business areas to easily and securely support cross-functional analytics throughout the enterprise
- A “self-service” business intelligence environment with all key business dimensions and vocabulary pre-built to help users get answers quickly and efficiently
- Fast query response when performing time sensitive ad-hoc analytics and reporting
- Consolidation of data across business lines to help reduce IT footprint and total cost of ownership.

With the right solutions, financial institutions can convert these new compliance mandates into a plethora of benefits, such as:

- Automation and streamlining of analytical processes
- Strong compliance posture and consistent operations at an “examination ready” state
- Real-time visibility and intelligence across the enterprise
- Continuous compliance and risk management

A Best Practices Approach: Four Steps to Get Started

There are many operational challenges to consider, while managing and maintaining day-to-day activities. As such, many institutions are left struggling with how to begin. Table 1 includes four steps financial institutions need to consider when beginning an IT transformation initiative.

Table 1 – 4 Steps to Get Started

Step 1

Obtain IT transformation expertise and resources. IT transformation involves in-depth knowledge on many complex elements. Technology personnel need to be experienced and must maintain knowledge on many topics. It is difficult to keep the level of skill that is necessary to manage change and maintain daily functionality of operations. Financial institutions need to either identify internal personnel that have the experience, skills, and time necessary to plan and manage the transformation, hire additional staff, or outsource to a third-party that can provide the expertise to implement and maintain the needed IT infrastructure.

Step 2

Define your IT transformation strategy. Successful deployment of new technology starts with the tone from the top. Without management’s formal commitment to transform IT to help meet the new compliance needs throughout the organization, it won’t happen. This means that management must have an IT transformation strategy that includes a balanced allocation of funding for personnel and tools to maintain a successful program.

Step 3

Implement an automated and intelligent real-time analytical infrastructure consisting of a unified financial services data model, analytical computations and business intelligence platform.

Step 4

Establish a baseline for data and expected activity. Due to the complex nature of systems, the applications, data silos, and environments are always changing to maintain a competitive advantage and serve customers. It is difficult to maintain a normal baseline. Dodd-Frank requires institutions to enable their businesses to perform complex “what-if” scenarios and enterprise-level analytics previously thought to be impractical or impossible. In order to enable real-time reporting and transparency with high data integrity, all relevant data should be centralized and empower the organization’s personnel to easily enter information, or automatically gather the information and then store it in a database for high-performance data warehousing, and online transaction processing. This will enable banks to simultaneously provide the fastest possible query response for time sensitive ad-hoc analytics and reporting and cut operating costs by combining siloed functional warehouses across business lines.

The Dodd-Frank Act: Preparing Your Organization for the Information Technology Impact

By Anoop Singh, Director—Banking & Capital Markets, PricewaterhouseCoopers

Overview

Representing the most sweeping change to financial regulation in the United States since the Great Depression, the Dodd Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank,” or “the Act”) is creating new regulatory bodies, regulating new markets, bringing new firms into the regulatory arena, and providing regulators with new rulemaking and enforcement powers. These impacts start with refinements to business strategy, including the identification of products and services that create revenue opportunities in a new market structure. This results in required changes to business operating models (new and updated business processes and the organizational structures required to execute them) and extend to the underlying business applications and data structures that support them. Drivers of information technology (IT) and data change will include requirements set by the newly created Financial Stability Oversight Council (FSOC) around systemic risk regulation, transparency requirements on derivatives, changes to the trade execution and clearance structure, introduction of a global legal entity identifier, and imposition of a fiduciary standard on broker-dealers.

No financial institution will escape the impact of Dodd-Frank's numerous requirements. To be compliant with new rules, firms will need to evaluate business models, operating models, supporting IT, and data environments to determine what changes and enhancements will need to be effected.

Key Provisions that Will Create IT and Data Challenges

The first year of the Act was demanding for the industry as regulations were released, business impacts were assessed, and business strategies were considered. During the Act's second year, firms will be required to bear the brunt of the effort as they start implementing changes to their existing operations and IT infrastructure. The following provisions of the Act are likely to create the most significant implementation challenges for firms:

Derivatives. The new framework is designed to bring transparency and additional risk management to derivatives traditionally traded in over-the-counter (OTC) markets. The framework includes (i) requiring financial services firms to centrally clear or trade eligible OTC derivatives on exchanges, (ii) the “push-out” of certain derivatives activities (e.g., commodities, equities, certain credit swaps) from insured deposit-taking institutions and other firms receiving federal support, (iii) the designation of qualifying firms as swaps entities (e.g., swaps dealers, major swaps participants), and (iv) enhanced prudential standards and transparency for swap entities and, as applicable, clearing houses, including margin, capital, and reporting requirements. Asset managers and sell-side dealers have a broad array of processes and

supporting applications in place today optimized around a market executed over the counter via bilateral contracts.

Central clearing. The creation of centralized clearing and exchange execution requirements for buy-side firms has IT implications around connectivity, straight-through processing, end-user service and support, and record-keeping. In order to support connectivity requirements, strategic decisions need to be made regarding which clearing houses and platforms should be supported, followed by the development of a technology strategy that enables connectivity and transaction activity monitoring. Systems that provide margin and collateral management functionality will need to be reviewed and potentially enhanced as specific assets that are acceptable to cover margin requirements are identified and updated.

Legal entity identifier. The single system of designating counterparties in a transaction is known as legal entity identifier (LEI). Correctly identifying parties to financial contracts is critical to assessing the connections among financial firms and to monitoring systemic risk. In parallel to the process being driven by the financial services industry via the Securities Industry and Financial Markets Association (SIFMA) to create a standard worldwide LEI solution, financial institutions should take this opportunity to (i) enhance existing internal processes (i.e., risk management, margin calculations, and back-office automation) and (ii) prepare for mandatory data requirements once the "single system" has been identified.

Broker-dealer oversight: Fiduciary standard. The Act defines the fiduciary standard as acting "in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment advisor providing the advice. Broker-dealers with a large number of registered representatives will need to enhance or develop business applications to enforce this standard of care. This could involve a direct linkage between the setting of investment objectives and risk tolerances, the risk of specific financial products in a customer's portfolio, and the impact of a specific trade on the risk profile. System-enforced restrictions (akin to pre-trade compliance checks for asset managers) may be required to help registered representatives manage their fiduciary responsibilities. Additionally, post-trade review will need to be enhanced to ensure the appropriate supervisory oversight is being performed.

Reporting: Internal, client, and regulatory. For internal management and regulatory purposes, data integration and sources of information will be required to provide for the various needs of reporting (e.g., positions, transactions, market and reference data, payment, clearing and settlement, stock lending, margining, risk, liquidity, legal entity, contractual agreements, side-pocket deals, executive compensation, etc.). Automated real-time processes will need to be in place for counterparty exposure risk monitoring and reporting. For client reporting, additional requirements imposed on asset managers will apply considerable pressure to provide the necessary information to their clients for compliance. While this undoubtedly increases overhead for such firms, it also provides opportunities as clients seek best-in-class service providers.

Preparing Your Organization for the IT Impact

While there is still much to be done by regulatory agencies regarding rulemaking, it is clear that there will be impacts on IT platforms and the associated data architecture. Given the length of time it has historically taken to implement technology and data changes, it is critical that organizations focus on the following areas during their planning and implementation phases in response to the Act.

Set Up a Program Management Structure

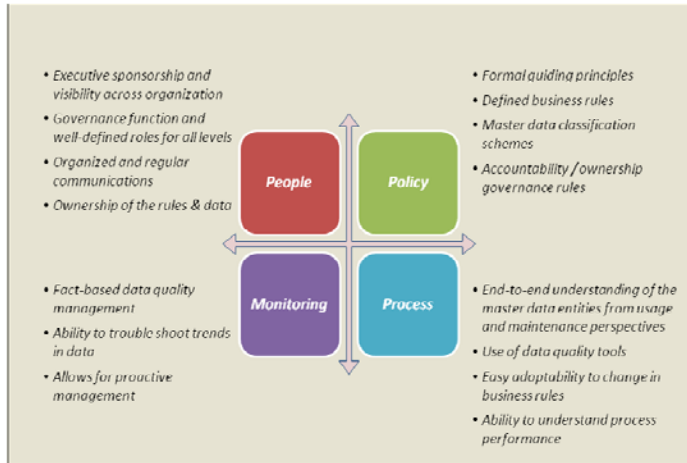
For enterprise-wide changes related to the Act, firms will need to establish a formal program management structure for driving and managing a multi-phased, multi-year effort that spans numerous business and technology organizations. This will allow organizations to align resources and begin the required communications and technology impact analyses.

Responsibilities. The program management office should report to a steering committee and involve full-time, senior-level executives. This centralized group should be responsible for defining the overall strategy to take advantage of business opportunities created by the Act, identifying gaps in compliance, ensuring consistency in messaging regarding the overall vision, coordinating execution of projects within the program based on the go-forward vision, defining the quality standards for the program, and ensuring appropriate staffing for projects.

Benefits. If organized and managed properly, compliance with requirements of the Act can be turned into a strategic opportunity to generate revenue, streamline operations, and limit negative cost impacts. Key decisions will need to be taken around the balance between "quick win" improvements to achieve basic compliance versus the execution of a more strategic approach. To ensure that all aspects of the requirements are being addressed, companies would do well to appoint a steering committee comprised of individuals with business, IT, operational, and compliance experience. Appropriate ownership and accountability will be crucial for success and, ultimately, compliance.

Adopt a Formal Data Governance Framework

As previously noted, sound management of core data assets is a foundational concept in regard to the Act's requirements. Data governance is the framework for making decisions about handling data. There are four interrelated yet distinct components that interact to foster ownership and accountability.



Without these components, an organization can spend millions of dollars on implementation of the Act's requirements yet still be unable to provide users with reliable, high-quality data, thus increasing the cost to procure accurate data and reducing the efficacy of the implementation.

Focus Upfront on Requirements

Given the importance of data requirements to the planning process, financial institutions must be prepared to invest adequate time and resources during this stage. Without proper data requirements, the cost of implementation will increase dramatically due to the amount of rework, confusion, and additional risk that arise due to unclear definitions. Data dictionaries, metadata, and data lineage documents should be developed to support the data requirements process.

Maintain Flexibility During the Rulemaking Process

In order to meet data management and reporting demands once the Act has been fully implemented, firms will need to ensure they have exceptionally strong and flexible information management and communication systems that offer a high degree of data integrity. These systems will need to be easily searchable and scalable to meet changing needs as the type and volume of data required from regulators increases. In addition, more regular and robust IT audits will be needed to ensure data security and integrity.

Get Started

Although the rules of the Act are still being developed, there are many actions that a firm can take now to get started. Given the numerous requirements and supporting data needed, firms are still struggling to understand the data implications for compliance. To ensure accurate reporting, organizations should begin an assessment to determine where required data should be sourced, the quality of the underlying data, and the supporting end-to-end architecture. Subject matter experts from representative business lines and IT resources should initiate discussions to begin planning for the Act.

How PwC is Helping Clients Prepare for the Act

PwC has experience in helping clients prepare by providing guidance in:

- Analysis of business strategies based on changing market structures,
- Interpretation of Notice of Potential Rule-making briefs and other public comments,
- Definition of issues specific to their business(es),
- Organization and execution of program management structures, and
- Impact assessments on organization and business structures, business processes and information technology including data.

Managing Revenues and Customer Value with Predictive Analytics

Carl Snyder, Senior Financial Services Industry Principal, SAP

The non-interest “revenue train” has left the station—the passage of regulatory reform is done and banks are facing the harsh reality of losing millions or even billions of dollars in revenue. The significant reduction of interchange income along with overdraft changes have banks scrambling to make decisions on how to make up for lost dollars. As 2011 progresses, the full impact of lost revenue dollars is becoming clearer to our nations’ banks. The passage of legislation may ultimately hurt those that it was meant to help—the “average customer” and the small businesses on Main Street. Banks must now decide how to make up the lost revenue, but to make the right decisions for the bank and its customers, a bank must employ *effective* business intelligence. If it doesn’t, it’s shooting at a moving target in the dark.

Banks are making decisions about fees and product changes to make up for lost revenue or to stop the bleeding from unprofitable products. Free checking accounts as we have known them—for both consumer and small businesses—are becoming a thing of the past. For many years, banks have used more profitable accounts and customers to subsidize the free accounts that may be earning nothing—or even losing money. Bank are forcing customers to go “all-electronic,” to increase their minimum balances to avoid fees, to have direct deposit, or they’re charging fees for the privilege of banking at their financial institution. Banks are also exploring additional revenue streams such as higher ATM fees to bring in additional income.

The urgency to recoup lost earnings is forcing banks to make these decisions quickly. With the pressure to increase earnings already in place from the financial crisis, banks are pressed to improve their income streams and reduce expenses while at the same time re-building and maintaining trust with customers who have lost confidence in the banking system. Customers expect transparency and clarity when it comes to account fees—and how to avoid them. Raising fees right now for customers—both consumer and business—is dumping fuel on a fire that is already burning bright. But what choices do banks have? The pressure from shareholders cannot be ignored and banks must address the issue head-on and make some tough decisions.

A recent survey shows that seven of the ten largest U.S. banks have introduced some type of new fee structure for customers who had free accounts. In a September 26 article in *American Banker*, we read that only 45 percent of checking accounts at U.S. banks are now free, down from 65 percent last year and 76 percent two years ago. The fees on interest-bearing accounts are up more than 8 percent from last year while the minimum balance to avoid the fee jumped a whopping 43.9 percent!

Although some of the requirements to avoid fees are not difficult for customers to meet, the relationship between the customer and the bank becomes strained as the bank imposes more rules on customers to waive monthly fees (e.g., requiring direct deposit). One bank that has decided to buck the trend is Huntington Bancshares. Their strategy is to continue to allow free checking

accounts. This may cause a short-term hit to the revenue line, but the bank believes that its customers will appreciate their willingness to stick with them, and customers will reward the bank with a long-term relationship that will add much more value over the long haul.

So if we agree that banks must be creative in finding new ways to generate income, how does the bank make sure that it is changing the right fees within the right account types? How can banks determine both the financial and customer-service impact by making these changes? Which unprofitable customer behaviors can be changed to reduce costs for the bank without negatively impacting overall service and profit?

For a bank to make these types of decisions wisely, business-intelligence and optimization tools must be properly employed. Sure, all banks have some type of profitability model and reporting. To varying degrees, banks also have the ability to determine which accounts (and customers) generate the bulk of the revenue. But few are able to accurately predict the actual impacts of decisions they are about to make when changing fees or adding features that cost more for the customer. In many cases, these choices are made without understanding their impact on the entire portfolio.

To illustrate, let's assume that a fee is increased in one particular demand deposit account (DDA) product type. This is the standard checking that previously was free as long as there was a minimum balance of \$1,000 in the account. The decision was made to increase the minimum balance to \$2,500 for customers to avoid the fee. A bank wants these checking accounts. They pay no interest and customers typically use their debit cards and have savings and/or money-market accounts. These are profitable customers for the bank. So the question is this: What impact will the minimum-balance increase have on the overall profitability of that account type and the accounts that the customer will move to? Again, let's assume the bank has another more "basic" account type that doesn't have as many bells and whistles but has a minimum balance of only \$1,000. How many customers and how much in balance will move to the other account? And more important, what impact will this have on overall revenue?

One might simply assume that the increase in minimum balance will increase revenue by a certain amount based upon the account type. But what the bank must understand is that this one decision will create a ripple effect that impacts other accounts as well. Not only will some customers migrate to the other checking account, but other customers may move balances from saving or money-market accounts to make up the difference to avoid the fee. This decision may ultimately help the bank (since it won't pay interest on those balances), but again, the bank must understand that impact before making the decision.

Using predictive modeling and analytics along with optimization tools is critical in making the correct pricing decisions that will benefit the bank without alienating customers. These tools arm the bank with insight into customers' behavior so that assumptions are replaced with predictive models. Additionally, banks are able to track the effectiveness and accuracy of their decisions.

In addition to changing fee structures on DDA accounts, it is also important to recognize that we must look closely at interest-rate pricing. The same tenets apply to rates as to fees. Again, the bank must be able understand what the impacts are when rates are changed on any account type. What's even more important is being able to predict what impact rate changes will have on the entire interest-bearing portfolio. As a bank uses predictive analytics to make pricing decisions, it can now accurately determine the behavior of its clients and thereby know what their reactions will be when rates change. Whether the bank has a goal of reducing interest expense or growing deposits, having an accurate model is necessary to achieve success.

Even though the “revenue train” is pulling away, there is time to still get on board and reap the rewards of the market. But in order to do so, there has never been a more important time to understand customers' behavior. It is time for banks to seek out and find analytical and optimization solutions that enable bank decision-makers to make more intelligent conclusions. This point was proven in a recent conversation with a top-20 bank in the U.S. By using an optimization solution, the bank was able to drive out significant interest expense while maintaining deposit levels in line with its growth goals. The bank realized financial benefits while not driving customers out the door because it had an understanding of how its customers would react to rate changes. This played out as the optimization solution's model predicted and considerable savings were realized.

Whether it is interest-rate changes or setting new fee structures on DDA accounts, now is the time for banks to invest in analytical tools and predictive models. These tools provide insight that will assist the bank in making the right decisions and growing revenues and/or reducing interest expense in ways that do not distance the bank from customers. Yes, there are ways to drive revenues in 2011 and beyond—but how effective will you be with your current analytical solutions?

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