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FINANCIAL SERVICES

The changes the sector faces are simply enormous writes **Kerry Hallard**.

Regulations and job losses are de rigeur

Banks continue to be knocked sideways. Costly new regulations are piling high at a time when many banks are struggling to remain profitable, as they try to recover from the financial crisis.

2011 saw the press littered with negative stories about the financial services industry, with many of them pertaining to job cuts:

April: Satyam Computer Services and its former auditor PricewaterhouseCoopers (PwC) have agreed to pay a combined $17.5m (£10.7m) in fines in the US after one of India's biggest corporate scandals. Satyam will pay $10m for falsely reporting more than $1bn in profits over five years.

June: Lloyds Banking Group Plc, Britain's biggest mortgage lender, announced it would cut 15,000 jobs and reduce costs by an additional £1.5bn ($2.4bn) as it withdraws from overseas units and increases its UK focus. The shares soared the most in more than a year.

June: HSBC announced it would cut 700 UK jobs. One hundred of the roles being cut are in IT operations and back office functions such as HR, finance and compliance. The majority of the cuts – 460 roles – are from the financial advice team in retail banking and wealth management. The roles represent 1% of HSBC's total UK workforce.

July: Swiss banking giant UBS cut 500 jobs from its worldwide operation. As part of a cost cutting drive, around 180 jobs were lost in Switzerland, 90 in the USA and the remainder from the UK and Asia-Pacific. The total represents marginally less than 6% of UBS' 8,700-strong total IT workforce. A spokesperson for the bank stated that some of the job cuts relate to its arrangement with Cognizant.

August: ABN Amro expected 2,350 positions to be axed over the next three to four years as part of an efficiency drive.

October: Barclays Bank cut 65 jobs in Glasgow and shipped the work offshore to India. In January 2012, it cut up to 422 staff in technology support. Barclays said the cuts are due to a restructuring of its technology and infrastructure division and most of the jobs affected are in Britain.

October: Credit Suisse has been fined £5.95m by the Financial Services Authority for system failures in its private bank, the second time it has fallen foul of the British regulator in less than two years.

November: Bank of America announced plans to cut 150 jobs at MBNA in Chester, but create up to 1,000 new posts in a global technology and operations centre. Another 100 jobs went from the MBNA base in Ireland. In October, Bank of America Europe Card Services, which operates the MBNA brand, started a collective consultation process in Chester, where it has 3,200 staff. Around 400 job losses were forecasted at the European credit card division.

Regulatory overdrive

Coinciding with intense business pressures, the sector has had to contend with a plethora of regulatory reform coming its way. Some of the key reforms to address include:

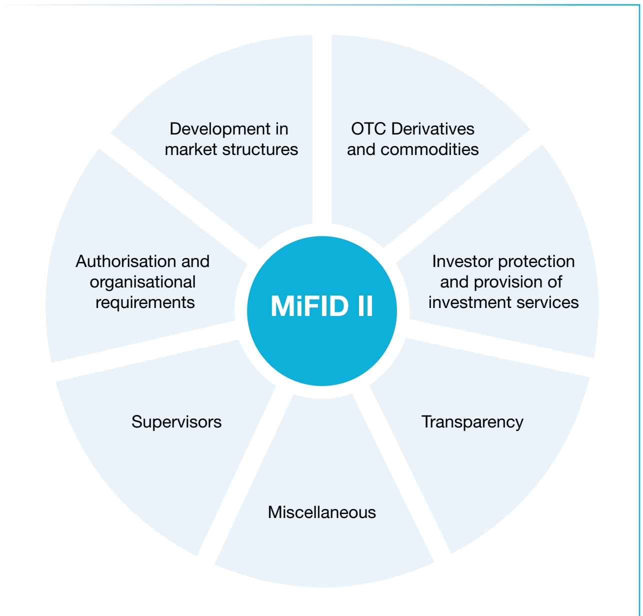
The Vickers Report – this is the biggest overhaul in British banking in decades and is making banks separate their retail and investment banking operations by 2019. This effectively ringfences all retail and small business deposits and overdrafts from investment banking activities.

A new switching service has also been announced to enable consumers to switch account providers within seven days. With consumer trust in banks at an all time low, this may see many more consumers abruptly responding to service dissatisfaction.

MiFID II – Markets in Financial Instruments Directive II or MiFID Review is the second version of the MiFID directive (MiFID imposed new rules for equity trading across 30 European countries when it became law in November 2007). Legislative proposals for the reform were launched by the European Commission and then passed to the European Parliament and the individual member states for "negotiation and adoption."

The second version is intended to tackle new issues such as over-the-counter (OTC) markets. It also addresses concerns over high frequency trading. MiFID II migrates the European regulatory landscape from a principles-based philosophy towards a more US-style rules-based regulatory regime. If implemented, MiFID II will lead to a reshaping of the financial markets, the products and services that banks provide and the relationship between banks and their customers.

The MiFID reforms cover seven main areas



Source: Linklaters

BASEL III – this is a global regulatory standard developed by central bankers and officials from the 27 member countries of the Basel Committee on Banking Supervision, in one of the most important reforms to emerge from the financial crisis and in response to inappropriate AAA ratings. Basel III strengthens bank capital requirements and introduces new regulatory requirements on bank liquidity and bank leverage, effectively tripling the size of the capital reserves that the world's banks must hold against losses. Banks whose capital falls within the buffer zone will face restrictions on paying dividends and discretionary bonuses, so the rule sets an effective floor of 7%. The new rules will be phased in from January 2013 through to January 2019.

Dodd-Frank Act – in July 2010, responding to the financial crisis, a comprehensive package of financial reform legislation was enacted in the US, known as the Dodd-Frank Act. This will affect banks and other financial institutions with significant US operations, and also those non-US companies whose securities are listed on a US stock exchange. However, according to Practical Law Company, the effects on non-US companies are much broader than that, extending to UK companies without significant financial services operations or a US listing. "The Act will have a sizeable effect on banks and other financial institutions with significant US operations, including many UK-based banks. There are also substantial changes for those non-US companies whose securities are listed on a US stock exchange."

Outsourcing service providers do not go untouched. To serve as an example, the provider processing transactions at the request of a client, could now be held liable for processing fraudulent or illegal transactions – effectively aiding and abetting – whereas before they could not. Following in the footsteps of Sarbanes-Oxley, it not only protects whistleblowers that report violations, but actively encourages them with a bounty reward. As with all new regulations, service providers to financial institutions now need to assess this risk and insure against it.

All of these regulations are putting significant restructuring costs and pressures on British banks, at what can be argued, is already a stressed time.

Is outsourcing the saviour for financial services?

2011 was a year of recovery for outsourcing in the financial services sector. According to the TPI EMEA Index 2011, it was the best year ever for outsourcing contracts in financial services in EMEA. Financial services was the biggest of all industry sectors and recorded a TCV (total contract value) for the year of €13.4bn. Manufacturing was a close second with a TCV of €13.2bn, but these two were far clear of the next largest sector: telecom and media, with €4.7bn contract value. On a global scale, 235 contracts (valued above $25m) were awarded in 2011 – the highest ever for the sector, with a value of $26.8bn.

The days of outsourcing for labour cost-arbitrage are over. Financial services organisations are increasingly seeking not only process efficiencies, but are turning to outsourcing service providers for the real transformations they can bring to drive more value for their business. The financial services industry continued to turn to outsourcing to help it reduce costs, increase revenues and boost capital, whilst attempting to retain ever more disillusioned customers.

Some of the bigger deals announced included:

June: Metro Bank, the first new high street bank in the UK for over 130 years, has agreed to outsource its recruitment function to RPO specialist, Consort Group, for a further three years. Consort Group is targeted with bringing the total number of Metro Bank employees to 400 by the end of the year as part of a drive to expand the bank's existing store network to a target of 200 sites by 2020.

August: Cognizant was selected by the UK Financial Services Authority (FSA) to be a key supplier as part of its Strategic Outsourcing Framework Agreement (SOFA).

October: IBM has announced that Westpac New Zealand has renewed its strategic information technology (IT) outsourcing agreement for a further five years to 2017. Under the new contract, which expands on an agreement first signed in 2000, IBM will deploy new technologies to improve customer service and sustainability, and upgrade existing systems.

October: New British bank Shawbrook has launched, targeting small and medium sized enterprises (SMEs) struggling to get funding from the UK's biggest banks.

October: BHF-Bank is outsourcing part of its IT system management to Atos. The international IT services provider will take over responsibility for the bank's workplace computers, file and e-mail services, as well as its telecommunications and network technology. BHF-Bank employees responsible for these services will transfer to Atos.

November: Diligenta, the insurance services subsidiary of Tata Consultancy Services, will assume administration responsibility for 3.2m policies for Friends Life, a provider of pensions, investments and insurance. The agreement, effective March 2012, is worth $2.2bn over a 15-year period, making it the largest life and pensions BPO engagement.

The 1,900 employee deal will increase the total number of policies administered by Diligenta to just under eight million. This will allow Friends Life to focus on its new proposition developments, including its new corporate platform, in its core markets of corporate benefits, protection and retirement income.

November: Accenture has signed five-year outsourcing agreements with both Banco Popolare Group and Alba Leasing under which Accenture will provide application management and infrastructure services to support the two companies' leasing operations. Banco Popolare is Italy's fourth largest bank by assets and Alba Leasing is among the country's top 10 leasing companies by new contracts.

As we were going to print, Spanish banking giant BBVA announced it is switching its 110,000 staff to use Google's range of enterprise software. The deal is the biggest that the search giant has signed with one company for its cloud-computing services, where software is offered as a service via the internet. The bank told the BBC it would use Google's tools only for internal communication. But the deal can be seen as a breakthrough in corporate adoption.

The Co-operative Bank renewed its IT services contract with Steria, as it continues on a £700m transformation programme. The bank said the all-encompassing deal – for which a value has not been disclosed – will now run until 2014. The original agreement was signed in 1995.

Also Spanish savings bank "la Caixa" and IBM announced a ten-year strategic services relationship. As part of the agreement, IBM will manage the infrastructure technology budget of "la Caixa" of more than €2bn over ten years.

A look ahead

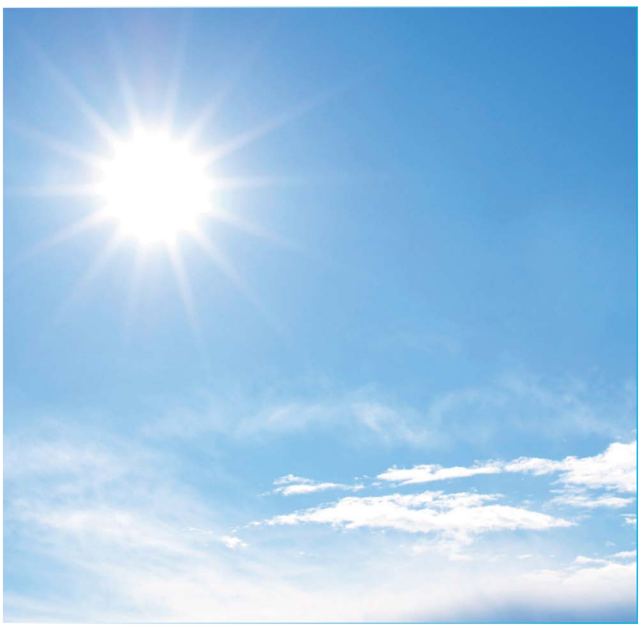
As for the future, it looks like more of the same – the financial services industry is not likely to lose its slot as the key vertical for outsourcing any time soon. According to research from HfS and the London School of Economics Outsourcing Unit 2011, a quarter of buyers within banking, financial services/insurance expect to significantly increase their BPO outsourcing over the next three years. A further 47% expect to increase it moderately, whilst only 5% are predicting they will reduce their spend on outsourcing.

HfS CEO Phil Fersht commented: "Secular changes drive bolder, more radical behaviours, and it's already clear that a more aggressive approach to outsourcing is high on these organisations' agendas."

Elix-IRR LLP, the outsourcing advisory firm, predicted the following trends in financial services:

- As the outsourcing models of the multi-national banks mature, much of the new activity will be among regional and mid-tier banking and insurance institutions
- Most financial services companies now maintain a 'multi-sourcing' approach to ITO and BPO
- Outsourcing is moving upstream in the value chain, to include financial services industry specific processes
- Financial services companies are starting to think like outsourcers, working to standardise and simplify their shared service delivery model internally, while utilising sourcing as the major component to deliver on their operating strategies
- Continued conservatism means the captive model has actually increased in the last two years
- Companies are increasingly acting as service managers and integrators themselves to remain competitive
- Innovative companies will look to commercialise their assets, partnering with service providers or industry competitors to create industry utilities

Additionally, financial analytics will be used increasingly to provide intelligence to give a more competitive edge.



Mobile banking – a ray of hope?

Mobile banking (mbanking) brings a glimmer of hope to the banking sector, as well as a great opportunity for service providers. Mbanking has been a buzz phrase on the lips of bankers over the last couple of years and looks to move from being a 'nice to have' to a 'must have'. It's widely predicted that over the next 18 months 80% of banks will have some sort of mobile banking offering.

According to Javelin Strategy & Research's latest research report *2011–2012 Mobile Banking Vendor Scorecard: Mobile Banking Has Moved*, consumer uptake of mbanking has jumped from 19% to 30% and corresponds to a rise in financial Institutions offering mobile banking and an increase in consumer smartphone ownership.

However, security remains a top concern, as almost half of consumers cite fear of security as the main reason they do not use mobile banking. To assuage safety fears, sophisticated security measures in the mbanking space are already in place. Encryption systems are in place, the main issue is if you lose your mobile phone. In addition, the sums being transferred are quite small making the possibility of large scale global fraud less likely.

The key focus now needs to be on changing customer perceptions to trial mbanking. Experience shows that once they've used a form of technology there is no going back, as the key factors of convenience, accessibility, simplicity and ease-of-use win through.

The evolution of smart phones is persuading even the most skeptical try mbanking and over time we will see the mobile channel handle more and more transactional banking – with the web being used more for advice and product selection.

Preparing for MiFID II

By **Tony Virdi**, Vice President and Head of Banking and Financial Services Practice for the UK and Ireland, Cognizant

Since the Markets in Financial Instruments Directive (MiFID) was enforced back in November 2007, the economic landscape has changed dramatically. Competition between trading venues has increased while investor choice has improved, due to enhanced availability of financial instruments, reduced transaction costs and increased integration.

As a result of the 2007 / 2008 financial crisis, both regulators and the G20 are demanding better execution, greater transparency, risk management and regulation of more opaque markets such as OTC derivatives. To meet these demands, the European Commission (EC) released MiFID II in October 2011. While not yet passed as legislation, MIFID II will require significant change for financial services firms amid the need to comply with other EU regulatory reforms, as well as US Dodd Frank reforms.

The impact on banks & financial institutions

MiFID II is simply the latest in a long line of regulations which require major changes in both internal infrastructure, and how companies conduct their businesses on a day-to-day basis. The EC's own estimates for one-off compliance costs for MiFID range between €512m–€732m and ongoing costs of between €312m–€586m. The challenge for companies, aside from the significant cost burden in an extremely challenged market, is to ensure they don't fall foul of the regulators – much easier said than done given how quickly regulation is prone to change.

The potential advantages are the harmonisation of rules but it will also be viewed as providing UK entities with less flexibility, especially for more specialised areas such as commodities. As necessary as this is, the continuation of changing regulation is placing pressure on financial institutions, particularly the sell-side firms, who need to pay close attention to how they adapt their systems and processes to adhere to strict transparency and reporting regulations.

There is little doubt that, for capital market segments, the impact of MiFID II will be felt strongly across all areas of the business and the different operating functions. The revised directives and regulations in MiFID II cover a vast amount of ground and, in addition, the full impact has to be analysed alongside other closely related regulations such as EMIR and Central Securities Depositories. Given that some of the revised regulations, including those on trade transparency and reporting, have already led to some objections, there is also the lingering possibility that once companies have put these regulations in place, they will be subject to yet further change.

Key Considerations

Regardless of any anticipated changes, the focus needs to be on enhancing the processes and systems for electronic trading, risk management, transparency and transaction reporting (across more asset classes), compliance and investor protection. MiFID includes a number of measures aimed at protecting investors in the context of the provision of investment services. However, modifications and improvements are clearly needed to strengthen the framework for the provision of services – whether broadening the scope of the directive to cover financial products (like structure deposits), services and entities which are currently not covered, modifying conduct of business and strengthening organisational requirements for the provision of services to investors, such as adopting and consolidating internal controls.

Another consideration is around data consolidation and dissemination. The reporting, publication and consolidation of trade data needs to be addressed due to problems with its formatting, cost, quality and reliability, with many issues highlighted by the European Commission.

To minimise the impact of all such changes, and given how often this can change, a carefully planned and phased approach for MiFID II compliance is vital. IT plays a pivotal role in allowing this change to happen smoothly, so it is important businesses think carefully about how they work with their technology teams when implementing these across the entire enterprise.

As it stands, the sell-side firms in their capacity as liquidity providers arguably have one of the biggest challenges to overcome with the introduction of MiFID II. Most of these were using pre-trade transparency waivers provided in the original MiFID, to avoid the public dissemination of bid and ask prices and depth of interest creating dark pools, which encouraged buy-side firms to use their services. With these waivers under review as part of the pre-trade transparency proposal in MiFID II, liquidity providers will need to reassess their service strategies in attracting buy-side clients. Similarly with the proposal on regulating the automated trading and HFT (high frequency trading) practices, sell-side firms employing alternative exchange venues, for example broker crossing, will need to adapt their systems and processes swiftly in order to adhere to the transparency and the reporting regulations.

Another point to note is around the proposal of bringing all standardised trading instruments, such as commodity derivatives, under the ambit of the directive. Sell-side firms already engaged in this business will need to establish systems and processes to meet the reporting and compliance regulations that are currently applicable on equity-related instruments. Additionally, the enhanced requirements for collaterals in the OTC segment, put in as part of risk control enhancement in MiFID II, could reduce the market interest in these instruments, thereby affecting the sell-side firms involved in the OTC segment both in terms of business and changes required in risk monitoring systems.

Finally, since MiFID II's main focus is on breaking the vertical integration in the sector, with the aim of increasing competition by freeing the Clearing service from the Trade service, sell-side firms can no longer hope to sell exclusive, fully integrated investment services to their clients. This could represent a significant change to their business model, which is why these companies need to approach the changes presented in MiFID II with careful thought.

Conclusion

However, the full impact of MiFID II on the capital markets and the financial services players can only be ascertained once the legislation is fully in place relative to other regulatory reforms such as EMIR and Dodd-Frank. Firms also need to take view of their front to back office infrastructure and have a holistic view of all regulatory impact on business and infrastructure, rather than taking a standalone approach to MiFID II.

To summarise, MiFID II will encompass:

- The addition of previously-unregulated organised trading facilities (OTFs) to the MiFID framework whereas MiFID only covered multi-lateral trading facilities
- New safeguards for algorithmic and high-frequency trading activity
- Additional and reinforced powers of supervision of derivatives markets, coordinated with the European Securities and Markets Authority (ESMA)
- More stringent requirements for portfolio management, investment advice and other investor protections

Some firms will re-evaluate which businesses (and products) still make sense. Others will use this opportunity to upgrade their IT infrastructure and ensure a flexible approach to take advantage of the market benefits MiFID II could bring.