Sourcing and Shared Services of Banking Processes

Analysis of Sourcing Potentials and exemplary Use Cases
The banking sector has to deal with tough challenges within the next years. The global landscape of financial institutions is changing due to several shifts in the economic cycle: especially low interest rates, loss of customer trust, strong competition and digitalization trends are responsible for changing the banks operating models. Since the financial meltdown in 2008, financial institutions struggle with an increasing number of regulations and existing and emerging trading and accounting rules. To survive and to keep up with within remaining high expectations, banks need to take huge efforts on transforming themselves and meet the new environment and regulations, in addition, a lack of specialized resources and insufficient processes prevent banks of necessary transformations.

A lot of banks around the globe are not able to deal with these new challenges and partially went bankrupt or were taken over by a larger institution. Besides several other key performance indicators for banks, the Cost-to-Income ratio remains as one of the most fundamental KPI. It generally indicates directly how good an institution is in adapting to the challenging settings within the industry. As shown in figure 1, the Cost-to-Income ratios of the top 25 banks worldwide differ between 30% and 80%. This allows the conclusion that some of the players have an operating model which gives them a significant strategic competitive advantage.

Based on Capgemini Consulting research analysis, in Germany, the Cost-to-Income ratio of financial institutions is around 70%. The implied question is: how are banks able to improve their incomes and reduce their expenses at the same time? A potential solution is the transfer of a proven approach for the operation model – a strategic sourcing and shared services approach across the entire bank. The global players are already using external service providers and support to unleash efficiency potential. A first consideration was to outsource some non-core bank processes (i.e. IT support processes, HR processes) to specialized external providers, where they can be done more effectively and with more know-how.

Outsourcing – derived from outside resource using – describes a service provided by an external supplier. In this context, sourcing handles all the tasks which provides a service, shoring explains the location where the service is provided. Our research initiatives show that the focus on non-core processes is only a first step to improve the Cost-to-Income ratio for financial institutions. It is more a question of general “Sourceability” of processes, core and non-core bank processes under consideration of regulatory requirements, such as MaRisk and KWG in Germany. The overall aim is to reduce overhead costs by improving the quality with standardized processes.

In order to identify sourcing potentials, our banking and Shared Service Center (SSC) experts have developed a “House of Banking”, representing the main bank functions, see figure 2. The rooftop reflects the overall Corporate Management of the
bank. Its major tasks are the operational planning for the fiscal year as well as the development of guidelines and frameworks for the future strategy of the bank. Besides, the Corporate Management has to deal with public relations and lobbying and is responsible for the investor relations. To run a bank, several “enabling functions” have to be provided. IT (e.g. for necessary infrastructure/ licenses, hard- and software), Legal (e.g. for fulfilling national and international legal frameworks), Finance (e.g. for booking and reconciliation), HR (e.g. for staff and talent acquisition) and several administrative controlling units are fundamental demands for operational business. Therefore, attention has to be given on Compliance and Risk Management “Constraints”, such as external (e.g. regulatory requirements) and internal constraints (e.g. market, liquidity and credit risk). To summarize in a first step, enabling functions and constraints build the ground floor of the House of Banking.

The main focus of discussing sourcing possibilities in this point of view is on Core Business functions of the bank, which represent the walls of our house. We separated those functions in three pillars: Retail and Corporate Banking – Investment Banking – Financial Markets & Treasury.

Retail & Corporate Banking
The retail & corporate banking cluster is dealing with all kind of Lending and Private and Wealth Management products. As a basis, the bank offers its clients their services all around accounts and transactions.

Investment Banking
In the investment banking cluster, the main focus is on internal and external support for Mergers & Acquisitions as well as Equity and Debt Capital Markets (i.e. for IPOs or trading debt securities).

Financial Markets & Treasury
The cluster financial markets & treasury represents all internal sales, trading and treasury functions of a bank for their operative business. Key aspects therefore are analyzing the development of interest rates and its impact on products and refinancing opportunities and as a result, the planning of the banks liquidity.

To all functions detailed service offerings are presented in our House of Banking. Our experts analyzed all of those services regarding their sourcing potential based on a standardized assessment model.
Considering the House of Banking, the sourcing potential of core activities can be only derived in evaluating the process along a specific set of criteria.

In addition to the described criteria in figure 3, there are of course other criteria when considering centralization, sourcing and shoring. Most of these factors are not essential for this discussion. The only one that could be considered as a further criteria is “process excellence”. In the context of process excellence, a detailed assessment including the identification of optimization potential is not necessarily mandatory for a sourcing/shoring decision. Therefore, we strongly recommend to assess and optimize process structures after a final decision on sourcing/shoring. Mainly because the detailed potentials can vary slightly depending on the chosen strategy, e.g. the delivery model setup.

The objective of the criteria set for this discussion is to focus on truly important factors in real life cases. The selection of the criteria is based on our long-term consultancy experience across all divisions in the Capgemini group and the extensive research done by Capgemini Consulting. Based on our gathered experience, the essential criteria can be structured into three categories (figure 3):

1. Strategic reasonability and compliance feasibility
   Assessment of the process in the context of regulatory as well as strategic restrictions, like significance within the business model of the bank.

2. Sourcing reasonableness
   Evaluation of the economic sense of a potential sourcing/shared service center centralization of the analyzed process. Additionally, the evaluation of the importance in the context of client intimacy, especially concerning the closeness to the client.

3. Transformational impact
   Often missed in evaluation models are the implications on the entire organization while conducting such a sourcing transformation. With this criteria set, a potential impact will be assessed on a high level and will be essential within the decision making for the transformation.

To sum up, based on our experiences in shared service center projects, outsourcing activities and other transformation programs within the banking sector, we were able to identify a set of criteria with a high degree of usability and focusing.

Applying these criteria to our House of Banking, the following conclusions can be taken:

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**Figure 3: Evaluation Criteria**

<table>
<thead>
<tr>
<th>Level 1</th>
<th>Level 2</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic reasonability and Compliance feasibility</td>
<td>Business Model Relevance</td>
<td>Activities, playing an essential role in order to execute the bank's strategy successfully</td>
</tr>
<tr>
<td></td>
<td>Legal/ regulatory restrictions</td>
<td>Degree of legal and/ or constraints as a limiting factor of sourcing and centralization, e.g. MaRisk</td>
</tr>
<tr>
<td></td>
<td>Core competence differentiator</td>
<td>Differentiators to generate customer demand, like specific additional services or special flexibility</td>
</tr>
<tr>
<td>Sourcing reasonableness</td>
<td>Critical mass/ efficiency potential</td>
<td>General transactional volume and potential for improvement levers, e.g., in respect of time etc</td>
</tr>
<tr>
<td></td>
<td>Customer intimacy relevance</td>
<td>Necessary customer closeness of the activities for process execution and customer satisfaction</td>
</tr>
<tr>
<td>Transformational impact</td>
<td>Transferability</td>
<td>General potential via ability for standardization and consolidation with clear splits/ demarcations</td>
</tr>
<tr>
<td></td>
<td>Political implications</td>
<td>Complexity of political implications of the re-sourcing, e.g., resistance of specific departments etc</td>
</tr>
<tr>
<td></td>
<td>Transformational repercussions</td>
<td>Impact of potential re-sourcing activities on culture, reputation, people, etc</td>
</tr>
<tr>
<td></td>
<td>Control/ Supervision implications</td>
<td>Necessity for steering mechanisms and complexity of potential controls in case of re-sourcing</td>
</tr>
</tbody>
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a) Retail & Corporate Banking

We identified huge potentials for cost optimization through sourcing and shared services. The banks’ alternatives are extensive, but barely used so far. “White labeling” outsourcing of retail lending, for example, could be highly attractive. The main advantage of “white labelling” is that the direct client contact remains with the operating bank while risks and the respective costs/requirements are carried by the service provider. This is often called “credit factory delivery”. The bank only has the positive commissions within its Profit and Loss statement, while missing costs for refinancing etc.

A less drastic approach inside the lending process concerns Standard Credits. In this area the process of credit review management, including the credit assessment, has sourcing potential. We have investigated this example in our first Use Case “Handling of credit transactions and collections”.

b) Investment Banking

In comparison to the other pillars of the typical universal bank, Investment Banking has only very limited potential for sourcing and shared services. The reasons therefore are numerous, but mostly due to missing standardization potential and very high importance of customer intimacy and closeness while doing Investment Banking.

c) Financial Markets & Treasury

The potential within Financial Markets varies widely depending on the current setup and structure within the bank. Some banks have centralized trading activities, others are characterized by very decentralized and redundant desks including back offices. In general the biggest potential for consolidation is offered by middle and back office activities. Treasury processes are too essential to be considered for outsourcing but the trading processes are worthwhile to take...
a deeper look at. If we picked the Execution and Settlement Process, for example, we would find out that the settlement and clearing of securities as well as the following custody services are characterized by a high process homogeneity which is a key characteristic for potential sourcing solutions. We have amplified this process in our second Use Case “Securities transaction and settlement”.

d) Marketing and Sales Infrastructure
Across all core business units, marketing services like product management, customer market knowledge, but also branch management etc. can be at least partially shored to central shared services organizations. Marketing services from promotion to intelligence are highly suitable for outsourcing.

e) Compliance
Tackling the costs to meet regulatory requirements intelligent and selective sourcing and centralization has the potential to be a key lever to realize slim budgets and meeting the requirements. Outsourcing should and can be conducted for a very narrow spectrum of processes due to the high sensitivity, but a hybrid sourcing approach could be the key in this case. The usage of external service providers for example for research activities or data analytics and then exploit the economies of scales for the remaining process parts throughout a captive SSC. Due to the high topicality of the Compliance function and its challenges, we have dedicated our third Use Case to identify sourcing potential in the three areas: KYC (Know Your Customer), Controls and Risk Assessment. This Use Case also illustrates the boundaries of sourcing solutions due to the nature of the function.

f) Risk management
Risk management activities has to be separated between direct risk management of the market units to support lending decision processes versus strategic risk management activities.

Considering sales unit risk activities, outsourcing can only be an option in context to sourcing activities of retail and corporate banking, but centralization is highly recommend due to its tremendous potential for cost savings. The potential for strategic risk management lies only within centralization and partially in shoring, but depend highly on the current setup of the bank.

For many risk management activities a wide-range outsourcing cannot be recommended due to strategic and regulatory relevance. However, selective outsourcing is already part of daily business, but mostly not integrated properly. For example rating modeling and other data gathering or analytical activities.

Nevertheless, we have to bear in mind that this overview reflects mainly best-practices and generalized client project experiences. Of course every bank’s structure is mostly historical driven with many specifics. Therefore the indications can be very different, but we strongly believe based on our experiences that there is unexploited sourcing and shared services potential.

In order to understand your specific potential we recommend to undertake a quick check with focusing on a specific business unit and based on our standardized assessment model.
To answer this question and to make sourcing solutions more tangible, we have identified, qualified and selected Use Cases. They are a central element for us to show the impact of sourcing solutions and to demonstrate concrete benefits and value potential for clients.

1. Handling of credit transactions and collections

**Description**

**Credit transaction**: The process of credit review management is split into two sub-processes: Assessment of credit worthiness and the review of existing credit profiles. Especially the credit assessment should be examined more closely when it comes to the identification of sourcing potential. Main tasks in this process are:

- Check the customer via Rating agency
- Writing of recommendation reports
- Making credit decision

These are laborious and complex tasks and consume a lot of staff time which make them predestinated for sourcing solutions.

**Collections**: The collection process consists of four sub-processes:

- Dispute Management
- Collect outstanding debt
- Doubtful receivables
- Send statements

Relevant work steps are the contact with the customer, reporting and documentation, triggering dunning actions and taking legal actions. All these tasks include a lot of administrative and transactional work and also consume a lot of resources. In this case it would even make sense to consider the complete collection process for sourcing solutions.

**Benefits for Sourcing Options**

In case of a transfer of the mentioned credit assessment or the collection process to an external service provider, banks could achieve the following benefits: External service providers have generally better systems, specialized software and tools to give an overview of the credit and collection data. Furthermore the outsourcing would lead to an improvement of working capital in the company especially due to the higher collectability of the outstanding debt with help of external know-how. Nevertheless there need to be rules and contract guidelines between banks and external service providers to guarantee the banks remain in charge of their own business and in control of their business risks. Therefore also precise and verifiable assessment criteria need to be passed and aligned with the providers.

**Market trend**

Since the turn of the Millennium many bank related service providers offer the support of credit transaction and collection process in their portfolio. Especially in the last years outsourcing of credit processing has reached a certain level of standardization in a lot of sectors which allows now for further outsourcing. In German financial institutions there was the trend that loan handling and sometimes also the credit assessment was outsourced. Furthermore it can be seen that rarely the complete credit and collection process has been outsourced but instead parts of the processes.

Due to the described challenges which banks are facing, they should consider these processes when they take outsourcing into account. It is a good way to become more efficient and to get along with rising regulatory attention.

2. Securities transaction and settlement

**Description**

When examining the customary handling of securities transactions in banks, the challenges and current problems emerge. Again the increasing number of new regulations and new product innovations as well as growing trading volumes needs to dispose banks to search for external help as they cannot manage it by themselves anymore. Furthermore there are complicated and error-prone transaction processes in place which are often not automated and harmonized. This is often the as-is situation in case of cross-border transactions.

To identify possible sourcing needs, the process of securities transactions will be analyzed and the relevant steps exposed.

The purchase or sale of securities can be split in three steps:

- Getting a quotation
- Concluding the transaction
- Posting the transaction

Especially the back-office functions in this process and the settlement and clearing of securities as well as the following custody services are applicable for outsourcing – a high process homogeneity is given.

**Market trend**

Based on the described challenges it is expected that the demand for sourcing solutions for security transactions will increase. In the service supplier market there are already players who offer the transfer of the complete processing of stock-market transactions, administrative and accounting services for these accounts. But predominant for outsourcing are still the back-office security processes.
Capgemini Consulting has longtime experience in creating feasibility studies and execute the implementation of Security Shared Service Center. Benefits which go along with such an outside solution are the reduction of cost per trade and the provision of a common, standardized and highly flexible operating platform. Furthermore, banks can reduce the complexity and the resources which are required to comply with the increasing regulations.

3. Compliance services and risk
Description
In the last years the Compliance function has faced new challenges which force it to reinvent itself. Regulations have been strengthened and sanctions against organizations have soared up. Financial crime is constantly evolving and adapts quicker than the organizations. Concerning the internal organization, Compliance Departments are seen more as a “business stopper” than as a business partner. These challenges lead to multiple requirements for the Compliance function. They need to increase expertise to better control risk, encompass more risks and improve processes, leveraging on new technologies.

As it is difficult to cope with those challenges only from within the company, it is time to consider some sourcing options. As a matter of source, the sensitivity of this topic needs to be taken into account when discussing possible solutions.

Compliance procedures
The compliance procedures can be split into three parts: Know-your-customer (KYC) which contains the process of getting information of the customer, Controls, and Risk Assessment. In the following the sourcing potential of these three components is analyzed.

KYC. This process could be supported by externals in terms of research services. Third parties could get reports and provide additional information on the customer and analyze public information. These providers are typically Intelligence Services companies.

Controls. Due to the sensitivity of this topic right now only captive Shared Service Centers are known. As an example, a big European bank processes controls for guarantees for example in a captive SSC in Mumbai. Banks started to industrialize these processes but they are careful to fully outsourcing this business activity. Furthermore the Compliance function is in charge of the second and third level of controls which means they control the controls and ensure that a full control framework is in place. Instead increasing the first level of controls, the main efficiency could be where operational activities are rising.

Risk Assessment. This topic is as sensitive as Controls. Nevertheless the data collection and the storage of data could be given to service providers as well as the analysis of qualitative information. But for the judgmental part, people would need deep knowledge and due to the high sensitivity it would be kept onshore. No industrialization would be possible in this area. In the context of Risk Assessment it can be also seen that banks are searching for partnerships with trusted partners (e.g. SWIFT) which provides data analytics and mapping of their transactions.

Market trend
Looking at what exists already on the market, and taking into account that the Compliance function needs to get more operational a growing offer of services can be seen. Starting from Compliance regulatory reporting, testing and monitoring of business processes or an Ethics hotline the range has expanded in the last years. Examples of processes which banks have already offshored are: Training support, Anti Money Laundry (AML) monitoring and filtering, electronic communications surveillance or Transaction monitoring consisting of pre-screening and alert management. These services are offered for Retail & Corporate Banking as well as Investment Banking.

Challenges
If banks think about outsourcing of Risk and Compliance, the data security requirements and expectations for the security environment are always in the center of attention. Units need to obtain assurances that outsourcing services are compliant with Group policies and regulatory requirements. Often this leads to a hybrid sourcing solution and banks prefer to work with captive SSCs.

The challenges banks are dealing with right now and the benefits of sourcing solutions like gains in quality and efficiency, access to subject matter experts and the availability of data analytics will lead to an increasing demand in finding solutions with employees outside the companies.

To sum up: The main driver of Compliance is to ensure very good quality to fulfill the requirements of the regulation. Sourcing solutions are a lever in this context but with limits because of the nature of Compliance.
4 Conclusion

In this point of view, we introduced our House of Banking which represents the core banking functionalities and its processes. Furthermore we described methods on how to evaluate sourcing potentials on core banking processes along a set of criteria. As mentioned in chapter two, the Capgemini Consulting’s proven approach is able to conduct quick checks within your bank and analyze hypothesis on future sourcing options. To underline our approach, three use cases were presented in chapter three describing sourcing potential and market trends.

To summarize, we have proven examples that lots of potentials can be raised to improve bank processes and make them more efficient at the same time. In the introduction, the Cost-to-Income ratio was stated out to be one of the most important key performance indicator within the banking industry and that the range differs widely between the institutions. Sourcing has proven to be one essential part in order to improve this figure.

5 Why Capgemini?

Capgemini Consulting is your partner to leverage your potential in your institution. With deep expertise in the bank industry, process know how and successful Shared Service implantations within a huge width of industries, we are able to offer full service also along technology and outsourcing services. This means, we are offering full end-2-end solutions, with the right know-how, at the right places, at the right time. One of our key differentiated advantages is our unique Collaborative Business Approach. We attend in joint teams with the client, consulting with best effort, using our broad project experience along best practices and are using our well-known international Capgemini network to get the best result for our client.
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