



# **Bankers As Buyers 2010**

*A collection of research, observations and articles about what technology, solutions and services bankers will buy in 2010 and the changing financial industry landscape*

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Dear Readers:

If you are reading this year's report, congratulations, you have made it through the toughest 12 months for the financial industry in most of our lifetimes. This year, I saw *my* bank fail and began a relationship with a progressive credit union (so far, so good). I was introduced to the term "pipe farm," meaning an unfinished residential development (and we now have a client who helps banks dispose of pipe farms).

I am also intrigued by all things outside the branch or "non-branch channels." A small minority of banks are expanding branch networks, fewer people are going to branches and there are more ways to connect to customers. Shouldn't banks learn how to develop deep relationships and cross-sell with customers they do not often see face-to-face? To that end, Richard Crone addresses in his article the importance of mobile payments and the need to integrate the mobile channel in the account opening process. Additionally, we have included several bankers and analysts discussing their views on social media.

The historical focus of *Bankers As Buyers* has been to help financial institutions and those companies serving them validate their strategic IT direction, compare investments in technology by type or direct further research. Today, we have narrowed our focus to discuss the trends and conditions that could impact spending in the coming 12 months and beyond. David Peterson's article highlights seven areas of opportunities. This year's edition is rife with practical realism and cautious optimism.

Quintin Sykes of Cornerstone Advisors starts his article with a disclaimer, "There is no absolute amount that a financial institution should be spending on technology...(it) must be considered in the context of the value received."

In his essay *The New Normal: Adapting to Change*, Zoot Enterprises' Chris Nelson addresses banks' need to break down internal barriers and view customers across the entire credit lifecycle.

We see the value of *Bankers As Buyers* as bringing together experts, various research findings and market data, then presenting the information in an organized report. This year's survey has been greatly enhanced by information provided by or originally published by:

**Aite Group**

Christine Barry

**Atlantic Southern**

Daniel Robbins

**Bradway Research**

Bill Bradway

**Celent**

Jacob Jegher

**Cisco 2009 Annual Security Report  
Continuity Engine**

Andrew Greenawalt

**Cornerstone Advisors**

Quintin Sykes

**Credit Union National Association  
(CUNA)**

**Crone Consulting, LLC**

Richard Crone

**Federal Deposit Insurance Corporation  
(FDIC)**

**IDC Financial Insights**

Jeanne Capchin

Marc DeCastro

Karen Massey

Dana Wiklund

**Independent Community Bankers of  
America (ICBA)**

**Javelin Strategy & Research**

James Van Dyke

**MountainOne Financial Partners**

Liz Bissell

**Pan American Bank**

Jesse Torres

**Pew Internet and American Life Project  
Sawyers & Jacobs, LLC**

Jimmy Sawyers

**The State Bank**

Brad Rose

**TowerGroup**

**Trusteer**

It is our pleasure to provide you with this 2010 edition of *Bankers As Buyers*. While the material is copyright protected, you have my blessing to share this document with your business associates, clients, prospects and friends within the industry.

Sincerely,



Scott Mills, APR

President

William Mills Agency

# Table of Contents

## Introduction

### I. Year in Review

### II. Spending Outlook

- A. Market Size
- B. Spending Projections

### II. Spending Breakdown

- A. Regulatory Spending
- B. Security Spending
- C. Mobile Banking
- D. Community Bank Perspective
- E. Cloud Computing, Software as a Service
- F. Social Media
- G. Integration
- H. Analytics
- I. Other Technology Spending

### III. Featured Articles

***Capitalizing on Opportunities in Times of Adversity:  
Seven Silver Linings in the Dark Clouds of Financial Services***

By David L. Peterson, i7strategies

***Well-Positioned IT Vendors Will Weather the Storm***

By Marc DeCastro and Karen Massey, IDC Financial Insights

***The Dude Will Not Let This Technology Spending Aggression Stand***

By Quintin Sykes, Cornerstone Advisors

***Top Trends Impacting Bank Technology for 2010***

By Jimmy Sawyers, Sawyers & Jacobs, LLC

***Mobile Banking & Payments: The One Who Enrolls is the One Who Controls***

By Richard K. Crone, Crone Consulting, LLC

***The New Normal: Adapting to Change***

By Chris Nelson, CEO of Zoot Enterprises

## **Introduction**

The effects of the credit slowdown that started in 2007 and picked up steam in 2008 were compounded by a sharp increase in unemployment in 2009. The result was higher defaults for mortgages and other types of credit, tightened credit terms and conservative spending that scrapped many technology and other projects that had been on the books.

So the technology spending reduction that began in 2009 is likely to continue in 2010, though there are signs that projects could pick up in the second half of the year. Even when spending does pick up, however, increases will be slower than in the past. Demand will be slightly lower because there are fewer financial institutions every year.

Even with constrained budgets and expected flat technology spending in 2010, decreases in some areas will permit increases in some other areas of technology spending.

### ***Regulatory Concerns Drive Spending Priorities***

After the failures of many financial institutions and federal assistance to others through the Troubled Asset Relief Program (TARP), analysts and bankers alike expect regulators to be more vigilant than ever in ensuring the bank meets regulatory standards for liquidity, safety and soundness. Another concern is financial reform legislation. Though it could be some time before the legislation becomes law, any new rules are bound to include stricter oversight.

### ***Mobile Banking Hits Critical Mass***

Mobile banking is catching on faster than any other bank technology in history. While relatively inexpensive for financial institutions to add, banks are seeing a quick ROI while attracting new customers and enhancing the relationships with current customers.

### ***Community Financial Institutions Face Opportunities, Challenges***

Many of the healthier community institutions continue to gain customers, some through acquisition of a growing number of small failed banks and others because consumers are seeking to spread their business among multiple institutions.

### ***Cloud Computing, SaaS Leverage Technology Dollars***

Financial services firms have been a little slower than some other industries to adopt cloud technologies, but are now moving to virtualization, which enables them to use and pay for hardware resources as they need them.

### ***Social Media Takes Center Stage***

Social media platforms, such as, Twitter and Facebook are exploding in popularity with consumers. Many bankers have dipped their toes into social media, but there are few case studies on how they have helped grow accounts or deposits or what the norm for return on investment (ROI) is or should be. While the platforms are “free,” banks are wrestling with policies, resources and integration with other marketing and customer service channels.

## **I. Year in Review**

Probably more so than any other year in memory, the projections for technology spending for the next year can't be discussed without looking back at the previous 12 months.

Perhaps Brad Rose, vice president of technology for The State Bank (\$100 million in assets), La Junta, Colo., put it best: "2009 was a horrible year."

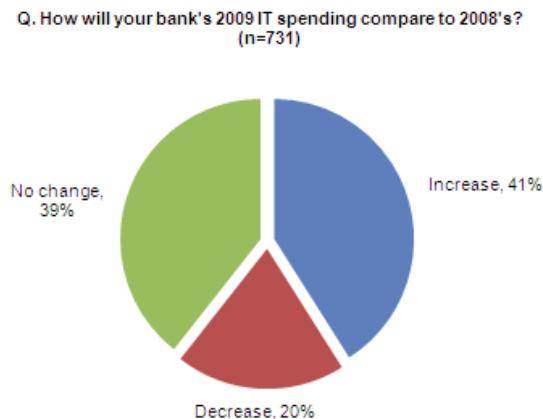
At the beginning of 2009, the banking industry was reeling from the subprime meltdown that eventually led to the government takeover of government-sponsored enterprises Fannie Mae and Freddie Mac, failures of Washington Mutual and smaller banks and near-failures of many other financial institutions. Concern over the health of remaining financial institutions eventually led to the recently approved banking reform legislation in the House that is also under consideration in the Senate.

The downturn in the financial services industry, particularly at the beginning of 2009, led to some sharp changes in technology budgets, most of which had already been scaled back.

"At the beginning of the year, we saw a lot of projects cancelled," said Quintin Sykes, managing director for Cornerstone Advisors, Scottsdale, Ariz., "A lot just got put off."

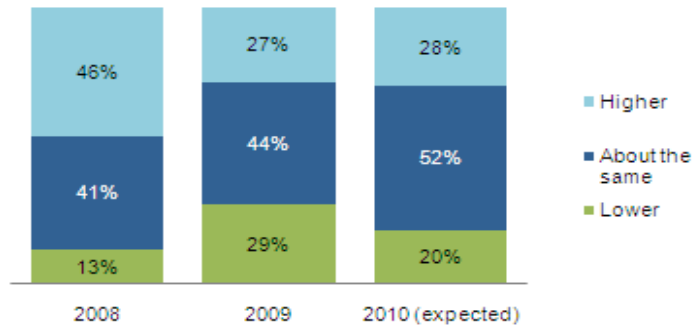
"Toward the end of 2008, we saw a slowdown that continued into 2009," said Christine Barry, research director for Aite Group. "Projects that had been considered a high priority were put to the side and the focus shifted to cutting costs and increasing stability. A lot of banks were distracted by the new regulatory requirements, which had a lot of impact on new product development. More of the focus was put on cost cutting and compliance."

In a February survey of community banks, Aite Group found that 41 percent of community banks expected to increase their technology spending from 2008.



Source: Aite Group/ICBA February 2009 Survey of Community Banks

Q: Please indicate how your firm's IT budget has changed/will likely change from the prior year.  
(Among Total FIs, n = 80)



Source: Aite Group's Survey of 80 North American Bank CIOs/Technology Executives, July-August 2009

*In a survey only four months later*, that outlook had waned, Aite discovered, with only 23 percent of small banks and 27 percent of all banks expecting to spend more on technology in 2009 than during the previous year. The outlook for 2010 was similarly bleak.

Though there has been no hard data since then, Barry says, the expectation is that the spending mood is even more conservative as the new year starts, an expectation that many other analysts and bankers share. However, the general feeling is that the soundest financial institutions will slowly look into some new areas of spending. But many will look for quick returns or technologies that offer Software-as-a-Service (SaaS) and other pay-as-you-go contracts.

However, Sykes said that *Cornerstone did see a slow pickup in technology spending the second half of 2009*, a trend that other analysts saw as well. While financial institutions were still focused on expense control, they started investing some money in mobile banking, risk management and online account opening efforts. "The mood was a little more upbeat, which was surprising to me."

In spite of the economic crisis, banks proceeded with strategically important technology initiatives, such as Bank of America's branch technology rollout, according to Bill Bradway, founder and managing director of Bradway Research.



Source: Aite Group, originally published in *Bank Systems & Technology*

## II. Spending Outlook

### *A. Market Size*

The consolidation in the industry continues, with the pace quickening in the second half of the year as failures and mergers of necessity removed an increasing number of financial institutions from the market here and overseas.

According to FDIC September 2009 and Credit Union National Association June 2009 data, the depository institution landscape is as follows:

Number of:	
Commercial Banks	6,911
Savings Banks	1,188
Credit Unions	<u>8,064</u>
Total	16,230

Though this represents only a 1.3 percent drop from the 2009 *Bankers as Buyers* report, more than a handful of additional institutions were shuttered since the FDIC and CUNA released their figures. To keep a closer look at banks in trouble, consider following Board of Governors of the Federal Reserve System enforcement actions press releases at: [www.federalreserve.gov/newsevents/press/enforcement/2009enforcement.htm](http://www.federalreserve.gov/newsevents/press/enforcement/2009enforcement.htm)

The decline could accelerate quickly in 2010 as regulators close more insolvent banks, most of them small, undercapitalized institutions. However, there's been much discussion about a coming wave of commercial lending defaults. Many economic experts have issued warnings about this for several months, but the crisis has yet to occur. If the gloom and doom predictions prove to be largely true, that could lead to the failure – barring further government assistance – of larger banks with large commercial lending portfolios. Smaller banks have failed as well, and more could be in trouble.

<b>TABLE III-A. Third Quarter 2009, All FDIC-Insured Institutions</b>					
Third Quarter (The way it is...)	All Insured Institutions	Asset Size Distribution			
		Less Than \$100 Million	\$100 Million To \$1 Billion	\$1 Billion To \$10 Billion	Greater Than \$10 Billion
Number of institutions reporting	8,099	2,912	4,496	579	112
Commercial banks	6,911	2,588	3,798	440	85
Savings institutions	1,188	324	698	139	27
Total assets (in billions)	\$13,247.3	\$160.3	\$1,346.1	\$1,497.9	\$10,243.0
Commercial banks	11,866.4	142.9	1,104.2	1,158.9	9,460.3
Savings institutions	1,380.9	17.3	241.9	339.0	782.7
Total deposits (in billions)	9,100.9	132.4	1,090.3	1,116.7	6,761.5
Commercial banks	8,178.2	119.0	904.3	863.5	6,291.4
Savings institutions	922.7	13.4	186.0	253.2	470.1
Net income (in millions)	2,833	72	-131	-1,761	4,654
Commercial banks	1,457	30	13	-1,508	2,921
Savings institutions	1,377	42	-145	-253	1,733

Source: <http://www2.fdic.gov/qbp/2009sep/all3a2.html>

## U.S. CU Profile

	U.S. Credit Unions					Asset Groups - Jun 2009			
	Jun 09	2008	2007	2006	2005	< \$5Mil	\$5-\$20	\$20-\$100	> \$100 Mil
<b>Demographic Information</b>									
Number of CUs	7,846	7,965	8,268	8,535	8,877	2,093	2,197	2,166	1,390
Assets per CU (\$ mil)	112.5	103.4	93.1	85.1	78.2	2.0	11.0	45.9	542.8
Median assets (\$ mil)	15.9	14.5	13.1	12.5	12.0	1.8	10.2	40.5	243.2
Total assets (\$ mil)	882,352	823,612	770,100	726,208	694,151	4,268	24,087	99,476	754,521
Total loans (\$ mil)	581,314	575,813	539,546	506,686	469,888	2,202	12,667	58,243	508,202
Total surplus funds (\$ mil)	268,310	217,340	199,252	190,548	198,284	2,023	10,784	37,128	218,375
Total savings (\$ mil)	746,239	691,765	646,820	615,303	590,781	3,511	20,391	85,838	636,499
Total members (thousands)	91,011	89,912	88,497	87,386	86,171	1,283	4,608	14,696	70,425
<b>Growth Rates</b>									
Total assets	8.2	6.9	6.0	4.6	4.9	2.7	5.3	7.4	9.9
Total loans	4.5	6.7	6.5	7.8	10.7	-2.6	0.1	-4.4	6.0
Total surplus funds	18.5	9.1	4.6	-3.9	-7.2	9.6	12.5	13.1	21.7
Total savings	8.5	6.9	5.1	4.2	3.8	3.5	5.9	7.6	10.1
Total members	1.9	1.6	1.3	1.4	1.1	-1.1	-1.0	1.2	4.1
% CUs with increasing assets	76.3	74.7	57.4	45.5	46.9	59.1	76.6	85.1	87.7
<b>Earnings - Basis Pts.</b>									
Yield on total assets	503	556	589	552	497	515	507	508	503
Dividend/interest cost of assets	188	242	278	235	173	120	136	154	195
Fee & other income *	197	128	135	129	125	119	156	184	201
Operating expense	320	356	338	333	324	431	418	404	305
Loss Provisions	110	88	43	31	39	42	46	63	119
Net income (ROA) after Stab Exp *	23	-2	64	82	85	-54	-29	-7	29
% CUs with positive ROA *	50.7	71.2	87.3	88.9	87.7	40.5	48.1	55.4	62.8
<b>Capital adequacy</b>									
Net worth/assets	10.0	10.6	11.4	11.5	11.2	17.0	14.3	11.8	9.6
% CUs with NW > 7% of assets	96.0	97.6	98.6	98.5	98.0	96.3	96.9	96.0	94.0
<b>Asset quality</b>									
Delinquencies (60+ day \$)/loans (%)	1.58	1.37	0.93	0.68	0.73	3.11	1.87	1.60	1.56
Net chargeoffs/average loans	1.15	0.84	0.51	0.45	0.54	1.02	0.77	0.82	1.20
Total borrower-bankruptcies	330,526	231,599	160,964	121,265	348,977	2,404	12,072	38,712	277,338
Bankruptcies per CU	42.1	29.1	19.5	14.2	39.3	1.1	5.5	17.9	199.5
Bankruptcies per 1000 members	3.6	2.6	1.8	1.4	4.0	1.9	2.6	2.6	3.9
<b>Asset/Liability Management</b>									
Loans/savings	77.9	83.2	83.4	82.3	79.5	62.7	62.1	67.9	79.8
Loans/assets	65.9	69.9	70.1	69.8	67.7	51.6	52.6	58.5	67.4
Long-term assets/assets	34.3	35.2	29.3	26.4	24.6	4.8	13.5	24.7	36.4
Liquid assets/assets	16.9	14.7	15.7	15.8	15.8	39.4	31.1	23.0	15.5
Core deposits/shares & borrowings	36.6	36.2	37.1	41.0	45.9	78.9	63.4	48.7	33.9
<b>Productivity</b>									
Members/potential members	7	7	7	8	8	16	10	6	7
Borrowers/members	50	51	51	50	50	32	39	43	53
Members/FTE	379	372	374	383	390	380	448	391	373
Average shares/member (\$)	8,199	7,694	7,309	7,041	6,856	2,737	4,425	5,841	9,038
Average loan balance (\$)	12,717	12,621	12,011	11,525	10,878	5,408	7,119	9,204	13,662
Employees per million in assets	0.27	0.29	0.31	0.31	0.32	0.79	0.43	0.38	0.25
<b>Structure</b>									
Fed CUs w/ single-sponsor	13.9	14.1	14.5	14.8	15.4	26.7	16.4	5.9	3.4
Fed CUs w/ community charter	15.1	14.8	14.3	13.6	12.5	5.4	11.6	22.9	22.9
Other Fed CUs	32.0	32.0	32.1	32.4	32.8	33.4	36.0	30.1	26.3
CUs state chartered	39.0	39.2	39.1	39.2	39.3	34.5	36.0	41.1	47.4

Earnings, net chargeoffs, and bankruptcies are annualized.  
 Due to significant seasonal variations, balance sheet growth rates are for the trailing 12 months.  
 US Totals include only credit unions that are released on the NCUA FOIA file.



Source: Credit Union National Association

According to the Aite Group survey of bank CIOs, 35 percent of institutions expect to be busy supporting growth by acquisitions by mid-2011. The expectation is that more banks will fail and that stronger banks will pick up the remains. As such, large institutions (43

percent) will be more likely to gear up for growth by acquisition than smaller institutions (28 percent).

FDIC-insured institutions lost \$3.7 billion in the second quarter of 2009, while total reserves of the deposit insurance fund stood at \$42 billion, according to the latest FDIC quarterly banking profile.

Nearly 20 more banks have been closed since the report came out. Bradway expects more bank closures in 2010 than there were in 2009. ***Institutions that are on the cusp of closure will be loathe to spend on technology in an effort to stay solvent, he said.***

“There is really no question that the high number of banks in the U.S. is a legacy of the old protectionist system ensuring that each community would have access to financial services from a community-based institution,” added Dana Wiklund, research director, risk management for Financial Insights, in a blog. “From a theoretical standpoint, I would argue that we have seen advances in financial services products, technologies and services that has created over-capacity in the financial services system. Our financial services system has so much capacity that it readily facilitated the housing bubble and subprime credit crisis.”

According to Wiklund, “Overcapacity in the system should signal technology companies to look at their products and their own business models to see if they are aligned with industry survivors, but also, are they exposed to the strategic risk of overcapacity within the solutions they offer? Do their forward looking product development cycles include solutions that are aimed at a highly saturated market segment and therefore open to the risk of pricing compression?”

Wiklund recommended that every solution look across their product and customer sets and map which products are well-situated in a sector of financial services that is fully saturated from an end-user and customer of end-user standpoint.

***“The world’s best technology companies have excellent foresight but also the fortitude to change direction ahead of the market realities of overcapacity,”*** Wiklund said. “The issues raised here can have very deep implications for organizations. They are part of an organization’s strategic risk assessment, but a part that is very difficult to manage because it is only partially within the organization’s control.”

### *B. Spending Projections*

Bankers and the companies that provide their products and services are expected to face another challenging year in 2010, with bankers focusing most of their spending on regulatory and security concerns and very little on new areas of business.

Rose said technology spending will be nil at his bank. However, he added that the financial institution has in-house technical expertise to handle any security or other

technology-related needs that might arise. *Financial institutions lacking this expertise will need to go to vendors and consultants to keep up with any technology changes.*

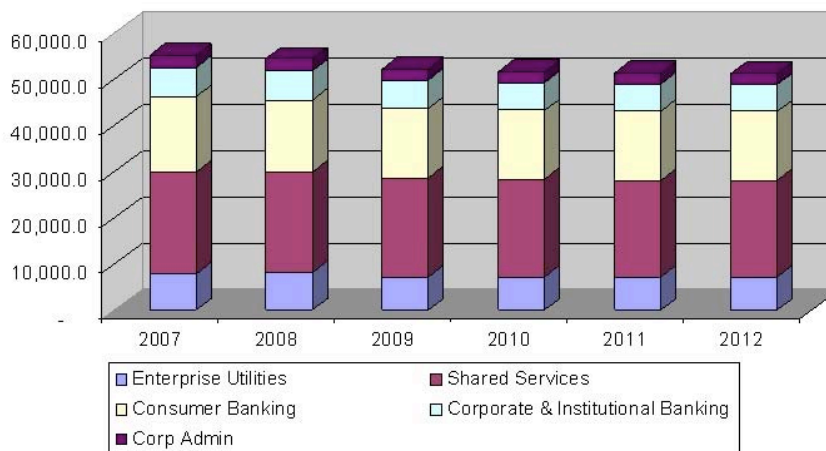
Jeanne Capachin, research vice president, global banking, for IDC Financial Insights sees a slight pickup in spending in the second half of 2010, with more growth in 2011. But even 2011 will be a new normal, with slower growth than was typical in the 1990s and earlier this decade.

“A lot of things will reset to lower levels than they were before,” said Capachin, who sees technology spending slightly down again to flat for the year.

Bradway agrees with the total spending assessment, but said that there will be growth in spending for operations expenditures that will be offset by a decrease in capital expenditures. Like other analysts, Bradway doesn’t expect spending outside of those areas that are considered mission critical, though the definition of what is absolutely necessary is very different for the largest 10 financial institutions than for the others.

“With slower growth being the norm, it’s important for financial institutions to carefully consider the financial health of technology vendors,” said Capachin. *“It would be good for banks to diversify some of their vendor risk.”*

## North American Banking IT Spend



Source: IDC Financial Insights 2009

According to an Aite Group survey of North American bank CIOs, 84 percent are going to focus on improving efficiencies through mid-2011. Two-thirds of respondents (multiple responses were permitted) expected to cut costs, while just 52 percent expected to support risk and 48 percent expected to enhance information security. Forty-three percent are also busy investing in virtualization technology, with large institutions (54 percent) being more likely than smaller ones (30 percent) to invest in virtualization technology.

Despite a primarily defensive focus in their IT spending for 2010, **39 percent were planning to focus in the next 24 months on preparing for future growth**, according to Barry.

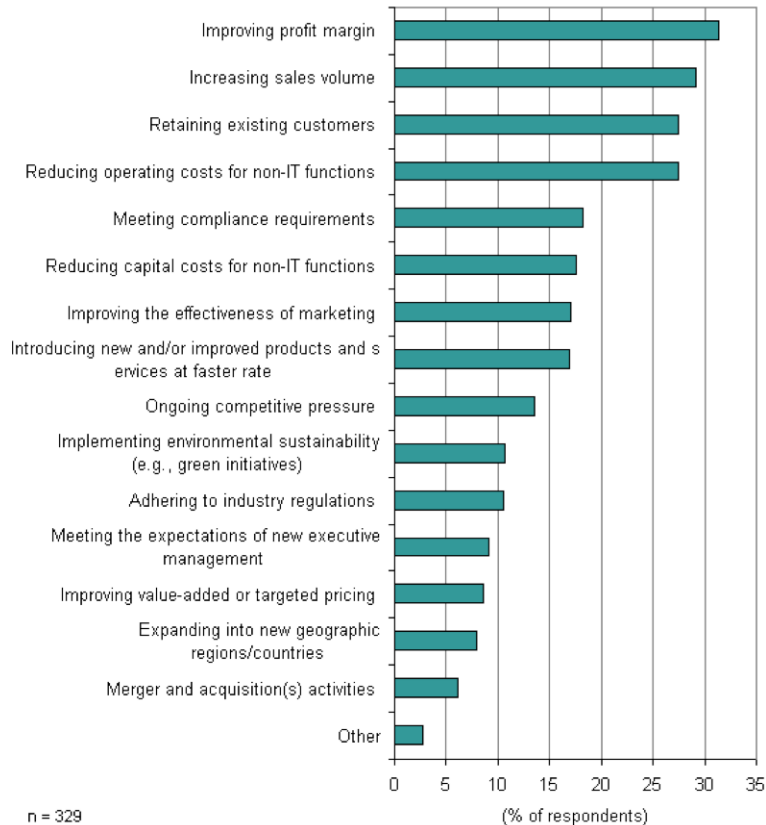
According to Aite Group, reducing the use of professional IT services vendors will be “very important” to 15 percent of banks and “somewhat important” to 58 percent of them. Large institutions will be more likely to embrace such tactics than smaller ones, a difference Barry attributes to the heavier reliance of large institutions on IT services vendors.

**IDC Financial Insights expects the top technology spending priorities for 2010 to be focused on improving profit margins, increasing sales, retaining existing customers, and reducing operating costs.**

Therefore, according to IDC Financial Insights, IT investment will focus on essentials, such as fraud and compliance, as well as maintenance, at the expense of innovation, which is unfortunate in this increasingly competitive industry. Security will continue to be a priority as well as financial institutions seek to protect and improve on their reputation of trust.

IT Investment Drivers

Q. Over the next 12 months, which of the following initiatives will be significant in driving IT investments at your U.S. organization?

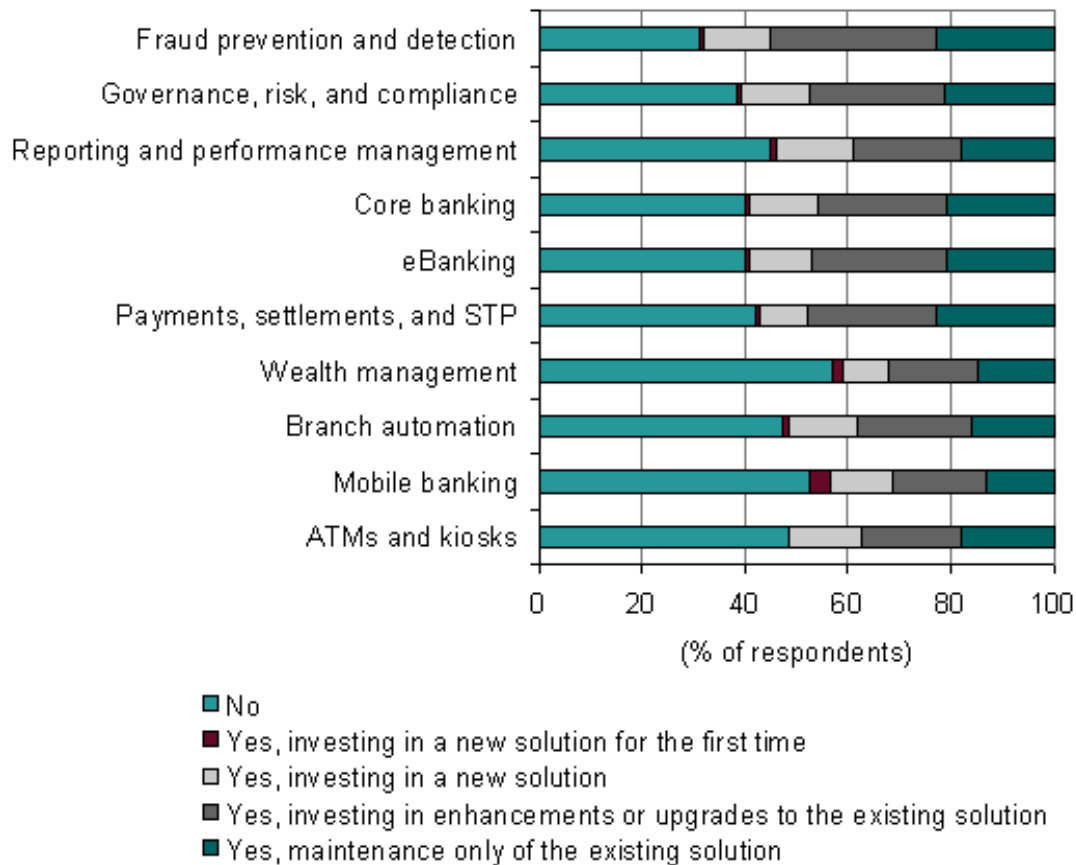


n = 329

Source: IDC Financial Insights, 2009

## Planned IT Investments Through 2010

Q. Do you plan to invest in the following solutions in the next 12 months?



n = 329

Source: IDC Financial Insights, 2009

**Bradway also sees different technology spending plans for the largest financial institutions.** While JP Morgan, Bank of America, Wells Fargo and PNC focus on integration and other technologies to enhance the synergies of their acquisitions of other large financial services providers, smaller financial institutions will focus their technology dollars on security, payment systems and other areas where they can achieve better efficiencies.

## II. Spending Breakdown

### A. Regulatory Spending

After the government assistance through TARP to some of the nation's largest banks and failures of many of the smallest ones, regulators will be scrutinizing financial institutions more closely than at any time since the thrift crisis of the early 1990s, and perhaps more than even then. The fear is that many more banks could fail as expenses for FDIC insurance, regulatory compliance and security go up, revenues stay flat at best and delinquencies in credit continue.

Much of the regulatory spending will center around better monitoring and transparency, according to Barry.

***Much of the problem with meeting regulatory compliance requirements is that most of the compliance technologies have been developed for the largest financial institutions,*** leaving thousands of smaller financial institutions with many of the same manual systems that they've had for the last 20 years – systems that require plenty of manual input, said Andy Greenawalt, CEO of Continuity Engine, New Haven, Conn. Those systems are not only expensive to operate because of the required manpower, they also don't provide the risk monitoring and controls that regulators want.

***“Compliance comes down to something that people have to do,”*** Greenawalt said. As regulators scrutinize bank lending, policies and other activities more closely, banks need to invest in compliance technology that helps them more closely monitor activities throughout the institution.

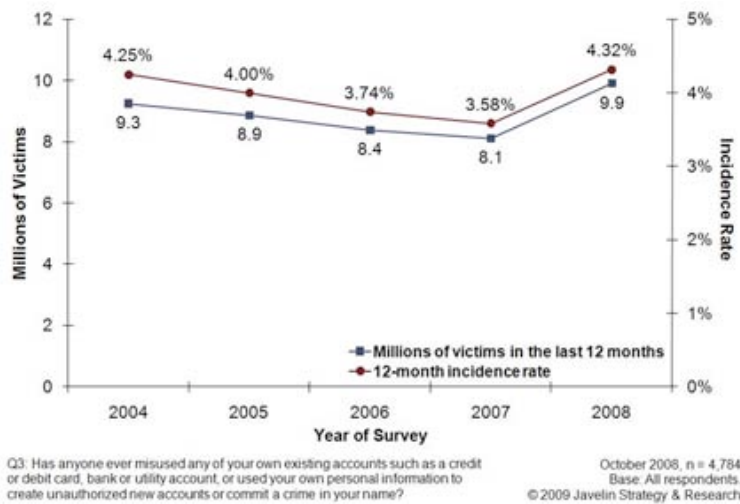
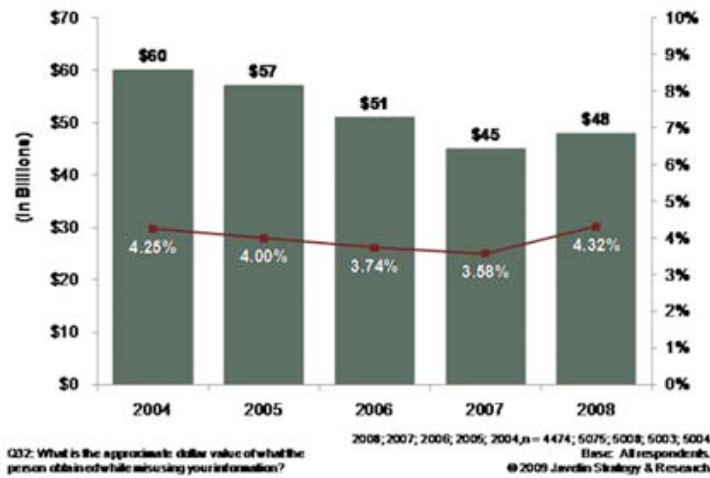
Analysts agree that regulators will more closely scrutinize bank compliance, including risk, stress testing and monitoring of financial health. But Bradway thinks that banks will hold off on any new regulatory spending until any financial reform legislation becomes final. Even when it becomes a reality, there will be several months between the law being finalized and the date it goes into effect, Bradway said.

### B. Security Spending

Financial institutions need to stay ever vigilant with their security as identity theft attempts and other security threats continue to mount.

In 2008, the incidents of identity theft grew 22 percent from the previous year, and more growth was expected when the 2009 figures were completed, according to Javelin Strategy and Research.

Trending Overall Fraud Amounts and Incidence Rates 2004 - 2008



Source: Javelin Strategy & Research 2009 Identify Fraud Survey Report

Financial institutions are the targets of much of this fraud, either through phishing attacks in which fraudsters send e-mails to prospective victims asking them for private account information or through more active hacking attempts. Insider fraud is another concern.

Trusteer, a company that sells communications security solutions, reports that 45 percent of bank customers who are redirected to a phishing site divulge their personal credentials. Though the percentage of fraud victims is small (.47 percent of a bank’s customers each year), the losses can be high – and estimated at \$2.4 million to \$9.4 million for every one million customers.

Financial institutions fight phishing through active customer warnings about responding to suspect e-mails.

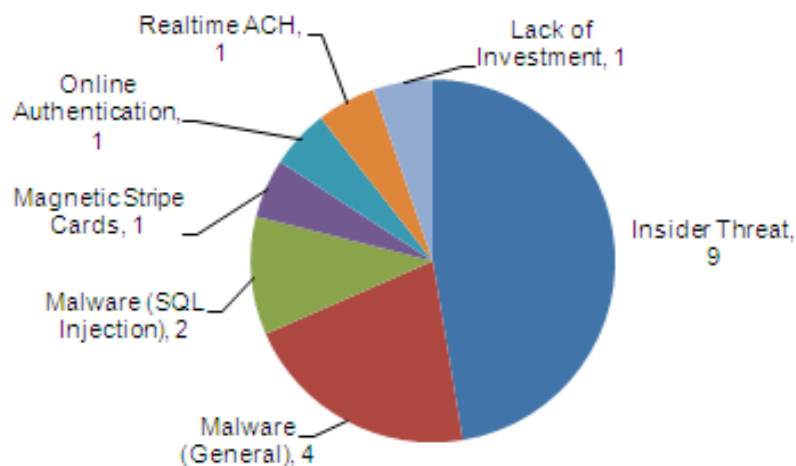
Fighting active hacking and internal fraud requires keeping up to date on the latest threats and strategies and technologies to fight them.

For example, in November, consumers and companies alike received a fraudulent e-mail that had the appearance of having been sent from NACHA. The only reason it was detected in one bank, according to Jimmy Sawyers, partner with Sawyers & Jacobs, LLC, a consulting firm based in Collierville, Tenn., was a high level of traffic noted by the bank's Managed Security Services Provider.

"That's why it's important to monitor outgoing, not just incoming, traffic," Sawyers said.

Analysts agree that it is important for financial institutions to keep up their investments in security, even when revenues are tight, to maintain the trust they have established with customers.

**Q: Focusing on the enterprise, banks in particular, what is the biggest security vulnerability today?(n=19)**



Source: Aite Group Survey of 22 Information Security Experts, May 2009

Yet some financial institutions continue to overlook some better security strategies. According to Javelin, 46 percent of the nation's largest financial institutions could more fully protect "contact us," "help," or other interaction pages against criminal hijacking.

***"We were surprised to find so many banks overlooking this potential area of exploitation,"*** said James Van Dyke, Javelin president and founder. "A cross-site scripting flaw on a customer-facing Web site could allow criminals to access the internal network or at the very least, insert counterfeit content alongside legitimate content on a site and redirect customers to a fraudulent third-party site. For financial institutions, it's all about shoring up even the most seemingly-innocuous areas of risk."

According to the Cisco 2009 Annual Security Report, "Social networking site Facebook reports that from August 2008 to December 2009, its active user base more than tripled, from 100 million to 350 million. As Cisco has continued to report, criminals migrate attacks to where their victims are. They have wasted no time targeting this huge audience, and they are creating more sophisticated ways to take advantage of the trust users place in social media. The Koobface worm, first detected on social networking websites such as

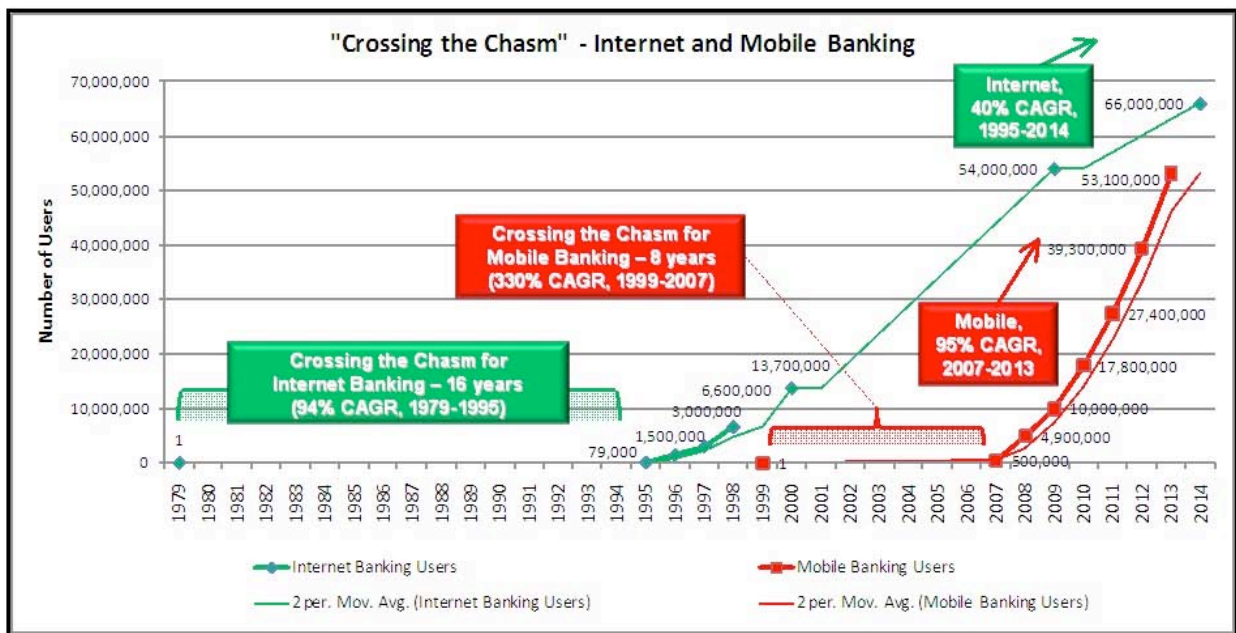
Facebook in 2008, appeared again in 2009, when yet more variants of the malicious software popped up on Twitter, the microblogging service. Estimates indicate that almost 3 million computers have been infected with Koobface.”

*C. Mobile Technology*

Mobile banking is growing hand in hand with the increased popularity of smartphones, netbooks with 3G connections and increased availability of free and low-cost wifi hotspots.

**Mobile banking is growing far faster than Internet banking** and is attractive enough to deliver significant numbers of new customers, said Richard Crone, CEO and founder of Crone Consulting, LLC.

**Mobile banking “crossed the chasm” in half the time of Internet banking and is projected to grow twice as fast because the device is already in use with no infrastructure lag experienced by PCs**



Source: Historical Internet and homebanking figures from Crone Consulting LLC Best Practices Benchmark Database™ with mobile forecasts by Crone Consulting LLC using data from TowerGroup Inc., Needham, Mass. as presented by Nicole Sturgill, Research Director, Delivery Channels at ATM, Debit & Prepaid conference Las Vegas NV October 18, 2009.

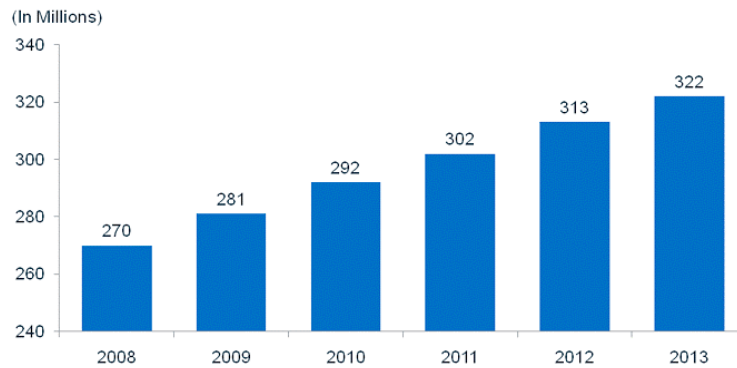
“The market for mobile commerce is coming in three waves, starting first by enabling mobile banking and self-service, followed by activating payment and third by allowing customers to opt-in to user-defined mobile marketing,” said Crone.

The opt-in feature provides a good revenue opportunity for banks because advertisers will pay significantly more to contact prospective customers via mobile communications than through other channels, according to Crone.

Pilots for mobile applications are relatively inexpensive for financial institutions to run, enabling banks to quickly test them without spending too much, Sykes adds.



### US Mobile Device Subscribers (2008–13)



Source: Cellular Telecommunications Industry Association (CTIA), TowerGroup

Exhibit # 59-15F-E2

By 2020 most people will connect with the Internet via a mobile device, according to the *Future of the Internet III*, a report from the Pew Internet and American Life Project.

But now is the time for banks to take advantage of the customer desire for mobile communications, according to Crone. “Mobile payment has been proven to move market. A Visa study shows that 64 percent of consumers ages 18 to 42 **would switch carriers** for phone with payment. More importantly, the same study shows that 58 percent of those ages 18 to 42 **would switch banks** for mobile phone with payment. I have been in the business for 32 years and have brought to market six new payment types, and I have never seen numbers this high for projected consumer adoption.”

Yet for mobile banking applications to be effective, they need to present basic information to customers in a quick, clean way, according to Sawyers. **“In the past, people wanted mobile banking to work just like Internet banking on their PCs.** But now they want something that’s quick loading and enabled to enter a PIN and password, so that you can check a balance, transfer funds or pay bills.”

More robust features, like ordering checks, or online check images, are best left for the full application rather than the mobile one, Sawyers adds.

#### *D. Community Bank Perspective*

Some of the smallest community banks, ones that became caught up in the mortgage lending bubble with risky products, are no longer around. And several, if not dozens of others, could be joining them in insolvency.

However, for the most part these failed institutions have been taken over, with government assistance, by larger community banks.

***“The recession is purging the banks that engaged in risky lending practices,”*** Sawyers says.

For the remaining community financial institutions, the ones that stayed with their core businesses and locations – parts of the business that they knew – are coming out of the crisis just fine, according to Sawyers. These banks are acquiring new customers as consumers seek to diversify their holdings across more financial institutions to minimize the complications from having too much of their assets with one financial institution.

“Community banks will emerge from this stronger than ever,” Sawyers says, adding that trust – which is an inherent characteristic among community banks – is more important than ever among consumers.

Though there are still concerns among regulators and consumers about the health of the remaining financial institutions, Sawyers attributes the larger number of failures among community banks to “the law of large numbers.” There were a larger number of community banks, so more were bound to fail during a financial crisis.

***“Community banks are seeing an increasing share of the deposits,”*** agreed Jacob Jegher, senior analyst for Celent. Now the community banks are pushing customers to move more accounts to them and away from the larger financial institutions.

#### *E. Cloud Computing, Software as a Service*

The value of cloud computing is real, even if the hype is overwhelming, according to Celent. While many community banks have used both for some time, more larger financial institutions are seeing the outsourcing of software and hardware as the best way to manage technology costs in a time of flat or shrinking revenues.

For a bank that has already built a large data center and hired and trained a team to manage it, cloud computing will not provide radical cost savings, according to Celent. But it can serve as an alternative to expanding the data center or as a way of scaling computing power when necessary. For a new bank without an existing data center, cloud computing can make it easier to enter the marketplace without a capital outlay on servers and IT staff.

For example, Celent said, a bank has an existing data center that does fine 30 days of the month. But during the end of month, there is typically a peak in usage that overloads its systems. Instead of spending a lot of money to buy servers that will remain unused 29 days of the month, the company utilizes a cloud computing provider to scale up the number of servers available for one day, paying only for the time used.

## *F. Social Media*

Social Media, part of “other technology spending” in the 2009 report, is quickly gaining traction as Facebook, Twitter, LinkedIn and other social media networks move out of the realm of consumer-to-consumer applications and encompass an increasing number of businesses and professionals who want to build stronger relationships with their customers.

Several large banks, such as Bank of America, are using Twitter to uncover customer issues in an effort to improve service. According to a September 2009 *CFO* magazine article, ***Umpqua Bank has trained 40 employees to respond to complaints via Twitter.*** “It’s savings us money because it’s saving customer relationships,” said Lani Hayward, EVP, creative strategies at Umpqua.

In many regards, social media tools are more easily deployed and used by small- to mid-sized banks, as the tools often cross over departments, require board approval and new policies to be created.

“You can’t argue with the adoption rates of Facebook,” Sawyers said. “It’s added over 100 million in less than nine months. And it’s not just for younger people. It has a large adoption rate for those over 35. It’s being embraced a lot faster than a lot of other technologies. It’s another communication channel for banks.”

The popularity of smartphones, particularly the iPhone, is driving the adoption of social media, according to Sawyers. The ability to be always connected and to send or receive frequent updates, such as account balances, makes social networking essential for customers and increasingly important for financial institutions.

Some financial institutions, “have hit Twitter like wildfire,” said Jegher. In the spring, William Mills Agency evaluated 1,176 tweets created by 63 financial institutions during a 30-day period. The sample group included 29 credit unions, 24 community banks, seven national banks and three regional banks. National banks posted an average of 53 tweets per month, followed by credit unions with 22.5 and community banks with 8.4. The regional banks analyzed did not make any tweets during the sampling frame. For a complete copy of The Bank and Credit Union Twittersphere report, go to [http://www.williammills.com/images/pdfs/research\\_fis\\_on\\_twitter\\_final2.pdf](http://www.williammills.com/images/pdfs/research_fis_on_twitter_final2.pdf)

A couple of bank executives just entering the social media world with their institutions discussed the importance of the new communications tool for their banks.

Pan American Bank (Los Angeles) at the end of November announced that it had entered the world of social media and Web 2.0 through the launch of a blog, Facebook page and Twitter account. Pan American Bank’s social media entry enables consumers to share their banking experiences, offer and read reviews and comments, and learn more about Pan American Bank’s current initiatives.

“The bank’s marketing strategy includes making Pan American Bank more accessible through new media channels that include a blog, Facebook page and Twitter account.

As social media use continues to rise among our target customers, it makes sense that we supplement our customers’ experience through the use of social media,” said bank president and CEO Jesse Torres. ***“As a bank we have a responsibility to meet the changing needs of our customers, including adopting new media in a manner that enhances our customers’ overall experience with the bank.”***

Social engineering is among the initiatives \$1.1 billion Atlantic Southern has on the drawing board for 2010, said Daniel Robbins, senior vice president for the Macon, Ga.-based financial institution.

Robbins sees social media as an important element to build relationships with customers and to separate the bank from many of the others in the state that have financial hardships. Georgia was one of the states hardest hit by bank closures in 2009.

“Social media helps build a sense of loyalty not just between the customers and the bank, but also between the bank and the community,” Robbins said. “It’s a catalyst for business-to-business relationships.”

Another important element of social media is that Facebook, Twitter and other social media portals are increasingly replacing e-mail as a communications tool because time-consuming spam has yet to be a problem with social media, according to Robbins.

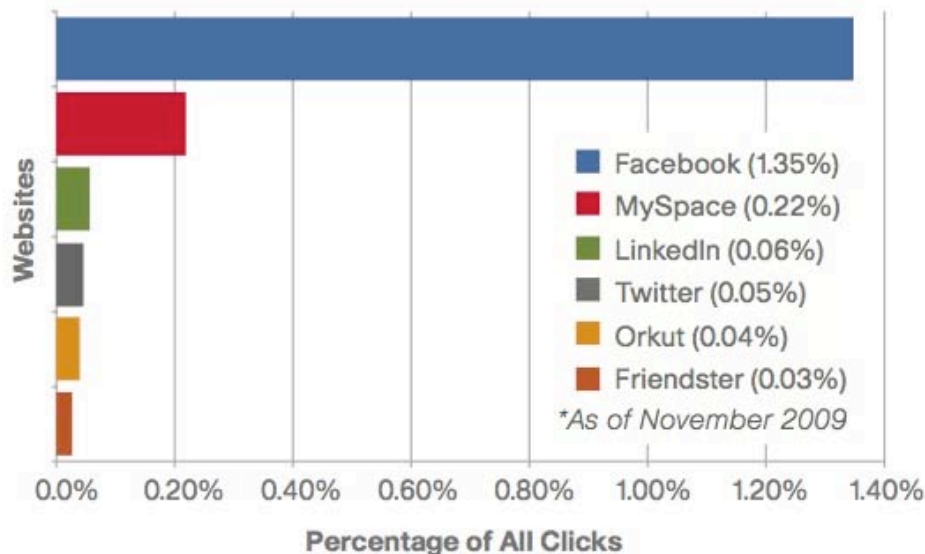
In a Bankerstuff.com webinar on the Banking Twittersphere, Liz Bissell, vice president of Marketing for MountainOne Financial Partners, a bank holding company in North Adams, Mass. shared her bank’s early findings on social media.

“We’ve officially been using Twitter since 4/21/09,” said Bissell. “To our surprise, we find that we connect most often with local community members, banks, and general users, rather than customers and staff as we had anticipated. ***Even though our actual experience is different from our expectation, we don’t find this to be objectionable, just unexpected.*** We also find that very few staff members actually use Twitter; instead, we find them more often using Facebook, which our company also utilizes.”

MountainOne also uses Facebook for featuring photo albums of events, sharing information about upcoming customer seminars, and other general communication, as well as LinkedIn for individual executives and select employees.

***“I strongly urge any company thinking of taking the plunge into official use of social media to have the employees who will be managing the programs first become personal users for several months,”*** said Bissell. “This allows the user to become well-versed in not only the actual mechanics of the service, but of the online “norms” or netiquette associated with the tool as well.”

## Social Media Usage in the Enterprise\*



*In an examination of weblog data from more than 4000 Cisco web security customers, the impact of social media usage on the enterprise is clear. As much as 2 percent of all web traffic in these businesses comes from accessing social media sites, such as Facebook, MySpace, and LinkedIn. "While 2 percent may seem like a small number in terms of an employee's total daily web browsing, it indicates an increase in an organization's need to educate employees on potential losses which could occur via social media," said Christopher Burgess, a senior security advisor to the Chief Security Officer at Cisco.*

Source: Cisco 2009 Annual Security Report

### G. Integration

The failures of smaller banks and consolidations of some of the larger financial institutions means that integration will continue to play an important role in many of the technology budgets.

Integration spending will benefit primarily from the large mergers/takeovers of the last two years, including JP Morgan-Bear Stearns, JP Morgan-Washington Mutual, Bank of America-Countrywide, Bank of America-Merrill Lynch and Wells-Wachovia.

"They have to conclude their integration programs," Bradway said. Integration spending for other banks will be primarily due to programs already in progress.

Many of these institutions had put off integration programs until the acquisitions were complete, Capachin concurred.

Analytics is critical to getting the most value out of mergers and acquisitions, Bradway pointed out. So investments in analytics is not only important for the mega-deals above, but also for the smaller takeovers of failed institutions made with FDIC assistance.

Better integration also leads to better analytics, added Atlantic Southern's Robbins.

#### *H. Analytics*

Financial institutions will attempt to improve analytics to better focus on the most profitable customers and to continue to get a better handle on credit risk. ***Barry expects financial institutions to invest in technologies that provide earlier warnings about mortgage and other credit defaults.***

Regulatory scrutiny will be another catalyst for analytic spending, analysts agree. After the recent financial industry problems, examiners will look at a financial institution's risk controls, including analytics, more closely than ever.

Large financial institutions have depended on analytics for several years to help them better manage their profitability – deciding how to establish fees for different products, what target customers are the most attractive, etc. ***But now more advanced analytics programs are making their way into smaller financial institutions,*** according to Capachin.

Robbins agreed, saying that better analytics also leads to better fraud detection, which is important from a regulatory and a business standpoint. Analytics can help indicate when a customer is conducting a transaction out of the norm (e.g., writing a check or making a deposit of \$5,000 when transactions are typically no more than \$500).

#### *I. Other Technology Spending*

With the items above and concerns about the economy and revenues, spending on other technologies will be limited again this year.

Some of the green technology programs that financial institutions have started will continue in order to maximize the use of document management and other paperless systems, but new programs are unlikely to be initiated.

Sykes sees a trend toward “insourcing” disaster recovery and that it is moving down-market to smaller institutions. Part of the rationale for this “do-it-yourself” mindset is cost and part is the issue of relocating to an outsourced disaster recovery site far away if an event occurs.

***Bradway expects to see some larger financial institutions invest more in video conferencing as banks continue to restrict travel budgets.***

Many financial institutions held off on upgrading to Vista desktop systems and are continuing to work with Windows XP systems, Sawyers said. Some of these banks will consider upgrading to Windows 7 once the first or second service pack comes out some time in 2010. Other deferred upgrades may also be considered later in the year, though most will probably be tabled until at least 2011.

### III. Featured Articles

#### *Capitalizing on Opportunities in Times of Adversity: Seven Silver Linings in the Dark Clouds of Financial Services*



By David L. Peterson, i7strategies

Few would argue that the current status of the financial services industry is depressed. While some green shoots of recovery are evident, employment, housing prices, and the dollar are all still at historic lows. Large financial institutions and mortgage companies have been much maligned by the national press as being primary contributors to the problem due to excessive marketing of adjustable rate mortgages to unqualified borrowers. Wall Street created mortgage derivatives; packaging loans, obscuring the associated risk, then selling these securities broadly throughout the world. The federal government added to the pain by encouraging, some might say demanding, that loans be made to borrowers with questionable credit in an effort to prove they were providing affordable housing options for voters. All of this has led to a recession, or at least an environment that mirrors a recession from an economic standpoint. Independent financial institutions such as small community banks and credit unions have largely been exempt from the loan problems plaguing their larger cousins. However, these smaller institutions are being “painted with the same brush” from the perspective of the news media and their customers, and so, for the most part have gone into “bunker mode,” willing to ride out the storm and hopefully emerge well after the economic recovery is in full swing. They figure it’s just like in the movies; the soldiers at the front of the charge are the ones who get shot. However, during times of great economic stress, the *greatest potential opportunities* exist for those institutions that will emerge from the bunker ahead of their competitors and capitalize on the earliest green shoots of economic recovery.

If you think of a continuum of economic upswings and downturns (see diagram), it would look like a traditional wave form with peaks and valleys. In some cases, the difference between the peak and valley from one year to the next would be minimal and could remain this way over a period of several years, even as long as a decade.

However, where there is significant increase or decrease in economic activity, a dramatic variance in the wave results.



To emphasize this point, the change from January 2008 to December 2009 would have the largest variance of any two years in the last 30. And just as we now can look back at the peak of early 2008 and see how far we could fall (and boy did we ever!), looking at the trough we are in today should give bankers a view of the tremendous upside the coming economic recovery will bring. The question is whether your institution will actively be a part of the green shoots of recovery or remain in the bunker until long after the victor's spoils have been distributed. Failure to recognize the coming opportunities and capitalize on them may represent the single biggest risk you face this year.

Few independent financial institutions are true trend setters. Most bankers “follow the pack,” paying attention to what institutions similar in size or geography are doing and follow suit. Yet for those that break out of the pack, there is an opportunity to take advantage of some unique circumstances that 2010 will bring. First, while larger financial institutions are doing better financially in recent months, there is significant residual mistrust among account holders, leaving the door open for key business account defections. Since business accounts represent your most profitable customer relationships, they are a critical segment of your customer base. Your ability to aggressively market to and attract these profitable accounts must be a key component of your overall marketing strategy. *Now* is the time to make it a “green shoots” priority. Second, there is a movement from the Federal Government to jumpstart lending to small- and medium- sized businesses. To that end, programs like the Small Business Administration’s 7a Guaranty Program will be emphasized as a key part of the green shoots of economic recovery. In addition, since 2010 is a mid-term election year, politicians will be eager to promote any programs that make them look good to voters. In the spirit of “It’s the economy, stupid!” this will be a year to jump on the green shoots bandwagon.

There is also a unique opportunity to cement relationships targeting multiple lines of business. Since credit was so free-flowing through mid-2008, no one seemed to care about consolidating their relationships at one primary institution. Banking services were literally spread among multiple institutions as car loans, credit cards and mortgages were sold to the lowest bidder. Personal and business customers saw no need for loyalty to one institution and banks did little to encourage loyalty. Then came the recession and the accompanying financial services crash; so suddenly, it knocked the largest financial companies off balance and very nearly led us into a depression. The withdrawal of easy credit came so swiftly, individuals and companies were left to search for lenders who, in

turn, no longer wanted to throw money at borrowers. That's when many individuals and companies realized that without a solid primary relationship with a financial institution, there was not a foundation built in the "good" times to be called upon when needed during the "bad" times. With focused effort, banks can reestablish these relationships now, and create a strong new bond that will likely survive the return of easily available credit.

Assuming that you will accept the premise that we are poised to head into a period of recovery, here are the seven areas of opportunity on which financial institutions should focus on for 2010 (not listed in priority order):

- 1) **Increasing Commercial and Industrial Lending** – all commercial banks likely do some commercial and industrial (C&I) lending. However, due to the significant income associated with mortgage lending and the real estate gold rush of the past decade, financial institutions had loan portfolios which emphasized mortgage lending over C&I lending. Now that mortgage lending is flat and banks are scrambling to find a replacement for the interest and fee income that mortgage lending contributed, C&I lending needs to be increased. Many banks do not have dedicated C&I lending professionals, and loan officers who primarily focus on mortgages may be uncomfortable in speaking with prospects for C&I loans. However, the loans secured by assets other than real estate and used for ongoing operations or expansion of new products and services are generally linked to increased sales for the borrowing company. Conversely, without loan sources, companies that are looking to expand or simply remain in operation may not survive a temporary economic downturn, further worsening the local economic situation. If you lack experience in offering these loans, then move aggressively to acquire that talent and ramp up your C&I lending. Even when mortgage lending comes back, and it will eventually, you will be poised for long-term success with a more balanced loan portfolio.
- 2) **The Small Business Administration (SBA) 7a guaranty program** – this is directly related to the C&I lending opportunity mentioned in #1 above. The Obama administration wants to get America back in business and to that end has created a program that will guaranty up to 90% of qualified loans. In the past, the documentation and reporting requirements for such a program have scared away potential participants; however, the economic downturn and reduction in mortgage fee income have led banks back to this potentially lucrative source of lending interest income and fees. By utilizing software that provides various underwriting scoring, documentation, and ongoing monitoring of loans covered by the SBA programs, FIs are learning that these loans need not be difficult to sign, package and monitor. In an area where reducing risk is always a component of finding new sources of revenue, the guaranty that accompanies these loans provides a safety net to be capitalized on.
- 3) **Reestablishing the position of the Financial Institution as Trusted Advisor** – Decades ago, bankers were considered business experts. A company looking for

something new associated with the financing of its business would look to their banker for advice, and in most cases, a product or service that would fill the need. However, for a variety of reasons, banks stopped providing many of the very services critical to the operation of businesses. Examples include payroll processing, bill payment, and merchant credit card processing. Bankers at the time wanted these services out of the bank, often complaining that people were “cluttering up their lobby,” not realizing that they were cutting out the very services that attracted profitable business customers to their institution. As the types of services declined, businesses found fewer and fewer reasons to turn to their bank, and instead turned to Independent Sales Organizations (ISOs) to fill the service void. Over the past 20 years, this reduction in service and the correlative reduction in customer interactions, have led to bankers being viewed as less trusted by customers. This makes sense; the less the bank is involved in new service opportunities, the fewer opportunities they have to be seen in a positive light (i.e., “I had a particular business problem but my banker solved it by offering me...”), and the lower the level of trust a customer has in their bank. This point is borne out in a recent Aite report that showed that banks had reached the lowest level of trust from customers in the last 40 years. Reestablishing the level of trust will put you back at the top of the list of who a business will call with a problem, which will lead to more multi-product sales. Getting back the trusted advisor status will require you to provide more products and services than you likely provide today.

- 4) **The FI as a one-stop shop, or at least the *first* stop** - the types of products and services you offer customers, particularly business customers, must be increased to cover more categories critical to basic business operations. Types of services offered could be: streamlined cash management and payroll processing integrated into accounting systems, credit and debit card processing, accounts receivable factoring, payroll processing, web design and hosting, and potentially even high speed internet and Voice Over IP phones. By creating a “one stop shop” approach, a bank focused on profitable business relationships can significantly increase its visibility as a trusted advisor and generate fee income, while increasing loyalty with key business customers. It will certainly not be as easy to reacquire these services as it was for banks to jettison them; however, by carefully partnering with one or more ancillary firms, banks can provide the types of services most important to businesses without having to operate the services in-house. In fact one such firm, Company.com, has created a business model that is specifically designed to provide key business services, which augment services already provided by your institution. Their program is geared toward rewarding financial institutions that enable its customers with services provided through the Company.com website, and it does so in a manner that does not disintermediate the institution. Regardless of whether you use a partner or offer more services in-house, augmenting basic account processing with critical business services is a primary component of capitalizing on 2010 green shoots opportunities.

- 5) **Small Business Payment Services** – As we roll into 2010, the service commonly known as Merchant Capture or Remote Deposit has established itself as the fastest-adopted product or service ever created for the financial services industry. Yet it is interesting to note that Merchant Capture embodied as capturing checks with a scanner at a time and place of the depositor's choosing, is not of itself a new payment service. It merely replaces the physical depositing of a check with an image captured on the scanner. But it is a service that is valuable to a business, and thus is easy to sell and deploy. As the excitement over Remote Deposit calms down in 2010, other true payment offerings should be reintroduced to customers and marketed with the same passion and budgets that Merchant Capture has enjoyed. Specifically, ACH origination, a low-cost payment service in existence since the 1960's, is a service that many financial institutions rarely offer to a customer unless asked. Yet ACH represents the most "sticky" service that a financial institution can provide; once a business is set up on ACH origination, it is unlikely that they will move their account. Other ancillary payment services include bill presentment and merchant credit card processing.
- 6) **Mobile Banking** – While the previous five items have been focused more on business customers (hello, that's where the revenue is!), this list should not omit services targeted primarily to consumers. First among these would be mobile banking. There is no denying that the ability to perform transactions and access banking information at their convenience is empowering to the customers who utilize mobile banking. The issue is the multitude of models for mobile banking, compounded by numerous carriers using various hardware and operating systems, all of which make choosing a "winner" in the mobile sweepstakes a very difficult proposition. A key element is how far back you want to reach to support older mobile technology. Most new devices have the capability to display a large amount of information on the screen and therefore can access a financial institution's full website and all of the options available for a personal or business customer. Older phones have a much more limited capability to display data, so specific applications were created to enable their use for basic banking transactions. If the move to newer devices is happening within your service area at a relatively rapid pace, logically you would focus on how newer phones access your online banking services via the web rather than on a specific mobile banking application. Even though specific banking apps for newer devices such as the iPhone are now being created, it may be more cost-effective to focus on changes to your online banking site which recognize how customers are accessing them, and adjust the user experience to match the access device.
- 7) **Engaging Customers and Transacting Business Using Social Media (Not Just For Gen Y)** – What are Facebook and Twitter to you? Something your kids (or grandkids) do for fun? At present, Social Networking sites such as Facebook and Twitter represent a new way for people to stay connected. Not just to each other, but also as a method to learn about and access basic services such as banking. New statistics show that more and more, people are using Social Media sites to get recommendations from "friends" as to where they should buy online and

which online services to try. The fact that the information disseminated on these sites is often accessed and trusted *more than any advertising you do*, should laser-focus your attention on the importance of these sites. However, just having a site does not an effective Social Media Marketing Plan make. Some bankers rushed out and setup a Facebook or Twitter site and then did literally nothing else. Being active in Social Media requires an ongoing commitment to make the content compelling and up-to-date *at least* twice a week. While we are not yet at the point where every financial institution should have a full-blown Social Media marketing effort, all FIs should at a minimum dedicate some marketing dollars to survey its customers to determine who is using Social Media and ascertain what expectations those customers may have.

In order to capitalize on any or all of the items listed above, financial institutions must change the focus of sales and marketing efforts from *reactive* to *proactive*. Traditionally, few FIs needed to have any real proactive marketing efforts; you expected potential customers to come to you. Now there are numerous competitors for the basic and ancillary banking services you are providing. Many of these competitors are non-banks: independent sales organizations which are highly effective in selling, and aggressive marketers. Until a financial institution recognizes that it must be more aggressive in its marketing and actually takes steps to create and sustain a sales culture, it will constantly be playing catch- up.

So how will you plan your exit from the bunker? Will you exit with confidence, with smart and safe services that can jump- start your community's recovery? Some might argue that the risk of charging out early is too great. While it is true that being too aggressive early may be a risky strategy; it would seem that given most bankers' proclivity to wait too long, if you think you are acting too early, chances are you are probably acting just in time. You have only so much bandwidth, so it's natural to be conservative. But by carefully crafting a strategy focused on establishing profitable new relationships and taking advantage of government guaranty programs, you will not only be a leader in the green shoots of recovery, you will be planting the seeds of your greatest successes in establishing a larger, more trusted, and more profitable financial institution for the coming years.

## *Well-Positioned IT Vendors Will Weather the Storm*



By Marc DeCastro, research manager, Consumer Banking and Community Banking; and Karen Massey, senior analyst, Consumer Banking  
IDC Financial Insights

North American financial institutions have taken drastic measures to weather this downturn and will spend \$51 billion on IT in 2010, representing a more than 4 percent decrease from 2009.

As budgets contract, financial institution executives are making difficult decisions to prioritize IT investment. Despite the drop in IT budgets, there is still plenty of work that needs to get done, and committed contracts prevent IT executives from being able to free up capital. As these contracts expire and the economic environment improves, IT managers will find themselves back in the game and should position themselves now to strike quickly.

Financial services firms are facing some of the most challenging times in recent history. Financial institutions have been hard hit by the declining economy and the crisis of confidence as the public becomes increasingly disenchanted by government bailouts, talks of excessive compensation, battered share prices, and long-term viability.

With IT budgets constrained, bank executives are being very careful with funds earmarked for IT investment. Limited IT budgets means that executives are diligently prioritizing where they will get the most return for their investment. In 2009, there was a unique period of time when IDC Financial Insights predicted a decrease in IT spend over the calendar year. While we continue to refine our projects for 2010, it is safe to say that any increase in projected spend will likely fall short of 2008 levels. This is a combination of both a consolidating industry and a continued trend to avoid large transformational projects.

The dismal economy has clearly had a negative impact on financial institution IT spending. Overall, IDC Financial Insights expects IT spend in the banking segment to be at a -1.5 percent five-year compound annual growth rate through 2012.

The majority of financial institutions cut IT staff as precautionary measures to reduce expenses as a result of the economic crisis. A surprising finding from this question is that a full 94 percent of financial institutions with \$1 billion to \$10 billion in assets implemented staff reductions as a plan to financially weather the downturn. These large regional institutions are struggling with financial performance. The concern also is that

such deep cuts make recovery a lengthier and more challenging endeavor. Emphasis has to eventually shift away from cost cutting and focus on new revenue opportunities, which requires staff. When the recovery begins in earnest, financial institutions that have cut too deeply may find themselves overspending to retrieve talent that they had recently let go.

A majority of financial institutions planned to reduce IT spend in 2009. Across all sizes of institutions, the percentage with plans to reduce IT spending is consistent at around 80 percent. However, the ways in which they will be controlling costs are varied.

Nearly half of financial institutions with more than \$10 billion in assets are postponing hardware upgrades, as they did in 2009. Financial institutions of all sizes are also reducing the use of contractors to reduce IT expenditures.

Other common actions include postponing software upgrades and postponing and/or reducing IT and business services spending. On the other end of the spectrum, only 8 percent of firms are relying more on outsourcing, and only 6 percent are relying more on software as a service (SaaS) to cut costs.

The financial services industry is indeed in turbulent times with no immediate recovery in sight. In late 2009, many large banks appeared to be stabilizing financially, even among talks of TARP paybacks, decimating executive pay, and mediocre earnings. Regional and community financial institutions, on the other hand, which had appeared more stable in the earlier days of this financial crisis were starting to falter. The number of failed institutions has exceeded the century mark, and this number, which has been growing steadily since 2008, will continue to grow as the industry consolidates.

When IDC Financial Insights looks at the financial services industry going into 2010, we identify four key themes that will be critical to navigating through these difficult times:

- Actively managing customer relationships
- Restoring trust and confidence
- Redefining the business model
- Innovation

IT is a central component to all these themes, and it has recently become more important than ever to make smart, strategic, and financially advantageous IT spending decisions to position the institution for success in 2010 and beyond.

IT priorities and purchasing decisions have clearly shifted in the current economy. Key considerations for financial institutions include:

- As IT spending contracts, financial institutions must not lose sight of current and future customer requirements. Financial institutions must also be sure to incorporate these requirements into their strategic IT plans.

- Vendor management will be critical to managing costs and become an increasingly regulated requirement. In an industry of consolidating vendors in a very competitive landscape, now is the time to evaluate existing and expiring contracts and licenses. Many FinTech vendors have expanded their product offering breadth and depth, and financial institutions may gain cost efficiencies by packaging solutions with these vendors.

FinTech vendors, today more than ever, must demonstrate value to the industry and their client base:

- Vendors must continue to develop IT solutions that will benefit not only the financial institution but the customers as well. Vendors must keep the momentum on innovation and solution-specific advances, Web 2.0, and cloud, for example, even as financial institutions shy away from IT expenses that aren't necessary. The economy will recover, and those vendors that have continued along the path of innovation will be more valuable in the marketplace.
- Pricing is the most important criterion for choosing an IT vendor, meaning these are challenging financial times for FinTech vendors as well. Existing relationships are not as meaningful as in the past since more institutions are under budget pressures and nothing is sacred. Vendors must understand the qualities financial institutions desire in a vendor and honestly rate themselves.

## The Dude Will Not Let This Technology Spending Aggression Stand



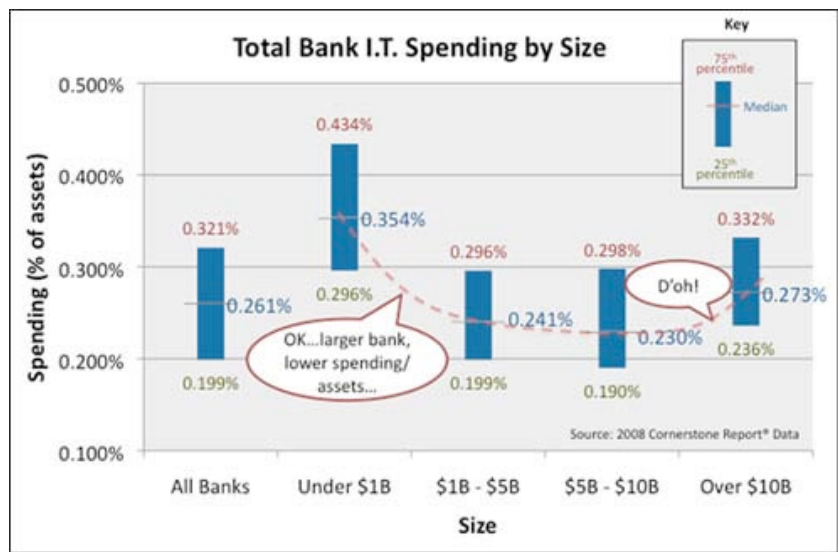
By Quintin Sykes, managing director, Cornerstone Advisors, Inc.

*DISCLAIMER: There is no absolute amount that a financial institution should be spending on technology! Technology spending must be considered in the context of the value received from it.*

I had occasion recently to recall bank merger deals in the go-go days (back when they were unassisted by the government), where a major part of the justification consisted of scale economies. While espoused by many investment bankers, the only thing that seemed to scale well consistently were investment banking fees, as projected cost savings were rarely realized.

The technology spending numbers in the forthcoming *Cornerstone Technology Report* are consistent with other research on the topic: scale economies exist, but only in smaller banks. We found that once banks reach a certain size, technology spending actually begins to *increase* as a percentage of assets. What's the cause? Strategic system spending.

### Bank Technology Spending Highlights, aka “\$1-\$10 Billion CIOs Sure Look Smart”

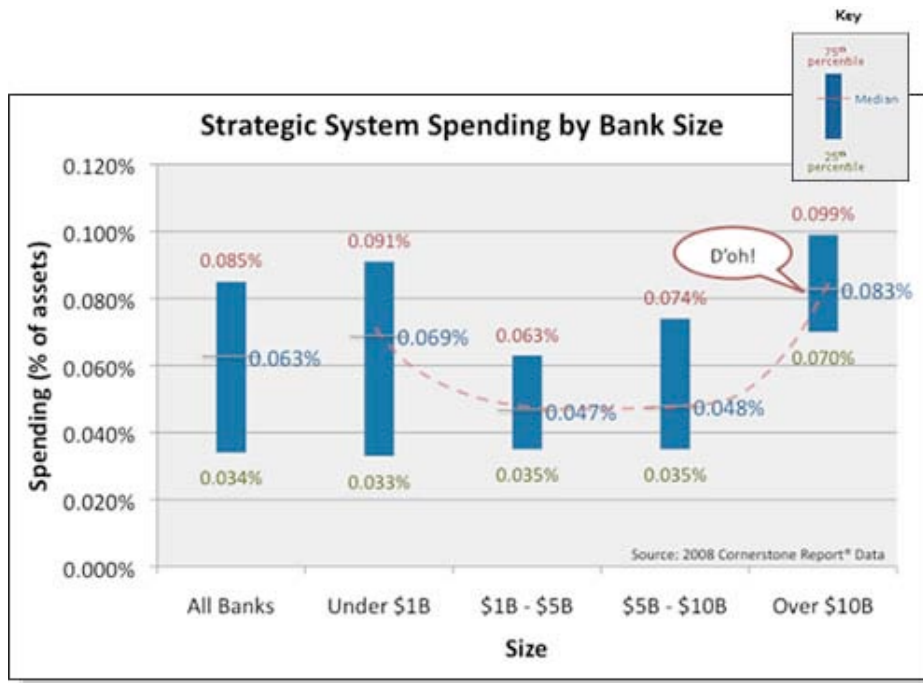


Note: Cornerstone considers the following areas in technology spending (not all of which may be charged to I.T. cost centers): core systems, data communications, electronic delivery, infrastructure, and strategic systems.

As expected, the smaller banks in our study also spend the most as a percentage of assets. They need most of the systems that larger institutions have but don't have the asset base to spread those costs across. As community banks grow beyond \$1 billion in assets, spending on an asset basis starts a gradual decline.

The (inexact) dotted line in the chart above illustrates the inflection point somewhere around \$7-\$9 billion where spending on an asset basis starts to increase. Median spending in \$5-\$10 billion banks is still lower than smaller banks, but in this range there are very different kinds of institutions from a spending perspective. Banks spending below the median tend to be riding their core system and core vendor-provided ancillary solutions (i.e., strategic systems), allowing them to spend less than similar-sized peers. On the other end of the spectrum, towards the 75th percentile, banks are using mainframe-based core solutions, supporting one or more major strategic systems that their peers are not and possibly engaging in large-scale custom system development.

Once banks hit \$10 billion, complexity seen in the bigger spenders in the \$5-\$10 billion segment becomes the norm, manifesting itself not only in the form of significantly higher strategic spending, but also higher infrastructure and core system spending.



What happened to strategic spending in the largest banks in our study (mostly in the \$10-\$20 billion asset range)? Part of the answer lies in utilization of non-traditional strategic systems such as trust and insurance. Larger institutions are more likely to be diversified into non-traditional businesses on a larger scale than their smaller peers. That explains

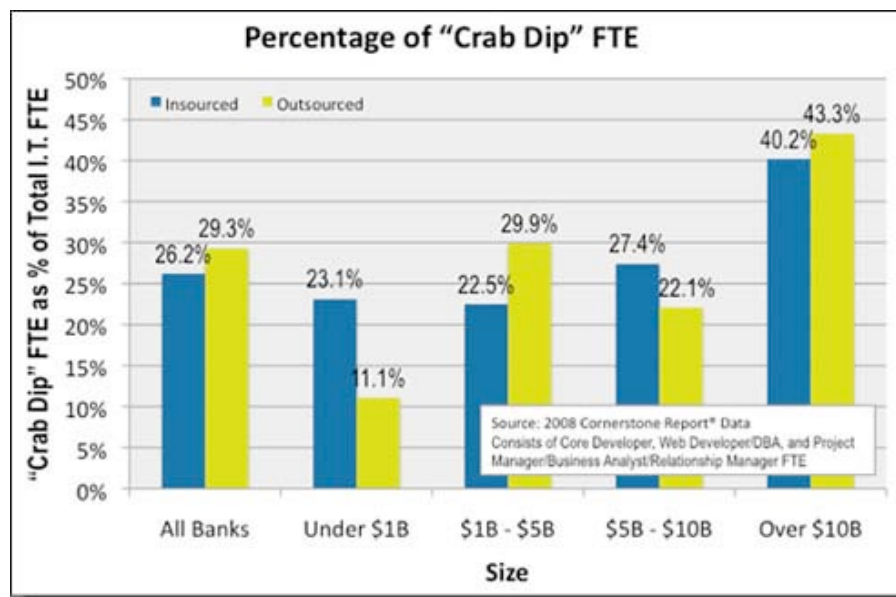
about one-fifth of the increase from the \$5-\$10 billion segment to the over \$10 billion segment.

Again, the bigger institutions get, the more likely they are to go best-of-breed for a given strategic system. Branch automation, loan automation, data warehouse, profitability, and various flavors of CRM solutions are all more likely to be found in these large institutions. Software, hardware, and outsourced services associated with these systems are more expensive than their core vendor-provided ilk and are responsible for much of the variance, but don't forget the significant number of resources that have to implement, upgrade, and support these systems—it's not just a one-time implementation event. In addition, large and mid-size institutions customize often, as opposed to smaller institutions, which rarely do. This adds to the complexity of an organization's IT environment.

### So, How Do You Like Crab Dip?

What kinds of resources are required to address this extra level of complexity? How about "Crab Dip":

- Core/Ancillary System Developers
- Relationship, Development, & Other I.T. Managers
- Application Support Analysts
- Business Analysts
- Database Administrators
- Intranet Developers
- Project Managers



Larger banks have to keep larger IT staffs to deal with the complexity of their best-of-breed environments. Staffing in "Crab Dip" categories described above makes up over 40

percent of IT staffing in \$10 billion and over banks. IT staffing ratios, when measured as a percentage of total bank staffing, are less efficient in banks where the strategic systems environment is more complex because of the additional staffing. This staffing has a substantial strategic spending impact in the largest institutions.

### **Follow a Few Rules to Keep Spending Grounded**

Banks that are already in the high-strategic-spend boat will have a hard time bringing strategic system spending down in the near term if the benefits don't justify the expense. In general, these kinds of systems can't simply be turned off. Limiting customization in the near term may be all these banks can do until depreciation runs out or contracts expire, at which point other solutions can be considered or the lower ongoing costs become tenable.

For growing institutions pondering strategic system acquisitions, here are some rules to live by when considering strategic system investments that will keep you out of the strategic system spending stratosphere:

- **Identify the 80 percent solution.** If possible, identify the 80 percent solution (meaning it does 80 percent of what the business needs) using systems already deployed or lower-cost strategic solution options. Take a hard look at the last 20 percent of requirements and the extra costs associated with them.
- **Don't pay for a toolkit if you don't need a toolkit.** If off-the-shelf functionality in another solution provides an 80 percent or better solution, do you need to pay a premium for a toolkit? Buy off-the-shelf functionality.
- **Avoid customization if possible.** If you need to customize significantly, what good is the package you're looking at?
- **Consider all costs.** Make sure internal staffing is considered in the recurring cost section of your total cost of ownership model (in addition to ongoing maintenance, upgrades, etc.).
- **Quantify the benefits.** Secure hard-dollar revenue or cost savings projections if possible. In addition, identify key metrics impacted by the strategic system investment, how they will improve, and by when they will improve.
- **Execute a lookback process.** For strategic system investments over a certain size, ensure a lookback process is executed to measure progress against benefit projections.

Now don't misread this as a treatise on why there's never a good reason to invest in a strategic system. There are plenty of success stories about high-dollar system deployments that were successfully implemented, achieving the desired payback. While spending will be higher as a result of implementing best-of-breed strategic systems, revenue or efficiency gains can more than offset the additional expense. **Remember, technology spending must be considered in the context of the value received from it.** If their business mix remains constant over time, banks can ride many of the integrated solutions from core providers a long way. By growing and not switching core systems, assets grow faster than maintenance costs, depreciation is reduced as installation costs are fully amortized, and better pricing tiers are achieved in outsourcing arrangements.

Keeping tightly integrated ancillary solutions provides additional benefit as \$1-\$5B institutions avoid the temptation to install best-of-breed solutions or to develop/support large custom solutions.

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## *Top Trends Impacting Bank Technology for 2010*



By Jimmy Sawyers, Sawyers & Jacobs, LLC

Goodbye “Downer Decade.” Many people will not be celebrating the arrival of 2010 so much as saying “good riddance” to the past decade. Perhaps the Downer Decade tag is a harsh moniker but let’s review: Terrorism, wars, hurricanes, tsunamis, corporate scandals, record job losses, divisive politics, pandemic influenza, steroid abuse, sex scandals, Wall Street fraud, bank failures, Ponzi schemes, Lady GaGa, reality TV, and Crocs (okay, those last three are a matter of personal opinion)...but, the decade clearly had its share of bad news on a daily basis.

To paraphrase Ronald Reagan, are you really better off now than you were at the beginning of the decade? Ask your investments. \$10,000 invested in the S&P 500 on January 3, 2000 was worth \$7,581 as of December 8, 2009, over a 24% drop, not counting inflation. Those were the lucky investors, not the clients of Bernie Madoff or Allen Stanford. So much for “buy and hold,” at least to begin the century. For the decade, even three of the bellwether tech stocks delivered subpar gains. According to Standard & Poor’s Capital IQ through December 14, 2009, Dell was down 73%; Microsoft was down 48%; and EMC lost 69% for the 2000s.

We started the decade delirious over anything Internet-related. The Bloomberg U.S. Internet Index had 280 stocks on it and those fell in value by a combined \$1.755 trillion in seven months following the 2000 crash. As noted in Lawrence McDonald’s *A Colossal Failure of Common Sense: The Inside Story of the Collapse of Lehman Brothers*, seventy-nine of the 280 Internet stocks crashed 90 percent from their 52-week high. Investors were willing to turn a blind eye to incompetent management, zero profits, geeks who didn’t understand basic business concepts, and unrealistic predictions of future success. Have we learned any lessons between the March/April 2000 tech stock crash and the 2007-2009 recession? Or, do we appear to be finishing the decade much like we started it?

On a positive note, we saw innovation that gave us more web-based applications as Web 2.0 technologies, the rise of smartphones, more affordable bandwidth, mobile devices, and improved communications all made our lives easier. Clearly, technology has made us more connected and more productive while flattening our world in ways previously unimaginable.

We believe 2010 will see a return to sobriety and common sense but that doesn't mean it won't be full of surprises and disruptive events. Here are a few predictions to kick off the new decade along with a few challenging questions to lubricate your bank's technology planning efforts:

***Prediction #1 - BlackBerry Peaks. iPhone Begins Era of Dominance.***

As of April 2009, 85% of U.S. adults had a cell phone, according to the Pew Internet & American Life Project. Apple iPhone sales exceeded sales of Windows Mobile Devices for the first time in history. In 2010, Microsoft will be left in the dust of Apple as Windows Mobile dies a slow death that not even Windows Mobile 7 can avert.

Time will tell how well phones running Google's Android operating system will do against Apple, but BlackBerry-maker Research in Motion (RIM) and Pre-maker, Palm, Inc., are not keeping pace with Apple's iPhone momentum. While BlackBerry still enjoys much success and was number one on Fortune's 2009 list of fast-growing companies, we predict BlackBerry sales will pale in comparison to iPhone sales in 2010, especially once iPhones are available on carriers other than just AT&T. As of late 2009, Verizon said it was "prepared" to support the iPhone if Apple ends its exclusivity with AT&T. Also, expect Google to produce its own phones in 2010 with the Nexus One being Google's first try at cracking this competitive market.

As a former Treo-then BlackBerry-now iPhone user, I speak from experience when I say emphatically that the iPhone blows the others away, and yes...it's all about the apps! Apple now has over 100,000 iPhone apps in its App Store compared to BlackBerry with only a few thousand. As users become more invested in iPhone apps, BlackBerry will fade into the mist just as former tech stalwarts, the Hayes modem and the Digital Equipment word processor. Disruptive technology strikes again.

USAA now allows their customers to take a picture of a check using their iPhone app, USAA Deposit@Mobile™. This is remote deposit at its most basic level and a great example of the further blending of consumer and banking technology.

***Challenge Question: Does your bank have an iPhone app strategy?***

***Prediction #2 – Consumer and Business Technology Continue to Merge***

Broadband penetration in U.S. households helped launch Web 2.0 applications that increased use of online services and paved the way for mobile devices. Mid-decade, laptops began outselling desktops for the first time in history. Now, a variety of handheld devices is changing the way we access information. Netbook sales doubled in 2009 compared to 2008. Expect the line between notebooks and netbooks to continue to blur. By the end of 2010, as many mobile devices as PCs will be accessing the Internet. Post-2010, mobile devices will be the primary Internet access device for the majority of Americans.

Bankers may ask, “Why all the buzz over gadgets and gizmos and Web 2.0 applications? Why should we care about such toys and personal technology?” The answer is simple: *Because consumer technology is driving business technology and the two are merging to produce some handy, time-saving devices.* Bankers will ignore this trend at their peril. If your best customers have embraced the iPhone and Facebook, then the race has begun to deliver banking services and financial information via these channels. Some bankers haven’t put on their running shoes yet.

Bankers should be paying attention to any consumer device that is becoming an integral part of their customers’ daily lives. Even e-readers could have implications in banking as consumers turn them into everyday utilities. Expect the Barnes & Noble Nook to unseat Amazon’s Kindle and the Sony Reader. That is, until the Apple Tablet is released.

***Challenge Question: Why can’t my bank deliver my statement on my e-reader?***

### ***Prediction # 3 - Network Upgrades Top IT Budgets***

We expect tech spending to increase 3-5% in 2010 as bankers upgrade PCs and networks. Cloud computing, in both public and private forms, will continue its positive trend as more enterprise infrastructure and applications move to this platform. Virtualization continues its march as bankers realize this is not bleeding edge technology but is very practical and proven, an excellent move for increased efficiency and cost containment. Disk encryption, remote backup, and wireless will all see continued adoption.

New entrants to the market will find their niche but Microsoft remains most formidable. According to Forrester, Microsoft still dominates most categories with 2009 market share of 67% in browsers and 66% in corporate email. As of May 2009, Microsoft Windows ran on 95% of all systems. Sales of the Microsoft Office Suite accounted for 94% of office productivity suite sales in 2008. Surprisingly, even though it was released eight years ago, Windows XP still dominates as the enterprise operating system of choice for 79% of companies. Most companies took a pass on Vista and stuck with XP. However, the introduction of Windows 7 promises to push these companies to leapfrog Vista and install Windows 7 which has drawn positive praise for its stability and fast boot times. Windows Server 2008 will bring better security with Network Access Protection (NAP) and AppLocker. Also, Microsoft will not ignore cloud computing. Expect to see it offer more applications via the cloud.

***Challenge Question: Is your bank’s network performing at maximum efficiency?***

### ***Prediction #4 - Enterprise Risk Management Takes Center Stage***

Regulators will expect banks to take a much more comprehensive approach to risk management. Expect to implement an Enterprise Risk Management program in 2010. Taking the lead of the COSO Enterprise Risk Management Framework, all banks, regardless of asset size, will experience a taste of Sarbanes-Oxley Act requirements whether they are publicly-traded or not. Unlike current information security, ID theft,

remote deposit, IT, internal controls, or business continuity risk assessments, the Enterprise Risk Assessment will consider the entire bank, key business functions, and their related threats.

Such enterprise risk assessments will need to address the most probable threats as well as Black Swan events, those unlikely instances that have low probability but a high magnitude of impact. Regulators will view these wide-ranging risk assessments as a preventive measure to the problems of the previous decade.

***Challenge Question: Does your bank have an Enterprise Risk Assessment?***

### ***Prediction #5 - Technology Planning Makes a Strong Return***

With so many new technologies to evaluate, bankers will dust off their technology plans and take a fresh approach to this important exercise. As many banks adjust the sails of their organizations to catch the winds of change, bankers will want to synchronize their technology plans with their business plans. Looking ahead, bankers will set short-term (next six months), mid-term (six to 18 months), and long-term (18 months plus) goals to allocate resources, assign accountability, and tackle new technology projects.

Many bank technology plans were developed at the turn of the century and are in serious need of re-vamping. The future is too important to leave to chance. A new technology plan for a new decade is a prudent move.

***Challenge Question: How fresh is your bank's technology plan?***

### ***Prediction #6 – IT Exams Expand in Scope and Get Tougher to Pass***

Remember the good old days 20 years ago when the bank's one computer was located in the computer room and every application ran on one hardware platform? IT exams were easy. Backups? Check! Source code? Check! Disaster Recovery Plan? Check! See you next year! Not anymore. IT audits and examinations must encompass systems and delivery channels never imagined 20 years ago. Auditors and examiners must be better trained and more knowledgeable on a variety of platforms. Accordingly, bankers must document controls over new areas such as Mobile Banking, Virtualization, Remote Deposit, and the plethora of web-based applications being introduced at a rapid pace.

U.S. Government spending as a percentage of GDP has been on a steady uptick since 1999, which represented a low point in the period from 1990-2009. Such spending has increased almost 13 percentage points during the 2000s. (Source: usgovernmentspending.com)

In late 2009, the FDIC Board of Directors approved a \$4.0 billion budget for 2010. The 2010 operating budget represents a 55% increase from 2009. The FDIC also plans to increase staffing by 1,643 employees. All of this is in preparation for more bank failures and more supervisory activity related to troubled banks. Expect IT to get its fair share of

scrutiny in 2010 as a new generation of examiners takes the field armed with ample resources.

***Challenge Question: Is your bank prepared for its next IT exam?***

***Prediction #7 – Some Jobs Disappear and Don’t Come Back***

High-paying jobs that once existed are now gone forever causing many to re-invent themselves in attempts to launch new careers. Unemployment stood at 10.2 percent as of November 1, 2009, a 26-year high. Some argue that many of the jobs lost were a Darwinian but necessary re-setting of the system and that pay cuts are simply market adjustments that now have many people getting paid what the job is worth.

According to a recent McKinsey Global Institute report, 71 percent of U.S. workers hold jobs that are experiencing decreasing demand, increasing supply, or both. In 2009, the average work week of U.S. non-farm workers dropped to an all-time low of 33 hours, the lowest level on record since the U.S. Bureau of Labor Statistics began tracking it in 1964. Certainly, reduced demand for goods and services has reduced the demand for labor. Accordingly, work weeks and paychecks are both lighter.

We’ve all heard the phrase “Work smarter, not harder.” Let me deliver the sober news for the future. As Americans, we must all work smarter ***and harder***. Further deterioration of the Great American Work Ethic is no way to pull our nation out of the worst economic times since the Great Depression. Create. Innovate. Do something. Now is a great time to be an entrepreneur, for individuals and banks.

We currently suffer from an underemployment of labor and human capital, which results in lower real income and a lower standard of living.

During World War II, the Greatest Generation was accustomed to working an average of 45 hours per week, which settled around the 40-hour level in the postwar years and into the 1950’s. We must work harder as a nation to remain competitive.

Gone are the ambiguous jobs with lofty titles. My favorite...*Lead Metrics Facilitator*. If you have a BS title, perhaps you have a BS job. Provide value or perish. Future success may require a little personal re-invention, but opportunities exist for those willing to change.

***Challenge Question: Is your job experiencing decreasing demand?***

***Prediction #8 - Bank Marketing Plans Get Re-Worked***

If banks put pushing products ahead of building customer relationships, they will fail. Today’s customers expect a softer, more intelligent approach that takes patience, adequate capital, the right strategy, hard work, advanced technology, and dedicated people.

Former Porsche CEO, Peter Schutz, notes that “People buy other people and corporate culture.” Schutz analyzes the difference in operating a “commodity” business and “people” businesses. UPS is a commodity business...so is AT&T. Their customers are not necessarily close to the corporation’s people. Customers just want their packages delivered on time and their telephones to work. Alternatively, consulting firms, law firms, healthcare professionals, and CPA firms are good examples of people businesses where confidence and trust are the foundation of the relationship. So, is a bank, a “commodity” business in terms of being a transaction engine and information network or a “people” business in terms of personal bankers and the close relationships its customers have with tellers, lenders, and branch managers? The answer is “both.” Bank customers want their transactions posted timely and accurately but most want a personal touch when obtaining a loan or opening a deposit account. Banks must be hybrids that have the best possible operations and technology and the most friendly, competent people. Technology and people...a winning combination.

CAPTCHAs are those distorted, wavy words one must decipher when ordering tickets online or setting up a social networking or e-mail account. CAPTCHA stands for Completely Automated Public Turing Test to Tell Computers and Humans Apart. CAPTCHAs decipher 10 million words each day and determine that you are human and not a computer trying to propagate spam or aid scalpers.

Many consumers will put banks through a CAPTCHA of sort in 2010, assessing whether yours is the cold, computer-like Wall Street bank they read about in the news or the warm, friendly Main Street bank with the human touch *plus* the latest technology to deliver a variety of services through multiple channels. Bankers’ marketing plans will need to be revised to achieve this new balance.

***Challenge Question: What is your customers’ perception of your bank?***

### ***Prediction #9 - Social Media Gets Busy***

Social media has transformed from a novelty used mostly by teenagers to a full-blown phenomenon in just over a year. Facebook added 100 million users in less than nine months and at the end of 2009 had 350 million active users. 700,000 of those are local businesses, some of which are banks. Since December 2008, more than 80,000 websites have implemented Facebook Connect. Think it’s still just a haven for teenagers? The fastest growing demographic for Facebook is 35 years and older.

While social media presents many opportunities for banks to reach current and potential customers, it also has its share of threats. Pages can be rigged to serve up malicious code. E-mails that appear to be from “friends” may be spear phishing attempts containing Trojan horse programs designed to steal one’s personal financial information. Acceptable use policies and security awareness will need to be updated in 2010 to make bank employees and bank customers aware of such hazards.

Nevertheless, social media should be embraced by bankers in 2010. It represents a powerful, collaborative tool that has endless possibilities for connecting with customers.

***Challenge Question: Does your bank have a Social Media Strategy?***

### ***Prediction #10 – Cyber Crime Increases***

As we predicted in 2009, cyber crime got organized and attacks on bank customers became more prevalent. As of October 2009, the FBI reported approximately \$100 million in attempted losses due to such activity. Unfortunately, we see more of the same in 2010 as ACH fraud via online cash management continues an upward trend. This will lead bankers to review their current cash management agreements with customers. Many of these agreements were drafted in the earlier part of the decade and do not consider the increased sophistication and growing number of threats. What is “commercially reasonable” security will be challenged by bank customers who have been defrauded by cybercriminals. Delineation of customer responsibility will be more clearly outlined in future agreements. Bankers will also increase customer education surrounding cyber crime in an effort to collaborate and defeat this growing threat.

***Challenge Question: Are your bank’s disclosures and agreements, plus security and technology, up-to-date enough to combat cybercrime?***

### **Summary**

Despite the miserable lowlights of the past decade, there was opportunity for those willing to take calculated risks on the right ventures. Banks that have been managed conservatively and understand the value of technology and building customer relationships will prosper in the years ahead. This is still America. We will recover. We will lead the world out of this quagmire with our ability to innovate and with a long-awaited return of the Great American Work Ethic.

As Thomas Edison said, ***“Be courageous. I have seen many depressions in business. Always America has emerged from these stronger and more prosperous. Be brave as your fathers before you. Have faith! Go forward!”***

So long, *Downer Decade!* Brighter days lie ahead in 2010. Say hello to the decade of recovery, transformation, innovation, and collaboration. May the new decade bring you peace, prosperity, and security.

**Sawyers & Jacobs, LLC** helps banks in four major areas: Technology Planning, Risk Management, Network Solutions, and Business Continuity. Our mission is ***to help our clients use technology securely, effectively, and profitably to better serve their customers, comply with laws and regulations, contain costs, and compete.*** To learn more, visit [www.sawyersjacobs.com](http://www.sawyersjacobs.com), call 901.487.2575 or e-mail [jsawyers@sawyersjacobs.com](mailto:jsawyers@sawyersjacobs.com).

## *Mobile Banking & Payments: The One Who Enrolls is the One Who Controls*



By Richard K. Crone, CEO & founder, Crone Consulting, LLC

Forward-thinking businesses and banks are finding that enabling mobile phone channels can do more than just reduce the cost of doing business, it can deepen customer relationships, build loyalty and create new revenue-generating lines of business.

To play in mobile, you need the mobile number. The rule here is the one who enrolls is the one who controls, meaning whoever enrolls the customer for a mobile offering will be in the driver's seat for other new valued-added services. Right now the only entities that have enrolled their entire customer base are the wireless carriers. For banks and others to participate in mobile commerce, they must first incorporate mobile registration as an integral part of the service delivery strategy, but more than 90% of the leading brands in America have yet to activate mobile registered services. Banks are fortunate in this regard compared to other businesses, since they are required by law to know their customer, and as a normal course of business register their customers. Other businesses have a tougher job to move customers from an anonymous relationship, such as a retail store or a restaurant, to a "participating patron" who willingly provides their mobile contact details.

One motivation for enrollment is mobile payment. According to surveys conducted by VISA USA, consumers are increasingly interested using their phone as a payment device, with 64 percent of ages 18 to 42 saying they would switch carriers for a phone with payment. Another 58 percent stated they would switch banks for mobile payment functionality. Customer satisfaction, loyalty and upside revenue opportunities clearly point to the end game being closely linked to mobile payment.

The challenge for banks is to integrate mobile registration and cross-channel support into the account opening, ongoing communications, service and payments mix before, during and after every purchase transaction.

The fastest and easiest way for banks to build a registered user base is to first enable mobile self-service and banking. Customers enrolled for example for a mobile balance alert via text message, can later easily activate other services such as mobile payment and user defined opt-in offers, advertising and rewards.

Banks should look to leverage all seven channels available on the mobile device for building a registered user base, including activating service innovations for voice, text, mobile web browsers, downloadable handset applications, near field communications, camera capabilities and Bluetooth.

Banks need to update service delivery strategies to harness the new potential of cross-channel integration, knowing that mobile is present in nearly every other existing channel experience and provides a continuous connection point.

Forrester is projecting that nearly 40 percent of all retail sales will be cross-channel enabled by 2012, a trend that banks can take advantage of by extending two-way communications with payment card customers before, during and after each purchase transaction.

Banks that build a registered mobile user base and wireless offering will have a series of opportunities to carry new revenue generating payloads within their existing transaction processing networks, delivering user defined, opt-in advertising and offers. Personalized mobile marketing and loyalty programs set the stage for payment product development heretofore never possible. This is not spam, nor mass marketing, but rather opt-in, user-defined mass customization where the customer defines the offers, advertising and loyalty programs that are meaningful to them.

Registered customers who opt-in to mobile marketing in this manner command some of the highest advertising rates in the market today. Knowing that the one who enrolls is the one who controls, this is a market that represents a whole new product life cycle for banks and their payment networks, one that is projected to grow fourfold to over \$12 billion in less than three years.

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## *The New Normal: Adapting to Change*



Chris Nelson, CEO of Zoot Enterprises

From both bank and borrower perspectives, 2009 was a year rife with economic turmoil, extreme cautiousness in lending and uncertainty about how proposed regulatory changes could bring unknown ramifications for the financial sector. There is optimism that recovery is on its way, even though it may be slow. This optimism is tempered by the certain impact that increasing government control will have on the industry and the ongoing challenge of reducing costs versus investing in the parts of the business that will have a positive impact on banks' bottom lines. There are financial institutions making decisions now that will prepare them to be ahead of the game when the economy picks back up. What these astute institutions understand is that there is no going back to the way things used to be. The new normal is adapting to change that will allow them to thrive.

Moving into 2010, banks will be faced with the challenges of bouncing back from repayment of TARP funds, managing collections losses and finding ways to fund new loans with less money flowing through their systems. To overcome these challenges, defining the right amount of exposure to be taken with each customer and improving the customer experience will be necessary. Cross-selling to increase wallet share with current customers is becoming less risky, but banking strategies are sure to include programs to push attractive products out to market and acquire new customers. Many financial institutions (FIs) are realizing that their credit scoring models from years ago are no longer effective and that they need to find an efficient, low cost way of updating them and adjusting them more frequently.

In the new normal, credit risk managers are examining their logic and making changes to ensure their credit parameters are not so tight that they miss out on offering credit to worthy consumers. Having the tools to be able to adjust their scorecards quickly and test them for accuracy will enable better lending decisions and stimulate the flow of revenue through the institution. In the past FIs had to work around lengthy development cycles, sometimes up to 18 months or more. Today, more institutions are learning that by using

tools and services to take control of this process, they can eliminate inefficiencies and take action sooner in a rapidly changing economic climate.

In 2009 new technology projects at financial institutions were placed on hold indefinitely or not even considered. However, FIs are realizing that not improving long-established practices is more expensive than the investment needed to implement change. In the past the most sophisticated analytics and modeling were used mainly in originations and building credit risk policies. With an uptick in the number of accounts going into collections and a need to sell more credit products in a competitive environment, other departments within banks can benefit from improving their analytic capabilities.

Historically, banks have been organized in silos by lines of business. Improving banks' infrastructure to take a more enterprise view of their customers will help catch consumer risk sooner, mitigating risk and losses from default. This is achieved by viewing customers across the entire credit lifecycle, taking into consideration all of their relationships with the bank, and using that data to drive more intelligent analytics and segmentation. An enterprise approach allows banks to see a complete picture of individual consumers: all accounts with the institution, previously made (and accepted) offers, payment history, etc. This provides the information necessary to optimize the offers made to individual consumers, ensuring the right product fit and in turn higher acceptance rates. While many institutions have attempted this in the past, the politics of doing so were prohibitive. Given the economic climate now, politics are a smaller problem today than they have been in the past. Banks that are poised for change and recognize the value of breaking down silos will see benefit across the institution as a whole.

Since the Great Recession began in 2007, consumer behavior has taken unexpected turns. Walking away from homes and allowing mortgages to go into foreclosure has rocked the financial sector. Rising unemployment across all socio-economic segments impacted many consumers that were once considered prime borrowers and arguably made credit scores less reliable. All of this established the new normal—that there is no normal—after many years of bank portfolios remaining relatively static. 2010 is going to be a time of adaptation, refining credit logic to make sure lending opportunities are not missed (or misunderstood) and investing in a technology infrastructure that has the flexibility to meet the changing demands of this new lending environment.

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