THE FUTURE OF BANKING—PART 2 Tech is key, both for mobile and reg changes

Looking ahead, mobile banking and other emerging technologies will help reduce the cost and time of product delivery. Could this be the dawn of a banking renaissance? In this second of a two-part series, Tech Topics moderated a panel of bankers and other experts who provided a frank evaluation of potential bank winners and losers.

Panelists include Kevin Petrasic, partner, Global Banking Practice, Paul Hastings LLP; Graham Hill, senior vice-president, Cloud Infrastructure, Citigroup; Bradley Schaufenbuel, director of information security, Midland States Bank, Effingham, Ill.; and Lawrence Kaplan, banking regulatory and payments attorney, Paul Hastings LLP. The roundtable was organized under the auspices of ClearPath Analysis. Its report, Banking Operational Technology, North America, includes sections on retail banking operations, investment banking operations, and one titled simply: “Running a bank in 2012.”

In Part One of the panel discussion, several panelists opined that mobile payments technology was ramping up very fast in the U.S. Bradley Schaufenbuel, for example, stated flatly, “I believe that mobile technology will change the industry, at least in the retail-banking arena. …These technologies have the potential to change the entire consumer-banking business model by eliminating the need for brick and mortar branches and possibly even automated teller machines.” Part 2 picks up on the mobile theme, and then considers regulatory impact:

Tech Topics: Is mobile banking a way that banks can optimize their efficiency as well as generating profit, moving forward?

Lawrence Kaplan: It is a way to keep customers happy by addressing their demand for innovation. Customers now demand that their bank is available to them 24/7, wherever they are. Mobile technology allows a customer to make deposits and move money around, and even though a customer cannot yet get cash out of their phone, they can walk into a coffee shop and pay for most things. Ten years ago, internet banking was done only by the biggest banks, but now virtually all banks are using this platform because of the enormous customer demand. Mobile banking is the next wave, and this will become as commonplace as internet banking.

Petrasic: With each new generation, we see greater ease with the use of technology, but more important, greater comfort with the rapid rate of technological change and innovation. Many in my generation are fairly new to the idea of rapid technology adoption and innovation. What will be interesting for the next generation of banking customers is that there are certain things that they will never really have, even though they were standard procedures for how past generations consumed financial products and services. Newer-generation bank consumers have a different view on the utilization of technology. For example, many of our parents can barely get their head around the concept of remote-deposit capture, whereas our children and their children will soon see the idea of going to the bank or ATM to make a deposit as needlessly inefficient and inconvenient. Our children view technology and technological change as a necessity to do what they need to do; for many in my generation, it is a convenience. For many of our parents and grandparents, it is a disruption in the way they are used to doing their banking activities. For the banking industry, this means that banks need to adapt more rapidly, but build in redundancy and educational tools to accommodate different consumer-banking styles. However, this is all difficult in our increasingly stringent and conservative regulatory climate, and there are many challenges for institutions to keep pace with innovation and stay within the risk curve.

Schaufenbuel: I do not really see the addition of robust mobile-banking capabilities as [banks’] long-term efficiency-optimization strategy or a profit-generation strategy. It is the price of entry for any institution hoping to survive for another generation. In other words, it is quickly becoming an absolute necessity. That being said, I believe that quick adoption of these technologies will improve efficiency, which in turn will increase profitability, at least in the short term (until the laggards adopt it or fail). The institutions that move beyond just rolling out mobile-banking technology to leveraging it to transform the way they do business will have a unique advantage over those institutions that are not as forward-thinking as wealth is transferred to new, more technologically savvy, and/or dependent generations.

TT: Given that banks are increasingly operating in a volatile, resource-constrained and highly regulated environment, what does the future hold for the banking sector?

Kaplan: Firstly, banks are facing incredible pressure from regulators for greater expenditures to ensure security and appropriate technological infrastructure. In banking, capital remains king, and it is the drive for capital that is requiring and causing consolidation within the industry. While the Dodd-Frank Act was intended to deal with the concept that some banks are “too big to fail,” in a post Dodd-Frank world, economies-of-scale are going to be critical, and what is going to happen, going forward, is that in order to keep up with all of these capital intensive activities, banks will have to combine. Thus, a by-product of Dodd-Frank is to create a class of banking institutions that are “too small to succeed.” Therefore, the future for banks in the United States is that we are going to see a smaller number of competitors offering homogeneous-type products copying each other. As banking has developed from a geographically distinct market place, to a worldwide market place, where customers demand global 24/7 access, in order to meet customer demands, banks must consolidate and become more efficient. Since the advent of the internet, we have been living in dog years, in a sense. What once required a year in planning and development is now being demanded in months. The whole banking world has accelerated in pace, and the challenge in a highly regulated industry is to make sure that you are doing it right. As part of that conversation, banks must also demonstrate that they have the appropriate risk-metrics monitoring. This gives the regulators the confidence to allow a bank to build new products quickly and adapt to any challenges, or problems that arise, efficiently.

Petrasic: Ultimately, it comes down to speed, efficiency, and execution—or, SEE. In order for a bank to remain competitive, all three of these must happen over a much shorter horizon in comparison to ten years ago. In terms of product execution, it is critical that you have buy-in from the regulatory community. Amongst our clients, we have seen how extremely interesting and innovative product designs have been embedded within sound IT solutions. Even if all the issues of risk management are taken into account, unless they are effectively communicated to the regulators, then there will be problems. Many times it is difficult to project what a product’s risks will be and how it may impact our financial system’s regulatory structure. The regulators are faced with daunting challenges in letting technological improvements move forward, and equally compelling challenges in failing to do so. Theirs is an unenviable job. I know because I was one for more than 20 years of my career. Moreover, dealing with the impact of technology and rapid technological change and innovation presents the most compelling challenges to the regulatory community. Therefore, an important part of planning new product offerings and IT developments is to make sure that the regulatory dialogue is built into the process. You need to implement conversations with examiners and supervisory staff to ensure that you understand their perspective, and appreciate and address their concerns. Ultimately, this will allow you to recognize what needs to be modified and better communicated to ensure that a new program passes muster and gets implemented.

Hill: The clear trend is that the rate of change is increasing and customers expect new services at a faster pace than ever before. The challenge is delivering that agility with efficiency and security, especially as no one can predict what the consumer experience will be in five years time.

Schaufenbuel: I think the outlook for the banking sector as it exists today is pretty grim. I predict continuing consolidation in the sector as those institutions that are not able to rapidly adapt to the new realities of the industry fail or are acquired by stronger players. On the one hand, for those institutions that are making the investments needed to effectively manage risks and transform their business model to serve a new generation of customers, this could be the dawn of a banking renaissance. On the other hand, for those institutions that have not adequately planned for the future or are just beginning the transformation, it is probably too late.

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