

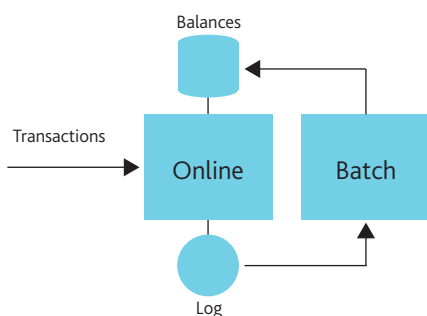
VIEWPOINT: John Schlesinger, Chief Enterprise Architect, Temenos

Removing the shackles: how branch accounting stifles efficiency and innovation in retail banking

On June 20th, 2012, a simple error caused the batch run of branch accounting at a major UK high street bank to fail, and rendered the bank unable to service customers properly for over six weeks. To its customers' fury, similar issues resurfaced in March 2013. This debacle has made it obvious that, for any bank, having almost every process go through a single set of interrelated overnight batch jobs is an unacceptably large risk. It also underlines the fact that branch accounting is one of the big culprits for the banking 'productivity gap' and is unsustainable in an increasingly competitive retail environment.

This was not so in the 1960s when retail banking took place exclusively in branches. The branch manager was effectively in charge of a self-contained local business; customers were customers of the branch first and of the bank second. All transactions went through the branch and, therefore, branch accounting made sense. With the introduction of online transaction processing in the late 1960s, transactions were entered into the online teller system, logged and added to the overnight batch book-keeping which was run centrally, thus eliminating the need to send transactions by hand from the branch.

Branch accounting



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These two systems constitute the prevailing architecture for retail core banking, called here "branch accounting". The major characteristics of this system are that it is branch based (sort code oriented in the UK), an accounting system, and predominantly makes payment decisions overnight in batch runs.

But, over time, new self-assisted channels were added to the teller system, such as ATMs, POS, internet banking, mobile banking as well as the implicit channels of credit cards and debit cards. New assisted channels have also been added such as the agent system for call centres and in branch relationship management. In short, the majority of transactions in retail banking are now self-assisted rather than assisted or in the branch. So, in this modern landscape, it is clearly no longer appropriate to associate customers with branches.

Even more significantly, banking regulations have enormously complicated information technology at retail banks. Basel II (and III) requires banks to keep details of credit, market and operational risk, meaning that the output of the daily batch runs needs to be sent to the risk reporting systems, as well as the general ledger, for further processing. Also, following the 2008 banking crisis, banks have had to implement new reporting for liquidity and for financial compensation schemes (e.g. FSCS

in the UK), putting even more strain and cost on the processing of transactions in batch. Clearly, it is no longer appropriate for a retail bank's core banking system to be a batch run.

Yet, even though modern retail banks run 24x7, effecting transactions all the time (branches don't close at 3 p.m. any longer) through multiple channels and need to produce a plethora of timely reports, many are stuck with 40-year old branch accounting systems which assume that customers goes through branches and which process in batch. This is a disturbing situation which constitutes a significant risk not only to the banks themselves but also to customers, shareholders, and even the financial system at large.

Indeed, most modern consumers would be surprised and, most probably, uncomfortable to learn that their bank functions as follows. Firstly, branch accounting records transactions during the day but delays payment decisions. All the thousands of transactions logged by tellers and on ATMs, points-of-sale, internet and mobile channels go into the overnight batch, as do the clearing files from payment channels. All of these go into a massive job schedule involving thousands of job steps. In effect, almost every process in the bank is dependent on this set of batch jobs... obviously a huge risk should the slightest glitch occur.

So, with batch processing, the risk from executing financial transactions is incurred by a wide array of stakeholders who shouldn't be incurring it. In contrast, modern organisations using modern architectural setups (e.g. Amazon.com, Expedia.com) operate middle offices to manage the risks incurred from executing financial transactions. Middle offices are able to keep track of this risk in real time through the use of straight-through-processing (vs. overnight batch processing), and to separate this risk from risks associated to the front office (orders, customer, channels) and the back office (resources e.g. shipment of goods).

Sources

1 See the "Tackling The Productivity Paradox" white paper available here: <http://www.temenos.com/tackling-the-productivity-paradox/>

Thirdly, and frustratingly, balances and holdings are not updated in real time and are not available to all channels at the same time. Nor does the customer have visibility on the quality of the service. When I transferred £14,000 from my bank account to that of VW finance to pay for my car, I got no confirmation from my bank. But when I order a book, even if it is free, on Amazon, I get an email thanking me for the order. So Amazon takes more care of an order for £0.00 than my bank does for a transaction of £14k. This is because Amazon does not process my order overnight in batch, whereas my bank does.

Finally, the bank incurs a whole array of costs related to having an antiquated set-up, and most probably passes on some of this cost to the end-customer, thus reducing its competitiveness. For instance, the rules for constructing products out of accounts (which should be in the middle office in a modern setup), have to be added on in an ad hoc basis, usually on a channel by channel basis, which is expensive and time consuming. Then, as customers today often have multiple accounts originated via multiple channels in multiple different cities, banks need to run overnight matching rules to work out which account holders are the same customer, a costly, slow and error prone process.

But, in some ways, the worst aspect of branch accounting is that it is fearsomely monolithic. Every process in the bank is dependent in some way on the overnight branch accounting run, including, ironically, the general ledger itself which is the real accounting system.

The future of retail banking, like travel, capital markets and online retail, is to see the value chain splinter between the front, middle and back offices. This was an insight shared with me by the Chief Architect of CIBC in 2001. He saw a need for front office only banks, selling other banks' products through innovative channels. Branch accounting is frustrating this at the moment, banks find it hard to white label successfully. This is evident in the UK in the move of Tesco Personal Finance off RBS onto their own banking systems.

Banking innovation is, in effect, being stifled by the dead hand of the overnight branch accounting run. Until it is replaced with a real time retail banking middle office, many established retail banks will be at a significant disadvantage compared to new banking entrants, all the more so that customers are becoming ever more demanding.

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John is responsible for the direction of the Temenos products given the company strategy, and in particular for the non-functional capabilities of the products and their suitability for all banks, from the smallest to the largest. Previously, he worked in Enterprise Architect leadership positions at Atos Consulting and Capgemini, and in various product and development related functions in a variety of companies, including with IBM for 15 years. John has degree in Physics and Philosophy and a post-graduate diploma in Software Engineering, both from Oxford University.

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