TEMENOS' 7TH ANNUAL SURVEY OF
CHALLENGES, PRIORITIES AND TRENDS
IN THE FINANCIAL SERVICES SECTOR

2014

SUCCEEDING THROUGH THE DIGITAL REVOLUTION

TEMENOS
The Banking Software Company

Contents

INTRODUCTION

For the past seven years, Temenos has conducted a comprehensive customer survey, covering areas such as banks' corporate and IT priorities, their challenges, and their view of the competitive environment.

Because the questions posed are largely consistent from one year to the next, our survey tracks how trends and attitudes have changed over time. Moreover, because the Temenos customer base is highly diverse, both in terms of types of banks and geographical location, the results give a broad view of banking sentiment.

The 2014 survey canvassed the opinions of 198 senior bankers (see breakdown in the appendix) – and the results are presented with Accenture, the management consulting, technology services and outsourcing company.

SURVEY FINDINGS

This year's survey canvassed the opinions of 198 senior bankers covering a cross-section of regions and bank sectors.

LOYALTY IS DISAPPEARING

30%

Customer loyalty is the banking industry's biggest challenge, as cited by 30% of respondents

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REGULATORY PRESSURE REMAINS

53%

believe that regulators will force banks to update their legacy systems

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DIGITIZATION IS BLURRING THE INDUSTRY'S BOUNDARIES

23%

Banks are as worried about competition from outside as from inside the industry. Tech companies like Amazon are seen as the no.1 threat

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PRODUCT INNOVATION AND DIGITAL CHANNELS TOP PRIORITIES

24%

24% of respondents cited product innovation as their top priority

18%

18% of respondents cited digital channels as their top priority

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EXECUTIVE SUMMARY

The 2014 survey continues to show an industry facing up to massive structural change, with diminishing customer loyalty its biggest challenge

Even more so than in 2013, bankers are concerned about the triumvirate of regulation, new competition and changing customer behaviour. While in 2013, fewer bankers than the year before had cited regulation as the industry's biggest challenge, in the 2014 survey the figure was back up, suggesting that, while the pace of regulatory change may have slowed, compliance with new regulation remains a major operational challenge. In common with the 2013 survey, maintaining customer loyalty was once again considered to be the industry's biggest challenge, cited by 30% of respondents, with bankers concerned that more empowered and better informed customers may begin to switch providers in greater numbers.

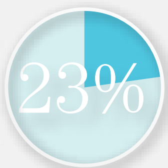
The competitive pressures from outside the industry are as big as from within, with technology vendors like Amazon seen as the biggest threat

In terms of where the competitive threat is coming from, the findings are very interesting and represent an area where opinion is changing fast. Today, bankers perceive the competitive pressures from outside the industry to be at least as great as from within and they see their biggest threat as being technology vendors, such as Apple and Google (cited by 23% of respondents). While large incumbent banks are still viewed as formidable competitors (cited by 20%), banks are noticeably less concerned about small banks, start-up banks and supermarket entrants than in previous years.

CHANGING COMPETITIVE PRESSURES

PRESSURES FROM OUTSIDE THE INDUSTRY ARE AS BIG AS FROM WITHIN

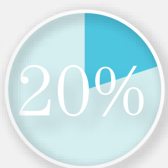
TECHNOLOGY VENDORS SUCH AS GOOGLE



of bankers see their biggest threat as being technology vendors, such as Apple and Google

29% of bankers in the Microfinance sector are concerned by competition from technology vendors

EXISTING LARGE INCUMBENTS



of bankers see their biggest threat as being large incumbent banks

28% of bankers in the Private Bank and Wealth Manager sectors are concerned by competition from large incumbent banks

3% of bankers see existing small incumbents as a threat

17% of bankers see new bank entrants as a threat

7% of bankers see supermarket entrants as a threat

Product innovation and investments in digital channels top banks' corporate priorities

Banks are responding to their structural challenges by investing chiefly in product innovation, in digital channels and in complying with new regulation. IT modernisation also remains a big priority for banks, cited by 16% of respondents. Banks are still investing in their branch networks, suggesting that they still see an important role for the branch within the channel mix, but it was highlighted as a priority by fewer respondents than in the past. Conversely, M&A seems to be rising up the corporate agenda, receiving its highest reading since 2010.

IT investments up strongly again

IT budgets are forecast to be up strongly again in 2015. The delta between the number of institutions expecting their IT budgets to increase in the next 12 months vis-à-vis those expecting budgets to contract is at its highest level since we began the survey in 2008. The areas with the highest levels of projected spend over the next 12 months are, in order, core banking systems, digital channels and analytics.

Cloud adoption increases again, although NSA revelations have heightened data security concerns

We have been tracking banks' attitudes towards cloud computing since 2008 and can evidence significant change. Over that seven year period, we have observed both a very clear shift in sentiment, with banks much more likely to countenance taking new software applications through the private or public cloud, and a significant increase in adoption. The 2014 survey showed another increase in levels of adoption with the data showing, for example, that banks are more likely than not (56%) to be running email and collaboration tools in the cloud. However, what was very interesting was the change in sentiment. Asked what would prevent more widespread adoption of cloud services in their organizations, 38% reported concerns with data security or confidentiality. This is a much higher reading than in 2013 (29%) and is the highest reading since 2011 and would seem to suggest growing sensitivity to this issue following revelations of NSA monitoring.

Recent IT glitches serious and can be attributed to legacy systems

Lastly, a large number of senior bankers believe that, ultimately, it will be regulators and not management who will force the issue of IT renewal. In this year's survey, we asked a series of questions about the health of banks' IT estates and their ability to cope with the demands of the modern, digital economy. The results are not a complete surprise given that still more than 80% of bank IT spend is directed to home-grown systems, but the vast majority of respondents (77%) believe that recent IT glitches can be clearly attributed to legacy IT systems. More interesting, however, is that more than half of respondents (53%) believe that regulators will ultimately force banks to update their mission-critical systems.

CHANGING ATTITUDES IN CLOUD COMPUTING

86%

Growing adoption (86% of bankers run at least one application in the cloud)

56% of bankers have a strong inclination to put certain types of application in the cloud (e.g. they are more likely than not to run email in the cloud today)

56%

@

!

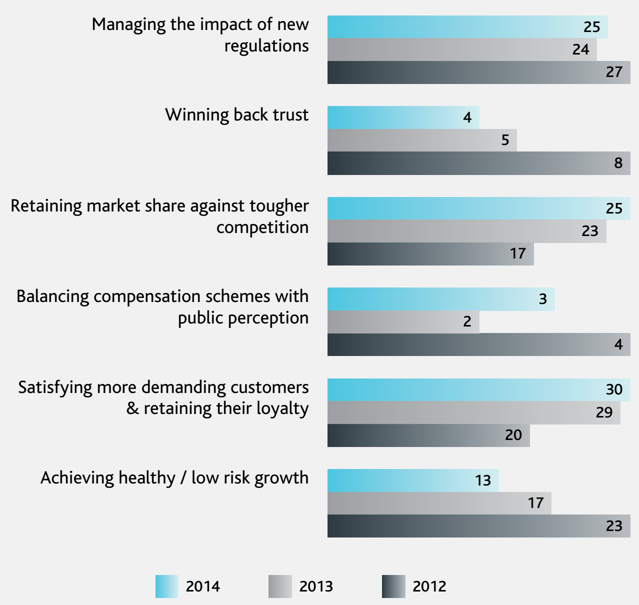
There is still low take up of mission critical applications in the cloud (just 1% of bankers are running any kind of core processing in the cloud)

Concerns over data security is still the biggest barrier to adoption (and these concerns have been heightened by NSA spying revelations)

LOYALTY IS DYING

For the second consecutive year, our survey of senior bankers found that the industry's biggest challenge is satisfying the demands of better-informed and less-loyal customers.

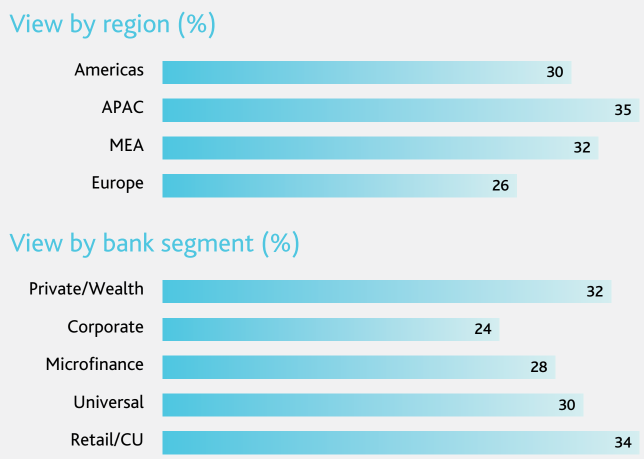
Biggest challenges facing the banking industry, 2012-2014 (%)



Not surprisingly, this challenge is felt most acutely by retail bankers, with 34% citing waning customer loyalty as their biggest challenge. Conversely, only 24% of corporate banks cited this as their biggest concern, suggesting that corporate customers are less disposed to changing banking providers or at least to changing their banks solely on the basis of price.

Perhaps more notable is the extent to which the private wealth respondents are now noting the challenge of customer loyalty, with 32% of respondents indicating that this is their biggest challenge, both a higher percentage than the overall average and eight percentage points higher than the equivalent response in 2013. As Temenos has highlighted frequently[1], the wealth industry faces a big challenge in catering for the needs of a younger generation, who have very different preferences about how their assets are managed compared to their parents' and grandparents' generations, and possibly the result here reflects a growing appreciation of this reality.

The challenge of maintaining customer loyalty



In terms of geography, diminishing customer loyalty is perceived to be a bigger challenge in emerging markets than in the developed world. It was cited as the chief threat to their business by 35% of Asian respondents and by 32% of respondents from the Middle East and Africa (MEA). In contrast, 30% of respondents from the Americas perceive customer loyalty to be their biggest challenge and 26% of Europeans. This may reflect the demographics of emerging markets compared to developed markets, since we know that the former have younger populations that consistently show a higher propensity to shop around for the best deals. In what looks like an interesting corollary, banks in emerging markets attach greater relative importance to investments in product innovation and in digital channels (see later), which are key for customer retention.

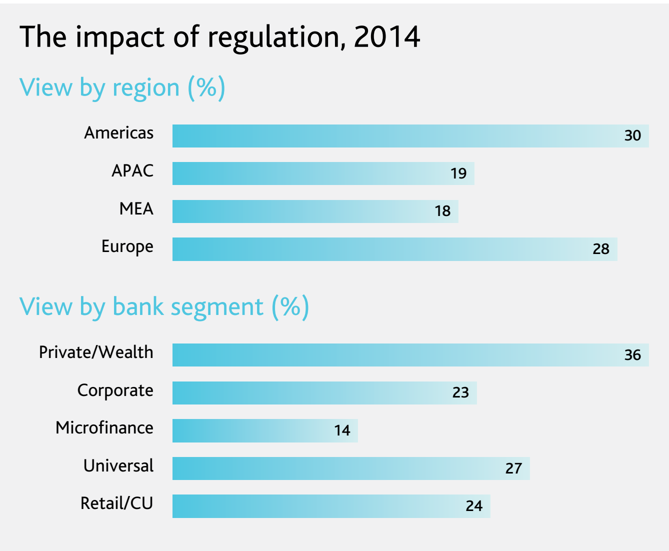
[1] See, for instance, our white paper on "Leveraging Technology to Capitalize on the Transfer of Wealth to Generations X & Y", downloadable at https://www.temenos.com/en/market-insight/private-wealth-insight/future-of-banking-white-paper/

REGULATION REMAINS TOP OF MIND

Regulation is a perennial concern for our survey respondents. It has been considered the industry's second biggest challenge for the last two years and was considered the biggest challenge every year before that.

What is interesting in this year's survey is that the number of bankers citing regulation as their biggest challenge has increased (marginally) compared to last year, to 25%. This perhaps reflects the fact that, while the pace of regulatory change may have slowed, the implementation of these complex new rules is far from straightforward and requires significant operational change.

The challenge of complying with new regulations is considered much greater in developed markets, which is no surprise given that the burden of new regulations has fallen chiefly in the US and western Europe, where governments and central banks have tried to atone for a perceived lack of regulation leading to the credit crisis and to put in place the safeguards to prevent another crash.



In terms of the sectors most affected, private wealth management (PWM) and universal banking viewed regulation as their biggest threat in 36% and 28% of cases, respectively. With regard to PWM firms, in addition to adhering to exacting but universal new rules, such as Basel III, they are also dealing with a raft of regulations that are either industry specific, such as the Retail Distribution Review, or which disproportionately affect their industry, such as the US Foreign Tax Compliance Act (FATCA). In terms of universal banking, regulation focused on ring-fencing retail banking from the rest of the banks' activities threatens the long-term viability of the model and, in the short term, is forcing significant operational change. An EIU report commissioned by Temenos earlier this year found that one-third of retail and universal banks globally had already ringfenced their retail banking operations, while a further quarter were divesting of their retail operations[2].

[2] The Economist Intelligence Unit, "Future Factors: How regulation, client expectations and technology are transforming retail banking" which can be downloaded at https://www.temenos.com/en/market-insight/retail-insight/teiu-retail-banking-report/

DIGITIZATION IS BLURRING THE INDUSTRY'S BOUNDARIES

Since 2012, we have asked respondents to rank the sources of competitive threat to the banking industry. What is interesting is the rate at which this picture is changing.

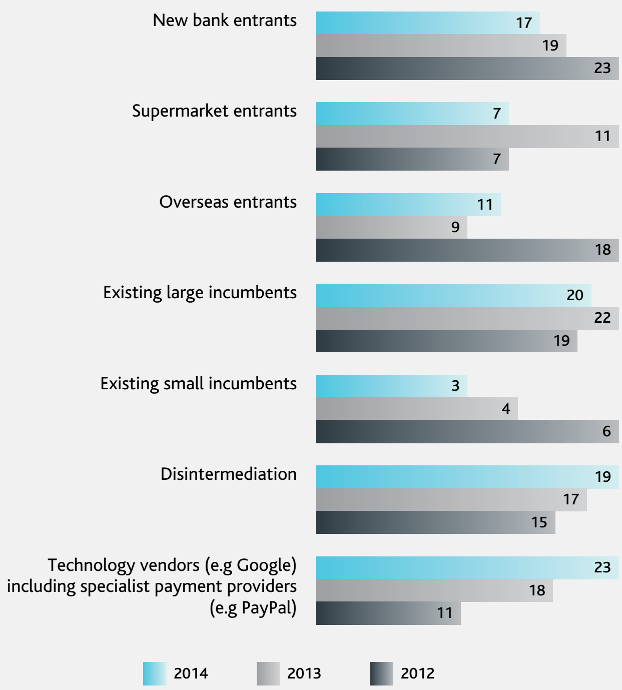
In 2012, the industry was most concerned with new bank entrants (17%), large incumbent banks (20%) and overseas banks (18%). That is, in 2012, the industry still very much saw the threat as emerging from within the industry, whether in the form of newly-created banks or from existing banks taking market share. Add in the 6% of respondents who considered small incumbent banks or credit unions as representing the biggest threat and, in total, two-thirds of bankers saw other banking institutions as the competitors to watch.

Cut to 2014 and the industry now sees as much of a competitive threat coming from outside the industry as from within it.

Today, our survey respondents view their biggest threat as coming from technology vendors such as Google (23%), as if heeding the warning from BBVA CEO Francisco González who wrote in the Financial Times that "banks need to take on Amazon and Google or die"[3]. As Mr González points out in the same article, banking is one of the most IT intensive industries, "where information, through technology, is transformed into knowledge" and is ripe for digitization. Clearly, rapid digitization, in conjunction with other factors – such as diminishing customer loyalty (discussed earlier) and transformative technology changes (discussed later) – is opening the industry to these technology vendors, many of whose business models are built on an ability to turn vast quantities of data into meaningful customer insights. Furthermore, as the banking industry value chain continues to fragment, it becomes increasingly likely that technology vendors (and other non-banking entrants) will be able to offer discrete financial services without having to incur the same risks as banks have done historically, or involve themselves in the low-margin areas of clearing and settlement, two factors which it is said have deterred the same companies from becoming more involved in financial services provision in the past.

Large incumbent banks are still considered to pose a significant threat (cited by 21% of respondents). This is no surprise, in our view. The fact is that large banks still have the capabilities to be highly successful in the digital world. They have large customer bases, access to significant customer data and the ability to offer integrated capabilities across the value chain. What is more, they have the resources to re-engineer their businesses for the digital age. The only point to note is that large banks must act if they are to withstand the competitive threat from new entrants, such as removing legacy applications and investing in analytical capabilities[4]. The window for action is shortening, as both the rate of innovation and change accelerates, and these new entrants eat away at existing banks' margin and, by extension, their available funding to make the necessary changes.

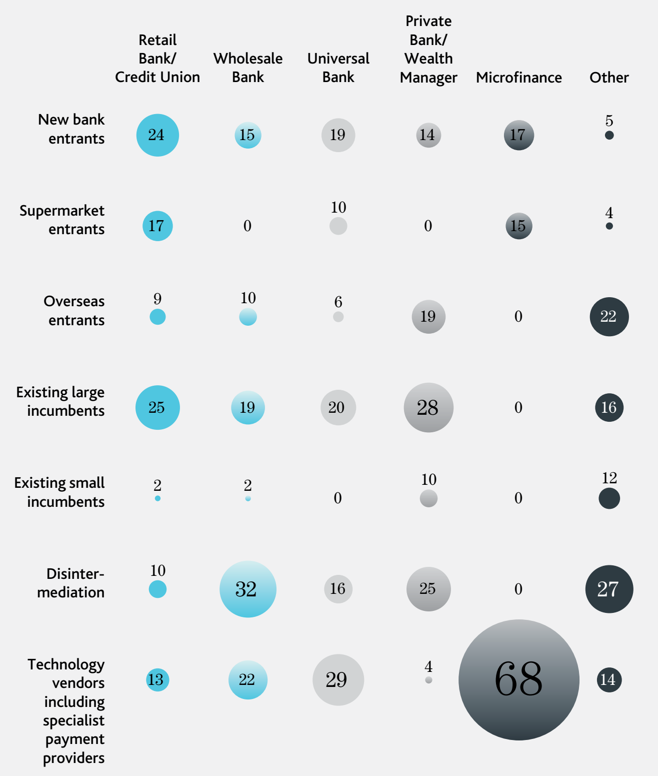
The evolving competitive threat, 2012-2014 (%)



[3] Financial Times, "Banks need to take on Amazon and Google or die", December 2 2013 http://www.ft.com/intl/cms/s/0/bc70c9fe-4e1d-11e3-8fa5-00144feabdc0.html#axzz3AkOTNqoK

[4] Temenos' list of imperatives for incumbent banks in "Succeeding through the digital revolution: lessons from banking industry disruptors" https://www.temenos.com/en/market-insight/corporate-banking-insight/lessons-from-banking-industry-disruptors/

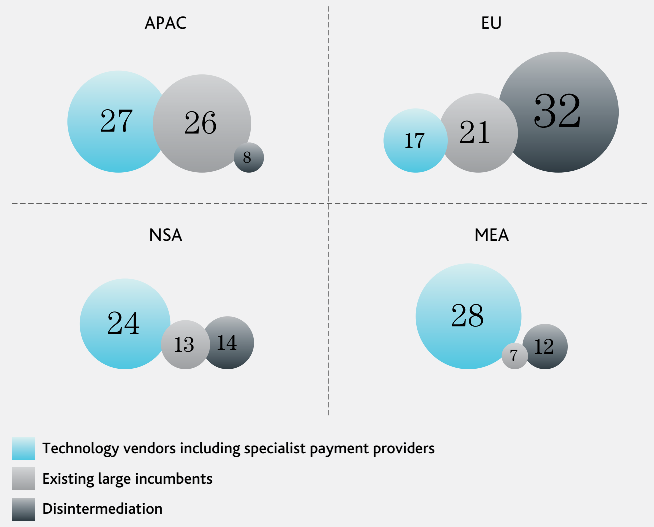
A view of the competitive threat by banking vertical (%)



The third largest threat lies in customers not using banks at all. Disintermediation, which could take the form of peer-to-peer services, such as Lending Club, a San Francisco-based lender that matches borrowers and lenders directly, was cited as the biggest threat to the industry by 19% of respondents. Disintermediation could of course take many forms, and one that is often overlooked is the idea that bank customers could increasingly use capital markets instead of banks to raise funds or to place their savings, which has happened to a much greater degree in the US than in other markets. Take corporate debt, for example: in Europe, 87% of corporate debt is raised through banks, compared to just 29% in the US[5].

Compared to 12 and 24 months ago, bankers are noticeably less concerned about the threats posed by new start-up banks (cited by 17% compared to 19% in 2013 and 23% in 2012), by supermarket entrants (cited by 7% vs. 11% in 2013) and small incumbent banks (cited by just 3% vs. 6% in 2012). Starting with small banks, this likely reflects a mellowing of the anti-big bank zeitgeist that followed the financial crisis and which, for a period of time, saw customers switching in large numbers from large banks to credit unions and other "local" players (switching in the US, for instance, has fallen from a peak of about 1 million customers a month in 2010 to just 1 million to 2 million a year[6]). In what seems a related finding, fewer banks cite "winning back trust" as their top corporate priority, just 4% compared to 13% in 2011.

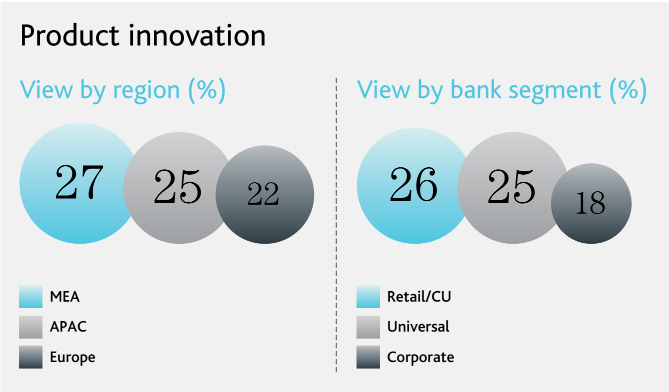
A regional view of the competitive threat (%)



With regard to supermarket entrants and new banking start-ups, the reduction in the level of perceived threat likely mirrors the lack of any major breakthrough by these entrants to date. Despite the hype, few supermarkets have launched fully-fledged banks and even fewer have made any significant impact so far on their local markets. For start-ups banks, the picture is similar. Take Metro Bank in the UK, for example. Probably the most successful of the challenger banks, it is more than doubling in size annually and now has over 300,000 customers, but in terms of assets, it is still only 1% of the size of Santander in the UK, Britain's fifth largest player. This may just be a time lag, but it is also interesting to note that many of most innovative and potentially disruptive new bank start-ups are being created by existing financial institutions, such as BforBank or Soon.fr in France.

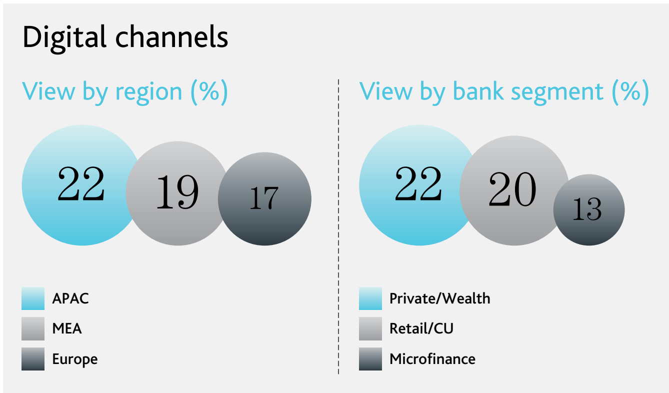
[5] Deutsche Bank research
[6] Research from Moebs Services

BANKS BET BIG ON DIGITAL CHANNELS AND PRODUCT INNOVATION, WHILE M&A LOOKS SET TO ACCELERATE



Product innovation is the industry's biggest corporate priority today, cited by 24% of respondents. As already noted, there is a bias in the results towards emerging markets, with 25% of Asian respondents and 27% of MEA respondents citing this as their biggest priority. Also suggesting that the need to innovate correlates with customer demands and the level of competition, 26% of retail bankers cited product innovation as their number one priority, compared to only 18% of corporate bankers. While the bulk of the investment dollars today are still being channelled into "traditional" product innovation, that is, extending the range of existing products and services to appeal to a wider customer demographic (especially younger customers), we also observe more money be spent on initiatives around open banking. These initiatives include creating app stores and in particular making available APIs. Partners can develop banking apps and ancillary services to extend the bank's innovation capabilities at the same time as potentially creating new revenue opportunities.

The picture is similar in digital channels, which is the second biggest corporate priority, cited by 18% of respondents. Investing in digital channels is a bigger priority for emerging market banks, cited by 22% of Asian banks and 19% of MEA banks. Similarly, it is a bigger priority for retail and universal banks (mentioned as top priority by 20% and 21%, respectively) than corporate banks (14%). However, only 13% of microfinance institutions stated that digital channels was a top priority, a surprise given the potential of mobile banking to reduce costs, improve outreach to remote areas and raise the level of banking adoption (given significantly more people have cell phones today than bank accounts). Also interesting is that 22% of PWM respondents said investing in mobile channels was their top priority, again suggesting that the industry is taking seriously the threat posed by the intergenerational wealth transfer.



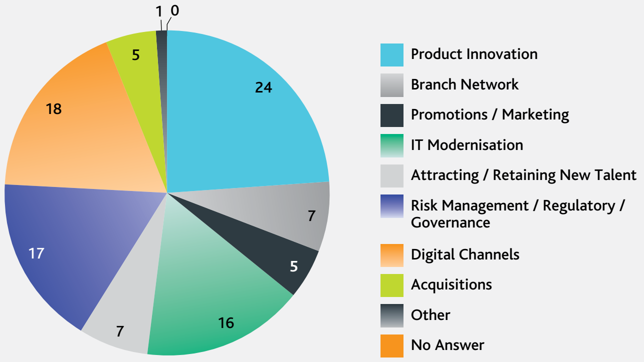
Complying with new regulations and IT modernisation also feature high on corporate priorities, cited by 17% and 16% of respondents, respectively, which is to be expected given the continued pace of re-regulation and the need for banks to bring their IT systems into the world of 24x7, digital banking.

Even though investing in branches scored significantly lower than in 2013 (at 7% vs. 12% last year), it remains an important corporate priority, indicating that banks, especially in the retail sector, continue to see the physical branch as an important component of a multi-channel strategy. Furthermore, as many respondents noted, the investment was being directed less towards extending the branch footprint, but rather in updating the branch formats, remodelling them as centres for sales and advice rather than making standard transactions.

THE MOST BULLISH EVER FORECAST FOR IT SPENDING…

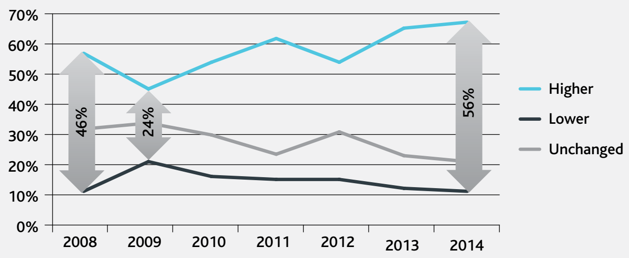
Each year, we ask our respondents about their IT budgets over the coming 12 months. In 2014, we had the most positive reading ever, with 67% of respondents expecting higher budgets and just 11% anticipating their IT budget to shrink, giving a positive delta of 56%, higher than in 2013 (53%) and in 2008 (46%).

Corporate investment priorities (%)



Interestingly, M&A seems to be rising up the corporate agenda. Still low in absolute terms, at 5%, this is nonetheless the highest score for M&A since we began the survey in 2008. The economics of the banking industry have of course been fundamentally reset since the banking crisis and it is logical that, in an era of lower margins, consolidation should take place. Moreover, it is in the markets where margin pressures are greatest that we see the greatest appetite for M&A, with 6% of European banks and 7% of PWM firms citing M&A as their top corporate priority.

Financial institutions intending to increase vs. decrease IT spending, 2008-2014



The scores were universally high, underlining the extent to which all banks regardless of sector and geographical focus recognise the need to invest in IT to sustain competitiveness in the digital age. Nonetheless, there were some noticeable regional variances with European banks the least bullish – with only 42% expecting budgets to be higher and 33% expecting budgets to be unchanged (vs. 22% overall) – and Asian banks the most bullish, with 76% expecting higher budgets (52% expecting budgets to be significantly higher) and only 5% expecting budgets to be lower.

…WITH CORE BANKING, DIGITAL CHANNELS AND ANALYTICS TOP OF THE SHOPPING LIST

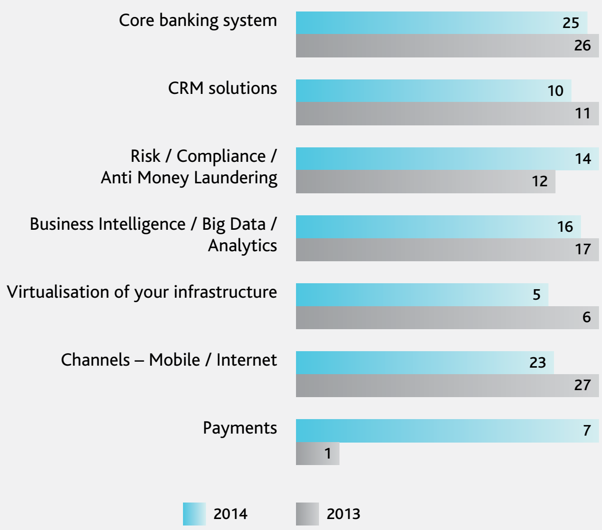
Core banking system renewal was cited as the number one IT investment priority for banks in 2014.

Spending on core banking spending makes up around 50% of most banks' IT spend (which in turn makes up around 14% of costs, twice as high as the average of other industries)[7] and so is an obvious candidate for efficiencies. Furthermore, the absolute number of core banking replacements has actually fallen over recent years, suggesting that there could be pent-up demand[8]. Lastly, we should also note that in the absence of real-time core banking systems, built around customer records and not products, many of the investments banks are making in areas such as CRM, analytics and digital channels are unlikely to yield the kind of outcomes that banks would hope for. For instance, a bank could build the best mobile apps in its market, but they are likely to be rendered much less effective if they are only updated with customer transaction information once a day.

According to Accenture*, to ensure their core banking systems can support their growth strategy in the digital world, key questions banks need to address are whether their legacy or target systems are/will be:

- Able to both serve mass transactions and personalize needs, at the right time and at a reasonable cost?
- Resilient enough, with the ability to scale and increase by several times the transactions generated by new digital interactions?
- Primed for high automation levels that help achieve the required efficiency heights, towards a zero back office?
- Ready to provide the right information at the right time without duplicating information across the different architectural layers?
- Ready to incorporate new technologies in ways that contribute to radical transformation of the cost structure, rather than adding complexity and cost?

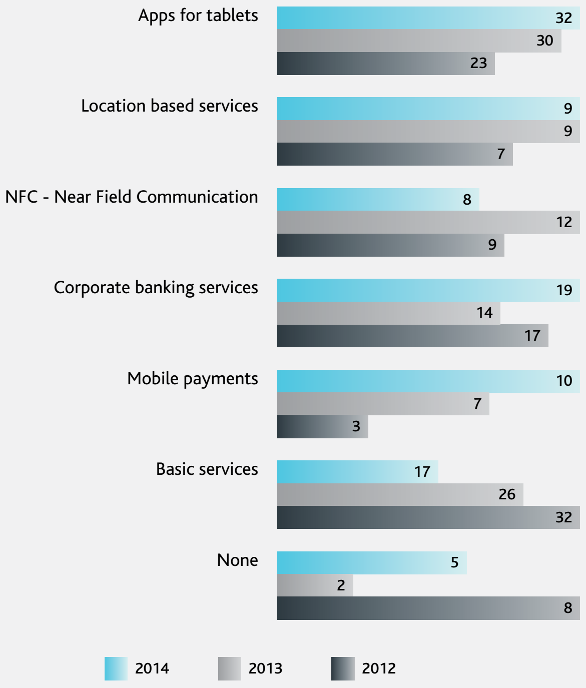
IT spending priorities, 2013 and 2014 (%)



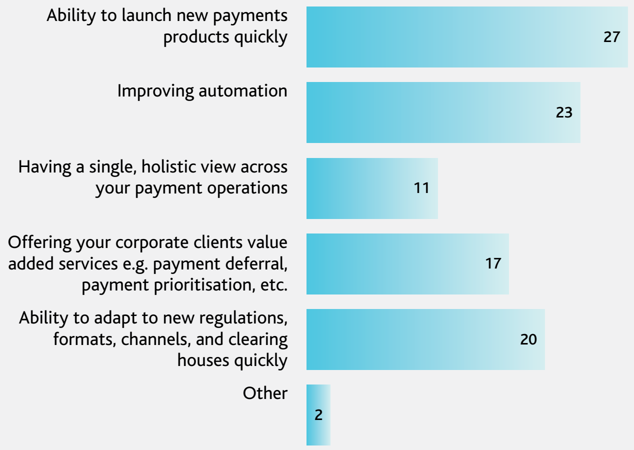
The second biggest priority for IT spending, cited by 23% of respondents, was digital channels. Looking at only mobile banking, the single biggest area of investment is mobile apps for tablets and smartphones, cited by 32% of respondents. Also high on the list were corporate banking services, cited by 19% of respondents, suggesting that corporate customers are increasingly expecting the same rich user experience across multiple devices that are they are accustomed to in the personal interactions with banks and retailers. Although a lower percentage than last year, still 17% of respondents say they are directing most of their mobile bank spending to building out basic services, such as balance requests and transfers. While slightly surprising, there is clearly still a big divergence between different countries in terms of the maturity of their digital channels. Asia is a case in point: overall, 20% of respondents stated that creating basic services was their top priority (the highest regional score) while 15% said that investing in location-based services was their top priority (almost twice as high as the average), underlining the disparity between some Northern Asia countries, such as Korea, where digitalization is highly advanced, and some of the countries in Southern Asia.

[7] See our white paper "Restoring Profitability in the digital age" https://www.temenos.com/en/market-insight/retail-insight/restoring-profitability-in-the-digital-age/
[8] *ibid*
* Note: Accenture, The Role of Core in Digital Adoption, 2014

Banks' planned mobile banking investments, 2012-2014 (%)



What do you consider most important to your corporate payments operations? (%)



Investing in analytics was highlighted as the third largest priority by our survey respondents, cited by 14% of respondents against 12% in the previous year. This is consistent with many of the other survey findings, such as concerns about new competition and customer loyalty. Initiatives around improving customer service, expanding product offerings and giving customers a better online experience won't be enough in themselves to insulate banks from the threat of disruptive new entrants. Key also will be using customers' data to offer value-added services, such as helping them to manage their budgets better or helping them to make smarter spending decisions. As such, investments in analytics make sense. However, for these investment to be truly effective requires a change of mindset, to move institutions from being data custodians that attach primacy to keeping data secure, to being data analysts that seek insights from customer data.

It is a new concept for banks to put data and analytics at the heart of their operations, across all application layers – commercial, operational and reporting. According to Accenture*, this is where improvements in core banking and analytics merge. Core banking must transform to provide contextual complete and raw information to users; store and deliver information in ways that allow real-time personalization through predictive analytics and analytical models; and allow decoupling of the data layer from business logic and processes.

Investing to modernize payments systems was cited by a significantly higher number of banks (7%) than in 2013 (1%), suggesting this issue is rising up the priority list – a finding echoed in other research[9]. Furthermore, we asked a follow-up question about why banks might look to upgrade their payments infrastructure and the primary reasons given – namely, to launch new payments products quickly (27%) and to improve automation (23%) – chime neatly with the prevailing conditions of a market that is fast-growing (growing at an estimated CAGR of 8%)[10] but where rising competitive pressures and falling fees per transaction are undermining margin and profit growth.

[9] For example, a recent report from Celent, Understanding Payment Services Hubs, found that the pre-packaged payment software to growing at a CAGR of 8.6%, significantly faster than the overall market for banking software
[10] BCG's "Global Payments 2013, Getting Business Models and Execution Right"
* Note: Accenture, The Role of Core in Digital Adoption, 2014

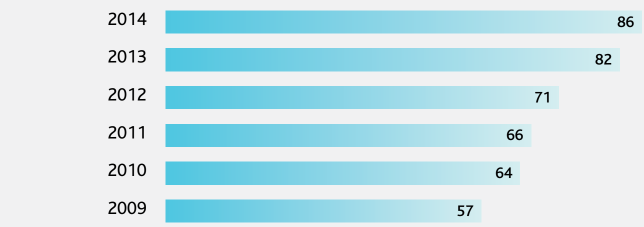
THE CLOUD OF EDWARD SNOWDEN

We have been including questions on cloud computing since 2009 and over that time we are able to chart a steady and significant rise in cloud computing adoption. Whereas in 2009, 57% of financial institutions ran one or more application in the cloud, the figure now stands at 86%, with the highest levels of adoption in Europe and the US.

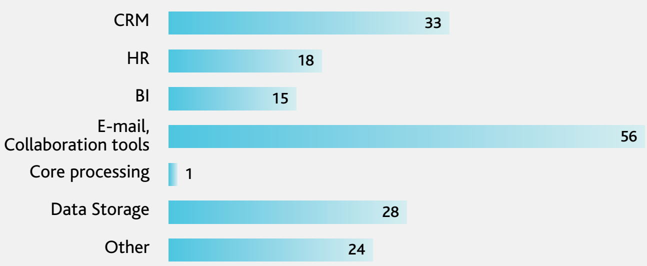
Today, banks are more likely than not to run email and collaboration tools (such as SharePoint and Yammer) in the cloud and over a third of banks are accessing their CRM information through the cloud. We see also lower, albeit still significant, numbers of banks running data storage, BI and HR applications in the cloud.

Cloud computing

Percentage of institutions running one or more application in the cloud, 2009-2014 (%)



Applications run in the cloud (%)



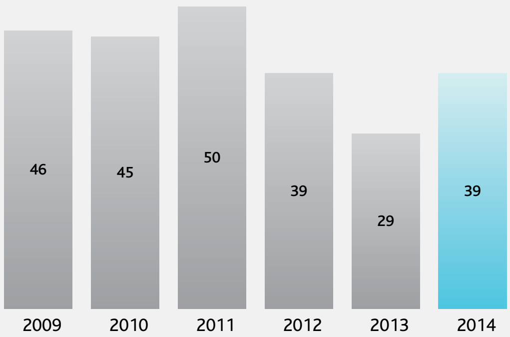
Where we still see negligible traction is with core banking. Only 1% of respondents run core processing in the cloud (microfinance adopters of Temenos T24 in the Azure cloud). Still, banks are reluctant to put into the cloud the applications running their most sensitive financial and customer data. Nonetheless, we expect the situation to change quickly as continuing pressure on margins will force banks to share infrastructure costs, and we stick with our prediction that by 2020 all new core banking replacements will be in the cloud.[11]

[11] Temenos white paper, "Banking in the cloud: from hype to reality" https://www.temenos.com/en/market-insight/microfinance-insight/banking-in-the-cloud/

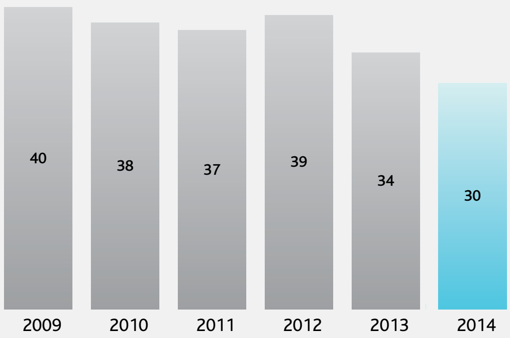
In terms of what is preventing more widespread adoption of cloud applications, the data this year shows an interesting break in an established trend. Since we initiated the survey, we have observed two clear trends: 1) a perception that the regulatory hurdles to cloud adoption are diminishing over time and 2) a perception that data security in the cloud is improving. In the 2014 survey, respondents indicated once again they believed that regulators were becoming more amenable to cloud adoption, but there was a spike in the number of banks citing information security as a concern and barrier to further cloud adoption.

Barriers to greater adoption of cloud in financial services, 2009-2014

Lack of data security and confidentiality (%)



Regulatory hurdles (%)



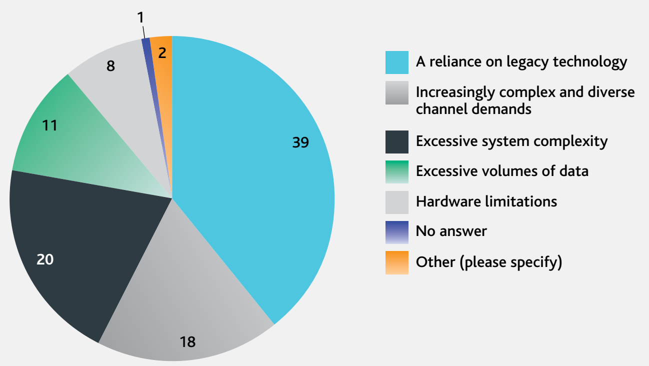
Intuitively, we would expect concerns over data security to fade over time as more universal standards around data and infrastructure security, such as ISO 27001 and SSAE 16, emerge and adherence to the same increases. We attribute this change in attitudes to an "Edward Snowden effect" in that revelations of NSA data monitoring have undermined confidence in internet security. While we predict that this is a temporary blip, we believe there will be longer-term implications in terms of concerns over "data residency" that will manifest themselves in firms choosing to use in-country or regional data centres and public cloud providers in preference to the US giants, such as Amazon.

WILL REGULATORS ULTIMATELY FORCE IT RENEWAL?

In the past 12 months, there have been numerous well-publicised bank IT system failures, which have left consumers unable to withdraw money from ATMs, unable to pay merchants with debit or credit cards, unable to use internet or mobile or, in some cases, unable to undertake any banking services at all.

Asked about the severity of these IT glitches and their probable root causes, 74% opined that the failures were very significant or significant, while 77% believed that the issues were caused either by legacy systems or by the overcomplexity of existing systems.

The perceived root cause of recent IT glitches (%)



While IT renewal is desirable on a number of levels, including future proofing ageing systems against these kind of outages, the vast majority of banks still run systems that are decades-old and home grown. As a follow-up question, we asked our respondents about the likelihood of bank regulators intervening to mandate change. A surprise to us, the majority – 52% – thought that it was likely or highly likely that the regulator would force change, as has happened in certain countries already, such as Ethiopia.

In the end, then, it may be that it is the regulator, rather than economics, that forces banks to renovate their IT estates.

CONCLUSION

The 2014 survey bears out our observation that the banking industry is undergoing massive structural change. Significant effort and resources are being invested in complying with a raft of new post-crisis regulation, which shows little sign of abating in the near term.

On top of that, banks are having to contend with a customer base that is much less loyal than in the past, as a new generation of digitally-native customers make different demands on providers, and customers of all generations use the internet to shop around for better deals. Furthermore, digitization is opening up the industry to new competitors, such as technology players like Google, which bring very different business models and customer value propositions.

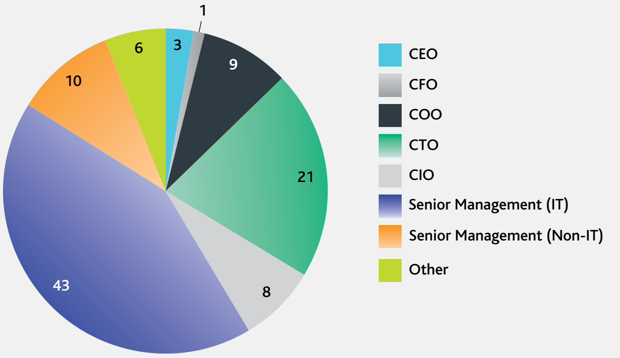
The good news from the survey is that banks are cognizant of the challenges and are making significant investments to ensure their ongoing competitiveness. IT budgets over the next 12 months look set to increase strongly across the board and banks are making a number of the right bets: investing strongly in core banking replacement to lower costs and improve agility; investing strongly in digital channels to give customers a rich experience and access to a broad range of services wherever they are, at whatever time of day, and using whichever device they choose; and, investing strongly in analytics, which will be key to transforming banks from being just transaction processors to being value-added services providers with an integral part to play in customers' lives. Accenture refers to this as the "Everyday Bank" strategy*, a vision that calls for a new way of thinking about the role of banks in the digital era. Banks pursuing this strategy no longer think of themselves as mere providers of financial products and services and enablers of transactions. They will be providers of solutions, playing a greater role not just at the moment of transaction, but before and afterwards as well, aspiring to be at the center of the digital life of their customers.

One area of uncertainty is the banks' real willingness to put mission-critical applications into the cloud. Nonetheless, we see the cloud revolution as nearing, as the new economics of banking will force the change, unless – according to one of the most surprising predictions from this year's survey – the regulator gets there first.

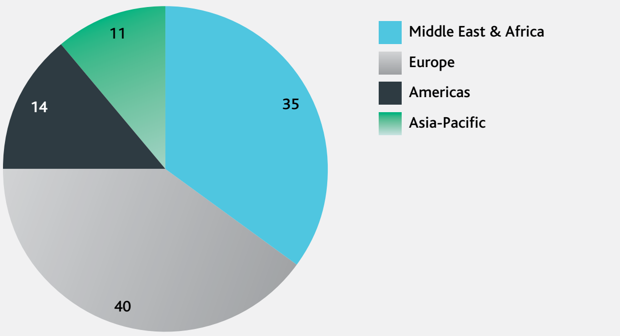
* Note: Accenture, The Everyday Bank: A New Vision for the Digital Age, 2014

BREAKDOWN OF SURVEY RESPONDENTS

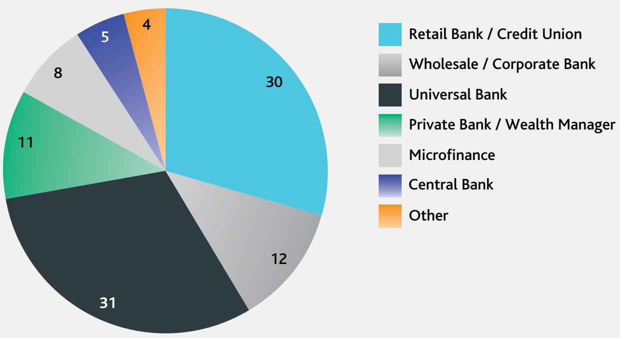
Survey respondents by level of seniority (%)



Survey respondents by region (%)



Survey respondents by banking segment (%)



About us

THE AUTHOR

Ben Robinson is Chief Strategy and Marketing Officer at Temenos, overseeing the group's Strategy, Communications and Marketing functions. Ben joined Temenos in 2007 and has held roles in investor relations and corporate development before becoming CMO in 2013. Ben also runs the "Swiss Technology Group", a networking group aimed at promoting the technology industry in Switzerland.

Prior to Temenos, Ben worked as an equity analyst at Exane BNP Paribas, covering the European software and IT services sector, and as an auditor at Deloitte. Ben is prize-winning UK chartered accountant and holds a first-class degree in Economics from the University of Leeds.

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TEMENOS

Founded in 1993 and listed on the Swiss Stock Exchange (SIX: TEMN), Temenos Group AG is the market leading provider of banking software systems to retail, corporate, universal, private, Islamic, microfinance and community banks, wealth managers, and other financial institutions. Headquartered in Geneva with 56 offices worldwide, Temenos software is proven in over 1,600 customer deployments in more than 150 countries across the world. Temenos' products provide advanced technology and rich functionality, incorporating best practice processes that leverage Temenos' expertise around the globe. Temenos customers are proven to be more profitable than their peers: in the period 2008-2012, Temenos customers enjoyed on average a 32% higher return on assets, a 42% higher return on equity and an 8.1% lower cost/income ratio than banks running legacy applications.

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