

Compliance as a driver of banking performance:

Temenos CEO Navigator

Introduction

Often perceived as a mandatory cost enforced by regulators, compliance related investment may also be analyzed with a different lens.

This short paper, illustrated by **Temenos Value Benchmark** observations, aims at demonstrating how targeted investments in compliance can have an overall positive impact on the bank's financial performance.

Acknowledging the importance of implementing mandatory regulatory change and the impact of compliance related costs on the bank's financial performance, the study will then highlight some positive externalities observed at banks having chosen to invest in sound compliance capabilities, effectively demonstrating how compliance related investments can drive higher financial performance.

*The consultative, survey-based strategic service enables banks to discover the drivers of performance and value creation and provides the business and IT metrics they need to track and improve profitability. It is built on Temenos' proprietary value benchmark program with over 100 participating retail, corporate and private banks from across the world.

Doing nothing is not an option

To demonstrate how operational risks are managed and compliant with local and international rulebooks every bank must be ready to face the regulator at any moment. This notably involves putting in place adequate controls, processes and systems that will ensure resilience, security and ethical standards in the industry.

With regulators around the world constantly raising the level of scrutiny and the amounts at stake, failing to comply can have significant financial implications and result in costly remediation plans leading to both business and reputational issues, often amplified by negative media coverage that can further damage customer confidence¹.

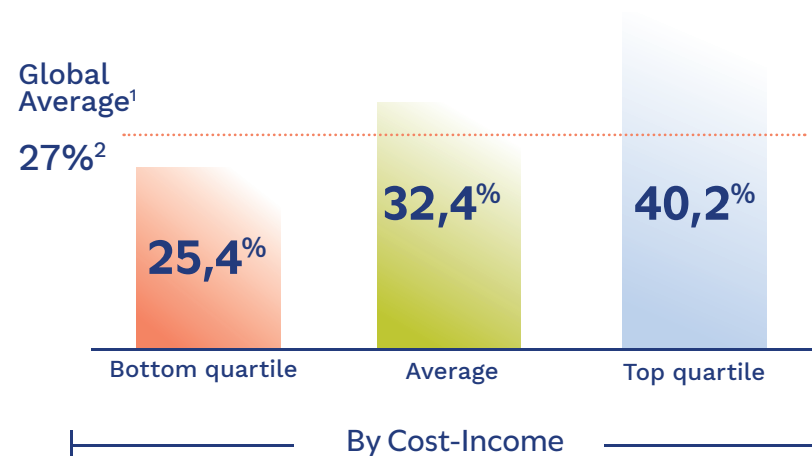
Compliance has a cost

On the other side, compliance with regulation has a significant cost impact, which is part of the nondiscretionary budget of every bank. Having the opportunity to directly observe the compliance costs through the Temenos Value Benchmark (TVB) – **Temenos' proprietary survey-based strategic programme discussing business performance and value creation** – our analysis reveals or confirms some important market trends:

Based on available benchmark data, participants confirm that their average total compliance spend, comprising People, Processes and Systems can be equivalent to **6.7% of revenues**, 69.5% of which are attributable to FTEs².

In addition to the directly identifiable compliance costs, some indirect costs may also be assigned to IT.

IT Spend Breakdown vs. Cost-Income Ratio



¹ 2018 Global average IT spend by Banks in new investments. Source: Celent 2019

² Chart bars indicate % of IT spend dedicated to growth and innovation Ratio

From an IT standpoint, an average of **68.6%** of TVB banks' IT budget is directed towards maintenance, including regulatory and compliance spend as well as the cost of "keeping the lights on". This means when ranked by cost-income ratio, the average participants dedicate **32.4%** of their IT spend on growth and innovation.

Already significant today, the compliance costs are not expected to ease in the coming years. Banks are fully aware of this trend, in a Reuters survey, 52% of participants stated that their Compliance budget is expected to grow and 36% to remain stable in the coming year³.

¹ <https://www.fintechfutures.com/2020/12/2020-review-10-largest-regulatory-fines-this-year/>

² Temenos Value Benchmark data

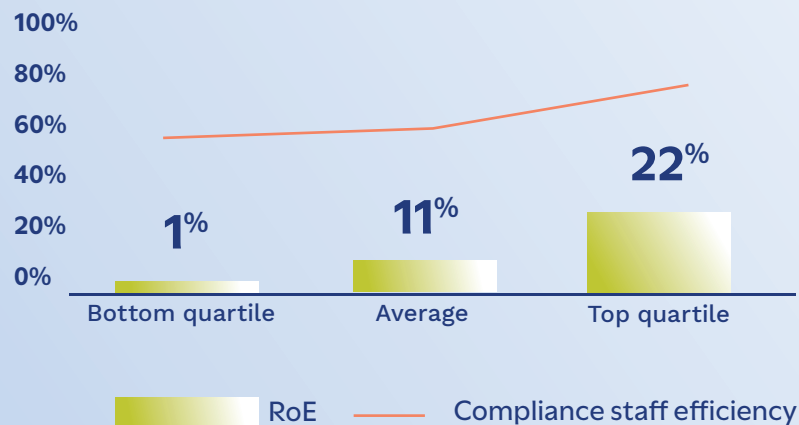
³ <https://legal.thomsonreuters.com/content/dam/ewp-m/documents/legal/en/pdf/reports/shaping-the-future.pdf>

The benefits attached to compliance

While on the face of it, compliance spend is perceived as a necessary cost of doing business in the banking industry, the Temenos Value Benchmark indicates that maintaining an efficient compliance function actually also contributes positively to the bank's financial performance.

As illustrations, the Compliance Staff efficiency, measured by the percentage of time spent by employees on non-administrative tasks has a positive correlation with the Return on Equity ratio. **The same relation to profitability is also observable from the percentage of false positive alerts being generated by compliance systems**, where TVB data show a direct correlation between the Return on Equity ratio and the accuracy of the compliance system calibration.

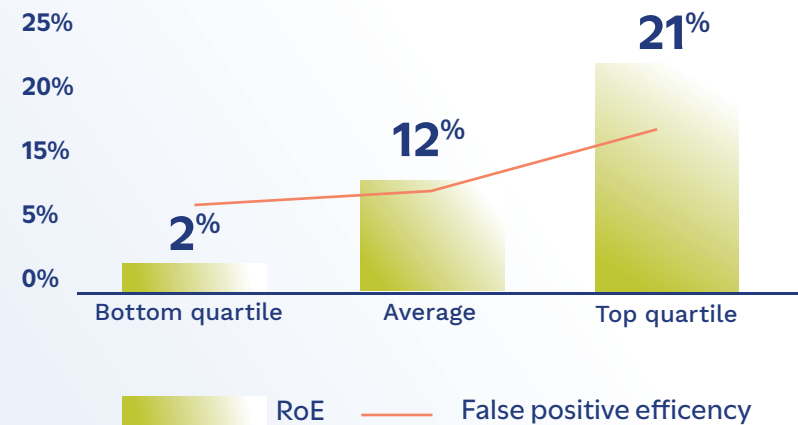
RoE vs. Compliance staff efficiency



These correlations are driven by multiple factors among which is the overall bank digitization. As visually evident from the below chart, when ranked by their digitization index, one can observe that efficiency of the compliance staff tends to follow the Digitization index.

The more digitized a bank is, the higher the compliance staff efficiency⁴.

RoE¹ vs. False positive efficiency²



Digitization being a driver of the compliance function's performance, it is also an important enabler of other good practices. Indeed, risk and compliance information availability⁵ or the use of predictive and prescriptive analytics⁶ capabilities as part of the day-to-day activities are examples of good practices positively correlating with the compliance function's performance and largely

1 TVB sample adjusted to reflect data accuracy and completion for RoE; Compliance Staff and False positive efficiency observations

2 % of False positive efficiency: computed as the inverse of "% of false positives" as a percentage of total alerts

4 Digitization index is composed of the average of % of digitally active customers;

% of Front-office STP rate; % of Operations & % of payment STP

5 Positively correlates with compliance staff efficiency

6 Positively correlates with compliance staff efficiency

Conclusion

As explained through this study, our data demonstrate the direct correlation between an efficient compliance function and bank's financial performance. **Compliance should not be perceived as a mere regulatory cost but as an opportunity to reduce operational and reputation risk, enhance the customer experience and lead to high overall digitization, ultimately benefitting the banking performance.**

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About Temenos

Temenos (SIX: TEMN) is the world's leading open platform for composable banking, creating opportunities for over 1.2 billion people around the world every day. We serve two-thirds of the world's top 1,000 banks and 70+ challenger banks in 150+ countries by helping them build new banking services and state-of-the-art customer experiences. The Temenos open platform helps our top-performing clients achieve return on equity three times the industry average and cost-to-income ratios half the industry average.

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