



TEMENOS
THE BANKING SOFTWARE COMPANY

Capgemini 

Shifting Sands: Banking in the Digital ERA

The eighth annual Temenos survey of challenges, priorities and trends in the financial services sector



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Introduction

For the past eight years, Temenos has conducted a comprehensive banking 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 respondent sample is highly diverse, both in terms of types of banks and geographical location, the results give a broad view of banking sentiment.

This year’s survey canvassed the opinions of 201 senior bankers (see breakdown in the appendix) and the results are presented in association with Capgemini, the management consulting, technology services and outsourcing company.



Survey Findings

This year's survey canvassed the opinions of 201 senior bankers covering broad cross-section of regions and bank sectors.

REGULATORY PRESSURE DIMINISHES...



17%

percentage of respondents identifying new regulations as top challenge (compared to 25% in 2014)

DIGITIZATION IS BLURRING COMPETITIVE BOUNDARIES



52%

more than half of respondents see non-banks as their biggest competitive threat

...GIVING WAY TO MORE FOCUS ON PROFITS AND DATA



15%

say it is capitalizing on their data

18%

of respondents say boosting profitability is their biggest challenge

IT MODERNIZATION IS BANKS' TOP PRIORITY



25%

of respondents cite IT modernization at their top priority. Last year, it was their 4th biggest priority

Executive Summary

The 2015 survey highlights some big shifts: in particular, banks' focus is quickly moving away from implementing new regulations to putting in place the right capabilities and talent to retain customers in the face of tougher, multiform competition.

For the third 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. Interestingly, the number of respondents citing regulation dropped significantly, suggesting that banks believe the brunt of re-regulation is now in the past. Instead, a growing number of bankers are worried about their ability to hire top talent (cited by 14% of respondents compared to 7% in the previous year) and a far higher number recognise the strategic importance of technology, as banks begin to grasp what it will take to be successful in the digital age.

Regulatory Burden Seems To Have Stabilised

Regulation has been a perennial concern for our survey respondents – it was considered the industry's second-biggest challenge in 2014 and 2013 and was considered the biggest challenge every year before that. However, in this year's survey, as the pace of new regulation has slowed, it has fallen to the third-biggest concern – with just 17% of respondents citing it as their biggest challenge, the lowest percentage in the history of our survey.

Focus Shifting To Growing Profitability And Capitalising On Data

In 2015 survey respondents cited maintaining profitability (18%) as their second-biggest challenge. While banking profitability has remained subdued since the financial crisis, it is only now appearing as one of the biggest challenges faced by banks. This likely reflects the fact that more bankers are realizing that in an era of tougher regulation, stronger competition and more fickle customers, low profitability is a structural rather than cyclical issue. In common with last year, retaining customer loyalty (22%) and a tougher competitive environment (17%) were also seen as significant challenges. The number of banks highlighting the issue of data was, however, much higher – at 15% – and underlines both the need to capitalise on data assets, but also the significant challenges in doing so. Respondents referred in particular to skills shortages and lack of strategic focus as big barriers to overcome.

Underlining The Dynamism Of The Competitive Environment, Almost Three-Quarters Of Bankers See Their Biggest Threat Coming From Players Not Operating In Their Market Today

While large incumbent banks are still viewed as formidable competitors (cited by 21%), our respondents are noticeably less concerned about small banks and, in total, only 26% of respondents cited incumbent banking players as their biggest rivals. Banks see a significant threat coming from banking players not operating in their market today, such as overseas banks and challenger banks. But banks are most worried about the threat from non-traditional players, especially technology companies, such as Google, who were cited by 27% of respondents, compared to 23% in 2014². Fintech start-ups are a big concern, cited by 14%, but this is down year-on-year, suggesting banks appreciate – as we do – the possibility of building a collaborative relationship with them.

IT And Innovation Top Banks' Corporate Priorities

Banks are responding to their structural challenges by investing in IT systems and innovation, cited by 25% and 24% of respondents, respectively. The focus on IT has grown significantly compared to last year as banks acknowledge the importance of putting in place the right IT assets to be able to deal with liquid customer expectations and the threat from technology players attempting to disintermediate them. Also interesting is the significant rise in the number of respondents citing talent acquisition as their biggest priority, reflecting the fact that banks' ability to attract the best talent is not what it was and, as a result, how they will need to work harder to steer the best people, especially graduates, their way.

1. This finding is consistent with a recent Capgemini report (World Retail Banking Report, Capgemini and Efma, 2015) that found banks are failing to elicit customer behaviours that can help them either save costs or improve revenues by providing referrals and buying additional products – reflecting on decreasing customer loyalty.

2. This finding is consistent with a recent Capgemini report (World Retail Banking Report, Capgemini and Efma, 2015) that found banking executive themselves consider Internet/Technology firms to pose the highest threat to their business.

IT Investments Up Strongly Again

IT budgets are forecast to be up strongly again in 2016. 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, at 58%. Most notable is the improvement in European sentiment, which recorded a 16pp year-on-year increase in the number of respondents expecting higher budgets. 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 Continues To Increase

While still very few banks run mission-critical applications in the cloud, almost every bank we surveyed (89%) is running at least one application in the cloud, compared to just over half in 2009. Regulation and data security are considered to be diminishing barriers to greater cloud deployment; instead, internal factors – especially lack of internal expertise – are increasingly coming to the fore.

Need For Openness Acknowledged – But Not A Top Priority Yet

We introduced a new question this year on “open banking” – essentially, the opportunity presented by opening APIs to third parties. What we observed is that, broadly speaking, our respondents see open banking as an opportunity for their business (52%) and essential to deal with the threat from non-traditional competitors (60%), but it is not yet on the radar of the C-suite, as evidenced, for example, by the fact that only 5% of innovation spend is being directed towards it.



Technology becomes top of mind



In this year’s survey, banks cited technology (IT modernization) as their biggest priority. To put that in perspective, it was the fourth highest-priority in our 2014 survey.

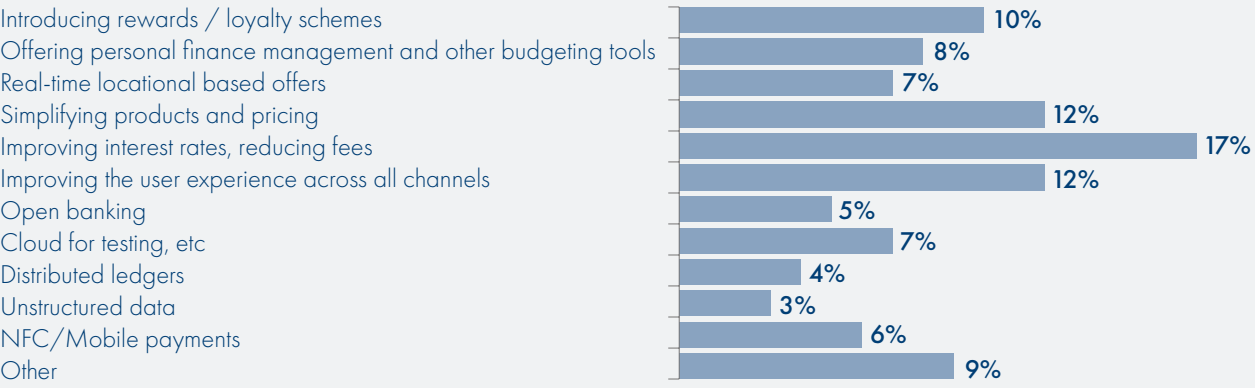
It would seem to be the case that, in the light of rapid digitization, banks are increasingly aware that technology investment is critical to developing new sources of competitive advantage.

As we will see later, banks are investing in capabilities such as analytics and channels that will help deliver a more intimate customer experience, but their biggest challenges in meeting their digitization

goals remain the constraints of legacy systems (27%), maintaining IT security (14%), coping with channel and device proliferation (19%) and resourcing and budget constraints (33%).

In the context of the last, it is maybe not surprising that hiring the right talent has become a much bigger priority compared to last year.

Where is the top area of innovation spend? 2015



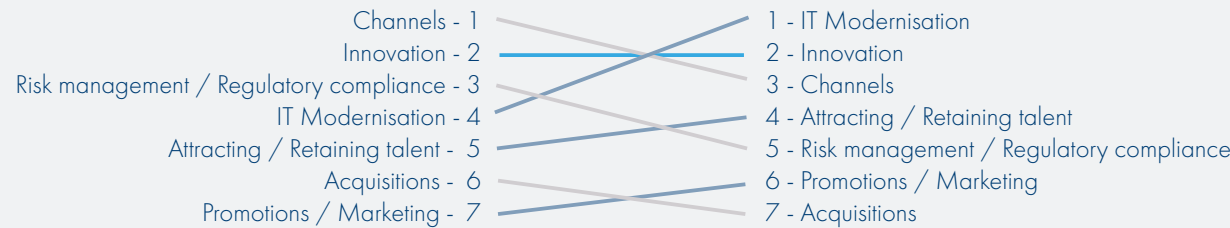
It was cited by 14% of respondents against only 7% in the year before. It seems that banks are battling against all industries for many of the same types of skills, such as data scientists, at the same time as banking has become a relatively less attractive place to work, particularly in the eyes of millennials³. It also reflects a number of sector-specific factors: for example, talent management was the biggest priority for wealth managers (cited by 26% of respondents), who face a shortage of experienced relationship managers as these increasingly near retirement⁴.

Innovation is banks' second-biggest priority, cited by 24% of respondents (unchanged from 2014). Banks in particular are looking to introduce products and services that can help develop a more intimate customer relationship in the digital world, such as rewards and loyalty (cited by 10%), offering PFM and other tools to help customers to manage their finances better (cited by 8%) and investing in real-time, location-based offers (cited by 7%). Conversely, although banks recognise the importance of open banking, only

5% see it as a top innovation priority today (see later). The biggest aim of innovation remains reducing fees and rates to end customers (cited by 17% of banks) and innovation is cited as a bigger priority in less mature, but more competitive markets, especially APAC and MEA (cited by 27% and 30%, respectively).

Interestingly, there was a big drop in the number of banks for whom investing in channels is their biggest priority. Arguably, this is because banks are realising that investing in channels by themselves cannot create great customer experiences; this can only be achieved through a fuller digitization of bank systems and processes that will deliver the necessary level of instant fulfilment⁵. There was one exception: in the Americas, 24% of respondents cited channels as their biggest priority against 14% in the prior year, with 15% saying that branch investment was their top priority. While this may seem counterintuitive, it is worth noting that there are still over 82,000 bank branches in the US⁶, which will need to be closed or, as these results suggest, be transformed into sales and advice (as opposed to transaction) centres.

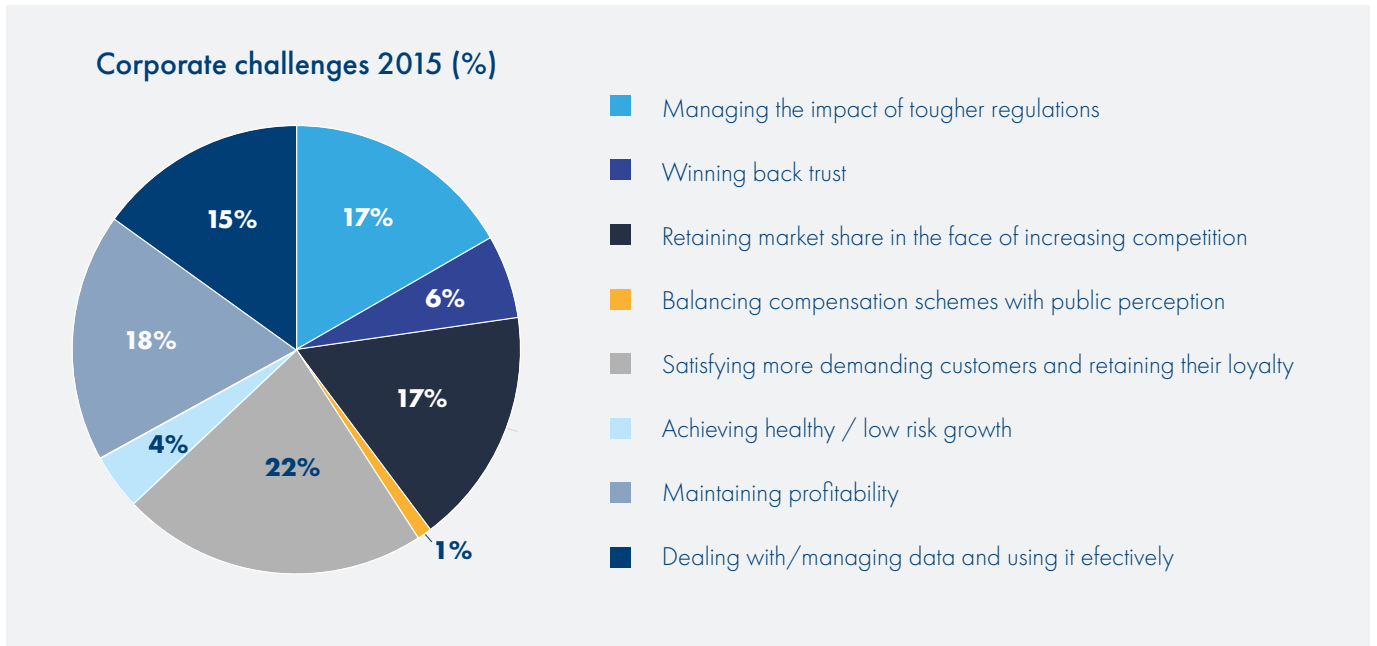
Corporate Investment priorities 2015 vs 2014



3. An annual Deloitte survey of graduates' preferred career choices has seen the popularity of banking decline every year since 2011 and lose out to FMCG as the most popular choice: <http://bit.ly/1MfR2GF>. Similarly, a very recent analysis from the Financial Times found that MBA graduates were 40% less likely to choose a career in banking than they were in 2008: <http://on.ft.com/1QoTE95>.
4. As examples, the Hong Kong Financial Services Development Council estimates that there is a shortage of 4,500 relationship managers in the city, while according to the CFA institute, the average age of relationship manager in the US is 50.9 years.
5. This finding is consistent with a recent Capgemini report (World Retail Banking Report, Capgemini and Efma, 2015) that found that there is an immediate need to transform middle- and back- offices to sustain the gains in customer experience delivered from investing in front-office.
6. FDIC data shows there are 82,613 branches in the US. See "Bricks & Clicks: The New Omnichannel Reality", The Financial Brand, November 2015

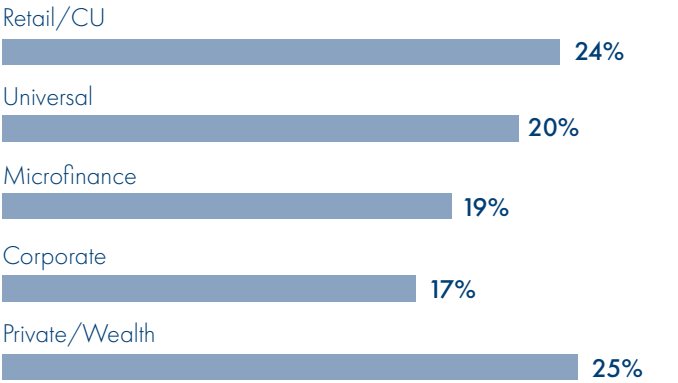
Banks Battle Against Diminishing Loyalty

For the third consecutive year, banks cited customer loyalty as their biggest issue. Almost one-in-four bankers (22%) believes this to be their biggest concern, with the highest readings for retail banks (24%) and private banks (25%), the two sectors that have seen the biggest shifts in how customers consume their services.



As a corollary to this, banks remain very concerned about retaining market share in the face of tougher competition (cited by 17%, their third-biggest concern). Interestingly, this seems to be particularly the case for banks in APAC (which worry about foreign banks looking to boost their profits – see below – and which are arguably more vulnerable to technology-led disruption given very high consumer adoption of new technologies), the retail market (where we see significant activity on the part of challenger banks and fintechs) and the microfinance sector, where regulatory barriers to entry are lowest and where, given high operational costs, technology innovations can have disproportionately large effects⁸. Nonetheless, somewhat surprisingly, only 9% of private banks cited increasing competition as their biggest concern, suggesting that falling loyalty owes to different factors, such as intergenerational wealth transfers (where retention rates are typically below 10%).^{9 10}

The challenge of maintaining customer loyalty 2015



8. For an interesting case study in how technology innovation had a massive impact in Kenyan banking, see Temenos' case study on M-Shwari, downloadable here: <http://tem.mn/1QA2tNq>.
9. See Temenos white paper, "Leveraging technology to capitalize on the transfer of wealth to generations X & Y", downloadable here: <http://tem.mn/1MZIW6g>.
10. This finding is consistent with a recent Capgemini report (Asia-Pacific Wealth Report, Capgemini and RBC Wealth Management, 2015), that private banking firms are struggling to retain relationships during movement of wealth from one generation to the other.

Data - An IT issue, right?

Later this year, we wrote a blog entitled Data – an IT issue, right? It argued that banks must do more to capitalise on data, which represents one of their strongest competitive advantages. And the strategy must be led from the top, not left just to the IT department.

What is interesting is how many of these same themes run through this year's survey results. Firstly, 15% of respondents cited leveraging data assets as their institutions' biggest challenge to-

day: that is, data's importance is gaining much more recognition at the top levels. However, when asked specifically about data challenges, most people pointed to issues that can't be solved by the IT department alone. Chief among these is that data is not seen as an area of strategic focus (23%), but also that data is locked up in silos, which is both an IT issue but also reflects the fact that data (like IT spend) is owned by multiple stakeholders in the bank, not just the CTO.

<http://tem.mn/1MtL6Kp>



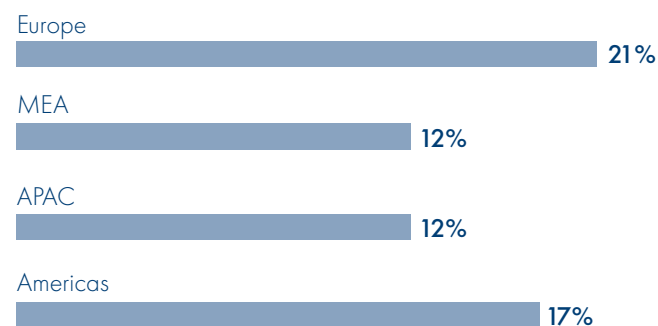
Focus Begins To Shift Away From Regulation...

Regulation has been an ongoing concern for our survey respondents – it was considered the industry's second-biggest challenge the past two years and was considered the biggest challenge every year before that. In this year's survey it has fallen to the third-biggest concern, with 17% of respondents citing it as their biggest challenge, the lowest percentage in the history of our survey. This perhaps reflects the fact that the pace of regulatory change has slowed, and the focus has now turned to the implementation of the new rules. This is consistent with the annual Temenos and The Economist Intelligence Unit report in the retail-banking sector¹¹ that also found a decreased concern about regulation among banks.

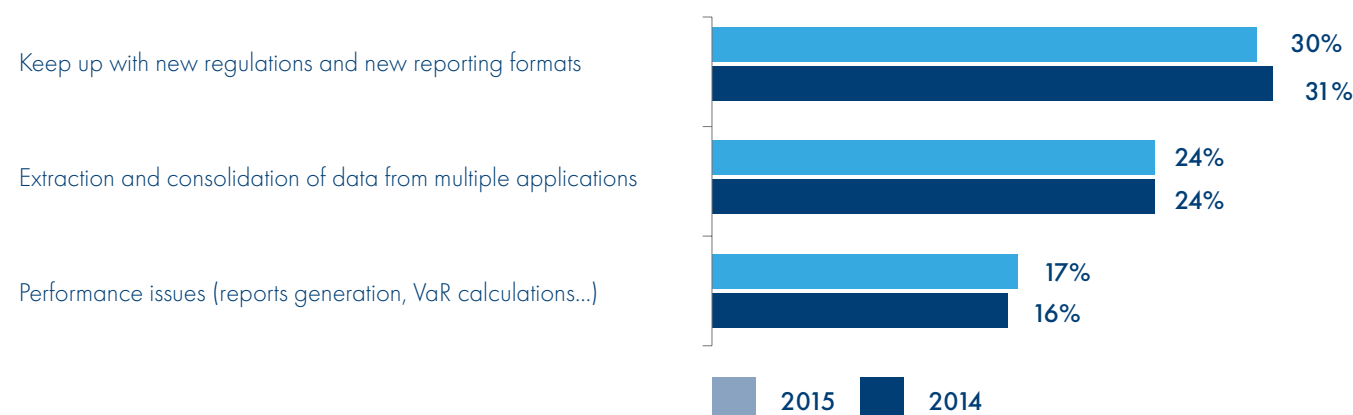
As expected and consistent with prior years, the challenge of complying with new regulations remains a much greater concern in developed markets. The burden of new regulations has fallen predominantly in the US and Europe, where regulators, governments and central banks have tried to address the view that minimal regulation led to the financial crisis and have put in place safeguards to prevent another crash. However, unlike last year, a gap is opening up between the Americas and Europe regarding the level of challenge posed by regulation. We believe this is due to: (1) the lag in implementation in Europe compared to the US with, for example, a new Eurozone regulator, established post-crisis, only now deciding on legislation; and (2) long gestation periods for new rules around areas such as leverage in Switzerland and ringfencing in the UK.

Within compliance and risk management, the challenges remain largely unchanged compared to last year. The main issues are seen as keeping up with new regulations and reporting formats (30%), where a lack of coordination between bodies sees frequent and often overlapping information requests, and extracting and consolidating data from multiple sources (24%).

The impact of regulation 2015



Compliance and Risk Management Top 3 Challenges 2015 vs 2014



11. The Economist Intelligence Unit, on behalf of Temenos, surveyed 242 global banking executives to investigate the views of retail banks on the challenges and changes they face in the years to 2020 and how they are responding. Get the report here: <http://tem.mn/1PFS82j>

...And Towards Improving Profitability

In 2015, survey respondents cited maintaining profitability (18%) as their second-biggest challenge.

While banking profitability has remained suppressed since the financial crisis¹², it is only now appearing as one of the biggest challenges faced by banks. Arguably, this owes to a greater appreciation that, in an era of rapid digitization – precipitated by technology and resulting in lower customer loyalty and increased competition – the issue of low profitability is a structural rather than a cyclical one (which will require a structural response, especially around IT replacement)¹³. It may more simply infer that, as the regulatory environment has become more certain and less onerous, management attention has returned to the issue of boosting profitability.

What is clear is that maintaining profitability is a much bigger concern for banks in developed markets compared with emerging markets. This is not surprising given that banks in emerging markets are, in general, benefiting from more favourable demographic and economic trends boosting profitability whereas banks in developed markets must contend with an environment of lower economic growth.

Importance of maintaining profitability, 2015



12. Global banking RoE has failed to surpass 10% since the financial crisis – see our paper “Restoring Profitability in the Digital Age”

<http://tem.mn/1Xgq3xB>

13. In the same paper, we attempt to quantify the effect that technology renewal could have on raising profitability towards pre-crisis levels

<http://tem.mn/1Xgq3xB>



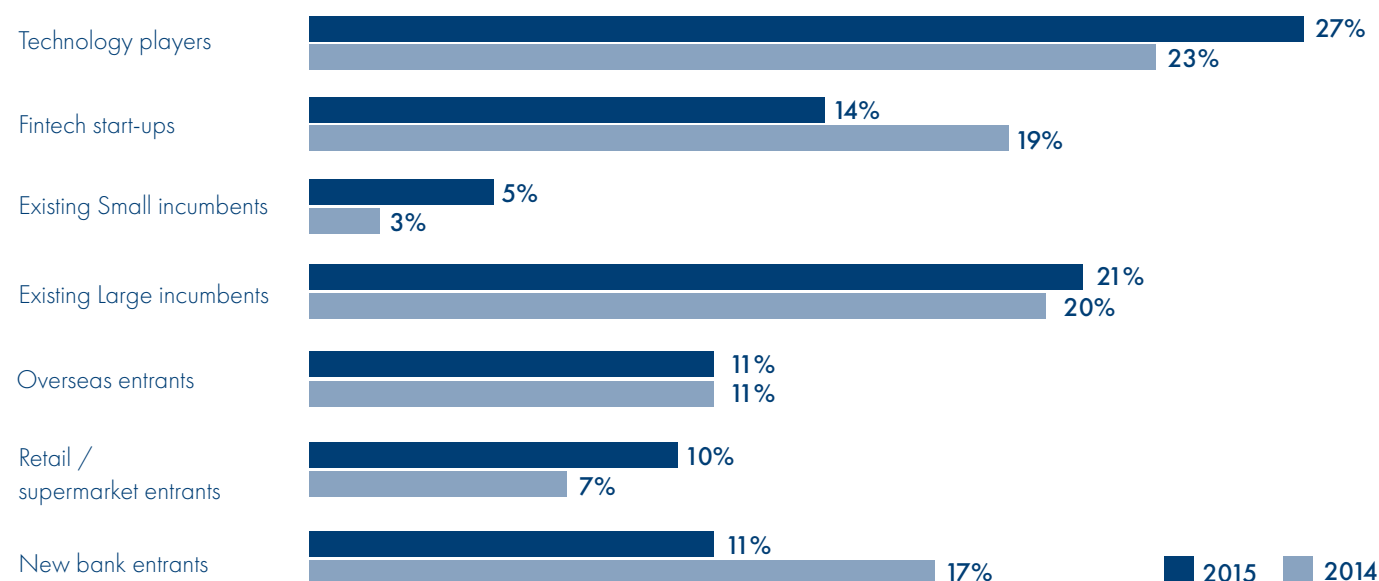
Digitization Is Blurring The Competitive Boundaries



What is interesting to observe in this year's results is that almost three-quarters of respondents are worried about competition that is most likely not present in their markets today.

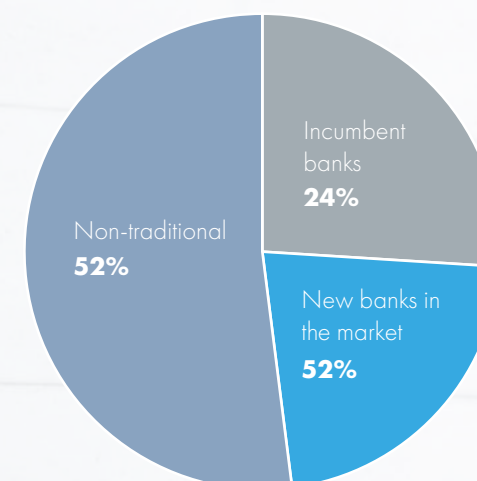
It is true that large incumbent banks are seen as a major source of competitive threat today, cited by 21% of respondents compared to 20% in 2014. This is especially the case for corporate and private banks, cited by 28% and 31% of respondents respectively. However, notwithstanding a small uptick this year, over the eight years we have run the survey, we have consistently seen banks becoming less concerned about the threat from small banks, which typically lack the nimbleness of new entrants and the economies of scale of the large banks. Moreover, unlike in the immediate aftermath of the credit crisis, it is new entrants and fintechs who are benefiting from bank dissatisfaction rather than small banks or credit unions. As such, taking together the readings for small and large incumbents, only 26% of bankers think their biggest competitor is operating in their market today.

The evolving competitive threat 2014-2015



22% of respondents worry about the threat from banks not currently operating in their market today, namely new entrants (or challenger banks) and overseas banks. Retail banks are most worried about the threat from challenger banks, such as Metro Bank in the UK that now boasts over 600,000 customers. As regards overseas entrants, it is banks in APAC (presumably concerned about foreign banks seeking to boost their profits) and corporate banks (nervous about overseas rivals gaining a larger wallet share with multinational customers) who are most worried.

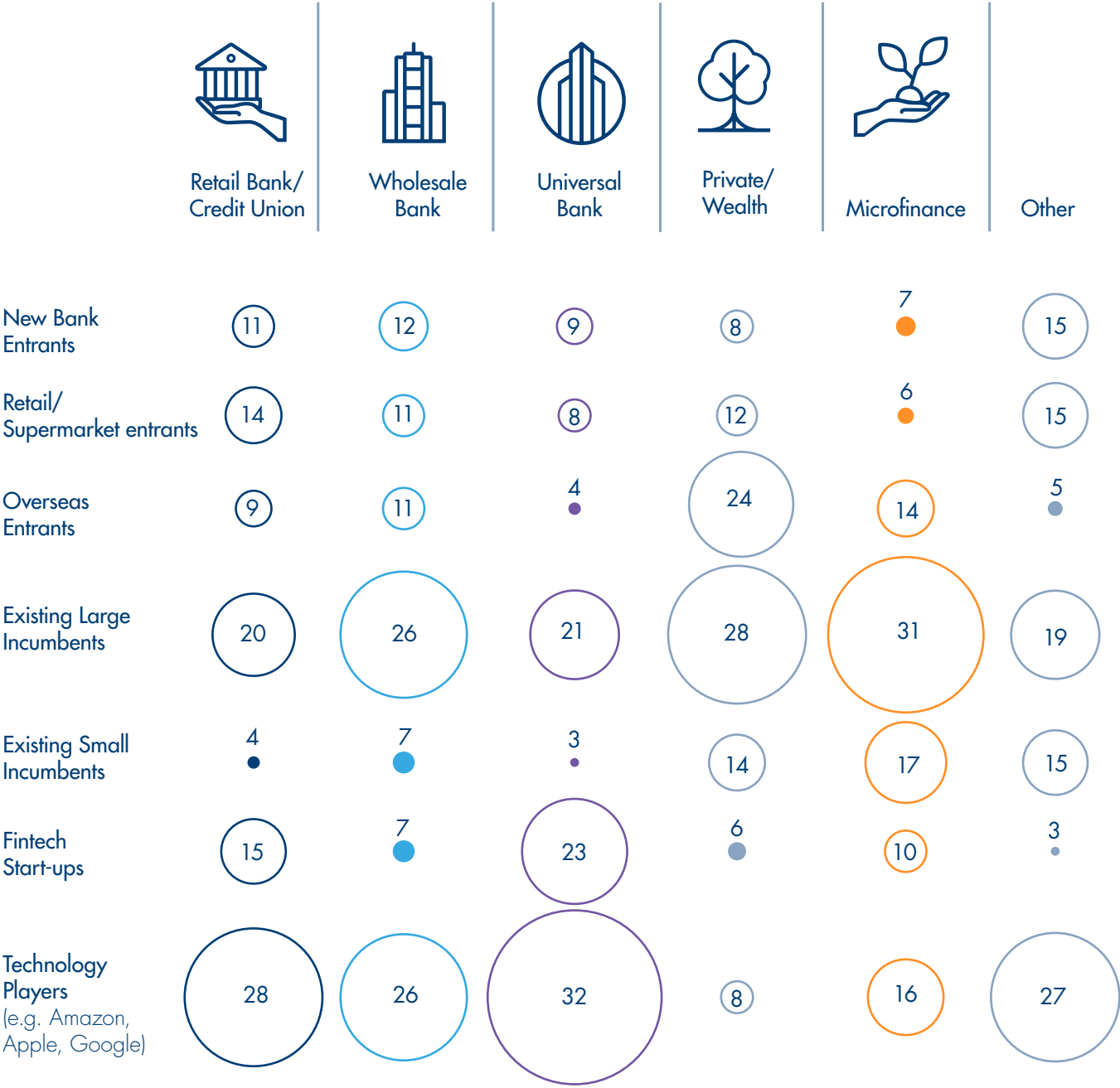
Competitive threat 2015



But the largest group, representing more than 50% of respondents, is most worried about non-traditional competitors. 27% see technology vendors such as Google as their biggest threat, up from 23% in 2014, constituting the biggest threat overall. This is particularly the case for retail, universal and microfinance institutions, who fear these vendors leveraging their existing platforms and customer relationships to begin distributing banking services.



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



10%, largely made up of retail and universal banks, see super-markets or other high-street retailers encroaching on their markets. This is slightly higher than in 2014 although there does not seem to be any evidence that retailers have become more active or taken market share in the last year. Nonetheless the threat posed by leveraging their large customer bases and distribution networks remains material.

In terms of fintech start-ups, we have actually seen fewer banks cite them as their biggest source of competition, 14% vs 19% in 2014. In our view, this may reflect a growing appreciation on the part of banks that, with the right strategy, they can capitalise on their own strengths, in particular around distribution, to develop fruitful partnerships with the fintech start-ups (see "Fintech: friend or foe?" section).

Nonetheless, fintechs still represent a significant threat, as seen especially by US banks (where there is the largest concentration of fintech companies), microfinance, which is still a largely untapped opportunity with low barriers to entry, and in retail banking, where arguably there is the biggest potential to improve the customer experience.

Banks Gear Up For Digitization

Digitization is having profound effects on financial services...



3rd

consecutive year - shrinking customer loyalty is considered industry's biggest challenge



74%

see biggest threat from players not in their market today (including 52% coming from non-banks)

...BUT BANKS ARE REACTING



64%

are increasing IT budgets over next 12 months



25%

IT modernization top priority



24%

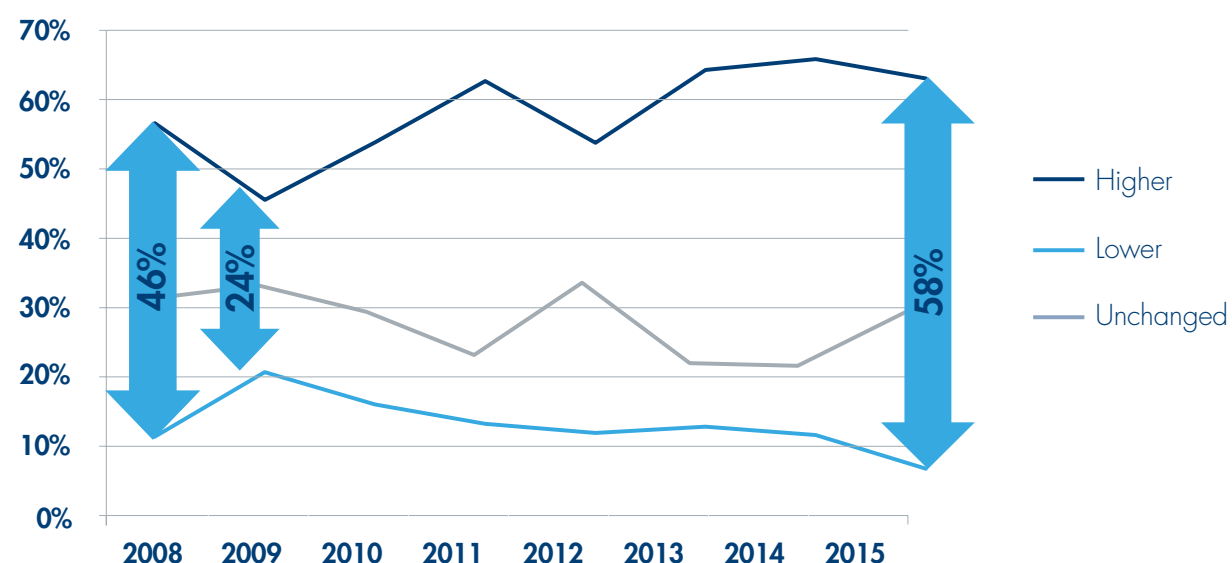
Innovation top priority for



Bullish Forecast For IT Spending...

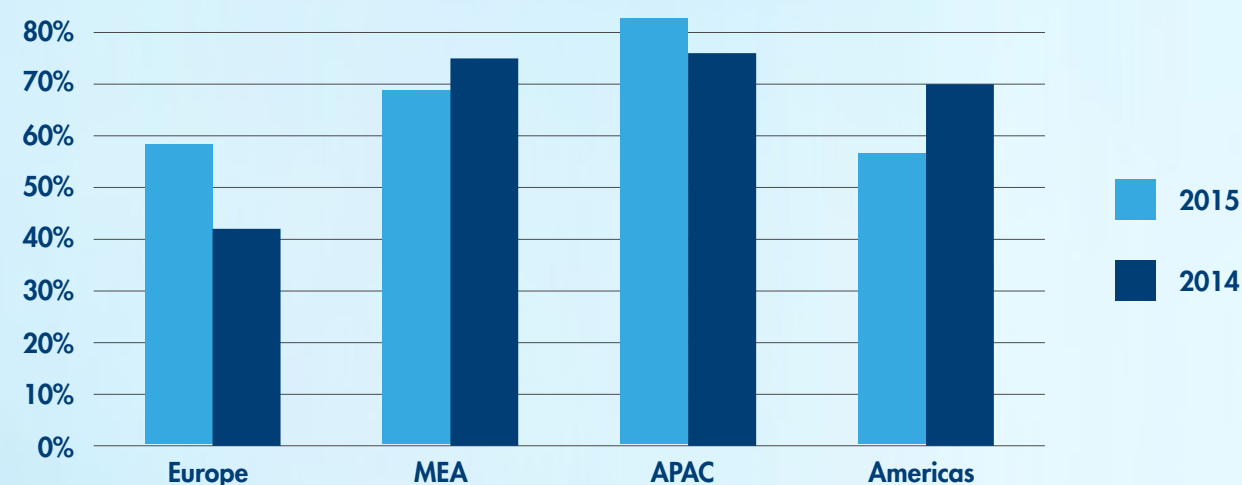
Each year, we ask our respondents about their IT budgets over the coming 12 months. In 2015 the results were extremely positive with 64% of respondents expecting higher budgets and just 6% anticipating that their IT budget would shrink, giving a positive delta of 58%. This is higher than in 2014 (56%) and 2013 (53%) and, in fact, the highest recording in the eight years we have conducted the survey.

Financial institutions intending to increase vs decrease IT spending 2008-2015



The scores were positive across all segments and regions, highlighting the extent to which all banks see the need to invest in IT to sustain competitiveness in the digital age. Nonetheless, there were some noticeable regional variances with banks in the Americas the least bullish – with only 56% expecting budgets to be higher (vs 70% in 2014) and 44% expecting budgets to be unchanged (vs 30% overall). Asian banks are the most bullish, with 82% expecting higher budgets and only 12% expecting budgets to be lower. It is also worth noting that banks in Europe are noticeably more positive with 58% expecting budgets to be higher compared with 44% a year ago, likely due to the improving macroeconomic situation or possibly just because of an increased urgency to act (given most European institutions are running legacy core platforms).

Institutions planning IT budgets increase by region: 2015 vs 2014



By segment, private bankers are planning the biggest spending increases with 75% of respondents expecting IT budgets to be higher, no doubt as they respond to customer demands for lower fees and richer digital experiences. Corporate bankers are least spendthrift, with only 40% expecting budgets to increase in the coming year, perhaps reflecting (for now) lower competitive and customer pressures.

Fintech – friend or foe?

We recently published a blog entitled “Fintech – friend or foe?” It challenges two widely accepted assumptions: firstly, that fintechs will successfully disrupt great swathes of the banking value chain and secondly, that it is a zero-sum, with fintechs benefiting only at the expense of banks.

What we suggest in the blog is that fintech start-ups are unquestionably doing great work in reducing friction and lowering the costs of banking across many important areas, but they have so far failed to gain significant traction and are unlikely to do so in the near term.

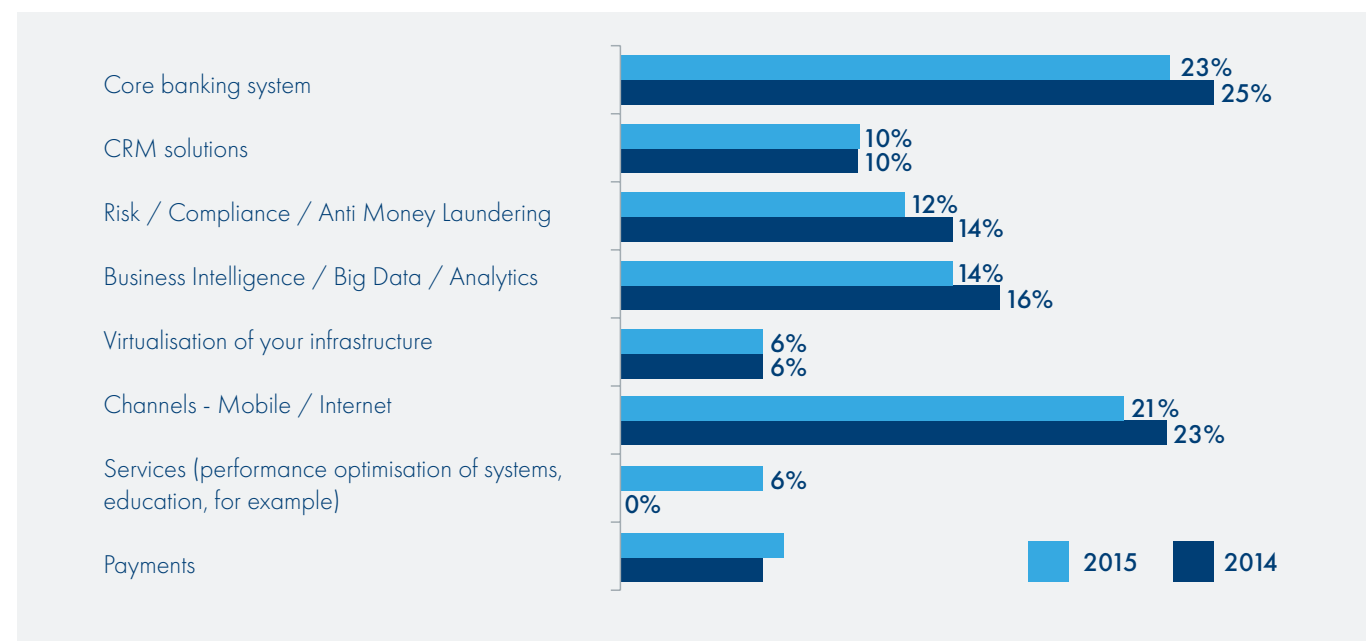
Fintechs are strong where banks are weak and vice versa, which makes for a win-win partnership in many cases. On the one hand, fintechs are small, nimble and innovative. On the other, banks have large distribution networks and large balance sheets. Collaboration between banks and fintechs is therefore highly synergistic, improving the former’s capacity for innovation and giving the latter scale and route to market.

...With Core Banking, Digital Channels And Analytics Top Of The Shopping List

As in 2014, core banking was the number one IT investment priority in 2015 (cited by 23% of survey respondents).

This is perhaps not a surprise since we polled mainly Temenos customers and prospects, many of who are in the process of making such an investment. However, we should also point out that core banking spending usually constitutes about half of a bank's total IT investment, making it a prime area for efficiencies. As well, in absolute terms, the number of core banking deals in the market has fallen in recent years, meaning there could be pent-up demand.

We should also note that without a real-time, customer-centric core banking system, many of the investments banks are making in other areas such as CRM, analytics and digital channels are unlikely to yield the benefits banks would hope for. For example, a bank could invest huge sums to build market-leading mobile apps, but the user experience would be constrained if they were not supported by complete information and real-time processing.



Digital channels were the second-biggest priority for IT spending by banks, cited by 21% of respondents in 2015. Although still the second overall IT priority, there has been a noticeable drop because digital channels were cited by 23% of respondents in 2014 and 27% in 2013. This likely reflects the fact that many banks have invested in their digital offering in recent years but are now realising that other investments, such as core processing (as discussed above) and analytical capabilities (discussed below), are essential to fully realise the potential of digital channel investments.

Investing in analytics was highlighted as the third-largest priority by our survey respondents, cited by 14%. 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. For banks to really capitalise on their strengths, they will need to use data to become more involved in customers' commercial and financial lives. In practice, this will mean analysing customers' financial, contextual and locational information to be able to serve them up insights – around, for example, how they could save money. It will also involve recommending them products and services, both financial and non-financial, own brand and third-party, that would really add value. We call this experience-driven banking¹⁴.

14. Please see our white paper which discusses the concept in detail, "Experience-driven banking: a race banks must win" - <http://tem.mn/1kN6PE5>

However, for banks to offer experience-driven banking, they will need to make more than technology changes. In addition, cultural change will be needed. Banks will need to move from being data custodians that attach primacy to keeping data secure, to being data analysts that seek insights from customer data. It will also necessitate, as we discussed above (see section "Data – an IT issue, right?"), the subject of data to be seen as a global corporate priority, not just an IT function.



Cloud Adoption Rising, But Still Not For Core Processing

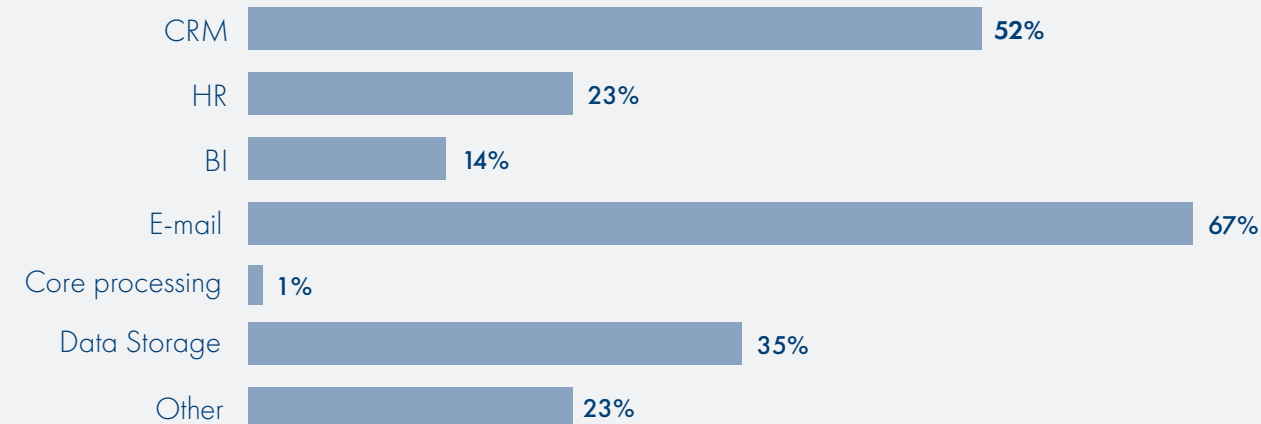
Since 2009 we have been including questions in our survey on cloud computing. Over the years, we have witnessed a continuous and material rise in the adoption of the cloud in the financial services industry. Our latest survey shows that 89% of institutions run at least one application in the cloud, which is up considerably from 57% in 2009 when our survey first included this question.

Percentage of institutions running one or more applications in the cloud, 2009-2015 (%)



Banks are now more likely than not to run email and collaboration tools (such as SharePoint) in the cloud and just over half of banks are accessing their CRM information through the cloud. We continue also to see lower, although still significant, numbers of banks running data storage, BI and HR applications in the cloud.

Applications run in the cloud 2015 (%)

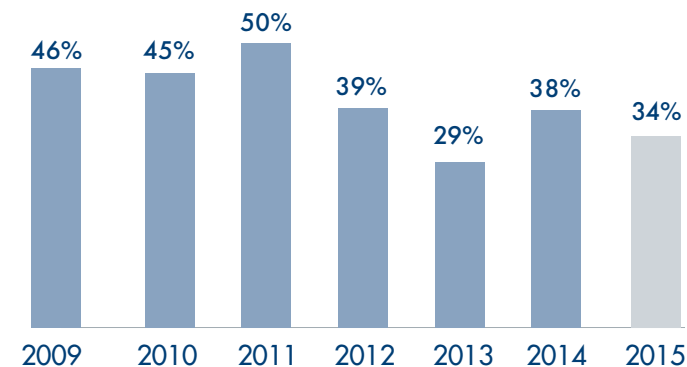


However, we continue to observe a reluctance to run core banking applications in the cloud with only 1% of respondents running core processing in the cloud today. Banks continue to be reticent about putting applications that use their most sensitive customer and financial data in the cloud. Despite the current hesitancy, we continue to expect this to change as a combination of factors will force cloud adoption. These include: (1) continued low profitability (2) a need to redirect IT budgets to innovation away from maintenance (which still takes up 75.4% of spend¹⁵); and (3) the capabilities to scale to meet an explosion in enquiries (brought on by the move to mobile channels and the Internet of Things). We maintain our prediction that by 2020 all new core banking replacements will be in the cloud.

This year's survey shows that the main barriers to adoption of the cloud remain the same as in prior years: (1) perceived regulatory hurdles and (2) a perception that data security and confidentiality in the cloud is lacking. While these remain the two biggest hurdles in the 2015 survey, respondents believe that the challenge has lessened in both cases in the past 12 months.

In 2015, 34% of respondents cited concerns around data security. This is lower than in 2014 (38%), but remains above the level seen in 2013 before revelations about NSA surveillance. Nonetheless, we would expect concerns over data security to fade over time as, generally, universal standards around data and infrastructure security, such as ISO 27001 and SSAE 16, emerge and adherence to the same increases. At the same time, cloud providers are putting in place additional safeguards about where data resides and who can access it, as Microsoft has done by creating its partnership with Deutsche Telecom in Germany.

Lack of data security and confidentiality (%)



What is interesting to note is that, as the perceived challenges around data security and regulatory objections have diminished, internal issues – especially around skills – have come to the fore. In the 2015, 18% of respondents said they lacked the necessary skills to be able to put more – and more mission-critical applications – into the cloud, which adds further impetus for banks to attract and retain the right kind of talent.

¹⁵ Celent paper IT Spending in Banking: A Global Perspective - <http://www.celent.com/reports/itspending-banking-global-perspective-2>

Banks Begin To Embrace Open Banking

In this year's survey, we added a new question on the subject of open banking. We broadly define open banking as the exploitation of APIs (Application Programming Interfaces) to: (1) make data and functionality available to any user-interface (UI), including third-party UIs; and (2) combine resources from other providers, both banking and non-banking, to enrich a bank's offering.

We included the question since we see the key to banks holding on to the distribution of financial products, and by extension maintaining relevancy and profitability in the digital age, lies in them opening up their platforms to third parties to become marketplaces for banking and non-banking products and services. This is the reason why Temenos has opened its own marketplace¹⁷.

What was encouraging about the responses we received this year is that, on balance, banks seem to agree. 52% of respondents see opening up their platform to third parties as more of an opportunity than a threat. 60% believe that to deal with new (non-bank) competition, it is essential to adopt open banking technology.

The challenge is that it is not yet a corporate priority, as already evidenced in the fact that only 5% of innovation spend is being directed towards it. The issue in part relates to resources: 53% of respondents say they cannot exploit a wide enough range of user interfaces due to technology or cost constraints. But the bigger issue is that only 30% consider open banking to be a high priority right now, grappling as they are with so many challenges and opportunities.

Ironically, what might force the subject of open banking up the corporate priority list is the action of regulators – especially in Europe. The UK government is planning an Open Banking API standard while the EU's Payment Services Directive 2 (PSDII) includes an Access to Accounts (XS2A) provision that will require banks, where customers request it, to provide third parties – via APIs – with access to customers' data.

Conclusion

This year's survey continues to show an industry in transition: moving from its analogue past to its digital future; shifting its spending priorities from implementing regulation to putting in place the right technology and people for success; confronting a competitive environment that is overwhelming dominated by new entrants; facing the slow, continued ebbing away of customer loyalty; and, increasingly acknowledging that low profitability is a structural rather than cyclical issue.

On a positive note, none of this seems to be lost on the banks, which are upping investment, especially in technology. It appears that banks recognise the importance of technology to deliver a more intimate customer experience and to counter the threat from a more competitive environment. Correspondingly, IT spending is rising, with 64% of respondents expecting an increase in budgets over the next 12 months, with the biggest positive change seen in Europe.

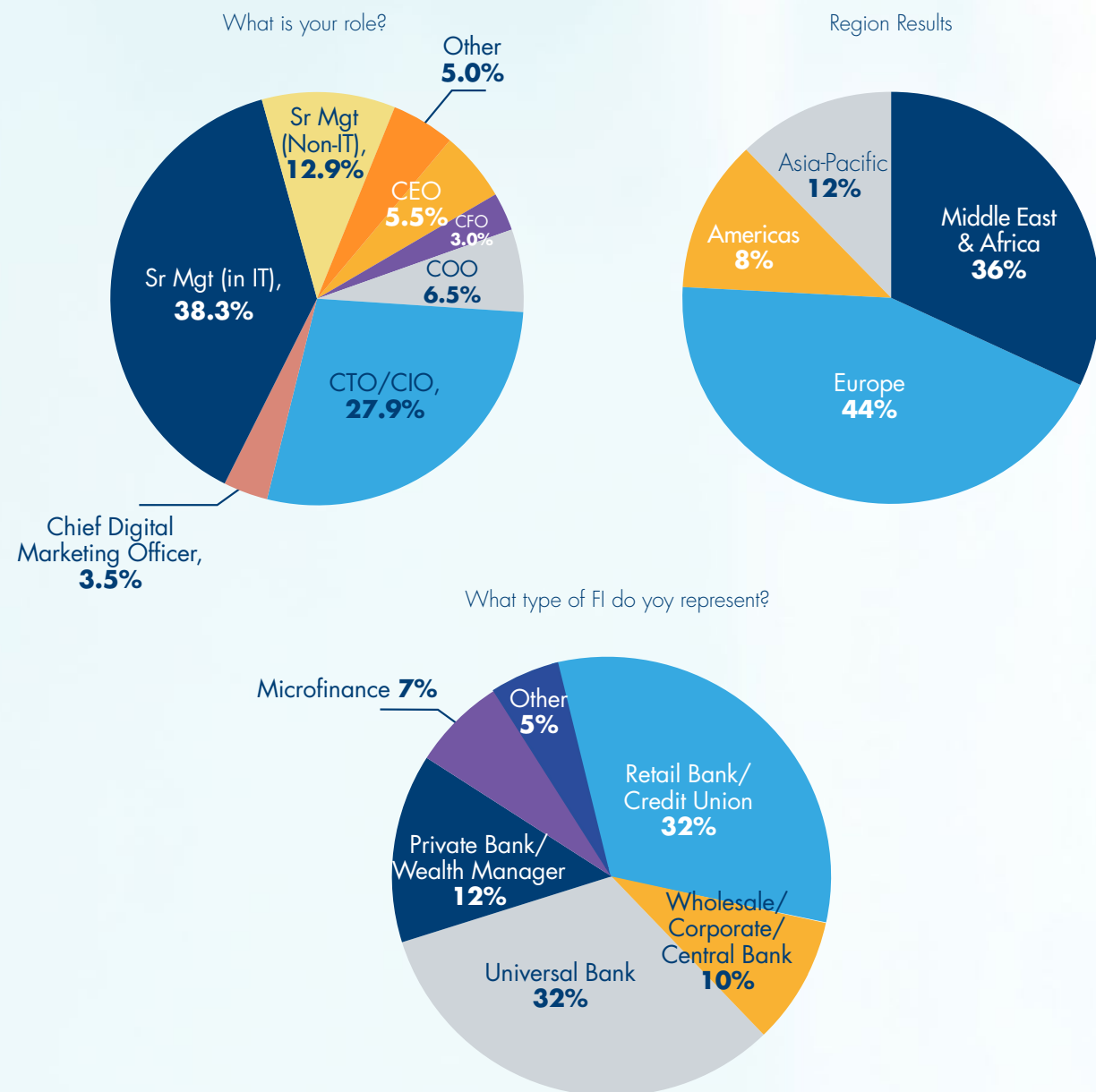
Furthermore, it would seem that the barrage of post-crisis regulation has slowed, with only 17% of respondents saying new regulation is their biggest challenge, freeing up time and resources for banks to concentrate on digitization, competition and customer retention. On a less positive note, many critical issues have so far failed to make the C-level agenda and banks are finding it harder to attract and retain the right talent. Compared to 12 months ago, banks are much more alive to the need to leverage their data assets, but almost a quarter say that this is not a top corporate priority and has been delegated to the IT team. Similarly, 60% of respondents opined that an open banking strategy was essential to competing effectively against non-traditional competitors, but only 30% see it as a high priority today.

In terms of competition, technology companies continue to be seen as the biggest threat in a field of mostly new entrants. Only 26% of respondents saw incumbent banks as their biggest source of competition.

There is no question that the industry is undergoing massive change. But, banks' strategies and investments are clearly shifting in response. It will be fascinating to observe how digitization continues to shape the industry and open it up to new competition and business models. What is clear, however, is that banks are up for the fight.



Appendix: Breakdown of Survey Participants



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A regular blogger and speaker on the subjects of innovation and fintech, Ben runs the "Swiss Technology Group", a networking group aimed at promoting the technology industry in Switzerland, and is a mentor at Fintech Fusion, Switzerland's first fintech start-up accelerator.

Ben joined Temenos in 2007 and held roles in investor relations and corporate development before assuming his current role in 2013.

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 in England.

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Chris McGinnis is Head of Strategy at Temenos and has been with the company since 2011. At Temenos Chris leads a team of professionals responsible for analysing industry and economic trends, monitoring competitor activities and developing the company's strategic vision. Chris also works closely with other parts of the business including Finance, M&A, Marketing, Investor Relations, and Communications.

Prior to joining Temenos, Chris worked for 10 years in the banking and technology industries at Merrill Lynch, UBS, Stifel Nicolaus and Deloitte.

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Michael Leyva is the Vice President in the Financial Services Practice. He is the global head of the Banking and Diversified Financials Practice for Capgemini. He has over 28 years experience in delivering banking transformational initiatives for Global Fortune 500 organizations. Michael has worked with a wide range of clients leading large business and technology transformations in core banking, leasing, lending and diversified financials.

Competences:

- Large scale Banking Transformation
- Lending (bank and non-bank) transformation
- Large scale program Management

About Temenos

Temenos AG (SIX: TEMN), headquartered in Geneva, is the world's leader in banking software, partnering with banks and other financial institutions to transform their businesses and stay ahead of a changing marketplace. Over 3,000 firms across the globe, including 41 of the top 50 banks, rely on Temenos to process both the daily transactions and client interactions of more than 500 million banking customers. Temenos offers cloud-native, cloud-agnostic front office and core banking, payments, fund management and wealth management software products enabling banks to deliver consistent, frictionless customer journeys and gain operational excellence. Temenos customers are proven to be more profitable than their peers: over a seven-year period, they enjoyed on average a 31% higher return on assets, a 36% higher return on equity and an 8.6 percentage point lower cost/income ratio than banks running legacy applications. For more information please visit www.temenos.com.

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