Economist Intelligence Unit

The Economist

An enterprise approach to bank payments
Elevating payments to strategic advantage

A white paper from
the Economist Intelligence Unit
sponsored by Oracle

Preface

An enterprise approach to bank payments: Elevating payments to strategic advantage is an Economist Intelligence Unit briefing paper, sponsored by Oracle.

The Economist Intelligence Unit bears sole responsibility for this report. The Economist Intelligence Unit's editorial team executed the survey, conducted the interviews and wrote the report. The findings and views expressed in this report do not necessarily reflect the views of the sponsor. Jackie Wiles was the author of the report.

Our research drew on two main initiatives:

- We conducted a global online survey in March and April of 2005 of 100 senior executives in banks across the globe on the topic of payments systems.

- To supplement the survey results, we also conducted in-depth interviews with senior executives at a number of banks.

Our thanks are due to all survey respondents and interviewees for their time and insights.

May 2005

Executive summary

By any measure, payments products and services represent a critical revenue stream for the world's banks. But innovation is long overdue. Today, changes in regulation and customer behaviour, new cost and efficiency pressures and the migration to electronic transactions are among the many forces driving change in payments products and processing.

As banks come to grips with the shifting payments landscape, one imperative is emerging: banks must take a holistic approach to payments-driven revenue in order to be able to lower their cost base, protect wallet share, retain customers, provide and develop profitable products, and operate in a way that supports and furthers risk-management practices.

In preparing this briefing paper, the Economist Intelligence Unit conducted a global survey of 100 bankers and consulted payments executives at several large and mid-tier banks around the world. Among the main conclusions drawn from this survey are:

- Most banks are evaluating their payments strategy, and many have started to re-engineer their infrastructure. Most hope to cut costs, particularly by rationalising the current plethora of products. Other potential benefits of re-engineering include information technology (IT) consolidation, workflow efficiencies and better straight-through processing.

- Few banks are "highly satisfied" with their approach to payments processing; most are merely "somewhat satisfied", and many wish their payments products and services delivered more operational, customer and risk-management benefits.

- Many banks concede that they would improve customer satisfaction and perhaps even increase customer wallet share if they were to change or improve their payments approach.

- Banks must afford payments the strategic position it deserves, if the payments business is to be fully optimised. This means viewing the entirety of the contribution that the payments business makes to the enterprise, its potential for fuelling revenue growth, and its ability to bolster a bank's position in the global market. In fact, many banks plan to supplement or supplant their product-silo leadership with some form of enterprise governance, or a so-called payments czar, in the next three years.

- A bank's CEO and senior management must affirm that managing payments across the enterprise is a business imperative, if an institution-wide payments approach is to succeed. It must be the job of every product manager to maximise enterprise payments revenue and manage key performance indicators in a way that aligns with strategic enterprise goals.

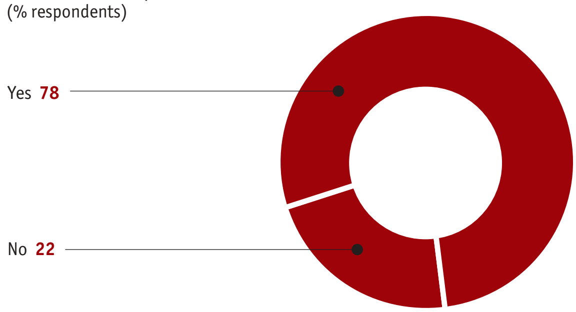
In short, many banks concede that by re-engineering their payments strategy, and particularly by taking an enterprise approach, they will be better able to share knowledge and best practices within the bank, reduce costs, protect and possibly increase revenue, better anticipate payments trends, more accurately identify new-product potential, improve risk management and provide a better service to customers.

Change is taking place, albeit slowly

For now, however, most banks still organise their payments businesses along purely product lines. Indeed, 78% of respondents to the Economist Intelligence Unit survey say their approach to supplying payments services is based on products — that is, one system for ATM, another for cheques, credit cards, wire transfers, and so on.

Bank executives say the enterprise payments approach has been slow to take hold for a variety of reasons. Some are concerned about change-management challenges, such as turf battles; others fear that an enterprise payments approach will involve a massive, and expensive, overhaul of technology. Ultimately, each bank must evaluate efficiency, cost effectiveness and risk across all of its payment mechanisms in order to identify the value of a holistic payments approach.

Is your bank's current approach to supplying payments services based on products (eg, one system for ATM/POS, another for cheques, credit cards, wire transfers, etc)?
(% respondents)



Source: Economist Intelligence Unit survey, 2005

As Bill Chua Teck Huat, executive vice-president (Operations) at United Overseas Bank Ltd, Singapore, responds, "The convergence of technology, IT, and

ABN AMRO: Capturing cost, customer, product and risk benefits

ABN AMRO has a Transaction Banking division that is responsible for co-ordinating all payments and trade product management for the bank's wholesale, commercial, private client and retail businesses worldwide.

Ann Cairns, senior executive vice-president of Transaction Banking, explains: "For any bank involved in the payments industry, the increasing investment requirements and the lack of scale is a big concern. By combining the transactions banking businesses, we have the scale to compete profitably and we can continue to build scale and grow revenue by offering in-sourcing or private labelled services to other local and regional banks. Combining the businesses also reduces the bank's risk profile by simplifying country-specific systems and processes."

Certainly, the enterprise payments approach makes it easier for the bank to respond to changing market conditions. Ms Cairns uses changing corporate cash management as an illustration. ABN AMRO's corporate clients, she says, "want more and more regional, and sometimes global, cash solutions for managing their liquidity and executing their local and international payments traffic. Payment requirements for financial institutions now go far beyond holding a simple 'nostro' (foreign-currency) account with another bank. The clients' growing expectations of a highly efficient payments service require a bank to deliver a high-volume straight through processing (STP) of payment transactions that is competitively priced."

Of course, STP cash management solutions create risk issues. According to Ms Cairns, STP makes payments a real-time business, so different groups within ABN AMRO require a tool to monitor and control a client's behaviour globally in real-time.

In response, the bank developed what it calls the Risk Management Dashboard (RMD), a proprietary, global intranet application that provides risk insight to its Transaction Banking and risk management functions. "(With the RMD), says Ms Cairns, it takes just a few clicks to get a client's global payments picture, and limits can be optimised to support the client's payments traffic. It reduces ABN AMRO's credit risk and translates into lower regulatory capital reserves."

business lines is likely to expedite the move towards an enterprise payments approach, to reduce costs, improve operational flexibility and increase speed to market to meet customers' needs. However, a thorough business case needs to be undertaken before one commits the time, monies and resources to implement such a project."

Nevertheless, bank executives agree there is a growing recognition that convergence in payments strategy is inevitable in order to align the bank's view of its payments businesses with the requisite horizontal view of the customer — with or without a concomitant integration of technology. In this way, the shift in the payments paradigm would mirror that seen in customer relationship management and risk management in recent years.

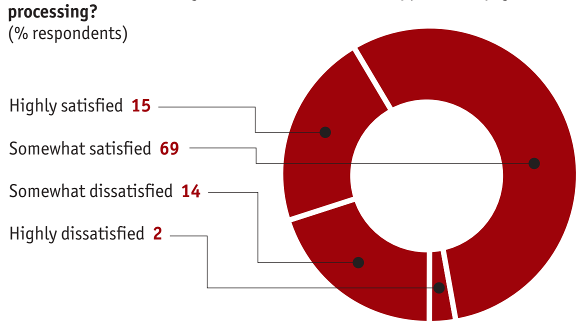
Rubina Havlin, vice-president of electronic payments at National Bank of Canada, believes that "the value equation is not necessarily in the technology. Rather the value creation occurs in strategy". She goes on to say that National Bank of Canada, like most financial institutions, has been maximising transaction efficiencies for many years. "Now, we need to make sure we're creating value through integration (the way products are bundled and offered, for example) not necessarily through technology or platform integration. We must invest in ensuring revenue growth through customer–centric strategies."

In fact, payments strategists say customer-centricity is a vital precondition for a successful enterprise strategy. Specifically, banks must recognise the pivotal role of payments in the banking relationship. Customer experience is driven first by transactions and second by loans, investments and other financial services, they say, so banks that focus strictly on individual payments products will fail to see the entirety of their payments proposition.

In the words of one US bank executive, "If your CEO doesn't believe you're in the relationship business based on some type of payment account—or doesn't understand that the payment account is the bedrock of the customer relationship—you have a problem."

Getting a stated company-wide strategy for payments revenue, championed from the highest levels in the organisation, is arguably the biggest imperative and obstacle to an enterprise payments strategy. Only with such a strategy in place can a bank begin to identify and prioritise an action plan for tackling persistent business challenges like cannibalisation, while minimising the cost of capturing maximum enterprise-wide revenue and profit from the payments business.

Overall, how satisfied is your bank with its current approach to payments processing?
(% respondents)



Source: Economist Intelligence Unit survey, 2005

Significantly, there is no "big bang" ahead for payments. Rather, banks will face unyielding pressure from competitors, customers and regulators to deliver value in their payments proposition—doubtless at a price that makes cost efficiencies a must.

So, bank executives can move aggressively to position their institutions to survive and thrive in the shifting payments landscape, or, in the words of another US payments executive, "put their heads in the sand" and hope to maintain incremental returns from product silos.

One thing is clear: change is under way. Only 15% of survey respondents say they are "highly satisfied" with their current approach to payments processing, compared with 69% who describe themselves as merely "somewhat satisfied".

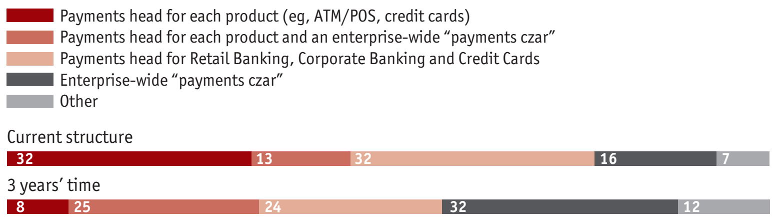
Prying open product silos

It is no mean feat, however, to see across a bank's individual products and services and garner a holistic view of the bank's payments business. Nevertheless, the survey shows a clear shift in payments governance, with many banks expecting in the next three years to acquire a payments "czar" to supplement or replace heads of separate products and business lines.

Significantly, enterprise payments strategy groups usually form a layer of governance over the product lines. In other words, the aim is not to abolish the sovereignty of product lines. Rather, enterprise strategists look across the entire franchise for opportunities to communicate and share best practice between business lines and identify when business decisions being made by one line of business may hurt another. There must, of course, be some mechanism to deal with those issues, perhaps a payments council or an executive committee—some body with the authority to weigh the impact on the enterprise as a whole, and decide on the best outcome for the bank.

BB&T Corporation, headquartered in Winston-Salem, N.C., is also pursuing a holistic payments strategy, confirms Woody Tyner, senior vice-president

How is the governance of payments structured at your bank? How do you expect it to be structured in three years' time?
(% respondents)



Source: Economist Intelligence Unit survey, 2005

Wells Fargo: Making payments a strategic priority

Wells Fargo, headquartered in San Francisco, generates about 30% of its revenue through payments services, including cheques, credit cards, cash and securities, direct deposits and wire transfers. It is therefore not surprising that the bank says we "must maintain our position as our customers' first choice for payment processing".

In fact, the bank has gone so far as to adopt a discrete payments plank in its ten-point strategic manifesto. In stipulating that it expects to "be our customers' payment processor", the bank says, "We need to make sure Wells Fargo adds real value so we can be the intermediary—electronic or paper—whenever and wherever our customers buy services, and be the payments link for our customers among all their Wells Fargo accounts."

Wells Fargo was thus an early adopter of an enterprise approach to payments and has had a Payments Strategies Group for about six years. "The challenge within the banking industry is that we by and large operate our businesses within silos. It's very difficult to get a holistic corporate view of the impact of the payments business without some global perspective and that is what our Payment Strategies Group intended to do," explains Mitch Christensen, the bank's executive vice-president for Payment Strategies. Wells Fargo's Payment Strategies Group takes this global view of payments for Wells Fargo and "helps guide their thought process and positioning around payments business", he says.

In practice, the enterprise strategy group can inform lines of business of long-term trends, and the business lines can then make business-based decisions about what products to build.

In response to Check 21, for example, Wells Fargo is introducing "remote image capture" at customer sites, a product that, according to Mr Christensen, "will create a tremendous opportunity for our customers". But, he notes, "the groundwork was laid over a period of three years", with the bank involving itself in industry and regulatory consultation over Check 21, and then structurally and architecturally preparing the organisation. Once Check 21 took effect, the Payment Strategies Group handed off the short-term implementation activities to Wells Fargo's respective lines of business, he says.

and payment systems strategist. “But we haven’t been trying to integrate the silos from a product management standpoint,” he adds.

“We’ve spent a lot of time making sure each product silo has a lot of information about what the other silos are doing and (sharing enterprise trend data). It helps one silo get context for product management and development,” he notes. BB&T has also integrated management of its sales teams. As a result, for example, Mr Tyner says “the Treasury Services Unit is now able to sell all the available products to the middle-market corporate and small-business clients”, whereas previously they were essentially selling cash-management tools.

Improving product discipline

Even with an enterprise approach in place, banks need to have clear ownership of individual payments channels and instruments in order to make sure the bank continues to develop a solid strategy for what customers want and how they want to access and use those products. But enterprise strategists may be able to improve the discipline of individual business lines by helping to fill information voids in understanding how cross-enterprise and industry trends are affecting enterprise revenue—links that individual product managers may not see.

At one US bank, for example, when the enterprise payments strategists investigated the declining income from non-sufficient fund fees, they identified a link with the increased use of debit cards, where there are no insufficient-fund provisions—the funds are either available or not. The enterprise strategists took ownership of non-sufficient fund (NSF) accounting and the debit-order-posting process—settling arguments between different product managers over which debits should be settled first.

As a result, the bank raised NSF income by nearly 70% per account per month. It then appointed a full-time NSF and overdraft product manager to protect what had proven to be a valuable revenue stream.

This type of revenue result is vital to the success of the enterprise approach, since it reinforces for the business lines the value of the enterprise view. "Once you have the freedom to surface (such issues), all of a sudden the silos start paying attention—and they reap the benefits, too," says Mr Tyner.

Nevertheless, it is a constant challenge for any strategic leadership group—which has no business line ownership per se—to succeed. Understandably, most product managers are focused on achieving revenue goals, and have a relatively short horizon, even for product development. In short, while one product group is seeking to optimise its own revenue, it may unknowingly be cannibalising enterprise revenue or strategic relationships elsewhere in the organisation.

Enterprise strategists help the organisation attain the requisite horizontal view across products. They help to identify and track the risks and opportunities for the enterprise. Once the enterprise impact has been recognised and quantified, it is also easier to get buy-in from lines of business when they are asked to steer a course that aligns with corporate goals, but may seem counter to the revenue or growth potential of an individual product.

The problem, say strategists, is that many corporate boards and CEOs still do not understand how significant a role payments play in a bank's revenue and cost structure.

Banks that report and monitor revenue numbers only by business—from the finance company and mortgage company to the wholesale group and retail bank—rarely understand the aggregate value proposition of payments to the balance sheet. And if CEOs do not understand the risks and rewards of the business, they will fail to champion the proposition.

Bolstering the customer proposition

Similarly, a siloed payments view may not fully exploit the power of payments in the banking relationship. "Payments are really the glue that holds customers to the bank," says one payments executive, but it takes time to educate the bank on the potential and risk on aggregate—especially if a bank's senior management equates banking with lending.

In fact, according to many of those interviewed, bank-wide analyses prove that payments, directly and indirectly, are responsible for a critical share of operating revenue.

Several findings from the survey support the contention that customers could be better served on payments than they are today. A full 77% of banks said they would increase customer wallet share or, at least, customer satisfaction by changing or improving their payments approach.

This finding suggests that although banks have long owned key elements of the relationship with payments customers, and they have often earned a reputation as preferred and trusted providers, they know they are under pressure to preserve and enhance their payments proposition. Indeed, they must stay focused on the customer to ensure transactions revenue is not snatched by bank competitors or non-bank players.

Furthermore, of the survey respondents who say they are considering, planning or making changes to their strategy for delivering payments products and services, 42% say they are doing so to improve customer support and experience, whereas others cite the need to reduce fragmentation of customer information and to segment customers for customised sales and service.

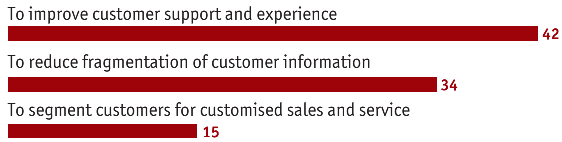
Similarly, many banks recognise that their existing payments products and services fail to deliver benefits that could bolster the relationship with, and understanding of, their customers. For example, 71% of respondents say they would like their payments products and services to deliver customer profitability analysis across all payments products and services. Fully 57% say they wish their products and services delivered a seamless interface for customers.

These imperatives are hard to achieve without a commitment to payments revenue or an institutional culture that demands a high degree of customer focus.

For example, UK banks are currently under pressure to speed up the payments cycle for standing orders and other electronic payments. The Office of Fair Trading and the UK Treasury has chastised banks for taking a return on electronic funds during the clearing cycle, which currently stands at three days. Lloyds TSB, however, has already surrendered the profit on that float to customers.

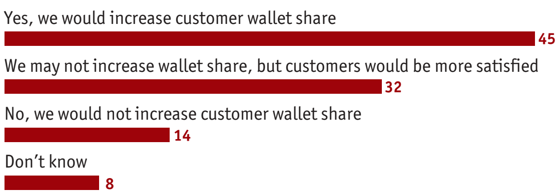
"The current management felt that carrying float in that way was not the right thing to do," explains Paul

Why is your bank considering, planning or making changes to its strategy for delivering payments products and services?
(% respondents)



Source: Economist Intelligence Unit survey, 2005

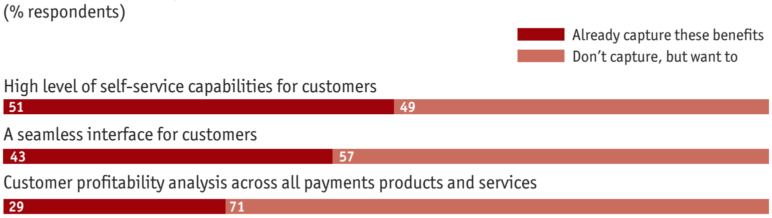
Do you think your bank would garner a greater share of your customers' total payments activity (ie, wallet share) if the bank changed or improved its payments approach?
(% respondents)



Source: Economist Intelligence Unit survey, 2005

Baker, director of Group Operations. “In a world that is very rightfully focused on customers, we needed to feel good in the way we do business with them, and treat them fairly. So, we felt the most appropriate thing to do was to take the cost (debit or credit interest) ourselves.”

Which of the following benefits do your bank's current payments products and services provide? Which benefits would your bank like its products and services to provide?
(% respondents)



Source: Economist Intelligence Unit survey, 2005

And the bank, which has the largest number of current account customers in the UK, has not “spent millions of pounds changing the system; we just made interest adjustments so the customer doesn’t suffer”, declares Mr Baker. “We know which customers have made the payments. We can work out the cost of that interest to us and we just don’t take that to profit. We just make sure the customer benefits. While the debit may still leave the account of the payer and might not get to the receiver for a few days, during that period we make sure that the interest is paid to those people who are in credit and not debited to those people who are overdrawn. So, we put the position right even though the transaction stays the same as it used to be.”

Tackling enterprise infrastructure

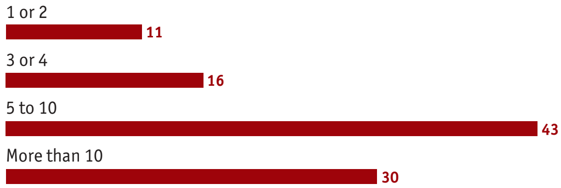
An enterprise payments strategy does therefore need to be supported by the bank's organisational and IT infrastructure—but that does not necessarily mean a common infrastructure for multiple payment systems.

Around 28% of survey respondents plan to eliminate some payments systems and consolidate others, but only 9% say they have adopted an enterprise level system for all forms of payments whereas only 11% say they plan to do so.

The number of payments products currently in use suggests that banks may want to rationalise in the future. Forty-three per cent of respondents say they use five or more different payments products to handle all forms of payments, and 30% say they use ten or more.

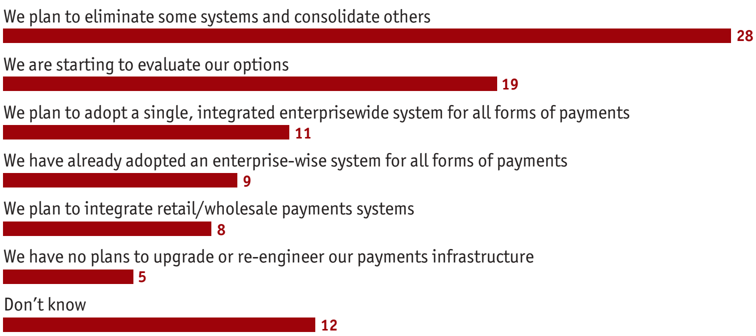
Even if banks are not seeking to adopt a single enterprise payments system for now, they are seeking a universal or enterprise view across payments silos. Thus, if applications are not physically consolidated, they must at least be managed co-operatively.

How many payments products does your bank currently use to handle all forms of payments?
(% respondents)



Source: Economist Intelligence Unit survey, 2005

Please select the statement that best reflects your bank's strategy for upgrading or re-engineering its payments infrastructure
(% respondents)



Source: Economist Intelligence Unit survey, 2005

Even highly sophisticated banks still tend to run multiple isolated applications, with the front and back office operations still structured largely around individual instruments. Although this does create interface problems, especially at the customer level, the systems are still "getting the job done. Over time, people will probably be pushed towards a more single-threaded system", said a payments executive at one large global bank, "but it's working pretty well."

Mr Baker echoed that sentiment, saying Lloyds TSB handles £200bn a day in payments, not including credit-card activity, so the bank "is constantly upgrading to make sure the payments systems are fully operational and to ensure the safety of payments...but in the UK, it's a highly standardised, uniform, well-tested environment (with banks sharing the same gateways, standards, accounting methods, sorting codes, and so on), so the level of ambiguity is virtually nil."

One key with infrastructure decisions, bank executives say, is to invest in new environments proactively, while making every effort to cut costs in fading instruments. In the UK, for example, banks have been outsourcing cheque-clearing for years, aiming to minimise costs and exposure to what has long been considered a dying payments tool.

Adapting to changing markets

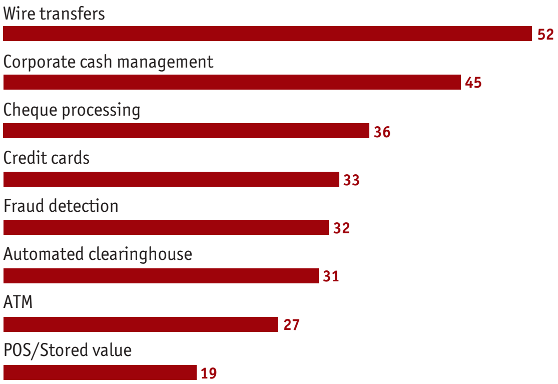
The survey shows that most payments applications are targeted for some kind of change over the next three years. This reflects changes in customer behaviour, industry trends, and the pursuit by banks of cost and process efficiencies.

For example, 52% of survey respondents say they are targeting wire transfers for change. Shifts within the US market for international money transfers by individuals offer one illustration of a changing environment. Monetary remittances sent by immigrants are big business. Remittances by Mexican nationals from the US, for instance, exceed US$9bn a year. But non-bank financial institutions like Western Union and MoneyGram have nabbed much of the market, offering lower-cost products than the wire-transfer option typically offered by banks.

Now, stored-value cards offer yet another cheaper alternative to wire transfers. Non-banks around the world are embracing these prepaid cards, but some banks are using them, too. For example, Bank of America has offered the SafeSend Transfer Card since 2002 for transferring or remitting funds between the US and Mexico. Safesend makes use of Visa's PLUS network of ATMs to deliver cash, and Bank of America leverages its alliance with a Mexican bank, Santander Serfin, to make the product even more affordable. Bank of America account holders are charged a flat fee of US$10, plus a 3% foreign-exchange fee, for each transfer to the card (the dollar transfers are immediately converted into pesos). Recipients, who receive their own card, can withdraw funds free of charge by using a Santander Serfin ATM. (Bank of America acquired 25% of Grupo Financiero Santander Serfin, Mexico's third-largest bank, in late 2002.)

Signalling another area of change, 45% of survey respondents say they are targeting corporate cash management for change over the next three years. In Brazil, for example, payments system reform is creating potential for companies to improve their cash management. Banks, therefore, are being pressured to improve their cash-management solutions, says one bank executive there. During Brazil's notorious high-inflation years, companies' demands—and the workings of the payments system—centred on the swift processing of payments to make sure liquid assets could be invested immediately in short-term vehicles to track inflation. In today's low-inflation economy, however, banks need to offer companies more sophisticated capabilities and solutions in order to manage local liquidity effectively, especially given the often onerous tax and regulatory environment, he said.

Which, if any, of the following payments applications has your bank targeted for change over the next three years?
(% respondents)



Source: Economist Intelligence Unit survey, 2005

Furthermore, some Latin American countries, including Chile and Mexico, are contemplating legal requirements that commercial documents be delivered electronically, creating a huge opportunity for banks that can offer electronic invoice payment and presentment.

HSBC Bank Brasil: Making cash management easier

Companies around the world face increasing pressure to compete with multinational and global enterprises. Those in emerging markets are no exception, and banks must gear up to help their corporate clients with one critical tool: cash management.

"It is not enough to simply guide companies around burdensome local regulations or the inevitable nuances of international trade," says Valdir Milani, head of Payments & Cash Management at HSBC Bank Brazil. "Rather, banks are adapting their systems to existing customer enterprise resource planning solutions, integrating data bases, and so on."

HSBC entered Brazil in 1997 with its purchase of Banco Bamerindus, one of Brazil's largest banks. HSBC Bank Brasil now operates across the country, through about 1,600 branches and service outlets. The bank, says Mr Milani, is innovating to ensure "fast, safe and easy payments and collections" for corporate clients big and small.

For example, HSBC Bank Brazil has developed "Internet solutions to host invoice slips that can be paid by individuals or enterprises almost in real time. You finish the negotiation, sign the agreement and then send the invoice to the bank via the Internet. A few minutes later, your customer can pay with a couple of mouse-clicks. It can be done physically (if you decide to print the invoice slip) or electronically (you just debit your current account and credit your client's account)." In the near future, corporate clients will also be able to send invoices via e-mail.

"It's all about making the customer's life easier," concludes Mr Milani.

Capturing cost and efficiency gains

Cost-cutting remains a key driver in many payments re-engineering efforts. Some 67% of respondents say their motivation in re-engineering is to reduce the overall cost of payments processing and 69% say cost-cutting is a top priority. Perhaps most importantly, costs are often the spark for management discussions about payments re-engineering.

According to the head of operations at one Asian institution, his bank's evaluation of its payment operations is prompted, in part, by the desire "to reduce costs by taking advantage of the economies that can be reaped from a streamlined central payments and department".

Such evaluations typically involve benchmarking costs against bank peers and non-bank competitors. Results showing a significantly sub-par performance will help the bank to decide how aggressively they should try to cut costs or raise quality standards to meet market and customer expectations. Furthermore, an evaluation can identify cases where process re-engineering, offshoring, outsourcing and other such initiatives will not be sufficient to meet the stated objectives, making fundamental infrastructure and organisational changes necessary.

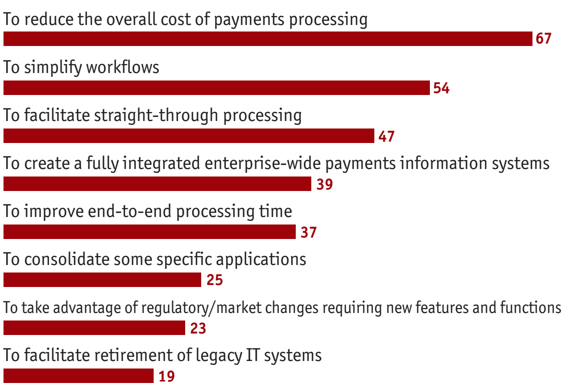
Clearly, cost efficiencies do hold significant potential. On aggregate, payments account for one-third of banks' operating costs, and when margins are being squeezed costs become even more important.

Costs are also a factor when investing in new environments. One European bank executive says the imperative is always to find the most appropriate delivery option for the customer at the least incremental cost. "We wouldn't be serving shareholders if we didn't seek to minimise those costs," he says.

Taking a bank-wide view of payments is intended to optimise savings and lower a bank's cost base, but, strategists say, it may also deliver other operational benefits, such as improved transparency in payments activity and better enterprise analytics.

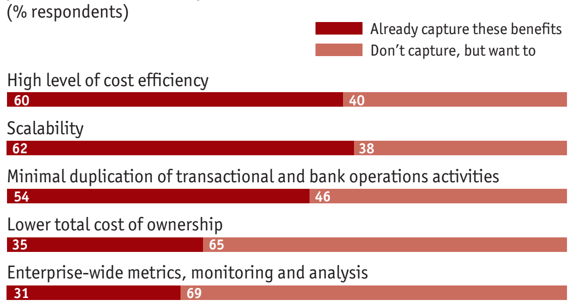
Survey respondents echo that sentiment: 54% say they are considering, planning or making changes to their strategy for delivering payments products and services to simplify workflows—for example, capturing incoming transactions only once and sharing

Why is your bank considering, planning or making changes to its strategy for delivering payments products and services?
(% respondents)



Source: Economist Intelligence Unit survey, 2005

Which of the following benefits do your bank's current payments products and services provide? Which benefits would your bank like its products and services to provide?
(% respondents)



Source: Economist Intelligence Unit survey, 2005 information with separate internal processes.

Many respondents would also like to reap operational benefits from their payments products and services that they do not capture now. A full 69% say they would like products and services to support enterprise metrics, monitoring and analysis, compared with 31% who say they capture that benefit already. In addition, 65% say they want a lower total cost of ownership, 46% say they want minimal duplication of transactions and bank operations activities, and a further 54% say they capture that benefit already.

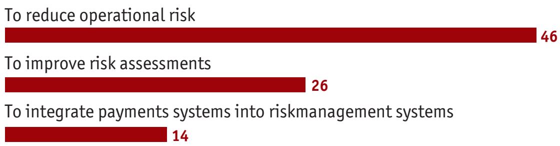
Supporting risk management

Risk management is yet another area—probably the toughest—in which banks see the benefits of adopting an enterprise approach. Says one European bank executive, "24/7, we know our position with customers and they know their position with us." But for many banks, the link with risk-management systems is established only at the end of the business day, if at all.

The view of one executive in South-East Asia is that "a central payments system should facilitate an integrated view of customer payments/receipts activities across all payment channels more equally. This will enable a more efficient monitoring of customers' cash positions, allowing for better liquidity management by both the customer and the bank."

The survey shows that risk-management objectives are among the priorities for banks that are considering, planning or making changes to their strategy for delivering payments products and services. Almost one-half of payments executives say they hope to improve operational risk management (for example, reducing human error) by re-engineering their payments strategy.

Why is your bank considering, planning or making changes to its strategy for delivering payments products and services?
(% respondents)



Source: Economist Intelligence Unit survey, 2005

Surprisingly, however, only 26% say they are

Standard Chartered India: Pioneering real-time gross settlement

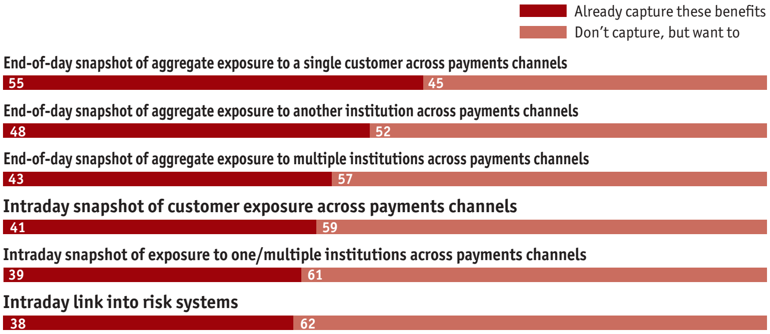
Standard Chartered was one of four banks selected by the Reserve Bank of India to test and pioneer the country's real-time gross settlement (RTGS) system implemented in 2004. Ashok Sud, the bank's regional head of Client Relationships, Wholesale Banking for India and Nepal, says RTGS helps eliminate settlement risk, mitigates fraud, and reduces transit risks typically associated with paper-based instruments. It also helps to improve processing efficiency and enables financial institutions to centralise their payment hubs.

But for the country's banks, RTGS offers both opportunities and challenges in terms of improving fee income from the cash-management business, as it could reduce float incomes and increase stress on intra-day liquidity management. Banks have also had to invest in upgrading their infrastructure and integrating with legacy systems. But, according to Mr Sud, "Over time, RTGS will reduce transaction processing costs from the paper-based cheque clearing system."

Standard Chartered, however, is now the largest international bank in the country with straight-through processing (STP) capability, which offers customers significant benefits. "RTGS enables faster realisation of receivables, predictability of funds flow, reduced paperwork, instantaneous settlement across banks and convenient cut-off times for transfer of funds," says Mr Sud.

"Our key product proposition is providing comprehensive outsourcing of payables and receivables management solutions to our customers through secure and robust electronic channels, which provide real-time information for ease of account reconciliation and MIS," he says. These products allow the customer to spend less time on non-core account payables and receivables management and "focus on the core treasury and finance issues facing their enterprise".

Which of the following benefits do your bank's current payments products and services provide? Which benefits would your bank like its products and services to provide?
(% respondents)



Source: Economist Intelligence Unit survey, 2005

seeking to improve risk assessments, and only 14% say they are seeking to integrate payments systems into risk-management systems. That finding, say strategists, reflects the daunting reality that risk-management systems tend to be the most unique and proprietary within any bank, quelling hopes for change anytime soon. Indeed, nearly all risk-management systems remain silo-based and few banks have a real-time link, or even an intraday picture, between payments and risk-management systems. And even when a link exists, it is usually at the customer level, not at the system level.

Only about 35%-40% of survey respondents believe their current approach provides an intraday link between payments and risk systems, an intraday snapshot of customer exposure across products, or an intraday snapshot of aggregate exposure to other institutions across payments channels. Nevertheless, banks clearly recognise the potential for improvement, as about 60% of bankers say they want more complex or timely links between their payments and risk systems.

Conclusion

Payments products, on aggregate, account for perhaps 40-60% of banks' total revenue. At many banks, certain payments revenue, such as non-sufficient fund fees, generates almost pure profit. It is hardly surprising, therefore, that some banks are loath to meddle with a winning formula. But the world of payments is under siege from trends in regulation, consumer behaviour, non-bank competition and technology.

Below are just some examples of the many payments-related developments taking place worldwide:

- The European Central Bank (ECB) is seeking to transform fragmented national retail payments systems into a Single Euro Payment Area (SEPA), essentially making all euro payments domestic for European citizens and companies. SEPA promises users potentially lower costs and greater transparency of fees, but banks will lose revenue currently earned on crossborder remittances made through the various national payments systems.

- More than 75% of UK credit-card holders now have so-called chip and pin cards that use "smart" chips and personal identification numbers, instead of signatures. The cards have sharply reduced fraud in other markets, but it remains to be seen whether they will have an effect on overall payments traffic by, for example, encouraging consumers to access cash via their credit accounts.

- The Reserve Bank of Australia is reviewing the interchange standards for the Bankcard, MasterCard and Visa systems, and is examining, in particular, the level of interchange fees paid between a cardholder's and a merchant's financial institution on each transaction.

- The US Federal Reserve reports that electronic-payment transactions exceeded cheque payments for the first time in 2003 and the Federal Reserve expects credit cards and debit cards to "both surpass cheques in terms of total annual transactions in 2007".

- Stored-value cards were used to make US$42bn in US transactions in 2003—transactions in which banks are largely pushed out of the payments loop. The Federal Reserve, which expects US$72bn in stored-value transactions by 2006, calls these cards "one of the most dynamic and fastest-growing products in the financial industry".

- Employers in Mexico are increasingly using stored-value cards as a payroll option for the country's large number of hourly employees. The employer loads the employee's net pay via the Internet and the card offers cash-dispensing and account-querying capabilities similar to those offered by an ATM card. The cards sometimes carry an option to build credit and other benefits, too. These stored-value cards are cheaper, quicker and less risky to administer than the cash payments that would otherwise be required, and, importantly, they offer companies just-in-time funding of payroll.

- In Japan, the East Japan Railway Company, NTT DoCoMo, a telephone company, and Sony, an electronics giant, are co-operating on a mobile phone that carries smart-card technology, allowing the user to "fill up" the phone with electronic cash at an ATM, as well as making electronic payments at train stations, vending machines and other "e"-enabled venues. Japan has 82m mobile-phone users, many of whom currently opt to carry cash.

- Four Chinese banks—China Merchants Bank, China Construction Bank, Agricultural Bank of China and Industrial and Commercial Bank of China—have agreed to use the AliPay platform for electronic transactions. On making an electronic purchase, AliPay account holders send money to an AliPay account, where it is held in escrow. Once the buyer indicates that the product has been received, the money is transferred to the seller. Credit-card usage remains low in China and the banks hope the AliPay system can ease and engender trust in electronic transactions.

These examples, diverse but far from exhaustive, illustrate the need for banks to respond to the dynamics of the payments space as a whole—to ensure that they manage product development and cannibalisation, retain loyal customers and properly manage risk.

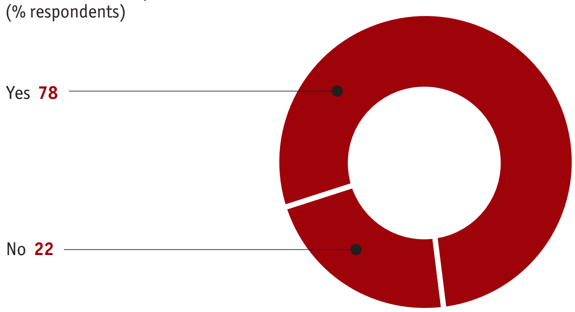
The environment calls for enterprise-wide governance of payments, with or without a single payments infrastructure. The role of enterprise payments strategists is analogous to that of a corporate governance or audit committee: they focus on setting strategy and ensuring implementation, developing a road map for product managers to follow, and providing them with sound economic scenarios for their business decisions.

Unless banks can do this, and assess the impact on revenue and margins across all payment channels, their business growth may be threatened. Aiming solely to preserve today’s revenue may mean future payments revenue will be left on the table.

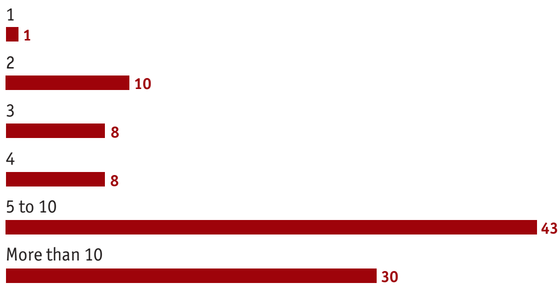
Number of respondents: 100

Please note that not all answers add up to 100%, because of rounding or because respondents were able to provide multiple answers to some questions.

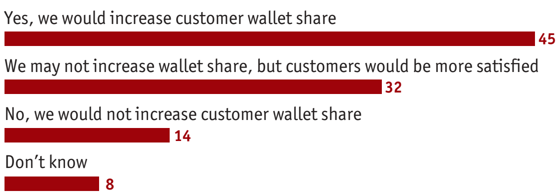
Is your bank's current approach to supplying payments services based on products (eg, one system for ATM/POS, another for cheques, credit cards, wire transfers, etc)?
(% respondents)



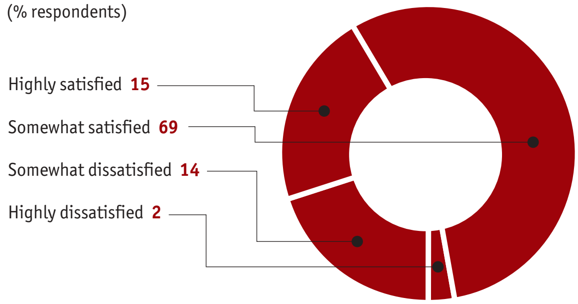
How many payments products does your bank currently use to handle all forms of payments?
(% respondents)



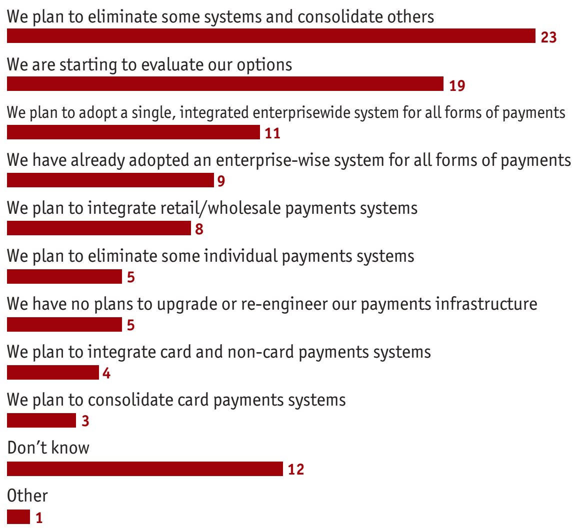
Do you think your bank would garner a greater share of your customers' total payments activity (ie, wallet share) if the bank changed or improved its payments approach?
(% respondents)



Overall, how satisfied is your bank with its current approach to payments processing?
(% respondents)



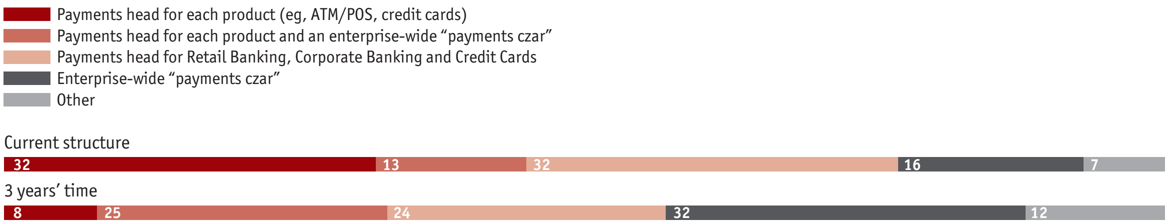
Please select the statement that best reflects your bank's strategy for upgrading or re-engineering its payments infrastructure
(% respondents)



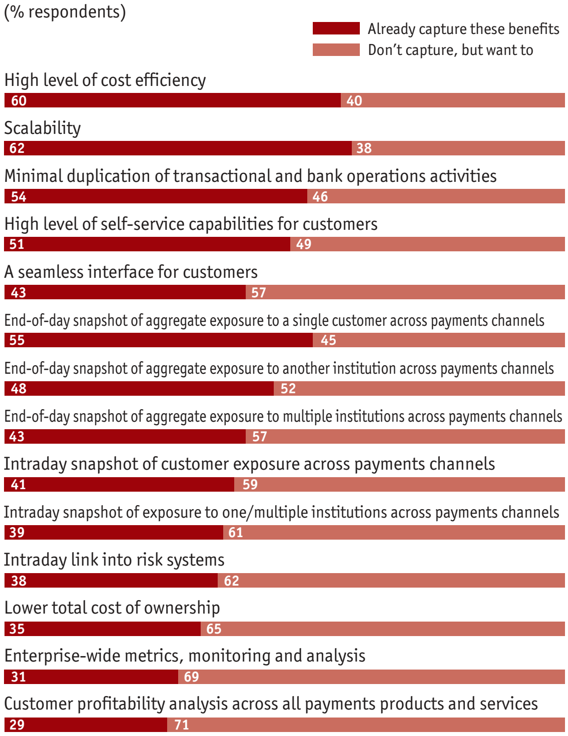
Why is your bank considering, planning or making changes to its strategy for delivering payments products and services?
(% respondents)

If you selected reasons for considering, planning or making changes to your bank's payments strategy, which three are most important?
(% respondents)

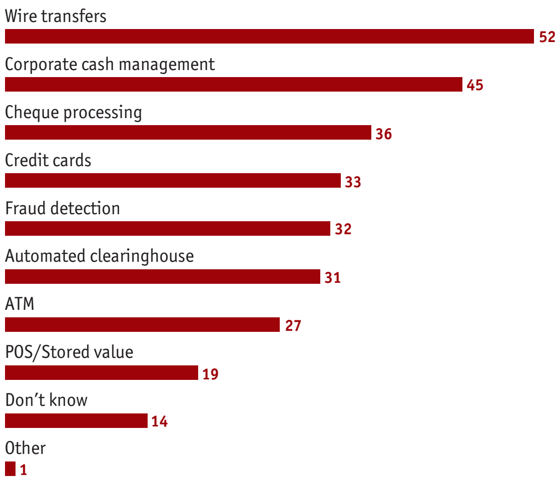
How is the governance of payments structured at your bank? How do you expect it to be structured in three years' time?
(% respondents)



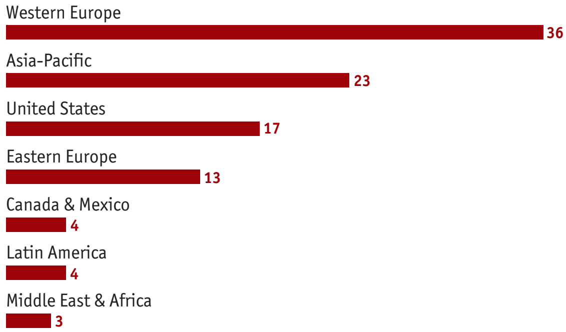
Which of the following benefits do your bank's current payments products and services provide? Which benefits would your bank like its products and services to provide?
(% respondents)



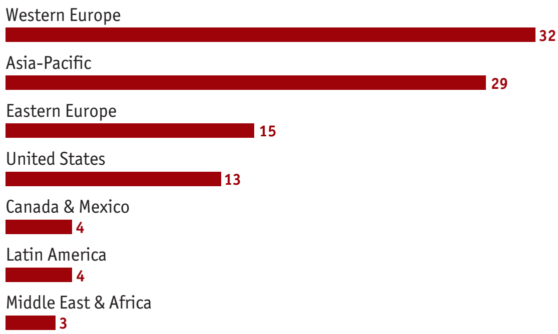
Which, if any, of the following payments applications has your bank targeted for change over the next three years?
(% respondents)



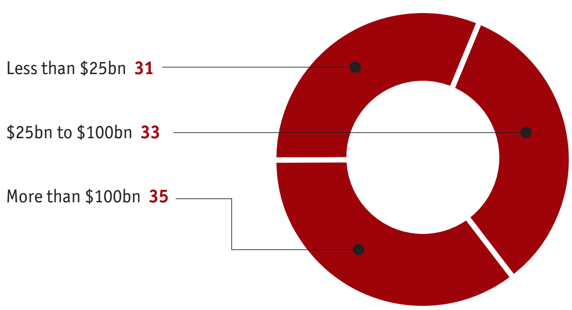
In which region is your institution headquartered?
(% respondents)



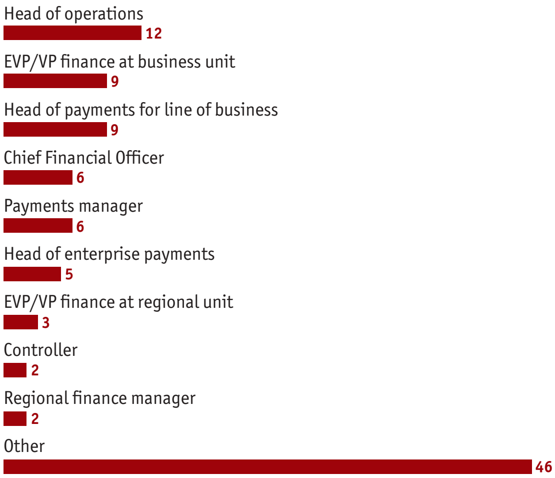
In which region are you personally located?
(% respondents)



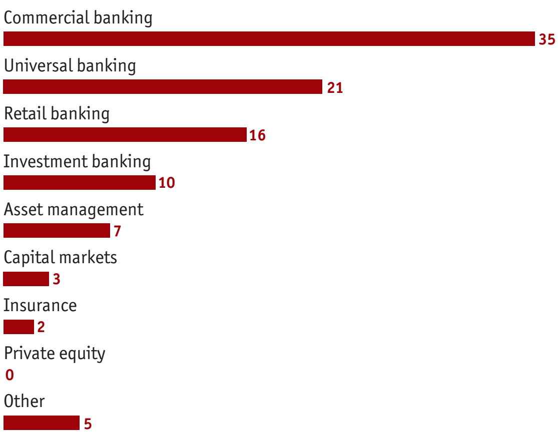
What are your bank's global assets in US dollars?
(% respondents)



Which of the following best describes your title?
(% respondents)



Which area of the financial services industry best describes your company's primary business?
(% respondents)



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