

IMPACT NOTE

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Sibos 2010: Light at the End of the Tunnel?

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INTRODUCTION

Sibos is an important stop on the conference schedule of various financial industry representatives across banking and the capital markets. The event is conducted annually by SWIFT, and was located this year in Amsterdam. Attending the show is a great way to take the pulse of the industry; it can yield solid insights into what's to come in the following year in financial technology, especially with regard to the SWIFT value propositions of community, network, and standards worldwide.

In this regard, there's fairly good news to report from this year's show in Amsterdam: The industry is slowly emerging from its under-siege mentality of 2008 and 2009. Weathering the fallout from the financial crisis had been the top priority, at least into the first part of 2010, and the market no doubt continues to feel that pain. Despite this, attitudes seem to be shifting back toward growth and tackling some of the problems that remain in the industry.

This Aite Group Impact Note is meant to provide clients with an impression of the conference as experienced by Aite Group analysts Nancy Atkinson, Enrico Camerinelli, and Fritz McCormick. Meant to be a brief overview of key trends and product updates, we'll provide perspectives on both the banking and securities & investments aspects of Sibos.

WHOLESALE BANKING

SUPPLY CHAIN FINANCE (SCF)

While a number of companies exhibiting at Sibos have presented on the subject of supply chain finance, the SCF industry is still shaping up. One significant trend sees SCF moving from a pure transactions-based practice toward a mix of finance and trade services.

The corporate treasurer's focus has shifted from yield to safety margins and lower processing times. The real concern for treasurers of large (above 1B US\$) and very large (above 10B US\$) corporations is no longer to reduce transaction processing fees or optimize the working capital; they now focus on improving processing tasks (e.g., bill reconciliation), and perceive SCF as a valid support behind reducing the associated costs through the presence and guidance of the banks. The significant cost elements are not bank transaction fees, but the full-time equivalent costs of processing manual operations and fixing errors caused by inefficiencies.

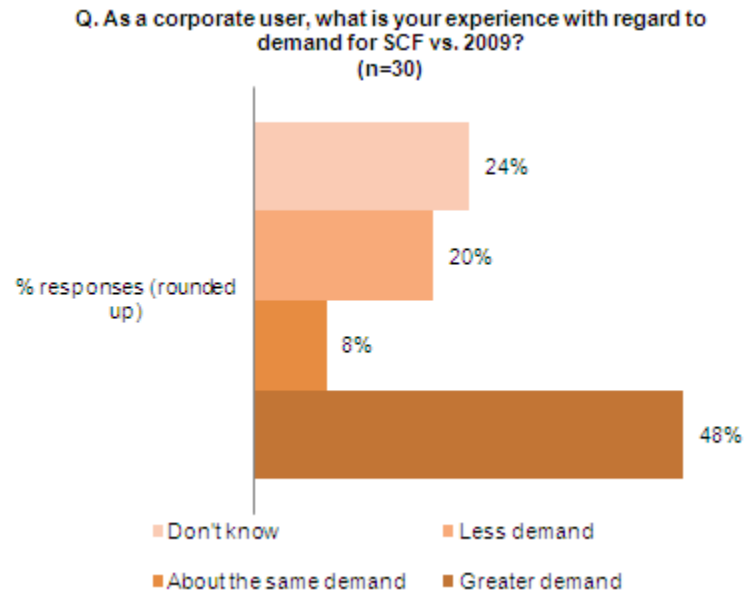
SCF instruments still represent a complex financing structure for suppliers, and one of their concerns relates to the numerous questions they are being asked in order to comply with the bank's Know Your Customer (KYC) requirements.

The best candidates for SCF programs are typically as follows:

- Suppliers in need of liquidity in an environment where banks and other classic lenders may be unwilling or unable to provide credit based on the supplier's credit rating—assuming a supplier is a strategic partner of the buyer (e.g., provides direct materials or critical services), then the buyer is incented to support the suppliers' liquidity management to ensure an uninterrupted supply chain;
- Companies that have been able to build integrated teams between the departments of finance, legal, IT, and logistics;
- Companies that are looking for medium- to long-term returns; and
- Banks that include in their offering the activity of on-boarding suppliers, oftentimes through the support of external resources/partners.

The major obstacles with SCF adoption were identified throughout the conference as complexity, lack of standardization, and lack of incentives for corporate adopters. To address these obstacles, SCF software solutions are built in modular fashion, with the objective to aggregate receivables, payables, liquidity management (including cross-border pooling), purchase order and invoice-based financing, and cash flow analysis for financial supply chain management execution.

Alongside the solutions is the growing appearance of portal-like dashboards, which integrate the use of cash, liquidity, trade finance, and payments, including mobile banking. In support of Aite Group's assertion that SCF is gaining in use, forty-eight percent of corporate users indicate that SCF is in greater demand in 2010 than in 2009 (see Figure 1).

Figure 1: Demand for SCF

Source: Aite Group online survey of European banks, corporations, and vendors, September 2010

PAYMENTS

Sibos attendees suggested at the conference that market players go forth focusing on the relevance of real-time payments: Is there a need for market segmentation? Is it possible to create an ecosystem in which players agree to execute fast payments? Is this linked to any geography or market sector?

There is a rising importance to understanding the dynamics of just-in-time (JIT) finance. With 30 to 60 days of payment terms, a company could pay on the very last day with an immediate settlement at the supplier's side. The buying company would benefit from keeping its cash till the last minute, resulting in no float and certainty of payment for the supplier.

Real-time payments alone will not facilitate the application of cash for suppliers, however. The payment transaction is a commodity, but the data that surrounds that payment is loaded with potential value for buyers, sellers, and banks. While JIT may eliminate float, knowing that a purchaser plans to pay on a given date provides the supplier with actionable information, including the potential for leveraging the aforementioned SCF.

Additionally, there is continued interest in and focus on the rationalization of banks' payments systems and the interfaces to corporations. SWIFT's ambitious effort to sign 5,000 corporate participants by 2015 aside, there remains little standardization and multiple competing solutions for technical interfaces to corporate systems. Still, progress is being made, and modernizing payments systems that have been in place for decades to centuries should not be expected to happen quickly.

PAYMENTS MATURITY MODEL

A panel including Louis Blatt, chief product officer, ACI Worldwide; Michael Anderson, senior vice president, Commercial Product Management Group, Union Bank; Leo Lipsis, chief executive officer, Lipsis & Lipsis GmbH; and Nancy Atkinson, senior analyst, Aite Group, presented a framework for an industry tool to modernize banks' payments processing. Interest has been solicited from banks, vendors, and consultancies to participate in the completion and rollout of the model.¹

A result of multiple mergers and acquisitions over the years, many banks maintain redundant systems for various types of payments. Further, banks and their clients maintain systems and operations, information technology, customer service, and risk and audit staff for each different type of payment. Banks are interested in moving toward "payments hubs" (consolidated payments systems) to achieve overall cost savings, improve margins, better manage risk, speed time to market with new products/services, and support true "markets of one."² Payments vendors want to support banks in these undertakings while promoting the opportunities as being iterative. Banks lack clarity regarding assessment of their current status, order of systems development or deployment, and value that can be achieved by the bank at each stage.

The Payments Maturity Model assesses a bank's current position, provides direction on the order and types of activities needed to progress to the next stage, and assists with creating the business case necessary to invest in that stage. Should the industry adopt it, a common vocabulary and understanding will exist, providing a guide for assessing the status of each bank and determining the next steps in that bank's evolution toward an agile payments environment—the desired goal.

SWIFT ADOPTION

It appears that the adoption of the SWIFT network by corporations is still slow, and its declared objective to get 5,000 corporations on the SWIFT network by 2015 seems very challenging, considering that their presence approximates 705 after nine years. One winning strategy is to encourage banks to use SWIFT as a platform to provide added-value services (e.g., remittance advice, reconciliation) to their corporate clients.

It appears that SWIFT bureaus offered and managed by solution vendors are a viable and compelling value-add proposition to banks, which can offer on-boarding and managed services to their corporate clients. Through the use of a vendor-managed SWIFT service bureau banks can also detach from the complexity of keeping current on SWIFT technology updates. This approach is supported by a SWIFT statistic according to which 70% of SWIFT users connect via a service bureau. Aite Group encourages and expects this trend to grow as banks realize that maintaining

1. For more information on the Payments Maturity Model, see Aite Group's report, [The Payments Maturity Model: A Tool to Modernize Payments Processing](#), June 2010. Individuals and companies interested in participating in the Payments Maturity Model should send an e-mail with that expression of interest to info@aitegroup.com.
2. "Markets of one" as a marketing concept describes the ability to make offers to an individual or employee of a company based on their current activity, past transactions, and account configuration, in effect offering to a market of one.

staff with SWIFT knowledge to keep their systems current is a drain on resources and not the optimal use of IT employees.

PAYMENTS HUBS AND ECOSYSTEMS

Payments hubs and ecosystems build on the concepts outlined under the SCF and payments sections above. From a corporate perspective, the creation of “shared service centers” such that payments initiation is consolidated either at the corporate level or regionally is one form of a payments hub.

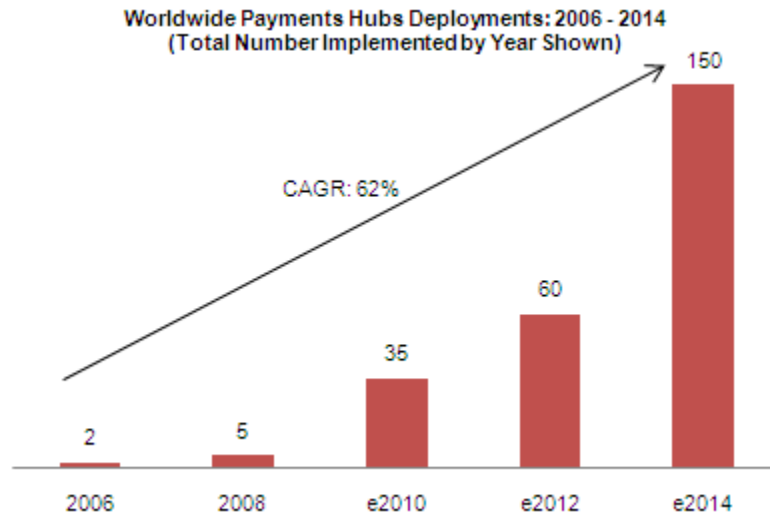
Current trends identify two types of corporate payments hubs, driven by the need for cost reduction and regulatory compliance:

- Locally distributed payments (“federated”) and
- Back-end payment factory.

The most implemented is the federated (i.e., locally distributed) model, which satisfies regulatory requirements and allows its redeployment to regional satellites to achieve local service-level agreement (SLA) objectives. Utilizing the federated model allows companies to direct payments initiation to the region or country in which they need to settle, and to avoid foreign exchange while ensuring regulatory and legal compliance.

The back-end payment factory is the full consolidation of all payments processing once invoices are approved by a centralized corporate entity. Its main drivers are cost efficiencies and removal of operational processes from treasury to allow treasury staff to concentrate on more strategic functions.

For banks, payments hubs promise lower total costs by the consolidation of multiple payments systems. These cost savings come from fewer systems to support, lower overall systems maintenance charges, and consolidate payments product, sales, and customer service staffs. Once a payments hub is established, the centralization of information about customers’ behavior, the data that accompanies payments, and the ability to analyze that data allows for the identification of new product or service offerings that generate new revenue streams for banks. Further, the broader ecosystem perspective and reach provides banks with greater insight into the needs of their corporate customers, and allows banks to strengthen their customer relationships by expanding from treasury to procurement, accounts payables, accounts receivables, and credit management. Bank adoption of payments hubs is growing from 2006 to Aite Group’s estimates of adoption by 2014 at a compound annual rate of 62% (see Figure 2).

Figure 2: Bank Payments Hubs Deployment Worldwide

Source: Aite Group

These are service-oriented architecture (SOA)-based information technology solutions that enable “seamless, straight-through processing” by integrating applications from various systems. The concept is to link the applications via file exchange workflows that share payment transaction data between different ERP systems. Alternatively, SOA-based solutions support an iterative conversion cycle to allow corporations and banks to experience short-term return on investment (ROI) that encourages continued phased development. To become partners of the ecosystem, candidate vendors are subject to a thorough assessment of their solutions’ SOA capabilities.

SECURITIES & INVESTMENTS

DERIVATIVES TRANSPARENCY: RISK, THEN REGULATORY

We tend to think of various initiatives in the industry these days with regard to transparency driven primarily by regulation. As true as this may be, there is yet to be any new regulatory standard to adhere to, with the possible exceptions of some interim swap reporting mandates the US Commodities and Futures Trading Commission (CFTC) and Securities and Exchange Commission (SEC) have ruled on.

Instead, conversations we had at Sibos were all about an emphasis on risk management at a level not seen before in the authors' collective careers. Solutions vendors are trying to meet requirements around risk "roll up" reporting and analytics, and the ensuing integration and data quality issues that arise as a result. There was a notion at Sibos that upcoming regulatory obligations would be substantially eased by this renewed focus on risk.

In the midst of financial regulatory reform activities in both the US and Europe, firms are beginning to try to understand their ideal state for the processing of listed and OTC derivatives. Process reorganization projects were discussed by a variety of participants on the institution and solution provider side. Projects focused on cost cutting and efficiency gains have begun to give way to projects focused on reworking processes and organizations to support a centrally cleared OTC derivatives program (across multiple central counterparties, or CCPs, and where possible, combine these activities with listed derivatives operations).

Corollaries to this were several discussions that Aite Group had regarding internal reconciliation and its role to facilitate these new processes. Another related consideration was the importance of rules management systems, especially in any environment requiring multi-asset class support.

POST- TRADE PROCESSING

SWIFT was busy at Sibos discussing its slate of post-trade related initiatives:

- Message price reductions;
- Successfully lobbying the SEC to win no-action relief as an electronic confirmation provider; and
- Plans for CCP connectivity enhancements to its Accord for Securities platform.

Meanwhile, the London Stock Exchange announced new functionality on its UnaVista electronic confirmation, data, and reconciliation platform.

What is clear from the post-trade discussions we had with financial institutions is the importance from both risk and efficiency perspectives of confirming trades as soon as possible after execution. This is the drum that Omgeo has been beating for many years, and it too could be found touting the launch of its EuroCCP connectivity capabilities, which it announced last year.

One large sell-side firm we spoke with discussed that they have made a global push to ensure they are affirming OTC derivatives across asset classes on (or close to) a trade-date basis. Where necessary, they are using front-, middle- and back-office staff. We don't want to suggest that this means that affirmation/confirmation processing has been mainstreamed (especially on an automated basis), but the last two years may have awoken the industry to the inherent value in more efficient post-trade operations. This may increase their adoption of solutions that automate these processes, especially outside markets where they are essentially mandated (such as the United States).

STANDARDS

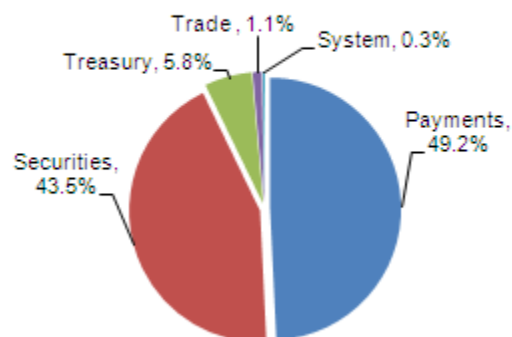
We heard some concern expressed about the emergence of ISO 20022 as a viable replacement for ISO 15022, with some attendees suggesting that the planned concurrence between the two standards might slow adoption of the newer version while creating additional overhead for vendors looking to support them. Of course, SWIFT is in a difficult position; they could receive even more criticism if they were to adopt a "big bang" approach.

The work that SWIFT is doing with the Depository Trust and Clearing Corp (DTCC) and extensible Business Reporting Language (XBRL) is looked on favorably, with the ultimate hope that support for XBRL tagging will continue to grow, potentially to the issuers themselves. With that goal many years off, however, there is support for the current activity to introduce XBRL to the corporate actions marketplace via the DTCC and intermediaries.

It's not just a theoretical exercise, either. SWIFT securities traffic has grown quickly over the years; representing 43.5% of SWIFT traffic, it is now a very close second place to SWIFT payments traffic. SWIFT securities traffic is also growing well, at a 6.2% clip year to date (Figure 3).

Figure 3: SWIFT Traffic Distribution

SWIFT Traffic Distribution YTD September 2010



Source: SWIFT

This suggests that while SWIFT has captured a large post-trade market share, it is still poised to grow. Aite Group believes the continued introduction of buy-side firms (including corporations) will support this growth.

REFERENCE DATA

Interest in enhanced reference data processing is high. This is a result of a confluence of events:

- Renewed emphasis on risk;
- Pending regulatory obligations in the United States and abroad;
- Data quality considerations; and
- Concern about data integration.

This interest revealed itself in Aite Group conversations with institutional trade operations and support functions, but also in the fact that a variety of solutions providers were emphatic about their reference data (or “Golden Copy”) capabilities as either standalone offerings or as a component of a larger application, such as the corporate actions solutions vendors.

CONTINUED EMERGENCE OF ASIA

Over the course of four days meeting with institutions and vendors, a clear trend with regard to economic growth in Asia became apparent. This was evident from two perspectives:

- Migration of back-office institutional staff to major Asian market centers, especially Hong Kong, to support strong growth in the Chinese financial services sector. While a seemingly expensive option, this trend is considered crucial to growing market share in the region.
- Solutions providers, across virtually all areas, are reporting stronger new license and pipeline growth in the region. China led the way, but other areas, including Australia, have emerged as strong buyers of technology to support growth initiatives.

CONCLUSION

As in years past, attending Sibos 2010 proved a good way to take the pulse of the marketplace. For wholesale banking, the following initiatives were highlighted:

- Supply chain finance is recognized as an important form of liquidity provision for the global trade markets, and greater understanding of it is growing;
- Payments-related data and real-time payments continue to be discussed, and models to provide both are evolving;
- The growing adoption of SWIFT by corporations and smaller financial institutions, although still slow, bodes well for the industry in terms of improving communications between companies and their banks; and
- Payments hubs and ecosystems—mostly intellectual ideas in the past—are becoming reality, with more consistent understanding of what they are and the benefits they provide.

On the securities and investments side several initiatives are gaining momentum:

- Post trade messaging by SWIFT and other parties, along with connectivity to industry infrastructure;
- Transparency, especially with regards to OTC derivatives; and
- Standards acceptance in corporate actions.

These initiatives are indicative of the positive attitude encountered at the event; the light is finally visible at the end of the tunnel. The industry is trying to make the shift back towards growth. Financial institutions and technology vendors should take note of the initiatives mentioned in this note to ensure that they are incorporating these advances appropriately in their strategy and implementations.

We expect that next year's event, scheduled to take place in Toronto, will provide another venue to discuss progress toward the initiatives mentioned in this Impact Note. It will also provide an apt venue to bring to light new issues and concerns in the marketplace as we put further distance between ourselves and the credit crisis of 2008.

RELATED AITE GROUP RESEARCH

[*The Payments Maturity Model: A Tool to Modernize Payments Processing*](#), September 2010.

[*Integrated Receivables Hubs: Revolutionizing Receivables Processing*](#), September 2010.

[*Supply Chain Finance: A Taxonomy*](#), November 2010.

[*OTCD: Clearing the Road for Progress*](#), June 2010.

[*Data Management Update 2010*](#), March 2010.

[*Smart Regulation: Is it Possible?*](#), January 2010.

ABOUT AITE GROUP

Aite Group is an independent research and advisory firm focused on business, technology, and regulatory issues and their impact on the financial services industry. With expertise in banking, payments, securities & investments, and insurance, Aite Group's analysts deliver comprehensive, actionable advice to key market participants in financial services. Headquartered in Boston with a presence in Chicago, New York, San Francisco, London, and Milan, Aite Group works with its clients as a partner, advisor, and catalyst, challenging their basic assumptions and ensuring they remain at the forefront of industry trends.

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