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Up to the task: An effective finance operating model for banks

Gearing up your finance function operating model to deal with tough new business and regulatory demands

January 2012

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Introduction
Pressure to deliver

Finance teams are facing unprecedented pressure as the fallout from the financial crisis leads boards, regulators and other key stakeholders to demand more information, more quickly than ever before, with greater insights into what the information means and with zero tolerance for errors and delays.

Finance teams are also at the forefront of dealing with new capital demands and their impact on the strategy, financial management and operational make-up of the business.

In turn, business demands are increasing as finance teams are expected to deliver a faster close, more granular information and the telling business insights needed to make sense of a complex and uncertain market environment, and help inform the restructuring and strategic re-orientation being conducted by many banks.

These tough new demands have required a thorough review and possible overhaul of the finance function target operating model. CFOs and their teams are striving to make sure that systems, processes, governance and organisational design are up to the task. With budgets constrained, the underlying requirement is the need to do more at less cost.

This paper provides an overview of the changing demands on finance teams, target operating model considerations that will be required to meet them and how to make the successful transition to a more efficient and higher performing finance function.

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Meeting regulatory and business demand

There seems to be no let-up in the increasing demands for information from regulators. The reporting requirements on capital and liquidity have soared. The new 'routine' also encompasses further demands in complex and multifaceted areas such as recovery and resolution planning. Yet, it is the surge in short notice ad hoc requests in areas such as exposure to market stresses which is proving most demanding and potentially disruptive, adding to the pressure on already stretched staff, systems and controls, and making it difficult to plan the allocation of resources. The fast moving pace of recent events means that requests for information are often broad, ill-defined and expected within days, yet the tolerance for errors and delays is effectively zero.

The quality of finance data, systems and analysis is going to be crucial in managing risk, capital, leverage and liquidity effectively and providing the sharp insights needed to judge the right strategic course.

New capital and liquidity requirements are further adding to the pressure on finance function operational capabilities and the infrastructure that underpins this. Management needs to know how these demands will affect funding costs and business line and product profitability. Many banks are looking to divest non-core and capital intensive assets as they seek to concentrate limited resources where they can earn the best return. In turn, many banks have sought to reduce their risk-weighted assets and scale back their balance sheets.

The quality of finance data, systems and analysis is going to be crucial in managing risk, capital, leverage and liquidity, effectively, and providing the sharp insights needed to judge the right strategic course. Key demands include greater granularity and closer collaboration with risk management teams, along with a thorough review of analytical assumptions to make sure they continue to be valid and consistent. The generation of much of this information depends on models, which need to be controlled and assessed for their accuracy against actual results.

Further challenges centre on the dynamic nature of capital and liquidity requirements. Frontline teams want to know how the cost and capital profile of current transactions are going to be affected as the regulations move from Basel II to the transitional Basel 2.5 and eventual Basel III. A typical instance would be the treatment and profile of a five year swap written today, which is going to keep shifting. Some trades that make good use of capital under current arrangements may cease to be so as the rules change.

Case study:
Geared up for the new regime

A multinational bank was required to file over 100,000 regulatory reports annually. The impact of the financial crisis and new regulation has increased the number of reports, while squeezing the timelines in many jurisdictions.

The bank recognised that its finance function's operational infrastructure was being overstretched by these new demands. Technology support was inadequate, adding to the need for manual processes, while also increasing the risk of error. Systems and processes were highly fragmented and CFOs did not have a clear line of sight where the most critical production risks lay. Mistakes were becoming more common, which was heightening the risk of regulatory sanction. In turn, the heightened demands on staff were leading to long hours and high turnover of personnel.

To speed up turnaround times and improve control, the bank is looking to minimise manual intervention through process automation. It is also planning to create a common data repository, capable of aggregating data across business lines and products, recognising that need to improve data governance and data definition standards to create consistency. Improvements in oversight and control are underpinned by clearer mapping of processes and associated risks, and the creation of a better co-ordinated and more sustainable centralised governance model. Greater efficiency has reduced the routine demands on staff and allowed them to devote more time to business insight. This is supported by closer attention to training and employee development.

At present, much of the evaluation is fairly fragmented in scope. A key priority is therefore bringing all the analysis together and communicating it across the business to inform the necessary debate about what business will and will not be viable under the new regime.

Many finance functions are finding that their current operating model can no longer cope with these heightened business and regulatory demands. A patchwork of workarounds may be able to deliver in the short-term. Some banks may have been reluctant to overhaul their operating model because of the investment this is likely to entail. Now, we appear to have reached a tipping point where many banks have come to view the business critical nature of the information and risk of inaccuracies, or failure to deliver outweigh the costs of putting it right.

Each bank faces different demands, depending on its products and geographical reach. Yet, there are a number of key considerations and principles that are likely to be common to all institutions as they look at how to make sure their operating model is fit for purpose:

- The need for flexibility.
- The need for timely and reliable data from around the organisation.
- The need for greater automation and streamlining of reporting to reduce the time lags and weaknesses in control, created by the proliferation of spreadsheets.
- The need to cut through the web of complexity created by fragmented processes, multiple legacy systems and lack of clear data governance and ownership.
- The need for clear identification of communalities on the one side and differences in compliance demands on the other. This is needed to balance the economies of scale created by a centralised shared service approach with the different expectations in each territory (e.g. the different scope of loan delinquency thresholds or ageing categories, as well as acceptable capital).

Strengthening operational efficiency

The first wave of operational efficiency saw the introduction of enterprise resource planning (ERP) systems. Having adopted these ERP solutions, financial institutions then embarked on delivery model analysis. The development of shared service centres (SSCs) for finance has further reduced costs and provided an opportunity to streamline and standardise processes. Today's finance function is faced with the challenge of providing deeper insights and leveraging these advances in technology and delivery capabilities.

With the demands on finance constantly changing, it will also be important to build in sufficient flexibility and effective data capture.

Certain activities will clearly need to be retained within the headquarter's finance operation, or be embedded within the business. This is likely to include insight capabilities and regulated activities. A key element of strengthening operational efficiency and developing the target operating model is therefore determining what activities should be kept within operating units and what can be centralised within an SSC to create scalability, along with how to maintain effective governance, control and reporting under the new structure.

With the demands on finance constantly changing, it will also be important to build in sufficient flexibility and effective data capture. Typical considerations might include whether the information contained in the general ledger and all of the various source systems is available in a consistent and flexible enough format to allow the SSC to use it without major cleansing for reporting across different jurisdictions. Proper data governance (data definition and data stewardship) can accelerate finance's ability to respond more quickly and with a higher level of comfort over the accuracy.

In the next stage of development, shared services for finance and accounting are being integrated more closely with other support functions such as IT, HR and customer services. This combined service approach allows banks to rationalise fragmented processes and improve the efficiency of their operations. Many of the new generation of SSCs are also developing into centres of excellence, focusing on both core processes and high-value adding activities.

Case study:
Cutting costs and turnaround times

The finance function of a large international bank was looking to deliver sustainable savings and faster reporting through the development of a new finance operating model.

The first stage was the selection of the target operating model and evaluation of what processes and activities could be centralised within a newly created SSC, and what should be retained within the business. Areas under consideration included financial accounting, management accounting and purchase-to-pay processes. The next stage focused on the standardisation of processes and elimination of duplication.

The creation of a standard set of internal reports for all legal entities cut the number of reports by nearly half. The removal of duplication allowed the bank to cut the number of processes by some 40%. Overall, the bank reduced finance FTEs by 20% from 250 to 200, while still being able to halve management reporting time. Further benefits of centralisation and standardisation included a reduction in the number of IT systems and related maintenance costs.

Faster close

The speed of closure is a key indicator of the efficiency of the reporting process. Key priorities include the implementation of standard charts of accounts within every business unit. It will also be important to build the finance architecture around an efficient enterprise-wide data model, and move towards greater integration of financial and management reporting data processes.

Effective process and data governance is critical to ensure timeliness and data reliability, the fundations of faster close. This includes assigning data owners from within the business for each key set of information and ensuring consistency across the organisation, whatever the geography or business unit. Regulators are not interested in where the information exists in the organisation as long as they get answers to their queries on a consistent basis. The underlying requirement is the recognition that good data and the decisions that flow from it are the responsibility of everyone within the business, rather than just being a matter for finance.

Case study: *Closer to the customer*

The finance function of the investment banking division of a large international bank was looking to develop a 'lean' transformation process, which would allow it to focus more closely on meeting changing user ('customer') needs and finding ways to continuously improve the value provided by finance.

The foundation has been greater clarity over who the customers are and engaging with them to find out what they require and how finance could improve delivery. The finance team can then look along the critical path to identify and eliminate hold-ups and waste in areas such as the use of spreadsheets (subsequently cut by half). This is underpinned by greater or 'right first time' processes and readiness to challenge and improve existing practices.

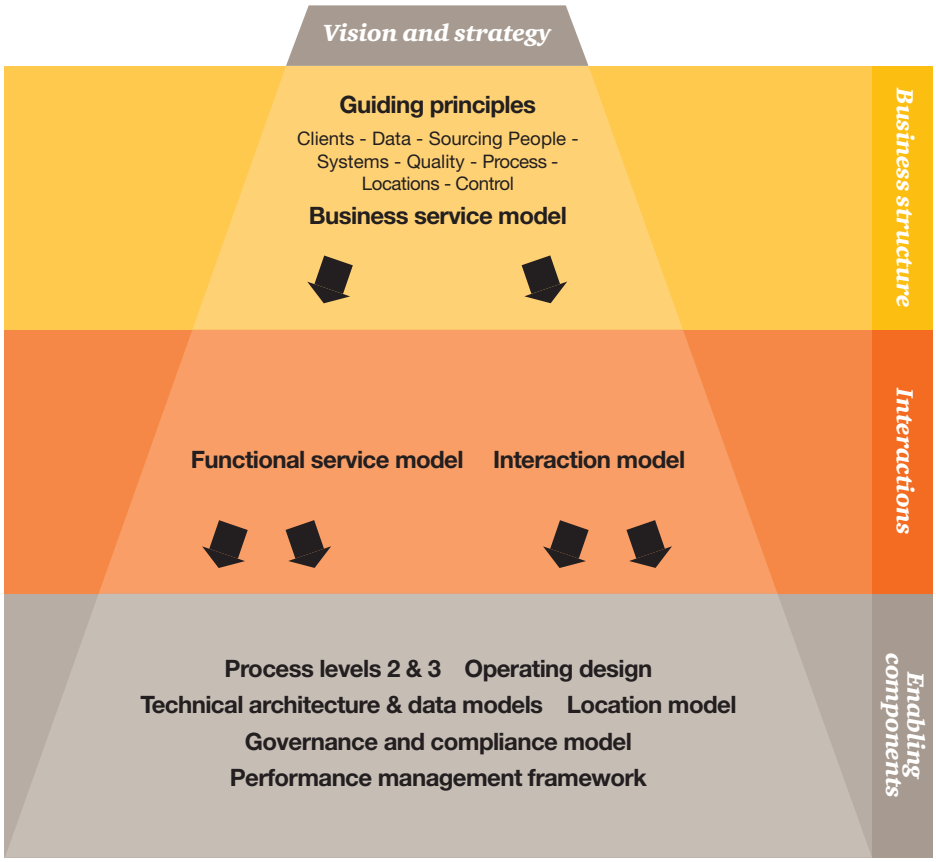
As a result, turnaround times for flash reporting have been cut from 5 working days to 1 and monthly reporting from 16 to 13 working days. At the same time, the finance team has been able to enhance disclosure, deliver more market-driven commentary and improve the quality of balance sheet substantiation, while still being able to reduce headcount by 17%. A notable feature of these improvements in performance is that they have been achieved without investment in IT.

Managing change

Creating an operating model capable of meeting these more exacting business and regulatory demands is clearly a huge challenge, which will be heightened by multiplicity of stakeholders, pressure on resources and the need to sustain core reporting responsibilities.

As Figure 1 highlights, the first step is a clear and compelling vision about what your organisation expects from its finance function, both now and in the future. A clear vision can make it much easier to target resources and assign roles and responsibilities. It will also help to make the business case for investment in new people, tools and technology. Key considerations include: What level and nature of decision support does the business require? Does the finance function have the talent and systems to deliver this? How can processes be made more efficient and hence free up more time to provide insight and analysis?

It is then possible to design a target operating model that works for your business and devise a roadmap for change. The operating model will define business expectations, the key areas of focus for the function and set out the aspirations for best practice. The target operating model will also govern which processes go where (i.e. SSC, or retained within business, or head office units). The roadmap will set out the initiatives required to realise the model and its benefits, along with a clear view of the phases and dependencies during the transition. As part of this action plan, it will be important to determine the priorities that can deliver quickest returns and help sustain the momentum of the change.



Our experience underlines a number of risks that can derail the transition and undermine the benefits. These include lack of senior management support, insufficient ownership and accountability and the absence of a consensus on shared service development. There is also the danger of allowing the model and change programme to be built around systems development rather than a clear articulation of business needs. These risks underline the importance of strong leadership from the board, the identification and management of stakeholder needs and clear assignment of responsibilities as part of strong and consistent programme management.

Once the target operating model begins to be realised, it can deliver considerable benefits across the organisation, including more streamlined processes, reduced errors and improved regulatory relations. It can also increase morale and create a better performing finance team capable of delivering greater value to the organisation.

Helping you to create a more effective operating model

PwC provides advisory and auditing services to leading banking groups worldwide. Strengthening finance function effectiveness is a key part of our support. Drawing on our wide-ranging banking industry expertise and tried and tested tools and methodologies, we can help you evaluate, design and develop a target operating model that best fits your business needs and evolving regulatory requirements. Our work with banking clients is backed by close liaison with regulators, analysts and other key stakeholders to help our clients develop a better understanding of stakeholder expectations and how best to meet them.

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