Digitalization in banking beyond COVID-19

COVID-19, an accelerator for the changes already underway in banking

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In an industry and a world in which digitalization was already a top-of-mind topic in board rooms, the circumstances created and trends accelerated by the recent COVID-19 pandemic may have made it more relevant than ever. The all-hands-on-deck mentality fostered by responsive organizations can and has accelerated the development of digital solutions to contemporary issues such as keeping employees engaged and operational while working from home, or more swiftly evaluating credit and market risk developments in certain facilities.

We have identified three key lessons that financial institutions could have learned from the current circumstances; lessons that speak to the importance of embracing digitalization – in other words, leveraging innovative tools and technology to lead efficiency and efficacy gains in processes, and unlocking associated benefits. From these, we have developed the paper that follows – specifically aimed at C-level and senior management of banks - which explores themes with an affinity to digitalization.

The importance of staying connected

Recent circumstances have shown that digital tools cannot fully replace the human element of social interactions, but they are the next-best alternative. Employees need to feel engaged with their team, to enable them to execute operational tasks remotely and in compliance with laws and regulations. At the same time, banks need to continue to service customers, through systems tracking customer-requests, or through superior and error-free digital journeys. This, while ensuring robust cyber security to accommodate the increased digital traffic. These digital tools are essential in enabling the entire organization to remain connected – within its own people, but also with its customers.

The importance of being flexible

Just as we have all been forced to change our ways and overcome challenges, banks have had to and will have to continue to showcase their ability to deviate from standard processes and accommodate exceptional circumstances. Temporary regulations have impacted customers and employees, thereby indirectly impacting banks. Regulators have allowed banks to make use of their capital buffers and banks now expect sharp increases in credit losses. Several of these sudden changes could have been further enabled and facilitated by superior digital tooling; whether for efficiently monitoring credit, liquidity and market risk to optimize decisions on capital reserves, or to efficiently track customer facilities, requests and associated exceptions. All of this has proven that all operating models need to take deviations into account, and the only way to optimize this flexibility, going forward, is by using digital tooling.

The importance of being compassionate

Exhibiting solidarity and understanding others' situations is key for everyone, including banks. They need to be part of the solution to current circumstances. So a strong focus on customer centricity is key. Customers will need extensions on mortgage payments and may benefit from money management tools to effectively manage their finances. Digital tooling can enable this customer-centric behavior – which is a core pillar of banks' strategies these days.

This paper is part of a broader series. See our blog [COVID-19, an accelerator for the changes already underway in Banking?]

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Digitalization across the board

Digitalization is about leveraging technology and innovative tools to improve the efficiency and efficacy of a given process; whether by building in-house capabilities or partnering with third-parties to do so. Because of the multidimensional benefits this brings, digitalization and, by association, digital transformation are top of mind in banking industry boardrooms. Prompted in particular by the COVID-19 pandemic, the European Commission[1] has called on the banking sector to accelerate their digital agenda, with the aim of improving remote and digital access to financial products and unlocking the associated cost reductions to safeguard banks' balance sheets.

Approximately 47% of financial services providers[2] – more than the global industrial average – expect to see a radical digital transformation in the coming three years, while 53% also expect more than 10% of their workforce to be automated and replaced by superior technology in the coming five years. Interestingly, while in several countries the board's top IT priority is to enhance customer experience, in the Netherlands it is about delivering consistent and stable IT performance to the business.

IT spend – highlighted by 58% of financial service providers reporting a year-on-year increase in IT budget – will continue to rise. This is not only strategic, but also hygienic. It will increasingly be a must-do to digitalize essential parts of the business to safeguard operational resilience, as well as customer relevance. This is borne out by the fact that digital security, a seamless omnichannel experience, and prioritization of vulnerable clients are among key drivers for banking customer satisfaction during the COVID-19 outbreak[3].

Digitalization as a key driver for operational resilience

Digitalization should not be viewed as an end, but as a means to ensure business continuity. Recent times have shown the importance of an organization's ability to withstand operational shocks and continue to deliver on their core business. Banks need to be able to protect their workforce, protect their balance sheet, support customers, and maintain their vital services, and digitalization is a way to achieve these objectives.

For instance, rationalizing the internal application landscape to improve process-efficiency will directly protect balance sheets by reducing operational (and IT) risks and costs. This digital transformation was a driving force behind the optimization of operating expenses of the four largest Dutch banks in 2019; exemplified by one large Dutch bank rationalizing its application landscape to unlock more than €30 million in cost savings going forward, and significantly reducing (IT) risks in the process. Hence, given the ECB's recent call to banks[4] to further reduce expenses to safeguard continuity, accelerating digital transformation is a way to deliver on this objective.

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[1] COVID-19 EU Banking Package, EC (2020)
[2] CIO Survey, KPMG (2019)
[3] Consumers and the New Reality (KPMG, 2020)
[4] Letter on Contingency Preparedness in Context of COVID-19 (ECB, 2020)

Digitalization and the customer experience

The extent to which banks can proactively offer relevant services – especially in times of crises - is key to maintaining customer relevance. In fact, digitalizing banking processes can lead to fewer system errors, faster response rates to customer service inquiries, and quicker onboarding for and disbursement of loans; something an increasing number of banking clients are demanding[5]. Also, offering seamless payment solutions will become a must, as COVID-19 has accelerated the path toward a cashless society. In fact, more than 55% of banks worldwide[6] are partnering with fintechs to provide additional services to clients, such as spending analytics, or to facilitate onboarding, and this trend is only expected to become even more popular.

Examples of Dutch banks using digitalization to improve customer-related KPIs include ABN AMRO's collaboration with Tink to produce Grip, a tool used by more than half a million customers to manage their finances. Floryn – which recently received sizeable financing from NIBC Bank – has been digitalizing the business credit application process to create a seamless and customer-centric experience in a traditionally tedious process. Simplifying onboarding processes by using such tools can improve conversion rates; showcased in Tink's collaboration with Avanza[7] – Sweden's largest stockbroker – as their onboarding solution improved Avanza's conversion rate on a given service by 150%

The benefits of deploying new technologies to streamline and simplify customer journeys, or to provide additional insights into customers' finances, are just two examples of banks leveraging digitalization to improve customer experience. Harnessing these benefits will increasingly be a must-do for banks to remain relevant and add value for their customers in the new reality.

Digitalization in banking in 2030

By 2030[8], banking customers will expect banks to know them, and be seamlessly integrated in their lifestyle. They will expect automated, intuitive and user-friendly processes to minimize time and effort when interacting with their banks. They will expect banks to be pioneers of trust and cyber security, and that they proactively manage the context of a customer's finances and offer both products and insights. Technologies such as AI and digital currencies, and enablers such as open banking and changing consumer behaviors will all have to be factored into banks' business and operating models.

Banking is at a revolutionary crossroads. With the rise of challenger banks, fintechs and non-financial institutions (NFIs), traditional banks will need to adapt to remain relevant. Digitalizing processes to safeguard the cost-base and to improve the management of (regulatory) processes and associated data in internal systems are increasingly becoming a strategic solution. Digitalizing product-offerings and partnering with third-parties – and viewing developments like Open Banking in an opportunistic rather than passive manner – are all measures banks will need to take to ensure that today's traditional banks remain relevant tomorrow.

[5] Consumers and the New Reality (KPMG, 2020)
[6] Forging the Future: Global Fintech Study, KPMG (2019)
[7] Eliminating Onboarding Friction at Avanza, Tink (2019)
[8] The Future of Digital Banking (KPMG, 2019)

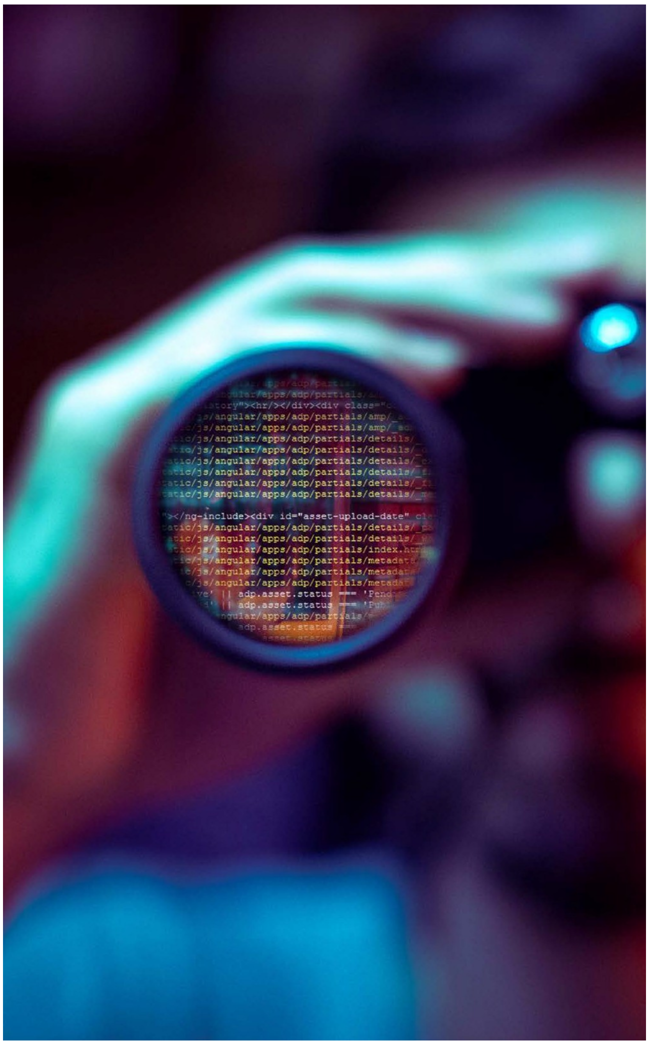
02 Strategic themes for digitalization and banking

Digitalization tends to be used as a broad and overarching term, which spans various dimensions and value chain activities of a bank, and other businesses. However, when scoped and made specific for banks – and the industry-specific components that interact with their business and operating model – there are concrete solutions, enabled by digital tooling, among other things. This tooling can help improve the operational performance of financial institutions, specifically, through a series of effects.

To identify key themes upon which digitalization could have a meaningful impact, we mapped the impact of the recent COVID-19 pandemic and other ongoing trends on banking operations. In the process, we identified six key strategic themes that are recurring and that have a strong affinity with digitalization, and where digitalization can play a significant role in achieving dedicated goals.

1. Simplifying Journeys and Using Digital Partners *to* **Drive Customer Centricity**
2. Strengthening Cyber Security *to* **Manage Increased Digital Traffic and Control IT Risks**
3. Rationalizing the Application Landscape *to* **Drive Cost Reductions and Control IT Risks**
4. Using Cloud Technology *to* **Increase Flexibility while Lowering Costs**
5. Strategic IT Outsourcing *to* **Increase Operational Resilience and Flexibility**
6. Leveraging Blockchain to Facilitate ESG-Reporting and Practices

We elaborate each theme in the following pages, with an explanation of their contemporary relevance, the impact of the current circumstances on the theme, and how digitalization and associated concrete solutions could be used to address banks' objectives regarding a specific theme.



1. Simplifying journeys and using digital partners to drive customer centricity

Before COVID-19 became part of our society, a number of developments were prompting banks to take action in the ever-changing competitive banking landscape. Some examples:

— *Challenger banks* are gaining traction in Europe based on their exceptional customer experience and agile operating models[9];

— *BigTech* players are using their data and insights to offer highly-relevant banking and payments solutions to customers that are integrated into wider core propositions; and

— *FinTechs* are using new regulations like PSD2 to bring innovations to market faster, and are attracting large capital investments in the process (globally USD 135.7 billion in 2019[10]). Either through direct competition with banks or by offering functionalities that can be adopted by banks, fintechs are becoming increasingly relevant for consumers.

At the same time, other sectors outside of financial services are redefining customer expectations. Empowered customers are demanding new (higher) levels of engagement and personalization. Customers have more power than ever before. They expect all the channels where they are most active to be fully integrated and connected, and available 24/7 wherever and whenever they want them.

Impact of COVID-19 on banking customers

On the back of rising expectations, customers are becoming more critical of their banks' services. Banks are now not only just competing with peers in their sector; they are competing with every other brand that consumers come into contact with. Expectations set by companies like Coolblue are rapidly becoming the standard expectation across all industries. Once consumers engage in an exceptional experience, they refuse to settle for less, regardless of brand or sector.

According to KPMG research[11] on the customer experience of 5,000+ respondents, Dutch banking customers are clear about what makes an experience excellent: it is Personalization. Yet our research shows that all banks are underperforming on this important front. Banks are striving to critically balance their data security and GPDR requirements against their use of customer data, while online banks are able to capitalize on their lack of legacy infrastructure and highly agile operating models to deliver exceptional customer experiences. This is a real missed opportunity for Dutch banks.

However, COVID-19 has given an unexpected twist to these developments, as there might be opportunities banks could leverage from the crisis, as we explain on the following page.

[9] The Rise of the Challenger Banks (KPMG, 2017)
[10] Pulse of Fintech (KPMG, 2019) A Digital Walk to Remember (KPMG, 2019)
[11] Consumers and the New Reality (KPMG, 2020)

Key considerations in customer centricity and digitalization in banking

Due to COVID-19, the position of online banks like Monzo and N26 is under pressure, as uncertainty in the market increases and investors are becoming cautious. Most, if not all, of these banks are not yet profitable and they need investments to fuel their growth. Despite this, they remain a threat to traditional banking due to their strong focus on customer experience; a net improvement of 24% being noted for digital banks vs. 12% for traditional banks, in light of COVID-19, in a recent KPMG survey[12].

In fact, customers are experiencing more digital interactions with their banks, for instance, due to limitations on the use of cash in favor of contactless payment methods, and the closure of bricks-and-mortar shops. As a result, customers are now demanding a great customer experience and seamless omnichannel interaction with their banks, as >30% of respondents made clear. Another 41% of respondents also claim to be open to switching to a digital bank in light of COVID-19. The failure to deliver on digital experience – now that it matters – may make customers move permanently to challenger banks that can deliver on this component.

Incumbents may be a little less fast and less hip or innovative, but they are also "too big to fail". That further increases the need for banks to take action and to step on to this fast-moving train called 'customer excellence'. The recent crisis is an excellent opportunity for incumbent banks to accelerate their ambition to improve customer experience and to stay relevant for their customers in the post-COVID-19 world. To do so, banks need to embrace the new reality, for instance by:

- *Connecting front, mid and back office* to deliver seamless and frictionless customer journeys (through all channels);
- *Investing in employee competences* (digital, agile, data) to connect employee and customer experience across front, mid and back office;
- *Converting insights from customer experiences and customer data into actions*, for instance by using data to improve customer processes, to place financials services in a wider customer-orientated context, offering personalized services, and more;
- *Integrating internal and external data sources* (not only historical but also predictive) and leveraging enablers like AI and IoT to improve KYC processes;
- *Focusing on fast(er) onboarding* through digitalization and automation (e.g. STP, RPA);
- *Delivering excellent customer services* through 24/7 availability and seamless omnichannel experiences;
- And above all: banks need *to realize operational excellence through extreme (client-focused) digitalization*. This means they need to find the right balance between high touch (customer intimacy) and high-tech (digital services).

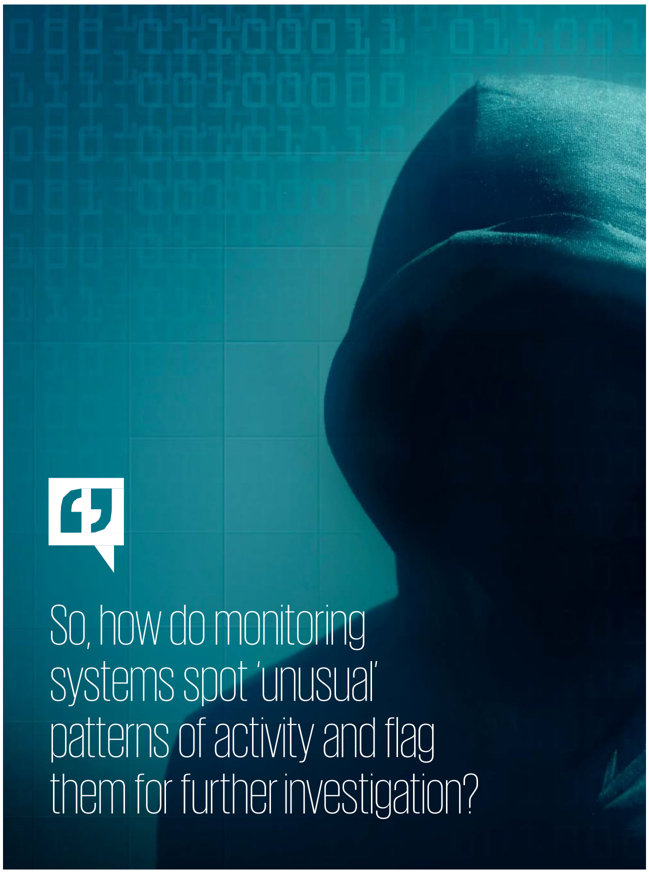
[12] Consumers and the New Reality (KPMG, 2020)

2. Strengthening cyber security to manage increased digital traffic

COVID-19 has posed huge and sudden challenges to societies and businesses, disrupting old ways of living and working. One of the most visible manifestations of this in the corporate sphere has been the need for organizations to rapidly transition all or most of their workforce to a remote working model. As the situation is unprecedented and unpredictable, authorities meet on a regular basis to discuss the current measures and threats. Regulatory contact with institutions has also intensified. And institutions are being urged to report any problems to the regulatory authorities promptly.

For financial institutions, the key priorities have been to ensure that they maintain their services and support for customers in difficult times. Effectively, COVID-19 has created a huge monitoring challenge.

- Banks (and indeed all businesses) need to ensure that remote users are who they say they are, and that their behavior is consistent with what would be expected.
- This is difficult when users may be logging in not only from company-issued laptops but also their personal phones, tablets and other devices. Banks and other businesses may have had to relax the BYOD (bring your own device) protocols that allow remote access from a single device. In addition, staff are most likely not following their usual work patterns (logging on around 9 am, logging out at around 5 pm) but may be working in bursts across a range of hours due to child care and other sporadic duties.
- So, how do monitoring systems spot 'unusual' patterns of activity and flag them for further investigation? In that regard, it is important to take account of new risks and patterns of financial crime resulting from the COVID-19 crisis. It should come as no surprise that COVID-19 has generated a significant increase in fraudulent activity[13].



All of these issues only serve to underline the key importance of strong information security, cyber and anti-fraud controls. This is an area that will continue to be a major focus as we move into the post-COVID recovery. Even prior to the COVID-19 crisis, 39% of leading international CIOs saw this as something lacking in their organizations[14]. Another factor at play here will be that, due to lockdowns, banks are expanding the range of self-service options available to customers online, for wealth management trades, mortgages, loan applications, etc. Ensuring robust security controls are in place for these new customer functionalities is becoming ever more essential. In addition, as a result of the crisis banks will face cost pressures, including in the cyber security domain, while being called upon by regulators and policy makers to remain vigilant of cyber security risks.

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[13] CIO Survey, KPMG (2019)
[14] Cyber Risks for Banks in COVID-19 (KPMG, 2020)

Cyber security has become more relevant than ever

Looking forward, we see two key trends arising from this experience. Firstly, with levels of remote working likely to remain higher than they were pre-COVID-19, banks may need to ‘reset’ some of their protocols and policies around access management, by finding ways to increase flexibility without compromising security.

Secondly, we anticipate an increase in banks moving parts of their IT operations to public cloud environments. Most banks use their own private clouds at present. However, in a lockdown and other emergency situations, these can be challenging to maintain. If a security patch needs to be rolled out across a system, for example, private cloud requires a team member be physically on site. But with public cloud, patch management and other security features can be run automatically from a remote location. For this to happen, public cloud operators will need to meet the very specific and stringent additional security requirements that banks are likely to demand.

Alongside all the other pressing issues of supporting customers and providing liquidity, cyber security will definitely remain a top priority for banks. Below, we outline some of the other key activities that are expected to become increasingly relevant:

— Dealing with COVID-19-themed cyber threats. Increased risk of phishing attacks and email fraud due to remote working

— Managing the escalating costs of IT security when budgets are constrained and cost savings are required

— Current Business Continuity plans assume that not every organization’s Business Continuity Plan is simultaneously triggered

— Accelerated moves to the cloud requiring adaptation of security models

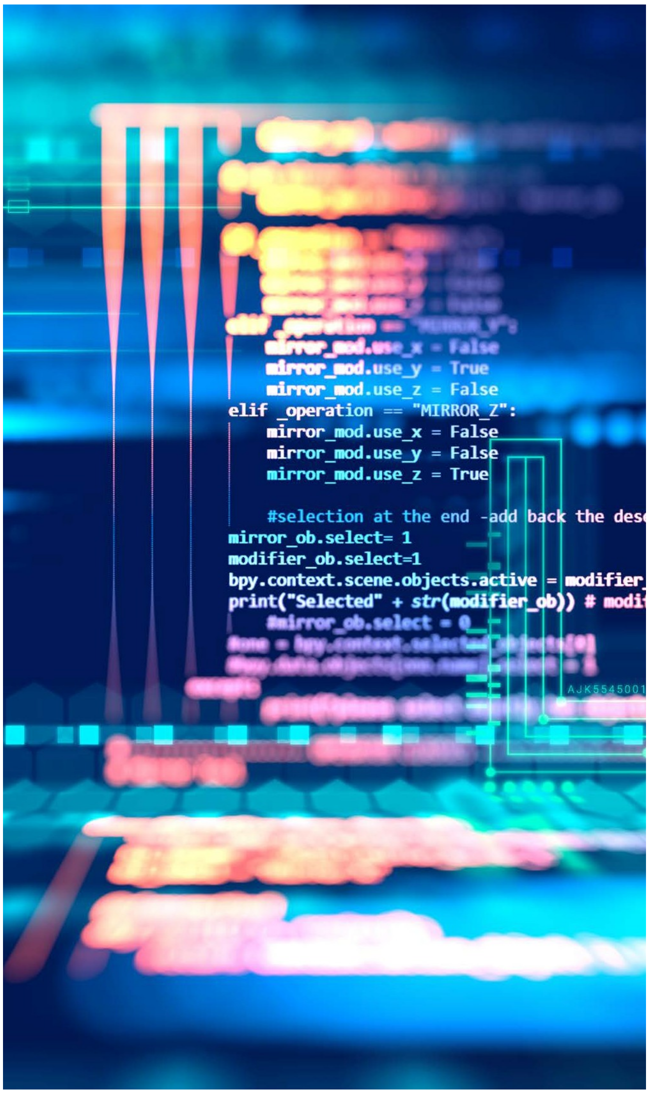
— Concerns about security and viability of managed service providers

— Increased pressure for automation to deal with regulatory changes and meet compliance requirements

The path towards security beyond compliance

The benefits of strong cyber security are clear, but the path to get there is often fuzzy in large organizations. They will need to:

1. *Focus on embedding pragmatic remote working security controls* to deal with threats, including education of employees.
2. *Act to secure cloud* and other ad-hoc collaboration environments and seek assurance on security controls of managed services providers
3. *Review and enhance business continuity management frameworks,* covering larger, more frequent and globally simultaneous events
4. *Test robustness of the banks’ cyber resilience* and *optimize controls* while reducing cost of ownership
5. *Plan to migrate to a security operating model* that enables higher levels of automation



3. Rationalizing the internal application landscape to drive cost reductions and control IT risks

Many organizations have a natural tendency to expand their application landscape, be it through mergers, organic growth or due to a lack of governance. This application expansion tendency, which can be referred to as 'application entropy', is extending time-to-market, processing times, and is significantly increasing operating costs.

Application rationalization is a reliable means of reducing costs and streamlining operations by consolidating a large portfolio of applications into a smaller subset of lean, vital, necessary and cost-efficient software resources. Streamlining an organization's application portfolio is likely to result in a **reduction** in annual software fees. Additionally, application rationalization is likely to generate operating efficiencies by reducing the number of applications that need to be operated.

COVID-19 has accelerated the need for an optimized application landscape

The COVID-19 pandemic has and is expected to continue to place enormous strains on the financial position of banks. Banks play an important role in supporting businesses in challenging times by providing credit. However, in times of economic downturn there is an increased risk of customers defaulting, resulting in elevated risk costs. Together with a need to restore capital buffers to pre-crisis levels[15], we see a strong need for cost-reduction initiatives, potentially catered to by rationalizing application landscapes. In fact:

— *Lower software vendor costs* as a result of fewer software applications;

— *Lower IT personnel costs* required to maintain fewer business applications, and;

— *Lower operational staff costs*, as the result of the operational streamlining of business processes.

Case in point:

A large Dutch bank that operated with a large number of autonomous, international offices. Throughout the years, these autonomous offices each acquired standalone software and data storage solutions to drive their own operating efficiencies. This resulted in a costly, complex application landscape as well as increased IT risks – frowned upon by regulators.

Application rationalization was used as a solution to effectively consolidate the high number of standalone applications and data warehouses. Consolidating the landscape for the bank globally unlocked economies of scale and global efficiencies. Furthermore, application rationalization enabled the bank to standardize processes, which led to shorter processing times and increased operational performance. Ultimately, these efforts resulted in more than €30 million in yearly cost-reductions and operational efficiencies.

[15] Capital and Business Model Resilience, KPMG (2020)

Forces driving banks to application rationalization

In addition to cost-reductions, application rationalization initiatives can also be driven by external forces, such as market forces and regulatory forces.

Market forces

Application rationalization can be initiated to gain a competitive edge over other banks in the market. For example, streamlining the application landscape could lead to, among other things: centralized portfolio management; enhanced customer insights; decrease in processing times and a faster time-to-market for innovative products. And of course the cost-savings gained can be reinvested in other relevant areas.

Regulatory forces

The need for application rationalization is reinforced by various regulatory trends. For instance, in 2015 the European System of Central Banks (ESCB)[16] initiated a long-term approach to banks' data reporting. The main objective is to increase the efficiency of reporting and to reduce the burden for banks by, among other things, integrating prudential and statistical reporting frameworks. This paves the way for banks to further rationalize the applications they use for reporting, a path many banks have already adopted. In addition to this, banks could leverage application rationalization to consolidate the wide variety of applications used in different (geographical) locations. This additional rationalization should enable wider global coordination and efficiency, as well as lower IT risk profiles.

The key success factors for application rationalization

Although application rationalization may be a way for banks to achieve cost reductions and competitive advantages, it is not a simple task that can be done 'on the side', so to speak. Without governance and a structural rationalization process, the entropy will return over time. To achieve real results via application rationalization, a pragmatic approach and company-wide commitment is needed. Banks that want to successfully rationalize their application landscape need to keep the following key success factors in mind[17].

The 10 key success factors for a successful application rationalization

1. Ensure the board communicates a clear rationalization vision
2. Define rationalization as part of management goals
3. Reserve a separate rationalization budget
4. Make rationalization 'attractive': reward the 'cleaners' and celebrate successes
5. Create a fact-based overview of the IT landscape
6. Ensure FTE reduction is not considered a primary goal
7. Establish an independent 'rationalization office'
8. Use rationalization as catalyst for other initiatives
9. Appoint 'promotors' to spread the rationalization vision and determine quick wins
10. Embed rationalization in the DNA of the IT architecture governance

[16] European Reporting Framework (ESCB, 2020)
[17] Removing Application Entropy (Compact, 2015)

4. Using cloud technology to increase flexibility while lowering costs

The introduction of cloud technology and its subsequent adoption by organizations is not new. In fact, it is the most invested-into technology across industries, with 44% of firms having engaged in large-scale transformations on this front[18]. Although banks have traditionally been relatively slow to adopt cloud solutions, this has changed over the past few years and we expect the impact of COVID-19 on banks to accelerate this trend; driven by cost-saving benefits, as well as the increases in flexibility that can be unlocked through investments in cloud technology.

The banking sector's original reluctance to invest in cloud technology was based on genuine concerns regarding, for instance, related security and privacy risks. Furthermore, regulatory and supervisory bodies were also reluctant, given the perceived increase in IT risks for such large-scale transformations. However, as the sector gains experience more and more banks have moved and are moving to private cloud, public cloud or hybrid cloud-based solutions.

Banks, like many other large organizations, often run multiple cloud solutions and are not realizing the financial returns expected from their migrations to the cloud. In fact, according to a recent survey[19], the proportion of cloud spend wasted on inefficient activities is estimated at 35%. In view of the fact that IT investments in cloud technology are higher than any other technology[20], and that the call for increased operational efficiency is particularly relevant at this point in time, together with the growing call for IT business owners to show tangible business results3, we see real potential for banks to optimize their cloud technology spend.

Cloud Technology can Improve Operational Flexibility

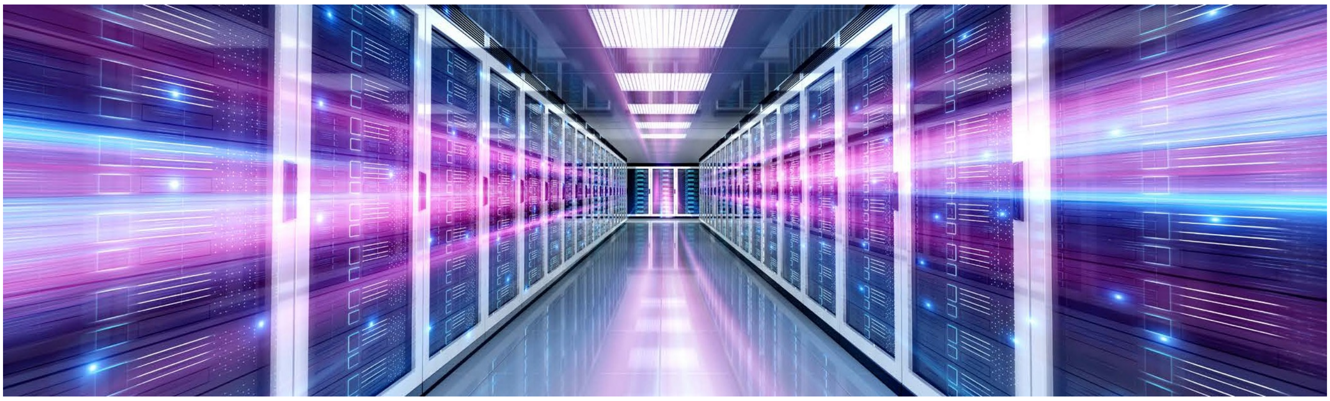
COVID-19 and its expected consequences will create a need for further cost reductions and related cost controls at banks[21], due to expected declines in profitability. In addition to this, the need for operational flexibility – i.e. seamless but controlled, allowing for deviations from the standard operating model in the face of uncertainty – will also increase going forward. Dedicated investments in cloud technology can facilitate this flexibility through the following mechanisms.

— **Optimizing Cost Allocation**
The cost savings of (public) cloud solutions are significant, especially given the reduction in initial CapEx requirements for traditional IT infrastructure. Saved costs can be reinvested in value-adding areas.

— **Flexibility in Peaks of Digital Traffic**
During periods of peak customer demand, the cloud can allow banks to manage computing capacity more efficiently.

— **Stimulating Innovation**
Additional services that require high computer power can be offered to customers, through the cloud.

— **Mitigating Risks**
The cloud can help to lower risks associated with traditional technology, such as capacity, redundancy and resiliency concerns.



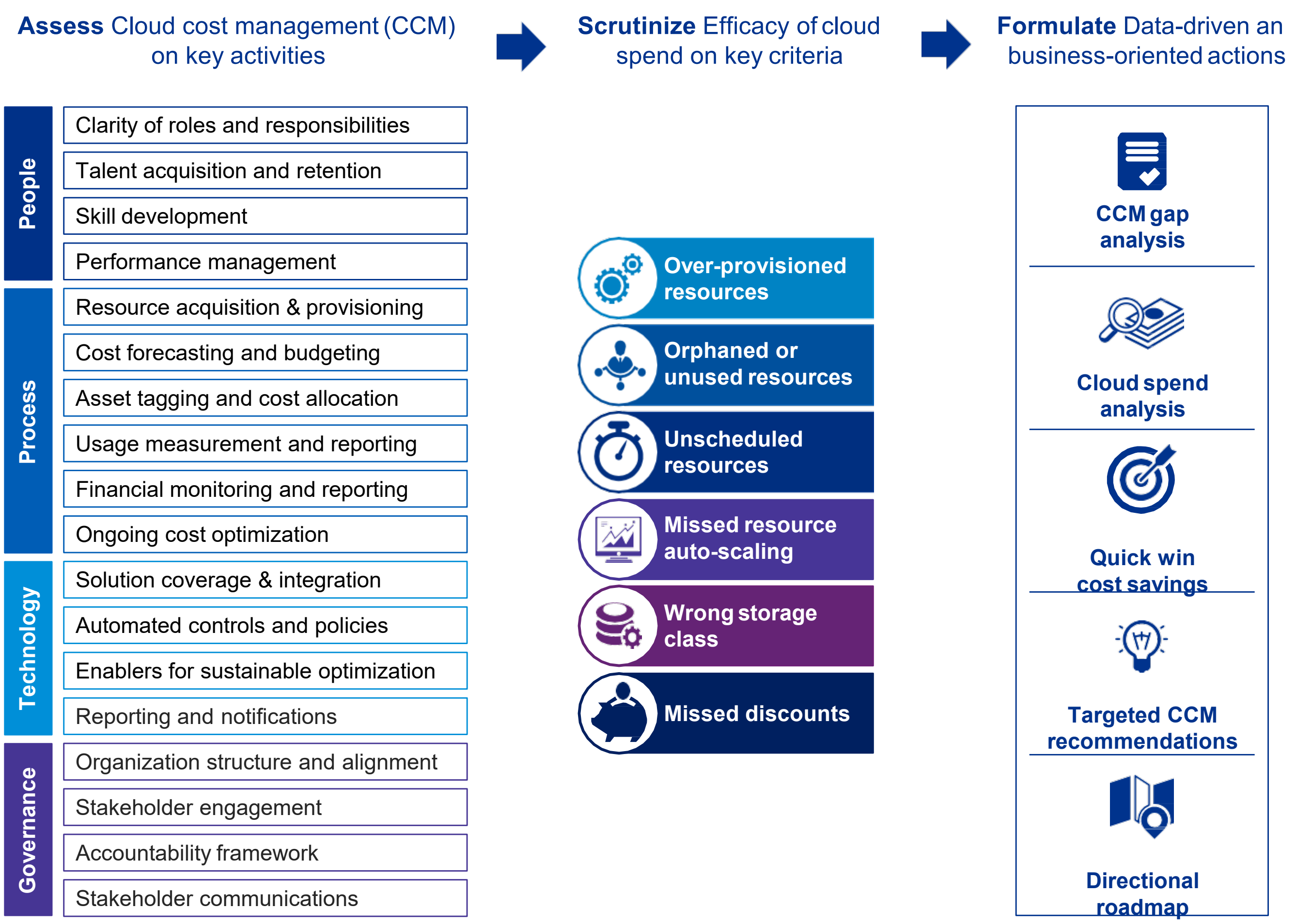
[18] CIO Survey (KPMG, 2019)
[19] State of the Cloud Report (Flexera, 2019)
[20] Cloud Investment and Real Value (KPMG, 2019)
[21] Capital Planning & Business Model Review (KPMG, 2020)

How to optimize spend on cloud technology for banks

Making cloud technology a strategic, cost-efficient and outcome-driven investment and activity for banks is key to achieving organization-wide objectives such as improved cost-efficiency, improved flexibility, secure working from home, and more – all objectives that are especially relevant now. However, the use of cloud solutions is often suboptimal users frequently fail to realize the initially planned level of standardization and cost benefits. In fact, only 21% of UK CIOs believe their organizations are highly effective at reporting and realizing the business outcomes of technology investments[3].

Due to the broad organizational impact of cloud technology, a multidimensional approach to assessing all costs associated with (multi)cloud environments is warranted. These costs should be benchmarked against industrial norms and subsequently scrutinized for efficiency gains based on a range of criteria. Once this is complete, organizations can gain actionable insights and identify quick wins. They can also draw up a directional roadmap that will informs the entire cloud investment strategy for the coming period, optimized on the basis of industrial best practices. Figure 1 highlights this process.

FIGURE 1 **Cloud cost maturity (CCM) assessment**



5. Strategic outsourcing to increase operational resilience

In times of market instability – like that created by the recent COVID-19 pandemic – it is essential for financial institutions to instill confidence and trust in their clients. Operational resilience and operating model flexibility will become increasingly relevant on this front. Sourcing (or outsourcing) offers an opportunity for banks to deliver significant impact. And done well and strategically it can reduce costs, improve services, and instill a spirit of innovation in banking institutions. It provides support in an increasingly complex and rapidly changing world.

— **Reduce costs and increase flexibility:** the standardization and higher efficiency of sourced processes will enable an organization to reduce costs. With cost structures based on volume, costs will fluctuate with demand

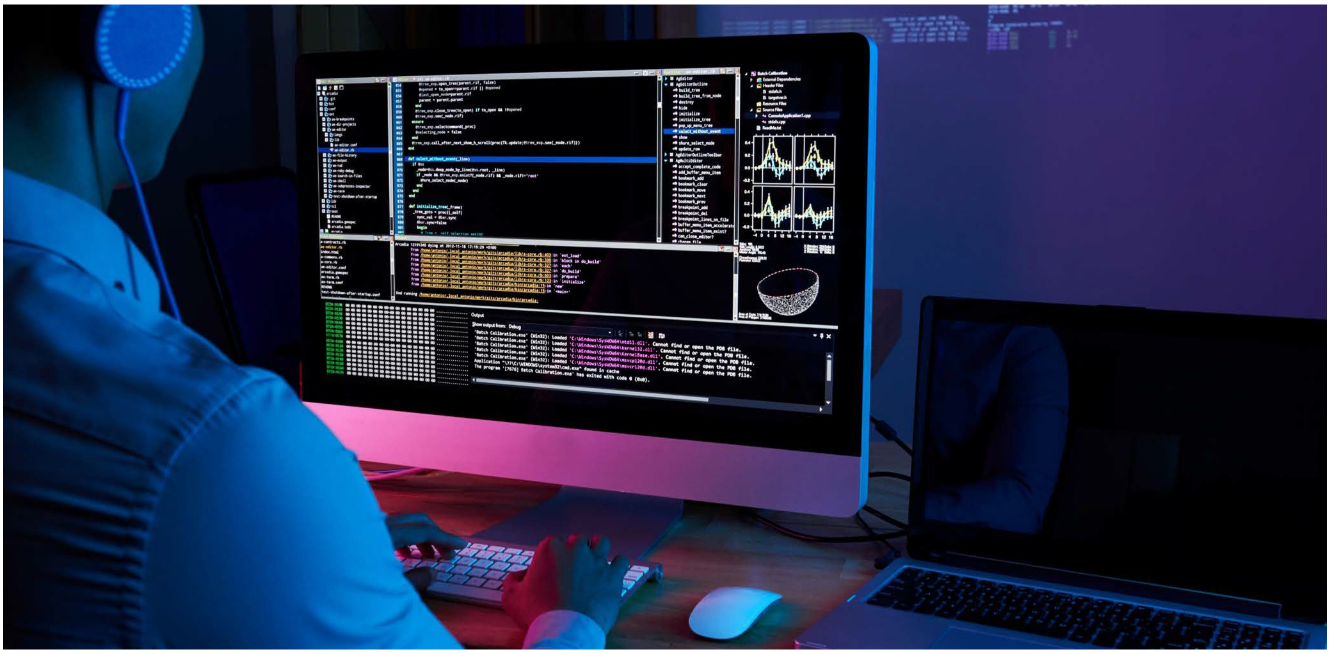
— **Improve services:** sourcing of non-core banking activities such as IT services enables banking institutions to focus on the improvement of their core-services.

— **Instill innovation:** institutions willing to provide innovative PSD2 services (AISP & PISP) often outsource the facilitation of these services to third parties.

Banks and other financial institutions can improve their services through standardization. Identifying and making a distinction between the differentiating and non-differentiating services helps them to identify sourcing potential. Sourcing non-differentiating services to a third party with dedicated knowledge and the potential to scale services enables banks to differentiate themselves through their unique selling points. The services and products offered are largely standard offerings and custom building standard offerings leads to a significant increase of effort without necessarily improving on the quality of a product/service. Although sourcing comes at a cost, it gives an organization the flexibility it needs to grow.

IT and cloud sourcing are increasingly popular among financial institutions, as they look to reduce complexity by sourcing IT services, infrastructure, hardware and even applications. Non-core business process sourcing is an equally prevalent type of sourcing, where administrative, HR, KYC, mortgage administration and transaction monitoring processes are handed over to expert third parties.

Parallel with the increasing demand for third-party support in the financial sector, the number of external services providers in IT and business process services is growing significantly. Sourcing the non-differentiating services of a financial institution creates room, both operationally and financially, for differentiating services such as client interaction. Saving costs on the ‘steady state run’ will also create room for innovative industry developments.



Increased scrutiny from regulators

The increasing popularity of sourcing by financial institutions has not gone unnoticed and awareness has been raised from a regulatory perspective. The European Banking Authority (EBA) published the final version of the "EBA Guidelines on outsourcing arrangements" in early 2019. These guidelines describe how financial institutions enter into, monitor and control outsourcing. As of September 2019, all outsourcing agreements entered into must comply with the new guidelines, and financial institution must devote specific attention to IT risks and controls[22]. The Dutch Central Bank (DNB) has stepped up its monitoring of how financial institutions enter into sourcing agreements and whether they remain in control[23]. This heightened scrutiny from the regulator demands significant effort from financial institutions on outsourcing–related internal controls, risk and compliance.

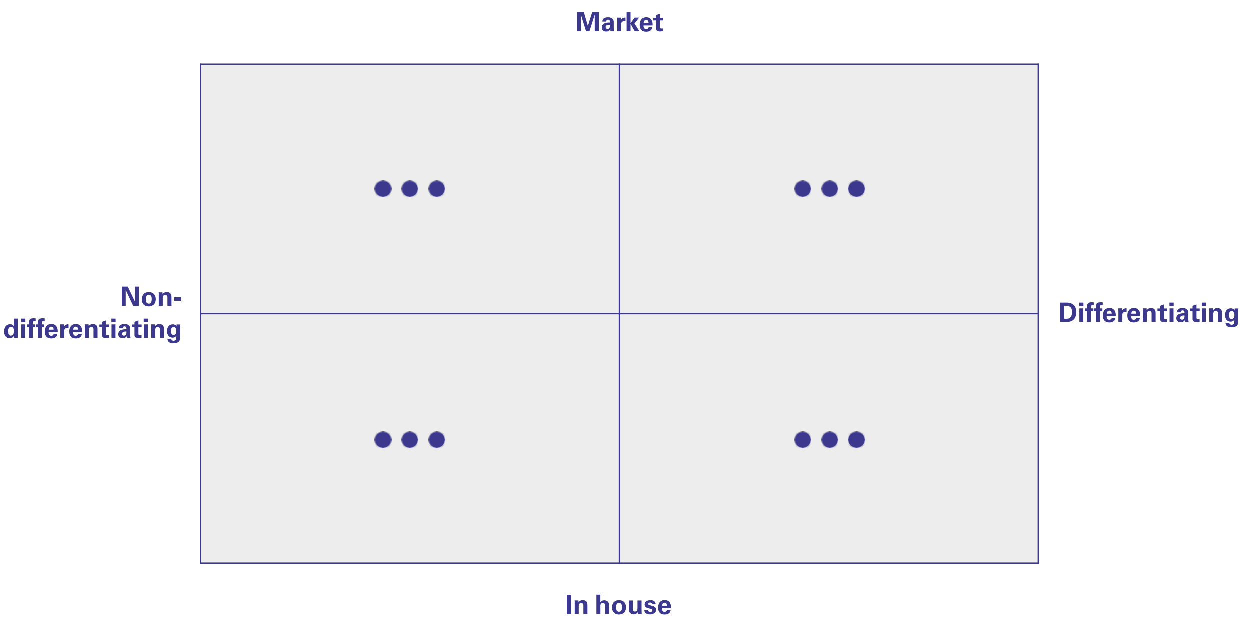
Redefining sourcing strategy to fit the new reality

The approach to controlled sourcing starts with a clear understanding and description of an institution's sourcing strategy and its correlated business case.

— *What are the institutions (non-)differentiating factors?*
— *What do the sourcing opportunities look like?*
— *And where is the potential in the market?*

Experience shows that the most essential yet highly challenging part of the sourcing lifecycle is the sourcing strategy. Determining an institutions sourcing strategy can be assessed along two axes, the horizontal axis defining what the differentiating products and services are, crossed by the vertical axes showing what the market has to offer (Figure 2). Finding a balance between the four quadrants can result in a highly effective and cost-efficient sourcing strategy.

FIGURE 2 **Sourcing strategy**



[22] SSM Supervisory Priorities (KPMG, 2020)
[23] Outsourcing at Financial Institutions (KPMG, 2020)

6. Leveraging Blockchain *to* Facilitate ESG-Reporting and Practices

Investing in Sustainable Finance assets represents a key growth theme for the Financial Services industry and tackles the root causes of climate change and social issues globally. As a consequence, more stringent ESG disclosure requirements for listed companies are coming into effect in the major financial markets such as London, Hong Kong and New York.

Clearly, ESG compliance is transforming from 'nice-to-have' to 'essential-to-consider' and many stakeholders feel the pressure to adapt and implement sustainability into their core operations, supply chains, products and investments. Talking to investors and listed companies, they start to feel the predication and operational effort to capture, process and report trusted ESG data assets.

This is often accompanied by the following key challenges:

— *Lack of transparency* and incomplete provenance in and across multi-national supply chains.

— *Duplicated reporting efforts* in preparing and sharing ESG data to/from multiple stakeholders such as customers, banks, investors, auditors, etc., and comply with the different frameworks and standards.

— *Lack of trust r misuse on the underlying data assets* would be a high risk to the investors and financiers

— *Capability barriers* for SME producers and brands to develop and market sustainable product lines or brands

KPMG Origins – The Infrastructure of Trust

KPMG Origins is our proposition of a blockchain based data exchange platform, enabling economic communities to store data in a independent, trusted single source of truth.

For ESG and sustainable finance, it is a Utility Platform to simplify the reporting effort for organizations and banks. It further drives top-line revenues through new offerings like parametric insurance and SME financing (e.g. targeted inventory financing or sustainable linked notes).

Selected Features:

- Record certifications and ESG data sets on an organization, SKU or product batch level
- Manage visibility and access permissions
- Act where certificates, reports or questionnaires are changing or about to expire
- Augment with information from a trusted third party

Rather than a mere technical solution, KPMG Origins also has a well-structured governance and decision making framework and the business and operating model that is expected from an independent, multi-party data platform, presenting an enormous consolidation and simplification for banks', investors' and corporations' reporting efforts.

Learn more here.

Case Study

The Queensland (Australia) sugar industry is facing a number of global and domestic challenges, largely driven by community and government expectation to meet strict environmental regulations in place to protect the Great Barrier Reef and, by the increasing demand of end-consumers to have access to sustainable sugar.

CANEGROWERS, the main industry body representing sugar cane growers across the state, engaged KPMG to investigate how to support the industry by improving collaboration, better sharing value and creating real-time demonstrations of their sustainability credentials using digital platforms and technologies like blockchain.

KPMG Origins is helping to unite the industry in a digital manner, improve stakeholder engagement develop a common data taxonomy model and guiding the industry towards a digital future. A world first in true sustainability traceability.

03 How KPMG can help

Supported by a global network, we can provide banks with a range of support services, as they set out to digitalize key aspects of their business to achieve strategic objectives, such as controlling IT risks, improving customer experience, lowering operating expenses, and more. KPMG takes a multidisciplinary and hands-on approach to a range issues, working with its clients to achieve meaningful outcomes.

Our advisory team combines strategy, technology, risk, M&A, accounting and regulatory consulting expertise in a number of areas, including:

Improving digital experience for customers

- Customer journey analysis and improvement
- Open banking strategy
- Fintech analysis and selection of additional services
- Support in licence applications to offer additional services

Ensuring cyber security beyond compliance

- Cyber incident response support and prevention
- Business continuity risk assessments
- Advice on and implementation of the automation of the Cyber Security function
- Offering cloud security as a solution, and devising cyber strategy

Outsourcing and cloud solutions

- Outsourcing policy, risk and governance management
- Business continuity planning and value chain assessment
- Partner due diligence, monitoring and reporting
- Cloud spend analysis and optimisation
- Gap analysis of capability maturity model, recommendations and roadmap

Rationalizing internal application landscape

- Quick scan and benchmark of current landscape
- Integrating business, financial and IT perspectives to build holistic business case
- Vendor selection for applications
- Co-creating through implementation services

Our services related to **Capital and business model resilience** and **Ensuring asset quality beyond COVID-19** may help to accelerate digitalization

Selected thought leadership

Consumers and the new reality
Retail banking and the consumer experience post-COVID-19

The future is open
Reshaping the banking experience: 2019 trends in review

The Future of digital banking
Impact of technology on banking in 2030

Banking on consumer platforms
Reshaping the banking experience

Supervision of outsourcing
Outsourcing at financial institutions

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