WHITE PAPER

Cost-Effective Customer Responsiveness Prompts Investment in Financial Services Value Chain Integration

Sponsored by: Sterling Commerce, an IBM Company

Maureen Fleming

November 2010

Global Headquarters: 5 Speen Street Framingham, MA 01701 USA P.508.872.8200 F.508.935.4015 www.idc.com

IN THIS WHITE PAPER

This paper looks at trends in the financial services industry that are causing companies to evaluate and revise their externally focused processes and integration capabilities in support of a wide range of business needs that include the ability to better meet regulatory requirements and internal data handling policies, provide greater responsiveness to customers, streamline operations, and pursue new business opportunities.

This paper shows how IT and business-to-business (B2B) teams are adapting their integration architecture by consolidating, standardizing, and improving their external and internal processes to help gain the speed and flexibility required to support critical business initiatives.

SITUATION OVERVIEW

Companies in the financial services industry are working to restore trust and confidence in the wake of the recent economic crisis. They are also focused on improving their external processes aimed at improving customer responsiveness. According to IDC Financial Insights, financial services companies are expected to spend the next few years focused on key initiatives, including:

- Financial services firms will look to make improvements in compliance, risk analysis, monitoring, security, business continuity, and reporting. They are also expected to tap into data faster and more efficiently to meet new regulatory requirements.

- Financial services firms will focus on better relationship management, looking to develop and improve relationships with key clients, vendors, and partners by improving externally focused communications and processes. Innovation around new offerings and speeding up cycle times to improve customer responsiveness are also important imperatives as the economy recovers.

- To capture new business and navigate the changing market landscape, financial services companies will accelerate the redefining of business models by leveraging cloud computing and software as a service (SaaS).

- Companies in this industry also face pressure to find new business models and compete on their ability to provide and utilize intelligence across channels and customers.

Improved Value Chain Integration Delivers Cost Savings and Growth

In discussions with financial services firms that identified value chain integration as a core strategic process, we found there was a consistent realization that they needed to shift their focus from point-to-point integration to a more architectural approach oriented toward standardization and reusability. This would allow them to minimize the amount of change required with the addition of each new relationship or change in business focus. By decreasing the time and effort involved with implementing any change, financial services firms are able to receive the business benefits of the change sooner. Those benefits may include:

- Cost-effective customer responsiveness
- Reputation protection
- Compliance with regulations around secure transactions
- Revenue growth from service innovation around a more dynamic value chain

Cost-Effective Customer Responsiveness

Many financial firms have invested to improve their processes around customer onboarding. Improvements in this area achieve faster time to revenue as well as greater customer satisfaction. Most onboarding projects involve automating the paperwork to sign up new customers or existing customers to new programs.

But for many complex corporate relationships, onboarding also involves automating the transactions that will flow between the two parties. This involves integration, with a need to establish the data mapping and translation logic to automate the exchange of data between the financial services firm and the customer.

By standardizing and automating the exchange of payment information and clearance and settlement information between a financial services firm and its corporate customers, both parties are able to reduce their costs and speed up cycle times.

Customer responsiveness also extends to a financial services firm's value chain. As enterprises continue to outsource core processes, such as credit card and payment processing, there is a need to improve reliable integration between the financial services firm and its service providers. For example, an insurer we spoke with was able to improve its partner onboarding times from six to eight weeks to an average of five to 10 days.

Meanwhile, the service providers are improving their processes involving integration to adhere to increasingly stringent service-level agreements set by their partners. Together, the financial services firm and its business partners are then able to improve their end-to-end process reliability and guarantee responsiveness to the customer.

Reputation Protection Through Focus on Reliability

In discussions with financial firms and their business partners, we found that there is a significant focus on being not only responsive but also cost-effective. The latter comes from reliability. By operating an infrastructure that is reliable and by implementing visibility tools to detect problems quickly and early in the processing cycle, financial services firms significantly reduce operating costs.

One national financial advisory firm was able to cut its troubleshooting — from alert to successful resend of a file — to an hour or less for most problems. Reputation problems come into play when there is a failure to deliver certain data — such as data tied to the movement of money — that can trigger regulatory action. Rapid response in detecting, troubleshooting, and resolving the problem will prevent any need for regulatory involvement.

Compliance and Proof of Compliance Around Secure Transactions

In the wake of the global financial meltdown, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed in July 2010, in part, to promote the financial stability of the United States by improving accountability and transparency.

These new regulations will result in significant expenditures in 2011 on activities related to compliance. Because financial services firms are highly interdependent and operate with sophisticated value chains, the ability to comply with requirements cost-effectively will involve B2B integration.

One area likely to change will be the need to provide an audit history of certain financial transactions as they flow through a value chain. By focusing on value chain integration, financial services firms will find that the secondary benefit of better control, management, and reusability is the opportunity to respond quickly to changes in the regulatory environment.

Because of the various current and emerging regulations, financial services firms are shoring up their ability to track and trace the flow of transactions, which is prompting a greater focus on reengineering their integration infrastructure around their value chain.

Service Innovation to Achieve a More Dynamic Value Chain

There will also be an opportunity to use an integrated value chain to grow revenue by improving customer responsiveness. As the tools become available to monitor and analyze transactional data and assemble single views of customers, financial services companies are better able to identify top clients and package and deliver information, services, and pricing on a custom basis.

Real-time and near-real-time interfaces offer across-the-board improvements, whether in data analysis, reporting, customer quotes, or error notification.

For example, using real-time interfaces, an insurance company is able to generate quotes in less than a minute by drawing on multiple data sources. Speed and accuracy are important in this scenario, as quotes are binding in some jurisdictions.

CASE STUDY

Note: IDC's typical approach for case studies is to name the specific customer, but this customer has requested anonymity due to the strategic nature of its story.

IDC spoke to a large United States–based property and casualty insurance company about its adoption of IBM Sterling B2B Integrator.

In the United States, the parent company's subsidiaries share most of their IT, accounting, human resources, and auditing services. Most of this company's IT operations are outsourced, although business-to-business operations are managed internally in the unit, focused on customer service.

Challenges and Solution

The company regularly exchanges data with banks, mortgage companies, auto finance companies, and state registries of motor vehicles (RMVs). The insurer is required to:

- Inform lenders of whether a home or vehicle is insured and whether the account is in good standing
- Report drivers' insurance status to the registries of motor vehicles in the states where its members write policies
- Reconcile records between the company, state department of motor vehicles (DMV) offices, and home mortgage lenders
- Work with third-party service providers for claims processing
- Receive epayments from customers via banks' third-party payment service providers
- Exchange data with fraud detection service providers

In addition, the company is required to support records audits of all of these transactions.

Challenges

Prior to adopting Sterling B2B Integrator, the company was handling the exchange of EDI- and non-EDI-based data through its IT operations. IT transmitted data via FTP with PGP security. Transmission over FTP was initiated by servers distributed across the organization.

When a partner informed the lines of business about a problem with the transmission, the business staff had to track down programmers to find out the status of the transmission and determine whether the data needed to be retransmitted. Because partner transmissions were addressed as part of the overall IT queue, business staff experienced long delays in troubleshooting and relatively high failure rates.

The company also was slow to onboard new partners, typically waiting six to eight weeks to bring a new partner on board. In onboarding, the business unit was the contact point with the partner and would set up the project. It then had to present the onboarding case to the IT group, which would advise how many hours would be involved with programming. Because B2B was not viewed as a priority, business units had difficulty getting to market fast enough.

Once the project began, the business unit had to coordinate testing between the partner and the IT project team. It also had to coordinate the exchange of security certifications.

The process was also time intensive, requiring four IT staff members and five to six business staff to handle onboarding.

Once the project was completed, there was not a clear understanding of which of the many FTP servers housed the onboarding code. With IT turnover, change management that required changes to a partner's mapping was problematic.

At the time, the company had about 80 trading partners and transmissions fail daily. This tied up resources not only on the business side, which had to hand off problems to IT, but also on the IT side, which had to troubleshoot the problems. Each failure required several days of follow-up, and not all problems were resolved.

In some cases, the file transfer problems led state DMVs to levy fines. The company had to use its legal office to negotiate with the state registries to allow it to continue underwriting in some of the states that were no longer willing to continue allowing the company to be out of compliance with their regulations.

Solution

Because business determined that partner and regulator integration were critical to success, the responsibility for B2B integration was moved to business. Part of that process was identifying software that would improve the reliability of communications with partners. The team was also looking for additional capabilities, including:

- Improve flexibility of communication with partners by supporting a wider range of communications protocols

- Provide total control and visibility of the exchange of all partner data across the company (The team wanted fast notification of transmission failures and visibility into the business processes.)

- Standardize and support all transfers across divisions on a single platform

Because the company used IBM Sterling Gentran EDI-based integration software on the mainframe and IBM Sterling Connect:Direct to transfer files internally in other parts of the company, the business organization went to Sterling to find out whether it had software that would meet the team's requirements. Prior to selecting Sterling B2B Integrator, the team also evaluated the B2B capabilities of its primary technology vendor. It also looked at one other vendor in addition to a proposal from the IT organization.

Business Case Rested on Three Important Areas

The business team also had to make a business case that substantiated the costs versus the benefits. The three main legs for the justification were:

- Compliance with state law
- Improving the customer experience of doing business with them
- Costs savings (In the business case, the team was able to identify process changes that reduced operating costs. For example, the company billed for a premium and received payment. By shifting to an electronic process, the company was able to reduce printing and postage while also reducing payment days outstanding.)

Implementation

A pair of Sterling Commerce consultants were onsite for 18 months to implement a detailed plan to support the core technology, provide training, and work with the business staff to modernize key partner processes, including a mortgage payment process, data synchronization with RMV offices, and support of mergers and acquisition audits.

Mortgage Insurance Payment Process

Most customers pay mortgage insurance from escrow accounts with their lenders. With the new process, the company sends the lender the premium invoice in a standard X12 format and the lender remits a payment file to the company designating which policies are to be paid. The lender follows up with a payment detail information file and a Fedwire transfer.

The financial transfer balances the account, and the funds are released into the company's accounting system and are then applied to the policies. The process essentially notifies mortgage companies about whether coverage is in place and whether any premiums are currently due. Banks then take that information and update their database. They also identify changes to insurers, when there is a switch from another insurer to the company.

Registry of Motor Vehicles Data Synchronization Process

The procedure is similar for state registries of motor vehicles. Because many U.S. states require minimum liability coverage, insurers are obligated to provide policy information. When the company writes policies in states that have active liability laws, the company sends data files containing proof of insurance. Those files also need to be matched to state databases. Records that don't match are kicked out and sent back to the company for reconciliation. The most common type of error is a mismatch of a vehicle identification number.

Partner Mergers and Acquisitions

In the case of mergers and acquisitions in the financial sector, a lender can initiate a book of business audit, through which the company cross-checks policies against the lender's records. In this process, similar to the state DMV process, the company sends and receives data via Sterling B2B Integrator. A bidirectional check is performed to synchronize the data. Where a record is not matched, an exception is kicked out that needs to be fixed and transmitted back to the requester.

This process is the same for auto lien holders and fire mortgagees, where they keep files synchronized with financial partners.

Results

The ability to reliably exchange data with the company's partners and state agencies directly affects expenses, cash flow, and standing with customers and regulators. Whether measured by reputation, service-level agreements with penalties, statutory fines, or the ability to do business in a given state, the company's performance has improved.

The company currently exchanges files with several hundred partners globally, with 19,000 transfers exchanged weekly. The number of partners roughly doubled from 2008 to 2009. Major factors in the increase included the addition of vendors for claims processing and fraud investigations that the company handles through outside vendors. The company also acquired other insurance companies and uses Sterling B2B Integrator to manage the reporting requirements to lenders and DMVs as well.

The business group supporting automotive, mortgage, and claims processing operations saw an increase of 15 additional partners during that period and expects further growth.

Benefits

Since upgrading to Sterling B2B Integrator, the company realized improvements in bottom-line financial terms, including direct cost savings, improved reputation, and significant gains in productivity.

- **Direct cost savings.** In 2009, the company realized $8.6 million in direct savings by converting a paper and postage mortgage lien process to an electronic process. Similarly, the software has helped eliminate human intervention in the billing and receipt of $1.4 billion per year.

- **Improved reputation.** In terms of reliability, the company is able to exchange data with partners with an exception rate of less than 1%, which is much improved from the past experience using FTP servers. The company's lawyers no longer need to negotiate with state agencies about compliance issues. This translates to an improved reputation in the market.

- **Significant improvement in staff productivity.** This success is reflected in staffing. Prior to the switch to Sterling B2B Integrator, there were nine to 10 full-time employees involved with onboarding, partner change management, and troubleshooting. The company currently has two full-time employees handling double the number of partners and volume of data exchanged. Despite the smaller staff, partner onboarding cycle times showed a dramatic improvement, from an average of six to eight weeks to an average of one week.

ESSENTIAL GUIDANCE

The use of technology to integrate and improve externally focused processes offers financial services firms strategic capabilities for responding to post-collapse regulatory requirements, identifying and capitalizing on new business opportunities, and increasing the reliability and predictability of their business-to-business interactions.

Aside from cost savings from improving B2B operations by increasing the efficiency of integration, a range of business benefits should be considered in making the business case for adopting B2B software:

- Shifting from paper to the electronic exchange of data can save millions a year. If there are manual processes that could be automated, this is a straightforward way to justify an investment in improved B2B integration.
- Preventing bad customer experiences can improve an enterprise's reputation and result in better retention rates or new business.
- Maintaining up-to-date, synchronized data between different systems within an enterprise and between partners allows the organization to make decisions based on current data. This has almost immeasurable benefit.

There are also several important considerations:

- Standardizing the process of integration is very important. In discussions with organizations that have built this into an art form, we found that the focus is very architectural, with reusability critical to keeping reliability high and costs under control. Standardization also transfers to the set of products used. We've found that when organizations support multiple integration products as well as open standards, like FTP, there is needless redundancy in staff to handle onboarding, change management, troubleshooting, etc. From a process context, this translates to waste — and waste translates to reduced profitability.
- Command and control is an important selection point. Key to that is visibility, with the ability to see exactly where the transmission is compared with its delivery schedule. When the exchange involves a file, being able to identify and automatically notify source administrators that a job failed to start is also critical in this category of software, given the length of time it can take to deliver a large file.

FUTURE OUTLOOK

There will be a continuing trend in financial services to move more processes to third-party service providers, increasing the complexity of the value chain. That means there will be a need to put greater emphasis on efficiency around core activities associated with the value chain, including partner onboarding, real-time problem detection, and partner performance monitoring.

According to IDC Financial Insights, financial services companies will need to cut IT costs significantly. To reduce high maintenance costs, they are expected to simplify and consolidate infrastructures. One area of cost savings from consolidation will involve integration. Customers in this white paper focused on standardizing internal and external integration using the same core technology because they recognized the importance of integrating their value chains into their core processes.