



Are You E-ready:
Going beyond Internet banking and seize the higher
technology ground.

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Surfs up! Financial institutions are lining up along the beachfront of the technology coast to compete in the technology wave competition. Forecasters are predicting a big turnout with tough competitors vying for the grand prizes of more customers and more cost effective delivery channels.

Why is this event drawing such a crowd, and what are some of the techniques and concerns of the participants?

Internet banking activities are growing among savings associations and other commercial firms. Clearly, federal savings associations are rapidly expanding their use of the Internet as a delivery channel for products and services.

Community banks and thrifts already have a reputation as a safe, sound, and secure place to transact business. This level of trust gives them an opportunity to attract new customers and retain existing customers by offering innovative services in a comfortable environment. As they continue to build a client base for Internet banking, they are in a position to offer additional “plug-in” services. For instance, they can become a portal of services for:

- Digital certification;
- Bill payment and presentment;
- Check imaging;
- Account aggregation;
- Insurance;
- Financial planning and investing;
- On-line real-time loan applications; and
- E-commerce.

Certainly, there is considerable competition among insured financial institutions and other firms offering Internet services. Any of the above services can be made available to the consumer by savings associations or other commercial firms.

Community banks and thrifts can offer these services directly or contract with vendors to outsource services. For example, a large bank may decide to retain in-house resources to support Internet banking, electronic bill payment, electronic investing, and other electronic services with a 24/7 help-line. Alternatively, a smaller association may opt to form an alliance with various vendors, outsourcing its electronic bill payment, e-commerce, on-line loan applications, electronic investing, and 24/7 help-line support.

Community banks and thrifts may also establish co-branding with commercial firms. For example, the consumer may prefer using a favorite portal to access the best loan or deposit rate, or to price a car, book, or insurance policy. Or they may want to see recent bills and authorize payment. Non-bank entities are already building portals that offer

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many or all of these services, including financial products. Banks and thrifts must consider how they will compete for customers in such an environment.

Under these and many other scenarios, consumers may begin to look for trusted certification labels such as the:

- FDIC-insured logo;
- TRUSTe privacy stamp;
- BITS, ICSA, or WEBTRUST certification; or,
- Better Business Bureau seal of approval.

Potentially, the consumer will view these labels as a representation of a behind-the-scenes protection, much as they now do deposit insurance when banking in the traditional way.

As consumers look for one safe and convenient source for Internet services -- such as banking, investing, loans, or buying a car, book, or insurance --, insured and commercial activities will be commingled. This blended offering of services may blur the line between insured activities and uninsured and commercial activities, if not done properly. The bank may also be exposed to additional liabilities. While the regulators want to allow for the use of technology within a free market, they will monitor these activities to ensure they are safe, sound, secure, and compliant with existing federal regulations and that institutions make a clear distinction between insured and uninsured products.

Look to a New Paradigm

Ready or not, the technology wave is cresting over almost every aspect of banking. It is no longer a back-office operation that can be viewed as a single cost center or line item in the budget, and it is no longer an area that falls solely on the shoulders of information technology personnel. The management of technology risk has become an integrated aspect of most business operations. Whether you are a CEO, CFO, CIO, senior executive, auditor, examiner, or consultant, you should enhance your understanding of the benefits and risks associated with technology and how it now blends with today's business strategies. Financial modernization, the Internet, and new technology are changing the landscape.

If you haven't started already, it is time to contemplate the role of the financial services industry for tomorrow and beyond. You need to consider some new ideas that could help you keep pace with today's changes and position you to better understand and manage the new risk. You may not agree with all of these ideas, but that's okay (it's human nature). You know best what your strengths are, who your customers are, and where you want to be this year, next year, and years into the future. The purpose here is to plant the seeds of some new ideas and risk issues that may help you get there.

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Banking is undergoing dramatic change once again. In the past, the advent of the mainframe, then the mini computer, and finally the personal computer caused similar revolutions in the banking industry. Now e-banking, m-banking, and electronic operations via the Internet are causing a new era of banking.

As each new era takes hold, people, tools, and methods undergo significant change. In short, there is a human side and a technical side. New tools and systems spur humans, both those who run the financial institutions and their customers, to explore new frontiers of banking conduct.

What is happening is simply that we are now exchanging information and money in electronic form. As Nicholas Negroponte explains this transition in his book, "Being Digital," society is changing from one of transferring atoms (physical tangible items) to one of transferring bits (electronic information digitally made of zeros and ones).

As we become more reliant on this electronic form of exchange, we rely more heavily on the use of technology designed to allow outsiders in, not keep them out. The movement of paper and back office operations is being replaced with networks, e-mail, instant messaging, databases, wired and wireless personal computing devices and the Internet.

This new paradigm can affect every aspect of your business.

Nature of the Beast

The power of the Internet and new technology changes our traditional understanding of strategic planning and risk. Technology has to move from the backroom to the boardroom. More institutions than ever now understand the strategic importance of technology. They are becoming increasingly aware of a potential downside: greater dependence on technology and the lurking pitfall of not keeping up with technological innovations and adopting it to improve operations. Whether or not you choose to offer products on the Internet or with new technologies, the Internet and new technology is changing the competition for banking customers, the behavior of your customers, and costs and profit opportunities in your market.

In the struggle to keep pace, it is important to remember that as you become dependent on technology and electronic information, your corporate risk profile increases. As your risk profile changes with the influence of technology risk, guess who understands the new risk best? – The techies! Your technical staff will usually anticipate a problem before it occurs. That's because they understand the technology, with its inherent problems and risks.

The challenge is to:

- Raise the board's awareness to these new risks;

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- Bridge the knowledge gap between technical staff, senior management, and the board; and
 - Build a strong and flexible infrastructure that can operate at Internet speed.

Plan @ Internet Speed

It is the rare financial institution that will thrive in this dynamic environment simply by doing what it has always done with the customers it has always had. Yet, where there is change, there are new opportunities. So it makes sense that you would explore new uses of technology and find improvements for blending your business and technology to improve your ability to retain customers and find new ones.

The question that everyone constantly struggles with is how to pull together a realistic game plan that will help your institution take advantage of opportunities and achieve the goals you have set. The answer, of course, is strategic planning. Done well, strategic planning - while demanding - is a rewarding exercise.

The need for an engaged, committed board and visionary management team has never been greater for financial institutions. Effective strategic planning is absolutely critical to the future success and survival of your institution. Identifying what you do best through the planning process, finding your niche in the market and deploying capital effectively to these areas to provide superior customer service will help you to remain competitive.

It's important to realize, however, that a strategic plan is dynamic and always changing. We used to refer to a three- to five-year strategic plan. Recently it was considered a quarterly process. Now, the brain-children of strategic planning believe it's daily! How the heck do you do daily strategic planning?

Here are a few steps that may help you in the planning process – there probably are others:

- Recognize that the competition within your market is no longer limited to the other banks and credit unions in town. The Internet has opened your market to the world.
- Monitor the competition's offerings on a daily basis, especially the Internet competition – it can change daily.
- Try to identify the threats and opportunities that the changing competition creates.
- Evaluate, daily, your options for meeting new opportunities, or defending against competitive threats.
- Pursue actions that are consistent with your broad business goals, the expertise of management and staff, and your systems, tools and resources - or your ability to obtain new skills and resources.

Indeed, the power of new technology and the Internet are changing our traditional understanding of strategic planning and risk.

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The best way to manage the strategic risk is by establishing a thorough board approved strategic plan. But along the way, you need to beware of what could be called the “light bulb” effect. For example, an institution develops and begins executing a plan for simply adding a new Internet delivery channel to its local community-based customers. Then the bulb lights up and the institution quickly realizes that with a few more dollars in marketing, it can reach customers nationally. That spells (T-R-O-U-B-L-E) trouble.

Before you make such a switch in direction, you must assess the capacity of your infrastructure and the ability of your staff to enter new markets. The financial impact on your capital and interest-rate risk should also be considered before you expand your customer base.

Two of your strongest attributes are knowledge of your community and customers and the high-quality service you can provide them. The questions you have to answer include:

- Who will be your customers in the future?
- What products and services will they want?
- How can you serve them directly by yourself, in strategic alliances, or as part of a larger corporate family?

In discussing new business opportunities, no institution should abandon its current customer base. As you well know, keeping customers is far less expensive than getting new ones. But to keep these customers, you need to continuously consider strengthening and expanding your core business by making a conscious effort to find out what products and services your customers really want—what are the things that could drive them to the competition if you don’t make a move?

Turn their concern, and yours, about security and privacy into a competitive advantage. Trust is your stock-in-trade. Consumers still trust their bank in a way they may not trust some other financial service providers. Make the most of it!

Continuously Reinvent Yourself

Moving to e-banking and other new technologies requires management to rethink traditional strategies. Today, a company’s success requires challenging traditional assumptions about organization, communication, decision-making, operating style, managerial behavior, and what tools to use. To take full advantage of the potential for e-banking and new technologies, management must lead differently and people must work together differently. Rosabeth Moss Kanter (from the Harvard Business School) captured this idea best when she called this new way of working “e-culture.”

One very important lesson Y2K taught us is the importance of communicating within your organization, with each other, and especially directly with customers.

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All operational areas (audit, compliance, legal, technology, and operations) need to be talking laterally, not hierarchically. For example, managers must learn to spread information, not hoard it. Break down those cyber silos and get all departments talking and networking.

Networking outside and inside your organization is crucial to your ability to survive and deliver the right products and services when needed, not 6 to 12 months after the competition. Through networking, you can extend a family of business relationships through partnerships or alliances, offering products and services more efficiently and cost effectively. This is often referred to this as the outsourcing trend.

As financial institutions search for new customers and the demand for better more cost-effective products and services increases, financial institutions are initiating or expanding their use of the Internet, technology, and third parties to deliver products and transaction-based services to attract and retain business.

The trend toward outsourcing technology and other electronic operations is likely to continue. Significant technical expertise and sophistication are required to design and implement a secure and reliable Internet banking system. The cost to license software or purchase services from a vendor is significantly lower than the cost to develop and maintain a proprietary system.

Do your due diligence evaluation of the vendors. Financial stability of a third party vendor is critical. Make sure you negotiate enforceable contracts. Here is another area where cyber silos must be dismantled. All departments need to work together to ensure the contracts cover all your needs.

Safe, Sound, & Secure

Clearly, the popularity of new technological capabilities such as e-banking, m-banking, e-bill payment, and account aggregation has raised everyone's awareness of the benefits as well as the risks associated with these delivery channels. As you employ these new technologies, you must make sure that you have established an adequate infrastructure to protect your institution and your depositors from misuse or abuse of the service.

Since many institutions have only recently begun engaging in these electronic activities, there is a lot of potential for trouble. For example, a weak security program, poor planning, insufficient audit coverage, or lack of good contract management can expose an institution to risk.

One of the best ways to ensure you have an adequate infrastructure is through your audit function. Get audit, compliance, legal, operations, and technical folks talking early.

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Cyber silos and poor communication can cost significant capital! You do not want to build anything twice.

Update your procedures to reflect new delivery channels or medium. And train your staff and customers. Don't expect or think your new products are so user friendly that no training is required; at least test-drive it on an independent sampling of users. And use your audit function to help validate your methods. Under the regulators' risk-focused examination approach, examiners will look first at the strength and results of your audit function.

A safe, sound, and secure methodology does not include just one solution. It requires open communication throughout your organization and a "layered solution" of comprehensive controls. A layered solution means the use of a variety of different risk management techniques. Typically, a layered approach will include:

- Proper planning that blends your use of technology with your business strategy;
- Open communication across organizational lines;
- Effective internal or external audit programs that include a review of electronic activities;
- Due diligence of third-party vendors (including their financial stability and infrastructure);
- Independent reviews and penetration tests of your systems; and
- Enterprise-wide training.

As you reinvent your organizational style, break down cyber silos, and establish an adequate infrastructure, you will create a constant feedback loop that can provide real-time knowledge to senior management, strategic partners, risk managers, and operations staff. An effective feedback loop can create new interactions between people that will, in turn, create new value.

So as you contemplate the role of your financial institution for tomorrow and beyond, prepare yourself to move at Internet speed. But do it with an up-to-date strategic plan. Do it with lateral communication throughout your organization and among your partners. And do it with a safe sound and secure supporting infrastructure that allows you to react and, if necessary, change direction quickly and prudently.

ABOUT REYMANNGROUP, INC.

ReymannGroup, Inc. provides finance and healthcare regulatory subject matter expertise. We assist companies in evaluating their information security infrastructure, determining exposure to vulnerabilities and threats, prioritizing solutions, and complying with legal and regulatory requirements. We provide you with "independent" high-caliber professionals, authors of regulations, and subject matter experts familiar with financial and healthcare industry regulations and best practices. Our experts will meet and exceed your business need. For more information contact or e-mail us at (410) 956 7334 or info@reymanngroup.com.

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Paul is the founder and CEO of ReymannGroup, Inc. Mr. Reymann is one of the nation's leading financial institutions regulatory experts and co-author of Section 501 of the Gramm-Leach-Bliley Act Data Protection regulation. Mr. Reymann has more than eighteen years experience in the financial services industry, including thirteen years with the Department of Treasury's Office of Thrift Supervision (OTS) in Washington D.C. There he guided the regulatory agency's Technology Risk management activities and authored several key regulatory directives and advisories on emerging risk management issues, including the industry's first regulatory directive on "Transactional Internet Banking."

Fortune 500 companies have leveraged Mr. Reymann's subject matter expertise. He is referenced frequently in industry news and magazine articles. He is also the author of numerous articles and papers on technology risk, transactional web sites, customer information, network security and other technology and safety and soundness topics.

Mr. Reymann is recognized in the prestigious 2006 Heritage Registry of WHO's WHO. He is referenced frequently in industry news and magazine articles. He is also the author of numerous articles and papers on technology risk, transactional web sites, customer information, network security and other technology and safety and soundness topics.