Sawyers & Jacobs LLC
1085 Halle Park Circle
Suite 101
Collierville, TN 38017
Phone: (901) 487-2575
Fax: (866) 488-4933
jsawyers@sawyersjacobs.com

Jimmy Sawyers
Sawyers & Jacobs LLC

Top Ten Trends Impacting Bank Technology for 2013

Growing up in rural West Tennessee, I learned many valuable lessons during long summer days spent shooting BB guns, playing sandlot baseball, riding horses, and roaming the deep woods and river bottoms seeking adventure. For my buddies and me, our favorite days were spent at our "campsite" where we had several Lord of the Flies moments as we tested our skills and courage. At this campsite, some of the older boys had hung a rope from a gigantic oak tree. Like a troop of monkeys, we spent countless hours swinging on that rope which was positioned over a deep gully.

To succeed, one had to get enough momentum to reach the other side of the gully but know when to let go of the rope and land safely on the other side. Not enough momentum and one would swing back, lose control and either crash George of the Jungle-like into a tree or twist helplessly until someone with a long branch could rescue you from your failure and humiliation. Likewise, not timing the release of the rope just right could result in a rough fall and some scrapes and bruises. But, a bold swing with a well-timed release would result in a perfect landing worthy of Tarzan.

It was a great feeling and typically established one as not quite *Lord of the Jungle* but certainly *King of the Campsite* for that brief moment in time.

In the jungle that is the banking industry, the past few years have seen some bankers hesitant to take a swing at all and some who swing but are reluctant to let go of the rope. The result has been much twisting in the wind and just hanging on, safe from the bumps and bruises associated with a hard fall but not moving forward and not having much fun.

As we look ahead to 2013, we believe now is the time to take that bold swing and make that perfect landing. Employing the right technology will be critical to success. To score that landing, we offer the following predictions:

Prediction #1 - Tablet Computers Evolve with Some Misfires Along the Way

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Apple hits another homerun and will see insatiable demand for the iPad mini due to its size and price point. The Microsoft Surface tablet will miss the mark initially due to its higher price point, limited marketing, and poor distribution by big box retailers but will rebound as more users demand Microsoft Office capabilities from their tablet computers. Despite my hope that Microsoft will unite the devices and offer Windows phones, tablets, gaming systems, and laptops on a single interface allowing access to network resources within one's organization and from the cloud, it appears I'll have to wait a bit longer. Windows 8 adoption will be slow as many bankers just recently upgraded from Windows XP to Windows 7 and will prefer to stick with 7 for the time being, partly due to their banking application vendors being slow to certify Windows 8. Those users who migrate to Windows 8 will find that having a PC with a touchscreen increases utility.

However, don't count Microsoft out. By the end of 2013, expect Microsoft to adjust its course and get closer to the device unity we all seek. In the meantime, maintain a flexible tablet computing strategy as last month's hot buy will cool quickly and next month's new version will continue the tablet evolution. According to the Pew Research Center, as of October 4, 2012, 25% of American adults owned a tablet computer, up from only 4% in September 2010. Faced with the realization that prohibition is futile, bankers will deploy more sophisticated tools to manage the increasing number of BYOD (Bring Your Own Device) endpoints on the network, resulting in better security, increased efficiency, controlled costs, and a more engaged and productive mobile workforce.

Challenge Question: What is your bank's tablet computing strategy?

Prediction #2 - Small Banks Get Serious About Small Business

In 2013, bankers will seek to expand their small business relationships by "banking the family" which will include business owners, their families, and their employees – the work family. By offering a full-service banking package, complete with mobile banking via smartphone and tablet, interfaces to QuickBooks and other leading small business accounting systems as well as PFM (Personal Financial Management) solutions, bankers will cement these profitable, long-lasting relationships.

One obstacle that remains to executing this strategy is many banks' inability to define the customer relationship and offer a summary view. Legacy systems that are still Customer Information File (CIF)-based will require a database re-boot to meet the sophisticated demands of tech-savvy business owners who expect their bankers to know them by more than just their account numbers. Community banks will benefit from missteps made by their big bank brethren whose fee structures continue to contain more sticks than carrots.

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Challenge Question: Can your bank define a small business owner's entire banking relationship on one page?

Prediction #3 - Security Strategy Becomes as Important as Security Tactics

As recent security breaches have shown, security is no longer a minor issue relegated to matters of password composition and acceptable use policies. Security has become a strategic issue that can make or break a bank or a technology provider. Expect more banks to develop Security Strategic Plans as Data Loss Prevention (DLP) programs complement banks' Information Security Programs and other risk management efforts.

Bankers will realize that security at outsourced providers is just as important as security within their banks. It doesn't matter where the hardware or the data resides physically, the responsibility for security cannot be outsourced. Technology providers will be pushed to answer tough questions and prove adequate controls beyond the basic SSAE 16 (formerly SAS 70) requirements and reporting.

Cybercrime will increase as criminals get more sophisticated, networks become more open, and data becomes more mobile. Small business customer relationships will require collaborative security awareness education to help mitigate risk of account takeovers and resulting ACH and wire fraud.

Challenge Question: What is your bank's security strategy?

Prediction #4 – The Checking Account Gets Modern

Despite the technology available, some banks' checking accounts operate no differently than they did 50 years ago. Driven by consumer demand for convenience, the checking account will undergo an extreme makeover with better access and increased use of technology channels. Prepaid cards such as Bluebird, a joint venture by American Express and Wal-Mart, will force bankers to break out of their comfort zone and make the checking account the feature-rich centerpiece of the customer relationship. Email and text alerts, subaccounts for family members, remote deposit capture via smartphone, mobile photo bill pay, person-to-person (P2P) payments, customized debit cards, and free ATM access will all become expectations by today's advanced consumer.

Long a difficult sell for most banks, bill pay will see revived interest as customer fatigue over frequently reissued credit cards (due to third-party security breaches) causes cancellations of the bill pay via credit card *pull* and stimulates conversions to a lower maintenance bill pay *push* from checking. Innovations in small business credit, such as Google's AdWords Business Credit Card, will force bankers to offer qualified small

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business owners easier access to credit through a variety of specialized channels. Bank surrogates such as SmartyPig, Mint, and Simple will push bankers to birth some of their own new, high-tech apps for visual banking via mobile devices.

Less focus on systems and compliance and more focus on utility and the customer experience will blast the rust off the checking account and help banks compete with the increasingly innovative products and services of non-banks. Also, expect banks to begin dispensing prepaid cards at ATMs to answer Bluebird's call to the banked and the unbanked. According to a 2012 NerdWallet study, the average prepaid card charges nearly $300 in basic fees each year. Bankers will reel these lost customers back in with their own versions of prepaid cards (in the slow-dying plastic form and in new smartphone apps) as an extension of the checkbook.

Challenge Question: Are your checking accounts using all the technology features available via your advanced systems?

Prediction #5 – Strategic Technology Planning Becomes Critical to Bank Survival

After years of playing the waiting game with many tech projects put on hold or grossly underfunded, bank CEOs will call on their IT people to become more strategic to help banks grow. IT should be a means to an end, not an impediment to progress. Those who craft strong strategic technology plans will map a course for success.

Smart bankers will realize that operations and technology benchmarking is a futile exercise designed to make their banks followers. Instead, they will look inward to the individual bank's productivity, efficiency, and decision-making ability to craft strategies and monitor performance unique to the bank, its customers, and its markets. The proper inward focus on what makes the bank successful will trump an overly outward focus on the competition. As Ralph Waldo Emerson said, *"Do not go where the path may lead, go instead where there is no path and leave a trail."*

Challenge Question: When it comes to strategy and performance, is your bank an "innie" or an "outie"?

Prediction #6 – Effective Vendor Management Exposes the Pretenders and Rewards the Performers

Faking sincerity won't cut it anymore. Bankers will require their providers to demonstrate and deliver value, not just talk a good game, as they inventory their contracts and determine what they *bought* and what they got *sold*. As we tell our clients who engage us for system selection help: (1) Have a compelling reason to convert,

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otherwise don't; and (2) the incumbent is the leader until unseated. In 2013, expect more compelling reasons and more incumbent fumbles.

Recently, during a system selection engagement, a relatively new core processor refused to answer the bank's Request for Proposal (RFP), which was very brief but required the vendor to answer certain questions in writing. The vendor's refusal smacked of the quote, *"Ask me no questions and I'll tell you no lies."* Some attribute that quote to the Anglo-Irish novelist, playwright, and poet, Oliver Goldsmith but the more cultured among us prefer to credit Ernest T. Bass from the Andy Griffith Show. Clearly, this vendor did not want to be subjected to the scrutiny that the RFP required. That was a major red flag and needless to say, that is where the vendor was dropped from the evaluation process.

Challenge Question: Is your bank's technology provider marriage a happy one or is it time for counseling, separation, or divorce?

Prediction #7 - The Core Processing Outsourcing Trend Continues But Invites More Scrutiny

The core processing provider oligopoly we reviewed last year is having an impact as more providers attempt to drive banks to the outsourced environment where providers can improve their profit margins as they leverage their data center investments and wring more efficiency out of recent acquisitions. The majority of community bankers have been on their current core processing system for over 10 years with 55 percent outsourced and 45 percent in-house (Source: ICBA), not exactly an area with frequent change. Some core processing providers now refuse to submit in-house proposals. This lack of competition and choice is not good for banks.

Bankers will begin to push back slightly as they realize that outsourcing comes with its pros and cons: Pros in terms of limited capital investments and cons in terms of higher per unit costs of growth and less control.

Core processing provider decisions are no longer just about who runs the bank's deposit, loan, and general ledger systems. Such decisions are now about much more, including the bank's image item processing, ATM/debit card processing, ancillary systems such as document imaging, loan origination, teller and deposit platforms, and new delivery channels and payments systems demanded by more mobile consumers. Such a decision is critical to the bank's future ability to compete. Complex decisions such as this require intelligent and thorough analysis.

The trend to outsourcing will continue, but bankers (and their examiners) will scrutinize vendor claims of "don't worry about disaster recovery" as recent tornadoes, ice storms,

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hurricanes, and floods have exposed the Achilles' heel of outsourced providers, especially those with data centers in coastal areas. Even the most geographically challenged bank customer has a hard time understanding why a Florida bank's systems are down because of an ice storm or a Missouri bank's systems are down because of a hurricane. Natural disasters aside, security breaches will continue to plague third-party processing centers. As with any low-probability, high-impact (Black Swan) event, the vendor's future reputation depends on how the incident is handled, not that it happened. Expect outsourcers to further harden their data centers and their business continuity and incident response plans.

Challenge Question: Does your bank's dependence on third-party relationships present an acceptable level of risk?

Prediction #8 – Enterprise Risk Management Models Mature and Become the Centerpiece for Every Well-Managed Bank

Enterprise Risk Management (ERM) has many definitions but can be simply described as a process that provides a high-level, top-down view of a bank's key areas of risk, allowing the bank's board of directors to identify potential threats that may affect the bank and therefore help to manage the bank within the bank's tolerance for risk.

Flying the bank by the seat of one's pants is no longer adequate. More sophisticated and quantitative measures of risk must be used in a rapidly changing banking environment. In recent years, bankers have faced risks for which they were unprepared, and in some cases unaware. These risk events caused some banks to crash and fail as they lacked the resilience to bounce back from adversity by mitigating risk and limiting the bank's exposure.

Every castle wall is only as strong as the people behind it. Overseeing risk management enterprise-wide is a key role of a bank's directorate. Without clearly understanding possible threats, their likelihood of occurrence, their magnitude of impact should they occur, and their related risk, board members cannot make the informed, strategic decisions necessary to manage risk and preserve and grow stakeholder value.

Challenge Question: Does your bank have an Enterprise Risk Management program customized to its unique environment and challenges?

Prediction #9 - The Customer Relationship Culture Replaces the Sales Culture

Think about your last purchase. Did you "buy" something or were you "sold" something? In today's information age where one can research products and services online before buying, the old sales tactics simply don't work. By focusing on the

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customer relationship, bankers can implement a culture that has customers buying products and services because they want to, not because they are being accosted.

Bankers will ask more out of their core systems and will buy more advanced CRM (Customer Relationship Management) systems as they attempt new ways to define value in customer relationships. Consumers continue to be influenced by loyalty programs when choosing an airline or hotel or just buying gas or milk. Bank customers will follow suit. Expect more customer loyalty programs and incentives to drive customer wallet share in leading banks.

Challenge Question: Which can your bank's executive management team name more easily: the Top 25 college football teams or the bank's Top 25 customers?

Prediction #10 – IT Risk Management Trends Prove What Passed in the Past Won't Pass Anymore

2012 saw many bankers get an education and a rude awakening on what constitutes proper IT risk management. Lulled into complacency by the cursory IT exams and weak IT audits of the past, many banks faced regulatory enforcement orders in 2012 for not having the proper controls, documentation, or audit coverage. A new breed of trained examiners and more thorough IT exams exposed weaknesses and areas long overdue for improvement. What we call the *"Deuces Wild IT Audit"* won't fly anymore. That's where a bank gets two days of fieldwork, a two-page report, and expects a 2-rating on its regulatory IT examination. An expanded IT and Operations environment requires an expanded IT audit scope. Mobile banking, social media, virtualization, enhanced multi-factor authentication, and mobile remote deposit capture are a few areas requiring expanded coverage.

The 2012 ICBA Community Bank Technology Survey cited bank's top technology concerns as (1) Complying with regulations; (2) Protecting data and infrastructure; and (3) Detecting and mitigating fraud. "Compliance" was cited as the number one area of increased IT spending. Accordingly, lightweight IT Audits and basic Network Vulnerability Assessments will be replaced by more comprehensive, collaborative, and competitive reviews by firms that understand technology and security but most importantly, the unique environments that drive the business of banking.

Smart banks ensure adequate coverage by requiring IT audits and network vulnerability assessments that have true value, are collaborative in nature, offer practical recommendations, and provide forward thinking related to recent technology innovations and serve as an early warning system regarding potential risk.

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Challenge Question: Is your bank's IT audit firm keeping up and delivering quality reports, expanded scopes, and fresh bank-specific perspectives on IT risk management trends?

Summary

Grab the rope, get a running start, take a bold swing, and execute a perfect landing in 2013 by employing the right technology, high-performing providers, and strong IT management. And remember, it's quite acceptable to yell like Tarzan when you stick that landing.

Best wishes for a high-flying, fast-swinging 2013 filled with safe landings and the satisfaction that comes with earned accomplishment.

Sawyers & Jacobs LLC helps banks in four major areas: Technology Planning, Risk Management, Network Solutions, and Business Continuity. Our mission is ***to help our clients use technology securely, effectively, and profitably to better serve their customers, comply with laws and regulations, contain costs, and compete. We make banks better.*** To learn more, visit www.sawyersjacobs.com , call 901.487.2575, or email jsawyers@sawyersjacobs.com.

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