Deloitte.

A resilient finance operating model for banks

Contents

A challenging environment

A challenging environment

Not everyone likes volatility. Planning teams like it least of all. How can the finance function provide the agility to guide the business through the uncertainty?

The increasingly volatile interest rate environment is impacting banks. Both the treasury function and planning, budgeting and forecasting (PBF) are being hit particularly hard in this environment. This can be seen by the GBP/USD, one of the most actively traded currency pairs in the world. Since recently reaching a new high against the US dollar, the British pound has depreciated massively in the face of rising inflation and slowing growth. In the same period, the US dollar has been supported by the Federal Reserve's monetary policy. Teams in banks need to be able to react quickly to this sudden divergence of the two economies to

mitigate or even take advantage of the impact. But achieving this responsiveness in the daily business is a major challenge for many teams. Does this sound familiar?

Deloitte's Swiss Finance & Performance Practice regularly helps clients to define their target operating model (TOM). In this article, we would like to shed some light on how the planning teams of banks can generate more accurate foresight in a difficult planning environment to improve decision-making, and how treasury can provide a better basis for interest rate hedging transactions.
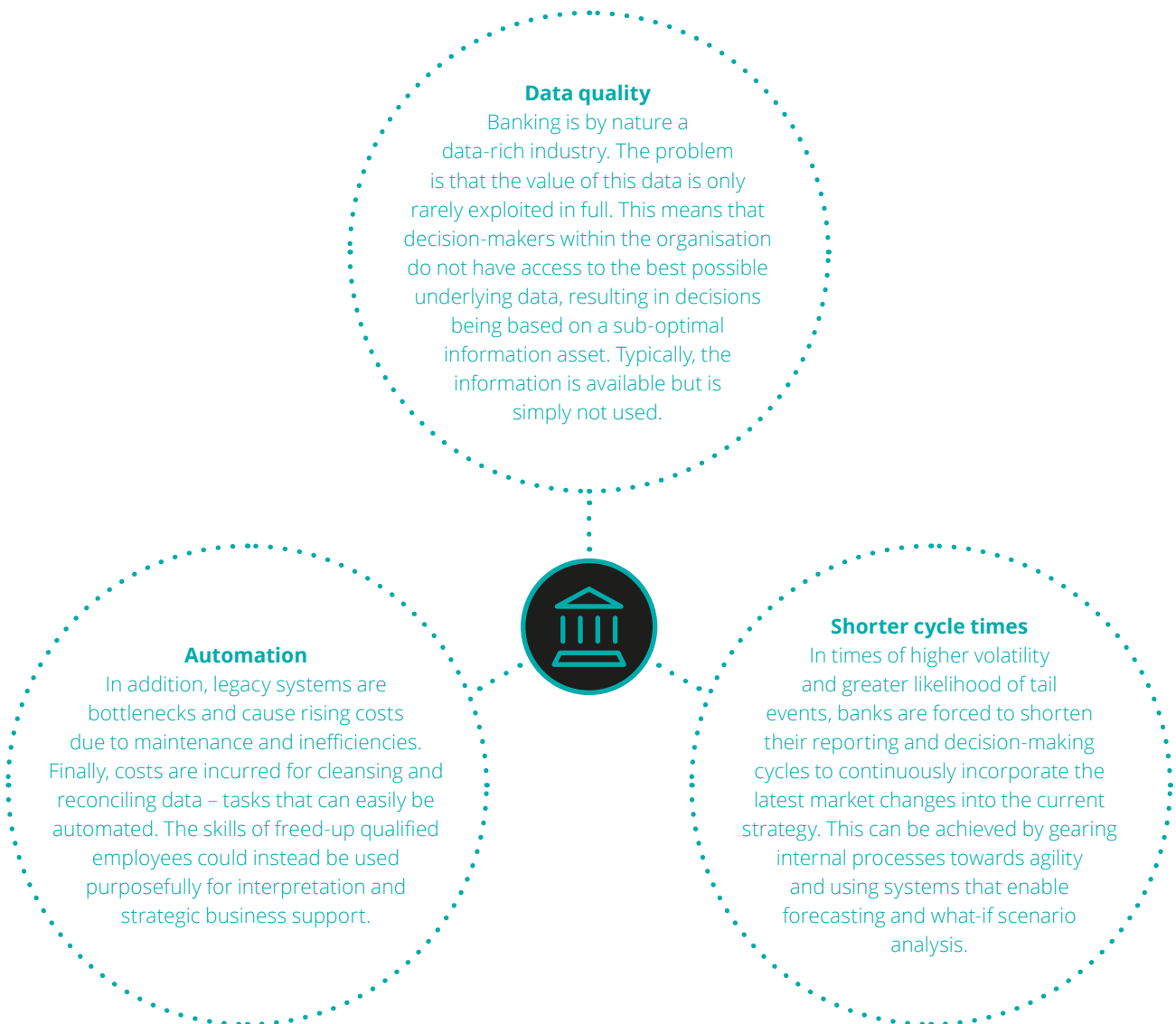
Initial situation

Initial situation

We find that banks struggle to reflect their ambitions in their operating model (OM). In this regard, we see the following shortcomings most frequently: The OM does not enable the agility to respond quickly to change in the marketplace, there is a mismatch of available skills with value-adding activities, and organisations do not make use of IT as efficiently and effectively as possible.

Many of these deficiencies are due to the ongoing use of legacy systems that compromise both data quality and process automation.

Data quality
Banking is by nature a data-rich industry. The problem is that the value of this data is only rarely exploited in full. This means that decision-makers within the organisation do not have access to the best possible underlying data, resulting in decisions being based on a sub-optimal information asset. Typically, the information is available but is simply not used.

Automation
In addition, legacy systems are bottlenecks and cause rising costs due to maintenance and inefficiencies. Finally, costs are incurred for cleansing and reconciling data – tasks that can easily be automated. The skills of freed-up qualified employees could instead be used purposefully for interpretation and strategic business support.

Shorter cycle times
In times of higher volatility and greater likelihood of tail events, banks are forced to shorten their reporting and decision-making cycles to continuously incorporate the latest market changes into the current strategy. This can be achieved by gearing internal processes towards agility and using systems that enable forecasting and what-if scenario analysis.

The two processes we are highlighting here – treasury and PBF – are particularly affected by these circumstances and therefore lend themselves to a discussion of possible improvements in the TOM. These challenges can be overcome with modern finance IT – but we first need to understand the challenges faced by the finance teams of banks.

Key challenges

Key challenges

The volatile macroeconomic conditions, driven by political uncertainty caused by Russia's invasion of Ukraine, among other things, pose a major challenge to risk management and planning activities.

On the one hand, the reaction time to adapt to different scenarios with a material impact on the business is currently very short, which makes it more difficult to define and monitor actions for achieving objectives. Furthermore, it is increasingly difficult for banks to plan product margins across all segments, especially in the interest-related business of retail banking.

The effects are not only negative. For example, the rising interest rate environment positively impacts the profit margin of new loans. In addition, the expanding spread between short- and long-term interest rates can be exploited. However, these positive effects are offset by the fact that the bank's current bond portfolio is losing value. Furthermore, because leading economists believe interest rates will continue to rise due to increasing inflation, a continuous negative price correction must be expected for the fixed-income securities already issued. Either way, an entire generation that has only experienced an environment of low interest and stable inflation rates in their working lives will have to adjust to a far less predictable reality. Thus, a key planning challenge that needs to be addressed is how to quickly obtain up-to-date and meaningful business data, including detailed sales figures, financial reports and departmental budgets.
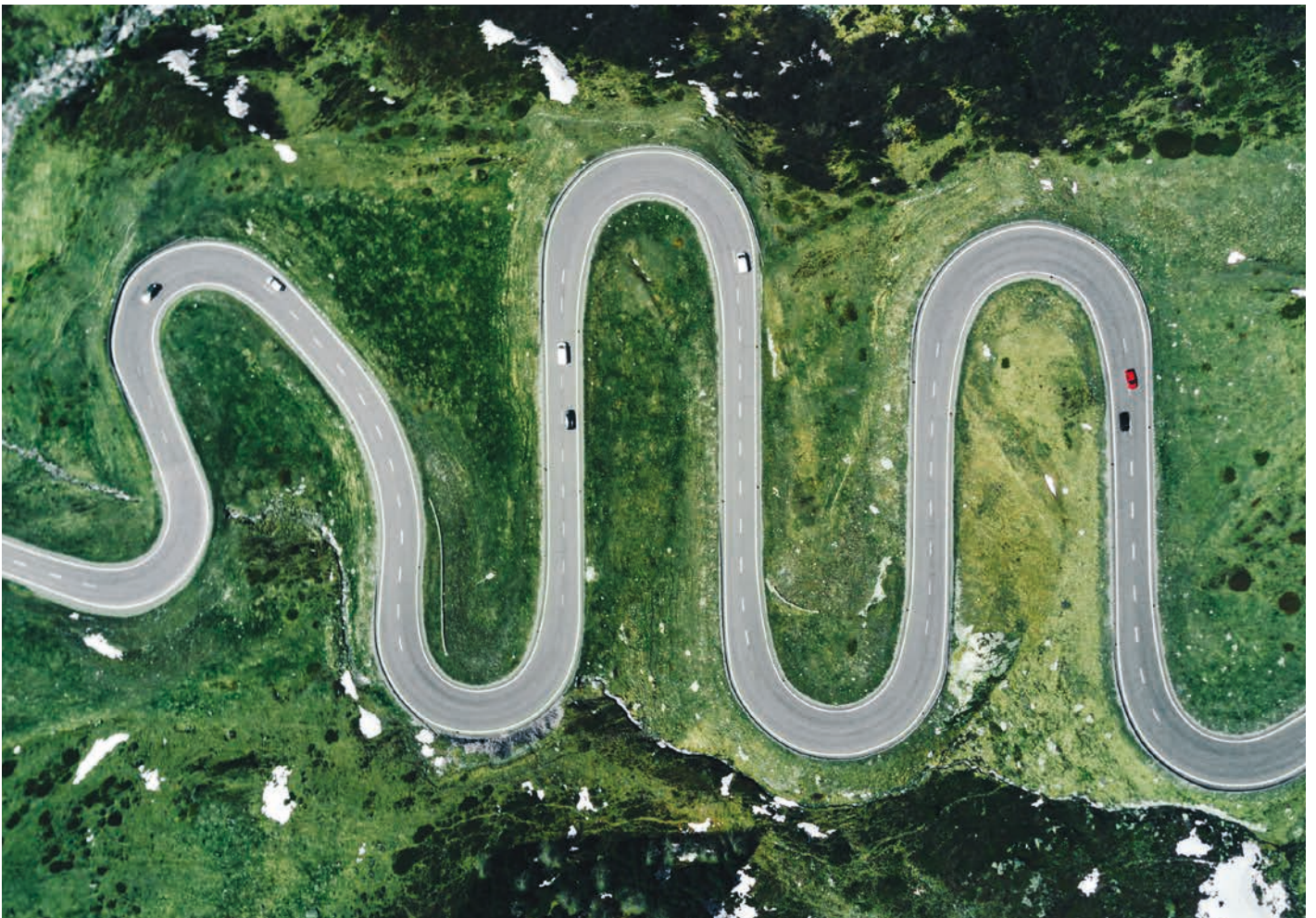
Treasury

Treasurers – the resource managers for the bank's balance sheet – are less in the spotlight now than they were during the liquidity crisis over a decade ago. Back then, the marketability of treasury assets suddenly deteriorated, which made it challenging to maintain the liquidity needed to honour obligations. This resulted in a regulatory wave that caused banks to focus more on liquidity and capital, ultimately making the banking system more capitalised and liquid. Now that the regulatory wave has progressed, the current challenge of the treasury function is to continuously provide business insights with an organic balance sheet perspective. This can be achieved by integrating risk and financial indicators, collateral and hedging information, and by providing a scenario analysis that enhances the decision-making process.

We see the following challenges within the treasury function:

• There is a siloed approach to collateral monitoring and management – data input and collection takes place on an ad-hoc basis across functions without consideration for the end-to-end process across transaction initiation, data input and reporting

• Manual activities to support the identification, measurement, monitoring and reporting of interest rate risk (IRR) are in many cases not well documented or understood

• There is no integrated process between treasury and operations (cash and collateral) to monitor intraday liquidity risk from cash and collateral across legal entities by currency and counterparties

Planning, budgeting & forecasting

PBF translates strategy into long-term plans, mid-term budgets and short-term forecasts. Resilient planning depends on skilled staff, robust processes and appropriate IT. Detailed budgeting, for example, is traditionally very labour-intensive and based on planning assumptions that become outdated very quickly. However, especially when the business environment is changing as rapidly and significantly as it is at present, the company's revenues or cost structure can change so radically that budget vs actual can diverge very quickly.

"An entire generation that has only experienced an environment of low interest and stable inflation rates in their working lives will have to adjust to a far less predictable reality."

Improvement potential

Improvement potential

Potential for optimisation can be found in all categories of the operating model. Given the challenges in banks' finance functions described above, we have identified the greatest potential for improvement in treasury and PBF and the associated digital landscape.

As a starting point, it is useful for the management team to define the desired degree of standardisation for these processes. On this basis, an assessment can be carried out to identify whether centralisation and automation potential can be exploited. Once the processes to be optimised have been defined in a target picture, this potential can be released with specific tools and technologies. This is especially true for standardised end-to-end processes.

"Only with agile and responsive financial processes will banks be able to compete in such a volatile environment."

Improvements will inevitably have an impact on other OM categories, such as the delivery model, organisation and people. Only with agile and responsive financial processes will banks be able to compete in such a volatile environment. In the following, we specifically address our approaches for treasury and PBF.
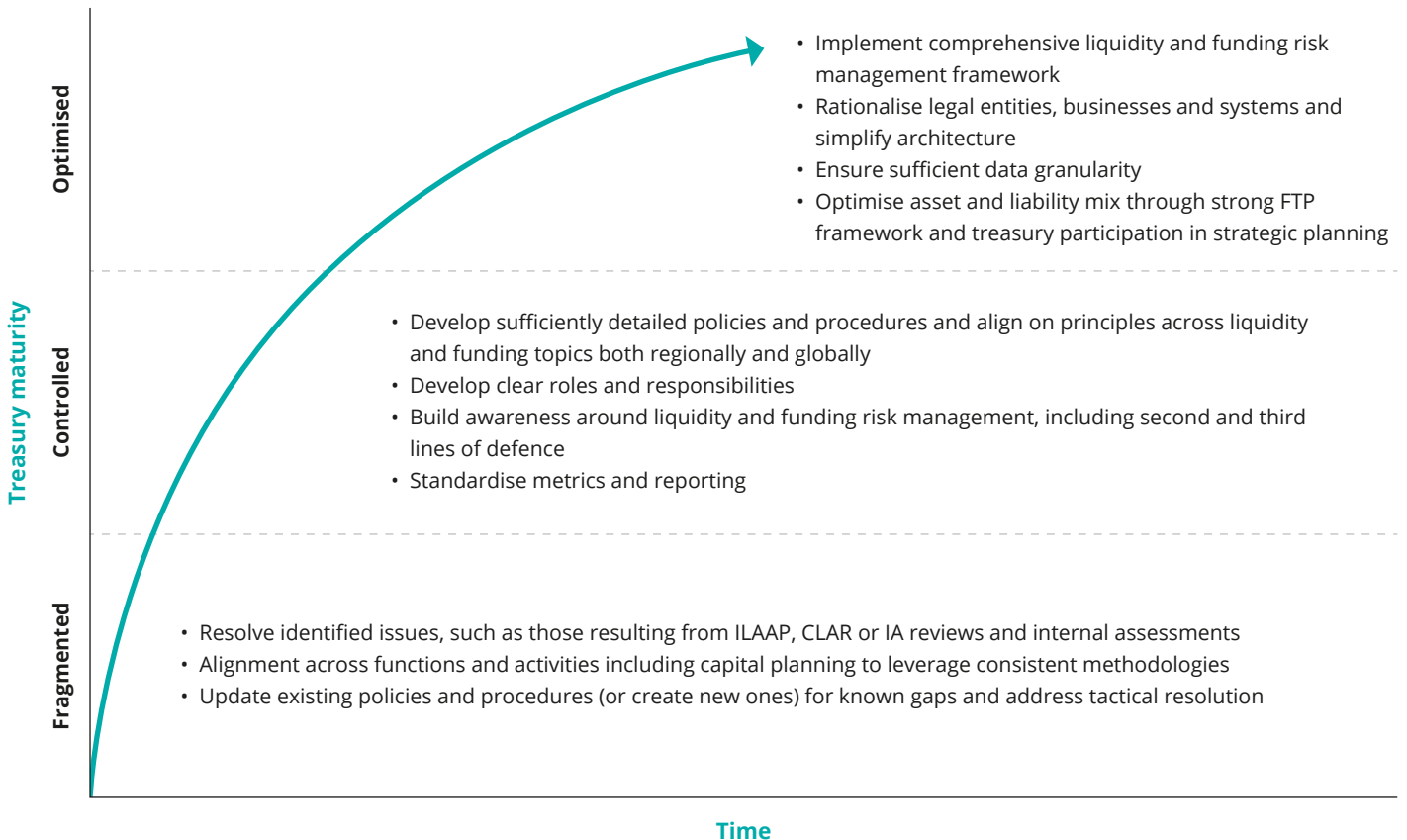
Treasury
The digital maturity of the treasury function and the use of advanced digital technologies and use cases can be effectively improved as part of a comprehensive digital strategy. Automation is already present in the calculation of regulatory measures (e.g., LCR, NSFR, etc.), but robotic process automation (RPA), machine learning (ML) and artificial intelligence (AI) can be further leveraged to increase risk transparency and provide insights for optimising bank balance sheets. For example, integrating machine learning algorithms into existing treasury systems can lead to more accurate predictions of capital and liquidity needs. Interest rate risk and liquidity risk can also be better anticipated with business intelligence integration.

These new insights will only provide real value if they are properly integrated into the decision-making process (e.g., hedging decisions, funding decisions, cash management decisions) and into the organisation of the treasury function. We have identified the following enablers for proper treasury optimisation:

- **Data architecture** should be integrated with relevant treasury and financial inputs and outputs, including consistent data sourcing and traceability

- **The technology platform** should include a single, centralised system for collateral data capture, including the attributes required to link the data to the underlying transactions

- **Report generation** should be consolidated into a single team within the treasury or finance department

Optimisation cannot be tackled overnight. Significant thought and analysis are required to understand and assess the maturity of a company's treasury function, define the desired target state, identify areas for optimisation and develop a roadmap to unlock the benefits. These steps must be taken in the context of the company's current and future self-assessment of the treasury maturity curve.

The chart shows Treasury maturity (y-axis) against Time (x-axis) with an upward curve passing through three levels:

Optimised
- Implement comprehensive liquidity and funding risk management framework
- Rationalise legal entities, businesses and systems and simplify architecture
- Ensure sufficient data granularity
- Optimise asset and liability mix through strong FTP framework and treasury participation in strategic planning

Controlled
- Develop sufficiently detailed policies and procedures and align on principles across liquidity and funding topics both regionally and globally
- Develop clear roles and responsibilities
- Build awareness around liquidity and funding risk management, including second and third lines of defence
- Standardise metrics and reporting

Fragmented
- Resolve identified issues, such as those resulting from ILAAP, CLAR or IA reviews and internal assessments
- Alignment across functions and activities including capital planning to leverage consistent methodologies
- Update existing policies and procedures (or create new ones) for known gaps and address tactical resolution

Time

Planning, budgeting & forecasting

To quickly identify potential challenges and mitigate uncertainty, it is necessary to create a unified corporate approach which ensures that the finance team is closely aligned with the business. Another lever to improve planning reliability and enable agile actions is to leverage real-time data from across the business and continuously identify emerging patterns. Operational forecasting is supported by technology, and we are seeing a steady trend towards AI-driven systems.
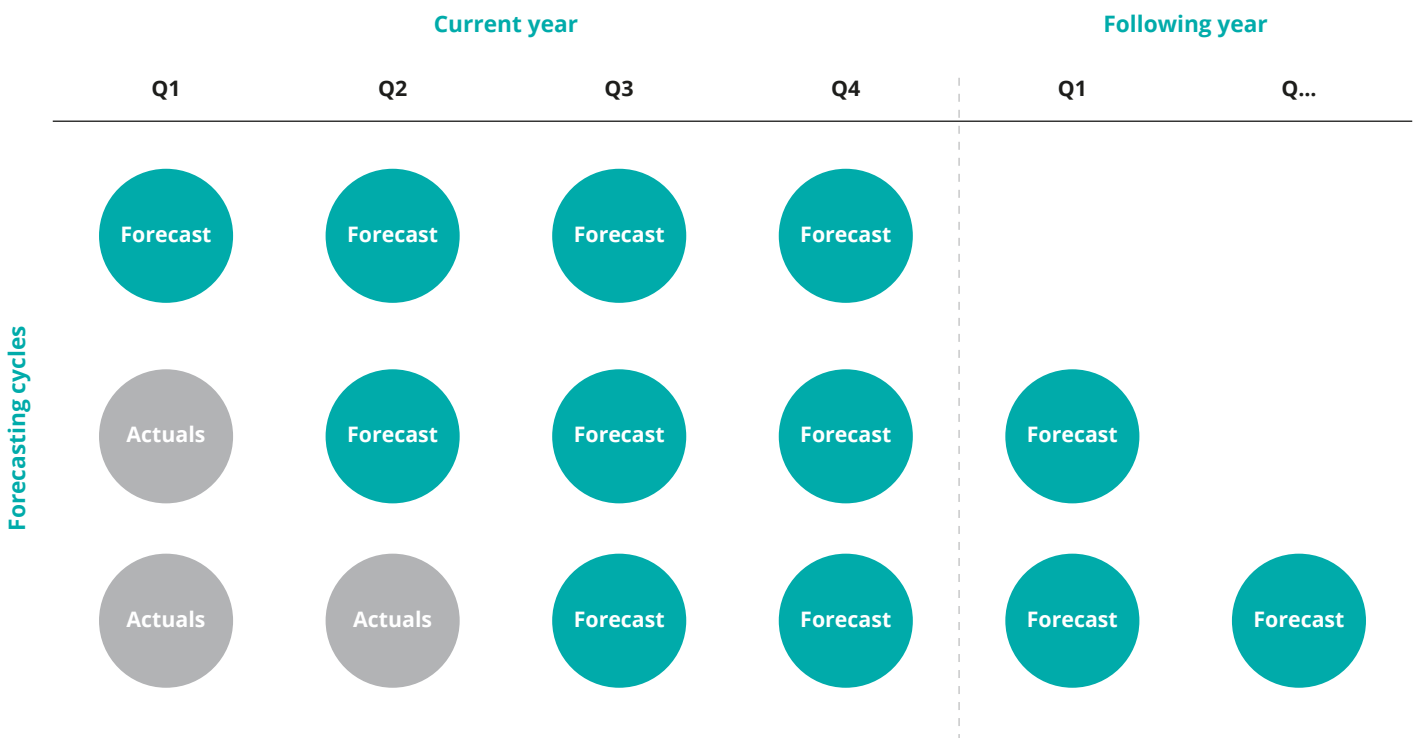
From a process perspective, one possible solution to the problem of volatility is to introduce an agile planning approach, such as rolling forecasts or continuous budgeting. This helps to focus on the most important drivers of the business rather than hundreds of items. And because shorter cycles are used, they help to improve visibility and act as an early warning system. Furthermore, by focusing on fewer but more important metrics, it is easy to include 'what-if' scenarios to assess the impact on the overall budget.

"One way to improve planning reliability and enable agile actions is to leverage real-time data from across the business and continuously identify emerging patterns."

From a technology perspective, data analytics and automation can help streamline the budgeting process and increase its efficiency. Applying analytics with financial and operational data can also provide CFOs with insights to influence operational planning decisions that define budget items.

Rolling forecasting

As mentioned earlier, a rolling forecast (RF) is particularly suitable for increasing adaptability. This approach allows budget, revenue and expenditure to be projected over a continuous period based on relevant real-time data. Factors such as annual performance, original budgets and the current economic environment are considered. A typical rolling forecast covers a period of 12 to 18 months, updated monthly to quarterly.

	Current year				**Following year**	
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q...**
	Forecast	Forecast	Forecast	Forecast		
	Actuals	Forecast	Forecast	Forecast	Forecast	
	Actuals	Actuals	Forecast	Forecast	Forecast	Forecast

Forecasting cycles

Rolling forecasts have their own challenges. For example, maintaining a rolling forecast becomes more complicated as the data becomes more complex. Furthermore, comparative analysis with past periods is limited as assumptions change.

Nevertheless, the advantages outweigh the disadvantages in many cases. RF is more accurate, efficient and relevant than the static approach. A responsive financial forecast makes it possible to react to market conditions, reduces the impact of fluctuating inflation rates and gives management more lead time to minimise the impact. The accuracy of a rolling forecast can also improve risk mitigation and financial performance tracking.

Our proposed approach

Our proposed approach

We propose the following approach to optimising the finance function, with a particular focus on the change-leading role of the CFO and the importance of combining digital technologies and operational capabilities.

1 Visioning

Activities:
Workshop to define following objectives
- Which business insights are needed
- Which business processes need efficiency gains

Deliverables:
- Goal-setting
- Guiding principles of transformation

2 Diagnostic

Activities:
- Map out the affected processes, considering systems, costs (affected offices and FTEs) and level of digitalisation
- Analyse the formal and informal elements of the organisation and identify elements of inefficiency in decision-making processes

Deliverables:
- Representation of the current process structure
- Process map with defined improvement areas
- Representation of potential obstacles to achieving efficiency

3 Design

Activities:
- Workshop to identify the TO-BE state and the actions needed for reaching it
- Define the TO-BE processes, systems and related ownership
- Define the required skills
- Define the success criteria including AS-IS measurement and target resource utilisation

Deliverables:
- TO-BE state process map, roles and responsibilities
- Evaluation criteria designed

4 Implementation

Activities:
- Select the target interventions
- Define the roadmap with an indication of priority and impact for each action
- Define efficiency targets that can be reached with the various initiatives

Deliverables:
- Roadmap and deliverables
- Process review including target measures

5 Ex-post verification

Activities:
- Measure processes ex-post
- Measure data insights effectiveness and response time

Deliverables:
- KPIs and bottom-up metrics
- Biannual reporting on status

Visioning

In the Visioning phase, workshops and brainstorming sessions are held within the finance function to define potential strategic guidelines. The aim is to agree on finance transformation objectives. The visioning phase is of utmost importance to:

- provide a clear vision of where the bank wishes to be in 3–5 years

- assure commitment of both CFO leadership and executive management towards the initiative

Diagnostics

In the Diagnostics phase, the main processes are analysed together with the related organisational elements. The assessment outlines the gap between the current state of the finance function against the set of capabilities and practices defined in the visioning phase. Bottlenecks, improvements and digitalisation potential is also identified.

Design

The aim of the Design phase is to define the future TO-BE state of the finance function and target operating model, including process map, organisational structure, digitalisation solutions and required skills of the TO-BE finance function.

Furthermore, in this phase, we recommend setting up a system for measuring the processes which also considers the AS-IS state. This should be done not just to justify the costs of the initiative but also to contribute towards a culture of continuous improvement with the required transparency further down the road.

Implementation

In the Implementation phase, target interventions are selected. A roadmap is defined with an indication of the priority and impact of each action, the expected deliverables and the implementation timeline.

Verification

The aim of the Ex-Post Verification phase is to define a measurement framework to verify the targeted efficiency gains and the contribution of the improved data insights towards the decision-making process.

Conclusion

Conclusion

In this article, we have described some of the challenges that banks face in today's increasingly volatile environment and how the finance function can react by setting up a future-proof TOM, thereby adding value to the entire organisation. In fact, a finance function built for the future must be dynamic, risk-sensing and able to react to any disruption that comes its way.

Although the finance department faces these challenges, it is also in the privileged position of acting as a data architect, taking ownership of the bank's data to design new planning models that enable the bank to better manage uncertainty.

Are you ready to take the next step towards your future finance capability?

Contacts

Markus Zorn
Partner
Finance & Performance
Lead Switzerland
+41 58 279 69 43
mzorn@deloitte.ch

Tobias Kern
Director
Finance & Performance
Switzerland
+41 58 279 69 32
tkern@deloitte.ch

Authors

Davide Botta
Senior Manager
Finance & Performance
Switzerland
dbotta@deloitte.ch

Benedict Baeurer
Senior Consultant
Finance & Performance
Switzerland
bbaeurer@deloitte.ch

Philippe Hartung
Senior Consultant
Finance & Performance
Switzerland
phartung@deloitte.ch

Deloitte.