ORACLE
FINANCIAL SERVICES

An Oracle White Paper
September 2013

Debunking the Case Against Transformation

ORACLE

Introduction: The Conflicted Retail Bank Executive

Retail bank executives juggle multiple diverging priorities and challenges. These challenges are only growing. Twenty years ago, the mobile phone was a rarity. Ten years ago, online banking was a novelty. Today, the prevalence of banking-on-the-go has dramatically shifted the way banks interact with a new generation of customers.

Mobility is just one aspect and stage in the evolution of retail banking – the bottom line is that banks are challenged by an increasing number of factors to become more agile in the way that they do business. In addition, they must do this in an environment where there is still an abundance of outdated, inflexible, legacy technology competing with current systems that are built for customers upwards of twenty—or even forty years—before the retail banking landscape had begun to vastly change.

For retail bank executives, this evolution is catalyzing a re-engineering of core processes, operations and infrastructure to better position for success. However, even when they need to re-align priorities—this veritable New World of banking is not simple.

As part of an overall modernization, bank executives may find themselves increasingly faced with the possibility of pursuing a bank transformation project. Bank transformation enables institutions to consolidate and replace legacy systems and manual processes with industrialized operations and an agile and modern core solution. Because these transformation projects are designed to progressively but fundamentally overhaul a bank’s core operations – the decision to transform cannot be taken lightly.

For the retail bank executive who already faces numerous pressures, pursuing a transformation project can feel like a career-making or breaking move. When faced with the decision to undergo a multi-staged, multi-business line program (that may take a number of years to complete) executives may grapple with preconceived notions as to why transformation is a bad idea.

Although bank transformation is not appropriate for every bank, executives should have all the right information at their fingertips before making such an important decision. In this paper, we'll look to debunk the case against transformation by peeling back the layers around commonly discussed and often mislead ideas around bank transformation.

> The systems crash was a stark wake-up call for global banks, many of which rely on decades-old IT systems.
>
> **Sharlene Goff,** Financial Times

Case #1: "It's riskier for me to pursue such a big project than not to transform – so why should I go through with it?"

In actuality, the risk of not pursuing a transformation project is only becoming greater due to banks' exposures to changing economic environments, increasing consumer demands, increasing competition and the sheer rate of evolution in the industry.

According to Aite Group in a recent report, "A flexible core system built on modern technology can mean the difference between future success and failure for many financial institutions. All banks, regardless of size and geographic location, need to be able to quickly launch new products, address the increasingly demanding needs of customers and regulators and operate as efficiently and cost effectively as possible in today's challenging economic environment."[1]

The report's author argues that "core replacement initiatives present high cost and risk levels, but replacement initiatives are now viewed by many institutions as a necessary evil that can no longer be ignored."

Although the apparent risk may seem greater, in reality, bank executives may be incurring a much higher degree of risk by not transforming. Aside from the benefits of increased agility and efficiency, banks are also placing themselves at risk of failures and system outages by relying on potentially 30-year old technology and the ability to support it. The headlines around bank outages are causing greater and greater consumer outrage and the sheer reputational risk that banks may face due to a widespread outage can be devastating. Simultaneously, supporting legacy systems running on outdated programming languages requires the employment of resources who may end up leaving the workforce – leaving banks in a bind.

In June 2012, millions of RBS and NatWest customers were unable to process their payments due to a system failure. In one of the most high-profile bank IT failure cases in recent years, RBS faced a hefty fine from the Financial Services Authority and a potential regulator-mandated IT upgrade. According

[1] Aite Group, David Albertazzi, Christine Barry, "Global Core Vendors: A Progressive Transformation," January 2013.

to the Financial Times, "The systems crash was a stark wake-up call for global banks, many of which rely on decades-old IT systems."[2]

Although IT stasis may seem like the easier option, banks are exposed to an ever-increasing amount of risk and must carefully weigh the cost and time of a transformation project against the cost and time of a potential systems outage, the inability to rapidly pursue new business initiatives and the inefficiencies of outdated technology.

Case #2: "My bank is too large to be able to rip and replace systems, particularly in this environment."

Already partway through a wide-scale transformation program, NAB is replacing 100 legacy systems and expects to save AUD 800mm annually.

A common misperception of core replacement programs is that the process involves "ripping and replacing" systems. Bank transformation should actually be a progression, using carefully staged phases that allow a bank to continue to operate successfully even while undergoing an enterprise-wide IT overhaul. Each phase of transformation can experience its own ROI, allowing the bank to pursue projects at a logical and gated pace.

According to Aite Group, "Today's more flexible solutions offer those institutions looking to replace their core systems many options, especially pertaining to deployment… Banks are now able to benefit from the broad experience, best-practice observations of their vendor partners. New core systems are being delivered preconfigured with "model bank" attributes, thereby improving bank process efficiencies and implementation times."[3]

In recognition of the crucial competitive advantages that modernization can bring to a bank, even the largest banks are pursuing core transformation projects. National Australia Bank (NAB) is one of the four largest institutions in Australia and the 17th largest bank in the world. Already partway through a wide-scale transformation program, NAB is replacing 100 legacy systems and expects to save AUD 800mm annually.

---

[2] Sharlene Goff, "Banks told to fix systems after RBS crash," *Financial Times*, July 25, 2012.

[3] Aite Group, Christine Barry, "Evaluating the Vendors of Global Core Banking Systems: Seeking New Opportunities in Emerging Countries," October 2010.

When considering a core replacement program, banks should seek out vendors that enable progressive transformation by:

- Addressing the risks of technology obsolescence
- Progressively enabling new business capabilities and realizing benefits
- Removing technology complexity and reducing technology total cost of ownership

A complex transformational program can take a number of years to complete and should be sequenced to reflect the bank's:

- Short- and near-term priorities and longer-range business strategies
- Available options for unraveling existing business and technology complexity
- Ability to successfully execute, absorb change and realize benefits

By partnering with a vendor that allows for a phased approach to core transformation, large banks can avoid the potential downside of a systems overhaul that could negatively impact the business bottom line.

Case #3: "A transformation project will outlive my career at the bank, so what's my motivation?"

Although a transformation project can take several years to complete in its entirety, retail bank executives can realize immediate gains as part of a progressive transformation project. "Through a progressive implementation, financial institutions, especially the largest ones, roll out their new core solutions in phases." For example, some banks might start with deposits or loans while others may focus on enterprise originations or on the customer. Some banks can begin the process with a direct bank or other self-contained business unit.

As was the case with NAB who is already a third of the way through its transformation project, one of the major elements of the program was rolling out its new platform to 300,000 customers of UBank, NAB's direct bank brand. NAB's customers are already experiencing a faster and more simplified online experience. For NAB's employees, a new "banker workbench" incorporates CRM, core banking and soft phone capabilities so that bank employees can have a 360-degree view of the customer and all their communications. This allows the bank to deliver better service and greater productivity.

Bank executives should be motivated by the knowledge that the decision to transform can yield fairly short-term benefits that can be realized during their tenure at the bank – while reducing enterprise-wide risk. This will rely on a progressive, rather than a "rip and replace" approach directly correlated to size. The larger the bank – the more a progressive approach will yield short-term ROI and simultaneously mitigate risk.

> Banks need to embrace the changes already seen in other industries, such as automotives, including business simplification, streamlined operating models and lean process optimization.
>
> **McKinsey & Company**

Case #4: "Transformation is too expensive and takes too long."

Bank executives should factor in the total cost of ownership of maintaining dozens if not hundreds of legacy systems, and the opportunity cost of not being able to go to market quickly with new products and services. The complex and antiquated programming languages of legacy systems require expensive processes and resources to support aging technology.

Banks have already been facing declining Returns on Equity (ROE). They will never return to pre-crisis levels, which present an "irrefutable case for modernization. Banks need to embrace the changes already seen in other industries, such as automotives, including business simplification, streamlined operating models and lean process optimization."[4] Expenses are under greater pressure than ever before.

The investment in bank transformation is worthwhile as the potential ROI is tremendous. "Improving system resilience and eradicating technology silos will improve organizational effectiveness and service to customers."[5]

The issue of bank transformation being "too expensive" is inextricably linked to the question of cost versus return on investment. Executives should accurately build a business case and analyze the total cost of maintaining numerous legacy systems and the cost savings realized over time of moving to a more efficient architecture. The actual cost of moving to a modern architecture may, in the end, be less than what the bank is already paying to maintain legacy IT. When it comes to value, banks should analyze the potential new revenue streams of being able to launch new products or customized services to its customers. ROI models will need to be supported by cost reductions, lowering of efficiency ratios and positive ROI. This will better enable a bank executive to understand the true cost of transformation before making a decision.

In terms of project length of time, as stated earlier in this paper, banks should consider a progressive, phased approach to transformation so that the project is sequenced according to the bank's priorities.

---

[4] McKinsey & Company, "The Triple Transformation: achieving a sustainable business model," October 2012.

[5] Ernst & Young, "Time for bold action: Global banking outlook 2013-14," December 2012.

Transformation does not happen overnight – but it can be timed to have minimal impact on a bank's operations and support strategic goals.

A modern core solution in itself does not reduce costs dramatically. However, it will dramatically change or eliminate thousands of operations processes that are in place solely because they are used to support a 30 year old core solution. It is this process efficiency that drives dramatic efficiencies, improved ROI and game changing efficiency ratios.

Case #5: "No one else is pursuing transformation – why should I?"

Bank transformation projects are increasing in prevalence. Although the majority of banks have not begun such programs, bank executives should view this as an opportunity to gain a competitive advantage as the trend towards transformation heats up.

In 2012, nearly 400 U.S. banks and credit unions signed contracts to replace core systems. Large banks should see that there is a competitive opportunity in transforming. In fact, Aite Group expects a rise in the number of large-bank deployments around the globe as these large institutions are left with "little choice but to replace or risk becoming less competitive."[6]

US banks also face increasing competition from several foreign owned US chartered banks who are less hindered by legacy technology and are ahead in pursuing transformation programs, such as BBVA and Santander. As their cost structures drop and their agility increases, this will begin to put enormous pressure on US banks that compete with them.

According to Aite Group,[7] several factors will drive the projected increase in core system replacements by banks around the globe, including:

- Pent-up demand: institutions have ignored the need to replace their cores for too long and are starting to feel the repercussions
- Slow speed to market for new products
- High maintenance costs
- Integration issues and limited flexibility

Bank executives should recognize that an increasing number of banks in their markets are adopting modernized technology and processes that can provide a distinctive competitive advantage. US banks

[6] Aite Group, David Albertazzi, Christine Barry, "Global Core Vendors: A Progressive Transformation," January 2013.

[7] Aite Group, David Albertazzi, Christine Barry, "Global Core Vendors: A Progressive Transformation," January 2013.

who embrace the benefits of bank transformation may realize significant gains over counterparts still relying on legacy technology. In the evolution of banks today, only the fittest may survive.

Case #6: "We don't have the skills to transform."

Banks may not always have the talent or skills in-house to support an enterprise modernization program. If they do have the skills in-house, these resources may be dedicated to legacy systems that are failing or outdated; or the resources themselves are poised to exit the workforce.

When faced with this challenge, bank executives must rely on a vendor that has proven expertise in delivering successful programs in the space. By partnering with a vendor that can offer best practices and crucial insights, a bank's internal resources will be less strained when pursuing a transformation project.

Additionally, the benefit of a phased transformation program is that integrated, modern technology can make the job easier for bank employees. By integrating data, interfaces and systems across the enterprise, bank employees are better positioned to do their jobs successfully.

The End Game: Making the Decision to Transform

Bank transformation isn't right for every bank, but with accurate information and a solid business case in hand, bank executives are better positioned to make the right decision when considering a modernization project.

When finally making the decision to transform, bank executives should ensure that they:

- Get executive management buy-in by presenting a compelling business case
- Communicate clearly to all internal stakeholders so that they understand the drivers and benefits of a transformation program
- Establish measurable KPIs and monitor progress
- Map out a progressive implementation aligned with key business goals

By debunking the commonly held misconceptions around bank transformation, we hope to provide bank executives with a more accurate picture of the potential impact and benefits of modernization.

To speak with an Oracle expert who can help you build a business case for transformation and to learn more about the Oracle Banking Platform, visit us at www.oracle.com/banking.

Oracle is committed to developing practices and products that help protect the environment

Debunking the Case Against Transformation
September 2013

Oracle Corporation
World Headquarters
500 Oracle Parkway
Redwood Shores, CA 94065
U.S.A.

Worldwide Inquiries:
Phone: +1.650.506.7000
Fax: +1.650.506.7200

oracle.com

Hardware and Software, Engineered to Work Together