



Why technology modernization should be a priority for all financial institutions





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A man with short, dark hair, wearing a dark suit jacket over a light blue shirt, is looking directly at the camera. He is positioned in front of several computer monitors. The background is dimly lit, showing the glow of the screens and some blurred data visualizations. The overall tone is professional and tech-oriented.

Introduction

This paper approaches the question of why technology modernization is a priority for all financial institutions, through the lens of community banks in the US.

Together with the perspective of Microsoft’s financial services expertise, representatives from two different community banks provide a clear sense of how the modernization story is evolving on the ground, and which priorities and drivers are most important.

What emerges is a narrative of rapid and agile change driven by customer demand and tech evolution, enabled by open finance, collaboration and innovation.

Introduction	Driver #1	Driver #2	Core questions	Replacing the core	Cloud	Why Microsoft	Key takeaways
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Driver #1: Customer expectations

Big Tech has transformed customers’ expectations around the way services are delivered.

Today, consumers expect services delivered how and when they want them, and financial services providers are expected to be able to offer the same level of service. Much of the change in consumer expectation is driven by Amazon, whose recommendation engine and seamless checkout has transformed and now defines the ecommerce experience.

The shift in expectation is not confined to a younger demographic. All age groups have been seduced by the power and simplicity of platform plays such as Uber, Netflix and Airbnb, so the customer experience bar for banks has been raised across the age range of its customer base.

As well as catching up on customer experience, banks will also have to look over their shoulders. As Fig. 1 shows, consumers are very willing to buy financial services from the big techs. And as the tech players push further into owning the customer relationships, banks will have to focus harder on delivering the kind of contextualized customer engagements that the big tech companies have become so adept at.

// ***This is where we believe payments and financial services are headed. They are not going to be in banks or on bank websites, they will be ubiquitous: on Google, on Apple, even on your doctor’s website.”***

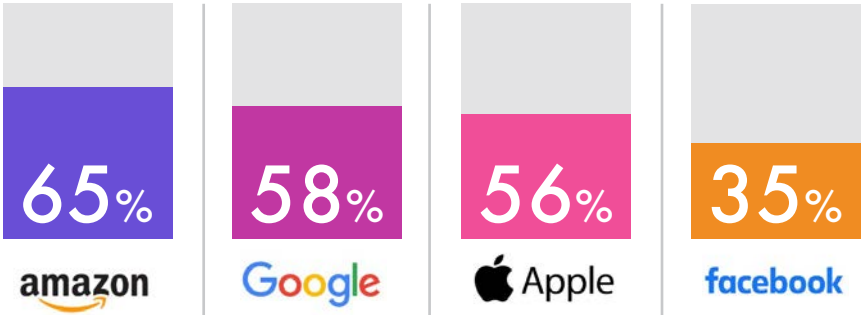
Jayson Callies
Seattle Bank’s EVP – CIO

Customer expectations – Digital transformation

Attract and retain new customers – Urgent need to drive innovation and digital transformation strategy



Fig. 1 Consumer willingness to buy financial products from big tech players





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As a result of Covid and digital transformation pushing consumers online, plus the fact that fintechs are driving innovation with offers like getting paychecks early. Banks must be able to support products like these, too. The key is to lean in to your existing client base and address what they require while also looking for new opportunities. It's critical that you have a partner that can help you meet these needs quickly because client expectations are rapidly evolving."

Jayson Callies
Seattle Bank's EVP – CIO

However, the big tech players are an opportunity as well as a threat for incumbents. For Seattle Bank, partnering with Google's Plex digital banking platform "is enabling it to extend beyond its comfort zone of commercial and HNWI business to target younger demographics who are already accustomed to Google's platforms from their educational experience," according to Jayson Callies.

Bank Midwest CIO Bryan Wilken pointed out that commercial customers have higher expectations, too. He notes that as open banking enables finance to be embedded into non-bank digital offers, "commercial customers are building bigger tech stacks and wanting different payment options, for example. And the bank's treasury management customers are requiring all services to be mobile-first."

Transforming to meet new customer expectations may be a big ask. But Covid has given CEOs a new outlook on how fast technology can be delivered: there's more of a belief today that it's possible for firms to match the speed of change they are seeing in their customer base.

Driver #2: Fintech disruption

As customers demand more, new players are rising to the challenge, giving banks a simple choice: Be disrupted or join the growth story.

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We see fintechs as opportunities. Although we could lose some customers to them, they also make it possible to deepen our relationships and gain customer share."



Bryan Wilken
Bank Midwest

Fintechs today provide nearly half of all unsecured personal loans: that's a lot of business no longer being done by banks. Alongside lending, payments is the other key area targeted by disruptive entrants: Venmo, for example, processed nearly \$160bn in payment volume during 2020. Fig. 1 illustrates how fintechs are expanding – in lending and payments, through acquisition and by applying for bank charters.

Like the big tech companies, fintechs present an opportunity as well as a threat. They can help banks to fill niches and build customer relationships – but only where banks have modern platforms. Legacy cores effectively lock out fintechs from collaboration with banks, putting both sides at a disadvantage.

However, it's worth pointing out too that fintech disruption can be positive for banks, too. Google's Plex offering, which is a mobile-first checking and savings account that integrates with Google Play, is currently partnered with 11 banks and credit unions in the US. If traditional financial institutions are looking for greater reach and new markets, partnerships like these could be channel opportunities rather than existential threats.



Fintech – Disrupting banking

Choice between getting disrupted or join the growth story

Fintechs are providing 49.4% of unsecured personal loans



- Financial lender of installment loans for consumers to use at the point of sale to finance a purchase.
- Reported a net revenue of \$509.5M in FY2020. Up 93 percent from 2019.



- Business loans - \$500K businesses - \$16B



- Processed \$159B in total payment volume in 2020, a 59 percent YoY increase.
- Venmo users – 3M in 2015 to 52M in 2020.

Fintechs applying for banking charter or acquiring banks



- To create an industrial bank in Utah.



- OCC approved the national bank charter.



- Recently completed its acquisition of Radius Bank.



- All have charter applications for bank subsidiaries pending.

Core questions

Finastra identified six questions that banks should be considering today in relation to their core systems.

- 1

Business growth.

Can you launch new business efficiently from where you are now?
- 2

Data monetization.

This depends on access to data. Do you have 100%, easy access to core data?
- 3

Innovation.

Is your core provider making it easy for fintechs to integrate with the core platform?
- 4

Digital transformation.

Is your core system standing in the way of digital transformation?
- 5

Lending.

Can you offer end-to-end lending (including commercial lending) supported by open APIs?
- 6

Scalability.

Will you require hardware/software upgrades for growth coming from organic and M&A activities?

Of these six questions, four had the highest priorities for both community banks and from a cloud vendor’s perspective.

Business growth. Community banks have seen a 30% decline in the past 10 years and it’s anticipated that this may well continue. Inflexible and closed core systems can certainly be a restraint on growth – but where community banks have moved away from a single-vendor solution, it can drive growth, as Bank Midwest’s Bryan Wilken notes: “Now that we no longer need to rely on a single vendor, we can assemble technology and even launch totally new business lines using some of the tech that is out there and available today. Revenue can come from this modernized tech stack that all of us are striving for.”

Data monetization. Traditionally, data is siloed at banks. This is reflected in the experience of Bank Midwest, whose previous core supplier was unable to provide access to all the data fields the bank needed. Being able to access and use data is key to both unlocking innovation and achieving digital transformation. This is especially important because in effect, customers speak to banks every day through their transactions, which show how they are interacting with the bank and other financial providers. The ability to access to this data is a prerequisite for both product innovation and ultimately, monetizing this resource. As Bryan Wilken confirms, “Access to all data fields is critical. If you don’t have 100% access, it makes it challenging to partner with a fintech or use the data yourself. You need the data to look for the opportunities.”

Innovation. As the community banks noted, if your scale is out of sync with the majority of your core provider’s customers – as it may be for many smaller financial institutions – you are unlikely to get the support you need. It’s essential for core providers to be able to support growth plans that more often than not involve digital banking.

Digital transformation. This is the “hottest buzzword in community banking at the moment” according to Bryan Wilken, and it is the issue that all other questions flow from. Achieving it requires a roadmap and partners that can accompany you on the journey. For community banks such as Bank Midwest, the challenge is to keep pace with other banks’ transformation plans while at the same time attending to a customer base that still puts a high value on in-person banking.

// *This isn’t just about banks. It’s also about our customers working out how they can get a competitive advantage: embedded finance is one way to keep customers on their platforms and ecosystems, so we’re seeing a lot of traction in that area.”*

Jayson Callies
Seattle Bank’s EVP – CIO

Replacing the core

To answer those core questions in the affirmative – and position themselves to meet customer expectations with, rather than against, big tech companies and fintechs – banks with inflexible legacy core systems need to replace them. Ageing technology is the underlying cause of many of the challenges that face financial institutions today. FDIC Chair Jelena McWilliams acknowledged this, noting that her number one concern in relation to the banking system was that banks’ legacy systems “frankly are impeding their ability to move forward.”

Seattle Bank’s Jayson Callies agrees. “The support and speed of innovation that we needed weren’t even on the roadmap of our core provider. It took 9-18 months and significant investment to bring about change. Today with access to data and tools and with an open core, our own developers can deliver innovations in 3-6 months.”

The prize is worth the effort. When consumers want a seamless experience across physical and digital channels (even 70% of boomers rely on mobile for banking today) an open, cloud-based core can deliver the data insights and ecosystem access that enable community banks and credit unions to deliver it, fast.

Ultimately, the key is that technology should enable strategy, not dictate it.

To stay relevant and grow, financial institutions must replace legacy core platform with a modern and open core system

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There are several things I would like to see done differently within the banking system, but I will say No. 1 is something that concerns me on a longstanding basis, which is the legacy systems... ‘a lot of banks have legacy systems that frankly are impeding their ability to move forward.’”

Jelena McWilliams
FDIC Chair

New rules of banking in the era of digitalization and multi-channel experience

The demand for true multi-channel experience

Consumers want a seamless experience across physical and digital channels that is truly customer focused. Powerful insights from data and the huge potential of platform ecosystem are creating and exciting outlook for community banks and credit unions.

70%

of boomers report mobile banking as their primary way of engaging with their finances

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Cloud: Leveling the playing field for innovation and growth

Cloud tech is making the core transformation possible. Its major feature, particularly important for community banks and credit unions, is that it democratizes technology for any size of player.

Where once a bank would have needed a huge R&D budget and a large hardware and software footprint to get access to best-in-class tech, today it's simply a question of accessing services via the cloud, with hosting and compliance taken care of by a player like Microsoft. The agile, "fail fast and try again" approach to innovation becomes both viable and cost-effective in this environment. The overall cost of entry is much lower and the ROI significantly higher.

How can community banks benefit from the cloud?

Cloud to level the playing field for innovation and growth by lowering barriers to entry

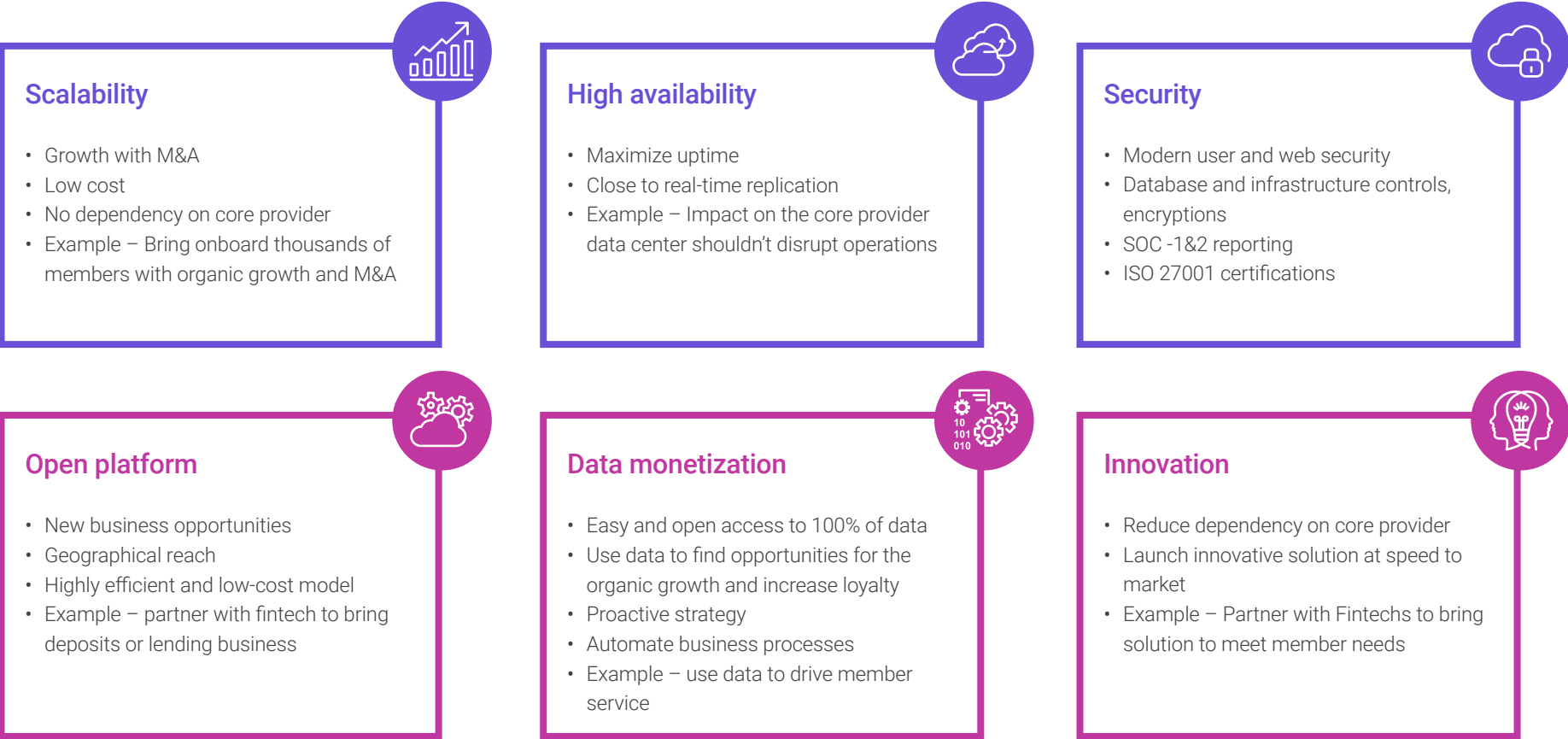


Fig 3 illustrates the key benefits of a cloud-based core banking system. The top three are “table stakes” today – the foundational and essential attributes for any bank or application in the cloud.

The second tier are the business drivers that are moving banks to the cloud and that will deliver growth and market share. The fintech partnerships that are essential to success today are only possible with an open platform. It’s open banking that enables new business models and capabilities that can either be delivered directly or embedded into fintech channels. Fast innovation is key, delivering the ability to pivot fast. And underpinning everything is data monetization: with easy, open access to 100% data, banks can see where customers are spending money, which products are most profitable and where the opportunities for proactive engagement are.

For community banks, innovation and open platforms are of prime importance, making it possible to move fast with minimal resource. Regulators have for some time pushed smaller banks not to have technology resources in-house, so open platforms create access to fintech resources that are essential to new developments.

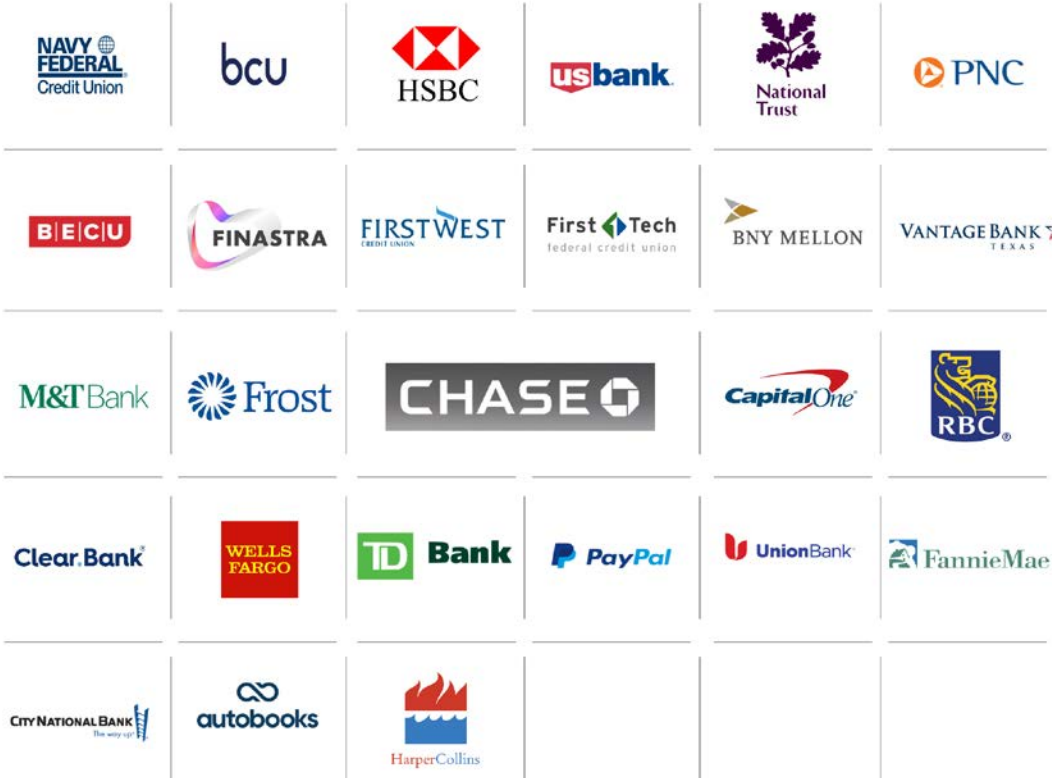
Fig. 3. Benefits of an open, cloud-based core banking system



Why Microsoft has emerged as the cloud provider of choice

Finastra’s cloud partner Microsoft is the choice of nearly all Fortune 500 companies and financial institutions of all sizes.

Its Azure cloud has transformed the trust in this technology among financial firms because of its strong focus on security, compliance and trust. It ensures industry requirements and standards are followed from on-premise systems to the edge and the cloud: Azure has over 90 base certifications and 35 industry-specific certifications, for example for SOX audits. The Microsoft model also ensures that customers retain data ownership.



Microsoft is enabling financial institutions of all sizes including 95% of all G-SiFi's

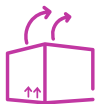
Key takeaways

This discussion of core modernization for community banks leads us to a number of key takeaways:



Find the right core. Start core due diligence to find the core banking system which is modern, open and on the cloud.

1



Look beyond limits. Go beyond traditional business models restricted by branches/ geographical boundaries.

2



Go digital. Branch traffic will continue to decline, and digital experience will be the key to growing and retaining members. Nonetheless, branches should be prepared to transform to be more about in-person consultation and less about transactions.

3

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Today, it's key to have a digital roadmap or digital transformation in process. And it's important to look at your core and ask whether it's going to meet you digital transformation journey."

Bryan Wilken
Bank Midwest

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Having an innovation champion embedded in the C suite is key."

Jayson Callies
Seattle Bank's EVP – CIO



Refresh leadership. Find ways to infuse talent who can relate to the future market needs. Make sure there's a tech champion in the C-suite.

4



Budget for innovation. Do you have specific resource allocation to drive the innovation strategy?

5



Challenge everything. Will you be successful if you continue to do what you were doing 10yrs ago?

6

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With thanks



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Bryan Wilken
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Resources



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THE FUTURE OF FINANCE IS OPEN

Finastra is unlocking the power of finance for everyone by creating a platform for open innovation in the world of financial services.

[Contact us](#)

About Finastra

Finastra is building an open platform that accelerates collaboration and innovation in financial services, creating better experiences for people, businesses and communities. Supported by the broadest and deepest portfolio of financial services software, Finastra delivers this vitally important technology to financial institutions of all sizes across the globe, including 90 of the world's top 100 banks. Our open architecture approach brings together a number of partners and innovators. Together we are leading the way in which applications are written, deployed and consumed in financial services to evolve with the changing needs of customers. Learn more at finastra.com

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