

The *Heart* of It All

The new generation of core banking platforms promises to improve agility and customer insight through streamlined systems integration. And intensifying competitive forces increasingly are driving banks to consider core system replacements.



IT HOUSES a bank's primary deposit and loan information systems, and helps the bank provide myriad day-to-day services. It's the core system. Without it, a bank would crumble. Given the state of most banks' core systems, however, it's a miracle that they are able to function at all, some experts say.

It may be the heart of the bank, but the core system often is held together by a complex and tenuous web of technology designed to force disparate systems to talk to one another. As the pace of change in the industry continues to accelerate, banks are beginning to realize that they might just need a heart transplant. >>

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By Maria Bruno-Britz

"Those [banks] still running mainframe-based [core] systems see [that] it's costly, and they can't justify the return on investment," says Zeynep Fredrick, EVP and CIO, Webster Bank.

"I see some very large banks spending millions of dollars a year to deal with their old batch systems to help them respond to customer demands in real time," says Bart Narter, senior analyst with Celent (Boston). "When you're looking at nine figures a year in additional maintenance costs, you start to think it might be worth it to migrate to a new system. It's getting out of control."

Undertaking a core systems replacement, however, is risky business, which is largely why, with a few exceptions, the U.S. market has seen little movement in this area. Banks face the quandary of whether to take the risk of replacing their existing core systems or simply to try to hold the old ticker together by piling on the middleware layers. Yet it's that specter of risk and uncertainty that keeps many from taking the plunge.

"It's like a heart surgery," says Wayne Busch, a Chicago-based partner in Accenture's banking systems integration practice. "You won't do it until it's absolutely necessary."

However, insiders agree that banks are thinking much more seriously about replacements than they have in recent years. "Almost every bank is looking for options to enhance its environment," says Zeynep Fredrick, EVP and CIO of Waterbury, Conn.-based Webster Bank (\$17.5 billion in assets). "Those still running mainframe-based systems see [that] it's costly, and they can't justify the return on investment. There's a need for more real-time solutions today."

C.G. Kum, president and CEO of First California Bank (\$1.2 billion in assets) in Camarillo, Calif., says there definitely is more talk in the industry about the viability of current core systems. "Over the past couple of years, my peer banks have been evaluating their core systems, in part so they could avail themselves of better technology that's more affordable," he comments.

The benefits of the new generation of core systems, suggests Dan Drechsel, SVP and GM for financial services for the Americas with SAP (Walldorf, Germany), include improved agility and systems integration. "The new systems are based on SOA [service-oriented architecture], a common integrated platform for visibility into CRM, customer information and transaction banking systems," he says. "This combination provides a core level of agility for financial institutions to take advantage of for a long period of time. Most believe this generation of SOA-enabled, built-from-scratch architectures will be able to withstand the 30-year duration [that banks are accustomed to]."

Although the U.S. is lagging behind even other parts of

the Americas in terms of core replacements, Drechsel says, he adds that he has seen more interest among banks recently in core systems replacement. "We've seen more RFPs in the last six months from U.S. banks than we have in the last five years," he relates. "They're doing serious investigative work now."

A lot of that investigative work is being driven by changing consumer behaviors and expectations, particularly in terms of real-time transactions in the payments space, according to Celent's Narter. "I'm seeing the banks look harder at their core systems mainly because of debit cards," Narter explains.

"These are real-time transactions that are irrefutable.



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They're not like batch ACH transactions," he continues. "You need real-time balances and real-time risk analysis because these payments are occurring in real time. The old systems were optimized for processing batch payments, such as checks. Payments and information demands will continue to go to real time and will drive a lot of the changes at banks as they move to the payments systems of the future."

Size Matters

Like SAP, core systems vendor Open Solutions (Glastonbury, Conn.), which caters to midsize and small banks, also has noticed an uptick in business over the past 12 to 18 months, according to Mickey Goldwasser, VP, product marketing and communications. "The fundamental reason they're looking is that a lot of their systems aren't cutting it anymore," he asserts. "The competition is changing, and they need to address different demographics as they come into play."

Don Free, research director with Stamford, Conn.-based Gartner, adds that while "There haven't been any visible changes beyond the normal replacement cycles, ... under the covers, I am hearing more noise, especially among the midsize banks."

It's no surprise that most of the action in core systems replacement is occurring among small and midsize players; size definitely is a factor when considering core replacement, experts agree, as the amount of IT complexity and risk varies dramatically according to a bank's size. Therefore, while the large, global players are using the vast resources at their

disposal to maintain and upgrade their existing legacy infrastructure, the smaller players, though lacking in comparable scale, see an opportunity to dramatically modernize.

According to Free, it's becoming a matter of survival for midsize banks to reevaluate their current systems. "Midsize banks are disappearing," he contends. "Either they're grow-



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ing larger or they're being acquired. These are grounds for developing business drivers around core replacement. They are seeing edicts from the board to position themselves for the future. By updating their cores, they become more agile. Being competitive today requires more than the typical transaction processing that [legacy] core systems perform."

Technology Divide

And competition in banking is growing more fierce every day — not just from domestic banks, but from foreign banks and nonbanks as well, Free continues. "Of the top 15 banks in the U.S., about a third are foreign," he notes, pointing out that foreign banks often bring different business models to the U.S. market, along with their own technologies that tend to differ from typical U.S. bank deployments. "They do bring some advantages to the table that the U.S. banks don't have," Free says.

The fact that foreign banks use vendors from their own regions is one factor contributing to the growing disparity between the systems found in U.S.-based banks versus others. According to Accenture's Busch, there are differences in core technologies based on geography. SAP, for example, often is deployed at European financial institutions, he says.

SAP, much like Oracle (Redwood Shores, Calif.), is bringing its enterprise know-how into the core systems space, Busch adds. "They're not looking to only slightly improve the existing platforms, but to create a new set of capabilities on a new platform with real-time processing," he explains. "They bring to bear standard software and integrated platforms."

But this doesn't necessarily mean that the solutions are better than those offered by U.S.-based core systems vendors, Busch notes. "The banks that use [SAP] might have a superior architecture, but they [often] lack some of the business functionality necessary to compete in the U.S. market," he contends. Busch explains that the issue of "localization" — ensuring that systems are updated to reflect

the regulations and products unique to each market — often drives a bank's decision to tap a local vendor.

The technology divide between U.S. banks and nonbanks in the financial services space is even greater than the disparity between domestic and foreign institutions. Particularly in the payments and lending areas, banks increasingly face competition from upstarts that aren't hindered by legacy architectures, observes Mike Nicastro, SVP and chief marketing officer for Open Solutions.

"They're using relational systems that help them better understand their customers," he says, adding that while banks want to pursue relationship-based banking, in many cases their systems still are accounting-based. "[Banks] need a relational/rules-based system that tells them what to do. Legacy systems can do this, but you need to create other systems to make it work."

Given the limits of legacy core systems and the increasing pressure from more-modern competitors, banks are upgrading their technology, according to Christine Pratt, research director with Framingham, Mass.-based Financial Insights. "To say no one is doing anything would be wrong," she insists. "They're all doing it a little differently. It's a question of where you put your money."

Supporting Growth

In fact, the banks interviewed for this article all have replaced their core systems to one degree or another. And in keeping with what the experts are observing in the industry, they all fall into the upper end of the midsize sector. While their journeys along the core replacement road have taken different turns, the one unifying theme appears to be their desire to have a system that will grow with them.

According to First California's Kum, the bank underwent a total core replacement about three years ago. The bank, he relates, was growing rapidly, mainly through acquisitions, and decided to reevaluate its existing systems. "At the time, we were a \$300 million bank, and we knew we were going to grow," he explains. "So we wanted a system that would grow with us." The bank chose to outsource its core processing, selecting the iCore client/server-based solution from Hutchinson, Kan.-based DCI.

"We were growing," explains Kum. "So our IT world became more complex. But the [DCI] core solution let us integrate our acquisitions much more easily."

The new operating model is more agile and gives the bank more control over its IT-related needs, Kum continues. "With the legacy system, everything is dictated to you, and the pro-

fessionals who grew up in that environment became order takers," he says. "We want our people to have an element of creativity."

Kum acknowledges that the replacement was disruptive. If any glitches occurred, however, it was more likely due to the humans than the technology, he says. "We had several individuals who grew up on our legacy system who were afraid of the core switch," he explains. "But they were the first ones to admit that the changeover wasn't as bad as they thought it would be."

Noting that mergers and acquisitions often contribute to the core systems problems that banks experience today, David Wegman, senior vice president for Raleigh, N.C.-based Fiserv ITI, contends that a good core helps ease the process of integrating the acquired entity onto the main platform. And, he adds, vendors often will assist with the process. "We have a team that helps convert banks acquired by our clients onto our core solution," says Wegman, who is in charge of the vendor's Premier core banking solution, which targets banks ranging from de novos to those with about \$20 billion in assets.

Webster Bank's core replacement came about as a result of a decision to change its charter. According to the bank's Fredrick, Webster originally was a thrift. Due to an increasing commercial client portfolio, however, it became clear that if the bank wished to continue to grow it would need to convert to a commercial bank. Part of that transition involved converting

its systems as well. "We were an S&L until 2004," Fredrick says. "But in 2004, our systems were effective for a thrift, not a commercial

bank with commercial loans and cash management clients. It didn't support our growth plans."

Webster now uses the core platform from Jacksonville, Fla.-based Fidelity National Information Services. "This runs on a mainframe, but we look at it as a utility — it's not what will differentiate us," explains Fredrick. "Instead, we focused on the channels and implemented new technology there. We built an SOA middleware layer so we could act in real time and not have to worry about going to the mainframe to make changes in COBOL."

This actually was Fredrick's second core replacement during her career. "One thing I noticed that never changes is that people underestimate the amount of training you need to give your employees," she relates. "We also tend to overestimate people's ability to learn these new things. One

For more on outsourcing core processing, see related case study, page 39.

of the most difficult parts of a core conversion is educating people on the new system and processes. Ultimately, the execution is in the hands of 3,000 people. I'm not trivializing

the IT aspect of the conversion, but I do think most banks overlook the training aspect."

Overcoming Limitations

While growth is a primary driver of core conversions, sometimes banks start down the road to a core replacement almost unintentionally. That was the case with Natick, Mass.-based Middlesex Savings Bank (\$3.4 billion in assets). According to Chuck Bauer, EVP and CTO, the bank originally was looking for a new front-end teller system. "We had a teller platform for about two years when we were informed that the vendor was discontinuing support for it," he explains. "As we looked for a new system, we realized we were limited in what we could buy because of our legacy mainframe transaction-processing engine. So we decided to broaden our search to find a new core system that would support a new front end."

Middlesex selected Open Solutions for its new core. But the bank didn't do a wholesale replacement of all its applications, Bauer relates. "What was appealing about Open Solutions is that we were able to keep in place our ancillary applications, such as the general ledger system and online banking, and create interfaces using Open Solu-



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tions," he says, adding that the bank moved from its old mainframe system to a Unix platform running on HP (Palo Alto, Calif.) hardware.

Middlesex Savings now has a system that will grow with it. "Our mission was to become more oriented to sales and service," Bauer says. "We have the ability to do that now and provide information to the people dealing directly with the customers."

Another benefit to the conversion was that the bank gained access to more skilled IT people, Bauer adds. "When we looked for people to help support our legacy mainframe systems, we found that experienced help from that era was hard to find," he relates. "The new system gives us the ability to run industry-standard applications, and we now have a wide range of folks to choose from." □