iGCB™ | intellect® Design for Digital

Core Banking Modernization in Europe – **Taking the Composable Route**

Author – Vikas Tripathi Senior Vice President, iGCB, Intellect Design Arena

Founded in 1896, Barclays is among the world's oldest banks and enjoys the patronage of some of Europe's most profitable corporations. In 2021, Barclays claimed over 48 million customers, amassed over its 120+ year history.[1]

On the other hand, Revolut is a UK neobank that has acquired over 15 million account holders in less than a decade since its founding.[2]

These numbers are illustrative of a larger shift in the global banking system, with agile, digitally empowered financial service providers making inroads into mainstream banking territory. Currently, traditional banks, with their large product and service portfolios and legions of loyal customers, still hold the lion's share of the European banking market.[3]

However, that situation may not last.

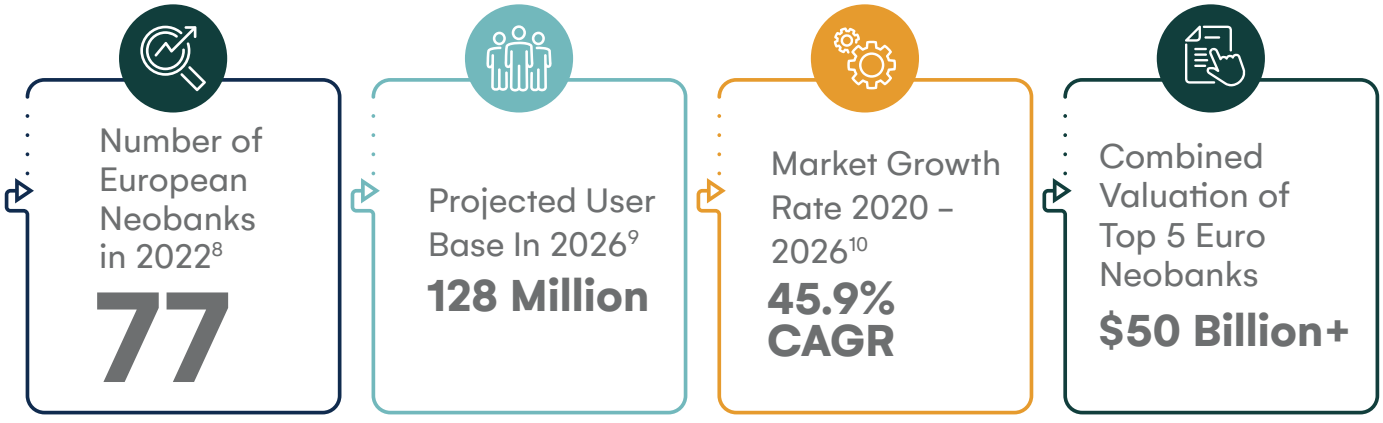
The Explosion of Fintech and Neobanks – Trends

Neobanks are rapidly gaining ground in the global banking market, with over 23% of traditional banking customers now holding a neobank account.[4] And the pandemic has further helped them get a foot in the door. With many traditional bank branches closed, customers have increasingly turned to purely digital financial service platforms, especially on the trading and international payment fronts.[5]

The question then arises, are mainstream banking models no longer relevant? And if not, how can banks rise to this new transformation challenge?

As always, much of the answer can be found in evolving customer expectations. Case in point, how often do you hear someone gushing about how wonderful their bank is? Today, more and more customers are dissatisfied with brick-and-mortar banking systems and their associated experience and instead clamor for the seamlessness and personalization of mobile technology.[6] Across Europe, digital banking adoption has risen by 10% to 20% in April alone.[7]

European Neobanking Trends



[1] https://www.banking.barclaysus.com/who-we-are.html
[2] https://www.statista.com/statistics/1089710/key-figures-for-revolut-bank- united-kingdom/
[3] https://www.ey.com/en_no/financial-services-emeia/how-traditional-banks- can-make-the-most-of-consumer-trust
[4] https://www.accenture.com/_acnmedia/PDF-147/Accenture-Consumer-Study- Banking-ASG.pdf
[5] https://fincog.nl/blog/18/performance-of-neo-banks-in-times-of-covid-19

Tied down by a combination of legacy core banking systems, complex regulatory compliance, and increasingly varied customer requirements, traditional banks are failing to keep pace with the entirely digital paradigm that neobanks offer. For legacy banks, the cost of ripping out existing systems and rebuilding their technology stack is far too high to contend with. And in a strange catch-22, many traditionalists feel that developing new platforms to counter tech-based competition will lead to a fragmentation of their core customer base.[11]

Neobanks, on the other hand, address some of banking's most ubiquitous problems. Given that most neobanks provide completely digital banking, they prioritize the consumer experience and round-the-clock availability, making it easier than ever for users to create an account without ever visiting a physical branch. Neobanks also tend to offer limited or specialized services, which, combined with their low overheads, allow them to offer customers higher interest rates and significantly lower fees.

A case in point is Bunq, an Amsterdam-based digital bank with over 5.4 million customers. They offer a zero fee online savings account with a 0.09% interest – that's over 9 times the average rate offered by traditional European banks.[12] Via the app, a Bunq account can be opened in about 5 – 10 minutes, which is a far cry from the 1-2 business day timeline touted by many incumbents.[13] In fact, at Lloyds, opening a basic savings account can take as much as 7 working days.[14]

Critically, the specialization of neobanks lets them effectively target unbanked sectors of the population with basic banking packages like checking accounts and consumer credit lines, as well as value-added services like smart savings plans, budget setting tools, and financial literacy apps.

---

[6] https://www2.deloitte.com/content/dam/Deloitte/de/Documents/financial-services/Banking_Trend_Radar.pdf
[7] https://www.mckinsey.com/industries/financial-services/our-insights/no-going-back-new-imperatives-for-european-banking
[8] https://neobanks.app/europe
[9] https://www.statista.com/outlook/dmo/fintech/neobanking/europe#transaction-value
[10] https://www.reportlinker.com/p06021862/Europe-Neobanking-Market-By-Account-Type-By-Application-By-Country-Industry-Analysis-and-Forecast.html#:~:text=The%20Europe%20Neobanking%20Market%20would,period%20(2020%2D2026).
[11] https://unitedfintech.com/blog/neobanking/

A lot of this change has been fueled by an overall shift from product-centricity to customer-centricity within nearly every industry. Neobanks and other alternative financial service providers have capitalized on this shift, creating a more streamlined customer experience while injecting disruptive products at different points within the financial value chain. This is not just a European banking trend. In India, for example, credit providers like Simpl and LazyPay offer customers instant payment facilities on popular e-commerce applications – not only does this eliminate the need for users to engage in lengthy authentication and payment processes, but it also eats into traditional banks' lending market share. In Europe, 44% of neobanks have begun offering customers investment products in addition to baseline banking services further democratizing the investment market. Revolut, for example, gives their users the chance to invest in crypto, stocks, gold, and commodities, with a minimum investment threshold of just $1.[15]

Most digital-first businesses now offer a low-friction user experience, real-time results, and increased personalization. Most banks on the other hand still possess just a digital front and have been slow to catch on.

And In the Incumbents Corner

Despite the agility and adaptability of fintech startups, traditional banks have a host of advantages on their books. This includes,

1. A loyal customer base

Banking customers are traditionally loathed to change service providers and offer a loyalty rarely seen in other industries.[16] Having a large customer base also makes it easier to successfully roll out new offerings and initiatives.

2. Easy access to capital

Most banks have large capital reserves that make transformation funding a matter of internal approval rather than outside interest. Unlike startups, banks rarely have to seek out VCs and investors to scale their transformation.

3. Stacks of data

Years of collecting customer information (no matter how siloed) means that banks have a wealth of insights and data mining opportunities. This data is essential to modeling market shifts and shaping new products and services.

[12] https://www.ecb.europa.eu/press/pr/stats/mfi/html/ecb.mir2201~ad7fe9eca4.en.html
[13] https://www.expatica.com/uk/finance/banking/opening-a-bank-account-in-the-uk-103992/#:~:text=Many%20standard%20bank%20accounts%20in,opened%20within%201%2D2%20days.
[14] https://www.lloydsbank.com/current-accounts/all-accounts/classic-account.html
[15] https://blog.bricknode.com/en/bricknode/investments-the-growing-opportunity-for-neobanks/
[16] https://www.statista.com/statistics/466271/uk-banking-length-time-use-main-account/

The Digital Banking Transformation Dilemma

Given that banks have every reason to change the status quo and realign their systems toward a digitally-focused future, why haven't they made a meaningful shift yet?

In Europe, many banks are pushing back against core banking modernization for a variety of understandable reasons[17], and we'll examine the major ones below:

Execution Risk:

Core technology overhauls are often long-term projects that run the risk of significantly exceeding cost and timeline projections. When added to the long payback periods inherent to such projects, few banks have the appetite for initiating modernization processes without seeing tangible (if not immediate) returns on their investment.

Hard-To-Migrate Legacy Systems:

While many core banking systems are old, they also tend to be tailored to a given bank's specific offerings and processes. This is particularly true for banks with cross-border operations that have systems designed to address regional compliance and product nuances. In fact, studies show that the average bank allocates 15-25% of its costs toward IT alone.[18] While there's no doubt that these bespoke software solutions are functional, it's also true that they're often time-consuming and cost-intensive to migrate. And where migration is successful, modernized banking cores will still need to support various APIs and third-party applications to compete with neobanks.

Studies show that the average bank allocates 15-25% of its costs toward IT alone.

The Pace of Technology:

With the complexity of Tier-1 & Tier-2 banking cores, it's understandable that modernization is likely to be a long-term project. Many management teams fear that the pace of technology change could outstrip the value of their new systems by the time implementation is complete.

Considering these pitfalls, bank CXOs are often confused about whether they should choose a complete overhaul or incrementally modernize their systems. A total replacement of existing systems will not only require years of development and software integration but also brings with it a slew of change management costs and is time intensive. Incremental changes, however, can take just as long and may only bring marginally competitive benefits over the next few years – by which time it may be too late to easily regain market share from neo and challenger banks.

Composable Architecture – The Solution to Core Banking Modernization

Instead of taking a monolithic approach to rebuilding your core banking system, or simply adding cosmetic, front-end changes, composable architecture allows you to cherry-pick the system components that you want to modernize.

1. It Starts with A Platform

Instead of managing all your core system needs in-house, pick a platform that's designed from the ground up for composability. This lets you focus on building better products and services, instead of wasting resources on the IT implications of a system change. Remember, customers don't particularly care about the systems you use, they care about the experiences you deliver. Additionally, since composable platforms and components that live on the cloud, are always-on, always accessible, and nearly infinitely scalable.

Besides building a cost-effective, phased modernization program, composable architecture lets banks evolve quickly, but without sacrificing resources on expensive feature builds.

2. Open APIs Reduce Vendor Lock-In

Using APIs to connect different components of your banking ecosystem, makes it easier to add components/functionality to and modify information flows within your ecosystems. If the regulatory environments necessitate new levels of authentication, or if you want to roll out a new service, you won't be reliant on a single vendor to get the ball rolling. This also means that building, integrating, and testing new features is more cost-effective since they don't require highly specialized knowledge or years of experience with your existing systems.

3. Scaling Gets Easier

Instead of investing in massive amounts of infrastructure and CPU power to handle vertical or horizontal scaling, a cloud based composable system simply adds new servers. This gives your systems the elasticity to go from one user to one million users and back down again automatically.

4. Continuous Delivery for The Win

Typically, when rolling out a large update, you run the risk of alienating some users who dislike your new UI or are confused by new features. Composable architecture lets you roll out updates on a granular scale instead, so that your banking platform evolves over time. This requires little to no change management, and lets users become comfortable with each upgrade before you unleash the next one.

5. Innovative Banking Ecosystems

Although we've outlined just how much of a potential threat fintechs pose to the traditional banking paradigm, there's always a flipside. Banks have a significant competitive advantage that stems from their native customer base, as well as from the entrenched catalogue of services they offer.

But despite not having anywhere near the same levels of user loyalty, the agility of fintechs makes for a tremendously innovative ecosystem. The question then arises, why not combine the two?

It's a fact that no single company can innovate as fast and as successfully as an ecosystem of specialized vendors.[19] This is especially true given the pace of technological development, where disruption hits the market every 3 years, on average, across all industries.[20]

Composable architecture makes creating this ecosystem easier, since each component can easily be integrated into a new one via API.

> **Instead of viewing fintechs as threats, banks should look to them as specialist partners that provide value added services and innovation opportunities.**

Picking The Right IT Partnership

When zeroing in on a suitable vendor, ask yourself the following questions,

Are they invested in your growth journey?

Highly specialized banking software vendors which focus on a few business units (say just digital channel or just banking without credit card or digital channel) can sometimes view customers as just another account. Typically, banks are better off building a relationship with an end-to-end banking solution provider and creating a mutually beneficial growth journey. This means that your chosen vendor will continue to align themselves with your needs post-implementation, and also that they play a key role in innovating the technology behind new banking products.

Do they offer managed services?

Taking the weight of technology maintenance off your internal IT team, means you need a reliable vendor to manage your cloud infrastructure. Easing the burden of technology, means your bank is able to devote more resources to what matters – the customer experience, the products, and the bottom line.

How flexible is their platform and innovation process?

If your vendor has a clear idea of the evolving industry landscape, they will be able to quickly understand your needs in the context of your vision.

Is your bank aiming to be a completely digital entity by 2030? What does your future service and product roadmap look like? What tech opportunities have you overlooked so far? A competent vendor should be able to offer a technological roadmap that is tailored to you, instead of just selling you an out-of-the-box solution.

---

[19] https://masschallenge.org/article/startup-innovation-ecosystem-explained
[20] https://blogs.cisco.com/digital/the-digital-vortex-where-disruption-is-constant-and-innovation-rules

Conclusion

As customer expectations evolve at an increasingly frenetic pace, banks and their software architectures must be more adaptable and agile than ever before. The rise of neo and challenger banks added a new layer of uncertainty to the banking sector, as traditional banks struggle to outcompete these tech-savvy, customer-focused entrants to the market.

The smart solution to this challenge is creating a composable banking platform that is, in effect, coreless. Besides offering flexibility and lower TCO, composable architecture allows banks to future-proof its systems, since components can be removed and integrated at will. This in turn allows banks to quickly align back-end systems with new product offerings, and rapidly take advantage of emerging market opportunities. Composable systems will also precipitate the creation of new partnerships between 'new' and 'old' banking enterprises, developing new financial ecosystems and profitability paradigms in the process.

About Intellect Global Consumer Banking (iGCB)

iGCB, the Retail and Central Banking Solutions arm of Intellect, offers an end-to-end Contextual Banking suite for retail and corporate banking across Core Banking, Lending, Cards, Digital Banking, and Central Banking. Its unique blend of integrated functionality and agility is made possible by its Microservices-based, API-first, cloud-native architecture with powerful integration capabilities.

iGCB brings to the table a deep knowledge of the developed and developing financial market space and seeks to be the Innovation Partner for those who are passionate about transforming the future of fintech!

www.igcb.com