

How Core Modernization Can Revitalize U.S. Regional Banking

Broad scale technology modernization holds the key to empowering the regional banking sector

For regional banks, competing with large national and multinational banks with huge technology budgets can be a daunting challenge. But instead of trying to keep up with the Joneses when it comes to technology spending, regional banks should rethink and adapt business models to focus on customer experience and then wisely invest in core modernization to accelerate business growth and agility.

"Regional banks must evolve to meet changing market needs," notes Rodrigo Silva, President—Americas, Temenos. "Modernizing the core helps banks to be more efficient, scale faster, launch new products, respond to regulatory changes, and anticipate consumer needs while staying ahead of the competition."

Silva adds, "A modern, cloud-native core builds the foundation for banks to be data driven, as well as to benefit from new developments such as open banking."

Unique Challenges for Regional Banks

Net interest margins are shrinking for every institution, from large nationals to community banks, but many in the regional banking sector face a few unique

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challenges. Their size means they tend to have less profitable small business loans than larger financial institutions and higher costs to manage dwindling deposits.

Last year's failure of Silicon Valley Bank, Silvergate Bank, and Signature Bank didn't help. After the crisis, large corporate deposits looked for perceived safety, migrating to larger banks with implied government funding because they were 'too big to fail'.

All financial institutions are struggling to keep up with regulatory compliance, but the struggle is more acute for regional banks due to their smaller budgets. The FDIC ordered regional banks to pay as much as $500 million as a special assessment to replenish its insurance fund—which ate into a larger percentage of 4th quarter profits for regionals than for larger banks.

And, since regional banks are more reliant on local market conditions, they are more impacted by regional economic fluctuations.

The Legacy Problem

Regional banks would love to invest in innovative technologies that could provide a competitive edge, but many are at the mercy of legacy core systems. These systems are unable to integrate cutting edge technology like Cloud, Gen AI and machine learning. Legacy core systems are also expensive to maintain and do not allow for the rapid innovation and speed to market vital for building better customer experiences and gaining competitive edge.

Core modernization is therefore imperative, but is nonetheless a major undertaking. Technology vendors must offer flexibility and choice to banks if they are to achieve success together, ensuring the project is aligned and suited to the bank's business strategy.

Deployment methods will differ for individual banks according to their business strategy, and so true flexibility means being deployment agnostic. Nonetheless, both banks and vendors should be clear on the particular strengths of Cloud and SaaS deployment. These offer greater computing power, cost-efficient scalability, lower up-front investment and increased business agility. Banks in North America appear to be prioritizing these advantages, moving their domestic core banking to the cloud more so than those in other regions (36% of North American banks vs. 20% of banks globally). [1]

Whichever method is chosen, there are four approaches to core modernization:

1. Big Bang Modernization: You implement new technology rapidly and completely remove legacy systems in one fell swoop. But it's expensive and disruptive, and not without risks.

[1] https://www.temenos.com/news/2023/11/20/economist-impact-research-for-temenos-shows-north-american-banks-betting-big-on-technology/

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2. Greenfield Modernization: You build new parallel systems from the ground up and migrate operations to this new platform. Without legacy system constraints, you can launch new offerings and deliver value quickly. This approach tends to be less expensive and lower risk than other modernization options because it doesn't expose your existing customer base to the platform until it's proven to work.

3. Sidecar Modernization: The goal of this approach is to move functionality off the legacy core by building new functions in parallel systems (sidecars). Sidecars handle specific tasks or data processes scaled independently from the core, allowing you to quickly adapt to market conditions, introduce new products, and improve customer satisfaction.

4. Progressive Modernization: Also called "incremental modernization," you replace legacy system components one by one. With this approach, you keep the core legacy platform but minimize reliance on it as you build a modern infrastructure around it. You prioritize components based on your needs for example, by business line. While the transition takes a little longer, progressive modernization is lower risk than the big bang approach because you can course correct along the way.

The Path to Core Modernization

The journey to core modernization starts by defining your strategic intent from the top of your organization. To achieve long-term value, build an appetite for change and facilitate collaboration between technology and business groups. In fact, core modernization should be viewed as a business-led transformation rather than just another system implementation.

Integrating disparate systems and promoting data sharing breaks down silos and encourages cooperation that results in better problem-solving and innovation. Access to real-time data and automated processes means employees spend less time on manual tasks and more time on higher value activities like customer service, engagement, and relationship management.

Core modernization introduces new technologies that can transform your culture to a more knowledge-driven one. Since employees will need to learn new skills, your culture should support continuous learning and adaptability.

Temenos client, Commerce Bank, is an example of a regional bank doing it right. Their business model puts a focus on investing in technology, alongside people and products. As Commerce Bank's chief financial officer, Chuck Kim, shares "Commerce's purpose

is to help customers focus on what matters most. We do that by opperating a Super Community Bank model, which means we bring sophisticated banking products with high-touch delivery that strengthens deep customer relationships."

With their unique business model in mind, Commerce established clearly defined objectives as it moved from its legacy systems to a modern, agile, and open platform for both deposits and loans. Core modernization has helped deliver on those objectives, providing real-time and straight-through processing, as well as a 360- degree customer view.

“Commerce Bank is focused on staying at the forefront of technology to ensure the best service to our customers,” explains David Roller, CIO, Commerce Bank. “We recognize that a modern core banking platform is an accelerator for innovation and digital customer experiences. The Temenos platform will enable Commerce to deliver innovative solutions to our customers today and well into the future.” [2]

Moving Forward

Regional banks face a host of challenges, including economic pressures, budget and resource constraints, and keeping up with regulatory compliance. However, regional banks, with their focus on personalized service in local markets, can stay ahead of the competition by modernizing their core banking infrastructure to be more efficient and lower costs, launch products faster, and respond quickly to regulatory changes.

About Temenos

Temenos (SIX: TEMN) is the world’s leading open platform for composable banking, serving clients by helping them build new banking services and state-of-the-art customer experiences. Top performing banks using Temenos software achieve cost-income ratios almost half the industry average and returns on equity 2X the industry average. These banks’ IT spend on growth and innovation is also 2X the industry average.

For more information, please visit www.temenos.com.

[2] https://www.temenos.com/news/2022/02/14/top-50-us-bank-completes-core-transformation-with-temenos/