Transform for the future:

How can mutual banks in Australia transition to a next-gen banking platform

MAMBU | 4impact GROUP

Mutual banks in Australia

Four trends that are shaping mutual banks in Australia

1. Growing customer demand
2. Rising cost pressure
3. Technology threats and opportunities
4. Consolidation is picking up

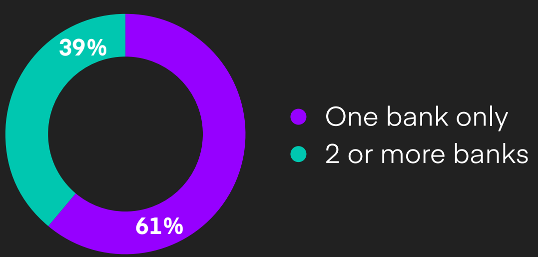
1. Growing customer demand

Competitiveness in the banking market lies in customer experience and product offering. In order to keep up with their expectations, mutual banks need to be able to continuously innovate their products, channels and invest in transforming their organisations to better reach their customers. In a recent study by KPMG Australia[1], 72% of the 18-29 year old demographic ranked digital personalisation as, at least, very desirable. This highlights the growing customer demand for operation of products, services, messaging and experiences. Customers want their experience to be frictionless and seamless thus a unified omnichannel experience is important. Mutual banks are losing customers due to the current experience or at least losing additional business revenue as they can't offer some of the required services.

We have seen the relationships between customers and mutual banks have evolved[2,3]:

One customer, multiple banks

Number of banks used by Australians



Millennials (48%) are the most likely to have accounts with more than one bank

Majority of consumers intending to switch banking providers view keeping up with new technology as very or extremely important.

About 20% of customers have changed the provider of at least one of their banking products in the last three years.

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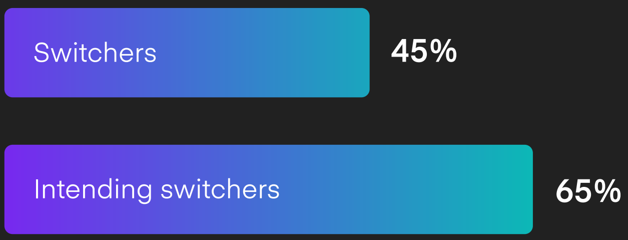
Switcher and intending switcher attitudes

Keeping up with new technology is at least "very important"



Switchers have changed providers of a banking product in the last three years, intending switchers plan to change providers in the next 12 months.

2. Rising cost pressure

With inflation, there has been increased pressure to reduce cost-to-income ratios . Despite during covid, Reserve Bank of Australia (RBA)'s has offered low cost funding with Term Funding Facility (TFF). But it is close to drawdown, banks need to have newer sources of funding and win over the customers to have more retail deposits. In addition, cost of compliance (CDR, APRA) has also made a disproportionate impact on smaller scale institutions like mutual banks to keep up with the same requirements. Open banking is expensive, therefore nearly one in every three Australian mutual banks do not comply with open banking, while others that are compliant on paper have systems that do not work in practice. Mutual banks' customers are not growing in line with the rising cost, making it more and more challenging to spread these cost to the existing customer base. Meanwhile, cost to manage customer data has also increased due to platform limitations,overnight batching, customer view provisioning and regulatory reporting (refer to APRA CPG-234/5, CPS-234). 60 percent of Australian banks ran into "considerable" or "significant" difficulty in trying to bring together these high-growth real-time data sources with historial holdings so as to create a deeper understanding of customers and behavioural trends[5]. Core banking system providers, including Ultradata and Data Action, are relatively small and have their own capacity constraint[6].

> **Where banks have migrated to next-generation cloud banking platforms, their IT costs associated with the 'core' have reduced by 50%.**
>
> — quote from Mambu based on a new digital bank implementation in a mid-sized legacy bank

Nearly one in every three Australian mid-tier credit unions, building societies and other institutions do not comply with open banking, while others that are compliant on paper have systems that do not work in practice[7].

3. Technology threats and opportunities

In a recent KPMG Mutuals Industry Review, technology and business transformation is viewed as the biggest opportunity to improve performance in the mutual banks sector (46.3%), showing in budgets with more than half of survey respondents indicating that at least 25% of their IT budgets were allocated to enhancement or business transformation. There is also a growing number of alliances between banks and fintech companies, highlighting the importance of partnerships to improve customer experience.

Therefore having the technology backbone and intelligent architecture is necessary to enable mutual banks to keep pace with market trends, partnership demand as well as regulatory changes in a cost-efficient way. The tech stack should also support real-time decisions and transaction capabilities. The requirement to participate in and comply with the evolving Consumer Data Right (CDR) has seen increased architectural and data governance pressures on technology choices. There is also a shift in architecture approach for core systems, moving from black box or modular based systems to composable, best of breed products.

4. Consolidation is picking up

The three key drivers:

Low-interest margin environment

Cost inefficiencies

The push to invest in transformations

There are limited resources to invest in technology and transformation due to already high cost-to-income ratios. Recent merger of Heritage Bank and People's Choice Credit Union (PCCU) shows the sector is looking for ways to improve operating efficiency. With further push from regulatory compliance (APRA), more and more mergers will happen in the mutual bank sector which is under pressure to increase investment to fend off technology-focused competitors that are luring their customers away[8].

Many mutuals recognise the need to change, however they faced certain challenges

Challenges to move ahead the transformation journey and replace the existing core

1. Short of financial resources:

- Many mutual banks do not have the deep-pockets for technology investment. It is hard to meet the ROI target with very high hurdle for the new investment
- Difficult to balance IT spending between tactical and strategic projects

2. Lack of capacity, talents, skill sets and partnership model

- Existing workforce has been maintaining the current platform for decades and requires upskilling
- To manage the core replacement requires dedicated teams and bandwidth
- Process changes that result from the new digital core require a new way of working with different skill sets and partnership model

3. Challenge to maintain good customer records

- Mutuals lack clean, organised, comprehensive records of customers, without effective tools to manage and process data with consistencies and quality

4. Lack of ability to write back to existing core platform when launching digital products

- Difficult to manage GL, payment integration
- Difficult to balance IT spending between tactical and strategic projects
- Tendency to add more technical debts to the existing platform

5. Risky for "Big bang" approach, costly to have "duo-core"

- Costly to maintain the licenses for the duo-core
- Lack of value-based approach for migration, no clear plan of which product or segment to migrate firs
- Difficult to create a robust Product strategy to balance new (products/revenue stream) and existing product cutover

However, there are also opportunities and strengths that mutual banks could leverage:

- Most mutual banks are collegial and not competitive (due to different regional and segment focus) which means there is an ability to share cost and risk in the digital path forward.
- There is opportunity to realise new economics, to capture new segments and expand existing product offerings with enablement from new banking platform and a next-generation core.
- There is also opportunity to create new shared services/capabilities that are non-differentiating and drive cost-efficiency, from platform to products and services.
- Tech ecosystem has proliferated and developed in Australia so that mutual banks could leverage digital partners with pre-integrated components to increase speed-to-market.
- Transition to a next generation core system will allow mutual banks to respond to market trends to iterate fast and be agile based on customer feedback and data analysis.

Strategic options for mutual banks

- **How players in other global markets solve the issues**

  A. **UK case study - Newcastle Building Society:** the building society opted to modernise its core while monetising this capability. Newcastle Strategic Solutions was borne out of the building society's own needs and now offers a range of savings management solutions to fintechs, challenger banks, and financial service providers.

  B. **Canadian case study - League Data:** engaged with a technology partner for managed services to optimise costs for un-differentiated banking infrastructure services: **shared-utility/consortium model** to gain the benefits of a modern core banking system at a lower cost than an individual model.

Albeit being examples with different compliance requirements, they still have implications on mutual banks in Australia as they faced similar challenges:

1. Staying "status-quo" is not an option anymore

Not replacing the core system will result in regulatory and compliance challenges for both the bank and core system providers. This has not been a smooth ride in recent times, mutual banks have to react and transform for their existence. There will also be gaps in customer experiences, missing out on opportunities to launch new innovative offerings. You will lose competitive edge and market share to digital challengers and larger banks.

2. Invest and innovate

Mutual banks with the funds required could invest in technology, replace the legacy core with a digital core. However, it is not feasible for most mutual banks due to capital requirements. They also require management and board's commitment to mandate the core replacement and financial resources as return on investment is usually more than two years. Core cutover strategy is critical whereas dual systems are cost vs risk and the decision required on core architecture is single provider (modular) vs SaaS digital platform and best-of -breed digital products.

3. Explore shared utility models

Engage with a third party banking service provider who will administer next-generation core banking solutions and drive incremental transformation. This way, mutual banks could share the infrastructure and core banking services. It will be feasible and cost-effective, less risky for 'like' platform banks. It will also reduce the cost of ecosystem partner integration, pre-integrated (repeatable) products, and potential for 'common service' consolidation
and savings.

Next steps for mutual banks

Mutual banks need to purposefully design their journey to transform and craft their own strategy. With common current platforms, challenges, and future goals, the opportunity for mutual banks is to form a 'consortium of the willing'. Share the cost and risk, develop once and leverage the common footprint in a digital banking platform, core functions (payments, settlements), and digital products (loans, credit cards) both current and new. For services outside the 'common footprint' mutual banks can integrate digital products as a standalone project.

As a first step, they need to be clear about the objective of transformation and the impacts across people, processes, and technology.

Transforming to a new digital core will deliver benefits in multiple ways: mutual banks then need to be clear about which ones resonate the most (compliance, new products). It is reasonably clear that mutual banks need to 'transition' to a new platform. But for mutual banks the big question is: how do I get to a modern digital banking platform?

Mambu and 4impact have a proprietary approach to help mutual banks transition from a **traditional core platform** to a new **digital and cloud banking platform**, incrementally. Mambu and 4impact are working with industry-leading, Australian-ready and digital solution providers to build an ecosystem of best-of-breed services pre-integrated to the Mambu platform.

Approach benefits are as follows:

Shared cost and risk – as they do today to an extent, a mutuals 'consortium of the willing' could share the development cost of the platform and common services with a transition plan sequence based on current licensing agreement dates.

Repeatability – process and technology ready to transition to the next 'common platform mutual' invested in the shared model.

Data – a data solution to manage tactical requirements such as 'single customer record' from multiple sources today through to strategic data management requirements (compliance) for a digital bank.

Integration and automation – capabilities to ensure your existing platform remains updated with any new digital product data (loans product) prior to the transition to Mambu and all integrations are developed to a repeatable architecture and are supported appropriately.

Compliance – maintain current and meet new compliance requirements across the transition journey, whilst implementing cost-saving automation.

In conclusion, the mutual banks face ever-rising challenges and can no longer rest on customers' trust and legacy systems. Transformation is the only way out for mutual banks to stay relevant and competitive in the market. Mutual banks need to continuously deliver distinctive digital experiences embedded in the daily lives of the members and modernise the core systems to drive innovation at speed. Focusing on differentiating services, mutual banks can explore shared utility models to lower the cost and risk. It will not be smooth sailing after such a long period of stability, and not a path that they can explore on their own.

Mambu and 4impact can help you make financial change happen. Our composable tech foundation can help you gain advantage by shifting to a high-velocity operating model. It is a new approach that goes beyond technology and empowers financial institutions to run at a faster tempo to keep up with customer and market expectations.
Embark on your digital transformation journey today and help mutual banks to continue to win the heart of the future generations tomorrow.

1 KPMG Australia Mutual Industry Review 2021
2 Finder.com.au
3 Deloitte, Open banking: Switch or stick
4 ARPA Requirement
5 IT News
6 Fintech Business
7 CDP Institute
8 AFR

About Mambu Advisory

Our Advisory team brings Mambu's unique knowledge from 200+ clients across 60+ countries, helping our customers carve a path through complex customer, commercial and operational challenges. Whether designing a proposition to access new customer segments or markets, defining digital product roadmaps, identifying ways to improve product flexibility, creating a speedboat or simplifying the business architecture, Mambu Advisory Team is here to help!

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MAMBU Advisory

We serve our clients across three key services:

- Customer strategy - Designing new propositions, understanding untapped customer segments, exploring unmet customer needs which can help create an unfair advantage in the market
- Commercial strategy - Developing growth engines to help achieve revenue (exploring new value pools within existing customer base) and cost outcomes (simplifying business and/or technology architecture to simplify legacy complexities
- Operational strategy - Defining strategic realignment to create a new way of doing business and creating organisational muscle for innovation.

About 4impact

As a Financial Services Integrator (FSI), 4impact Group brings the benefit of experience, capability and capacity to deliver new Fintech product integrations to the Mambu platform, as well as manage customer Fintech transition projects.

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4impact seeks out best-of-breed fintech solutions to help banks and lenders evolve and transform. We deliver 'rapid value' business outcomes through the orchestration of composable digital banking platforms and products, leveraging our knowledge, experience and skill sets to get you to where you need to be.