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Transforming UK Banking Business Architecture:

A Suggested Approach

How to manage the implementation of the UK

Banking Reform Act through business architecture

transformation.

by David Winders, Senior Consultant, iGrafx

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In September 2008 we saw the demise of Lehman Brothers and the iconic images on television news of morose staff, some in tears, carrying out their belongings in boxes into the streets of the city of London; this was the beginning of the deepest crisis in banking since the great depression in the 1920s. With the imminent collapse of several household named banks in the UK the government stepped in with billions of tax payers' money to underpin the continuing integrity of the UK banking system to prevent the systemic failure of the economy

Emerging from these dramatic events was the concept of institutions being "Too Big to Fail" whereby the normal fear of going out of business, as restraint to how much risk should be taken, was effectively removed by the notion that major banks will never be allowed to go under because the consequence would be too big for society as a whole.

The British government therefore asked Sir John Vickers to chair an Independent Commission on Banking ("ICB") to make recommendations on how to resolve this situation. The commission made a series of recommendations, the majority of which were captured and put into legislation in the Financial Services Banking Reform Act 2013. This act of parliament covered a number of topical items in financial services but specifically included legislation to mitigate against banks being "Too Big to Fail" through the introduction of a concept called Ring-Fencing.
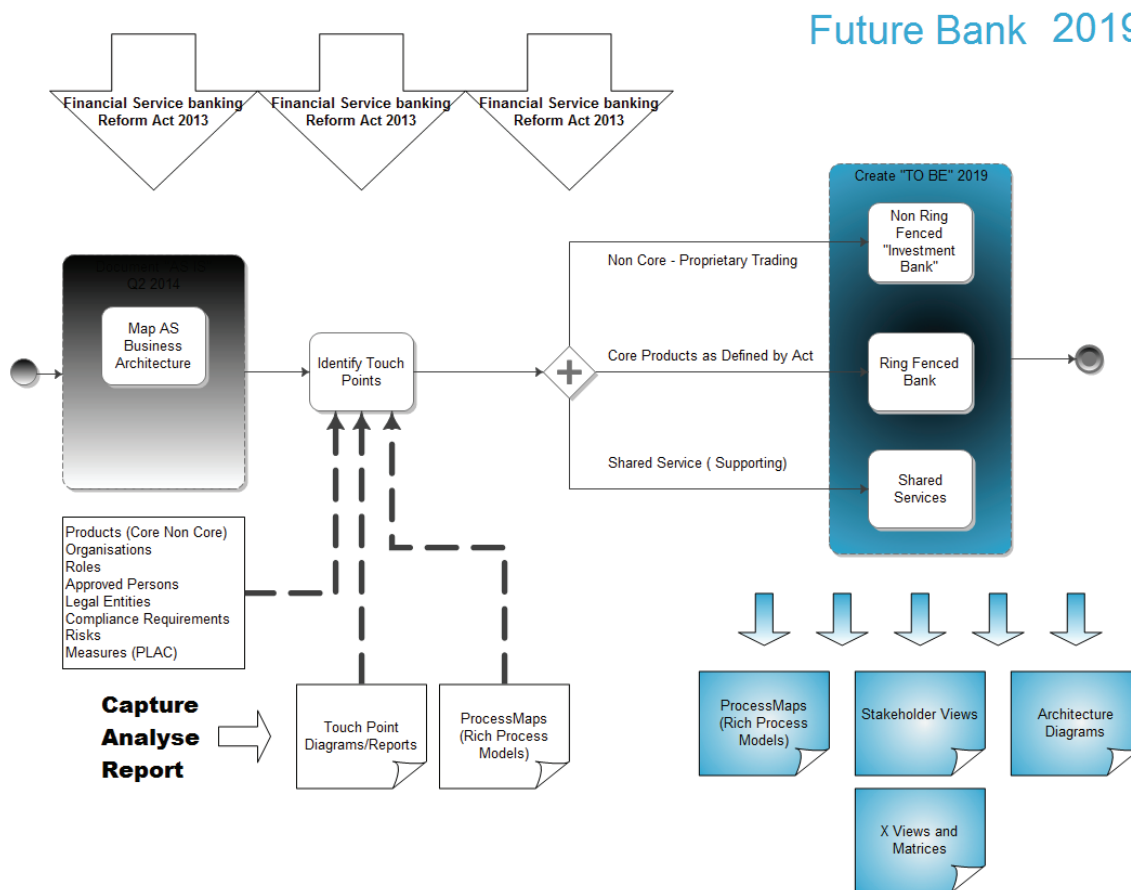
What ring-fencing means for UK banks

Ring-fencing requires a restructure of a bank to ensure that its perceived riskier endeavours of investment banking are separated out from core banking services. Ring-fencing as a concept has been legislated in the UK through the Banking Reform Act, and is a compromise from the more draconian alternative of complete separation which was considered too onerous in terms of cost, capital adequacy requirements and EU law.

Ring-fencing allows ring fenced entities to remain in a group structure but be separated functionally and economically as separate legal entities. As opposed to complete separation, this approach avoids the explicit duplication of all structures, processes and activities in each new entity. However, to implement ring-fencing, banks are still faced with a requirement that leads to a full transformation of their banking business architecture. This is a mammoth task that UK-owned banks must take on to meet the requirements of the Banking Reform Act by 2019 at the latest.

Future state: ring-fencing banking business architecture

To master the job of meeting the requirements of the Financial Services Banking Reform Act 2013 demands a methodological approach. It requires a process that starts with modelling the enterprise as it exists today and then identifying the places in the model where banking products affected by the new rules touch or overlap. Once these parts of the business are identified, the business elements can be divided into two or three future models. The outputs described in the diagram reflect best practice in communicating the future target operating models through stakeholder views and viewpoints.

Ring-fenced Process Transformation Methodology

Future Bank 2019

Financial Service banking Reform Act 2013

Financial Service banking Reform Act 2013

Financial Service banking Reform Act 2013

Create "TO BE" 2019

Map AS Business Architecture

Identify Touch Points

Non Core - Proprietary Trading

Core Products as Defined by Act

Shared Service (Supporting)

Non Ring Fenced "Investment Bank"

Ring Fenced Bank

Shared Services

Products (Core Non Core)
Organisations
Roles
Approved Persons
Legal Entities
Compliance Requirements
Risks
Measures (PLAC)

Capture Analyse Report

Touch Point Diagrams/Reports

ProcessMaps (Rich Process Models)

ProcessMaps (Rich Process Models)

Stakeholder Views

Architecture Diagrams

X Views and Matrices

Using business architecture to guide the implementation of the Financial Services Banking Reform Act

Source: iGrafx

Stage One: understand the current state

The first task to undertake is to understand the existing way that the bank's operations are structured, its business architecture, to prepare for rearrangement so that core banking activities are separated out from non-core activities and placed in a protected "safe" area: the "ring fence". This means all the components of the business need to be identified and mapped so one can see what parts should be ring-fenced or not. What might these components be?

- Products and Services (both Core and Non-Core)
- Processes and Activities undertaken in supporting products and services
- Organisational Structures that support those activities
- Treasury Functions - underlying financial structures that provide the financial foundations
- Risks and controlling measures that occur in various parts of the operation
- Approved Persons and Governance frameworks
- Key Regulatory Compliance Requirements

In an enterprise as complex as a major bank, there are many thousands of operational factors that link together, the numbers increasing substantially as analysts uncover the details. By identifying and capturing these factors as well as the linkages between them down to a level of detail sufficient to identify, the result is an "AS-IS" model of the business at a level of detail sufficient to identify what needs to move.

Understand the connections

Source: iGrafx

Stage Two: identify what goes where

Once the "AS-IS" state is defined, a touch point analysis needs to be performed to separate out the ring-fenced and non-ring-fenced elements by running reports across the architectural model; this will identify clearly what should go where. The need is to be able to run reports across a model to identify what objects should belong where. This is based on whether business objects are intrinsic to the defined core products or not, or in the case of supporting activities, where a "lift and deploy" into a shared services environment can be performed to avoid duplication. The many connections between the ring-fenced products and all the business objects that connect to them, will enable the isolation of items to be placed in one target operating model or another. The attribute applied to processes, of whether or not they are operational or supporting activities, will identify objects as candidates for shared services provision to avoid the unnecessary duplication of activity.

Stage Three: develop the future states

Once the split is defined it is necessary to create at least two new target operating models, "TO-BE" states, to represent the new entities; one ring-fenced and one for everything else. It should be considered to create a third target entity for the creation of a set of shared services to avoid duplication of common supporting activities. Items such as HR, Procurement, Financial Accounting and I.T. are classic candidates, but there may well be others. Therefore, you would potentially end up with three "TO-BE" operating models. These models describe the business architecture of each, clearly representing how the various business factors are interrelated, and perhaps most importantly, how each of the models are distinctly separate from each other.

The primary purpose of these target operating models is to communicate with clarity to management, staff and the regulator that the bank is truly ring-fenced and that the Banking Reform Act 2013 has been heeded, else the regulator may well insist on a more radical legal separation. The act makes provision for "electrifying the fence"; should the Prudential Regulation Authority (PRA) not be happy that ring-fencing has been carried out sufficiently. The PRA intends to audit UK banks annually, so the means to explain how ring-fencing is maintained is essential. The challenge here is to communicate the substantial complexity and show the traceability from regulation to operational activity in a clear and effective way; this is carried out by capturing regulatory requirements in the models and showing how they are managed in business activities through the clear identification of risks and by placement of controls.

Stage Four: user adoption of the new business architecture

Once the future state operating models have been defined, the next challenge is to fill in the details and plan for deploying the new world. Operational processes will certainly have been modified as a consequence of the transformation and the new way of working needs to be distributed and accepted throughout the organisation.

Effective business architecture has to have both the big picture and the appropriate detail beneath it; communicating at the right level with the right type of information provided to the right people is the aim. To maintain the integrity of the architecture models, they should be kept in a controlled, central location, where various stakeholders need to have access to information within their domain and appropriate views targeted to their needs.

The easier information is readily available to all, with minimal end-user learning hurdles, the better the business adoption will be. Pinpointed access to pertinent information for the level and role of every different stakeholder is essential:

- Operational team leaders need access to the relevant processes measures and goals for the purpose of day-to-day operations management
- Functional department heads need to monitor performance measures on process activities and how compliance and risks are being managed within their domain
- Approved Persons need to see all activities under their control, where the compliance controls sit and who is responsible for the day-to-day maintenance of compliance controls so they can manage their operational staff and perform their responsibilities as a key accountable individual

Compliance Managers need to be able to explain to a regulator how the organisation has been made compliant by showing traceability easily from regulation to operational activity; which elements of compliance regulation link to what process, who is responsible and how compliance is measured. During the actual implementation of changes, collaboration between team members needs to be controlled and coordinated. There are three principle management cycles that are required:

- Collaboration of work under construction where content is authored and peer reviewed
- Sign off and Approval of the finished work by stakeholders
- Acceptance by the business that the new processes have been received and are being put into live operations

For business readiness, the ability to ensure changes have been received, read and accepted into the business is good for both project management and proof of compliance.

The future for banking reform

The media presents the reform of banks as being a good thing, but often fails to explain to the public at large that this creates an additional cost of a substantial nature, that gets passed on to customers. Beyond the cost avoidance of fines and reputational threatening sanctions, the effective management of the banking reform act becomes a cost differentiator. Organisations that can manage compliance more efficiently than others will have a competitive advantage with potential cost reduction. By deploying effective solutions to manage business architecture, a bank can set itself above and beyond its competitors by becoming smarter at implementing ring-fencing for less cost.

In conclusion this paper proposes a four-staged approach to transforming a bank to comply with the legislation using business architecture modelling concepts:

- Model the "AS-IS" state by understanding and joining business objects
- Identify the split required

- Build the appropriate target operating models to assist in the implementation of the future form of the enterprise

- Communicate with clarity to the business what the new world will look like and manage the review, approval and acceptance of changes with the added benefit of providing a foundation for the cost-effective management of compliance on an ongoing basis

Banking reform is something that is not going to go away as legislators respond to continuing media focus on fair and trustworthy operations and robust governance. The approach to meet these demands effectively while reducing the burden of increased overhead expenses will be a critical strategic decision for many UK-owned financial organisation.

About the author

A seasoned Financial Services sector expert and consultant of iGrafx, David Winders mentors clients on the development of business architecture, incorporating an enterprise-wide view into all levels of the organisation to communicate a vision and baseline for business change. David specialises in training, customer experience development and process improvement through the application of agile and Lean business change in both the IT and business sides of business transformation.

About iGrafx

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EMEA Headquarter
iGrafx GmbH
Dr.-Johann-Heitzer-Str. 2
85757 Karlsfeld Munich
Tel: +49.8131.3175.0
Fax: +49.8131.3175.101
www.iGrafx.de

Contact Consulting
David Winders
Senior Consultant Europe
London | United Kingdom
david.winders@igrafx.com
Tel.: +44.1202.651297

Contact Marketing
Linda Holz
Marketing & Communications EMEA
Munich | Germany
linda.holz@igrafx.com
Tel.: +49.8131.3175.170

For more information
www.iGrafx.com