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From
THE PULSE

FALL 2023

Practical Considerations for the Merging of Two Banks

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The merging of two large banks is a major undertaking, and one that many of us in the financial industry have gone through multiple times. Given the market instability earlier in the year, we take time here to reflect on M&A and present some practical considerations for those involved.

The Initial Decision-Making Takes Time

The first thing to note is that once the decision is made for two banks to merge, it then takes a significant amount of time before the wider groups within the banks get involved in any integration activities. During this period, the M&A transactions are finalized, and the board engages with external consultants to develop a clear view of what the integrated organization should look like. Decisions will be taken on which businesses to keep, grow, downsize, or exit. Deliberations will take place on the overall scale of the target organization and which locations to retain as core for the merged bank.

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Once these key questions are answered, the vison must be aligned with primary regulators and potentially other stakeholders, to ensure the acceptance of the strategy before proceeding.

Beginning the Journey

With a newly defined business strategy and a high-level understanding of the target organization in place, the work of moving toward the new structure and setup can begin. One of the first hurdles that has to be addressed is determining what the new leadership organization will look like. Many merged banks have taken an approach of initially agreeing on the composition of the board, then defining the organizational structure in a phased manner—looking at the structure immediately below the board, then the one beneath that (usually one month later), then down to the next (after two to three months).

This is often a period of significant anxiety for the management teams involved, since they do not necessarily know where, or if, they will fit into the new organization until these deliberations have concluded.

A key decision during this period is to define how the "integration program" will be delivered. The size of the group directly involved in the integration program is likely to be 20% to 40% of the merged organization, during the two to three years it takes to complete the program. Given the importance, scale, and complexity, many firms have taken the view that the integration team should be largely separated from the "business as usual" section of the bank(s). That way, the program can focus entirely on delivering the organization as quickly as possible. This setup introduces some important challenges, such as determining how the integration team fits into the organization post-integration. Given this type of consideration, it is usual to leverage external support to a large degree in the integration organization. This helps ensure motivation for delivery, without necessarily having large numbers of people concerned for their future post-execution. As the saying goes, "Turkeys don't vote for Christmas."

Many of us have worked within merged banks that, many years after the integration, still appear to be two banks internally from a process, platform, and data perspective. This can lead to unnecessary complexity, additional cost, and fragility. The merging of platforms, processes, and data is one of the fundamental hurdles that should be cleared during the integration period.

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The application architecture within a bank is complex, with many interconnected systems. Developing these interconnections is expensive and time consuming. Large components within the architecture can often have more than 20 or 30 connections to other platforms. Some mergers have fallen into the trap of selecting "the best platform for the job" in too many cases. This can lead to a never-ending scenario where interfaces are being developed and thrown away as the target

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systems are moved into the target architecture on a piecemeal basis. More efficient mergers often limit this systems selection process as much as possible. A common approach is to select the applications architecture of one bank as the core of the target. New systems from the other bank are then only added on an exceptional basis, either where a new business function is added or where there is a business case to retain a specific platform.

This can be one of the pivotal choices for the whole integration.

Moving into Concrete Steps

Once the actual, concrete integration activities can begin, there are a few things that are central to the planning.

Coordination is key. With many business lines looking to change things simultaneously, there will be bottlenecks across the organization in the finance, risk management, operations, and technology functions. Everything can't happen all at once. Reviewing business priorities and aligning the various milestones in an overall plan enables these groups to ensure appropriate staffing, coordination, and management of risks.

There will be opportunities to deliver "quick wins." These can realize benefits early and "get the machine moving," so everyone across the firm can start to see the integration gather pace.

During the early phases, there will be a lot of uncertainty and also potentially a lot of changes in management. Sometimes managers will find themselves in roles they do not feel comfortable with, or agendas will not align. Substitutions will be required. The organization must find a way of dealing with this uncertainty while still keeping the overall program moving forward as efficiently as possible.

Communication will be key, especially ensuring that a single target vision is communicated to all.

Execution and Coordination

As the integration picks up pace, many work streams will be running in parallel. These work streams will often be aligned to business/front office areas, and they will likely be considering the full end-to-end process of the data flows associated with each business line.

A shared target per business line will be defined, which will encompass the end-to-end process, the target platforms, data flows and all associated sub-processes. In all likelihood, for example, transactions and positions will be migrated from the legacy platform/processes to the new target platform/process, in a very controlled

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manner. Depending on scale, this migration process may be executed a number of times, moving portions of the business to the target setup in a phased manner, enabling risk to be managed, and allowing for process nuances based on product, location, or other factors.

While these activities are being planned, managed, and executed, an environment is created where the staff involved work closely together with a shared goal. This helps to build teams across the two integrated organizations and enables a shared culture to begin developing. Successfully merged organizations leverage this opportunity to bring the previously separate organizations together and meld them into a single firm.

It's All About the Data

Just because the data required by the business exists in both banks, the functions requiring the data (e.g., trade revaluation) cannot necessarily be executed easily in a single platform or process. In practice, even if you know both banks must have the same data, it is likely to be labeled, provided, and formatted differently.

Keep in mind that when migrating trades and positions between risk/price engines, avoiding jumps in P&L or financing costs will be a key aim of the migration process.

Data consistency will be challenged by a merger. For example, the number of different/conflicting market data snapshots and the number of different/conflicting reference data sources will increase, resulting in instantly lower data quality. It will take time to restore consistency.

If the target systems are cloud-based, accommodating increased volumes in a target platform should be painless. If they are not, an important piece of work is required to ensure that service levels can be retained while volumes are increased.

Counterparty unification, specifically, is a well-known problem and figures highly in M&A activities.

Keep Celebrating Successes Along the Way

Banking integrations are big and complex, and they cost a lot of money. The board will create a budget and define a timeframe within which they think the integration can be achieved. Shareholders and market commentators will buy into this high-level plan and focus on it as a measure of success. In order to retain positive market sentiment, the merged entity will need to ensure that the bulk of integration activity is achieved within this window so that success can be declared.

No integration is ever "all done." However, it is key to decide how much is enough, then allow the organization to move beyond integration and focus on business growth.

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No integration is ever 'all done,' so it is key to decide how much is enough and then allow the organization to move on.

Celebrating each key milestone along the way will help to maintain the motivation and engagement of all those involved during this long and arduous process. Because at the end of the day, a successful merger is embodied in the team that has come together through the hard work of integration.

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