Report

FinTech & Banking

Collaboration for Disruption

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Summary

PRESENTATION 05

EXECUTIVE SUMMARY 07

INTRODUCTION 08
Preparing for the New Banking Age
Juan Rufat

KEY FINDING #1 10
The FinTech Age

KEY FINDING #2 12
Friends, Enemies, or Frenemies?

ARTICLE #1 13
I choose the car of my dreams... in my bank
Antonio Camacho

KEY FINDING #3 14
The Banking Sector Moves beyond Banks

ARTICLE #2 15
Blockchain: More than Bitcoins
Antonio Sanz & Sebastian Anderson

ARTICLE #3 16
Shaping a Customer-Centric Strategy in the New Banking Age
Callum Russell

ARTICLE #4 18
The Customer is Still King
Daniel Meere

ARTICLE #5 19
Digital Wallets: Gaining a Foothold
Oriol Villalante

KEY FINDING #4 20
The Future of Alliances

KEY FINDING #5 24
Bank-FinTech Collaboration

ARTICLE #6 26
Regulators - Refereeing the Digital Revolution
Darrell King

ARTICLE #7 27
Regtech. Holding the Keys to Regulatory Compliance?
Juan Rufat & Jorge Montana

CONCLUSIONS 28

METHODOLOGY 31

TEAM 31

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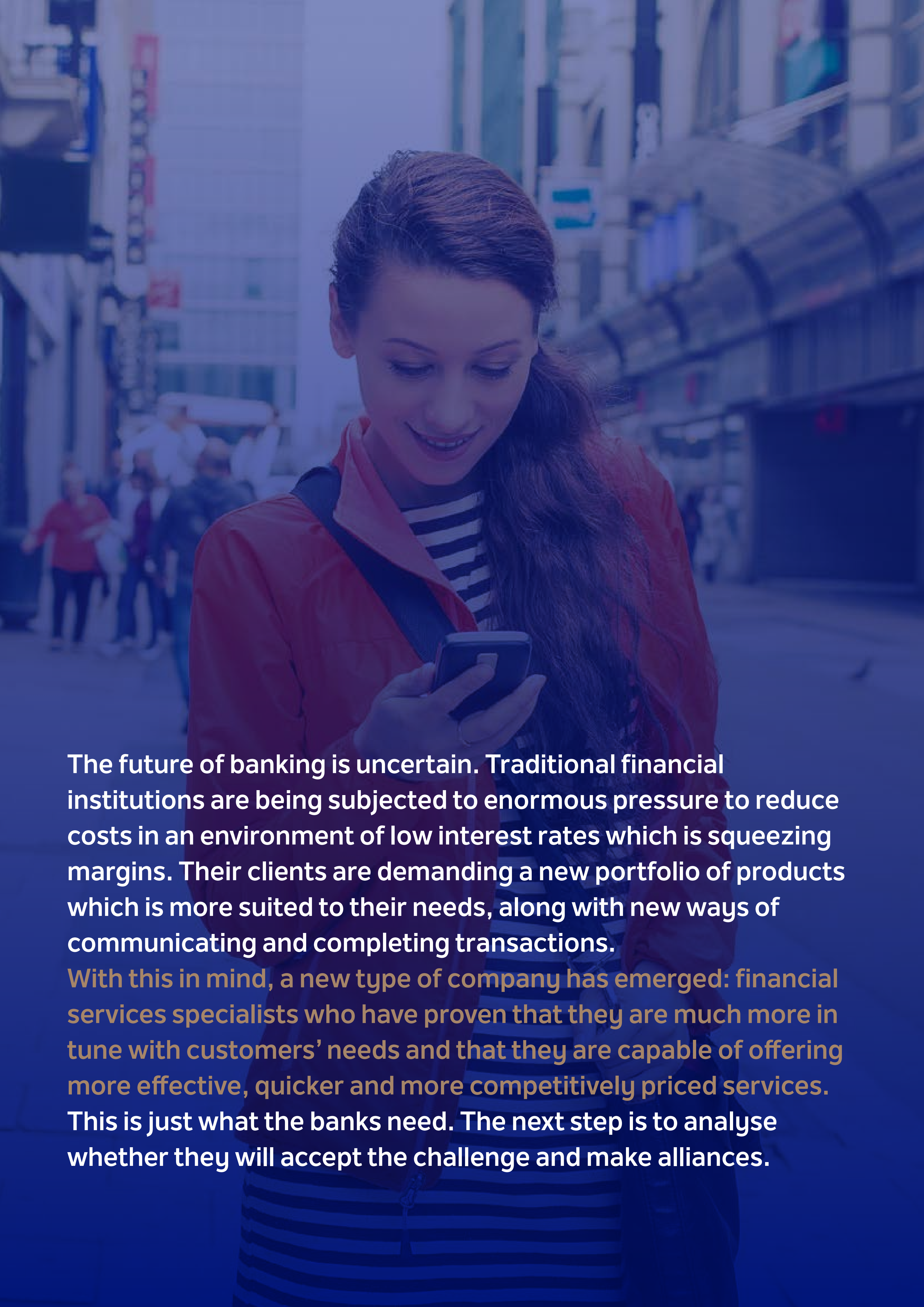
The banking sector finds itself at a crossroads. It was not only the financial crisis which forced it to take a strategic turn in 2007, many of the standards which had been valid up to that point changed. This is a revolution which has only just begun and one in which banks have found new allies and rivals, depending on how they want to view it.

EFMA and AXIS CORPORATE take great pleasure in presenting our combined FinTech & Banking publication.

The age of banking 3.0 has moved on from its association with traditional brands to a new generation of financial service companies (FinTechs). These have demonstrated an ability to change the relationship models between banks and their customers, and are also using new tools to redesign the platforms and internal processes which banks have used up until now. The big question now is; how will the conventional players react to the arrival of these new players?

Here at EFMA and AXIS CORPORATE, we have tried to find answers to the many questions that loom over the new age of banking. A panel made up of banking sector Executives and from new FinTechs have debated the pros and cons of what banks and modern FinTechs can provide. They discussed the obstacles they face when attempting to collaborate and which areas and formulae can be used to unite them to achieve a common objective. The following articles, written by our banking experts, expand on these discussions and the different themes where FinTechs are having an impact on the banking world and customer environments.

We hope that this report will help you to broaden your view of the future of the banking sector and that it will allow you to gain a good appreciation of the challenges faced and solutions created by the banking sector.



The future of banking is uncertain. Traditional financial institutions are being subjected to enormous pressure to reduce costs in an environment of low interest rates which is squeezing margins. Their clients are demanding a new portfolio of products which is more suited to their needs, along with new ways of communicating and completing transactions.
With this in mind, a new type of company has emerged: financial services specialists who have proven that they are much more in tune with customers' needs and that they are capable of offering more effective, quicker and more competitively priced services.
This is just what the banks need. The next step is to analyse whether they will accept the challenge and make alliances.

Executive summary

- **Young FinTech companies have proven that they can play a prominent role in delivering innovation strategy** by creating a more modern product portfolio and accelerating the process of transforming customer experience. They have shown that they are better at adapting to customer communication preferences, more agile and more competitive in the development of digitised processes.

- **Banks and FinTechs have already started collaborating using various models.** However, the banking sector still has to overcome a few prejudices which impede truly integrated projects. Until now, the sector has opted to create its own innovation labs, undertake joint ventures with technology companies or, in other cases, it has chosen to purchase FinTechs directly. Banks have retained control, whilst the new players catch up.

- **Against this new backdrop, it is important for banks to clearly define their strategy - what they want to do and where they want to do it, and to find the partners who can balance risk and value.** Only projects with clear and realistic objectives will move forward. With scarce financial and human resources available, saying 'no' has never been easier.

- **Banks must be capable of leaving behind the heavy baggage which conditions their thinking.** Likewise, they must put an end to the internal habits which cause them to mistrust and discount new technology service companies which could be their new partners.

- **FinTechs require partners who are flexible, transparent and have a culture of collaboration.** They employ talent and ways of working which are unheard of in traditional banking. All in all, this is a focus which must be respected in order to maintain their disruptive capacity once they are allied with traditional financial entities. Getting this right means embracing new ideas and overcoming the fear of failure.

- **FinTechs cover such a broad spectrum of activity that, viewed as a collective, they could create a next generation bank.** Now more than never is the time for banking to make a choice based on win-win collaboration models.

- **If technology companies wish to attract banks, they must provide security, ensure investment return, ensure a term for obtaining results and help to resolve collaboration problems.** This is new ground, and some 'test and learn' approaches will be required to land on successful outcomes. One size will not fit all in this sense.

- **If the banking sector reacts in time, the traditional companies will maintain their leadership in relationship management, customer insight, product innovation and, more importantly, they will remain relevant.** Banks must opt for forming business alliances to develop payment systems, to create new business models, and build trust whilst complying with regulation. Very possibly, companies will be acquired to develop new systems, rather than wait for the traditional in-house solutions to materialise.

- **The areas in which banking will find the most added value and which are the most vital for banks will be customer experience and innovation.** Here, there is much to do. Banks are often cited as propping up the Customer Satisfaction tables due to their low Net Promoter Scores. With this injection of new technology capability, the competitive tension that has for so long been lacking, and the increasing demand of a digitally-enabled customer base, the conditions are set for a welcome change.

Preparing for the New Banking Age

Juan Rufat

AXIS CORPORATE banking partner

“Clients need banking but they don’t necessarily need banks.” Society is sending us a clear message: if banks don’t change, banking will be undertaken without them.

The revolution experienced by the world of Financial Services in recent years has led to the loss of prominence of some of the historical monopoly players, the increased presence of players who, until a short time ago, were at best marginal, and the explosion of new players onto the market. FinTechs – are the current stars within this new breed of technological start-ups who have accelerated the transformation needed to adapt the range of banking services to demand. They have brought in a new basis for banking relationships, a new product focus, new ways of working and, more broadly, an innovative and disruptive attitude. The clearest examples of this trend are in key strategic areas such as customer experience, digital transformation and the adoption of new business models.

From humble beginnings, the FinTech revolution has now made a clear and bold statement: "Clients need banking but they don't necessarily need banks." This relates to a banking sector in which products and services are simple, transparent, and above all underpinned by an attractive customer experience. The lines between bank-owned and operated services, and those delivered by external partners have become blurred; the result being that traditional banking services are being disintermediated. Risk and accountability still lie with the bank, although the cost premium of performing more ‘commoditised’ services in-house is forcing banks to look to alternative sourcing models. This is proving to be as much a cultural challenge as a technological or operational one.

At Axis Corporate, we have experienced and analysed this transformation from various angles, examining the consequences and winning strategies in order to create a methodology which could reduce the margin of error for our clients. The willingness to participate in this revolution is as essential as defining a clear strategy. The challenge that banks now face is how to deliver this effectively and position themselves for success in the future financial universe. In the case of the majority of traditional banking entities, there is a need for a profound transformation in their culture, whereas for the new players, the need is to very quickly absorb many large doses of knowledge and financial experience.
While financial technology start-ups tend to get a lot of attention, FinTech isn’t just about them—it’s about the new banking ecosystem as a whole. Established financial institutions continue to act as the main financial hub for many people and businesses, and are providing the backbone upon which all this innovation sits. New technology is simply making it easier for new entrants to build upon that foundation. The regulator has a key role to play here – they need to ensure that legislation and regulation is effective in its efforts to mitigate and suppress risk and misconduct, but balanced with allowing the sector to experiment, innovate and deliver wider benefits to consumers, businesses and the industry. As the ecosystem has evolved, it has become clear that the best path forward lies in collaboration among all stakeholders. •

Key finding #1

The FinTech Age

They appeared as an alternative, but what lies ahead?

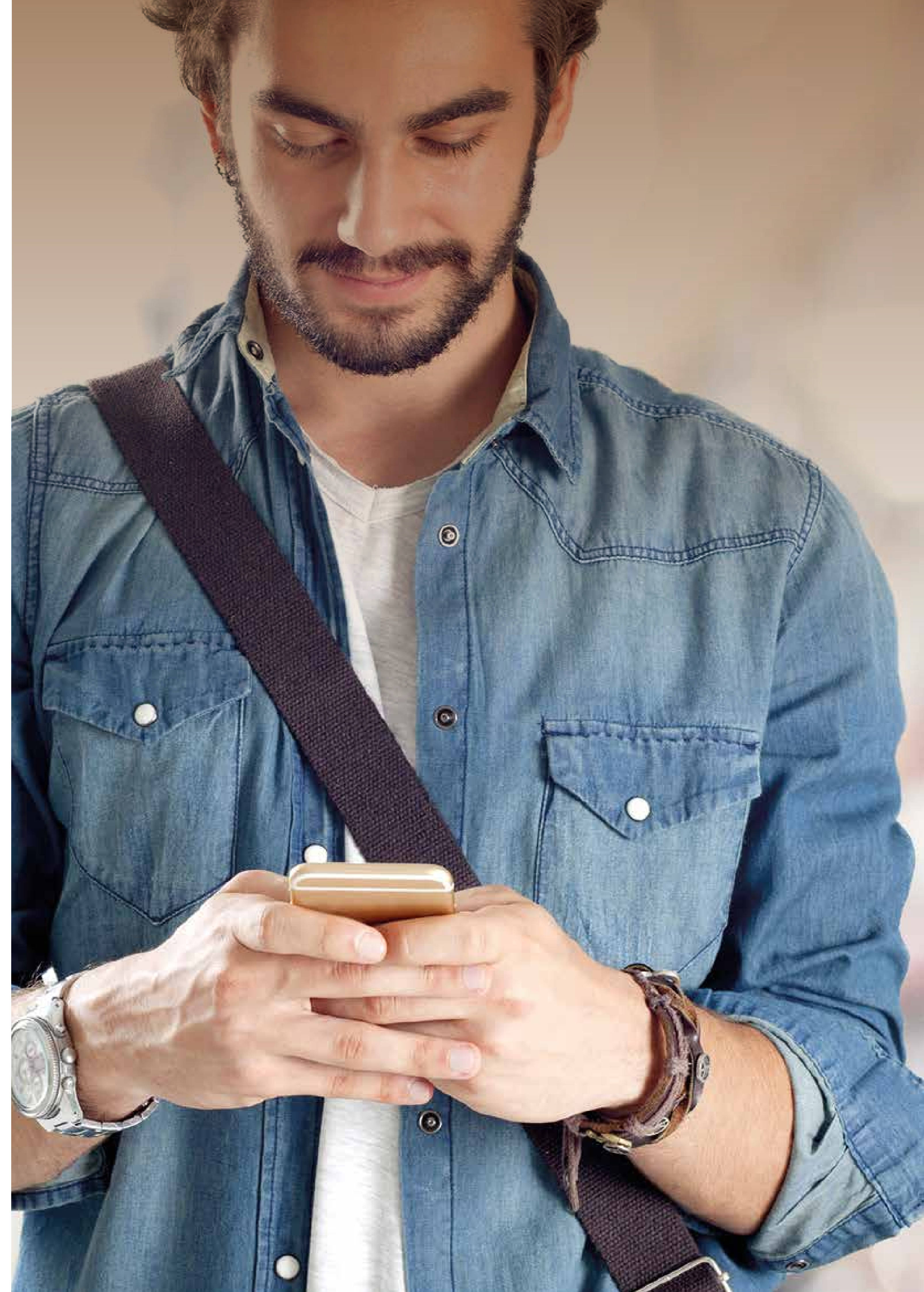
The World Bank maintains that the great emergence of financial service focused technological companies (FinTechs) came about due to the global crisis of 2007. The banking regulatory framework was strengthened and traditional sources of finance became scarcer and pricier. At that time, we were on the cusp of an intense process of "en-screening" caused by the digital avalanche; that is essentially, the conversion of any screen, from that of a smartphone to a control panel in a car, to becoming a potential shop window for a bank.

Since then, change has been constant. FinTechs are no longer the only companies able to create new solutions which attract clients who are disillusioned with traditional banking. A large number of small businesses have emerged to cover the entire spectrum of the financial services value chain. While some of these offer solutions directed at end clients (B2C), others are focusing on the development of technology for the sector as a whole (B2B). All have been pursuing a data-driven, customer-centric approach which the sector sorely needed. In the UK, the government's drive for increased competition in what it saw as a monopoly for the 'big 5' high street banks, has further accelerated this move.

Although some Executives in the sector believe that, at least for the time being, FinTechs won't be able to offer a full service platform for banking products, they know that FinTechs are beginning to play a lead role in improving customer experience for existing products and could potentially disintermediate the relationship between traditional banks and their customers. Ownership of the customer relationship is the source of fierce industry competition. If they want to compete, traditional banks need to evolve their business models.

There is a consensus amongst analysts about the differing speeds at which the evolution of traditional banks and advances of FinTechs will occur - the former are laden with heavy 'technology debt' and an inherent aversion to risk, limiting the pace of change. Audacious start-ups on the other hand, are free of technology debt and are capable of quickly developing, deploying and refining their technology with successful results. They also have the benefit of avoiding many of the regulatory pressures to which traditional financial entities are subject, although it is precisely this lack of experience with the regulators which could prove to be a hindrance in the long-term.

It does take time for a complete paradigm shift to take effect. The FinTech sector still has its limitations: its consumer base is narrow, its youth, lack of experience and lack of proven financial results do not instil confidence among potential partners. In addition, products are not highly diversified, and there is a dearth of experience in risk management. However, as more investment flows into FinTechs, and as technology develops, they will go from strength to strength and ultimately we will see FinTechs pervasively change the financial sector. ●



Key finding #2

Friends, Enemies, or Frenemies?

The FinTech ecosystem is growing. Incumbent banks must decide whether to compete, collaborate or acquire.

Investment in developing new technology for financial services totalled $14bn in 2015. In recent decades, banking has made significant contributions to the innovation of its internal platforms with the objective of reducing costs. However, this new period of evolution is nothing like the placid development which preceded it. In addition to bank-led investments, there are also other investors who have detected an important business niche in an ever-closer future.

The acquisitions made by giants such as Apple and Google to establish themselves in the sector clearly show that the boundaries in this sector are becoming ever more blurred. Other companies have appeared, lending money to their clients, investing capital in businesses and becoming equal or better in critical elements of the banking value chain offering. They may even force a degree of customer migration to other platforms offering greater convenience, as demonstrated by PayPal.

A key feature of the FinTech ecosystem is the sheer number of firms increasing the pressure on traditional banks across a broad range of products and solutions. In order to avoid death by a thousand cuts, Executives of the large, global financial corporations have created investment platforms to identify and second resources into companies in the hope that they will reap greater future benefit from them. These Executives, with their deep knowledge of the sector, know that something fundamental is happening.

Globally, national governments fought for years to house the powerful financial sector. The world now revolves around a handful of financial capitals with a concentration of the largest banks' headquarters. The new battle being fought is to house the future of banking: the British government wants the UK to build the largest FinTech hub by 2020, adding 100,000 more employees to a sector which currently has 135,000. The Monetary Authority of Singapore plans to invest $225 million in the next five years, so as not to miss out on the list of growing FinTech hubs which also features Silicon Valley, New York, Tel Aviv, Frankfurt and Hong Kong. Governments and regulators are no longer ignoring the possibilities of this sector. They understand that it needs support to force the required change on the banking industry, and as a result are injecting more fuel into a sector which some already believe is creating a speculative bubble.

Incumbent banks cannot ignore this push either; they must decide whether they want to compete, collaborate, or acquire new players in their industry. Innovation for customers has never had powerful brakes to shackle it, and with the current momentum it will not get them now. Some banks have started an internal revolution in this regard, aware that there is no turning back.

The appearance of FinTechs has prompted banks to rethink many things, including how to take the technological leap facing them. Do they use innovation developed in-house for financial services or back disruptive new ideas arising from talent born in other sectors? Do they acquire companies and their talent or to seek to establish collaborative ventures? Everyone will find their own way forward. Individual innovation labs, purchases and partnerships are all, a priori, good strategy for facing the future. The decision will be influenced by the culture of each entity but, above all, they will have to analyse which model will bring about more benefits, less risks and better results. One thing is clear, the disruptive force of innovation and change in banking has begun and shows no sign of fading. •

> **"Innovation for customers has never had powerful brakes to shackle it, and with the current momentum it will not get them now."**

New Players, New Money
Selected major FinTech deals

Company	Operation	Value (US$ M)
First Data	Flotation	3700
LendingClub	Flotation	900
Xoom	Paypal buys	890
APT	MasterCard buys	600
Yodlee	Envestnet buys	590
Paydiant	Paypal buys	280
Adyen	Funding Round	250
Square	Flotation	243
Viki	Rakuten buys	200
Mozida	Funding Round	180
Renrendai	Capital Injection	130

Source: Axis Corporate, 2016

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I choose the car of my dreams… in my bank.

06 May 2017. John has decided to change cars. His old car has started to give him problems after many years of use. He has arranged, via his mobile, a meeting for the following day with the car expert in the local branch of his bank. For the first time ever, he is not going to visit dealership after dealership, but he doesn't know whether he is going to waste his time in the bank.

07 May 2017. A normal working day at the bank. Richard, the bank's car consultant has met John with a full financial study based on a complete view of his financial holdings. He has informed him that the bank can offer him a loan of up to €20,000 at an annual interest rate of 5.5%. This is more or less what John expected: that he would save a lot of time talking about financial matters and that he would be able to focus on the type of vehicle he wanted and the essential features he wants from his car.

Minutes later, John was sitting in a chair designed like a car seat and putting on a virtual reality headset. Suddenly, he was looking at 25 cars lined up in front of him on a test track. Richard tells him that these are the ones within his price range and with his chosen optional extras. John walks down the line and rejects the ones he doesn't like. He ends up choosing seven cars. "I got in all of them, I looked around the inside, saw what space and features they had… I drove a few laps with almost all of them. I finally decided on one and Richard arranged a real test drive for me for the next day at an authorised brand dealership."

08 May 2017. John has driven the vehicle and made his decision. He has finalised the features he wants and fixed the delivery date. With pricing and financing already agreed, there is no need for painful negotiations. Richard will call him later to confirm the terms and to verbally sign the contract. •

Key finding #3

The Banking Sector Moves beyond Banks

New to market players are eyeing up banks' traditional markets, while other players are splitting the sector at the seams.

The emergence of new technologies has shaken the banking sector. Financial entities are finding it hard to weather the cultural change brought about by this, and hard to start the transition to a less rigid paradigm which is more open to innovation. One of the problems is that their expectations, in terms of accessibility and reliability, are much greater than those of any other digital organisation. This makes them mismatched soulmates for FinTech firms, with their agile, informal 'open standards' approach to developing and sharing platforms.

Improved customer experience has become an obsession across the industry, after traditional banks reluctantly and belatedly accepted that the case for such a change in focus is compelling, and that they themselves are compelled to change. Being attractive to consumers who are moving away from the traditional idea of a bank and now use their mobile phone as their main tool is an important and substantial shift.

Until now, banks have had an advantage over other players. However, the approval of the new European Payment Services Directive (PSD2) gave third party payment service providers access to the bank accounts they service, thus allowing them to offer their services via bank infrastructure. This was a seismic shift, seeing as it obliged banks to seek new sources of value in their relationship with other players in the sector. Unsurprisingly, this has been warmly received by new players in the market and far less so by traditional players with more to lose.

This new backdrop has led to new challenges. In the medium-term, the cycles for the implementation of new technologies will be much shorter. Banks are good at suggesting how the processes should be, but the hierarchy of their organisation takes away their agility in executing new developments and in being open enough to carry out collaborative projects with other partners. In the long-term, the 'technology debt' of their legacy systems is causing the difficulty in making changes with the required speed. Security concerns relating to new or non-standard technologies are two of their biggest challenges moving forward. The flexibility of FinTechs enables them to work more efficiently, to be quicker and to innovate more. However, the 'trust-based' environment from which they have emerged is yet to be fully tested at scale in financial services.

In this competition, banks should bring their strengths to the table. One of the key fields of competition is distribution; the channels through which banks connect with their clients. Traditional players must benefit from their experience in relationship management by understanding the needs of their clients, or using the trust they build from clients or risk management programmes to compensate for the shortcomings of FinTechs. They must recognise that they can create greater value than new, inexperienced players with less mature relationships.

One field in which banks lost some of their market position (which they later recovered) is that of payments. Eight years ago, other competitors started to take the lead and remove began to receive the support of large payment processors. This then spurred on technology companies to search for solutions to open up a competitive gap. Traditional banks have ceased to be the sole participants in this field but they have learned to work alongside the other firms more effectively. They have also developed better collaboration models, in the payments processing world in particular. Witness the launch of ApplePay, and collaboration around e-wallets as evidence here. PayPal is also both a disruptor and collaborator, and is now ubiquitous.

> "Being attractive to consumers who are moving away from the traditional idea of a bank and now use their mobile phone as their main tool is an important and substantial shift."

In SMEs, FinTechs found credit orphans, created by the regulatory pressure which fell on the banking sector. This is a challenging opportunity not only on a technical level, but also due to the traditional model for managing these clients and culture. This segment potentially offers greater opportunity for disruption due to the lack of competition to date, and the drift between what traditional banks offer and the experience offered in other sectors such as vehicle leasing and travel services.

A promising example in the UK is Mondo bank, which offers new entrants to the country a route to a quick, low-risk, limited functionality bank account without the traditional delays and issues due to a lack of credit history. With immigration high in both volume and on political agendas, this could prove to be a shrewd move in attracting lifetime customer value in a growth segment. Experiences logged by the World Economic Forum show that, for example, the Bank of China revamped its internal process to streamline the granting of loans, even to within four working days. Previously, ten management layers were involved in the same loan granting processes. Now there are only four. The pressure has begun to show, and we are starting to see benefits for consumers at last.

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Blockchain: More than Bitcoins

Blockchain gained recognition thanks to one of the first applications of this technology - Bitcoin. The Blockchain acts as a general ledger for electronic recording of every exchange of value by everyone in a globally integrated framework ensuring transactions can only take place once and cannot be revoked. An example of its current application is that of electronic contractual exchanges; 'smart contracts' which automatically execute certain terms of an agreement once a series of conditions are met, thus adding a layer of security as the exchange can never be performed twice without permission of both contracting parties. This automation will benefit the advancement of the Internet of Things (IoT), as it enables connected smart devices to replace the need for a physical presence.

Another indication that Blockchain has an existence beyond Bitcoin is its application in the field of logistics. Blockchain technology offers the possibility of registering products and exchanges within the supply chain, providing the ability to monitor hand-offs in real time, as in the case of provenance. Another example is Wave, which connects all the participants in an international maritime transport chain (companies, banks, traders, etc.). Its objective is to assert their rights when necessary, without the need for intervention from a third party. It does this via the integration of the "bill of lading" in the chain.

In the field of finance, the Blockchain is being applied to the exchange of products such as gold and currency. An example of which is Ripple, a platform for currency exchange and cross-border payments in which Banco Santander has invested $4m. This application allows financial entities to make direct transactions to each other, without the need for a central or clearing bank, thus reducing their operational costs supporting new products and service offerings for their clients.

Blockchain's future depends on other practical applications which go beyond the field of the virtual currency, both within and outside the financial universe. The potential for its use in markets where political and/or economic instability are common, or where corruption is an issue, holds particular appeal. Could the Blockchain do for land and asset owners in the developing world what mPesa did for farmers and market traders? Watch this space.

Shaping a Customer-Centric Strategy in the New Banking Age

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"The future belongs to banks that put the customer at the heart of their business model."

"New customer demand amid changes in technology has proven itself to be one of the key forces in shaping new competitive frontiers and is carrying a high priority from a strategic standpoint."

A fundamental understanding of how value for companies and their customers is going to be created given certain competitive forces is at the heart of good strategy. In the financial services industry, new customer demand amid changes in technology has proven itself to be one of the key forces in shaping new competitive frontiers and is carrying a high priority from a strategic standpoint. Many financial institutions are rolling out diverse digital initiatives in their efforts to adopt a customer-centric approach. Vast sums have been spent on these efforts, but for the most part, they have only served to provide banks with a list of actions, not a cohesive strategy that redefines how to create customer value. The future belongs to banks that put the customer at the core of their business model, but how can they effectively achieve this?

Banks need to ensure that they have developed a clear and consistent customer-centric vision. For this to prove effective, they need to create measures to ensure that employee behaviours are aligned to the customer vision, which in turn provides a framework for the functional alignment of business model activities with a customer-centric approach.

Applying data-driven processes aimed at shaping customer service or product offerings, to ensure that the right experience is delivered for each of them, is a proven approach for banks to deliver the tangible vision to their customers. Banks can apply a 'customer journey' approach, which traces the touchpoints a customer has with their bank to yield deep insights on their behaviours, needs and preferences. These insights can then be used to tailor products and services accordingly, and make better decisions for customers across the entire value chain.

Deep knowledge of customer needs and preferences is an essential input for core functions within the bank, which need to be designed to represent the customer focus. It is important that the core functions have the power to implement solutions to the customer's benefit. Besides such powerful core functions, banks also need overarching customer and product management to ensure that the needs of the customer are integrated in all core business processes. As banks look to achieve this, they must determine which capabilities they want to build or enhance themselves, and which they should leverage through strategic partnerships. They need to define the best approach to effectively address consumer pain points, achieve savings for the bank, or indeed both.

Giving the customer centre stage in the business model must begin with the development of a clear vision, supported by data-driven insights, overhauled core functions aligned with customer and product management, and smarter partnering. If they can do this, they will win share of wallet, market and mind - all essential to long-term success in today's low-growth, low-margin environment. •

Article #4

The Customer is Still King

By **Daniel Meere**
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Banks have no other choice but to innovate. The question is where to do it. It could be as simple as asking the customer where change is needed most.

Banks are heavily investing in Innovation. In part this is a response to the rise of new technologies, from wearable payment devices to analytics tools using Machine Learning to anticipate and predict behaviour. It is in part also as a response to the growth of FinTech firms that once posed little threat to their established customer base, but now seemingly from nowhere, have amassed loyalty and uptake levels that traditional banks still dream of.

The question for banks is not whether, but where to innovate. Most observers agree that -defence and government aside- Financial Services is the last industry to be subjected to real disruption. In other industries (music, retail, broadcast entertainment, airlines, fashion) those that resisted the innovation wave disappeared - either by being acquired or becoming obsolete. With resistance futile, the innovation race is on. There is certainly no shortage of opportunity for banks - current accounts, unsecured loans, credit cards, mortgages, investments - all are relatively unchanged since their inception. The challenge for banks then, given their scarce capital resources to deploy and large customer bases to convince, is where to focus their innovation efforts.

Our response is simple - ask the customer. If you can answer 'yes' to three simple questions, then the change proposed through innovation is likely to succeed.

1. **Will the customer notice the change?** Too often changes are made which help the bank but not the customer, or deal with the 'noise' rather than the issue itself.
2. **Will the customer value the change?** If it makes their lives easier, makes banking more fun (or at least less onerous), or helps them to achieve their financial goals, then the customer will value it.
3. **Will the customer pay for the change?** Longer term, banks need to see a return on their innovation investment. This 'payment' may not need to be a direct fee. It could be taking a share of the value created, or the catalyst for a customer to switch to regular usage, but without a payback innovation change can be costly. If the customer will pay for it, it is a safe bet that they value it, reinforcing the response to question (2).

The task is relatively straightforward, and the solution can be also. The key is a change in mind-set. Start by allowing all ideas to develop; there is little point to stifling creativity or discounting potentially valuable initiatives too early. The mind-set also needs to encompass learning from 'failure', and even redefining failure itself. Failure here is failure to act, failure to listen and failure to say 'no' to ideas that do not meet the stated objectives or have proven that they will not work. Prioritising the innovative ideas that meet the three customer criteria is a good start. These can then be worked up into 'proofs of concept' to test real customers' real reactions. Social Media makes this possible in a quick and inexpensive way. Most banks now operate 'labs' where new ideas are tested, and these give far better feedback than traditional focus groups. Feedback is instant, at scale and -most importantly- authentic due to the removal of any bias associated with customers being asked directly.

The 'fail fast, fail early' mantra holds true. But for banks to truly innovate, what matters is how they fail, and what they learn from it. Failing to innovate is certainly no longer an option. •

“Innovation change proposals should answer three simple questions – will the customer notice the change, will they value the change, and ultimately will they pay for the change?”

By **Oriol Villalante**
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Digital Wallets: Gaining a Foothold

The mobile wallet space has been fragmented without a clear leader. Non-financial services institutions, such as Facebook, and device manufacturers and operating systems providers such as Apple, Samsung and Android, have been launching wallets in their own efforts to enter the payments space. The lack of a universal technology standard, disparate interests of stakeholders, and poor user experience have previously limited the adoption and growth of digital wallet usage. With an ever-growing number of NFC-enabled merchant terminals however, the non-physical card market is now growing fast and the number of transactions is expected to overtake that seen with physical card transactions.

Traditional payment providers, such as MasterCard and Visa, are set to lose out on fees from processing payments via physical card transactions, and as a result have begun to explore the use of their own wallets and devices (e.g. the bracelets launched by Visa and Santander Spain for the Rio Olympics). Security and user experience are the key deliverables from digital wallets. This is where Apple Pay has become the clear market leader. They introduced fingerprint biometrics, on-device storage, and have appealed to banks and consumers by offering a simple, fast and private way to pay.

In an interesting reversal of the trend towards ‘remote’ payments, what we are seeing with wallet and contactless is that ‘presence’ is redefining payments – at least at the low-value, regular transaction level. Perhaps banks and payment service providers can make use of the richer stream of data around customer behaviours that these trends are providing to tailor and adapt services to become even more relevant.

Banks have traditionally been the natural owners of the payments ecosystem, but they must follow clear strategic imperatives in the space if they wish to remain relevant as a broad range of players accelerate innovations and enhanced services (e.g. bracelets, enhanced functionality, greater security, biometrics and deeper customer insights) around how consumers move their money, manage their money and make payments. •

Key finding #4

The Future of Alliances

Until now, the banking sector has been slow to collaborate with FinTech firms. Could new technology services companies offer the missing link in improving business strategy, control of market risks or client / investor control?

"The best contribution of FinTechs, will be in customer experience - channels, on-boarding tools and marketing - given that they have launched into the sector by re-thinking the target experience, unencumbered by 'traditionalist' fixed ideas."

Every bank and every FinTech will affect the future of the collaboration which will govern the sector's future. The exceptional characteristics of each of them will be the factor which establishes the rules of this new era of collaboration. But at first glance, everything points to FinTechs being truly important in 'commodity areas' in which they could accelerate the evolution of internal and control processes. The impact will be felt both in a reduction of costs and in an increase of income. However, the traditional bank business model deriving income from charging fees and commissions, and interest rate spreads -under pressure now more than ever- has led some banks to sense a significant opportunity is opening up for collaboration in the utility area, because this is where the business might gain the most added value. Therefore, exploiting this area is of real interest as a more sustainable and longer-term boost to profits.

The graph on the following pages shows how we see the bank value chain being disintermediated. Where banks see differentiated value in the services that they offer directly to their end customers, the so-called 'vital ground', they will look to retain control. There may be opportunities to collaborate with FinTech partners, but this will be the banks directing operations and the FinTech firms accelerating delivery. In the next wave of activities, where low-cost, scalability and the ability to manage at arm's length are key, banks will likely look to buy these 'commodity' functions on an 'as a service' basis. Here, FinTechs can play a role due to their technology advantage, although we see this developing as more of a scale play with relatively few players emerging as providers. The final and most interesting area for disruption is where the banks feel that the industry can play a greater role, both in the control it exerts and the value it creates. These 'utility' services benefit from network effects, with greater volumes creating greater value, and the ideal scenario being full industry participation in a single utility. Fraud prevention is the obvious example here, as an industry aggregated view of data and fraud incidences would be highly valued.

Banks will continue to control their key areas of differentiated value very closely and these are the areas in which FinTechs will have a more limited space to work unless they offer real internal revolutions. This has not happened up until now and experts believe that they have little to offer in this 'vital ground' of a bank. Until now, the banking sector has been slow to embrace FinTech collaborators and it seems to have ruled out that new technology services companies might be the missing link in improving business strategy, control of market risks or client/ investor control. If they pursue collaboration, they will do it via joint ventures, potentially limiting the field of play as this model may not align interests of all parties, particularly where Fintechs crave continued independence and non-exclusivity. We are yet to see what will happen in the field of cybersecurity, but this again appears an attractive area for disruption.

Within the 'vital ground' areas for banks, we expect the boost that FinTechs can offer to be centred on customer experience and that collaboration will occur through joint ventures to avoid blocking the creative edge of FinTechs. Even though FinTechs will have freedom, banks will exert powerful control over all the activities they consider vital to their business activity.

The best contribution of FinTechs, however, will be in customer experience - channels, on-boarding tools and marketing - given that they have launched into the sector by re-thinking the target experience, unencumbered by 'traditionalist' fixed ideas. The question is whether the FinTechs will occupy an internal position within the banks or whether they can work from the outside. Without a doubt, this decision will depend on the play they wish to offer the banks and the collaboration model selected. Banks must make a decision based on how they value the FinTech's ability to contribute and the need to interact with other areas of the bank that are more difficult to source from outside.

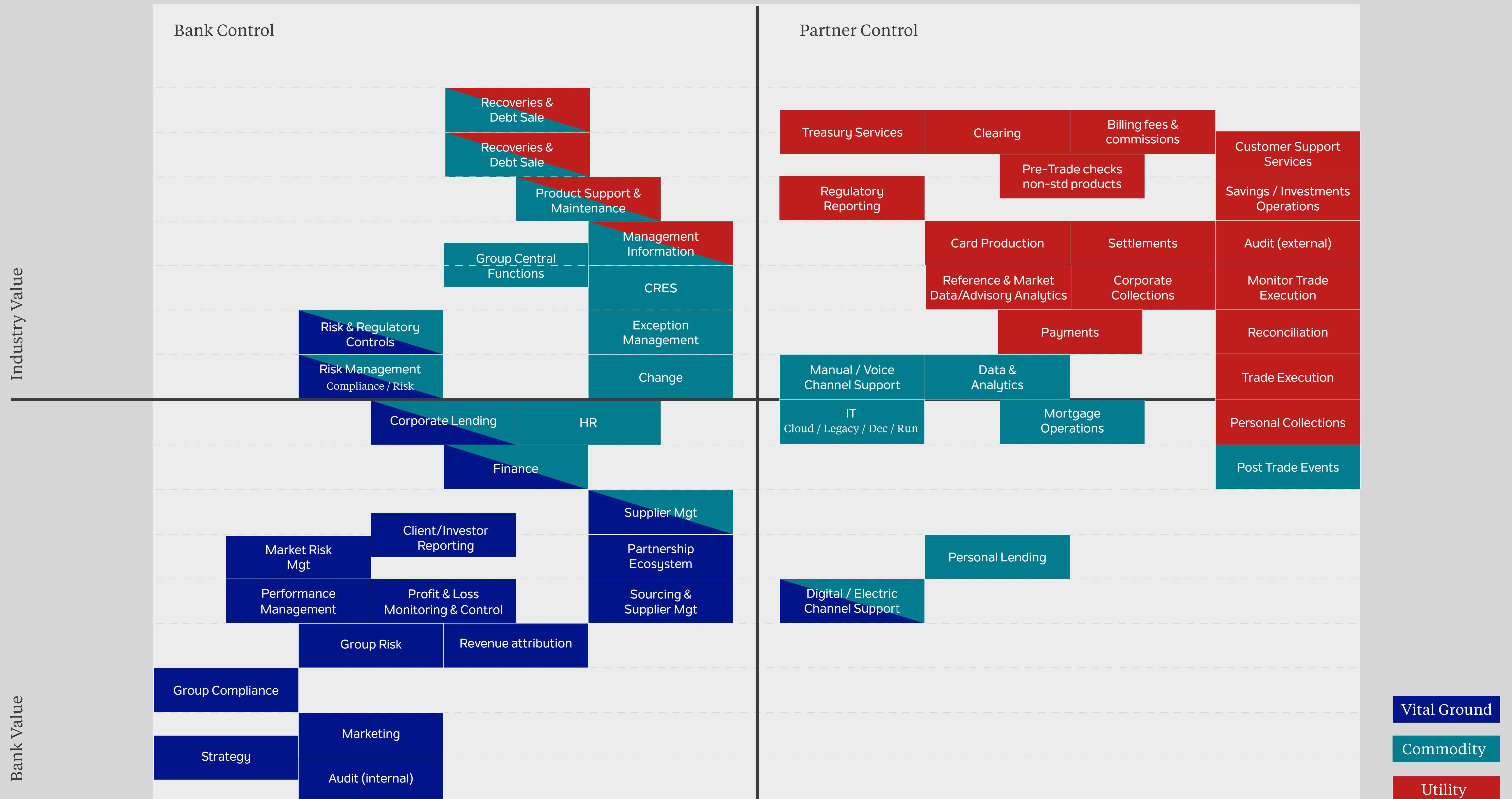
The experts who took part in the panels organised by EFMA and Axis Corporate believe that some of the 'commodity' activities will cease to fit inside the banks' structure, due to the need for collaborative models. IT and Operations functions are at the heart of this 'smartsourcing' approach, for which banks have sought external providers for a long time, aware that cost and speed are critical, and that direct control is less important.

The cost of buying-in FinTech services will be a key element when deciding the best type of collaboration deal with banks. In the utility area, for example, FinTechs do not yet offer enough scale or added value to make them viable partners. However, the emergence of new platform players (Solaris Bank is a good example, through its 'passport' banking platform) may be set to change this. More established technology firms who operate at scale may also look to move into this area more actively, as their legacy 'licence' business continues to decline.

Beyond these examples, the banking sector is under further pressure to work with an 'open banking standard' (API) in which banks and FinTechs will become 'utility providers'. But this will not be a feasible situation in the short term; banks must first decide which future scenarios best fit their current vision. One option is playing the role of product provider for other intermediaries, another is to accept the product innovation challenge and 're-imagine' themselves, or enter a price war. The future is uncertain. It is not known whether the new FinTech operators will work to traditional NII and Fee Income bank revenue models, or a new 'share of value created' approach. One key question remains, however. Would banks be willing to welcome that level of sharing?.

Graph

An Illustrative Distribution of Services across the New Bank Operating Model



Source: Axis Corporate, 2016

Key finding #5

Bank-FinTech Collaboration

The formula for success – the banking industry is stronger when players recognise and leverage the strengths of each other.

There is no question that financial services, as we have known them, are evolving and that FinTech is leading much of the change we are seeing. In the early days of FinTech, the common perception was that FinTech firms were poised to slay the major banks and eventually replace them. Instead, we are increasingly seeing FinTech companies partnering with these institutions in order to provide faster and more affordable services to customers.

The experts who participated in the panel created by EFMA and Axis Corporate believe that a joint venture approach between banks and FinTechs will foster the most successful industry ecosystem. For it to be an optimal relationship, however, banks need to overcome their own internal barriers and, above all, identify the people best-placed to bridge the gap between their team and that of the FinTech. This must be done to promote a suitable collaboration framework which provides transparency for teamwork, clearly sets realistic objectives and gives both sets of workers the freedom they require.

Banks must recognise that FinTechs are are here to stay and that they will, with varying degrees of success, overcome the barriers they currently face. Even though there are examples of start-ups which have become sufficiently large or sufficiently good enough to compete with banks - Zopa is a leading example - they still only constitute a relatively small group overall which is restricted to highly specific activities within the sector. The vast majority are providers of services, applications or new customer relationship models which banks cannot ignore.

Although the pursuit of joint ventures with FinTechs is a much lauded approach, the future of bank-FinTech collaboration is still uncertain. There are alternative models shaped by the business culture of each institution, from innovation labs acting as 'incubators' to white-labelled offerings. Regardless of approach however, traditional banks want to ensure that they have control of the development and data associated with their businesses. Hence the most conservative approach which they have pursued to achieve technology and talent development objectives: the creation of the in-house innovation labs.

Each form of collaboration has its own challenges and its own obstacles, but ultimately big banks and FinTechs have a great deal to offer each other. Banks have a large customer base, stable infrastructure, and deep pockets to fund new projects. Start-ups provide out-of-the-box thinking, technical expertise, and the agility to adapt quickly to change. The limitations of FinTechs are precisely the strengths of incumbent banks, and vice-versa. The future for them lies in pursuing a collaborative relationship. Together, they can be far more successful at improving financial service offerings than if they compete against one another. ●

"Banks must recognise that FinTechs are players who are here to stay in the sector and that they will, with varying degrees of success, overcome the barriers they currently face."

Article #6

By **Darrell King**
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Regulators – Refereeing the Digital Revolution

"As the rules have rightly tightened controls around traditional banks, the unintended consequence of opening up competition and transparency in the market is the emergence of unregulated start-ups."

Regulators can't win. They are the referees of the Financial Services sector, and even when they get it right, they upset one party or another. Their task just became harder with the increased pace of change brought about by digital innovation in the banking sector. There are a number of reasons for this, and also some mitigating factors explaining why their response has not been as fast as some would have liked.

Firstly, the scope of regulation is constantly changing. As the rules have rightly tightened controls around traditional banks, the unintended consequence of opening up competition and transparency in the market is the emergence of unregulated start-ups, picking off the 'unlicensed' products as niche providers. This has led to calls for a 'level playing field' which, although a misleading label, has some basis. Regulators have rightly focused on their primary remit of supervising the major banks, so most innovation has focused on unregulated areas.

Secondly, much of the new ground being broken in the digital innovation arena is yet to operate at scale and therefore is on the radar of, but not yet on under the supervision of, the regulator. Machine Learning, wearable payment devices, the blockchain, identity as a currency. All are emerging themes that may require more direct regulation and supervision in future. The challenge for banks is to understand the ruleset before they plunge investment into an area that on first view is attractive, but if the cost of compliance becomes excessive will not be. Regulators will set the rules as the changes begin to stick. Will this be soon enough?

Thirdly, the purpose of regulation is to offer guidelines and supervision, not to set strategy. If banks choose to use the cloud to store their data they can. Some already do. The rules are clear around data privacy, and the need to retrieve and segregate data. It is not for the regulator to define which technologies to use or how to solve the issue of delivering savings through more efficient use of storage. One potential route would be to treat these 'commodity' services as industry utilities, and work on a collaborative effort to drive out industry-wide cost and reflect this ultimately in lower pricing for customers. Fraud prevention would be an ideal candidate here, as banks investing in better detection and remediation systems as a collective would gain the benefit of industry aggregated data in the same way that antivirus software alerts all devices to the threat of an attack. The regulator should support this aim, as it would offer better protection to consumers and lower industry costs through reduced losses.

Finally, regulators should collaborate actively. Not only across country borders within an industry, but across industry borders too. Data is at the heart of many of the business world's key issues. From privacy laws to cross-border restrictions, from reporting on activities to measuring complaints. The combined experience of the commercial world's exposure to digital innovation working together will have two profound impacts. In the first instance, it will help all industries to arrive at potential solutions more quickly through the sharing of ideas to solve common issues. Secondly, and just as importantly, it will reduce the scope for complaint among banks that they have it harder than their non-banking counterparts. This is slowly beginning to happen. Through the FCA, the UK in particular is making some headway with its 'innovation hub' advice service and 'regulatory sandbox' to test supplier capabilities. However, there are only glimpses of cross-border regulator collaboration (e.g. UK, Australia and Singapore) and we've yet to learn of any success stories in encouraging innovation through its services. Once it bites, the referee may then finally get the respect it deserves. •

Regulators should collaborate actively. **Not only across country borders within an industry, but across industry borders too.**

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Regtech. Holding the Keys to Regulatory Compliance?

In recent years we have seen how the various supervisory bodies have increased the regulatory demands on banks. These demands have absorbed much of the effort and resources of the sector, and monopolised change and IT spend due to the need to implement and adapt to new regulations.

These stretching demands have been and continue to be similar for all banks. Even though banks have used the Joint Money Laundering Steering Group's (JMLSG) steer and the Wolsfberg Principles' guidance to create an industry standard, banks acknowledge that they have not been sufficiently lean or agile in this regard. This has mainly been due to the large number of fronts on which they have had to work simultaneously.

After the regulatory 'tsunami' of recent years, banks now know the calendar of new regulatory demands up until 2019, when they will have to adapt their platforms to the next milestones. These are linked to the implementation of MIFID II, IFRS (IASB), FATCA, CRS and AML Directive IV. They have already begun to plan how they should be organised to improve their efficiency in the monitoring, definition and implementation of the various measures that were approved by supervisors in economic and political regions, and then adapted to each local market.

RegTech, the name given to the FinTech firms focused on the application of new technologies in the field of regulation, can play a key role here. RegTech solutions will not only provide innovation and answers to existing problems but they will also improve efficiency and standardisation in the short term, with the adaptation of mandatory regulations for all financial entities. They will do this by taking advantage of synergies and by applying the agility and scale of new technologies to solve regulatory challenges. We see key developments here in the areas of regulatory reporting, use of industry data sources, ability to store and extract huge quantities of data (utilities), and monitoring of compliance to regulations to assure conduct is in line with commitments. •

CONCLUSIONS

The banking environment has changed substantially in the last ten years. The digitalisation of the 21st century has dramatically changed consumer expectations and behaviours. In the banking industry, this has meant a loss of relevance of local bank branches, a growth in the use of mobile devices to carry out all types of transactions, and a growth in the number of FinTech firms looking to exploit opportunities across the banking value chain. They have been able to better connect with customers and have moved in a way that banks, with their heavy legacy structures, have not been able to emulate. FinTechs are forcing a change in the banking model.

This growth is no longer being ignored by incumbent firms, yet they do not yet know the path of best fit in an ecosystem with an ever-growing number of players. The regulators have a key role to play in this ecosystem. They have greatly modified the rules of business post-financial crisis for incumbent banks, forcing the restructuring of operating and governance models according to stricter demands. However, a lighter-touch approach is being adopted for FinTechs, with the regulator wary of stifling much needed innovation across the industry, and indeed in the field of regulation itself, which would ensure that better services are delivered to customers.

We believe that the best fit model for success is found through collaboration. There is a widely-held view that the joint venture will be the model that is used the most, seeing as it will allow the banks to lead the process and ensure that objectives are attained without uncertain expenditure, whilst at the same time giving the FinTechs freedom of movement in their developments. In this type of collaboration, the banks' main fear is that the FinTechs may be promiscuous in offering the same to their competitors.

In any case, the future of the relationship between banking and FinTech is yet to be written. The current disruption has the potential to shrink the role and relevance of today's banks, but we believe that by putting the customer at the heart of their visions, strategies and innovation initiatives, and collaborating with the right FinTech firms, they can create better products and services that make them an even more essential part of the new banking age. This is as close to a Win/Win/Win as possible. The sector as a whole will be far stronger as a result.

Methodology

This report was made possible thanks to the qualitative results obtained from the organisation of three think tanks organised on a European level by EFMA and Axis Corporate. Members of the main European financial entities and FinTechs were invited. The debate on the points of common interest was directed by the coordination team from EFMA and Axis Corporate and conclusions were drawn from a multitude of reports addressing the various scenarios of the future of financial services. The report was supplemented with articles portraying the views of Axis Corporate experts about what should be the connection points between banks and new FinTech companies.

About Axis Corporate

We are an international business and technology consultancy firm, focused on improving companies' results. We help our clients by providing them with advice, from the strategy, through the definition of their business model, to bottom line business impact.

We work on complex global transformation programmes, advising and supporting delivery throughout the programme lifecycle. We seek to make a direct impact on the levers of growth of organisations, via the improvement of their income and increased efficiency.

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About EFMA

As a global non-profit organisation, EFMA brings together more than 3300 financial services companies from more than 130 countries. With a membership base which consists of almost one third of all the large minority banks in the whole world, EFMA has proven to be a valuable resource for the global industry. It offers its members exclusive access to a large quantity of resources, data bases, studies, articles, news and publications. EFMA also offers numerous networking opportunities via work groups, webinars and international meetings. True to its vocation, EFMA has recently developed an innovation portal with the objective of identifying and rewarding the most innovative projects in the field of financial services.

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