Banks or platforms
The digital future

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Digital opportunities and threats for retail / SME banks

**Threats**

**New players**
- Digital challenger banks
- Adjacent industries
- Other FinTechs

**Data**
Access by third parties to their customer data

**Service Unbundling**
E.g. Lower cost FX (peer to peer)

**Opportunities**

**Increased efficiency internally**
- Block chain enabling real time, fully automated banking transactions – early days but being used for live banking activities
- Smart data analytics
- Automation of processes via robotics and machine learning

**New ways of interfacing with customers**
The backdrop is pressure on conventional banks …..

- Challenger banks with lower cost income ratios
- Other players searching for yield and entering traditional banking areas
- High cost income ratios – European country averages range from 55% to 77%
- Difficulty remunerating higher post-Basel III capital
- Investor pressures re ROE
- High regulatory costs
Open banking

Regulation is leading compliance in Europe

Against a rich backdrop of innovation

FS is lagging other industries in sharing technical standards so that products and services can be transferred efficiently
PSD2 in Europe (implementation 2018/9) will change the landscape

- **Data portability**
  Retail/SME Customers will be able to authorize third parties to access transactions history from their banks

- **Payment initiation**
  Third parties can initiate electronic payments to another party through APIs linked to the payer’s bank accounts

- **Banks /other payments providers** serving large corporates do not have to comply but may be forced by customer demand to move towards open API

Access to customers payments services and account information

Merchants might try to offer this service directly – avoids credit card fees etc.

This open API technology creates major strategic choices for banks
- Providing products and services of other banks – i.e. distribution channel
- Keeping a traditional relationship with customers and generating own products
- A platform offering own products and products of others – mixed product provider and distribution channel

Regulators are monitoring developments in retail and SME- and may apply more widely
Challenges – regulatory

EBA is setting the regulatory technical standards, RTS, before Jan 2018. But two key areas will lag 18 months

- Delay creates uncertainty around strategy and planning
- Strong customer authentication
- Common and secure communication

EU General data Protection Regulation

- GDPR already approved – covering protection for personal data
- Consent to enable data portability sourced on unambiguous informed basis
- Personal data must be processed in a lawful transparent manner
- Personal data must be adequately protected
- Go live May 2018
How PSD2 directive works – leading to potential fragmentation of the payments value chain for traditional payments for goods and services

Credit cards and payments providers can be disintermediated

3rd party Service provider/platform – can initiate payment to themselves or another party via customers own account – merchants can offer financial incentives to use this route

Customer provides consent/authentication

API (Portal)

Another party

Banks must provide payments initiation service – Become public API providers and data custodians

Fines for non compliance

Question of where liability sits if payment initiated by 3rd party is fraudulent – to be resolved

Will force greater unbundling of banking services but challenges in messaging for customers and grit with consent and authentication as two separate processes – can they be combined?

Will lead to innovation combining different services from different suppliers to create new products

► 29 May 2017
An information revolution – the most important part?

Will facilitate new aggregator services

- Aggregating customer current account and savings data across a variety of accounts with different banks
- Provide greater insight to customers on what they are spending money on, their overall financial position
- Currently can be achieved by scraping – aggregator ‘impersonating’ the customer to access data using their login and passwords – open API much more efficient

Greater information allied with artificial intelligence will enable more precise customisation of products to customers

Price comparison websites for loans and savings could gain customer financial history data to offer even more customized price comparison

Money managers could for a fee churn an individual’s savings across the most advantageous products for their circumstances and in current conditions

Erodes barriers to entry
Access to customer past transactions data in retail banks across Europe
The ultimate goal – e.g. loans and investments for SME

- Single point of contact for customer
  - Interface with credit rating provider through API
  - Interface with savings products through APIs
  - Predictive analytics
  - Collection of data on customer history
  - Execution of product
  - Assessment of best product

► Link to other products through APIs, insurance, FX etc.
► Accounting services etc.
Effect on the competitive banking landscape

Some will bolt on new services but not fundamentally change

High cost income ratios of traditional banks with branches and old technology will make it harder to compete

Some will change more fundamentally working alone or through strategic partnerships and new challenger institutions will build the business model in a different way

Traditional banks may see erosion of market share as platforms become the norm – business moving to other intermediaries and new entrants

Traditional banks will be more protected in highly regulated markets such as France

Question is in this platform environment where will value accrue – is it in aggregators, price comparison websites?

Banks will also disintermediate other players – e.g. in business banking

Non banks will be able to offer many of the services offered currently by banks and new banks can benefit from data on customers’ in traditional banks – peer to peer websites will gain

Banks as platforms of services some their own some they are distributing for others
A brave new world facilitating new entrants

Challenger banks eg Atom in the UK

FinTechs – e.g. Transferwise in the UK for FX – peer to peer

Non financial services providers and accounting service providers for SMEs

Aggregators – offering financial management tools

Data access drives change – opens the Pandoras box of disintermediation?

Willingness to adopt by customers and security are key

Airline industry has already adopted open API technology

29 May 2017
What about wholesale banks

- Disintermediation already underway
- Driven by costs, high capital requirements, search for yield by other players

Average ROE of top 14 global investment banks in 2015 6.3%

- Project finance – structures, pension funds, insurance companies
- Infrastructure lending / energy finance - pension funds insurance companies
- Barter exchange between companies
- Hedge funds/asset managers trading
Collaboration between investment banks and fintech?

► Process and service externalisation
► Managed or outsourced services
► Industry utilities – e.g. AML
► Collaboration with competitors – interoperability to gain geographic reach
► API led transformation to facilitate innovation - IP and data being made available to external parties to support development of new products
► Goldman packaging what they do to support 3rd party risk management and redesigning round APIs – amassing data, analysing it and putting it in the hands of customers

Highlights issue of safeguards round use of 3rd parties/suppliers, vendors – in US commission external reports on cyber, controls etc., which can be made available to customers, not the case in Europe.
Digital and investment banking

To reduce cost income ratios radical change is needed in terms of core infrastructure

► Spend to date has been on front office straight through processes
► Much less focus on middle and back office and control functions
► Digital must be the way forward – distributed ledgers i.e. block chain
► Digitising client on boarding – with industry utilities emerging
► Enhancing collateral management / custody and asset servicing
► Robotic process automation
► Improving efficiency of reconciliations etc.

Block chain could also enable the creation of new products / financial instruments
Digital supporting enhanced data

► Enhanced data

► Allied to artificial intelligence

► Supporting advanced analytics
  ► Identifying patterns and trends
  ► Identifying best customers for future
  ► Improving understanding attributes of highest performing clients
  ► Predictive analytics – to focus time of relationship managers
  ► Behaviour based pricing
  ► Pre trade analytics
  ► Real time analytics of trades
  ► Post trade analytics
Conclusion

Some banks will gain, some will lose

And the landscape will undoubtedly change