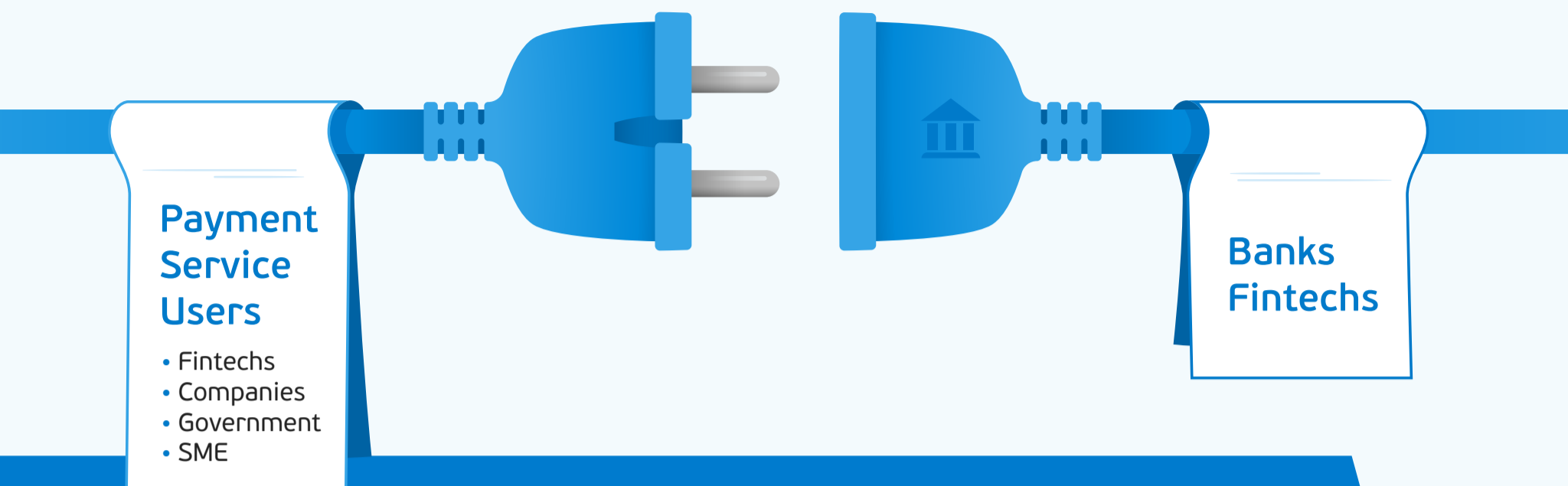


What will the future of banking look like?



## What will the future of banking look like?

Big tech, Fintech and increased regulation are putting pressure on banking incumbents. How can they rise up to the challenge?

The financial services industry is in upheaval and while there is a lot of recent talk about rising complexity and disruption, this transformation has actually been almost twenty years in the making. Since the year 2000, banks have faced stricter and more regulations, driving up the cost of compliance. Investment in new fintech players has grown steadily in the last decade. Big tech companies are entering the consumer finance space. At the same time, banks are struggling to innovate, with many still running their business on legacy systems. It's an almost perfect storm. In this article, the first in a series, we explore each of these developments and outline strategies banks can focus on to take back their future.

# Laws and regulations: a timeline

In 2001, the United States congress passed the [Patriot Act, Title III](#) as a response to the 9/11 attacks. This would be the first in a host of upcoming regulations meant to prevent international money laundering and terrorist financing. Three years later, we would see [Basel II](#) emerge, which meant to ensure banks have adequate capital to assume the risks they expose themselves to. Around this same time, we see the adoption of IFRS reporting standards. The picture gets even more intricate. In 2007, the markets in financial instruments directive ([MiFID](#)) was introduced to increase transparency across the European Union's financial markets and standardize regulatory disclosures. Then the financial crisis struck in 2008, resulting in a major process of [regulatory reform](#) that gave birth to the Basel III framework.

## Laws and regulations affecting Financial Services

2001 – Patriot Act Title III: Anti-money-laundering to prevent terrorism  
2002 – SOx  
2004 – Basel II  
2005 – IFRS  
2007 – MiFID  
2009 – PSD  
2010 – Dodd Frank / FATCA / Basel III  
2015 – AML 4  
2018 – GDPR  
2019 – PSD2

The decade following the financial crisis has been turbulent to say the least when it comes to regulation. Most recently, we saw GDPR and PSD2 come into effect. As EY [writes](#), both of these regulations focus on consumer data but were “developed from very different perspectives.” While PSD2 seeks to open up banking and create access to personal data, GDPR aims to protect it and put consumers back in control. This adds even more complexity to the regulatory landscape. Altogether, it has resulted in a higher cost of compliance. By some estimates, banks spend around [\\$270 billion per year](#) in compliance and have spent [\\$321 billion](#) in fines since the financial crisis. Another big trend impacting the banking sector since the financial crisis is the growth of fintech.

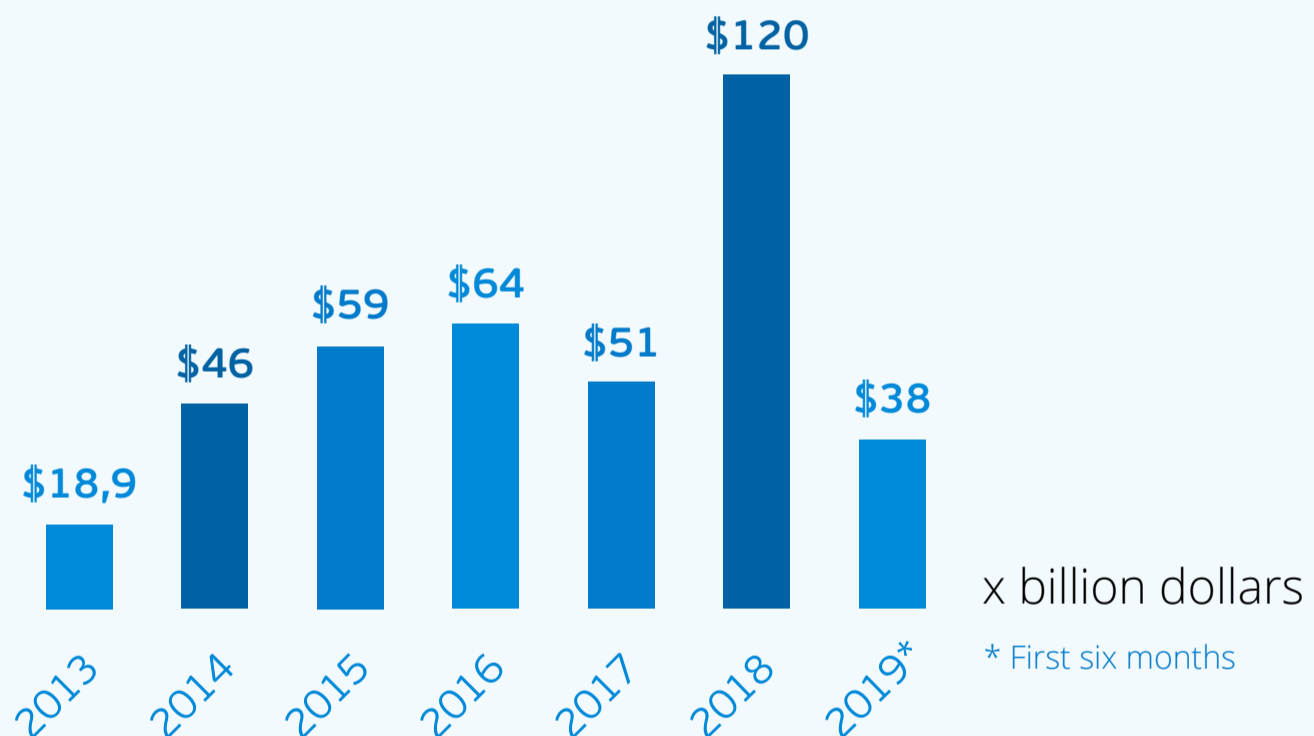
## Challenger banks and new fintech companies are entering the game

Investment in fintech has grown steadily since 2013, going from \$18.9 billion that year to \$120 billion in 2018 (as KPMG’s [research](#) shows). Most of these new market entrants focus on payments, personal finance management and credit solutions. Wealth management and insurance services are also picking up steam.

The biggest impact of these newcomers is an improvement of the customer experience. While most banks are still using legacy systems, mobile-first banks like Chime in the US and Netherlands-based bunq, to name a few, are redefining transactions and ease of use. In a 2016 [survey by PwC](#),

53% of respondents from the banking sector stated that their company was “customer-centric,” compared to 80% for fintech survey participants. In the same survey, 76% of banking respondents reported feeling that part of their business is at risk due to new fintech. An [Accenture study](#) estimates that competition from nonbanks, along with other factors, could cost banks “\$280 billion in payments revenue by 2025.”

### Fintech Investments (KPMG Pulse of Fintech)



Mergers, acquisitions and investments seem to be the preferred strategy for banks eyeing these fintech products and looking to develop their own. BBVA is among the “[most active acquirers](#)” of fintech start-ups in the last five years, having bought Madiva Soluciones in Spain, [Holvi](#) in Finland, and [Openpay](#) in Mexico. CNBC [reports](#) that major Wall Street banks have participated in 24 deals this year

alone. The market is also consolidating and has been for some time. In the European Union, the [market contracted](#) from 8,525 credit institutions in 2008 to 6,250. The numbers are similar in the [United States](#), where the number of commercial banks sat at 7,077 in 2008 and fell to 4,717 in 2017.

Besides M&A, cooperation with some of the bigger tech players is also growing. Let's take a look at the impact Amazon, Google, Apple, Facebook, WeChat and Alibaba are having.

## Events Financial Services Industry



## Big tech's influence on banking

Amazon launched Amazon Pay in 2007 and has since become a force of its own when it comes to online finance. The company has made several fintech investments of its own. All of them revolve around their core e-commerce business and expanding to international markets. India and Mexico have been the focus so far and the tech giant has been willing to make a loss to get traction in these markets. Amazon's goal is clear-cut: giving customers a seamless experience. On the merchant side, they have also developed a loans service (Amazon Lending) for businesses to finance stock which can then be sold on the Amazon web store. They have also been in talks with several banks to develop a [checking account service](#) and have considered entering the home [insurance market](#).

Alibaba, the Amazon of the East, is betting on a similar strategy. Their Alipay ecosystem offers financial services within the app: insurance, payments and more - all with the push of a button and offered in collaboration with banks.

Google is another big tech firm collaborating with banks. The company's recently announced partnership with Citigroup will allow customers to open a bank account through Google Pay. Compliance and KYC principles will remain in Citigroup's domain, while consumers enjoy a modern user experience. This has led to some privacy concerns and may raise red flags for regulators. Google has stated that they will not sell the extra data they acquire from bank account activity, but use it instead to "bring value to consumers, banks and merchants with services that include loyalty programs." People are skeptical about this statement.



Only time will tell if they will sell the data or not. Still, 57% of millennials [would reportedly switch](#) their existing bank for a better banking technology platform, so there may very well be a market that's ripe for the taking.

Like Google, Apple is also collaborating with banking incumbents to expand their fintech offering. The company's partnership with Goldman Sachs allows US consumers to get their own Apple credit card through an Apple interface. Although it was met with skepticism and a [gender-bias scandal](#) at the outset, unique selling points include more security (you need the card and your phone to shop) and cash-back rewards for certain purchases, which are paid out on a daily basis. A recent [announcement](#) shows that Goldman Sachs has lent out about \$10 billion in credit to Apple customers so far.

Facebook is taking a very different approach. Like Amazon and the others, they also ultimately want to retain their customers' attention by offering payment services within their own environment. Facebook Pay, a simple payment request tool, is just an example. Unlike the other big tech firms, they also made an attempt to launch Libra, their own "cryptocurrency." The crypto experiment's future is unclear and it's currently on hold due to regulatory pressure, but it certainly poses a risk to central banks all over the world.

WeChat is a remarkable contender on its own as well. The messaging app now turned fintech giant, enables users to pay bills, recharge mobiles, make online purchases and money transfers, and pay using QR codes at merchant stores in China and abroad. The company effectively transformed China from a [cash-based to a cashless](#) society. Where the Chinese consumer goes, WeChat goes.



In short, more customer “stickiness” is the business model for big tech companies. This poses a threat for banks, who have to compete for consumers’ time. The challenge for incumbents is to develop equally enticing and seamless service offerings, while still relying on foundational legacy systems that are excruciatingly difficult to migrate to the cloud. It’s join big tech or adapt.

## The Cloud as imperative

A [2018 study](#) by Accenture shows that banking incumbents are well aware of the benefits of the cloud. 77% cited “the ability to scale their IT operations up - and down - as needed” as a top benefit. Another 63% see the ability to launch applications faster as a key advantage of cloud adoption. Other benefits include enterprise synchronization (better sharing of data across business units), regulatory compliance and more resilient operations, as Deloitte [outlines](#). Not to mention efficiency. New banks like N26 and Revolut are cloud-based, and therefore more agile and able to deploy solutions faster. In stark contrast, many of the legacy IT systems incumbents currently use have become redundant and expensive to maintain. In the UK, nearly [50% of banks](#) fail to upgrade old IT systems as soon as they should. In the US, [43% of banks](#) still use COBOL, a programming language dating from 1959. Layering solutions on top of these old systems inevitably leads to inefficiencies and outages. Often, these core banking systems do not run on real-time, making it nearly impossible to develop the type of solutions consumers demand today.

Although there is an upswing in cloud adoption lately, many banks and other financial services companies are still reluctant to go all-in. Going back to the [Accenture survey](#), 43% of executives said their bank lacks a strategy to move to the cloud. Security concerns abound. Nonetheless, the cloud is a key enabler for banks to offer the seamless digital experience customers crave. It's high time for banking executives to upgrade their systems. Taking an incremental approach, as [EY suggests](#), can help to embark on this journey with the right degree of oversight.

## So, what's next?

Banks have to rethink their role in the financial landscape of the future. The ongoing pressure of regulation may push some to prioritize survival above innovation, but this strategy will not hold out much longer. Acqui-hires and fintech investments may prove fruitful and more collaborations with big tech are likely on the horizon. Ultimately, banks need to increase their focus on the customer and the financial products that they offer and to do this, having a cloud strategy is crucial. Their advantage is the wealth of experience and knowledge they have of financial services. Banks still excel at this. To maintain a razor-sharp focus on the customer, banks can choose to become primarily service providers and outsource anything that is not differentiating (back-office, payments and core banking) to other companies. This is a subject we will explore further in our next article. Stay tuned.

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## About Visma Connect

Visma Connect offers: payment services, information portals and integration services. Our experts are specialized in Payments, Standard Business Reporting, Blockchain and Artificial Intelligence. Visma Connect was established in 2006 as EBPI and since 2019 has been part of the Visma Group.

## About Visma

Visma delivers software that simplifies and digitises core business processes in the private and public sector. With presence across the entire Nordic region along with Benelux, Central and Eastern Europe, we are one of Europe's leading software companies.

We believe in empowering people through technology. By helping close to one million customers run their business every day, we give companies a competitive edge and individuals time to focus on what they love.

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