# The Banking and Fintech Leadership Forum

October 2019

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## The evolving relationship between fintech and banking

The emergence and growth of a range of financial technology companies in businesses historically dominated by large incumbents has changed the financial services ecosystem. Although incumbents initially viewed fintechs as a competitive threat, bankers increasingly see them as potential partners to help more quickly launch new products and services and migrate away from legacy systems. Many fintechs, meanwhile, now see banks as important customers and sources of capital. On 26th September 2019, fintech CEOs and other executives, bank executives and directors, and other industry participants convened in London for the second Banking and Fintech Leadership Forum hosted by Tapestry Networks and LendIt Fintech. The Forum was sponsored by Sidley Austin LLP. Two of their senior partners also contributed legal and regulatory perspectives to the discussion, which focused on how the financial services ecosystem is likely to evolve and opportunities and practical challenges to partnerships among banks and fintechs. A complete list of participants is included in the appendix.

## There is still room for fintech to grow

The emergence of fintech and regtech players has helped to transform the financial services landscape. Some of these players are starting to achieve scale in core banking businesses. UK-based Revolut, for instance, launched just four years ago and has onboarded 3.7 million users in 28 European markets. German-headquartered N26, meanwhile, now has 2.3 million customers and is active in 24 European markets. [1] And yet, most fintechs remain focused on delivering a finite number of core products, or have developed technology platforms or processes that they are open to selling to banks or are specifically designed to support other banks and fintechs alike.

Participants discussed the forces shaping the current financial services ecosystem and how things may continue to evolve, including where additional growth opportunities exist for fintechs and challengers.

### External factors are changing the market for financial services

The financial services space continues to experience significant disruption. While fintechs have clearly contributed to this disruption, participants identified several exogenous factors that could further influence bank and fintech business models:

- **Barriers to entry in banking are falling across Europe, but inconsistent in other markets.** Open banking is helping to usher in a new era of innovation. A participant observed, *"The problem with the banks is that they were previously shielded from competition due to regulation and bank licenses. With the advent of Open Banking and the development of new licenses for payment service providers which do not take deposits, such as e-money and payment institution licenses, this is changing. While banks still have a monopoly over deposit taking, where a fintech product does not have a depository element, others can easily step into the shoes of the banks."* Further, in Asia, several major financial centers, including Hong Kong and Singapore, are now offering virtual banking licenses to digital challengers which will also compete with banks on deposit taking. That said, as firms contemplate expanding operations into the vast U.S. market, they should not assume a similar ease of access. Joel Feinberg of Sidley cautioned, *"The licensing barrier has moved in the other direction in the U.S. Prior to 1996, anyone could have gotten a bank license. In [2006], Walmart tried to acquire a bank and when they tried, the regulator shut down the licensing. But alternatives to bank licensing were always there. For example, SoFi has state lending licenses. For payments, the state licensing scheme has always been there too, and that field has exploded. Amazon and Facebook have all those state licenses."*
- **Changing customer preferences are creating new models.** As regulators have been opening the playing field in Europe and to some extent in Asia, consumer preferences have also been changing. An executive said, *"The customer has definitely changed. It could be because of mobile, maybe it's generational. It is easier now to get into the space."* A fintech leader noted that some fintechs are focused on building digital platforms and marketplaces, which can create revenue streams beyond their core financial products: *"It's about establishing touch points and how many times you open your app. N26 say their customers open their apps eight-to-10 times a day. I don't see any banks doing that today."* A banker agreed, *"That's what we've seen with the Asian competitors. It is a lifestyle app. They're using it 10 times a day and think of it as a companion service."*

  While slick apps create opportunities to engage with customers in new ways, earning a customer's trust is more difficult. One executive said, *"Revolut and Monzo have millions of current accounts now, but we all know that few of those customers use them as their primary bank. It's about where your paycheck goes. And I think that's a trust issue. Perhaps over time though they will build that trust."* That day may be coming sooner than some expect. A banker explained, *"All the juniors on our floor have accounts with Revolut. They're moving to the next stage of transferring their deposits over. The trust is there from a generational perspective."* In the small business space, an executive observed that alternative providers may already be well-positioned: *"For SMEs, I would look at the service providers. QuickBooks* *for instance. Those guys own the customer data. They own the trust. Banks are looking at that and trying to figure out what they are going to do."*

- **Big Tech's ambitions remain the biggest question**. The potential for an Apple, Amazon, Facebook, or Google to formally enter financial services more directly and truly disrupt the status quo continues to capture the attention of incumbent and fintech leaders. A bank leader wondered, *"The big question is if and when a big internet company with millions of customers might decide to truly enter the banking space? To date it has not happened. Why shouldn't a fintech partner with a big tech company?"* A fintech CEO offered, *"I doubt we'll see the fintechs really take on the universal banks. That may change with the likes of Amazon."*

## How sustainable is the growth of fintech?

Whether and how the growth of fintech will progress remains to be seen. Some question whether models that emerged post-crisis will be able to weather an economic downturn, especially in businesses like lending that have, in some cases, focused on customers deemed too risky by the banks or rely on new approaches to credit underwriting. A banker asked, *"If you are going to build real scale, at some point the economics need to be viable. And therein lies the question. At some point, fintechs will need to spend and earn money since they're competing against lots of people. Will private markets continue to support that journey?"* A fintech CEO conceded that a path to profitability must be part of the business plan. *"The current path is feasible until the funding stops."*

Participants identified a few ways fintechs can grow their businesses in a sustainable manner on a standalone basis:

- **The underbanked market represents a large opportunity.** Many fintechs have grown by focusing on segments underserved by banks or which banks exited post-crisis. A participant said, *"Where will growth come from? The underserved SME market in the UK is huge and growing because the banks have largely abandoned that market."* Another participant agreed, stating, *"Growth comes not from doing what the big banks are doing, but rather the business that the banks don't want to do anymore."*
- **Increasing specialization may be the future of financial services.** A former banker explained, *"The future is to serve a particular segment really well. Sustainability comes from serving that niche segment better than the big banks. I am skeptical that you can build a digital bank that serves all people. Even Monzo, which has a lot of customers, is building a niche bank that really serves the needs of young people living in Shoreditch."*
- **Fintech cost structures are an advantage.** Banks are burdened with legacy technology and compliance obligations derived from the *"sins of the past."* For some, the advantage that fintechs can exploit, and which may insulate them from a downturn, is cost as much as revenue growth. As they grow, the accompanying compliance and other costs could catch up

to them. A fintech CEO said, *"In my view, the bet on the challenger bank is not on the top line. It is clear how they can earn money. It is more of a bet on the cost side. Can they build their customer base and keep their structural advantage since they don't have legacy?"*

- **Consolidation could be the path to achieving scale.** One way for fintechs to acquire customers and potentially reduce costs would be to merge or acquire other fintechs. A banker suggested this would create more direct competitors to large banks: *"I don't know if three quarters of the fintechs will go bust, but I do think there will be consolidation. It is inevitable. Once that consolidation happens amongst fintechs, once fintechs have more scale, watch out. The banks will be in more trouble."*

  The nature and importance of scale may have shifted as well. Where large balance sheets and books of business were among the greatest competitive advantages for incumbent banks, whoever owns customer data may now have the advantage. A fintech executive surmised, *"10 or 20 years ago, the appeal of JP Morgan was their asset book. Now, Gen Z looks at who has the coolest app and what they publish real time. It's totally different. Long term, it's going to be about who's best at using the data. The banks have more data than anyone else. It is also what makes Amazon the biggest threat. The question is who can get there first."*

## Partnerships: both sides see benefits and challenges

A participant asked, *"Are we headed toward an arms race in technology? If you have the cash, do you go out and acquire it all, or is a partnership, co-working approach better? Does that allow you to be nimbler as the technology changes?"* This is the question many large banks are now grappling with. Acquiring fintechs to buy the technology rarely makes economic sense given current market valuations. Fintechs looking for additional revenue channels see opportunities to partner with banks to access their distribution channels or to help them address a specific need. As a result, some participants see mutually beneficial partnerships expanding. A fintech CEO observed, *"It's no longer correct to say that fintechs are out to eat Jamie Dimon's lunch. Many fintechs are out to help banks become more efficient and customer friendly. For us the bank is the customer. It is not point-of- sale competition. Banks and fintechs are often in different spots in the value chain."* Another fintech CEO observed, *"There are examples of good partnerships, including some that we are involved with. Banks are looking for solutions and we need money."*

Some of the bank participants also saw clear value in partnering with fintechs. One banker said, *"At least for us, collaborating with fintech is really important to provide the capacity and knowledge that we don't have. We need the muscles and innovative capacity that others have in order to be relevant in the long run. We have a whole team within the bank dedicated to partnerships."*

Not everyone, however, is convinced that banks and fintechs can collaborate effectively. A participant stated, *"I am bearish on partnerships. It just doesn't seem to work. We are not talking* *about vendor relationships."* Another said, *"I have seen distribution partnerships fail many times. You are in someone else's domain, selling your brand to the customer. We tried pilots, trained bank employees, changed incentive schemes, and it never worked. It is on the c-suite agenda, but making it work down in the organization, on the ground, is hard. It could be irrational fear of someone else stealing my customers."* In fact, one participant asserted, *"PSD2 and Open Banking recognize that banks and fintechs can't do partnerships by forcing access without the need for a contract or relationship."* The same participant noted that Japan and Hong Kong introduced their own open banking standards but require banks to have a contractual relationship with the third parties. In response, one of the large banks developed a platform, but then charged millions of dollars for fintechs to access their APIs.

## How can partnerships be effective?

Participants delved deeper into the core question of whether and how bank-fintech partnerships can be effective, outlining some aspects of partnerships necessary for them to be mutually beneficial:

- **Improvement in speed and efficiency.** Banks operate at a different pace than smaller fintechs. A participant from a bank described, *"In one case, we completely outsourced the tech because we didn't think we could do it fast enough and efficiently."* Fintech partnerships can speed up banks' ability to adopt new technologies without having to develop it themselves.
- **Ability to scale effectively.** For large banks determining where to focus their efforts, a participant said the central question is, *"Can it scale?"* Equally, this participant said bank leaders should ask, *"Will it make us more or less complex? Simplification is important."*
- **Clarity around objectives.** A participant described one of the ways partnerships can fail: *"Some banks feel like they need to do something to be hip and cool. So, they bring in a fintech. But then so many people want to kill it because it threatens their silo."* Instead, clarity around what the bank is trying to accomplish, alignment with their strategic objectives, and clearly communicated and mutually understood goals are required to be effective. Referring to a successful partnership in developing a new digital offering, a participant said, *"They had a strategic vision and the courage to follow it up. That's why it works."* That requires senior buy-in from bank leadership. A participant said, *"We met with the CEO because the IT team was being challenged by the commercial side of the business. The bank was then able to talk to their regulators to get them comfortable with a new approach developed with us."*
- **Alignment on expectations.** Because banks and fintechs operate at different speeds and with different structures and approaches, they need to be aligned regarding expectations about how they can work together. According to one fintech participant, *"For fintechs, time is your enemy because your funding can run out,"* acknowledging, however, *"Fintechs can't*

*expect banks to behave like fintechs."* Another participant agreed that both sides need to be realistic and willing to compromise: *"You start off together mapping the perfect customer experience, then rapidly discover that something has an extraordinarily high cost for example, so you make 80/20 decisions. You will never get to perfect. You have to agree together on a road map – start small and then if customers like it, move on to the hard stuff. Fintechs often lack pragmatism."*

## Outstanding challenges to be overcome

Participants acknowledged that there are structural, technological, and cultural barriers that need to be overcome to make partnerships work.

### Fintechs and banks rarely share similar risk appetites

Several participants challenged the common perception that fintechs are not subject to regulation. One said, *"The hope among fintechs that they won't have to bear the banks' compliance burden is a misperception. Banks may force it, or the regulator may do so. And if they mess up, the regulator can skip over the bank and go to them directly."* However, even when subject to many of the same compliance requirements as banks, as John Casanova, a partner at Sidley observed, *"The approach from fintechs is different. Banks and fintechs have different risk appetites. Our fintech clients not only maintain bigger risk appetites but are also nimbler in making risk decisions."*

Concerns about security are also heightened at large banks. *"Protecting customer data makes it difficult for us to be a good partner,"* according to one bank participant, who continued, *"It is preventing us from building the same customer journey and experience."* Another warned, *"We will not give you our data. If we are working with you, you need to run it on our platform. Data security has to be top notch."*

Issues relating to the use of public cloud linger as well. While many tech companies are cloud-native and see the benefits of lower costs and more agility, some large banks remain cautious about moving to the public cloud or working with cloud-dependent partners. One bank participant said they had tried to develop a solution on the cloud but were unable to get comfortable: *"For a very large company, like a global bank, I am not sure why we need to deploy on the public cloud. Anything we put on the public cloud we have got to be prepared to lose."*

### Legacy banking systems remain a central inhibitor

Banks are investing massive sums in maintaining and updating their technology. Yet, they remain largely reliant on core banking systems developed in the 1960s and 1970s, which have grown and become more complex over time with layers of technologies and applications sometimes described as "spaghetti." A participant noted the challenge this creates for partnerships: *"The core banking system is the big challenge. The dream is that a fintech will arrive with a new core banking system. Until that gets solved, 90% of the cost is often just bridging to the core banking system. It costs 10 times as much for a bank to bring it in than for fintechs doing it themselves."*

### Starting fresh might be the most effective approach

*"Is it ultimately better to set up a brand new bank with a brand new way of thinking?"* asked one participant. Many see the legacy systems, cultures, and organizational structures of large banks as an almost insurmountable barrier to the kind of innovation and agility needed to transform operations and business models and collaborate with fintechs. For example, one fintech executive noted the discrepancy in their costs relative to banks, saying, *"We have exactly the same licenses as small banks and the same requirements around KYC, AML, etc. But compliance is fully automated, with a staff of 12 people, not hundreds."* Some participants, therefore, advocate the greenfield approach to developing new models, which might be more amenable to partnerships with fintechs. Goldman Sachs' Marcus is often cited as an example of an effective attempt by a large incumbent to launch a new business on an entirely new platform. While some highlighted the cost relative to challenger banks and startups, one participant stated, *"Goldman did not burn through billions in building Marcus. This was part of a vision. It lowers their cost of capital and allows them to compete with banks with retail businesses."*

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The discussion on 26th September provided a unique opportunity for a candid exchange of views among senior leaders from banks and fintechs. It highlighted the opportunities for fintechs and incumbents to explore new approaches as the financial services ecosystem continues to transform, but also highlighted the practical challenges fintechs and banks face in adapting.

## Appendix: participants

On 26 September 2019 Tapestry and LendIt Fintech hosted the Banking and FinTech Leadership Forum with sponsorship and support from Sidley Austin LLP. Discussion focused on exploring opportunities and challenges, including partnership opportunities, in a changing financial services ecosystem. This Summary of Themes draws primarily on insights from the discussion on 26 September, as well as calls with participants in preparation for the meeting. These discussions were held under a modified version of the Chatham House Rule, whereby the names and affiliations of participants are a matter of public record, but nothing is attributed to any individual or institution. Unattributed quotes from these discussions appear throughout.

The following individuals participated in the pre-meeting calls and 26 September discussion:

- Jeremy Anderson, Audit Committee Chair, UBS
- Dennis Andrade, Partner, Tapestry Networks
- Alex Bannister, Director of Strategic Partnering, Nationwide Building Society
- Peter Briffett, CEO and Co-Founder, Wagestream
- Bo Brustkern, Co-Founder and CEO, LendIt Fintech
- Pat Butler, Chair of the Board, Aldermore, PLC
- John Casanova, Partner, Sidley Austin
- Jamie Cooke, Managing Director, fscom
- Charles Delingpole, CEO, ComplyAdvantage
- Joel Feinberg, Partner, Sidley Austin
- Conrad Ford, Former Founder & Chief Executive, Funding Options
- Imran Gulamhuseinwala, Implementation Trustee, Open Banking
- Tom Hambrett, Head of Legal, Revolut
- Michael Hansen, Founder, Capcito
- Christer Holloman, CEO & Co-Founder, Divido
- Husayn Kassai, CEO and Co-Founder, Onfido
- Sharron Khela, Director, Citigroup
- Matthias Knecht, Co-Founder, Billie
- Stuart Law, Founder and CEO, Assetz
- Andrew Lowe, EMEA Head of Business Development for Technology, Bank of America
- Kathryn Matthews, Non-Executive Director, Barclays Bank UK Plc
- Roberto Nicastro, Vice Chair and Risk Committee Chair, UBI Banca
- Tucker Nielsen, Principal, Tapestry Networks
- Neil Radley, CEO, Jaja
- Ahsan Raza, Managing Director, Financial Institutions Group, Barclays
- Peter Renton, Co-Founder and Chairman, LendIt Fintech
- Kristina Salemyr, Head, Consumer Finance, Nordea Finance
- Tim Sievers, Founder and CEO, Deposit Solutions
- Daniel Zakowski, VP Marketplace Investments & Chief of Staff to the CEO, auxmoney
- Olga Zoutendijk, Non-Executive Director, Julius Bär

## About LendIt Fintech

LendIt Fintech held its inaugural event in 2013 in New York and has since grown to become the largest lending and fintech event of its kind in three markets: the United States, Europe and China. Thousands of attendees join fintech executives, bankers, and investors to learn directly from senior executives about key trends shaping the financial services industry.

## About Sidley Austin LLP

Sidley Austin LLP is a premier law firm with a practice attuned to the ever-changing international landscape. The firm advises clients around the globe, with 2,000 lawyers in 20 offices worldwide. In our regulatory and fintech practices, we combine strategic regulatory advice, transactional counseling and a deep knowledge of the financial services industry. The result is a comprehensive approach to formulating and executing strategies for clients who innovate and operate in the evolving fintech industry. Our record is strong with established financial institutions and start-up companies alike, as they have acquired, invested in, developed, implemented and brought to market new financial technologies, platforms, products and services.

## About Tapestry Networks

Tapestry Networks is a privately-held professional services firm which operates networks, working groups, and research workstreams for senior leaders from many of the largest corporations and institutions in the world. Tapestry events create an environment where leaders—directors, senior executives, regulators, and policymakers—learn from one another, explore new ideas, and collaborate to solve complex problems.

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## Endnotes

[1] Roger Baird, "Jaja Finance launches credit card into crowded market," *AltFi*, February 28, 2019.