A WHITE PAPER FROM FINEXTRA IN ASSOCIATION WITH TEMENOS
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HOW TO REALISE A DIGITAL STRATEGY IN FINANCIAL SERVICES

Leveraging the cloud, harnessing data and reinventing business models for the digital age

TEMENOS
The banking software company
Finextra

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INTRODUCTION: WHY BANKS NEED DIGITAL STRATEGIES

During 2017, Finextra, in association with Temenos, hosted a seminar series in London designed to unpick and explore the challenges – and opportunities – for financial services firms grappling with the transition to a digital world.

The three co-hosted sessions brought together 100 plus delegates to hear experts from across the industry deliver insightful presentations and participate in in-depth discussions. The aim of the seminars was to examine in detail the options for financial services firms as they reshape their business models and reinvent their technology approaches in response to digitalisation.

Since January 2018, when the revised Payment Services Directive (PSD2) came into force, the concept of open banking has become a reality. This has made it possible for new competitors to enter the fray, offering innovative products and services and excelling in customer experience and intensifying the pressure on established banks to leverage the data they possess to match the customer engagement levels achieved by the new entrants.

To stay relevant, financial institutions now need to execute their strategies for responding to this fundamental market change. They must implement the new business models on which they are betting their futures - along with the technology architectures required to support them.

At the time the Finextra/Temenos sessions took place, the new world of open banking was fast approaching, and attendees' minds were clearly focused on achieving compliance, fending off new sources of competition, and making the most of the opportunity presented by the changes: to deliver a better service to their customers, and to drive revenue growth for their own businesses.

In this context, the three seminars examined in turn the role of cloud computing within a digital strategy, progress by financial institutions in harnessing data and analytics to improve customer experience, and options open to them to reinvent their business models for open banking.

The discussions during all three sessions, held under the Chatham House Rule, were lively and wide-ranging. Their main conclusions, described in detail during the pages that follow, included:

– For financial institutions of all shapes and sizes, the decision to move to the cloud is involves complex considerations which are still being worked through – but there is no question that the future of core banking is cloud, even for the biggest banks.
– For many financial institutions trying to move from ‘branch banking’ to ‘data banking’, culture is the biggest issue, hampered as they are not only by legacy technology but by legacy organisational structures. However, the prize – achieving digital, ubiquitous, embedded, contextual, conversation-led customer intimacy – is well worth the fight.
– Despite the influx of new entrants into the space and the upheaval promised by the move to open banking, incumbent financial institutions have some inherent advantages: compliance, capital and customers. They can leverage these to become successful platform providers and secure their relevance in a world likely to be dominated by a handful of digital ecosystem providers.

This white paper, produced by Finextra in association with Temenos, distils the outcomes of the seminar series, and presents a set of key takeaways for financial institutions looking to realise their digital strategies to remain relevant and successful in the banking landscape of the future.

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CLOUD STRATEGIES FOR CORE BANKING: CONTROVERSIAL PROCLAMATIONS FROM CONCEPT TO REALITY

Participants in the first Finextra/Temenos seminar made and critiqued a number of pointed statements about the role of cloud in the future of banking.

Among the assertions hotly debated were the following:
– Core banking systems will become increasingly cloud-based- some saying by 2020 each one that goes live will do so in the cloud, driven by the clear cost and scale benefits to be gleaned from this Any new bank starting its operations now would be 'mad' to go any other way than cloud.
– As PSD2 puts it beyond doubt that banking is an internet service, cloud becomes an essential weapon in financial institutions' armouries.
– When core banking moves to the cloud, banks will be able to move their spend more into distribution, gaining competitive advantage.
– Even neo-banks have concerns about how the regulators view cloud, (despite increased clarity and promotion of cloud in regulatory reports)
– The attitudes of IT departments, motivated by job protection and by CIOs who have grown up with infrastructure roles, are an inhibitor to cloud adoption.
– The cost of one year of private cloud use buys 44 years of public cloud use.

The seminar participants, a healthy mix of practitioners from established and new - and even yet-to-be – banks, broadly agreed that cloud is the way forward, but behind that broad agreement were many nuanced observations.

For example, some participants felt that though cloud is surely the direction of travel even for big banks for core banking - the obvious benefits in terms of cost, security and speed of deployment being too powerful to deny - a target of 2020 for everything new being done in the cloud is ambitious.

There are several potential drags, they suggested – not least, as mentioned above, the vested interests in IT departments, and the ever-present spectre of legacy.

And while cloud is certainly the preferred option for start-up banks, those present displayed several concerns in common with established players – including worries about how the regulators view cloud.

True, the latest publication from the EBA on cloud use tends towards simplifying the regulatory backdrop to cloud for banks. And true, the new banks that are cloud native from the outset report compelling results in terms of cost and agility.

But it is also the case that for established banks the knotty question of how to migrate core to the cloud is still to be answered. And new banks have concerns that without the financial muscle of the big banks, the public cloud might not reach its potential for the financial industry.

Interestingly some of the start-ups also expressed concerns about whether they can successfully implement their USPs in a cloud environment used by all banks.

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03 DIFFERENTIATING PUBLIC AND PRIVATE CLOUD

In addition, it came across very clearly from the discussion that, out in the real world, firms are still grappling with the definitions and differences and similarities between public cloud and private cloud and shared infrastructure and dedicated infrastructure and infrastructure as a service IaaS) and platform as a service (PaaS) and software as a service (SaaS).

Even more importantly, they want to know whether the regulators grasp those differences and take a view on the safety or otherwise of cloud use across these different configurations.

All of this complexity notwithstanding – and slight disagreements over timescale to one side – it was nonetheless apparent from the discussion that in future core banking will take place in the cloud.

The vendors around the table report that all new RFPs require the option of cloud (whether for immediate use or not). Small and new banks go to the cloud for 99% plus of their activities from the outset. Big banks are developing new functionality to be cloud native, and are trying to use the cloud where they can – and though they have to eat the elephant one bite at a time, they are committed to doing it.

For banks under margin pressure, the cost argument is compelling – not just in hardware terms but through the extra automation that becomes possible with cloud. The agility argument is also irrefutable– taking minutes to provision new infrastructure, and the viability of testing new products and ditching them if they don't work, in order to try again.

Even from a security perspective few would argue with the obvious truth that hyperscale cloud providers can spend more on this than any individual bank alone could ever do.

But it's also the case that there is no 'one size fits all' cloud approach for banks. One attendee broke the landscape down thus: tier one banks will build platforms on IaaS; tier two banks will leverage PaaS; and tier three and four banks will leverage SaaS. And every tier one bank is a tier three or four bank somewhere.

All that said, there is no denying that the outcome of the discussion was that cloud for core banking is fast moving from concept to reality. As one participant said, cloud "is almost like a mindset": one the participants in the seminar had clearly bought into, and one that will no doubt become more pervasive over time.

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04

LEVERAGING EMBEDDED ANALYTICS FOR DIGITAL CUSTOMER ENGAGEMENT

The second Finextra/Temenos session set out to answer an important question: how can financial institutions maintain meaningful interactions with their customers as they favour mobile and online communication instead of face to face interactions?

The premise of the session was simple. In the digital world, as personal encounters between banks and their customers continue to dwindle, there is a risk that the quality of their customer relationships diminishes too (especially as digital channels are inherently ‘leakier’ than physical ones, as delegates heard).

Compounding this challenge for traditional banks, innovative new entrants have stolen a march by providing more attractive digital-first banking experiences.

The good news for banks is that they have rich data about their customers, ripe for exploiting to drive intimacy - assuming they have the capabilities to do this.

In addition to an overall customer engagement strategy, financial institutions also need clean, broad and deep data, flowing in the right way throughout the organisation, protected from cyber threats, and being used in a fashion that is compliant with regulation such as PSD2 and the General Data Protection Regulation (GDPR).

So what should banks be doing to ensure they can successfully capitalise on their data, leverage sophisticated analytics, and excel in digital customer engagement?

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ACTION POINTS

Seminar attendees, who hailed from financial institutions large and small, heard clear guidance on what they should NOT be doing. If the goal is to match the performance of online retailers - able to send emails in near real-time to shopping cart abandoners to try to revive the sale – then what doesn't work is having siloed business lines serving the same customers, product-level analytical teams, data held in silos, product pushes, treating customers like robots or treating all customers the same, delegates heard.

Another no-no is crude segmentation. Even the much-vaunted millennial segment is misleading: consumers within an age range can differ massively in terms of where they live, what they do and what their financial aspirations are.

Tracking the wrong metrics around customer engagement is another failing that is common among banks, the discussion revealed. For example, interaction rates will often be viewed as a positive marker, when in fact many customers will say they actually want a lower level of (more effective) engagement with their banks.

What banks need to do, seminar attendees were told, is shift from 'old world digital' – built around channels, access, content, interactions and personalisation – to 'new world digital': this is based on ubiquitous, embedded, contextual, conversation-led customer intimacy, enabled by data-driven engagement.

The effect will be the banking equivalent of the advertising boards in Piccadilly Circus that deliver content tailored to the people that will see them, delegates heard – catering for tourists during the day and partygoers at night. Ultimately, becoming data-driven could lead to a fundamental change in how banks do business, transitioning from holding deposits of money, to holding customers' data, it was suggested.

In this vision of the future of banking, the model of customer data use is reversed. Whereas today every bank builds a picture of each customer and tries to push products and services to them, in this future, individuals own their own data and expose it to companies when they have a need for products and services.

This could begin at a visual level with a customer demanding the same user interface from every online provider with which they interact, and could then build from visual preferences to preferences based on beliefs and aspirations. In this 'reverse marketplace' environment, banks could play a critical role, as it is recognised that data has value and consumers can lend, spend and invest that data, creating an alternative business model for banks.

Whatever their future, banks do face hurdles in getting there, the discussion acknowledged. One challenge is legacy technology, and, somehow, financial institutions need to conquer this challenge and implement single, centralised decisioning platforms that can leverage unified data sources and support omni-channel customer engagement.

Another is legacy culture: siloed thinking and siloed organisations are anathema to data-driven customer engagement. To that end, delegates were encouraged to think big, but start small, and ensure they have a senior sponsor for data and analytics projects geared to delivering better customer experience.

Overcoming the hurdles in one way or another and perfecting the art of data-driven engagement is critical for banks, attendees at the seminar were told, since "they who own the conversation, own the client".

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RESTRUCTURING YOUR BUSINESS MODEL FOR OPEN BANKING

The final seminar in the Finextra/Temenos series took place in December 2017, with open banking literally weeks away from being a reality. This session tackled perhaps the biggest questions of all facing financial institutions in this fast-evolving landscape. What business models can banks adopt in an open banking environment – and what will it take for them to make a success of their chosen approach in practice?

They could retain full custody of products, operations, sales and marketing, and servicing, or decide to outsource parts of the business, in order to specialise in either the 'manufacturing' end of the value chain, i.e. creation and management of banking products and services, or the 'distribution' end ie. sales, marketing and servicing. Broadly speaking, banks must decide whether they are going to take control of customer interactions, or whether they will focus on manufacturing and leave the customer relationships to other players.

But beyond that decision, what are the cultural challenges banks must tackle to achieve successful change? What are the technical requirements of each business model, how might banks' existing technical architectures impede their progress, and what solutions can they apply to overcome these hurdles?

In a world where any company with a customer base and scale could be a competitor, it is vital for financial institutions to work out where they are going and how they are going to get there, and the richness and energy of the discussion during this session demonstrated how front of mind the business model question was for the bank representatives present.

Delegates were given food for thought by a presentation from one fintech operating in the aggregation space today, outlining its own 'open banking business model': via partnerships with banks and other fintechs, this company is providing what it believes to be a 'future looking whole customer view, enabling contextual delivery of a breadth of products across a customer's financial journey'. They have targeted a niche segment of the market – those

struggling with their finances and hence are making a significant contribution to society.

This perspective reinforced attendees' understanding that in the world of open banking, providing banking services is not the preserve of traditional financial institutions. Further reinforcement came later in the discussion, from insights confirming that the business model options available for established banks to pursue – broadly, manufacturer, full-service bank, distributor and platform – are also up for grabs by new entrants as well.

Think of ClearBank bidding to become a manufacturer, Starling a bank, Centralway Numbrs a distributor and The Glue a platform.

The consensus during the discussion was that some form of platform play, whereby banks could distribute third party products, and perhaps also some of their own, holds the most potential for the banks with the capability to go in that direction. While this model clearly won't be in the gift of every bank, in general, banks have powerful attributes as platform players, over and above what fintechs can bring – trust, as well as compliance capabilities, customers and capital.

In addition, banks can move towards a platform-based future in manageable stages, delegates heard: become compliant first, then work out how to charge for additional data beyond that which PSD2 requires them to share, develop capabilities as an account information service provider (AISP) or payment initiation service provider (PISP) to deliver value-added services to customers, and, finally, mature as an ecosystem player, leveraging analytics-driven platforms in the B2B and B2C spaces.

There is certainly more than one model in the platform spectrum, the discussion confirmed. Banks could opt to offer open platforms, in which their traditional bank services are augmented though partnerships with fintechs.

This approach has its challenges – banks would need the ability to collaborate and partner at scale to meet acceptable cost margins, to ensure ease of use and rapid time to market. The model also comes with a high capital requirement.

But such an approach would clearly position banks well to remain relevant while responding to the changing competitive environment and enabling customers to access new and valuable services.

Arguably the bank as an ecosystem model – also described during the session as ‘alliance banking’ – is the most innovative and powerful approach open to banks today. Emulating ecosystems like that created by Nike, this route would essentially take banks into the realms of no longer just being banks – and widen their sphere of influence well beyond the financial services industry.

Again, this future is by no means easy to achieve. It requires agility, cultural change, a sustained focus and strong senior leadership, delegates heard.

Of course, all open banking models also require renewed technology infrastructures, as the session explored: specifically, architectures which enable integration via open APIs. But this sits within the unanimous agreement that banks must have a broad digital capability regardless of what business model they pursue.

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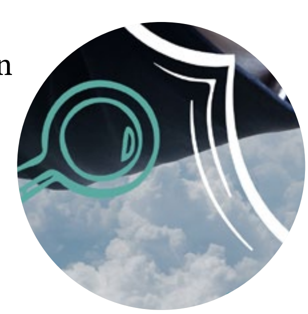
07

FINEXTRA'S KEY TAKEAWAYS ON REALISING A DIGITAL STRATEGY IN FINANCIAL SERVICES

1) **Adopting cloud is a powerful way for banks to reduce their costs and increase their agility in an increasingly competitive landscape**. Savings come not only through reduced hardware costs but also through the extra automation cloud adoption makes possible. Efficiency gains and money freed up to spend on additional innovation can boost incumbent banks' ability to compete with new entrants.
2) **Established banks with legacy transitioning to cloud must do so in phases**, ensuring that any new capabilities developed are cloud native from the outset.
3) **Banks cannot hope to hold their own against customer-centric new entrants unless they implement data-driven digital engagement capabilities**. A technology prerequisite for this is to centralise and clean all customer data and implement a single decisioning engine to feed all customer interactions.
4) **Success in data-driven engagement also requires cultural change**, buy-in from senior management and a move away from siloed thinking. Together the right technology and the right culture will enable banks to own the conversation – and therefore the customer.
5) **For banks looking to retain their relevance in an open banking world, the platform play is very appealing**. One option is to augment traditional banking services with innovations from fintechs. Another is to reach beyond the financial services space completely and shoot for a coveted role as ecosystem provider, in a world likely to be dominated by a number of such players across different sectors.
6) **Success here is also dependent upon technology and culture**. Banks must implement architectures to underpin API-driven integration and wider digital agility. They must also hone their skills in collaboration and ensure they have sustained senior leadership committed to staying on the path to an ecosystem future.



08 ABOUT

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Temenos

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