Coming in from the cold

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If there is one thing the financial world is not short of it's financial technology start-ups, incubators, 'sandboxes' and innovation centres. The intense interest in financial technology start-ups and innovation is a natural evolution of technology in the financial world. First institutions built their own infrastructures, applications and services, then they bought them from vendors and many eventually outsourced some technologies and operations to third parties.

Outsourcing innovation seems to be the next step. Partly this is because the more stringent regulatory environment acts as a brake on innovation. Downward pressure on costs has also come into play. For many financial institutions, enabling innovation to occur in a controlled and comparatively low-cost environment is seen as a way of incorporating new technologies without running the risks associated with them. It is also viewed as a cost-effective way to remain competitive in an environment where more nimble, non-bank companies are increasingly cherry-picking the most lucrative financial services.

Whereas a few years ago financial technology start-up companies were viewed as a potential threat, financial institutions are taking a more inclusive and collaborative approach towards them. However, this approach is not limited to start-up companies; well-established technology vendors have a much more collaborative relationship with financial institutions than in the past.

A recently published research paper by Santander Innoventures, Oliver Wyman and Anthemis Group, *The Fintech 2.0 Paper: rebooting financial services*, states that although successful, many financial technology companies are still operating "only at the edges of banking". To help engineer more fundamental improvements to the banking industry, says the paper, "they must now be invited inside, to contribute to reinventing our industry's core infrastructure and processes. That can succeed only as a collaborative endeavour, with banks and fintechs working together as partners".

Collaboration is a strong theme running through many banks' technology development strategies. But given regulatory requirements and the security concerns of banks, innovators are kept at arm's length, hence the tendency to set up separate divisions or to fund financial technology incubators. Swift's Innotribe division was established to bridge the gap between financial institutions and start-up innovators, which typically are considered high risk by most institutions.

The UK's Barclays Bank, for example, runs the Barclays Accelerator, which gives start-up financial technology companies access to Barclays' data and technology as well as providing mentorship and coaching from banking industry experts. Those involved also get to pitch their ideas at a special demonstration day.

UBS has set up an innovation laboratory in London to investigate blockchain and other distributed ledger technologies. The laboratory is based at Level39, a technology accelerator for financial, cyber, retail and 'smart cities' technologies. In August, the bank also launched its UBS

Future of Finance Challenge, an open, global competition for entrepreneurs and technology start-ups. The bank says it is looking for innovative and "potentially disruptive" technological ideas and solutions that will support the transformation of the banking industry.

In September the Bankers' Association for Finance and Trade (Baft) launched an initiative to drive awareness of innovations in financial technology. Baft will create a 'Fintech and Innovation Council' to shape its efforts around emerging technology and payments, as well as drive execution. The council will be tasked with developing educational member resources on the technological applicability to transaction banking.

"We have to embrace new technology but also understand that our role as financial institutions is to provide safety and soundness to customers," says Ather Williams, head of global transaction services at Bank of America Merrill Lynch (BAML). "Overall, we have to incorporate technology in a responsible way in order to maintain the integrity of the financial system." The bank moves more than $1 trillion a day globally on behalf of its clients and "there is not much financial technology out there that has the scale" to deal with that, he adds. Williams describes the relationship between financial technology companies and financial institutions as a "give and take, learning relationship".

Unlike some other banks, BAML believes the best innovation comes from within, says Williams. The bank has a series of governing councils for different activities (such as payments) which discuss common issues for its consumer and business clients, working together with them to align services with the needs of individual, SME, multinational and financial institution clients.

"We look for partners to do things collaboratively, or work directly with financial technology companies," he says. BAML has partnered with Earthport to deliver low-value payments to a growing set of countries in which it wouldn't make sense for BAML to develop services itself. "Earthport is a customer of ours, so we understand them. We have a strategic relationship with them."

At BNY Mellon, a network of innovation centres has been created around the globe, including centres in the west and east coasts of the US, Europe and India. Each innovation centre has a particular responsibility; for example, the Silicon Valley centre is tasked with identifying new and emerging technologies and how the bank can consume and industrialise these. The bank encourages staff to bring their ideas, approaches or challenges to the innovation centres.

"We are a globally systemically important financial institution and have to think about technology and innovation in that context," says Mark Gibbons, chief information officer, Emea, at the bank. For BNY Mellon, the innovation centres are catalysts that help to stimulate innovation and enable staff to look at technology in different ways. BNY Mellon staff can spend time at the centres working on their ideas in a creative and innovative environment. The bank also works with many early stage start-ups that normally struggle to engage with financial institutions. "We have found it is useful to get our staff to go to accelerator weekends, where they meet with the start-ups and learn how to look at problems with new eyes. Hopefully they also get something of an entrepreneurial streak from working with these financial technologists."

Financial services firms have to be optimistic yet cautious in evaluating innovative financial technologies, says Tapiwa Manjengwa, a senior consultant at financial services business and technology consultants Capco. “Innovative technologies, by their nature, can present unknowable and or unquantifiable risks both positive and negative to their adopters.”

It is, however, also worth noting that the objective of incorporating innovative technology is not in opposition or mutually exclusive to the core tenets of continuing operations and security. “For example, financial services firms are eagerly exploring blockchain, the distributed ledger technology, as this is likely to disrupt the industry by making existing processes more efficient, secure, and transparent, thus reducing the overall costs,” he says. “With constraints such as time and cost, an important question for all financial services firms in responding to competitive, regulatory and value creation challenges is ‘how best can we optimise the sources of and integrate innovative technology?’ If the ultimate price for not doing so is extinction, it must be the highest priority to not only identify but also implement the relevant innovations in time.”

There is “a high level understanding” now that not all technologies should be built by every financial institution, says Ebru Pakcan, global head of payments and receivables at Citi. Citi’s approach to technology innovation can be summarised in three words: partner, integrate, collaborate. There are some strong trends in the market, such as real-time payments, that place significant technology requirements on banks. “If a start-up or other technology company has come up with an idea that can be replicated elsewhere, why do it yourself? It is a waste of resources,” she says.

Partnership with financial technology companies can help banks to better address customer needs, she adds. For example, Citi’s institutional clients are dealing with individual customers with digital wallets. There is potential, says Pakcan, for the bank to collaborate with the financial technology companies that operate the wallet, supporting the transactions just as it does for wire, ACH and cheque transactions as those companies look to expand their service globally.

Citi has a dual approach to fostering innovation: Citi Innovation Labs and Citi Ventures. Combined, these businesses invest in start-up companies, pilot new technologies and test new solutions and business models, says Citi, “to accelerate product roadmaps and expedite commercialisation opportunities within Citi”. Pakcan says while it is “relatively easy to be a start-up company, becoming scalable is difficult”.

Scalability is important for financial institutions. David Watson, global head of GTB cross-product components and regional head of product management, Americas, global transaction banking at Deutsche Bank, says while financial technology companies have been quick to adapt and meet consumer demands, their strategic growth in the business to business segment is still limited. “Here, banks can provide the missing link of processing power and the stability of a well-governed, global infrastructure for financing, risk management and regulation,” he says. “Instead of competing with fintechs, collaboration offers banks the opportunity to provide a more modern, agile service to their clients. Partnership also offers fintechs access to a larger, more competitive B2B space.”

Deutsche Bank views the proliferation of financial technology companies as a collaboration opportunity, he adds. “If we want to evolve with the market and provide a better end to end offering to our consumers, we will need an aggregate of best practice, thought leadership and skill.”

Neil Vernon, chief technology officer at software firm Gresham Computing, says banks are increasingly recognising the need to act as technology companies. They are using technology to better manage their business and also to provide value added services to customers – either directly or in partnership with financial technology companies.

He believes the successful banks will be those that recognise the opportunities technology can bring in delivering benefits to customers as well as inside their business, while also ensuring their internal risk control environment is up to the task.

In his 2014 letter to shareholders JP Morgan chief executive Jamie Dimon, acknowledged the threat posed to the firm and the industry in general from technology start-ups, says Capco’s Manjengwa. “His words, ‘Silicon Valley is coming’, appear to me more a rallying cry for the industry to be diligent, open minded and alert to the threats of such start-ups. In yet another comment, he stated ‘there are hundreds of start-ups with a lot of brains and money working on various alternatives to traditional banking… they are very good at reducing pain points’.”

Dimon is not alone, of course, in identifying why financial technology companies are making inroads into the banking world. BNY Mellon’s Gibbons says the massive insurgence of digital capabilities and mobility mean that the average consumer has a higher expectation of technology and the way he or she interacts with businesses. The “digital maturity” of consumers, he says, outstrips many companies, including financial institutions. Williams adds that financial institutions are burdened by business models and technology stacks that are rapidly becoming outdated as consumer technology rapidly advances.

Through partnerships, acquisitions and incubators financial services firms can not only look to compete but also to thrive in the changing environment, says Manjengwa