HOW IS FINANCIAL TECHNOLOGY EVOLVING?

A guide to all the major trends that you should not miss.

A few decades ago, business owners, home buyers, and investors had to go through a lot of hurdles personally with their bankers to apply for an SMB loan, mortgage, or opening a trading account. Besides, the customers had to bear hidden charges for services they opt-in. One such example is the currency conversion, for which the exchange bureau still charges hefty exchange rates to customers.

As a matter of fact, even today, a few traditional banks follow the same old brick and motor model with all the old elements intact.

But, not anymore. Thanks to Financial Technology.

Financial Technology, or Fintech, is playing the role of a catalyst in every sector of the financial services industry. Fintech has disrupted the entire experience of banking, from opening a savings account and borrowing, to investing online or with a mobile phone with just a few clicks. And, all this is possible without reaching out to your bank.

But on the other hand, this Fintech revolution has both winners and losers. The winner is the Fintech firms themselves and their customers, and in contrast, the most significantly impacted by this Fintech revolution are those who work in the financial industries - Bankers. The Bankers of the future will be very different from today's bankers with very different backgrounds & skill sets.

But, first, let's understand what Fintech (or Financial Technology) is and the major trends disrupting the role, structure, and competitive environment for financial institutions; and the markets in which they operate.

What is Financial Technology (Fintech)?

Fintech - (the short form of Financial Technology) is the innovative use of technology in the design and delivery of financial services. The term Fintech includes a huge range of products, technologies, and business models that are changing the financial services industry. This includes everything from cashless payments, crowdfunding platforms, robo-advisors to virtual currencies - to name a few.

So, every time you or your customer transfers money to someone's kickstarter campaign or to your friend's account using Google Pay or Apple Pay or Venmo - that's Fintech. And that's just one example of Fintech.

Similarly, hundreds of companies disrupt the banking and finance industry by changing the way customers pay and borrow money through software or innovative technology.

Evolution of Fintech

Historically, as technology evolved, the banking and financial services industry was reasonably good at integrating those new technologies in order to serve customers better. But all this changed during the financial crisis of 2008. Back then, banks started dealing with the numerous rules, regulatory requirements, and fines imposed on them. And, innovation became a far distant priority.

But at the same time, some of the most game-changing technological innovations have transformed the way we live and became a part of our lives. For example, think about WhatsApp, Facebook, or Uber.

This innovation change led to a gap between what the banks offered to their customer with respect to convenience & overall experience.

And this gap is where the Fintech innovations are filling in and disrupting the overall banking & financial services landscape.

Before proceeding any further on why these new fintech models are better, let us understand more about the fintech landscape, segmentation by customers, and finally, the tech trends for 2021 & beyond.

With that being said, let's get started.

Fintech Landscape: Categorization & Funding Statistics

The main players in the Fintech Landscape are (listed by the scale of importance):

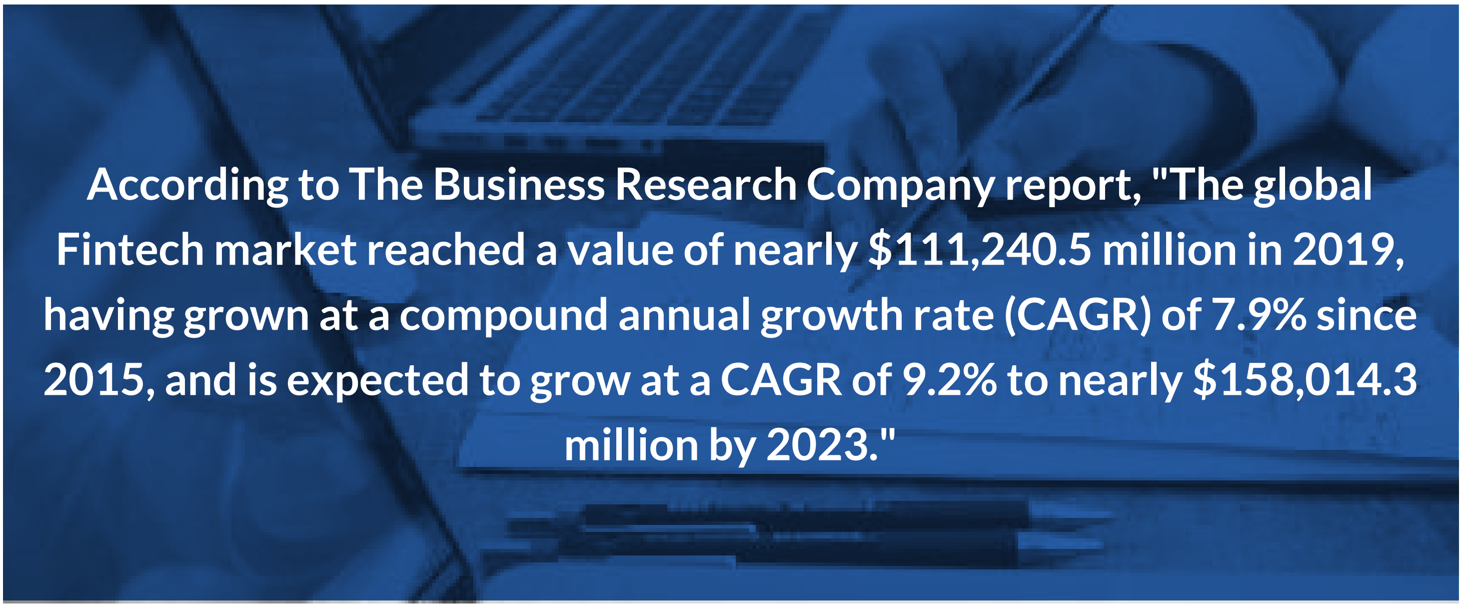
- **Government entities:** like regulators, central banks, sovereign wealth funds, and all the authorities that grant licenses can actively influence the financial sector.

- **Traditional financial services firms:** Involved both as investors, potential strategic acquirers, and as promoters of innovation.

- **Tech companies:** For instance, Google & Apple providing financial services alongside their core products.

Tech companies aiding financial transactions: American Express, Visa, Bloomberg, etc.

Professional investors: For example, venture capitals, private equity – to name a few.



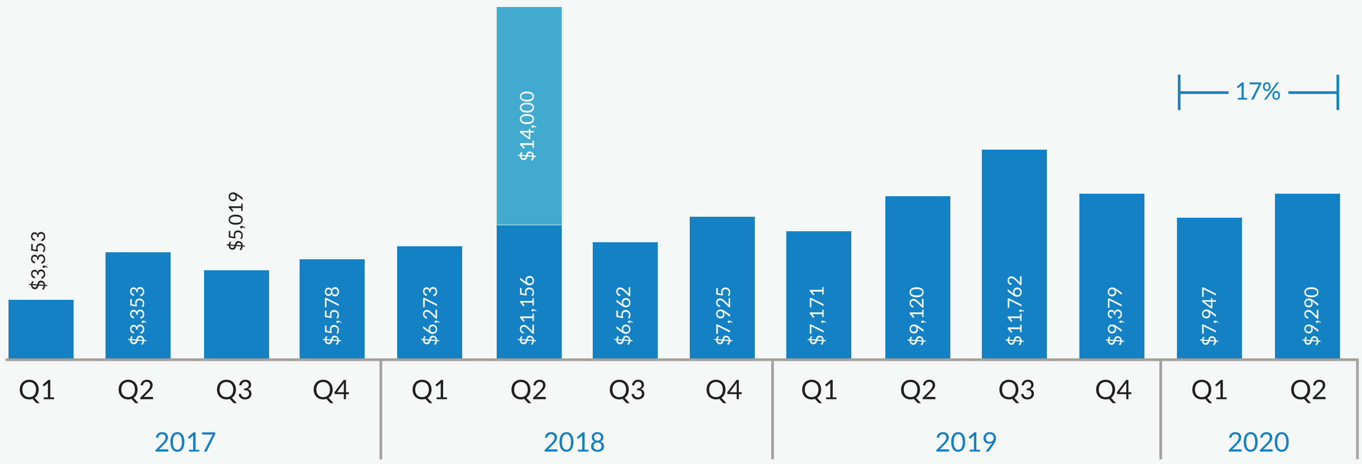
Even though the industry is shifting towards convenience and superior customer experience using technology, it's still a long way to go. The Fintech firms are still only getting a slice of the entire banking customers.

According to The Business Research Company report, "The global Fintech market reached a value of nearly $111,240.5 million in 2019, having grown at a compound annual growth rate (CAGR) of 7.9% since 2015, and is expected to grow at a CAGR of 9.2% to nearly $158,014.3 million by 2023."

Despite the economic uncertainty surrounding the Covid-19 pandemic, US banks are futureproofing by actively investing in Fintech. In 2020 YTD, US banks have made 40 equity investments into fintech companies.

And, funding increased by 17% quarter-over-quarter (QoQ) to $9.3B in Q2'20.

Quarterly global VC-backed fintech, Q1'17 - Q2'20 ($m)



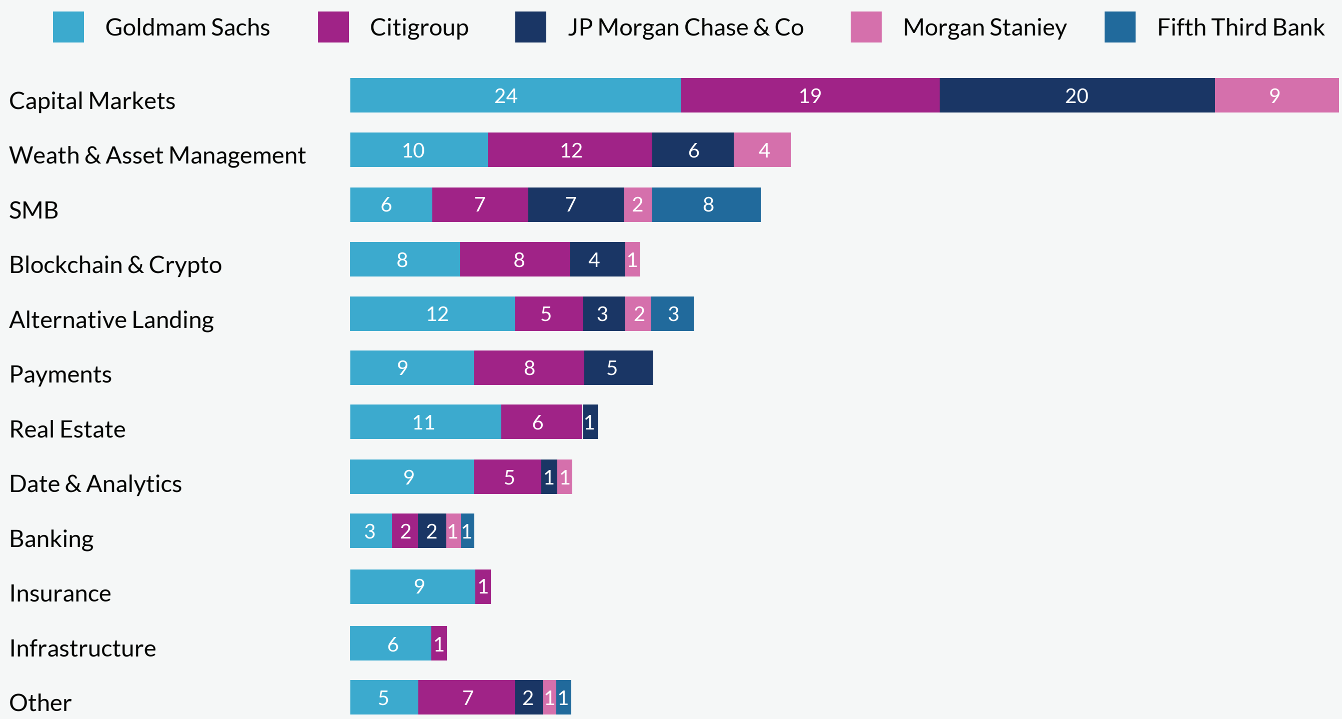
Source: CB Insights

The most active US bank investors in Fintech (by number of deals backed) are Goldman Sachs, Citigroup, and JP Morgan Chase & Co. While all 3 have ramped up their fintech investment activity in recent years, they've taken different strategic approaches.

Take a closer look at where leading US banks are focusing their fintech investments.

Where the top 5 banks are focused in fintech

Number of fintech startup investments made by category 2020 - 2020 YTD (8/27/20)



Source: CB Insights

Goldman Sachs and Citigroup are the most active investors largely because of their investment arms — Goldman Sachs Strategic Investments and Citi Ventures — which have participated in 59 and 38 fintech deals from Q1'18 through Q2'20, respectively. As a result, the 2 banks continue to invest in a wide range of fintech sectors.

Goldman Sachs has focused its M&A strategy in recent years on wealth management. In May 2019, the bank spent $750M on wealth management firm United Capital. More recently, it snapped up boutique wealth management custodian and technology provider Folio Investing in May 2020.

Adding, the Fintech mega-rounds ($100M+) hit a new quarterly high of 28 as the largest companies in the space raised additional funding.

These are signs that the fintech ecosystem is continuing to mature, especially as financial technology becomes more deeply embedded across other sectors of the banking and financial services industry.

Categorization of Fintech Landscape

As FinTech represents an umbrella term for business models and products, to display the complexity of a classification, we tried to bucket the Fintech customers and the user segmentation into separate sub-categories in the below table.

Fintech Users	Sub-categories
Consumer	• Lending • Personal finance • Money transfer / FX / Remittances • Payments and billing • Crypto • Insurance
High Net Worth (HNW)	• Wealth management • Crowdfunding and other investment platforms • Real estate
B2B - small-to-medium enterprise (SME)	• Infrastructure providers • Lending • Insurance • Payroll and accounting
B2B - enterprise	• Capital markets • Regtech • Infrastructure providers • Blockchain • Insurance

FinTech companies provide the same output to the end customer, but use a different process than the banks, similar to the difference between the Wikipedia and Britannica analogy.

Now, let's look at the major technological trends in the Fintech landscape that you should be aware of - for 2021 and beyond.

Trends to Watch: Major Fintech Trends in 2021 and Beyond

Over the past few years, Fintech services have delivered exceptional convenience and cost-effective access to millions of consumers.

This section will cover all the major technological trends for 2021 and the future that you would not want to miss.

Let's get started.

1. Instant Payment with International Interoperability

The concept of Instant Payment has become highly important in both consumer and B2B payment areas, where settlement time has really been a challenge earlier.

The term "Instant Payment" refers to the ability to make payments within a matter of seconds, which in turn will be highly beneficial for both parties throughout the payment landscape.

As a result, Instant payments have become an integral part of both financial institutions and regulators, driven by key success stories in early deployments.

> The SEPA (Single Euro Payments Area) scheme in the EU has significantly brought down settlement times, and the SEPA Instant Credit Transfer Scheme further reduced it.

> In SEPA Instant, the payment will be received in a matter of 10 seconds, which is dramatically faster than traditional methods. However, still much more work needs to be done.

> Adding, the US Federal Reserve has announced FedNow. This service will process individual credit transfers valued at $25000 or less within seconds. But this service will not launch until 2021.

Why is this important to banking & financial services and what should they be prepared for?

Instant payment schemes will accelerate and focus on international interoperability in 2021, enabled by standardization with ISO 20022 and cross-border schemes. This will allow banks and financial services to upgrade to:

- Faster and simpler accounts payable/receivable processes
- Less complicated B2B payment systems
- Increased payment volume for payment processors

In order to achieve these benefits, banks will need to update their systems because the whole chain needs to support the instantaneousness of payments.

2. Open Banking for Digital-only Banks

In recent years, Digital-only banks have emerged in numerous markets by focusing on disrupting the single elements of the banking experience. This has left digital banks limited in scope and not widely utilized as main accounts.

What are Digital-only banks?

Digital banking or Digital-only bank is part of the broader context for moving to online banking, where banking services are delivered over the Internet.

But Open Banking is enabling a change to this by providing users with services such as insurance, mortgages, credit, and much more at one single digital bank provider.

What is Open Banking?

Open Banking is a model in which the banking data is shared between two or more unaffiliated parties to deliver enhanced marketplace capabilities.

Open Banking APIs mean that the Digital-only banks do not necessarily have to offer these other services themselves, but it can be added from third parties via APIs. Therefore, this provides a significant appeal to their brand by providing complete banking services without having to do an enormous amount of work themselves from the get-go.

Starling Bank in the UK is one such example of an API-based marketplace for personal and business customers, offering further financial services.

Why is this important to banking & financial services and what should they be prepared for?

Open Banking has become relatively well established in Europe due to the changes under PSD2, meaning the customers are now more open to shared access.

As a result, Digital-only banks will evolve into full-bundle bank offerings by increasing their value proposition significantly. This will create:

- Additional impetus for digital transformation at traditional banks
- Higher traction in the digital-only banking space, with users moving all transactions to these accounts

Therefore, traditional banks should launch digital-only brands of their own, such as Bo from NatWest, to defend and withstand the market share.

3. Consolidation of Challenger Banks

Challenger banks have been an important new element in the financial services ecosystem in the last few years.

What is a Challenger Bank?

Challenger Banks, for the most part, is exclusively mobile, who have their own charter, and they are challenging the status quo of the incumbent banks in the marketplace. For example, N26 is a mobile-only bank.

However, despite nine challenger banks reaching Unicorn status & over $1 billion of funding and reaching millions of customers worldwide, the outlook for these banks is a little shaky at the moment.

Adding several challenger banks have made it clear that they are still prioritizing growth over profitability, which will deter investors.

Back in July of 2019, following a fresh round of investment, N26 co-founder Maximilian Tayenthal told the Financial Times that "In all honesty, profitability is not one of our core metrics. We want to build a global financial services company… in the years to come, we won't see profitability; we're not aiming to reach profitability."

Why is this important to banking & financial services and what should they be prepared for?

The current year has a variety of different market trends converge on challenger banks. Mainly due to Covid-19, with rising defaulters, which in turn dropped the profitability further. Adding, the capital to fund ongoing investment in technology-focused companies is drying up as part of the 'techlash.'

Moreover, several traditional banks have recently launched their own digital-only offerings, showing the desire to compete with digital-only banks.

We expect 2021 to be a key year for the consolidation of challenger banks because of a broader trend in the technology investment market. Juniper Research report predicts, “lack of funds will also force challenger bank exit in 2020, typically through acquisition.”

One way or the other, most challenger banking start-ups will be in a better competitive position with larger banks as partners, and vice versa. With the number of partnership announcements made around Money2020 Europe, the industry is clearly turning to maturity and scalability through collaboration.

4. Tech Firms Move into Banking

Tech firms like Apple, Google & Samsung have been providing payment services for several years now, and few have started to coalesce to accelerate their financial services movement.

The primary reason is the decreasing financial brand loyalty, due to open banking, which has loosened the rope that banks have on their customer data. Adding, many countries are mandating a streamlined switching service to move from one bank to another much more quickly.

Most importantly, banks have limited ability to retain their users compared to what they are traditionally used to. At the same time, technology companies have always had much more success in developing in a closed ecosystem. And they are now looking to bring finance under their banner.

Why is this important to banking & financial services and what should they be prepared for?

With Apple Card showing its prominence. And Google, Stripe, and PayPal preparing to start, or expand banking and payment-related offerings, it is evident that the industry is already shaken.

Moreover, the Open Banking tools made available from PSD2 guidelines give these companies the ability to be bank-like, without needing to be banks.

We think that the partnership between banks and tech companies are more likely than tech companies outright becoming banks.

Instead of viewing big tech companies as a threat, banking and financial institutions should embrace partnerships and collaboration with them.

5. Contactless Cards to Reach scale in the US

Following the successful transition from magstripe to EMV (Europay, MasterCard, and Visa) cards, the US's next area for significant growth is contactless payment cards.

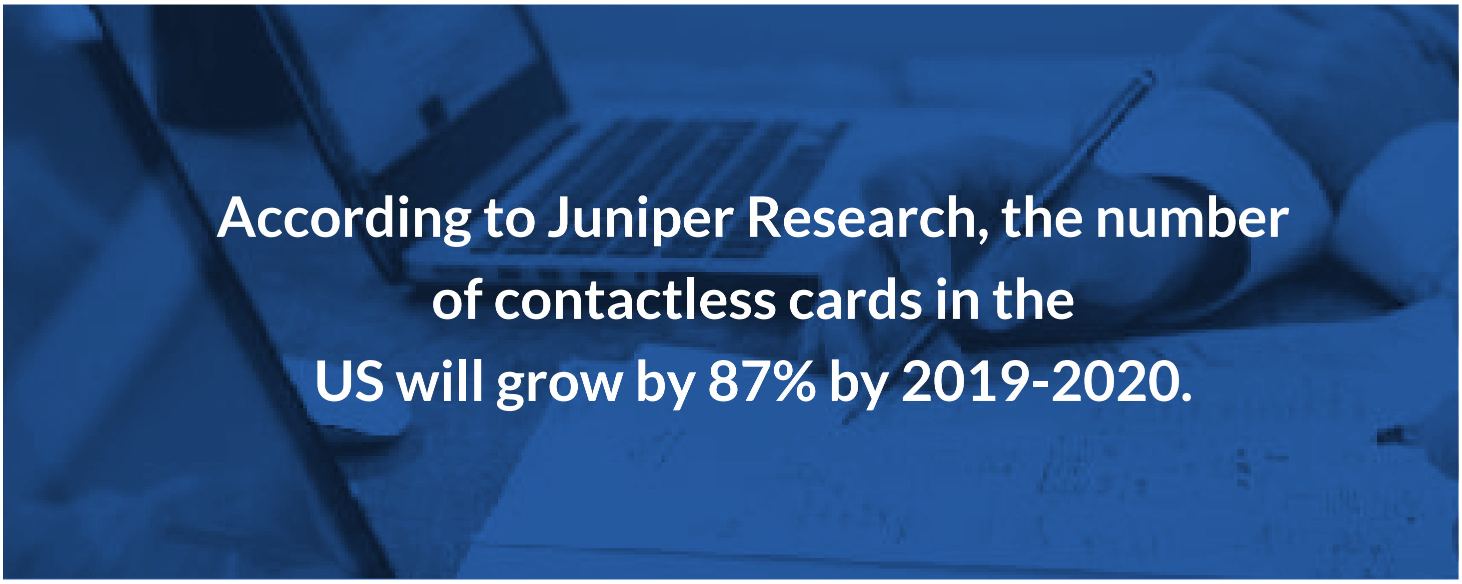
Contactless acceptance has risen at POS (Point-of-Sale), with card issuer support growing rapidly. The EMV rollout means that much of the POS infrastructure in the US already supports contactless in principle, and thus a rollout of cards will be smoother and swifter.

Adding, many of the major card issuers in the US have now added contactless functionality for their cardholders.

Why is this important to banking & financial services and what should they be prepared for?

The cost of issuing contactless cards has declined significantly as a result of major card issuers sharing economies of scale. In 2019 US banks like Bank of America, Wells Fargo & Chase, and credit card providers like American Express started issuing contactless cards.

Also, an increasing number of contactless-enabled payment cards are being introduced by several major banks and credit card issuers. Visa has already conducted an extensive advertising campaign designed to raise awareness of contactless payment cards and has set a goal of 300 million cards by 2020.



This will enable a greater throughput of transactions at POS. Moreover, contactless transactions provide a speed advantage over Chip & PIN transactions, leading to reduced POS payment times and superior customer satisfaction which banks and financial institutions should not skip.

6. Blockchain will disrupt International Money Transfer

Traditional money transfer solutions have been problematic in both the B2B and P2P areas, plagued by slow transfer times and high costs.

The clearing firms involved in the transactions have independent processing systems. Each party involved in that process will keep their own copy of that record of a given transaction, making it stringent.

The lack of standardization between these bodies and correspondent banks means that costs are high, and settlement periods are longer. But, thanks to Blockchain.

Blockchain has the potential to solve these challenges by offering faster transaction times, more transparency, and lower costs, changing the money transfer equation.

Why is this important to banking & financial services and what should they be prepared for?

In the last year, Blockchain has emerged as a promising approach in the money transfer field, backed by Visa (B2B Connect), IBM (Blockchain World Wire), and Ripple (RippleNet). And all the three being fairly different from one another.

These players have also announced several partnerships with traditional money transfer operators and IT providers, providing necessary infrastructure, showing signs of momentum.

In the future, Blockchain will become a viable technological solution in money transfer. And, banks & traditional money transfer operators will be able to use Blockchain to improve services, enabling them to retain market share. As a result, customers will benefit from improved settlement times and easier processes.

7. Cyber-Security will be a top priority

Banks have always been at the forefront of enterprise cybersecurity. Their enormous stores of cash and consumer data have made them a top target for hackers, and the threat of financial losses, regulatory consequences, and reputational damage has spurred them to innovate and accelerate the field of cybersecurity.

Financial services executives are already depressingly familiar and aware of the impact of cyber-threats on the industry.

According to the PWC report, "69% of financial services' CEOs reported that they are either somewhat or extremely concerned about cyber-threats, compared to 61% of CEOs across all sectors."

Why is this important to banking & financial services and what should they be prepared for?

Cybersecurity has been of great importance in the financial sector. It becomes all the more necessary since the very foundation of banking lies in nurturing trust and credibility. Here are five reasons why cybersecurity is important in banking and why it should matter to you.

- Increase in third-party vendors support
- Rapid innovations and complex technologies
- A rise in cross-border data exchanges
- Heightened cross-border information security threats
- Greater use of mobile technologies by customers, including the rapid growth of the Internet of Things

Banks and financial institutions must leverage technologies like biometrics, credential management, restricted access, network monitoring, and intruders' rapid isolation to secure digital platforms.

This becomes very important to gain the customer's trust and loyalty in an industry where it matters the most.

Final Word

As Financial Technologies keep innovating rapidly, disruption in the financial services industry is inevitable. It is high time for traditional financial institutions to rework their offerings from the inside out to meet customers' expectations by upgrading or partnering with Financial Technology providers.

About ZUCI

Zuci Systems is in the business of pivoting technology to help organizations transform the future of digital. Zuci Systems is a trusted partner in the digital landscape and always strives to deliver genuine value to customers. Their focus remains on helping customers evolve, thrive, and stay agile in a challenging business environment.

Zuci has worked with several financial institutions and helped them enhance their user experience journey using technology by building progressive web applications, mobility, and digital lending platforms, among other solutions. Learn More.

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