FinTech’s effect on banks’ Front, Middle and Back offices

Hollis W. Hart
June 2nd 2016
Topics to Cover:

- Definition
- **FinTech – always with us.** 1991 & 2008
- **Focus:** Front – Middle – Back Office
  
  Institutional and Retail/Consumer

- **Cyclical or Structural?**
- **Transition Timing?**
- **Opportunities & Challenges from FinTech**
- **Exiting:** Clients and Functions and Products
- **Moral Hazard**
Any business model invented before the advent of the PC and the Internet is likely to be outdated.
FinTech: Key Dates

- **1991**: Tim Berner-Lees sends first documented transmission – World Wide Web
  (PC already established in 1980’s)

- **2008**: Global crisis triggered enhanced regulatory requirements (*capital, liquidity, oversight*) – opens door wider for FinTechs.
FinTechs: 1990’s Mostly Gone

- McKinsey reports in 1990’s there were 450+ FinTechs
- Today only five from then remain: PayPal the largest
Why should banks think it is different this time?

**Different this time? Yes. Various factors include:**

- Mobile Banking
- Demographics
- Cloud Computing – inexpensive entry
- APIs and other new technologies
- Changed regulatory environment
- And for now, low interest and capital costs…
FinTech:

Where FinTechs can operate outside today’s regulated environment their competitive advantage is significant
FinTech – Even Larger Today

- Per Thomas Curry (Comptroller) – OCC’s Recent White Paper:
  - USA / UK over **4,000** FinTechs
  - $24 billion plus of investment
FinTech - Ubiquity

- Today’s FinTech focus is heavily on consumer and payments, most profitable area for banks
  
- **But** FinTech efforts across all bank activity.

- This talk looks at the Front – Middle –Back Office FinTech initiatives. How banks can leverage FinTech or compete.
**FinTech**: BANKS NEED TO DECIDE

- Leverage/participate with FinTech companies
  
  *or*

- Compete

- What they should not do is *ignore* FinTech advances
Response to FinTechs: 3 choices

- Build / Own
- JV / Consortiums
- Vendors / Outsource
FinTech - Focus

- Front - Middle - Back office

- Institutional & Consumer/Retail
**FinTech - Front Office**

- **FinTech’s Focus (*today*):** Estimated to be **70%** focused on **Consumer** and **Payments**
  
  ✓ **Profitable Segment**

- **Some countries advanced:** China (WeChat; Ant Financial…) stands out;

- **Africa (Kenya):**

- **Mexico Remittances**
FinTech - Middle Office

greatest area of escalating costs for banks

- There are FinTechs looking at: Audit, Compliance, Controls, Cyber (!), HR, Legal, Risk....

- FinTechs and FinTech consortiums for AML / KYC

- Smart Contracts / Derivatives: Barclays has used the Corda Blockchain developed by R3 – a consortium of the world's biggest banks

- And others such as Amenity
NEXT GENERATION INVESTMENT PLATFORM

Smarter  Deeper  Cutting Edge
PROBLEM:
1. Investors are drowning in a deluge of data and lack ability to quickly process and effectively integrate into investment process

Amenity Solution:
1. Text Analytics platform opens unstructured data:
   1. Sentiment and events from news
   2. Topics and tone from conference call transcripts
   3. Risk items from SEC filings

2. Pattern recognition system allows clients to put this data to work by showing the user the combinations of factors set by the analyst and optimized using machine learning
FinTech - Back Office

- AFS ...

- They are doing this within the regulatory framework. Having partnered with the banking industry.
FinTech Opportunities for banks

- Leverage Operating Costs
- Fast Technology Adoption
- Possibly avoid “bleeding edge”
- Uniform execution
- Efficient Use of capital
- Acquire best practices from the market place…
Challenges for Banks vs. FinTech

- **#1:** Uneven Playing field, regulated vs. *unregulated*

- **Regulatory Ring Fencing** *(restricting data centers and operations)*

- **Vendor** Control Risk

- **Legacy** Systems at established banks

- **Expensive** – banks today are focusing on achieving cost controls and operating leverage. Cost of incubating and developing is high – and daunting. *Being done – but is it enough?*
FinTech Challenge for banks

Closer to UBER & Google

• Banks do not have a history of success in absorbing technology companies

• FinTech’s “Culture” is very different than the “Culture” in a traditional, regulated bank.
Unintended Consequences if FinTechs operate outside the regulated bank area

- Banks will not be able to compete in many areas and will exit:
  - Traditional clients (NGOs; Charities; Embassies; Small Consumer/Retail)
  - Traditional functions/products (Trust; Trade; Small ticket remittances)
- Loss of Transparency/Information
- Most vulnerable may end up being serviced outside the regulated environment with fewer protections
Moral Hazard Risk – need FinTech

Inside the Tent

- “Sandbox” approach seems to work
- Need clarity regarding regulatory oversight and responsibility
- Increased Coordination and cooperation globally
FinTech Impact on Banks

- Will traditional banks be eliminated – no.
- FinTech will help reduce costs, improve controls and compliance and improve customer experience.
- FinTech can support Financial Inclusion
- Most profitable activity takes place outside regulated industry, unless significant changes in regulation
- Risk that the industry becomes marginalized and looks like a utility, with minimal innovation.