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THE IRISH BANKING ECOSYSTEM, INTERCONNECTION AND THE SPEED OF CHANGE



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EXECUTIVE SUMMARY

Irish banks are operating in a rapidly changing market and must embrace new technologies and business models to keep pace and to stay ahead of energetic new entrants. But the same banks should accept that they cannot make this transformation alone and have to seek out new partners if they are to succeed or even survive in a new marketplace.

The current wave towards open banking services, increasingly digitised products and the appetite for real-time payments, is playing out globally. In Ireland, where fintechs and big tech both reside in increasing numbers, the trend is especially acute.

The race is on to carve out fresh lines of revenue in the newly unfolding ecosystem. Emerging technologies, notably AI and Machine Learning (ML), are helping to create a new online experience for banks and their customers. For incumbent banks to remain competitive, it will be key to transform into not only a digital, data-first enterprise, but also an agile one, able to deal with regulatory changes, new consumer demands and emerging technologies.

Many banks are adopting a cloud-based strategy to cope with new processing demands and to extract value from the increasing amounts of data, constantly generated from a myriad of remote devices. They are also adopting APIs to connect to a wider network of players and partners to facilitate the demand for instant payments and also to meet EU regulatory demands such as the second Payment Services Directory (PSD2).

These changes instigate new business models, which will require new skills and significant cultural change, not least because banks will be required to pursue a more collaborative approach with new external partners in order to monetise these new models and open up new revenue streams.

‘Fast, agile and secure’ is the order of the day in order to join up the dots in the emerging ecosystem and be a frontrunner in the development of dynamic new products and services. The question is, can banks do it alone and what are the key ingredients for a successful partnership?



A NEW BANKING WORLD

The traditional retail banking market in Ireland is changing rapidly and radically as it is the world over. It is also happening on multiple fronts – competition, technology – and under an intense regulatory spotlight. In addition to the mountain of existing rules around money laundering and Know Your Customer (KYC), financial institutions have also had to deal with open banking, the EU’s initiative to inject more innovation and competition into the payments market.

Open banking, or open finance as it is also known, encapsulates the changes and challenges facing traditional banks. Not only do they have to comply with specific rules, such as PSD2 and Strong Customer Authentication (SCA), they have to meet the heightened expectation of consumers for new digital payment services. And they also have to cope with a new wave of competition from digital-only challenger banks, laser-focused fintechs and titanic tech firms looking to muscle in on the traditional banking market.

In order to cope with these changes, incumbent banks and all recognisable high street brands are undergoing fundamental changes in their business models and underlying infrastructure. When the phrase ‘digital transformation’ is invoked, this is the change to which they are referring.



GREAT EXPECTATIONS

But why is it happening? The biggest driver has been changing consumer demands and expectations. They see the use of digital services through their e-commerce transactions and rightly expect the same level of convenience, security and speed from their banks.

This trend is playing out globally but is especially evident in Ireland, a country that has prided itself on a high benchmark for innovation, technology and education. Unsurprisingly, this has led to the development of a vibrant, diverse and homegrown fintech market incorporating regtech firms, money transfer players and payment providers.

In 2018, Irish fintechs raised more than €36m in funding and 55 start-ups set up shop creating a further 4,500 jobs. Meanwhile one of Ireland's most successful start-ups, the online payment player Stripe, has gone from strength to strength. The firm was granted an e-money licence earlier this year by the Central Bank of Ireland (CBI), which allows it to process payments for users across Europe and further compete with the incumbent banks for payments business. It has consequently looked to expand its Dublin base to employ more than 150 people.

Ireland has also become home to a number of banks' innovation labs and accelerator programmes, including international financial services firms such as Citi and MasterCard as well as indigenous institutions like Bank of Ireland (BoI). Even the country's central bank has opened its own Innovation Hub designed to act as a point of contact for the growing number of fintech start-ups.



BIG TECH'S BIG THREAT

Ireland is also home to many of the big tech firms, which have chosen to base their European headquarters in the country. But big tech and the GAFA quartet of Google, Amazon, Facebook and Apple are thought to be one of the biggest threats to traditional banks.

Back in March, BoI's chairman, Patrick Kennedy, told the annual conference at University College Cork Business School that the big tech firms are "all looking at financial services" and represent "as big, if not bigger, a threat than the pure fintechs because they know how to retail and they know how to personalise and they know how to use data".

The introduction of PSD2 is designed to bring more competition to the payments sector, particularly among non-traditional banks. Consequently, there has been a significant rise in the number of fintech start-ups and big tech firms seeking regulatory approval to operate banking and payment services. As of September 2019, the number of licensed payment and e-money firms had risen to 14 and eight respectively.

In January 2020, the CBI granted authorisation for Google to operate as a payment institution, a move that could see the big tech giant significantly expand its financial services offerings across the European Union.

Facebook was granted an e-money licence by the CBI two years ago, although it has yet to fully develop its payments offering. Meanwhile Amazon has also made statements about taking on the banks' hold on payment services.

However, Google executives have previously said that the company is more interested in working with banks to develop opportunities in the payments market rather than looking to compete, strengthening the case for greater collaboration between banks and non-banks, something that has not traditionally been a feature among financial institutions more used to competing amongst themselves for market share.



Ireland has also welcomed a number of challenger banks to its shores, most prominently the German fintech N26 and the London-based Revolut, with both offering no fees, instant payments and more effective user interfaces. As of November 2019, Revolut claimed to have more than 500,000 customers in Ireland, more than doubling its client base in less than a year.

Meanwhile N26 has seen its Irish client base increase by 152% in 2019, reaching more than 100,000 by the end of the year and announcing plans to “significantly increase investment” in the Irish market in 2020. N26 has more than two million customers across Europe. Another London-based fintech, Starling Bank, has also looked at expanding into Ireland, having applied for a banking licence from the CBI.

Alex Frean, Starling’s corporate affairs chief, said: “We are bringing genuine competition to a market that has been lacking it for so long by offering an app-based personal and business current account that is free and loaded with a host of smart money management tools.”

Frean also made clear the advantage that these challengers have over the incumbents. “With no branch networks and no legacy systems to maintain, we have a much lower cost base than the legacy banks. They can try to copy our features, but they can’t copy our cost base.”

“In Ireland, some 99% of transactions are now conducted remotely outside bank branches with an increasing amount done on a mobile phone or tablet.”



THE PILLAR BANKS' RESPONSE

One reason that BoI's Kennedy is keen to talk about the issue is that he can promote how his bank has responded to these threats, ostensibly by "investing very heavily" in technology and the bank's online offering and digital services. Kennedy says that BoI will "spend well over €2bn" over the next six years with €1.2bn alone spent on replacing its whole processing system.

"We have an old proprietorial system that needs to be replaced," he says, not least because "fintechs and large tech firms are raising the expectations of consumers around what type of product and interfaces need to be provided".

The statistics back this up. In Ireland, some 99% of transactions are now conducted remotely outside bank branches with an increasing amount done on a mobile phone or tablet.

Bank's traditional mainframe-based operating model is no longer fit for purpose and this has led to a transformation in infrastructure. Banks have turned in increasing numbers to cloud technology to cope with the processing demands and to extract value from the increasing amounts of data constantly generated from numerous remote devices.

"A survey published by the Bank of England and the Financial Conduct Authority, Machine Learning in UK Financial Services, found that 52% of respondents have a dedicated strategy for ML research development while 19% have a dedicated centre of excellence for promoting ML deployment."



In September, Allied Irish Banks (AIB), the largest bank in Ireland with over 200 branches nationwide, struck a deal to implement a cloud banking platform from nCino in order to automate a host of manual processes – from customer relationship management to loan origination to account opening to digital engagement to instant reporting.

In this digital age, financial services have become increasingly data-driven and greater use of the cloud allows for better storage and security of data.

There has also been greater use of artificial intelligence (AI) and machine learning (ML) technology in order to enhance the analysis of the data and derive actionable insights for banks and their consumers. This has greatly improved the user experience for consumers, typified by the growth of the so-called ‘financial wellness’ market, and going some way to meeting the heightened digital expectations of modern consumers.

Start-up funding for AI firms globally reached a record high of \$7.4bn in the second quarter of 2019, according to technology research firm CB Insights. Meanwhile a survey published by the Bank of England and the Financial Conduct Authority, Machine Learning in UK Financial Services, found that 52% of respondents have a dedicated strategy for ML research development while 19% have a dedicated centre of excellence for promoting ML deployment.

Irish banks have also increased their use of AI and ML and Ireland is home to a number of AI and ML specialists. The latest of these is Horizon8, a Chinese tech firm founded in 2004 as a partnership between US bank State Street and Zhejiang University, that provides tech development consultancy to Thomson Reuters, Agricultural Bank of China and UnionPay among others. It has opened an office in Cork employing 50 people.



BOOSTING THE DIGITAL PRESENCE

It is not just BoI that has boosted its digital presence. As of March 2019, AIB claims to have more than 1.4 million digitally active customers. And in August 2019, the bank announced that it had more than one million customers using its mobile app, making it the number one banking app in Ireland. The app allows customers to open an account via a mobile app, as opposed to the physical card readers it used to employ for not just new account openings but also for adding new payment beneficiaries.

AIB has also opened up its technology to external developers, enabling them to develop apps via application program interfaces (APIs). It is also reportedly considering a subscription banking model similar to Revolut and N26. And it has acquired a stake in B2B payment start-up TransferMate.

According to AIB's chief digital and innovation officer, Fergal Coburn, the bank is better placed than its fintech rivals because it has a "multi-product offering" rather than "the single or limited range of products" of the fintechs.

Demonstrating even more as to how the lines have blurred between pillar and challenger banks, Ireland has also welcomed Belgium's KBC Bank Ireland to the retail market which describes itself as neither a pillar bank nor a digital-only bank but "the best of both worlds". After focusing on corporate lending for decades, the Belgium-based bank opened its first retail branch in 2012 and has since invested heavily in boosting its digital presence.

In January this year it became the first bank in Ireland to offer multi-banking, a service made possible by open banking whereby customers of other banks can check their balance on the KBC app. Meanwhile other providers are looking at similar products such as one that enables users to feed their transaction data directly into budgeting software.



Such services are likely to become more commonplace as open banking and the use of APIs matures. According to a survey from Accenture, The Brave New World of Open Banking, 50% of consumers said they would use these functions, provided they were secure. So far only a handful of fintechs have been authorised by the CBI to provide payment or banking services but this will no doubt increase, especially as any bank licensed in the EU can provide services to any other EU member state under passporting rules.

“The course forms part of our Digital Excellence Programme...designed to educate our staff and ensure they have the knowledge and confidence to empower our customers to get the most from AIB’s digital banking challenges.”

ROBERT MULHALL, MANAGING DIRECTOR OF CONSUMER BANKING, AIB



THE AGILITY CHALLENGE

The new operating models have created a number of challenges for banks – both technological and cultural. Banks must be fast, agile and secure. While banks have historically been secure, they have not been either fast or agile. Furthermore, the fact that more data is being generated remotely, via mobiles and tablets, means that the notion of bank security has changed markedly.

In addition, under PSD2, banks have had to apply SCA which requires consumers to regularly verify their identity when banking and buying online. For banks, they must balance the need for robust data security while ensuring that these enhanced security measures don't impinge on the quality of the user experience.

The challenges have not escaped the attention of Ireland's politicians. In May the Irish government announced its 'Ireland for Finance' strategy, a five year plan designed to make Ireland a "top-tier global location of choice for specialist international financial services" by 2025.

At the launch of the strategy, minister for finance Pascal Donohoe referred to the challenges facing banks. "Unless you can change to meet the ongoing challenges and opportunities of our modern dynamic world, there is a danger of standing still and eventual decline."

Following the general election in February 2020, it is unclear if Ireland will still commit to this 'Ireland for Finance' strategy. No party won a clear majority, although the left-leaning Sinn Féin party amassed the biggest share of the vote (25%) and is looking to put together a coalition with like-minded parties. This could signal a change in the low corporation tax rate that has characterised Ireland's financial services sector, although there is no indication as yet, that any radical changes will be made.



The need for speed and agility requires a cultural change for banks and a need to acquire new skill sets, either by training existing staff in new capabilities, recruiting a new generation of employees from more consumer-led industries or partnering with a number of outside parties.

This was also recognised by the government's strategy which includes a "technology and innovation pillar focused on providing a collaborative approach to addressing emerging challenges and opportunities in technological developments" and a "talent pillar" to ensure there are enough skilled people.

The banks themselves have also recognised these challenges. In March, AIB launched an education programme for its staff called Digital Banking Revolution. Developed in partnership with Ireland's industry association, The Institute of Banking, it provides a series of online modules on the changing digital landscape and changing customer expectations.

AIB's managing director of consumer finance, Robert Mulhall, said, "The course forms part of our Digital Excellence Programme...designed to educate our staff and ensure they have the knowledge and confidence to empower our customers to get the most from AIB's digital banking challenges."



PARTNERSHIP PROGRAMMES

Ireland's banks have been especially active in terms of fintech partnerships. As far back as 2017, Bank of Ireland set up what it described as “an open ecosystem for innovation”. According to its head of open enterprise and innovation, Dave Tighe, the bank “decided to create an ecosystem that was as open as possible and that would allow us to work with lots of different tech partners – from start-ups, through scale-ups to well-established companies”. And earlier this year BoI partnered with digital finance company Jaja Finance on its credit card accounts and card issuing services.

In addition to the government's Ireland for Finance strategy, Enterprise Ireland, the state body charged with encouraging foreign direct investment into Ireland, has also called on banks to embrace collaboration with fintechs. A survey it commissioned in May 2019 concluded that Irish banks must employ fintechs to modernise their systems and remain attractive or even relevant to consumers.

“In an environment where smart phones are ubiquitous, consumers have come to expect payment solutions that are seamless and available 24/7 across different channels,” wrote Enterprise Ireland's fintech adviser JF Clarke. “Traditional forms of banking have become almost obsolete, particularly across the younger generations who are far more familiar with digital software like apps than cheques.”

Ireland's trade associations are also helping to promote a more collaborative spirit among financial institutions. In August, Banking & Payments Federation Ireland (BPFI) established the Fintech Foresight Group to help harness new technical developments from the start-up community and to inform policy under the government's Ireland for Finance initiative.

Richard Walsh, BPFI's head of digital and payments strategy, said: “Fintech has now moved centre stage in financial services and we are seeing an increasing interest in collaboration between the start-up fintech firms and the more established domestic and international banks.”



The interest in further collaboration is driven by a number of factors. Open banking and PSD2 are reshaping the market and the prices in payments are coming down so much they are becoming a commodity. Similarly, in retail banking, the emergence of digital-only banks offering no-fee current accounts has forced incumbent banks to do the same, reducing their margins further. And if you can no longer compete on price or fees, then the only differentiator is the quality of the user experience.

Consequently, banks have recognised they need the user experience know-how of fintechs, just as the same fintechs need the market experience, brand recognition and large customer base of the banks.

However, such collaboration is not straight forward and there is some operational complexity required to connect a pillar bank and its data centre-based legacy infrastructure with a fintech based in the cloud, akin to connecting the analogue with the digital. Banks would be wise to invest in technology that enables them to link these two disparate parts of the banking ecosystem together.

Fintechs are increasingly cloud-based and given the growing importance of partnerships, it is becoming paramount to be able to make fast connections and links to different organisations as part of a populous playing field. Cloud services themselves are proliferating and banks are turning to the cloud and specialist service providers and managers to refine their overall business model and operations.

Operational efficiency is pertinent, especially to Dublin banks operating across multiple international markets while at the same time trying to innovate and digitally transform services.

The need for banks to explore this connectivity is critical because it allows them to address their long overdue investment in innovation. Ever since the financial crisis, most banks have had to place regulatory burden as their top priority in terms of investment budgets, as noted by Niall Buckley, head of Digital Ecosystems from AIB Group, at a recent industry event (Swift's business forum in Dublin in May). This is especially true in Ireland where all of the pillar banks had to be rescued by a government bail-out in the aftermath of the 2008 crisis.



Despite the arrival of the likes of Revolut and N26, the level of challenger banks and the fintech market in Ireland is not yet where it is in the UK, for example, but this may change as greater collaboration takes place and cloud offerings or banking-as-a-service infrastructures are more widely adopted by both incumbent institutions and new challengers.

It may also change as a result of Brexit disruption in the UK. In February 2020, N26 announced plans to pull out of the UK just 18 months after launching due to the loss of passporting rights that allowed it to operate in the UK with a German banking licence. Consequently, the UK's loss may prove to be Ireland's gain.

Collaboration is fast moving up the agenda in the financial services industry, a significant shift from previous, more adversarial times. It is also a massive cultural change for the banking industry that has been built on competitive instincts and signifies a significant change in traditional industry thinking. In previous decades banks had well-populated IT departments and developed all their own technology in-house. Over the years, the willingness to turn to third party software developers has increased. And more recently, there has been a shift in how banks view fintechs.

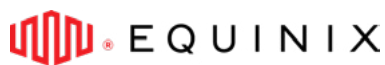
Brian Hayes, CEO of the BPF, says that banks have moved on from worrying about fintech competition to focusing on collaboration, adding that it must be done “in a way where all parties win and the consumer receives the biggest benefit”.

Despite the significant progress, Ireland's banks are only at the beginning of this change. The drivers – outside competition, consumer expectations, dwindling margins and technology advancement – are all going to intensify so it is crucial that banks recognise the need to find reliable partners.



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