Digital Innovation Focus Team

Banks Focus Team

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Team leader
Tommaso Faelli
Tommaso.Faelli@belex.com
Tel: 02-771131

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Team leader
Emanuela Da Rin
Emanuela.DaRin@belex.com
Tel: 02-771131

Author

Ignacio Pereira
Ignacio.Pereira@belex.com
Tel: 02-771131

Digital Transformation in Banking

I. Challenger banks

Startups and technology giants are expanding in the financial services industry – and they are challenging the traditional business model. In 2018, total global investment in fintech companies hit **$111.8 billion** across 2,196 deals.[1] In Europe alone, investment in fintech reached **$34.2 billion** across 536 deals.[2] In terms of customer growth (a key measure of success in the digital economy), Revolut – to name one of the highest-growth challengers in this industry – acquired two million users in its first two years of operation.[3]

Technology giants such as **Alibaba, Alphabet, Amazon, Apple** and **Facebook** are venturing into the financial services industry to **disintermediate** the distribution channel through **new payment methods** and other financial services. In fact, $14 billion of the total global investment in fintech in 2018 came from the Series C funding round by Ant Financial, Alibaba's payment services affiliate. **Most established banks believe the "Tech Giants" are their greatest challengers** because they can make financial services available to their userbase directly on their websites, mobile applications, or operating systems, thereby removing the bank from the middle and relegating it to a back-end intermediary.

Consequently, banking clients today can choose from a broad range of options, which are especially suitable to younger generations who prefer to use different banks depending on which has a product or a service that is best placed to satisfy their specific needs. Challenger banks and **Tech Giants** are **putting pressure** on established financial institutions' retail banking divisions by providing clients with more choices and innovative products.

However, newcomers have yet to establish a reputable brand name in the banking industry, let alone expand their services and scale their international presence. Thus, incumbents' full-service established brands and traditional global distribution networks remain strong advantages, in ad-

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[1] KPMG, The Pulse of Fintech 2018, Biannual global analysis of investment in fintech, 13 February 2019

[2] *Id.*

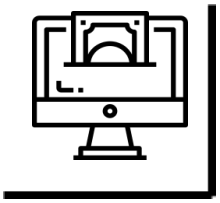
[3] CNBC, Revolut has 2 million users; to launch commission-free trading service, https://www.cnbc.com/2018/06/07/revolut-has-2-million-users-to-launch-commission-free-trading-service.html

dition to their generally larger client bases. Nonetheless, **traditional banks ought to adapt and improve their business models** to keep pace with new market demands.

II. How Banking is Being Transformed

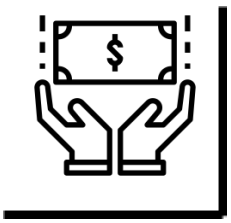
Below are some of the areas in the financial services industry that are being challenged and reshaped by technology:

a. Processing Payments and Transferring Funds



Innovation has made it possible to transfer funds and make payments faster, at a lower cost and through mobile devices. As e-commerce continues to grow and more brick and mortar businesses adopt various online payment methods, banks will have to modernise their offerings in terms of payment processing by either integrating existing solutions or developing their own. Furthermore, startups committed to lowering fees on money transfer services and currency exchange are blurring traditional national borders. However, the regulatory environment and still-relevant geographical constraints (among other reasons) mean that many startups still need to build partnerships with incumbents in order to operate across borders. In this scenario, incumbents will broaden their value proposition by looking for opportunities to introduce new digital solutions and broaden their product and service offerings. The latest changes to banking and data privacy regulations will also facilitate the entrance of new players and foster collaboration between incumbents and challengers in the digital ecosystem.

b. Financial Advisory and Wealth Management



Advice on financial services will also change. Algorithms programmed to match the client's risk profile and objectives with personalised and automated investment strategies are helping financial advisors in their **decision-making**. **Robo-advisors**, as they are called, reduce costs and improve connectivity and efficiency. Presumably, wealth management and personal finance platforms will significantly improve in step with the acceleration of data analytics tools. Wealth management and financial advisory services will thus

be rendered online faster and with lower fees – and clients previously unable to build a portfolio will now be able to access these services.

c. Lending and Fundraising

Peer-to-peer lending and crowdfunding can connect SMEs and startups directly with lenders and investors online, circumventing bank financing. These products respond to a traditional problem: typically, entrepreneurs take higher risks than those that banks are willing to take at the interest rate entrepreneurs are willing to pay. In this sense, **technology is changing the funding options** available to this customer segment. New regulations in this area are enabling new digital lending platforms and marketplaces that are faster and simpler. It will be up to the incumbent banks to keep up with the new market for investment and financial services, and their ability to navigate crowdfunding and peer-to-peer regulations will serve not only as a competitive advantage but also as a starting point when designing these platforms.

d. Blockchain

Blockchain technology can potentially disrupt all the areas mentioned above. First, this technology can facilitate **faster and more secure payments** at lower fees than traditional financial institutions, by eliminating the need to rely on other intermediaries to approve or settle transactions. Second, the systems currently in place for executing cross-border and intra- and inter-bank transfers could be improved in terms of time and costs by adopting a blockchain platform as a **transparent public ledger** that records all transactions. Third, in addition to the creation of **new types of assets** such as cryptocurrencies, financial trading could be transformed if blockchain is adopted for processing financial assets. Fourth, securities could become **tokens and smart contracts,** as evidenced by the market's thirst for ICOs in 2018. These tokens, for instance, could be programmed to pay dividends when certain conditions are met.

Although it is unlikely that blockchain technology will transform all these markets in the near term, several banks are already actively experimenting with it through **partnerships** and strategic investments. For example, some **financial institutions and technology companies** formed con-

sortia with aims of developing an industry-wide, open-source enterprise blockchain platform that provides a globally interoperable system for finance and commerce. However, as the technology matures, legislative support – which should also address data privacy issues – will be crucial to the success of these projects.

III. Digital Strategies in the Banking Sector

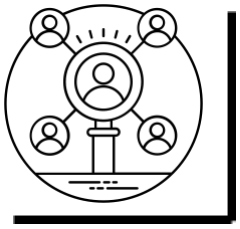
The digital economy is people-centric: businesses focus not only on satisfying their clients' needs, but also on nurturing and **attracting technical talent**. Furthermore, innovation often entails **investments in research and development**, not to mention competition among business models and a race to find new ways to take advantage of collected data. In this context, traditional banks will have to undertake digitally driven transformations by implementing innovative long-term strategies.

a. Leveraging Data

Banks will continue to collect and process information regarding their clients' transactions and behaviours to gain new market insights. Banks will thus be able to build large **data assets** that will allow them to **personalise their offerings based on clients' needs and expectations** and to make informed strategic decisions. For example, by using new demographic information, banks can relocate branches so that they are closer to their higher-end clients or those that demand in-person assistance, as the younger client base no longer needs those branches. These data will also allow banks to serve their clients with tools such as robo-advisory, chatbots and other automated processes.

These projects require a careful assessment of the legal aspects related to the **protection of data** (personal or otherwise), the legality of datasets, and the assignment of rights over data usage in general. Moreover, big data and the exploitation of new technologies can sometimes lead to **barriers to entry,** vertical or horizontal agreements, or other relevant conduct under competition law. Lastly, regulatory compliance and cybersecurity policies are fundamental for the effective development of new business models.

b. Recruiting Talent and Reskilling the Workforce



New roles in digital marketing, data analysis, and technology areas such as computer science are emerging in the financial services sector. This means financial institutions will have to **bring in tech talent** through traditional recruiting channels or by partnering with – or even acquiring – startups. These deals can allow banks to secure new skills and make themselves more attractive for prospective talent. Moreover, banks will have to promote new ways of working enabled by technology and advance an innovation-driven culture if they want to attract a highly motivated and skilled workforce.

It is fundamental to have legal assistance in the creation and implementation of internal reorganisations in order to ensure compliance with employment law. Furthermore, digital retraining programs that meet specific criteria can obtain the EU's support through funding opportunities, making it that much more important to have highly qualified legal assistance.

c. Scaling Mobile Development and Technology

On the front end, banks are using more user-friendly UI and UX designs, digital assistants and more to **enhance the customer experience** and enable their clients to accomplish more with **simple mobile applications**. On the back end, these digital branches – augmented by chatbots, budgeting tools, and digital investing and trading solutions – need to upgrade or replace legacy **IT structures, advance cloud-based systems, and integrate with APIs and open architectures**.

Legal support with negotiating contracts for the acquisition, development and integration of technology is thus paramount. Professionals who know the specific aspects of these contracts (e.g., avoiding a technological lock-in, guaranteeing operational stability and clearly distributing tasks between the company and its suppliers) can find sustainable solutions for the various parties to these transactions.

Some financial institutions are also **developing proprietary technological solutions** in-house. Tools for the protection and exploitation of intellectual property – especially software patents – are regaining importance due to algorithms developed for artificial intelligence applica-

tions and the internet of things. However, in some cases, more flexible tools serve as efficient alternatives, such as the legal protection of databases, software, trade secrets and (technical or commercial) know-how. The right counsel can assist in making the best strategic decisions in this context.

Furthermore, Italian law envisages several measures aimed at supporting investments in research, development and technological innovation, including **tax incentives** for investments in technology.

d. Engaging in strategic partnerships and acquisitions

In forging new partnerships and alliances with businesses across diverse sectors such as retail, telecommunications, healthcare and travel, **banks will become a digital marketplace for a broader range of goods and services** attached to innovative financial products. These digital ecosystems will enable banks to provide a range of seamless and attractive offerings to their clients. Financial institutions will interconnect with clients, partners, suppliers and retailers and simultaneously increase the volume of transactions conducted on their platforms, enrich customer experience and loyalty, and enhance their own data sets. At the same time, the other stakeholders of the digital ecosystem will increase their sales volumes.

Leading banks are also increasingly availing themselves of collaborations and strategic acquisitions to fuel product innovation, especially in deals with fintech startups. These deals allow banks to create communities through which they can **connect or integrate with startups to innovate their business models**. Some turn to incubators, accelerators or funds; others create their own equivalent corporate division to discover the next breakthrough innovation. In any case, a multidisciplinary team of legal professionals experienced in the fintech sector can reduce friction between the parties involved and help them avoid common pitfalls in all phases of a deal – from negotiations to the design and implementation of innovative products.

IV. Conclusion

Challenger banks and technology giants are disrupting the banking sector. Payments, financial trading, wealth management, lending, fundraising and many other areas are being transformed by technological and business innovation. But leading traditional banks are not standing on the sidelines – on the contrary, they are **reinventing** themselves as digital banks by leveraging **data**, recruiting **talent**, reskilling the **workforce**, scaling **mobile** development and technology, and engaging in **strategic partnerships** and acquisitions.

In a highly regulated sector within an increasingly digitalised economy, a specialised legal partner that can provide not only good legal advice but also business insights is vital to a successful digital transformation in the banking industry.

Banks Focus Team – contact info

Emanuela Da Rin, Team leader
Emanuela.Darin@belex.com

Marco Arato
Marco.Arato@belex.com

Stefano Cacchi Pessani
Stefano.Cacchipessani@belex.com

Massimiliano Danusso
Massimiliano.Danusso@belex.com

Monica Iacoviello
Monica.Iacoviello@belex.com

Paolo Oliviero
Paolo.Oliviero@belex.com

Giuseppe Rumi
Giuseppe.Rumi@belex.com

Francesco Lucernari
Giovanni.Lucernari@belex.com

Giovanni Muzina
Giovanni.Muzina@belex.com

Andrea Savigliano
Andrea.Savigliano@belex.com

Giuseppe Sacchi Lodispoto
Giuseppe.Sacchilodispoto@belex.com

Francesco Sbisà
Francesco.Sbisa@belex.com

Catia Tomasetti
Catia.Tomasetti@belex.com

Enrico Vaccaro
Enrico.Vaccaro@belex.com

Federico Vezzani
Federico.Vezzani@belex.com

Digital Innovation Focus Team – contact info

Marco Adda
Marco.Adda@belex.com

Giulia Bianchi Frangipane
Giulia.BianchiFrangipane@belex.com

Gianpaolo Ciervo
Gianpaolo.Ciervo@belex.com

Tommaso Faelli, *Team Leader*
Tommaso.Faelli@belex.com

Alessandro Musella
Alessandro.Musella@belex.com

Barbara Napolitano
Barbara.Napolitano@belex.com

Maurizio Pappalardo
Maurizio.Pappalardo@belex.com

Vittorio Pomarici
Vittorio.Pomarici@belex.com

Federico Vezzani
Federico.Vezzani@belex.com