Published in Journal of Payments Strategy & Systems Volume 13 Number 1
https://www.ingentaconnect.com/content/hsp/jpss/2019/00000013/00000001
also published extract as Opinion Piece at EPC
https://www.europeanpaymentscouncil.eu/news-insights/insight/banks-regaining-initiative
(also for eWL Blog, also to EACB as Discussion Paper, …)

Banks taking back control

M. Salmony February 2019

Abstract

Banks are increasingly concerned that they are being driven by others. And they are right. Regulators, new customer demands, new technology are increasingly driving the agenda. This paper examines why this is so and how banks can – and should – react so as to "take back control".

Warning: this paper speaks plainly with little respect for sensitivities

Background

It has been evident in the last years that banks are increasingly ***being driven***

- by the regulator
    - (stop thinking nationally ! do instant ! open up ! reduce interchange ! keep cash available ! …)
- by customers
    - (merchants demanding pan-European solutions, customers wanting immediate/free/convenient/secure services, …)
- by technological developments
    - (mobile, API, DLT, wearables, AI, IoT, connected cars, …)
- by new competitors
    - (FinTech, challenger banks, big tech, …)

Banks are struggling to keep up, find themselves faced with high infrastructure and compliance costs and increasing demands under the agenda of others.
Maybe it is time for banks to take back control and drive their agenda themselves?

This is getting increasingly urgent as there is no indication that the pressure on banks is reducing. Quite the contrary.

At this moment banks are being requested to:

- accelerate Europe's efforts to digitise payments, increase its capacity to stand on its own feet in the world, indeed play a leading role in the development of new and open market standards and set the new global standards for payments (European Commission agenda[1])
- support ECB in strengthening the role of the Euro (ECB Agenda)
- provide novel end-to-end point-of-interaction solutions (driven by merchant agenda)
- develop an API access scheme (ERPB Agenda)
- support account portability, account switching (user agenda)
- …

this is in addition to the ever increasing technological developments, compliancy challenges and global competition.

In order to come off the back foot and be more pro-active maybe it is time for banks to consider how to take back control – or at least drive their agenda more according to their own strategy.

This short thought piece aims to show some of the options in going forward in this sense.

Options going forward

Do nothing

The first option is to let events develop and await instruction from the regulator on what to do, triggered by increasingly unsatisfied customers demanding change.

This means that banks will have to implement changes, at high expense, under time pressure, under rules laid down by others.

Non-banks[2] will also entrench themselves in key areas with customers and will be hard to displace later.

This is clearly not an attractive option[3] and will thus not be explored further

[1] VP Dombrovskis speech February 2019 https://ec.europa.eu/commission/commissioners/2014-2019/dombrovskis/announcements/vp-dombrovskis-speech-opening-3rd-annual-afore-fintech-conference_en with the clear implication that regulation will follow if the market "starts again with national fragmented schemes that will require years to overcome"

[2] banks still bear the scars from PayPal's smart early moves here. Now novel point-of-sale solutions such as HIPPOS are being developed now (just like ELV was) by merchants – since banks are seen as not providing a solution.
Also, FinTechs are famously cherry-picking key opportunities left unclaimed by banks.

[3] although some critics may say this has been the modus operandi in the past

Actively follow developments

A more pro-active approach is to systematically follow changes in technology, user demands, market developments and actively consider which should be met.

The European banking industry has set up world-class infrastructures and defended very well against numerous onslaughts[4] which many predicted would cause their demise. However, it must also be objectively acknowledged that a number of trends that were clearly visibly coming, were not addressed head on. Coming changes were not systematically monitored. For example,

- when it is clear that all systems are moving to real-time, to consider moving to Instant Payments before being forced to
- when it is clear that users are moving online and to mobile devices, to consider offering new channels and solutions[5] before being forced to
- when Open Systems are becoming the norm in all industries[6] to consider the advantages of opening up before being forced to
- when Europe[7] and the World are becoming ever more integrated, to consider developing pan-European/global solutions before being forced to
- …

Thus, we see that banks have a mixed record of adapting to changes that are visibly coming. So, actively following developments and making a conscious choice on whether to engage in the changes of the environment gives one a strategic insight and the option to act. Some very sophisticated filtering solutions are available[8] to decide on which of the many coming changes it is best to react to and are thus an excellent first step.

However, it is far from "taking back control" as this in no way shapes the industry, but is a *follower* position with, at best, optional engagement.

Also, the identified topics are typically taken up by individual banks (single bank solutions) or isolated groups of banks (e.g. regional solutions). So, this is typically not a concerted initiative of the industry.

---

[4] online/direct banking, mobile banking, distributed ledgers, digitisation, FinTech etc were all predicted to cause the demise of banks. Instead banks have actually absorbed and embraced these developments well. However, this was usually done in "catch up" mode – after the pressure became too great.

[5] the German example of Paydirekt showed how much time, effort and cost (100M€?) are required when one is too late and tries to catch up (in this example against Sofort, PayPal, etc in the online payment market)

[6] Telcos were opened up in the 1970s. Open APIs, open protocols/identity, post-batch real time architectures have also been available for decades.

[7] it cannot be that the only way to pay truly in a pan-European way is via 1) cash or 2) American card scheme like VISA/Mastercard/AmEx

[8] "Innovation Radar" and "Innovation Sounding Board", Salmony, since 2006

Take Back Control

Taking Back control means not only being aware of what is needed, but actually actively acting upon it in a timely manner and indeed shaping the developments oneself.

This is not easy for individual banks (e.g. due to budget constraints), even harder for groups of banks (e.g. due to competition concerns[9]) and hardest of all for a whole industry to move in a concerted way (e.g. due to the need for alignment across many actors).

However, in a network economy like payments, all actors do tend to need to move together.

It is very clear that if banks are not willing to move together of their own accord, they *will* be forced to – by the regulator, by new entrants taking the new market spaces, by public pressure.

Banks will never turn from the tortoise into the hare – nor should they, as reliability, solidity, compliance are great assets over other market players. But banks can and should become more active, regain the initiative through smart approaches, and not just continually chase the hare's tail.

[9] moving together is made no easier by the uncertainty from possible cartel authority rulings where banks are sometimes not allowed to cooperate – despite other authorities rightly demanding collaboration and cross-bank solutions

Is there a business case ?

One frequently perceived impediment is that it is not easy to find a clear business case[10] in emerging trends. Especially when developments are still uncertain[11] and revenues not guaranteed. However, as we cannot operate here as in the traditional loan business, instead it is critical to break out of the cycle:

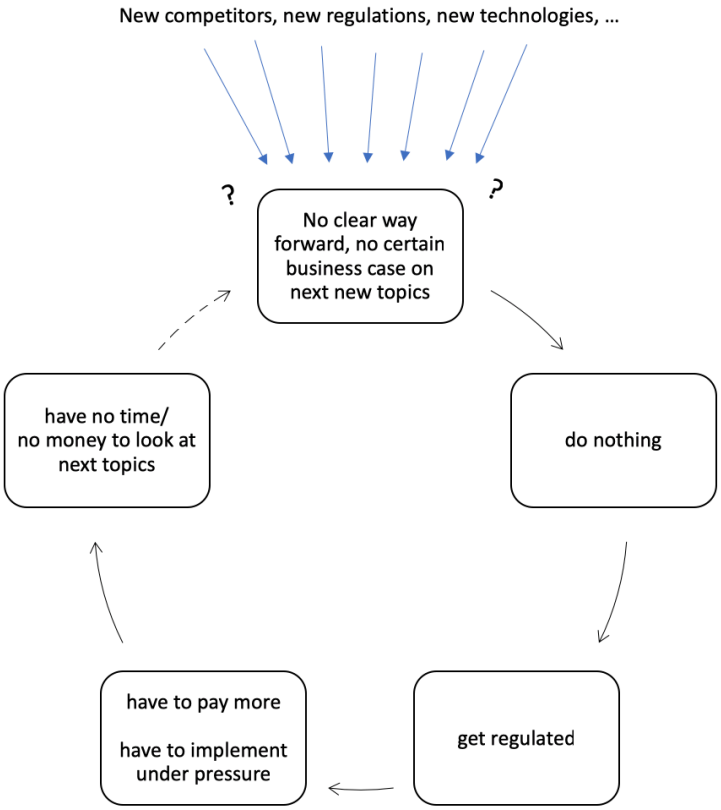

Figure 1 - The current vicious circle

The business case for actively moving in these dynamic times is given by two factors:

- if the development is inevitable, it is better and cheaper to start early. Active, timely implementation of *own* smart solutions is to be preferred over later, costly, stressful implementation of regulations imposed by others[12]

[10] and sometimes there is no business case – see Monnet

[11] for example, there currently appears to be little business case for cross-border payment being only 3% of the payment market. Customers indeed will continue to behave nationally (e.g. in Italy: RIBA, Bulletino) for a good while yet. However international merchants like Carrefour (and their banks) and competitors like PayPal, FinTechs do see the need. Banks must occupy this space - despite no immediate business case.

[12] for example, a timely pan-European iDeal solution may have avoided the billions of investments in SCT^{inst} – it solves the key merchant problem of instant guarantee without replumbing the whole infrastructure

- future payments-based services are not a zero-sum[13] game: smart new business models will dramatically increase the size of the market[14] and allow incumbents to take a large slice of the *bigger pie*[15]*.* Thus all will win.

So, a *strategic* approach[16] is required, which balances potentially large future gains against current uncertainties[17] and maybe initial sacrifices[18]. We need to look at the bigger picture.

Selected financial services communities have shown that this is possible – and met with great success. Over 10 years ago, when it was becoming likely that online payments were going to be big and that nimble competitors might occupy this increasingly significant space, the Dutch banks created iDeal – a world-leading solution, which has kept all competitors at bay[19] to this day and enjoys amazing growth rates. Similarly, the Nordic banks recognised early that one needs to move up the value chain around payments and have created world leading solutions for identity (BankID), mobile (Swish), invoicing etc which have ensured that the customer relationships, data and profits stay with banks. Thus, seeing the writing on the wall and acting upon it is the clear and proven way forward.

[13] Two examples show the fallacy of the zero-sum premise that all incumbents assume:
- IBM held on for many years to its closed architecture until it was forced to open to third parties. Thereafter it indeed no longer controlled its proprietary SNA protocol and was no longer able to charge $300,000 for a communications controller – but the market for open IT systems exploded and IBM sold many more servers and services than ever before (even though TCP/IP was now free and "communication controllers" became $300 modems). Everybody – including, and especially IBM, won.
- Deutsche Telekom fought liberalisation tooth and claw in the 1970s. Although today it no longer "benefits" from intransparent tariffs and being in command of who to allot the black-only bakelite-only phones to, the world of open telecommunications has brought massive benefits and hugely bigger telecommunications market to all – including, and especially, the old incumbents.

[14] if we all work together to make the tide rise (secular shift from cash to electronic payments) this floats all boats and existing and new players find bigger markets

[15] for example, the Open Economy will be much bigger – and banks are well positioned to take the biggest slice of the benefits

[16] for example, rather than grudgingly being dragged into API compliance, embrace BaaS and the open API economy

[17] true entrepreneurship and leadership is about making choices without having all the facts and without having a guarantee that one makes the right choice.

[18] e.g. offering PSD2 APIs for free under regulation, but aiming for the bigger prize of the Open Economy with financial services at its centre

[19] within the Dutch online payment payment market PayPal, Sofort, American card schemes, etc have never attained market shares seen elsewhere. Not because they were kept out – but by fair competition: because the banks' offering was better

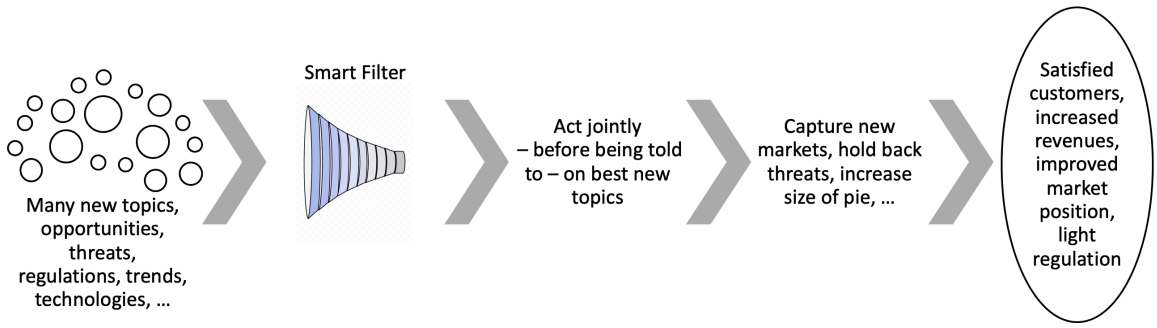

Figure 2 - Moving forward under control

Especially by now embracing modern Open Banking – although this does require some initial investment – banks have the opportunity to take pressure off. FinTechs can supply the solution to the latest wearable gadget, RegTech can help make compliance easier, smart partnering with solution companies can share the burden on satisfying the latest customer/regulator/technology demands. Banks no longer have to take care of everything themselves. Indeed, banks can then themselves cherry-pick which propositions they want to address themselves and which to leave to others.

Thus, paradoxically,
- by *investing* banks can *save* money and indeed open up *new revenues*
- by smart *partnering* with those who used to cherry-pick, *become cherry-pickers* themselves
- by *opening* up to others, banks can reduce the pressure and *take back control*.

The opportunities in the new world for banks with all their assets (digital infrastructure, client base, trust, …) are truly exceptional.

Recommendation

If banks are truly willing to consider being more active, regaining the initiative and taking back control, then the following approach is suggested:

1. The Diagnosis (understand why financial services companies often do not see the writing on the wall, what prevents them from acting ?) – the WHY:

   Concrete recommendation: host open discussion *within* key banking communities[20] on the analysis and the appetite to really take back control (not just paying lip-service to this, but instead assuring pro-active investment in potentially uncertain developments without – indeed well before – anyone drives banks into this). This must clearly be done whilst observing horizontal competition guidelines and conducted in an open, inclusive manner.
   Even within communities there will surely be divergent views and preferences which may require a "coalition of the willing" to be formed of fore-runner banks[21].

2. The Cure (what would a new approach look like (ideally based on current European leadership assets such as Open Banking, "SEPA 2.0" – see Appendix for concrete examples), what would be a coherent recovery plan to get there ?) – the WHAT:

   Concrete recommendation: host joint workshops *across* banking communities to explore the joint appetite for bringing the industry forward actively. Maybe a third party can facilitate such an open collaborative forum.
   Of course, there will be divergent views on this between communities and amongst the banks. For example, the more commercial private banks may wish to be more active for their international merchants than local retail banks. However, it is imperative to put local and individual interests aside for the greater good of the industry, and of Europe.

3. The Recovery (what "medical team" should take leadership on administering the cure - banks themselves or under leadership from EU institutions for the benefit of Europe ?) – the WHO and HOW:

   Concrete recommendation: if there is indeed an appetite to move actively the results of this process should be conveyed forcefully publicly to and with regulators. When regulators see that banks are stepping up to the changes[22], they will have much less motivation to develop pre-emptive regulation or act on what they see as a (coming) market failure. Indeed, regulators may wish to step up to moderate the process and be even more part of the solution.

[20] for example within the savings/cooperative banks, within merchant banks, within national banking organisations

[21] the coalition of the willing may then be extended even beyond banks: IndiaStack is perhaps a poster child for this redefinition of such competitive/collaborative boundaries

[22] the regulator is expecting the banks to "rise to the digital challenge" and not leave this to BigTech, see Yves Mersch, Member of the Executive Board of the ECB, speech February 2019 https://www.ecb.europa.eu/press/key/date/2019/html/ecb.sp190226~d98d307ad4.en.html

Key Quotes

"The European banking industry has set up world-class infrastructures and defended very well against numerous onslaughts which many predicted would cause their demise. They can do it again."

"Banks can and should become more active, regain the initiative through smart approaches, and not just continually chase the hare's tail"

"The banking industry repeatedly and for decades, finds itself - despite clear warning signs - on the back foot, on the defensive. This means that banks had to implement changes driven by others, under timetables determined by others, at massive catch-up costs"

"Smart banks have recognised the need to move up the value chain and have created world leading solutions for identity etc which have ensured that the customer relationships, data and profits stay with banks"

"If a development is inevitable, it is better and cheaper to engage early."

"A strategic approach is required, which balances potentially large future gains against current uncertainties and maybe initial sacrifices. We need to look at the bigger picture"

"True entrepreneurship and leadership is about making choices without having all the facts and without having a guarantee that one makes the right choice"

"it is imperative to put local and individual interests aside for the greater good of the industry"

"It is time for banks to take back control"

Summary

During the development of modern electronic payment, we have repeatedly seen the writing on the wall. It was clear to all who did not entirely have their heads in the sand that inevitable changes were afoot:

> batch to real-time, national to global, physical to online, online to mobile and now proprietary to open systems.

Yet the financial services industry repeatedly had to be pushed into these changes by outsiders, especially regulators and nimble competitors. Thus, this industry repeatedly and for decades, finds itself - despite clear warning signs - on the back foot, on the defensive. This means that banks had to implement changes driven by others, under timetables determined by others, at massive catch-up costs.

Meanwhile other competitors, some even from other industries, had entrenched themselves so deeply with customers and in the infrastructure that it later proved impossible to reclaim the lost terrain.

In this paper we argue that the industry needs to change its strategy.
From defensive/reactive/driven to being *in control*.

Today we again see a large number of inevitable changes afoot:

> API economy, Amazonisation of payments, fragmentation and reassembly of the value chain, new data services, value added services, rise of account-based payments, unbundling identity from payments, connecting all merchants and all customers in SCF, need for end-end solutions, need for better B2B solutions, to move up the value chain, build on Europe's assets towards global solutions, ….

Let us this time not wait for others to drive us – but instead let us this time embrace the new changes – even though all questions may not yet be answered, even though competition concerns need to be addressed, even though the business case may not yet be fully clear.

This will mean we can choose our own timetable, develop answers according to our rules and maybe spend the money more wisely.

It is time for banks to take back control.

Michael Salmony, February 2019

Appendix: Possible concrete content of pro-active approaches

We have seen that a number of coming trends were missed in the past. What are the coming trends now ?

If banks do feel that taking back control, shaping their own agenda and actively investing in the future is the way to go, one should consider the current writing on the wall, concretely the following content topics:

- Drive the *Open Mashup Economy* with financial services at its centre ("own" the API economy, be the platform)

- Be clear that future propositions will be aggregated/*customer centric* rather than current "only the accounts at this bank" view. This may mean a redefinition of the collaborative/competitive space with other banks and other industries.

- Provide new *data*-driven services to customers (do not leave this to GAFA, AliPay, etc)

- Provide *value-added* services based on payments (e.g. unbundle KYC and authentication to provide bank-based[23] *Identity* to all industries, unbundle the 4-corner transport network for eInvoicing)

- Move up the value chain and provide complete *end-end* solutions (e.g. for the lucrative and currently underserved *B2B* market)

- Leverage European assets (especially Open Banking, Instant) towards *global* standards – Europe is the world-wide leader in payments and should play a shaping role[24] in the world

- Develop an end-end *scheme* based on instant and open banking (not on cards) to cover the European and Global market (including not only the clearing and settlement – but also end-end aspects, governance, banding, refund/dispute management etc – learning from what paved the way for the success of the global card schemes)

- Consider what resources (esp. data[25], APIs[26]) the financial services industry could *use from other industries* (turning the tables on PayPal, ELV, and now FinTechs using the bank infrastructures for free)

- …

[23] not Facebook/Google/Amazon/Microsoft/Alipay-based identity … as is emerging now

[24] the Mexican fintech charter and Mojaloop are perhaps some other interesting parallels in other regions

[25] e.g. using GDPR Art 20 on Data Portability for *all* industries

[26] https://www.programmableweb.com/apis/directory

Developing the above – all topics which one can again clearly see coming - will allow banks to offer new services to customers, attain new sources of revenue and become the driving industry of the future.

These actions are necessary[27], but will of course also need to be complemented with organizational changes such as agile development, modern IT and processes.

Across all these content topics, banks may also wish to consider new governance models and new KPIs to drive transformation. The former will facilitate change[28], and the latter will show a more useful and realistic[29] bank performance forecast - e.g. using ARPU (used in mobile industry), legacy P&L vs new business P&L (used in all other modern industries).

Banks can thus build on their existing excellent base – capital, customers, regulation, secure IT, infrastructure, data. Now these must be secured with the above new topics.

[27] not addressing the topics listed here must surely almost inevitably lead to failure

[28] new governance can enable true leadership from the top, drive a change of mindset, making transformation a business science, and maybe avoiding the barriers often found in middle management ("where innovation goes to die" according to Money2020)

[29] today often hidden by the still satisfactory-looking classical bank performance measures (assets, liabilities, CIR, personnel costs, …)