The Economist Intelligence Unit

A report from The Economist Intelligence Unit

Retail Banking

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EXECUTIVE SUMMARY

The digital revolution has moved from existential threat to potential survival strategy for the world's retail banks.

For the first time in three years, the post-crisis regulatory squeeze no longer tops our retail banking trends. Banks may not like the renewed regulatory focus on know-your-client and suitability, but they now have a more pressing draw on their resources: financial technology (fintech).

The Economist Intelligence Unit's previous reports reflected a somewhat defensive attitude from incumbents about the rise of non-financial sector competitors. Times change quickly, however, and banks are risking their own existence if they choose to ignore the rise of smartphones and the proliferation of real-time, low-cost competitors.

The scale of disruption is unprecedented, across every market, every distribution channel and every single product line. Fintech poses a potentially fatal risk and will be a severe test of banks' IT systems and their ability to respond to rapid changes in customer expectations, short product development times and growing cyber risks.

Discussions now centre on just how quickly and how far transactional banking will be unbundled and margins slashed. Strategically, banks have a number of potential responses; the correct path is not yet clear-cut.

Some banks are building their own technological solutions, where resources allow. Others are buying the fintech upstarts outright, a quicker but increasingly expensive option to molly-coddling fintech hubs.

Partnering or opening up bank platforms to give third parties access to customers are two other strategies that are gaining ground. A European regulatory push would allow retailers and aggregators unhindered access to account information for client-approved payments and data-mining.

The question is who will survive the disruption. Trust and customer experience are at the heart of the battle; banks have the upper hand on the former, not on the latter.

Even if access to information is eased, tougher data protection and liability rules may delay the death of the banking laggards; customer apathy may buttress their market share for a few more years. Regulators will also have to stay ahead of the game, and will have to ensure that cyber crime does not become the next big global crisis.

In the meantime, why not let the fintechs burn cash experimenting with what works? In order for that strategy to work, bankers must ensure that they have the resources and architecture to embrace emerging channels, products and services quickly. Failure to do so will leave them as mere "dumb pipes", providing the infrastructure for others, with few touchpoints to drive growth and higher-margin cross-selling.

To gauge the pace and extent of this revolution, The Economist Intelligence Unit surveyed 203 senior retail banking executives around the world about customer expectation, regulatory and technological developments. The key findings are as follows.

- **The banking world of the future.** By 2020 bankers expect the banking environment to be shaped strongly by technology and non-traditional competitors. They believe that retail peer-to-peer (P2P) lending will be available via banking platforms (65%); retail banking will be fully automated (64%); and more money will flow via fintech firms than traditional retail banks (57%).

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- **Profits face multiple attacks.** Business models must adapt to survive. Individually, the "scare scores" attached to changing customer behaviour (22%), new entrants (26%) and new technology (24%) are significantly lower than in previous years; collectively, however, they still represent a significant threat.

- **A multi-headed monster.** That competitive threat will come from many quarters. Apple Pay and its ilk (20%) and other non-financials (20%) may yet emerge to really upset the traditional banking sector. As keen as regulators are to encourage competition, new banks are seen as less of a threat (16%). Robo-advisers could lure away more profitable wealthy (and the not-so-wealthy) clients (17%), and P2P lenders attract dissatisfied borrowers and savers (21%).

- **Regulators still watching.** The too-big-to-fail rules are almost complete, but there is still plenty to keep compliance departments busy. Regulators now have time to cast an eye over consumer protection issues, with product design and transparency (24%) and fines and recompense orders (19%) still in play.

- **Banks are adapting.** Bankers see three main areas that they must change in order to survive: adapting the role of the branch network (36%); getting the right talent (35%); and modernising their technology (31%). Banks still have the relationships and the data, but can they maintain and build on that advantage?

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ABOUT THIS REPORT

In December 2015 The Economist Intelligence Unit, on behalf of Temenos, surveyed 203 global banking executives to investigate the views of retail banks on the challenges and changes they face in the years to 2020 and how they are responding to these.

Respondents were drawn from across the world, with 61 from Asia Pacific, 62 from Europe, 60 from North America and 20 from the rest of the world. Over one-half (135) of the respondents work for banks with assets of less than US$50bn. Some 44 have assets of US$250bn or more. The split between C-suite (101 respondents) and executives and managers (102) reflects a balance between strategic and implementation concerns.

In addition, in-depth interviews were conducted with 33 senior executives from banks of all sizes, start-ups, venture capitalists and mutual fund managers. Our thanks are due to the following for their time and insight (listed alphabetically).

Giles Andrews, co-founder and executive chairman, Zopa

Billy Avarado, chief business officer, Stripe

Chad Ballard, director of mobility and new digital business technologies, BBVA Compass

Raja Bose, head of Diebold Global Advisory Services, Diebold

Ricardo Campos, senior director electronic banking, Bank Millennium

Tony Craddock, director general, Emerging Payments Association

Stephane Dubois, chief executive officer, Xignite

Chris Dunne, director of market development, VocaLink

Dr Edward George, head of group research, Ecobank

Ivan Stendal Hansen, director, Jyske Bank

Chris Hamilton, chief executive officer, Australian Payments Clearing Association

Neil Hiltz, head of financial services for global vertical strategy, Facebook

Mike Hirst, managing director, Bendigo & Adelaide

David Howell, chief executive officer, Guardian Life Management

Neira Jones, adviser and ambassador, Emerging Payments Association, and non-executive director, Cognosec

Michael Laven, chief executive officer, Currency Cloud

Chris Low, group chief executive officer, Letshego

Severin Mayer-Heinisch, deputy head, business management & development, Raiffeisen Bank International

Pralay Mondal, senior group president for retail and business banking, YES BANK

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Michelle Moore, head of digital banking, Bank of America

Tomasz Motyl, chief innovation officer, Alior Bank

Michal Panowicz, deputy head of digital banking, Nordea

Simon Pickering, head of retail financial services, Isle of Man Bank

Wim Raymaekers, head of correspondent banking, SWIFT

Peter Schlebusch, head of personal and business banking, Standard Bank Group

Nadeem Shaikh, founder and chief executive officer, Anthemis Group

Vince Tallent, chairman and chief executive officer, Fastacash

Maximilian Tayenthal, co-founder and chief financial officer, Number26

Suresh Vaghjiani, executive vice-president, card services, Global Processing Services

Ashok Vaswani, chief executive, Barclays Personal and Corporate Banking, Barclays

Adam White, vice-president, development and strategy, Coinbase

Christopher Woolard, director of strategy and competition, Financial Conduct Authority

Joe Ziemer, director of communications, Betterment

The report was written by Paul Burgin and edited by Monica Woodley of The Economist Intelligence Unit.

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INTRODUCTION: NOW IT GETS SERIOUS

"Banks are being disintermediated. They are no longer fit for purpose, are doing too little for too much money for too few." - Tony Craddock, Emerging Payments Association

A clearer picture is emerging of where the battle lines lie in the financial revolution that threatens traditional transaction and relationship banking models.

At the front-end, customers want quick, cheap, simple access to banking by any means they choose. But the smartphone cannot do it all; banks must be multi-channel. Branch, call centre, remote video, phone, PC and automated teller machine (ATM) must function as one. Right now, they often operate in separate silos.

Digitisation could be a godsend, lowering costs and upping functionality for bank and customer. However, it is also the biggest threat; new transaction services may have already fatally wounded existing national and international payment architectures. Blockchain distributed ledger networks (as opposed to pseudo-currency bitcoin) could be what finally kills them off.

"Paytech" is where the big money is being invested. Card, contactless and e-wallet payments have largely rendered cash obsolete in Denmark and Norway. With cash declining, in-branch human interface is rarer with every passing day.

High-margin lines are also being squeezed. Robo-advice is front-page news, with cheap, functional, index-tracking model portfolios and fancy rebalancing tools. Hefty bank adviser and wealth unit fees will not last as consumers come to realise that they are paying a lot for fund managers who largely fail to deliver.

If there is a bright side for banks, it could be that P2P lenders and robo-advisers may struggle to establish harmonised global franchises. Their business models are easily copied; local credit, tax and advice law is harder to assimilate. Both markets may remain fragmented.

"Regtech" is the next battleground. Overseeing this wave of new technology is fast replacing post-crisis measures on the regulatory to-do list. Cyber security is a genuine threat to the trust that billions of customers place in their banks, apps and e-wallets. Whatever their faults, banks do take compliance and security seriously; fintechs typically focus more on customer experience. If the traditional players can maintain their hold on keeping their customers' money safe, system integrity may also be the key to securing the future role of the traditional bank.

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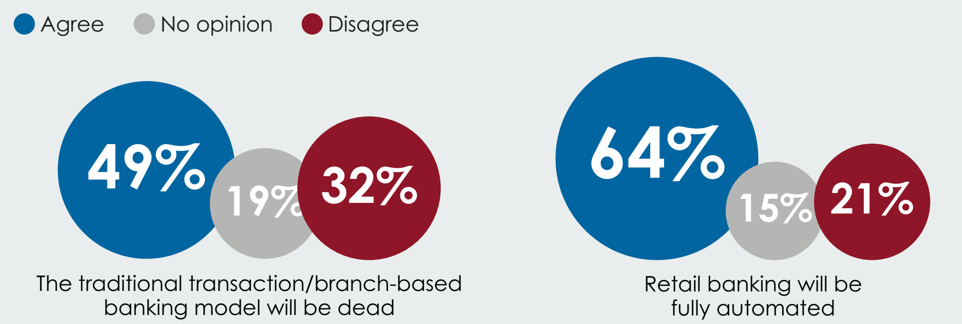
SECTION ONE – THE FUTURE IS HERE

"The payments battle is over" - Nadeem Shaikh, Anthemis Group

The problem with innovation is that it is unpredictable in terms of timing, scale and consequence. Yet our respondents make bold predictions about how the traditional banking business model will look in five years' time.

Chart 1

Do you agree/disagree with the following statements?
(% respondents)



Source: The Economist Intelligence Unit.

Modern banking has not changed much since the moneylenders of Renaissance Italy employed a trust-based system to move money from one merchant to another for a hefty fee. That transaction model is the basis for relationship banking, the high-profit lines on which bankers rely.

Digitisation is driving major transformation, rewriting the model as customer expectations change. The touchpoints of branch footfall and human interaction are in rapid retreat. Banks hope that the role of the branch will shift from cash-handling to that of providing value-added financial advice.

Denmark's Jyske Bank will have no teller desks by the end of this year. Branch numbers have fallen to 97; they may dip further. The challenge is how the bank stays close and relevant to customers who no longer visit branches regularly, says Jyske's network head, Ivan Stendal Hansen.

"With self-servicing, the number of branches will continue to reduce. However, financial advisers still need to be in the local environment for bigger financial decisions," he says.

Mobile banking can even counter declining footfall. At Bank of America, clients are now scheduling as many as 18,000 adviser appointments per week via a phone app.

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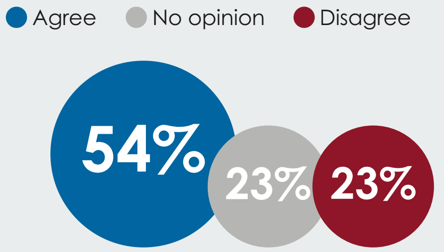
Chart 2

Do you agree/disagree with the following statement?
(% respondents)



Cash will represent less than 5% of all retail transactions

Source: The Economist Intelligence Unit.

"They want someone to talk to, more advice and guidance on how to make their financial life better," says Michelle Moore, head of digital banking.

Cash is expensive to manufacture, sort and distribute – for banks as well as customers. It is also potentially dangerous. The head of Norway's DNB recently pointed out that if you get rid of cash, criminals stop targeting your branches. It is inconvenient, too. That is why early adopters of M-Pesa, the ubiquitous Kenyan mobile money network, quickly learned that their phones could store and pass money to friends, not just pay their bills.

While Asia, Africa and Latin America remain more cash dependent than Europe and the US, the demise of cash may be speedier than in developed markets. Some 62% of Asia Pacific respondents say that cash will represent fewer than 5% of transactions by 2020.

Early movers can benefit from the transition to mobile payments. Danske Bank launched MobilePay in 2013, and the service is now used by 2.7m Danes; they transferred just shy of Dkr22bn (US3.3bn) last year. Two-thirds of them are not Danske clients, but they represent a great source of insight into consumer expectations and may be receptive to other products and services.

Even ATM providers need to rethink their game. Next-generation machines will have no screen and no PIN access as routine transactions like reporting lost cards will be initiated from your mobile phone. Opening up accounts and other functionality will see manufacturers move into bespoke bank back-end software provision, predicts Raja Bose of machine manufacturer, Diebold.

Many bank customers have never written a cheque, and. even credit cards are at risk of becoming obsolete, thinks Ms Moore of Bank of America. Near Field Communication (NFC) payments in shops and one-click app payments to friends and family will all be completed on a mobile phone.

But if the banks are not even handling the digital payments (and upselling to customers), then who will be? Fintech has stepped into the breach, on the premise that cheap, fast and convenient will supplant the human touch.

Banks struggle to match the efficiency of their challengers, hampered by their own internal structures, where customer services, account management, foreign exchange

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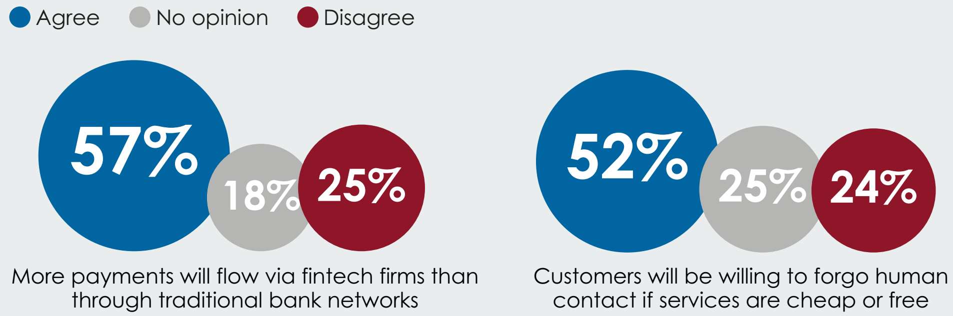
Chart 3

Do you agree/disagree with the following statements?
(% respondents)



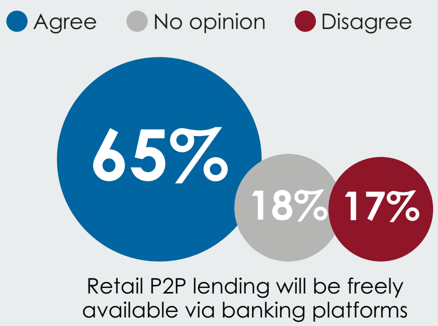
Source: The Economist Intelligence Unit.

trading and reconciliation operate as individual fiefdoms, each with its own costly IT system. The World Bank says that bank fees for account-to-account remittances are more than 10%; online products cost less than 6%.

Yet fintechs, merchants and individual users cannot avoid banks altogether; cash has to enter and exit the fintech ecosystem somehow. Deposit-taking institutions still have an important role. As Currency Cloud's Michael Laven points out: "The actual currency translation and putting money into bank accounts still has to be done by the banks."

Chart 4

Do you agree/disagree with the following statement?
(% respondents)



Source: The Economist Intelligence Unit.

Paytech, however, is not the only challenge. Bankers face a multi-headed monster attacking multiple product lines.

Customers do not want to be confined in their choice of loans. Pass-through volumes to P2P lenders from bank platforms may be low, says Zopa's co-founder Giles Andrews, but they indicate a willingness to coexist. Banks may never have the ability to assess the risks of real P2P lending, meaning that an in-house solution may not be an option.

"At the end of the day, we are a data analytics business with ten years of through-the-cycle data. Banks cannot match our analytics," says Andrews.

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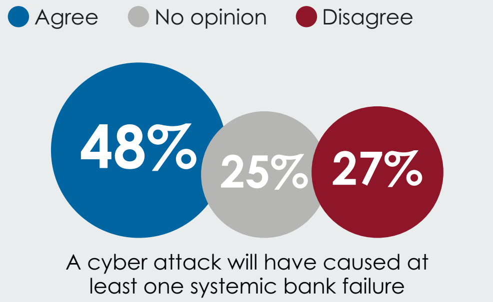
Chart 5

Do you agree/disagree with the following statement?
(% respondents)



Source: The Economist Intelligence Unit.

There is emerging evidence too that robo-advisers are already squeezing the charges that private bankers and wealth managers can extract from wealthier clients, and with lower minimum investment levels that banks find unprofitable, meaning that they can offer their services to a wider range of clients.

Better, faster, more transparent products and services tick all the regulatory boxes. However, client data theft and distributed-denial-of-services attacks are already regular occurrences. Respondents fear that a whole bank could be brought down. As Neira Jones, an ambassador for the Emerging Payments Association and non-executive director at Cognosec, points out, increased digitisation and cooperation increase the risk to a system's integrity.

"You squeeze fraud in one place, it pops up in another. Cyber-security and fraud prevention are joined at the hip," she says.

Banks are already raising the alarm about fintech security weaknesses. After being criticised over their surly response to the launch of Apple Pay, Australian bankers have countered that it and other mobile wallets are not subject to the same prudential regulation and supervision of their privacy compliance.

Bank directors in the UK could even face imprisonment under the Bank of England's new Senior Managers' Regime if security breaches were to lead to a bank's failure on their watch. They will not want to do prison time on behalf of lax customers, retailers and app suppliers.

Moreover, customers may be unwilling to ditch their banks entirely. Deposit guarantee schemes make savings 100% safe, even if a bank collapses, and balances may be better off in a bank, not stored somewhere in "the cloud".

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PSD2: BE CAREFUL WHAT YOU WISH FOR

Europeans question why US bank customers continue to photograph their cheques for digital processing or pay extra for same-day transfers.

The Single Euro Payment Area (SEPA) already makes cross-border payments as fast and as cheap as domestic ones across 35 member countries. In contrast, Americans will have to wait until end-2017 for real-time transfers.

Europe wants to go further. Its banks are finally waking up to the enormity of the revised Payment Services Directive (PSD2), which will force them to provide account information to third parties, via Application Programming Interfaces (APIs) that cut out transaction intermediaries. Aggregators will have a field day. They will be able to harvest account information from multiple banks in a single app. Banks could become mere "dumb pipes" unless they lever their brands, client bases and compliance skills to become aggregators of choice.

In the rush, fintechs may overlook the security issues that are a mandatory requirement for banks under PSD2. Badly managed, the API-economy could result in greater security gaps, and a consequent consumer backlash.

"The banks are saying: are we going to eat or be eaten?" says Chris Dunne of VocaLink, the company behind faster payment systems in the UK and Singapore.

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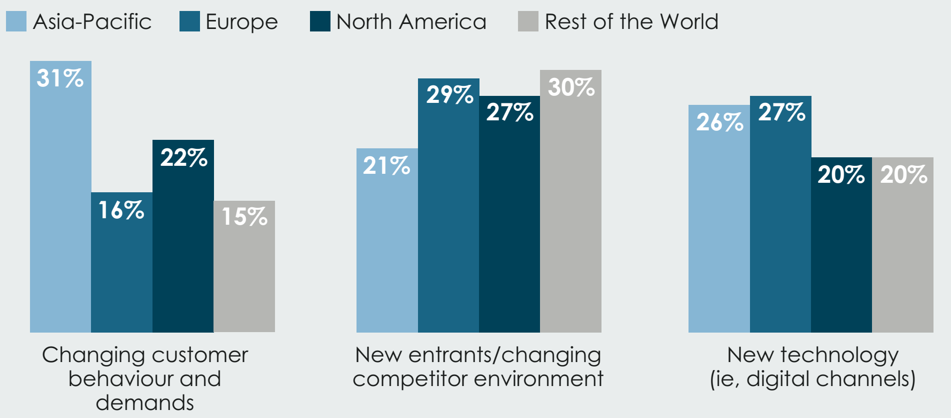
SECTION TWO – TIMES, ALREADY CHANGING

The banking revolution is global and not just led by Silicon Valley. Changing customer demand is the single biggest driver in Asia, twice as important as it is to banking executives in Europe.

Chart 6

Which trends will have the biggest impact on retail banks in your country in the years to 2020?
(% respondents)



Source: The Economist Intelligence Unit.

In saturated European and North American markets, the focus is on newcomers wanting a slice of an already large and profitable pie. As Maximilian Tayenthal of the Berlin-based pan-European online bank Number26 points out: "If you had just 1% of the German market, you would already have quite a valuable company."

The Asian picture is different, possibly because the penetration rates for traditional banking can be low in certain parts of the region. Rapid economic growth and urbanisation are a chance to pull people into the system and to grow the whole banking sector.

Players in less mature markets may have already stumbled on the strategic solution for other banks: cooperation.

In India, YES BANK operates a dual implementation strategy. In urban and metropolitan areas, the bank is full-service and multi-channel. Customers want everything everywhere, closely monitored by a relationship manager who can anticipate their every need.

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"You cannot be a one- or two-product niche player," says Pralay Mondal, senior group president for retail and business banking at YES BANK.

But for rural customers it is entirely different, he adds. Banks do not have the physical infrastructure or expertise to reach the country's unbanked. So they provide the backbone correspondent banking facilities to Mobile Network Operator (MNO) transfer services, often through SIM card stickers, to add functionality for those without smartphones, or to local co-operatives and micro-finance lenders.

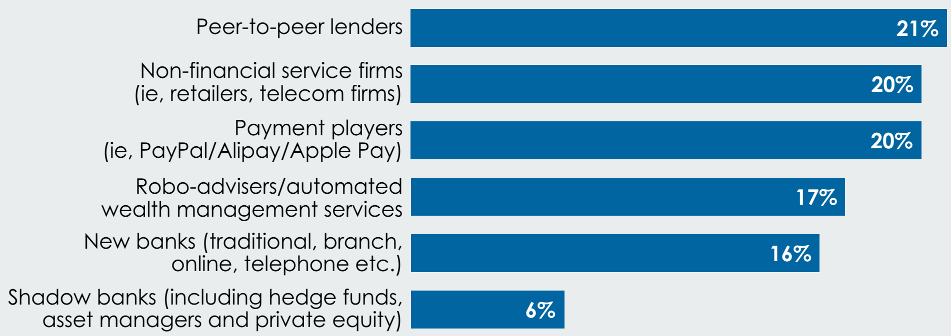
South Africa's Standard Bank Group, the country's biggest, works with M-Pesa to convert mobile credits into cash machine withdrawals. Partnering with Shoprite, Africa's largest retailer, has lowered the cost of cross-border remittances.

"We do not have to invent everything ourselves, we are very open-minded about working with others," says Peter Schlebush, the bank's head of personal and business banking.

In Central Africa, EcoBank is also keen on co-operation with multiple partners. MPesa aside, MNO market shares are more fragmented in other markets, and inter-operability is weak. EcoBank has links to other banks, such as Nedbank in South Africa, in order to extend its footprint across the continent.

Chart 7

Which non-traditional entrant to the retail banking industry will be your company's biggest competition in the years to 2020?
(% respondents)



Source: The Economist Intelligence Unit.

While the US has been quick to close down its smallest, shakiest lenders, other global regulators want to break the stranglehold that bigger banks have on retail business. Client distrust also makes customers more receptive to new players and ideas, particularly as fintech has a distinct time-to-market advantage over incumbents.

However, consumers should not expect a slew of new banking names on the high street. The reason is simple: becoming and being a bank is a complex, capital-intensive,

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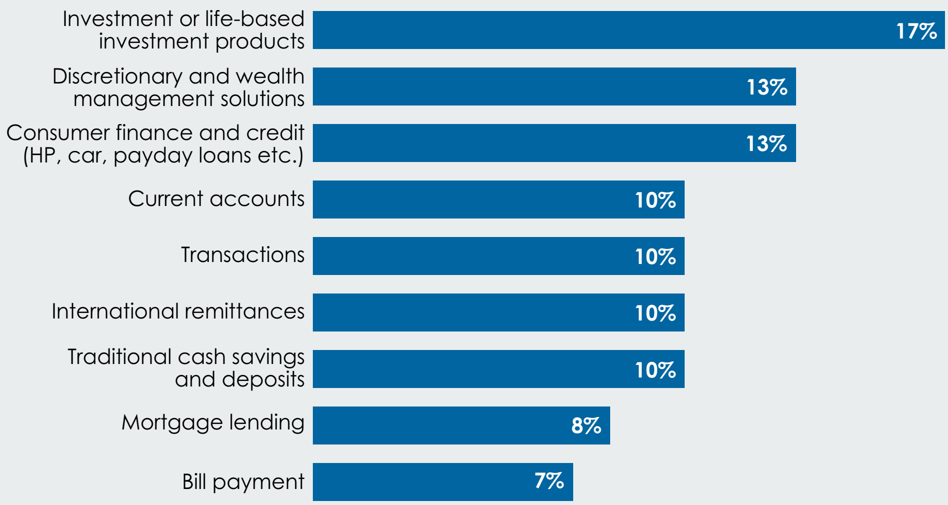
regulatory minefield. Competition will come from non-financial services firms, payment players and P2P lenders, suggesting a "pic'n'mix" for customers rather than lots of new one-stop shops. Indeed, even many "challenger" banks are opting for lighter regulatory options, suggesting that they do not want to be full-licence either.

Chart 8

What is the main area where you expect new entrants to gain the most market share?

(% respondents)



Source: The Economist Intelligence Unit.

Transactions and international remittances by banks face significant speed, cost and convenience pressures. That will squeeze current accounts too. But low-margin/high volume is not the ultimate target, say survey respondents. Investment, life-based investment products, discretionary wealth management and consumer finance face the biggest threat. They also happen to be the high-margin product lines.

Comparison with the online stockbroker revolution of the 1990s is wrong, say interviewees. Back then, online outfits such as E-trade slashed the cost of buying equities, and banks had to follow suit. Even though transaction costs plummeted, top-line revenue was largely maintained as investors merely traded more often.

Today's emerging price wars will cut top-line income, while banks struggle to protect the bottom line. As fee levels fall, mutual fund and pension contribution volumes are unlikely to rise to compensate for the growing banking compliance and IT cost burden.

"Wealth managers and private banks have woken up to the fact that customers are no longer willing to pay the margin," says Nadeem Shaikh of advisory and venture capital firm, Anthemis Group.

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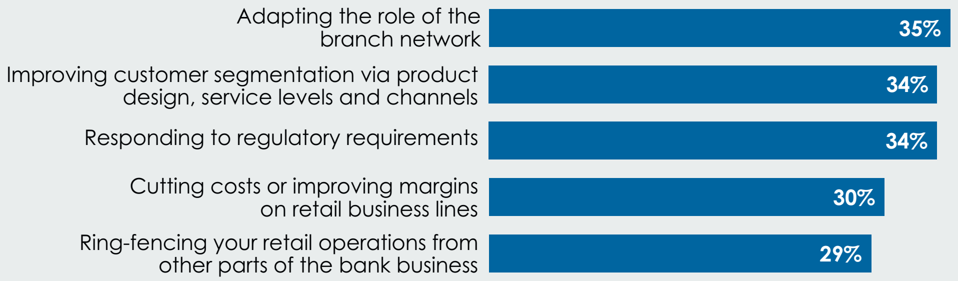
Chart 9

What are the top priorities for your company in the years to 2020?
(% respondents)

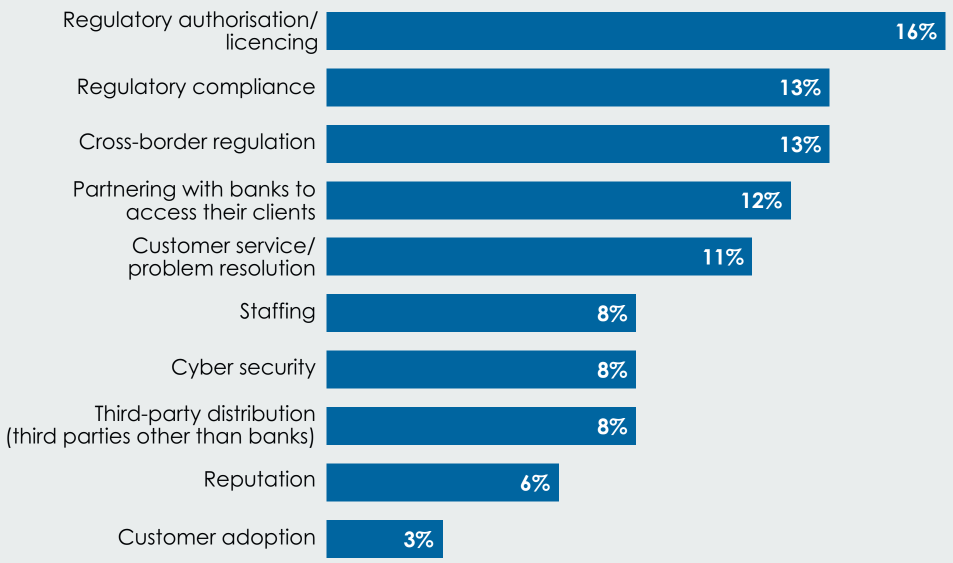


Source: The Economist Intelligence Unit.

Responding to regulatory change is an on-going task, as is the real physical separation of retail business units from investment banking activities in Europe and the US. However capital and liquidity regulation is no longer the executive priority that it was just two years ago. The urgent need is responding to changing consumer demand, by having the right number of branches in your network and better segmentation of products, services and channels.

Chart 10

What is the biggest challenge faced by fintech entrants?
(% respondents)



Source: The Economist Intelligence Unit.

The good news, of sorts, is that the banks are not alone. The revolution is no pushover for the newcomers either.

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Fintechs face significant barriers as a result of the current regulatory structures. That may explain why we have not seen an Apple Bank, Google Bank or Facebook Bank and perhaps never will, according to our interviewees.

Regulation may curb global ambitions too. Robo-adviser Betterment says that expanding from its home in the US even to neighbouring Canada would be too much of a distraction, and despite the attractiveness of the UK wealth or Australian superannuation market, the compliance burden is something that the company can do without right now.

Newcomers still have a small share in most of their markets. As they are under less regulatory pressure (for now), reputational issues are not yet a big challenge. That is expected to change, particularly if their strategic plans include partnering with banks in order to gain bulk. And when complaints and outages go viral on social media in minutes, the importance of reputational and complaint resolution issues may rocket, with serious implications for e-businesses without the staff or expertise to remedy their mistakes quickly.

IF YOU CAN'T BEAT 'EM

For those banks that lack in-house development expertise, help is at hand. Fintechs such as Fastacash and Letshego have partnering at the heart of their business models.

Letshego started ten years ago, lending to government employees in Africa. It now provides a link between microfinance, mobile transactional capability and fintech, and the full-licence banks.

Singapore-based Fastacash wants to help banks get to grips with facilitating transactions through social media. Chairman and CEO, Vince Tallent, wants sending money to be as easy as sending a picture by WhatsApp. But banks worry about which social media to focus on, so Fastacash is agnostic about which networks are used. India's Axis Bank and Singapore's DBS have already signed up.

Fastacash also focuses heavily on security to minimise fraud risk and reputational damage. It has even taken out a patent application on its "host value emulation" that protects transaction data, rather than simply copies credit card data onto a phone or app. That may avoid problems like the reported spike in identity theft that followed the introduction of Apple Pay in the US.

What is more, Tallent says that he can have a bank's social media payment solution up and running in 90 days. That may be worth a "like".

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THE BANKER FIGHTS BACK

Tracing its roots back to 1690, Barclays hardly counts as a banking upstart. Yet it is aggressively adopting new technology and tackling newcomers head-on. The bank is going digital and multi-channel, believing that customer service is what will help the bank to stand out, not its product range of mortgages and current accounts.

"My vision is that we grow our reach as a major bank but continue to foster the spirit of a challenger bank," says Ashok Vaswani, head of personal and corporate banking at Barclays.

He can claim a number of UK market firsts: mobile banking in 2012; free P2P payments the same year; extended to Twitter in 2015; cheque imaging and video banking in 2014.

The bank even has 15,000 Digital Eagles in branches, giving free technology advice to customers and non-customers alike.

"Customers expect banking on their own terms. So we have created digital innovations that allow them to choose how, when and where they bank, as well as helping customers boost their skills and confidence," says Mr Vaswani.

The need to become entirely instant is "huge", he admits. It comes with significant cost and time implications, even though the transformation programme has no end-date as the digital vision keeps changing.

"The real benefit of the cost implications comes only when automation is end-to-end," says Mr Vaswani.

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SECTION THREE – ADAPT OR DIE

As the banking revolution gathers pace, getting it right and keeping it legal are genuine headaches. In order to remain relevant, banks have to change from within and they have to respond to change forced upon them by newcomers and regulation.

Regulators are piling on the pressure with tougher know-your-client and anti-money-laundering rules, and are demanding more responsive remedial action when systems and product suitability fall short.

Chart 11

What are the top priorities for your company in the years to 2020?
(% respondents)

Source: The Economist Intelligence Unit.

Chart 12

What is the primary driver of your digital investment?
(% respondents)

Source: The Economist Intelligence Unit.

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If technology is the competitive threat, it has to be part of the solution. "In tech we trust" may be the banking industry's new motto, but implementation is complicated. The past looms large. Banks have more than one legacy system, and national networks and global infrastructure add layer upon layer of IT issues.

Banks are spending significantly on digital solutions, but the reasons why are increasingly diverse. With growth and cost bases under pressure, client acquisition and pricing are still the main drivers, but not by much. Customers are already multi-channel, whether they want higher-priced products or a speedy resolution to a complaint.

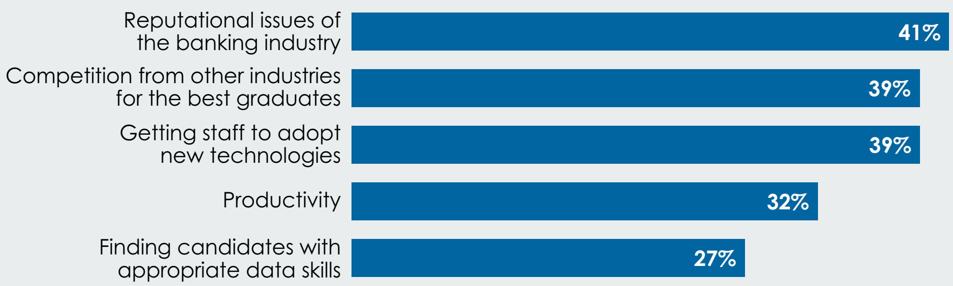
At Nordea, five legacy systems are being replaced in four countries to create a modern "product factory", says Michal Panowicz, deputy head of digital banking. The progressive rollout will take four or more years and cost €1bn; it is certainly not "mobile only", nor even "mobile first".

"There will be a proliferation of devices, even though mobile is growing rapidly and is always in your pocket," says Mr Panowicz.

The IT upgrade bill will be worth it. Mr Panowicz believes that the most exciting technological development for banks is video banking, known as telepresence technology, as it offers banks the chance to capitalise on the human touch. As such, banks have an advantage over the fintechs when it comes to selling profitable mortgages, investments and pensions. Secure, well-executed remote advice retains those vital touchpoints, he thinks.

Chart 13

What are biggest talent challenges your company currently faces?
(% respondents)



Source: The Economist Intelligence Unit.

It should come as no surprise that attracting the brains to solve these issues is rapidly becoming a top priority. It is particularly urgent in North America, where tech geeks can chose between Silicon Valley and Wall Street, and in less developed markets, where remuneration and living standards may not appeal.

Banks still need to spruce up their reputations, which does not help when trying to attract the best graduates and employees. The option of retraining existing staff to work with

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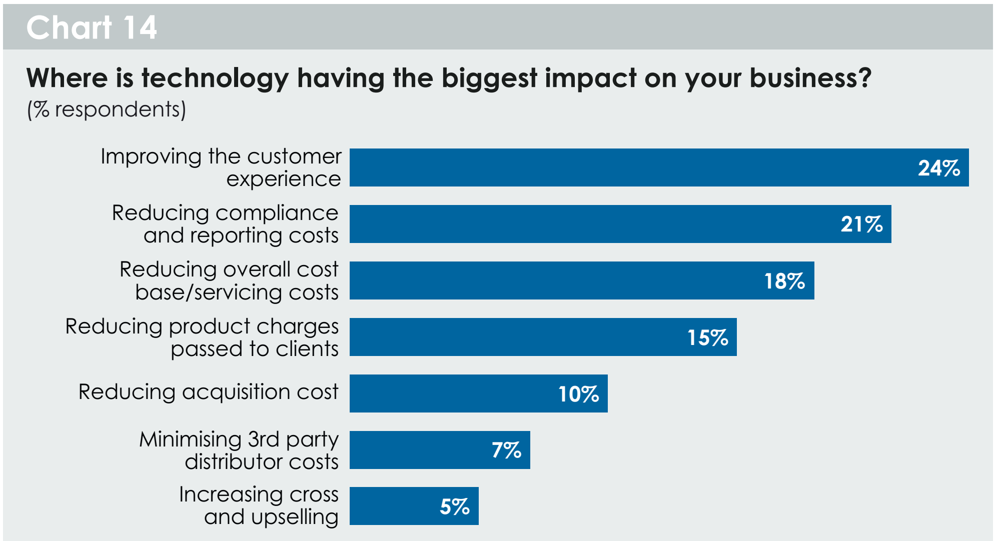
new technologies should not be overlooked; for example, Nordea staff undergo 240 hours of training, some with trained actors, before they are allowed to work in video banking.



Source: The Economist Intelligence Unit.

In order to survive, banks must improve the customer experience, but they must do it profitably and legally. For those who do it well, the benefits are huge.

Raiffeissen Bank, a mid-sized central and eastern European player, is learning both from outsiders and from within. It operates as a network of 14 banks in different territories with different systems, making economies of scale difficult. Slovak subsidiary, Tatra Bank, is its innovation leader, recently transferring its voice recognition expertise for digital lending to Romania, Belarus and the Czech Republic.

"In the digital arena, our position is a smart follower, leveraging the 14 in-house innovation partners. We do not intend to reinvent the wheel in each and every one of the 14 units," says Severin Mayer-Heinisch.

Fast-growing fintechs know that data management is their unique selling point, and a barrier to stop others from threatening their intellectual property and market share. Banks know that they have to get better at data too; why do customers still have to submit proof of income for loans when their bank sees their salary come in every month?

Smart banking means integrating products and channels in order to better leverage them. Poland provides a useful case study of how upgrading core systems, integrating front-end channels and cooperating can lead to multiple benefits.

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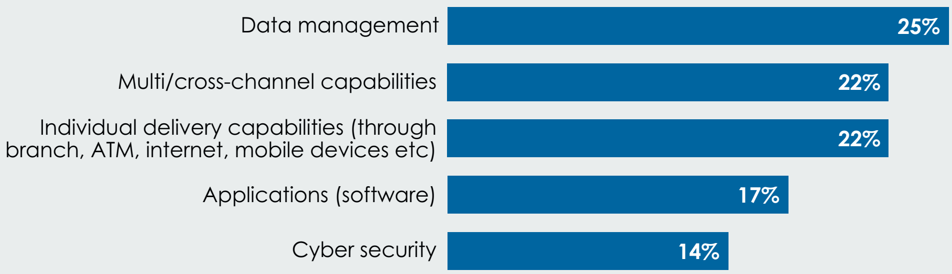
Chart 15

Where is your company focusing its digital investment?
(% respondents)



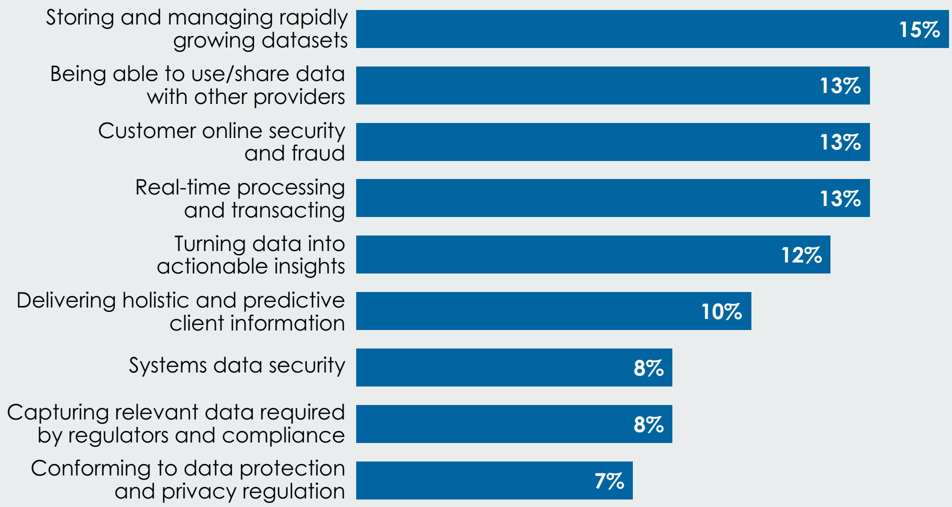
Source: The Economist Intelligence Unit.

Polish banks have worked together to deliver seamless mobile payments, P2P transfers and ATM withdrawals by phone through the new BLIK system. NFC payments have increased dramatically.

Yet each bank has to maintain its own competitive advantage. So Bank Millennium has gone further, removing internal product and channel silo structures to deliver true omni-channel banking. Even with a relatively modern IT backbone, head of electronic banking, Ricardo Campos, says that different areas of the bank did not always communicate. Now all front-ends, from call centre to online, function as one. Customers can start a loan application online, ask questions in branch, sign a contract and get the cash from an ATM.

Chart 16

What is the biggest challenge your bank faces concerning data?
(% respondents)



Source: The Economist Intelligence Unit.

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“Omni-channel is not about doing the same process on every channel, but about being able to do the same process using several channels,” says Mr Campos.

Even banks with poorly integrated systems already collect vast pools of data. Alas, few have the tools to interpret them well. Nor are they ready to share these, as they will be compelled to do in the EU from next year.

While Polish banks are IT-savvy, they need to get better and faster at delivering new ideas to customers. Tomasz Motyl of Alior Bank says that no bank wants to become a mere back-office or white label for new market entrants. Aggregation is a new war zone.

Mr Motyl and his colleagues are working on apps for private banking advisers that will aggregate client products and investments from Alior and other financial firms. As Polish customers expect free transactional banking and interchange fees are now capped, banks need to monetise higher margin opportunities wherever they can. Shared data should improve Alior’s ability to sell profitable loans.

“It will only work if the client values your services in the first place,” he admits.

In banking, size matters too. Poland’s banking industry is consolidating to boost margins and revenue. Alior recently absorbed Meritum Bank. IT migration was relatively painless and extraordinarily quick. The financial deal was done and system integration completed within a year. Other banks and fintechs could be future targets. Alior has set up Motyl’s IT team as a separate business unit to sharpen its tech skills.

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REGTECH: THE NEXT BATTLE FRONT

Regulation may prove to be a protective shield for the banks. In banking culture, the tendency is "compliance first, innovation second". Fintechs do the reverse, often significantly underestimating the regulatory burden that they face.

Christopher Woolard, director of strategy and competition at the Financial Conduct Authority (FCA), says that regulators do not expect people to like them. However, frostiness and regulatory complexity can deter newcomers, which can be an issue when the regulator's remit also includes boosting competition, as it does in the UK.

"In the past, it was about stopping bad things from happening, and there are still good reasons for regulators to focus on that. But then there is a danger that you lose sight of the good things that could happen," he says.

The FCA's Project Innovate nurtures new entrants, guiding them through the regulatory framework. Some 327 firms have requested the regulator's support. Out of these, 177 have received assistance; 18 have gone through to full authorisation and another 21 cases are in the pipeline.

The FCA has also looked at what stops good ideas from becoming new banks. In the past, granting a licence was "all or nothing", says Mr Woolard. New players had to have capital, people and systems in place before seeking authorisation. Now, the FCA approves the building blocks one by one. A total of 15 new banks have been authorised since 2013.

The FCA is also working with non-bank fintechs, like short-term car insurer, Cuvva, and alternative credit reference firm, Aire. Most are less likely to want to become fully fledged banks as they develop.

Proposals for a regulatory "sandbox" would allow all players to test new products and services. Firms would need consumer consent, just as with clinical trials, and promise to compensate them if experiments go wrong.

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CONCLUSION: IN BANKS WE TRUST

With all the noise, it is easy to forget why we have banks. They store value for us, keep our money safe. Deposit guarantee schemes make banks even more secure.

Newcomers have yet to be as harshly tested as the global banking system was in 2008. There will be casualties when they are.

Yet the banks know that they must up their game. Wim Raymaekers, head of correspondent banking at SWIFT, the payment messaging network, says the fact that 45 banks signed up within three months for a new initiative is proof that they want to improve the customer experience.

Fintech has set many benchmarks. Real-time is the "North Star", admits Mr Raymaekers. But banks can set benchmarks too, given their existing customer reach, infrastructure and compliance prowess. Indeed, SWIFT comfortably beat its own 50% price cut targets in three successive five-year plans from 2001 onwards.

But even SWIFT member banks will no longer be able to work solely within a closed network, as many in India, Africa and Asia have found. Getting comfortable with that is part of the battle.

The true winners will have the technology to cope with co-operation. SWIFT, other networks and their member banks may still be the backbone that holds the whole system together. Security and integrity will be as important as cost, efficiency and speed.

But they may also be a little more humble; the mighty bank brand could be reduced to a mere screen icon for many customers. In an unbundled world, many banks will aim to be the partners of choice for back-office functions, savings and loans, offering low cost and efficiency. The clever ones will aim to rebundle, using their reach, brand and data skills to harvest clients from others.

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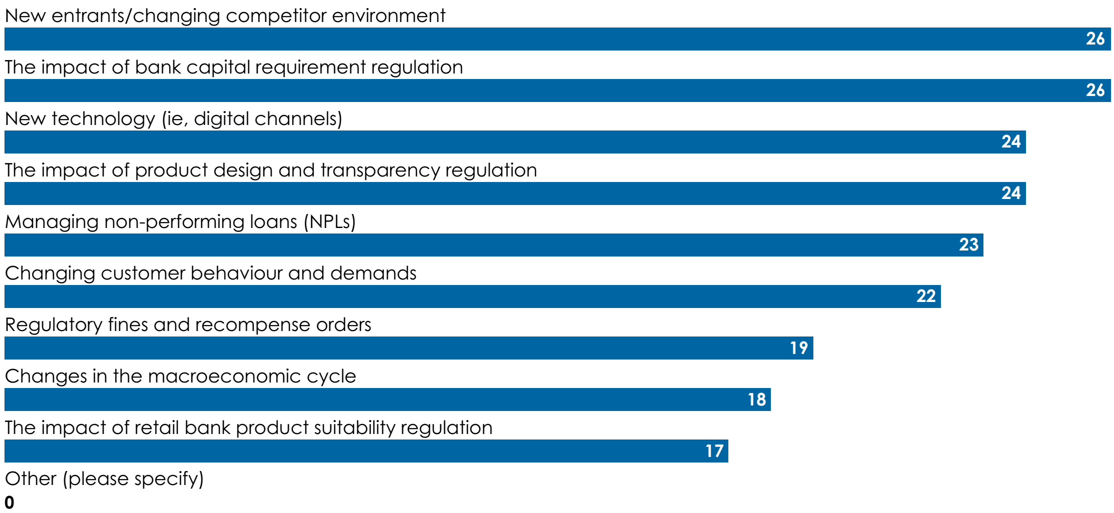
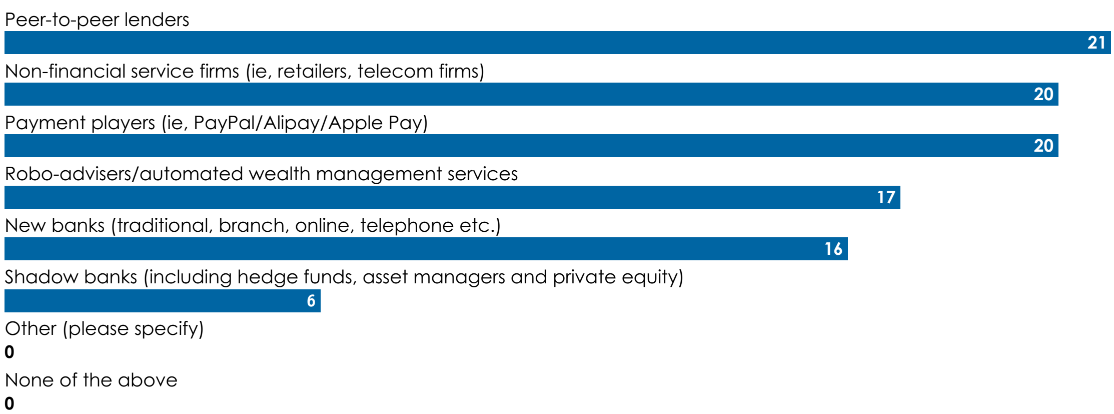
APPENDIX

Which trends will have the biggest impact on retail banks in your country in the years to 2020?
(% respondents)



Which non-traditional entrant to the retail banking industry will be your company's biggest competition in the years to 2020?
(% respondents)



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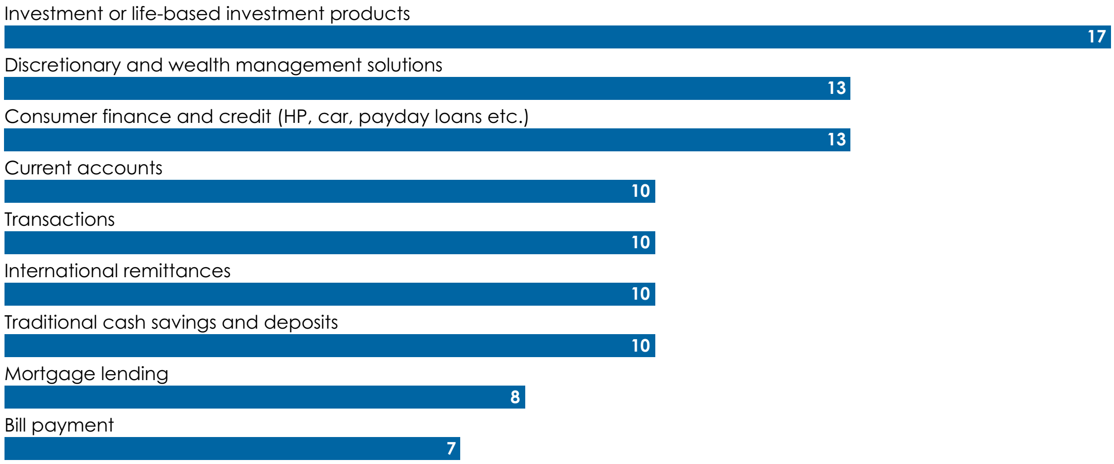
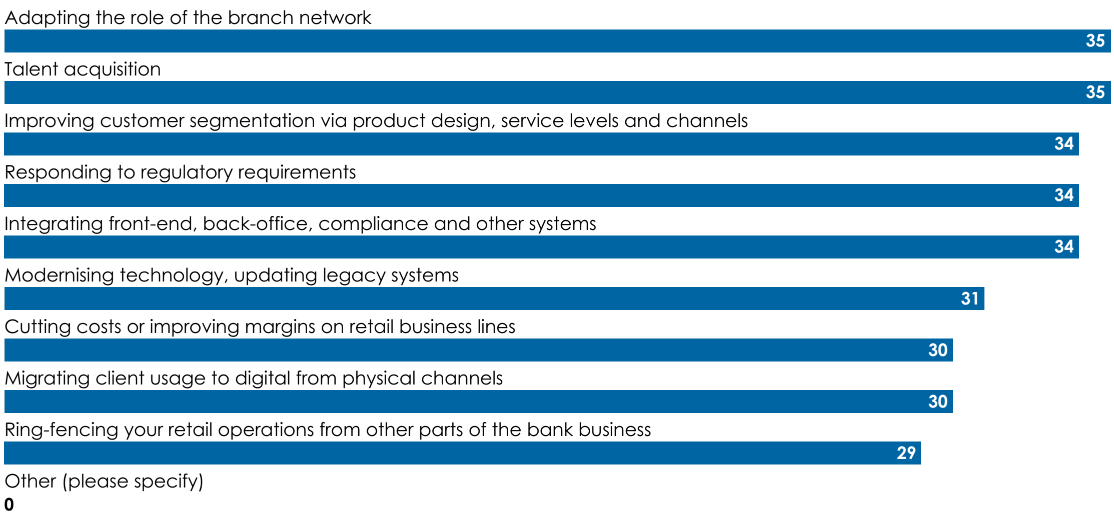
What is the main area where you expect new entrants to gain the most market share?
(% respondents)



What are the top priorities for your company in the years to 2020?
(% respondents)



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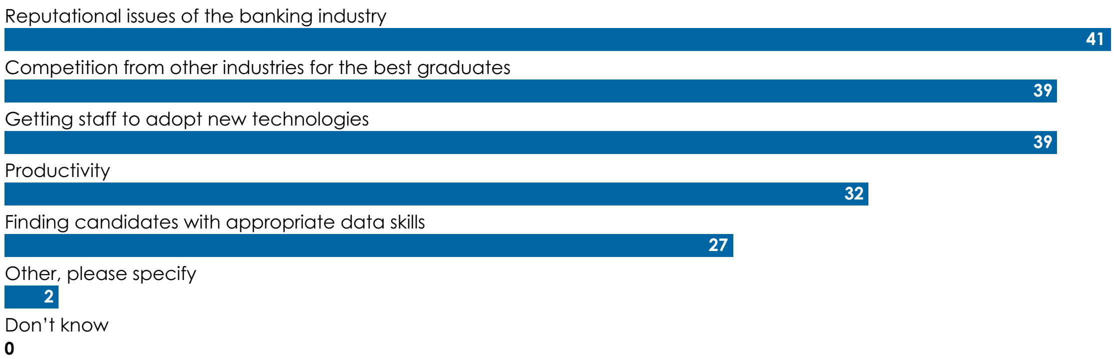
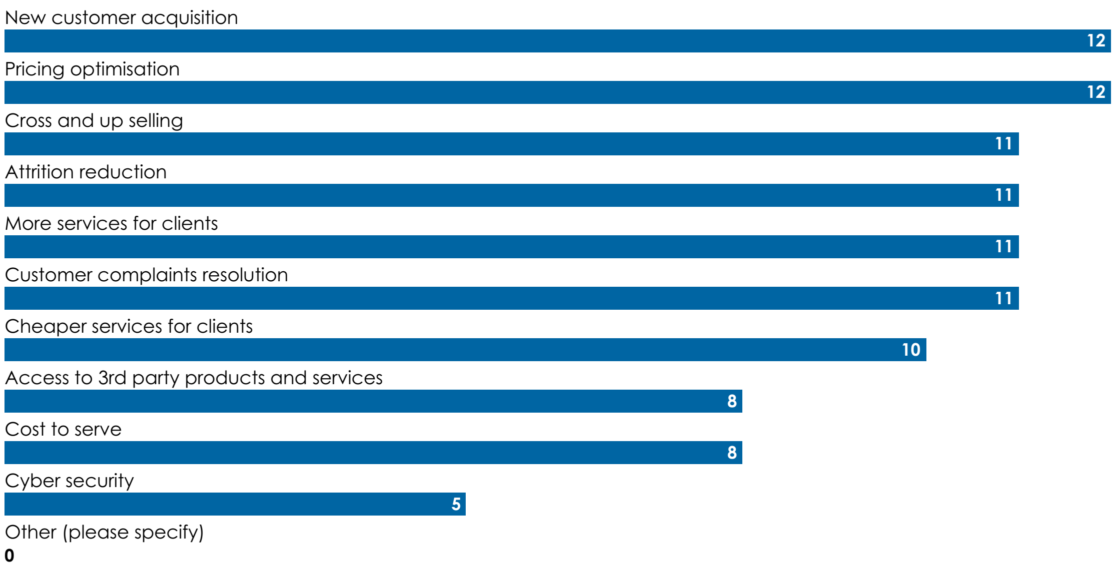
What are biggest talent challenges your company currently faces?
(% respondents)



What is the primary driver of your digital investment?
(% respondents)



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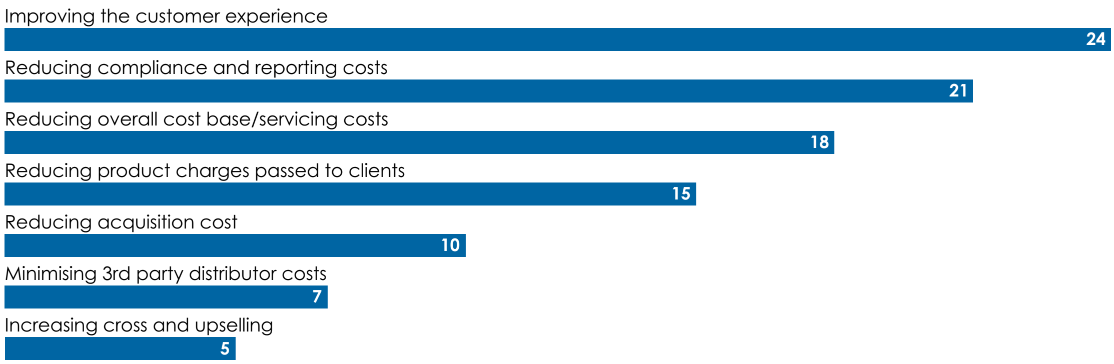
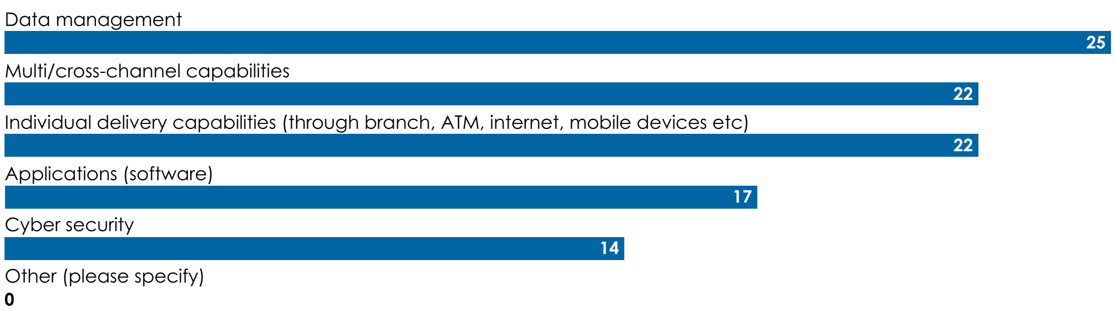
Where is technology having the biggest impact on your business?
(% respondents)



Where is your company focusing its digital investment?
(% respondents)



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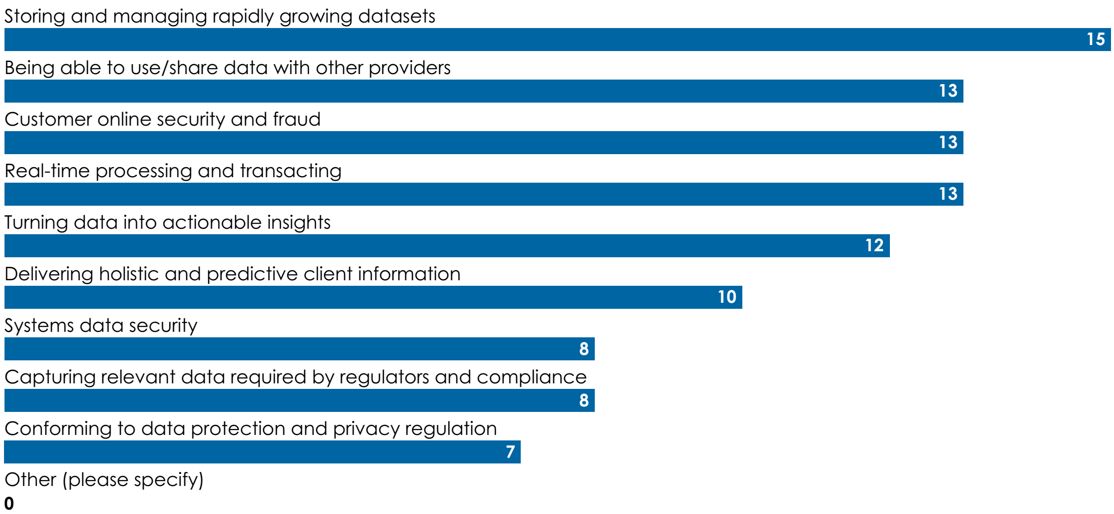
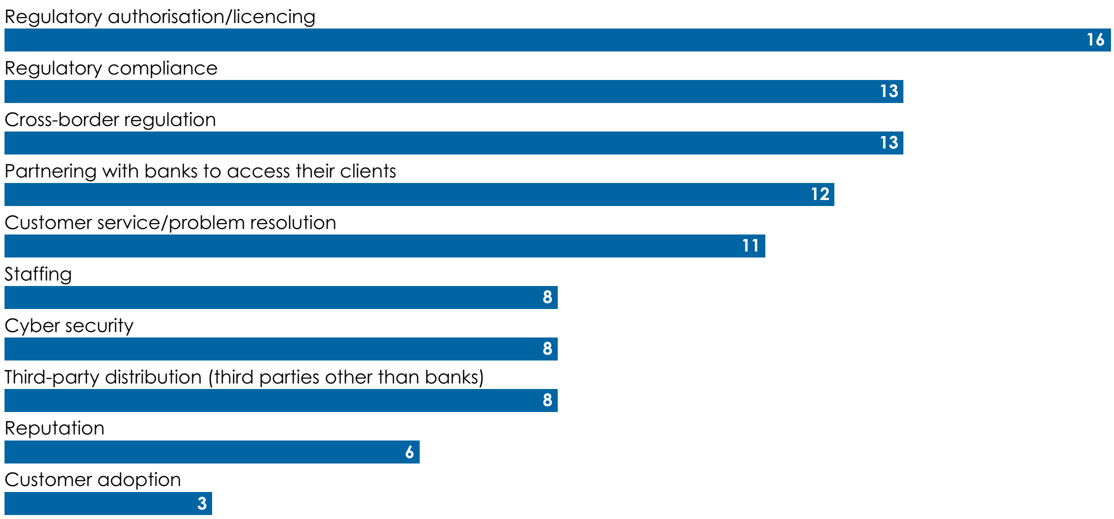
What is the biggest challenge your bank faces concerning data?
(% respondents)



What is the biggest challenge faced by fintech entrants?
(% respondents)



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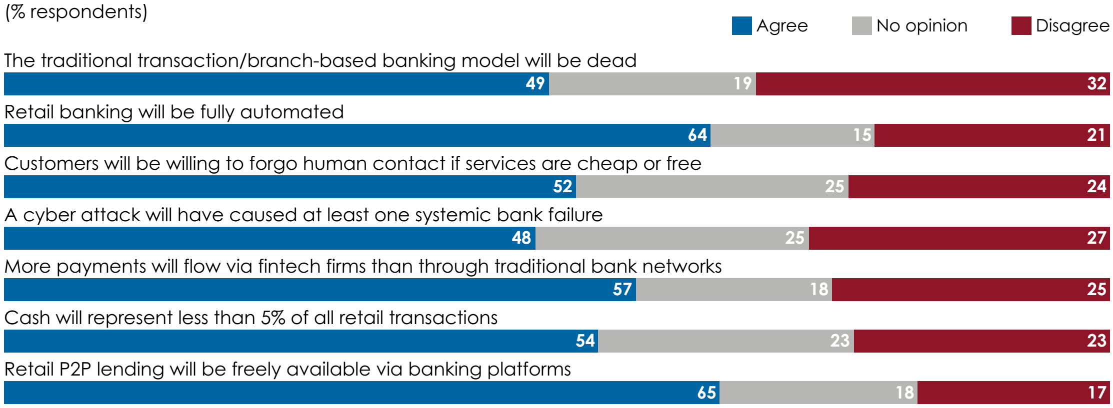
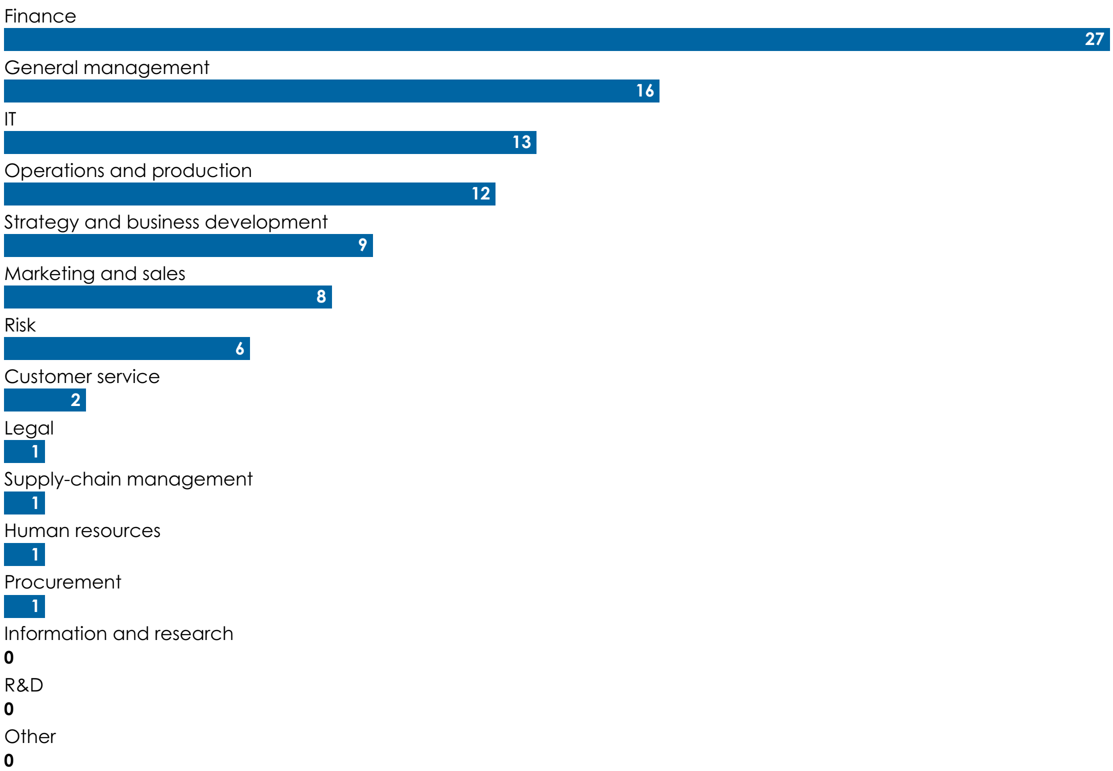
Do you agree/disagree with the following statements?
(% respondents)



What is your primary job function?
(% respondents)



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Region
(% respondents)

Which of the following best describes your job title?
(% respondents)

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