



# FROM TRADITIONAL BANK TO MARKETPLACE BANK

**07** A GUIDE ON HOW TO SURVIVE  
AND DOMINATE THE FINTECH ERA

# INTRODUCTION

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Change. The financial world is buzzing with it. With this buzz, we think about how to leverage new technologies such as cloud banking, Internet of Things, smart appliances and API layers. They all seem rather important, and they are.

Banks know they have to innovate in order to stay relevant to their customers, certainly in times like these when customer loyalty has become a thing of the distant past. But sadly for them, there seems to be no such thing as a simple upgrade path to make the transition to Banking 2.0 or 3.0. Challenges include compliance, security, legacy and old paradigms.

In IT there is a saying that “nobody has ever been fired for buying IBM”. Conservative choices are stimulated or even applauded. Ventures into the ‘unknown’ are much scarier and their outcomes more uncertain. But let’s face it, traditional banking is on a burning platform. The future is fintech marketplace banking. This trend is not as disruptive as it may seem.

# INTRODUCTION

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Many industries have already been technologically disrupted. Financial services and banking won't be any different. New digital banking platforms will emerge with an automated, compliant core and a connection layer for all kinds of third party services to tap into. This is API banking, or marketplace banking.

In the evolution of fintech, we are currently experiencing the first wave. New companies compete with banks on specific products, but they rely to a great extent on the traditional banking infrastructure. Banks are pressurized by these newcomers, but the first wave of fintech has by no means the potential for disruption as the second wave. In two to five years fintech banks are expected to emerge and disrupt traditional banks. Traditional banks can survive or even dominate the fintech era by investing in their own digital banking platforms.

Evolving into a marketplace bank means mitigating several obstacles: regulations and compliance, security, organizational impact and legacy IT systems. There is a fast way: resulting in banks operating on a lean back end, being agile again and go wherever their customers are.

Digital banking initiatives will fail without strategic investments in emerging technologies. Analysts signal new, open, unified digital banking platform providers who offer new technologies. It is not clear that financial institutions are prepared for digital banking. But there is no doubt that the new business model of marketplace banking will emerge. Digital banking with open banking APIs will be mainstream in a few years time.



# THE FUTURE IS MARKETPLACE BANKING

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The financial world is one of few industries that haven't been uberized... yet. In other industries, from journalism to retail, technological disruption is taking place on a large scale. In the world of financial services and banking it won't be any different. New digital banking platforms will emerge with an automated, compliant core and a connection layer for all kinds of third party services to tap into.

Some call this phenomenon 'API banking'; others talk about marketplace banking'. The new type of bank will limit their services to a handful of core services: a bank account, a credit/debit card and maybe something like an eWallet for various (crypto) currencies. All further services that we are used to getting from traditional banks will be delivered by third parties through the API layer.

Think about insurance, personal loans, mortgages and much, much more. Those third parties could be traditional banks, financial institutions or fintech companies. The vision stated above is not one of a single individual or even organization. Many thought leaders in finance, including Gartner, foresee a future for digital banking with open banking APIs. Banking is becoming open, despite security and compliance concerns about the use of technologies like Web APIs in such a heavily regulated industry. There are several drivers behind this, among them the CEO's agenda (revenue growth, efficiency, customer experience), digital transformation and competitive pressure. The development of open API standards by governments and regulatory bodies provide banks with another driver.

The evolution of the fintech market means many fintech businesses have evolved from pure 'peer-to-peer' models into marketplace models, where liquidity can come not only from peers but also financial institutions. This brings the second wave in fintech, expected in two to five years time. Exemplary for this evolution is Lending Club, originated as a P2P lending platform but nowadays known for getting up to 80% of its liquidity from financial institutions. Banks consider it more efficient and profitable to lend money through Lending Club than through their own branches. In marketplace banking, banks no longer aim to offer all their services through their own branches but to connect their customers to their network while keeping a 360 view of their customers.

# TRADITIONAL BANKS CAN START DIGITAL BANKING PLATFORMS

Banking is becoming open and quite a few business analysts and other industry experts expect new fintech banks to emerge and disrupt traditional banking. Currently we are in the middle of the first wave of fintech. New companies compete with banks on specific products: loans, payments, foreign exchange and remittance, wealth management and many more. Banks are pressurized by these newcomers, but certainly not pushed out of business. New companies in the first wave of fintech even rely on traditional banking infrastructure and mainly improve on things like the user experience, user interface and business models. They are in competition with the traditional banks; they disrupt a bit but they also bring in new business for the banks, for example, when a bank decides to act as a business incubator for innovative startups or flat-out buy a successful fintech player to improve on their customer experience.

In two to five years however, fintech banks are expected to emerge and disrupt traditional banking. This is the second wave of fintech. Marketplace or fintech banks will be based on a few simple elements: a digital banking platform built from scratch, an API layer to connect to third parties, a compliance/KYC infrastructure and processes, a banking license and a CRM system. It will only offer 'core' services and rely on third parties for all other services, including traditional banks, financial institutions and fintech companies. This future vision is, to say the least, not very reassuring for traditional bankers. But the thing is: it doesn't have to be this disruptive. Traditional banks can ride or even initiate the second wave of fintech themselves. They can build their own digital banking platforms and facilitate marketplace banking. They can develop their own models or buy and finance them according to pay-per-use principles.

Future banking can be organized with banking verticals that look like Salesforce but for banks, with automated, compliant processes on the inside. Last year, Gartner observed that the early adoption of open banking strategies and technologies has already occurred, but early mainstream adoption is just beginning. However, many of these strategies and technologies will become mainstream within the next two to five years. Numerous banks have started with internal APIs to form a solid foundation to begin using APIs externally. A few even purposefully created third-party ecosystems, examples being BBVA and Citi. Banks like these run hackathons and/or act as fintech accelerators to speed up the realization of these marketplaces. The second wave of fintech can be as cooperative as the first wave - or even more so. A digital banking platform can even include multiple banks, with bank X products and provider Z services.

# WHAT IS HOLDING BANKS BACK?

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Seen from the bankers' perspective, we are moving towards an environment that is fast and agile, running in the cloud, where on and off-boarding of new services is lightning fast. What is stopping banks from starting with it today? Well, many will see the launch of this marketplace bank as too disruptive for their current processes and business models. Or they are afraid of cannibalizing their portfolio of services. But the reality is, marketplace banking is inevitable. All technological elements are already available and it is only a matter of time before someone is willing to take the risks, find the right investors and put in the hard work needed to establish a fully-fledged fintech bank. As a matter of fact, it is be happening right now.

Evolving into a marketplace bank means mitigating several obstacles. For one, there is a cultural element to it where fintech is sometimes seen as a threat. Regulations and demands on compliance play their role and there are the matters of security, organizational impact and legacy systems. Current banking systems often rely on old technology and these systems have to perform tasks they were never built for. With a more modern system, this problem disappears. Banks realize this but continue putting new layers on top of their old legacy systems. It's a bit like putting lipstick on a pig. It may look shiny and new, but it's still a pig. What the customer never sees is the outdated technologies and systems banks have to combine in order to offer him/her a 'modern' experience. As a result of traditional paradigms, bank backoffices have become monumental megaliths; inflexible high-maintenance conglomerations on diverse architectures that are barely capable of keeping step. Traditional mid-office services and the front-office have fared little better. For example, front-office systems have become, after two decades of rapid customer channel evolution, a chaotic and labyrinthine mess of unrelated channel interfaces.

This should be - and can be - different. Banks can operate with a lean back end, with automated and compliant processes. With the needed knowledge available in the market, they can implement, test and deploy new systems. They can become agile again - the launch time of new products and processes will go from months to weeks - and survive or even dominate the fintech banking era. They will develop a 360 view on customers and the means to give them better products and processes and a more satisfactory experience through their API environment. Banks do have a choice. Do they want to continue doing everything in their own walled-in environment, or do they want to go wherever the customer goes?

# INVESTMENTS ARE NEEDED

Digital banking initiatives will fail without strategic investments in emerging technologies.

Gartner signals, new, open, unified digital banking platform providers who offer new technologies. With these technologies, transactions are not limited to a specific channel but can be delivered with an optimal customer experience, depending on their device of choice.

However, Gartner Industry predictions for 2016 and beyond contain some alarming findings.

“Despite the significant ongoing activity in financial technology (...) it is not clear that financial institutions are broadly prepared for digital banking” is one of these key findings. The analyst firm also states that the acquisition and investment in disruptor providers does not guarantee digital banking success: “Bank CIOs must leverage them to transform banking, not just put a prettier face on it.”

Are fintech banks inevitable and will they replace the current bank dinosaurs?

Will they eventually rule the banking world? It may very well be the future, but it hasn't been decided yet. Whether or not the business model of marketplace banking will emerge is pretty much a no-brainer. Analysts expect digital banking with open banking APIs to become commonplace in a few years time – that's just around the corner. And it's not hard to foresee a future where this new type of bank will rule the waves. What the industry will look like – the landscape and the players – is hard to say right now, but we can safely assume that the players will be those who handle the second wave of fintech and marketplace banking the best.

# EXTERNAL SOURCES USED FOR THIS WHITEPAPER INCLUDE:

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- “Why Fintech Banks Will Rule The World”, by Phillippe Gelis, co-founder and CEO of Kantox
- “Hype Cycle for Open Banking APIs, Apps and App Stores, 2015”, by Kristin R. Moyer (Gartner), published on July 6th, 2015
- “Predicts 2016: Digital Banking Initiatives Will Fail Without Strategic Investments in Emerging Technologies”, by Stessa B. Cohen (Gartner), published on November 16th, 2015



# HOW TO BECOME A TRUE MARKETPLACE BANK

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Five Degrees Matrix acts in a banking landscape as an orchestrating hub between channels, back-end systems and the fintech eco system. Matrix enables banks to easily connect to 3rd party fintechs/banks to provide additional services and products to their own clients. On the other side, Matrix open architecture also provides banks with the opportunity to provide their own products and services to other banks or financial services distribution platforms, allowing them to become a true Marketplace Bank in an interconnected network of product and distribution players.

Matrix is a Digital Core Banking Platform that offers functionalities that any modern financial services operation needs independent of their client segments, products and services. Matrix enables marketplace banking, supports regulatory requirements like PSD2 and GDPR, and fully unlocks the potential of the fintech ecosystem.

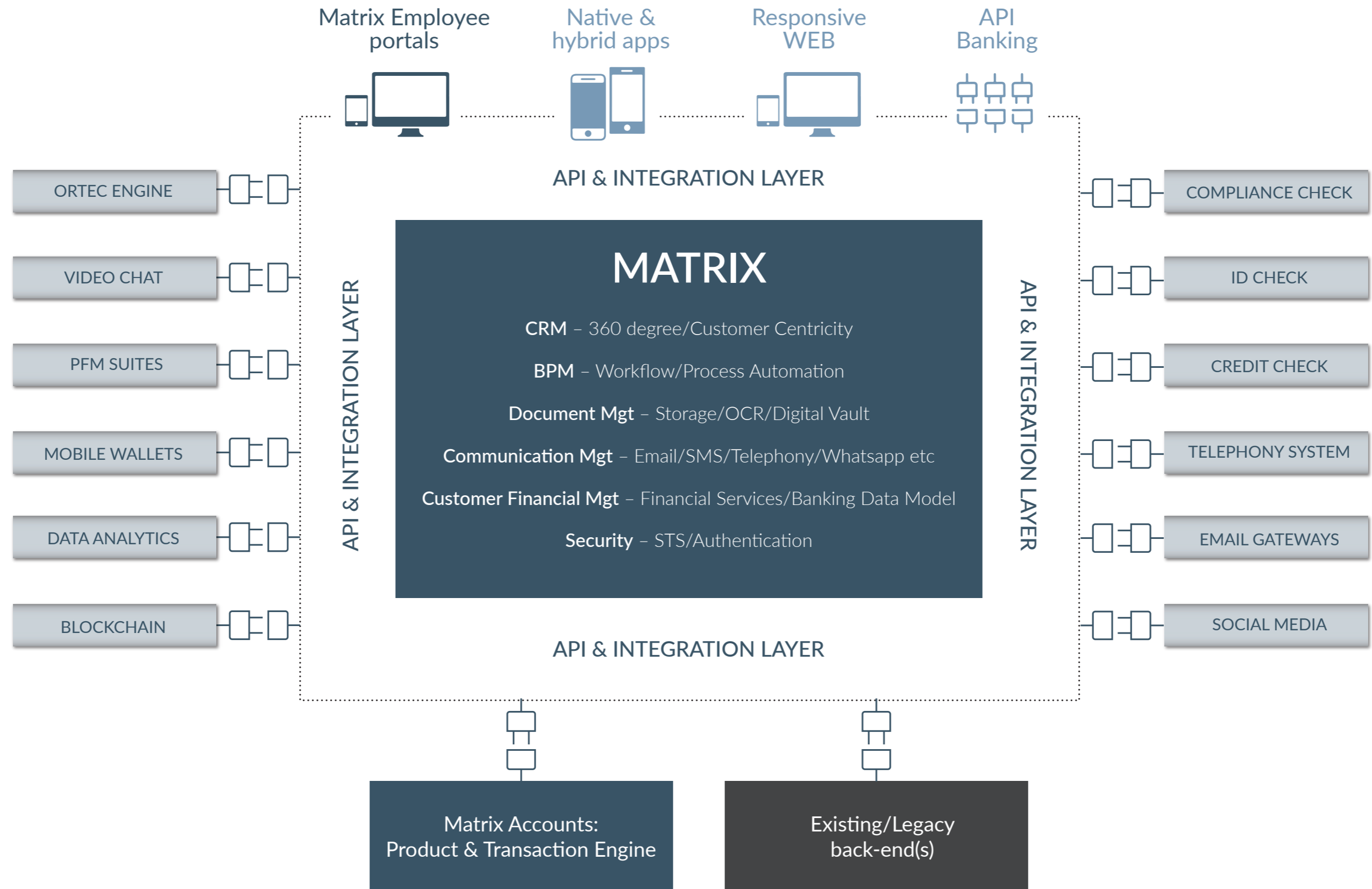
Matrix connects to any (legacy) core banking system, to provide true agility, responsiveness towards the market requirements and an excellent Digital CX. Matrix can also replace the legacy core with a lean & mean product and transaction engine for achieving a full Digital Transformation.

Matrix can be implemented – on site or hosted – in short, focused projects to bring fast returns and reduced risk.

**The following solutions can be built for retail,  
private wealth and SME banks within 3-9 months:**

- Marketplace and Open API Banking
- Robo Advice
- FX Trading & Payments Platform
- Lending (Retail & SME)
- Savings & Deposits

All the solutions are applicable for greenfield or incumbent organization in Retail Banking, SME Banking and Wealth management.





Please contact [sales@fivedegrees.nl](mailto:sales@fivedegrees.nl) and learn how you can transform to a Marketplace Bank and to seize the opportunities that comes with it.

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