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Sibos Issues

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In today's fast-changing and unpredictable business environment, it's important to engage with experts and peers on strategies for success. With just a few months of preparation left, we're working hard to ensure Sibos 2016 provides delegates with informed debate and networking opportunities to help them handle their ever-evolving challenges.

Best wishes
Sven Bossu, head of Sibos

IN BRIEF

Sibos 2016 tackles key industry challenges

Geneva's Big Issue Debates focus on banks' role in digital economy

SNB chair Jordan to open Sibos 2016

Swiss 'solar' explorer Piccard to close

In an increasingly digital economy, what kind of services should the banking and financial services sectors be offering to customers? And how should they leverage technology innovation to deliver value?

These are among the most urgent questions facing the industry and as such will be discussed throughout Sibos 2016 in Geneva – but in particular during the key plenary sessions. To help

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Thomas J. Jordan, chairman of the governing board of the Swiss National Bank

BANKING

A new era for payment providers

#Payments #Technology

How will PSD2 re-shape Europe's payments market?

Payments innovation has led to significantly greater convenience and choice for customers in many European markets, but the benefits have been unevenly spread. Whether facilitated by national schemes, such as Sweden's Swish or the UK's Faster Payments, or driven by new products and services introduced by innovative payment institutions to address the needs of a particular market segment, payments are becoming faster, cheaper, more flexible, and more transparent. Indeed, the pace of change has outstripped the 2007 Payment Services Directive that opened the door to much of the recent payments innovation in Europe.

As such, a new directive, PSD2, has been drafted to update Europe's regulatory framework for payments from 2018. PSD2 will introduce two new categories of third-party payment provider (TPP) – account information service providers (AISPs) and pay-

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A new era for payment providers

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ment initiation service providers (PISPs) – as well as detailed rules governing how they interact with existing payment institutions and their customers. PSD2 also includes rules on card surcharges, transparency and security. Alongside other pan-European initiatives on interchange fees for card payments and security for internet-based payments, PSD2 represents a new region-wide effort to improve the payment service user experience through innovation and competition.

What will the post-2018 European payments market look like? Merchants will be attracted by the services of PISPs, which should make online payments simpler and cheaper, while multi-banked customers – individuals, corporates or institutions – are offered the opportunity for greater visibility and control of their account balances by AISPs. But with many of the details still being drafted by the European Banking Authority (EBA), which has been mandated to deliver five sets of guidelines and six regulatory technical standards (RTSs), the rules of engagement have not been finalised. As such it is hard to say what kind of payment institutions will thrive.

Easier entry?

Tuomas Toivonen, co-founder of Holvi, a payment services provider serving SMEs in Finland, Germany and Austria, suggests PSD2 will stimulate competition and give both new entrants and incumbents a clear, common basis for new relationships and services. "Once PSD2 comes in, new entrants will find it easier to establish the relationships with banks to underpin new payment aggregation and initiation services. Although such firms will be able access and extract the information required to deliver new services, the underlying banks will still be visible within the payment chain, which prevents them from offering services on a white label basis," he explains.

Should banks engage with new service providers or compete with them? According to Toivonen, both options are on the table, and they're not mutually exclusive. Persisting with traditional models, however, may be more challenging. "PSD2 will force banks to reconsider their core strengths. The directive makes it easier for smaller firms to leverage infrastructure to meet the needs of niche markets with highly targeted services. In this era of micro-customisation, it will be much harder for banks to preserve their existing universal models," he adds. "Instead, they may be better off choosing in which niches they want to compete, or focus on infrastructure services, becoming a service provider to a range of customer-facing firms rather than end-users."

A number of established payments banks are investing in the development of new services to existing customers, as well as forging links with a new customer base. Damian Richardson, head of innovation and strategic initiatives for payments services at the Royal Bank of Scotland, expects an incremental shift in customer behaviour rather than an overnight overhaul in the payments market in 2018, but he suggests banks should be positioning themselves now.

> **Working with developers is very different to serving retail, corporate or institutional clients.**
>
> **Damian Richardson,** head of innovation and strategic initiatives, payments services, Royal Bank of Scotland

"Already, we have begun to see the emergence of app-based services that embed the tools and capabilities of other offerings. This could be the future model for banks, which can provide the payment functionality within a range of niche retail apps. To do this, banks must adjust to serving a new kind of client: working with developers is very different to serving retail, corporate or institutional clients," says Richardson. "In the short term, however, there may be a mixed approach, with banks providing payment tools and services to the end-user, whilst also collaborating with developers. For us, the aim is to put in place the capabilities that will enable us to have strategic options in the future."

The Royal Bank of Scotland has been establishing links with the developer community while also supporting the creation of new services via a series of 'hackathons'. The bank has also gained valuable experience of linking to third parties via API connectivity with FXmicropay, its multi-currency FX pricing service. Moreover, Richardson believes the fruits of innovation will not be confined to the consumer market.

"For many corporates, the key to improved cashflow management and visibility is real-time availability of data, which is one of the aims of PSD2. Consumer payments services have leveraged digital technologies more quickly, and now corporate treasurers will benefit too," he says.

> **In this era of micro-customisation, it will be much harder for banks to preserve their existing universal models.**
>
> **Tuomas Toivonen,** co-founder, Holvi

Regulatory scrutiny

As banks and TPPs position themselves for the post-PSD2 market, many will be paying close attention to regulatory developments. As part of its efforts to deliver RTSs by January 2017, the EBA issued a discussion paper on strong customer authentication and secure commission in December 2015, and is due to publish a follow-up consultation paper over the summer, outlining its response to industry feedback and proposals for the final standards. The ensuing RTS – which is directly applicable once adopted by the Commission, without further national legislation – will define how payment institutions communicate, collaborate and compete.

"In the Eurozone, the Single Euro Payments Area already provides a common technical standard for payments, but for firms looking to offer services in the UK, Nordics or other non-euro markets, which run separate payment schemes, the details of the EBA's RTS for PSD2 will be important in harmonising payment initiation mechanisms," says Holvi's Toivonen. "If the RTS allows a certain degree of flexibility at the national level, firms that want to offer services across European borders may have to navigate variation across local markets or rely on payment initiation aggregators. On the other hand, initiatives such as the UK's Open Banking Working Group could provide the framework for developing standards to meet specific needs within national markets."

> **Insufficiently detailed standards for interfaces between banks and TPPs could lead to a scenario whereby industry develops numerous technical solutions.**
>
> **Dr Dirk Haubrich,** head of consumer protection, financial innovation and payments, European Banking Authority

Having received more than a 100 responses to the initial discussion paper, Dr Dirk Haubrich, head of consumer protection, financial innovation and payments at the EBA, acknowledges the difficulties the regulator faces in meeting competing priorities.

"The RTS on strong customer authentication and common and secure communication, which PSD2 specifies will apply from October 2018 at the very earliest, requires us to strike a balance between competing demands. On the one hand, providing standards that enable common and highly secure communication between banks and TPPs would imply a great level of detail and prescription in the RTS. On the other, allowing scope for the possible use of innovative and improved technologies in the future would imply a much less detailed RTS," says Haubrich. "A further consideration is that insufficiently detailed standards for interfaces between banks and TPPs could lead to a scenario whereby industry develops numerous technical solutions, all of which would be compliant with the EBA's high-level RTS. However, this could lead to high levels of fragmentation – perhaps geographical, but also by sector – which could be used by incumbents to thwart access by new entrants, thus limiting innovation and competition."

By Sibos 2016, the EBA will have released its consultation paper, which will undoubtedly further fuel debate among payments experts in Geneva. With PSD2 due for phased introduction in 2018, there is still time for banks and other payments providers to finalise their strategies for an even more competitive European payments market – but the countdown has begun. ■

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Adoption, not disruption

#Technology #Innotribe

Pierre Maudet, member of the executive council of the state of Geneva in charge of security and economy, explains how banks, FinTech startups and government agencies are working together to create an innovative finance sector in Switzerland which nevertheless leverages traditional strengths.

Sibos Issues: **Switzerland is a pioneer in financial services, for example launching Europe's first real-time payments system in 1987. What can Switzerland bring to the financial community in 2016?**

Pierre Maudet: I believe that Switzerland has the potential to emerge as an innovation driver in the FinTech segment, given the presence of global banks and a highly competitive information and communication technology infrastructure. Thanks to its excellent reputation for responsible data handling, Switzerland is particularly well-positioned to become a prime location for 'big data' management centres. The Swiss banking tradition also brings added value to clients, becoming increasingly connected thanks to its continued focus on providing a tailor-made service for all clients, via the latest technology or the still-trusted face-to-face discussion.

SI: **In March, it was announced that the Swiss Financial Market Supervisory Authority will amend certain regulation to support FinTech growth, including a 'sandbox' for startups, which is exempt from licensing requirements. What do you see as the key measures needed to help Switzerland grow as a FinTech hub?**

Maudet: The 'sandbox' is a great first step from a technological and regulatory point of view. Together with a lighter licensing procedure for FinTech companies, it will help both private and public partners to rapidly understand the specific requirements needed for FinTech initiatives to prosper in Switzerland.

We still need to do more to encourage dialogue between regulators and innovators to ensure we are facilitating innovation. We are supporting the adoption of a common API (application programming interface) which would allow new services and technologies promoted by startups to be connected to existing banking systems. In the public sector, we cannot determine which API has to be chosen, but our role is to promote an efficient relationship between the key players in the industry and to ensure the general framework conditions are in place.

These initiatives (the sandbox and the API) will naturally lead to a more friendly environment where government, traditional banks and startups will be able to collaborate on adapting or changing the rules in a cooperative manner, managing the inevitable transition toward increased innovation in the finance sector.

SI: **How do you think banks and startups can best work together to leverage new technologies?**

Maudet: As noted, the role of government is to ensure that all parties are involved in a collaborative approach. Banks are realising that FinTech innovations are inevitably modifying relationships with customers. Banks are aware, especially in Geneva where developments are less disruptive and more B2B-oriented, that startups are not only competitors. In fact, most of the time, startups are real partners to the banks in the field of innovation, while the banks are the first clients of the FinTech startups.

In a small market such as ours, startups understand they have to partner with banks to access the market, and banks on the other hand realise that startups provide access to new generations of clients, as well as specific innovative competencies they don't have.

Unlike in the past, I believe that the most suitable word to describe the FinTech wave rolling over us should not be 'disruption', but rather 'adoption'. This would lead to an inclusive FinTech environment, rather than an exclusive one, and the outcome would be a win-win situation for all involved.

> **Switzerland is particularly well-positioned to become a prime location for 'big data' management centres.**
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> **Pierre Maudet,** minister for the economy, state of Geneva

Adoption, not disruption

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“The role of government is to ensure that all parties are involved in a collaborative approach.

Pierre Maudet, minister for the economy, state of Geneva

SI: How is the Swiss finance sector evolving in response to the regulatory, competitive and technological changes of the post-crisis era?

Maudet: The World Economic Forum's Global Information Technology Report 2015 places Switzerland among the 10 nations that are best equipped to face the technological evolution. The Swiss finance sector is founded on a solid tradition, but at the same time is open-minded and flexible, enabling it to meet the changing requirements of new regulations and technological issues. Swiss banks are investigating the potential of blockchain technology to overhaul existing banking infrastructure, speed-up settlements and streamline stock exchanges.

SI: What are the key challenges/ priorities in ensuring the Swiss finance sector continues to thrive in the medium to long term?

Maudet: Defending the competitiveness of the national and local finance sectors, expending market access, improving the regulatory process and promoting innovation are the current priorities of the Swiss finance sector. The banks are continually working on the growth drivers of tomorrow. A number of measures have seen significant progress in the last years, such as strengthening asset management, establishing a renminbi hub and promoting the ideal framework conditions for a digital ecosystem.

SI: How is the role of policy-makers and regulators evolving in ensuring the stability and success of national finance sectors?

Maudet: Investors from all over the world value the transparency and reliability of Switzerland's economy and regulatory framework. Its stable political structure, robust parliamentary democracy, reliable legal system and well-governed domestic institutions boost the attractiveness of its economic environment. In order for the Swiss financial centre to remain competitive, banks, politicians and the authorities work together to achieve the best possible framework.

SI: What are your priorities for the finance sector as minister of the economy for Geneva?

Maudet: Geneva has 500 years' experience in financial services. Over this time, the sector has regularly had to adapt to new situations. We see some very deep changes, such as digitisation, affecting many industries at the moment. Clients are evolving, together with their expectations. Technologies are rapidly evolving, offering new opportunities. My priorities are in line with those of the financial sector; we have to defend this crucial sector for our prosperity. We are convinced that bankers will continue to be needed in the future and we look forward with confidence to tomorrow's financial evolutions. ■

At Sibos 2016, the exhibition will feature a lounge dedicated to promoting the Swiss FinTech sector. For more details, see the Monday preview edition of Sibos Issues.

Re-assessing the risks

iStock

Data # Blockchain # Technology # Financial Inclusion

Serving low-risk clients in high-risk markets is made harder by financial crime compliance obligations, but not impossible.

Financial crime compliance is very different from the political processes that give rise to the rules and sanctions lists with which banks and others must comply. It is as unequivocal as a light switch: there is no gradual withdrawal of darkness, nor partial application of light. "Compliance is not negotiable," says Jochen Metzger, head of department, payments and settlement systems, Deutsche Bundesbank.

In the context of geo-political shifts, financial crime regulatory requirements are continually reshaped by events, but the obligation on banks to comply is constant, fixed and immovable.

Political leaders express goodwill towards former ideological adversaries; diplomats negotiate partnerships with once-hostile counterparties. But where sanctions apply, they remain switched on until they are switched off. "In high-risk jurisdictions, a high quality of compliance standards and their application are the crucial factor in the decision process whether business in the end will be conducted or not," says Metzger.

For international banks, de-risking options are very much on the agenda, including the ultimate don't-go-there option, which might be understandable from any individual bank's perspective, but is politically unacceptable if pursued collectively. Increasingly, the question is: can technology help banks to comply with regulations while also profitably serving low-risk customers in potentially volatile, high-risk markets? And if technology holds the key, what role does risk management play, from an overall governance perspective and on the ground?

New models, new technologies

In compliance and in banking more generally, technology is only an enabler, albeit a critical one. Compliance is not just a matter of implementing technology, however many systems, solutions and frequent upgrades it might require to keep within the rules. At the same time, changing business and risk models and emerging payments methods open up new opportunities, rendering existing remote markets more accessible. Advances in technology help make these new business models possible: more transparent transaction chains – enabled by technology innovations such as blockchain – can enable banks to nurture client relationships they might previously have shied away from.

But the compliance obligation – at the risk of repetition – doesn't change. "Independent of underlying trends in business models, legal requirements need to be applied properly. Compliance processes and their proper application must not be left behind due to innovations and possible disruptive trends," Metzger adds.

The evolution of financial crime compliance practice by banks can be viewed positively. "Compliance adds real value. It protects reputations and saves lives. If your anti-money laundering/counter-terrorism financing efforts catch something, think about what you might have prevented," says

Stuart Weinstein, professor at the Faculty of Business and Law, Coventry University, and author of the International Securities Services Association's study on 'Transparency in Securities Transactions and Custody Chains'. Weinstein argues that financial crime compliance is a "societal responsibility" for individual banks and the wider banking industry alike – a responsibility that is shared by regulators even more than it is overseen by them. This suggests we all have a role in maintaining compliance. But Weinstein goes further: "International banks and the whole banking system are an essential infrastructure. Banks can't cut out whole sections of the globe from the international market. They have to find better solutions than that."

Opportunity cost

An analogy: if you're getting burnt, withdraw your fingers from the stove. It is wholly rational – and compliant – to address "extremely big penalty risk" by withdrawing from relationships, and indeed, from whole markets – Somalia, for example. Cutting out whole sections of the globe, as Weinstein puts it, is an extreme form of de-risking, and in the short term, it does indeed amputate a whole set of risks. But to sever an array of relationships, to withdraw from a geography, is not only to cut off today's dialogue; it is to put

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> **Jochen Metzger,** head of department, payments and settlement systems, Deutsche Bundesbank

Re-assessing the risks

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the phone down on tomorrow's potential, which may be harmful to future profits, more so to political stability. "As banks de-risk, people invest less in their due-diligence processes and they invest less in their correspondent-banking relationships, and it really should be the other way round," says Weinstein.

For banks unwilling to accept the opportunity costs inherent in extreme de-risking Weinstein highlights possible ways forward. "International banks and their correspondents have to work together. Blockchain technology has the potential to introduce transparency throughout the transaction; payment-screening processes and the use of greater information helps as well. Data analytics is very promising," he says – concluding with the suggestion that a "good-faith standard" backed by technology-enabled transparency and mutual understanding may be more effective than today's strict-liability standard.

Consulting Group McKinsey & Company put out a paper in January 2016 – 'A best-practice model for bank compliance' – that gives an interesting slant on de-risking. The paper's authors, Piotr Kaminski and Kate Robu, director in McKinsey's New York office and principal in the Chicago office

respectively, argue for "active ownership of the risk-and-control framework" alongside "integration with the overall risk-management governance, regulatory affairs, and issue-management process". The paper makes a very neat point: "Compliance risks are driven by the same underlying factors that drive other banking risks, but their stakes are higher in the case of adverse outcomes … Therefore, it's only fitting that a modern compliance framework needs to be fully integrated with the bank's operational-risk view of the world."

In the current environment, compliance considerations are inherent in the business of banking. But if improvements in technology and processes allow banks to engage with risk rather than stepping away – even where that might seem the prudent move – how do we exploit the opportunities while avoiding the pitfalls? Beyond core compliance, what are the next steps to safely banking low-risk clients in high-risk jurisdictions?

Risk and reward

For reasons of politics and profits, banks must be able to support sound business cases when the appropriate opportunity arises. "In principle, it should be possible for correspondent banks to safely bank low-risk clients in high-risk jurisdictions. However, the underlying risks involved need to be addressed

> **"Banks can't cut out whole sections of the globe from the international market. They have to find better solutions than that.**
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and minimised by applying compliance standards and requirements accurately. Compliance and its proper application may not only add value to an evolving correspondent model, but in the end may be the key to conducting business successfully at all," says Metzger.

Compliance requires engagement, and engagement requires communication, and ultimately, the determinant of successful compliance is the communication of best practice down to the local level. As well as enterprise-wide risk management policies and processes that are coordinated and calibrated to the bank's overall risk appetite, this 'risk-sensitive' approach to financial crime compliance also demands education, if not enterprise-wide then certainly at several levels within the bank, especially for client-facing staff. While bank staff need constant education in understanding and identifying the different types of risk that new clients and markets represent, they too can be the educators. As a compliance culture evolves and takes root within banks, and the understanding of compliance obligations become embedded, there is also an opportunity to educate local clients on how to comply with sanctions and identify behaviours and patterns consistent with criminal activity.

We have the technology and the will. We can, as Weinstein suggests, save lives. So, is it time to take the more extreme de-risking options off the agenda of effective compliance? Do we have the skills and the tools to achieve the levels of engagement needed to safely bank low-risk clients in high-risk jurisdictions? Given the penalties for non-compliance, it's a judgement every bank must weigh seriously and continuously. "The solution to that one," Weinstein says, "is the customer-relationship person at the local bank. Every day, people who work in those banks have to deal with these situations; every day, they have to rely on their gut sense, which is usually right. They're the unsung heroes of compliance." ■

Sibos 2016 tackles key industry challenges

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delegates formulate their own positions, experts and industry leaders will share their views and experience, examining these core issues from every angle in a series of five big issue debates.

The tone for the week will be set in Monday's opening plenary, during which Thomas J. Jordan, chairman of the governing board of the Swiss National Bank, the central bank of Switzerland, will provide his perspective on the current state and future of the financial industry. Having spent almost a decade on the SNB's governing board, as well as holding positions on the Bank for International Settlements, the Financial Stability Board and the International Monetary Fund, Jordan is well placed to talk about both Switzerland's financial evolution and that of the global industry.

Further depth will be added to the debate by five further keynote sessions throughout the week, focusing on the following themes:

Future of money

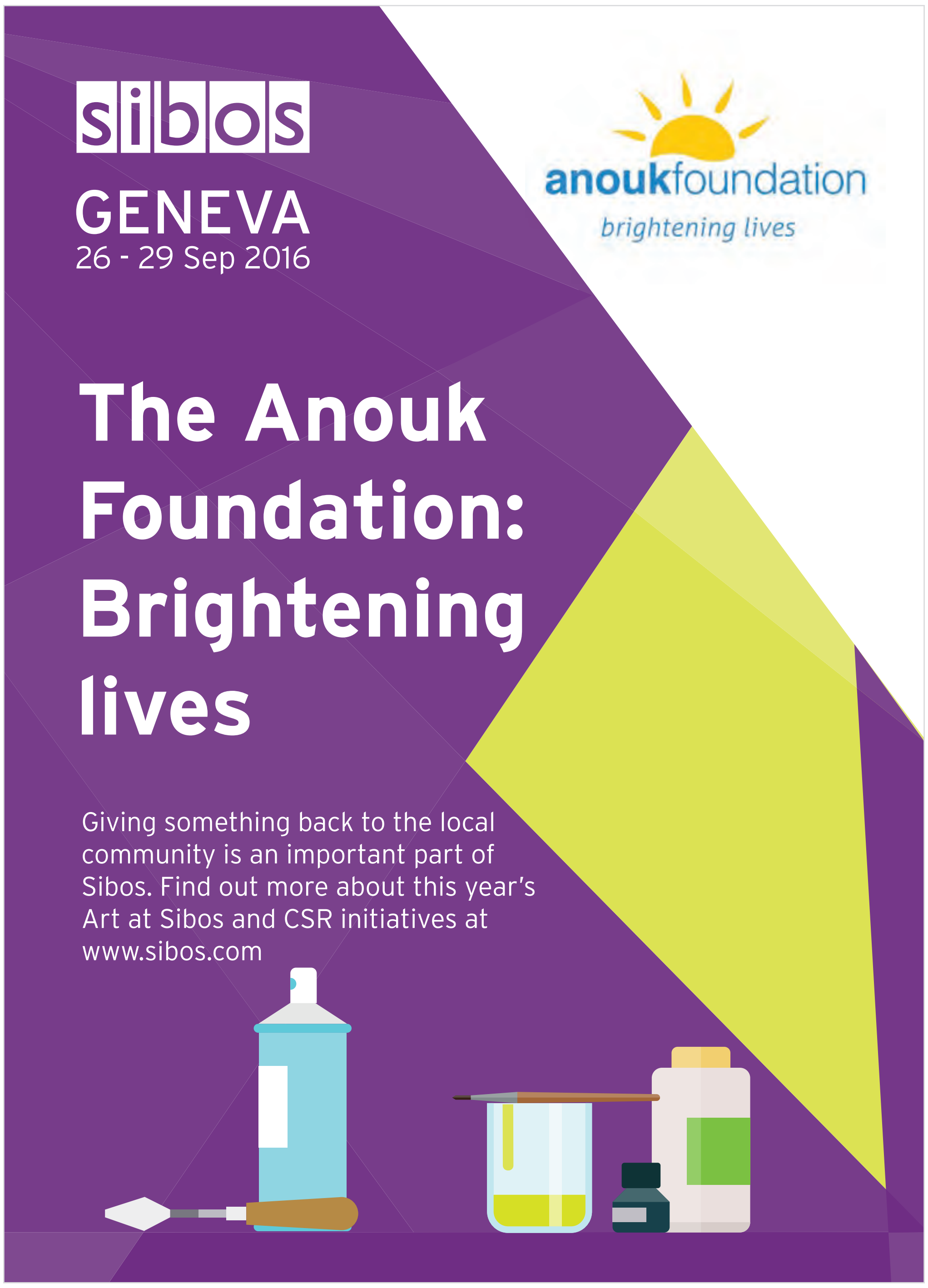
Sibos' traditional 'crystal ball' session considers interconnectedness this year and the role of financial services in a world where 'everything talks to everything' and, increasingly, machines take decisions. The scale, speed and transparency of the emerging real-time economy ask some fundamental questions of traditional concepts such as ownership and management of assets, property and rights. This session will highlight the path to at least some of the answers.

Financial stability

Rebuilding economic confidence while restructuring the finance sector in the aftermath of the global financial crisis has been the primary concern of policy-makers for almost a decade. Panellists in this session will comment on how policy-makers and regulators should manage the tensions between these twin objectives, as well as the potential strategic response of financial service providers – traditional or otherwise – in meeting the individual needs of customers and the collective need for stability and growth.

Cyber-security

The digitisation of banking carries with it a profound and evolving threat from a range of sophisticated, highly-organised and well-trained cyber-criminals. With all elements of the financial services industry under threat, skilled staff are being deployed, budgets are rising exponentially and collaboration between firms and with law enforcement agencies is increasing in breadth and scale. This session examines the practical and strategic approaches that banks and other financial institutions should pursue to protect themselves and their clients, while gathering counter-intelligence to catch the perpetrators.



> **There is now a greater need for financial decision-makers who have the ability to deal with the unknown.**
>
> **Bertrand Piccard**

Cognitive business

As banks and their customers operate in an increasingly digital world, cognitive systems and intelligent automation have the potential to transform every aspect of commercial activity, from client interaction to supporting back-office processes. The long-term implications of 'going digital' are neither widely understood nor set in stone, making this panel of banking and technology experts a keenly anticipated event.

Disruptive innovation

Having initially seen start-ups as a threat, banks have fuelled the FinTech boom through engagement, collaboration and investment, with the aim of bringing new ideas to market, and delivering greater value to existing and new customers. This session will see leaders from the financial, technology and FinTech ecosystems focus on the impact of technology on the financial industry, examining both the benefits being brought to end-users and the capacity to change how we do business beyond technology investment cycles.

This year's Sibos will close with a session that places the challenges facing the finance industry in context of those facing the wider world. Swiss psychiatrist, environmentalist and explorer Bertrand Piccard hit the headlines last year when he piloted a solar-powered aircraft from California to Abu Dhabi. In closing Sibos 2016, Piccard aims to share his experiences in deploying resource-efficient technologies with fellow explorers from the finance sector. "The global financial system, which is essential to the economic development of mankind, is undergoing a rapid evolution, and facing fresh challenges. There is now a greater need for financial decision-makers who have the ability to harness disruptive forces, and to deal with the unknown," he says. ■

The allure of disruption

Innotribe # Blockchain # Data # Technology

Banks can take advantage of disruption patterns, but the cultural change involved requires a nuanced approach by their leadership.

> **Pick areas of exploration away from the core, because they can be pretty disruptive.**
>
> **Val Srinivas,** research leader for banking and capital markets, Deloitte Center for Financial Services

Disruptor or disrupted? Financial services firms are determined to avoid being the latter. However, the operational straitjacket of regulation (not to mention legacy systems, structures and fiefdoms) often stifles attempts at being the former. With FinTech firms stepping up to offer new models for conducting traditional business, banks are in danger of being wrong-footed or outpaced by newcomers looking to disintermediate incumbent firms.

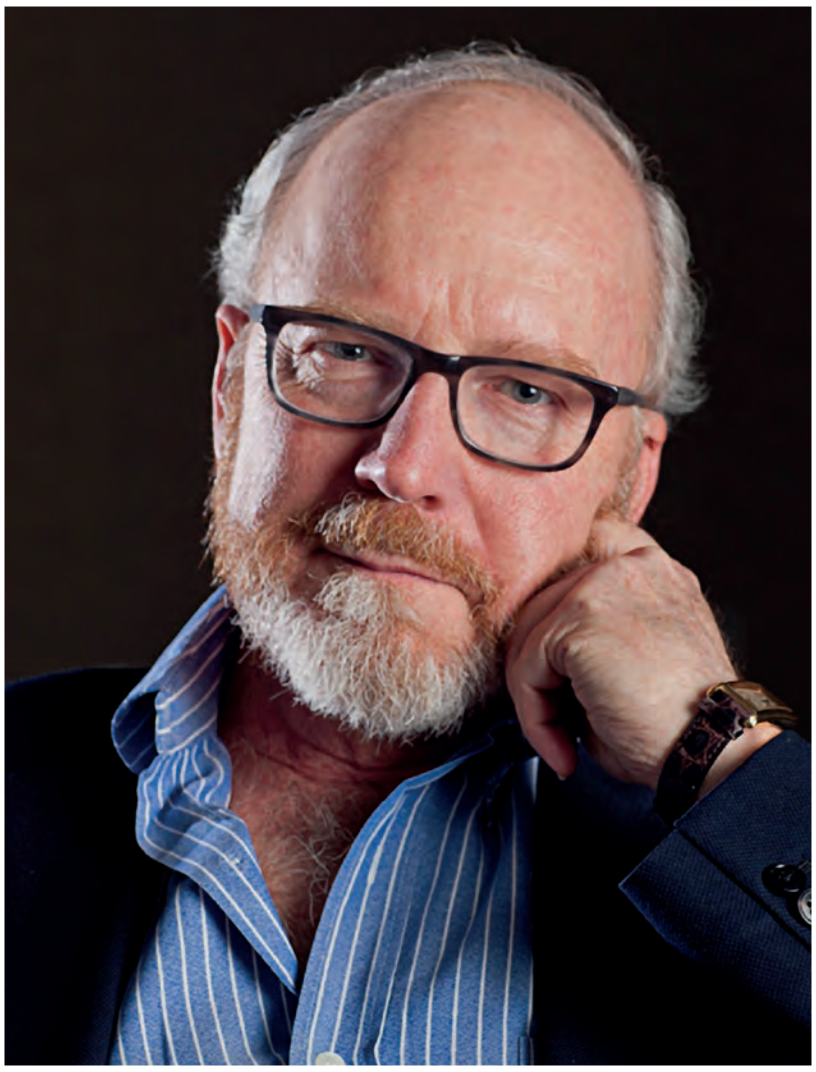
"The worst case scenario is they get displaced and are no longer leading incumbents," says John Hagel, US-based co-chair of Deloitte's Center for the Edge. "They will not close up shop, but will they be leaders in the relevant market segments? No."

In a recent paper, entitled 'Patterns of Disruption – Impact on Wholesale Banking', Hagel and Val Srinivas, research leader for banking and capital markets at Deloitte's Center for Financial Services, outlined the effect of digital transformation and a long-term public policy shift towards economic liberalisation – which they term the 'Big Shift' – on banks and other financial service providers.

Responding to disruption is no easy task for banks in the current market environment. Almost all banks are under considerable pressure to increase profitability and reduce costs. Investment banks saw return on equity in 2015 fall to somewhere between 6% and 6.7% according to industry estimates, down by some 30% on the previous year. Capital adequacy requirements have led banks to reduce risk-taking activity considerably.

For less capital-intensive activity in the retail and wholesale markets, low or negative interest rates are crushing margins. Wholesale banking has been a solid business for many banks in post-crisis markets, yet an increased emphasis on know-your-customer requirements, risk management and transparency is adding to costs. All the more reason for banks to take control of the situation.

"There is no question that it's challenging; the regulatory environment imposes a lot of constraints on activity," says Hagel. "Having said that, banks often use regulation as an excuse for not acting; within limits, there are things they can start to do in certain areas, starting to build more focus or revenue around a certain type of product or service and demonstrate to the regulators that they are doing this in a responsible way. Over time that gives more latitude to pursue those opportunities."



From push to pull

The uncharted waters in which banks now swim make traditional 'push' models for resource mobilisation inefficient, Hagel and Srinivas argue, as they require a clear demand forecast to determine which resources should be pooled. Uncertain markets require a 'pull' model to be adopted, in which a range of potential resources are identified and made accessible, so that they can be pulled together as and when they are needed.

Responding to the disruptive approach will not be easy, the pair acknowledge, and may require firms to cannibalise existing current revenue, write off assets on the balance sheet and rethink key assumptions about what delivers business success.

Other industries offer examples of the risk that disintermediation poses. Over the last ten years, firms like Apple, Netflix and Amazon have taken pole position in the digital-only entertainment businesses, winning market share from established firms with both technology expertise and licencing rights such as Sony and AOL Time Warner.

There are already clear incursions into the wholesale banking space by non-banks, not necessarily from FinTech startups. Cash-rich corporates are funding supply chain partners and asset managers are moving into short-term funding of trade finance. The Financial Stability Board estimates shadow banking assets grew by over 10% to reach US$36 trillion by the end of 2014.

To avoid disintermediation, banks can learn to take advantage of patterns of disruption. According to Hagel and Srinivas, these break into two main groups: the transformation of the value/price equation via a "radical redefinition" of product, pricing and processes; and the "unleashing" of network effects. Three specific patterns are useful to the wholesale banking business.

The first of these is the expansion of market reach. By deploying platforms that help to connect fragmented buyers and sellers, working 24/7 and globally, firms can work with smaller players particularly in specialist products and gradually build critical mass.

The second pattern that banks can use is to turn products into product platforms, based on a foundation of core functionality that can subsequently be built upon by third parties in order to provide tailored services that more directly meet customer needs.

The third pattern, that of connecting peers, is more speculative, according to Hagel and Srinivas. With a focus on the benefits of "greater speed and lower cost in transactions", a practical example is the use of distributed ledger technology in order to reduce the number of intermediaries in the transaction lifecycle. Subsequently, greater access to data about transactions can enrich learning about activity that creates more value over time.

From theory to practice

These may appear attractive models to follow in theory, but the existing set of constraints and priorities can make them difficult for banks to put into practice. Adopting large-scale change is beyond most firms, given the cost and complexity involved, and the existing operational burdens they face. Srinivas recommends a cautious approach. "Pick areas of exploration away from the core, because they can be pretty disruptive and you will see a lot of 'antibodies' coming at you," he says.

Cultural change will also be necessary if firms are to move away from a focus in the quarterly view, targeting instead the successful execution of a longer term strategy.

"How do you model the incentive structure to ensure that everybody is onboard and they are willing to look at more the long-term implications and the big picture?" Srinivas asks. Although that is a universal problem, it can be more problematic in businesses such as finance given the nature of existing incentive structures.

"We counsel clients that small moves, smartly made, can set big things in motion," says Hagel. "Resist the temptation to go with massive transformational approaches and start small. Learn as you go, get some experience, build credibility, address the regulatory issues as they emerge, evolve some kind of accommodation with the regulatory environment that serves the needs of all sides. But the key is to get started with small moves so start moving now." ■

> **Small moves, smartly made, can set big things in motion.**
>
> **John Hagel,** co-chair, Deloitte Center for the Edge

Bridging the trade gaps

Trade finance # Technology # Blockchain # Corporate treasury

Can recent innovations help to solve new challenges in trade finance and close trade gaps for SMEs and emerging market players?

"Suppliers in emerging markets urgently need supply chain finance solutions to obtain liquidity.

Angela Koll, vice president, specialist trade and supply chain finance, Commerzbank

The way the world does business is changing dramatically, but banks and their corporate customers are struggling to move the financing of trade into the 21st century. Trade patterns are shifting (south-south trade is estimated to represent 30% of world trade by 2020[1]) and today's supply chains are ever more complex, involving multi-locational assembly and more SMEs (the imported content of exports is estimated to grow to 60% by 2030[2]).

The regulatory environment is also more challenging. Basel III impacts capital allocation for trade finance transactions, disadvantaging emerging markets in particular: in Latin America, for example, a risk weighting of up to 150% may be levied on short-term loans related to trade finance, while weighting for developed countries is closer to 20%[3].

Add to this the impact of know-your-customer obligations and other regulations on correspondent relationships and it is no surprise that banks are not always able to meet customer needs by taking up financing opportunities. A recent survey conducted by the International Chamber of Commerce (ICC) identifies that, while there is no lack of liquidity in the market overall, SMEs and businesses operating in emerging market economies struggle most to obtain trade finance. According to the ICC, while trade proposals from large corporates were accepted on 79% of occasions, 53% of SME trade proposals were rejected. From a geographic perspective, rejection of trade finance proposals is highest in Asia (31%), Africa (18%) and Russia/CIS (15%).

1 WTO World Trade Report 2014

2 Standard Chartered Bank research, May 2015

"If financiers have visibility through the supply chain, they can approve and provide cheaper purchase order or invoice financing.

Michael Vrontamitis, head of trade product management, transaction banking, Standard Chartered

3 Rethinking Trade & Finance 2015, An ICC private sector development perspective, International Chamber of Commerce, September 2015

Is technology the answer?

While development banks, credit insurance and non-bank investors are helping to close these gaps, banks and their customers are looking to technology for at least some of the answers. The story of "digitising" the web of documents along a supply chain is already a very long one; critical mass has failed to build for many initiatives, due to the difficulty of getting different players, industries, geographies and commercial interests to agree.

But incremental progress has been made. For example, the MT798 messaging type makes it possible for corporates to exchange trade data with their banks over SWIFT with the ease and automation of open account transactions. Nokia has been using MT798 for export letters of credit (L/Cs) and guarantees since autumn 2015. Says Jari Hänninen, head of structured finance, credit products at Nokia: "We're using MT798 for trade finance-related applications and transactions with up to ten banks and it works well. Banks which are not able to send or receive MT798 messages yet are able to use a web interface, which is free for banks and speeds up the adoption process."

Today's technologies and standards are cheaper, more agile and more democratising than ever. And there's no shortage of innovators and FinTechs looking to help banks meet the challenges of digitising trade finance. A recent report from the Euro Banking Association[4] makes the case for crypto-technology (an umbrella term that includes blockchain, public and private distributed ledger technology (DLT), smart contracts etc) to deliver transparency with security and accuracy. Banks and FinTechs are actively pursuing pilots and use cases.

With 90% of transactions now on open account, Michael Vrontamitis, head of trade product management, transaction banking at Standard Chartered, says achieving visibility throughout a transaction – from presentation of a purchase order to an invoice being

4 Applying Cryptotechnologies to Trade Finance, EBA Working Group on Electronic and Alternative Payments, May 2016

Bridging the trade gaps

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accepted – is key to closing the financing gap currently experienced by SMEs and emerging market players. "If financiers have visibility through the supply chain, they can approve and provide cheaper purchase order or invoice financing," he says. The ability to then build a credit history based on individual transactions can be particularly useful for SME financing, he adds.

Standard Chartered has worked with DBS Bank and Infocomm Development Authority of Singapore to realise a proof of concept called TradeSafe to safeguard against duplicate invoice financing. The initiative creates a single source of invoice financing status, while preserving client and commercial confidentiality.

Barclays is partnering with Wave, an Israel-based startup, on an electronic bill of lading solution using blockchain technology. Another startup, US-based SkuChain, is developing products to support trade and supply chain financing using blockchain-based smart contracts, called brackets, covering data L/Cs, a blockchain-based obligation, deep tier financing and cash flow scrips.

Dealing with today

Angela Koll, vice president, specialist trade and supply chain finance at Commerzbank, notes the applicability of DLT to trade finance, but says: "It's early days for DLT and it will take years to offer suitable solutions. But innovation by digitisation in trade finance needs to happen now. Also, suppliers in emerging markets urgently need supply chain finance solutions to obtain liquidity." Commerzbank is actively promoting the Bank Payment Obligation (BPO), developed by SWIFT in conjunction with the ICC, as a digitised solution that can provide risk mitigation through secure matching of agreed data online and facilitate financing in favour of the supplier. "BPO is a hybrid instrument, positioned between an L/C and open account that offers lots of potential; it's wrong to think of it as an electronic L/C," she says. Commerzbank's first BPO transaction was between a German SME and a counterparty in Thailand.

SWIFT is working with essDOCS, a paperless trade solutions provider, to enable use of trusted data from digitised title documents, e-bills of lading, as well as automating the transfer of title when data has matched or has been accepted, for an extension to the BPO, the Bank Payment Obligation Plus.

> "Retail and SME segments can adopt technological changes more easily and quickly and are more likely to turn to non-bank financing options.
>
> **Raphael BarIsaac,** head of trade products, UniCredit Group

Although SMEs might be finding it harder to secure trade finance support from their banks, they may find it easier to adopt new solutions. "SMEs account for more than 50% of global GDP and two-thirds of the global workforce. Retail and SME segments can adopt technological changes more easily and quickly and are more likely to turn to non-bank financing options such as peer-to-peer and crowd funding," says Raphael BarIsaac, head of trade products at UniCredit Group.

BarIsaac also sees the BPO as highly relevant to the financing and risk mitigation needs of smaller and emerging market corporates because it provides a level of certainty to support open account transactions. "Once understood, our customers really like the BPO and are expanding their use," he says. One drawback, he suggests, is that the BPO is currently designed for use with a single transaction. "We need a way for customers to develop a BPO stream," he says.

Like any initiative that requires collaboration among multiple counterparts, Commerzbank's Koll admits critical mass for BPO cannot be achieved overnight. "Banks are the biggest bottleneck; we need to talk to our correspondents as well as our corporate customers and transfer knowledge about the benefits and the handling," she says.

The new technologies may yet dramatically improve processes, communications and efficiency and help to unlock financing for SMEs and emerging markets players, but innovation is not an easy path, particularly in the context of the fast-evolving regulatory landscape facing banks.

"Innovation isn't just doing something new with technology, it's really about going into something without a guarantee of success," says UniCredit's BarIsaac. ■

All in a day's work

Data

Regulatory requirements for the monitoring and management of intra-day liquidity may still be evolving, but banks are already beginning to leverage greater transparency.

Following the financial crisis of 2008-9, much of the global regulatory focus has been on ensuring that banks have stronger capital buffers to withstand future market stress. Certain riskier lines of business have been curtailed or discouraged, whilst the governance of other core banking activities has been reappraised, re-engineered and generally tightened up.

Intra-day liquidity monitoring and management falls squarely in that category. The US Federal Reserve Board defines liquidity as a financial institution's capacity to meet its cash and collateral obligations without incurring unacceptable losses: "Adequate liquidity is dependent upon the institution's ability to efficiently meet both expected and unexpected cash flows and collateral needs without adversely affecting either daily operations or the financial condition of the institution."

According to Natalia Blatter, head of transaction banking product and market development, UBS, real-time liquidity management and monitoring has long been a well-established direction of travel in global transaction banking, notwithstanding the increase in regulatory attention since the financial crisis. "Although the definition of intra-day liquidity management may differ among financial institutions, there has been a definite change over the past decade in attitudes to such exposures," she says. From a general assumption that everything would settle on the ledger overnight or reparations would be made in the morning, via overdraft charges, financial institutions have hitherto realised they need to be more proactive in their liquidity management approach.

Local differences

In addition to the liquidity ratios defined as part of Basel III, the Basel Committee on Banking Supervision, (BCBS) issued a paper in 2013 which detailed a number of liquidity monitoring tools with quantitative data requirements. The paper requires implementation by national regulators between 1 January 2015 and 1 January 2017. Although the reporting requirement is essentially retrospective, national regulators vary in the level of oversight they wish to exercise in order to ensure banks are able manage intra-day liquidity effectively. In the UK for example, banks are required to submit reports tailored to their own particular risk profile under the Individual Liquidity Adequacy Assessment rules set out by the Bank of England's Prudential Regulatory Authority, but they must also conduct analyses that demonstrate their understanding of the liquidity risks they are managing.

> **The optimisation of liquidity involves different measures, including knowing where our cash is and how much it costs us to have it there.**
>
> **Natalia Blatter,** head of transaction banking product and market development, UBS

The BCBS paper leaves a degree of provision to national regulation, leading inevitably to different approaches. In principle, its metrics apply to nostro and custody-related accounts and to the accounts banks maintain with high-value payment systems. However, national regulators may limit their application to currencies that represent 5% or more of the total liabilities of the bank.

Even such a limitation does not absolve a bank from tracking its overall liquidity position, since positions in other currencies may still need to be reported at an aggregated level. In addition, says Catherine Banneux, senior market manager, banking market at SWIFT, one of the required metrics to be reported is the top three peaks and troughs for each of a bank's nostro accounts on a monthly ba-

> **Having a very clear best practice on the use of intra-day reporting messages is essential.**
>
> **Michael Knorr,** head of payment and liquidity risk management, Wells Fargo

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sis. "To produce this, you need to track positions on a movement-by-movement basis, which is not a trivial exercise."

Keeping pace

Have operational abilities kept pace with regulation? Real-time liquidity monitoring is an aspirational goal, determined by regulators, says Michael Knorr, head of payment and liquidity risk management at Wells Fargo. While Basel III set the direction of travel, many financial institutions are waiting for their local regulators to produce detail. "That hasn't happened at the same speed everywhere," he notes. With a deadline of January 2017, the fact that some regulators are yet to release their detailed requirements cannot be taken as reason to delay preparations. "Obviously, banks are not doing this just for regulatory purposes," says Knorr. "In the meantime, banks have established intra-day data warehouses to capture the necessary information."

SWIFT has a key role to play in making the requisite data accessible. "To support the BCBS requirements, SWIFT messages are the predominant source of data," says Knorr. "Having a very clear best practice on the use of intra-day reporting messages is an essential tool that will enable banks to collect the necessary data to support the regulatory requirements across different jurisdictions."

Since the issue was discussed at Sibos 2015 in Singapore, has the industry been able made the progress it should have? "Personally, I would have assumed more defined requirements, but regulators have had to focus on other issues," says Knorr. "However, the Liquidity Implementation Task Force has recently started to work on the next version of market practice guidelines and is considering whether to elevate these to service level agreements."

Business benefits

For Blatter, while regulation may have been a spur, the wider business benefits of better liquidity management are placing the subject firmly at the top of the agenda for many banks. "The optimisation of liquidity involves different measures, including knowing where our cash is and how much it costs us to have it there. We're now aware of the costs of our intra-day balances," she says.

But can banks derive commercial benefit from closer intra-day liquidity monitoring? It all depends of how they leverage the information, says Blatter. "If we treat it as another regulatory compliance tick-box, then no. But these tools have provided transparency, which we did not have as an industry until very recently. That transparency drives a totally different dialogue among the providers and consumers of intra-day lines." ■

BANKING

"Everything starts with the customer"

\# Payments

As retail payment innovation goes from strength to strength, Olivier Denecker, director of knowledge, global payments, McKinsey & Company, examines the need to rejuvenate correspondent banking.


Olivier Denecker

If bankers were asked to point to those areas of their business that are at the cutting edge of innovation, correspondent banking would be an unlikely candidate. From another perspective, one would also have to say that use of nostro and vostro accounts within longstanding bilateral banking relationships has stood the test of time as a way of handling cross-border payments.

Digital innovation is, however, posing a strong challenge to tradition. Olivier Denecker, director of knowledge, global payments, McKinsey & Company, says correspondent banking today is on a transformational journey: one that starts with customer centricity and ends with material change.

"Correspondent banking is really the fabric on which international trade and cross-border payments are built," says Denecker. "It is a very complex network of rules, agreements and relationships going well beyond reciprocity." In essence, corresponding banking entails the linking of business opportunities through networking, supported by a set of operational criteria. It is the latter that are most challenged by the arrival of new entrants to the payments market. "Some of the new players that have appealed primarily to retail requirements work in a closed loop," he comments. "Because of that, they do not have all the complexity of the many-to-many activity that the correspondent banking system has. They can introduce more efficient processes and adopt a different approach to customer services, but they cannot get the same coverage as a correspondent banking network."

Higher expectations

Nevertheless, the service levels of the new entrants are setting expectations. The start of the transformational journey for correspondent banking is addressing the shifts that these closed loop systems have effected in perceptions of customer value and back-office efficiency. "Banks realise the need to be able to handle payments in a timely and cost-effective fashion that is closer in experience to some of these closed loop systems," says Denecker.

"To judge from the last two Sibos conferences, the need for change is well recognised," says Denecker. "It is not driven by regulation per se, but by customers becoming much more aware. It's very difficult to say to a customer that, as an individual, you can do a faster payment in the UK immediately, for example, but if you want to make a payment through a correspondent banking channel, it will take you three to five days. That doesn't compute anymore. Customers expect more and competition is also pushing banks to change." In addition, he says, the wider operating environment for correspondent banks is unforgiving. "Interest rates are at an all-time low which means that some of the main sources of revenue that were fuelling a more expensive system are actually not there anymore."

Denecker suggests that there are short- to medium-term improvements to the nature of correspondent banking that can be made, and notes that incremental process changes can deliver value to customers before more fundamental reforms are considered. "The changes are quite transformational, but less than revolutionary," he says. "Should we enforce a standard agreement across banks and step away from everybody having the right to differ bilaterally? Should we introduce certain types of monitoring systems that all participating banks adopt? How can we make it possible for customers to pre-check the account information they use for cross-border payments? These could bring significant benefit before considering reforms to the fabric of correspondent banking. Eventually the fabric – reciprocity, nostro/vostro accounts – will need to be addressed, but that's not the starting point."

Drivers of change

As with many other aspects of the wholesale complex markets, the transparency of the blockchain is often touted as a fast-track to a new, more efficient paradigm for correspondent banking. But while Denecker acknowledges that technology has a role to play in improving payment systems, it is not in itself the driver of change. "Changing the system doesn't automatically introduce the changes that are necessary from a customer perspective," he says. "One of the learnings on the retail side is: everything starts with the customer." ■

A great leap forward for funds?

Market Infrastructures # Blockchain

Market structure and technology changes could pave the way for new efficiencies in mutual fund settlement.

Mutual fund settlement for subscriptions and redemptions is typically carried out by a centralising agent, which sends orders to fund registers, operated by fund managers or their transfer agents (TAs). Settlement of subscriptions and redemptions into units of a fund must be finalised in a fixed time as laid out in the fund offering prospectus. On a cross-border basis, settlement is effected via fund distribution market infrastructure operators, some but not all of which are international central securities depositories (ICSDs).

"The mutual fund settlement landscape was traditionally the preserve of the ICSDs, although national central securities depositories (CSDs) have begun to encroach on the space as well, particularly in domestic transactions," says Sandor Szalai, head of strategy and client relations at Keler, the Hungarian CSD, which operates a mutual fund order-routing platform in its domestic market. CSDs in France, Germany and Denmark, to name but a few, have been engaged in the practice for several years, in response to local fund manager demands for domestic fund settlement, but CSDs overall have refrained from cross-border business.

As such, while French and German domestic funds settle in local CSDs, mutual funds domiciled in Luxembourg, which are distributed around the world, must be delivered not only to national CSDs and ICSDs (such as Clearstream Banking Luxembourg and Euroclear Bank in Brussels) but also into the registers of fund managers or transfer agents.

Catalysts for change?

Further change to mutual fund settlement processes are anticipated once TARGET2-Securities (T2S), the European Central Bank's (ECB) project to harmonise securities settlement in Europe, becomes fully operational across European markets by the end of 2017. On the other hand, the biggest game changer could be the known unknown that is the distributed ledger technology (DLT), aka the blockchain, which many believe could have a massive influence on the future of fund settlement.

Just seven CSDs have connected to T2S to date but in total more than 20 will have done so once the next three waves have been completed. T2S is not aimed specifically at mutual funds, although transactions in European securities instigated by mutual funds can settle on the platform once they are accepted by one of its participant CSDs. Some have acknowledged that T2S could extend beyond settlement in central bank money for equities and bonds into mutual fund settlement, a move that could reap cost-savings for cross-border transactions.

Fund distributors and transfer agents, which exchange cash and fund shares frequently, are likely to achieve greater process efficiencies in the event of a migration of fund settlement to T2S, but will first need to convince their fund manager clients of the advantages. According to Paul Bodart, a former member of the T2S Board, quoted in a recent paper by fund order routing platform FundSquare and the Association for the Luxembourg Fund Industry (ALFI), there may be cash benefits too. "As a distributor, you can pool all your shares and bonds activity with your funds activity, so the cash flows to one central bank account, as opposed to multiple accounts with multiple commercial banks. The benefits of pooling, and the liquidity related to that pooling, should not be forgotten or discounted," Bodart explained.

At present, fund settlement remains highly manual, in part because of the number of intermediaries involved across the transaction cycle. As an international, if not global, business, mutual fund distribution requires the support of CSDs, ICSDs and TAs with cross-border processing capabilities. Very few national CSDs settle transactions in domestic funds that occur in a foreign market, although VP Lux, the Luxembourg-based CSD and fund platform operated by Denmark's VP Securities, is an example of the potential for internationalisation. Overall, however, the systems on which these fund settlement processes are run are somewhat antiquated and the scope for error – e.g. administrative failures resulting from process breaks in manual intervention – is high.

Once CSDs and ICSDs sign up to T2S, thereby migrating cross-border securities settlement flows to a single platform, fund managers and their TAs could face pressure from clients and distributors to settle mutual fund subscriptions and redemptions in T2S too, thereby gaining harmonisation benefits and cost savings across multiple EU markets. Such savings could be welcome, given the increasing scope and complexity of regulation with which asset managers, and the ongoing squeeze on fees.

> **National CSDs have begun to encroach on the mutual fund settlement space.**
>
> **Sandor Szalai,** head of strategy and client relations, Keler

Nonetheless, some believe that much other remedial work must be done by existing fund providers, intermediaries and market infrastructure operators, before migration to T2S can become a realistic source of process efficiency. "Automation in mutual fund settlement is something that needs to continue. Many distributors and TAs still continue to rely on paper-driven processes and faxes. I do not, however, see T2S disintermediating the traditional mutual fund settlement processes. Many of the traditional settlement participants are moving away from antiquated technology towards forms of automation, such as use of SWIFT messages for fund distribution processes," says Tom Casteleyn, head of product management for custody, cash and FX at BNY Mellon.

Direct access to T2S is predominantly the preserve of market infrastructure operators and major banks. Fund managers or TAs backed by banks may gain access to T2S through their parent companies, but the success of T2S in the fund space may depend on the willingness of counterparts to use the platform and agree to settle in central bank money, which is unlikely to happen overnight.

The FundSquare/ALFI paper acknowledged dual settlement systems might have to co-exist before fund settlement gradually migrates to T2S. This could require fund managers to maintain the supporting infrastructure and ensure they collect data on whom their distributors are selling to as part of their KYC and AML obligations.

> **Traditional settlement participants are moving away from antiquated technology towards forms of automation.**
>
> **Tom Casteleyn,** head of product management for custody, cash and FX, BNY Mellon

Benefits of disruption

Separately, disruptive technologies are being assessed by a number of financial institutions and infrastructure operators as a way to scale down costs and obtain business efficiencies. Many middle- and back-office processes around settlement or settlement repairs are manual. To reduce the need for manual intervention, many are looking to the blockchain, a distributed ledger containing data supplied on an on-going basis by multiple parties which is resistant to tampering (in theory) due to its rigorous cryptography.

As the blockchain is a single-source database which cannot be manipulated, advocates of the technology feel it can be deployed to speed up and improve a multitude of back-office processes, including mutual fund settlement. In theory, blockchain would allow for accurate T+0 or real-time settlement for mutual funds, but is currently facing scrutiny across the finance sector over its lack of standardisation, interoperability, scalability and cyber-security.

However, BNY Mellon's Casteleyn says market practice issues must be addressed before blockchain can benefit mutual fund settlement. "Blockchain can be a catalyst for change, but it cannot force change. Blockchain could have a major impact on fund settlement but its impact will not be immediate. Standardising rules around fund subscriptions and redemptions is complex. Look at how long it took to achieve uniform rules for settling European securities under T2S," says Casteleyn. ■

Solving everyday challenges

Financial Inclusion # Diversity # Technology

Financial inclusion initiatives often focus on Africa, but banking and telecommunications infrastructures can make a significant difference to lives in other regions, as this Middle Eastern example shows.

All banks are investing in digital technologies to enhance the customer experience. But the constraints of legacy infrastructure – internal and external – is a bigger consideration for some than others. Bank of Palestine, for example, must contend with two unusual factors. First, it operates in two small territories in which daily commercial and economic activities have been regularly interrupted by military conflict, with inevitable consequences for key infrastructures, from banking to utilities to telecommunications. Second, many of its potential customers reside beyond the borders of the West Bank and Gaza. Of approximately five million Palestinian refugees registered with the United Nations Relief and Works Agency (UNWRA), more than three million live in Jordan, Syria and Lebanon, many in UNWRA camps.

Understandably perhaps, the bank's efforts to get closer to its customers encompass disruptive technologies and positively old-fashioned approaches to relationship banking. As with many banks in emerging markets facing challenges on data collection, sharing and scrubbing, Bank of Palestine is not yet in a position to use data from digitised services as a key input into the personalisation of banking services. Nevertheless, it is already leveraging existing infrastructure in innovative ways and developing tools that will ensure technology plays a greater role in the future customer experience.

At the same time, Bank of Palestine is increasingly supporting the needs of retail and small

The World Bank's International Finance Corporation is planning to roll out Bank of Palestine's 'mini-MBA' for female entrepreneurs in other countries.

business customers beyond core services. The bank realised its many small business customers needed business expertise at least as much as greater access to financing. This requires on-the-ground support from relationship managers via the bank's branch network. "In markets like ours, to be the bank of choice and to contribute meaningfully to financial inclusion, you have to have local knowledge, understand customers' challenges and aspirations, and you have to look beyond loans and accounts to non-financial services. In any market, banking is about trust and relationships, which can be undermined when technology is introduced," says chairman and general manager Hashim Shawa.

Relying on relationship managers rather than big data to distil customer requirements, Bank of Palestine is providing small business customers with business advisory services, in areas from human resources to pricing strategy to branding to supply chain management, some, such as book-keeping software, via electronic means. "As a bank, we have strengths and resources that are sometimes overlooked, like the ability to connect one customer to another," he adds.

Overcoming obstacles

So far, so traditional. But Shawa insists banks must also embrace change if they are to survive in a world where disruptive technologies are fast democratising and personalising the customer experience.

To this end, Bank of Palestine established PalPay in 2010, a subsidiary focused on developing technology-based solutions that meet the everyday needs of households and small businesses across the Palestinian territories. Both among the bank's customers and the unbanked that make up around half of the Palestinian population, the difficult conditions and many obstacles to travelling between towns mean that a high proportion of the day can be spent paying bills for essentials, from water to power to education to micro-loan repayments. Direct debits were not going to help the unbanked, so the technology unit focused on leveraging an existing resource, a 6-7,000-strong credit card point of sale network spread throughout the West Bank and Gaza.

In short, the bank developed a solution that would turn points of sale into points of payment (POP), used by customers to upload payments to one or more of the hundreds of service providers that have signed up to a single online gateway operated by the bank. As such, billers are paid more promptly, in a more automated and auditable fashion, payers discharge their debts more efficiently, with immediate settlement, and POP-site owners benefit from more footfall and liquidity, with the circulation of cash concentrated in fewer hands. Banks make revenues from transaction volumes of course, but more important in this case is the data, the goodwill of the unbanked, and the cross-selling opportunities from a client base whose behaviour it is getting to know slightly better than before.

While the POP solution makes sense in a market where mobile telephony is under-developed and wifi is limited to core population centres, Bank of Palestine is anticipating the arrival of 3G with the development of smartphone-based banking apps. Customers can already make small payments (below USD 200) via their phones to other Bank of Palestine customers, but they will soon be able to send funds to a much wider range of contacts, without needing to know their bank account details.

The phone-based PalPay services will replace the POP network over time, and there is scope to extend the service geographically too. Bank of Palestine has discussed with UNWRA the possible provision of PalPay's services to the registered refugees in neighbouring countries, but the bank admits that such developments are only in their early stages.

Empowerment though education

In parallel with these efforts to deploy technology to overcome barriers to the efficient provision of banking services to its customers, Bank of Palestine is relying on face-to-face interaction to meet the needs of a key demographic, while also building important brand awareness. In a market where women make up more than half the population, but barely 20% of the bank's account holders (and an even smaller proportion of the bank's loan book), Shawa saw that both the Palestinian economy and the Bank of Palestine could benefit by mobilising this under-utilised and under-educated resource. According to Shawa, the path to greater empowerment was blocked by an "alarming" lack of knowledge. To stimulate demand, the Bank of Palestine undertook an education programme, explaining basic products and concepts to women to engender an understanding of how banking and finance service can help to solve everyday household challenges. The bank now offers non-collateralised loans to female customers.

The bank has already run a seven-month MBA for female entrepreneurs in partnership with the World Bank's International Finance Corporation, which is planning to roll out the concept to other countries. The course covered accounting, budgeting, HR, marketing and financial planning; every one of the 40-strong first year intake has agreed to serve as mentors for the next cohort.

Shawa is aware that the bank's boots-on-the-ground approach to relationship management is hard to scale. As such, he is looking forward to the days when capturing, storing and sharing data from digitised services will be easier for him and his clients, not least because certain non-financial services for SME clients can be easier and cheaper to distribute via digital banking channels. For now, the emphasis remains on providing solutions to everyday problems, with the aim of reaping the digital dividend in the future. "Banks should first invest in their non-financial services and then look to develop scale," says Shawa. ■

> **To contribute meaningfully to financial inclusion, you have to understand customers' challenges and aspirations.**
>
> **Hashim Shawa,** chairman and general manager, Bank of Palestine