How innovation shape the financial industry's transformation agenda

Innovation and Value Creation in the Financial Industry

March 2023

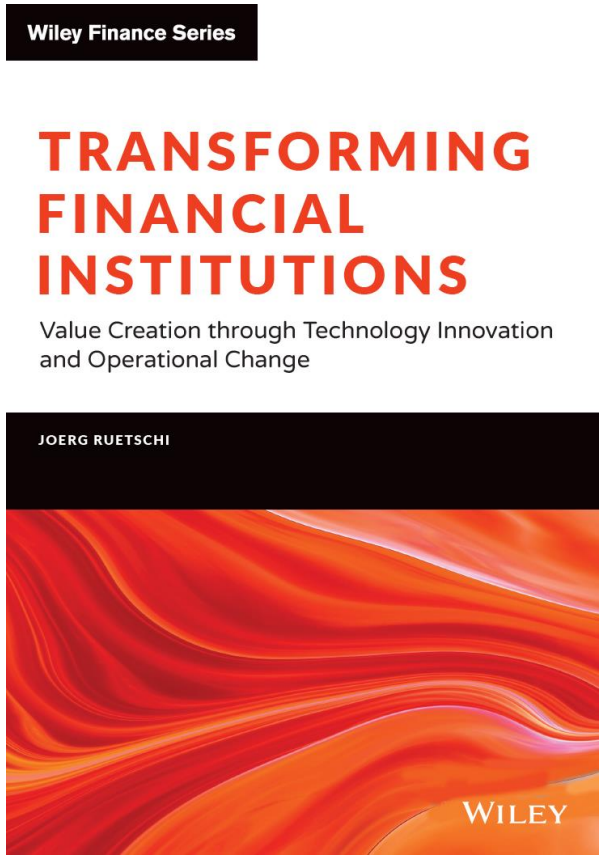
Some personal background and motivation…

Career in investment banking and alternative investments before focussing on bank restructuring and the transformation of financial institutions. Specialised in the commercialisation and operationalisation of emerging technologies in finance

Background

- Value creation leader with focus on innovation and special situations at the intersection of finance and technology; thought leader for transformative technologies in finance
- Currently lead as Chief Operating Officer & President the scale-up of Finsemble, the US interoperability player while remaining closely involved in intelligence/decision augmentation as well as specialty finance
- Originally a banker at Goldman Sachs, then led several restructuring/transformation mandates with financial institutions at Booz & Company/Strategy& before focussing as an executive and operating partner on financial technology businesses under the umbrella of EES, an independent platform for operational VC and PE
- Long-term technical background through a combination of a PhD in Finance with the Certified Turnaround Professional (CTP), Chartered Financial Analyst (CFA) and Financial Risk Manager (FRM) professional designations

The book published by Wiley discusses the value-creation approach at EES which combines technology innovation with operational change



VC = venture capital I PE = private equity

The value-creation lens on technology innovation with its use cases

Value creation is a management philosophy that focuses on the evolution of businesses across the corporate lifecycle with emphasis on institutional growth, operational excellence and corporate development

Value creation is a top-down management methodology

- Focus on institutional growth, operational excellence and corporate development
- Defined by the concept of **intrinsic value** that measures the financial impact (**KPIs**, e.g. cost of capital) of dedicated strategic and operational initiatives across the corporate and M&A lifecycle
  - Incubation
  - Scale-up
  - Performance improvement
  - Turnaround & transformation
  - M&A

  → **Value drivers**
- Technology innovation adds a specific value creation lens with focus on how we do business and operate (i.e. the impact on commercial and operating models)

- The changed regulatory and competitive landscape in finance has challenged established commercial models with their profitability thresholds (the GFC as turning point)
- Large scale financial institutions struggle to earn their cost of capital (H1)
- The regulatory and operational complexity endanger creation of shareholder value (H2)

Key questions:

- How to respond and reposition financial institutions for growth?
- How to manage the industry's change agenda to transform commercial and operating models?

KPI = key performance indicator

H = Hypothesis

Value drivers of the financial industry

Operational efficiency, decision augmentation, financial innovation as well as asset-liability management are the core value drivers of financial institutions. The change and growth agenda in finance has be driven by these technology innovations

Asset-liability management	Technology innovation
Risk taking, transfer, management and custody	Operational efficiency
Financial engineering [capital management]	Decision augmentation
Capital adequacy and regulatory supervision	Digital infrastructure

Value drivers with its individual components

Operational change

- Straight through processing and intelligent automation with the objective that people can focus on value-added (versus utility-like) services
- Specialised value propositions (specialty finance) dedicated capabilities to take, transfer, manage and custody risk
- New operational designs through best-in class service and technology integration and interoperability (ecosystem play)

Technology-enabled operating platform

Technology innovations in finance

Emerging technologies have been transformative for the financial industry across the areas of operational efficiency, augmented decision making and digital financial innovation

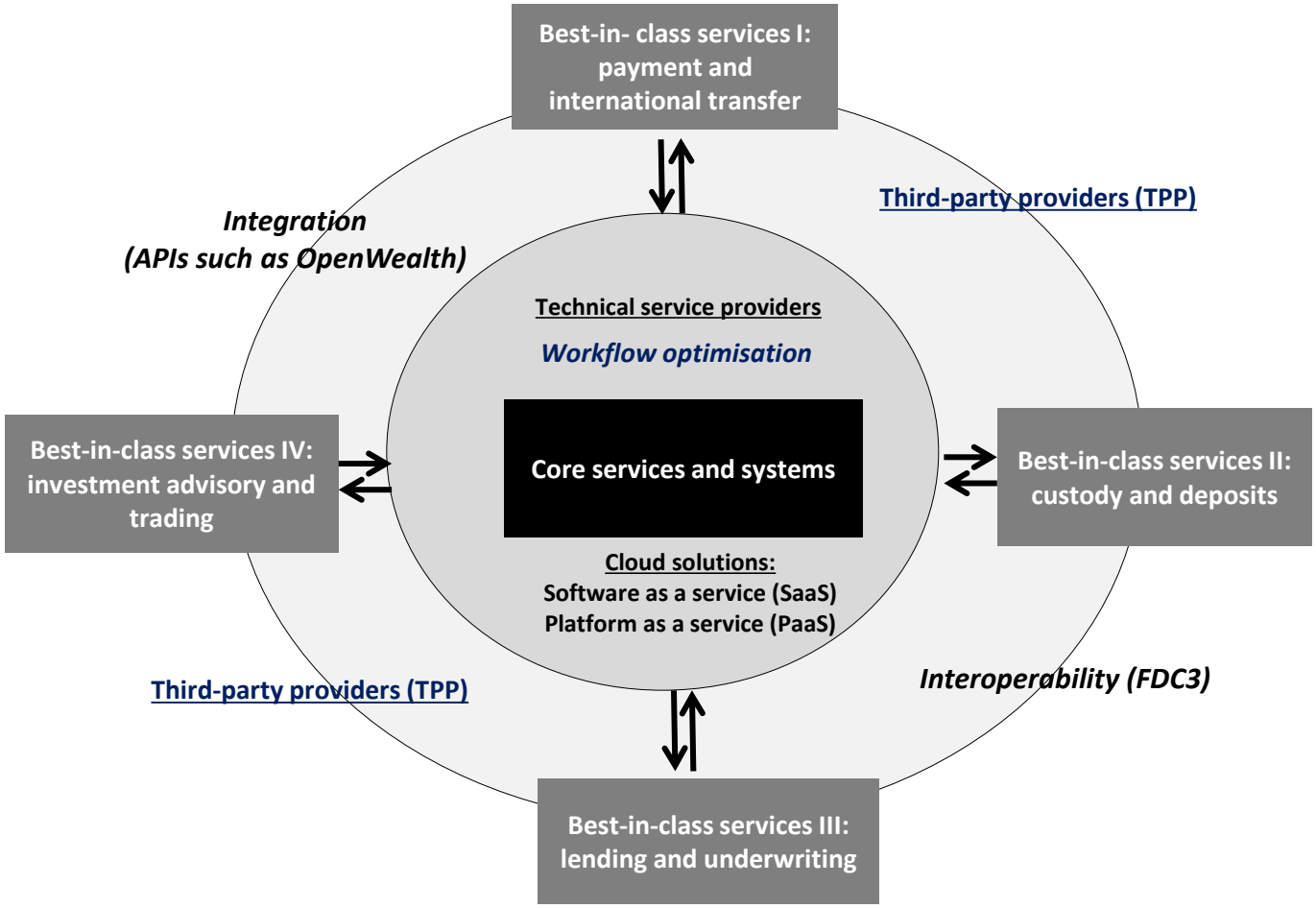
	Open-source Software	Artificial Intelligence	Blockchain
Technology features	▪ Standards and protocols (e.g. APIs) allow third party and clients to interact with FIs' core systems ▪ Interoperability enables agile workflow optimisation through connectivity and communication ▪ Cloud computing offers new infrastructure and service solutions to drive and scale change	▪ Machine learning (ML) facilitates information gathering, processing and analysis ▪ Algorithmic decision making facilitates more accurate predictions ▪ Robotic Process Automation (RPA) streamlines and optimises workflows	▪ Blockchain facilitates transparent and secure transactions between non-trusting parties ▪ No central authority and intermediary ▪ Bespoke contracts that can be individually designed
Value impact	**Operational efficiency** ▪ Data connectivity ▪ Accessibility of services ▪ Core system development ▪ Leverage of all applications ▪ Advanced workflow management and automation	**Augmented decision making** ▪ ML algorithms ▪ Alternative data ▪ Advanced analytics ▪ Predictions ▪ Algorithmic trading ▪ Investment advisory ▪ Risk management ▪ Compliance	**Digital infrastructure** ▪ Decentralised finance (DeFi) ▪ Digital financial innovation ▪ Crypto assets ▪ Web3

API = application programme interface

Operational change with a new target operating model

The new operating models drives the integration and optimisation of technology innovation, based on a collaborative approach. It allows incumbents to specialise in their core competence and embed best-in-class services by building universal platform offerings

The emerging commercial and operating landscape



Outcomes

- Open architecture platforms integrate different technology and services of TPP such as FinTechs [H3]
- As set of codified specifications for writing API, communication/language and taxonomy allow intelligent workflow optimisation to improve front-to-back automation; integration, connectivity and interoperability is evolving into full-service customer solution with dedicated interfaces
- On core platform offerings, utility-like services can operationally be delivered at scale and efficiency by the incumbents while making sure that the regulatory requirements are fulfilled
- The inherent value in specialised technology, risk-transfer and distribution capabilities, provided by the FinTech challengers, can be materialised [H4]

FDC3 = Financial Desktop Connectivity and Collaboration Consortium

The role of "Open Finance" in the broader transformation agenda

OF is the commercial and regulatory concept that defines the operational roadmap by integrating different service layers on one customer experience. It drives the industry's strategic design by combining operational change with innovation

- Open finance (OF) provides the framework to implement open-source technologies and make the design of new operating platforms reality
- It integrates all the required capabilities in a broader operational framework by setting standards and best practices, the key pillar that transforms the financial-services business models

Regulatory development

- OF the next step in the open banking journey that drives the broader transformation agenda
- Originally, the focus was on payments, but there is a much wider role for open-source technologies in building out a commercial offering across lending, investing and other financial services on one interface (i.e. the platform offering, defined by web-based integrations and desktops)
- The agenda is defined by a series of use cases in custody and wealth management, investing and trading, lending and insurance

The UK case with its wider implications

- The UK government and regulators mandated and endorsed open banking by law through second Payment Services Directive (PSD2) and 2017 Retail Banking Order by the Competition and Markets Authority (CMA)
- By early January 2018, it forced the UK's nine biggest banks to release their data in a secure, standardised format, so that it can be shared more easily between authorised organisations
- The UK continues to plan the implementation of open finance by law and make it a key objective of the government's national data strategy, delivered by the Financial Conduct Authority (FCA) by facilitating the changes to the legislative and regulatory framework

Key takeaways and the potential of open finance

Conclusions from the keynote

- There is inherent value in specialized technology, risk-transfer and distribution capabilities that are provided by fintech challengers
- These services are defined by differentiating sets of capabilities and getting deployed by specialized value propositions; standards and protocols allow the integration of services on a new operating platform
- Through a core platform, utility-like services can operationally be delivered at scale while making sure that the regulatory requirements are fulfilled
- OF drives the potential of open-source technologies further, driving the industry's go-forward strategic design by combining operational change with innovation
- OF sets the commercial and regulatory framework to reshape the financial industry

Follow-up questions for the panel

- What is the experience with open finance so far, and what has the operational and commercial impact (e.g. on the wealth management industry in Switzerland)
- The underlying technology components and their potential to scale
- The market-driven versus the regulated approach; a view on the situation in Switzerland
- Leveraging the experience of the FinTechs and the incumbents financial institutions
  - The profitability and viability of the standalone FinTech model
  - The openness of service integration by the incumbents in their ecosystem
- The challenging reality of targeted re-platforming initiatives at the incumbents

Interoperability and FCD3 advance the transformation agenda further by building a collaborative framework between applications

Deep dive on application interoperability and the FCD3 standard/protocol

- Interoperability is the ability of different systems or applications to communicate with each other, exchange information, and then take action with that information. It has now evolved into a full-service platform solution which includes container support, basic exchange between web and web, but also native support for other application types and advanced window management
- Smart desktop platforms provide the infrastructure to create intelligent workflows with customized workspaces. It allows cross-application data sharing in an instant and eliminates manual re-entry and error rates. This optimisation of workflows leads to substantial gains in effectiveness and efficiency in an open architecture framework
- Interoperability acts as the integration hub to execute the vision of open standards in finance. Open standards are an important enabler for interoperability as they allow any vendor to implement them and make their applications interoperable with the ones of the other vendors
- The FDC3 standards are driving these developments under the umbrella of the Fintech Open Source Foundation (FINOS). A growing number of financial institutions have worked collaboratively with technology vendors to accelerate these developments given the substantial potential to optimize the workflows across the sell and buy side

Blog: The Role of Interoperability in Digital Transformation

Panel discussion on driving the financial industry's transformation agenda through "open finance"

The vision of transformational change

"Imagine a world in which Financial services were built with software building blocks like "Lego".

These blocks could be assembled flexibly to allow for hundreds of different use cases.

Furthermore, each of these Lego-like blocks were the result of ongoing collaboration between the smartest minds in the world, continuously iterating and improving upon each piece.

[…]

Just as modern architects can source the best-in-class parts, so fintech builders will have the ability to leverage "building blocks" from engineers, product managers, and compliance experts to experiment with entirely new combinations of code and discover solutions not before possible."

Angela Strange from Andreessen Horowitz on the potential of open source coming to financial services

Blog: Open Source Is Finally Coming to Financial Services

The harsh reality of implementation

- Slow implementation without the pressure of the regulator and government
- Fragmented technology stacks as starting point of targeted re-platforming initiatives at the incumbents
- Protective commercial behaviours of the incumbents
- Lack of commercial profitability and viability of standalone FinTech propositions
- …

Disclaimer and further information

Further information to

- The book “Transforming Financial Institutions” and its value creation methodology for financial services: Evolve Enterprise Solutions (EES) on www.eesadvisory.com
- Interoperability and the FDC3 standard: Finsemble on www.finsemble.com