1 Executive Summary

Digitalization has fundamentally changed the way financial services operate today. For example, e-banking and m-banking have become the new norm, most banks have launched mobile apps, back-office banking processes have moved from paper to the cloud, and emerging neobanks in Europe and super apps in Asia have captured significant market share.

And while the digital transformation in finance is still a work in progress – for example, penetration in some sectors, such as SMEs, still lags significantly – digitalization across the financial industry is accelerating rapidly. The next phase is already here, with three major developments actively under way:

- First, over the past decade, we have seen a major transformation in financial infrastructure. Two fundamental drivers that have fueled this change are: (1) API connectivity and (2) better use of data, which have enabled a wide range of new data-driven applications, innovative business models and the rise of multi-party platforms. Most of these products and services would not have been possible to build without modern API technology that enables connectivity between banks and third parties. These processes are ongoing and will continue to shape the financial industry in the future.

- Second, building on the above changes and catalyzed by regulatory (e.g., PSD2 and similar regulations) and industry forces (e.g., disruption by fintechs), the formerly closed and integrated banking value chain is being transformed into components that can be sourced separately and combined with other financial and non-financial services. Selected banks have embraced the opportunities of a potentially new (financial) ecosystem. For example, some traditional financial institutions are willing to rethink their existing business models by offering their core capabilities to non-bank players. Similarly, some established tech companies, as well as emerging startups, have also recognized the potential and are starting to enter the financial space with brand new and legacy-free offerings, collaborating and sometimes competing with financial institutions.

- Finally, the line between financial and non-financial services is becoming blurred. Financial products and services can now be offered by non-financial brands and other third parties without their own banking license or financial infrastructure and seamlessly integrated into any software. As a result, the end client experiences a financial solution as part of the product they are using, sometimes without even realizing they are interacting with a financial institution in the background. However, the regulatory responsibility remains with the financial institutions. This new setup presents both new opportunities and challenges for financial institutions, as it opens up new client channels, but also introduces new risks in terms of compliance, data security, etc.

In a very simplified manner, we will try to describe the three major developments mentioned above, namely open banking, Banking-as-a-Service (BaaS) and embedded finance. Much has been researched and reported on each of these, but sometimes, especially in the general press and in non-specialist circles, these terms are used interchangeably, often confused due to technical jargon or lack of clarity.

The purpose of this position paper is therefore to clarify these widely discussed terms, to define and explain their differences and similarities and to explain how they are interrelated. To better illustrate these trends, we present selected case studies that showcase a number of companies that have already built innovative business models around these trends. Most importantly, we attempt to explain the changes the banking industry is facing and draw lessons for the Swiss financial center to support its future competitiveness.

Note to the Reader

Author

The views expressed in this paper are those of the author and do not necessarily reflect those of SIX or the contributors. For more information about this report, please contact the author.

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