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SaaS: The case for building a new banking business model

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01 | Introduction

Banks are no longer only interested in building their infrastructure in order to serve their customers the best they can. Rather, they strive to position themselves as the orchestrators of API platforms. Software as a Service (SaaS) deployment models are the ideal tool to reduce the struggles faced by banks as their role evolves.

SaaS models are highly effective, as they target some of the key challenges banks face in their efforts to digitally evolve while remaining competitive. An increasingly demanding customer base, competition from agile digital players, regulatory burdens and legacy technology are four of these significant hurdles that can be mitigated using SaaS.

Not only does SaaS assist in managing these challenges, it can also equip financial institutions with the toolkit required to thrive in the future.

As customers become more demanding of the services they use, the manner in which they interact with these brands is changing. We've seen these shifts of customer's changing their interactions with banking before, first with internet banking and then through mobile banking. Customers are now comparing their experiences to online and application-based experiences, resulting in a shift of expectations toward 24/7 banking availability.

When leveraging the technology available by third party providers, banks must assess how they can best configure their own system in an agile, adaptable manner. While close attention must be given to the selection and ongoing management of technology providers, capitalising on the benefits can not only help banks to mitigate or resolve significant pressures threatening their business model, it can also drastically improve their ability to remain competitive in an increasingly digital financial services industry.

- **How can banks position themselves as orchestrators of API platforms?**
- **Why is SaaS pivotal to tackling regulatory, competition and technology challenges?**
- **How are changing customer expectations impacting banks' technology strategies?**
- **How can working with third party providers help banks relieve current and future business pressures?**

02 | Identifying and meeting customer expectations

Changing customer expectations are reshaping the way in which banks approach their tech strategy. While the industry was already tracking toward digitisation, the Covid-19 pandemic pushed the need to offer extreme customer-centricity to the top of the agenda.

The pandemic encouraged a dramatic shift toward online channels, and digital banking was no exception. **McKinsey** explains that across developed markets, banks closed 9% of their branches during 2021 on top of **previous significant closures**, as they reassessed how they would cater to a significantly more digital consumer.

In order to meet this demand, financial institutions were faced with the need to pivot quickly to meet their customers' new expectations. While some banks were able to leverage the technology opportunities rapidly and evolve, many are still trying to transform legacy tech stacks into a more agile, adaptable framework. API platforms have been invaluable to these firms.

Buy now pay later (BNPL) is a clear example where retailers have been pressured to offer new forms of payment options to meet customer demand, requiring retailers to partner with regulated entities in a way that has not been done historically.

According to **EY**, the UK's BNPL market grew to five million users in just over 12 months, and despite a slower embrace of BNPL, the US is expected to reach an anticipated compound annual growth rate (CAGR) of 20.7% between 2021 to 2028.

- **Demand for customer-centricity surged in response to the Covid-19 pandemic**
- **Financial institutions were forced to pivot toward digital to meet new customer expectations**
- **Customer-centric products and trends have now been pushed into the mainstream**

What's more, **41% of US banking customers** are now digital-only with respect to managing their finances. Banks wary of losing access to a significant portion of millennial and Gen Z customers have begun to turn their focus toward offering BNPL, with the notable arrivals of **Deutsche Bank**, **NatWest**, and **Barclays** earlier this year.

Open banking has also birthed a revolution in its own right, by requiring financial institutions – typically incumbents – to share customer data to third parties. This has resulted in banks having to evaluate their position within an ecosystem of players which now includes neobanks, fintechs, payments providers and ecommerce retailers. While achieving full momentum has taken longer than anticipated, open banking's success can be seen as an initiator of the now vibrant and growing SaaS ecosystem, which is fertilised by the rich opportunities APIs provide.

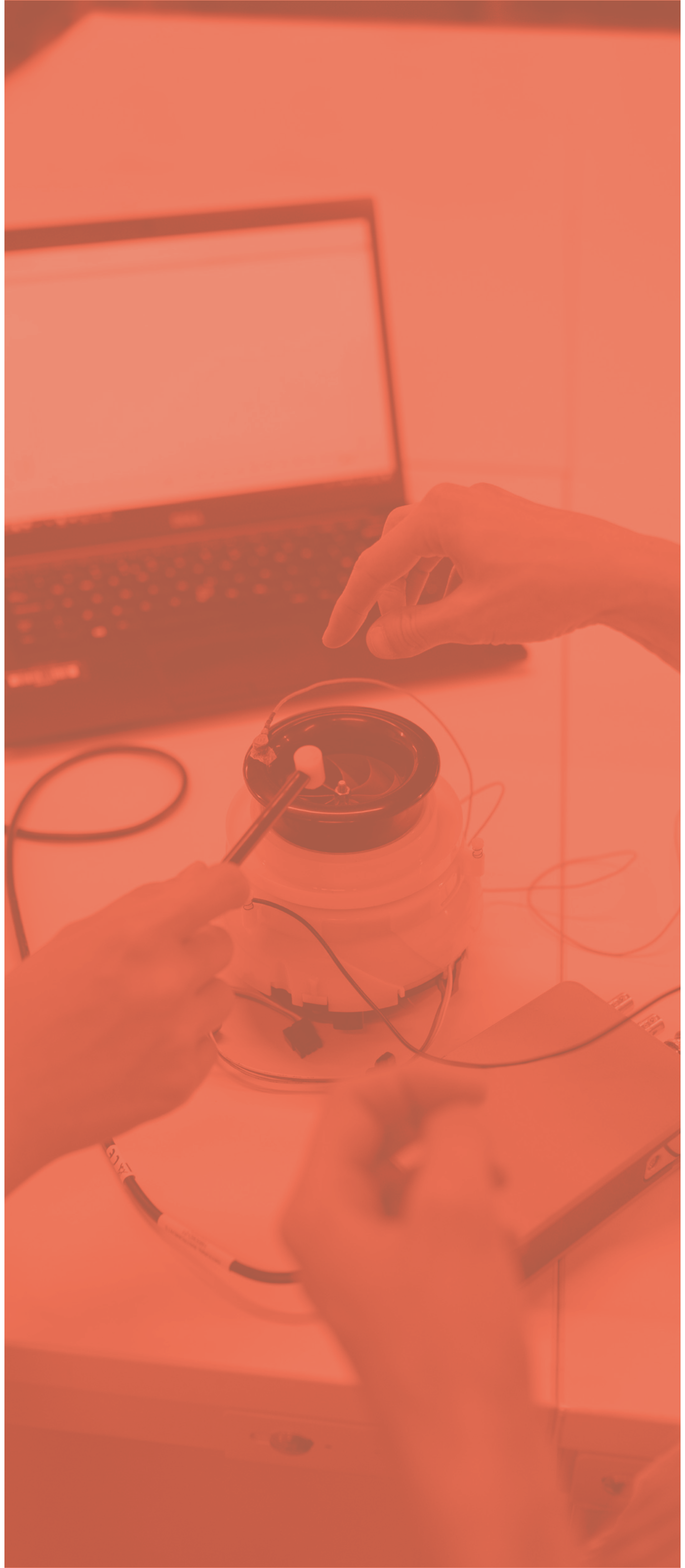
Open banking, and decentralised finance more generally, have also injected the industry with a new understanding that the consumer should have greater control of their own data and finances.

Personalisation, including messaging tools such as live chats, has also become a crucial offering for financial institutions, as consumers look toward services which can engage with them whenever and wherever they find themselves – rather than having to wait hours on a helpline or find a branch. AI driven personalisation, particularly explainable AI (XAI), allows banks to better meet personalisation expectations. XAI equips financial institutions with the insight and transparency needed to create seamless consumer journeys. Automation and rapid onboarding are other features which continue to attract new customers, as users seek out services which streamline their application and account opening services.

Trends underscoring the push toward customer-centricity include:

- **Buy-now-pay-later (BNPL)**
- **Decentralised Finance (DeFi)**
- **Open Banking and related services**
- **AI driven personalisation**

APIs have proved to be a turnkey for banks seeking to cater to these consumer-driven trends by building innovative interactions between two interfaces. By partnering with technology providers, the role of banks is evolving to focus on orchestrating technology providers to deliver a handpicked selection of API powered services that cater to the specific needs of their customer base. They offer a flexibility for banks looking to deliver services from card issuing and processing, accounting and financial solutions, customer relationship management, to regulatory reporting, data analytics and mitigation of financial crime.



03 | How competition is pushing banks toward SaaS

Competition presents a significant pressure being experienced by incumbents as new entrants enter the scene. Neobanks without legacy systems are cloud native and function without cumbersome IT departments, meaning they can operate in a highly agile way to meet specific needs of their customer base by delivering efficient technology orchestration.

This disruption is in some cases being driven by regulators themselves, as they try to open up markets to create more innovation and reduce the tight grip of incumbents over financial services.

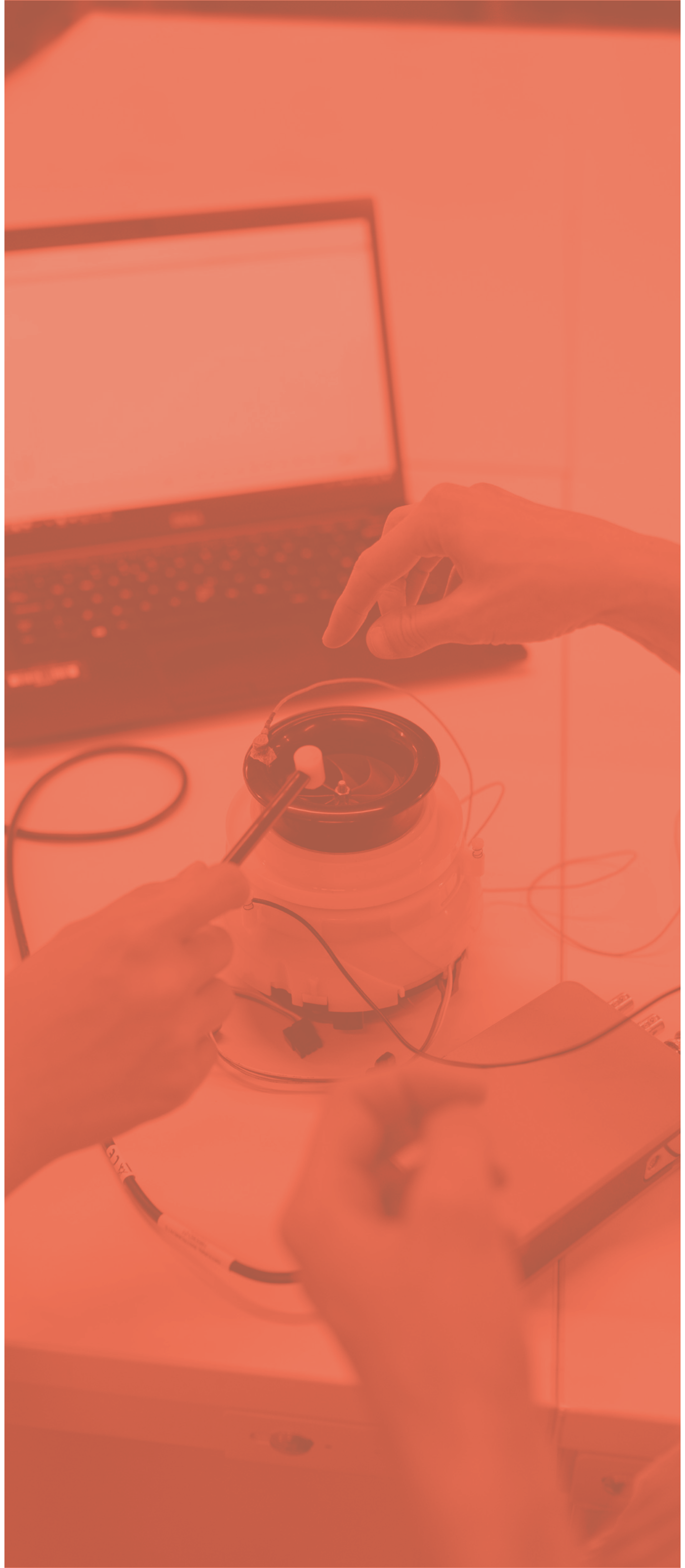
As touched on earlier, certain jurisdictions, notably the EU and UK, now mandate that banks share consumer data with third parties, which has opened up the industry to significant competition not only from neobanks, but a tsunami of third-party providers.

This has been viewed by incumbents not only as the loss of effective control over customers' financial data, but as rolling out a welcome mat for competitors to encroach on their tight control of the market through more innovative products and services.

Research from **EY** explains that as payments become more essential to remaining the primary financial provider/service of consumers, neobanks will have the upper hand. However, their reliance on integrating multiple financial service providers should be considered a significant opportunity for banks. Additionally, incumbents remain the frontrunner when it comes to trustworthiness, and are well positioned to leverage the technology available through ecosystem development. That is, orchestrating API-powered services to give their offering a competitive edge.

- **Market-driven competition and regulatory pressures are pushing banks toward SaaS**
- **Financial institutions must reassess their place and business model in this new ecosystem**
- **Trust remains a key differentiator that banks should leverage in this digital ecosystem**

Even the **World Economic Forum** is calling on banks to adopt cloud and SaaS solutions in their offering in order to improve inclusive banking. Given the extent to which the cost of living crisis and global uncertainty around an impending recession is negatively impacting consumers, it is only logical that banks begin to reshape their offering to better target and serve the needs of their customer base.



04 | Why SaaS will help banks navigate regulatory pressures

Regulatory pressures spanning from data privacy and consumer data protection, to operational and supply chain resilience, are adding further pressure to financial institutions' compliance regimes. As more banks move toward cloud and SaaS technologies, regulators are also turning their attention to concentration risk.

While these pressures demand significant financial and human resource from financial institutions, the new normal of banks as API orchestrators means that SaaS providers are uniquely placed to assist in meeting these standards. In fact, SaaS providers cannot only help financial institutions meet regulatory requirements, but can position them to achieve significant financial benefits. A 2018 paper from Microsoft found that Azure can be 93% more energy efficient and as much as 98% more carbon efficient than on-premises solutions.

- Covid-19 recovery and climate risk present long-term pressures that financial institutions are grappling with. While uniform global standards that stipulate how a firm should report the social elements of their operations are not in place, government guidance around managing the cost of living crisis and inflation post-pandemic are likely to influence the way banks choose to interact with their customer base.

- The EU Taxonomy Regulation's climate change mitigation and adaptation objectives applied from the January 2022, and is currently being reviewed with the intent of extending its remit to include social objectives.

SaaS can help banks manage regulatory updates around:

- Data privacy
- Consumer data protection
- Operational and supply chain resilience
- Cloud technology
- Concentration risk
- ESG standards

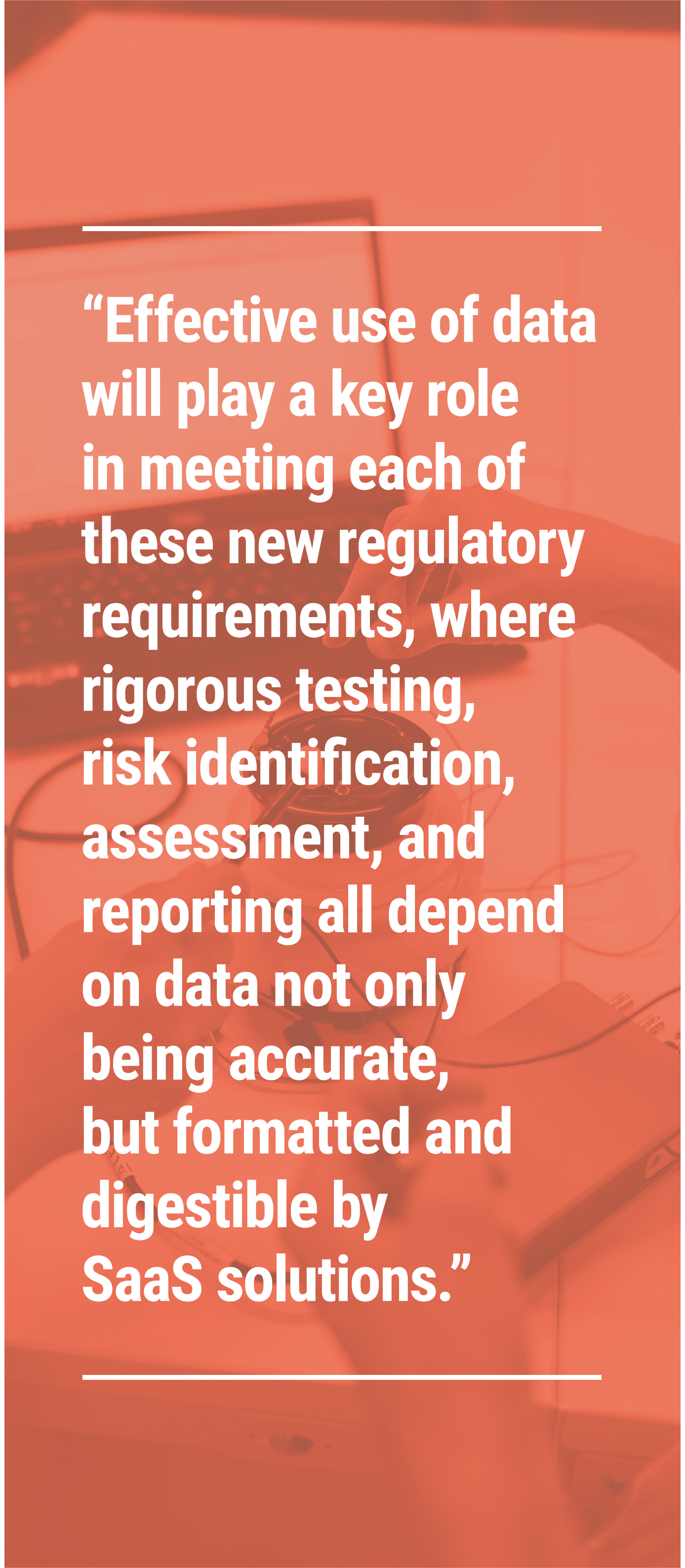
- Rules barring funds to be transferred in and out of Russia following its invasion of Ukraine, have also required financial institutions to put significant compliance measures in place or risk breaking sanctions.

- Operational resilience is also a dominant feature of regulators' agendas, with several jurisdictions in the late stages of drafting rules or preparing to bring them into force. Adoption of the EU's Digital Operaitonal Resilience Act (DORA) is slated for approval in October 2022 as predicted, and in-scope banks and payments providers will likely have a 24 month period in which to finalise their DORA implementation.

Rules tied to resilience largely target the increasingly digital and interconnected nature of financial services and the wider economy. Particularly given the dramatic surge in use of third party technology and cloud providers by financial institutions to deliver their services digitally. Therefore, not only must banks ensure they are meeting stringent new standards, they must also adhere to third-party risk management requirements when making use of critical ICT third party providers (CTPPs) and third party providers (TPPs).

Effective use of data will play a key role in meeting each of these new regulatory requirements, where rigorous testing, risk identification, assessment, and reporting all depend on data not only being accurate, but formatted and digestible by SaaS solutions.

Banks recognise the importance of preparing their data storage and deployment frameworks, transforming their systems to ensure their infrastructure is compatible with the SaaS solutions available. By positioning themselves in a way that allows them to capitalise on tech solutions, banks will not only be able to more effectively meet regulatory standards, but will position themselves at the core of a sophisticated and carefully customised portfolio of API-driven SaaS solutions.



"Effective use of data will play a key role in meeting each of these new regulatory requirements, where rigorous testing, risk identification, assessment, and reporting all depend on data not only being accurate, but formatted and digestible by SaaS solutions."

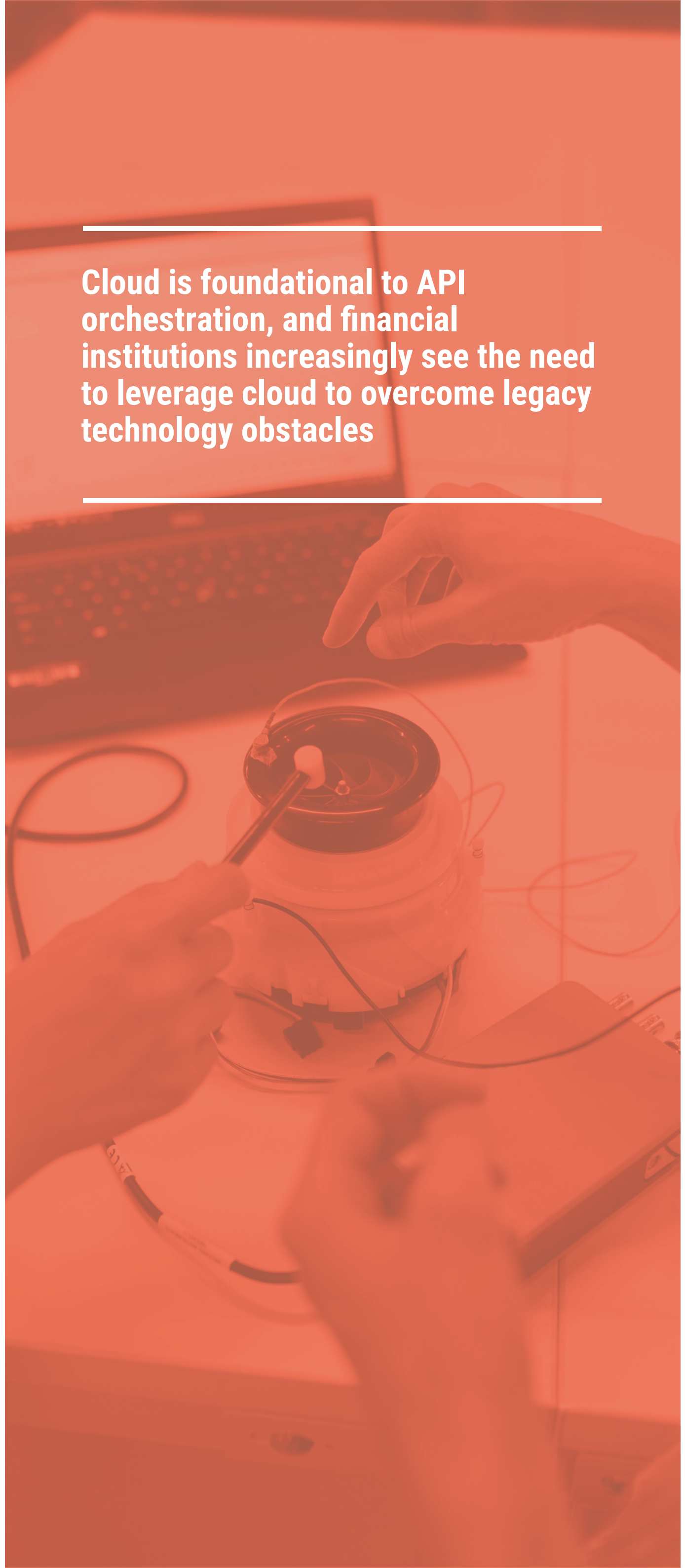
05 | Overcoming internal legacy challenges

Given these onerous pressures of competition, regulatory changes, and a demanding customer appetite, the role of the bank is changing. The key opportunity lies in banks' ability to leverage cloud and ultimately, SaaS providers. SaaS solutions which can be quickly deployed on the cloud present a highly attractive option for banks, however, the tech stacks of legacy institutions can mean that this is a high hurdle to clear.

Rather than trying to evolve the complex web of legacy banks' core banking systems, financial institutions recognise that outsourcing this work to expertise available through technology providers allows banks to prioritise serving their customers, while only consuming the specific tools and services from the vendors they partner with.

This transformation can be categorised into different stages, with Infrastructure as a Service (IaaS)and Platform as a Service (PaaS) capabilities evolving into partnerships with large scale cloud providers that are better positioned to provide the volume, security, and control that banks demand of their cloud provider. These providers are able to inject significant capital into their services in a way that isn't viable for most financial institutions, making them a highly attractive and efficient choice.

Cloud is a foundational element to effective API orchestration, and banks would be well advised to assess the nature of cloud involvement when making a decision around partnerships. Many technology providers also work with renowned and hyper scalable cloud providers, such as Google, Microsoft, and AWS, which ensures scalability and rapid testing so that any tweaks or bugs can be honed swiftly.



Cloud is foundational to API orchestration, and financial institutions increasingly see the need to leverage cloud to overcome legacy technology obstacles

Technology providers are seeing enormous growth across SaaS services as banks turn toward packaged banking services to deliver a fast time to market. When partnered with leading cloud networks, these providers are uniquely positioned to scale.

The increasingly collaborative nature of banking means that moving to a fully cloud native and API-first stack on a leading cloud provider will set financial institutions' innovation and offering apart. Enabled by AI, open APIs and new-age DevOps practices, established technology providers offer financial institutions with the ability to digitally transform and enhance banking products and services through personalised interactions with customers.

As part of the complex ecosystem in which financial institutions are now operating, vendor management is role which must be actively adopted. As banks are likely to be managing or partnered with multiple providers throughout the ecosystem, be it for core banking software, onboarding, risk mitigation, fraud monitoring or customer engagement, the relationships must be treated carefully with ongoing management and refinement. Where finance is being embedded into these new channels, banks will benefit from implementing strong API orchestration to roll out and maintain these opportunities.

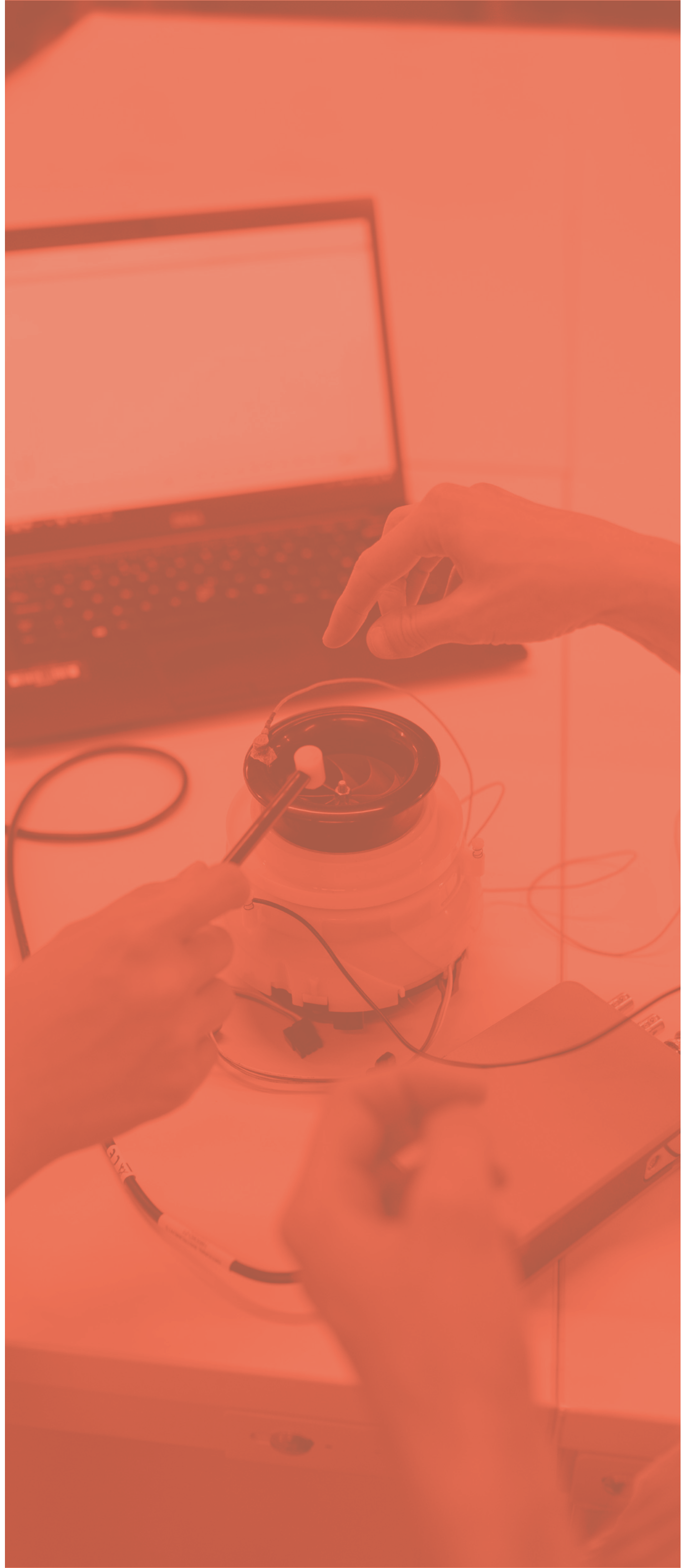
- **Increased adoption of SaaS solutions and cloud is allowing banks to scale rapidly**
- **This collaborative financial services ecosystem is embedding true digital transformation into banks' operations**
- **Partnerships between financial institutions and tech providers are the keystone to leveraging digital opportunities**

06 | Conclusion

Banks today are faced with a host of internal and external pressures which must be addressed effectively if they are going to flourish in the long term.

Given the wide range of pressures being navigated by financial institutions, relieving these pressures through SaaS is increasingly ranking high on banks' agendas. While banks will inevitably follow a unique journey to effective digitisation, SaaS is proving to be an impactful and highly agile method to drive complex strategy across every market.

By collaborating with technology providers to step in and solve for the consumer's specific needs, financial institutions can become the orchestrators of a customised, agile and adaptable suite of API-driven services long into the future.



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