FinTech Partnerships

Building the digital future

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Over the last decade the world has become increasingly digital and interconnected. In the UK, as technological capabilities have increased, there has been an explosion in FinTechs (Financial Technology companies).

FinTechs are keen to offer new functionality and services that will meet the needs of customers directly or will enhance the offerings of other market players. Many also aim to offer existing services more efficiently, reducing costs. This Fintech proliferation has been supported by the government and regulators' commitment to enhancing competition and innovation in financial services and ensuring the UK continues to be a key destination for inward investment. In the first half of 2021, the industry body Innovate Finance reports $5.7bn raised across 317 deals in UK FinTech firms – more than any other nation in Europe and second globally to only the USA[1].

A key driver for investing in FinTechs is the promise of innovative solutions that can drive value by way of partnership opportunities. Both established banking and payments business models and FinTech business models, broadly speaking, have a range of advantages and disadvantages. Working together can enable both established providers and FinTechs to maximise their potential. FinTechs in banking and payments can benefit from lower operational overheads, utilise cutting edge developments in technology, specialise in specific activities or market segments and develop a fresh organisational culture. More established providers often have higher operational costs associated with a multiservice and branch approach that must contend with legacy platforms and may have an ingrained culture that takes time to evolve.

However, established providers may also have advantages – alongside greater capital reserves, they may well carry trusted brand names and generally have established customer relationships. Additionally, offering a wider range of products and services can scale down costs, spread risk and offer greater opportunities for customer engagement. Newer FinTechs might have less of their own capital available for investment, require time to establish their brand, have less established customer relationships and specialisation in a narrow range of products or services can in some cases limit growth potential.

These complementary advantages give rise to the potential for the UK banking and payments market to be more customer focused, efficient and scalable by way of

1 https://www.innovatefinance.com/news/record-breaking-year-for-uk-fintech/

Evolving at pace

In the current environment, technological capabilities have accelerated, enabling more innovation opportunities, and the regulatory environment has evolved to place a stronger focus on facilitating pro-competitive cooperation and innovation for the benefit of customers.

strategic partnership opportunities. In this way, organisations can play to their respective strengths to deliver enhanced products and services, more efficiently than if they were operating alone. In this paper, we consider the history of banking and payments partnerships, current case studies and further opportunities for collaboration. We also outline Lloyds Banking Group's partnership activities.

Banking Partnerships

The payments sector can be characterised as one having a "network effect" – i.e., the more financial service providers, businesses and consumers use particular payments rails, the more useful and valuable these rails become. This means payments providers are, by necessity, well-versed in collaborating to set standards and ensure that functionality is aligned, whilst utilising new technology.

UK banks have a long history of collaborating and partnering with each other and other industry participants; initially driven significantly by the need to share run and capital costs, and subsequently with a growing focus on the opportunities for innovation which could not be achieved, or achieved efficiently, alone. This collaboration has strengthened the provision of financial services to the benefit of customers and the financial industry as a whole, such as in risk management and supplier management.

The UK retail payment scheme Bacs was launched in 1968 as the Interbank Computer Bureau in order to take advantage of technological advancements that enabled electronic fund transfers without the need for paper documentation. It was vital that the payments providers of the day collaborated to ensure the success of the scheme, including developing the enduring direct debit and credit functionality.

Additionally, UK banks have often purchased a variety of technical platforms and services from major vendors, such as gateways, in 'partnership' with technology companies such as Microsoft or IBM. These have often been 'off the shelf' products which were then tailored to fit a bank's individual systems. There are also instances where UK banks have worked together to create industry-wide services that support UK payments, such as:

iPSL - was founded in 2000 as a co-operative between Unisys, Barclays and Lloyds Banking Group in order to centrally handle and process cheques across the UK. iPSL is a key player in processing cheques in the UK, handling over 500m cheques per year[2]. In this case, a collaborative approach to cheque clearing and associated services was more efficient and provided better value than each organisation supporting and maintaining its own cheque clearing division.

Loomins (Valtex UK Ltd) a joint venture by HSBC Bank and Barclays Bank to provide cash management and in transit services for its members rather than using an existing security company for the same services.

In the current environment, technological capabilities have accelerated, enabling more innovation opportunities, and the regulatory environment has evolved to place a stronger focus on facilitating pro-competitive cooperation and innovation for the benefit of customers. Against this backdrop, there are a wide range of opportunities for established banks to explore partnering, whether working collaboratively as service providers or partnering with gateway and platform providers.

FinTech Collaboration

The last decade has seen an increase in the adoption and utilisation of smartphones, with the UK telecoms regulator Ofcom reporting 82% take-up of people aged 16+ in 2020, up from 27% in 2011[3]. Mobile banking has also increased, with 29 million users in 2020, or more than half the UK adult population, up from 15 million in 2014 when UK Finance first began reporting figures[4]. Given this behaviour change over time, many new entrants have developed 'app only' banks with no physical presence.

Building from the ground up has enabled

2 https://www.ipsl.co.uk/about-us

3 https://www.ofcom.org.uk/__data/assets/pdf_file/0027/196407/online-nation-2020-report.pdf

4 https://www.ukfinance.org.uk/sites/default/files/uploads/SUMMARY-UK-Payment-Markets-2021-FINAL.pdf

Kalifa review

In the UK, there is a continuing effort to ensure that policy changes are effective and that customers continue to get the best deal. In 2020 the UK government commissioned the Kalifa Review, which was made at the request of the Chancellor, to identify priority areas to support the UK's FinTech sector.

the development of microservices and digital insourcing, supporting innovation at pace. Monzo for example uses Amazon Web Services (AWS) cloud hosting for its core banking needs[5], with APIs helping to facilitate customer requirements.

Additionally, FinTechs often look to focus on, and to excel in, one particular area of a customer or product journey, then slowly expand outwards by developing their propositions in order to scale up. This focus on one area of the product journey is an example of the unbundling of financial services. In the past, customers tended to be served by a smaller number of large retail banks, which provided a wide range of products to a broad customer base. Now, the regulatory environment combined with technological progress has enabled a wider range of players that often focus on a smaller range of products or services and sometimes a narrower range of customers. This evolution has given rise to discussions globally about the disintermediation of high street banks from the end-to-end product journey[6].

Further, some FinTechs have become known for offering user-friendly interfaces and new user experiences such as opening an account via an app or having a functional debit card within five minutes of opening an account. Being able build up a platform from the ground up has meant that some FinTechs have been to rapidly develop and grow. Indeed, some FinTechs have become known as providers of 'super apps': for example, Revolut, originally an app for currency cards, now offers trading in cryptocurrencies, plus investments, savings pots and insurance.

Other FinTechs provide infrastructure to other organisations. 'Banking as a service' is the concept of FinTechs building a platform or elements of a product or customer journey and providing that service to other FinTechs or Banks. For the FinTechs this provides scalability and makes it easier for new to market banks. For Banks, this provides another option when considering new platform or software partners. This has led to FinTech partnerships, for example:

- **Starling Bank**, a UK FinTech, initially started by only offering an app-based personal current account, but then created a 'marketplace' within their banking app. The marketplace allowed other FinTechs to sell products such as loans and pensions, utilising APIs to connect customers and data with products.
- **ClearBank** obtained a banking licence in 2017 and provided agency banking in what was then a relatively novel way, offering API access to its cloud infrastructure and white labelling its services providing agency bank facilities. ClearBank states that this enables potentially speedier entry to market[7]. Their offering provides connections to payment schemes but also an app and website.

As FinTechs start to expand their offering and digital capabilities increase, we are also seeing payments embraced in other markets such as social media. In China, Alipay and WeChat are known as "apps for everything" and are widely used. In Q1 2021, WeChat had 1.24 billion active users[8]. Additionally, US tech giants Facebook and Google are increasingly integrating payments into their platforms.

A supportive legislative and regulatory environment

Financial legislators and regulators globally are naturally keen to foster a competitive and innovative market. This helps ensure that customers get the best deal from their financial providers while also enabling the sector to innovate and attract investment, which benefits the wider economy.

Within Europe, the second Payment Services Directive (PSD2) came into force in January 2018, with the aim of enabling the continued development of an integrated internal market for safe electronic payments (following the first PSD that came into force in 2009). One of the major new elements of PSD2 was a new class of entities known as Third Party Payment Service Providers, which paved the way for FinTechs to have access to customer data and initiate payments. This

5 https://aws.amazon.com/solutions/case-studies/monzo/

6 https://techcrunch.com/2015/05/29/the-unbundling-of-finance/

7 https://www.clear.bank/newsroom/clearbank-offers-multi-currency-bank-accounts

8 https://www.businessofapps.com/data/wechat-statistics/

Further innovation

At Lloyds Banking Group, we have partnered with Minna Technologies to enable customers to manage their subscription services via our banking apps.

has created a platform for FinTechs and banks to both compete and where beneficial collaborate, as new models and services are created on top of existing banking infrastructure.

In the UK, there is a continuing effort to ensure that policy changes are effective and that customers continue to get the best deal. In 2020 the UK government commissioned the Kalifa Review, which was made at the request of the Chancellor, to identify priority areas to support the UK's FinTech sector[9]. Recommendations include the creation of a £1bn FinTech-focused and market-led growth capital investment vehicle as well as fostering partnerships between incumbent financial institutions and FinTech firms.

The FinTech Delivery Panel was set up at the request of HM Treasury and develops collaborative initiatives to support domestic FinTech start-ups and accelerate their time to market[10]. One of the key initiatives of the FinTech Delivery Panel is the FinTech Pledge, launched in September 2020, the aim of which is to enhance collaboration between banks and leading FinTech firms.

Following this pledge, Lloyds Banking Group launched a dedicated FinTech landing page, providing an opportunity, and outlining our desire to partner and path to collaborate with FinTechs. This should enable Lloyds Banking Group to continue to enhance our capabilities as a bank and deliver exceptional service across the Financial Services market[11].

The UK's Financial Conduct Authority (FCA) established a sandbox programme in 2016[12], enabling firms to test innovative propositions in the market with real consumers. Whilst open to a wide range of organisations, many FinTechs have taken up the opportunity to test new propositions in a controlled environment. Following the success of the programme, the FCA proposed and now chairs the Global Financial Innovation Network, which is a group of more than 60 regulators and supervisors committed to supporting financial innovation in the interests of consumers[13].

A new kind of collaboration

FinTech platforms can offer established UK banks opportunities to acquire or use an external banking platform instead of developing their own in-house, which may be difficult or inefficient to do. Alternatively, banks can partner with several different FinTechs that specialise in different parts of a product or customer journey. As an example, a new FinTech bank, or even an existing bank looking to renew their infrastructure might choose to use a FinTech Bank as their banking service provider, but then partner with another for international transfers.

A superficial look at the market as it stands could lead to the impression of legacy banks versus new agile competitors. However, this is simplistic and misrepresents the dynamic nature of financial services. In fact, we are witnessing a growing number of different types of industry participants with bespoke specialisms and abilities that allows for strategic collaboration and partnerships to take place, which in turn drives innovative and competitive solutions that benefit the customer. For example:

- At **Lloyds Banking Group**, we have partnered with Minna Technologies to enable customers to manage their subscription services via our banking apps[14].
- **Apple** has moved into the payment space through Apple Pay and Apple Pay Cash launched a credit card in partnership with Goldman Sachs[15]. Apple in this instance has developed the user experience and provide the platform across their eco system through iOS devices and Macs while Goldman Sachs has provided the underwriting and accounting platforms.
- **Natwest** partnered with Pollinate, a FinTech that provides Cloud toolkits, along with processor gateways and an agnostic terminal to create 'Tyl' by Natwest[16]. This partnership has allowed Pollinate to have access to a large percent of the UK market, and has given Natwest the ability to create its own card acquiring platform.

9 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/978396/KalifaReviewofUKFintech01.pdf

10 https://technation.io/about-us/fintech-delivery-panel/

11 https://www.lloydsbankinggroup.com/who-we-are/working-with-suppliers/collaborating-with-Fintechs.html

12 https://www.fca.org.uk/firms/innovation/regulatory-sandbox

13 https://www.thegfin.com/about

14 https://minnatechnologies.com/2021/01/14/series-b/

15 https://www.goldmansachs.com/our-firm/history/moments/2019-apple-card.html

16 https://www.rbs.com/rbs/news/2019/05/natwest-launches-natwest-tyl.html

Partnering for success

There are a wide range of FinTech accelerators in the market, with many large players in the financial services industry looking to help develop new players. For example, at Lloyds Banking Group we've partnered with FinTech Scotland and introduced an incubator programme called 'Llaunchpad'.

The sharing of talent to combine the extensive payments experience seen in banks with the technical capabilities of technology company employees gives the partnership model a significant benefit in offering specialised capabilities.

Combining forces with FinTechs is one important way that UK banks can run their infrastructure on the latest technology, utilising the specialist knowledge of the FinTech market to their advantage and that of their customers. In return, the smaller new entrants in the market have the opportunity to receive investment, access a wider customer base, and collaborate with, and compete against, those more experienced with the banking and payments regulatory frameworks.

Investment in FinTech collaboration

Government, regulators and industry groups are showing their support of the FinTech market by implementing policies, promoting external investment and setting up structured programmes to support FinTechs.

FinTech incubators and accelerators, often set up by banks or consultancy firms, are key tools for FinTechs by providing access to funding and development. Incubators offer the opportunity for funding to new players in the market to develop business models and provide collaboration with experts. Accelerators help to develop companies that are further along in the journey to offering products and services to market by connecting start-ups with investors and providing industry guidance[17].

There are a wide range of FinTech accelerators in the market, with many large players in the financial services industry looking to help develop new players. For example, at Lloyds Banking Group we've partnered with FinTech Scotland and introduced an incubator programme called 'Llaunchpad', based out of our Edinburgh hub. It aims to bring together FinTechs to help tackle the challenges of digital services and sustainability. The first showcase is expected in 2022.

Additionally, Lloyds Banking Group is a key member of Innovate Finance which provide an industry-led, independent platform for government and regulators to engage with representatives from across the industry[18].

Lloyds Banking Group's Strategic Partnerships

In 2021 Lloyds Banking Group refreshed its organisational strategy, setting clear ambitions for building on our progress to become a digitised financial services organisation.

We've laid out four priorities that will transform our organisation and enable us to serve our customers long into the future: delivering a modernised technology architecture, building integrated payment solutions, creating a data driven organisation and implementing reimagined ways of working[19]. The right strategic partnership opportunities can help us deliver these priorities, and we have an established recent history of investment.

Innovation is at the core of our organisation, building a solid foundation which will allow us to move at pace in the light of changing customer behaviours and wider technological landscape. This approach enables us to provide API and data-driven support utilising standards such as ISO 20022 and modern APIs. Which will then in turn allow us to develop rich front-end propositions which translate into great customer experiences.

In 2020 we announced our strategic partnership with Form3[20], a cloud-native payment technology FinTech, to accelerate our transformation and enhance the digital experience for customers. The partnership represented a significant milestone to update our payments architecture and payments transformation projects, utilising C-based capabilities and readying the Group for the move to the New Payments Architecture.

In 2019 we invested in Fnality[21], founded to create a network of decentralised Financial Market Infrastructures (dFMIs) to facilitate international payments using digital cash assets to settle tokenised transactions.

17 https://technorely.com/fintech-incubators-accelerators/

18 https://www.innovatefinance.com/about/

19 https://www.lloydsbankinggroup.com/who-we-are/our-strategy/enhancing-our-capabilities.html

20 https://www.lloydsbankinggroup.com/media/press-releases/2020/lloyds-banking-group/lloyds-banking-group-enters-strategic-partnership-with-fintech-form3.html

21 https://www.fnality.org/about-fnality

Collaboration

We recognise the contribution FinTechs are making to innovate and develop better outcomes for customers, and we're committed to strengthening our collaboration.

Fnality will do this by utilising both blockchain and distributed ledger technology, and we are exploring the opportunities for our business and our clients as the digital currencies market matures.

Our Fnality investment followed our announcement in 2018 of a strategic partnership with Thought Machine, a UK-based growth stage technology company whose core product, Vault, is a Cloud-native next generation banking platform. In the course of our strategic partnership with Thought Machine, we made an £11m investment, representing a 10% stake and demonstrating a desire for Thought Machine to grow in both size and capability[22].

We recognise the contribution FinTechs are making to innovate and develop better outcomes for customers, and we're committed to strengthening our collaboration in this area.

The future of FinTech Partnerships

The UK banking and payments industry has a history of collaborating, from delivering the domestic payments scheme Bacs in the 1968s, to iPSL in 2000 to find efficiencies in the provision and processing of cheques. As the industry has evolved, more players are operating in the payments chain and technological capabilities have increased; there are now many ways that established providers can collaborate with FinTechs.

The benefits of collaboration can be significant. Sharing research and development resource by combining forces can link up the innovation from the smaller players with the significant experience, reach and data of the larger corporations. Access to technology, platforms and channels is significantly strengthened by a collaborative approach between institutions.

Governments and regulators in the UK and globally are keen to foster a vibrant growth environment in the UK banking and payments industry, which can benefit customers by providing the latest innovative platforms and delivering further efficiencies. Such an environment also supports inward investment, which is a key priority for the UK.

Our focus on Helping Britain Recover and Prosper continues, and with the FinTech sector being a key provider of jobs and upskilling in the UK we are committed to its development. Lastly, we are strong advocates of the benefits of collaboration in banking and payments and we will continue to identify potential FinTech partnering opportunities that could deliver new and enhanced services and experiences for our clients and customers. A competitive market is a must and so is recognition that a competitive market can be, and sometimes must be, built on collaboration.

22 https://www.lloydsbankinggroup.com/media/press-releases/2018/lloyds-banking-group/lloyds-banking-group-enters-into-strategic-partnership-with-thought-machine.html

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