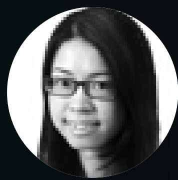
This latest report in the WORK_IT series discusses the challenges FinTech is posing to traditional banks and the ways in which they are responding.

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FINTECH CHALLENGES TRADITIONAL FINANCIAL SECTOR

Tighter regulations have restricted the banking and financial services industry's ability to expand and drive new revenue growth in recent years. At the same time, the evolution of consumer preferences and significant advances in technology are supporting the rapid expansion of financial technology (FinTech).

FinTech is driving the transformation of the financial sector in terms of the delivery of financial services, the medium of transactions and the approach to business analysis. It is providing alternative solutions to customers and redefining standards and expectations within the financial services industry.

Examples include:

- Mobile payment and digital currencies are enabling faster and more transparent payment and settlement.

- Online loan applications and more powerful loan analysis are speeding up the lending process.

- Robo-advisors are utilising machine learning algorithms and data analytics to recommend suitable portfolios to investors at lower management fees. They also have the capability to extend these services to unserved or underserved clients of traditional financial institutions.

- Crowdfunding is providing new sources of finance for start-ups and riskier businesses unsuitable for public listings.

Many FinTech services and solutions are being provided by start-ups and tech companies and pose a serious threat to traditional financial institutions in terms of market share, revenue and strategic and operational models.

PwC's 2017 Global FinTech report found that 88% of large financial firms in Asia believe part of their business is at risk of being lost to standalone FinTech companies. Traditional consumer banks' personal loans and financing businesses were identified as being most at risk.

Table 1: PROVISION OF NEW AND INNOVATIVE FINANCIAL SERVICES BY FINTECH

	Banking and payments	Credit and lending	Investment management	Fund-raising
Old format	Banking branches and ATMs	In-person loan applications and approvals	Rely on personal bankers	IPO or securities issuance involving highly paid investment bankers
New format	E-banking Non-bank e-payment Digital currencies	Online loan applications P2P lending	Robo advisors	Crowdfunding
Challenges	Largely replaced by payment systems developed by tech companies	Removal of banking intermediaries Simplification of loan approvals	Cost efficiency Fund management fees less than half of current levels	Fewer intermediaries Lower regulatory requirements
Benefits	Less reliant on physical touch points	More efficient loan approvals	Efficiently generate investment recommendations to clients	Capture business for smaller and/or riskier projects not suitable for listings

Source: CBRE Research, September 2017.

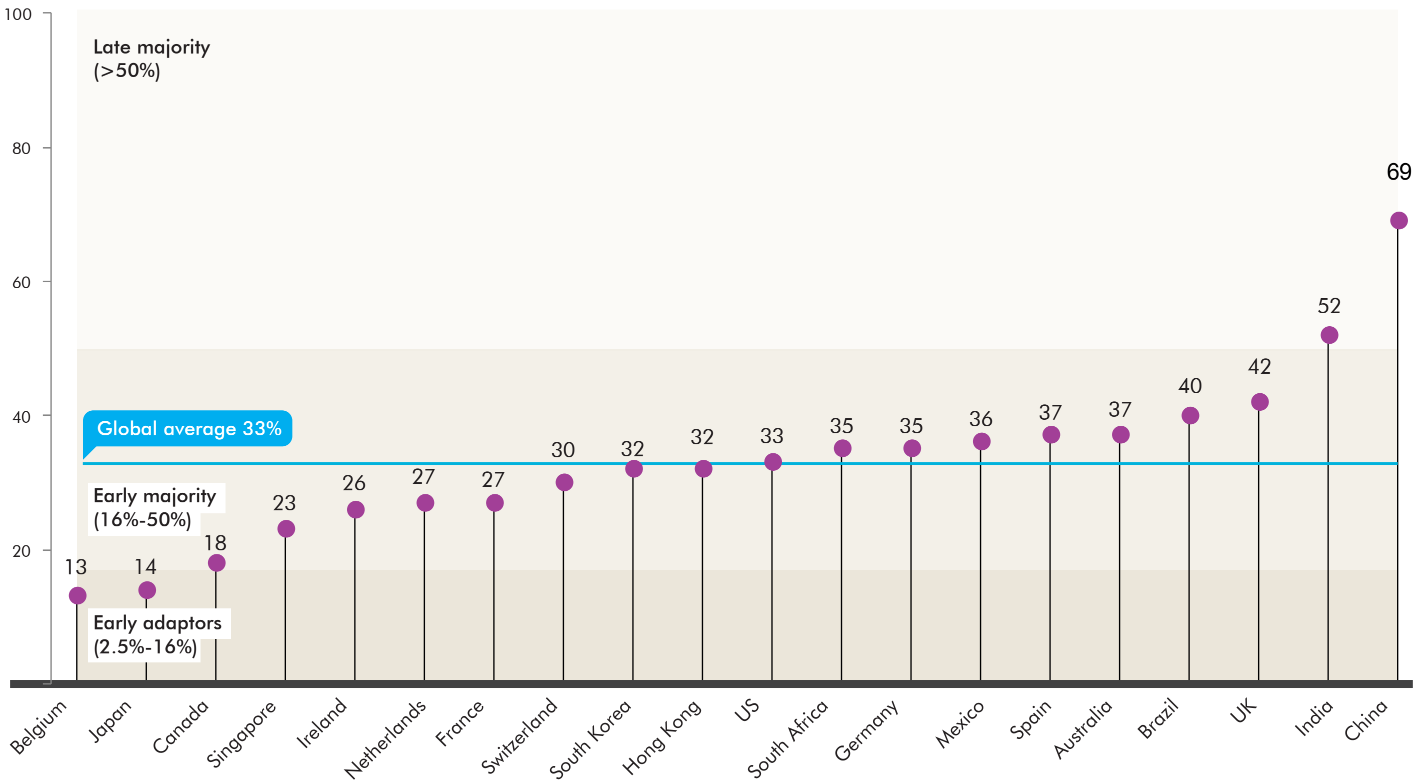
ASIA PACIFIC EMBRACES FINTECH

The number of users of FinTech services has grown rapidly in Asia Pacific in recent years. Instead of being driven by established business and financial hubs such as Hong Kong, Singapore and Tokyo, it is China and India that are leading the way (Figure 1).

The enormous size of these two countries makes it difficult for traditional consumer banks to provide efficient service at a low cost. This is encouraging the adoption of mobile payment, digital money transfers and credit and lending services. Tencent's WeChat Pay has around 600 million active users while Alipay, the online payment arm of Ant Financial, has more than 400 million. These internet giants have also set up FinTech services in areas including financing for consumers and small firms, along with wealth management.

The adoption of FinTech in mature markets varies. Australia, Hong Kong and South Korea are progressing well while Japan and Singapore are lagging.

Figure 1: RATE OF FINTECH ADOPTION IN 20 MARKETS WORLDWIDE



Source: EY – FinTech Adoption Index 2017

COMMERCIAL BANKS STRUGGLE TO ADAPT

Financial institutions urgently need to respond to the challenge posed by FinTech by embracing technological innovation and rethinking their traditional business model and service offering. However, the pace of change has been slow. This is due to several major barriers, including:

a. Large and complex operating systems: Most large banks continue to utlise the I.T. infrastructure they have developed and invested in for many years. These legacy systems are often unwieldy and complex due to the many linkages between different departments and mean banks generally lack the agility of FinTech companies and start-ups.

b. Strict regulations: FinTech companies and start-ups are usually less subject to financial sector regulations and thus are compliance-light. In contrast, regulatory requirements for banks have significantly increased since the global financial crisis. Banks are therefore subject to a far higher degree of risk assessment and compliance when introducing new products and services to market.

c. Focus on risk aversion: Banks place a strong emphasis on risk aversion as even a small error in their operational systems could result in a large financial loss. Operational systems are therefore designed to be robust rather than flexible. This conservative attitude means banks' willingness and capacity to accommodate new technology is limited.

HOW CAN BANKS RESPOND?

Despite the numerous barriers preventing traditional financial institutions from adopting innovative technology, PwC's 2017 Global FinTech report found that a majority plan to make a bigger effort to innovate. Western banks are generally more proactive in terms of embracing new technological trends but Asian banks are beginning to catch up.

Many banks are now allocating larger budgets to digital banking and gradually turning their focus to new technology including artificial intelligence (A.I.) and the blockchain[1]. To accelerate innovation within their organisation, some large banks have used venture capital to directly invest in FinTech start-ups in Asia Pacific. Banks are also partnering with FinTech start-ups to set up innovation labs and launch accelerator programmes, as well as launching joint programmes with co-working space operators as corporate partners.

[1] PWC's Global FinTech Report 2017

1) Set up innovation labs and accelerator programmes

PwC's 2017 Global FinTech Report found that around 82% of banks expect to increase their partnerships with FinTech start-ups over the next three to five years. Such collaboration can be mutually beneficial; banks bring a large customer base, extensive infrastructure and deep knowledge of regulations and risk management, while start-ups possess technical expertise, innovation and agility.

The two most common approaches are opening innovation labs and setting up accelerator programmes. Both formats can help banks explore the use of new technology and innovative solutions for digital product and service delivery while utilising FinTech start-ups' entrepreneurial mindset.

Innovation labs in Asia Pacific tend to be concentrated in major financial hubs such as Singapore, Hong Kong and Sydney. Major banks such as Standard Chartered, DBS and ANZ have all opened innovation labs in Singapore over the past three years, while Hong Kong is home to 12 FinTech labs, including initiatives from financial institutes along with the participation of Accenture and universities. In Sydney, large domestic financial institutions such as Commonwealth Bank of Australia, Westpac and IAG have also opened innovation labs.

The trend is now spreading to other markets. Examples include Axis Bank opening an innovation lab in Bangalore, where is the tech hub of India, in June 2016; and Japan's Mizuho opening its first innovation lab inside the co-working space Finolab in Tokyo.

Some labs are located on banks' main premises but many are situated outside traditional business areas and in business parks. Examples include Cyberport and Science Park in Hong Kong and One North in Singapore. The size of labs can vary from a few thousand sq. ft. in a banks' main premises to a standalone office of over 10,000 sq. ft. Labs in Asia Pacific are generally smaller than those in the U.S. A major U.S. bank's innovation lab in Manhattan hosts more than 700 tech employees in a 120,000 sq. ft. space. The bank plans to expand this to nearly 428,000 sq. ft. to accommodate 2,000 - 2,500 tech employees in the coming years.

Accelerator programmes often make use of co-working and incubator space to host participants. Such locations provide an atmosphere that appeals to millennial employees that comprise the bulk of the workforce in FinTech start-ups. These spaces also offer more flexibility regarding lease terms, choice of location and unit size compared to a traditional lease. Examples of banks using co-working space include Standard Chartered partnering with Chinese online search giant Baidu and co-working space operator TusPark Global Network to open a FinTech incubator programme in Kwun Tong of Hong Kong.

Table 2: INNOVATION LABS AND ACCELERATOR PROGRAMMES IN ASIA PACIFIC

By Financial institutions

Financial institution	Program	Market	Location	Size
DBS	DBS Asia X / DBS HotSpot Pre-Accelerator	Singapore	Sandcrawler Building@ One North / BASH @ One-North	16,000 sq ft (>5,000 people) BASH : 25,000 sq. ft.
Standard Chartered Bank	eXellerator	Singapore	Marina Bay Financial Centre	15-20 staffs
CitiBank	Citi Innovation Lab	Singapore	n.a.	12 staffs
Oversea-Chinese Banking Corporation (OCBC)	The Open Vault	Singapore	New Bridge Road	2,400 sq. ft.
Monetary Authority of Singapore	Looking Glass@MAS	Singapore	Shenton Way	n.a.
Commonwealth Bank	The CommBank Innovation Lab	Hong Kong	Central	n.a.
Westpac	The Hive	Sydney	Kogarah hub	8,000 sq. ft.
Commonwealth Bank	The CommBank Innovation Lab	Sydney	Commonwealth Bank Place	7,000 sq.ft.
Mizuho	Innovation lab	Tokyo	Finolab	n.a
Axis Bank	Thought Factory	Bangalore	n.a.	10,000 sq. ft.

By partnership

Financial institution	Program	Market	Location	Size
SGInnovate and United Overseas Bank	The FinLab	Singapore	BASH @ One-North	BASH: 25,000 sq. ft.
HKMA & ASTRI*	Fintech Innovation Hub	Hong Kong	Hong Kong Science Park	200 workstations
Standard Chartered Bank and Baidu	SuperCharger (accelerator programe)	Hong Kong	TusPark Global Network @ Kwun Tong	TusPark Global Network: 8 floors
Accenture, supported by 11 other financial institutions	Fintech innovation lab (accelerator programe)	Hong Kong	Smart FinTech Space @ Cyberport (Finalists will receive 3-6 months complimentary co-working space)	Smart FinTech Space: 35,000 sq. ft.
24 corporates including Westpac, Macquarie, ANZ, Suncorp Bank	Fintech start-up hub (accelerator programe)	Sydney	Stone and Chalks @ AMP Tower	Stone and Chalks: Whole floor

*Note: ASTRI: Hong Kong Applied Science and Technology Research Institute.
Sources: Various news, CBRE Research, September 2017.

2) Upskill their I.T. workforce

Banks in mature markets in Asia Pacific plan to increase their I.T. spending to US$67 billion in 2017, representing a growth rate of 5.4% y-o-y[2]. They are also stepping up their hiring of I.T. professionals. However, they face stiff competition for tech talent from FinTech start-ups and are therefore focusing on upgrading and equipping their existing I.T. professionals with the right skillset such as product development, engineering, data analytics and cyber-security. In China, large banks such as Bank of China(BOC), Industrial and Commercial Bank of China (ICBC), China Construction Bank (CCB) and Agricultural Bank of China prefer to partner with tech giants such as Tencent, Alibaba and Baidu to harness the latest financial services technology related to consumer finance and cloud computing to cover the broader population. This can also provide opportunities for banking staff to familiarise themselves with the latest financial services technology.

More banks are setting up specific facilities for their I.T. talent which are often co-located with their innovation labs and/or data centres. For example, most of the Hong Kong Stock Exchange's I.T. development and support staff are based in its Tseung Kwan O data centre where they develop new applications and maintain state-of-the-art systems for trading, clearing and settlements. This data centre has largely replaced the Hong Kong Stock Exchange's 31-year-old trading hall in Central, which will cease operation in October 2017.

Financial institutions are also focusing on improving the digital and technology knowledge of their workforce by providing training. DBS recently opened its DBS Academy at a 40,000-sq. ft. innovative learning space for its employees.

3) Transform retail banking

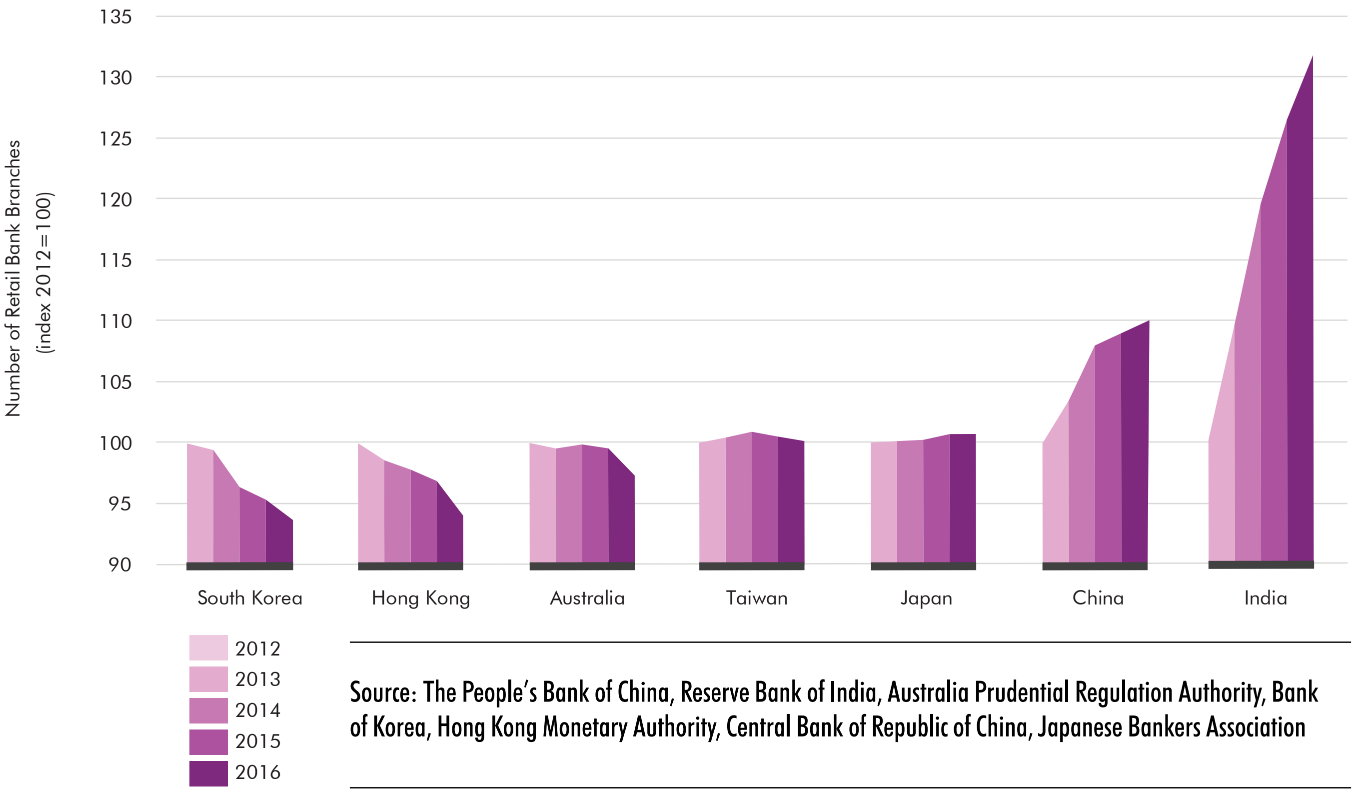
FinTech is enabling mobile banking and electronic payment and is reducing demand for bricks-and-mortar banks. Retail banks are evolving rapidly and the role of retail branches is shifting away from transactions to advisory.

Mature markets including Hong Kong, Australia and South Korea saw the number of retail branches decline by 5% between 2011 and 2016. In contrast, overall branch density in China and India is still increasing as banks seek to capture market share and reach a large unserved population. Nevertheless, large Chinese banks have recorded a reduction in their number of branches in recent years along with a stronger emphasis on 'light branches' with fewer staff.

With customers visiting physical branches less frequently, banks are placing a stronger emphasis on providing a good customer experience in full-service branches. Designs now feature more open space and area to facilitate greater interaction between staff and customers. Some banks have remodeled their branches into a cafe style format providing a more relaxed environment for clients to discuss their financial plans.

[2] Gartner Says IT Spending in the Banking and Securities Industry in the Mature APAC Region to Reach $67.1 Billion in 2017: http://www.gartner.com/newsroom/id/3602217

Figure 2: NUMBER OF RETAIL BANK BRANCHES IN ASIA PACIFIC



Source: The People's Bank of China, Reserve Bank of India, Australia Prudential Regulation Authority, Bank of Korea, Hong Kong Monetary Authority, Central Bank of Republic of China, Japanese Bankers Association

CBRE GLOBAL RESEARCH

This report was prepared by CBRE Asia Pacific Research Team, which forms part of CBRE Global Research – a network of preeminent researchers who collaborate to provide real estate market research and econometric forecasting to real estate investors and occupiers around the globe. For more information regarding this research report, please contact:

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As technology exerts a greater influence on all aspects of our lives, this report series examines the various dimensions and impacts of technological change in the workplace.