



Digital intelligence

Our takeaways on the top developments influencing financial services

Amazon is in early stages of building a set of banking services

- Several recent reports highlight the increasing aspirations of BigTech entering financial services
- BigTech expansion will likely include partnerships or co-branding opportunities with settlement still via the traditional banking system
- However, BigTech brings well-known and liked retail brands, a large and loyal customer base, and scale—all areas where FinTech struggles
- This could bring newfound pressure to banks to further reduce costs and reevaluate strategy for relevancy should BigTech “own” customer distribution
- Several precedent examples exist where BigTech has disrupted incumbents’ economics by inserting themselves directly within the higher return parts of the value chain. Effective response requires testing old assumptions and reassessing how value is generated in a digital-first world

According to recent [reports](#)¹, Amazon has had partnership discussions with major banks to offer a **checking account product**. If the company proceeds, it could insert itself directly into the primary financial activity of consumers, well beyond existing services such as Amazon Cash, Amazon Pay, and co-branded credit cards. Further, the company is reportedly [hiring for a new mortgage business](#)², has [partnered with Bank of America](#) for small business lending³, and is in discussions with other banks about [co-branded small business credit cards](#)⁴.

The report also suggests that Amazon will specifically target younger and underserved customers with its digital and mobile banking checking product. It has been challenging for banks to serve these customer segments from both a customer engagement and initial revenue standpoint, which is one reason digital models and non-bank alternatives have emerged. Despite these developments, checking accounts—which often come with direct deposit, debit cards, and bill pay—remain a “gateway product” for retail banks, as they anchor sticky relationships and allow banks to then cross-sell other services such as credit cards, savings accounts, and lending products.

In other countries (notably China, but also India) technology companies already supply many of the financial needs of consumers. Regulatory considerations clearly remain a significant factor, however technology companies that excel with consumer engagement and in using data to fulfill future consumer needs provide a differentiated approach in the financial services value chain, especially as consumer finance transitions to digital.

¹ Emily Glazer, Liz Hoffman, Laura Stevens. “Next Up for Amazon: Checking Accounts”, The Wall Street Journal, March 5, 2018

² Jacob Gaffney. “Amazon hiring head of newly-formed mortgage lending division”, HousingWire, March 8, 2018

³ Eugene Kim. “Amazon has partnered with Bank of America for its lending program: Sources”, CNBC, February 14, 2018

⁴ Hugh Son, Spencer Soper, Jennifer Surane. “Amazon Wants to Dominate Office Supplies With Its Credit Card”, Bloomberg, March 12, 2018



A potential expansion of BigTech into financial services comes at a time when there has been a huge shift in value away from point-in-time transactions and toward an ability to deliver convenient personalized services. In a scenario in which Amazon offers checking account services, the company could extend its reach to a new part of consumer finance in a highly convenient fashion and possibly alter the traditional data flow between banks and consumers. Just as many retail payments activities are now subsumed directly into daily consumer activities (e.g., ride-hailing payments, e-commerce transactions, monthly media subscriptions), deposit services offered by nontraditional providers could change how consumers perceive, pay for, and use transactional banking services. The challenge for banks is to continue to own the client relationship to maintain connectivity with their brands in a digital-first world when many nontraditional competitors arguably have a lead with digital consumer experience, engagement, and intuitive product delivery across an increasing breadth of services.

Amazon is known for its [obsessive customer-centric approach](#), which is relevant when considering a long-term strategy around financial services, ease for consumers to use money, or the potential for new pricing models. In specifically targeting customers early, additional financial services could be offered as this customer base matures. The average age of millennials is 26.5 years and prime income years for the demographic do not start until 2028, meaning demand for home purchasing, investments, retirement savings, and insurance are just starting to materialize.

New BigTech entrants could build business cases around customer lifetime value with cost structures that leverage digital economies of scale. Further, the technology industry typically has a faster pace for new product introduction—when BigTech expands with new products, they come at the market with significant customer scale, an unprecedented ability to ramp up quickly, and a longer-term mindset about market share gains. In general, there is greater willingness from technology investors (rather than financial services shareholders) to sacrifice short-term profitability in order to generate sustained growth, even if in initially unprofitable areas. Further, BigTech platforms have historically been less concerned with individual product profitability and have consistently used certain products (e.g., Amazon Prime Video, Amazon Echo Alexa Speakers) as loss leaders for new customer acquisition and loyalty, thus increasing customer lifetime value.

Implications across retail financial services

Regardless of whether Amazon or other BigTech companies further enter financial services or not, banks already are measured against technology companies, FinTechs, and rival banks for user experience and relevance. As methods of distribution evolve, customer engagement will be a critical factor for financial institutions trying to avoid being relegated to transaction facilitators. A path forward for retail financial services providers can involve elevating the consumer relationship from transaction to engagement by better addressing the lifetime journey or “cradle-to-grave” themes. When a consumer applies for a mortgage, for example, it should not be viewed as a point-in-time transaction and could be related to a relocation or move. This could be considered a life event that may influence many other financial decisions. The financial institution should be present throughout the full consumer journey to assist with one-time moving expenses, auto financing, and other related financial decisions.

From a pricing model perspective, three top consumer technology services in the US collectively have very high household penetration (170 million-plus cumulative active paying subscribers in the US), and the technology industry as a whole has largely moved toward subscription-based pricing. Financial services companies could consider new pricing models that may appeal to younger or digital-centric consumers should the trend of BigTech entering financial services continue. For example, banks that offer a monthly or annual subscription fee for basic bank services rather than potential overdraft or ATM fees could appeal to select individuals. In many other geographies such as Canada and the UK, monthly maintenance fees for checking accounts or retail brokerage accounts are significantly more prevalent.

Implications for deposit banking: commoditization risk, newfound pressure on costs and digital transformation

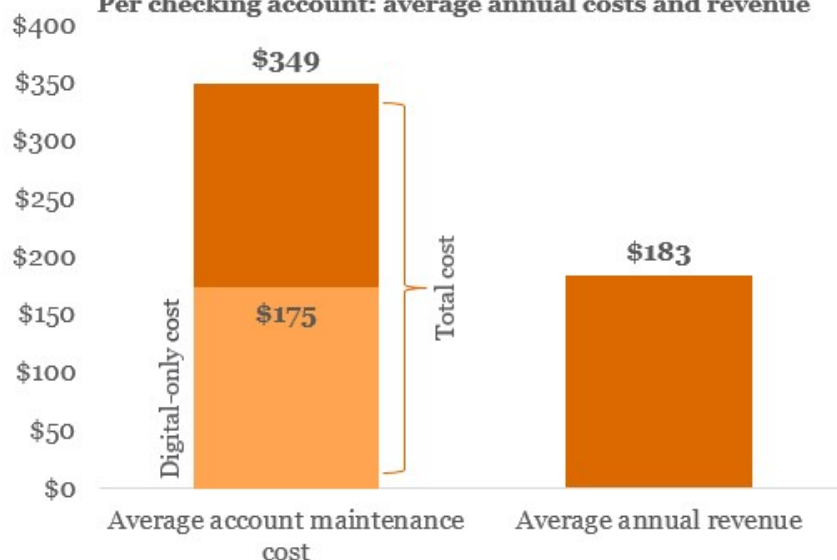
The cost of account maintenance will need to trend lower should digital channels become the primary form of interaction. The forces behind this trend are obvious in the proliferation of mobile devices and the 5,000-plus FinTech startups that stimulated a customer-focused innovation overhaul of financial services. Despite these trends, FinTechs have struggled in achieving scale, customer acquisition, and trust. However, with BigTech pushing

deeper into financial services an argument can be made that these companies bring proven scale with a large customer base (hundreds of millions of users) that banks haven't faced before. This could bring additional pressure for banks to rationalize costs, and it also adds to the risk of consumer interaction and associated data shifting away from banks to established BigTechs rather than FinTechs.

In recent years, banks have shied away from offering free deposit accounts for younger and low balance individuals given the challenging short-term economics of this business. This strategy does not hurt banks as over time customers will pursue bank accounts as they require other services to manage their finances. Still, the environment has changed as consumers now enter the financial services system earlier than ever through services such as peer-to-peer payments and non-bank digital alternatives (such as the P2P payments providers) that now offer deposit accounts. With this new on-ramp to financial services, banks may see a need to 1) consider free basic bank services as a needed investment to attract new customers, 2) further reduce costs to more closely align with the digital economic model, or 3) evaluate partnerships with financial or technology incumbents to help subsidize the initial cost of basic bank services.

Exhibit 1: BigTech scale could bring additional cost and digitization pressure to banks

Per checking account: average annual costs and revenue



- Banks spend an average of \$349 annually on account maintenance costs
- Roughly 40% to 50% of this cost is from physical branch and legacy costs
- Should BigTech push further into financial services, they will bring proven scale and a large customer base
- This could bring newfound pressure for banks to reduce costs or accelerate digitalization efforts

Note: Illustrative example

Source: American Banker, Federal Reserve Survey of Consumer Finances, Company filings, PwC estimates

BigTech expansion to financial services will likely be partner-led, amplifying the conversation around a bank-initiated ecosystem approach. This may involve a strategic shift for banks to move beyond individual products and could also include offering third-party services such as alternative credit decisioning models or features to view cross-bank aggregated data. Notable to this is a shift from bank-FinTech to incumbent-incumbent partnerships. Open APIs remain a primitive project for financial services, but many banks are starting to build teams to explore the business case and rationale for a more open bank experience with third-party providers.

Implications for retail payments: interchange fee compression

The retail payments market represents a large and fast growing profit pool. The value chain is currently split across card issuers (dominated by regulated banks), payments networks, and merchant acquirers—the latter two categories tend to be dominated by non-banks and offer greater growth and higher returns.

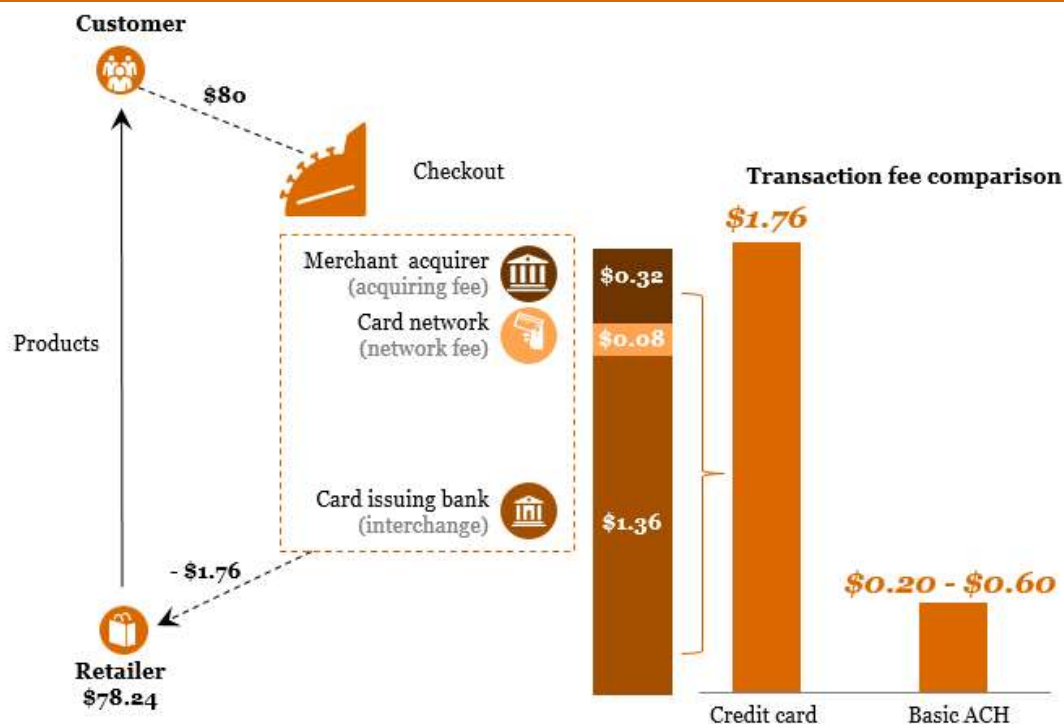
Many of the large technology companies that have made forays into retail financial services have done so with payment services. They have arguably started here due to accessibility to consumers through mobile and low notional dollar transactions. Importantly, while many tech companies may provide a next generation consumer connection point, settlement still occurs in the incumbent banking system—meaning the interchange economics enjoyed by incumbents and long-standing habits of card-based payments have hardly changed.

BigTech may continue to target this incumbent profit pool, and Amazon in particular has a strong incentive to leverage deposit account offerings as a tool to reduce interchange fees. Every transaction that is settled through a

deposit account at checkout contributes an incremental 150 bps to Amazon's net margins, a significant delta in retailing where net margins in the US market are in the low single digits. Amazon already offers ACH funds transfer as a payment option, although an Amazon-branded deposit account may find greater success in steering meaningful volume to the lower cost credential. To date, success has eluded alternative payment credentials in digital commerce.

Further, new payment models typically need incentives for both merchants and consumers. Beyond lower merchant transaction fees, BigTech brings a deeper understanding of customer behavior to develop meaningful incentive packages, early access to relevant digital content, and expedited delivery of purchases. Amazon is also unique in that it can introduce new payments credentials in a closed-loop environment, so adoption requires no change in consumer checkout behavior.

Exhibit 2: Sample \$80 ecommerce transaction



Note: Illustrative example
Source: PwC

A few reasons for wealth managers to consider banking

Retail wealth management firms may have an interest in expanding to bundle bank services due to incremental revenue and new customer opportunities. Some wealth management firms have introduced lending products over the last several years by way of existing bank charters. Other firms that have shied away from bank licensing are incrementally pursuing partnerships or other methods to expand their revenue stream beyond commission fees.

New basic bank services combined with brokerage can bring revenue synergies from earned interest, interchange fees, or the potential for incremental trading activity from enhanced client engagement. PwC estimates this could amount to a measurable 20%-plus uptick in revenue per account for discount and full-service brokers. Integrated account offerings also can provide a strategy to target the younger and lower income individuals that wealth managers typically ignore. Similar to many FinTechs, wealth managers can target this demographic with refinance options to lower consumer interest expenses (e.g., student loans or other debts). This serves the purpose of new customer acquisition with different economics due to interest earned from the consumer, essentially subsidizing the account until an accumulation of wealth materializes.

The interest in offering an integrated solution has increased due to a rising rate environment, potential for alternative licensing (e.g., OCC Special Purpose National Bank Charters, ILC bank license), and partnership opportunities. Several industry conversations with brokers and banks suggest the appetite for partnerships has become more focused

on incumbent financial services or technology companies than on FinTech startups. Wealth management firms that consider incumbent partnerships to offer out-of-footprint core bank services may see lower risk (going concern, operational, cyber), refined digital distribution, and economies of scale as reasons to pursue these partnerships. Questions on standards for data sharing and the potential for shared economics or alternative fee structures are areas of potential pushback.

Potential for vertical integration in the home-buying process

An ideal candidate for BigTech entry is the US mortgage market. This addressable market is a trillion dollar opportunity where a lack of vertical integration between the search process, the purchase, and financing create a very poor user experience. It remains unlikely that a BigTech company could become a mortgage lender but more likely that they could target the lead generation, listing, and ownership aspects of the home buying process to improve the home buying experience. BigTech companies could create value not currently captured by the mortgage market in other areas such as with new homeowner upsell opportunities on housing improvements, electronics, or a system of connected-home devices.

These advantages will likely be about the total homeownership experience, with potential for BigTech to expand to the higher margin adjacent businesses that have yet to be digitized, such as title insurance, as opposed to taking on actual balance sheet risk of a mortgage. By working to capture more of the homeowners' experience, BigTech should be able to connect more of these current standalone processes and streamline the consumer experience.

Further, the FinTech focus on superior consumer experiences has not yet found its way into the mortgage industry, as there have been few material changes in the home-buying experience. The key will be to integrate the many aspects of home purchasing journey, from discovery to initial home ownership needs. BigTech companies such as Amazon have an opportunity to leverage strong consumer engagement channels to help shepherd families through the complex home-buying experience. Incumbents may look to Amazon's current use of its distribution channels to create better shopping experiences in grocery as a guide for how an ecommerce marketplace might approach mortgages.

Additional information

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