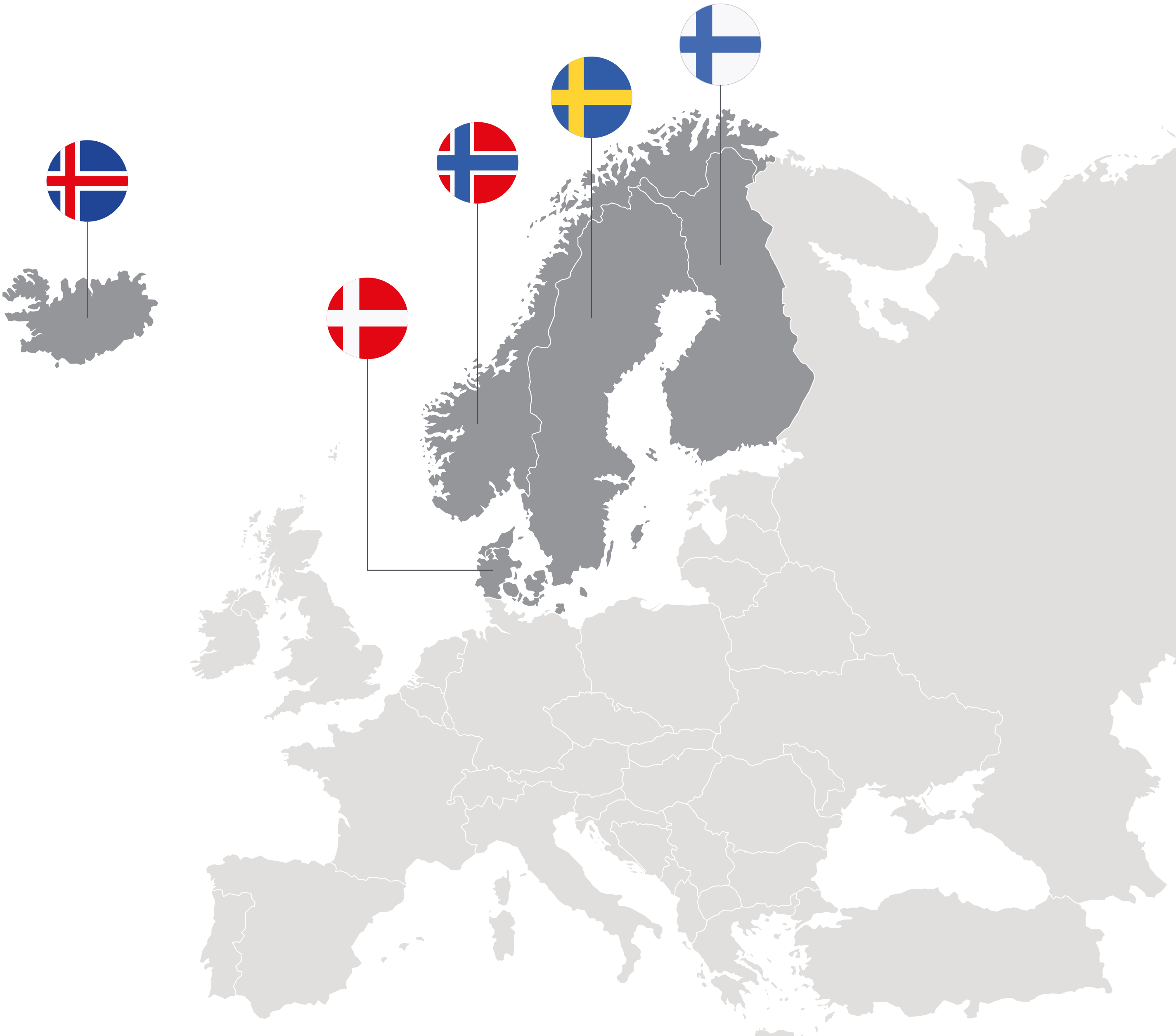
FinTech in the Nordics

A Deloitte review

Contents

The Nordics in short



27 million people

928,057km2

€1,443,626bn nominal GDP

10thlargest world economy

7 banks with balance sheets each exceeding €100bn

Source: The World Bank and The Nordic Web

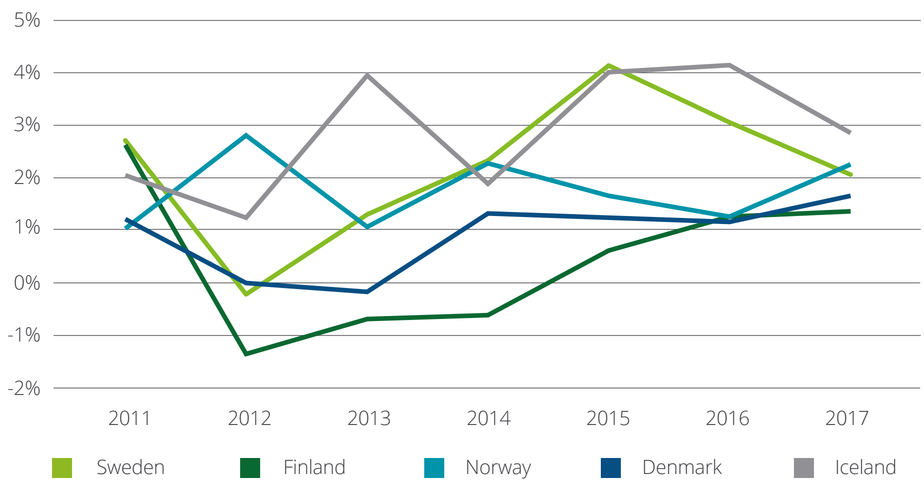
Introduction

The buzz surrounding FinTech has become more and more profound in recent years. This report will comprehensively present to you our thorough market research into FinTech in the Nordics. We will share with you what this excitement has been built on, and where we see the market heading.

It certainly seems that Schumpeterian destruction, where creating new markets is preceded by old ones being challenged or even destroyed, applies in the Nordics. The Nordic FinTech market is rapidly growing and diversifying, with more companies and new technologies being created. This is happening regardless of the fact that the incumbent financial institutions are challenged by the lagging economic growth rates and ever changing regulatory burden, both if which afflict those who are looking to enter the market.

The graph below shows that economic growth has been moderate in the Nordics for past years, and the trend is predicted to continue. For this year, Danish, Norwegian and Finnish economies are all expected to grow just by one per cent. Sweden's growth is expected to cease this year and Iceland's the following year.

Nordic GDP growth rates



What is FinTech?

Beyond being a compound word for 'Financial Technology', FinTech is defined:

Most broadly
Any digital financial service, regardless of whether the provider is an established financial institution or a seed funded start-up

More narrowly
Recently founded start-up companies entering the financial market, seeking growth rather than profitability, and building their business on some form of innovation which is new to the market

But more commonly
Technology and/or business model based financial innovations. These innovations may be launched by established companies from financial services or other industries as well as start-ups

In this paper, we will use the final definition, and focus on industry dynamics. However, our objective is to clearly distinguish between the effect of the new entrants and the possibilities they entail. When talking about the actions taken by established financial institution, we are using the term 'Incumbents'.

If the general economic outlook is not predicting better times to come, one needs to question firstly what kind of facts the current growth in the FinTech sector is based on,
and secondly whether it is all just hype. Many experts wonder what kind of impacts FinTechs can have on the Financial Service industry and the economy as a whole.

Furthermore, one must carefully assess how realistic the expectations and assumptions which the growth around FinTechs is built on are. We have found tangible factors and intangible expectations to base our analysis of the current market sentiment. The sheer size of financial volumes and ancient processes in operative business create attractive incentives for the FinTechs to base their disruptive desire.

Growth is limited, but profitability is increasing
It seems that the Nordic financial market has ceased to grow, but the banks especially have found ways to remain profitable. In the graphic below we have gathered the latest change in net interest incomes of the Nordic banks, whose total assets value exceeds 100 billion euros. The overall average has slumped approximately 4%.

"The distribution cost of financial services is approaching zero."

Reijo Karhinen
President and Group Executive Chairman of OP Financial Group

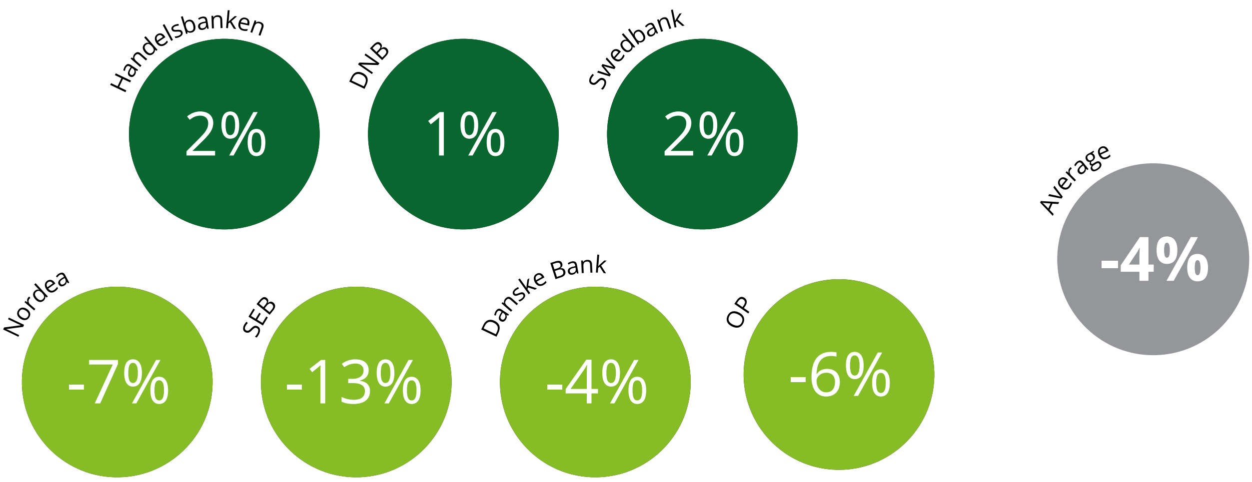


Figure 3: Net interest income, Source: Annual reports 2014-2015

The darker tones of declining net interest incomes somewhat changes when assessing profitability. The following graph shows the net profitability of the same banks and financial institutions. Much of the same success is seen in the standalone insurance companies as well, whose average profitability increased by 20% in the Nordics from 2014 to 2015.

As the overall cost-to-income ratio in European banks is an average of 59%, Nordic rivals top the figure with a 45% average ratio.[1] The

"Both the incumbents and FinTechs should constantly ask themselves 'how would I build my product if I could start with a clean sheet?"

Frans Borgstrand
Partner, Mobiento at Deloitte Digital

Figure 4: Net income, Source: Annual reports 2014-2015

interpretation of the findings is simple, what the incumbents lack in growth, they seem to make up in profitability. This certainly shows the banks' capability to cope with difficult times as well as the efficiency of their current business.

Someone considering entering the market may speculate this even further that the market is appealingly profitable and while general growth may be difficult to find, one is able to capture a fair share of business by offering innovative services. When the one considering the entry is also starting the business from scratch, aiming to be fully digital, free from the burden of legacy system and have a workforce with digital business capabilities, they have the opportunity to choose the most profitable services to disrupt. The ability to digitally provide high-margin services is the key factor driving the potential shift in industry paradigm.

"Incumbents choose to follow their traditional methods for their own success, and then miss opportunities that new technologies and new business models can give and which will meet future market needs far better"

Kirsti Merethe Tranby
Partner, Financial Services at Deloitte

[1]https://www.eba.europa.eu/documents/10180/1280458/2015+EU-wide +Transparency+Exercise+Report+FINAL.pdf

Before we present our insights in more detail, we will provide you with a deeper look into the Nordic FinTech market. We'll go over the capital invested and the type of companies these investments are made into. As the Nordic FinTech start-ups scene consists of hundreds of companies, we have focused most of our analysis on the ones who have received funding since January 2014. The data was provided by our partner The Nordic Web.

At Deloitte we are very excited about the opportunities FinTechs bring to the incumbent companies. At the same time we see, perhaps more than ever, the ways established financial institutions are threatened, and that there is a very real chance that the industry dynamics will shift permanently. In our view the winners will ultimately be those who are bold enough to make the hard decisions to walk away from certain traditional ways of financial services and transform the business according to the unveiling new paradigm. FinTechs have the ability to grow into relevant market participants and in collaboration with the right companies, eventually change the financial service industry we see today.

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A diverse ecosystem

Key players

Before moving on to the market overview, it is essential to clarify the key players and how they affect each other. We have recognized five different segments of players which act as key influencers in the FinTech market.

Financial services institutions have dominated the market by providing various products for a large customer base. In cooperation with **stock exchanges** and **payment service providers**, incumbents have created much of the financial network we have today.

Regulatory oversight and cost structure have developed over time with the operations and actions of the incumbents.

As new technologies emerge accompanied by changing customer behaviour, the new **FinTech players** are starting to break the status quo by offering faster and cheaper solutions than the incumbents, often also providing a better customer experience.

> "The financial market regulation is designed to put a threshold for the entry of a new service provider"

Janne Lauha
Partner at Castrén& SnellmanAttorneys

Figure 5: Key players, Source: The Nordic Web, Deloitte

These FinTech players are starting to operate faster and on a large scale, enabled by increased capital availability from **investors**.

Naturally, new technologies and entrants to the highly regulated financial market add new pressure to amend regulation. This topic is discussed in more detail in Chapter 7.

FS Institutions

5-10

Number of years we predict it will take for the core customer segment to shift

In the Nordics, banks and other financial institutions are running a profitable business and relatively well weathered the last financial crisis. The seven biggest Nordic banks have a combined balance sheet exceeding 2000 billion euros and have generally performed well in the EU stress tests.[2]

Due to the current business environment they have been less compelled to re-think their existing business models compared to their European rivals. However, the change seems inevitable for them now. In the center is one particular customer group, the Millennials.

Millennials are unlikely to visit branches or consume financial services the way older generations have done. They would rather use financial services via apps or web browser. Over time, the economic activity of FS institutions' core customer segments will decline and Millennials will become the new core. As the Millennials are accustomed to using non-traditional service channels, reshaping services to fit future needs is required. Namely, FS institutions need to develop services that are not only accepted by the millennials but also designed for them, providing the user experience they are expecting from any other digital service provider.

[2]https://www.eba.europa.eu/documents/10180/1532819/2016-EU-wide-stress-test-Results.pdf

The importance and the urgency of the change has been widely recognized, but the change in large complex organizations is difficult, takes time and requires tremendous effort. Already today banks' service offerings are no longer compared only against other banks, but to the experiences digital consumer businesses provide to Millennials.

"Digital wrapping is no longer a viable option –instead you need to build a digital core."

Jyrki Suokas
VP Financing Services Products at Basware

As of now, the incumbents are using vast amounts of money to digitalize their existing operations and to develop offerings. Despite heavy war chests, FinTechs have been disporting the business for years now and will continue to do so. They lack the rigid systems of the incumbents, and with agile customer targeting, they are able to provide services in a more focused manner than the incumbents.

"If a customer visits our branch office 20 times a day, our personnel may start to question this customer's balance of mind. If the same customer visits our mobile app 20 times a day, we are pleased to have such an active customer."

Reijo Karhinen
President and Group Executive Chairman of OP Financial Group

FinTech

As the FinTech market in the Nordics is rapidly developing and consists already of hundreds of companies, a complete overview would be impractical to create. But to clarify the areas where most of the FinTechs are focusing, we are using a framework containing nine subsectors. They, and their key players, are as follows:

> "I think a key success factor for FinTechs is to focus on changing the customer experience to the better"
>
> **Johan Dalnert**
> **CMO at Behaviosec**

Payments

Personal financial management

Investment management/ Robo-advisors

Blockchain technologies

Challenger banks

FX/Cross-border payments

Insurance

Cybersecurity and fraud detection

Alternative lending

Figure 8: FinTech sub-sectors, Source: The Nordic Web

As evident, FinTechs are offering a broad scope of services accompanied by non-traditional business models. What is more, if the current growth pace continues, it is likely that the scope of services provided and customers targeted will broadened even further.

Perfect examples of owning the point-of-sale with substituting traditional payment intermediaries are Klarna and iZettle, Sweden's FinTech crown jewels. Companies offer value-adding services to both stores and end customers and have started to use customer data to fulfil other points of their financial needs.

For example iZettle began to offer overdraft loans based on customers cash flow history. The company reported an astonishing 30.114% turnover growth rate from 2010 to 2015 being the fastest growing FinTech Company in EMEA region[3].

	Founded	Valuation	Funding	Category
iZettle	**2010**	€424m	€146,1m	Payments
Klarna	**2005**	€2bn	€247,1m	Payments

Investors

The amount of global start-up funding has seen a steady rise for the past few years, and experienced a 41% increase from 2014 in the EMEA region[4]. As there are hundreds of different types of investors, we identified half a dozen Venture Capital funds which have been particularly active in the Nordic FinTech market.

As the Nordic FinTech markets mature, the share of Nordic capital has increased from 32% in 2014 to 80% today. The reliance on domestic capital points towards a more sustainable start-up ecosystem as foreign capital can become scarce in times of crisis. However, this is also a strong indicator that the majority of investments are being made at an early-stage, which in turn indicates an emerging/growing FinTech hub, one less mature than, say, London, as typically international money comes in at a later stage.

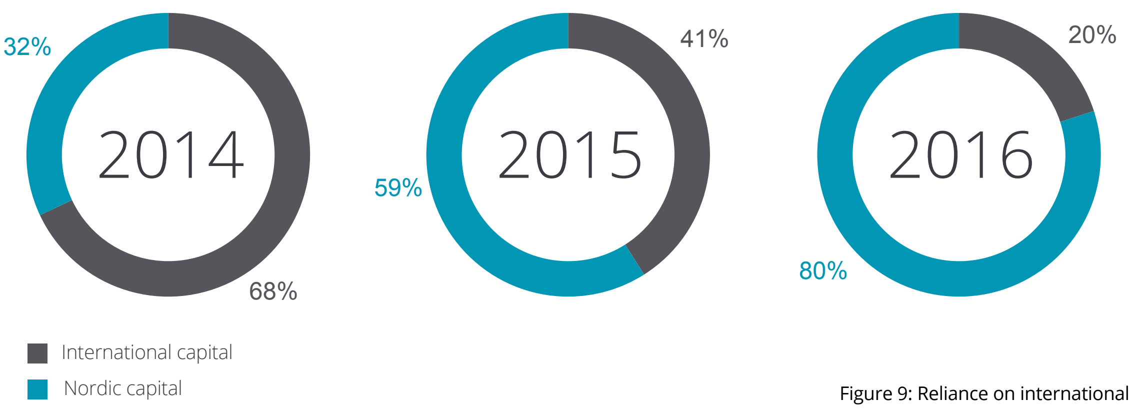


Figure 9: Reliance on international capital, Source: The Nordic Web

[3]Deloitte 2015 Technology Fast 500
[4]Funderbeam FinTech report

The Swedish based VC fund NFT Ventures has taken the leading role with a growing portfolio in several Nordic FinTech start-ups. Investors behind NFT Ventures include Bonnier, Swedish Media Company and Collector Bank AB, established in 1999. To maximize relevant competence, NFT Venturs focuses on the financial technology sector within the Nordic and Benelux region.
SEB Venture Capital is the leading Nordic VC backed by Nordic bank to invest into financial technology and Oslo based Northzone, which has a strong presence in Sweden, is another active investor with large investments into iZettle (2012) and Qapital (2014) amongst others.

"Despite the traditional wisdom of Enterprise SaaS, Gaming and Health being the dominant sectors in the Nordics, FinTech has rapidly become the most backed vertical in the region."

Neil Murray
Founder of The Nordic Web

"A major driver for banks is a strategic response to the imminent PSD2 EU regulation. Almost every bank seems to be massively increasing their levels of investment in innovation in their digital channels and partnerships with FinTechs."

Georg Ludviksson
CEO of Meniga

Sweden has a dominant role providing local financing and competence for companies due to capital rich economy whereas Finland for example has seen a preference for state backed investment from institutions such as Finnvera and Finnish industry investment. Incumbents have also started to make straight investments or acquisitions in the market as a strategic response to the FinTech disruption, including the imminent upcoming PSD2 EU regulation. PSD2 is discussed further in chapter 7.
As payments sector has attracted evidently the most capital, largely due to Klarna and iZettle, our findings indicate that other areas are gaining more and more traction in terms of investments. Personal finance solutions are attracting almost as many investments (21) as payments and many already have a proven business track record. The three biggest investment were made to Meniga, Tink and Qapital which gathered over €20 million between 2014 and 2016 (Q3).

An impressive growth

FinTechs are the fastest growing branch of start-ups in the Nordics

FinTech accounts for over 11% of total capital invested in the Nordics

"As the FinTech market matures, some companies will face challenges providing results for their investors."

Kirsti Merethe Tranby
Partner, Financial Services at Deloitte

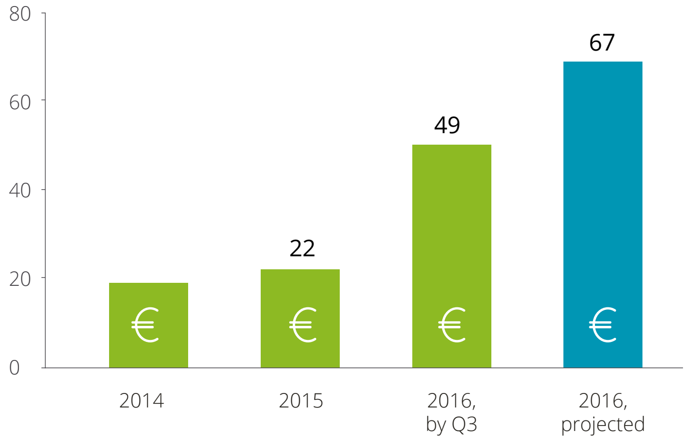


Figure 10: Number of investments in FinTech, Source: The Nordic Web

What's makes the findings even more interesting is how they compare against the other European FinTech hotspots such as the UK and Germany. According to Tech.eu, already last year the total number of investments made positioned the Nordics as the number three in Europe.

FinTechs recorded more investments and attracted more capital than any other sector in the Nordics in 2015 and are very likely to do so again this year according to The Nordic Web. The result is not surprising, as the investment growth rate has been substantial. The number of investments has risen from 19 in 2014 to 49 already made by Q3 this year. The Nordic Web predicts that the final number of investments for the year 2016 could be close to 70.

Growth wise the projected 67 investments in 2016, would be over three times more than the total number of investments made in 2015. The prediction also seems likely to realize, as 2016 has already resulted in more investments than during years 2014 and 2015 combined.

The growth rate of individual investments shown in table below beats both the UK and Germany. The graph shows how the Nordics are gaining traction as the new hub for FinTech in Europe. As the market in the Nordics is less mature than in the other two leading hotspots, it seems evident that the activity will increase and the current market dynamics will be challenged even more in the near future.

In monetary terms, the Nordic market is catching up to the UK and Germany. This is largely due to the fact that the UK investment size is projected to decline almost €550 million in 2016. The graph might seem to show that the Nordics haven't been able to repeat the success of the year 2014 in monetary terms. This is however well explained by a statistical bias caused by Klarna and iZettle.

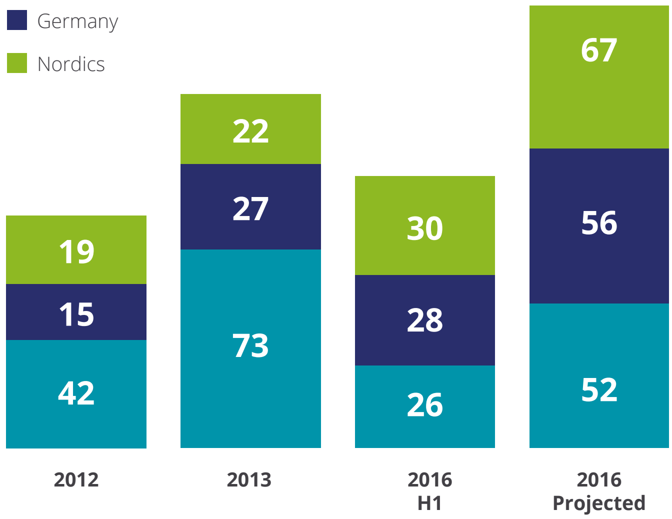


Figure 11: Number of investments in Europe, Source: CB Insights and The Nordic Web

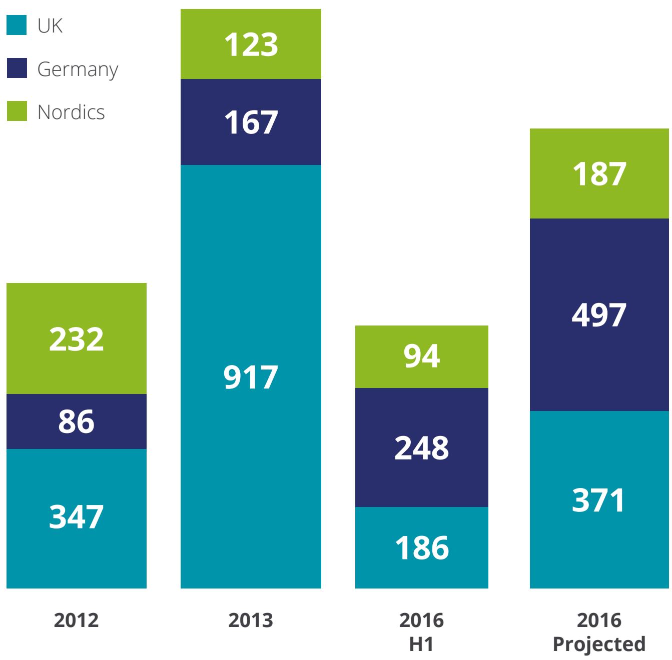


Figure 12: Amount (€million) invested in Europe, Source: CB Insights and The Nordic Web

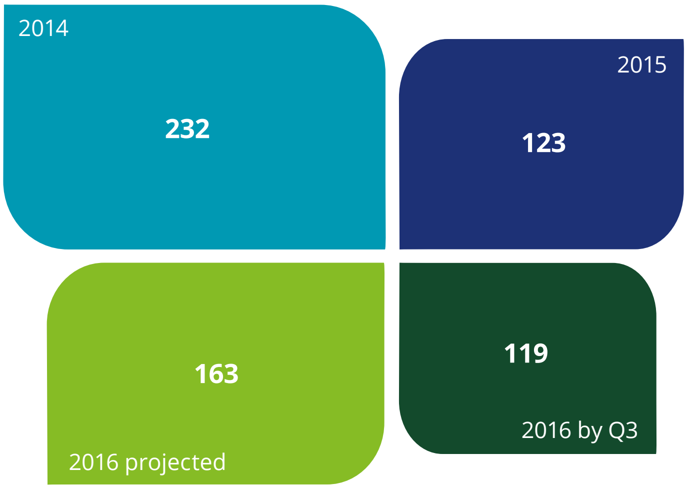


Figure 13: Amount (€million) invested in the Nordics, Source: The Nordic Web

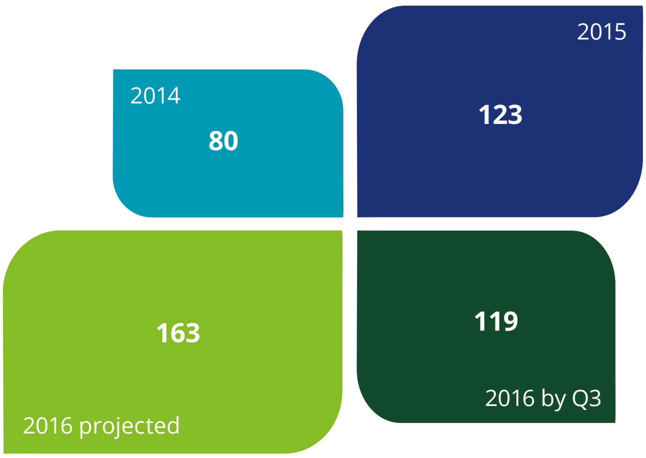


Figure 14: Amount (€million) invested in the Nordics, Source: The Nordic Web

In graph below displays the distribution of investment values during the past three-year period. The first graph shows that the majority of the money was invested in 2014 and investment levels haven't recovered since. This contradicts the growing number of investments made.

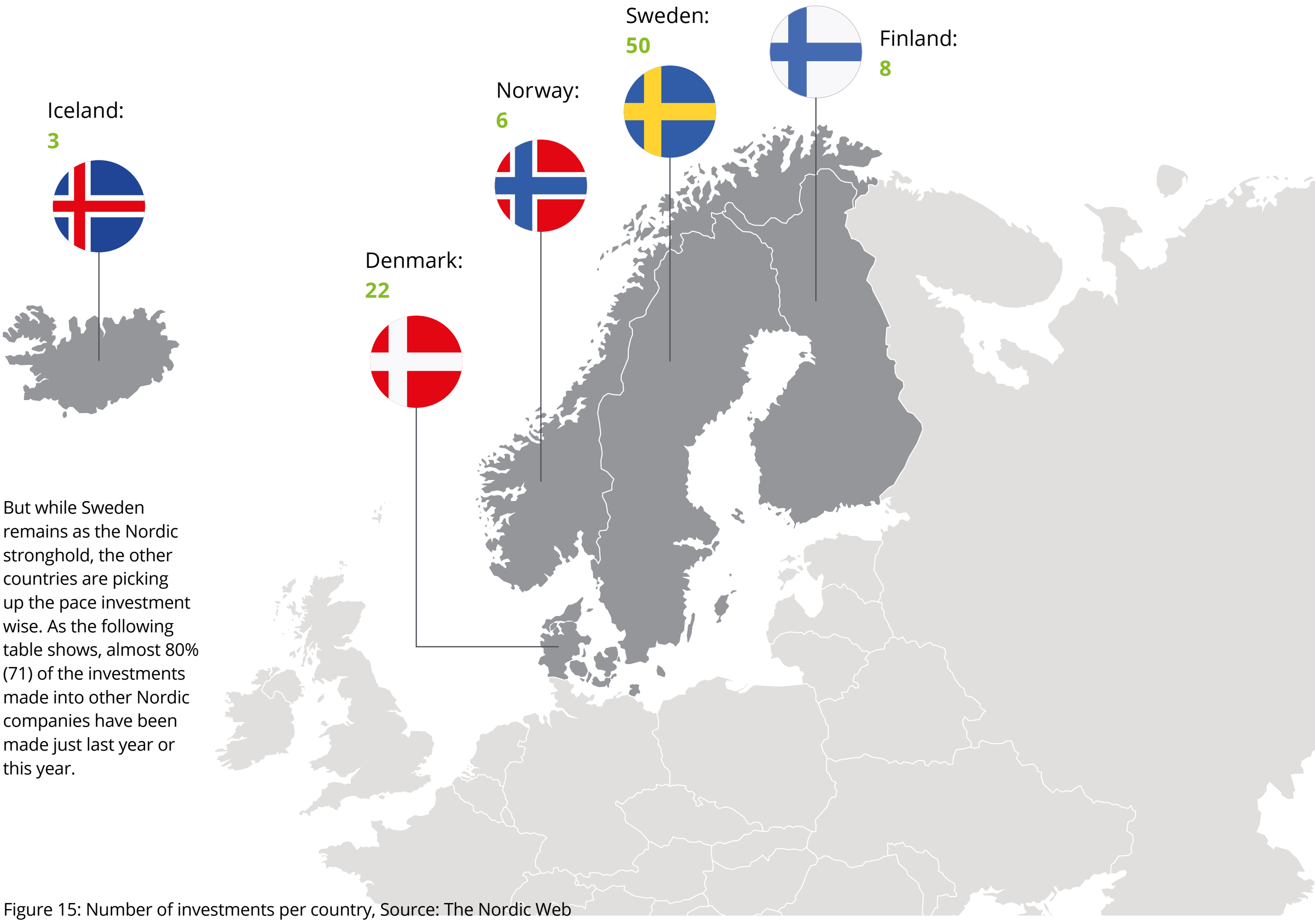
The high value of the year 2014 is explained by two grand investments made into Sweden that year. The combined value of the €106 million investment made into Klarna and €46,6 million investment made into iZettle exceeded the combined value of other 17 investments, which totalled €53,7 million, almost three times. Therefore, the second graph, where the effect of these two grand-investments have been removed, gives a more accurate overview of the trend.

From this perspective, the cumulative value of investments has already surpassed the 2014 cumulative value by €39 million, and by the end of September 2016, the cumulative value was reaching the year 2015. Without a doubt, the excitement around the Nordic market is more than justified based on this analysis.

Who drives the FinTech trend?

Nordics are growing. Sweden leads the way, but other countries are picking up the pace

The past years, Sweden has led the way in the market with 50 individual investments made since January 2014, as shown in the figure below. The total value of investments made into Sweden during this time was approximately 400 million euros.



But while Sweden remains as the Nordic stronghold, the other countries are picking up the pace investment wise. As the following table shows, almost 80% (71) of the investments made into other Nordic companies have been made just last year or this year.

Figure 15: Number of investments per country, Source: The Nordic Web

Country	Investments	Investments 2014	% of Nordics	Amount (M€)	% of Nordics
Sweden	50 (8 undisclosed)	11	56,67	399,1	84,10
Denmark	22 (12 undisclosed)	3	24,44	15,9	3,3
Finland	8 (1 undisclosed)	3	8,89	39,6	8,5
Norway	6	1	6,67	12,0	2,5
Iceland	3 (1 undisclosed)	1	3,33	7,8	1,6
Totals	89 (22 undisclosed)	19	100	474,4	100

Figure 16: Investment breakdown, Source: The Nordic Web

The dominance of Sweden is perhaps best explained by the strong ecosystem in terms of availability of funding and other resources for start-ups. It also stems from the long history of easy access to education and technology. A large part of the reason why FinTech and start-ups are more prominent in Sweden and the ecosystem is stronger, is also due to cultural reasons. Success stories such as Spotify, King and Klarna, have made it very acceptable to be an entrepreneur as a profession. These success stories have also been a driving force behind setting up world-class university entrepreneurship programmes and support mechanisms across Sweden.

Denmark comes in second as the leading FinTech Hub in the Nordics, which is a good indicator of the strong ecosystem in place as well as government-led initiatives aimed and strengthening the FinTech and start-up sector.

When looking at the actions taken by the incumbents and national regulators in the Nordic countries, we are expecting to see further growth in the Nordic market for FinTechs. We are seeing that incumbents are more and more starting to collaborate with the FinTechs, offering them more opportunities for growth and data accesses. As an example Nets have been a participant in two of the largest Nordic FinTech deals and acquired smaller players, such as Dibs, Paytrail and Storebox. This illustrates well the transformation payments service providers are going through.

Another example is Danske Bank, who have just this year started to collaborate with the equity crowdfunding company Invesdor, in their SME area, and announced plans of spinning its mobile payments solution Mobile Pay off into its own subsidiary, which will enable other Nordic banks to employ the software[5]. At the same time, the Nordic regulators are making efforts to lower entry barriers, however, there still remains a lot of complexities that need to be solved regarding regulation for both FinTechs and incumbents.

"The Nordics punch above their weight in terms of investment into the FinTech sector compared to the rest of Europe."

Marta Sjögren
Principal at Northzone

"The FinTech scene in Stockholm is a great melting pot of driven technical entrepreneurs and an early adopter approach from the financial sector."

Johan Dalnert
CMO at Behaviosec

[5]http://www.nordea.com/en/press-and-news/news-and-press-releases/press-releases/2016/2016-10-13-nordea-joins-mobilepay.html

How do FinTechs position themselves towards the traditional players?

Competition, Co-opetition, collaboration

When assessing FinTech trends, you have to take into account the historical development of digital banking services in the market. Many of the Nordic banks were pioneers in developing digital banking services. The Finnish bank assurance group OP launched its internet banking services in 1996, the second bank in the world to do so and the first in Europe. Swedish Handelsbanken then launched their service in 1997. The Nordic societies have been looking for ways to operate electronic financial services for a longer period of time, which shows today. According to the Deloitte Global Mobile Consumer Survey 2016, 57% of Nordic citizens are using mobile banking, when the European average is just 44%.

Another example is cashlessness. According to paymentscm.com, card payments in the Nordics are two-and-a-half to four times higher than the European average, and what's more, the Danish government has set a 2030 target for a cashless society. Sweden is also aiming on becoming a cashless society, only about 20% of all payments in Sweden are done with cash. Comparing this with the worldwide average of 75% of all payments done by cash, the claim that Sweden is the nation closest to abandon cash is valid[6].

Given the history, it is not necessary surprising that the FinTech revolution didn't start in the Nordics. However, when looking at the investments made into the Nordics, we see strong indications that both the investors and FinTechs believe in the opportunities offered by the revolution. For this report, we have analysed all the investments made in Nordic companies since January 2014 against the framework used for the FinTechs, which was introduced in section 2.

"FinTechs need to figure out how to secure the trust of end customers and how to bring value to them while keeping within the regulatory boundaries."

Daniel Blommé
Senior Manager, Financial Services and PSD2 Expert at Deloitte

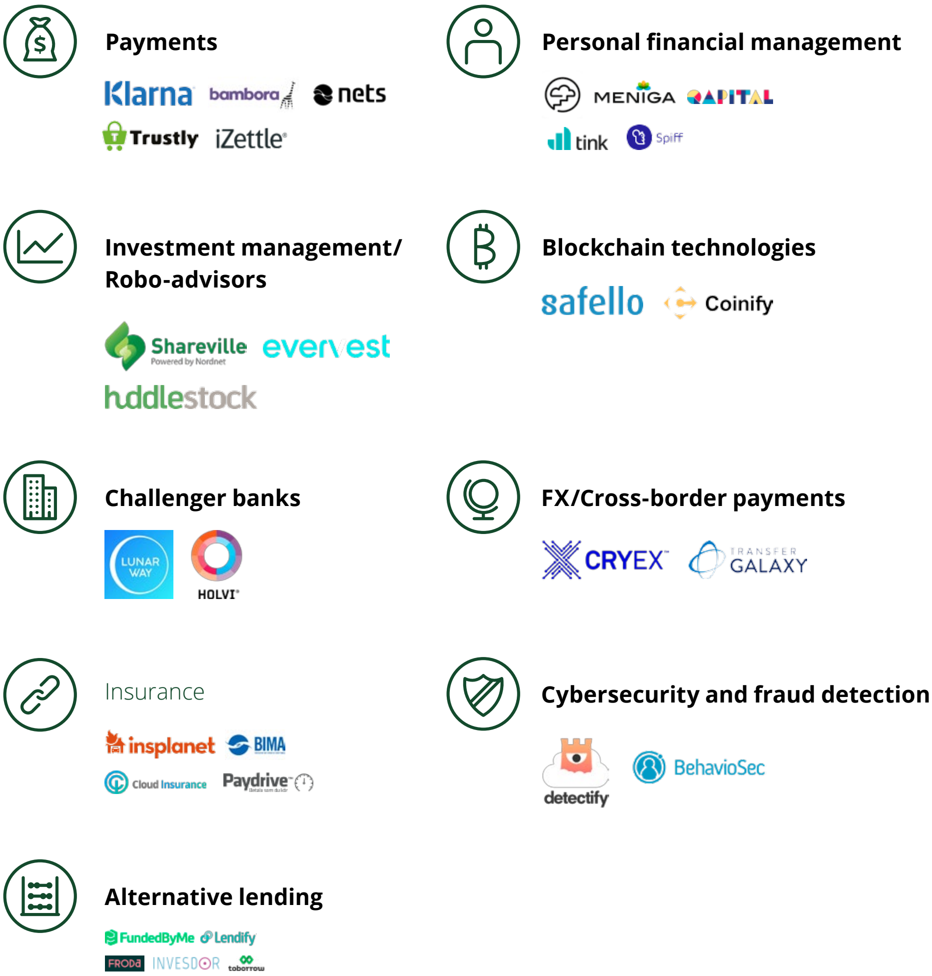


Figure 17: FinTech sub-sectors, Source: The Nordic Web

[6]New York Times, In Sweden, a cashfree future nears, December 2015, http://www.nytimes.com/2015/12/27/business/international/in-sweden-a-cash-free-future-nears.html?_r=0

We categorized the companies always into just one of the categories. This was done based on our analysis of their core business. Some companies could be categorized into more than just one, but in order to be clear and to the point, we have categorized the companies always into just one category.

Altogether there were 89 individual investments made since 2014. The great majority of the investments were made into payments, personal finance, investment management, and lending.

> "A positive impact of FinTechs is their out of the box thinking, leading to a situation where new, unexpected kinds of applications of technology emerge."
>
> **Jyrki Suokas**
> **VP Financing Services Products at Basware**

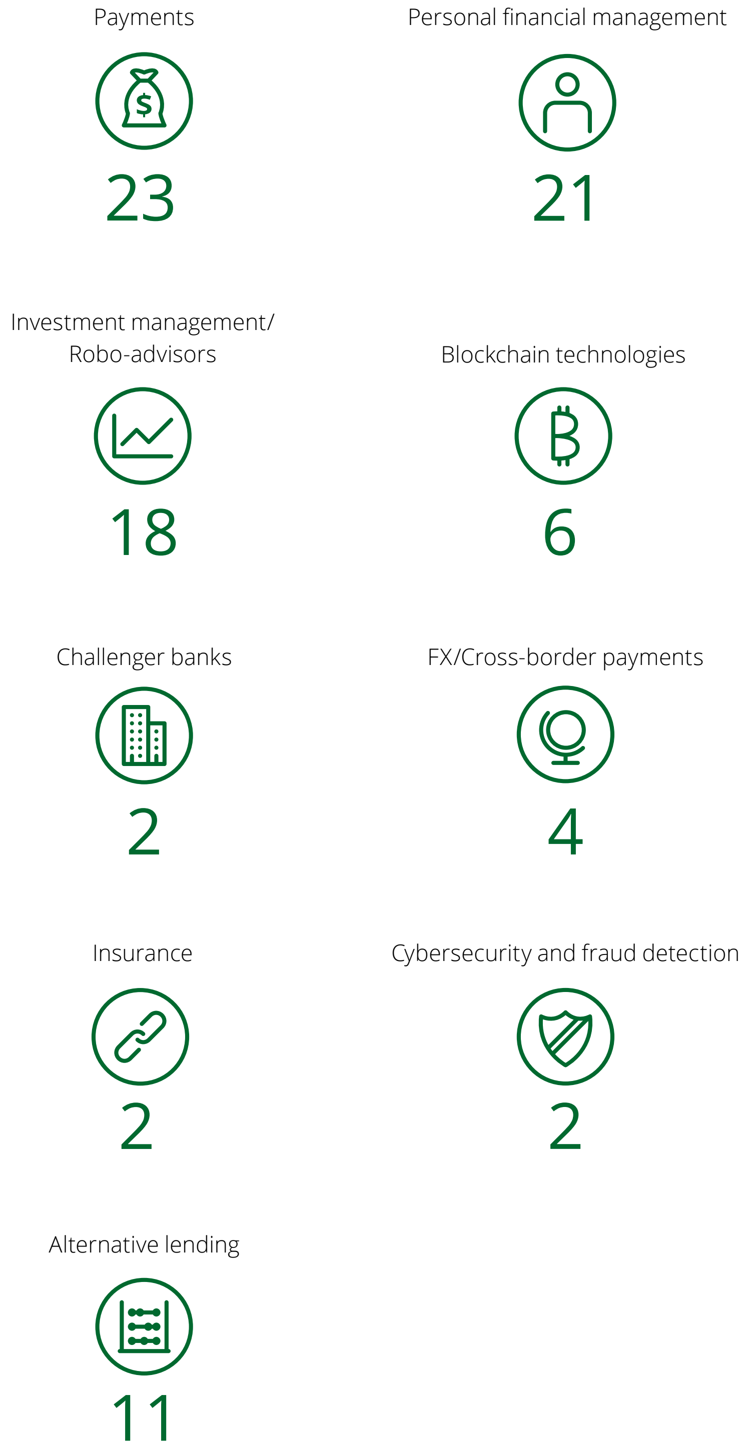


Figure 18: FinTech investments, Source: The Nordic Web

In order to understand better the development in the Nordics, we took a deeper look at the companies and their strategies in order to understand what the entrants seem to target. For this purpose we used the same subsectors as above, but we also categorized the companies based on what their strategy appears to be. Our framework has the following dimensions:

Competition

These FinTechs are aiming to compete with the incumbents head on, and capturing market share from the incumbents' servable market. The FinTechs' target market is not necessarily incumbents' core market.

CO-opetition

These FinTechs are mostly focusing on the customer relationships the incumbents have. While there are competitive elements between the incumbents and the FinTechs, the FinTechs are still relying much on the incumbents in terms of their infrastructure, e.g. accounts, loans and payment rails even in a co-operative manner.

Collaboration

These FinTechs are focusing on providing value added services to the incumbents customers. The companies rely on incumbents providing the core services to the customers and focus on collaboration.

FinTechs and incumbents could consider:

- Look beyond the current hype
- Disrupt yourselves
- Decentralized services, where to remove the middle man
- Explore the ecosystem
- Consider collaboration
- Focus on the future customer experience with use of technology

Kirsti Merethe Tranby
Partner, Financial Services and Nordic Blockchain Lead at Deloitte

The following analysis is a high-level snapshot of the current state of the Nordic market. In the final section, we'll provide you with our perception of where the market is heading. The strategy evaluation was based on publicly available information of FinTechs' products and services, partnerships, resources and latest actions. The chart shows our findings. Arguably, FinTechs being relatively new and generally small in terms of operative scale, the direction of their strategy is not always clear and may combine elements from multiple strategic directions. However, we have always categorized a company into just one based on our insight about their primary objectives and development potential.

Based on our analysis, approximately two thirds of the FinTechs, which received funding since January 2014, are aiming to utilize the incumbents to create a business for themselves. Just one third are applying a more aggressive strategy and aiming to serve the market with their own capabilities, in other words competing with the incumbents.

Another interesting point is also shown in the chart. Most of the money is invested in the co-opetition branch of FinTechs, almost 40% or 134 million euros was invested into the companies following the competitive strategy. It is tempting to draw a conclusion that FinTechs are more about collaboration than competition. One should bear in mind though that ultimately, even a collaborative strategy may still result in a FinTech capturing an essential part of business, even if it's not in terms of revenue, but in terms of access to customer, customer loyalty and pushing the incumbents to less profitable parts in the value chain.

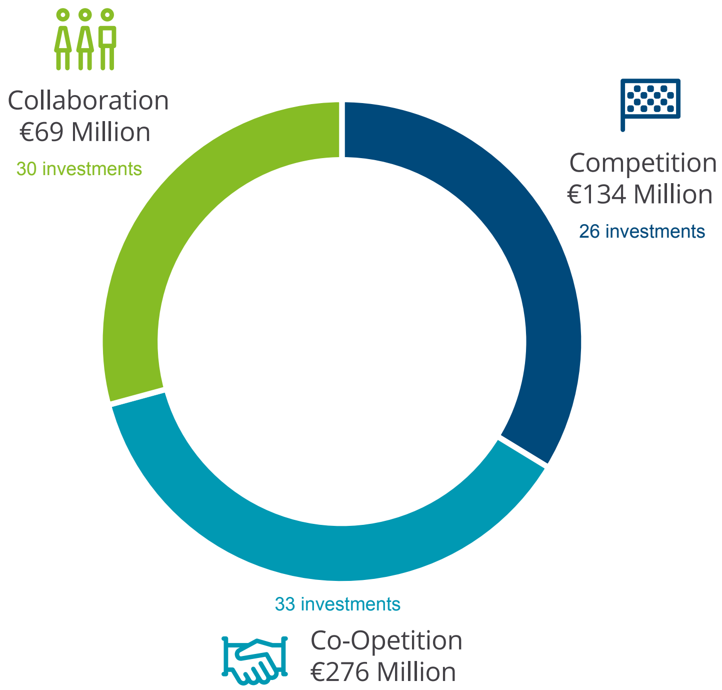


Figure 19: Investment breakdown in dimensions, Source: The Nordic Web

"Incumbents need to be able to challenge their own pricing and value chain structures e.g. "cannibalize" their own business model upfront before someone else does."

Johan Ekström
Head of Customer Proposition and Marketing at Skandia Norden

A deeper look into the FinTech subsector provides more insight to the industry and the strategies. The table below presents a complete overview of the FinTechs, into which investments have been made since January 2014 categorized into subsectors and in terms of their strategy. We have highlighted the largest strategy categories in each of the FinTech subsectors.

Subsector	Competition	Co-opetition	Collaboration
Payments	13%	58%	29%
Personal financial management	<1%	45%	55%
Alternative lending	>99%	<1%	<1%
Challenger banks	>99%	<1%	<1%
Blockchain technology	67%	33%	<1%
Investment management / robo-advisors	44%	39%	17%
FX / Cross-border lending	50%	<1%	50%
Insurance	>99%	<1%	<1%
Cybersecurity and fraud detection	<1%	<1%	>99%

Figure 20: FinTech subsector analysis, Source: The Nordic Web

Payments

In the payment subsector, most of the companies seem to follow co-operative collaboration. While these companies utilize in many ways the existing infrastructure, they may pose a threat to the payment business revenues. Furthermore, many of them are aiming to become intermediaries in the market. As PSD2 will come into effect in January 2018, there might be a shift in strategies towards even more collaborative strategies. The reason is that banks will be forced to open up their platforms to payment initiations by third parties, which most typically will be FinTechs[7].

Personal financial management

Most of the companies in the subsector are providing value added services to the customers. While this may even boost incumbents business in some cases, it may also result in a similar outcome as payments. Personal finance will also, in the same way as Payments, be heavily impacted by PSD2. Banks will be forced to accept requests for customer account information from third party providers. This means that the incumbents could risk losing their customer interface, depending on how far the directive goes. This is even more of a threat under the co-opetition.

[7]Deloitte industry interviews

Alternative lending

This is the subsector where FinTechs are most often seen competing with the incumbents however, one must bear in mind that peer-to-peer and crowdfunding solutions are currently not the primary source of funding for individuals and larger companies. That is not to say, that the low cost and ease of access may well disrupt the market but so far this has not yet occurred, at least on a large scale. Just last year, the combined lending volume of FinTechs in the Nordic marketplace was 107 million euros. However, we're seeing more collaboration in this area, which perhaps indicates that incumbents are starting to take the competitive threat posed by the FinTechs more seriously and preparing for possible larger scale disruption.

"FinTechs are speeding up payments development by simplifying and improving the customer experience."

Financial Service Provider executive

FX / Cross-border payments

In this subsector, the companies who have received funding seem to be divided between the competing and complementing strategies. The companies are building on the bilateral nature of FX trading. While some are seeking to provide customers with tools to become more effective in FX trading, some are deliberately seeking to capture a share of the fees, especially in the SME corporate customer segment.

Blockchain technology

Blockchain companies are mostly not an immediate threat to the incumbents. Blockchain companies are already to some extent working with incumbents as the technology has the potential to provide significant cost reduction opportunities and faster transaction times for the incumbents. Blockchain will however in the long run change the way incumbents and the industry as a whole operates.

As for the technology, considerable amount of the research and experimentation is being conducted by banks examining how the blockchain concept can be implemented without Bitcoin or other cryptocurrencies. Therefore, blockchain provides more of an opportunity than threat to the incumbents, but at the same time of course also to the new entrants in the market.

"Corporate customers are typically conservative; therefore FinTechs are not likely to gain traction as fast in the corporate market as they gain in the consumer market. But when they do, large volume shifts rapidly."

Ilkka Huikko
Partner, Financial Services, Deloitte

Investment management / robo-advisors

In the investment management category we saw the most even distribution in terms of strategies. This is telling us that firstly, the incumbents have not perfected their digital offerings, creating a need for external service providers to develop complementing services. Secondly, the incumbents do not offer customers, especially smaller corporate or retail customers, enough customization and sophistication in their investments, driving the co-opetition. Thirdly, as the smaller and agile competitors are arising, the incumbents should rely even more on automated, self-service customated solutions in their own offerings. They need to provide the same level of digitalization compared to Fintechsin order to compete with low-fee providers.

Robo-advisors: As the funded companies in the robo-advisors subsector are predominantly applying the competitive strategy, they pose a threat to large banks. This has already been seen in the United States and is expected to develop in the Nordics in the upcoming years. However, contrary to the larger incumbents, the primary target group are individuals who currently do not have enough capital to qualify for investment services offered by the incumbents. Many of these customers are in their 30s and at the early stages of their careers. The threat however, arises when the customers who have accustomed themselves to the low fees and user friendly digital interfaces of the robo-advisors, have gained more wealth but are not interested in paying the current level of fees for traditional investment management services.

Insurance

The insurance subsector has received a low number of investments in recent years. This is not surprising since the insurance sector is more rigid and more difficult to disrupt with capital-intense industry dynamics. Yet, it still is the subsector that will be disrupted next, as there are very tempting opportunities in utilizing sensors, dynamic pricing and the power of peer-to-peer. In all of these areas, there are already global examples of FinTechs' capabilities and a clear growing global trend in the FinTech insurance sector can be observed. We expect the Nordics to follow this.

Cybersecurity and fraud detection

The cybersecurity companies that have received funding since January 2014 are building on the digitalization of the whole industry. As more and more of the financial services are delivered digitally, companies are focusing on making delivery more efficient, user-friendly and safe. Hence, these companies do not threaten the current businesses of the incumbents per se but improve it.

"There is pull from customers and B2B segments for well-designed [investment management] services, suggesting there is market potential which incumbents are unable to serve."

Jussi Kallasvuo
Co-Founder & Chairman at Evervest

How do traditional players respond?

The FinTech impact is causing incumbents to take action in the Nordics

The Nordic trends reflect the development that incumbent companies are starting to take very serious steps to cope with the impact caused by the rise of FinTechs. Many incumbents are exploring various collaboration methods with FinTechs, VCs and external advisors to find the appropriate ways to cope with the change.

In our research through the market data and interviews, we have found that the potential impacts on the incumbents and the market varies depending on the strategy the FinTechs are following i.e. are they competing, competing co-operatively or complementing the market. The graph below summarizes the likely impacts of each of the strategies based on our research.

Competition

The current fee levels and market dynamics are being challenged, opening up the possibility of new players capturing the customer group, while some of the traditional ones lose position.

CO-opetition

The front-end operations are threatened, endangering client relations and access to client data.

Collaboration

Banks can consider relying on FinTechs to provide the client value-added services and save in R&D costs.

Figure 21: Strategies breakdown, *Source: Deloitte*

"Right now FinTechs are trying to figure out their business models, while incumbents are busy reading the executive summary of The Lean Startup."

Frans Borgstrand
Partner, Mobiento at Deloitte Digital

From the incumbents' perspective, none of the impacts above are without a risk, but perhaps even a greater challenge is the fact that most FinTechs do not immediately have a drastic effect on earnings or revenues of the incumbents. Therefore, the incumbents will not necessarily "feel" the attack until the cumulative effect of multiple FinTechs carving out minor shares in most of the key business lines exceeds a tolerable level. The starting point to prevent such developments, is of course to have a comprehensive and deep view to the current businesses. That view needs to be coupled with a strategy that clarifies where the company will play and where it won't. Then answering the key question, how and where to win, and what capabilities are needed, becomes more straightforward.

"A key differentiator in the future will be the ability of management at incumbent banks and insurers to onboard Fintechs and make it a top priority to drive their integration with the existing business in a rapid manner, cutting through red tape in their own organizations."

Victor Kotnik
Managing Partner, Deloitte Sweden

"FinTechs might emerge as a natural touchpoint for customers accessing their everyday banking services."

Daniel Blommé
Senior Manager, Financial Services at Deloitte

"Banks are going to die by a thousand cuts."

Financial Service Provider Executive

A deeper view to the FinTech impact on the incumbents
So far we are seeing various ways how the incumbents are reacting to the impacts that FinTechs are causing. The most common actions taken by the financial institutions are presented in the graphic below.

Competition	Lending, Robo-advisors, Insurance, Blockchain, Foreign exchange	- Consortiums between incumbents - Proprietary co-operations - Consortiums between FinTechs
CO-Opetition	Investment management, Payments	- Acquisitions - Direct investment
Collaboration	Personal finance, Cybersecurity and fraud detection, Foreign exchange	- Accelerators - Hackathons - Roadshows - Joint programs

As the table tells, a lot of the actions taken are based on some form of collaboration between the incumbents themselves or the incumbents and FinTechs. These are quite logical and well justified actions but nothing that guarantees positive results. If the incumbents are focusing on consortiums and joint ventures among their peer group, they risk lacking the insight from the agile FinTechs. In other words, what is the incumbents' position when compared to the young and agile counterparts?

Then again, collaboration with FinTechs is not without risk either. The challenge is to ensure that the incumbents are able to collaborate with the top-level start-ups. Even if the Financial Institutions are willing to offer funding to start-ups, scale and access to resources, the best companies, who also are the true game changers, may refrain from collaboration if the incumbents cannot allow them sufficient independence. Instead they may collaborate with actors from other industries, e.g. mobile operators to gain the exact scale they need but rely on their own financial industry capabilities.

FinTechs and incumbents have a lot to gain from collaboration. Possibilities to leverage incumbent's specialized networks, infrastructure and customers can prove to be a game changer for the FinTech. While the speed, creativity and user journey of the FinTech can be a winning factor for an incumbent. However, early corporate takeovers present a viable threat to the industry, and may lead to severe hindrances and sometimes complete failure to implement and scale.

All in all, the key players in the Nordic market are still in the search for best strategies and tactics to cope with the disruption. In the final section we'll share our view, where the market might be heading. But when analysing financial services, you can only get so far without scrutinizing the regulation. That's where we head next.

"As there is such obvious 'you got what I lack' in the relationship between incumbents and FinTechs, I believe we are going to see '50 shades of consolidation' in the years to come."

Frans Borgstrand
Partner, Mobiento at Deloitte Digital

"We believe there is less of a threat and more of an opportunity for both the FinTech companies and the traditional institutions."

Marta Sjögren
Principal at Northzone

FinTech and regulation: a cat and mouse game?

Regulatory overview

Regulation plays a crucial role in the financial industry, which is economically prone to bubbles and bursts. Over the years there have been severe exposures to market manipulation and other misconducts. For FinTechs this is a two-folded issue. On one hand, it should make the market somewhat clear to operate in. On the other hand, the cost to enter is high and the incumbents are better equipped to cope with regulatory changes and compliance requirements. Although the necessity of regulation is widely recognized, the sufficient and beneficial level is highly debatable.

FinTech regulation in the Nordics
As discussed previously in this report, the Nordic FinTech sector is growing rapidly. Fast innovation based growth and high-degree of existing regulation is hardly an easy mix. For example in Denmark, the license process for a FinTech to conduct business in the financial market can take up to 18 months to get and cost up to €1 million. In Finland, FinTechs have reported that the process may cost over a hundred thousand euros and also last over a year. The reason for such a diligent process is that in the Nordics, FinTechs are expected to comply with the same regulations as the incumbents, if the nature of their business is comparable, regardless their operative scale.

One of the regulations that has the potential to have the largest impact on the Nordic financial sector will be PSD2. The EU legislation will be transposed into national legislations by January 13th 2018. The purpose of the directive is to increase competition and foster innovation within the payments area. One of the implications will be that banks are forced to open up their infrastructure for payment initiations as well as for requests for customer account information by third parties. This means that new opportunities and challenges will arise for all involved players. Fintechs will challenge the banks' ownership of the customer interface and the banks may be forced to re-think their business models and strategies.

"Start-ups seeking for an investment firm license in Finland should be prepared to invest at minimum some tens of thousands of euros and 12 to 18 months to get a license."

Janne Lauha
Partner at Castrén & Snellman Attorneys

"The situation is worst in terms of regulation, which in many cases is truly prohibiting growth, especially for smaller market entrants."

Jussi Kallasvuo
Co-Founder & Chairman at Evervest

"PSD2 is arguably the most disruptive event to hit retail banking in decades."

Georg Ludviksson
CEO at Meniga

The directive has the potential to become one of the biggest operative change in decades. The opening of banks infrastructure to third parties blurs traditional lines between institutions. Incumbents, who control a major share of national financial data have to open their interfaces with clients' permissions. Many Nordic banks have been active to acquire data specialising FinTechs and have started to prepare themselves for the possibility of an age of open application interfaces, where the interface seen by users is not limited to the banks they operate with.

The regulation applies to all of the Nordic countries in European Union (even Norway and Iceland as members of EFTA ratify much of the legislation)[8]. The pressure to tighten regulation has increased significantly since the 2008 financial crisis, making it understandable that regulation is becoming more of a hot topic. The aftermath caused by the bankruptcy of the Swedish crowdfunding FinTech Trusbuddy in October 2015 is an example of the potential risks within the FinTech industry and a justified argument for regulatory oversight. However, as FinTech is one of the key areas where the governing bodies of the Nordic countries hope the overall economies would benefit, the pressure to also support and provide regulation consultation for FinTechs is increasing[9].

The actions taken in this domain by the national authorities vary among the Nordic countries. The authorities in Denmark and Norway have not provided much targeted support in terms of regulation consultation explicably for FinTechs. In Sweden, the FSA has focused on sharing information actively. For example, in a report published in May 2016 they pointed out the possible upcoming regulations in crowdfunding, payments and robo-advisory, in order to allow the industry to better prepare for the potential change. Perhaps the most practical, recent example about the authorities trying to actively support comes from Finland where the local authority launched an Innovation Helpdesk to support FinTechs. The companies can call or set up a meeting with a staff member from the helpdesk in order to get regulatory support.

Despite the regulation in Sweden and Finland being more progressive than in their neighbouring countries, the relationship between the regulators and industry it is still a far cry from being a collaborative one that supports innovation and growth in the sector.

"If a FinTech fails, customers may face unpleasant situations and realize risks they did not understand existed."

Ilkka Huikko
Partner, Financial Services at Deloitte

[8]The EFTA Surveillance Authority
[9]World Economic Forum –Business Finance report 2015

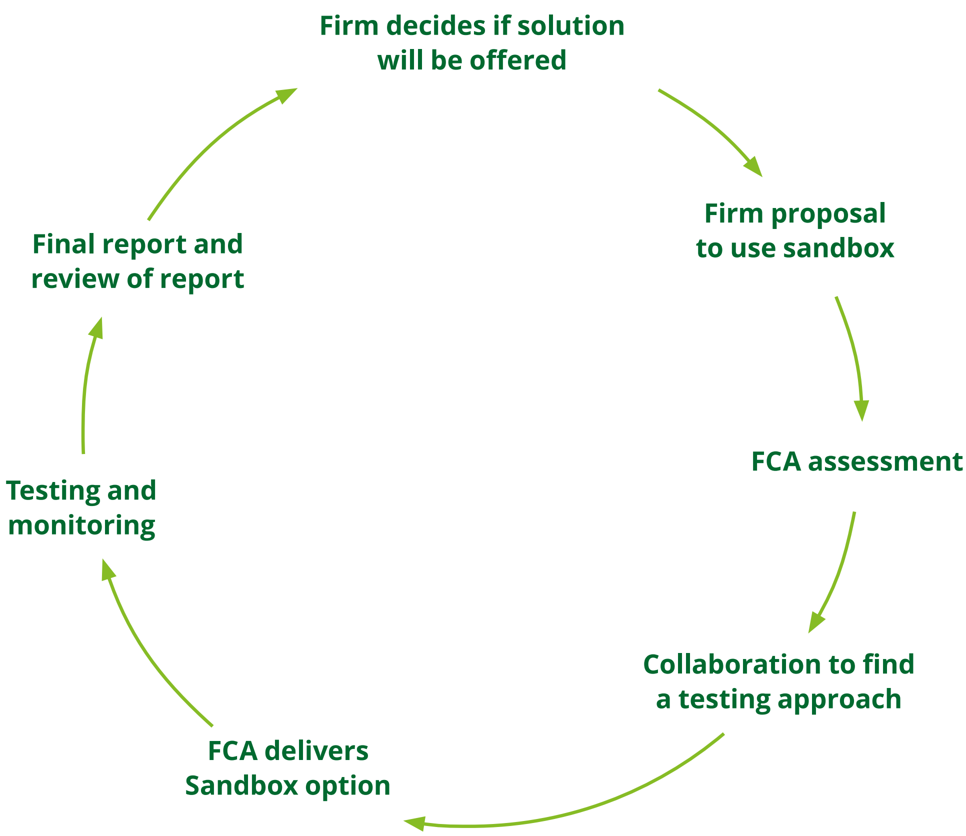
Regulatory needs of the FinTechs and the Incumbents - and the ideal solution

For FinTechs the need is clear, they wish to have regulation that makes it easier for them to enter and operate in a new market. As an example, a regulatory structure where they could rapidly proceed to testing, even if it does not mean a complete license to operate in the market, would be very beneficial based on the interviews we conducted.

For the incumbents the need is straightforward. From their point of view, someone entering the market targeting their current customer base needs to operate under same restrictions and requirements regulation wise. Alternatively, the incumbents would also benefit if they were also able to develop and deploy innovations in a less restricted environment.

A potential solution for the issues has been implemented and tested by the Financial Conduct Authority (FCA) in the United Kingdom, called the sandbox model. The term refers to a “regulative sandbox”, which is a limited environment enabling FinTechs and incumbents to build and test their products and services in a less restricted environment. If the testing results in a positive outcome, the firm can then complete the regulative process and apply for a full license. At this point the regulator has a comprehensive understanding of the solution. As for the Nordics, it is not clear whether the authorities will be moving forward with the model.

On a practical level, the opportunity to offer a sandbox model is based on different legislative systems. As the FCA not only monitors that market participants comply with the regulation, they also legislate the market. The sandbox model is based on this dual role, as FCA is able to permit exceptions from the regulation for a certain limited time.



The United Kingdom's sandboxes model has made it possible to achieve more efficient competition in the following ways:

- Reduce the cost of getting an innovation to the market
- Enable greater access to the finance sector for innovators
- Enhance product testing
- Allowing regulators to work together with Fintechs

The development of the Sandbox model may be the key factor why the United Kingdom is today the biggest FinTech hub. The FCA has received over 600 requests. Out of these requests, over 300 have been approved and a sandbox for these companies has been implemented. Of these 300, over 40 have applied to the final process. Over 75 %, of the over 300 firms that was given sandbox-status regarded the sandbox test as good or excellent.

According to some of the Nordic authorities, this type of a sandbox model is not possible under the current legislation. However, at Deloitte we believe that the Nordic authorities need to make a collaborative effort to assess if any of the elements that the sandbox is based on, i.e. the support, the simplified process for application or separating testing and actual business phase could be implemented in the Nordics.

lso, as the regulation between the Nordics varies, the collaboration between the Nordics regulatory bodies should not be overlooked. At best, FinTech companies should not have any problems scaling their business in the way the technology and the Nordic market similarities would enable. Hence, if the individual elements of the sandbox model cannot be replicated in the Nordics, deeper collaboration among the regulators would still be beneficial. Ideally, the different national institutions could point out market possibilities in other countries and still maintain the monitoring focused role.

> "Regulation-wise, UK is leading in Europe, which is an advantage to UK-based FinTech companies."
>
> **Georg Ludviksson**
> **CEO at Meniga**

> "Those who master balancing between innovative business opportunities and compliance requirements have the competitive edge."
>
> **Toni Oras**
> **Senior Manager at Deloitte Legal**

The most essential regulation that effects the market

Legislative focus	Regulations	Main objective
Market structure regulation	European Market Infrastructure Regulation (EMIR) Alternative Investment Fund Managers Directive (AIFMD) Undertaking for the Collective Investment in Transferable Securities (UCITS V) Market Abuse Regulation (MAR) Market Abuse Directive (MAD and MAD II) Markets in Financial Instruments Directive II (MIFID II & MIFIR)	Increase transparency on the financial market Strengthen protection of investors
Bank structure	Structural reform of banking Capital Requirements Regulation and Directive (CRR/CRD IV)	Banning proprietary trading and separation of high-risk trading activities of banks core activities
Tax regulation	Foreign Account Tax Compliance Act (FATCA) Common Reporting Standard for the Automatic Exchange of Financial Information (CRS) UK Crown Dependencies and Overseas Territories Regulation	Make taxation of private individuals and entities more transparent
Capital and Liquidity	Basel III Capital Requirements Directive IV (CCR/CRD IV) Solvency II	Increase banks capital requirements and their liquidity Defines risk management
Payments	PSD 2 Interchange Regulation (MIFR) Payment Accounts Directive (PAD)	Develop unified payment services and increase competition, foster innovation and improve security
Anti-money laundering	Anti-Money Laundering (AML)	Detect and report suspicious activity
Stress testing	Single Supervisory Mechanism (SSM)	Ensure security and stability of European banking system
Transparency	Securities Financing Transaction Regulation (SFTR)	Improve regulation on transparency of securities financing transactions and reuse.
Key information regulation	Key Investor Information Documents for package Retail and Insurance-based Investment Products (PRIIPs) Prospectus Directive (New proposal on Prospectus regulation pending) Insurance Distribution Directive (IDD)	Provide sufficient information to investors before they make an investment decision

Where are we going next?
Future regulation is a two-fold issue. A differentiated regulatory framework is rarely perfect and creates incentive traps and possible loopholes. The latest topics in the Finnish media and political discussions show that innovation-based entrepreneurship is gaining more and more attention. As a result, pressure to take legislative actions supporting new technology and innovations is increasing and the trend may also affect the investment decisions of the Finnish government. A concrete example of the recent regulatory measures is a ratification of the Finnish Crowdfunding Act. The Crowdfunding Act entered into force in September 2016 and, according to the Ministry of Finance, it will particularly ease the regulation of investment-based crowdfunding and correspondingly clarify the ground rules for loan-based crowdfunding. The Ministry of Finance is also preparing a decree that elaborates on the duty of disclosure applicable to crowdfunding recipients.

Since the mid-1990's, legislation that protects the information privacy of individuals in the European Union (EU) has been primarily based on the Data Protection Directive 95/46/EC. This is the legislative act that has set out the minimum standards on data protection in the whole of Europe. Since the Directive has essentially not changed since 1995 and all local legislation based on it has only seen minor updates, the European Commission and European Parliament deemed it too outdated to meet modern privacy needs and concerns. Therefore preparations were started a few years ago to come up with a replacement: the General Data Protection Regulation, or GDPR, that is up to date and protects individuals' privacy in the digital world we live in today. The GDPR will cause significant changed in several areas of business, including accountability and data governance, data inventory, data protection by design and by default as well as data portability etc.

As the Nordic regulatory agencies have increased their degree of cooperation, national boundaries create limitations. EU level regulation is rarely designed from a Nordic point of view, which creates a need for pan-Nordic legal execution. The collaborative direction is on the right tracks, but as so often working with legislative bodies, the process is slow and facing difficulties on a globalized scale.

"The Nordic governments and regulators should embrace and foster the emerging change in the financial markets and be prepared to tolerate even some disruption."

JanneLauha
Partner at Castrén& SnellmanAttorneys

What next for FinTech in the Nordics?

A future of changes

On a high level, the development of the Nordic FinTech market is based on four key drivers; regulation, talent, capital and collaboration.

The basis of legislation in the Nordics lies in the decisions of the European Commission, but national regulators can take definitive action to tackle the obstacles as the UK example shows. To maximize the Nordic market potential, the country-specific resolutions would optimally be aligned across all the Nordic nations. Deloitte highly recommends that the authorities increase their current collaboration level even more and establish purpose-driven tools and forums to increase cross-Nordic alignment.

The talent pool for FinTech is another driver. The long history of easy access to education and technology have been the mainstay of the Nordic countries. The big success stories Spotify, Supercell, Klarna and others have made it very acceptable to be an entrepreneur as a profession and strengthened the positive culture.However, we are still a small region and if we want to compete with the likes of the UK and the US we need to make it easier for companies to bring more talent to the Nordics and to offer them competitive compensation. Here, as recent events have shown, there is still a lot that needs to be done from a regulatory perspective.

Access to capital may have been a larger barrier in the past with more capital available in the region today than before however, it still presents a significant hindrance for companies looking to scale beyond their local market. As the data in section 4 shows, the number and value of investments is on the rise, increasing the possibility for companies to receive funding from both local investors as well as foreign ones. Additionally, the current low-interest environment and high stock-market valuations are shifting an ever larger portion of global capital flows into alternative investments. This shows however very clearly that access to capital is highly dependent of the overall economic activity in the region, and is prone to high volatility. The Nordics are moving in the right direction, however we still face the issue that despite capital being more available for early stage companies, we are still lagging behind other FinTech Hubs when it comes to later stage investments.

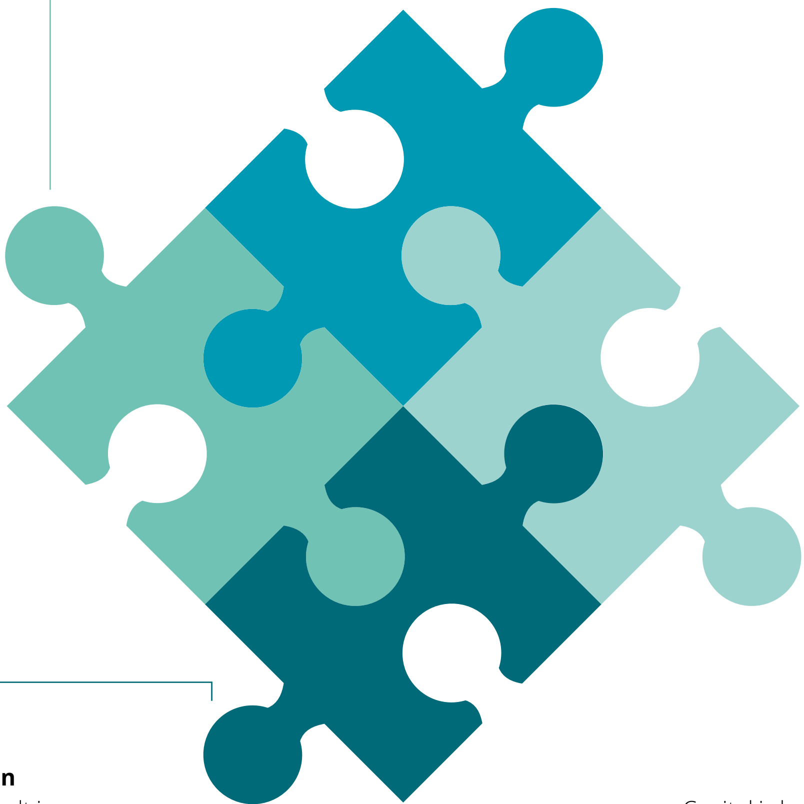
Perhaps cross-industry collaboration, the fourth driver is the most challenging one. Introducing truly game-changing innovations and creating completely new opportunities will require further collaboration across the industry between start-ups and incumbents, than we are seeing today. Designing innovations without seeing organisational or cultural boundaries as obstacles or restricting factors, innovators on both sides will require deeper commitment to each other without limiting each other's core strengths. Not an easy task, but a necessary one to enable further growth in the sector.

"Cross-industry collaboration –Looking at the Nordic FinTech market, one may come to a conclusion that to introduce truly game-changing ideas, more collaboration would benefit both the incumbent companies and FinTechs."

Jessica Stark
CEO & Co-Founder SUP46

Regulation
As the UK sandbox example shows, regulators need to assume a more active role and support FinTechs. Similar solutions to the UK Sandbox model are urgently needed. The regulatory structure should be changed to enable Sandbox operational model

Talent
The Nordics have a long and successful history in high-tech industries, furthermore education is free and valued in all countries. Borders need to be opened up and compensation regulation simplified in order to compete for future talent against peers in the UK and US



Cross-industry Collaboration
The FinTech disruption may result in FS institutions branching out to other industries, rather than just others entering financial services. Therefore, to truly revolutionize the industry we hope to see further cross-industry collaborations where incumbents and FinTechs join forces and revolutionize the way we have traditionally viewed financial services

Capital
Capital is becoming less of an issue at an early stage, however the region still lags in terms of capital availability for later stage investments. Besides the government lead institutions supporting entrepreneurs with funding, the increase level of venture capital and increasing number of investments provides faith that the market is maturing

"As FinTech continues to increase its share of investment in the region, the sector will grow even more important to the future success of the Nordic start-up scene."

Neil Murray
Founder of The Nordic Web

"It is easy to focus on what's going on in the short term, but it is challenging to think of what is going to happen in 5 years or 10 years."

Kirsti Merethe Tranby
Partner, Financial Services at Deloitte

Market outlook

As explained, the market development depends ultimately on the four introduced drivers. However, as there is a lot of activity in the market, we have summarised our point of view of the likely developments below. We utilized the strategy framework introduced earlier to categorize the impacts we are expecting to see.

For the competitive strategies, in the shortterm we are expecting to see minor changes in the incumbents' revenues as the smaller players are entering the market and capturing minor shares. This however will change in a long-term. If the current development continues, there will be drastic changes in the market structure as the current earning models will eventually become too expensive for customers.

In the co-opetition we are expecting that in the upcoming years the development will benefit incumbents rather than hurt them. However, there is very likely chance that eventually the FinTechs capture more of the front-end than the incumbents business can take. If this the case, the incumbents role will be more technology focused, providing the infrastructure for the market rather than having the kind of deep relationships with the end-customers as they do today.

In the collaboration space we are expecting to see new markets starting to emerge. The source for this is combining financial services with other services, improving the customer value. Therefore, in the long-run we are very likely to see that industry boundaries will diminish. If this is the case, FS institutions need to reassess their own focus areas. On a high level, we see three options. They can branch out to new industries themselves, decreasing dependency on their current businesses. They can focus on the technology, becoming world-class infrastructure providers. Or finally, they can select key areas from their current businesses and focus on them.

Collaboration and co-opetition will be the main drivers shaping the relationships between incumbent's and Fintechs. It would be a narrow view to look at collaboration only as a way for FinTechs to prosper. As collaborative advantage is the new competitive advantage, it is the incumbents who should position themselves as the most desirable partners for FinTechs. Mutually beneficial partnerships can often open more doors than competitive confrontations.

Competition

1 –5 years

- Servable market shrinks, as FinTechs capture non-core customer segments
- Minor changes in revenues
- Increasing amount of acquisitions and mergers

5+ years

- Drastic change in the market structure
- Consumer prices will fall, major changes in revenues
- Major pressure to change revenue model

CO-opetition

1 –5 years

- Only small changes in market shares
- New products that benefit customers
- Some significant FinTech exits

5+ years

- Competition over the cross-industry technology solutions
- If the front-end is lost, incumbents will become technology providers

Collaboration

1 –5 years

- New markets start to emerge
- Increased service quality and more versatile offering for customers
- Some mergers and acquisitions

5+ years

- Industry boundaries diminish
- FS institutions are more technology focused or have broadened their offering
- Differentiation in services
- New positioning era within FSI sector

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