



Open banking: revolution or evolution?

Incumbents are launching open bank hub initiatives as challenger banks and financial technology firms face a differentiation imperative in the wake of the Covid-19 pandemic

Key highlights:

- **Open bank hub initiatives, giving customers the option to connect their bank data with third-party providers, were the second most chosen innovation strategy by respondents in a 2020 global banking survey conducted by The Economist Intelligence Unit (EIU).**
- **Open banking could benefit banks greatly by making it easier for them to leverage their own data internally for better service personalisation, a top priority for nearly a third (32%) of respondents in the EIU survey. Banks could also play a leading role in digital identification.**
- **Regulation has been the main driver in many regions, notably Europe and some Asian and Latin American countries. Meanwhile in others, open banking has evolved owing to market forces and new competitors including e-commerce giants in China and nimble challengers in the US.**
- **Although 87% of countries reportedly have some form of open APIs in place, laying the foundation for further development of open banking depends on the degree of customer confidence in sharing their data, interoperability, enhanced user experience, and the added value of products and services.**

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- **The UK is leading the way in open banking owing to regulatory requirements and a dedicated central programme and platform, the Open Banking Implementation Entity, funded by the country's nine biggest banks. Other regions are following suit, notably Hong Kong, with the APIX API platform; and Scandinavia, with the Nordic API Gateway. Australia, Mexico and Brazil have introduced open-banking legislation, while Canada has started the second phase of its "consumer-directed finance" consultation.**
- **The Covid-19 pandemic has boosted open banking and the financial technology ecosystem. In the UK, for example, the user base of the Open Banking Implementation Entity platform doubled between April and September 2020, reaching 2m.**

Open banking, which allows third-party providers to access the financial information of banking customers through Application Programming Interfaces (APIs), was launched with the aim of providing customers with more tailored and innovative products and services, and to foster more competition in the banking industry. As banks attempt to broaden and improve their digital offerings, countries and regions have approached open banking in different ways. Some, like the US, take a market-led but fragmented approach. Asia has a mix of regulation, supervisory guidance and market-led approaches. Others, particularly the EU, have legislated, obliging all banks to open their data and payments—with customers' consent—to third-party providers.

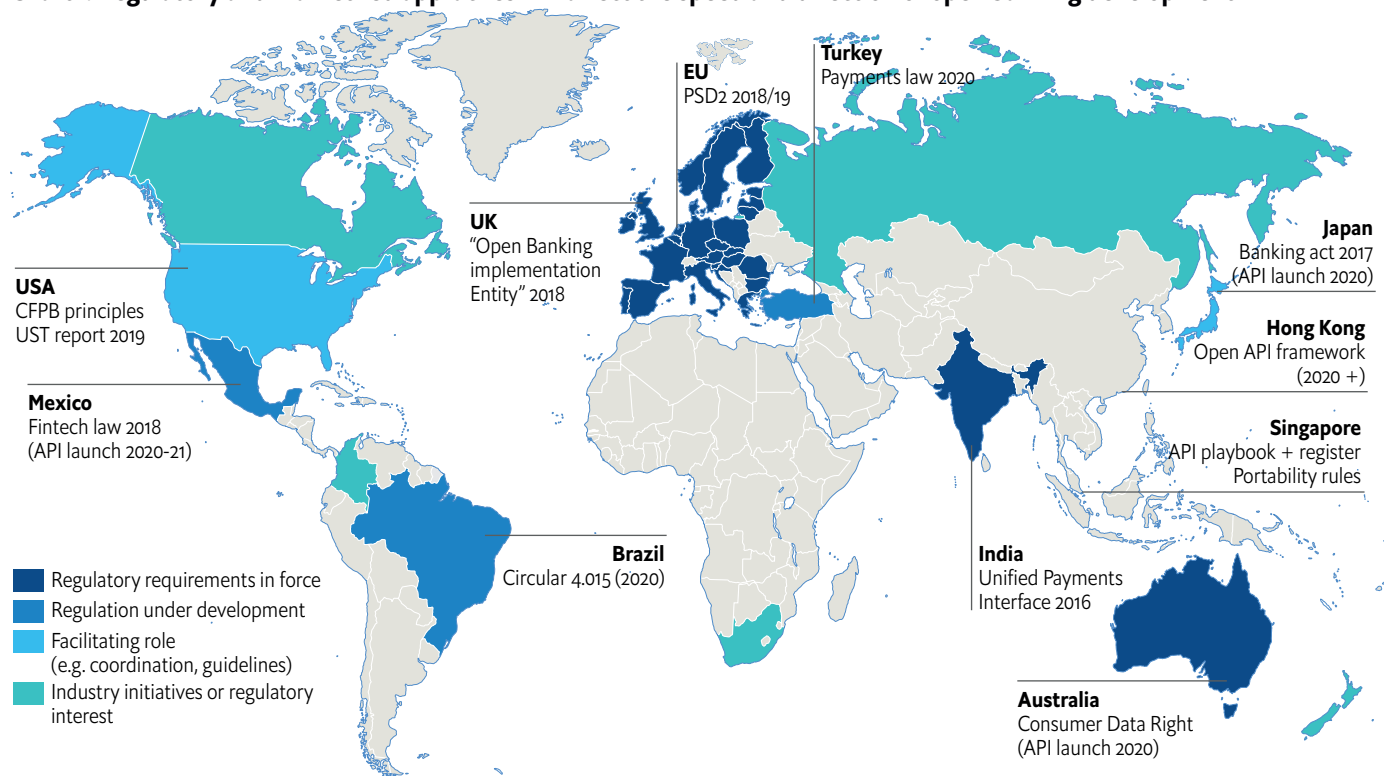
Globally, open banking could generate more innovation and competition, ultimately leading to a better end-user experience. Incumbent banks could be the biggest beneficiaries, providing that they adopt adequate technology strategies to compete with nimble new entrants.

Regional strategies

In Asia, large existing financial technology (fintech) platforms have developed open banking services in a low regulatory environment. For instance, China's Alipay and WeChat Pay exploited their huge social media and gaming platforms and customer bases to offer other services. Such firms needed to develop payment systems in a country where credit card penetration is low. In effect, their closed ecosystems bypassed the banking system altogether, offering their clients AI-driven lending, wealth products and more. The fact that Asia-based users are broadly willing to share their data has reinforced this trend.¹

¹ <https://techwireasia.com/2019/01/hong-kong-more-open-to-sharing-financial-data-says-new-report/>

Chart I: Regulatory and market-led approaches will affect the speed and direction of open banking development



Source: BBVA.

Conversely, in the mature, highly regulated banking markets of North America and Europe, it is harder for tech giants to supplant incumbent banks and traditional payment channels. In the EU, the second European Payment Services Directive (PSD2) obliges banks to allow access to authorised third-party providers (TPPs) that offer account information services or payment initiation services. The directive dictates that banks must create APIs to interact with third parties, but there is no specific guidance on how to do it. That has led to differing interpretations between domestic regulators, banks and the fintech community. As a result, open banking works well in some EU countries, but not all, and it does not work efficiently across borders.

According to John Broxis, managing director of the Open Banking Europe initiative, the reason why the UK is recognised as an open banking

leader is because the country's competition authority set early deadlines for its biggest banks to build APIs and infrastructure. More importantly, the country's nine biggest banks funded a central programme and platform, the Open Banking Implementation Entity (OBIE), that cost at least £60m (US\$82m), on top of their own development costs. This contrasts with the situation in continental Europe, where a year after the regulatory deadline, there are "thousands of banks, no central entity trying to implement it, and no central infrastructure," according to Mr Broxis.

Similar patterns can be seen in other markets. In Hong Kong, for example, the APIX API platform is supported by a number of local banks, ensuring high levels of interconnectedness; however, HSBC, the territory's biggest player, is not part of the programme.

Directory of TPPs

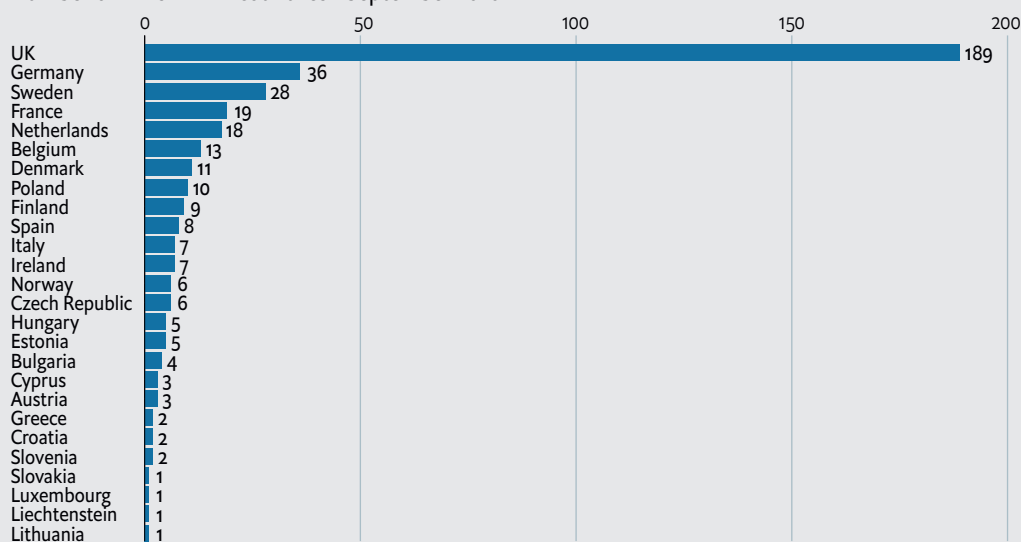
According to Open Banking Europe, a repository and registry of open banking permissions and digital signatures, there are, as at September 2020, 410 TPPs across the EU and the UK.

John Broxis, managing director of the Open Banking Europe initiative, believes that the pace and spread of innovation in open banking needs to be taken into context. There are some 6,000 banks across Europe, and interoperability is low. Sorting teething issues about digital certification and how institutions are classified is ongoing.

“Creating the registry is the easy bit,” says Mr Broxis; the difficulties spring up, he says, “once you get real customers involved.”

PSD2 had two goals, firstly to loosen the hold that banks have on customer data to encourage innovation and, secondly, to boost competition from challenger banks. According to a global banking survey conducted by The Economist Intelligence Unit in 2020, open bank hub initiatives, giving customers the option to connect their bank data with third-party providers, are the second most chosen innovation strategy globally, cited by 29% percent of respondents—a figure rising to 32% in Asia, and 36% in Africa and the Middle East.

Chart II: The UK leads Europe - for now
 Number of TPPs in EEA countries - September 2020



Source: Open Banking Europe.

Meanwhile, other countries are also moving forward with regulatory initiatives for open banking. In Australia, the new Consumer Data Right Act, which allows consumers to share their banking data with accredited TPPs, became law in July 2020, while Canada started the second phase of its “consumer-directed finance” consultation on open banking in November 2020. Latin America is also seeing a fintech boom as new regulations, such as Mexico’s Fintech Law and Brazil’s Circular 4.015 reduce barriers to entry, attracting new capital into the sector.

Beyond finance

The lockdowns imposed by the Covid-19 pandemic have proved a powerful booster for open banking and the fintech ecosystem, as bank customers have been forced to embrace digital channels. In the UK, for example, the user base of the OBIE platform doubled between April and September 2020, reaching 2m.²

Furthermore, new use cases for open banking are emerging, driven mostly by young affluent consumers. In the UK, a survey conducted by YouGov in February 2020 found that 84% of so-called HENRYs (“high-earner not rich yet” consumers, aged 25-44 with income above £50k) would use a feature making it easier to view recurring subscriptions that they pay for; 82% would use a feature that would bring together information on all their pensions; 81% would use a feature allowing immediate transfer of money between accounts, regardless of which bank; and 79% would use a feature that would help them to understand their spending by grouping expenses into buckets.

But the opportunities are expanding beyond the financial industry, with use cases emerging

in new sectors. In real estate, for instance, open banking technology can allow software to automate payments and reconciliation, or to improve the tenant referencing process.³ It can also be deployed in mortgage processes, to simplify affordability assessments and the establishment of expenditure patterns.

The charity sector has seen several initiatives powered by open banking, such as a donation platform allowing people in the UK to give directly to a chosen charity by scanning a QR code with their phone.⁴ Several banks are piloting “charity pots”, where expenses are rounded up and the remainder is transferred to a chosen charity each month.

In-app payments and integration

More robust, widespread APIs, high uptime—where systems operate reliably—and quick responses to API requests make for a better user experience, and will ensure that customers who try new functions stick with them, thinks Rune Mai, CEO of Nordic API Gateway. His company provides a platform with ready-made, tested APIs that any bank can sign up to and any regulated TPP can use.

Nordic API now covers all Nordic markets, with a penetration rate of 95% among retail and business accounts. Coverage in the Baltics, Poland, the Netherlands, the UK and Ireland is approaching similar levels, with infrastructure expected to be ready across the rest of Europe by summer 2021. National regulators in Asia are also working on open banking to connect their national payment systems.

Mr Mai believes that banks increasingly see open banking as an opportunity to bring in new functionality to market, often deploying technology that can be developed and implemented more efficiently. “This is a great

² https://www.altfi.com/article/7089_open-banking-doubles-its-user-base-to-2m-brits-in-just-six-months

³ <https://www.lettingagenttoday.co.uk/breaking-news/2020/3/breakthrough-for-agents-as-open-banking-set-to-speed-and-improve-payments>

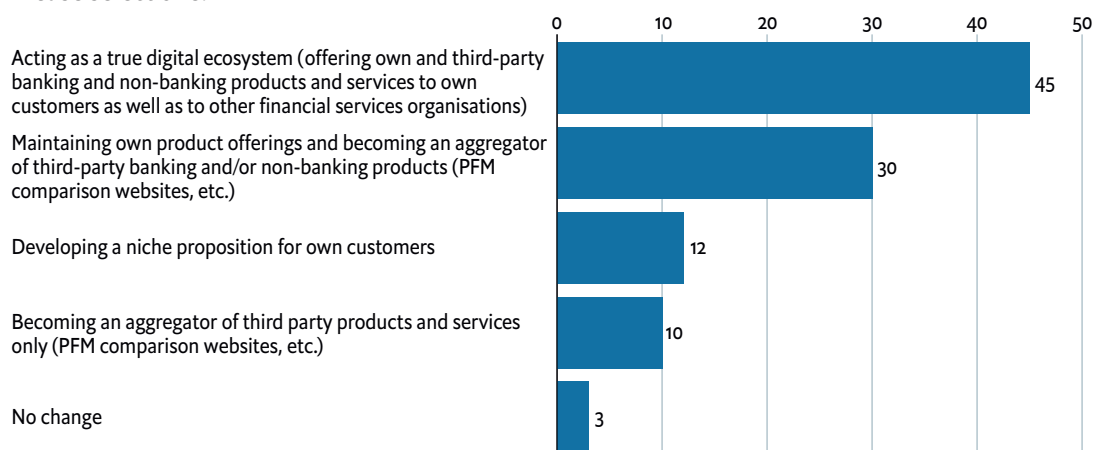
⁴ <https://www.moneyhubenterprise.com/press-blog/17/09/20/open-banking-excellence-moneyhub-and-streeva-launch-worlds-first-qr-code-based-open-banking-payments>

opportunity for banks, once you explain it. APIs and PSD2 are a way of sealing off incumbents' core systems and allowing the banks to move at the same speed as anyone else," he says.

In the 2020 global banking survey conducted by The Economist Intelligence Unit, 45% of

respondents said that they want their banks to become digital ecosystems. This may lead many incumbents to follow multiple strategies, including partnering with platform players and fintech firms, in addition to offering third-party products on their own portals.

Chart III: What is the primary way in which you see your current digital business model evolving? Please select one.



Source: The Economist Intelligence Unit.

Usability and accessibility are key, says Masa Peura, senior vice-president of payments, accounts and personal finance management at OP Financial Group, a Finnish banking firm. "The bigger players have big user bases. Start-ups might be more agile in bringing features to market, but the real question is how well you compete in the user experience."

Customer confidence

Whether regulation- or market-led, global payment efficiency and integration with accounting and invoicing software will be crucial offerings for commercial customers, particularly small and medium-sized enterprises (SMEs), and online businesses.

In fact, according to a survey conducted by KPMG in November 2018, 30% of SMEs had a "good" appetite for open banking. The

firms in question were typically sophisticated and larger businesses in manufacturing, technology, media and telecoms, or financial services; 28% had "some" appetite, typically low-growth, mid-sized businesses. Overall, 24% of SMEs would pay to make and receive payments to and from suppliers and customers more easily and quickly, while 22% would pay for a dashboard of all business financial accounts, loans, savings and assets. In addition, 60% of SMEs would prefer that their own bank provided an open banking ecosystem, according to Accenture.

A single button for account-to-account payments with the same experience for every customer is vital if banks want consumers and businesses to use the service. Without collaboration between banks and fintech firms, competing efforts are likely to fragment

the user experience and hinder, not help, customer acceptance and confidence.

“Opening up banking isn’t enough unless you can prove to your customer base the certainty of how their data is going to be treated, certainty about refund periods and reconciliation information, or certainty about what happens if you do something wrong,” says Mr Broxis.

When the basic system is in place, banks could benefit greatly, pulling in data that enables them to know their customers better and provide the payment services for non-financial mobile apps. As consumers adopt the Internet of Things, conduct online shopping or hire

e-scooters, banks must also consider their essential role in digital identification when clients pay for these products and services.

“We need to identify ourselves to make payments to use new products and services,” says Mr Broxis. “You need an open banking infrastructure if you mix identity and payment, especially for small amounts.”

Whichever open banking route is taken, market-led infrastructure, universal service standards and, crucially, customer confidence are vital. Banking data is beginning to flow, allowing new features and services to be developed and brought to market—the global open-banking revolution is a work in progress.

A bird’s eye view on personal finance

In the UK, banks such as Natwest and ING (via its Yolt service) have been offering account aggregation services since 2018. More recently, OP Financial Group, a Finnish bank, launched its “multi-bank” account aggregator, which allows customers to view all their finances in one place—in OP’s main mobile banking app. More personal finance management and payment integration tools are also priorities for the firm, explains Masa Peura, OP’s senior vice-president of payments, accounts and personal finance management.

Read-only, open banking account aggregation could be a first step towards customers being able to initiate payments or complete transactions from a single app. As any bank can create an aggregating service, competition for retail customers should be intense. And early evidence suggests that users are more interested in aggregating to their primary bank,

rather than to secondary banks, Mr Peura highlights.

This ties into findings from The Economist Intelligence Unit’s global banking survey, which found that pure aggregators are not viewed as a main competitive threat by banking executives. Only 9% of respondents to the survey cite aggregators and platforms such as Cleo, Bud or Yolt as their biggest projected non-traditional competitor, far behind payment players (50%), and technology and e-commerce disrupters such as Google or Apple (34%).

This may be because banks will be able to purchase the aggregation technology from newcomers to beef up their own offerings. “We won’t use these new fintech companies as the way to aggregate banking data, but the latter will sell their services to the banks,” predicts John Broxis, managing director of Open Banking Europe.

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