Open Banking and the stigma of regulation

A look at how regulation has tainted Open Banking

Summary

The term Open Banking started to gain notoriety in 2016 as a direct result of the UK's Competitions Market Authority announcing plans for the top 9 banks in the UK to deliver open source APIs for 3rd party use by January 2018.

Open Banking has been introduced in many countries around the world with varying regulatory controls. As a result, Open Banking is now seen by many in the industry as a compliance project and is facing internal resistance.

However, this needn't be the case. Opportunities exist for banks and financial institutions across the globe should they embrace Open Banking and see beyond the regulatory framework.

This report sets out to remind us of what Open Banking is, where it can be beneficial and explain why it hasn't been the innovative explosion everyone was hoping for.

WHAT IS OPEN BANKING?

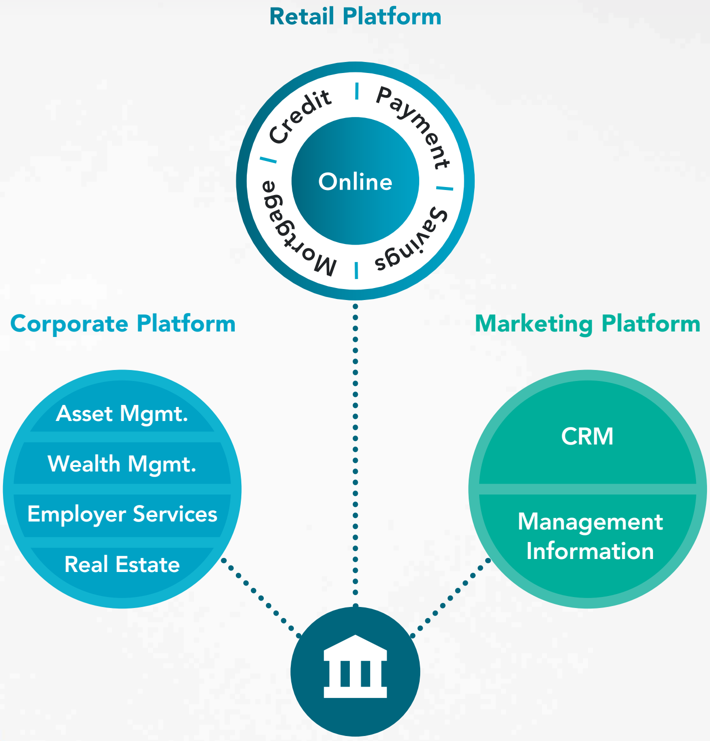
Open Banking today means different things to different people around the world.

For fintechs it is the ability to provide additional service offerings to both the bank and the end consumer through consent, automation and digital experiences, such as a bank-controlled consumer portal.

For banks, it is a costly piece of regulation that poses a threat to their much-valued customer relationship.

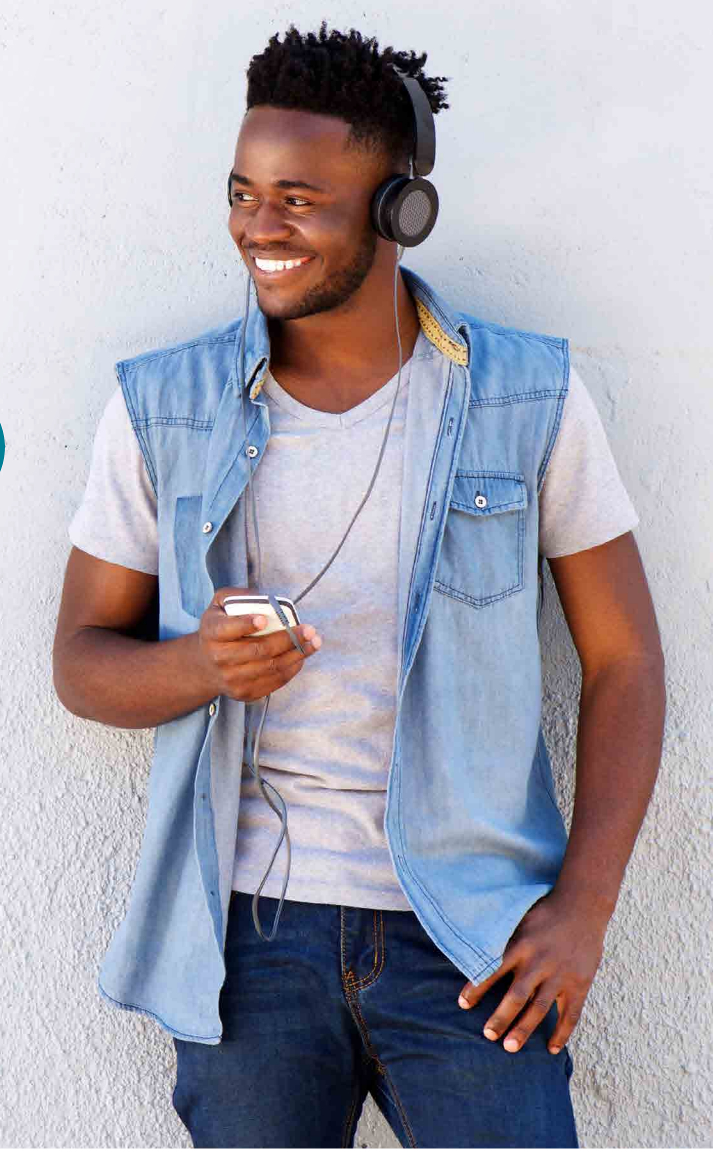
For most consumers, it is relatively unheard of. Those that have heard of it are confused by the mixed messages from banks regarding sharing personal data.

All these descriptions have some truth to them, but Open Banking is much more. It is about banks digitising their business, turning their siloed software into accessible services that can be more efficiently used, both internally and externally.



Traditional Banking Software

- × Single application supporting multiple core functions
- × Siloed business units
- × Costly and risky maintenance
- × Infrequent change
- × Inefficient working



Open Banking

✓ Functions exposed through common interfaces (APIs)

✓ Splitting applications into micro services

✓ Support frequent changes

✓ Reduced risk and maintenance cost

✓ A connected business

Open Banking is essentially a concept known in the technology world as "Everything as a service" (XaaS), which is a design approach that enables software to expose its functions to other software, so that a business can operate more efficiently. This software design approach typically results in Application Programming Interfaces (APIs).

An example of XaaS might be a piece of HR software that requires employee's payroll data, which is currently stored in the company's payroll software. If both the payroll and HR software used XaaS in their designs, then HR would be able to directly pull the information from payroll as and when it is required, using an API.

However, many legacy systems do not support XaaS and therefore a cumbersome, error prone, manual process is in place to import payroll data into HR once a month.

A perfect example of how a company has successfully adopted XaaS within its business model is Amazon. Amazon evolved from providing an online retail environment to boasting a $7.7 billion cloud-based platform business today.

It is said around 2003 Amazon CEO, Jeff Bezos, sent a memo to his staff stating that moving forward all Amazon teams would expose their data and functionality through generic interfaces (APIs) to be used by any technology – internally or externally. During the years that followed Amazon further developed its own IT infrastructure, one that better suited their internal business needs. With the original intention in mind of sharing data to achieve business objectives, Amazon were able to capitalise on their internal systems, marketing this solution to the outside world.

Amazon has proven that a successful implementation and business strategy based around XaaS can positively impact your business. When directly translating this across to Open Banking, the potential benefits include:

- Operational efficiencies
- Cost savings
- The creation of digital revenue streams
- Utilising existing software to create new innovative services
- Enhance the customer's experience

With these available opportunities on offer, it's a wonder why banks are not interested in embracing Open Banking more.

SO WHY THE LACK OF INTEREST?

Despite the unlocked potential of Open Banking, adoption rates are still low. In the UK only 17% of banks have enrolled onto the UK Open Banking directory. Banks lack of interest in Open Banking can be attributed to several different factors.

Regulation

Governments around the world, recognising that financial data belongs to the individual and not the bank, have started introducing legislation to force banks to provide their services externally to authorised third party providers (TPPs). In the EU it was PSD2 and the legislation was known as common secure communication. It focusses on providing both account information and payment services for payment accounts. In some countries, regulation encompasses more account types but focuses solely on account information. Many have labelled this legislation as Open Banking and it has unfortunately stuck. Externalising services to TPPs is a subset of Open Banking.

Banks that fall under the legislation have an obligation to comply before a certain date and so for many their only concern is to comply in time and so any Open

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Banking conversations are kept within the confines of regulation until banks are compliant. Banks that don't fall under the legislation dismiss Open Banking as something that doesn't concern them and therefore do not explore its opportunities.

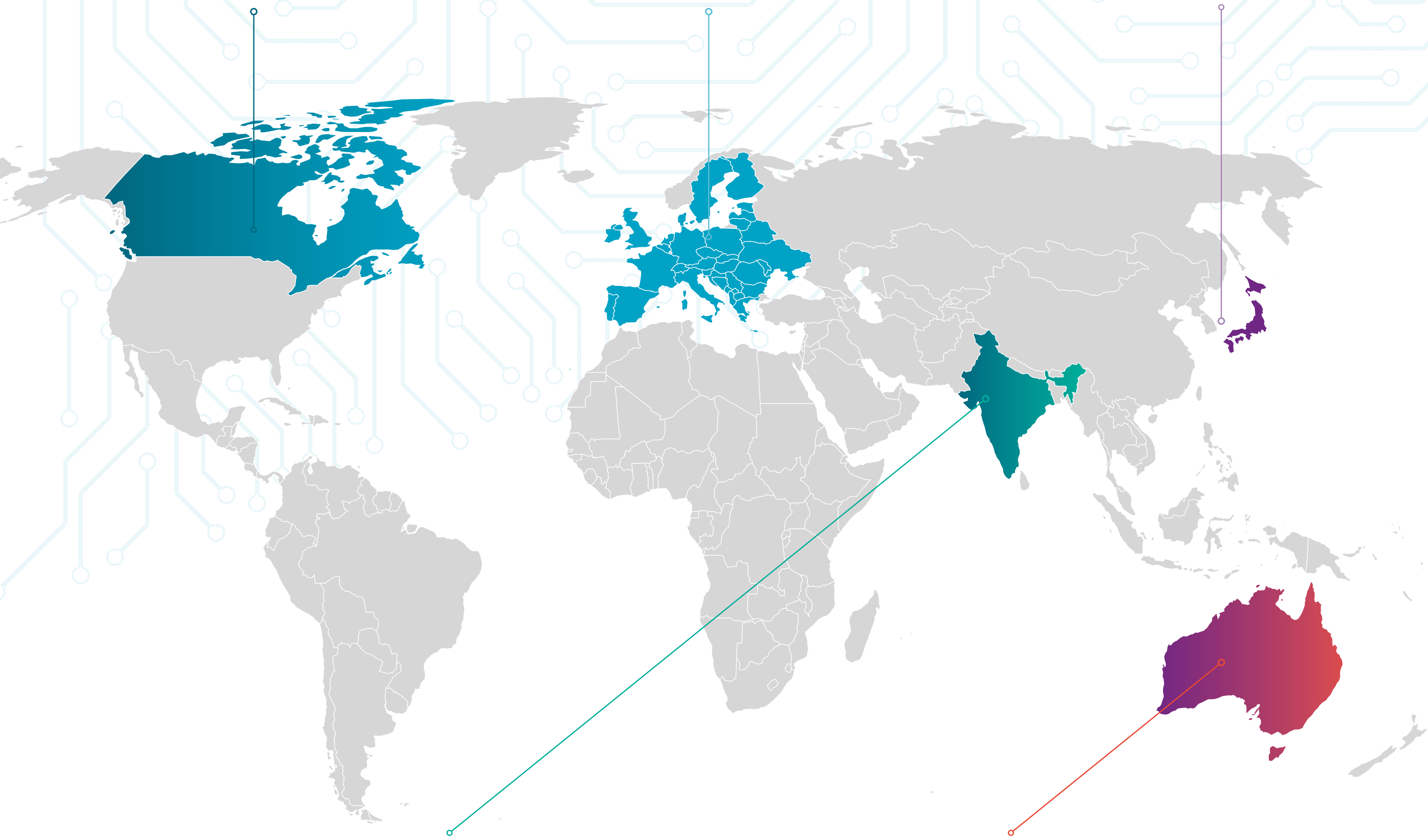
Regulation hasn't helped with consumer uptake either. The customer journey imposed on TPPs, thanks to PSD2, and the lack of a refund service for third party payments, are some examples highlighted in a published UK Open Data Institute report.

Countries with Open Banking Initiatives

A report released in 2019 titled "Open Banking: what it means for you", aimed at laying the foundations for Open Banking in Canada

PSD2 is the regulation forcing Open Banking implementation onto banks in Europe. Only the UK have a mandated implementation body and so many banks have come up with non-standardised solution, resulting in fragmentation.

The Amended Banking Act in Japan encouraged banks to open their APIs by 2020. Focus on payment services with 2020 Olympics in mind.



India are perhaps the market leader in Open Banking with the Unified Payment Interface (UPI). Launched in 2016, the UPI uses an API framework to deliver an instant real-time payment system and accounts for an average of just under 800 million transactions a month.

Australian Competition and Consumer Commission (ACCC) has an overseeing role of Open Banking in Australia. Standards are technically similar to UK but focussed on wider consumer data and not services.

Complexity

It is no secret that digital transformation is a complex and costly exercise. Traditional IT systems that provide end-to-end solutions are expensive to transform away from and present high operational risk too, since they are often at the core of business process.

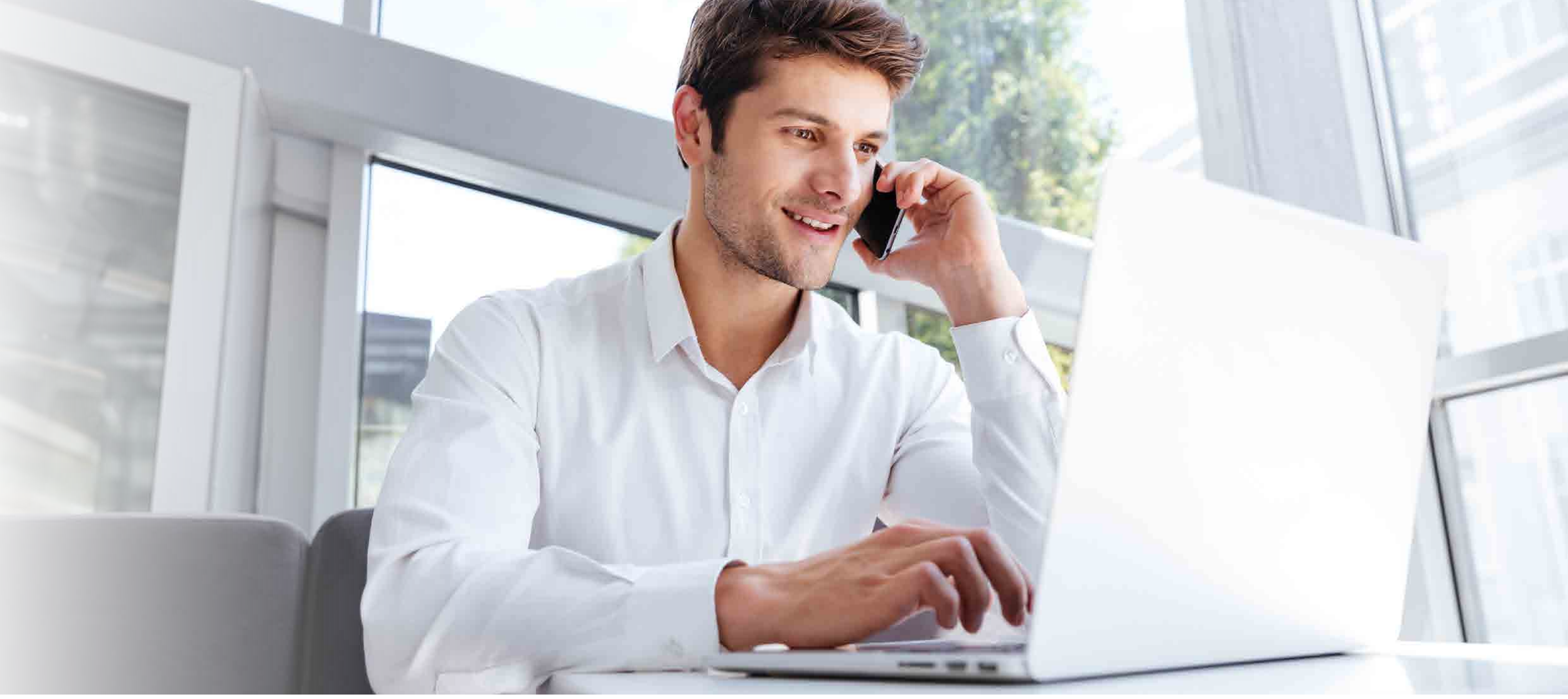
Furthermore, providing secure external APIs to third parties is a complex task. Software providers offer Open Banking components, but few provide complete solutions. Therefore, in a lot of cases banks are having to engage with multiple providers, learn the trade-off points between them and manage the delivery.

This endeavour comes at a price, as banks are having to upskill and invest in technologies, which until recently were technologies primarily used by enterprise businesses.

Fear

Banks see the legislation as a major threat to their highly valued customer relationship. Selling products through branch visits is close to disappearing. For their online services to also be under threat makes for an unsettling future for banks and so any bank not regulated will, understandably, not want to explore Open Banking.

Banks are not the only entities to fear Open Banking. Consumers who, for a long time, have been told not to trust anyone with their bank details are now being told the reverse. Though a lot of investment has gone into making Open Banking secure, this is not obvious to a customer. There is a lot of education required to help consumers adopt Open Banking, coupled with online and mobile apps that make saying no difficult.



WHY SHOULD BANKS THINK AGAIN?

Despite the concerns there are many opportunities worth exploring for banks.

Increased efficiencies

We used the HR and payroll example earlier on, but how many other business processes could be streamlined by opening access through APIs? The efficiency that could be gained from more streamlined processes could drive down operational costs and increase staff utilisation.

Enhanced customer experience

Open Banking allows banks to take advantage of another bank's services. Savings banks can now access the account information of a nominated account, enabling them to identify savings opportunities from transactional data. Furthermore, using the payment services offered in the EU savings banks can use Open Banking to action a bank to bank withdraw from nominated accounts, creating that much desired closed transaction loop.

New revenue streams

Amazon would have never perceived the idea that they would be able to one day commoditise their IT infrastructure into a multibillion-dollar business. Though it might be hard to see now, what services exist within a bank that could be commoditised?

The UKs Open Banking group (OBIE) have started exploring the development of premium APIs. APIs that could be monetised.

One area which might be worth exploring is data. Today data is also a multibillion commodity. So do opportunities exist for banks to benefit from sharing anonymised data sets?

Better equipped for the future

PSD2 came into force in September 2019. Following on from PSD2 are new initiatives such Confirmation of Payee and Request to Pay, both adopting APIs as the method for exposing services externally. Already third parties are lobbying to bring non-payment accounts under the Open Banking regulation. Until such time, account aggregation services will never recognise their potential. Therefore, it is better for banks to embrace Open Banking sooner, rather than wait until they are under pressure from their regulators.

WHAT ARE THE NEXT STEPS FOR BANKS?

Since the term Open Banking is now so closely attached to regulation, it is perhaps no longer appropriate to be used as a description for a bank digitising their business. Perhaps a more appropriate term would be 'Banking as a Service'.

Instead of banks looking at digitising as a strategic goal, they should instead look at how digitising can support their strategic business goals.

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Whether a bank's strategy is to drive down operational cost while increasing productivity, onboarding more customers, being more socially responsible, or improving their customer experience, banks should take the time to identify where the digital transformation of their business can help. Once a bank has identified where digitisation can accelerate achieving their strategic goals, they can develop a digital roadmap - where they want to be in the future and how they plan to get there.

From a regulation perspective, it will almost certainly increase competition within the banking space, and it is anticipated future regulation will bring more banks into the Open Banking ecosystem. Banks, therefore, need to decide how much to invest. Choosing to only comply could ultimately see a bank lose their much-valued customer relationship. Whereas choosing to go beyond and embrace Open Banking could be a decision that proves to be successful in the long term.

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TRANSFORMING BANKING EXPERIENCES

About Sandstone Technology

Before "fintech" was a thing, our founders were dreaming up new ways to transform banking, simplifying the customer journey and the employee experience.

More than 20 years later Sandstone Technology is still leading the charge, innovating and evolving as the industry evolves. Our high client retention rate is our proudest achievement with 40+ financial institutions across United Kingdom, Asia, Australia, and New Zealand putting their trust in our solutions.

From digital banking and digital onboarding to origination and AI-based data analysis, with cloud-based or on-premise deployment, we create flexible, robust, end-to-end solutions using a multi-channel approach that gets our clients to market faster.

Seamless customer experiences start with Sandstone Technology.

Your trusted partner in the banking revolution.

Contact Sandstone Technology for more information about Open Banking and how we can help partner with you in digitising your business.

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