Open Banking: How Australia can learn from the UK

Open Banking drew global attention 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 Application Programming Interfaces (APIs) for 3rd party use by January 2018.

Since then, Open Banking has been introduced in many countries around the world with varying regulatory and standardisation controls. In the UK the regulatory framework and cost of entry has seen significant shortcomings in the uptake of Open Banking.

Here in Australia, the government announced a review into Open Banking as part of 2017 Federal Budget. Open Banking legislation passed in August 2019. We should not be looking at the UK experience as one which will be replicated as there exists significant differences between the two markets which will see Australian banks and Financial Institutions approach Open Banking with a shift in mindset.

Open Banking in Australia is an industry-wide initiative and accounts for the full range of financial products including loans, mortgages and investments.

In Australia, payments are not part of the regulatory framework as the focus has been only on read access to the data.

A consistent authentication flow has been adopted by the Consumer Data Right (CDR) which requires a One Time Password (OTP) to be delivered to the consumer through existing and preferred channels. Strong Customer Authentication (SCA) in the UK has placed restrictions on banks and inhibited the customer experience.

The Open Banking Directory (OBD) in the UK regulates third party providers and account providers that operate in the Open Banking ecosystem. Regulated third party providers manage the digital certificates and software statements needed to connect to account providers using the Open Banking API Standards. In Australia, the Competition and Consumer Commission (ACCC) will perform the role of the CDR Registrar. The CDR Registrar will maintain the Register of Accredited Persons (the Register) who have been accredited by the ACCC in its capacity as Data Recipient Accreditor. The ACCC Certificate Authority (CA), DigiCert, will issue and manage certificates to CDR participants as directed by the ACCC in its capacity as the CDR Registrar.

The CDR is to be rolled out sector-by-sector across the economy, starting with the banking industry

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, the clear differences between the Australian and UK market, where Open Banking can be beneficial and identify what the areas of focus should be in both the short term and long term.

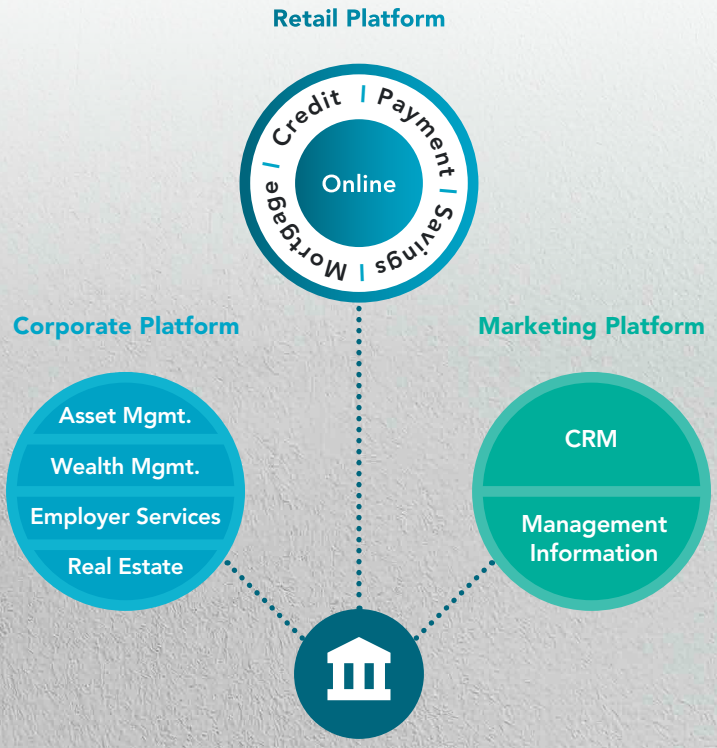
WHAT IS OPEN BANKING?

Open Banking today means different things to different people. For Fintechs it is there 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 piece of regulation that poses a threat to their much-valued customer relationship, however, must be implemented and therefore explored in detail.

For most consumers, it is relatively unheard of and 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 a concept known in the Fintech industry 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 employees 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.

In 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, to one that better suited their internal business needs. With the original intention in mind of sharing data to achieve business objectives, Amazon was able to capitalise on its' internal systems, marketing this solution globally.

Amazon has proven how a successful implementation and business strategy based around XaaS can positively impact businesses. 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
- Enhancing the consumer's experience

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

SO WHY THE LACK OF INTEREST IN THE UK AND WHAT DOES IT MEAN FOR AUSTRALIA?

Despite the unlocked potential of Open Banking, adoption rates are still low. In the UK only 15% of banks have enrolled onto the UK Open Banking directory.
A banks lack of interest in Open Banking can be attributed to several different factors however the three main drivers have been regulation, complexity and fear.

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 (3PPs). In the EU it was PSD2 and the legislation was known as common secure communication. It focuses 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 3PPs is a subset of Open Banking.

Regulation hasn't helped with consumer uptake either. The consumer journey imposed on 3PPs, thanks to PSD2 and the lack of a refund service for third party payments, are some examples highlighted in a recently published UK Open Data Institute report.

In Australia the ACCC have set down specific regulatory compliance pieces surrounding Open Banking including the CDR Rules required to implement the CDR in banking.

The UK rolled out Open Banking for Current Accounts only and targeted nine (9) banks initially. In contrast Australia, Open Banking (aka CDR) is an industry-wide initiative and accounts for the full range of financial products including loans, mortgages and investments. The initiative is being rolled out in 6 stages. The first stage commences on 01 July 2020 and the last stage goes live on 01 February 2022. An industry wide initiative may not guarantee a higher uptake, but it guarantees an increased awareness.

UK Open Banking is heavily focussed on payments while CDR is focussed on sharing product and consumer data, payments is not part of the regulatory framework here in Australia. Accredited Data Recipients have a wider opportunity to deliver value to consumers using the product and consumer data.

Strong Consumer Authentication (SCA) in the UK has placed restrictions on the banks and inhibited the consumer experience. Whereas a consistent authentication flow has been adopted by CDR which requires an OTP be delivered to the consumer through existing and preferred channels. This should help deliver consumer journeys with less friction and confusion as consumers continue to use existing authentication mechanisms.

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In contrast to the UK and Australia, New Zealand has different market conditions which dictates its' approach to Open Banking. The New Zealand government has been content in letting the banking industry take the lead on Open Banking initiatives. Although optional, New Zealand Open Banking binds account information and Payments in their standards. Micropayments will end the habit of running consumers "coffee ledgers" in their heads.

Complexity

It is no secret that digital transformation is a complex and costly exercise. It is expensive to transform away from traditional IT systems that provide end-to-end solutions which can present high operational risks as 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 primarily used by enterprise businesses.

Fear

In the UK, banks see Open Banking 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. Customers 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 customers adopt open banking, coupled with online and mobile apps.

Open Banking will be a multi-year programme with significant investment to install necessary infrastructure and support processes. Banks will be forced to put in place strong remedial structures. They suspect regulators will come hard on banks and enforce penalties for any non-compliance. Banks are not immune to legal action by customers. A possible erosion of trust between the Bank and their customers seems imminent if customer's privacy and data is managed safely. They fear their primary relationship with their customer will change permanently and that loyalty will be shown the door.

WHERE DO THE OPPORTUNITIES EXIST?

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

Enhanced customer experience

An improved customer experience is the most obvious outcome of Open Banking APIs. Imagine customers being able to pull account transactions to prefill account opening applications. There is no need to download electronic statements. This will simplify the process of applying for loans and mortgages, reducing friction.

Banks and accredited third parties are now able to aggregate accounts from different financial institutions to present a single view of a customer's portfolio. The portfolio will diversify to include property, investments and other instruments.

Now imagine customers receiving deep insights into their financial behaviour helping them take corrective actions and improve their financial wellbeing. This is possible by applying machine learning to a customer's portfolio and money movement. The most exciting outcome for customers.

CDR is expected to be rolled out to other industries such as utilities. This would further open up the opportunities towards innovative offerings. Banks and accredited third parties can potentially design new offerings by aggregating bank account information of a nominated account, with services consumed in other industries such as utilities, education, etc.

Increased efficiencies

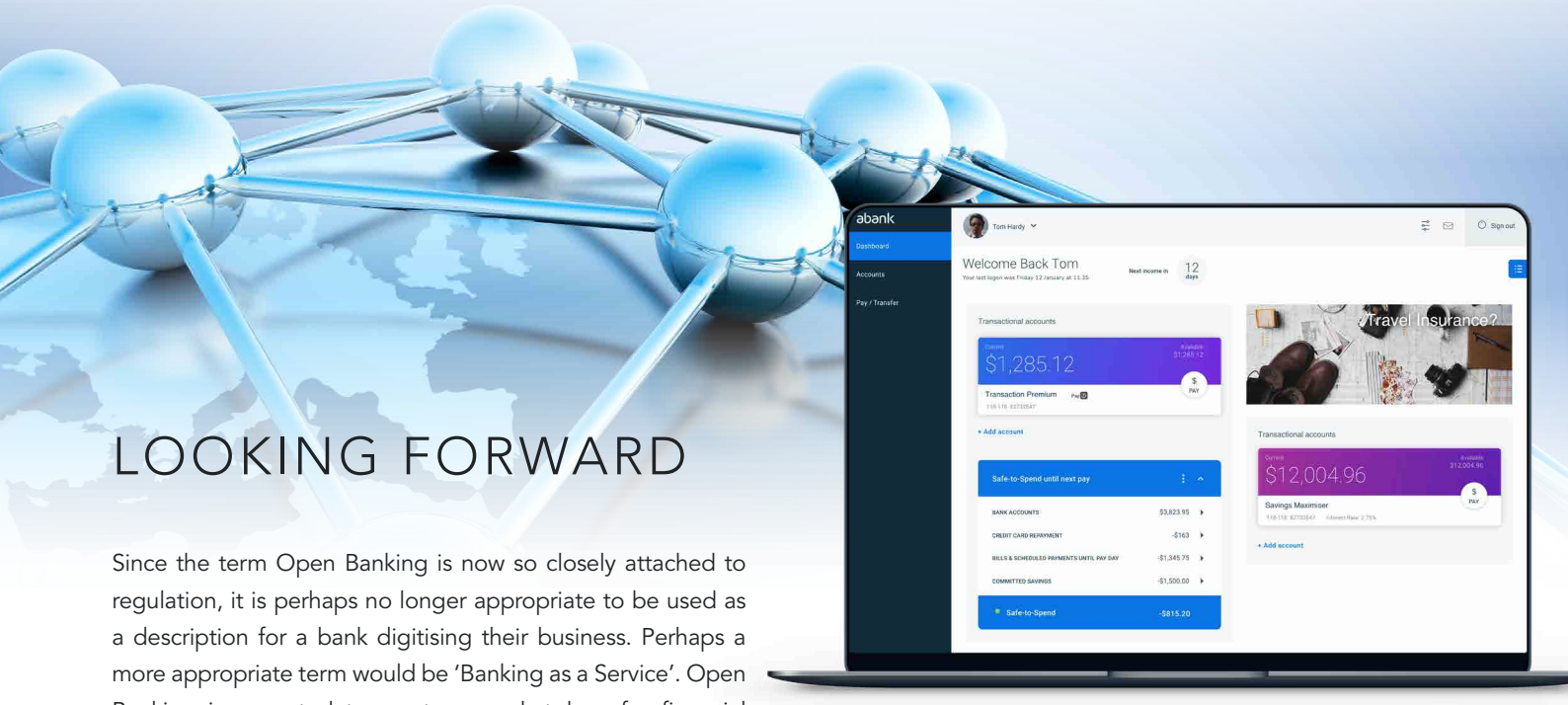
Open Banking will drive innovation and efficiencies within the banking system by fostering competition and targeting specific pain areas for customers. A case in point is around accounting software packages being used by business customers. Currently bank customers are bound to a handful of accounting software packages, ones supported by banks. Open Banking is expected to create more opportunities for other accounting software providers who will have a lower barrier to entry into banking ecosystems. Furthermore, businesses stand to benefit as they may be using a multitude of such services to help with their day to day operations. An improved enterprise resource plan will bring in increased efficiencies by offering better cash management.

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.

Open Banking also presents asset monetisation opportunities. The UK's Open Banking group (OBIE) have started exploring the development of premium APIs, the APIs that could be monetised. For example, a Third party Provider (TPP) would like to take regular payments from a bank's customer. The bank could charge the TPP for the use of their standing order service, which the TPP could then set up with the customer.

Within the AU market, while banking and customer data sharing is mandated by regulation, there is potential to share insights around the data for a fee if any of the data recipients have the needs to consume it for their solution. Banks can also tie-up with fintechs and take advantage of the Open Banking data to build solutions across domains such as risk scoring, digital lending and financial management, thereby potentially creating new revenue streams. Additionally, they can look at monetising payment services once CDR allows payment initiation from third parties.



LOOKING FORWARD

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'. Open Banking is expected to create a marketplace for financial products, drive innovation and improve customer experience.

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

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, bank 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.

Neobanks are expected to have a first movers' advantage over traditional banks and credit unions. These digital only banks are well placed to scale up their business by leveraging the data available through Open Banking. Traditional banks are spinning off digital only banks as well exploring partnerships with fintechs to counter challenges and address the opportunities posed by Open Banking.

Credit Unions are being encouraged to look beyond compliance and regulation. However, conflicting priorities and lack of abundant funding has directly impacted the phased approach to Open Banking. A number of Credit Unions have shown leadership in recognising the need to improve the digital banking experience, especially mobile banking. Credit Unions are actively partnering with fintech providers to offer value services to their members and grow their customer base.

Technology is the backbone of creating the Open Banking ecosystem. API management, security and clean management of data are the key for a successful operation in the new reality. A number of top-notch providers are bringing strong value proposition to the table. The providers are managing the movement of data in a secure way. By offering systems that help manage the customer identity, consent and create gateways to exchange data across the banking ecosystem. Winning customer confidence is paramount to the success of Open Banking and all participants need to ensure that the underlying technology enables the same.

Customers trust their banks however; reinforcement and assurance are necessary to bring continuity in this relationship.

Customer adoption could be challenging if necessary investment is not made to educate the benefits of Open Banking. Customers trust their banks however; reinforcement and assurance are necessary to bring continuity in this relationship. Banks can put some of the onus on accredited third parties by setting up benchmarks to educate customers.

From 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. Expansion of regulation to other industries such as the energy sector, or introduction of write access to the data would create further opportunities for the industry participants.

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 a success in the long term.

Open Banking has arrived and is here to stay. For banks it is a major disruption, but with Sandstone Technology the journey to Open Banking needn't be so difficult.

SANDSTONE - OPEN BANKING SOLUTION OFFERING

Sandstone BankFast Experience Platform (BXP) and BankFast Mobile App solution have been designed to support Open Banking requirements across different markets.

Sandstone BXP has enabled a leading UK Building Society to comply with the Open Banking requirements and meet the September 2019 regulatory timelines.

Sandstone's solution for the Australian market is fully compliant with CDS and data security requirements. Sandstone is closely working with multiple banks in Australia to define the Open Banking solution approach and enable regulatory compliance.

We understand the complexities of the financial industry and strive to ensure this complexity is removed from the customer journey. We make the complex simple, so you don't have to.

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TECHNOLOGY
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 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 Australia, New Zealand, Asia and the United Kingdom placing 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 us today for further information or free product demonstration.

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