Open Banking

A description and interpretation

JOHNSTON CARMICHAEL

An independent member firm of Moore Global Network Limited

MOORE

“The goal of the UK’s Open Banking initiative is to allow consumers and small businesses the option to securely and safely make the most of their financial data. In time, Open Banking will give consumers and small businesses more choice, better services and cheaper products.

The work we are doing here is genuinely world-leading. The UK is the first nation to implement a standardised Open Banking solution. In the UK we are creating a single technology standard enabling new services to be easily built and offered to consumers and small businesses. Open Banking will help make Britain one of the best places in the world to bank and will, in time, stimulate the digital economy.

While the UK is leading the way, we are incredibly excited at the opportunities created by working with peers around the world, and in Europe in particular.”

Imran Gulamhuseinwala OBE,
Trustee of the Open Banking Implementation Entity

A definition

Open Banking is now widely referred to in the financial services industry and relates to technology that allows:

1. The use of open APIs* that enable third-party developers to build applications and services for a financial services institution's customers to access.

2. Greater financial transparency options for account holders ranging from open data to private data.

3. The use of open-source technology to achieve the above.

Open Banking, as a concept, is linked to shifts in attitudes towards the issue of data ownership illustrated by regulation such as GDPR.

In October 2015, the European Parliament adopted a revised Payment Services Directive, known as PSD2. The new rules included aims to promote the development and use of innovative online and mobile payments through Open Banking. On the back of that diktat, in August 2016, the UK's Competition and Markets Authority (CMA) issued their own ruling that required the nine biggest UK banks - HSBC, Barclays, RBS, Santander, Bank of Ireland, Allied Irish Bank, Danske Bank, Lloyds Banking Group and Nationwide Building Society - to allow licensed start-ups direct access to their data.

The new regulation came into force on 13 January 2018 and is overseen by Open Banking Limited, a non-profit entity created especially for the task – although enforcement rests with the CMA.

In theory, Open Banking is seen as positive in encouraging new competition and crucially more choice for consumers. Critics, however, believe that only the technologically proficient will benefit and at worst it could lead to greater financial exclusion for those on low incomes. There are also concerns in relation to data security and, from that, risks that consumers will be exploited, either by businesses offering new types of expensive payday loans or by crooks who have access to data and personal information that people have revealed and which is now in the public domain.

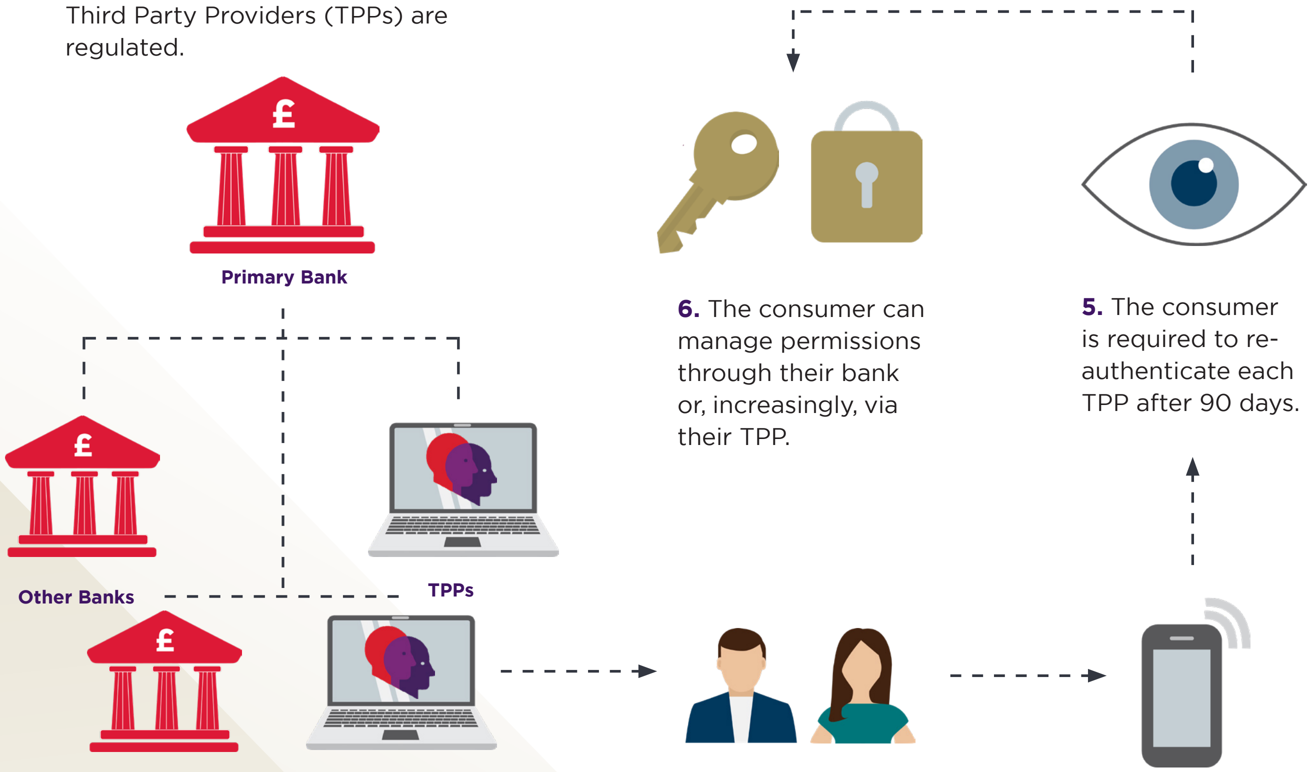
*API - Application Programming Interface. In basic terms APIs allow applications to communicate with one another. Generally, API is commonly used to describe a publicly available web-based API that returns data.

What does Open Banking look like in reality?

Open Banking is a mechanism by which customer banking information is shared with third parties through APIs. This creates a data ecosystem that can be used to solve customer needs, suggest services and, for financial institutions, generate additional business.

Open Banking requires data related to current accounts and credit cards to be shared and payments to be made securely (the first phase has focused on secure payments and current account data). Critically, the data is then stored in a data warehouse and, rather than being the sole preserve of the organisation that provided the financial product, the data is available through the various APIs and starts an exchange process that should lead to a greater and more specific set of personalised financial product offerings to a consumer.

1. Primary Bank checks the Open Banking directory to ensure the Third Party Providers (TPPs) are regulated.



2. Primary Bank opens API feeds to TPPs or Other Banks - currently for current accounts and payments accounts.
This enables the Other Banks or TPPs to:

- access recent & historic transaction data and regular payments data
- collect relevant data
- make one-off payments on a consumer's behalf

3. The consumer decides to access the Other Bank's or TPP's services. Current "live" services include:

- account aggregation services
- personal financial management
- SME financial management
- Open Banking as a service

4. The consumer is redirected to the Primary Bank's app in order to grant the TPP access to the current/ payments account

5. The consumer is required to re-authenticate each TPP after 90 days.

6. The consumer can manage permissions through their bank or, increasingly, via their TPP.

Adoption process to date

Over the period, financial institutions and FinTechs alike attempted to deliver APIs to comply with the mandate put forward by the CMA and, in turn, ensure that data structures and security architectures were secure enough for customers to confidently share their information.

Despite the UK's nine biggest current account providers being told by the CMA to launch their Open Banking initiatives by the 13th January 2018, only four of that group were ready on the due date: Allied Irish Bank, Danske Bank, Lloyds Banking Group and Nationwide Building Society.

Barclays, Bank of Ireland, RBS and HSBC were given an extra six weeks, while Santander-owned Cater Allen got another year.

Expectation versus reality

The first 12 months of Open Banking has seen incumbent banks loosening their tight grip on payments services, FinTechs gaining access to a larger potential customer base, and a springboard created for a possible revolution in retail finance.

However, the incumbent players have had to juggle the ambitious timelines to implement Open Banking alongside the existing and heavy regulatory change burden to make their legacy platforms more robust and less prone to outages. This has led some to view Open Banking as a part compliance and part innovation exercise – the expected 'big bang' of innovation ushered in by Open Banking has yet to happen.

Early innovations

It is important to note, however, that we have already seen some impressive early signs of new technologies powered by Open Banking. At present, there are three main 'live' use cases of Open Banking:

Qualifying banking products	Credit cards	Debit cards	Pre-paid cards
Data & functionality available	Transaction Data		
'Live' Open Banking use cases	Account aggregation services	Personal financial management	SME financial management
	Enables customers to see all of their accounts through one single banking portal.	Helps consumers to optimise their personal financial circumstances according to their goals and spending habits.	Helps organisations minimise their time spent on financial admin, forecasts cash flows and benchmarks spending against competitors.
Examples	**Barclays** has over 6m users that are able to manage their day-to-day services across multiple Other Bank current accounts within the Barclays estate. **NatWest, RBS, Lloyds Banking Group** and **HSBC** have also enabled consumers to see all Other Bank accounts through their respective interfaces.	**Yolt** is an app that allows users to monitor upcoming debts, track subscription renewals, categorise spending and set budgets whilst viewing all bank accounts in one place. **Starling app** is a direct offering by Starling Bank providing customers with money management services around budgets and savings.	**Astro Digital** is an app that enables SME consumers to send and track invoices through their app, seek invoice finance on these invoices and store receipts digitally. This is done via account aggregation, leveraging Open Banking.

Other notable innovations

- Bluestone, the specialist mortgage lender, launched an Open Banking pilot with Experian in January 2019, enabling them to access customer spending and income data to assess mortgage affordability and eligibility.

- Newcastle Building Society announced that they are to launch a debt support service, leveraging the power of account aggregation to pull together all customer spending and earnings in under 20 seconds.

- AccountScore enable retail customers to apply for loans using their aggregated transaction history to increase the speed and efficiency of the credit decisioning process.

- iwoca are leveraging Open Banking to improve their SME loan underwriting by using actual historic spending and income data (as opposed to relying on credit scores).

Overcoming the obstacles

Customer confidence

The challenge from a consumer perspective is that, in and of itself, Open Banking means very little to most people. This is borne out by the research – a Splendid Unlimited poll found that only 9% of adults in the UK have used an Open Banking service and only 22% of the wider population have heard of Open Banking as a concept.

Most consumers do not understand the benefits and risks that they face when they consent to their data being made available via APIs. GDPR has not boosted consumer confidence as many organisations also approached this as a compliance exercise - although the more informed organisations saw this as the trigger to create their data strategy.

The lack of awareness could lead to potential security threats as consumers could end up giving their information willingly to fraudulent actors. This could come in the form of phishing emails, cold calls, SMS messages or through social media where fraudulent actors can imitate a representative of an authorised provider (such as broadband, phone or insurance) and offer bespoke deals which require the consumers' banking details.

Under Open Banking, aggregated customer data such as transactions and balances held in the TPPs infrastructure and servers pose a significant risk to cyber security by presenting an additional access point for hackers to target.

Finally, as the Open Banking ecosystem serves as a platform for multiple participants (data providers, TPPs, customers, regulators and government agencies), friction due to information asymmetry might emerge between the counterparties involved in a contract that makes use of customer data. For example, financial institutions with increased access to consumer data can engage in predatory lending and target financially unsophisticated borrowers.

Mitigations

Regulators must reassess the balance of accountability for financial crime risk management in the new environment fostered by Open Banking. This can be achieved through offering incentives and enforcing penalties for all relevant players in the market to drive desired behaviours. Clear roles and responsibilities must also be delineated for all parties with a framework in place to enforce and evolve them as the market changes.

By collaborating and sharing intelligence, learnings and data, organisations will be better able to identify the financial crime activities that are endemic in the system. This needs to be a shared responsibility between the industry and the regulatory bodies in order to address data privacy concerns.

Both banks and FinTechs need to harness their technical expertise and set aside sufficient budgets to stay ahead of any potential threats to their customers' data and meaningfully invest in developing new approaches to managing financial crime risks.

The above measures should contribute towards the success of Open Banking which should be measured on consumer understanding and their confidence in banks when granting access to their payments accounts. The current uptake may not be particularly encouraging if it largely happens in ignorance of the benefits and the risks!

Beyond compliance

The benefits of Open Banking will certainly not be realised if financial services institutions see the next stage of implementation as merely extending their compliance to the next phase of legislation (the PSD2/CMA regulation that comes into effect between March and September 2019). This phase will extend Open Banking to include the sharing of credit card account data, making more complex payments and ensuring that the process for authorising with a third party is seamless.

Open Banking though can be more than adherence to regulation and some institutions, including Nationwide, also intend to use this as the impetus to push ahead with the 'Open Banking For Good' initiative that brings together government, charities and FinTech companies to help those who struggle with money on a monthly basis.

Key mantras for success

If we look at the progress and the challenges to-date, four ‘key mantras’ are emerging for the incumbent banks to follow in order to remain current and competitive.

Four key mantras for Open Banking

See the opportunity

See the opportunity in the legislation and discard protectionism and the attitude of minimum compliance.

Embrace a new business model

Embrace a different business model – rather than seeing FinTechs as competitors, work out which can enhance your proposition for your target customers.

Collaborate

Work with chosen partners and create a new landscape of suppliers, technology and customer offerings via APIs.

Educate

Educate consumers in relation to their data and how to leverage and protect it – this needs to be industry wide and some common industry standards would be a huge step forward.

Summary

Many commentators have predicted that Open Banking will bring about the death of the big banks. We don't agree as the incumbents have advantages of scale, distribution and diversification of revenue streams that offer many advantages over the newer players.

In fact, it certainly seems that the appetite for collaboration is increasing alongside the progression of Open Banking and the dividing lines between banks and FinTech start-ups are becoming blurred as each works together more and more. Potentially, banks and FinTechs have a bit of what the other needs and can benefit from collaboration. Banks have direct distribution to a significant customer base and their customers' trust. FinTechs have the innovation, agility and unblinkered thinking that can help banks unlock customer value in a way that their in-house development has been unable to do to date.

It appears that more and more firms are realising the opportunity of leveraging Open Banking. As at October 2019, the Open Banking Implementation Entity has reported that there are now 188 regulated providers (of which 123 are TPPs) using Open Banking in the UK. Indeed, there are 58 regulated entities with at least one live customer proposition.

In order to be successful, established banks need to follow the four key mantras and begin formulating a comprehensive Open Banking strategy. This strategy should articulate:

- How you will bring about a culture/mind-set shift to exploit the opportunities presented by Open Banking.
- What your future operating model will look like – what are your core competencies that you want to build out vs. those you are happy to outsource?
- Which partners you want to work with in the various parts of the value chain where you cannot build your own capability.
- How you will improve customer education and confidence.

If you would like to discuss any aspect of your Open Banking strategy or the translation of your strategy into an effective and results orientated organisational change programme, then please get in touch with Ewen Fleming.

Ewen Fleming
Partner, Financial Services Advisory

07733 236 559
ewen.fleming@jcca.co.uk

Samuel Church
Financial Services Consulting Manager

07775 583 598
samuel.church@jcca.co.uk

JOHNSTON CARMICHAEL

Where sharp minds meet

Aberdeen 01224 212222	**Forfar** 01307 465565	**Inverness** 01463 796200	**Stirling** 01786 459900
Dundee 01382 411790	**Fraserburgh** 01346 518165	**Inverurie** 01467 621475	
Edinburgh 0131 220 2203	**Glasgow** 0141 222 5800	**London** 0203 7144 350	
Elgin 01343 547492	**Huntly** 01466 794148	**Perth** 01738 634001	

jcca.co.uk