From Open Banking to Open Finance and Beyond

Whitepaper

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Executive summary

Open Banking already allows regulated websites and apps to access transaction data from bank accounts and payment services. Open Finance builds on the Open Banking model, allowing third party providers (TPPs) access to new forms of fi nancial data: savings accounts, consumer credit, insurance, pensions, mortgages, and investments.

The Financial Conduct Authority's (FCA) vision for Open Finance is improved fi nancial health, driven by market innovation and competition. The coming years could see consumers being offered tailored products and services that represent a better deal, while for businesses, Open Finance could lead to increased demand for their products and services and encourage the innovation that will be needed to meet this demand.

But before Open Finance is rolled out, we need to fully understand how consumers have been affected by its predecessor. In this white paper, we will look at the lessons that need to be learned from Open Banking so we can ensure the expansion to Open Finance can realise its full potential.

Introduction

By Kamran Hedjri

More than ever, consumers expect low-cost, transparent, and frictionless alternatives to traditional fi nancial products. It's an expectation Open Banking was created to meet and does so by giving consumers' the right to securely control and share their fi nancial information with fi nancial institutions and third- party applications.

We're now at the stage where many consumers and providers have chalked up several years' Open Banking experience... so, what's next?

Open Finance is an extension of Open Banking. It means data-sharing will no longer be limited to transactional bank account data. Introducing Open Finance to a broader range of fi nancial products and services –such as pensions, insurance, mortgages, and stock trading -will be key to offering tailored information that enables consumers to make decisions that benefi t their long-term fi nancial health. So, what's in it for merchants? Put simply, it's good for your long-term fi nancial health too. As the technology's potential is realised, merchants will enjoy wide-ranging improvements at checkouts, enhancing the payment experience for customers which ultimately boosts revenue. It will also boost the security, speed and convenience already enjoyed by Open Banking adopters.

The bottom line is, every business deals with transactions and customer data. The real winners in the Open Finance revolution will be those who understand and adapt to it early. I hope this paper proves useful in deepening your understanding of Open Finance and demonstrates why businesses that develop solutions for customers using Open Finance stand to gain a competitive edge.

Chapter 1

Open Banking and the birth of Open Finance

Open Banking launched in the UK in 2017 in response to the Competition and Markets Authority's (CMA) investigation into retail banking. It enables consumers and businesses to share bank account-to-account (A2A) and credit card transaction data securely with trusted third parties, who in return can provide them with applications and services which save time and money.

The exchange of data is facilitated through Application Programming Interfaces (APIs) - computer programmes which make it easier for banks and financial services to communicate with each other across different platforms.

94 %

of fintechs are considering how Open Banking can enhance their current service. [1]

There are currently more than 6 million users of services powered by Open Banking technology. By September 2023, an estimated 60% of the UK population will be using Open Banking payments. [2]

[1] EY FinTech Open Banking Snapshot

[2] Next steps on future oversight of Open Banking announced

Use cases

Payment initiation

is a type of account-to-account (A2A) payment enabled by Open Banking. It allows banks and other financial institutions make their customer's financial data available to third parties through secure application programming interfaces (APIs). As with other types of A2A payment, the funds from the payers' bank account go directly to the recipient's bank account, with no intermediaries. Money is moved almost instantly and in a highly secure way, delivering a higher rate of settled transactions and no risk of chargebacks.

Account aggregation

allows customer to see multiple accounts from different providers on a single interface. This is great for customer but has signifi cant merchant benefi ts too. Since account aggregation gathers information already verifi ed by a user's bank, it can help confi rm a customer's identity to speed up onboarding processes.

Personal finance management

tools give customers a complete overview of their fi nancial situation. Although fi nancial management and wealth management pre-date Open Banking, it has contributed to a greater proliferation of these services.

Instant credit risk

is possible as Open Banking can rapidly speed-up credit applications by allowing lenders to gain almost instant overview of an applicant's credit history and allow consumers to quickly fi nd the products they are most likely to be approved for.

Subscription management

detects all the recurring payments from the customer and shows them in one interface. From here the customer can manage the recurring payments by, for example, cancelling unwanted subscriptions or getting notifi ed about upcoming payments.

Opening new accounts

is now much easier and faster. Open Banking facilitates the fl ow of bank data so information such as an address, occupation, income details, name and date of birth as well as credit history all match up.

In an industry where larger, established banks have traditionally accounted for more than 80% of the current account market, Open Banking encourages account switching and drives down costs for small and medium businesses, boosting competition and innovation. But it has not enjoyed universal support.

In October 2021, Anne Boden MBE, founder, and CEO of Starling Bank, told MPs: "Open Banking has not been a success".[3]

She argued that other measures would be best deployed to encourage customers to switch accounts.

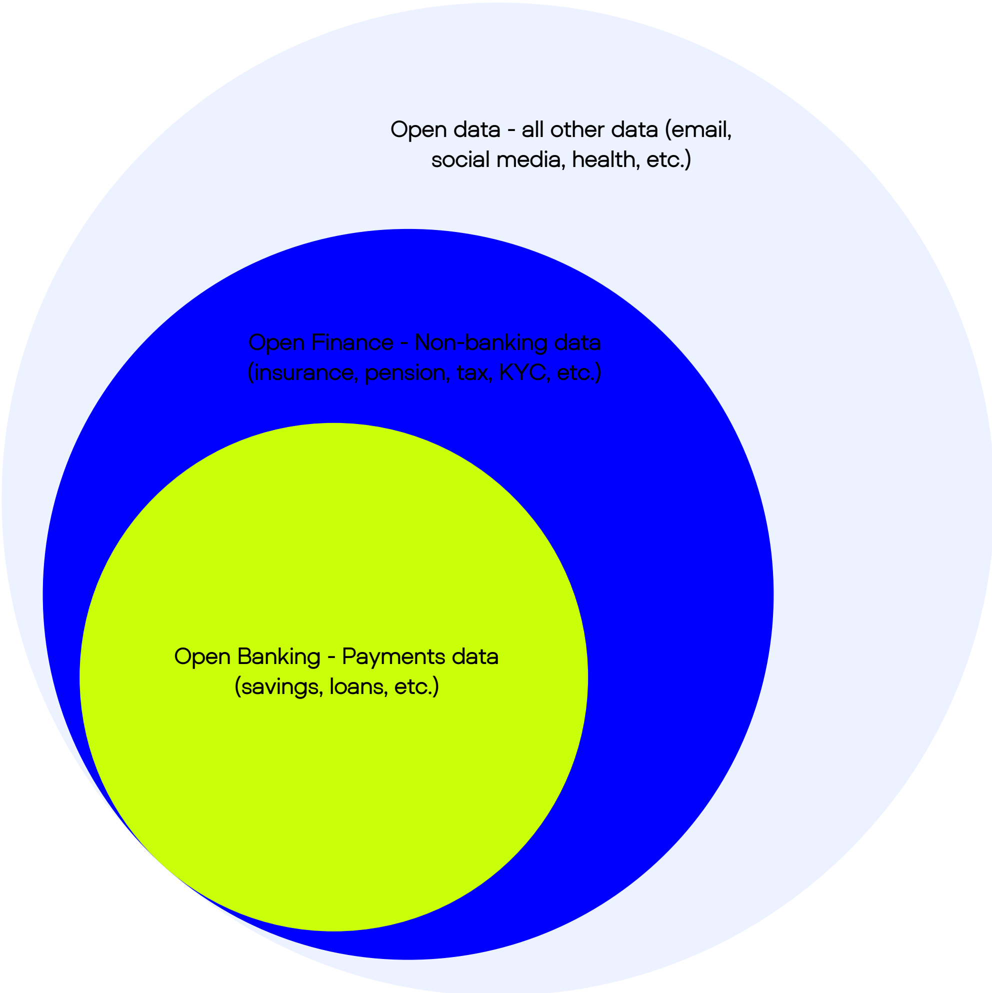
[3] Next steps on future oversight of Open Banking announced

But at the same hearing, John Collins, Chief Legal and Regulatory Officer at Santander UK, commented: "Open Banking has been slow, but it is a good example of banks and FinTech's getting together and working out where the opportunity is for the consumer in the future."

He added:

"Open Banking cannot be limited as it is at the moment... The system needs to open up so that all partici- pants share data to the maximum benefit of the consumer, so that we can all participate on a level playing field."

Open Finance promises to go beyond the scope of data and services available at banks, covering the consumers' entire financial footprint. Financial data related to pensions, tax, and insurance could all be accessed by a trusted third party, allowing for tailored consumer services for payments and a range of other financial products.



In the next chapter we will look at how this will work in practice, and the challenges of expanding the scope of Open Banking.

Chapter 2

Taking the next step: what the transition to Open Finance looks like

There's no doubt Open Banking has had a significant impact on the financial and consumer landscape over the past few years. But as Open Finance promises to build on a model that many are still unsure about, what will giving TPPs access to even more kinds of financial data mean for consumers and merchants?

What Open Finance looks like

Perhaps the easiest way to think about Open Finance is as Open Banking 2.0, expanding the scope of its predecessor with ‘premium’ or ‘value-added’ services. This allows for a greater depth of secure data sharing, as well as features such as recurring payments, future dated payments and payments to multiple counterparties.

By bringing the benefi ts of Open Banking to a broader range of fi nancial products, Open Finance aims to give consumers and businesses alike greater control and visibility of their economic lives.

Last year, the European Commission completed a public consultation on open finance.[4] Recognising that a person’s financial life is not limited to their payment account, the EU is looking at how to expand the principles of Open Banking in other areas as well. A legislative initiative may follow in the near future.

[4] Targeted consultation on open fi nance framework and data sharing in the fi nancial sector

The FCAs vision for Open Finance is:

To gain access to a wider range of financial products/services

To engage with their finances and empower better financial decisions

To have greater control over their data

The ultimate goal is improved financial health driven by market innovation and competition.

Automated switching and renewals, combined with advice and financial support services, are high on the Open Finance agenda, along with accurate creditworthiness assessments.

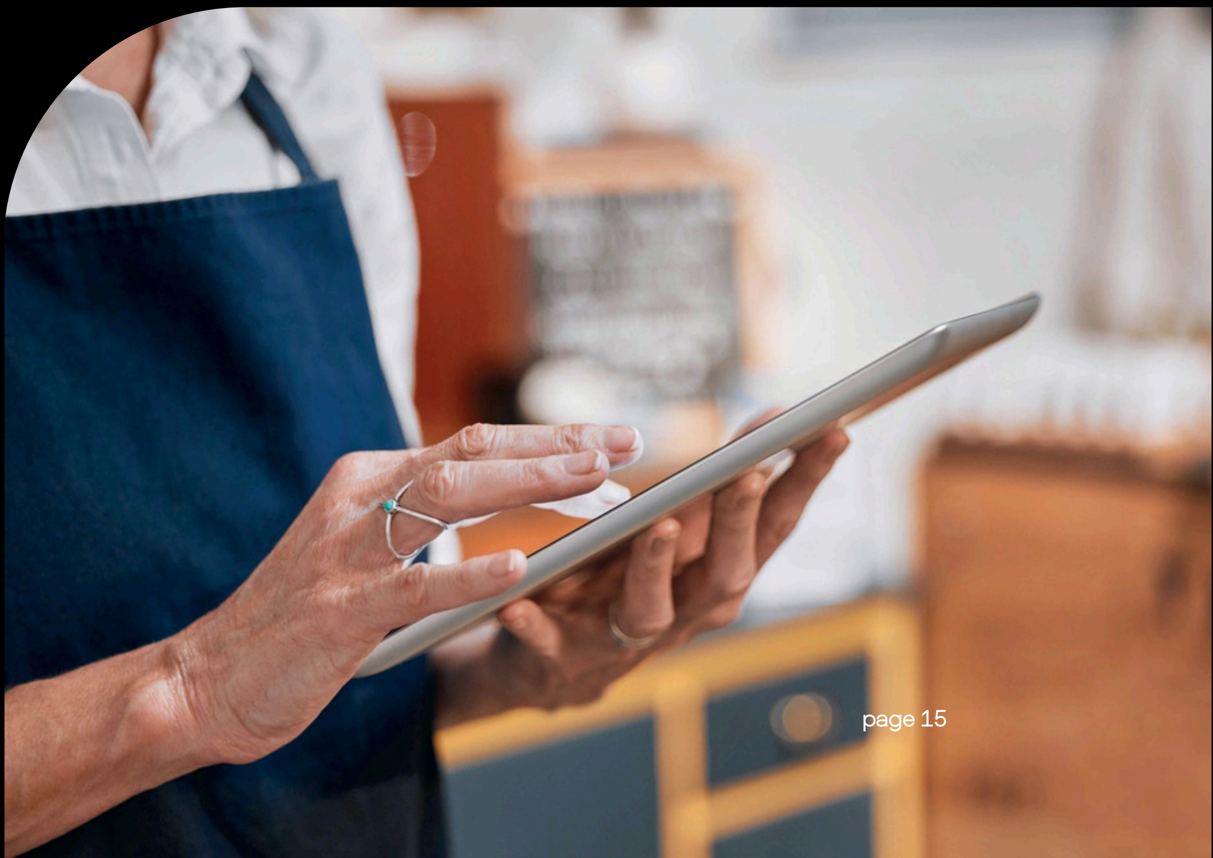
What opportunities does Open Finance offer to merchants over and above Open Banking?

The idea of Open Finance is to get more information than a bank account alone can give. Giving merchants access to this kind of information in turn gives them the ability to offer highly personalised services to consumers, going beyond the simple approval and issuing of credit.

With the rise of payment methods such as buy now, pay later (BNPL), Open Finance could help streamline creditworthiness assessments. Many businesses already use Open Banking to make better-informed decisions about a potential customer’s income and spending habits, so Open Finance could allow them to analyse the broader financial patterns of customers, giving even greater insights into a customer’s financial profile.

For e-commerce merchants, Open Finance will further boost the security, speed and convenience already enjoyed by Open Banking adopters. As the technology's potential is realised, merchants should see wide-ranging improvements at checkouts, which translate to an enhanced payment experience for customers.

Of course, the roll-out of Open Finance is not without risk, the main being associated with data misuse, fi nancial crime, fraud or scams, which could be increased by the greater value and quantity of shared fi nancial and non-fi nancial data. Furthermore, high regulatory compliance burdens and costs could lead some fi rms to stop providing certain services. We will take a closer look at these issues in the next chapter.

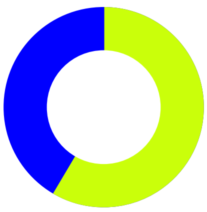


Chapter 3

Weighing the risks and overcoming trust issues

As previously discussed, Open Finance unlocks a range of opportunities and benefi ts for merchants. However, like Open Banking it is an opt-in system, so if consumers don't opt-in, no one will benefi t.

According to Zopa research,



63 %

of people have never heard of Open Banking, while

26 %

of Open Banking users do not want companies to have access to their fi nancial records.[5]

So how can businesses and fi nancial institutions gain the confi dence of customers who may be reluctant to give consent to use their data for developing new products and services?

First, it's important to understand where trust issues lie, and look at Open Finance from the consumer's point of view.

[5] Open Banking to Open Finance

‘How will my data be used?’

Open Finance seeks to put control of fi nancial data back in the hands of customers, so data won’t be accessed without the consumer’s consent. Providers will only be able to access data needed for the service the consumer has signed up to, and only if they are authorised to do so.

‘What’s the risk of financial crime, fraud or scams?’

Although the ability to initiate payments from more sources benefi ts the customer, it also provides new opportunities for fraudsters, such as Authorised Push Payment (APP) fraud, where an individual or business is tricked into sending money to a fraudster posing as a genuine payee.

Currently, the risk remains with the bank, which continues to have responsibility for authenticating the transaction, but this may change as more payments are initiated by TPPs and customer authentication is taken on by the TPP. Questions over whether banks, account information service (AIS) providers or payment initiation service (PIS) providers should be liable for fraudulent Open Finance transactions may hinder growth.

Another risk is that cyber-criminals could seek to access a customer’s fi nancial history or make payments from their bank account.

‘How will my data be protected?’

There are no new fraud types created by Open Banking but there will be new opportunities for fraudsters. Open Banking has expanded the attack surface for fraudsters to infi ltrate, increasing the number of entry points for fraudsters to exploit. Currently, this fi eld is regulated by the Payment Services Directive (or PSD2). Only apps and websites regulated by the FCA or European equivalent can enrol in the Open Banking Directory.

But both Open Banking and Open Finance lack legal regulation, a fact that exacerbates customer distrust. That said, all providers must comply with data protection rules, including General Data Protection Regulation (GDPR). The provider should disclose exactly which data it will use, how long for and what it will do with it up front. It’s worth noting that the US lags behind Europe on regulation, partly because it lacks any uniform federal standard similar to GDPR.

The FCA believes Open Finance could offer benefi ts to consumers through improved advice and access to a wider range of fi nancial products and services, but that Open Finance also poses a number of risks around areas such as data ethics. As such, it proposes a slow and steady expansion and recognises that legislative changes are needed.

Gaining consumer trust

If Open Finance players want consumers and businesses to trust them, they must be able to guarantee the identity and authorisation status of TPPs that interact with customers' data at the time of the request. Open Banking has been created with security in mind and, together with industry experts, the OBIE has produced good practice guidance – the Security and Counter Fraud Good Practice Guidance – and provides a counter-fraud maturity self- assessment tool to enable organisations to benchmark their counter-fraud and security approach.

It's crucial that such guidance is adopted to secure consumer trust. Once customers can see how Open Finance solutions will help them to manage their fi nances more effectively, less than 10% would be uncomfortable sharing their data.6

Chapter 4

Regulating Open Finance

Education about Open Finance will be key to obtaining and retaining consumer trust, but arguably regulation is even more crucial to this end. While Open Banking is subject to a legal, regulatory framework, it only shares basic account data. Open Finance is currently not subject to regulation despite providing more detailed data across a broader range of services.

This means the shift from Open Banking to Open Finance means some degree of centralised control is likely to be required. Approaches to this vary from region to region:

United Kingdom

Secure consumer data-sharing is a key objective of the UK Government's National Data Strategy and the FCA has committed to working with the Government to deliver the Smart Data initiative[7] by facilitating changes to the legislative and regulatory framework. Proposals for such a framework will pave the way for a phased Open Finance implementation, expected in late 2023 or 2024. Some Open Banking requirements will read across to the future Open Finance framework, but we also expect important differences.

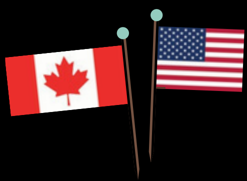
For example, Open Banking requires that a TPP's access to payments accounts data be equivalent to that of a customer via online banking. Such an approach could probably work for savings or investment accounts, but it is unlikely to be suitable for insurance data.

[7] Data Protection and Digital Information Bill

Europe

In Europe, Open Banking came into law as part of the Revised Payment Services Directive (PSD2)[8]. PSD2 forms the backbone of Europe's Open Banking ecosystem, but its scope is limited to payment accounts. Financial products such as savings, investments, mortgages, and pensions all fall outside its parameters. Open Finance is shorthand for any Open Banking activity that goes beyond the regulatory scope of PSD2's Access to Account provisions. The European Commission recognises that an Open Finance Framework should be in place by 2024.

USA & Canada



President Joseph Biden signed an executive order in July 2021 directing the Consumer Financial Protection Bureau (CFPB) to move forward with Open Banking efforts and establish rules for consumer data-sharing to make it easier for bank customers to share their data with FinTech's or TPPs. Meanwhile, the Canadian government has issued a report outlining a plan to introduce Open Banking to the nation's fi nancial system by 2023.

In Mexico, the Law to Regulate Financial Technology Institutions, known as the 'Fintech Law', came into effect in 2018. It states that users' individual transaction data can only be shared with express authorisation and pays particular attention to security mechanisms.

[8] What is PSD2? Everything you need to know

APAC

In some jurisdictions in the region, such as Australia, Open Banking is part of a wider Consumer Data Right regime that will be extended to other sectors such as energy and telecommunications. This creates a choice for policymakers to determine whether Open Banking will be confi ned to fi nancial services or extended as a general right for consumers to control their own data across the economy.

MENA

The Middle East and North Africa's overall regulatory landscape is a picture of rapid development. The Dubai Financial Services Authority (DFSA) has introduced licences authorising the provision of AIS and PIS activities. On the other hand, Saudi Arabia is putting its 2021-introduced Open Banking policy into practice as part of the country's „instead of" plan. In its endeavours to encourage Open Banking and fi ntech innovation, the Saudi Central Bank (SAMA) is leading the way, now requiring banks to open their APIs.

While jurisdictions vary in their decisions to regulate Open Banking, the advancement seen across all regions is a positive step in building confi dence in Open Finance.

Chapter 5

Lessons from Open Banking

For many, Open Banking has failed to live up to expectations. Postponements, corporate inactivity and incomplete use cases mean there are still gaps in both the provision of account information and the ability to initiate payments via open, robust, fully functioning APIs.

Before Open Finance is rolled out, we need to fully understand how consumers have been affected by Open Banking – particularly those who are vulnerable/on low incomes – so lessons can be learned and applied.

In 2022 the income generated by the Open Finance scheme will reach a total of $ 9,870 million.[9]

Tendencias de Open Finance en 2021

In 2021, the FCA published its feedback statement10 on Open Finance following its call for input. Respondents identifi ed several lessons that could be learnt from the implementation of Open Banking:

Consumer sentiment and awareness

Feedback suggests that the biggest single barrier to customer uptake was consumer sentiment and awareness. A perceived failure of Open Banking is the lack of consumer awareness. Open Finance needn't be concerned by this. An end consumer does not need to know that Open Finance exists as a concept. They only need to know they have the opportunity to use a convenient, digital solution that makes their life easier, in one way or another.

Delivery

There is a need for a phased delivery and transparent approach to understanding industry. Realistic timelines are essential where cross-industry collaboration is needed.

[10] Open Finance Feedback Statement

Overlapping legislation

Lessons need to be learnt from Open Banking in relation to confusion created by overlapping regulation (e.g., the CMA Order, the PSRs 2017 and the SCA-RTS, as well as related legislation such as GDPR). Initially, many incumbent organisations saw the CMA Remedies and PSD2 regulatory directives as a threat. This is understandable, as much of the driver behind the initiatives was the need to increase competition in the market. However, it's safe to say that the majority of participants in the industry can now view Open Banking as a great opportunity to improve the customer experience, create organisational effi ciencies and develop new products. The same, therefore, should be said of Open Finance. Regulation is inevitable. Organisations required to comply with these regulations should view them solely as an opportunity to improve the business, the market and the industry as a whole.

In addition to the above, a consistent approach to contextualised data needs to be defi ned. Whether through industry collaboration, government cooperation or a regulatory impetus, fi nancial services need a consistent approach to authenticating an individual or business and managing consent to share data between parties. To truly enable Open Finance, this can't be limited to traditional banking entities. Identity needs to become a utility that truly empowers consumers. An identity solution that allows data to be shared across the entirety of fi nancial services is the answer, and a step in the right direction for Digital Identity generally.

Final thoughts

We live in a world where customised products and services are increasingly becoming the norm, and almost every aspect of a person's data can be leveraged. Open Finance will not only allow for the type of personalisation consumers have come to expect, it will offer merchants the opportunity to quickly deploy omnichannel payment gateways that feature the latest payment options, improving shopping experiences and boosting conversion rates.

But for Open Finance to realise its full potential, consumer trust needs to be gained through a combination of awareness-raising and expanded regulations that fi ll in the gaps of PSD2. But most of all, we need to learn from the Open Banking experience.

All stakeholders have an important role to play if we are to achieve a truly open, inclusive and sustainable ecosystem, from the regulators who set the guardrails of policy, to the FinTech's with their ability to innovate quickly. These diverse voices need to work together to foster an open ecosystem than can support customer choice, innovation, security, privacy, and the production of technology solutions that can keep up with consumer demands.

An open payments ecosystem will not end with Open Finance. In the years ahead we will see the next step in its evolution, Open Data, where all industries will share data using the principles of data exchange we've learnt from Open Banking.

McKinsey analysis suggests the boost to the economy from broad adoption of Open Data ecosystems could range from 1% to 1.5% of GDP in 2030 in the European Union, the United Kingdom, and the United States, to as much as 4% to 5% in India.

Its clear Open Banking has opened the world to a whole new way of harnessing our data, largely without the consumer even realising it. Open Finance will prove equally revolutionary, by benefi tting from the successes of its predecessor, and learning from its shortfalls.