Preparing for open banking: Lessons from the U.K.

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Whether it's what you make, spend or owe, financial data has traditionally been the preserve of financial institutions. Open banking proposes to change all that by putting the customer in control.

Open banking — a model that allows customers to safely and easily share their data with third parties and competing banks — has started to spring up in various forms around the globe, from Singapore and Japan to the EU. In the United Kingdom and Australia, open banking has been distinctly government-led, tracing a course similar to what Canadian financial services providers may follow as a result of the Department of Finance Canada's current review.[1]

Though Canada's regulatory, industry and constitutional frameworks pose a unique set of challenges, there's a lot to learn from the experiences of both established players and new arrivals in these countries as federal governments and the financial services industry work toward defining a made-in-Canada model of open banking.

Paving the way in the U.K.

Open banking was born in the U.K. in August 2016, when the Competition and Markets Authority (CMA) published a report[2] on the country's retail banking market which concluded that "The sector is still not as innovative or competitive as it needs to be."[3] With little incentive for the few dominant banks to improve or expand their services, leverage emerging technologies or make room for new entrants, the market had become difficult for personal and small business customers alike to navigate, let alone understand.[4]

The report identified numerous issues affecting client service and industry competitiveness, including:

- the banks' unnecessarily complicated and opaque fee structures, making it challenging for customers to compare providers
- an overly lengthy and onerous process for opening small business accounts
- customers paying too much for overdraft and underestimating their use of it

- small businesses not being provided with adequate information to inform their choice of potential lender
- too much money sitting in customers' current (chequing) accounts not earning interest
- too many barriers to entering the market for smaller players who could improve overall competitiveness

To improve the customer experience and promote innovation, the CMA proposed a series of measures that banks would have to observe. This includes mandatory overdraft alerts with grace periods, monthly maximum charges, improved account opening and switching processes, loan rate transparency, and most importantly, the development of an open application programming interface (API) banking standard that would allow customers to share their data with third parties—a system known as open banking.[5]

With broader access to customer financial data, third parties and banks alike would be able to develop new and better services, allowing customers to:

- manage accounts held with several providers through a single app
- authorize the movement of funds between accounts to help avoid overdraft charges or benefit from higher interest rates
- make simple price and service quality comparisons tailored to their own usage patterns

Open APIs also empower banks and third parties to monitor accounts and forecast a customer's cash flow, helping them avoid overdraft charges; as well as use a small business's transaction history to allow a lender to assess the business's creditworthiness and offer better lending deals than they would without this information.[6]

Creating a private–public entity: The Open Banking Implementation Entity

To put the open API standard into effect, the CMA created the Open Banking Implementation Entity (OBIE), a non-profit steering group comprised of representatives from major banks, challenger banks, fintechs, and consumer and small business groups. Tasked with defining and developing the APIs, data structures and security architectures in a standardized way, the OBIE's mission is to make it easy and safe for customers to share their financial records with third parties.[7]

"Coming up with a set of common standards for APIs, security and data handling was critical," Dr. Bill Roberts, Head of Open Banking at the CMA, told BLG in a telephone interview. "It's difficult enough trying to develop apps for three or four different mobile phone platforms. If developers had to create apps that worked with a thousand different banks, it would effectively discourage competition and innovation by ruling out the smaller players."

Given the competing interests at play, disputes over implementation and data access were inevitable. "The legal, order-making powers the CMA possesses are awesome," says Roberts. "But no matter how extensive they are, you can't compel two people to agree with each other. So we had to think of a mechanism for ensuring agreement."

The solution was to create the role of and appoint an Implementation Trustee who would have the final say on standards to be adopted. “In the event that the banks and fintechs don't agree among themselves, the Trustee is empowered to impose a decision, and the players are obliged under the order to accept that decision.”

Open banking roll out

Rather than introduce all of the proposed measures at once, the CMA pursued a phased implementation, beginning with the deliverables that should have been easiest to adopt in terms of the confidentiality of the data concerned. Beginning in March 2017, banks were required to share generic, impersonal data on items like bank products and branch and ATM locations in a standardized way, making it easier for customers to weigh their options and find better deals.[8]

Open banking came more fully into effect in January 2018 when customers were first able to safely and easily share their personal and small business current (chequing) account data with third parties. This allowed third parties to initiate payments from those accounts while also fostering the creation of aggregator services that could enable customers to view all of their accounts across banks through one provider. It would also permit third-party companies to analyse customer account data so that they might, for example, offer automated budgeting advice or cheaper overdrafts. Such moves would make the U.K. the first country to launch open banking in a meaningful way.[9]

Meanwhile, the scope of OBIE’s purview expanded to include opening up banking standards for all payment account types—not just those for personal and small business—as mandated by the European Union’s second Payments Services Directive (PSD2). This meant customers using credit cards, e-wallets and prepaid cards would eventually be able to take advantage of open banking services as well. As OBIE’s Trustee Imran Gulamhuseinwala remarked at the time, these enhancements would “create standards for future dated, recurring and international payments as well as all the payment and product types covered by PSD2.”[10]

In parallel with developing standards and structures for the financial sector, the OBIE was also establishing an eligibility criteria and application process for third-party service providers hoping to enter it. In the U.K., every company that wants to leverage customer data or provide customers with open banking-based services has to be authorized by the Financial Conduct Authority (FCA) or another European Regulator, as well as enrolled on the OBIE directory.[11]

As open banking rolled out over the course of 2018, new services and firms have been quick to emerge. As of February 2019, the U.K. boasted 110 regulated open banking providers, consisting of 76 third-party providers (20 of them live with customers) and 34 account providers.[12]

Roberts notes there is now “a huge pipeline of third-party providers. The scale of entry by new digital providers is unprecedented.” And he adds that the pace of adoption by all the stakeholder groups required to make the new system work—banks, third-party providers, customers—is accelerating. “We can see that from the call volumes to the APIs,” he says. “Last July [2018] they were two million a month, this past February they were 27 million, and in April approaching 50 million.”

Australian Open Banking and the "Consumer Data Right"

Product & service breadth

The breadth of services currently on offer in the U.K. is impressive. From the arrival of customer-facing "aggregators" or "smart money managers" like ING's Yolt, HSBC's Connected Money, and CYBG's 'You and B', to the development of back-end API providers like TrueLayer and Token, and AI-powered data analysis and decisioning tools like Direct ID, the products coming to market have been as varied as their intended audiences.

Aggregators are particularly noteworthy. Allowing customers to manage their finances across institutional lines and even switch providers inside a single app, they aim to be the primary interface between a customer and their money.

"If you're measuring success in terms of adoption," Roberts says, "I think it's pretty clear that the people who are producing aggregating products at the moment are doing quite well. Companies like Yolt, for example, who are owned by a bank, but not a U.K. bank, made quite a lot of headway with an aggregator product."

Specific products and services aside, the overall attitude from firms has been generally positive. According to one source from November 2018, 72 per cent of financial services companies see open banking as a positive initiative, 77 per cent see open banking as one of the most radical changes in recent history, and 84 per cent have new offerings in launch or in development.[13]

Beyond aggregators: The early innovators

More than a utility: Becoming a "digital aggregator"

Given their size and stability, incumbents are in a unique position to become the "platforms" of this new market. Rather than view themselves as service providers in competition with third parties, major banks are learning to foster and play host to third-party services in ways that give them increasing interest in a multi-sided marketplace. In this spirit, Roberts expects that banks are likely to acquire or partner with some of the more promising fintechs and start-ups on top of developing their own services.

A good example of the "platform mentality" at work in the U.K. is innovation foundation Nesta's Open Up Challenge, mandated by the CMA and which required the banks to provide the funding for the £4.5 million project providing cash prizes to start-ups developing new financial services targeted at SMEs.[14]

But "platform" can have a lot of meanings.

As Roberts speculates, "There is one scenario in which banks become simply the vault where you keep your money, the equivalent of the mobile phone operator who doesn't do much of the exciting or interesting stuff like the applications on your phone. I think that's a little alarmist."

Instead, Roberts forecasts a range of plays from banks and third parties alike, depending on whether they see open banking as a threat or an opportunity: “I think what you’re likely to see first is a defensive response, particularly to third-party aggregators, which pose the risk of disintermediating banks by becoming the lens through which customers look at their finances. All four of the major banks have launched their own aggregators in recent months, for example.” But some banks seem to be quite proactive already in launching new products and services, using open banking functionality, for example, to make it easier to find and apply for a mortgage.

Nevertheless, Roberts was quick to note, “There's no killer app out there so far. People are still watching and waiting, they're finding their feet,” adding in particular that “we're still waiting to see what the big tech players are going to do, all of which have an interest and have started to dip their toes in the water. As they’ve got pretty big toes, [laughs] people are watching very carefully what they’re doing.”

The market seems willing and ready for these aggregator services. A survey of more than 4,000 U.K. banking customers reported that 59 per cent of them are willing to try a platform that aggregates banking products and other services (such as insurance and investment advice) in order to save money and simplify financial transactions. Within younger, high-risk groups, that figure is much higher, at 74 per cent.[15]

Open Banking for SMEs & Corporations

Sidebars

Beyond aggregators: The early innovators

Avoiding the overdraft trap

So-called “sweeper services” such as SafetyNet Credit are offering customers new ways to save money on overdrafts. With an eye on both current balance and planned upcoming transactions via open banking, the services smooth things out by either moving money from a savings account or automatically lending from a line of credit to keep accounts in the black. As Roberts explains, “The proposition of sweeper services is this: If they lend you the money to avoid bank overdraft charges, they'll guarantee that they will do so at a rate lower than your bank would charge you for an overdraft. You don't need to do anything. Just tick this box, and that will all happen automatically. You’ll be paying less for your overdrafts than you were before.”

Putting your idle cash to work

Other emerging services like Deposit Solutions help customers put the relatively predictable nature of a customer’s monthly cash flow to work for them. As Roberts explains their proposition, “If at the beginning of the month when you just got paid, you’ve got cash you’re not using, and if your bank’s not paying you very much interest or no interest at all, then they will take the money out of there and put it into an interest-earning account.” Interest rates in these accounts will be higher than standard bank offerings. “When your bank cash starts to go down, they just pay it back into your account again. You need do nothing. They'll do it all for you.”

Building good credit from everyday transactions

New providers are offering new perspectives on the traditional credit score for those with little to no borrowing history—something Roberts points to as a particular issue for millennials without a mortgage history. “They don't own houses, because house prices in London are very high, so they're renting,” he explains. New products, such as Credit Kudos and Credit Ladder, use transaction history from current accounts to demonstrate good money management. “*That* is being used as a proxy for the more conventional kinds of credit scoring algorithms that lenders use, which means that people can either get a loan when they couldn't get a loan before, or they can get it at a much lower rate than they would have before.”

Open banking for SMEs

One theme to emerge in the U.K. is the emphasis not just on retail customers, but on small business owners. According to one survey from November 2018, 77 per cent of SMEs are already using or plan to use open banking ecosystem platforms in 2019, while over 80 per cent of banks already invest significantly in open banking use cases for SMEs and corporations or plan to do so.[16]

In particular, SMEs and large corporations expect to partner with third-party providers around payments, expense management, and B2B services, while more than two-thirds are interested in joining open banking ecosystem platforms with banks.[17] Despite the promise held by targeting SMEs and corporations, gaps exist between what corporates want and what banks expect to provide.[18]

In the aforementioned U.K. survey, SMEs cited payments and cash management as the top two areas of their business that could be most improved in partnership with their bank. Only 45 per cent of companies were fully satisfied with the software they use for payments and banking.[19] This indicates an opportunity for banks to help SMEs streamline and integrate their business and administrative processes, such as accounting, bookkeeping, payments, taxation and cash management.[20] Yet banks seem to have their early focus elsewhere, expecting to enable banking as a platform (33 per cent) and finance (15 per cent) as open banking-related value-added services for their SME customers. Only 10 per cent of banks cited cash management and 9 per cent stated payments.[21]

Australian open banking and the “Consumer Data Right”

Just as open banking was coming to fruition in the U.K., it began to garner serious attention on the other side of the world. In July 2017, Australia’s then-Treasurer Scott Morrison commissioned the *Review into Open Banking in Australia* to recommend the most appropriate model for open banking in the country.[22] The final version was published in February 2018 and contains 51 recommendations.[23]

A key takeaway for Australian open banking is its “outward-facing” approach: Though open banking is government-led in both U.K. and Australia, for the latter, it is inherently part of a broader effort towards consumer data rights across the board.[24] It is the first tangible phase in the rollout of a broader government mandate, the Consumer Data Right (CDR), which will be implemented initially in the banking, energy, and

telecommunications sectors, then rolled out economy-wide on a sector-by-sector basis.[25] Just like the U.K.'s OBIE, Australian open banking standards will be implemented by a Consumer Data Standards team.[26]

The U.K.'s OBIE scope was eventually broadened well beyond personal and small business current accounts, and Australia's scope will be large from the get-go, including debit/credit, deposit/transaction, lending accounts and mortgages.[27] While the rollout was initially scheduled for February 2020, it was recently postponed to July 2020 in order to address privacy and security concerns.[28] Australian open banking mandates are staggered, beginning with the four major Australian banks at the outset, leaving the remaining Australian Deposit-taking Institutions (ADIs) to comply 12 months later. In this way, ADIs will be able to benefit from lessons learned through earlier phases.

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