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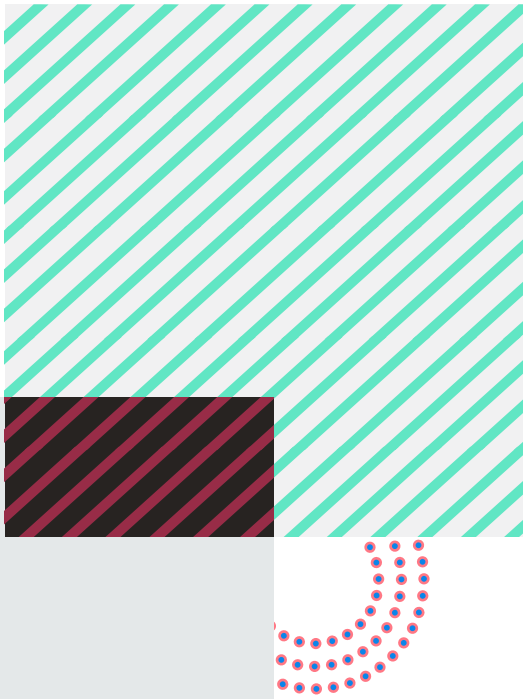


Open finance: shaping the future of financial services

Contents

Executive summary

Whether you're working for a bank, a fintech, or a data-driven business examining potential new ventures, open finance matters. It matters to the products you offer today, those you're looking to broaden with new data sources, and the digital services you haven't started to design.

We'll outline the potential for the concept of open finance more broadly to deliver the next generation of digital financial services.

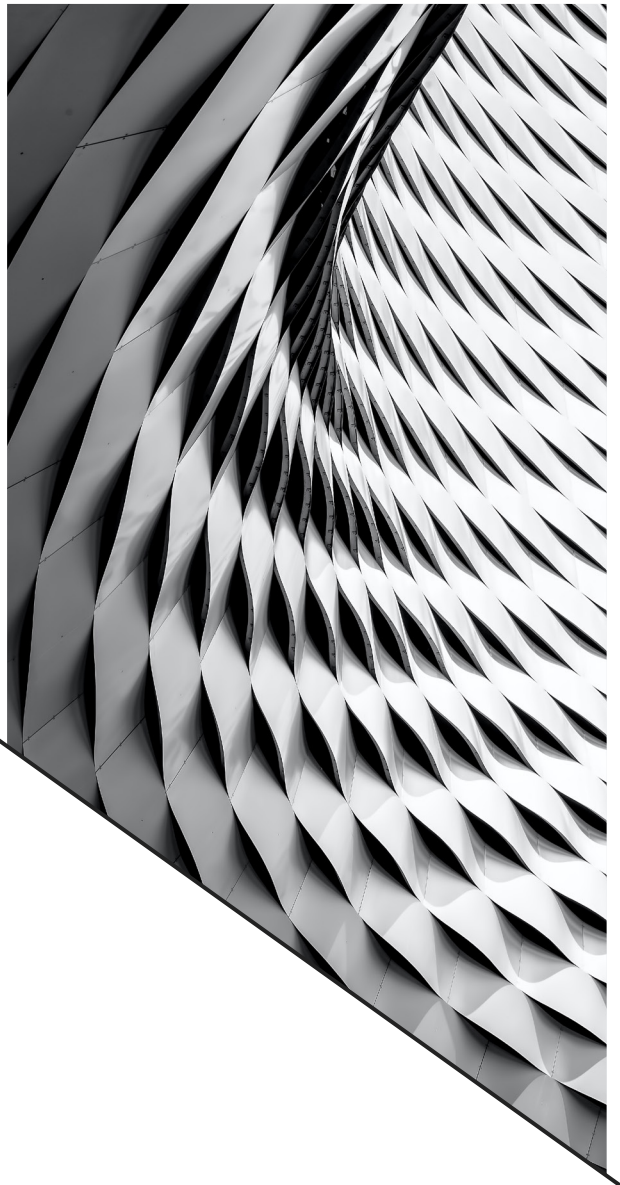
That is why 11:FS and Plaid have come together to write this paper.

The transformative impact the UK's open finance framework could have across a customer's total financial exposure is what separates it from other regulations. It's genuinely exciting — not something you can always label a regulatory initiative — and will have tangible and immediate, beneficial impacts for consumers.

In this paper, we'll outline the potential for the concept of open finance more broadly to deliver the next generation of digital financial services. We'll look at what lessons can be learned from the implementation of open banking regulations, and suggest key considerations for policymakers to bear in mind when implementing the open finance initiative. Finally we'll provide an overview of the impact of open finance on different areas of financial services, and key considerations providers will need to examine.

An introduction to the ‘open’ concept

In the UK, upwards of 300 million calls are made via regulated open banking rails every month.



The concept of facilitating access for consumers to see and leverage their financial data from different sources, known as "open finance", has been around for a while. In the US, Mint.com was one of the early purveyors of insights based upon account aggregation going back 15 years to 2006. It was a valuable business even then, selling to Intuit three years later for upwards of a reported $170 million.

Since this first wave of companies embraced open finance, we have seen the concept become more widely accepted and utilised following the introduction of open banking regulations.

In Europe, these rules have driven the creation of new products and services over the past couple of years. Similar rules have had the same effect in Singapore, while Australia, Canada and others are working on their own versions.

The positives

In the UK the Open Banking regulation came about principally to reduce the barriers to entry to the financial services sector. Across Europe, PSD2 served a similar purpose and there have been advocates and challengers to both frameworks and their impact — all much publicised. The positives are encouraging — in the UK, upwards of 300 million calls are made via regulated open banking rails every month, and the technology has enabled a variety of use cases. These include: supporting ID verification services enabling faster account application processes, reducing the need for physical bank statements, and services for social good (see Open Banking for Good).

The challenges

There are procedural, UX and process issues that are impeding open banking's wider adoption that are well known. However, one of the most fundamental challenges is that existing European regulations only require access to a limited data set, namely payment accounts. Now that is useful, but alone it offers only a slither of data from which third parties can create some short term insights and recommendations. However, for long term financial planning, you need a much broader set of data including investments and insurance policies to offer truly useful services, educated recommendations and insights.

Some lessons learned from Open Banking/PSD2 implementation:

Don't over standardise

Trying to implement a unified technology and governance standard across the entire financial sector will kill the movement before it starts.

Think about regulatory requirements

The requirement to be regulated should be considered proportionally to the size and scale of the firm and where possible smaller startups should be able to partner with larger firms.

Don't let security kill the customer journey

Consumer trust and security is paramount to the success of open finance but PSD2 security requirement Secure Customer Authentication (SCA) has created unnecessary friction and will damage the long term success of open banking unless reformed.

Provide more granular recommendations

Adoption will be limited if discretionary rules are applied differently by each FS provider — in the UK you see this with payment consent standards and intra-bank payment limits. Make sure that recommendations are made where it is relevant within the proposed flows.

Incentivise for maximum value

Open banking is a bet on a customer preference (that customers want to share data, and do it securely) rather than being underlined by any specific fraud / operational metric. Think about and apply measures of success.

Think about use cases

Regulators should work with industry to identify potential use cases that could arise in the future before they develop principles/rules. By only thinking about use cases in the market, now regulators risk limiting future innovations.

Cue open finance

An evolution of the open banking framework that covers all financial data — not just payment accounts.

In the UK, regulators have recognised the need to allow a wider range of financial data to be accessed and have issued a Call for Input (CFI) due in October. That CFI is broad in scope, but could result in segments such as insurance, wealth management, pensions and investments being required to provide consumers with access to their data.

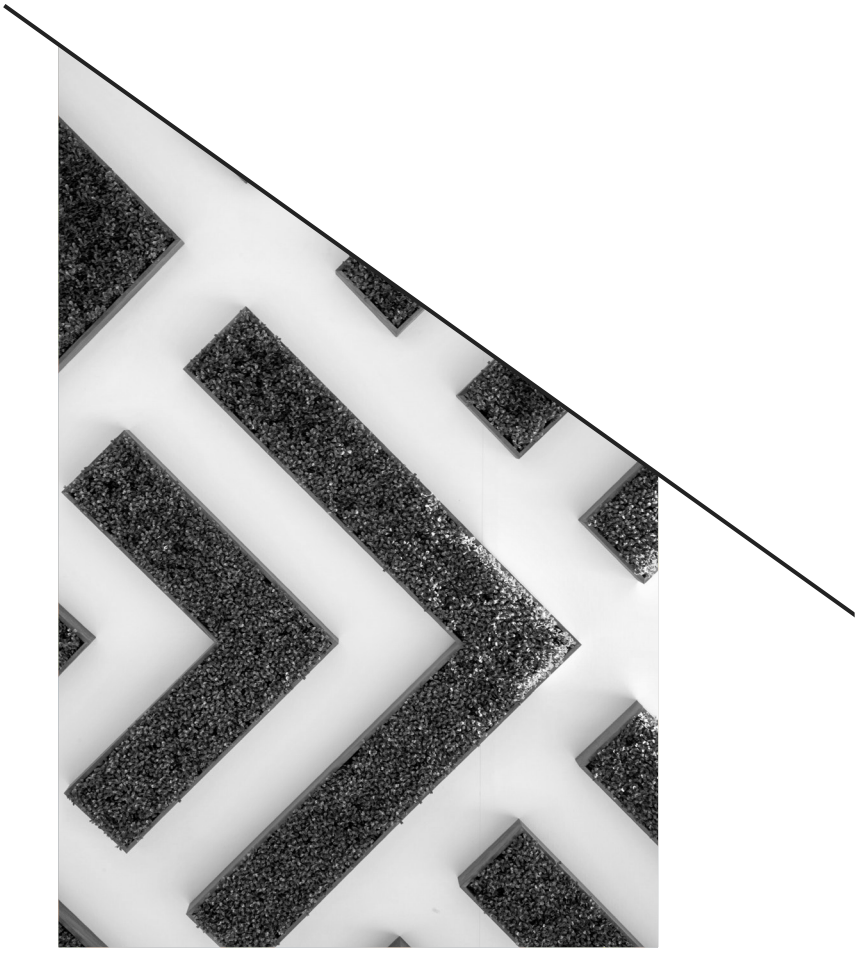
It is a mammoth task — but there is no doubt that it is encouraging to see the FCA and other regulators globally embrace the possibilities of open financial data.

IMAGE SOURCE: UNSPLASH | 11:FS / PLAID

Different approaches to implementing the ‘open’ concept

The move towards the concept of open finance is a global trend. Policymakers and market participants are moving toward a more open financial future, underpinned by technology.

While the movement is global, it is not uniform in approach. Broadly we have seen two approaches develop which are not always mutually exclusive. Countries have decided to either take a prescriptive government-led path (ie, the UK, EU and, to some extent, Australia) or a more market-led path (ie, the US and Canada).



Market driven: US and Canada

These jurisdictions have not introduced a formal open banking or open finance regime although Canada is now exploring structures for Consumer-Directed Finance over 2020.

The US is also developing industry-wide standards such as FDX, but not having a legal mandate or regulatory regime to open up data means third party providers (TPPs) sometimes rely on Data Access Agreements (DAA). While these DAAs provide access to the data, they can take significant time to sign and only provide access to the data held by that one provider.

Government driven: EU, UK and Australia

These jurisdictions have gone down the prescriptive route by establishing regulatory frameworks that recognise the consumer's right to access and use their own financial data.

This method has its benefits and downfalls. Plaid, which operates in the US, UK and EU, has already seen the challenges of a prescriptive regulatory regime. Central to this is the limiting of consumer access to only payment account data, which is not the case in the US or other more market-based approaches.

This may begin to change as we move away from open banking towards open finance across Europe. In addition to the FCA's call for input, the European Commission is also exploring open finance through a new digital finance strategy and data strategy as well as revisiting elements of PSD2 through a review of retail payments.

Of all the government-driven initiatives, The Australian Competition and Consumer Commission (ACCC) is introducing arguably the most expansive open data regulation. Despite delays to implementation it will be one of most comprehensive open finance type programmes in the world.

The Australian Consumer Data Right (CDR) will give consumers the right to access not just their financial data but also, utility and telecom data. This is in part a government-led approach as the security and integrity of the CDR system will be maintained by Privacy Safeguards, which are contained in the legislation and will be supplemented by rules.

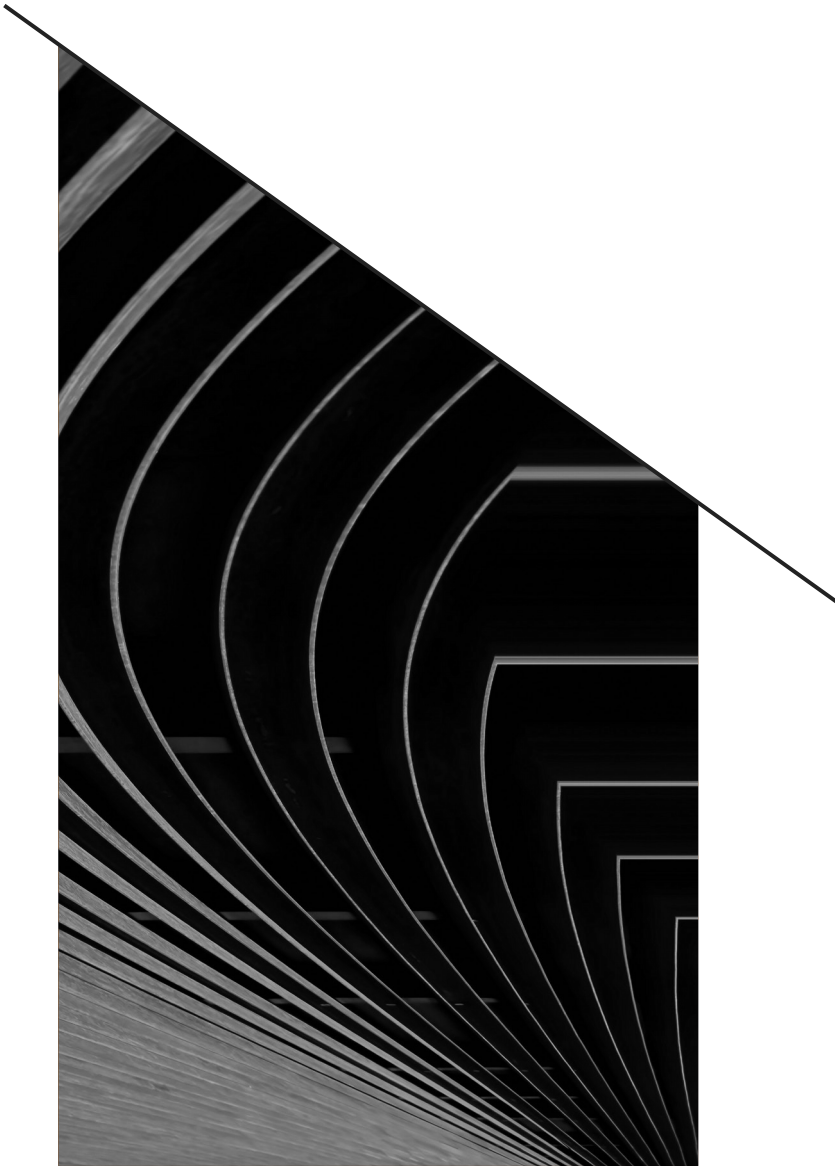
The ACCC is also considering the important role of market intermediaries like Plaid within the legislation as a way of encouraging new products and services and increasing the uptake of the CDR across a wide range of sectors.

Policy considerations: delivering an optimal path to open finance

We have already seen that access to payment account data in open banking has led to the proliferation of products and services that help consumers improve their financial lives.

It would be wrong to suggest there is one clear, best path to achieving open finance as markets are diverse and political and regulatory structures are unique.

Regardless of the approach taken by policymakers there are some proposals which should be embraced by all in some form or another.



01

Implement customer data rights (for all financial data)

As a first step, policymakers should guarantee consumers and businesses a right to all of their personal data directly or through a third party and where already implemented, expand the current open banking regulatory frameworks such as PSD2 to cover all financial accounts. We have already seen that access to payment account data in open banking has led to the proliferation of products and services that help consumers improve their financial lives. Access to all financial accounts can accelerate that transformation.

02

Ensure regulatory clarity

Finding the right regulatory framework will always be country specific but there should be commonality, including things like access, liability and governance. In the US, not having a strong legal mandate to open up data means TPPs like Plaid rely on Data Access Agreements (DAA), which are uneven and can be uncertain for consumers.

03

Think about where regulatory interventions are most needed

Open finance is a huge concept across areas as diverse as insurance, banking or long term investments like pensions. To understand which sectors may need further regulatory intervention to facilitate consumer data access, policymakers should conduct an evaluation of the regulatory requirements and barriers associated with different financial sectors. This could also include where there is already machine readable data or a need to digitise, paper-based or in-person ID requirements, or other technical standards.

04

Liability frameworks provide certainty

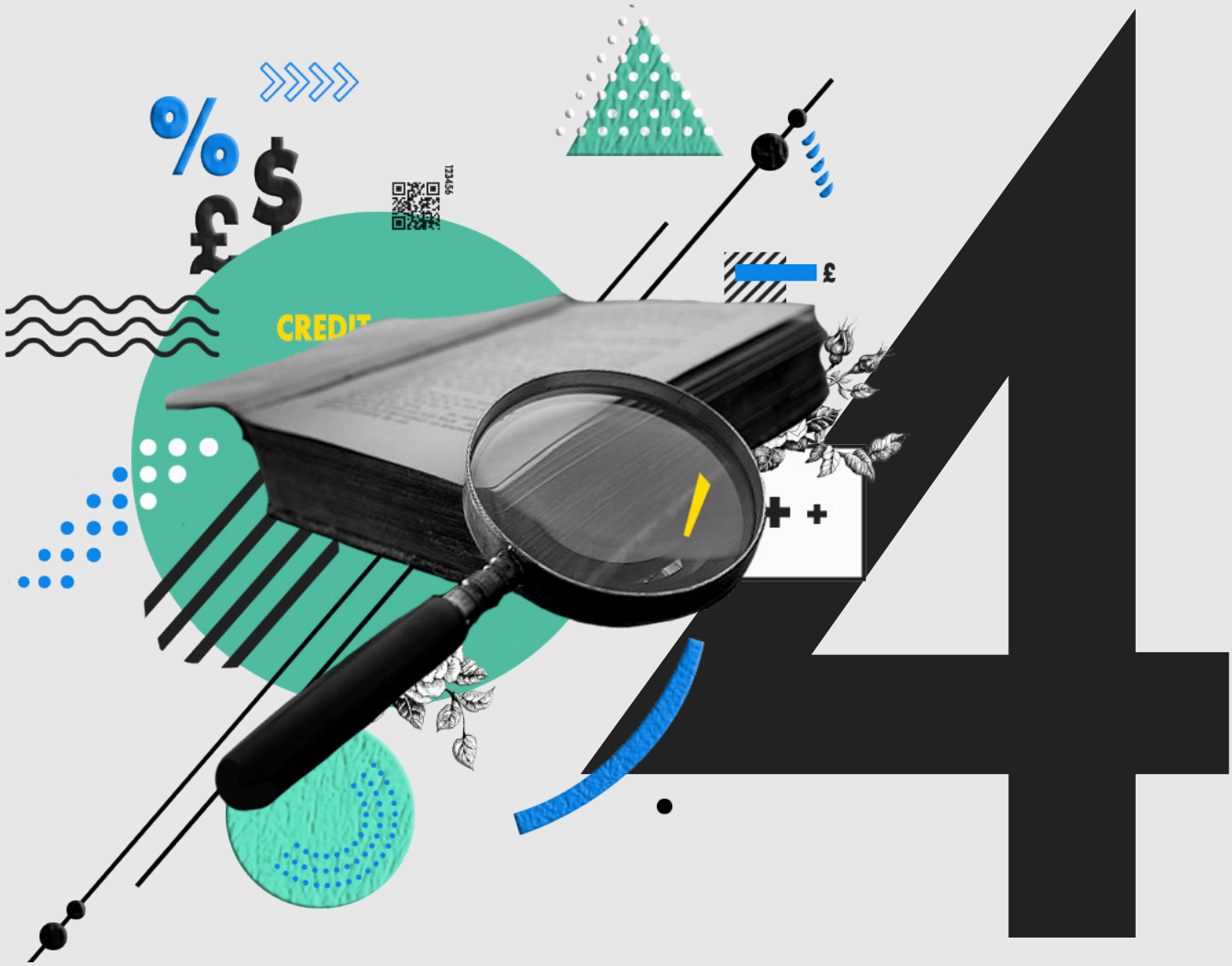
In order for open finance to develop there needs to be a clear liability framework that is proportionate to the services being provided, but still ensures consumers are protected. The liability model for open finance should seek to understand the potential losses which may occur and the types of issues that may arise. This will help define customer redress, quantification of loss and who is ultimately liable. The Open Banking Frameworks have been reasonably successful in setting clear guidelines on how liability works and it would make sense to adapt these for an open finance environment, albeit with some changes to reflect the different regulatory requirements in different financial sectors.

05

Let the market build open finance infrastructure

Aggregators, Technical Service Providers (TSPs) and other intermediaries will need to play a part in developing open finance — they can promote competition while developing APIs that deliver the customers' needs and wants. Open finance could potentially encompass disparate and diverse sectors, which would be very difficult to coalesce around a particular technology and governance standard. PSD2 did not consider aggregators within legislation (the firm retrieving the consumer's data) and instead focused on the firm presenting the data back to the consumer. This should be reassessed as we move to open finance. Aggregators and TSPs have the expertise and experience of building API connections. Australia is considering how "accredited intermediaries" can unlock the CDR for businesses and consumers alike.

With or without industry standard APIs, competition will allow firms that specialise in API development and integrations to build the infrastructure needed to make open finance a success.



Where open finance can make a difference

The real value of data does not come from a single data set but from a combination of different data sets.

Its value is unknown until it has been used for a particular purpose, in what economists know as an "experience good".

In other words, we do not yet know the true value of an open financial system and all the potential use cases which can emerge from new combinations of financial data. What we do know is that money is fungible and financial choices are interdependent. With access to new datasets unlocked, innovators will develop better, more competitive solutions and financial services will be more insightful, affordable and effective.

Beyond finance there is a huge range of data sources that make up a person's financial life. For example, utilities, telecoms, and key public data, such as tax, all connect back to finance. That means access and ownership over this data is just as critical for full control over a person's financial life. However, data in these sectors tends not to be standardised or digital, there is a lack of APIs and significant regulatory and process friction.

Early success stories for open finance will be the sectors that are adjacent to payment accounts data under PSD2, such as non-invested savings, credit and mortgages. Given that these financial products and services represent the next phase of a financial life after banking, they'll be the easiest sectors to implement open finance first and will help to provide consumers with a holistic view of their finances. This includes:

Personal Financial Management (PFM)

Today many PFM applications run on limited payments data which only allows consumers a narrow financial view. Open finance will allow a more holistic view of their financial health in order to make more informed decisions and help users manage and understand their true financial position.

SME finance

Between bookkeeping and payroll it can be challenging for a business to organise and track their finances. Open finance will allow faster payroll, simpler expense management and streamlined invoicing and budgeting.

Accessing credit is also a core challenge for SMEs, which could be made easier through open finance. The Bank of England (BoE) published a paper in March 2020 looking at how open finance could make it faster and easier for SMEs to shop around for credit. The paper explains what an Open Data Platform would mean in practice and how using a standardised set of APIs could help SMEs use their data more efficiently.

Credit facilitation: mortgages, loans and credit cards

Lenders need to gather a holistic picture of their applicants' finances to underwrite a loan before approving the loan. Open finance will allow lenders, with consent, access to the consumer's full financial state — assets and liabilities, net income and cash flow — for a better understanding of the applicant's ability to pay back a loan, and approve that loan in real time.

That enhanced view will enable them to make more informed decisions and offer the applicant the most appropriate loan before approving it in realtime. These services are reasonably easy to develop off the back of payment APIs with core functionality including things like credit assessments, address details etc. While some banks already provide access to their customers assets and liabilities, open finance would guarantee that right to access.

Pensions management and retirement planning

This is a financial product that has been chronically neglected and mismanaged with many consumers having multiple pensions and providers. Imagine the ability to automate pension switching based on current and projected financial states, underpinned by real-time data across every financial instrument that the customer owns.

Open finance will allow consumers to make informed choices on how to save for their retirement and how to spend their retirement funds. The UK Government is already considering it as part of the Pensions Dashboard and established fintech providers such as Pensions Bee are already building a market for these purposes.

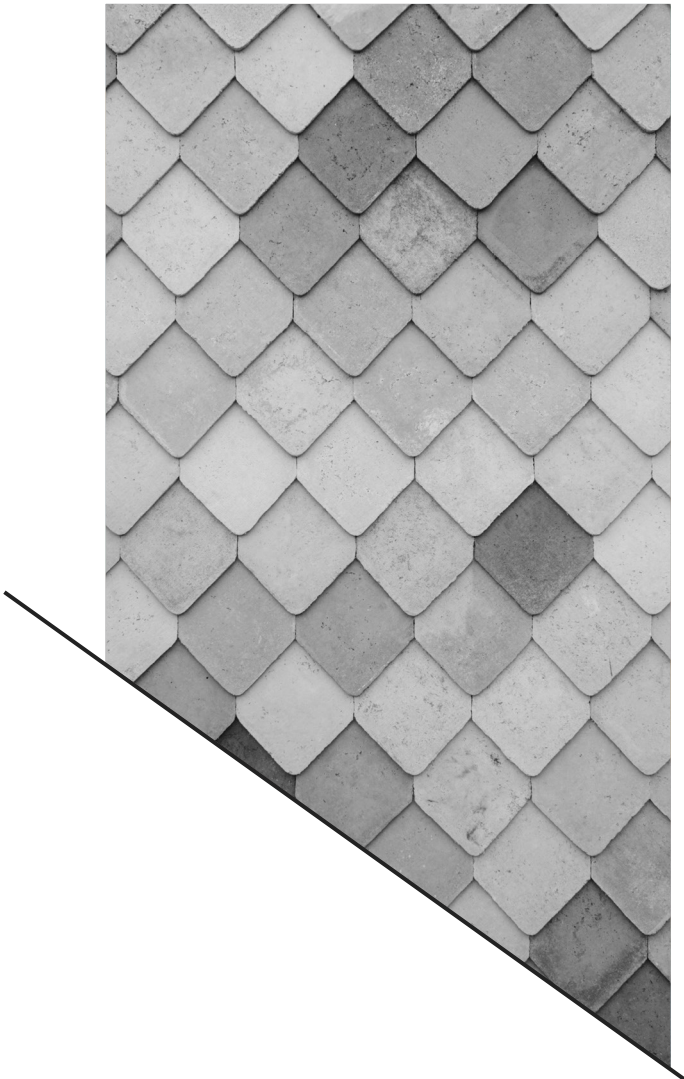
Digital identity and onboarding

Open finance could improve efficiency while reducing costs for identity verification supporting both better Know Your Customer (KYC) and onboarding requirements. Open finance has the potential to remove the need for verified physical documentation confirming identity by allowing a consumer to share digitally identifying data attributes permissioned across a range of accounts. Of course, much of this is tied to regulatory requirements, which can vary greatly across jurisdictions.

While some banks already provide access to their customers assets and liabilities, open finance would guarantee that right to access.

The potential benefits of open finance

Executed well, open finance will allow a re-imagining of value and revenue models for the industries it serves.



You might be an insights engine, an Account Information Service Provider (AISP), or a bank and your app now allows your customers to see all their payment account balances in one place. What comes next?

Can you offer:

- a beautiful, seamless experience aligned to a mortgage and an upfront deposit that is perfectly tailored for any customer?
- a savings account with a tailored interest mechanism that appreciates and rewards your customers' exposure to other products procured from you?
- an appreciation of your customers' personal invested risk vs more stable havens?

And can you achieve all that without having to ask your customer for an abundance of additional information?

IMAGE SOURCE: Unsplash | 11:FS / PLAID

Making data available from a wider range of segments and industries allows the creation of truly digital and personalised services — your customers will no longer have to live with commodity products that suit no-one.

The UK conduct regulator, the FCA, is particularly interested in how this can be applied to financial advice. It wants more people to have a better understanding of their money and how to manage it on the basis that it should make more people better off — IFAs in their pockets, if you will.

The 'nirvana' impact would facilitate access to the best digital financial management — akin to what you can receive from an IFA now, tailored to your customers, for no extra cost. That said, advice is a heavily regulated product — and with good reason — so firms will need to be given significant incentives to take this route. They will need to see obvious benefits.

Executed well, open finance regulation will allow a re-imagining of value and revenue models for the industries it serves. Think about the cost of an IFA: an initial consultation and modelling underpinned by a manual data provision provided by the customer, costs thousands. What if there was no initial cost and the recommendations provided were rich — how does the role of an IFA evolve? Curating a servicing model that is good enough to generate premium investment recommendations to the mass market could see a comeback as more data generates accurate investment models powered by open finance.

As a consequence of using more data to properly personalise products, risk models, credit decisioning and treasury models will need to become more sophisticated to deal with a higher amount of income variables.

Open finance rules could also bring financial services to more companies from outside the sector as the barriers of entry will be lower. Any firm with a data-first approach could partner or build these new services. As a consequence, banks' values and their products will need to improve — probably (and we would suggest) fueled by better, integrated partnerships across an FS and non-FS ecosystem.

Plenty of new revenue centers could open up for firms. If they haven't done so already, companies with the right scale should start exploring partnerships needed to offer pensions, investment management and insurance products where they don't currently do so.

The winner in all of these scenarios is the end consumer.

What are the hurdles to implementation?

If open finance regulation becomes a reality in the UK, the total scope of data sets and the associated cross industry implementation roadmap will indicate if there is an opportunity to build new services.

To do so would mean having the right culture, digital-first attitude and technical flexibility to manage a mandatory regulation whilst taking advantage of other opportunities.

In Europe we have already seen banks struggle with this juggling act, shying away from launching discretionary products powered by open banking APIs and technical service providers (TSPs) taking advantage and becoming unicorns in their own right. Understanding the lessons from the open banking implementation could mean the difference between facilitating digital across the customer journey and sitting idle. If banking responses to the coronavirus pandemic tells us one thing, it is that being digital-first in both your value proposition as well as your operations is no longer a nice to have — it is a must — and open finance might prove to be the right catalyst at the right time.

Practically, the first step is a reality check. Most pension and some insurance providers do not have digital data, let alone data that is machine readable, in a standard format. Without the data being online, there is no way for third parties to access or build APIs to retrieve that data.

If firms want to participate in open finance, or are mandated to do so, they will have to undergo fairly extensive programmes to digitise paper records. How onerous this will be depends on a few factors, not least to what extent historical records are required, and which of these historical records are still a valid input in assessing a customers total wealth.

Conclusion: the future is open

Perhaps the right way to answer the impact that any open finance framework might have is with an ambiguous, "we don't know yet". Directionally the vision is for an open, competitive and customer-centric approach.

However, the implementation roadmap itself needs to be thought through carefully, as does a viable way to fund the central bodies across the FS industry who will act as custodians. All eyes will be on this, as the vision and scope laid out in the FCA's CFI is so transformative, but the steps to get there are potentially perilous. There is no doubt that analysing some preceding examples of other jurisdictions' attempts to do this might give an insight into the potential feasibility.

One thing is for sure — the runway to implementing any open finance related rules will be long. But that does give the regulators and the industry plenty of time to get it right, to future proof against debates on its meaningfulness and demonstrate unquestionable value to the organisations it will impact.

What should organisations do right now? Well if you are a bank, an insurance provider, a wealth manager or in the pensions market, getting familiar with the CFI and thinking about how it could be implemented would be a start.

The FCA will continue to seek industry-wide consultation, so it is worth being in, or at least being aware of, the evolving conversation before it is too late. For some companies it might be worth looking at the first steps proactively, understanding the high level technical requirements that might be used to provide access to this data (e.g. API / MCI), and beginning to put in place basic housekeeping — like digitalising any paper records or looking into how customer data is stored at the moment in your organisation. This could impact resourcing, as different types of digital expertise will be needed.

Positioning yourself to take advantage of the framework is key — not doing this will materially impact the 'dollars left on the table' and your competitive stance going forward.

If you have any questions on the potential impact of open finance, the lessons learned from what has happened thus far or what to do next, why not get in contact with the authors of this paper:

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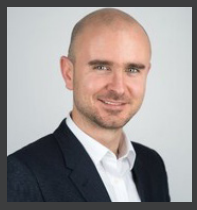

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11FS is the challenger firm defining and building truly digital financial services. We've assembled the world's top banking, fintech and insurance leaders to transform traditional financial services from within, and build new truly digital services from scratch. We field interdisciplinary teams bringing the best designers, product experts, consultants, researchers, technologists and domain specialists together to deliver tangible outcomes in the shortest possible time frames.

Plaid powers the fintech tools millions of people rely on to manage their finances. Since 2013, Plaid has been enabling open finance with secure and reliable connections to financial apps and services like Coinbase, Monzo, and Transferwise. Many of the largest retail banks choose Plaid to make it easy for their customers to securely access their financial data when and how they choose.

Glossary

ACCC: the Australian Competition and Consumer Commission - an independent authority of the Australian Government.

AISP: Account Information Service Provider - a type of TPP authorised to access an individual or SME's account data from their financial institutions with their explicit consent.

API: Application Programming Interface - a computing interface which defines interactions between multiple software intermediaries.

CDR: The Consumer Data Right - it aims to provide greater choice and control for Australians over how their data is used and disclosed.

CFI: Call For Input - the mechanism used by the FCA to solicit industry opinions and feedback on a specific topic.

FCA: Financial Conduct Authority - the conduct regulator for 58,000 financial services firms and financial markets in the UK.

FDX: FinancialDataExchange - a US non-profit dedicated to creating unified and interoperable data standards.

MCI: a Modified Client Interface - a technical interface that exposes interfaces from a bank, e-money Institution or payment institution under PSD2 to AISPs/PISPs.

Open Banking: UK reforms aligned to PSD2 that requires all UK-regulated banks to let consumers, with explicit consent, share their financial data with regulated third parties.

Open Data Platform: The Bank of England's proposed method to boost access to finance for SMEs

Open Finance: The UK's framework that builds on Open Banking to allow consumers and SMEs to access and share their data with TPPs to develop new products and services.

PISP: A Payment Initiation Service Provider - a type of TPP that allows consumers to make online payments without the need for credit or debit card details.

PSD2: The Payment Services Directive 2 - a European regulation for electronic payment services

SCA: Strong Customer Authentication - a requirement under PSD2 requiring electronic payments are performed with multi-factor authentication.

TPP: a Third Party Provider - an authorised online service provider that has been introduced as part of Open Banking. There are two types of TPPs - a PISP and an AISP.

TSP: a Technical Service Provider - a business that obtains and processes payment account information to support an authorised or registered account information service provider. It does not provide the information to the user itself.