# How to develop a profitable, customer-focused digital banking strategy: Open banking services and developer-friendly APIs

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**Abstract** With the introduction of the update to Europe's Payment Services Directive, PSD2, banks have a significant opportunity to implement new digital strategies. While the Access to Account (XS2A) scheme within PSD2 means banks need to completely overhaul the way they give access to and process customer data, a more open approach to how they work with other banks and new players in the ecosystem could enable them to create services that will help them to attract and retain increasingly digitally savvy customers while finding new revenue opportunities. This paper looks at the opportunities and threats to banks of adopting an open strategy on the back of the introduction of PSD2 and XS2A.

KEYWORDS: PSD2, XS2A, FinTech, mobile payments, p2p, online banking, mobile banking, AISP

## INTRODUCTION

The lives of ordinary consumers have changed almost beyond recognition in the past 20 years. First with the introduction of high-speed internet access; but more recently with the arrival of mobile computing devices, such as smartphones and tablets, and innovations like GPS and price comparison engines, customers are permanently connected and able to interact with their friends, environment and a whole variety of service providers in a completely different way from they did back in the early 1990s.

This has led to a profound transformation of consumers' lives in many areas. Amazon's Kindle and other e-readers such as the Kobo or Nook mean that we can instantly buy, store and read thousands of books all on one compact device. The same is true with music and various other industries. High street retailers have put an enormous amount of resource into developing e-commerce websites and delivery services that mean we do not have to move from our sofa to order anything from groceries to televisions to clothes. These retailers have understood

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that it was not only important for their customers to be able to order anything they like online but also to have the smoothest buying experience possible, with personalised recommendations based on their buying habits and those of people with similar profiles, seamless and secure payments, express delivery and so on.

Other areas of life have not been changed nearly as much by this digital 'revolution.' Banking is one of these areas. It is not as if there has not been interest in online banking — figures from the British Banking Association show that there are 9.6 million internet bank logins in the United Kingdom every day, while 2015 was also the year that mobile banking logins overtook branch interactions for the first time.[1] In 2014, 44.1 per cent of EU citizens used online banking services — this figure was 56.8 per cent in the United Kingdom.[2] But banks have had to face many challenges over the past 15 years, including their legacy main banking systems dating back from the 1970s, more stringent regulations and lower IT budgets — stemming directly from repeated financial crises in the 2000s. Organisational inadaptability with strong hierarchy and numerous stakeholders involved in any decision has also been a challenge, compounded by the fact that many have no real processes in place to listen to their customers.

While one could argue that online services and mobile apps that let customers check their balance and even move money at any time of day or night does represent a sea change in the banking industry, the current crop of digital services offered by banks does not go nearly far enough. Consumers are still expecting much more from their banks, including a differentiated offering — a clear USP, real-time and forward-looking personal finance analysis and personalised offers suited to their needs — not the bank's target revenues. In a survey conducted in the United States in 2014, 53 per cent of people did not think their bank offered anything different from other banks.[3] The inability of customers to get what they want has driven the increased popularity of fintech companies, which have been focusing on customer experience and alternative business models to differentiate themselves.

Fortunately for customers, the update to the European Payment Services Directive, PSD2,[4] should be the catalyst for a wave of innovation and customer-focused services. While the short-term impact on banks could be quite painful as they will need to organise around it, the XS2A provision within PSD2 will represent an opportunity for them to serve their clients better while finding new revenue streams for those who decide to embrace it by going beyond the minimum requirement of the directive.

## WHAT DO CUSTOMERS WANT?

The banking industry's failure to keep up with innovations in other technology-reliant industries means that it has also fallen behind when it comes to customer expectations. If customers are being offered numerous tools and features that make their lives easier in other areas, they soon become frustrated with services that do not offer them similar levels of convenience and choice. Customers vote with their feet, and if banks want to continue to be profitable and relevant in the financial services value chain, they must transform themselves.

So, while banks have to accept that the wider digital revolution has greatly increased customer expectations of what to expect from modern life, they then need to ask what it is they can be doing to meet these expectations.

While the banks have struggled to give customers what they want to date, a wave of innovators have been moving in to fill the gaps. Companies like Mint and MoneyDashboard are helping ordinary customers get a much better overview of their finances — account balances, utility bills, loan repayments and so on — all in one place.



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In short, customers banking services that help them plan their budgets, make payments more easily, forecasting tools for savings and pensions, discounted offers adapted to their spending habits and the like — not just to view statements and make transfers. A Gartner study from 2014 predicted that 25 per cent of the Top 50 Global Banks will launch a banking 'app store' for customers — something that Credit Agricole has already done — illustrating the belief that these customers also want all of this presented in a more cohesive way. Having access to all of the services in one place will make a consumer's life much more convenient than having to go to a number of different websites or apps to carry out each task.

Happily for the end user, provisions within PSD2 under the XS2A scheme mean that banks will be required to open up customer data to third-party software and app providers, giving at the same time the banks the opportunity to integrate third-party services into their platform — something some banks like Fidor are already doing with Smava and Currency Cloud.

## OPEN APIs

The mechanism by which XS2A is to be implemented is not yet confirmed, but it is expected that it will be achieved by the use of open application program interfaces (APIs). These are effectively a set of tools that allows new feature sets and services to be plugged into existing platforms. Open APIs are nothing new in online services — in fact, Salesforce was using them as far back as 2000 and opened an app store for its customers in 2006. To put this in some context, Apple's App Store, providing apps for the iPhone, did not open its doors until 2008. And even then, it was not yet open to third parties.

In the past decade, APIs have allowed organisations that hold large amounts of data to become platforms for third-party innovation. Google, Twitter and Facebook offer APIs to third parties, and in the payment space PayPal has pioneered open APIs since 2010, spawning a whole new ecosystem. In fact, the financial sector has seen more APIs launched than any other sector except for social media,[5] something that has played a important part in the development and growth of fintech.

While APIs are something that banks already use for the exchange of data within their own systems and with established partners, opening up these APIs to third parties is a completely different matter. Until now, banks have been the sole, trusted guardian of customer data information, and the regulations are akin to them being forced to open up their jewellery box and let everyone rummage around.

So, although this change is creating a lot of opportunities, it is also causing a number of headaches for the banks. The first and most obvious is that banks need to ensure that customer data is shared in a safe and secure way with third parties. The regulatory technical standards for these APIs will be defined by the European Banking Authority (EBA), so the first step to doing this is to ensure that you understand these standards and build the APIs accordingly.

They also need to create the front-end interfaces for third parties to access this data, which will be a time-consuming process full of challenges — banks will have to deal with the process of integrating these interfaces into their important banking systems in order for the data to be extracted and shared. If the important banking system in question is a number of years old, this process becomes even more complex.

But to take advantage of the opportunities, banks need to do this quickly while keeping an eye on costs.

There is an even greater risk, although, of disintermediation. If customers can use services that link to their bank account, but do so outside of the bank's online banking website or app, then these customers no longer have the bank at the front of their mind.



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## THE ADVANTAGE OF BEING AN AISP

There is an opportunity — the banks need to be aware of with XS2A. Under the new directive, there will be a new way of carrying out online transactions without using cards — great news for those who do not want to use their card or do not have one. If a customer buys something from a retailer online and pays for their purchase from their current account, the customer will simply give the retailer permission to execute payments on their behalf via their current account — this would only have to happen for the first purchase, and the permission would remain valid until the customer says that it is not.

In the earlier example, the bank plays the role of the Account Servicing Payment Service Provider (ASPSP). However, banks are also in a position to become an Account Information Service Provider (AISP), under PSD2 regulations. This is where it consolidates information from a variety of ASPSPs, meaning all the details of an individual's different accounts are all in one place, and can present them all to the customer in a dashboard and even allow customers and merchants to complete transactions that do not involve accounts that they hold.

Although there are several companies such as Mint that already present a dashboard view of multiple accounts, XS2A will see a number of other organisations — whether traditional banks or not — enter this space in an attempt to become the interface through which a customer views and manages their finances. The bank has an opportunity to be the AISP that remains front-of-mind for their customers — and if they tie this in with an app store-like experience, they put themselves in a very strong position — but also the threat of becoming as good as invisible to the people who hold accounts with it if they decide not to become an AISP.

So, the question is: will it be fintech companies or banks becoming the primary interface for the personal finances of their customers? With PSD2 coming into force in 2017, both types of organisations have their chance, but only if they realise what is at stake.

## COMPETE OR COLLABORATE?

With the fintech revolution that is taking place in Europe — where many of the most interesting companies linking themselves to London's heritage in the financial services industry — banks have a fantastic opportunity to expand the number of services that they have available to their customers, as well as integrate current account balances and transactions from other banks into their own services in order to become the primary interface a customer uses.

The relationship between some banks and these fintech innovators is already, to some extent, symbiotic. After all, these companies rely on existing banks to provide them with accounts so they can get set up, and sometimes even on their banking licence to operate. The banks, in turn, are starting to take advantage with partnerships and the like — take GoCardless as just one example, which has partnered with several of Europe's biggest banks. These partnerships can work in a number of ways — they can be white-labelled, for example, with Fidor's use of Currency Cloud's payment engine[6]; or where the partner still retains their own branding, but delivers the service through the bank's platform, such as with Metro Bank's partnership with peer-to-peer lending platform Zopa.[7]

Although there are several players beginning to emerge from the fintech sector that have been set up to directly challenge the banks, such as Transferwise, the majority of the companies in this area are actually building services that are complementary to banks' current service offerings. Indeed, it is more Transferwise's marketing strategy that leads to the perception of it as a challenge to the banks — its peer-to-peer



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exchange platform could potentially be used as a white-labelled service by banks. But for an innovator like Xero, which provides accounting tools to individuals and businesses, it finds itself hamstrung if it does not have a direct connection to the banks its customers use, with users having to manually enter transactions.

By connecting third-party web services to primary services or data stores, it will be possible to build new, better tools for customers to use. These connective tissues are like translators that will help improve the entire ecosystem for everyone, providing the access that third parties like Xero — and their customers — crave.

## STAYING RELEVANT FOR CUSTOMERS

There are several potential paths that the banks could take, all with their own pros and cons. The first option would be for banks to simply do enough to comply with PSD2 in the creation of open APIs for third parties. This is the worst option — while it might cost the least in terms of investment and time, it will not make money either, and will almost certainly lead to the bank disappearing from the customer's sight behind a wall of third-party services.

A better option for the banks would be to go beyond the confines of PSD2 and create a number of open APIs to use: not only the APIs required under PSD2, such as account balance, fund availability check and account verification, but also additional payment and non-payment APIs they could charge for such as payment guarantee, real-time payments, conditional payments, authentication, age verification, payment status reports, opening up a new revenue stream.

But, if banks want to make the most of the opportunity that XS2A brings, then they need to think about becoming more than just that bank account provider, but a provider of third-party services too, building their own services to integrate with the open APIs of other banks, which again would open up new revenue streams. Banks can also begin to integrate some of the best fintech services on the market into their own offering — whether as white-labelled partnerships or in a kind of 'app store' approach, where customers can get the best experience by having a wide choice of financial tools and services at their fingertips.

Another option would be for banks to become fintech enablers by providing them with their technology on top of the banking licence. A useful analogy here would be the mobile network operator (MNO) industry. MNOs have come under pressure for years, reduced to mere pipes to carry other people's services. But the networks are also embracing this diminished position, licencing their network capacity to other companies operating as virtual networks, just as O2 does to Tesco Mobile, which are focusing on marketing while leveraging their customer base. They have also been creating other services to stay relevant, with schemes such as O2's Be More Dog, which gives priority offers and cashback to customers.

In a similar way, some banks are making their underlying centralised infrastructure available to a new gamut of operators who could both rely on and build upon this core. By embracing an open philosophy, on top of leveraging new revenue streams by lending their 'banking rails,' banks could bring external services into their own online banking sites, enriching their own services with all the diversity of external web services right there under their own brand. Some UK banks that have been doing this historically include HSBC with M&S Bank. Fidor Bank is also doing this with FidorOS, which serves as a bridge between traditional banking and new banking, letting innovative services like money transfer via social networks and instant money transfer be linked to traditional core banking systems. While banking offerings are becoming more and more targeted to niche segments, such



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as young people, SMEs, expats, this option of lending the essential infrastructure to new players gives them the opportunity to indirectly reach out and generate revenues from these niche segments they have been under-addressing in the past for a variety of reasons.

The reality of the situation, however, is that it is going to become increasingly difficult for banks to ensure they are the primary interface that their customers come into contact with as more and more entrants to the market come along — established banks, challenger banks and third-party service providers of all shapes and sizes.

## THE BENEFITS OF PARTNERSHIP

Partnerships with and acquisitions of fintech start-ups are an option that all traditional banks should be considering. The 2015 Innovation in Retail Banking report from Efma,[8] however, showed that although many in the banking industry are positive about working with start-ups as either suppliers or partners, there are in fact very few instances of this happening right now. The primary reasons why banks want to work with start-ups is to improve their ability to provide more innovative solutions, get products to market more quickly, lower the cost of innovation and make a business impact.

While working with fintech start-ups will present challenges to banks — aligning company cultures being one of the most significant — the benefits should be clear for forward-thinking banks. There are a number of different options here, whether in terms of partnerships, investments or outright acquisitions, such as BBVA's purchase of Simple in February 2014 as well as its 30 per cent stake in Atom Bank taken in December 2015.

One major advantage that many fintech start-ups have over established banks is that they are able to develop products and services and get them on to the market quickly. The process from conceptualisation to realisation is short and neat, whereas in established banks this is often not the case. The approvals, utilisation of resources and testing processes required make this a real headache for large organisations. Legacy IT infrastructure is also a problem, holding banks back from developing and plugging new services in quickly.

Like in many industries, there is a lot that banks can learn from start-ups. Many large organisations — for example Accenture — have already benefited from creating small, agile divisions within the company that have the freedom to work quickly and without having to constantly report in to senior management about their activities to seek approval for the various projects that they are working on — they simply come up with ideas, execute and get them to market as quickly as possible. If they do not work, they are quickly scrapped and replaced by a new idea — if they work, the company can then think about how it approaches implementing the project on a much bigger scale.

The banks that quickly realise the opportunities that PSD2 and XS2A bring and move to put their strategies in place will have a definite advantage over the competition. Whether it is a fully-featured app store or a branded finance dashboard, customers hungry for a more 21st Century banking experience will be won over. While it will be the very best of these services that come to the fore, banks cannot afford to wait around and watch others — including the new breed of hungry, innovative start-ups — do it better than them.

## SUMMARY

As the dust settles on the introduction of PSD2 and the XS2A scheme, it is important to remember that at the moment, we are all very much pioneers. Time will tell if the regulations actually go far enough to truly enable the creation of cutting-edge banking services that let customers really



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do everything they want to do. And, of course, there will be scenarios that none of us have yet imagined, and business cases and applications that have not even been dreamt up yet.

In summary, to take full advantage of the opportunities presented by XS2A, banks need to ensure that they are thinking about:

- how they monetise the APIs they develop, for example by not only providing the main PSD2 APIs but also creating more advanced payment and non-payment APIs that they could charge for, hence creating new revenue opportunities.
- whether they want to go even further and become 'fintech enablers' by developing a full set of Banking in a Box APIs, such as Telcos have done with MVNOs.
- the kinds of new services that will appeal to customers and how they can execute them correctly (either by themselves internally or by integrating third-party services directly onto their platform) to maximise chances they remain the preferred personal finance management interface of their customers.

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