

Open Banking – Creating a new revenue opportunity





Introduction

“Open banking enables people, businesses and things to give, take and multiply value creation for the bank by sharing assets like data, algorithms and transactions with business ecosystems”
- GARTNER, 2016

APIs, open banking, platform banking, bank as a service- these are some of the buzzwords which are doing rounds in the financial services industry. Banks are under pressure to open up their doors to third parties and developers. Open API banking seems inevitable at this point with governments around the world pushing for regulations to make the banks hand-over the customer data to third parties, a move that is enabling open API economy to take off.

For a long time, Application Programming Interfaces (APIs) have been the typical method of how software systems interact with each other. But in the recent few years, they have been discussed in the context of financial services as ‘a game changer’. There are a number of factors behind this “game-changing” stuff, but a prominent fact is that they are now always referred to as open APIs – publicly available services which will allow anyone to connect to these services and build applications around them.

Application Programme Interfaces (APIs) in financial services have the potential to create new services delivered by existing players and new players. There are number of use cases which can be envisaged around open banking ranging from aggregation of financial products in one place, insights about spending patterns, recommendation about

customer’s spending behaviour, automating processes and so on.

The word “open” is vital for both the main drivers of API development in financial services: the rise of financial technology companies fin-tech start-ups and regulatory initiatives taken up in certain geographies to open up the market for further innovation and competition. Open banking has the power to completely change and revolutionise the way Banks offer products services to the customer and the way a customer interacts with the bank.

Open Banking - Driven by regulation

While there are number of factors driving this open banking phenomena, the most relevant are the regulatory measures taken by regulators in EU to allow access of customers data to third parties (with the permission of the customer) and to enable payment on behalf of the customer (Figure 1).

First, there is the mandatory adoption of PSD2 compliance into EU member state legislation by January 2018.

European Banking Authority has also come out with a defined set Regulatory Technical Standards (RTS) which will be subsequently implemented by European banks. Second, the Competition and Markets Authority (CMA) in the UK is making considerable efforts to enforce banks to openly share their banking data with the Third Party Providers (TPPs) to enable and foster innovation.

The Competition and Markets Authority (CMA) within the UK is pushing for the adoption of open API standards with respect to the sharing of customers’ personal and current account transaction data by larger retail banks.

Recommendations for this are developed by Open Banking Working Group which has been appointed by the UK government. The CMA wants banks in the UK to

REGULATION WILL DRIVE GLOBAL OPEN BANKING

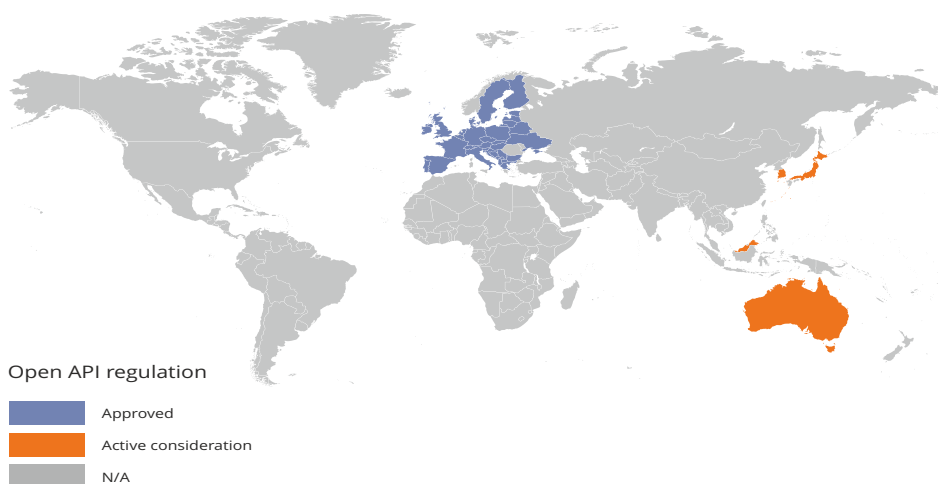


Figure 1

Source: The Open Banking Report by Business Insider Intelligence

implement these recommendations by no later than January 2018.

Thus, at present Europe is showing the way in open banking economy, with the rest of the world keeping a close watch on how the innovation and competition works out in the EU banking sector. Going forward, we are more likely to see similar steps in other geographies as well. In an ever increasing globalized and connected world, the open API economy will truly develop only when non-EU countries and regions also come on-board. That is when we will get to experience the real beauty and power of open banking.

Even outside the EU where regulations do not apply, there are number of initiatives that banks are already taking on to open up their data and services via APIs. For instance, Citibank in US launched its open API platform in November last year and has already made available seven of its services accessible via APIs. In Australia, the House of Representatives recommended to develop a framework to support data sharing for open banking initiative.

Experts believe that the wave of open banking is moving at a rapid pace and will spread in different geographies sooner or later. While the banks are already putting considerable effort and investment in devising their open banking strategies and getting the infrastructure ready for open APIs, banks will also eventually look at ways in which they can build a revenue model around this open ecosystem.

This whitepaper focuses on various options available to banks to adopt to the open banking phenomena and how some banks are already embracing the open banking ecosystem. It also goes into some

of the revenue models built around the API ecosystem in other industries which can be replicated to financial services and how banks can build a whole new revenue stream around the APIs by getting the right API monetization strategy.

Making The Right Choice

“Right now there is some talk about APIs, but in five to 10 years they will become a facet of doing business online that everybody has to do or end up being left in the dust.” - Head of open APIs, BBVA

An open API economy will create an environment of competition and innovation within banking space and thus, forcing banks to revisit their business strategies. It will also pose challenges to profitability and will make banks to rework on their future revenue streams. Open banking will act as a catalyst for entry of new players in financial services space and will enable the delivery of products & services through partnerships and collaboration within the business units of the bank, other banks and partners.

Leader banks of the future will have a greater focus on their end customers and markets. Such banks will openly collaborate with other partners to accelerate their market position through increased use of digital platforms and digital insights that support their specific business strategies. Leaders of such banks will have to clearly define their strategies related to their fitment and positioning in this open landscape.

Banks can adopt to the best-fit model based on their capabilities and long-term strategies. The basic

strategy for any bank will be to meet the regulatory requirements which can be termed as a service based approach. However, going a step ahead, banks can also strategize to offer more API services beyond the compliance and create an open ecosystem for third parties for app development which will lead to a more consumer oriented approach (Figure 2).

Some banks (like BBVA, Nordea) are using different models of open banking including an app ecosystem model while other smaller banks will put compliance as the priority before going forward with an ecosystem approach. The model bank will eventually adopt depends on its preferences and business drivers it finds most critical to its business.

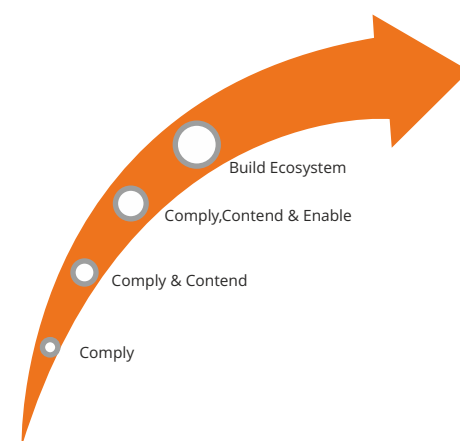


Figure 2
Source: Strategic options in the open banking economy

Comply

- Make sure that the Bank is PSD2 compliant by meeting the regulations laid down by EBA and CMA and provide Access to accounts (XS2A) to third-party providers TPPs for customer information & payment initiation.
- Develop commercial partnerships with TPPs accessing Bank's data and also put revenue model in place in agreement with TPP in order to recover costs incurred in compliance.

Contend

- Expose the minimum mandated API services to TPPs and also build its own innovative account and payment initiation services to compete with TPPs.
- Act as an AISP/PISP with offerings such that customers holding accounts with other banks can also avail these services thus, contending with other banks & other AISPs/PISPs.

Enable

- Develop and expose additional APIs which go beyond the minimum mandated compliance.
- Share additional customer & account data with the third parties post gaining customer consent and generate additional revenues. This can indirectly refer to monetizing the data and cross-selling of products to customers.

Build ecosystem

- Build an Appstore sort of ecosystem for the developers, third parties and partners to easily consume API services and think of newer ways of delivering products & services to customers.
- Strive towards becoming an everyday bank by building partnerships and connections with goods & services provider partners in areas like retail, travel, transport, insurance and the likes.

Challenges & Opportunities

“Although big banks are well aware of how agile and innovative their newcomer market competition is,



Figure 3: Challenges & Opportunities

their legacy IT systems often present serious and specific challenges to overcome when trying to adopt similar innovations themselves. APIs are a prime example of this. Many banks have an IT infrastructure that was developed before the introduction of modern data sharing techniques and then upgraded in a piecemeal fashion over the course of decades rather than years” - Currencycloud: “The state of APIs in banking”

Similar to many ideas which emerge around the digital economy, open banking has its own advocates and sceptics. Open banking and API will create both opportunities and challenges for banks as it will create new ways of interacting with partners, service providers, competitors and customers

(Figure 3). Banks will no longer be in competition with banks but with everyone who is providing financial services - Fintechs, telecom players, TPPs, social media players and so on.

Banks embracing the open API ecosystem

BBVA - API Market

BBVA has taken the open API environment head on and exposed a range of APIs already to authorized developers well ahead of the regulatory timelines in its home market. BBVA is in the process of making eight APIs commercially available to external third parties &

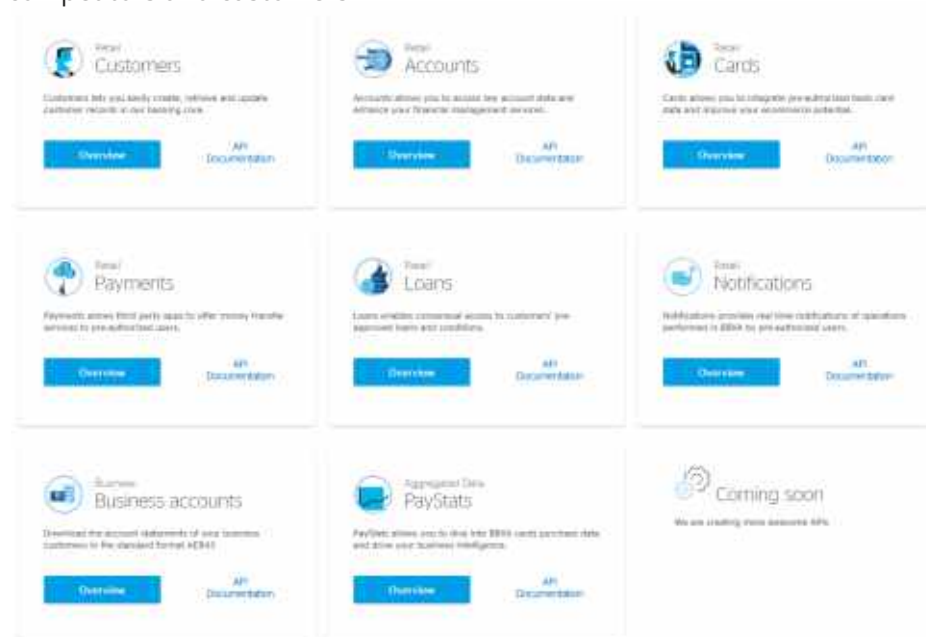


Figure 4 Source: <https://www.bbvaapimarket.com/>

developers to enable integration of customer banking data with TPPs (Figure 4).

Currently, the APIs are available for

- Retail customers data
- Retail accounts data
- Retail cards data
- Retail payments
- Retail loans
- Retail notifications
- Business accounts data
- Cards purchase data

Fidor - Banking as a platform

Fidor has been another great example of a bank embracing open APIs with open arms. With its proactive open API strategy, the bank now stands out for being PSD2-compliant for more than two years. Fidor has placed open APIs at the centre of its strategy and firmly believes in a bank of the future where bank primarily acts as a platform and offers an experience to its customers where they can pick and choose services as per their discretion and choice. Fidor seems to work more like a tech-company which has a banking license (Figure 5).

Fidor has also developed a very active developer community where it's very easy for the developers to build, plug in and launch new innovative services using their APIs.

Fidor offers APIs for

- Banking
- Payment
- Credit
- Card management
- User management
- Scoring
- Integrated & third party services

HSBC Developer portal

HSBC was the first of the large UK

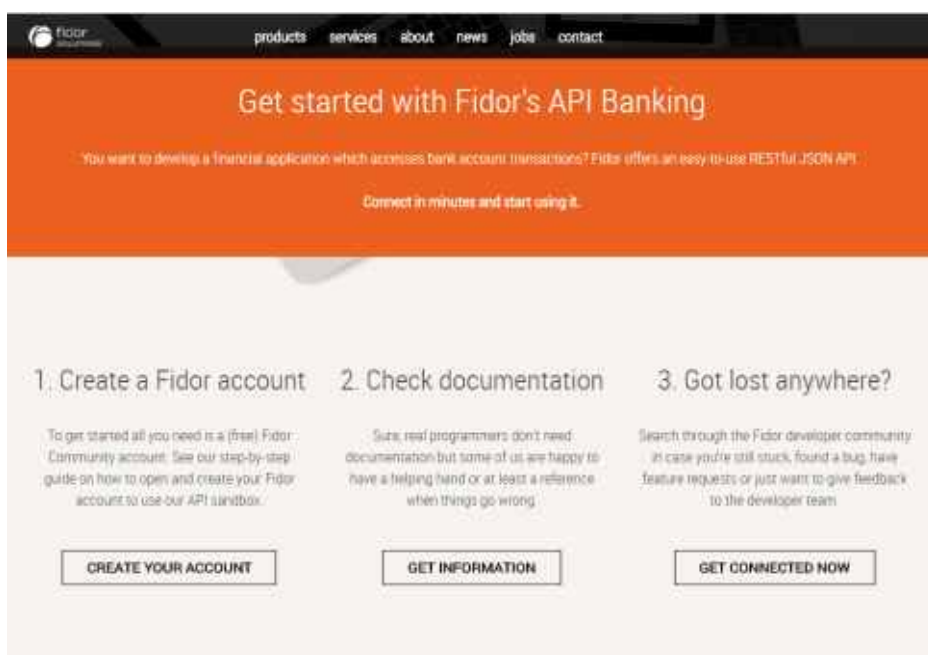


Figure 5 Source: <https://www.fidor.com/products/api-banking>

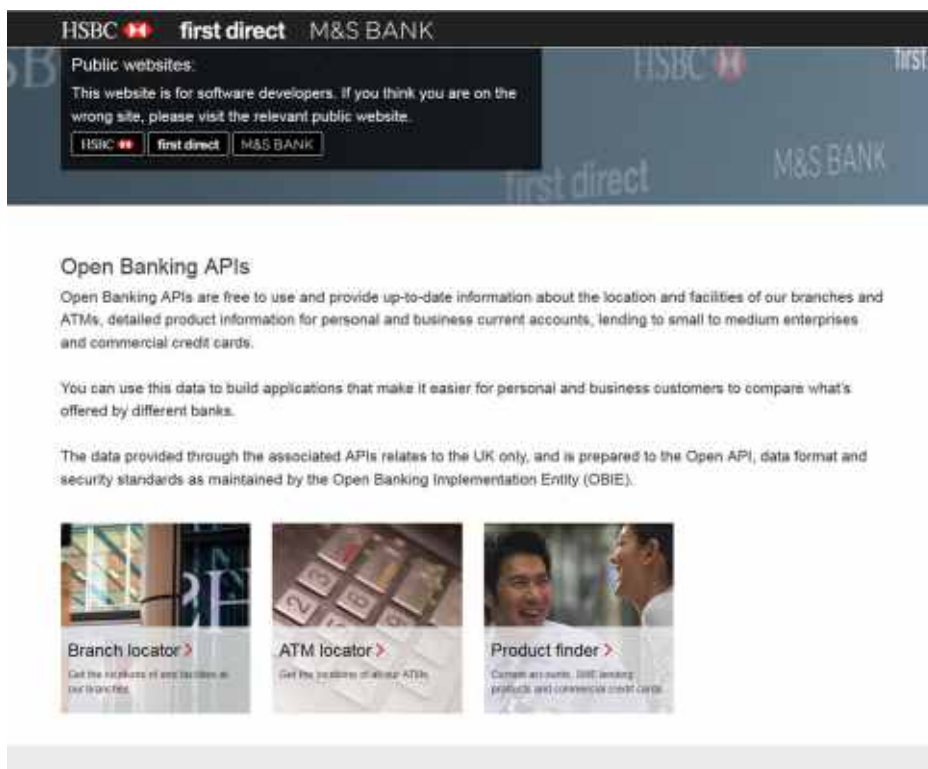


Figure 6 Source: <https://developer.hsbc.com/>

banks to satisfy the CMA requirements for publishing APIs to open up their data. The bank launched a developer portal at the end of 2016 and has so far exposed three API services- Branch locator, ATM locator and Product finder to be used by developers (Figure 6).

"This is nothing short of a revolution in banking and will

change the face of financial services forever" - HSBC

Credit Agricole Appstore

Credit Agricole opened up its APIs way back in 2013 and has built an Appstore ecosystem for banking related apps. Credit Agricole has exposed 14 APIs that provide authentication, credit, location-

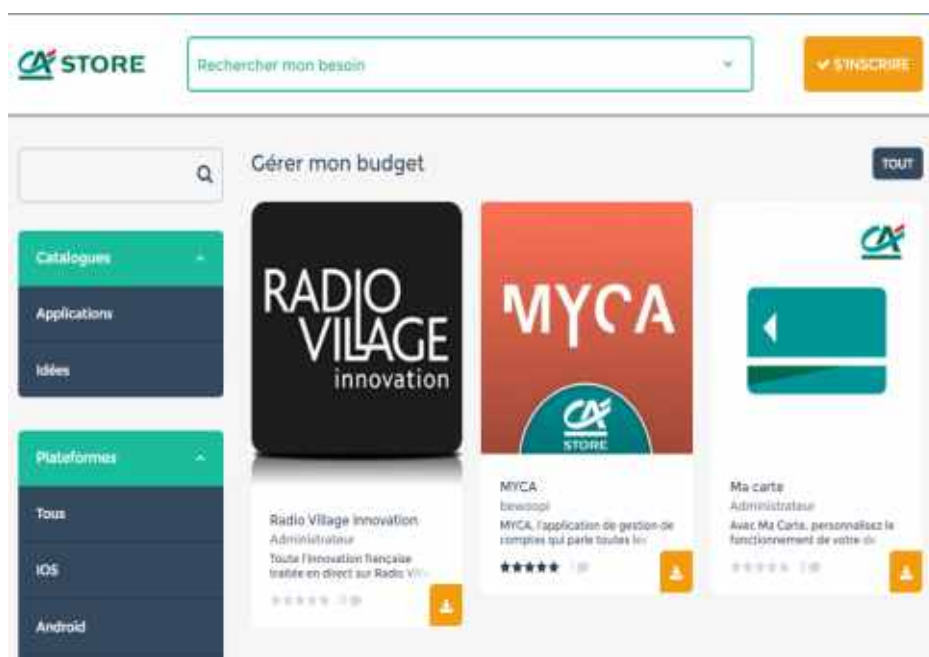


Figure 7 Source: <https://www.creditagricolestore.fr/>

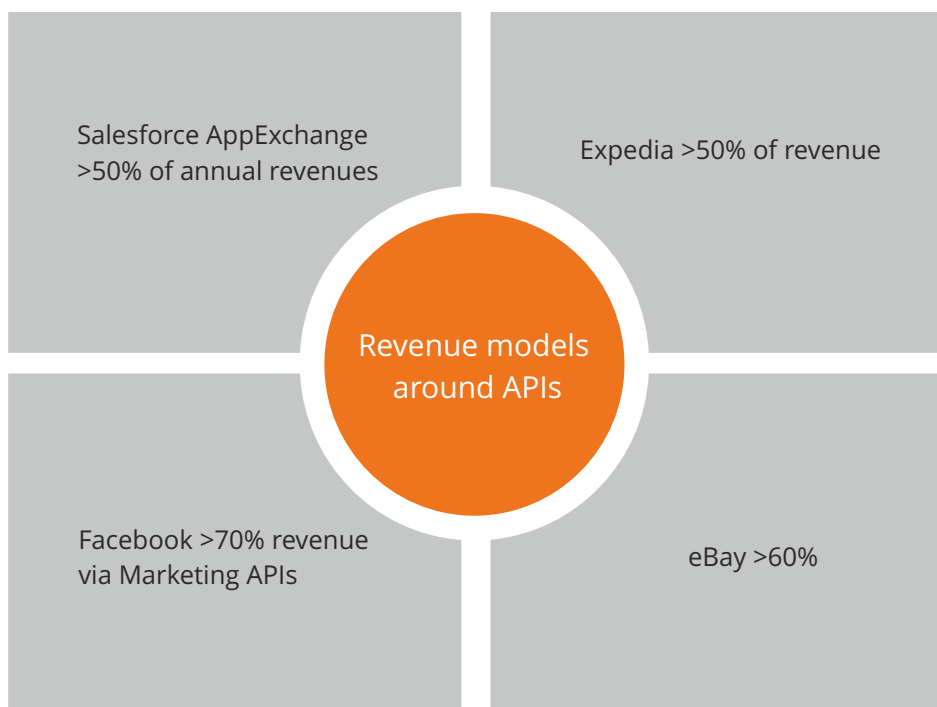


Figure 8: Business revenue models around APIs

based functionalities among others. Using these, community developers have built 47 apps around different ideas ranging from personal finance management to location based service apps (Figure 7).

It also has an active developer community where different developers can ideate & collaborate on a novel concept around its APIs and take it to execution.

New revenue channels for Banks?

While there are multiple options available with Banks for making themselves ready for the open API economy and many banks already making moves in making themselves ready for the API economy, banks will have to think

through new ways of recovering their investments and building a sustainable business model around APIs.

Outside of the banking industry, technology biggies like Google, Amazon, Salesforce, Twitter, eBay and Facebook could not have grown at such a rapid pace without business accelerating capabilities of APIs.

Salesforce.com generates 50% of its revenue through APIs. Salesforce has an “AppExchange” marketplace for apps created by its partners that work on its platform and offers multiple flexible pricing plans to its partners. There are 2900+ apps listed on its public AppExchange and generated \$1.5 billion in license. Expedia.com, a \$4 billion company generates more than 50% revenues through its Expedia Affiliate Network .Expedia’s APIs allow customers to use its functionality to book flights, cars, hotels using the third party apps.

Another great example of building a business model around APIs is Facebook. Ads on mobile devices accounts for its major revenue chunk and much of this success is down to its Marketing API. This API provides developers & advertising teams with all the resources they need to market their product as per their need.

Banks Can Build New Revenue Streams Around APIs

Many banks are investing considerable sum into their preparation for open API banking and PSD2 regulations. While the



innovation is driven by regulation and there are banks which have even gone beyond the regulation in exposing their data and services through these APIs, it is imperative for banks to think of ways to generate revenues out of this ecosystem. When exposed to the right combination of technologies, regulation stops being a compliance headache and transforms into the biggest revenue opportunity for banks.

API monetization revolves around finding a suitable business model for API products. Of course, the business model should be in line with the long term vision of the bank and strategic agenda. It is all about understanding the end-consumers who will pay for your API product, why will they pay, how the pricing will happen and under what terms should they pay.

In order for banks to pursue a successful monetization strategy, they must approach APIs with a clarity of well-thought out products, clear intention & articulation of value and clear identification of the target consumer of the API product.

Categorize APIs & API products

First level of classification of APIs starts with the kind of access the external partners and internal consumers get over the API services. In broader terms, API consists of two parts: published API standard and the actual connection (API access).

Public APIs are the APIs for which the standards and the access is open to all interested third parties to encourage use of data & business information in innovative ways. For private APIs, the standards and access are limited only restricted to internal developers and approved external third parties. These are primarily used within the businesses' internal operations for sharing of information and collaboration.

Banks should treat API as a product which will need to be actively maintained & supported and should be easy to use for internal consumption and external developers. Further, banks should

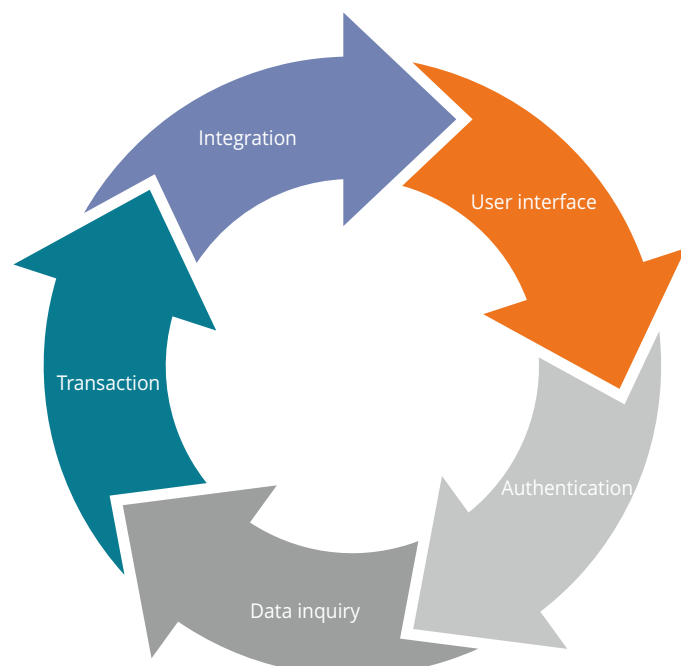


Figure 9: API product categorization

also spend considerable time and thoughts in identifying similar APIs which can be bundled under an API product.

- Data inquiry (Utility) APIs
- Transaction APIs
- Integration APIs
- User interface APIs
- Authentication APIs

Understand your target API consumer

With the ever increasing APIs in the open banking economy, the diversity of players consuming your APIs will also increase as the market evolves with time. Consumer profiling is an important aspect in traditional business models and the same can be extended in the API ecosystem as well. Understanding target API consumer will help the bank in:

Better functionality offering

Identifying and understanding use cases for target API consumers can help design better APIs around the identified need.

Better segmentation

Better knowledge of your target consumer can help in better positioning of your API products & reduce acquisition cost.

Better market fitment

Identifying open needs in market which are still unmet and how can your API potentially meet that need.

Setting price points

Identifying the value your API delivers to the target consumer will help in setting a better price point for the API consumers.

Identify monetization models

While devising monetization models, banks will have to identify the value their APIs deliver to the API consumer. There is no “one size fit all” model when devising pricing models for different category of API products and thus, banks should get into deeper details and conversations for the best suited model.

Freemium is a great model to kick-off and is also widely prominent in the API ecosystem for both the API publishers (Banks) and the third parties who are curious to connect and want to test the waters before a full dive-in. This can also serve as a first step towards other monetization models like subscription and pay per call. In this model, Banks offer third party developers a part of their API services for free and charge for additional services. A freemium model can also be knit around the volume or value of API calls wherein a third party has a free access up to a certain volume of API services and pays over the free usage. For example, a bank can expose low number of API calls to its account inquiry API service for free and then any additional calls to this service are charged. In a similar way, a bundle of APIs say account inquiry and customer inquiry are free to use but additional API service like a customer authentication API is chargeable.

Subscription based pricing offers multiple subscription plans available to the third parties to subscribe as per their need. A subscription model can be fixed or dynamic. Under the fixed model, various



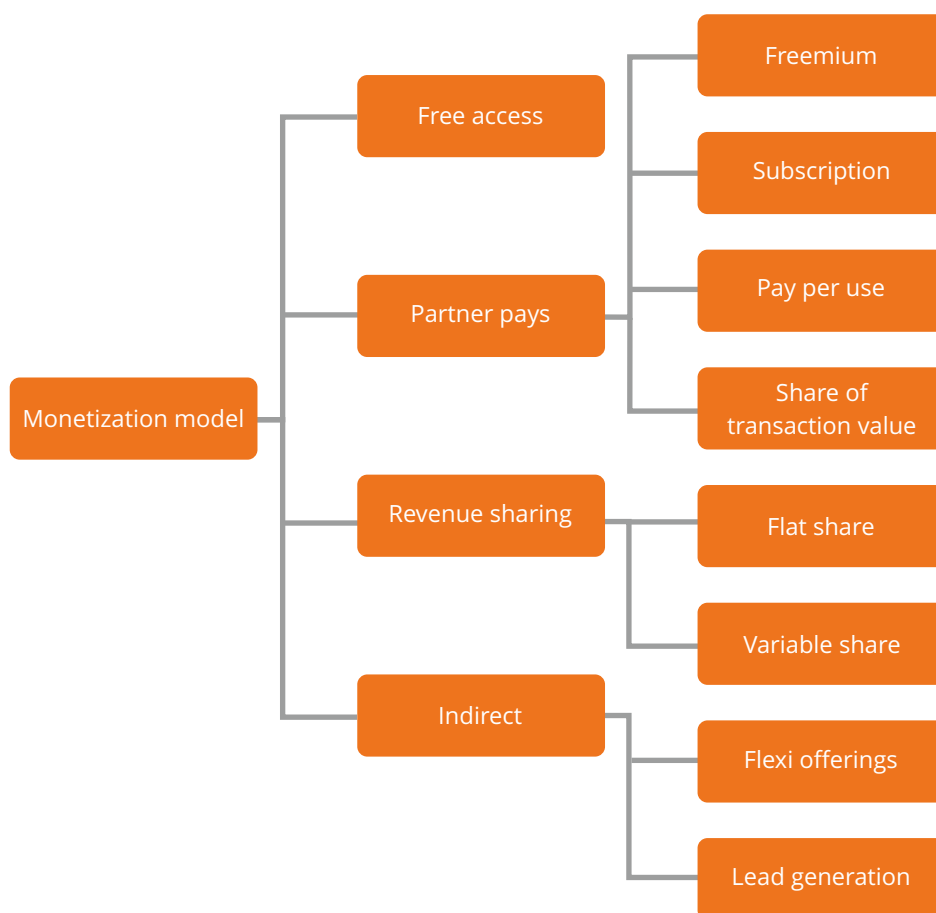
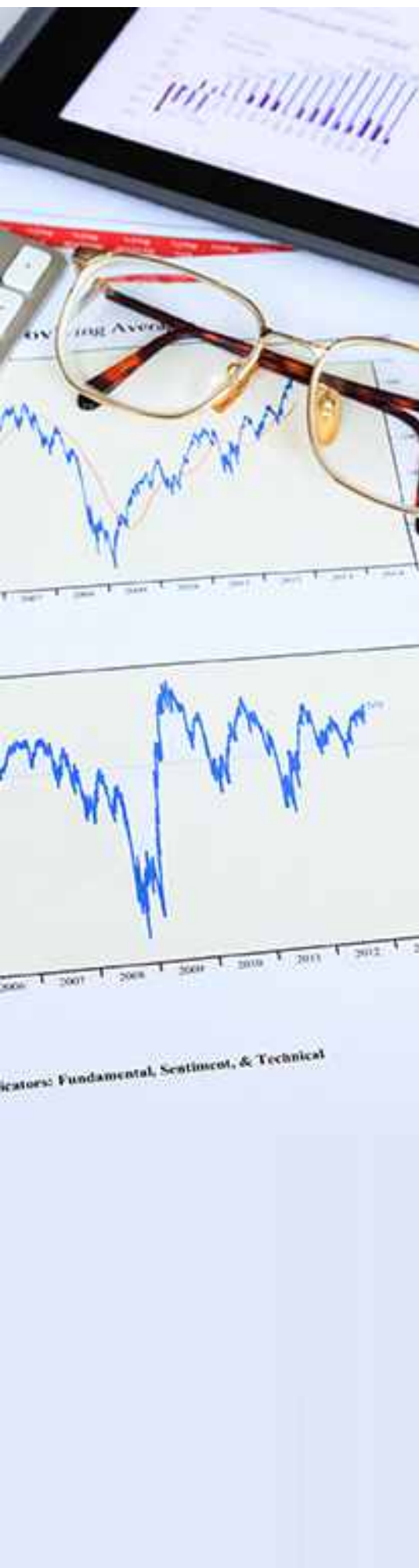


Figure 10: Monetization models

plans (e.g. Silver plan, Gold plan, and Platinum plan) can be defined with third parties having full access to the APIs covered under the respective plans.

A more dynamic model can have additional services under a subscription plan charged as pay per use or as a tiered pricing. Third parties can sign up for a particular tier usage over a period of time. While under different tiers, the cost of the plan increases but the cost per API call goes down and thus, third parties with more volume consumption will prefer opting for higher tier plans.

Pay per use or Pay as you go is the most straight forward monetization model. Under this model, third party pays each time the TPP makes an API call. This is a direct monetization model and in order to succeed with this model, it is important to clearly identify the value your API creates

for the third parties and the willingness to pay for the value proposition of the APIs.

Share of transaction value based pricing charges third parties on the value of transaction done through an API call rather than directly charging for an API call. This is more relevant for payment transaction APIs and can be defined as an absolute amount based on tiers defined on transaction value or as a percentage of the transaction value.

Revenue share with partner is an excellent option to encourage open innovation and enhance the reach of your product offerings. Under this model, the third party often gets share of fees (charged by bank to end customer) for every successful transaction or event initiated by the third party. Even a step further, in case multiple third party partnerships are involved in an end to end process, revenue

sharing agreements can be set-up between third parties and revenue sharing can be done as per the agreement.

Other indirect monetization methods can include ways which may not directly generate a revenue for the bank but will help the bank in acquisition of new customers or in improving customer service.

Exercise flexible monetization techniques

Cab aggregators' surge price mechanism works on real-time analytics which seeks to put

a premium on limited supply of cabs during peak hours and offers services to customers who are willing to pay more. Twitter uses a rate limit window of 15 minutes wherein it allows 15 API requests per allotted user. For users who want higher traffic, Twitter offer this for a fee.

In the open banking context, server availability is one similar parameter which can be used to offer "premium" access to partners at peak working hours who are willing to pay more. It is crucial for bank to clearly identify its "resources" which can be offered at a premium to the third parties.

Monitor performance of your API products

Banks will also need to periodically review and measure the performance of certain indicators to understand the direction in which their overall API strategy is heading and take appropriate measures in the necessary areas. Keeping track of parameters at API product level and partner level like the API traffic, traffic from individual partners, partner engagement, top performing partners and apps, revenue from API products and individual partners can help in taking a better informed decision about any change in strategy.

Conclusion

Rapid growth of Fin-tech industry worldwide and entry of major digital players in financial services is continuously mandating banks to think of new ways of deeper engagement with customers and devising new ways of revenue generation. While Europe is one of first regions which has mandated the use of open APIs for sharing information to third parties under PSD2, continuously changing customer preferences are rapidly driving the initiatives and discussions in other geographies as well. Banks and financial institutions have multiple options to choose from in the open banking economy depending on the strategic and tactical priorities. Readying for open API economy will need considerable investment & effort from bank's side and thus, it is imperative that banks will also need to deliberate about building newer revenue streams around the open banking ecosystem sooner than later.



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