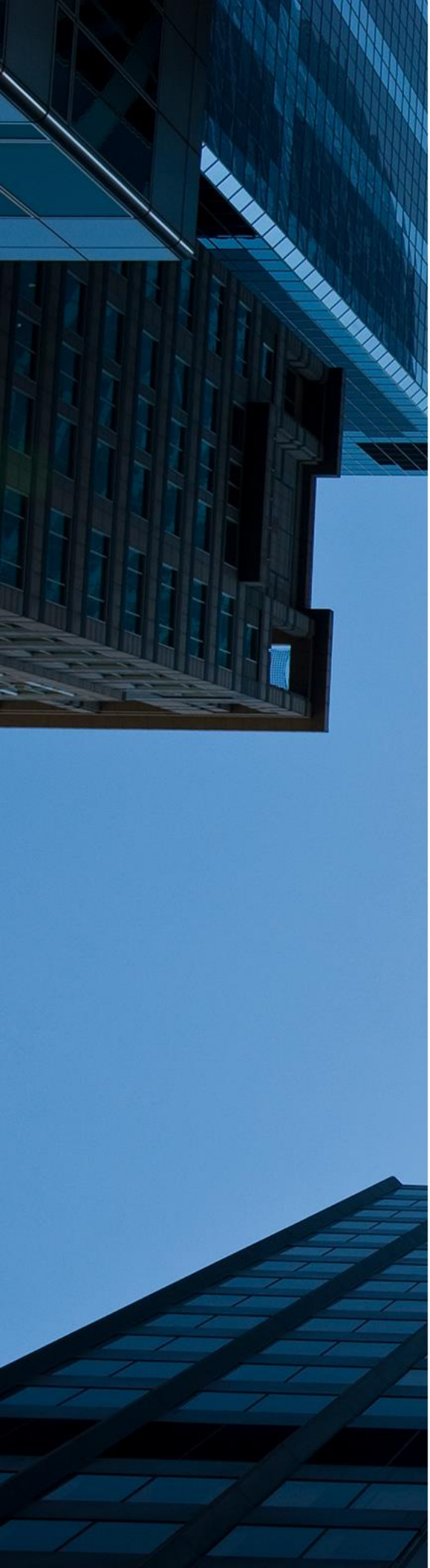

Aite Novarica

JANUARY 2022

OPEN BANKING EVOLUTION

FROM COMPLIANCE TO STRATEGIC ADOPTION

PREPARED FOR:

axway

JANUARY 2022

OPEN BANKING EVOLUTION

From Compliance to Strategic Adoption

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EXECUTIVE SUMMARY

This report analyzes post-regulatory global trends in open banking, identifying use cases for commercial and retail clients based on value-added services supported by open banking for treasury management operations, acceleration of prebuilt enterprise resource planning (ERP) connectors, and how open banking can support new models for payments.

Key takeaways from the study include the following:

- **"Platformization" is at the core of open banking deployment:** The development of open banking is accelerated by fintech firms that provide robust API integration platforms through which financial institutions (FIs) and businesses can quickly and easily consume on-demand apps built by a healthy ecosystem of third-party developers.
- **Banking-as-a-Service (BaaS) responds to increasing business needs for embedded finance:** Leveraging APIs, banks have started to offer BaaS to fintech firms and other enterprises. The services are delivered through the bank's API platform or through a third-party platform with which the bank has contracted.
- **Banks are testing strategies to monetize open banking:** To remain competitive, banks are developing end-to-end specific journeys that help them identify how to monetize the adoption of open standards, how exactly to find—and partner with—the right fintech vendor, and how to effectively provide the banking back end to the fintech front end that will turn the construct into a repeatable business.
- **Open (banking) payments respond to business needs for new payment methods:** Online merchants have a growing interest in adding open payments as a new payment method to their checkout page, as open payments can offer several advantages over cards. Conversion and cost reduction are the main business drivers.
- **Open payments are a strategic opportunity for FIs:** Banks and payment service providers (PSPs) can offer innovative account-based payment services to their clients. FIs that go beyond compliance and integrate open payments into their payment strategies will create new customer value and compete for the increasing share of account-to-account (A2A) payments in commerce and other industries.

INTRODUCTION

The distribution of banking products is changing to an API-first model as the next step in the evolution of bank distribution models. APIs enable new open API business models that facilitate partnerships between banks and enterprises. Open API banking enables banks to more flexibly distribute its products through third-party channels provided by fintech partners, facilitating innovation and reducing time to market. A bank can also connect to open APIs of other financial services providers and integrate their products into its own offering. This makes the API technology a strong driver to open banking. APIs make banking programmable, opening opportunities for new entrants to innovate and compete with incumbent banks. At the same time, banks can create new value for customers and monetize the API economy.

While still in initial stages, open banking will lead to the next wave of digitization in payments, reconfiguring age-old value chains and changing business models. Banks that look at API development beyond regulatory compliance (e.g., the second Service Payment Directive [PSD2]) are now starting to ask where the real value is—and if there is any—in such an approach, how can such value be generated, and how to extend, expand, and grow the business through that reach. FIs and fintech vendors are aware that APIs are part of the bigger picture of open banking. They want to know, now, up to what point they should be further developing APIs without common standards and a clear indication of what services clients would be ready to pay for.

METHODOLOGY

For this paper, Aite-Novarica Group strategic advisors relied on information collected through briefings conducted with Axway executives, getting insights into current product set offerings and competitive positioning and messaging. In addition, Aite-Novarica Group leveraged existing research and expertise, knowledge base and proprietary contact databases, and publicly available information.

MARKET OVERVIEW

Open banking is often associated with regulatory requirements to allow third-party access to bank accounts, most notably in the U.K., where "Open Banking," written with initial capital letters, is the national program to implement the legal requirements for access to the account. However, open banking (or more broadly, open finance) is also understood as the development of a new financial ecosystem based on connectivity among FIs and businesses, powered by APIs. FIs are enabling fintech firms and other businesses to integrate financial services into their customer proposition, not only providing access to bank data but also delivering entire banking services through APIs.

ACCESS TO THE ACCOUNT

Banks are increasingly enabling third-party developers to access bank accounts via open APIs to retrieve account information. When bank account data become accessible to third-party providers, new products that work across multiple banks can be developed. Examples include the following:

- Products for personal financial management, bank product comparison, and online accounting
- Payment apps to initiate payments directly from a bank account for person-to-person payments, commerce payments, bill payments, and other applications
- Consumer lending products that are based on a credit score built from a consumer's account history
- Authentication services to identify customers using their bank credentials

This open banking trend is moving beyond mere compliance with regulatory requirements. Banks require more control over account access by third parties to counter alternative methods such as screen scraping used by such companies. Fintech vendors are turning the learnings from the implementations made at bank accounts into packaged open banking accelerators based on robust API integration platforms through which corporate clients can quickly and easily consume on-demand apps built by a healthy ecosystem of third-party developers. So-called platformization is at the heart to

ride this disruptive wave, with open banking platforms now being the norm in front of over 1,455 self-declared open banking platforms as of the end of Q2 2021.[1]

BAAS

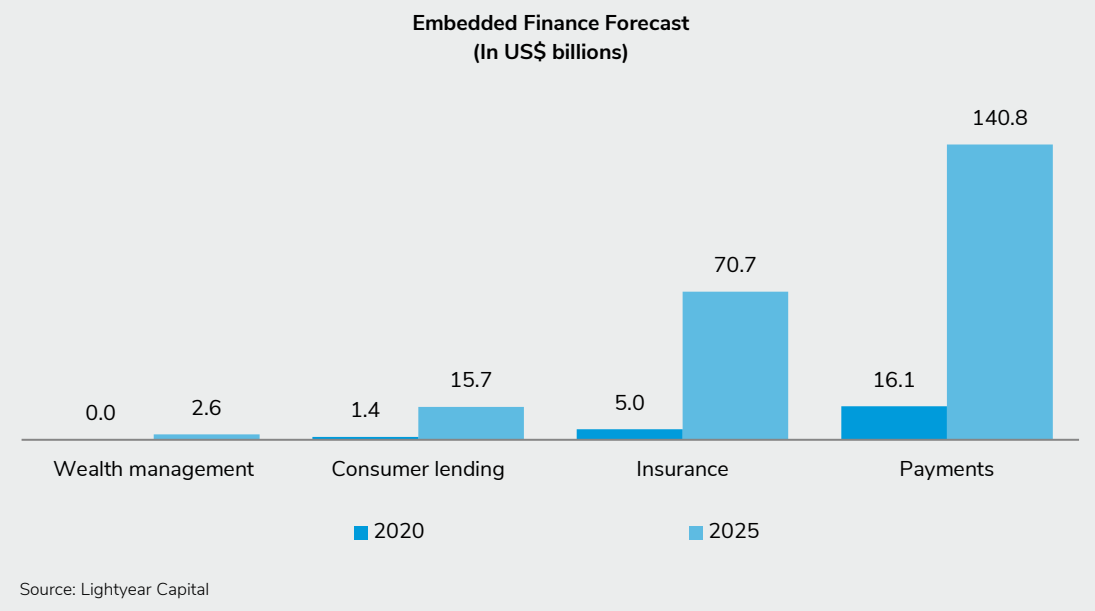
Businesses (e.g., fintech firms, enterprises) seek to embed financial services into their native customer experience or white-labeled entire services. By embedding services, companies do not have to hand over the customer relationship to a bank and can maintain direct customer contact throughout the entire customer journey. The sales process becomes seamless for the customer, as banking services are fully integrated as opposed to forcing the customer to redirect to a bank channel or switch between different user interfaces.

Whereas integration of banking services into enterprise systems used to be a complex undertaking requiring a bespoke implementation project, APIs have made such integrations much easier. API integrations often require not more than the inclusion of a few lines of code in the logic of the enterprise.

The embedded finance case is forecasted to grow from US$22 billion in 2020 to US$230 billion by 2025 (Figure 1).

[1] "Open Banking/Open Finance Quarterly Trends: Q2 2021," Platformable, accessed November 15, 2021, https://platformable.com/static/48c4d4e3a1a0e43559619398d1eb5152/Platformable-Q2-2021-Open-Banking-Open-Finance-Trends-Report.pdf.

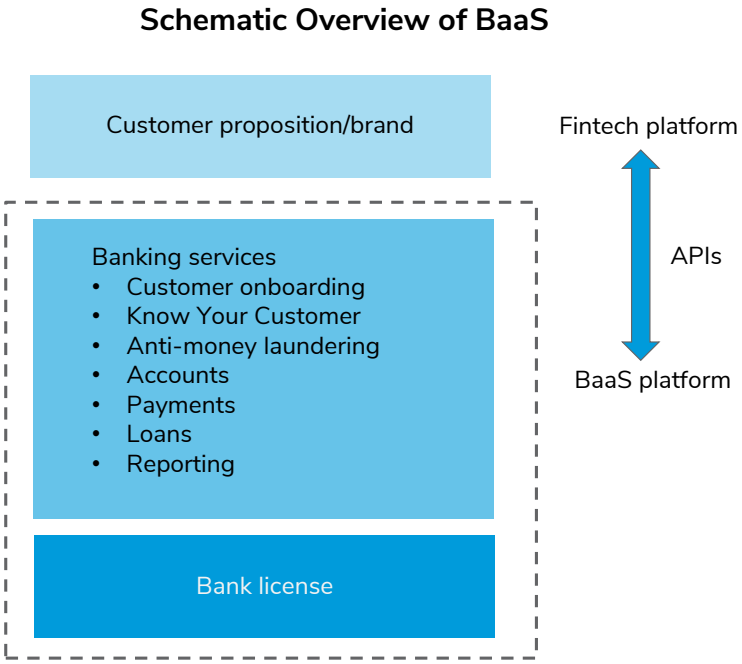
FIGURE 1: THE EMBEDDED FINANCE OPPORTUNITY



Source: Lightyear Capital

Leveraging APIs, banks and other FIs have started to provide BaaS to fintech firms and other enterprises. BaaS enables the provision of complete banking processes, such as deposit accounts, loans, payments, or compliance, as a service to nonbanks using an existing licensed bank's secure and regulated infrastructure (Figure 2). The services are delivered through the bank's API platform or through a third-party platform with which the bank has contracted.

FIGURE 2: SCHEMATIC OVERVIEW OF BAAS



Source: Aite-Novarica Group

Examples of banks providing BaaS are Goldman Sachs (partnering with Apple for its credit card product) and Bancorp Bank (partnering with Chime for debit cards and deposits). As more and more fintech firms are looking for bank partners to provide banking services, there is a significant opportunity for banks to offer a BaaS solution and develop new relationships with enterprises, creating new revenue streams.

REGIONAL DEVELOPMENTS

In some regions, open banking dynamics are regulatory driven, while other regions are taking a more market-driven approach. The following are examples in Europe, North America, and Latin America.

Europe

Banks in Europe are regulated by PSD2 and U.K. Open Banking. In the European Union, there has been limited central coordination for the implementation of PSD2, leading to a fragmented market, lack of a common API standards, and varying quality of bank APIs. Nevertheless, there is significant market activity by banks and fintech players that find

creative ways to develop new solutions. Nordea, for instance, has partnered with Tink to provide its customers with visibility of all their finances, such as mortgages, investments, loans, and current accounts, in one place, even if these accounts are held with other banks.

In the U.K., the central governance and management of the open banking implementation made the country the leading example of open banking. Until October 2021, adoption among consumers has continued to grow, with 7.5% to 8.5% of digitally enabled consumers now estimated to be active users of at least one open banking service. Consumers report that open banking services are helping them manage their finances and reduce fees and charges. Services seeking to help consumers make better financial decisions seem to be doing exactly that. Significant portions of customers claim that these platforms are helping them keep to budgets, reduce unnecessary expenditure, shop, and minimize fees and charges.[2]

One example of open banking helping consumers is U.K. pensions. Increasingly, pension providers allow users to see their pension balance and other finances (bank accounts, credit cards) side by side in one app. For the future, pension providers are working to enable open pensions, (i.e., enable consumers to see and manage all of their pensions in one place).[3] This example shows how open banking will transform into open finance. Open finance goes beyond open banking to combine data from all of a consumer's financial service providers, including mortgages, savings, pensions, and investments, to provide a single view of the overall financial position and provide advice on how to better manage those finances.

In Europe, open banking has created the possibility for fintech firms and FIs alike to develop new payment methods based on payment information services (PIS). The open (banking) payments opportunity will be further explored in this paper.

United States

The groundwork for the legal framework for open banking in the U.S. has already been laid in 2010 with the Dodd-Frank Act. Section 1033 of that law states, among other things, that "subject to rules prescribed by the Bureau of Consumer Financial Protection

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[2] "The Open Banking Impact Report," Open Banking UK, October 2021, accessed December 13, 2021, https://insights.openbanking.org.uk/the-open-banking-impact-report-october-2021/home/.

[3] See, for example, "Open Pensions and Open Finance: Building a Better Future for UK Savers," Innovate Finance, October 1, 2020, accessed January 10, 2022, https://www.innovatefinance.com/reports/open-pensions-and-open-finance-building-a-better-future-for-uk-savers/.

(Bureau), a consumer financial services provider must make available to a consumer information in the control or possession of the provider concerning the consumer financial product or service that the consumer obtained from the provider." Recently, the Consumer Financial Protection Bureau has been instructed to develop its rules to bring the law into action.[4]

But the U.S. financial industry has not waited on legislation to engage in open banking. There is significant demand for open banking solutions, as the following examples indicate:

- **Access to the account:** Open banking payments network Plaid has launched a "payment partner ecosystem" comprising around 50 U.S. and European companies, with the aim to boost A2A payment transactions. This should enable payment companies such as Checkout.com, Square, and Stripe to make A2A payments an option in their checkout flows and help streamline digital account onboarding, top-ups, and payouts.
- **BaaS:** According to venture capital firm Andreessen Horowitz, there were more than 30 BaaS partnerships between banks and fintech firms in 2020. A survey of partner banks' returns shows that many operate at profitability levels two to three times above average.[5]
- **Standards:** The Financial Data Exchange (FDX) is a nonprofit organization led by major U.S. and Canadian banks and other industry players. The FDX is focused on moving the industry to the FDX API standard for secure access of user-permissioned financial data. The National Automated Clearing House Association is also developing an API standard.

While driven by market forces, it could be argued that the U.S. open banking ecosystem is already further developed than a regulated market such as Europe, perhaps with the exception of the U.K.

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4 "Consumer Access to Financial Records," Federal Register, November 6, 2020, accessed December 13, 2021, https://www.federalregister.gov/documents/2020/11/06/2020-23723/consumer-access-to-financial-records.

5 Rex Salisbury and Anish Acharya, "The Partner Bank Boom," a16z, June 11, 2020, accessed July 2, 2021, https://a16z.com/2020/06/11/the-partner-bank-boom.

Canada

Canada released a public consultation on open banking, with the second government review of the consultation still in progress. The Open Banking Implementation Plan is due to go live in January 2023, with the core objective to realize consumers' right to data portability and move to secure, efficient consumer-permissioned data sharing enabled by a system of open banking. The Retail Payments Activities Act has been introduced to encourage more fintech vendors to participate.

Canada is considering a hybrid framework for open banking, relying on regulation as an enabler for open banking/open finance. According to the Advisory Committee on Open Banking, the scope of Canada's open banking system in its initial phase should include data that is currently available to consumers and small businesses through their online banking applications. FIs should be allowed to exclude data enhanced by FIs to provide additional value to their consumers, such as internal credit risk assessments.[6] By limiting the initial scope of open banking functions to lower-risk, read-only activities (i.e., allowing third-party service providers to receive consumer financial data but not edit this data on banks' servers), it will be possible to bring secure open banking to Canadians more quickly. Once the system is in place and operating well, consideration could be given to expanding the scope to write-access functions, such as payment or account creation functions, as well as including new types of data for inclusion.

Under Canada's prudential regulatory framework, banks retain ultimate accountability for all outsourced activities, and this may leave banks ultimately accountable not only for how the data is transmitted but also for how the third-party service provider uses that data after it is shared. Canada's own Financial Consumer Protection Framework also carries many best practices regarding liability protection, complaints handling, and redress that can be applied to open banking. The Canadian government has introduced the Consumer Privacy Protection Act, which, if passed, will increase protections for Canadians' personal information by giving individuals more control and transparency when companies handle their personal information.

In April 2021, Open Banking Initiative Canada (OBIC)—a not-for-profit organization that wants to make consumer empowerment possible in the country—published the OBIC Manifesto that proposes OBIC as an advocate for consumer protection and plays a

[6] "Final Report—Advisory Committee on Open Banking," Government of Canada, accessed November 15, 2021, https://www.canada.ca/en/department-finance/programs/consultations/2021/final-report-advisory-committee-open-banking.html#a1.

significant role in preparing the market for open banking in Canada. It also provides support to both the Canadian government and ecosystem stakeholders toward the establishment of open banking. The manifesto is OBIC's statement of purpose. It is a thoughtfully informed, collaborative plan to bring open banking in Canada to fruition.[7]

Brazil

Brazil continues to roll out open banking, despite some expected delays in full implementation.[8] Strong digital adoption and strong market pressures in the country create opportunities for digitally savvy consumers and neobanks, such as Nubank. Brazil represents a relatively small manageable market, so players that already have a good presence are incentivized to launch pilots to see if they attract adoption. Initially scheduled to be completed on August 30, 2021, the integration of all means of payment to open banking in the country will be done in a staggered manner that is now expected to be completed by September 30, 2022.

The Central Bank of Brazil has launched several deliveries of open banking steps simultaneously, so institutions need to test implementations and seek certifications. FIs want to check that all of these deliveries are in place and properly functioning before making open banking available to consumers. Currently, only the first phase of open banking is in place. Since February 1, 2021, banks can share information about products, services, service channels, and agency locations. Based on the data, banks can make comparations through APIs. Public consultation on open banking regulation is underway. Under the new schedule, on February 15, 2022, same-bank account transfers and the Electronic Transfer Available feature will integrate open banking. On June 30, 2022, bank slips will be included. On September 30, 2022, the debit account service will be shared among FIs in the country. Lastly, it will be possible to share information on investments and insurance.

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7 "OBIC Manifesto 2021," OBIC, April 2021, accessed January 7, 2022, https://obicanada.ca/wp-content/uploads/2021/03/OBIC-Manifesto-OpenBanking.pdf.

8 "Open Banking," Central Bank of Brazil, accessed January 11, 2022, https://www.bcb.gov.br/estabilidadefinanceira/openbanking; Wellton Máximo, "BC Adia Para Setembro de 2022 Funcionamento Completo do Open Banking" June 24, 2021, accessed January 20, 2022, https://agenciabrasil.ebc.com.br/economia/noticia/2021-06/bc-adia-para-setembro-de-2022-funcionamento-completo-do-open-banking.

THE WAY FORWARD

Whichever the scenario—regulated or not—of open banking in each country, FIs will need to demand a common, open, shared standard for the secure exchange of financial data. To fulfill this demand, FIs must avoid putting a bunch of smart engineers in a closed lab just to theorize possibilities and, instead, build a solution, go to market, speak to the market, determine whether clients' expectations are being met, and then iterate from there. Banks are all on the same journey and have by now opened developer portals to offer APIs and genuinely take this platform strategy to heart, encouraging third-party developers to use those open APIs. And while banks are squarely looking to offer development environments that build APIs beyond regulatory compliance, they're also starting to ask the questions of where the real value is, how to generate that value, and how to expand and grow business.

Open banking introduces a very important element: when banks talk to each other, they should do so based on a common open standard that is shared by the entire financial ecosystem for the secure exchange of financial data. Every bank should take its capabilities, unbundle them, publish them as open APIs based on open banking common standards, and invite developers to build on those APIs. This approach allows FIs to grow a strong developer ecosystem around their platforms and embed their banking capabilities into all varieties of digital contexts. Fintech partners may reach market pockets to bring a new customer base so banks can grow their loan book or build relationships with new customers they previously didn't have access to. Via open banking, API tool providers and consultants can generate income by offering services to banks and fintech vendors, helping them increase the mediating value of security and developer experience.

This business scenario is creating a potential gridlock to banks that consider APIs as a product, treat APIs like a product, and fund them like a product. These banks are—in fact—struggling to find the way to make the next move. If APIs are really only a product, the challenge then is to find the single-most-important customer segment for this 21st century platform. The hard wake-up call for these banks is that the "kingmakers" are the app developers—the ones who are going to decide which bank API platforms will be adopted and which ones will be left behind. Catering to them the way the bank would do for real customers is the key to success of open banking. This step is a challenging one for banks, especially ones that see customers as targets to sell products to, such as a credit card or a mortgage. It's even more challenging because their competitors are tech players that are actually quite good at attracting developers.

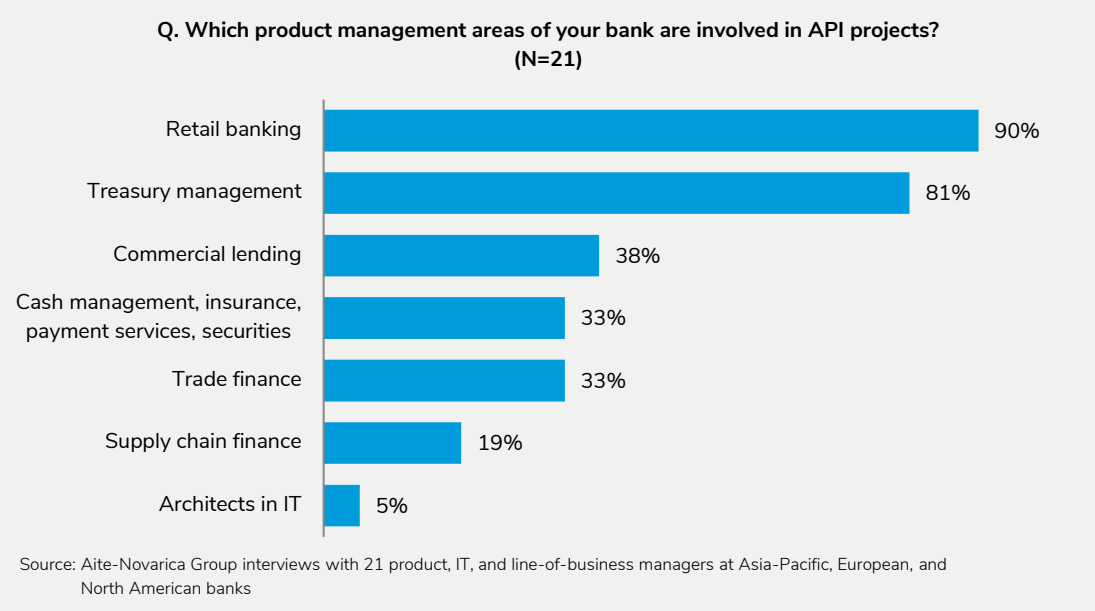
The value of open banking is to build a developer ecosystem around a bank's platform to reach the corporate target personas. Attracting fintech challengers enables an FI to build the bridge between the business side and the technical side. This is about how a bank builds a 21st century business around APIs: targeting both technical and corporate personas. The combination of hybrid integration platform and strong developer experience will shorten the gap between open banking developers and businesses, allowing the latter to embed banking services into the customer journey. Banks are for sure the first to be engaged in this new proposition, but fintech vendors must be looking at the whole financial services ecosystem of credit unions, other fintech vendors, and eventually credit reporting agencies, regulators, and everyone involved in developing and supporting the use of open and common standards.

So, savvy banks are looking at fintech vendors to make the transition. To do that, fintech players look at open banking as a global movement, a global transition, and global disruption that's happening. Forward-looking fintech vendors want to help banks understand how to import and export the best of what's happening in all regions.

COMMERCIAL BANKING: TREASURY ON DEMAND—EMBEDDING PAYMENTS WITH MONEY MOVEMENT

In regular conversations with banks, Aite-Novarica Group finds that FIs looking at open banking as a source of revenue and growth are more receptive and work to overcome any form of friction when compared to those in more conservative regions, or more deeply buried in the troughs of API-as-a-product disillusionment. With their first round of open banking implementations, innovative banks enjoy top use cases in consumer-driven peer-to-peer payments, borrowing, and lending (e.g., buy now, pay later). These wins are followed by less hyped use cases on the commercial side of cash management payments and corporate treasury (Figure 3).

FIGURE 3: OPEN BANKING IMPLEMENTATIONS PRIVILEGE RETAIL CLIENTS



Source: Aite-Novarica Group interviews with 21 product, IT, and line-of-business managers at Asia-Pacific, European, and North American banks

To remain competitive, banks are developing end-to-end specific journeys that help them identify how to monetize the adoption of open standards, how exactly to find—and partner with—the right fintech vendor, and how to effectively provide the banking back end to the fintech front end that will turn the construct into a repeatable business.

Enterprises can either use a fintech app that integrates with their bank accounts or use the APIs directly provided from the bank portal and integrate them into their business

workflows. The key driver to success for a bank—as previously discussed—is to entice developers to work with its own platform. An intuitive developer experience is front and center: Low developer experience makes it harder for others to integrate with the APIs and build products and services. The key resides in the experience that developers will have in quickly and easily understanding the potential use case applications, seeing the efficient and user-friendly professional layout of the APIs, and being able to consume and use them in meaningful ways as quickly and easily as possible. In other words, the key is in delighting developers.

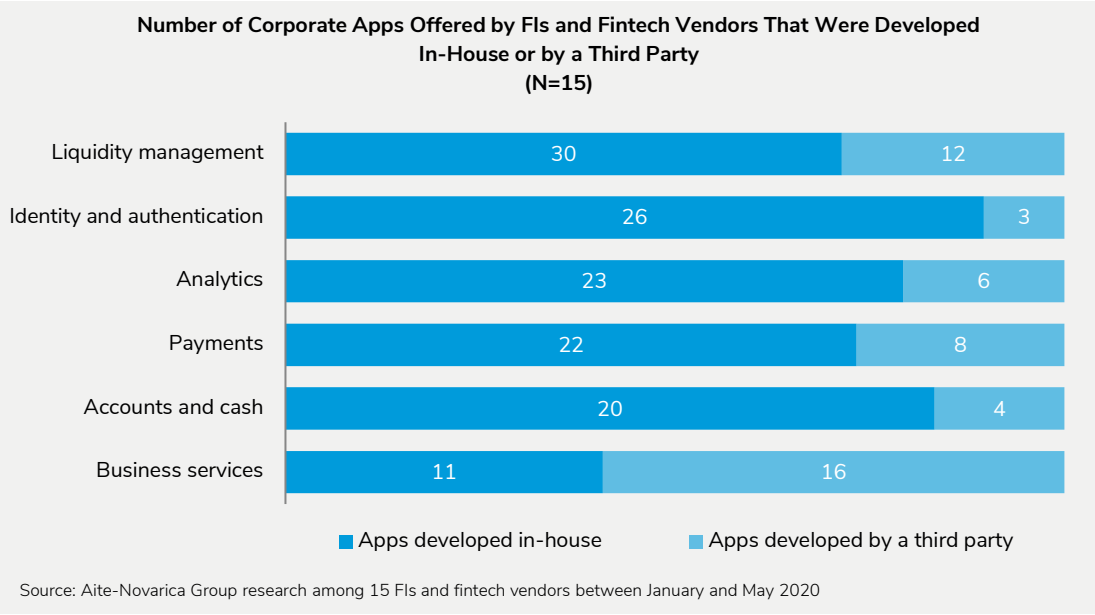
A second key feature is to offer prebuilt open banking APIs. A powerful strength of an open banking proposition is to give developers the possibility to start working with out-of-the-box APIs, especially when engrained in regional standards. So, whatever step or standard happens to be the one that's dominant in the client's region, the bank will give those APIs prebuilt—a full stack implementation with all of the consent and security concerns already baked into the APIs. Security is a value enabler that can increase the value generated from the bank APIs.

Why Banks Have to Compete Now

Banks and fintech vendors wonder what business opportunities the open banking framework may generate for them. The answer is to ask corporate treasurers. Treasurers tell Aite-Novarica Group they want real-time access to information to make quick decisions and execute immediately. Information in real time requires the elaboration of data extracted in real time from all possible sources. Open banking offers banks the opportunity to implement the "treasury-on-demand" strategy. To do so, open banking must go beyond APIs and incorporate the foundational elements of treasury on demand that access, transform, enrich, and consume banking data through an ecosystem of technical and rules governance building blocks.

Treasury on demand goes beyond payments and helps treasurers allocate funds actively and in an intelligent way. It is fair to say that the open banking ecosystem operates as a decision support system for corporate users. Banks and fintech partners must avoid developing an open banking strategy in a vacuum (Figure 4).

FIGURE 4: CORPORATE APPS AND THE PLATFORMS USED TO DEVELOP THEM



Source: Aite-Novarica Group research among 15 FIs and fintech vendors between January and May 2020

In this period of pandemic turmoil, corporate treasurers find it more important than ever to express what products, solutions, and services they want from their banks. Aite-Novarica Group research finds that to transform the bank-client relationship and to bring corporate banking to the next level, corporate users expect a collaborative (i.e., co-creation) approach, with banks and fintech vendors working together to design solutions that fit each other's needs.

By implementing digital liquidity management dashboards, corporate treasurers benefit from the immediate results of adopting innovative technology, starting with process digitization and data management.

Breaking the Wall Between Payments and Money Movement

The inability to fully operate due to the COVID-19 pandemic has drained the financial liquidity of an increasing number of companies. Corporate treasurers are living in a changing business world in which points of reference have completely changed. The ability to consolidate and concentrate cash is key. Treasurers must immediately establish centralized cash pools to fully grasp where the cash is, and then establish strong ties with bank and fintech partners to mobilize that cash around the company from areas with excess liquidity to where liquidity is missing. Timely access to information enables corporate users to profitably utilize funds and build key indicators to check if the idle

cash is increasing or decreasing in proportion. Idle cash should always decrease to get the maximum grip on company value.

A combined strategy, both on the receivables and payables side, identifies the company's biggest customers and the biggest amounts of cash inflow that the treasurer is relying upon to maintain target cash flow levels. In case of liquidity shortage, early payment strategies in exchange for discounts on the receivable side can be put in place with select customer segments to achieve receivables quicker while working with partner banks to open a factoring program. Alternatively, on the payable side, supply chain finance instruments offer control on the cash outflows generated and allow the treasurer to implement payment schedules in case of excess liquidity. Large group treasurers are supporting their smaller suppliers through shortened payment terms or by helping them secure trade finance. This ensures both viability of supply and an even stronger supplier relationship for the future.

Liquidity management automation requires the use of a technology capable to extract, elaborate, and share data that provide banks and their clients with new ways to interact and complete transactions, in quasi-real time. The solution to this is a collaborative effort among FIs, fintech partners, and corporate users. Most of a bank's IT core is not prepared to operate in real time and needs the injection of advanced technology from fintech vendors. Modern finance operators need to visualize the sources and destinations of liquidity they are responsible for. Most importantly, decision and action must follow and be immediately executed to move that liquidity where it's most needed.

Liquidity management treasury modules offer treasurers the possibility to overlay the predicted cash collection values with the scheduled spending already fed into the module from the company's ERP system. At the same time, the liquidity management treasury module knows the cash balances from the connected bank statements, so it becomes possible for users to assemble all of this information and predict the likely cash balance for the incoming days. With this visibility, corporate users are empowered to predict the cash budget necessary for managing the company's spending. For this purpose, payments modules must be able to filter the cash outflows by spending type so that users can decide whether to include payroll or supplier invoices to check the cash balance.

A liquidity management platform's API-based connectivity and its operations layer modules make it possible to see cash positions in real time and execute payments in real time, which provides the possibility to do real-time investments with any surplus cash.

EASIER, FASTER, CHEAPER: BUSINESS DRIVERS FOR RETAIL PAYMENTS INNOVATION IN EUROPE

The digitalization of commerce continues to drive merchant demand for payment solutions that are fast, transparent, less risky, and cost efficient. With the arrival of open banking, new payment models are emerging to compete with card payments as the dominant online payment method.

In Europe, the PSD2 has opened the payment arena for PSPs to innovate and deliver new payment services for digital commerce. To facilitate the settlement of a commerce transaction between a business and its customer, the PSP can leverage PIS to offer open (banking) payments to end users as an alternative to card payments. Open payments are A2A payments that are initiated by the PSP directly from the customer's bank account (with the customer's consent) and credited to the merchant's account.

OPEN PAYMENT MARKET TRENDS

Open payments are expected to take an increasing share of European payment volume as a result of trends in client demand, the availability of real-time infrastructure, and regulatory support (Figure 5).

FIGURE 5: MARKET TRENDS DRIVING THE GROWTH OF OPEN PAYMENTS IN EUROPE

Market Trends Driving the Growth of Open Payments in Europe

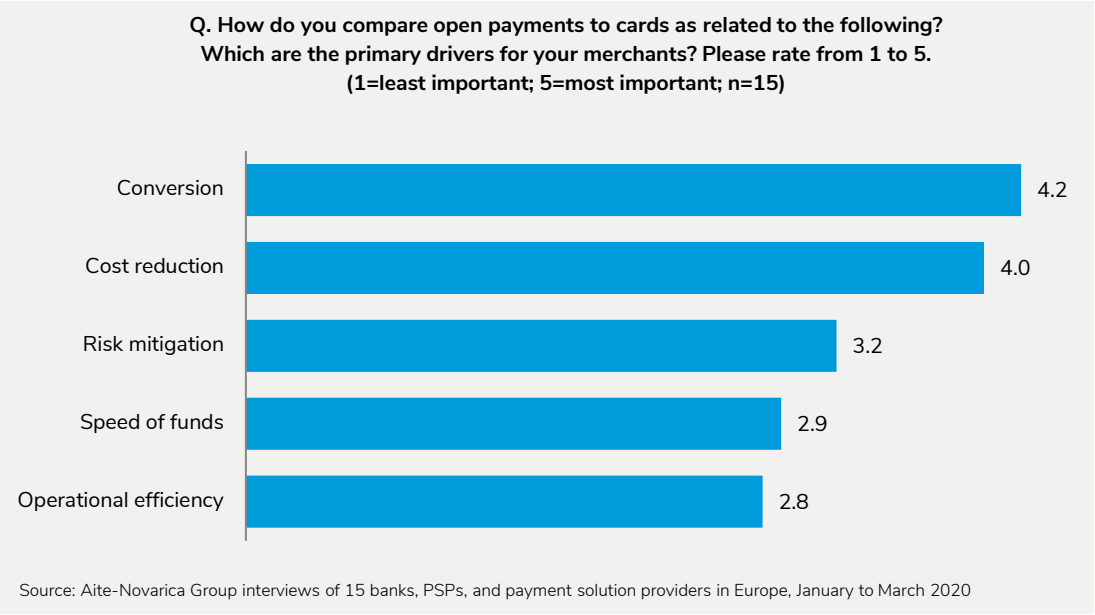
Companies are looking for new payment solutions	• Companies want alternatives for inefficient payment instruments to reduce cost, better serve their customers, and streamline their operations.
Instant payment facilitates open payments	• The new schemes for instant payments will put open payments at an advantage over cards, incentivizing merchants to steer to open payments.
Regulators are pushing for more competition	• Uncomfortable with the dominance of the global card networks, European regulators are pushing for more competition in the payments market.

Source: Aite-Novarica Group

Companies Are Looking for New Payment Solutions

Online merchants have a growing interest in adding open payments as a new payment method to their checkout page, as open payments can offer several advantages over cards. According to research by Aite-Novarica Group, conversion and cost reduction are the primary drivers for merchants to adopt open payments as a payment method (Figure 6).

FIGURE 6: PRIMARY DRIVERS FOR MERCHANTS TO ADOPT OPEN PAYMENTS



Source: Aite-Novarica Group interviews of 15 banks, PSPs, and payment solution providers in Europe, January to March 2020

Conversion

The user experience is critical for any payment method to drive conversion, and open payments are no exception. Consumers have a low tolerance for friction in the checkout process, and shopping cart abandonment is the main issue in e-commerce. Making a payment should be easy. For instance, having to type in payment details such as card number or IBAN is a dissatisfier for consumers and may lead them to abandon the transaction. Open payments can help to mitigate this problem by allowing consumers to pay without typing in payment details.

If merchants can control the customer journey end-to-end and avoid friction in the checkout process, open payments can certainly compete with cards on the user experience. At the same time, introducing open payments will require promotional

activity to educate customers and make them comfortable with giving consent to access their account.

Cost Reduction (Lower External Fees)

Reducing the cost of acceptance is important, particularly for large merchants. Card payments are priced at a fee that includes acquirer margin, interchange fee, and card scheme fees. Merchants have a long history of combating card processing fees, as they feel that these fees are overpriced due to the market power of the card networks. The most recent example is Amazon's dispute with Visa about U.K. credit card fees.[9]

Open payments will give online merchants an alternative to card payments that should attract lower pricing, as open payments incur no interchange fees or card scheme fees. The cost reduction can be a significant driver for merchants to favor open payments over cards. Open payments can be up to four times cheaper than card payments.[10]

Instant Payment Facilitates Open Payments

Open payments will increasingly make use of the instant payment mechanism to allow instant credit to the merchant account. This is an advantage over card payments, which can take several days to settle depending on the contract that the merchant has with its acquirer. Small merchants may benefit from faster liquidity. Large sellers will see less benefit in immediate credit. The important factor is the payment guarantee so goods or services can be delivered. However, there are also cases in which immediate credit is an important advantage—for example, for online gaming and money transfer services.

Instant payments are immediate, are irrevocable, and allow for the exchange of rich data (important for business-to-business applications). Companies benefit from instant payment rails to provide faster liquidity, reduce risk, and lower payment cost.

Clearly, instant payments will be at the core of payment innovation and the development of open payments for both online and in-store applications. The next wave of payment innovation may happen at the point of sale (POS) or, rather, the point of interaction, which includes in-store transactions as well as other environments, such as online payment pages and vending machines. In the Netherlands, popular mobile payment

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[9] Matt Scuffham, "Amazon May Drop Visa as Partner on U.S. Credit Card," Reuters, November 17, 2021, accessed December 13, 2021, https://www.reuters.com/world/uk/amazon-stop-accepting-visa-credit-cards-britain-2021-11-17/.

[10] See Aite-Novarica Group's report The Road to Open Payments, April 2020.

apps (e.g., MobilePay in Denmark, Vipps in Norway, and Swish in Sweden) are used for almost any use case, including P2P payments, commerce payments, bill payments, and ticketing. Payments are made in real time. These solutions use bridging technology, such as QR codes, to enable online A2A payments at the POS.

This way, instant payment rails and open banking form the ingredients of a powerful cocktail of payment innovation and the development of open payments.

Regulators Are Pushing for More Competition

The European regulatory agenda for the internal market has a strong focus on competition and innovation in the payments market, strengthening the internal market and breaking up the perceived oligopolies of banks and card networks. PSD2 has enforced open banking via access to the bank account, leveling the playing field for PSPs to provide account information services (AIS) and PIS, and to compete with banks.

Open payments will benefit from the regulatory push to create an efficient internal market for payments and stimulate payment innovation and competition. Additional regulatory guidance and legislation can be expected to remove existing barriers for open payments and accelerate the road to critical mass.

OPEN PAYMENT USE CASES

Open payment use cases can help companies provide better payment experiences, not only for e-commerce but also in other online environments to replace legacy payment methods, such as bank transfers and checks. Examples include the following:

- **High fee environments, such as travel industry/airlines and luxury goods:** Open payments enable high-value purchases (no risk), eliminate chargebacks, and reduce cost.
- **Repeat businesses with high velocity and returning customers:** Such businesses can offer loyalty programs to convert consumers to open payments.
- **Gaming/gambling industry:** Clients are more used to a wider choice of payment methods, as issuer risk policies limit the use of cards. One example of an open payment implementation in this industry is Trustly's Pay N Play solution. Using open

payments, users can complete registration, wallet loading, and customer verification in one step.[11]

- **Companies with an online presence that only accept debit payments, such as bank transfers, debit card payments, and checks:** Using open payments will improve the reconciliation of receivables, as the payment reference is automatically included. An example is property/rental payments in countries such as the U.K.
- **Financial services—for example, money transfers and credit card repayments:** One promising use case is POS finance, combining PIS with AIS to obtain a real-time credit score on a customer during a transaction and offer an instant loan to that customer.

OPPORTUNITIES FOR BANKS

Open payments are a strategic opportunity for banks and PSPs to offer innovative account-based payment services to their clients. FIs that go beyond compliance and integrate open payments into their payment strategies will create new customer value and compete for the increasing share of A2A payments in commerce and other industries. According to research by Tink, the mean spending by retail banks on open banking in 2020 was 84 million euros. Open payments (based on PIS) were seen as the most important use cases across all segments.[12]

Given the current fragmented infrastructure and lack of API standards in Europe, banks and PSPs should consider working with specialized aggregators to provide the backbone connectivity for PIS, rather than build the connections with thousands of banks in-house. Banks and PSPs will then accelerate time to market and reduce investment for PIS deployments.

To complement their offering and deliver a comprehensive payment solution, providers can offer value-added services to their corporate and small and midsize enterprises (SME) clients, including refund management, consolidated reporting, and reconciliation. These services should work in harmony across all payment methods globally.

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11. "Appetite for Disruption," iGaming Business, accessed March 23, 2020, https://magazine.igamingbusiness.com/2019/03/19/appetite-for-disruption/content.html.

12. "Following the Money," Tink, 2021, accessed December 10, 2021, https://tink.com/survey-reports/investments-use-cases.

CONCLUSION

FIs:

- FIs should avoid developing an open banking strategy in a vacuum. They should use open standards that are shared by the entire financial ecosystem for the secure exchange of financial data.
- As more and more fintech firms are looking for bank partners to provide banking services, banks have a significant opportunity to offer a BaaS solution and develop new relationships with enterprises, creating new revenue streams.
- FIs that go beyond compliance and integrate open payments into their payment strategies will create new customer value and compete for the increasing share of A2A payments in commerce and other industries.

Businesses:

- Merchants should consider offering open payments to streamline the checkout process and reduce the external cost of payment processing. However, introducing open payments will require promotional activity to educate customers and make them comfortable with giving consent to access their accounts.
- Fintech companies and other enterprises should partner with FIs to monetize the embedded finance opportunity, which is estimated to be worth US$230 billion by 2025.
- Fintech firms should engage with the whole financial services ecosystem of FIs, other fintech companies, and eventually credit reporting agencies, regulators, and everyone who's involved in developing and supporting the use of open and common standards.

ABOUT AITE-NOVARICA GROUP

Aite-Novarica Group is an advisory firm providing mission-critical insights on technology, regulations, strategy, and operations to hundreds of banks, insurers, payments providers, and investment firms—as well as the technology and service providers that support them. Comprising former senior technology, strategy, and operations executives as well as experienced researchers and consultants, our experts provide actionable advice to our client base, leveraging deep insights developed via our extensive network of clients and other industry contacts.

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