New Challenges for Open Banking - Between Past Weaknesses and Future Potentialities

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Abstract

Considered one of the milestones of the second European Payment Services Directive, the concept of open banking has, indeed, brought a novelty to the financial scenario. The idea of opening up access to consumers' banking information to third parties - so far the prerogative of the banks - certainly has a revolutionary scope. A few years after that moment, it is perhaps worth asking whether open banking actually brought that long-awaited revolution to the financial system.

Questioning its limits, analysing its criticalities, and keeping open banking at the core of the political and regulatory debate can help to overcome these limitations and move it towards the broader concept of open finance, a concept that will see the forthcoming Payment Services Directive as the regulatory vehicle on which the European institutions will focus their activity.

Open banking seems to suffer, today, from an inefficient implementation, incapable of exploiting its potential: the expectations associated with the emergence of genuinely new subjects, and truly bearers of value-added services, do not seem to have been fully met.

However, the new challenges of geopolitics and the legislative innovations that the European Union is working on, from the digital euro to Instant Payments, could mark the turning point towards a truly effective open banking, capable of bringing innovation and competitiveness, and thus, of repopulating the Fintech world with new players

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Introduction

The principle behind open banking, i.e. allowing third-party financial service providers to access consumers' banking information, is considered to be one of the cornerstones underpinning the Second Payment Services Directive.

It is through open banking, moreover, that the European legislator intended to foster the emergence of third parties - the notorious TPPs (Third-Party Providers) -, harbingers of innovation, stimulus, and competitiveness in a financial system to be opened up and populated by new players, to balance the oligopoly of the major banking subjects that, until then, had dominated the European and world economic scene.

More than seven years now, after the issuance of the Directive, it seems to be an opportune time for a reflection on how and whether this principle has been correctly implemented, and whether open banking has indeed contributed to open innovation in the financial sector.

The new challenges of geopolitics and the new legislation on which the European Union is working, and which will soon become reality, will lead to a rethinking of open banking, which to date seems to have been caught in the meshes of a less than optimal implementation, unable to fully exploit its potential.

The revision of the Payment Services Directive, the new Regulation on Instant Payments, the rulebook on the SPAA Scheme, and, last but not least, the great and challenging test of the Digital Euro, could change the face of open banking for the better, leading it to actually achieve its goal: to create competitiveness in Fintech and foster the emergence of new, truly ground-breaking value-added services.

Open banking - Some considerations on PSD2 implementation

The second Payment Services Directive aimed to create a banking system based on open data, requiring banks to open up their application programming interfaces to third-party developers, in order to overcome the competitive logic between these subjects and open the way to start-ups, fintechs and new innovative realities.

The fact that banks were obliged to share their account holders' information with third parties was, in fact, a revolutionary concept, a picklock able to disrupt the traditional financial model and open it up to competition between old and new players in an environment - the banking one - in which the revolution that had already characterised other sectors had not been triggered until then.

At the core of this revolution is the opening of European banks' APIs to allow third parties access to payment data. It is worth asking, in this regard, whether this has actually led to more competition in areas of traditional bank dominance.

Borrowing a term from game theory, PSD2 intended to trigger what is known as 'coopetition' between banks and third parties: cooperation between competitors that increases the benefits for all players and makes the market win-win, with a profitable outcome for all competitors when they cooperate.

Well, co-opetition, a term that returns often in the open banking debate, seems far from having occurred, both for banks and third parties.

First of all, many traditional banks, in order to compete with the emerging third parties, have ended up creating new banks, entities that are, to all intents and purposes, listed as 'traditional' rather than new. Banks that are banks, but appear as TPPs: a circumstance, this, rather far from the principle of competition to which open banking should aspire.

Looking, however, from the perspective of third parties, as the market consolidates, it is possible that many players will be acquired by larger players, foreshadowing a scenario, also from the TPP side, in which a few, large incumbents will be the leading providers of the future - a scenario closer to concentration than to competition.

The reason why this scenario can be considered plausible is, surely, an inadequate implementation of the Directive by banking entities, whose implementation of open banking platforms remains far from expectations.

To compensate for inadequate bank APIs, the TPPs that came into being thanks to PSD2 are, in almost all cases, entities that implement and manage APIs, rather than entities that provide banking services: entities, therefore, whose intermediation is necessary to access open banking services.

Although these are services with a high added value in terms of innovation and technology, looking at the general offerings of the companies created by the Directive, what emerges is that they are primarily developer of as-a-service solutions, software solutions that enable banks to be PSD2-compliant, to offer

API interfaces for TPP providers in order to allow access to the end customer's current account.

Third Party Providers were conceived, in the idea of the European legislator, as subjects necessary to stimulate competition in a sector traditionally dominated by the large banking incumbents and thus to expand the range of financial services available to the customer: asset management, savings and investment, payment management, credit scoring, lending.

Services which, however, in the majority of cases, continue to be provided by traditional banks, often using in-house companies that provide the service and which, although they are listed as TPPs, certainly cannot be classified as 'newcomers'. These entities cannot be said to have contributed to increased competition in the provision of value-added financial services.

On the other hand, the entities that really came into being by exploiting the Directive's potential are companies that can be properly ascribed to the IT category - rather than Fintech - which, aware of the banks' implementation limitations, specialised in developing complex and comprehensive IT solutions, capable of compensating the banks' insufficient APIs.

Finding minimum common standards on API

So far, the impression is that the Open Banking paradigm is still in its early stages, and its potential benefits could materialise further.

The efficiency deficit of APIs and the banks' difficulties in finding an effective solution surely also stem from the inconsistent implementation of the Directive among the Member States. The divergences in the implementation of APIs, due to regulatory divergences between the Member States, constituted a substantial barrier to the full implementation of the directive's goals. As a result, greater difficulties have emerged in promoting and developing European rather than national solutions, with all that this has entailed in terms of fragmentation and - therefore - barriers to the emergence and access of new players in the financial services market.

The absence of common criteria enabling the market to develop technical implementation standards also led to integration problems, long lead times for API adaptation, and the need for prolonged testing phases.

The revision of the Payment Services Directive will necessarily have to take these aspects into account. It will be crucial to find the balance in ensuring the adoption of common minimum standards while avoiding the adoption of a legislative framework that risks blocking or slowing down technological developments.

Currently, a number of standard-setting organisations coexist in Europe, whose role is generally limited to the publication of periodic API specifications, the implementation of which is then left to the individual banks, with all that this entails in terms of fragmentation and high integration costs - again, barriers to entry to the detriment of the emergence of new players.

It could be argued that TPPs were born with the aim of being able to co-exist with different technologies, to the point of making the banks' weaknesses their strengths: they built business models based on the creation of unique APIs for those who do not want to deal with technical differences.

Once again, a missed opportunity - and one that must be recovered - for the hoped-for creation of a competitive environment in which new, *genuinely* Fintech players can bring value to the financial ecosystem.

It will be interesting, in this regard, to follow the developments of the SPAA Scheme and the recently published first version of the Rulebook. A set of rules, practices and standards that will enable the exchange of payment account data and facilitate the initiation of payment transactions in the context of the Directive's 'value-added' services could indeed be a way of revising the potential of open banking in an efficient and competitive manner.

Between the new Payment Services Directive and Digital Euro - the possible future for open banking

A new perspective on open banking may come from the revision of the Second Payment Services Directive. The trend towards more and more open data has in recent years extended to new areas such as insurance and asset management. The growing interest of Big Tech in the financial sector, the platform economy, and the impact of the recent conflict on geopolitical settings and global finance are irreversibly changing the order of priorities in European economic and monetary policy.

Looking at PSD2, it is noticeable how the European legislator set itself the objective of combining the concept of open data with the necessary security guarantees. An objective that is certainly still relevant in the transition towards a broader concept of open finance; however, not the only one and no longer the priority. The axis seems to be shifting, more and more, towards the new paradigms of competition and sovereignty.

The existence of large BigTechs increasingly playing a leading role in the financial services market forced the European Union to adopt measures to tackle abuses of dominant market positions and to prevent access to data from becoming the exclusive monopoly of non-European players. Moreover, the development outside Europe borders of stable digital currencies was immediately perceived as a risk to European monetary sovereignty.

Protecting European economic sovereignty from the above-mentioned threats is probably one of the most important reasons behind the decision to implement the digital euro.

While the issuance of a digital currency is a huge challenge, this may indeed be the challenge that can take open banking to the next level and really meet its goal of populating the financial services market with new players.

Financial services are going through a period of great change in a very challenging economic and geopolitical environment, and it is in this context that the digital euro is taking shape: the hope is that these challenges that are accompanying its creation can make it a resilient, receptive financial instrument, capable of adapting to the backdrop of a shifting economy.

Access to the digital euro by a plurality of actors - be they credit institutions, payment institutions, e-money institutions - will have to be guaranteed by a set of common rules, guarantees and minimum requirements, in order to achieve the goal of making it an instrument capable of responding to new consumer needs in terms of fast and secure digital payment instruments.

To achieve this goal, it will be essential to think of a way of accessing deposit data in Digital Euro that is uniform, standardised, and capable of facilitating the emergence of new players and enabling existing ones to create new value-added services for users based on the Digital Euro.

In this scenario, truly high-performance open banking could really be the key to the implementation of a truly universal digital currency in terms of access and use.