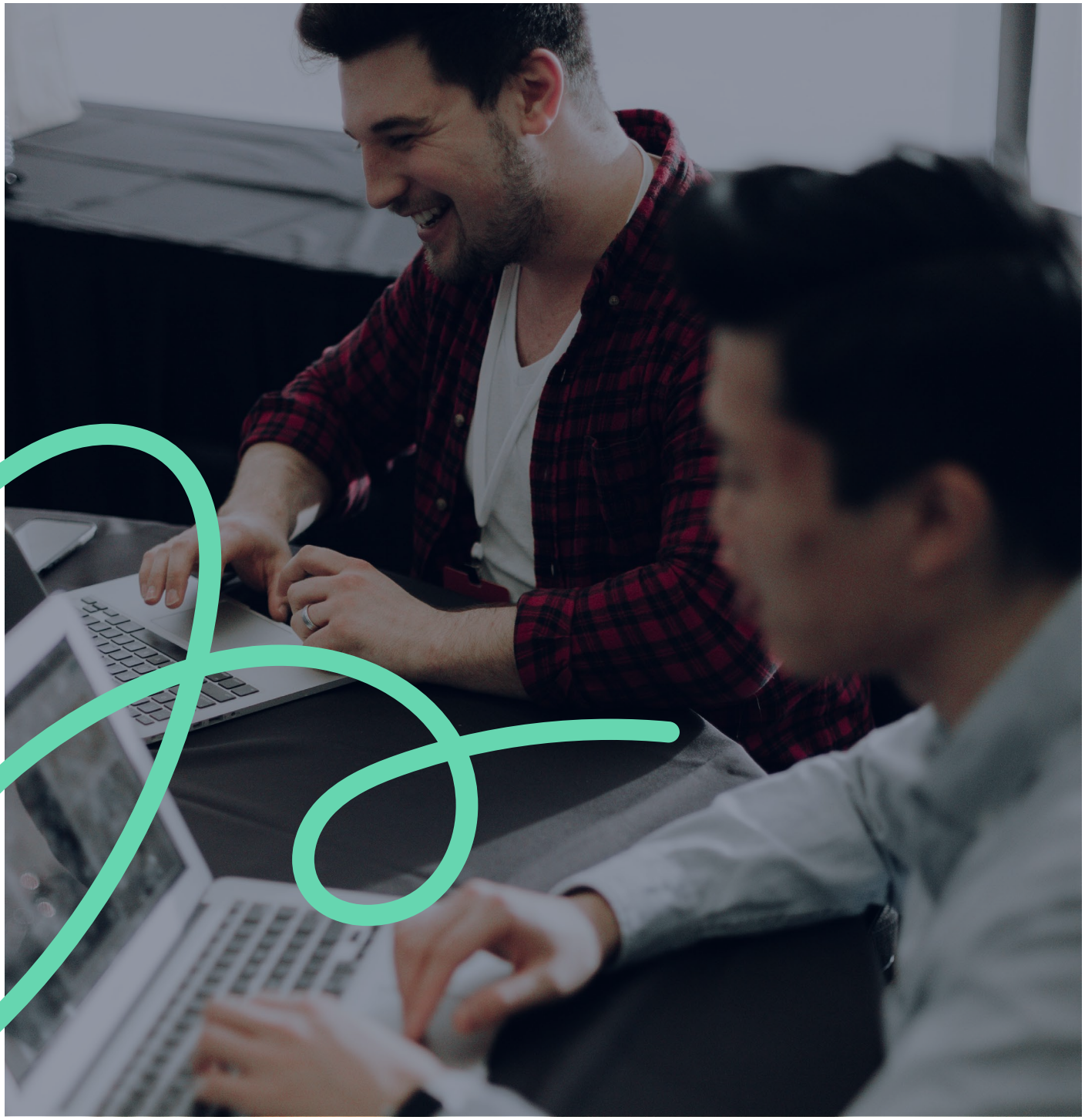

Open Finance:

Shaping the next-gen data-driven financial services

Spread your banking to the underserved and make intelligent decisions through data insights

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Table of Content

Executive summary

Today, open finance is a trending topic in the fintech industry. The technology and legislation for it can disrupt the financial marketplace, unlocking new opportunities for businesses and consumers and creating an atmosphere of innovation.

Open finance can be interpreted as open banking 2.0, expanding the original scope to greater depths of secure data sharing with the customer's consent, among other things. The idea is to get more information than a payment account can provide. For example, does the user invest money, and in what? Does she have a mortgage? How much pension savings she has? Essentially, consumers will have greater control of their data and more freedom to pick the companies and products.

We live in a world where every aspect of a person's data can be leveraged. Open finance will allow such intense personalization to consumers and offer merchants the technology to do them quickly and securely.

Of course, the world is slowly embracing open finance. The Berlin Group's standardization initiative, the first steps of Brazil, South Africa, Australia, and Europe - all point to this new trend.

Want to know more? Explore this whitepaper to learn about:

- Open banking vs. open finance
- Relevance to the customers, banks, and TPPs (third-party providers)
- Selected use cases
- Regulations, challenges, and the future.

Introduction

The banking and financial institutions are moving towards an open ecosystem. Such an ecosystem provides a better view of customers' overall financial health and helps them to make better financial decisions. "Open finance" is the logical next step to "open banking." Unlike open banking, no regulations surround open finance now. Both open banking and open finance aim to break the monopoly and introduce competition in the BFSI space.

Open finance aims to provide control of the financial data to the customer. The customer chooses to whom the data should be shared. This enables them to share data with TPPs or applications that provide the best value. The value could be better financial planning, investment recommendations, better offers, better financial products, etc. Unlike open banking, open finance aims at providing data like wallet transactions, access to loan accounts, crypto wallet transactions, and transaction data from gig economy apps – stuff that is beyond the scope of open banking regulations.

Open finance aims to gather data from all possible accounts, gig economy applications, payment wallets, and crypto wallets with the user's consent. The open banking regulations have forced banks to modernize their systems and act as the base for innovation related to open finance and open data.

What's in for the customer

At the core, open finance will allow deep integration into a user's financial data. This will add to financial literacy, ensure financial inclusion to the underserved, and economic growth. Open finance will democratize data; users can control access to their financial data. Data transparency will ensure that customers make more informed financial decisions. The already established consent mechanism in the open banking ecosystem can be leveraged.

Open finance will enable new players to extend services that will help people working on gig-economy-based jobs get into the financial ecosystem. People working gig-based jobs usually receive money through non-banking channels like wallets and cash. Due to the nature of the jobs, these people are rarely connected to the banking systems. Open finance will allow these people to connect to the system and better manage their finances. This will create an opportunity for TPPs to provide better customer offers and products based on the data available. Plific is an example of such a system that is helping gig-based workers in Brazil manage their finances better and more efficiently.

What's in for the banks and TPPs

Open finance levels the playing field and creates an atmosphere of healthy competition in the finance ecosystem, like open banking did in the payment space. Today customers are free to choose payment applications instead of the banks' net banking portals. The choice might depend on the rewards, ease of use and/or features offered. This trend forces TPPs and banks to provide innovative solutions to their customers, leading to more customer-centric banking.

Banks and TPPs can leverage the open finance framework to provide better-customized offers based on the customer's overall financial health. The framework would open doors not only for gig-job workers but also help small businesses get better loan offers from the banks. As per a survey conducted with gig workers, 50% reported being denied a financial service at some point - out of which 49% believed that they could repay the financial products they were denied. The banks could use the data open finance offers and evaluate the associated risks while extending loans to gig workers. The system will open a new dimension for credit rating and risk analysis.

The inclusion of this new customer section will increase the user base for banks and other financial service providers. By being early adopters of the open finance concept, banks can position themselves as tech-savvy and new-age that focus on technology and provide innovative solutions. A large user base is an indicator of better services and trust in the industry.

The open finance framework will ensure better financial inclusion and take banking to the doors of the underserved. An example is from India, where UPI revolutionized digital payments. Today, monthly UPI transactions are in excess of 6000 million. The success can be attributed to the inclusion of small businesses into the digital payment ecosystem without the hassle of owning PoS machines and paying hefty fees for each transaction. The system just requires a simple mobile app, and the merchants instantly receive funds in their bank accounts. A similar shift can be expected with open finance. The growth of the financial sector is only possible through financial literacy and the inclusion of people with non-regular incomes. The banks that leverage the open finance framework can take their services to the underserved population through loans and offers. This would mean a larger user base. Once these users are connected to the financial ecosystem, they will realize the benefits and possibly continue to be loyal customers of the banks.

Unlike open banking, open finance is not regulatory compliance and could present better monetization opportunities for banks. Open banking regulations have already forced banks to modernize their infrastructure. This new infrastructure can now be used as a foundation to build open finance over it. It's important to open systems that are not under the purview of open banking, like loan accounts, card accounts, insurance details, and investment accounts. They can be a good starting point to explore the scope of open finance.

The amount of data that open finance brings to the table is huge. Banks and TPPs could utilize this data and create AI-based solutions that offer investment advice to customers or guide them toward their financial goals by course correction (based on their overall financial standings). Parameters like loans, investments, and assets that customers hold but are currently not part of the open banking framework could prove to be the game changers for AI-driven platforms. By building such platforms and integrating them into the net banking portals, banks can better place themselves against the tech giants and new-age start-ups that focus on technology to make more customer-centric applications.

Use cases

1. Availing loans

Open finance can help people with no or messed-up credit history (due to missing EMI payments) get closer to availing of better bank offers. As per GAO, it is estimated that roughly 45 million people in the US don't have a credit history due to not owing a credit card or taking a loan. Open finance can limit the number of statements needed and fill in the credit rating gaps to process a loan, thereby providing a quicker loan disbursal.

Imagine a student without any credit history and seeking a loan for higher education or a vehicle. Throughout college, she worked hard to pay the fees; she might have worked on freelance projects for which she was paid through wallets or cryptocurrencies. A bank in the open finance ecosystem could request her consent to share this data. And based on the data, the bank can calculate the risk involved and offer her a loan. The bank will gain from a long-term relationship and deep-rooted customer trust.

Similarly, those that have survived and lived through global recessions and pandemics likely have missed an EMI or two. This adversely affects credit ratings. You, as a survivor, have learned to maintain multiple earning streams and invest in diversified asset classes. But when you approach the bank for a loan or a credit card, that missed EMI always remains a part of your credit history. Under open finance, you could simply share the data with the bank to reflect your financial health and avail yourself of the best offers.

2. Mortgage lending

In countries like Japan, the Netherlands, or France that rely heavily on steady income sources, length of employment, and proof of income to determine the creditworthiness of a person, open finance can limit or reduce the amount of paperwork needed. A simple button click can provide all the necessary information: it can fill credit rating gaps or provide income proof for gig-based workers.

The impact open finance has is far-reaching. Tenants or small businesses can provide their overall financial health data (from investments and insurance) to landlords and prove their creditworthiness. In short, the sole reliance on credit rating companies can be reduced. The integration will ensure less manual effort; automation can handle most paperwork and compliance.

3. Safeguarding lenders against bad loans

Lenders can utilize the open finance framework to control their risks when approving loans. People/businesses with good credit history may make bad investments or be overspenders. Open finance can be used to pull in the entire financial standing of such users/businesses, and lenders can make informed decisions to reduce risks against default. Data-driven decisions while providing loans can help prevent an economic crisis like that in 2008. Data available digitally through APIs can ensure better automation of the credit rating systems on a larger set of parameters and lesser human intervention, thereby providing better and consistent credit risk analysis.

4. One-step investment advice

Imagine seeking financial assistance from an investment banker. You would need to collect your financial data from various bank accounts, current investments, insurances, etc. Using open finance, you could simply link all the data into one platform of your choice and download it in real-time with just a button-click. You can then ask him to analyze and give you the best investment suggestions. Similarly, an investment platform can use AI to provide investment advice based on your overall financial health.

Such platforms can guide users about their risk exposure based on their risk a ppetite and financial health. They can suggest diversification across asset classes to reduce risk and make the most gains. They can suggest pensioners invest in relatively safe classes but offer good returns.

Regulations and standards

Brazil seems to be leading in the open finance space. In December 2021, Brazil announced the last phase of open banking - which can also be considered the start of open finance. The regulation extended open banking beyond the traditional boundary of banking data and has included investment, insurance, pension, and exchange operation in its last leg. The last phase is scheduled to complete by the end of 2022. In a similar move, Australia has allowed sharing of data on loans, bank accounts, personal loans, and offset accounts with accredited organizations on user consent.

The "Berlin Group," a widely adopted open banking specification, is also working actively to design open finance API framework. The framework is built on top of NextGenPsd2 API framework. This framework will open access to new account types, such as savings, loans, and securities accounts. The framework also aims at extending payment services to include Pay by Loan, Request-to-Pay, and Reservation of Funds, on direct access APIs for corporates and digital contracting, and on SEPA Direct Debit eMandates.

With more standardization and implementation of open finance, we could see new players enter the financial sector. We have already seen an uptick in tech companies venturing out into the payment space with products such as Apple Pay, Google Pay, WeChat Pay, and WhatsApp Pay. We can expect similar participation in other areas, such as insurance and investments. Tech companies bring a host of technical expertise which helps them design simple, useful, and customized solutions for various user segments. Such increased market competition prompts better offers for the end customers.

Technology and challenges

Open finance focuses on opening the bank systems that have traditionally been closed ecosystems. This brings some security concerns and technical challenges. However, the choice of technology and expertise can minimize these concerns. Like open banking, open finance can be built on APIs. APIs are shaping the future of the banking and financial services industry by allowing banks to open their systems securely. API management helps banks better maintain, secure, and monetize their API solutions. The security challenges are well handled by APIM solutions today. Securing the API against unauthorized access stays on top of the list.

Another challenge could be customer credibility. Data-sharing frameworks like open banking and open finance are often scrutinized from a privacy point of view. This is mainly due to the lack of knowledge of how these systems work and what data is shared. Customers often don't realize they can control the amount of data they want to share. A mechanism like consent management for data sharing is integral to such frameworks. Banks and TPPs will have to make a conscious and continuous effort to educate the customers on how they can control the data shared to gain their trust in the system.

Banks will face competition from other banks and TPPs. Banks may need to adopt new strategies and innovative solutions to bring business. The increased competition may also lead to lower margins for banks. Early investments in the open finance system will ensure banks remain relevant in the long term

Conclusion: The future

Open banking was the first step to a data-driven economy, and open finance is the natural evolution. Brazil's first step towards open finance and Berlin Group's standardization initiative are clear indicators of open finance's potential. The European market seems to be moving towards open finance. South Africa and Australia are already working toward implementing open finance regulations.

The move towards open finance ensures data collection via more secure channels rather than relying on screen scraping mechanisms. Summing up, open finance is an opportunity through which the TPPs and banks can collaborate rather than compete to provide better services to their customers.

About the author

Ankur Sinha
Ankur has 9+ years of experience in the IT industry, working in multiple domains like BFSI and telecom. As a technical architect, he works on multiple technologies like Java and NodeJs. He has been actively designing API and API testing frameworks. He is primarily responsible for developing open banking APIs for one of the largest banks in Central and Eastern Europe.

About Nagarro

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We have a broad and long-standing international customer base, primarily in Europe and North America. This includes many global blue-chip companies, leading independent software vendors (ISVs), other market and industry leaders, and public sector clients.

Today, we are over 18,000 experts across 33 countries, forming a Nation of Nagarrians, ready to help our customers succeed.

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