OPENBANKPROJECT

# How to Regulate Open Banking

## Blog Post

Written by Ismail Chaib

The financial services industry is bringing about a revolution in how software solutions are manufactured and delivered to end customers. The services which we know as **Open Banking** enable individual customers and businesses to share their financial data with third parties. As a direct result, consenting customers can now benefit from a host of innovative applications for use outside of their bank's 'walled gardens' - people with hearing issues might use an app which speaks their account balance to them, young graduates living on a tight budget might benefit from an app which helps them manage their finances and saves automatically, SMEs can quickly compare loan products from various banks to choose the most appropriate.

This openness is a quiet revolution. The banking industry, traditionally closed and secretive, is being forced to rethink its basic model in order to work in a more collaborative manner with other banks and with with up-and-coming fintech startups. This response to customer demand of course comes with a plethora of challenges; issues of security, liability, business models and partnership at scale are all radically new dimensions unimaginable only a few years ago.

Today, as the technology matures and a number of banks begin to show the way forward in Open Banking, some regulators have stepped in to regulate (or at least provide guidance) for the rest of the banking industry. Gartner estimates that regulators in 50% of G20 countries will create an open banking API standards or gateways this year[1].It all began, as so often, in Europe. My boss Simon Redfern and I started banging the drum for the idea of Open Banking some five years ago. Our ideas about openness, transparency and data sovereignty found echo in both the European Commission and the UK Treasury. As a result, both Simon and I contributed significantly to the UK Treasury-commisioned Paper on Open Banking back in 2014 and to the UK Open Banking Working Group. The world's first regulation mandating open APIs for the 9 largest banks in the UK became law as the result of these initiatives.

Since then, further countries have jumped aboard the bank-wagon and have begun exploring Open Banking regimes suited to their local context (the latest is New Zealand, who debuted an industry API pilot led by Payments NZ in March 2018). We've kept a close eye on these developments and in some cases we've used our technology and expertise to help out.

# Why Open Banking?

One thing that regulators around the world agree on is the fact that Open Banking is a formidable tool which can:

- foster competition in financial services and create a level playing field
- drive innovation and unleash the full power of the fintech revolution

Both of these goals help provide better services to end customers and drive prices down. In an Open Banking world, an individual can easily move an account to a more competitive or accommodating challenger bank, an SME can easily obtain a loan via a new fintech startup who, having been granted access to the organisation's bank accounts, make their offer based upon their specific analysis of the SME's transactions and requirements.

# Regulating Open Banking

Our team has spent the last few months reviewing various regulatory standards, legislations and working papers produced by regulators and industry bodies involved with Open Banking. This has helped us gain key insights into where markets are heading as well as an overview of the essential elements of a good Open Banking regime.

With this work in progress, we are already able to identify a number of key dimensions underpinning this action. Here below are the issues which we most often encountered:

[1] Hype Cycle for Open Banking APIs, Apps and App Stores - K. Moyer, Gartner, 2015

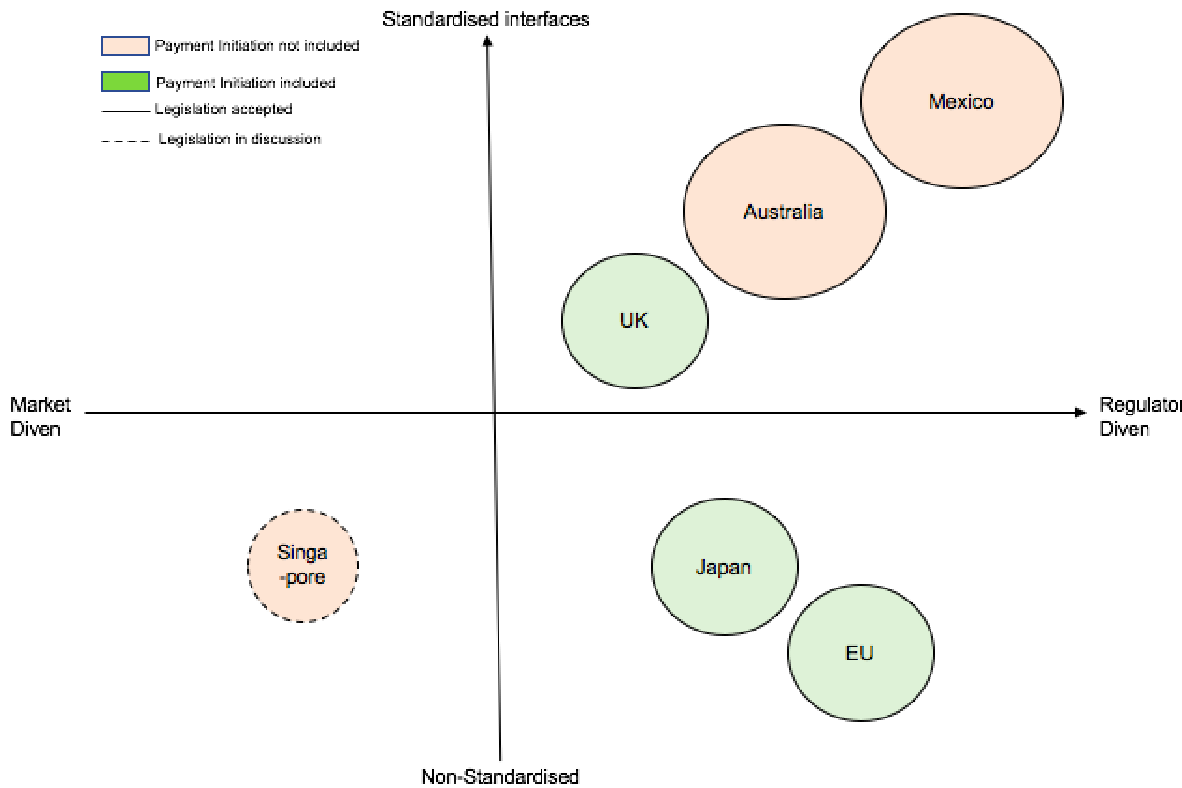


**Figure 1: Mapping of current & upcoming regulations globally**

1. **Target:** which institutions should be targeted by the Open Banking regime? UK regulators exclusively targeted the UK's **nine largest banks**. In Australia, the regime will affect the **four big banks** first and will subsequently spread to the rest of the market. In the EU, PSD2 encompasses both **retail and corporate banks.** To achieve effective regulation, it is important to have a clear vision about **which financial institutions**, of **what size and** in **which line of business** are in the scope of proposed regulation.
2. **Top-down vs bottom-up:** would the regime be legally mandated or is compliance proposed on a voluntary basis? Determining whether Open Banking is left to the market or is brought about through law is a crucial step towards implementation, and will have tremendous impact on all other dimensions.
3. **Assets to open up:** which internal services should be opened to third parties? Should the openness be applied to core services such as access to accounts, transaction history and KYC, or limited to non-core services such as ATM, Branches & Products and Loyalty points ? Is it read-only services (e.g. transaction history) or should it also include payment initiation?
4. **Governance & Standardisation:** are these services made open via a common interface or is each institution required to devise its own interfaces? Who decides about interface requirements and how does the standard evolve? Well-designed standard interfaces are more attractive for fintech, but a fixed standard might in some instances present a roadblock to innovation.

5. **Security & Liability:** how is security handled? If something goes wrong, who is liable? How does authentication actually work and how is personal data stored and processed? Due to the sensitivity of the issue, security must be thoroughly addressed and strict checks and balances must be established. In this area, industry standards such as OpenID Connect have emerged to begin to address these issues.

Other aspects such as **monitoring & reporting, data privacy, fraud detection and onboarding of third-party partners** are also critical components of any Open Banking regime. In addition, the inevitable exemptions and specificities of individual countries have to be considered. The list above is by no means exhaustive, but it provides an overview of the fundamental issues to be addressed at the creation of an Open Banking regime.

Perhaps the best way to start grappling with these issues is to experiment in the open: cross-industry working groups, sandbox environments and hackathon events are all ideal tools to test and iterate solutions; no two countries are the same, and everyone can benefit from collaboration. As this report outlines, Open Banking is neither momentary, transient nor geographically specific to Europe. Similar initiatives in Mexico and Australia are underway, as more countries announce their intentions to engage with the Open Banking regime. Regulators and industry bodies around the world would be well advised to seriously engage with Open Banking in preparation for an imminent open future, so does New Zealand!

Many thanks to Martin Gordon for reviewing drafts of this.

## Bio

*Ismail Chaib is the Chief Operating Officer at TESOBE / Open Bank Project, the leading open source API solution for banks. Ismail graduated from the University of Nice, France with a Master's Degree in IT. Passionate about the role fintech can play in society, he is a vocal advocate of Open Banking. He appeared on the Bank Innovation list of 44 Innovators to watch in fintech. Originally from Algeria, he's based in Berlin, Germany. Ismail tweets as @iChaib*

## About Open Bank Project

*Open Bank Project (OBP) is the leading open source API solution for banks. Together with our vibrant global fintech developer community of over 8000 developers, OBP's technology and surrounding ecosystem of tools empower financial institutions to securely and rapidly enhance their digital offerings using an ecosystem of 3rd party applications and services while complying with Open Banking regulations including PSD2.*