# Brussels sprouts a new era for banking

## HOW OPEN DATA COULD TRANSFORM THE ECONOMICS OF FINANCIAL SERVICES

A combination of technological change and regulatory action aims to deliver "common open data standards" in banking across Europe within the next couple of years. The dry terminology belies the powerful competitive forces and disruptive innovation that could be unleashed. This bulletin explores how the economics of financial services might be transformed.

New regulations at EU and UK level will usher in changes that could dramatically reshape the competitive environment for retail banks across the EU and how people use their services. The big shift will be to allow third-party businesses to gain access to banking data and payments mechanisms - with the customer's permission. Regulators and policymakers are hoping that this will kick-start innovation and invigorate retail competition through new digital services and business models.

Our earlier bulletin, *There'll be an app for that*, explored some of the new services that will become possible with the opening up of banking data required by the Second Payment Services Directive (PSD2) across Europe. Potentially the most powerful of these is a personal financial agent.

A personal financial agent would be able to aggregate the details of a customer's financial products in a single place and to transfer funds between accounts in real time. In this way, the agent would be able to optimise the customer's use of different services, helping to reduce the cost of borrowing and to increase returns from savings and investments. And the agent could recommend entirely new products to the customer.

Services focused on each of these elements in isolation already exist, and several new start-ups have said they are working on integrating them all under one hood. Many incumbent banks are exploring their options too.

### The six transformations

There are many good reasons to be sceptical whether personal finance agents will ever come about, let alone take off. After all, foreseeing those innovations that succeed is more of an art than a science.

But let us set the doubts aside and explore what would happen to the economics of financial services if the agents were indeed to flourish.

The arrival of new digital competitors can drive a wedge between banks and their customers. These channels will offer new services that can add value for customers by helping them to manage their money and borrowings across accounts. The traditional vertically integrated value chain of many banking services will be breached. Banks will lose contact with some of their customers. In one way or another, new service providers will capture a share of the value that banks have had to themselves.

It is yet to be seen which organisations customers will trust to provide these services. They could be digital giants such as Amazon or Paypal, or an as yet little-known fintech. Or it could be the banks themselves striving to maintain their primary relationship with their customers and to avoid disintermediation. No doubt customers' sense of security and trust will be important in determining the take-up of the new services, but so will the quality and ease of the user experience.

This would lead to six potential transformations.

- **Banks will offer each other's products.** The key selling point for non-bank agents is impartiality and the ability to offer a range of products from across the market. This means that in order to credibly compete against the newcomers, banks will simply have to do the same. Among the knotty questions that will have to be answered: how do I include a competing bank's product in my range? Is this indeed something that customers would value?

- **Cross-selling will be different.** Business models and strategies that rely on selling customers multiple products will be challenged. Opportunities to cross-sell from one area to another will remain, but the incumbent's advantage is reduced as alternative providers find it easier to get their own messages to the customers with the agents. The main customer relationship will no longer be in the hands of the product providers.
  - For example, the chance to sell investment products to current account holders will diminish as the new intermediaries offer a suite of financial services. Similarly, proposing a loan to a company with a current account will no longer be straightforward once it becomes easier to compare terms and conditions. Moreover, as with personal customers, the relationship will be held by intermediaries.
- **'Hot money' will move faster.** Nudges to shift between accounts – either to offset an overdraft or to move excess savings to better-earning accounts - will increase the speed at which money moves, especially when it starts to be done automatically by a personal finance agent. The process will become easier and faster. This might require banks to rethink how they manage their balance sheets in future.
- **Product line distinctions will blur**. An economically 'rational' personal finance agent will be able to spot the most favourable sources of borrowing and shift balances between, say, a credit card and an unsecured personal loan or even an offset mortgage. Working in this way, an agent can generate value for many customers who do not regularly check whether their financial affairs are ship shape.
- **Pricing practices will be tested.** Greater visibility, nudging, moving and switching will inevitably lead to fewer customers sticking with a particular product once the introductory offer has expired. This will reduce the amount banks are willing to invest in acquiring customers, especially given diminished opportunities for cross-selling
- **Legacy costs will have to be managed aggressively.** Digitisation reduces the cost of serving customers, while the large scale adoption of independent agents would mean significantly fewer interactions by phone, branch or online with underlying product providers. This would increase the burden of fixed costs allocated to those customers who remain wedded to more traditional methods of providing banking services. Banks will have to charge these customers more and/or significantly reduce their costs, further pushing people to the new channels.

The new regulations are set to change some of the core economics of retail banking markets. But considerable uncertainties remain. For one thing, financial service providers have yet to set out their stall fully – indeed, as the date for implementing PSD2 approaches, it is unlikely that all banks will be compliant on time. And the way in which customers will adopt the new services that the directive makes possible is anything but clear. So while there is little dispute about the direction of travel, how quickly the new paradigm for financial services is established is much less certain.

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