

Open Banking as a Catalyst for Industry Transformation: Lessons Learned from Implementing PSD2 in Europe

Banks and other large financial institutions can play a vital role in the emerging innovation ecosystem as managers of customers' data, assets and digital identity.

Summary

Open banking is one of the rare cases globally where regulation precedes innovation.

It was born from the need to tackle the shortcomings of competition and to introduce more pressure on “the older and larger banks which accounted for the majority of the retail banking market”.

By redefining the ownership and therefore data-sharing rights, Open Banking and PSD2 regulations put the customer at the centre and aimed to lower entry barriers into the financial sector.

This paper follows on from an initial assessment of the API economy in banking and explores the changes that incumbents and new entrants experienced following implementation of open banking and PSD2 in the UK and EU. It explores the strategic importance of open banking, and takes us on a

journey through the rise of neo-banks and fintechs, the initial incumbent bank responses to the new regulations, and how they ultimately learnt to take advantage of the opportunity.

Open banking has been described by both regulators and practitioners as a catalyst for reinvention in the banking sector, as such the paper discusses the market transition and industry architecture pre and post PSD2, and the entry of Big Tech into financial services (e.g. the GAFAM firms - Google, Apple, Facebook, Amazon and Microsoft).

Culminating with a view to the future, the findings in the study serve as a warning. In industries with high customer inertia, regulations that open up the industry to platform business models may in reality be opening it up to competition from large platforms from other industries. This could create a new kind of monopolistic / oligopolistic industry structure.

Key Takeaways

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1. A shift in mindset from reluctant compliance to active collaboration, as well as digital transformation to enable the IT infrastructure for collaboration, will bring banks abundant opportunities in an open banking environment in the future.

 2. Open banking and PSD2 regulations are also particularly advantageous for established players from other industries to enter banking. Among such possible entrants, those that a) are digital born and innovative, and b) have a large customer base and a trusted brand name.

 3. When platforms are able to combine financial data with other customer data (e.g. retail, fitness, employment, social interactions, travel, etc.), they will be in a position to gain a significant competitive advantage in using AI and machine learning tools to predict which products and services customers are likely to consume and how they may be swayed to change their preferences.

 4. Unless financial regulators start to respond to the gradual entry of GAFAM firms into the banking sector, the architecture of the industry can shift slowly, but dramatically leading to a new form of intermediation and potentially monopolistic behavior by GAFAM firms as gatekeepers of customer data.

 5. Banks and other large financial institutions can play a vital role in the emerging innovation ecosystem as managers of customers' data, assets and digital identity. They have time to surround themselves by innovative partners, small and large, to bring more value and innovation to their customers.

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