



WHITE PAPER

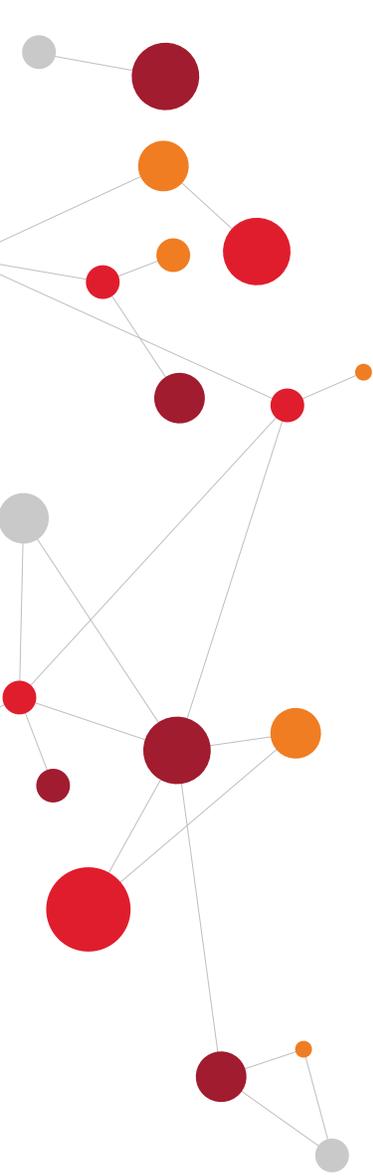
Creating value from the open API economy

A blueprint for banks

Change is inevitable as banks explore opportunities for leveraging open APIs to extend and transform their business models. This exploration is fueled by increasing pressures from customers, competitors and regulators — pressures that are driving innovation and opportunities within financial services.

An Open API economy will impose new demands on banks' business strategies, revenue streams and profitability. Bank leaders of the future will have a clear focus on their customers and markets and will collaborate with other organizations to strengthen their market position, either through increased use of digital technology platforms and/or digital insight that supports their specific business strategies.

An Open API economy will enable the delivery of new products and services through collaboration among business units within a bank, among banks across the industry, and between banks and other related sectors of the economy, particularly technology and data businesses. For European banks, or those with European operations, that serve retail and small-and medium-size business (SMB) customers, the Open API economy will likely develop (at least initially) out of the Payment Services Directive 2 (PSD2) legislation within the European Union (EU) member states. Overall, at the heart of this legislative activity is a requirement for banks to allow third-party providers (TPPs) to access customers' online payment services and account information in a regulated and secure way.



This is not to say that financial services industries within non-European countries have been passive spectators to the Open API economy. In North America, for example, collaborative partnerships are developing among traditional industry players, FinTechs and other organizations to drive innovation and differentiation in bank products and services.

Citi, Capital One and Mastercard were some of the first financial institutions to launch API developer exchanges, enabling third-party developers to create innovative products and services to benefit their customers. Multiple card payment services providers, such as Braintree and PayPal, have APIs to support e-commerce sites that connect merchants to their services, and BBVA partnered with Dwolla (a bank transfer platform) to support real-time payments by leveraging the latter's FiSync API.

How will the Open API economy impact banks?

Banks that serve consumers and/or small- and medium-size businesses in Europe are being forced by PSD2 legislation to pursue one or both of the following courses of action:

1. Make customer transaction data held by banks available to authorized third-party service providers

PSD2 is forcing banks to share certain data they hold about customers with third-party providers known as account information service providers (AISPs). These AISPs now have access to customer data and, once authorized, will seek to use it for commercial purposes. The intention is to provide AISPs and other banks and financial institutions with a defined level of data to encourage competition, increase product innovation and improve customer service. Banks can seek to respond to this challenge on their own or partner as they aim to monetize customer data in new ways.

2. Establish a new service for customer payments to be processed and charged

PSD2 allows third-party payment initiation service providers (PISPs) to provide customers with an alternative payment mechanism linked directly to their bank accounts, which could result in the disintermediation of existing card networks and their associated merchant service fees. This is good news for merchants because it should result in a reduction in absolute fees for customers who opt for a PISP-initiated payment rather than one made by debit or credit card. Moreover, merchants can benefit from the removal of liquidity risk within the transaction and the faster clearance of funds from the customer (assuming the underlying payment is made via a real-time payments rail).

If the merchant is of sufficient scale (e.g., Amazon), we may even see these players vertically integrate to become full-fledged PISPs, retaining 100 percent of the merchant service fee. In this scenario, banks' current revenue levels from payment transactions will be under threat as new entrants offer a PISP service. With the reduction in merchant service fees, customers should expect to see some of these savings passed on to them in the form of cash rebates or more generous loyalty schemes.

Banks that serve small- and medium-size businesses are likely to come under pressure to leverage Open API technologies to address declining satisfaction and high churn among their SMB customers. Many business customers are frustrated with corporate banks' slow progress in harmonizing and seamlessly integrating their services into customers' increasingly digitized supply chains and harmonizing interface standards across banks. Open APIs offer not only a solution to these issues, but enable third-party services to be more easily accommodated and encouraged by corporate banks.

Who are the new players in the Open API economy?

The rise of the Open API economy will see an unprecedented number of new players entering the financial services markets. Entrants will take many forms, some of which are already establishing themselves in anticipation of the Open API economy in banking:

- 1. Challenger banks** are entering the market and offering a more customer-focused model that connects the customer to their own products and services, as well as relevant third-party products and services. Their banking platforms and business models are “API first,” and they operate more like FinTechs than traditional banks.
- 2. Financial Technology (FinTechs)** firms specialize in a particular bank product or service but leverage a model that is more transparent and generally less costly to the customer.
- 3. Technology giants**, such as Facebook, Apple, Google and Samsung, will be interested in leveraging financial information available via Open APIs to augment their own customer data, refine their marketing strategies, expand their product and service offerings, and increase their brand presence and share of wallet with customers. Three of these technology giants (Apple, Google and Samsung) already have entered into the world of payments through offering payment services linked to customers’ debit and credit cards.
- 4. Non-financial service sectors** with retail customers, such as utility companies, may expand into offering financial products and services traditionally reserved for banks as a way to grow revenues and enhance monetization of their existing customer data sets.
- 5. Aggregators** will take advantage of both PISP and AISP aspects of PSD2 legislation to develop services such as personal financial management (PFM) tools. Current aggregators in the marketplace, such as Mint in the U.S., aggregate basic product information today and offer simple budget planning software for retail customers.

New Players in the Open API Economy



- Challenger banks
- FinTechs
- Technology giants
- Non-financial service sectors
- Aggregators
- Payment service providers (PSPs) and card networks
- ERP providers

6. Payment service providers (PSPs) and card networks also will be impacted, both adversely and favorably. The idea behind initiatives such as PSD2 is to increase competition and lower the cost of transactions in the market for both merchants and customers. Therefore, acquirers (e.g., WorldPay and First Data) and card networks (e.g., Visa and MasterCard) all will see a reduction in revenues from a lower volume of card transactions. They will look seriously at becoming a PISP and/or AISP in the EU markets. PSPs will need to respond by offering this new payment mechanism to customers at point of sale, although some providers, such as PayPal, already offer similar account-to-account payment services.

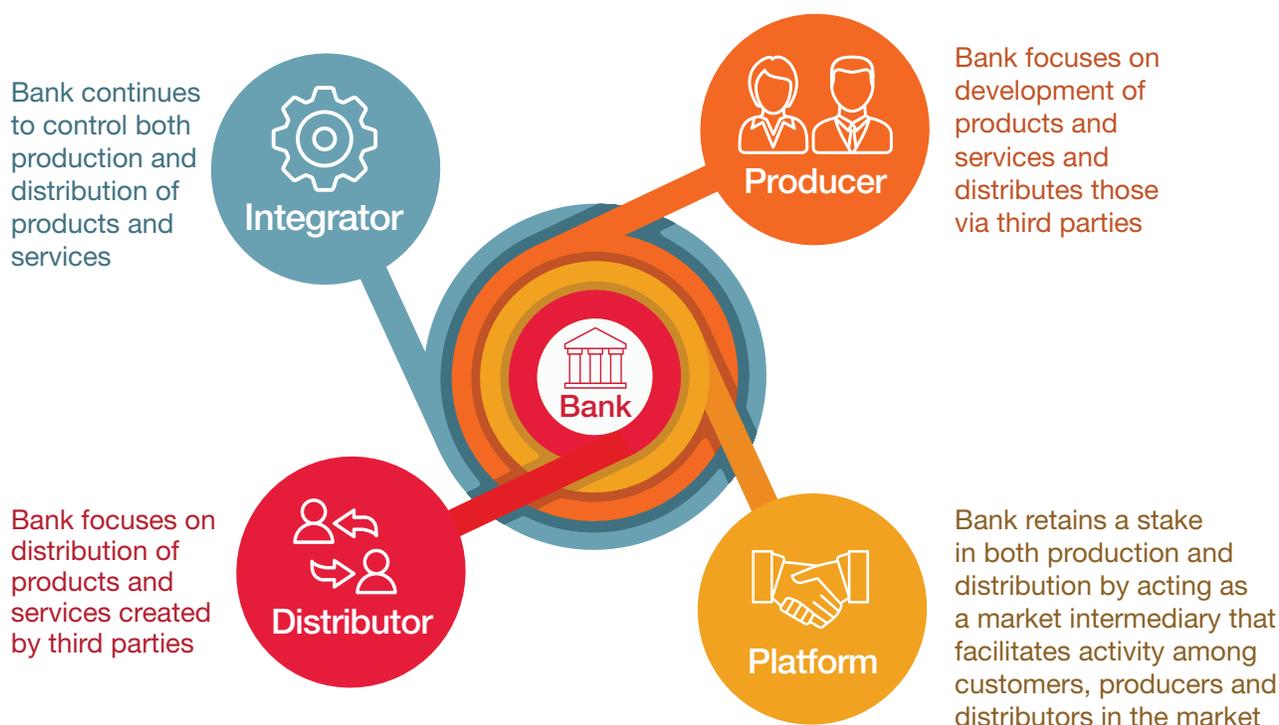
7. ERP providers in the SMB market, such as Sage and Xero, both of whom already provide comprehensive accounting services to small businesses, also could take advantage of PSD2 legislation to further strengthen their relationship with the customer by providing new products and services tailored for clients around tax advice, cash management and forecasting activities. Even traditional banking incumbents are creating 100 percent digital banks, removed from their parent bank’s legacy IT infrastructure. In France, many of the large banks have launched 100 percent digital banks that are separate subsidiaries and brands from their parent companies to minimize cannibalization of revenues from their parent brand.

What role can banks play in the Open API economy?

As threats and opportunities emerge from the Open API economy, banks are facing two strategic choices:

Operate either as a “white-label” service provider, delivering products and services for other banks and third-party providers (TPPs), or evolve into a trusted lifetime advisor to customers, operating at the epicenter of a new breed of customer-centric banking models.

For those banks that choose to respond proactively to the Open API economy, the European Banking Association suggests there are four roles from which they can choose, each of which will change the traditional “producer-distributor” model banks employ today and are described below. These four roles are emerging as a result of using Open API technology to interface between product development and distribution, which enables banks to decouple those two functions. The combination of decoupling and opening up bank APIs to third parties allows banks to play one or more of the following new roles:



In the coming years, bank platforms may become the norm for all financial services and products. Traditional banks that refuse to change their business model may be disintermediated from the customer and could become limited to the role of producer or back-office provider for a number of “over the top” product and service providers in the marketplace (e.g., know your customer checks).

How can banks proactively respond to the strategic challenge of the Open API economy?



Short-term (0-12 months)

Revisit business and technology strategies that seek to exploit future markets and revenue streams through emerging business models

1. Refresh your business and technology strategy
2. Determine your future markets and revenue streams based on existing/new products and services powered by an Open API economy
3. Define the pathway(s) to future operating model(s) based on specific products and services, recognizing the market will evolve over time
4. Consider the role of potential partnerships with FinTechs in extending reach into new products and/or customer segments



Medium-term (12-36 months)

Actively seek to “test and learn” by exploring the use of new business models—leveraging both internal expertise and appropriate partnerships

1. Clarify Open API strategy, including defining an integrated business and technology roadmap
2. Respond to emerging standards around Open APIs
3. Confirm your initial operating model, including your customer data approach



Long-term (36+ months)

Adapt business models and invest in new technologies and partnerships that drive new products and services, as well as provide a strong distribution channel to customers

1. Respond to competitive threats and opportunities that arise in the emerging Open API economy
2. Adapt your business model to protect revenue streams and customer relationships
3. Build institutional capability to screen for new technologies and partners, ensuring you stay at the forefront of product and service development and distribution

What are the key operational challenges to succeeding in an Open API economy?

We are still in the early days of the Open API economy within banking; however, time is of the essence. The next 18 months for banks will be crucial in establishing the right operational and technical standards for Open APIs and ensuring a framework within which all can operate.

This will inevitably raise important operational challenges for banks in terms of the following:

1. Implementing the right operating model to drive profitability
2. Establishing security and permissions among parties
3. Setting the right data strategy that will deliver maximum value
4. Providing appropriate service levels for performance of the APIs
5. Establishing appropriate governance among financial service players

Despite these strategic and operational challenges, as well as other regulatory and balance sheet imperatives, leading banks realize that the time to act is now. The rise of the Open API economy is underway, representing not only a threat but also a great opportunity to gain a competitive advantage in an increasingly complex and customer-centric marketplace.

What are the key takeaways for banks in this new Open API economy?

Regardless of whether you are in retail banking or commercial banking, consider acting now. The rise of the Open API economy is here, and CGI advises banks not to wait for regulators and competitors to force you to change. Banks should see the Open API economy as a great opportunity to do the following:

1. Maximize payment transaction revenues for current and future payment mechanisms
2. Exploit customer transaction data to offer tailored products and services, leading to profitable growth
3. Implement new business models to extend the reach of the bank into new products, new customer segments, and new sources of revenue—all while improving customer experience

Banks that respond quickly to these changing market dynamics will be able to shape and lead conversations with customers, regulators, and potential (FinTech) partners. Those that adopt a “wait and see” approach will find it increasingly difficult to keep pace and maintain market position. CGI believes that the ultimate winners in this competitive battle will be the ones who can plan for and adapt to a banking model where flexible and open “banking-as-a-service” platforms source and distribute tailored products and services to customers, utilizing third parties when required. Getting ahead of this “Open Banking” trend is essential for banks to survive and thrive as trusted financial partners for their customers.



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