Why the Future of Banking Is 'Open'

BY MARK SMEDLEY

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Traditional banking is starting to undergo a fundamental transformation, one similar in scope to the digital business model disruption of retail, hospitality, transportation and other industries during the past decade.

The movement is called open banking, starting with a European regulatory mandate that established banks securely open their core, mostly mainframe-based applications to third-party service providers via APIs. The goal: Stimulate competition and innovation.

Amid already increasing competition from niche "fintech" providers as well as the financial services units of large platform companies such as Alibaba, Apple, Facebook and Tencent, banks worldwide are increasingly embracing the idea of collaborating with those third parties to create new digital channels and services—regulatory requirement or not.

Under open banking, the established banks can offer innovations such as mobile payments, intelligent portfolio management services infused with artificial intelligence and faster client onboarding using blockchain and biometrics—without having to develop those services in-house or acquire third-party providers. Instead, they can partner with the fintechs (non-traditional, technology-driven financial services upstarts) or with other financial institutions, offering services on a common cloud computing platform that customers can access on the device of their choice.

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This open model already is established in other industries, such as healthcare, where providers share data across applications and wearable devices via open APIs. A less collaborative example is in telecommunications, where U.S. and European regulators had to force their Open Network Architecture and Open Network Provision directives on entrenched public telecom operators, requiring them to open their core network facilities and services to third-party providers on an equal-access basis. An even more contentious example came as a result of the U.S. Justice Department's antitrust victory against Microsoft in the 1990s, in which the DoJ required the software giant to open its Windows APIs to third-party companies.

Key Tech-Based Enablers

The confluence of three megatrends—fintech, blockchain and cloud—provides the foundation for the more collaborative, open model now taking shape in the banking industry.

1. Fintechs are redefining the industry. They include startups such as TAS Group, IPsoft and Biz2Credit, as well as the new financial services subsidiaries of more established companies. Alibaba's Ant financial unit, for example, offers online payments, microloans and other digital banking services.

Fintechs are becoming market movers by offering low-cost, easy-to-use, "born in the cloud" capabilities unmatched by conventional financial institutions. No wonder banks are looking to partner with them.

2. Helping to facilitate the transition to open banking is blockchain, a digital chain of records, or blocks, in a monetary transaction. Blockchain is a shared accounting ledger, visible to and verified by all parties, that continues to grow as transactions are added.

Blockchain decentralizes transactions and tracks them securely using cryptography for faster, more automated processes. The beauty of blockchain is that it eliminates the intermediaries in any transaction and increases visibility.

Cryptocurrency is the most common example, but blockchain also has potential to remove cost and complexity from the back offices of financial institutions, eliminating multiple subledgers, creating permitted trading and settlement communities and eliminating duplicative and costly reconciliation and error-correction processes. As the technology matures, it has the potential to replace legacy banking processes at scale.

3. Scalable, secure and regulatory-compliant cloud platforms are the final open banking ingredient. Every major new financial service provider has its roots in the cloud.

Open Season

While traditionalists may view this wave of changes as a threat, those changes also present banks of all types with tremendous growth opportunities. Customers now expect their financial providers to offer more than just transactional services. Rather, they want innovations that help them manage their financial matters conveniently and securely from any device.

Banks and other established financial service providers still enjoy loyalty and distribution scale. But as the aforementioned fintechs and platform players encroach on their turf, they must adopt new digital strategies and business models, either collaborating with those players or becoming digital platforms themselves.

In any scenario, the future of the industry is open.

Mark Smedley is vice president of Financial Services Solutions at Oracle.