FINTECH TRENDS 2018
THE RISE OF MARKET PLACE BANKING

Imagine a bank that doesn't want to sell you its products and services but instead offers 'best in class' mortgages, insurance, foreign exchange services and loans from its competitors; a world where consumers hand over access to their bank accounts and transaction information to get the best deals. This is exactly what we will begin to see this year in the UK and across Europe as Open Banking and PSD2 take effect.

In the UK, Open Banking is a project initiated by the UK's Competition and Markets Authority that requires the UK's largest banks to let consumers easily and securely share their financial data with other banks and third parties. The aim is to increase competition and give consumers easier access to the best products and services for them. A similar (but perhaps not as extensive) initiative came into effect across the European Union at the beginning of the year in the form of the EU's Second Payment Services Directive (PSD2).

> **"Banks that fail to adapt will become basic utilities providing the 'plumbing' that simply moves money."**
>
> Peter Chapman,
> Senior Associate

Across Asia, there has also been a push by regulators to create a framework to facilitate open banking. The Hong Kong Monetary Authority published a consultation paper on its proposed policy framework at the beginning of the year, under which the banking sector would adopt infrastructure to facilitate Open Application Programming Interfaces (Open APIs) and data sharing between banks and third parties. Interestingly, the UK's Open Banking project is cited as one of the sources for the core functions of Open APIs in the proposed policy, though the proposal is arguably not as far-reaching in terms of adopting a set of standardised Open APIs and mandating interaction between banks and third parties. The Monetary Authority of Singapore and the Association of Banks in Singapore published the "Finance-as-a-Service: API PlayBook" in late 2016, which provides guidance to financial institutions, FinTech players and other interested entities on developing and adopting open application programming interface based infrastructure to facilitate open banking. The PlayBook boasts an impressive scope, covering numerous processes across several asset classes, however unlike Open Banking and PSD2, adoption of the PlayBook is voluntary. Nonetheless, these developments mark a shift in thinking about bank models.

In the United States, by contrast, there is no regulation which demands that banks open services to third parties. The absence of a standardised approach to data sharing and open banking has resulted in varying degrees of engagement from market players. This has included several ad-hoc data sharing arrangements between banks and third-party companies, with only a minority of banks offering open banking services.

At an international level, the Basel Committee on Banking Supervision recently envisaged the emergence of five potential banking models for the future, four of which would see third parties playing an important role in the relationship with customers:

- the "better bank": the modernisation of banks' existing legacy infrastructure to develop value propositions allowing them to retain existing business – the only model which does not envisage a third-party role;

CLIFFORD
CHANCE

- the "new bank": challenger banks and third parties build upon existing modernised infrastructure, providing them with the capability to manage the entire banking service;
- the "distributed bank": modular banking allows banks and third parties to choose areas in which they would like to compete, facilitating more collaboration between them;
- the "relegated bank": banks become commoditised service providers, with third parties assuming the customer facing role and cherry-picking the most appropriate product from a range of service providers; and
- the "disintermediated bank": customers are less reliant on intermediary banks, with more developed technologies allowing customers to be more involved in directly sourcing the required product.

While we are in practice unlikely to see a single model monopolise the banking sector, each of these potential outcomes will have a material impact upon existing banks.

What's next?

PSD2 and open banking are a game-changer for banking services. However, it could come at a cost as it raises fundamental questions about the future of banks.

- Banks that fail to adapt will become basic utilities providing the 'plumbing' that simply moves money rather than offering competitive, profit-generating products and services. Once, banks become a utility, then utility-style regulation may not be far behind.
- Balance sheet disruption – if third parties are providing lending services to customers, banks may need to acquire new asset sources or, potentially, shrink the deposit book.
- The end of traditional banking brands? If a bank offers third-party products, what happens to customer loyalty and why will customers come to the bank and not go directly to the product provider?
- Banks will need to adjust their business models – they will need to consider what it means to become a marketplace and not a universal bank. Banks will need to deal with the transition from being a distributor to a manufacturer and what this might mean for them, for example regarding, product liability and conduct obligations.
- Will banks become "third-party" providers making use of open banking in their own right? If so, they will need to consider the regulatory, privacy, security and anti-trust implications of access and data sharing.

CONTACTS

Peter Chapman
Senior Associate, London
T: +44 20 7006 1896
E: peter.chapman@cliffordchance.com

Arpan Bhatt
Trainee Solicitor, London
T: +44 20 7006 1551
E: arpan.bhatt@cliffordchance.com