Open Finance: innovation potential and policy proposals

Introduction

The Chair outlined that open finance is about promoting innovation in the financial sector through data sharing. Digitalisation is transforming finance and many other activities both for businesses and individual consumers. The European Commission has made groundbreaking policy proposals on the use and sharing of data, such as the Data Governance Act, the Digital Services Act and Digital Markets Act, all of which apply to all sectors of the economy. However, financial data is a major part of the data space and requires a specific approach to data sharing, which is the objective of the Financial Data Access (FiDA) proposal. The ultimate goal of FiDA is to enhance consumer trust in data sharing and enable effective access to data for third party data users, in order to foster innovation and the improvement of financial services and products. It should be a win win for all parties involved.

1. Open finance: objectives and opportunities

1.1 Objectives and expected impacts of open finance

A regulator explained the rationale behind open finance. There is a broad spectrum of financial decisions that people are expected to make as informed and rational agents. This might include relatively complex decisions related to loans, investments and pensions. In addition, these decisions need to be made in a holistic way, taking into account the different accounts and investments held by savers, their current and future financial situation and so on. Individuals are not equipped with the proper tools to make these decisions. An informed person might try to download data from different financial provider websites or pension systems, but they will quickly run into limitations in making simulations, such as the lack of access to market prices or difficulty in aggregating their overall financial position. Open finance is a way to help consumers and other economic agents consolidate their financial positions and perform accurate simulations in a more holistic way or compare different financial options and products. Some users will be able to do this autonomously; while others may use services offered by new types of providers in this space.

An industry speaker observed that the use of data from multiple sources will unleash the imagination of the private sector, enabling it to develop new financial services and support customers in new ways. At the moment, data is trapped in different silos. If it flows more freely, with the consent of individual and business customers, service providers will be able to develop more personalised services. With open finance, service providers will also benefit from increased efficiency and accuracy in their data collection and management processes, which will allow them to deliver services at lower cost and risk. Open finance will also benefit consumers by giving them greater visibility and control over their finances. They will be able to better balance in their financial decisions the 'fast' money they need today and the 'slow' money they will need in the future, which should lead to better financial planning. Open finance should also provide additional lending possibilities for under served businesses such as SMEs. Less wealthy customers should also be able to use the improved view of their financial position to build up a financial cushion more easily.

A second industry representative concurred that open finance could have a very broad effect. Much financial data is currently locked in legacy systems and software, which makes it impossible to extract and utilise. Open finance will facilitate access to this data and pave the way for systems with improved data architecture based on open APIs, which may support further interoperability between systems. Financial services firms and tech companies should both be able to take advantage of the opportunities of data driven innovation in a win win way in order to provide better services for consumers.

Open finance should also help open up the EU financial market to new entrants such as fintechs, the industry speaker emphasised. This will foster innovation in the market and offer mutual learning and cross pollination opportunities in terms of data management and API standardisation. The smaller players will face some challenges from a competition perspective, however. While fintechs and start ups can be agile in the way they develop services and unlock opportunities from access to data, they may find it difficult to build customer trust and confidence. Consumers are often more inclined to trust in the services provided by larger players. The framework must ensure that the market remains open for new entrants and the requirements must build consumer trust. Conversely, the more established financial players may feel that obligations that mandate a sharing of data they have accumulated over decades sometimes is unfair. Solving these issues will involve the implementation of an appropriate incentive structure as well as efforts to educate stakeholders about the implications and benefits of open finance. It will also be important to take into account the network effects that open finance might have, which could advantage larger players, and also potential interconnectedness risks associated with open finance models.

1.2 Open finance use cases

An industry speaker suggested that creditworthiness and affordability insight is a key use case for open finance. If lenders can access more sources of data, they will be able to develop a more nuanced and granular

view of a client's financial situation. This will allow lenders to optimise the cost of lending because they will no longer be lending blindly. It will also benefit consumers and businesses, who will be able to borrow at a more appropriate cost. Lenders will also be able to offer more tailored and dynamic lending solutions, offering for example more flexibility in the positioning of credit repayments. Open finance also offers new use cases in relation to sustainability. Current IT systems make it practically impossible for suppliers to share sustainability data with businesses for the purposes of sustainability reporting. As FiDA is introduced and the industry moves towards open data, this information will flow more simply and enable businesses to understand the sustainability of their supply chain on a factual basis. This will enable them to make better decisions. This cross sector data flow will potentially work to the benefit of all the organisations that contribute to it.

A second industry speaker described how open finance could contribute to a financially sound and sustainable society by creating a flow of data in the financial sector and between sectors. Sustainability will be a key area of application. One example of this is data sharing between the energy sector and the financial sector. In Sweden, there are innovative solutions which track energy usage in order to help consumers reduce their energy consumption.

Pensions are another interesting use case, the industry speaker suggested. There is a public private platform in Sweden where users can check their total pension savings and their expected pay out. This is a good example of how open finance can help individuals to take control of the 'slow' money they will need later in life.

A third industry representative observed that open finance also offers new opportunities to leverage the benefits of artificial intelligence (AI) by increasing the amount and scope of data available for training new AI models. This will allow financial services providers to better understand customer needs and offer more tailored services and products.

2. The proposed Financial Data Access Regulation (FiDA)

2.1 Objectives of FiDA

An official considered that the FiDA proposal is an adequate basis for the discussions between the co legislators and with the industry. The experience of open banking from the Payment Services Directive 2 (PSD2) shows that it is preferable to define a regulatory framework for open finance upfront before market players develop unregulated services based on web scraping and similar techniques too widely. To ensure the success of FiDA, there are two key issues to consider. First, the framework must support innovation and allow the private sector to create new services for customers based on the fluid and safe use of data. Secondly, FiDA is an opportunity to prepare the ground for a common EU financial data space through the establishment of data sharing requirements and common governance principles involving the public and private sectors. This objective is also in line with the EU open strategic autonomy agenda.

A second official noted that FiDA is part of the Capital Markets Union (CMU) action plan. One of the objectives of FiDA is to increase investor confidence and engage more retail clients in the capital markets. FiDA was launched alongside the review of the PSD2. Some key lessons learned from the experience of implementing PSD2 appear to have been taken into account.

A regulator stated that while the FIDA proposal can be seen as a continuation of PSD2, it differs from it on some fundamental aspects, because it would not impose uniform obligations on all products in scope from the outset. Instead, rules would be defined for each of the main categories of customer data covered by FiDA in the context of a specific Financial Data Sharing Scheme (FDSS) in charge of governing access to customer data and comprising representative data holders and data users. This market based approach offers significant opportunities for data driven innovation in the EU financial sector and avoids the need for extensive legal requirements. In that regard, the novelty of FiDA is that the success of the framework will depend on the industry players part of an FDSS agreeing, within a period of 18 months, on issues such as the liability regime, the compensation principles for data holders and the functionalities to be met by the access interfaces (APIs) used for data sharing. The safeguards provided by FiDA to ensure the proper use of personal data are moreover necessary to avoid the market for open finance services turning into the 'wild west'.

An industry speaker considered that the regulatory requirements for open finance should strike an appropriate balance between risk mitigation and fostering innovation. It is vital to ensure cyber resilience and protect customers, but the framework must also drive innovation and increase value for all stakeholders by creating real customer demand and incentivising data holders and open finance providers to put in place effective solutions. Excessive or inappropriate regulatory requirements will limit the incentive for firms to develop the market.

A second industry representative suggested that FiDA is also an opportunity for the EU to take a leadership position in open finance and to develop innovative solutions that are attractive for a wide range of customers within and outside the EU, including third world countries and under served markets.

2.2 Incentives for data holders and users

An industry speaker expressed support for the Commission's proposal to introduce compensation for data holders. Fair compensation models are essential for a well-functioning and innovative financial market. This is a lesson from PSD2, which did not provide for any remuneration of data holders and therefore did not lead to the high level of innovation expected. In addition the data to be shared under FiDA requirements should be related to real business cases and a customer demand.

A second industry speaker emphasised the importance of proper incentives for the success of open finance. If

the incentives are correct, behaviour will evolve and data will flow. It is also essential to think about the ecosystem as a whole. Open finance will not work if it only works for one type of player; it must work for everybody. There must be an economic ecosystem model within which different viable open finance business models can thrive. Both data holders and consumers must see the benefits.

An official welcomed the fact that the Commission proposal is not overly prescriptive on the question of incentives. The compensation of data holders will be defined by FDSSs. The question is whether the industry will be able to self organise. In this regard, it could be beneficial to explore the possibility to implement a compensation scheme with a similar structure to the one used in the payments industry. The difficulty with FiDA is that the scope of the proposal is very large ranging from insurance policies to savings products. It applies to very different markets that use different types of data. It is difficult to know whether the same approach to incentives will work in every sector. It might be more productive to use a nimbler 'learn and adjust' approach instead of setting detailed rules from the start.

2.3 Safeguards for customers

The Chair noted that the FiDA proposal seeks to balance the opportunities and risks from open finance. Customers must trust the framework because ultimately, they will be taking the decision to share their data. This means they should understand the implications of sharing their data and be protected by the appropriate safeguards, including the horizontal frameworks around data and the General Data Protection Regulation (GDPR).

An official agreed that the main safeguard for individual customers is GDPR. It is sometimes perceived as a heavy burden by the industry, but its requirements are increasingly complementary with financial sector legislation and aim to balance efficiency with customer protection. For example, there is a provision in PSD2 which enables banks to process data to meet the anti fraud objectives while respecting GDPR obligations. Besides GDPR, the main component of customer protection proposed by the Commission in FiDA is the establishment of permission dashboards to allow customers to retain control over who their data is shared with. The initial consensus is that this is a good idea, but it is difficult to understand how the dashboards will work in practice without a prescriptive regulation.

A regulator stated that the question of customer trust and how customers feel about sharing their data is very important for the success of open finance. There are five key issues to bear in mind. First, customers will be inclined to share personal data if the value proposition is attractive. However, it will be a challenging task to align the interests of many data holders and data users in such a short period of time, when considering the experience of PSD2. Finding an agreement within a FDSS may be difficult indeed for data holders and data users without legislative intervention. Secondly, permission dashboards will allow customers to check with whom their data is being shared and to revoke access at any point in time, which should provide the necessary safeguards to instil confidence in the public. However, these dashboards have to be well designed and work in real time. In addition, who will administer them needs to be clarified. They could be managed as a common utility or be left to the private sector. Thirdly, it is important to determine how customer data can be accessed safely. The concepts used in the context of PSD2 such as strong customer authentication (SCA) are a possibility to further explore. Fourthly, it will be important to assess the safety and suitability of open finance service providers, given that the range of firms could expand. It would be sensible to explore whether these new entities will need to be subject to authorisation requirements or supervision. Finally, it is vital to ensure that the implementation of open finance services does not increase financial exclusion. Many consumers are already ill equipped to manage their financial decisions. If FiDA introduces new barriers to accessing basic financial services or if customer profiling means that firms only want to serve certain categories of clients, there may be a significant risk of financial exclusion. Some customers may be unable or unwilling to operate in this new environment, but they should retain access to basic financial services.

An industry speaker agreed on the importance of preventing financial exclusion. Every individual and business, no matter how small or niche, should benefit from a holistic view of their financial situation. The financial sector is moving away from mass produced products and one-size-fits-all solutions towards more personalised services, which should contribute to increasing the engagement of customers in financial services.

A second industry speaker emphasised the importance of maintaining data integrity and safety for creating consumer trust. Handling customer data is as important as handling their financial assets and must be done in a careful and sustainable way. Opening data to third party access increases privacy risks and creates new vulnerabilities. Operational resilience and technical robustness requirements are being reinforced. Data holders also work persistently on security. At the same time, customers do not always fully understand what data sharing entails and where privacy risks might arise.

A third industry representative emphasised that customer education is also important for achieving effective data sharing and permission management. With the progress of AI, GDPR and the multiplication of consent requests, people are becoming more vigilant about sharing personal data and want to understand what their data is going to be used for. Consumers must be educated about these technologies and the possibilities that open finance will make available for them in order to embrace these new market developments more readily. This is not being done sufficiently at European level. In countries such as Singapore, for example, processes akin to country wide upskilling happen on a regular basis. Mitigating risks that may impact customers such as cyber-risks, fraud and data leakage is also essential for reinforcing trust in a context where open finance will further open up access to customer data.

3. FiDA implementation challenges

An official noted that the main challenge for co legislators is achieving a balanced legal framework that leverages the potential of open finance for the benefit of citizens and the whole financial system. This is not an easy task. There is a need for coherence between FiDA and the rules that exist in the payments area, where there are many different pieces of legislation including PSD2.

An industry speaker suggested that there should be a gradual approach to the implementation of FiDA. It should be implemented on a category by category basis with a different timeline for each data category. Savings data could be addressed first before moving to investments, mortgages and other categories of data. There are several reasons for this. First, this will facilitate the implementation of adequate risk mitigation measures notably concerning cyber risk. Secondly, a gradual approach would provide market participants with more time to identify business cases likely to create long term value for all stakeholders in the market and allow a more consistent implementation of the measures across EU member states.

A second industry representative stated that the lessons learned from PSD2 in terms of the need for high API quality and data standardisation need to be taken into account in the implementation of FiDA for the success of open finance. A high quality API is one that is accessible by all users and designed in such a way that any developer can extract data from it and create services around it. Ideally, the market should progressively evolve towards an open API driven architecture to support interoperability and reduce operational risk. However, systems that do not use this approach are still being installed by financial services firms. It will be a long journey to make this change throughout the market. In addition, while progress has been made on data standardisation over the last few years at the EU level and in other jurisdictions, significant work is still required in the area of data.

Open finance also faces a major challenge in terms of upskilling and change management, the industry speaker observed. This concerns the people in charge of technology and data management in the financial sector, such as CTOs and CDOs. These people need to be convinced of the benefits of open finance. Upskilling is also a relevant issue for regulators, who need to understand the implications of the systems supporting open finance and be convinced of the need for high quality APIs.