

OPEN BANKING TO OPEN FINANCE: LESSONS LEARNED AND OPPORTUNITIES FOR THE UAE



Peter Ware, Head of Research & Development at the ADGM Academy Research Centre, invited Professor Markos Zachariadis from the Alliance Manchester Business School at the University of Manchester, who holds the Chair in Financial Technology and Information Systems and Barry West, Senior Manager, Applied Innovation & Research at the ADGM Financial Services Regulatory Authority (FSRA) to discuss what lessons can be applied from Open Banking to the future of Open Finance in the UAE financial sector.

OPEN BANKING – INNOVATION OR MISSED OPPORTUNITY?

Established in 2017, The Open Banking Implementation Entity (OBIE) was the UK delivery organisation working with CMA9 (the nine largest UK retail banks by volume of personal and business current accounts) and other stakeholders to define and develop the required APIs, security and messaging standards that underpin Open Banking¹. Reflecting on the innovation resulting from Open Banking, versus the cost to the industry, OBIE is an interesting indicator. In 2019 it was estimated that the cost to the nine funding banks had risen to GBP 81 million². This does not take into consideration the individual cost to each bank to implement the technology needed to utilise the data, which is most likely residing in core legacy infrastructure. While the banks undoubtedly see the investment as money well spent, the sum is significant for the results achieved; a relatively small new ecosystem still lacking that powerful super app that leverages all the potential data points and brings useful insights to the consumer.

¹ UK Government initiative requiring retail banks to share data on their customers' current accounts with fintechs.

² [The cost of open banking: £81m and counting - Financial News \(fnlondon.com\)](https://www.fnlondon.com)

ONWARDS TO OPEN FINANCE

Continuing with the UK as a reference point the FCA has created an advisory group with the remit to develop a framework around Open Finance³, with the intention to expose more datasets across a wider range of financial products like mortgages, credit and insurance.

With this in mind there is the obvious question around cost. How much additional cost will this entail as other players are involved, and for what benefit? Will we simply see more account aggregators, or will there be some real innovation?

Prof Zachariadis agreed that while there has been substantial progress in terms of the entire infrastructure as referred to with the OBIE, the resulting innovation that would both justify the cost and also bring real benefits to consumers and businesses has been slow and there is still a long way to go.

In his current research around Open Banking, Prof Zachariadis is investigating across three axes.

Firstly at the firm level: To explore how open APIs are implemented, their benefits and how these can fully be realized. Is there evidence of new business models from the companies that implement these open APIs? Has the push to provide, use and adopt Open APIs brought any benefits to the bottom line?

With regards to business modes, Prof Zachariadis draws attention to the concept of network externalities that create and encourage the development of ecosystems on top of platforms, which function as a driver to further innovation and benefits. Within the financial industry there is some progress from this perspective but not as much innovation as one might expect considering the extensive infrastructure that has been developed, particularly in comparison to other industries or the platforms built by large tech players such as Google and Apple. This is due to several reasons such as stricter regulation, and in particular, the greater level of sensitivity around financial data versus other industries, such as in gaming, or social media.

Secondly at the industry level: The main objective is to examine how open APIs have impacted the overall architecture.

In this regard there has been an increase in terms of the modularity of 'independent or autonomous' services that make up the value chain. For example, prior to PSD2, a vertical integrated bank owned the whole product and technology stack to deliver a service. Now we may have a fintech developing a solution for a specific module within the value chain that integrates with multiple other organisations, ultimately providing a myriad of services rather than attempting to recreate the whole value stack. Essentially PSD2 has enabled the different verticals to be exposed in different modules, in different sections within banks, or at least enabled this style of thinking.

Thirdly at the level of the economy: In order to provide quantitative evidence that the investments have resulted in productivity gains for the regulators, industry and for consumers,

³ Open Finance extends the principles of Open Banking to investment-based financial products. These include savings accounts, mortgages, insurance, and pension accounts – to name just a few. Under Open Finance, customers can agree to share their financial data using trusted APIs to access broader services, such as financial advice and wealth management.

we need data measurements. Whether it's a question of measuring the increased profitability of a financial institution or an account information service provider (AISP) / payment initiation service provider (PISP) through its usage and adoption of open APIs, the proof is in the data and particularly usage data. As previously stated, financial data is highly sensitive, and therefore, there are many barriers to accessing this data for research purposes.

THE NATURE OF FINANCIAL DATA AS A BARRIER TO INNOVATION

Picking up on the aspect of data, Barry West noted that the inherent confidentiality and sensitivity of financial information can limit innovation, or at the very least, cause a certain level of apprehension in using it.

GDPR (General Data Protection Regulation) has been a welcome piece of regulation, enabling fintechs to demonstrate their commitment to protecting personal information and fostering a positive market reputation. As a result, it is crucial for fintechs to adhere to strict requirements for data handling, storage, and processing. Non-compliance can lead to significant fines and penalties, which can be particularly damaging not only financially, but also in terms of reputation. Therefore, it is understandable that fintechs may be hesitant to push the boundaries too far in terms of innovation involving personal financial data, given the sensitive nature of the information, the need to adhere to stringent regulations like GDPR and the consequences if something should go wrong.

The capital and resource requirements for PISPs and AISPs to obtain licensing may also create a certain barrier to entry, which may inadvertently stifle innovation or influence the types of fintechs capable of meeting these demands. The initial costs involved in the licensing process and ensuring regulatory compliance, such as technology investments, cybersecurity measures, and personnel, can be challenging for smaller startups or innovators with limited funding. This financial burden could hinder their ability to enter the market.

Furthermore, the ongoing costs associated with maintaining compliance, including technology upgrades, employee training, and regular audits, can be taxing for fintechs, particularly those with limited resources. The stringent requirements might favour established players with deeper pockets, potentially reducing market competition and innovation.

Fintechs may also need to redirect resources away from research, development, and innovation in order to meet licensing requirements, which could impede the creation of new financial products and services. Additionally, the rigorous licensing process and the risks associated with non-compliance might discourage smaller fintechs and innovators from experimenting with novel ideas or business models. This reluctance to innovate could limit the diversity of services and solutions available in the market, ultimately shaping the types of fintechs that can successfully meet the licensing requirements.

OPPORTUNITIES FOR THE UAE

Steering the discussion to the context of the UAE, Barry highlighted that there has been a similar discussion in terms of open banking as a framework. The UAE is likely a year away from implementation, with similar questions and issues being raised as previously seen in the UK and Continental Europe. From the risks arising from screen scraping through to the sensitivity around financial data, an additional specificity is the need for local data residency whereby all

data must be stored within the UAE. Cloud infrastructure providers such as Amazon Web Services (AWS) and Microsoft Azure are recent additions to the UAE ecosystem and their services are necessary to be able to crunch larger size datasets, but in addition to ensuring technical feasibility, regulators in the UAE are also engaging in similar discussions around capital adequacy. The key question faced by regulators in the UAE is: What can be done to apply acquired learnings around open banking and PSD2 in a manner to leapfrog its adoption in the UAE?

Given the movement towards Open Finance a key area of interest is the interoperability across different regions and jurisdictions.

According to Prof Zachariadis there are many lessons that the UAE can leverage to accelerate open banking infrastructure. He explains that through the OBEI the UK has managed to solve many of the problems that other countries are struggling with in terms of standards and interoperability.

A major barrier for fintechs is often cited as the lack of standards enabling them to access banking data in a unified manner; the availability of a standard API plugin eliminates the need to develop a customized solution to access each individual bank.

Referring to a previous paper [Data Sharing Frameworks in Financial Services: Discussing Open Banking Regulation for Canada](#), Prof Zachariadis explains that other key considerations relating to the data include how open the data will be, how open the standards will be and how this will all integrate with existing payment infrastructures.

In terms of competition, innovation and sustainable business models, a big lesson is that there must be an economic incentive for the industry to compete, integrate their solutions and give rise to innovation. It must be seen as an opportunity rather than a regulatory compliance exercise. Furthermore regulators need to be clear that we are on a long-term digital transformation journey, not a single stop destination.

When PSD2 came into force, many institutions failed to see the opportunity and perceived the requirement to open up access to account data as a competitive threat. Consequently, many banks developed minimal but compliant solutions, resulting in inferior quality APIs that discouraged integration.

Barry West emphasized the need for regulatory vision and support, one such example being ADGMs initiative to build its own Digital Lab. This digital platform, open to all fintech firms and financial institutions, facilitates the testing and development of new solutions in a neutral virtual environment provided by the regulator, complete with synthetic data and APIs. The lab has been established to enable organizations to safely develop and showcase their services and value-added offerings from a bank or financial institution perspective. This approach allows for early testing of the potential monetization of these services for specific customer segments, all within a secure and well-regulated environment.

OPEN FINANCE TO OPEN REGULATION

There have been multiple high-profile instances around the world of regulated financial firms that have misappropriated client money with catastrophic consequences for both parties.

Regulated firms with permission to hold client money and client assets are not allowed to mix client money in with any of their operational or investment activities. Regulators currently only have one tool to provide assurances that the client money or assets are not being misappropriated; that is the annual audit report by a third-party audit company which is a yearly snapshot, rather than an ongoing exercise.

The UAE is currently experimenting with several regulated firms an account monitoring solution to address this problem, by providing regulators with real-time oversight; Barry describes the approach to link into the bank account where the firm holds the client money using APIs to connect into their accounting data within the firms infrastructure, while doing real-time reconciliation of the client money. This flags and alerts the regulator to any mismatches in balance if there is money coming in or going out.

This approach addresses the Open Finance piece in providing more transparency for both the regulator and the industry, potentially reducing capital adequacy requirements for regulated firms and lowering the barriers to entry. For the firm, the benefits include cost savings and, over time, possible elimination of the obligation to produce audit reports. From the banks point of view, if this entity is banking with them, essentially, it's a 'regulatory compliant' bank account, so they can provide additional services to the firm secure in the knowledge that the regulator is monitoring them in real-time. This scenario opens up possibilities for new offerings and data points to be integrated. Consequently, there is potential for a new direction in open finance, such as open regulation.

WHAT DOES THE FUTURE HOLD?

Currently there is an appreciation for financial data related to transactions and credit. As we move into Open Finance there will be a need to assess different types of data sets and regulators will need to address their terminology and understanding of financial data. Could financial data incorporate a social media influencers' monetary value? What are the implications of overlaying multiple data sets for individuals and businesses? How do we regulate transactions based on social media platforms that may be based on misinformation, or aimed a market manipulation? Ultimately, we need to determine what is required to safely manage Open Finance and protect the stability of the market and protect consumers.

Concluding the conversation with a final observation, Prof Zachariadis includes examples from the BigTech sector and notes that going forward regulation in financial services has to be more data-driven than entity driven. It is not the entity that is important, but rather the flow of data and the impact of that data and inferences that can be made of it. Regulators, therefore, may indeed need to revisit their definition of financial data.



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