June 2023

Open Banking:

A collaborative roadmap for South African banks and fintechs

Current Open Banking Ecosystem in South Africa

A Global Perspective on Open Banking

The Benefits & Challenges for SA Banks

The Potential Future Landscape in Africa

[Read full article here]

finch technologies

Contents

Executive summary

South African banks have often been hesitant to embrace open banking technology. As custodians of our money and data, both security and data privacy are understandably top priorities for banks. They hold our value and our transaction history. The depositors they sit on, and the data insights generated drive value for shareholders and sometimes their users. It is for this reason that banks worry open banking may disrupt their traditional business models and give an advantage to newer competitors.

While more banks are joining the conversation around open banking, these concerns remain valid. However, there is **potential for new market opportunities if trust and outside partnerships can be established**. Open banking requires stringent security measures to protect customer data; therefore, banks must ensure this is considered before implementation. Moreover, it could forge **partnerships that could help banks capitalise on fresh sources of revenue while safeguarding their interests at the same time**.

A great example of this, is how fintechs and banks are both actively modernising payment methods to drive growth in the economy. To achieve this goal, they are investing in robust banking systems and technology while implementing new regulations related to open banking. This is intended to benefit both banks, by enhancing their value proposition, and TPPs that will now be able to participate in the payments space on more equal terms. This is just one example of many fintech offerings being rolled out in the open banking environment.

Market projections anticipate that open banking will see **22.3% growth by 2031, bringing the total market value to more than $123.7 billion. Additionally, global card payments, are set for 9.16% CAGR for the same forecasted period, bringing the total market value to $327.68 billion.** If South African banks want to stay ahead, embracing open banking is crucial as global trends forecast significant growth in this ecosystem.

Unleashing the Power of Data

The Rise of Open Banking

An open banking ecosystem is one where a financial institution offers TPPs the ability to connect into the bank's infrastructure. A common method and one you will hear in the narrative frequently is the use of APIs (Application Programming Interface). **Opening up the infrastructure also offers financial institutions the ability to leverage the third party's technologies to improve their own infrastructure**. It is a collaboration outlook and infrastructure that allows all parties to build solutions by plugging in specialised tools for each part of the journey.

Today cash and cheques, physical or card, have lost market share to alternative payment solutions, such as digital wallets, bank-to-bank payments, BNPLs, and cryptocurrencies. 89% of South Africans are turning exclusively to digital banking, meaning an ever-decreasing need for brick-and-mortar facilities to service these digital customers.

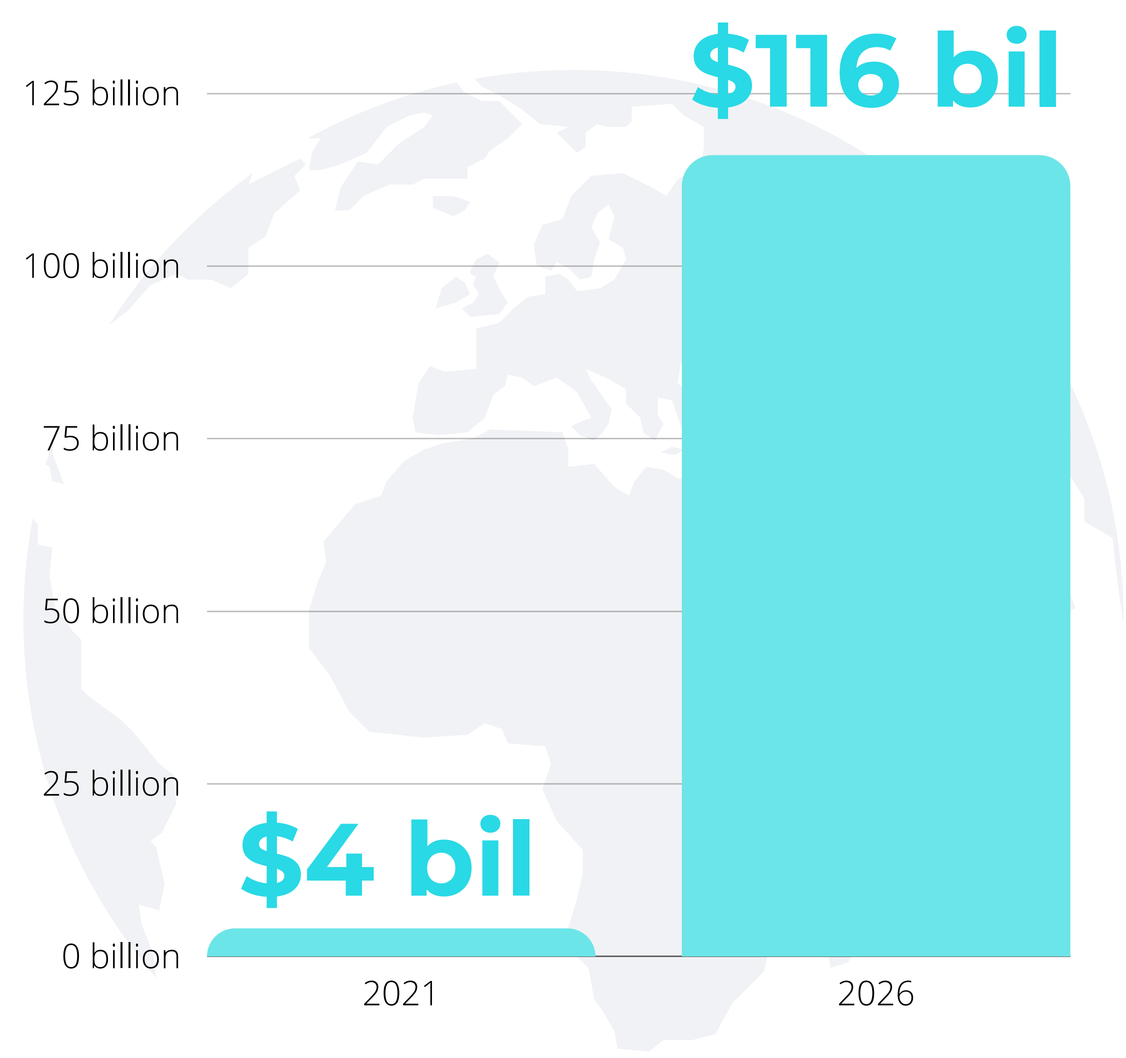
Open banking is also helping to facilitate financial inclusion for those on the margins of society. Clearly, new payment solutions are here to stay – meaning it's critical for banks, lenders and fintech companies to understand their role in its adoption. A critical example of the success open banking can drive.

Open banking involves the use of open APIs by third-party providers, granting them secure access to customers' financial information. This opens opportunities for all key players to leverage innovative technologies and offer services that improve customer experience. Screen scraping and open APIs can permit open banking; however, it's the latter that is most popular with regulators and banks due to its added security measures. It allows for real-time payments, greater financial transparency options for account holders, as well as marketing and cross-selling options for financial institutions.

89%

of SA consumers turning exclusively to digital banking

A Global Perspective on Open Banking



Global value of open banking payments

The number of open banking users worldwide is expected to grow at an average annual rate of nearly **50% between 2020 and 2024.** In terms of value, Juniper Research estimates the global value of open banking payments will exceed $116 billion by 2026, up from $4 billion in 2021.

When looking at open banking in the South African context, there are important insights to gain by studying open banking systems in other countries. This provides a guide to getting traction and learning from critical mistakes. Regulatory frameworks differ depending on the jurisdiction. They may include rules for product and service offerings, data-sharing practices, permissions for TPPs to access data, and regulations regarding the reuse or redistribution of shared data.

International regulatory frameworks include the revised **Payment Services Directive (PSD2)** in the European Union. This directive promotes data sharing and competition amongst businesses and encourages innovation.

The **Financial Conduct Authority (FCA)** authorises UK companies to use open banking APIs for accessing financial data or initiating payments. While the Central Bank of Ireland regulates open banking in Ireland.

The **Hong Kong Monetary Authority (HKMA)** introduced the Open API Framework making it easier for banks to access APIs. Phase I includes 20 banks offering more than 500 different APIs that provide customers with information on products and services.

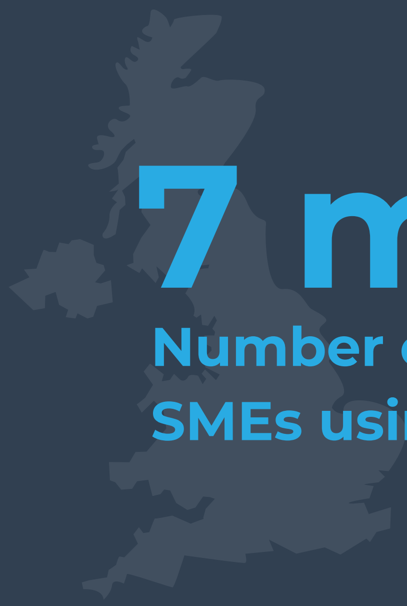
How the UK has succeeded in the Open Banking Ecosystem

On its current growth trajectory, the UK surpassed 8 million monthly open banking payments by the end of 2022 and will reach 10 million by the end of the first half of 2023. Open Banking LTD reports that 7 million UK consumers and SMEs are now actively utilising open banking services. Over the last year, we've seen the usage of open banking products and services in the UK **change from basic account aggregation to innovative use cases, particularly in lending and identification**.

For example, TrueLayer and Klarna offer Know-Your-Customer (KYC) products where customers simply allow access to their bank accounts to be verified for new product applications. The entire process only requires a small monetary payment to the relevant institution or partner. This eliminates time-consuming onboarding processes like filling out forms, lowering potential drop-off points in the process as well.

Neobanks such as Bunq are using open banking protocols to authenticate existing customers. This reduces call centre volumes and encourages customer loyalty by providing alternate solutions when card usage is blocked due to fraud or additional KYC requirements gotten up.

Fintern and Koyo are two online lenders who utilise bank account information to calculate an applicant's creditworthiness quickly. Through bypassing traditional bureaus, no one's credit score is affected during the procedure, making it convenient for those in search of financing without any risks.



7 million

Number of consumers and SMEs using Open Banking

How TrueLayer became a leader in Open Banking in the UK

TrueLayer is considered a trailblazer in the open banking landscape in the UK. The fintech company specializes in providing open banking APIs and infrastructure to facilitate secure and seamless data sharing between financial institutions, third-party providers, and end-users. Notably, they were among the first TPPs to successfully implement variable recurring payments (VRPs), introducing a paradigm shift in the industry.

TrueLayer has developed a robust and reliable API platform that enables easy integration with financial institutions and seamless data exchange. Part of TrueLayer's success has involved strategic partnerships with several UK banks, including Barclays, HSBC, and Lloyds Bank, among others.

SA players ready to drive this revolution

Regulators

Recently, a Directive issued by the South African Reserve Bank is a promising indication of the evolution of open banking. Beyond regulating open banking participants, the directive will need to extend the effort further to get the banks to participate in a meaningful way and it will need to broaden its scope to allow more momentum to develop by third-party fintechs.

Conversations around this ecosystem are picking up, and regulatory forums are being created like the Intergovernmental Fintech Working Group (IFWG) forum in 2016. IFWG consists of all the key players needed to drive open banking forward, being the financial sector regulators market conduct authorities, the competition authorities and industry players such as banks.

Financial institutions

Banks act as the gatekeepers of data, safeguarding funds and offering tailored money management options. Open banking allows banks to access customer data and insights that could inform their decision-making.

Capitec Bank and Discovery Bank have seen major value in partnering with Easy Equities, where both clients now have an alternative method to save, directly in their banking app. Bidvest Bank and Grindrod Bank have already partnered with fintech players such as Spot Money, Lesaka and Redcloud with business models that target a different section of the market such as SASSA beneficiaries. Other banks who have dipped their toes in the water include, Nedbank and Investec, who are already making open APIs available.

Third-party providers

As the catalysts of open banking, TPPs will benefit from this ecosystem by getting access to reliable financial data. truID for instance allows users to securely access consumer financial data with the aim of creating a unified open data framework. Payshap combines open banking APIs and instant payments. Ozow, a payment solution provider, has collaborated with banks to analyse customer payment data using AI. Stitch enables businesses to connect to the financial system and deliver payment experiences for their users.

Finch Technologies, a SaaS business offers on demand live quoting capabilities for business and consumer finance as well as open API infrastructure into affordability, verifications and authentications.

Fears & challenges for banks

Why is there reluctance to engage with Open Banking?

Security & potential data breaches

Open banking requires the sharing of data with TPPs, which can, in the wrong hands, increase the risk of data breaches and compromise customer information. Banks may be hesitant to adopt open banking until they are confident that the technology is secure enough to protect customer data. Beyond the customer roadblock, ensuring secure storage and transfer of shared information will be key for combating cybercrime & money laundering. Stricter KYC checks should be adhered to in safeguarding customer assets and keeping their data safe from fraudsters.

Disruption

Financial institutions fear that this new ecosystem may disrupt traditional banking business models, and lessen their ability to control access to customer data in order to maintain a competitive advantage. This disruption also presents a huge opportunity for banks, where they can embrace new possibilities outside of their core level of expertise, especially if they move first. Banks should view TPPs as potential collaborators and partners.

Cannibalisation of the customer base

In this ecosystem, the concern of cannibalisation of the depositor base for banks is amplified because customers have more choices when it comes to banking services. Open banking allows TPPs to access a bank's customer data and offer their own financial services, which may compete with the bank's own products. In this ecosystem, customers have greater visibility and transparency into the financial products and services available to them. This means they can easily compare and switch between products and providers, which can result in increased competition for banks. As a result, banks need to focus on offering competitive and innovative products to retain and attract new customers.

Additionally, banks need to be proactive in identifying customer needs and developing products and services that meet those needs. They also need to be aware of the competition and continuously evaluate and refine their offerings. By doing so, banks can maintain their deposit base and ensure their long-term viability in an increasingly competitive financial landscape.

Global lens

On the consumer front, **61%** of North American customers are wary of sharing their data with a TPP; whereas in the UK & Europe, only **53%** are reluctant. The General Data Protection Regulation (GDPR) has enforced a stricter data security, potentially leading to this favourable outlook on data sharing in the UK & Europe.

What are the barriers and challenges for banks?

Regulatory Challenges:
The Big 5 SA banks are subject to stringent regulations and compliance requirements imposed by regulatory bodies such as the South African Reserve Bank (SARB) and the Financial Sector Conduct Authority (FSCA). Adapting their existing systems and processes to comply with open banking regulations can be a complex and time-consuming task.

Legacy Systems and Infrastructure:
Many SA banks have legacy systems that were not initially designed to interact with external TPPs. Integrating these outdated systems with modern open banking APIs can be challenging and require significant investments in infrastructure upgrades, SA banks will need to make big changes to their architecture to effectively pull it off.

Customer Trust and Education:
Building trust among customers is crucial for the successful adoption of open banking in South Africa. Banks will need to invest in advanced encryption protocols, multi-factor authentication, and secure data storage practices. Additionally, educating customers about the safeguards of open banking is essential for its wider adoption.

> SA banking has been well placed in its monopolistic market where it has not had to worry about opening access to other institutions.

Financial exclusion is still rife:
Although there is some benefit for previously excluded consumers with these alternative products within the open banking ecosystem, ultimately this data is not effectively used by banks to broaden the available product set offered by banks.
Banks, alternative financiers, and consumers all pay the price for this. Products remain unnecessarily expensive, banks miss out on new clients who are proving they can participate financially, and consumers fight to build a healthy banking portfolio. So, while South Africa may have a high penetration of banked clients, there is room to argue that a large portion of these banked individuals and businesses are not receiving financial products and are thus financially excluded.

How does open banking benefit banks?

Collaborative Advantage

Open banking gives an opportunity for banks to stay ahead of the competition by letting them explore data-sharing agreements with TPPs and other non-financial service institutions. There is an opportunity for banks to use open banking to allow the innovators to create products around the banking ecosystem that service the the bank's clients in an efficient manner.

Rather than investing time and resources in building niche products, it is more beneficial for large retailers or corporate banks to actively observe innovators and their directions. By doing so, banks can identify the winning trends and segments that would benefit from becoming part of their mainstream offerings. This approach allows banks to leverage the expertise and innovations of external players, enabling them to stay competitive.

Open banking will offer seamless integration of innovative services, nurturing customer loyalty and engagement

Better customer engagement

Banks will be able to deeply engage with customers and foster relationships of trust by providing user-friendly customer experiences revolving around aggregated, accessible financial information. An improved interface can create a less intimidating space for customers and encourage them to be in better control of their finances. Banks can gain insights into a customer's habits and preferences.

Simplified compliance & costs

Open banking holds the promise of easing compliance burdens and lowering costs. This ecosystem relies on standardized APIs to facilitate data sharing between financial institutions and third-party providers. This makes it easier to manage and exchange data, streamlining processes, minimizing complexity and associated costs. By utilizing these APIs, banks can reduce the amount of manual labour needed for operations while achieving an efficient flow of information across different organizations. Additionally, new KYC and Anti-Money Laundering (AML) protocols can potentially be developed from the ability to access data across different platforms. Traditional banks routinely keep track of consumer data, yet prevalent KYC/AML costs are anticipated to be shared among service providers who have access to said data.

How does open banking benefit banks?

Embedded finance

Embedded finance provides a huge opportunity for banks, where non-traditional industries are starting to offer financial products and services that used to be provided by banks. Open banking can facilitate the data sharing and connectivity required for embedded finance. An ideal example is a large retailer that starts to offer credit cards in partnership with a bank, the payment app built by a third-party provider will enable customers to make purchases and manage their finances.

This allows banks to access an entirely new customer base that they may not have been able to reach otherwise. This will also be a huge cost saving as often the retailer and Fintech provider will take on all the costs when building out the product. Additionally, these Fintech providers aim to build seamless and user-friendly experiences, with the focus on ensuring customer retention. Consumers want integrated financial solutions, and they need to be as accessible as possible.

Re-package finance products

As the fintech sector continues to grow, customers are presented with more choice in terms of banking products and services. This leads to customers no longer being tied to traditional bank packages and instead opting for tailored services from both fintechs and banks. As a result, it is becoming increasingly popular for banks to unbundle their existing financial offerings and contract out specialized parts of their products. Open banking offers banks the opportunity to unbundle large banking services into smaller components which can then be re-bundled in a customer-focused manner. In essence, they are able to shed off less profitable parts of their product bundles, and re-package them with the assistance of fintechs.

At the end of the second quarter of 2022, there were 1,578 operational open banking platforms. These platforms collectively provided a comprehensive range of 5,564 API products.

At the end of 2022

1 578

open banking platforms collectively provided

5 564

seamless API products

Open Banking Case Studies

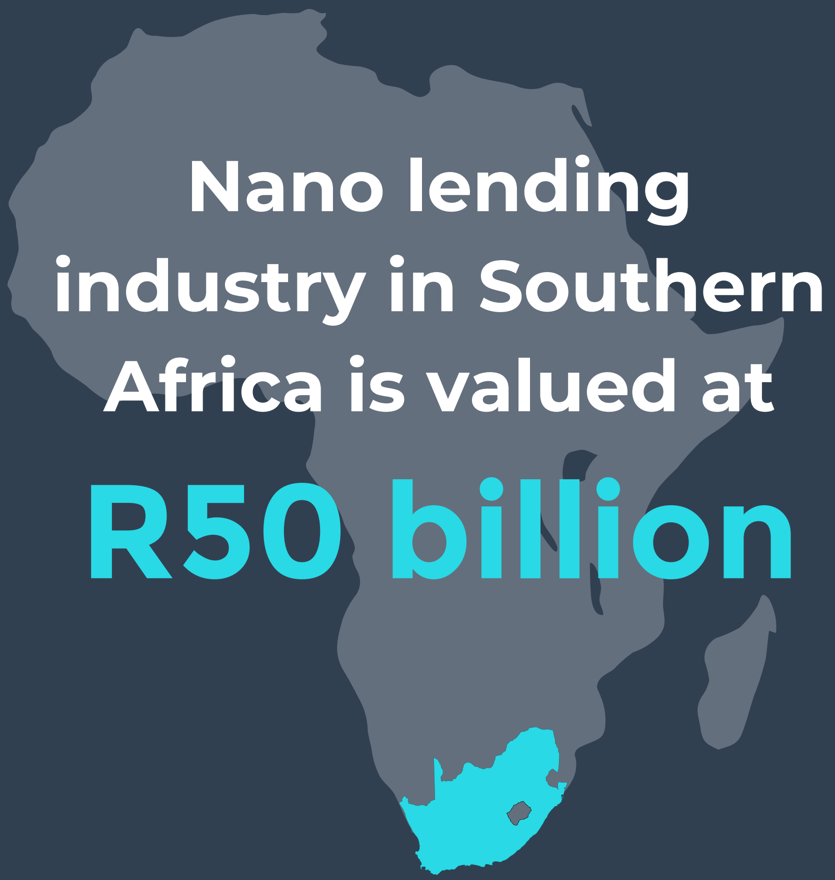
What does it look like in Africa and South Africa?

South Africa has the benefit of one of the most established banking technology and platforms. The next iteration is making it work for a broader market. Here are a couple of open banking case studies in country:

Nano Lending

On the back of Airtime Advance, a large mobile operator wanted to enter into the lending space through a product called Nano lending, which is an advance of R50-R1,000 paid back from 7 days through to 21 days.

Due to the nano size of the loan, there could not be any human intervention in the scoring process. Using Gathr, the digital onboarding solution built by Finch Technologies, the client was able to acquire all the financial transactions which included main income, debit orders and all expenses to conduct an affordability assessment. All this information is passed into a risk scorecard, where application to approval is done in minutes.



Taxi Finance

There is a significant amount of physical cash that is traded in this mini-bus taxi industry. This includes the taxi operators paying off their vehicle finance in weekly instalments with cash.

A leading SA taxi finance business wanted to digitise its collections. Their preference for these collections was linked to the extra cash handling costs, risk of violence and theft around cash and the added difficulty of cash reconciliation.

This business wanted an open banking solution to calculate the seasonality of a taxi owner’s cashflow to calculate optimal strike times in a month to collect the capital and interest owed on a loan. By digitizing these transactions, one is quickly able to build several forecasting models using seasonality analysis. The taxi owner has the added benefit of not having to deliver cash, has efficient seasonality analysis to optimise collections and access to a product that is not a mainstream product of a bank.

Open Banking: Benefit to Banks

Merchant Services and Payments

Open banking has revolutionized merchant services and payments in South Africa. Fintech companies leverage open banking to build payment solutions that allow merchants to accept payments directly from customers' bank accounts, eliminating the need for card-based transactions.

A notable illustration of this symbiotic relationship between banking and fintech can be witnessed within the South African payment solution provider space. By integrating with all major banks in the country, Ozow, a payment solution provider, has recently joined forces with a prominent bank, Capitec, to successfully introduce Capitec Pay, the country's pioneering payments API.

Additionally, payment system provider BankServeAfrica launched PayShap, a Payment Initiation Service App (PIS). Combining PIS apps with open banking APIs and instant payments can revolutionize the payment process, enabling seamless transactions from initiation to settlement within seconds.

By utilising PIS apps, retailers accepting payments can ensure prompt payment settlement before releasing goods to customers. While banks will continue to receive payment initiation requests, their role remains crucial as they are responsible for facilitating instant payments. To retain retailers as customers who rely on instant settlement, banks need to ensure optimal performance of their payment's platforms.

Personal Finance Management

Open banking APIs have empowered financial institutions and fintechs to develop personal finance management (PFM) applications. These apps aggregate data from multiple bank accounts, credit cards, and other financial accounts, providing users with a comprehensive view of their finances in one place. Users can track their expenses, set budgets, and receive personalized financial insights. Open banking ensures that the data is securely accessed and updated in real-time, enabling users to make informed financial decisions. Discovery Bank has done this with Vitality Money, where consumers can track their financial behaviours and improve their status.

Personal finance management tools are poised to become the flagship sector of open banking, empowering individuals to take control of their financial lives by seamlessly accessing and managing their accounts. PFM applications are expected to reach a global market value of **$3.3 billion in 2025, which is a CAGR of 12.65% from 2018.**

Does open banking augment or challenge how banks make their money?

Traditionally, banks have been set up to make money on consumer's money. How does that work? Consumers generally put their money somewhere safe and it must be available when they need it, so they deposit this money into their bank account. If a consumer puts money into a long-term savings account, they earn interest. Banks then use this money to lend out at a rate that is greater than what the consumer lend it out at. Considering a default rate, banks aim to make money in the interest differential between what they pay the consumer and what they charge to their borrowers.

A big shift in banking has been towards the fees that banks earn from their clients. For example, Capitec has evolved as a bank where a large portion of its earnings were interest income vs now where more than a third of its income comes from fees.

So, why should there be any reluctance to embrace the open banking landscape? This model at its core is all about opening up the ecosystem to other providers, it allows banks to bring in revenue through direct streams, where previously they relied on global payment processing networks e.g., Visa, now they can cut out the middleman and improve profitability.

This transformative shift will empower banks to deliver personalised services, enhance customer experiences, and explore new revenue sources beyond traditional banking, ultimately propelling them towards a future where innovation and profitability go hand in hand.

Open banking will sit alongside traditional revenue streams, where various fintech tools will assist in efficiencies and customer retention. **Repackaging products and creating additional product offerings based on open banking data, will allow banks to create an even larger revenue pool,** where consumers can now take out additional insurance offerings or make use of financial health tools all within their banking ecosystem. Customer retention will be a key focus for banks going forward, mainly as customers will be looking for the best service provider coupled with the cheapest banking fees, and it's cheaper for banks to keep a client than it is to bring in a new one. Open banking infrastructure will allow banks to offer consumer's the diverse services they need at a reduced cost.

What is the way forward for open banking in South Africa?

To stay competitive, many established banks are now realizing they must have an open banking strategy. It can be difficult to monetize APIs beyond account aggregation; however, incentives for customers could be extremely helpful in capitalising on open banking opportunities. These benefits may include **faster loan applications and reduced credit score impact, simplified KYC processes or credential requirement simplification, and leveraging existing fintech innovations** rather than starting from scratch.

in South Africa, some banks are embracing these changes while others remain against them—regardless, incumbents and neobanks will be able to leverage open banking to their advantage by providing attractive customer incentives. This underscores the importance for traditional banks to embrace this ecosystem and avoid falling behind their more progressive counterparts. It's only a matter of time before open banking becomes part of the traditional banking landscape in South Africa.

> Open banking in South Africa hinges on active collaboration between regulators, banks, and stakeholders to foster financial inclusion, drive innovation, and unlock new unlock new opportunities for banks to deliver value.

Conclusion

While South African banks have initially approached open banking with caution, there are significant benefits and market opportunities to be gained by embracing this landscape. Key players in this ecosystem will need to take it one step further than just being pioneers, they will need to help both create and embrace open banking regulatory frameworks and groups.

Global players have demonstrated the success of open banking, and market projections forecast significant growth in the next five years. To stay ahead and remain competitive, it is essential for South African banks to **embrace open banking and leverage its potential for customer-centric solutions and securing a prominent position in the evolving financial landscape**. Open banking is set to combat financial exclusion, and collaboration between fintechs and banks is crucial in developing accessible and affordable financial products for South Africans.

Certain banks have a significant opportunity to gain a competitive edge within the open banking landscape. Those banks that seize the initiative and make the initial move will enjoy a compounded advantage in the market. Catching up with these pioneering institutions will prove challenging, given the increasing elasticity of customer behaviour.