The Economist INTELLIGENCE UNIT

A WHOLE NEW WORLD:

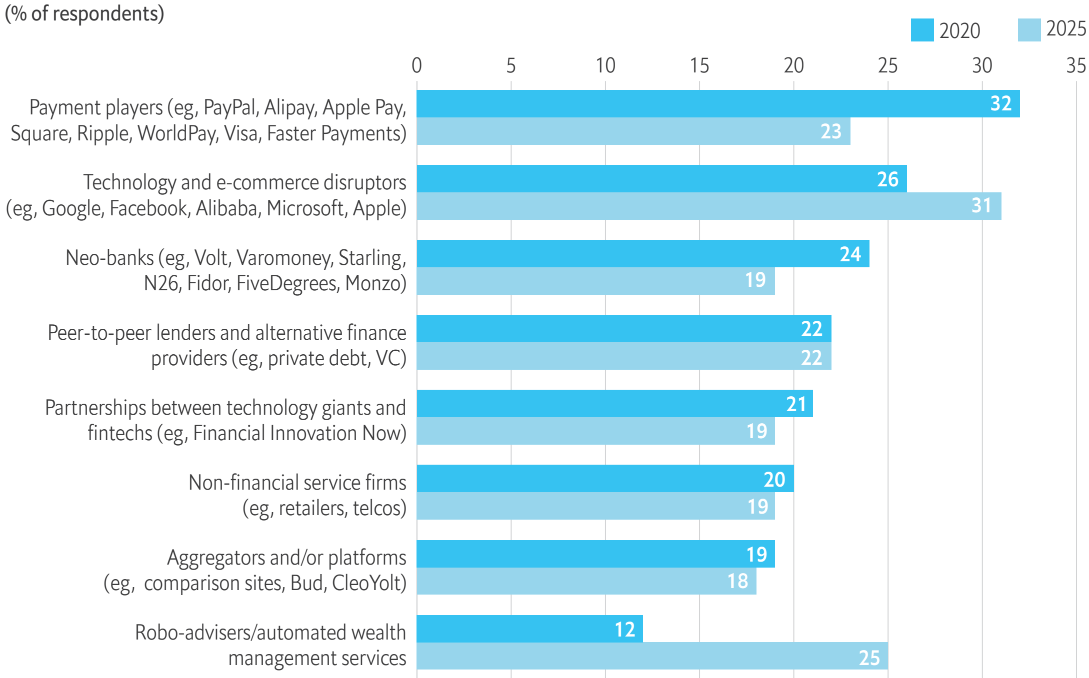
How technology is driving the evolution of intelligent banking in Europe

In the short term, open banking presents practical challenges. Longer-term, it poses strategic questions about the future of Europe's banking sector

In Europe, as in the rest of the world, technology is setting the agenda for the banking sector. This year, European respondents to The Economist Intelligence Unit's global retail banking survey identify new technologies as the primary driver of change for retail banks, both in the coming year and up to 2025, overtaking changing customer behaviour and demands for the first time.

Unlike the rest of the world, however, technology-driven change in the banking sector is following a very particular agenda, in the short-term at least: the EU's revised Payment Services Directive (PSD2).

Chart 1: Which non-traditional entrants to the retail banking industry will be your company's biggest competitors by 2020 and by 2025?
(% of respondents)



Source: The Economist Intelligence Unit.

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For citizens, the open banking mandated by many of PSD2's provisions promises a new world of intelligent, intuitive and accessible banking services. New features and services will depend heavily on data to manage spending and personal budgets, and encourage long-term savings.

For banks, it offers long-term opportunities but, as the survey reveals, short-term challenges too. Competition from the digital sector is hotting up: a quarter of respondents believe tech giants will be their biggest non-traditional source of competition by 2020; 31% believe that will be the case by 2025 (see chart 1).

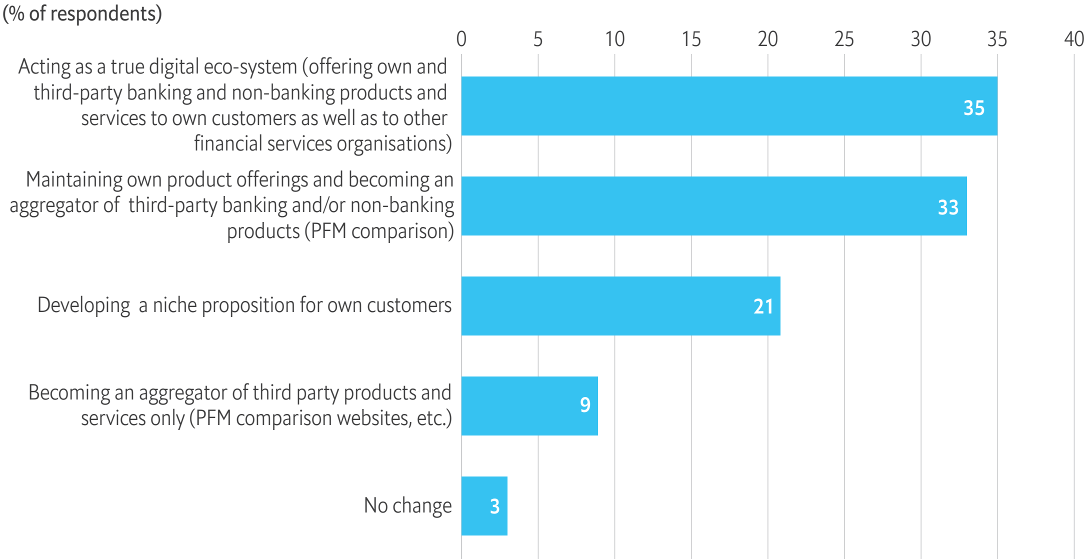
European banks know they have no time to waste. Making open banking work, both practically and strategically, is the order of the day.

Short-term headaches

Unsurprisingly, given the mandate of PSD2, launching an open banking strategy is a top priority for the coming year for 29% of European respondents, second only in prevalence to talent acquisition and retention (30%). Open banking will still be a priority in 2025 for 26% of respondents, although more expect to be prioritising responding to regulation (35%), migrating clients to digital channels (29%) and mastering digital marketing (29%) by then.

Furthermore, the largest share of European bankers sees embracing openness as the future of the industry: 35% of respondents see acting as a true digital ecosystem—offering both banking and non-banking services that originate either internally or from third parties to customers and other financial services providers—as the primary direction in which their organisation's business model will evolve (see chart 2).

Chart 2: What is the primary way in which you see your current digital business model evolving?
(% of respondents)



Source: The Economist Intelligence Unit.

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But the minds of Europe's bankers are also occupied by the short-term technical challenges that open banking presents, the survey reveals. Banks in the EU are due to deliver fully operational portals for their application programming interfaces (APIs), intrinsic to open banking, by September 2019. However, three in ten respondents from Europe identify a lack of international standards for APIs as their greatest concern regarding regulation and standards.

Indeed, the introduction of APIs in the European banking sector has not been smooth sailing so far. Banks had until June 14th 2019 to prove they had dedicated APIs available for testing by third parties. If they missed the deadline, they may have to offer fallback options and spend more IT money on secure screen scraping.

"Whether the third parties test [our APIs] is out of our control," says Matt Cox, head of open banking at Nationwide Building Society, one of nine UK banks charged with leading the open banking push, called the CMA9.

"For us, testing is still in early days. We were one of few of the CMA9 to have the full suite ready for the March deadline. We are working with two to four different third parties and are only just at the beginning of testing payment journeys in any meaningful way,'" he says.

Mr Cox feels that the majority of European banks are further behind than the UK. He may be right; a recent survey found 41% of banks[1] failed to have API testing sandboxes ready in March to allow third-party providers the chance to test them for six months.

ABN AMRO puts distance banking to work

Over 70% of sales and services at Dutch bank ABN AMRO are now digital, says Roland Booijen, director of grid apps and digital innovation. But delivery is still in a state of flux, with new capabilities such as video banking coming to the fore.

"Our advisers initially had their doubts on clients' satisfaction, [but] they were soon convinced when they saw that the Net Promoter Score of customers was higher for conversations via video banking compared [with] those on our branch office location," says Mr Booijen.

More complex, regulated products are being added to the mix, although the private banking division may take more time, he explains, as its clients are not a homogenous group. Some want control via apps and digital channels; others prefer more human interaction.

"The complexity of the financial solutions this group demands and deserves will inevitably require relatively more human assistance. We do see that these clients also appreciate our video banking capabilities," says Mr Booijen.

[1] https://tink.com/blog/2019/3/20/psd2-sandbox-status

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A third of respondents identify challenges around authenticating their customers' digital identities as their greatest regulatory concern. PSD2 also mandates that, by September 2019, all online transactions over €30 will require two-factor identification, whether by card or direct from an account. This provision, titled strong customer authentication (SCA), could lead to a sharp increase in declined payments and abandoned baskets at online checkouts.

Banks will need to be flexible, offering a range of authentication options for those suspicious of relying too heavily on mobile devices. If not, €57 billion worth of e-commerce could be abandoned at the checkout in the first year of SCA, according to recent estimates[2].

Longer term, bigger picture

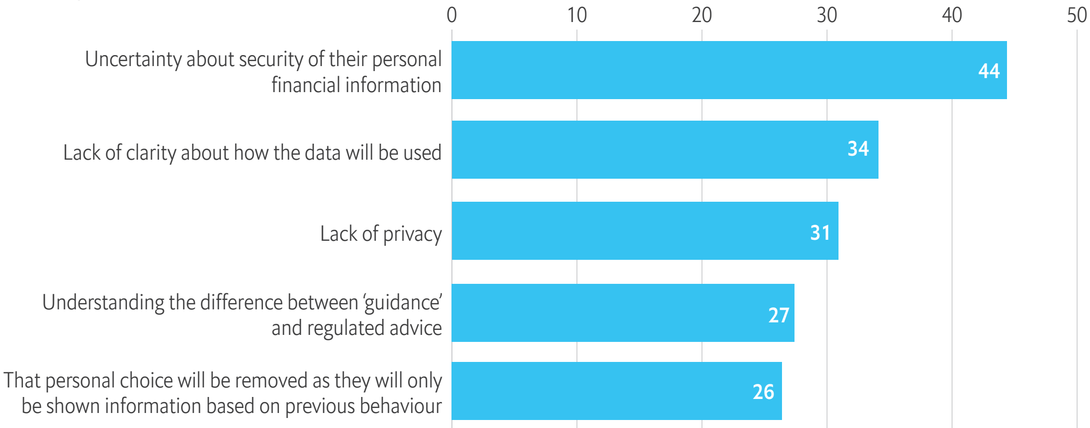
While there is work to be done on technical matters in the short term, the bigger question for banks is how they will continue to create value for customers in a highly digital, highly disaggregated banking system.

While European banks are increasingly open to the idea of becoming the architect of an ecosystem of services, many of which are provided by third parties, they nevertheless need to keep their customers engaged and loyal.

This means that to stave off the threat of being disaggregated themselves, banks must offer something their customers cannot get elsewhere. "The only way to stay relevant these days is to be a platform that users want to use," says Ali Niknam, founder of bunq, a mobile bank based in the Netherlands (see box for more on bunq's digital strategy).

Personal financial management (PFM) is one area where banks have sought to convert their data assets into customer value, by providing insight and guidance into customers' spending habits and financial position. The appeal of this strategy for traditional banks is that it turns their long-standing customer relationships, and the data that accompanies them, into a driver of digital engagement.

Chart 3: What do you think are customers' biggest concerns related to artificial intelligence?
(% of respondents)



Source: The Economist Intelligence Unit.

[2] https://stripe.com/gb/newsroom/news/sca-impact-study

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The challenge of PFM is not crunching the numbers but providing useful insight in a timely and accessible fashion, explains Christoffer Malmer, head of SEBx, the innovation studio of Nordic bank SEB. “It is about turning the data into insights with a value-add. We need to match the demand, data collection, presentation, report generation and compliance with a pleasant customer journey.”

This ability to turn data into insights that customers value and can incorporate into their lives will become all the more pressing as banks and their digital-native rivals develop their artificial intelligence (AI) capabilities.

Improving the user experience through greater personalisation is the most widely anticipated benefit of AI, both in Europe (15%) and globally (20%). But European bankers also anticipate risks: when asked to identify their customers’ greatest concerns regarding AI, 31% select ‘understanding the difference between guidance and regulated advice’ (see chart 3).

European banks, our survey confirms, have accepted that theirs is now a world where openness is the most viable strategy. Determining how best to deploy technology innovation to create value for customers in an open ecosystem is still a work in progress.

bunq, the bank you subscribe to

“Traditional banks see the whole interaction with the customer as a mandatory step to acquire more deposits, as more deposits means more profit. With bunq, the whole user experience is key,” explains Ali Niknam, founder of the Dutch mobile bank.

When he and his team looked to offer foreign currency transfers, they naturally considered building the service from scratch, like a traditional bank would do. Instead, they decided to incorporate third-party provider TransferWise as it offered an experience bunq itself could not beat.

Extrapolating this approach to its furthest extent could lead to a mobile banking platform offering no own-brand products, making money solely from commission and fees. This is not a strategic option many established banks relish: just 9% of European survey respondents see becoming an aggregator of third-party products and services only as the future of their business model.

Instead, bunq charges a monthly ‘membership’ fee for the bank account and cards that banks usually offer for free, although Mr Niknam takes exception to their definition of ‘free’ and its implications.

“Traditional banks tempt you with saying current accounts are free,” he says. “In reality, they have fees that are not transparent, like markups on foreign exchange or overdraft penalties.”

For their fixed fees, bunq customers receive better exchange rates, free overseas cash withdrawals and other benefits, Mr Niknam says. He admits that convincing customers to pay for accounts that are typically free is difficult. Explaining how conventional banks ‘hide’ their fees is more compelling, he says.

The subscription approach has other benefits. As bunq relies on service-fee income, it does not have to maximise margins on every product line. That allows it to offer more control to customers, such as letting them decide that their savings are only used to fund green companies or mortgages, without lowering the interest rates they receive.

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