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THE FUTURE OF DIGITAL BANKING IN EUROPE 2023

A MONEY20/20 EUROPE SPECIAL EDITION

Finextra

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INTRODUCTION: WHAT IS EUROPE'S FORMULA FOR SUPPORTING THE FINTECH INDUSTRY?

"The fintech industry in Europe has, up to this point, been supported by relatively favourable regulation, an abundance of capital, consumers who have embraced digital transformation and an ecosystem that promotes innovation. However, the era of over-hyped valuations and the availability of cheap money is now well and truly over. What we're now seeing is a correction in valuations and any fintechs that need to go to the market to raise further capital are going to face significant challenges. Those fintechs that can demonstrate the ability to scale internationally and maintain a strong and engaged user base will be the ones that can ride out this storm. The UK is probably the leading fintech ecosystem in Europe and is a force for growth, innovation, job creation and social mobility. There are, of course, pockets of fintech development and growth all over Europe, with some of the highest populated countries such as Germany, France, Italy and Spain punching below their weight."

Justin Basini
CEO, ClearScore

Growth across the European fintech industry is fluctuating, and it is becoming increasingly evident that the record levels of funding and deals seen in 2021 will not happen again any time soon. As revealed by CB Insights, funding rose by a staggering 168% to reach $131.5 billion in 2021 from $49 billion in 2020 after fintech firms the likes of Klarna and Stripe achieving monumental valuations. However, 2022 saw rising interest rates, a cost-of-living crisis and continued geopolitical instability which led to trillions in valuation being erased from public markets.

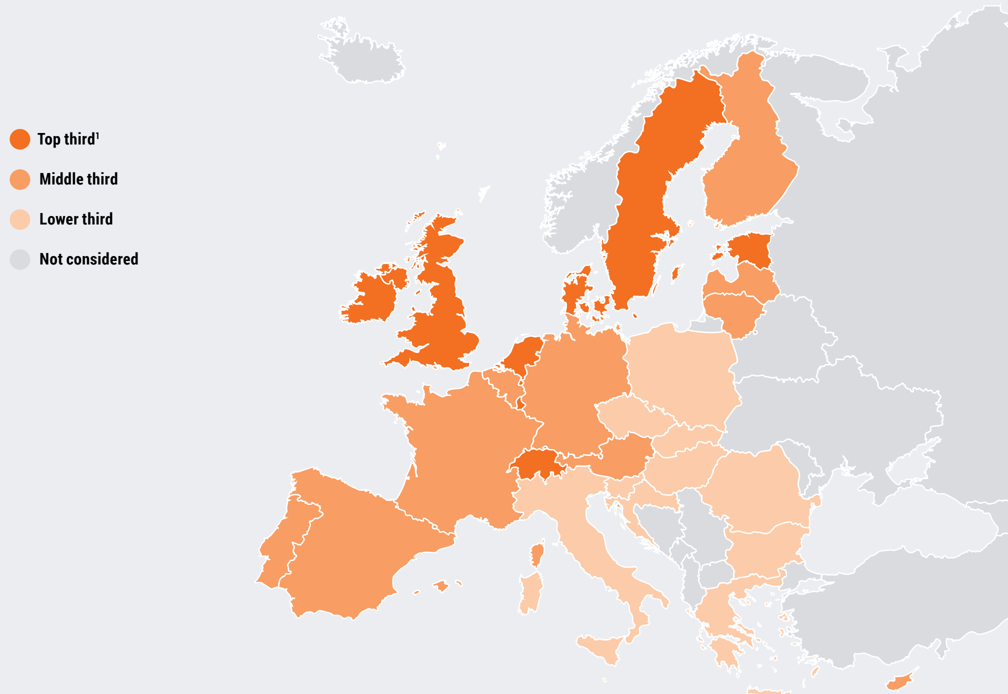
In conversation with Victor Trokoudes, CEO and founder, Plum, says that "it is true that we are now in a different economic climate following the Covid-19 pandemic and the outbreak of the Russian war in Ukraine, with high inflation and more aggressive tactics on interest rates from central banks. However, investors need to keep an open mind and acknowledge the integral role fintech has to play in this environment. Fintechs that provide an essential service, either beneath the bonnet or to consumers, have great potential to rise to the current challenges. European investors are in a good position to capitalise on that and ensure that the right companies are able to flourish and provide value across Europe."

This macroeconomic deterioration has however resulted in access to financing becoming more difficult, but Europe's fintech sector remains at the core of the financial services industry, rather than at the fringes as it was once before. According to McKinsey, in each of the seven largest European economies measured by GDP – France, Germany, Italy, the Netherlands, Spain, Switzerland and the UK – at least one fintech firm ranks among the top five banking institutions.

The McKinsey research continued to state: "If fintech ecosystems in all European countries were able to attain the same level of performance as the best in the region, the upside could be substantial. The number of fintech jobs in Europe would grow by a factor of 2.7 to more than 364,000; the volume of funding would more than double to almost €150 billion from €63 billion; and valuations would grow by a factor of 2.3 to almost €1 trillion—almost twice the combined market capitalization of Europe's top ten banking players as of June 2022."

Europe is in need for more jobs, more funding, and more substantial valuations for the fintech industry to flourish, but as Justin Basini, CEO, Clearscore highlights, "the era of over-hyped valuations and the availability of cheap money is now well and truly over. What we're now seeing is a correction in valuations and any fintechs that need to go to the market to raise further capital are going to face significant challenges." For progress to continue, Europe's regulatory approach must continue to balance innovation with consumer protection, as Annelina Koldewe, global head of wholesale banking payments, ING posits.

Fintech performance is variable across Europe, with the United Kingdom, Sweden, and Northern European countries leading.



Fintech ranking by performance

Countries with GDP > $100 billion
Countries with GDP <$100 billion

Top third	Middle third	Lower third
United Kingdom	Germany	Italy
Sweden	*Republic of Cyprus*	Hungary
Malta	*Lithuania*	*Slovenia*
Luxembourg	Finland	Czech Republic
Switzerland	Austria	*Croatia*
Estonia	France	Poland
Ireland	*Latvia*	Greece
Netherlands	Spain	*Bulgaria*
Denmark	Belgium	Romania
	Portugal	Slovakia

Note: KPIs considered for all EU-27 countries, United Kingdom, and Switzerland: fintechs founded per million capita, 2021; fintech funding per capita in €, 2021; deals per million capita, 2021; unicorns per million capita, 2021; workforce (fintech jobs) as share of total workforce in 2021. The boundaries and names shown on maps do not imply official endorsement or acceptance by McKinsey & Company.

[1] We have also considered the United States as an additional market for comparison (a top-third country based on our analysis) Source: Dealroom.co

Source: McKinsey & Company

Koldewe continues: “Europe is supporting the fintech industry in multiple ways. Most visible is the regulatory approach, where Europe’s regulators balance innovation with consumer protection. Regulatory frameworks like PSD2 and GDPR create a level playing field and promote innovation. Collaboration and partnerships between financial institutions and fintechs are very common, focusing on a joint journey to foster innovation and leverage the infrastructure and client base of banks.”

Kilian Thalhammer, global head of merchant solutions - fintech and platform, Deutsche Bank AG, adds that Europe is leveraging “the scale of the ‘single market’ through targeted regulations and market developments to foster innovation and incubate new competition. From open banking, underpinned by the payments service directive, through to fully scalable (and now instant) cross-border payments across SEPA markets, Europe has been a pioneer in fostering a dynamic fintech landscape.”

He continues: “Not only in terms of Europe’s approach to fintech, but so too when looking at the positive impact fintechs have had conversely on Europe - through to the boom in new players Europe’s previous sometimes sluggish retail banking landscape has been revived, with fintechs setting new standards in digital client interfaces, consumer experiences and whole new offerings resulting in a positive innovation pressure on incumbents in the market to keep up.

“These two strong forces have created a dynamic environment, with European frameworks lowering barrier entries for fintechs, and more fintechs positively pushing the boundaries of new retail solutions, experiences and opportunities for consumers. With continued focus on pan-European innovation, from the digital Euro project through to EPI, Europe still has much more up its sleeve to contribute to the digital banking landscape and to keep the positive momentum further enhancing the fintech players growth by seeing them as co-innovators and partners.”

This Finextra report, a Special Edition for Money 20/20 Europe, collates interviews with a range of leading players across the financial services and fintech industries operating across Europe and explores topics that will be covered at the event in Amsterdam. Key insights from Accenture, Clearscore, Deutsche Bank, ING, Nium, Plum, Ripple, Societe Generale, Tink, Visa and Zopa will discuss how digital banking across the continent will evolve.

"It's no coincidence that European countries feature so heavily in lists of the world's fintech hubs or that global businesses descend on events like Money 20/20 Europe to showcase their services, network, and knowledge-share. Europe is a champion of the industry and over the last decade, it has taken a progressive approach to regulation, committing to ending monopolies, encouraging cross-industry collaboration and interoperability, and allowing innovation to grow. We saw this in 2018 when PSD2 came into force, ushering in improved customer authentication processes, and again in 2021 with the migration of ISO 20022 messaging standards. This year, we're watching very closely how the next update to the Payment Services Directive (PSD3) progresses. It promises to uniformly regulate e-money and payment services and establish operational clarity in payments – all key to driving out bad actors and supporting those with real use-cases – although it remains to be seen how European regulators will make big tech companies more accountable. This regulatory approach is a winning formula that continues to make Europe an exciting place for startups to thrive, supporting innovation and growth. The recent acquisition of iDEAL by the European Payments Council shows that the region is ready to lead by example, support member states to benefit from a consistent cross-border payment standard, and ultimately give the fintech industry a platform to drive positive change."

Manuel Sandhofer

Senior vice president and general manager Europe, Nium

02

HOW CAN DIGITAL TRUST BE BUILT AMID GLOBAL UNREST AND UNCERTAINTY IN EUROPE?

"It's evident that 2022 has been a difficult time for many in the UK, and the challenges of higher cost of living, higher mortgage rates and negative real income growth are expected to continue into 2023. In this macro-environment, trust is earned, not given. Digital banks and fintechs alike have to consistently put their customers first, and proactively champion their interests. They also have to ensure the highest standards or governance and regulatory compliance are always observed."

Merve Ferrero
Chief strategy officer, Zopa

After a few stagnant years, the world is certainly in motion and macrotrends are forcing organisations to drive change in financial services, disruption in fintech, expand usage of mobile devices and adopt emerging technologies. Digital banking transformation is advantageous to those companies that can keep pace with the challenges presented such as increased competition, meeting evolving customer requirements and mitigating privacy and cybersecurity issues. Alongside this, regardless of a bank or fintech firm's size, identifying and managing risk is crucial to future success.

In conversation with Visa, Mehret Habteab, head of product for Europe, explores how "building digital trust amid global uncertainty is one of the biggest challenges our sector faces today. Transparency in data handling and privacy practices will be key to this, alongside strong cybersecurity measures to help protect customer data, collaboration with regulatory authorities and adherence to industry standards to ensure best practice."

According to a recent EY report: “As the amount of digital information grows exponentially, devices become smarter and connectivity increases, the digital environment is likely to become even more complex. Trends towards more social networking, the growth of cloud computing and varying (and often lagging) national regulations will only add to this complexity.” All customers want is to manage their money with providers that they trust and those offering financial services must comply.

Tasha Chouhan, UK and IE banking director, Tink referenced their research and reveals that “more than four in ten (43%) financially vulnerable consumers express a wish to learn more about managing and optimising their finances. If banks can fulfil this wish and help their customers identify their biggest expenses, they can help them make ends meet at the end of each month – while possibly putting some away for even rainier days. Doing this will cement trust and boost consumer confidence at a time when people are in dire need of guidance.”

While technologies like cloud are known and today, well utilised, organisations must leverage emerging technologies such as artificial intelligence (AI), robotic process automation (RPA), internet of things (IoT), blockchain and others that help to improve digital banking business models. Furthermore, that also allow companies to offer advanced products in line with their competitors and at lower costs.

However, in order for these technologies to be used securely, risk functions within banks and fintech firms must also evolve to keep up with developments, ensure they are trained with relevant skills to manage new risks and interpret the impact global unrest and uncertainty will have on business.

The EY report continued: “Digital transformation creates new risks or magnifies existing risks that need to be properly managed to fully achieve the benefits of innovation and investment. In order to manage these risks effectively, risk functions need to empower executives with the right information to enable them to make risk-informed decisions and need to implement the right approach to manage these types of risks. With maintaining and building trust as the ultimate goal, how risks are identified and responded to can create new business value and unlock business potential.”

Identifying and responding to risk can create new business value and unlock business potential.

Source: EY

On this, Kilian Thalhammer, global head of merchant solutions - fintech and platform, Deutsche Bank AG, says that while trust is not limited to digital only, it is gaining more focus when considering digital risks and threats as fraud and cybercrime are becoming more prevalent than ever and “topics such as security, safety and even sovereignity are becoming more and more top of mind.”

Thalhammer adds that “data is the game changer. Safety and storage of sensitive data and transparency of not only how data is deployed but who is using it are essential – whether it is in the hands of the human or the machine – it ultimately comes down to the clarity of the data strategy.

“However, whilst much of ‘the what’ of building trust in the digital world is also digital in nature, trust itself goes beyond the digital realm. Machines provide facts, but humans provide experience and context and whilst we embrace the new era of technology, it is key to engage, educate and advise through ‘real life’ exchanges, in particular in times of heightened sensitivity still personally.”

Justin Basini, CEO, ClearScore has a similar view and says that as a credit broker, rather than a digital bank, his company understands that "users are open to sharing their banking data, but only if there is a meaningful value exchange. This is crucial to drive a willingness to share into a reality. Our research shows that people are more likely to share their financial data with third parties such as credit marketplaces than mortgage providers, loan providers, banks, and insurance companies. The question of trust is clearly a key driver of propensity to share data with a particular brand."

> *"Recent turmoil in the banking sector has impacted trust around digital companies, as you often see people use organisations they've known for longer in times of uncertainty. However, the fintech sector has matured and improved their standing with the regulator, which means they are better placed to build trust. Customers today are better educated on how fintechs work, which means they will be better placed to assess which fintechs are legitimate and safe to use. Fintechs, for their part, need to be transparent about how they operate and communicate clearly with customers about the protections and regulations they operate under. And underline their dedication to high levels of security and data management by having robust processes."*
>
> **Victor Trokoudes**
> CEO and founder, Plum

03

WHAT NEEDS TO BE CONSIDERED WHEN MAPPING AND SCALING AN EUROPEAN DIGITAL BANKING STRATEGY?

"In mapping and scaling a digital banking strategy, it's important to understand customer needs and preferences in order to develop tailored digital services that meet them. Maintaining trust is fundamental to digital banking and, for the payments sector, it's especially important that customers are able to fully exercise choice and control in how they manage their money, as well as feel confident that they have protection when things go wrong."

Mehret Habteab
Head of product, Europe, Visa

Digital transformation is an intimidating project and altering a business's strategy cannot be done at the flick of a switch. While change is challenging, recent developments across technology have revealed that transformation does not have to be arduous, but departments, companies and industries must reach an inflection point before unpacking the layers of complexity of legacy banking platforms.

With thin margins and high costs, for large traditional lenders, change usually means making a dent in the operating budget and in some cases, there is hesitance to not follow the status quo. Considering the cloud again, because legacy infrastructure is static, high maintenance and cost inefficient, changes in strategy and utilisation of this technology will allow financial institutions to meet customer demand, improve speed and security, and allow for greater expansion.

But what needs to be considered when mapping and scaling a digital banking strategy? Kilian Thalhammer, global head of merchant solutions - fintech and platform, Deutsche Bank AG also expands on how technology can be used to accelerate and scale new digital banking strategies. In Thalhammer's view, simplicity, agility and flexibility are key and he continues to say that "in many cases this statement is focused on the technology and architecture, however, to be truly effective in deploying a digital strategy in any industry, it is essential to also ensure that all components apply the same logic.

“From operations procedures through to business processes, it is the end-to-end holistic simplification and automation of processes and procedures across sales, product, technology and operations combined that differentiate a technology strategy from an overall digital strategy. Within this, it is also key to be pragmatic and foster a culture where it’s acceptable to fail as long as you fail fast, learn and move on.

“With this modus operandi, institutions are able to establish a trial-and-error framework that creates more out of the box thinking, creates a safe space to incubate innovation and entrepreneurial mindsets and result in greater outcomes for the firm, Thalhammer mentions.

McKinsey outlined six strategic action areas that could help European countries catch up with fintech leaders.

1 **Drive the alignment of market structures within the European Union**

An overall simplification and harmonization of fragmented national country regulation is already taking place in the European Union, enabling fintechs to understand key pillars of legal frameworks and to focus on regional specifics. Cultural exchange among countries can equip fintechs to understand key customer needs outside their home market. Meanwhile customers may catch up with a more digitalized way of living.”

2 **Encourage more diverse, ‘homegrown’ capital**

Local political players and regulators have an important role to play in shaping restrictions on institutional investors’ access to growth capital. For example, they could create stronger incentives for venture capital and private-equity investments compared with debt investments. Relaxing investment restrictions for capital accumulation institutions could also make a difference. For example, only about 10 percent of German insurers’ investments are currently in alternative assets such as venture or private capital, whereas in the United Kingdom this share is approximately 30 percent.

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Exploring a similar perspective, Merve Ferrero, chief strategy officer, Zopa, states that the "so-called 'fintech winter' has abruptly ended an industry model that traditionally prioritised vanity metrics and 'growth at all cost' that often yielded frothy valuations. While growth is of course one of the many ingredients for success, sustainable growth is the secret sauce for exceptional outcomes for customers and shareholders alike.

"How do we look to create good outcomes for our customers? We keep three simple things at the heart of all our products and services: value, ease and transparency. Through all our products and services, we aim to improve our customers' financial resilience and well-being. Customers will advocate for those banks that enable great outcomes for them. We also believe that scaling a digital banking strategy needs a profitable, sustainable business model. This allows to attract capital for further growth and innovation. That is why achieving and growing our profitability is also key for us and, ultimately, our customers."

3 Foster regulation with an innovative mindset

The aim here is to create a regulatory framework that fosters innovation and provides companies with the necessary conditions to compete domestically and internationally, while ensuring stability and protection of both investors and customers. Programmatic coordination aimed at strengthening fintech ecosystems is particularly important in this context. Specifically, this can mean minimizing the administrative burden and associated costs for fintechs, adapting regulatory requirements where necessary, and making implementation more customer friendly.

Sendi Young, managing director UK and Europe, Ripple, explores regulation while considering a different technology: blockchain. "When scaling a digital banking strategy underpinned by crypto and blockchain technologies, businesses need to consider the individual regulations of the markets they plan to operate in. At present, there is no global standard meaning collaboration with regulators will be essential to navigate different landscapes.

cont.

"They must also build a strong partner ecosystem, which will involve engaging with financial institutions, payment processors and technology innovators to ensure interoperability of solutions. Another fundamental consideration will be ensuring availability of liquidity to help financial institutions bridge between traditional fiat and crypto assets. This will allow businesses to streamline consumer and business transactions, treasury management and other applications."

4 Become a magnet for global talent

Fintechs can do their part by offering attractive jobs with excellent development opportunities. They can also commit to creating a modern work culture that responds to a diversity of backgrounds and needs. For example, the ability to work remotely without an in-person office requirement can be a valuable offering for many prospective employees. Political players and regulators can also help establish modern ways of working within their countries and make the tax framework appealing to foreign talent.

5 Enable fintechs to thrive in target markets

Fintechs may be able to make more informed decisions about future target markets if all stakeholders—from investors and incumbent banks to public players and regulatory bodies—bundled their insights on foreign markets with the respective foreign regulations and industry requirements in one central hub.

On this point, Victor Trokoudes, CEO and founder, Plum, reveals that to meet changing customer expectations, "those scaling across multiple markets must take into account the different approach of customers from country to country. Right now, the cost of living crisis is affecting everyone across Europe, but each region is reacting differently, and needs its own tailored response from digital companies. In the UK, for example, inflation remains stubbornly high, and brings its own set of challenges that fintech can help to solve. Meanwhile in Ireland, inflation is lower, but interest rates on saving accounts have remained at rock bottom for the majority of banks, despite rises from the European Central Bank. It is definitely not a one-size-fits-all approach, particularly in these turbulent times. But for those who can provide real value, there is a great opportunity."

6 Increase customer choices and access

If fintechs put as much focus on product safety and stability as they do on customer experience, they might be able to avoid some regulatory challenges from the start. For example, they could go beyond established data and customer protection norms and be more transparent about securities and the inherent risk to customers before trading. Political players and regulators could also develop Europe-wide initiatives to make it easier for fintech companies to demonstrate their credibility to customers."

"The digital banking strategy should always start with the customer's needs, their pain points, which solutions can we offer to solve these pain points, how we can improve the user experience. Next to this, it's of course also important to consider technological opportunities and limitations, potential impact of regulations, etc. While investing in digitisation, it is important to take financial inclusion into account. With further digitisation, new cybersecurity and fraud challenges emerge. Clients must be able to trust their banks to keep their funds safe."

Annelinda Koldewe
Global head of wholesale banking payments, ING

04

WHAT TECHNOLOGIES ARE BEING USED BY EUROPEAN PROVIDERS TO ENSURE SMOOTH INTERACTIONS?

> *"Smooth financial services interoperability across borders has long been an aim of the European Commission and the UK, with both setting out intentions to streamline payment service provider (PSP) operations and encourage innovation. For example, the Commission has specifically recognised crypto's natural place in facilitating seamless financial interactions, by initiating proposals for a sandbox environment for crypto-enabled payments within the EU. Regulators have leveraged this sandbox to test innovative propositions and to study the impact these innovations will have on market integrity and financial stability. Regulators applied these learnings to the MiCA regulation - establishing crypto as an integral part of future cross-border interactions."*
>
> **Sendi Young**
> Managing director UK and Europe, Ripple

Looking to the future, the financial services and fintech industries will be reliant on technology and collaboration to move the needle. Digital transformation across mobile devices, chatbots and automation has led to digital banking becoming more tailored to specific groups of customers. After mitigating threats from fraudsters and ensuring skilled individuals are hired, organisations can truly overcome challenges and navigate change with an evolved future in mind.

However, technology and collaboration are not and will never be a silver bullet for digital transformation; technology should be invested in, but performance is what will be measured, and companies must make sure that change is never a hindrance to success. For instance, mobile banking applications are crucial to digital transformation because they are no longer a nice-to-have, but a mandatory feature that fintech firms and banks should offer.

Manuel Sandhofer, senior vice president and general manager Europe, Nium believes that improving customer experience and reducing friction are part of this mandatory feature. "Opportunities to reduce friction and improve customer experience with real-time cross border payments are in abundance across Europe and beyond." Discussing specific technologies, Sandhofer adds that "API technology works in conjunction with modern payments infrastructure to enable fast, secure, and reliable B2B transactions instantly across the globe.

"And we're only just at the tip of the iceberg, especially when we think about one-to-many payout applications like payroll, spend management and ecommerce marketplaces. Take payroll, for example. Despite volatile macroeconomic and political conditions, most businesses still have ambitious growth plans, making the ability to hire and scale across borders a key differentiator for many. To tap into and retain global talent, businesses and payroll platforms need to pay employees and contractors in a way that's flexible, efficient, and works for them, so funds aren't locked in slow settlements, encumbered by hidden FX fees, or sent to an unused account, wallet, or card.

"At the same time, businesses are increasingly worried about their ability to access cash-flow, chase down late payments and offset rising interest rates. Knowing exactly when they are getting paid provides much needed peace of mind when they have no choice but to pay more on existing loans. In challenging times, businesses want to be able to choose how, when and where they get paid, so they can better plan ahead, remain nimble to new challenges, access cashflow when they need it most – and ultimately, unlock growth."

Further to this, with the customer-centric outlook that these organisations now have, technologies such as AI, machine learning (ML), and robotic process automation (RPA) have become vital for serving the consumer base. Customer requirements and behavioural patterns are identified and analysed in real time and financial service providers can offer solutions that are relevant. But the kitchen sink cannot be thrown at the problem.

In Victor Trokoudes, CEO and founder, Plum's view: "Technology like variable recurring payments (VRP) for example, which lets customers safely connect providers to their bank account to make payments on their behalf, is revolutionising the ease and speed of which transactions can happen." On AI, Trokoudes says that "compliance technology has also advanced substantially, with AI being increasingly used to assess risk, prevent fraudulent behaviour and avoid account freezes and transaction delays. In general, AI will add a new dimension to interactions, improving operational experiences but also giving customers more control over their transactions by instructing providers to perform tasks for them seamlessly via AI."

Starting small is the best bet. Working with cloud technology partners, for example, can ensure that technology, particularly core banking platforms, are managed well, data centre costs are reduced, and teams of inefficient, underused engineers are resourced elsewhere. To achieve smooth interactions with customers, financial service providers must partner to alleviate the burden of responsibility.

However, while traditional financial institutions have historically been resistant to relinquishing control over operations and processes, an ownership model where partners manage core banking frees business executives up to deliver on business outcomes, not focus on technology problems. At the end of the day, the reason for transforming digital banking strategies is to serve smooth interactions to the customer by building new products and offering personalised services.

Mehret Habteab of Visa agrees with this sentiment and said that consumers now expect seamless, intuitive and personalised payment experiences and this is “vital to staying competitive in today’s digital world. Token technology embeds payment credentials and authentication natively into the purchase experience, stripping out the friction in most transactions today. Open banking and digital identity frameworks will extend these capabilities further, by easily embedding other identity attributes – such as age, income, and address – giving consumers and businesses more personalised experiences and ultimately more control over their money.”

However, as the Societe Generale spokesperson elucidates, “digital, data and artificial intelligence are much more than just technologies: they are transformational opportunities revolutionising the financial sector with a major impact on customer experience, service delivery and operational efficiency.” They continue to state that the bank prioritises offering a “more accessible, seamless and personalised service, meeting the new market standards set by platforms and fintechs, in a fully responsible way. To manage to do so, future-proof financial services must rely on a unique combination of digital technologies including cloud, APIs, data, IA or blockchain.”

On artificial intelligence – or IA – the spokesperson mentions that “even if these tools were already well-used by our customers and staff thanks to our awareness and upskilling programs, the GPT-wave has fostered a natural and massive acceleration. This massive adoption is a formidable source of potential additional value to better serve our customers with more personalised products and advice, to better understand their expectations, to respond rapidly and to develop our activities and improve operational efficiency.”

Following on from this and commenting more specifically on generative AI, the spokesperson says that “this technological revolution will complete and accelerate our digital and AI roadmap. These new models raise the performance standards in language processing that the Group raise the performance standards in language processing that the Group already uses at scale (chatbot/call centre customer conversational interfaces, automated processing of legal documents, analysis of market conversations) and should allow us to increase the performance while facilitating the creation of new initiatives.”

“In addition, the generation capacities open the field to transformative uses (e.g. computer code generation, automatic documentation) and increased productivity (e.g. help with email writing, automatic synthesis).”

“PSD2 has aimed to improve the security of payment transactions and enhance consumer protection. While this is sufficient for a minimum standard, it can be enhanced and extended to open finance. The big opportunity is to educate consumers on the benefits of unlocking data in a secure way to provide personalised products, increased efficiencies, greater convenience and reduced friction for moving money around and switching providers.”

Justin Basini
CEO, ClearScore

05

HOW CAN THE POTENTIAL FOR OPEN FINANCE IN EUROPE BE UNLEASHED AND BECOME A REALITY?

> *"There are several hurdles to overcome to make open finance a success. Namely, the quality and limited number of standards (ideally one!) to implement APIs; the adequate trade-off between user experience/ease of use and security (i.e., how to implement strong customer authentication in an innovative way); and to make sure that all the players contributing to the service are properly remunerated to at least cover their implementation/ running costs."*
>
> **Societe Generale**

Justin Basini, CEO, ClearScore, believes that we have reached a tipping point in the open finance space. "The pandemic drove increased consumer adoption of digital channels and an increased propensity for consumers to share data online. Furthermore, the macroeconomic environment has shifted rapidly and traditional means of assessing consumer finances are not accurate, reflective, or reliable enough. Consequently, the time is right to consider alternative data sources that are more granular, more comprehensive, and more real-time – in order to ensure consumers are assessed fairly. A lot of data is out there already, but the challenge most organisations have is where to use it, and how to make sense of it."

In March 2023, Mairead McGuinness, commissioner of the financial services, financial stability, and Capital Markets Union at the European Commission, addressed European Parliament and explored what the future holds for the move from open banking to open finance. She posited that strategies around data access using open banking as a starting point is fundamental. "On access to data, our starting point is Open Banking. So banks that hold the payment data for their customers must give access to it to other providers under certain conditions."

She continued: “It’s hard to see how Open Finance could work if we don’t give access rights to new data, beyond payment accounts. We are still assessing how far that should go, based on what data would bring most value to customers. And just as important, we should exclude data whose use could give rise to risks of financial exclusion,” McGuinness said. In May 2022, the Commission opened consultations into revisions to the Second Payment Services Directive, PSD2.

Tasha Chouhan, UK and IE banking director, Tink explains that “open finance goes beyond the scope of data and services available at your bank, covering the financial information and services that may exist across other areas of finance. It captures all of open banking and more. With the customer's consent, personal financial data related to pensions, tax, and insurance could all be accessed and retrieved by a trusted Third Party Provider (TPP). This opens opportunities for better-tailored consumer services and payments, as well as other financial products.

“Just as with open banking, open finance — and by extension open data — is not defined by the sharing of data and services, but rather by the access to it. While regulators talk about open finance as a potential opportunity to unlock innovation and competition, industry participants talk about open finance as the next frontier for open banking – with untapped potential. Specifically, to some people open finance refers to an umbrella term that may capture all of the commercial opportunities outside the regulated scope.

“However, to most people in Europe, open finance describes the access to financial data and services that fall outside the scope of PSD2 and the UK open banking initiative. It refers to the opportunities for banks to provide premium APIs which would allow them to commercialise access to savings information, credit card information, investment information, and so on. Commercialising access to financial information beyond payments would give banks an opportunity to earn back their investments from their compliance efforts.”

Since PSD2 was implemented in 2016, the payments, fintech and digital banking landscape is substantially different. New entrants leveraged the opportunity that this new ecosystem provided to develop products and services that put the customer first. Open banking allowed these organisations to succeed and with initiatives like embedded finance coming to the fore, innovation and collaboration accelerated. Consumers and businesses alike were able to consent to share data from their bank with third parties to make payments seamlessly, and Strong Customer Authentication (SCA) provided extra protection for online payments.

The Commission's consultation may lead to revisions to PSD2 and perhaps, a new legislation that could be referred to as PSD3 or PSD2 2.0. The revised legislation could consider embedded finance, digital wallets, cryptocurrency payments and buy-now-pay-later – leading to increased standardisation and interoperability with APIs. Also, with ISO20022, the new PSD2 could help further simplify the processing language behind transactions and unlock the value of data to ensure open finance becomes a reality.

However, as Kilian Thalhammer, global head of merchant solutions - fintech and platform, Deutsche Bank AG says, there is still potential on how the fintech business models are embraced across the European market to further unlock the advantages of open finance. "Whilst Europe has come on leaps and bounds over the last decades, the divergence in the level of adoption and embrace of fintechs varies widely still across countries, with markets such as UK, Netherlands and Nordics very much as pioneers versus other markets still in the infancy of their journey towards a digital payments economy.

"Fintechs still have two dependencies i) the regulatory guardrails and the associated legal frameworks of the respective jurisdiction and ii) their banking partners. Whilst banks provide fintechs scale and access to local markets, it is national regulators that define the local requirements and consumers that shape the demand. This means thinking global, acting local and having a clearly defined macro scalable platform with the ability to fine tune at the micro level depending. Whilst the diversity of maturity levels in the market remains high, this juxtaposition of global and local is a continuous balancing act.

"Therefore, for open finance to truly take off, the gap in digital payments adoption needs to narrow so that the focus of financial service providers can pivot from the banking and market regulation view, more towards use cases, experiences and value add for the end consumer (or corporate). With the ability to increase adoption through elevated consideration and focus on customer needs, the region can generate a positive network effect that will see open finance boom."

Victor Trokoudes, CEO and founder, Plum agrees: "Many European countries are still some way behind on enabling open access to data, perhaps due to a lack of customer trust in technology, a less innovative banking system or varying regulatory approaches. This has been a big challenge for us as we expanded, and a major reason why we could not launch in all European regions as quickly as we would have liked, despite strong interest for our product across the continent.

"One benefit for those that have been less quick off the mark is that they have the opportunity to learn from and tackle some of the blockers that early adopters have been facing.

The UK is a good example of a country which has seen many benefits from open banking early on, but has also faced challenges, such as a strict 90 day reauthentication limit which can negatively impact customer experience. By knowledge sharing, countries across Europe will be in the best place possible to get the most out of open data."

Amit Mallick, Accenture's open banking and APIs lead summarises the key actions that need to be taken to ensure the industry is ready for open finance.

"Open banking and its ongoing evolution into open finance is the next step in the journey towards 'openness' and will accelerate the trend towards cross-industry, platform-based business models and give participants more opportunities to innovate, extend their reach and expand their ecosystems. With PSD2 coming to the end of its lifecycle and the imminent arrival of PSD3 and open finance, Europe has the unique opportunity to follow a trajectory of rapid if not exponential growth in this space. However, there are key actions that need to be taken:

- **Align and learn from other regulators:** Collaborate with regulators and authorities in other jurisdictions to align on open finance scope, approach, standards, learnings and KPIs to accelerate the journey towards open finance and help local fintechs expand their footprint regionally and globally.

- **Customer education and awareness:** Educate consumers, businesses, and enterprises on the benefits of open finance - including increased access to financial services, better products, and a better digital experience - to build trust and encourage adoption. This should be a joint responsibility among banks, regulators, policymakers, and industry bodies.

- **Fintech promotion:** Create a robust fintech environment through fintech hubs, VC funding, industry partnerships, and government grants. Provide industry-level infrastructure and policy support to encourage new open finance initiatives and develop a thriving ecosystem.

- **Foster innovation through sandboxes:** Establish open finance sandboxes or innovation hubs through public private collaboration to incubate and test new open finance solutions. This allows participants and policy makers to understand the potential risks and benefits while enabling banks, non-banks and fintechs to develop and refine their proposition."

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CONCLUSION: WHAT DOES THE FUTURE HOLD FOR DIGITAL BANKING IN EUROPE?

"Connectivity, Collaboration and Consolidation. On the one hand there is heightened scrutiny on fintechs to demonstrate that they are here to stay and not just here to grow, or in other words the focus on the new players is moving away from market share gains towards a heightened scrutiny on profitability. In order to do so, this segment will pivot focus towards larger revenue pools and look to the B2B arena, which banks continue to dominate, as new sizeable and sustainable opportunity area. Simultaneously, as traditional B2B players evolve and transform their own business models, their traditional banking needs are also evolving to demand new age solutions from asset as a service solutions through to marketplace payments and advisory. This is where the power of the ecosystem will come into play, with banks able to leverage the scale, stability and long-standing regulatory know-how to position themselves as strong partners for fintech's entry tickets into ready-made B2B relationships. This is where it is key for both fintech and banks to execute innovation for highly integrated partnerships offering. With strategic highly integrates partnerships offering life-blood for fintechs in their moment of truth and whole new revenue sources for traditional banking players."

Kilian Thalhammer
Global head of merchant solutions - fintech and platform, Deutsche Bank AG

"A lot of good is being done by fintech companies across Europe already. Customers are benefitting massively from the lower costs, better accessibility and top-quality service that technology can provide. International fintechs are able to bring exciting new products across borders, while local fintechs are able to solve specific problems quickly and efficiently for their audience. Despite economic challenges, the fintech industry has proved its resilience and importance across the continent. With support from Governments across Europe, citizens can continue to benefit from the power of fintech to improve their everyday lives."

Victor Trokoudes
CEO and founder, Plum

"Digital banking will continue to grow in popularity as traditional banks and institutions struggle to meet business customer needs. Swift, for instance, has been an industry stalwart for almost half a century with its correspondent banking model. But legacy systems such as these are no longer fit for purpose. Cross-border business payments now require a great deal more transparency, speed and cost-efficiency, especially in the current economic climate. There are a number of emerging financial services players that address Swift's shortcomings, but moving away from a system that is the standardised payment process for many traditional banks is no easy task. While banks are dipping their toes into new technologies and real-time payment infrastructures, there is still a nervousness around changing the way things have always been done. Status quo is a stifler of innovation, and the key to challenging the status quo here will be trust. Demonstrating adoption and clear use cases will be vital to unlocking the real-time B2B payments opportunity in Europe. It's just a matter of time. Look at challenger banks like Starling and Monzo, for example. Once trust was built, adoption skyrocketed, and now they are considered leading disruptors in Europe."

Manuel Sandhofer
Senior vice president and general manager Europe, Nium

"In recent years, consumers have become more conscious of the environmental impact their purchases may have. But it's often hard to understand the extent of the adverse effects without access to transparent data. Here's where open banking can help. It offers valuable insights into people's transactions – such as money spent on travel or energy – enabling them to make greener choices in the future. Open banking aggregates, categorises and analyses billions of transactions every day. Financial institutions can then use this data to identify patterns and provide individuals and businesses with actionable goals."

Tasha Chouhan
UK and IE banking director, Tink

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