Alberta Young Leaders

The Countdown to Open Banking

Jeffrey Nordstrom – Servus Credit Union
Craig Witcher – Connect First Credit Union
Sean Hurst – Connect First Credit Union

Contents

Executive Summary

The financial services industry in Canada is on the cusp of a revolutionary change, the likes of which the industry has not seen. Open Banking is just as it sounds. Consumers will have the ability to dictate which one of their financial service providers have access to their information – and more importantly their business. A true open environment to conduct ones financial transactions across a wide variety of service providers.

Open Banking through the use of a standard application programming interface (API) will create opportunities for financial institutions to create or partner with fintech companies to elevate member service. To be successful in this new environment, credit unions are encouraged to pursue the following:

1. **Adapt and embrace Open Banking**
2. **Build a "personal profile" for our members**
3. **Add value in our services**

The risk of inaction is too great. Open Banking stands to redefine how financial institutions communicate, advise and market to their customers. It represents not only a new way of thinking, but opens the door to possibilities not yet imagined.

What is Open Banking?

Open Banking presents a radical change to the financial system in Canada, revolutionizing how our members will interact and chose to do business with credit unions and other financial institutions. Open Banking is a term used to identify a large framework that's purpose is to enable consumers to have greater control over their financial data resulting in improved financial awareness and access to tools, products and services that may not be possible today. This framework enables consumers to authorize third party financial services providers to access their information typically through a standard application programing interface (API) which allows different information to be passed between the financial services providers for the benefit of the consumer in regards to better management of their financial affairs.

Canada is still in the infancy stages as it relates to Open Banking with the Government of Canada preparing to investigate its merits. This is a large endeavor and involves many stakeholders. Other countries are further along with regards to the implementation of Open Banking. Countries such as the United Kingdom, Australia, Korea, European Union, and Japan have varied strategies, regulations, infrastructure, governance, and security measures already in place.

The Government of Canada has appointed an Advisory Committee to assess the merits of Open Banking with the additional phase to assess the implementation considerations. These considerations will be for consumers and the financial industry which will include; regulatory and legislative requirements, governance, technology framework, cyber security, and a possible implementation strategy.

As Canada continues to assess the merits of Open Banking, other countries have already implemented although the approach, governance, or intention may vary. A commonality found in many countries is in regards to technical standards through the development and implementation of an application programming interface (API); however, this hasn't been adapted by all countries. A variance to the scope relating to Open Banking by different countries is illustrated by the UK focusing on data sharing with payment initiation being introduced later on. Australia is working through phased implementation starting with credit/debit card and deposit/transition accounts later this year and expanding to mortgages by 2020. Australia's scope is for data sharing purposes only and no payments initiation has been identified.[i]

"Open banking has the potential to boost the competitiveness of the financial sector by giving a wider range of players access to financial data they can use to develop new and more tailored products and services"

- Department of Finance, Canada

As technology has evolved it impacts expectations consumers have and how they want to interact with service providers. Due to how companies such as Apple, Google, Amazon, and Facebook have built their platforms, which results in a highly responsive and customized service approach, this is becoming the standard consumers expect. As Apple, Google, Amazon, and Facebook continue to become involved in the financial industry, Credit Unions need to understand how to leverage technology and data to interact with consumers in meaningful and tailored ways as the openness to do banking services with alternative provider's increases - 31 percent of consumers would consider purchasing banking services from an online provider, such as Google or Amazon, this rises to 41 percent among Gen Z respondents.[ii]

The Credit Union system faces many factors in our environment; increasing competition, compressed margins, member retention, regulatory restraints, aging membership demographic, legacy infrastructure to name a few. These are not new or necessarily associated with Opening Banking but have the opportunity to be impacted through opportunities that Open Banking can address.

"Open banking demands a fundamental rethink of the traditional business model, enabling banking to become more customer-centric"

- Deloitte

Retail banking challenges exist in many forms. We are challenged by our technology in regards to the number of systems used, with limited, if any, integration to one another. Our systems require large amounts of manual effort and even when the amount of data compiled from our membership is stored within the varied databases; there are challenges in accessing quality information when it comes to extracting personalized information that would enable staff to provide truly tailored services.

It's our belief that Open Banking is an ecosystem that can impact many aspects of our business but specifically how we interact with our membership and enable us to truly understand a member's personal financial, and non-financial profile. Our current environment is reactionary, based on limitations associated with obtaining information and waiting for verification documents, and many times waiting for members to approach us. The current member experience is not all that unchanged from 100 years ago. In 1914 an economist named William Scott wrote a book called "Banking". In his book, Scott outlined the four main services that commercial banks performed:

1. The safekeeping of money and other valuables
2. The making of payments
3. The making of loans
4. The making of investments

Some banks might look at this list and feel assured that nothing is different today and take comfort in this fact that the four pillars are holding true. The services outlined by Scott are the same in modern banking but the methods for performing them have changed.

A short history of banking…

Processes used to be completely paper based. Computers started to make their way into banks in the late 50's and over the next two decades they became a mainstay revolutionizing the industry and providing the opportunity to complete processes faster and add new products and services. In 1981, four New York based banks created "At Home Banking" and in 1983 Bank of Scotland introduced the first version of "online banking". In 1994 Stanford Federal Credit Union becomes the first to offer online banking in the United States. Fast forward to 2006 and 80% of American financial institutions were offering online banking to its customers. In 2010, Fiserv conducted a survey and found that online banking was growing at a pace faster than the internet. Online banking has continued to evolve as more innovations and conveniences have been offered. Online banking has become the new standard in the industry now for years but online banking the way it is today is outdated.

Enhancements to online banking have been made over the years to attempt to keep up with the large financial institutions. Additions like remote cheque deposit, e-transfer, and online loan applications just to name a few have been made to increase member convenience and overall experience. However, there remains a disconnect between the online/digital experience and a member's experience in branch.

Open banking stands to change it all.

Customers everywhere want to log in…

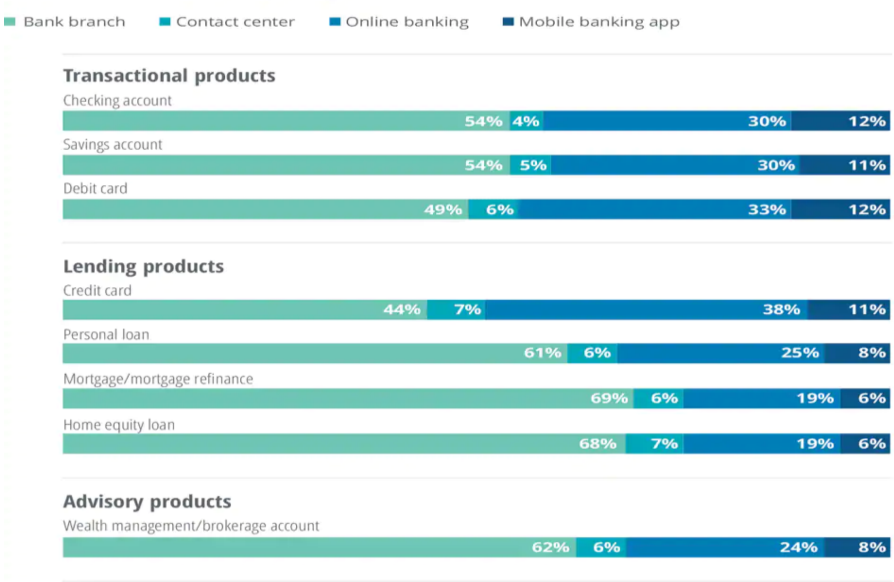
There is no doubt now that banking customers around the world want (and need) digital options to manage their savings and take up new products, Oracle's survey finds. Overall, 67% of global respondents said they were active on digital banking platforms already.[iii] Although there is still a large number of members that prefer visiting a branch first over digital offerings.

Over 50% of the time members will choose to come to the branch when they are looking for a new product or they need advice.

FIGURE 4

Most respondents prefer traditional channels to handle complex or advisory services

Where respondents go to buy new products



Source: Deloitte Center for Financial Services analysis.

Deloitte Insights | deloitte.com/insights

It's important to recognize that members still value in branch experience but the need to enhance both the in branch and online/mobile experience offered is key. Imagine regardless of how members choose to bank, in branch or online that they are able to gain access to the same tools, products and services. Ignoring the close to 40% of members that look to online/mobile channels for advice and new products, is not a good business plan.

Open Banking is the solution that unlocks the door to truly provide a superior member experience regardless of the channel that the member chooses, in branch or digital.

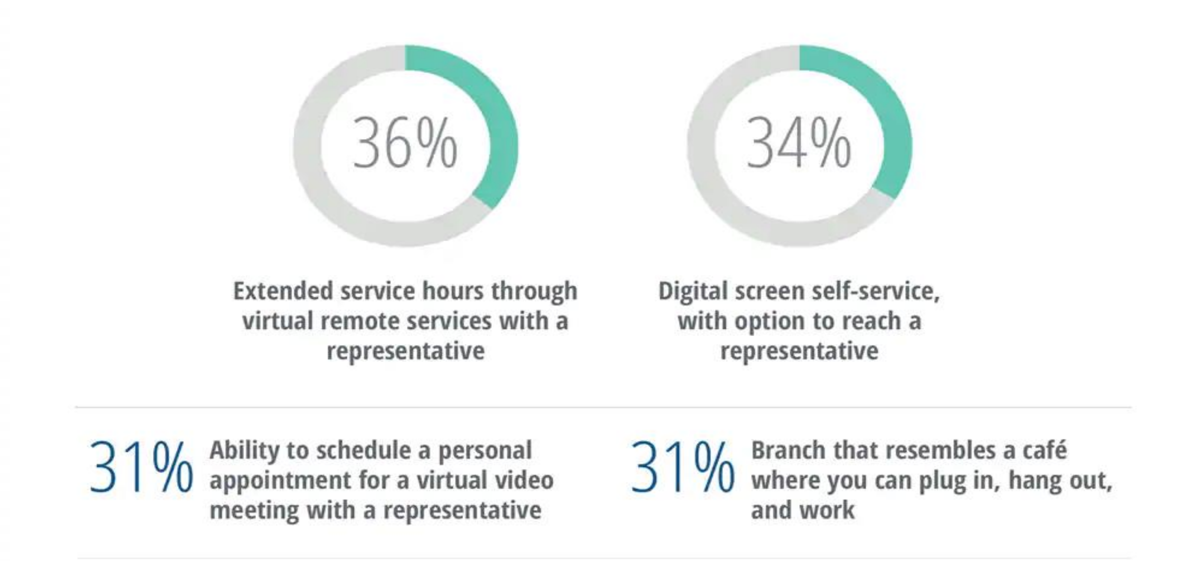
Members want to login from anywhere at any time. They still value in branch offerings. But where is the opportunity to enhance and improve to ensure that the system not only is retaining members but attracting new members.

Looking at the graphic below members still value using branches as their first choice in dealing with a financial institution. However, there is a need to improve this experience.

FIGURE 9

Consumers are likely to bank more at a branch if the following features are offered

Percentage of respondents who replied "likely" or "very likely" to use a bank branch more



Source: Deloitte Center for Financial Services analysis.

Deloitte Insights | deloitte.com/insights

Trust/brand

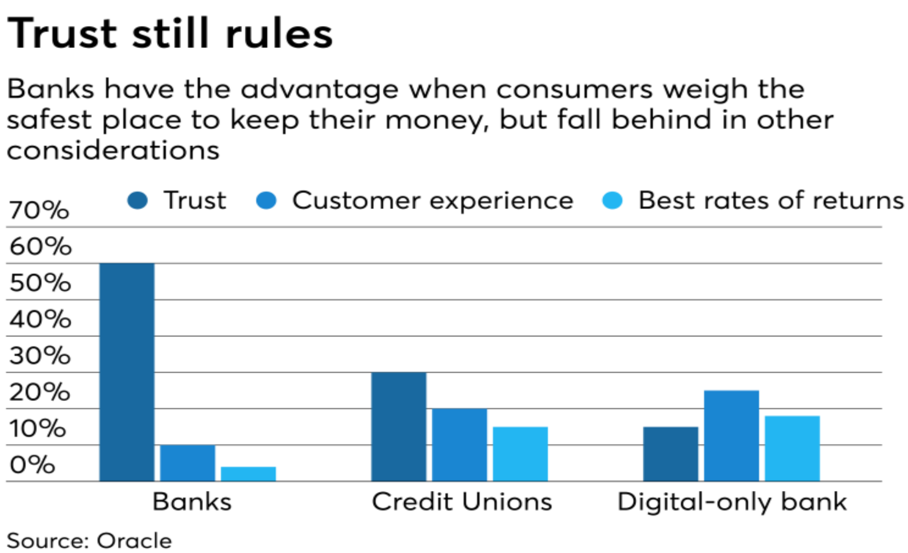
It's possible that with the introduction of Open Banking in Canada there will be new digital banks entering the marketplace. The big 6 banks will potentially roll out new offerings to attract new customers similar to what has occurred in the mobile phone business. Companies like Telus and Shaw introduced new mobile providers like Koodo and Freedom Mobile to capture a greater portion of the market.

This behaviour is certainly not something new within the global financial services industry either. A number of large global institutions already own and operate a number of digital banks. Some dating back as early as 1989. HSBC opened First Direct in 1989 in the UK. First Direct brought text message banking in 1999, internet banking in 2000 and claim to be the first UK bank to have a twitter account.[iv]

In the past number of years there has been a large number of new digital offerings globally increase and here in lies the opportunity for credit unions. Just like HSBC, BMO, RBC, credit unions have brand recognition here in Alberta and the potential to increase that to across Canada.

Brand and trust are key attributes members have when it comes to handling their money. It does not mean that credit unions can ignore these new digital banks as they are focusing on creating a superior online experience to attract members. Not to mention the deep pockets the large financial institutions have to invest in technology which again puts risk of having members leave.

According to the graph below, trust is one of the most important things that financial institution customer's value. It's even above more competitive rates.



Trust advantage: Banks

When weighing traditional banks versus alternative banking options, banks win on trust, Oracle's survey finds. Digital-first banks rank low among customers globally on the issue of stability. But traditional firms fall behind competitors when customers are asked which option delivers the best experience, and the best returns on their savings.[iii]

"The good news for Canada's largest banks is they're already trusted custodians of customer data with strong brands that they can take advantage of to position themselves for success in an open banking framework."

\- pwc

The one area that has not been addressed is while credit unions can win due to trust, brand, rates, member experience they often lag in an emotional connection with members. Particular concern is what happens when some of the largest brands in the world, Apple, Google, Amazon decide to enter into the finance industry? Not only do they bring a high level of trust, and brand recognition but also emotional connection to their customers.

How did these large consumer brands develop the emotional connection with their customers? First it started within the company, building on a strong vision and mission about what they wanted to create and achieve. They looked to build a strong sense of connection with the end user. Apple for example had someone whose job it was to unbox. It helped them gain an understanding of what the user's experience was when they opened one of their products right from taking that new iPhone out of the bag and opening the box.

Having built this connection helps them maintain and attract new customers, it makes customers feel like they are part of something special.

Why can’t credit unions create a similar connection with members? People are emotional about their money, so shouldn't there already be an emotional connection with members? Credit unions have been able to rely on the logo on the outside of their branches to attract new members and make a profit. Great companies like Kodak did the same for decades but they failed to remain relevant as their industry changed and what their customers wanted changed as well.

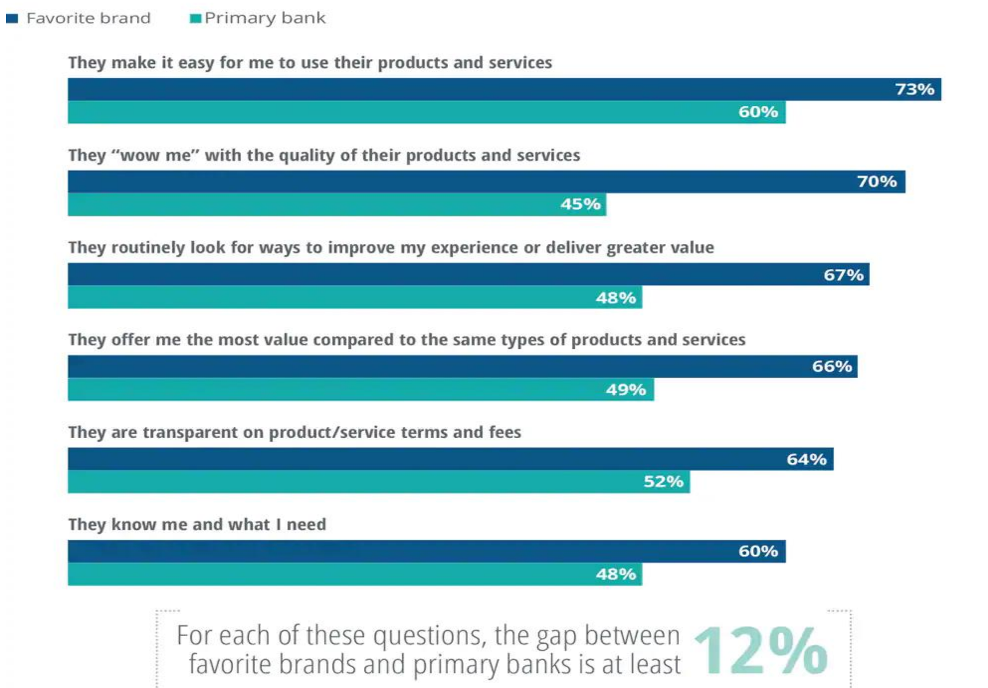
Credit unions are at a critical focal point. If the credit union system does not evolve the member and online experience, the industry is at risk of falling into the same footsteps as Kodak.

Open Banking can be used to help establish this *emotional connection*.

FIGURE 2

Making an emotional connection: How banks compare to favorite brands

Percentage of respondents who agreed or strongly agreed



Source: Deloitte Center for Financial Services analysis.

Deloitte Insights | deloitte.com/insights

The Deloitte Center for Financial Services looked to understand the digital-emotional connection. Deloitte did an analysis of nearly 14,000 global respondents and learnt that there were three distinct consumer segments. They named them traditionalists, online embracers and digital adventures.[v]

Traditionalists comprised 28 percent of the sample. They are light digital users who do most of their banking in branches and through ATMs. Nearly one-half of these respondents who check their bank balances used ATMs; a fifth used branches. Of the traditionalists who transferred money from one account to another, one-third used ATMs while another one-third used branches.[v]

Nearly one-quarter of traditionalists have never used online banking to access their primary bank. Their reluctance to use mobile apps is even higher—44 percent have *never* used mobile apps to access their primary bank. Even among users of online and mobile banking in this segment, only one-tenth have used these channels 10 or more times in a month. Traditionalists also hold fewer products, such as debit and credit cards, than the other segments.

Online embracers comprise the largest segment, at 43 percent. They are more digitally engaged with their banks than are traditionalists, but prefer online over the mobile app channel for types of transactions that banks have spent years perfecting online, such as balance and transaction inquiries, transferring funds, and paying bills. They have higher product holdings than traditionalists and transact with their banks more frequently, but not all the time; about 20 percent of online embracers accessed their bank online more than 10 times a month, and 25 percent accessed their mobile apps more than 10 times per month.

Digital adventurers comprised 28 percent of the sample; millennials comprised the highest share of adventurers compared to the other segments. Like online embracers, this group exclusively uses mobile and online channels to inquire about their account, transfer funds, and pay bills; however, many more adventurers are comfortable, and prefer, to perform them on their mobile devices. As an example, 48 percent of digital adventurers transfer money person-to-person (P2P) online and 44 percent do so on mobile apps, while 52 percent of online embracers make P2P transfers online and 37 percent prefer to do so on mobile apps.

Digital adventurers also own many products, but they transact much more frequently than online embracers do. Over half of users of online and mobile banking in this segment have accessed these channels 10 or more times a month. A significant proportion of digital adventurers prefer to use online and mobile channels combined more than visiting a branch to apply for simple products such as debit cards and checking accounts. And although just under 32 percent and 11 percent would prefer to apply for a personal loan online and on their mobile app, respectively, this compares to 25 percent and 7 percent for online embracers and only 17 percent and 6 percent for traditionalists.

Most tellingly, digital adventurers demonstrate the highest levels of satisfaction and advocacy for (are most likely to recommend) their primary banks. And they also generally express a deeper emotional engagement with their primary banks compared to online embracers and traditionalists (figure 5), at least in absolute terms. Nearly one-quarter of traditionalists have never used online banking to access their primary bank.[v]

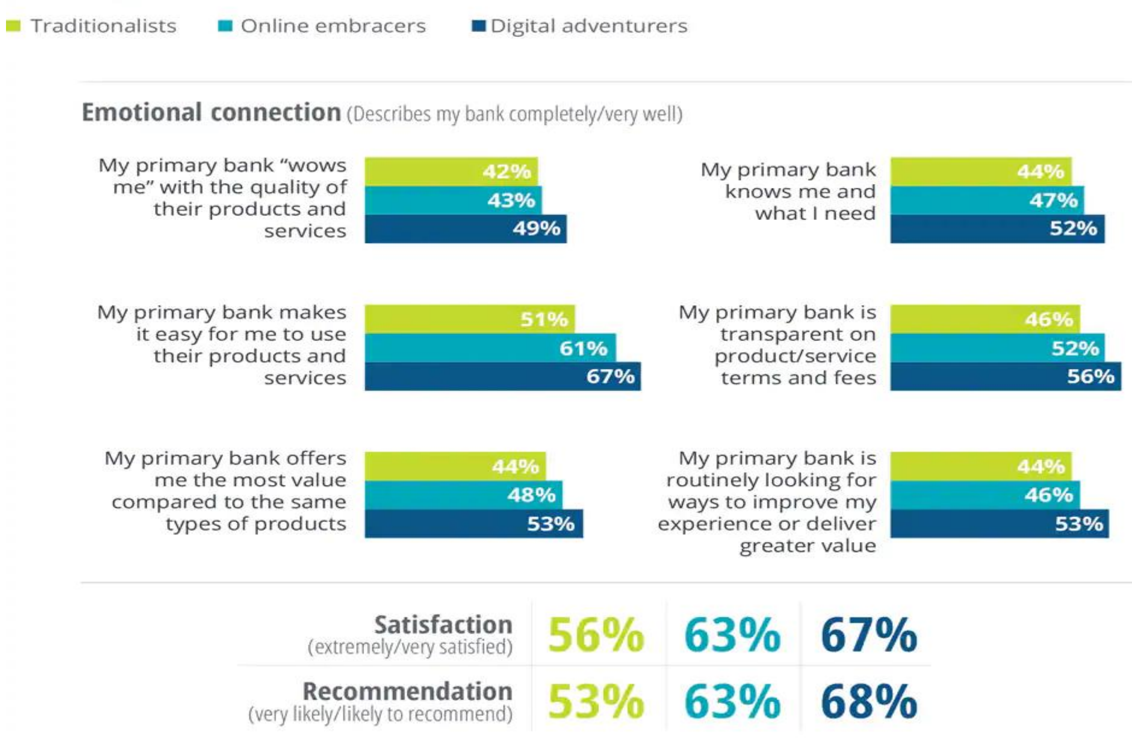
Further, banks' "pull" approach versus a "push" approach to digital service could be standing in the way of creating emotionally engaging digital interactions. Today's consumers still come to the bank's platform to meet their needs—be it monitoring account details or understanding their spending patterns—and banks tend to react to their needs. Meanwhile, fintechs have shown a better way to digitally engage consumers through a "push" strategy that includes sending them intelligent, tailored insights based on their spending behavior or notifying them about discounts or loyalty offers at nearby retailers.[v] Although banks have made the important step of making the login process easier by having mobile devices remember information in a secure manner, they can invoke more push strategies, such as providing customers with alerts regarding unusual movement in their accounts.[v]

When evaluating digital adventurers' emotional engagement with their banks compared to their favorite brands, an interesting twist emerges. Although digital adventurers are the most emotionally engaged banking consumers in absolute terms, the gap between engagement with their favorite brands and primary bank is higher for four of the six parameters. Banks have some road to travel, if their most satisfied, seemingly more engaged consumers are not as "wowed" by banking services as they are with their favorite brands. To that end, are banking consumer relationships truly sticky? If these favorite brands become financial services providers, then what?

FIGURE 5

How emotional engagement varies by consumer segment

Percentage of respondents who agreed or strongly agreed



Source: Deloitte Center for Financial Services analysis.

Deloitte Insights | deloitte.com/insights

What needs to change to ignite an emotional connection?

Summary of recommendations of what Open Banking will provide to Credit Union system.

As part of understanding the impacts of Open Banking to the finance industry here in Canada we reviewed how Open Banking has an opportunity to truly make positive changes to not only Credit Unions in Alberta but across Canada.

We have identified three areas that credit unions need to focus on in order to build more emotional connection with our membership.

1. Adapt and embrace Open Banking
2. Build a "Personal Profile" for your members
3. Add value to our membership

Adapt and embrace Open Banking

Open banking is inevitable. Our research leads us to answer one really important question. It is believed that financial institutions will need to decide if they want to be a manufacturers of products made possible by Open Banking or if they want to focus on offering products that include a variety of third-party service providers (fintechs).[vi] It's our opinion that as a credit union system should create partnerships with fintechs to build the member connection. With these new partnerships it will provide the opportunity to increase the systems competitive advantage and more easily embrace the changes that Open Banking will bring.

Embracing this change actively, will place the credit union system ahead of the curve to this new disruptor. As a credit union system we will stand to benefit from Open Banking as we can easily adopt new partnerships with innovative fintechs to keep pace with emerging technologies as things continue to change. This provides the most value to credit unions, rather than the outlay of capital required to develop these technologies in-house. The partnerships enabled by Open Banking will ensure the online experience will match the experience within branch.

Build a "Personal Profile" for your members

We envision a "personal profile" to evoke member emotion. It is a holistic view of our members personal, professional and financial profile. What does this include?

Personal – The basics (address, SIN, birthdate, etc), social profile (Facebook, Linkedin, Instagram, Twitter), employer and tenure

Financial – a complete view of the members financial well-being (credit cards, insurance providers and coverage, transactional history, a consolidated view of investments – and not just balances!)

What do we do with all of this information? This will now allow us have a deeper understanding of our members entire financial well-being.

Consider this scenario – A large and local company lays off a number of individuals. Through the new channels enabled by Open Banking (connection with social media platforms, online media, etc), the credit union can identify unique members impacted by the change and provide targeted messaging as a touchpoint for the member. Not only is this proactive from a risk perspective to protect the credit union, it also establishes a stronger emotional connection with the member as the credit union helps the individual through this difficult time.

The scenario above highlights a unique opportunity to build and establish an emotional connection. However, Open Banking will also allow us to continue to do what we do best – provide financial advice. With our member's permission, credit unions will be able to consolidate all of a member's financial information into one picture. No longer would there be a reliance on outdated monthly statements for our member's financial profile, Open Banking would create the opportunity to automatically consolidate all financial information. Think of having an individual's transactional history (across all channels and service providers such as other institutions and card providers) to see exactly where members are spending their money and how much – this can then be tied into a budget, which then leads to retirement planning. By having a complete understanding of a member's financial picture, credit union advisors can provide real honest advice to help the member achieve their financial goals. It allows our teams to now become that trusted advisor for our members based on fact-based data to fully leverage our financial expertise.

Add value to our services

Capturing our member's data is one thing, Open Banking will create the opportunity to interpret that data in the context of truly knowing our member's financial picture. Our value will be to offer personalized solutions tailored to each member's situation. Advisors will have tools at their disposal to analyze member data to advice the most cost effective solutions based upon actual member behavior (not expected behavior).

Open Banking will create more data driven decisions for our members. We have identified the three key areas that credit unions need to focus on to create and enhance member engagement and establish and grow an emotional connection. In order to achieve this, we need to embrace Opening Banking allowing us the ability to unlock member data and provide value-added advice to ensure financial wellness. Without Open Banking, we do not have the ability to provide a truly holistic view of our members financial wellbeing.

What are the risks of not embracing the Open Banking revolution?

The risk of inaction by the system is too great. Open Banking stands to redefine how financial institutions communicate, advise and market to their customers. It represents not only a new way of thinking, but opens the door to possibilities not yet imagined. While for many jurisdictions Open Banking is just in its infancy, the financial industry is slowly beginning to put together new and exciting opportunities for the everyday consumer.

Canada has a unique financial services industry. While often revered internationally following the financial crisis for the strength of the system and its ability to withstand financial shocks, one key downside is the concentration of large financial players. The six largest financial institutions in Canada represent 90% of the financial industry in the country.[vii] Conversely, many other countries have a more diversified composition for the financial industry. As Canada begins the journey to adopt Open Banking, many international players will have years of experience and will certainly have their eye on new markets to enter into.

Credit unions will have more than just the typical big players to be cognizant of in the Open Banking space. Competition will range from the current players (charter banks, other credit unions), through to international players, and new fintechs not yet established. Being "ahead of the curve" is an understatement at this point, as so many players have or will be investing a great deal of resources into the Open Banking concept. Credit unions will need to play to their strengths and learn to think differently in order to capitalize and stay relevant in the Open Banking world.

Competition Risk

With the UK having just finished their first year under Open Banking protocols, new information is coming into light with respect to how consumers are taking up this new technology. Like most new developments in the financial world, retail uptake takes time to ramp up. Current forecasts in the UK suggest that by the year 2020 – 64% of the population will be utilizing Open Banking in some form or another.[viii] For credit unions this presents an interesting challenge. Traditionally our member base is older relative to other financial institutions. Research has shown that millennials and centennials are more willing to share data, credit unions will need to become more efficient at attracting the younger generation in order to capitalize on the efficiencies of Open Banking.

Customers – prefer to look at a third party provider

A recent survey completed by Oracle found that "Consumers aren't satisfied with personal financial management and investment options offered by traditional banks…reporting that more than 40% of its survey respondents said nonbank alternatives could help them better with these needs". This is a concerning trend for credit unions as well as we often lag behind in terms of providing cutting edge software for our members.

Mint offers a unique personal management tool, allowing people to better manage their funds by having a better understanding of how they are spending their money. Since its inception in 2007, Mint has grown to over 20 million users – clearly there is demand within the retail banking environment for this type of service. Open Banking will create a level playing field for financial institutions to compete in a similar manner to how Mint targeted a specific market. The credit union advantage will be to create (or partner to find) solutions to engage the membership and meet their needs before a third party provider has that opportunity.

Failure to embrace Open Banking

Open Banking has the potential to create a level playing field for financial service providers in Canada. The risk of not taking this opportunity to use this to our advantage could result in the credit union system falling behind and running the risk of losing relevance to the consumers of the future. Creating added value for our members through this change is crucial to the long-term success of the industry and ensuring our members financial wellbeing.

Conclusion

The countdown to Open Banking is well on its way. One of the largest disruptors to retail financial services is about to take the industry by storm.

The risk of inaction by credit unions is too great. The technology enabled by Open Banking will provide members and non-members alike the opportunity to access a vast array of financial services at the "click of a button". We suggest that to combat the digital banking revolution, credit unions focus on the following three things:

1. Adapt and embrace the Open Banking revolution
2. Build a "personal profile" for your members
3. Add value to our services

Open Banking will create new opportunities for credit unions to better serve our members. The key to our continued success in this environment will lie with a renewed focus on what we do best. Listen to our members.

Sources

[i] Department of Finance Canada – Consultation Document: A Review into the Merits of Opening Banking

[ii] Accenture Financial Services 2017 Global Distribution & Marketing Consumer Study: Banking Report

[iii] Slideshow Digital banking's key trends: Demand, competition, mobile on the rise, 2018).

[iv]First direct, a division of HSBC UK Bank plc. Retrieved from: http://www.firstdirect.com

[v]Accelerating Digital transformation in banking, October 9, 2018; Deloitte Insights. Retrieved from: https://www2.deloitte.com/insights/us/en/industry/financial-services/digital-transformation-in-banking-global-customer-survey.html

[vi] Open Banking is coming, Canadian Banks 2019; PwC Canada. Retrieved from: https://www.pwc.com/ca/en/financial-services/canadian-banks-2019/p501472-canadian-banks-2019-report-en-final.pdf

[vii] The Canadian Financial System, Department of Finance Canada. Retrieved from: https://www.fin.gc.ca/toc/1995/fctshtsum95-eng.asp

[viii]The future of banking is open, How to seize the Open Banking opportunity, PwC UK. Retrieved from: https://www.pwc.co.uk/industries/financial-services/insights/seize-open-banking-opportunity.html