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The era of open banking:
Impacts on business models

An abstract graphic composed of numerous overlapping, light blue lines that form a complex, circular, wireframe-like structure. The lines vary in density and orientation, creating a sense of depth and movement. The overall shape is roughly circular but with irregular, flowing edges. The background is a solid dark blue/black color.

Open banking has the potential to reshape the future of the financial-services industry. However, realizing its full capability will require prudent consideration of its design, applications, and implications. This article is Deloitte's third in a multipart series that explores the most pertinent open-banking issues facing Canada's financial-services sector.

Open banking is just one piece of the puzzle

The Canadian retail banking sector is rapidly evolving, with open banking becoming a reality. However, to properly analyze the contributions of this banking practice to the industry as a whole, it's essential to examine it in the context of a series of shifts in the financial-services sector.



For starters, we're soon likely to see an overall reduction in payment friction due to the Real-Time Rail (RTR) payments system and the Retail Payment Activities Act (RPAA),¹ both of which will contribute faster, more efficient, and more data-rich payment experiences. Together with open banking, these measures aim to remove the two most common barriers to working with nonprimary financial institutions and switching providers:

1. Sharing financial information to facilitate opening accounts and managing them with third-party institutions; and
2. Dealing with inefficiencies of quickly transferring funds across institutions.

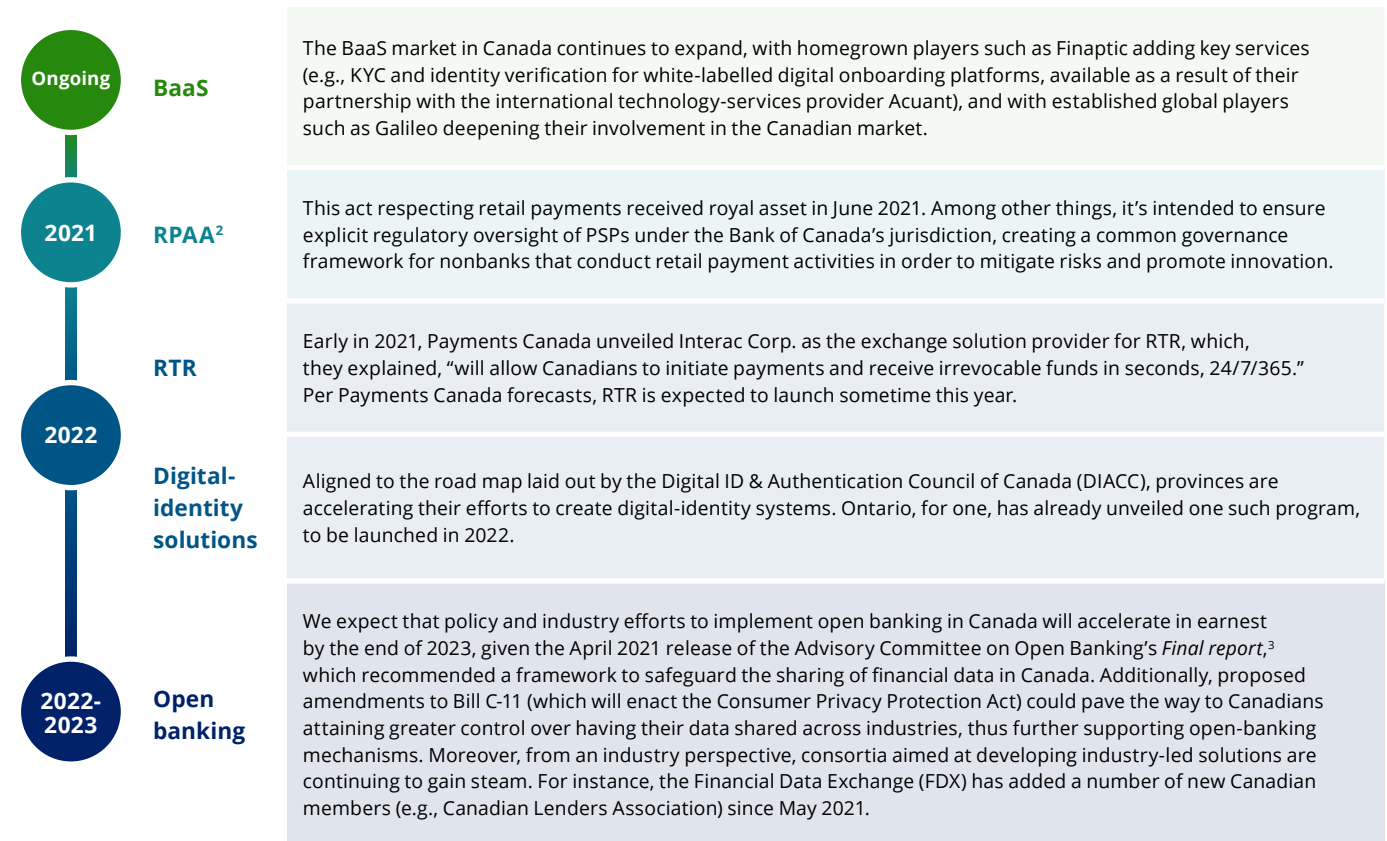
However, we don't have to wait for these developments to witness their potential impacts. For instance, Questrade and Wealthsimple are already partnering with a payment service provider (PSP), Zum Rails, to enable instant funding of investment accounts.

Furthermore, emerging identity-verification practices and digital-identity solutions enable secure, end-to-end digital account-opening flows and reduce time and cost burdens (e.g., manual know-your-customer, or KYC, checks). In conjunction with data provided through open banking, this can significantly improve the onboarding experience for clients by automatically completing forms and user profiles on their behalf, assessing their eligibility criteria, and setting up payment authorizations. For example, people can join Wise using their Facebook accounts and Google IDs; the service also conducts digital document scans to verify identities, allowing clients to begin converting currencies and transferring payments in minutes.

Finally, banking-as-a-service (BaaS) providers have been lowering barriers to financial solutions by assuming traditional regulatory and capital burdens and employing white labelling in product manufacturing. These steps can lead to an end to the product shelf as a hurdle for prominent nonbank players—promoting closer integration of banking and adjacent customer journeys and drive the emergence of more providers targeting niche segments. In Canada, the impact of BaaS is seen, for example, through retail provider KOHO, who partnered with Galileo for payment processing, Visa for cards, People’s Trust for card issuing, and Wealthsimple for high interest saving accounts.

While these sector shifts are already beginning at home, they’re coinciding with the rapid expansion into international financial-services markets of non-traditional players—particularly those with scaled user bases. Take, for example, Balance, Shopify’s upcoming entry into banking for small-to-medium-sized enterprises (SMEs) in the United States: the product combines a user’s current account, cashback capabilities, and loyalty offers. However, these new players are still nascent in Canada, allowing for a unique window of opportunity for our institutions to create defensive moats against foreign profit-pool disruptions.

Timeline of shifts



Breaking down traditional profit pools

With these environmental shifts converging with open banking, traditional banking is likely to erode profit pools in four key ways:

1 Using deposits more wisely and efficiently

The number of chequing accounts with dormant balances will likely decrease as lines between spending, saving, and investing blur. This trend is expected to be driven by open-banking applications that can analyze a client's entire financial portfolio and provide advice on optimizing fund allocation (e.g., determining a safe-to-spend amount each month). A modern payment infrastructure could also help clients automate fund transfers between and within spending and savings accounts. As a result, these changes should ultimately increase average capital costs for banks. For example, between 2016 and 2020, the proportion of savings in Canadians' high-interest accounts increased from 48% to 62%, with interest rates in these accounts as much as 200 basis points above those of standard savings vehicles.⁴

2 Converting loan balances to installments

Account aggregation via open banking will make it easier for clients to take advantage of credit-consolidation services and spend-management advice. Today, interest income accounts for as much as 45% of credit-card revenues,⁵ accruing when people are unable to manage their finances and/or make their monthly payments in full; better money management and cheaper consolidation options could drive significant erosion of this profit pool. By early 2021 (the latest figures available), Canadians held credit balances of more than \$75 billion, with figures having grown by 20% annually since the early 2000s.⁶ Further, as assessing creditworthiness and managing multiple instalment payments becomes more common under open banking, the rise of off-card instalment offers (e.g., buy now, pay later arrangements) could further cannibalize card fees and interest revenues. Deloitte estimates that the installment financing market in Canada will reach ~\$30 billion annually in the next few years.

3 Refinancing term loans and optimizing back-book pricing

We expect that back-book stability of term loans will decline as digital intermediaries and lenders focus on renewal and switching as their sources of growth. Open banking can change lending intermediaries' paradigms by providing these companies with data to allow them to monitor loan-optimization opportunities on an ongoing basis instead of simply competing for first-time borrowers. By assessing customers' incomes, expenses, and lending arrangements over time, such organizations could automatically and periodically determine possible empirical savings that can be unlocked by switching lenders. A substantial profit pool is ready for the taking by digital intermediaries, with mortgage switching valued at \$28 billion annually and portions of mortgage renewals priced higher than market rates.

4 Using third-party investing platforms

It's anticipated that clients will migrate at an accelerated rate to third-party investing platforms. Increasingly in Canada, long-term investments are becoming a priority asset allocation. In a recent Deloitte Canada study, saving for the future and managing investments were identified as the top two concerns for which Canadians expected advice from their primary banks; yet, nearly 20% of respondents said they were unhappy with their banks' advice.⁷ Still, a study by Investor Economics found that, by 2028, Canadian households will have converted a further 5% of their total financial wealth from deposits to investment products.⁸ Recent market evidence also points to this shift: Wealthsimple doubled its assets under administration (AUA) and tripled its client base between 2020 and 2021. Third-party platforms could further capitalize on this investment trend, using open banking to provide wealth-building financial advice on clients' entire portfolios as an enticement to more investing behaviour; they could even make primary banking products available via BaaS to drive wallet consolidation.





A business-model problem at the core

Open banking is expected to be far more than just an interesting solution to financial-data aggregation—it will no doubt have a real and foundational impact. For instance, with multiple profit pools at risk across a number of core banking products, acquire-and-franchise models will no longer be sustainable and the primary-deposit relationship as an anchor will become less efficacious. Data democratization will increase the availability of hyper-targeted offers and thus improve clients' power to compare opportunities across providers, while innovations in payment and identity infrastructure will make it easier for customers to act on these offers. Therefore, spending upward of \$300–\$500 to acquire a new primary-deposit relationship (an average range for all-in client acquisition costs in Canada)⁹ in the hopes of cross-selling high-margin credit cards, secured lending, and eventual wealth will become a far less successful bet over time as clients mix and match banking services and as retention rates drop.

In the longer term, these shifts will also accelerate the *platformification* of financial services—that is, the trend toward platform banking as a new business model—by disentangling product manufacturing from distribution, therefore reinforcing the strategic importance of employing engaging customer interfaces. With access to rich third-party product shelves via BaaS, these interfaces can heighten product-by-product competition—as a result, per-client, per-product profitability will likely decrease across the board. Moreover, in an age of commoditized financial data due to open banking, those who contend for customer interfaces can benefit from unfair access to proprietary data from financial activities and financial-adjacent behaviours (e.g., data generated as a result of major life events and interactions that result from specific personality traits). This increased access can enable interfaces to offer customized product, service, and advice delivery better than can standard competitors; it can also improve client-relationship intimacy, as has been the case in retail and media sectors. But not everyone can win in a platform world—after all, it's a zero-sum game, so more engagement with one platform necessarily means less engagement with others. As a result, competition is expected to intensify in a platform economy.

Creating new sources of defence and differentiation

With open banking and its complementary forces rapidly becoming realities in Canada (see "Timeline of shifts"), the moment has arrived to create new sources of defence and differentiation. The following section outlines key activities that we believe financial institutions should pursue. Overarchingly, however, we expect successful competitors to excel using three key measures:

1. Relentlessly aligning costs to serve each client with constantly updated data-driven predictions of their lifetime values
2. Optimizing for high client-productive engagement to maintain deep and intimate relationships, especially given the anticipated increased use of automation
3. Building proprietary and defensible data sets in order to offer insightful financial and financial-adjacent advice and tailored servicing that will be hard for competitors to replicate



Specifically, the following five actions can help financial-services providers create defensibility and differentiation in an open-banking milieu:

1 Optimizing digital sales

Low cost-to-serve and cost-to-operate values will become necessary conditions regardless of strategic direction. Therefore, focusing on digital sales practices to optimize acquisition costs is a critical first step. Tangible next actions include improving lead management to facilitate easier lead sharing across an institution; building feedback loops to rapidly assess and address frictions in sales pipelines; and investing in behavioural science and analytics-driven customer targeting to better tailor value propositions to clients and to better segment clients by value extractability—deploying always-on, next-best engagement engines (e.g., AI-based content-optimization tools) to refine and deliver offers.

2 Scaling relationship banking

With new challenges to client relationships, satisfaction and retention will depend on ability to build and deepen trusted client relationships. Therefore, designing advice-led relationships around intimacy (frequent, empathetic engagement), relevance (addressing salient needs in a timely and effective manner), and perceptiveness (identifying evolving requirements and providing solutions) is critical. However, achieving these goals with millions of clients will require common digital capabilities, such as a single robust view of customers (e.g., customer relationship management, or CRM) constantly updated via persistent, data-driven discovery (e.g., identifying client needs on an ongoing basis); common orchestration of next-best engagements (e.g., via automated advice and servicing engines) based on firm-wide views of best outcomes; and an ability for clients to configure preferences across all interaction channels at once.

3 Securing third-party distribution

It's unlikely that institutions will develop winning platform interfaces across all their markets. Additionally, with the increasingly modular nature of financial products, some static offers are expected to be replaced by just-in-time solutions embedded in user flows (e.g., flight insurance included in ticket purchases). Therefore, extending client reach by supplying financial products to third parties can be critical for any scaled institution. This could mean setting up marketplaces with application programming interfaces (APIs)—as per BBVA's global marketplace of banking APIs—or becoming BaaS providers. Given the presumed intense competition, securing exclusive partnerships with third parties with wide reach will be critical to defensibility. Simplifying products and building flexibility into technology stacks (e.g., via APIs) can also help support diverse product constructs required by third-party partners and their clients and drive efficiency improvements to maintain profitability.



4 Owning journeys for key client segments

Given how important proprietary data and client relationships are to competitive success, it's likely that institutions will race to secure exclusive positions at key points in customer journeys, moving beyond fulfilling clients' core financial needs alone. Therefore, organizations that can establish relationships early on (e.g., when clients buy homes, begin raising families, embark upon careers) will likely benefit from disproportionate retention over the long term. As an example, the RBC Small Business Navigator, a virtual

storefront comprised of homegrown and partner offerings, provides financial and nonfinancial solutions to small businesses across their life cycles. It's critical, then, to understand target segments of customers' journeys, secure exclusive relationships with suitable ecosystem partners at these key segments, and gain clients' trust to extend relationships beyond simple banking (e.g., to incorporate their financial-adjacent needs). Analytics, marketing, and CRM capabilities will be essential to nurturing relationships across banking and nonbanking touchpoints and commercializing them through product sales.

5 Designing bank-wide loyalty programs

With financial relationships prone to fragmenting in this new milieu, fresh approaches to loyalty could help erect switch barriers and promote wallet consolidation. Tier-based membership programs tied to estimates of each client's lifetime value—and including features such as preferential pricing on products, tier-matched servicing (e.g., priority phone support for higher-tiered clients), and behaviour-based incentives (e.g., interest-rate bonuses for increased savings)—could help align perceived worth with costs to both serve and create customer stickiness. Banks already offer relationship pricing in many ways, such as via discretionary discount wallets for distribution channels. By consolidating and presenting these offers clearly and consistently, banks can increase their chances of defending and retaining their most profitable customer relationships. Bank-wide loyalty can be an effective driver of customer acquisition, too. In a Deloitte Canada survey,¹⁰ 13% of respondents said that a membership-style loyalty program that recognized and rewarded them for the duration and depth of their relationships with a given bank (i.e., extending beyond card-based, purchase-driven loyalty) would make them strongly consider changing financial institutions; this is a considerable figure, given that the usual switching rate is just 4%.

Summary and path forward



Open banking is slated to emerge alongside a series of complementary environmental shifts, such as payment modernization, digital-identity solutions, and BaaS.

Together, they're on course to substantially affect retail financial institutions' business models by eroding common profit pools, putting traditional acquire-and-franchise models at risk, and accelerating the platformification of the financial-services industry. Subsequently, these outcomes will likely put more pressure on financial organizations to align costs and value of their products and offers, enhance relationship intimacy with clients, and capture pools of unique, defensible data in order to differentiate themselves from the competition. To achieve these aims, they should explore strategies to develop engaging customer interfaces, protect and deepen vertically integrated relationships across financial and finance-adjacent value chains, and continue to find new ways to scale the reach of their products and services.

Endnotes

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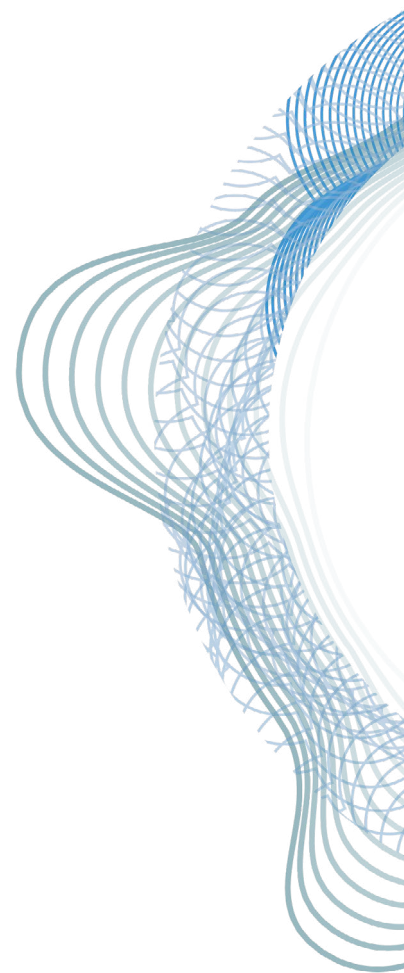
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