What's the Difference Between Open Banking and Banking as a Service and Why CIOs Should Care

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Initiatives: Financial Services Digital Business Strategy and Innovation

Open banking and banking as a service (BaaS) are often used synonymously, but they’re not the same. As a result, bank CIOs often create technology strategies without fully understanding the differences, leading to misplaced investments and missed business outcomes.

Quick Answer

What’s the difference between banking as a service and open banking?

- **Open banking** enables third-party financial service providers access to financial data from banks and nonbank financial institutions via open application programming interfaces (APIs). These APIs can use customers’ shared data to create a range of financial service value, which includes, for example, comparing and aggregating a customer’s accounts across participating financial institutions to create marketing personas or perform transactions on a customer’s behalf. This includes the capability to allow third parties to conduct transactions on behalf of the customer. Customers must be able to opt-in or opt-out of data sharing. Nonbanking data from third parties or ecosystems is also under this umbrella of open banking.

- **Banking-as-a-service (BaaS)** can be a discrete or broad set of financial services functions exposed by chartered banks to power business models deployed by other banking market participants — fintechs, neobanks, traditional banks and other third parties. Typically exposed via APIs, these business services have the potential to enable banking market participants to offer innovative financial services solutions without the burden of regulatory compliance. Access to payment platforms and originating/servicing of deposit or loan accounts are other examples of BaaS.

More Detail

The terms “open banking” and “banking as a service” have been around for a while. But based on client inquiries Gartner receives, it’s clear there is widespread confusion about what these terms really mean and how they relate to — and are different from — each other. As a result, bank CIOs often develop technology strategies without fully understanding the differences, which can lead to misplaced investments and missed business outcomes.
Origins

The term open banking originated at the outset of digital business to describe financial services conducted externally with both known and unknown third-party providers. Data aggregators such as Mint were the primary beneficiaries, as they promoted value propositions tied to centralizing customer financial data. The data was acquired primarily through screen scraping.

As banks moved to reassert their position in the financial services value chain, the strategic launch of personal financial management solutions intended to keep their customers in-hand, largely missed the mark. Data monetization became the next targeted iteration of banks’ digital business strategy. Initial efforts stressed data protections to promote secure outbound data transfers with third parties, and the result was API generation becoming a center of gravity for banks. But independent and isolated attempts to make money with data as a direct revenue generator continued to be a challenge.

Although open banking was an adequate way to describe early digital business strategies tied solely to data aggregation and monetization, this term isn't sufficient alone to describe current market conditions. The supply and demand participants of the banking market have expanded far beyond the simple business model that consists of a bank and its customers.

Enter, banking as a service. BaaS represents a diverse set of business models that pairs banks in symbiotic business relationships with other banks and nonbanks. Although open banking and BaaS define distinctly different opportunities, progressive banks are blending these approaches to support the bank’s broader digital business strategy (see Figure 1).
Open Banking: Access to Data

Although the initial capability of open banking — permissioned customer data transfers to third parties (via APIs) — is still quite common, it’s typically an entry point on the path to innovation within financial services. The support of networked APIs enables customers to share their financial information with other financial institutions seamlessly and with the potential to do so securely. Customer data exposed with APIs may feed advice engines that identify the best financial products and services for the customer. These might include a lower-rate mortgage loan or credit card, or a new savings product that earns higher interest than what the customer has currently.

Another leverage point for open banking is financial data monetization. Data monetization refers to using data for quantifiable economic benefit. Open banking enables the potential for both direct (capturing fees, interest payments, commissions, etc.) and indirect intermediary data monetization opportunities (improving process performance, developing new products, etc.). Data monetization through open banking is continuing to evolve with an emphasis on analytics and AI; however, the primary payoffs for banks are cash flow, a deeper knowledge of their customer base, and effective and relevant financial services being driven to their customers at just the right time.

Apart from consumer-driven transactions, open banking can enable differing data-sharing models with third-party providers. For example, banks can allow third-party access to their APIs and receive data every time their APIs are consumed. Open banking can be leveraged as a direct monetization opportunity (trading or bartering information), either to underpin intermediary monetization (enhancing product or services with information) or as an indirect financial service lead generation tool.

Example: Account Aggregation and Analysis

A common use case for open banking is aggregating accounts. This kind of service brings together everything from a customer’s account balances such as deposits, credit card information, credit score — every aspect of a customer’s financial life — within a single view or “dashboard.” The service can also analyze checking, savings, credit card, brokerage, and time accounts and other offers and make customized recommendations designed to help the customer find the best interest rates, account types, investment vehicles and more.

For example, Snoop is a U.K.-based fintech that aims to save £1,500 for every household that enlists in its services. Beyond categorizing transactions and alerting customers to anomalies in expenses, Snoop targets value-added services, including Friend Spend Pools for shared expenses, energy bill monitoring and sending voucher codes for items their customers normally purchase.

BaaS: Access to Functionality

Banks operating as BaaS providers offer a range of financial products and services to support nonbanks, neobanks, digital giants and traditional enterprises. BaaS is enabling an increasing diversity of third parties to connect directly with banks via APIs to create or extend their value proposition. These third parties are a broad range of participants with differing profiles:
At this point, common monetization models for BaaS are:

- **Revenue sharing** — One-time charges for accounts originated
- **Balance sheet growth** — Fees generated as a percentage of account profitability (interest)
- **Freemium** — Foundational services free and premium services charged
- **Subscription** — Periodic fees or pay-as-you-go
- **Transaction** — As part of a collaborative solution, revenue shared

BaaS is gaining traction from both banks and nonbanks aspiring to establish or enhance direct and intermediated revenue streams. Market participants are increasingly drawn to collaborative models that enable enhanced customer experiences such as richer features, a broader set of products and innovative customer experiences.

**Example: Rellevate — Pay Any Day**

Targeting a market segment that offers payday loans, Rellevate — a nonbank fintech launched in August 2020 — is driving a solution that enables its customers to withdraw 50% of their accrued payday earnings without penalty. Rellevate doesn't possess a banking license, but it does have a partnership with a chartered bank to host its accounts. Rellevate's proprietary software enables it to serve a market segment that most in the industry have ignored.

**Why CIOs Should Care**

- Bank CIOs must have a clear understanding of what their banks are trying to accomplish — open banking, BaaS or both. Technology investments and strategic objectives will be different for each.
- For open banking, CIOs must pay special attention to regulatory-required data privacy that impacts consumer trust, security, and data integrity, thus ensuring that their technology investments support
strong data privacy and security.

- For banks pursuing the supply side of BaaS, CIOs must align technology investments that manage API products through external marketplaces, drive fintech collaboration through ecosystems and build support for development portals.

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