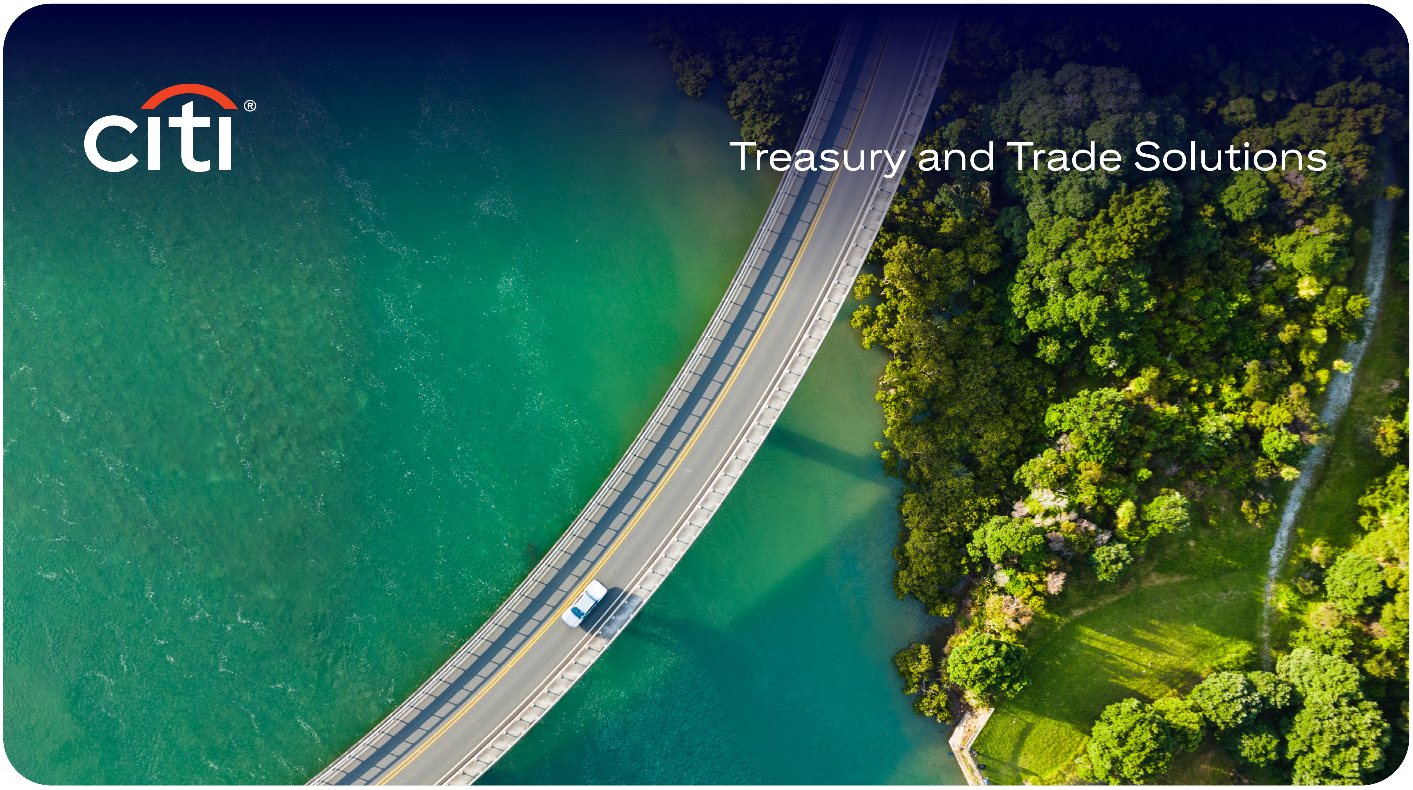


The Rise of Open Banking: *How Pay by Bank Will Transform Online Payments*

Open banking is growing globally and is poised to take off in the United Kingdom and United States. Treasury and Payments teams should prepare to leverage the opportunities presented by account-to-account (A2A) payments via open banking.

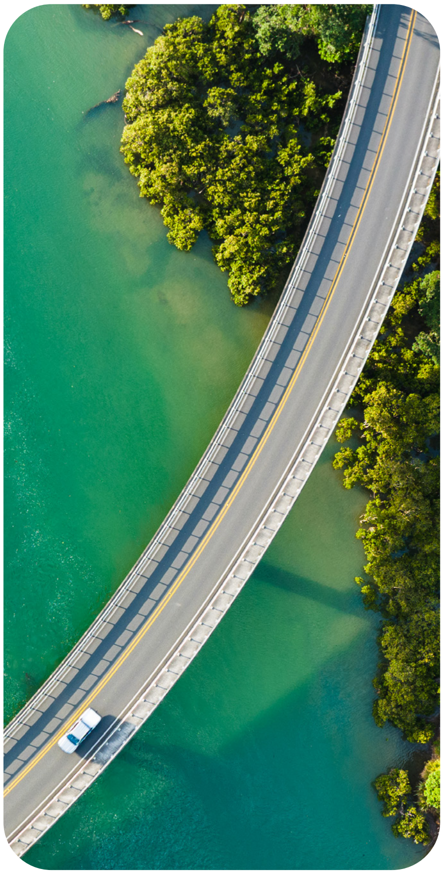
Matt DeMerlis
eCommerce Business Development, North America, Citi Treasury & Trade Solutions

Ross McEwan
Head of eCommerce, UK, Europe & MEA, Citi Treasury & Trade Solutions

Open banking, which enables consumers to make payments directly from their bank accounts to merchants' accounts – so called A2A payments – is a relatively new concept but has already established a track record in many markets. Pioneered by the European Union and the United Kingdom in 2018, there are now similar initiatives taking flight around the world, from Canada to Australia.

While initial take-up has been slow across some use cases, momentum is building. In the six months to June 2023, over 11% of British consumers were active users of open banking, an increase from 7% in 2021, for instance.[1] The value of global open banking payment transactions is predicted to exceed $330 billion by 2027, up from $57 billion in 2023.[2]

[1] https://www.pymnts.com/wp-content/uploads/2023/12/PYMNTS-Tracking-the-Digital-Payments-Takeover-December-2023.pdf
[2] https://www.pymnts.com/wp-content/uploads/2023/12/PYMNTS-Tracking-the-Digital-Payments-Takeover-December-2023.pdf



Key Merchant Benefits *of Open Banking*

Cost-Effective: Savings on transaction fees can deliver cost savings for merchants.

Speed: Payments are processed instantly or within a day, unlike credit card payments which can take up to three days.

Security: Open banking uses high-level authentication methods via the bank's familiar interface, giving consumers confidence about security. Furthermore, the merchant does not store the consumer's payment details, reducing the risk of fraud.

Customer Experience: The payment process is straightforward, eliminating the need for entering routing or account numbers manually.

A2A payments via open banking *align with consumers' expectations for simplicity and convenience.*

Importantly, the US, which has previously taken a market-led approach, now looks set to introduce regulation. The Consumer Financial Protection Bureau (CFPB) has proposed a new Personal Financial Data Rights rule to allow financial data sharing (with customers' permission), paving the way for easier open banking. The CFPB believes this will increase competition, cut costs and broaden the range of consumer financial products and services.

In the UK, Open Banking is now regulated by the Financial Conduct Authority (FCA). Only companies that are authorized by the FCA can use open banking APIs to access financial information or initiate payments on behalf of a customer.

With adoption expected to take off in the near-future due to consumer sentiment and push in regulation, Treasury and Payments teams should stay informed with all the developments in this space.

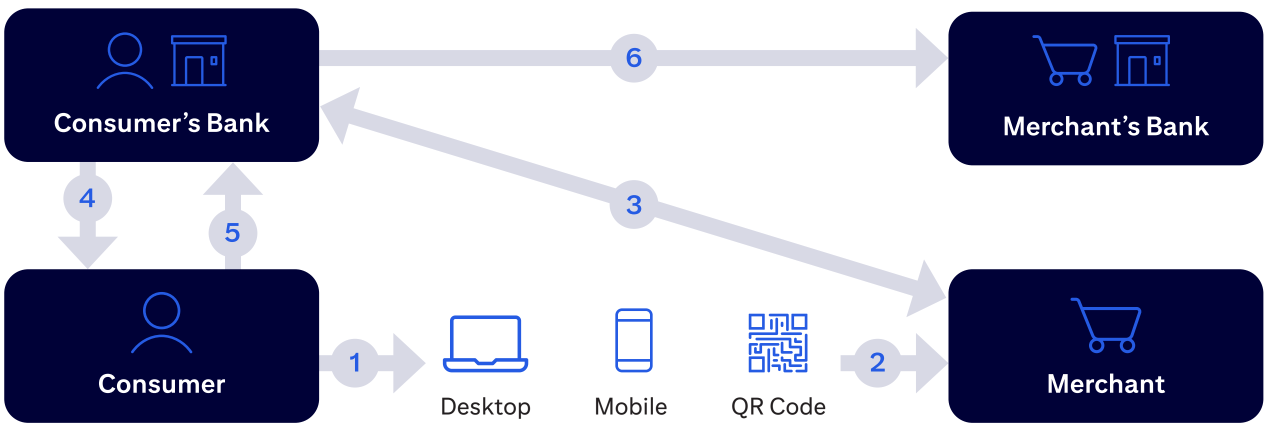
How Does Open Banking Work?

Open banking enables consumers to make payments to merchants straight from their personal bank account, online or in-store through various channels such as QR codes, application programming interface (API) requests, or direct online banking login right on the merchant's website. It uses existing bank transfer systems, such as ACH or real-time payments, separate from card networks.

Consumers have long been able to pay for items online using their bank accounts. But the process has been cumbersome, requiring account and routing numbers to be inputted for every transaction. Adding a bank account to a digital wallet is easier but involves an intermediary and can limit consumers' visibility of funds, which are usually retained on the wallet.

Pay by Bank Flow

1. Consumer visits merchant site and goes to checkout page to complete transaction
2. Consumer selects ‘Pay by Bank’ as a payment method
3. Merchant initiates open banking checkout flow via API
4. Consumer is prompted to authenticate their personal bank account
5. Consumer authenticates account by logging into their banking app and approving transaction
6. Funds are sent from consumer’s bank account to merchant’s bank account



In contrast, A2A payments via open banking align with consumers’ expectations for simplicity and convenience. A typical transaction involves the following steps:

- The customer chooses to pay using open banking at a checkout, instead of credit card or PayPal.
- They select their bank and are sent to its app for strong authentication, typically using biometrics such as fingerprint recognition or face ID.
- The bank verifies that the customer is who they say they are before authorizing the payment, which is sent to the merchant’s account.

Why Now?

The US faces challenges to open banking adoption due to the large number of banks, limited consumer knowledge about the payment method, and many competing alternatives (like rewards-based card programs).

However, the picture is already changing: 36% of US consumers have made at least one A2A payment in the last three months.[3] Those who have done so are happy with their experience: 84% of users are very or extremely satisfied with their most-used A2A payment platform.[4] Moreover, the majority of Generation Z and millennial consumers would be highly willing to try open banking payments for at least one type of common transaction.[5]

In this climate, the CFPB proposals could be transformative. They will increase awareness of the benefits of open banking among consumers and merchants, helping to allay concerns about security and fraud. The move by the CFPB is also likely to galvanize interest among merchants.

According to the 2024 WorldPay Global Payments Report, open banking transactions are set to grow at the expense of credit and debit cards for e-commerce sales. In North America, open banking transactions are projected to rise from 5% in 2023 to 7% by 2027, while card usage is predicted to drop by 5% in that same time period. Latin America should enjoy the greatest increase in open banking as a share of e-commerce sales, rising from 20% in 2023 to 29% in 2027.[6]

[3] https://www.pymnts.com/wp-content/uploads/2023/12/PYMNTS-Tracking-the-Digital-Payments-Takeover-December-2023.pdf
[4] https://www.pymnts.com/wp-content/uploads/2023/12/PYMNTS-Tracking-the-Digital-Payments-Takeover-December-2023.pdf
[5] https://www.pymnts.com/wp-content/uploads/2023/12/PYMNTS-Tracking-the-Digital-Payments-Takeover-December-2023.pdf
[6] https://offers.worldpayglobal.com/rs/850-JOA-856/images/TheGlobalPaymentsReport2024.pdf

Initially, A2A payments via open banking will compete primarily with debit cards as consumers – especially in the US – still value the fraud protection and insurance offered by credit cards, the typical 30-day float period, and the rewards many cards offer (like points, cash back or discounts). However, given the attractiveness of A2A payments for merchants, open banking is likely to develop a system of rewards to attract those same consumers. Already, some online retailers are experimenting with discounts if the shopper pays by bank or other incentives (such as free or faster shipping, store credit to be used on a future purchase, or charitable donations made on behalf of the shopper).

In the UK, although adoption remains low compared to cards, the share of A2A value has the potential to grow to 8-10% of e-commerce spending by 2027.[7] A2A success will depend on the initiatives by the UK government and the European Commission, which include obligations for banks to provide an API-based open banking interface amongst other related to data transparency.

Choosing the Right Partner

Open banking is now at an inflection point. It offers a streamlined, secure, and cost-effective alternative to traditional payment methods and looks set to gain traction given the potential benefits to both consumers and merchants.

For merchants, integrating open banking into payment processes should come after due consideration. Payment methods need to be carefully curated to the buyer group or price point, in order to avoid abandoned carts and customer "churn". Given the greater protections currently offered by credit cards, they are likely to remain dominant for high value items in the medium term. The use case for open banking will initially focus on smaller ticket sizes but could grow as rewards are attached. However, the cost savings cannot be ignored – from bypassing the card network rails, to guaranteed funds that help with days sales outstanding, and faster settlement times to help with cash flow forecasting, the economic benefits are real.

Likewise, simplicity is central to customers' payment experience. A2A payments via open banking must be seamlessly integrated into the customer journey. As businesses consider adding open banking to their payment strategy, they need to work with trusted partners that can provide innovative technology to enable them to prosper in the evolving payments landscape.

Citi has developed a compelling offering that is designed to enable merchants to increase customer conversion at checkout and lower the cost of payment acceptance globally. Spring by Citi®, our leading digital commerce solution for online payment acceptance, has several Pay-by-Bank options for A2A payments in the US, UK, Europe, Brazil and India that will be launched in the next year.

Not only will Spring by Citi's Pay-by-Bank solution present this payment seamlessly alongside other payment options, like cards and wallets, it will also bridge any regional differences in how A2A payments are executed globally (in the US they will use ACH, Request for Payment (RfP), Real-Time Payments (RTP) or FedNow while the Faster Payments network is used in the UK, for example). Spring by Citi offers a uniform experience to merchants and a single unified API, helping merchants integrate quickly and easily.

[7] https://offers.worldpayglobal.com/rs/850-JOA-856/images/TheGlobalPaymentsReport2024.pdf

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