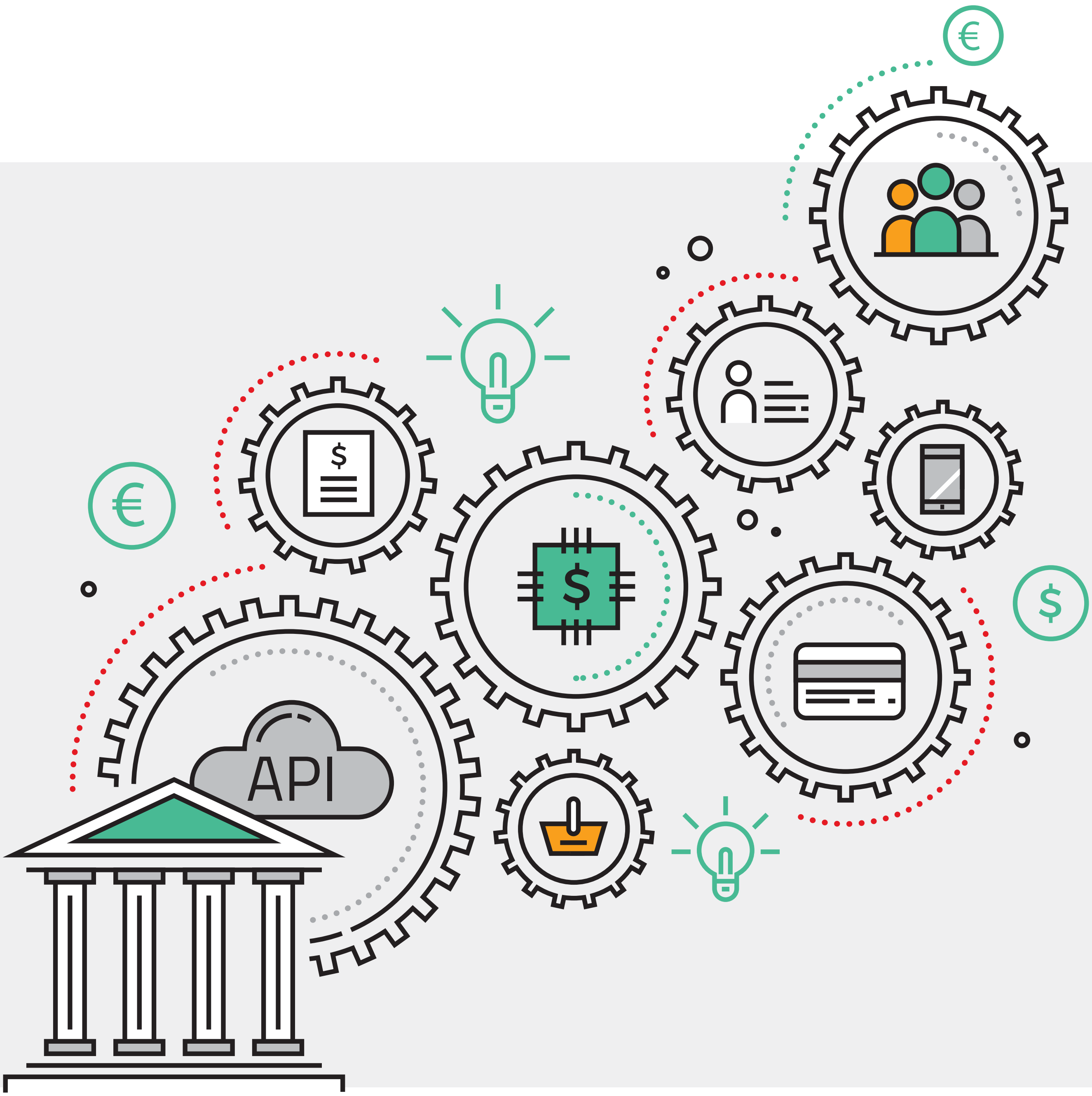
PSD2 in Action

Opportunities to optimize the consumer experience



mastercard

The European Commission's revised Directive on Payment Services (PSD2), finalized in January 2016 and set to become mandatory as of 13 January 2018, will revamp the region's payment services industry.

As the EC notes, the new regulations were developed to facilitate and secure cross-border payments and reduce costs for consumers by increasing competition among providers.[1] Crucially, the revised directive requires Europe's banks to offer third-party payment (TPP) systems greater access to customer data and payment infrastructures to facilitate online payments and account management.

As you will learn in this whitepaper, the revised directive is not merely an updated set of rules that the financial services industry must follow. Rather, the new framework opens opportunities for banks and payment processors to access information that will enhance their customers' experiences, grow new revenue sources and align their businesses with today's latest technology players.

Painting the New Landscape

The revised Directive on Payment Services will pave the way for a more open banking landscape in Europe. According to Payments UK, a payment industry trade association, this is a key step toward building a single market in Europe, one that is fit for the digital age.[2] The regulations must be incorporated into law in the member states of the European Economic Area, which comprises the 28 EU members plus Norway, Iceland and Liechtenstein.

Depending on how banks choose to respond, the new directive could be "either a catalyst for jump-starting the development of valuable new business models or a threat that will spawn serious competitive challenges," PwC's Jörg Sandrock and Alexandra Firnges explain in the strategy& report, "Catalyst or threat? The strategic implications of PSD2 for Europe's banks."[3]

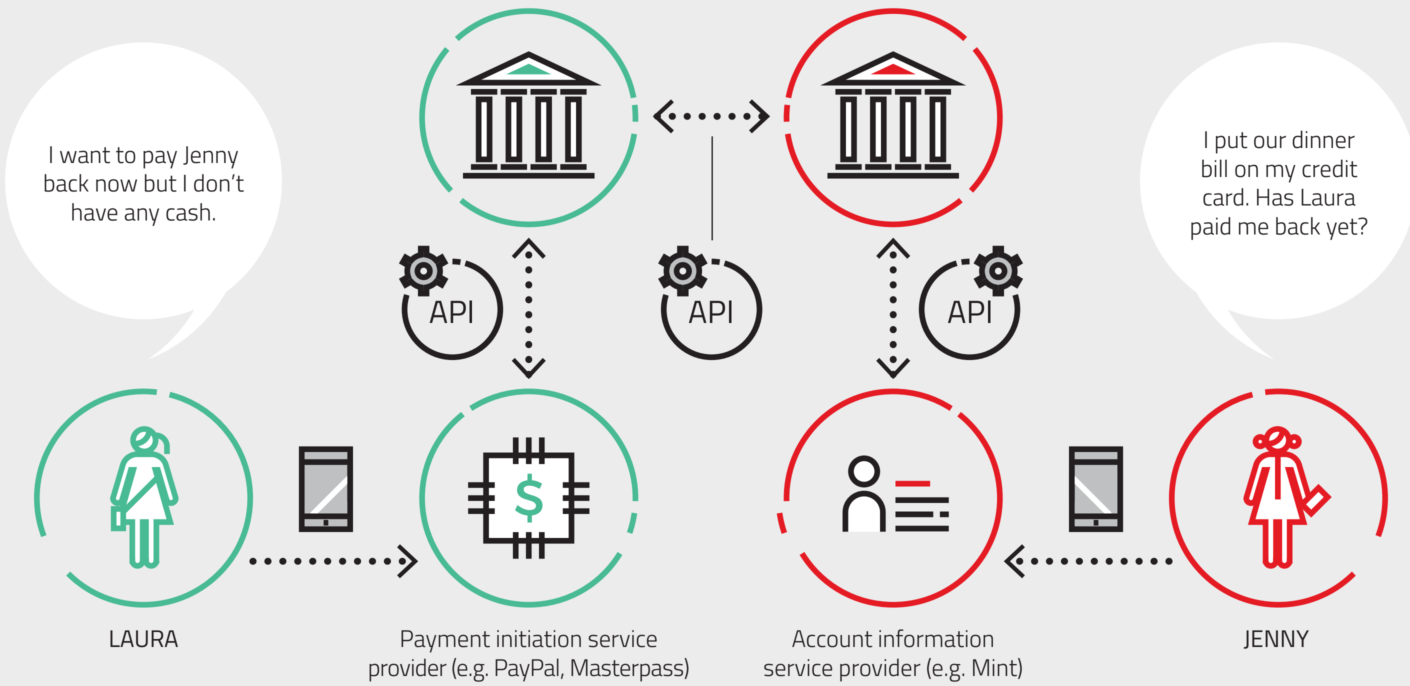
The PSD2 requires payment service providers (PSPs) to make significant changes to their operations. It's not difficult to see why the time is right for a new framework. Market development, changing customer needs and technological advancements are all impacting the financial services sector, creating a demand for updated legislation to remain relevant to the industry it patrols.

"The PSD needed to be updated to make it future proofed for the new breed of PSPs that are becoming increasingly active in the pan European market," Payments UK states.

1 "Directive on Payment Services (PSD)," European Commission
2 "The Second Payment Services Directive (PSD2)," Payments UK, July 2016
3 Jörg Sandrock, Alexandra Firnges, "Catalyst or threat? The strategic implications of PSD2 for Europe's banks," Strategy&, PwC, 25 July 2016

A Day in the Life of PSD2

Consumers now take for granted the complex API-based financial transactions that PSD2 is designed to facilitate. The simple scenario outlined below — two friends splitting a dinner tab — shows the many players and APIs involved in a single transaction.



Source: PwC (2016)

The Specifics

Two new TPPs that have entered the market in recent years will become regulated under the updated payment services directive. These services are provided by payment initiation service providers (PISPs) and account information service providers (AISPs). These providers will be able to initiate payments to online retailers or other merchants directly from the customer's bank account via an online portal in a secure and regulated manner.

The updated directive sets out a common legal framework for making and receiving payments. At the core of the revised payment services directive is the requirement for banks to open customers' online accounts and payment services to TPPs.

Payments UK notes that the PSD2's main aims are to:

- Contribute to a more integrated and efficient European payments market
- Promote competition and encourage integration of new financial technology players (FinTechs)
- Improve consumer fraud protection through enhanced security requirements
- Encourage lower prices for payment

This access will most likely be provided through application programming interfaces (APIs), which are powerful facilitators and drivers of digital businesses and a cost-effective tool to scale new enterprises. To date, their ability to access and exchange data in the banking sector has been limited. However, the revised Directive on Payment Services kicks off a whole new ball game.

"Now, European banks must open their data and infrastructure to fulfil regulatory requirements. Even though the professed focus of PSD2 is on payments and access to accounts, its ramifications extend far beyond that limited area. In addition to using APIs to achieve compliance, Europe's banks and third-party providers will be able to use them far more strategically," PwC notes.

APIs Open New Opportunities to Optimize UX

To remain competitive under the new regulations, banks could incorporate third-parties' API capabilities to their core business to create and test new models and concepts more efficiently. Meanwhile, they could boost their cross-selling abilities and extend into new markets using customer insights to develop new products and services.

Global payments company ACI Worldwide agrees the directive and open APIs have created an opportunity for traditional banks to rethink their business models by adopting new digital techniques while maintaining their central position in the payments ecosystem via trust-based offerings.[4] But the knowledge and skills necessary to maximize this new opportunity extend beyond technology, says Lu Zurawski, solutions practice lead, consumer payments EMEA.

"Fresh ways of thinking about business relationships, customer propositions, user experience and engagement with untethered developer communities are also required," he says.

This is an opportunity banks can seize, according to Accenture: "PSD2 presents significant opportunities to grow new revenue streams, capture customer ownership and progress toward an extended ecosystem centred on the Everyday Bank. The imperative for banks is to leverage API integration and their existing customer relationships to develop a customer value ecosystem centred on their own banking portals."[5]

A Market Hungry for Change

A strong consumer appetite for third-party digital payment providers suggests that market share is assured. Accenture estimates that PISP services could account for up to 16 per cent of online retail payments by 2020.

PwC's strategy& study on the revised directive, conducted in the first quarter of 2016, found that using third-party providers for digital payments is already standard among European consumers, with 88 per cent of survey respondents stating they use alternative payment services such as PayPal and Sofort. In addition, nearly three quarters knew that these digital payment services are not affiliated with banks. Further, a substantial 85 per cent rated the security of these alternative payment services as either 'high' or 'very high' and 82 per cent agreed that companies like PayPal and Amazon can handle cash transfers as reliably and safely as their banks. The study says, "In short, third-party payment services have earned consumer trust."

Of course, the extent to which third-party providers can capitalise on this level of trust will determine how much of a competitive threat they could be to banks.

4 Lu Zurawski, "Open API: unlocking innovative new services in banking," GTNews, ACI Worldwide, 05 January 2016
5 Accenture Payment Services, "Seizing the Opportunities Unlocked by the EU's Revised Payment Services Directive," Accenture Consulting, 2016

PSD2 by the Numbers

16%
The projected percentage of retail payments accounted for by third-party payment initiation by 2020

85%
European consumers who rate the security of alternative payment services as high or very high

€730M
The amount saved by surcharging ban on credit card payments in Europe

88%
The percentage of European consumers who already used third-party providers like PayPal, Sofort and Masterpass

88%
Percentage of senior executives at leading banks across Europe who expect the PSD2 to have an impact on their business

The Providers Respond

Third-party providers could also build a solid foundation for expansion beyond payments into other services, such as account monitoring and personal financial management.

"The directive is seeking to encourage third-party providers to create innovative new products," says Ron Kalifa, vice chairman and executive director at payments processor Worldpay. "It is therefore a potential opportunity for companies in the marketplace, but the scale and nature of the opportunity will depend on the technical standards that are set and each player's ability to respond to them."[6] Banks, meanwhile, will need to grasp the nettle and create more convenient and compelling products and services to meet consumer needs and remain competitive.

MYPINPAD, a technology provider of multifactor authentication solutions, views the revised directive as a huge opportunity to rethink, reshape and renew the financial services industry. "It should give a strong foundation and framework for having a customer-centric banking industry, something perhaps long overdue," says David Poole, director of business development.[7]

According to Poole, the new regulations have the potential to guide the financial services industry toward this goal, but banks need to get to work now, strategising and introducing new services to make the most of this structural change. "They will have the opportunity to expand their services and become TPPs themselves. The possibility for banks to gain new business by strategic diversification is considerable," he says.

For digital ID verification specialist Jumio, the directive puts consumer convenience at its heart. Banks, both challenger and traditional, will have to explore new methods of identity verification such as biometrics and remote ID scanning and verification to access the enhanced services, Philipp Pointner, Jumio VP of product, wrote in ITProPortal. "Banks will have to start planning for this in 2017. Getting the right verification methods in place to not only comply with PSD2 but, also, keep customers happy will be a priority."[8]

6 Rob Kalifa, Interviewed by Fiona Briggs, January 2017
7 David Poole, Interviewed by Fiona Briggs, January 2017
8 Philipp Pointner, "The central role of identity verification in 2017", ITProPortal, December 2016

A Brief History of PSD2

By the time PSD2 comes into force in 2018, the directive will have been five years in the making.

2013 — European Commission (EC) Proposes PSD2
New initiative is designed to replace PSD1, which took effect in 2007

2014 — EC hammers out details
The commission holds parliamentary sessions and revises the text of the legislation multiple times

2015 — PSD2 Is Approved
The European Parliament and the Council of the European Union adopt PSD2

2016 — Implementation Begins
EU member states consult with the European Banking Authority (EBA) on Regulatory Technical Standards (RTS) and begin to incorporate PSD2 into national legislation

2017 — Implementation Plan Complete
EBA to publish RTS and EU Member States to complete legislative process

2018 — PSD2 Launches
EU Member States to ensure compliance with PSD2 regulations and application of RTS

Sources: Deloitte, European Payments Council, Digital Baobab

Impacts on Banks, Consumers, Retailers

Increased marketplace fragmentation in the form of new payment types and products, most likely on a regional and consumer basis, is on the cards. The widespread shift from cash to digital payments is also set to continue. The new standards are set at a high level, leaving the opportunity for a wider interpretation of the technical implementation. What the directive does introduce is regulatory standardisation for bank-to-bank payments. Payment facilitators like Swish (Sweden), iDeal (Netherlands) or Sofort (Germany) will now have clarity around how to expand in other EU countries. Retailers will have to offer support for these new payment methods as they gain popularity among consumers.

The revised Directive on Payment Services will enable customers to use payment initiation services and account information services, where their accounts are accessible online. This will make internet and mobile payments easier and will help customers manage their accounts and improve deal comparisons.

Payments UK also anticipates that new value-added offers could be introduced, such as services to assist people who are currently financially excluded. Customer protection measures will also be enhanced under the revised directive. For example, surcharging for card payments is set to be banned in the vast majority of cases, which the European Commission estimates will save consumers €730 million annually.[9]

See the Promise, Not the Threat

For banks, the second payment services directive presents an opportunity to play a central role in customers' everyday lives; or become what Accenture calls an "Everyday Bank." PwC's research among bankers, meanwhile, revealed there were three schools of thought with regard to the revised directive: a group that sees it as a threat, a wait-and-see group and those who consider it to be a catalyst for a move toward open banking.

"The catalyst school represents the only viable approach to PSD2," PwC says. "Because the directive mandates open banking, Europe's banks should respond by formulating business models that embrace collaborative relationships with new partners and the exchange of data via APIs. Otherwise, banks will be vulnerable to service commoditization and competitive marginalization."

ACI Worldwide's Zurawski agrees. "Banks and national associations need to have a better understanding of how faster payments will work in a collaborative environment across multiple borders. The many roads toward potential PSD2 completion highlight this need for hands-on collaboration across the industry," he says.

The second payment services directive will be a disruptive force in the banking industry, but it is also set to stimulate positive change and innovation to optimize customer convenience and regulatory compliance, not simply with payments, but with a whole new range of value-added services.

9 "Payment Services Directive: frequently asked questions," European Commission, 2015

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