

How will you manage the impact of the Payment Services Directive 2?

By Edwin van der Molen
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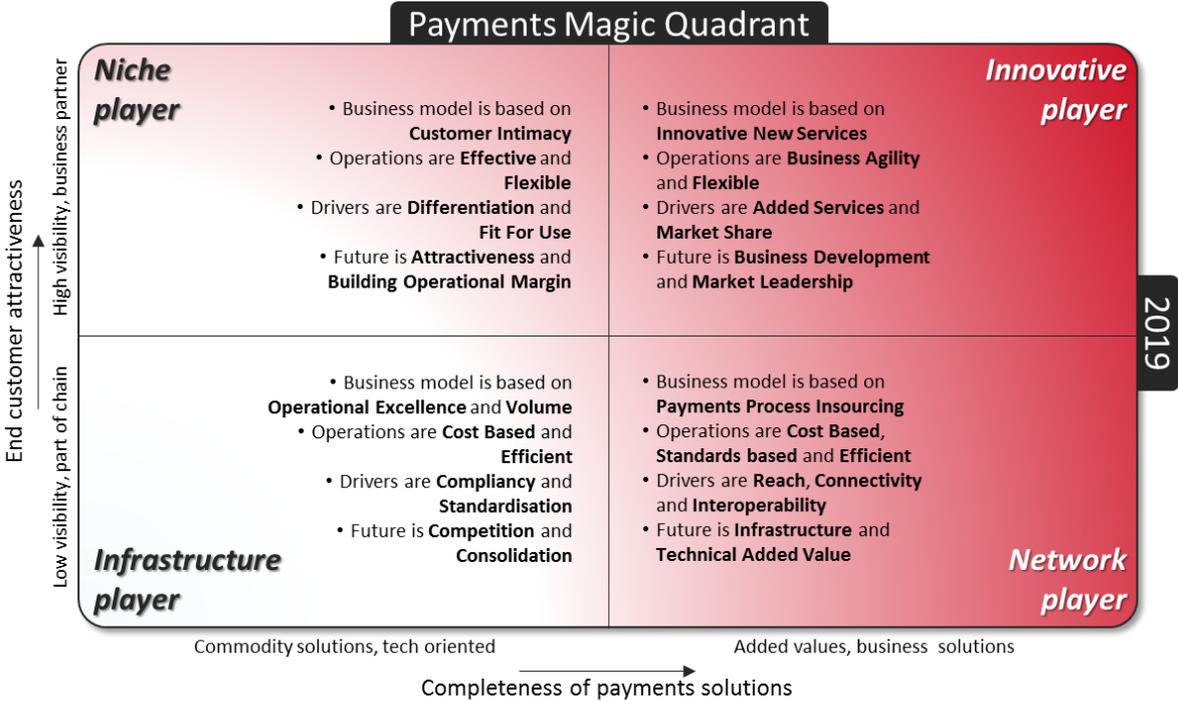
What is your strategy?

The topic of this white paper might be the Payment Services Directive 2 (PSD2) but the actual underlying issue goes a lot deeper and comes down to accelerating successive change in the financial industry. The multitude of changes makes that many banks are struggling with their future position and revenues.

Discussed and debated at seminars, during conferences, in boardrooms and in many articles the main topic of conversation is PSD2, either focused on independently or in relation to Instant Payments, it is described by many as a 'game changer'. Many (especially smaller) banks across Europe are wondering how long they will be able to maintain the pace of change. The costs are enormous, while the competition is fierce and their traditional revenue streams are decreasing. Moreover, the competition between the various banks is not the only factor that impacts the landscape, the disruption caused by Fintech and Bigtech companies also plays a vital role.

The core questions that arise are: How will the financial landscape look after PSD2? Will there be mergers, take-overs, outsourcing or major cooperation between parties? Will new entrants finally come to the market and take over?

One question in particular: **What is the future of your bank?** To answer that question we have plotted it to the following subsequent question: Will you be an infrastructure provider, a network player, become a niche player or an innovator?



? Where will you be in 2019 in this magic quadrant?

Figure 1: Source: Juffermans, Bouwmeester, Kalina, van der Molen, © 2017

Strategic choices for banks

For banks the big question is how to maintain the primary contact with their customers for all payment transactions. Payments are a lifeline and more spin-off business for banks like loans and mortgages are derived from having this direct contact with the customers.

However, customers will always look towards their banks if payments are not carried out correctly even if the payment is initiated by a third party.

❶ Are you going to take action to check duplicate payments by initiating parties?

❷ Now that banks need to share information with third parties, the question is how to ensure that your Big Data will continue to be valuable, even if payments are handled by third-party in their own systems?

What initiated this?

On 23 February 2017, the European Banking Authority (EBA) announced the Regulatory Technical Standards (RTS) for safe access to the bank account. The industry has eagerly awaited this RTS as this is an essential pillar of a revolutionary move by the European Commission (EC): the customer can grant third parties access to their bank accounts, without any formal agreement between the third party and the account servicing bank. This is called Access-to-the-Account, abbreviated as XS2A.

XS2A is to bring more competition and innovation to the payments domain. How this will work out is a big question. A safe assumption is that legislature and supervision have not yet assessed all consequences that will arise.

Privacy

Various Silicon Valley Bigtech companies meticulously follow the internet click and browse behaviour of every consumers and have transformed that data into a billions dollar industry by selling precisely targeted advertisements. But the most valuable information (your salary and how you spend it, how often you go on vacation, how much you pay for health care, insurance, childcare, rent, mortgage, utilities, gas, clothing, shopping, restaurant visits, sports, etc.) can only be found on your bank account.

Banks are expected not to use this data, let alone to earn money by selling it to others. But after PSD2 has been implemented banks will have to share the information with whomever their customer chooses to. These third parties called 'Payment Institutions' may under PSD2 only offer these specific services:

- to initiate a payment transaction;
- to collect and process account information for a 360° view on their financial situation;
- to query the account if there are sufficient funds for a payment of a specific amount.

Given the huge value that account information represents, we expect that the market will push its boundaries of what is acceptable and what is not, especially given the incremental value that account data holds. Innovation and convenience of use will be important drivers to stretch the threshold. Important to note is that in PSD2 'sensitive payments' data has been defined as data that can be used to carry out fraud, not as data related to customer privacy. The account holder's name and account number are thereby explicitly declared as not constituting sensitive data.

Supervision

In the Netherlands, the Autoriteit Financiële Markten (AFM) is the only regulator that is openly concerned about the privacy risks, especially with regard to the effectiveness of supervision. Rightly so, given that the monitoring of compliance with PSD2 in the Netherlands alone is divided among four different supervisors each with their own objectives. Besides the AFM there is the privacy watchdog Autoriteit Persoonsgegevens, the Dutch Central Bank (DNB; prudential supervision of the financial sector and the licensing of Payment Service Providers) and the Autoriteit Consument & Markt (ACM; the competition watchdog will monitor access to the account).

Important to note that also foreign Payment Institutions can offer these services under the 'Passporting regime', during which they continue to fall primarily under the supervision of their domestic regulator (the competent authority from the home Member State country of origin).

Trusted role banks

Banks are expected to implement controls that block fraudulent parties from accessing your data.

3 How does your bank organise this?

The success of PSD2 depends on other legislation...

PSD2 which will come into effect on 13 January 2018 is often seen as a catalyst to Open Banking. Open Banking can be defined as banks that open up to and share their infrastructure with other parties, usually through an Application Programming Interface (API). APIs are part of a frequently designed and deployed architecture across the digital world. Whether the full potential of Open Banking can be deployed will depend on the interplay of supervisors and in particular the enforcement of privacy laws. New European legislation, the General Data Protection Regulation (GDPR), comes into force on 25 May 2018.

...and the market

To make the Single Euro Payments Area (SEPA) a success, banks formed the European Payments Council (EPC), which established rulebooks (specifications) for credit transfers and direct debits and defined the ISO 20022 standard. For XS2A, the EPC however plays no significant role, partly because the EC wanted XS2A not to be confined to the banking sector. The Euro Retail Payments Board (ERPB), designated by the EC to take a leading role, looks fundamentally divided.

This means that the way banks should grant access to the account is not standardised. Each bank can define its own set of APIs and the data that will be provided is only defined on a high conceptual level. Neither PSD2 nor the RTS force harmonisation. With more than 7,000 banks in Europe (of which approximately 4,400 retail banks) and about 1,000 Payment Institutions (which is expected to grow with hundreds of FinTech companies), the market is highly fragmented at its core. The United Kingdom could have played a leading role when it established the Open Banking Working Group in September 2015, but the first Minimum Viable Products (comprising of APIs) are not in line with the three new PSD2 services, those are scheduled for later this year. In the Netherlands, the Maatschappelijk Overleg Betalingsverkeer (MOB) initiated a working group earlier this year. But the dilemma is that no one is waiting for a Dutch solution. There are several initiatives, but there is currently only one initiative from Germany that seems to get traction in Europe.

Back to the legislature

Even though the EBA final draft RTS has been offered to the EC there is yet no confirmation for the final RTS. Despite the EC having been informally involved they recently announced that they need at least three months before they finish their analysis of the RTS. The European Parliament and the European Council have a right of scrutiny and if one of them objects, the RTS will not come into force. And the probability that this occurs is significant given the critical statements of the Parliament in the past to certain key points in the RTS, in particular the prohibition of 'screen scraping'. The EC may demand changes in the RTS from EBA or ultimately incorporate the changes themselves.

Once published, the market has eighteen months to meet the RTS requirements.

Game changer

The time is now to make choices, not only what kind of player your bank is and wants to be (providing infrastructure, be a niche player, innovator or network player) but also how to proceed. Will you decide to continue performing all processes independently or (partly) outsource could be a logical follow-up question. Waiting to see how it plays out is not an option anymore. Clear choices will have to be made, not just by banks but also by regulators. Whatever the choices will be, one thing is certain this will be a big change and therefore proves to be a real 'game changer'.

About the authors

Bernard Juffermans (info@bernardjuffermans.nl), independent (interim) manager with over 25 years' experience in line, programme and interim management. Executive coach and consultant at strategic level in several companies. Worked in various management positions, including at board level, in re-integration, IT, insurance and finance (banks and processors).

Bert Bouwmeester (Bert.Bouwmeester@sqs.com) is an experienced line and programme manager. His passion is to successfully implement changes in complex and politically sensitive environments, usually within payment in banking environments. He takes full responsibility to ensure sustainable growth of organisation, processes and people and will always strive for simplification and application of a minimum viable solution.

Michal Kalina (info@savnar.nl), since 2003 at home in (inter) national payments as product owner and driver of innovation. Effortlessly switching between details and high level outline, boardroom and customer. Excels in realising lasting results through teamwork. Always accountable. The large increase in laws and regulations, with PSD2 in particular, was for him reason also to specialise in Finance & Law.

Edwin van der Molen (OPS.Netherlands@rgp.com), has worked over the years in various roles within the payment system and has experience in Domestic and SEPA Payments, Cards, Outsourcing and Ecommerce. He also follows the trends in the payment industry, including the development of new payment products like 'Instant Payments' and PSD2, but also the entry of new market players.

About RGP

RGP assists companies with strategic issues and to make the best choices in business models, strategy, opportunities and compliance despite large uncertainties. And above all implement these choices in your organisation. Our subject matter experts have a broad view of the developments in payment and obvious deep knowledge of the matter. We look forward to an acquaintance.