# RESEARCH BRIEF ON THE REVISED PAYMENT SERVICE DIRECTIVE FRAMEWORK

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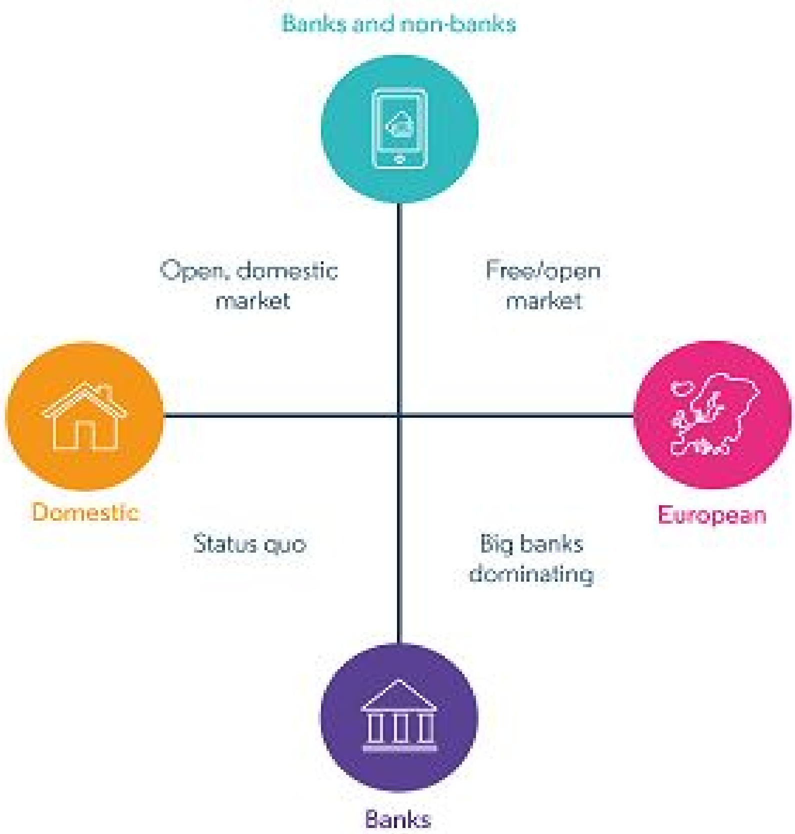
## Introduction

The **Payment Services Directive** (PSD, Directive 2007/64/EC, replaced by PSD 2, Directive (EU) 2015/2366) is an EU Directive, administered by the European Commission (Directorate General Internal Market) to regulate payment services and payment service providers throughout the European Union (EU) and European Economic Area (EEA). The Directive's purpose was to increase pan-European competition and participation in the payments industry also from non-banks, and to provide for a level playing field by harmonizing consumer protection and the rights and obligations for payment providers and users.

In short, PSD2 enables bank customers, both consumers and businesses, to use third-party providers to manage their finances. In the near future, you may be using Facebook or Google to pay your bills, making P2P transfers and analyse your spending, while still having your money safely placed in your current bank account. Banks, however, are obligated to provide these third-party providers access to their customers’ accounts through open APIs (application program interface). This will enable third-parties to build financial services on top of banks’ data and infrastructure.

The entry of PSD2 requires that banks take a number of strategic choices. This is not an easy task, as the choices partly depend on how the payment landscape will evolve after PSD2. We envision four possible scenarios, based on two variables: 1) how domestic or European the financial market will be, and 2) whether the consumers will stick to traditional banks or trust non-banks for making payments.




## Major Objectives :-

The revised Payment Services Directive (PSD2) updates and complements the EU rules put in place by the Payment Services Directive (PSD1, 2007/64/EC). Its main objectives are to:

- Contribute to a more integrated and efficient European payments market

- Improve the level playing field for payment service providers (including new players)
- Make payments safer and more secure
- Protect consumers

## History of the Payment Services Directive System

The first Payment Services Directive (PSD1) was adopted in 2007. This legislation provides the legal foundation for an EU single market for payments, to establish safer and more innovative payment services across the EU. The objective was to make cross-border payments as easy, efficient and secure as 'national' payments within a Member State.

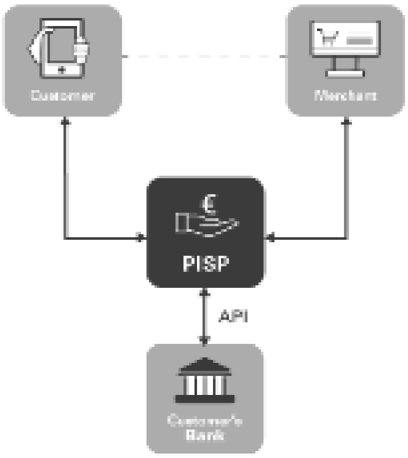
Since 2007, this Directive has brought substantial benefits to the European economy, easing access for new market entrants and payment institutions, and so offering more competition and choice to consumers. It offered economies of scale and helped the Single Euro Payments Area (SEPA) in practice. The first PSD has meant more transparency and information for consumers, for example about execution time and fees; and it has cut execution times, strengthened refund rights, and clarified the liability of consumers and payment institutions. A very tangible benefit is that payments are now easier and quicker throughout the whole EU: payments are usually credited to the payment receiver's account within the next day.

## General Impact on the Payment Landscape

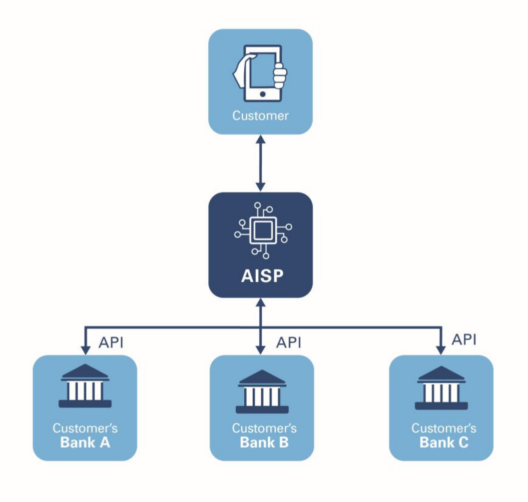
PSD2 has promised to bring some rather radical changes to the payments landscape but since it’s been brought into force at the beginning of this year little real change has occurred to date - on the surface at least. What’s happening in the background, however, has the potential to drastically alter how people choose to pay and be paid within the EU

The payment landscape has changed significantly since the original Payment Service Directive (PSD1) and many new, innovative players have emerged that offer a genuine alternative to the traditional banking and card payment providers. If you make use of the Global Payments Alternative Payment Method offering you may already be familiar with the likes of Sofort, Trustly or iDeal, which are defined in

PSD2 as Payment Initiation Service Providers (PISPs), offering consumers the option to pay using their online banking tool rather than with a credit or debit card.




The issue with these PISPs, and the other new branch of service providers defined in PSD2, the Account Information Service Providers (AISPs), had been the lack of regulation prior to PSD2s enforcement. For example, many of these services rely on a technique defined as screen-scraping. As a result, some organisations, including the European Banking Authority, has objected to this technique due to inherent risks with customers needing to present a third party with login information and passwords. While this is still a contentious debate, one of PSD2s core goals has been to set standards around privacy and security for these new players and impose a consistent regulatory framework. The benefit for businesses is clear; safer, more secure payment options that their customers can trust.




PISPs and AISPs may now have additional requirements to comply with these new EU regulations but there's plenty of positives for them too. PSD2 effectively breaks the banks' monopoly over customer account information and payment services - forcing them to open up their data to the AISPs and PISPs via a dedicated interface (i.e. an API). This offers new entrants a viable, potentially superior alternative to the screen scraping techniques relied upon until now. The lack of a unified API standard for Europe is a potential issue but initiatives such as Open Banking in the UK aim to unify the approach, at least on a national level.

## Timeline of the Directive

- March 2000: Lisbon Agenda to make Europe "the world's most competitive and dynamic knowledge-driven economy" by 2010
- December 2001: regulation EC 2560/2001 on cross-border payments in Euro
- 2002: European Payments Council created by the banking industry, driving the Single Euro Payments Area initiative to harmonize the main non-cash payment instruments across the Euro area (by end 2010)
- 2001–2004: consultation period and preparation of PSD
- December 2005: proposal for PSD by DG Internal Market Commissioner McCreevy
- 25 December 2007: PSD entered into force

- 1 November 2009: deadline for transposition in national legislation
- 2009 update: eliminated differences in charges for cross-border and national payments in euro (EC Regulation 924/2009)
- 2012 update: Regulation on cross-border payments, 'multilateral interchange fees' (EU Regulation 260/2012)
- July 2013: report on implementation of PSD and its two updates
- 16 November 2015: The Council of the European Union passes PSD2, giving member states two years to incorporate the directive into their national laws and regulations.
- 13 January 2018: Directive 2007/64/EC is repealed and replaced by Directive (EU) 2015/2366
- September 2019: all companies within the EU must comply with the national laws and regulations pertaining to directive (EU) 2015/2366 (PSD2)

## Scope for the Directive

The Directive applies to payment services in the European Union. The Directive focuses on electronic payments, which are more cost-efficient than cash and which also stimulate consumption and economic growth.There are a number of payment means (including cash and cheques) not falling within the scope of this Directive.

The updated version of the Payment Services Directive (PSD) — enacted by The European Union (EU) in November 2009 — PSD2, is expected to be implemented by 2018.

PSD2 proposes to change the scope of certain exemptions, and their interpretations, to bring more firms under its purview. This will bring additional categories of payment transactions under its coverage.

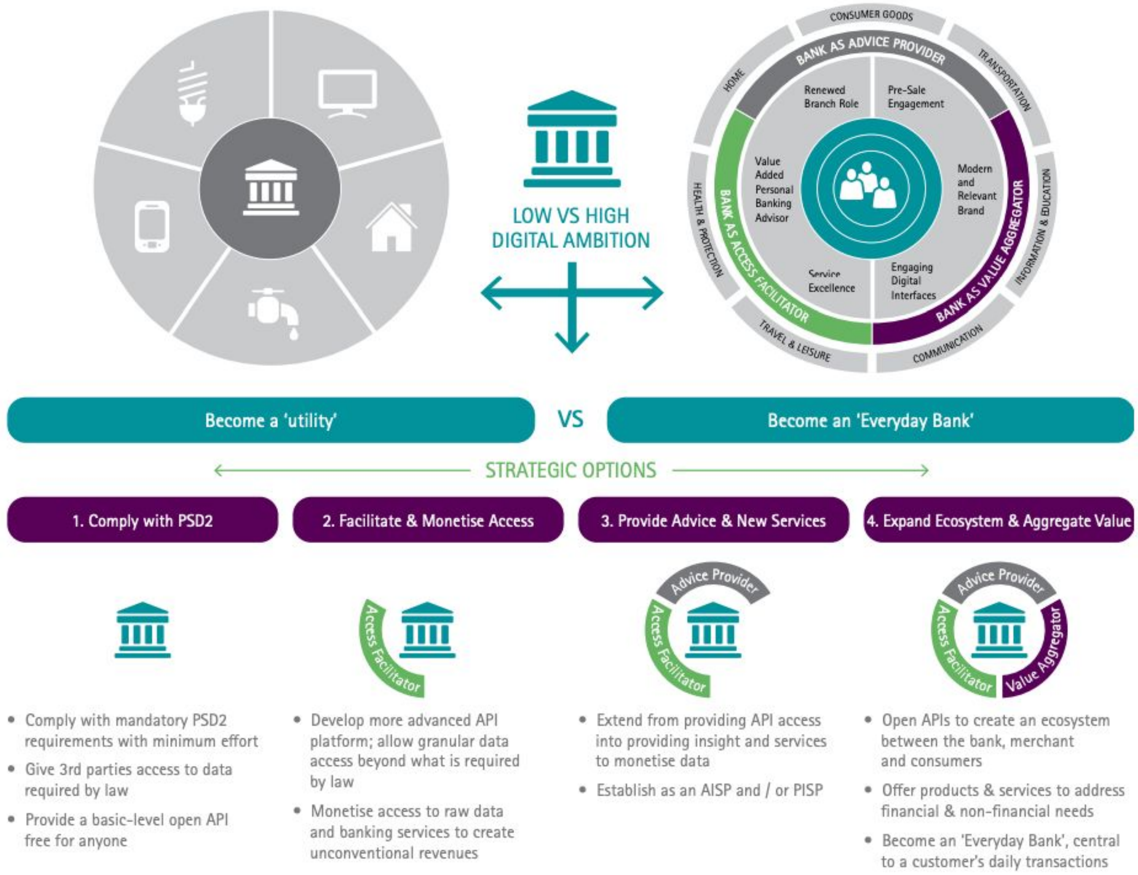
Though PSD2 will affect all stakeholders, including the European Banking Authority (EBA), the EU, central banks, and various other players in the payments landscape in some way, it will have far-reaching implications for banks, third-party payment service providers (PSPs), and customers

## PSD2 for the Banking Sector and Strategic Options

A rapidly changing payments industry is threatening incumbent **banks**' payments revenues and customer ownership. To add to that, the revised Payment Services Directive (**PSD2**) is driving European **banks** to a defining moment.

The imperative for banks is to leverage API integration and their existing customer relationships in order to develop a customer value ecosystem centred around their own banking portals.

Four primary strategic options are available to banks in order to respond effectively to the threats and opportunities of PSD2— while deciding whether to become a banking ‘utility’, or to continue to play a central role at the heart of their customer’s daily lives. These strategic options are laid out in Figure below.




Banks that allow third party providers (TPPs) to access customer information, have to upgrade their infrastructure to respond effectively to such requests. The most efficient way to provide this service is to embrace the API framework.

Rather than adopting the API framework to merely comply with the account information services (AIS) provision of PSD2, banks should opt for full-scale adoption that can enable interaction with external entities such as the central bank; clearing house; and other third party service providers. This will allow banks to focus on developing value added products and services, and thus increase their market share.

Implementation of PSD2 is an opportunity for banks to establish a service bus integration layer to separate backend complexities from API consumers, thus enhancing operational efficiency.

Banks can become third party providers themselves, and access the payment systems of competitor banks to offer new and aggregated services such as enabling a portfolio view of customer accounts. Banks can offer personalized products and services as they will have more information about the customers, and their spending patterns. Banks can emerge as a one-stop-shop, offering a wide range of products and services, which generate additional revenue.

Banks can form consortiums or joint ventures, taking into consideration each entity's respective areas of operation, target customer segments, and offerings. Thus, banks will be able to reap the benefits of economies of scale and achieve operational efficiency.

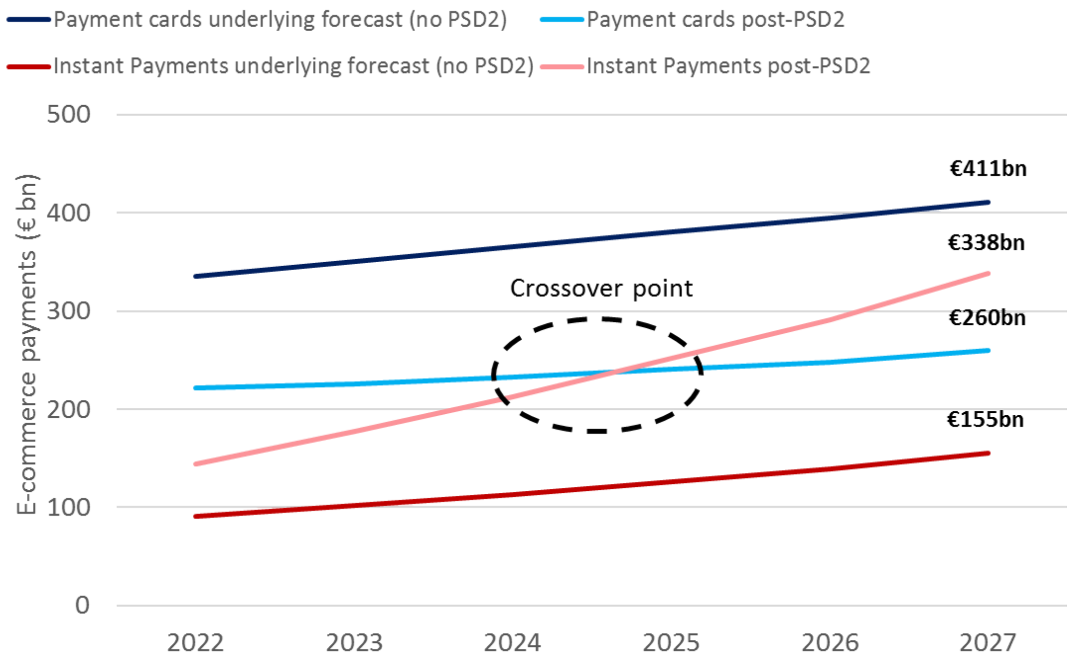
Banks will have to make additional investments to adopt multi-factor authentication, and take measures to educate customers to ensure a seamless shift. Non-compliant players may lose their competitive edge, and consequently, their market share.

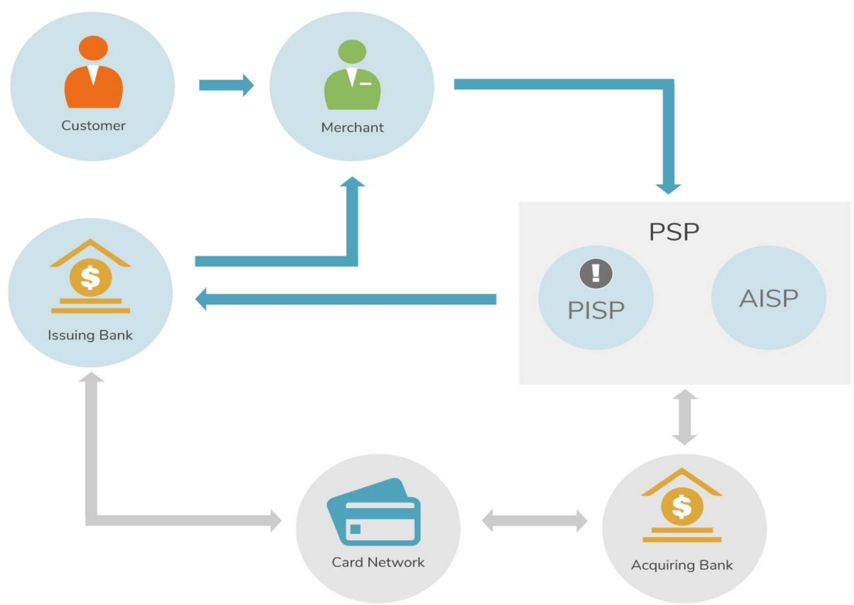
The monitoring of financial institutions by the European Banking Authority (EBA) mandated in PSD2 will ensure smooth dealings and enhanced transparency among banks, and between banks and TPPs. PSD2 has well defined dispute resolution procedures that are uniformly applicable to all stakeholders.

## A Look at Card Systems

PSD2 isn’t just about bank transfers either, the card payments industry is also bound by PSD2 rules around Strong Customer Authentication. This regulatory requirement will be addressed by the card industry via a revamped 3D Secure protocol (such as Verified By Visa, MasterCard SecureCode) that will aim to keep card payments as frictionless as possible while offering a level of security for consumers and businesses alike that's on par with even the best alternative payment methods.

The success of PISPs in these card dominated regions will likely be a slow burn (at best), as consumers become aware of the new options that become available. The real question is whether PISPs can offer a sufficiently superior payment experience to win over card paying consumers and incentivise them to change their payment habits. For businesses, the opportunity to avail of lower processing fees is an obvious incentive to encourage adoption but meeting consumers' demands will always come first. What's more, the recent regulation around interchange charges has driven down the cost of card acceptance in the EU anyway.



## Footprint on Consumers

Understanding consumer payment preferences and meeting their needs should always be the goal. Consumers will tend to have one, potentially two, preferred payment methods and are unlikely to want to change these behavior patterns, so the question of how these new entrants are going to gain traction and break these habits is definitely one worth asking.

For those consumers that are already accustomed to paying online from their bank account, the PISP model will not present any significant change to their current payment experience. What we will likely see is these existing players, and the new entrants that aim to challenge them, begin to push out of the existing regions and into new EU markets to challenge the payment card industry head-on.

For those regions that are card dominated, it will be a significantly larger challenge to break existing consumer habits. The card industry itself is working overtime to focus on streamlining the payment flow and ensuring that payment is as pain free as possible. Solutions such as tokenization and the e-wallets ( such as Apple Pay, Google Pay ) are designed to ensure a quick, easy and secure payment experience via credit or debit card, reducing the likelihood of customers looking for alternative payment experiences.

With the consumer becoming more digital and mobile in their approach to companies, the banks as well as non-banks will need to follow this trend . These tech savvy consumers are asking for financial service offerings that are faster, less formal, more personalized, easy accessible and cheap . So far, non-banks have proven to meet these requirements in a more innovative and human-centric way than many traditional banks.

Consumers are slowly getting used to using non-banks for financial tasks and it seems like this trend is only continuing. Paypal has already existed in close to 15 years and has gained great consumer trust. Swedish Tink and the Danish Billy are companies that have also gained a great market share without a banking license. And every fifth European consumer say they would use by financial products from challengers such as Google, Facebook and Amazon.

## Increased Competition

It is arguable that the competition within the financial sector will be dramatically increased, due to the introduction of PSD2, technological innovations and changing customer demands. We see several reasons to this. One is, that new entrants in form of non-banks will get easier access to the market after PSD2. The regulation removes some entry barriers to the financial market, and hence, more competitors are likely to emerge. Furthermore, customers can easily choose new financial service providers with the introduction to PSD2. This means, that customers will be enabled to create their own collection of smaller service providers instead of choosing one specific bank for all financial needs.

In conclusion, this increased competition along with consumers increasingly turning to non-banks for financial services, we might see an exponential growth in consumer trust in non-banks in the future.

## International Payments

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## Key Changes from the former

The Financial Conduct Authority (FCA) summarises the aims of the directive:

- Contribute to a more integrated and efficient European payments market
- Create a level playing field for payment service providers
- Promote the development and use of innovative online and mobile payments
- Make payments safer and more secure
- Protect consumers
- Encourage lower prices for payments

Below are the main and most important changes taking place with the new legislation, as revealed by the European Payments Council.

**New entrants & competition**

The EU is removing barriers for new entrants to the finance industry and, thus, is welcoming competition between new tech services and the established banks. The objective is that in the near future consumers will be able to view all of their bank accounts, payments' accounts and bills in one place, such as an Application Programming Interface (API), through third-party providers. Of course, the payment account holder will have to give prior consent for this to take place. Furthermore, new players will be able to access the aforementioned accounts (with prior consent) to make payments via credit transfers on behalf of their customers.

This could be revolutionary. Until now, a new entrant had to obtain near-to-impossible licenses, which are mostly held by credit institutions, such as banks. PSD2 is meant to streamline this process for new companies, allow them to compete with each other and with the established institutions.

**Increased security**

Strong Customer Authentication (SCA) will be implemented in order to reduce the risk of fraud. This means that when accessing their data or accounts, users will have to take two or more independent actions in order to enhance protection. These include:

- Knowledge – something only the user knows (password, PIN, etc.)
- Possession – something only the user possesses (card or other material)
- Inherence – something the user is (fingerprint, voice or facial recognition)
- For remote transactions (internet, mobile), a unique authentication code will dynamically link transactions to the respective amount and payee

These elements will have to be applied each time a user makes a payment above a certain amount (unless the beneficiary is already identified). These will apply only the first time a user accesses their payment account, and then every 90 days.

**EU-wide and beyond**

If one of the parties processing a transaction is located outside the EU, the transaction is still under the scope of PSD2. This includes all official currencies (excluding cryptocurrencies) and aims to offer more information for the consumer and more protection for the European part of the transaction.

**Refunds**

The unconditional right of refund for Direct Debit until up to 8 weeks after payment, will become a formal legal requirement. This already applies to the European Payments Council SEPA Direct Debits cheme (EPC SDD).

**Surcharging ban**

Surcharging for card payments will be banned. This applies to card payments that are subject to interchange fee caps under the Interchange Fee Regulation.

**Unauthorised payments**

Consumers will not pay more than €50 (compared to €150 previously) for unauthorised payments, except in situations such as fraud or gross negligence.

## Enabled Opportunities for Financial Institutions

As we've seen from a recent report by PwC, more than two thirds of bankers believe that PSD2 will mean they lose control of their client interface.Many bankers have already said they will be adopting a 'wait-and-see' approach, but that will leave them in the dark ages once the new rules come into force in 2018. Banks who take a proactive approach to PSD2 will be able to steal a march on their competitors though.

Here are three key things for banks to bear in mind when they consider their approach to the new regulation.

**1) Banks have an inbuilt advantage at the moment:**

Banks already have an inbuilt advantage because they have a trusted relationship with their customers.

By creating their own financial oversight and management tools they, along with their customers, will be able to see their finances in one place, thereby enabling banks to offer more suitable products to their customers.

**2) It's not just about technology:**

The buzzword around the financial sector might be 'technology', but it doesn't stop there.

Those creating the strategies within the banks need to change their mindset.

They need to understand that including third party services is not a bad thing, and they must convince their customers that they are acting in their best interests.

**3) Utilise a connections platform**:

By utilising a connections platform to act as a bridge between their core banking system, there only needs to be one set of API's from the system.

This platform will carry significant benefits, including a reduction in the amount of development required, an environment where security can be managed, and an ability to leave the current core systems undisturbed.

Additionally, the platform will quickly and easily integrate third party services, providing opportunities to sell more products to their customers.

Crucially though, the connections platform will also allow the bank to maintain control of the client interface and strengthen the customer relationship.

To add to the pain for banks, a survey of 1000 German consumers, carried out by PwC, found that almost 90 per cent already use third party digital payment services such as PayPal, and that over 80 per cent believe that companies like PayPal can handle transfers as reliably and safely as their banks.

Banks need to face the reality- the PSD2 regulation is coming into force. The only decision they have is whether they want to be the ones left on the sidelines.

## Challenging Consequences Created

- The PSD only applies to payments within the European Economic Area, but not to transactions to or from third countries.
- PSD exemptions related to payment activities leave users unprotected.
- The PSD option for merchants to charge a fee or give a rebate, combined with the option for countries to limit this, has led to "extreme heterogeneity in the market".
- So-called “third party payment service providers” have emerged, which facilitate online shopping by offering low cost payment solutions on the Internet by using the customers' home online banking application with their agreement, and informing merchants that the money is on its way. Other ‘account information services’ offer consolidated information on different accounts of a payments service user. Harmonisation of refund rules regarding direct debits, a reduction of the scope of the “simplified regime” for so-called “small payment institutions” and addressing security, access to information on payment accounts or data privacy with possible licensing and supervision have been proposed.

## Market Implementation

The impacts of PSD2 will be felt across the operating models of European banks. These impacts will vary in scale depending on each individual bank's strategic response to the new opportunities enabled by PSD2. In some cases entirely new platforms, roles and capabilities will emerge within the bank, while in others existing capabilities will gain rising importance and complexity.

**Head of Ecosystem & Partnerships**

In an expanded ecosystem, banks will have to negotiate new relationships and interactions with third party providers to drive mutual benefit for the bank, partner and customer alike. In order to support this new level of complexity, forward-looking banks will need to create an Ecosystem and Partnerships platform. This will provide ongoing and proactive oversight of the relationship between the bank and its network of external partners, covering aspects including partner assessment, contract and commercial management, governance, lifecycle management, performance management, and decommissioning. Effective management of partners drives alignment to a common agreed ecosystem operating model, which enables consistent service delivery and rapid decision-making throughout the ecosystem. It also ensures that the management and governance of partners is fully integrated with the bank's internal operational & compliance structures, processes and technologies, encouraging ongoing collaboration and service improvement.

**Head of API Management/ Open APIs**

As banks open up their APIs and allow TPPs to use their data, products and services, they will need to put in place infrastructure and roles to manage all their APIs in a reliable and secure fashion while negotiating the complexities of existing IT platforms.

**Head of Data Security & Identity**

A bank centred on a Digital Ecosystem will rely heavily upon customer data and insight. This will include the existing data already held within the bank as well as new customer data owned by third parties working in partnership with the bank or connected to it via APIs. As significant quantities of customer data begin to concentrate around the bank ecosystem, the monitoring and protection of this data becomes an increasingly core aspect of a bank's operations and value proposition. Safeguarding this data will require the bank to ensure adequate controls are in place to verify the identity of the customer or TPP seeking access to bank's APIs or customer data.

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