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Financial Risk&Regulation

PSD3 & PSR: New opportunities for consumers and providers

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On 28 June 2023, the European Commission published a proposal for PSD3[1] (Payment Services Directive 3) and the new PSR[2] (Payment Services Regulation), which concluded the review period of PSD2. PSD2 was designed to enhance competition, security, and innovation in the European payments market, but the revision was timely given significant changes in the market and technological environment since the introduction back in 2015. The main objectives of the revision were to address the shortcomings of the previous directive, simplify regulation, fulfillment of "open banking" and the facilitation of digital payments' spread.

Analysis of PSD2 and the review's background

The payment services' market in the past few years has changed significantly. The number of electronic payments in the EU is increasing steadily, a trend that has been accelerated by the covid crisis. New services (account information services, payment initiation services) and numerous new open banking providers have entered the payment services market and more sophisticated types of fraud are emerging. In response to these developments and to adapt to the digital transformation, the EU Commission has published proposals. The aim of the forthcoming legislative package is to consider over the regulation of electronic payment services and the banking ecosystem in the EU Single Market, to meet the expectations (set out below) that were not met by PSD2. This will include the PSR, which will cover all activities of payment service providers.

In 2007 the PSD1[3] was adopted and established a harmonized legal framework for the creation of an integrated EU payments' market. Establishing on PSD1, PSD2 has abolished barriers to new types of payment services and improved consumer protection and security for payments.

PSD2 contains rules for the provision of payment services and the authorization and supervision of payment institutions which are a category of payment service providers. Other categories of payment service providers include credit institutions, which are subject to EU banking regulation, and electronic money institutions, which are subject to the EMD (Electronic Money Directive).[4]

Subsequently to the Commission's announcement about its Retail Payments Strategy[5] that it will undertake a comprehensive review of the application and impact of the PSD2 at the end of 2021 in the light of the above-mentioned changes in the market environment, the review concluded that the Directive has not fully met the objectives of the legislator.

1 Third Payment Service Directive - Proposal for a Directive of the European Parliament and of the Council on payment services and electronic money services in the Internal Market amending Directive 98/26/EC and repealing Directives 2015/2366/EU and 2009/110/EC
2 Payment Service Regulation - Proposal for a Regulation of the European Parliament and of the Council on payment services in the internal market and amending Regulation (EU) No 1093/2010
3 Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007
4 Directive 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions
5 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on an EU Retail Payments Strategy

Among the positive impacts of the study is the prevention of fraud through the introduction of strong customer authentication (SCA). Although more challenging to implement than expected, SCA has already had a significant impact in mitigating fraud (the study report shows that fraud cases are 70-80% lower for card payments than for payments without SCA). PSD2 has also been particularly successful in its objective to increase efficiency, transparency, and choice of payment methods for users of payment services.

It was stated that there are limits to the effectiveness of PSD2 in achieving a level playing field, which was mainly due to the imbalance between bank and non-bank payment service providers, results from the latter's lack of access to certain key payment systems. Open banking, the proliferation of services where new non-bank providers enter the payment system with new services while having access (with consent) to customers' banking data, for instance Barion, Billingo, has been a mixed success because problems with providers' access to data can be identified As regards the internal market objective, while the cross-border provision of payment services is increasing, many payment systems - in particular the debit card system - remain national. The cost reductions expected from merchants because of new and cheaper payment methods have not been fully realized.

Objectives of the proposals

PSD3 has four main objectives reflecting the imperfections of the previous regulation:

1. **Strengthening security and consumer protection:** Improving the usage of the SCA, defining the legal basis for fraud information exchange between institutions and the obligation to inform customers about fraud, extending IBAN checking to all transfers and conditionally withdrawing liability for authorized push payment fraud (fraud committed on behalf of the given institution); requiring payment service providers to improve access to the SCA for users with disabilities, elderly and other persons who face challenges in using the SCA; measures to improve the availability of cash; improving user rights and information.
2. **Prompting innovation and competition** by opening the market to new players, for instance payment initiation and account information providers, which offers alternative solutions to traditional payment methods.
3. **Facilitating regulatory harmonization** across the EU by creating a common legal framework for all payment services, whether domestic or cross-border, by replacing the relevant provisions of PSD2 at the directly effective EU regulation level and removing regulatory and technological obstacles to the Digital Single Market. Unifies rules for electronic money institutions and other payment service providers. It also strengthens the provisions on sanctions.
4. **Strengthening the ecological transition** by encouraging the use of more sustainable payment methods such as instant payments, mobile payments, or digital currencies.

Impact of the new regulation

Considering that the regulation is at the proposal stage, the final wording or technical parameters can be easily changed during the (political) legislative process, but the main areas covered by the amendment and the intended effects of the objectives have been captured at the expert stage. These are the following:

- **Market opportunities for new providers:** The PSD3 seeks to create parity between old and new financial service providers by imposing stricter requirements on non-bank providers to deny access to payment accounts held with banks. Under PSD3, access could be only denied on reasonable grounds (for example suspicion of illegal activity).
- **Improved applicability:** There is a clear expectation of uniformity of application by transposing certain provisions of PSD2 into the new PSR, which will be directly applicable as a regulation in EU Member States, focusing on all payment services' rules. The common regulatory structure for electronic money institutions and payment service providers (at the same time it got unified) will be regulated in PSD3, at the EU directive level which needs to be implemented. Thanks to stricter liability rules and stronger fight against fraud the trust in services has increased.
- **Open banking could make a huge improvement:** Open banking creates new opportunity that enables third parties to initiate payments or provide any other money market service alongside the bank and the customer. This was first introduced in a regulated framework by PSD2, which required banks to create application programming interfaces (APIs) that allow third-party service providers to securely access data approved by customers. The new regulation - as described above -, extends access to payment accounts and, to

enhance transparency, requires banks to create a user interface where customers can track which third parties have access to their data and unilaterally withdraw their consent to such access. The extension of the scope of accounts is necessary in view of the evolution of the market for payment services, which is leading to new services in a regulated framework.

- **Cash withdrawal facilities are extending:** A new feature of PSD3 is that the proposal extends the range of retail cash withdrawal facilities to retail outlets. The new PSD3 proposal introduces the possibility for retailers to withdraw cash up to the amount that can be limited by the physical retail outlet - currently €50 per payment – with additional costs. This limitation is necessary to ensure fair competition between retailers and bank ATMs and to avoid retailers running out of cash. The operation of ATMs is subject to a license, but for retailers this service will be exempted from the licensing procedure for payment institutions under the regulation and will only be subject to registration.

Next steps

The regulatory process has started in May 2022, following two rounds of feedback from market participants and external experts, the feedback was received by the Committee. An extended feedback period - originally planned for 8 weeks - was currently underway and is scheduled to last until 17 October 2023. The Committee will then prepare the final proposals for the European Parliament and Council. The planned date of entry into force is not known, however based on the normal EU legislative process, we expect the final directive and regulation to be in place by the end of 2024, and the application could therefore be delayed until 2026.

The MNB (Hungarian National Bank) will continue to publish its response to questions received from payment market participants in the context of PSD2 and is expected to publish its views on the practical implementation issues for PDS3 and PSR.

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Before the validation, domestic financial institutions will have sufficient time to assess their level of preparedness - by examining IT security and controls, analyzing relevant EU legal sources (for instance DORA, MiCA, SFD), developing a framework for possible cooperation with non-bank service providers, developing the data management user interface and assessing their product development options in the context of changes that will increase competition.

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