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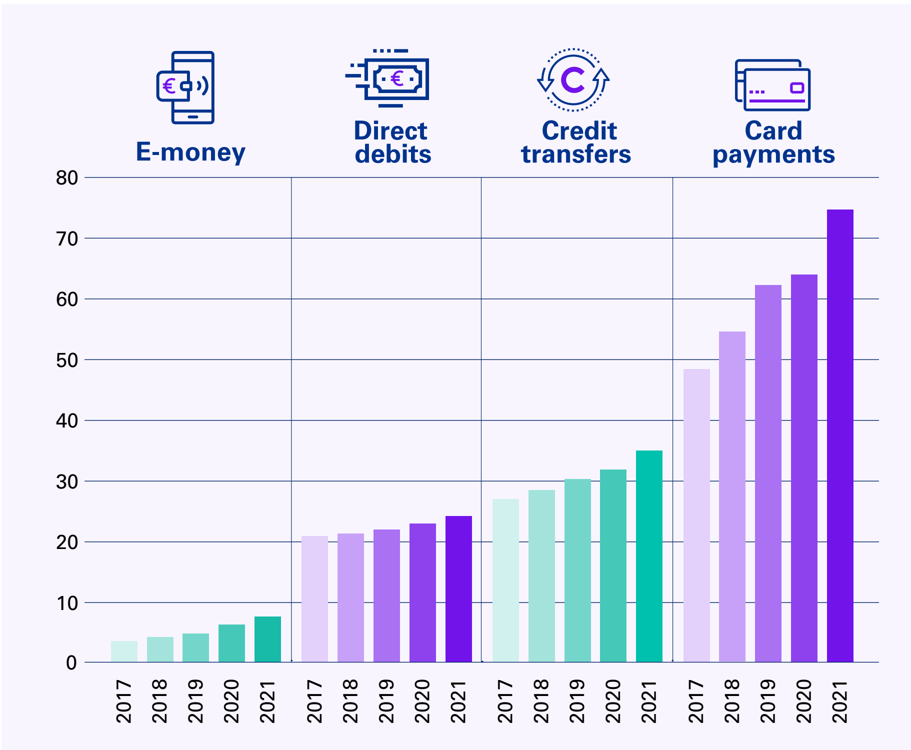
PSD3 / PSR and SEPA Instant legislation

Why the incoming PSD3 / PSR and SEPA Instant legislation levels the playing field for Irish and European Payments and levels up Open Banking and Consumer Protection

Executive Summary

The European payments landscape has changed considerably since the introduction of PSD2 and Open Banking in 2015. Demand for cashless payments have increased greatly over the past number of years, further accelerated by the Covid 19 pandemic, while the launch of new payments rails such as SEPA Instant Payments in 2017 have shifted the European payments landscape considerably.

In parallel, there has been significant technological advancements with institutions delivering more sophisticated customer journeys and full-featured digital wallets, while providing their customers with more choice around payments to reflect the ubiquity and popularity of contactless payments.



No. of cashless payments in the EU 2017 – 2021 (in billions)
European Commission June 2023

The growth has created lots of opportunities for new players but obstacles still remain for Payment Service Providers (PSPs). The introduction of Open Banking has allowed consumers to access their financial data efficiently and securely, but service providers, such as Account Information Service Providers (AISPs) and Payment Initiation Service Providers (PISPs), still have trouble accessing data. For example, interfaces designed to facilitate their data access can vary in quality and performance and in most jurisdictions, it is difficult to get sight of API performance metrics such as response times and availability to highlight this.

To address some of the challenges in the payments market and to keep pace with the requirements of consumers and businesses, a new legislative framework has been proposed by the European Commission; Payment Services Directive 3 (PSD3) and the new Payment Services Regulation (PSR)[1]. The proposed new requirements aim to strengthen customer protection and define parameters within which Open Banking should operate, therefore enhancing opportunities in this space. It also helps to level the playing field for all participants across the payments industry, allowing for the first time non-banks to participate directly in the SEPA payment schemes. Up until this point, Fintechs have had to participate in the schemes through Correspondent Banking relationships.

In addition to PSD3 / PSR, new SEPA Instant Payments legislation has been provisionally agreed and is expected to enter force in Q1 2024. This will most notably make participation in the Instant scheme mandatory for all PSPs who currently offer SEPA Credit Transfer to their customers. This is a welcome move which reflects the relative lack of uptake for this scheme thus far (today across Europe, just 61% of participants are live on the SEPA Instant scheme and this varies greatly across the SEPA zone) and supports the vision that instant payments in euro will be affordable, secure, readily available and processed without hindrance across the EU.

These legislative changes will fundamentally alter the European Payments landscape for the better, strengthening consumer protection (most notably through enhanced payment fraud and security provisions), enriching open banking, enforcement, and unification. In Ireland, we have seen the Central Bank's supervisory approach to payments and e-money institutions intensify over the past 24 months with the publication of two industry Dear CEO letters and the focus will continue to grow through the shift to instant payments, growth in open banking and broader regulatory landscape.

In addition to the emergence of PSD3 / PSR and SEPA Instant legislation imminent, we are seeing progress being made with the Digital Euro, with it having progressed to the next phase in its development earlier this month. While there is still a long road ahead, it does suggest there is more certainty around it being a case of when, not if, for the European CBDC (Central Bank Digital Currency). The shifts across the European Payments landscape will continue to evolve, bringing more choice, security and standardisation across the industry.

In this article, we provide an overview of some of the key regulatory changes including the impacts of PSD3 / PSR such as the increase of open banking competitiveness and the re-authorisation process for firms, as well as the evolution of instant payments. These are areas which Fintechs should not only be aware of but should be preparing for in the short, medium and long term.

1 The exact timelines for entry into force are not yet known. Based on the usual legislative process, the final versions may become available by the end of 2024. Since Member States are usually granted a 18-month transition period, the Directive and Regulation will likely start to apply somewhere in 2026.

PSD3 / PSR

Macro drivers of change since PSD2

The highly anticipated proposals for PSD3 and PSR were published by the European Commission on 28 June 2023. To understand the impact PSD3 / PSR will have on European Payments and Open Banking, it is perhaps useful to reflect on what has brought us to this point.

The second Payment Services Directive (PSD2), introduced in 2015, brought in a new range of measures, including the strengthening of consumer protection through secure customer authentication (SCA). It also represented the launch of Open Banking in Europe with the creation of AISPs and PISPs to facilitate interaction between the bank and the customer. To deliver the promise of Open Banking, banks across the industry delivered APIs (Application Programming Interface) that were accessible to 3rd party AISPs and PISPs. Effectively, the banks used 3rd parties – with the permission of the end customer – to collect information on their accounts and trigger payments via 3rd party apps and websites in a seamless way and without the need for them to be redirected to their own banking app for authorisation.

During a European Commission evaluation[2] of the PSD2 implementation, the European Commission found that while PSD2 positively impacted fraud prevention through SCA (70-80% lower for remote card payments[3]) and brought increased efficiency, transparency and choice of payment instruments, some improvements were still required. They found that AISPs and PISPs experienced issues accessing data as the APIs varied in quality and performance. In some member states, including Ireland, there is no publicly available data showing API volumes, efficiency, uptime etc, as distinct from other jurisdictions which do publish regularly[4].

2 https://ec.europa.eu/commission/presscorner/detail/en/qanda_23_3544
3 https://kpmg.com/nl/en/home/insights/2023/06/psd3---psr-.html
4 E.g. UK, API performance stats – Open Banking

An evolution, not a revolution

The findings from the European research formed the basis of the EU proposals for PSD3 / PSR. The proposals aim to achieve four key objectives and introduce a number of revisions and improvements to PSD2[5]:

01 Strengthening user protection and confidence in payments

Proposed fraud and liability improvements:

- Extended IBAN/name matching verification to all credit transfers and particularly, for instant payments conducted in euros
- Strengthening of transaction monitoring, most notably the introduction of a legal basis for sharing fraud-related information between PSPs.
- Obligation to provide education to increase awareness of payments fraud among customers and staff
- Extension of refund rights: in case of failure of IBAN/name verification or for victims of 'spoofing' fraud (where fraudster contacts consumer pretending to be an employee of the consumer's bank), victims can be entitled to claim damages from their PSP.
- Improvements to strong customer authentication. For example, requiring PSPs to ensure that SCA methods do not depend on one single technology, device or mechanism, such as the possession of a smartphone. Also, banks holding payment accounts will only need to apply SCA for the first access to payment account data by open banking AISPs unless there are reasonable grounds to suspect fraud. AISPs will then be responsible for SCA for subsequent data accesses.

Proposed consumer rights and information improvements:

- Obligation to inform payment service users on estimated charges for currency conversion for credit transfers and money remittances from the EU to third countries.
- PSPs must provide information on payment account statements to unambiguously identify the payee.
- The EC also aims to clarify the interaction between payments and GDPR. For example, by clarifying that PSPs may process special categories of personal data which are needed to provide payment services.

02 Improving the competitiveness of open banking services

- New requirements for dedicated data access interfaces with prohibited obstacles. Examples of these obstacles currently listed, are requiring additional checks of the permission given by the payment service users to a PISP or AISP, or restricting payments initiation via a PISP only to those payees that are on the payer's beneficiaries list.
- No permanent "fall-back" interface for banks required anymore.
- Banks and PSPs are required to set up a dashboard for consumers of open banking to provide insight in data access rights they have granted and to whom, with a withdrawal functionality.
- To ensure the continuity of open banking, PSPs can request the national authority to be allowed to use an effective alternative interface, such as using the interface banks use for their customers, if the dedicated interface is down and the bank cannot rapidly offer effective alternative solutions.

03 Improving the enforcement and implementation in Member States

- Shifting elements from PSD2 into the new PSR. As opposed to Directives (such as PSD2), Regulations (such as PSR) apply directly and consistently across the EU.
- Integration of the Electronic Money Directive (EMD) with PSD3 and PSR. The EMD will cease to exist. E-money institutions will disappear. Payment Institutions can be authorised to offer e-money services.
- Enhancing enforcement of the rules, including a list of breaches (infringements) and administrative sanctions and measures. For these breaches, such as on the rules on access to accounts maintained by banks, secure data rules by ASPSPs, AISPs, PISPs and fraud prevention mechanisms, the nature of sanctions and measures will therefore be known upfront.

04 Improving (direct or indirect) access to payment systems and bank accounts for non-bank PSPs

- Toughened requirements for banks to provide bank account services to non-bank PSPs are proposed. For example, banks need to explain and justify access refusal based on the specific situation including serious grounds to suspect illegal activities by or via the PSP.
- PSPs may be offered an additional possibility to safeguard users' funds, namely to hold those funds at a central bank.
- Possibility of direct participation to payment systems for non-bank PSPs.

5 KPMG Netherlands, PSD3 & PSR: New EU proposals game-changing for payments?

While these proposals have been put forward as evolutionary rather than revolutionary to reflect the ever-evolving payments landscape, they do represent a welcome move to strengthen Open Banking and level the playing field for participating Fintechs across the European payments landscape.

The proposals will be reviewed by the European Parliament, Council and Commission. The exact timelines for entry into force are not yet known. Based on the usual legislative process, the final versions may become available by the end of 2024. Since Member States are usually granted a 18-month transition period, the Directive and Regulation will likely start to apply somewhere in 2026.

While the proposals for PSD3 / PSR will undoubtedly evolve, firms should not delay in considering the likely impacts the regulatory requirements will have on their business models. In consideration of the upcoming changes, PSPs should start to prepare by undertaking a gap analysis against the PSD3 / PSR requirements to identify a remediation plan and undertake implementation of the necessary requirements to meet the legislation.

How KPMG can help?

We have a deep understanding of the complex operational and regulatory landscape you operate in and the challenges that all Irish payments institutions face. We have worked with numerous firms to assist them in meeting the Central Bank's regulatory standards and implementing the requirements of a regulated entity. We can help you with identifying the changes required to your business as a result of PSD3 / PSR by:

- Supporting you with preparation of a gap analysis against the relevant regulatory requirements;
- Identifying the impacts of regulatory change on your business and strategy to determine the necessary changes in process, capability, technology etc.;
- Helping you to identify the areas of deficiency where you need to enhance your regime in order to meet PSD3 / PSR; and,
- Supporting you with the implementation of changes to ensure timely compliance.

Re-Authorisation under PSD3 / PSR

Merging the E-money and Payment firm regimes

One of the objectives of PSD3 / PSR is to simplify the regulatory structure governing payments across Europe. Reflecting this objective, a key proposed change in PSD3 is the merger of the licencing and authorisation frameworks applicable to Payment and E-money Institutions to increase harmonisation of the regulation and supervision process across Europe with the removal of the Electronic Money Directive[6].

With the consolidation of their legislative basis, E-money firms will become a subset of Payment Institutions and existing Payments Institutions and E-money firms will have to reapply for authorisation under PSD3.

What that re-authorisation will look like, depends on a number of factors, including:

- Where competent authorities have evidence that a currently authorised Firm meets the requirements of PSD3 they can automatically authorise these firms as PSPs.
- Firms will need to seek re-authorisation from national authorities within 24 months of the new rules coming into force, with existing licences grandfathered for 30 months after PSD3 enters into force.
- Where a Firm does not meet the authorisation requirements of PSD3, the competent authorities will decide what measures are necessary to ensure such compliance.
- If a Firm ultimately does not meet the requirements of PSD3 it will no longer be authorised as an E-money firm or Payment Institution once the grandfathering period ends.

In general, while the requirements for authorisation of PSPs should not change significantly and many firms will meet the majority of the requirements already, some of the key changes to promote consistency in authorisation are outlined below.

- **Winding-up plan:** A "winding-up" plan will be required for all firms under PSD3.
- **Notification procedures for limited network activities or exclusion based on payment volumes:** Self-assessments will no longer be effective and firms will be obliged to notify their competent authority when seeking to benefit from the limited network or exclusion based on payment volume thresholds. This notification process will allow authorities to assess whether the relevant requirements are fulfilled.
- **Professional indemnity insurance:** Due to the difficulties in obtaining professional indemnity insurance, PISPs and AISPs will be able to hold initial capital of €50,000 instead of obtaining professional indemnity insurance. This will apply at the licensing or registration stage only.
- **Initial capital requirements adjusted for inflation:** Initial capital requirements have been increased to reflect the impact of inflation since the adoption of PSD2. Initial capital requirements for PISPs will not increase given the relatively short time they have been in operation.

How KPMG can help?

Payment and E-money Institutions will need to prepare for re-application for authorisation. We have "hands on" experience of the Central Bank's authorisation process and supervisory approach across all sectors, including the payments and e-money sector.

We can help you with the preparatory phase for authorisation under PSD3 / PSR including:

Supporting you with the preparation of re-authorisation material;

- ✓ Partnering with you in shaping and crafting the narrative for any discussions with the CBI with regards your authorisation/re-authorisation;
- ✓ Helping you to remediate any areas of deficiency where you need to enhance your regime in order to meet PSD3 / PSR; and,
- ✓ Supporting you with the implementation of changes to ensure timely compliance.

6 While legal frameworks are similar for both E-money firms and Payment Institutions the licencing requirements and the available products are quite distinct as they are rooted in two separate pieces of legislation; PSD2 and E-money Directive

SEPA Instant

Instant payments; the new normal?

In parallel to the PSD3 / PSR draft legislation, work to finalise the SEPA Instant Payments mandate has almost been reached, allowing up to €100k to be transferred within 10 seconds, anywhere in the SEPA zone 24 hours a day, 7 days a week and every calendar day of the year.

The legislative intervention was brought about as the current non-mandatory SEPA instant payments scheme, which was launched in 2017, has not seen the impacts and uptake initially envisaged. Today, 61%[7] of PSPs operating in the SEPA Credit Transfer scheme (SCT) in Europe also operate in Instant. That number is significantly less in Ireland, with only 11 of 195 SCT participants operating in the SEPA Instant scheme[8].

Spotlight: country analysis

Participation in SCT and Inst today	EU	Ireland	UK	Germany	France	Italy	Spain
SCT	3,684	195	107	1,274	259	387	119
Inst	2,274	11	34	1,127	136	294	93
Coverage	61%	6%	32%	88%	52%	76%	78%

Research conducted by the European Commission indicates lack of uptake was largely down to four reasons:

01

Reluctance to invest:

As the PSP of both the sender and receiver must use instant payments technology for the instant transaction to be successful, many PSPs are reluctant to invest in instant payments without having the guarantee that other providers will be able to support these transactions. As a result, one third of EU PSPs do not offer instant payments today.

02

High cost to the consumer:

In many member states, consumers and businesses are put off by the high price of instant payments.

03

Perceived concerns about the risk of fraud and errors:

Consumers and businesses do not have sufficient assurances to address their concerns with instant payments.

04

High failure rates:

A high number (9.4%) of cross border instant payments fail due to slow, inefficient sanctions screening methods used by the industry which are not fit for instant payments[9].

As such, the new SEPA Instant Payments mandate, which is intended to co-exist alongside the mandatory SEPA Credit Transfer scheme, needs to be seen as affordable, secure and the 'new normal'.

7 As at 15 October 2023
8 https://www.europeanpaymentscouncil.eu/sepa-payment-schemes
9 https://ec.europa.eu/commission/presscorner/api/files/attachment/873809/2022-10-instant-payments_en-.pdf.pdf

01

Mandatory participation:

All PSPs currently offering SEPA credit transfers must offer instant payments to all customers

02

Restrictions on cost to the consumer:

Charges for instant payments must be equal to or lower than charges for non-instant euro credit transfers

03

Verification Process:

All providers must offer a service to check the match between IBAN and beneficiary name, warning about any detected discrepancy as it could suggest fraud

04

Harmonisation of sanctions screening processes:

All PSPs must follow a harmonised procedure for sanctions screening based on daily checks of their own clients against EU sanctions lists.

The legislation has been provisionally agreed by Parliament and Council and is expected to be published in the EU Journal in Q1 2024. Once published, the legislation will enter into force 20 days later.

A staggered timeline is proposed where institutions must offer the ability to receive instant payments within ninemonths and send instant payments within 18 months of the legislation entering into force. In an effort to minimise Authorised Push Payments (APP) fraud, an additional requirement of the legislation requires institutions to offer a name and IBAN matching service – similar to the Confirmation of Payee seen in the UK – prompting senders with a warning where the recipient name does not match the IBAN. In line with receiving instant payments timeline, this must also be implemented within 18 months.

The real value of Instant Payments

The movement from a bulk processing environment Mon – Fri (as is the case with SCT), to having all channels, across all accounts, operating in real time (less than 10 seconds) 24 x 7 x 365 means significant change.

For consumers, online and mobile banking payments have jumped 60% in Ireland in the last 5 years[10]. Consumers are tapping for 85% of their in-store transactions, showing the customer preference for digital and quick, frictionless payments – which Instant Payments will support. Instant Payments are a major technological innovation in payments. They allow releasing funds that are locked in the financial system (currently €200bn in Europe at any given time)[11], making them immediately available to end users – consumers and businesses in the EU – for consumption and investment.

For businesses, instant payments mean better real-time visibility of cash and an improved cash flow. For e-commerce retailers particularly, it means less risk, since they can fulfil orders immediately (for comparison, online card payments take up to three days to settle).

Benefits of Instant Payments

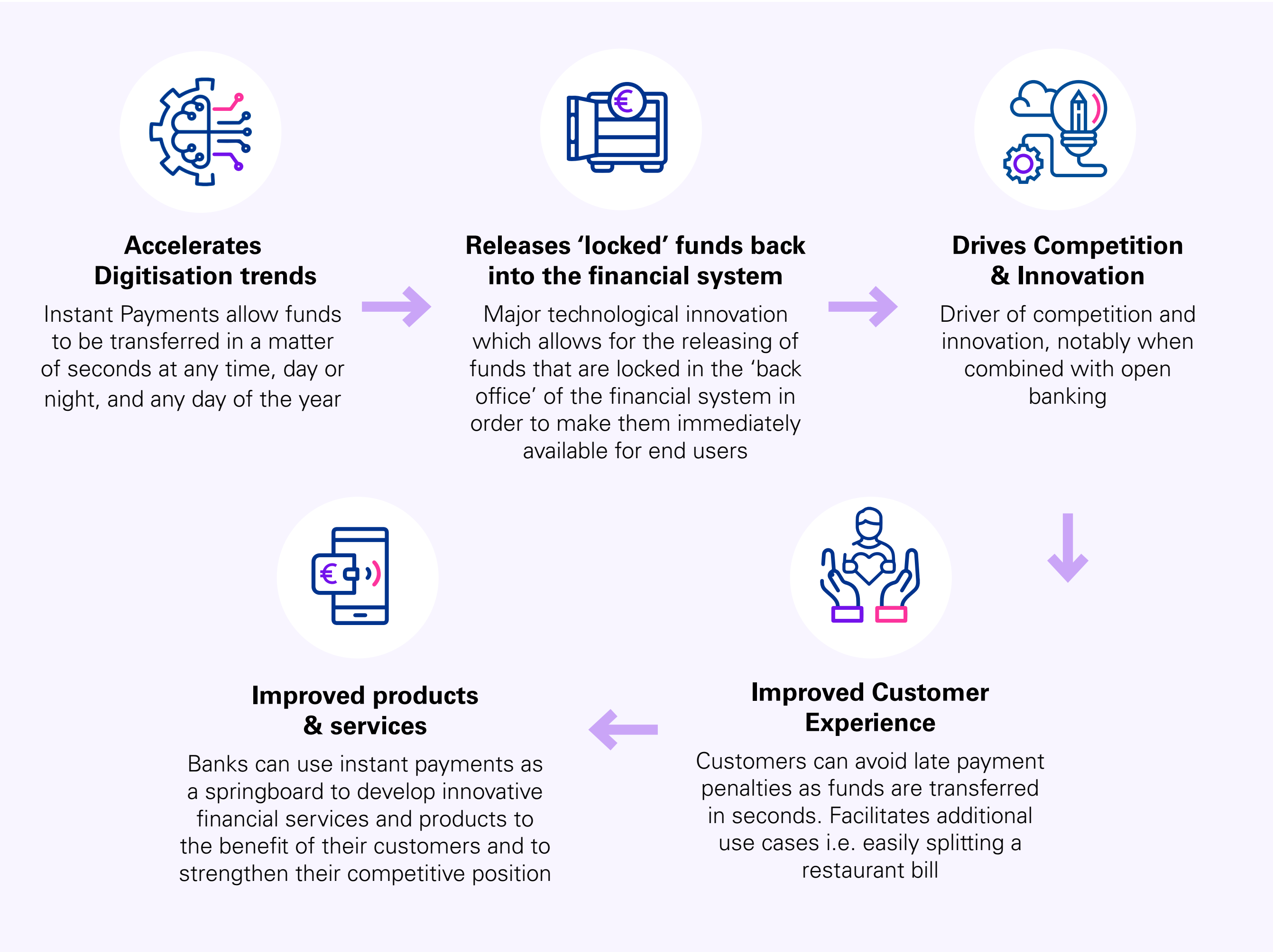


Figure 2 - Benefits of Instant Payments

The mandating of Instant Payments will fundamentally alter the European Payments landscape, for the betterment of the customers, both business and consumers. Financial institutions who embrace these opportunities to get ahead of the game and plan for the future and will be the long-term winners.

10 BPFI Payments Monitor Q27
11 https://ec.europa.eu/commission/presscorner/api/files/attachment/873809/2022-10-instant-payments_en-.pdf.pdf

How KPMG can help

While we now know that the SEPA Instant Payments timelines have been extended to nine and 18 months, given the operational and technical complexities associated with the move to instant payments these timelines remain challenging for institutions, and it is important to find the right partner.

Through our extensive Europe wide network, experts sitting within KPMG's European Payments centre of excellence have been assisting clients with their instant payments needs for years. KPMG have developed a proven framework, delivering successful instant payments onboarding projects for our customers.

Our Approach

1 Strategy

- Current state diagnostics & development of overall Payments and Product Strategies
- Revenue, cost & competition analysis
- Assist with new product development
- Help to align and implement ISO Strategy
- Review of existing sanction screening approach, systems and methodologies

2 Design

- Design programme & governance structures
- Produce implementation & migration plans based on use cases
- Design the payments system architecture
- Standards, rules, and process catalogue definition
- Create logical data model
- Establish an appropriate and robust risk-based approach for sanctions screening

3 Execution

- Leadership, governance and end to end delivery support
- Platform build & development support
- Quality assurance and testing services
- Engineering services
- Business and change readiness support
- Implement a risk-based approach for sanctions screening

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