PSD2 Strategy

Comply, Compete or Innovate?

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Will PSD2 determine the future of payments and banking? Account Servicing Payment Service Providers (AS-PSPs, hereafter 'banks') in Europe are being forced to open their doors to licensed or registered third-party providers (TPPs). With the Payment Services Directive 2 (PSD2) being implemented across Europe, payment initiation services and payment account data are no longer confined solely to traditional parties. TPPs can act as Account Information Service Providers (AISP) and Payment Initiation Service Providers (PISP), see Figure 1. Based on customer consent, banks have to give these parties access to their payment account information, including transaction information, and give them the ability to initiate payments on behalf of the account holder. PSD2 presents a large range of new opportunities for parties playing the role of a TPP. Fintechs, Big Techs, and traditional banks can create new business models, based on new services and products. There is however still a lot of confusion surrounding the finalisation by the European Banking Authority (EBA) of PSD2’s regulatory technical standards (RTS).

### The Dutch market view on PSD2

Potential Third Parties
- Fintech
- Social Networks
- Telcos
- Challenger Banks
- Online Retailers
- Aggregators/Comparators
- Traditional Banks
- Utilities
- Network Disruptors
- Tech Companies
- Traditional Retailers

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1 PSD2 has a wider scope than solely third-party access to payment account data; this publication will primarily focus on the third-party access aspect.
Numerous publications have covered and explained the key elements of PSD2, its potential and its struggles. As the effective date (13 January 2018) is approaching, we have gone beyond explaining PSD2 and conducted market-wide research by means of interviews and a survey. Respondents ranges from traditional banks to retailers, telcos, PSPs and Fintechs. This paper provides insights into initiatives taken by the market in anticipation of PSD2 and the perception regarding innovative initiatives, state of compliance, and expectations about the changing ecosystem. Are you ready to comply, compete, and innovate (Figure 2)?

**FIGURE 2 PSD2 implementation strategies**

**Innovate**

“Our organisation has a strategy to extract a competitive advantage from this change. Open Banking is an opportunity to assess and re-align our operating model and technology capabilities to this new strategy, ensuring we are able to respond as an agile and innovative organisation to not just defend ground, but to attract new customers and partners.”

**Compete**

“We have defined an Executive-sponsored strategy to defend ground against new challengers and heritage institutions seeking to disintermediate us from our customers. We have identified elements of our operational functions that may need to change but have not assessed our organisational design and interdependencies in their entirety.”

**Comply**

“As an organisation we view PSD2 and Open Banking as a regulatory requirement and have defined a regulatory action plan. Although we recognise the disruptive elements, at this stage we do not have any ambitions to leverage this industry-wide change at a competitive level.”
Innovate

“
Our organisation has a strategy to extract a competitive advantage from this change.
”
Beyond PSD2

Although PSD2 is one of the forces that will drive change in the financial ecosystem, our research shows that it is one of the means rather than an end in itself. To truly benefit from this changing ecosystem, market players can choose to adopt an innovative strategy, that impacts business and operating models and goes beyond being compliant and developing new products and services. It focuses on gaining competitive advantage from the changing ecosystem and enables organisations to respond in an agile and innovative way to new developments and changing customer demands.

Towards Open Banking

Our research shows that the vast majority of the market believes that PSD2 will accelerate a shift to open banking, see Figure 3. More than half of our respondents are planning to open services that go beyond the scope of PSD2 or are (digitally) transforming their business, potentially using PSD2 as a trigger, see Figure 4.

The invisible bank

PSD2 allows the creation of new innovative models that exploit the penetration of technology in our day-to-day lives. We believe that a gradual shift towards invisible banking is imminent. Platforms are emerging that connect suppliers of data and financial services with the customer. This “Invisible Bank” will play a supplier role. It will be buried within a broader digital customer experience that will be delivered through the platform. Consumers will interact with a personal digital assistant, taking advantage of new technologies such as advanced data analytics, cognitive robotics, voice authentication, application programming interfaces (API) and the Internet of Things. The key question is which party or parties will own the platform, orchestrate the platform and manage the customer interaction.

This question is not easy to answer. Customers demand safe, easy to use and fairly-priced services that bring perceived value. It goes without saying that customers will need to trust the party delivering the service. Will this be established banks, or will it be other parties that win the trust of their customers?

2 We define Open Banking as the delivery of banking data and services to or via third parties.

FIGURE 3 PSD2 and Open Banking

Does the introduction of PSD2 stimulate or accelerate a shift to Open Banking (covering financial services beyond the payments account)?

80% 13? 7%

FIGURE 4 Scope of services

What is the scope of services you plan to open towards third parties (via APIs or other technologies)

55%

Services beyond PSD2, related to 'Open Banking': banking services scope, e.g. including other payment services, savings, lending, etc.

45%

Services directly related to PSD2: Payment-related (account information services, payment initiation services, confirmation on availability of funds services)
Instant payments
The development of instant payments, 24/7/365 payments executed within seconds, is another driver of change. Especially in combination PSD2, Open Banking and instant payments deliver numerous opportunities. As an example payment transactions that are conducted via a card scheme today can be replaced by account to account payment transactions enabled through PSD2 and instant payments. This directly impacts merchants and established parties like card schemes that may be threatened by these forces.

Strategic fit
These forces fundamentally change the business models of individual parties as well as the interaction between them. Open Banking will drive sharing of financial data and enable a more connected financial services ecosystem. Organisations should adopt a truly innovative strategy impacting all aspects of their business and operating models:

- The markets addressed with the services and products offered;
- The propositions and brands used;
- The clients addressed and channels through which these clients are reached;
- The financial aspirations associated with the business model;
- The core business processes used to operate the business model;
- The operational setup and technologies used to run the business processes;
- The people and associated culture;
- The measures and incentives applied;
- The organisational structure, governance and controls that are in place to manage the business.

"These type of changes fundamentally change the business models of individual parties as well as the interaction between them."
We have identified elements of our operational functions that may need to change but have not assessed our organisational design and interdependencies in their entirety.
Banks face the risk of losing their current monopoly on customer interaction as TPPs are introduced. Both existing players such as banks as well as new entrants such as Fintechs, telcos, social networks and retailers can play the TPP role. They can start to offer new, innovative (payment) services. For example, ‘one click mortgages’, where the mortgage service provider can access payment account data to perform credit rating calculations in order to offer a competitive rate instantly. This technique can be used during the initial sales process, as well as continuously to monitor the credit risk as it evolves over time. As non-banks can now offer these services, they can take over the customer relationship, in which case the customer’s bank may be pushed into the background.

PSD2 enabled opportunities
TPPs have a lot to offer in terms of innovative, technology-based customer experiences and services. Many TPPs, however, lack scale and do not generally have a trust-based relationship with their customers. Banks in turn, can leverage their scale and trust assets to remain in the driver’s seat and retain or expand their positions.

Through a compete strategy, existing as well as new parties will actively seek to exploit opportunities offered through PSD2. This can be achieved either by utilising data and payment services that are currently available to existing banks, and/or through offering data and services to TPPs in a way that is beneficial for the business. A wide range of PSD2-enabled opportunities is seen by the participants to our study, see Figure 5 and Figure 6.

Which opportunities are enabled by PSD2 (in general)? Please choose three that are most important.

- Personal finance management services (47%)
- Data & analytics based services (47%)
- New/adapted payments products (47%)
- Revenues from provision of payments and/or banking data towards third parties (40%)
- Provision of payment services (to support the current business model) (40%)
- New/adapted cash & liquidity management services (33%)
- Consumer advice / robo advice based services (20%)
- Improving current products (7%)
- Other (0%)

FIGURE 5 PSD2; a threat or an opportunity?
How does your company view PSD2?

- 73% As an opportunity?
- 27% As a threat?
For Big Techs
Big Techs like Google, Facebook, and Amazon already benefit from a strong brand, stable infrastructure, and a large user base. They are able to utilise the existing banking infrastructure. Imagine a scenario where a firm like Google, with millions of monthly active users in Europe, decides to leverage the PSD2 opportunities by playing the Account Information Service Provider (AISP) role. It can provide a centralised storage place for customers’ banking details and single-handedly become a market leader. The Big Techs already have a wide reach and expertise in developing new customer-friendly services and products. They can take a front seat on the PSD2 train and may drive the expanding payments ecosystem. Whether or not they will be the ones to do so remains to be seen.

For Fintechs
Fintechs in turn are developing new technologies without having to worry about creating an expensive banking infrastructure to facilitate their products and services. This effectively lowers the entrance barrier. They can leverage the scale, data and services of banks to bring solutions to the market directly, or through partnerships with other Fintechs and existing banks.

For banks
Finally, banks have the necessary brand, experience and infrastructure. However as will be described KPMG’s 2017 Banking System Survey, they do not consider themselves to be effective innovators. They run the risk of losing out by not effectively responding to the changing playing field. See Figure 7.

“Finally, banks have the necessary brand, experience and infrastructure.”
Strategic options
Implementation strategies can be focused on leveraging individual strengths – through building their own solutions – either through buying solutions or as part of mergers and acquisitions. Alternatively, forming partnerships can address weaknesses. Our study reveals that entering partnerships is one of the three most frequently used implementation strategies, but building and buying solutions are both more or less evenly well represented across market participants, see Figure 8.

Partnerships
Engaging in partnerships is a viable strategy as some of our respondents mentioned that they lack the necessary knowledge and expertise to offer technology-enabled fluid customer experiences. Interviews revealed active engagement between parties to further develop and mature services.

In-house development
A second strategy is to develop PSD2-enabled services in-house. The bigger banks in particular are creating offerings to already pre-empt the market with PSD2-like services. Examples are new payment methods connected with loyalty schemes, personal finance management solutions and models that expose internal risk models to the outside world. This strategy should be considered in combination with a strategy to leverage third-party solutions, which may accelerate the delivery of the service.

Wait and see
The third strategy is to wait and see. This can be a viable strategy given the delays experienced to date in the transposition of the PSD2 as well as the lack of uniform standards (see the ‘Comply’ section). It may also be a strategy that allows parties to buy time to implement other solutions. Nevertheless, all parties offering payment services today will need to ensure that they are compliant, as a bare minimum.

One thing is certain, payments will not remain limited to the existing parties in the payment value chain. Developments such as PSD2 will lead to an expanding ecosystem. As all actors want to obtain a piece of the cake, it is essential for market players to assess their strengths and weaknesses and to position themselves strategically to benefit from the changing payments landscape. As the ecosystem will keep expanding, the big question that remains unanswered is whether this expansion will be sustainable for all parties in the long run.

FIGURE 8 Implementation strategies (the figure exceeds 100% as each respondent could select three options)

What best defines your implementation strategy under PSD2?

- Buy solutions/leverage 3rd party solutions: 53%
- Build solutions ourselves: 53%
- Enter into partnerships: 47%
- Wait and see: 20%
- Acquire parties to obtain (parts of) the solution: 0%
- Other: 0%
We aim to comply with the regulation and don’t want to pursue opportunities at this stage.
For both new entrants and existing parties delivering payment services, compliance is the minimum requirement to enter or stay in the new PSD2-enabled payments playing field. It is the licence to operate.

Network economies (such as payments) need standards to create stability and efficiency. For PSD2, European standards have not yet been finalised. The European Banking Authority (EBA) has the mandate to propose the rules of the game. It is doing that through the Regulatory Technical Standards (RTS) for Strong Customer Authentication (SCA) and common and secure communication. However, these have not yet been finalised, and they are not expected to contain standards on a detailed level in time for the implementation of PSD2. As an example, the minimum data to be exchanged is not specified. Nor are interaction patterns that specify the sequence of communication between TPPs and banks included. The statement was issued by the EBA however that interfaces should follow the standards of communication issued by International or European standardisation organisations. Given the fierce debate over the 2017 summer period between the European Banking Authority (EBA) and the European Commission (EC), it should be noted that it is not clear whether the final draft of the RTS will remain as is. We will further describe some aspects in more detail, see also Figure 9.

**Strong Customer Authentication**

Safety is vital for payments, including in respect of the protection of personal data. A safe payments system builds trust in society. The PSD2 introduces the need for Strong Customer Authentication (SCA). These SCA requirements will increase the frequency of use of two-factor authentication (2-FA) and payment transactions will have to be signed with an authorisation code. Channels that are not mobile or online may also qualify for the application of SCA. The requirements may prove difficult to implement, for example in the case of placing a payment order by phone, which is still common in private banking. This qualifies as a remote action that implies a risk of fraud, therefore SCA is needed. The distribution of a transaction authorisation code for such cases is difficult to implement if not impossible. Banks have no option other than to weigh the risks associated with such channels and to decide whether the channel should remain open.

**FIGURE 9 Risk categories** (the figure exceeds 100% as each respondent could select three options)

**What are the three main risk categories you associate with the introduction of PSD2?**

- **Privacy (e.g. transaction data available to third party without consent of consumer or identity theft)**
  - 73%

- **Liability (e.g. refund of unauthorised transactions)**
  - 47%

- **Fraud (e.g. unauthorised payment initiation)**
  - 47%

- **Operational (e.g. inability to handle disputes or non-performing APIs)**
  - 40%

- **Business model (e.g. disintermediation or loss of revenues)**
  - 33%

- **Continuity/stability (e.g. increased outages or lack of performance of systems)**
  - 27%
Standards for access to payment accounts by TPPs

When it comes to standards, a standardisation organisation like the Berlin Group has traction with its NextGenPSD2 taskforce, however it will not be able to finish its tasks fully prior to finalisation of the RTS. Across Europe there are more standardisation activities underway. It is highly likely that multiple standards will exist across Europe, even at the level of individual organisations. This will make it cumbersome to connect for TPPs. See also Figure 10.

Technology used to allow TPP’s to access payment accounts

There is a debate regarding the manner of access to payment accounts. Currently the two most widely used access methods are specific interfaces, often built with Application Programming Interface (API) technology and screen scraping. The EBA’s position is to ban screen scraping, but the EC is sensitive to arguments from established Fintechs that use the technique in their operations today. It is not yet clear whether screen scraping as practiced today will be allowed after the RTS comes into effect. Dedicated channels, often explained as APIs, represent the alternative. During our research we came across players who intend to use APIs exclusively. Banks in particular regard screen scraping as a high-risk practice, therefore APIs are probably going to become the dominant design for account access. This is reflected in the Dutch marketplace survey with most of the participants stating that they will use API as the basis for TPP access. See Figure 11. When looking at the market’s main concern with regard to third-party access to accounts, the misuse of account holder consent is mentioned most, see Figure 12. It is a challenge to ensure that consent is captured correctly and with certainty. This challenge needs to be solved in the user experience flow between TPPs and banks.

FIGURE 10 Standard adoption
Are you planning to develop your own implementation standard, or do you plan to adopt the standards being set by standardisation initiatives like the Berlin group or PRETA?

47% We plan to adopt an existing standard
40% Not yet sure
13% We plan to develop our own standards

FIGURE 11 Third-party access technology
What is the technological basis for your solution for third-party access?

21% API technologies
11% Other technologies
57% Not applicable
11% Re-use of existing front-office/channel technologies
Data privacy (GDPR)
An important factor increasing the compliance complexity is the link with other regulations, most prominently the GDPR. The GDPR introduces high standards in terms of personal data protection. With TPPs potentially getting access to sensitive personal data that is included in transaction information, privacy risks are introduced. Clear guidance has not been supplied by the regulator yet and is left up to market interpretation at present. This cocktail of requirements may hinder innovation and requires close monitoring to ensure the development of compliant products and services. Not surprisingly, when respondents are asked for the main risk categories associated with the introduction of PSD2, privacy is mentioned most frequently. See Figure 9.

Licensing requirements for TPPs
The two new services will be introduced as part of PSD2: payment initiation services and account information services which are defined as a payment service. An applicable payment service provider licence is needed to offer payment services to customers. TPPs will therefore have to acquire a licence. A credit institution licence, a payment institution licence or an e-money institution licence can be used as a payment service provider licence.

Our figures show that the Dutch market expects between 100 and 1,000 TPPs to apply for licences across Europe in the coming two years, see Figure 13. As of now, the licence requirements in the Netherlands have not yet been finalised, however the EBA has provided some guidance. As in today’s situation, a solid business plan underpinned by a secure, controlled organisation and operations remain the most important elements. For TPPs that offer account information services, a lighter regime applies.
**Timeframe for implementation**

The Dutch regulator has already announced that it will not make the deadline of 13 January 2018 for the PSD2 transposition into Dutch law. Furthermore the RTS will be enforced from the second half of 2019 at the earliest. This brings uncertainty as to what requirements will apply and when. It also introduces waste as solutions for SCA and TPP access to payment accounts will need to be adapted over time in line with changing requirements. It brings uncertainty for TPPs as they are not certain that they will be able connect to all banks from 13 January 2018. TPPs cannot implement a viable and scalable operating model across Europe or even in specific countries. This may jeopardise meeting the increased competition and innovation objectives of PSD2.

With the introduction of SEPA, the lesson was learned that leaving the implementation to the market did not work and the SEPA project was over schedule. As a consequence the regulator stepped in. History may be repeating itself and PSD3 may well be under way already.

Today’s leading financial services companies are operating in a new and more complex environment, one where the fundamental definition of how customers experience and interact with a bank is being challenged and redefined. Organisations need to ask themselves if they aim to reinvent their complete business to gain competitive advantage, compete through new products and services or comply with regulatory requirements. Each player will need to make a deliberate choice about what strategy to follow, and implementation of the strategy will be key. Waiting is not an option: in a digital economy the winner might take it all.
APPENDIX

PSD2, its progress across Europe

The progression of the transposition of PSD2 as at 6 October 2017 is shown below.

The UK, France, Denmark, and Germany are taking the lead in transposing PSD2 into national law. This is not surprising since these countries have some of the biggest online payment industries in Europe.

The UK in particular is taking big steps towards the transposition with its announcement of opening up licence applications for TPPs on 13 October 2017. The authorities there have already published a 238-page booklet on how to apply for a licence and how to be compliant.

This is in contrast with the Netherlands and Sweden, who recently announced that they will delay the transposition due to data privacy complications. Furthermore, Belgium and many Eastern European countries are lacking in progress on PSD2, the likely explanation being that these countries in general still rely heavily on cash transactions.
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