WINNING IN A POST PSD2 WORLD

Why banks must rapidly enhance their mobile banking experiences or face a declining presence in the European payments market

Introduction

The adoption of the revised Payment Services Directive (PSD2) has set the stage for a new era of open banking in Europe. In 2018, PSD2 will be implemented across the European Union, eliminating banks' long-held monopoly on their customers' data and opening up a once protected market to a stream of innovative non-bank competitors.

Reactions from incumbents have so far been characterised by uncertainty and fear as executives remain unsure of how to respond. But the reality is that PSD2 is coming, and the impacts will be profound. Banks can ill-afford to do nothing. A dramatic increase in competition in payment services from large existing non- bank players that have already started offering financial services like Facebook and a rush of smaller third-party companies should be a grave cause of concern for incumbents. If complacent, there is a high likelihood that banks will lose their interface with consumers, resulting in a loss of control of and a deterioration of the customer relationship.

With little time to waste until PSD2 gets implemented, banks must move rapidly to improve their mobile banking services. Attracting new clients and securing current relationships before APIs are opened and new competition gains a foothold is of vital importance.

Relying solely on internal development and innovation will not produce the quick reforms required. By partnering with fintech startups, banks can optimize their financial services experiences at speed, ensuring first mover advantage and securing their position as market leaders in a post PSD2 world.

PayKey's social banking solution can play an integral part in a bank's larger strategy to optimize its mobile banking services by delivering an enhanced experience in one of the fastest growing parts of retail banking - mobile P2P money transfers.

Understanding PSD2

What is it?

The revised Payment Services Directive (PSD2) is a transformational piece of legislation that sets out a legal framework within which all payment services within the European Economic Area must operate.

Aimed at promoting innovation and fostering competition from non-banking institutions in the payments industry, PSD2 legally obliges banks to allow third-party providers access to their customers' accounts and data through open APIs. The directive introduces two new market players, Payment Initiation Service Providers (PISPs) and Account Information Service Providers (AISPs), and enables them to build financial services on top of banks' data and infrastructure.

PISPs are third-party service providers that can initiate payments on behalf of the account holder, providing the account holder grants permission. Bill payment and P2P transfers are examples of PISP services that banks will be legally required to enable.

AISPs are providers that can connect to bank accounts and retrieve account information from them to enable the delivery of a variety of services. Examples of these services include investment recommendations and tailored personal finance services.

Why was it created?

PSD2 is an overhaul of the original Payment Services Directive (PSD), which was introduced in 2007 to standardise the rules regarding payments in 30 European countries. PSD2 widens the scope of the regulatory framework in PSD with the aim of making it faster, easier, safer, and cheaper for consumers to make payments. PSD2 encourages this by lowering the barrier to entry for third-party service providers, promoting innovation, and enhancing customer protections.

Implementation Timeline

2013 - June

Revised payment services directive (PSD2) first proposed by European Commission

2015 - November/ December

PSD2 adopted by the European parliament and made legally binding in all member states

2016 - January

PSD2 officially implemented, giving all member states two years to enact it into national law

2017 - May

European Banking Authority (EBA) published final draft of the Regulatory Technical Standards (RTS) for PSD2

2018 - January

Deadline to transpose PSD2 into national law of member states - the provisions of the new directive will apply

Implications for the Banking Industry

Beyond the compliance, IT, and security demands that banks must adhere to, the implementation of PSD2 will have two significant implications for the banking industry.

Increased competition

Under today's regulatory framework, there is no guarantee for third-party payment service providers that banks will grant them access to consumers' bank accounts, without which they cannot offer their solutions. This is due to the fact that currently; banks have the right to refuse access to non-bank payment service providers for one simple reason - their relationship is not regulated. Today, only ad-hoc agreements between third-party payment service providers and banking institutions exist.

This will all change with the implementation of PSD2. One of the most consequential parts of PSD2 requires member states to ensure that third-party payment service providers have access to banks' payment account services on an "objective, non- discriminatory and proportionate basis." After PSD2 gets implemented in January 2018, European banks will be required by law to open their payment infrastructures and APIs to all non-banks, giving all third-party service providers the ability to build services on top of any banks' infrastructure.

Open APIs will result in a dramatic increase in competition in the payment services industry. Large non-bank players that have already started offering payment services like Facebook, as well as a wave of new fintech companies will create fierce competition in the payment market.

Payment Initiation Service Providers (PISPs) which can initiate a payment on behalf of an individual will also add to the mix. Peer-to-peer transfers between friends and bill payments are among the first PISP services expected to take off after the implementation of PSD2.

Loss of customer relationship

Under the new PSD2 regulatory regime banks will have a much harder time maintaining control of their customer relationships. PSD2 allows third-parties to build applications on top of a bank account and engage customers in their own user interface. Account Information Service Providers (AISPs) and Payment Initiation Service Providers (PISPs) will compete directly with banks for the engagement of their customers.

AISPs, with the ability to connect to bank accounts and retrieve information from them, will build their own platforms based on information within a customer's bank account, while engaging the user in their own external platform. Instead of a consumer logging into their Barclays or Santander accounts, for example, they will be able to log into a new personalized platform which presents balance and transaction data from all their accounts in a single aggregated view. A typical example of an AISP would be an investment recommendation service.

With permission from users, PISPs will have access to customers' bank accounts and will be able to carry out transactions on behalf of the customer with no action required from the bank. Instead of a retailer or social media platform being provided a customer's payment card details and then requesting and receiving a payment through a card scheme and a customer's bank, a PISP will be able to create a software bridge between the customer's and the retailer's accounts to facilitate the information exchange necessary to make a transaction.

PSD2 will make it harder for banks to get their brands in front of customers. While banks are left holding customers' money and dealing with all the associated regulatory risks, new third-party payment providers will be able to capture the client interface and eliminate the regular interactions customers have with their banks.

As a result, trust and brand loyalty will diminish, customer relationships will deteriorate, and banks' opportunities to cross-sell will be severely impacted.

Views from the Frontline

"PSD2 is a major milestone on the way to an open financial services market. It will be a great test for a range of companies who need to rethink and redefine their business models – including us. This is really the game changer of the decade – the inevitable, unstoppable opening up of the payments infrastructure for competition and new entrants."

Jurgen Vroegh, Global Head of Payments, ING

"Banks no longer own the end to end value chain and every piece of what we do can now be provided by a non-bank service provider"

Kevin Hanley, Director of Innovation, RBS

"The second payment services directive builds on the original payment services directive from back in 2009. It will update and modernise that legislation leading to greater openness, transparency, competition and innovation in the area of payment services."

Gavin Maclean, Head of Cash Management & Payment products, Global Transaction Banking, Lloyds

"PSD2 is considered a threat to banks because we have new entrants coming in, of course, looking for the most profitable parts of what banks are doing today."

Erik Zingmark, Co-Head of Transaction Banking & Products, Nordea

"We should regard it as a major step forward along the road to a more open, digital payments market in Europe that refocuses from pure payment execution to service provision in which the payment is only one contributing element. Additionally, providers should be regarding PSD2 as a potential source of new business – there is no doubt there will be opportunities in its wake for all participants who welcome, and adjust to, an extended list of players in the payments market."

Shahrokh Moinian, Managing Director & Global Head of Cash Management, Deutsche Bank

"The banks see the threat coming from the fintech sector, but competition in the area of payments will not only come from the fintech sector but also from communications operators such as Orange, which will offer mobile banking, and from established online platforms like Google or Apple that are breaking into the world of payments"

Álvaro Martín, Head Economist of Digital Regulation at BBVA Research

Winning in a Post PSD2 World

There can be little doubt that PSD2 is a significant threat to traditional financial institutions. As PSD2 takes effect, the competitive landscape in the finance industry will change very quickly, as banks find themselves no longer competing only with other banks, but with any company that is looking to take a bite out of the lucrative payments market. When tech giants like Apple, Google, and Facebook can offer fresh and innovative financial services, banks will face more competition than ever before, and will be faced with the challenge of attracting and retaining customers who have developed an expectation for new levels of usability and connection to the social world from financial services.

On a positive note, PSD2 also brings into play unprecedented opportunities for banks to enhance their payments services. Decades-old regulations that have protected banks from new competition have also discouraged them from expanding their businesses and providing innovative solutions to their clients. In addition, research has shown time and time again that people trust their banks over third-party providers. New research from Accenture highlights this sentiment, showing that 69% of UK survey respondents are not keen on sharing their account information with third-party providers.

Herein lies the key to succeeding in the new PSD2 world. Banks that can enhance their payments services and meet the needs of their customers for contextual, channel-agnostic user experiences that are tailored to their social lifestyle will have the greatest chance of retaining existing customers and attracting new ones. Financial institutions that fail to seize the moment and act fast will become less and less relevant for their customers and will end up losing parts of their business to new players.

The good news for banks is that there is still time to act. But they cannot afford to sit back and wait for the implementation of PSD2 to formulate a strategic response. Banks must begin enhancing their mobile banking solutions now in preparation for an influx of competition.

The legacy systems and risk-averse corporate cultures that have defined large financial institutions and led to the reliance on internal innovation will not produce the quick reforms required to remain competitive. Achieving speedy innovation will require incumbents to partner with agile fintech companies.

Securing Innovation & First Mover Advantage with PayKey

As the countdown to PSD2 continues, banks will need to transform not only their payments services, but also many aspects of their mobile banking services if they want to remain competitive. PayKey's social banking solution can play an integral part in a financial institution's strategy to increase brand engagement and enhance their customers' banking experiences as they fight to retain and attract customers in a more competitive market.

The PayKey solution not only offers innovation at speed in an important and growing part of the payments landscape – mobile P2P money transfers – but also delivers banks the opportunity to create a new channel for financial services, information, and communication, while placing their brands in front of their customers in all mobile applications, including popular social media and messaging applications.

PayKey's social banking solution seamlessly integrates with mobile banking applications, giving users the ability to initiate and complete financial services from within any application, without having to leave the app they are already in to switch to a different app. By transforming the mobile banking experience into an immediate, intuitive, contextual, and seamless experience, PayKey helps banks to meet rising customer expectations for instant services while maintaining control of the customer relationship.

PayKey's patent-pending Mobile Banking Keyboard integrates on the API level in a matter of weeks and retains the bank authentication method without compromising the security level.

About PayKey

PayKey bridges the gap between banking and social, enabling banks to have their brands become a part of their customers' social and messaging experience. PayKey enables banks to provide their customers with the ability to initiate and complete a range of financial services, including P2P payments, request payment, balance check, cardless withdrawal, and more, from within any mobile application.

Offering a cross-platform banking button on the smartphone's keyboard boosts the bank's brand engagement while making the banking experience quick, contextual, and simple for users.

Contact us here to set up your free demo today to see how PayKey can drive brand awareness for banks by creating a platform-agnostic channel for financial services, information, and communication.

PayKey is already working with leading financial institutions including:

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