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Short Communication

Dissemination of PSD2 (the revised directive on payment services): Opportunity or intimidation?

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INTRODUCTION

2018 is going to be a year of change for European banks and payment operators. The revised Directive on Payment Services (PSD2), which goes into effect in January, sets the stage for open banking, providing third-parties access to banks' customer data and infrastructure. PSD2 will lower the barriers to entry for these third-party providers, such as FinTechs, and stimulate the development of new business models. This is a huge impact to traditional banking business because this is the first time parties outside banking industry are invited to join in their application programming interface (Nair, 2017). Because EU members must make substantial changes to comply with the new rule by the January deadline, PSD2 demands immediate attention. Despite the legal enforceability in each country, PSD2 is a framework that changes the way banks operate and provide their services, and how consumers value their bonds with their banks, following usage trends and technology. The EU's vision of a Single Euro Payment Area is an act towards cashless society and PSD2 is a step closer in that journey. This is all part of even bigger transformation shift that is evolving the whole society, and it's called digitalization. According to Honkapohja (2016, p: 3), it challenges old and established payment practices and will likely change them. Banking industry is in the middle of a large digitalization phase that affects first of all customers with different kinds of more convenient services but it also impacts the staff of banks with a risk of losing jobs. According to a survey on the availability and pricing of basic banking services in 2016 the amount of bank branches has declined to around one thousand from 1,500 in a six-year period in Finland (Financial Supervisory Authority, 2016). Consequently, it is clear that banks will no longer compete with each other, but with all organizations providing financial services. Size of payment market is massive. According to European Central Bank's (2017) payment statistics, the total number of payment transactions in EU in 2016 was 122 billion. As seen in Figure 1 below, number of transactions has risen in EU for the past five years making payments market larger and everything including in it, for example security and risk management activities.

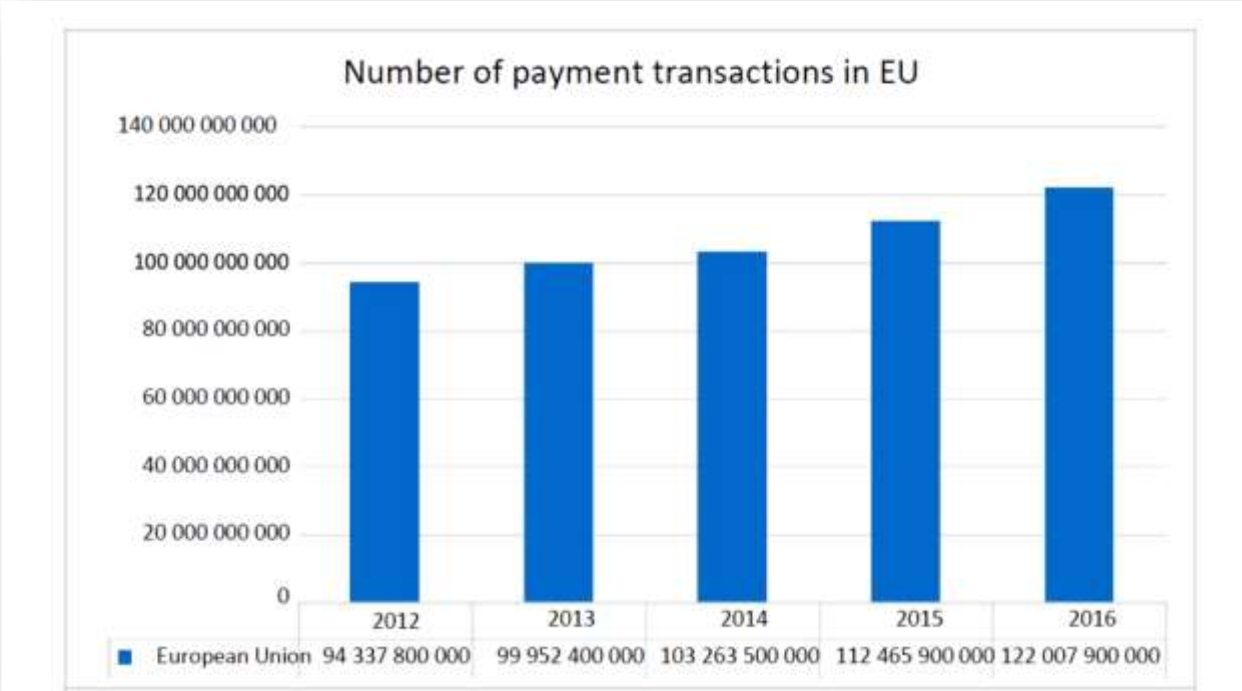

Figure 1: Number of payment card transactions. European Central Bank (2017).

Top of payment amounts, business-to-customer ecommerce has risen 15% in 2016 and forecasted to grow 14% in 2017 in Europe according to European Ecommerce Report 2017. If banks don't develop, or only remain the same, other players will capture this business area and PSD2 brings appropriate push factor to the innovation process of whole industry. Due to creative destruction, fintech startups or tech giants have the opportunity to replace as mass' payment platform.

The PSD contains two main sections

The 'market rules' describe which type of organizations can provide payment services. Next to credit institutions (i.e. banks) and certain authorities (e.g. central banks, government bodies), the PSD mentions electronic money institutions, created by the E-Money Directive in 2000, and created the new category of 'payment institutions' with its own prudential regime rules. Organizations that are neither credit institutions nor EMIs can apply for an authorization as a payment institution if they meet certain capital and risk management requirements. The application can be made in any EU country where they are established and they can then "passport" their payment services into all other EU member states without additional PI requirements. The 'business conduct rules' specify what transparency of information payment service institutions need to provide, including any charges, exchange rates, transaction references and maximum execution time. It stipulates the rights and obligations for both payment service providers and users, how to authorize and execute transactions, liability in case of unauthorized use of payment instruments, refunds on payments, revoking payment orders, and value dating of payments.

From banking

Banks In 1990, Bill Gates wisely stated that banking is needed, not banks. The new directive opens up the EU payment market for companies providing payment services, based on access to payment account details, in particular for:

Account Data Services Providers (AISPs), which allow payment service users to have an overview of their financial situation at any time, allowing users better management of their personal finances. Moven is an example in this regard.

Payment Initiation Services Providers (PISPs), which allow customers to pay through their simple online purchases by providing merchants with guarantees that payment is initiated, so that goods or services can be sent or offered without delay. Sofort is an example in this regard. According to a recent study published by PwC, 68 percent of bankers worry that the new directive will bring less control over their clients, while feeling unsafe about how to respond to the challenges it brings. Consequently, they are following the strategy of "seeing and doing" in comparison with other providers of these services and FinTech-save, who are now embracing open banking opportunities, aiming to gain a dominant position in the new arena of payments.

PSD2

A Fundamentally Transforming Private Banking Directive Paying Bills (Liabilities) Directly From Your Facebook Account Account? This is what PSD2 will bring to practice. The PSD2 is an EU directive that sets out a number of new rules for payment services in order to make international payments within the EU so simple, efficient and safe as payments within a single country. In short, PSD2: (i) aims to provide electronic payments and expand the financial services ecosystem; (ii) Provide payment service providers with service; (iii) Requires strong customer authentication; (iv) Exhibit Banking Data to Third Parties through APIs. Given the emerging technologies in the payment landscape, this directive seeks to open the payment market for new players, leading to greater competition between banks, FinTech-saves and other stakeholders. In addition, the purpose of PSD2 is to stimulate innovation by introducing new types of customer services and to overcome the gaps in existing legislation in order to enhance customer protection and transparency. PSD2 covers a number of payment services, including:

- Provision of deposit and withdrawals in cash.
- Execution of transfers, Permanent Payment Orders, Direct Debits.
- Payments by cards or similar devices.
- Issuance of payment instruments (cards, portfolios) and / or receipt of payment transactions.
- Money remittances.
- Initiation of payment services.
- Services about account data.

Despite the legal enforceability in each country, PSD2 is a framework that changes the way banks operate and provide their services, and how consumers value their bonds with their banks, following usage trends and technology. Consequently, it is clear that banks will no longer compete with each other, but with all organizations providing financial services.

COMPLIANCE OR COMPETITION?

Open Banking will eventually revolutionize the value chain in the payments field. For "traditional" banks to continue to be competitive in this new era modeled by PSD2, they should focus their digital strategy on transforming a simple financial transaction into a means of establishing personalized relationships with customers. Since there is no universal answer on how strategically all these challenges can be addressed, banks need to find modular solutions through the use of APIs to link data, products and services that belong not only to the financial services sector but even other sectors. In this way, they can capture consumer demand and transform it into more and more compelling solutions. Banks can act as aggregators and provide "Account Data Services" for their clients, as well as provide Personal Financial Management services. Banks need to see it collaborating with FinTech-sat as an opportunity to use APIs to integrate them into their platforms in order to provide new services based on data analysis. As access to payment account data is already open, banks can also extend their services to individuals' payments by expanding their services as PISP. The implementation of a flexible IT architecture that will enable the provision of services beyond access to account data is crucial for the transition period. Rather than simply being a payment processor, banks can raise their value chains by offering payment initiation services via the Internet, directly via their websites or mobile channels. Key Recipes: Klaus Schwab (founder and chief executive of the World Economic Forum) says:

"In the new era, it's not the big fish that eats the fish, but it's the fast fish that catches the fish."

CUSTOMER RELATIONSHIPS

With a customer that is becoming more and more digital, all existing payment providers and new ones have no other option than to adapt their strategies quickly and effectively according to circumstances. Increasing competition may result in passionate technology-seeking customers using companies that offer a range of services for all their financial needs, instead of a single bank. Clients are seeking immediate, personalized, and more convenient experiences and if they do not get what they expect from financial service providers, they will easily pass to the competitor as they do with any other purchases they make. However, it should also be borne in mind that security consumers are equally concerned about the security of their information and, depending on their profile (age, adaptation to technology, etc.), many would feel safer with a "traditional" bank, rather than a FinTech.

OPPORTUNITY OR THREAT?

The directive may be a serious threat to banks that decide not to take action, despite the existence of national-level regulations to be enforced, - someone else, whether a domestic or global actor, will do so. So the question here is not "if", but "when". On the other hand, PSD2 is a good opportunity for banks seeking to be transformed and differentiated, using the advantages of the PSD2 platform for implementing innovative services for their customers, competing with FinTechsat and, most importantly, protecting the wealth of their most valued customers.

SUMMARY AND CONCLUSION

Compliance expenses and possible complaint handlings or errors among new third-party services are difficult to forecast but have to be considered. Banks may lose their market share and customer relevance in payment services to third parties and therefore suffer a loss in revenues, in use of traditional cards and in cross-selling other products. Product developing landscape is under threat to shift to third parties which can slow rate of innovations in banks. Incumbent banks can also benefit from opportunities that the new directive raises. The rules will apply EU wide which means that business environment will grow and possibly brings more competition. Increased competition may lead to smaller transaction fees which will reduce revenues. Banks could benefit from new innovative services of third parties and this way their customers could get better payment services; the size of future transaction services portfolio could enlarge. Less use of cash is easier and more inexpensive for bank to operate. More innovative payment services could mean more transactions which could mean more revenues. Partnerships may generate new revenue streams through new services. Banks need to stay relevant in developer landscape to get bright ideas and skilled staff. The head of banks need to carefully decide how to approach PSD2 and create a strategy to stay relevant to customers and keep cross-selling. This way incumbent banks could be ahead in innovation competition and make it more difficult for new competitors to succeed in their market. Changing consumer behavior has been grown during digital technology's influence into daily life of a consumer and it has driven to customers' developed expectations regarding to payment services. Goal of the new directive is to develop and integrate payments market further in EU. The directive is established to set a clear and comprehensive legal foundation for existing and new PSPs. PSD2 aims to ensure PSPs equal competition environment resulting to greater efficiency, multiple choice of services and lower prices, transparency and strengthening the vision of harmonized payments market. Strategies consider bank revenues, business model, customer relationships, market positioning and future growth. These are components that banks should include into consideration when planning a strategy for PSD2.

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