Payment Services Directive 2: What it Means for Banks, Customers, and Payment Service Providers

Abstract

The Payment Services Directive 2 (PSD2) can have a significant impact on customers, banks, and payment service providers (PSPs).

This white paper highlights the benefits of adopting PSD2, and its implementation challenges.

PSD2: Scope and Impact

The updated version of the Payment Services Directive (PSD) — enacted by The European Union (EU) in November 2009 — PSD2, is expected to be implemented by 2018.

PSD2 proposes to change the scope of certain exemptions, and their interpretations, to bring more firms under its purview. This will bring additional categories of payment transactions under its coverage.

Though PSD2 will affect all stakeholders, including the European Banking Authority (EBA), the EU, central banks, and various other players in the payments landscape in some way, it will have far-reaching implications for banks, third-party payment service providers (PSPs), and customers.

Let's look at how the new regulation will change the dynamics of the payment ecosystem.

What banks must focus on

Leverage API frameworks to develop compelling offerings

Banks that allow third party providers (TPPs) to access customer information, have to upgrade their infrastructure to respond effectively to such requests. The most efficient way to provide this service is to embrace the API framework.

Rather than adopting the API framework to merely comply with the account information services (AIS) provision of PSD2, banks should opt for full-scale adoption that can enable interaction with external entities such as the central bank; clearing house; and other third party service providers. This will allow banks to focus on developing value added products and services, and thus increase their market share.

Implementation of PSD2 is an opportunity for banks to establish a service bus integration layer to separate backend complexities from API consumers, thus enhancing operational efficiency.

Collaborate with other banks to facilitate seamless transactions

Banks can become third party providers themselves, and access the payment systems of competitor banks to offer new and aggregated services such as enabling a portfolio view of customer accounts. Banks can offer personalized products and services as they will have more information about the customers, and their spending patterns. Banks can emerge as a one-stop-shop, offering a wide range of products and services, which generate additional revenue.

Banks can form consortiums or joint ventures, taking into consideration each entity's respective areas of operation, target customer segments, and offerings. Thus, banks will be able to reap the benefits of economies of scale and achieve operational efficiency.

Install robust customer authentication mechanisms

Banks will have to make additional investments to adopt multi-factor authentication, and take measures to educate customers to ensure a seamless shift. Non-compliant players may lose their competitive edge, and consequently, their market share.

Ensure comprehensive data reporting for EBA monitoring

The monitoring of financial institutions by the European Banking Authority (EBA) mandated in PSD2 will ensure smooth dealings and enhanced transparency among banks, and between banks and TPPs. PSD2 has well-defined dispute resolution procedures that are uniformly applicable to all stakeholders.

What PSPs must do, and their perceived benefits

Make additional investments in customer authentication area

Since PSPs will be allowed to access the payment systems of banks, they have to facilitate multi-factor authentication. This may necessitate significant investments to upgrade infrastructure, re-engineer current processes, and train the personnel.

The new authentication methods could help PSPs enhance revenues by reducing fraud, and grow customer base, with enhanced customer confidence.

Ensure compliance with regulatory controls

Since all PSPs will be brought under the purview of the Network and Information Security Directive (NISD), customers will feel more confident. This will not only attract new customers, but also encourage existing users to avail the entire spectrum of services.

To comply with PSD2 standards, PSPs will have to be transparent, ensuring a high degree of financial discipline, as regulatory authorities monitor their activities and financials.

Gather insights on customer spending behavior

The account information service (AIS) provision of PSD2 provides PSPs access to customer account information with banks. PSPs can use insights about customers and their spending habits to offer innovative and tailored products and services.

Additionally, PSPs can offer account information service itself as an unbundled service to provide customers a single, unified view of information of accounts with different banks.

How customers will benefit

Lower transaction costs

The implementation of PSD2 will change customers' online experience by enabling them to conduct payment or remittance transactions directly from their bank accounts. Various entities involved in a typical payment card transaction such as the issuer and the acquirer, and the card scheme may become redundant, thereby reducing associated overheads.

Entry of new entities in the payments ecosystem

PSD2 recognizes two more entities in the payment ecosystem — account information service providers (AISPs) and payment initiation service providers (PISPs). New players will emerge with the increase in volumes, fostering innovation. Customer experience in terms of payment services will become richer, simpler, and economical, because of competition-driven initiatives.

Enhanced transparency

PSD2 mandates that terms and conditions associated with transactions be disclosed by PSPs, before a transaction is initiated. This will give customers a clear picture of the processing time, fees, charges, and so on, enabling them to make an informed decision.

Stringent transaction security

PSD2 has mandated stringent customer authentication methods for customer-initiated electronic transactions.

Banks will have to adopt robust authentication mechanisms to make transactions more secure, and avert identity thefts. This enables customers to carry out transactions confidently.

Streamlined refunds

PSD2 has streamlined rules governing the refund of payee-initiated transactions (for example, recurring transactions). As a result, refunds in respect of payee-initiated transactions will be treated at par with other regular transactions.

Quicker grievance redressal

PSD2 has streamlined out-of-court complaints and redress procedures. PSPs will now be required to reply to customer queries in writing within 15 days in case of a dispute.

Better services to customers of smaller banks

Large traditional banks can provide account information to smaller banks, where smaller banks act as PSPs for the larger banks. Customers of smaller banks can now be offered an array of services, including personalized offers.

Greater scope for one-leg transactions

Payments or remittance transactions where one PSP is located within the EU and another located outside (one-leg transactions) will be brought within the scope of PSD2, irrespective of the transaction currency.

Thus, customers can make secure payments to and from non-EU countries.

Elimination of surcharges

PSD2 prohibits surcharging, which will reduce the cost, and thus enable customers to choose any convenient payment option.

Issues with implementation, and recommended solution approaches

Though PSD2 will be beneficial for all the parties involved, there may be some implementation hurdles.

Sl. No.	Issue	Potential Approach
1	Fraud management: Monitoring and preventing AISP frauds and absorbing cost	Enforce uniform regulatory guidelines for fraud monitoring
2	Multi-factor authentication: Interpreting various standards	Mandate a single method to avoid varied interpretations Reduce complexity for integration
3	Integration with TPPs: Ensuring inter-operability across multiple TPPs	Define standard interfaces and security protocols across all European banks through a regulation
4	Cross border payments management: Ensuring modernization and transparency	Consider simplified APIs for cross border payments Standardize terms and conditions for all types of transactions
5	Settlements and reconciliation: Ensuring efficient settlement and reconciliation even with multi-fold increase in transaction volumes	Deploy sophisticated reconciliation systems with capability to interface with the clearing house Ensure costs are not passed on to retailers. Encourage them to promote 'pay by bank' to avoid scheme charges

Conclusion

PSD2 offers a huge opportunity for banks to re-imagine their digital transformation initiatives by streamlining operations, reducing time-to-market, exploring collaboration opportunities with new players, and gaining direct access to competing banks' customers. Banks should not strive to merely comply with the regulation, but embrace this opportunity to drive their digital transformation.

With its ability to address all anomalies and shortcomings of PSD, PSD2 is set to emerge as a game-changer. If enforced in all earnestness, PSD2 will prove to be a win-win for all stakeholders.

About The Authors

Prasad Hosadurga

Prasad Hosadurga is a Domain Consultant with the Cards and Payments Practice of the Banking and Financial Services (BFS) unit at Tata Consultancy Services (TCS). He has over two decades of experience in retail banking, credit cards, and core banking solution implementation. Hosadurga plays an active role in managing consulting and delivery engagements covering analysis, solution definition and design, and planning and implementation.

Subhendra Mohanty

Subhendra Mohanty is a Business Analyst with the Cards and Payments Practice of TCS' BFS business unit. He plays an active role in market research and consulting engagements. He has a Post Graduate Diploma in Management with specialization in Finance from Xavier Institute of Management and Entrepreneurship, Bangalore.

Contact

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Email: bfs.marketing@tcs.com

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