

# *Waiting until the Eleventh Hour*

European banks' reaction to PSD2





# Executive summary

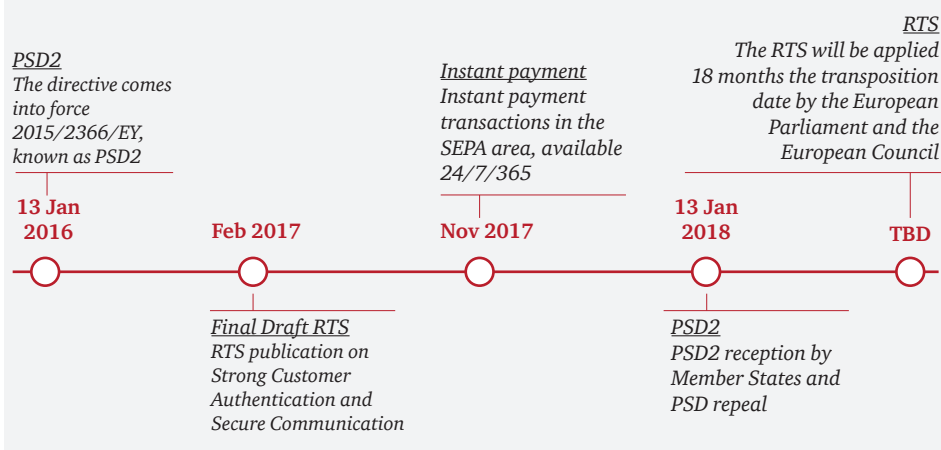
The revised Payments Services Directive (PSD2) goes into effect in Europe in January of 2018, but few banks are ready. By law they will need to make customer data available in a secure manner, and eventually to give third-parties access to their customer's accounts. But equally important to these compliance efforts are the strategic implications for banks.

How will they organize themselves and operate in a world of "open banking"? We designed our recent survey<sup>1</sup> - coming a year after our PSD2 report "[Catalyst or Threat](#)" - to better understand how well banks are advancing toward PSD2 compliance and the strategic direction they are choosing. Encouragingly, two out of three banks in this year's PwC survey say they want to leverage PSD2 to change their strategic positioning. To do so they will need to analyse the emerging payments landscape and identify new revenue opportunities for services, something most have yet to do. Indeed, despite the late hour, in the first half of 2017 38% of banks was still in the early stages of assessing the impact of PSD2. This figure is especially startling given that two-thirds of banks anticipate that PSD2 will affect all bank functions with numerous interdependencies with other regulations. The clock is ticking.

As part of our study, we identified several best practices that banks should follow to ensure they address PSD2 effectively and efficiently. Perhaps our most important finding is that banks should ensure their top management is part of developing a strategic response to open banking. Currently, strategic considerations are oftentimes a by-product of a PSD2 compliance project managed by IT and operations. Given the far-reaching impact we expect PSD2 to have, however, banks that take this approach will miss the opportunity to become powerful operators in the new world of open banking about to unfold.

## A PSD2 Primer

On October 8, 2015, the European Parliament adopted the revised Directive on Payment Services (PSD2) to make it easier, faster, and more secure for consumers to pay for goods and services by promoting innovation (especially by third-party providers), enhancing payment security, and standardizing payment systems across Europe. PSD2 uses three mechanisms to achieve these goals: First, it expands the regulatory purview of the European Union (E.U.) to include new kinds of providers, such as payment initiation and account information services. Second, it imposes limitations on transaction fees and stricter rules on refunds to lower transaction costs for consumers. Third, and the most disruptive, it requires European banks to open their payment infrastructure and customer data to third-party providers of financial services. In January 2016, the PSD2 directive came into force – and the clock started ticking. With less than six months left, banks are under increasing pressure to fulfill the PSD2 requirements.



## Methodology

In the first half of 2017 PwC and Strategy& analyzed banks' perception of PSD2 again. To capture the industry perspective, senior representatives of 39 leading banks in eighteen countries (Italy, Denmark, UK, France, Slovakia, Czech Republic, Belgium, Finland, Luxembourg, Poland, Ireland, Switzerland, Spain, Portugal, Germany, Netherlands, Austria and Norway) were interviewed. The findings were analyzed and evaluated by leading thinkers of the global PwC PSD2 center of excellence, which combines experts with regulatory, technology and strategy backgrounds.

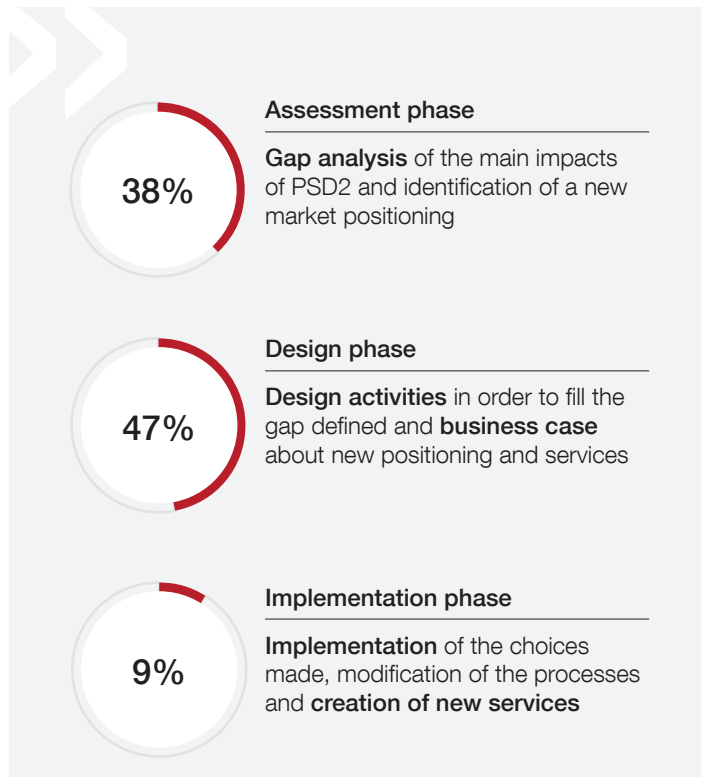
1 | Based on the interviews developed from April to July 2017

# A Lack of Readiness

The world is going to change radically for banks after January 2018 - but given the lack of readiness at many banks you wouldn't know it. That's the date when the revised Payments Services Directive (PSD2) goes into effect in Europe, the date when banks' monopoly over customer account information and payment services will cease. After that, banks must have the legal, operational and technological systems in place for strong customer authentication (SCA) so they can make customer data available in a secure manner. About 18 months later, banks must give third-parties access to their customers' accounts (XS2A), providing a definite end to banks' gatekeeper role of customer payment data (see sidebar 1 for a PSD2 timeline)<sup>2</sup>.

So the clock is ticking, with far reaching consequences. Not surprisingly, 94% of banks are currently working in some manner on PSD2, according to a survey we conducted of 39 senior executives in 18 European countries in the first quarter of 2017 (see sidebar 2 for more on our methodology). However, 38% of banks are still in the early stages of assessing the impact of PSD2 (see exhibit 1).

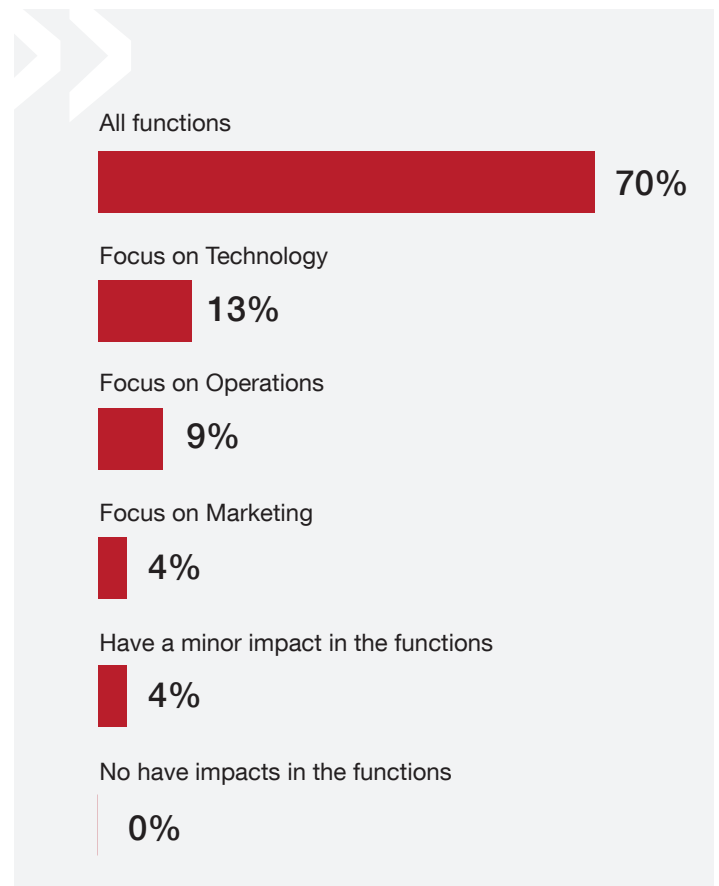
## Exhibit 1: Phase of the project<sup>3</sup>



These highlights present the situation in the first half of 2017, and just recently banks are boosting up to reach the minimum level of compliance in time for the due date of January 2018. A recent catch up with the main players shows that they are now moving from the assessment phase to the design and implementation phases.

The figure is especially startling given that two-thirds of banks anticipate that PSD2 will affect all bank functions, ranging from digital transformation to legal & compliance, IT and many others (see exhibit 2).

## Exhibit 2: PSD2's Wide Ranging Impact on banks' functions

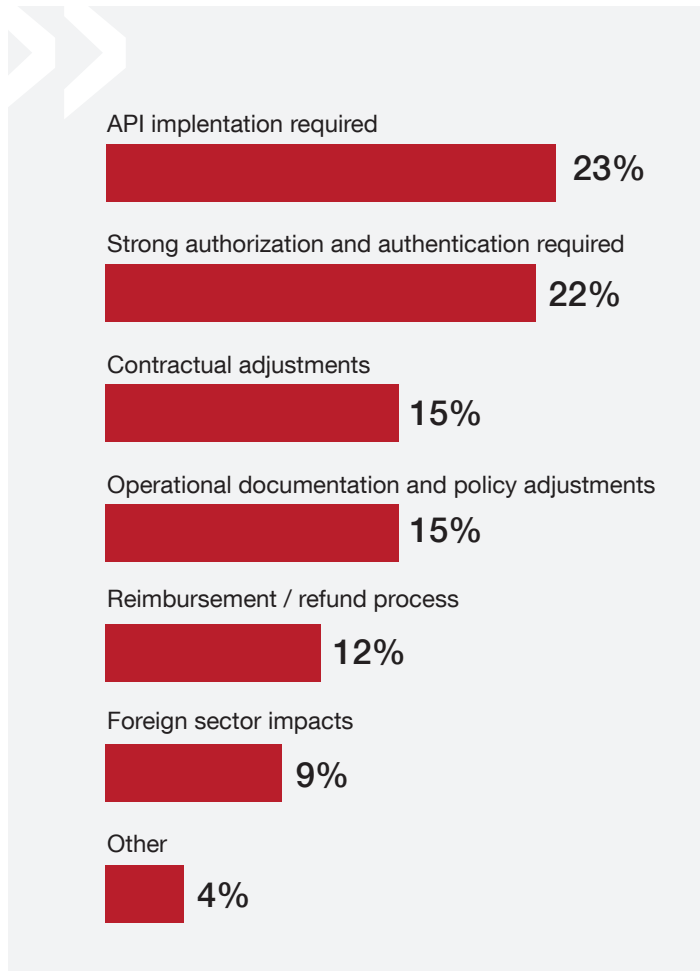


Most banks believe PSD2's impact will be wide-ranging, and also believe the main impact will involve new technology requirements (see exhibit 3).

2 | All member states must turn PSD2 into national law by January 2018. However, the European Banking Authority needs to define Regulatory Technical Standards (RTS). Some of these won't come into force until the beginning of 2019.

3 | 6 % of the answers referred to «Other»

### Exhibit 3: PSD2's Technology Impact

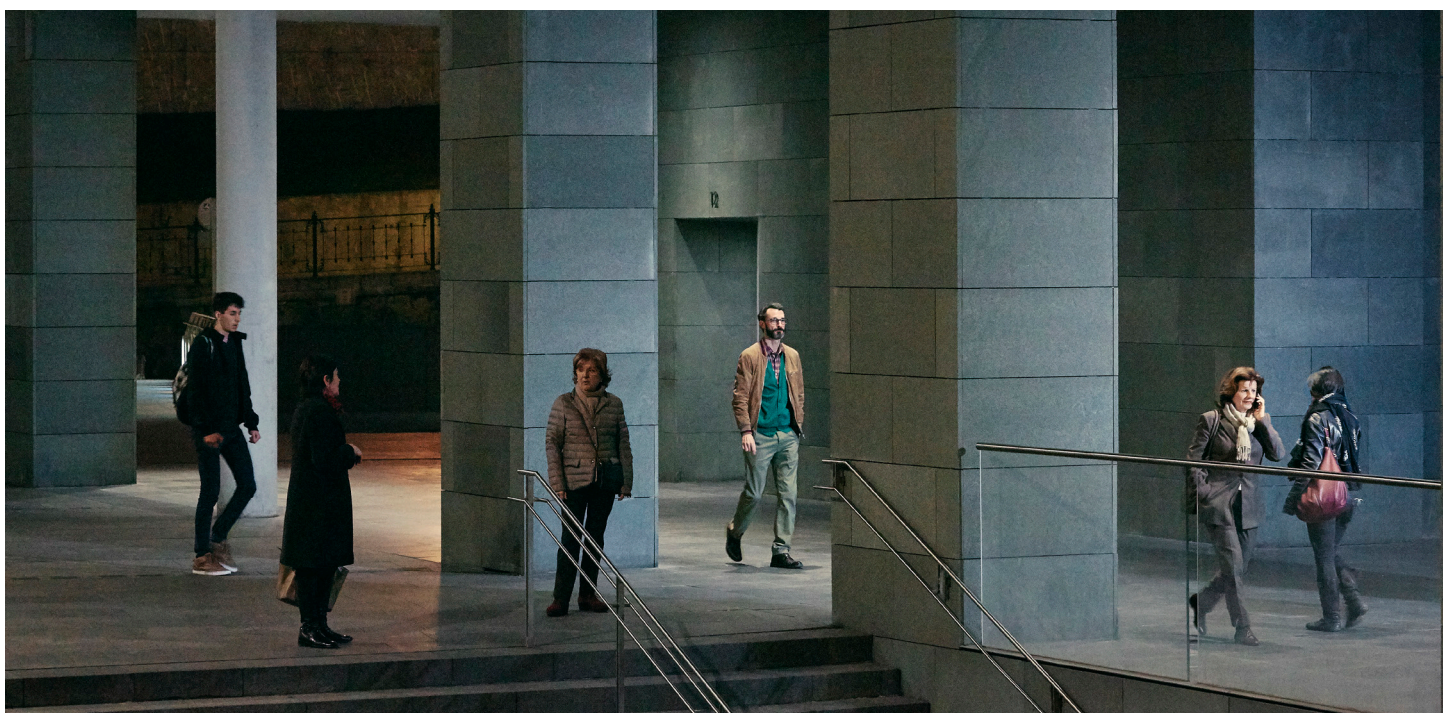


Moreover, PSD2 has numerous interdependencies with other regulations (such as the General Data Protection Regulation, GDPR, or e-Identity), promising a complex implementation with multiple stakeholders. For many banks, compliance by 2018 will be a challenge.

But mere compliance - though challenging in itself - cannot be banks' only concern. As of today, few banks have experience granting third parties access to customer data or payment functionality via application programming interfaces, so-called APIs. According to our survey, such data and functionality sharing, commonly referred to as "open banking", is currently pursued by only 47% of banks.

That's understandable given the competitive risks associated with opening data to third parties. Banks need a proper strategic response to avoid becoming disintermediated by more customer-oriented third-party offerings. Further, real revenues are at stake, such as the lucrative card business, since third-party providers could offer low-cost "payment initiation services" to compete for that business.

The bottom line is that it's time for banks to move beyond talk and analysis to take decisive steps. Based on these insights, we have identified steps for tackling the PSD2 challenge in the months ahead.



# New Business Models

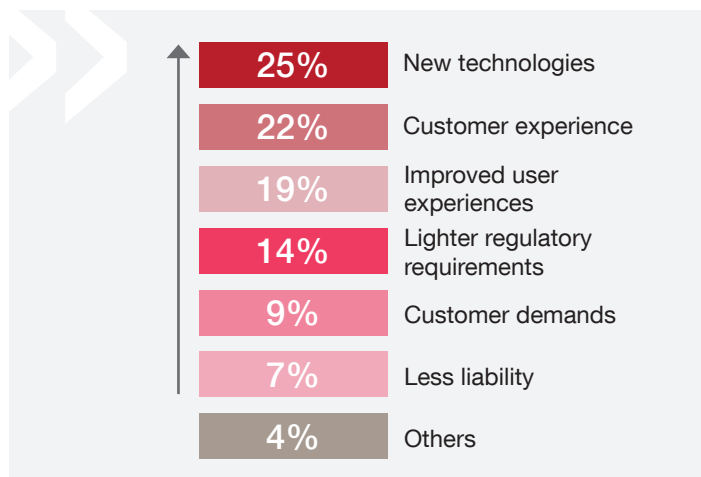
Encouragingly, two out of three banks in this year’s study say they want to leverage PSD2 to change their strategic positioning.

To change their strategic positioning, banks will need to analyse the emerging payments landscape bearing in mind their main strengths as well as the main strengths of the many FinTech players (see exhibit 4).

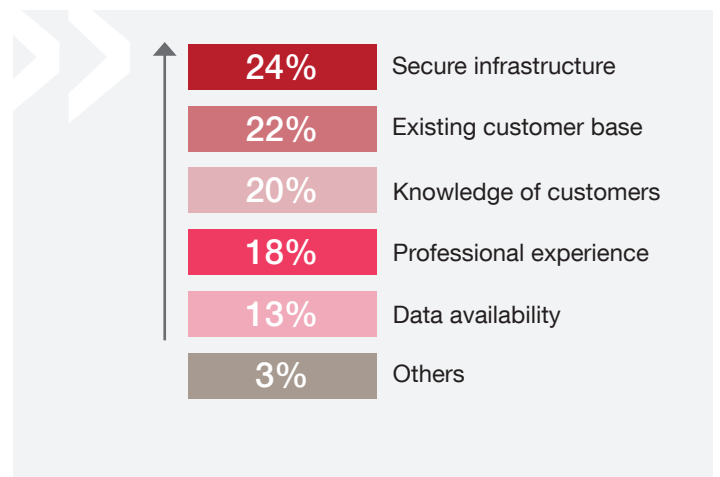
They can then begin to identify new revenue opportunities for services, such as AISPs (Account Information Service Providers), PISPs (Payment Initiation Service Providers), and CISPs (Card-based Payments Instruments Issuers), and consider new business models.

## Exhibit 4:

**Which are the FinTech’s main strengths according to respondents?**



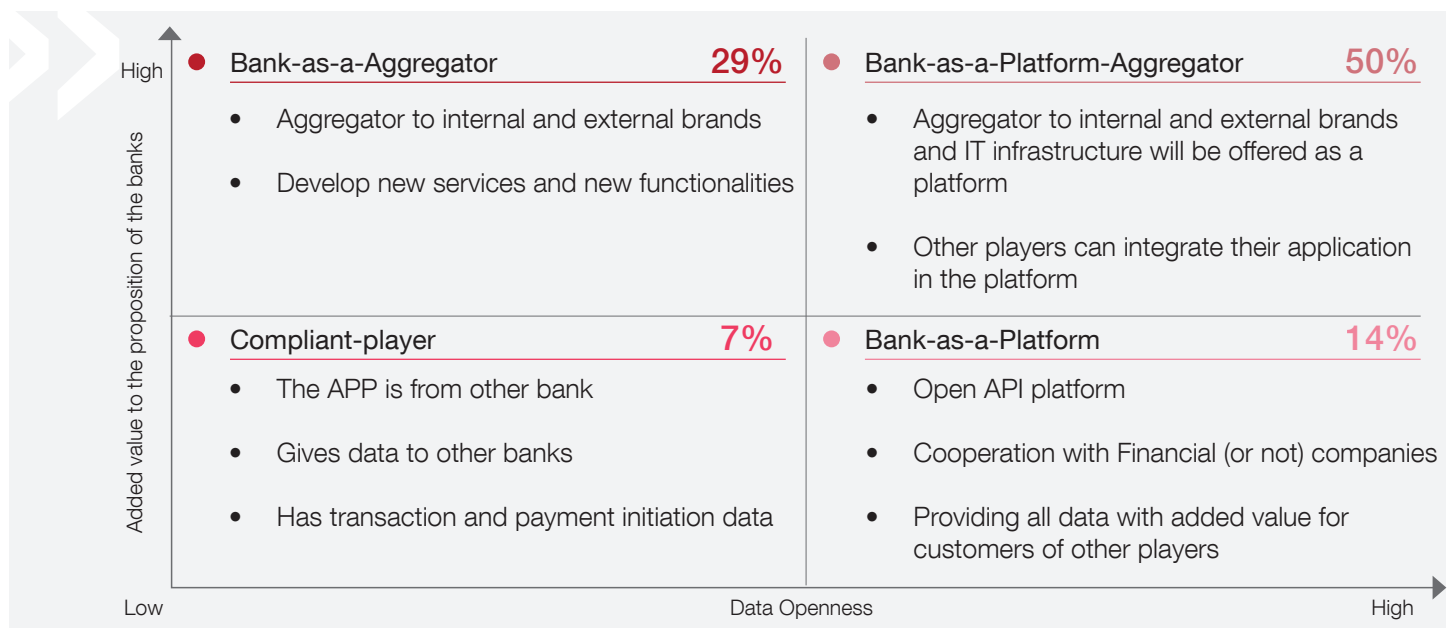
**Which are the Banks’ main strengths according to respondents?**



In our survey, we also asked banks about their preference among four types of emerging business models (see Exhibit 5).

## Exhibit 5:

**Which strategic positioning are Banks aiming to achieve in the long term?<sup>4</sup>**



4 | See Nutshell number 5 “Roles for Banks and payment operators. How the scenario might evolve in the future” <http://www.pwc.com/it/en/industries/banking/assets/docs/psd2-nutshell-n05.pdf>

As Exhibit 5 shows, half of banks aspire to be a platform aggregator, which would mean developing an open platform that allows partners to integrate their products and services into the bank's offering while providing an open platform for generating new products and services based on the bank's API and data. Any bank that could achieve this would be a powerful operator. However, the reality is that only a handful of large banks could reasonably expect to build a truly powerful partner ecosystem.

In fact, we doubt that many third parties will be willing to connect to multiple banks as long as there is no common API standard across Europe. Third parties will instead turn to data consolidators to accomplish this cumbersome job for them. Only those banks that are important enough due to their size, that offer attractive, value-adding APIs (which are considered a business by themselves) or that are a compelling strategic partner will be attractive to third parties.

Given this reality, banks need to perform a rigorous self-assessment as they transition to the world of opening banking, including their market positioning and competitive strengths. Further, they need to analyze their products and services portfolio and determine their disintermediation risk for each product and service they offer. Additionally, factors such as capital requirements and various risks (such as operational and IT risks) might need to be analyzed to determine in which areas and how actively a bank should push an open banking approach.

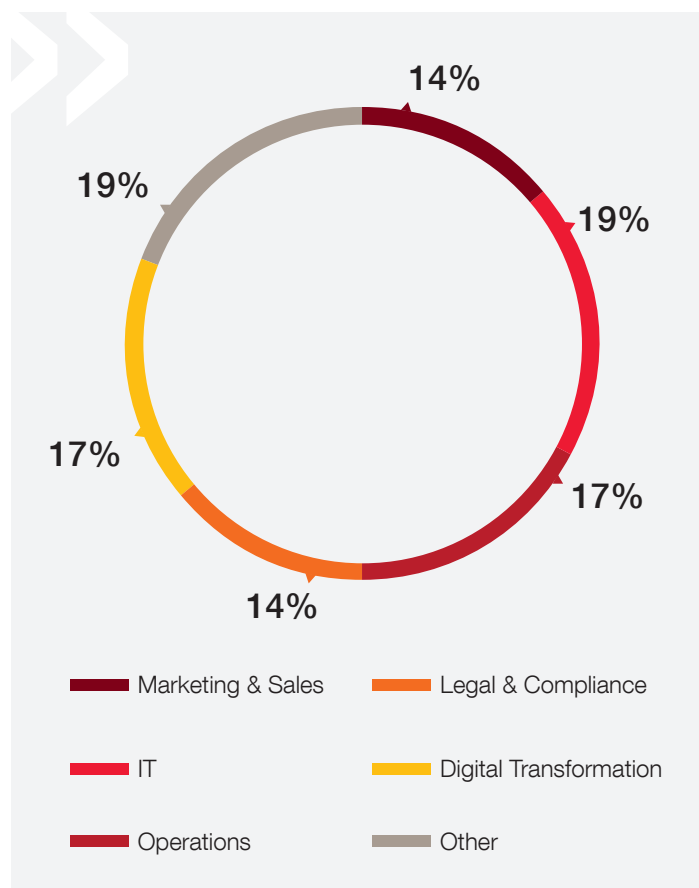
Based on this assessment, banks can define their desired open-banking footprint. They should maintain or develop internal capabilities for products and services they deem "core" to their value proposition, but they might turn to third-parties for ancillary offerings. Taken to one extreme, a bank might decide that its value add lies in curating the best products for their customers and on ensuring a flawless bank backbone. In such a scenario, the bank's open-banking strategy might be to act as a product aggregator with a compelling client interface that provides one-stop-access to superior, third-party products.

However, although half the banks named "platform aggregator" as their business model preference, very few are moving decisively in this direction and fewer still have undergone the rigorous strategic analysis described above. Based on our interviews, our suspicion is that many banks named this option by default as a way to keep their options open and postpone making a "definite" strategic decision.

Without acknowledging it, most banks are actually in a wait-and-see mode, perhaps focusing on compliance and a few short-term tactical moves (such as collaborating with a couple of FinTech without an overarching strategy).

So why is there a lack of strategic direction at this late hour? One reason may be that PSD2 is still a "niche topic" at many banks. About half say their PSD2 project is driven by IT, Operations or Legal & Compliance alongside other compliance projects that rarely get the attention of top management (see exhibit 6). As a result, we expect that in most cases PSD2 is not included in banks' strategy discussions.

**Exhibit 6:**  
**Areas of the Bank that are Driving PSD2**



# The Path Forward

The main challenge for banks is that PSD2 requires action on two fronts. On the one hand, banks need to ensure compliance by January 2018, and on the other hand they need to adapt their strategies to stay competitive, which at most banks is likely to lead to long-term, profound changes to the business model. To manage these two aspects of PSD2, we recommend separating compliance efforts from strategic initiatives. Banks can and probably should pursue both in parallel but keep them separate and led by different inter-disciplinary teams. With this in mind, we have identified the following best practices.

## Compliance Best Practices

- **Understand your path to compliance**  
Conduct a gap analysis to identify the areas PSD2 impacts, bearing in mind PSD2's two main milestones. The first is January 2018, relevant for legal, operational and technological compliance for strong customer authentication (SCA). The second milestone - the requirement to provide access to accounts (XS2A) - comes into force 18 months later. In our experience, tech, legal and operations experience the most impact. For each of these areas, assess the path to compliance by mapping PSD2 requirements with the status quo. The most successful banks appoint a small, multi-disciplinary team to perform these tasks.
- **Mapping Customer Journeys**  
In our experience, the best way to understand how the operating model must change is to start by mapping key PSD2 customer journeys and processes. This mapping should involve all stakeholders, such as representatives from client businesses, operations, IT and legal. This inclusion creates transparency into the process, IT impact and functional interdependencies.
- **Use hypotheses when final rules are not known**  
Detailed (technical) requirements for several elements of PSD2 are still not available. In these cases, we recommend that inter-disciplinary teams take a hypotheses-driven approach that factors in industry expectations, as well as the bank's own discussions with authorities.
- **Identify particularly critical elements**  
In most regulatory implementations there are certain elements that are especially critical (e.g., due to short lead times). By comparing the new PSD2 operating model with the status quo, banks can define necessary changes and assess required implementation efforts. Typically, SCA and API implementations, as well as the refunds process and the value date change require special attention.

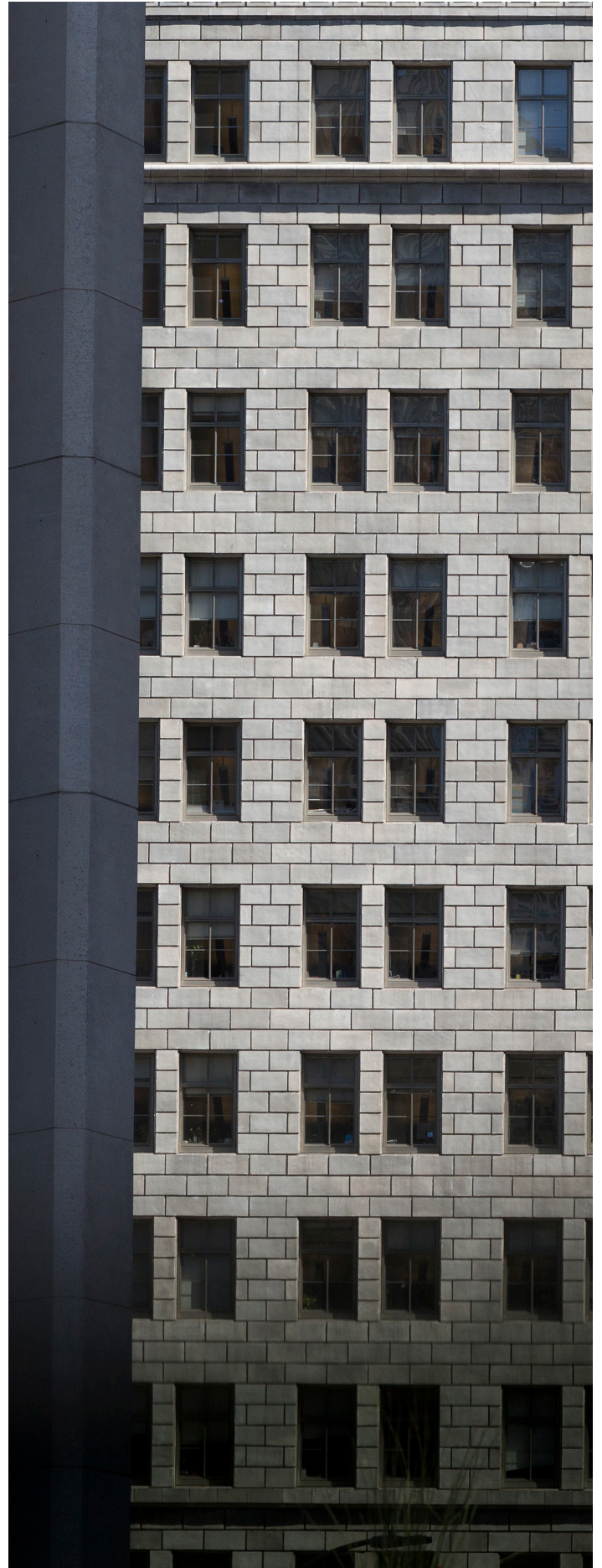
## Strategy Best Practices

- **Involvement of senior leadership**  
Unlike the compliance aspect of PSD2, senior leaders need to be deeply involved in the strategic discussions about open banking in 2018 and beyond. Given that PSD2 will usher in a new era of data sharing and usage, very top level bank executives should not rush through the strategic assessment as a mere agenda item to becoming PSD2 compliant, rather they should take the time to develop a thorough understanding of the implications of open banking in order to set a robust strategic direction.
- **Create a dedicated team**  
Compliance projects are typically large and run by project managers focused on implementation details; by comparison, strategic development is better served by a small, visionary team looking at the big picture. Creating this small project team also helps prevent the strategy aspects of PSD2 from getting lost in compliance.
- **Integrated planning**  
While compliance and strategy can run in parallel, leaders must ensure they don't work in contradiction. By taking an integrated planning approach that maps key milestones for all compliance and strategic efforts, leaders can align both sets of requirements before crossing "points of no return".
- **Explore new frontiers**  
Regulatory changes could be creating the conditions to an Open Banking scenario and trigger an increase in market competition. Banks should consider using PSD2 as an opportunity as an Open Banking environment unlocks new opportunities and revenue streams alongside the traditional offerings delivered through Third Party ecosystem. In fact, some advanced banks have already adopted new models and threaten traditional banks with innovative business models and customer propositions.



For many banks, becoming PSD2 compliant will (and must) be the priority in the coming weeks and months. Still, since strategic planning cannot be ignored banks might be tempted to have the same team handle both aspects of the implementation.

A small, visionary team--empowered by senior leadership--can keep the bank from falling into strategic paralysis. By daring to ask themselves what their role will be in an increasingly interconnected, data driven world, banks can avoid being trapped in a “wait-and-see” mode, and might become powerful operators in the new digital reality about to unfold. Competition is expected to increase. So, it is up to the banks to define their strategic response to shape a future of open banking, or risk being left behind with few alternatives left.



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