A FINEXTRA RESEARCH SURVEY

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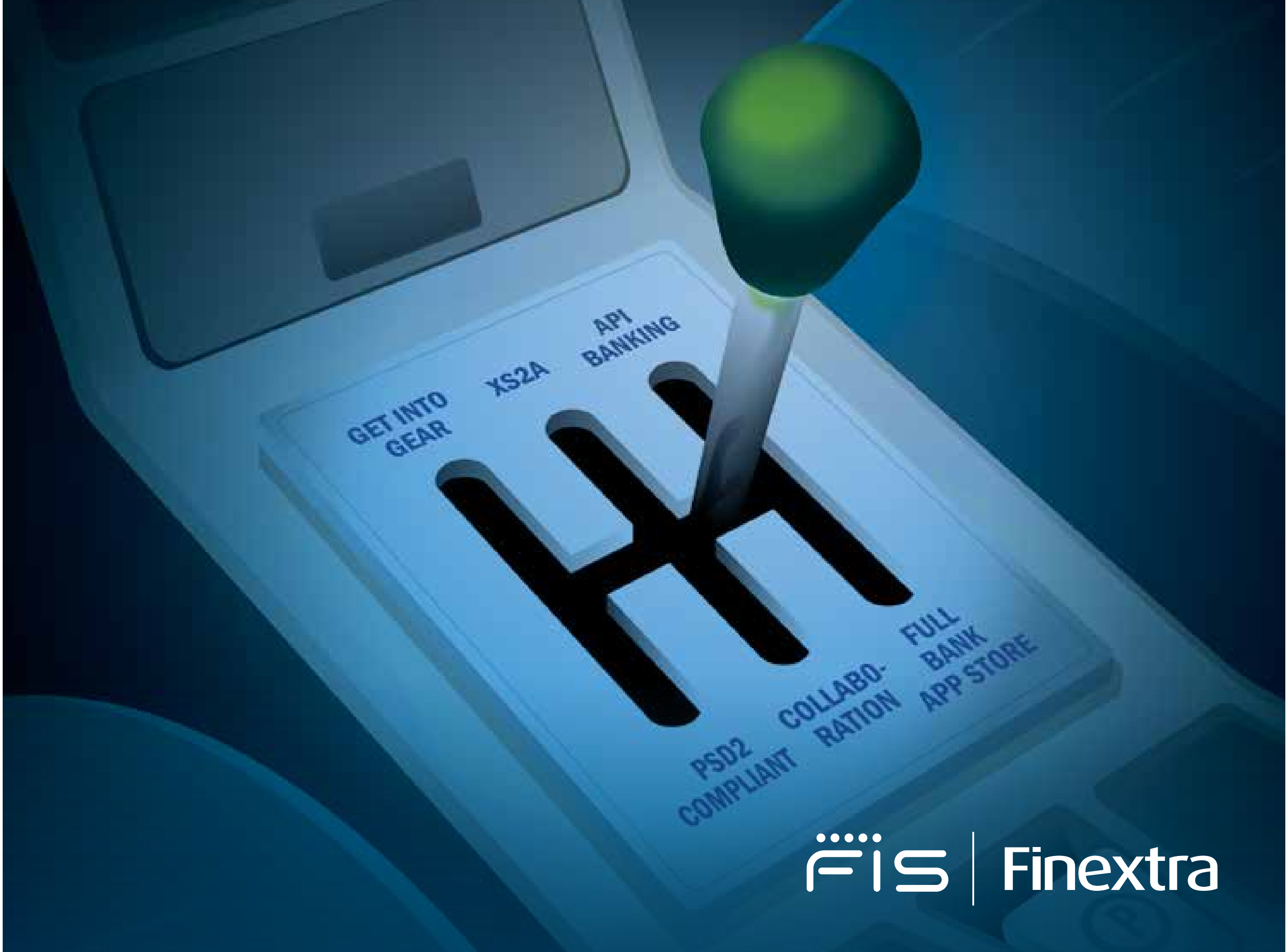
MAY 2015

PSD2 AND XS2A – REGULATION OR OPPORTUNITY?

REPORT ON A SURVEY BY FINEXTRA AND FIS



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01 INTRODUCTION

1:1 Finextra

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1:2 FIS

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02
EXECUTIVE SUMMARY

2:1 The next steps in European payments regulation

This survey conducted by Finextra in March and April 2015 targeted financial institutions worldwide to take a snapshot of how banks in Europe are reacting to the Payment Services Directive 2 (PSD2), and what other banks worldwide think about some of the related trends in open access and payments innovation that underpin it.

PSD2 is a work-in-progress European regulation that will impact financial institutions already operating within the scope of the Payment Services Directive of 2009, but also extends to operators of e-commerce marketplaces, gift card and loyalty schemes, bill payment service providers, public communication networks, account access services, mobile wallets and anyone who receives payment by direct debit.

PSD2 has been the subject of consultation and debate within the European Commission since 2013. Negotiation and compromise revisions extended until January 2015, and the regulation is now expected to be passed by European Parliament sometime in 2015 and then transposed into national regulations across the region from 2016.

The new directive seeks to extend and clarify some of the provisions of the first directive, while also fostering payment innovation, particularly in mobile, and harmonising some of the national interpretations. Key elements of the directive include opening access across the industry to payment processing services, as well as to the customer accounts held by banks.

It recognises a market demand for payment service providers (PSPs) granting third parties access to their online payment services in a regulated and secure way. This is Third Party Payment (TPP) service provision in the directive's terminology. Also, under the 'Access to Accounts' (XS2A) rule, it will force banks to facilitate access via API to their customer accounts and provide account information to third party apps if the account holder wishes to do so.

This creates a range of new service opportunities for new entrants, but also for the banks themselves – and this goes way beyond compliance.

The PSD2 doesn't just affect banks. And the non-bank financial organisations impacted by the directive are very likely to have different views about how it should be implemented and what action they will take. But this survey focuses on the banks' perspective – their awareness, concerns, hopes and plans for their future in the evolving (European) payments landscape.

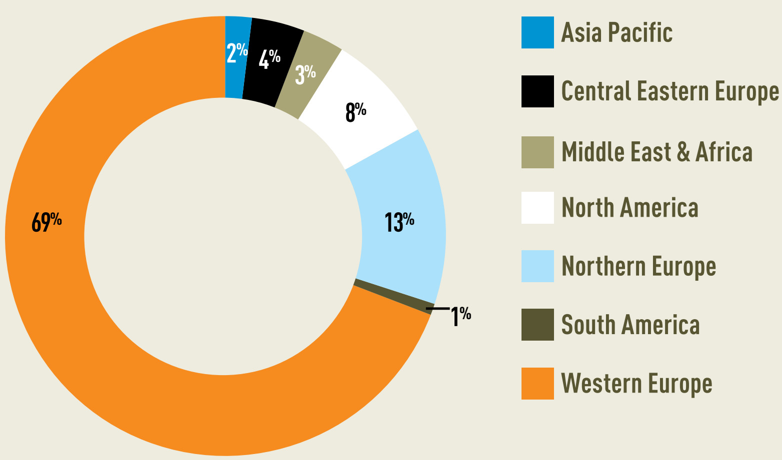
Key findings:

- More than half of banks are rethinking retail banking customer relationships and revenue models. But in Europe when it comes to PSD2, only 37% of respondents are confident that all relevant parts of their organisation have an appropriate understanding of the directive and its implications.
- Both big established non-bank players and new entrants are a concern for banks as competition increases due to regulation and other disintermediation trends. But only 20% of respondents were sure that new entrants coming into the market on the back of PSD2 would pose a competitive threat right away.
- Security is the biggest concern about the XS2A rule, with 88% agreeing strongly that data protection and risk to reputation are significant issues yet to be dealt with. There was also demand for issues around liability to be further spelled out by the directive, with 60% agreeing or completely agreeing that ambiguity in this area concerned them.
- Compliance programmes are only now being kicked off in earnest at many banks, and a step-by-step compliance approach is being adopted. Teams who worked on SEPA compliance are being moved onto PSD2 projects, but a majority of banks will also turn to external partners for help with developing APIs, security layers and app stores as well as new business processes and product development.
- With no hard deadlines in place, and more details on the implementation of PSD2 to be agreed, only 14% of banks were confident that on 'day one' they would have APIs in place to support open access. But 65% of banks said they wanted to create their own app store, with PSD2's access requirements as the launching pad.

03
ABOUT THIS SURVEY

3:1 About this survey

fig 1: **GEOGRAPHICAL DISTRIBUTION**



Respondents: 103

We used a six-point Likert scale to get respondents to show their level of agreement or disagreement with a number of statements about their business grouped under five themes – awareness of the Payment Services Directive 2 and its implications, the threat of non-bank competitors and new entrants, concerns about Access2Account, current compliance progress and resource allocation and whether banks are moving towards an open-API model for their business, including app stores.

Throughout the analysis we have paid more attention to those who felt strongly either way, discounting those more neutral respondents who selected slightly agree or slightly disagree.

We received 103 responses from 64 different financial organisations and 28 countries. Where multiple responses came from a single large financial group they were frequently from different geographies or business units -- e.g. cards, retail, or transaction banking. 69% of respondents came from Western Europe, 13% from Northern Europe and 4% from Central and Eastern Europe, with the remainder spread worldwide. Where regional differences in responses were apparent, this has been noted in the analysis.

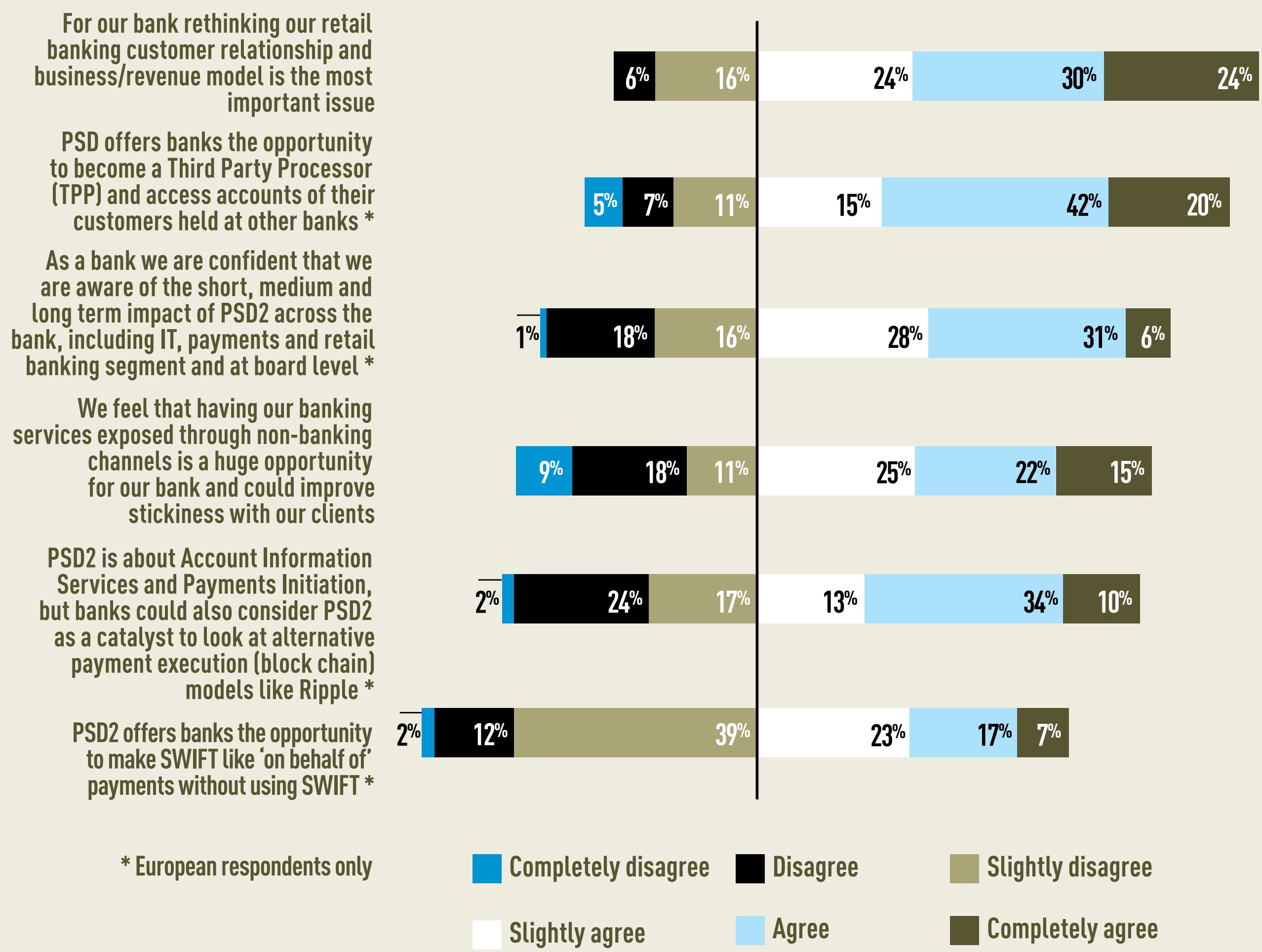
While some respondents were from financial institutions with no operations in European countries that come under the remit of PSD2-based regulation, their responses have been included in analysis of those questions pertaining to general industry trends, as compliance projects do have knock-on effects of changing accepted best practice and banking business models worldwide. These respondents have been removed from analysis of questions that asked directly about compliance with specific elements of the regulation, to paint a truer picture of PSD2's impact.

Sample job titles:
- COO
- CIO
- Global Head Regulatory
- Head of Transaction Banking
- Global Cash Management -Head of SEPA offering
- Head of Innovation Strategy
- Director of Payment Services
- Chief Enterpise Architect
- Chief Information Security Officer
- Head of Fraud
- Head of Banking Market
- Manager - Payments systems
- Sr. Director of Brand Marketing
- Head, Payments Infrastructure
- Head of Product - International Payments
- Operations Director
- Head of Banking Partners

04
IMPACT AND AWARENESS OF PSD2

4:1 The next step in European payments regulation

fig 2: **IMPACT AND AWARENESS OF PSD2**
MORE THAN HALF OF BANKS ARE RETHINKING CUSTOMER RELATIONSHIPS AND REVENUE MODELS



Why is the PSD2 regulation an opportunity?

"Under the PSD2 legislation banks must allow access to any TTP. The interesting question here is who will be the TTP? Surely not only the feared new market entrants. Banks could also act as a service provider through the TTP network to other smaller banks who want to offer a broad range of payment services to their clients, and as such invent a 'correspondent banking model LIGHT for 'on-behalf of payments'. Banks could also act as an aggregator or better said concierge to offer a range of additional services to their customers through their current account. Think of advanced seat bookings for preferred clients, hotel and open table bookings. Last but not least, history has taught us that although banks are positioned at the heart of their customer's life, in practice it is very hard to be both manufacturer of the right solutions and products as well as distributor and most importantly service provider. Banks are simply not able to get 'cool and niche' solutions to them at the speed fintech companies can. Under the new legislation, the real opportunity is to collaborate with customers and partners to create an app store with the ensuing loyalty, without having to build it all, maintain it all and stay at the innovative edge."

Mark Hartley, Global Strategic Investments, FIS

According to our survey, among European banks there is widespread awareness that banks themselves could become a third-party service provider in this model, accessing the accounts of their customers held at other institutions and providing an aggregation service, for example. 62% agreed or completely agreed with this statement. But 12% disagreed or completely disagreed, indicating either they are not aware of this possibility, or are definite that going down this route would not be appropriate or feasible for their organisation.

Far fewer organisations (37%) were confident that having their own banking services exposed by other non-banking channels could benefit them by improving stickiness with customers, with an aggregate positive score for this of 78%. For example, a customer might be less likely to switch current account providers to chase a better mobile experience or app at a different bank if their current account can just be accessed by a range of overlay services, including those from other banks.

54% of all respondents agreed or completely agreed that they are in the process of rethinking their retail banking customer relationship and revenue/business model, with an aggregate positive score for this of 78%. In Europe, PSD2 is an obvious catalyst for this, particularly coming on the back of previous regulation such as SEPA which paved the way for greater cross-border business models within the region. But in other parts of the world too, the ubiquity of mobile devices and trends in digital service delivery across other industries such as telecommunications are forcing the banking sector to adapt. And adapting means a totally different mindset: from channel to access, from integrating to opening up.

4.2 Do banks understand the requirements and implications for new service delivery?

Confidence that the short, medium and long-term impact of PSD2 is understood across banks is not particularly high, which could be a concern with the first transposition of the EU directive into national regulation possibly coming as soon as 2016. Only 37% of European banks agreed or completely agreed that understanding was high across all of their IT, payments and retail banking units and at board level.

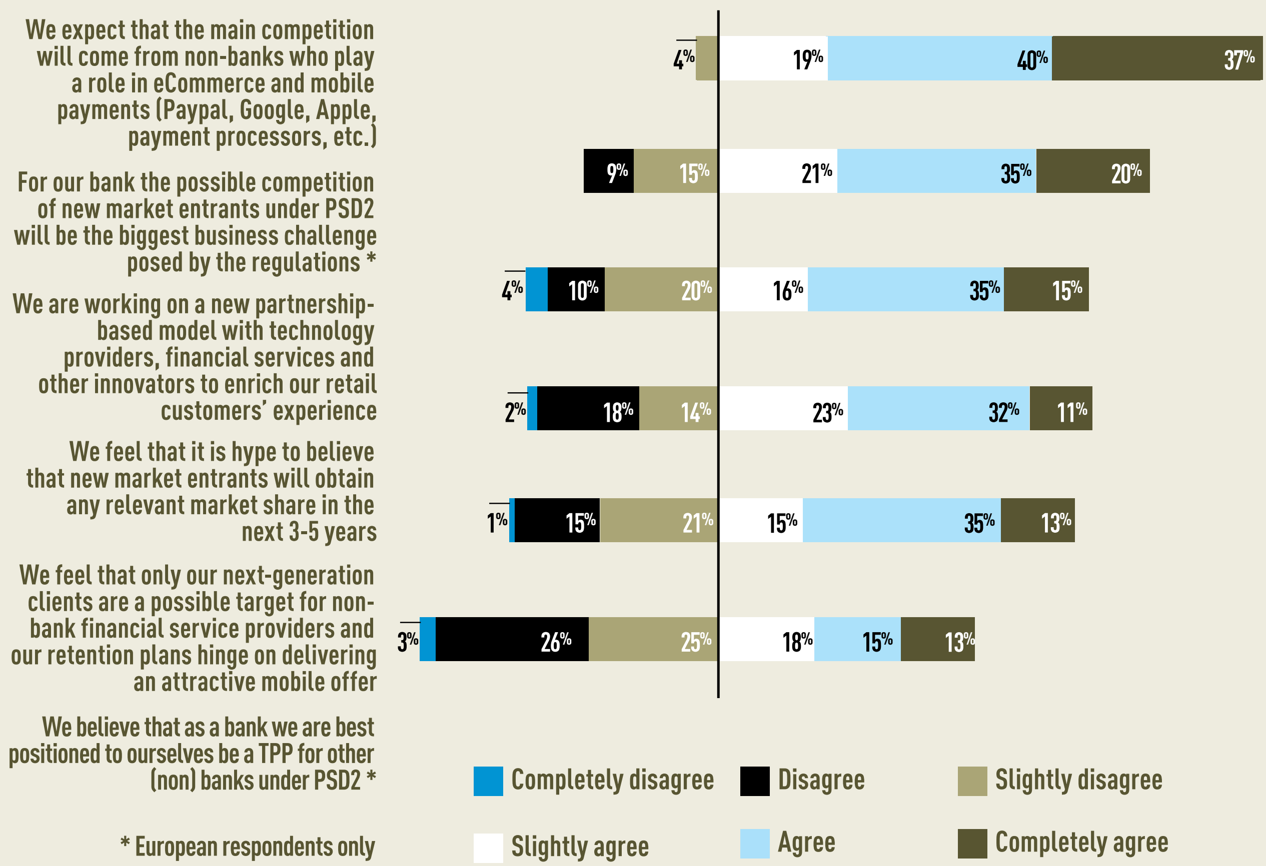
But 44% were confident that it would enable them to pursue alternative payment models in future, using innovative foundation technology such as the blockchain transaction ledger pioneered by Bitcoin, which could remove the need for centralised third-party payment processors.

A smaller number of organisations (24%) were in strong agreement that they would be able to conduct SWIFT-like 'on behalf of' transactions without using the SWIFT network. An aggregate negative of 53% disagreed with this statement. But these are just some examples of the range of payment models that could be developed on the basis of provisions in the PSD2, and as indicated by the low confidence in total understanding of the directive's implications, there are many possibilities that have just not yet been considered by banks.

05
NEW MARKET ENTRANTS – FEND OFF OR EMBRACE?

5.1 The elephants already in the room

fig 3: **NEW MARKET ENTRANTS - FEND OFF OR EMBRACE?
BOTH ESTABLISHED NON-BANK PLAYERS AND NEW ENTRANTS ARE A CONCERN FOR BANKS**



* European respondents only

What do banks need to do to become good partners to their app co-creators in an open API banking ecosystem?

"Established banks are wary of newcomers, as figure 3 illustrates, but they equally do have all it takes to minimise the intrinsically high failure likelihood of a start-up. Attractive partnerships that enable and support a higher satisfaction ratio on the customer side take out operational risk and help to evolve the business towards a new and open model. In return, models need to be defined between partners regarding stake holdings, growth participation etc. A key success factor is to provide the right incentives in an ecosystem to the advantage of all participants."

Hans Kraus, CEO Central & Eastern Europe, Capco

Existing non-bank players in mobile payments and e-commerce are seen as a bigger threat to banks than new start-ups, and with the likes of Apple, Google, PayPal and others holding balance sheets and new product development budgets that some banks could only dream of, this isn't surprising. 77% of respondents agreed or completely agreed that their main competition in future will come from this provider segment.

55% were sure that significant competition would also come from new entrants, often start-ups, enabled by the open access rules of PSD2, to act as payment intermediaries and deliver other innovative services on top of existing bank accounts and infrastructure.

While banks are concerned with the competitive threat, not all see it as a short-term danger. 43% felt strongly that it is hype that new market entrants could achieve any relevant market share within three to five years, while 20% strongly believe they could be a threat within this timeframe.

Perhaps relying on customer inertia and brand stickiness, 48% felt strongly that it would only be their next-generation customers at risk of being poached.

5.2 Mobile channel and partnerships to the rescue

In the face of competitive threats, what are the banks planning to do? Delivering an attractive mobile offer is a key component. But some banks are realising that doing everything themselves within their traditional bank structure will not give them the best chance of success. Instead they are increasingly looking to use partnership-based models, with other financial services providers, innovative start-ups that they mentor and/or fund, and technology providers. 50% of all respondents agreed or completely agreed that their banks is taking this approach to enrich their customer proposition, attract new customers and retain existing ones.

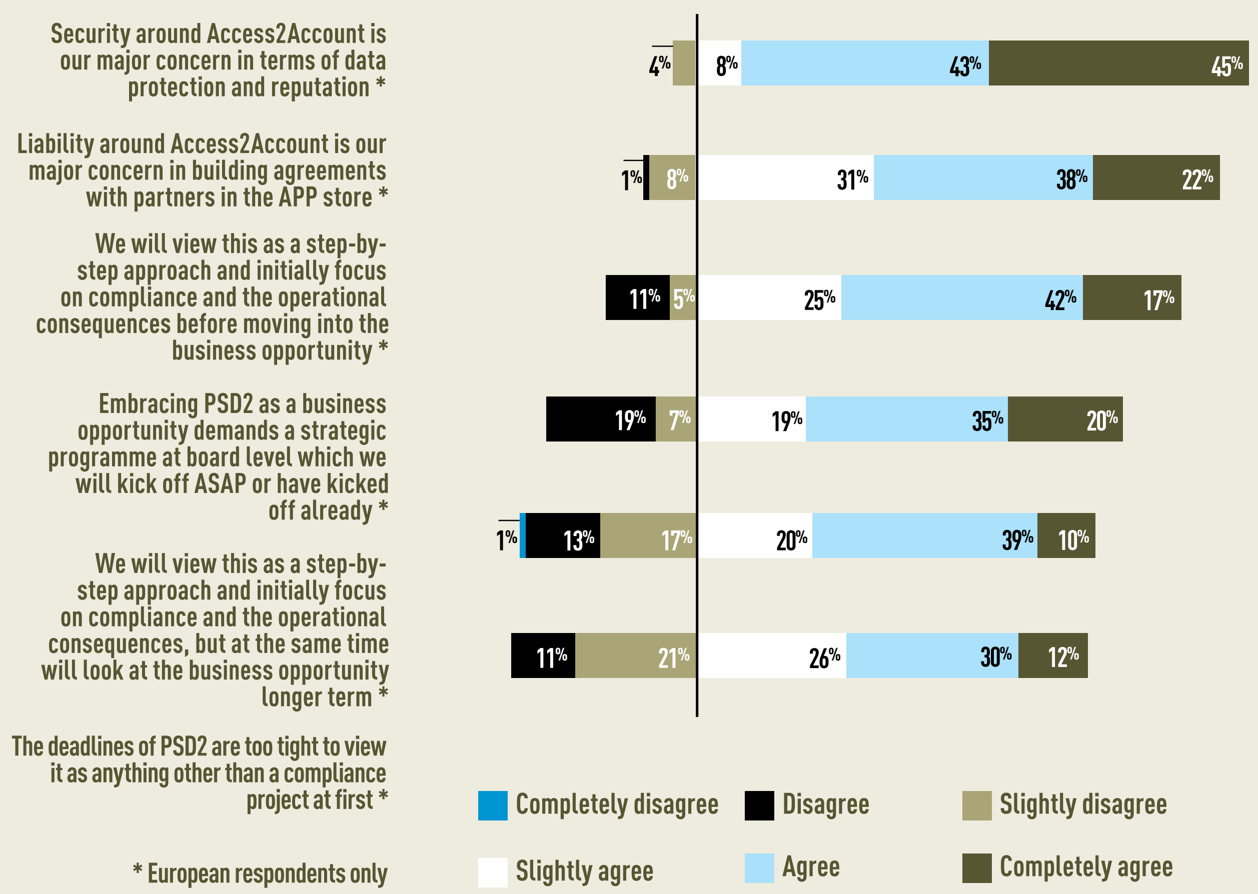
But a smaller number of European banks expected that this collaborative approach would extend to them being best placed to act as a TPP service provider for other non-banks under the directive. Only 28% of respondents were confident that this is something that would benefit their bank.

06

XS2A – COMPLIANCE OR BUSINESS OPPORTUNITY?

6.1 Opening up, while staying locked down

fig 4: XS2A - COMPLIANCE OR BUSINESS OPPORTUNITY?
SECURITY AND LIABILITY ARE CONCERNS, BUT MOST BANKS ARE LOOKING FOR OPPORTUNITIES



What needs to happen for the security issues to be addressed safely and efficiently?

"One of the stimulants of the XS2A legislation is that it is already being provided by a number of third parties, albeit through an informal, unregulated process. One of the problems with the current providers is the way they access client information by encouraging customers to disclose or share their credentials with them. The two opposing schools of thought are that this is either causing customers to breach their T&Cs with their bank or not. Either way, few would dispute that a better, more secure way would be to provide access through APIs. The PSD2 is not clear about the method for optimal security, the debate still sways between prescriptive solutions versus guidelines and for many reasons we would suggest that the European Banking Authority (EBA), should opt for the latter. The account holder (and thus the bank) as well as the TTP needs to be able to authenticate the user. At the moment the draft legislation focuses merely on the TTP and the bank and TTP are not allowed a contract with one another. This is a major concern for banks in terms of the liability chain and it unfairly puts the onus on banks holding the account on behalf of the customer even though they cannot even validate whether the individual customer has given the TTP access."

"Perhaps a more important note for the EBA who is chartered with either providing a prescriptive technical solution or, hopefully, a set of guidelines, is that the debate around whether credential sharing or overlays should be allowed is moot We should be looking forward into the short term future where IDs, passwords and credentials will be a thing of the past. The EBA should most definitely focus on guidelines that allow innovation to occur whilst ensuring the solutions are secure and usable. We are living in an age of biometrics, behavioural analytics and social media rather than an age of IDs and passwords. To reiterate my previous point on APIs, few would dispute that there are safer, securer and more customer friendly solutions out there today than ID and passwords, and certainly there will be in the future. Let's make sure the EBA is properly informed and we as an industry should push for guidelines rather than a prescriptive outdated technical solution."

Mark Hartley, Global Strategic Investments, FIS

Whenever a bank has to deal with external parties, security is quite rightly at the forefront of their thinking. And when this interaction with third parties can take place without specific bilateral contracts and jointly developed integration, it is even more critical. Under the XS2A service requirements, European banks must create an API structure that any company registered with a 'competent authority' and with the consent of the bank customer, can tap into to provide a service. 88% of respondents feel strongly that security around their data integration points is a major concern.

PSD2 itself contains a number of specific requirements for strong customer authentication and internal controls. But payment service providers will also be subject to the Network and Information Security Directive, including risk management and incident reporting obligations. This further complicates the compliance scenario and project scope, even though the requirement for the utmost security in this area should be self-evident.

Because the access is so open, the question of how to manage liability has been recurrent through the directive's gestation in the European bureaucracy since 2013. The latest draft of the directive states that the account provider is liable to restore the funds to the payer in the event of an unauthorised payment, even if a payment initiation service provider, accessing under XS2A rules, was involved. There is recognition that the initiation provider could, as a result, owe the account provider compensation, and further details on burden of proof and claims procedures are described. But although the liability scenarios have become more concrete, this area is still a major concern for banks, with 60% agreeing or strongly agreeing that this is a major issue in providing access to partners.

6.2 How are banks looking for new business opportunities?

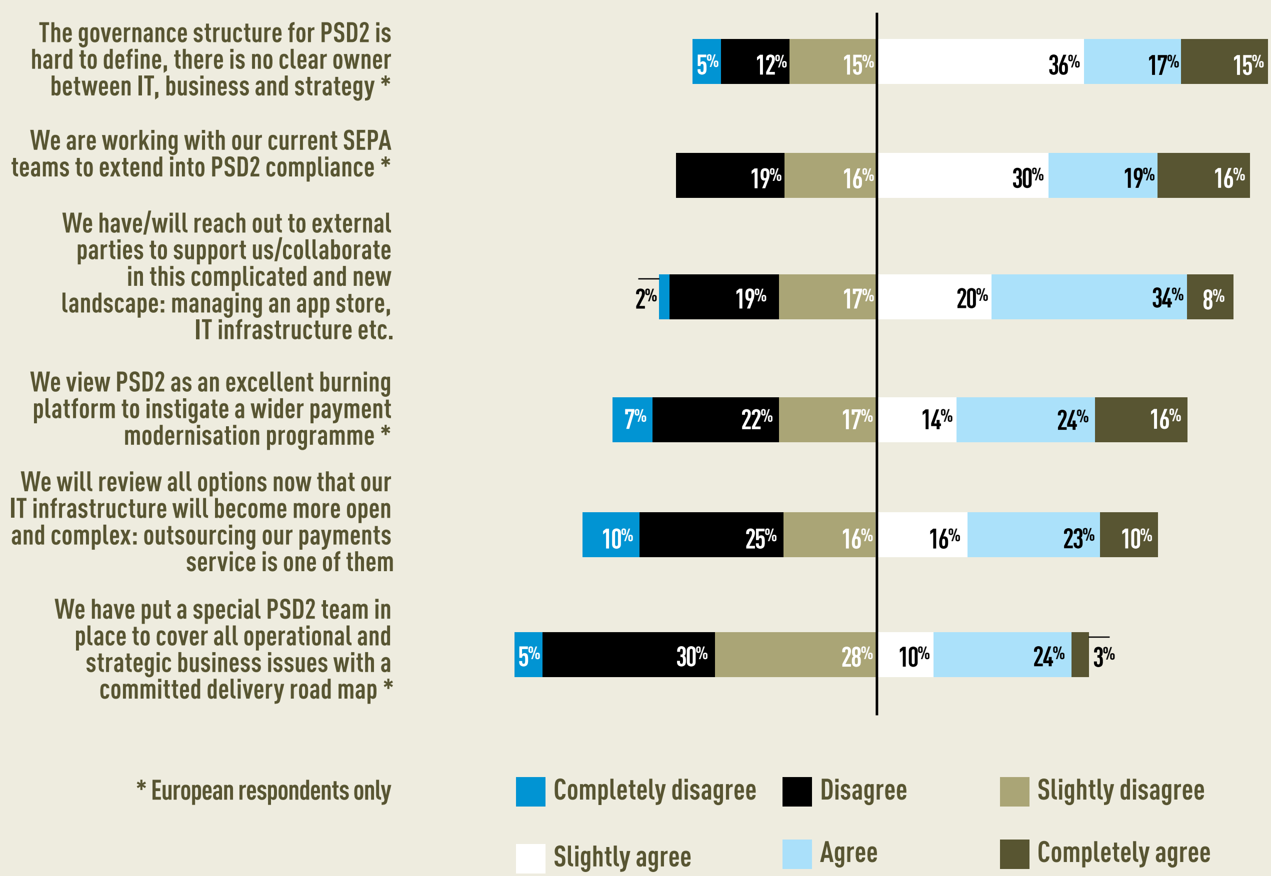
Aside from concerns about specific service requirements under the directive, the majority of banks say they are taking a step-by-step approach to compliance, while simultaneously looking for business opportunities to be gained from their investment in organisational and technology change. 59% of European respondents are confident that this is the approach being taken by their bank, to some degree at least. This compares to just 11% who felt strongly that this was not being done.

But 42% felt strongly that given the timeframes involved, PSD2 was first and foremost a compliance project for now, so the resources required internally to conceptualise, validate and implement possible value generating projects off the back of the compliance efforts are likely to ramp up significantly only once a base level of compliance has been achieved. That said, the groundwork for this value creation is being well laid at a majority of banks, as 55% say they have or are about to begin a strategic programme at board level to set out what their organisation hopes to achieve.

07
PLANNING AND ACTING FOR READINESS

7.1 Many banks are looking for external assistance

fig 5: **PLANNING AND ACTING FOR READINESS**
SEPA TEAMS MOVING ONTO PSD2 PROJECTS, BUT EXTERNAL SUPPORT KEY FOR MANY



* European respondents only

How can banks define new client and business models?

"Here are two 'HOWs' of particular relevance: a tactical one and a strategic one. A key fast impact tactic is to create an innovation cell for targeted disruptive change, i.e (financial) planning on the total bank relationship perspective. A strategic one starts with the exploitation of a new business value proposition enabled by the 'open access' technology and derives either new sub-branded target business models or a substantial reframing of the current offering. We do see all three already happening as many banks seek help from external partners as figure 5 indicates."

Hans Kraus, CEO Central & Eastern Europe, Capco

In this complicated new payment landscape, which requires additional IT infrastructure, access channels and security layers, as well as new business processes and product development, external parties will be engaged for support by at least the 44% of respondents who responded with a strong positive to this statement. 33% of respondents also agreed or strongly agreed that as IT infrastructure becomes more open and complex they would consider outsourcing payment services.

Internally within the banks, less than a third (27%) of respondents were confident they already had in place a dedicated PSD2 team covering operational and strategic issues with a delivery roadmap. This reflects the previous responses discussed in 6:2 which showed that compliance programmes were only now being kicked off in earnest at many banks, and a step-by-step compliance approach was being adopted.

Where internal resources are being pulled together, it is often from the pool of staff that was responsible for the bank's SEPA projects. 35% agreed or strongly agreed that employees who were on SEPA teams were being moved into PSD2 compliance projects.

7.2 Governance challenges and payments modernisation

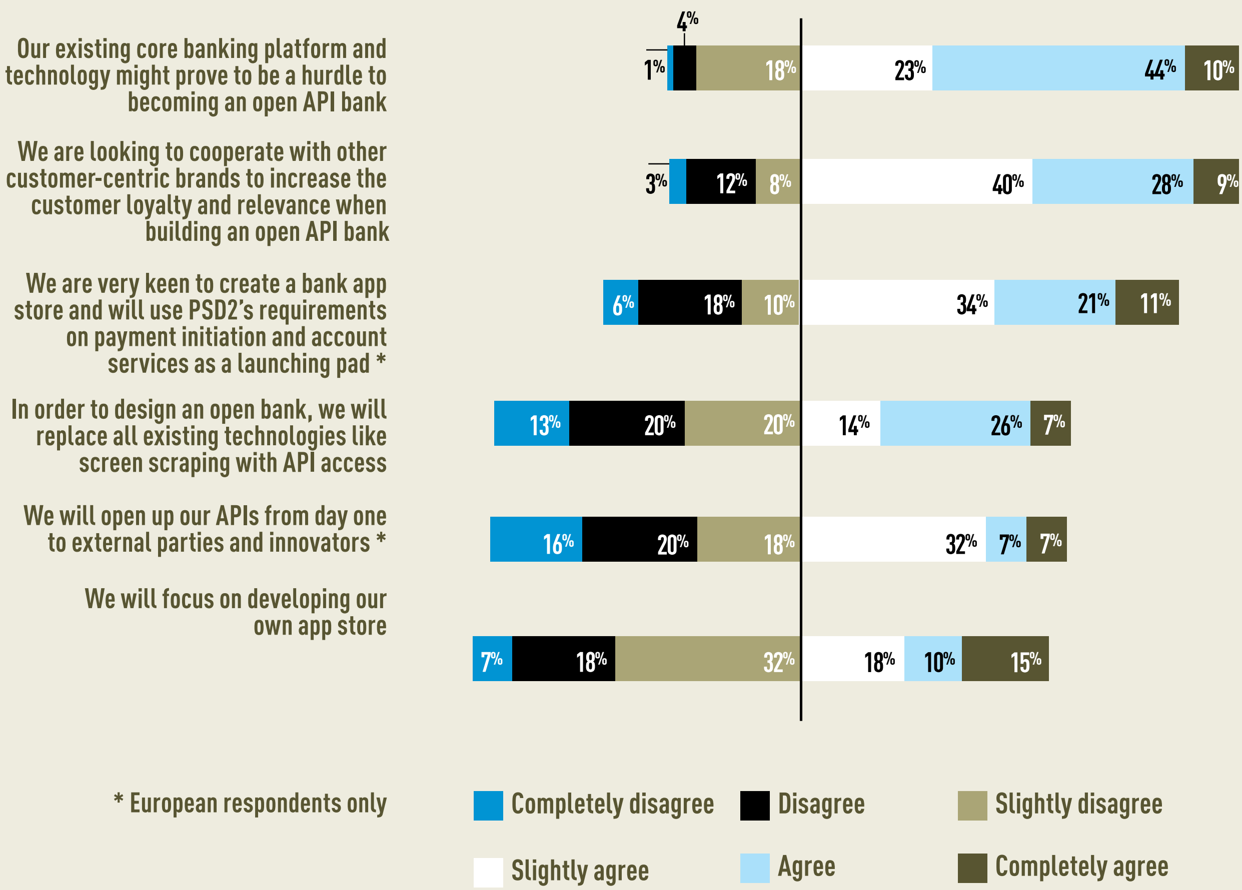
The statement that received the highest overall agreement was that PSD2 governance structures are hard to define because there is no clear owner between IT, business and strategy. 32% agreed or completely agreed that this was their current situation, while a further 36% slightly agreed. This is a common scenario in large organisations faced with compliance projects that affect multiple stakeholder groups.

While governance structures are still being defined by many banks, there is a strong appetite for considering the requirements of PSD2 compliance as a catalyst for a wider payments modernisation programme. Depending on the number of legacy payment systems still in operation at the bank, and how much has been consolidated and modernised already over the past decade through dealing with initiatives such as SEPA and support for immediate retail payments, it seems many banks will look to extend the usefulness of PSD2 projects once base compliance has been achieved.

08
THE NEXT STEP: UNIVERSAL API BANKING

8.1 Core system hurdles to opening up

fig 6: **THE NEXT STEP: UNIVERSAL API BANKING**
CORE SYSTEMS HINDER ADOPTION, BUT OPEN ACCESS AND APP STORES ON THE AGENDA FOR MANY



* European respondents only

Will PSD2 act as a precursor to API Banking?

"I truly hope so. Banks need to become more open and look at new business models and ways of working. Collaboration and partnership is the way forward and APIs facilitate this. It should, however, not be viewed as a trivial task that can be achieved through a few hackathons, accelerators and some RESTful APIs with associated documents. As Dave Birch comments (p25), it is a business strategy that requires a radical rethink, a whole new layer of middleware and a set of processes and departments that provide marketing, education and support. For incumbent banks with vast amounts of legacy it is not a 'lipstick on the pig' strategy, and for challenger banks it is not as simple as providing that horribly phrased omni-channel banking. It is a completely different philosophy on banking and what a bank does. It is more about what you are to your customers and what they are to you. Customer centricity is a philosophy not a technology."

Mark Hartley, Global Strategic Investments, FIS

One risk of opening up access to data and functionality hosted in a bank's core system is that if the core systems are ancient and inflexible, these limitations become apparent outside the confines of the bank's operations teams. A greater risk is that this access can't be granted at all in a robust, secure manner due to these limitations. 54% of respondents agreed or completely agreed that their core banking platform could prove a hurdle to becoming an open-API bank. Only 5% were sure it would not.

As part of building an open API bank, it's not just technology that's required. The business side of marketing and the customer experience also needs to be considered. 37% agreed or completely agreed that they would be cooperating with other customer-centric brands when building their offering

8.2 From API to app store

Beyond offering programmatic access to data and systems via an API, the next obvious step would be to package access and services in the manner popularised by one of those looming non-bank payments competitors, Apple. Of European banks, 31% of survey respondents were strongly positive that they wanted to create their own app store, with PSD2's access requirements as the launching pad. And a further 34% slightly agreed, for an aggregate positive response of 65%. Only 25% will be developing this app store themselves, however, which indicates that there will be demand for external parties with experience in financial services apps and B2B delivery.

But app stores are necessarily a future step beyond offering API access. And it seems that given the state of current PSD2 readiness, few expect to be able to offer API access from day one to external parties and innovators. Exact deadlines and therefore the timing of 'day one' are unknown at this stage, but only 14% agreed or strongly agreed that they would be open and ready for access. A further 32% slightly agreed, while 54% indicated negatively.

Together these survey statistics reflect that industry awareness, planning and activity for PSD2 are rapidly accelerating, and this needs to continue. Given the regulations could come into effect as early as the end of 2016 or start of 2017 banks should continue to ramp up their efforts and get into gear. Governments and regulators should also move fast to answer outstanding questions. The European Banking Authority will need to consult industry on the best way to implement the PSD2 and seek industry's help to ensure some of the ambiguities and holes are closed.

09

OPINION: OPPORTUNITIES FOR NEW BUSINESS MODELS WILL SHAPE FUTURE OF BANKING

By Dave Birch, Director of Innovation at Consult Hyperion

One topic always raises its head when it comes to innovation: how to get there. As banks traditionally have organised themselves along competence silos: business, compliance, IT, it is no mean task to kick off, let alone successfully execute an innovation programme. However business and IT are all but the same in banking: instigator, creator, executor and operator. They need each other to survive and thrive. However, the line is hard to draw, which is once again surfacing now that the new payments regulation is all about opening up the bank: with technology and huge business model impact.

9:1 Don't set strategy without understanding technology, but it's more than just IT

The relationship between business strategy and technology strategy is complex. It is not as easy as setting business strategy and then leaving it to the engineers to implement the technology to execute it because in some cases the business strategy is the technology itself. If the people responsible for business strategy do not understand the technology then they will have the wrong envelope for decisions and be more vulnerable to competitors who do.

A good example of this dynamic in banking is the regulatory push for what Europeans call 'XS2A', or mandatory access to bank accounts via APIs, part of PSD2. While banks naturally have concerns (security, unsurprisingly, the most important one with 88% of respondents to the FIS Finextra survey agreeing that it is a 'major' concern), regulatory change is also an opportunity. XS2A is a fantastic opportunity to develop wholly new business strategies to the great benefit of banks, customers and regulators. But it is vital for strategic planners to understand that even though it appears to be some obscure European Commission directive about application programming interfaces, it's not about technology. It's about the future of banking and it's really important for banks to take advantage of it. This why I was surprised (and I hope this comment won't be seen as unfair) to see that only 5% of the respondents to the survey were sure that their core banking systems will not be a barrier to becoming an 'open API bank' in response to the regulatory pressures in Europe. That suggests to me that they don't understand the shift in competitive strategy that XS2A will stimulate. Putting a minimally-functional API on top of the core banking platform is a technology fix, not a business strategy.

9:2 Rebuild the whole business around using APIs for everything

The winning bank strategy here is what is often referred to as the 'Amazonisation' strategy. By this I don't mean having an excellent gift wrapping operation, but an operation that uses APIs for everything, which means restructuring around APIs and opening them up both internally and externally. As I have said before, the focus of the external API should be the customer rather than their account or their money. This means making identity central to the API framework a point that I see echoed in the EBA vision for a 'Digital Customer Services Interface' (DCSI) that highlights non-mandatory non-payment APIs (not only identity, of course, but identity is central to all other APIs so it is the most important aspect) as an opportunity for banks to build new business.

My observation is that it is important for banks to see the API framework, their API strategy and their APIs as business issues, business decisions and business architectures and not as some obscure technology problem to be solved in the bowels of the IT department. This new approach means shifting to components and networks and APIs connecting everything in an organisation, not simply adding an API layer on top of customer interfaces. The goal is to extend innovation throughout the organisation as well as facilitating co-creation with customers and suppliers. It may be hard for traditional banks providers to come to terms with the idea of opening up in this way but it seems to me to be an inevitable restructuring in organisations that are going to survive in the new environment.

9:3 Unleash internal creativity to avoid becoming a 'dumb pipe'

What will the 'API bank' look like? I happened to have had the great good fortune to be on a panel with J.P. Rangaswami, the Chief Scientist at Salesforce, discussing this issue and others. He observed in passing that the power of the Salesforce API is that they have 100 times more developers than staff. One hundred times! This is really a new way of doing business. Allow developers, innovators, customers and (and we must build strategies that account for this) competitors to have access to accounts, which means a very different landscape where banks will be competing on their app store and developer programme as much as their interest rates or debit card designs.

There is, however, a potential trap that business strategy must navigate. If the banks are forced to open up their APIs then they should build their own services on top of these APIs to take advantage of the flexibility and efficiency and to unleash creativity amongst their own teams. And they should probably start fairly soon because there is a world of difference between making a strategic choice to be a smart pipe and being left with no option but to be a dumb pipe.

David Birch is an internationally-recognised thought leader in digital identity and digital money; named one of the global top 15 favourite sources of business information (Wired magazine); One of the top ten most influential voices in banking (Financial Brand); One of the top ten Twitter accounts followed by innovators, along with Bill Gates and Richard Branson (PR Daily); Named one of the 'Fintech Titans' (NextBank); Voted one of the European 'Power 50' people in digital financial services (FinTech Awards) and ranked Europe's most influential commentator on emerging payments (Total Payments magazine).

10

ACCESS TO ACCOUNTS – WHY BANKS SHOULD EMBRACE AN OPEN FUTURE

By Dr Michael G Salmony

This article provides a fresh perspective on the recent Access to Accounts (XS2A) law introduced by the European Commission and as such wants to paint the broader outline that underpins this survey on PSD2 and XS2A. There is a history of success of open versus closed systems and it is now the banks' turn to open up. As it is better to disrupt yourself rather than letting others disrupt you, an open standard interface for controlled payment services is proposed: CAPS (Controlled Access to Payment Services).

10:1 Background

In July 2013 when the European Commission published the first proposal that would become PSD2, the Access to Accounts topic triggered intense debate. The question of 'how?' is still unclear for many market participants; in particular how to do this in a safe, secure, regulated and fair way.

For this it is worthwhile to step back and take a look at other industries. Examples are to be found in the former situation of national monopolies enshrined by law well into the 80s, such as telecommunications players, who had initially resisted liberalisation as long as they could. Yet today, across all major European markets, the previous market leader generally still commands as much as all the other new market players combined – in a hugely bigger market – even in more recent service categories such as mobile. Thus opening up can be beneficial – especially to the previous incumbents.

Telecoms companies, while being forced to open up, were granted the right be paid for the use of the 'last mile' to their customers and other services they provided to the new entrants – and thus everybody won. Will this apply to financial services and payments too?

10:2 Time to open up in payments

It is now the banks' turn to open up. And as the survey suggests more than 50% of EU respondents wholeheartedly agree on rethinking business and revenue models. (See Figure 2) The PSD2 proposal is clearly demanding access to bank accounts (or more correctly: to selected payment services) for third parties. Banks can potentially be those benefitting most if they take the right decisions now and if the regulator and market ensure a fair ecosystem where – as in the successful examples in all other industries - contracts regulate liabilities and fair prices are paid for services rendered.

Looking into the current e-and m-commerce space, there are already strong alternative payment solutions including PayPal, Amazon Payments and diverse overlay services, even without access to accounts legislation.
Some may think the fight in online is lost for the banks, however, despite 15 years of active market development, good growth rates and huge media attention, PayPal's processed volume still only represents less than 0.05% of global electronic transactions and is really putting no dent at all in banks' business. It is in the interests of all that innovative third parties help develop and grow the total payments market.

Most of the current 'winners' in online payment are overlay services riding on bank infrastructure. Building on banks' card or ACH networks, these overlay services provide significant additional convenience to consumers and merchants and should be welcomed under a new fair regime. In this world of overlay services, banks run the risk of being increasingly disintermediated; degraded to commodity providers and losing many transactions to TPPs. For example, through wallet-to-wallet, in-game or mobile-to-mobile transactions without any connection to the bank account.

10:3 Controlled access to payment services (CAPS)

If bank accounts (or selected online payment services) are to be opened up to third parties this must happen in a controlled, secure, trusted, safe and fair way. An analogy may be seen in the app store model provided by Apple or Google. They provide a platform with a common standard and interface and allow third parties to develop applications under a well-defined set of rules. These rules specify what the liabilities of the parties are, how the revenue is shared, how conflicts are handled in a harmonised way to the benefit of all. This is highly attractive for both developers and Apple or Google and has led to an explosion of creativity and innovation benefitting all involved. The important thing is that this access is not open to everybody but only to those who comply with the rules.

Especially in payments one particularly critical issue is security, and 88% of survey respondents firmly agree on this. (See Figure 4) No consumer or bank would endorse a situation where unregulated third parties would be granted uncontrolled access to users' accounts. This is why there is a need for a (user-)Controlled Access to (selected) Payment Services (CAPS) rather than full access to all data and payment on accounts. This is in contrast to current practices where the users' full online banking credentials are passed on to third parties allowing them potentially full access to everything on the account: past history, salary incomes, security settings etc.

The new payment services defined in the PSD (information on funds, payment initiation) must only be permitted under specific conditions to ensure the risks will be contained. Third parties need to be certified and regulated by PSD2. There need to be contracts with banks and merchants in place that clarify things such as liability partitions. This was another big area of concern for more than 60% of the survey respondents. (See Figure 4). The system needs to be secure, handling access to accounts in a controlled way with authentication being given only for specific accesses. Transactions need to be entirely controlled by consumers to avoid a situation where consumer account data is exploited without permission. And last but not least, there needs to be a fee attractive enough for all parties, including merchants, banks and TPPs, to provide the infrastructure, develop innovative services and provide customer support. A modest and fair recompense to the banks (like the 'last mile' charge for third parties to use the incumbents' telecommunications network) seems only fair and reasonable. Let the market forces decide.

Furthermore, the TPP should contract (for reasons given before) with contract aggregators, speaking for and bundling banking groups across Europe, to avoid having to negotiate with each bank individually.

10:4 The future is already happening

Some examples from the payments industry demonstrate this potential of open innovation. PayPal has already opened up its services to the developer community in 2009 and actively invites third parties to develop new and creative ideas on how to use their payment services. This has already led to some interesting services, including Venmo, Playspan and Expensify. The technical solution (API) behind this has also enabled more traditional payment players (Discover, Moneygram) to deposit/withdraw funds easily to and from PayPal.

Selected banks are also active in the field. For example Crédit Agricole today has more than 50 outside companies and individuals who develop applications available on the CA AppStore. Since its launch in 2012, these 'digiculteurs' have create new applications, such as 'Pimp ma banque' in less than three months.

10:5 The PSD2 proposal answers some questions but creates others

In general, under PSD2, the current PSD is now extended to cover all transactions made through IT devices (mobile, internet etc.) and sets out the path to more open payments. However the many topics still leave some room for further clarification. A standard multi-bank API needs to be defined to let

TPPs access standard services in a harmonised way. A legal framework will need to specify liabilities, contact points, fees, redress procedures, harmonised communication, dispute management, etc. in the interests of all market participants. Some of these topics will be addressed by the European Banking Authority.

10:6 A wealth of opportunities – with potential to benefit all parties

Several overlay service layers, which we know today, have driven a wedge between the consumer and the bank, sometimes easing the way consumers pay, but often confusing them with multiple virtual accounts, wallets, passwords etc. Banks are clearly being disintermediated in online payments and need to act. The underlying conviction is that a world where both transaction volumes and customer value are maximised is one with a key role for banks. 62% of respondents indicated positively in some way that this new world creates an opportunity for existing banks with stickier customer relationships (see Figure 2). Providing a standardised controlled access to the bank account can help reduce and simplify the multiple layers observed today and provide new value to both banks and alternative providers.

The value creation potential is seen across the board. Merchants have been looking forward to this and demanding it unequivocally. Furthermore this survey, like other recent ones, prove the biggest technology trend that is driving innovation in payments is the embracing of open APIs. (See Figure 6):

10:7 The way forward

The next steps that can be considered by the stakeholders could be:

1. The regulator must clarify some of the open issues in the new PSD2 whilst leaving enough room for the market to manoeuvre.

2. Banks, beyond implementing what they are forced to by PSD2, could embrace this development and actively assist TPPs for example by hosting developer conferences (as PayPal does) to ensure that the new services are used and to promote common understanding of business rules and technical interfaces.

3. Coalitions of the willing between banks, TPPs, infrastructures/service providers, merchants, users and other relevant stakeholders are already being formed on how to make PSD2 work in practice and to agree across these stakeholders ways of working together to ensure that TPPs can unfold their full potential.

4. The infrastructures/processors/service providers could come together to agree on a common service layer so that developers can produce new apps, according to the app-store model, across Europe in a standardised way without having to tailor individually to the specifics of each of the 7000 banks in Europe.

5. Standardisation bodies such as ISO could develop standards inspired by the above ad hoc industry agreements.

If all stakeholders work together in this constructive way – in analogy to the Apple and Google app store models – we will see an explosion of safe, secure, innovative new services for users based upon bank and payment infrastructures. The European Digital Market, the developers, the infrastructure providers, the users and banks all win and as such the disruptive potential and business opportunity from opening up accounts to third parties is not to be underestimated.

If open access is an inevitable step, then banks should act already now to secure a vital role in the future of payments. It is not about fighting for a larger slice of a given pie, but about jointly growing the pie with the potential to make all parties better off.

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