Analysis

Effects of the revised Payment Services Directive: first assessment

Financial stability | 23 May 2018 | Aleksi Grym

AUTHOR



Aleksi Grym
Head of Department

In retail banking, the two key services are the provision of credit and management of payment transfers. The revised Payment Services Directive (PSD2), which regulates payment transfers, entered into force in Finland for the most part in January 2018. The purpose of PSD2 is to increase competition, and it has been prepared with the consumer's interests in mind. In addition to benefits, the revised Directive involves also risks and uncertainties.



Payment transfers are an important source of income for banks. Finnish banks' aggregate income from payment transfers in 2016 was some EUR 0.5 billion, i.e. nearly one-fifth of their profits.[1] In addition to banks, other types of entities also participate in the payment transfer process. For the regulation of this complex industry, the EU adopted the Payment Services Directive, the purpose

of which is to promote competition and ensure a level playing field for all actors. The Directive is also based on the understanding that retail trade is increasingly moving onto online and mobile applications.

The revision of the Payment Services Directive is a significant step for the entire banking sector. It will introduce to the sector two new types of service provider that will require licensing: account information service providers and payment initiation service providers. The account information service provider may collect into one service a customer's payment account information located in different banks. The payment initiation service provider may initiate a payment transaction from any of the customer's payment accounts. To enable the services, the Directive requires that banks grant new service providers indirect access to the payer's account. Banks may not charge a fee for the access. However, access can be granted only with the consent of the customer, i.e. the account holder.

PSD2 enables new types of payment applications

In retail trade, electronic payment has thus far and in practice involved only payment by card, and debit payment has been the only form of payment in which the customer's account is charged directly. PSD2 enables new types of payment applications in which payment takes place in the form of a direct credit transfer between customer and merchant. Under the revised Directive, neither the consumer nor the payment initiation service provider may be charged for initiation of a payment transaction. It makes the new forms of payment services very cost-competitive compared with card payments. This competitive advantage will be more pronounced as credit transfers gradually become real-time in the new payment systems. The popularity of traditional card payments may be threatened because in the new environment customers will have at their disposal payment solutions by several service providers, and money transfers between accounts will take place immediately.

The entry onto the market of payment initiation service providers will increase competition significantly in the field of retail payments. It is, however, still unclear which types of company will assume the role of payment initiation service provider. They may be small start-ups that develop mobile services, international technology majors, retail merchants, telecommunications operators, current payment institutions or banks, naturally.

Stiffer competition in retail payments will benefit consumers, but it may be a challenge for the banks. In Finland, banks have traditionally been significant actors on the payments market. The Directive causes direct costs to banks because they have to modify their systems to enable use by the new actors. Under the new regulation, banks must make these investments without any additional costs to third party service providers that use the systems. In addition to direct

investment costs, banks' income from the management of payment transfers may decrease, due to heightened competition in the sector. Competition does not necessarily mean loss of market share, because price erosion, too, may result in loss of income. Competition would thus decrease profitability for all the actors in the sector. In addition to banks, tighter competition will affect also international card companies because, in future, it will be possible to execute retail payments outside the card schemes.

Payments shaped not only by regulation but also by digitalisation

The revision of the Directive is part of a wider phenomenon in which not only payment transfers but also the entire business of banking will be increasingly opened to competition. The change will be furthered not only by regulation but also by digitalisation, as this enables new types of services and business models. The role of banks as providers of financial services may change. We can roughly foresee at least two possible scenarios. Banks may remain in the role of account-servicing bank, whereas value added services would be provided by other actors. In such a trend, the task of banks would be mainly the safekeeping of funds as well as customer identification. Another possible scenario is that of banks acting as innovative ecosystems where they would provide versatile financial services in cooperation with other companies. The task of banks would be to produce technical platforms for the ecosystem and support the provision of services.

The above examples of possible future scenarios show that the revision of the Payment Services Directive is a significant force for change in the financial sector and compels banks to rethink their role in the provision of financial services. Banks may adopt a variety of strategies, and the regulatory reform can be taken both as a threat and as a possibility.

Consumers, too, will be faced with challenges brought about by the regulatory changes. With the large number of applications and alternatives available for payments, the situation may be confusing for consumers. It is important that users of payment services can rely on the services and the companies that provide them.

Risks must be addressed as the operating environment changes

PSD2 also introduces new risks. Of these, particularly important are cyber risks, and close attention should therefore be paid to technical systems and the security of services. Cyber risks will be an even more important factor when the sector operates as networks and entities are increasingly interconnected.

Another risk is the increasing speed and seamless integration of payments with the purchase transaction, which may make the management of personal finances more difficult. Spending and excess debt accumulation are increasingly easy and inconspicuous. Even though PSD2 encourages the launching of financial management applications, thus far we have only limited experience of these applications. Nobody knows how easy it will be for consumers to adopt them.

The revised Payment Services Directive will affect the financial sector extensively. The roles of the actors may change, and at least in the medium term their number may grow significantly. The fundamental objective of the new regulation is to increase competition, which will nevertheless ultimately be to the advantage of the consumer.

Notes

1. https://www.suomenpankki.fi/fi/media-ja-julkaisut/puheet-ja-haastattelut/2017/olli-rehn-digital-transformation-in-the-financial-industry-whats-good-for-the-society/ ↑

Keywords

payments, regulation