PSD2 AND OPEN BANKING

UNDERSTANDING THE OPPORTUNITIES

IN A NEW ERA FOR PAYMENTS, REGULATORY DEVELOPMENTS AND NEW TECHNOLOGY ARE POISED TO SHIFT CONSUMER AND CORPORATE EXPECTATIONS AND DRIVE FURTHER CHANGE. JAMES McMORROW EXPLORES HOW TO TURN THAT CHANGE INTO ADVANTAGE

Much is changing in the world of payments, with the arrival of both the second payment services directive (PSD2) and the UK's Open Banking standards within the European economic area. Under PSD2, European banks will be required to give third-party providers direct access to customer payment accounts, while Open Banking requires the UK's nine largest banks to open up their bank data via open application programming interfaces (APIs).

Though Open Banking is still in its infancy, we are already seeing a number of business solutions emerging amid considerable interest from fintechs, financial institutions and corporates. Furthermore, there may be some attractive opportunities for corporates to reduce costs and achieve efficiency gains when Europe implements data sharing and payment-initiation solutions post September.

How will Open Banking and PSD2 change client experience?

The UK saw the successful launch of Open Banking on 13 January 2018. The regulation is designed to promote competition and innovation, and aims to do this in two ways. Firstly, regulated third parties (when authorised by consumers and SMEs) will be given access to current account transactional information. This enables third parties to provide innovative services, such as aggregation of multi-bank balances and, potentially, enhanced transactional information and analytics.

Secondly, the regulation enables third parties to initiate payments, bringing opportunities not only for users to see an aggregated balance position, but to move funds via a third party.

PSD2: the benefits for treasurers

PSD2 builds on Open Banking and is set to bring far-reaching changes for the European payments landscape, by broadening the types of account information and bringing additional types of payment services into scope across Europe. For corporate treasurers, these changes could bring considerable benefits, from real-time reporting to new sweeping solutions.

Real-time reporting

Under existing processes, it is not always straightforward for treasurers to obtain visibility over all their account transactions. Sourcing information from multiple online banking solutions can be arduous, while newly acquired subsidiaries may have legacy bank accounts that are difficult to access. As a more efficient option, corporates may obtain their reporting information via SWIFT messages – but this is provided based on previous-day (MT940) or intraday (MT942) balance updates, meaning that information may not be fully up to date.

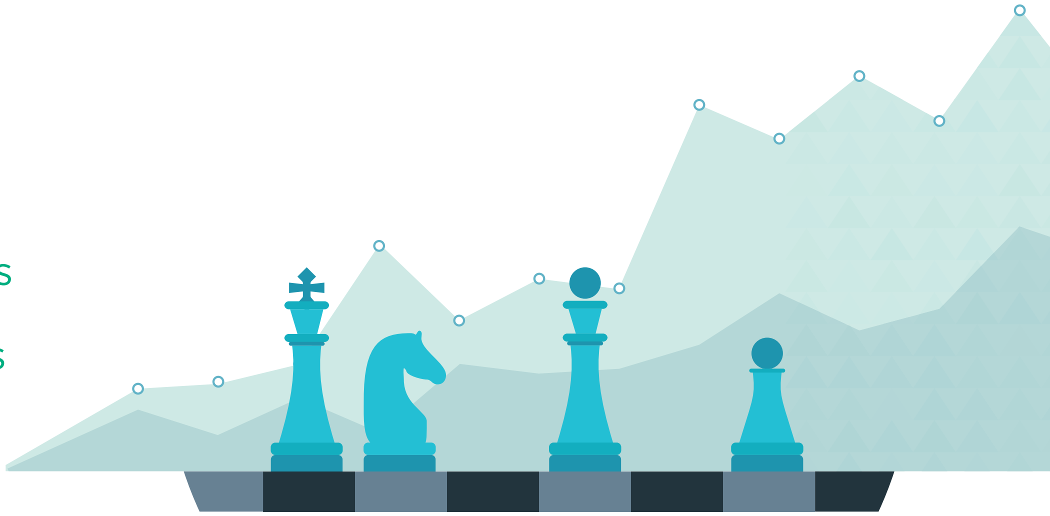
Under PSD2, banks will need to provide access to account transactions, which will give treasurers greater visibility over their cash positions. Instead of having to set up access to multiple banking solutions, treasurers will have the opportunity to draw upon API reporting, which could feed directly into third-party aggregation solutions, or even their existing enterprise resource planning (ERP) systems, providing a clear view of cash across the group. These data feeds are likely to be offered on a real-time basis, meaning that treasurers can access fully up-to-date transaction information.

As well as streamlining the reporting process, this information could drive further opportunities for corporate treasurers to operate more efficiently:

- **Freeing trapped cash.** Drawing upon real-time reporting information may enable treasurers to address issues such as trapped cash. For example, the use of enhanced data analytics may create opportunities to maximise the efficiency of cash across different geographical locations, legal entities or financial institutions. In time, it is possible that we could see corporate treasurers moving from SWIFT reporting to real-time reporting via APIs.
- **Sweeping and pooling.** It is also worth noting that PSD2 enables third parties to initiate payments through the account holding bank. Combining this functionality with the ability to request real-time balances may give rise to interesting pooling and sweeping solutions – and these could replace existing solutions, which are typically reliant on SWIFT messages.

While PSD2 is a European regulation, other countries such as Australia and the US will be closely monitoring these regulations and the uptake of API technology. As a result, it is possible that the technology will be adopted globally, as we have seen in the case of instant payments.

The benefits of Open Banking and PSD2 are not limited to aggregation solutions. The new rules will also give consumers and businesses the opportunity to use a new payment method for e-commerce transactions: instead of using existing



Regulatory developments and new technology will bring many opportunities for companies to gain more visibility over their accounts

payment methods such as cards, customers could choose to make e-commerce purchases directly from their bank accounts.

This could bring considerable benefits for retailers, as such payments would be received immediately via Faster Payments, enabling them to reduce card-related fees and improve working capital. Indeed, this e-commerce model has already been adopted successfully in Europe: in the Netherlands, payment method iDEAL is now offered by more than 100,000 merchants and represented 56% of online transactions in 2015.

Changing consumer expectations

The arrival of a new payment method has the potential to shift consumer expectations and, consequently, drive change in the associated solutions on offer – just as the introduction of Faster Payments brought changes to the types of solutions offered by corporates. Refunds and insurance payments, for example, may now be initiated via Faster Payments instead of by cheque, thereby meeting consumer expectations regarding speed and visibility.

However, where the use of direct payments under Open Banking is concerned, there may also be some obstacles for corporates to overcome. Whereas retailers tend to process card transactions in bulk files, individual payments could be received 24 hours a day, seven days a week. Businesses will therefore need to consider whether they could handle real-time transactions and provide real-time notifications to consumers and/or businesses. It is unclear at this stage how quickly payers would want confirmation that funds have been received – and how soon they would expect goods to be shipped – when using this type of payment method.

Other considerations could include the level of consumer protection that providers offer. Higher percentages of online credit card payments for e-commerce compared to in-store transactions suggest that consumers place value in purchase protection and recourse should something go awry.

While businesses will need to understand the implications, it is clear that the potential cost savings and working capital improvements could be very attractive. Open Banking is already live in the UK and, as such, we may see new payment solutions come to market in 2018. Further, and in consideration of the potential savings, retailers may opt to incentivise customers to adopt new payment mechanisms by offering discounts or reduced delivery charges. Businesses should also consider that not adopting this type of solution could leave them at a competitive disadvantage.

Security standardisation

While there are plenty of opportunities for new solutions to change customer behaviour and increase efficiency, PSD2 will also bring some challenges. For example, under the regulatory technical standards – which go live in September 2019 – retailers and their payment providers will need to comply with rules requiring the standardisation of security for online payments. Secure customer authentication will include the need for two-factor authentication, which includes two of the following elements: something you are (for example, biometric recognition), something you know (for example, a password) and something you have (for example, a device or token).

This requirement will lead to changes at the checkout and payment process, and could lead to more friction for online payments – something that retailers will be keen to avoid. Retailers should therefore consider whether they will be materially affected by these changes and should engage with their payment providers about the implications.

Investing in technology

While these regulatory developments have much to offer businesses, it is important to note that investment may be required in order to leverage this new technology. Treasurers – particularly those who identify a strategic advantage in early adoption – may therefore wish to factor these changes into their investment strategies. At the same time, they will need to ensure that their ERP providers can meet their future needs and support them in leveraging the opportunities.

In summary

Regulatory developments and new technology will bring many opportunities for companies to gain more visibility over their accounts, as well as the ability to adopt innovative services and offer new payment methods. Treasurers should take the time to understand new solutions and consider the challenges they may need to overcome – and whether investment may be needed to benefit from the efficiency and cost-reduction opportunities.

James McMorrow is head of payment strategy, global transaction banking, at Lloyds Bank

LLOYDS BANK