



AN RS2 WHITE PAPER

**SEPTEMBER 2017**

# OUTSOURCING AND PSD2



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**“Banking may be on the cusp of an industrial revolution. This is being propelled by technology on the supply side, and the financial crisis on the demand side. The upshot could be the most radical reconfiguration of banking in centuries.”**

**Andy Haldane, Chief Economist, BoE**

## Introduction

Haldane made his prediction in September 2013. Just over four years later, in January 2018, the EU's Revised Payment Services Directive (PSD2) will come into effect and the regulatory framework will be in place to make the revolution happen, making it easier, faster, and less expensive for consumers to pay for goods and services.

The intended goal of PSD2 is to foster competition, digital innovation and security within retail banking and payments. It does this firstly by changing the rules of participation in the banking and payments industry and includes new kinds of providers, such as payment initiation and account information services within its regulations. Under its 'Access to Accounts' (XS2A) rule, open access to account information, transaction information and payment initiation must be given to these AISPs, PISPs and third-party apps.

Secondly, to lower transaction costs for consumers PSD2 imposes limitations on transaction fees and stricter rules on refunds. And finally, it requires European banks to grant third-party providers of financial services (TPPs) access to their customer accounts and data, provided the account-holder consents.

In this paper we will focus on the third, and most disruptive of these changes: providing access to customer data and transactional histories via APIs, and how working with existing trusted partners can smooth the transition to a more open form of banking.

### The language of PSD2: a glossary

**PISPs:** Payment Initiation Service Providers. As the name suggests, PISPs are bodies that can initiate online payments on behalf of consumers without necessarily using existing payment networks and schemes. As an example an e-commerce or m-commerce merchant could establish itself as a PISP, and initiate a payment request directly to their customer's bank via without going through any intermediaries.

**AISPs:** Account Information Service Providers. These are bodies that will be able to access customer core banking data and use it to provide value-added services. For example, a data aggregator could register as an AISP and offer consumers a single aggregated view of their numerous banking accounts, and adding value through personal financial management tools informed by the customer's historical transaction data.

**ASPSPs:** Account Servicing Payment Service Providers. The new collective name for credit institutions (banks) and payment institutions (payment service providers). They will be required to offer open APIs to PISPs and AISPs. They can charge PISPs a small price per transaction but may not charge differently for payments initiated through their own products.

**XS2A:** The access to account rule. The specific rule within the PSD2 regulations that requires banks to begin opening up their customer data to third party providers of financial services, including FinTech companies, PISPs, and AISPs.

## The revolution realised

**The underlying assumption of PSD2 is that banks are not the owners of customer data but instead merely its trusted custodians. Ownership remains in the hands of customers who can choose who to share it with.**

In effect, it removes a significant barrier to entry faced by non-established players and creates a path for the deployment of far more customer-focused, digital services throughout the industry by:

- › Giving FinTechs and other innovators access both to invaluable data and trusted distribution channels for their solutions through the use of APIs
- › Obliging banks to work with these innovators to deliver new and better services to customers, and creating the regulatory landscape to enable this to happen.

This is the revolution that Haldane pointed to in 2013. Certainly PSD2 is being driven in part by technology and the desire to introduce the same level of digital experience and real-time, personalised, and seamless services that consumers have in other areas of the personal and professional lives.

It is enabled by advances outside the FinTech community and within, including blockchain, mobile authorisation, advanced analytics, and the Internet of Things, among others, which together are creating new ways of digitising the payments value chain. It's also a much-needed jolt in the arm when it comes to payments innovation – something that has remained sub-par in the wake of the financial crisis.

But there's also something more profound going on. PSD2 is set to change the very ethos of a financial services sector committed to creating impenetrable fortifications from which to wage a battle of attrition against competitors.

The move from closed to open introduces and, indeed requires, a completely new mindset. Exceptional physical and technological barricades are still needed to protect the citadel from the hostile intrusion – but the gates must be opened to external traders, giving them full access to the data stores, and hoping they don't hollow it out in the process.

### Open APIs

The Open Data Institute describes APIs as follows: "An application programming interface (API) is a proven technology that can help provide access to open data (such as a list of products that a bank provides) and secure shared access to private data (such as a list of the transactions in an individual's bank statements)."

APIs are widely interoperable, relatively easy to create and form the front end of many digital platforms. APIs are used to access the core services provided by these platforms and can be used to create partner and customer ecosystems. Firms like PayPal, Amazon, Square, and Mint all use APIs to open their platforms to millions of developers and to offer innovative services. The use of APIs as mandated by PSD2 needs to be supported by robust security, legal and governance frameworks.

## The uber-isation of banking

The use of APIs to share data in the banking industry is not new; they can be found throughout the payments value chain. But deployment has been limited and confined to very specific functions.

This is why processing consumer loans, for example, to the point where the decision is made to approve or decline, is still a cumbersome process – despite a degree of automation in place. It requires key information to be brought together at various stages and a series of interactions from different decision-makers. Which is why it can take days to arrange.

Contrast this with ordering an Uber: finding and booking a car, planning a route, paying for the service, and leaving feedback can all be done from the same app. That's because Uber's service is based on a series of APIs: it uses the Google Maps API to locate customers and track drivers, Google's Cloud Messaging API for instant messaging, and PayPal's Braintree API for payment.

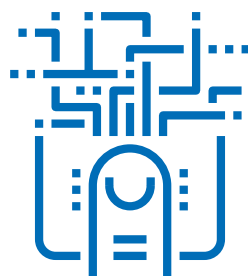
Uber also has its own API that it provides to other companies to extend customer convenience still further. OpenTable, the online reservation network, incorporates Uber's API in its app so diners can book a car when they make a reservation – and then get home comfortably at the end of the evening.

By applying the same model to their payment and retail banking services, banks could transform the daily transactions their customers rely on. Just using APIs internally would ensure that loan gets approved in a matter of seconds. It could also enhance the bank's core business offerings with new capabilities.

Whereas today account-holders can download their bank statements through online banking facilities, with the use of APIs that information could be automatically shared with other banking systems for swift credit approval, passed on to financial advisory services, confirm proof of address for non-financial services and so much more.

This is just one example. Developing an API-enabled ecosystem could augment cross-selling efforts and accelerate entry into new markets. Banks could create, test and, if necessary, exit new models and concepts to speed up and de-risk innovation, while still controlling their costs. They could use insights into their consumer's behaviour and their preferences to develop new and better-targeted products and services.

It is expected that new high-margin data-driven services will be developed around lending to consumers and small businesses, financial advice and consultancy, peer-to-peer payments, crowd-funding, and comparison shopping made available through banking app stores.



## The triple challenge

This model might be described as hyper-outsourcing. The roles, responsibility and value for each player are distilled down to fundamentals, and additional expertise is provided by a broader ecosystem of formal and informal partners. But the contracts are fluid rather than fixed, and zero-touch data sharing removes all but the initial human interventions.

However it presents a number of challenges for traditional financial institutions.

**1** Legacy platforms. Not only does this require a change in mindset, it also requires a serious look at existing IT infrastructure and the challenges presented by legacy systems. PSD2 will mark increased machine-to-machine processes and interfaces and decreased human interaction, with the errors, duplications, inefficiencies, and bottlenecks that tend to come with manual interventions. Although a degree of automation has taken place, considerable human interaction is still required in the traditional relationship outsourcer and service provider to ensure that proper documentation is created and made available at each stage; processes and procedures are implemented in the right sequence; and that necessary permissions are acquired and compliance requirements are met. That most legacy platforms are a series of impenetrable silos does not help.

**2** Culture clash. Legacy platforms are the inflexible, non-agile, fail-averse IT backdrop to a new series of relationships with FinTechs and other digital disruptors whose own platforms and work culture often run on almost diametrically opposite

principles. The social, cloud, mobile and app-driven culture they represent contrasts strongly with the world of monolithic platforms and heavy implementations of only a few short years ago. FinTech culture is decentralised and democratic, and its developers have little experience of the infrastructure in place at most banks – not to mention the simple inability of many platforms to incorporate APIs.

**3** Customer experience. Finally, banks are naturally concerned about protecting the personal and financial data of customers as well as their transaction history. This is both a regulatory issue – which is due to become more acute in May 2018 with the introduction of GDPR – and an existential one. We have spoken before about the disappearance of payments, but with PSD2 banks themselves face the possibility of being disintermediated from the value chain by losing control of its customer data – and consequently the relationships that it has with them. In a business landscape where customers and data are the two most valuable assets any organization has this is a serious threat.

## The new banking models

So how do banks respond to the PSD2 challenge? As the date for implementation approaches, industry analysts have developed a series of alternative business models on a spectrum from compliance-only to fully embracing the new opportunities.

For example, Accenture suggests that in the compliance-only model banks give third parties access to the data required by law, and provide a basic-level open API that is free for any third party to use. In this model, the bank has a narrow focus on providing liquidity and infrastructure services to TPPs. It is these TPPs who then 'own' the customer experience.

At the other end of the spectrum, Accenture suggests banks can expand their ecosystems and aggregate the value of their partner networks by offering products and services that meet customers' daily needs in both financial and non-financial spheres. In this model, an online banking portal could become a single source for business advice, with direct access to management tools like web pages, payment options, digital marketing capabilities and customer communication channels.

Meanwhile, Strategy& has identified three schools of thought among banks that range from the threat school that views PSD2 as a compliance exercise only, and the wait-and-see school that does exactly what its name implies, to the catalyst school, which rightly sees PSD2 as one of the primary forces accelerating the inevitable transition to open banking.

Strategy & suggest the latter is the only feasible approach and describes six potential models:

- › The modular digital bank: Building a bank based on modules from third parties
- › The Pan-European FinTech Hub: Complementing bank offerings with third-party (FinTech) products and services
- › The API-powered personal financial management (PFM) solution: Leveraging APIs and data for a holistic PFM solution
- › The API-powered P2P payment solution: Using APIs to integrate the bank's own offering into third-party networks
- › The Open API and app marketplace: Offering an open API and app store
- › The API and data provider: Providing a banking-as-a-service platform that includes data and functionality.



## The role of intermediaries

Each of these is a radical overhaul of current banking practice that requires not just the agile platforms and technical interfaces to make it happen, but the processes and workflows for different financial services to be redesigned and then fully automated.

One option is to undertake all this work in-house. But a more realistic alternative for many is to work with an a specialist intermediary, like RS2, who can apply the necessary expertise and technical platforms to support effective integration between FinTechs and app developers, financial institutions, new value-add partners, merchants and customers.

By developing and implementing an open platform for integration, specialist providers give banks the flexibility to onboard – and offboard if necessary - new services, apps and third parties in a matter of hours. Even the most complicated of integrations take days at most – in contrast to the weeks or sometimes months at present.

In this way, banks IT teams can continue to play to their strengths of delivering superior customer service and managing the functionality and security of its own IT infrastructure, while integrations with multiple new players and updating background processes are handled by experienced practitioners who are able to translate and implement the requirements of all parties.

Mechanisms can be put into place ensure that all APIs comply with the required standards, even within machine-to-machine processes, so that the bank retains ownership of the customer relationship (and maintains its role as data custodian) but not the process intervention.

In a banking landscape in which openness will become the new watchword, and partnership thinking replaces silo thinking, it is only fitting that one of most effective means of overcoming the potential challenges is to work with a trusted service provider. By addressing the challenges around culture clash, legacy platforms and ownership of the customer experience, this is the solution that meets the immediate needs of financial institutions and allows them to focus on making sure that experience is exceptional. Exactly what a good outsourcing deal – and indeed the entire PSD2-mandated revolution – is designed to do.

## Conclusion

PSD2 is fast approaching, and all European banks need to decide now what role they want to play in the new open banking game. Even those outside the EU still need to decide where they want to be in this re-shaped competitive landscape. Will they be innovators, network providers or infrastructure suppliers? Will they become an essential hub for new, API-enabled services, or a simple source of liquidity and data?

Each of these choices is a legitimate. But each has implications for the future direction of the bank and the type of organization it wishes to be. The status quo will not hold: there are too many hungry alternatives that can already fit seamlessly into the new order ready and able to snatch customers from incumbents.

However, the space for experimentation is small. Banks therefore need to determine what course is best for their own customers and stakeholders, decide where they wish to concentrate their strengths and their resources – and then let others, whether competitors, partners, or some combination of the two, take on the other roles of the game.





## About RS2

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