Accenture Payments

How payments regulation will disrupt and reshape Europe's card payments ecosystem

Scoping out the risks and opportunities resulting from PSD2 and IFR for all participants in the payments value chain
The revised Payment Services Directive (PSD2) was introduced by the European Commission to improve customers’ payment experience by promoting innovation, increased competition and security. The Interchange Fee Regulation (IFR) is another disruptive regulation aiming to reduce the cost of cards payments by placing a cap on interchange fees. The IFR also addresses wider areas such as processing and settlement, transparency and commercial cards, effectively redistributing the costs and revenues of cards transactions. Financial institutions in the payment market are facing new waves of regulations and can no longer afford to ignore their longer term implications if they want to remain competitive in the PSD2 era. Reassessment of the business and operational models – along with customer relationships – is crucial for achieving success in the next-generation payments landscape.
## Introduction: How PSD2 and IFR are reshaping Europe's payments landscape

**Impacts will vary across member states...**

Europe's cards industry is on the cusp of a significant change catalysed by innovations in technology, which will be further accelerated by forthcoming regulations. This regulatory wave is being led by the revised Payment Services Directive (PSD2) and the Interchange Fee Regulation (IFR)—see the accompanying information panel. These regulations are set to drive a fundamental change in the European cards industry, requiring incumbent players to adapt their business models and compete with new entrants.

However, the extent of the impact will vary between EU member states, and will depend on various factors including existing payment infrastructure (e.g. the availability of a real-time settlement facility); customer behaviour (e.g. a greater proportion of debit cards versus credit cards, online versus in-store shopping); existing interchange rates; and the level of usage of alternative payment mechanisms (e.g. PayPal and others). For example, the uptake of Payments Initiation Service Providers (PISPs) will be higher in countries where there is an existing real-time settlement facility, as this mitigates funding risks for merchants. That said, in some geographies the relative reduction in merchants' liabilities through using PISPs may be less significant when compared with the other associated costs (such as implementation and ongoing account management costs, which in a number of cases are currently provided for by acquirers). Meanwhile, consumers who are more inclined to use credit cards may decide not switch to what many might perceive as direct access to their bank accounts through the PISPs. Also, PISP-type services are likely to achieve only limited uptake in countries where either consumers pay to make digital interbank payments, or merchants' accounts are charged for receiving funds.

### Payments Services Directive (PSD2)

The revised Payment Services Directive (PSD2) is a data— and technology-driven directive which aims to drive increased competition, innovation and transparency across the European payments market, while enhancing the security of Internet payments and account access.

PSD2 will bring about important changes to the European Payments industry, including:

- **Article 2(1)** says it applies to payment services provided within the Union. The extension relates only to “one leg” transactions where only one part of the transaction takes place in the Union, whereas PSD applies only to transactions where both legs are in the Union.

- **PSD2 will regulate payment initiation service providers (PISPs).** These services allow users to initiate online payments to an e-merchant or other beneficiary directly from the payer’s bank account via the online portal of the PISP.

- **PSD2 will also regulate account information service providers (AISPs).** These services act as aggregators of customer payment account information allowing users to log-in to a single online portal to view all their payment account transaction history and balances.

- **PSD2 seeks to standardize the different approaches to surcharges on card-based transactions which are currently applied across EU.**

- **PSD2 will also introduce new security requirements for electronic payments and account access along with new security challenges relating to AISPs and PISPs.**

### Interchange Fee Regulation (IFR)

The provisions under this (which came into force in December 2015) include:

- **Fee caps:** Interchange fees on consumer card transactions have been capped, at 20 basis points for debit and prepaid cards and 30 basis points for credit and charge cards, with discretion by Member States for lower caps.

- **Unblending:** Acquirers required to separately list interchange and scheme fees from the merchant service charge.

- **Individual transaction information:** Including reference number, fees and value in account currency.

- **Card acceptance terms:** Abolition of “Anti-steering” rules and restrictions on honour-all-cards rules across all card networks.

- **Network licensing to cover the entire EU.**

- **Separation of network processing:** Card networks would be required to separate their network processing functions (in which transactions between different issuers and acquirers are processed for authorization, clearing and settlement).

- **Co-badging of cards:** A single card may bear the brand of multiple networks and be used to process transactions on any of those networks.
...but opportunities for innovation will arise throughout

As incumbents respond to these impacts from IFR and PSD2, both pieces of regulation will also present them with opportunities. While IFR is likely to have a significant effect on card issuers’ income, PSD2 enables innovation and creates the potential to help customers fund their transactions in new ways that offer them more choice and control. For the players in acquiring industry (including eCommerce gateways), IFR has increased the transparency of fees for merchants, thus challenging acquirers to find a competitive edge. And while acquiring businesses may be enjoying a short-term boost to margins due to reduced interchange, this also offers a one-off window of opportunity (until these margins erode due to factors such as competitive pressures) to invest in new, more competitive propositions and services.

PSD2’s provision for PISPs poses the risk of disintermediation to issuers and card networks. We estimate that merchants and consumers switching to PISPs will see overall online debit card volume in the UK fall by 33% and online credit card volume by 10% by 2020. However, this shift also presents opportunities to leverage this new channel and offer innovative payment mechanisms, filling a gap that will open up between debit and credit card products. On one side of this gap is immediate funding through a current account, while on the other is a fixed credit line—and between the two is the potential to access the required credit at a transactional level. While there are already some examples—such as Klarna and PayPal Credit (see information panel)—in the market for certain purchases, there is clear potential to leverage the infrastructure available through PSD2 to make these offerings more widely accessible.

The opportunities for innovation also extend to card network operators. These players—the likes of Visa, MasterCard and American Express—are already integrated with most banks across the EU. Their core strength is in processing real-time, enterprise-scale data messages across a massive network of financial institutions with virtually 100% reliability 365 days a year. Network operators have the opportunity to leverage these strengths and provide the infrastructure necessary to support PSD2—not only to run real-time interbank payments across the EU, but also to become the standard interface for banks to provide third-party payment providers (TPPs) with access to their APIs.

PSD2 and IFR: combined impacts, continuing uncertainties—and a need for collaboration

While IFR and PSD2 are targeted at addressing different issues, they overlap in many areas—meaning their impacts are best analysed in combination. For example, both sets of regulations aim to create more competition, increase consumer protection and security, and promote innovation. A further similarity is that both regulations—especially PSD2—are open to significant interpretation, creating uncertainties over how they will play out in practice. This lack of clarity underlines the need for card companies and financial institutions to take steps now to analyse the impacts of the regulations, and work collaboratively across the industry and in different geographies to gain an all-round perspective.

Against this background, this paper explores the implications of IFR and PSD2 for acquirers (including e-commerce gateways), issuers and network operators—the main participants within the cards payments ecosystem. Our assessment shows clearly that there are areas where each of these players can innovate and expand, enabling them to mitigate the disruption from the regulations while simultaneously seizing the opportunities they present.

Klarna and PayPal Credit

Both of these digital payment providers offer an option to “buy now, pay later”. There are various customer propositions, with some offering one-off purchase finance with instalment payments or a credit line available for repeat purchases. These digital finance solutions are quicker and simpler than traditional POS finance, and leverage a number of customer data points to complete real-time risk analysis and offer varying rates or grace periods.

E-commerce gateways

E-commerce gateways play an integral role in online payments as they help connect merchants to their acquirers and processors. Over the years, these providers have accelerated digital commerce by providing secure solutions to accept both traditional payments (like debit and credit cards) and alternative payment methods (like PayPal and iDeal).

With the availability of open APIs through PSD2, existing gateway providers—such as Global Collect, Ogone and Adyen—can leverage on their existing merchant relationships to offer PISP or AISP services. This will enable repositioning of the gateway providers within the payments value chain and open up new revenue potential.
Card payments are losing ground in e-commerce...

While payments behaviour in Europe differs considerably between countries, the broad trends over the past decade have been similar. These include a proliferation of Alternative Payment Methods (APMs) in each member state, with the e-commerce payments market—which has a higher potential to leverage open access in payment initiation services—already exhibiting rising uptake of APMs. This migration to APMs is reflected by a decline in card payments’ share of e-commerce transactions across Europe from 59% in 2012 to 51% in 2014.¹

**FIGURE 1. Share of online payment methods in Europe**

Online payments methods  
(2015, % of online purchases)

<table>
<thead>
<tr>
<th></th>
<th>Card centric</th>
<th>Bank transfer centric</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>65%</td>
<td>6%</td>
</tr>
<tr>
<td>France</td>
<td>62%</td>
<td>11%</td>
</tr>
<tr>
<td>Italy</td>
<td>59%</td>
<td>14%</td>
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<tr>
<td>Spain</td>
<td>59%</td>
<td>16%</td>
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<tr>
<td>Belgium</td>
<td>62%</td>
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<tr>
<td>Denmark</td>
<td>22%</td>
<td>22%</td>
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<tr>
<td>Poland</td>
<td>15%</td>
<td>5%</td>
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<tr>
<td>Norway</td>
<td>23%</td>
<td>19%</td>
</tr>
<tr>
<td>Germany</td>
<td>23%</td>
<td>19%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>13%</td>
<td>13%</td>
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</tbody>
</table>

Others include Cash on delivery, direct debit, e-invoices, mobile carrier billing, vouchers, cryptocurrencies and other emerging technologies.

(Source: Accenture Research analysis on WorldPay “Global payments report Your definitive guide to the world of online payments”, November 2015)
...as market participants face profound and pervasive impacts

Such figures underline that card payments are already under pressure, and it is against this backdrop that the EU regulations will have a profound and pervasive impact on the various market participants. To set the context, Figure 2 shows the revenue split and sources across acquirers, network operators, and issuers. Figure 3 builds on these insights by providing a heat map of the relative impact on the three participants’ various revenue sources. In the next three sections, we’ll take a closer look at how the new regulations will impact each of these three types of business.

FIGURE 2. Card players in the payment value chain and revenue sources

<table>
<thead>
<tr>
<th>DESCRIPTION</th>
<th>MERCHAND ACRUER/PROCESSOR</th>
<th>NETWORK OPERATOR</th>
<th>ISSUING BANK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Holds merchant accounts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Responsible for connecting the</td>
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<tr>
<td>merchant to payment networks</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>and performing authorization,</td>
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<tr>
<td>settlement</td>
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<td></td>
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<tr>
<td>Provides software and gateway</td>
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<td></td>
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<tr>
<td>for payment capture, routing</td>
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<td></td>
<td></td>
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<tr>
<td>Connects and switches</td>
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</tr>
<tr>
<td>transactions between acquiring bank</td>
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<td></td>
<td></td>
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<tr>
<td>and issuing bank</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Provides transaction</td>
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<td></td>
<td></td>
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<tr>
<td>authorization, clearing and settlement</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grants Line of Credit</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Markets card based products to</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>consumers</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Handles settlement with consumers</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>REVENUE SPLIT*</th>
<th>~30-45%</th>
<th>~10-35%</th>
<th>~15-30%</th>
</tr>
</thead>
<tbody>
<tr>
<td>REVENUE SOURCES</td>
<td>Acquirer Margin</td>
<td>Transaction fee</td>
<td>Interchange fees</td>
</tr>
<tr>
<td></td>
<td>Processor fee</td>
<td>Domestic Assessment</td>
<td>Interest income</td>
</tr>
<tr>
<td></td>
<td>FX and Collection Charges</td>
<td>Cross Border Charges</td>
<td>Currency Conversion</td>
</tr>
<tr>
<td></td>
<td>Value Added Services</td>
<td>Value Added Services</td>
<td>Value Added Services</td>
</tr>
</tbody>
</table>

* Illustrative split of Merchant Service Charge (MSC) for a UK card transaction. The split varies depending on multiple parameters like value of the transaction, card security, merchant type, card present vs card not present etc.

FIGURE 3. Revenue impact of card players in the payments value chain
Internal actions that acquirers are taking now

IT changes

With the growth in e-commerce, acquirers have moved beyond the physical point-of-sale (POS) and are continuing to offer an expanding array of new services within the digital market place. Direct IT impacts on acquirers have been driven mainly by the Article 12 requirements from the IFR, which include obligations:

• To provide merchants with individual references for each transaction
• To display transactions in the currency in which the merchants account is credited
• To show charges for individual transactions showing separately the MSC and interchange fee.

Although these provisions have been in force since December 2015, a number of acquirers are yet to implement the changes or only have manual solutions in place. While the API requirements driven by PSD2 have limited compliance impacts on acquirers, they do offer them opportunities to develop new services, either by developing their own platforms or accessing some of the additional data now available.

Pricing

Acquirers are required to unblend pricing separating out service charges from interchange and scheme fees. This impacts various pricing packages for acquirers and could require a number of merchants to be re-priced as a result.

External industry-wide issues that require action and/or collaboration

Competition from TPPs/PISPs

As a result of the direct fallout from PSD2, acquirers will face direct competition from third-party providers (TPPs) acting as PISPs. PISPs compete by offering a fast secure alternative digital payment channel with immediate settlement and low risk of chargebacks. As a result, acquirers are at risk of being bypassed by new PISPs entering the market, offering direct payments to merchants’ bank accounts with potentially reduced settlement times, lower costs and lower liability.

Increased price transparency

IFR has increased price transparency to drive increased competition—a change that will likely have the effect of driving down margins for acquirers. In this environment, a number of acquirers may struggle to compete, while those with an aggressive sales strategy may have the opportunity to increase market share. The driving force towards achieving differentiation in the market will be developing new products or value added services (VAS)—this should be a strong area of focus in the short term, while acquirers are still enjoying the benefits of MIF capping.

Compliance implications for acquirers

<table>
<thead>
<tr>
<th>Merchant Acquirers’/Processors’ Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquirer Margin</td>
</tr>
<tr>
<td>Processor Fees</td>
</tr>
<tr>
<td>FX &amp; Collection Charges</td>
</tr>
<tr>
<td>Other Revenues (includes. VAS)</td>
</tr>
</tbody>
</table>

- High - Very High Impact
- Medium - High Impact
- Low - Medium Impact
- Very Low - Low Impact

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Internal actions that issuers are taking now

Interchange caps
The main commercial impacts felt by credit card issuers result mainly from the direct capping of interchange, as well as competition from PISPs shifting spend and borrowing to current accounts post-PSD2. The cap does not really impact debit businesses as, based on the average transaction value for debit, the new percentage-based fees are equivalent to the fixed fees they used to receive.

Immediate release of blocked funds
In the context of card-based payments where the payment transaction amount is not known in advance, PSD2 calls for increased consumer protection. Article 75 mandates that issuers can only block funds to the extent of the payer’s consent and earmarked funds must be released when the exact amount is known. This will further imply operating model changes for issuers and reassessment in existing card platform capabilities.

External industry-wide issues that require action and/or collaboration

Rewards and loyalty programmes
Since the capping of interchange fees results in a loss of revenues from credit card-based transactions, some issuers will find it difficult to fund rewards and loyalty programmes, and will most likely be forced to abandon these programmes or charge annual or monthly fees. We estimate that the cap on interchange fees will drive a 27% fall in card-based revenues for UK issuers by 2020. On the positive side, the prevention of surcharging will increase the number of credit card transactions, as they will become cheaper for customers.

Merchants seeking alternatives to cards
A further consideration is that the regulations may make merchants look to move away from card payments and towards alternatives. Although the MIF cap on debit transactions has a relatively low impact on issuers, some merchants will be significantly more impacted than others, and may explore alternative payment schemes as a result. For example, in the UK, Visa debit transactions originally had a fixed interchange fee of GBP 0.08, but have now shifted to a percentage of 20bps plus GBP 0.01 capped at GBP 0.50 for secure transactions. For transactions lower than GBP 35, merchants benefit from a lower rate, but above that amount they will be paying more.

For most issuers, GBP 35 is close to the Average Transaction Value (ATV) of their debit portfolio—though this may vary by member state—meaning this change will have a low direct impact on their income. However, merchants with a high ATV such as travel agents, hotels, airlines, high-end electronics, utilities, financial institutions, and government agencies could find themselves paying over six times the interchange they were accustomed to with the current cap, and even more when that cap is removed in September 2016. So there is a very real prospect that these merchants could shift a proportion of their turnover to go through alternative payments such as PISPs, reducing interchange income even for debit issuers.

Rising interbank transfer volumes
PISPs rely on a “push” model where the money is transferred from the customer’s to the merchant’s account via a bank transfer. This will result in an increase in interbank transfers which are currently free of charge in a number of EU member states, increasing costs for the banks and potentially causing them to revisit their fees and pricing models—which could in turn impact the uptake of PISP services.

IT Infrastructure
Issuing banks will incur the costs of upgrading IT systems to support the PSD2 Open APIs technical specifications, which allow AISPs to access customer information and PISPs to initiate payments on behalf of customers. Credit issuers need to consider the implementation of platform capabilities which may enable them to offer payment functionality via PISPs. Open APIs will increase the load on core systems, and the fact that future usage is difficult to project accurately at the early stages of implementing PSD2 will mean banks face challenges in efficiently sizing the underlying infrastructure.
Compliance implications for network operators

Internal actions that network operators are taking now

Adjusting to the new environment

Network operators own and manage their acceptance mark and brand; define the technical and business rules for the network, including pricing; provide the transaction gateway; and facilitate settlement between the acquirers and issuers. PSD2 regulation effectively enables an alternative payment ecosystem that does not rely on the existing network operators, starting with open APIs where PISPs have direct access to issuing banks. Additionally, the regulators mandate the separation of the scheme and processing entities and the abolition of cross-border fees, as well as the removal of a number of brand-related rules. PSD2 not only provides opportunities but has the potential to increase competition for network operators.

External industry-wide issues that require action and/or collaboration

Commercial changes impacting revenues

Since IFR mandates the separation of payment card schemes and processing entities, this will adversely impact the revenues generated from transaction processing by the shifting of P&Ls. In the medium to long term, as a result of PSD2, the displacement of cards and adoption of “push”-based payments through PISPs will further reduce the revenues from transaction processing.

Cross-border issues

Since the interchange cap also applies to cross-border transactions, this will have a significant impact on the cross-border volume fees enjoyed by the networks. Additionally, network operators can no longer charge for passporting to individual member states, further reducing their income.

Incentives to issuers

Article 5 of the IFR prohibits circumvention, and considers the net compensation of fees received and paid between the issuer and the network operator inclusive of any interchange fees. This may make it difficult for network operators to provide incentives or compensation to issuers in return for migrating portfolios or opening new products on a different scheme.

Three-party schemes

Three-party schemes with licensees are exempted from domestic interchange fee cap until 9 December 2018, provided that on a yearly basis they do not process more than 3% of the value of all card-based payment transactions made in that member state. In the UK, American Express—having a market share of more than 3%—is already under the ambit of the IFR, meaning Amex partners will have to review its portfolio strategy. The inclusion of three-party schemes will further reduce the availability of reward and cashback cards for consumers, while these are unlikely to be impacted in the corporate card market.

Limited authority

The removal of the “Honour all Cards” rule (Article 10 of the IFR) implies that merchants are no longer obliged to accept all cards issued under the same brand. This will require that cards are labelled correctly to allow merchants to differentiate between different products within the same scheme. Issuers are no longer forced to have one network brand per card—a change that impacts brand image for schemes, while also enabling issuers to potentially bundle products within form factors.
Strategic opportunities for innovative use cases opened up by EU payments regulations

All players have strategic options to gain and sustain competitive advantage

With revenues shrinking and new competitors entering the market, acquirers, issuers and network operators will have to adapt their business models and embrace the shift to digital. Although the threat of new entrants comes with the recognition that FinTechs can deliver great products at high speed, the public at large are still wary of entrusting their financial information to lesser-known third-party providers (see Accenture’s recently-released PSD2 Consumer Research point of view). This caution on the part of consumers mean established players can gain an advantage if they innovate to deliver previously unmet needs, develop new products and evolve the way they interact with their customers.

In this environment, all participants in the card payments value chain have a range of strategic options to generate value from the changes driven by the new regulations. While more options will emerge as the detail of the impacts become clearer, a number are already evident. These include:

Innovative offerings will be essential to any successful strategy

A loss of “screen time” to third-party aggregators (AISPs) not only results in a reduced ability to cross-sell, but also means AISPs could steer customers away from existing providers towards cheaper products or partner banks. To tackle this threat, issuing banks and other players will have to provide innovative offerings that increase customer satisfaction and retention. Also, while third-party AISPs do pose a threat, banks have the option of offering AISPs services themselves. By doing this they may not only mitigate the risk, but can also boost customer stickiness/retention and create a new channel for cross selling, potentially enabling them to steal a march on their competitors.

Migrating SMEs from consumer to corporate products

As centrally-billed corporate cards require sophisticated customer servicing and reporting, they have been exempted from the regulation. This presents an opportunity for issuing banks to review their consumer portfolios and migrate any small to medium-sized enterprises (SMEs) to a corporate product offering higher interchange. At the same time, individually-billed corporate accounts are likely to be phased out or have rebates removed. This means multinational corporations will need to consider different solutions for workforces inside or outside of the EU, creating opportunities to service them with new products.

Intelligent routing

A potentially important strategic option going forward is “intelligent routing”, which enables acquirers with multiple offices across the EEA to offer merchants enhanced rates by routing certain transactions to be processed cross-border in a different member state. The potential to adopt this model depends on how each member state implements the IFR and the caps it sets for domestic and cross-border fees, as well as on the interchange rates set by the payment networks themselves.

An example of this approach is the Cross-Border Domestic Interchange Programme (CBDIP) offered by Visa Europe, which enables payment processors to offer merchants lower interchange fees (0.2% for debit cards) by routing transactions cross-border rather than domestically. In the UK, Visa set the interchange fees for domestic debit transactions at 0.2% + 0.01 GBP capped at 0.50 GBP for secure, and at 0.2% + 0.11 GBP capped at 1.00 GBP for non-secure. This means that for transactions of a value of less than GBP 250 for secure or GBP 500 for non-secure it would be cheaper to process cross-border, while for those of greater value it would be cheaper to do it domestically.

As market participants pursue these options and more, several areas of opportunity are emerging where payments innovation can be applied to create compelling use cases that meet users’ needs more fully and effectively. Here are some of the areas that we believe have significant potential.

Payment initiation services at point-of-sale (POS)

The introduction of IFR has reduced the overall Merchant Service Charge (MSC). However, it is likely that some merchants will aim to leverage PSD2 to completely avoid card transactions and the associated costs.

To counter this threat, acquirers and PSPs (Payment Services Provider) can enhance their product suite by offering PISP services to their customers, like MobilePay in Denmark and Swish in Sweden. This approach would allow acquirers and PSPs to retain their position as provider of payment solutions to merchants, as well as mitigating some of the revenue loss from the displacement of card transactions (PISPs are expected to charge merchants a processing fee of between 0.2% and 0.68% of the transaction value).

Acquirers and PSPs can offer PISP services either by developing a proprietary PISP solution or partnering with established or new PISPs. In each case, the solution can be integrated within physical and online terminals, alongside the option to pay by means such as card and e-wallet. The use cases called out below illustrate how this model can be applied for both online and in-store payments.
Pay online

By integrating a PISP solution within the online checkout process (Figure 4), acquirers can give customers the opportunity to choose an alternative payment method, directly authenticate themselves with their bank, and give consent to initiate an interbank payment to the merchant’s bank account. The concept is similar to that of an online wallet, with the main difference being that the PISP allows the customer to communicate directly with their bank, rather than holding their payment details or funds.

FIGURE 4. Illustrative customer journey for an online payment with integrated PISP

Pay in-store

For purchases made in-store, merchants can offer their customers a checkout process integrated with their own personal devices. This would enable users to pay for goods via their mobile, using either the retailer’s app, a partner app (e.g. Zapper) or their Banking apps (e.g. Pingit). This type of PISP solution, integrated within the physical POS, would require the till to produce a code that the customer can scan with their app, initiating the interbank transfer from their own account to the merchant’s. However, there is certainly the opportunity to remove the physical POS from the checkout journey, by allowing customers to scan and pay for goods with their own devices—much like what happens in an Apple Store (Figure 5).

FIGURE 5. Illustrative customer journey for an in-store payment with integrated PISP
Credit, debit and lending solutions

As transaction volumes shift from traditional products to newer alternatives, digital lending solutions will have to be developed to allow direct access for PISPs and AISPs. These will be vital in order to generate new revenues and provide customers with more flexible money management and credit facilities. The use cases called out below illustrate how this model can be applied for credit payments, point-of-sale finance, and deferred payments.

Pay by credit

Credit card providers can open up APIs in a similar fashion to banks, and continue to offer their product as a payment option even through PISPs. As illustrated in Figure 6, the solution would work in the same way as the PISP journeys described above under “Payment initiation services at point-of-sale”, with the difference being that customers would be able to select their credit card provider, rather than their current account, to complete a purchase. Merchants would receive their funds in real-time, via bank transfer from the issuer, while customers can still enjoy the benefits of short-term credit.

Forex income for PISP transactions

Cross-currency card transactions use the network operator exchange rate, with the issuer usually applying additional fees or a commission on top. Alternatively, acquirers can offer merchants Dynamic Currency Conversion (DCC) services which allow them to convert the currency at the POS so that the transaction can be settled in their domestic currency. Acquirers often partner with specialist DCC providers to do this, with the profits split three ways between the acquirer, DCC provider and the merchant.

In a PISP model, whereby a payment instruction is being sent by a PISP to the bank, if the transaction is cross-currency it would be the payer’s bank that converts the transaction amount based on their exchange rate. However, PISPs could choose to partner with payee banks and utilize a “FX API” to check the bank’s exchange rate. This would allow the PISP to send the instruction to the payer bank in the account’s own currency. The payee bank would then apply the conversion on receipt of funds at the pre-agreed rate, allowing the PISP and payee bank to share the revenues generated on the foreign exchange.

FIGURE 6. Illustrative customer journey showing PISP’s integration with credit card issuers
Point-of-sale finance

Lenders could offer open APIs accessible by PISPs and partners to provide customers with loans at point-of-sale, both physical and online (see the sample customer journey shown in Figure 7). More advanced solutions can leverage customer balance and transaction data to provide enhanced offerings.

Deferred payment

To support a PISP purchase, issuers could develop temporary credit solutions which would enable the transaction to be settled in real time between the issuer and the merchant, while allowing the customer to choose the funding account at a later time. This would give customers the opportunity to fund individual transactions, within a defined period, via their preferred method (Figure 8).

As a result, it would enable customers to manage their finances by funding transactions from current accounts where they hold funds, paying off the individual transaction in instalments or utilising revolving credit facilities where they assign the transaction to an interest-bearing account. Furthermore, if the issuer doubles up as an AISP/PISP, customers would be able to view their full range of bank accounts and decide to fund the transaction from an account held by another bank, thus initiating a payment between the two.
Network operators acting as interbank platforms

Interbank payments network

Real-time interbank payment networks will be a fundamental factor in the success of PSD2, as they enable immediate receipt and confirmation of payment, meaning the merchant can be sure that the goods have been paid for before shipping them or allowing a customer to leave the store. As a result, the payments industry is already looking at the Faster Payments Scheme as the main beneficiary in the UK. However, the UK is one of a few European member states with a real-time or near-real time interbank network. In the remaining member states, card network operators have the opportunity to leverage the existing infrastructure and their relationships with banks and issuers across Europe to establish new real-time interbank schemes. This will allow them to maintain their critical role within the payments lifecycle.

Centralised API layer

Network operators are also best placed to provide a standardised interface that TPPs can utilise to access bank APIs across Europe. This type of interface would provide great benefits to all parties involved. In particular, FinTechs and small businesses who wish to use multiple banks’ APIs but may lack the capability to integrate with banks on an individual basis, would only have to plug into a single gateway. This would also reduce the complexity of integration across multiple banks within the EEA region.

Similarly, banks and issuers who are required to provide access to their information via a common standard would also benefit from a single platform, enabling them to both share and consume data while meeting common security standards. This type of model is illustrated in Figure 9.

**FIGURE 9.** Illustrative representation of a standardised API layer across Banks and TPPs
Our analysis of the impacts of PSD2 and IFR on the payment cards value chain has highlighted many opportunities for incumbent players—but also underlines that several uncertainties and questions remain. As existing and new players define their strategies, the payment landscape will continue to evolve. Acquirers will have to build new expertise to expand their payment capability and remain relevant with merchants. Issuers will have to review their products and propositions, moving away from traditional products and schemes. And card network operators still have the opportunity to play a central role in the payment lifecycle, so long as they support their clients in the digital evolution.

While these imperatives can be stated with certainty, there are a number of areas—especially in PSD2—where additional work is required to determine the specifics of the compliance obligations. These areas include the security and authentication mechanisms for PISPs and AISPs. A comprehensive risk management framework will be needed to address any barriers to uptake of these new services, and this will have a significant impact on whether these regulations succeed in achieving their intended objectives.

Another area yet to be defined is around liability and charge-back rules. Although some areas of liability have been defined within the regulation, it remains to be seen if further levels are mandated by individual member states. Even with a mandatory framework in place, will that be enough to convince consumers or merchants to switch from using a card scheme? How much further would PISPs and banks need to go to ensure digital push payments are the success they have the potential to be?

As market participants wrestle with such questions, there are uncertainties at a macro level—not least those raised by the referendum held in June 2016 when the UK electorate voted to exit from the EU. While the effects are unclear at the time of writing, the UK Banking industry has declared its intention to proceed with the implementation of PSD2.

Whatever the longer-term outcomes of such events, the fact remains that there is no one-size-fits-all solution for card payments in Europe’s new regulatory environment. The optimal solution for each player will depend on the specific characteristics of the organisation, its revenue model, and above all the local market considerations. However, with the deadline for opening up APIs fast approaching and the risks of disintermediation from new entrants growing by the day, the consensus is that incumbent payments providers must act—and do so with urgency—if they’re to fully realise the opportunities these regulations offer. Put simply, there’s no time to lose.
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NOTES


2 The revenue split referenced here is an illustrative split of the Merchant Service Charge for a UK card transaction based on Accenture Research. The split defines the percentage of the MSC that is shared between the merchant acquirer/processor, network operator and issuing bank.

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