Paysafe:

Open Banking and PSD2: A confused roadmap to innovation

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For months, and even years, in the run-up to January 13 2018, the date was circled in the diary of every bank and fintech in Europe. It marked the launch for one of the most seismic shifts in financial services for decades; the implementation of the Second Payment Services Directive (PSD2). This would be the regulatory catalyst which would provide improved banking and payment facilities in Europe, and initiate Open Banking in the UK.

Banks were required to permit registered third parties access to customer accounts (with the customer's permission) directly through open APIs. This access would enable those third parties to make a payment to a merchant directly from a consumer's account without going through an acquirer or card scheme.

A second facet of PSD2 compels banks to give third parties visibility of an account holder's data in order to consolidate multiple accounts or financial service in one place. These third parties are referred to as Account Information Service Providers (AISP).

Understandably fintechs had high expectations of PSD2 prior to its implementation. Paysafe was one of the first third party providers (TPPs) to have its PISP licence approved, in anticipation of the transformation of the payments landscape.

However, it is fair to say that some of wind has been taken out of its sails. There is still an unshakeable belief in the payments community that PSD2 will have an incredibly significant impact eventually, but the reality is this will be achieved over time rather than in the immediate future.

PSD2 ten months on: where are we now?

Since the implementation of PSD2, banks, third party providers, and regulators have been at something of an impasse which is both caused by and is contributing to a debilitating lack of clarity over what the path to an Open Banking future looks like. All parties are clear with regards to the regulations themselves, the current confusion surrounding Open Banking stems from the lack of standards defining how the banks should implement the legislation practically. There are 3 API initiatives proposing standards, Open Banking UK, STET (France) and the Berlin Group, each vary in implementation.

The PSD2 regulation was intentionally drawn up to not be prescriptive in how it should be applied, in order to facilitate a greater degree of innovation. However, the lack of a common standards framework across UK and EU market is having the effect of stalling innovation, which goes against the intended spirit of the law.

As things stand a bank can define its own interface, which is resulting in not only a lack of a common standards across the industry that's needed to enable third parties to build successful products, but also a sub-optimal level of API capabilities generally.

Banks have had a mixed approach to PSD2. The majority have treated it as an exercise in minimum compliance rather than looking for customer led outcomes. This has resulted for example in many banks currently forgoing the opportunities of creating a slick app to app authentication experience, leveraging technology such as fingerprint ID, and instead insisting the customer is redirected to a multipage web browser to authenticate. Whilst this perhaps fulfils the legislation by allowing the customer to authenticate, it certainly restricts a third party in being able to offer a compelling competitive service in the spirit of the legislation.

Recognising that banks themselves could be the beneficiaries of this Open Banking regulation some have being proactive in releasing new services; one notable example would be HSBC's Connected Money app which launched using screen scraping rather than APIs. This refers to the process where a customer shares their account credentials with the scraper, in this case HSBC, and they use these credentials to log into the relevant accounts with another bank and collect the data or initiate a payment. This is not new technology and is indeed one we use at Paysafe for our Rapid Transfer service, but it is one that we want to see solved by APIs not workarounds. This example highlights the disjointed approach banks have taken to this point; the strategy for PSD2 compliance isn't reflective of the bank's own innovation projects.

To try and alleviate the situation of non-compliance with the open API rollout, the European Banking Authority (EBA) introduced the concept of a fall-back whereby if a given bank's API was substandard or not implemented by the deadline it would have to provide a screen scraping solution in which the third party identified themselves as part of the process. Whilst this is satisfactory in concept, many banks have interpreted this as a path to legally comply with the legislation without providing a workable API and instead qualify for this exemption. Third-party providers on the other hand tend to believe there is a legal obligation under PSD2 on the banks to provide a performant API. This places significant pressure on the regulatory bodies who as a result will likely have to struggle with scenarios where a bank may legally meet PSD2 standards but have built an API which third party providers cannot use competitively.

As a caveat to this frustration, the costs of overhauling legacy technology to permit open API integration is significant so there should be some empathy for the banks that are trying to achieve this. Everyone is adjusting to the volume of regulation financial services providers are having to manage, and the cost of that compliance is now so extensive that there is little bandwidth for innovation generally. Maintaining compliance of legacy systems when the regulation goalposts are constantly moving is arduous, especially currently when financial services are also having to adapt in the face of Brexit. With Brexit and Strong Customer Authentication compliance on the agenda already for 2019, the prospect of finding the time and resources to innovate beyond basic compliance seems challenging.

Delays, and the knock-on effect on consumer perception

One further fundamental hurdle that needs to be overcome for Open Banking to flourish is consumer and business appetite for adoption. Let's face it, consumers do not sign up for open banking they sign up for a compelling service that offers value, if the value of the proposition isn't clear than why bother.

Despite the volume of research that has been dedicated to consumer attitudes to PSD2-enabled products, customer understanding is at a very primitive stage. As the products are not in the market to educate consumers on the benefits of PSD2, a negative narrative, particularly focused on security issues, has monopolised the conversation.

So when's the crunch?

By March 2019 Banks and account servicing PSPs need to provide testing facilities for their new APIs so that third parties can successfully integrate by September 14 2019 when the regulatory technical standards for PSD2 come into force.

This is significant as it gives banks very little time to improve on what is already in market and as we've seen the legislation has a broad spectrum of interpretation. So the industry faces a compliance lottery with banks facing the risk of non-compliance and third party providers not being able to migrate existing services from screen scraping. There is no winner in this scenario.

Industry confusion: Where to turn for answers

The question, therefore, is where or who the industry should turn to for guidance in resolving the disconnect between banks and the third-party providers that want to innovate. Well there is the API evaluation group which is the industry body responsible for what good looks like.

There are many initiatives underway in this space with various bodies, but these initiatives need to come together with a common standard that prioritises the customer outcomes. Let's compete on user experience not the standards.

API integration or screen scraping: A fork in the road?

As mentioned, once banks have implemented the non-standard APIs mandated by Regulatory Technical Standards (RTS) on Strong Customer Authentication (SCA) and Secure Communication, fintechs will no longer be permitted to screen scrape bank account data in the manner which many do to operate products currently. But for a product such as Paysafe's Rapid Transfer, a direct bank transfer service which currently operates using screen scraping but that is determined to fully utilise the intended benefits of open APIs post-PSD2, plotting a path forward becomes more complicated. Whilst development remains ongoing, it is increasingly difficult to make a business case for committing resources to development of an API enabled product on a grand scale when the size of the market is undeterminable.

There is almost a feeling of inevitability that the market will contain a mix of banks offering APIs and banks permitting screen scraping come September 2019, but until the landscape is confirmed there will be delays in understanding the size of the opportunity Open Banking presents in 2019 and acting accordingly.

Why haven't there been early adopters of Open Banking?

This lack of sense of a definitive direction between APIs and screen scraping feeds into the larger question of why more third-party providers haven't jumped onto the bandwagon as early adopters for Open Banking. Activity hasn't been non-existent (PISP licence holder Token and Santander processed the first end-to-end payment through a public bank API on June 1) but in general the reception for Open Banking has been lukewarm at best.

In the current Open Banking environment, the lack of scalability and certainty of direction of travel means that there is no advantage in being an early adopter of PSD2.

For established fintechs there is always a desire to not be caught behind the innovation curve, but at the same time a business case needs to be evident before a commitment can be made to developing or modifying any product or payment service. In a business where there is competition for time and resources, priority cannot be given to projects surrounded by excessive noise but without a clear vision for progress and revenue growth, regardless of the potential future benefits.

This issue is perhaps less significant as a factor for start-ups that are actively looking to disrupt a niche element of the payments ecosystem by being an early adopter, and perhaps this is where we will continue to see most action when it comes to API-enabled product development for the next 12 months.

But for major payment service providers with established businesses that require strategic decision-making, a sense of confusion is something to avoid, so it comes back to common standards to drive adoption across areas of the payments.

The cost of this compliance could also be viewed as a barrier to market entry, which again is a stifling effect on invention. New competitors in the market are constantly having to wrestle with the issue of generating revenue with the looming threat of compliance costs, which is curbing their ability to make the most of regulation designed to promote innovation.

Conclusion

As things currently stand third party providers are struggling to build usable services that plug into the APIs that have been made available by banks, and so innovation has ground to a halt. The "lack of commercial incentive to go 'over and above' the strict regulatory requirements or the implementation of a standards framework has resulted in 'compliance teams being determined to satisfy the demands of the regulation without regarding its ultimate purpose and ignoring separate 'innovation' teams that are developing an understanding of how PSD2 can enrich the customer experience through Open Banking.

Third-party providers simply don't know whether to stick or twist with API innovation as the likelihood of reverting back to screen scraping grows, and this is contributing to delays in product development with business cases not stacking up.

Ultimately the responsibility must lie with the national regulators and the EBA to break the deadlock by enforcing a tighter framework on the banks, as without this there seems little hope that banks and fintechs will come to an alignment that delivers the Open Banking landscape that was promised and more importantly deliver compelling services that offer value for consumers.