The Impact of PSD2 on Financial Services Brands

By Armen Najarian

Are European banks about to get “Starbucked”?

On the heels of the final Regulatory Technical Specifications (RTS) for strong customer authentication under PSD2, brands in this once-staid industry category are bracing for impact.

To be sure, the EU’s revised payment services directive may find some banks commiserating with retail counterparts who’ve been “Amazoned” in recent years — disrupted by more innovative challengers.

In some ways, Starbucks may offer a more instructive analogy.

Open Banking: Brand Builder or Buzzkill?

Think of it this way. Amazon enlists technology in the service of consumer convenience. Starbucks does that too. But its focus is on deepening customer relationships to help them enjoy plenty of caffeine and carbs, served up just the way they like them.

For many, this is more than just a transaction. It’s an experience that frequently warrants a post on social media. In other words, we’re talking about some serious brand love here for Starbucks — the kind most incumbents in this industry could never hope to inspire.

In similar ways, PSD2 could precipitate banking’s own Starbucks moment.

Under the directive, financial institutions are required to modernize legacy systems that have left far too many banks and their customers vulnerable to cybercrime. However, they must also open up customer account data to third parties through APIs, and securely authenticate all account access and payment authorizations made through them.

“Asking banks to give up their transactional data is like asking Google to give up its metadata,” said Ben Robinson, Chief Marketing Officer for banking software company Temenos.

It will now be easier than ever for third-party brands to forge relationships with a bank’s own customers — and even lure them away through competing offers. That is, if banks don’t develop breakthrough offerings of their own.

Disruption by Design

By its design, PSD2 will create productive tension.

On the one hand, it establishes requirements for making transactions simpler and more secure. On the other, it spurs increased competition through data-enabled apps and services that could herald a transformative new era in banking.

As a result, apps from third-party “super banks” might soon link all of your bank, credit card and investment accounts into a single interface to give you a whole level of visibility and control over your finances.

They might send you alerts when you're spending too much at Louis Vuitton — or Starbucks. Or, as The Economist points out, they might serve up the best loan rates based on an aggregated view of your financial data, even if they divert you away from your own bank's offerings.

Indeed, they might even bypass your bank completely. It's estimated that banks could lose up to 43 percent of retail payments revenue by 2020. One survey indicated that 68 percent of banks believe PSD2 could leave them in a weaker position.

Yes, there are plenty of challenges ahead. But, there are also ample opportunities.

Banks: The Other Fintechs

According to a new report from Edelman, EU-based banking brands are struggling to move past heavily transactional customer relationships, even while fintechs appear quite adept at inspiring consumer trust.

Even now, some banks view PSD2 as merely an unwelcome compliance issue. But a growing number of more forward-thinking institutions are starting to see things differently.

Recognizing the risk of becoming "dumb pipes" that authenticate transactions for more innovative players, these brands view open banking as a chance to achieve competitive differentiation by:

- Building better relationships: Banks already possess the most valuable asset — their own customer data. So Barclays, Lloyds, HSBC and others are preemptively putting it to good use by funding initiatives with fintech players to solve customer pain points and delivering better services. Ulster Bank is even working with big tech and emerging fintechs to combine banking and non-banking APIs in hopes of developing "brand love"-worthy services.
- Leveraging Brand Equity: Incumbent banks also possess brand recognition that fintechs can only dream of. As PSD2 opens up the floodgates to new entrants, the best-known brands will have a leg up on third-party players struggling to generate consumer awareness, trial and adoption. But that's only if they deliver the goods before others gain traction in the marketplace.
- Fighting Fraud and Friction: As it happens, the authentication role is actually fundamental to banking's future. According to the Edelman report, consumers see safeguarding against cybercrime key to building brand trust and affinity. In fact, nothing's harder or more important to earn.

As Mark Carney, the Governor of the Bank of England puts it: "Trust arrives by foot and leaves by Ferrari."

Even then, it's worth noting that Ferraris are known for being quite fast. Yes, consumers will surely appreciate the strong customer authentication (SCA) the RTS requires for higher-risk transactions. And they'll no doubt love the risk-based authentication (RBA) allowed for lower-risk purchases under €30. But that doesn't mean they'll wait around for either one of them.

This could present a significant problem. Compared to RBA, SCA has been shown to cut overall transaction volumes by as much as 4 percent — a costly proposition for banks and merchants alike. In response, look for banks to seek out systems that are capable of eliminating fraud and user friction regardless of authentication model, especially as new transaction touchpoints emerge.

Fintechs: Put It There, Partner

While fintech brands stand to flourish under PSD2, it's not all blue skies ahead.

These emerging brands can look forward to:

- Higher margins: According to research from Deloitte, fintechs will find open banking especially lucrative for brands developing highly-targeted services that deliver true value to consumers. But, just as in other categories, apps will be quickly discarded if there isn't enough substance to them.
- More scrutiny: The fintech sector has gone largely unregulated — until now. While customer account data is now opened to them under PSD2, access is quite narrowly defined. With screen scraping now prohibited under the directive, there will still be gaps in customer data that make it advantageous for fintechs to get along well with banks.
- Increased competition: With the potential to disrupt the industry, fintechs seeking to play Starbucks to the stodgier bank brands could quickly face market saturation. Over time, it will grow increasingly difficult to break through, especially against better known financial institutions offering similar services. Even existing payment service providers (PSPs), such as Visa and PayPal, are getting into the act with new services.
- Ready partnerships: Because of all these factors and more, look for many fintechs to seek partnerships with banks. In fact, incumbent institutions may ultimately become fintechs' primary clientele. Wealth Wizard, Aixo and Momento are just a few of the fintech players who are already tapping this market by helping established institutions meet mandates and develop exciting new services.

Change Brews Fast

Unlike their coffeehouse counterparts who never saw Starbucks coming, financial services brands have a head's up about the kind of game-changing competition that could be coming their way.

But they also have a deadline. With the final RTS headed to the European Parliament for ratification, PSD2 is set to become law by November, 2018.

Determined to avoid getting left behind, a growing number of financial services brands seem to agree that now might be the perfect time to wake up and smell the coffee.

Need help with PSD2 implementation? Read out exclusive white paper on the open banking mandates and anti-fraud solutions for securing them.