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PSD2 & CONSUMER PROTECTION

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ABSTRACT

The European payments industry has witnessed path-breaking changes over the last few years. These include the introduction of new payment services, increased technological innovation, and the entry of non-traditional service providers. In a bid to further boost competition and innovation in the industry, the European Commission has proposed the Payment Services Directive 2 (PSD2), which will come into force in 2018. The directive aims to regulate the payments industry better, and bring third party providers under the regulatory umbrella. Furthermore, PSD2 envisions opening up the payments industry through the 'account information service' rule that will make it mandatory for banks and financial institutions to provide third party service providers access to customer account information through a robust API framework.

Though the regulation will require banks to make sweeping changes to their processes, it will offer major opportunities for innovation and creation of new services and business models, apart from increasing process transparency. This paper captures the provisions of PSD2 and analyses its implications for consumers.

Introduction

The global payments industry has witnessed phenomenal growth over the last couple of decades. Significant technological advances have resulted in the entry of non-traditional players, like payment service providers (PSPs), into the ecosystem. Regulators across the globe felt the need to control the payments landscape because of the rise in the volume of business as well as the number of players. The European Commission (EC) enacted the Payment Services Directive (PSD) in November 2009. It provided a legal framework and a set of rules for payments in the European Union (EU). Key objectives of this directive were: enhancing process transparency and consumer protection, expediting transaction processing by establishing service level agreements (SLAs), and optimizing costs. It also sought to promote the entry of new players and boost competition to increase efficiency. The provisions of PSD applied to electronic payments made through any channel (card, internet, or mobile) in any European currency. Banks, payment institutions, and service providers across 28 EU nations were brought under its purview. Over the last couple of years, the financial services industry has witnessed significant growth, process innovation, and technological advances, especially in the payments ecosystem, thus necessitating a restructuring of PSD provisions. In addition, due to inappropriate interpretation of the definition of certain business entities (as in the case of 'limited networks'), several payment services firms escaped the provisions, raising concerns among regulators. The EC therefore proposed the Payment Services Directive 2 (PSD2), which redefines certain provisions of the PSD and introduces new clauses to bring more firms within its scope.

Payment Services Directive 2: A New Era Begins

The objective of PSD was to amend the regulatory framework to improve customer experience, foster innovation, enhance transparency, and drive competition by facilitating the entry of new players, rather than limit its mandate to rigid oversight of transactions. PSD2 redefines certain provisions of the older directive, and is being viewed as a major policy development that will impact the payments industry across Europe. It seeks to:

- Standardize and make card, internet, and mobile payments interoperable.
- Reduce the entry barriers, particularly for card and internet payment service providers.
- Align charging and steering practices across the EU.
- Ensure consistent application of the directive across the EU—for instance, giving member states less freedom regarding the transposition of the directive.
- Bring emerging types of payment services within the ambit of the regulation.

Key provisions and objectives

The PSD2 regulation, enacted in October 2015, had been the subject of discussion since 2013. It is set to impact financial institutions and non-banking firms already operating within the scope of PSD, as it comes into force in 2018. Furthermore, the provisions of PSD2 will extend to a varied range of payment firms such as card issuers, acquirers, loyalty programs, bill payment providers, mobile wallet operators, and e-commerce and m-commerce firms. In summary, anyone who offers payment services in Europe will fall within the scope of this directive.

Account information service: The 'account information service' provision of PSD2 essentially means that payment service users will be able to access aggregated information of all their payment accounts held with one or more account servicing payment service providers through online channels provided by the account information service providers. Payment service users can therefore get an overall view of their financial situation as and when they feel the need. This rule requires banks to allow third party providers (TPPs) access to customers' account information through secure and standardized APIs, of course, subject to customer consent. The rule envisages user controlled access to services, and once a customer grants consent to data sharing, banks will be obligated to provide TPPs with the requisite access. With regard to payments, banks will need to instantly address any request for access to customer information, institute fool-proof authentication methods, and automate exception management (for instance, reconciliations and audit processes).

User authentication: PSD2 mandates payment service providers to put in place multi-factor customer authentication (based on two or more elements, through dynamic codes) for execution of electronic payments initiated by payment service users, as a means to resolve identity management issues between customers, the bank, and the TPP. This will also require secure access between transacting parties (the bank and the third party), which will be established through a standardized API framework. In addition to implementing the authentication measures prescribed by PSD2, PSPs will also come under the purview of the Network and Information Security Directive (NISD) and its provisions on risk management and incident reporting. The key challenge lies in access management because under PSD2, the account servicing payment service provider (the bank that maintains the customer account) is responsible for deploying security measures to safeguard the customer's identity. Given that the customer's account information will be accessible to multiple third parties; it is likely that traditional authentication methods such as the use of IDs, passwords, or even tokens, may potentially pave the way for the adoption of biometrics or other robust authentication mechanisms as mainstream solutions.

The following outlines some of the PSD2 changes to improve consumer protection:

Limiting payers' liability when unauthorised transactions take place: Under the current regime payers' liability for unauthorised transactions is currently capped at £50 in the UK - unless the payer has acted fraudulently or has, with intent or gross negligence, failed to comply with the conditions governing their use of a payment instrument or failed to notify the PSP without undue delay on becoming aware of its loss, theft, misappropriation or unauthorised use. Under PSD2, the liability cap is reduced to €50. Payers will only be liable in cases of user fraud, gross negligence or failing to notify their payment service provider without undue delay on becoming aware the loss. The European Commission will publish a leaflet by Q4 2017 which will explain the changes to the liability regime and consumers' rights and obligations under PSD2.

Transactions which have been made incorrectly: PSD2 requires PSPs to be responsible for undertaking payments in an accurate and timely way. It also specifies that payers should always be entitled to make any relevant claims for refunds to their Account Servicing PSP (ASPSP), whether or not other PSPs are involved in the transaction. These other PSPs will be liable to the payer's ASPSP. However, each PSP's liability is limited to correct execution within their area of competence. As with PSD, payers will need to notify the PSP of incorrect transactions as soon as possible and within a maximum of 13 months of the date the payment was made. If the payer has given the wrong unique customer identifier, the payee's PSP is now required to 'cooperate' in efforts to recover the funds.

Complaints handling: Under PSD2, payment service providers must give a full response to complaints that involve rights and obligations under PSD2 within 15 days. If there are exceptional circumstances, this is extended to a maximum of 35 days and the firm must send the payer a holding letter in the interim.

Strong customer authentication: PSD2 requires Strong Customer Authentication (SCA), which is also known as two-factor authentication. Payment service users will need to use SCA whenever they access their payment accounts online, make an electronic payment or carry out any action through a remote channel which may carry a risk of fraud or abuse. SCA is made up of two or more elements, including knowledge (something you know, such as a password), possession (something you have, such as a card or mobile device) or 'inherence' (something you are, such as a fingerprint or voice recognition). Each element must be independent from the others so that if one is breached this does not compromise the integrity of another. The EBA is developing regulatory technical standards for SCA.

CONCLUSION

PSD2 will have implications for not just the payments space, but other areas of the financial services industry as well. The primary intent of this directive is to provide a level playing field for all stakeholders and encourage the development of new and innovative payment services. Access to payment systems will foster innovation and encourage competition, paving the way for the creation of new disruptive business models. This will in turn drive the entry of agile niche firms, making it imperative for banks and financial institutions to innovate and collaborate to increase customer loyalty and expand the overall base. While competition will increase dramatically, the PSD2 will provide a greater degree of transparency to the products and services offered by traditional players. In addition, it will also introduce tremendous opportunities for payment firms to create new ecosystems and participate in newer value chains to differentiate them in the marketplace. This will also allow financial institutions to forge synergies across payment ecosystems, beyond traditional borders. All these development will help the consumers in long run.

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