www.pwc.com/it/psd2-en

Roles for Banks and payment operators. How the scenario might evolve in the future.

PSD2 in a nutshell

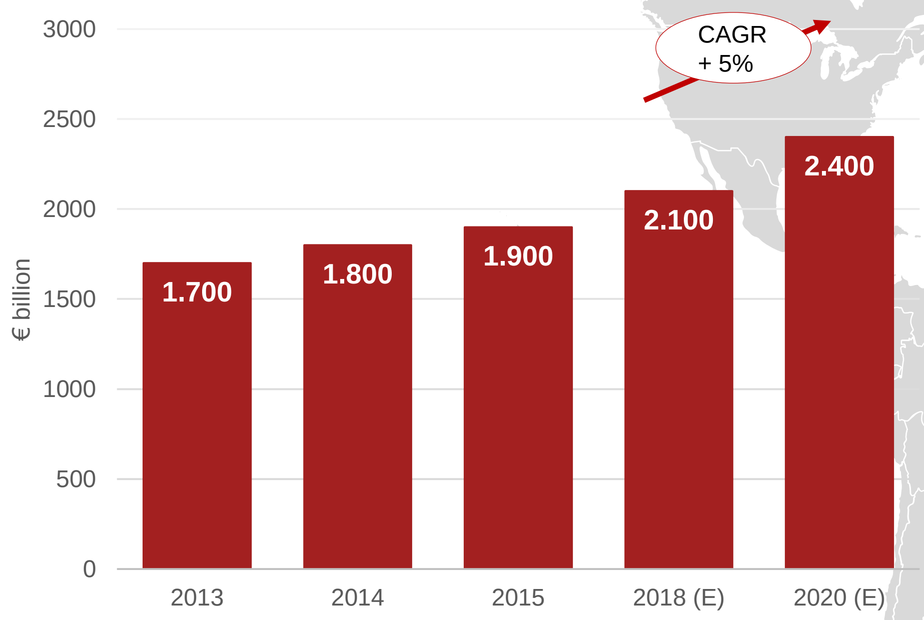
5

pwc

PSD2 in the payments market

The global payments industry is growing, at an estimated rate of 5% and could reach about € 2,400 billion within the next 5 years[1].

Revenues from global payments industry



Source: PwC analysis on public market data

The **payments business**, therefore, may prospectively be a **substantial source** of revenues: it provides stable earnings, does not absorbe significant capital and constitutes a stock of information regarding clients behaviour.

Nevertheless, in the Italian banking sector the margin from fees for **Payment and Collection** services only accounts for a **small portion** of the total margin from fees (~10/15%)[2].

So far **leading players** in this business have been **operators handling large volumes** able to **take advantage of economies of scale** in order to offer payment services at an increasingly low margin, enriching the range of their services with complex products concerning cash management, foreign currency transactions and services to manage cross-border transactions (for example, cash pooling). At the same time the payments market of private or small operators is quite fragmented, dominated by operators holding their client's payment account and providing banking and traditional services.

In this context, **PSD2**[3] and the **combined impacts of other regulations in the sector** (for example, SCT Inst, e-identity), increase **regulatory and competitive pressure** within the payments market, contributing to the reshaping of the scenario and creating opportunities for the development of new business models.

1) *PwC analysis on public market data*
2) *PwC analysis on the financial statements of the leading banking groups*
3) *See PSD2 in a nutshell 1 and 3 on the website http://www.pwc.com/it/psd2 to analyse the deadlines for the main regulations related to the Directive and the key impacts arising from its implementation*

The reshaping of the scenario and the entry of new operators

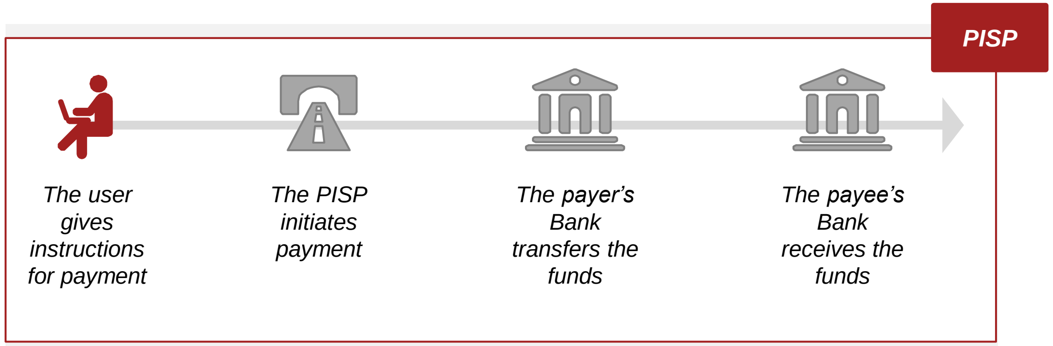
The introduction of PSD2 overturns an established European Banking market paradigm: the **information** on payment transactions, as well as on the account balance, **will be accessible** – at the request of the account holder – to external operators authorised to operate as payment or electronic money institutions.

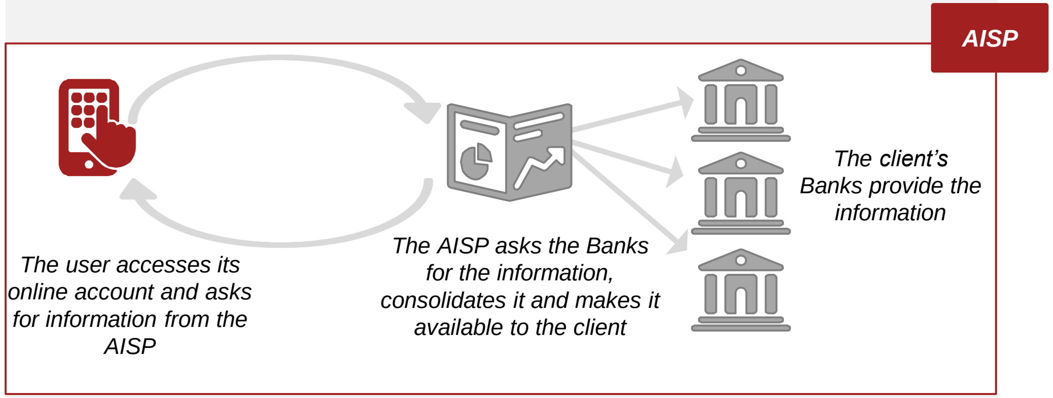
The regulations also introduces three new services:

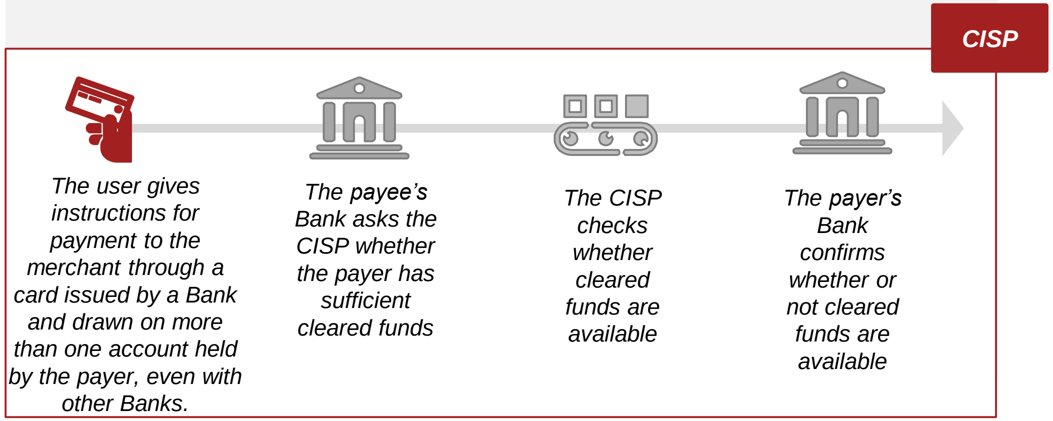
- **payment initiation** through a PISP – Payment Initiation Service Provider;
- consultation of the aggregate information regarding the accounts held (**account information**) through an AISP – Account Information Service Provider;
- **funds checking** through a CISP – Card Issuer Service Provider.

These services will allow operators, intending to become payment or electronic money institutions, to **enable new business models**.

While, until now, a merchant can be paid during the purchase process, initiated by the debtor, with a payment card or by fund transfer, under PSD2 the beneficiary (a merchant /retailer qualifyied as third party or acting through an approved party) could send a request for payment, allowing the customer to pay directly from their current account through the contact channels or interfaces used for initiating the purchase (for example, a website or an e-commerce or service App).







Example

The risk of market operators disintermediation

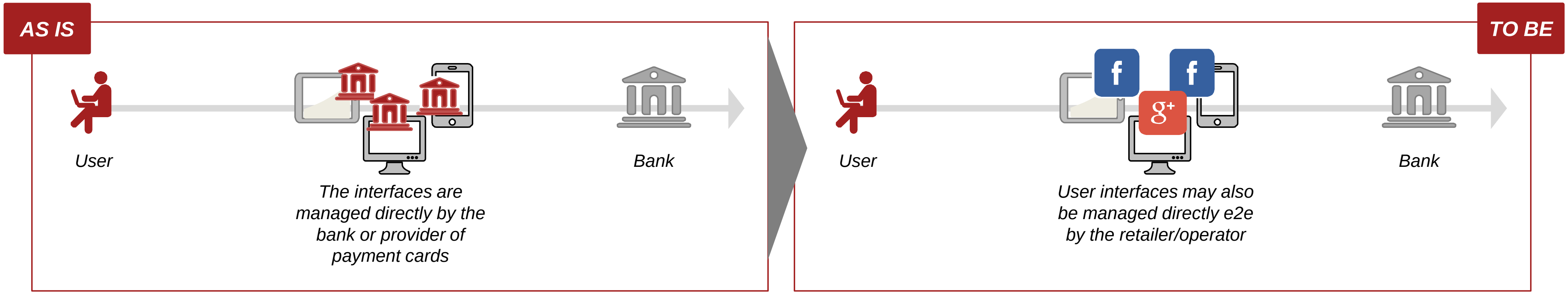
The entry of third parties (authorised to operate in the payments market) and the development of new services could lead to bypassing the **payment interface**, usually handled by the Bank or the payment card provider, and to allowing the client experience to be managed end-to-end by the retailer/operator that sells their own products/services.

This explains why Over the Tops (for example, Facebook, Google, Amazon) are closing in on and are interested in the payments market: they want to both widen the range of their services and the purchasing experience, and managed the end-to-end relationship and collect data on client behaviour (an activity Banks have not performed in an organised way so far).

This means that Banks and other payments market operators must consider the impact of disintermediation on **client loyalty** processes in the medium to long-term.

Banking and payment operators risk **losing their roles as intermediaries with their clients** and undo some of the marketing and technology investments made in this area.

In the end, competition among payments market operators will involve operators' capacity to build new engagement and relationship models with their clients with the aim of learning as much as they can about their needs and to structure a range of products/services in line with them. The responses of Banks and current payment operators on PSD2 depends on their **aspiration to have a role in the payments market** and on their **capacity to invest in new business and technology solutions.**



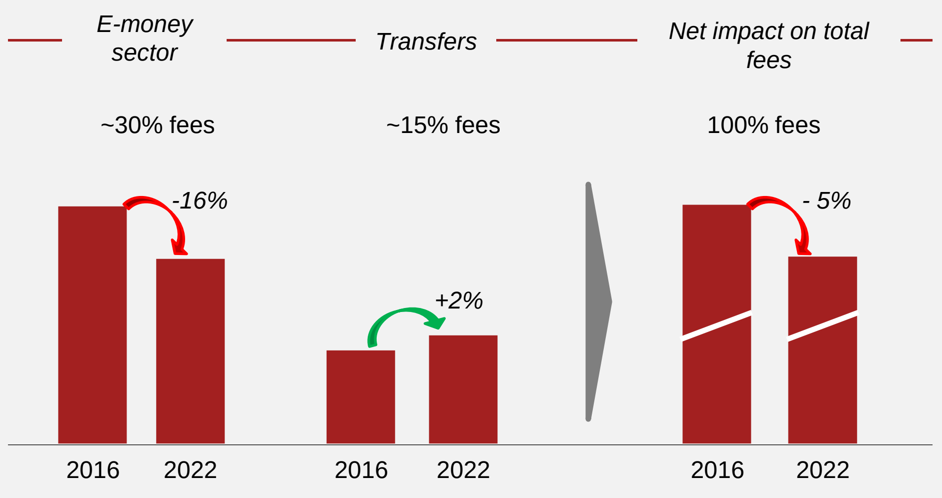
Analysing the sector …

Before working out their strategical positioning, operators already in the payments market (for example, Banks) should undertake an **analysis of the sector** in order to:

- determine the **margins produced** by the sector and the contribution it guarantees to the total business results (see the Case Study: Payments & Collections sector revenues);
- estimate the **additional revenues** which could be generated by **an advanced form of utilisation** of information on client **behaviour** (for example, Big Data, Advanced Analytics) to structure the offer of services that add value (including through TPPs);
- assess the concentration and distribution of the **volume among the segments of clients** and the related risks of PSD2 services offered by competitors;
- redefine and optimize the **pricing models** to adopt compared to other players;
- evaluate the **adaptability** and **flexibility** of the **applications** and **architectures** which make the business work and the room for growth (in terms of management of volumes and process capacity);
- analyse the **level of innovation** to be brought into the offer, possibly integrating other initiatives available in the payments sector, such as SCT Inst, payment services for public authorities (for example, payment of fines, collections) and e-identity.

Case study: Payments & Collections sector revenues

The introduction of new services enabled by the Directive could lead to a ***reduction of revenues****, especially those within the* ***e-money sector,*** *resulting from new tools****,*** *such as those used for* ***e-commerce purchases.***
There may be an ***increase*** *in the use of* ***online transfers of funds*** *to make up for the* ***potential losses****.*
In case Banks decide to follow the path of ***merely adjusting to regulations, a net revenue between -5% and -9% is expected within the Payments & Collections sector*** *in the short and medium-term.*



Source: PwC's processing of data from the Client Banking Group

… to see how operators can position themselves strategically

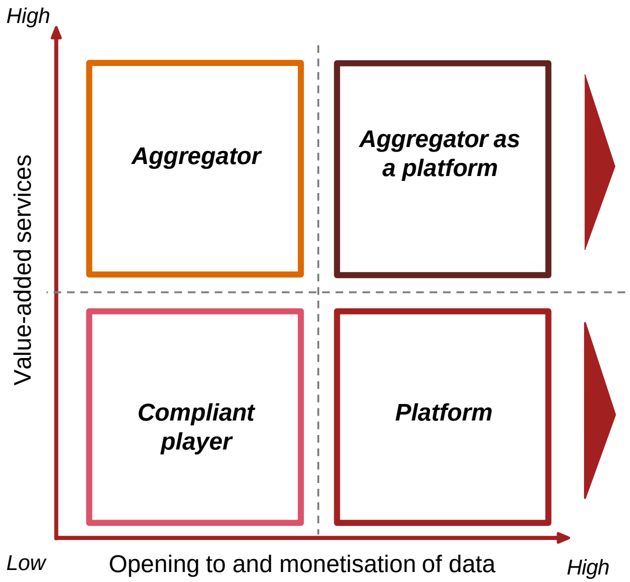
In order to make a decision on how to position themselves strategically, PwC suggests that payment market operators consider, among other things, two main drivers for revenue raising from fees in the payments business.
Operators should consider, in particular:

- ***Development of value-added services:*** measure how much the operators invest in innovation and development of their business propositions in order to differentiate themselves from the competitors, satisfying increasingly sophisticated financial needs and other expectations, improving the user experience and evolving their pricing model;
- ***Opening to and monetisation of data:*** operators should gauge their capacity to manage information, create open architectures (for example, open API) and extract value from analysing client behaviour. The more **information** is **available on the customer base**, the more it will be possible to profile clients to anticipate their needs and create innovative, digital business models and eventually develop processing platforms able to extract value also for other operators/competitors.

PwC View: possibile positions in the market in the new scenario

- **Benefits**: expansion of the product catalogue, protection of the client base, new business ideas to respond to new needs, possibile collaborations/ alliances with TPPs to retain clients
- **Investments**: compliance modifications, commercial investments for the development of new value-added banking services and functionalities, integration with third parties
- **Revenue model**: new fee revenues from value-added services

- **Benefits**: acquisition of clients and offer of VAS, including not strictly banking services, collaboration with TTPs in order to cover new clients and develop innovation
- **Investments**: compliance modifications, development of new banking services and VAS, IT infrastructure, operational mechanism as a factory for the market/competitors, development of digital skills
- **Revenue model**: new revenues (from fees and volumes) from VAS, proceeds from collaboration with FinTech and TPPs with the possibility of providing technology services/products also to competitors



- **Benefits**: compliance with regulations
- **Investments**: operational compliance modifications (ICT, security, processes, contracts)
- **Revenue model**: unvaried without the benefit of additional revenues from VAS, possible modifications to the pricing of payment products

- **Benefits**: open up to clients looking for a provider of technology and digital services, with processing capacity
- **Investments**: compliance and IT infrastructure security modifications, enhancement of technical and analytics expertise
- **Revenue model**: offer of traditional banking services to clients, provision of technology services to competitors

Source: PwC analysis

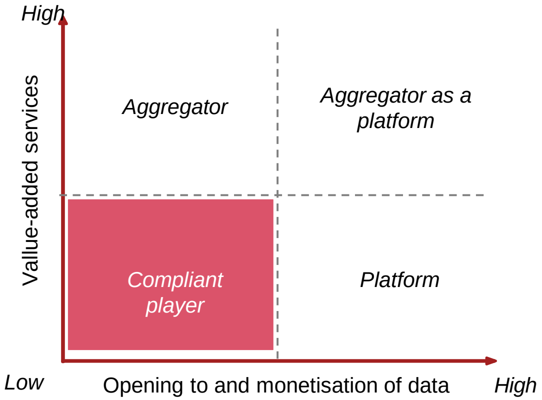
Chose ones role (1/2)

Compliant player

Compliance is the minimum objective for all market operators. To pursue this choice, investments aimed to adjust procedures, processes and contracts with clients have to be made in order to open up to the market and obtain access to back-office services from third-parties (or other Banks).

The services offered in the payments market will remain predominantly aligned to the current situation, **without the benefits** arising from **additional revenues** providing VAS. The push towards innovation generated by PSD2, the effects of other market standards (for example, SCT Inst) and the aggressive strategies of new operators can put at risk part of the **margin** from payments**.**

According to the first surveys conducted on medium-sized Italian Banks[4] these institutions **risk losing** from 5% to 9% of **their business**, the exact proportion depending on the importance of their corporate division and the share of business relating to e-money services.



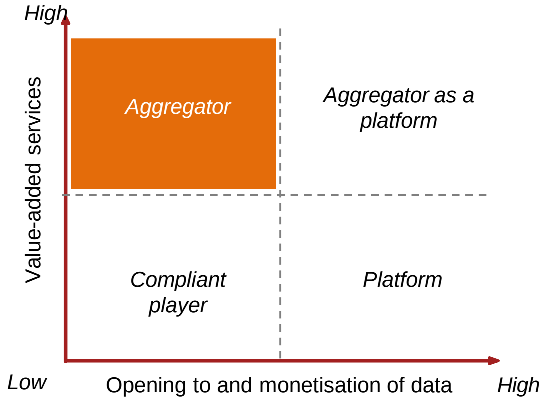
Aggregator

Operators acting as "Aggregators" **integrate information** and **initiate payment transactions** on competitors' current accounts.

The possibility of developing new services is an opportunity, in particular for small and medium-sized Banks. to prepare **a more sophisticated catalogue of services** and **secure their customer base**.

Players which make this choice aim at making **commercial investments** in developing products and revenue models in addition to their basic payment services (or based on them – for example, payments to Public Authorities).

The choice of the service model to pursue may also entail **partnerships with third parties** (for example, FinTech), which may reduce development and innovation costs and improve "go-to-market".



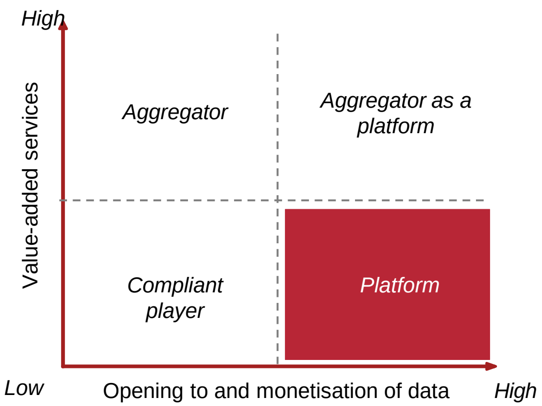
4) PwC analysis conducted on clients over the period from 2014 to 2016H1

Chose ones role (2/2)

Platform

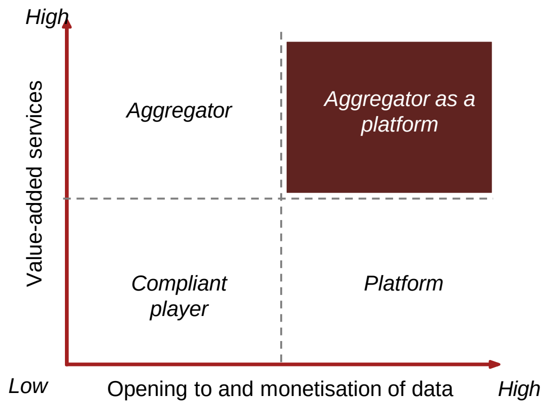
This position assumes an **investment** capacity in **IT infrastructures** and **Security** in order to provide a compliant environment based on innovative architectural logics (for example, open API) which guarantee calculation and process skills with a decreasing "cost to serve" and exploits economies of scale.

Developing architectures that can also manage the informative contents of payments, allows the operator to complement traditional payment services with **digital services**, reaching a digital clients base and to widen their target also to other financial operators and/or Banks (for example, development of B2B services: offering the technological environment to third parties, providing outsourced auditing and compliance services or developing a product factory and services to other operators which do not have the expertise nor the funds to do so themselves).
Specific expertise in **technology, security** (for example, blockchain) and **analytics** is necessary for this position in the market.



Aggregator as a platform

This role may be a target for **operators that handle big volumes**, have a substantial cross-sector customer base in the market of reference (for instance, retail, corporate, public administration segments) and can **take advantage of their capacity of process and investments** in technology and marketing.
This allows them to enable access to their services also to smaller operators looking for a performing payment engine with an architecture compliant with the regulation which supports the development of advanced products and pricing models.
In this role, the benefits of direct **collaboration/alliance** with **third parties or other financial institutions** are **essential** to sharing knowledge and innovative technologies.
Digital expertise is a critical success factor for the development of new products and services, starting from **advanced analysis of client information** (for example, Big Data, Advanced Analytics).



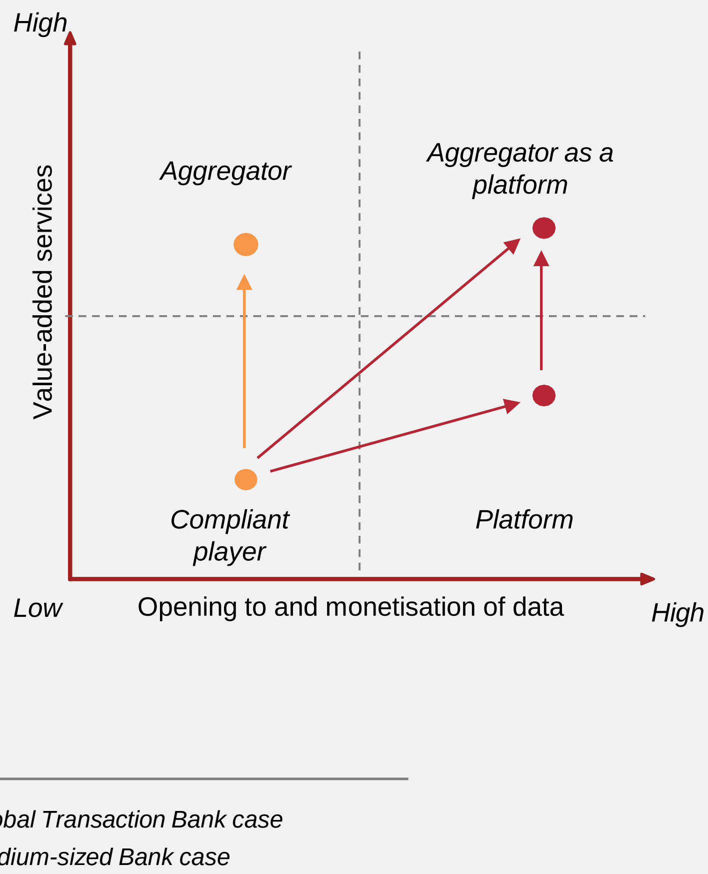
The paths to follow

Each operator affected by the transformations in this scenario must conduct a **cost-opportunity analysis** based on their size, investment capacity and risk appetite in order to **determine their positioning in the short to medium/long-term.**

The first step Banks need to take is being **compliant** with processes, procedures and infrastructure, and afterwards the analysis must **evolve** into **strategic and business objectives**.

After the compliance modifications, small and medium-sized Banks may make **further commercial investments** and enter into partnerships/alliances with new market operators (for example, FinTech) in order to take advantage of their capacity and technical knowledge, helping to develop **new value-added and aggregation services**. Larger Banks can aim at offering a wider and more digital range of services, allowing them to broaden their target client base, encouraging them to **migrate** towards **digital channels** and **more innovative** and cost effective **service models**.

Some possible positioning paths



Source: PwC analysis

Consider the involvement of the organisational structures

Depending on the strategic positioning the operator decides to adopt, it will be necessary to involve either partially or entirely some organisational structures in the change process.

	Organisational functions	Compliant player	Aggregator	Platform	Aggregator as a platform
Key organisational functions involved	***Compliance***	●	●	●	●
	Organisation/ Processes	◕	◑	●	●
	Sales	○	●	◑	●
	Marketing	○	◑	◔	●
	Architectures	◔	◑	●	●
	Security	◕	◕	●	●
	Channels	◔	◔	◑	●
Critical success Factors	***Expertise***	○	◑	●	●
	Change Management	○	◔	●	●
	Investment capacity	◔	◑	●	●
	Time to Market	◔	●	◑	●

Source: PwC analysis

○ ◔ ◑ ◕ ● Low → High

*The more the strategic objectives entail investments in commercial and marketing and ICT projects in order to sustain a competitive positioning with respect to other operators, the more necessary it will be to diversify the **expertise** of the resources engaged and, above all, to assess the degree of their involvement.*

*It could be necessary to consider **acquiring** the **knowledge** and **know-how** needed to support the path towards the desired positioning **on the market** and/or in other business sectors.*

*Therefore it is important to see which **success factors** are **critical** to achieve the desired target objectives.*

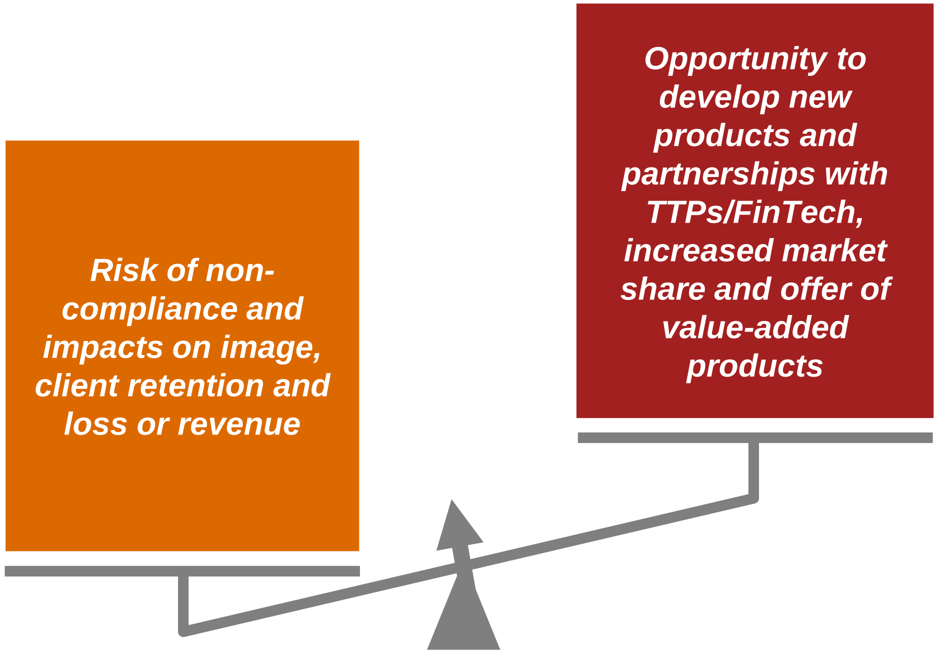
Risks and opportunities

Traditional Banks may consider PSD2 as **an opportunity to renew themselves and innovate**, enlarging their customer base and client proposition and creating new revenue streams.

The coming into force of PSD2 rules (13 January 2018), together with the impacts of **other sector legislation** (for example, Article 5 of Digital Administration Code and SCT Inst) and the extent of the action needing to be planned, mean that **decisions must be taken in the short term**.

All operators, therefore, must consider the necessity of applying minimum compliance modifications and of having clear medium-term **objectives: the amount to set aside for investment, the target clients**, the expected composition of the **revenue model** and, especially, the **contribution** that **payments businesses,** strategic for client engagement, can generate, in the PSD2 scenario.

Indeed, it is the knowledge of clients and the identification of their needs that is fundamental in **determining their strategic position**: in fact, with detailed knowledge of the targets, operators can make the right decisions regarding the commercial proposition of innovative and digital services.



www.pwc.com/it/psd2

Marco Folcia

Associate Partner | Strategy & Operations
+39 347 3786843
+39 02 66720433
marco.folcia@it.pwc.com

Fabrizio Cascinelli

Director | Regulatory
+39 345 6981767
+39 02 91605293
fabrizio.cascinelli@it.pwc.com

Gianmarco Zanetti

Director | Technology
+39 342 3039480
+39 02 66720567
gianmarco.zanetti@it.pwc.com

Sara Marcozzi

Manager | Strategy & Operations
+39 346 7809698
sara.marcozzi@it.pwc.com