3 PSD2, a Business Model Perspective: Financial APIs will foster business model innovations

The Takeaway

PSD2 introduces major changes in the European payment landscape. From a business model perspective, financial services firms can become TPPs (Third-Party Providers: PISPs and AISPs) and bundle APIs to capture value by focusing on making payment systems "bigger & better"; or become ASPSPs and unbundle APIs to capture value by finding or creating "new" sources of revenue.

Recent Developments

On 16 November 2015, the Council of the European Union adopted the revised Payment Services Directive (PSD2). According to the European Commission, "the new rules will protect consumers better when they make payments, promote the development and use of innovative online and mobile payments and make European payment services safer". Member states now have two years to introduce the necessary changes into their national laws in order to comply with the new rules.

Key Concepts of PSD2

The revised payment scheme prescribes the disappearance of some traditional players; while the revised information scheme postulates the emergence of new players: TPPs (Third Party Providers). Also, in both the payment and information schemes in the post-PSD2 world, all interactions (Access to Accounts – XS2A) will go through APIs (Application Programming Interfaces); which, put simply, are rules that govern how applications "talk" to each another. Not only will APIs allow standardised interactions amongst the various players in the payments ecosystem, but they will also enable and empower business model innovations.

The disappearance of some traditional players. Given the changes laid out in PSD2, some traditional players such as the merchant acquirers (e.g. WorldPay) and card schemes (e.g. MasterCard) will be challenged. For consumers, the payment experience will stay much the same in both the pre-PSD2 and post-PSD2 world: go to anydigitalstore.com, shop, and pay. For firms who initiate the payment (aka "PISPs" – Payment Initiation Service Providers), the back-end relationship changes: instead of interacting with merchant acquirers, the PISPs will interact directly with banks that manage the customers' accounts (aka "ASPSPs" – Account Servicing Payment Service Providers).

The emergence of new players: the TPPs. We have already discussed one of the two Third Party Providers (TPPs) described in PSD2 above; namely the PISPs (merchants). Then there are the AISPs (Account Information Service Providers), which aggregate information from multiple ASPSPs; effectively "rolling up" multiple relationships into a single touchpoint for the customer. A couple of proxy examples of this concept can be found today in services like Mint (US and Canada) and Fintonic (Spain). AISPs will access information from different ASPSPs via open APIs at the request of customers. This "access" is referred to as "XS2A" in PSD2, which we will discuss next.

XS2A will go through APIs. On a customer's request, ASPSPs must provide Access to Accounts (XS2A) to PISPs and AISPs via APIs under Regulatory Technical Standards (RTS) as defined by the European Banking Authority (EBA). Let's parse some of this alphabet soup for the sake of clarity. In the payments scheme, customers give PISPs (the merchants or retailers) permission to execute payments without having to divulge the ASPSP (the bank) login details; using tokens. In the information scheme, customers give AISPs (the information aggregators) permission to pull information from multiple ASPSPs (the banks).

Business Model Impact

According to Raymond Kurzweil, a well-known technology futurist, “once any domain, discipline, technology or industry becomes information-enabled and powered by information flows, its price/performance begins doubling approximately annually” and does not stop as technology further advances technological development. The result is exponential growth, which begins slowly, then accelerates. Seen from this perspective, PSD2 will not only regulate payments (supporting linear change) but also will lead the payment industry into the future (supporting exponential change); thus ensuring the "dynamic" nature of payment systems in Europe.

The customers. Exponential technologies are directly responsible for the proliferation of smartphones (and internet devices). In Europe, there will be 815 million smartphone users with 90% broadband connections (3G+ speeds) by the year 2020; meaning that there will be literally hundreds of millions of customers for digital financial products, services and experiences in Europe. With the advent of PSD2, many players will aggressively pursue a relationship with banking customers by becoming AISPs, competing for a share of customers’ wallets (economies of scope). Given the fact that payments are seen as a gateway product/service, the prevailing logic dictates that whoever offers the best customer experience (CX) in payments will own the customers for other products/services and create additional upselling or cross-selling opportunities. To do so, AISPs need to have intimate knowledge of customers (big data) and build experiences by bundling (using information from ASPSPs).

The infrastructure. When Amazon launched AWS in 2006, it changed the game by destroying the “economies of scale” advantage of large companies. Today, every start-up has the ability to reach two billion customers and access to digital infrastructure that can scale to serve those customers. In PSD2, start-ups and other entrants will take advantage of this scale and massive customer reach to build platforms; more specifically, to build Customer Experience (CX)-focused platforms (or "marketplaces") to lead the customer relationship as AISPs. The AISP that puts together the best payment experience (with APIs and in accordance with XS2A) will find business opportunities in the PSD2 world. As a result, they would be looking to ASPSPs to provide banking APIs. Given this focus, banks and other financial institutions (ASPSPs) are poised to offer banking APIs as a service to AISPs.

Bottom line

PSD2 will drive changes in the European payment landscape and banks, and other financial services players will have to make the necessary adaptations. Broadly speaking, banks and other incumbents will either have to lead payments CX by bundling APIs or be part of other CX platforms by unbundling APIs, or even do both.

Bank-led CX. Digital platforms are built with “Big Data” and APIs (bundling or unbundling key APIs). Under PSD2, banks could become AISPs by curating the "right" payment APIs for customers. Since banks have a wide array of data available, especially "decision data," incumbents should be well-positioned to compete. As mentioned, as banks accumulate more information they have opportunities to become exponential organisations.

Banks in every CX. PSD2 also forces the unbundling of business models and "products". In the Directive, banks have to choose a focus: own/operate a payment platform (AISPs) or offer payment infrastructure as a service (ASPSPs). As ASPSPs, it may be interesting for them to atomise or unbundle banking functions/processes into APIs so that they may be consumed easily by AISPs. By making the most banking APIs available individually, banks (or their APIs) can, in theory, be part of every customer experience.

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