

Future of Banking: Digital and Regulatory

Link 'n' Learn

March 22, 2018

Welcome

Agenda & Deloitte presenters

Today's agenda

- 1 Introduction & PSD2 regulatory context
- 2 PSD2 opportunities and impacts on Banking strategy decisions
- 3 Which technology to face those challenges
- 4 Conclusion
- 5 Q&A

Presenters



Xavier Turquin

Senior Manager

Moderator & speaker on Banking strategy

xturquin@deloitte.lu



Benoit Sauvage

Senior Manager

Speaker on PSD2 regulatory context

bsauvage@deloitte.lu



Andy Fossion

Consultant

Speaker on technology impacts

afossion@deloitte.lu

1. Introduction and PSD2 regulatory context

Our perspective on PSD2 requirements

Under PSD2, the regulated payment landscape is further expanded and new requirements come in place in terms of security, access to information and insurance

Terms & Conditions

Terms and conditions (T&Cs) signed by the customer need to include more information on the PSP, the services provided, charges, communication and safeguards

Risk management

Payment Service Providers need to have frameworks in place for managing risk, including mitigating actions and classification of incidents, which needs to be updated on a regular basis

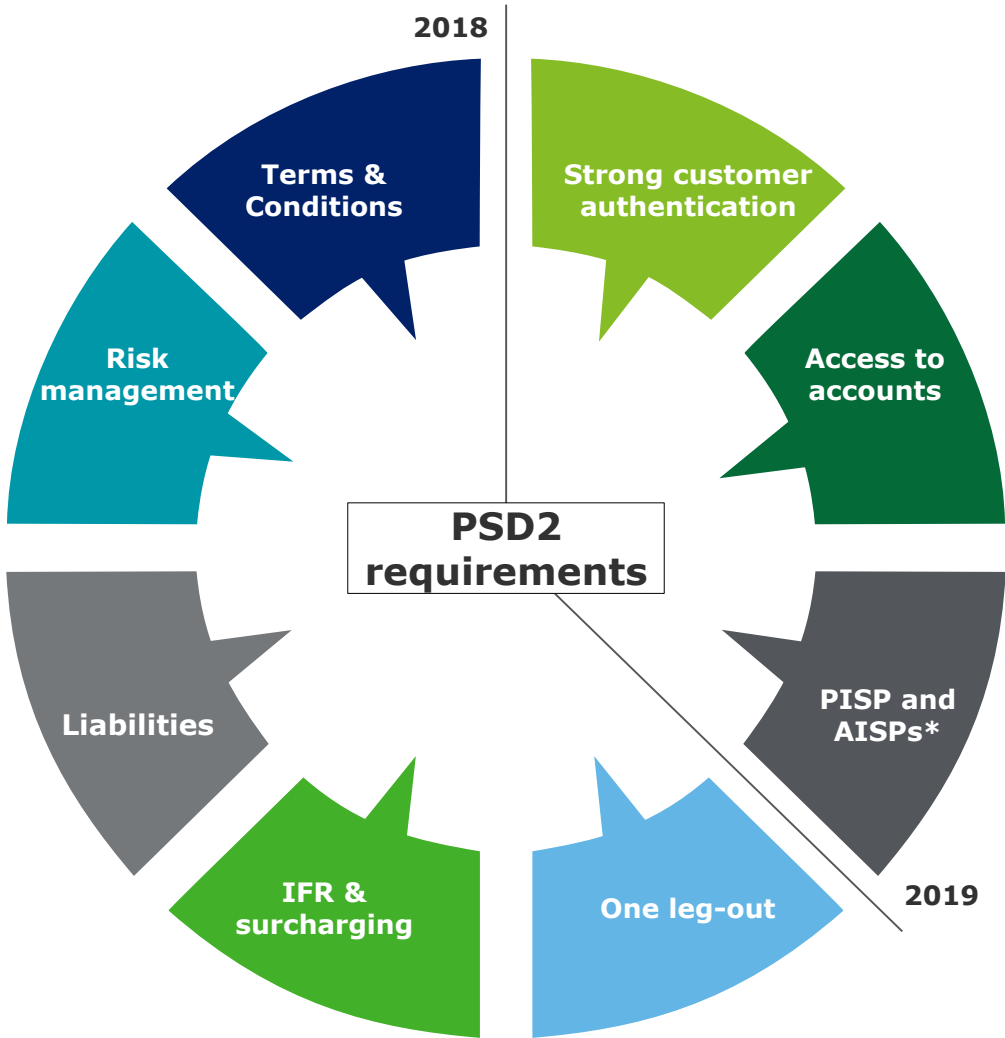
Liabilities

All parties need to ensure that payment transactions are appropriately executed, supporting payer or payee disputes. Liabilities are reduced from €70 to €50

IFR & Surcharging

Surcharging is no longer permitted if the payment instrument already benefits from Interchange Fee Caps

SHA becomes the default option for intra-EEA payments in EEA currencies



Strong customer authentication

Significant implications for financial institutions and third party providers (TPPs) e.g. two-factor authentication. Comprehensive annual reporting to the local competent authority

Access to accounts

Banks must adopt EBA Regulatory Technical Standards (RTS) to open their platforms to TPPs for PISP and AISP services

PISP & AISP*s

Financial institutions will be required to support new Payment Initiation Service Providers (PISPs) initiating payments and provide transactional data to Account Information Service Providers (AISPs)

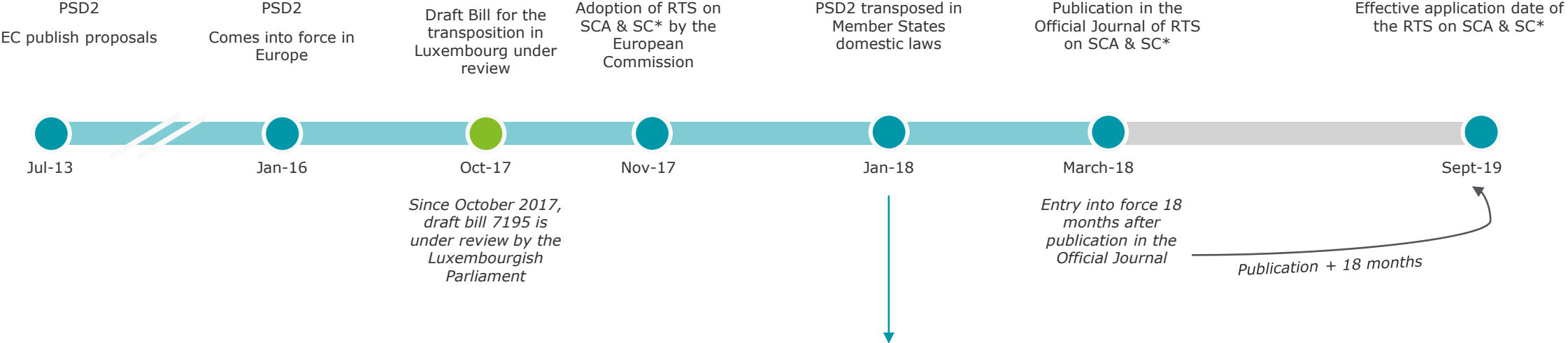
One leg-out transactions

PSD2 will apply to payment transactions where at least one of the Payment Service Providers (PSPs) is based in the EU, and EEA for specific clauses

* PISPs and AISPs together are referred to Third Party Providers (TPPs)

Timeline for PSD2 implementation

PSD2 entered into force on January 13th 2018 with an effective application date of the RTS on Strong Customer Authentication and Secure Communication for September 2019






- National legislative process
- European legislative process

The core of the Directive is to be transposed by the Member States by January 2018 and is immediately applicable to banks and payment institutions, including EBA secondary legislation (i.e. Guidelines on Management of operational and security Risks).

* RTS on Strong Customer Authentication & Secure Communication



Minimum actions to comply with January 2018 requirements

Short-term requirements & action plan

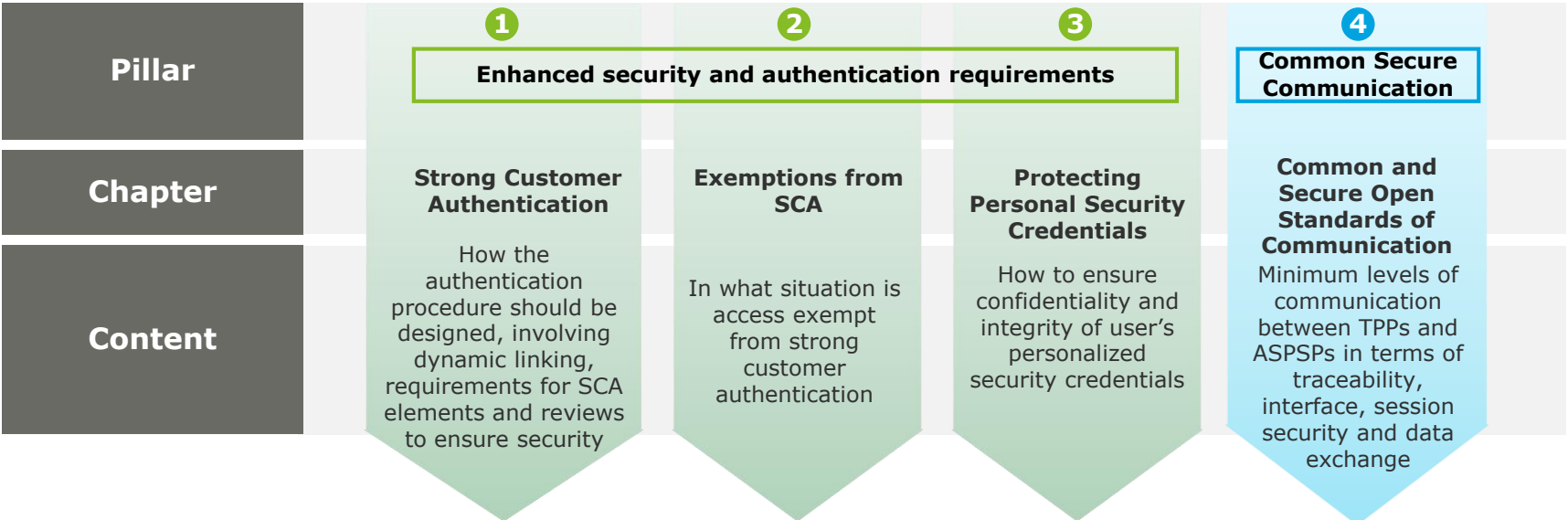
Domain	You are expected to...	...to this end you should	Expected impact		
			IT	Business	Compliance
	<ul style="list-style-type: none"> Be responsible for incorrectly processed payments, providing as well a complaint resolution procedure for the customer Put in place a comprehensive internal control framework and reporting to the competent authorities, including detection and classification of major operational and security incident Provide account information and customer protection information in a readily available, accessible and understandable format in the terms & conditions 	<ul style="list-style-type: none"> Review current risk frameworks and systems to include appropriate mitigation measures and control mechanisms in relation to payment processes risks Perform an annual risk assessment and provide an annual report to the authorities. In the case of a major incident, notify the competent authorities & relevant customer Set-up workflows to ensure reimbursement of payment amounts and related fees, charges or interests incurred by a consumer in an incorrect payment Select at least one Alternative Dispute Resolution procedure (ADR) entity and make the information available to the customer Respond to customer complaints within 15 working days 	✓	✓	✓
	<ul style="list-style-type: none"> Ensure PSD2 compliance across any transaction that has at least one leg within the EU The obligation on transparency of conditions and information applies to transactions with one leg within the EEA as well 	<ul style="list-style-type: none"> Ensure all necessary information is provided at least in respect of their part of the transaction, regardless of the currency used Review corresponding bank strategies to ensure mutual compliance 	✓		✓
	<ul style="list-style-type: none"> Reduce consumer interchange fees to 0.3% and 0.2% for credit and debit cards respectively "Unblended" pricing, separating service charges from interchange and scheme fees Provide merchants for each type of payment the separation between merchant service charge, interchange fee and scheme fee 	<ul style="list-style-type: none"> Implement the required caps Ensure that from a compliance and reporting side, relevant workflows are in place to ensure correct information to the relevant actors 		✓	✓

Minimum actions to comply with Q2 2019 requirements

Mid-term requirements & actions

Domain	You are expected to...	...to this end you should	Expected impact		
			IT	Business	Compliance
	<ul style="list-style-type: none"> Set up a strong customer authentication system, through the use of minimum 2 features (knowledge, possession, inherence) to confirm customer's identity and validate payments 	<ul style="list-style-type: none"> Review the current authentication procedures Amend the technical infrastructure and the operational workflows to adapt to strong customer authentication requirements 	✓		
	<ul style="list-style-type: none"> Ensure access to accounts in order for AISPs and PISPs to provide their services. As long as the bank only provides e-banking with consultation mode, the bank will have obligations towards AISPs only*. <p><small>* The Bank will have obligations toward PISPs only when providing online transaction services for its own customers</small></p>	<ul style="list-style-type: none"> Ensure the installation (and potentially the development) of suitable software modules (i.e. API exposed to PISPs and AISPs), with all related change management and process design aspects 	✓	✓	

Those requirements are described in the pending RTS on Strong Customer Authentication and Common and Secure Communication



2. PSD2 opportunities and impacts on Banking strategy decisions

Disruption in traditional industries

Customers have quickly adopted new ways of consuming goods and services, completely disrupting whole industries

Alibaba

The most valuable retailer in the world, has no inventory



Retail

Media



Facebook

The world's most popular media owner, creates no content

Airbnb

The world's largest accommodation provider, owns no real estate



Accommodation

Taxi



Uber

The world's largest taxi company, owns no vehicles

Coming soon?





The world's largest financial services provider, holds no bank accounts

Financial Industry disruption has already begun




PSD2 Regulation and Open banking context

The directive has direct impacts in the banking industry, namely in the relationship between the banks and their clients

PSD2 – Key components

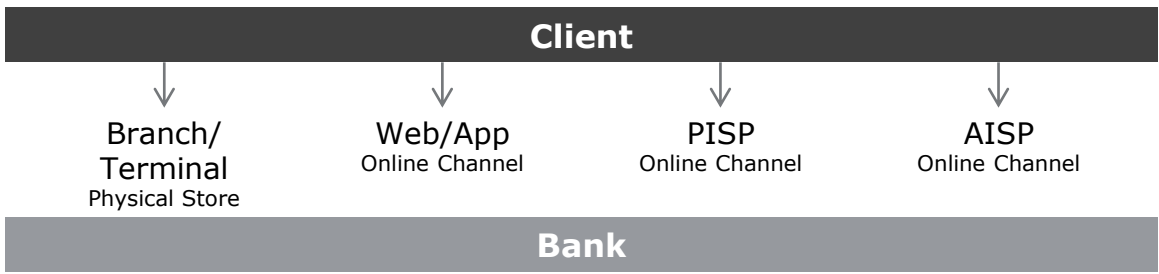
-  Higher variety of service providers
-  Payment Initiation Service Provider role
-  Account Information Service Provider
-  Security requirements

Market trends

-  Client expectations
-  Monetization of data
-  Third party ecosystem

PSD2 – Banking industry impact

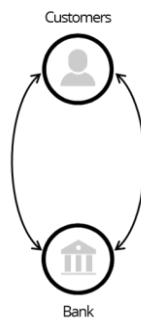
The banking sector is forced to open their platforms through APIs, in order to provide access to information to TPPs, so far considered privileged.



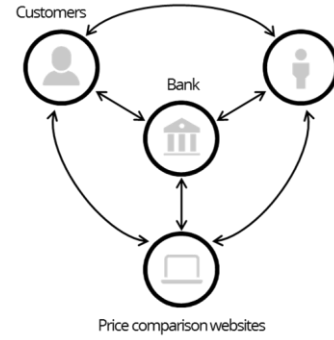
Open Banking

Open Banking requires a rethink of the traditional banking business model, enabling banks to improve the customer experience. Banking actors that embrace this **new business model** will enjoy a significant advantage given their access to existing customers, strong brands and expertise.

Closed banking



Open banking

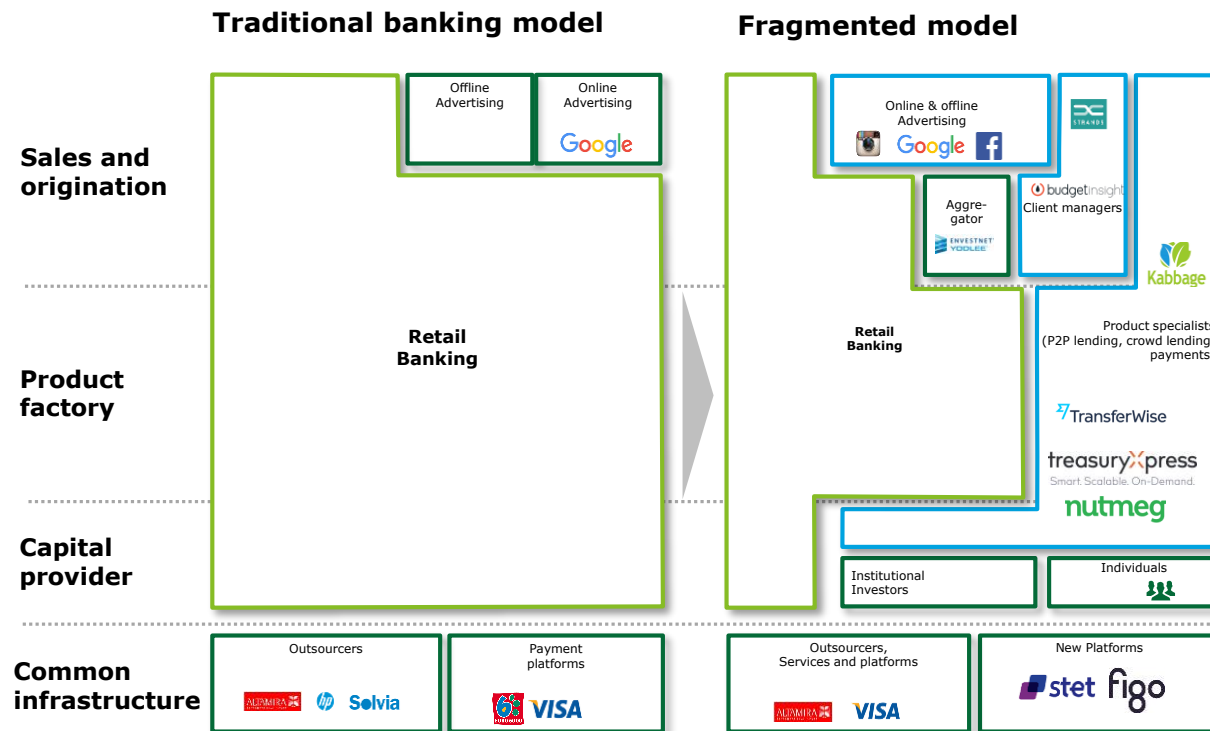


Evolution of the Banking Model

The Directive accelerates the «Open Bank» movement and creates new market opportunities both for Banks, Fintechs and other non-financial players

The traditional banking model is evolving to a fragmented model, where multiple players have different roles in the marketplace

Relationships with customers are changing, typically improving the customer experience but threatening the incumbents role

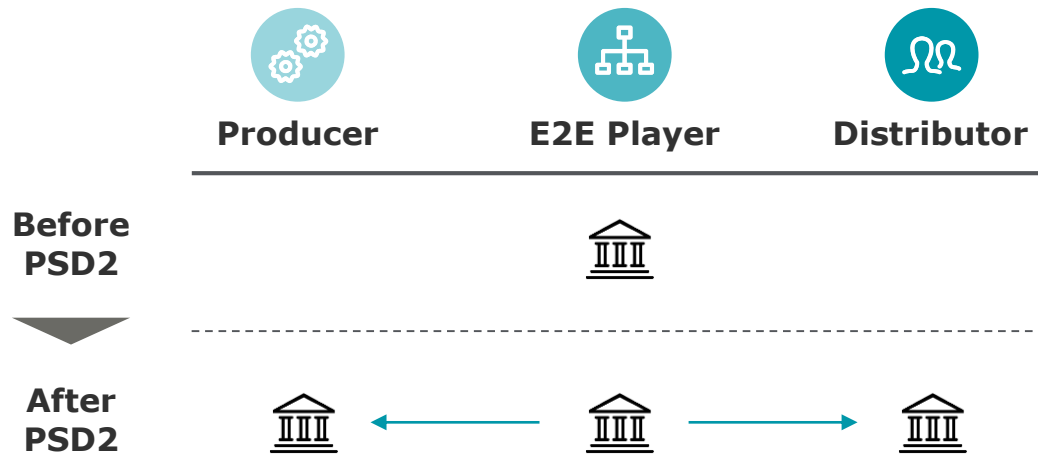


- 1 Help customers' money go further**
 - Personalizes real-time offers
 - Services triggered by customer activity
- 2 Help customers manage their money**
 - Services for account management (budgeting, warnings of likely overdraft)
- 3 Help customers save and borrow wisely**
 - Savings prompts
 - Automated savings rules
- 4 Help customers grow their money**
 - Account aggregation and optimization
 - Real-time advice on digital supports

Risks for incumbent banks

Historical actors are pushed into changing their role in the financial services value chain while they struggle with the expected reduction in traditional revenue streams

Changing the position in the value chain



Reduction of the traditional revenue

- 1 Transactions**
 - Decrease in transaction fees due to new regulation
 - Emergence of new players in the digital payments provision
- 2 Cards**
 - Reduced card usage by pushing revenue associated with annuities and interchange
 - Preference for non-credit card payments
- 3 Interests**
 - Preference for non-credit card payments



In case of absence of a response strategy, the **incumbent Banks tend to loose the distribution role** through their interfaces and to be forced into a position of solely producers of products and services



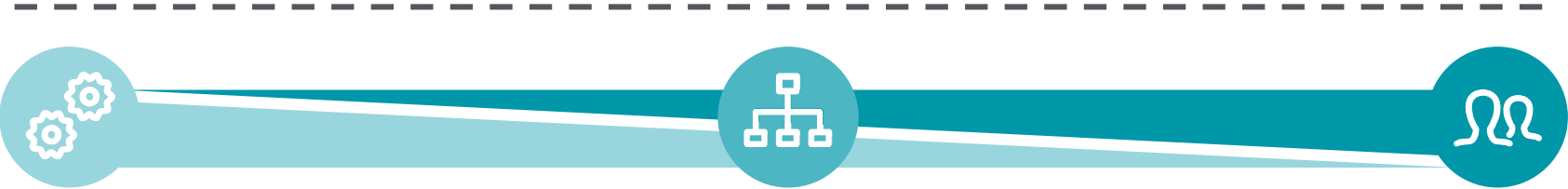
Transparency of commissions in transactions

- Comparison Tools
- Easiness in changing financial providers

Strategic Decisions

The Bank's way of acting in the open banking context will depend on its position on the value chain...

How do banks want to be positioned in the value chain ?



Focus on the production

- Focus on the production of **financial products for third-party distribution**
- Create new revenue streams, by monetizing beyond-PSD2 APIs

Requirements

- Focus on efficiency, scale, risk assessment, product quality and pricing

End-to-end player

- Maintain the role of distributor and producer, leveraging their position through cooperation with other entities at all stages of the value chain

Requirements

- Focus on organizational structure, building internal capacity and cooperation with strategic partners

Focus on the distribution

- Focus on the **relationship with the client**, through the distribution of **products and services of multiple providers**

Requirements

- Continued investment in channels, counseling and service

Strategic Decisions

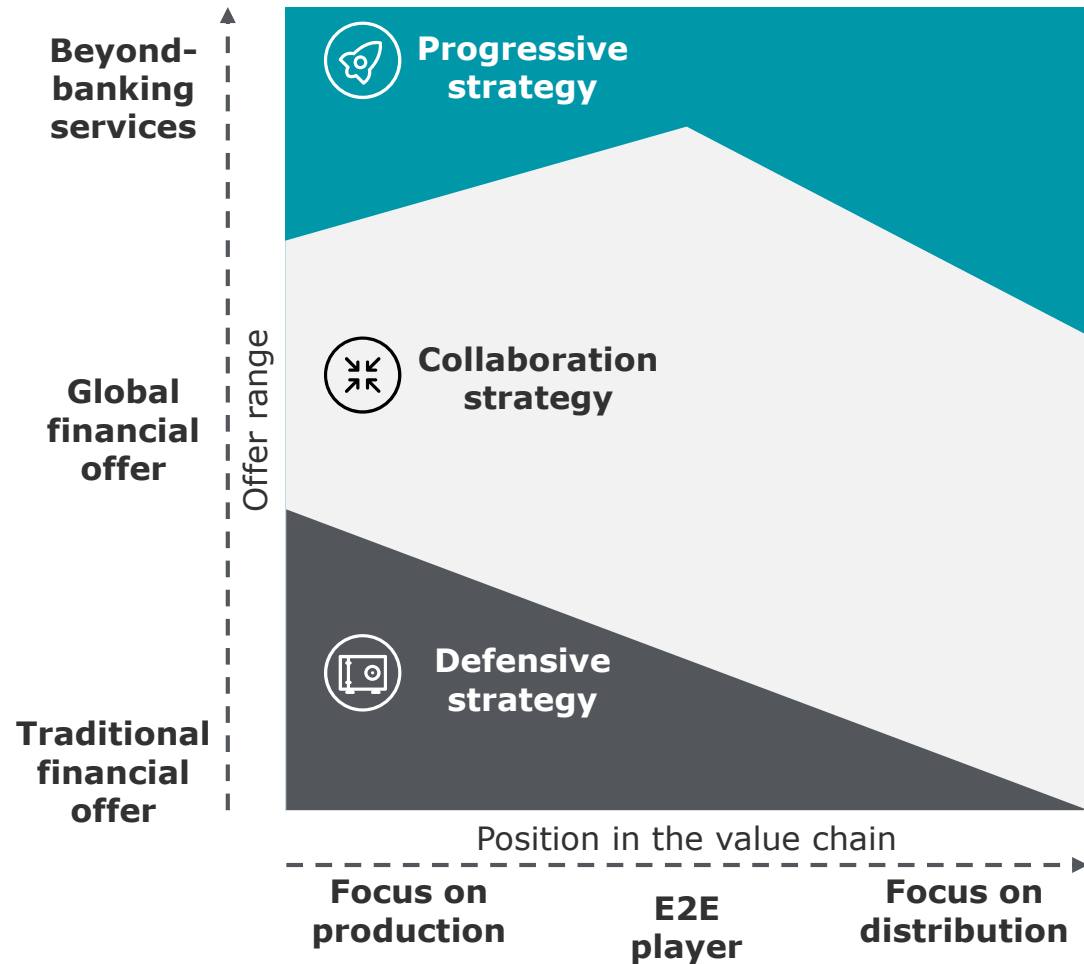
... and the scope of its offering

What products and services will the bank have ?



Strategic Positioning

By combining different decision axes, it is possible to obtain alternative positioning scenarios



- **Define market patterns** and make commitments to become a **clear market leader**



- Actively **participate** in broader digital **ecosystem**
- Actively create **partnerships** with **FinTechs** and other companies in order to add commercial value to the offer

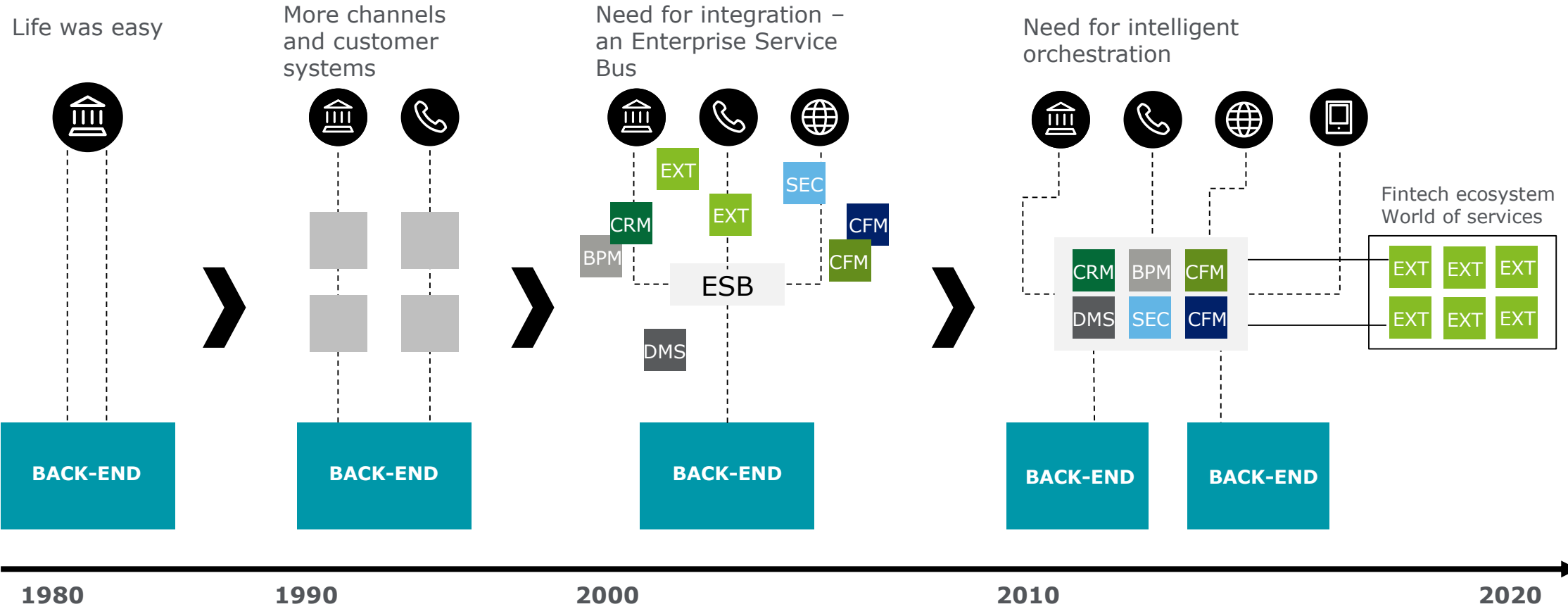


- **Defend the relationship with the client**
- Implementation limited to the **regulatory minimum**

3. Which technology to face those challenges?

Banking ecosystem evolution

The need for intelligent orchestration is not new, it appeared and increased with the evolution of the banking ecosystem



“ “ An **Application Programming Interface** (API) is a set of clearly defined methods of **communication** between various **software components**

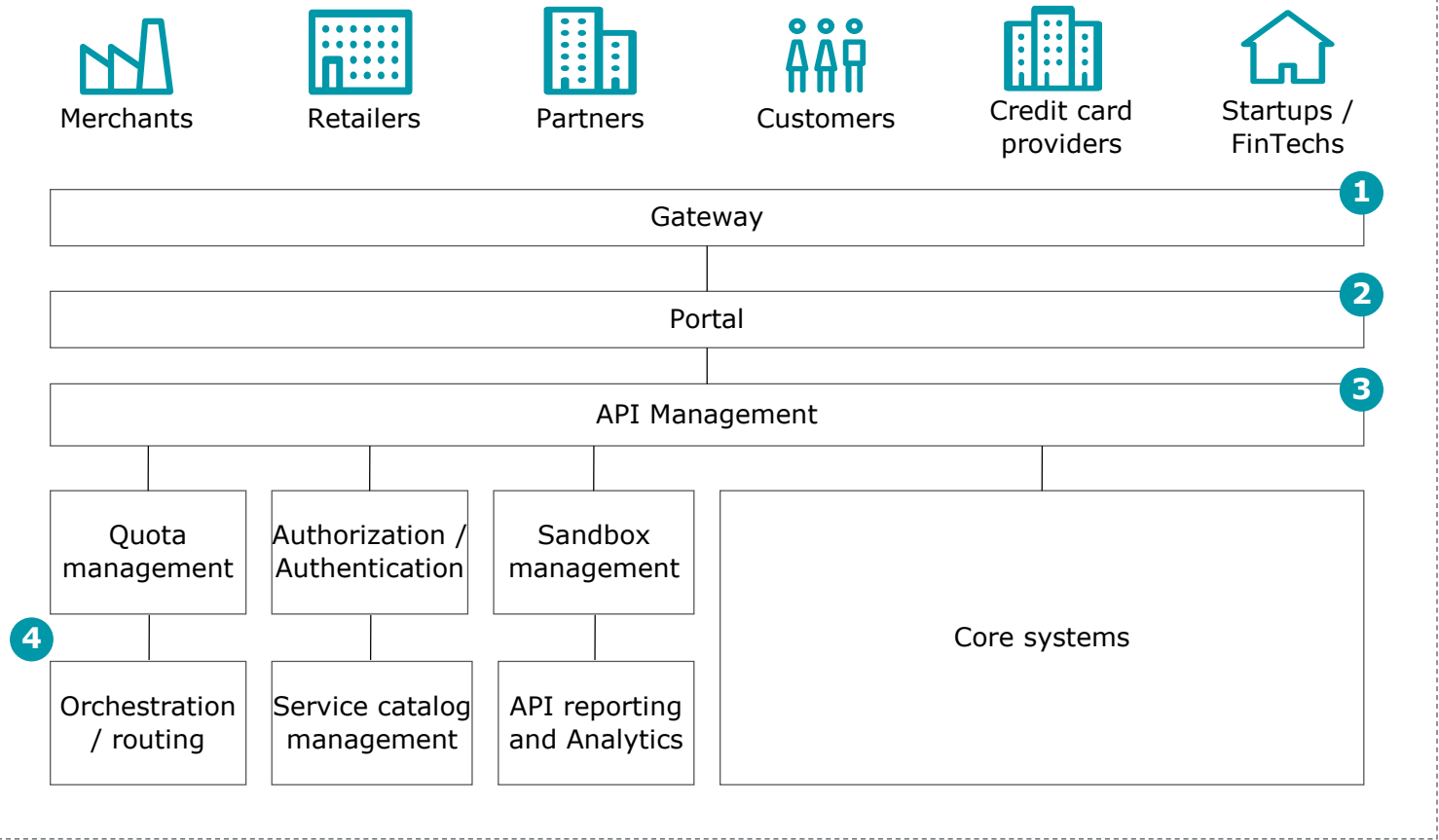
Typical API-based architecture

Building an API-based architecture requires to implement several components

An API-based architecture is characterized by several components such as:

- 1 A **Gateway** acting as the front-end, receiving and routing requests, dealing with security aspects, etc.
- 2 A **Portal** listing services available and allowing users to subscribe / access them.
- 3 An **API Management** component which is the core component interacting whit features and backend systems.
- 4 Other **Common Features** shared among all other components. Those features are generally provided by an API Management solution selected to implement an API-based architecture.

Sample of high-level API-based architecture for a bank



Key benefits of API management

API Management provides key benefits both from an internal and external perspectives

External Benefits

Internal Benefits



Integration with 3rd Parties

APIs can act as critical components of 3rd party services, providing organizations with entirely new distribution channels and the potential to expand their reach beyond the immediate customer base.



External Collaboration

API standards are increasingly evolving towards a universal format that is vendor neutral, portable, and open. This “common tongue” provides access to an ever-expanding body of use cases, development materials, and talent.



Innovation

Making digital services publically available opens a channel for third parties to experiment and develop innovative new products without requiring any financial investment or risk, effectively crowdsourcing innovation.



Internal Collaboration

The “plug-and-play” nature of APIs fosters the ability of teams working on separate systems or projects to easily link or incorporate each others’ solutions.



Compliance

Reusability and consistency are core characteristics of API design, and facilitate the ability to apply universal governance measures from a centralized platform to ensure compliance.

Main PSD2 standards

France, Germany and UK have started to build their own standards to support compliance with PSD2



STET (France) / The Berlin Group (Germany)

Both standards have been initially defined by consortiums of banks with the objective to align payments processing. They are now being extended to cover broader services, in particular related to PSD2, with the aim to target new businesses.

OPEN BANKING

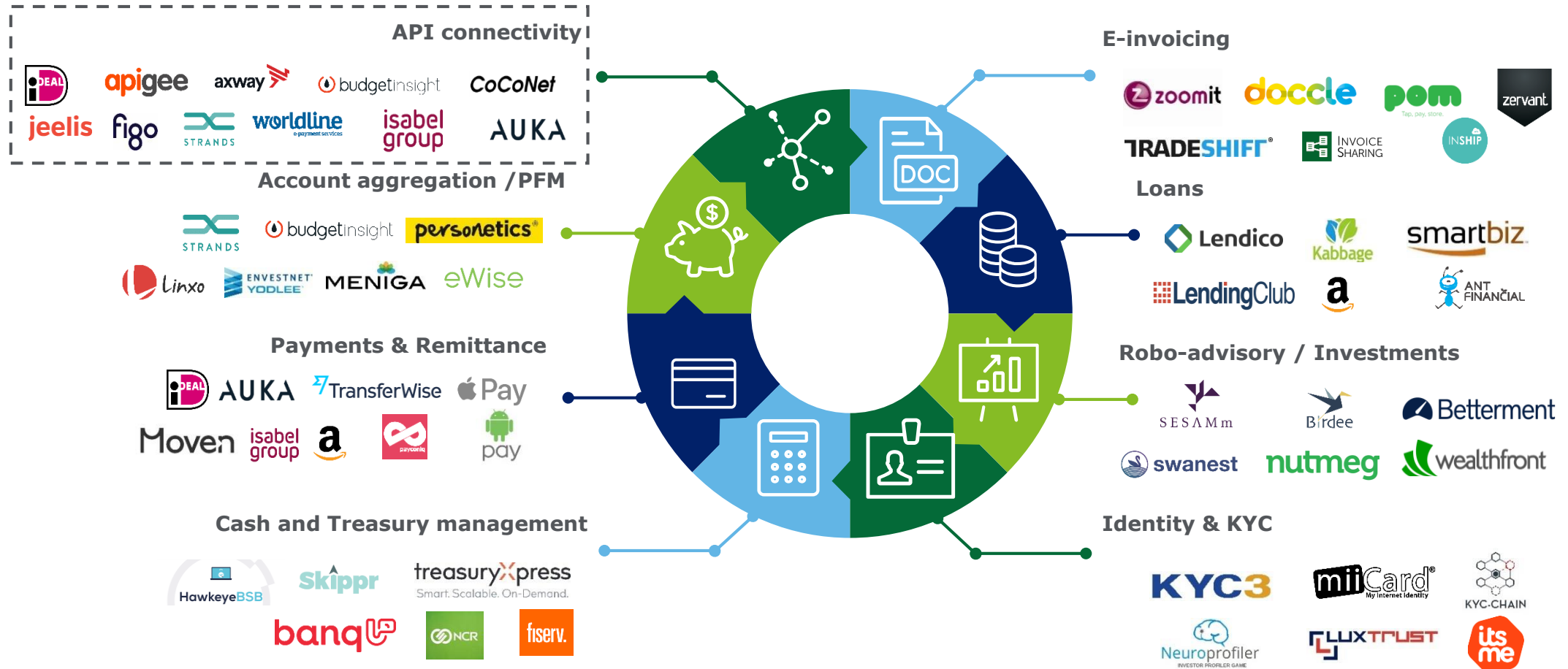
Open Banking UK

Created in 2010 with the CMA9 bank, this standard aims at covering a broader scope than PSD2 in particular regarding user experience.

Financial API world

FinTechs have already taken the opportunities offered by APIs by using them to propose products and services

NON EXHAUSTIVE



4. Conclusion

Future of Banking

What are the questions to consider to live in the future open banking world



Strategy

- What are the risks that open banking could pose to your current business model?
- What is your bank's API strategy?
- What are the opportunities to go beyond simply complying with open banking regulation?
- In which products and in which segments of the value chain should you be focusing your open banking investment?



Risk

- Do you understand the (additional) cyber and fraud risk associated with this opening up of customer data?
- Do you understand the conduct risk associated with potential propositions?



Data and technology

- Do you have the data capability to fully exploit the opportunities from the opening up of customer banking data?
- Are your back-end systems robust enough to enable winning open banking propositions?
- What role can RPA and cognitive tools, and distributed ledger technologies, play in helping you adapt to this future?



Leadership and culture

- How can your leadership help facilitate an 'agile' and pro-innovation culture across the organisation from the top down?
- How can your organisational structure become more 'agile'? How can you erode barriers between department and product 'silos'?
- Where are the opportunities to collaborate with FinTechs to drive efficiencies/improve propositions?

“ Banking is essential, banks are not.

Bill Gates, 1994

5. Q&A



Next Link'n'Learn

Date: Thursday 12th April 2018

Topic: GDPR from different perspectives



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