OLIVER WYMAN

WAKE UP TO BANK-TO-BANK PAYMENTS

REAL MASS-MARKET ALTERNATIVES TO CARD PAYMENTS COULD BE ARRIVING SOON

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WAKE UP TO BANK-TO-BANK PAYMENTS

In January 2018, Europe will be hit by the next wave of payment regulation: the Payment Services Directive 2 (PSD2). PSD2 has broad implications. We believe these will lead to bank-to-bank payments becoming an everyday reality for consumers, and will potentially capture 20% of customer spend away from existing card schemes, and provide consumers a real alternative to pay instead of using debit and credit cards.

We also believe this time is different compared to previous attempts at bank-to-bank consumer payments because the regulation will mandate direct, secure, and faster access to current accounts. Shifts in technology towards mobile payments will make the consumer experience increasingly easier and potentially simpler than secure card transactions today.

In this new payments world, the gateways to consumers' bank accounts will be owned by Payment Initiation Service Providers (PISPs), which will potentially replace at least one role of today's banks and cards. The opportunity to become a PISP will be open to a wide range of different companies, as shown in Exhibit 1.

From an economic perspective, large merchants such as retailers are likely to prefer payments through a bank-to-bank mechanism due to the ability to eliminate interchange and scheme fees that are paid for a card transaction. With the lower fees, there is potentially €1.3 BN+ of value that can be shared between consumers, the PISPs, and banks, in EU countries. More importantly from a strategic standpoint, if you are a large merchant, having the ability to initiate a payment directly from a consumer's bank account will become a powerful weapon to develop the customer relationship and further reduce friction in transactions, giving you a compelling edge over competitors.

In the light of the potential financial and strategic impact and the timing of the regulation, we think major players in the payment ecosystem need to define their strategies now. For banks, card networks, acquirers, and merchants, there are some hard questions to answer:

- How will PSD2 affect the payments landscape in two years and five years from now?
- What happens if my major competitors become a PISP and I do not?
- Should I become a PISP? Or should I partner with someone likely to be a PISP, and if so who?
- What additional business opportunities could arise if new payment methods become popular with consumers? How can I capitalise on them?
- What other changes – operating model, organisation, culture – are required to thrive in the new market environment?

In this article, we will explore some of these likely scenarios and provide international examples to begin to hypothesise how the future might unfold and what it all means for you – incumbent and emerging players alike.

Exhibit 1: Many sectors are well placed to move into the bank-to-bank payments space

TYPE	EXAMPLES
• Retailers and any large merchants, both online and offline, who have a large customer base and high turnover	• Tesco, Amazon, or Carrefour
• Consumer tech companies who have access to a large customer base through their mobile devices or operating system (or both)	• Apple, Google, and Samsung
• Banks could act as PISPs to access other accounts held by the customer	• HSBC and Santander
• Fintechs including merchant acquirers and start-ups	• First Data, Worldpay, and Stripe
• Card networks themselves	• Visa, MasterCard, and American Express

WHAT'S NEW WITH PSD2?

The PSD2 legislation is 280 pages long and is available via eur-lex.europa.eu. We have highlighted the most commercially interesting features of the legislation below. Please note this is not a comprehensive summary but some of the most important strategic and commercial elements that senior executives should be aware of:

1. Creation of payment initiation service providers, or PISPs: these parties would bypass the traditional card networks and facilitate direct bank-to-bank payments. In time, these PISPs could be powerful gateways to consumers' bank accounts, replacing one role of the bank today
2. Creation of account information service provider, or AISP: these parties would be able to access bank account information in order to present consumers with a consolidated view of their finances
3. Elimination of card surcharges (not a focus of this article): the additional fees charged for credit and debit cards subject to the EU's interchange caps (most transactions) would not be able to be surcharged to the consumer

WILL CONSUMERS GET ON BOARD?

One of the key questions regarding the legislation is about consumer adoption and why consumers would switch from card payments to a different bank-to-bank payment method. The answer will depend on the payments channel and the type of transaction (see Exhibit 2):

- For larger-value transactions, it will be easiest to incentivise the customer to use bank-to-bank payments: because they have the highest transaction fee from traditional card payments, the savings made from avoiding these fees can be passed on to the consumer as a one-off discount
- Larger businesses with strong brands will have the most success in driving consumer adoption due to a high degree of trust and existing loyalty schemes
- New payment channels such as mobile and online will be able to adapt easily as technology shifts are commonplace in this space and a phone upgrade could drive an update to payment methods
- We see slower adoption of PISP through the point-of-sale (PoS) solutions in shops due to the need to upgrade terminal infrastructure to take these payment types. However, ApplePay and SamsungPay could potentially help accelerate PoS readiness

Exhibit 2: Adoption of bank-to-bank payment will depend on payment channel and transaction type

	LARGE MERCHANTS/BRANDS		SMALL MERCHANTS/BRANDS	
	High transaction value	Low transaction value	High transaction value	Low transaction value
MOBILE/ONLINE EXAMPLES	Payment for a holiday with a major travel website	Regular payments to an App store, or online retailer	Payment for a holiday rental property	Mobile payment at a kiosk
OFFLINE POS EXAMPLES	Purchase of a vehicle at a major dealership	Contactless card payment in a grocery chain	Purchase of a luxury item from a boutique	Contactless card payment in a taxi

Many positive opportunities to benefit from PSD2

Neutral or mixed opportunities from PSD2

Least likely to benefit or be affected by PSD2

For AISPs, the value proposition is more obvious: consumers will have a dashboard of all of their personal finances – various current and saving accounts, investment accounts, mortgages – which is hard to deliver today. There are several successful examples in the US, such as Mint.com, making it conceivable that consumers will allow value-added AISPs to access their account information directly.

HOW MUCH IS AT STAKE?

Part of the disruption thesis assumes that, by avoiding traditional card schemes, there is a meaningful saving in transaction cost that can be shared between issuing banks, PISPs, merchants, and ultimately consumers.

While the cost of a PISP transaction is not yet clear, we have carried out analyses using analogies from other bank-to-bank payments costs: the overall merchant service cost typically ranges between 0.35–2.0% for Visa and MasterCard transactions (depending on merchant size, card mix, transaction type, and so on). Let's assume a PISP transaction would be priced at a similar level to a Single Euro Payments Area (SEPA) bank-to-bank payment (€0.02–0.04) per transaction, and that 20% of debit and credit card transactions were to migrate to a PISP. This would represent €1.3 BN "freed up" in the overall EU payment market.

WHAT DOES IT MEAN FOR ME?

Some of the details remain unclear. However, for PSD2 to gain traction and potentially disrupt the current card-based payment scheme, the following changes will need to take place first:

- The European Banking Authority (EBA) needs to clarify the secure authentication and tokenisation approach to be used
- More work is needed to establish a legal framework to regulate the technology linking different banks and to clarify liabilities among different parties
- Bank IT systems require an approach to take a PISP payment, including changes to data infrastructure and to authorisation and security technologies to ensure secure, reliable, and fast processing of payment
- The consumer-facing technology to encourage customers to link their bank account details needs to be developed

Given the anticipated changes above, the implication of PSD2 direct access for different players in the payment ecosystem today is quite different (see Exhibit 3). We will explore these implications and paint a few plausible pictures for the future payment for different players.

Exhibit 3: Is PSD2 direct bank access an opportunity or a threat?

SECTOR	OPPORTUNITIES	THREATS
MERCHANT ACQUIRER	Sell PISP proposition alongside acquiring as a one-stop-shop for merchant payments	Lose card volume to alternative PISP providers cannibalising card payments
CARD NETWORKS	Build PISP proposition as a defensive play and sell direct to major merchants and acquirers	Lose card volume and scheme fees to alternative PISP providers
CARD ISSUERS	Build PISP proposition as a defensive play and incorporate into payment card proposition for consumers	Lose card volume (hence interchange revenue) to PISPs and associated card fees and interest income
BANKS	Build AISP and PISP proposition to access own and other consumer bank accounts and control consumers' access to all financial information	Other banks have the AISP and PISP consumer wallet
CONSUMER TECH COMPANIES	Become the preferred PISP wallet for consumers, e.g. as per Alipay below, and AISP to consolidate account information	Others become the PISP wallet and AISP portal
CONSUMER RETAILERS	Become the preferred PISP wallet for consumers hence new source of revenue. Also link PISP with loyalty and customer marketing to provide consumers with payment and loyalty card one-stop-shop	Other retailers do this and become payment gateway to your customers
FINTECHS	Build and launch disruptive models around PISP and AISP entities defined in the regulation, like Mint in the US	N/A

CASE STUDY: CHINA

The Chinese market represents a good analogy for how the disruptive players Alibaba and Tencent were able to build powerful bank-to-bank payment propositions outside the local card scheme, Union Pay. In 2015, Alibaba's Alipay and Tencent's TenPay took the majority of market share (90%+) of €3.1 TN of mobile payments in China, up 134% from the year before[1]. It is also estimated that China's banks lost €20 BN of deposits in 2015 to Alibaba and Tencent[2].

Alipay was launched in 2004, initially as a payment platform dedicated to serving Alibaba's e-commerce businesses including the popular sites Taobao and Tmall. Alipay built the bank-side payment technology to access consumer bank accounts securely and directly and improve the consumer experience of making online payments. In the past few years, Alipay has evolved into a comprehensive consumer portal that not only connects consumers to various products and services but also provides consumers with a broad range of financial services, including payment, banking, and microloans.

Consumers can perform the following activities seamlessly on Alipay:

- Payments
  - Shop online (through Taobao or Tmall, the largest C2C and B2C e-commerce site owned by Alibaba) and pay directly from Alipay
  - Other digital products: e.g. lottery, charity
  - Other offline services: e.g. air and rail tickets, trips, movie tickets, taxis
  - Public services: e.g. utility, send and track packages
  - Person-to-person: e.g. transfer money between friends and family
  - Person-to-business (through a QR code or bar code): e.g. PoS payment – merchants, restaurants (bills can also be split between friends)
- Other financial activities
  - Transaction and balance history
  - Transfer money from or to other bank accounts (including paying for credit card bills)
  - Investing in money markets (platform for third parties), including products that allow you to earn interest on the balance
  - Provide your credit rating
  - Personal mortgage and savings calculators
  - Take a loan from the microloan platform
  - Mobile wallet: save all cards, coupons, and tickets in one place
  - Track different stocks and indices

For consumers, Alipay created a one-stop-shop portal to fulfil many consumer needs on a daily basis, such as shopping, payment, wealth management, and ordering services (see Exhibit 4). Consumers can keep all of their financial information in one place and manage it easily, and they can make mobile and online transactions using Alipay with very little difficulty.

1 Bloomberg Technology: "Apple, Samsung to Enter China Payments Market With UnionPay" 18 December 2015
2 Forbes.com, "China's banks lost $22B to Alibaba and Tencent in 2015, but that's not their biggest problem", 6 March 2016

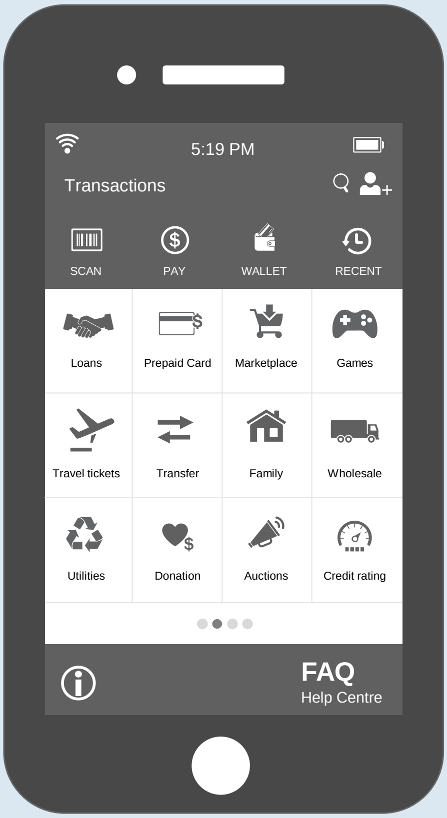
For merchants, Alipay is able to offer a much lower rate than the traditional card-based payment method. It does so by establishing a direct relationship with all the major banks in China and bypassing the card schemes (such as UnionPay in China). And by creating a “closed-loop”, it attracts many online merchants to partner with them.

As for banks, Alipay enables them to be more competitive in becoming the first choice for online and mobile payment by giving them access to a network of millions of consumers and billions of dollars of transactions. Also, given the transaction volume on Alipay, thanks to its massive e-commerce platforms, banks must participate even when they realise that they are getting much lower fees and losing direct engagement with consumers.

Alipay is able to offer compelling value propositions to all the stakeholders: consumers, merchants, and banks. It has also invested heavily in the past couple of years in offering incentives to consumers to adopt the new payment method and change their payment behaviour. As a result, Alipay is currently the leader of online and mobile payment in China, with ~80% market share, over 300 MM users and 80 MM transactions per day.

More importantly, Alibaba now has access to valuable and vast transaction data and allows e-commerce closed loops to be created. This gives them a superb ability to market different products and services to consumers in a highly relevant and targeted way.

Exhibit 4: Illustration of a one-stop-shop portal for multiple bank-to-bank consumer activities, modeled on examples from China



CONCLUDING REMARKS

Whether you are an acquirer, merchant, consumer tech company, or a financial institution, the opportunities and threats will be abundant in the next few years as PSD2 is clarified. Innovations are bound to emerge and competition will intensify. The value at stake is significant and, more importantly, the strategic impact may make a business prosper or wither, depending on what actions it takes, and when. It takes time to build new business models and the technology infrastructure to enable them. So the time to ask difficult questions is now.

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ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation.

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www.oliverwyman.com

CONTACTS

DAVID ADAMCZYK
Partner
david.adamczyk@oliverwyman.com
+44 20 7852 7781

KAIJIA GU
Principal
kaijia.gu@oliverwyman.com
+44 20 7852 7393

KEVIN McCARTEN
Partner
kevin.mccarten@oliverwyman.com
+44 20 7852 7457

CHRIS MCMILLAN
Partner
chris.mcmillan@oliverwyman.com
+44 20 7852 7764

MURIEL SCHTICKZELLE
Partner
muriel.schtickzelle@oliverwyman.com
+33 1 45 02 37 20

MATTHEW SEBAG-MONTEFIORE
Partner
matthew.sebagmontefiore@oliverwyman.com
+44 20 7852 7417

GIOVANNI VIANI
Partner
giovanni.viani@oliverwyman.com
+39 02 3057 7504

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