

EDPIA letter accompanying the response to the European Commission's targeted consultation on the review of the revised payment services Directive (PSD2)

July 2022

Executive summary

Overall, EDPIA believes PSD2 has helped to foster innovation in the European payments ecosystem.

The review of PSD2 presents an important opportunity both to improve the practical function of today's framework and to look towards the future needs of the market.

Key recommendations for today's framework:

- **The logic behind the licensing regime should be maintained** whereby firms that hold client funds, and perform more complex operations with them, are subject to stricter requirements.
- **Security rules should be harmonized** to reduce the multitude of different interpretations which fragments the European market.
- **Effective governance mechanisms and incentives are crucial for open finance** based on our experience with PSD2 and with other jurisdictions.
- **Banks and non-banks should have equal access to key infrastructure** in order to provide a level playing field and a sustainable business model in areas such as instant payments.

Key recommendations looking towards the future:

- **Regulators should facilitate innovative around authentication** to combat crime as effectively as possible and address possibilities such as object-based payments.
- **Machine-to-machine scenarios raise questions around access to infrastructure** given the potentially distortive position of device manufacturers (though this needs careful assessment).
- **Device-level security will be crucial** as the internet-of-things develops. We welcome the Commission's stated ambition to improve the cyber-resilience of connected devices.

Authorisation, supervision, and passporting

PSD2 has done a good job of facilitating innovation while maintaining a basic level of equality in the consumer experience, for example through horizontal security rules.

The payment sector has grown since PSD2. However, the types of risks involved remain similar to those that were foreseen when the legislation was proposed (from financial crime to operational failures). And basic distinctions – such as whether a provider holds client funds or not – remain highly relevant for designing payments regulation.

The creation of distinct regulatory categories, subject to scaling requirements based on their risk-profile, is a major success in European payments legislation.

This has allowed innovative firms to specialize and flourish across Europe while still ensuring that firms are regulated according to their risks. For example, technical service providers do not hold client funds and therefore are rightly not regulated as payment providers. However, they can still fall under cybersecurity rules.

Overall, the EU passport has succeeded in fostering an innovative payments market.

However, fragmentation in other rules (such as AML) can hinder the effective use of the passport.

Moreover, there is considerable national divergence in how PSD2 has been implemented and interpreted. This appears to have given rise to some amount of regulatory arbitrage, given that firms can then passport their service across Europe from wherever they are established.

Ideally, a more harmonized rulebook would reduce the possibility for arbitrage while simultaneously strengthening the passport.

Security

PSD2 has been successful in raising the level of security across Europe.

However, there is significant fragmentation around the implementation of strong customer authentication rules for different countries and use-cases.

Beyond tweaking the existing rules to reduce fragmentation, we believe that regulators should also ensure that the payments framework facilitates the use of innovative technology to fight crime. This is not only a matter of payments regulation but requires a holistic approach when considering data protection, anti-money laundering and counter terrorist financing, and legislation upon technologies such as artificial intelligence.

Use-cases such as machine-to-machine payments also underline the need to ensure the security of the devices used to make payments.

Open banking

The current implementation of open banking under PSD2 is fragmented, and the ecosystem would benefit from further standardisation. There are a variety of different APIs at national level, as well as divergence around issues such as consent management and the messages to be exchanged between different actors.

We can see a clear difference comparing the EU to jurisdictions with a powerful governance body to oversee the open banking regime, such as the UK and Brazil.

At the same time, the European banking sector has invested significantly into developing APIs. Implementing open banking has taken considerable time and effort. The community might be understandably reluctant to waste this investment and repeat the implementation experience.

We do believe that policymakers should aim for a greater level of harmonization in the end, but that this must be based around a long-term roadmap with a practical phased approach. Any mandatory elements should be introduced with significant transition periods. (An alternative option would be to allow for monetization of APIs meeting specific standards to incentivize their uptake).

We recommend providing a flexible mandate for a governance body to oversee this project.

This body could positively start with interim steps towards greater harmonization such as:

- Providing a centralized hub for documentation and certification.
- Tweak rules to harmonise the user experience without requiring full standardization.
- Supporting convergence around the national interpretation of open banking rules.

We would furthermore urge European regulators to build standardisation in from the outset when developing new pieces of data access legislation. For example, if future open finance initiatives

foresee the development of new APIs then this should be taken as an opportunity for harmonization. Indeed, this might retroactively encourage banks to align to those new standards for access to payment accounts as well.

In this regard, we note that the data access regime for connected devices in the recent data act does not provide for detailed mandatory standards. While this reduces cost in the short-term, the lack of harmonization it implies could be harmful in the long-term.

Practically, we recommend that policymakers should clarify the role that might be played by different initiatives including for example the work in the EPC for a SEPA Payment Account Access Scheme.

Finally, we believe that adequate compensation is needed to make the European data economy a success. Firms should have a sustainable incentive to invest continuously in their user experience and functionality.

Access to infrastructure

Equal access to core infrastructure is vital to create a level playing field between banks and non-banks.

This has important practical consequences. For example, the uptake of instant payment solutions would be supported by ensuring that non-banks can engage with them on equal terms to banks.

Generally speaking, EDPIA believes that regulatory intervention to open up private infrastructure should be an exceptional measure.

At the same time, in areas such as machine-to-machine payments it is worth being aware that manufacturers could have a privileged position over design choices (as they are integrated into connected devices). Actors with a genuinely privileged position should be prevented from distorting the payment market as the machine-to-machine space develops.