Roland Berger Spotlight

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Staying relevant in a disruptive market. EU member states have until January 2018 to implement the revised EU Payment Services Directive 2. But many banks in Central and Eastern Europe are still hesitant on how to respond.

Roland Berger

50 YEARS navigating complexity

The revised EU Payment Services Directive (PSD2) will increase competition among traditional banks. It will also open up the banking market to competition from nonbanks and smaller emerging banks.

With billions of euros in revenue at stake, it is crucial that incumbent banks in Central and Eastern Europe (CEE), just like their counterparts in the rest of Europe, adapt their strategy in order to prosper post-PSD2.

40% of banks in CEE have not yet decided which strategy to pursue

PSD2 empowers consumers by giving them control of their financial information. It will compel banks to supply third-party providers (TPPs) with the relevant data, subject to their clients' consent. The directive also forbids banks to discriminate against third-party payments. This means that banks risk being bypassed completely, with their products commoditized and the entire customer interface opened up to new competitors.

Our research shows that the majority of banks in CEE are aware of the challenge and are preparing to take action. We surveyed representatives of approximately 50 banks in eight countries across the region: Austria, Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania and Slovakia. The clearest message from the survey was that the new legislation will have a major impact on traditional banking models. We found that around three-quarters of banks believe that PSD2 will change their business model significantly, or even radically. The vast majority (85 percent) already have a plan in place for how they will implement the technical requirements of PSD2. However, few have actually started on implementation.

This leads to an obvious question: What are the banks planning to do about it? Many are intending to become a TPP in their own right. Just over half say that they will offer both account information (as account information service providers, AISPs) and payment initiation (as payment initiation service providers, PISPs). A mere ten percent definitely do not plan to become TPPs. That leaves a massive 40 percent who have not yet decided which strategy to pursue – a risky situation to be in, given the time constraints and complexity of implementing whatever approach they ultimately choose. → 01

CEE banks are planning to leverage the new framework and opportunities from PSD2 for the benefit of their business. This will mainly involve providing advice and new products or services (65 percent). Roughly half the respondents plan to facilitate and monetize API (application programming interface) access, develop an ecosystem with other partners, and use additional information for E2E (end-to-end) digitization and improved processes.

PSD2 will also accelerate the development of PFM (personal finance management) solutions, where clients have a single account consolidating all their financial activity – from accounts held at various financial institutions to insurance policies and utility bills. The directive's stated aim is to improve convenience for customers and widen the scope of services offered. Incumbent banks are likely to want to operate such portals themselves, becoming their clients' platform for day-to-day transactions. This will enable them to build loyalty and hold on to their cross-selling activities, which currently generate a large share of their revenues.

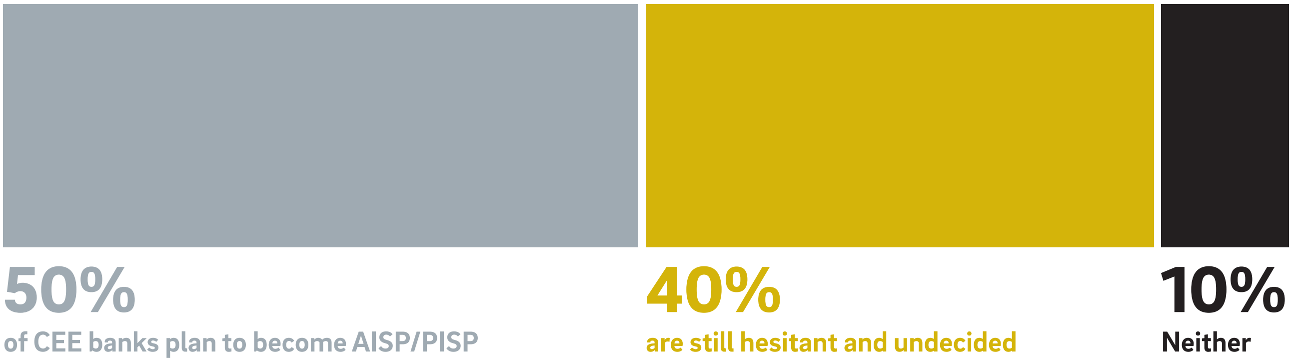
Cautious optimism reigns

Banks in CEE are generally rather upbeat about the coming revolution, focusing on making the most of the opportunities rather than worrying about the threats. Many of them are convinced that they will significantly benefit from the development – or are at least putting a brave face on it.

In practical terms, the survey found that most banks have already integrated the projected impacts of PSD2 into their strategy and project roadmaps, as well as their IT implementation plan (35 percent have done this "to some extent", 40 percent "to a large extent"). However, they are uncertain about how the directive will be implemented and how their competitors will react to the new legislation. For this reason, they are generally not yet incorporating the projected impacts into their future revenues and profits.

Having said that, banks are generally optimistic about the longer-term effects on their revenues. More than two-thirds (70 percent) expect to see an increase

Figure 01: Are banks in CEE planning to become an AISP or PISP?



AISP: account information service provider PISP: payment initiation service provider

Figure 02: Three strategic options for CEE banks regarding PSD2

1. DEFENSIVE
Fulfill minimum requirements

Open system up to other TPPs to allow access to accounts

Revise KYC and customer protection processes for TPP access

Foster strong customer authentication tools, and process and review related customer experience

Allow access to raw data as required by law

2. OFFENSIVE
Optimize current business model

Fulfill minimum requirements

Move from simply providing access to APIs to actually becoming established as an AISP and/or PISP

Optimize current business model by leveraging PSD2 opportunities (end-to-end digitization of processes, improve existing products such as building a personal finance solution, etc.)

3. DISRUPTIVE
Innovate business model

Fulfill minimum requirements

Transform into an AISP/PISP

Become a platform provider/digital marketplace (e.g. API platform aggregator, open comparison model)

Create a partnership network and leverage partners (e.g. FinTechs) to gain a competitive edge

Provide bank's infrastructure to other banks to generate additional revenues

DEGREE OF TRANSFORMATION REQUIRED

Low .... Medium .... High

Source: Roland Berger

in revenues, with most putting the impact at between two and ten percent. While they acknowledge that some banks will no doubt lose clients, 60 percent think that this impact will be very limited. Indeed, a quarter of respondents do not expect a net loss in clientele, as they think that they will pick up clients from the competition.

We also asked banks what they consider the key capabilities for successfully managing the PSD2 revolution. Their answer? Above all, intelligence in data management, open organization and partnerships, and the ability to properly implement partnerships.

A wide range of reactions

Banks in different countries varied in their responses. Banks in the Czech Republic are the most conservative in their expectations of how PSD2 will impact traditional banking business. They perceive the new directive as an opportunity rather than a threat, and are concentrating more on IT implementation than strategic considerations for the moment. About two-thirds of Czech banks have already decided on their approach, and all of this group are planning to become both AISPs and PISPs. Most often, they intend to leverage partnerships with FinTechs. Almost 80 percent plan to provide additional advice as well as new products and services, albeit largely within the framework of the traditional banking model.

Banks in Hungary show the greatest optimism regarding the revenue impact of PSD2. Most predict a slight increase in the short term and an even stronger positive impact in the longer term. While not expecting radical changes, they foresee further market consolidation, along with the entry of FinTechs and other players into the market. More than half of the country's banks have yet to decide whether to pursue new partnerships as a part of their PSD2 strategy. This is more often seen as a key success factor here than in other countries.

Of all the countries we investigated, Austria's banks expect the new directive to have the biggest impact. All respondents here thought that PSD2 would significantly or radically change the banking business model. They expect to see FinTechs and other players entering the market and services being commoditized. All Austrian banks have a plan in place to implement the technical requirements, and more than two-thirds have already started working on implementation. Most expect to see an increase in revenues in both the short term and the long term. Data management and partnerships are viewed as the key success factors, with employees and clients also playing an important role.

Finally, banks in Romania are the least advanced in their thinking about PSD2 strategies and IT implementation plans. They take a rather defensive approach compared to the others in the survey. Almost half are unsure about exploring new partnerships, and nearly 40 percent have no plan in place yet regarding implementing the technical requirements. More than in other countries, Romanian banks fear losing clients due to the changes. Regarding key success factors, they draw particular attention to intelligent data management and the digital savviness of employees.

Of course, if incumbent banks lose out, then other players stand to gain. Technology companies, such as Google and Apple, as well as retailers, utilities and telecommunications companies will have a golden opportunity to enter the market when the new legislation comes in. These players can leverage their already large customer bases to build client relationships in areas that were formerly the exclusive domain of the banks. The result? Most likely a platform war for clients, with the winners gaining key access to clients for cross-selling. And if the non-banks win, incumbent banks could well find themselves pushed into a purely product-factory role, with accompanying pressure on their margins.

Three options – one path to success

Banks fall into one of three groups when it comes to their choice of strategic option. Those choosing a defensive approach will meet the minimum requirements of the directive, opening up their system to other TPPs to allow access to accounts, revising processes and strengthening customer authentication tools as required by law. However, in all of these areas they will do no more than the minimum required. → 02

Players choosing an offensive strategy will go beyond simply providing access to APIs and will establish themselves as AISPs and/or PISPs. They will seek to optimize their current business model by leveraging the opportunities that PSD2 creates through end-to-end digitization of processes and the introduction of personal finance solutions. Some banks with a limited risk appetite intend to be "smart followers". The offensive approach has certain advantages over a purely defensive approach, but we believe it still does not go far enough.

The most radical approach – and the one we recommend – is a disruptive strategy. Banks choosing this option will establish themselves as AISPs and/or PISPs. They will become platform providers, such as API platform aggregators or providers of open comparison models. This radical step will enable them to earn fees rather than taking risks themselves. They will secure a first-mover advantage by building a network of partnerships, for example with FinTechs. And on top of this, they will provide their infrastructure to other banks – a "white label" approach – as a way to generate additional revenue. We believe that a disruptive strategy such as this offers the strongest chance of true success.

In practical terms, the first step for banks in CEE is to achieve clarity regarding the strategic implications for their current business model and their strategic options in the context of PSD2. The next step is to redefine their strategy and business model in light of the challenges and opportunities, and develop a profitable platform strategy. In many cases external support will be required, providing an invaluable outside perspective and helping the bank accelerate the process. With a revolution in progress, the only way for banks to stay relevant in a changing market is to adapt and change. It's time to get off the fence and start taking action.

Pragmatic support on all strategic topics related to PSD2 strategy and solution implementation

A	**AWARENESS OF STRATEGIC IMPLICATIONS**	Clarity regarding the strategic implications on bank's current business model and potential strategic options in the context of the new PSD2 regulation.
B	**STRATEGY UPDATE FOR PSD2**	Redefining bank's strategy and business model in the light of the challenges and opportunities delivered by PSD2 (incl. innovative use cases).
C	**PLATFORM STRATEGY**	Integrated partnership approach to capitalize on PSD2 opportunities (value-adding-fundamentals, partnership form, partner short list, operating model etc.).
D	**360° READINESS ASSESSMENT**	Holistic health check from strategy to operations on bank's readiness for PSD2 (customer journey, organization, processes, level of digitization, etc.), resulting in as-is vs. to-be requirements and roadmap for how to close the gaps.
E	**IMPLEMENTATION SUPPORT**	Project management office for coordinating and aligning all relevant work streams (commercial, regulatory, IT, organization, etc.) to ensure the on-time go-live of new PSD2 realization program.

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WE WELCOME YOUR QUESTIONS, COMMENTS AND SUGGESTIONS

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