Mitek

Whitepaper

Understanding and making the most of PSD2 and SCA

How can financial and online payment companies meet compliance and mitigate the risk of fraud –while improving customer acquisition?

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1. The second Payment Services Directive (PSD2) explained

PSD2 is the second Payment Services Directive (EU Directive 2015/2366), designed by the countries of the European Union. It will revolutionise the payments industry, affecting everything from the way we pay online, to what information we see when making a payment. PSD2 will transform the payment services market by regulating the changes in payments that we are already seeing on a community level.

PSD2 will:

- ✓ Broaden the scope and comprehensiveness of SCA standards.
- ✓ Regulate transactions with only one of both parties in the EU (previously both needed to be).
- ✓ Require compliance with new security and authentication regulatory standards.

What is Strong Customer Authentication (SCA)?

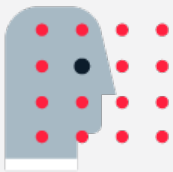
At the most basic level, Strong Customer Authentication is an authentication based on the use of two or more elements categorised as:

KNOWLEDGE

Something the customer knows, as in a password or a security question.

OWNERSHIP

Something the customer owns, as in a smartphone or identity document.



INHERENCE

Something the customer is, as in biometric features such as face, fingerprints or voice.

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2. What is driving the need for PSD1 and PSD2?

The continued development of an integrated internal market for safe electronic payments is crucial in order to support the growth of the EU economy and to ensure that consumers, merchants and companies enjoy choice and transparency of payment services.

In order to achieve both security and convenience in the European digital economy, PSD (Payments Service Directive) was adopted in 2017, intended to create a single market for payments within the European Union. But because the EU economy continues to evolve, the European Commission proposed the revised PSD2 (EU Directive 2015/2366) in 2013 with the objective of creating a level playing field.

Key drivers for PSD2

- Extend the reach of the original Payments Services Directive
- Enhance customer protection and security
- Improve the European payments industry
- Increase competitiveness
- Standardize payments across markets
- Bring into scope new types of payments
- Accelerate technological innovation
- Fight cybercrime and online fraud

What is authentication?

A procedure which allows the payment service provider to verify the identity of a payment service user or the validity of the use of a specific payment instrument, including the use of the user's personalised security credentials.

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3. Who is impacted by PSD2 and SCA?

PSD2 and its SCA applies to all forms of electronic payments, including bank and card payments, unless they fall into a small number of exemptions. It applies to eCommerce, mobile, remote, face-to-face and faster bank payment transactions. All payment transactions performed with a card issued by a European card issuer and processed by a European acquirer are impacted. This effectively means all European merchants have to comply.

PSD2 will break the bank monopoly on customer data, allowing merchants, PSPs, fintechs and other third parties to access account data from a customer's bank —with their permission.

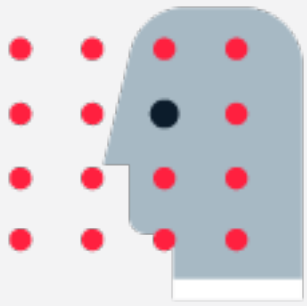
What are banks' third-party access APIs?

Namely AISPs or PISPs:

- **AISPs (Account Information Service Providers)** which are authorised to retrieve account data from an account. For instance these could an give financial advice based on spending patterns.
- **PISPs (Payment Initiation Service Providers)** which can initiate payments on behalf of a customer directly from their bank account. For example, initating a payment directly through a social media network without the need for a wallet.

Key points on the scope of PSD2

- More companies will be defined as **"payment institutions"** and will be regulated.
- Banks will open up access to bank accounts via APIs to third parties, in order to **encourage new players**.
- **PSD2 bans surcharges** for consumer debit and credit card payments.



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4. About PSD2 and identity verification

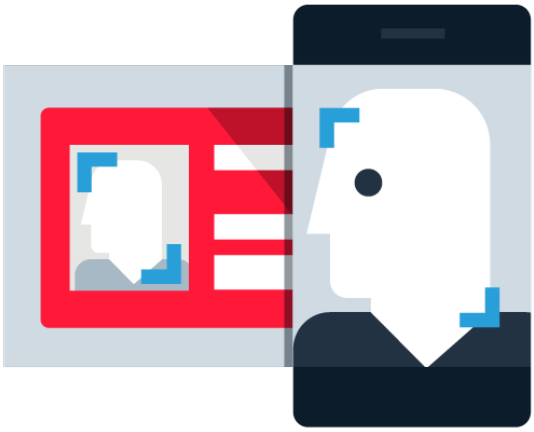
Latest updates and key issues

ON FEBRUARY 21, 2017

The European Banking Authority (EBA) chairman said that, following a volley of complaints from financial services industry and other incumbent supervised players, they will relax the proposed standards on a requirement for SCA.

ON NOVEMBER 27, 2017

The European Commission issued new regulatory technical standards (RTS) outlining security measures that stem from two key objectives of PSD2: ensuring consumer protection, enhancing competition and promoting a level playing field in a rapidly changing market environment.



These measures are:

- As of Feb 2017, the threshold for Strong Customer Authentication was raised from €10 to €30 for remote consumer transactions (also known as Card Not Present or CNP).
- Firms which use "transaction risk analysis" will have a get-out clause and may not have to implement SCA.
- The rules won't apply to unattended terminals, such as parking meters or transport tickets.
- On the issue of third-party access to consumer data, "screen-scraping" will be banned under PSD2, instead shifting the burden to banks to maintain access arrangements.

ON AUGUST 13, 2019

The UK's Financial Conduct Authority (FCA) and the Central Bank of Ireland both offer an 18-month delay to the introduction of Secure Customer Authentication enforcement for e-commerce transactions to those that they feel "have taken the necessary steps to comply with the plan".

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5. How can we help you make the most of PSD2?

Regulatory Technical Standards, Strong Customer Authentication and identity verification

New Regulatory Technical Standards (RTS) have been created as part of the PSD2, in order to enhance security protection and reduce financial fraud. A key element of these security standards is the requirement for Strong Customer Authentication (SCA) to be performed for electronic payments.

While parts of PSD2, like the Strong Customer Authentication requirements recently delayed in the UK and Ireland, are often portrayed as burden due to the added friction they can pose, these processes also offer payments providers the opportunity to take their identity verification process to the next level to ensure customer satisfaction and safety.

Mitek has found that the digital identity verification process is one that is ripe for transforming.

One option for enhancing the verification and authentication process, already in use by many financial institutions for onboarding new customers, is digital identity document verification.

Consisting of a quick image capture of an identity document on a smartphone or webcam, followed by a selfie, Mitek's Mobile Verify® can rapidly assess the authenticity of ID document and conducts a biometric facial comparisons to tie the face of user to the portrait on their identity document. Solutions like Mitek's Mobile Verify can quickly provide the digital experience of an in-person identity check and help establish "ownership" of an authentic identity document and confirming the "inherence" of that customer being who they say they are.

All told, digital identity document verification can offer a seamless and secure user experience while helping to ensure compliance with stringent Strong Customer Authentication, Anti-Money Laundering (AML), Know Your Customer (KYC) requiremtnts, and regulations such as PSD2.

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Furthermore the European Union's AMLD 4.1 states that it is essential to recognise secure electronic copies of original identity documents in processes like:

- Onboarding
- Payments
- Authentication

To help fight terrorism and organised crime, AML regulations around money movement and payments are stringent, and only growing more so. As payments processors, money transfer platforms, and P2P payments companies face new regulations and customers become ever more digital savvy, the challenges, but also the opportunity to digitise identity verification and to make the most of regulatory requirements has never been more clear.

Mitek's solution for digital identity verification establishes mutual trust between the individual and institution, creating a completely digital journey that empowers financial institutions to better meet European regulatory requirements.

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6. Timeline of PSD1 and PSD2

2007, DEC Final text of PSD is published in the Official Journal of the European Union.

2009, FEB PSD is transposed into law in the UK. Also applied through the Payment Services Regulations 2009.

2013, JUL EC proposes revisions to the PSD, in the form of the draft PSD2.

2015, OCT European Banking Authority (EBA) tasked with turning PSD2's principles into standards.

2015, DEC Final text of PSD2 is published in the Official Journal of the European Union.

2016, JAN PSD2 (Directive EU 2015/2366) enters into force, though it will not be applicable until 13 January 2018.

2016, AUG EBA issues Consultation Paper + Draft Regulatory Technical Standards (RTS) are published in the Official Journal in EU.

2016, JUL-SEP HM Treasury to consult on draft UK regulations

2017, JAN-JUL HM Treasury to publish UK regulations. EBA to submit the draft RTS to the European Commission.

2017, OCT Commission publishes regulatory technical standards for SCA.

2018, JAN State Members should adopt PSD2 via their own legislation. PSD2 to be transposed into national law in the UK.

2019, AUG FCA and Central Bank of Ireland offer 18-month delay in Strong Customer Authentication rule enforcement, allowing more time to adapt to the requirement

2019, SEP In Europe, SCA has to be performed from 14 September 2019, or card issuers will be required by law to decline transactions.

2021, MAR SCA enforcement scheduled to begin in UK and Ireland.

Earliest date security standards outlined in RTS enter into force.

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