



Bocconi Students Fintech Society

Banking as a Service

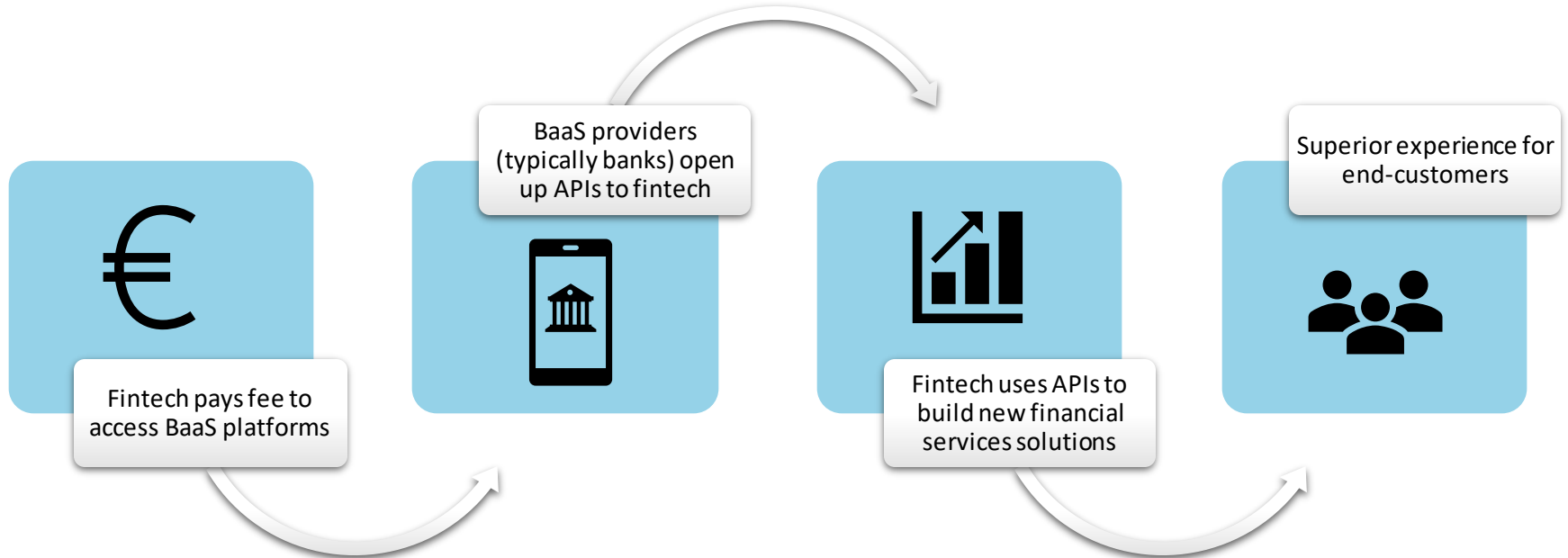
www.bsfintechsociety.com

Banking as a Service - BaaS



Banking-as-a-Service (BaaS) is an entirely new business model that enables non-banks institutions to offer banking services under their own brand seamlessly embedded into their digital offering.

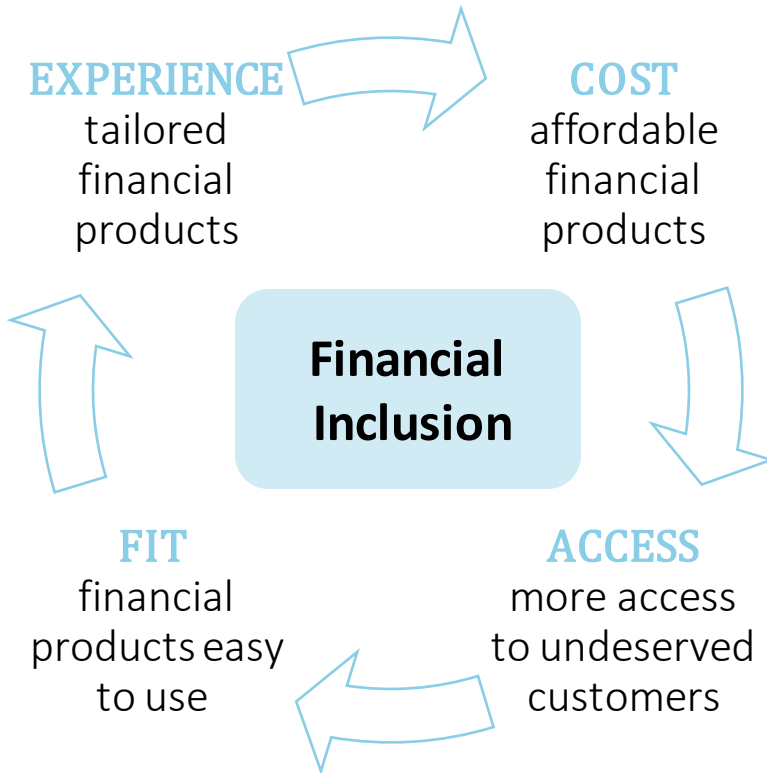
This service includes: program management, core banking, payments, capital-related services, compliance & risk, banking license, front-end UX/UI







Economic Impacts of Farther Reaching Credit



Impacts on customers



Impacts on banks

-  **Business expansion at a very low cost:**
cost for acquiring new clients can range between \$5 and 35\$ instead of 100\$ to 200\$
-  **Cheap distribution channels:**
BaaS platforms are cheaper compared to traditional online banking systems
-  **Escape from high operational costs**
Costs for developing and maintaining BaaS are relatively low
-  **Leverage vast customer bases**
Underserved customers can use BaaS platforms rather than a bank

https://www.cgap.org/sites/default/files/publications/slidedeck/2022_06_Reading_Deck_BaaS_Case_Studies.pdf

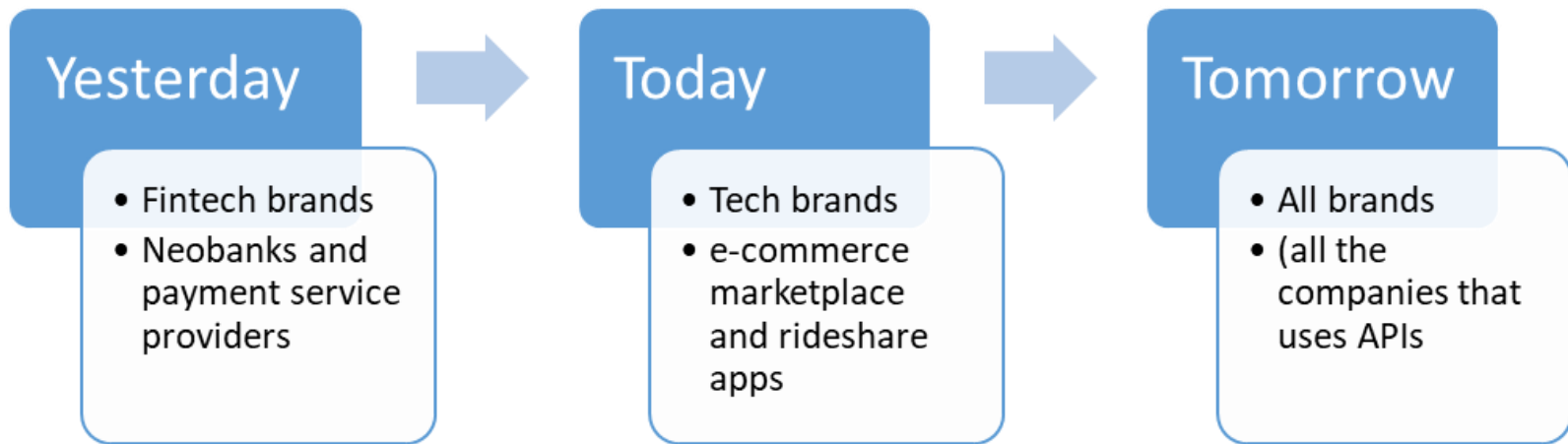
<https://www.oliverwyman.com/our-expertise/insights/2021/mar/the-rise-of-banking-as-a-service.html>

Projections & New Markets



Embedded finance—where non-chartered companies like fintech and consumer brands provide financial services from chartered financial institutions—is projected to reach \$7 trillion in transaction value by 2026 (Forbes)

Total BaaS Revenue from 1.7\$ billion in 2017 to over 17.3\$ billion in 2026 (“*Embedded finance: Key trends, segment opportunities & market forecasts 2021–2026.*” Juniper Research, July 2021)



<https://www.mastercardservices.com/en/reports-insights/opportunities-banking-service>

<https://www.forbes.com/sites/ronshevin/2023/03/06/banking-as-a-service-what-are-the-risks-and-who-owns-the-customer/>

Financial Services Evolution



Transformative Shift: Banking as a Service (BaaS)

Paradigm shift in financial services with the advent of Banking as a Service.

- Compliance with Third-Party Risk Management Obligations
- Complexities in Allocation of Data Ownership and Use Rights
- Handling of the Customer Relationship
- Contract Structuring Challenges
- Challenges from the BaaS Partner's Perspective

PSD2 - A Regulatory Game Changer

Main Objectives of PSD2:

- Integrated and Efficient European Payments Market
- Leveling the Playing Field
- Safety and Security of Payments
- Consumer and Business Protection
- Key Components and Implications:
- Strong Customer Authentication (SCA)
- Third-Party Payment Service Providers



- Liability Regime
- Consumer Protection
- No Surcharges
- Increased Security for Payment Services
- Exemptions from Strong Customer Authentication
- Criticisms of PSD2: concerns about infrastructure costs and cybersecurity threats.



What does PSD2 mean for Fintech/BaaS?

Opportunity for access to traditional bank data but with potential higher compliance/technical requirements.

Source: https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3543 | <https://ec.europa.eu/new-draft-payment-services-regulation-overview-main-differences-from-psd2> | https://www.ecb.europa.eu/paym/intro/mip-online/2018/html/1803_revisedpsd.en.html | <https://www.pwc.com/it/en/industries/banking/assets/docs/psd2-nutshell-n03.pdf> | <https://www.kevin.eu/blog/psd2-explained/> | [eu/commission/presscorner/detail/en/qanda_23_3544](https://www.commission/presscorner/detail/en/qanda_23_3544) | https://www.ey.com/en_be/financial-services/



Core Objectives and Implementation of PSD2

Achievements of PSD2:

- Making Digital Payments Safer
 - Enhancing Consumer Protection
 - Fostering Innovation
 - Ensuring Fair Competition
-
- Distinction from Open Banking: PSD2's has a role as the regulatory foundation enabling open banking practices in the European Union and the European Economic Area.
 - Compliance Requirements: Necessity for financial institutions, including third-party service providers and banks, to meet specific requirements such as licensing and secure APIs.



Benefits and Examples of PSD2

Strong Customer Authentication (SCA)

- Benefits for Consumers and Merchants:
 - Improved Payment Experience
 - Enhanced Security Through SCA
 - Increased Choices with New Financial Providers
 - Access to Consumer Financial Information for Risk Assessment
 - Flexibility in Offering Varied Payment Options
 - Reduction in Fraud
- Real-World Example: Kevin and uniPark scenarios, clearly show how PSD2 allows for secure and efficient payment solutions and cost savings on transaction fees.

Source: https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3543 | <https://ec.europa.eu/new-draft-payment-services-regulation-overview-main-differences-from-psd2> | https://www.ecb.europa.eu/paym/intro/mip-online/2018/html/1803_revisedpsd.en.html | <https://www.pwc.com/it/en/industries/banking/assets/docs/psd2-nutshell-n03.pdf> | <https://www.kevin.eu/blog/psd2-explained/> | https://www.ey.com/en_be/financial-services/

Current Developments in the EU Legal Landscape



Due to a number of developments in the payment services area over the recent years, the European Commission reviewed PSD2 and put forward a proposal for a revised directive in June 2023.



Rise of Electronic Payments

Accelerated by the Covid pandemic, the number of electronic payments has been growing in the EU, increasing from €184.2 trillion in 2017 to €240 trillion in 2021.



Rise of Open Banking

Digital technologies are giving rise to new open banking services, such as providers enabling the secure sharing of financial data between banks and FinTechs.



Emergence of New Types of Frauds

More sophisticated types of fraud are emerging in the area of payment services putting consumers at risk and negatively affecting trust between service providers and clients.

On June 28, 2023, following the review, the **European Commission** put forward a **proposal to amend PSD2 into PSD3** and **establish a Payment Services Regulation (PSR)**. The new directive is expected to **enter into force in 2026**.

“This proposal will ensure customers and businesses benefit from more innovative payment and financial service options, whilst being confident that these are offered in a safe, transparent and secure way.”

~Mairead McGuinness, Commissioner for Financial Services, Financial Stability and Capital Markets Union

Sources: <https://www2.deloitte.com/nl/nl/pages/legal/articles/psd3-and-psr-minor-update-or-major-overhaul.html>,
https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3543

What Does the Revision of PSD2 Mean for BaaS?



The revised payment services directive will likely have a positive impact on Fintech/BaaS providers by further levelling the playing field between banks and non-banks.

Impact of PSD3 on BaaS Providers

Amongst other aspects, PSD3 is aimed at:

- **Further levelling the playing field between banks and non-banks**, in particular by allowing non-bank payment service providers access to all EU payment systems
- **Fighting economic inefficiencies or discriminations faced by non-bank Payment Service Providers (PSPs)** by improving their access to payment systems and bank accounts

Hence, the proposal can **help BaaS providers to further strengthen their competition position** as non-banks in the European payment services market.

How Can Firms Prepare for the New Directive?



Identify business functions impacted by the legal changes



Assess the impact of the PSR on each affected function to determine required changes, budget and capabilities



Incorporate the identified impacts into the strategic planning of the organization



Roll-out changes to ensure timely compliance

Sources: https://www.ey.com/en_be/financial-services/new-draft-payment-services-regulation-overview-main-differences-from-psd2,
https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3543

Bundling in BaaS: A New Paradigm



Bundling refers to the integration of diverse financial and non-financial products into a single platform. This innovative approach leverages flexibility, enabling BaaS to evolve in parallel to customers' needs.

Benefits :

- accurate and timely data insights, maximize opportunities, and mitigate risks.

How?

- By unifying financial and non-financial data, organizations can respond more effectively to business changes.

Example:

- An apartment rental app partnering with an insurance provider offering customized renters insurance bundled with the rental transaction leading to convenience.

Step forward or step back ?

The financial landscape has witnessed a shift towards the fragmentation of banking relationships across multiple service providers, known as **unbundling**. This has paved the way for a counter movement of "**rebundling**" which provides a consolidated view of client data for a more holistic understanding of customer activity.



Sources: <https://fintechmagazine.com/banking/six-examples-embedded-finance-changing-future>

<https://fintech.global/2021/10/06/what-is-the-future-for-bundling-in-financial-services-in-fintech/>

An Example of BaaS



A key benefit to consumers of BaaS is the "buy now pay later (BNPL)" scheme which is currently becoming more and more popular among online retailers as a method of payment



What is it?

BNPL schemes provide a financial model for consumers to purchase goods and services online without paying the full price. Instead, users make a series of interest free Bi-weekly or monthly installments to alleviate the financial burden of paying the full price of a good/service.



Benefits

BNPL schemes offers a convenient way to pay for purchases over time, without the need for credit checks and the financial burden of interest. These services are provided on demand and are therefore quick to sign up for and use to make payments. Furthermore, they don't impact or rely upon "credit scores."



Disadvantages

BNPL schemes, similarly to most firms in the Fintech space, are likely to face legal barriers to entry as local regulations on Fintech and BaaS vary vastly. For customers, missing payment dates means fees, usually where these companies make a profit. This can lead to debt accumulation in the form of overdue fees which can be further exacerbated by the varying terms and conditions of different BNPL platforms



Deductions

Generally, BNPL schemes highlight the difficulties firms in the fintech industry face all the while bringing an enormous amount of value to customers and highlighting the potential of BaaS overall

Sources: <https://www.investopedia.com/buy-now-pay-later-5182291>



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