



# LEVELING THE PLAYING FIELD

Rethinking PSD2 from a Customer Centered Perspective

## **Know Your Dispute Rights**

The payment landscape has undergone and is undergoing revolutions within revolutions. Old laws and regulations written for the days of paper and plastic clearly needed updating for the era of bits and bytes.

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**WHITE PAPER**

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The EU stepped into the breach in 2007 and 2015 with the two Payment Services Directives, the second taking the place of the first. By creating a new way for consumers to pay for products, PSD2 will create a more open and secure payments ecosystem. By extension, it may revolutionize the world of banking and payments. If you use a credit card, and especially if you make purchases online, you will definitely be affected. The same holds true for merchants and financial institutions.



## PSD2 was written to achieve a number of stated goals.

Among these are:

- + A better integrated internal market for electronic payments within the EU.
- + Making international payments (within the EU) as easy, efficient and secure as payments within a single country.
- + Opening up payment markets to new entrants leading to more competition, greater choice and better prices for consumers.

Unfortunately, as happens so often, the entire directive seems to be written from the point of view of the merchants and, even more so, financial institutions. The consumers have been left out of both the decision making process and the final result once again.

**MyChargeBack** proposes a more customer centered approach to legislation, regulation, and banking practices for the benefit of all.

# PSD2: Regulating Payments for the Digital Age.

The first Payment Services Directive (PSD) was promulgated in 2007, and was replaced by the PSD2 in 2015. Execution and enforcement has been a piecemeal process ever since, but is finally set to reach completion in all of Europe before the end of 2021.



## PSD2 establishes standards in two separate areas related to digital payments:

- + **Open Banking:** and the ability of third party applications, at the customer's discretion, to aggregate, display, and manipulate a customer's records from various financial institutions all in one place.
- + **Secure Customer Authentication (SCA):** to be discussed in much greater detail below.

## Aside from SCA, PSD2 includes a number of other mandates which are more directly related to consumer protection. Among these are:

- + The reduction of a consumer's maximum theoretical liability for an unauthorized transaction from €150 to €50.
- + The unconditional right to a refund of any direct debit transaction for a period of eight weeks within the Single Euro Payments Area (SEPA).
- + The abolition of surcharges on the vast majority of consumer credit and debit card transactions.

# SCA: Taming the Wild West

Strong Customer Authentication (SCA) is part of a constellation of several distinct but related terms. To be specific:

## Two-factor authentication (2FA) / Multi-factor authentication (MFA)

**This is a general term for any secure method for logging into online accounts, including payments, email, health services, and much more.** As opposed to old-fashioned online security that simply relied on a password, MFA is based on independent factors whereby if one is compromised, the rest are unaffected. Logging in requires using at least two of the following factors:

- + **Knowledge:** something you know, such as a password.
- + **Possession:** something you have, such as your smartphone.
- + **Inherence:** something you are, such as your fingerprint or iris scan.

## Strong Customer Authentication (SCA):

**The term used by the EU in PSD2 mandating the use of MFA systems such as 3DS for many payments.**

Among the stated objectives of SCA are the related concepts of fraud reduction, improved security, and consumer protection. While all of these are undoubtedly admirable goals, it is worth taking a closer look at how and for whom mandated SCA is particularly useful and/or desirable.

## 3-D Secure 2.0 (3DS)

**A 2FA system originally designed for Visa, now used by many payment systems.**



## The consumers?

Fraud costs are borne primarily by merchants, and not consumers. Existing regulations and card network rules already absolve customers from responsibility for most unauthorized transactions. At the same time, the increased friction and aggravation of multi-factor authentication may be a barrier to making purchases. This is especially true for some of the most vulnerable populations, such as seniors with limited technological access and skills, and immigrants that may face language barriers.

## The merchants?

Each merchant can already measure the costs (including technology adoption, customer avoidance, and customer purchase abandonment) versus the benefits (reduced fraud cost) of implementing SCA, and many already implement it voluntarily. In the event a merchant has made an informed business decision – based on factors understood best by them – to absorb the cost of fraud in exchange for a more frictionless customer experience, forcing that merchant to implement SCA may cause irreparable financial damage

## The authentication providers?

Currently there are several SCA solutions from which to choose from. PSD2, while not explicitly mandating one over another, nevertheless creates a climate of compliance anxiety that may lead to herd adoption of a single solution. It may not be surprising if in a few years SCA is effectively synonymous with 3-D Secure 2.0. Such a market contraction would effectively kill competition, reduce innovation, and increase costs.

## The banks?

Some banks may welcome the increased stability and predictability of lower fraud levels and a more uniform set of expectations, even given the possibility of additional work and cost, and even at the expense of harming some of their own customers and merchants.

**It is worth noting that this has already been tried elsewhere.**

In 2016 the Australian Payments Clearing Association (APCA) proposed legislation mandating the adoption of 3DS for online payments. The Australian Competition and Consumer Commission (ACCC) objected and blocked the proposal<sup>2</sup>. Their decision was based on arguments substantially equivalent to several of those made by us above.

# Consider the Consumer

SCA was designed first and foremost to combat fraud. However, it also is intended to shift the liability to the cardholder for unauthorized transactions as a means of discouraging friendly fraud.

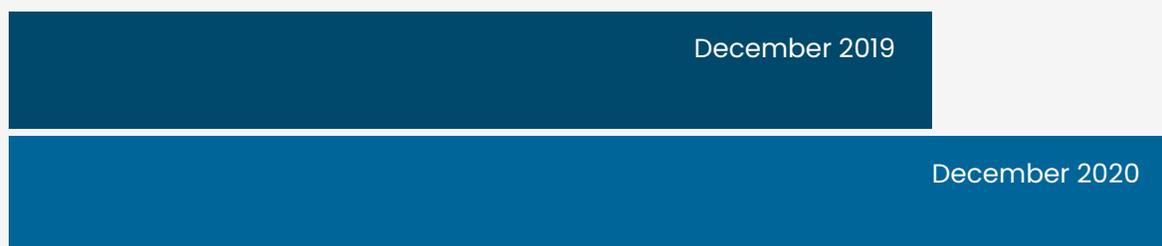
Both of these are without doubt laudable goals. Also known as chargeback fraud, friendly fraud occurs when the legitimate cardholder disputes a transaction despite receiving the goods or services. It costs merchants tens of billions of dollars per year; in fact it consumes a full 28% of all ecommerce revenue today<sup>3</sup>.

What PSD2 and SCA fail to address is cardholder disputes of authorized transactions. Worse yet, they threaten to exacerbate and further normalize the common but mistaken correlation of chargebacks with fraud. The reality is that the very changes in purchasing habits that spurred the development of PSD2 have also led to increases in other types of complex payment disputes.

Today, online transactions are the norm. COVID-19 and resulting stay at home policies have accelerated the spread of e-commerce even more. Ecommerce purchase volume rose globally by 15% over the first half of 2020 compared to the same period in the previous year<sup>4</sup>.

Predictably, more card-not-present (CNP) transactions means more disputes. The fraud and friendly fraud aspects have been well covered. However, even with the best of intentions, when purchases are made online, with less opportunity to closely examine the purchase or discuss it with the seller, the chances of dissatisfaction go up. In fact, the world is seeing an unprecedented increase in authorized payment disputes, with December 2020 values more than 25% higher than a year earlier<sup>5</sup>.

## Authorized Payment Disputes



Specifically in the EU, the European Central Bank (ECB) recorded a **66% increase in CNP fraud** between 2011-2016, which was the main reason behind why fraud overall increased by 35%. **Online fraud now makes up 73% of fraud in Europe** and this is steadily rising. In fact, CNP fraud was the only type that saw any increase at all<sup>6</sup>.

## Conclusion

**For all the expressed commitment to consumer protection behind PSD2, it is disappointing to see the final result being so industry-focused.** It largely addresses the concerns of financial institutions, and to a smaller extent the merchants. The few provisions that do directly strengthen consumer rights are relatively minor and in many cases largely cosmetic. On the other hand, the groundswell of consumer disquiet regarding authorized payment disputes is not dealt with at all; indeed, between the lines PSD2 minimizes those concerns even more than before.

The above trends run up against an uncomfortable fact that must be addressed far too many bank dispute departments lack sufficient training and staffing to effectively handle complex payment disputes, particularly authorized CNP transactions. Unsurprisingly this has resulted in frustration among consumers.

MyChargeBack advocates for rethinking legislation and regulation from the point of view of the consumer. How can this perspective be achieved? To this end we propose the adoption of three principles:

- + **Prohibit SCA from shifting responsibility to the cardholder.**
- + **Prevent SCA from creating a sense of complacency or ignorance among financial institutions regarding disputed authorized transactions.**
- + **Proactively implement education, training, and advocacy regarding consumer protection pertaining to authorized transactions.**

[www.mychargeback.com](http://www.mychargeback.com)

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