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Position Paper

European migration plan for Strong Customer Authentication
23 July 2019

1. Executive Summary

Despite extensive investments to build an infrastructure which complies with the incoming Payment Services Directive (PSD2) Strong Customer Authentication (SCA) requirements, significant challenges remain and not all parties in the card payment ecosystem will be able to implement the SCA regime in full by 14 September 2019. The introduction of SCA capabilities by market participants has suffered a number of setbacks. The late publication of the necessary clarifications to the regime by European Banking Authority (EBA) guidance resulted in further delays to the availability of technological solutions to fully implement SCA, the SCA exemptions and carve outs from the scope (e.g. payee-initiated-transactions, including direct debit transactions). Low merchant awareness about the potential impact of only a partial implementation of SCA has also contributed to poor preparedness across Europe.

Bitkom welcomes the pragmatic approach outlined in the EBA opinion, providing additional time to allow issuers to migrate to authentication approaches that are compliant with SCA, and acquirers to migrate their merchants towards solutions that support the SCA regime in its entirety. However, we are concerned that pursuant to EBA-Op-2019-06 any suspension will be decided on the national level. This will inevitably lead to national fragmentation across Europe, to more complexity and it will harm the ease of cross-border payments and therefore the common market.

We strongly recommend that EBA provides an SCA migration plan that is coordinated at European level. A harmonized approach is needed to avoid market fragmentation and reflect the cross-border nature of card payments in e-commerce.

We recommend
- **A European-wide harmonised timeline at market level, not at individual issuer/acquirer level, to map the complexity and interdependencies of the payments market.**
- **A timeframe of 18 months (09/2019 – 03/2021) for the whole ecosystem to upgrade to the new technological standards to avoid any disruption in the card industry.**
- **This includes a 6-month period (09/2020 – 03/2021) for merchants to run end-to-end-tests for their SCA routines. These tests will only be possible and can only generate reliable and meaningful results, if the underlying 3DS 2.2 solution is implemented by all of the different service providers involved in the supply chain between merchant and issuer in a mature and stable manner.**

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2. The SCA readiness gap

SCA represents a significant shift for the whole ecosystem and requires all issuers, merchants, acquirers and the other intermediate service providers such as e-commerce software vendors and gateways to have the right technology in place.

It is important to approach the SCA grace period from an ecosystem point of view, and not at individual issuer or acquirer level. The reason for this is that even if most of the issuers have SCA compliant methods, it may be that merchants are not enrolled in 3DS yet, and, equally important, have not been able to test the new features. This will – despite of individual SCA readiness – lead to many transactions having to be declined by issuers and/or account-servicing PSPs because the ecosystem has not been sufficiently coordinated and tested. Similarly, issuers and/or account-servicing PSPs may not be ready to accept the merchant's PSPs (in particular its acquirer's) exemptions yet.

We see four key issues around SCA technological readiness:

1. Issuer and acquirer readiness to enable full use of SCA capabilities
Merchants must decide how to process in scope transactions – 3DS or direct to authorization in the e-commerce field and contactless solutions in a face-to-face environment – based on their own (through acquirers) and the issuers' technical capability. Not all European issuers can support direct-to-authorization exemptions. However, today only half of all EU-wide credit card payments can support direct-to-authorization exemptions (although many issuers are already compliant with SCA), while it will take 18 months for all issuers and acquirers to have technically enabled 3DS v2.2[1]. The latter will allow retailers and issuers to make full use of the SCA exemptions, such as Transaction Risk Analysis (TRA) and low value contactless transactions that are critical to maintain a good customer experience.

2. Merchant readiness
55% of European merchants are not on any version of 3DS. These merchants will still be able to send authorisation requests to acquirers from 14 September. However, since the transactions will be transmitted to the issuer as an unauthenticated authorisation request – with no other information on authentication method used or exemption taken – issuers would basically have to decline these transactions in order to be SCA compliant. Moreover, estimations show that more than 75% of European merchants are unaware of SCA requirements.

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[1] The 3DS 2.2 specification was published in December 2018; the test facilities provided by the international card schema are available since July 2019.

Even the merchants that are aware and are consequently working on SCA implementation face the following difficulties: Merchants strive to provide the best possible, secure but also convenient user experience to their customers. Finding such solutions usually includes an iterative approach of testing new features with small customer groups in order to validate how each feature impacts user behaviour and ultimately the merchant's business. Only after such tests are completed, new validated features will be rolled out to all customers. Changes in the checkout process are extremely sensitive, as any negative impact on the conversion rate easily eats up the investments the merchant has done in the early stages of the customer journey.

Simply rolling out SCA overnight to all customers has the potential to put a merchant's business at risk (tests with 3DS 1.x have shown that 50% of customers failed to pay when confronted with it for the first time; even once customers got used to the flow after several purchases, 20% do not convert). Merchants ultimately need sufficient time to test their PSD2 compliant checkout implementation, to identify areas where they have potential to optimize and, ultimately, to iteratively implement and test those new approaches. A minimal timeframe for such a testing period would be 6-9 months, in order to have sufficient time for at least a few test-, analysis-, redesign-, and implementation iterations with the objective to safeguard current conversion rates.

Such tests can only generate reliable and meaningful results if the underlying 3DS 2.x solution is mature and stable. This means that the whole card industry must not only have provided SCA flows and enrol all their cardholders for it (in order to comply with PSD2) but must also have stabilized their exemption handling (esp. related to TRA and MIT) and 3DS 2.x based authorizations, before merchants can run their tests.

Given the unavoidable negative conversion impact that SCA will have on customers that are not yet used to SCA, we believe it is essential that retailers have the flexibility to ramp up over a longer period, rather than launch the new solution to all customers in one go. This would allow retailers to spread the negative financial impact and customer education effort over a longer period.

3. Identification of out of scope of transactions
Merchants and acquirers need time to code to new flags to identify out-of-scope merchant-initiated transactions (MIT). Otherwise these transactions will be declined by issuers and cause disruption to subscription business models that rely on MITs, including software licencing, streaming services, utility bills or car rental services. Because of its complex nature, merchant readiness to flag MIT transactions is still low, while also not all issuers are prepared to recognise MIT flags.

4. Travel industry readiness

The travel industry comprises a range of services such as flights, hotels, car rental, excursions and ancillary products (such as insurance) etc.

- In the flights sector, there are hundreds of individual carriers globally ranging from full service regional/global carriers to local providers with one or two aircrafts. There are a range of intermediary service providers, including online travel agencies, meta search engines, aggregation tools, global distribution service providers and others involved in some way in managing a booking and associated payment.

- In the accommodation sector, there are millions of providers, including major hotel chains, regional hotel chains, independent hotels and vacation rental properties owned by individuals. The ecosystem is highly complex. Even at the major chain level, brands sometimes operate as overarching service providers, management service providers and intermediary solution providers (so-called property management service tools). Major chains can often be affiliations of individual hotels, each of which operates as an individual entity.

This snapshot of just two parts of the travel industry – flights and accommodation – is offered to provide an insight into the range of potential actors involved in the travel payments ecosystem. There are many other actors, such as the car rental industry, those involved in the provision of other travel services and, of course, the payment services industry itself. As a result of the complexity of the online travel payments landscape and the wide range of players that are often not regulated, but play key roles based on systems designed well before payment services were regulated, the travel industry needs extra efforts – and guidance – to be fully compliant with SCA, for example also concerning dynamic linking.

These are the three most common of the more complex payment transactions generated by the travel industry:

- where one party conducts the authentication on behalf of another (agency)
- where there are multiple elements to a booking (multi-merchant/package)
- where there is a time gap between a booking and the travel event itself, especially relating to penalties for non-compliance with terms and conditions (no shows).

In each case, there will need to be extensive collaboration between the different ecosystem participants, including the merchants, online travel agencies, intermediary solution providers, acquirers, issuers and the card schemes to develop robust and functioning payment systems and processes.

5. Cardholder readiness

Not all cardholders are aware of the new PSD2 changes and many have not enrolled in SCA compliant authentication solutions yet. This is because the EBA Opinion has stated that legacy solutions based on SMS One Time Passwords (OTP) and 3DS/card data are not compliant. The transition solution incorporating behavioural biometrics into 3DS, however, takes more time. Factors that use static data like PINs or knowledge-based questions are prone to fraud data breaches and are not viable long-term solutions. In addition, even if SCA compliant authentication methods are in place, customers need to be informed and take actions themselves to be enrolled in certain methods. That is a time-consuming process and cannot be done overnight.

3. Suggestions for a European roadmap

Bitkom is aware that migration plans are currently being discussed by payment industry participants, together with their respective national authorities. To avoid any disruption in the market, it is of utmost importance to find appropriate solutions for solving technical and operational readiness challenges for remote card payments and to come up with European-wide measurements for NCAs to be able to track implementation progress.

Bitkom proposes the following European review points for the 18 months implementation period on a half-yearly basis:

- **14 September 2019:**
  Issuers would continue to apply risk-based analysis as they do today and also continue on using 3DS authentication if and when available and appropriate. Issuers will also continue to enrol their customers into 3DS and promote other authentication solutions.

- **14 March 2020**:
  Issuers and acquirers are technically enabled for 3DS v.2.1. or higher. Acquirers should report the number of merchants that are 3DS ready as well as issuers report the number customers enrolled in 3DS. Merchants start actively testing.

- **14 September 2020**:
  Issuers and acquirers are technically enabled for 3DS v.2.2. or higher. Acquirers should report the number of merchants that are 3DS ready, and issuers should report the number customers enrolled in 3DS. Merchants continue testing.

- **14 March 2021**:
  Start of active supervision (enforcement) by NCAs. Issuers have to start declining transactions that are not flagged correctly or strongly authenticated through 3DS.

Bitkom suggests that progress should be tracked by looking at merchant, issuer and customer readiness indicators.

- **Merchant readiness**
  Merchant readiness can be measured by looking at the percentage of merchants that are 3DS v.2.1. and / or v.2.2 ready. Enrolment in 3DS is strongly encouraged by the EBA. Acquirers could report progress in enrolling their merchants. In addition, schemes could report data on the usage of 3DS.

- **Customer readiness**
  Customer readiness can be measured by the percentage of customers that are enrolled in 3DS. These data could be provided at issuer level.

Bitkom represents more than 2,500 companies of the digital economy, including 1,700 direct members. Among the members are 1,000 small and medium-sized businesses, over 400 startups and nearly all global players. They offer a wide range of software technologies, IT-services, and telecommunications or internet services, produce hardware and consumer electronics, operate in the sectors of digital media or are in other ways affiliated to the digital economy. Bitkom represents members from the whole payment ecosystem, such as e-commerce retailers, issuing and acquiring banks as well as the major credit card schemes. Bitkom supports the digital transformation of the German economy and advocates a broad participation in the digital progression of society. The aim is to establish Germany as globally leading location of the digital economy.