

## An introduction to the Payment Services Directive

AFTER SOME 16 MONTHS OF WRANGLING, resulting in extensive amendments to the European Commission's originally proposed text, the European Parliament has at long last adopted the proposal for the Payment Services Directive (PSD).<sup>1</sup> This will now be forwarded to the EU Council for final adoption and is to be transposed into national law by 1 November 2009 at the latest.

The PSD is a key element in the realisation of the Single Euro Payments Area (SEPA). The idea behind SEPA is to facilitate cashless cross-border payments from an account anywhere within the euro area, using a single set of payment instructions, as easily, efficiently and safely as making a domestic payment. The European Payments Council has been working with the banking and payments industry towards SEPA for some time, with the objective of developing SEPA-compliant payment instruments in time for deployment from 1 January 2008. The PSD supplies the necessary common legal framework to underpin that work.

However, if you were to conclude that the PSD is only relevant to countries within the euro area, or to cross-border payments in euros, you would be very wrong. It will have an impact on anyone within the EU who provides or uses payment services: all of us, in other words.

So what does the PSD do and why is it important?

Broadly, it introduces:

- a new scheme of regulation for payment institutions,<sup>2</sup> together with passporting provisions entitling them to provide payment services across Europe under the freedom to provide services or freedom of establishment;
- rights of access for payment service providers to payment systems, such as Visa; and
- a common legal framework for rights and liabilities as between payment service provider and user, including:

- requirements as to information which must be provided or made available to the user of payment services;
- an obligation to effect most payments by the end of the next business day (referred to as 'D +1');
- transparency of charges and an obligation to transfer the full amount specified in the payment order, without deduction for charges; and
- allocation of liability for incorrect or fraudulent payments.

The European Commission argues that the PSD will save European citizens at least €28bn a year and maybe as much as €100bn.<sup>3</sup> The payment system in Europe processes 231 billion payments a year, representing a value of €52trillion.<sup>4</sup> Currently, the cost impact of the payment system is said to be some 2% to 3% of GDP. Cash transactions account for the lion's share of costs: some 60% to 70% of the total.<sup>5</sup> Widespread adoption of electronic payments could potentially bring costs down to 0.3% to 0.5% of GDP.<sup>6</sup> The PSD aims to set a legal framework that will enable, say, supermarkets or phone companies to compete with banks in providing cashless payment services, without becoming subject to the full panoply of regulation of banks or electronic money (e-money) issuers. The theory is that by opening up participation in the payment services market to non-banks, innovation will be encouraged and new types of service developed, particularly those aimed at consumers looking for quick, safe and cheap ways of paying relatively modest sums.

The PSD is not limited to payments denominated in euros, but will apply to cross-border payments within the Europe Union in any official currency of a member state, as well as to domestic payments. So, for example, the European Payments Council has been working for some time on resolving the remaining technical and commercial issues in the way of pan-European direct debits.

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Once the mechanisms are in place, someone with a holiday home in Spain, for example, will be able to set up a direct debit from their UK bank account to pay the electricity bill for that property. Equally, someone whose work takes them to live in another member state may choose to leave their bank account in their home state and make any necessary payments from that account rather than transferring their banking to the state where they are temporarily resident. Businesses with pan-European operations will be able to make and receive all of their payments from one member state and can, for example, choose the most competitive merchant acquirer for payment card services, even if located outside their home state. In each case, the PSD specifies what minimum rights and obligations will apply in respect of that payment service. By taking the route of maximum harmonisation, it is intended to ensure that a payment order will be executed safely and quickly, and with the same rights and obligations, between payment service user and payment service provider, wherever in Europe it takes place.

What's more, the PSD enables payment service providers in this country to compete in offering payment services to users in, say, Italy, where bank charges are currently much higher than in the UK. That fact explains why the negotiations over the PSD were so long and drawn out. A rearguard action was fought by the French, Italian and Spanish banking industries, which wanted to impose a heavier scheme of regulation on payment service providers, arguing that this was necessary for banks to compete on a level playing field. The UK and others favoured light-touch regulation in order to minimise the obstacles for new entrants to the industry, arguing that the risks involved did not justify imposing bank-style regulation on payment service providers. The final text was a compromise between these competing view points.

Let's look at the Directive in a little more detail.

### TITLE 1: THE SCOPE OF THE PSD

The Directive applies to payment services within the European Community, whether made in euros or in another official currency of a member state (Art 2). However, there are numerous exclusions for particular types of payment (Art 3), including payments by cash, cheque or promissory note, and payment instruments that can be used only on the issuer's premises or within a limited network of service providers or for a limited range of goods (in other words, university canteen cards and Oyster travel cards are not covered).

There is a particularly delphically worded exclusion (in Art 3j) intended to ensure that the Directive does

not apply where the payment service is purely ancillary to other digital services offered by telecommunication, IT or network operators, for example where a mobile phone operator offers ring tones or other digital content for sale and simultaneously offers a means of payment for that service through the mobile phone. This is distinguished from a situation where a mobile phone operator, for example, acts as intermediary in effecting payments to third-party suppliers of services, where the Directive will apply (see recital (6)). This particular exclusion is one of the areas where the UK government pushed for greater clarity – with what success may be debated.

More successful was the UK's lobbying to cut out the European's Commission's originally proposed threshold of transactions in excess of €50,000, above which the conduct of business rules were not to apply. This has now gone and such transactions are subject to the Directive.

### TITLE 2: A NEW REGIME FOR AUTHORISING PAYMENT INSTITUTIONS

This was perhaps the most controversial section in the negotiations. In its final form the Directive differs radically from the European Commission's original proposal in that, whereas the original draft did not impose any quantitative requirements for authorisation, the Directive now requires that a payment institution's own funds must meet specified initial capital and ongoing capital thresholds (Arts 5a, 5b and 5c). The initial capital requirement of €125,000 (which applies to those wishing to provide the full range of payment services) is significantly less than the capital requirements imposed on credit institutions, reflecting the lower risks involved, given that payment institutions are not authorised to act as deposit takers and are not permitted to loan out funds received from payment service users (Art 10(2) and (2a)), which they must either keep separate from their own funds or insure so as to ensure repayment in the event of insolvency (Art 5d).

Furthermore, these capital requirements are structured in such a way as to impose a lesser burden on payment institutions that only provide money remittance services, ie a payment service where funds are received without any payment accounts being created in the name of payer or payee, for the sole purpose of a corresponding sum being transferred to the recipient (definition in Art 4). Many such companies are small-scale enterprises, and there is therefore a concern to avoid pricing them out of participation and to match the capital requirements to the limited nature of the risks involved in the nature of the service. There is also a reduction in the capital requirement >

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applicable to telecommunication, IT system or network operators acting as intermediaries.

Credit institutions and e-money issuers are not subject to this part of the Directive, but remain subject to their existing authorisation requirements. The remainder of the PSD will, however, apply to them. So, for example, a bank making a payment by direct debit or e-money will be subject to the conduct of business rules laid down in titles 3 and 4; while a payment institution that wants to issue e-money will need to apply for separate authorisation as an e-money issuer.

Title 2, s4 contains a waiver regime permitting member states to waive all or part of the pre-conditions for authorisation in relation to small-scale payment service providers, ie where the transactions they have executed do not, on average, exceed €3m a month. This enables member states to reduce or eliminate capital requirements in the case of such applicants for authorisation. They will still be subject to anti-money laundering provisions and to the conduct of business rules in titles 3 and 4. However, payment service providers authorised under this waiver will not have passporting rights (Art 21(2)).

Article 23 provides for a right of access to payment systems. Currently, the incumbents of the existing schemes, predominantly banks, are in effect able to block new entrants: this was identified as a key competition problem in the UK in the Banking Review and Cruikshank Report (March 2000). Now member states must ensure that the rules on access are objective, non-discriminatory and proportionate to the risks. This opens up systems such as Visa to new entrants that meet appropriate objective criteria. This right of access does not, however, apply to payment systems where a sole payment provider can act as payment service provider both for payer and payee and is exclusively responsible for management of the system (Art 23(2)).

### TITLES 3 AND 4: CONDUCT OF BUSINESS RULES FOR ALL PAYMENT TRANSACTIONS

Whereas the original draft provided that these titles would not apply to transactions in excess of a €50,000 threshold, that has now been excised. Instead, parts of title 4 are specified not to apply to enterprises exceeding the size of a micro-enterprise and, where the payment service user is not a consumer, the parties are free to agree that all or part of title 3 does not apply (Art 23b). Member states can elect to treat micro-enterprises as consumers for the purposes of the conduct of business rules.

Title 3 specifies what information must be supplied to the user of the service before and after the transaction (Arts 25-27 and 28), and before entering into a framework contract (Arts 30-37), with derogations for individual transactions below a threshold of €30 or for payment instruments that have a spending limit of €150 (Art 23f). Notably, information need only be provided on paper or in another 'durable medium' if the user so requests (compare, in this respect, the provisions in respect of distance contracts). Generally, it will be sufficient if the information is made available to the user, for example by providing a log-in to a website where the information can be checked.

### TITLE 4: PARTIES' RIGHTS AND OBLIGATIONS IN RELATION TO THE PROVISION AND USE OF PAYMENT SERVICES

It is only possible, in the space of this article, to give a broad summary of the key features.

Payment transactions are to be treated as authorised only if consented to, such consent to be transmitted in the manner agreed between the parties (Art 41). Payment orders are to become irrevocable once received by the payer's payment service provider (the time of receipt being defined in accordance with Art 54(1)), or receipt by the payee's service provider, in a case where the payee initiates the payment (Art 56), subject to specified exceptions (including that direct debits may be revoked at latest by the end of the preceding business day). Thereafter, the payer may not withdraw their consent.

Users must notify any claim in respect of an allegedly unauthorised or incorrect transaction within 13 months of the debit date, although this will be extended if the payment service provider has failed to comply with its information obligations (Art 47).

The burden of proof is on the payment service provider to prove a transaction was authenticated and accurately recorded (Art 48).

The payment service user will bear the loss from unauthorised transactions up to a limit of €150 (Art 50(1)), but will be liable for all losses if they acted fraudulently or grossly negligently in respect of their obligations to use the instrument in accordance with its terms, and give prompt notice of its loss (Art 50(2), Art 46). Other than where they are fraudulent, the user can terminate all further liability by giving notification of loss (Art 50(3)).

The payment service provider is obliged to refund unauthorised payments (Art 49), save for any sum for which the user may be liable under the

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provisions summarised above. The payment service provider also has 'end-to-end' liability for non-execution or defective execution of the payment order (Art 67), unless force majeure applies (Art 70) or it can prove that the payee's service provider received the sum, in which case that entity becomes liable to the payee for correct execution (Art 67). The PSD also provides for there to be rights of recourse as between payment service providers (Art 69a). Payment orders are deemed correct if executed in accordance with the unique identifier supplied by the payment service user (Art 66).

### The full amount principle

In general, payment service providers cannot deduct their charges from the payment but must credit the full amount specified in the payment order (Art 58). There is an exception which allows the payee's payment service provider to deduct a charge for receiving the credit, where this is agreed (Art 58(2)). Clearly, if the PSD succeeds in its objective of opening up competition, few users will opt to stick with payment service providers that do charge for receiving credits.

### Execution time and value date

In the case of euro-currency payment transactions, all domestic transactions and payment transactions involving only one conversion between euros and the currency of a non-euro member state (Art 59), transactions must be effected at latest by the end of the next business day after receipt, ie D+1, but the parties can agree on D+3 for a transitional period ending on 1 January 2012 (Art 60). The payee's payment service provider is to be required to value date and make available the funds on receipt (Art 60(1a) & 64a). Similarly, where a consumer puts cash on a payment account with a payment service provider in the currency of that account, that sum must be made available and value given as at the date of receipt (Art 63) and the debit value date must not be earlier than the date any payment transaction is debited to the account (Art 64a). This excises the scope for payment providers to manipulate value dates for their own profit. These provisions will apply to outbound cross-border transactions from the UK only if the funds are converted to euros before being transferred.

### CONCLUSION

The remainder of the PSD contains provisions relating to complaints procedures and out-of-court redress and the establishment of a Payments Committee tasked with ensuring uniform application

of the Directive. The PSD is fully harmonising, ie member states may not maintain or introduce measures other than those prescribed (Art 78(1)) although payment service providers are free to grant more favourable terms (Art 78(3)).

Although less light of touch than was argued for by those who opposed the inclusion of any capital requirements, the PSD does attempt to produce a framework that is flexible enough to accommodate low-value/low-risk transactions without overburdening their providers with regulatory requirements, while making the regime more stringent as the sums, and risks, involved become more significant. Small players in the money remittance industry who have no ambitions to provide cross-border services may see little to celebrate, just additional compliance costs. However, for those who are, for example, looking to break into the charmed circle of merchant acquirers for the major credit card schemes, or who want to tout their payment services to users across Europe, the PSD could usher in a brave new era of opportunity. For the rest of us, if all goes according to plan, we'll be able to pay that seller on e-Bay using our UK debit card, wherever in Europe they happen to be located.

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## NOTES

- 1) The PSD has not yet been published in the Official Journal. A provisional edition of the text adopted on 24 April 2007 has been published on the European Parliament's website (reference P6\_TA-PROV(2007)0128).
- 2) Anyone wishing to provide payment services, other than credit institutions or e-money issuers, must be authorised as a payment institution, unless exempt or a waiver applies.
- 3) 'Payment services Directive: Frequently Asked Questions', European Commission, MEMO/07/152, 24 April 2007.
- 4) Study by McKinsey & Company for the European Commission, 2005.
- 5) MEMO/07/152, 24 April 2007.
- 6) Impact assessment published by the European Commission as an annex to the proposal for the PSD, COM(2005) 603 Final.