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21st Century Payments in Europe: The Payment Services Directive

Introduction

The EU's proposed Payment Services Directive is intended to provide the legislative framework for payments in Europe. The European Commission has concluded that the current setup for payments is still fragmented along national lines, and that this is incompatible with the single market and causes unnecessary cost and poor service. For example, you can imagine that a consumer living in Brussels may bank with a French bank and buy his electricity from a German company, and this would be perfectly acceptable under the single market. Moreover, as all three countries are in the eurozone, you would expect that the consumer should be able to pay by direct debit. But as payments infrastructures and their supporting laws are still organised on national lines, this is not presently a reality.

To tackle this problem, the Commission and the European Central Bank have been encouraging the development of a Single Euro Payments Area (SEPA) and proposed the Payment Services Directive. SEPA is being brought to fruition through new EU-wide schemes for credit transfers and direct debits, and "frameworks" for card schemes and clearing and settlement mechanisms. Rulebooks for the schemes and the cards and clearing and settlement frameworks have been created by the European Payments Council (EPC), which is a grouping of banks and banking associations drawn from across Europe. The participating banks are expected to adhere to the scheme rulebooks in order to ensure pan-European adoption of SEPA-compliant credit transfer and direct debit banking products. Card schemes and infrastructure providers will measure their own rules with the compliance frameworks established by the EPC, in order to assess whether they meet the requirements for SEPA compliance.

In this briefing we examine the shape of the proposed Payment Services Directive.

The Payment Services Directive

Legislative underpinning to back up these private sector initiatives is being proposed in the form of the Payment Services Directive. This has two main objectives. The first is to introduce a regulatory regime for "payment institutions" – namely, organisations which provide money transfer or similar services, but which are not banks or otherwise regulated. The other is to ramp up the rights of payment services users and obligations of payment service providers. This briefing focuses on this latter part of the proposed Directive.

A huge number of amendments have been proposed since the Directive was first put forward by the European Commission. At a meeting of the European Parliament's Committee on Economic and Monetary Affairs on 12 September 2006, many of the amendments were discarded, but some important questions remain unanswered, and the text may change again.

Key Issues

New EU payments legislation

Rights of payment service users, and implications for banks

Banks face new obligations effecting payments

Implementation challenges

If you would like to know more about the subjects covered in this publication or our services, please contact:

Dermot Turing +44 (0)20 7006 1630

Simon Crown +44 (0)20 7006 2944

Roger Best +44 (0)20 7006 1640

To email one of the above, please use firstname.lastname@cliffordchance.com

Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London, E14 5JJ, UK
www.cliffordchance.com

Scope
The questions on which all financial institutions will focus are to whom the new responsibilities will apply, and in respect of what types of payment transaction.

The proposed Directive will apply to all payment service providers located in the EEA. As to payment service users, the Directive will allow a payment service provider to opt out of its consumer-protection provisions by agreement with a "professional user". A professional user is a person acting exclusively for purposes related to that person's trade, business or profession. Financial institutions may wish to take advantage of this to offer differential pricing according to the level of responsibility required, and corporate treasurers may wish to take advantage of lower rates for payments of secondary importance.

Some types of transaction are clearly out of scope: payments by cheque and other paper instrument, and payments in notes and coins, in particular, are excluded. Payments in non-EEA currencies are out of scope. Payments where either the payer's or the payee's payment service provider is located outside the EEA (but regardless of the location of the payer or payee) are also outside scope. Another controversial feature is that the Directive's requirements will apply to large-value (EUR 50,000 or more) payments.

Information
Financial institutions are already familiar with the idea, from the Cross-border Credit Transfers Directive and the Cross-border Euro Payments Regulation, that payment service providers are required to provide various items of information to their customers, on charges, exchange rates, execution times and so forth. These information requirements will be added to by the proposed Directive. Financial institutions may feel that these requirements, which are designed to provide transparency for retail customers, are inappropriate for corporate customers or high-value payments, unless specially negotiated.

Refund rights of payment service users
The principal right created by the proposed Directive is a right of refund for the payment service user. The user can have a refund of amounts in dispute, even for transactions which have been duly authorised, if the authorisation did not specify the exact amount of the payment and the amount executed is not the amount that a reasonable payer would expect. While many European direct debit schemes already give payers a right of refund with no questions asked, this provision would extend across all payment types. Moreover, it comes with a requirement that the payment service provider must grant or contest the refund within 10 business days of receiving a refund request.

If a payment is unauthorised, there are controversial provisions about who bears the losses. Retail payment service users may hand over their cards, or allow third parties to know their PIN, or engage in other unsecure behaviours which are unwelcome to banks. Yet the Directive would, as proposed, put the burden on the payment service *provider* to show that the transaction was authenticated properly where authorisation is disputed. And the payment service provider's liability may not be limited to the amount of the debit to the payment service user's account after the user has notified the provider of the loss or theft of a security device (called a "payment verification instrument" in the proposed Directive).

Given the wide scope of the Directive, these proposed rules raise the awkward question as to who should pay the costs of fraud or error in relation to corporate payments as well as for retail payments. Corporate treasurers and banks are used to the debate about responsibility in this area and have typically agreed business terms which allocate the risks proportionately. It is not yet clear whether such agreements would have to be overhauled to take account of the Directive.

Execution duties
Payment service providers will also have a new obligation to execute payment transactions by "D+2", that is the business day after the date on which the payment instructions were received by the payment service provider. Large amounts of controversy surround this proposal. In the first place, the existing payments infrastructures may not be able to process payments with this degree of rapidity. Secondly, as cross-currency payments are within scope, it could be hard to reconcile this obligation with the standard foreign exchange transaction which settles on T+2, for example if the payment instruction is received very late in the day. Thirdly, payment service providers believe that time should be measured from the moment when they instruction is accepted for processing, rather than received. Fourthly, there is a debate as to what should count as a business day for these purposes: the text currently proposed appears to indicate for these purposes that only banking business days applicable to the payer's payment service provider would count as business days, suggesting that a payee's bank may need to be open for processing, or to give interest compensation, even when D+2 is a bank holiday in its country.

As with existing EU payments legislation there are restrictions on the ability of payment service providers to deduct fees from monies in transit. The Directive also tries to ensure that funds become available to payees as soon as they are received by their payment service providers; this is well and good, but falls short of the desire by users to ensure that there are no "lost days in clearing", whereby money is debited from the payer's account on day 1 but does not reach the payee's account until day N.

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Wider Context

The proposed Directive is not the only piece of draft EU legislation about payments. An EU Regulation requiring "complete information on the payer" to accompany transfers of funds has been agreed and awaits the final stages of the EU legislative process. This Regulation implements the FATF's Special Recommendation VII designed to combat money-laundering and transfers of funds to support terrorism. Banks will have to wrestle with the systems changes needed to give effect to its provisions, and how to reconcile the receipt of "complete information" with sanctions legislation which prohibits transfers of funds by or to certain named individuals or organisations.

Conclusions

Banks and their trade associations have been lobbying hard to scale back the European Commission's original draft of the proposed Directive, which was widely seen as very "consumerist" in nature and potentially damaging to the payments industry. While the value to consumers of these legislative arrangements can be seen, the danger in pushing the finance industry too hard too fast may be that some service providers decide to exit the market, or that the cost of other banking services has to increase to compensate for the extra cost and risk of providing enhanced payment services.

Financial institutions will wish to examine their payment services in light of the new Directive and consider the strategic, risk and documentation implications it contains. To do this at a time of intense change in the regulatory environment, with the Markets in Financial Instruments Directive and the Capital Requirements Directive already placing a heavy burden on banks, will be a challenge.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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