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Client briefing
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The Payment Services Directive I New Year Resolutions

Key Issues

- **Facilitating cross-border electronic payments within Europe**
- **Harmonising payment infrastructures within Europe**
- **Providing a legal framework for SEPA**
- **Increasing competition**
- **Protecting consumers**
- **Promoting transparency**

You are invited to attend ***Payments Taking Off - the new legal world***, a conference on the PSD, on 13 February 2008, 8.30am - 10.45am at Clifford Chance LLP, 10 Upper Bank Street, London, E14 5JJ.
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To facilitate cross-border electronic payments within Europe

On 5 December 2007 the Payment Services Directive 2007/64/EC (PSD) was published in the EU Official Journal. European member states must implement it by 1 November 2009: HM Treasury issued a consultation paper on its UK implementation on 19 December 2007. The European Commission proposed the PSD in December 2005 in an attempt to harmonise the fragmented nature of national payment infrastructures and their supporting laws. Prevailing inefficiencies in effecting cross-border electronic payments in Europe were felt to be incompatible with the single market and to result in unnecessary cost and poor service.

To harmonise payment infrastructures within Europe

The PSD is intended to render cross-border electronic payments within Europe, including credit transfers, standing orders, direct debit and card payments, as simple and secure as domestic payments within a member state. Its aim is to harmonise the regulatory regime for payment services across the EU. Broadly, all euro and European domestic currency electronic payments, as well as other payments involving euro currency exchange, are to be completed within one day after the payment order is given (see *Execution duty controversy* overleaf). The new rules will apply to payments made in any EU currency, where each of the payer's payment service provider and the payee's payment service provider is located in the EU.

The PSD is a maximum harmonisation Directive, but gives member states some discretion regarding the implementation of certain provisions. The Commission is accordingly setting up a transposition group to highlight any discrepancies at an early stage in order to facilitate consistent interpretation. It has said that it will also hold regular meetings with the payments industry and other interested parties in order to identify potential issues arising during the implementation process.

To provide a legal framework for SEPA

The PSD also provides a legal framework for the proposed Single Euro Payments Area (SEPA), an integrated payment services market for transactions in euros. SEPA is a self-regulatory initiative of the European banking industry, represented by the European Payments Council (EPC) and supported by the European Commission and the European Central Bank (ECB). The EPC is leading the creation of new EU-wide schemes for credit transfers and direct debits and frameworks for credit and debit card schemes and clearing and settlement mechanisms. It has issued rules and standards for the schemes and frameworks to which participating banks are expected to adhere in order to ensure the pan-European adoption of SEPA-compliant products by 31 December 2010. Card schemes and infrastructure providers are also checking their own rules against those of the EPC in order to ensure they are SEPA-compliant. The first SEPA products are available from January 2008 and the aim is to build up a critical mass of users by the end of 2010, based on the legal platform provided by the PSD.

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To increase competition

The PSD has the twin objectives of opening up markets to competition and consumer protection. It introduces a new EU-wide licensing regime to allow non-bank payment service providers to operate across borders. This will apply to payment institutions: organisations which provide money transfer or similar services, but which are not banks or otherwise regulated. These non-bank providers will be able to passport their services throughout the EU on the basis of a licence obtained in one member state. They will, however, need to comply with conduct of business and capital requirements, including, for high-volume payments processors, maintaining the higher of an initial capital ranging between €20,000 and €125,000 and a different, ongoing capital requirement. Conduct of business requirements include sound administrative, risk management and accounting procedures, proper internal control mechanisms and directors and managers with appropriate knowledge and experience. Payment institutions must also ring-fence funds received from payment service users.

Authorisation and supervision of payment service provision in the UK will be conducted by the Financial Services Authority, while HM Revenue & Customs will continue to supervise the anti-money laundering requirements on money service businesses. A publicly available register of authorised payment institutions must also be maintained.

To protect consumers

To date, European legislation protecting consumers in the payments world has focused on cross-border payments. Payment service providers are already required to comply with pricing rules, execution time limits and obligations to provide payment service users with certain information. The PSD builds on these basics, extending these conduct of business obligations to cover purely domestic (including non-euro) payments and expanding the scope of consumer protection into new areas.

European payment service providers will be liable for defective and non-execution of payment transactions, but they can opt out of the PSD's consumer protection provisions by agreement with users acting only for purposes related to their trade, business or profession. Financial institutions may wish to take advantage of this to offer differential pricing according to the level of responsibility required. Corporate treasurers may wish to benefit from lower rates for payments of secondary importance.

The PSD creates a right of refund for the payment service user 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 exceeds 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. In addition, the payment service provider must grant or contest the refund within 10 business days of receiving a refund request.

Execution duty controversy

Controversy surrounds the new obligation on payment service providers to execute payment transactions by D+1 for the following reasons:

- Existing payments infrastructures may not be able to process payments with this degree of rapidity
- Because cross-currency payments are within the PSD's scope, it could be difficult to reconcile D+1 with the standard foreign exchange transaction which settles on T+2, for example if the payment instruction is received very late in the day
- Payment service providers believe that time should be measured from the moment when the instruction is accepted, not received, for processing.

Parties may, however, agree on a deadline of D+3 for transfers until 2012 and D+1 thereafter.

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 puts the burden on the payment service provider to show that the transaction was authenticated properly where authorisation is disputed. In addition, 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 the user's personalised payment instrument.

To promote transparency

The PSD's move towards more transparency of information and the elimination of hidden costs is intended to enable better-informed consumers to compare prices for payment transactions more easily. The Directive sets out information obligations on payment service providers relating to the contracts for and authorisation and execution of single payment transactions, those covered by a framework contract and those involving currency conversion, the imposition of surcharges or deductions for the use of certain personalised payment instruments. The obligations cover content and communication of the main terms of the transaction, including fees, charges and currency exchange rates. The information and conditions are to be clear and comprehensible in both language and format and must be in an official language of the member state where the payment service is offered or in any other language agreed between the parties.

Comment

Financial institutions will wish to examine their payment services in light of the PSD and consider the strategic, risk and documentation implications it contains. Unfortunately the PSD comes soon after banks have had to wrestle with the systems changes needed to comply with Regulation (EC) No 1781/2006 requiring "complete information on the payer" to accompany transfers of funds for the purposes of preventing and detecting money laundering and terrorist financing. Payment service providers may feel that the new PSD customer information requirements, which are designed to provide transparency for retail customers, are inappropriate for corporate customers or high-value payments, unless specially negotiated.

Terminology

D+1: New maximum execution deadline by which payment service providers must execute electronic payment transactions: by the business day after the date on which the payment instructions were received by the payment service provider. Parties may, however, agree on a deadline of D+3 for transfers until 2012 and D+1 thereafter.

EPC: The "European Payments Council", formed by a group of European banks and banking associations which has created rulebooks for the pan-European adoption of SEPA-compliant credit transfer and direct debit banking products. Participating banks, card schemes and infrastructure providers are comparing their own rules against the EPC framework in order to assess whether or not they are SEPA-compliant.

Framework contract: Agreement covering repeated payment transactions e.g. direct debits.

Payment institution: Organisation which provides money transfer or similar services, but which is not a bank or otherwise regulated. The PSD sets out a new regulatory regime for these entities.

PSD: Payment Services Directive.

SEPA: The "Single Euro Payments Area", an initiative of the European banking industry, represented by the European Payments Council. The European Commission and the European Central Bank view SEPA as a fully integrated market for payment services within the euro area based on the legal foundation provided by the PSD.

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