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The PSD and SEPA: Customer Impact

From IBANs to Additional Optional Services (AOS): the Payment Services Directive (2007/64/EC) (PSD) and the Single Euro Payments Area (SEPA) - for which the PSD forms the legal basis - will make customers focus on payment data storage and security and reconsider their payments needs. Businesses benefiting most from the changes brought in by the PSD and SEPA will be those deriving the greatest savings from reduced charges, uniform processing standards and the opportunity to rationalise multiple accounts and banking relationships in different countries. These are likely to be multinationals operating cross-border throughout Europe with high levels of payment transactions of different types from different countries and using different invoicing and reporting formats.

Key Issues

- **IBANs**
- **Terms of Business**
- **Additional Optional Services**
- **Implications of D+1 for liquidity and treasury products**

IBANs: from cross-border to domestic use

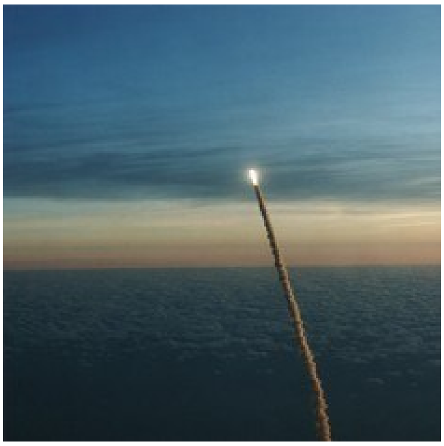
Customers will need to review their IT systems and internal processes and identify any changes required in order for them to become fully PSD and SEPA-compliant. They will not be able both to send and receive SEPA credit transfers until enough banks have updated their technology platforms and processes. The standardised formats for SEPA direct debits and credit transfers require the use of certain uniform content (IBANs and BICs) and software (ISO 20022 XML standards) in order for businesses to connect to their banks' systems and accept SEPA transactions. Non SEPA-compliant payment orders will be returned to the sender or processed manually.

A Bank Identifier Code (BIC) is used to ensure that payments are routed to the correct beneficiary bank. An International Bank Account Number (IBAN) is a standard format for account information identifying the accounts of payer and recipient.

Most businesses should already be able to verify BIC and IBAN codes, as it is mandatory for corporates to obtain both from euro zone recipients and print them on their invoices for cross-border euro payments within the EU (Regulation 2560/2001 Art.5). A major change is that this requirement will also apply to domestic SEPA-compliant credit transfers, where payer and recipient are located in the same country.

A payment order for a SEPA credit transfer will be rejected by SEPA-compliant systems if the payer does not know the recipient's IBAN. Omission of the proper details in the correct format from a payment order entitles the bank receiving the payment to charge a fee for processing the transaction. SEPA-compliant banks are printing account numbers in IBAN format on statements. Businesses anticipating SEPA-compliant payments should print them on their invoices and make sure they have the IBANs for their customers and suppliers. They will also need to update their databases and accounting systems to incorporate and store these new payment details.

The need for corporate treasurers to keep details of their counterparties' IBANs begs the question as to how that data is stored and updated. Recent newspaper headlines concerning data transferred insecurely and lost CD-ROMs may not have arisen if encryption and secure data warehousing systems had been used instead.



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Terms of business

Customer protection and consumer choice are among the main objectives of the PSD, which gives consumers strengthened refund rights, more information, more transparency of information, higher levels of certainty for payment transactions and clearer rights in relation to security matters. Frequent travellers, consumers with accounts in different countries and those based in member states where there are high charges for payment transactions should benefit most from the changes brought about by the PSD and SEPA.

PSD information and transparency requirements

The PSD 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. Article 34 of the PSD allows a lighter information regime for low-value payment instruments and electronic money - individual payment transactions that do not exceed €30 or which either have a spending limit of €150 or store funds that do not exceed €150 at any time. For national payment transactions, member states may reduce or double these amounts and for prepaid payment instruments the amounts may be increased up to €500.

PSD Article 67 requires the payment service provider of the payer, the payment service provider of the payee and any intermediaries to transfer the full amount of the payment transaction and refrain from deducting charges from the amount transferred. If the payee and its payment service provider agree to a deduction, the payee will receive a statement showing the charges separately.

"Business days": PSD implications

"Business day" is defined in the PSD as a day on which the relevant payment service provider of the payer or the payment service provider of the payee involved in the execution of a payment transaction is open for business, as required for the execution of a payment transaction.

The term is used in various customer-facing provisions of the PSD. Requests from customers trigger a refund from the payment service provider (or an explanation of the absence of a refund) within 10 business days of receipt of the request. If a payment order is not received on a day which is a business day for the payer's payment service provider, the payment order is deemed by the PSD to have been received on the following business day. The payment service provider may establish a cut-off time near the end of a business day after which any payment order received is deemed to have been received on the following business day. The payer of a direct debit may revoke the payment order by the end of the business day preceding the day on which the debit is to be made. The PSD's new maximum payment execution deadline and value dating requirements also use the business day terminology.

Banks and customers alike will want to consider how the business day terminology used for these and other PSD time limits and rules would tie in with that used in other agreements, transactions, market conventions and processes which need to overlap with or are part of a chain which includes PSD governed payment

PSD

- European member states must implement the PSD by 1 November 2009.
- 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.
- The PSD aims for transparency of information and charges, certainty of transaction execution, clarity on rights and liabilities of payment service providers and users, consumer protection and the opening up of national payment transactions markets to competition from non-bank payment institutions.
- The main impact of the PSD relates to its scope. 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 extends these conduct of business obligations to cover purely domestic (including non-euro) payments.

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transactions. A business day for a transaction falling under the PSD may not be a business day for the purposes of a non-PSD transaction, despite the fact that both are meant to be effected on the same day.

SEPA direct debit scheme: risk management issues

Because it took longer than expected to agree and approve the final text of the PSD, implementation of the SEPA direct debit scheme, which is particularly reliant on the PSD as its legal foundation, was delayed. Concerns have been expressed about the impact of the scheme and the timing of its clearing and settlement chain on risk management processes designed to deal with fraud and unauthorised debits. Businesses potentially faced with the uphill task in a non-automatic migration process of persuading every single one of thousands of their customers to complete and send them new SEPA direct debit forms may need some persuading that the risk of losing those of their direct debit customers who are reluctant to sign a second form is nothing compared to the advantages of managing a SEPA compliant scheme which draws in cross-border direct debits on a pan-European basis.

Additional Optional Services

Concerns expressed in jurisdictions whose direct debit schemes work differently from the new SEPA direct debit scheme have led the European Payments Council (EPC) to facilitate the potential development of local enhancements to SEPA instruments. These Additional Optional Services (AOS) may be provided by banks to their customers as specialist services based on the core SEPA credit transfer and direct debit payment schemes and as a tool tailored for certain customer segments to help increase the market share of individual banks in a newly commoditised post-SEPA environment. "Community AOS" may also be provided by local, national and pan-European communities of banks. Examples of AOS range from e-invoicing and e-reconciliation to online payment initiation and m-payments (payment confirmation via mobile phones).

The higher fees which banks would be able to charge for these services may help them to offset the set-up and maintenance costs of different systems: one for SEPA-compliant products in the euro zone and another for payments in other European currencies falling under the conduct of business and other requirements of the PSD. The fees may also go some way to compensating banks for the loss of fee revenue from more commoditised payment transactions which is expected to result from PSD and SEPA implementation.

AOS may, however, perpetuate the fragmentation of the SEPA product range along regional lines. The SEPA rules address these concerns by requiring that AOS should not compromise the interoperability of the SEPA schemes or create barriers to competition. The rules state that commonly used AOS may eventually be incorporated into the SEPA schemes and become fully commoditised. Community AOS are required to disclose certain details on a publicly available website in both the local language and English for transparency purposes.

Implications of D+1 for liquidity and treasury products

Payment service users will benefit from the certainty introduced by the PSD's new maximum execution time (see box entitled *Execution and value dating timelines*). Full implementation of the maximum execution deadline of D+1 in 2012 will mean that

SEPA

- The PSD forms the legal basis for the proposed Single Euro Payments Area (SEPA), an integrated payment services market for transactions in euros across the EEA and Switzerland being created at the initiative of the European banking industry, represented by the European Payments Council (EPC).
- 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.
- The SEPA project sets out interbank rules and standards for payments in euros using direct debit and credit transfer schemes and provides a framework for the clearing and settlement infrastructures which provide operational processing services for euro payments.
- Once SEPA instruments and processes achieve critical mass, it is intended that any payment in euros within the SEPA region would be effected as quickly and securely as payments within domestic markets are today, using uniform terms and standards.
- SEPA-compliant standardised transactions processes will enable euro remittances to be effected under the same terms within the SEPA region. Such commoditised payment services will in turn enable more efficient pricing.

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transfers must be credited to the payee's account by the end of the next business day. The elimination of value dating will also allow payees to use monies credited to their account immediately. Where a payment order is initiated by the payer, the latter's payment service provider is liable to the payer for correct execution of the payment transaction, unless he can prove that the payee's payment service provider received the correct amount, in which case the payee's payment service provider is liable to the payee for correct execution.

Businesses will want to consider carefully the impact of D+1 on treasury products which settle under different market conventions and timelines and which are in the same processing chain as payments transactions falling within the scope of the PSD - especially foreign exchange transactions settling on a T+2 basis. Mismatches will need to be anticipated and dealt with up front so as not to trigger penalty clauses or indemnities. Businesses will need to factor the D+1 time limit in to their liquidity models.

Want to know more?

You may find the following of interest:

- Clifford Chance briefing: *Payment Services Directive I: New Year Resolutions* (January 2008)
- Clifford Chance briefing: *The PSD and SEPA: Strategic Impact* (February 2008)
- Clifford Chance briefing: *The PSD and SEPA: Operational Impact* (February 2008).

Execution and value dating timelines

- The elimination of value dating will allow payees to use monies credited to their account immediately.
- D+1 is the 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.
- Controversy surrounds the new D+1 obligation 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.
- Businesses need to consider the impact of D+1 on liquidity risk management and cashflow and the interface with non-PSD treasury products.

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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