

# The Second Coming for Payment Services

May 2016

*Like a galleon on the horizon, advancing towards us at a small rate of knots, the Second Payment Services Directive ([Directive 2015/2366, "PSD2"](#)) continues its stately progress towards implementation. When something is so slow in coming, it is easy to forget it is on its way, or to pick a time when one should start preparing for its arrival. But now would be a good time to start preparing, for this galleon is furnished both with treasure for some and with cannons for others to face.*

*This directive will be of interest to all those involved in money services. It will cause some businesses that are currently unregulated to fall into regulation for the first time. For businesses that are already regulated it includes new requirements.*

*The changes will shake up the market for payment services as well as change the way businesses operate - and will serve to reallocate transaction risks in some cases.*

PSD2 is part of the legislative package in the field of the EU payments framework, adopted by the European Commission on 24 July 2013, which also includes the new Regulation on interchange fees for card-based payment transactions ([Regulation 2015/751, the "MIF Regulation"](#)).

The official text of PSD2 came into force on 12 January 2016. Member states must transpose it into their national laws and regulations by 13 January 2018. The long-awaited finalised text contains a variety of new provisions which will have an impact on existing providers of payment services as well as participants new to the regulatory regime.

PSD2 is intended to build on the success of the first Payment Services Directive ([Directive 2007/64, "PSD"](#)) as a harmonising measure. It operates by repealing and replacing PSD. The main changes it introduces from the existing position under PSD are outlined below:

## 1. A wider regulatory net

PSD2 widens the scope of payment arrangements that fall within the scope of regulation by abolishing a number of exemptions that allowed many payments bodies to remain out of scope. If your business currently is relying on one of these exemptions, it is now time to start thinking about how you will comply going forwards. In particular:

- E-commerce platforms will no longer be able to rely on the **"commercial agent" exemption** to escape regulation where

they act for both the buyer and seller in a payment transaction. Consumers were at a risk of using such platforms without the legal protections of PSD, so this exemption is being tightened and a commercial agent will, if the e-commerce platform wishes to rely on the exemption, only be able to act for one party or another but not both.

- The **"limited network" exemption** has been redrawn, with a view to bringing large scale or high volume payments or wide ranges of products and services into the regulated arena. The reference to the range of products and services is now prescribed as a "very limited range of goods or services" and so the new breadth of the exemption remains unclear. In addition, operators must inform the regulator when the average of the previous 12 months of payment transactions exceeds €1million per month, and the regulator will decide if the limited network exemption can apply in such circumstances. We will therefore need to see how the national regulator applies the new terms of the exemption in practice and how far the approach is consistent across Member States.
- For the first time, **"one-leg" transactions** (i.e. where the payment service provider of either the payer or the payee is outside the EEA) and transactions in any currency (not just in the currencies of EU member states) will be subject to regulations relating to transparency and the supply of information to users. This is one area where Member States were inconsistent in their implementation of PSD and the aim here under PSD2 is to ensure that users receive equal protection regardless of where in the EU they are located. Providers with products which previously relied on the "one-

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leg" transaction rule to avoid regulation will need to reassess their regulatory status and product features if they are to avoid non-compliance.

- Under the PSD, cash-to-cash 'money exchange' services were exempt from the PSD where the funds are not held on a payment account. However, PSD2 clarifies this exemption as 'cash-to-cash currency exchange operations where the funds are not held on a payment account'.

On the other hand some changes have not gone quite as far as was expected:

- The **"digital services" exemption**, which some had expected to be removed, has been retained, but with tighter controls on its scope. The aim is to cover ancillary payment services carried out by the providers of electronic communication networks or services, such as mobile network operators, connected with the sale of digital content to their subscribers. The new rules will set limits on the levels of mobile payments (€50 per transaction and either a total of €300 per billing month or, for pre-funded accounts, €300 per calendar month per subscriber) for the exemption to apply but the type of device used will be irrelevant. These changes will cause some businesses currently relying on the digital services exemption to review whether they will need to be authorised or registered as a payment services institution.
- The **"ATM exemption"** which allowed operators of independent ATMs to avoid regulation, remains intact, although there are new requirements about the information that must be provided to customers.

Third party providers ("TPPs") offering **payment initiation services** and **account information services** will be regulated for the first time.

- The payment initiation services are provided by a '*payment initiation service provider*' ("**PISP**") who is requested by the user to initiate a payment order by way of an interface operated by the PISP. The PISPs are not entitled to handle the user's funds and PSD2 prevents them from entering into contracts with the account servicing payment service providers ("**ASPSP**"), usually banks, as a way of avoiding the potential for anti-competitive practice.
- The newly regulated activity of *account information service* is a service to provide consolidated information on one or more payment accounts held by a payment service user with one or more ASPSPs. The providers of these services are exempt from authorisation but will need to register with the regulator and satisfy certain regulatory requirements.

In addition, **issuers of payment instruments** are brought within scope as TPPs even where they do not manage the account of the payment service user.

## 2. Changes to the regimes for authorisation and supervision

The requirements to obtain an authorisation to provide payment services are not greatly altered under PSD2. The main changes are:

- applications for authorisation should in future include a security policy document and descriptions of security incident management procedures, contingency procedures, etc.
- there are specific initial capital requirements for TPPs in relation to their activities and the risks these represent; TPPs are not subject to own fund requirements, but need to hold professional indemnity insurance.
- the current option for Member States to put in place a "lighter regime" for small payment institutions (firms with an average volume of monthly payment transactions below €3 million) still remains under PSD2 but Member States are given the freedom to define a lower threshold.
- PSD2 requires Member States to align their administrative sanctions, and introduces more detailed procedures applicable in the case of passporting. This will strengthen the investigative and supervisory powers of the Member State where a payment institution intends to provide payment services, including enabling Member States to appoint a "central point of contact" at firms which passport in to their territories through branches or agents. The European Banking Authority (**EBA**) will specify in due course the functions of the central point of contact and will hold a central register which national regulators are to ensure is accurate.
- Member States are required to lay down effective, proportionate and dissuasive penalties.
- Member States have to allow their competent authorities to disclose administrative penalties, unless this seriously jeopardises the financial markets or causes disproportionate damage to the parties involved.

## 3. Changes affecting service provision

Various changes affect how services are to be provided:

- **Blocking of payment instruments.** Whilst PSD already includes obligations on PSPs to include security features on a payment instrument, so that the payment instrument can be blocked at any time, it does not prevent charges being made for this service. Under PSD2, the blocking of payment instruments will have to be provided free of charge.
- **Surcharging.** PSD allows Member States flexibility on whether they can forbid merchants from imposing surcharges on customers using a payment service, and this has led to a lack of consistency in approach across Europe. Under PSD2 surcharging is no longer allowed for payment cards falling under the MIF Regulation (which covers more than 95% of the consumer card market) but will still be allowed for payment cards that are not regulated by the MIF Regulation, although limited to the costs borne by the payee.
- **Access to accounts.** Credit institutions will be required not to block or hinder access to payment accounts and to allow payment institutions to have access to credit institutions' payment accounts services in an objective, non-discriminatory and proportionate manner. This aspect is very relevant for money remittance services as many of them have lost access to the banking system in the recent years.

- **Liability regime.** Important mandatory legal provisions are included in PSD2 that will affect the balance of liability across a payment transaction. These provisions need to be considered carefully by anybody involved in this industry, and existing documentation may need to be revisited. In particular:
  - **PSP Liability for unauthorised payment transactions.** PSD2 requires that, after a prima facie investigation of fraud by the payer, a PSP must repay the payer immediately the amount of an unauthorised payment transaction (for example following the cloning of a bank card). Where the loss occurs as a result of a lost or stolen card it remains the case that the payer is to be held harmless from losses from the point he or she has notified the loss of a payment instrument unless the payer has acted fraudulently or failed intentionally or with gross negligence to fulfil his own obligations, but the maximum amount for which a user can be held liable is reduced from €150 to €50, and the PSP is responsible even where there has been gross negligence if the PSP did not put in place "strong customer authentication". More guidance is due from the EBA on what will count as strong customer authentication.
  - **TPP Liability.** When an unauthorised payment transaction takes place through a TPP, the TPP can also be responsible to compensate the payer and also the PSP.
- **Direct Debits.** Relevant to direct debits, PSD provides that - even where a transaction was authorised - the payer can ask for financial recovery where the exact amount of the payment transaction was not specified in his instruction and the amount of the payment transaction was higher than the user could expect having regard to relevant circumstances. PSD2 by contrast provides an unconditional right to a refund by his PSP in the case of a direct debit.
- **Security measures.** PSD2 deals with security aspects including authentication, introducing the concept of "strong customer authentication" and other requirements to reduce the risk of fraud and protect confidentiality. However, these security measures will only enter into force eighteen months after the adoption of EBA standards by the European Commission.
- **Funds segregation.** The current PSD requirements for a PSP that has other business interests to avoid commingling the funds received for the execution of a payment transaction with the funds of other persons and to safeguard payment service customers from claims of other creditors of the payment institution are largely unchanged except that the current possibility for Member States to limit safeguarding requirements to funds of service users whose funds individually exceed €600 EUR is removed.
- **Information requirements.** PSD2 details information that PSPs must provide to service users with derogations for contracts dealing with smaller transactions.
- **Complaints and disputes.** PSPs are required to apply effective complaint resolution procedures in every Member State where

they offer payment services and in the Member States' official language (although another language is possible if agreed upon). PSPs are also required to make every possible effort to reply to complaints on paper (or in another durable medium), within specific time periods and to inform service users of at least one competent alternative dispute resolution venue.

## Next steps

Member States have to transpose PSD2 into national law by 13 January 2018. During this time, firms will need to consider how they are impacted by the changes, especially if they are (i) already authorised by the FCA or (ii) likely to be covered by the new regulatory regime having been exempt under PSD.

The FCA published a "Call for Input" in February 2016 seeking views on whether the existing guidance consisting of its payment services approach document and chapter 15 of its Perimeter Guidance Manual (PERG) has kept pace with market developments and the growth in payment services. This is the FCA's first step in the process of updating the current guidance to reflect PSD2. The FCA anticipates further consultations over the next two years focusing specifically on changes to its approach resulting from PSD2. HM Treasury, as the government department responsible for transposing PSD2 into national law by January 2018, is expected to separately launch its own consultation in the summer of 2016.

Of course if in June the UK votes to exit the European Union, the implementation of PSD2 in the UK and indeed the continued applicability of PSD within the United Kingdom will no longer be legally mandated following the exit. During the interim period (while the terms of the UK's exit are being discussed), PSD2 would remain binding on the UK, creating the interesting dynamic that firms might be required to update their systems to accommodate a directive that might never come into force, or only come into force for a very short period. How the UK government would deal with this is a much larger topic, but it is likely that the UK would in the short term at least continue largely to harmonise its domestic rules to the European rules, although the passporting regime may be more difficult to agree, even if there is the political will to do this.

As the galleon continues to lumber towards us, Fieldfisher will review its progress. It is our intention to publish further articles considering in more detail aspects of the legislation and its likely effect on the market and on market participants. If you have any request as to topics we should prioritise, please contact one of our experts below, or your regular Fieldfisher contact.

## Contacts



**Nicholas Thompsell**

Partner - London

**E:** [nicholas.thompsell@fieldfisher.com](mailto:nicholas.thompsell@fieldfisher.com)

**T:** +44 (0)20 7861 4292

**M:** +44 (0)7795 267 789



**John Worthy**

Partner - London

**E:** [john.worthy@fieldfisher.com](mailto:john.worthy@fieldfisher.com)

**T:** +44 (0)20 7861 4392

**M:** +44 (0)7912 952 088



**Nick Tye**

Associate - London

**E:** [nick.tye@fieldfisher.com](mailto:nick.tye@fieldfisher.com)

**T:** +44 (0)20 7861 4330

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