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Brexit and Payment Services

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Brexit: options for Payment Services providers

The payment services industry is, by nature, particularly international in its outlook. It is therefore one of the industries that is most likely to feel an impact from the momentous decision of the British electorate to turn its back on more than 40 years of integration with EU countries.

Brexit is likely to bring about further disruption in a business area already rocked by the emergence of disruptive technologies, and the likely further changes to the market to be brought about by the implementation of the Second Payment Services Directive (**PSD 2**) (see our briefing on PSD2) and the working out of the Interchange Fee Regulation. For cross-border businesses, it will be necessary to work out the details of how harmonisation measures such as the Single Euro Payments Area (**SEPA**) will operate. Card schemes such as those operated by Visa and MasterCard will need to consider whether the UK can still be classified as part of Europe, with implications for cost and speed of settlement.

These industry-specific issues come on top of the general issues facing international businesses, and in particular staffing issues where businesses currently rely on European staff whose ability to remain in the UK post-Brexit is no longer guaranteed.

It is too early to comment on how these matters will work out. It is worthwhile, however, to give some initial consideration to one key question: to what extent will you need to move operations or establish operations in Europe following the implementation of Brexit?

We do not yet know what settlement the UK will reach with the EU, and specifically whether it will be possible to secure any continuation of passporting under the post-Brexit settlement. Nevertheless, some thought should be given to what Plan B would look like if the UK fails to secure a post-Brexit deal that would allow UK-based firms continued access to the European single market.

Travelling without a passport

UK Payments Institutions (payment services firms based in the UK with full authorisation) up to now have benefited from passporting, allowing them to provide payment services into the rest of the EEA. Such firms (and particularly growing firms, who are dependent on fundraising to maintain expansion) will need to consider their options.

If a new passporting regime applies (for example if the UK pursues the "Norway option" of becoming a member of the European Free Trade Agreement, and therefore of the EEA, or if the UK negotiates a bilateral agreement with the EU covering this), there may be an option to continue operating very much on a similar basis as applies at present. At the time of writing, however, this does not look a likely outcome since the price to be paid for such arrangements seems likely to include a continued requirement for free movement of labour between the UK and the EU and this price may not currently be politically acceptable.

If we assume then that passporting will no longer apply, what options would be available to an authorised payment service firm wishing to continue to provide its services into the European single market?

Is your journey really necessary?

To answer this question we must first look carefully at the payment services that the firm provides and consider where these are in fact provided. Where the regulated services are all being undertaken in the UK, there will in fact be no need for passporting.

It is also necessary to consider in what currency or currencies the services are provided. Once the UK leaves the EU (assuming that it does not become part of the EEA) Sterling will no longer be an EU currency and this will affect which of the rules will apply, even where a transaction is taking place within a single jurisdiction.

Assuming that the analysis confirms that activities are taking place within the EU that would normally require authorisation then, based on the existing legislation within the Payment Services Directive (PSD) and PSD2, the possibilities would appear to be as follows:

1. Move the company to another Member State

Moving an existing Payment Institution to another Member State is not a simple process. To obtain registration as a Payment Institution in a Member State it is necessary to be established in that state.

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There is only one form of business organisation which benefits from a straightforward process to change its corporate seat from one Member State to another – a company that has been established as a Societas Europaea (SE). This is a special form of public company established under EU law. It is still fairly rare, with under 3,000 in existence across Europe and only around 50 with their corporate seats in the UK, although this includes a subsidiary (but not the active payment institution) of one notable payment services provider – PayPal.

For other types of companies set up in the UK there is at present usually no direct means to transfer the establishment or registered office to another country. It may be possible, however, to achieve the same result by indirect means:

- One such means would be to convert the company into an SE (which can usually be done fairly easily) and then transfer its registration to another Member State. This transfer cannot, however, be done at the same time as the conversion and there is then a two-month waiting period after the decision has been made to transfer.
- An alternative might be to use the EU Merger Directive by establishing a company in another Member State and merging the original company into that company. The new company would thereby be recognised legally as the successor to the business of the old company. However there are some doubts about whether this regime may be used for mergers of a UK company involving a newly incorporated transferee company.

In either case the effect of the transfer would be to cancel the company's UK authorisation (as it would no longer meet the threshold requirements for being authorised in the UK). It would therefore, before transferring its registration to another Member State, need to have put in place a new authorisation in that Member State, which could be activated on its becoming registered there.

If it is the wish to move a business overseas (or turn an overseas branch into an overseas company), both the above routes have certain advantages compared with the other legal possibility of transferring the business through an intra-group sale of assets. In particular they avoid the need for the consent of counterparties to transfer third-party contracts, they allow liabilities to be transferred automatically, and they do not require the transferring business to go into liquidation. Also, there are special tax rules that may be attractive and it may also be possible to avoid stamp duty/stamp taxes. Tax advice will still be needed, however, in relation to the position of the transferee company.

However, depending on the settlement reached between the UK and the EU, moving the company to the EU might allow payment services to be provided in the EU, but still leave a problem as to whether the services can be provided within the UK.

Given the difficulty of transferring the Payment Institution itself to another state and the challenges this might create for the business still being done in the UK, for most UK businesses it will be more practical to maintain an establishment in the UK and obtain authorisations or other regulatory cover for business undertaken within the EU.

2. Operate branches in other Member States

Unless the business can be established as a credit institution or an Electronic Money Issuer (which themselves involve specific requirements for authorisation or registration), an authorisation as a Payment Institution in a Member State is the only practical way of obtaining an EU passport.

In the absence of a passport, it is necessary to look at the legality of the firm's activities on a state by state basis and to consider whether it is possible to obtain a local authorisation under the national laws of each relevant state for the activities carried out in that state - this is likely to require at minimum for a branch to be established in each state.

3. Operate as a small payments institution in another Member State

There is theoretically at least also the possibility, under the drafting of both the PSD and PSD2, that a UK incorporated firm could operate post-Brexit in one other Member State if it moved its head office to that Member State and became registered as a small payments institution under the laws of that state. This appears possible under the exemption in Article 26 PSD (which is carried forward in Article 27 PSD2). This exemption applies when the amount of business being done within the Member State falls below a certain threshold and appears to cover any legal person that has its head office or place of residence in the Member State in which it carries on business.

Whether any solution along these lines would work in practice, however, would depend on the law and the relevant jurisdiction having taken the benefit of this exemption. Also this is unlikely to be a practical solution for most businesses as it would allow business to be done only in the UK and one other EU country, and would limit the amount of business that could be done in that country.

4. Establish a subsidiary that is authorised in another Member State

The next possibility would be to establish a subsidiary in another Member State. As this subsidiary would need to pass all the threshold conditions for authorisation in that Member State, there is likely to be some duplication of costs. There would be issues to unpick as to how to sign up customers to become clients of the new company and in relation to the transfer of client data. Of course, the use of customer data across borders will be affected by the General Data Protection Regulation (GDPR) and the way in which it is applied before and after Brexit. The Fieldfisher Privacy Security and Information team's guidance on this issue can be found here.

For an existing UK-based firm the decision as to what state to establish a subsidiary in will be determined by a number of factors. Such factors may include where the firm already has links and does business, the cost and quality of service providers and resources such as premises in the jurisdiction and general business climate such as tax and labour laws in each jurisdiction

For groups with established UK operations, one factor that may be important is the attitude of the Member State to outsourcing by its authorised Payments Institutions. It is likely to be operationally efficient to outsource as much as possible of the activities of the business to the UK entity, taking advantage of the systems, personnel and organisation already established in the UK.

From our experience, and having undertaken a comparative analysis with colleagues in other EU Member States, the outsourcing process is recognised and accepted under the regulatory regimes in the major EU states, but will typically require advance notification to the local regulator and is subject to certain constraints. As one would expect, there are common themes. All the Member States we have looked at do allow outsourcing but impose mandatory provisions as to how this may take place so as to protect the ability of the regulator to supervise, and as to the minimum level of resource in the home state, with a view to ensuring that the central management is situated within the authorising state. Thus the outlook and practices of local regulators on this issue may be relevant alongside the broader commercial and legal factors. In any event, the outsourcing agreement will need to meet the standards of the regulator and GDPR requirements for customer data flows.

PSD sets a three month time period for applications to be heard but it would be prudent to allow six to nine months for the process.

5. Operate as an agent of a firm authorised in the EU

It may be possible to continue to carry on business through an EU branch if that branch can be appointed to act as an agent of another firm that is authorised in that country (or is authorised in another EU country and has passported into that country). Care will need to be taken that the arrangements can properly be seen as an agency, and it is possible that the arrangements would lead to some dilution of the branding of the service provided. However this could be a practical solution for those not wanting to go to the extent of duplicating the costs of authorisation.

6. Operate in conjunction with an authorised firm in the Member State

This solution would involve setting up partnering arrangements with another firm authorised in a Member State so that that organisation handles any activities being undertaken in the Member State. This will involve close attention to the business model to make sure that there is a clear geographic demarcation, so that the activities being undertaken by the UK firm would not be considered to be happening within the EU, and all activities being undertaken in the EU are being undertaken by the partner firm. The UK firm would not need a passport because it would not be operating in a Member State. This would involve a change of business model as there will be another party who would need to be remunerated for its contribution. Indeed, the collaboration may be set up on a mutual basis. Whether the relationship is one-way or mutual, branding and data protection would need to be thought about carefully.

Where the UK firm already has set up any branch arrangements in the Member State, these would become redundant on this model, and probably this model would involve a sale or transfer of the branch assets in the European Member State to the new commercial partner.

Brexit cuts two ways

The discussion above focuses on UK Payment Institutions that rely on passporting into Europe. Of course, Brexit cuts both ways, and will also cause issues for Payment Institutions based elsewhere within the EU that rely on passporting into the UK. Whilst we expect the UK's natural disposition would be sympathetic towards such businesses and would allow some easy route for them to continue to enjoy some kind of passporting regime, their fate may be one of the pawns to be sacrificed as part of the negotiations and it is possible that there will be no such opportunity at first. If this happens, the analysis mentioned above may apply similarly, but in the opposite direction.

Conclusion

There is no need to panic. A period of at least two years is likely during which the UK will remain a member of the EU and payment services firms will be subject to the same regulatory regime that exists at present. Indeed, the FCA in its response to the Brexit decision has underlined the need to carry on as before, both in following the existing rules and in preparing for the new EU legislation that is in the pipeline (including, of course, PSD 2).

It is possible that a deal may be done that secures passporting and that no action need be taken. Even so, contingency planning from an early stage would be prudent as some of the options may take time to put in place and there will be a need beforehand to assess the opportunities in each jurisdiction. Whilst the authorisation framework should be the same in each EU jurisdiction, there may be nuanced local differences as to how this framework is applied and in the helpfulness of the regulator. Just as importantly, it will be necessary to assess the general business environment, including taxation, labour law, operating costs and quality of local partners and service providers.

As a European firm, Fieldfisher stands ready to help with whatever route you may choose to navigate through the coming uncertainties.

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