

## EPFSF Briefing: Payment Services Directive

### The context

Today the European Union is confronted with a fragmented payments landscape which has developed along national lines. The use of payment instruments varies significantly from country to country since each Member State has tailored standards and practices to the needs of domestic users and the requirements of national legislation. Furthermore, the vast majority of payments are still domestic which has resulted in established and distinctive national payment systems that are not compatible at EU level.

The European payments Infrastructure is also fragmented with differences in technology, processes, standards, services and communication used by the clearing and settlement schemes.

With the introduction of the Euro, this fragmentation became even more apparent. The EU institutions, together with industry, have pro actively sought to remedy this situation. The European Commission has taken regulatory action while industry has responded with self-regulatory initiatives.

### Background

In 2001, the European Commission adopted Regulation 2560 on cross-border payments to encourage the establishment of a single payments market and introduce the principle of equality of charges for payments made in Euro (or any other "opt-in" currency) within a Member State and cross-border. This Regulation came into force in 2002 for card based payments and in 2003 for cross-border transfers and is currently under review by the European Commission.

In 2002 the industry responded by establishing the European Payments Council (EPC) which brings together the European banking industry and is committed to creating a Single Euro Payments Area (SEPA).

With regard to payments infrastructures, in January 2003 the EPC endorsed the definition of Pan-European ACH (PE-ACH) and stated that EBA STEP2 was the first such provider (and the only one at least in the short term).

The EPC Roadmap 2004-2010 sets out the SEPA milestones and deliverables. In 2005 this resulted in the preparation of the SEPA Scheme Rules Books for direct debits and credit transfer as well as a SEPA cards framework for Euro card payments to be delivered from 2008 onwards. The agreement on the design of the schemes is expected to be endorsed at the March 2006 EPC plenary meeting. In addition, consistent technical standards are being developed to ensure the interoperability of systems.

In parallel to the work of the EPC, the European Commission started to develop a legal basis upon which SEPA could be built. On the basis of its 2003 Communication<sup>1</sup>, the Commission undertook extensive consultations with all stakeholders to harmonise the legal framework which it referred to as the New Legal Framework for payments or NLF. In broad terms, the European Commission's vision is to establish an EU market for payments with a high level of competition both nationally and cross-border, and a high level of consumer protection. The Commission is seeking more efficient payment systems with advanced payment technology serving as a basis to deliver benefits for EU citizens including a reduction in price divergences. It is acknowledged that industry has a crucial role to play in delivering an integrated payment infrastructure. However the role of customers in the SEPA is also significant, as standards and schemes have to be in widespread use by 2010.

In 2004 the European Parliament adopted a Resolution<sup>2</sup> which supported the need for a legal framework to create a level playing field for Payment Service Providers while also supporting the self regulatory route to SEPA taken by market participants. This Resolution provided an important

<sup>1</sup> Communication concerning a New Legal Framework for Payments in the Internal Market (COM(2003)718)

<sup>2</sup> European Parliament Resolution on a legal framework for a single payments area, P5-TA (2004)0348

political signal of the importance placed on a single payment system by Europe's elected representatives and the direction that the process should take.

### **Proposed Directive on payment services in the internal market: The Payment Services Directive (PSD) formerly known as NLF**

In December 2005, the European Commission issued a proposal for a Directive on payment services (PSD), together with an impact assessment. The PSD aims to establish a harmonized legal framework by removing legal and technical obstacles for the creation of an integrated payments market in the EU. The Commission proposes the introduction of a new license for non-credit institution payment service providers which do not take deposits or issue e-money ("payment institutions"). This license aims to increase competition in the market by removing any existing barriers and to facilitate entry into the market of new payment service providers such as retailers, money remitters or mobile operators.

The proposed Directive focuses on a harmonized set of rules with regards to transparency conditions of payment services and information requirements provided to the payer/user (for payments under Euro 50.000). It sets out full harmonisation rules on the provision and use of payment services including on execution time (mandatory D+1 for all credit transfers by 2010), liability of a payment provider in case of non-execution or defective execution, liability of the payment service user in case of misuse of a payment instrument (limited to Euro 150) and the introduction of the full amount principle and conditions for revocability and refunding.

The proposal covers electronic payments made in any currency where either or both the payer's payment service provider or the payee's payment service provider is located in the EU. The proposal will not apply to cheque payments or most cash transactions.

### **Link with SEPA**

The EPC's self-regulatory initiatives and the PSD proposal are seen by the European Commission as complementary, with the PSD creating the legal platform on which market forces can build SEPA.

One key difference is that the PSD will apply to payments in any currency and is not limited to Euro, as is the case for the EPC schemes and rulebooks and the EPC Cards Framework..

Over the course of 2006 the European Commission will examine possible further incentives which could support the realisation of SEPA. The competition inquiries into cross-border payments and cards launched in 2005 may further complement the SEPA progress, as it gathers information on possible market distortions from a competition perspective.

### **Industry's view**

The payments industry welcomes efforts to build a harmonised legal framework for payments and views it as an essential building block in the creation of a Single Euro Payments Area, which will require significant investment from the industry. Furthermore the payments industry welcomes the substantial improvements in the proposed Directive in comparison to former working documents drafted by the European Commission.

It is crucial that a balance is struck between consumer protection requirements on the one hand and the costs for the industry on the other. Moreover, the economic and technical framework of the existing payment systems has to be taken into account.

While the PSD is largely welcomed by the payments industry, concerns remain on some key provisions:

- Geographical scope: the proposal covers not only payment transactions made in the EU, but also transactions with "one-leg-out of the EU" meaning that either the payer's or the beneficiary's payment service provider is not based in the EU. Some banks see a number of difficulties arising in this respect such as being able to meet certain information requirements: information on third

countries Payment Service Provider's practices (e.g. provisions of deductions) to be given to the payee. In light of these concerns, some industry players plead for limiting the scope to the EU. However, others consider the scope should, as the Commission propose, include such 'one-legged' transactions: this is especially important for payments to/from countries which have major trade links with the EU and thus require efficient systems to support the related payment flows.

- Currency scope: the proposed Directive covers payments made in any currency. This poses particular difficulties, especially for those currencies which are not widely traded. The Directive should therefore be restricted to payments in Euro and other EU currencies.

- Mandatory execution time: The payment industry is concerned about the requirement of complying with a D+1 maximum execution time from 2010 for transactions in the EU and is eager that the impact of this proposal is properly assessed. There are two main concerns: Firstly compliance with D+1 will be a problem for banks that are not currently connected to the Pan-European Clearing and Settlement Mechanism who will be unable to execute payments without considerable investment and reengineering of their systems. Secondly, the current priority for the payments industry is the roll-out of SEPA Schemes for Credit Transfers and Direct Debits currently in preparation by the EPC. To retrospectively enforce D+1 mandatory execution time will create many technical and organizational obstacles. Furthermore, it is also questionable whether this approach will allow appropriate use of scarce resources. Instead of forcing considerable investment into the acceleration of clearing cycles, it might be more beneficial for the end users if industry would support the development of other more relevant services.

- Licensing: the proposed Directive differentiates between requirements for the licensing of financial institutions and those for payments institutions. As illustrated by earlier consultations, the industry's view is split. On the one hand potential new payment providers find it logical that they do not have to meet the same licensing criteria as financial institutions since this would hinder their entrance into the market. The banking sector on the other hand insists on the need for the creation of a level playing field for the licensing of payment service providers, particularly the prudential requirements that are necessary to safeguard financial stability and consumer confidence.

From a risk perspective one should note that payments services are faced with a number of risks – especially when it comes to direct debits return scenarios - such as credit and liquidity risk as well as operational including legal risks. Problems arising with a Payment System Provider (PSP) may have a deep impact on the credibility of whole payments business itself. A different regulatory regime may also pose threats in creating divergence in compliance with anti-money laundering rules and consumer protection. In addition, in order to guarantee a level-playing field, it should be clearly stated that competent authorities entitled to oversee Payment Institutions must be the same envisaged for the other categories of Payment Service Providers. Furthermore, settlement and liquidity risks may be transmitted onto other financial institutions if open access to payment systems is allowed without additional membership requirements or conditions.

- Liability clause: Title VI of the proposed PSD proposes heavy liabilities on the payment provider vis-a-vis the user which will be difficult to meet and moreover are not proportionate with the limited liability of the user up to Euro 150. These provisions cause a shift of responsibilities almost exclusively to payment service providers. Industry would like to see a more balanced approach concerning the liabilities of payment service providers and payment service users.

- Consent & authorization: the banking industry remains concerned about the apparent ease with which user consent and authorisation can be repudiated. The risk is that this will reduce user incentives to institute and maintain fraud prevention measures. Banks already provide good guarantees to retail and micros users, but applying a universal formalisation of such guarantees to medium and large corporate users could significantly impact their appetite for providing payment services to these markets with their higher volumes and values. The banking industry is therefore seeking that the exemption given in Article 51.1 be extended to cover Article 48, as well as Article 49 and 50.

- Refund clause: the disposition contained in the proposed Directive envisaging a period of four weeks for asking a refund represents an important practical issue both for existing Local Direct Debit payment Schemes and for the SEPA Direct Debit Scheme in preparation by EPC.

Other concerns relate to excessive information requirements, lack of clarity around a number of definitions, requirements with regard to the acceptance of payment orders and unauthorised transactions and disputed transactions. Also concerns exist with regard to the fact that banks shall debit/credit the customer's account with a value date equal to the point in time at which the account is booked and the impossibility for banks to require fees for the closing of accounts. This will impact competition. In these cases the industry is seeking workable solutions that would be supportive of the SEPA schemes.

From the users' side consumers, corporates and retailers' organisations such as BEUC, EACT and EuroCommerce see the PSD as a step in the right direction but are critical of the delay that will impact the timetable for the realisation of SEPA. Corporate users have many more complex demands of SEPA, which the industry wishes to satisfy, but only after it has delivered the basic, core services to mass-market consumers, as this will provide the basis for the development of more specialised, niche payment products.

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Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

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