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Payment Services Directive: Frequently Asked Questions (See also *IP/07/550*)

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BACKGROUND TO PAYMENT SERVICES DIRECTIVE (PSD)

1) Why has the Commission proposed this Directive?

The proposed Directive aims to establish the modern and harmonised legal framework necessary for the creation of an integrated payments market which would enable payments to be made more quickly and easily throughout the whole EU.

By removing the legal obstacles blocking the creation of a Single Payments Market, the Directive aims to introduce more competition in payment systems and facilitate the realisation of economies of scale. This will improve efficiency and reduce the cost of payment systems to the economy as a whole.

2) Why do we need a Single Payment Market?

Although the Single Market has existed since 1992 and citizens and business have been able to buy and sell in cash using euros since 2002, the Internal Market for payment services remains hugely fragmented. Furthermore, electronic payments, which are an increasingly popular and efficient means of payment, cannot always be used across Member States.

For instance, direct debits, which are a common and cost-efficient service to pay for utilities (e.g. gas, water electricity bills) and other regular bills, cannot be used across borders, even though they represent a cheap, reliable and secure means of payment whose use reduces costs for business and their customers. Similarly most of the popular and more economical national direct debit cards do not operate across national borders.

A real Single Payment Market would therefore allow all citizens and businesses to make payments throughout the whole EU electronically, just as conveniently and rapidly as the most efficient national payment systems existing today. Furthermore, whatever the payment instrument used (e.g. card payments, credit transfers, e-payments and direct debits, etc.), the Directive provides users with the same level of protection and legal certainty, independent of the origin of the payment instrument. The Directive would therefore allow huge savings to be made to the current high cost of making payments.

3) What are the potential savings from a Single Payments Market?

Studies have estimated that the overall cost to society of the current payments system could be as much as 3% of GDP. Inefficient cash payments are the main cost driver and account for 60–70% of total costs.

Instead of using efficient electronic payment services, which costs only a few euro cents, the cost of a cash transaction ranges between 30 and 55 euro cents. Given that the EU currently handles 231 billion payments per year (representing a total value of EUR 52 trillion), the potential savings linked to use of efficient payment services are enormous and amount to billions of euros. Service providers are effectively blocked from competing and offering their services throughout the EU. Removal of these barriers could save the EU economy upwards of EUR 28 billion per year. Furthermore, very considerable savings can be generated for the overall economy if banks were to offer EU-wide payments related services, such as e-invoicing. A conservative estimate of these project savings would be EUR 50-100 billion per year for businesses.

The economic sectors that would gain most by switching to electronic payments are shops and merchants as well as the payments industry itself. However, the payments industry often cross-subsidises the high cost of cash operations by revenues from charging for existing electronic payments and bank account management fees.

4) What are the main objectives of the Directive?

The Directive has two main objectives:

The first objective is to generate more competition in payment markets by removing market entry barriers and guaranteeing fair market access. Currently, the diverging legal rules in 27 different Member States represent a significant impediment to new payment service providers (such as supermarkets, money remitters or, in some cases, telecom or IT providers), and effectively block them from competing and offering their services throughout the Internal Market.

The second objective is to provide a simplified and fully harmonised set of rules with regard to the information requirements and the rights and obligations linked to the provision and use of payment services. For technical reasons, payments providers in a payment system must respect standard rules covering, among others:

- Execution time: all credit transfers without any currency conversion must mandatorily be carried out at the latest by the end of the next business day (i.e. the so-called "D+1" basis)
- Liability of a payment provider in case of non-execution or defective execution of a payment transaction

- Liability of payment service user in case of misuse of a payment instrument (limited to EUR 150). This amount may be reduced by Member States and there is no liability for unauthorised payments occurring after the user has properly notified his/her payment service provider.
- Introduction of the full amount principle according to which the full amount specified in a payment order shall be credited without any deduction to the beneficiary.
- Conditions for refunding when a payment transaction has been authorised.
- Irrevocability of payment orders (e.g. the ability of the payment service user to reject a payment wrongly made on his/her behalf)

As the Directive introduces a harmonised set of rules for payment providers throughout the EU, it will therefore reduce legal compliance costs for payment service providers and foster competition between payment services, as well as allow payment service users to shop around on the basis of an informed choice.

SINGLE EURO PAYMENTS AREA (SEPA)

5) What is the link between the Payment Services Directive and the Single Euro Payments Area (SEPA)?

The adoption of Regulation (EC) No. 2560/2001 stimulated an initiative by banks to achieve a Single Euro Payment Area (SEPA). The first steps in this initiative were the creation of a common decision making-body, the "European Payments Council" (EPC), and the adoption of a road-map with the aim of developing the necessary procedures, common rules and standards for EU-wide payments (covering credit transfers, direct debits, credit and debit card payments) in euros by 31st December 2010. These rulebooks and standards are now very nearly complete.

The EPC's initiative and the Payment Services Directive are therefore complementary and the Payment Services Directive should be seen as providing the necessary legal platform on which the payments industry can build its activities to make the EU payments market as efficient and competitive as that within the most effective Member State. Consequently, given this partnership, the Commission will continue to work in close co-operation with payment market participants and other parties (including non-banks) on all these issues.

6) Why is adoption of the Directive so important for SEPA?

The Payments Services Directive provides the required legal foundation to make SEPA possible. The banking and payments industry are making substantial investments to ensure the realisation of SEPA. The timetable for SEPA is very tight: the first SEPA products should be available as from 1st January 2008 and by end 2010 a critical mass of users should have migrated or moved over from existing national payment instruments to the new SEPA products. Finally, while SEPA only covers euro payments, today these already represent about 70 percent of all payments in the EU and this percentage will increase in the future as more Member States adopt the euro.

For all these reasons, rapid adoption of the Directive is essential for the success of SEPA.

7) What are the differences between the Payment Services Directive and SEPA?

By removing the legal obstacles and setting-up a harmonised legal framework, this Directive should enable the EPC to complete this ambitious program by end-2010. Consequently, the Directive forms the cornerstone for building a true Single Payments Market (SPM). However, the important difference is that the Directive has a wider scope covering payments made in any EU currency and is not limited to euros only.

Nevertheless, once the Directive is adopted, the Commission will consider whether any further action (legislative or otherwise) is needed to ensure that industry delivers the SPM with all the expected economic gains.

SCOPE OF PAYMENT SERVICES DIRECTIVE

8) What is the scope of the Directive?

The Directive focuses on electronic payments, which are more cost-efficient than cash and which also stimulate consumer spending and economic growth.

The new rules will apply to payments made in any EU currency, where both the payer's payment service provider and the recipient's payment service provider is located in the EU.

Finally, there are a number of activities (including cash and cheques) not falling under the Directive.

9) So, will the new Directive deal only with payments executed in euro?

No. As stated above, the Directive will cover not just payments made in euros but also those made in another national currency used in the EU.

This is also a key difference with the Single Euro Payments Area (SEPA) initiative consisting of the delivery of common standards and services for euro payments.

10) What about payments made to recipients outside the EU or received from payers outside the EU ?

For the moment, the Directive only covers payments where both the payer and the recipient payment service provider are located in the EU (the so-called "two-leg payment transactions") made in EU currencies.

However, after three years of operation a review of the Directive is foreseen. This will examine the possible need to expand the scope of the Directive to include payments where either the payer or the recipient is outside the EU (the so-called "one-leg payment transactions") as well as non-EU currencies.

11) What mobile payment services are included?

Put simply, where a telecom operator makes a payment on behalf of a payment service user to a third party, the payment transaction will fall within the scope of the Directive when operator acts solely as an intermediary making the payment.

On the other hand, payments relating to the purchase of digital services such as ring tones, music or digital newspapers which are sent to a mobile phone (or some other digital device e.g. a computer) are not normally covered by this Directive.

12) What exactly can payment institutions do under the Directive?

The Directive broadly authorises three different types of payment institutions:

- money remitters,
- payment transactions carried out by mobile telecom operators, and
- full-range payment service providers (e.g. credit transfers, direct debits, card payments) including credit related to the payment.

Additionally payment institutions may carry out payment related services e.g. foreign exchange services, safekeeping activities, operation of payment systems for their payment services.

Finally, payment institutions are allowed to carry out other business activities, e.g. retailing, telecoms.

BENEFITS FOR CONSUMERS

13) How do consumers benefit from increased competition?

A general increase in competition should benefit all users including consumers by lowering price and improving service performance as well as promoting more innovation and wider choice. In markets where payments are relatively slow and expensive improvements will be greater than in markets where they are already very fast and efficient. In the latter markets there will be much less scope for improvement.

The Payments Services Directive should increase competition in three main ways:

- first by creating an integrated market, existing providers will be able to compete more easily across borders;
- second by facilitating the market entry of new competitors, e.g. 'pure' payment institutions or hybrid payment institutions such as telecoms, supermarkets;
- third, by more transparent information (e.g. on the cost of a payment account) and the elimination of hidden costs (e.g. value dating) customers will be able to compare prices more easily and shop around.

14) What are the concrete benefits for consumers?

The Directive will bring major benefits for consumers, as follows:

- Permit cross-border direct debits (see below).
- Allow the use of a debit card anywhere in the euro area: This is particularly useful for persons who do not have a credit card, or for making low-value purchases for which a credit card is often not accepted.
- Only one bank account is needed for the whole euro area: persons working or studying abroad in another euro area country will be able to manage all their finances from an existing euro account in their home country.
- Faster payments: the D+1 rule for the execution time of electronic credit transfers means payment monies must be credited to a recipient's account at the latest by the end of the next business day. Banks will no longer be able to keep for up to 5 days the funds received before executing a payment.

- Immediate use of payments received: the practice of value dating to the disadvantage of the user is no longer permitted; so when payment monies are credited to an account, a recipient will have full and immediate use of the monies.
- Crediting of the full amount: the full amount specified in a payment order shall be credited without any deduction to the beneficiary. This provides legal certainty with respect to the fulfilment of any underlying obligation. (Although most banks do not charge for the receipt of credit transfers, banks will be allowed to continue this practice. However, the amount charged will have to separately shown and deducted).
- Enhanced consumer protection: through, for example, better information and clear rules on refund where a transaction is wrongly executed.
- Limited liability: in the case of loss or theft of a payment instrument (e.g. a debit or credit card) the maximum liability of consumers is limited to EUR 150 (of course this does not apply for fraudulent behaviour). This amount may be reduced by Member States and there is no liability for unauthorised payments occurring after the user has properly notified his/her payment service provider.

15) Will consumers be able to make cross-border direct debits?

Yes. Direct debits are an efficient way of paying regular bills but this service is not currently possible on a cross-border basis. One of the main advantages of the Directive will be to make such services possible.

However, the availability of direct debits will depend on when banks and other payment service providers first start to launch such products.

16) Will faster payments mean extra costs?

No

- Under the Directive banks and other payment service providers will need to guarantee the maximum time it takes to make a payment and that this will be standardised for credit transfers, no matter which EU country the payment is coming from or going to.
- This should not lead to higher costs for users including consumers. In fact, in some Member States banks are already making payments the same day or within a matter of hours, and at lower costs.
- Nevertheless, some payment service providers have still to make the substantial investments already made by their competitors to speed up their payment systems. These providers will have a choice between making the investments required and then recovering the costs through greater overall efficiency, or outsourcing their payments processing to more efficient market players.
- Either way, in the more competitive market, payment service providers will have to ensure that they provide a quality service at a competitive price.

AUTHORISATION RULES FOR PAYMENT INSTITUTIONS

17) What authorisation requirements are payment institutions required to fulfil?

Payment institutions are required to fulfil a variety of qualitative and quantitative requirements.

Qualitative requirements include, but are not limited to, sound administrative, risk management and accounting procedures, proper internal control mechanisms, directors and managers that are of good repute and possess appropriate knowledge and experience, as well as shareholders that are suitable taking into account the need to ensure the sound and prudent management of a payment institution.

Quantitative capital requirements to ensure financial stability. These include initial and ongoing capital requirements appropriate to the low level of risk of payment institutions.

18) What are the capital requirements for payment institutions and how do these compare with banks?

For both payment institutions and banks, the capital requirement is the higher of the initial and the ongoing capital requirement. The initial capital requirement is a fixed, flat amount whereas the ongoing capital requirement tends to increase with business volume. A simplified presentation of the capital requirements for payment institutions as compared to banks is given below:

Initial capital

Payment institutions:

EUR 20 000 money remitters

EUR 50 000 mobile payments

EUR 125 000 full-range payment service providers including any credit

Banks

EUR 5 000 000

Ongoing capital

Payment institutions:

The competent authorities of Member States may choose between one of three methods:

- Method A: 10% of fixed overheads (admin expenses, rent, salaries, etc)
- Method B: Degressive percentage (from 4% to 0.25%) of amount of monthly payment transactions in previous year
- Method C: Degressive percentage (from 10% to 1.5%) of sum of relevant indicator (sum of interest income, interest expense, commissions & fees, other operating income)

For Method B and C, a scaling factor is used to reduce the ongoing capital as follows:

0.5 money remitters

0.8 payment transactions carried out by mobile telecom operators

Additionally, depending on the quality of the payment institution's risk management, the competent authorities of the Member State may increase or reduce the ongoing capital requirement for all three methods by up to 20%.

Finally, where a payment institution grants credit in connection with a payment, national supervisory authorities must also be satisfied that the own funds of the payment institution are appropriate in view of the overall amount of credit provided.

Banks:

The situation is more complicated. Under Basle II, sophisticated rules have been developed for banks to ensure financial stability and that depositors can be repaid on demand. Put simply, banks have ongoing capital charges calculated as the sum of three components:

- credit risk : based on the amount of loans they make,
- market risk: based on possible losses incurred when trading,
- operational risk: based on risks they incur for people, processes and systems.

19) So are capital charges for payment institutions generally higher or lower than for banks?

It is not meaningful to make a full comparison because payment institutions and banks carry out different business activities and have very different risk profiles. However, if we consider payment services in isolation, then payment institutions have generally significantly lower capital charges. This can be seen from the following comparison:

Initial Capital

For payment institutions the amount varies from EUR 20 000 to 125 000 whereas banks require EUR 5 000 000.

Ongoing capital

It is possible to make a rough comparison only for Methods A and C:

- Method A: In some cases banks and investment firms can have a capital charge based on fixed overheads. In this case the charge is 25% not 10%.
- Method C: This is a simplified version of the operational capital risk charge for payments services carried out by banks. This capital charge is given in Annex X of the CRD (Capital Requirements Directive 2006/48/EC). For payment services the CRD capital charge is a flat rate percentage of 15% as compared to the degressive percentage (from 10% down to 1.5%) under the PSD.
- Method B: There is no comparable risk charge for banks.

20) Why do banks have generally higher capital charges for payment services?

Banks hold deposits which they use for a variety of risk-taking activities, <u>including providing credit</u>, and can pose a systemic risk to the wider financial system. On the other hand, payments institutions cannot take deposits, cannot use monies in a payment account to finance its payment activities (including possible credit granting). Payment institutions are therefore subject to an extremely low level of risk which does not pose a systemic risk to the financial system (but even so payment institutions are still subject to oversight arrangements by the ECB and national central banks).

These are not just theoretical considerations. Payment institutions are already making payments in some Member States and in other parts of the world with no or minimal capital requirements and have done so successfully with very low levels of risk. However, these payment institutions will now be required to respect the capital requirements laid down in the Directive.

21) Why are Member States allowed to waive some or all of the authorisation requirements for small payment institutions?

There are three main reasons:

- First, to facilitate market entry and innovation by new players without subjecting them to the full rigours of the authorisation framework.
- Second, to encourage small scale market players, e.g. typically persons providing remittance services, that may currently be operating informally to leave the black economy and have them officially registered and identified.
- Third, to comply with international obligations[1] which requires all EU governments to register money remitters for global anti money laundering and anti terrorist financing purposes.

22) Are there restrictions on the waived payment institutions?

Yes:

- The total amount of payment transactions carried out by a waived PI may not exceed EUR 3 million per month.
- The persons responsible for the management or operation of the business may not have been convicted of offences relating to money laundering or terrorist financing or other financial crimes.
- They do not enjoy a single passport allowing them to trade in other Member States.

In addition where a Member State makes use of this derogation, it must provide an annual report to the Commission indicating the number of natural and legal persons concerned and the total amount of payment transactions for each calendar year. Member States may also decide to limit the range of payments activities waived.

CREDIT GRANTING BY PAYMENT INSTITUTIONS

23) Why should payment institutions be allowed to grant credit?

While the Payments Services Directive is not about regulating cross-border credit, there are some existing payment products, such as credit cards which are used for payments and which typically allow customers to repay over an extended period.

Consequently, payment institutions should be allowed to grant credit in accordance with the rules laid down by the Payments Services Directive.

Under the Directive, any credit provided by a payment institution has to be provided from the payment institution's own funds or monies that it has raised in capital markets, not from the funds received or held for the purpose of execution a payment transaction. National supervisory authorities must also be satisfied that the own funds of the payment institution are appropriate to the overall amount of credit provided.

[1] Special Recommendation VI of the FATF (Financial Action Task Force).

24) What are the rules applying to payment institutions on credit duration?

There is no restriction on credit duration for national rules on credit cards. (National rules may provide for a credit duration period longer or shorter than 12 months.)

However, when a payment institution wishes to trade in a Member State other than the home Member State in which it is authorised, credit provided through a credit card must be repaid within a short period which must not exceed 12 months.

So if an authorised payment institution wishes to start marketing credit cards to users in other Member States, the maximum credit duration period is 12 months.

This situation must be clearly distinguished from the use of a national credit in other Member States. For example, if a user is entitled to a credit duration period exceeding 12 months for national payments, this extended credit period will also apply to payments carried out by the same user when using the credit card in other Member States.

25) Are there any other restrictions on credit granting by a payment institution?

Yes:

- In all cases the credit must be ancillary and granted exclusively in connection with the execution of a transaction.
- Furthermore, any credit provided under the Payments Services Directive will be subject to the future rules of the Consumer Credit Directive as well as existing national and community rules on credit, e.g. national rules which aim to stop card-users falling into too much debt.
- Finally, as noted above, any credit provided by a payment institution has to be provided from the payment institution's own funds or monies that it has raised in capital markets, not from the funds received or held for the purpose of execution a payment transaction. In addition, the national supervisory authorities must be satisfied that the own funds of the payment institution are appropriate to the overall amount of credit provided.

PAYMENT EXECUTION TIME ("D+1" rule)

26) Why is it important that payments are made at the latest by the end of the next business day and when does this rule apply?

Rapid payment is essential for a modern and properly functioning economy. Today, several countries already provide that national payments must be made by the end of the next business day (the so-called "D+1" rule) and some even make payments the same day. If some banks can already provide such rapid payments profitably, there is no good reason why other banks should not also be able to provide such rapid payment.

Moreover, if the new SEPA payment products are not at least as good as existing national payment instruments, users will not switch over from existing national payment instruments to the new SEPA products with the result that the success of SEPA could be jeopardised. For this reason, the ECB has also supported a maximum execution time of D+1.

However, the Commission recognises that banks need time to upgrade existing products and systems. Therefore, up to 1st January 2012, the Directive allows parties to agree on a maximum execution time of "D+3" for credit transfers. Furthermore, the Directive allows the parties to agree on an extra business day for paper-initiated payment transactions.

27) But does this mean that existing payments that are made the same day will now be made a day later?

No:

- The 'D+1' payment time under the Directive is only a maximum period. There is absolutely no obligation or intention for payment service providers now to start making slower payments where currently payments are made on the same day. On the contrary, payment service providers should not use the Directive to justify a deterioration in existing service quality or price.
- Moreover, to guard against this risk, the Directive also allows Member States to opt for a shorter payment time for purely national payment transactions. In addition, the Directive always allows payment service providers to give customers more favourable terms than the minimum standards required under the Directive.
- So there are absolutely no grounds in the Directive for banks and other payment service providers to charge higher prices or offer slower service.

28) What payment transactions must be made at the latest by the end of the next business day?

From 1st January 2012 the following credit transfers must be made at the latest by the end of the next business day:

- euro currency payment transactions, both national and cross-border within the EU;
- national payment transactions in the currency of the Member State concerned;
- certain payment transactions involving currency conversion between the euro and the currency of a non-euro Member State.

Before 1st January 2012, a payer and his/her payment service provider may agree on a maximum period of 3 business days.

29) How long will other payments take?

- For intra community credit transfers not covered above (e.g. cross-border transfers in a non-euro, EU currency), the maximum period to make a payment shall not exceed four days.
- For paper initiated payments, the period may be extended by an extra business day.
- For direct debits, settlement should take place on the agreed date.
- For cards, the parties enjoy contractual freedom.

SOME SPECIFIC CONSUMER PROTECTION ISSUES

30) What happens to payment monies with a payment institution if the other business activities carried out by a payment institution fall into difficulties?

The normal supervision of the payment activities of a payment institution and the qualitative and quantitative requirements set out in the authorisation framework are designed to avoid problems with the payments activities of a payment institution. Although these rules do not in general apply to the other business activities of a payment institution, supervisors can require additional capital where these non-payment activities threaten the financial soundness of the payment activities.

However, the Directive also provides that where a payment institution engages in non-payment services business (e.g. retailing or telecom activities), funds received from payment service users (or from another payment service provider) shall be safeguarded[2] in one of two ways.

- Either, the funds shall be kept separate from other funds of the payment institution and protected against the claims of other creditors of the payment institution; or
- These funds shall be covered by an insurance policy or some other comparable guarantee, payable in the event that the payment institution is unable to meet its financial obligations.

31) Why do consumers enjoy less protection for certain low-value payments?

Cost-effective, easy-to-use payment instruments cover a broad range of different payment methods, such as classical e-money (e.g., Proton in Belgium, ChipKnip in the Netherlands), mobile-payments and new payment solutions. Although new payment solutions are evolving rapidly, consumers seem to have confidence in using them. Consumers appreciate their simplicity and convenience and in exchange are willing to receive less information and enjoy less protection than would be the case if the same payment were made from a classical bank account.

Since such instruments are designed to be used mainly for the frequent purchase of low-priced goods and services, in the interest of simplicity and convenience, the Directive allows them to be used without being overburdened by excessive requirements (e.g. information on all transactions executed; reimbursement of pre-paid card if lost or stolen).

[2] In some situations (e.g. prepaid telecom instruments) only a small portion of the amount of the funds available are typically used in practice for future payment transactions. In such cases, Member States may decide to apply the safeguarding requirement only to the part of funds typically used to make payments falling under the Directive. An example may make this clear. On average say 90 % of funds on a prepaid telecom card are used for making telephone calls. These payments do not fall under the Directive. Only 10 % are used on average for making payments falling under the Directive, e.g. purchasing confectionaries or drinks, paying for a taxi. Then if such a user had a 600 EUR prepaid card, only 10% or 60 EUR would require safeguarding. Alternatively, in the interests of simplicity, Member States may waive these safeguarding requirements provided the total funds on the prepaid card do not exceed 600 EUR.

However, there are limits: individual payment transactions must not exceed EUR 30 or there must be a spending limit of EUR 150 or the maximum amount of funds stored on the instrument must not exceed EUR 150 at any time.

For purely national payment transactions, Member States or their competent authorities may reduce or double the above amounts and for prepaid instruments the threshold may be increased up to EUR 500.

32) Can a consumer be sure that a payment will be received by the intended recipient?

To maximise and simplify customer protection, the payer’s payment service provider is liable for the successful execution of a payment transaction on a so-called "end-to-end" basis (i.e. the payment service provider is responsible for ensuring payment from the sender's account to the recipient's account no matter what intermediaries or channels are used to make the payment).

However, where a payment is incorrectly carried out or not made at all, e.g. if the payer's bank can prove that the correct payment was received by the bank of the recipient, then the recipient's bank is liable and not the payer's bank.