Banking and Capital Markets

Surviving the Payment Services Directive sea change

Transaction Banking Compass

PricewaterhouseCoopers

In November 2009, the Payment Services Directive[1] (PSD) will be enacted into legislation and will change the nature of payment processing in Europe for ever. The PSD establishes a 'level playing field' across 30 countries, makes it significantly easier for non-credit institutions to offer payment services and further shifts the balance of liability in favour of consumers. It also fundamentally changes the way in which payment services are delivered: radically affecting technical architectures, operating models, product design and business processes.

Leading organisations have already established a range of strategies to anticipate and leverage these changes. Clear blue water is emerging, particularly since the financial implications can vary by up to 100 times between organisations.

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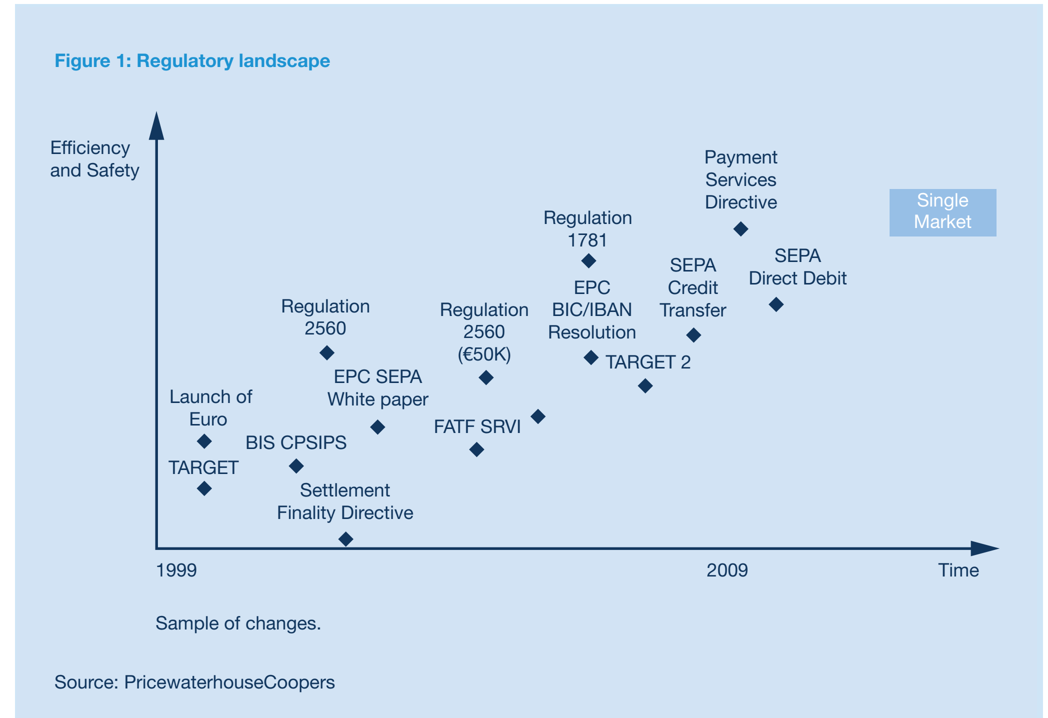
1 Directive 2007/64/EC of the European Parliament and of the Council 13.11.07.

Figure 1: Regulatory landscape



Sample of changes.

Source: PricewaterhouseCoopers

Banks shouldn't fight the tide of change

The political commitment to the Single Market, the potential to create more economic value and the need to address perceived market imperfections have all driven the demand for new legislation. Price variations in different national markets, complex and expensive cross-border payment processing and outmoded service levels have all combined to create an unstoppable political and customer demand for change. The European payment market is widely regarded as oversupplied, uncompetitive and imbalanced. The PSD is intended to change this.

The PSD builds on a number of previous interventions designed to improve the functioning of the payments market in Europe (see Figure 1). Changes come in waves that are as regular and persistent as they are consistent in intent: price transparency, consumer protection and more effective competition are all common themes.

Legislation to equalise domestic and cross-border pricing, to promote international account numbering conventions and to require more structured and reliable transmission of remitter information are all part of the programme. Reduced clearing cycles, removal of float and value dating requirements are also

part of the story. So too is the challenge to multilateral interchange fees and the establishment of tourist tests. Banks, therefore, urgently need to revitalise their product development capabilities, establish revenue growth strategies and innovate if they are to continue to enjoy traditional success.

The European Commission is not alone in creating these changes and in addition to the ebb and flow of the customer lobby:

- The European Central Bank is acting as a catalyst for change to euro payment processing: promoting smoothness, safety and greater efficiency in payment instruments and systems; and
- The European banking industry through the European Payments Council is implementing the standards, schemes and foundations of a new Single Euro Payments Area (SEPA).

These changes affect strategies, planning assumptions and business cases in every bank that does business in Europe:

- CEOs need to understand the implications to the strategic market landscape.
- COOs need to understand the implications to operating models.
- CMOs need to understand the implications to business models and products.
- CROs need to understand the implications to operational risk profiles.
- CFOs need to understand the implications to funding, capital and liquidity management profiles.

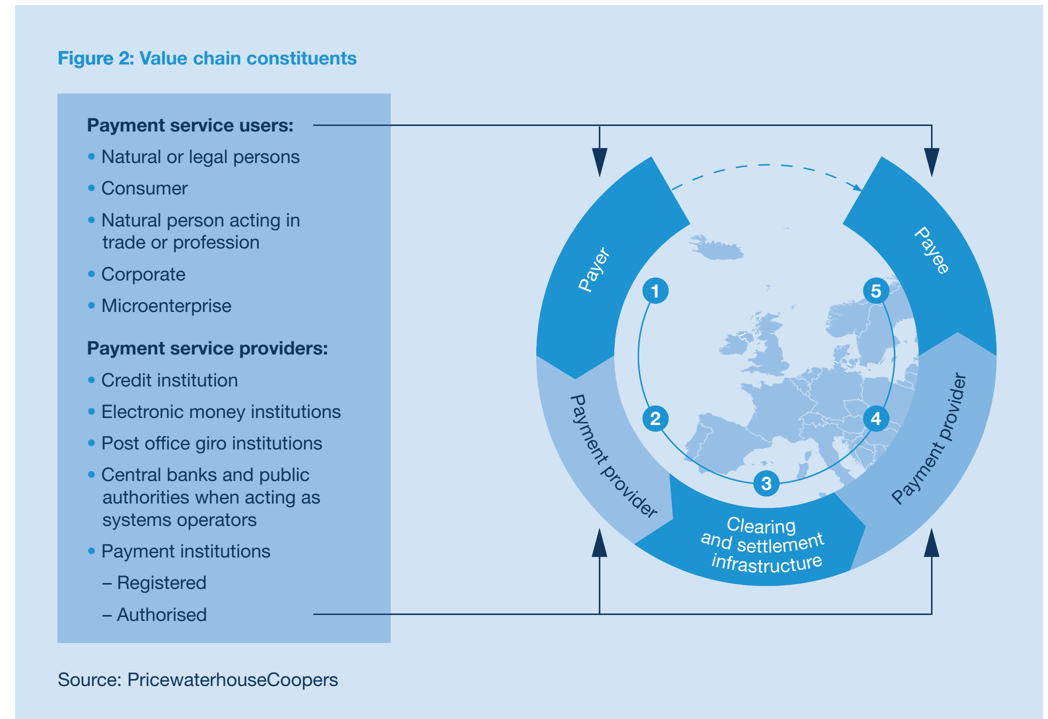
A complex and difficult piece of legislation needs to be thought through

The passage of the PSD has not been smooth and remains contentious in many areas. With many areas of national derogation available to each Member State, the consequent legislative environment requires a detailed understanding of how it has been implemented into the legal framework of every country within Europe, as well as the European Economic Area (EEA). This potentially detracts from the Single Market vision, risks creating market uncertainty and therefore threatens the related SEPA timetable.

In a domestic payment context, national variations in European payments legislation is analogous to having different legal rules applying to otherwise identical payments, depending on where they are geographically conducted within an individual country. This is untenable from a customer perspective, as well as onerous from a provider perspective. It is therefore also at odds with the vision and operation of a level playing field.

Payment service providers (PSPs) with international operations within Europe therefore need to assess the implications of the PSD on their regional propositions, operating models and supervisory arrangements. This will be a critical consideration for the entry strategies of new entrants to the market and for the existing providers of payment services that will be caught within the scope of the new payment institution (PI) provisions from November 2009.

Figure 2: Value chain constituents



Source: PricewaterhouseCoopers

The market now needs to speak a new payments language

Before the PSD the concept of payments was often regarded as primarily a banking activity. However, this was an oversimplification and ignored important sectors of the payments market such as money remitters. As a result it created artificial barriers to entry to the market and with the creation of the PSD no longer applies.

The PSD is founded on the premise that the payments business is not the exclusive preserve of banks, that the regulatory requirements for payments should be independent of banking regulation and that all providers of payments services should be regulated. It therefore introduces important new terms to the market (see Figure 2):

- Payment service providers – a higher standard of authorisation;
- Payment institutions – a lower standard of authorisation; and
- Payment service users (PSUs) – the customers;

Table 1: PSD impact scope

Impacted services	Impacted products and channels (illustrative)
1 Services enabling cash to be placed on a payment account as well as all the operations required for operating a payment account.	**Instruments** • Payment accounts • ATM disbursements, payments and deposits • Credit transfers and direct debits • Debit cards • Credit cards • Electronic purses/Contactless cards • Mixed deposits • Cash deposits onto payment accounts • Remittance **Channels** • Branch • Agency • Telephone • Internet • Mobile • ATM • POS
2 Services enabling cash withdrawals from a payment account as well as all the operations required for operating a payment account.	
3 Execution of payment transactions, including transfers of funds on a payment account with the user's payment service provider or with another payment service provider: • execution of direct debits, including one-off direct debits; • execution of payment transactions through a payment card or a similar device; and • execution of credit transfers, including standing orders.	
4 Execution of payment transactions, where the funds are covered by a credit line for a payment service user: • execution of direct debits, including one-off direct debits; • execution of payment transactions through a payment card or a similar device; and • execution of credit transfers, including standing orders.	
5 Issuing and/or acquiring payment instruments.	
6 Money remittance.	
7 Execution of payment transactions where the consent of the payer to execute a payment transaction is given by means of any telecommunication, digital or IT device and the payment is made to the telecommunication, IT system or network operator, acting only as an intermediary between the payment service user and the supplier of the goods and services.	

Source: PricewaterhouseCoopers

The scope of the PSD is different from SEPA

The scope of the PSD is as far-reaching as it is broad in its scope and it applies to all specified payment services conducted within the European Union (EU), irrespective of their currency.

The legal relationship between the EU and the European Economic Area (EEA) means that the provisions of the PSD also extend to the EEA countries as well.

The scope of SEPA is related to, but different from, the scope of the PSD in two important respects:

1. Agreements within the European Payments Council (EPC) means that with the exception of pricing requirements, the Swiss banking community has also agreed to abide by the provisions of the PSD to allow their inclusion and participation in the SEPA.
2. The scope of SEPA only applies to payments undertaken in euros.

The PSD covers many different electronic payment instruments (see Table 1), each with distinct operating characteristics and different propositions. While the Directive seeks to cater for specific differences in instrument, it inevitably consists of compromises and contains ambiguities as a result.

PSPs and PIs therefore need to take great care as a result. Terms and conditions, definitions, operational activities and business process all need to be analysed and assessed to ensure that the implications are completely addressed and fully understood.

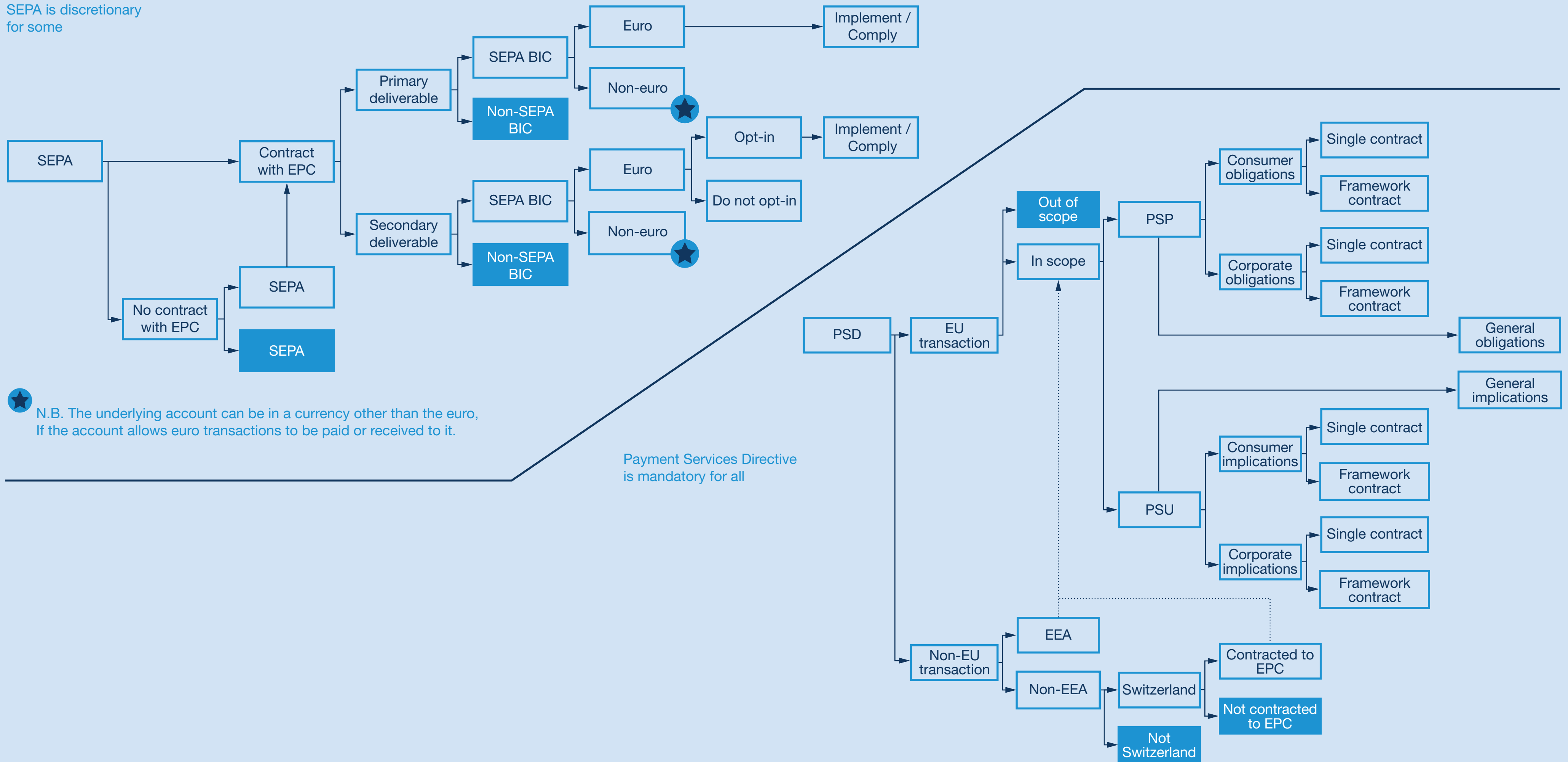
The PSD needs a different response to SEPA

The PSD creates a legal requirement, is not optional and therefore requires compliance. The SEPA initiative is not the same and depending on an organisation's relationship with the EPC, more discretion may be available.

Decision trees (see Figure 3) provide helpful tools to navigate these often complex decisions and make the process both rigorous and easy.

In understanding the optional nature of SEPA, the outcome of the current consultation regarding the establishment of a mandatory 'end date' to migrate national euro electronic payment schemes to EPC SEPA schemes is important. Market forces combined with an end date will make the optional nature of SEPA a question of when to change and not if to change.

Figure 3: Key decision points when considering SEPA and PSD



Source: PricewaterhouseCoopers

A benign looking sea can mask a dangerous 'rip tide'

The PSD involves a substantial number of issues that need to be assessed and addressed by PSPs (see Figure 4). Whereas almost all of the PSD requirements have to be addressed by November 2009, one critical requirement is deferred to 2012: the requirement to reduce the clearing cycle to D+1. It would be a mistake to underestimate this and it is not three years away. Decisions are needed now.

In practical terms the requirement for 2012 means completion of change activities in Q4 of 2011 and business cases agreed in 2010. This means feasibility study, strategy and business case development now.

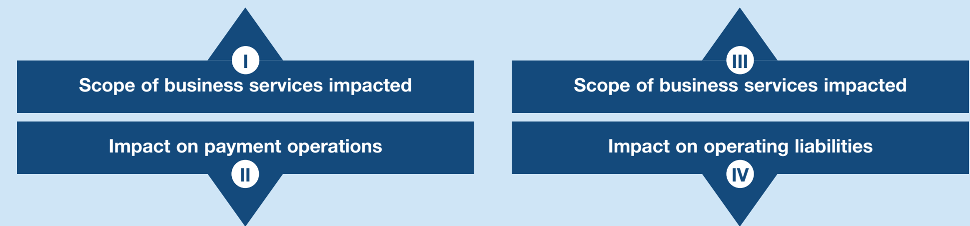
The shift to D+1 and the 'real-time' requirements that pervade the PSD require a fundamental rethink of payment architectures and operating models. Combined with technology trends, customer demand and market expectations, banks now need to provide real-time servicing models and 24/7 support models. Banks can no longer cope with payment processing downtime 'behind the scenes': incidents and problems have an immediacy and visibility that they have never had before.

Compliance is not enough. While a compliance approach may get banks past the immediate requirement in 2009, the strategic implications are both significant and potentially dangerous. It is therefore essential that banks don't get swept away by reaching the November milestone. This is not the finish; rather it is the start of the next wave of change.

Figure 4: PSP considerations

- Transactions caught by the legislation
- Internal definition of a payment account
- Internal definition of a business day
- Approach to one-leg transactions

- Impacted terms and conditions
- Decision regarding single contracts
- Approach to corporate opt-out clauses
- Approach to microenterprises
- Treatment of FX and interest rates



- Risk/control reduced clearing cycles
- Application of full amount principle
- Value dating and fund availability
- Blocking of payment cards
- Cash on payment account

- Approach to corporate opt-out clauses
- Refunds for unauthorised transactions
- Evidence and accounting
- Non-execution processes
- Defective execution processes

Source: PricewaterhouseCoopers

Contacts

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