

# The Payments Revolution

## Conduct of Business (Part 1) - for your information



21 April 2009

As we mentioned in one of our previous notes (*"The Payments Revolution - is your head on the block?"*), when the new Payment Services Regulations (the "**PSRs**"), come into force on 1 November 2009 they will, amongst other things, usher in new "conduct of business" ("**COB**") requirements to which you may be subject. They will impose across Europe minimum standards of business conduct in an area that up until now has largely been left to industry self-regulation.

For the most part the COB requirements will apply to all types of payment service provider (*with the exception of credit unions, municipal banks and the National Savings Bank but including those firms making use of the transitional provisions in the PSRs*) (each such firm being a "**PSP**" for the purposes of this note). However, it is important to note that some specific and limited requirements will apply to persons who are not PSPs - e.g. where they offer a currency conversion service or they are the payee in a transaction and they seek to levy additional charges for the use of a particular payment method (such as a credit card).

In outline, the COB requirements fall into two main categories:

- the requirements to provide *information* about a payment service to customers before and after a payment transaction is executed; and
- the requirements governing the *respective rights and obligations* of the PSP and its customer.

This is the first of two notes looking at the COB requirements: in it we address the scope and application of the requirements generally and then focus specifically on the information requirements which apply to single payment service contracts and framework contracts respectively. The second note, which will be issued shortly, will focus on the statutory provisions governing the rights and obligations of the parties.

### The scope and application of the COB requirements

#### When will the COB requirements apply?

Subject to the "corporate opt-out" (see below), the COB requirements will broadly apply to contracts for payment services where the following three conditions are satisfied:

- *the services are provided from an establishment maintained by a PSP or its agent in the UK* - this includes a UK firm passporting its services into another EEA state on a cross-border basis (rather than through the establishment of a branch) and also a UK branch of an incoming EEA authorised payment institution;
- *the PSPs of both the payer and the payee are located within the EEA* - so, "one leg" transactions, where one of the PSPs is outside the EEA, will fall outside the PSRs (although there is one regulation which applies regardless of the location of the PSPs - regulation 73 (on value dating and the availability of funds)(see below)); and
- *the payment services are carried out in the currency of an EEA State* - i.e. euro or the national currency of an EEA State which has not adopted the euro - e.g. pounds sterling. This means that the PSRs will not apply where payment transactions are denominated in non-EEA currencies, such as US Dollars.

#### Key client points:

- *From 1 November 2009, the COB requirements will broadly apply to payment services provided from an establishment maintained by a payment service provider (or its agent) in the UK, in the currency of an EEA State - so-called "one-leg" transactions will mostly not be covered.*
- *Subject to a few exceptions, all payment service providers will be subject to the COB requirements.*
- *Some specific and limited COB requirements will apply to persons who are not payment service providers.*
- *Payment service providers may agree with their corporate customers to disapply many of the COB requirements.*

## **What is the “corporate opt-out”?**

Provided your customer is not one of the following:

- a consumer - i.e. an individual who is acting for purposes other than a trade, business or profession;
- a “micro-enterprise” - i.e. a business with a turnover of less than EUR 2 million per year and nine or fewer employees; or
- a UK registered charity with an annual income of less than £1 million,

then you may agree with your corporate customer that:

- all (or some) of the information requirements which are set out in Part 5 of the PSRs shall be disapplied; and
- a significant number (but not all) of the provisions which are set out in Part 6 of the PSRs and which govern the respective rights and obligations of PSPs and their customers shall also be disapplied.

On the face of it this is a welcome concession for PSPs, at least to the extent that they provide payment services to wholesale customers. However, where you have both wholesale and retail customers and you wish to take advantage of the corporate opt-out as regards the former, you will need to ensure that you have different contractual arrangements in place together with systems and controls to ensure that the COB requirements are complied with in respect of those customers which are consumers, micro-enterprises or charities (and as regards any corporate customers with whom you do not agree a contractual opt-out).

## **Can the COB requirements be disapplied in any other circumstances?**

Yes, but only to a limited extent:

- if the contract under which the payment service is to be provided is or will be a *regulated consumer credit agreement*, then, to avoid unnecessary conflict or overlap between the payment services regime and the Consumer Credit Act regime:
  - certain specified information requirements under the PSRs will be switched off and other requirements as to the provision of information will be scaled back; and
  - certain specified rights and obligations provisions under the PSRs will be disapplied in favour of broadly corresponding requirements under the Consumer Credit Act 1974; or
- in the case of “*low-value payment instruments*” under a framework agreement governing their use, certain information requirements are disapplied and the parties may agree to disapply certain rights and obligations that would otherwise apply. A “low-value payment instrument” is one which, under the framework contract governing its use, can be used only to (a) execute individual payments of EUR 30 or less (or EUR 60 or less for UK-only transactions); (b) execute payment transactions with an aggregate spending limit of EUR 150 (or EUR 300 for UK-only transactions); or (c) store funds that do not exceed EUR 500 at any time.

## **The COB information requirements**

### **What are the information requirements and where can you find them?**

Broadly, the COB information requirements set out the information that must be provided at various stages of the payment contract cycle - i.e. before a contract is entered into, at the time the relevant payment order is made and following execution of the relevant transaction. The more detailed requirements are summarised in the remainder of this note.

The COB information requirements are set out in Part 5 of the PSRs. A distinction is made between:

- *single payment service contracts* - i.e. single, one-off payment transactions with no ongoing relationship between the PSP and the customer; and
- *transactions under a framework contract* - i.e. a contract governing a series of future payment transactions under an ongoing relationship with the PSP, for instance, in the form of customer terms and conditions.

Although this distinction is important in order to determine precisely how the COB information requirements will apply to your business, you must remember that there are certain common requirements which apply to PSPs whether they are involved in single payment service contracts or transactions under a framework contract. Otherwise, the COB information requirements are separated out into those which apply to single payment services contracts and those which relate to framework contracts. As might be expected, considerably more detailed information requirements apply to framework contracts than for single payment transactions.

### **What are the common information requirements for both single payment transactions and framework contracts?**

The following overarching information requirements under the PSRs are common to both single payment transaction contracts and framework contracts:

- *Communication of information* (Regulation 47) - any information provided or made available to customers in relation to single payment transactions and framework contracts in accordance with the PSRs must be provided or made available:
  - in an easily accessible manner;
  - if the customer so requests, on paper or on another “durable medium” (such as e-mail) - where the customer has agreed under a framework contract that information on individual payment transactions will be provided in a manner which enables him to store and reproduce the information unchanged (see Regulations 45 and 46 below) then this agreement will meet the overarching Regulation 47 requirement;

- in easily understandable language and in a clear and comprehensible form;
- in English (or other agreed language).

Although Regulation 47 is a common requirement, you will see from the detailed summaries below that information in relation to framework agreements must always be “provided” whereas information in relation to single payment service contracts may, instead, be “made available”. As H.M. Treasury said in its July 2008 consultation paper, “the use of the words “made available”... is of significance in imposing a lower burden upon providers of single payment transactions, and stands in contrast to the range of information which must be actively provided to users under a framework contract” (H.M. Treasury: “*Implementation of the Payment Services Directive: a consultation on the draft legislation*” (July 2008)). Information may be “made available” by providing a link to a secure website and this facility should constitute a “durable medium” provided the “link is addressed personally to the payment service user, is accessible for future reference and allows the unchanged reproduction of the information stored for a period of time adequate for the purpose of information” (EC Commission: “*Your questions on PSD*”).

It should be noted that, in respect of low-value payment instructions, the parties may agree that the Regulation 47 requirements do not apply to information which is provided or made available under Regulation 42 (changes in contractual documentation).

- **Charges for information** (Regulation 48) - a PSP may not charge for providing or “making available” information pursuant to the information requirements of the PSRs; however, the PSP and its customer may agree on charges for any information which is requested by the customer, where the information is additional to or more frequent than what is required under the PSRs or where the information is transmitted by means of communication which are different to those specified in the framework contract. Such charges must reasonably correspond to the PSP’s actual costs.
- **Currency and currency conversion** (Regulation 49) - payment transactions must be executed in the currency agreed between the parties. Where a currency conversion service is offered before the payment transaction is initiated at the point of sale or by the payee customer (for example, where a UK shop offers a non-UK customer the opportunity to pay his bill in euros rather than sterling), the party offering the currency conversion service to the payer customer must disclose to the payer customer all charges and the exchange rate to be used for converting the payment transaction before the transaction is initiated.
- **Information on additional charges or reductions** (Regulation 50) - the payee must inform the payer of any charges requested or reduction offered by the payee for the use of a particular payment instrument before the payment transaction is initiated. The example the FSA gives is of a shop or other merchant as payee levying an additional charge (or offering a reduction in cost) for using a particular means of payment, such as an additional charge for using a credit card. In this case, the information must be advised to the customer before the start of the payment transaction. In a similar vein, if a PSP or relevant third party (e.g. a retailer) levies a charge for the use of a particular payment instrument, it must inform the customer of the charge before a payment transaction is initiated.

#### **What are the specific information requirements for single payment transactions?**

Regulations 36 to 39 of the PSRs set out the information requirements for single (one-off) payment transactions.

We set out below a summary of the key information requirements of the PSRs for single payment transaction contracts. Remember that, although the PSP may choose to “provide” this information, it can instead elect to make it “available” (see above).

- Before the transaction: information to be provided or made available prior to (or, in certain circumstances, immediately after) the conclusion of a single payment transaction contract (Regulation 36) - a PSP must provide or “make available” certain information about the prospective payment transaction to its customer (whether it is the payer or payee):
  - details of the information or unique identifier (e.g. for sterling transactions, the payee customer account sort code and account number) that must be provided by the customer in order for a payment order to be properly executed;
  - the maximum execution time-frame - i.e. how long before the funds will be received;
  - charges payable by the customer to its PSP, including (where applicable) a breakdown of the amounts of those charges;
  - any actual or reference exchange rate to be applied to a payment transaction; and
  - such information as is specified in Schedule 4 as is relevant to the single payment transaction - this is problematic in that it rather begs the question as to which items in Schedule 4 will actually be “relevant” to the single payment transaction. In its Approach Document of March 2009, the FSA has said that what is “relevant” will depend on the nature of the payment service and the circumstances. However, the regulator does say that it considers that it will *always* be relevant to include details of the PSP and its regulators (and sets out suggested status disclosure wording for those PSPs regulated by the FSA) and, in respect of a customer who is an eligible complainant, to notify him of the availability of the Financial Ombudsman Service as an out-of-court redress mechanism.

This information may be supplied to the customer in the form of a copy of the draft single payment contract or draft payment order “or otherwise”. The general rule is that information must be supplied *before* the single payment transaction contract is concluded (i.e. the point at which a customer is bound by the contract). The PSP is permitted to supply the information immediately *after* the transaction is executed but only if, at the customer’s request, the contract is made using a means of distance communication (i.e. using the internet or other means where the PSP and customer are not simultaneously physically present) and that means of communication does not permit information to be given prior to execution. As to how information may be “made available” to the customer, the guidance from the European Commission indicates that the PSP may make the information available through “posters, leaflets or other kinds of information tools in his premises or on his website. The idea is that the user can access the information easily if he wants to.”

- *Information for the payer customer after receipt of the payment order* (Regulation 37) - a PSP must provide or “make available” to the payer customer the following information immediately after it receives the payment order:
  - a reference enabling the payer customer to identify the payment transaction and, where appropriate, details of the payee customer;
  - the amount of the payment transaction in the currency used in the payment order;
  - the amount of any charges for the payment transaction payable by the payer customer, including (where applicable) a breakdown of those charges;
  - if applicable, the actual exchange rate or reference rate, where the actual exchange rate or reference rate used in the payment transaction is different from the rate provided to the payer customer prior to the conclusion of the payment transaction contract; and
  - the date on which the payer's PSP received the payment order.

Under the PSRs, the time of receipt of a payment order is the time at which the payment order, given directly by the payer customer or indirectly by or through a payee customer, is received by the payer's PSP. If you receive a payment order from a payer customer after close of business, the payment order is deemed to have been received on the following business day. The close of business is determined by the business hours of the payment system through which the payment transaction is processed. Payer PSPs are entitled to set a cut-off time towards the end of a business day after which any payment order received will be deemed to have been received on the following business day, but payer customers must be made aware of the cut-off time before the payer PSP receives their payment orders.

- *Information for the payee customer after execution of the payment transaction* (Regulation 38) - a PSP must provide or “make available” to its payee customer the following information after the payment transaction is executed:
  - a reference enabling the payee customer to identify the payment transaction and, where appropriate, the payer customer and any information transferred with the payment transaction. The FSA says that including the name of the payer and invoice number will be relevant but otherwise, in deciding what is appropriate and relevant, the PSP should take into account its other obligations, including those relating to customer confidentiality or the security of the payment system itself;
  - the amount of the payment transaction in the currency in which the funds are at the payee customer's disposal;
  - the amount of any charges for the payment transaction payable by the payee customer and, where applicable, a breakdown of those charges;
  - if applicable, the exchange rate used in the payment transaction by the payee's PSP and the amount of the payment transaction before the currency conversion; and
  - the credit value date - i.e. the date on which payment pursuant to a payment transaction is credited to the payee customer's account.
- *Single payment transactions arising from use of a payment instrument issued under a framework contract* (Regulation 39) - where a payment order for a single payment transaction is transmitted by way of a payment instrument issued under a framework contract, the PSP in respect of the single payment transaction does not have to provide the information outlined above to the extent that such information has been provided by another PSP under the framework contract. The example the FSA gives is of a cash withdrawal by a customer of one bank using another bank's ATM machine. The latter bank will be a single PSP and does not have to provide information that will be made available by the customer's bank under the framework contract. The FSA understands that LINK rules require ATM operators to disclose any charges before the customer agrees to the transaction.

### **What are the specific information requirements for framework contracts?**

Regulations 40 to 46 of the PSRs set out the information requirements. Remember that all this information must be actively “provided” to the customer:

- *Information to be provided prior to (or, in certain circumstances, immediately after) the conclusion of a framework contract* (Regulation 40) - except in the case of low-value payment instructions, a PSP must provide certain information to its customer (whether it is the payer or payee) as specified in detail in Schedule 4 to the PSRs. In outline summary, this information includes:
    - information about the PSP (e.g. name and address, details of regulator(s));
    - information about the payment service itself (including a description of the main characteristics of the payment service, the information or unique identifier that must be provided by the customer in order for a payment order to be properly executed and the maximum execution time for the payment services to be provided);
    - information about transaction charges, interest and exchange rates;
    - information about the means of communication that will be used, the manner in which, and frequency with which, information will be provided and the language which will apply to the contract and information or notifications provided under the PSRs;
    - information about “safeguards and corrective measures” where relevant, including a description of the steps the customer must take to keep safe a payment instrument, the conditions under which the PSP proposes to reserve the right to stop or prevent the use of a payment instrument, the payer's liability for unauthorised payment transactions and for the execution of payment transactions and for non-execution or defective execution of payment orders;
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- information about future changes to the framework contract, the duration of the contract and the customer's right to terminate the framework contract;
- information regarding the applicable law of the contract and the availability of out-of-court complaint and redress procedures.

The PSP may satisfy the Schedule 4 information requirements by supplying its customer with a copy of the draft framework contract containing all the required information - and, in practice, this is probably the most likely way in which PSPs will satisfy their obligations.

In terms of timing, the PSP must provide the information required by Schedule 4 information to its customer "in good time" before the customer is bound by the framework contract. The information may be provided immediately after the transaction is executed if, at the customer's request, the contract is made using means of distance communication (e.g. over the internet or by telephone) which does not permit information to be given prior to execution.

After the contract has been entered into, the customer is entitled to request the PSP to provide a copy of the framework contract and Schedule 4 information (if such information is not set out in the framework contract) at any time during the period of the framework contract.

In the case of low-value payment instructions (see above), Regulation 40 does not apply and instead the PSP is only required to provide the payer with information about the main characteristics of the payment service (i.e. the way in which the instrument can be used, the payer's liability for unauthorised payment transactions, details of any charges applicable and any other material information that the customer might need to make an informed decision). However, the PSP must also tell the customer where the detailed information in Schedule 4 of the PSRs is made available in an easily accessible manner. In practice, this information could be maintained on the PSP's website.

- *Other information requirements applicable to framework contracts* - in addition to the information set out in Schedule 4 of the PSRs, PSPs must comply with the following information provisions.

Information to be provided to payer and payee customers

- *Changes in contractual information - general* (Regulation 42) - any proposed changes to the existing terms of the framework contract or the information provided in accordance with Schedule 4 of the PSRs must be communicated to the customer at least two months before the date on which the change will take place. The framework contract may provide that any such changes may be made unilaterally where the customer does not object before the date on which the changes come into force. Where the PSP has such a provision in its contract, then it must inform the customer that it will be deemed to have accepted the changes if it does not object to the changes and that it has the right to terminate the framework contract immediately and without charge before the date on which the change will take place. In implementing the requirements and rights under Regulation 42, you will need to have regard to The Unfair Terms in Consumer Contracts Regulations 1999 and The Consumer Protection from Unfair Trading Regulations 2008, where relevant.
- *Changes in contractual information - interest and exchange rates* (Regulation 42) - any changes to interest rates or exchange rates must be notified to the customer as soon as possible unless the parties have agreed on a specific frequency or manner in which the information is to be provided or made available. Immediate changes to interest or exchange rates without notice may be made where they are more favourable to the customer or where the right to make such changes is agreed in the framework contract and the changes are based on reference rates that have already been provided to the customer. Importantly, you must remember that any changes in interest or exchange rates must be implemented and calculated in a "neutral manner" that does not discriminate against the customer - the FSA says that this means that customers should not be unfairly disadvantaged and gives the example of using a calculation method which delays passing on advantageous rates to customers but passes on disadvantageous rates more quickly (to the benefit of the PSP).
- *Termination of framework contracts* (Regulation 43) - a customer may terminate the framework contract at any time without notice, unless the parties have agreed that a period of notice is required (which must not in any case exceed one month). If the framework contract is open-ended or is for a fixed term of 12 months or more, then after the expiry of the first 12 months, the PSP cannot charge the customer for any subsequent termination of the contract. If an open-ended framework contract so provides, the PSP may terminate the contract by giving its customer at least two months' notice. Any charges for the payment service which are levied on a regular basis must be apportioned up until termination and if any charges have been paid in advance the PSP must make a pro-rata reimbursement to the customer. It should be noted that this regulation does not affect any legal rights either of the parties has to treat the contract as void or unenforceable, including any rights it may have arising out of a breach of contract.

Information to be provided to payer customers

- *Before execution - information to be provided to payers prior to execution of individual payment transactions (on request)* (Regulation 44) - where a payment transaction under a framework contract is initiated by the payer customer, at the payer customer's request, the PSP must inform the payer customer of the maximum execution time and transaction charges payable by the payer customer, including a breakdown of those charges, where applicable.
- *After execution - information to be provided to payers on individual payment transactions (mandatory)* (Regulation 45) - the payer's PSP must, as soon as reasonably practicable after the amount of the transaction is debited from the payer customer's payment account or (where the payer does not use a payment account) as soon as reasonably practicable after receipt of the payment order, provide the payer customer with information which is almost identical to that which must be provided to payer customers after the receipt of a payment order for a single payment transaction (see above). Instead of having to provide this information on a transaction-by-transaction basis, the framework contract may stipulate that it is provided or made available at least once a month

and in an agreed manner which enables the payer to store and reproduce the information unchanged. A bank may therefore satisfy this by providing monthly statements or otherwise making them available. This does not have to be in paper. The information could be made available through a secure and dedicated section of the PSP's website for instance - provided the customer is aware of this and can use it to store and reproduce the information unchanged.

### Information to be provided to payee customers

- *Information for the payee customer on individual payment transactions* - (Regulation 46) - as soon as reasonably practicable after the execution of an individual payment transaction under a framework contract, the payee's PSP must provide the payee customer with information which is almost identical to that which must be provided to payee customers after the execution of a single payment transaction (see above). Instead of having to provide this information on a transaction-by-transaction basis, the framework contract may specify that it is provided or made available at least once a month and in an agreed manner which enables the payee to store and reproduce the information unchanged - this facility may be provided through a dedicated section of the PSP's website for instance.

### **Is that all for a PSP?**

The above is an outline of the COB information requirements as set out in the PSRs. However, as these are minimum standard requirements, you could, if you wanted, offer more advantageous terms to your customers. If you did decide to do this and set out additional terms, you would need to be careful to ensure that in doing so you did not accidentally undermine a COB information requirement as prescribed by the PSRs.

### **If you are not a PSP are there any information requirements which apply to you?**

Yes. Businesses that do not provide payment services to their customers, but who may or may not themselves be customers of PSPs, will still be subject to certain COB requirements, such as the requirement in regulation 49 (regarding information on currency conversions and related charges) and regulation 50 (regarding information on additional charges and reductions) which are discussed above.

If a non-PSP breaches either of these requirements he is guilty of a criminal offence and is liable on summary conviction to a fine. The non-PSP will not commit the offence if he took all reasonable steps and exercised all due diligence to ensure that the relevant requirement would be complied with.

Note that it is also a criminal offence to provide payment services if you are not a PSP. It is also an offence to make a false claim that you are such a PSP or otherwise hold yourself out as one.

### **What should you be doing?**

In the light of these impending information requirements, you will need to revisit and amend your existing customer documentation in readiness for complying with these requirements from 1 November 2009. In doing so - and where relevant - you should also bear in mind the Unfair Terms in Consumer Contracts Regulations 1999, which apply to retail payment services contracts with consumers and which require the PSP to ensure that their standard-form consumer contracts are fair and written in plain and intelligible language.

### **What happens if the COB requirements are breached?**

The FSA has the power to impose regulatory sanctions for non-compliance with the COB requirements against PSPs. Examples include:

- the imposition of potentially unlimited financial penalties (Regulation 85); and
- the power to require the PSP to make restitution to anyone who has suffered loss as a result of the PSP's breach of a PSR requirement (see Regulations 88 and 89, together with the FSA's right to apply to court for a restitution order).

As outlined above, there are specific criminal offences which may be committed by a person who is not a PSP.

### **Disclaimer**

Please note that the contents of this note provide an overview only. This note is guidance only and should not be relied upon as legal advice. Clients' circumstances will differ in each case. If you would like to receive specific advice on the new regime for payment services, please contact:

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