

The Payments Revolution

- it's a class thing



13 March 2009

The nature and extent of the impact of the new Payment Services Regulations (the “PSRs”) on your business will depend on what class of “payment service provider” you are; and what kind of “payment services” you provide. The PSRs take effect on 1 November this year.

The categories of “payment service provider”

The principal impact of the new payment services regime will be on “payment service providers” listed in Box 1. Within the category of “authorised payment institution”, it will also be important to consider the nature of the “payment services” which you are authorised to provide - Box 2 provides a reminder of the categories of relevant payment services.

Why is your categorisation important?

Your categorisation as a payment service provider, and the nature of the payment services you provide, will be important because this will determine the potential extent of your regulatory obligations and rights under the PSRs.

Authorised payment institutions: prudential requirements

Only authorised payment institutions (category (a) in Box 1) are required to comply with the following prudential requirements of the PSRs:

- the initial and on-going regulatory capital requirements imposed by regulation 18 and Schedule 3 of the PSRs – the extent of these capital requirements will differ depending upon the category of payment services that are provided (e.g. a money remitter need only generally have an initial capital of at least EUR 20,000, whereas an authorised payment institution that provides any of the payment services specified in paragraphs (a) to (e) of Box 2 must generally have an initial capital of at least EUR 125,000);
- the safeguarding requirements of regulation 19 – which require an authorised payment institution to keep customer funds in excess of £50 (the float) either segregated from its own funds or covered by an eligible insurance policy or guarantee from an eligible insurer or bank;
- the accounting and statutory audit requirements of regulation 20 – which require that, where an authorised payment institution carries on activities other than the provision of payment services, it must provide to the FSA separate and audited accounting information in respect of its provision of payment services; and the institution’s auditors have a duty to communicate to the FSA information relating to the institution or a person with whom it has “close links” in respect of identified matters relevant to the FSA’s performance of its regulatory functions;
- the outsourcing requirements of regulation 21 – which require the authorised payment institution to notify the FSA if it intends to outsource the performance of any operational functions relating to its provision of payment services and requires the outsourcing of any “important” operational function to meet certain specified conditions;
- the record-keeping requirements of regulation 22 – under which an authorised payment institution must maintain and keep records relating to its compliance with the prudential requirements of the PSRs for a minimum of five years.

Key client points:

- *If you provide payment services in the UK, the kind of “payment service provider” you are will have a major impact on the authorisation, registration and prudential requirements applicable to you*
- *Transitional provisions relating to the authorisation and registration regimes might be available to you*
- *Only authorised payment institutions can “passport” their payment services into other EEA states*
- *All payment service providers are subject to the COB requirements of the PSRs from 1 November 2009*

These prudential requirements do not apply to “deemed” or “transitional” authorised payment institutions (see 2 and 3 under “Transitional” payment institutions’ below).

Authorised payment institutions: passport rights

In addition to providing payment services in the UK, authorised payment institutions will be able to “passport” their payment services into any other EEA state (as the “host state”). A notice of intention to exercise its passport rights must be given to the FSA; and the FSA must, within one month, inform the host state supervisory authority.

If an authorised payment institution provides its payment services in a host state from an establishment (e.g. a branch) there, the authorised payment institution will need to comply with the conduct of business (“COB”) requirements of the host state in relation to those services, and not the COB requirements under the PSRs. Conversely, an authorised payment institution is subject to the COB requirements of the PSRs in relation to the payment services it provides from an establishment in the UK, whether cross-border or within the UK.

Authorised payment institutions may not provide payment services in the exercise of their passport rights through an agent in another EEA state, unless that agent is included in the FSA register of authorised payment institutions.

If you are a “deemed” or “transitional” authorised payment institution, you will *not* be able to provide payment services outside the UK in exercise of a passport right.

Small payment institutions

If you meet the conditions for qualifying as a small payment institution (category (b) in Box 1), you are waived from the requirement to be authorised and, instead, need to apply to the FSA to become *registered* as a small payment institution. Further, you will not be subject to those prudential requirements solely applicable to authorised payment institutions (as outlined above).

Small payment institutions cannot, however, passport their payment services into another EEA state. Therefore, if you meet the conditions for being registered as a small payment institution, but intend to provide your payment services in another EEA state from an establishment there or otherwise cross-border, you will need to become an authorised payment institution in the UK in order to “passport” your payment services into that EEA state.

Although small payment institutions are not *required* to comply with the prudential requirements of authorised payment institutions outlined above, they can choose to do so. For example, a small payment institution has the option of voluntarily safeguarding customer funds. It may wish to do this to give comfort to its customers as to the safety of their funds prior to execution of their payment transaction. Where a small payment institution voluntarily safeguards funds in accordance with the requirements of regulation 19, in the event of its winding up or administration, the claims of the customers have statutory protection and must be paid from the ring-fenced asset pool in priority to all other creditors.

Prudential requirements applicable to both types of payment institution

The following prudential requirements apply to both authorised payment institutions and small payment institutions:

- regulation 27 (additional activities) - payment institutions are subject to restrictions on the range of the additional activities that they may undertake and generally may only provide operational and closely-related ancillary services (e.g. foreign exchange services or the storage and processing of data);
- regulation 28 (payment accounts) - payment institutions may only hold payment accounts that are used exclusively for payment transactions;
- regulation 29 (use of agents) - when intending to use an agent to offer its payment services in the UK, payment institutions must first arrange for the agent to be added to the FSA register;
- regulation 31 (reliance on a third party) - where a payment institution relies on a third party for the performance of operational functions (e.g. the provision of payment transaction software), the payment institution is responsible for ensuring that the third party complies with the PSRs;
- regulation 32 (duty to notify change in circumstance) - a payment institution must notify the FSA “without undue delay” of any significant change in its circumstance that would (or is likely to) affect its (or its agent’s) ability to meet the conditions for being included in the relevant FSA register.

These requirements do *not* apply to “transitional” payment institutions.

EEA authorised payment institutions

If your head office is in another EEA state (your “home state”) and you are authorised by your home state as a payment institution, you can “passport” your provision of payment services into the UK. The prudential requirements of your home state (e.g. regulatory capital requirements) will apply to you.

An EEA authorised payment institution that provides its payment services in the UK from an establishment here (whether maintained by the EEA authorised payment institution or its agent) will, however, need to comply with the COB requirements of Part 5 (information requirements for payment services) and Part 6 (rights and obligations in relation to the provision of payment services) of the PSRs.

“Transitional” payment institutions

If you provide payment services in the UK and are not a payment service provider within categories (c) to (h) of Box 1, you must (unless you are an exempt person) be authorised or registered with the FSA by 1 November 2009. However, certain transitional provisions may be available to you if you were lawfully providing payment services in the UK before 25 December 2007 and fall under one of the following three categories of “transitional” payment institution.

1. "Transitional" small payment institutions

If you intend to be registered as a small payment institution, you must do so before **25 December 2010**. If you intend but fail to be registered before 25 December 2010, you may be committing a criminal offence, unless you can rely on the "transitional" authorised payment institutions provision (see 3 below) – that transitional provision will only be available to you if you meet certain qualifying conditions and, if you rely on that provision, you will have to be authorised as a payment institution before 1 May 2011.

To be a "transitional" small payment institution, you must meet the following criteria:

- the EUR 3 million financial limit and other qualifying conditions for being registered as a small payment institution; and
- you must not be a "deemed" authorised payment institution (see 2 below) or a "transitional" authorised payment institution (see 3 below).

If you rely on the "transitional" small payment institutions provision, you will still be subject to the COB requirements of the PSRs from 1 November 2009.

2. "Deemed" authorised payment institutions

You will be automatically deemed to have been granted authorisation if:

- you are a financial institution within the meaning of the Banking Consolidation Directive (e.g. a non-bank credit card issuer);
- you are the subsidiary of an EEA authorised credit institution or the jointly-owned subsidiary of two or more EEA authorised credit institutions; and
- your activities as a financial institution are included in the consolidated supervision of your parent company (or each of your parent companies) for regulatory capital purposes.

You will only continue to be a "deemed" authorised payment institution if, by **25 December 2009**, you have notified the FSA of the types of payment services you provide and certain other information, such as a description of your structural organisation, the identity of your directors and other management staff and the address of your head office (the "Relevant Information").

If you provide the FSA with the Relevant Information by 25 December 2009, you will continue to be a "deemed" authorised payment institution until the FSA decides whether to include you on the FSA register of authorised payment institutions. The FSA may decide not to include you on the FSA register (and, therefore, you will, subject to a right of referral to the Financial Services and Markets Tribunal, no longer be able to provide payment services in reliance on this transitional provision) if you fail to meet certain conditions – examples of such conditions include having robust governance arrangements, a suitable business plan and demonstrating that your directors and other management staff are of good repute and have appropriate experience.

As a "deemed" authorised payment institution, you are *not* permitted to provide payment services outside the UK in exercise of a passport right.

Once the FSA includes you in the relevant FSA register, you will immediately cease to be a "deemed" authorised payment institution and will be treated as a normal authorised payment institution.

Upon appearing in the FSA register of authorised payment institutions, you will automatically have the right to passport your services into other EEA states and you will also become subject to the prudential requirements of the PSRs in the same way as any other authorised payment institution.

"Deemed" authorised payment institutions will be subject to the COB requirements of the PSRs from 1 November 2009.

3. "Transitional" authorised payment institutions

You do not need to become an authorised payment institution before **1 May 2011** if you meet the following criteria:

- you are a UK incorporated body corporate with a head office in the UK and, if you have one, a registered office in the UK; and
- you are not a "deemed" authorised payment institution.

You will be committing a criminal offence if you rely on this transitional provision and fail to be authorised as an authorised payment institution before 1 May 2011.

If you rely on this transitional provision, you will still be subject to the COB requirements of the PSRs from 1 November 2009. However, you will not need to meet the prudential requirements of the PSRs until you have applied to become an authorised payment institution and appear in the FSA register of authorised payment institutions; but, prior to authorisation, you will not have any passporting rights.

Other categories of payment service provider

Payment service providers within categories (c) to (h) of Box 1 do not need to comply with the authorisation or registration regime (and the accompanying relevant prudential requirements). However, all payment service providers will be subject to the COB requirements from 1 November 2009. Examples of the COB requirements include:

- the standardisation of information requirements relating to payments, the time it will take for payments to be processed and the rights and obligations for both customers and their payment service providers for cross-border and national payments;

- restrictions on payment transaction charges that a payment service provider can impose on the customer;
- the liability of payment service providers where payment transactions fail to be executed, are defectively executed or are executed without the customer's authorisation; and
- the conditions for making refunds relating to payment transactions.

In addition, as of 1 November 2009, the categories of payment service providers set out in categories (f), (g) and (h) of Box 1 must notify the FSA that they provide (or propose to provide) payment services if they have not already done so before then.

Box 1: Categories of “payment service provider”

A payment service provider is any of the following when carrying out payment services:

- (a) authorised payment institutions

These are payment institutions authorised by the FSA under the PSRs (and included in the FSA register of authorised payment institutions) or any person that is a “deemed” authorised payment institution under the transitional provisions.

- (b) small payment institutions

These are payment institutions that are registered by the FSA as small payment institutions, being essentially payment institutions (a) which execute payment transactions with an aggregate value of EUR 3 million or less per month (averaged over twelve months); (b) whose directors and other persons responsible for the management and operation of the business have not been convicted of offences relating to money laundering or terrorist financing or other financial crimes; (c) whose head office, registered office or place of residence (as the case may be) is in the UK; and (d) which (where required) are registered under the Money Laundering Regulations 2007.

- (c) EEA authorised payment institutions

These are payment institutions authorised in an EEA state other than the UK to provide payment services in accordance with the Payment Services Directive.

- (d) credit institutions

These are essentially banks and building societies. It is still being determined, as part of the European transposition work, whether a “credit institution” includes not only a bank whose head office is located in an EEA state, but also a bank whose head office is located outside the EEA and which is providing payment services from a branch or other establishment located in the EEA.

- (e) electronic money institutions

These are e-money issuers.

- (f) the Post Office Limited

- (g) the Bank of England, the European Central Bank and the national central banks of EEA states other than the UK, other than when acting in their capacity as a monetary authority or carrying out other functions of a public nature

- (h) governmental departments and local authorities, other than when carrying out functions of a public nature.

Box 2: Categories of “payment service”

- (a) Services enabling cash to be placed on a payment account and all of the operations required for operating a payment account;
- (b) Services enabling cash withdrawals from a payment account and all of the operations required for operating a payment account;
- (c) The execution of the following types of payment transactions –
 - (i) direct debits, including one-off direct debits;
 - (ii) payment transactions executed through a payment card or a similar device;
 - (iii) credit transfers, including standing orders;
- (d) The execution of the following types of payment transaction where the funds are covered by a credit line for the payment service user –
 - (i) direct debits, including one-off direct debits;
 - (ii) payment transactions executed through a payment card or a similar device;
 - (iii) credit transfers, including standing orders;
- (e) Issuing payment instruments or acquiring payment transactions;
- (f) Money remittance;
- (g) The execution of payment transactions where the consent of the payer to execute the 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 or services.

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:

Mark Evans, Head of Payments Group, Travers Smith

E: mark.evans@traverssmith.com

T: +44 20 7295 3351

or any other member of our Payments Group.

Travers Smith LLP

10 Snow Hill

London EC1A 2AL

T +44 (0)20 7295 3000

F +44 (0)20 7295 3500

www.traverssmith.com