

## FINANCIAL REGULATORY QUICK START GUIDE

### REVISED PAYMENT SERVICES DIRECTIVE (PSD2)

#### OVERVIEW

The new PSD2 regime came into effect on 13 January 2018, replacing the original Payment Services Directive and amending other related legislation. PSD2 has been implemented in the UK via the Payment Services Regulations 2017 (PSRs 2017), and changes to the FCA Handbook.

PSD2 governs the authorisation, registration, and prudential requirements for payment institutions and account information service providers, and sets the conduct of business requirements for all firms providing payment services (including payment services providers authorised under different regulatory regimes, such as banks).

*The original Payment Services Directive (PSD) took effect in 2009, and was in need of revision to keep pace with developments in technology, the scope of exemptions, and new types of payment services.*

Among other things, PSD2 aims to:

- contribute to a more integrated and efficient European payments market
- accelerate the move to a level playing field for payment service providers

- promote the development and use of innovative online and mobile payments
- make payments safer and more secure
- enhance consumer protection
- encourage lower prices for payments

As well as changes to the scope of regulation, PSD2 introduces strengthened requirements relating to conduct of business and security measures.

#### CHANGES TO SCOPE

PSD2 extends the geographical scope of the regime to include “one-leg” transactions – payments where only one of the payment service providers is located in the EU – and foreign currency transactions. Previously, PSD requirements relating to transparency and conduct of business only applied when both parties’ (i.e. the payer’s and the payee’s) payment service providers were located in the EU, and the payment was in euros or another EU currency.

#### EXEMPTIONS

Certain of the exemptions under the PSD have been narrowed or “clarified”, following concerns that they were being interpreted and applied too broadly.

Previously, the limited network exclusion exempted payment transactions based on payment instruments accepted only (i) within the issuer’s premises or certain limited networks; or (ii) used only to acquire a “limited range” of goods or services. It has been modified under PSD2 to clarify that it may only be used where the payment instrument can be used within a specific retailer or retail chain,

to acquire a very limited range of goods and services.

Further, those relying on the exemption must notify the regulator annually if the total value of transactions in that year exceeds €1 million. This notification system will mean that the regulator could potentially challenge the use of the exemption.

The “digital download” exclusion, which previously exempted transactions executed by means of, and delivered or used through, telecommunication, digital or IT devices, has been removed and replaced by an “electronic communications” exclusion.

The new exclusion only applies to providers of electronic communication networks or services (such as mobile network operators) providing specified goods and services, up to given monetary limits. Permitted goods and services are digital content, voice-based services, electronic tickets and charitable donations.

Businesses using the exclusion must provide an auditor’s report to the regulator, testifying that the payment transactions they provide do not exceed limits of £40 per single payment transaction or £240 cumulative value of payment transactions for an individual subscriber per month.

The commercial agent exclusion has also been narrowed under PSD2. Under the PSD, this exclusion applied to transactions concluded by the payer and the payee via a commercial agent acting for both sides. Under PSD2 it only applies to transactions where the commercial agent is acting on behalf of either the payer or the payee.

## NEW PAYMENT SERVICES

PSD2 brings two types of payment service within scope of regulation for the first time; account information services, and payment initiation services.

These concern services that may be provided in relation to a payment account by a third party provider that does not itself operate the payment account in question.

An account information service is an online service that provides consolidated information on one or more payment accounts held by a customer of other payment service providers. This is meant to help customers view all of their accounts in one place, and to allow them to be offered tailored deals based on their consolidated accounts data.

A payment initiation service is an online service to initiate a payment at the request of a customer from a payment account held with another payment service provider. Such payments are initiated with the customer's consent and authentication. This service allows customers to make online payments straight from their payment accounts without the need for a credit or debit card.

## OPEN BANKING

PSD2 introduces new requirements for providers of payment accounts that are accessible online, to help facilitate the provision of account information and payment initiation services.

Such account providers must provide third party account information service providers and payment initiation

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service providers with access to their customers' accounts, where the customer has provided their explicit consent for the third party to do so.

Work has been ongoing in the UK among a number of payment account providers to develop common application programming interface (APIs) standards to ensure that these third party providers can easily "plug-in" to those payment account providers' systems. This forms part of the UK's wider "Open Banking" initiative, designed to help open up the banking market to smaller players and new entrants.

## STRONG CUSTOMER AUTHENTICATION

One particularly controversial area of PSD2 has been the Regulatory Technical Standards on strong customer authentication (SCA). The SCA requirements are being introduced to help reduce the risk of fraud, by ensuring that payment services offered electronically are carried out in a secure manner.

This means that payment service providers will need to apply SCA whenever a payer accesses their payment account online, initiates an electronic payment transaction, or carries out any action through a remote channel that may imply a risk of payment fraud or other abuses.

In this context, authentication includes any procedure that allows a payment service provider to verify the identity of a payment service user or the validity of the use of a specific payment instrument. For authentication to be "strong", it must be based on two or

more independent authentication elements (e.g. something only the user knows), and designed in such a way as to protect the confidentiality of the authentication data.

The SCA requirements came into force on 14 September 2019. However, many payment service providers have struggled to prepare for this compliance deadline.

Acknowledging the difficulties that providers have faced in preparing for the SCA requirements, the EBA issued an opinion on 21 June 2019 that allows national regulators to provide limited additional time for providers to comply.

In the UK, the FCA has confirmed an 18-month phased implementation plan for SCA in relation to e-commerce transactions to give card issuers, payments firms, and online retailers more time to ensure compliance. The FCA has confirmed that it will not take enforcement action against firms within scope of the plan, if there is evidence that they have taken necessary steps to comply with the plan. However, the FCA expects all firms to have made the necessary changes and carried out the required testing to apply SCA for online sales by March 2021.

## FINTECH

One aim of PSD2 is to promote the development and use of innovative online and mobile payments.

The new framework aims to help with attracting innovative new providers and technology companies to participate in payment services markets.