



“Connecting the  
payments landscape”

# The Payment Services Directive

**An essential guide for financial institutions**



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# 1: Executive Summary

The Payment Services Directive (PSD), formally known as the New Legal Framework for Payments, has been in preparation and was published in the Official Journal of the European Union (EU) on 5 December 2007. All 30 countries of the European Economic Area (EEA), which makes up the Single Market in the EU, must have implemented the requirements of the PSD into their national legislation by 1 November 2009.

The very broad and ambitious scope of the PSD makes it the most significant piece of EU Financial Services legislation in relation to the payments market ever seen! The PSD will impact all current and future providers and users of payment services within the EU and beyond as well as market infrastructures, card schemes, software vendors and other ancillary service providers.

In addition to providing the legal foundations for the Single Euro

Payments Area (SEPA) initiative, the Directive introduces a new licensing regime to encourage non-banks to enter the payments market; sets common standards for terms and conditions with a focus on high levels of transparency; establishes maximum execution times for payments in euro and other EU currencies; introduces a shift in liability between providers and customers in the interests of consumer protection; and looks to encourage the adoption of more efficient payment types.

**Citi has proactively taken steps to ensure a clear interpretation of the PSD at European level.**

While the PSD brings positive change for payment service users in terms of enhanced transparency and streamlined operational rules around payment service

execution, European financial institutions are likely to face high compliance costs and many adjustments to systems and services in order to ensure they are PSD-compliant in time for the 2009 deadline.

At the same time, aspects of the PSD that are still either unclear or contradictory will need to be further clarified as part of the transposition and implementation process. In this respect, Citi has proactively taken steps to work towards a clear interpretation of the PSD at European level where Ruth Wandhöfer, EMEA Treasury and Trade Solutions, is leading the ongoing negotiation, with the European Commission (EC) and Member States, as part of the PSD transposition process. This ensures all efforts are made to achieve a level playing field by November 2009.

With the various challenges outlined above, many opportunities lie ahead for European payments providers and their clients. As soon as the legal playing field

has been established with the PSD, the way is clear for a full-scale implementation of SEPA. The harmonised legal environment will allow banks to develop new services and venture beyond their existing footprint. Interoperability, collaboration and innovation will become key drivers of transaction banking in Europe.

This booklet aims to provide guidance for banks that face PSD implementation and to identify opportunities that could significantly limit a bank's exposure to the challenges and cost of the PSD.

Please feel free to contact Citi for any further information on this topic.

“Connecting the payments landscape”

## 2: What is the Payment Services Directive?

The PSD is a critical piece of legislation that will have an impact on how banks do business across the 30 countries of the EEA that make up the Single Market. The law will govern payment service providers within the Single Market, while banks outside of Europe will not be subjected to those regulatory requirements. The PSD is due to enter into force in all EEA countries via national legislation by 1 November 2009, and it will have an impact on all current and future providers and users of payment services within the EU and beyond, and on market infrastructures, card schemes, software vendors and other ancillary service providers.

The PSD was initially intended to provide the required legal harmonisation for the SEPA. However, the EC Internal Market Services Directorate General (DG Markt) opted instead for a more far-reaching law that would standardise information requirements and rights and obligations of payment service providers and users. The PSD's objectives range from regulatory capture of non-bank payment service providers to enhancing consumer protection, transparency, competition, efficiency and modernisation of payment systems and services, integration and consolidation of the payments market, enhanced innovation and the legal basis for SEPA.

Divided into four broad pieces (so-called Titles), the PSD covers scope and definitions (Title I), the regulation of payment institutions (Title II), conditions for transparency and information for payment services (Title III) and rights and obligations of users and providers of payment services (Title IV). The one-size-fits-all approach to payment services and payment service providers does not always exactly fit with the detailed provisions, hence posing some challenges in terms of application.

### Payment services regulated under the PSD framework cover transactions within the Single Market in all Member State currencies.

Payment services covered by the PSD are defined in the Annex of the Directive and include the following: cash placements on payments accounts and the operation of payment accounts; cash withdrawals from payment accounts and the operation of payment accounts; payment transactions including direct debits and one-off direct debits; credit card payments; credit transfers and standing orders; the provision of these

payment transactions when covered by a credit line; issuing and acquiring of payment transactions; money remittance and payment transactions where the consent of the payer is given by means of telecommunication, digital or IT device and where the payment is made to the telecommunication, IT system or network operator, who only acts as an intermediary between payment service user and the supplier of the goods/services.

In addition, certain types of payments, described under Article 3 of the PSD, are exempted from the requirements of the PSD. These include amongst others cash-to-cash transactions, paper cheques and payment services associated with securities asset servicing are exempted from the scope. As a practical recommendation any business involved in payment transactions should carefully review these exclusions in order to prevent potential compliance gaps.

Although this is a "full harmonisation" directive intended to provide clear and harmonised rules across Europe, Member States have a number of options to implement certain provisions differently or to waive them altogether. For example, Member States have the discretion to decide on shorter maximum execution times for purely national payments, treat 'micro-enterprises' as

consumers under the PSD and establish slightly differing rules for the newly regulated non-bank payment institutions.

In addition, certain aspects of the PSD that are either unclear or contradictory and are thus open to misinterpretation will need to be further clarified as part of the transposition and implementation process. In light of this, Citi has proactively taken steps to work towards a clear interpretation of the PSD at European level (see also Chapter V.).

### 3: The PSD and SEPA – a broader picture

In order to achieve a more consistent integration of the European payments market under the single currency, a payment system for the euro, SEPA, has been developed under the auspices of the European Payments Council.

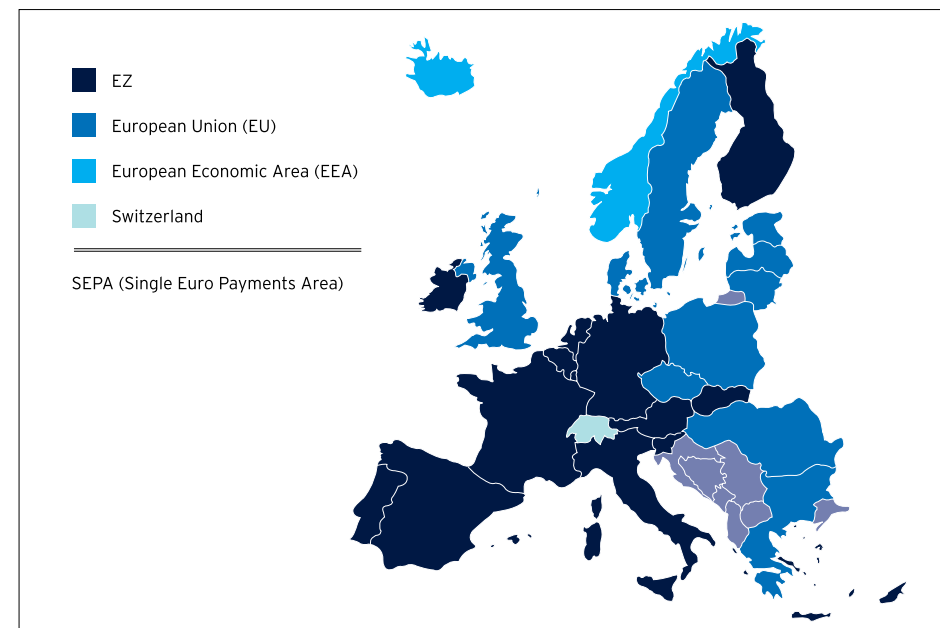
There was a clear expectation that SEPA legislation would also ensure the removal of Central Bank balance-of-payments reporting for euro payments in SEPA.

The SEPA project includes a common scheme for credit transfers and direct debits as well as a framework for euro cards transactions where, in the long run, this SEPA standardisation will allow removing the distinction

between domestic and cross-border euro payments across Europe. To allow for a legally harmonised environment on which to build SEPA, the EC was approached to provide assistance by removing legal barriers in key areas such as refunds rules and unique identifier primacy. At the same time, there was a clear expectation that SEPA legislation would also ensure the removal of Central Bank balance-of-payments reporting for euro payments in SEPA.

In support of SEPA, the PSD provides the required legal harmonisation in the area of refund rules, which have been established to support the SEPA Direct Debits Scheme, while the unique identifier primacy has been defined to ensure enhanced levels of straight-through processing (STP), limiting banks' and other payment service providers'

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liability in case customers have provided a wrong unique identifier. Central Bank Reporting requirements for euro transactions have not been abolished and thus continue to constitute a barrier to the free flow of SEPA transactions.

It is also important to note that the geographical scope of the PSD is different from the scope of SEPA. As outlined in the figure below, SEPA covers euro-denominated payments in 31 countries (EEA + Switzerland), while the PSD considers all Member State-

currency denominated payments in the 30 EEA countries. The euro zone itself will be enlarged to EU-16 from January 2009 with the adherence of Slovakia.

Due to fact that the final version of the PSD is a broad-ranging and ambitious legislative project, aimed at uniting a number of objectives far beyond the initial legal underpinning of SEPA, there are numerous issues in relation to many of the other areas the PSD is now addressing (see chapter V.).



## 4: More competition in payment services – are PIs a threat to banks?

In the context of the EC's obligation to implement Financial Services Action Task Force (FATF) Special Recommendation VI on "alternative remittance", the PSD also introduces a prudential framework for any entity or person, unregulated today, who provides or wishes to provide payment services. This requirement essentially aims to support the global fight against terrorist financing and money laundering, while at the same time having the potential side effect of stimulating further competition in the European payments market. Any person or business can decide to obtain a licence under the PSD, which permits the provision of payment services as a payment institute (PI). While natural persons are limited to provide payment services at the domestic level, legal persons (businesses) can obtain a European passport and thus offer payment services across the Single Market. While a number of existing businesses will have to be regulated as a PI due to their core business activity (for example, money remitters), any other company that does not provide payment services at this point in time will have the choice under the PSD to obtain a PI licence in addition to their core business allowing them to become a "hybrid payment institution".

With a view to the prudential supervision of these of non-bank payment service providers, it is still questionable whether the implementation of supervisory standards will be coherent, as Member States have the choice to appoint any "competent authority"

to look after the new PIs. This could, in practice, be a different authority from banking/financial services supervisors and might thus create a non-level-playing field between banks and PIs when it comes to the degree of supervisory burden.

Any person or business can decide to obtain a licence under the PSD, which permits the provision of payment services as a Payment Institution

Furthermore, the fact that PIs are enabled by the PSD to access open payment systems on a non-discriminatory basis (for example, no banking license requirement can be stipulated by those systems as an entry barrier) is likely to have a significant impact on what used to be the bank's remit only. Open payment systems, such as global card schemes, will have to open their doors to "payment institutions" including "hybrid payment institutions" where the latter could pose specific risk issues that could emanate from their "other" business activity. A number of additional concerns remain with the "access to payment systems" provision as the exemption of closed-loop systems from these access provisions appears not to be in line with the goal of enhancing competition.

## 5: The PSD's Conduct of Business Rules:

a significant compliance burden enriched with increased liability for all payment service providers

The PSD defines conduct of business rules in great detail, touching all stages of the relationship between customer and bank. However, as the PSD takes a one-size-fits-all approach to payment services and payment service providers, practical inconsistencies arise due to the fact that there is a multitude of different payment services to which legal rules cannot be applied uniformly.

Rules on transparency and information define terms and conditions focused on payment services, providing customers with information before, during and after a payment.

Rules on transparency and information define terms and conditions specifically focused on payment services, with the effect of providing customers with information before, during and after a payment is made, including detailed descriptions of, for example, maximum payment execution cycles. In relation to corporate payment service users, parties may agree to opt-out of all requirements

on information and transparency (Title III) as well as a number of Articles in Title IV<sup>1</sup>. Banks will have to carefully assess the impact of those rules on customer statements and terms and conditions, ensuring the appropriate information for each client segment.

Thirty PSD provisions covering rights and obligations of users and providers of payment services define rules in relation to authorisation and execution of payment transactions and around liability and disputes between payment service users and providers. Against the normal principle-based character of legislation, the PSD dives deep into the operational and technical field of payment services and considers it necessary to mandate service levels that govern, for example, how payments should be received, authorised and executed; how long it should take to execute them; and who is liable when something goes wrong. Refund rules are standardised for authorised and unauthorised transactions in support of SEPA Direct Debits, payment providers are limited in their ability to take float and the 'full-amount principle' are expected to change overall market practice in Europe. The radical shift

<sup>1</sup>Under Article 51 the following provisions of Title IV can be opted out with corporate clients: Articles 52 (1), second subparagraph of Article 54(2), Articles 50, 61, 62, 63, 66 and 75 as well as the discretion to define a different time period under Article 58.

## 6: Uncertainties in PSD interpretation and transposition

in liability towards payment service providers could have the potential of increasing fraud on the side of consumer payment service users, but it also creates a number of important legal questions for the inter-bank/ payment service provider space.

### Key PSD requirements include:

- Maximum execution time for electronic payments: default to D+1 max. from November 2009 with the possibility until 2012 to agree to a max. of D+3 between provider and user. For paper based transactions an additional day is granted.
- Detailed definition of receipt and refusal of payment orders
- Requirement for payment service providers and users to agree on rules regarding payment authorization and the use of payment instruments
- Liability limitation for payment service providers in case a payment is executed on the basis of a unique identifier (e.g. IBAN)
- Requirement for funds to be credited and made available on the same day that the beneficiary PSP receives them
- The establishment of the full-amount principle for payment transactions
- Right of payment service users to enjoy immediate payment refunds in case of unauthorised transactions, following the establishment of relevant proof.

The broad set of objectives in the PSD – including regulatory capture of non-bank payment providers, enhanced consumer protection, transparency, competition, efficiency and modernisation of payment systems and services, integration and consolidation of the payments market, innovation and the legal basis for SEPA – actually conflict with each other. This situation leads to the fact that the requirements established by the PSD are still unclear.

Strong coordination between European countries during the transposition phase is essential. This will be crucial to ensure legal certainty across SEPA.

Key concepts such as the geographic scope of the PSD are still unclear today, despite the fact that we have a final legal text since December 2007. Although the scope of the PSD explicitly covers the Single Market, recent EC recommendations to Member States are likely to have the effect that several countries in Europe will apply parts of the conduct of business rules to payments that travel between the Single Market and the rest of the world (so-called "leg-out transactions"). This will in particular create additional complexities for financial institutions operating, or intending to operate, in more than one European country.

Further irregularities arise from a number of Member State derogations, which are likely to result in gold plating and will consequently lead to non-harmonised legislations across Europe.

Also, a number of key definitions in the PSD still raise concern and need to be clarified during transposition.

Citi has proactively taken steps to work towards a clear interpretation of the PSD at European level where Ruth Wandhöfer is leading the ongoing negotiation with the EC and Member States as part of the transposition process. In that context, she is also the Chair of the PSD Implementation Expert Group established by the European Banking Federation and working in cooperation with the other two European Credit Sector Associations (ECSAs), which drives PSD analysis and implementation at European banking industry level. This ensures all efforts are made to achieve a level playing field for European payments where strong coordination between European countries during the transposition phase is essential. A very positive signal is the growing consensus among Member States that 1 November 2009 should be the common date of entry into force of domestic PSD legislation. This will be crucial to ensure legal certainty across SEPA.

As soon as key definitions and concepts of the PSD are clear at European level, the PSD Implementation Expert Group will issue specific guidelines for all European financial institutions.

## 7: Recommendations for financial institutions – how to cope with the PSD?

The PSD will affect all providers of payment services and is bound to have a substantial impact on European banks from both a revenue and a competition angle. Many financial institutions question when would be the best time to initiate a designated compliance project. The answer to this has to be, simply, yesterday!

Compliance with the PSD will be a challenging exercise, exacerbated by the current ambiguities in the text and the various approaches taken by Member States.

To tackle the PSD, banks need to establish first of all an appropriate project governance structure, which will allow an in-depth gap analysis of payment products in order to determine how PSD requirements are likely to affect current product propositions. For some markets in Europe, the PSD will be more significant than for others. A detailed analysis of impacts on revenues and the competitive environment is essential to ensure compliance and strategic positioning across the board.

On a strategic level banks need to consider the changed parameters in terms of the competitive environment and build a strategy around product, customer and target market that will allow the best possible leverage of PSD harmonisation. In this context, the advantage of streamlined legal documentation in the field of payments has the potential of making it significantly easier to provide services at a broader scale within the Single Market.

Due to the liability shift towards the sending bank in the PSD, financial institutions are advised to review their third-party-provider relationships. Terms and conditions will need to be upgraded in line with the PSD, and relevant client communication should be in place when national PSD legislation becomes effective. Ongoing PSD implementation at national level needs to be monitored, for example, through local banking associations and public consultation efforts.

Citi can provide flexible outsourcing payments solutions for SEPA and non-SEPA payments across the region.

The cost implications of the PSD are very clearly high, and upgrading legacy instruments and systems in addition to the continued rollout of SEPA capabilities will create significant budget constraints. The individual impacts to financial institutions, among others, also depend on the geographical footprint, product strategy and client base. Some banks may find that the option to white-label and outsource parts of their payments processing could be interesting. Citi can provide flexible outsourcing payments solutions for SEPA and non-SEPA payments across the region.

## 8: Useful Links

**The PSD legal text can be found on the following EU Commission webpage:**  
[http://eurlex.europa.eu/LexUriServ/site/en/oj/2007/l\\_319/l\\_31920071205en00010036.pdf](http://eurlex.europa.eu/LexUriServ/site/en/oj/2007/l_319/l_31920071205en00010036.pdf)

**Latest information on PSD transposition can be found at this EU Commission webpage:**  
[http://ec.europa.eu/internal\\_market/payments/framework/transposition\\_en.html](http://ec.europa.eu/internal_market/payments/framework/transposition_en.html)

**European Commission**  
[www.ec.europa.eu](http://www.ec.europa.eu)

**European Payments Council**  
[www.europeanpaymentscouncil.org](http://www.europeanpaymentscouncil.org)

**European Central Bank**  
[www.ecb.int.eu](http://www.ecb.int.eu)



**Ruth Wandhöfer**  
EMEA Payments – Industry and Strategy  
Treasury and Trade Solutions

Phone: +44 (0) 20 7508 2421  
Email: [ruth.wandhofer@citi.com](mailto:ruth.wandhofer@citi.com)

**Global Transaction Services**  
**[www.transactionservices.citigroup.com](http://www.transactionservices.citigroup.com)**

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