The Payment Services Directive:

A revised Regulatory Impact Assessment

December 2006

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HMSO
Licensing Division
St Clements House
2-16 Colegate
Norwich
NR3 1BQ

Fax: 01603 723000

E-mail: hmsolicensing@cabinet-office.x.gsi.gov.uk

HM Treasury contacts

This document can be found on the Treasury website at:

hm-treasury.gov.uk

For general enquiries about HM Treasury and its work, contact:

Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 4558
Fax: 020 7270 4861
E-mail: public.enquiries@hm-treasury.gov.uk

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The Payment Services Directive: a revised Regulatory Impact Assessment

Title of proposal

1.1 This is the revised Regulatory Impact Assessment (RIA) of the legislative proposal published by the European Commission on 1 December 2005 for a Directive of the European Parliament and Council on payment services in the internal market [Payment Services Directive], COM (2005) 603 final. The proposed Directive is under negotiation in the European Parliament and the Council of Ministers.

Purpose and intended effect

A) Objective

1.2 The Directive's ultimate goal is to improve the EU's competitiveness by integrating national payment markets and creating a Single Payments Market. This is expected to improve economies of scale and competition, which would increase efficiency and reduce the total cost of payments to the EU.

To achieve this, the Directive has three main objectives. These are:

- To enhance competition between national payment markets by opening up markets and ensuring a level playing field;
- To increase market transparency for both providers and users; and
- To standardise the rights and obligations of providers and users of payment services in the EU, with a strong emphasis on customer protection.

1.3 In addressing these issues, the Commission believes that the Directive will provide the legislative support necessary for the EU payments industry to build the infrastructure for a Single Euro Payments Area (SEPA), where cross-border Euro payments can be made as easily, safely, efficiently and inexpensively as within national borders.

1.4 If adopted, the Payment Services Directive will apply across the United Kingdom.

B) Background

1.5 Facilitating payments within the EU and harmonising the relevant legal provisions has been a priority for the European Commission's Directorate General for the Internal Market (DG MARKT). In 1997, a Directive on consumer protection rules for cross-border credit transfers (Directive 97/5/EC) was agreed. In 2001, the EU brought in Regulation 2560 on Cross-Border Payments in Euro. This Regulation stipulates that cross-border payments in Euro should be the same price as an equivalent domestic payment in Euro within any EU Member State, and was intended to provide industry with an incentive to build the payments infrastructure necessary for the creation of SEPA.

1.6 These existing pieces of legislation have, to some extent, made it easier and cheaper to make Euro payments across the EU. They have also encouraged industry to start the process of building the payments infrastructure necessary for SEPA. However, an internal market in payments has not yet been delivered. In 2003, the Commission published a consultation document identifying 21 potential barriers to the development of SEPA. Following detailed consultation, the Commission decided to proceed with a proposal for a Directive to address the issues identified.

1.7 The Payment Services Directive aims to establish a licensing regime for a new and third category of payment service provider – in addition to credit institutions and E-money issuers - known as a Payment Institution, allowing them to operate across the EU on the basis of a licence obtained in any one EU Member State. This follows recent work by the Commission to harmonise the licensing of credit institutions and E-money issuers across the EU.

C) Rationale for intervention – facilitating SEPA and an EU internal market in payments

1.8 How payments are made can have a significant impact on the productivity of an economy. Studies have shown that gains in efficiency, particularly by taking advantage of economies of scale and by moving to electronic products, can increase a country's GDP by several percentage points. The efficiency of payment systems in the UK was raised in the Cruickshank Report on Competition in UK Banking of March 2000, which noted that "given the fundamental importance of payment systems to economic life, any inefficiency in these systems will have a significant impact on economic welfare". Following the publication of the Cruickshank Report, work has been undertaken in the UK to improve the efficiency of the UK's payment systems, primarily through the Payment Systems Task Force of stakeholders from the banking industry, consumer and business groups and Government, chaired by the Office of Fair Trading.

1.9 The current fragmented state of payment systems among EU Member States is believed to be imposing significant costs on the EU as a whole. A study completed for the European Commission by McKinsey & Company in 2005 showed that they are currently around 231 billion payments per year in the EU, representing a total value of EUR 52 trillion. Moving to more efficiency payment services could bring significant savings to the EU. Opening up national payment markets to providers from across the EU should encourage this, increasing competition and facilitating the cross-border marketing and provision of payment services. For example, bringing in an EU-wide direct debit scheme should significantly improve the ease and efficiency with which regular bill payments are made across the EU, generating benefits for cross-border trade and mobility.

1.10 There is great variation in the efficiency of payment markets in different EU Member States. In some countries, low-value electronic payments take three days to execute, whereas in other countries the execution of a payment transaction is same-day. In addition, if the price of payments were to fall to the current EU average, huge savings could be achieved. For example, merchants have reported that if they were able to source payment services from the most competitive providers in the EU they could, in some cases, pay up to 20 times less for card payments.

1.11 From a UK perspective, some consumers and businesses encounter difficulties when making cross-border payments within the EU. Payments made solely in Euro can be expensive, and take some time to clear. Significant benefits could accrue if customers and businesses were able to make these payments more easily and at lower cost. Businesses, in particular, would benefit from the greater automation of cross-border payments. Some UK firms offering payment services currently experience difficulties in gaining entry to other European markets and in accessing some payment systems. This is particularly the case for payment service providers that are neither credit institutions nor E-money issuers. These hurdles may hamper the development of a true internal market in payments, preventing customers and businesses across the EU from choosing the most efficient European provider.

1.12 There are a variety of different types of non-bank payment service providers operating in the UK that would fall within the scope of the proposed Payment Services Directive. These include money transfer companies, non-bank cash machine operators and bill payment providers. Payment services are currently subject to very little financial regulation in the UK, whilst current payment service providers need banking or other financial institution licences to operate in some other EU Member States. Banking licences can be costly and difficult to obtain and impose requirements which are not relevant to a firm which only provides payment services. Capital adequacy requirements, for example, provide important protection for bank customers, whose money is taken in by banks as deposits and lent out again. Banks incur credit risk, which in aggregate can pose systemic risk to the financial sector. However, payment service providers that are not credit institutions or E-money issuers do not hold deposits. Money remitters pose little or no systemic risk as they generally pay out funds to the payee almost immediately, and do not lend out the money they receive from customers. Cash machine operators dispense their own cash to customers and rely on the customers' bank to reimburse the operators' cash position via a clearing agent.

D) Rationale for intervention – the Payment Services Directive

1.13 Building the infrastructure necessary to create SEPA is a complicated project. Without harmonisation of the legal provisions relating to payment services, it would be extremely difficult for the EU payments industry to reach agreement on a common solution. Even if they were able to agree, it is likely they would only be able to deliver "lowest common denominator" products, rather than products which are better or at least equivalent to existing national standards. Equally, without such legal provisions, non-bank payment service providers will continue to find it difficult to set up in other EU Member States. Economies of scale through larger markets would not be realised, with consumers and businesses severely restricted in their ability to shop across the EU for the best products.

E) Intended effect of the Directive

1.14 The Directive's impact will be twofold. First, it will create a new EU-wide licensing regime for Payment Institutions, which are providers of payment services that are not credit institutions or E-money issuers. National rules from 25 Member States, which currently differ significantly, will be harmonised. In the UK, payment services are currently subject to very little financial regulation, although Money Services Businesses (MSBs) are required to register with Her Majesty's Revenue and Customs (HMRC) for anti-money laundering purposes. The new regime will also give all payment service providers, including Payment Institutions, a right of access to certain payment systems, unless denying such access can be justifiably refused to safeguard against specific risks or to protect the financial stability of the system. These measures can be found in Title II of the proposed Directive.

1.15 Secondly, the Directive will introduce harmonised conduct of business rules for all payment service providers. Again, the UK has very little regulation in this area, although for the banking sector, many of the provisions in the Directive are covered by industry self-regulation under the Banking Code and the Business Banking Code. The conduct of business provisions can be found in Titles III and IV of the proposed Directive.

CONSULTATION ON THE DRAFT REGULATORY IMPACT ASSESSMENT

1.16 Before publishing its proposal for a Directive on 1 December 2005, the European Commission consulted on five versions of the draft Directive, as well as a draft impact assessment. They held a series of Payment Systems Government Expert Group meetings for governments and regulators, in addition to Payment Systems and Markets Groups meetings for industry and other stakeholders. The Commission also requested written comments on each version of the Directive. HM Treasury has sought the views of UK stakeholders at each stage of this process, holding meetings with stakeholder representatives and reviewing written submissions.

1.17 HM Treasury published a consultation document on the proposed Directive on 3 July 2006 as a continuation of this process, and to inform its negotiating strategy. A partial Regulatory Impact Assessment (RIA) was published within this consultation document, which this document now finalises.

1.18 A summary of responses to that consultation, which examines the issues considered by respondents and the Government's policy response, is being published on HM Treasury's website alongside this document.

1.19 HM Treasury held over 25 stakeholder meetings and received 27 written responses during the consultation period. Most of these responses provided comments which were directly or indirectly related to our partial RIA. Respondents represented a broad range of payment service providers, users and payment system proprietors, ranging from credit institutions, E-money issuers, money transfer companies, ATM operators, bill payment service providers, mobile phone operators, credit unions, card issuers and trade associations.

1.20 Respondents broadly agreed with the assumptions underlying the RIA as well as the estimated benefits and types of cost identified. Some provided supplementary comments on the RIA to account for benefits and costs relevant to their particular business model or to their role in the payments market.

1.21 Where possible, respondents were asked to provide accurate estimates of the Directive's potential benefits and costs. By and large, however, respondents could offer only tentative estimates of such benefits and costs. Those who supplied quantitative estimates caveated them on the basis that the Directive has yet to be finalised and that consultation on the implementation of the Directive has not begun. Therefore, estimates would have to be revised depending on the final shape of the regulatory regime and the way in which the Directive will be implemented.

RESULTS OF THE RE-EXAMINATION OF COSTS

1.22 The main conclusions of our re-examination are that:

- The revised RIA could account more for user benefits, which are likely to increase over time as more users and providers start appreciating the legal certainty provided by the Directive and new providers obtain licences and passport into other EU Member States. As the Directive is an enabler of the industry's broader efforts to create a Single Euro Payments Area (SEPA), the wider benefits of more automated end-to-end payments and increased customer mobility delivered by SEPA should also be assessed.

- The partial RIA was broadly accurate in estimating the types of costs that would affect each category of payment service provider in the UK, including Payment Institutions. However, despite several attempts to obtain figures on potential compliance costs, we received a limited response from those consulted. Generally, most respondents found it difficult to accurately assess the costs of the Directive without more detail on the likely shape of the final licensing regime for Payment Institutions, and how the Directive will be implemented and enforced.

- Of the sample of respondents who provided figures, the estimated cost of complying with the entire Directive ranged would be between £15,000 to £6 million for Payment Institutions ranging from a medium-sized firm to a large multinational corporation. Additionally, credit institutions could incur a one-off cost of around £20 million for complying with updated conduct of business rules in the Directive. For E-money issuers, it is likely that the cost of complying with updated conduct of business rules will be a low proportion of that estimate for credit institutions, as there are currently only 6 authorised E-money issuers in the UK. Costs might be lower depending on the extent to which a company's current systems and standards match the requirements proposed in the Directive. Equally, if the Directive imposed a much heavier authorisation regime than anticipated, costs per payment service provider may increase or get directly or indirectly passed on to consumers and businesses.

OPTIONS

OPTION 1 – OPPOSE THE EUROPEAN COMMISSION'S PROPOSAL – DO NOTHING

1.23 The power to propose legislation in this area lies with the European Commission. Qualified Majority Voting (QMV) is applicable to this Directive, which means that it is not possible for one Member State to block or force a change to a provision by itself. The Payment Services Directive will also be voted on by the European Parliament. This means that the Council of Ministers and the European Parliament act together in co-decision.

Risks

1.24 If legislation in this area not introduced, the benefits outlined in the revised RIA would not be realised. EU payment systems will continue to remain fragmented and much less efficient than desirable and a true internal market in payments will not be able to develop.

Issues of compliance and enforcement

1.25 The achievement of a true internal market in payments without legislative intervention would rely on voluntary compliance and enforcement by industry. This is likely to be a major challenge in the absence of clearly delineated compliance and enforcement responsibilities between payment service providers, users and other players in the payments market. It is also unclear how the proposed EU-wide licensing regime for Payment Institutions could be established without harmonising relevant legislation among Member States.

Unintended consequence

1.26 It is difficult to envisage the unintended consequences which might flow from a decision not to intervene legislatively. However, as indicated previously, the foreseeable consequences are not likely to bring additional benefits to EU citizens and businesses. Non-bank payment service providers would not be able to passport into other EU Member States, limiting customer choice and competition across the EU. Confusion around the applicable conduct of business rules will most likely persist among citizens and businesses that make cross-border payments with the EU.

Implementation and delivery plans

1.27 The proposed Directive harmonises the regulatory regime for payment services among EU Member States, with a strong emphasis on customer protection. Payment service providers aiming to improve customer protection are likely to incur costs regardless of whether the implementing vehicle is voluntary or legislative. Firms wishing to operate in other EU Member States are likely to experience continued uncertainty and administrative burdens, since they would have to ascertain the applicable law, or comply with a multiplicity of different laws if they choose to operate in many EU jurisdictions.

OPTION 2 – SUPPORT THE EUROPEAN COMMISSION'S PROPOSAL

1.28 As outlined below, the European Commission's proposal should bring some significant benefits. The regulatory regime for Payment Institutions proposed by the European Commission is broadly balanced in matching the regulatory requirements to the level of risks involved in providing payment services.

1.29 During the European Commission's consultation on previous drafts of their proposal, the UK successfully sought to introduce key changes to prevent the proposal from bringing disproportionate costs to the UK. One such change is the insertion of a waiver regime for small Payment Institutions (Article 21). There are over 2,000 small money transfer companies registered in the UK that would risk being driven out of business or underground if they are required to comply with the full licensing regime for Payment Institutions within the Directive.

1.30 The UK has also been supportive of the changes made to liability requirements. In the previous drafts of the Directive, the balance of liabilities was disproportionate and risked providing an incentive for fraud. In the current draft, business users the size of a micro-enterprise and above will no longer be subject to a maximum liability protection of EUR 150 in cases where payments are made fraudulently from their account. While such a requirement may be appropriate for consumers and very small businesses, extending the provision to business users may introduce the risk of moral hazard. For example, some corporates may look to shift the responsibility for safeguarding their payment authorisation systems to banks, without improving their own safeguard procedures. Such actions could potentially impose losses on banks and undermine the provision of electronic banking services to corporates.

1.31 In comparison to previous drafts, payment service providers will now no longer be liable for payments arriving at a payee in third countries outside the EU. While payment service providers should be liable for payments arriving at a payee's payment service provider, they have no control over what that provider then does with the funds transferred. Extending liability beyond this point would seem disproportionate and unenforceable, and may risk reducing service provision or increased costs if Payment Institutions need to take out additional insurance to cover such eventualities.

1.32 The UK also welcomed the Commission's introduction of a provision to open up access to certain payment systems (Article 23). One of the conclusions of the Cruickshank Report on Competition in UK Banking was that competition in the payments market was limited because many payment systems were unjustifiably closed to non-banks. This provision should help to address this concern.

Risks

1.33 Some other Member States will seek to influence the shape of the authorisation regime for Payment Institutions and the level at which conduct of business rules should be harmonised, in a manner which diverges from the UK's negotiating objectives. The UK will seek to defend and obtain results on its objectives to ensure that the Directive remains proportionate, encourages innovation and does not result in unintended consequences. Stakeholders have identified possible changes to the Directive at various points during our consultation process, many of which, if incorporated, could help to reduce the costs and maximise the benefits to the UK from the Directive.

Unintended consequences

1.34 If the UK supports the European Commission's proposal without engaging in further attempts to ensure its provisions are proportionate and workable, there may be inadvertent consequences for payment service providers and users owing to weak drafting or unsolved legal issues. It is difficult to gauge in what form such unintended effects may materialise. It will be important to examine the proposal as it evolves during negotiations to ensure that our key objectives are met and that the concerns of stakeholders are addressed.

Implementation and delivery plans

1.35 For the Directive to pass Parliamentary scrutiny, HM Treasury must demonstrate that it has assessed its costs and benefits and considered the proposal's regulatory impact within the UK. Some stakeholders have undertaken a similar assessment, and used the evidence obtained to suggest particular changes to the Directive. If the UK adopts a negotiating approach that does not account for these proposed changes where they are justified and appropriate, it is likely that Parliament, other scrutiny bodies and the wider public will raise significant concerns.

OPTION 3 – SUPPORT GENERAL THRUST OF EUROPEAN COMMISSION'S PROPOSAL BUT PUSH FOR CHANGES IN SOME AREAS

This is our preferred option.

1.36 There is much in the European Commission's proposal that is favourable to the UK. However, there are a number of changes the UK believes will improve the Commission's proposal, to make the regulatory regime more proportionate and better targeted. In addition, there will be legal and drafting issues that might need to be addressed, to avoid the Directive having unintended consequences. The UK has identified several changes, largely matching those identified by stakeholders who responded to our recent consultation document:

- Clarifying the scope of the Directive;
- Seeking an exemption for credit unions;
- Ensuring a proportionate authorisation regime for Payment Institutions in Title II;
- Maintaining the waiver provision in Article 21;
- Supporting access to payment systems in Article 23;
- Re-examining provisions under Title IV to ensure they are workable;
- Removing the EUR 50,000 threshold, transaction sizes beyond which the conduct of business rules in the Directive will not be applicable ; and
- Amending provisions on maximum execution time to ensure next-day execution is not mandatory on transactions other than Euro payments across the EU and/or domestic payments in the currency of an EU Member State.

1.37 The consultation responses we received also requested other substantial changes which we believe to be justified and appropriate:

- Rationalising the list of information requirements in Title III, rejecting information overload in favour of a balanced approach to ensuring customers are sufficiently informed;
- Favouring drafting that that will allow users larger than a micro-enterprise to agree alternative contractual arrangements with their provider; and
- Supporting appropriate derogations for low-value/micro-payments.

1.38 In sum, Option 3 appears to be the most constructive and realistic approach to the UK's negotiations on the proposed Directive.

Risks

1.39 Employing legislation to achieve an internal market in payments could result in over-regulation. The proposed Directive may focus regulatory pressure on areas where it is not required, particularly if there is little or no evidence of consumer detriment or non-compliance by industry. Firms could incur unreasonable licensing or conduct of business costs. The Directive may also stimulate further regulatory initiatives in related areas, diverting the EU payment industry's attention from its work to deliver the Single Euro Payments Area (SEPA) in a timely and optimal manner.

1.40 These risks can be minimised by pursuing Option 3 as a negotiating approach. The European Commission's rationale for intervention in this policy area is persuasive, and its resulting proposal is headed in the right direction. To ensure that Commission's proposal remains proportionate and workable, the UK should work towards clearer analysis and better drafting within the Directive to ensure the Directive achieves it aims without disproportionate costs. Getting the details right on the proposed Directive will directly impact on the success of SEPA.

Unintended consequences

1.41 HM Treasury has not been able to identify any unintended consequences beyond those mentioned within this document and the summary of consultation responses.

Implementation and delivery plans

1.42 HM Treasury will use the responses received to inform its ongoing negotiating strategy for the proposed Directive.

1.43 Once adopted, the Directive will need to be implemented in the UK.

1.44 After adoption, HM Treasury will launch a consultation process on the issues around implementation including enforcement, sanctions and monitoring.

COSTS AND BENEFITS

Benefits of Option 1

1.45 The main benefit of doing nothing is the avoidance of regulation which might increase compliance costs and form a barrier to entry for new market participants. Alternatively, the UK could decide to introduce regulation in the payments sector with domestic legislation set at a level that is less onerous than that in other Member States.

Costs of Option 1

1.46 By opposing the European Commission's proposal for a Directive in this policy area, the UK would be reneging on its commitment to implement the Financial Services Action Plan (FSAP), endorsed by the Lisbon European Council in March 2000. The proposed Payment Services Directive is one of 42 measures identified necessary within the FSAP to achieve the overarching goal of completing the Single Market in financial services.

1.47 The UK would lose an opportunity to shape a legislative framework that could underpin the development of a well functioning internal market in payment services. The European Commission's concerns about the current state of payments systems in the EU, which it believes to be fragmented and impacting negatively on the EU's competitiveness, will not be addressed. To the extent that the Directive sets out the legal framework necessary for the delivery of pan-European payment schemes and infrastructures under SEPA, the weakening of such efforts to maximise economies of scale in the European payments market and to standardise and consolidate payment transactions is likely to have a significantly negative impact on efficiency savings, estimated to be around £6.6 billion.

1.48 Option 1 alone does not impose any direct costs to industry, but payment service providers and users wishing to make payments across the EU are likely to incur adjustment costs when their payments cross into another EU jurisdiction. Customers will also continue to be limited in their ability to choose between different payment service providers across the EU, and suffer from information overload and/or asymmetry when faced with different terms and conditions applying to different types of payment services both domestically and in other EU Member States. These costs are very difficult to quantify.

Benefits of Option 2

1.49 If the Commission's original proposal for a Payment Services Directive is adopted, an EU-wide licensing regime for Payment Institutions will be introduced. This will enable UK non-bank payment service providers to use their licence obtained in the UK to passport into and compete within other payment markets across the EU. A set of harmonised conduct of business rules will also improve legal certainty and information transparency for payment service providers and users. This will encourage UK providers to expand into other EU markets without incurring significant legal and administrative costs. Customers, businesses and corporate users will be able to choose between a wider variety of comparable products and services.

1.50 The EU would also have in place a harmonised legal framework for payment services that can underpin the creation of a Single Euro Payments Area (SEPA). The development of more standardised payment service products and the consolidation of payments infrastructure across the EU could, according to the European Commission, result in efficiency savings of around £6.6 billion. The European Commission also estimates that if standardised, end-to-end automated payments were introduced through the integration of electronic payments with established business processes, such as e-invoicing, the EU as a whole could make further savings of around £33 – 66 billion per annum.

1.51 It is difficult to accurately attribute the UK's share of the aggregate benefits mentioned. However, as the UK accounts for the largest share of EU wholesale financial service output (35%), of which London accounts for 80%[1], the UK's position as a leading financial services centre within the EU – including for Euro-denominated transactions - suggests that savings from greater economies of scale and enhanced efficiency are likely to benefit the UK to a greater extent than many other EU Member States. More broadly, the advantages to the EU of having a single payments market when trading and competing globally with other financial service areas should not be underestimated.

1.52 Some respondents to our consultation document felt it would be helpful to analyse consumer and small business benefits in more depth. They were encouraged by the guaranteed minimum level of service for users that the Directive aimed to provide, and believed that increased competition could lead to lower prices for consumers and business users. Small businesses were thought to benefit most from a simple transparency regime that enables them to easily keep track of their payment costs. However, when firms invest in compliance and security to increase customer protection, it would be equally important for these firms or consumer bodies to educate consumers on these measures, so that consumers are aware of the new benefits offered.

Costs of Option 2

1.53 As indicated in a previous section, the risk of relying solely on legislation to resolve problems in a market is that over-regulation could result. Compliance costs could outweigh the anticipated benefits, thwart innovation and present a barrier to entry for smaller firms. Most crucially, the risk of over-regulation could be high.

1.54 In comparison to other EU Member States, the payments market in the UK has been subject to very little regulation. Some Member States require payment providers to acquire banking or other financial institution licences before commencing operations. Such a licence can be difficult and costly to obtain, and present a huge financial consideration for new market participants. If these Member States are successful in having their heavier domestic regulatory models for payments reflected within the Directive, UK payment service providers may bear significant costs of adapting their business models and systems to the new legal framework. Whilst increased user confidence in a more transparent payments market could increase the volume of cross-border transactions, providers may feel it necessary to pass on higher compliance costs to consumers, or reduce service provision to maintain revenue flows.

1.55 Credit institutions and E-money institutions would not need to apply for licences under Title II of the Directive as they already operate under existing banking and E-money licences. However, they would incur costs in complying with new, and possibly additional, information requirements within the Directive. One trade association estimated that the one-off cost of updating a 16-page document of terms

[1] "The Importance of Wholesale Financial Services to the EU Economy 2006", Centre for Economics and Business Research Ltd, City of London Corporation, April 2006

and conditions and sending it to all payment account holders in the UK could cost in the region of around £20 million.

1.56 Payment Institutions would need to comply with the Directive's licensing regime in Title II, in addition to the conduct of business rules in Titles III and IV. Depending on the size of the business, we received estimates from stakeholders that the cost of complying with the entire Directive was predicted to range from £15,000 - £25,000 for a relatively established medium-sized firm to approximately £6 million[2] for a large multinational company with high market capitalisation. Payment Institutions will include money transfer companies, independent cash machine operators, bill payment providers, mobile phone providers and card businesses. If the waiver in the Commission's original proposal is maintained, it is likely that 80% of existing money transfer companies, some independent cash machine operators and a few bill payment service providers will not incur any costs in the range stated above. However, it is difficult to estimate the total cost of compliance incurred by Payment Institutions as one single category of payment service provider, as it is unclear how many existing or new Payment institutions will opt to apply for a licence. In addition, the actual cost for each licensed firm would depend on how the Directive is implemented by the UK, which will be subject to a further consultation exercise.

1.57 Waived Payment Institutions will not need to comply with the licensing regime under Title II. Our consultation under the Small Firm Impact Test (see below) has indicated that this will mean virtually no additional costs for them under the first part of the Directive. Waived firms will need to comply with the conduct of business rules under Titles III and IV, but these changes are not likely to translate into significant changes to current procedures.

1.58 Operators of payment systems will need to ensure their compliance with Article 23. This could entail changes to their rules and an initial increase in legal costs if test cases arise. However, Article 23 will only apply to certain open payment systems. Closed systems, such as proprietary card systems, should be able to continue exercising discretion on which entities to admit to their systems, or whether to award licences to providers wishing to issue and/or acquire the system brand and associated payment products and services.

1.59 Customers and business users may incur costs if payment service providers pass on their compliance costs. Alternatively, high compliance costs could cause providers to reduce the service they provide, or withdraw the service altogether.

1.60 The public sector is likely to incur initial and ongoing costs when implementing the Directive. It is likely that fees to regulated firms would cover the costs of monitoring and compliance. The revised regulatory impact of the proposed Directive will depend on how the UK implements and enforces its provisions. HM Treasury will publish a separate consultation document on this and related issues after the Directive is adopted, to ensure that the regulatory burden is minimised.

1.61 The wider economy may incur costs if the Directive imposed heavy costs on the payments industry. This would affect the competitiveness of a sector which facilitates much of the country's economic activity both domestically, within the EU and internationally.

[2] This figure is likely to include the cost of corporate re-organisation, systems changes, creation of new compliance units and the procurement of legal advice.

1.62 In sum, whilst there are significant benefits to be gained from pursuing Option 2, these benefits could be significantly offset by highly disproportionate compliance costs if the UK did not seek to push for changes where needed to maintain the Directive's proportionality and workability.

Benefits of Option 3

This is our preferred option.

1.63 The benefits are similar to those identified in Option 2. However, these anticipated benefits are more likely to be realised if the UK successfully secures drafting changes to enhance the workability of certain provisions, and to ensure the Directive does not deliver any intended consequences which could reduce any benefits reaped.

1.64 As market players become more confident in the effectiveness of a legal framework, they are likely to develop more products and services on the back of that framework. For this to happen, the UK should work to ensure that the Directive is proportionate and does not deliver unintended consequences. The Directive should provide incentives for the integration of the European payments market stimulate innovation in relation to SEPA and enable a wide variety of payment products and services to develop for the benefit of users and the wider economy.

Costs of Option 3

1.65 Many of the costs identified under Option 2 could be reduced or at least kept to a minimum if the UK pursued Option 3 as a negotiating approach. In the feedback received on our consultation document, most respondents found it difficult to accurately assess the costs of the Directive without more detail on the likely shape of the final licensing regime for Payment Institutions, and how the Directive will be implemented and enforced. However, all welcomed the opportunity to influence the shape of the regulatory regime of the Directive and to propose changes where needed.

1.66 The cost of complying with the authorisation regime in Title II of the proposed Directive would only apply to firms that wish to become licensed as Payment Institutions. To ensure such costs remain manageable, the UK will continue to oppose any strengthening of the authorisation regime, and push for regulatory requirements to remain proportionate to the risks involved in the provision of payment services. The UK will also continue to support an appropriate waiver provision for smaller payment service providers, such as money remitters, to ensure they are not subject to regulatory requirements that force them underground or out of the market.

1.67 The new conduct of business rules under Title III and IV of the proposed Directive would apply to all payment service providers, including credit institutions, E-money issuers and authorised and registered Payment Institutions. To ensure the cost of compliance is minimised, the UK will work to ensure the information requirements contained in Title III contained balanced provisions that do not cause information overload, and ensure that the rights and obligations in Title IV are workable and do not deliver unintended consequences for individual types of payment service. Furthermore, the UK will support appropriate derogations for low-value/micro-payments from the conduct of business rules, in line with our proportionate and risk-based approach to regulation.

1.68 Finally, the extent to which the quantified costs identified under Option 2 accurately reflect actual costs would depend on whether firms see compliance with the Directive as an additional step in their ongoing programme of internal systems changes, or as a standalone exercise in itself requiring additional resources.

SMALL FIRMS IMPACT TEST

1.69 Throughout discussions on previous drafts of the Commission's proposal, we have been concerned about the impact that the Directive might have on small firms in the UK, especially through the licensing regime for Payment Institutions. We discussed the proposal with E-money issuers and HM Revenue and Customs, which supervises the application of money laundering rules to money service businesses such as money transfer companies. We produced a simplified description of what the Directive could mean for small money transfer companies, and visited several such businesses to hear their views.

1.70 As a result of the information obtained during this initial process of consultation, the UK pressed for the introduction of a waiver clause for small firms from the licensing regime (Article 21), to prevent disproportionate impact on small firms. This would be particularly important for money transfer companies, which are often very simple operations operated by only one person, from small premises and with a relatively low turnover. Our discussions with such operators indicated that the cost of complying with the Directive's authorisation regime would be too onerous for many of these small companies, potentially leading to their closure. However, initial discussions also suggested that the new conduct of business rules introduced by the Directive would in practice only require minor systems changes by these firms.

1.71 In response to our consultation document, several stakeholders agreed that a waiver provision was essential to ensuring that money transfer companies continue to be registered and subject to appropriate regulation in the UK. Firms were encouraged that the waiver could cater for different types of smaller payment service firms, as migrant workers and other groups are more likely to be clients of smaller firms that target their services at specific transaction corridors or language communities. A few firms noted, however, that the Directive should not prohibit those eligible for the waiver from applying for a Payment Institution licence, if they have the necessary controls in place. Larger money transfer companies believed a waiver to be acceptable, as long as waiver firms provided migrant workers with a level of protection comparable to that provided by licensed firms.

1.72 We also received feedback from trade associations representing the UK's credit unions, many of which provide basic banking services to the financially excluded. They judged the annual cost of complying with the proposed Directive's licensing regime as estimated in the consultation document to be excessive, which could lead to the closure of even the larger credit unions. This could generate a significant social cost, impact negatively on the Government's financial inclusion agenda and greatly reduce the availability of affordable credit. Moreover, the conduct of business requirements within the Directive were perceived as burdensome and impracticable. Many credit unions work to provide low-cost loans and need to avoid undue administrative burdens. Smaller credit unions cannot guarantee next-day execution times as some are not staffed for the full working week. The UK would not want the Directive to limit current and future payment services provided by credit unions, and has been pushing to secure an exemption for them from the Directive.

1.73 The consultation responses indicated that the Directive's licensing regime would be acceptable to independent cash machine operators, as they "tend to be larger than small money transfer companies and generally have more established operating procedures and business plans". One respondent noted that even if this were the case, a licensing regime which included initial capital requirements would greatly increase compliance costs and create a barrier to entry for aspiring market participants. Another stakeholder proposed that smaller Payment Institutions that operate solely in the UK should have the benefit of the waiver as a default position, whilst having the option of a licence should it desire to expand its operations to other EU Member States.

1.74 Some respondents stressed the importance of assessing the Directive's impact on small firms from both a provider and user perspective. Whilst many small firms provide payment services, many more small- and medium-sized firms were users of payment services to settle accounts with suppliers and customers across the EU. These businesses would benefit from a simple transparency regime which helps them exercise an informed choice between different providers, while keeping payment transaction costs to a minimum.

1.75 In light of this revised assessment of the Directive's impact on small firms, we will continue to support an appropriate waiver provision for small players. We will continue our efforts to gain an exemption from the Directive for credit unions, and reject unnecessary increases in information requirements in favour of a balanced approach to ensuring customers are sufficiently informed to exercise choice.

COMPETITION ASSESSMENT

1.76 The market to which the Directive will apply is the market for payment services in the UK. Payment services are provided by credit institutions, E-money issuers, money transfer companies, ATM operators, bill payment service companies and mobile phone operators. Credit institutions and E-money issuers already have to comply with existing licensing requirements. The Directive will introduce a new licence for other firms – Payment Institutions – offering payment services but not taking deposits or issuing E-money. As credit institutions and E-money issuers are already licensed, they will not have to meet these new licensing costs. The cost of the new licensing regime is unlikely to significantly alter the market structure of payment services in the UK. However, it is envisaged that an increasing number of non-bank service providers will enter the market through the new licensing regime. The Directive will also open up access to certain payment systems to new payment service providers, which will have a significant positive impact on competition.

1.77 The Directive will require all firms offering payment services to comply with the conduct of business rules contained in Titles III and IV. This includes new Payment Institutions, which are developing new payment technologies to deliver faster, and more convenient payments. Responses to our consultation document indicated that the information requirements proposed by the Directive in Title III could form a market entry barrier to developers of more innovative payment instruments designed for low-value transactions. Developers of such products depend on fees paid by merchants who sign on to accept payment using the instrument. To compete with other card schemes, this new Payment Institution would need to set low operating margins. Any provisions requiring the firm to communicate with customers in a manner other than via Internet or text messaging would radically increase the cost per transaction, potentially pricing their new payment product out of the market. To address this, the UK will work to prevent information overload, in favour of a balanced approach to ensuring users are sufficiently well-informed to exercise choice in the payments market.

1.78 In conclusion, we believe that the Directive is not likely to have any significant negative impact on competition in the UK payments market.

IMPLEMENTATION AND DELIVERY PLAN

1.79 Once adopted, the Directive will need to be implemented in the UK.

ENFORCEMENT, SANCTIONS AND MONITORING

1.80 After adoption, HM Treasury will launch a consultation process on the issues around implementation including enforcement, sanctions and monitoring.

POST IMPLEMENTATION REVIEW

1.81 The European Commission is expected to undertake a review of the implementation and impact of the adopted Directive no later than three years after the Directive has been transposed into the national law of each EU Member State.

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