

PSD2: The Two Minute Guide

PSD2 Background

The Second Payments Services Directive ((EU) 2015/2366) aka PSD2 came into force in January 2016 and replaces the existing Payment Services Directive. The Directive requires all Member States to bring PSD2 into national law by 13 January 2018. In the UK, this is being done through The Payment Services Regulations 2017 (PSR 2017). The bulk of PSR 2017 comes into force on 13 January 2018, although certain provisions, in particular the application and notification requirements to the Financial Conduct Authority (FCA) come into force on 13 October 2017.

PSD2 replaces the existing Payment Service Directive (2007/64/EC) (PSD), a European wide framework for payment services which was implemented into the UK by the Payment Services Regulations 2009 (PSR 2009). PSR 2009 requires firms carrying on certain payment services, to name a few, providers of a payment account, acquiring services, money remitters, issuers of payment instruments and those that execute payment transactions, to be authorized to carry on such a service. In the UK, authorization is granted by the FCA. PSR 2009 also introduced operating standards, information disclosure requirements and particular obligations on such payment service providers. In addition it provided greater protection to users of these payment services, such as the right to terminate a contract for payment services and a limit on a user's liability in the event of an unauthorized or incorrectly executed transaction.

How does PSR 2009 and PSR 2017 relate to e-money issuers?

PSD2 and PSD sit alongside another piece of European regulation, the Electronic Money Directive (2009/110/EC), implemented in the UK via the Electronic Money Regulations 2011 (EMR). Firms who issue products that fall within the definition of electronic money, are required to be authorized (by the FCA in the UK).

“electronic money” means electronically stored monetary value as represented by a claim on the electronic money issuer which—

(a) is issued on receipt of funds for the purpose of making payment transactions;

(b) is accepted by a person other than the electronic money issuer; and

(c) is not excluded by regulation 3 [the limited network exclusions and the electronic communications network exclusion].

Firms issuing electronic money are subject to the regulatory regime under EMR and must also comply with the conduct of business requirements in PSR 2009 and PSR 2017.

PSR 2017 also amends certain provisions in the EMR, such as the type of products that benefit from the permitted exclusions which take it outside the scope of the EMR. PSR 2017 also

introduces an obligation on firms relying on such exemption to notify the FCA of the products operated under it (see further details below).

For gift card issuers, the EMR will apply to products that are issued by one legal entity and may be accepted to pay for goods or services provided by another legal entity UNLESS such product falls within the permitted exclusions. These products are generally referred to as open loop products and are often card scheme (MasterCard or Visa) branded.

So what's the relevance of PSD2 to issuers of gift cards?

The limited network exclusions

PSD2 through PSR 2017 amends the existing limited network and electronic communications exclusions that are in PSR 2009 and EMR. As stated above, these exclusions do not require the issuer to be authorized to provide them and they won't be subject to the conduct of business rules (information disclosure, user rights and obligations of service providers) that are set out in EMR and PSR 2017. However, issuers benefiting from an exclusion will be required to notify the FCA of its exempt activities and the FCA has the right to determine whether it concurs with the issuer's assessment of the product under PSR 2017. In short, excluded products are not classified as a regulated financial service and they will continue to be subject to relevant consumer protection regulations e.g. Consumer Contracts (Information, Cancellation and Additional Charges) Regulations 2013 and the Data Protection Act 1998.

The exclusions that apply to gift card products under EMR (and PSR 2017) are below:

Limited Network Exclusions:

(a) monetary value stored on specific payment instruments that can be used only in a limited way and meet one of the following conditions -

(i) allow the holder to acquire goods or services only in the issuer's premises;

(ii) are issued by a professional issuer and allow the holder to acquire goods or services only within a limited network of service providers which have direct commercial agreements with the issuer;

(iii) may be used only to acquire a very limited range of goods or services; or

(iv) are valid only in a single EEA State, are provided at the request of an undertaking or a public sector entity, and are regulated by a national or regional public authority for specific social or tax purposes to acquire specific goods or services from suppliers which have a commercial agreement with the issuer;

Electronic Communications Network exclusion:

(b) monetary value that is used to make payment transactions resulting from services provided by a provider of electronic communications networks or services, including transactions between persons other than that provider and a subscriber, where those services are provided in addition to electronic communications services for a subscriber to the network or service, and where the additional service is -

(i) for purchase of digital content and voice-based services, regardless of the device used for the purchase or consumption of the digital content, and charged to the related bill; or

(ii) performed from or via an electronic device and charged to the related bill for the purchase of tickets or for donations to organisations which are registered or recognised as charities by public authorities, whether in the United Kingdom or elsewhere, provided that the value of any single payment transaction does not exceed £40, and the cumulative value of payment transactions for an individual subscriber in a month does not exceed £240.

What are the notification obligations?

Issuers that benefit from the limited network exclusion will have to notify the FCA if the total value of payment transactions made in any 12 month period are over €1 million and provide a description of their activities. When the FCA receives this notification, it will decide if these services are exempt or not. Issuers in this position must continue notify every year, unless the transaction value falls below the €1 million limit. The financial threshold applies to the aggregate value of payment transactions made for all excluded products issued by an issuer, not when the limit is reached for one particular excluded product.

The FCA has provided a form for notification.

If the FCA's view is that a product does not fall within the exemption, an issuer may refer the matter to the Upper Tribunal.

Currently there is no guidance on the procedure to follow or the status of gift cards already in circulation in the event the FCA view the product as electronic money and subject to EMR.

All firms relying on the Electronic Communications Network Exclusion must notify and give the FCA a description of the service. Firms must also provide the FCA with an annual audit opinion that their customers' transactions fall within the financial limits stated in the exclusion.

What does this mean for UKGCVA Members?

(i) Closed loop products; one legal entity issues and accepts gift cards

These products remain outside scope of the EMR, PSR 2009 and PSR 2017. The obligation to notify the FCA does not apply.

(ii) Restricted loop products; a selected group of legal entities accept gift cards issued by one legal entity, e.g. group of companies under one brand, franchise network, predefined group such as a shopping mall, or those that accept a gift card for the purchase of a limited range of products only.

Restricted loop products in the marketplace include products that fall under the limited network exclusion and those that are classified as electronic money (so subject to EMR , PSR 2009 and PSR 2017). The status of a product depends the goods or services that can be purchased using the card and / or with whom the gift card can spent. All products need to be analysed on a case by case basis. If a Member is unsure of the regulatory status of its product, we strongly recommend it takes legal advice.

We believe many of the programmes currently benefitting from the limited network exemption under EMR are likely to continue to remain outside of scope of the EMR. however it is for the issuer to undertake a review to ascertain this is the case.

For excluded products, every issuer must notify the FCA about its products once the financial threshold is reached.

(iii) Open loop products: gift cards that can be spent with many legal entities e.g. card scheme branded (MasterCard / Visa) gift cards

These products are classified as electronic money and so are subject to EMR, PSR 2009 and PSR 2017.

Strong Customer Authentication

PSD2 aims to reduce fraud for electronic payment transactions and enhance protection of consumer data. For all electronic payment transactions, strong customer authentication (SCA) will be required to be applied unless an exemption applies to the relevant transaction. Under PSD2, the European Banking Authority (EBA) has been tasked with drafting Regulatory Technical Standards on SCA, which set out the security measures to be followed by firms carrying out regulated payment services. The EBA's Regulatory Technical Standards come into force 18 months after they have been published in the Official Journal of the European Union. To date, the draft published is not agreed.

SCA means a transaction is authenticated by 2 or more independent elements. The elements are:

Knowledge – something only the user knows e.g. password or PIN;

Possession – something only the user possesses e.g. the gift card; and

Inherence – something the user is e.g. a biometric such as a fingerprint, voice recognition.

Exemptions apply to some payment transactions e.g. contactless payments, low value transactions and those below a fraud limit.

Surcharges

UK Government has gone beyond the requirements in PSD2 by banning the practice of applying a surcharge for the use of all retail payment instruments, so the ban includes consumer debit and credit cards including MasterCard, Visa, Amex and Diners cards as well as non-card based instruments. This ban does not apply to commercial payment instruments.

There is some scope however for a merchant to recover its costs for the use of particular payment instruments. PSR 2017 states (in its amendment to the Consumer Rights (Payment Surcharges) Regulations 2012 “A payee receiving a payment by means of a payment instrument must not charge the payer, in respect of such payment, a fee which exceeds the costs borne by the payee for the use of that specific payment instrument.” So whilst fixed amounts are banned, it may be possible for a merchant that, accepts particular payments instruments to pass on its direct processing costs to consumers. No guidance on the scope of costs that may be recovered has been published yet.