TaylorWessing

PSD3 & PSR: What the proposed changes mean for your business?

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Agenda

Reform of the EU payment services regulatory landscape

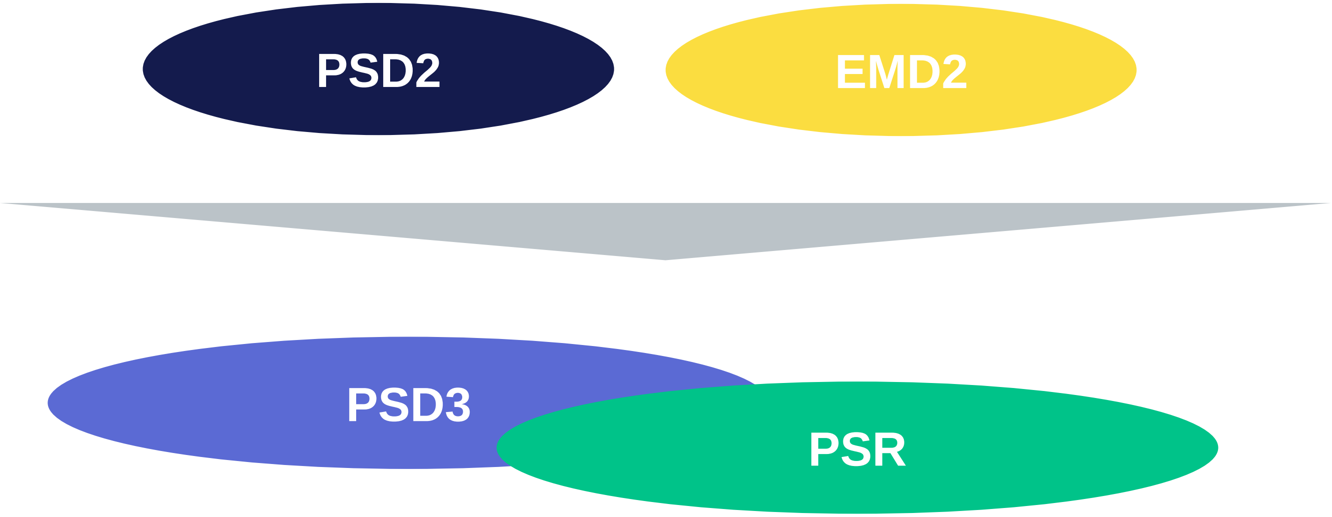
- The European Commission adopted the Digital Finance Package on 24 September 2020.
- **Retail Payment Strategy (RPS)** – set of legislative and non-legislative measures to improve functioning of the EU payments market
- The Commission has identified fragmentation in the EU payments market that prevents cross-border functioning of the payment services industry across the EU 27

- **PSD2 review** was defined as one of the primary goals of the Commission
- Improving the functioning of the payment market, open banking and instant payments
- Creating the first regulatory framework on open finance

- On 28 June 2023, the Commission published legislative proposals for the **third Payment Services Directive (PSD3)** and the very **first Payment Services Regulation (PSR)**
- Proposals are complemented by the proposal for the Financial Data Access Regulation (FIDA) that shall create the first open finance framework in the world

PSD3 & PSR Proposals: Overview

- Currently separate regulatory frameworks on payment and e-money services will be blended into one single regulatory framework
- PSD2 and EMD2 will be replaced by a new Directive (PSD3) which will be accompanied by the very first payment services regulation (PSR)
- In the past, divergences in interpretation of definitions set in EU Directives at national level, created a fertile breeding ground for forum shopping (i.e. regulatory arbitrage between EU Member States)
- The main aim of the proposed Regulation, is to provide for further harmonization of the existing requirements regulating the payment services industry in the EU
- PSR will be directly applicable without need for implementation at national level, while PSD3 will need to be transposed into national law regulating payment services (e.g. ZAG in Germany)



- Authorisation requirements
- Supervision of payment institutions
- Cooperation between NCAs

- Scope & Exclusions;
- Transparency requirements;
- Contractual requirements and rights and obligations relating to the provision and use of payment services including open banking;
- operational and security requirements.

Payment Services Directive (PSD3)

PSD3: Licensing framework

Initial Capital & Own Funds

- Increased initial capital requirements for non-bank PSPs, factoring in inflation since the adoption of PSD2
- Own funds calculation method linked to payment transaction volumes (Method B in Article 9 PSD2) will become the default calculation method
- NCAs can decide apply other methods in individual cases
- AISPs will be able to hold own funds (EUR 50 000) as alternative to professional indemnity insurance

Recovery & winding-up

- PSD2 and EMD2 do not contain any specific provisions on recovery & winding up of payment and e-money institutions
- Payment and e-money institutions will be required to develop and maintain winding-up plans (authorisation requirement)
- The plan should be appropriate to support an orderly wind-up of activities (including continuity or recovery of any critical activities performed by outsourced service providers and agents

Safeguarding requirements

- Obligation to avoid concentration risk (i.e. safeguarding of all assets with one institution);
- PSPs will be obliged to keep NCAs informed about third parties with which they are keeping customers' assets (and any material change in those arrangements)
- PSPs will be able to store customers' assets with the Central Bank as well

PSD3: Other changes

Agents, distributors, branches & outsourcing

- There are some changes to general requirements on the use of agents by PIs and distributors by the issuers of e-money;
- Outsourcing requirements are clarified in more detail;
- PIs and EMIs will be required to develop outsourcing arrangements in accordance with new requirements laid down in DORA and notify their NCA whenever entering into an outsourcing arrangement (in some EU Member States this is already the case e.g. Germany)

Cash accessibility

- Aiming to further improve access to cash, Commission is proposing that retailers should be allowed to offer, in physical shops, cash provision services even in the absence of a purchase by a customer
- Retail stores that offer cash withdrawals without a purchase will not need authorization where cash withdrawals take place solely within their premises and do not exceed EUR 50.

Registration obligation for ATM operators

- Operators of automated teller machines (ATM) that do not service payment accounts (so-called "independent ATM deployers") will remain exempted from licensing obligation
- However, by taking into account the limited risks involved in the activity of such ATM deployers, the EU Commission has decided to subject them, to a specific prudential regime adapted to those risks, requiring only a registration regime
- Compliance with transparency and operational requirements

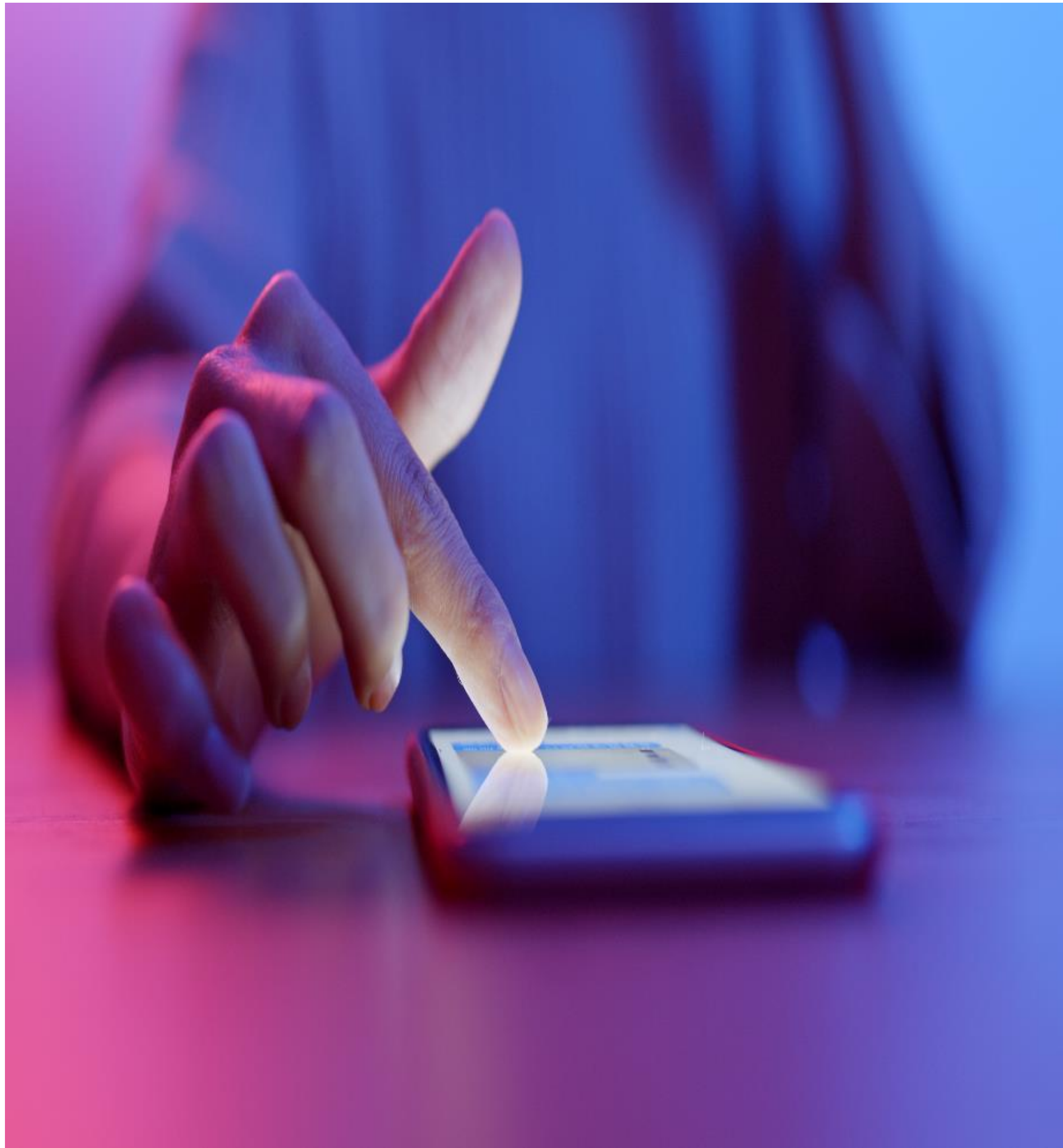
Triangular passporting

- PSD3 provides some clarifications with respect to the so called triangular passporting structures
- In situations where a payment institution authorised in a country "A" uses an intermediary, such as an agent, distributor or branch, located in a country "B" for offering payment services in another country "C", the host Member State should be considered to be the one where the services are offered to end-users.

PSD3 – Impact on existing PSPs

Reapplication?

- Existing PIs and EMIs need to submit to NCA documents and information demonstrating their compliance with new requirements under PSD3 (initial capital, own funds, safeguarding, outsourcing etc.);
- NCAs can recommend remediation measures to be taken or withdraw their existing license if they are not satisfied with provided information
- Exceptionally, NCAs will be able to grant a license automatically to existing institutions where they are satisfied that the new conditions are met



Timeline

- Existing PIs and EMIs can continue operating for 24 months as of the date of entry into force of the new Directive (i.e. 6 months once PSD3/PSR framework starts to apply)
- In the meantime, they need to submit to their NCAs documents demonstrating their compliance with new requirements

Payment Services Regulation (PSR)

PSR – Scope & Exclusions

Definitions

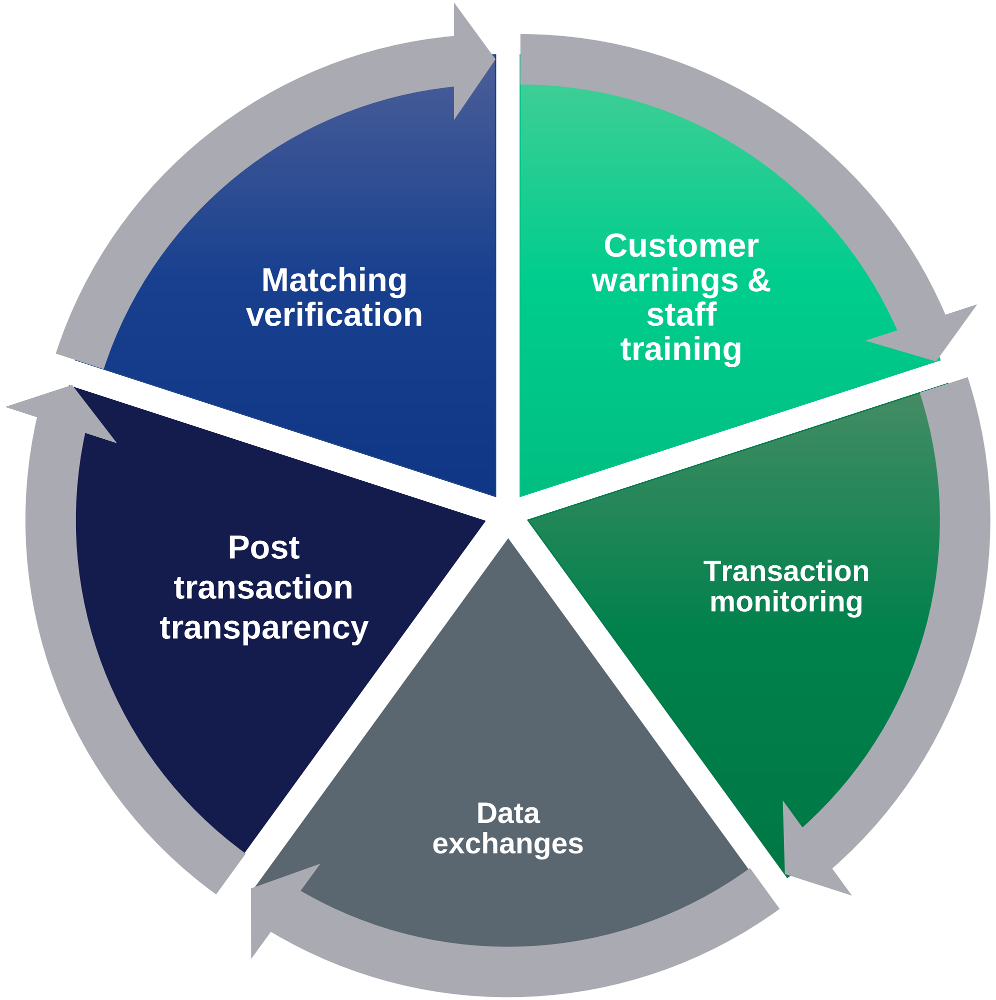
- **Payment instrument:** amended definition with a reference to “individualized instruments”, clarifying that even not fully personalized instruments (like prepaid cards with customers’ name on them) can fall under the definition of a regulated payment instrument (mirroring recent CJEU decisions)
- **Payment account:** determining criterion for the categorization of an account as payment account lies in the ability of the customer to perform daily payment transactions from such an account.
- **Acquisition & issuing service:** listed now separately given that joint listing of these two services under PSD2 was a cause for a lot of confusion in the industry

Exclusions

- **Commercial agent exclusion:** narrowing the scope by replicating BaFin requirements on the applicability of this exclusion - payer or the payee contracting with the agent need to have “a real margin to negotiate with the commercial agent or conclude the sale or purchase of goods or services.”
- **Limited Network Exclusion (LNE):** EBA is mandated to develop RTS that will set out clear criteria based o which the scope of the LNE can be assessed. The first limb of the LNE is narrowed, since the Commission has specified that “premises” only include physical premises of the issuer.
- **Technical service provider exclusion:** pass-through wallets (such as GooglePay and ApplePay) involving for example the tokenisation of an existing payment instrument (like a credit card), will not be deemed as a payment instrument than rather payment application

PSR – Fraud Prevention

- On the request of the payer's PSP, payee's PSP will be required to verify, whether the unique identifier (e.g., an IBAN) and the name of the payee matches with those details supplied by the payer, and to communicate the outcome of such verification to the payer's PSP.
- Will be mandatory, free of charge, for all credit transfers not apply to instant credit transfers



- PSPs required to alert their customers "via all appropriate means and media" when new forms of payment fraud emerge,
- Need to provide them with clear indicators on how to identify fraudulent attempts, and warn them as to the necessary precautions to avoid becoming victims of fraud
- Minimum an annual training to employees on payment fraud risks and trends

- PSPs will be required to implement additional monitoring mechanisms to detect and prevent fraudulent payment transactions
- These should be based on the analysis of prior payment transactions and access to payment accounts online

- Post transaction identification of a payee- still remains a challenge for customers;
- PIs will be required to go a step further, and include additional information that enable clear identification of the payee (that may go beyond legal name)

- For the purpose of effective transaction monitoring, PSPs will be able to exchange the unique identifier of a payee with other PSPs, subject to information sharing arrangements (where PSP has sufficient evidence to assume that there was a fraudulent transaction taking place)
- Compliance with data protection and professional secrecy laws and regulations

PSR – Liability

- **Liability for unauthorised payment transactions**
  - Current liability principle for unauthorised payment transactions remains maintained in PSR
  - **New –** mandatory timeline for fraud investigation and procedure - Within 10 business days, PSPs need to refund the payer or provide justification to the payer as to why is refusing to refund the payment (adjustments of internal policies and processes may be necessary)
- **Liability for incorrect application of the matching verification service**
  - Where the PSP of the payer fails to notify the payer of a detected discrepancy between the unique identifier and the name of the payee provided by the payer, PSP shall refund financial damage to the payet;
  - Within 10 business days after noting or being notified of a credit transfer transaction executed the PSP shall either refund the amount to the payer or provide a justification for refusing the refund and indicate the bodies to which the payer may refer the matter;
  - Where the fail in identification was committed by the PSP of the payee, this PSP shall bear liability and refund the financial damage to the payer.
  - The burden of proof will be on the PSP (of the payer or the payee as the case might be) but never at the customer
- **Liability for technical service providers**
  - PSR introduces liability for technical service providers (TSPs) and operators of payment schemes for financial damages caused to payees or PSPs resulting from the TSP or operator's failure to provide the services necessary to enable the application of SCA.
  - This can be a significant practical challenge for TSPs – redrafting of cooperation agreements will be necessary.

PSR – Consumer Rights & Information Obligations

More transparency for credit transfers and money remittances to third countries

- For transfers outside the EU, estimated time for funds to be received by PSP of the payee outside the EU
- PSPs that execute credit transfers or money remittance transactions involving a currency conversion will be required to disclose to their customers the estimated charges for currency conversion
- Estimated currency conversion charges to be expressed as a % mark-up over the latest available applicable FX reference rate issued by the relevant central bank (where applicable).

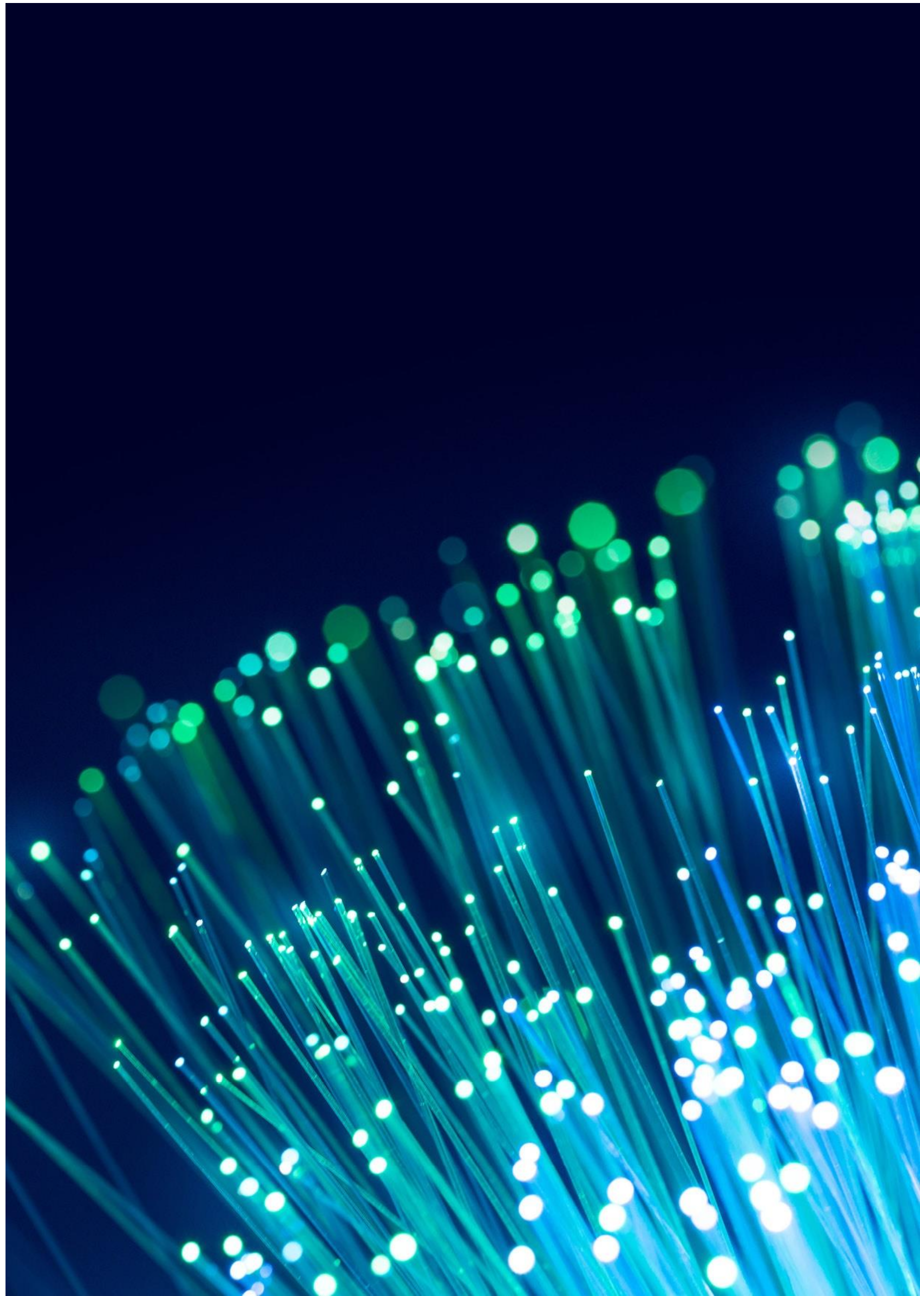
Payment transactions where the transaction is not known in advance and funds are blocked on a payment instrument

- For payment transactions where the transaction amount is not known in advance and funds are blocked on a payment instrument, a legal obligation is introduced for the payee to inform the PSP of the exact amount of the payment transaction immediately after delivery of the service or goods to the payer (e.g. after issuance of a final hotel invoice)
- The amount of the blocked funds must be proportionate to the amount of the future payment transaction that can reasonably be expected at the time of blocking of the funds
- Payer's PSP release blocked funds "immediately" after receipt of this information (previously "without undue delay"), and at latest, immediately after receipt of the payment order (in practice - expected to speed up the release of customers' credit card balances)

PSR – Open Banking (1/2)

- Introduced as part of the PSD2 framework, enables new entrants to get access to the EU payments market
- Introduced Payment Initiation Service Providers (PISPs) and Account Information Service Providers
- PISPs and AISPs can access customers' accounts and compete with banks in the provision of payment services

- Implementation challenges;
- Lack of proper API standards, and problems with the functioning of APIs that banks have implemented so far;
- Market fragmentation, divergences in interpretation and application of new requirements (EBA intervention);
- PISPs and AISPs still remain “a novelty” for customers in certain parts of the EU Single Market



PSR – Open Banking (2/2)

- **Dedicated interfaces**
  - Account servicing payment service providers (ASPSPs such as banks) will be required to offer a dedicated interface (API) for data exchange with PISPs and AISPs (no single EU API standard though)
  - Banks must ensure that dedicated interface remains available – however there will no longer be required to maintain a fallback interface for AISPs and PISPs.
  - Where a bank fails to provide alternative, PISPs and AISPs will be able to request access to customers' accounts through NCA directly. ASPSPs will be required to publish on their website quarterly statistics on the availability and performance of their API

- **Access rights**
  - PSR extends non-discriminatory access requirements to payment systems designated by a Member State pursuant to the Settlement Finality Directive – operators of payment systems (e.g. Target 2) will have to enable access to non-bank PSPs
  - Access to payment accounts: Credit institutions can refuse to open or unilaterally close a payment account for a PSP only in certain limited situations and will need to provide detailed explanation for refusal (PSPs can file a complaint with NCA)

- **Permission dashboards**
  - Banks will be required to provide their customers with a permission dashboard to monitor and manage any permissions provided to account information services providers (AISPs) on an ongoing basis and in a convenient way.
  - This will be an important novelty, especially nowadays when broader sector is facing rising number of subscription management providers that are using similar models as a basis

PSR – Strong Customer Authentication

Scope

- Merchant Initiated Transactions (MITs) only out-of-scope of SCA where "*initiated without any interaction or involvement of the payer*"
- SCA should be applied at the set-up of the initial mandate, although not for subsequent merchant-initiated payment transactions.
- MITs should benefit from the same consumer protection measures, including refunds
- Mail Orders and Telephone Orders (MOTOs) – out of scope, where the order is sent via non-digital means (regardless of the system used for order processing later)

Access

- PSPs are required to ensure that all their customers, including persons with disabilities, older persons, with low digital skills and those who do not have access to digital channels or payment instruments, have at their disposal at least a means which enables them to perform SCA
- PSPs will not be allowed to not make the performance of SCA dependant on the exclusive use of a single means of authentication (e.g. via smartphone app)

Outsourcing

- Technical service providers (incl. operators of digital pass-through wallets) that verify the elements of SCA when tokenised instruments stored in the digital wallets are used for payments will be required to enter into outsourcing agreements with the payers' PSP to allow them to continue to perform such verifications.
- A payer's payment service provider shall, under such agreement, retain full liability for any failure to apply strong customer authentication and have the right to audit and control security provisions.

Open Finance Framework

Open Finance: Financial Data Access Regulation

Open Finance?

- Open Finance is the term used to describe the extension of Open Banking data-sharing principles to enable third party providers to access customers' data across a broader range of financial products, including insurance, savings and investments.
- Open Finance relies heavily on business-to-business data sharing which increases competition between financial service providers and provides customers with greater level of flexibility and choice when using financial services
- Consent based sharing and use of customers' data about their financial behaviour that goes beyond sharing of payment account related data (mortgages, financial instruments, insurance products etc.)
- Main aims:

1. Enable use of customers' data that gives them access to more presonalised products and services;
2. Improve competitiveness in the financial services sector;
3. Open the door for third party service providers

Financial Data Access Regulation

- Proposal for a Regulation that shall create a framework for controlled and consent-based sharing of financial data in which customers have effective control over their financial data and the opportunity to benefit from open, fair, and safe data-driven innovation in the financial sector;
- Wide scope of application (banking, investment services, asset management, insurance industry);
- In-scope financial entities will need to have in place dedicated interfaces (APIs) that grant access to customers' data for other players in the industry (consent based);
- New authorisation framework for the so-called financial information service providers (FISPs)
- FISPs will be allowed to have access to customers' data for the sole purpose of providing financial information service (compare platforms)
- Will likely have a significant operational and technical impact on the entire financial services industry – chance for emergence of new business models and financial products and services

Practical considerations for the industry

PSD3/PSR: Practical Impact

Exempted entities

- ESAs are still to publish a number of RTS that will provide more clarity on the applicability of LNE that is of critical importance for non-regulated entities
- E-money: will be regulated under the same roof – easier to maneuver the scope of application and exclusions
- Technical service providers: prepare to enter into outsourcing arrangement with PSPs (SCA)
- Pass through wallet providers will get exemption at the EU level enabling them to operate across the EU 27 more easily

Authorised entities

- PIs and EMIs will have a number of challenges to prepare for;
- Banks, PIs and EMIs will need to prepare for new requirements and this will require significant effort especially on the operational and technical front (primarily in the area of open banking and SCA)
- Re-drafting of the existing customer agreements will be necessary during the implementation process;
- Delegated acts will provide more clarity, especially on more border line questions that were subject to discretion of individual NCAs so far

Stay ahead of the curve

1

Assess your exposure

- Non-regulated entities: assess whether and to what extent your operating model is in line with the borders of the regulatory perimeter.
- PSPs – operational and technical requirements will have a significant impact on the existing processes and procedures
- Banks – adjustment of the technical infrastructure deserves a particular attention

2

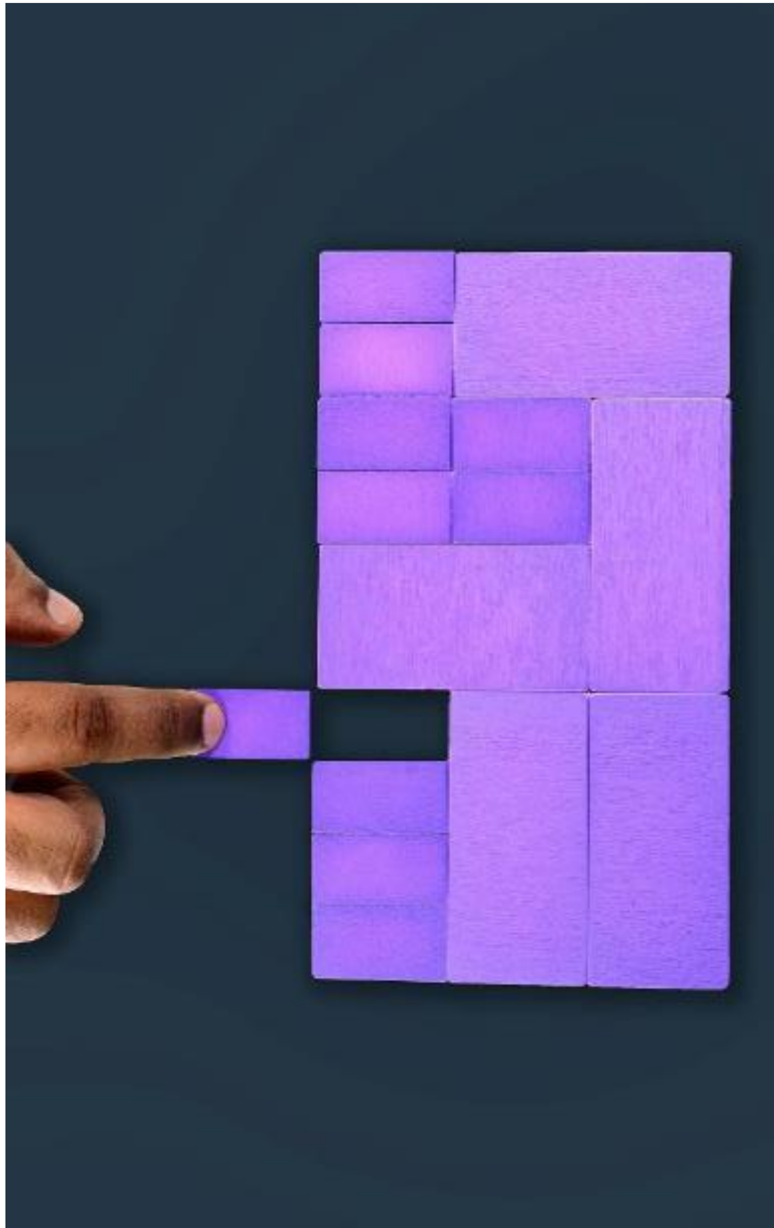
Consider your options

- Operating under exclusion – may well become easier especially on a cross-border basis, however new requirements may require additional adjustment to your existing business model;
- EBA will publish RTS that will provide more clarity on the exact scope of individual exclusions;
- Applying for a license – consider operating, financial and personnel implications as well as timing;

3

Prepare for the new requirements

- **Timeline:** finalisation of the proposed framework (est. Q4 2024/Q1 2025) go-live date (est. mid 2026) factoring in forthcoming EU elections
- Do not underestimate the timeline - start early on with the preparation for new requirements that demand significant effort especially on the operational and technical front (SCA, Open Banking, Payment Execution)
- Assess whether and to what extent contractual arrangements with third parties needs readjustment (outsourcing arrangements)



Thank you!

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