Payment Services Directive: a consultation document

July 2006

HM TREASURY

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1

1.1 On 1 December 2005, the European Commission adopted a legislative proposal for a Directive on payment services in the internal market.

1.2 This proposal aims to improve the competitiveness of the European Union (EU) through integrating national payment markets and providing support for the European payments industry in building the infrastructure necessary for a single payment market.

1.3 Over the past 2 years, the European Commission has consulted on 5 versions of a draft Directive, as well as a draft impact assessment. They has held a series of Payment Systems Government Expert Group meetings for governments and regulators and Payment Systems and Markets Groups meetings for industry and other stakeholders. It has also requested written comments on each version. HM Treasury has sought the views of UK stakeholders at each stage of this process, holding meetings, discussing with different sectors and reviewing written submissions.

1.4 HM Treasury is now seeking the views of all interested parties on the Commission's proposal. These views will be used to inform the UK's approach to negotiating the Directive, on which work has begun in the Council of Ministers and the European Parliament.

1.5 This document sets out the background to the Directive and poses a number of questions for interested parties. This document also contains a Partial Regulatory Impact Assessment on which we would welcome views.

1.6 This document:

- sets out, in Chapter 2, the background to the Commission's legislative proposal, and outlines some of the issues which the Commission is intending to address through legislation;
- outlines, in Chapter 3, the proposed policy framework, and the main contents of the Commission's proposal;
- sets outs, in Chapter 4, the consultation process and how interested parties can respond; and
- contains, in Annex A, a Partial Regulatory Impact Assessment.

2 Payment services in the EU

Payment services

2.1 Efficient and secure payment systems are of key importance to the functioning of modern economies. In 2005, the average total daily value passing through the UK's retail payment systems was around £20bn, representing almost 100 million transactions. In the EU, payment systems provide for 231 billion transactions (cash and non-cash) per year in the Community with a total value of EUR 52 trillion.

2.2 Conceptually there are two main types of payments – those made through four party systems, and those made through three party systems:

- in four party systems, two payment service providers are involved in providing payment services. Typically, these systems involve one bank providing services to the originator of a payment, with another bank providing a service to the recipient. These banks may be linked by a payment scheme that connects many paying and receiving institutions, or they may be linked directly through a correspondent banking relationship. In the UK, inter-bank systems like BACS, CHAPS and CCCL, and card schemes like VISA, MasterCard and LINK are four party payment schemes;
- in three party systems, one payment service provider provides services to both the originator and recipient of a payment, with the transaction travelling across the books of this one provider. In some three party payment systems, the customer may have a relationship with an agent of the payment service provider who might facilitate origination or receipt of a payment on behalf of the payment service provider. In the UK, E-money issuers like PayPal and most money remitters are three party schemes.

2.3 Across the EU, payment systems have been built to serve the needs of domestic national markets. Three party systems have been built to allow consumers and business to make payments to other payment service users within Member States, as well as to make certain types of international payment.

2.4 Similarly, four party systems have developed to allow consumers and businesses to make payments to other payment service users within Member States. Most Member States have payment systems that facilitate the provision of similar payment services, allowing for the processing, clearing and settlement of credit transfers, direct debits, debit and credit card payments and ATM withdrawals.

Problems with EU payment services

2.5 The European Commission has identified a number of problems with the EU's payment systems and is proposing legislation to address these.

Fragmentation of EU payment systems

2.6 The first problem identified by the Commission is the fragmentation of the EU's payment systems. As payment systems have evolved within national borders, most current systems operate on proprietary standards. This means that cross-border payments within the EU (other than card payments) have typically been delivered by banks through a limited number of correspondent banking relationships, although an increasing number of payments are now being routed through the EBA STEP2 clearing system for credit transfers.

The Single Euro Payments Area

The introduction of the Euro as a currency in 1999 and of physical notes and coins in 2002 established a single area for cash and integrated cash payments across the 12 Member States who joined. The "Single Euro Payments Area" (SEPA) is both the vision of establishing a single area for electronic payments in Euro and integrating the methods for making these payments, and the industry-led project to deliver this vision.

The vision, developed by the European Central Bank and the European Commission, is of a euro area in which all payments are domestic, where the current differentiation between national and cross-border payments no longer exists. This would be delivered by the development of common instruments, standards, procedures and infrastructures in order to foster substantial economies of scale. Within SEPA, customers would be able to make payments throughout the whole Euro area as efficiently and safely as in the national context today, and would be able to do so using a single bank account and a single payment card. There is an expectation that by 1 January 2008, SEPA schemes will be available to customers, and that by the end of 2010 most Euro payment traffic, both domestic and cross-border, will flow through the schemes.

Concerned by the apparent slow progress made by industry in delivering this vision, and with Euro notes and coins about to be introduced, the European Commission introduced legislation in December 2001 designed to act as a catalyst for change in the banking industry. The Cross-Border Credit Transfers Regulation (2560/2001) laid down rules on cross-border payments in Euro in order to ensure that charges for those payments are the same as those for payments in Euro within a Member State. At the same time, the European Central Bank published a number of reports from 2000 setting out its views on the (lack of) progress being made by industry.

In response to this pressure, the European banking industry began a project in 2002 to define and to deliver this vision. To co-ordinate this project, they established the European Payments Council (EPC). The EPC published a White Paper in May 2002, which set out an emerging common vision on SEPA among industry participants. It followed this up with a Roadmap for SEPA, published in December 2004, which built on the White Paper and set out an industry action plan and timetable with milestones for defined deliverables. The Roadmap envisaged the industry designing schemes between 2004 and 2006, making schemes operational by 2008 and migrating national payment traffic in Euros by 2010.

The Payment Services Directive is designed in part to address legal barriers to the building of SEPA, with the industry arguing that a harmonised legal environment for payments is an essential building block for the creation of SEPA. The Commission also intends the Directive to provide an additional incentive for the industry to build SEPA by setting maximum execution times for payments.

Looking ahead, the Commission is continuing to consider whether more action is needed to deliver the full economic benefits of SEPA, and is currently consulting industry and EU governments on a range of issues set out in a 'SEPA incentives' consultation document.

2.7 Given the low volume of cross-border transfers (97% of payments are within Member States), and taking this as a starting point, the Commission argues that existing systems had no incentives to invest in technical inter-operability with other systems for these few cross-border transactions. As a result, consolidation on an infrastructure level between national and cross-border payment infrastructures has not made much progress. A less fragmented payment system would benefit from increased economies of scale and reduced transaction costs, particularly for cross-border payments. These lower transaction costs could encourage greater cross-border trade, driving efficiencies from more accessible markets and increased competition across the EU.

Inefficiency of EU payment systems

2.8 The second problem identified by the Commission is the inefficiency of some payment systems within the EU. The Commission argues that the huge price differences for payment services, of a factor 1 to 8 between EU Member States, demonstrate the differences between the best and worst systems in terms of efficiency. The Commission argues that differences in service level also demonstrate the differences in the efficiency of different national systems. In some countries the standard execution time for payments is the same day, while with providers in other countries the settlement of payment transactions takes up to 3 days.

2.9 The Commission argues that these inefficiencies have a substantial negative impact on business, affecting cash flow and working capital. More generally, slower payment systems are an inefficient drag on the rest of the economy with "artificial" delays in the availability of funds negatively affecting the efficient allocation of capital.

2.10 The Commission argue that this inefficiency can be seen in the macroeconomic cost of the payment system. They note that estimates of the aggregated cost for the EU payment system range from 2–3 % of GDP. This compares poorly with those Member States like Belgium, the Netherlands and Sweden, where evidence suggests that the costs of these payment systems are between 0.3–0.5 % of GDP. In particular, the Commission identifies that the use of cash is a key driver of this cost, accounting for as much as 60–70 % of the total cost of the payment systems. Where cost-efficient self-service channels and fully electronic payments have been widely adopted, for example in the Nordic countries, payment systems operate at much lower cost levels. Electronic payments can pass through a payment system with almost no manual intervention, with the cost depending primarily on the level of development of the system, and its ability to Straight-Through-Process payments.

Lack of competition

2.11 The third main problem identified by the Commission is a lack of competition in payment services across the EU. It argues that the extent to which market forces and competition determine levels of efficiency and prices in payment markets is unsatisfactory. Competition between existing players and the level of market entry of new providers is very low.

2.12 The lack of competition in the UK's payment systems is a continuing concern to the UK Government. The Cruickshank Report on Competition in UK Banking, published in March 2000, identified serious competition concerns in the UK's payment systems. Following this report, the Government committed to tackle these competition concerns. In 2004, the Office of Fair Trading (OFT) established the Payment Systems Task Force, which is working to identify and seek to resolve competition and efficiency issues in the UK's payment systems (see box below for more detail).

2.13 The Commission has identified a number of competition concerns similar to those that have been identified in the UK. In particular, the Commission has noted its concern about competition between banks as the traditional providers of payment services, and the market access and level playing field for new payment service providers entering the market.

2.14 The Commission argues that the current regulatory situation seems to create a lack of competition in many payment services, with banks often enjoying a privileged competitive position in payment markets. This existing bank monopoly in payments excludes many innovative new players from entering the payment services market.

2.15 Those excluded include both non-bank payment service providers who themselves provide three party schemes, and non-bank payment service providers who would like to gain access to existing four party schemes. The first category includes money remitters, who face very different levels of regulation across the EU, while the second category includes existing or potential non-bank participants like independent ATM deployers.

2.16 In the UK, the Government has established a regulatory framework to encourage non-bank payment providers to enter the market. For example, the UK regime for money remitters applies anti-money laundering rules but does not apply any strict prudential criteria as a pre-requisite for authorisation. In addition, the OFT Payment Systems Task Force is considering access issues as part of its work to examine competition and efficiency in the UK's payment systems.

The OFT Payment Systems Task Force

The Payment System Task Force, chaired by the OFT, brings together industry, retail, consumer and government representatives with an interest in payment systems, with the Bank of England and the Treasury participating as observers.

The Task Force was created following the 2003 Pre-Budget report, which set out that the OFT would take on an enhanced role on payment systems for a period of four years. The Government is committed to legislating if the Task Force fails to deliver significant improvements in competition.

The Task Force's role is to identify, consider and seek to resolve competition, efficiency and incentive issues relating to payment systems, particularly looking at network effects of the existing payment mechanisms. Where appropriate, it also considers issues affecting consumers that derive from, or are associated with, features of payment systems.

The Task Force meets on a regular basis and publicly reports on its work programme and findings annually.

So far, the Task Force has agreed to introduce a form of faster electronic clearing for telephone banking, internet banking and standing order payments. The Task Force has also agreed a number of changes to the governance of BACS, designed to improve BACS's objectives and to give BACS's users an opportunity for more influence. Work is currently ongoing on proposals for a wider range of changes to the governance of the UK's payment systems and on the cheque clearing system.

More information on the Task Force is available on the OFT's website.

2.17 The Commission argues that studies undertaken in this context have shown that limiting the provision of payment services only to fully-fledged credit institutions such as has a negative impact on competition and restricts access more than is necessary to ensure financial stability.

2.18 The Commission goes on to argue that to increase competition and to achieve improved levels of service, some market entry barriers need to be removed, and that specific measures might be needed to allow new entrants to enter the market and compete on a level playing field with banks.

THE CURRENT REGULATORY FRAMEWORK

2.19 The EU has already adopted a number of measures aimed at harmonising the regulatory framework for payments:

- Recommendation (97/489/EC), providing for the protection of customers using electronic payment verification instruments, such as payment cards.
- Directive (97/5/EC), facilitating cross-border credit transfers in establishing common customers' protection requirements;
- Regulation (2560/2001) on cross-border payments, eliminating the difference of price between cross-border and national payments.

2.20 The Commission believes that Community legislation, in particular the Regulation on cross-border payments, has made it easier and cheaper for customers to perform many types of payments in Euro within the internal market and has 'kick-started' the industry’s initiative for a Single Euro Payments Area (SEPA).

2.21 However, the Commission believes that this legislation does not go far enough to address the problems outlined in this Chapter and to achieve a true internal market in payments. It is therefore proposing further legislation in the form of the Payments Directive. Chapter 3 sets out the Commission’s proposed policy framework for tackling the problems identified above.

3 THE PROPOSED POLICY FRAMEWORK

THE SINGLE MARKET IN FINANCIAL SERVICES

3.1 The Lisbon European Council of March 2000 endorsed the Financial Services Action Plan (FSAP), a set of 42 measures with the overarching goal of completing the Single Market in financial services. A better integrated single market in financial services market would:

- reduce the cost of accessing capital and improve the allocation of capital across the EU;
- give firms increased opportunities to access markets in other Member States and to carry out business effectively on a cross-border basis; and
- give retail consumers access to a wider range of more competitively priced financial services products[1].

3.2 The Payment Services Directive has the potential to help create a better integrated single market in payment services. This would increase competition, leading to better value for consumers and a more efficient market for payments across the EU.

Post- FSAP priorities

3.3 The FSAP's specific objectives are: a single wholesale market, an open and secure retail financial services market and state-of-the-art prudential rules and supervision[2]. The Commission and Member States have made substantial progress in promoting further financial integration during the last five years through the FSAP and the debate now centres on how to make further progress. The UK has set out a strategic approach to developing the Single Market in financial services; the key priorities, which are directly relevant to the Payment Services Directive, include[3]:

- alternatives to EU regulation. In general, EU legislation should be a last resort. Alternative approaches to policy making, such as more use of EU competition policy, market-based solutions and initiatives at national level, should be considered first. In relation to the Payment Services Directive, consideration will need to be given on whether the different provisions of the Directive are needed;
- better regulation. In some specific cases, market failure analysis may demonstrate that new or further EU legislation in financial services could be necessary. When new EU legislation on financial services is being considered, a proper assessment of the costs and benefits should be undertaken, and financial market participants should be fully consulted. In relation to the Payment Services Directive, consideration will need to be given on whether the different provisions of the Directive are the most appropriate or whether alternative provisions could deliver a better cost-benefit outcome;

[1] After the EU Financial Services Action Plan: UK response to the reports of the four independent expert groups, HM Treasury, 2004.

[2] After the EU Financial Services Action Plan: A new strategic approach, HM Treasury, 2004.

[3] The other priorities are: seeking alternatives to new EU regulation (such as more use of EU competition policy) and implementing the existing FSAP measures and enforcing them effectively. Solvency II is clearly one of the exceptions where the necessary reforms do require new EU legislation and in time consistent enforcement of the new framework will be a key priority.

- recognising the global nature of financial services. A global and not just EU perspective is needed when considering the impact of EU financial services regulation on the competitiveness of EU-based firms and financial centres. In relation to the Payment Services Directive, consideration will need be to given on the global nature of the payments business and the impact of regulating EU payment service providers in this context.

THE PAYMENT SERVICES DIRECTIVE

The history of the Directive

3.4 For some time, facilitating payments within the EU and harmonizing relevant legal provisions has been a priority for the European Commission. As set out in Chapter 2, the EU has already adopted a number of measures aimed at harmonising the regulatory framework for payments.

3.5 In 2003, the Commission published a consultation document identifying 21 potential barriers to the development of a Single Euro Payments Area (SEPA). Following the consultation they decided to proceed with a Directive to address a number of these issues.

3.6 On 1 December 2005 the European Commission published a legislative proposal for a Directive on payment services in the internal market, the Payment Services Directive. The full text of the proposal and the accompanying Impact Assessment are available at:

europa.eu.int/comm/internal_market/payments/framework/index_en.htm

The main aims of the Directive

3.7 The Directive's ultimate goal is to improve the competitiveness of the EU through integrating national payment markets and providing support for the European payments industry in building the infrastructure necessary for a single payment market.

3.8 To achieve this ultimate goal, the Directive has three main objectives, which are:

- to enhance competition by opening markets and creating a level playing field;
- to increase market transparency for providers and users; and
- to standardise rights and obligations of providers and users of payment services in the EU, with a strong emphasis on a high level of consumer protection.

3.9 By creating a single payment market in the EU, the Commission's goal is to allow citizens and businesses to make payments across the EU as easily, safely, efficiently and inexpensively as within national borders. The Payment Directive seeks to remove the legal barriers to the provision of payment services across the EU.

3.10 In seeking to deliver the objectives above, the Directive will do two main things:

- the Directive will create a new EU-wide licensing regime for 'Payment Institutions' (i.e. providers of payment services that are not credit institutions[4] or E-money issuers). There are currently significant differences between the regulatory regimes for payment services in EU Member States. These regimes are not harmonised and 25 sets of different national rules exist. In France, for example, it is necessary to be a licensed credit institution to offer payment services such as money transfers, whereas in others, like the United Kingdom, providers of money transfer services are required only to register with HM Revenue and Customs to comply with anti-money laundering rules (although many payment service providers are licensed for other activities like deposit-taking); and
- the Directive will also introduce conduct of business rules for all payment service providers (including credit institutions and E-money issuers) for payments under EUR 50,000. In doing so, the Directive should harmonise legal and technical requirements relating to the provision of payment services, give Payment Institutions access to other EU markets and facilitate the creation of SEPA.

The provisions of the Directive

3.11 This section of the consultation document seeks to outline provisions of the Directive, picking out the main themes emerging from each of the six titles. The potential impacts of the provisions of the Directive are set out in the Partial Regulatory Impact Assessment in Annex A.

Title 1 **3.12** Title 1 of the Directive sets out its subject-matter, scope and definitions:

- Article 1 covers its subject-matter, and excludes central banks and public authorities from the Directive's scope;
- Article 2 sets out the Directive's scope, and cross-refers to an Annex that lists the activities caught by the Directive;
- Article 3 sets out the Directive's negative scope, listing for clarity those activities not caught by the Directive; and
- Article 4 provides the definitions for the Directive.

Title 2 **3.13** Title 2 of the Directive establishes a new regulatory regime for Payment Institutions, one of the four categories of payment service provider set out in Article 1:

- Section 1 sets out the general rules applying to Payment Institutions, covering the requirements that would need to be met in order for a Payment Institution to become authorised and limitations on its activities. Along with Section 2, these provisions would form the basis of the new regulatory regime that would apply to Payment Institutions;
- Section 2 sets out other requirements applying to Payment Institutions, particularly in relation to the use of agents by Payment Institutions;

[4] In the UK both banks and building societies are authorised as credit institutions.

- Section 3 sets out provisions relating to competent authorities and supervision, setting out the controls that may be exercised by supervisors in relation to Payment Institutions;
- Section 4 establishes a waiver regime for certain types of payment service provider. This would allow smaller firms meeting certain requirements to be exempted from the requirements set out in the rest of Title 2; and
- Article 23 is related to access to and operation of payment systems. This Article would stop payment systems from imposing any access conditions beyond those needed to safeguard against risks and protect financial stability.

Title 3 **3.14** Title 3 of the Directive sets out the requirements on payment service providers to provide information to consumers in order to ensure transparency:

- Chapter 1 covers single payment transactions, including obligations to provide information prior to and subsequent to making and receiving a payment, setting out both the information that needs to be provided and how it should be communicated to customers;
- Chapter 2 covers framework contracts involving multiple payment transactions, again covering obligations to provide information prior to and subsequent to making and receiving a payment and setting out both the information that needs to be provided and how it should be communicated to customers; and
- Chapter 3 covers provisions common to both single payment transactions and framework contract involving multiple payment transactions, including those related to currency exchange.

Title 4 **3.15** Title 4 of the Directive covers the rights and obligations in relation to the provision of and the use of payment services:

- Chapter 1 sets out rules relating to the authorisation of payment transactions. These establish what constitutes authorisation and what happens in the event of unauthorised payments being made and also establishes provisions for refunds for certain types of payments. Article 51 provides a specific exemption for micro-enterprises and electronic money;
- Chapter 2, Section 1 sets out rules relating to payment orders and amounts transferred, harmonising the point in time at which a payment is considered to be accepted by a provider and requiring that providers ensure that the full amount of the payment transferred is received by the intended recipient;
- Chapter 2, Section 2 provides for a maximum execution time for payments both initiated by the payer and initiated by the payee;
- Chapter 2, Section 3 sets out rules relating to the availability of funds and non or defective execution of transactions;
- Chapter 3 covers data protection; and
- Chapter 4 covers penalties and complaint and redress procedures.

Title 5 **3.16** Title 5 of the Directive establishes a Payments Committee and provides for various provisions of the Directive to be updated.

Title 6 **3.17** Title 6 of the Directive contains the final provisions, including the provision making the Directive fully harmonising (with some limited exceptions) and transposition requirements applying to Member States. It also contains provisions allowing payment service providers to grant more favourable terms to payment service users.

How the Directive will impact in the UK

3.18 The list below summarises in broad terms the current regulatory regime for payment services in the UK and how the Payment Services Directive will impact on the different types of firms subject to it. More details can be found in the Partial Regulatory Impact Assessment in Annex A.

Type of Business	Current Regulation	Impact of Payments Directive
Credit institutions	Credit institutions are authorised by the FSA following the requirements of Directive 2000/12/EC. Conduct of business rules for payment services provided by credit institutions are covered by the Banking Code and the Distance Marketing Directive 2002/65/EC.	Title 2 will not apply. Subject to rest of the Directive.
E-money issuers	E-Money issuers must be either authorised by FSA or granted SMEI certification under Directive 2000/46/EC.	Title 2 will not apply. Subject to rest of the Directive.
Money transfer companies	Registered with HM Revenue and Customs under the Money Laundering Regulations (2003).	Large companies subject to full requirements of Title 2. Smaller providers that meet certain tests may be eligible for a waiver from Title 2. All companies subject to the rest of the Directive.
ATM operators	ATM operators are not currently subject to regulation or supervision. However, as members of the LINK Card scheme they must comply with rules on transparency and execution of transactions.	Greater clarity is needed on whether these firms would be able to meet the waiver provisions, but otherwise subject to the rest of the Directive.
Companies offering bill payment services	Not regulated.	Subject to the entire Directive.
Mobile Phone operators and other digital payment service providers	Not prudentially regulated, although some are providing services close to the boundary of E-money. OFCOM regulates competition and ICSTIS regulates premium rate services.	There is an exclusion from the Directive (Article 3 (j)) that may exempt at least some of the payment-type services currently offered by mobile phone operators and other digital payment service providers. However, greater clarity is needed regarding this

		exclusion. Mobile phone operators and other digital payment service providers not exempted will be subject to the entire Directive.
Credit unions	Credit unions are authorised by the FSA under FSMA but have an exemption from Directive 2000/12/EC.	The UK is seeking an exemption for Credit Unions mirroring that in the Directive 2000/12/EC. Otherwise subject to the entire Directive.
Payment systems	The Bank of England applies a non-statutory oversight regime, focusing especially on those systems whose reliable functioning is critical to financial stability.	Article 23 will require that access requirements to four party schemes be established on objective and proportionate risk-based criteria. Not subject to the rest of the Directive.

4 THE CONSULTATION PROCESS

NEGOTIATIONS AHEAD

4.1 Following its adoption by the European Commission, the Council of Ministers and the European Parliament are now considering the Directive. The Council will consider the Commission's proposal and agree or disagree to adopt it, or an amended version agreed with the European Parliament, under the Council's rules of Qualified Majority Voting. The European Parliament will also consider the proposal and agree or disagree to adopt it or a similarly amended version. The Directive will enter into force if the Council of Ministers and Parliament both come to an agreement on a common text.

4.2 Austria holds the Presidency of the Council of Ministers during the first half of 2006. The Austrian presidency held its first formal Council Working Group on the Directive on 15 March 2006. This is being followed up on through further meetings approximately every three weeks. The Austrian Presidency is aiming to progress work on the Directive as far as it can during the first half of 2006. However, given the issues involved it is unlikely to reach final agreement in the Council before June 2006. Negotiations are therefore likely to continue into the Finnish Presidency.

4.3 HM Treasury will participate fully in these negotiations. We expect this consultation to inform the position we take.

CONSULTATION PROCESS

4.4 To inform its negotiating strategy, HM Treasury has prepared a Partial Regulatory Impact Assessment (RIA) of the proposed Payment Services Directive, to be found in Annex A. The Partial RIA covers:

- The background to the Commission's proposal;
- The rationale for legislation in this area;
- A consideration of the options available to the UK in negotiations ahead;
- A partial assessment of the costs and benefits for the UK associated with the proposal; and
- A partial assessment of the proposals impact on small firms and on competition.

4.5 This consultation is being conducted in line with the Government's Code of Practice on Consultation. The criteria can be found in Annex C.

4.6 If you feel that this consultation does not fulfil these criteria please contact:

Meenakhi Borooah
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ

Email: Meenakhi.Borooah@hm-treasury.x.gsi.gov.uk

HOW TO RESPOND

4.7 The Directive will apply to all businesses currently offering payment services that fall within the definitions set out in the Directive[5]. In the UK, these businesses include credit institutions, E-money issuers, money transfer companies, ATM operators, companies offering bill payment services and possibly mobile phone operators and credit unions. It will also affect payment systems, users of payment services (consumers, businesses and not-for-profit organisations) and the public sector as overseers. A list of those with whom we have so far discussed or intend to discuss the Directive is attached in Annex B. This consultation document will be sent to those on this list. If you have any suggestions of others who may wish to be involved in this process please contact us.

4.8 HM Treasury would welcome any general comments on this consultation document, our Partial RIA and the Commission's proposal. The Partial RIA also asks for responses and views in a number of specific areas:

- Do companies that would have to become licensed as 'Payment Institutions' believe the licensing regime is appropriate, and have they already have the relevant systems and controls in place to comply with it?
- Do the information requirements in the Directive would pose any particular problems to specific types of firm and if so, why?
- Do the rights and obligations under Title IV would pose any particular problems for the smooth execution of payments or create any unintended consequences?
- Do stakeholders believe the Directive maintains an appropriate balance between user protection and the proportionate regulation of providers?
- Do stakeholders believe having a threshold of EUR 50,000, above which Titles III and IV of the Directive will no longer apply, is appropriate?
- Do stakeholders agree that the Directive, as drafted, will not have a disproportionate impact on small firms?
- Do respondents agree with our partial assessment of the benefits of the Directive? Are there any other significant benefits that we need to consider? Also, why and to what extent do you think the Directive will achieve its aims of creating an EU internal market in payments and removing legal and technical barriers to SEPA?
- Overall, do you agree with our partial assessment of the costs of the Directive? Are there any significant impacts that we need to consider, other than those that can be smoothed out through drafting changes? If so, are you able to quantify the impact?

4.9 In addition, there are also a number of questions not included in the RIA on which responses would be particularly welcome (see box below).

4.10 The consultation period will begin on 3 July 2006 and will run for 12 weeks until 25 September 2006. All responses received by this date will be taken into account.

[5] The Annex to the Directive contains a list of payment services that are in scope under Article 2. Article 3 contains a list of services that are excluded from the scope of the Directive.

However, respondents should note that negotiations in the Council of Ministers will already be well under way by this point. Therefore any comments sent earlier than the deadline would especially welcome. Respondents should also note that information on costs and benefits is likely to be particularly useful to us in negotiations, as it would allow us to base any requests for changes on clear evidence.

4.11 When responding please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of a larger organisation please make it clear who the organisation represents, and where applicable, how the views of members were assembled.

Questions

- Are there any groups or sectors that will be affected by the Directive that have not been identified in the Partial RIA?
- Do you agree that the provisions establishing a waiver regime (Article 21 of the Directive) mean that any race equality impacts will be avoided?
- Do you support the proposed negotiating approach set out in the Partial RIA? Why?
- If you support the proposed approach, which changes do you think would be appropriate and what would be the costs and benefits of these changes?
- Have you identified any drafting changes that need to be made? (Please provide clear justification for any proposed changes.)
- Are you able to provide information on costs and benefits in the areas where we have requested it?

4.12 Please send responses to this Consultation Document to:

Veda Poon, Payments and Inclusion Team
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ

Email: PI.consultationresponses@hm-treasury.x.gsi.gov.uk

CONFIDENTIALITY

4.13 All written responses will be made public on HM Treasury's website unless the author specifically requests otherwise. In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of emails will be disregarded for the purpose of publishing responses unless an explicit request for confidentiality is made in the body of the response. If you wish, part, but not all, of your response to remain confidential, please supply two versions – one for publication on the website with the confidential information deleted, and other confidential version for the Payments Consultation Team.

4.14 We are particularly interested to obtain information about costs and benefits. If you would prefer such information not to be made public but would be happy for us to use it in order to reach general estimates of total costs to a particular sector please state this in your response.

4.15 HM Treasury will review responses received by the deadline above. Where appropriate we will meet with respondents to discuss their views in further detail. These responses will then be used to inform our final negotiating strategy.

4.16 Even where confidentiality is requested, if a request for disclosure of the consultation response is made in accordance with the freedom of information legislation, and the response is not covered by one of the exemptions in the legislation, the Government may have to disclose the response in whole or in part

A PARTIAL REGULATORY IMPACT ASSESSMENT

TITLE OF REGULATORY IMPACT ASSESSMENT

A.1 This is the Partial 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. This proposal is under negotiation in the European Parliament and the Council of Ministers.

PURPOSE AND INTENDED EFFECT

(i) Objective

A.2 The Directive's ultimate goal is to improve the EU's competitiveness through integrating national payment markets and creating a Single Payment Market where improved economies of scale and competition would increase efficiency and reduce the total cost of the payment system to the EU.

To achieve this purpose, 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 consumer protection.

A.3 In addressing these issues the Commission hopes the Directive will provide the legislative support for the EU Payments Industry in building the necessary infrastructure for a Single Euro Payments Area (SEPA) in which Euro payments can be made as easily, safely, efficiently and inexpensively as within national borders.

A.4 The Payment Services Directive will apply across the United Kingdom.

(ii) Background

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

A.6 These existing pieces of legislation have, to some extent, made it easier and cheaper to make Euro payments in the EU. They have also encouraged industry to start the process of building the infrastructure necessary for SEPA. However, a true internal market in payments has still not developed. In 2003, the Commission published a consultation document identifying 21 potential barriers to the development of SEPA. Following the consultation, the Commission decided to proceed with a Directive to address the issues identified.

A.7 The Payment Services Directive will establish a new licence for Payment Institutions, allowing them to operate across the EU on the basis of a licence obtained in any one Member State. This follows work the Commission has recently done to harmonise the licensing of credit institutions and E-money issuers across the EU and will create a third category of institution that is permitted to offer payment services.

(iii) Rationale for intervention - facilitating SEPA and an EU internal market in payments

A.8 How payments are made has a significant impact on the productivity of an economy. Studies have shown that gains in efficiency, particularly in taking advantage of economies of scale and in moving from paper-based 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 of March 2000[6] which set out the conclusions of the independent review the Government had launched into competition in UK banking. It noted that 'given the fundamental importance of payment systems to economic life, any inefficiencies in these systems will have a significant impact on economic welfare'. Following the publication of the Cruickshank Report, work has been set in motion in the UK to improve efficiency in UK payment systems, primarily through the Office of Fair Trading's Payment Systems Task Force[7].

A.9 The current fragmented state of payment systems among EU Member States is believed to impose significant costs on the EU as a whole. A 2005 study for the European Commission completed by McKinsey & Company showed that there are currently around 231 billion payments per year in the EU, representing a total value of EUR 52 trillion. Moving to more efficient 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 provision of services. For example, bringing in an EU-wide direct debit product would significantly improve the efficiency of regular bill payments and therefore bring benefits for cross-border trade and mobility.

A.10 There is large variation in the efficiency of payment markets in different EU Member States. In some countries, for example, low-value electronic payments take 3 days to execute whereas in other this happens on the same day. Another issue is price levels. If these were to fall to the current EU average this too could generate some large savings. For example, merchants report that if they were able to buy services from the most competitive providers in the EU they could, in some cases pay up to 20 times less for card payments.

[6] The Cruickshank Report can be found at http://www.hm-treasury.gov.uk/documents/financial_services/banking/fin_bank_index.cfm

[7] Further information on the Payment Systems Task Force can be found at http://www.oft.gov.uk/Business/Payment+systems+task+force/default.htm

A.11 From a UK perspective, consumers and businesses often encounter difficulties when making cross-border payments within the EU. Even payments made solely in Euro can be expensive and take some time to arrive. If these payments could be made more cheaply and easily it would deliver significant benefits. Businesses, in particular, would benefit from greater automation of cross-border payments. This would allow them to make savings by improving the efficiency of their systems.

A.12 Some UK firms offering payment services currently incur difficulties, both in gaining entry to other European markets and in accessing some payment schemes. This is particularly the case for payment service providers that are neither credit institutions[8] nor E-money issuers. Both these hurdles hamper the development of a true internal market in payments, preventing consumers and businesses across the EU from choosing the most efficient European provider.

A.13 There are a variety of different types of non-bank payment service providers operating in the UK offering payment services that would fall within the scope of the Payment Services Directive. These include money transfer companies and non-bank cash machine operators. Payment services are currently subject to very little financial regulation in the UK[9], whereas, at present, these firms need a banking or other financial institution licence to operate in many EU Member States. Banking licences can be costly and difficult to obtain, and impose requirements not relevant to the provision of payment services only. Capital adequacy requirements, for example, provide important protection for bank customers due to the fact that banks take deposits and lend the money 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. Capital adequacy requirements are therefore unnecessary.

(iv) Rationale for intervention - the Payment Services Directive

A.14 Building the infrastructure necessary to create SEPA is a complicated task. 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 reach a 'lowest common denominator' product, not the 'best of breed' products and schemes the Commission would like in place. Equally, without such legal provisions, payment institutions will continue to find it difficult to set up in other EU Member States, and many will not be able to afford the investment. Economies of scale will not be realised and consumers and businesses will be severely restricted in their ability to shop across the EU for the best products.

[8] In the UK both banks and building societies are authorised as credit institutions.

[9] Any payments made by UK providers that fall within the scope of EC Regulation 2560/2001 (and the Cross-Border Payments in Euro Regulations 2003) and also the implementing legislation for Directive 97/5/EC on Cross-Border Credit Transfers will be subject to limited regulation. Payments made by most banks and building societies are also subject to industry self-regulation under the Banking Code and the Business Banking Code.

(v) Intended effect of the Directive

A.15 The Directive's impact will be twofold. First, it will create a new EU-wide licensing regime for 'Payment Institutions' (i.e. providers of payment services that are not credit institutions or e-money issuers), harmonising 25 sets of national rules, which currently differ significantly. In the UK, payment services are currently subject to very little financial regulation, although Money Service Businesses are required to register with HM 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 payment systems, unless denying such access can be justifiably refused to safeguard against specific risks or to protect the financial safety of the system. These measures can be found in Title II of the Directive.

A.16 Secondly, the Directive will introduce conduct of business rules for all payment service providers (including credit institutions and E-money issuers) for payments under EUR 50,000[10]. Again, there is currently very little regulation on this in the UK, 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[11]. The conduct of business provisions can be found in Titles III and IV of the Directive.

CONSULTATION

A.17 Over the past 2 years, the European Commission has consulted on 5 versions of the draft Directive, as well as a draft impact assessment. They have held a series of Payment Systems Government Expert Group meetings for governments and regulators and Payment Systems and Markets Groups meetings for industry and other stakeholders. They have also requested written comments on each version. HM Treasury has sought the views of UK stakeholders at each stage of this process, holding meetings, discussing with different sectors and reviewing written submissions. Annex B contains a list of groups and organisations that have been consulted so far and to whom we intend to send this consultation document. Although there are likely to be some concerns that still need to be resolved, the view of all sectors is that the Directive has greatly improved since previous drafts. Large money transfer companies and some ATM operators are particularly welcoming of the access it should give them to other EU markets. Large businesses that trade across the EU are supportive of the greater level of standardisation the Directive will introduce. This will help them in their processing of payments.

A.18 HM Treasury intends to continue this consultation process throughout negotiations as they go forward and is also now publishing this consultation document on its negotiating strategy.

[10] The €50,000 threshold is intended to place a cap on the liabilities that payment service providers could potentially incur. However, some users, particularly large businesses, have expressed concerns about it leading to the splitting of payments and causing problems for the straight through processing of payments.

[11] The Business Banking Code covers businesses with an annual turnover of up to £1 million.

OPTIONS

Option 1 – Oppose the European Commission's proposal i.e. do nothing

A.19 The power to propose legislation in this area lies with the European Commission. Once the Commission has made its proposal, Member States begin formal negotiations on the text. The UK has been an important voice in those negotiations, but is one Member State out of 25 in an area where qualified majority voting applies. It is not possible for one Member State or a small number of Member States not constituting a 'blocking minority' to block or force change to a proposal. The Payment Services Directive will also be voted on by the European Parliament. This means that the Council (representatives of Member States) and Parliament act together in co-decision.

A.20 Legislation in this area is a high priority for the European Commission and for many EU Member States. If it is not introduced, the benefits outlined below will not be realised. EU payment systems are likely to remain fragmented and less efficient than they could be and an internal market in payments will not be able to develop.

A.21 The UK has worked hard during the Commission's consultation on previous drafts of this Directive to assess whether particular courses of action would be disproportionate, and, if so to ask for them to be altered. We believe that we have made progress in most of the key areas, for example in lobbying for a waiver regime in Title II and for changes to the liability requirements in Title IV. We will continue work to ensure that the regulatory regime for Payment Institutions is not strengthened and remains proportionate to the service being provided. Looking at the evidence below, we see the proposal as bringing significant benefits to the UK. We would therefore be at a significant disadvantage if we oppose the Commission's proposal altogether.

Option 2 – Support the European Commission's proposal

A.22 As outlined below, the Commission's proposal should bring some significant benefits. In comparison with these benefits, the initial estimates of costs do not appear to be disproportionate. The regulatory regime for Payment Institutions that the European Commission has proposed is broadly successful in matching the regulatory requirements to the level of risks involved in providing payment services. The risks involved in the provision of payment services are different to those incurred by deposit-taking institutions, both for users and for the economy. Payment service providers that are not credit institutions or E-money issuers, such as money transfer companies, generally pay out money almost immediately. They do not reinvest it at high risk, as deposit takers often do. The risk to users is therefore small in comparison. Furthermore, this type of payment service provider does not pose a systemic risk to the stability of an economy. There will therefore be a strong case for defending the Commission's proposal, or at least large parts of it[12].

[12] The European Commission has assessed the different risks posed by different types of payment service provider in Annex 5 of its impact assessment on the Directive.

A.23 In particular, there are some areas where the UK has successfully sought to introduce changes in previous rounds of negotiations and which we are now particularly supportive of. Without these measures, the proposal could bring disproportionate costs to the UK. One of these is the waiver regime for small payment institutions (Article 21). There are nearly 2,000 small money transfer companies registered in the UK that would risk being driven out of business or underground if required to comply with the full licensing regime in the Payment Services Directive. Research undertaken by HM Revenue and Customs indicates that over 70% of these businesses have an annual turnover of less than £1 million. Many of these businesses provide important access to remittance services for migrant workers from developing countries wishing to send money home at low cost. It is important that such firms are not operating underground because of their vulnerability to use for money laundering and terrorist financing activities.

A.24 We are also supportive of changes made to liability requirements. In previous drafts, the balance of liabilities was disproportionate and risked providing an incentive for fraud. 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 above a certain size 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 internal safeguard procedures. Such actions could potentially impose heavy losses on banks and lead to restrictions in the services banks offer to larger businesses. In addition, payment service providers will no longer be liable for payments arriving at a payee in non-EU countries. While payment service providers should accept liability for a payment arriving at a payee's payment service provider, they have no control over what that provider then does with the money. Extending liability beyond this point therefore seemed to be disproportionate and risked reducing service provision.

A.25 We also welcome the fact that the Commission has brought in an Article opening up access to payment systems (Article 23). One of the conclusions of Cruickshank's Report on payment systems was that competition in the payments systems market was limited because many systems were unjustifiably closed to non-banks. The Payment Services Directive should now address this concern.

Option 3 – Support the general thrust of the EC proposal but push for changes in some areas

A.26 As set out in Option 2, we think that, given changes to previous drafts, there is now much in the proposal that is favourable to the UK. The approach that the Commission has taken in this proposal seems broadly proportionate.

A.27 There are a number of changes the UK believes will improve the Commission's proposal, making the regulatory regime created more proportionate and better targeted. In addition, there will undoubtedly be many legal and drafting issues that will need to be addressed, to avoid the Directive having unintended consequences. The UK has identified the main priorities in this context.

Clarifying the scope of the Directive in Title I

- The UK believes that a number of changes to Title 1 would be helpful in making the scope of the Directive clearer. In particular, it is important that the boundary of the application of the Directive to mobile phone operators and other digital payment service providers is clear.

Ensuring a proportionate regulatory regime in Title 2

- The UK believes that any significant increase in the regulatory requirements in Title 2 would not be justified. The UK is keen that the regime focuses on the low-level of risk involved in the activities in the Annex not limited to credit institutions. The Commission's Impact Assessment sets out the arguments for such a regime very clearly.
- In addition, the UK believes that the waiver provisions in Article 21 are crucial in ensuring that smaller providers, operating in their own Member State only are not subject to regulatory requirements that might force them underground. The UK suggests that a single simple quantitative criterion would help ensure a straightforward and simple implementation in those Member States wishing to use the waiver provision.
- Finally, the UK supports Article 23. Such a provision is a very important step in promoting competition and efficiency in payments across the EU.

Ensuring the conduct of business rules in Title 4 are workable

- The UK believes that a number of changes to Articles in Title 4 are needed to ensure the regulatory regime is workable.
- In particular, the inclusion of Article 48 in the exemption for enterprises in Article 51 would ensure that the electronic banking arrangements used by corporates are not undermined. It would also allow the EUR 50,000 threshold to be removed.
- Also, changes to Article 54 are needed to enable the practice of corporates submitting forward payment instructions to continue.
- Finally, changes to Article 60 are needed to reflect the difficulty faced by the industry in executing payments denominated in less-used currencies by the next working day. Enforcing a next day execution time for payments where there are no payment systems available is likely to result in banks refusing to provide such services, or in huge development costs (which will be passed to customers) for little benefit.

A.28 We would welcome input from stakeholders on any areas where you think drafting changes need to be made, with supporting evidence or justification.

A.29 The purpose of this consultation is to identify whether there are any other areas, particularly larger areas of policy, where the costs introduced by the Directive would outweigh its benefits. In particular, we are interested in:

- Whether companies that would have to become licensed as 'Payment Institutions' believe the licensing regime is appropriate, and have they already have the relevant systems and controls in place to comply with it;
- Whether the information requirements would pose any particular problems to specific types of firm and if so, why;
- Whether the rights and obligations under Title IV would pose any particular problems for the smooth execution of payments or create any unintended consequences;

- Whether stakeholders believe the Directive maintains an appropriate balance between user protection and the proportionate regulation of providers; and
- Whether stakeholders believe having a threshold of EUR 50,000, above which Titles III and IV of the Directive will no longer apply, is appropriate.

A.30 More information on the points above, which we think are likely to be the key policy issues on the table, and on any other issues believed to be relevant should help us to identify whether Option 3 is the most appropriate option and, if so, which further changes we should seek to obtain.

COSTS AND BENEFITS

(i) Sectors and groups affected

A.31 The Payment Services Directive will have an impact on all businesses currently offering payment services as defined by the Directive. As far as we are aware, these are:

- Credit institutions;
- E-money issuers;
- Money transfer companies;
- ATM operators; and
- Companies offering bill payment services.

A.32 In addition, when definitions are clarified, the Directive may also apply to:

- Mobile Phone operators and other digital payment service providers; and
- Credit unions.

A.33 Credit institutions - on 9 December 2005 there were 396 credit institutions incorporated in the UK. Credit institutions are authorised under the Consolidated Banking Directive (2000/12/EC). Conduct of business rules for payment services provided by credit institutions are currently covered by industry self-regulation under the Banking Code. Credit institutions would have to comply with Titles III and IV of the proposed Payment Services Directive.

A.34 E-money issuers - on 9 December 2005 there were 4 licensed E-money issuers in the UK and 33 certified small E-money issuers. E-Money issuers must be either authorised or certified under the E-Money Directive (2000/46/EC). Like credit institutions, E-Money issuers would have to comply with Titles III and IV of the proposed Payment Services Directive.

A.35 Money transfer companies - on 9 December 2005 there were 1,946 money transfer companies in the UK, registered with HM Revenue and Customs under the Money Laundering Regulations (2003) and operating from 26,349 premises. Money transfer companies have an important role in facilitating migrant remittances to developing countries. Remittances are the second largest financial flow to developing countries, after Foreign Direct Investment. It is estimated that around £2.3 billion is sent from the UK each year.

A.36 Money transfer companies are currently subject only to the UK's Money Laundering Regulations. The Government is currently reviewing the UK's regulatory regime for all Money Service Businesses (as well as money transfer companies, these include cheque cashers and bureaux de change, which are excluded from the scope of the Payment Services Directive). A consultation document will be published on this [early in 2006], looking at ways to strengthen anti-money laundering and counter-terrorist financing controls. The Payment Services Directive will introduce conduct of business rules and some light-touch prudential regulation. Money transfer companies would have to comply with Titles II, III and IV of the Directive.

A.37 ATM operators - on 9 December 2005 there were 13 non-credit institution ATM operators in the UK (one of these is an arm of the company offering bill payment services below). ATM operators are not currently subject to regulation or supervision. However, in order to operate ATMs they must be members of the LINK Card scheme and must therefore comply with its rules. These include provisions on transparency and execution of transactions. ATM operators would have to comply with Titles II (unless they are waived from it), III and IV of the Directive.

A.38 Companies offering bill payment services - as far as we are aware, on 9 December 2005 there was one company offering bill payment services. Such companies are not currently subject to regulation or supervision. Companies offering bill payment services would have to comply with Titles II, III and IV of the Directive.

A.39 Mobile Phone operators and other digital payment service providers - on 9 December 2005 there were 6 major mobile phone operators in the UK and a number of smaller operators. There is an exclusion from the Directive (Article 3 (j)) that may exempt at least some of the payment-type services currently offered by mobile phone operators. However, greater clarity is needed regarding this exclusion and if mobile phone operators offer or want to offer services not covered by it they would have to comply with Titles II, III and IV of the Directive.

A.40 Credit unions - on 9 December 2005 there were 566 credit unions in the UK, authorised by the FSA under the Financial Services and Markets Act. Credit unions have an exemption from the Consolidated Banking Directive and the UK is seeking an exemption for them from this Directive. They have a particular role in providing credit to those on low incomes who might encounter difficulties in accessing affordable credit elsewhere.

A.41 Other types of company - the Directive will also have implications for any other type of business that wishes to offer such payment services in future, perhaps in new and innovative ways.

A.42 Payment systems – there will be a need to ensure that their access requirements meet the criteria set out in Article 23 although there is currently a lack of clarity as to how many UK payment systems would fall within the Commission's definition.

A.43 In the UK, the Bank of England currently oversees the following payment systems:

- CHAPS (which provides Real Time Gross Settlement for high value payments);
- BACS Payment Schemes Ltd (which handles low-value, high-volume payments);

- LINK (the UK's cash machine network);
- Cheque and Credit Clearing Ltd;
- MasterCard (which provides credit card and Maestro debit card transactions); and
- VISA (which provides credit card and VISA debit card transactions).

A.44 The Bank of England also oversees CLS (which provides for foreign exchange settlement) and the embedded payment arrangements supporting Crest and LCH. Clearnet. These arrangements are exempt from the scope of the Directive, except for Article 23.

A.45 All businesses, consumers and not-for-profit organisations in the UK need to make and receive payments. The Directive will mean changes to their relationship with their payment service provider, including changes to their rights and obligations.

A.46 How payments are made also has a significant impact on the efficiency and competitiveness of the wider economy. The Directive may lead to changes in this area.

A.47 The Directive will also have an impact on the public sector. Payment services are currently subject to very little financial regulation in the UK. The Directive will therefore necessitate an extension of current regulators' powers and resources to allow them to oversee this sector. Credit Institutions and E-Money issuers are currently supervised by the FSA whereas HM Revenue and Customs currently oversee the application of money laundering rules to money transfer companies. OFCOM regulates competition and ICSTIS regulates premium rate services for mobile phone operators. As part of its role on financial stability, the Bank of England has responsibility for the oversight of payments systems. However, these powers are non-statutory.

Race Equality Impact Test

A.48 As noted above, migrant workers from developing countries who with to send money home often use money transfer companies. Remittances are second only to Foreign Direct Investment in terms of financial flows to developing countries. Although individual transfers are often small in value, the funds can have a very significant impact on the daily lives of family and friends in receiving countries. There is evidence that migrant workers are particularly reliant on smaller money transfer companies, who often charge far lower prices for transfers than banks and may also have better delivery networks at the receiving end. If the licensing regime imposed disproportionate costs on small money transfer companies, these companies may be put out of business or be driven underground. This would be likely to have a disproportionately negative impact on many migrant communities by limiting their choice of remittance service provider, potentially forcing them to pay significantly more for services or, if they are unwilling to do this, making it more attractive to them to use illegal operators to send money. This is one of the reasons why the UK supports the waiver regime in Article 21 of the Directive, and why the Government has argued for it. As shown by the consultation we have undertaken as part of the Small Firms Impact Test and in our analysis of costs and benefits, we believe that this waiver regime could help avoid disproportionate costs being borne by money transfer companies. We therefore believe that the waiver regime will avoid the Directive having any impact on race equality. In fact, the greater transparency that it will bring should be of benefit to migrant workers in their use of money transfer companies as it should allow them to compare prices more easily. However, we would welcome any further views from money transfer companies and from users of remittance services as to whether they agree with this assessment.

(ii) Analysis of costs and benefits

Benefits **A.49** If, as expected, the Directive helps the European payments industry in its plans to deliver SEPA, payments across the EU will become quicker, cheaper and more efficient. Based on a comparison of costs in EU member states against savings made in Nordic countries, which recently introduced more efficient systems, the Commission estimates that businesses in Europe as a whole could make savings of EUR 50-100 billion per annum from the introduction of standardised, end-to-end automated payments in the EU. The benefits to consumers are more difficult to quantify, but they should also be significant. Those living and working abroad or wishing to send money to family should find transferring money easier and cheaper. They should have a wider choice of payment service providers, allowing them to choose the most efficient option. They will also have access to a greater range of services. Someone living in the UK but with a holiday home in France, for example, would be able to set up a direct debit from a UK Euro bank account to make electricity payments to a French company who supplies their holiday home. People would no longer need to open a new set of bank accounts to conduct business in a different EU Member State.

A.50 The right to offer EU-wide services on the basis of a single licence is likely to bring significant benefits to both payment service providers and users. This Directive is broadly maximum harmonising, with specific provisions allowing Member States to impose alternative arrangements through national legislation. Entry barriers to other European markets, such as the requirement to hold a banking licence in order to offer payment services, should therefore be removed. Any of the 1,946 money transfer companies that decide to obtain a licence in the UK would be able to offer services in any other Member State. The same would be true for ATM operators, mobile phone operators or any other licensed Payment Institution. This has the potential to allow such companies to improve their efficiency through greater economies of scale and to expand their business in new markets. We understand that several such companies have encountered difficulties in gaining access to other EU markets in the past. Credit institutions and E-Money issuers already have a right of access to other EU markets, established in previous directives. However, the new Payment Services Directive should also make it easier for these institutions to offer common products across the EU, should they wish to do so.

A.51 Article 23 provides for a right of access to payment systems unless denying this can be justified to guard against specific risks or to protect the financial stability of the system. In the UK, the Banking Review and Cruickshank Report of March 2000 identified access to schemes as being a key competition problem, with incumbents effectively able to block new players, especially non-banks, from entering the market. Since 2000, some progress has been made on this in the UK. For example, LINK, the UK's ATM network has been opened up to non-bank ATM operators, leading to an increase of over 20,000 in the number of ATMs deployed in the UK. However, there is evidence that further opening of the market could bring significant additional benefits. Some of the firms that would be classed as payment institutions are very keen to enter the acquiring market in card schemes, for instance. Prices for acquiring services can be high, particularly for small businesses. Allowing new entrants in has the potential to reduce prices and increase efficiency in this market.

A.52 Consumers and small businesses should also benefit from greater transparency, ease of comparison of payment products and greater certainty as to how the payment will be executed, leading to increased consumer confidence. For example, this should be of benefit to migrant workers looking to send money back to their home country, often through money transfer companies. A recent report by the UK Remittances Working Group (funded by the Department for International Development) found that many remittance companies are not perceived to be 'secure,' that customer awareness and understanding of the remittance market is low and that customers are unaware of the full costs involved when sending remittances. The Directive should lead to improvements in all of these areas, significantly helping migrant workers and their families in developing countries.

A.53 We would welcome feedback from respondents as to whether they agree with our assessment of the benefits. Are there any other significant benefits that we need to consider? Also, to what extent do you think the Directive will achieve its aims of creating an EU internal market in payments and removing legal and technical barriers to a SEPA and why do you hold this view?

Costs

A.54 Credit Institutions - Credit institutions will have to comply with the transparency conditions under Title III. However, credit institutions already provide a large amount of information to their customers, particularly as a result of their obligations under the Banking Code and the Business Banking Code. The Directive would probably mean that credit institutions would need to amend or re-issue their terms and conditions and in some case make changes to information provided on statements. However, this is something that credit institutions do regularly anyway so the Directive is unlikely to mean significant additional costs.

A.55 Credit institutions will also need to meet the rights and obligations set out in Title IV. We have identified the following areas where this may mean significant changes to current systems and practices:

- They would become liable for fraudulent transactions under EUR 50,000 made on the accounts of personal customers and micro-enterprises unless the customer himself has acted fraudulently or with gross negligence;
- They would become liable for errors they make in the execution of transactions under EUR 50,000;
- They would become liable to the payer for the execution of payments under EUR 50,000 arriving at institutions in non-EU countries;
- Changes would be needed as to how transactions are authorised;
- Changes would be needed as to how transactions are revoked or refunded; and
- They would need to provide shorter execution times for some payments.

A.56 We would welcome information from credit institutions on how much these and any other changes might cost. We would also welcome information on the ongoing compliance costs that would ensue.

A.57 E-Money Institutions - Like credit institutions, E-money issuers will have to comply with the transparency conditions under Title III and would need to meet the rights and obligations set out in Title IV. We would welcome information from E-money issuers on the changes this would require and how much these changes would cost. We would also welcome information on the ongoing compliance costs that would ensue.

A.58 Payment Institutions - Money transfer companies, ATM operators, companies offering bill payment services and possibly mobile phone operators and credit unions will need to obtain licences to operate as Payment Institutions. This will mean they will need to apply for this licence and notify the regulator of any changes to the information given when the licence was granted. These companies will also need to comply with the conduct of business rules in Titles III and IV.

4.17 We estimate, on the basis of the costs faced by existing regulated firms, that smaller firms would face the following costs in complying with Title II:

- One off cost of application (including legal fees and compliance manuals): £50,000
- Annual compliance overheads (including training and employing a compliance officer): £50,000

4.18 This represents a total cost of £100,000 per firm in the first year and £50,000 per annum afterwards. We would welcome information from businesses that will need to become licensed as Payment Institutions on the robustness of our cost estimates and what the change is likely to mean for their business.

A.59 Waived Payment Institutions - Payment Institutions meeting the waiver criteria under Article 21 will not need to comply with the licensing regime under Title II. These are predominantly likely to be small money transfer companies. Such firms will simply need to register, as they are currently obliged to do. Our consultation under the Small Firms Impact Test has indicated that this will mean virtually no additional costs for them under the first part of the Directive. Such firms will still need to comply with Titles III and IV but again, our consultation under the Small Firms Impact Test has indicated that this will not mean significant changes to their current procedures and additional costs should therefore be kept to a minimum.

A.60 Payment systems - Payments systems will need to ensure that they comply with Article 23. This may mean changes to there rules and increases in staff and legal costs to ensure ongoing compliance. We would welcome information from payment system providers as to the nature and value of these costs.

A.61 Users: consumers - If costs are imposed on firms providing payment services in order to comply with the Directive, then at least some of these costs are likely to be passed on to users. However, this is a re-distribution of costs rather than additional costs. One area where the Directive may risk imposing new costs on consumers is if the costs of compliance for payment service providers lead them to reduce or, at worst totally withdraw certain services. This would lead to a reduction in choice for consumers. We would welcome information from payment service providers as to whether there are any areas in which the Directive might compel them to do this.

A.62 Users: businesses - If costs are imposed on firms providing payment services in order to comply with the Directive then at least some of these costs are likely to be passed on to users. However, this is a redistribution of costs rather than additional costs. One area where the Directive may risk imposing new costs on businesses is if the costs of compliance for payment service providers lead them to reduce or, at worst totally withdraw certain services. This would lead to a reduction in choice for businesses. We would welcome information from payment services providers as to whether there are any areas in which the Directive might compel them to do this.

A.63 The fact that the proposed Directive only applies to payments below EUR 50,000 could impose additional costs on business. It would mean a lack of clarity as to the terms and conditions for individual payments, which could cause problems for straight-through processing and necessitate systems changes for companies. We would welcome information from businesses as to the costs that the EUR 50,000 threshold might impose on them.

A.64 The public sector - There would be one-off costs for the public sector in implementing the Directive and we are working to identify the extent of these costs. It is likely that fees to regulated firms would cover the ongoing costs of monitoring compliance.

A.65 The economy - If the Directive were to impose heavy costs on the payments industry then this could have an impact on the competitiveness of this sector of the economy. However, we do not anticipate costs to industry are likely to be on a scale that would mean this would be a significant impact.

A.66 Society - As far as we are aware, there are no social costs associated with this Directive.

A.67 The environment - As far as we are aware, there are no environmental costs associated with this Directive.

A.68 Overall, do you agree with our partial assessment above of the costs of this proposal? Are there any significant impacts that we need to consider, other than those that can be addressed through drafting changes? If so, are you able to quantify the impact?

Small Firms' Impact Test

A.69 It has been clear from previous drafts of the Commission's proposal that it will have an impact on small businesses in the UK. Money transfer companies and operators will become subject to new licensing arrangements and conduct of business rules; E-money issuers will have to comply with the conduct of business rules. As noted below, on 9 December 2005, there were 1,946 money transfer companies in the UK, 13 independent ATM operators and 33 small e-money issuers. All of these companies, aside from a few large money transfer operators, could potentially be defined as small firms. Of the money transfer companies, research undertaken by HM revenue and Customs indicates that over 70% have an annual turnover of less than £1 million.

A.70 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. From the outset, we have discussed the proposal with HM Revenue and Customs (who supervise the application of anti-money laundering rules applying to money transfer companies) and the Electronic Money Association to understand the impact of the draft proposal on money transfer companies and E-money issuers. We have held regular meetings with both parties, when we have assessed previous drafts in detail. We drew up a simplified description of what the Directive might mean for small money transfer companies and went on a series of visits to several such businesses to hear their views.

A.71 It was as a result of information gained during this process of consultation that we lobbied the Commission to introduce a waiver clause for small firms from the licensing regime (Article 21). It quickly became clear to us that this would be particularly important for money transfer companies. Many of these are very small businesses, often operated by only one person, from very small premises and with a relatively low turnover. The costs of meeting the requirements of the Directive's licensing regime would be too great for many of these small companies to absorb and it would not be viable for them to continue operating. However, our consultation established that meeting the requirements of Titles III and IV of the Directive would probably mean very little change to these firms' current practices and therefore would not pose significant additional costs. We therefore welcome the introduction of the waiver clause in Title II and believe that it will avoid disproportionate impact on these small firms.

A.72 We have also held meetings with independent ATM operators. It is not yet clear from the Directive whether these firms would be able to meet the waiver criteria, should they desire an exemption. However, these firms tend to be larger than the small money transfer companies and generally have more established operating procedures and business plans. The licensing regime would therefore be unlikely to pose a significant problem for them and some were interested in the opportunity it would offer them to set up business in other EU countries. There are some drafting issues with the conduct of business rules in Titles III and IV that will need to be smoothed out in order to ensure that the regime works for ATM operators. Other than this, our consultation so far has not indicated that the Directive will impose disproportionate costs on these firms.

A.73 Our conclusion at this stage is therefore that the Directive, as drafted, will not have a disproportionate impact on small firms. However, we would welcome comments from stakeholders as to whether they agree with us that this is the case and what the potential impact could be on market entry, competition and innovation if the licensing regime were to be strengthened. We will hold further meetings and discussion with small businesses as negotiations progress to ensure that we aware of any issues that may arise.

Competition Assessment

A.74 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, companies providing bill payment services and possibly also mobile phone operators and credit unions depending on how the scope of the Directive is understood. Credit institutions and E-money issuers already have to comply with licensing requirements under the Banking and E-Money Directives. Credit institutions in particular typically tend to be larger than the other types of firms offering payment services. Under Title II, the Directive will introduce a new licence for other firms – Payment Institutions - offering payment services but not taking deposits or issuing E-money. As they are already licensed, credit institutions and E-money issuers will not have to meet these costs. However, we do not think that that the cost of the new licensing regime will be such that it will significantly change the market structure. It contains lower requirements than the current licensing rules for credit institutions and E-money issuers. It will not introduce additional set-up or ongoing costs for new firms that existing firms will not have met or have to meet.

A.75 The Directive will require all firms offering payment services to comply with the conduct of business rules in Titles III and IV. This part of the Directive will therefore apply to all firms equally and again, we do not expect it either to have a significant impact on market structure or to penalise new entrants.

A.76 The payment services market is characterised by technological change. However, on the basis of our consultation so far we are not aware of specific areas where the Directive would be likely to limit progress. We would welcome information from stakeholders if they are aware of any such areas. We are also not aware of any areas where the Directive would lead to a reduction in the services offered to users, although there needs to be some clarification as to how the Directive will work in its application to a payment service provider's relationship with business users of payment services, but again we would welcome information from stakeholders if they believe there to be any such areas.

A.77 We therefore conclude at this stage that Directive is not likely to have any significant negative impact on competition in the market in the UK. In contrast, opening up access to payment systems to new payment service providers should have a significant positive impact on competition. As described in above, this was identified by the Cruickshank Report of March 2000 as a significant market failure, with banks able to block the access of non-banks to the main UK payment systems, even in cases where this could not be justified on grounds of risk. The Directive should open up some of these systems to non-banks, removing a significant barrier and allowing them better to compete in the market.

A.78 We would welcome comments from respondents as to whether they agree with our partial competition assessment or whether they believe there are significant impacts that we have missed.

Enforcement, sanctions and monitoring

A.79 Once agreed, the Directive will need to be implemented in UK law. Issues around enforcement, sanctions and monitoring will be addressed through this consultation process. The Government will consider these issues further in due course.

COMPENSATORY SIMPLIFICATION MEASURE

A.80 The proposed Directive will replace Directive 97/5/EC, Article 8 of Directive 97/7/EC and Article 8 of Directive 2002/65/EC. At a European level, the Directive should simplify the regulatory regime facing companies who operate across borders by replacing 25 sets of national rules with a single harmonised approach. In the UK, the Directive will lead to the introduction of regulatory rules in a number of new areas. The Government will consider how it might act to reduce these additional burdens in the context of the responses provided to the consultation.

B LIST OF THOSE CONSULTED

B.1 The organisations consulted by HM Treasury in relation to the Payments Directive include:

Allied London
American Express
ARC Financial
Association of British Credit Unions Ltd (ABCUL)
Association of Corporate Treasurers
Association of Payment and Clearing Services (APACS) whose members are:

- Abbey
- ABN Amro
- Alliance and Leicester
- Bank of America
- Bank of England
- Bank of Scotland
- The Bank of Tokyo-Mitsubishi
- Barclays
- Capital One
- Citigroup
- Cooperative
- DnB NOR
- Deutsche Bank
- Egg
- GE
- HSBC
- HFC
- JP Morgan
- LloydsTSB
- MBNA
- Morgan Stanley
- National Australia Group
- Nationwide
- Northern Bank
- Northern Rock
- Royal Mail
- RBS
- Standard Chartered
- Wachovia

Banking Code Standards Board
Bank Machine
Bank of England

Barclays
BPSL
British Bankers Association
British Chambers of Commerce
Building Societies Association
Calypso
Cardpoint
Cash4all
Cashbox ATM
CBI
CHAPS
Cheque and Credit Clearing Ltd
Chequepoint
Citigroup
Cooperative Bank
Department for International Development
Department of Trade and Industry
Eiger Systems
Electronic Money Association
Federation of Small Businesses
Fexco
Financial Ombudsman Service (FOS)
Financial Services Authority (FSA)
First Data
Fujitsu UK
Halcrow PLC
Hanco
HM Revenue and Customs
HSBC
IBM
InfoCash
JP Morgan
LINK
Lloyds TSB
MasterCard
Mobile Broadband Group
Moneygram
National Consumer Council
Northern Ireland Banker's Association
Office of Fair Trading
Omnicash
Orange
Osborne Clarke

O2
Paypoint
Royal Bank of Scotland Group
Scott-Tod
Securicor
Shell
Small money transfer companies
Three
T-Mobile
Travelex
TRM
UK Money Transmitters Association
Visa
Vodafone
Which?
Western Union

Cabinet Office Code of Practice on Written Consultations

C.1 The Cabinet Office has published a Code of Practice for Written Consultations to guide Department's activities in this area which sets down the following criteria:

- Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy
- Be clear about what the proposals are, who may be affected, what questions are being asked, and the timescale for responses
- Ensure the consultation is clear, concise and widely accessible
- Give feedback regarding the responses received and how the consultation process influenced the policy
- Monitor the department's effectiveness at consultation, including through the use of a designated consultation coordinator
- Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

C.2 If you feel that this consultation does not fulfil these criteria, please contact:

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Confidentiality Disclosures

C.3 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily) the Freedom of Information Act 2000 (FOIA), the Data Protection Act (DPA) and the Environmental Information Regulations 2004). If you want the information that you provide to be treated as confidential, please be aware that, under the FOIS, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality will be maintained in all circumstances.

C.4 An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department. The Department will process your personal data in accordance with the DPA, and in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.

Freedom of Information Contact

4.19 Any Freedom of Information Act queries should be directed to:

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