Title: Implementation of the EU Payment Services Directive II **IA No:** **RPC Reference No:** RPC16-HMT-3462(2) **Lead department or agency:** HM Treasury **Other departments or agencies:** Financial Conduct Authority, Payment Systems Regulator, Trading Standards.	**Impact Assessment (IA)** **Date:** 23/02/2017 **Stage:** Consultation **Source of intervention:** EU **Type of measure:** Secondary legislation **Contact for enquiries**: PSD2consultation@HMTreasury.gsi.gov.u

Summary: Intervention and Options

RPC Opinion: Green

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2014 prices)	**In scope of One-In, Three-Out (OI3O)?**	**Business Impact Target Status**
			No	NQRP

What is the problem under consideration? Why is government intervention necessary?

The original Payment Services Directive (2007/64/EC) (PSDI), which came in to force in 2007, will be replaced by the Payment Services Directive II (PSDII), which will contain the bulk of the PSDI substance with modifications. These will increase competition in the payments market, leading to new services and lower costs for payment transactions across Europe. As with other EU financial services legislation, PSDII will be implemented in the UK through secondary legislation.

What are the policy objectives and the intended effects?

PSDII aims to streamline and further integrate payment services across the EU. The Government's policy intention is to achieve compliance with the PSDII while continuing to protect customers in line with innovations in the market and minimising the impact on UK industry in terms of their costs. The PSDII will lead to a more competitive payments market, including by bringing new payment services into the scope of the PSDI and creating a level playing field, leading to a downward convergence of costs and prices for payment users.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The Government has considered three options:

Option 1 – Copy out the PSDII's requirements into UK legislation while making use of the flexibilities used through the original implementation of the PSDI.

Option 2 – Copy out the PSDII's requirements into UK legislation, without amendment.

Option 3 – Do nothing. In practice, it will not be possible to do nothing as the PSDII places legal obligations on the UK.

Option 1 is the preferred option, as it will achieve compliance with the PSDII and enhance competition in the payments market, while minimising the cost to UK industry and consumers by providing greater certainty and continuity.

Will the policy be reviewed? Yes, in the UK and by the European Commission. **If applicable, set review date:** Within 5 years of the legislation coming into force and by January 2021, respectively.

Does implementation go beyond minimum EU requirements?			Yes		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** n/a	**Non-traded:** n/a	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: Date: 01/03/17

Summary: Analysis & Evidence Policy Option 1

Description: Copy out the PSDII's requirements into UK Legislation, without amendment

FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year 2018	Time Period Years 10	Net Benefit (Present Value (PV)) (£0m)		
			Low:	High:	Best Estimate:

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised costs by 'main affected groups'

Key affected groups are current payment service providers (PSPs: 277 UK banks and building societies, 96 e-money institutions, 367 authorised payment institutions; 729 registered small payment institutions), new payment service providers brought into regulation (an estimated 80 – 130), and retailers. The Government will seek further evidence during consultation to provide a fuller picture of monetised costs in the final stage impact assessment.

Other key non-monetised costs by 'main affected groups'

New payments firms will be brought into scope of the regulations through a narrowing of existing exemptions and the regulation of two new payment services; this will require them to become authorised or registered with the FCA and to meet the obligations of PSD2, including relevant prudential and conduct requirements. Additional burdens will fall on existing and new PSPs as a result of new conduct requirements, including around security and dispute resolution, and for PSPs providing accounts due to requirements for them to provide access to firms providing third party services to users. Retailers are expected to bear some additional costs from a ban on surcharging on most cards.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

The benefits of PSD2 are likely to be realised principally by firms wishing to expand their services or enter the payments market for the first time, consumers and retailers. The Government will seek further evidence during consultation to provide a fuller picture of monetised benefits in the final stage IA.

Other key non-monetised benefits by 'main affected groups'

The PSD2 is expected to lead to new business model opportunities for firms wishing to provide new Account Information or Payment Initiation Services. Consumers will benefit from additional conduct requirements, including around security and disput resolution, from being able to use innovative new services, and from the ban on surcharging for certain cards. Retailers will benefit from lower transaction costs for accepting payments stemming from new services and a more competitive payments market.

Key assumptions/sensitivities/risks	**Discount rate (%)**	3.5

Some estimates drawn from the European Commission's impact assessment have been scaled to provide a cost/benefit for the UK market. As implementation is expected to encourage innovation and competition, the number of new firms that could enter the market is uncertain.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			Score for business impact target £m (qualifying regulatory provisions only)
Costs:	Benefits:	Net:	

Summary: Analysis & Evidence

Policy Option 2

Description: Maintain the existing regulatory framework and UK structures, minimising any adjustments required to implement the PSDII

FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year 2018	Time Period Years 10	Net Benefit (Present Value (PV)) (£0m)		
			Low:	**High:**	**Best Estimate:**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised costs by 'main affected groups'

In addition to the costs in option 1, key affected groups will include credit unions (approx. 500), who would need to adhere to the requirements in PSDII for the first time and small payment institutions (729), who would need to be authorised, rather than registered, and adhere to additional requirements in the PSDII. The Government will seek further evidence during consultation to provide a fuller picture of monetised costs in the final stage impact assessment.

Other key non-monetised costs by 'main affected groups'

In addition to the costs outlined in option 1, other affected groups will include

- microenterprises – loss of consumer-like protections when conducting transactions; and
- payment service providers issuing low-value payment instruments – administrative costs from additional information requirements.

Consumers could see a reduction in the breadth of products available and an increase in the cost of some existing, particularly niche, products. Where credit unions are no longer able to provide basic financial services, financially excluded and/or low-income consumers are likely to be particularly affected.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

Other key non-monetised benefits by 'main affected groups'

Firms providing payment services to microenterprises may benefit from a small reduction in administrative costs. Consumers may benefit from some additional protection when using small payment institutions or credit unions as payment service providers, or when using low-value payment instruments.

Key assumptions/sensitivities/risks | **Discount rate (%)** | 3.5

Some estimates drawn from the European Commission's impact assessment have been scaled to provide a cost/benefit for the UK market. As implementation is expected to encourage innovation and competition, the number of new firms that could enter the market is uncertain.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			Score for business impact target £m (qualifying regulatory provisions only)
Costs: 4	**Benefits:**	**Net:**	

Evidence Base

Background to intervention

1. The revised Payment Services Directive (2015/2366/EU) (PSDII) was published in the Official Journal of the European Union on 23 December 2015. The Directive entered into force on 12 January 2016 and Member States are required to transpose the Directive into national law by 13 January 2018. The Directive will replace the first Payment Services Directive (PSDI), which came in to force in 2007. The PSDII will contain the bulk of the PSDI substance, with modifications intended to further enhance competition in payment services across the EU.

2. Facilitating payments within the EU by harmonising the relevant legal provisions has been a priority for the European Commission. In 1997, a Directive on consumer protection rules for cross-border credit transfers (Directive 97/5/EC) was agreed. In 2001, the EU implemented Regulation 2560 on cross-border payments in Euro in order to reduce the cost of cross-border Euro payments to the same level as that of domestic Euro payments. This was intended to provide industry with an incentive to build the payments infrastructure necessary for the creation of a Single Euro Payments Area (SEPA).

3. Through a consultation in 2003, the European Commission identified 21 potential barriers to the development of SEPA and published, in 2005, their proposal for a new Directive, the PSDI. The European Commission subsequently conducted analysis on how to further enhance payments services across the single market, and proposed the PSDII on 24 July 2013.

Problem under consideration

4. The goal of PSDI was to improve the competitiveness of the EU by integrating national payments markets and to support the creation of a single market for retail payment services. The PSDI was expected to improve economies of scale and competition, which would increase efficiency and reduce the total cost of payments in the EU. To achieve this, the Directive had three main objectives:

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

5. Payment services cover a broad range of activities, including:
   - the execution of payment transactions (such as credit transfers, direct debits, or use of a payment card); money remittance;
   - the issuance of a payment instruments (such as a debit or credit card); and
   - the acquiring of payment transactions (receiving payment instructions on behalf of a payer/payee).

6. The PSDI sets out the rights and obligations of providing and using payment services, principally:
   - transparency requirements, i.e. the information that must be provided to a user making a transaction;and

- other consumer protections, such as the maximum execution times for a transaction; the refund rights for a user; and the liability between users and firms providing payment services if a transaction is incorrect or fraudulent.

7. The PSDI set out the 6 types of institutions, known as payment service providers (PSPs), that must be authorised and must adhere to the requirements of the Directive when providing payment services:
   - credit institutions;
   - electronic money (e-money) institutions;
   - post office giro institutions;
   - the ECB and national central banks when not acting in their capacity as monetary authority or other public authorities;
   - Member States or their regional or local authorities when not acting in their capacity as public authorities; and
   - payment institutions.

8. This last category, payment institutions, was established by the PSDI as a new authorisation regime for non-bank payment service providers. This allowed such institutions to provide payment services across the EU on the basis of authorisation obtained in any one EU Member State (commonly known as passporting).

9. Firms are required to meet the Financial Conduct Authority's (FCA)'s minimum standards for authorisation. This requires a firm to demonstrate that it is suitable for the regulated activities it seeks to conduct. Authorised payment institutions are required to meet obligations such as an ongoing minimum capital requirement, an obligation to protect certain funds held for the execution of a payment transaction, and an obligation to notify the FCA of any intention to outsource operational functions or to passport its payment services.

10. However, a number of shortcomings in the PSDI have been identified since its implementation. These stem particularly from limits to the scope of the PSDI and due to technological and market developments, such as the emergence of new electronic and mobile payments.

11. This has led to legal uncertainty, potential security risks in the payment chain and to a lack of consumer protection. This is the case, for example, for transactions that start or finish in a country outside the European Economic Area (EEA) which are out of scope of the PSDI, or for online-banking based Payment Initiation Services (PIS) provided by third parties which do not currently have to be authorised to provide payment services.

12. Some of the exempted and therefore unregulated service providers are now competing with the regulated players, resulting in an un-level playing field and gaps in consumer protection.

Rationale for intervention

13. The Government is required to transpose the PSDII into UK law from 13 January 2018 to meet its treaty obligations and avoid the risk of facing legal proceedings as a result of infraction. The UK has little discretion in relation to this. The purpose of providing draft secondary legislation is to provide stakeholders with the chance to comment on the drafting and raise any technical concerns they may have.

14. The Government is seeking to introduce legislation in the UK in 2017 to allow businesses and the financial sector to make the necessary adjustments in order to comply with the Directive's provisions.

Policy objective

15. The policy objective in implementation is to achieve compliance with the PSDII, obtaining the benefits of the Directive, while preserving key aspects of existing UK practice so as to minimise the impact on UK industry in terms of their costs and competitiveness.

16. **The PSDII is a maximum harmonising Directive. This means that Member States cannot go beyond, or reduce, the requirements set out in the Directive, expect where flexibility is explicitly provided for.**

17. Where the same flexibilities from the PSDI are still available in the PSDII and the original policy rational still stands, the approach is to continue to use them in the same way in order to provide certainty and consistency in the market and minimise adjustment costs for industry.

18. In the UK, the new PSDII obligations around open access for AISPs and PISPs are closely aligned with the Government's vision for enhanced competition in the retail banking market through the delivery of an Open Banking Standard.

19. In 2015, HM Treasury asked industry to look at how an Open Banking Standard could be delivered. The Open Banking Working Group published their report in January 2016. Following this, as part of its retail banking market investigation, the Competition and Markets Authority (CMA) will require the nine biggest UK current account providers to adopt and maintain common Open Banking API standards through which they will share data with other providers and third parties.

Description of options considered

The Government has considered three options:

Option 1 – Seek to maintain the existing regulatory framework, minimising any adjustments required to implement the PSDII

20. The first option employs copy-out wherever possible, but tailors the approach to the UK market where necessary. To achieve this, the flexibilities used in the PSDI that are still available in the PSDII will be carried across and implemented in the same way.

Option 2 – Copy out the PSDII's requirements into UK legislation, without amendment

21. The second option would revoke the Payment Services Regulations, which implement the PSDI, and copy out the PSDII into new regulations, without amendment. While this would avoid potential gold-plating, it would not reflect the UK's existing use of flexibilities granted to Member States under the PSDI.

22. The UK would no longer take advantage of exemptions for a number of firms, including small payment institutions and credit unions, or exclusions for low value payment

instruments. This would significantly increase the compliance burden on affected firms. The UK would also be removing the additional consumer-like protection for microenterprises that is currently in place.

Option 3 – Do nothing

23. In our assessment of options 1 and 2, we have taken the hypothetical 'do nothing' scenario to be the counterfactual. In practice it will not be possible to do nothing as the PSDII places legal obligations on the UK.

Direct costs and benefits to business calculations (one-in, three-out)

24. As this measure involves the implementation of an EU Directive, and does not add to existing costs on business other than in areas where this is required by the Directive, it is out of scope for the purposes of one in, three-out (OITO). The Government will take advantage of the most relevant exemptions to limit additional regulatory burdens on UK business.

Overview of the changes in the PSDII

25. The Directive is divided into six titles, which focus on different aspects of the Directive subject-matter. Title I (Articles 1 - 4) sets out the scope, Title II (Articles 5 - 37) relates to the provisions around authorisation requirements and competent authority supervisory rules for payment service providers, Title III (Articles 38 - 60) addresses transparency and information requirements for payment services, Title IV (Articles 61 - 103) deals with the rights and obligations in relation to the provision and use of payment services, Title V (Articles 104 – 106) concerns Delegated Acts and Regulatory Technical Standards and Title VI (Articles 107 – 117) sets out transitional provisions.

26. The provisions that have changed from PSDI can be split into two categories – those which are maximum harmonising and which the Government has limited scope to deviate from, and the aspects of the Directive that offer the Government flexibilty to choose how it implements the provisions.

27. In the maximum harmonising areas, the PSDII makes three broad types of changes to the PSDI. The UK cannot go beyond, or reduce, these requirements. The PSDII:

- extends the scope of the Directive by narrowing the exclusion of particular business models, bringing additional firms into the regulatory perimeter for the first time.

- provides for additional consumer protections in a number of areas, imposing additional requirements on regulated firms, including through an extention to the scope regarding the currency and location of transactions bringing additional transaction types into regulation, and an increase in security requirements for most transactions; and

- introduces entirely new "open access" or "open banking" provisions, designed to allow third party firms to provide services to users by accessing the data and payment functionality of their online payment account (e.g. current account; credit card account; e-money account). To achieve this, PSDII extends the scope of regulated activity to include two new types of payment services, bringing firms providing these services into the regulatory perimeter for the first time, while also

imposing new obligations on existing firms providing online payment accounts to facilitate the necessary access.

28. In terms of flexibilities, the PSDII carries over from PSDI the majority of the explicit flexibilities that were afforded to Member States, which include options to exclude particular types of firms and to implement a lighter-touch regulatory regime for small firms.

29. Further details of each of the changes that the PSDII makes from PSDI in the maximum harmonising areas, as well as a list of the flexibilities that are available, is provided below.

Maximum harmonising provisions – changes from PSDI

Extension of scope – currency and location of transactions

30. Under PSDI, only transactions conducted in Euros or the currencies of other Member States of the EU were in scope. Under PSDII, so-called one-leg transactions (i.e. transactions where only one end of the transaction starts of finishes in the EU) and transactions in the EU that are in non-EU currencies are now within scope.

31. All firms engaging in these transactions are expected to need to update their systems and processes in order to deliver the transparency and consumer protection requirements set out in the PSDII. Such firms will already be authorised to provide intra-EU transactions, and so no new firms are expected to be brought into regulation by this change.

Extension of scope – change to exclusions

32. In the PSDII, four exemptions from PSDI (commercial agents, limited network, telecom and independent ATMs) will be updated.

Commercial agent exemption

33. The exemption for commercial agents will be narrowed to only exempt agents which act on behalf of either the payer or the payee via an agreement to negotiate or conclude the sale or purchase of goods or services and not to exempt agents who act for both sides of a payment transaction.

34. This will have an impact on a number of “marketplace” platforms, which act on behalf of both the buyer and seller, i.e. concentrate on management of financial flows between buyers (typically consumers) and sellers on a professional basis. Affected firms would need to be authorised (or registered) as payment institutions for the first time, bear the associated compliance costs, and make changes to their internal systems and processes to ensure they are meeting the requirements of the PSDII.

Limited network exemption

35. Under PSDI, payment services based on a payment instrument that can only be used in a limited way (such as a store card) were exempt. This exclusion has now been narrowed slightly, with tighter language regarding the limited range of goods and services that can be bought with an instrument and still allow the payment service to qualify for the exemption.

36. This may mean that some instruments that would have previously been excluded through use of this exemption will now be within scope of PSDII. Where this is the case, the firm will either need to be authorised (or registered) for the first time, , outsource the service, or reduce or eliminate the service.

37. The use of the limited network exemption will now also impose an obligation on firms to report to the regulator where transactions utilising this exemption exceed €1 million within a 12 month period. This is expected to generate small additional administration costs for a wide range of firms that issue payment instruments for use within a limited network, such as store cards, fuel cards, public transport cards, or vouchers for specific services.

Electronic communication network providers

38. A revised exemption for payments made through electronic communication networks means that only digital content or voice-based services provided via an electronic device as an ancillary service and charged to the related telecoms bill are excluded, along with specific services related to charitable giving or the purchase of tickets. These exemptions are aimed at micro-payments with a low risk profile and would be limited to €50 per transaction and a total of €300 per month.

39. Mobile network operators and fixed line operators are expected to need to either be authorised (or registered) for the first time, or to need to make the necessary investments in their systems to ensure that they can track the €50 and €300 thresholds so that they are not breached by users.

Extension of transparency requirements to independent ATMs

40. Independent ATM operators will be subject to new obligations to provide customers with information on withdrawal charges prior to the transaction and on the customer's receipt.

<u>'Open access' provisions - Account access for third parties</u>

41. The PSDII introduces entirely new "open access" or "open banking" provisions which are designed to allow "third party" firms to provide services to users by accessing the data and payment functionality of their online payment account (e.g. current account; credit card account; e-money account).

42. The regulation of "third party" payment services for the first time under the PSDII recognises recent changes to the payments market where such services are becoming increasingly popular with payers and other end users.

43. As these activities are not currently regulated payment services there are only limited amounts of consumer protection in place (related to more general consumer and data protection legislation). Requiring that firms offering these services be registered or authorised, depending on the service being offered, and therefore meet certain security, risk management, transparency and other standards, will ensure that users are protected and treated fairly.

44. To achieve this, PSDII:

- extends the scope of regulated activity to include two new types of payment services, bringing firms providing these services into the regulatory perimeter for the first time; and
- imposes new obligations on existing firms providing online payment accounts to facilitate the necessary access.

Extension of scope – Account Information Services and Payment Initaition Services

45. The two new types of services will now be regulated as payment services under the PSDII are:
    - Account Information Services – at a customer's request, third parties will be able to obtain transaction information from the online payment accounts the customer holds.
    - Payment Initiation Services – at a customer's request, third parties will be able to trigger a payment operation that is normally available to a customer through their online payment account.

46. The types of activities which are expected to be classified as Account Information and/or Payment Initiation Services include:
    - dashboard services that show aggregated information drawn from a number of online payment accounts;
    - income and expenditure analysis, including affordability and credit rating or credit worthiness assessments performed on data drawn from an online payment account; and
    - expenditure analysis that alerts users to consequences of particular actions, such as breaching their overdraft limit.

47. Where firms wishing to engage in these activities have not already been providing payment services, they will need to become authorised (or registered) for the first time. All firms then providing these new services will need to adhere to the requirements of the PSDII.

Additional obligations – providing access to firms wishing to offer Account Information or Payment Initiation Services

48. Regulated payment service providers providing payment account services online must give other authorised firms wishing to provide the new Account Information or Payment Initiation Services access to their customers' online payment accounts in order to provide their services to the user.

49. Payment accounts include:
    - current accounts;
    - credit card accounts;
    - instant access savings accounts; and
    - e-money accounts.

50. As such, the regulated payment services providers providing payment accounts online are expected to include the majority of credit institutions and a subset of e-money institutions and payment institutions.

51. These 'account servicing payment service providers' (ASPSPs) will be required to ensure their systems provide non-discriminatory access to third parties and will need to develop online authentication and communication procedures that are consistent with

regulatory technical standards to be drawn up by the European Banking Authority (EBA).

Additional consumer protections

Banning surcharging

52. Under the PSDII retailers will no longer be able to charge consumers to use payment instruments for which interchange fees are regulated under the Interchange Fee Regulation (IFR). This includes the majority of consumer debit and credit cards. Not all retailers currently surcharge and, where they do, the Consumer Rights (Payment Surcharges) Regulations 2012 limits this to the cost borne to the retailer when making the transaction.

Dispute resolution

53. All PSPs will have to adhere to the new maximum processing time for the resolution of customer complaints of 15 days. PSPs should have existing dispute resolution systems in place in order to be able to deliver this, but there will be some adjustment and ongoing administrative costs for some PSPs if they are required to speed up their existing processes.

Increased security and reporting requirements

54. PSPs must adopt specific security requirements to protect the confidentiality and integrity of the users' personalised security credentials, including 'strong customer authentication' using two-factor authentication for electronic transactions and dynamic linking for remote electronic transactions for certain transactions. These will have a substantive impact both internally (in setting up the appropriate compliance functions and operations) and also in a firm's user experience.

55. We expect that many already regulated PSPs will already have in place formal security policies and procedures to assess security risks and processes for the internal reporting of security incidents as part of their existing compliance and information security functions. Under the PSDII, there will be more specific requirements on what these will need to look like, which may require regulated PSPs to assess their current procedures and potentially introduce amendments to their business processes.

Member State flexibilities

56. As the PSDII is a maximum harmonising directive, flexibility for Member States to deviate from the requirements in implementation is limited to particular provisions, which have all been carried over from PSDI.

57. The flexibilities that the UK has utilised in the PSDI that will be available in the PSDII are set out below, followed by the flexibilities that were not used but remain available.

Flexibilities exercised under the PSDI and carried over to the PSDII

Continued use of the flexibility to exempt particular firms, including credit unions (article 2)

58. The continued use of this flexibility would exempt the following institutions, meaning that their treatment is the same under PSDII as it was under PSDI:

- Crown Agents Bank is now regulated as a credit institution;
- The Agricultural Mortgage Corporation Limited and Scottish Agricultural Securities Corporation Limited do not undertake payment services in scope of the Directive;
- The Commonwealth Development Finance Company Limited was dissolved in 1994;
- It would not be appropriate to apply the provisions to the National Savings Bank, including National Savings and Investments, but it should comply with the conduct of business provisions to products that are in scope of the Directive on a voluntary basis;
- The Directive would impose a disproportionate regulatory burden on the municipal bank and credit union sector.

59. The use of this flexibility would avoid constraining the ability of credit unions to offer payment services to their members, while maintaining the redress protection that members are currently afforded through the Financial Ombudsman Service (FOS). As this would maintain the current arrangements, there would be no cost or benefit impacts of this in option 1. Further analysis of this option is provided below as part of option 2.

Continued use of the flexibility to exempt small payment institutions from authorisation (article 32)

60. This option would continue the use of the flexibility where small payment institutions (SPIs) have the option to take advantage of the exemption from the prudential requirements (licensing conditions, minimum capital and client money safeguarding) and register rather than obtain authorisation from the FCA. This applies to firms that:

- are legal or natural persons;
- execute less than €3 million worth of payment transactions a month;
- do not wish to sell, or "passport" their services in other EU Member States; and
- can prove that none of the persons responsible for managing the business has been convicted of offences relating to money laundering or terrorist financing or other financial crimes.

61. This lighter regime, with lower administrative costs, is designed to ensure that a proportionate regulatory regime is in place for small firms that means they are able to compete with larger firms, or to offer niche services. Firms benefiting from the exemption must still adhere to the conduct of business requirements, ensuring there is adequate consumer protection in place.

62. As this would maintain the current arrangements, there would be no cost or benefit impacts of this in option 1. Further information on the costs and benefits of ending use of the flexibility is provided as part of option 2.

Continued use of the flexibility to provide additional protections for micro-enterprises (articles 38 and 61)

63. This option would maintain the approach used in implementing the PSDI where the provisions on transparency and information requirements are applied to micro-

enterprises using payment services in the same way as they are to consumers, ensuring that they continue to receive similar levels of protection.

64. Micro-enterprises are defined in Commission Recommendations 2003/361/EC as businesses that have a turnover of less than €2 million per year and nine or fewer employees.

65. Were the use of this derogation not to be carried over to PSDII, some payment service providers could agree with micro-enterprises that certain types of information will not be provided. This would risk micro-enterprises being charged for information provision by their payment service providers, a factor that might restrict their use of certain payment methods. The Government therefore proposes to maintain the information provisions as compulsory where the payment service user is a micro-enterprise.

Continued use of the flexibility to reduce requirements for low-value payment instruments and e-money (articles 42 and 63)

66. This option would continue the approach used in implementing the PSDI where providers of low-value payment instruments need only provide users with information on the main characteristics of the payment service, ensuring that requirements for these instruments are proportionate when making low value payments.

67. The flexibility can be exercised if such instruments are used as part of a framework contract and:
    - are used to make individual transactions not exceeding €30; or
    - have a spending limit of €150; or
    - have stored funds which do not exceed €150 at any time.

68. Under this option the Government would also make use of the flexibility, as under PSDI, which doubles the €30 and €150 threshold to €60 and €300, and increases the limit for prepaid instruments to a stored value of €500 (for intra-UK transactions only, which is all that the option allows).

69. As this would maintain the current arrangements, there would be no cost or benefit impacts of this in option 1. Further information on the costs and benefits of ending use of the flexibility is provided as part of option 2.

User's liability for unauthorised use of payment instruments (*article 74)*

70. Under the PSDI the UK applies a lower maximum liability for users of £50, rather than the default €150. The maximum is now falling under the PSDII to €50 (using the average exchange rate for 2015, equivalent to £36.5), with flexibility for Member States to reduce the liability faced by payers who have been grossly negligent but not fraudulent.

71. The Government proposes to maintain the maximum liability at the new rate set by PSDII, to be implemented as £35 for greater practicality, rather than reduce it further. In any event, the majority of payment service providers are understood not to impose a liability in cases of gross negligence and as such the impact of this change is expected to be negligible. As this reflects current UK practice, the Government estimates that there will be no impact on firms as a result of this change.

<u>Flexibilities not exercised under the PSDI and carried over to the PSDII</u>

Key flexibilities that the UK has not utilised in implementing the PSDI that are available in the PSDII include (further discussion on this can be found in Option 1 below):

Surcharging (article 62)

72. The UK does not currently use the flexibility to prohibit retailers from charging customers to process the transaction. The PSDII will now introduce a default prohibition for payment instruments regulated under Chapter II of the Interchange Fee Regulation (this covers most retail debit and credit cards) and continues to allow Member States to prohibit surcharging on other payment instruments if they wish.

Termination of framework contracts (article 55)

73. Article 55 sets out the terms under which payment service users and providers may terminate contracts. Member States may provide more favourable provisions for payment service users terminating a framework contract with their service provider. The term “favourable provisions” is quite broad, and could potentially be used to allow, for example, users to give only give one day’s notice when terminating a contract, or a customer to terminate a one-year framework contract before the year elapses without incurring charges.

74. Such provisions, although benefitting consumers, would be likely to increase costs for the firms providing the payment service. As framework contracts are believed to be functioning adequately, to prescribe further conditions might confuse the legal landscape for both providers and users, and encourage passporting providers to deploy different pricing strategies in different EU Member States. The Government therefore believes that this is an area which should be left to competition between providers.

Information for the payer and payee (articles 57 and 58)

75. Information for the payer and payee (articles 57 and 58) – Member States may require that PSPs provide information on their transactions to payers and payees at least once a month, on paper or on another durable medium.

76. Currently, as with termination, the Government believes that this is an area which should be left to competition between providers rather than be subject to impose further legal requirements, but is seeking further feedback through the consultation document.

Approach to analysis of costs and benefits

77. On 23 June 2016, the EU referendum took place and the people of the United Kingdom voted to leave the European Union. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period the Government will continue to negotiate, implement and apply EU legislation. The outcome of these negotiations will determine what arrangements apply in relation to EU legislation in future once the UK has left the EU. The assumptions used in this impact assessment have been chosen accordingly.

78. The sections below look at the costs and benefits of these changes to UK payment service providers and consumers. As option 1 uses copy out where possible, while option 2 uses copy out through-out, there is some overlap in the analyses set out below.

79. In practice, it will not be possible to ‘do nothing’ (option 3). However, in our assessment of costs and benefits for options 1 and 2 we have taken the hypothetical ‘do nothing’ scenario to be the counterfactual. As this would leave the PSDI in place as it currently stands, the costs and benefits of options 1 and 2 therefore relate to the additional costs and benefits in moving from the PSDI to the PSDII with the approach set out in each option.

80. **The PSDII is a maximum harmonising Directive. This means that Member States cannot go beyond, or reduce, the requirements set out in the Directive, expect where flexibility is explicitly provided for. Given this, there have been a very limited number of publically available analyses performed on all aspects of the PSDII, and which therefore means there is limited quantitative data on which to draw.**

81. The monetised and non-monetised costs and benefits highlighted in this impact assessment have been drawn from a variety of sources, including:
    - the European Commission’s impact assessment on the PSDII;
    - discussion and engagement workshops with affected firms and industry trade bodies (including Payments UK, the Electronic Money Association, the Association of UK Payment Institutions, and the Association of Foreign Exchange and Payment Companies);
    - discussion with and analysis performed by the regulators (the FCA, Payment Systems Regulator, Trading Standards and Competition and Markets Authority).

82. There have been a limited number of impact assessments carried out on all aspects of PSDII, however, the most notable is the European Commission’s impact assessment which was published in 2013 and was developed to inform the provisions of PSDII. A number of the assessments contained within it are drawn on below.

83. The Commission’s impact assessment is based on two external studies assessing the economic and legal consequences of the implementation of the PSDI. The first provided a legal conformity assessment regarding the transposition of the PSDI in the 27 Member States. The second study analysed the impact of the PSDI and any possible areas for amendment or revision of the regulation.[1] The Commission also published a Green Paper “Towards an integrated European market for card, internet and mobile payments” in January 2012 which was followed by a public consultation.[2] Input was also gathered from Member States and industry through relevant retail payments related Commission advisory committees.

84. The Commission provided a qualitative assessment of their preferred policy options against a baseline of no revision to PSDI and looking at other policy options. The various studies and stakeholder feedback identified a range of problems in the EU payment markets, identifying market failures and regulatory and supervisory gaps, and analysed the rationale and potential implications of intervention at EU level.

85. Although we have included quantitative estimates and indications of monetised costs and benefits where we have relevant data, these will need to be developed and expanded wherever possible in the final stage impact assessment, using the information we receive from consultation respondents.

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[1] London Economics and iff in association with PaySys Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community (February 2013).

[2] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0941:FIN:EN:PDF

86. The Government is seeking further data from stakeholders to test the assumptions in this draft impact assessment and to inform the final impact assessment and final implementing regulations.

Risks and assumptions

87. The main risk is in the uncertainty of the analysis due to lack of data and quantitative estimates. As noted above, the analysis will be developed where possible based on information received from further discussions with stakeholders and consultation respondents.

88. The Commission impact assessment has a number of limitations when considering how useful it is in determining costs and benefits for the UK:
    - given it was produced to inform the initial draft of the PSDII it only covers a portion of the changes that were included in the final PSDII text and may not be aligned exactly with the final provisions;
    - it typically draws from data (such as the number of firms affected) from a limited number of Member States and extrapolates this for the wider EU and this underlying data or extrapolated data may not be representative of the underlying situation in the UK;
    - it typically provides expected one-off costs to firms rather than ongoing costs.

89. However, we consider it helpful to provide the Commission's estimates for context. These have been scaled, where possible and appropriate, to indicate the UK's likely share of the EU-wide estimate and converted into pounds sterling (based on an average GBP-EUR exchange rate for 2015 of 0.82). The methodology for doing this varies depending on the provision, but includes:
    - scaling by the UK share of EU nominal GDP, estimated to be 17.6% based on Eurostat data; [3]
    - scaling by the UK share of the (EU) payments market considered in the Commission's analysis, estimated as the likely number of affected UK payment service providers as a proportion of the Commission's assumption of the number of affected payment service providers.

[3] The UK's % of EU GDP calculated using current prices from Eurostat GDP data - http://ec.europa.eu/eurostat/data/database

Option 1 – Seek to maintain the existing regulatory framework, minimising any adjustments required to implement the PSDII

90. Option 1 is the preferred option. It employs copy-out wherever possible, but tailors the approach to the UK market where necessary by carrying across the use of flexibilities from the PSDI that are still available in the PSDII. Option 1 does not use any new flexibilities.

Monetised and non-monetised costs of option 1

<u>Member State flexibilities</u>

91. Under option 1 the use of flexibilities in the PSDII will remain the same as in the PSDI. This is in line with the policy objective to achieve compliance with the PSDII, whilst continuing to minimise the impact on UK industry. The Government expects that there will be no impact on firms, consumers, or regulators in maintaining the existing use of flexibilities.

<u>Maximum harmonising provisions</u>

Firms

92. There will be four main impacts on costs to firms of the new provisions in the PSDII (and over which the government has no discretion to go further, or reduce the requirements):

    - *New firms being brought into regulation* – the extension of scope of the PSDII through the narrowing of some exemptions, and the introduction of two new types of payment services will bring additional firms into regulation for the first time. Such firms will need to become authorised (or registered) and then meet the ongoing requirements of the PSDII.

    - *Additional requirements for all existing and new payment service providers* – PSDII introduces a number of new requirements that payment services providers will have to adhere to, including bringing one-leg transactions into regulation; higher security standards; additional regulatory reporting requirements; and minimum response times to complaints.

    - *Additional requirements for payment service providers providing payment accounts* – PSDII introduces requirements for providers of payment accounts to allow access to other PSPs wishing to offer new Account Informaiton and Payment Initiation Services.

    - *Additional requirements for non-payment services providers* – where firms make use of an exemption from the PSDII, in some cases there are now tracking and reporting requirements. In addition, the ban on surcharging will affect a wide range of retailers.

93. There are 1,469 PSPs currently operating in the UK presently, made up of 277 credit institutions (banks and building societies), 96 e-money institutions and 367 authorised and 729 registered small payment institutions. The impact of the PSDII on their administrative and compliance burden will depend on their business models.

94. The Government estimates that the number of PSPs could increase by at least 80 to 130 firms. However, this number is highly uncertain as it depends on how firms adjust to the changes brought in by the PSDII, and does not include estimates for the number of new firms for areas where there is a high degree of uncertainty.

95. Particular uncertainty exists around:
   - how firms adjust their business models in response to the narrowing of exemptions in order to stay outside the regulatory perimeter; and
   - whether firms choose to enter the payments market (and therefore be regulated) in order to offer the new Account Information and Payment Initiaiton Services which the Directive makes possible.

Payment Service Provider	Current number of PSPs	Expected number of PSPs
Credit institutions (banks and building societies)	277	
E-money institutions	96	
Authorised payment institutions	367	
Small payment institutions	729	
Commercial agents		50 – 100
Limited networks		Uncertain
Electronic communication networks		0
Account information service providers		20
Payment initiation service providers		10
Total	**1,469**	**80 - 130**

New payment service providers brought into regulation

96. For the estimate 80 to 130 firms that may be brought into regulation for the first time, each firm would be required to assess their current service offering and make any necessary changes and conditions to ensure they are able to meet the requirements of PSDII. Where firms are brought into regulation for the first time, they would face the following costs:

   - One-off implementation costs, including:
     - initial familiarisation process;
     - one-off application fee to become an authorised or registered payment institution or e-money institution by the FCA:
       - small payment institution - £500;
       - small e-money institution - £1,000;
       - authorised payment institution or e-money institution – between £1,500 - £5,000 depending on the type of payment service the firm intends to carry out;
     - system changes to meet the obligations of PSDII, for instance, technical modifications;
     - updates to customers regarding any changes to their terms and conditions.

   - Ongoing costs, including:
     - annual fee to the FCA that varies depending on whether they are registered or fully authorised (where it then also scales depending on their size):
       - small payment institutions – fixed fee of£433;
       - small e-money institutions – fixed fee of £1,084;

- authorised payment institutions pay on the basis of relevant income: a minimum fee of £433 up to £100,000 of income, then £433 + £0.1647 per £100,000. The latest FCA figures indicate that the average annual fee for authorised payment institutions is between £4,694 - £141,813, depending on the size of the firm;
- authorised e-money institutions pay on the basis of average outstanding e-money: £1,626 up to £5 million of average outstanding e-money and above that £1,626 + £120 per £m[4] –

o compliance costs of prudential requirements, including costs of raising and maintaining own funds, and the costs of safeguarding client funds (typically achieved by holding them in a separate account at a credit institution);
o compliance costs of conduct requirements, including providing appropriate information to payment users and adhering to minimum transaction processing times;
o regular and ad hoc reporting requirements, including the detection and classification of major operational and security incidents;
o operational costs, such as maintenance of systems.

97. Some firms may seek assistance from compliancy firms in order to manage and mitigate some of the processes and costs above. The table below sets out some indicative quantitative estimates, based on data provided by the FCA, related to the total cost of the one-off authorisation process if conducted with the support of a compliance firm (excluding the cost of firm specific system changes and updates to customers):

Type of firm	Authorisation (with compliancy firm support)
Small payment institution	£2,000 - £10,000
Payment institution	£12,000 - £15,000
Small e-money institution	£15,000
E-money institution	£15,000- £18,000

98. In relation to the safeguarding of client funds (typically achieved by holding them in a separate account at a credit institution), the PSDI impact assessment estimated that the one-off costs to payment institutions for installing new software to disaggregate payments of different thresholds was £40,000 to £200,000 per firm, with ongoing technical and maintenance costs ranging from £35,000 to £85,000 per firm per annum, dependent on the size of the firm. For the purposes of this impact assessment, the Government considers this to be a good indication of the cost that firms may incur as a result of system change requirements, though costs may have changed reflecting technological developments, market developments, and inflation.

99. Further details on each of the areas where new firms may be brought into regulation for the first time are set out below. All firms brought into regulation are expected to bear some or all of the costs set out above.

Commercial agent exemption – marketplace platforms

100. Firms that may be brought into scope by the narrowing of the commercial agent exemption are expected to be marketplace platforms, typically online, as they work on behalf of both buyers and sellers. For example, firms with a similar business model to

[4] https://www.handbook.fca.org.uk/handbook/FEES/4/Annex11.html

eBay, Amazon Marketplace or AirBnB. Whether they now fall into regulation will depend on the particular circumstances of each firm.

101. The Commission's impact assessment concluded that, in the majority of cases, agents would most likely be large commercial platforms handling large volumes of transactions each month and would most likely be of strong financial standing, and would likely be able to obtain a payment institution licence. Whilst the number of large e-commerce platforms in each Member State varies, the Commission assumed that between two and five exist in each. PwC analysis on the sharing economy indicates that Europe has the potential to build on its position as a major global marketplace for the sharing economy.[5]

102. Initial FCA estimates indicate that, in the UK, the number of firms that would be brought into the scope of PSDII as a result of the change to this exemption could be between 50 to 100 firms, which is considerably larger than the Commission's estimate. We believe this is a more accurate estimate, as it reflects the UK's position as a sharing economy hub in Europe and the range of platforms that may be brought into regulation.

103. Many of the larger cross-border marketplace platforms are expected to already have put in place the necessary changes to their business models and contract terms in order to comply with the more stringent requirements already in place in other European countries, such as Germany.

Limited network exemption – Firms providing store and membership cards

104. The narrowing of the limited network exemption is expected to bring some firms providing store or membership cards into regulation for the first time. The impact of this change is difficult to quantify as firms currently using the exemption are outside of the regulatory perimeter, and as such there is little data available. Firms which continue to use the exemption and exceed particular thresholds (€1 million of transactions within a 12 month period) will now need to make annual reports to the FCA.

105. The Commission impact assessment estimated that 156 - 284 new firms in Europe, exempted under PSDI, might require a license. For reference the Commission's estimated cost impact for all these firms across the EU for the limited network exemption was between €57.95 million - €103.50 million. A method of calculation can be found in the annex.

106. For the purpose of the calculations, the Commission assumed that the number of firms currently using this exemption was the same as the number of currently licensed payment institutions. It was also assumed that 50% to 70% of these firms would still be exempted under the PSDII as an exempted entity or be subject to lower requirements through as a small payment institution.

107. The FCA do not expect that a large number of firms that are currently exempt would be required to be authorised. Given the broad assumptions utilised by the Commission and uncertainty about their applicability to the UK market ,we do not currently consider it possible to estimate with confidence the number of firms likely to be brought into regulation by the narrowing of this exemption. Further estimates may be possible based on information received from firms in response to the consultation.

[5] http://www.pwc.co.uk/issues/megatrends/collisions/sharingeconomy/outlook-for-the-sharing-economy-in-the-uk-2016.html

108. The FCA estimates that around 200 firms would continue to take advantage of the limited network exemption and that, under the new requirements, would need to notify the FCA on reaching certain thresholds (€1 million of transactions within a 12 month period). The FCA expect that firms will be required to complete a form containing the information specified in the Regulations. However, firms that are notifying for the first time may incur additional costs as result of required system changes and additional resource to provide the information required by the FCA.

Electronic communication network exemption

109. The narrowing of the electronic communication network exemption means that providers of services through such networks, that were previously exempt from the PSDI, must now either become authorised (or registered), or adhere to requirements of the revised exemption, including new monthly thresholds. These firms include mobile network operators (MNOs), mobile virtual network operators (MVNOs), and fixed line operators.

110. Firms that wish to use the exclusions would have to determine how they put in place a per transaction limit of €50 and monthly limit of €300. Depending on the nature of the existing billing systems at a firm the cost to make such changes may vary significantly and, as such, are difficult to estimate. We are encouraging firms to provide information on costs and impacts in relation to this provision in responding to the consultation document.

111.
The European Commission impact assessment assumed that most European MNOs would be interested in acquiring a payment institution license, where mobile payments form a core part of an MNO's business strategy.

112. Initial discussions with MNOs in the UK have not indicated that they would seek authorisation, but that they would instead adjust their business models to continue to take advantage of the exemption. The Government is seeking to gather further data through the consultation process in order to be able to assess what impact system changes or adjusting business models may have on MNO and fixed line operators.

Independent ATM providers

113. Independent ATM operators will be subject to new obligations to provide customers with information on withdrawal charges prior to the transaction and on the customer's receipt. In the UK, there are currently 10 independent ATM operators. The majority of independent ATM deployer operated cash machines, which in 2015 was 38,923 (55% of the total number of cash machines) according to Payments UK, are already meeting these requirements through their adherence to the scheme rules for the UK's largest ATM network, LINK, and additional costs are therefore expected to be negligible.[6]

Expansion of scope to include third parties providing Account Information and Payment Initiation Services

114. Two new types of services will now be regulated as payment services under the PSDII:

- Account Information Services (AIS) – at a customer's request, third parties will be able to obtain transaction information from the online payment accounts the customer holds.

[6] http://www.link.co.uk/media/1227/uk-cash-cash-machines-2016-summary.pdf

- Payment Initiation Services (PIS) – at a customer's request, third parties will be able to trigger a payment operation that is normally available to a customer through their online payment account.

115. The types of activities which are expected to be classified as Account Information and/or Payment Initiation Services and therefore the types of firms that will be affected include:
- dashboard services that show aggregated information drawn from a number of online payment accounts;
- income and expenditure analysis, including affordability and credit rating or credit worthiness assessments performed on data drawn from an online payment account; and
- expenditure analysis that alerts users to consequences of particular actions, such as breaching their overdraft limit.

116. As firms currently providing these types of services are unregulated and the provisions are expected to lead to new entrants into the market, it is currently difficult to estimate how many firms will be affected. It is estimated that there are currently under 10 AIS in operation and under five PIS in operation in the UK, based on trade body membership[7].

117. We do not anticipate the number of firms seeking authorisation under the PSDII to initially be much higher than these indicative numbers of current providers, particularly as we expect a significant number of firms wishing to offer AIS and PIS will already be providing other payment services and therefore already regulated. However, over time this figure is expected to rise markedly as firms develop their business offering and as the sector develops.

118. A PwC study on the PSDII, conducted in the first quarter of 2016, suggests that 88% of consumers across the EU use third party providers for online payments, which suggests that, although they are not common in the UK, this is an aspect of digital banking service that will see significant growth in the future.[8]

119. The European Commission's impact assessment identified a number of existing market participants in a number of European countries, including the established presence in Germany and the Netherlands. The European Commission's impact assessment found that a large majority of the 20 third party firms already operating in the market in eight Member States would ask for a license to comply with the rights obligations under the PSDII, which accords with discussions with potential third party firms in the UK. A Finextra white paper on the impact of the PSDI also found that there was appetite among third parties for them to be given legal certainty and so it is expected that new players are likely to seek to enter the market.[9]

120. A conservative estimate is that the market may double in size from its current point (based on trade body membership, noted above), suggesting that there could be at least 20 AIS and 10 PIS in operation. As already noted, we expect the number of firms providing these services overall to be much higher, but that many will already be regulated as they currently provide other payment services.

121. Where firms wishing to engage in these activities have not already been providing payment services, they will need to become authorised (or registered) for the first time.

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[7] http://fdata.org.uk/our-members/

[8] https://www.finextra.com/finextra-downloads/newsdocs/catalyst-or-threat.pdf

[9] https://www.ingwb.com/media/1609662/preparing-for-psd2_vroegh.pdf

All firms then providing these new services will need to adhere to the requirements of the PSDII. In addition, firms providing PIS will need to hold professional indemnity insurance or a comparable guarantee against their potential liabilities.

Additional requirements for new and existing PSPs

122. The provisions of the Directive set out below will effect all existing and new PSPs – an estimated 1,549 – 1,599 institutions, though this may be higher as there are areas where it has not been possible to quantify the number of institutions that are expected to be brought into regulation. A breakdown of the type of institutions is provided above.

One-leg and non-EU currency transactions

123. One-leg transactions and non-EU currency transactions taking place within the EU will now be in scope, requiring firms to meet the conduct requirements of the PSDII when providing these transactions as payment services. These requirements include:

- transparency requirements, i.e. the information that must be provided to a user making a transaction;and
- consumer protections, such as the maximum execution times for a transaction; the refund rights for a user; and the liability between users and firms providing payment services if a transaction is incorrect.

124. The cost of implementation is not expected to be high as firms already have the necessary technical solutions and procedures in place related to intra-EU currencies. PSPs would not be expected to accept responsibility for parts of a transaction that remain outside their control and there would be no need to change the procedures that are already in place for such elements of transactions.

125. The Commission's impact assessment identified the only cost to firms as preparing and changing the information for consumers on their new rights and better protection upon extension. The impact assessment estimates that this could lead to costs in the region of €1.3 million to €2.8 million for all PSPs in the EU. A method of calculation can be found in the annex. Assuming that UK firms' share of this cost is approximately equal to its share of EU GDP (estimated to be 17.6%), or its share of the EU PSP market (estimated to be 17%, based on an expectation of 1,599 PSPs in the UK in the future and a Commission estimate of 9,400 PSPs across the EU) the cost to UK PSPs could be between £0.2 million - £0.4 million.

126. We believe that there are likely to be some additional system change costs that PSPs must incur, and so the Commission's figures are likely to be underestimates. Data is not available to quantify the cost of these system changes, however, for the reasons noted above, they are not expected to be significant.

Increased security requirements

127. The PSDII requires PSPs to adhere to tighter security standards for electronic transactions, including so-called Strong Customer Authentication (also known as two-factor authentication). Precise requirements regarding these standards, including exemptions, will be set out by the European Banking Authority in Regulatory Technical Standards.

128. A majority of credit institutions (a maximum estimate of 277) are thought to already be utilising this approach and so are expected to have minimal adjustment costs.

However, this may require other non-credit institution PSPs to change their business processes regarding customer authentication for payment transactions. Given a lack of information regarding PSPs current approaches and data on the cost of any system changes, if any, as well as the dependency of these on the Technical Standards, it is not currently possible to provide a quantitative estimate of the cost of these changes.

Additional reporting requirements

129. All PSPs would be required to comply with additional regular and ad hoc reporting requirements set out in the PSDII, further to those already required by the PSDI. PSPs will be required to establish and maintain effective incident management procedures, including for the detection and classification of major operational and security incidents. They would also need to report to the competent authority on their security risk assessment and notify them of any major incidents without delay.

130. There are a range of new requirements for PSPs to regularly report to the FCA and submit notifications in the event of incidents to both regulators and customers. This includes incident reporting, assessments of operational and security risk mitigation measures, annual reporting of statistical data on fraud. Depending on the size and extent of changes, and whether the changes can be incorporated into existing reporting, and given the EBA are still developing some of the exact requirements in their regulatory technical standards, the costs are not possible to quantify and the associated costs may vary considerably.

131. The Government assumes that many already regulated PSPs under PSDI will have in place formal security policies and procedures to assess security risks and processes for the internal reporting of security incidents, but firms may be required to introduce amendments to their business processes. For instance, in relation to fraud reporting, according to the FCA, many bank PSPs already collect data to feed in to industry-wide statistical reporting for UK banks and so we would expect firms to onward report some of this data.

Dispute resolution

132. All PSPs will have to adhere to the new maximum processing time for the resolution of customer complaints of 15 days (or where further time is required, within 35 days). PSPs should have existing dispute resolution systems in place in order to be able to deliver this, but there will be some adjustment and ongoing administrative costs for some PSPs.

133. Firms currently handle complaints under FCA dispute resolution (DISP) rule time limits (8 weeks) and will need to make changes to reflect the new processing times. Expected costs are likely to include:

- Retraining of complaint handling staff and additional staff if necessary to increase response times;
- System changes to differentiate between payment services and other complaints;
- Cost associated with changing complaint communications and customer’s terms and conditions.

134. The Government is seeking further information and data from firms in order to be able to assess the expected costs they are likely to incur as a result of the significant change to complaint handling times.

Additional requirements for PSPs providing payment accounts

135. Regulated payment service providers providing payment account services online must give other authorised firms wishing to provide the new Account Information or Payment Initiation Services access to their customers' online payment accounts in order to provide their services to the user.

136. Payment accounts include:
- current accounts;
- credit card accounts;
- instant access savings accounts; and
- e-money accounts.

137. As such, the regulated payment services providers providing payment accounts online are expected to include credit institutions, e-money institutions and a subset of payment institutions – at least 373 firms.

138. These ‘account servicing payment service providers’ (ASPSPs) will be required to ensure their systems provide non-discriminatory access to third parties and will need to develop online authentication and communication procedures that are consistent with regulatory technical standards to be drawn up by the European Banking Authority (EBA).

139. The additional costs involved are likely to vary depending on the complexity of a firm’s business offer (i.e. the range of payment accounts available) and the complexity of its existing IT systems. There is insufficient data to provide quantitative estimates of these costs.

140. Some of these costs are likely be reduced by coordinated development of an Open Banking API Standard, which the Competition and Markets Authority (CMA) has now required nine banks across Great Britain and Northern Ireland – working with other ASPSPs and current and potential “third party” providers – to deliver, and would meet these requirements. The CMA make clear that this API Standard will need to align with the PSDII, requiring banks to deliver it by January 2018 when the PSDII comes into effect.

Retailers

Ban on surcharging

141. Under the PSDII retailers will no longer be able to charge consumers to use payment instruments for which interchange fees are regulated under the Interchange Fee Regulation (IFR). This includes the majority of consumer debit and credit cards. Not all retailers currently surcharge and, where they do, the Consumer Rights (Payment Surcharges) Regulations 2012 limits this to the cost borne to the retailer when making the transaction.

142. Merchants that currently surcharge would be expected to see a direct effect of a reduction in revenues as a result of not being able to benefit from surcharging in order to recover the costs of accepting card payments. Consumers could equally see a benefit through no longer having to pay surcharges when making card payments.

143. However, merchants may decide to offset this by increasing prices, or by changing the mix of payment instruments they encourage or accept. For example, they could promote the use of cash. How merchants respond in such a situation will depend on the state of competition of the sector in which they operate and whether the surcharge reflected the costs faced by merchants when accepting a card payment or was at least in part a source of profit for merchants.

144. A study undertaken by London Economics and iff, across nine EU countries, including the UK, which informed the Commission's impact assessment, suggested an initial total cost of surcharging – borne by consumers – of at least €731 million annually EU wide. [10] The aggregate value does not indicate how much relates to 'true' surcharging, when merchants recover the costs of specific payment instruments and pass on these savings to consumers through retail prices, and how much corresponds to extra revenues from retailers (illegally) surcharging over the costs of payment instruments and/or not passing on the savings generated to consumers through retail prices. Disaggregated data by country was not provided and it is not therefore possible to assess robustly the UK's portion of this cost assessment.

145. The Consumer Rights (Payment Surcharges) Regulations were introduced in 2015, which now ban excessive payment surcharges being charged to consumers, while allowing retailers to recover the fees directly charged to businesses for taking payments from consumers. The regulations do not prevent retailers from applying payment surcharges but the amount is required to be limited to the fees directly charged to a business as a result of the consumer using a particular method of payment.

146. Based on market research carried out by the HM Treasury in 2011, cited by the Department for Business, Innovation and Skills (BIS) in their consultation stage impact assessment on the ban on above cost payment surcharges published in September 2012, the total value of card payment surcharges (both at cost and above cost) in the UK in 2010 for debit and credit cards was estimated to be £473 million across a range of sectors.[11]

147. In their impact assessment, BIS estimated that the direct one-off costs of a ban on payment surcharges would be borne by the merchants that impose payment surcharges. No direct costs on card networks, acquirers or payment service providers were identified. The direct costs to merchants would include making system changes to disaggregate their pricing by identifying and removing payment surcharges.

148. The impact assessment assumed that merchants would likely compensate the lost revenues and profits from payment surcharge revenue likely through a change in their pricing structures such as a rise in headline prices, or through other non payment-related charges, such as administration fees, delivery charges, or optional extras.

149. The impact assessment also identified that merchants already make frequent systems changes and so any changes to prices could be incorporated in to routine price updates, systems upgrades and maintenance and so the one-off cost of this to firms was considered to be near zero.

150. The study showed that the largest monetary value of the surcharge were in the travel/hotel/hospitality sector in the UK, reflecting a relatively high surcharge rate and a high incidence of surcharging. The results also indicated that surcharging practices in

[10] http://ec.europa.eu/finance/payments/docs/framework/130724_study-impact-psd_en.pdf
[11] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32704/12-1009-consultation-ban-above-cost-payment-surcharges-impact.pdf

2012 were more predominant than in 2009 and found that 14% of merchants in the UK applied surcharges on credit cards. Evidence following a super-complaint received by the Office of Fair Trading in March 2011 confirmed excessive payment surcharging was high across the transport sector and estimated that consumers spent around £300 million on payment surcharges in 2010 in the airline sector alone.[12] The same report also noted that the evidence provided in the Which? super-complaint, as well as OFT survey evidence from 2007, indicated that surcharging outside travel markets is fairly limited.

151. A British Retail Consortium (BRC) 2015 payments survey identified a decline in the cost to retailers of handling credit and debit card transactions. They predict further cost reductions as the full impact of the Interchange Fee Regulation (IFR) takes effect as benefits of the reduction multilateral interchange fees are being passed on to merchants from acquirers, and in turn to customers.

152. The BRC's survey also highlights that the merchant service costs (which include interchange as a major element) accounted for more than 96% of the total costs incurred in the acceptance of any type of card by retailers. However, the survey also found that the costs for the handling of debit and credit card transactions, by retailers, had reduced by £159 million in 2015: For debit cards savings were circa £122 million and for credit cards savings were found to be circa £37 million.

153. Although it is not possible to provide a precise quantitative estimate of the direct or indirect cost to retailers of ceasing surcharging, based on the evidence presented in the BIS impact assessment it is expected that they will fully pass on the majority of the costs to consumers through higher prices, just as they would other routine costs of doing business. Furthermore, the BIS estimate of the total value of card payment surcharges of £473 million is now likely to be a significant over estimate of the direct cost to businesses of ceasng surcharging for a number of reasons:

- It included both at cost surcharging and above cost (now illegal) surcharging – the latter is now expected to have fallen as a result of firms adhering to the Consumer Rights (Payment Surcharges) Regulations;
- the cost to retailers of accepting cards is expected to have fallen, following the implementation of the Interchange Fee Regulation, which capped multilateral interchange fees and which the OFT estimated made up to 80% of the cost of overall merchant service charges.

Consumers

154. Costs to consumers may arise from changes to the prices and services offered by PSPs as a result of compliance with the regulations. While the exact nature of this is difficult to estimate, we do not expect a notable increase in prices or reduction in range of services on offer. The PSDII's provisions are largely in favour of the consumer and so any costs borne are expected to be indirect as a consequence of PSPs changing their business models or terms and conditions to comply with the Directive's provisions.

Wider Society

155. The UK's lead competent authority would continue be the FCA, with a limited role also expected for the Payment Systems Regulator, for Trading Standards and the CMA. We expect that there would be additional costs to each organisation in light of additional

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[12] http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.oft.gov.uk/shared_oft/super-complaints/OFT1349resp.pdf

supervisory responsibilities, with the majority of any increase falling on the FCA as the lead competent authority.

156. Additional costs to the FCA would arise in relation to an increase in the population of regulated firms due to narrower exemptions and new types of payment institutions (AISPs and PISPs), as well as additional reporting requirements for existing firms. The FCA is an independent regulator and will publish its own cost-benefit analysis as part of its consultation on guidance on its enforcement of the PSDII.

157. Trading Standards and CMA already have co-current roles in relation to the enforcement of the Consumer Rights (Payment Surcharges) Regulations 2012, as such the additional costs associated with cases related to the ban on certain forms of surcharging is expected to be minimal.

Monetised and non-monetised benefits of option 1

Member State flexibilities

158. The Government has not identified any wider benefits to firms as a result of mainting the flexibilities as under PSDI, as no changes in approach are proposed under the PSDII.

Maximum harmonising

Firms

PSPs – third parties providing Account Information and Payment Initiation Services

159. Third parties wishing to provide AIS and PIS to consumers will benefit from being able to access customers' online accounts on the terms set out by the PSDII in order to provide AIS and PIS. This will allow them to grow existing services and bring new business models to market more easily and at lower cost.

160. As the provisions are expected to lead to new entrants into the market, it is currently difficult to estimate how many firms will benefit. However, as noted above, interest from existing and potential third party firms, as well as growing use of third party services, suggests that this aspect of digital banking will see significant growth in the future, with a crude estimate that 30 new firms will enter the market in order to provide Account Information and Payment Initiation services.

Retailers

161. Retailers – principally those offering goods and services online – are likely to benefit from lower transaction costs arising from AIS and PIS providers contributing to increased competition and innovation that leads to new, cheaper payment methods.

162. The Commission's impact assessment assessed that opening access to information on the availability of funds and a consumer's payment account to AIS and PIS upon consent of the account holder, would result in a downward pressure on merchants' transaction costs as the result of increased competition from new entrants. This will vary depending on the extent of market entry and the relative market share gained by these new entrants and the current level of transaction costs in the Member State considered. The merchants with less negotiating power, including the smaller ones, are also

expected to benefit from additional payment solutions to meet their needs.The resulting decrease in their costs should be in part transferred to customers.

163. Based on the population of Member States and the percentage of the population making purchases on the internet on each Member State, the Commission's impact assessment calculates that on average almost 165 million Europeans made purchases on the internet in 2011 (this excludes data from the Czech Republic). More recent Eurostat data from 2015 showed that the UK had the highest proportion in the EU (81%) of individuals buying or ordering goods or services over the internet in the 12 months preceding December 2015.[13]

164. An independent study by RetailMeNot and the Centre for Retail Research[14] for 2016-17 shows that the European online market is dominated by the UK, Germany and France which together are responsible for 81.5% of European sales in eight European countries. The UK has the highest online market share of £60.04 billion (16.8%) forecast for 2016. Data from the UK Cards Association, shows that 21% of all retail spending is now online and that the average transaction value (ATV) online was £68.02 in 2015. Further analysis shows the ATV at UK e-retailers is much higher (£98.85) than those outside the UK (£25.17).

165. Latest Eurostat data shows that, in terms of amount spent, the highest proportion of individuals making purchases online (40%) bought goods or services for a total of €100 - €499.15 These estimates are expected to be conservative and do not reflect the UK demographic and spending trends in the future, which are likely to be higher still.

166. By extrapolating the fees applied for a transaction on the internet with a credit card or with a third party service provider in the Netherlands to the number of internet transactions in Europe, the Commission estimated that savings generated for retailers/businesses by the use of PIS instead of credit card could range from €863 million to a maximum of €3,520 million per annum. Based on an average expenditure per internet user in 19 Member States and the average amount of a transaction in an online shop of €110 in the Netherlands, the Commission estimated that in average an internet user makes around eight purchases on the internet per year. Further details on the Commission's method of calculation can be found in the annex.

167. The fees applied for a transaction on the internet with a credit card or with a third party service provider in the Netherlands were used as a benchmark, as the market was competitive for credit cards and the market for PIS is well developed. In the Netherlands, the fees for a transaction on the internet with a credit card range from €1.65 to €3 and the fees for a transaction on the Internet with the third party ranging from €0.35 to €1.

168. A rough indication of the potential benefits that might accrue to the UK can be calculated by assuming that the UK's share of the total EU benefits calculated by the Commission would be broadly proportional to its share of EU GDP (17.6%). This is essentially assuming that the UK has a similar fee structure for cards to the Netherlands and a proportion of internet transactions equal to its share of EU GDP. This would suggest a range of benefits of £110.5 million to £450 million per annum.

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[13] http://ec.europa.eu/eurostat/statistics-explained/index.php/E-commerce_statistics_for_individuals
[14] The study from RetailMeNot is based on data from government statistical sources and analysts, telephone interviews with 100 major retailers from all types of business (20%+ of national retail sales), and interviews with 1,000 consumers in each of the nine countries (9,000 in total).

169. The assumption regarding the similarity to the Netherlands card market is a reasonable approximation, given that both are competitive payments markets with high levels of online retail use with card payments. However, the use of the cost of credit card payments as the current baseline is likely to result in an overestimation of the benefits because:

- they are more expensive than debit card payments, which are more prevalent in the UK (53% versus 21% of purchase values as estimated by the British Retail Consortium in their 2015 payments survey);
- the cost of credit (and debit card) transactions has fallen over time, including since the Commission's impact assessment was published. While an exact equivalent estimate of the transaction fees is not available, one can be estimated based on the average transaction value for UK retailers (£98.85) and the average cost to handle a credit transaction reported by the British Retail Consortium (0.79% for credit in 2015). This produces an indicative transaction fee of £0.78 (€0.92 at an exchange rate of 0.85), which is significantly below the transaction fee range used by the Commission of €1.65 to €3.

170. That said, given the scale of use of e-retailers in the UK (noted above) and the higher average transaction value at UK e-retailers, which suggest that the UK share of the value of internet transactions is likely to be higher than its share of EU GDP, as well as interest from existing and potential third parties of providing AIS and PIS in the future (discussed above) it is possible that the UK will see benefits in the mid to upper end of the indicated range.

Consumers

171. Consumers will benefit from the expected expansion in AIS and PIS services available, along with the additional consumer protection that will stem from existing firms being authorised, including higher security and transparency requirements, refund rights, maximum liability for unauthorised payment transactions, and ban on surcharging for some payment instruments.

172. The obligation for the AISPs and PISPs to explicitly inform consumers about the information they access would come on top of the consumer protection provisions already required by the PSDII. Extending the rights and obligations of the PSDII to AISPs and PISPs and defining the management of liability between third parties, ASPSPs and consumers will provide a legal certainty for all parties, as well as payment users.

173. New AIS and PIS firms are expected to compete with established PSPs leading to increased competition across the payments market, though the implications for the range and cost of services is difficult to quantify.

174. Consumers will benefit from the higher security requirements for all electronic transactions, which includes two factor authentication, which is expected to reduce the opportunities for fraud. Detailed requirements will be set out by the EBA, with certain lower risk transactions likely to be exempted to maintain proportionality.

175. Consumers will benefit from additional consumer protection for the broader range of transactions which are now covered by the PSDII, including one-leg and non-EU currency transactions and purchases using some marketplace platforms. As with AIS and PIS services, this will include minimum security and transparency requirements, refund rights and clear maximum liability in the event of unauthorised payment

transactions.

176. The PSDII will ban surcharging for card payments in the vast majority of debit and credit cards – those for which the cap on interchange fees applies, which includes all retail Visa and MasterCard debit and credit cards. This will apply to domestic as well as cross-border payments. As discussed above, as retailers are expected to react to this by recouping the cost of receiving card payment transactions through other mechanisms, such as an increase in prices, consumers are likely to see just a portion of the surcharging amount passed through as savings.

Wider Society

177. We have not identified any benefits to wider society not already captured above.

Small and micro business assessment (SaMBA)

178. Option 1 will allow the UK to continue use the flexibility to exempt credit unions, to exempt small payment institutions from being authorised under the Directive and to maintain protection for microenterprises using payment services. As this continues the current treatment, there is no impact on costs or benefits to firms or consumers.

179. The small payment institution exemption can be used where a firm executes less than €3 million of transactions per month and none of the persons responsible for the management or operation of the business has been convicted of offences related to money laundering, terrorist financing, or other financial crimes.

180. Firms using the exemption must still be registered with the FCA and cannot benefit from passporting into other Member States. They can, however, choose to become authorised if they wish.

181. Microenterprises would continue to benefit from additional protections (compared to larger businesses) through treatment as consumers, with additional information provided to them as part of their transactions.

182. Beyond the exemption outlined above, and the exemption for credit unions, some of which may fall within the category of small businesses, the Directive does not provide Member States with any additional flexibility with regard to the application of the requirements to small and micro businesses.

Administrative burden

183. We have not identified any additional administrative burdens under option 1.

Wider Impacts

184. HM Treasury has not identified any wider impacts resulting from this proposal, including on our responsibilities under the Equalities Act 2010 and does not believe these measures will impact upon discrimination or other prohibited acts, equality of opportunity or good relation towards people who share relevant protected characteristics and others under the Act.

Option 2 – Copy out the PSDII's requirements into UK legislation, without amendment

185. Under option 2, the Government would revoke the Payment Services Regulations, which implement the PSDI, and copy out the PSDII into new regulations.

186. This would not reflect the UK's existing regulatory approach and use of flexibilities granted to Member States under the PSDI and that continue to be available in the PSDII:

- credit unions and municipal banks would no longer be exempt from the requirements of the PSDII and would need to be authorised, imposing large administrative costs as they engage with the regime for the first time;
- small payment institutions would need to be authorised, rather than just registered, imposing additional administrative costs as they introduce new prudential arrangements;
- microenterprises would no longer benefit from additional protections where transparency and information requirements are applied to their transactions;
- providers of low-value payment instruments would need to adhere to all the information requirements, rather than a reduced set.

187. This option would impose all the costs and benefits of option 1, as well as the costs and benefits of not using the flexibilities that were used in the PSDI and continue to be available in the PSDII. The analysis below therefore considers the additional costs and benefits over and above option 1.

Monetised and non-monetised costs of option 2

Maximum harmonising

188. As the PSDII is a maximum harmonising Directive, the Government's assessment of the costs to firms under Option 2 do not differ from those assessed under Option 1 above.

Member State flexibilities

Firms

<u>*Credit unions*</u>

189. In Q2 2016, the Bank of England estimated that there are 484 credit unions in the UK providing basic banking services, typically to the financially excluded.[16] The application of payment services requirements for the first time to these firms would impose a large cost as they would need to become authorised for the first time and then meet the ongoing obligations of the PSDII. Due to the limited resourcing and staffing of credit unions and their existing internal processes, credit unions would likely to have to undergo significant system changes and staff training/hiring.

190. .

[16] http://www.bankofengland.co.uk/pra/Pages/regulatorydata/cu/creditunionsstatistics/default.aspx

191. As set out during the implementation of the PSDI, these requirements could impose a disproportionate regulatory burden on the sector, which might result in the sector being unable to offer basic financial services to low income consumers. Indeed, this potentially large increase in operational costs could result in some firms having to withdraw products from the market, and others to cease operating altogether. As credit unions are already exempt from the prudential requirements of the Capital Requirement Regulations, it would be inconsistent not to exempt them from the Title II prudential requirements of the PSDII.

192. Credit unions could also struggle to comply with many aspects of the PSDII conduct of business rules in Titles III and IV, particularly those pertaining to execution times and value dating. Due to the limited resourcing and staffing of credit unions, payments are typically not processed on a daily basis. Credit unions also rely on weekly or monthly statements from banks, which set out the inward payments that have been made to the credit union's pooled account before monies are segregated among members. Credit union members are generally well aware of these delays, and continue to use this type of payment service for reasons other than fast payments processing.

193. Credit unions are already required to be registered under the FCA's Banking: Conduct of Business sourcebook. The Government expects that if brought into scope of the directive that credit unions would be treated like banks as they provide regulated activities, including deposit-taking, savings and lending. Credit unions would therefore not be expected to meet safeguarding and prudential requirements.

194. There is limited quantitative data available regarding the likely cost to credit unions of being brought into regulation (beyond the one off costs outlined in option 1 regarding initial FCA authorisation costs). We are seeking addditional data from the industry to contribute to quantitative estimates in the final impact assessment.

<u>Small payment institutions</u>

195. Under this option, SPIs would no longer be able to be registered with the FCA, and would have to be fully authorised. As a result, they would be subject to additional prudential requirements, including minimum capital requirements (starting at €50,000) and operational requirements, such as how they handle client funds.

196. SPIs are limited in scope and scale of their operations often offering niche services, which may struggle to upgrade their business to the level of an authorised payment institution. The additional prudential requirements are likely to result in an increase in administrative costs, which would make it harder for smaller firms to compete with larger firms and for the providers of niche services to stay in business.

197. There are currently 729 SPIs registered with the FCA. If firms did choose to become authorised as payment institutions, the Government expects these firms to incur the following costs:

- One-off costs – The FCA estimates that compliancy firm assistance costs for an SPI would range between £2,000 and £10,000. FCA authorisation fees for SPIs would be £500 (monthly average payment transactions <€3 million).

- Ongoing costs – Firms will be required to pay annual authorisation fees, reporting costs and system running costs. The latest FCA figures indicate that the average annual fee for authorised payment institutions is between £4,694 - £141,813. SPIs

would also be required to hold a safeguarding account and meet prudential requirements (licensing conditions, minimum capital and client money safeguarding), all of which would involve ongoing system costs.

198. An indicative quantitative estimate of the costs can be drawn from the benefits outlined in the PSDI impact assessment. This captured the benefits of the more light-touch small payments institution regime against full authorisation – which is what would result from this option. As such, the PSDI benefits can now be thought of as covering the costs of this option. This approach indicates that one-off costs for small payment institutions, related to authorisation fees and introduction of new systems, would be £121,560 per firm, or £88.6mn in total, while ongoing costs, including higher annual fees and ongoing cost of safeguarding and prudential requirements, would be £67,040 per firm, or £48.9mn in total.

199. A breakdown of the elements of this cost is not available which limits the ability to compare and update the costs for 2017. More generally, although there is limited quantitative data available to update these figures, we are seeking addditional data from the industry to contribute to quantitative estimates in the final impact assessment.

Micro-enterprises

200. Micro-enterprises (firms with a turnover of less than €2 million per year and nine or fewer employees) would no longer benefit from the conduct of business protections as payment service providers would not have to provide the same information as they would to a consumer as part of a transaction.

201. This could result in micro-enterprises being charged for information provision by their payment service providers, and which might restrict their use of certain payment methods. It has not been possible to quantify the costs associated with this.

Payment service providers issuing low-value payment instruments

202. Under this option, the Government would no longer exercise the flexibility providing for reduced requirements for information provision as part of a transaction with a low-value payment instrument. Providers of low-value payment instruments would now need to offer users additional information, which would increase the cost of providing these services. This additional information would include information on each transaction and information beyond the main characteristics of the payment instrument (such as the way in which the payment instrument can be used, liability, and charges levied).

203. Firms issuing these instruments, particularly e-money and pre-paid card firms, would have to absorb higher administrative costs and would find it harder to compete with firms offering higher-value payment instruments, although we have not been able to make quantitative estimates of this direct impact. Where the business model is affected by additional requirements, this could result in certain instruments being withdrawn entirely, indirectly affecting competition and innovation in the provision of, particularly low-value, payment instruments.

User liability for unauthorised use of payment instruments

204. The Government proposes to maintain the maximum liability at the new rate set by PSDII, to be implemented as £35 for greater practicality, rather than reduce it further. In any event, the majority of payment service providers are understood not to impose a

liability on consumers in cases of gross negligence and as such the impact of this change is expected to be negligible.

Consumers

205. The removal of these flexibilities is likely to result in a reduction in the breadth of products available to consumers and could increase the cost of some existing products. The availability of niche services previously provided by small payment institutions and of low-value payment instruments would be expected to decline and/or costs to consumers to increase.

206. Where credit unions are no longer able to provide basic financial services, financially excluded and/or low-income consumers are likely to be particularly affected.

Wider Society

207. There would be additional costs and resourcing implications for the lead competent authority, the FCA, stemming from the increase population of authorised firms.

Monetised and non-monetised benefits of option 1

Firms

208. Firms providing payment services to microenterprises would benefit from no longer having to adhere to the same information requirements as when providing services to consumers. This would be a small reduction in administrative costs, though it has not been possible to provide a quantitative estimate of this.

Consumers

209. Consumers may benefit from some additional protection when using small payment institutions or credit unions as payment service providers, or when using low-value payment instruments.

Wider Society

210. There are no further benefits to the wider society in applying option 2 compared to option 1.

Small and micro businesses assessment (SaMBA)

211. The withdrawal of the flexibilities used under PSDI is expected to impose large additional costs on small businesses, through the combination of:

- credit unions and municipal banks now being in scope of the requirements;
- additional administrative burdens for small payment institutions (firms conducting less that €3 million of payment transactions per month) that must now be authorised rather than registered and meet additional prudential requirements;
- microenterprises (firms with a turnover of less than €2 million per year and nine or fewer employees) no longer benefitting from additional information requirements.

212. In the case of credit unions, municipal banks and small payment institutions, firms are believed to have limited staffing and regulatory expertise and would not be expected

to be able to adjust easily to the change in requirements. As such, a significant number of these firms would be expected to be at risk of having to reduce their services or even being driven out of business as a result.

Wider impacts

213. HM Treasury has not identified any wider impacts resulting from this proposal, including on our responsibilities under the Equalities Act 2010 and does not believe these measures will impact upon discrimination or other prohibited acts, equality of opportunity or good relation towards people who share relevant protected characteristics and others under the Act.

Option 3 – Do nothing

214. In our assessment of options 1 and 2, we have taken the hypothetical ‘do nothing’ scenario to be the counterfactual. In practice it will not be possible to pursue option 3 and make no changes, as the PSDII places legal obligations on the UK.

Implementation plan

February – March 2017	Consultation on draft regulations
Q2 2017	Publish government response
Q2 2017	Lay implementing regulations
13 January 2018	Implementing regulations enter into force
13 January 2021	Commission’s proposed date for review

Summary

215. The Government’s preferred option is Option 1: seek to maintain the existing regulatory framework and UK structures, minimising any adjustments required to implement the PSDII.

216. Option 1 employs copy-out wherever possible, but tailors the approach to the UK market where necessary by maintaining the:

- Exclusion of particular institutions (article 2) – including credit unions and municipal banks, National Savings and Investment and crown agents for overseas governments and administrations.

- Exemption for small payment institutions (article 32) – firms below a threshold of €3 million need only be registered, rather than authorised.

- Additional protection for microenterprises (articles 38 and 61) – the provisions on transparency and information requirements are applied to microenterprises using payment services in the same way as to consumers.

- Exclusion for low-value payment instruments and e-money (articles 42 and 63) – providers of low-value payment instruments need only provide users with information on the main characteristics of the payment service.

217. This is in line with the policy objective to achieve compliance with the PSDII while continuing to protect customers in line with innovations in the market and minimising the impact on UK industry in terms of their costs and competitiveness.

218. The Government is consulting on these proposals. The Government aims to lay legislation in Q2 2017, ahead of the date at which the PSDII comes into force, in order to give firms time to make the necessary changes.

219. The Government expects to provide a final stage impact assessment alongside its final legislative proposals, which will include more details of the estimated costs of implementation.

Annex

Commercial agents – Marketplace platforms

220. The European Commission's calculation of the costs of the change to the commercial agent exemption is as follows:

The Commission estimated that between 26 - 70 platforms would need a payment institution license (€125.000) and the necessary own funds (assumption: funds are calculated using method B of the PSDI, the average payment volume (PV) of the payment services provided in the framework of commercial agent exemption is €120 million, which would put the value of commercial agent payment services to consumers at between 2 to 5% of the total estimated value of the EU B2C e-commerce in 2012).

For the administrative costs calculation, it was assumed that the preparation of the necessary documents would take one employee five business days of eight hours and includes the average cost of one hour of work of an employee in the financial services sector of €37.30 (Eurostat labour cost survey 2007). (The most recent labour cost survey from 2012 stated that average labour costs for financial and insurance activities amongst EU counties were €41.2.)

Limited network – Firms providing store and membership cards

221. The European Commission's calculation of the costs of the change to the limited network exemption is as follows:

The Commission estimated that 156 - 284 new firms in Europe, exempted under PSDI, might require a license. Calculation of own funds were based on method B of the PSDI. It was also assumed that 80% of new entities would have relatively small PVs, averaging €60 million annually and the remaining 20% would have much higher volumes, averaging €240 million annually.

The Commission's assessment also includes an average cost of one hour of work of an employee in the financial services sector of €37.30 (Eurostat labour cost survey 2007). (The most recent labour cost survey from 2012 stated that average labour costs for financial and insurance activities amongst EU counties were €41.2.)

One-leg and non-EU currency transactions

222. The European Commission's calculation of impact is as follows:

The cost of changing terms and conditions of PSPs was estimated on the basis that it would require one employee two hours to prepare the necessary documents and under the assumption that this would involve all credit institutions and licensed payment institutions, roughly 9,400 PSPs (an overestimation). The cost of one working hour in the financial sector, based on the labour cost Eurostat survey, is €37.30. (The most recent labour cost survey from 2012, stated that average labour costs for financial and insurance activities amongst EU counties were €41.2)

The information would also need to be delivered to PSUs. The Commission's impact assessment assumes that the distribution costs would be zero, as the information would normally accompany the account statements sent to payment service users or delivered electronically. The only additional cost would be for printing the information. It is assumed that the information would require one sheet of A4 paper for each consumer

account and that for 30% to 70% of the account owners the information will be delivered on paper.

Calculation of the cost of removing the small payment institution regime

223. The PSD impact assessment estimated the benefit of the use of the flexibility to offer reduced requirements for small payment institutions, with the assumption that there would be 2,500 such institutions. As the counter-factual in the PSD estimate was full authorisation, which is what would be imposed under option 2, these benefits can be used to estimate the costs under option 2.

224. The table below shows the PSD benefits per institution and the result if these amounts are then aggregated for the total number of actual small payment institutions.

£m	PSD aggregate benefit of SPI measure (2500 firms)	PSD per institution benefit	PSDII Small payment institution cost (729 firms)
One-off	303.9	0.12	88.6
Ongoing	167.6	0.07	48.9