Payments UK

The UK's exit from the EU:

How could payments be affected?

February 2017

Introduction – what does Brexit mean for payments?

The UK's exit from the EU or 'Brexit' will impact the UK and EU in many significant ways. This process will require the government and regulators to evaluate the extent to which EU legislation should be retained, amended or repealed in light of the UK's new status, whatever that may be.

Since the referendum in June 2016 a number of significant political developments have moved the conversation forward and we now know a little more about the UK government and EU27's possible assumptions and aims for the negotiations.

As the negotiations approach, it is important to consider the challenges specifically impacting the UK and EU payments sector as an enabler to the wider economy and to consider the medium and long-term implications of Brexit for the industry and customers.

An interconnected ecosystem

The payments industry is a networked and highly-regulated industry that has evolved significantly over time. It brings significant benefits to the UK and EU's customers and businesses. The industry involves an extensive number of players at a domestic, pan-European and global level to make up the interdependent and interconnected ecosystem.

Much of the financial regulation applicable to the payments industry in the UK today is derived from EU legislation, which is part of what makes our payments systems work so seamlessly for customers. This makes negotiating our exit from the EU particularly important from a payments perspective, to ensure that there is no detriment for customers or businesses, and the UK economy continues to operate smoothly.

At the same time, such consideration will need to take into account the unprecedented rate at which the payments landscape is also evolving, driven by a combination of regulatory developments, changing customer expectations, competition from innovative market entrants, technological advances and the need to combat the emergence of new fraud and cyber-security threats.

The purpose of this report is to explore some of the practical implications for payments arising from the UK's exit from the EU in terms of how the wider agreement reached between the UK and the EU27 may affect consumers, businesses and payment service providers (PSPs).

Four key areas

Against the background of likely future agreements, we highlight four key payments topics for consideration:

- The Payment Services Directive (PSD)
- Passporting
- The Single Euro Payments Area (SEPA)
- UK access to euro payment systems.

These topics are at the heart of our current payment arrangements, both domestically and across the EU; however, they are by no means the only payments policy areas impacted by Brexit. In this regard, this report forms only part of the activities to support and guide the industry through what is likely to be a lengthy and complex negotiation.

Any changes ultimately required in the UK and EU's payments industry as a result of the UK's exit from the EU will also need to be scheduled and prioritised into existing industry long-term strategic planning, and managed in such a way that puts customer interests and economic stability first and foremost.

What could a future relationship with the EU look like?

'We do not seek to adopt a model already enjoyed by other countries... so we do not seek membership of the single market. Instead we seek the greatest possible access to it through a new, comprehensive, bold and ambitious free trade agreement'

UK Prime Minister Theresa May's Speech, 17 January 2017

Before moving to payments specific elements, it is worth considering what our future relationship with the EU could look like. As the negotiations progress and the shape and status of the UK's future relationship with the EU becomes clearer, we will be better placed to consider what the specific impact on payments will be.

Based on Theresa May's speech on the 17 January 2017, the most likely scenario for our new relationship is a new market access regime. The UK Prime Minister has made clear that the greatest amount of mutual market access is the most likely and most desired outcome to stem from Brexit negotiations.

It is recognised by the UK and EU27 that when the UK leaves, we will already have a unique level of alignment in regulatory approaches with the EU, which is much greater than any other regulatory framework upon which previous trade agreements have been negotiated.

Mutual market access

The UK and the EU could plausibly conclude a bespoke agreement that delivers mutual market access.

This could rely on the mutual recognition of regulatory regimes which both builds on and goes beyond the existing equivalence regimes and could be embedded in a long-term, stable framework which can only be changed by formal agreement. The UK would maintain the same access for EU-based businesses and products as the EU would for the UK.

This could also cover transitional arrangements to allow for enough time to implement the new relationship.

There are three additional other widely-accepted potential models of relationship between the EU and non-Member States that are briefly explored below, along with the associated high level implications.

Alternative 1: Remaining in the European Economic Area (EEA)

The UK could leave the EU but remain in the European Economic Area (EEA). The EEA agreement permits countries to participate in and benefit from the EU's single market, but without all of the responsibilities and privileges attached to full EU membership.

In this scenario, the UK would have to agree to give effect to a number of EU laws and policies, including the single market, employment, consumer protection, environmental and competition laws. This would also include the UK being subject to the freedom of movement rules, in line with the other EEA countries.

Alternative 2: Re-joining the European Free Trade Area (EFTA)

One option would be for the UK to re-join the European Free Trade Area (EFTA) – but remain outside the EEA – and enter into a series of bilateral agreements that would govern the UK's relationship with the EU and also, separately, with the rest of the world.

EFTA comprises four Member States (Iceland, Liechtenstein, Norway and Switzerland), which act together to promote free trade and economic (as opposed to political) integration. The free trade agreements principally cover trade in goods, but EFTA has recently entered into agreements that cover services as well.

Alternative 3: Accessing the EU using World Trade Organisation (WTO) rules

If the UK does not join the EEA, EFTA or have an alternative system of free trade agreements in place, it would be in the default position of relying entirely on World Trade Organisation (WTO) rules for access to the EU.

Access to the EU would depend on bilateral agreements, with the WTO principles acting as the backstop. The UK would be entitled to trade in the EU on the basis of the WTO's principle of non-discrimination. Substantively, the WTO rules would not put the UK on the same footing that it currently enjoys with respect to the EU or those nations with which the EU has trade agreements.

What could Brexit mean for payments?

The rules and regulations for many aspects of the way we make and receive payments in the UK have been set by the EU, including how consumers manage their day-to-day transactions.

Although the majority of our payments tend to be conducted within the UK, growth of the EU single market, together with use of the internet and electronic payments, have made cross-border payments more common. Legislative developments such as the Cross-Border Payments Regulation and Payment Services Directive, coupled with the Single Euro Payments Area initiative, have encouraged a greater incidence of cross-border payments, as well as the establishment of pan-European payment systems, like STEP2. Cross-border payments are used by all customer segments and underpin UK-EU trade and wholesale market activity.

There is a chance that the UK's exit from the EU will allow UK policymakers to amend some of the rules that impact the payments industry. However, this depends heavily on the final agreement reached between the UK and the EU. Again, the UK Government has now made clear that the intention is for the UK's exit from the EU to be orderly and – where necessary – to be a phased process that best reflects the differing needs of the UK's various industries. The Prime Minister has also been clear on the importance of financial services to the economic well-being of the country and that we will be aiming for the freest possible trade in financial services between the UK and EU Member States.

UK access to euro payment systems

What euro payment systems are there?

There are a number of pan-European payment systems currently available to UK payment service providers (PSPs), These include retail euro systems like STEP2 and more wholesale systems like EURO1 and TARGET2. UK PSPs' ability to maintain or gain access to such systems will depend significantly on the eventual settlement between the UK and EU27 and the extent to which this may be reflected in amendments to those payment systems' admission or access criteria.

Although UK retail and corporate customers would continue to be able to send and receive euro-denominated transactions, the conditions may well be less favourable than today with higher fees and longer settlement times.

How could changes to access affect the industry?

Firms are unlikely to be able to use a non-connected UK PSP for euro clearing purposes, which would impact all PSPs and broker dealers that use UK banks for euro correspondent banking services, including non-bank PSPs such as payment institutions and electronic money institutions and, potentially, some non-bank financial institutions such as fund managers, investors and others. They may therefore need to consider alternatives, such as holding an account with a PSP in the EU.

The Payment Services Directive (PSD)

"It is clearly crucial that all firms understand that they must continue to abide by their obligations and continue with implementation plans for legislation due to come into effect, including PSD2."

HM Treasury, following the referendum result

What is the Payment Services Directive (PSD)?

The payment services directive, which came into force in 2009, is the primary piece of EU payments-related legislation, which establishes a European-wide legal framework for payment services. It is fundamental to how each one of us makes and receives electronic payments, and the protections that are in place should something go wrong.

Payment Services Directive 2 (PSD2) is the revised and updated directive, building on the original scope to bring legislative requirements up to date with technological developments in the payments industry. As well as applying to all EEA currency payments where the PSPs of both the payer and the payee are located within the EEA, PSD2 will apply to (i) non-EEA currency payments between EEA-domiciled PSPs; and (ii) one-leg transactions (where one of the PSPs is located outside of the EEA) in any currency.

PSD2 will also bring into scope two new types of payment service: payment initiation services (PIS) and account information services (AIS). These services represent a significant, European-wide shift in terms of the accessibility of customer data and payment accounts to third parties and are expected to encourage greater competition and the development of a whole host of value-added services for consumers and businesses.

PSD2 is very much in line with UK government aspirations and regulatory objectives around Open Banking, the growth of the FinTech sector and the use of application programming interfaces (APIs) as a way to enable customers to securely share their data with trusted third parties. Most recently this was called for by the Competition and Markets Authority as part of the follow-up to its market investigation into SME banking and personal current accounts.

Further detail on the rules and operational changes that PSD2 will bring can be found in our PSD2 report: www.paymentsuk.org.uk/reports

What could Brexit mean for PSD2?

The majority of the PSD2 provisions apply from 13 January 2018. The exception is certain requirements around strong customer authentication and secure communication which run to a longer timescale. With Article 50 being triggered in March 2017 and a two year negotiation period, this means PSD2 will be in place before the UK exits the EU.

Transactions that would currently be seen as intra-EEA payments in a currency of an EEA Member State may, post-exit, be treated as 'one-leg out' (OLO) payments (by the PSP in the EU). This means only some of the legal provisions and protections in PSD2 would apply, or could fall entirely outside the scope of the legislation.

Other aspects of PSD2, relating to cross-border activities, may also need to be considered in the context of the specifics of any withdrawal agreement. These relate to the exchange of information, notification and cooperation between home and host Member State competent authorities. However, other aspects also relate to ongoing regulatory convergence and, more generally, link heavily with the passporting regime in financial services.

Brexit could potentially have ramifications as to how payments (in sterling, euro and other currencies) will be treated and what rights and obligations customers and UK PSPs will have, both while the UK remains part of the EU and after the UK's exit.

The UK electronic payment schemes (Bacs Direct Debit and Direct Credit, Faster Payments and CHAPS) and their rules and procedures have been adapted to meet the requirements of PSD1 and other relevant legislation. While it seems unlikely that these rules would change overnight as a result of Brexit, it is possible that the domestic schemes could have greater freedom to define their rules in future.

There is general agreement in the industry that any changes should not diminish the levels of service and protections that UK customers currently enjoy.

The Single Euro Payments Area (SEPA)

"SEPA is a European Union (EU) integration initiative in the area of payments. With the introduction of the euro currency in 1999... EU governments, the European Parliament, the European Commission and the European Central Bank (ECB) have focused on the integration of the euro payments market."

European Payments Council, 2013

What is the Single Euro Payments Area (SEPA)?

SEPA is essentially an area in which consumers, businesses and other economic actors are able to make and receive payments in euro, within Europe, whether between or within national boundaries under the same basic conditions, rights and obligations, regardless of their location. For businesses and governmental organisations, this means improved efficiencies with common standards, faster settlement and simplified processing; it can also help facilitate access to new markets.

The European Payments Council (EPC), which is not part of the EU institutional framework, supports European payments integration through the development and management of the pan-European SEPA schemes. These schemes offer payment service users the assurance of common rules and maximum execution cycles. From a consumer perspective they support individuals working and studying abroad, those who have retired to another EU country or with second homes. For example, a euro account in the UK can receive a salary earned in Spain or be used to pay a recurring utility bill in France.

The SEPA schemes make it easier and cheaper for UK businesses to send and receive euro payments. In addition to applying common standards, businesses that operate on a pan-European basis are able to rationalise their cash management and card acceptance arrangements, generating processing efficiencies and facilitating access to new markets.

The success of SEPA is very important economically as well as politically, with numerous EU institutions underlining the importance of SEPA to complete euro monetary integration and to create an efficient payments market. It is a key foundation of the single market in the EU.

What could Brexit mean for the UK as part of SEPA?

Once the UK ceases to be a member of the EU, continued involvement in SEPA would depend significantly on the future UK-EU relationship model. The EPC will need to monitor the UK's continued compliance with the eligibility criteria for UK PSPs' participation in the SEPA schemes.

The EPC plays a role in defining the geographical scope of SEPA, which only covers euro payments but extends beyond the EU and EEA and also includes several third countries or territories.

A plausible SEPA-related implication of Brexit could be the UK possibly losing its automatic qualification to be part of the geographical scope of the area.

Further information about SEPA can be found on the Payments UK website: www.paymentsuk.org.uk/policy/european-developments/sepa-faqs

The provision of euro retail payment services to UK consumers and businesses could be impacted if PSPs in the UK and these other countries are unable to exchange SEPA payments. Use of alternative mechanisms is likely to make euro payments to and from the UK less efficient and more costly, with potential implications for the continued support for UK-EU trade.

This might mean that customers on both sides of the Channel could therefore lose the benefits that SEPA payments provide. It would also mean that a number of guarantees and certainties derived from the SEPA schemes and corresponding EU legislation may no longer apply (e.g. the charging protections under the Cross Border Payments Regulation), affecting payers and payees.

More information about the Cross Border Payments Regulation is available here: www.paymentsuk.org.uk/policy/european-developments/cross-border-payments-regulation

Passporting

What is passporting?

Subject to meeting the conditions set by the relevant single market directive, a firm authorised in an EU Member State is entitled to carry out permitted activities in any other EU Member State by either exercising the right of establishment (of a branch and/or agents) or providing cross-border services.

This applies to both the inward and outward provision of services. From a payments perspective the relevant single market directives are the capital requirements directive (CRD), which applies to credit institutions, PSD (and PSD2), which applies to payment institutions (and, in PSD2, to providers of account information and payment initiation services), and the second electronic money directive (EMD2), which applies to electronic money institutions.

What this means in practice is that passporting has enabled a number of innovative new players to enter the UK market as payment institutions and electronic money institutions, thereby increasing competition and choice for UK customers.

What could Brexit mean for passporting?

According to figures from the FCA, 359,953 passports have been issued, used by 13,484 firms, with 5,476 firms using 'outbound' passports issued by a UK competent authority to do business in one or more EU/EEA member states.

The passporting rights enshrined within CRD, PSD and EMD only apply within the EU/EEA. PSD and EMD do not provide for equivalent rights for 'third country' firms, i.e. firms incorporated outside the EU, as is the case in a select few other financial services regimes.

How could passporting changes affect the industry and UK customers?

In the absence of any mitigating steps, a non-EU firm could face a number of licensing regimes and, potentially, would be subject to a range of local requirements. Passporting rights have been a significant factor in attracting firms to the UK to take advantage of London's position as a global financial centre and for the pan-European access it has given to firms from outside Europe.

While firms incorporated outside Europe cannot benefit from passporting rights, their EU subsidiaries can. Such firms may now consider the possibility of relocating some or even all of their business and operations to another Member State.

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Other relevant European policy areas

In addition to the four key policy areas set out in this section, there are other relevant EU legislative developments which Payments UK is monitoring:

- The application of the money laundering directive (MLD) and funds transfer regulation (FTR) could potentially be affected by Brexit, with greater requirements for UK PSPs to provide more detailed information for cross border activities.
- The general data protection regulation (GDPR), due to come into force in 2018, harmonises data protection across the EU. Post-Brexit, the UK could take a different approach domestically – but firms would still need to comply if any personal data was sent cross-border between the EU and UK.
- The network and information systems (NIS) Directive (to be transposed by Member States in 2018) seeks to deliver EU-wide rules on cyber security. The extent of the impact in this country will depend on the UK's approach to implementation.
- The electronic identification and trust services directive (eIDAS), introduced in 2014, sets security standards for digital signatures and certificates. These will remain in force in the UK until Brexit is finalised, and need to be considered alongside the ongoing work on the PSD2 Regulatory Technical Standards on strong customer authentication and secure communication.

Summary

What happens next?

It is clear that the impact of the UK's exit from the EU on customers and on the payments industry will vary significantly, dependent on the possibly wide-reaching agreement between the EU27 and the UK.

It is also evident that there are a number of key possible impacts on payments which need to be considered in the UK and EU negotiations in a way that puts customer interests and economic stability first and foremost.

During the negotiation it needs to be recognised that there has been a revolution in the way we make payments across the EU over the past decade and this pace of change is only speeding up.

The payments landscape is evolving at an unprecedented rate, driven in no small part by a combination of regulatory developments, changing customer expectations, competition from innovative market entrants and technological advances.

Therefore, it is of the upmost importance that any changes ultimately required in the UK and EU's payments industry as a result of the UK's exit from the EU will also need to be scheduled and prioritised into existing industry long-term strategic planning, and managed in such a way which consider the medium and long-term implications of Brexit for customers and for the industry.

Going forward, it is vital that we maintain open communication between industry, government and regulators to ensure the best possible outcome for customers and the UK more generally.

Payments UK will continue to monitor developments and what they mean for all users of payment services and provide further updates in due course.

Acronyms

AIS
Account Information Services

CRD
Capital Requirements Directive

CBPR
Cross-Border Payments Regulation

EBA
European Banking Authority

ECB
European Central Bank

EEA
European Economic Area

EFTA
European Free Trade Area

EMD
Electronic Money Directive

EPC
European Payments Council

EU
European Union

EU27
The 27 Member States of the EU

FTR
Funds Transfer Regulation

GDPR
General Data Protection Regulation

MLD
Money Laundering Directive

PIS
Payment Initiation Services

PSD
Payment Services Directive

PSP
Payment Service Provider

SCT
SEPA Credit Transfer

SDD
SEPA Direct Debit

SEPA
Single Euro Payments Area

WTO
World Trade Organisation

Our experts

Elizabeth Fraser
Head of European Developments

Liz has led European Developments at Payments UK and its predecessors since 2006. Liz established the unit as a centre of expertise on European payments-related market and regulatory developments, conducting proactive research and analysis on payments industry issues. In particular Liz's work focuses on the Single Euro Payments Area (SEPA), the revised Payment Services Directive (PSD2) and the work of both the European Payments Council and Euro Retail Payments Board.

Liz manages Payments UK's two largest member committees (the European Payments Working Group and PSD Working Group) and represents the UK at European level on the European Banking Federation's Payment Systems Committee and Payments Regulatory Expert Group and the European Commission's EU Forum of National SEPA Co-ordination Committees.

David Song
European Developments Manager

David leads Payments UK's work on Brexit, having joined Payments UK's predecessor, the Payments Council, in 2013.

David focuses on representing Payments UK members by providing knowledge and expertise, developing policy and engaging externally with a wide network of stakeholders in relation to strategic UK and European developments. In particular David's work focuses on the Single Euro Payments Area (SEPA), the revised Payment Services Directive (PSD2) and a number of other EU legislative developments related to financial services and payments.

Once a quiet corner of the financial world, the payments industry is transforming like never before. Technological advances, new players to the market, fresh regulation coupled with UK customers' appetite for more convenient and improved services mean that change is inevitable and there is enormous potential for the UK payment markets to continue to lead the way.

Payments UK is the trade association launched in June 2015 to support the rapidly evolving payments industry. Payments UK brings its members and wider stakeholders together to make the UK's payment services better for customers and to ensure UK payment services remain world class.

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