UK/EU regulatory developments in payments, crypto-assets and buy-now-pay-later agreements

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Abstract

This article examines key recent developments in payment services regulation in the UK and EU. In addition to proposals to reform traditional payment services legislation, it also considers proposals to regulate crypto-assets when used as a means of payment and proposals to regulate buy-now-pay-later agreements, as these are increasingly offered by merchants as a means of payment. Both the UK and EU have proposed broader regulation of crypto-assets, but this article considers only those aspects of the proposals with the greatest relevance to payment services.

Keywords: PSD2, PSD3, PSRs, crypto-assets, BNPL, open banking, SEPA, safeguarding

INTRODUCTION

2023 is set to be a pivotal year for the regulation of UK and EU payments firms. The UK government is forging ahead with proposals to enhance consumer protections, and adapt the post-Brexit financial services regulatory framework with rules tailored to UK markets. Further afield, the EU remains focused on enhancing the scope and application of key payments legislation, including but not limited to the regulation of digital assets, the potential transition from PSD2 to PSD3, and instant payments in euro. This article examines key recent developments in payment services regulation in the UK and EU.

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In addition to proposals to reform traditional payment services legislation, it also considers proposals to regulate crypto-assets when used as a means of payment and proposals to regulate buy-now-pay-later (BNPL) agreements, which merchants are increasingly offering as a means of payment. Both the UK and EU have proposed broader regulation of crypto-assets, but this article considers only those aspects of the proposals that are likely to be most relevant to payment services.

UK PAYMENT SERVICES DEVELOPMENTS[1]

Currently, UK and EU payment services regulations are broadly aligned. The second Payment Services Directive 2015/2366/EU (PSD2) is the primary EU directive for the regulation of payment services. PSD2 came into force before the UK's exit from the European Union (Brexit). The Payment Services Regulations 2017 (PSRs) transposed PSD2 into national law in the UK, although changes have since been made to adapt the PSRs to make the changes necessitated by Brexit.

Forthcoming changes to both the PSRs and PSD2 will likely lead to divergence between the UK and EU regimes. The extent of divergence is of significance to banks, e-money institutions (EMIs), and/or payment institutions (PIs) providing payment services (payment service providers — PSPs) because (among other things) the continued participation of UK PSPs in the Single Euro Payments Area (SEPA) requires a certain degree of alignment between the UK and EU regimes, particularly in regards to execution requirements.

Review of the UK Payment Services Regulations

In January 2023, the UK government published a review of the PSRs and a related call for evidence (together, 'the Consultation').[2] The Consultation closed on 7th April 2023. So far, there is little detail on the planned changes to the PSRs, but the Consultation identifies certain areas of regulation that are likely to be reformed.

One of the UK government's key objectives in reviewing the PSRs is to achieve 'agile and proportionate regulation, which facilitates the international competitiveness of the UK economy through growth and innovation in the UK'.

These comments suggest the UK government may have an appetite for significant shifts from EU standards in certain areas. However, this may only become noticeable over time as the UK government is likely to be selective and iterative in its approach. It has not expressed an ambition to break suddenly with the EU regime in a wholesale manner. As noted above, the continued participation of UK PSPs in SEPA is predicated on a certain degree of alignment between UK and EU payment services regulation. The UK government acknowledges this issue in the Consultation while also noting that it will balance continued participation in SEPA against the UK's ability to determine its own regulatory approach.

Key areas of review in the consultation

Safeguarding

The UK government believes current statutory rules underpinning the safeguarding regime provide insufficient clarity on the status of customer funds and facilitating returns in the event of an institution's insolvency. The Consultation suggests delegating to the Financial Conduct Authority (FCA) the development of an updated safeguarding regime that would enable it to 'benefit from greater regulatory agility by setting requirements in regulatory rules', explaining that the FCA has experience in the area of client assets rules that currently apply to certain other categories of regulated financial services firms. The UK government has invited the FCA to consult later in 2023 on potential changes to the safeguarding regime. While the FCA has yet to launch its consultation, a recent Dear CEO letter addressed to payments firms[3] suggests that it could take a more stringent approach in setting its expectations for firms, including requirements for: (1) appropriately documented processes for identifying 'relevant funds' that must be safeguarded; (2) daily internal and external reconciliations of safeguarded funds; (3) maintenance of accounts holding relevant funds; and (4) compliance with record-keeping requirements.

Any changes to safeguarding requirements under the PSRs would be of particular interest to PIs and EMIs with complex settlement arrangements or that have found existing requirements to be operationally challenging.

Strong customer authentication

Under the PSRs, PSPs are required to apply strong customer authentication (SCA) in certain circumstances. The requirement to apply SCA was one of the main changes introduced by PSD2 and was transposed into UK law by the PSRs. The Consultation notes that the relatively prescriptive regulatory technical standards of SCA (which provides an additional layer of security to prevent fraud) may exclude certain customers from accessing payment services, like those without reliable mobile coverage. This is because many PSPs rely heavily on the use of mobile devices to apply SCA. The UK government is seeking evidence on whether a more flexible 'outcome-based approach' to SCA would be more appropriate.

Settlement requirements

The PSRs impose certain requirements on PSPs related to the settlement of payments for customers. In some cases, PSPs are required to ensure that payments are settled to the receiving account by the end of the working day following the relevant payment instruction. The UK government is considering whether greater flexibility through a 'risk-based approach' could produce better outcomes. In particular, the Consultation suggests considering whether PSPs should have greater flexibility to delay the execution of a payment where there are financial crime concerns, such as a customer being at risk of fraud. In tandem, the UK government is considering whether a receiving bank should have greater scope to delay crediting payments to a payee's account if it suspects the account may belong to a fraudster.

Allowing for such delays could assist firms in reducing customer harm from financial crime. However, changes could also introduce additional operational complexity when processing payments. Further, PSPs could be forced to assume greater responsibility for customer losses if permitted to delay payments to prevent fraud. A customer that suffers loss where a fraudulent payment was not delayed could question why its PSP failed to delay payment to carry out additional checks. Alternatively, allowing for the discretionary delay of payments could create other types of liability risks for PSPs. For example, if a PSP's customer were to suffer loss as a result of a delayed payment, that customer might claim that the PSP lacked sufficient justification for delaying the payment.

In terms of liability for authorised push payment (APP) fraud, signatory firms to the voluntary Contingent Reimbursement Model Code for Authorised Push Payment Scams currently provide enhanced consumer protection standards to reduce the occurrence of fraud. However, a recent consultation paper published by the Payment Systems Regulator suggests that there should be a '50:50 split' between the sending and receiving banks when allocating the cost of reimbursing victims of APP fraud.[4] This approach is based on the presumption that receiving banks are better positioned to detect potentially fraudulent payments to their customer's accounts by leveraging the information they hold on their customer.

Information requirements

PSPs are subject to various customer disclosure requirements under the PSRs and, in certain cases, the EU Cross Border Payments Regulation (as retained in the UK post Brexit). These include requirements to disclose information related to currency conversion charges.

The UK government is considering whether these disclosure requirements 'can be enhanced to provide relevant information to consumers' and 'support a better, competitive market'. The relevant section of the Consultation focuses on currency exchange disclosures, suggesting this is likely to be a key component of any future review.

Changes to currency exchange disclosure requirements may create significant operational challenges for PSPs, particularly if PSPs are required to display live rates or differences between offered rates and published benchmark rates.

Termination practices

PSPs are generally permitted to terminate customer contracts by giving two months' notice under the PSRs. The extent to which this provides adequate protection for customers has been called into question following several high-profile cases where PSPs have allegedly terminated accounts due to a customer's political views.

The Consultation emphasises the importance of free speech, stating that 'as a minimum … a notice-period and fair and open communication with a customer must apply in situations which relate to termination on grounds other than suspected or actual criminal offences or when otherwise allowed by law'.

Any changes in this area will be of particular interest for firms that combine a platform service (eg social media offering) with payment services. All in-scope firms will also need to consider how proposed reforms affect the manner in which they communicate with customers in relation to suspending or terminating their payments services.

EU PAYMENT SERVICES DEVELOPMENTS[5]

Review of PSD2

On 23rd June 2022, the European Banking Authority (EBA) published its opinion on the ongoing review of PSD2.[6] The Opinion is the EBA's response to the European Commission's call for advice, which was published 20th October 2021.

In the Opinion, the EBA sets out its findings on the implementation of PSD2 and suggests how to address the identified issues through a revised Directive (PSD3).

The contents of the Opinion are likely to be of particular interest to PSPs as well as other firms that operate in the EU payments sector (eg card schemes and providers of technological services to PSPs), and merchants, particularly providers of unregulated cards and/or e-commerce services.

The key proposals set out in the Opinion are summarised below.

Key proposals in the Opinion

Scope and definitions

Merging PSD2 and EMD2

The EBA is strongly supportive of consolidating PSD2 and the Second Electronic Money Directive, Directive 2009/110/EC (EMD2) under a single regulatory framework. It argues that such consolidation would likely minimise regulatory arbitrage and ensure technological (and also business model) neutrality. The EBA contends this change would improve the clarity and reduce the complexity of the current payment services and electronic money regulatory regimes. The Opinion does not elaborate on how the EBA proposes to consolidate the two regimes; however, it is possible that e-money issuers will become subject to additional obligations.

Territorial scope

The Opinion addresses the uncertainty that persists with respect to PSD2's territorial scope (including the scope of regulatory authorisation requirements under PSD2), especially where payment services are provided online. As such, the Opinion stresses the need for clarity on identifying the place of provision for services provided online. However, it also acknowledges this is an issue that needs to be addressed at a broader level for the entire financial sector and beyond.

Significant and systemic PIs and EMIs

At various points in the Opinion, the EBA proposes the introduction of certain additional prudential requirements (see below) that would only apply to 'significant' PIs and EMIs. Separately, the Opinion also refers to 'systemic' PIs and EMIs. As the EBA acknowledges, these two concepts do not exist under PSD2 or EMD2, and they would therefore need to be defined. However, the Opinion suggests a PI or EMI might be considered 'significant' if it is 'likely to have an impact on the payments market and the economy overall, or to have a spillover effect on other financial institutions, including across borders'. It does not elaborate further on the meaning of 'systemic'.

Payment accounts

There continues to be legal uncertainty regarding the scope of the term 'payment account' under PSD2. This is significant because account servicing PSPs (ASPSPs) are only required to grant payment initiation service providers (PISPs) and account information service providers (AISPs) (together, TPPs) access to the accounts the ASPSP provides if those are payment accounts. This issue also determines whether accessing an account online would trigger a requirement to apply SCA.

Many PSPs have relied on both the clarification handed down by the Court of Justice of the European Union in Case C-191/17, and also the EBA's response to question 2018 4272 (which references that decision) in its Q&A on PSD2, which collectively indicate that only an account that can both send and receive funds is considered a payment account. However, as the EBA notes in the Opinion, Case C-191/17 drew an analogy from the definition of a 'payment account' under the Payment Accounts Directive, Directive 2014/92/EU (PAD) which is narrower than the definition provided in PSD2.

The EBA therefore proposes to include a clearer and more detailed definition of 'payment account' in PSD3 that, in its view, should not be narrowed to the scope covered by the PAD definition.

Definition of payment instrument

In the EBA's view, the definition of a 'payment instrument' requires clarification, particularly as to whether a mobile phone or computer can be considered to be a payment instrument.

The EBA expresses the view that issuing tokenised card details that enable users to initiate a payment order would constitute the issuance of a payment instrument. This perspective could have implications for merchants providing certain card-on-file services as well as for PSPs supporting e-commerce businesses.

Conversely, the EBA contends that services related to the operation of a digital wallet, which are of a technical nature, would not constitute a payment service. As such, the EBA proposes that the nature and regulatory treatment of digital wallets be clarified in PSD3.

Initiation of payment transactions

The EBA also argues that the process for initiating payment transactions and the requisite steps could be clarified. Determining when this process has been completed has important implications — for example, for mandatory execution timeframes, determining when a payment order becomes irrevocable, and at what point SCA should be applied.

BNPL business models

According to the EBA, the existing scope and requirements set out under PSD2 are sufficient for the regulation of payment services provided by BNPL providers, so additional regulation under PSD3 is not required. However, the EBA does suggest clarifying whether BNPL services can be treated as ancillary credit provided in relation to a PSP's payment services and how the interplay between BNPL services and the provision of payment services should be treated.

Exclusions

The EBA proposes that the extent of certain exclusions from regulation under PSD2 / EMD2 be clarified.

- *Limited network exclusion (LNE):* Interpretations as to the extent of the LNE vary across member states. The EBA has published guidelines on the extent of the LNE and proposes these be incorporated into PSD3. The EBA also believes that further clarifications regarding the extent of the LNE are required — for example, on the geographical limit of the provision of the excluded services and the interpretation of the terms 'professional issuer' and 'premises', which form part of the LNE's definition.
- *Commercial agent exclusion (CAE):* The EBA has identified various issues with the CAE that it proposes be addressed in PSD3. In particular, a lack of clarity with respect to: (1) the meaning of 'agent' (which differs among member states) and whether this should be understood to have the same meaning as under the Commercial Agents Directive, Directive 86/653/EEC; (2) what it means to 'negotiate or conclude' the sale or purchase of goods or services (especially when contracts are concluded electronically) as well as the intended meaning of having a 'real margin' to do so as per Recital 11 of PSD2; and (3) distinguishing between a payment initiation service and the acquiring of payment transactions and services provided by commercial agents, particularly in the context of e-commerce platforms. The EBA proposes that the specific use cases intended to be within the CAE, and the references to 'negotiate or conclude' are all clarified. Were these changes to result in a narrowing of the exclusion, it could have significant implications for e-commerce platforms and other intermediaries that facilitate sales of goods or services and that hold or control funds as part of that role.
- *Resellers:* The EBA is concerned about the circumvention of PSD2 by resellers that do not bear the responsibility for the goods and/or services being provided but are nevertheless in control of the financial flows. The EBA proposes specifically addressing such business models in PSD3 and delineating models that should be subject to regulation from those that should fall outside the scope of regulation.

Prudential requirements

Initial capital and own funds requirements

The EBA proposed that the requirements for initial capital and own funds for PIs and EMIs be harmonised. The EBA also proposes that the EC assess the appropriate level of initial capital and whether there is a need to adjust the calculation of the own funds requirements by introducing an additional buffer in respect of payment services where funds are held for longer periods of time.

Making Method B the default position for calculating own funds

The EBA also suggests that Method B be made the default method for the calculation of own funds in relation to payment services, with an EMI or PI being permitted to use other methods subject to approval from its regulator. Under Method B, own funds requirements are calculated by reference to transaction volumes. For firms that currently use Method A or C, this could result in a requirement to change the method used.

Capital requirements for credit relating to payment services

The EBA considers it necessary to include in PSD3 a uniform calculation method to determine own funds requirements for credit risk based on the standard method under the Capital Requirements Regulation ((EU) 575/2013). This may mean that certain PIs and EMIs are required to hold more regulatory capital than is currently required by PSD2/EMD2.

Safeguarding

The EBA notes there is uncertainty as to whether safeguarding accounts can be opened with non-EU banks. The EBA proposes that PSD3 confirm that safeguarding accounts may be held only with EU banks and EU branches of third-country banks.

The EBA proposes that the EC clarify that funds held by EMIs and PIs in safeguarding accounts are protected by the relevant deposit guarantee scheme (DGS) in the event of the bank's failure.

The Opinion does not address the question of whether the DGS compensation limit of €100,000 would apply only to a claim from the PSP, or also in respect of each client whose funds are held in the safeguarding account.

Consolidated supervision

The EBA discusses the benefit of establishing own funds requirements at a consolidated level, including for groups containing multiple regulated entities as well as non-regulated entities that cooperate in the provision of payment services. The EBA suggests that one balanced option could be to limit its scope to 'significant' or 'systemic' (these terms are not defined) PIs/EMIs only.

If consolidated supervision were introduced, some corporate groups with multiple licensed entities could be required to hold more regulatory capital or may be otherwise constrained in the allocation of capital across their group structures.

Liquidity buffers

The EBA suggests the introduction of liquidity risk monitoring and management for nonbank PSPs, including the maintenance of liquidity buffers. This would represent an extension to PIs and EMIs of requirements that have to date been more typical for banks.

In addition, the EBA claims PSPs issuing payment instruments or providing acquiring services may experience liquidity shortages as a result of exposures to merchants with high levels of chargebacks. Card scheme settlement guarantees and chargeback procedures already seek address such risks, so it is not clear (at least in the context of card acquiring) why such liquidity shortages would arise.

Recovery and wind-down frameworks for PSPs

The EBA proposes a simplified recovery and wind-down framework for 'significant' PIs and EMIs (see above). The EBA suggests the EC may wish to take into account the approach on recovery and wind-down frameworks adopted in other EU laws.

Account access and open finance

Third-party provider access to payment accounts

The EBA proposes a common API standard for TPPs to access payment accounts held with ASPSPs, which, in the view of the EBA 'the industry would be best placed to develop'. The EBA also notes that a common API standard could have additional benefits such as: (1) creating a foundation for the future development of open finance beyond the requirements set out in PSD2; (2) reducing the complexities associated with the different interface specifications used by various ASPSPs; and (3) levelling the playing field across the industry, particularly for new market entrants.

The EBA favours the removal of the option for PSPs to provide repurposed customer interfaces for use by TPPs. This would require all in-scope ASPSPs to have a dedicated interface for TPPs. The need to provide a repurposed customer interface as a fallback mechanism would also be removed.

The EBA considers that an exemption could be made for 'specialised niche activities that do not service retail customers'. This exemption could be very helpful for B2B PSPs, especially if the EC does not confirm the narrow interpretation of the term 'payment account' based on recent EU case law and the EBA Q&A (see above).

The EBA has requested that the EC clarify the meaning of 'online access' to payment accounts, particularly whether this covers secure corporate protocols and machine-to-machine communications. Any such changes could have significant implications for B2B payment services that involve payment accounts.

Contractual arrangements of PISPs

The EBA has clarified that in its view, PISPs must have a contractual agreement in place with the payer even where they also contract with the payee. As such, PISPs that currently contract only with merchants will need to onboard the merchant's customers.

Distribution of liability between TPPs and ASPSPs

The EBA proposes that PSD3 should further clarify the distribution of liability between TPPs and ASPSPs and also the PSP that payment service users (PSUs) should approach with any complaints.

Open finance

The EBA is supportive of the proposal to extend account access provisions to cover 'non-payment accounts and banking products and subsequently extend to other financial products' but states that it favours a phased approach to implementing this proposal.

The EBA proposes that the EC considers bringing AISPs within scope of any (broader) new legal framework for open finance and remove them from the scope of PSD3. This would probably mean a broadening, rather than a narrowing, of regulatory requirements for AISPs.

Strong customer authentication

Meaning of 'electronic payment transaction'

One of the triggers for applying SCA is a payer initiating an 'electronic payment transaction'. However, this term is not defined in PSD2. Alternatively, the EBA proposes requiring SCA for the initiation of all payment transactions and the specification of which payment transaction types are exempt. This could result in a broader application of SCA requirements.

Application of SCA by AISPs

The EBA proposes allowing AISPs to apply their own SCA using security credentials issued to the PSU by the AISP instead of those issued by the ASPSP (although for the initial connection to their payment account, PSUs would still need to authenticate themselves to their ASPSP). This could have an impact on the allocation of liability between ASPSPs and AISPs (see below).

Outsourcing of SCA

The EBA proposes that PSD3 clarify when the use of third-party SCA technology would be considered 'outsourcing' (and therefore trigger the application of the EBA Outsourcing Guidelines) and whether conditions nevertheless need to be applied in the event the EC concludes this does not constitute outsourcing.

In the EBA's view, a PSP's delegation of SCA to a technical service provider (including another group entity) does constitute outsourcing and should therefore be clarified in PSD3.

Payee-initiated transactions including merchant-initiated transactions

The EBA proposes that the definition of merchant-initiated transactions (MITs) be clarified. It also proposes that MITs and direct debits are distinguished, with the applicable regulatory requirements for each clarified.

Additionally, the EBA proposes new requirements for establishing electronic mandates for payee-initiated transactions. The EBA also proposes introducing limits on the maximum number of payment transactions executed and/or the duration of the mandate before it needs to be renewed by the PSU. These changes could have significant implications for subscription-based business models.

Behavioural characteristics

The EBA reiterated its view that behavioural characteristics cannot constitute inherence for the purposes of applying SCA. The EBA notes that 'some market participants argued that behavioural characteristics related to the environmental analysis and payment habits, such as those related to location of the PSU, time of transaction, device being used, spending habits, online store where the purchase is carried out, should qualify as inherence'. However, the EBA responds that such behavioural characteristics 'do not relate to a physical property of the body and thus cannot be considered as an inherence SCA element'.

The EBA's view is that further clarifications in PSD3 are required on this point.

Application of SCA to refunds

There is ongoing debate as to whether SCA should be applied to refunds. The EBA's view is that refunds initiated by merchants are separate payment transactions in respect of which the merchant is the payer and so SCA must be applied. The EBA proposes the EC clarify its position in PSD3 and either reflect the EBA's view or introduce an exemption from SCA for refunds.

Potential security measures other than SCA

Under SCA requirements, PSPs are required to monitor transactions to detect unauthorised or fraudulent payment transactions. The EBA proposes that a general transaction monitoring obligation be introduced in PSD3. It is unclear how this would interact with the separate obligation of PSPs to conduct transaction monitoring as part of their anti-money-laundering obligations.

Agents and distributors

Harmonised rules for agents and distributors

The EBA argues that EMD2 does not provide sufficient detail as to the nature of e-money distributors. In its view, there is a lack of recognition of business models under which e-money distributors provide additional services akin to those provided by PSD agents (who are subject to more stringent requirements).

The EBA therefore advocates the application of a single framework to PSD agents and distributors of electronic money. In practice, this could result in an extension of the regulatory requirements that apply to e-money issuers in relation to their supervision of distributors.

White labelling

The Opinion identifies specific concerns in relation to business models where a white-label provider carries out payment services on behalf of the PSP and obtains control with respect to the business and relationship with the PSU. Namely, the EBA notes this create information, communications technology and operational risks as well as money laundering and reputational risks. The EBA notes the PSU may not always know which entity is the authorised provider of the payment service.

The EBA considers that business models where a white-label provider acts on behalf of a PSP should fall within the scope of the PSD2 framework for agents. This would mean certain firms that rely on third parties to provide white-labelled services would need to register those third parties as agents and would bear regulatory liability for their actions related to the relevant services.

Conduct of business

Instant payments

In anticipation of the further development of instant payments in the EU, the EBA proposes that PSD3 be adapted to account for the specific features of instant payments, for example, execution times, finality of payments, and the specific risks arising from instant payments.

The EBA proposes that PSPs should be required to inform a PSU of the irrevocability of instant payments, immediately notify the PSU of the execution (or non-execution) of an instant payment, and obtain express consent from the PSU for use of instant payment instruments.

Direct obligations on payment schemes, merchants and intermediaries

The Opinion suggests introducing certain specific requirements for technical service providers and other intermediaries in PSD3. The EBA also suggested that under PSD3, merchants could be liable for unauthorised and/or fraudulent transactions instead of their PSP if they have not implemented IT solutions supporting the application of such security requirements.

The EBA notes that there are potential challenges to imposing such requirements on merchants, such as the question of which competent authority would be responsible for enforcing compliance where the PSP and the merchant are not located in the same member state.

Bank de-risking

The EBA supports the introduction of specific criteria to determine when a bank may refuse to provide a PI or an EMI with a bank account (or terminate an existing account). The EBA has also requested more detailed requirements on banks in relation to notification to competent authorities, specifically notification to the home state competent authority of the PI/EMI refused access to a bank account.

Vulnerable groups

The EBA observes that the reliance on the use of mobile phones for the application of SCA has excluded certain groups of society from accessing some payment methods. This includes customers who do not have reliable access to mobile devices, and also people with certain disabilities.

The EBA has suggested introducing a general duty for PSPs to account for the needs of all their customers when designing authentication solutions. Alternatively, the EBA suggests introducing specific measures, such as educational campaigns regarding authentication measures used by PSPs, and/or requiring PSPs to inform their customers about the different SCA solutions offered by the PSP.

EC Report on the application and impact of PSD2[7]

On 2nd February, 2023, the EC published its report on the application and impact of PSD2. The EC Report analyses legal and economic evidence from the industry to outline PSD2's benefits and challenges, accomplishment of stated industry objectives and proposed revisions to PSD2 to address areas of market failure. The EC Report concludes that PSD2 has enhanced competition, innovation (eg open banking) and consumer protection, but considers there is still some way to go in developing a more consolidated cross-border payments market within the EU and resolving some of the operational challenges for firms implementing PSD2.

The proposals under the EC Report are split into three pillars, as set out below.

Pillar I: Scope and exclusions of PSD2

This includes proposals to:

- improve the consistent application of PSD2 across EU member states by better aligning licensing and supervisory rules;
- address competition issues, particularly by increasing anti-trust scrutiny of big tech firms and better aligning the national approaches to the surcharging ban;
- address legal uncertainty about the scope and application of PSD2 as a result of new distribution chains and payment processes resulting from technological developments, including by revising definitions such as 'payment service';
- consider the interaction between MICA, PSD2 and the future regulation of central bank digital currencies given that crypto-assets are expected to affect payment methods;
- align PSD2 and EMD2 to address the divergent application of rules across member states such as in relation to the commercial agent exemption; and
- strengthen cooperation between national supervisory authorities over payment platforms and digital platforms providing payment services.

Pillar II: Recommendations on open banking

This includes proposals to:

- address standardisation and interoperability issues in the euro area, focusing on QR codes, card-payment transactions and API standards;
- ensure emerging payment service providers are covered by the EU regulatory framework for retail payments; and
- address FinTech industry concerns about PSD2 implementation by amending Article 97 of PSD2 to make clear that when a PSU authorises an AISP to access its payments account, that permission is valid on an ongoing basis until otherwise revoked.

Pillar III: Recommendations on data protection and consumer protection

This includes proposals to:

- set a more efficient data authorisation and customer identity control system by improving coordination between the EBA and data protection authorities; and
- improve the protection of PSUs, focusing on different levels of protection and liability, cross-border ADR mechanisms, and extending existing data protection safeguards in PSD2 to all payment services.

Read alongside the Opinion (see above), the EC Report may be considered a precursor of issues that legislators may seek to address under PSD3.

UK PAYMENTS-RELATED DEVELOPMENTS IN REGULATION OF CRYPTO-ASSETS[8]

UK stablecoin proposal

In April 2022, the UK government published its response to its earlier consultation on the regulatory approach to crypto-assets, stablecoins and distributed ledger technology. The Consultation Response sets out the UK government's proposal to regulate certain activities relating to fiat-linked stablecoins due to their potential to become widely used payment methods.

The Consultation Response relates to 'Phase 1' of the UK's proposed regulation of crypto-assets. On 1st February 2023, a separate consultation was published that sets out further details of Phase 1, and other proposals to regulate certain other categories of crypto-assets, referred to as 'Phase 2'.

Scope of the proposals

The new Phase 1 requirements will apply to firms engaged in 'activities that issue or facilitate the use of stablecoins used as a means of payment' and firms that provide/arrange custody of stablecoins. The Phase 1 proposals are limited to stablecoins that reference a single fiat currency or a basket of fiat currencies.

Redemption rights

The definition of 'electronic money' under the Electronic Money Regulations 2011 (EMRs) will be extended to include fiat-linked stablecoins. Stablecoin holders will be given a statutory right to redeem coins on demand, at par value. However, the Phase 1 proposals acknowledge that holders of stablecoins may not always have a relationship with the issuer; for example, it could be with a third party such as an exchange or wallet provider instead.

The UK government considers that holders should generally be able to make a claim against either: (1) the issuer; or (2) customer-facing entities as appropriate. The requirement to allow the redemption of stablecoins on demand and at par value will remain with the issuer, but they may not always be required to directly fulfil requests.

Safeguarding

Requirements to safeguard customer funds under the EMRs will apply to funds received in exchange for the issuance of fiat-linked stablecoins. Generally, this means that such funds would need to be segregated and not be used for any other purpose unless insured or covered by a comparable guarantee from a non-affiliated bank.

It is not clear yet how (or to whom) the safeguarding requirements will apply where stablecoins are distributed via exchanges or wallet providers. However, the Consultation Response states that guidance on this topic will be issued by the FCA.

Custodial services

The Consultation Response sets out proposals to regulate firms that provide or arrange for the custody of fiat-linked stablecoins. These proposals are intended to capture wallet providers as well as exchanges that offer similar services. The FCA will issue detailed regulatory rules for stablecoin custodians covering (among other things):

- prudential and organisational requirements;
- reporting requirements;
- conduct of business requirements;
- operational resilience;
- custody/safeguarding requirements; and
- consumer protections.

Oversight of 'systemic' stablecoin payment systems

Part 5 of the Banking Act 2009 will be extended to apply to 'arrangements that facilitate or control the transfer of 'digital settlement assets.'', capturing stablecoins and enabling the Bank of England (as lead prudential regulator) to oversee stablecoin-based payment systems where the risks (including that of failure) are considered 'systemic' (the criteria for this including potential to cause disruption to the financial system). Relevant factors include the likely volume and value of transactions, their nature, links to other systems, substitutability and use by the Bank of England in its capacity as a monetary authority. This regulation would also capture firms providing custodial services for such systemically important stablecoins.

The UK government is proposing to widen the act's application to incorporate a defined set of service providers (including some wallet providers) to which regulation would apply. These could potentially apply to entities such as exchanges or stablecoin reserve custodians. Such entities may be subject to regulation where making use of 'digital settlement assets', the UK government intends keep legislation flexible to account for future stablecoin developments.

The UK government is also considering whether there is a need for a bespoke legal framework to govern the failure of systemic stablecoin firms, and intends to publish a consultation on this.

Competition oversight

The UK government intends to extend the application of the Financial Services (Banking Reform) Act 2013 to operators of and participants in stablecoin-based payment systems to ensure that these are subject to competition regulation by the Payment Systems Regulator (PSR).

Under Phase 1, the UK government is also considering extending the PSR's jurisdiction to certain additional entities including wallet providers, exchanges, and custodians of stablecoin reserves.

EU PAYMENTS-RELATED DEVELOPMENTS IN REGULATION OF CRYPTO-ASSETS[9]

MiCA and stablecoins

The proposed EU Markets in Crypto-Assets Regulation (MiCA) establishes a regulatory framework for crypto-asset services, with implications for issuers of stablecoins. As MiCA is an EU regulation, it will apply directly in EU member states without needing transposition into national laws.

In October 2022, the European Council published the agreed text of MiCA. If approved by the European Parliament, MiCA will be published in the Official Journal of the EU, entering force 20 days after publication. The final published text of MiCA may differ from the agreed text.

Certain provisions in MiCA relating to issuers of asset-referenced tokens and e-money tokens (see below) will apply from 12 months after MiCA enters force, with other provisions applying 18 months after.

Scope

MiCA applies to the issuance, public offering, and admission to trading of crypto-assets as well as the provision of certain crypto-asset services in the EU.

MiCA defines a crypto-asset as a 'digital representation of a value or a right which may be transferred and stored electronically, using distributed ledger technology or similar technology'. This broad definition could capture coins such as Bitcoin and Ethereum.

MiCA establishes three subcategories of crypto-assets including two types of so-called stablecoins:

- '*Asset-referenced token*': 'a type of crypto-asset that is not an electronic money token and that purports to maintain a stable value by referencing to any other value or right or a combination thereof, including one or more official currencies'. This captures stablecoins linked to *multiple* fiat currencies and/or other assets/indices.

- *'Electronic money token'/'e-money token'*: 'a type of crypto-asset that purports to maintain a stable value by referencing to the value of one official currency'. This captures stablecoins linked to a *single* fiat currency.

Requirements for issuers of asset-referenced and e-money tokens

Authorisation

Issuers of asset-referenced tokens or e-money tokens must be established in the EU. The former must be authorised under MiCA or as a credit institution. The latter must be authorised as an EMI or a credit institution.

Because e-money tokens are considered electronic money under the EMD2, rules under that Directive regarding: (1) the issuance of e-money; and (2) related regulatory capital requirements, will also apply to e-money token issuers.

Ongoing regulatory obligations

Issuers of asset-references tokens will need to establish a reserve of assets backing the tokens. E-money token issues must instead safeguard funds received in exchange for e-money tokens in accordance with EMD2.

The granting of interest on asset-referenced tokens and e-money tokens is prohibited.

E-money tokens must be issued at par value and issuers must grant holders the right to redeem e-money tokens at par value.

White papers

Issuers of asset-referenced and e-money tokens must produce a white paper containing (among other things) information on (among other things) the key features and risks of the tokens.

White papers for asset-referenced tokens (but not e-money tokens) must be approved by the issuer's home-state competent authority. The white papers for both asset-referenced tokens and/or e-money tokens must be published on the issuer's website no later than the starting date of the public offering of the token, or the admission of such token to trading.

Digital Euro[10]

The ECB is currently investigating whether to introduce a digital euro guaranteed and backed by the ECB, which would provide 'an electronic means of payment' in euro area member states. The investigation commenced in October 2021 and is expected to conclude in October 2023, at which point a decision will be made as to whether to proceed to the next stages of designing, issuing, and implementing the digital euro.

The digital euro is intended to support digitalisation, enhance payment systems, and provide a safe, alternative method of payment, particularly as the use of cash gradually declines. However, the ECB notes that these considerations would need to be balanced against the need to avoid unintended consequences, such as adversely affecting monetary policy, or increasing the size of the Eurosystem's balance sheet and expanding its exposure to potential shocks, which could give rise to challenges in international financial markets.

PROPOSED REGULATION OF LENDING UNDER BNPL AGREEMENTS[11]

Consultation proposals capturing BNPL agreements[12]

In February 2023, the UK government published a consultation on its proposal to regulate lending under BNPL agreements.

Scope

Firms will need to be authorised if they lend under BNPL agreements that are:

- for fixed-sum credit to individuals or 'relevant recipients of credit'. Relevant recipients of credit' include: (1) a partnership consisting of two or three persons not all of whom are bodies corporate or (2) an unincorporated body of persons that does not consist entirely of bodies corporate and is not a partnership; and
- interest-free and repayable in 12 or fewer instalments within 12 months or less.

The authorisation requirement will only apply to third-party lenders. Lenders that are also the supplier of the goods or services that the BNPL agreement finances will not require authorisation.

Exemptions

The following credit arrangements will be exempt from the authorisation requirement:

- trade credit, where a small business can defer payment for goods or services until its own customers have paid;
- agreements to finance insurance premiums, including where a third party, such as a broker, is involved in the transaction;
- employee credit agreements resulting from an arrangement between their employer and the lender or supplier; and
- agreements offered by a registered social landlord.

Merchants that offer BNPL credit provided by a third-party lender as a payment option will be exempt from requiring authorisation for credit broking unless they are so-called 'domestic premises merchant', ie merchants that sell goods and services when visiting a customer's home.

Financial promotions

The UK's financial promotions regime will apply to in-scope BNPL agreements. Unauthorised merchants offering BNPL credit will need to ensure that any promotions for newly regulated BNPL agreements are approved by an FCA-authorised firm, which could be the lender under that agreement.

Creditworthiness assessments and credit files

The UK government proposes a tailored application of current FCA rules on creditworthiness assessments with consistent reporting of newly regulated agreements across the three main credit reference agencies. Detailed proposals for how these rules will be tailored to BNPL agreements have not yet been published.

Pre-contractual requirements

The UK government proposes a tailored application of current FCA rules on creditworthiness assessments with consistent reporting of newly regulated agreements across the three main credit reference agencies. Detailed proposals for how these rules will be tailored to BNPL agreements have not yet been published.

Content of BNPL agreements

Requirements on the form and content of regulated consumer credit agreements under the Consumer Credit (Agreements) Regulations 2010 will apply to BNPL agreements. This means that incorrectly executed BNPL agreements will be unenforceable without a court order.

Section 75 — Consumer protection

Section 75 of the Consumer Credit Act 1974 (CCA) (which allows borrowers to bring a claim against the lender for breaches of contract or misrepresentation by a supplier) will be extended to in-scope BNPL agreements.

Arrears, default and forbearance

The UK government previously proposed that CCA requirements on dealing with consumers in financial distress should apply to BNPL. Despite concern from industry participants that the requirements for the provision of post-contractual information would be disproportionate, the UK government has confirmed that it will not amend the timing triggers for disclosures of post-contractual information for BNPL agreements. The UK government has stated that it may reconsider this issue as part of its broader reforms to the CCA (see above).

Financial Ombudsman Service

Consumers will be able to lodge complaints against BNPL lenders with the Financial Ombudsman Service (FOS). The UK government is continuing to engage with FOS on its approach to BNPL lending, particularly around potential disproportionality of case fees.

Temporary permissions regime

A temporary permissions regime (TPR) will be introduced for firms wishing to carry out regulated BNPL activities while awaiting full authorisation.

To join the TPR firms will need to register with the FCA before new regulation comes into force. Firms in the TPR will be supervised by the FCA and subject to the provisions of the CCA as well as FCA rules in relation to in-scope BNPL agreements.

Broader reforms in the UK and EU

The broader consumer credit regime in the UK (notably the CCA) is also under review and so market participants should expect further reforms going forward. Additionally in the EU, the European Council and the European Parliament announced in December 2022 that they had reached provisional agreement on a legislative proposal for a revised consumer credit directive and it is expected that BNPL products will also be brought within the scope of the EU regulatory regime.

PROPOSED REGULATION OF INSTANT PAYMENTS IN EURO[13]

On 26th October, 2022, the EC published a proposal to increase the availability and use of instant payments in euro by amending SEPA. Despite implementation of technology that processes instant payments in euro, only about one in ten euro credit transfers in the EU are processed as instant payments. Accordingly, the EU considers that legislative measures are necessary to unlock the full potential for EU citizens.

Under the EC's proposals:

- all PSPs (subject to a few exceptions) that offer credit transfers in euro will be required to offer instant payments in euro to all their customers;
- fees for instant payments in euro must be equal to or lower than fees for non-instant euro credit transfers;
- all providers of instant payments in euro should provide a service to check for consistency between the account number (IBAN) and the name of the payment beneficiary and, before the payer authorises the transaction, notify the payer about any inconsistency which could be indicative of fraud; and
- all providers of instant payments in euro must follow a standardised procedure for sanctions screening, based on daily checks of their own clients against EU sanctions lists while checks on normal transfers should be carried out on a transaction-by-transaction basis.

The obligation to enable receipt of euro instant payments will apply six months after the legislation enters into force, and the obligation to enable sending euro instant payments will apply 12 months after the legislation enters into force for PSPs located in euro area member states. The obligation to notify payers of inconsistencies between the name and IBAN of the beneficiary will apply from the same date as the obligation to provide the service of sending instant payments in euro.

EU PSPs should consider whether these proposals could give rise to additional compliance costs in preparing to send and receive instant payments in euro, and implementing mechanisms for the service of matching the name and IBAN of payment beneficiaries. Notwithstanding, these proposals are expected to reduce the operational burden of sanctions screening obligations by increasing efficiencies and reducing dependence on manual input.

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