Making connections
Digital Financial Services:
Payments and regulatory matters

16 June 2016
With the increasing technology of mobile devices and the sophisticated apps and services available to accompany them, Digital Financial Services have never been more relevant.

Internet and mobile banking are the norm and innovative payment services continue to hit the market. The exponential rise of digital financial services has led to a close focus on the legal issues that arise.

At Eversheds we have spent many years advising on the increased use of technology by financial institutions. We are delighted to be hosting today’s seminar to examine this developing area and help you become a truly digital business.
Eversheds is one of the world’s largest corporate law firms. Committed locally, but connected globally, with offices based in the world’s major economic centres, we have a proven track record of delivering consistently high quality legal services across jurisdictions.

Our dedicated international sector group offers the benefit of over two decades of experience advising financial institutions in relation to the issues and developments impacting upon the market. Few law firms are able to combine industry specific skills with the breadth of resource offered by us across multiple jurisdictions.

We have a special focus on innovation in financial services, including mobile payments and e-money. We have market-leading and legal directory ranked teams in payments, data privacy, consumer credit, financial services regulation, insurance and consumer law, as well as extensive experience of e-commerce in retail and other sectors.
Welcome

Thank you for joining us at this morning’s seminar. We will be covering the following topics:

– Regulatory update
– The FCA and Project Innovate
– Update on the Interchange Fee Regulation and general payment services

Ask a question
Join us at slido.com using the event code #eversheds to view this morning’s presentations, bookmark your favourite slides and submit your questions for our speakers.

Wifi
Access to our wi-fi network is available throughout the seminar. To connect please select the Eversheds network, open your browser and click the login button to be automatically connected.

CPD points
This workshop is accredited for 1.5 hours of Continuing Professional Development (CPD) points. Please use the information below to claim your points.

Conference name: Digital Financial Services seminar – 16 June 2016
Company: Eversheds LLP
Reference code: 042/EVER
Matthew Gough
Head of Digital Financial Services, Eversheds

Matthew specialises in commercial law, particularly in the areas of intellectual property (IP), information technology (IT) and commercial contracts. Matthew is rated as a Band 1 Leader in his field by Chambers Guide to the Legal Profession which states that Matthew’s team is “meticulous and immensely practical” and that he is “incredibly dedicated to serving his clients’ interests” and he is also noted in the Legal 500.

Matthew and his team have a particular focus on advising clients on the implications of consumer law on their businesses and he leads Eversheds Commercial Contract practice in this area of law in the United Kingdom.

Matthew Gough
Geraint Thomas
Jo Owens
Dan Rawling
Geraint Thomas  
*Head of Retail Finance, Eversheds*

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Geraint’s particular expertise is in Consumer Credit, Mortgage Regulation and savings/deposit products. Geraint has settled standard documents under FCA, CCA and other regimes for clients such as HSBC, Barclays, Ikano, Lloyds Banking Group, Nationwide, Morgan Stanley, Aldermore Bank, Aviva, Principality Building Society and others. Product experience includes first and second charge residential mortgages, buy to let and commercial mortgages, lifetime mortgages, home reversion plans, unsecured loans, credit and store cards and savings products.

He also advises on sale and purchases of loan portfolios and securitisations.
Jo Owens
Principal Associate, Commercial, Eversheds

Jo specialises in consumer finance and advises clients on matters relating to the Consumer Credit Act and the CONC sourcebook of the FCA’s handbook, as well as associated consumer protection legislation. Jo works with a variety of clients including credit card issuers, short term lenders, pawnbrokers, motor and asset finance providers, retail banks, credit brokers and debt collection firms. Jo’s advisory work includes dealing with a range of retail finance products including loans, credit cards, overdrafts and current accounts as well as motor and assets finance products. Her work covers all aspects of the firm’s interaction with customers including financial promotions, the drafting of credit documentation, post contractual obligations including the provision of statements and notices as well as advising on debt collection compliance. Jo has experience in advising clients on remediation projects.
Speaker biographies

Dan Rawling
Senior Associate, Payment Systems Regulator

Dan Rawling is a Senior Associate at the Payment Systems Regulator. Dan joined the PSR in July 2014 from the CMA. Prior to the formation of the CMA, Dan worked at the OFT from 2006 on a variety of competition law investigations, consumer protection matters and market studies. He spent over seven years on the OFT/CMA’s investigations into MasterCard and Visa’s interchange fee arrangements in the UK, including a period as Team Leader of those investigations. Dan trained for the Bar before joining the OFT.
Presentations

Digital Financial Services: Payments and Regulatory Matters
Matthew Gough, Eversheds

Digital Financial Services: Payments and Regulatory Matters
Dan Rawling

FCA: Project Innovate
Matthew Gough, Eversheds
Digital Financial Services: Payments and Regulatory Matters

16 June 2016
Matthew Gough
Partner
Regulatory update

16 June 2016

Geraint Thomas
Partner

Jo Owens
Principal Associate
Regulatory update

- Consumer credit retained provisions
- Digital transacting
- Publications and research
- Financial inclusion
Call for input - retained provisions

- What is it?
- Background
- Timetable
- Scope
- FCA initial views
Our thoughts

− General approach:
  • substance not form
  • tidy up definitions
  • legislative architecture

− Areas affecting digital:
  • multiple agreements
  • modifying agreements and variations
  • unenforceability
  • section 176A consent and “appropriate method”
  • post-contractual communications
Digital transacting

- Wider agenda - but...
- Savings products:
  - well established
  - consider back book variations
- CCA:
  - s176A
  - sign up
  - sending/uploading
  - post contract information
  - in-store
Publications and research

- FCA Business Plan and Risk Outlook 2016/2017
  - one of the fastest evolving FCA priorities
  - the regulatory Sandbox
  - areas of FCA focus:
    - operational resilience
    - cyber-crime
    - financial inclusion
    - use of smart data and advanced analytics
    - automated advice

- FCA Discussion Paper: Ageing Population and Financial Services
  - 1.1 million increase in over 65s by 2020
  - less likely to be digitally included?
  - prefer face to face access?
  - increased risk of vulnerability
Publications and research continued

- Call for Input: Supporting the development and adoption of RegTech – November 2015
- Feedback Statement: Regulatory Barriers to Innovation in Digital and Mobile Solutions – March 2016
- BBA : Improving Outcomes for Customers in Vulnerable Circumstances – February 2016
  - assess the impact of branch closures
  - understand what customers need
  - provide technical guidance
  - harness video technology
Financial inclusion

- Mind the Gap research November 2015:
  - independent research commissioned by the FCA
  - considered digital and physical barriers
  - opportunities for change

- FCA Occasional Paper 17: Access to Financial Services in the UK
  - importance of access
  - is access an issue?
  - the “Void”
  - computer says no
FCA: Project Innovate

16 June 2016
Matthew Gough
Partner, Commercial Contracts & Head of Digital Financial Services
Overview
FCA: Project Innovate

Agenda

- FCA: Project Innovate – an overview
- Regulatory Sandbox
Project Innovate
Overview
Project Innovate

The Financial Conduct Authority: Project Innovate

– Initiated by FCA in July 2014 influenced by increased innovation in the FS industry
– It is consistent with its objective to promote effective competition in the interests of consumers
– Aim: to assist new and established businesses, both regulated & non-regulated, to introduce innovative financial products into the market
“The key challenge for government, industry and regulators is to continue to ensure the regulatory environment fosters the best of financial innovation. Our ultimate goal is that the benefits of competition can be realised in the interest of UK consumers”

Christopher Woolard, FCA Director of Strategy and Competition, in speech delivered at the FCA’s event on UK FinTech: Regulating for innovation on 22 February 2016
Project Innovate

Project Innovate

- Hub for connections, resources & experience
- Assistance with applications to become authorised
- Dedicated contact for up to a year after authorisation
- International engagement
  - the FCA & the Australian Securities and Investments Commission (ASIC) have entered into an agreement granting increased support for UK and Australian FinTech companies if they enter the other’s market
  - To qualify the business must meet the eligibility criteria of their home regulator’s innovation hub
Key features

- 3 main strands:
  - Core inputs
    - emerging issues e.g. barriers to adopting mobile technology
  - Regulatory sandbox
    - provision of safe space for firms to enter the market and experiment with ideas
    - firms will be able to apply for the first cohort of the sandbox until 8 July 2016
  - RegTech
    - technology between regulators and firms to try and deliver regulatory requirements more efficiently & effectively
    - e.g. distributed ledger technology known as “Block chain”

- A different way for the regulator to work
  - Roundtables and engagement
Regulatory Sandbox
Project Innovate

Regulatory Sandbox
- Provision of a safe space for firms to enter the market and experiment with ideas “in a live environment” without immediately incurring the normal regulatory consequences
- Firms are able to apply until 8 July 2016 for the first cohort
- Open to authorised terms, unauthorised firms and Fintechs – very inclusive
- Two cohorts anticipated annually initially
  - Second cohort applications open from November to mid-January 2017
- Eligibility criteria:
  - genuine innovation
  - benefit to consumers, either direct or indirect
  - the idea is designed for the UK financial services market
  - a need for testing in the sandbox alongside the FCA
  - readiness to test – feasibility of tests: firms will be selected for the first cohorts based on their readiness, encouraging well-developed testing plans to be submitted
- Dual regulated firms will have sandbox tools agreed with both the FCA and the PRA
Project Innovate
Eligibility criteria

- Is the firm in scope?
- Is it genuine innovation?
- Is there a consumer benefit?
- Is there a need for a sandbox?
- Is the firm ready for testing?

FCA assistance

FCA can assist during a Sandbox test in the following ways:

- Individual guidance – explaining interpretation of rules in the context of the firm’s test
  - acting upon the guidance provided will mean that the firm has complied with the aspects of the rules that the guidance relates to

- Waivers or modifications – the FCA may be able to waive or modify a rule where it is unduly onerous or not achieving its intended purpose
  - waivers or modifications will not be given if the result would be to adversely affect the advancement of the FCA objectives
  - FCA are not able to waive national or international law

- No enforcement action letters
  - aim is to provide firms with assurance that as long as they deal with the FCA openly, remain within the agreed testing parameters and treat customers fairly
  - FCA expects some unexpected issues may arise but they do not expect to take disciplinary action
  - this tool would only be used where it is not possible to issue individual guidance or waivers
  - no current examples of particular circumstances where “no enforcement action letters” may be appropriate
Project Innovate

Project Innovate: Sandbox conditions

- Sandbox conditions
  - proposals will only be considered where the FCA are satisfied that there is a prospective direct or indirect consumer benefit
  - upfront testing parameters and customer safeguards will be agreed with the FCA on a firm by firm basis
  - fair exit strategy for consumers – strategies will vary from firm to firm depending on the test
  - agreed monitoring and reporting
Project Innovate
Testing parameters

- Duration
- Number of customers
- Customer selection
- Customer safeguards
- Disclosure
- Data
- Testing plans

FCA Default standards for sandbox testing parameters available at
https://www.fca.org.uk/your-fca/documents/default-standards-for-sandbox-testing-parameters
Project Innovate

Project Innovate: Sandbox conditions

- Sandbox Firms who are not authorised will be initially authorised with restrictions, allowing them to test their ideas but no more
  - threshold conditions still apply
  - consumer confidence is more likely if the new product is within the regulatory framework
  - sandbox firms should be ready to operate within the regulatory framework after the sandbox
  - full activity in the wider market will require authorisation and meeting the threshold conditions for the particular activity

- Banking licenses
  - restricted authorisation is not an option for firms looking to become a bank. These firms should contact the FCA & PRA’s New Bank Start-up Unit
  - the New Bank Start-up Unit was set up on January 20th 2016
Project Innovate: Monitoring

- Reporting requirements will be agreed between the firm and the FCA, based on what is appropriate for the test in question

- Starting position:
  - weekly monitoring
  - agreed testing milestones
  - key findings
  - risk management during testing
  - four weeks to produce and submit a final report once test is complete
  - FCA will provide feedback on the report but will not certify business models or sign off products/services
  - sandbox findings may be published – reviewed on a case-by-case basis to ensure confidential information is protected

- Failure to report to the innovation hub or non-compliance with Principle 11 of the FCA handbook (Relations with regulators) may result in the FCA ending the test
**Project Innovate**

Firm journey

- Firm submits proposal to use sandbox
- FCA assessment
- Firm and FCA agree testing approach
- Delivery of sandbox option
- Testing and monitoring
- Final report submitted for FCA review
- Firm decides whether to offer solution outside the sandbox

Digital Financial Services:
Payments and Regulatory Matters

Eversheds LLP
16 June 2015
An update on payments

- Digital financial services: examples of innovation in payments
- Various legal regimes and why they matter
- Focus: Interchange Fee Regulation
The PSR’s role

**Aim**
Payment systems that work well for the people and organisations that use them

**Vision**
Payment systems that are accessible, easy to use, reliable and secure, and provide value for money
The path to the PSR

2000 - Cruickshank report

2003 - 2007 - OFT: payment systems taskforce

2003 - 2007 - OFT market study on UK payment systems

2009 - 2011 - Martin Cave review of Payments Council

2010 - Independent Commission on Banking [ICB]

2012 - HMT consultation on 'setting the strategy for UK payments'

2013 - HMT consultation on 'opening up UK payments'

Oct 2013 - Government publish Banking Reform Bill to set up PSR

Nov - Jan 2015 - PSR formal consultation

March 2015 - PSR fully operational

Apr 2014 - PSR Incorporated and appointment of the PSR Board

Apr 2015 - HMT designate payment systems for regulation

2013 - 2014 - Parliamentary Commission on Banking Standards

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Examples of innovation

- Digital wallets
- Mobile banking
- Contactless (plastic and mobile devices)
- Point of sale technology
- Development of Paym and Zapp
- Integrated payments
Multiple legal regimes

- Financial Services (Banking Reform) Act 2013
- Enterprise Act 2002
- Competition Act 1998
- EU competition law
- EU Interchange Fee Regulation 2015
- EU Payment Services Directive 2007
- Revised EU Payment Services Directive (PSD2) 2015
- EU Payment Accounts Directive 2014 (and implementing Regs)
PSR’s economic regulatory objectives

Financial Services (Banking Reform) Act 2013 (FSBRA) - Sections 50 to 52:

• Promote effective **competition** in the interests of service-users

• Promote **innovation** in the interests of service-users

• Ensure that payment systems are operated and developed in the interests of **service-users**
PSR’s concurrent competition competition powers

- **Competition Act 1998**: The PSR has powers to enforce UK competition law (the Chapter I and II prohibitions of CA98) in relation to agreements and conduct relating to participation in payment systems.

- **Articles 101/ 102 TFEU**: The PSR is designated as an national competition authority empowered to apply Articles 101 and 102 TFEU.

- **Enterprise Act 2002**: The PSR has powers to carry out market studies and to refer markets to the CMA for investigation.

- **PSR is a concurrent regulator**: These powers may also be exercised by the CMA with regard to all sectors of the economy.
PSR’s work programme

- Access package
- Governance package
- Cards programme (inc. IFR)
- Indirect access market review
- Infrastructure market review
Interchange Fee Regulation

- Part of the Commission’s Payments Package – along with PSD2
- July 2013 - Proposal published by the Commission
- Trialogues involving Council (Italian Presidency) and Parliament
- 10 March 2015 - Adopted by the Parliament
- 20 April 2015 – Adopted by the Council
- Publication in the Official Journal of the EU on 19 May 2015
- The IFR came into force 20 days after publication in the Official Journal and is directly applicable in Member States
- Effective dates: 9 December 2015 and 9 June 2016 (for different provisions)
IFR provisions

- Card-based payment transactions where both the payer’s and the payee’s payment services providers are in the EU
- Sets out caps on interchange fees paid by acquirers to issuers (both for cross-border and domestic transactions), applicable from 9 Dec 2015
- Debit card interchange capped at 0.2%
- Credit card interchange capped at 0.3%
- Includes anti-circumvention provisions
- Provides for certain Member State discretions regarding domestic interchange fee caps
- The IFR does not cap the MSCs paid by merchants to acquirers
- Also contains various ‘Business Rules’ provisions
National discretions

- National discretions for Member States on domestic interchange fee caps (note: use of ‘Member State’ as opposed to ‘the competent authority’)

- Three-party systems operating with licensees: can be exempted from the domestic interchange fee caps for three years after they take effect (subject to a 3% (by value) market share threshold)

  **HMT has decided to exercise this exemption in the UK**

- Domestic credit card interchange fee cap: Member States can cut deeper than 0.3%

  **HMT has decided to stick with the 0.3% cap**

- Domestic debit card interchange fee cap: various options for Member States

  **HMT has decided to stick with the 0.2% cap but to allow a weighted average approach rather than a per transaction cap**
Business Rules

- Separation of scheme and processing activities (Art 7): 9 June 2016
- Licensing (Art 6): 9 Dec 2015
- Co-badging and choice of payment brand or payment application (Art. 8): 9 June 2016
- Unblending (Art. 9): 9 June 2016
- Honour All Cards rule (Art. 10): 9 June 2016
- Steering rules (Art. 11): 8 June 2015
- Information to the payee on individual card based transactions (Art. 12): 9 Dec 2015
Enforcement of the IFR

**System operator (e.g. MasterCard)**

- **IFR scope (PSP)**
- **IFR provisions with FCA relevance**
- **Interchange fee**

**Payment system**
- System operator to PSP relationships (system rulebook and obligations of participation are key components)
- PSP to PSP relationships (interchange fee is a key component)

**Payment services**
- PSP to end-user relationships
- PSD/PSRs 2009 focuses on these relationships
- Typically ongoing relationships covered by a 'framework contract'

**Issuer/PSP**
- Consumer (Cardholder)

**Acquirer/PSP**
- Merchant

**Digital Financial Services: Payments and regulatory matters**

**About Eversheds LLP**

**Welcome**

**Speaker biographies**

**Presentations**

**Future events**
Future events

Details of all upcoming events for the financial institutions sector can be found at eversheds.com/financialinstitutions/events. If you have any queries or would like to register your interest in any of our events, please contact Rabya Khanan (rabyakhanan@eversheds.com).

We provide regular and ad-hoc legal, regulatory and industry updates on key issues affecting financial institutions, including:

- Retail finance round-up
- Payment matters
- Investment management update

To register to receive our briefings, please contact Rabya Khanan (rabyakhanan@eversheds.com).

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