GETTING TO GRIPS WITH NEW GOVERNANCE: A REGULATIONS UPDATE

Helping business navigate the changing payments landscape
The world of payments is undergoing great change. As card, web and mobile payments increase, regulators want to create a more integrated payments environment. New governance is designed to create more competition, drive innovation and provide a better service for business and customers. This White Paper will guide you through the raft of new rules and help you understand how compliance will affect your business.

**KEY UPDATES**

- Interchange Fee Regulation
- The Payment Systems Regulator
- Payment Services Directive 2
- Data security standards
- E-Money and Anti-Money Laundering directives

**Interchange Fee Regulation**

Merchants pay interchange fees as part of the Merchant Service Charge to the acquirer, and these are passed on to the card issuers.

EU regulators were concerned by the levels of interchange fees and wanted to correct them, so it would not cost merchants more to accept card payments than cash. From 9th December 2015, new interchange fee caps come into force. Domestic debit card fees will be capped at 0.2% of the transaction value, and credit card fees at 0.3%.

Merchants who operate in more than one country should note that debit card fees will still vary across European Union member states. This is because, historically, countries have set domestic debit rates in different ways and member states insisted on maintaining their country-specific models. This will result in five models from which member states can choose.

Here in the UK, the Treasury (HMT) has confirmed that a weighted average approach will be taken. This means the domestic debit card interchange rate, dominated by the Visa brand, will remain as it is today. Visa has demonstrated to HMT that the current rate falls below the 0.2% cap set by the European Commission.

**Surcharging** - one of the key impacts of the new Interchange Regulation will be on surcharging. This is the fee charged by merchants to offset the cost of acceptance when customers wish to pay with a credit or debit card. The Interchange Regulation strongly recommends member states and merchants remove surcharging on all payment transactions using consumer credit and debit cards. However, this recommendation is only included in the recitals of the regulation, meaning it will not be a legal requirement.
Interchange fee caps introduced on the 9th of December 2015

0.2% cap on domestic debit cards

0.3% cap on credit cards

The impact may be most strongly felt by airlines and other companies in the travel industry, as well as many small and medium-sized businesses that use surcharging to offset the cost of interchange fees. However, since the new laws on interchange fees should reduce the cost of card transactions to merchants, surcharging would no longer be justified in any case.

The new regulations will cover consumer cards branded with Visa or MasterCard but will not apply to corporate cards or those that belong to three-party schemes such as American Express. Merchants will still be able to surcharge on these cards.

‘Honour All Cards’ Rule – the current rule that requires merchants to accept all cards from a given brand is also going to change. Merchants will be able to choose which types of card they want to accept. In order to allow merchants to distinguish between debit, credit, prepaid and commercial cards, issuers will have to visually identify them on the plastic and electronically within the chip. This will apply to all newly issued or re-issued cards from 9th June 2016.

The industry is currently working to establish a common way to do this across all schemes and issuers. Merchants who wish to selectively accept cards will also have to make changes, either to their point of sale terminal software or further down the processing chain.

It is important to note that selective acceptance by merchants will only be allowed for cards issued in the European Economic Area (EEA), which includes EU countries as well as Iceland, Norway and Liechtenstein.

Payment Systems – under the new Interchange Regulation, card schemes such as Visa and MasterCard will be forced to separate their scheme and processing functions with regard to accounting, organization and decision-making by June 2016. Card schemes are awaiting publication of technical standards for this separation by the European Banking Authority (EBA) but there will be future implications for the way card schemes deal with their customers.

Transparency - two key articles within the Interchange Regulation focus on driving greater transparency of data for merchants. Article 9 - effective from June 2016 - focuses on the pre-contractual discussions and the merchant agreement, and Article 12 - effective from December 2015 – focuses on the data available after a transaction has been processed.

However, there are no prescriptive details on what information must be provided or how. This will mean different acquiring interpreters can interpret the regulation in different ways. Lloyds Bank Cardnet will be making changes over the next six to 12 months to provide merchants with additional information as required by the regulation.

Payment Systems Regulator (PSR) - the PSR has been designated as the competent authority and will work with other regulators such as Trading Standards and the Financial Conduct Authority (FCA) to monitor Interchange Regulation in the UK. The PSR has told Lloyds Bank that it is currently conducting a consultation and will publish the results in early December 2015. They have also outlined how different regulators will be responsible for different Articles within the legislation, and have said they will collaborate with the EBA to oversee the separation of payment schemes and processing solutions.

Lloyds Bank Solutions - Lloyds Bank Cardnet understand the impact these changes will have on our customers and we will be feeding back to the PSR so it understands the consequences, and potential unintended consequences, of the regulation. Cardnet will also be looking to introduce a new pricing proposition and a new solution aimed at providing greater transaction data transparency.
Payment Services Directive 2 (PSD2)

PSD2 aims to create a single market for electronic payments that will continue to be effective as innovation takes place throughout the payments industry. The new rules focus on areas such as liability, access to payment accounts, transparency and customer authentication. They are intended to expand regulations at a Europe-wide level to reflect the new landscape where cards have overtaken cash and a host of new payments innovations are being adopted.

In the UK, the FCA will be in charge of implementing PSD2 and is expected to publish a document in the next three to six months outlining the transition from EU directive into UK law. The timeline for completing this transition will then stretch into late 2017 or early 2018. PSD2 must be transposed into national law within two years of its adoption by the European Parliament.

The final draft text of PSD2 released in November 2015 highlights three key issues:

- **Prohibition of surcharging** – Interchange Regulation recitals strongly recommend the removal of surcharging but PSD2 will prohibit its use altogether. Merchants should be aware that UK regulators could act to ban surcharging ahead of PSD2 being adopted.
- **Greater reporting and monitoring of payments** – making sure all Payment Service Providers report risk and security incidents to regulators.
- **Security of e-commerce** – stronger authentication for all electronic payments and account access is likely to be introduced between 2016 and 2018. The EBA is expected to release a consultation paper on this around the end of 2015.

**Payment Card Industry Data Security Standard (PCI DSS)** - The PCI DSS provides a framework for developing a robust payment card data security process to ensure card data is safe. These standards to prevent security breaches are going to come under severe scrutiny over the next few years as the new Data Protection Act is introduced.

Under PSD2, card acquirers and other financial institutions will need to report all data breaches to the regulators. Data breaches will therefore be in the public domain, raising consumer awareness of the issue. This should increase the level of priority that a merchant's business gives to PCI DSS compliance.

Visa is looking to amend their approach to PCI DSS to focus more on risk than monitoring. Fines will be increased if a merchant or acquirer is found to have been negligent when it comes to data security.
Other Regulations

We think customers should be aware of a number of other new regulations:

**E-Money Directive** – this is a legal framework for electronic payment products, designed to:

- Enable new, innovative and secure electronic money services to be designed by Payment Service Providers
- Provide market access to new companies
- Foster real and effective competition between all market participants

The E-Money Directive will bring the regime of e-money institutions in line with the requirements of payment institutions with the aim of benefitting consumers, businesses and the wider European economy.

**Anti-Money Laundering (AML) Directive** - the European Commission approved an agreement earlier this year with the European Parliament on strengthening rules preventing money laundering and terrorist financing. The agreed text focuses on ensuring consistency with the international approach, specifically with the information that accompanies funds transfers. Member states, such as the UK, have two years to bring this into national law.

Conclusion

It is a time of great complexity for merchants, but there should be more clarity going forward as new regulations are finalised and domestic regulators publish the results of consultations.

New interchange rules will empower merchants with additional data and payment acceptance methods, while PSD2 should see the payments market evolve with more competition and innovation.

Through close engagement with our customers and the regulators, Lloyds Bank Cardnet will continue to play a strong role in helping to shape strategy and offer solutions.

### Regulatory Horizon Overview

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- **July 2015**: PSR publish Call for Inputs on Card Payment Systems Programme of Work
- **August 2015**: HMT publish Consultation on Implementation of Interchange Regulation – Gov Response expected in September
The information shared during our Cardnet Regulation Update webinar was accurate at the time of recording but many of the regulations we discussed that form the basis of this report are subject to change.

Lloyds Bank Cardnet encourage clients to remain up-to-date on regulations and we will continue to use a range of communications platforms to help you navigate the changing payments landscape.