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by payvision

PSD2, marketplaces and the future of payments

A LOOK AT THE REGULATIONS, EXEMPTIONS AND IMPACT OF PSD2 ON THE ECOMMERCE MARKETPLACE MODEL

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Introduction:

NEW LEGISLATION, NEW CHALLENGES

13 January 2018 will be a watershed moment for the European payments landscape, with major ramifications for ecommerce. From that date onwards, the revised Payment Services Directive (PSD2)[1] will come into force across the European Economic Area (EEA), bringing with it a long list of changes to how online transactions are handled.

While this revision of PSD1[2] will impact all companies within the payments ecosystem, this paper focusses on one particular business model that will be heavily affected by its demands: the online marketplace.

The online marketplace model

The marketplace model can be easiest described as an online platform that enables transactions between buyers and sellers. While it can come in many guises (Foodora connecting restaurants with stay-at-home diners; Amazon connecting merchants with consumers; Airbnb connecting home owners with short term renters), this simple framework has been the foundation upon which many of ecommerce's most innovative and successful companies have been built.

In fact, by 2020, it's predicted online marketplaces will account for 39% of the entire online retail market.[3] Yet, if they fail to successfully adapt to PSD2's game-changing regulations, even the most successful marketplace could find itself penalized in 2018.

THIS PAPER LOOKS AT PSD2, THE KEY REGULATIONS, THE CHANGES TO ITS KEY EXEMPTIONS AND THE POTENTIAL NEXT STEPS FOR ONLINE MARKETPLACES.

1. DIRECTIVE (EU) 2015/2366 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.
2. DIRECTIVE 2007/64/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC.
3. Ecommerce News Europe: Global marketplaces to own 39% of online retail market in 2020, 2015

The legislation:

'THE BIGGEST CHANGE EVER IN BANKING'[4]

The central areas that PSD2 focuses on are competition, innovation, security and consumer protection. It aims to maintain a level playing field for payments, protecting smaller companies, as they are the ones truly driving innovation in the sector, and consumers, who will benefit from a more secure shopping process and a greater variety of choice across the EEA.

The approach is three pronged:

- PSD2 Level 2 measures[5] (expected to apply by mid-2019) give way to new and stricter standards for 2-factor customer authentication for all electronic payments across the EEA.
- PSD2 mandates the opening of banks' application programming interfaces (APIs) to third parties across the EEA, who will be able to securely access their customer accounts and data if the account holder provides such third parties with his/her consent.
- In line with the above, PSD2 lays down new services and categories of Payment Services Providers (PSPs), such as Third Party Providers (TPPs). An example of those are the Payment Initiation Services (PIS), through which PIS providers will initiate the payments following a customer's request from their account at their Account Servicing PSP (ASPSP). This will be done through a dedicated interface set up by the ASPSP. In

4. PSD2: The single biggest change in the banking industry ever – Ikka Ruotsila and Petri Syvanne, Accenture, 2016
5. The Level 2 measures in question are the "Regulatory Technical Standards (RTS) on strong customer authentication and secure communication under PSD2", mandated by Article 98 of PSD2, the final version of which is due to be published in early 2018. More information can be found on https://www.eba.europa.eu/regulation-and-policy/payment-services-and-electronic-money/regulatory-technical-standards-on-strong-customer-authentication-and-secure-communication-under-psd2

real terms, this means that payments can be made directly from a bank account rather than through payment cards. It also means more disintermediation, paving the way for more innovative payments, primarily through the use of Application Programming Interfaces (APIs).

In practice, this means stricter security requirements for electronic payments and the handling of consumer data, a more open market for companies offering innovative, business-oriented payment services, enhanced consumer rights regarding refunds and liability, and less leeway and more transparency regarding the charging of additional fees on certain types of payments.

One of the aspects that makes PSD2 particularly notable is that it is focused on the future. While previous, similar legislation, like PSD1, sought to legally clarify the payment processes already being followed across the EU/EEA, PSD2 is designed to ensure rapid digital payment innovations are not made at the expense of the consumer's security or the market's competitive edge.

As EU Commissioner Margrethe Vestager said when the European Commission voted in favor of PSD2 in October 2015,

"We have already used EU competition rules to ensure that new and innovative players can compete for digital payment services alongside banks and other traditional providers. Today's vote by the Parliament builds on this by providing a legislative framework to facilitate the entry of such new players and ensure they provide secure and efficient payment services. The new Directive will greatly benefit European consumers by making it easier to shop online and enabling new services to enter the market to manage their bank accounts..."[6]

What is regulated?

PSD2 places an increasing amount of scrutiny on any operator that, at any stage in a transaction, is handling another party's money. In an unprecedented step, it even regulates and requires a license from TPPs that do not handle customer's funds. With that in mind, it is wise for all ecommerce operators to understand what activities are considered to be payment services

6. European Parliament adopts European Commission proposal to create safer and more innovative European payments – Europa.eu, 2015

under PSD2. These include, amongst others:

- processing a payment made from a buyer to a seller;
- transferring funds to a seller on behalf of a buyer;
- initiating a payment from a buyer's bank account to a seller;
- acquiring and processing payment card transactions;
- holding a seller's money in a payment account before releasing it at the request of the seller;
- offering consolidated information on payment accounts that are held with PSPs.

A company that, at any point of its operation, could be said to be rendering any of the above services (as well as any of the ones listed in Annex I of PSD2) must obtain a license as a payment institution unless it qualifies for one of the detailed exemptions. And it is the narrowing of one the original PSD's key exemptions that should be of most concern to online marketplace platforms.

PSD2 and online marketplaces:

THE NARROWING OF THE COMMERCIAL AGENT EXEMPTION

One facet of PSD1 was the Commercial Agent Exemption, which establishes that the Directive shall not apply to "*payment transactions from the payer to the payee through a commercial agent authorized to negotiate or conclude the sale or purchase of goods or services on behalf of the payer or the payee*"[7]

As explained by the Financial Conduct Authority, this meant:

Payment transactions made via commercial agents could be exempt under certain conditions. The exclusion applied where payment transactions between a payer and payee were made through a commercial agent with permission to negotiate or conclude the sale or purchase of goods or services

7. DIRECTIVE 2007/64/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC. Article 3.b.

on behalf of the payer or payee.[8]

Over the last decade, many online marketplaces have operated under this exemption. They were allowed by some regulators to act as a (payment) intermediary between the payees (sellers or merchants) and payers (typically buyers) using their platform without being a licensed payment institution. The exclusion, therefore, has been used for payment transactions carried out from the payer to the payee through a commercial agent (the marketplace operator) authorized to negotiate or conclude the sale or purchase of goods or services on behalf of the payer or the payee. The Commercial Agent Exemption seems to provide that the intermediary (marketplace operator) only needs to be such an agent to negotiate or conclude sales (and not necessarily both). The scope of this exclusion within PSD1 would seem to apply to ecommerce marketplace providers who, by setting up their business operations to act as a commercial agent with their customers, can process their transactions on their behalf. Such a structure also typically provides for the sender of funds (usually a buyer) to write-off their debt owed to the ultimate recipient of those funds (the seller) upon the commercial agent's receipt of those funds.

In other words, by their reading of the law, the marketplace operators interpreted that the buyer does not pay the marketplace but pays the seller via an agent. The seller has legally received the payment, according to this interpretation, as soon as it has been received by the agent – i.e. the marketplace.

This activity has never been universally approved by all EU regulators and, country-to-country, enforcement of the exemption varies. While some regulators, including the supervisory authorities in some of the biggest European ecommerce markets, have been strict when implementing the Commercial Agent Exemption to ecommerce platforms, most local regulatory bodies have been happy to extend it to every platform using the marketplace model.

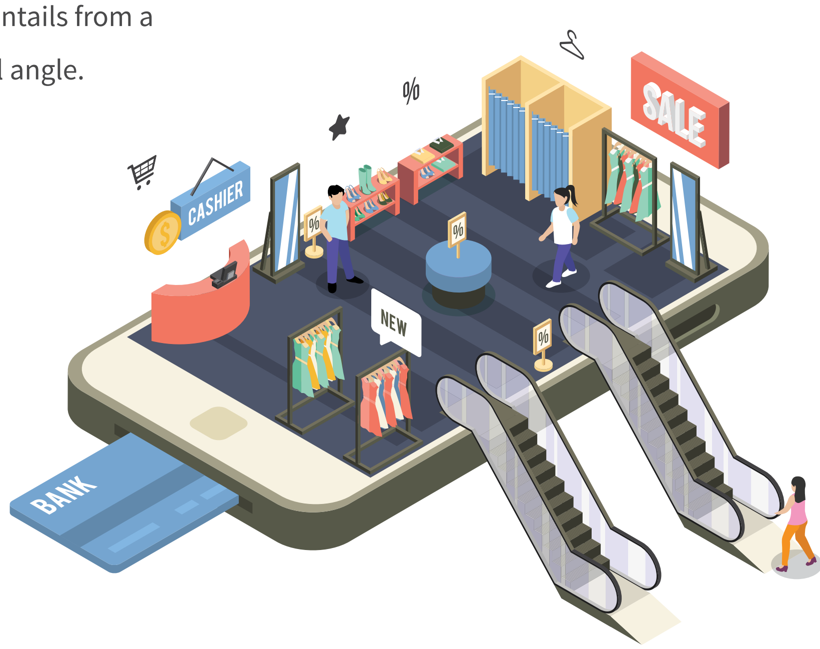
Filling the loophole

PSD2 explicitly narrows the number of ecommerce companies that will be able to rely on the Commercial Agent Exemption. It states that this usage of the exemption *"goes beyond the intended scope set out in the directive and has the potential to increase risks for consumers, as those providers remain outside the protection of the*

8. FCA.org.uk
9. The Impact of PSD2 Explained – Let's Talk Payments, 2016

legal framework… the exclusion should therefore only apply when agents act only on behalf of the payer or only on behalf of the payee, regardless of whether or not they are in possession of client funds. Where agents act on behalf of both the payer and the payee (such as ecommerce platforms), they should be excluded only if they do not, at any time enter into possession or control of client funds." [10]

The key and very significant change is that, according to PSD2, the commercial agent can only be an agent of either the payer or the payee (and not both, as is permitted under PSD1). This means, from January onwards, many online marketplaces will need to be licensed as a payment institution, with all that it entails from a financial, regulatory and operational angle.



10. DIRECTIVE (EU) 2015/2366 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC. Recital 11.

What to do next:

THE CHOICE FOR ECOMMERCE PLATFORMS

If you run an online marketplace, you now face a choice. You can either apply to operate as a licensed payment institution or outsource control of some or all your funds to a licensed payment institution. So, what would these moves entail?

Becoming a payment institution

Before you can apply for a payment institution license, you must first ensure all payment institution policies are being followed within your company. These include, but are not limited to, the following:

- a Money Laundering Officer must be employed;
- a Compliance Officer must be employed;
- a Risk Monitoring Officer must be employed;
- must have minimum capital of €125,000;
- must implement a cap on financial rewards to staff;
- must create an Underwriting Department;
- must create an Internal Audit Department;
- a set of strict AML policies must be in place;
- must limit your offering of equity to staff;
- senior management must undergo and pass fit and proper test, knowledge tests on AML policies, counterterrorist finance tests, risks when managing funds tests and tests on sanction law and the Financial Supervision Act.

Changing your infrastructure to meet these stipulations (e.g. to comply with PSD2's stricter IT security requirements) takes, on average, six months and will require assistance from a law firm specialized in payment services. Once it is all in place, you can apply for your license. The application process takes, generally, between 6 and 12 months to complete.

While the costs of this process will vary depending on your current business setup, they can be as high as €200,000 in some cases. If your application is successful and you are granted a license, you can continue operating as an intermediary between your buyers and sellers after paying the supervisory fees due to regulators.

Working with a licensed payment institution

The quicker and more cost effective option for dealing with PSD2 is to outsource control of some or all of your funds to a licensed payment institution. As the PSP is already compliant with PSD2 and they are now the ones acting as a funds safeguarding intermediary between those using your platform, you will not need to make huge system changes to continue operating as normal.

Conclusion:

MOVING FAST IS KEY TO SUCCESS IN 2018

PSD2 is a laudable and forward thinking piece of legislation that will, eventually, deliver a fairer and more innovative online retail world. Yet marketplaces that want to continue building on the success of recent years will have to react quickly to ensure PSD2 doesn't place a barrier in front of their growth.

As an online marketplace you have nothing to fear from PSD2 so long as you take the right steps in a timely fashion and ensure you become compliant before January next year.

About the publisher, author and editor

ACAPTURE.

Acapture is the subsidiary company of Payvision, one of the world's fastest growing global card acquiring networks. Licensed as a payment institution by the Dutch Central Bank, Acapture combines with Payvision to maximize the revenues of merchants and help them grow their business globally through a complete data-driven omnichannel payment solution, capable of managing a payment at every stage, from checkout to fund collection to settlement.

Together with its parent company, Payvision, Acapture, was awarded Best PSP at the 2017 MPE Awards in Berlin, and it specializes in maximizing revenue for merchants and marketplaces with international ambitions. Acapture's system features SlicePay for simplified allocation of funds to multiple parties from a single transaction, data science management for improved authorization rates, a one-day integration using one RESTful API, flexible, consolidated reporting, a streamlined reconciliation process, global card acquiring and the ability to handle 80+ of the most popular alternative payment methods and 160+ transaction currencies.

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