Hard Brexit: implications for banking, payments and consumer finance products

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To ensure the financial system continues to work effectively if there is a "hard Brexit" HM Treasury has been finalising a series of statutory instruments which will ensure there is a workable legal framework for retail banking services. The changes will take effect on exit day – at the moment that may well be 29 March 2019.

This note looks at some of the key changes for retail banking, payment services and consumer lending. Almost without exception the aim is to maintain the current framework and only change aspects which need to be changed for the legislation to continue to work effectively. These changes include giving the FCA or PRA power to do certain things which were previously reserved to European institutions such as the EBA. The other change is to narrow the geographic scope of the various regimes restricting them to the UK. Overall the impact is to "tweak" – however, certain of the changes will result in the need for changes to some processes and customer documentation.

Key Changes

Consumer Credit

The Consumer Credit (Amendment) (EU Exit) Regulations 2018 make some minor amendments to the Consumer Credit Act 1974 and associated regulations. The key amendment is to the standard pre-contract information, although it is typographical in nature. On exit day the word "European" will need to be deleted from the title of the SECCI and the ECCI and the reference to "your Member State of residence" will change to "the UK". Although minor in nature if a lender fails to make the changes the credit agreement will be technically unenforceable without a court order.

E-commerce and Distance Marketing: The FCA Handbook

The FCA is proposing to amend the sections of the FCA Handbook which deal with e-commerce and distance marketing – including BCOBS, MCOBS, ICOBS and CONC. Broadly the requirements will be limited to where the customer is in the UK and will no longer extend to situations where the customer is based in another EEA State. The e-commerce amendments will dovetail with amendments to other financial services legislation which will take away the right of an incoming firm to rely on the current e-commerce exclusion for some regulated activities. In terms of updating documentation, there will be changes to the content of pre-contract information including the ESIS – but the amendments are relatively minor.

Payment Services

The Electronic Money, Payment Services and Payment Systems (Amendment and Transitional Powers) (EU Exit) Regulations 2018 (**Payments Brexit SI**), amend the Payment Services Regulations 2017 (PSRs 2017) as well as the Electronic Money Regulations 2011.

If the Payments Brexit SI takes effect, it will amend the geographical scope of the PSRs 2017.

On exit day the PSRs 2017 conduct obligations will apply:

- to transactions that occur within the UK,

- to euro transactions between the UK and the EEA via a payment scheme that covers the EEA such as SEPA; and
- where either the payer or payee's PSP (but not both) is present in the UK.

Certain of these obligations will be disapplied depending on whether the transaction:

- is in a currency other than sterling or euro; or
- is made to or by a PSP outside the UK unless it is a euro transaction between the UK and the EEA in a EEA payments scheme.

In effect the Payments Brexit SI seeks to preserve the approach adopted currently in the PSRs 2017 by simply reducing their territorial scope. However, with the exception of Euro transactions this would alter the current treatment of non-sterling transactions between the UK and the EEA and EEA currency transactions that occur within the UK.

Charging, execution, value dating, and liability requirements imposed by the PSRs 2017 may cease to apply depending on the nature of the transaction in question.

Requirement	Intra UK sterling	EEA-UK in euro via SEPA	Intra UK non-sterling/euro	One leg out of UK – and not euro via SEPA	Corporate Opt Out available
The requirement for "SHA" Charges	√	√	√	x	N/A
Deduction of charges	√	√	x	x	N/A
D+1	√	√	x	x	N/A
Other execution times	√	√	x	√	N/A
Value Dating	√	√	√	√	N/A
Refunds for payee initiated transactions	√	√	√	x	Yes
Liability for non-execution, defective or late execution	√	√	√	x	In part[1]
Right of recourse against PSP	√	√	√	x	N/A

A key point to note is that the Payments Brexit SI assumes that the UK will be able to stay within SEPA. If that does not turn out to be the case, the SI would need to change and this is built into the amended PSRs.

The overall effect is that PSPs will have greater flexibility in terms of how they process payments to recipients outside the UK. However, changes to conduct requirements such as charging, execution times and the liability regime imposed by PSD2, may result in changes to an ASPSP's current processes and/or procedures which would need to be reflected in the information an ASPSP is required to disclose under the information requirements.

[1] Due to the way the UK has implemented PSD2, PSPs are still liable to a client who has agreed to the "corporate opt out" in respect of defective transactions initiated by a PISP

E-money Services

If the Payment Brexit SI takes effect, the Electronic Money Regulations 2011 (EMRs) will be amended with the result that:

- Electronic Money Institutions (EMIs) with their head office outside the UK can apply to have a branch directly authorised in the UK (previously this was only possible if the head office was outside the EEA);
- EMIs will be able to safeguard funds not just at banks in the EEA, but will elsewhere, by being able to safeguard in:
    - the central bank in an OECD state;
    - a bank that is regulated by an OECD state regulator; and
    - any other bank that meets certain regulation, auditing, surplus revenue, minimum asset, and reporting criteria.
- The conditions for authorisation are being amended so that any person outside the UK with close links to an EMI will need to be notified to the regulator (previously this requirement was relevant to persons outside the EEA).
- Accounting information required under the EMRs must be prepared subject to an auditor's report prepared by the institution's statutory auditor as defined in the Companies Act 2006.

(The last three changes are also relevant to payment institutions.)

SEPA Regulation

The Credit Transfers and Direct Debits in Euro (Amendment) (EU Exit) Regulations 2018 keep an amended version of the SEPA Regulation, and amend the Payments in Euro (Credit Transfers and Direct Debits) Regulations 2012 in an attempt to retain SEPA rules for payments between the EEA and the UK. HM Treasury is able to amend relevant legislation if it appears that PSPs in EEA states are complying with the "SEPA Regulation", as it applies in the European Union, by using payment schemes that discriminate against UK PSPs.

Payment Accounts

The Payment Accounts (Amendment) (EU Exit) Regulations 2018 (PARS Brexit SI) are intended to amend retained EU law relating to the Payment Accounts Regulations 2015, which transposed the Payment Accounts Directive (PAD) into UK law.

If the PARS Brexit SI takes effect:

- the FCA will assume responsibility for implementing technical standards relating to PAD documents setting out fees and charges (although, at least on day one, the status quo will continue since such documents will need to comply with the relevant "Commission Implementing Regulations" as amended from time to time, as well as any such technical standards);
- the FCA will maintain its own list of linked services (which need not follow EU standardised terminology) and assess this list for updates every 4 years, without reporting to the EBA and the European Commission;

- payment account providers will no longer need to facilitate cross-border opening of accounts; and
- payment account providers will be prohibited from discriminating against consumers resident in the UK (rather than the EU).

UK payment account providers will have discretion whether to continue to offer basic bank accounts to customers legally resident in the EU and whether to offer cash withdrawal or payment transactions outside the UK or in a currency other than sterling on any basic bank account (including basic bank accounts held by UK residents).

As before, the nine UK designated basic bank account providers must continue to offer basic bank accounts to UK residents and sterling cash withdrawals and sterling transactions on UK basic bank accounts must continue to be free.

Money Laundering Regulations and Wire Transfer Regulations

The Money Laundering and Transfer of Funds (Information) (Amendment) (EU Exit) Regulations 2018 will amend:

- the Money Laundering, Terrorist Financing and Transfer of Finds (Information on the Payer Regulations) 2012 (MLRs); and
- the Wire Transfer Regulation (Regulation (EU) 2015/847).

The MLRs will provide for EEA members to be treated as third parties. The key consequences are that UK institutions must carry out enhanced due diligence on correspondent relationships with institutions in the EEA. In certain scenarios the MLRs expand the potential scope of exemptions/carve outs. For example:

- Business relationships/transactions with persons established in high risk third countries will not be subject to enhanced due diligence where the customer in question is the branch of an entity established in a third country that is subject to national legislation that is equivalent to the fourth money laundering directive as it had effect on 26 June 2017.
- The MLRs expand the factors an institution must use to determine whether simplified due diligence is permitted to include whether the customer is an credit/financial institution that is subject to national legislation that is equivalent to the fourth money laundering directive as it had effect on 26 June 2017.
- An institution may rely on a third party to conduct customer due diligence in a high risk country, where that entity is the is the branch of an entity established in a third country that is subject to national legislation that is equivalent to the fourth money laundering directive as it had effect on 26 June 2017,

in each case this enables UK firms to consider whether other third countries have legislation in place that achieve an equivalent effect which may permit them to be considered on a par with an EEA country.

According to the explanatory memorandum, the intention is that the MLRs will retain the definition of a high risk country as a country identified on the list maintained by the European Commission; but that list will be on-shored as of exit day and remain static unless it is updated by the FCA.

The Wire Transfer Regulations are being amended so that certain derogations and protocols permitted or required for payments within the "Union", will now only relevant to payments that occur within the UK and Gibraltar. For example, the requirement to also include the payment account number of both payer and payee or the unique transaction identifier would not now apply to payments to the rest of the EEA.

Interchange Fees

The Interchange Fee (Amendment) (EU Exit) Regulations 2018 will amend:

- the Payment Card Interchange Fee Regulations 2015; and
- The Interchange Fee Regulation (Regulation (EU) 2015/751) (**IFR**), which will be retained in UK law in amended form (**UK IFR**).

The changes essentially reflect a reduction in scope in both cases, such that obligations that currently only bite on card based transactions carried out in the EEA will only bite on card transaction that occur wholly in the UK (for this to be the case both the issuer and acquirer, and the point of sale, must be in the UK). The obligation and current levels of caps are not changing.

The power to amend these will now rest with the Treasury.

Transactions that occur within the EEA will remain subject to the IFR as it currently stands; however, this will no longer apply to the UK. As a result, cross-border card transactions that occur between the UK and the EEA are no longer subject to either the IFR or the retained version in the UK IFR. The card issuer could therefore receive higher interchange fees. However, with the continued regulatory and competition focus on this area the levels of interchange are likely to be controlled.

Passporting for Payment Institutions and E-Money Institutions

The Payment Brexit SI does away altogether with the UK passporting regime for PIs under the PSRs and for EMIs under the EMRs. (There is one exception for PIs/EMIs passporting between the UK and Gibraltar, for whom this arrangement can continue.)

However, the Payment Brexit SI establishes a temporary permissions regime to enable EEA firms currently operating in the UK to continue their activities for up to a maximum of 3 years after exit day, so long as they have notified the relevant regulator in the 3 month period before exit day

An entity wishing to conduct its activity in the UK for longer than 3 years will need to become authorised its own right.

Authorised branches of EMIs with their head office outside the UK will only be able to provide payment services that are related to e-money activity. EEA firms currently able to carry out payment services under a passporting arrangement will need to consider how this impacts their business if they seek authorisation as an EMI longer term. This will not apply during the transitional period, but will apply in relation to any application for authorisation during the temporary permission regime.

The EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018 (EEA Passport Rights Regulations), establishes a similar regime for entities passporting under the Financial Services and Markets Act 2000 (although there is less detail around timing).

Other changes

There are also proposed changes to:

- The scope of the FSCS and in particular the way the deposits are covered although from a practical perspective the changes will not impact UK deposits; and

- The scope of FOS and the how the scheme covers EU consumers.

At the moment it is impossible to anticipate whether these changes will be implemented or not – the definition of exit day can be changed depending on what happens next. But firms will need to think about the possible options and what they may need to do to prepare if exit day is indeed 29 March 2019.

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