BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

CONSULTATIVE PAPER
ON

RETAIL PAYMENT SERVICES POLICY

AND THE

PAYMENT SERVICES DIRECTIVE

Deadline for replies: **31 March 2008**.
Replies can be sent to: gattj@centralbankmalta.com.

This document is prepared as a basis for consultation and discussion with all stakeholders. It does not prejudge the final form or content of any decision or position to be taken by the Central Bank of Malta.

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1. INTRODUCTION

1.1. Importance of this paper

This paper should be considered carefully by your organisation for the following reasons:

- Developments in the Central Bank of Malta's retail payment services policy, coupled with transposition of the Payment Services Directive (PSD)[1] and implementation of the Single Euro Payments Area (SEPA) will considerably change the payment services market landscape in Malta and will affect the businesses processes of all enterprises which process their own payments or the payments of others;

- The PSD will integrate payment systems in Europe so that the euro area will become a single currency area not only in respect of cash, but also in respect of other payment instruments. This will facilitate import, export, travel and virtually any cross border transaction;

- Progress in the functioning of retail payment systems may lead to significant developments in supply chain management, promises large cost savings to corporates, and necessitates the reformulation or reassessment of the business processes and competitive strategies of organisations involved in retail payments service provision;

- The Central Bank[2] wishes to examine whether these developments require the re-examination of the legislation in Malta that covers the cheque as an instrument of payment. This would have significant implications for treasury and credit management;

- The Single Payments Market (SPM) promises strong benefits for the Maltese economy. It is in the interest of corporates to engage in this process in order to identify opportunities or challenges for their business;

- The Central Bank launches this consultation having no fixed ideas, in the interest of seeking guidance from the market as to the most appropriate course of action to take where the Directive allows for discretion in implementation. This consultative paper is therefore an opportunity for your organisation to help shape to its advantage the development of the payment services market in Malta over the next years.

1.2. Aim

This paper seeks to initiate discussion and collect the views of stakeholders in light of Malta's implementation of the Payment Services Directive (PSD), which is to be completed by 1 November 2009, and inform the Central Bank's future policy initiatives in relation to retail payment services. It seeks to clearly identify the legislative options open to the Maltese legislator with a view to correctly understanding the operational implications of the options and selecting the regime most favourable to the Maltese economy in light of the new realities to be created by a Single Payments Market (SPM).

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[1] Council Directive (EC) 2007/64 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, at {http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:319:0001:0036:EN:PDF} (18/01/2008)

[2] The terms 'Central Bank of Malta', 'Central Bank' and 'the Bank' are used interchangeably within this document, save where context indicates otherwise.

As the euro was born without an SPM, cross-border direct debits are currently impossible, debit cards are predominantly national in reach and there is little pan-European technical standardisation in payments. Corporates active across borders as well as individuals exercising their free movement rights are obliged to have bank accounts in each country they operate in. Such fragmentation is particularly untenable in a single currency area such as the euro area. The Payment Services Directive's ultimate goal is to improve competition in the EU by integrating national payments markets and creating an SPM where improved economies of scale and efficient resource allocation increase economic welfare and reduce the total cost of payment systems to the economy. The PSD seeks to harmonise the law for the bulk of non-cash payment instruments – in particular credit transfers, debit and credit cards, and direct debits. With a common set of rules applicable in the Union, it is intended to make cross-border payments as easy and efficient as national transactions.

The Directive seeks to simultaneously enhance product quality and reduce costs by opening the payments market to new entrants, including non-bank institutions. Further intensification of competition will benefit consumers (lower prices, better quality), banks and payment service providers (which will be better able to expand across national borders), as well as various other stakeholders (cheaper, better payments mean lower costs for business, more trade). The PSD is also seen as the foundation for the Single Euro Payments Area (SEPA), a self-regulatory initiative by the banking industry to standardise, consolidate and Europeanise payment infrastructures and instruments, which was launched on 28 January 2008. An SPM in Europe, if achieved, promises huge benefits for the European economy, estimated by the Commission at € 28 billion p.a. as of itself[3], with further savings of € 100 billion p.a. once banks start to offer extended services that will be made possible, including pan-European e-invoicing and e-reconciliation[4], often termed "the dream of most corporate treasurers"[5]. The realisation of these goals will require substantial bank investment.

The PSD, while being a maximum harmonisation measure[6], does leave various options open to the national legislator in its implementation. Thus, transposition is not sufficient and the creation of a coherent implementation policy and strategy is essential. Furthermore, **the implementation of the PSD forces a review of various related matters**, in particular the regulatory capacity of the Central Bank in relation to payments systems, the regulation underpinning retail payments systems which are not within the scope of the PSD, and the relative position of non-electronic payment instruments such as cash and cheques within the economy.

1.3. Consultation process

It is important to stress that this paper does not contain any fixed ideas. It casts the net as wide as possible with the aim of generating maximum insight in all areas, looking for feedback on possible recommendations and suggested ways forward.

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[3] EUROPEAN COMMISSION, "Payment Services Directive: Frequently Asked Questions", MEMO/07/152, 24 April 2007, at {http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/07/152&format=HTML&aged=0&language=EN&guiLanguage=en}.

[4] Consultative Document on SEPA Incentives, European Commission 2006, at {http://ec.europa.eu/internal_market/payments/docs/sepa/sepa-2006_02_13_en.pdf} (25.03.07) (hereinafter 'Incentives paper'), p.14.

[5] CAPGEMINI, ABN AMRO AND EFMA, *World Payments Report 2006*, ABN AMRO 2006, at {http://www.transactionbanking.abnamro.com/html/knowledge%20zone%20articles/articles_and_white_papers/world_payments_06.html}(25.03.07), p.10.

[6] Meaning that Member States may not derogate from or supplement provisions unless expressly permitted in the text.

Nevertheless, this paper has been preceded by significant preparatory work and coordination between the actors involved in the process. As the authority with responsibility for the regulation and oversight of payment systems[7], the Central Bank is concerned with all issues related to wholesale and retail payment systems and instruments, be they cash, chartal or electronic. The Central Bank is therefore steering this consultation process. However, as the PSD also creates a new kind of financial institution and a corresponding prudential and supervisory regime, the Malta Financial Services Authority (MFSA) is closely involved. Furthermore, as the prime objective of the PSD is to foster and enable competition on the market, the Office for Fair Competition is also highly concerned with the process. The Central Bank has sought to work in close conjunction with these actors, and their views have already been taken into account in the drafting of this paper.

The Central Bank is interested in grasping stakeholders' views on its development of payment services policy and on all regulatory options within the PSD, as set out below. However, while it seeks to ensure that the consultation process is as open and comprehensive as possible, it also understands that many decisions in connection with both policy development and PSD implementation, especially as far as concerns matters related to prudential supervision, financial stability, consumer protection and enforcement, should remain the prerogative of market regulators acting in the public interest. Therefore, especially in relation to these matters, while the Central Bank will endeavour to understand stakeholders' views, decisions in respect of the framework to be applied will ultimately be coordinated by the Maltese authorities concerned within a context of best-practice-sharing with their European counterparts.

The consultation process will last for nine weeks, and submissions will be received until 31 March 2007. During this time, any queries arising may be directed to the Central Bank as per the contact details provided in this document. Please note that any responses received by the Bank could be made public unless a request otherwise is made and the Bank feels that the request is justified.

Upon completion of the consultation process, the authorities involved shall produce legal amendments as the outcome of the process shall require. An opinion of the European Central Bank shall be requested by any authority preparing a legislative provision, where required by Malta's obligations under European law[8]. Draft texts shall be made available on the Central Bank's website pending response by the European Central Bank, although the bank offers no guarantees that any views expressed at such a late stage will be taken into account. While much of the PSD's implementation may be carried into effect by subsidiary legislation or Central Bank Directives, any necessary Bill to amend the Laws of Malta shall be placed before Parliament in ample time for it to be passed before November 2009, the PSD's transposition deadline. Once all implementing measures have undergone legislative process, the Central Bank shall coordinate Malta's notification obligations towards the European Commission. In light of the Commission's Better Regulation initiative, correlation tables showing the link between the provisions in the PSD and national rules shall be created by all authorities preparing legislative provisions, and shall be compiled by the Central Bank and made available to the Commission.

[7] Central Bank of Malta Act, Cap. 204 of the Laws of Malta, Article 36.

[8] See Council Decision (EC) 98/415 of 29 June 1998 on consultation of the ECB by national authorities regarding draft legislative provisions, [1998] O.J. L189/42.

2. VISION OF THE CENTRAL BANK OF MALTA

2.1. Vision of the Eurosystem in creating a Single Payments Market

While having its eye set on the national market, the Central Bank of Malta shares in the Eurosystem's vision for a pan-European SPM. It is therefore interested and involved in both the implementation of the PSD as well as in the oversight and supervision of developments towards SEPA.

The Eurosystem and the Central Bank of Malta believe that the essential aim of the PSD is **to ensure that payments within the EU – in particular credit transfers, direct debits and card payments – become as easy, efficient and secure as domestic payments are now within an individual Member State** by providing the legal foundations to make SEPA possible. The PSD will reinforce the rights and protection of all users of payment services, whether consumers, retailers, large or small companies, or public authorities.

The PSD will greatly **facilitate the operational implementation of SEPA payment instruments** by the banking industry, as well as their adoption by end-users, by harmonising the underlying legal framework. This will provide the foundations for a single "domestic" euro payments market. The PSD will also **underpin consumer protection, and enhance competition and innovation**, by establishing an appropriate prudential framework for new entrants to the market for retail payments. This should **encourage technological progress and the realisation of new product opportunities**, such as e-payments, e-invoicing and e-reconciliation, which can provide major benefits to the wider economy.

Currently, divergent legal settings in the 27 member states not only introduce price rigidities and unjustifiable differences into national payment services, but they also create significant impediments for players who are interested in offering their services across member state borders. The same holds for potential new entrants to the market for payment services – such as supermarkets, telecommunications providers and other non-bank institutions.

Together, the PSD and SEPA should also mean that it **will no longer be necessary for corporates and individuals to hold a bank account in more than one country within the euro area,** as it will be possible for payment transactions to be effected or received across the euro area from one bank account under domestic conditions, and therefore for corporate payment processing to be centralised. The Eurosystem sees this as a precondition for the euro area to become a true single currency area.

2.2. Vision for the development of retail payment systems in Malta

The role of the Central Bank in relation to payment systems has traditionally largely been limited to operational involvement in wholesale payment systems, as well as payment systems oversight especially where there is systemic importance. This role is set to evolve significantly, as emerging responsibilities for the execution in Malta of the Eurosystem's priorities pertaining to payment systems necessitate an **updated role for the Central Bank**.

This need becomes more urgent in light of the necessary implementation, and subsequent enforcement, of the PSD, as well as in relation to oversight of the SEPA project. The Central Bank, therefore, must increasingly be concerned with the regulation and oversight of retail payment systems, services and instruments, with a view to promoting a competitive, safe, effective and efficient payment systems environment.

The Central Bank believes that a pan-European level playing field leading to an SPM will, by removing obstacles to cross-border service provision, **enable increased market competition in**

Malta, reduce technical inefficiencies and economic rents, as well as allow for greater recourse to scale, orienting market structures towards increased efficiency, generation of consumer welfare and consequently economic growth. Such developments are welcomed and pursued within the national context, and remain the primary orientation of the Central Bank in relation to the PSD and SEPA. However, the national context requires the Central Bank to also focus on areas of particular relevance to its tasks and responsibilities.

Implementation of **the PSD will cause the updating of Malta's regime relative to electronic payment instruments**, and the creation of a single, clear and harmonised regime for those instruments. Clearly, the Central Bank wishes to **ensure correct and timely implementation of the PSD** in order for it to achieve its desired results in Malta, to facilitate banks' initiatives in relation to SEPA and to ensure that Malta follows through on its European commitments.

However, the Central Bank believes that the advantages of the PSD may only be achieved in Malta within the framework of a comprehensive retail payment services policy. This PSD requires certain supporting or flanking measures in order to translate into maximum gain for the Maltese economy. It will also have knock-on or indirect effects which should be correctly foreseen and analysed, while offering future possibilities which should be utilised to full benefit.

The Central Bank believes that updating the law relative to those instruments which fall within the ambit of the PSD is not necessarily sufficient. In order to reach its objectives, the Central Bank considers that improvement of the legal or operational regimes underpinning other payment instruments may also be desirable if current provisions or practices do not provide the efficiency, clarity, legal certainty or guarantees for free competition that are required of a modern operational framework or regulatory regime.

Within this context and as a result of its increasing focus on the regulation and oversight of retail payment systems, services and instruments, the **Central Bank wishes to ensure that it has the legislative and operational capacity it requires to be an effective regulator**, with such administrative powers as to safeguard its ability to steer development and ensure competition. Making certain that users of retail payment services have adequate possibilities for administrative redress is also a priority for the Central Bank. A market landscape which is efficiently regulated, ensures financial stability and provides legal certainty will help market participants take well-informed investment decisions, diminish risk and develop new product offerings in line with their business objectives.

Within this context, **the Central Bank strongly believes in light-touch regulation where this is possible**. The Central Bank notes that it is the market that is best equipped to develop economically optimal outcomes, save in cases where market failures prevent it from doing so. For this reason, it believes that it should not intervene with regulation unless the existence of persistent and well-defined market failures (such as informational problems, transaction costs, agency problems, public or common-pool resources, defective rights systems, externalities and market power) necessitates regulatory intervention in order to restore optimal market functioning. Save in such cases, the Central Bank considers that minimal regulation is best consistent with its objective of **increasing the competitivity of market participants based in or operating out of Malta and attracting payments business to the country** – be it in the form of retail service providers or back-end support services to corporates, such as in the form of payment factories.

The **repositioning of certain payments instruments** may also offer very substantial benefits to the economy. Whilst cash must be safely produced, carried, counted, controlled, tracked, kept, and disposed of, cheques are printed, issued, mailed, received, sorted, inputted, deposited, accounted for, cleared and reconciled (each of these processes being largely manual and costly), generating costs for organisations handling these instruments at each stage of their lifecycle. These high costs

account for a notable percentage of GDP and are met by the Central Bank, commercial banks, along with all organisations involved in cash or cheque processing. The latter often largely ignore or take for granted these costs in considering them a necessary business overhead.

Electronic payment instruments, however, can be processed at the push of a button and cleared automatically, at a fraction of the cost. They are capable of point-to-point straight through processing (STP), altogether eliminating intermediate processing involving manual intervention, and speeding up execution time. Furthermore, they are less susceptible to theft, fraud and abuse and increasingly sport robust anti-fraud mechanisms ranging from secure internet banking authentication to chip and PIN technology for cards. Pre-acceptance verification of funds means that electronic payment instruments result in lower credit risk and costs for businesses and organisations, especially as compared to cheques, which may be returned to drawer. Finally, STP instruments are susceptible to Electronic Bill Presentment and Payment (EBPP), by which banks enable businesses to fully integrate their accounting or business process software with internet banking facilities, allowing for fully electronic invoicing, payment and reconciliation, along with further large cost reductions.

These developments have increasingly made the cost and inefficiencies of cash and cheques more apparent. At least six EU countries have already phased out cheques altogether, while all seek to reduce cheque usage and reduce the volume of cash in circulation. Nevertheless, the Central Bank believes that current economic incentives in Malta may often encourage the use of less efficient and less secure payment instruments. Such **market distortions must be progressively removed or mitigated in order for consumers to be encouraged to switch to more efficient and secure** instruments, including those made possible by the PSD and SEPA, and see and enjoy for themselves the real savings and advantages they offer. Allowing consumers to choose on the basis of efficiency will reduce the cost of payments, and will result in greater social welfare generation coupled with a reduction in dead-weight loss[9] for the economy. Such developments would therefore foster economic growth.

2.3. Future orientations of the Central Bank's vision

In the longer term, the Central Bank seeks to **maintain, develop and oversee a regulatory regime which encourages the stable and sustainable development of payments services in Malta, while facilitating opportunities for competition, growth and innovation**. It intends to ensure that the entire landscape of retail payments services is afforded a modern and effective regulatory framework.

In doing so, it wishes to encourage the use of **electronic payments instruments** and facilitate market participants' obtention of higher STP rates. It wishes to progressively reposition cash and cheques and see increased use of more efficient and secure payments instruments. While it does not believe that it should dictate to customers their choice of payment instruments, it does wish the market to develop according to incentives which are undistorted and efficiency-inducing.

The Central Bank also intends to assert its role as **guarantor that SEPA will be implemented correctly and in a timely fashion, with envisioned benefits in actual fact finding their way to citizens**. While the Central Bank fully supports SEPA and self-regulation by banks as a first-best option, and while it must be mentioned that significant progress has been made by Maltese banks, should the market encounter any substantial difficulties in implementing or realising the potential gains of SEPA, or in making product offerings which are at least of as high quality as current non-SEPA offerings, or in obtaining satisfactory migration rates to SEPA instruments, the Central

[9] This is further discussed in section 5.2.

Bank might find itself having to regulate in order to make SEPA a reality for citizens. Furthermore, while the Central Bank believes that its operational involvement in retail payments is not currently justified, it would not hesitate to become operationally involved should it find that this becomes necessary. The Central Bank is deeply convinced that developments are such that the present traditional methods of processing and executing retail customer's payments need to be changed.

The PSD provides the required legislation to launch the use of direct debits in Malta. The use of this very efficient instrument could provide the basis for improved collection of money by retail business, and would create the context to introduce inter-bank clearing services for such instruments.

Finally, the Central Bank wishes to encourage the marketing of value added services in addition to core SEPA instruments, and believes that value-added services will form strong business opportunities for service providers over the coming years. In particular, the Central Bank hopes to see substantial development in relation to e-payment, m-payment, e-invoicing, and e-reconciliation.

3. OVERVIEW OF THE SUBSTANTIVE PROVISIONS OF THE PSD

3.1. A new legal framework for payments[10]

The PSD has an impressively broad scope. It sets out to enact comprehensive rules for the bulk of payment instruments, excluding cheques, which are currently used as an alternative to legal tender, and applies to domestic and cross-border transactions in euro as well as in the currencies of other Member States, while furthermore attempting to do so on a technologically neutral basis. A summary of the content of the more important of its provisions is set out below[11].

By introducing a single set of rules for payments, the Directive seeks to foster competition between players in an otherwise fragmented market, as well as by creating a regulatory regime for payment institutions which are neither credit institutions nor electronic money institutions.

In introducing a single set of rules, it most notably makes provision for:

Information requirements: Before a payment service user is bound by a payment service contract or offer, the payment service provider is (with certain exceptions) to fulfil certain information requirements, including making available clear and understandable information on pricing (breakdown of charges and exchange rates applied) and maximum execution time[12]. Certain information is also to be provided to the payer and to the payee after execution of payment transactions[13]. A Member State may place the burden of proof for the fulfilment of information requirements upon on the payment service provider[14].

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[10] For responses to frequently asked questions on the PSD, see EUROPEAN COMMISSION, "Payment Services Directive: Frequently Asked Questions", *supra* note 3.

[11] For a more detailed analysis of not the final but the proposed text of the Directive, refer to PRIESEMANN J., "Proposal for a Directive on Payment Services in the Internal Market, Overview and Initial Comments", (2006) 1 EUREDIA 15, and STEENNOT R., "Erroneous Execution of Payment Transactions and Unauthorised Use of Payment Instruments: The Proposal for a Directive on Payment Services in the Internal Market", (2006) 1 EUREDIA 69.

[12] PSD, *supra* note 1, Articles 36, 37, 41, 42 and 46.

[13] Ibid., Articles 38, 39, 47 and 48.

[14] Ibid., Article 33

Execution time: All payments falling within the scope of the PSD are subject to a one business day execution time, calculated from receipt of the payment instruction[15]. However, parties may, until 1 January 2012, agree upon a timeframe of up to three days for payments initiated by the payer and denominated in euro or another national EU currency (even if these entail one currency conversion between the euro and another currency), and up to four days for other intra-Community payments (including card/direct debit transactions, which are initiated by the payee, and payments which involve a currency conversion between two non-euro currencies). Parties may increase execution time by one day for paper-initiated transactions, and Member States may decrease it for purely domestic transactions[16].

Liability for faulty execution: In case of non-execution, late or defective execution of a payment transaction, liability towards the payer rests with the service provider. This liability results in full responsibility for any failure by other parties in the payment chain up to the account of the payee (without prejudice to the provider's ability to seek redress from others). This liability does not arise under abnormal and unforeseeable circumstances or if it would not have arisen except for the acts and omissions of the payee's payment service provider (for whose selection solely the payee is responsible), though with burden of proof on the payer's service provider[17].

Liability in case of misuse of a payment instrument: This rests with the payment service user, but is limited to € 150. However, this amount may be reduced by Member States and does not arise for unauthorised payments occurring after the user has properly notified his/her payment service provider. The payer is to bear all the losses on unauthorised transactions if he incurred them either by acting fraudulently, or by acting intentionally or with gross negligence in failing to fulfil the terms governing the issue of the payment instrument or in failing to notify the payment service provider without undue delay in case of the loss or theft of the instrument[18].

The full amount rule: The full amount of a payment order is to be credited to a beneficiary, without deduction. The payee's payment service provider may levy separate fees if this has agreed upon by the parties[19].

Refunds/revocations: The Directive also harmonises conditions whereby a payer may request and obtain a refund in respect of payment transactions initiated by or through a payee (e.g. direct debits)[20], as well as by which a payer can (not) revoke a payment order received by his payment service provider[21].

These are but a few of the rules set out within the PSD; a detailed reading is strongly suggested.

3.2. A new financial institution: The payment institution

Along with a single regime as described above, the PSD also introduces the regulatory recognition of a new kind of financial institution, the 'payment institution', together with a corresponding prudential and supervisory regime.

The Directive broadly caters for the authorisation of three different types of payment institutions:

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[15] Ibid., Articles 64, 69.

[16] Ibid., Articles 68, 69.

[17] Ibid., Articles 60, 75.

[18] Ibid., Article 61.

[19] Ibid., Article 67.

[20] Ibid., Article 62.

[21] Ibid., Article 66.

– money remitters,

– mobile telecom operators carrying out payment transactions, and

– full-range payment service providers (e.g. credit transfers, direct debits, card payments) including credit related to the payment.

In order for it to be authorised, a payment institution is to satisfy a variety of qualitative and quantitative requirements.

Qualitative requirements "include, but are not limited to, sound administrative, risk management and accounting procedures, proper internal control mechanisms, directors and managers that are of good repute and possess appropriate knowledge and experience, as well as shareholders that are suitable taking into account the need to ensure the sound and prudent management of a payment institution"[22].

Quantitative requirements, on the other hand, relate to the provision of adequate capital. The institution is to maintain capital as least equal to the higher of the initial or ongoing capital requirements.

Initial capital requirements are of € 20,000 (money remitters), € 50,000 (mobile payments) or € 125,000 (full-range payment service providers including any credit). Ongoing capital requirements, on the other hand, are calculated on the basis of either (at the supervisory body's choice, in line with Member States legislation) 10% of fixed overheads, or a digressive percentage (from 4% to 0.25%) of the amount of monthly payment transactions in previous year, or a digressive percentage (from 10% to 1.5%) of the sum of interest income, interest expenses, commissions and fees, and other operating income. Multipliers of 0.5 and 0.8 apply to money remitters and payment transactions carried out by mobile telecom operators respectively. Furthermore, national competent authorities may increase or reduce the ongoing capital requirement by 20% (whatever the method chosen) on the basis of the quality of risk management.

In addition, where credit is granted by the institution, the supervisory authorities are to be satisfied with the amount of own funds of the payment institution in light of the amount of credit provided. Any credit granted is to be strictly ancillary to the execution of a payment transaction, and is to be provided exclusively from own funds of the institution or from monies raised on capital markets.

4. REGULATORY OPTIONS IN THE IMPLEMENTATION OF THE PSD AND QUESTIONS FOR DISCUSSION

Note: In this section, comments in square brackets ([ ]) are at times used within quotes from the directive. Kindly note that such comments do not form part of the Directive and are used here for clarification / readability purposes only.

4.1. Introduction

This section sets out to clearly identify the options open to the Maltese legislator within the PSD. It explains each of the options, usually quoting the relevant provisions of the PSD. However, for the various options to be properly understood, this section should be read in conjunction with the PSD itself as a whole.

[22] EUROPEAN COMMISSION, "Payment Services Directive: Frequently Asked Questions", *supra* note 3.

4.2. PSD: Title I – Subject-matter, scope and definitions

4.2.1 Exempted institutions

Some institutions may be exempted from the scope of the Directive:

> *Article 2 – Scope, paragraph 3:*
> *3. Member States may waive the application of all or part of the provisions of this Directive to the institutions referred to in Article 2 of Directive 2006/48/EC, with the exception of those referred to in the first and second indent of that article.*

Article 2 of Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) refers to certain institutions in the Member States which have a particular state-assigned purpose or function. Other than the Central Bank of Malta, no such Maltese institution is included. Therefore, while the Central Bank of Malta is automatically authorised to act as a payment service provider[23] , it is up to the Maltese legislator to determine the extent to which the provisions of the PSD apply to the services it offers to the Government or other persons.

However, the regime to be applied in respect of the Central Bank of Malta should be determined in light of its responsibilities, tasks and functions within the European System of Central Banks, and in coordination with its other National Central Banks and the European Central Bank. Other than in this regard, this option is not relevant to the Maltese legislator.

4.3. PSD: Title II – Payment service providers

4.3.1 Waiver of ongoing capital requirements for subsidiaries

The Maltese legislator may choose to exclude subsidiary companies fulfilling certain conditions from ongoing capital requirements:

> *Article 7 – Own funds, paragraph 3:*
> *3. If the conditions laid down in Article 69 of Directive 2006/48/EC are met, Member States or their competent authorities may choose not to apply Article 8 of this Directive to payment institutions which are included in the consolidated supervision of the parent credit institution pursuant to Directive 2006/48/EC.*

The conditions laid down in Article 69 of Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) are:

> *(a) there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities by its parent undertaking;*
>
> *(b) either the parent undertaking satisfies the competent authority regarding the prudent management of the subsidiary and has declared, with the consent of the competent authority, that it guarantees the commitments entered into by the subsidiary, or the risks in the subsidiary are of negligible interest;*
>
> *(c) the risk evaluation, measurement and control procedures of the parent undertaking cover the subsidiary; and*
>
> *(d) the parent undertaking holds more than 50 % of the voting rights attaching to shares in the capital of the subsidiary and/or has the right to appoint or remove a majority of the members of*

[23] PSD, *supra* note 1, Article 1 read in conjunction with Article 29.

the management body of the subsidiary described in Article 11.

Article 8 relates to the minimum ongoing capital requirements of payment institutions, and is described in further detail under the following subtitle.

Questions for discussion

Q1. In your view, should the Maltese legislator avail itself of this option? Why (not)?

4.3.2 Method used for the calculation of on-going capital

Payment institutions are to hold own funds equivalent to the higher of initial or on-going capital requirements[24]. However, the PSD allows for the use of different methods in calculating ongoing capital requirements. The Maltese legislator may prescribe that calculations should always be made according to one of the methods, or may allow for the use of more than one option, with the competent authority choosing the one method applicable *in casu* at its discretion.

The methods applicable are the following:

> *Article 8 – Calculation of own funds*
> *[…]*
> *Method A*
> *The payment institution's own funds shall amount to at least 10 % of its fixed overheads of the preceding year. The competent authorities may adjust that requirement in the event of a material change in a payment institution's business since the preceding year. Where a payment institution has not completed a full year's business at the date of the calculation, the requirement shall be that its own funds amount to at least 10 % of the corresponding fixed overheads as projected in its business plan, unless an adjustment to that plan is required by the competent authorities.*
>
> *Method B*
> *The payment institution's own funds shall amount to at least the sum of the following elements multiplied by the scaling factor k defined in paragraph 2, where payment volume (PV) represents one twelfth of the total amount of payment transactions executed by the payment institution in the preceding year:*
>
> *(a) 4,0 % of the slice of PV up to EUR 5 million, plus*
> *(b) 2,5 % of the slice of PV above EUR 5 million up to EUR 10 million, plus*
> *(c) 1 % of the slice of PV above EUR 10 million up to EUR 100 million, plus*
> *(d) 0,5 % of the slice of PV above EUR 100 million up to EUR 250 million, plus*
> *(e) 0,25 % of the slice of PV above EUR 250 million.*
>
> *Method C*
> *The payment institution's own funds shall amount to at least the relevant indicator defined in point (a), multiplied by the multiplication factor defined in point (b) and by the scaling factor k defined in paragraph 2.*
>
> *(a) The relevant indicator is the sum of the following:*
>
> *– interest income,*
> *– interest expenses,*
> *– commissions and fees received, and*
> *– other operating income.*
>
> *Each element shall be included in the sum with its positive or negative sign. Income from extraordinary or irregular items may not be used in the calculation of the relevant indicator. Expenditure on the outsourcing of services rendered by third parties may reduce the relevant indicator if the expenditure is incurred from an undertaking subject to supervision under this*

[24] PSD, supra note 1, Article 7(1).

Directive. The relevant indicator is calculated on the basis of the twelve-monthly observation at the end of the previous financial year. The relevant indicator shall be calculated over the previous financial year. Nevertheless own funds calculated according to Method C shall not fall below 80 % of the average of the previous three financial years for the relevant indicator. When audited figures are not available, business estimates may be used.

(b) The multiplication factor shall be:

(i) 10 % of the slice of the relevant indicator up to EUR 2,5 million;
(ii) 8 % of the slice of the relevant indicator from EUR 2,5 million up to EUR 5 million;
(iii) 6 % of the slice of the relevant indicator from EUR 5 million up to EUR 25 million;
(iv) 3 % of the slice of the relevant indicator from EUR 25 million up to 50 million;
(v) 1,5 % above EUR 50 million.

Methods B and C are subject to a scaling factor calculated as follows:

Article 8 – Calculation of own funds, paragraph 2:
2. The scaling factor k to be used in Methods B and C shall be:

(a) 0,5 where the payment institution provides only the payment service listed in point 6 of the Annex [money remittance];
(b) 0,8 where the payment institution provides the payment service listed in point 7 of the Annex [e- & m-payments];
(c) 1 where the payment institution provides any of the payment services listed in points 1 to 5 of the Annex.

One should note that, whichever of the methods chosen, the competent authority will be able to choose to vary the amount of minimum on-going capital by +/- 20% on the basis of "an evaluation of the risk-management processes, risk loss data base and internal control mechanisms of the payment institution"[25].

Questions for discussion

Q2. Would any of the methods create operational or other difficulties for your organisation?

Q3. Do you have any other comments, concerns or suggestions in relation to the above?

4.3.3 Commingling of funds

The Maltese legislator must provide for a regime that safeguards funds received from payment users and funds received for the execution of payments transactions from commingling with other funds. It may do so either by requiring operational separation (separate accounts) plus legal insulation against the claims of other creditors or by requiring an insurance policy or guarantee that covers such funds, payable in the case of insolvency. The legislator may provide for only one of these two methods, or may provide for both, allowing either the competent authority or the financial institution itself to choose which method to apply:

Article 9 – Safeguarding requirements, paragraph 1
1. The Member States or competent authorities shall require a payment institution which provides any of the payment services listed in the Annex and, at the same time, is engaged in other business activities referred to in Article 16(1)(c) to safeguard funds which have been received from the payment service users or through another payment service provider for the execution of payment transactions, as follows:

Either:

[25] PSD, supra note 1, Article 8(3).

(a) they shall not be commingled at any time with the funds of any natural or legal person other than payment service users on whose behalf the funds are held and, where they are still held by the payment institution and not yet delivered to the payee or transferred to another payment service provider by the end of the business day following the day when the funds have been received, they shall be deposited in a separate account in a credit institution or invested in secure, liquid low-risk assets as defined by the competent authorities of the home Member State; and

(b) they shall be insulated in accordance with national law in the interest of the payment service users against the claims of other creditors of the payment institution, in particular in the event of insolvency;

or

(c) they shall be covered by an insurance policy or some other comparable guarantee from an insurance company or a credit institution, which does not belong to the same group as the payment institution itself, for an amount equivalent to that which would have been segregated in the absence of the insurance policy or other comparable guarantee, payable in the event that the payment institution is unable to meet its financial obligations.

However, where funds are received from a client which may be used either for future payment transactions or for other business services, and it is unknown how the client will use the funds, the Maltese legislator may chose to either require safeguarding of all the funds received, or solely of a representative portion calculated on the basis of historical data:

Article 9 – Safeguarding requirements, paragraph 2
2. Where a payment institution is required to safeguard funds under paragraph 1 and a portion of those funds is to be used for future payment transactions with the remaining amount to be used for non-payment services, that portion of the funds to be used for future payment transactions shall also be subject to the requirements under paragraph 1. Where that portion is variable or unknown in advance, Member States may allow payment institutions to apply this paragraph on the basis of a representative portion assumed to be used for payment services provided such a representative portion can be reasonably estimated on the basis of historical data to the satisfaction of the competent authorities.

The Maltese legislator may require the safeguarding of funds even when the financial institution is not engaged in business activities other than payment services:

Article 9 – Safeguarding requirements, paragraph 3
3. The Member States or competent authorities may require that payment institutions which are not engaged in other business activities referred to in Article 16(1)(c) shall also comply with the safeguarding requirements under paragraph 1 of this Article.

The Maltese legislator may require safeguarding only of the funds of clients which exceed € 600:

Article 9 – Safeguarding requirements, paragraph 4
4. The Member States or competent authorities may also limit such safeguarding requirements to funds of those payment service users whose funds individually exceed a threshold of EUR 600.

Questions for discussion

Q4. Are any of the two methods provided for in Article 9(1) easier to operate? Why?

Q5. Do either of the two methods provided for in Article 9(1) provide for better security for clients? Why?

Q6. In your view, who should choose which method to apply – the legislator prescriptively (legal certainty), the competent authority (adaptability and control) or the financial institution itself (flexibility)? Why?

Q7. Where funds are received for future transactions of an unknown nature, are there any substantial risks or benefits that may materialise by allowing for the safeguarding of a representative portion based on historical data?

Q8. Do you agree that safeguarding of funds should also be required when the payment institution only carries out payments business? Why?

Q9. Should the Maltese legislator only require the safeguarding of clients' funds exceeding €600? Why? Always or at the discretion of the competent authority? Why?

4.3.4 Designation of competent authorities (authorisation and prudential supervision)

> *Article 20 – Designation of competent authorities*
> *1. Member States shall designate as the competent authorities responsible for the authorisation and prudential supervision of payment institutions which are to carry out the duties provided for under this Title either public authorities, or bodies recognised by national law or by public authorities expressly empowered for that purpose by national law, including national central banks.*
>
> *The competent authorities shall guarantee independence from economic bodies and avoid conflicts of interest. Without prejudice to the first subparagraph, payment institutions, credit institutions, electronic money institutions, or post office giro institutions shall not be designated as competent authorities.*
>
> *The Member States shall inform the Commission accordingly.*
>
> *2. Member States shall ensure that the competent authorities designated under paragraph 1 possess all the powers necessary for the performance of their duties.*

While the Eurosystem (as of 1 January 2008) and the Central Bank of Malta are responsible for the regulation and supervision of payments systems in Malta, the authority responsible for the authorisation and prudential supervision of payment institutions in Malta need not be the Central Bank. As the MFSA currently is responsible for the authorisation and prudential supervision of all credit, financial and investment services institutions, it is envisioned that such responsibility for payment institutions will also be vested in the MFSA, within the framework provided for in the Financial Institutions Act[26].

However, in terms of Article 10(2) of the PSD, the competent authority may be required to, or may be allowed the discretion to, consult with the Central Bank before an authorisation is granted.

4.3.5 Derogation from authorisation/supervision requirements for small payment service providers

The Maltese legislator may prescribe that small payment services providers (monthly transactions of less than € 3 million) are not subject to the authorisation and prudential supervision regime, certain criteria within the PSD being fulfilled. Additional criteria set out by the Maltese legislator for exclusion may also be required. The legislator may also decide to allow discretion in this regard to the competent authority. Furthermore, such excluded institutions may be disallowed from carrying out certain services other than payments services (services ancillary, operation of payments systems, and other business activities):

> *Article 26 – Conditions*

[26] Cap. 376 of the Laws of Mata.

1. Notwithstanding Article 13, Member States may waive or allow their competent authorities to waive the application of all or part of the procedure and conditions set out in Sections 1 to 3, with the exception of Articles 20, 22, 23 and 24 [designation of competent authority, professional secrecy obligations of the competent authorities, right to judicial review against decisions taken by the competent authorities, exchange of information by the competent authorities], and allow natural or legal persons to be entered in the register provided for in Article 13, where:

(a) the average of the preceding twelve months' total amount of payment transactions executed by the person concerned, including any agent for which it assumes full responsibility, does not exceed EUR 3 million per month. That requirement shall be assessed on the projected total amount of payment transactions in its business plan, unless an adjustment to that plan is required by the competent authorities; and

(b) none of the natural persons responsible for the management or operation of the business has been convicted of offences relating to money laundering or terrorist financing or other financial crimes.

2. Any natural or legal person registered in accordance with paragraph 1 shall be required to have its head office or place of residence in the Member State in which it actually carries on its business.

3. The persons referred to in paragraph 1 shall be treated as payment institutions, save that Article 10(9) and Article 25 [both related to passporting] shall not apply to them.

4. Member States may also provide that any natural or legal person registered in accordance with paragraph 1 may engage only in certain activities listed in Article 16 [services ancillary, operation of payments systems, other business activities].

5. The persons referred to in paragraph 1 shall notify the competent authorities of any change in their situation which is relevant to the conditions specified in that paragraph. Member States shall take the necessary steps to ensure that where the conditions set out in paragraphs 1, 2 and 4 are no longer fulfilled, the persons concerned shall seek authorisation within 30 calendar days in accordance with the procedure laid down in Article 10.

6. This Article shall not be applied in respect of provisions of Directive 2005/60/EC [on the prevention of money laundering and terrorist financing] or national anti-money-laundering provisions.

Questions for discussion

Q10. In your view, are there any reasons why small service providers should / should not be excluded as above? Would any such exclusion be commensurate with the risks faced by such providers and their customers in the course of their business?

Q11. In your view, should such exclusion be dependent on any criteria additional to those in the PSD?

Q12. In your view, should such exclusion operate *ex lege*, or at the discretion of the competent authority / according to preset criteria requiring verification by the competent authority?

Q13. If such preset criteria are used to establish a turnover threshold lower than € 3 million, in your view, what would be a reasonable threshold given the size of the Maltese market?

Q14. In your view, should small service providers be excluded from providing ancillary services, operating payments systems, or from carrying out business activities other than payment services? Why?

4.4. PSD: Title III – Transparency of conditions and information requirements for payment services

4.4.1 Consumer protection and micro enterprises

The PSD provides for certain consumer protection rules which may not be derogated from by contract, but allows agreement otherwise between enterprises (any entity engaged in economic activity irrespective of legal form, i.e. even sole-traders) and organisations. The rules relate to information requirements, charges for information and the burden of proof in establishing that such requirements have been carried out, as applicable to single payment transactions, framework contracts and the payment transactions covered by them.

However, the Maltese legislator may decide that micro enterprises (enterprises which employ fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million[27]) are to also fall under the regime applicable to consumers:

> *Article 30 – Scope, paragraph 2*
> *2. Member States may provide that provisions in this Title shall be applied to micro enterprises in the same way as to consumers.*

Questions for discussion

Q15. What are the perceived advantages/disadvantages of the applicability of consumer rules to micro enterprises?

Q16. Could the inclusion of micro enterprises as described create any operational difficulties for payment institutions or for the micro enterprises themselves?

4.4.2 Burden of proof on information requirements

While burden of proof usually rests with the party alleging a fact, there is a relative difficulty for consumers to prove that they have not received information. This has resulted in an option for the Maltese legislator to prescribe that the burden of proof relating to the fulfilment of a payment service provider's information requirements is placed upon the payment service provider itself:

> *Article 33 – Burden of proof on information requirements*
> *Member States may stipulate that the burden of proof shall lie with the payment service provider to prove that it has complied with the information requirements set out in this Title.*

Questions for discussion

Q17. Would there be any difficulty for service providers to discharge this burden of proof? How does this relate to any difficulties that may be experienced by consumers?

4.4.3 Derogation from information requirements for low-value payment instruments and electronic money

The PSD allows for derogation from information requirements for payment instruments governed by a framework contract, which according to such contract concern only payment transactions not

[27] See Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, [2003] O.J. L124/36-41.

exceeding € 30 or which have a spending limit of € 150 or store funds which do not exceed € 150 at any time[28]. In such cases, simplified requirements apply.

The Maltese legislator may vary the above amounts for domestic transactions only. Any of the amounts may be reduced or doubled. The amounts may also be increased to € 500 for prepaid payment instruments:

> *Article 34 – Derogation from information requirements for low-value payment instruments and electronic money, paragraph 2*
> *2. For national payment transactions, Member States or their competent authorities may reduce or double the amounts referred to in paragraph 1. For prepaid payment instruments, Member States may increase those amounts up to EUR 500.*

Questions for discussion

Q18. Should this option be exercised, or would it be more beneficial to apply a single regime to local and cross-border transactions indiscriminately? Why?

Q19. What other factors come to mind in relation to information requirements for prepaid instruments?

4.4.4 Termination of framework contracts

Article 45 of the PSD governs the termination of framework contracts, and allows for the legislator to set up grounds or conditions for termination more favourable to payments service users:

> *Article 45 – Termination*
> *1. The payment service user may terminate the framework contract at any time, unless the parties have agreed on a period of notice. Such a period may not exceed one month.*
>
> *2. Termination of a framework contract concluded for a fixed period exceeding 12 months or for an indefinite period shall be free of charge for the payment service user after the expiry of 12 months. In all other cases charges for the termination shall be appropriate and in line with costs.*
>
> *3. If agreed in the framework contract, the payment service provider may terminate a framework contract concluded for an indefinite period by giving at least two months' notice in the same way as provided for in Article 41(1).*
>
> *4. Charges for payment services levied on a regular basis shall be payable by the payment service user only proportionally up to the termination of the contract. If such charges are paid in advance, they shall be reimbursed proportionally.*
>
> *5. The provisions of this Article are without prejudice to the Member States' laws and regulations governing the rights of the parties to declare the framework contract unenforceable or void.*
>
> *6. Member States may provide more favourable provisions for payment service users.*

Questions for discussion

Q20. If applicable, what is the current practice in your organisation in relation to termination of framework contracts?

Q21. What further grounds or conditions do you believe would facilitate or encourage the safe use of payment services? Are any further conditions necessary for the safety or peace of mind of users?

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[28] PSD, supra note 1, Article 34(1); see also recitals 24 – 28.

Q22. Are there grounds to differentiate between framework contracts relative to different payment instruments, for example for reasons of public confidence in a particular product or due to the design of the product itself?

4.4.5 Information for the payer on individual payment transactions

On execution of an individual payment transaction, the payment service provider is to provide the payer with the information prescribed in the directive. The Maltese legislator may further impose that certain information is to be provided free of charge on paper on a monthly basis:

> *Article 47 – Information for the payer on individual payment transactions*
> *1. After the amount of an individual payment transaction is debited from the payer's account or, where the payer does not use a payment account, after the receipt of the payment order, the payer's payment service provider shall provide the payer without undue delay in the same way as laid down in Article 41(1) with the following information:*
>
> *(a) a reference enabling the payer to identify each payment transaction and, where appropriate, information relating to the payee;*
> *(b) the amount of the payment transaction in the currency in which the payer's payment account is debited or in the currency used for the payment order;*
> *(c) the amount of any charges for the payment transaction and, where applicable, a breakdown thereof, or the interest payable by the payer;*
> *(d) where applicable, the exchange rate used in the payment transaction by the payer's payment service provider, and the amount of the payment transaction after that currency conversion; and*
> *(e) the debit value date or the date of receipt of the payment order.*
>
> *2. A framework contract may include a condition that the information referred to in paragraph 1 is to be provided or made available periodically at least once a month and in an agreed manner which allows the payer to store and reproduce information unchanged.*
>
> *3. However, Member States may require payment service providers to provide information on paper once a month free of charge.*

Questions for discussion

Q23. Is there any reason that justifies the imposition of such a monthly paper-based information requirement? If yes, what kind of information should be included?

Q24. How useful would such a measure be to payment service users? How costly would this be to payment service providers?

Q25. Is there reason to exercise the option in paragraph 3, however only following a request to that effect by a payment service user?

4.4.6 Information for the payee on individual payment transactions

Article 48 establishes similar information requirements to Article 47, though here in respect of payees. The option allowed to the Maltese legislator is identical to that described in the preceding section:

> *Article 48 - Information for the payee on individual payment transactions*
> *1. After the execution of an individual payment transaction, the payee's payment service provider shall provide the payee without undue delay in the same way as laid down in Article 41(1) with the following information:*

(a) the reference enabling the payee to identify the payment transaction and, where appropriate, the payer, and any information transferred with the payment transaction;
(b) the amount of the payment transaction in the currency in which the payee's payment account is credited;
(c) the amount of any charges for the payment transaction and, where applicable, a breakdown thereof, or the interest payable by the payee;
(d) where applicable, the exchange rate used in the payment transaction by the payee's payment service provider, and the amount of the payment transaction before that currency conversion; and
(e) the credit value date.

2. A framework contract may include a condition that the information referred to in paragraph 1 is to be provided or made available periodically at least once a month and in an agreed manner which allows the payee to store and reproduce information unchanged.

3. However, Member States may require payment service providers to provide information on paper once a month free of charge.

Questions for discussion

Q26. Is there any reason that justifies the imposition of such a monthly paper-based information requirement? If yes, what kind of information should be included?

Q27. How useful would such a measure be to payment service users? How costly would this be to payment service providers?

Q28. Is there reason to exercise the option in paragraph 3, however only following a request to that effect by a payment service user?

4.5. PSD: Title IV – Rights and obligations in relation to the provision and use of payment services

4.5.1 Out-of-court redress procedure for enterprises and organisations

As discussed above (in section 4.4.1), various rules in the PSD relating to consumer protection are subject to agreement otherwise by the parties if both are enterprises or organisations. As also discussed under that section, the Maltese legislator may prescribe that micro enterprises are to be treated as consumers. While an out-of-court redress procedure (see section 4.6 below) is to be made available to consumers, doing so for users who are enterprises or organisations is at the option of the legislator:

Article 51 - Scope
1. Where the payment service user is not a consumer, the parties may agree that Article 52(1), the second subparagraph of Article 54(2), and Articles 59, 61, 62, 63, 66 and 75 shall not apply in whole or in part. The parties may also agree on a time period different from that laid down in Article 58.

2. Member States may provide that Article 83 [out-of-Court redress] does not apply where the payment service user is not a consumer.

3. Member States may provide that provisions in this Title are applied to micro enterprises in the same way as to consumers.

[…]

It is envisioned that micro enterprises will be treated under this article in the same way as determined by the outcome of questions under section 4.4.1 above.

Questions for discussion

Q29. Is there any reason not to offer out-of-court redress also to enterprises and organisations?

4.5.2 Payment of charges applicable

The PSD establishes that each party to a payment transaction that does not include a currency conversion is to pay the charges of their own payment services provider (also known as 'shared charges' or 'SHARE'). This encourages the use of efficient payment instruments and encourages the choice of the most efficient service provider by each party. Sharing of charges has also been shown to facilitate straight through processing (STP). The mandated sharing of charges does not affect the ability of payment service providers to levy a zero charge on the payer and/or payee, should they choose to do so.

However, the PSD does also give the right to the payee to request a charge from, or offer a reduction to, the payer in respect of the use of a given payment instrument.

The exercise of this right also has the potential to promote the use of more efficient instruments, as it allows payees to charge for the use of instruments which are less efficient and/or cause them to incur extra expenses. Payees may also choose to reward the use of certain instruments by means of a reduction in the amount to be paid, presumably where the use of a particular instrument results in lower costs or other benefits for the payee.

Nevertheless, this right may also be misused and may lead to abusive pricing practices or pricing which does not encourage the efficient use of instruments. For this reason, the national legislator is offered a corrective mechanism whereby the right may be limited or altogether forbidden.

> *Article 52 – Charges applicable, paragraphs 2 and 3*
> *[…]*
> *2. Where a payment transaction does not involve any currency conversion, Member States shall require that the payee pays the charges levied by his payment service provider, and the payer pays the charges levied by his payment service provider.*
>
> *3. The payment service provider shall not prevent the payee from requesting from the payer a charge or from offering him a reduction for the use of a given payment instrument. However, Member States may forbid or limit the right to request charges taking into account the need to encourage competition and promote the use of efficient payment instruments.*

Questions for discussion

Q30. Is there any reason why the Maltese legislator should, at the time of transposition, limit or forbid the right discussed above?

Q31. If at all, what limitations would be appropriate?

Q32. Could the exercise of the right by payees cause any operational difficulties for payment service providers or make it harder to achieve STP? How difficult would it be for the market to overcome such difficulties?

4.5.3 Derogation from certain rules for low value payment instruments and electronic money

Section 4.4.3 above discussed the exclusion of low value payments and electronic money from many of the information requirements within the PSD. Article 53 is structured similarly and allows for derogation for low value payments and electronic money in respect of the rules relating to

unauthorised use, notification of a lost payment instrument, authentication and authorisation, notification of refusal of execution, revocation and execution time[29].

The derogation, like that discussed in section 4.4.3 above, applies to payment instruments governed by a framework contract, which, according to such contract, concern only payment transactions not exceeding € 30, or which have a spending limit of € 150, or store funds which do not exceed € 150 at any time. Again, the Maltese legislator may vary the above amounts for domestic transactions only. Any of the amounts may be reduced or doubled. The amounts may also be increased to € 500 for prepaid payment instruments.

Rules on liability for unauthorised transactions also apply to electronic money, except where the payer's payment service provider does not have the ability to freeze the payment account or block the payment instrument. However, this last exception may be limited to apply only to payment accounts or payment instruments of a certain value.

> *Article 53 – Derogation for low value payment instruments and electronic money*
> *1. In the case of payment instruments which according to the framework contract, solely concern individual payment transactions not exceeding EUR 30 or which either have a spending limit of EUR 150 or store funds which do not exceed EUR 150 at any time payment service providers may agree with their payment service users that:*
>
> > *(a) Article 56(1)(b) and Article 57(1)(c) and (d) as well as Article 61(4) and (5) do not apply if the payment instrument does not allow its blocking or prevention of its further use;*
> > *(b) Articles 59, 60 and Article 61(1) and (2) do not apply if the payment instrument is used anonymously or the payment service provider is not in a position for other reasons which are intrinsic to the payment instrument to prove that a payment transaction was authorised;*
> > *(c) by way of derogation from Article 65(1), the payment service provider is not required to notify the payment service user of the refusal of a payment order, if the non-execution is apparent from the context;*
> > *(d) by way of derogation from Article 66, the payer may not revoke the payment order after transmitting the payment order or giving his consent to execute the payment transaction to the payee;*
> > *(e) by way of derogation from Articles 69 and 70, other execution periods apply.*
>
> *2. For national payment transactions, Member States or their competent authorities may reduce or double the amounts referred to in paragraph 1. They may increase them for prepaid payment instruments up to EUR 500.*
>
> *3. Articles 60 [provider's liability for unauthorised transactions] and 61 [payer's liability for unauthorised transactions] shall apply also to electronic money within the meaning of Article 1(3)(b) of Directive 2000/46/EC [of 18 September 2000 on the taking up, pursuit of and prudential supervision of the business of electronic money institutions], except where the payer's payment service provider does not have the ability to freeze the payment account or block the payment instrument. Member States may limit that derogation to payment accounts or payment instruments of a certain value.*

The exercise of options under this Article is linked to the exercise of options discussed in section 4.4.3 above. Note that paragraph 1 of this article as of itself contains no options for the national legislator.

Questions for discussion

Q33. Should the option in paragraph 2 be exercised, or would it be easier to apply a single regime to local and cross-border transactions indiscriminately? Why?

[29] See PSD, supra note 1, recital 30.

Q34. Is there any reason for the Maltese legislator to limit the exception/derogation found in paragraph 3?

Q35. What advantages or challenges can be envisaged in relation to the exercise or otherwise of options under this Article?

4.5.4 Payer's liability for unauthorised payment transactions

The maximum liability of a payment service user for unauthorised transactions is of € 150, subject to certain conditions as described below. Such amount may be reduced in the user's favour by the Maltese legislator.

> *Article 61*
> *Payer's liability for unauthorised payment transactions*
> *1. By way of derogation from Article 60 [service providers shall immediately restore the amount of unauthorised payment transactions] the payer shall bear the losses relating to any unauthorised payment transactions, up to a maximum of EUR 150, resulting from the use of a lost or stolen payment instrument or, if the payer has failed to keep the personalised security features safe, from the misappropriation of a payment instrument.*
>
> *2. The payer shall bear all the losses relating to any unauthorised payment transactions if he incurred them by acting fraudulently or by failing to fulfil one or more of his obligations under Article 56 [use in accordance with terms; notification of any loss/theft/misappropriation] with intent or gross negligence. In such cases, the maximum amount referred to in paragraph 1 of this Article shall not apply.*
>
> *3. In cases where the payer has neither acted fraudulently nor with intent failed to fulfil his obligations under Article 56, Member States may reduce the liability referred to in paragraphs 1 and 2 of this Article, taking into account, in particular, the nature of the personalised security features of the payment instrument and the circumstances under which it was lost, stolen or misappropriated.*
>
> *4. The payer shall not bear any financial consequences resulting from use of the lost, stolen or misappropriated payment instrument after notification in accordance with Article 56(1)(b), except where he has acted fraudulently.*
>
> *5. If the payment service provider does not provide appropriate means for the notification at all times of a lost, stolen or misappropriated payment instrument, as required under Article 57(1)(c), the payer shall not be liable for the financial consequences resulting from use of that payment instrument, except where he has acted fraudulently.*

A higher liability limit (up to € 150) acts as an incentive for users to keep their payment instruments secure and avoid unauthorised use and fraud. However, a lower liability limit acts as an incentive for payment service providers to invest in increased security features, better detect fraud, and spreads the risk of loss, theft and misappropriation across the pool of service users. Thus the balance to be struck relates to levels of avoidable unauthorised use through the better conduct of users – if there are substantial gains to be made here, a higher liability limit may be justified.

<u>Questions for discussion</u>

Q36. What is the current reality in relation to unauthorised transactions? In what proportion of cases is the user to blame, as opposed to genuine cases of loss despite normal use?

Q37. Are there any difficulties inherent in proving fraud, negligence or wilful misconduct by users?

4.5.5 Execution times

As set out in section 3.1 above, all payments falling within the scope of the PSD are subject to a one business day execution time, calculated from receipt of the payment instruction[30]. However, parties may, until 1 January 2012, agree upon a timeframe of up to three days for payments initiated by the payer and denominated in euro or another national EU currency (even if these entail one currency conversion between the euro and another currency), and up to four days for other intra-Community payments (including card/direct debit transactions, which are initiated by the payee, and payments which involve a currency conversion between two non-euro currencies). Execution time may be increased by one day for paper-initiated transactions. Member States, however, retain the option to decrease execution times for purely domestic transactions[31]:

> *Article 72 – National payment transactions*
> *For national payment transactions, Member States may provide for shorter maximum execution times than those provided for in this Section.*

Shorter times for national payment transactions may encourage the use of STP and efficient processing, ensure the maintenance of existing service levels, and may force better preparation of the national industry for the competitive environment within a future SPM. This article may also be used as a tool in relation to SEPA instruments only, causing these to offer higher levels of service than current instruments and facilitating SEPA migration of domestic transactions.

Questions for discussion

Q38. If applicable, what are the current execution times of payment transactions carried out by your organisation? How and on what basis are these established?

Q39. Do you envisage any major challenges if maximum execution times for national payment transactions falling under the PSD were to be reduced? In relation to which instruments do you envisage challenges to arise?

Q40. If shorter execution times were only established in relation to SEPA-compliant instruments, do you believe this would facilitate and reduce the costs of SEPA migration by encouraging users to change more swiftly?

Q41. Do you believe that forcing the reduction of execution times sooner rather than later would enable national service providers to be better prepared for an SPM and increased competitive pressure?

Q42. Would any such advantages justify the application of different rules to local and cross-border transactions?

4.5.6 Transitional provisions

The PSD makes allowance for bodies carrying out payment services during initial period after entry into force of national provisions implementing the PSD, in order to allow them to continue transacting business on a transitional basis pending authorisation or registration as required.

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[30] PSD, *supra* note 1, Articles 64, 69.

[31] Ibid., Articles 68, 69.

4.5.6.1 Provision of payment services pending authorisation

Once the PSD enters into force (20 days after publication in the Official Journal), persons conducting payment services may continue to provide their services, pending authorisation, until 30 April 2011 (18 months after the transposition deadline, 1 November 2009):

> *Article 88 - Transitional provision, paragraph 1*
> *1. Without prejudice to Directive 2005/60/EC or other relevant Community legislation, Member States shall allow legal persons who have commenced before [date of entry into force of this Directive] the activities of payment institutions within the meaning of this Directive, in accordance with the national law in force to continue those activities within the Member State concerned until 30 April 2011, without authorisation under Article 10. Any such persons who have not been granted authorisation within this period shall be prohibited in accordance with Article 29 to provide payment services.*

4.5.6.2 Institutions included in the consolidated supervision of a parent undertaking

Despite the above, institutions that provide money transmission services in accordance with Maltese law before 1 November 2009, and which are **effectively included in the consolidated supervision of a parent undertaking (a credit institution), are exempted from authorisation** as a payment institution, provided they notify the competent authority of their activities by the date of entry into force of the Directive, including with such authorisation information that shows that they fulfil the criteria within Article 5 (a), (d), (g) to (i), (k) and (l) of the PSD. However, the Maltese legislator may allow the competent authority to exempt such institutions from showing that they meet these requirements under Article 5 of the PSD. The criteria within Article 5 (a), (d), (g) to (i), (k) and (l) refer to the submission of a programme of operations; a description of systems for the safeguarding of funds; a description of structural organisation; notification of identity/ size of holdings in the organisation; directors and persons responsible for management and demonstration of aptitude; legal status and articles of association; and notification of the address of head office, respectively:

> *Article 88 - Transitional provision, paragraph 2*
> *2. Notwithstanding paragraph 1, an exemption to the authorisation requirement under Article 10 shall be granted to financial institutions that have commenced activities listed in point 4 of Annex I [money transmission services] to Directive 2006/48/EC [of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast)] and meet the conditions of point (e) of the first subparagraph of Article 24(1) , of that Directive [the financial institution is effectively included in the consolidated supervision of the parent undertaking] in accordance with national law before [date of entry into force of this Directive]. However, they shall notify the competent authorities of the home Member State of these activities by [date of entry into force of this Directive]. Furthermore, this notification shall include the information demonstrating that they have complied with Article 5(a), (d), (g) to (i), (k) and (l) of this Directive [certain requirements for authorisation]. Where the competent authorities are satisfied that those requirements are complied with, the financial institutions concerned shall be registered in accordance with Article 13 of this Directive. Member States may allow their competent authorities to exempt those financial institutions from the requirements under Article 5 [applications for authorisation].*

Questions for discussion

Q43. Is there any reason why the legislator should not allow the discretionary waiver of requirements under Article 5 as described above?

4.5.6.3 Institutions already authorised under other laws

The Maltese legislator may provide that any person that has already satisfied the requirements of Articles 5 and 10 of the PSD (which together constitute the criteria for authorisation), presumably

because such person is already licensed as a financial or credit institution, may be authorised and registered automatically without further formality:

> *Article 88 - Transitional provision, paragraph 3*
> *3. Member States may provide that legal persons referred to in paragraph 1 shall be automatically granted authorisation and entered into the register provided for in Article 13 if the competent authorities already have evidence that the requirements laid down in Articles 5 and 10 are complied with. The competent authorities shall inform the entities concerned before the authorisation is granted.*

Questions for discussion

Q44. Is there any reason why the legislator should not implement this option?

4.5.6.4 Small payment institutions eligible for a waiver

Section 4.3.5 above discussed the possibility for the Maltese legislator to waive authorisation requirements for small payment services providers subject to certain criteria. If this option is availed of, payment institutions which are eligible for such a waiver may continue to provide payment services for a period determined by the Maltese legislator, not being longer than three years, before they are required to obtain a waiver and be registered in order to operate.

> *Article 88 - Transitional provision, paragraph 4*
> *4. Without prejudice to Directive 2005/60/EC [of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing] or other relevant Community legislation, Member States may allow natural or legal persons who have commenced the activities of payment institutions within the meaning of this Directive, in accordance with the national law in force before [the date of entry into force of this Directive] and who are eligible for waiver under Article 26 to continue those activities within the Member State concerned for a transitional period not longer than 3 years without being waived in accordance with Article 26 and entered into the register provided for in Article 13. Any such persons who are not waived within this period shall be prohibited in accordance with Article 29 to provide payment services.*

Questions for discussion

Q45. What period, being of not longer than 3 years, do you believe would be reasonable to allow before an institution is required to obtain a waiver?

4.6. Enforcement and redress

The PSD requires that authorities designated in respect of the authorisation and prudential supervision of payment institutions (Title II) have all the powers necessary for the performance of their duties. As discussed in section 4.3.4 above, it is currently envisaged that this role is to be performed by the MFSA, within the framework provided for in the Financial Institutions Act[32]. The Maltese legislator is also to ensure that the competent authority has the powers required by Articles 20 and 21 of the PSD:

> *Article 20 – Designation of competent authorities, paragraph 2*
> *2. Member States shall ensure that the competent authorities designated under paragraph 1 [in respect of authorisation and prudential supervision] possess all the powers necessary for the performance of their duties.*
>
> *Article 21 – Supervision*

[32] Cap. 376 of the Laws of Mata.

1. Member States shall ensure that the controls exercised by the competent authorities for checking continued compliance with this Title are proportionate, adequate and responsive to the risks to which payment institutions are exposed.

In order to check compliance with this Title, the competent authorities shall be entitled to take the following steps, in particular:

(a) to require the payment institution to provide any information needed to monitor compliance;
(b) to carry out on-site inspections at the payment institution, at any agent or branch providing payment services under the responsibility of the payment institution, or at any entity to which activities are outsourced;
(c) to issue recommendations, guidelines and, if applicable, binding administrative provisions; and
(d) to suspend or withdraw authorisation in cases referred to in Article 12.

2. Without prejudice to the procedures for the withdrawal of authorisations and the provisions of criminal law, the Member States shall provide that their respective competent authorities, may, as against payment institutions or those who effectively control the business of payment institutions which breach laws, regulations or administrative provisions concerning the supervision or pursuit of their payment service business, adopt or impose in respect of them penalties or measures aimed specifically at ending observed breaches or the causes of such breaches.

3. Notwithstanding the requirements of Article 6, Article 7(1) and (2) and Article 8, Member States shall ensure that the competent authorities are entitled to take steps described under paragraph 1 of this Article to ensure sufficient capital for payment services, in particular where the non-payment services activities of the payment institution impair or are likely to impair the financial soundness of the payment institution.

Thus, while it is envisaged that tasks under Title II of the directive will be entrusted to the MFSA in accordance with the provisions above, the remainder of the directive, and in particular Titles III and IV ('Transparency of conditions and information requirements for payment services' and 'Rights and obligations in relation to the provision and use of payment services' respectively) are also to be implemented in national law. Effective, proportionate and dissuasive penalties are to be available in respect of all infringements of national provisions implementing the PSD. As titles III and IV of the PSD fall within the competence of the Central Bank, it is expected that much of the implementing legislation necessary will be carried into effect by Central Bank Directives. As such, it must be ensured that adequate penalties are available for their enforcement:

Article 81 – Penalties, paragraph 1
1. Member States shall lay down the rules on penalties applicable to infringements of the national provisions adopted pursuant to this Directive and shall take all measures necessary to ensure that they are implemented. Such penalties shall be effective, proportionate and dissuasive.

Finally, the PSD also provides for the availability of a complaint and out-of-court redress procedure available to payment service consumers, and possibly all users (see section 4.5.1 above):

Article 80 – Complaints
1. Member States shall ensure that procedures are set up which allow payment service users and other interested parties, including consumer associations, to submit complaints to the competent authorities with regard to payment service providers' alleged infringements of the provisions of national law implementing the provisions of this Directive.

2. Where appropriate and without prejudice to the right to bring proceedings before a court in accordance with national procedural law, the reply from the competent authorities shall inform the complainant of the existence of the out-of-court complaint and redress procedures set up in accordance with Article 83.

Article 83 – Out-of-court redress

1. Member States shall ensure that adequate and effective out-of-court complaint and redress procedures for the settlement of disputes between payment service users and their payment service providers are put in place for disputes concerning rights and obligations arising under this Directive, using existing bodies where appropriate.

2. In the case of cross-border disputes, Member States shall make sure that those bodies cooperate actively in resolving them.

The MFSA is already empowered by legislation to oversee credit and financial institutions, and is thus already largely capable of carrying out the tasks that may be entrusted to it under measures implementing the PSD. While certain legislative amendments will have to be carried into effect, these largely relate to imperatives under the PSD for which there is no legislative discretion available to the Maltese legislator. Any legislative options or possibilities in this regard have been detailed in other parts of this document[33].

The Central Bank of Malta is also already empowered by legislation to oversee and regulate the operation of, and participation in, domestic payment systems[34], and may issue Central Bank Directives in this regard[35]. However, certain changes will have to be carried into effect in order to ensure that the Central Bank is vested with the powers and tools it requires to enforce a PSD-based regime.

As enforcement remains the prerogative of market regulators, decisions in respect of the framework to be applied will be coordinated by the Maltese authorities concerned, within a context of best-practice-sharing with their European counterparts.

Questions for discussion

Q46. Do you have any comments, concerns or suggestions in relation to the above?

4.7. Choice of legal instrument

It is currently envisioned that legislation implementing the PSD will be put into force by amendment of the Financial Institutions Act and the Central Bank of Malta Act, as well as by subsidiary legislation under those Acts as issued by the MFSA and the Central Bank respectively.

Without prejudice to legislative consistency and the necessary differentiation between financial institutions and payment institutions, the provisions of Title II of the PSD, relating to the regulation and oversight of payment institutions, will form part of the Financial Institutions Act, with implementing provisions issued in the form of MFSA Rules. On the other hand, the substantive provisions of Titles III and IV will take the form of a Central Bank Directive issued under Article 36 (5). Amendments to the Central Bank of Malta Act will likely also be necessary in order to implement the outcome of discussion under section 4.6 of this document. Amendments to the Banking Act and Financial Institutions Act may also be necessary in order to implement the outcome of discussion under the same section. Finally, amendments will also be needed in respect of legacy instruments amended or repealed by the PSD.

Questions for discussion

Q47. Do you have any comments, concerns or suggestions in relation to the above?

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[33] See sections 4.3 and 4.5.6 above.

[34] Central Bank of Malta Act, Cap. 204 of the Laws of Malta, Article 36(1).

[35] Ibid., Article 36(5).

5. OTHER ISSUES RELEVANT TO THE IMPLEMENTATION OF THE PSD

5.1. Introduction

While section 4 discussed options within the PSD, this section examines matters which are not a direct result of transposition of the PSD nor necessarily essential in order for Malta to fulfil its transposition obligations.

However, the Central Bank believes that the advantages of the PSD may only be achieved in Malta within the framework of a comprehensive retail payment services policy. This because, in order for the PSD to translate into maximum advantages for the Maltese economy, certain supporting or flanking measures are required (e.g. SEPA implementation, migration and oversight, repositioning of cash and cheques). The PSD will also have knock-on or indirect effects which should be correctly foreseen and taken into account (e.g. increased competitive pressure, reduced ability of payment service providers to cross-subsidise certain payment instruments), while offering future possibilities which should be utilised to full advantage. This section, therefore, seeks to introduce and advance a discussion of these issues.

5.2. The repositioning of cash and cheques

Payments systems account for around 3% of EU GDP, and cash is the major cost factor, with studies estimating that it accounts for 60-70% of the overall cost to society of payments systems across the EU[36]. As the European Commission describes, "[i]nstead of using efficient electronic payment services, which cost only a few euro cents, the cost of a cash transaction ranges between 30 and 55 euro cents. Given that the EU currently handles 231 billion payments per year (representing a total value of EUR 52 trillion), the potential savings linked to use of efficient payment services are enormous and amount to billions of euros"[37]. Potential savings in Malta are likely to be particularly noteworthy as the amount of currency in circulation (Lm 474.90 million, March 2007) is, per capita, around four times the Euro-12 average[38], standing at around 21% of GDP as opposed to 5% of GDP (2002) in the EU-12, and 11% of GDP (2004) in Latvia, the country with the next highest amount of currency in circulation per capita[39].

Furthermore, cheques are also still in great use in Malta, even though they have been virtually eliminated in some other EU Member States, such as in Germany, Austria, the Netherlands, Belgium, Sweden and Finland. In 2006, 12.539 million transactions (52.8%) were carried out by cheque in Malta, out of a total of 23.750 million non-cash payment instrument transactions. The necessary human manual intervention required for cheque deposit, clearing and reconciliation leads to substantial costs for commercial operators, especially when contrasted with those inherent in electronic payment processing. Cheques are also, by their nature, more vulnerable to fraud, and the absence of pre-acceptance verification of funds availability leads to increased costs and credit risk in relation to returned instruments, of which there were over 65,000 in Malta in 2006. This number, furthermore, does not represent the full extent of incurred costs as commercial banks often intervene to avoid returns by contacting drawers in order for them to correct a problem with a cheque or deposit funds. Such intervention also leads to higher costs in itself.

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[36] EUROPEAN COMMISSION, "Payment Services Directive: Frequently Asked Questions", *supra* note 3.

[37] Ibid.

[38] Prior to Slovenia's euro adoption.

[39] Oesterreichische Nationalbank, Gruber T., Ritzberger-Grunwald D., The Euro Changeover in the New Member States — A Preview, 2005, p. 65; Central Bank of Malta, Thirty-Eighth Annual Report and Statement of Accounts (2005), 2006, p. 23; European Central Bank, "Blue Book, December 2006, Payment and Securities Settlement Systems in the European Union and in the Acceding Countries: Addendum Incorporating 2005 Data", 2006, p. 467.

Studies within other national contexts show that 70 percent of the costs in the payments value chain can be addressed by a reduction of costs at the front end by repositioning cash or paper-based payment services[40]. Further studies show that cost-based pricing of payment services triggers customer behaviour and the right price signals can drive customers to select more efficient payment services rather than less efficient ones[41]. When prices paid by users reflect the real cost value of the service, they provide an incentive for users to select services that meet their needs at the lowest possible private and social cost. This promotes the efficiency of the payment system, and can result in sizable savings for the economy and economic growth. Moreover, studies in other countries have shown that if banks adopt active policies and incentives to develop non-cash transactions they can increase payments business revenues by as much as 19% within a few years[42].

However, the change is difficult because clear pricing signals (i.e. prices based on cost and effective competition) to users are largely absent, particularly in Malta. Commercial banks and corporates internalise and cross-subsidise the costs of cheque and cash processing, with the result that they often appear free of charge to use. The repositioning of cash and cheques will not therefore result directly from the current market process. However, increased competition in the market for electronic payment services will reduce economic rents and thus the ability of payment service providers to cross-subsidise[43].

Within this context, a cautioned approach is in order. Rationalising economic incentives in relation to cash and cheques may cause the introduction of transparent charges where costs are currently hidden and unapparent to the consumer. In particular, while mandating commercial bank charges reflective of costs and/or prohibiting cross-subsidisation for ATM cash withdrawals and/or cheque use would be beneficial to the economy and consumer overall for the reasons described above, benefits are likely not to be transparent, and reflected in lower public expenditure and decreased costs for services which currently cross-subsidise cheque processing costs (other bank services, or generally any other commercial service which absorbs costs of cheque processing and reconciliation). The introduction of any charges, on the other hand, is likely to be highly visible, while a further danger relates to consumers perceiving that the charges may be related to the introduction of the euro.

The Central Bank therefore believes that it should act progressively and initially concentrate its efforts on the removal of false or negative incentives relating to electronic payment instruments, while causing the increase of charges where these may be easily justified (e.g. in relation to cheques returned to drawer). Furthermore, the Central Bank wishes to collect views and suggestions from stakeholders on law and practice related to cheque clearing (see section 5.3 below).

The Central Bank is also considering the desirability of a law which would provide that monies transferred directly into a payee's bank account are capable of extinguishing legal payment obligations without consent of the payee being required first. Currently, and subject to usages of trade, it is generally only cash that a payee is legally bound to accept in fulfilment of a payment obligation. The Central Bank, therefore, is considering introducing legal recognition of what is often known as 'book money legal tender'. This would give corporates and individuals who tender

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[40] See, for example, McKinsey, "Ergebnis im Girokonto Österreich", 1999 and 2001.

[41] Sveriges Riksbank, "Do prices reflect costs? – A study of the price and cost structure of payment services in the Swedish banking sector 2002"; October 2004. Norges Bank, "Cost and Income in the Norwegian payment system 2001", September 2003.

[42] *World Payments Report 2006, supra* note 5, p. 41

[43] This phenomenon is known as 'cream-skimming' in economic terminology.

book money, by for example using credit transfers for payment, peace of mind that the relevant underlying legal payment obligation has been extinguished.

However, within this context, the Central Bank will continue to work towards progressively restoring undistorted market incentives in relation to payment systems by causing the elimination of cross-subsidisation and the increase of pricing transparency.

Questions for discussion

Q48. Do you agree with the Central Bank's analysis and intentions as set out above?

Q49. What problems or challenges do you believe may arise in carrying out the changes outlined?

Q50. Can you suggest any other ways by which to rationalise economic incentives in relation to payment instruments?

Q51. How aggressive do you believe the Central Bank should be in causing the elimination of cross-subsidisation and the increase of pricing transparency? What time-frames do you believe would be appropriate?

5.3. Cheques & other payment instruments

As set out in section 2.2, the Central Bank must increasingly be concerned with the regulation and oversight of retail payment systems. This role does not limit itself to electronic payment systems within the scope of the PSD, but extends to all payment systems generally. In fact, it is clearly recognised by both the Eurosystem and the Central Bank of Malta that significant challenges exist also in relation to payment systems and instruments that do not fall within the scope of the PSD, including as detailed in the preceding section.

In particular, while they have not always been, electronic payment instruments have today become a complete, practical and viable alternative to paper-based instruments such as cheques, as evident in the fact that a number of countries have eliminated the use of cheques altogether. Nevertheless, many EU countries have not only sought to reposition cheques within the economy, but have also taken specific measures designed to mitigate the costs and disadvantages of cheque processing, including high costs, slow clearing, cross-subsidisation, fraud and credit risk, limited consumer protection and inadequate comparability of service levels.

In light of the Central Bank's efforts to collect best practice, the result of a comparative analysis of legislation in other countries has found that, in the absence of concerted EU legislation in the area, Malta's European partners have pursued objectives which include the following:

i. clearly laying down the rights and obligations of parties within a modern legal framework which updates what was currently in force within their law (Maltese law currently contains few provisions specifically regulating cheques and, for the most part, includes them under the detailed provisions on bills of exchange in the Commercial Code);

ii. removing legal or operational barriers preventing more efficient cheque clearing, in order to reduce costs and the duration of the clearing cycle;

iii. mitigating fraud and credit risk within the economy by tackling abuses which may jeopardise the principle of trust that should preside over the circulation of cheques (e.g. through charges for cheques referred to drawer, or mandatory temporary/permanent revocation of cheque conventions for repeated abuse);

iv. rationalising the economic incentives apparent to cheque users by reducing cross-subsidisation of cheque-related costs and causing the introduction of more transparent pricing.

Furthermore, specific measures which have been considered or implemented by some EU Member States include:

A. Granting cheques the legal character of a direct debit payment instruction, enabling the use of the SEPA Direct Debit framework to make cheques presentable nationally, and possibly soon across the SEPA-area, as paper-initiated direct debit transactions, and thus subject to automated clearing and settlement;

B. Facilitating or mandating the use of cheque guarantee cards, in order to allow for pre-acceptance verification of funds availability and subsequent transition to guarantee cards with a debit card function, eliminating cheques;

C. Integrating cheques regulation within the regime implementing the PSD in order to, as far as possible, align the legal framework governing cheques with that governing other payment instruments;

D. Facilitating/allowing for the truncation of cheque processing and/or the issuance of non-transferable cheques, in order to reduce bank clearing costs and shorten the clearing cycle;

E. Imposing fees upon drawers when cheques are returned and/or prescribing the revocation of cheque conventions when abuse is repeated and/or creating a list of cheque defaulters maintained by the Central Bank (a similar framework was recently implemented by the Banco de Portugal).

Within this context, the Central Bank is interested in hearing from stakeholders their views on Maltese cheque-related legislation and practice. It wishes to explore whether changes are necessary, as well as the scope and extent of challenges faced as a result of high cheque usage within the national context.

While the widespread use of cheques in Malta calls for the Central Bank to give them priority, it also wishes to hear from stakeholders any views they may have in relation to the modernisation of other payment instruments not covered by the PSD.

<u>Questions for discussion</u>

Q52. Do you believe any of the objectives set out under points (i) to (iv) should be pursued in Malta? Why? Which do you believe are more important?

Q53. Do you believe any of the specific measures under points (A) to (E) above are applicable, and would be beneficial if applied, in Malta? Why? Are there any particular problems or challenges in relation to the exercise of any of the measures that would result in the Maltese context?

Q54. Do you have any other comments, concerns or suggestions relating to cheques or cheque processing?

Q55. Do you have any comments, concerns or suggestions relating to other payment instruments not falling within the ambit of the PSD?

5.4. SEPA

The coming into force of the PSD will facilitate the operational implementation of SEPA payment instruments. While a full discussion of SEPA is beyond the scope of this document, the Central Bank wishes to hear from stakeholders any views they may have on how the exercise of any options within the PSD may facilitate market participants' fulfilment of SEPA objectives.

Questions for discussion

Q56. Would early implementation of the PSD in Malta (before the November 2009 deadline) assist the market in its roll out of, and migration towards, SEPA instruments?

Q57. Is there any way that regulatory options under the PSD or other initiatives discussed within this paper could be exercised in order to facilitate the obtention of SEPA objectives?

5.5. Value added services

5.5.1 E-invoicing and e-reconciliation

In recent years, the electronic transmission of invoices to customers has attracted much attention. There are several ways in which this can be done in practice, but generally the e-invoices are sent either directly to the customer or to a payment service provider, which collects the e-invoices of several beneficiaries for the customer. The latter service is also called Electronic Bill Presentment and Payment (EBPP) and the service provider that operates the EBPP system and presents the bills to the customer is termed a 'consolidator'. The consolidator can be a general information service provider or a financial institution. In some countries, banks have become increasingly interested in providing EBPP services. In an EBPP service, customers can centrally receive all e-invoices, including any relevant information, and have e-payment facilities available to initiate the payment[44].

E-invoicing is a major issue for the European Commission, which believes that it will allow integration of the processing of payments and the administrative processes related to it. It is part of a wider development of dematerialisation in supply chain management. E-invoicing can contribute to a major leap in productivity and efficiency going beyond just payments. Invoicing is the link between internal company processes and the payment system. The potential economic gains of automating that link are so large that they could make a significant and genuine contribution to economic growth and the Lisbon agenda[45]. The European Commission conservatively estimates potential savings of greater than € 100 billion p.a. across the EU, while the European Association of Corporate Treasurers (EACT) estimates a savings potential of € 243 billion p.a.[46].

The PSD and SEPA will largely create the legal and operational environment to make national and pan-European mass-adoption of e-invoicing and e-reconciliation possible. The Central Bank is therefore interested in hearing from market participants in relation to their plans and intentions. It is furthermore committed to the facilitation and encouragement of e-invoicing and e-reconciliation and wishes to identify and evaluate any support measures it may carry out to facilitate transition by market participants.

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[44] ECB, Issues Paper, E-Payments in Europe – The Eurosystem's Perspective, 2002 (hereinafter 'Issues paper'), p. 8.

[45] Incentives paper, *supra* note 4, p. 20.

[46] Issues paper, *supra* note 44, p. 42.

Questions for discussion

Q58. What are the potential benefits and challenges for your organisation in relation to e-invoicing or e-reconciliation?

Q59. Does your organisation plan to offer or benefit from e-invoicing or e-reconciliation services? What are the major factors affecting your organisation's decision? What timeframes do you think are realistic for your organisation?

Q60. Do you believe the Central Bank can assist or support the adoption of e-invoicing and e-reconciliation? How?

5.5.2 E-commerce

E-commerce transactions enabled by (or transacted through) the internet or wireless networks are growing rapidly in the European Union. The e-commerce market in Europe was valued at €14 billion in 1999 and €95 billion in 2000, reflecting growth of 680%. The rapid growth of e-commerce in Europe has continued since, and is also expected for the next years[47].

The Central Bank is interested in attracting e-commerce payment service providers to Malta, and believes that Malta's human resource endowment and value advantages, tax regime and communication and IT infrastructures mean that it is ideally placed to be used as a platform for pan-European e-commerce payment processing. Malta has already attracted enterprises active in this market to a significant extent, and the Central Bank believes that the combined effect of SEPA and the PSD will be to greatly facilitate cross-border payment processing and allow consolidation while facilitating offshore location decisions, including to Malta.

For this reason, it wishes to ensure that no operational or legal barriers exist to impede the development of this market. It also wishes to identify any support measures it may carry out.

Questions for discussion

Q61. Are there any operational or legal barriers impeding the development of e-commerce payment services in Malta?

Q62. Do you believe the Central Bank can assist or support the development of e-commerce payment services? How?

5.5.3 M-payments

Over the last years, several initiatives have emerged in other EU member states for initiating e-payments from mobile phones by using short messages (SMS) or phone calls. These are often referred to as m-payments. Most m-payment initiatives follow a simple model whereby the customer (payer) first identifies him/herself to the merchant by providing his/her phone number or by calling the merchant. The merchant forwards the payment and customer information to the payment service provider (e.g. through the mobile phone network). The service provider then presents the payment information to the payer for confirmation and upon confirmation (e.g. with a PIN number) records the transaction. The communication between the customer and the payment provider and/or merchant can take place through phone calls and/or short messages. The paid amount is collected by direct debit from the payer's account and credited to the beneficiary's

[47] Issues paper, *supra* note 44, p. 6.

account[48]. Low-value m-payments are also possible by deducting value from a prepaid account held by the merchant, or by billing a post-paid consumer's telephony bill.

Mobile devices are well positioned for making payments as the penetration level of digital mobile phones is higher than that of personal computers. It is possible to use mobile phones for all types of payments, both at manned and unmanned payment terminals, for internet payments and possibly for payments between consumers. Mobile phones can be used both to initiate and to validate payments. It is thus envisaged that they have the potential to eventually replace both the POS terminal and the payment card. Mobile devices are also constantly developing in ways which allow them to better support m-payment solutions[49].

The Central Bank believes that there is significant scope for the development of m-payments in Malta, in particular due to the very high mobile penetration rates on the island. It wishes to ensure that no operational or legal barriers exist to impede the development of this market. It also wishes to identify and evaluate any support measures it may undertake.

Questions for discussion

Q63. Are there any operational or legal barriers impeding the development of m-payment services in Malta?

Q64. Do you believe the Central Bank can assist or support the development of m-payment services? How?

5.6. Special treatment and conditions for non-resident account-holders

Unlike discrimination on the basis of nationality between EU citizens, differentiation in the conditions for the supply of a service on the basis of country of residence is not prohibited by Community law, in so far as it does not constitute indirect discrimination on the basis of nationality[50].

However, such differentiation runs theoretically counter to the notion of an SPM. Any restriction based on country of residence has the effect of fragmenting the single market by not allowing persons in one country to seek services overseas, and thereby reduces competition and economic welfare within the market.

However, at times, differentiation in the conditions for the supply of a service on the basis of country of residence may well be justified and necessary in light of other considerations, as when ensuring against use of the financial system for purposes of money laundering or terrorist financing.

Furthermore, where risks, rules and practices differ cross-border, it is fully understandable that market participants operate within the local or national ambit, where they have knowledge of the market as well as of the law applicable. Market participants may decide to attempt to penetrate cross-border markets and free movement law, harmonization of national provisions and passporting regimes have made it easier than ever for businesses to seek opportunities within other EU states.

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[48] Incentives paper, *supra* note 4, p. 16.

[49] Issues paper, *supra* note 44, p.16.

[50] Indirect discrimination may be loosely defined as a provision, a criterion, or a custom that appears neutral (it does not refer to a prohibited criterion, such as nationality or gender) but which has the potential to be particularly disadvantageous for individuals meeting one or more criteria as prohibited, and that is not objectively justified.

Nevertheless, without prejudice to rules designed to combat money laundering and terrorist financing, where a service to be offered is purely national in scope and remains governed by national rules (e.g. the operation of a sight deposit account or payment account), there is certainly less reason to exclude or impede non-residents in their use of the service. Where there is such exclusion and it is the result of an agreement or concerted practice, it may even result in a prohibited and sanctionable market-sharing arrangement under competition law.

The PSD and SEPA aim to drastically reduce impediments to cross-border payment service provision. However, the full benefits of both projects will not be realised for the Maltese economy unless payment service providers also rationalise their service conditions for non-residents.

The Central Bank expects this to be a market driven process, and believes that, as legal and technical barriers to the provision of cross-border services decrease, it will be in the direct interest of market participants to seek to capture cross-border customers.

Within this context, the Central Bank wishes to collect intelligence on the special treatment and conditions imposed by local institutions upon non-resident account-holders. Without prejudice to anti-money laundering/terrorist financing rules, it encourages the rationalisation of service conditions, and is willing to provide legislative or other assistance should this be necessary.

Questions for discussion

Q65. If applicable, what is the practice in your organisation in relation to non-resident account holders (excluding anti-money laundering/terrorist financing procedures)? What special treatment or conditions apply in relation to the access to, and performance of, the various services offered by your organisation?

Q66. What are the considerations (besides money laundering/terrorist financing) that currently lead to the application of such special treatment or conditions in respect of services to non-residents which remain governed by Maltese law and are put into effect in Malta?

Q67. Does your organisation plan to change these practices as the SPM becomes a reality? Which considerations, as outlined above, do you believe will persist despite the PSD and SEPA?

Q68. Is there any assistance of a legislative or other nature that the Central Bank may offer in order to facilitate the rationalisation of service conditions for non-residents?

6. CONCLUSIONS AND NEXT STEPS

This consultative paper serves to prepare Malta's implementation of the Payment Services Directive and inform the Central Bank's future policy initiatives in relation to payment systems. In the interest of transparency and honest dialogue, the Central Bank has included within it any current views or concerns it may have in relation to the subjects discussed. However, it is important to reiterate that the paper does not contain any fixed ideas. All submissions and comments received will be given serious consideration.

Questions for discussion

Q69. What is your general impression of the PSD?

Q70. Do you see any further barriers for its effective implementation within the context of the infrastructure available to society today?

Q71. What areas need most improvement in order for the PSD to reach its objectives?

Q72. Do you have any comments on this consultative paper or on the consultation process?

Q73. Do you have any further suggestions or comments, of any nature?

This paper is aimed at raising questions and gathering input from all stakeholders, and will be distributed among the financial services industry, payment service users, constituted bodies, corporates and government authorities and entities. It will also be publicised and posted on the Central Bank of Malta's website in order to encourage the collection of views from the widest possible community. Reaction is sought before 31 March 2008, should be marked '**PSD Consultation',** and sent to:

gattj@centralbankmalta.com

or in writing to:

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