Paying the price after Brexit

How will Brexit affect the way UK companies make payments to the EU? The answer depends on the Brexit we get. ***Tim Green*** *takes a look at some of the possibilities*

In early 2016, six months before the Brexit vote, *Financial World* attended a workshop on the Second Payment Services Directive (PSD2). During the Q&A, I asked what might happen to the regulation in the event of a leave vote. Everyone laughed. It was clearly a ridiculous question.

They are not laughing now. The UK voted leave. And with just weeks to go until Brexit Day on 29 March, 2019, there is still no certainty on the withdrawal agreement. No one knows what kind of Brexit there will be, never mind the future participation of the UK in EU payment schemes.

It is an important topic and worth investigating. First, what are these schemes? The central one is the Single Euro Payments Area (Sepa). Briefly, Sepa harmonises the way people make digital payments inside the EU. Sepa sets the same rules for all payment processors and insists their systems are technically interoperable. In theory, it makes cross-border electronic payments (in euros) as easy as domestic ones. It covers credit transfers, direct debit payments and card payments.

Sepa enables "passporting", which lets payment companies authorised in one member state trade in others without the need for multiple authorisations. The benefits are self-evident. For example, thanks to Sepa, any business can set up a direct debit from an account in one country and charge to an account in another.

The other key payment schemes potentially affected by Brexit are PSD2, which opens up payment processing to new players and hardware platforms, and the e-Money Directive 2011.

Despite the uncertainty, the UK government has said it wants to "maximise the prospects of the UK remaining in Sepa". To that end, it issued three statutory instruments in September 2018. The instruments exist to tweak UK law when EU rules no longer apply. The three relate to the Payment Services Regulations, the Electronic Money Regulations and Sepa. A smooth transition is the obvious aim here, but it cannot be guaranteed. It all depends on the complexion of the final Brexit deal. The European Payments Council, which is responsible for upholding Sepa, posits three possible outcomes:

1. The UK remains in the European Economic Area (EEA). This would keep the UK aligned with the EU legal framework, enabling it to uphold its participation in Sepa.

2. The UK leaves the EU and EEA but activates a free trade agreement. This would have the "functional equivalence" of the EU legal framework. Again, this should put the UK in a position to continue its participation in Sepa.

3. A no-deal Brexit. This would not necessarily rule out participation in Sepa and other schemes but the European Payments Council would have to assess whether the UK was eligible.

It is likely that most payments insiders are hoping for an agreement that ensures "business as usual". But in the event of a hard Brexit what might the consequences be? Here are the answers to some key questions.

> *Most payment providers are hoping for an agreement that ensures it will still be business as usual*

What payment types will not be affected by a hard Brexit?

Domestic payments will go ahead as before. The same is true for international payments by correspondent banks (ie two banks that have reciprocal accounts with each other) via Swift. Payments and ATM withdrawals made by the EMV network also will be technically unaffected. Visa said: "There have been reports that UK-issued cards will not work after Brexit. It is nonsense. We process payments all over the world between countries with no regulatory agreements. Brexit will not make any difference." That said, future transactions may be subject to new charges.

What kind of new charges could be levied?

First, card interchange. In 2015, the EU imposed a cap of 0.2 per cent on debit card transactions. Since the cap does not apply where either party is located outside the EEA, the UK schemes might be able to raise fees domestically, while UK issuers might also receive higher interchange fees from transactions that involve EEA acquirers. The Treasury could also decide to set its own caps.

The second possibility is "one leg out" fees. In the event of a hard Brexit, the UK would be regarded as a non-EU country,

no different from the US or South Sudan. Paul Anning, international payments practice leader at law firm Osborne Clarke, explains: "At present, charging is done on a shared basis – banks only pay their own costs. With one leg out, that principle doesn't apply. An EU bank could therefore charge the sender. They could deduct any fee from the recipient's account. But for now, no one knows whether this will happen."

Could the UK stay in Sepa and retain passporting rights with a hard Brexit?

Yes, it could. Territories outside the EU are in Sepa. This system includes non-EU states Iceland, Liechtenstein, Norway, Monaco, San Marino, Switzerland and Andorra. So it is possible that the UK could still take part in the passporting system so long as its regime has "regulatory equivalence".

What if the UK regime is not approved?

In theory, a payments institution would need to be approved separately by every EU regime in which it is active. But UK banks could also take part in Sepa by gaining regulatory approval as a "community of institutions" irrespective of where they are based.

There is another possibility: everyone just carries on as normal and hopes for the best. Anning says: "It is possible payment companies could just continue to make transactions as before unless asked to cease and desist. They might find some regimes will take action and some won't. And some might be lenient if a payment provider has started a process of applying for a licence. Again, the truth is no one really knows."

What are payment companies doing to mitigate Brexit disruption?

Some are setting up subsidiaries in EU countries to ensure they stay in Sepa. Others are ensuring they keep deposits in UK banks that have agreements with EU counterparts. This is the strategy of Caxton FX, a foreign exchange specialist. "Having an arrangement like this means we can hold most of our money in the EU institution," says Rupert Lee-Browne, chief executive. "That way, we can ensure our customers are not compromised. It's a significant advantage we have over most banks that are doing foreign exchange."

> *Countries look to the UK as a place of innovation. I don't think other regimes will be able to replicate that quickly*

Could the UK lose its leadership in financial services thanks to a hard Brexit?

It is hard to see how being outside the EU could help maintain it. Lee-Browne says: "Whatever happens, if we want to make payments with EU companies, we will have to accept EU rules. That means we become a rule-taker. We will be no different from a small African country in that regard."

But on the more optimistic front, some observers believe overseas rivals will find it hard to displace the UK's pre-eminent position. Stephen Ley, leader of the UK payment practice at Deloitte, says: "Countries look to the UK as a place of innovation. We have a very supportive regulator and a huge network of experts here. I don't think other regimes will be able to replicate that quickly." ■

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