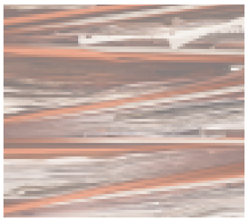

A full in-tray

BOB LYDDON EXPLORES HOW THE EU'S PAYMENT SERVICES DIRECTIVE WILL AFFECT THE CORPORATE CUSTOMER.

The European Commission's Payment Services Directive will become national law throughout most of Europe from November this year. It will not only apply to the EU member states, but also Iceland, Liechtenstein and Norway (the 30 countries that together constitute the European Economic Area, or EEA); Swiss banks also intend to adopt its provisions into their general banking conditions.

While the directive's main aim is consumer protection (although it adds little to existing protection in countries like Belgium and Finland), it offers no blanket exemption for corporates as a group or those above a certain size. Instead, it envisages that corporates will sign framework contracts with their banks to deal with those areas of payment services where the directive specifically permits a different treatment than the base one.

Box 1: The ACT's PSD workshop

The Payment Services Directive (PSD) comes into force this November, bringing with it the likelihood of wholesale changes in banks' terms and conditions. This essential update will enable you to understand the potential impact of this change in European legislation and to take early action to maximise the benefits while limiting possible downside.

The course provides an overview of what the PSD means to corporates, the opportunities it offers for efficiencies and greater transparency, and the threats to realising those opportunities.

For details of the workshop, go to **www.treasurers.org/training/psd/jun09**
For more information, contact **training@treasurers.org**

Executive summary

The likelihood is that the Payment Services Directive, which comes into force this year, will lead to wholesale changes in banks' terms and conditions. Treasurers have a mountain of detail to master to ensure that they choose the best payments route for their companies.

Many corporates probably already have agreements with their payment banks which could be classified as framework contracts under the directive. It would be a stroke of luck if these agreements matched the Payment Services Directive in both scope and content. A more likely scenario, though, is that most corporates will face a very full in-tray of substitute contracts/unilateral amendments in the autumn.

That is one reason why the ACT has decided to arrange a workshop on the Payment Services Directive in London on 30 June (see Box 1) to brief corporates in greater detail.

The base scope of the directive covers electronic payments – including card payments and direct debits but excluding cash and cheques – where both endpoints are in the EEA. Payments must be in euros or a member state currency, and cover the Norwegian krone, the Icelandic krone and the Swiss franc to/from Liechtenstein. Swiss banks will apply the directive's terms to Swiss franc transactions to/from Switzerland at their end, although banks in EEA countries are not legally bound to treat them as in-scope at their end.

This is one anomaly that corporates will want to be aware of, and is a feature of the so-called leg-in/leg-out discussion: this is not a folk dance but an aspect of transposition where certain countries have elected to extend the scope of the directive in their environment to further currencies and endpoints outside the EEA.

And the anomalies do not end there. The Payment Services Directive contains specific rights of derogation, with member states permitted to adopt or ignore certain provisions. The ones of greatest interest to the corporate are:

- for smaller corporates, whether micro-enterprises are to be treated as consumers by law or not;
- shorter termination of framework contracts; and
- whether out-of-court complaints and redress procedures will only be available to consumers (which may include micro-enterprises).

Further country-level differences can be anticipated due to translation, interpretation and how transposition takes place. Some countries are introducing one law; others are amending existing laws. In the UK the definitive interpretation will be derived from case law – after implementation. In Spain the banks can go to the Bank of Spain and present an interpretation in advance and have it stamped: that then becomes definitive. Some countries will just have the law itself; in others the state council will deliver detailed regulations. Place your bets on the chance of harmonisation!

In terms of substance, the directive has three main sections:

- the introduction of a new type of capital/regulation-lite competitor to bank payment service providers (PSPs), described as payment institutions and contemplated as being for the unbanked and worker remittances, so not particularly relevant for corporates unless they want to set up their own;
- the transparency of conditions and information requirements; and
- the rights and obligations in relation to the provision and use of payment services.

The latter two section (titles III and IV respectively of the directive) are the meat as far as a framework contract is concerned, although a PSP and its corporate customer can opt out of title III, which lays down:

- the minimum information to be supplied before a contract is entered into to make a payment;
- the minimum information to be supplied afterwards to both payer (to prove fulfillment) and to payee (to tell them they received the money, who from and why);
- the provision of information by PSPs about how the service can be used, electronic banking requirements, timings, charges and spending ceilings; and
- how communications with the PSP work, security, how contracts are to be amended and terminated, and redress.

For corporates it is much more convenient to use one electronic banking contract to govern all activity rather than to get a contract every time a payment is requested. However, corporates undoubtedly want that single e-banking contract to cover at least all of the above aspects and to the same standard – which is their right if they do not sign a framework contract. Title IV does the following:

- moves the burden of proof for authorisation of payments to the PSP;
- limits a customer's liability to €150 if a payment instrument (such as a card, a token or an electronic banking authorisation device) is misused;
- defines the rights of refund;
- provides for all payments to be charged on an SHA (shared) basis;
- forbids deductions from the principal;
- orders the payee's bank to put incoming payments at the payee's disposal immediately (ie, in the ledger balance, in the available balance, and with that day's value);
- limits end-to-end timing to D+3 at worst between 1 November 2009 and 31 December 2011, and D+1 at worst thereafter; and
- does not allow any float for payee banks.

Table 1: The opt-outs

ARTICLE 54 (2) Consent and withdrawal of consent	■ Sub-para 1: The payer has to give consent to individual payments or, under a framework contract, to a series; payer and bank agree the form of consent ■ Sub-para 2: "In the absence of such consent, a payment transaction shall be considered unauthorised" ■ Sub-para 2 can be waived, but what auditor would permit that as a routine solution to a breach of an agreed process?
ARTICLE 59 Evidence on authentication and execution of payment transactions	■ The bank has to provide proof of proper authorisation, rather than the customer having to prove defective authorisation or non-authorisation ■ Use of a payment instrument is not in itself sufficient to prove due authorisation
ARTICLE 63 Requests for refunds for payment transactions initiated by or through a payee	■ Enacts eight weeks' right to claim a refund, which is vital to SEPA direct debit; there is no right of national derogation to vary this ■ A bank has 10 days from the request to pay it or explain why the refund will not be paid ■ Enables shorter reclaim period for business-to-business direct debits
ARTICLE 75 Non-execution and defective execution	■ Payer's bank is liable for execution up to when it can prove it put funds into the account of the payee's bank ■ If the payer's bank is liable, the bank has to make good the payer's account ■ If funds have been put onto the account of the payee's bank, then the payee's bank has to make the payee's account good ■ Whoever is liable, the payer's bank must investigate, trace and notify the payer of the outcome

Table 2: The non-negotiables

ARTICLE 67 Amounts transferred and amounts received	■ No deductions from principal by payer's bank and any intermediaries
ARTICLE 69 Payment transactions to a payment account	■ Cycle time can be up to D+3 until 31 December 2011 by mutual agreement, but must be D+1 after that, with no need for any agreement ■ One day more for paper-based payments
ARTICLE 73 Value date and availability of funds	■ A bank must credit the payee no later than the day on which an incoming payment was received by the bank itself – ie, when it was credited to the bank's own account ■ The bank must ensure funds are available to the payee immediately they are credited to the bank's own account ■ The debit value date for the payer is no earlier than when the payment was debited to the payer's account

TO DEAL WITH A FULL IN-TRAY, TREASURERS NEED CLARITY ON WHAT THEY GET FROM THE PAYMENT SERVICES DIRECTIVE BY LAW, AND HOW CURRENT TERMS AND CONDITIONS CONTRAST WITH THAT.

A corporate and its bank can opt out of certain features of the directive or vary them in a framework contract, including the first three points listed on the previous page for Title IV. Opt-outs exist for articles 52(1), the second sub-para of 54(2), 59, 61, 62, 63, 66 and 75 (which can be varied in whole or in part) and 58 (where a different time period can be agreed).

Much of the directive is designed to protect consumers – the logic of the drafters was that large corporates could look after their own interests – but in practice companies may want those protections or at least use them as the starting point for negotiating their own framework contract.

These articles will be gone through in detail in the ACT's Payment Services Directives course, so the articles commented on in Tables 1 and 2 are meant to give a flavour of what is and isn't available for opt-out.

In order to prepare to deal with a full in-tray, treasurers need clarity on what they get from the Payment Services Directive by law, and how current terms and conditions contrast with that. Discounting the idea that banks might simply stop executing or receiving payments for clients unless they get the new documents they want, a corporate would want to establish the benefits that will flow without their signing a framework contract – in other words, by being treated as a consumer.

The inconveniences of not signing a framework contract (for example, payments might have to be contracted for individually, making e-banking superfluous) provide the basic trading material, although the inconvenience would be for the PSP as well.

Corporates may trade away title III in the form of an electronic banking contract with substantially the same provisions as title III.

Title IV presents the more challenging negotiation. The negotiable provisions all seem to have benefits for the corporate, so why would the corporate wish to trade them away and what for? What would a corporate do if a bank presented a framework contract as a series of one-way communications that it did not ask the corporate to countersign, and which represented various opt-outs? What if all the papers land on the desk in October and have to be processed by November? These are hard questions and ones that will be gone into in the ACT workshop on the Payment Services Directive.

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Home and away

MICHAEL BURKIE DISCUSSES HOW AND WHY CORPORATE BANKS CAN REAP THE REWARDS OF OUTSOURCING CASH MANAGEMENT AND TRADE FINANCE ACTIVITIES TO SPECIALIST PROVIDERS.

Executive summary

Outsourcing can help corporate banks retain their corporate clients while relieving them of the financial and resources costs of keeping cash management and trade finance processes in-house. Using specialist providers can also give them local presence and knowledge combined with a global delivery platform.

Surveying the wreckage of the credit crunch, many corporate banks are keen to go back to basics. This sounds like good news for corporate treasurers focused on working capital services and finance. However, while the traditional corporate treasurer concerns are indeed the nuts and bolts of banking, some banks are

concluding that cash management and trade finance activities are support functions for their core business rather than an integral part of their banking offering.

Also, both cash management and trade finance processes depend on a costly and closely monitored infrastructure, and most banks are currently experiencing sub-optimal returns on these activities. Some corporate banks are therefore concluding that these functions are ideal for outsourcing to specialist providers.

Certainly, investment in state-of-the-art cash management and trade finance systems comes at a high and rising price in terms of both development and running costs. The current startup development costs of global cash management and trade finance systems encompassing a full range of functionality are estimated at around $200m. The figure is so large because it has to cover the initial costs of technology, personnel and Swift membership as well as, for disaster-recovery purposes, the duplication of the entire system (with, for example, the backup contingency model needing an entire replication of independent energy supply and telecoms providers).

Once the global transaction banking infrastructure is up and running, the maintenance costs – which are subject to variation – must then be taken into consideration. Monthly overheads of $300,000 are not unheard of; it's the sort of sum that would make a significant difference to any banking unit's bottom line, especially in today's environment of plunging bank profits.

And the expenditure does not end with the upkeep costs. If the system should need to be adapted or updated – a very likely scenario as technology advances and the need to comply with multinational regulatory guidelines grows – further costs will also be incurred.

Given this, the establishment, upkeep and potential adaptation of proprietary working capital transaction services that banks offer to corporate clients may simply not be feasible for many at present, even though such a service is increasingly vital to meet the demands of corporates.

INTERNATIONAL WORKING CAPITAL Yet if they are to compete with their peers, these banks will have to invest either directly or indirectly in multicurrency trade, cash management and trade finance services.

But their costs do not end there. Banks that in-house these services will often need to support payments, liquidity and trade services by using cash reserves across their international correspondent network. This exposes these institutions to counterparty risk, which in turn requires its own high-priced and consistently monitored risk mitigation infrastructure. That adds a further expense and and is a distraction from their core business.

These banks must maintain correspondent banking relationships with banks that operate in the key currencies that their clients require, which could be a sizable number and are subject to almost constant review and change. A further regulatory obligation for these banks is executing know-your-customer and anti-money laundering checks with members of their correspondent banking network. Meanwhile, they must also work within the parameters of a

OUTSOURCING IS A POTENTIAL SOLUTION FOR ALL CASH MANAGEMENT, MOST NOTABLY MULTICURRENCY PAYMENTS, AND ALL TRADE FINANCE ACTIVITIES.

number of global regulatory agencies – for example, the Financial Action Task Force blacklist – all of which is very costly in terms of time and resources.

Such burdens make outsourcing to a specialist provider that has already invested in the required infrastructure, and is now looking for additional volume, look like a sensible if not obvious solution.

HOW AND WHY Collaborative outsourcing is essentially a strategic decision for mid-tier banks. Many cannot afford to keep up with the global banks that have developed their own global infrastructure and can therefore see the tangible positive impact outsourcing will have on their bottom line. Certainly, outsourcing allows mid-tier banks to benefit from the economies of scale realised by the global banks.

Indeed, outsourcing is a potential solution for all cash management, most notably multicurrency payments, and all trade finance activities. In fact, if requested, the specialist service provider can undertake all the back-office functions typically performed by the corporate banks, such as multiple currency payments and trade document checking as well as all trade-related operations and custody management. In short, specialist providers can supply as much or as little as the outsourcing bank requires – and the arrangement can be changed over time.

In terms of the all-important fiscal benefits, the process not only relieves the outsourcing bank of the steep initial costs, it also turns a high fixed cost into a much lower variable cost around which the business can then be budgeted almost on a pay-as-you-use (or pay-as-your-corporate-clients-use) basis. This will help with any challenges that may arise as a result of limited credit facilities, and gives the outsourcing bank greater control and flexibility over the services it offers to its corporate clients, as well as better managing its revenue/expense ratio.

As for issues that may arise once the outsourcing arrangement is in place, any further future expenses, such as new payment channels and regulatory adaptations – should the currencies and transaction volumes of the client base increase or decrease – also become the responsibility of the specialist service provider. This frees the outsourcing bank from potential future transaction risk – as well as system interoperability concerns – while providing a scalable path for future growth as the economy improves and its client demands change.

The implementation procedure and project completion times are dictated by the scale of the outsourcing bank's requirements and transaction volumes. For those with low

volumes in foreign currencies, an optimal option is to open a domestic currency account with a specialist payments provider, which can then complete foreign exchange (FX) transactions at prenotified rates and pay away the required currency to the overseas beneficiary.

For banks with a high volume of transactions, a more advantageous alternative is to open individual foreign currency accounts, which the provider can then debit as instructed. This proves more economical for the outsourcing bank as it gives it greater control over the foreign exchange rates and costs, which in turn allows it to pass these benefits on to its corporate clients. In terms of typical timeframes, the outsourcing of multicurrency payments can be achieved in three months, while the entire cash, trade and FX operation can be migrated in six months.

CONTRACTS And what of fees and contractual obligations? The five intrinsic elements of cash management – payments, receivables, liquidity, information management and customer support – are the first headings to be incorporated in any contract between an outsourcing bank and a specialist provider. Examples of other factors to be included are cut-off times, what to do with surplus liquidity, and the provision of 24-hour client services in local languages.

Aside from these compulsory elements, the terms of outsourcing contracts can be relatively flexible – an important benefit given that the strategic business need for outsourcing will be individual to each bank. This flexibility will give outsourcing banks more options to consider, and therefore control, particularly with regard to the management of operating costs.

In some cases, the contract can even be open-ended, with pre-agreed monthly fees, as the specialist payments provider can calculate a fee-based solution on the back of the outsourcing bank's previous two years' transaction volumes and values. These fees can be renegotiated at a later date should the transaction volumes increase or decrease.

IN TERMS OF THE ALL-IMPORTANT FISCAL BENEFITS THE PROCESS NOT ONLY RELIEVES THE OUTSOURCING BANK OF THE STEEP INITIAL COSTS, IT ALSO TURNS A HIGH FIXED COST INTO A MUCH LOWER VARIABLE COST AROUND WHICH THE BUSINESS CAN THEN BE BUDGETED ALMOST ON A PAY-AS-YOU-USE BASIS.

Such flexibility results, in turn, in greater operational flexibility for the outsourcing bank when dealing with its corporate clients, which means that any new initiatives and products can be implemented with greater speed and efficiency, and cashflow can be redirected to capitalise on new market opportunities.

SPECIALIST PAYMENTS PROVIDERS It is clear that the establishment and maintenance of a proprietary working capital services infrastructure comes at great cost in terms of both time and money. Yet such infrastructure services are of the utmost importance if corporate banks are to remain competitive and not be pushed out of providing working capital, international trade and cash management services to their clients by the global banks.

However, why outsource to specialist payments providers rather than global banks when this seems to be the most straightforward solution? Forming outsourcing relationships with specialist providers – such as the Bank of New York Mellon – rather than the global banks can allow corporate banks to benefit from the best of both worlds: local presence and knowledge, combined with a global delivery platform, without fear of competition from the specialist service provider. When outsourcing to a bank that also provides retail and corporate services to corporate clients, there is always the potential risk that the corporate bank may also be providing their business partner with insights into their affairs – potentially resulting in the loss of the corporate client to the global bank.

However, using specialist payments providers which offer a non-compete approach eliminates this risk for the corporate bank. As a result, corporate banks can reduce cost and effort at the heart of their business while benefiting from the technology and expertise that a specialist payments provider can offer – and all on a flexible and non-competitive basis.

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