



## Telcos and the PSD2 exclusion – what next?

A pragmatic view for companies using the exclusion.

While businesses around the world are busy getting ready for GDPR, another wide-reaching EU regulation crept up and took many outside the Financial Services industry by surprise in January 2018 – the Payment Services Directive 2 (PSD2).

PSD2 removes the easy-to-use exemption for electronic communications providers. Instead it introduces a much more limited exclusion – and if they want to exercise it, they must provide an annual independent audit opinion relating to it. If they are unable to use the new exclusion, they may need a full Financial Conduct Authority (FCA) licence as a payment institution.

Most telcos seem to have concluded that the application and compliance costs of a full licence outweigh the benefits, as many have opted for the electronic communications exclusion (ECE) for now. There is recognition, however, that this may be a holding position until there is greater clarity around what will be covered in practice and what the FCA will expect.

### Why does PSD2 matter?

Electronic communication providers were usually exempt under the original Payment Services Directive. Under PSD2, the following charges to users' related phone bills are in scope:

- **Premium voice services** – eg directory enquiries, advertising, and adult chat lines;
- **Premium rate SMS services** – eg competition entry, ringtones, games and sales services;
- **Direct carrier billing (DCB) services** such as in-app purchases charged to a phone bill rather than paying with card

## So what are the next steps?

While the audit opinion may not be due until later this year or even next year, telcos need to ensure they are on track for one that will satisfy the FCA that the financial limits are being observed. Identifying problems only at the end of the year will leave it too late to manage the situation effectively, especially if further guidance requires a change of position.

### Develop a clear position based on legal advice

This might seem obvious but some important issues remain unclear. For example, there have been varying opinions within the industry as to which services are covered by the ECE, and whether certain deductions can be made. Some argue that they are acting as a "commercial agent" for one party only - which falls outside the scope of PSD2 - or as principal rather than any kind of agent. If they act as an agent for both sides of the transaction, they are now caught by PSD2, on the same basis as e-commerce platforms who collect payments from buyers and then remit the funds to sellers.

The strength of these arguments will depend on robust legal analysis of the reality of the situation, and the balance of risks. If the FCA wishes to take a firm line on the other side of the argument, clear supporting evidence for your decisions will help manage any potentially awkward regulatory discussions.

It is also of course the most sensible starting point for deciding practical next steps.

### Assess and review

The current business model and services should be reviewed alongside future strategy to assess which transactions may fall under the ECE. Then appropriate controls and processes can be set up to ensure the transactions stay within the limits and breaches are flagged and managed. In many cases, it may be possible to adapt existing data capture and control processes to meet the requirements.

Setting up a real-time monitoring system across different billing platforms may have substantial costs and resource implications. However, such a system will be needed anyway when section 124S Communications Act 2003 comes into effect in October 2018. This requires telcos to enable users to specify a cap to their phone bills, and to notify them when this is likely to be reached. Given that planning should already be underway for this, PSD2 exemption compliance could potentially be woven into this.

### Customer experience

Some thought needs to be given to what should be done if the limits are reached - cut customers off, or simply not charge more than the ECE limits allow. Neither is ideal, particularly if users realise that premium services will only cost them up to the caps rather than the full price. However, applying a user-requested cap is far less likely to generate reportable complaints than applying a cap due to a regulation the user has probably never heard of. It also seems reasonable to assume that

### How the ECE applies

The Electronic Communications Exclusion applies to payments for ancillary services charged to a related bill either:

- to buy digital content and voice-based services, whatever device is used to buy or access that content; or
- by using an electronic device for certain charitable activities or to buy tickets.

The exclusion only applies for single payments not exceeding £40 and cumulative payments not exceeding £240 in a month.

The FCA has clarified that the value will be based on individual phone numbers or SIM cards, rather than account holders.

Telcos should have notified the FCA of their intention to use the ECE by 13th January 2018.

The submission date for the independent audit opinion depends on when the company's year end falls.

If it falls before 13th April this year, the opinion is due within 3 months of the year end taking place in 2019. This means that if your financial year end is 30th March for example, the first audit opinion is due before 30th June 2019.

If the year end falls on or after 13th April 2018, the opinion is due within 3 months of the upcoming year end.

heavier users of premium services may be less concerned about capping their bills than the average user.

In practical terms, of course, the answer will be based on commercial considerations. Whatever that answer is, an integrated approach to managing PSD2 with section 124S could be most cost effective.

#### And some known unknowns

There are still significant areas of uncertainty, which is obviously undesirable now that the law can be enforced. These tend to reflect that these payments are not the primary target of the legislation, but included mainly for anti-avoidance purposes – a situation that all too often leaves both regulators and the regulated struggling to find practical solutions to cope with previously unexplored challenges.

In this case, they include:

- The FCA's application of the financial limits on a per number/SIM basis, which is probably the best outcome consistent with the legal drafting. The FCA acknowledges the challenge where one number has numerous extensions, such as in an office or a hotel, meaning that the caps are reached more quickly. However, whether or not this in itself in principle should result in a full FCA registration and regulation remains unclear.
- Lack of consensus on what is covered under 'premium voice services'. In addition to the discussion over whether the telco is agent or principal, there are queries about whether this should include conference call facilities, for example, and the proportionality of doing so.
- This factor also means that the industry itself has to manage differences of view between wholesalers and retail on the same product.

Doubtless some of these issues will resolve over the next year or so, but in the meantime, a pragmatic, flexible approach to manage this uncertainty is needed.



## Contacts



#### Ros Baston

Director

+44 20 7303 6190

rbaston@deloitte.co.uk



#### Thuong Nguyen

Manager

+44 20 7007 5419

tnguyen@deloitte.co.uk

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