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CONSULTATION: LAYING OF REGULATIONS TO IMPLEMENT THE NEW E-MONEY DIRECTIVE (2EMD)

The ea Consulting Group (eacg) welcomes this opportunity to respond to the questions raised in the above consultation paper and to comment on the draft Electronic Money Regulations (EMRs). The UK is, of course, the focus of e-money activities in the European Union. Although for the most part a maximum harmonizing directive, we are pleased to see that HM Treasury is approaching the discretionary elements in 2EMD in a manner that should reinforce this strong market presence.

By way of background, eacg has been closely involved in the implementation of the Payment Services Directive working with a number of UK-based high street bank and building society clients. We readily recognise the significance of the latest 2EMD text if successful in attracting mobile phone operators. It remains to be seen if new low cost e-money accounts or their equivalent will evolve in the UK to compete with bank current accounts but the potential exists.

Although our detailed responses are to be found in the attached appendix I believe it may be helpful at this stage to highlight our general approach to regulatory change and our principal comments on the 2EMD proposals. It is, of course, imperative for the competitiveness of the UK than any new regime is proportionate. Whilst consumer protection is paramount the new EMRs should also enable e-money operators to deliver a cost effective service and be attractive to new players. To this end, the new capital arrangements are to be applauded. eacg, with expansion of the sector likely, also favours introducing the safeguarding of customer funds proposals for all small electronic money issuers.

As both a regulated and non-regulated e-money market sector will continue to exist inevitably seeking a level playing field can only be a wish rather than a core strategy. This is especially so in terms of protecting consumer funds. A voluntary code for the unregulated sector must be the preferred outcome and every encouragement should be given for such firms to sign up. For the regulated sector, we must recognise the importance of scale and complexity in the business operating models. As the second directive on this subject, past difficulties experienced in the implementation of EU text should not be repeated. They serve, however, as a timely reminder of the importance of clarity in the EMR text and a common interpretation. The draft Electronic Money Regulations (EMRs) have been well written and appear similar in style to the earlier Payment Services Regulations (PSRs). The proof of the pudding will be in the eating and we await the publication of the FSA's own "Approach" document in due course with much interest as it will play a key role in assisting change programme managers and risk personnel. Sadly, a true Single Market has yet to be achieved in the payments arena. It is our belief that 2EMD could ultimately transform the marketplace for retail payments on a pan-European basis as cheque and cash-only transactions become less popular and new forms of money evolve.

The term "limited network", as recognised, is problematic and the law of unintended consequences could await a more expansive but loosely defined UK definition. We have witnessed similar issues with the term 'adequate explanations' in the new Consumer Credit Directive. What exactly is the meaning of the word "adequate"? With the 2EMD and 'limited network', the FSA proposes issuing guidance on the topic. However, it remains to be seen if such an imprecise approach is appropriate bearing in mind the significance of the term in identifying the boundary between regulated and unregulated activity. We forecast that e-money issuers will seek competitive advantage operating on a fuzzy unregulated boundary. Despite much support for the FSA approach, on balance, eacg believes that the future development of the e-money sector requires an unambiguous definition of 'limited network' rather than reference to a series of examples as likely to appear in any guidance. Accurate and fair enforcement demands certainty of scope of the new regulations.

If you require clarification on any point do please contact me directly.

Yours sincerely,

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APPENDIX

Question 1:

Is FSA guidance, and case-by-case consideration, the right approach to determining what constitutes a limited network?

It is a practical solution acknowledging the difficulties in defining the term 'limited network' and reflects similar treatment in the PSRs (Payment Services Regulations). However, as key to deciding what is and what is not regulated it is believed that the proposal is suboptimal in the longer term. We agree with HM Treasury that 'a clear delineation of the regulatory boundary is desirable'.

Case-by-case consideration looking at a range of examples given in the FSA guidance may be acceptable and clear in certain circumstances but experience says that strategists will test the unregulated perimeter. On balance, eacg believes that text governing the precise meaning of a 'limited network' in the EMR's is the preferred route to regulatory clarity and will ultimately provide the consumer with greater transparency and understanding.

It does appear strange that the scope of the new directive might be left for the courts to decide rather than being defined and identified by the regulator and supervisor from the outset.

Question 2:

Are there any examples of cases where the law determining what constitutes a limited network may be unclear? How should these cases be resolved?

Inevitably, there will be examples where the meaning of a 'limited' network will be tested (eg Pan-European brand, multiple outlets etc). Ultimately, resolution will be a decision for the courts looking at the merits of the individual case and the various factors involved. It will be important to reflect the interpretation(s) of other Member States to ensure that the UK is not disadvantaged. We must also anticipate that there will be interaction between regulated and unregulated sector. See response to Q1.

Question 3:

i) Are voluntary codes of conduct, supported by safeguarding arrangements for customer funds, the right way to protect consumers in the unregulated sector?
ii) Is there a better alternative?

- i) **YES:** By its very nature this sector is unregulated! A voluntary code, however, is essential to protect the consumer especially if e-money activity increases at the levels anticipated in the future. Such a voluntary

code could bring significant marketing advantages. The new safeguarding proposals similar to those applying to existing PIs are essential for consumer protection and vital to inspire confidence in the sector.

- ii) **NO:** Without extending regulation into this sector (which in terms of cost or availability may well be contrary to consumer interests) a voluntary code is thought to be the most cost-effective solution for all parties.

Question 4:

What are the pros and cons of extending FSCS cover to e-money issued by banks and building societies?

The "pros" inevitably reflect the benefits to the customer should a bank or building society e-money issuer fail together with the alignment of treatment with some other, although not all, EU jurisdictions (eg Ireland). A common playing field is always desirable if economically feasible.

As recognised, it is a potential barrier to business should the quality of e-money in the UK be looked upon as inferior to that of other Member States.

It is likely that discerning consumers will in future select a certain e-money product fundamentally on the grounds of a repayment guarantee should the issuer fail.

However, on the "cons" side there may be significant practical difficulties in dealing efficiently with a multitude of often very small balances and such increased FSCS cover will come at a cost. An accurate CBA is required to make an informed decision but on empirical evidence, and unless bank failures accelerate, the case appears weak.

In summary, unless average outstanding balances increase over time it is thought that the benefits to be gained by the consumer in extending FSCS cover are limited and additional charges will be an issue. Any decision taken on the subject should be reviewed in light of market dynamics at regular, say annual, intervals.

Question 5

(i) Do you think there should be a prescription period?

(ii) If so, how long should such a period be?

(iii) Should a prescription period apply to claims on banks and building societies, as well as non-bank e-money issuers?

i) **NO:** A level playing field is important to avoid market anomalies and to aid consumer understanding of the sector. eacg believes that a prescription period will significantly hinder the development of e-money as a cash substitute and particularly its future viability as a longer term payment conduit.

In drawing this conclusion we firmly believe that applying a prescription period to a bank/building society e-money issuer will undoubtedly make their e-money product inferior to a cash account. The consumer will also rightly be confused if prescription periods only apply to non-bank operations. That being said, there are obvious advantages to the issuer in providing such a backstop and thereby the avoidance of maintaining dormant accounts indefinitely. This may, of course, be contrary to needs of the typical consumer. On balance, we do not support the introduction of a prescription period although we accept that one could be adopted based on the rules of limitation (6 years) if other Member States are similarly inclined.

ii) **N/A**

iii) See response to i). Should a prescription period be adopted for non-bank e-money issuers we could not support any move for its universal adoption. This would inevitably make a bank e-money product inferior to a cash account which we believe is contrary to the longer term interests of the consumer.

Question 6

(i) Do you agree that the exemption from carrying out customer due diligence checks should be raised from €250 up to €500 for national payment transactions?

(ii) Please give reasons if you do not agree.

- i) **YES:** 2EMD permits Member States to raise the exemption from customer due diligence checks specifically for non-rechargeable devices from €250 up to €500 for national payment transactions. Although a potential risk exists that criminals will exploit the higher limit it must be stressed that the new limit only applies to non-rechargeable 'devices' and that issuers with this electronic medium will be able to provide a comprehensive audit trail.

If excessive fraudulent activity ensues then the former limit should be simply reinstated.

- ii) N/A

Question 7

(i) Is a fixed minimum requirement of €75,000 for a small electronic money institution's (SEMI's) initial and ongoing capital a sensible approach to setting an own funds requirement?

(ii) If not, what are the preferred alternatives and why?

- i) **Overall YES:** As stated in the CP text, the initial capital requirement for a large authorised issuer is €350,000. If seeking to attract new players then it is both appropriate and prudent that a smaller figure of €75,000 (£65,000ish) applies as the fixed minimum requirement for a SEMI's initial capital (or 'own funds'). Set at this level and in reducing initial costs it will encourage new e-money issuers whilst also reflecting the capital needs for such firms with liabilities of upto €5M. A zero initial capital requirement might well attract undercapitalised ventures whose failure might harm the development of the e-money sector.

Any move encouraging greater competition with the possibility of greater innovation must be good news for the consumer. Any increase in the €75,000 figure will, of course, improve the capital base of any new SEMI but it will conversely make the sector less attractive for any business start-up.

- ii) **N/A**

Question 8

(i) Should the full safeguarding requirements apply to small electronic money institutions (SEMI's)?

(ii) If not, what are the preferred alternatives and why?

- i) **YES:** It is a primary purpose of regulation to protect the consumer and the full safeguarding requirements should apply to all SEMIs. It is very sensible to replicate the basic safeguards outlined in the PSRs. eacg agrees that the right balance has been struck for SEMIs in the overall proposals, removing potentially onerous prudential requirements but also in protecting the consumer.
- ii) **N/A**

Question 9

Is there any case for setting a limit for average outstanding e-money for small electronic money institutions lower than €5 million?

NO: The float limit - a limit for average outstanding e-money for SEMIs of €5 million in any six month period – appears appropriate. As pointed out by industry working groups, any lower limit could have a negative impact on the existing institutions that currently benefit from exemptions.

Question 10

Does the proposed approach to enabling small electronic money institutions to carry out other regulated and non-regulated activities strike the right balance?

YES: eacg welcomes this proposal permitting SEMIs to carry out “mixed business” activities. In our opinion the right balance has been struck by HM Treasury.

This development is crucial to the future development of the sector. It will give SEMIs the ability to undertake payment services, as a function of an e-money issuer, and ancillary payments services closely connected with issuing e-money together with the capability to provide payment services and operating payment systems. Very importantly, SEMIs may also carry out other non-regulated business activities outside of issuing e-money.

The original EMD, of course, restricted SEMIs to issuing and administering e-money or storing data. The proposed EMRs should greatly encourage new entrants to enter the market and develop new customer-centric services.

Source:

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