



Impact of the E-Money Directive

Its application to 'hybrid' operators issuing e-money

Ir. S.L. Lelieveldt

Netherlands Bankers' Association (NVB)
Dutch issuers of Electronic Money (NVIEG)

E-Money Directive (2000/46/EC) – Round Table Meeting
Brussels, 8 March 2006

- The market for innovative payments....
- A bit of history on the E-money Directive
- What is a hybrid operator...?
- M-payments and Eu-legislation
- Question for the Commission....

- Electronic purse (IC-card-based)
 - value: € 600-700 Million (150 Million transactions)
- Payments via mobile telephone (content services)
 - Value € 1000 Million (> 500 Million transactions)
- Payments over the Internet
 - value € 2000 Million (5-7 Million transactions)



- E-money as an IC-chip has limited take-up
- Digital travelers cheque works fine / gift cards on the rise
- E-money on the Internet is a succes (5 billion trx in 2005)
 - In its 8 years of existence, Internet-based e-money issuer Paypal has achieved worldwide reach with 100 M customers, compared to a worldwide reach of only 15 M customers for Internet-based ING Direct bank (that started 1 year earlier)
- E-money / payments via the telephone (pre-paid or via the bill) are even more succesfull
 - 23 billion Euro in 2004 for content services
 - (value and transaction details remain scarce)

- **1994: all innovative payments viewed as taking deposits**

Central banks and supervisors considered any funds attracted from the public and used for innovative payments as taking deposits, an activity to be carried out by full-swing credit-institutions only

As a result KPN was asked either to get a bank license, cooperate with a bank or withdraw commercial offerings where the existing prepaid phone card would be used for payments to third parties ; KPN chose for a joint venture with Postbank: the Chipper e-purse

- **1997: Commission pushes light regime: e-money directive**

The Commission found the regulators/supervisors interpretation to heavy and intervened with a proposal for the e-money directive so that a light approach would allow new players to operate innovative pre-paid payment schemes (regardless of the technology applied) under lighter rules:

- No € 5 M but € 1 M required as core assets
- No complicated Basel (1/2) requirements but more straightforward set of liquidity requirements
- Similar requirements to administration, organisation and integrity; among which: separation of consumer funds from working capital

- **Relevance of e-money for (mobile) operators timely identified**

In 1999 ETNO recognized the relevance of the proposed e-money directive for the business of (mobile) telephone operators and ventilated an opinion on the draft e-money directive to the Commission

In 2001 the Electronic Payments Observatory e-news network repeatedly discussed the status of the e-money directive and its relevance to mobile industry

- **Mobile operators ask and receive preferential treatment from EC**

In 2002 GSM Europe requested a proportional treatment under the e-money directive:

The E-money directive is important as it may affect the prepay services of mobile operators, (intended to be) used for third parties content and applications

Letter of June 12, 2002 by Mr Obermann to Commissioner Liikanen

Without any legal or stakeholder consultation, the Commission sent a **comfort letter** to GSM Europe (18.10.02)

The E-money Directive should not affect pre-paid services and calls to premium rate services. Of course we shall examine the implementation measures adopted by the Member States and take action where necessary

- **Supervisors (except UK) fail to appreciate/understand market developments**

Since entry into force of the E-money directive (mid 2002) most supervisors in Europe (with the exception of the UK) still assumed that the only technical appearance of e-money could be a balance on an IC-chip; when confronted with Internet-based or telephone-based e-money mechanisms, their instinctive reaction was still that that would not be e-money but the business of being a credit-institution.

- **Supervisors in Member States get in trouble with new players**

- While some new players for Internet-e-money or e-money on mobile phones, fought to be treated as e-money institutions rather than credit-institutions, the mobile operators argued that the pre-paid payment services were insignificant in comparison to the main business of providing voice services; treatment under the e-money directive would thus be disproportional ;

- **Commission facilitates further discussion/consultation on application of e-money to mobile industry**

- Upon discovering that some member states were having issues with market players on the topic of application of e-money directive, the Commission lived up to its promise and organised a consultation on the application of the e-money directive to mobile operators; which is when the concept of **hybrid operators** turned out to be useful.

- Concept was first mentioned in 2002 but became a cornerstone for the commission consultation/guidance on application of e-money for mobile operators, to support the line of reasoning below:

Mobile operators may actually receive (some) pre-paid funds from customers and transfer a tiny bit of those funds as payment for services to third party content providers. Yet, that doesn't justify application of the e-money directive given that (tick one or more below):

- the payments involved cannot really be considered a payment to third parties, so it's actually not even e-money,*
- the value of the content services is incredibly low/insignificant (1%)*
- application of the regular e-money rules would constitute a disproportionate burden and stifle innovation*

- (the pre-paid value of consumers should then be returned upon first request of the consumer)
- (the VAT regime for delivering financial services would then apply)

- While the concept of a hybrid issuer is often used in discussions, there is no explicit definition.
- From the commission guidance on the application of e-money for mobile operators the closest approximate to a definition is:

A hybrid operator is a provider that may be issuing e-money as a non-core part of their business

- 1. As a matter of principle, mobile operators do e-money,**
While there is a school of thought that suggests that no e-money is created when pre-paid customers use their store of value with mobile operators to purchase third party services, most commentators agree that e-money is created when the monetary value stored on a pre-paid card is accepted as payment by a third party merchant in line with Article 1.3(b)(iii) of the Directive.
- 2. But as it is now only 1%, we advise the member states to use broad waivers and exemptions, applied by local supervisors**
- 3. While for the longer term we suggest to discuss the issue more in depth during the review of the E-money Directive:**
- 4. Taking into account consumer protection issues and other legislative EU-initiatives (rules on payments, anti-money laundering etc)**

Which M-payments issues are currently under debate:

- The Eu 6th VAT Directive
- The New Legal Framework for Payments in the Internal Market
- Regulation to implement FATF-Special Recommendation VII to include originator information with payments
- The E-Money directive

M-payments are regular payments under VAT-Directive !

Taking cash from the consumer by selling vouchers that will top up an amount of phone credits, is essentially a transfer of money from the consumer to the seller/issuer of e-money; such activity falls within the scope of the 6th VAT Directive. See case for Arena Cards.

OR / BUT

M-payments are not payments under the 6th VAT Directive?

Loading credits on a mobile phone should not be considered a VAT-exempt financial transfer of money but a 'nothing' transaction without VAT ; all the VAT burdens which results from the substantial sale of content by third parties should be borne by those third parties and not by mobile operators. It would be a disproportionate burden for the mobile operators to deal with the VAT-issues themselves. This is particularly relevant now that the data revenue involved approaches 25 % of the revenue stream of mobile operators (Vodafone/O2).

The New Legal Framework for Payments in the Internal Market

- **The NLF applies equally to all players in the market !**

The NLF ensures a level playing field for all organisations that are active in the payment business. Sector specific exemption to those rules qualify as state-aid and need to be avoided as they negatively affect the level playing field.

OR / BUT

- **Mobile operators will not fall under the New Legal Framework for Payment in the Internal Market**

- if:

- *(i) the service provider operating the telecommunication or IT system or network is closely involved in the development of the digital goods or electronic communication services provided;*
- *(ii) the goods and services cannot be delivered in the absence of the service provider;*
- *(iii) there is no alternative option for remuneration.*

- **Special regulation number VII of FATF, imposing the transmission or originator details with every payment, does not require alteration for m-payments !**

If mobile payments qualify as e-money, they will be exempted; if not, the regulation applies, given that mobile operators act as payment service providers of the payer and FATF intends to cover all payment channels/organisations

OR / BUT

- **Special regulation number VII of FATF should be amended to exempt M-payments ?**
 - and not apply to post-paid m-payments because that would hinder further development of this business;
 - require an additional exemption rule beyond the e-money exemption, so that it allows for pre-paid m-payments that are not considered e-money, to benefit from from the same exemption clause as e-money providers

Pre-paid payments services of mobile operators are e-money !

Now that the mobile industry has developed its pre-paid payment business to third parties far beyond the 1% there is no longer a rationale for continuing with waivers and exemptions. It is clear that payments to third parties occur and the pre-paid value qualifies as e-money. Whether or not e-money business can be exempt only depends on objective value/volume criteria in the e-money directive.

OR / BUT

Pre-paid payment services of mobile operators may in some cases also remain exempt in the future because of

Referring back to some current exemptions and the agreement in the Banking Advisory Committee to solve the issue more definitively in the reviewed e-money directive, the Member States may for unknown reasons conclude that they have no other option than to construct a new line of reasoning to justify a more permanent exemption for the mobile industry (which by the way should not look like a sector specific exemption)

- It appears to be the case that the Commission has indeed paid the fullest attention to the regulatory issues raised by the mobile operators in their letter of June 2002
- The old argument that the industry is in its infancy and that regulation might stifle innovation does not appear to be true any more; certainly when one can also observe:
 - That the segment of independent m-payment service providers (m-payment aggregators) is actually making profits,
 - The increasing reluctance of the mobile industry to disclose specific information on m-payments transaction value and volume, as well as on revenue and industry structure

Is the Commission willing to specify as of which value or volume of European M-payments they will start to consistently regulate m-payments (be they pre-paid or postpaid) as the straightforward payment and e-money business that it is ?

OR

Will the Commission continue their current view of M-Payments as:
something special,
something out of the ordinary,
something so unusual,
so incredibly incomprehensible,
that it defies any categorisation ever made....

Which would then, in good European spirit, require a solid (re-)definition of M-Payments....

M-Payments can be defined as:

- **Magic** events (certainly not payments),
- that occur only when using **Magic** ICT-device-like instruments (most definitely not payment instruments)
- which are somehow issued by **Magic** hybrid organisations (by no means a regular bank, payment institution or e-money institution),
- to allow consumers to transfer some **Magic value** (not money) to compensate merchants for services/goods delivered.

As a consequence, for M-payments, there is no need to comply with:

- anti-money laundering rules and know your customer procedures,
- the obligation to provide originator information
- VAT-rules for payment business
- supervisory rules for banks, e-money issuers or payment institutions
- requirement to redeem (unused) e-money to consumer

M-Payments can be defined as:

Only magic defies all logic

Any questions....?

Simon Lelieveldt
+31 20 5502 827
lelieveldt@nvb.nl





Generic model for analysis

Wants to buy

Customer

has

Account / billing
relation & agreement
Credit-institution, utility company, e-money institution,
phone operator, ISP, ...

and

Device / technology
Card, PC, Internet, landline, mobile phone, etc

to pay

Payment procedure / mechanism
Transfer of payment intention and authorization method
Payment taken out of pre-paid funds or account (pay direct) / Payment added to bill (pay later) /

Wants to sell

Retailer

has

Account / billing
relation & agreement
Credit-institution, utility company, e-money institution,
phone operator, ISP, ...

and

Device / technology
Card, PC, Internet, landline, mobile phone, etc
E- & M-Payments Service Providers

to receive



Typical e-money set-up

Loading e-money

Cash
(top up card)

Bank Account

Credit Card

Customer



transaction

Payment Service Provider

Processes all types of payment transactions for merchant and claims on behalf of the merchant with the right issuer

Retailer



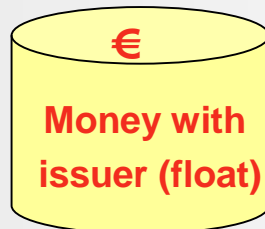
Account Merchant

Issuer receives money and converts to digital form



Digital world

Money world



Issuer receives transaction data and pays out into the merchant's bank account

€

€

