HM TREASURY

The Electronic Money Directive Consultation

a summary of responses

February 2011

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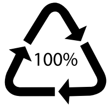

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1 Introduction

1.1 The Government published a consultation on 21 October 2010[1] on the options for implementing the Electronic Money Directive in the UK (the Directive)[2]. The consultation closed on 30 November 2010.

1.2 The consultation set out the key changes that will be made to the legal framework for e-money. It set out the Government's proposed approach to the discretionary elements left open by the Directive, which is maximum harmonisation in other respects, and invited comments on this approach, and on the draft implementing Regulations.

1.3 This document summarises the responses that were received:

- Chapter 2 summarise the responses.
- Chapter 3 analyses the responses, and sets out the next steps, subject to Parliamentary approval.
- Annex A lists the consultation respondents.

1.4 The Government is grateful to everyone that responded to the consultation document in writing or participated in the meetings that were held as part of the consultation process.

[1] Laying of Regulations to implement the new E-Money Directive. A consultation document. HM Treasury October 2010.

[2] Directive 2009/110/EC on the taking-up, pursuit and prudential regulation of the business of electronic money institutions amending Directives 2005/6-/EC and 2006/48/EC and repealing Directive 2000/46/EC.

2 Summary of responses

2.1 The consultation invited comments on the Government's proposed approach to implementing the Directive, on draft implementing Regulations and on a Regulatory Impact Assessment.

2.2 The Treasury held or attended over a dozen stakeholder meetings and received 20 written responses during the consultation period. Respondents represented a broad range of electronic money institutions, payment service providers, trade bodies, consultants and user groups. These stakeholders helped to provide a view of the implementing Regulations from a practical, market entry and future-proofing perspective.

2.3 The respondents were broadly supportive of the Government's proposed approach which is designed to promote the growth of the market, encourage innovation, and improve consumer protection.

2.4 . There was general recognition that the new capital requirements are a step in the right direction, and that it is important for the competitiveness of the UK that the new regulatory regime should be proportionate, enabling e-money institutions to deliver a cost-effective service and be attractive to new entrants, while protecting consumers. However, there were some issues which provided debate and where respondents were unable to reach a consensus.

2.5 Some respondents expressed concern about the potential impacts of new refund rights for consumers, as at present, many consumers do not reclaim any residual balances of e-money. Implementing an indefinite time limit in which a refund may be requested would significantly impact on the present business model of some e-money institutions, raising the costs of issuing e-money, and impeding the development of the market. The Government's approach includes a prescription period that will allow customers to reclaim funds for six years. This period strikes the right balance between mitigating the business impacts whilst still protecting consumers.

2.6 There was also a desire from many respondents for greater clarity over the delineation of the boundary between the regulated and unregulated sectors (the definition of an exempt "limited network"). Some respondents called for clear criteria to be written into the Regulations to provide transparency and certainty to both industry and users. A small majority supported the Government's proposed approach to deal with the issue through Financial Services Authority (FSA) guidance.

2.7 Child protection groups expressed concern about the absence of due diligence checks for non-rechargeable devices (mainly anonymous prepaid cards). They called for the imposition of checks, while the industry broadly supported the extension of the exemption from due diligence checks from €250 to €500.

3 Questions and summary of responses

3.1 The consultation document set out 10 questions.

Consultation question 1

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

3.2 The Directive does not set objective criteria for what constitutes a limited network. In this it follows the precedent set by the Payment Services Directive. The responses to this question stressed the need for transparency and clarity on what constitutes a limited network.

3.3 Respondents were, however, divided on the best way to resolve this question. Some respondents suggested a more prescriptive approach to setting the boundary between regulated and unregulated products, while others (a small majority) recognised the benefits of a nuanced case by case approach that can respond to changes in the market and evolving business models.

3.4 It is not ultimately possible for the Government to legislate for certainty in drawing the boundaries of a limited network, because the interpretation of what constitutes a limited network depends on the language of the Directive. This will be for the courts to determine. For the same reason, it is not desirable to develop a hard and fast set of criteria to apply to each regulatory decision, as these may not always be appropriate to every case, and may themselves be subject to legal challenge.

Conclusion

3.5 The Government will adopt a pragmatic approach. It will require the FSA to publish guidance. The Treasury has asked the FSA to develop the guidance in consultation with the industry and the Treasury, based on general principles (such as the distinction between open loop and closed loop prepaid cards), supported by case studies and practical experience of different business models. This will narrow the scope for uncertainty from the outset, and in this way it is expected that a more responsive and growing body of knowledge will gradually develop to inform decision making on a case-by-case basis. The Government believes this is a more sensitive and responsive way to resolving uncertainty than hard-wiring criteria in legislation that may not be able to address ongoing developments in the market. It will ensure that UK industry is not put at a disadvantage compared to other Member States.

Consultation 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?

3.6 Respondents gave a number of useful examples. The main area of uncertainty identified by respondents lay in business models that offer prepaid cards that are accepted by multiple legal entities, for example gift cards that may be accepted by a number of retailers. One respondent gave the example of shopping centre gift cards with networks ranging from small outlet villages of no more than a dozen shops to the biggest shopping malls in the country.

3.7 Another area is where a limited range of goods and services are offered, for example on a mobile network, or by cards that can only be spent on a narrow range of products. The range of products may be ill-defined. It may depend on a constantly shifting product range stocked by participating retailers. One respondent gave the example of fuel cards provided by large fuel companies. These often offer the ability to buy other goods at a petrol station convenience store.

3.8 The majority of responses suggested that FSA guidance would solve uncertainty regarding areas in which the limited network concept is unclear.

Conclusion

3.9 The FSA will consider the extent to which prepaid cards or other instruments that can be accepted by multiple legal entities constitute a limited network in its guidance.

Consultation 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?

3.10 There was little or no support for voluntary codes as a solution to improving the safeguards for consumers in the unregulated sector.

3.11 Responses fell into two broad categories: those that argued that tougher regulation and enforcement than voluntary codes is necessary to address perceived shortcomings in the unregulated sector; and those that felt that there was no justification for action due to the low risk of consumer detriment. The main reason for the general dissatisfaction with voluntary codes was that, although models vary, supervising and enforcing a voluntary code is often thought to be difficult. There are usually no limits to the number of violations a company might have, no financial incentive to abide by a code, and weak rights of recourse for consumers.

3.12 Some respondents argued that no action was necessary because the perceived risks are low. It was also argued that voluntary codes would be unworkable in practice because the average amounts outstanding on unregulated products (mainly gift cards) are less than £30. These responses concluded that the risk of loss per customer did not warrant a new protection mechanism.

3.13 The Treasury has asked the Office of Fair Trading (OFT) to provide some advice on the prepaid market, the effectiveness of current self regulatory solutions for protecting consumers, and the interaction between the regulated and unregulated sectors. This advice will be fully considered before the Government decides what, if any, action to take.

Conclusion

3.14 The Treasury will continue to look at the interaction between the regulated and unregulated sectors. It will work with the industry to consider the options for enhancing consumer protection in the sectors, focussing particularly on the areas identified by the OFT as presenting the highest degrees of risk to consumers.

Consultation question 4

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

3.15 Only one response, from a consumer body, favoured extending Financial Services Compensation Scheme (FSCS) protection to e-money issued by banks and building societies. The industry as a whole did not favour extending such cover.

3.16 The responses recognised that extending FSCS protection to e-money issued by banks and building societies would increase consumer protection, and would make e-money issued by those institutions more attractive. Customer confidence and perceptions of the industry could be improved if this protection was extended. It was generally accepted that extending FSCS cover to e-money issued by banks would create a level playing field between bank and non-bank e-money issuers in the sense that there would be broadly equivalent arrangements for safeguarding customers against the insolvency of bank and non-bank issuers.

3.17 Against this, it was argued that FSCS protection would increase costs in an industry where margins are low. The benefits to consumers were said to be limited, given low average outstanding e-money balances, unless these balances increase over time.

3.18 Non-bank issuers hold customer funds in a segregated account, with these funds ring-fenced and having customer priority in the event of an insolvency. However, there is no independent body or industry levy to finance and pay out claims if a non bank issuer fails. The responses from non-bank issuers stressed that extending FSCS cover might put them at a competitive disadvantage compared to banks. This was due to a perception that FSCS cover for banks would be of higher quality than the consumer safeguards in place for non-banks.

Conclusion

3.19 The Government will, in the first instance, seek to clarify whether the Deposit Guarantee Schemes Directive, which governs the eligibility of FSCS protection for bank deposits, precludes European Member States from extending FSCS protection to bank-issued e-money. It will consider whether a better alternative might be to seek changes to the Electronic Money Directive, when it is reviewed in 2012 to level the playing field for bank and non-bank electronic money institutions.

Consultation 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?

3.20 There was majority industry support for a prescription period to end the right of customers to redeem funds after a specified interval from the end of a contract. One consumer group was against this proposal. One consultancy said that a prescription period would significantly hinder the development of e-money as a cash substitute, and particularly its future viability as a longer term payment conduit.

3.21 Responses stressed that the requirement to maintain and store dormant funds could be significant, raising the total costs of issuing e-money and requiring expensive re-engineering of some business models. Firms also stated that, in practice, dormant funds that are not reclaimed within a few months are very rarely reclaimed at all.

3.22 A distinction was made between gift cards and higher value reloadable products, where both the typical value and life of a contract differ substantially (ranging from £5 and a few months to substantial sums via an open ended contract). The proposed prescription periods ranged from two to five years. This would give firms certainty over the potential costs they may incur, while allowing consumers sufficient time to reclaim funds.

3.23 On the question of whether a prescription period should apply to e-money issued by banks and building societies, responses highlighted the confusion for consumers, should different rules apply to banks and non-banks. On the other hand, banks have systems to manage dormant deposit accounts and were therefore unlikely to be as adversely impacted as non-bank issuers by having to maintain dormant e-money accounts.

Conclusion

3.24 The Government will introduce a prescription period of six years. It will apply to e-money issued by banks, building societies, and non-banks. This will avoid customer confusion.

Consultation 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

3.25 Industry responses unanimously supported an increase from €250 to €500. They did so mainly on grounds of cost. Respondents highlighted that the margins on low value cards are thin, and the costs of carrying out due diligence checks on low value cards may be an obstacle to the development of new services. The risks associated with non-reloadable cards were also thought to be lower than for reloadable cards.

3.26 Child protection groups were concerned that the absence of due diligence checks would facilitate the sale of images of child abuse and the sale of age-restricted goods and services. This is because some prepaid cards can be acquired anonymously, or by giving false details, to hide the identity of the user. The Treasury has explored these concerns, and believes there are sufficient measures in place to address this issue. For example, international card schemes have sophisticated monitoring systems that trawl the internet looking for sites accepting card payments for illegal material. Such sites, and the businesses behind them, are closed down very quickly.

3.27 Anonymous prepaid cards are typically given as gifts, or are used by those who do not have access to a bank account. Their anonymity does not, however, help anyone using such a card to buy illegal images. The card schemes already subject the merchants who accept anonymous cards to the same monitoring and controls as any other card. In other words, the websites that

accept cards in payment for abusive images are targeted, irrespective of whether a card is anonymous or not.

Conclusion

3.28 It is difficult to assess the risks of raising the due diligence limit, due to the intangible nature of the pros and cons of raising the limit. Neither the financial inclusion benefits nor the potential crime risks can be quantified. The fact that as many as 14 other Member States will be raising their due diligence checks is an additional factor to be considered.

3.29 The benefits of raising the limit for due diligence are for those who do not have access to a bank account or debit or credit card, cautious individuals who do want to give out their bank/card details, and those people that use anonymous prepaid cards for gifts, or by. The Government has therefore decided to raise the due diligence exemption to €500.

Consultation question 7

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

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

3.30 The consultation proposed a fixed minimum capital requirement for small firms set at €75,000.

3.31 The consultation recognised that it would be possible to lay down no initial or ongoing capital requirements for small electronic money institutions. However, a minimum capital requirement was recommended for four main prudential reasons: (i) there will be no limit on the amount of e-money a small institution may issue; (ii) firms will be able to undertake mixed business in future, including unregulated activities (they will not be restricted to issuing e-money); (iii) they will be able to undertake the same business as payments institutions; and (iv) capital will act as a buffer to prevent a failure, and protect creditors who are not customers and whose funds will not otherwise be safeguarded. The increased potential risks therefore warrant a setting a minimum level of capital.

3.32 The FSA also recommended that small firms should have adequate capital resources to act as a buffer, absorbing both unexpected losses that arise while the business is a going concern as well as the first losses if it is wound up.

3.33 Consultation feedback suggested that the proposed fixed minimum capital requirement of €75,000 would impact a number of small issuers (broadly micro enterprises) with a low volume of business. It would act as a deterrent to start-ups and pilot programmes. A few responses however called for higher prudential limits to be set.

3.34 The FSA carried out a survey of a representative sample of small e-money issuers. This survey found that, of those that responded, there was average outstanding e-money in issue of £160,000. The median was £30,000. This suggests that if we were to require a minimum capital of €75,000, a majority of small firms will be disproportionately capitalised and may not continue in business if this minimum capital requirement is imposed on them.

3.35 Following discussion with the industry, the preferred alternative is to set a threshold for micro enterprises, below which there will be no minimum capital requirement. A threshold of €500,000 of average outstanding e-money was thought to be suitable (the average balances may be turned over several times a year).

3.36 In terms of impacts, a €500,000 threshold will exempt 80-85% of existing small firms (40 firms) from holding a minimum level of capital altogether. Above the threshold of €500,000 and up to €5 million of outstanding balances, it is estimated that existing small institutions already meet or exceed the minimum level of capital based on 2% of average outstanding balances. Therefore this option would be expected to have a minimal impact on existing firms and new entrants.

Conclusion

3.37 The Government will set a threshold of €500,000 average outstanding e-money, above which firms will be required to hold capital equivalent to 2% of their average outstanding e-money balances. This means that the starting level of capital will be €10,000 based on average outstanding e-money of €500,000, rising to €100,000 capital required to support the maximum of €5 million average outstanding e-money per firm. The new arrangements will set a floor below which firms will not be able to fall, therefore protecting creditors, but it has also been set at a level that will have minimal impact on existing firms, and can equally be expected to have minimal impact on new entrants. The Government believes, therefore, that setting the threshold at this level strikes the right balance between protecting consumers and not imposing onerous requirements on small firms.

Consultation question 8

i) Should the full safeguarding requirements apply to small electronic money institutions?

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

3.38 There was broad support for this proposal, with no dissenting views expressed.

Conclusion

3.39 The Government will proceed on this basis.

Consultation question 9

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

3.40 Setting a limit for average outstanding e-money for small electronic money institutions at €5 million attracted broad support, with the proviso that full safeguarding requirements should apply to supplement the limit. Only one response called for a lower threshold (of €2 million), given the reduced prudential requirements and increased freedoms for firms contained within the Directive.

Conclusion

3.41 The Government will set the limit for average outstanding e-money for small electronic money institutions at €5 million

Consultation 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?

3.42 There was broad support that the proposed approach was proportionate.

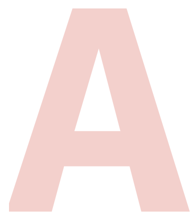
3.43 The Government will proceed on this basis.

Next steps

3.44 .The written responses, together with the feedback received from the stakeholder meetings have been used to inform the Government's response, and the draft Regulations have been amended accordingly, as described in this response document.

3.45 The draft Regulations were laid on 19 January 2011.

3.46 Subject to Parliamentary approval, the regulations will come into force on 30 April 2011, with some provisions coming into force on 9 February 2011, to meet the implementation deadline set by the Directive. The Financial Services Authority will publish its general approach document in February 2011.



List of respondents

Age UK

American Express

The Association of Accounting Technicians

B&Q plc

The British Bankers' Association

The Child Exploitation and Online Protection Centre

The Children's Charities' Coalition on Internet Safety

E-Money Association

EA Consulting Group

Edgar, Dunn and Company

Flex-e-vouchers Limited

The Gift Voucher Shop Limited

The Horticultural Trades Association

The International Association of Money Transfer Networks

The Mobile Broadband Group

The Prepaid International Forum

Raphaels Bank

Ukash

Visa Europe

Western Union

HM Treasury contacts

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