

Consultation on the revision of the E-money Directive and implementation of the EU Regulation on cross-border payments in Euro

January 2009

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of the E-money Directive and
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Regulation on cross-border
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Executive summary

In October 2008 the European Commission published proposals for revising two pieces of legislation in the payment service sphere. The first concerns the revision of the E-Money Directive (EMD), which creates a prudential regulatory regime for e-money institutions. The EMD was adopted at EU level in 2001, and implemented through the Financial Services and Markets Act (FSMA) in 2002. The second proposal concerns the revision of Regulation 2560, which addresses the charges levied on cross-border payment transactions. Regulation 2560 was adopted at EU level in 2001, and the HMT Regulations on Cross Border Payments in Euro came into force in March 2003.

This document consults on both proposals, with a view to informing the Government approach towards EU level negotiations on revision of the EMD, and the implementation of a revised Regulation 2560 into UK law. Significantly, both proposals seek to align these pieces of legislation with the agreement on the Payment Services Directive (PSD) reached in 2007.

The Government welcomes the Commission's approach towards revision of the EMD. As set out in this consultation document, the Government proposes to support the proposal while seeking certain changes, notably with respect to the capital requirements methodology and waiver provision. The Government also welcomes the Commission's approach to revising Regulation 2560. In the event that an agreement is reached at EU level in 2009, the Government would propose (in alignment with the PSD regime) that the FSA is assigned responsibility as competent authority for the revised Regulation, with the Financial Ombudsman Scheme (FOS) to act as the out of court redress mechanism. The Government proposes not to use the opt-in for Sterling payments.

Stakeholder reactions to the consultation are invited by 14 April 2009.

The existing EMD and Regulation 2560 and Commission proposals can be found at: http://ec.europa.eu/internal_market/payments/emoney/index_en.htm and http://ec.europa.eu/internal_market/payments/crossborder/index_en.htm, respectively.

1

Introduction: context to consultation

AIM OF CONSULTATION

1.1 In October 2008 the European Commission (Commission) published proposals for revising two pieces of legislation in the payment service sphere. The first concerns the revision of the E-Money Directive (EMD) (2000/46/EC), which created a framework of regulation for providers that issue e-money, known as electronic money institutions (ELMIs). It also facilitated issuance of e-money by credit institutions, by amending the Capital Requirements Directive. The EMD was adopted at EU level in 2001, and implemented into UK legislation through the Financial Services and Markets Act (FSMA) in 2002.

1.2 The second proposal concerns the revision of Regulation 2560, which addresses the charges levied on cross-border payments in euro. Regulation 2560 was adopted at EU level in 2001 and, in the UK, by means of the HMT Regulations on Cross Border Payments in Euro (2003).

1.3 Significantly, both Commission proposals seek to align these pieces of legislation with the agreement reached in 2007 on the Payment Services Directive (PSD) (2007/64/EC). The PSD must be implemented in all EU Member States by 1 November 2009. The Commission's proposal to revise the Regulation would see the revised Regulation 2560 coming into force on 1 November 2009, to align with the PSD implementation deadline. ELMIs and credit institutions issuing e-money will need to comply with both the PSD and existing EMD requirements from 1 November 2009, pending EU level agreement on the revision of the EMD.

1.4 EU negotiations on the EMD commenced with a first Council meeting of experts under the French EU Presidency on 8 December 2008. Regulation 2560 negotiations have also commenced at expert level, with two Council meetings under the French EU Presidency on 11 and 20 November 2008. EU level negotiations will continue in 2009, with the possibility of agreement on both dossiers in the first half of 2009, ahead of the PSD implementation deadline. There is pressure to swiftly revise these pieces of legislation, in order to ensure consistency with PSD implementation.

1.5 This document consults on both Commission proposals with the aim of:

- informing the Government's approach towards EU level negotiations on the revision of the EMD; and
- informing the Government's approach towards implementation of a revised Regulation 2560 into UK law.

1.6 In this chapter, the background to the existing EMD and Regulation 2560, and the context to the proposed revisions are explained. In the following chapters, the details of the proposed changes and key issues of interest from a UK perspective are discussed. Stakeholder comments are invited on the proposed Government approach towards negotiating and implementing the revised EMD and Regulation 2560 respectively. An impact assessment of policy options in the EMD is included at Annex B.

REVISION OF THE E-MONEY DIRECTIVE (EMD)

Original objectives

1.7 E-money is described in the original EMD as monetary value that is stored on an electronic device (such as a chip card or computer memory), that is accepted by undertakings other than the issuer, and that is generally intended to make payments of a limited amount. The EMD considers e-money to be an electronic surrogate for notes and coins. The original EMD had the following objectives:

- to **protect the consumer and ensure bearer confidence**. To achieve this the Directive created a prudential framework to ensure the financial integrity and stability of ELMIs. The consumer also has the right to redeem his/her e-money back into notes and coins or a deposit of the same amount;
- to **improve the single market in financial services** through the introduction of (minimum) harmonising rules, and, in particular, by establishing a single passport for ELMIs with the principle of home state regulation. ELMIs authorised in one Member State are thereby entitled to issue e-money throughout the EU;
- to **avoid any distortion of competition** for the issuance of e-money between traditional credit institutions and ELMIs, by subjecting both to prudential supervision; and
- by harmonising the legal framework for e-money across the EU, to **create the legal certainty necessary for e-commerce to develop**.

1.8 The Government welcomed the aims of the original EMD. The EMD was implemented in the UK by making the issuance of e-money a regulated activity under the Financial Services and Markets Act (FSMA), with the Financial Services Authority (FSA) taking on responsibility for the supervision of ELMIs.

Rationale for proposed revision

1.9 In early 2005 the Commission launched a review of the EMD, in accordance with Article 11 of the Directive. Having already published a staff working document in July 2006, in its proposed revision of October 2008, the Commission identified certain issues with the EMD, which were believed to have hindered its success, in particular:

- a lack of clarity surrounding the definition of e-money and the scope of the Directive, generating legal uncertainty and hindering the development of the market; and
- an inconsistent legal framework, with a disproportionate prudential regime, inconsistent waivers and passporting procedures, and the application of anti-money laundering rules to electronic money services.

Linkage to Payment Services Directive

1.10 Concerns with the original EMD will be exacerbated by the implementation of the Payment Services Directive. In particular, the PSD prudential requirements for (non-bank) payment institutions differ widely from those for ELMIs under the EMD, with the former able to engage in a wider range of services. The Treasury has previously consulted on implementation of the PSD in the UK, and will be making and laying the PSD legislation shortly.

1.11 The Commission proposal considers that alignment of the EMD with the PSD regime would be an appropriate way forward. However, the Commission proposal considers that the revised

prudential regime for e-money should take into account the specific risks represented by e-money issuance, rather than merely requiring Member States to apply the PSD capital requirements to ELMIs as for payment institutions.

Core elements of change

1.12 The main changes to the EMD regime in the Commission proposal concern the following issues:

- **Scope and definition of e-money** (Articles 1 and 2): the proposal seeks to clarify EMD scope, producing a technologically neutral and simpler definition of e-money, capable of encompassing innovation in e-money;
- **Prudential requirements** (Articles 3, 6, 7 and 9): the Commission proposes the application of PSD qualitative prudential requirements, a reduction of initial capital from €1 million in the existing EMD to €125,000, and the replacement of ongoing capital requirements in the existing EMD with new methods of calculation, based on the nature and risk profile of ELMIs;
- **Waiver regime** (Article 10): the proposal aligns the waiver with the PSD waiver criterion;
- **Activities and safeguarding** (Articles 8 and 9): the proposal removes the prohibition on mixed business and imposes the safeguarding requirements established by the PSD prudential regime for payment institutions;
- **Redeemability** (Article 5): the proposal seeks to clarify application of redeemability requirements and consumer rights;
- **Anti-money laundering rules** (Article 16): the proposal aligns the anti-money laundering thresholds brought in by the Third Money Laundering Directive on 15 December 2007, beneath which e-money institutions need not comply with full due diligence requirements, with PSD Articles 34 and 53. The latter establish derogations for low-value payments from certain PSD conduct of business rules; and
- **Amendment to Capital Requirements Directive (CRD)** (Article 17): the proposal seeks to change the status of ELMIs from credit institutions to financial institutions, while also seeking to ensure that credit institutions may continue to issue e-money.

1.13 Further details of each change are presented in the following chapters, along with consultation questions on the Government's proposed approach to the negotiations.

Government approach to the EMD revision

1.14 The Government view is that regulatory requirements need to be proportionate to the risks involved in the activity in question. With this in mind, the Government supports the Commission view that the existing regulatory burden on e-money issuers imposed by the EMD is excessive. The Government supports the objectives of the Commission proposal to modernise the provisions of the EMD, and to ensure logical consistency with the PSD regime. In assessing the EMD proposal, the Government's priorities are to ensure that the UK and European payments markets are open and transparent, competitive, innovative and efficient. This must be balanced with achieving an appropriate and proportionate regulatory regime for e-money issuance, and appropriate consumer protection. The Government looks forward to engaging at EU level to ensure the final outcome meets these concerns, and will seek technical changes to the proposal where necessary.

REVISION OF REGULATION 2560

Original objectives

1.15 The original Cross-Border Payments in Euro Regulation 2560 sought to address the Commission's aim of achieving a smooth and efficient functioning of payment systems, deemed indispensable to the success of the internal market. With the launch of the single currency, the Commission saw a need for a modern, stable and efficient payment infrastructure to assist cross-border electronic payments, and to support the single monetary policy for the euro area. EU Member States' payment systems have historically been designed to meet the needs of domestic markets. Following introduction of the euro, the Commission sought to encourage a remodelling of such payment systems to address the higher cost of cross-border payments.

1.16 The main objectives of the original Regulation were therefore to:

- **reduce the level of charges levied on cross-border electronic payments in euro**, perceived by the Commission to be unduly high after the introduction of the single currency; and
- **encourage the payments industry to make improvements to the existing cross-border payment infrastructure**, in terms of cost, speed and quality, in order to support the Internal Market.

1.17 The existing Regulation 2560 applies to credit transfers, ATM cash withdrawals and card payments up to the amount of €50,000. It guarantees that, when a consumer makes a cross-border payment in euro, this will cost the same as a corresponding national payment in euro within his/her own Member State.

1.18 The impact assessment accompanying the Commission's proposed revision of Regulation 2560 notes that, at the time Regulation 2560 was introduced, the necessary infrastructures to efficiently process cross-border payments within the EU were not in place, with widely differing national rules, performance levels and prices. In reviewing the success of the Regulation, the Commission proposal for revision considers that the Regulation has brought down the charges for cross-border electronic payments in euro to the level of national charges. The Commission further notes that the Regulation provided the impetus to the payments industry to undertake the Single Euro Payments Area (SEPA) initiative to create pan-European payment schemes and infrastructure for credit transfers, direct debits and card payments in euro.

Rationale for proposed revision

1.19 The PSD, when implemented into EU Member States national legislation by November 1 2009, will introduce a number of conduct of business requirements for payment service providers. These conduct of business requirements will apply to all electronic payment services, including cross-border credit transfers, ATM withdrawals and card payments, which are currently in scope of Regulation 2560. The PSD will also apply to cross-border direct debit payments, which are not currently in scope of the Regulation. The Commission's proposal therefore seeks to align the Regulation with the incoming PSD requirements. It also seeks to support the SEPA initiative.

Core elements of change

1.20 The main changes to the Regulation 2560 set out in the Commission proposal concern the following:

- extension of the scope of the Regulation to **include direct debits** (Article 2 definitions and recitals);

- **alignment with PSD transparency requirements**, concerning provision of information on the International Bank Account Number (IBAN) and Bank Identification Code (BIC) (Article 4);
- **phasing out settlement-based Balance of Payments reporting** requirements by 2012 (Article 5); and
- requiring Member States to **appoint a competent authority and out-of-court redress mechanism** for the purposes of the Regulation, along with a complaints procedure, appropriate penalties and cross-border cooperation with other Member States' authorities (Articles 6-10).

1.21 This consultation deals with two issues of interest to the UK. The first issue, concerning currency scope, is explained in chapter 2. Importantly, under the Commission's proposal, the UK would retain the possibility to opt Sterling into the scope of the Regulation. The second issue, concerning the proposed supervisory requirements, is set out in chapter 5, along with the Government's intended approach towards appointing a competent authority, in the event that an agreement on the Regulation is reached in early 2009.

1.22 The extension of scope to direct debits, and alignment with PSD transparency requirements on provision of the IBAN and BIC, do not appear to present any specific issues of concern for the UK in implementing the revised Regulation, and are therefore not addressed further in this consultation. In particular, the extension to direct debits concerns direct debits in euro rather than Sterling, and the transparency requirements in the Regulation are already encompassed by the wider PSD transparency requirements.

1.23 Nor does this consultation address the Balance of Payments reporting provision. This aspect of the proposal is aimed at supporting SEPA, which the Commission believes to be hindered by the operation of such systems in certain Member States. This will be a matter for those Member States to consider during the Council negotiations on the proposal. This issue does not, however, affect the UK, which does not have a settlement-based system.

Government approach to the revision

1.24 The Government welcomes the proposed revision of Regulation 2560 on cross-border and domestic payment services in euro within the EU. The Government agrees that the revised Regulation should take into account the provisions of the PSD, and its aims to provide the legislative underpinning and support to SEPA. This is in line with the UK's better regulation commitment to improve the quality of legal provisions and to keep administrative burdens to a minimum.

1.25 In view of the linkage with the PSD, and as set out in chapter 5 of this consultation, the Government intends to appoint the FSA as competent authority for the purposes of the Regulation, and the Financial Ombudsman Scheme (FOS) to act as the out-of-court redress mechanism. This is in the event that an agreement is reached on the revision of the Regulation at EU level in the first half of 2009.

1.26 The Government does not intend to extend the Regulation to Sterling payments. The Regulation may have merit in the context of SEPA and creation of pan-European payment schemes for euro payments. However, the cost of developing the systems necessary to effect cross-border payments in Sterling in the same way that Sterling national payments are made may outweigh the benefits for users. Imposing the Regulation on Sterling payments in the absence of a systems change could risk the cost of domestic payments rising to meet those of cross-border payments or, alternatively the withdrawal of certain products from the market, which would be detrimental to UK payment service users.

HOW TO RESPOND

1.27 HM Treasury invites reactions on any of the issues raised in this consultation or on the Commission proposals more generally. Specific questions are included in subsequent chapters, and a full list of questions is included at Annex A. The consultation period begins with the publication of this document, and will run for 12 weeks. Please ensure that your response reaches us by 14 April 2009. Responses should be sent to:

E-Money Directive and Regulation 2560 Consultation
Payments, Credit and Inclusion Team (Room 3/20)
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ
E-mail: EMDandReg2560consultation@hm-treasury.gov.uk

1.28 If you have a specific query about this consultation document, please contact:

angela.vanderlem@hm-treasury.gsi.gov.uk or
meenakhi.borooah@hm-treasury.gsi.gov.uk.

1.29 This consultation document can also be found on the HM Treasury website: www.hm-treasury.gov.uk.

1.30 When responding, please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of a larger organisation, please make it clear who or what the organisation represents and, where applicable, how the views of members were assembled.

Code of practice for written consultation

1.31 This consultation process is being conducted in line with the code of practice for written consultation (<http://www.berr.gov.uk/files/file47158.pdf>) which sets down the following criteria:

- consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy;
- be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses;
- ensure that your consultation is clear, concise and widely accessible;
- give feedback regarding the responses received and how the consultation process influenced the policy;
- monitor your Department's effectiveness at consultation, including through the use of a designated Consultation Co-ordinator; and
- ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

1.32 If you feel that this consultation does not fulfil these criteria, please contact:

Luke McNerney
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CONFIDENTIALITY OF RESPONSES

1.33 Written responses may be made public, unless the author specifically requests otherwise. In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of emails will be disregarded for the purpose of publishing responses unless an explicit request for confidentiality is made in the body of the response. If you wish part, but not all, of your response to remain confidential, please supply two versions; one for publication on the website with the confidential information deleted, and a second confidential version for the Payments, Credit and Inclusion Team only. Since the FSA is the existing competent authority for the EMD and for most aspects of the Payments Services Directive, consultation responses will be shared with the FSA for the purpose of analysis, unless the author specifically requests otherwise.

1.34 Even where confidentiality is requested, if a request for disclosure of the consultation response is made in accordance with freedom of information legislation, and the response is not covered by one of the exemptions in the legislation, the Government may have to disclose the response in whole or part.

1.35 Any Freedom of Information Act queries should be directed to:

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Email: public.enquiries@hm-treasury.x.gsi.gov.uk

2

Scope of the EMD and Regulation 2560

2.1 This chapter addresses key issues of interest in the Commission proposals concerning the scope of the EMD and Regulation 2560.

SCOPE OF THE EMD

Subject matter, scope and definitions (Articles 1 and 2)

Definition of e-money

2.2 E-money is described in the original EMD as monetary value that is stored on an electronic device, that is accepted by undertakings other than the issuer and that is generally intended to make payments of a limited amount. The EMD considers e-money to be an electronic surrogate for notes and coins.

2.3 The Commission's proposal to change the definition of e-money and clarify the scope of the EMD comes partly in reaction to stakeholder concerns surrounding diverging interpretations across Member States. In particular, product offerings have fallen into or out of scope, depending on Member States' approaches toward the definition of e-money, and differing approaches towards the waiver provision in the Article 8 of the existing EMD.

Account-based schemes

2.4 The proposed revision seeks to produce a technologically-neutral, simpler definition of e-money across Member States. One of the differences in Member State approaches towards e-money has concerned whether account-based e-money products (i.e., e-money held remotely from the owner, whether stored on a computer or smart card, and directly spent by the owner) are considered to fall into scope of the EMD. HM Treasury has always held the view that the existing definition does allow for account-based schemes to fall into the definition of e-money. Not allowing account-based e-money schemes would effectively create a regulatory gap between e-money and deposit-taking schemes, and a difference in treatment between schemes that present similar risks. In implementing the EMD into UK legislation it was clarified that such schemes are in scope. Nonetheless, a clarification at EU level through the EMD revision would be helpful to both providers and users in ensuring consistency, and the Government welcomes this aspect of the Commission proposal.

Negative scope

2.5 The Commission proposal makes two further revisions in relation to the scope of the Directive, concerning the treatment of:

- limited networks, where the service is based on an instrument that can be used to acquire goods or services only within the premises used by the issuer, or under commercial agreement, either within a limited network of service providers, or for a limited range of goods or services ; and

- services based on telecommunications, digital or information technology (IT) devices, where the goods or services purchased are delivered to and used through an IT device, provided the operator does not act only as an intermediary between the payment service user and the supplier of the goods or services.

2.6 The proposed revision explicitly exempts both types of service from the EMD, removing in parallel some aspects of the Member State waiver in the original EMD. The waiver permits Member States to exclude certain services from their national implementing legislation (Article 8(b) and (c) of the original EMD). The proposed revisions largely mirror the exemptions in the PSD for limited networks and payments via digital device where the operator is not acting only as an intermediary in the transaction (3(k) and (l) of Directive 2007/94/EC). The Government supports the proposed clarifications.

2.7 It would, however, be preferable to achieve technological neutrality between digital and material goods and services. In the PSD, payment transactions executed by means of digital devices, where the operator acts only as an intermediary between the payment service user and the supplier of goods and services, fall into scope. However, no reference is made to whether the goods or services consumed are material or digital, thereby providing technological neutrality, and scope is based on whether the provider is an intermediary (provider) or not. The Government will seek changes to refine the scope of the EMD, in order to provide technological neutrality between digital and material goods, as provided for in PSD Annex 7.

Outstanding e-money

2.8 The Commission proposal adds a new definition into the EMD, seeking to define outstanding e-money in terms of the monthly average of the preceding 12 months financial liabilities related to electronic money. In relation to the definition of “outstanding e-money”, however, this definition might more appropriately be based on the float of the e-money issuer, i.e. financial liabilities in issue at any time. For fast-growing businesses, capital requirements based on averages quickly become meaningless. For some ELMIs, issuance of e-money remains highly seasonal, and a capital requirement based on a year’s average income could fall short of that demanded to cover peak issuance.

Amendment of Capital Requirements Directive (Article 17)

Existing interaction with CRD

2.9 The existing EMD creates a prudential regulatory regime for ELMIs; non-bank issuers of e-money. However, there is an important interaction between the EMD and the Capital Requirements Directive (CRD), such that:

- e-money issuers currently have the status of credit institutions under the CRD, but without the ability to accept deposits; and
- certain EMD provisions, namely the conduct of business requirements around redeemability and anti-money laundering, are also applicable to credit institutions issuing e-money, with credit institutions having permission to issue e-money under CRD.

2.10 Article 2 of the existing EMD (Application to Banking Directives) provides that, while chapter 2 of the CRD shall apply to ELMIs, Articles 5, 11, 13, 19, 20 (7), 51 and 59 of Directive 2000/12/EC shall not apply. Essentially, certain parts of the CRD are switched off in relation to ELMIs, in view of the bespoke prudential regulatory regime created by the EMD. Conversely, some aspects of the CRD are applicable to ELMIs, notably, the legal ability for ELMIs to passport their e-money services.

Proposed revision

2.11 The Commission's proposed revision of the EMD entails a change in the status of ELMIs under the CRD, from credit institution to financial institution. This is to ensure there is clarity that ELMIs are not to be treated as credit institutions, since they do not have permission to accept deposits. In future, the only prudential requirements to which ELMIs will be subject will be set out in the EMD and, where applicable, the related PSD provisions. The legal ability to passport e-money services is also transferred, by the Commission's proposed revision, from the CRD to the PSD Article 25 passporting provisions. Notably, the PSD passporting provisions will be wider for ELMIs, since this presents the opportunity to benefit from freedom of establishment, to operate through a branch or agent in another Member State, in addition to freedom to provide services cross-border.

2.12 The Government's view is that, while the existing aims and legal position surrounding the definition of e-money and status of ELMIs appear to be relatively clear, the proposed clarification of the future status of ELMIs with respect to deposit-taking is to be welcomed from a consumer protection perspective. The distinction between e-money stored with an ELMI or a credit institution, and a deposit held with a credit institution is also important. The recitals to the Commission's proposal further clarify that, in view of the specific character of e-money as an electronic surrogate for notes and coins, e-money is only likely to be used for making payments of limited amounts, and not as a means of saving. For this reason, the prudential regime for ELMIs must be proportionate to the operational and financial risks they face in the course of their business, rather than tied to the CRD requirements. The next chapter of the consultation deals with the proposed changes to prudential requirements for ELMIs.

Consultation questions: scope of EMD

- 1 Do you agree that the proposed new definition of e-money, and the exemptions for limited networks and digital payments where the operator is not acting only as an intermediary, are positive developments?
- 2 Do you agree that the exemption for digital payments could be further refined, with the aim of achieving technological neutrality between digital and material goods, and if so, how?
- 3 Do you agree that the proposed definition of outstanding e-money should be based on float (i.e. financial liabilities in issue at a point in time)?
- 4 Do you agree with the Commission's proposed change in the status of ELMIs from credit institutions to financial institutions?

REGULATION 2560 CURRENCY SCOPE (ARTICLE I)

Currency scope

2.13 The purpose of the original Regulation was to address the Commission's concern that cross-border charges for euro payments were higher than corresponding domestic payments in euro. The Regulation therefore stipulates that charges must be the same for a cross-border payment as a corresponding national payment. Further to the introduction of the single currency, the rationale for proposing Regulation 2560 was based on:

- reducing the level of charges levied on cross-border electronic payments in euro, which were perceived by the Commission to be unduly high; and

- encouraging the payments industry to make improvements to the existing cross-border payment infrastructure, in terms of cost, speed and quality, to support the Internal Market.

2.14 The original Regulation covered payments in euro, but with an opt-in for non-euro EU Member State currencies. Sweden has taken up the currency opt-in, while the UK and Denmark have not. The new EU Member States have not stated an aim to opt-in, but will be required, in varying time periods and when eligibility criteria are met, to adopt the euro.

2.15 At the time of adoption of the original Regulation 2560, the Government considered its approach to be inconsistent with the competition-based approach believed to be the best means of tackling market failure in cross-border payments. Furthermore, at that time there was no EU-wide payment system for payments covered by the Regulation. The Government had concerns that, by requiring the charge for a cross-border retail payment in euros to be the same as a domestic payment, without any account taken of the difference in costs involved:

- there could be upward pressure on charges for making domestic payments, to bring them into line with the cost of cross-border; and/or;
- some institutions might withdraw from offering such cross-border payments entirely.

2.16 There are additional costs associated with transfers between national payment systems, and the costs will necessarily be greater than those of a domestic payment made entirely within a national payment system.

2.17 In the light of the agreement on the PSD, and in support of further competition in the EU payments market, as well as the industry's work on SEPA, to develop pan-European payment systems for payments in euro, the Government welcomes the proposed revision of the Regulation. With pan-European payment systems in place for euro payments, there is a stronger underlying rationale for the Regulation. Nevertheless, Sterling payments are not in the scope of the SEPA project, and the Government's original concerns with applying the Regulation to Sterling payments remain valid. Based on these concerns, the Government does not, therefore, propose to opt Sterling payments into the scope of the Regulation at this time. During the negotiations, maintenance of the opt-out for non-euro currencies, and Sterling in particular from a UK perspective, will remain crucial for the UK.

Consultation questions: currency scope of Regulation 2560

- 5 Do you agree that Sterling payments should remain outside the scope of the Regulation? Please give reasons.

3

The prudential regime for e-money institutions

3.1 This chapter explains those aspects of the Commission’s proposal seeking to revise the prudential regime for e-money institutions (ELMIs).

GENERAL PRUDENTIAL RULES (Article 3)

Alignment with PSD

3.2 Currently the prudential regime for e-money institutions is closely linked to the prudential regime for credit institutions under Directive 2006/48/EC. However, the Commission considers the current prudential requirements for ELMIs to be excessive, based on a risk assessment undertaken as part of its impact assessment for the proposed EMD revision.

3.3 In order to ensure consistency with the regime established for payment institutions under the PSD, and in view of the close relationship between e-money and payments, the Commission proposal imports the PSD’s qualitative prudential requirements into Article 3 of the EMD (i.e., Articles 5, 10-15, and 17-25). In practical terms, ELMIs would need to follow the type of authorisation procedure established for payment institutions in the PSD, including submission of an application to the competent authorities, to include, *inter alia*:

- the programme of operations;
- submission of a business plan;
- evidence of initial capital; and
- details of governance arrangements.

3.4 As with the PSD regime, the competent authority (the FSA) would have to inform the applicant within three months of receiving the application of whether the authorisation had been granted or refused.

Passporting

3.5 Notably, the PSD passporting provisions are also incorporated into the proposal for revising the EMD regime. As noted in chapter 2, the PSD provisions are wider in scope than the existing passporting possibilities for ELMIs, such that ELMIs should also be able to operate through freedom of establishment in future. However, the drafting could be made more explicit with respect to producing a combined passport for a firm offering e-money and payment service. In particular, the words, “mutatis mutandis”, leave room for ambiguity on whether an e-money institution receives only an e-money passport, or also a passport for its payment service activities.

3.6 Assuming that appropriate transitional arrangements are found for existing firms (see chapter 5 on supervision), alignment with the PSD application process and provisions could deliver longer-term benefits, if this serves to reduce the cost burden of regulation facing firms. The Government proposes to support the broad aim of aligning the EMD with PSD provisions, while seeking to ensure appropriate passporting and transitional provisions for existing businesses.

INITIAL CAPITAL (Article 6)

Reduction in initial capital to EUR 125,000

3.7 Under the existing EMD, the initial capital requirement for ELMIs to become authorised is set at €1m. The Commission view is that such a high level of initial capital has been both excessive and disproportionate to the prudential risk of the service, and the principal obstacle to smaller firms applying for authorisation. The proposal entails a reduction in this requirement to €125,000, which will align the EMD with the highest initial capital figure in the PSD regime for payment institutions.

3.8 The Government agrees with the Commission view that the existing initial capital requirement is excessive, based on the risk profile of the activity involved, and supports the proposed reduction, towards facilitating greater market access.

OWN FUNDS (article 7)

Existing own funds requirement

3.9 The existing EMD ongoing capital requirement is based on a calculation of own funds, equal to or above 2% of the higher of the current amount, or six months' target total amount, of financial liabilities related to outstanding e-money. In addition, ELMIs are subject to limitations on their investments, as set out in Article 5 of the existing EMD.

Member State options and Method D capital

3.10 Taking into account the capital requirement methodologies agreed under the PSD for payment institutions, the Commission proposal entails an option for Member States to choose one of the three methods in the PSD for calculating capital requirements (based respectively on fixed overheads, payment volume, and interest income). Alternatively, competent authorities can choose to require firms to use another method of calculation, Method D (Article 7(3)), specifically geared towards the risk profile of e-money issuers. This method is based on a calculation of payment volume, requiring the ELMI to cumulatively hold the higher amount of outstanding e-money or payment volume as follows:

- 5% of the slice of e-money up to €5m;
- 2.5% of the slice of e-money above €5m up to €10m;
- 2% of the slice of e-money above €10m up to €100m;
- 1.5% of the slice of e-money above €100m up to €250m; and
- 1% of the slice of e-money above €250m.

3.11 The Commission proposal removes the limitation of investments provision in the existing EMD, on the basis that the newly aligned requirements with PSD will replace it.

3.12 While the Commission's proposal to assign Member States a choice over the capital requirements for ELMIs, and the removal of the limitation of investments are to be welcomed, a simple method D based on float (outstanding liabilities in issue at a given time) – rather than based on payment volume – might be more proportionate to the risks involved in e-money. As stated above, in relation to the definition of outstanding e-money, the risks in e-money are based on the float held by the issuer, rather than the amount of payment transactions. Requiring ELMIs to hold own funds at 1.5% of outstanding e-money (based on float, rather than the Commission's proposed definition) would therefore be more appropriate.

ACTIVITIES (Article 8) and SAFEGUARDING (Article 9)

3.13 Under the existing EMD, ELMIs are prohibited from conducting any business other than issuance of e-money and related services. Under Article 1(5) of the existing EMD, ELMIs are permitted to issue and administer other forms of payment, limited by a prohibition on their granting any form of credit. This is in contrast to the approach for payment institutions in the PSD, which will be able to engage in the full range of payment services in the PSD Annex, in addition to non-payment services business, and may grant credit with certain restrictions applicable. Under the Commission's proposal, ELMI's would be permitted to:

- provide the payment services listed in the PSD Annex;
- grant credit related to the payment services in points 4, 5 or 7 of the PSD Annex, where the conditions in Article 16(3) and (5) of the PSD are met;
- provide operational and closely related ancillary services, closely related to the issuing of e-money;
- operate payment systems; and
- conduct business activities other than issuance of e-money (having regard to other applicable Community and national legislation).

3.14 Under Article 5 of the existing EMD, ELMIs are currently subject to strict requirements on asset-liability management. On the basis that ELMIs will be able to conduct mixed business in future, the Commission further proposes that the PSD safeguarding requirement, that providers must ring-fence client funds to ensure they are protected in the event of an insolvency, be extended to such ELMIs.

3.15 The Government welcomes the proposed alignment with the PSD, which should be supportive of competition and innovation, enabling certain businesses to enter the e-money market. Some businesses are currently constrained, since their e-money business model would require the ability to conduct other (core) business activities (e.g. mobile network operators, whose main activity is telecom service provision).

3.16 The alignment with PSD safeguarding requirements is also welcome, along with the flexibility in the Commission proposal to extend such requirements to pure ELMIs, not conducting other business activities. In implementing the PSD, the Government has opted to extend the PSD safeguarding requirements to pure payment institutions holding client funds above a £50 threshold. However, absent from the proposal is PSD Article 9(2), which permits a representative portion of funds to be safeguarded, where that portion is variable or unknown in advance. It would be appropriate to incorporate this aspect of the PSD safeguarding requirements into the EMD, in order to support mixed businesses.

WAIVER FOR SMALL FIRMS (Article 10)

Existing waiver criteria

3.17 The waiver provision enables small firms meeting certain conditions to be exempted from the full EMD authorisation requirements. Under the existing EMD, Member States may allow their competent authorities to waive the application of some or all of the provisions of the EMD for e-money institutions where either:

- the total business activities generate total financial liabilities related to e-money which do not normally exceed €5m and never exceed €6m; or

- the e-money issued is accepted as a means of payment only by any subsidiaries of the institution which perform operational or other ancillary functions related to e-money issued or distributed by the institution, any parent undertaking of the institution, or any other subsidiaries of that parent undertaking; or
- the e-money issued by the institution is accepted as payment only by a limited number of undertakings, which can be clearly distinguished by:
 - their location in the same premises or other limited local area;
 - their close financial or business relationship with the issuing institution, such as a common marketing or distribution scheme.

3.18 The e-money issued by the (waived) institution must provide that the electronic storage device involved is subject to a maximum storage amount of no more than €150. Waived institutions cannot benefit from the passporting provisions of the EMD. They must also report periodically to the competent authority on their activities, including the total amount of financial liabilities.

3.19 In revising the EMD waiver, the Commission proposal explicitly places into negative scope some of the current waiver options for Member States, in particular, limited networks (a welcome step, as noted in the preceding chapter of this consultation on scope). However, the proposed revision also replaces the threshold value criterion for considering whether a small e-money issuer can be waived, with the PSD waiver threshold value. The Commission's proposed EMD waiver is such that the average preceding twelve months' total amount of payment transactions executed, including any agent for which it assumes responsibility, does not exceed €3m per month.

3.20 The Government considers the waiver for small e-money issuers to be an important aspect of the Directive. The proposed revision of the waiver must be considered alongside the changes to the authorisation regime, with a view to ensuring proportionality. Adoption of the PSD waiver threshold might be an inappropriate measure for the specific business of e-money issuance, and could serve to bring a significant number of existing small firms in the UK into full authorisation. A more appropriate measure would be one based on float (i.e. outstanding liabilities in issue at any time), and with a minimum threshold of €5-6m. The Government, intending to prioritise this issue in the negotiations, invites stakeholder views on the waiver.

Consultation questions: the prudential regime for e-money

- 6 Do you support the Commission proposal to align the qualitative EMD prudential requirements with those of the PSD?
- 7 Do you support the Commission proposal to reduce initial capital from €1m to €125,000?
- 8 Do you agree that Method D own funds for e-money institutions should be based on float (i.e. financial liabilities in issue at a point in time) rather than on payment volume?
- 9 Do you support the Commission proposal to remove the prohibition on mixed business for ELMIs?
- 10 Do you support the Commission proposal to extend the PSD safeguarding requirements to ELMIs and agree that PSD Article 9(2), enabling a representative portion to be safeguarding, should also be extended to ELMIs?
- 11 Do you agree that a more appropriate EMD waiver criterion would be one based on float (i.e. outstanding liabilities in issue at any time) rather than payment volume, and with a minimum threshold of €5-6m, as contained in the existing EMD?

4

Conduct of business rules for e-money issuers in the EMD

4.1 This chapter of the consultation addresses the redeemability and anti-money laundering provisions in the EMD.

EMD CONDUCT OF BUSINESS REQUIREMENTS

Redeemability (Article 5)

Existing provisions

4.2 Under the existing EMD, a bearer or holder of e-money may, during the period of validity, request redemption of the e-money at par value in notes and coins, or by transfer to an account, free of charges other than those strictly necessary to conduct that operation. The contract may include a minimum threshold for redemption, which may not exceed €10. The aim of the redeemability provision is to ensure adequate consumer protection, with bearers of e-money being able to claim their money back at all times. The right for users to redeem their e-money at all times and at par is critical to maintaining confidence in the value of e-money.

Application to mobile network operators

4.3 However, according to the Commission proposal, the redeemability requirement as drafted in the existing Directive appears to present a problem for Mobile Network Operators (MNOs) and electronic voucher issuers. MNOs are unable to split out, *ex ante*, their customers' prepaid funds for mobile services and funds for e-money (i.e., payments for third party goods and services). The Commission considers that the redeemability provision is one of the reasons for the observed lack of MNO issuance of e-money and MNO products remaining outside the EMD. The Commission further notes that there is a lack of clarity surrounding how funds, which are never redeemed, should be treated.

Proposed clarification

4.4 The Commission's proposed revision to the EMD redeemability provision (Article 5 of Commission proposal) seeks to clarify the application of this requirement, with special reference to MNOs. The proposal reiterates the importance of consumers having the right to redeem funds at all times, and free of charge. In the event of partial redemption, the proposal notes that issuers may charge the holder a fee, commensurate with the cost of the redemption.

4.5 The proposed revision includes neither a threshold value, nor time limit, for redemption. Instead, the proposal refers to the contract between the issuer and holder, and requires that the contract shall clearly state the conditions for redemption, at the time the contract is entered into between the e-money issuer and bearer of the e-money. Under UK (FSA) implementing rules for the existing EMD, there is a minimum threshold for redemption of €10 and time limit of one year, within which e-money can be redeemed. It is questionable whether these thresholds should be left solely to contractual regulation without compromising consumer protection. This proposal might, for example, create a loophole for issuers of e-money to impose excessively short time limits or high value thresholds for redemption.

4.6 Accordingly, it might be appropriate for a competent authority to retain some supervisory control over consumer protection features in redeemability provisions. The Government intends to work with the Commission and other Member State, to ensure that the final revised redeemability provision meets the original aim of ensuring adequate consumer protection, while supporting competition in the e-money market.

Anti-money laundering measures (Article 16)

Existing anti-money laundering provisions

4.7 The Commission proposal notes that, in view of the average low value amounts involved in e-money transactions, full application of identification and record-keeping requirements for anti-money laundering purposes would be disproportionate, taking into account high administrative costs. While the existing EMD contains no specific provisions concerning anti-money laundering, Directive 2005/60/EC introduced a simplified customer due diligence regime applicable to e-money. A similar regime was also introduced into Regulation 1781 on information on the payer to accompany funds transfers.

Proposed revision

4.8 In its revised EMD proposal, the Commission proposes to align the threshold values beneath which an e-money issuer need not comply with full due diligence requirements for anti-money laundering purposes, with amounts specified in the PSD below which providers may derogate from certain of the information and liability requirements. This revision would see the thresholds in Article 11(5)(d) of Directive 2005/60/EC rise:

- from an existing maximum storage value of €150 to €500, where the device cannot be recharged;

or, where it is possible to recharge the device,

- from a limit of €2500 in the existing EMD to €3000 on the total amount transacted within a calendar year.

4.9 The Commission proposal further notes that accompanying measures adopted by industry should contribute to mitigating the money-laundering risk.

4.10 The Government considers the alignment of the thresholds with the PSD amounts to be appropriate and welcome from a better regulation perspective.

Consultation questions: EMD conduct of business requirements

- 12 Do you support the Commission's proposed clarification of the redeemability requirements?
- 13 Do you support the Commission's proposed increase in threshold values beneath which e-money issuers need not comply with full anti-money laundering due diligence requirements?

5

Supervision

5.1 This chapter addresses those measures in the EMD and Regulation 2560 revisions concerning the supervision of firms. In the event that an EU-level agreement is reached in the Council and European Parliament on a revised EMD, the Government will consult on implementation of the EMD in the UK, and in particular, on how the existing FSA regime for e-money issuers should best be revised to reflect the new requirements. The competent authority for the existing EMD is the FSA, which will also be the competent authority for much of the PSD from 1 November 2009. However, one of the key issues of concern in the EMD negotiations from a supervisory perspective relates to transitional provisions for existing firms, as noted in chapter 3 on the prudential regime. This chapter sets out the Commission's proposed EMD transitional provisions, and the Government's proposed approach to the EU negotiations.

5.2 Based on the currency scope of the Regulation, its impact on providers in the UK is, and should remain, light, under the Commission's proposed revision. Nonetheless, all Member States will be required to establish a complaints regime, with sanctions and penalties for abuses of the Regulation, and a competent authority and out-of court redress mechanism to administer the regime. This chapter sets out, therefore, the existing UK sanctions for infringements of the Regulation, the Commission's proposed revisions, and the Government's intended approach to supervision in future, in the event that an EU-level agreement is reached in 2009.

EMD TRANSITIONAL PROVISIONS (Article 15)

Current FSA regime for e-money

5.3 E-money issuers based in the UK are subject to FSA rules which implement the EMD requirements, and as set out in the FSA handbook. There are 16 (larger, fully authorised) ELMIs and 50 small institutions with a certificate to issue e-money under FSA supervision. Small e-money institutions must provide reporting information to FSA on their activities, and may not passport their services to other EU Member States.

Proposed transitional periods

5.4 Under the Commission proposal, Member States would have to allow ELMIs already in business to continue operating, without having to comply with the new authorisation procedure. However, they would be required to submit all relevant information to their competent authority within **six months** of the date of entry into force, to enable the competent authority to assess whether they comply with the new requirements and, if not, which measures would need to be taken for compliance. Member States may allow firms currently benefiting from a waiver to continue operating until twelve months after the deadline for transposition without seeking authorisation.

5.5 While the Government envisages that an EU-level agreement on a revised EMD should be beneficial for firms, it is important for both firms and regulators to have sufficient time to adjust to the new requirements. It is also important for the transitional provisions to be sufficiently clear as to what is expected of firms at EU level, currently operating cross-border. The Government intends to seek appropriate changes to the transitional provisions, such that existing firms will be grandfathered into the new regime.

Consultation question: EMD transitional provisions

- 14 Do you consider the transitional provisions in the Commission proposal to be appropriate?

REGULATION 2560 COMPETENT AUTHORITY (ARTICLE 6)

Existing UK sanctions

5.6 As a regulation, Regulation 2560 is directly applicable in all Member States, and does not need implementation. As explained in preceding chapters, the Regulation prohibits providers from charging more for cross-border than domestic euro payments in scope of the Regulation. It also requires all payment service providers to transparently provide information on their charges and the use of International Bank Account Numbers (IBAN) and Bank Identifier Codes (BIC), where applicable. In providing for effective, proportionate and deterrent sanctions to ensure compliance, in accordance with Article 7 of the original regulation, in 2003 the Government made section 2(2) regulations, cited as the Cross Border Payments in Euro Regulations 2003 (the Euro Regulations).

5.7 Regulation 3 of the Euro Regulations provides for civil proceedings to be brought in cases where an institution breaches Article 3 of Regulation 2560 (charges). Regulation 4 of the Euro Regulations created criminal offences in respect of breaches of the provisions of Articles 4 and 5 of Regulation 2560, setting out the maximum penalties which may be imposed on persons convicted of offences. Regulation 5 provides for directors and managers of companies, partners of partnerships and other similar persons to be liable to conviction if these offences are committed as a result of their neglect.

5.8 When Regulation 2560 was adopted in 2001, payment services were an unregulated activity in the UK. At the time of introducing the Euro Regulations, the approach set out in paragraph 5.6 was deemed appropriate to achieving the objective of ensuring effective, proportionate and dissuasive sanctions. With the implementation of the PSD in November 2009, and in view of the linkage between the PSD requirements and those of the Regulation, it might be appropriate to revisit the Euro Regulations.

Requirement for a competent authority

5.9 The Commission's proposal expressly requires Member States to appoint a competent authority, and also have in place an out-of-court redress mechanism for the purposes of addressing complaints about infringements of the Regulation. The proposed date of application of the Regulation, and a number of the proposed revisions to its scope, have been aligned with that of the PSD. In view of the FSA taking responsibility for PSD conduct of business requirements and establishing a regime for that purpose, and the Financial Ombudsman Scheme (FOS) acting as out-of-court redress mechanism for the PSD, it would, from a better regulation perspective, be appropriate for the FSA and FOS to take on the respective functions in Articles 6-10 of the Commission's proposal.

Consultation question: competent authority for Regulation 2560

- 15 Do you agree that the FSA and FOS should take responsibility for the applicable aspects of Articles 6-10 (including complaints procedures, cooperation with other Member State authorities, and penalties) in the Commission's proposed revision of Regulation 2560?

A List of consultation questions

Chapter 2: Scope of EMD and Regulation 2560

EMD

- 1 Do you agree that the proposed new definition of e-money, and the exemptions for limited networks and digital payments where the operator is not acting only as an intermediary, are positive developments?
- 2 Do you agree that the exemption for digital payments could be further refined, with the aim of achieving technological neutrality between digital and material goods, and if so, how?
- 3 Do you agree that the proposed definition of outstanding e-money should be based on float (i.e. financial liabilities in issue at a point in time)?
- 4 Do you agree with the Commission's proposed change to the status of ELMIs from credit institutions to financial institutions?

Regulation

- 5 Do you agree that Sterling payments should remain outside the scope of the Regulation? Please give reasons.

Chapter 3: The prudential regime for e-money institutions

- 6 Do you support the Commission proposal to align the qualitative EMD prudential requirements with those of the PSD?
- 7 Do you support the Commission proposal to reduce initial capital from €1m to €125,000?
- 8 Do you agree that Method D own funds for e-money institutions should be based on float (i.e. financial liabilities in issue at a point in time) rather than on payment volume?
- 9 Do you support the Commission proposal to remove the prohibition on mixed business for ELMIs?
- 10 Do you support the Commission proposal to extend the PSD safeguarding requirements to ELMIs and agree that PSD Article 9(2), enabling a representative portion to be safeguarding, should also be extended to ELMIs?
- 11 Do you agree that a more appropriate EMD waiver criterion would be one based on float (i.e. outstanding liabilities in issue at any time) rather than payment volume, and with a minimum threshold of €5-6m, as contained in the existing EMD?

Chapter 4: EMD conduct of business requirements

- 12 Do you support the Commission's proposed clarification of the redeemability requirements?
- 13 Do you support the Commission's proposed increase in threshold values beneath which e-money issuers need not comply with full anti-money laundering due diligence requirements?

Chapter 5: Supervision

EMD

- 14 Do you consider the transitional provisions in the Commission proposal to be appropriate?

Regulation

- 15 Do you agree that the FSA and FOS should take responsibility for the applicable aspects of Articles 6-10 (including complaints procedures, cooperation with other Member State authorities, and penalties) in the Commission's proposed revision of Regulation 2560?

B

Impact assessment

Summary: Intervention & Options

Department /Agency: HM Treasury	Title: Impact Assessment on the proposal to revise the Electronic Money Directive	
Stage: Consultation	Version: Negotiating	Date: 20 January 2009
Related Publications: Consultation on the revision of E-money Directive and Regulation 2560 on Cross Border Payments		

Available to view or download at: <http://www.hm-treasury.gov.uk>

Contact for enquiries: Meenakhi Borooah/Angela van der Lem **Telephone:** 020 7270 5234/5920

What is the problem under consideration? Why is government intervention necessary?

The Electronic Money Directive (EMD) (2000/46/EC) established the regulatory regime for e-money issuers across the EU. The Commission review on the application of the EMD concluded, in 2006, that while the directive has encouraged the participation of non-banks in the provision of e-money, few e-money licences across the EU have actually been granted (20 in total). One of the benefits of e-money is that it provides an alternative method to cash and other card payments. In August 2007, e-money represented only 0.1% of banknotes and coins in circulation across the EU. The review considered that the development of certain payment products might have been constrained by legal uncertainty regarding the scope and applicability of the Directive to business.

What are the policy objectives and the intended effects?

To address these concerns, on 9 October 2008, the Commission published a proposal to revise the EMD. The main objectives of the proposal included:

- enabling innovation and the design of new and secure electronic money services, creating tangible benefits for consumers, businesses and the wider European economy;
- providing market access to new players, enabling effective competition between all market participants; and
- modernising the provisions of the EMD ensuring consistency with the Payment Services Directive (2007/64/EC).

What policy options have been considered? Please justify any preferred option.

During negotiations to revise the EMD within the Council, the Government could take forward one of the following approaches:

- Option 1 – do nothing (i.e. reject the proposal and push to retain the current e-Money legislation);
- Option 2 – accept the Commission proposal to revise the regulatory regime for e-money issuers; or
- Option 3 – accept the Commission proposal but push for specific amendments.

The Commission approach to revise the EMD (option 2) seems broadly proportionate and should enable new firms to enter the market, increase the proportion of e-money in circulation and align the Directive with the PSD. However, the Commission proposal to use payment volume rather than float (outstanding liabilities) for ongoing capital requirements might result in a more restrictive regulatory environment than the current regime. The preferred approach is option 3, which the Government believes would improve the Commission proposal by making the regulatory regime more proportionate and better targeted. If this option were to be taken forward it has been estimated that the unit cost per firm could fall from £900k to £200k one off and £1.5m to £1.3m p.a.

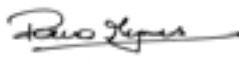
When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The Commission proposal, subject to negotiations, indicates that it will conduct a review on the application of the new directive on e-money issuers 3 years from the date the provisions are transposed into national law.

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options

Signed by the responsible Minister:

..... Date: 20 January 2009

Summary: Analysis & Evidence

Policy Option: n/a

Description: Current application of the E-Money Directive

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' The EMD scope concerns non-bank e-money issuers (ELMIs). In the UK there are 16 authorised ELMIs and 50 small, waived ELMIs. The unit cost per authorised ELMIs has been estimated to be £900k one off (which includes initial capital requirements, professional & legal fees, & the FSA licence fee (£5k)) & £1.5m p.a. (which includes ongoing capital requirements, operational and compliance costs).
	One-off (Transition)	Yrs	
	£ 14.4m		
	Average Annual Cost (excluding one-off)		
	£ 24.0m		Total Cost (PV) £ 69.6m
Other key non-monetised costs by 'main affected groups' The current e-money regime has hindered the EU market, including the UK market, from reaching its full potential. The implementation of the Payment Services Directive serves to create an un-level playing field between payment institutions, which are subject to lower level of prudential regulation, and ELMIs.			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' E-money offers an alternative to cash. At present it has been estimated that the UK ELMIs issue £220.8m worth of e-money. The cost to produce £1 million of cash (based on the proportions of coins and bank notes currently in circulation, simplified estimates and current market prices) has been estimated to be £17.3k. (This does not cover e-money issued by banks.)
	One-off	Yrs	
	£ Unknown		
	Average Annual Benefit (excluding one-off)		
	£3.8m		Total Benefit (PV) £ 11.2m
Other key non-monetised benefits by 'main affected groups' The UK implementation of the EMD has resulted in a regulatory environment whereby ELMIs have chosen the UK as the base of their EU operations, often migrating from other Member States. The benefit is therefore a competitive & innovative UK industry, with increase consumer choice. The EMD has entrenched important consumer protection within the market. Merchants might benefit from lower transaction costs and ELMIs from the fees charged to consumers and merchants. Bank issuers of e-money may also benefit from cost savings as a result of reduced cash handling.			

Key Assumptions/Sensitivities/Risks.

Although the UK e-money market has developed well improvements could be made to encourage further market entrants and innovation. However, the boundaries of the regime would have to be reassessed.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £ -58.4m
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What is the geographic coverage of the policy/option?	
On what date will the policy be implemented?	Current regime
Which organisation(s) will enforce the policy?	FSA
What is the total annual cost of enforcement for these	£ n/a
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	No
What is the value of the proposed offsetting measure per year?	£
What is the value of changes in greenhouse gas emissions?	£ n/a
Will the proposal have a significant impact on competition?	Yes

Annual cost (£-£) per organisation (excluding one-off)	Micro n/a	Small n/a	Medium £530*	Large <£554.75*
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2007 Prices)		(Increase - Decrease)	
Increase	£6.8m-	Decrease	£
		Net	£ 6.8m-22.6

Key:

Annual costs and benefits: Constant Prices	(Net) Present Value
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Summary: Analysis & Evidence

Policy Option: 3

Description: Accept the Commission proposal but push for specific amendments

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' As proportion of the current market, the UK e-money sector by 2012 could be in the region of 100 to 240 authorised e-money issuers (ELMIs) and 118 to 295 waived firms. The unit cost for authorised firms has been estimated to fall to £200k one off and £1.3m p.a..
	One-off (Transition)	Yrs	
	£ 20.0m to 48.0m	1	
	Average Annual Cost (excluding one-off)		
	£ 130.0m to 312.0m	Total Cost (PV)	£ 377.0m to 904.7m
Other key non-monetised costs by 'main affected groups'			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' Authorised ELMIs could benefit from a reduction of unit cost of £700k one off and £200k p.a. resulting from initial capital requirements falling from €1m to €125k and basing ongoing capital calculations on 1.5% of float. (This has been taken into account in the above costs.) Rough estimates suggest that UK ELMIs might issue in the region of £0.3bn to £1.2bn by 2012. (This does not cover e-money issued by banks.)
	One-off	Yrs	
	£ Unknown	1	
	Average Annual Benefit (excluding one-off)		
	£ 10.4m to 53.9m	Total Benefit (PV)	£30.4m to 158.0m
Other key non-monetised benefits by 'main affected groups' This approach should enable the development of an innovative environment for the design of new, secure electronic money services, and modernize the provisions of the EMD, while ensuring consistency with the Payment Services Directive (PSD) (2007/64/EC). The new directive proposes to introduce enhanced consumer protection provisions.			

Key Assumptions/Sensitivities/Risks The EMD proposal introduces a maximum harmonisation regime for e-money, whereby flexibility for Member States will be limited. The existing EMD is minimum harmonisation, which has enabled the FSA to take a proportionate approach towards regulation. The UK industry therefore has more at stake than most other Member States during negotiations, as a number of overseas companies have established in the UK in order to get the benefit of our regulatory regime and to passport through the EEA.

Price Base Year 2007	Time Period Years 3	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £ -346.6m to -746.7m
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	Unknown
Which organisation(s) will enforce the policy?	FSA
What is the total annual cost of enforcement for these	£n/a
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	No
What is the value of the proposed offsetting measure per year?	£
What is the value of changes in greenhouse gas emissions?	£ n/a
Will the proposal have a significant impact on competition?	Yes

Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium £530*	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2007 Prices)			(Increase - Decrease)	
Increase	£	Decrease	£	Net
				£

Key:

Annual costs

(Net) Present Value

Evidence Base (for summary sheets)

*The initial authorisation fee is £5k and the annual authorisation fees are calculated on 31 March based on outstanding float:

Float (£)	FSA annual authorisation fee (£)
Less than 500k	0
500k –2m	£380
2m-10m	£530
10m-200m	£530+ £24.75 per million there after
200m-2bn	£530+£24.75 per million (between £10m-£200m) and £24.69 (between £200m-£2bn)

Objectives of the Commission proposal to revise the Electronic Money Directive

1. The Electronic Money Directive (EMD) (2000/46/EC) established the regulatory regime for electronic-money (e-money) issuers across the European Union (EU). The Directive represented a response to the emergence of new pre-paid electronic payment products. It was intended to create a legal framework so that the e-money market could deliver its full potential. Whilst ensuring an adequate level of prudential supervision, it aimed to encourage new market entrants to the e-money market, thereby promoting competition between non-banks and banks.

2. In early 2005, the European Commission launched a review of this Directive in accordance with the Article 11 review clause of the EMD. On 9 October 2008, the Commission adopted a proposal to revise the current rules governing the conditions for issuing electronic money based on the findings of the review. The aims of the revised rules include:

- providing market access to new players and fostering real and effective competition between all market participants;
- enabling the development of an innovative environment for the design of new and secure electronic money services, which would create tangible benefits for consumers, businesses and the wider European economy; and
- modernising the provisions of the EMD ensuring consistency with the Payment Services Directive (PSD) (2007/64/CE).

3. Once the European Council and European Parliament adopt an agreed text, the new directive concerning the prudential framework for e-money issuance will apply across the United Kingdom.

Background

4. In 2000, the European Council and European Parliament reached political agreement on the Electronic Money Directive (EMD). This established a new regulatory regime for e-money issuers (ELMIs) across the EU, and in 2002 the provisions of the Directive came into regulation under the Financial Services and Markets Act 2000 (FSMA).

5. The goal of the EMD was to facilitate the development of electronic commerce within the EU and to make it easier for consumers to use electronic money to make small payments in other Member States without having to convert national currencies, notably during the period before

euro notes and coins were introduced. In the main, the EMD introduced a prudential regulation regime for non-bank ELMIs to promote confidence amongst business and consumers. The Directive aimed to ensure a level playing field between traditional credit institutions and other firms issuing e-money, and to allow e-money institutions (ELMIs) to offer their services throughout the EU on the basis of supervision by their home Member State. There were also certain requirements that affected bank-issued e-money (principally, guaranteeing a right of redemption for the user).

6. The consumer experience of e-money is divided into monetary value stored on a chip card (pre-paid card or 'electronic purse') or server-based e-money (spent on-line)¹, which is accepted as a means of payment by undertakings other than the issuer.

7. In early 2005, the European Commission launched a review of the EMD in accordance with the review clause within Article 11 of the Directive. In 2006, the review concluded that the European e-money market had not developed as originally anticipated. While it recognised that the Directive encouraged the participation of non-banks in the provision of e-money, few e-money licences had actually been granted. The review further considered whether the development of certain payment products might have been constrained by legal uncertainty regarding the scope and applicability of the Directive due to differing interpretation and implementation of the Directive across EU Member States (MSs). MSs and stakeholders, which were consulted in the review process, supported the need to re-assess the proportionality of the Directive's prudential requirements in relation to the actual risks posed by the e-money institutions.

8. Further to this, in April 2007, political agreement was reached on the EU Payment Services Directive (PSD) (2007/64/CE) and work is underway to implement it by 1 November 2009. The PSD introduces:

- conduct of business rules for payment services, concerning:
 - the information that needs to be provided to users (individuals and businesses); and
 - liability requirements in the event a payment goes wrong; and
- a prudential authorisation regime for non-bank providers known as payment institutions (typically money remittance operators, or non-bank credit card issuers).

9. Under the PSD ELMIs, as well as banks and payment institutions, will have to comply with PSD conduct of business rules. The PSD prudential regime for payment institutions is much more permissive than the regime for ELMIs under the EMD.

Rationale for intervention

a) Development of a proportionate prudential regime

10. The findings of the Commission review on the application of the current EMD showed that some of its provisions, for instance the prudential requirements, might have hindered the development of the e-money market and hampered technological innovation. Across the EU

¹ In practice all e-value is stored on a server.

there is a limited number of fully licensed electronic money institutions (20 electronic money institutions and 127 entities under the waiver) and volume of e- money issuance is low (the total amount of e-money in circulation in the EU, as of August 2007, amounts to €1 billion in comparison to more than €600 billion of cash).

11. To foster a true single market for electronic money that promotes market access and competition, generates benefits for the EU economy the Commission believes that a more proportionate prudential regime is necessary.

b) Alignment with the Payment Services Directive

12. Once implemented, the PSD will introduce a prudential regime for non-bank firms that offer payment services such as money remitters and non-bank credit card issuers. This regime in comparison with that of the EMD for ELMIs will be lighter and serves to create an un-level playing field between payment institutions, which are able to undertake a wide range of activities, and ELMIs, which remain constrained by the EMD and are unable to undertake mixed business.

13. It is worth noting the difference between the services provided by payment institutions and ELMIs, which gives rise to the need for a different regulatory regime. Consumers approaching a payment institution to effect a money remittance payment, or make a credit transfer, typically have a specific transaction in mind, which, under PSD rules, must be executed by D+1 (i.e. the business day after the payment has been authenticated). In using an e-money product, the consumer typically does not have a particular transaction in mind, with the e-money representing an easily accessible store of value for several future payments (it is meant to be an electronic surrogate for coins and banknotes). The long-term storage of consumer funds on e-money represents a greater degree of risk to users than balances held by payment institutions (generally only stored overnight). The EMD contains provisions, which seek to protect customer funds held by the e-money issuer (known as the “e-money float”).

14. The Commission has proposed a new prudential regime, ensuring greater consistency between prudential requirements of electronic money institutions and payment institutions under the PSD. The new prudential requirements include a lower initial capital threshold enabling market entrance for smaller players and a new formula to determine ongoing capital requirements.

Intended effect of the revised Directive

15. The new directive on e-money will be a maximum harmonising directive whereby flexibility for Member States would be limited. Although the EMD is being revised on a stand-alone basis, the longer-term Commission view is to possibly integrate the directive into the PSD.

16. The proposed new directive’s impact should be twofold. First, it is envisaged that it would create a more proportionate EU-wide licensing regime for e-money institutions harmonizing national rules, which currently differ significantly as the current EMD is a minimum harmonizing directive. This should help develop a single market for electronic money that promotes market access, competition and innovation. Secondly, with greater alignment to the prudential regime within the PSD, the new directive should introduce enhanced consumer protection provisions, such as safeguarding of user funds and clarity on the redeemability requirements, to ensure customers have the right to redeem funds at all times.

Options

17. The adoption of a new directive on e-money is dependant on Qualitative Majority Vote in the European Council. This means that it would not be possible for one Member State to block or force a change to a provision within the Commission's legislative proposal by itself. The European Parliament will also vote on the new directive on e-money issuance. The European Council and European Parliament will therefore have to act in co-decision.

18. During negotiations to revise the Electronic Money Directive (EMD) within the Council, the Government could take forward one of the following approaches:

- Option 1 – do nothing (i.e. reject the proposal and push to retain the current e-Money legislation);
- Option 2 – accept the Commission proposal to revise the regulatory regime for e-money issuers; or
- Option 3 – accept the Commission proposal but push for specific amendments.

Option 1 – do nothing (i.e. reject the proposal and retain the current e-money legislation)

19. The EMD (2000/46/EC) mandated the establishment of a new prudential supervisory regime for issuers of e-money. The main objectives of the Directive were:

- to create a regulatory framework to ensure the stability and soundness of e-money issuers (ELMIs), so as to increase business and consumer confidence in this new and developing means of payment;
- to eliminate legal uncertainty created by the lack of harmonisation in this field; and
- to facilitate access by e-money institutions from one EEA Member State into another.

20. The Government was obliged by European Community law to implement the EMD into UK law in a minimum way consistent with the Directive. The only area in which the UK regime for ELMIs went further than the minimum requirements of the Directive was in specifying e-money issuance to be a regulated activity under the Financial Services and Markets Act 2000 (FSMA). The Financial Services Authority (FSA) as the competent authority was responsible for producing guidelines on how the Directive were to be applied in practice.

Proportionate prudential regime

21. The EMD provides for initial capital requirements for ELMIs of €1m. This has been transposed into national legislation. Once a permission has been granted by the FSA to an e-money issuer, the legislation provides that the firm shall maintain at all times own funds which are equal to or in excess of 2% of the higher of:

- the current amount; or
- the average of the daily amounts for each day of the preceding six months of its outstanding e-money liabilities. Such own funds must not at any time fall below the threshold of €1 million (or its equivalent).

22. Under the UK regime, the FSA has been given the power to grant waivers on a case-by-case basis to small ELMIs provided that relevant conditions had been met. A waiver may be granted to an ELMI when the amount that can be stored on the electronic storage device used by

customers of that issuer is limited to a maximum of not more than €150 and if at least one of following three criteria are met:

- the total financial liabilities related to the e-money activities do not normally exceed €5 million and never exceeds €6 million;
- the e-money is accepted only by: the parent undertaking of the ELMI; subsidiaries which perform operational or other ancillary functions; or other subsidiaries of the parent; and the total financial liabilities related to the e-money activities do not exceed €10 million; or
- not more than one hundred undertakings accept the e-money and they are either located within a limited geographical area or have a close financial or business relationship with the ELMI; and the total financial liabilities related to the e-money activities do not exceed €10 million.

23. A waived firm is not be treated as carrying on a regulated activity under FSMA, and so is not be subject to most of the requirements of the Directive - including the need for their e-money to be redeemable. Equally, waived firms are not be able to exercise passport rights in other EEA Member States. In order to verify the continued existence of the conditions for the waiver, waived firms are obliged to report periodically to the FSA on their activities and the FSA is given powers to obtain the necessary information from them.

Costs

24. In the UK there are currently 16 authorised electronic money institutions (15 banks and 1 building society have also been authorised to provide e-money) and 50 small, waived institutions. The total initial cost to a firm, which would cover initial capital requirements, professional and legal fees, and the FSA licence fee (£5k), has been estimated to be approximately £900k. The total ongoing annual costs, which would cover ongoing capital requirements, operational and compliance costs, have been estimated to be around £1.5m per year. The UK e-money sector has, therefore, faced estimated one off costs of £13.5m and faces estimated annual costs of £23m.

25. The UK currently has the largest number of authorised electronic money firms in Europe (16 out of a total of 20, EU wide, plus 16 UK banks/ building societies with permission to issue e-money). The Commission review on the application of the EMD has determined that current e-money regime EU-wide has hindered the market, including the UK market, from reaching its full potential. A revised, proportionate directive on e-money might facilitate to the development of the sector as well as a greater contribution to the UK economy by the sector.

26. The implementation of the Payment Services Directive serves to create an un-level playing field between payment institutions, which are subject to lower level of prudential regulation and able to undertake a wide range of activities, and ELMIs, which will remain constrained by the EMD. If the regulatory regime for ELMIs is not reassessed, the e-money market could stagnate, as firms might not be able to enter the market or be constrained in terms of innovation.

Benefits

27. The EMD implementation in the UK has been proportionate within the limits of the Directive itself, and this has resulted in an attractive regulatory environment in the UK. Issuers of e-money have chosen the UK as the base of their EU operations, often migrating from other EU Member

States. The benefit is therefore a vibrant industry and competitive payments environment exported to other EU member states.

28. The wider benefits of the Directive include lower transaction costs with e-money for merchants since e-money reduces the need to handle banknotes and coins, and require fewer data exchanges and online authorisations than other forms of electronic payment. Issuers of e-money may benefit from the fees charged to consumers and merchants as well as from the revenues from the investment of outstanding e-money balances. Bank issuers of e-money may also benefit from cost savings as a result of reduced cash handling.

29. One of the benefits of e-money is that it provides a natural substitution to cash. The Commission proposal indicates that in August 2007 approximately €1.053bn euros of e-money were in circulation - €0.658bn by traditional credit institutions and €0.395 by licensed and waived ELMIs. This equates to roughly 0.1% of the total notes and coins in circulation across the EU. The amount of e-money issued by UK ELMIs, as a proportion of the number of institutions in the EU could be estimated to be £220.8m. The cost to produce £1 million of cash (based on the proportions of coins and bank notes currently in circulation, simplified estimates and current market prices) has been estimated to be £17.3k. The benefit in terms of an alternative to cash production could be in the region of £3.8m.

Option 2 – accept the Commission proposal to revise the regulatory regime for e-money issuers

30. The Commission review on the application of the EMD concluded that while the directive has encouraged the participation of non-banks in the provision of e-money, few e-money licences (20 in total) across the EU have actually been granted. The report considered that the way in which the Directive's requirements had been interpreted and implemented by Member States could have partially hindered the development of the money market. In addition the development of certain payment products might have been constrained by legal uncertainty regarding the scope and applicability of the Directive to business. The review also concluded that there was a need to reassess the proportionality of the Directive's more onerous requirements in relation to the actual risks posed by e-money institutions.

31. To address these concerns on 9 October 2008 the Commission published its proposal to revise Electronic Money Directive. The main objectives of the proposal included:

- enabling innovation and the design of new and secure electronic money services, creating tangible benefits for consumers, businesses and the wider European economy;
- providing market access to new players and fostering real and effective competition between all market participants; and
- modernising the provisions of the Electronic Money Directive ensuring consistency with the Payment Services Directive (PSD) (2007/64/CE).

32. The key factors of the Commission proposal to revise the EMD include:

- the clarification of the definition of e-money – the proposal aims to simplify and clarify the definition, which has been subject to diverging interpretations across Member States. Notably, limited networks (i.e. where the e-money is only accepted by a limited number of merchants) would cleanly fall outside the scope of the new EMD. Currently, competent authorities can choose to waive firms from regulation

- under certain conditions, including where the e-money is only accepted within a corporate group. While the FSA has used this option, some Member States have not, leaving the firms in question subject to differing approaches across the EU;
- a lighter prudential regime – the proposal aims to lighten prudential requirements than the current EMD regime and align them with the Payment Services Directive (PSD), notably:
 - lowering initial capital from €1m to €125k, and aligning ongoing capital requirements with the PSD;
 - introducing an additional ongoing capital method for e-money to those within the PSD², in view of the different risks involved in issuing e-money to payment institution activities; and
 - aligning the waiver for small e-money issuers (ELMIs) to that of the PSD;
 - Mixed business - it is proposed that ELMIs be permitted to do mixed business, as payment institutions may under PSD. The current EMD prevents ELMIs from leveraging e-money issuance off their core business, requiring them to set up a separate company;
 - Safeguarding requirements – it is proposed that ELMIs should safeguard user funds in line with safeguarding requirements for payment institutions under the PSD;
 - Redeemability – the proposal is aimed at clarifying redemption requirements to address consumer protection and market confidence concerns in relation to the ability of a user to redeemable e-money at all times, and at par value;
 - Maximum harmonisation – the EMD proposal introduces a maximum harmonisation regime for e-money. This means that Member States cannot diverge from its requirements, unless a specific option is provided for. The existing EMD is minimum harmonisation, which has enabled the FSA to take a proportionate approach towards regulation;
 - Passporting and credit institution status – the proposal introduces further alignment with the PSD, enabling ELMIs to set up a branch in a host Member State. Currently, the EMD only allows such providers to offer their services cross-border, without the possibility to use the freedom of establishment under the Treaty to set up a branch and passport into other countries.
 - Anti-money laundering – the Third Money Laundering Directive (3MLD) considers normal customer identification requirements to be disproportionate where e-money is of a limited value. Where the e-money product (e.g. a card) cannot be reloaded and the amount that can be stored is less than €500 (up from €150 in 3MLD), or where it is possible to recharge the card/device, and a limit of €3000 (up from €2500 in 3MLD) is imposed on annual transactions, the provider will not need to comply with upfront customer due diligence requirements.

² The PSD facilitates a choice between three capital methodologies, based on fixed overheads, payments volume, and an operating income indicator.

Costs

33. The overall cost of regulation to the e-money sector could increase, even if a proportionate prudential regime were to be implemented, as it is likely that the number of firms would increase. With a reduction in the initial capital the initial unit cost to a firm (which includes the initial capital requirements, professional and legal fees, and the FSA licence fee (£5k)) is likely to fall to around £200k one-off. The number of fully authorised ELMIs further might further increase as a result of the direct importation of the PSD waiver criteria into the EMD regime. It would be important to balance the waiver criteria with the authorisation requirements to ensure that small firms are not over burdened.

34. The Commission proposal suggests that across the EU the number of fully licensed ELMIs could range from 125 to 300 and the number of waived firms could range from 300 to 750. Based on current market proportions the number of fully licensed ELMIs in the UK could range from 100 to 240, and waived firms from 118 to 295. If unit cost per firm were to fall to £200k one off and remain the same for ongoing (£1.5m per year) this would mean that the sector could face costs of £20m to £48m one off and £150m to £360m per annum.

Waiver for small firms

35. The Commission proposal simply imports the PSD waiver for small firms into the EMD. The PSD waiver is, however, on a different basis (historic payment volume) to the current EMD (total financial liabilities related to e-money activities, i.e. float). Many small ELMIs' business models are based on high velocity of small value payments. They maintain a small float but potentially have a large turnover or payment volume. Therefore, the current proposal of basing exemption from the EMD on payment volume/turnover could increase the number of small ELMIs seeking full authorisation as an ELMI bringing with it the increase in costs of compliance together with a raise in the total admin burden of the directive.

36. Of the 50 firms in the UK, it has been estimated that there are approximately 15 active small ELMIs. If it is assumed that half of these small ELMIs (i.e. 7) have already reached the €3m/month payment volume threshold then potentially they would have to become fully authorised ELMIs under the current proposals. If the one off costs to market entry, and ongoing costs for ELMIs were adjusted to the proposed EMD regime the following cost estimates (noting that for simplicity that ongoing capital requirements are not included) could be:

- one off costs (which would include €125k initial capital requirements, professional/legal fees, and FSA fees for authorisation to become authorised) per firm would be in the region of £200k; and
- ongoing operational costs of compliance/year (which would include senior management oversight, compliance team resources, AML/Fraud team resources, AML/Fraud systems, FSA and Financial Ombudsmen fees) per firm would be in the region of £750k.

37. Therefore, this could result in an estimated additional cost to the industry of: £1.4m one-off costs for these 7 issuers to become fully authorised, and thereafter £5.25m on-going operating costs per year (excluding on-going capital requirements).

Prudential regime

38. The proposal suggests that the ongoing capital requirements should be based on payment volume. If payment volume is used there is a potential problem in that the true risk may not be captured, since risks are rooted in the float.

39. The additional ongoing capital requirement for ELMIs should be based on the outstanding float of the e-money issuer (i.e. with the total of customer funds that are actually at risk at any particular moment), rather than on payment volume, as proposed by the Commission. This is because the prudential risks involved in e-money are rooted in the float held by the issuer, rather than volume of transactions. This change to the ongoing capital methodology would also better align the capital requirements with the specific risks of the e-money industry.

Benefits

40. The Commission proposal offers clear benefits including lightening the onerous prudential requirements burdening ELMIs, with a view to promoting new market entrants, competition and innovation. One of the benefits of e-money is that it provides a natural substitution to cash. The Commission proposal indicates that by 2012 e-money could be region of €2-10bn (roughly 0.3% to 1.7% of banknotes and coins currently in circulation across the EU). If the European Parliament and Council agreed to the Commission proposal, the amount of e-money issued by UK ELMIs, as a proportion of the number of institutions currently in the EU could be estimated to be £0.31bn to £1.2bn. The current cost to produce £1 million of cash (based on the proportions of coins and bank notes currently in circulation, simplified estimates and current market prices) has been estimated to be £17.3k. The benefit in terms of an alternative to cash production could be in the region of £10.4m to £53.9m.

41. Other specific benefits include:

Definition of e-money

42. Clarification of the definition of e-money is considered to be helpful, since the definition has constrained ELMIs in offering services EU-wide. The limited network exemption matters, since it affects the number of firms the FSA needs to regulate. It matters to firms, as it has bearing on commercial decisions EU-wide.

The prudential regime

43. Closer alignment with the PSD is appropriate, since the risks involved in e-money issuance are closer to payment institution than credit institution activities. Helpfully, the proposal clarifies that issuance of e-money relates to making payments of limited amounts, and should not be considered as means of saving. It is important that e-money is not considered to be a substitute for a current or savings account, since it is not subject to deposit-taking consumer protection (the Financial Services Compensation Scheme (FSCS) does not apply to e-money) and the prudential rules applicable to credit institutions.

Mixed business

44. The proposal to remove the current restriction on mixed business is welcome, with a view to encouraging further market access and innovation in the e-money sector.

Redeemability

45. The right for consumers to redeem their e-money at all times and at par are critical to maintaining confidence in the value of e-money. The Commission proposal broadly appears to meet this concern.

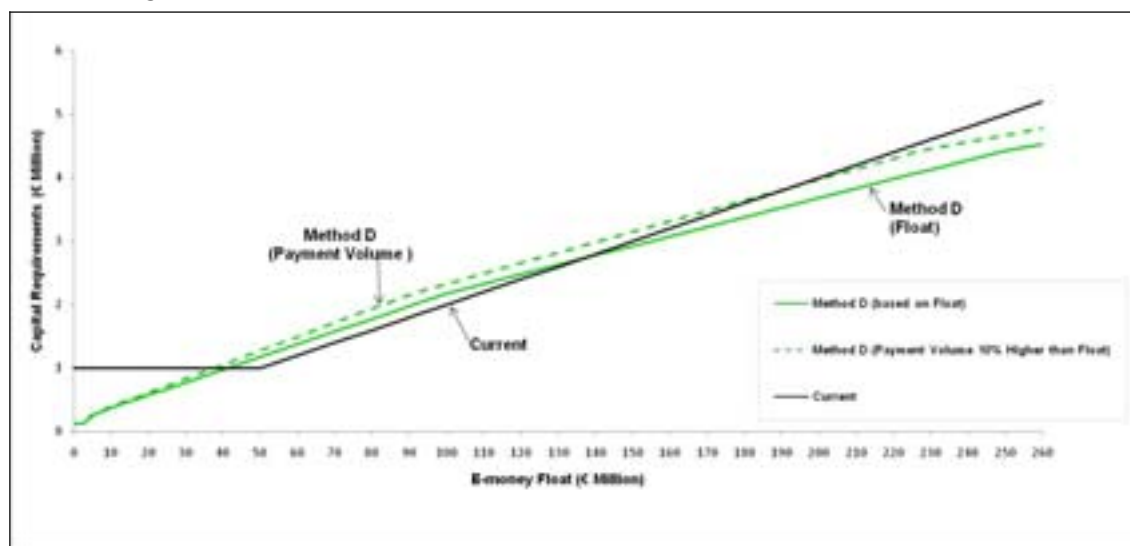
Option 3 – Accept the Commission proposal but push for specific amendments

46. The Commission approach to revise the EMD as set out under Option 2 seems broadly proportionate. There are, however, a number of changes the Government believes would improve the Commission proposal, making the regulatory regime more proportionate and better targeted. In addition, there will undoubtedly be many legal and drafting issues that will need to be addressed, to avoid the Directive having unintended consequences. The Government has identified the key priority in this context as being ensuring a proportionate prudential regime.

Prudential regime

47. The payment volume for most ELMIs (other than for very mature systems) is likely to be higher than float due to the velocity of transactions. Therefore the calculation of own funds, as proposed by the Commission³, is more likely to be based on payment volume rather than outstanding float (i.e. with the total of customer funds that are actually at risk at any particular moment). The calculation of the ongoing capital for ELMIs should, however, be based on the outstanding float of the e-money issuer, rather than on payment volume, as the prudential risks involved in e-money are rooted in float held by the issuer, rather than volume of transactions. This change to the ongoing capital methodology would also better align the capital requirements with the specific risks of the e-money industry.

Graph 1: comparing the impact of the ongoing capital based on payment volume and outstanding float



³ Method D: where electronic money represents the highest amount between outstanding electronic money and payment volume, the own funds of electronic money institutions shall amount at least to the sum of the following elements:

- 5% of the slice of electronic money up to EUR 5 million;
- 2.5% of the slice of electronic money above EUR 5 million up to EUR 10 million;
- 2% of the slice of electronic money above EUR 10 million up to EUR 100 million;
- 1.5% of the slice of electronic money above EUR 100 million up to EUR 250 million;
- 1% of the slice of electronic money above EUR 250 million.

48. Graph 1 illustrates that:

- the proposed method of calculating ongoing capital based on payment volume could be more proportionate for ELMIs with a float of €0-40m;
- the own funds requirement for would increase over the previous requirement for issuers with a float €40m–140m. If the payment volume were to be higher than the float, then the own funds requirement would be higher still; and
- own funds requirement only begins to decrease at €140m; a limit too high to benefit most issuers.

49. If it is assumed that the average float held by existing ELMIs is approximately €45m, and then if payment volume were to be used as a basis for calculation for ongoing capital requirements then the sector could potentially be subject to increased capital requirements. This is demonstrated in Table 1, where the average payment volume has been conservatively estimated to be 10% above the outstanding e-money liabilities.

Table 1: the impact that the increase in capital requirements may have on the on-going costs for ELMIs and the UK industry as a whole.

Float of € 45m	Capital Requirements (EUR)	% Change	Estimated Annual Operating Cost (£)	
			ELMI	Industry
Current	€1m	-	£1.5m	£23.0m
Method D – PV* less than float	€1.075m	+ 7.50%	£1.65m	£24.75m
Method D – PV 10% higher than float	€1.165m	+16.50%	£1.75m	£26.3m

*PV = Payment Volume

UK Industry = 16 licensed ELMIs

50. To ensure a more proportion regime the total funds requirements need to decrease earlier, and perhaps more linearly. Graph 2 illustrates that on-going capital requirements calculated using either 1% or 1.5% of the float would provide an effective reduction in capital requirements. If an average ELMI with a float of €45m were to calculate its own funds at 1.5% of float, then the ELMI would see a reduction in capital requirements of 33% to €675k. Thus reducing estimated annual operating costs to approximately: £1.3m from the current estimated £1.5m. Averaging across the industry as a whole this would represent a reduction of £3.5m annual costs (or a total of £19.5m compared with previous estimates of £23m).

Graph 2 – Proposal to use initial capital and % float to calculate ongoing capital requirements

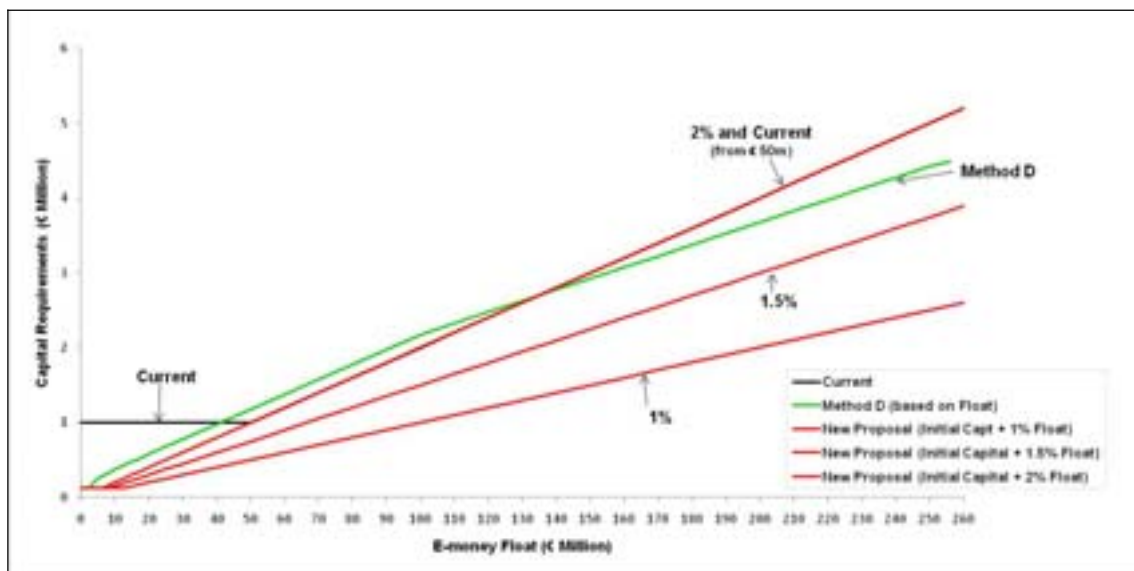


Table 2: the impact that the increase in capital requirements may have on the on-going costs for ELMIs and the UK industry as a whole.

Float of €45m	Capital Requirements (EUR)	% Change
Current	€1m	-
New Proposal - Method D = 1.5% Float	€675k	-33%

51. The UK is seeking to negotiate to base the calculations of ongoing capital requirements on 1.5% of float.

Waiver for small firms

52. The Commission proposal simply imports the PSD waiver for small firms into the EMD. The PSD waiver is, however, on a different basis (historic payment volume) to that of the current EMD waiver (€5-6 million float). As the payment volume for most ELMIs is likely to be higher than float due to the velocity of transactions, a €3 million payment volume threshold could potentially bring more UK firms into scope of full EMD authorisation. The UK is seeking to negotiate a minimum threshold of €5-6 million float, while ensuring that small firms just above the threshold can deal with the newly proposed authorisation requirements.

Discussion and risk

53. Notwithstanding the heightened concerns surrounding banking sector risks, the Government continues to believe that the issuance of e-money does not constitute a threat to financial stability, nor do ELMIs represent a systemic risk.

54. The UK has the largest number of authorised electronic money firms in Europe (15 out of a total of 20, EU wide, plus 16 UK banks/ building societies with permission to issue e-money). A further 50 smaller UK firms (out of a total 127 EU-wide) have been waived from FSA regulation. A number of overseas companies have established in the UK in order to get the benefit of our regulatory regime and to passport through the EEA. The UK industry therefore has more at stake than most other Member States.

55. The Government believes that any regulatory requirements need to be proportionate to the risks involved in the activity in question. In this context, the UK has consistently argued that the regulatory burden imposed by the existing EMD is too high. The Government supports the objectives of the Commission proposal which are to modernise the provisions of the EMD and to ensure consistency with the provisions of the Payment Services Directive (PSD), and to support market access and foster effective competition to enable further growth and innovation in the e-money market and, ultimately, to create benefits for the EU economy.

56. The Government is supportive of the Commission's aim of better aligning the prudential regime for ELMIs with the specific risks involved, which are closer to those of payment institutions than those of credit institutions. The lowering of the initial capital threshold from the existing €1m to €125,000 is welcome, from the perspective of encouraging market access for smaller providers. The proposal to remove the restriction on mixed business is also welcome, since this currently serves to constrain market access and, potentially, innovation in the market.

57. As set out in option 2, the proposed method of calculating ongoing capital for ELMIs might, however, merit further consideration. It will be important for any changes to the waiver regime for smaller ELMIs to be considered in parallel with changes made to the prudential regime. This is with a view to ensuring small businesses can cope with the new requirements, and are not disadvantaged by the overall package of provisions.

58. The Government's preferred negotiation approach would be option 3, as the Government's priorities are to ensure that the UK and European payments market should be open and transparent, competitive, innovative and efficient, balanced with ensuring an appropriate and proportionate regulatory regime for e-money issuance and, ultimately, ensuring appropriate consumer protection. The Government looks forward to engaging at EU level to ensure the final outcome meets these concerns, and will seek technical changes to the proposal where necessary.

Negotiation and implementation timetable

59. In the short-term, the Electronic Money Directive has been revised on a stand-alone basis, with a longer-term view to integrate the new directive on e-money issuers into the PSD. Once the new directive comes into force, the current EMD (2000/46/EC) will be repealed.

60. The Commission proposal has moved to the Council and European Parliament for negotiation. The responses to this impact assessment and accompanying consultation document

will inform the UK's negotiating position. Negotiations within Council and Parliament will determine the date from which the provisions of the new directive should be transposed.

Monitoring, enforcement and sanctions

61. The Financial Services Authority will continue to be the competent authority responsible for enforcing the legislation concerning the activity of issuing e-money, with the Financial Services and Markets Tribunal as the appellate in relation to its decisions.

Post implementation review

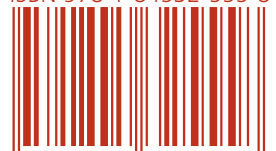
62. In its proposal the Commission, subject to negotiations, has indicated that it will conduct a review on the application of the new directive on ELMIs 3 years from the date the provisions are transposed into national law.

Specific Impact Tests: Checklist

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes/No	No
Small Firms Impact Test	Yes/No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

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