



**HM TREASURY**

**IMPLEMENTATION OF THE  
ELECTRONIC MONEY DIRECTIVE**

**A Response to Consultation**

**MARCH 2002**

# IMPLEMENTATION OF THE ELECTRONIC MONEY DIRECTIVE

## INTRODUCTION

1. The Treasury issued a consultation document in October 2001, which sought views on its proposed legislative measures for implementing the Electronic Money Directive into UK law – effectively by specifying the issuing of e-money as a regulated activity under the Financial Services and Markets Act 2000 (FSMA).
2. The consultation period closed on 8 January and a total of 17 responses were received, mainly from existing and prospective e-money issuers. The Treasury wishes to thank all those who took part in the consultation. A summary of the responses received forms an annex to this document.
3. The responses to consultation have confirmed the Treasury in its view that the proposals in the October consultation document generally represent the best way forward. However, some changes have been made to the detail of the proposed legislation in the light of consultation responses received. The reasoning behind these changes – and a more general response to consultation – is given later on.
4. The Treasury's revised proposals are reflected in the two statutory instruments laid before Parliament today – 14 March 2002. These are: The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2002; and The Electronic Money (Miscellaneous Amendments) Regulations 2002. To accompany these statutory instruments, an Explanatory Memorandum, a Transposition Note, and a Regulatory Impact Assessment have also today been provided to Parliament. All these documents can be found on the Treasury website at [http://hm-treasury.gov.uk/Documents/Financial\\_Services/Regulating\\_Financial\\_Services/financial\\_services\\_money](http://hm-treasury.gov.uk/Documents/Financial_Services/Regulating_Financial_Services/financial_services_financial_services_money).

## THE TREASURY'S REVISED PROPOSALS

5. Today, the Treasury has laid two statutory instruments before Parliament to implement the Electronic Money Directive into UK law. Set out below is a description of how these measures have been amended following consultation.

### *Definition of "e-money"*

6. The draft Order contained in the October consultation document effectively copied out the Directive's definition of e-money. The exception was that the definition in the draft Order did not refer to criterion (ii) – which states that e-money must be “issued on receipt of funds of an amount not less in value than the monetary value issued” – on the grounds that it presents a loophole in the Directive's definition. The proposal was to bring e-money issued at a discount within the scope of regulation, so that the FSA could then make rules relating to the issuing of e-money at a discount.
7. The Treasury's aim of closing this loophole was supported by respondents to consultation. Concern was expressed, however, that omission of criterion (ii) in its entirety from the definition of e-money would have the effect of removing the 'pre-paid' requirement of e-money products, and thus to widen the scope of the definition. This was not the Treasury's intention, so the phrase “issued on receipt of funds” has been reinserted into the definition of e-money (article 2 of the Order). This has the desired effect of providing a means of closing the loophole, whilst maintaining the pre-paid element of e-money.
8. It has been deemed necessary to confer a specific power on the FSA to prohibit the issuing of e-money at a discount, subject to conditions etc. This is because it is doubtful whether the rule-making powers under section 138 of FSMA would cover all cases in which the Directive requires a prohibition of issuing e-money at a discount. This power is included as the new article 9H.

9. As noted in the October consultation document, the Directive's definition of e-money leaves a lot of room for interpretation. Several respondents to consultation were keen for the Treasury to clarify the definition as much as possible in the implementing legislation. However, given the emergent nature of the e-money industry, the Treasury remains of the view that it is not possible to elaborate on this definition in any meaningful way.
10. An important issue that respondents requested clarification on was whether the Directive's definition should catch account-based schemes (i.e. e-money held remote from the owner and spent at the owner's direction) as well as, for example, card-based schemes (i.e. e-money in the possession of the owner, whether stored on a personal computer or a smart card, and directly spent by them). The Treasury believes that the Directive's definition does allow for the possibility of account-based schemes being e-money. Not allowing account-based e-money schemes would effectively create a regulatory gap between the e-money and deposit-taking regimes – and a difference of treatment between schemes that pose similar regulatory risks. Rather than attempting to amend the definition in the Order (which is already expressed suitably widely), the Treasury has clarified in the accompanying Explanatory Memorandum that the definition of e-money is to be interpreted as covering account-based schemes (so long as they remain distinct from deposit-taking).

### *Waivers*

11. The Directive stipulates that waiver of some or all of its provisions is possible when the amount that can be stored on the electronic device in question is limited to a maximum of €150 (and one of three other criteria are met). This limit is replicated in the Order. Several respondents to consultation sought clarification that this maximum storage limit may be less than €150. The Order has therefore been amended to read "...subject to a maximum storage amount of *not more than* €150." This is contained in the new article 9C(4)(a).
12. Respondents also sought clarification that the €150 limit does not apply to the electronic device used by merchants to accept e-money. The

Treasury believes that this was not the intention of the Directive. It simply does not make sense for the “maximum storage amount” of €150 to apply to the device used by merchants to accept e-money payments and to present that e-money for redemption by the issuer.

13. The draft Order sought to clarify the meaning of the Directive’s phrase “accepted by a limited number of undertakings” by proposing that an absolute limit of one hundred “persons” was imposed. Respondents generally thought this figure reasonable. However, some respondents were concerned that this condition would mean that schemes allowing purse-to-purse transfers between consumers would automatically not qualify for a waiver – because consumers may accept payment of e-money in satisfaction of private debts. To clarify that the phrase “one hundred persons” excludes purely private transfers, the Order has been amended to say that the e-money in question needs to be “accepted as a means of payment, *in the course of business*, by not more than one hundred persons...” This is contained in the new article 9C(6)(b).
14. With regard to the “limited local area” condition, several respondents were concerned that no allowance was being made for ‘virtual’ (e.g. Internet-based) e-money schemes. The Treasury believes, however, that Article 8(1)(c)(i) of the Directive was intended to apply only to the ‘physical’ world. ‘Virtual’ schemes are, of course, capable of satisfying the other waiver conditions.
15. Several respondents argued that this geographical waiver condition did not recognise the needs of local authorities’ e-money schemes. The Directive does not, however, make provision for special treatment of particular kinds of e-money schemes. Local authority schemes may be able to qualify under the geographical condition in the new article 9C(6)(b)(i) and will also be eligible to meet the other waiver conditions.
16. In the consultation document, the Treasury asserted that a “close financial or business relationship” – of the kind envisaged in Article 8(1)(c)(ii) of the Directive – would not exist merely by virtue of a group of undertakings all accepting the e-money of a particular scheme. Respondents generally

supported this view. The Order has therefore been amended, to clarify that for waiver purposes, persons are not to be treated as having a “close financial or business relationship” merely because they take part in the same e-money scheme. This is contained in the new article 9C(8).

17. Several respondents were concerned by the potential for schemes meeting the more subjective waiver conditions – and hence being effectively unregulated – becoming quite large and having an unfair competitive advantage over similarly sized schemes that are subject to full regulation. The Treasury believes that the Directive does not envisage these criteria allowing for schemes of unlimited size. For example, the Commission has made clear that the waiver should “only be applied to e-money institutions underpinning relatively small schemes”<sup>1</sup>. This suggests that there should be some kind of limit on the size e-money schemes can grow to before needing to become fully regulated. To deal with this point, an additional waiver condition has been included in the Order for issuers seeking waiver under the second and third criteria – a limit to total e-money liabilities of €10 million. This is contained in the new article 9C(5)(b). Although this additional condition was not something that was originally consulted on, informal consultation has revealed widespread support from members of the industry.
  
18. Waived e-money schemes could potentially be fairly large and sophisticated, with tens of thousands of users and total liabilities of up to €10 million. Obtaining and verifying information about whether a scheme complies with the waiver conditions could be quite difficult and may require technical IT skills that the FSA does not have available to it. The Treasury believes it would be helpful for the FSA to have the powers in section 166 of FSMA (Reports by skilled persons) though, in practice, these powers are likely to be used only in exceptional circumstances. The Order has therefore been amended to make provision for the application of section 166. This is contained in the new article 9G(7).

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<sup>1</sup> COM(1998) 461 final – Explanatory Memorandum

19. The information requirement rules for waived firms will inevitably be fairly detailed. The Treasury believes it is appropriate for the FSA to have the power to waive or modify these requirements in suitable cases – so as to reduce the burden on certain small schemes. The Order has therefore been amended to allow waiver of rules made under article 9G(1). This is contained in the new article 9G(2).

#### *Rule-making powers*

20. Section 150 of FSMA (Actions for damages) provides that a contravention by an authorised firm of an FSA rule is actionable at the suit of a private person who suffers loss as a result of the contravention. The Treasury believes that this right should also apply to a contravention by a waived firm of rules made under article 9G(1) of the Order. Article 9G(3) has therefore been included, which applies section 150 to rules made under article 9G(1).

#### *Transitional arrangements*

21. As proposed in the consultation document, all UK and EEA e-money issuers operating immediately before 27 April 2002 are to be granted a time-limited exclusion, whereby they are treated as not carrying on a regulated activity under FSMA until 27 October 2002. The aim is for these existing issuers to use the six-month grandfathering period to apply for either authorisation or a waiver. There are many reasons why a firm with the benefit of the grandfathering exclusion might want to become authorised and get the permission before the end of that exclusion. The most obvious reason is that it would enable them to passport their activities into other EEA Member States. The Order has therefore been amended to make clear that it is possible for an existing issuer to apply for (and get) an e-money permission before 27 October. This is contained in the new article 9(6).
22. Several respondents to consultation were concerned with the possibility that an existing issuer's application for permission may not have been finally determined by the end of the six-month grandfathering period,

particularly if it is using the appeal rights available to it under FSMA. The Treasury believes that such an outcome would be unfortunate. In order to make allowance for existing issuers whose applications are outstanding at 27 October to continue issuing e-money until such time as the matter is resolved, the Order has been amended to allow unauthorised issuers to operate after the grandfathering period, so long as they have submitted a completed application to the FSA by 27 June – i.e. within two months of the regime coming into force. This is contained in the new articles 9(7) and (8). Existing issuers are still encouraged to submit their applications at the earliest possible opportunity.

23. Several respondents questioned whether the transitional exclusion should be extended to cover non-EEA e-money issuers operating in the UK immediately before 27 April 2002. The Directive, however, makes no provision for such issuers. The Treasury though does not foresee this as a problem as consultation did not reveal any such schemes as operating in the UK at present.
24. It may be observed that services provided from outside the UK which may be accessed by electronic means from the UK may not, in any event, be regarded as constituting the carrying on of activities in the UK, if the provider has no establishment or any other physical presence in the UK (though this will depend on the precise circumstances). In such cases the services will not be regulated under FSMA at all.

## **ANNEX: RESPONSES TO CONSULTATION**

### **Introduction**

- A1. The Treasury's consultation document "Implementation of the Electronic Money Directive", issued in October 2001, sought views on its proposed legislative measures for implementing the Electronic Money Directive into UK law. This annex summarises the 17 responses to consultation received by the Treasury. A list of these respondents is contained in the appendix.

### **The definition of electronic money**

- A2. The majority of respondents were supportive of the Treasury's general approach of effectively copying out the Directive's definition of e-money – on the grounds that it allows for a flexible approach to regulation. Only one respondent objected to our suggested approach, on the basis that there a number of ambiguities within the Directive's drafting and that a more prescriptive definition that removes as many of the uncertainties as possible would be preferable. Several other respondents also noted this lack of clarity in the Directive's definition and the potential drag this could have on the market.
- A3. The majority of respondents supported the proposal to bring e-money issued at a discount within the definition of e-money. Concern was expressed, however, that omission of criterion (ii) in its entirety from the definition of e-money has the effect of removing the 'pre-paid' requirement of e-money products, and thus to widen the scope of the definition and create uncertainty as to whether 'post-paid' schemes would fall under it. Numerous respondents therefore proposed omitting only the second part of criterion (ii) and retaining the phrase "issued on receipt of funds" – which would have the desired effect of providing a means of closing the loophole whilst maintaining the pre-paid element of e-money.
- A4. Several respondents argued specifically that the practice of issuing e-money at a discount should not be prohibited outright, on the basis that

the ability to issue discounted e-money should remain a commercial decision. However, most respondents supported the proposal for the FSA to prohibit the issuing of e-money at a discount, subject to clarification that certain measures (e.g. marketing promotions) were not to be regarded as issuing e-money at a discount so long as the float was topped up to the full value of e-money issued.

A5. Respondents argued that some issuing of e-money at a discount should be allowed. This was because of (a) the commercial need to promote the use of e-money and (b) the fact that such promotions avoid the financial risk that might affect a firm that issues e-money for less than the amount required to redeem it – by ensuring that the float held by the issuer must immediately and always equate to the full value of the e-money in issue.

A6. Respondents also raised several other issues in relation to the definition of e-money. These are outlined below:

- Several respondents sought assurance that the term “electronic device” used in the definition of e-money included network- or server-based account systems as well as e-money payment cards with electronic chips. This would, it was argued, be in line with the Directive’s aim of providing a technology-neutral framework.
- The Directive states clearly that sums received [in exchange for e-money] do not constitute deposits if they are “immediately exchanged for e-money”. Respondents welcomed the Treasury’s proposal to use this wording in the implementing legislation – on the grounds that it provides a clear distinction between e-money and deposit taking. However, several respondents noted that scenarios could be envisaged where there is a time period between when a consumer purchases the e-money and when he activates his e-money account or card. During this time period the e-money issuer has in effect received the funds for the e-money but the funds are only exchanged for e-money when the consumer activates his e-money card or account. These respondents felt that such a delay in issuance can be justified on operational grounds and should not remove such schemes from the

definition of e-money. However, they did also suggest that the time period for activation should be clearly limited in order to maintain the clear distinction between e-money and deposit taking.

- If the definition of e-money requires value to be issued on receipt of funds then, in practical terms, such payment is likely to be made by cheque, credit card, debit card or bank transfers. All such payments involve a period of settlement ranging from one to several days. Several respondents proposed that ELMIs should have the option of issuing e-money immediately upon receipt of such payment (i.e. ahead of receipt of funds), making the necessary transfer to the float from working capital. The issuer would then accept the risk of payment default pending settlement as part of normal commercial risk.

## **Waivers**

- A7. In general, respondents favoured the Treasury's proposed approach of implementing Article 8 (Waiver) as widely as permitted by the Directive and also the objective of introducing greater clarity into waiver criterion (c). Three respondents were, however, uneasy about waivers in general. They noted the potential risks to consumers from unregulated issuers and raised concerns about the potential adverse effects on competition of not having a level playing field.
- A8. Responses to consultation revealed a wide range of views about the appropriate form of the waiver conditions. There was no consensus on whether to elaborate on the conditions and, if so, how. However, many respondents felt that the Treasury's proposals were as appropriate as possible at present. Comments focused on criterion (c) – notably regarding the interpretation of the conditions on locality, close relationships and number of accepting undertakings.
- A9. Several respondents felt that the Treasury's interpretation of the waiver conditions was too restrictive and suggested that no fixed figures should be set in legislation, but rather that the FSA should use such figures as guidance only, in the context of other relevant parameters (e.g. float size,

number of consumers). Other respondents, however, argued that our interpretation was in fact wider in scope than envisaged by the Directive – in particular regarding the “limited local area” and “limited number of undertakings” conditions. Some respondents were concerned by the potential for schemes meeting these conditions becoming quite large and having an unfair competitive advantage over similarly sized schemes that were subject to all the provisions of the Directive.

- A10. Several respondents argued that if clarification was to be given to the phrase “limited number of undertakings”, then a figure of around 25 undertakings would be acceptable – reflecting their view on schemes that could acquire critical mass and success but at the same time would be limited in size and risk. However, other respondents noted that the appropriate number of undertakings was highly dependent on the size and turnover of each scheme involved. Concern was also expressed that the use of the word “persons” in this condition rather than “undertakings” (the word used in the Directive) would result in the inclusion of person-to-person transfers within this definition and that this could prevent innovative products in this area being developed.
- A11. With regard to the “limited local area” condition, it was argued by some respondents that the proposed figure of 4 square kilometres was arbitrary. The main concern revolved around the fact that there would be different implications depending on whether the area in question was, for example, urban or rural. Some respondents felt that whilst greater certainty was desirable, no fixed figure should be set in legislation, leaving the FSA to address applications on a case-by-case basis. Several respondents argued that the current waiver proposals did not recognise the needs of local authorities’ e-money schemes – and requested a revision to the geographical condition to include specific reference to them.
- A12. Several respondents were concerned that no allowance was being made in the waiver proposals for ‘virtual’ equivalence. They submitted that undertakings which have their principal places of presence on common websites (portals) or which are part of a common television shopping

offering should qualify for the “location on the same premises or other limited local area” criterion.

- A13. With regard to the “close financial or business relationship” condition, respondents mostly sought guidance on how it would be interpreted by the FSA. Several respondents agreed with the assertion that this condition would not be satisfied if the close relationship were merely one related to the e-money scheme in question.
- A14. With regard to the €150 limit for waived schemes, respondents argued that it should not apply to the device used by merchants to accept e-money; and that it should be clarified that the maximum storage limit may be less than €150.
- A15. The majority of respondents agreed with the Treasury’s proposal to disapply as many of the provisions of the Directive as possible for waived firms. The general consensus was that – provided that waivers were granted only to genuinely “limited” schemes – this approach would reduce the burden on small schemes and start-ups, and would provide the opportunity for them to grow. Only one respondent argued that this general approach was inappropriate, noting the risks to consumers. Concern was also expressed about the need to maintain a level playing field between ELMIs and credit institutions.
- A16. The only provision that anyone argued should be maintained for waived firms was the redeemability requirement. Several respondents thought that this would provide certainty for consumers and would avoid confusion by establishing a common basic attribute for all e-money schemes. On the other hand, some respondents argued that placing a requirement to provide redeemability may restrict the development of new products due to the costs involved and that it also seemed inappropriate when looking at the type of schemes to which the waivers would apply, such as university campus schemes.

A17. There was broad support for the Treasury's proposals for the FSA to grant and revoke waivers. The general feeling was that these procedures appeared logical and fitted with existing FSA practices.

### **Transitional arrangements**

A18. The consultation exercise revealed mixed feelings about the Treasury's proposed transitional arrangements. Several respondents thought the proposals sounded reasonable and were not aware of any problems they might cause for existing e-money issuers. Others, however, had concerns – mostly about the practical implementation of the arrangements.

A19. The main concern appeared to be the time it would take schemes to make their applications and for the FSA to process them – and that delays beyond 27 October 2002 would force some schemes to cease their e-money activities through no fault of their own. It was thought that there might be a degree of flexibility in the time that may be allowed to achieve full compliance. Several respondents proposed an extension to the deadline – preferably by around 12 to 18 months.

A20. A further issue raised by several respondents was whether, although outside the scope of the Directive, the transitional exclusion should be extended to cover non-EEA ELMIs operating in the UK immediately before 27 April 2002.

### **Financial Services Compensation Scheme**

A21. The majority of respondents – particularly those in the industry – felt strongly that introducing a compensation scheme for e-money scheme would be inappropriate *at this time*. The most common argument used was that the costs of maintaining a compensation scheme would be prohibitive and that such a scheme would be of limited application.

A22. Only three respondents argued that a compensation scheme should be introduced straight away – in the interests of consumer protection and maintaining public confidence in e-money. For example, it was noted that

small businesses might be less willing to accept e-money transactions without a compensation scheme, which could be a barrier to the successful development of e-money.

### **Ombudsman Scheme**

- A23. The consultation exercise revealed mixed feelings about whether the Ombudsman scheme would be appropriate for e-money. As in the case of the compensation scheme, the majority of the industry felt strongly that applying the Ombudsman scheme for e-money would be inappropriate at this stage of the industry's development. It was argued that the estimated levels of contribution necessary for participation suggest that the cost to a fledging industry would be highly onerous and out of proportion with the typical values of money that may become subject to consumer complaints. Some respondents also argued that the scheme itself would be of limited application. For example, many of the existing e-money schemes in the UK already have an Ombudsman in place (e.g. banks, train operators, telecoms operators).
- A24. Only four respondents felt that e-money schemes should be subject to the Ombudsman scheme straight away – for consumer protection and public confidence reasons.
- A25. Opinion was divided about whether the FSA should be left to decide upon the application of the Ombudsman scheme in relation to e-money. Some respondents thought that the FSA should make the decision – based on a full cost-benefit analysis; others thought that the Treasury should do so.

### **Financial Promotion Regime**

- A26. The vast majority of respondents agreed with the Treasury's proposal that e-money should not be subject to the financial promotion regime of FSMA. The main arguments used were that (a) whilst it was difficult to quantify costs, they were likely to be significant as a proportion of an ELMI's cost base and (b) the provision and offer of a means of payment is not the type of activity which poses a risk to consumers by way of promotion; instead,

this aspect of consumer protection is normally applied to investment and other financial activity where the consumer is at risk from inadequate advice and can suffer significant financial loss.

- A27. Only three respondents believed that the activity of issuing e-money should be made subject to the financial promotion regime. The main arguments used revolved around the need for consumer protection.

### **Draft Regulatory Impact Assessment**

- A28. Only three respondents commented on the draft Regulatory Impact Assessment included in the consultation document. One respondent accepted the difficulty of meaningfully quantifying the costs and benefits of regulating e-money issuance by way of FSMA. They also noted that a light touch approach to implementation would be more likely to reduce costs whilst maintaining the benefits of the regulatory provisions that were applied.
- A29. The other two respondents expressed concern at the impact and cost of these proposals – and a desire that innovation in the e-money industry should not be stifled by costs (e.g. authorisation fees) that would be prohibitive, especially for smaller ELMs. However, these concerns appeared to relate to the provisions of the Directive, rather than the Treasury's proposed method of implementation.

## **APPENDIX: LIST OF RESPONDENTS**

Abbey National Plc  
Association for Payment Clearing Services  
Barclays Plc  
Bracknell Forest Borough Council  
Creative Star Ltd  
Financial Services Consumer Panel  
Legal & General Assurance Society Ltd  
Mike Hendry  
MondexUK Ltd  
Rail Settlement Plan (Association of Train Operating Companies)  
Smartex Ltd  
Southampton City Council  
The Electronic Money Association  
Transport Card Forum  
Visa International EU  
Vodafone Ltd  
Vodafone Ltd (on behalf of BT Cellnet, BT Plc, One2One and Orange)