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Consultation on the revision of the Electronic Money Directive. A response from the Mobile Broadband Group

The Mobile Broadband Group ('MBG'), whose members are the UK mobile businesses of O2, Vodafone, Three and Everything Everywhere (which operates under the Orange and T-Mobile brands in the UK) welcomes the opportunity to respond to the consultation by Her Majesty's Treasury on the transposition of the revised Electronic Money Directive into UK law.

In summary, the MBG is broadly supportive of the revisions made to the Directive. Many of the concerns highlighted by the industry in relation to the first Electronic Money Directive (i.e. definition, scope) have been addressed. We also welcome the alignment between this revised Directive and the Payment Services Directive.

Background

None of the MBG members currently operate business models that fall within the scope of the Directive. In situations where third party value added services can be purchased via the mobile operator, no direct payment relationship between the customer and the merchant exists and so no e-money is ever created; fundamentally there is no payment transaction (as defined in the payment services regulations), as the mobile operator stands between the two parties.

This has been the same situation since the Commission issued guidance in 2005 on the applicability of the E-money Directive to mobile operators, it stated in paragraph 13 that:

"First, given the fact that in many cases (though not all), it appears that mobile operators themselves arrange for the payment of third party content providers, either as a result of a contractual relationship under which the mobile operator assumes the liabilities of its pre-paid customers towards a merchant or through a revenue-sharing arrangement with a merchant, it is arguable that many purchases of third-party content do not give rise to e-money."

A similar type of arrangement falls within the negative scope under Article 3(b) of the Payment Services Directive (*payment transactions from the payer to the payee through a commercial agent authorised to negotiate or conclude the sale or purchase of goods or services on behalf of the payer or the payee*).

There are examples in the market of mobile operators partnering with financial institutions to provide prepaid cards. In such instances, the financial institution is acquiring the appropriate licences, while the mobile operator provides expertise on the telecommunications, security and technical aspects and a distribution channel to the customer base. The MBG therefore wishes to see an appropriate transposition of the Directive into UK regulations, one that maintains the regulatory treatment of existing models and that is appropriate for any potential new ones.

Question 1: Definition of limited network

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

Yes. It should be possible to achieve reasonable regulatory certainty through this route. The FSA should try to provide as much details as is practical, though, with thorough consultation with interested parties. The downside of relying too much on a 'case by case' basis is that precedent can accumulate in a rather random way, depending on the cases that arise and thus end up driving policy rather than the other way round. As a result organisations that believed they were operating a 'limited network', relying on FSA guidance, are brought within scope as a bi-product of a court decision to which they were not a party but nevertheless has knock on effects.

The examples referred to at paragraph 3.13 of the consultation document all refer to 'cards'. It would be helpful for the FSA guidance to include some examples of how the limited network exemption might apply to e-money transactions effected via other e-money services, perhaps in the ICT sector.

Question 2: Boundaries of a Limited Network

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

No comments

Question 3: Self-regulation in the unregulated sector

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

ii) Is there a better alternative?

The MBG would not support voluntary self-regulation for unregulated limited networks. Done properly, self-regulation is every bit as complex as formal regulation. As a matter of principle, we would not want to see it implemented where there is no demonstrable need and where the reach of regulation could be very wide indeed – perhaps even the prepaid card issued for use in HMT's staff canteen.

Products falling within the limited network exemption to the Directive (or the added value exemption) cannot be regulated as e-money, on a voluntary basis or otherwise – they have been specifically exempted from e-money regulation. A voluntary code could have the effect of introducing a three tier system: (i) e-money issuer regulated under the Directive; (ii) participant signed up to the voluntary code; (iii) entity legally falling within the exemption(s) to the Directive. In such a system, the products would still potentially compete with one another – a voluntary code would not address the perceived risk of one entity having a competitive advantage over another.

Introducing the concept of a code of conduct to an exempt product could also mean that Member States implement different forms of ‘self-regulation’. Consequently, the same product could be subject to different regulatory requirements in different jurisdictions – which would add to, rather than lessen, any confusion in this area.

If there is a real and valid concern, it could be raised with the European Commission but one imagines that, if it was thought limited networks needed to be regulated, they would not have been exempted in the first place.

The best way to address this matter may be with consumer education. It falls primarily to the national regulator to clearly communicate and educate consumers about the difference in regulation between regulated e-money products and those that fall within exemptions to the Directive. Regulated e-money issuers would also play a role in: (i) emphasising to consumers the advantages of their products; or (ii) in the event that the issuer offers both in and out of scope products, clearly setting out the differences between such products.

Question 4: Financial Services Compensation Scheme

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

The MBG has no comments

Question 5: Redeeming E-money

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

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

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

The experience in the UK so far is that mobile operators wanting to provide an e-money service have partnered with a financial institution and kept the e-money aspect completely separate from the basic airtime product. As explained above, there has not been a payment service relationship between customer and merchant for value added services acquired using a prepaid airtime product. Were an organisation, with a prospectively hybrid business model, to consider entering the e-money market this would be one of the most difficult issue to deal with. (A hybrid model in such a context would be using stored value purchased primarily for one purpose - such

as prepaid airtime- being used as e-money for the secondary purpose of executing payment transactions with 3rd parties and not having the e-money as a standalone account.)

In the example of a mobile operator, very large numbers of pre-pay subscribers top up small amounts frequently. The average annual spend per customer on a 'pay as you go tariff' is in the region of £100 and there are over 40 million prepaid subscriptions; outstanding balances are typically of the order of £5-£10.

Churn in the prepaid segment of the mobile market is of the order of 40-50% of the base per annum. Prepaid airtime purchased has no expiry date. However, there is a need to disconnect regularly customers' inactive accounts. There are a number of reasons for this: mobile operators reserve network access capacity for active subscribers, based on an estimate of their expected usage. They do not want to maintain capacity for subscribers that are not going to use it. This is wasteful. Secondly, subscriber numbers are a Key Performance Indicator for the financial markets and it would be wrong to inflate subscriber numbers with non-active customers, even though they may still hold small outstanding balances. Thirdly, mobile operators need to recycle the telephone number, which is a scarce resource, and allocate it (after a suitable quarantine period) to new customers.

The MBG recognises that, in the event a provider launched a hybrid model, they could still end the service contract and, theoretically maintain a liability for any unused balances. And we recognise that outstanding balances could be eroded over time by service charges. However, there are significant problems. First, the vast majority of customers do not authenticate their identity and so reactivating an account at a later date in order to redeem an outstanding balance could be very problematic from an administrative point of view. Secondly, it is not clear, in the hybrid model, what proportion of the balance would be deemed e-money and thus 'redeemable' under the regulations. In any event it would only be practical and viable to reactivate an account for the purpose of any outstanding balance being used for its original purpose – the consumption of network airtime. In summary, these provisions work as a significant disincentive for operators to enter the e-money market with a hybrid offering, as it would require a substantial change in terms and conditions for prepaid airtime contracts.

In answer to question 5, then, it would be advisable to introduce a prescription period so that there is some definition and end point to the liability. However, if the Government wishes industry to take advantage of any opportunities presented by the revision of the Electronic Money Directive, then there would need to be further discussion of how the hybrid model could work in the new context with any parties interested in pursuing such a model.

Question 6: Storage limits

- (i) Do you agree that the exemption from carrying out customer due diligence checks should be raised from €250 up to €500 for national payment transactions?*
- (ii) Please give reasons if you do not agree.*

Yes.

Question 7: Capital requirements

- (i) Is a fixed minimum requirement of €75,000 for a small electronic money institution's*

initial and ongoing capital a sensible approach to setting an own funds requirement?

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

A fixed minimum requirement seems straightforward and sensible.

Question 8: Safeguarding

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

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

The MBG supports the Government's proposal to follow the safeguarding model established for the Payment Service Regulations, section 19, whereby the relevant funds to be safeguarded in the situation where some funds are used for in scope activity and other funds for out of scope activity are an amount *"as may be reasonably estimated, on the basis of historical data and to the satisfaction of the Authority, to be representative of the portion attributable to the execution of the payment transaction"*.

Question 9: Float limit

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

The MBG is content with the Government's proposal of €5 million.

Question 10: Additional activities

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

No comments