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Response of the Mobile Broadband Group to HM Treasury's consultation on the implementation of the Payment Services Directive.

Introduction

The Mobile Broadband Group ("MBG", whose members are O2, Orange, T-Mobile, Virgin Mobile, Vodafone and 3) welcomes the opportunity to respond to HM Treasury's consultation on implementation of the Payment Services Directive.

One of the consequences of customers being able to do more and more things on their mobile is that the mobile operators come into contact with more and more regulation. The role of the Mobile Broadband Group is to work with Government and regulators to ensure that this complex interaction of regulation works for customers. Beyond basic telecommunications regulation, the MBG deals also with at least gambling, advertising, television & Internet regulation – and, if applicable, payments regulation.

The MBG agrees with HM Treasury's overall approach of taking up the available derogations and not gold plating the Directive. This will minimise the risk of introducing unintended consequences and will maximise the opportunity for innovation, while at the same time providing appropriate protection for customers.

A mobile operator can be in the value chain of a payment type transaction in perhaps three basic scenarios:

1. First, where it is providing the communications connectivity, the mobile device is just being used to execute instructions and the payment service is being provided by a third party. The mobile operator would not be a payment institution under this model. For example, where connection to the Internet is via a mobile broadband connection and a customer is using a solution such as Paypal, the telecommunications network may be used as a communications method but is not involved at all in the provision of the payment service.
2. Secondly, where the mobile operator provides a dedicated payment service business which is separate to its telecommunications service. There are a few examples of such business models emerging round the world, particularly where the banking system is not widely used (for example the M-pesa service in Kenya).
3. Thirdly, the so-called hybrid situation – where the customer may be using his or her mobile account to pay for both mobile services and as a source of funds for

executing payments to third parties. At present, there are no services which fall within this section in the UK, as the E-Money Directive does not permit hybrid accounts and it is likely that any solution offered by mobile providers would involve the provision of services for both contract and prepay customers (the latter would be caught by the E-Money Directive).

The Directive represents progress on the E-money Directive in that it at least recognises the possibility of hybrid business models. The MBG believes that no mobile operator should need to seek an authorisation or registration for the general national mobile services currently offered as all services fall within the negative scope of the Directive. Nevertheless, the Directive has begun to open up opportunities for mobile operators to develop business in international remittance and national person to person payment and, to the extent that any operator enters into this type of hybrid business, the MBG would expect the relevant authorisation to be sought. It should be noted, though, for this latter category to emerge, it will also be necessary to review the E-Money Directive in such a way that hybrid services are allowed under that Directive. Approximately 65-70% of mobile customers in the UK use a prepaid account.

This response from the Mobile Broadband Group focuses on the third model – the hybrid institution (i.e offering both payment for goods and services covered by the negative scope and in scope payment services). Even though the MBG does not anticipate an operator applying for a registration/authorisation for a hybrid business model in the short term, it is the one where the terms of the Directive sits least comfortably and where it would be helpful to receive clarification from the Government

1. Do you think you will need to obtain authorisation as a payment institution, or would you qualify for the waiver, enabling you to register only?

Currently, where MNOs enable customers to purchase third party goods and services by way of premium rate services and Payforit, they also offer additional services and value, taking those services out of the scope of the PSD. Recital 6 highlights the intrinsic value that telecommunications operators can add, for example, in the form of 'access, distribution or search facilities.' The way in which the MNOs offer this value is set out below in response to question 2.

In the future, if the E-Money Directive is amended to permit hybrid accounts, MNOs may offer different solutions whereby they do act simply as a payment intermediary. There are 70 million active mobile subscriptions in the UK, two thirds of which are pre-paid accounts. The use of mobile devices is far more widespread than credit cards. It is possible that this accessibility and convenience will open up opportunities for the hybrid institution to be involved merely as a 'payment intermediary' but it has not happened so far and the arrival of the PSD does not, of itself, change much in this regard.

Where an operator sets out specifically to offer a dedicated payment service, such as international remittance for migrant workers, and where the operator acts simply as a payment intermediary, then that operator would, in principle, appear to be more in the nature of a business that would need to obtain the appropriate authorisations under the PSD.

2. What types of payment services do you provide?

At present, the most prevalent method that customers use for purchasing value added services on a mobile is through a premium rate service as defined under Section 120 of the Communications Act 2003. PhonepayPlus, the premium rate services regulator estimates that customers spend around £1billion per annum on such services (which would include services such as voting on TV shows and entering competitions).

This is a highly regulated area of the telecommunications industry where the use of a communications network for payment is inextricably linked with the use of the network for communications (see S120 of the Act). As defined within that Act, a service is only a premium rate service if it involves content sent via a communications network or if it is a facility reliant on transmissions by means of that network. Because of this link, PRS falls out of scope, as the provider is, by definition, doing more than merely acting as a payment intermediary.

Mobile operators also offer value added services on their own branded content portals – games, comedy clips etc., and these are paid for through the mobile customer's account. Such services are delivered to the mobile device or PC and fall within the negative scope.

The UK mobile operators have recently launched a cross operator service called Payforit, a mobile payment mechanism that is designed to offer a more consumer friendly interface than is possible with PRS. For the reasons mentioned above, it is expected that the vast majority of purchases will, in the short term at least, concentrate on goods and services delivered to the handset.

In these examples, the mobile operator is acting more than simply a payment intermediary and the relationship between the service provider (of the ring tone or whatever) should be characterised as a commercial relationship rather than a banking one. Moreover there is no direct payment relationship between the customer and the third party merchant.

As part of any transaction a mobile operator will negotiate commercial terms with the service provider and in return match the needs of the customer with the goods/services of the seller by adding value in one or more of the following ways: convenient short dialling codes that work across all networks, mobile search facilities, WAP connectivity to browsable digital catalogues, a billing mechanism and a delivery mechanism.

3. How many agents and branches do you have?

Mobile operators have extensive networks of both own branded and independent retail outlets for selling airtime contracts, handsets and prepaid cards. They are servicing the needs of customers that need to compare the prices of handsets and communications services, sign up for airtime and/or upgrade their handset and airtime provision. To the extent that customers may subsequently use their mobile provider for an 'in scope' activity is purely incidental.

Mobile operators also contract with 'aggregators'.

Aggregators provide connectivity between mobile operators and third party service providers. For example, if MTV wants to distribute a music service to mobile

customers, it will contract with an aggregator to provide the connection to the mobile network, rather than connect with each network individually. There are approximately ten to twenty significant aggregators active in the UK market. Aggregators are also responsible for passing to MTV (in this example) the money that the mobile operators collect from end users, less any revenue share due to the mobile operator. Aggregators do not provide any service directly to end users.

4. Do you agree with the suggested interpretation of payment service activities covered by the PSD annex?

As set out in the introduction, a mobile operator can be involved in the value chain of a payment in various ways and so 'mobile payments' is a rather sweeping way of describing part 6 of the Annex.

Nevertheless, the MBG recognises, as set out above, that there is potential for there to be some in scope payments under part 6 of the Annex (e.g. where the operator has set out to offer a dedicated service such as international remittance for migrant workers, acting simply as an intermediary).

5. Do you agree with the interpretation of negative scope? Are you aware of activities or business models that might unintentionally fall within scope of the PSD?

The MBG is uncertain whether the text (in 2.47) in the consultation document provides any further interpretation over and above the text in Article 3 (l) and the Annex.

In practical terms, with respect to value added services chargeable to the mobile account in the UK today, the mobile operator is acting as more than a simple intermediary (for the reasons given above). Nevertheless, it is possible that this situation could change in the future. The best way to promote regulatory certainty is to transpose the Directive using language as close to the Directive as is compatible with UK law. Subsequent to that, if there are any grey areas, it would be helpful to produce guidelines to demonstrate the practical application of the Directive's text – but this should be a matter for guidelines not the legislation itself.

6. Are there any concerns or issues you would wish to raise with respect to the interpretation of any definitions in the Directive?

HM Treasury correctly identifies that the Directive does not clearly distinguish between the different types of payment account.

As stated in the introduction, this response focuses on the scenario where a customer's mobile account can be used in a hybrid way – to execute payment transactions for goods and services that fall both within negative scope (specifically 3 (l)) and part 6 of the Annex.

The MBG's understanding is that when the Directive states in Article 16(2) that payment accounts must be used exclusively for payment transactions, they must not be used for any payment activity for which additional licences are required without first obtaining those additional licences – for example, authorisation as a payments institution will not enable the authorised institution to offer banking activities from the

same payment account unless that institution also obtains a banking licence. It would be helpful if the Government could provide clarity on the language used in this article.

Limited network

The Directive is silent on what is meant by 'limited network'. The MBG requests that the Government gives guidance on their interpretation of the meaning of limited network.

7. Are there reasons to exempt any of the following institutions from all or part of the PSD: the National Savings Bank, the Commonwealth Development Finance Company Limited, the Agricultural Mortgage Corporation Limited, the Scottish Agricultural Securities Corporation Limited, Crown Agents for overseas governments and administrations, and municipal banks?

No comments

8. Do you agree that credit unions should be exempt from all of the PSD?

No comments

Chapter 3: Title II: the prudential regime

9. Are there issues relating to the initial or ongoing capital requirements which would benefit from further clarification? Please also give views on which of the three methods would be most appropriate to your business model.

It is likely that hybrid institutions would chose method B, as this is really the only practical option. Method A and Method C are based on a firms' fixed overheads (which would be applicable to all services) or income over the preceding year (again, presumably applicable to all services offered). We are not sure whether Method A or C could be applied to a hybrid organisation by working out the relevant proportion of the measure suggested based on payment volumes. In any event, the MBG strongly believes that, subject to agreement with the FSA, the payment institution should be allowed to choose the method used for calculating ongoing capital.

10. Should payment institutions be able to choose the method they use for calculating their ongoing capital, subject to final agreement by the FSA?

Yes

11. Does your business currently operate some form of ring-fencing or safeguarding of user funds? If so, how does this match the ring-fencing options under the PSD? If you do not currently ring-fence user funds, how will this requirement affect your costs and business model? How might ring-fenced user funds be best protected in the event of insolvency?

Mobile operators do not ring fence. It would be administratively cumbersome to do this for all prepaid accounts, as most customers keep very low balances on their

prepaid accounts. As we set out in the answer to question 17 we support taking the option to require ring fencing only for balances in excess of 600 Euro. There is intrinsic value in the mobile customer base that protects them in the event of insolvency.

12. Do you agree that ongoing capital requirements should be applied for payment institutions already included under the consolidated supervision of credit institutions? Do you intend to passport your services? If so, please provide details.

In the short to medium term at least, it is envisaged that the hybrid model would purely be used in a national context. However, this is not to say that opportunities to passport and execute cross border transactions in the future will not emerge.

13. How do you think the FSA should approach its ability to exercise the discretion to vary ongoing capital charges by 20per cent?

No comments

14. Should payment institutions be able to apply safeguarding measures only to an estimated portion of funds which might be used for future payment transactions, where these are unknown in advance?

Yes – this will be the only practical solution for hybrid companies.

15. Should non-hybrid firms have to safeguard user funds in a similar manner to hybrid payment institutions? What would be the costs and benefits of this?

No comments

16. How should the competent authority approach the option to demand the legal separation of a payment institution's payments business from its non-payment activities?

The MBG does not support a requirement to have legal separation. Taken together with the requirement for initial capital, ongoing capital and the safeguarding requirements, it should be left up to the organisations themselves to make a decision on this point.

17. Should safeguarding be limited to funds exceeding €600? How might the use/non-use of this flexibility affect firms' processes and operating costs?

The MBG agrees with limiting this to Payment Service users whose funds exceed 600 Euros. This would be proportionate and practical. In reality, the most likely situation for a mobile operator to be holding customer funds, is where the customer has topped up a pre-pay card. The vast majority does this in the range of £5-£20. It would be very unusual for customers to hold prepay balances much in excess of this and so taking advantage of the derogation would considerably ease the administrative and financial burden.

The risk of a mobile customer being stranded by an operator withdrawing from the market involuntarily is really very small. Moreover, there is intrinsic value in the customer, which protects their interests considerably. The last time a UK operator changed hands was the purchase of O2 by Telefonica where the purchase price was around £1000 per customer.

18. Do you agree with the approach to exercise the waiver, while retaining the fit and proper test outlined in MLR07?

Yes. The MBG supports the Government's proposal for choosing option 3 – to operate a registration scheme.

It should be clarified by the Government that the measure of the 3 million euros should apply only in payment transactions that are within the scope of the Directive.

19. Should the agents of registered payment institutions be registered?

Mobile operators have extensive networks of both own branded and independent retail outlets for selling airtime contracts, handsets and prepaid cards. Such outlets are not engaged any activity that is relevant to the provision of a payment service. They are servicing the needs of customers that need to compare the prices of handsets and communications services, sign up for airtime and/or upgrade their handset and airtime provision. To the extent that customers may subsequently use their mobile provider account for 'in scope' activities is purely incidental.

The MBG believes that no useful purpose would be served by registering these outlets as agents for the purposes of providing payment services.

20. Do you intend to take advantage of the transitional provisions? Please provide details.

No comments

Chapter 4: Access to payment systems

21. Do you agree with the interpretation of the scope and aim of Article 28 on access to payment systems, and the schemes that will be affected in the UK? Are there other payment systems that may be affected?

22. What are the merits of an ex ante or an ex post approach to implementation of Article 28 on access to payment systems? Are there any other approaches that should be considered?

With existing business models for value added services, the MBG would not anticipate mobile operators needing access to banking payment systems, as the 'upstream' settlement with service providers is a trading relationship settled through normal commercial terms or through the telecommunications operators' interconnect agreements.

However, for other models, such as international remittance, access to payment systems could be important. There should be an ex ante requirement on payment systems providers to give access to their systems on fair, reasonable and non-discriminatory terms.

Chapter : Titles III and IV conduct of business rules

23. Is any clarification needed in relation to any of the information requirements and how they relate to a given payment method or business model?

Where the Directive refers to provision of information via a “durable medium”, it would be helpful if this expressly includes making information available via a website. We would not want to provide information on paper for premium rate services or Payforit services, as for prepay customers, we generally do not hold address details.

24. Do you agree with making Title III provisions compulsory when payment service providers deal with micro-enterprises, as for consumers?

No – our view is that where the parties are not consumers, they should be free to agree not to apply these requirements.

The problem of extending the Directive to cover micro-enterprises is that it will be very hard to detect if and when a corporate client now longer qualifies because of a growth in the company’s revenue beyond the limit of micro-enterprise.

25. Do you think the UK should exercise the right to adjust thresholds for low value payment instruments in Article 34(1) for national payment transactions?

Yes. Our view is that operation of a payment service within national boundaries is an intrinsically less risky proposition than offering the same service across boundaries. Where the payment instrument has a lower risk, there is no need for onerous regulation and consequently, the payment levels should be doubled. For prepaid payment instruments the amount should be increased to 500 Euro, in line with the derogation available.

Taking up the derogations available will increase the range of potential applications for hybrid solutions and would thus be beneficial to the overall competitiveness of the market.

26. Do you agree with the approach of not imposing further requirements on conditions for termination, as provided for in the derogation under Article 45(6)?

Yes

27. Do you agree with the approach of not imposing additional requirements concerning the provision of information on paper, as provided for in Articles 47(3) and 48(3)?

Yes

28. *Do you agree with the Government's intention of disapplying access to our of court procedures only where the payment service user is corporate and not a micro-enterprise?*

No – out of court procedures should only apply to consumers, unless the parties agree otherwise. As with the response above, the size of a micro-enterprise is dynamic and it would cause unwarranted complications if the business in question expanded or contracted markedly in a way that made it metamorphose from a micro-enterprise into a normal corporate customer or vice versa.

29. *Do you agree with the approach of not exercising the derogation to forbid or limit the right of payees to request charges for payers' use of a given payment instrument?*

Yes

30. *Do you think the UK should exercise the right to reduce or increase the thresholds permitted for low value payment instruments under Article 53(1) for national payment transactions?*

The UK should increase the thresholds permitted for low value payment instruments. Please see our answer to question 25.

31. *Do you agree with the approach to derogations in relation to Article 61 of the Directive on the user's liability (i.e. to maintain current UK standards)?*

Yes – however, consideration must be given to how this will apply to hybrid accounts. The limits must not apply to transactions that are out of scope. The limits, for example, would not apply if the mobile were used to run up a telephone bill. This eventuality is covered by other regulatory arrangements.

32. *Do you agree with the approach of not legislating beyond the maximum execution times set by the Directive?*

Yes. However, where payment services are executed through hybrid institutions offered by mobile network operators, the processes do not fit within the traditional payment service model – once the consumer has confirmed payment, the relevant service will be provided immediately. However, settlement between the mobile operator and the third party service provider will take place in accordance with either an interconnect agreement (which link telecommunications networks) or a commercial contract with an aggregator- typically by the end of the month following the month in which the payment was made. Increasing settlement would not be feasible because the payments would be very small on a daily basis, which would increase the cost of providing the service. It should be noted that, for premium rate services (which we believe by definition are out of scope), the regulator Phonepayplus (appointed by Ofcom pursuant to the Communications Act) forbids settlement earlier than 30 days from the date of payment, as an anti-fraud measure.

33. *Do industry groups intend to produce codes of practice on PSD implementation for their members? To what extent can this be based on any existing trade association standards?*

If thought desirable and relevant, mobile operators can willingly (and have in relation to other matters) develop codes of practice. However, before this is done, there will need to be an assessment of where it would be useful in relation to the implementation of the PSD.

34. How do you think the PSD rules will interact with existing consumer credit legislation, and any other existing conduct of business legislation?

There is clearly a certain amount of overlap with existing business legislation – for example, a number of the information requirements are already contained in the Consumer Protection (Distance Selling) Regulations 2000 and the Electronic Commerce (EC Directive) Regulations 2002. The E-Money Directive continues to apply to e-money and to restrict mobile operators from offering innovative payment products. Along with other stakeholders, the mobile operators are keen to see an early review of the e-Money Directive so that that is permissible to offer a broader range of services. As specified above, the Phonepayplus Code also applies to premium rate services.