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## 1. E-Money Directive II

On October 13 the European Commission published a proposal[1] for an amendment of the existing E-Money Directive of 2000 (EMD – 2000/46/EC) after a long period of consultations. The Commission beliefs that the reason for the still very low volume of e-money in the European market (outstanding volume today approx. 1bn €) is the high regulatory burden based on the existing EMD and its implementation into national laws. The main amendments are:

- Compared to the originally narrower definition of e-money as monetary value stored on an electronic device (e.g. chip card), a **new broader definition of e-money** more in line with regulatory practise in member states which explicitly includes "server-based" or "account-based" payment systems (like Paypal).
- A **new prudential regime** for electronic money issuers with a substantial lower regulatory burden more or less at the same level as for payment institutions regulated by the PSD[2]: Reduction of the initial capital from 1 Mio. to 125,000 €; new calculation methods for ongoing capital requirements including the 3 methods of the PSD, application of the PSD qualitative prudential requirements, etc.
- **Extension of the commercial activities** of e-money institutions (besides issuing e-money) to all the payment services of payment institutions incl. granting credit related to payment services.

[1] Available at: http://ec.europa.eu/internal_market/payments/emoney/index_en.htm
[2] Payment Services Directive (Directive 2007/64/EC)


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Hugo Godschalk, Malte Krueger, Christoph Strauch

- Restriction of the full **redeemability requirement** for mobile payment providers and electronic vouchers.
- Lower threshold for a **waiver** at the same level as for payment institutions: outstanding e-money volume or monthly payment volume of 3m € maximum; no application of the Directive to payment instruments within limited networks or two-party systems.
- Update of the **Anti-Money-Laundering und KYC-requirements**: exemption of full customer due diligence for e-money products with a relatively low amount loaded (500 €) or with a limited transaction volume of 3,000 € p.a. (reloadable products)

***Our Comment:***

*The Commission states that the current volume of e-money is "unsatisfactorily low" and that it has not been a credible alternative to cash yet. Traditional e-money like e-purses on debit cards flopped in most of the national markets. Outside Germany and Austria, banks stopped further investments in these systems or took these loss-making products off the market (e.g. Denmark). But the European Commission is very optimistic about the future of e-money. This new regulation-light will "accelerate the up-take of e-money in Europe", Commissioner McCreevy said. The Commission expects a volume of 10bn € by 2012. We ask ourselves where the additional volume is supposed to come from: lighter regulation or more encompassing regulation? First the bulk of e-money in the market (mostly device-based) is still issued by credit institutions (approx. 70%[3]) and not by e-money-institutions. Lowering the regulatory hurdle for e-money-issuance will not affect the market penetration of these products and will not prevent the market failure of e-purses offered by banks (like the bank-issued GeldKarte in the German market). Second, in its impact assessment document the Commission expects new players and volumes from the mobile operators offering prepaid mobiles as payment instruments for other services than air time and from operators of electronic service vouchers (e.g. meal vouchers) which are still paper-based today. By extending the definition of e-money to account-based payment instruments the regulation is extended to other products in the market and therefore the volume of e-money will increase. Third, another reason for the coming "success" of e-money is the lower threshold of the waiver from 5 to 3m € issued e-money. So the waiver regime will become more stringent than it is today. An unknown percentage of the waived institutions today (approx. 125 within*

[3] Estimate of the European Commission

*the EU) will need a full licence as e-money institution. So much of the expected "success" of e-money will be due to a re-labelling of existing products as e-money.*

*The bad news of the new Directive is more regulation in the payment market – in spite of the lack of any market failures in the past - but more regulation in financial markets seems to be extremely trendy at the moment.*

*The good news about the proposed EMD II is the alignment of the e-money regulation with the PSD. It makes electronic money issuers de facto a payment institution with a special additional licence. Players in the market who have to become a payment institution by November 2009 should take into consideration to acquire this additional e-money-issuance licence, mainly without additional regulatory burden. As e-money-institutions they will be more flexible in designing new payment services including e-money. They should take into consideration that the definition of e-money will become less clear and it will be very difficult to make a clear demarcation between payment account covered by the PSD and e-money-account of the EMD II (see next topic of this newsletter).*

## 2. Account-based payment services: credit institution, payment institution or e-money-institution?

Member states are in the process of implementing the Payment Services Directive into national laws. Some countries like Germany, the Netherlands and the UK already presented drafts of the new banking and civil laws for public and parliamentary discussion. One of the main questions is the minimal prudential regime for payment service providers. Depending on the range of products or services a provider will need a full credit institution licence (e.g. deposit taking business or granting loans), an e-money-institute-licence (issuing of e-money), the newly created status of payment institution (e.g. issuing or acquiring of payment instruments) or no prudential supervision at all. After November 2009, the new payment institutions can offer payment instruments based on payment accounts and they may grant (short-term) credit in connection with the execution of payment transactions. Therefore, a clear line of demarcation is needed between traditional payment accounts which constitute deposit accounts (business restricted to credit institutions) and other payment accounts which can be offered by payment institutions too[4]. This demarcation should be the subject of the national implementation drafts because the PSD provides no clear guidance on this

[4] The same clear demarcation is needed for granting credit, which was already recognised by the authors of the PSD (Article 16).

point. At the moment, we already see different national interpretations (UK: payment institutions may offer interest bearing accounts; this is not allowed for German payment institutions).

The definition of e-money also needs to be clarified, because payment institutions are not allowed to issue e-money within the meaning of Article 1 (3) of Directive 2000/46/EC (EMD; E-Money Directive). Currently, we have one definition and many interpretations. On the one hand, there is the definition of the EMD, which is still relevant. On the other hand, we see the (different) interpretations of this definition by regulators in the national markets who extended the e-money definition within their regulatory practise from device-based (e.g. e-purses) to account-based (or server based) products (e.g. PayPal). The just published new proposal for EMD II adopts this practise by introducing the new broad legal definition of e-money (see topic 1 of this newsletter). So after implementation of PSD and EMD II we will have 3 different regulatory regimes regarding account-based payment services:

| Account Product: | **Current Account (Deposit)** | **Payment Account** | **E-Money-Account** |
|---|---|---|---|
| EU-Regulation: | Directive 2006/48/EC | Directive 2007/64/EC (PSD) | Proposal for new E-Money Directive (EMD II) |
| Licence requirement: | Credit Institution | Credit Institution or E-Money-Institution or Payment Institution | Credit Institution or E-Money-Institution |
| Demarcation line: | Lack of clear statements in the PSD; local discussions within national implementation processes of the PSD | | |
| | | No statement at all in text of both Directives (PSD and EMD II) ; No discussion yet | |

### *Our Comment*

*In the PSD we do not find a clear definition of payment accounts which would exclude account-based e-money products like PayPal. So, if a market player wants to start an account based payment product, he will not find a clear answer if this product falls under the PSD or under the new EMD. This important question - especially for the emerging market of (open-loop or semi open-loop) prepaid cards - has not yet been answered in the published drafts of national legislators for implementation of the PSD. On 23 July 2008 we raised this question on the Q&A webpage of the European Commission on the transposition of the PSD*[5]

[5] http://ec.europa.eu/internal_market/payments/framework/transposition_en.htm

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*and we are still waiting for an answer. However, we found some indications for a regulatory change of mind at national level where national lawmakers intent to include account-based products under the PSD which the Commission with its wide definition would see as e-money.*

*In the explanation of the **German** draft of the new PSD-legislation ("Referentenentwurf") the Ministry of Finance explicitly uses a narrow e-money definition (only device-based instruments – concurring with the original definition of the EMD[6]). The Ministry of Justice, however, refers to account-based e-money in its draft[7]. Some legal experts like Christian Walz[8] already stated that account-based prepaid products, which were until now regulated as e-money, will probably be payment services after implementation of the PSD in Germany.*

*In the explanation of the **Dutch** draft of the PSD implementation "Conceptwetsvoorstel"[9] there is an indication[10], that prepaid open-loop gift cards are in the scope of payment instruments which could be issued by payment institutions. Up to now, these products are considered as being e-money!*

*In its summary of consultation responses of the implementation of the PSD, **HM Treasury (UK)**[11] states that some e-money institutions are planning to become a payment institution[12]. So the question arises whether these players will stop offering e-money products. Or - more likely - do these providers have services which are no longer interpreted as e-money services (after PSD implementation)? It could be an indication of a new (more narrow) regulatory interpretation of e-money in the UK. On the other hand, the Treasury is producing some misty statements relating to "e-money accounts including pre-paid e-money accounts"[13]. So the Treasury is seeing e-money accounts which are not prepaid!!*

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[6] See:http://www.bundesfinanzministerium.de/nn_4328/DE/BMF__Startseite/Aktuelles/Aktuelle__Gesetze/Referentenentwuerfe/011__a__zahlungsdiensterichtlinie,templateId=raw,property=publicationFile.pdf, page 57

[7] But in the explanation of new law proposal of the German government of implementing the PSD regulation of payment institutions (Zahlungsdiensteaufsichtsgesetz) this narrow e-money definition is surprisingly deleted.

[8] Dippel, Frey & Walz, A Single Euro Payments Area (SEPA), in: Kontoführung & Zahlungsverkehr, Rechtsfragen aus der Bankpraxis, 3th edition, Heidelberg 2008, p. 658

[9] See: http://www.minfin.nl/nl/actueel/nieuwsberichten,2008/07/Consultatie-conceptwetsvoorstel-Europese-richtlijn.html

[10] Page 48

[11] See: http://www.hm-treasury.gov.uk/media/1/0/consult_paymentservicesdirective_response170608.pdf

[12] Page 27 and 32

[13] Page 14

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*Overall it will be very difficult to find a clear dividing line between payment accounts[14] and e-money accounts. Why is a PayPal-account still interpreted as e-money and not as a payment account covered by the PSD, which could be provided by a payment institution? Why are regulators looking at payment cards linked to an account without overdraft facility (usually named as prepaid cards) as e-money?*

*Regulators seem to be very fond of the misty criterion "prepaid" or "issued on receipt of funds". But what does "prepaid" actually mean? In a way, every account with a positive balance is "prepaid" by someone (either by the account holder or by other entities in the system). I can have a PayPal-account with a positive balance although I never paid any monetary funds to the issuer, because "e-money" could have been transferred within the system. If I open a traditional current account at a bank and deposit 100 € in cash the new starting balance is issued on the receipt of funds, so it is prepaid. Is it e-money too? Thus, it remains an open question: What are the specific criteria of account-based e-money compared to other payment accounts (with positive balances)?*

*From **a pragmatic point of view** someone could argue that this definition-issue is a more or less academic question because, after implementation of the EMD II, the regulatory burden for e-money-issuers will be lowered to the level of payment institutions. Because we do not have a clear definition of (account-based) e-money a regulator in member state A could regulate a specific payment product as e-money, in member state B exactly the same product will be regulated as payment service under the PSD. We already see this today with open-loop prepaid cards with international brands like Visa or MasterCard (e.g. e-money in Italy[15]; no e-money in some other member states). Thus, the result would not be the intended harmonisation within the EU. Based on the existing unclear definition of e-money and the not-harmonized regulatory practise of the national prudential regimes, there is no correct statistical overview of the existing e-money (balances or activities) within the EU. After implementation of EMD II it will be even more difficult or even impossible to monitor e-money and distinguish it from other means of payment. Moreover, any comparison between member states will make no sense.*

*From **an evolutionary point of view** the only new characteristic of e-money was the decentralised storage of monetary value on an electronic device (e.g. chip) held by the owner as a bearer instrument without the necessity of an account! The lack of necessity of a*

[14] Definition of the PSD: „payment account means an account held in the name of one or more payment service users which is used for the execution of payment transactions" (Article 4 (14))
[15] This interpretation makes Italy to the European e-money-leader with a market share of 65% of total European e-money transaction volume!

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*payment account is the essential criterion of e-money. If you lose the e-money bearer instrument (for instance your e-purse), you will lose the money, just like in the case of traditional cash. E-money, properly defined, is not an access instrument to a payment account like debit cards, credit cards and prepaid cards.*

*In the current transition period of the implementing of the PSD on national level and proposing a new EMD on European level it makes sense to return to the traditional (narrow) e-money definition and to put all the account-based payment systems into the list of payment services that can be offered by the new payment institutions. In this case you would have a clear definition of e-money, a full harmonised e-money prudential regime in the EU-member-states, a fine-tuned monitoring of the real e-money and a lower regulatory burden for all the existing e-money-issuers (device- and account-based products).*

## 3. PSD implementation: German government takes a restrictive view

In Germany, PSD implementation has been split into two parts: the rules relating to payment oversight (mainly the introduction of the payment institution) and the rules relating to rights and obligations of payment users. For the first part, the German government has passed a draft (prepared by the ministry of finance) that will be passed on to the German parliament.[16] If the parliament approves the draft, a quite restrictive interpretation of the PSD will become law in Germany. In particular ATM business will remain “credit business”. As to cash-back, it is open to interpretation how far cash-back at the POS will be exempted from banking regulation. Finally, given the current institutional set-up of the German debit card and ATM systems, it is not clear whether these systems are “schemes” in the sense of the PSD. Thus it is not clear whether the participating banks will have to grant access to payment institutions.

***Our comment:***

*One of the aims of the PSD was, to increase competition in the payment sector.Finally, a new institution was created, the “payment institution”. This institution should be allowed to*

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See http://www.bundesfinanzministerium.de/nn_1928/DE/BMF__Startseite/Aktuelles/Aktuelle__Gesetze/Gesetzentwuerfe__Arbeitsfassungen/058__Entw__Zahlungsdienste__anl,templateId=raw,property=publicationFile.pdf

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*provide payment services so far reserved to banks. Moreover, payment institutions should have access to "payment schemes". Finally, the PSD enumerates a number of services that should not fall under payment regulation. It appears that German law makers do not share this vision. In important aspects, they have chosen very restrictive interpretations of the PSD. Most importantly, the draft interprets article 3 (o) which exempts cash withdrawal services at ATMs from the provision of the directive to apply only to outsourcers who provide services on behalf of licensed credit institutions.*[17] *Thus, cash provision at ATMs remains a business confined to fully licensed banks. As in the PSD, cash-back is included in the catalogue of activities that do not fall under the regulation of payment services. However, the commentary stresses that the current practise of German banking regulators to view cash-back as credit business will be upheld in the future if transactions are based on electronic direct debits. So, clearly, cash-back based on an ELV transaction is credit business. With respect to ec cash transactions and credit card transactions, the regulation is less clear. In the past, retailers wishing to offer cash-back based on ec cash had to apply for an exemption from banking regulation which was granted under restrictive conditions.*[18]

*Banks are concerned that the introduction of the new "payment institution" will increase competition in the fields of payment. If regulators around Europe follow the German example, banks do not need to worry too much.*

*Finally, as an aside, it is interesting to note that the commentary accompanying the law explicitly states that the national implementation of the PSD implies that the German direct debit does* <u>*not*</u> *have to be discontinued.*

## 4. Spain: Servired and 4B join processing forces

The two Spanish schemes Servired and 4B are starting negotiations about a merger of their processing units Sermepa and Redes y Procesos.[19] Both players are pointing to the consolidation process in European processing and the need to gain scale. Currently, Servired has a market share of approximately 60% and 4B a share of approximately 25%. The remaining 15% are covered by the scheme of the savings banks, Euro6000.[20] Based on

[17] See Gesetzentwurf, Zahlungsdiensteaufsichtsgesetz (ZAG) §1 (10) 14 and the accompanying commentary.

[18] Cash-back may be given only if there is an accompanying purchase of at least 20€ in value. the value of the cash-back transaction is limited to 100€.

[19] See http://www.servired.es/espanol/indexx.htm

[20] Some of the larger savings banks have joined Servired a few years ago.

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current figures, the merged entity would process about 3.5bn transactions a year. For the moment, however, it is not planned to merge the two schemes.

***Our comment:***

*Things are evolving quickly in Spain. Not long ago, both 4B and Servired implemented the separation of processing and scheme – one of the criteria for "SEPA compliance" set out in the SEPA Cards Framework (SCF). Now they are moving towards a merger of the processing units. If completed, this merger will result in a large processor, even on a European scale. It will also leave the third Spanish scheme, Euro6000, which has a market share of only 15%, in an uneasy position. For the Spanish savings banks there are basically three options:*

- *join processing forces with Sermepa and Redes y Procesos,*
- *sell the processing unit to one of the large third party processors*
- *play the European card.*

*From a European point of view, the third option is the most interesting. Euro6000 is already part of the Euro Alliance of Payment Schemes (EAPS) and Eufiserv. Eufiserv (and its 15 shareholders) have recently joined forces with First Data.[21] The aim is to connect national card payment and ATM systems and eventually create a new integrated European scheme. This would be another way to gain the economies of scale deemed necessary in the evolving European market. Moreover, it would be a decisive step away from more or less national solutions.*

## 5. European retailers criticise MasterCard's new acquirer fees

On October 1st, MasterCards new fee structure for volume and cross-border fees became effective. The new structure implies higher fees for acquirers. Retailers throughout Europe have been quick to criticise this step. For instance, Xavier Durieu of EuroComemrce states that the fee rise is an "attempt by MasterCard to circumvent the Commission's decision against their cross-border interchange fee."[22] Similar statements have been made by the

[21] See "First Data acquires stake in Eufiserv", SEPA Newsletter June 2008.
[22] http://www.eurocommerce.be/content.aspx?pageId=41316

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British Retail Consortium (BRC) and the German Retailers Association (HDE).[23] According to retailers, fees have risen up to 160%. According to Peppi Kiviniemi from MarketWatch.com, EU antitrust authorities are looking into the case.[24]

***Our comment:***

*When expressed in relative terms, the fee hike seems impressive. However, it has to be taken into account that it starts from a relatively low base since, so far, schemes have derived their revenue to a larger extent from issuers. Moreover, some of the fee changes only apply to cross-border transactions. Thus, in absolute terms, the increase looks much less impressive.*

*Still, the retailers' reactions can be understood. Even if it is only a small fee hike, it may be an attempt to "test the waters". If competition authorities stay put, more fee increases may be in stock.*

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[24] http://www.paymentsnews.com/2008/10/eu-studying-new.html