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1. Apple PAY: another chapter of the m-payment saga

On September 9, 2014 Apple announced its debut in m-payments: Apple Pay.[1] In October Apple Pay will be available in the US. It will work on the new iPhone 6 and the Apple Watch. Moreover, it is compatible with the iPhone 5, iPhone 5c and iPhone 5s. It allows its users to make contactless payments at the POS.

Apple Pay relies on an NFC antenna and a secure embedded chip (secure element). Its Passbook software allows users to store multiple payment cards on the secure element alongside loyalty cards, boarding passes, coupons, etc. When using an iPhone the user can rely on Apple's Touch ID for authentication. However, when using the Apple Watch, this security feature is not available, users simply have to double-click.

Like other initiatives, Apple Pay tries to replace the plastic card at the physical POS. It is noteworthy, however, that Apple does not simply put a tow into the water. Rather it takes a determined step, partnering with the main card schemes, American Express, MasterCard and Visa, and most of the large bank card issuers in the US (including Bank of America, Capital One Bank, Chase, Citi and Wells Fargo).

Apple will not be involved in the payment flow and will not track customer transactions. Thus, for the moment it acts more like a technical service provider. However, it is remunerated with a considerable fee – 0.15% according to press articles.[2]

Our Comment

Apple, the iPhone, NFC and payments – there have been rumors, speculations, predictions en masse. Finally, Apple made a move. To be sure, this is another example of the "Apple

[1] Apple Announces Apple Pay (https://www.apple.com/pr/library/2014/09/09Apple-Announces-Apple-Pay.html)
[2] Kelly Fiveash: Apple Pay is a tidy payday for Apple with 0.15% cut, sources say, The Register, 13 Sep 2014 (http://www.theregister.co.uk/2014/09/13/apple_to_get_15_cents_for_every_100_dollar_payment_on_its_pay_service_says_ft/)

way of doing business". No half-baked product, no little pilot. Right from the start, Apple has the big guys on board.

Compared to other contenders, however, Apple is entering the market fairly late. Some large US telecommunication operators have teamed up with a number of banks to create ISIS, which has been in the market for some time. However, for obvious reasons ISIS has been unhappy with its brand name and recently re-branded to "Softcard". This certainly is not helpful but other impediments such as limitations on the types of phones and mobile networks have also been at work.

Google also has been in the market for some time. Considering that Google's smart pone operating system Android is the clear market leader with a much higher market share than Apple's iOS, Google certainly is a formidable competitor. However, so far, its endeavors have not been a smashing success. PayPal also tries to migrate into the real world allowing POS payments via "PayPal Here". Moreover, in partnership with Samsung, PayPal also has introduced touch sensors to authenticate payments.[3]

Apple's move has been heralded as "New Era at Cash Register".[4] *But what exactly is going to change? If Apple (and other contenders) were successful, cards would be replaced to some extend by smartphones. But that does not mean that the traditional players of the large 4-party card schemes will also be replaced. For the moment, Apple relies on these players to deliver its payment service. Apple itself provides a wallet that contains card credentials that can be used for payments. Unlike PayPal, Apple is not integrated in the payment flow. Apple does not provide e-money or payment accounts. In this sense, the Apple wallet is more like a "container" whereas the PayPal wallet includes PayPal branded payment services. This matters from a business as well as a regulatory point of view. Apple is unlikely to fall under payment regulations and does not pose a threat to financial institutions, yet.*

There is a hitch, however. If press reports are to be believed, Apple receives a hefty fee of 0.15% for providing "container services" (or "wallet services"). The mere fact, that Apple has been able to negotiate such a high fee already shows its strong position vis-á-vis the banks. If Apple Pay were to become a success and a significant share of consumers were to use it, Apple's service as a kind of gatekeeper would be even more valuable. The banks would be

[3] PayPal did this in a partnership with Samsung. This partnership apparently has led Apples to stop talks about including PayPal in Apple Pay.
[4] Mike Isaac: Apple Pay Signals New Era at Cash Register, New York Times Online, Sept. 30, 2014, http://www.nytimes.com/2014/10/01/technology/apple-pay-signals-new-era-at-cash-register.html

more and more dependent on Apple. So far, banks have always tried to avoid such a position of dependency. In the past, this has been a major stepping stones in joint projects between telecommunication operators and banks. Banks were hesitant to put payment applications on operator controlled SIM cards. In particular, they did not like the idea of having to pay operators for using the SIM. Now, in the end, this is the model they have agreed upon with Apple. Maybe in the future there will be a similar deal with Google. But will the banks be happier and less dependent with these two giants as partners than they would be with the operators?

For now it is still too early to predict whether Apple Pay will actually fly. Apple points out that Apple Pay can be used in over 220,000 merchant locations equipped with NFC terminals. However, given that the large card payment processor and acquirer First Data alone serves 3.9 million merchant locations in the US, this is only a small fraction of the market. Thus, a significant replacement of cards by mobile phones seems a long way off. Worse, in spite of the customary user friendliness of Apple products, customers may be disgruntled by the lack of acceptance points and finally quit using m-payments.

2. Amazon´s interpretation of “e-money”

Do you have a shop on the Amazon platform? If so, you recently may have received an email from the platform provider Amazon Services Europe. As seller you need a “seller payment account” held at the e-money institute (EMI) Amazon Payments Europe s.c.a. (authorized by the Commission de Surveillance de Secteur Financier CSSF in Luxemburg). To open such an account, Amazon has to verify the identity of the seller according to the rules of the third European AML-Directive. In an online process, the seller has to provide ID card data. In addition, Amazon makes a credit transfer of a few cents to the bank account of the seller to verify that the seller has access to this bank account. After that, the new seller account will be activated. The user agreement does not state explicitly whether the funds in such a seller account are e-money or not. However, if you are accepting “pay with amazon” in an e-shop on your own website, the seller payment account is definitely regarded by Amazon Payments Europe as an e-money account.

Amazon EU (not Amazon Payments Europe) is issuing the Amazon gift card, which can be used as means of payment at Amazon, but also at other retailers on the Amazon-platform.

Although this prepaid card can be used for payment transactions in an open-loop environment (three-party), the card is explicitly not regarded as e-money by Amazon, although Amazon has a licensed EMI subsidiary (Amazon Payments Europe). Several regulators in the EU (outside Luxemburg) are regarding this card as being e-money, but are hesitating to take legal action.

Our Comment:

Like Amazon several e-platform service providers are involved in the payment flow between its users e.g. Uber, Airbnb, Rakuten. The buyer is transferring funds to the provider via credit card, direct debit, Paypal etc. Usually, the provider disburses these funds to the payee (after deduction of fees) periodically. From a regulatory point of view the critical issue is that the platform provider has access to the funds, even if this access is limited to a short time during the payment chain between payer and payee. Within the EU, such payment services are usually subject to the Payment Services Directive (PSD), even if regulatory authorities in some Member States are tolerating these services as being "out of scope" (according to their national implementation of the PSD). Two years ago, Ebay withdrew its envisaged escrow services for its platform after learning that in needed at least a license as a Payment Institute (PI). To bypass the regulatory requirement of establishing an authorized PI, some platforms made complex legal constructions (based on collection services or factoring), but regulators don´t like this circumventions. Others, like Uber, are offering their services in Member States without even considering this legal hurdle.

However, Amazon Payment Europe has performed its compliance job well. It is an e-money institute, licensed in Luxemburg by the CSSF. In addition to the issuing of e-money, it is authorized to carry out the payment services according to the PSD, like the execution of payment transactions (credit transfer, direct debit or card-based), even if the funds are covered by a credit line, and money remittance. Amazon does not allow users to transfer traditional money into their own account held with Amazon. Therefore, according to the second E-Money Directive II (2009), funds in these accounts are not e-money. The essential "prepaid"-criterion of e-money "issued on the receipt of funds for the purpose of making payment transactions" is not applicable. The payer is transferring funds to Amazon by using the Amazon digital wallet and Amazon is transferring the funds to the payment account of the seller.

Things are changing if a seller is offering goods and services via his own website. In this case, based on the user agreement of Amazon, e-money comes definitely into play when the Amazon wallet (pay with Amazon) is used. According to the user agreement, payer and payee are holding e-money in their accounts. The seller is receiving e-money, but he cannot use this e-money for other payments. Interestingly, the flow of funds (payer to Amazon; Amazon to payee) remains exactly the same as between buyers and sellers on the Amazon platform. So, how does e-money come into existence in this model? If the seller receives e-money in his account, the e-money must be issued by Amazon Payments Europe somewhere in the payment chain. This creation of e-money could probably be interpreted as a "transubstantiation" of traditional money into e-money during the payment initiated by the payer using its Amazon wallet. During a millisecond the account of the payer is loaded with e-money and in the same time unloaded by transferring the e-money to the account of the seller, irrespectively of the money-flow between the payer and Amazon, which occurs definitely later (if the wallet is funded by credit card or in some countries by direct debit). But based on the usual interpretation of the e-money regulation (EMD II), e-money can only be issued "on receipt of funds" by the issuer or its agents ("prepaid"). Is Amazon issuing e-money on credit? Is e-money still "prepaid"?[5]

Let´s think about the reason why Amazon is regarding this payment service (subject to the PSD) as e-money (subject by the EMD II), although it is obviously not e-money according to the legal definition. Several reasons come to mind:

- *e-money is still exempted from the AML-requirements regarding KYC depending on loading amount thresholds (simplified due diligence). By defining the accounts as e-money-based, the provider could have a benefit regarding the AML-requirements. But these exemptions will probably be amended in the coming Fourth AML-Directive.*
- *Amazon is starting its wallet without the possibility of having prepaid funds in the account of the payer (buyer). Other digital wallets, like ClickandBuy, Yapital or PayPal, do have the option to hold funds paid in by the account holder respectively are offering P2P payments. Amazon may intend to extend the product features of its wallet, for which an e-money license is required.*

As consequence funds are legally interpreted and regulated as e-money which are not e-money according to the legal definition. Some national regulatory authorities obviously do

[5] Other regulatory questions (e.g. the restricted redeemability of the e-money in the Amazon account of the seller) are not to be discussed here.

accept this self-designation by payment service providers, watering down the legal e-money definition.

What about the open-loop gift card of Amazon? It seems to fulfill all the legal criteria of the e-money definition. But is the gift card really accepted by merchants on the Amazon-platform? You can use the gift card for paying Amazon Services Europe on the Amazon platform or to pay Amazon Payments Europe to fund your wallet for payment transactions on other websites by using “pay with amazon”. Merchants are accepting “pay with Amazon”. They are not accepting the gift card or any other payment instrument used by a buyer to fund his Amazon wallet. Merchant even have no knowledge about the funding method of the wallet-transaction. From this perspective, the Amazon gift card, issued by Amazon EU is accepted by Amazon Services Europe and by Amazon Payments Europe, but not by merchants. Thus, the Amazon gift card looks more like a “semi-open-loop” gift card used within the Amazon Group, which could be exempted as limited network from falling under the e-money regulation.

E-money started two decades ago as a real digital bearer instrument (digital cash and token-based e-purses). Today, e-money chiefly consists of funds held in closed payment account schemes which are not directly linked to the traditional interbank current account schemes. The designation is still fluent. E-money is whatever is labeled as e-money. The legal definition lags behind the evolution in the payments market.

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