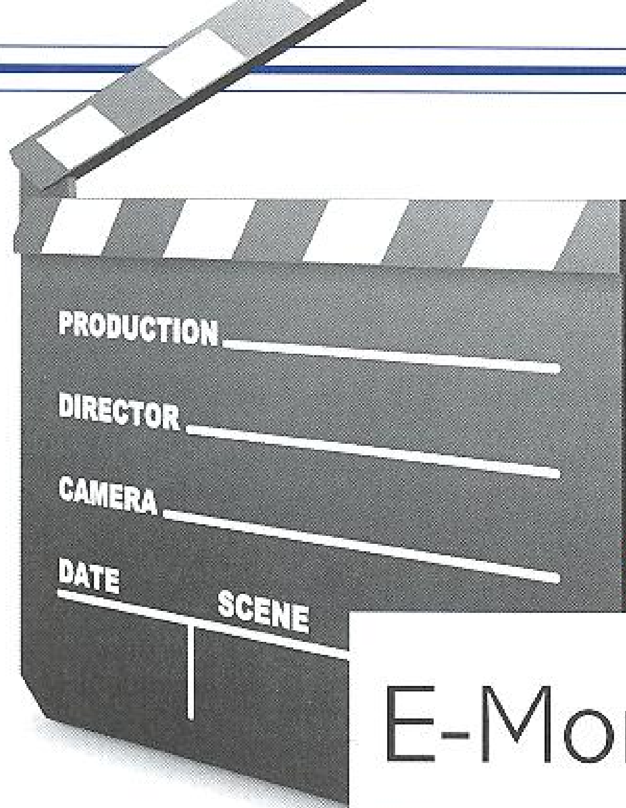

E-Money Directive
TAKE TWO

Revised reg could open doors to innovation, but serious implementation questions remain

VIEWPOINT

By Monica Monaco, Senior Manager, EU Relations/Regulatory Affairs, Visa Europe

The payments industry in Europe is focused on the implementation of the second E-Money Directive (Directive 2009/110/EC).

The first E-Money Directive (Directive 2000/46/EC) was adopted in response to the emergence of new prepaid electronic payment products and was intended to create a clear legal framework designed to strengthen the internal market while ensuring an adequate level of prudential supervision.

In its review of Directive 2000/46/EC, the European Commission (EC) highlighted the need to revise that directive since some of its provisions were considered to have hindered the emergence of a true single market for electronic money services and the development of such user-friendly services.

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The second E-Money Directive was adopted on Sept. 16, 2009, published in the *Official Journal of the European Union* on Oct. 10, 2009, and adopted and published by all the European Union Member States on April 30, 2011, at which time the first E-Money Directive was repealed.

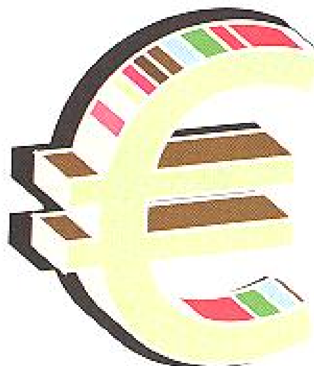
In my role at Visa Europe, I am charged with providing timely and relevant information to my colleagues at Visa, our members and the broader industry on the regulatory environment for payments. At the same time, I spend much of my time ensuring that individuals within the EC and the European Parliament understand the way Visa Europe operates, is governed, our points of view and, of course, our products and innovations.

I have been working on the second E-money Directive review for more than three years now. First, during the various phases at the European level and now, following the implementation process at the national level in a number of Member States, with particular attention to how each Member State will use the flexibility provided by the directive text.

Visa Europe shares the EC's hope that such implementation will reflect technological changes and promote innovation while increasing competition in the market. At the same time, it should modernize the rules for e-money issuers and align them with existing rules for payment service providers.

Open to Misinterpretation

Despite the potential benefits of the new regulation, there are areas in the text that could be more precise.



A critical aspect of the directive text in respect to its business implementation is the clear definition of what is excluded from the directive's scope, and, in particular, the description of what constitutes a limited network. Article 1(4) of the second E-Money Directive states that the directive does not apply to monetary value stored on instruments that qualify as limited networks. The wording mirrors Article 3(k) of the Payment Services Directive, to which Visa Europe previously had voiced certain reservations. At Visa Europe we believe the definition of a limited network should be as firm and clear as possible to allow a level playing field for all the stakeholders present in the e-money sector and to ensure legal certainty.

The term "limited network" is insufficiently clear, as it is very difficult to determine when a network is limited and when it is not, and thus, when a network would qualify for the exemption. In addition, it is difficult to determine when a limited network has expanded so that it falls outside the exemption and also who would be responsible for such a determination.

Some guidance on what could practically constitute a limited network comes from Recital 5[1] to the directive, which lists store cards, petrol cards, membership cards, public transport cards, meal vouchers and vouchers for services as examples of limited networks. But the list is not defined as exhaustive, leaving room for misinterpretation.

Furthermore, the second part of the recital indicates that "where such a specific-purpose instrument develops into a general-purpose instrument, the exemption from the scope of this directive should no longer apply" since "instruments which can be used for purchases in stores of listed merchants should not be exempted from the scope of this directive."[2] This is because such instruments typically are designed for a network of service providers that is continually growing. Hence, the recital text itself recognizes the difficulty in drawing a line between what does and does not constitute a limited network.

To add to this uncertainty, the recital does not constitute binding European Law, as a recital is equal to a simple interpretative note in European Law. The problem of how to define a limited network is consequently left to the Member

In Viewpoints, prepaid and stored value professionals share their thoughts and perspectives on the industry. These are not necessarily the viewpoints of Paybefore.

IMPORTANT DEFINITIONS
FROM DIRECTIVE 2009/110/EC, ARTICLE 2

Electronic money institution means a legal person who has been granted authorization under Title II to issue electronic money. E-money issuers can be credit institutions, electronic money institutions, post office giro institutions that are entitled under national law to issue electronic money, the European Central Bank and national central banks when not acting in their capacity as monetary authority or other public authorities; Member States or their regional or local authorities when acting in their capacity as public authorities.

Electronic money means electronically—including magnetically—stored monetary value as represented by a claim on the issuer which is issued on receipt of funds for the purpose of making payment transactions as defined in point 5 of Article 4 of Directive 2007/64/EC, and which is accepted by a natural or legal person other than the electronic money issuer.

Average outstanding electronic money means the average total amount of financial liabilities related to electronic money in issue at the end of each calendar day over the preceding six calendar months, calculated on the first calendar day of each calendar month and applied for that calendar month.

Limited network As defined by Article 3(k) of the Payment Services Directive (Directive 2007/64/EC), a limited network provides services based on instruments that can be used to acquire goods or services only on the premises used by the issuer or under a commercial agreement with the issuer either within a limited network of service providers or for a limited range of goods or services.

States in the implementation process. To date, the U.K. Financial Services Authority has issued guidance in this respect, providing a list of products that can be regarded as limited networks. Such guidance is different from the Recital 5 list, in the sense that it mentions many factors that may be used to distinguish between what is and what is not a limited network, e.g., the number of service providers involved, the scale of the services provided, whether membership of the network is open ended, the number of clients using the network and the nature of the services being offered.

Most other European Member States have not expressed their opinions in this respect yet, while one Member State is currently looking at how to make the definition of limited networks in Article 1(4) more precise. This could be achieved, according to the aforementioned Member State, by the addition of a reference to the maximum chargeable amount on the prepaid instrument, in order for the prepaid instrument to qualify as a limited network.

The lack of common criteria on this aspect of the directive could develop into a major problem, as the establishment of common objective criteria would be fundamental to preserving a level playing field. In our view, it is difficult to link the notion "limited" to size. Any attempt by Member States in the Payment Services Directive context to quantify the notion of "limited" has encountered resistance from the EC based on the harmonization principle. Therefore, capping the number of merchants that would allow a network to qualify as limited does not seem to be a possible solution.

At the same time, obviously there is a specific technical point beyond which it becomes unsustainable to manage a limited network with the "limited" structure it has to run the network in question. One possibility may be to use the closed-loop versus open-loop argument as a common criterion. A closed loop is a limited network. When the closed loop expands considerably, there is a point at which operating as a limited network is no longer possible from a technical perspective, and the network ceases to be limited and becomes open. Once this is the case, the limited network exemption no longer would be applicable in the prepaid products context.

Issues over Expiration

Another relevant aspect of the second E-Money Directive is the prescription period and redeemability for prepaid products in Article 11. Article 11(2) requires that

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> "The implementation of this aspect of the directive across Europe could therefore result in 27 different capital regimes for small e-money institutions."
>
> —*Monica Monaco, Visa Europe*

Member States shall ensure that, upon request by the electronic money holder, electronic money issuers redeem, at any moment and at par value, the monetary value of the electronic money held. Article 11(4) requires then that redemption may be subject to a fee only if stated in the contract and only in any of the following cases:

(a) Where redemption is requested before the termination of the contract;

(b) Where the contract provides for a termination date and the electronic money holder terminates the contract before that date; or

(c) Where redemption is requested more than one year after the date of termination of the contract. Any such fee shall be proportionate and commensurate with the actual costs incurred by the electronic money issuer.

There are many concerns in the industry about the redeemability provision, as the extension of time now provided has a significant impact on the business case for a large proportion of e-money issuers. Not only could the business case for gift cards no longer exist if a prescription period for redeemability rights is not established, but any issuer that is using a processor will be subject to account fees for an indefinite period of time to cover the maintenance of dormant accounts still in the system. As a result, issuers will be less interested in entering the e-money market.

Such a situation appears to be in clear contrast to the EC's aim to ensure that the implementation of the second E-Money Directive promotes innovation and increases competition in the market. Consequently, Visa Europe believes that a prescription period should be established, particularly since in many European countries there are no existing regulations or legislation to cover the expiration of dormant accounts.

The decision as to when exactly such a prescription period should start also is very important, in view of the practical implementation of the directive by the industry. Such a period, in our view, should date from the moment the e-money is no longer available for payment transactions as it has expired—not from the moment when the demand for repayment is formulated, as a demand for reimbursement potentially could arise at any point in time, even after the expiration of the e-money value.

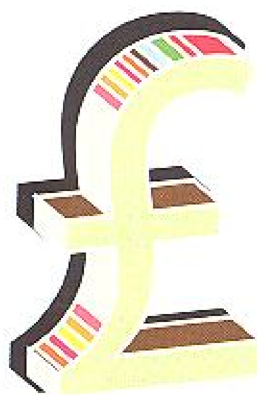
Capital Requirements

A third aspect of the directive, which seems to raise concern from a commercial perspective, is the capital requirements for small e-money institutions and the waivers such institutions may benefit from, according to Article 9 of the directive. According to Article 9, Member States may waive the application of all or part of the procedures and conditions set out in Articles 3, 4, 5 and 7, with the exception of Articles 20, 22, 23 and 24 of Directive 2007/64/EC, and allow legal persons to be entered in the register for electronic money institutions if both of the following requirements are met:

(a) The total business activities generate an average outstanding electronic money that does not exceed a limit set by the Member State but that, in any event, amounts to no more than €5 million (US$7.2 million); and

(b) None of the natural persons responsible for the management or operation of the business has been convicted of offenses relating to money laundering or terrorist financing or other financial crimes.

Some Member States already have declared themselves against the use of such a waiver. We understand that it will be offered as an opportunity for e-money issuers in Member States, such as the U.K., but not offered to e-money issuers in other countries such as Portugal. Some Member States, for instance Ireland, have been consulting on the proposal to have €350,000 (US$504,300) as the initial and ongoing capital requirement for small e-money issuers, while other Member States, such as the U.K., would prefer €75,000 (US$108,000) as the capital requirement. The implementation of this aspect of the directive across Europe therefore could result in 27 different capital regimes for small e-money institutions.

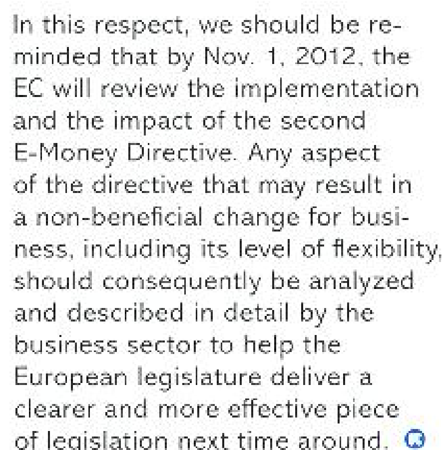


During the Payment Services Directive negotiations, Visa Europe put forward strong arguments to the EC in favor of higher initial capital requirements and of stricter methods for calculation of payment institutions' own funds to create a truly level playing field among payment service providers and to better reflect the risks that payment institutions' activities could entail. We, therefore, believe that as far as initial and ongoing capital requirements for small e-money issuers are concerned, this should be looked at from a risk perspective when such institutions could ask, according to Article 28 of the Payment Services Directive, for membership to a payment system.

Furthermore, in the current financial climate, capital requirements for banks are under review, despite their level being considerably higher and more clearly related to risks inherent to the banks' activities than the capital requirements proposed for e-money institutions. Experience has shown us that entities with low capitalization are unable to cope when they run into difficulties. We, therefore, believe the capital requirements should take into consideration such elements.

Our View

Leading up to the April 2011 implementation deadline, all Member States had been preparing, albeit at different speeds. While Member States opt for workable solutions at a national level on the aspects left open by the flexibility of the directive text, businesses will have to implement the directive, translating its provisions into procedures and decisions. Such an exercise is likely to be particularly difficult for businesses operating cross-border in Europe, as the flexibility in the text of the directive may result in quite divergent national laws on e-money.



In this respect, we should be reminded that by Nov. 1, 2012, the EC will review the implementation and the impact of the second E-Money Directive. Any aspect of the directive that may result in a non-beneficial change for business, including its level of flexibility, should consequently be analyzed and described in detail by the business sector to help the European legislature deliver a clearer and more effective piece of legislation next time around.

Based in Brussels for the past eight years, Monica Monaco is responsible for the relations of Visa Europe with the relevant EU institutions, such as the European Commission and the European Parliament, as well as with various national regulators. Monaco's areas of focus are payment systems, consumer credit, e-money, contactless payments, e-commerce and financial education. Before joining Visa Europe, she was a consultant for Andersen, Deloitte & Touche and the OECD in Paris, dealing with a variety of financial services matters. She can be reached at monacom@visa.com.

ENDNOTES

1. Recitals, also known as "whereas" clauses, appear in contracts as well as legislation, although not all legislation contains recitals. Recitals are also a feature of European Commission (EC) legislation. Recitals in EC legislation must specify the reasons the operative provisions were adopted and, if they do not, the legislation is void. Although EC recitals have no legal value and cannot be the cause of derogation from an operative provision, they nevertheless create legitimate expectations.
2. Recital 5, Directive 2009/110/EC of the European Parliament and of the Council of Sept. 16, 2009.