Mobile Payments: Global Markets, Empowered Consumers and New Rules?

Observations on an evolving regulatory landscape:
the 1st and 2nd E-Money Directive
and the Payment Services Directive

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Thaer Sabri

Chief Executive

Introduction

- The Electronic Money Association
- Overview of the payments regulatory landscape in the EU
  - The E-money Directive - a significant step
  - The Payment Services Directive (PSD), a new regime for payment service providers
- The parallel business evolution of alternative payment products, including mobile
- The new E-money Directive, lessons learnt
- Opportunities
- Summary

Members of the EMA

The EU regulatory landscape – an overview

- Up until 2000, payments provision was not regulated in a harmonised manner – no EU wide legislation
  - Money transfer was for example regulated as a banking activity in some member states, and financially unregulated in others
  - Prepaid payments were regarded as the **domain of banks**

- In 2000, the **E–money Directive (EMD)** created a carve-out from banking; establishing electronic money issuers; as a new type of CI

- This created the opportunity for new players to enter the marketplace
  - We now needed a **business case and a compelling consumer proposition!**

The EU regulatory landscape – an overview

- At the end of 2007 harmonisation was extended to other payment services, and the **Payment Services Directive (PSD)** was born. Intended to encourage the creation of the **Single Euro Payment Area**. It achieved three objectives:
  - It created a new type of FI known as a **Payment Institution (PI**)
  - It applied **conduct of business (COB)** rules that to all payments
  - It prohibited **discrimination** on membership of payment systems

- In 2009, the E–money Directive was updated and revised, including a provision for issuers to offer all payment services offered by a PI

PSD, summary of COB provisions

- **Disclosure** obligations:
  - Contract and transaction related
  - Interest rates, FX , amounts transacted, sent, received etc.
- Right to have **unauthorised transactions** refunded immediately; burden of **proof on payment service provider** (PSP);
- Rights in relation to **non execution and defective execution**
- **Transactions to be completed** within time limits (T+3, +1)
- **Notice periods** for changes to contract terms and to termination
- Right to **out of court** dispute resolution

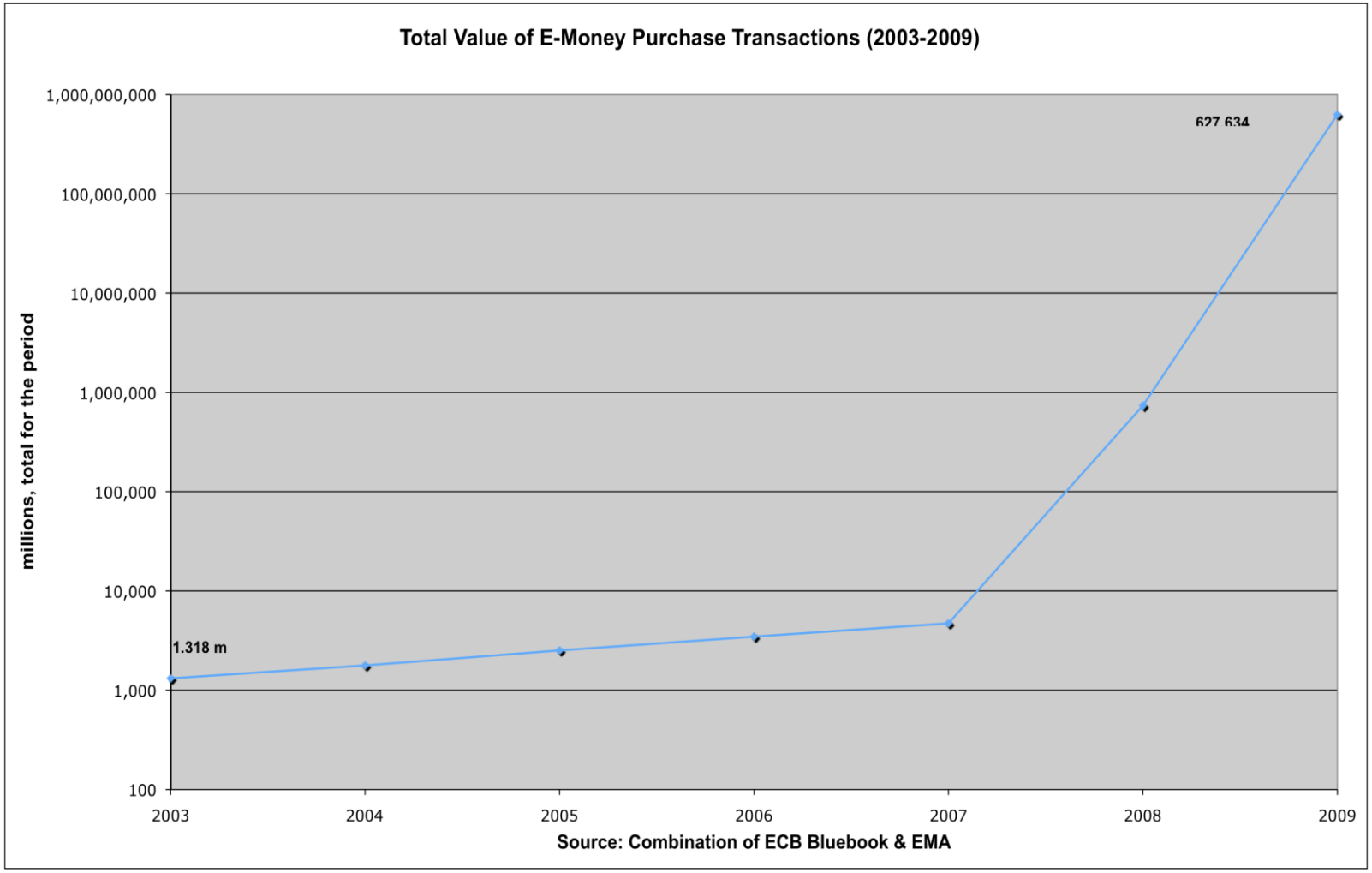
EMD, summary provisions

- The EMD provides the regulatory regime for **prepaid payment** products
  - That is, products where funds can be held on an account on an ongoing basis; rather than used immediately
- It creates the concept of an **E-money Institution**
  - Also that of a partly exempted (**small**) E-money Institution
- It sets out the **prudential regime** for supervision:
  - Capital requirements, safeguarding, permitted activities, authorisation and supervision
- It also deals with **redemption rights,** fees and dispute resolution

What happened to business?

- Pre-EMD (1990's) e-money issued by banks met with **limited success**, with take up however being significant at 'unattended terminals'
- Then **the Internet** happened!
  - eBay and PayPal
  - Online **gambling** and with it a group of e-wallet providers
  - Money **remittance** where the source of funding was electronic; and the relative cost could be significantly undercut
  - Prepaid **electronic vouchers**, where funding was with cash and vouchers could be used to make purchases online
  - Prepaid **cards** are beginning to gain acceptance in niche propositions;
- To date, **no** general **substitution of cash** for e-money

Growth in prepaid market 2003-2009



What happened to business?

- EMD and the mobile experience:
  - The consumer payment proposition had, up until that time been focused on **handset and network consumed services**; and payments were made using Premium Rate Services (PRS), and Reverse Charge SMS
  - The EMD definition of e-money suggested the regulation of the entire prepaid airtime float; where payments were made to third parties
  - It also potentially impacted the revenue models for PRS

What happened to business?

- The mobile experience…
  - MNO's sought an exemption from the Directive, carving out digital goods and services. Money transfer was not exempted, nor were payments for physical goods: see Guidance Note:

http://ec.europa.eu/internal_market/bank/docs/e-money/guidance_en.pdf

  - This exemption was **carried-through** to the new EMD and PSD
  - The question that remains, is whether the exemption from regulation has had **a positive or a mixed effect** on the scope of payment services offered, favouring digital goods and services

Industry challenges along the way

- E-money issuers identified a number of challenges, and began to address them:
  - **AML** and obligation to **verify identity** at the outset
    > developed de minimus based on **risk sensitive** regime; then included in the Third Money Laundering Directive
  - Approach to supervision and the **degree of engagement** by regulators; industry engaged with regulators:
    > The **UK stole a march** and became the location of choice for e-money issuers
  - Enabled resolution of **business and prudential policy** issues
- The result has been a maturing alternative payment industry, but limited **financially** regulated mobile payment service

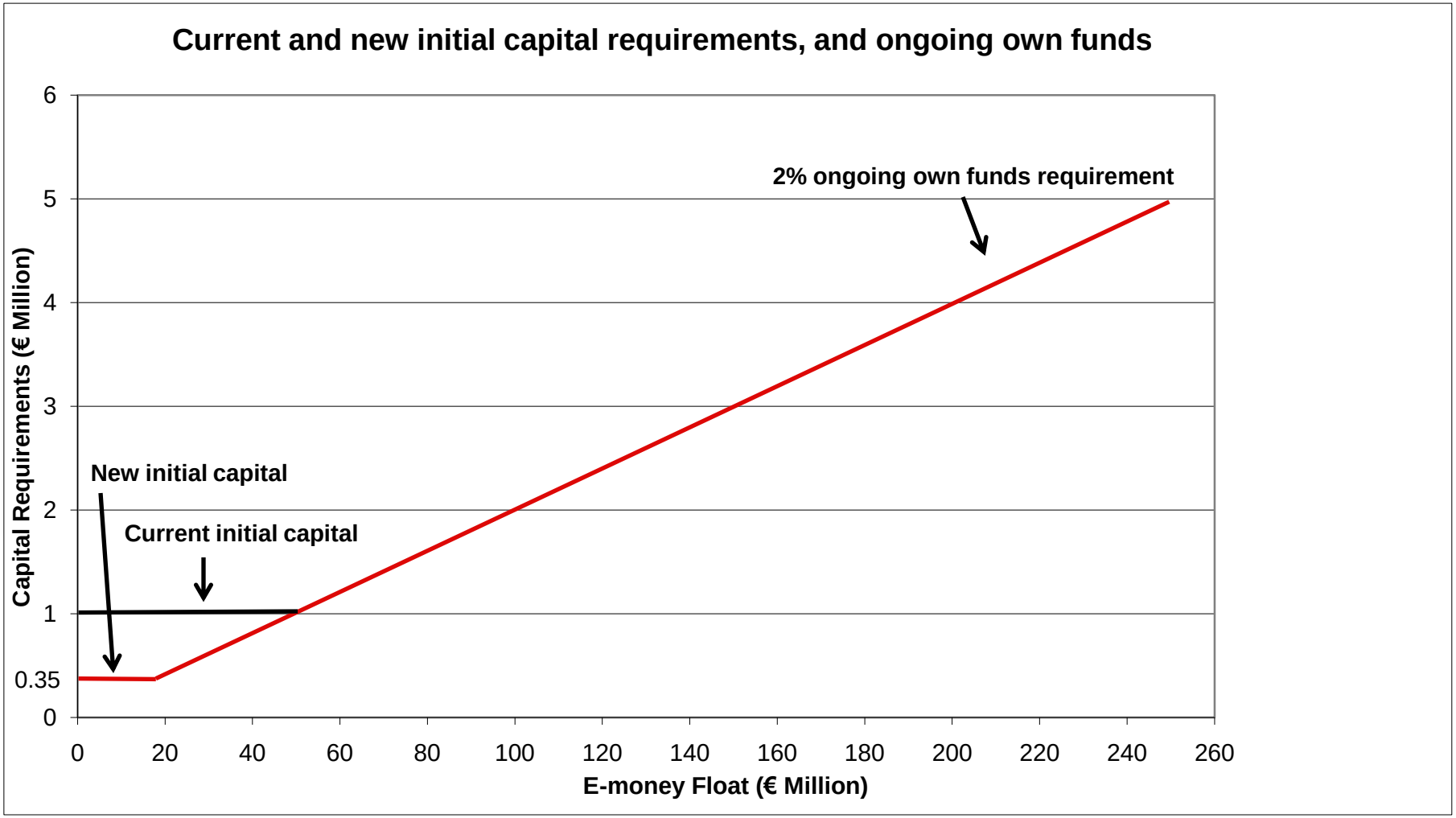
EMD2: evolution of the EMD

- Lower **initial capital and ongoing own funds** requirements.
  - Lower initial capital (barrier to entry) **€350k**
  - Own funds subject to discretionary risk assessed **±20%**
- **Scope of activities** to include **all payment services** offered by a PI
- Other:
  - Wider **scope of investments** for float assets, and safeguarding
  - Waiver **purse limit** removed, but prudential supervision allowed
  - Prohibited payment of **interest** to users; differentiate from deposits

EMD2: evolution of the EMD

- **Expiry** of e-money: debate on meaning of ‘redeemable at all times’; interpreted to prohibit expiry
- **AML**: Simplified DD threshold increased from €150 to €250 – for non reloadable purses; with option of €500 for national transactions
- **Exemption for IT network operators** (mobile included) where goods or services are delivered and used through a network
- **Exemptions also created for limited networks** of sellers or of goods and services sold will **re-classify** many gift and corporate incentive products; excluding them from regulation

Change in capital requirements



Opportunities under current regulatory regime

- Lower overall regulatory burden
- Lower barrier to entry
- Wider scope of service offering
- Can combine financial services with non financial business
- Mobile Network Operators can offer e-money without affecting the nature of prepaid airtime fund;
  - Proportionate regime; safeguard only e-money related funds
  - Hold ‘own funds’ relating only to the regulated element of the business

Opportunities …

- The right to join payment systems, such as card schemes
  - Enables issuers to occupy a larger part of the **value chain**
  - And to take charge of **own compliance** and scheme obligations
- The exemptions from regulation under the limited network exemption (copied into the EMD) will **re-classify** many gift and corporate incentive products; removing the burden of regulation
- May end up creating a payments specialist business!

Summary

- The regulatory evolution has played a key part in the evolution of the payments business, particularly prepaid
- Mobile payment providers have focused on non financially regulated services and often partnered up with FI's for regulated payments.
- The EMD creates specialist payments providers with the potential for competing with traditional providers

Thank You

thaer.sabri@e-ma.org
M +44 797 111 2066