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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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

[Various logos and images of payment providers and financial institutions]
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
• **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
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


Source: Combination of ECB Bluebook & EMA
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

Current and new initial capital requirements, and ongoing own funds

- Current initial capital
- New initial capital
- 2% ongoing own funds requirement
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

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