



# Impact of the E-Money Directive

## Its application to 'hybrid' operators issuing e-money

**Ir. S.L. Lelieveldt**

Netherlands Bankers' Association (NVB)  
Dutch issuers of Electronic Money (NVIEG)

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- The market for innovative payments....
- A bit of history on the E-money Directive
- What is a hybrid operator...?
- M-payments and Eu-legislation
- Question for the Commission....

- Electronic purse (IC-card-based)
  - value: € 600-700 Million (150 Million transactions)
- Payments via mobile telephone (content services)
  - Value € 1000 Million (> 500 Million transactions)
- Payments over the Internet
  - value € 2000 Million (5-7 Million transactions)



- E-money as an IC-chip has limited take-up
- Digital travelers cheque works fine / gift cards on the rise
- E-money on the Internet is a succes (5 billion trx in 2005)
  - In its 8 years of existence, Internet-based e-money issuer Paypal has achieved worldwide reach with 100 M customers, compared to a worldwide reach of only 15 M customers for Internet-based ING Direct bank (that started 1 year earlier)
- E-money / payments via the telephone (pre-paid or via the bill) are even more succesfull
  - 23 billion Euro in 2004 for content services
  - (value and transaction details remain scarce)

- **1994: all innovative payments viewed as taking deposits**

Central banks and supervisors considered any funds attracted from the public and used for innovative payments as taking deposits, an activity to be carried out by full-swing credit-institutions only

As a result KPN was asked either to get a bank license, cooperate with a bank or withdraw commercial offerings where the existing prepaid phone card would be used for payments to third parties ; KPN chose for a joint venture with Postbank: the Chipper e-purse

- **1997: Commission pushes light regime: e-money directive**

The Commission found the regulators/supervisors interpretation to heavy and intervened with a proposal for the e-money directive so that a light approach would allow new players to operate innovative pre-paid payment schemes (regardless of the technology applied) under lighter rules:

- No € 5 M but € 1 M required as core assets
- No complicated Basel (1/2) requirements but more straightforward set of liquidity requirements
- Similar requirements to administration, organisation and integrity; among which: separation of consumer funds from working capital

- **Relevance of e-money for (mobile) operators timely identified**

In 1999 ETNO recognized the relevance of the proposed e-money directive for the business of (mobile) telephone operators and ventilated an opinion on the draft e-money directive to the Commission

In 2001 the Electronic Payments Observatory e-news network repeatedly discussed the status of the e-money directive and its relevance to mobile industry

- **Mobile operators ask and receive preferential treatment from EC**

In 2002 GSM Europe requested a proportional treatment under the e-money directive:

***The E-money directive is important as it may affect the prepay services of mobile operators, (intended to be) used for third parties content and applications***

*Letter of June 12, 2002 by Mr Obermann to Commissioner Liikanen*

Without any legal or stakeholder consultation, the Commission sent a **comfort letter** to GSM Europe (18.10.02)

*The E-money Directive should not affect pre-paid services and calls to premium rate services. Of course we shall examine the implementation measures adopted by the Member States and take action where necessary*

- **Supervisors (except UK) fail to appreciate/understand market developments**

Since entry into force of the E-money directive (mid 2002) most supervisors in Europe (with the exception of the UK) still assumed that the only technical appearance of e-money could be a balance on an IC-chip; when confronted with Internet-based or telephone-based e-money mechanisms, their instinctive reaction was still that that would not be e-money but the business of being a credit-institution.
- **Supervisors in Member States get in trouble with new players**
  - While some new players for Internet-e-money or e-money on mobile phones, fought to be treated as e-money institutions rather than credit-institutions, the mobile operators argued that the pre-paid payment services were insignificant in comparison to the main business of providing voice services; treatment under the e-money directive would thus be disproportional ;
- **Commission facilitates further discussion/consultation on application of e-money to mobile industry**
  - Upon discovering that some member states were having issues with market players on the topic of application of e-money directive, the Commission lived up to its promise and organised a consultation on the application of the e-money directive to mobile operators; which is when the concept of **hybrid operators** turned out to be useful.

- Concept was first mentioned in 2002 but became a cornerstone for the commission consultation/guidance on application of e-money for mobile operators, to support the line of reasoning below:

*Mobile operators may actually receive (some) pre-paid funds from customers and transfer a tiny bit of those funds as payment for services to third party content providers. Yet, that doesn't justify application of the e-money directive given that (tick one or more below):*

- the payments involved cannot really be considered a payment to third parties, so it's actually not even e-money,*
- the value of the content services is incredibly low/insignificant (1%)*
- application of the regular e-money rules would constitute a disproportionate burden and stifle innovation*
  
- (the pre-paid value of consumers should then be returned upon first request of the consumer)
- (the VAT regime for delivering financial services would then apply)

- While the concept of a hybrid issuer is often used in discussions, there is no explicit definition.
- From the commission guidance on the application of e-money for mobile operators the closest approximate to a definition is:

**A hybrid operator is a provider that may be issuing e-money as a non-core part of their business**

- 1. As a matter of principle, mobile operators do e-money,**  
*While there is a school of thought that suggests that no e-money is created when pre-paid customers use their store of value with mobile operators to purchase third party services, most commentators agree that e-money is created when the monetary value stored on a pre-paid card is accepted as payment by a third party merchant in line with Article 1.3(b)(iii) of the Directive.*
- 2. But as it is now only 1%, we advise the member states to use broad waivers and exemptions, applied by local supervisors**
- 3. While for the longer term we suggest to discuss the issue more in depth during the review of the E-money Directive:**
- 4. Taking into account consumer protection issues and other legislative EU-initiatives (rules on payments, anti-money laundering etc)**

Which M-payments issues are currently under debate:

- The Eu 6<sup>th</sup> VAT Directive
- The New Legal Framework for Payments in the Internal Market
- Regulation to implement FATF-Special Recommendation VII to include originator information with payments
- The E-Money directive

### **M-payments are regular payments under VAT-Directive !**

Taking cash from the consumer by selling vouchers that will top up an amount of phone credits, is essentially a transfer of money from the consumer to the seller/issuer of e-money; such activity falls within the scope of the 6<sup>th</sup> VAT Directive. See case for Arena Cards.

### **OR / BUT**

### **M-payments are not payments under the 6<sup>th</sup> VAT Directive?**

Loading credits on a mobile phone should not be considered a VAT-exempt financial transfer of money but a 'nothing' transaction without VAT ; all the VAT burdens which results from the substantial sale of content by third parties should be borne by those third parties and not by mobile operators. It would be a disproportionate burden for the mobile operators to deal with the VAT-issues themselves. This is particularly relevant now that the data revenue involved approaches 25 % of the revenue stream of mobile operators (Vodafone/O2).

## The New Legal Framework for Payments in the Internal Market

- **The NLF applies equally to all players in the market !**

The NLF ensures a level playing field for all organisations that are active in the payment business. Sector specific exemption to those rules qualify as state-aid and need to be avoided as they negatively affect the level playing field.

### OR / BUT

- **Mobile operators will not fall under the New Legal Framework for Payment in the Internal Market**

- **if:**

- *(i) the service provider operating the telecommunication or IT system or network is closely involved in the development of the digital goods or electronic communication services provided;*
- *(ii) the goods and services cannot be delivered in the absence of the service provider;*
- *(iii) there is no alternative option for remuneration.*

- **Special regulation number VII of FATF, imposing the transmission or originator details with every payment, does not require alteration for m-payments !**

If mobile payments qualify as e-money, they will be exempted; if not, the regulation applies, given that mobile operators act as payment service providers of the payer and FATF intends to cover all payment channels/organisations

**OR / BUT**

- **Special regulation number VII of FATF should be amended to exempt M-payments ?**
  - and not apply to post-paid m-payments because that would hinder further development of this business;
  - require an additional exemption rule beyond the e-money exemption, so that it allows for pre-paid m-payments that are not considered e-money, to benefit from from the same exemption clause as e-money providers

### **Pre-paid payments services of mobile operators are e-money !**

Now that the mobile industry has developed its pre-paid payment business to third parties far beyond the 1% there is no longer a rationale for continuing with waivers and exemptions. It is clear that payments to third parties occur and the pre-paid value qualifies as e-money. Whether or not e-money business can be exempt only depends on objective value/volume criteria in the e-money directive.

### **OR / BUT**

### **Pre-paid payment services of mobile operators may in some cases also remain exempt in the future because of .....**

Referring back to some current exemptions and the agreement in the Banking Advisory Committee to solve the issue more definitively in the reviewed e-money directive, the Member States may for unknown reasons conclude that they have no other option than to construct a new line of reasoning to justify a more permanent exemption for the mobile industry (which by the way should not look like a sector specific exemption)

- It appears to be the case that the Commission has indeed paid the fullest attention to the regulatory issues raised by the mobile operators in their letter of June 2002
- The old argument that the industry is in its infancy and that regulation might stifle innovation does not appear to be true any more; certainly when one can also observe:
  - That the segment of independent m-payment service providers (m-payment aggregators) is actually making profits,
  - The increasing reluctance of the mobile industry to disclose specific information on m-payments transaction value and volume, as well as on revenue and industry structure

Is the Commission willing to specify as of which value or volume of European M-payments they will start to consistently regulate m-payments (be they pre-paid or postpaid) as the straightforward payment and e-money business that it is ?

OR

Will the Commission continue their current view of M-Payments as:  
something special,  
something out of the ordinary,  
something so unusual,  
so incredibly incomprehensible,  
that it defies any categorisation ever made....

Which would then, in good European spirit, require a solid (re-)definition of M-Payments....

**M-Payments** can be defined as:

- **Magic** events (certainly not payments),
- that occur only when using **Magic** ICT-device-like instruments (most definitely not payment instruments)
- which are somehow issued by **Magic** hybrid organisations (by no means a regular bank, payment institution or e-money institution),
- to allow consumers to transfer some **Magic value** (not money) to compensate merchants for services/goods delivered.

As a consequence, for M-payments, there is no need to comply with:

- anti-money laundering rules and know your customer procedures,
- the obligation to provide originator information
- VAT-rules for payment business
- supervisory rules for banks, e-money issuers or payment institutions
- requirement to redeem (unused) e-money to consumer

M-Payments can be defined as:

Only magic defies all logic

**Any questions.....?**

Simon Lelieveldt  
+31 20 5502 827  
lelieveldt@nvb.nl





# Generic model for analysis

Wants to buy

Customer

has

Account / billing  
relation & agreement  
Credit-institution, utility company, e-money institution,  
phone operator, ISP, ...

and

Device / technology  
Card, PC, Internet, landline, mobile phone, etc

to pay

Payment procedure / mechanism  
Transfer of payment intention and authorization method  
Payment taken out of pre-paid funds or account (pay direct) / Payment added to bill (pay later) /

Wants to sell

Retailer

has

Account / billing  
relation & agreement  
Credit-institution, utility company, e-money institution,  
phone operator, ISP, ...

and

Device / technology  
Card, PC, Internet, landline, mobile phone, etc  
E- & M-Payments Service Providers

to receive



# Typical e-money set-up

