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CP10/25 “Implementation of the second Electronic Money Directive (2EMD): supplement to HM Treasury’s consultation”

The ea Consulting Group (eacg) welcomes this opportunity to respond to the above consultation paper. Although the scope of the CP is limited on this occasion we recognise with declining cheque usage and fewer cash transactions that electronic money will become of major economic significance in the years ahead on a pan-European basis.

Our comments on the specific questions raised in the CP concerning the technical changes to the Handbook and amendments for payment service providers are to be found in the attached appendix. We have noted the FSA's intention to publish feedback to CP10/25 in a Policy Statement in due course accompanied by the final Handbook text.

In addition to this response, we have also forwarded comments directly to HM Treasury concerning the draft Electronic Money Regulations (EMRs) and their own consultation entitled 'Laying of regulations to implement the new Electronic Money directive'. We fully appreciate that HM Treasury has primary responsibility for 2EMD implementation in the UK. In our response to HM Treasury we have recommended that a precise definition be given for a 'limited network' as it is key to establishing the boundary of the e-money regulated sector. We have also supported the proposal extending the safeguarding of consumer funds to small electronic money issuers.

As you may be aware, eacg has advised a range of financial services clients on the successful implementation of the Payment Services Directive (PSD). We are acutely aware of the issues now posed and the opportunities created for the banking industry by 2EMD. eacg firmly believes that the 2EMD proposals are of far reaching significance. In attracting mobile phone operators, 2EMD and the EMRs could transform the retail payment services marketplace after its transposition into UK law in late April 2011. Increased competition should encourage greater innovation and directly benefit the consumer.

eacg is very pleased that an 'Electronic Money Approach' document is to be issued. Its sister publication, which has been regularly updated, has proved very useful in ensuring PSD compliance within the spirit and letter of the law. It is hoped that an online test of 2EMD and EMR knowledge, again similar to that made available on the PSD, might also be created on the FSA website

If you require clarification on any point do please contact me directly.

Yours sincerely

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APPENDIX**CP10/25: "Implementation of the second Electronic Money Directive"****Q1: Do you agree that our proposals do not raise any issues in relation to equality and diversity?**

YES. We confirm that in our opinion the various proposals outlined in CP10/25 do not raise any issues of potential discrimination and therefore conform with our understanding of UK equality and diversity legislation.

Q2: Do you have any comments on the draft text of the perimeter guidance?

The Q & A section appearing in Perimeter Guidance chapter 3 appears comprehensive and is relatively easily understood. We, therefore, have only a few more general comments.

Re Q6: We appreciate the legal status of the Perimeter Guidance but the lack of more positive direction is disappointing. What other views are there?

Q6: *If you are a payment institution that wishes to also issue electronic money then, **in our view**, you should cancel your authorisation or registration as a payment institution and apply to be an electronic money institution. An electronic money institution does not need to be authorised or registered under the Payment Services Regulations to provide payment services.*

Whilst it is important that all sections of the Perimeter Guidance are written in a common style and format could not some of the most important clauses be highlighted for the benefit of readers (see examples Q7/8/10/11 below)?

Q7: *.....The conduct of business requirements in Parts 5 and 6 of the Payment Services Regulations apply to all payment service providers, including electronic money issuers.*

Q9: *.....These changes make it clear that electronic money stored on computers hard drives or account-based schemes are caught.*

Q10: *.....The definition of electronic money says that for a product to be electronic money, it must be issued on receipt of funds. This part of the definition means that electronic money is a prepaid product.*

Q11. *Does it matter that the device on which electronic value is held may be used for other purposes? No. The fact that the device on which monetary value is stored is made available, for example, on a plastic card that also functions as a debit or credit card or is a mobile phone does not stop that monetary value from being electronic money.*

Finally, it is believed that the wording of Q13 could be improved by simplification. Is 'electronic money holder' (or better still 'e-money holder') a more user-friendly term than 'holder of the value' or 'holder of the prepaid value'? Similarly, 'e-money issuer' rather than 'the issuer of the value'? Also, what is meant precisely by 'artificial features'?

Q13. What sort of factors will the FSA take into account in deciding whether a particular scheme might be electronic money?

In considering this question relevant factors include:

- the risks incurred by the holder of the value;
- the nature of the rights and obligations of the holder of the prepaid value,
- the issuer of the value and third parties involved in the scheme; and
- what the scheme allows the holder of the value to do.

Therefore artificial features of a scheme that disguise, or try to disguise, the payment function as the supply of another sort of service are not likely to prevent the scheme from involving the issuance of electronic money

Q3: Do you think there are any issues not covered in the draft guidance that it should address?

NO: We believe that the draft Perimeter Guidance is comprehensive. Although mentioned in the text consideration should be given to a separate question specifically on the passport and related issues?

Q4: Do you have any comments on the proposed reporting requirements for authorised electronic money institutions?

NO. This clearly is an area in which the FSA as the EMR supervisor must lead. We can only concur with the FSA if it believes that the reporting requirements specified in section 3.6 are the minimum necessary to ensure that all authorized electronic money institutions meet their obligations under 2EMD.

Q5: Do you have any comments on the proposed reporting requirements for small electronic money institutions?

The list appearing in section 3.13 for FSA065 appears comprehensive but not excessive. We recognise the requirement to collect the total amount of electronic money outstanding as at 31st December by FSA066.

Q6: Do you have any comments on the proposed reporting requirements for other electronic money issuers?

The requirement for 'other electronic money issuers' (eg Post Office, Bank of England, Local Authorities, Credit Unions, Municipal banks, National Savings Bank) if they issue e-money to provide on a half-yearly basis the average total amount of outstanding electronic money appears entirely appropriate as not available from other sources. A 30 day response period is fair and should cause no reporting difficulties with the sophisticated accounting databases now available.

Q7: Do you have any comments on the application of a late return administration fee for authorised electronic money institutions, small electronic money institutions, authorised payment institutions and small payment institutions?

It has been noted that such a late return fee already applies to ELMIs. In extending this charge to all authorised electronic money institutions and other businesses authorised or regulated outside of FSMA this will become a universal charge. The £250 fee is presumably suitably punitive to ensure that firms will submit complete and accurate returns on time. It is disappointing that such a fee should be necessary but equally we must acknowledge that the number of returns is increasing and turnaround time for summary data can be dramatically impacted by the absence of one or two returns.

Q8: Do you agree that the FSA should amend the compulsory jurisdiction of the ombudsman service to cover all electronic money issuers in the scope of 2EMD in relation to issuing electronic money?

YES: The proposed change will rightly extend the compulsory jurisdiction of FOS to cover complaints about the 'issuance and redeemability' of e-money by all e-money issuers within scope of 2EMD. As an informal dispute resolution service it is entirely appropriate for consumers that the jurisdiction of FOS should include small electronic money institutions.

Q9: Do you agree that the FSA should extend the compulsory jurisdiction of the ombudsman service to cover former electronic money issuers?

YES: It is sensible to reflect existing practice and provide consistency of treatment for all businesses authorized or registered by the FSA. Under current rules firms formerly authorized fall within the compulsory jurisdiction of the FOS providing the relevant rules were in force at the time in question. Extending this rule will, of course, enhance consumer protection.

Q10: Do you agree that the FSA should exclude from the ombudsman service complaints from electronic money issuers about activities they are entitled to undertake themselves?

YES: Again, it is sensible and consistent to reflect existing practice. Under current rules a firm or PSP is not eligible to make a complaint that 'relates in any way to an activity which it is allowed to undertake itself'. Under this new rule complaints will rightly be excluded from FOS jurisdiction if from electronic money issuers in respect of payment services as all e-money issuers are entitled to provide such services.

Q11: Do you agree issuing electronic money should be within the scope of the ombudsman service's voluntary jurisdiction?

YES: It is entirely appropriate for electronic money issuers to be able to sign up for the FOS's voluntary jurisdiction when the type of complaint is not covered by the compulsory or consumer credit jurisdictions. This is particularly relevant for those firms based in other EEA Member States but marketing to UK consumers. The voluntary jurisdiction can also apply when complaints refer to business undertaken before the normal FOS service became available. Importantly for consumer protection, this will bring authorised and small electronic money institutions into the voluntary jurisdiction concerning complaints regarding their issuance of electronic money before 30th April 2011.

Q12: Do you agree with our proposed approach to enforcement and do you have any comments on the proposed changes to DEPP and EG?

YES: The approach, as outlined in chapter 5 in some detail, appears fair and comprehensive. With regard to enforcement, it is imperative that it should prove to be 'transparent, proportionate, responsive to the issue and consistent with our publicly stated policies'. We would expect the FSA to enforce the new regulations in a manner consistent with the new FSMA policy on imposition with penalties and suspensions as specified in DEPP 6 and DEPP 6A. Consistency of treatment is essential for effective supervision. We are mindful that the FSA is consulting on amendments to EG and DEPP but fully support the applicability of the revised handbooks in the enforcement of the new EMRs.

Q13: Do you have any comments on the proposed consequential changes to the Glossary?

We have read at some length the proposed changes to the Handbook glossary. In our opinion the new terms are both accurate and helpful, and reflect the definitions and nomenclature used in the 2EMD and the new EMRs. The two part division (post-20th January 2011 and post-30th April 2011) also aids the reader in understanding the applicability of the new regulations at different times.

Q14: Do you have any comments on the proposed consequential change to PRIN?

2EMD is a maximum harmonising directive and no gold-plating is therefore possible. Although PRIN 3.1.6R already states that the Principles for Businesses do not impose any obligations inconsistent with an European Union instrument it is prudent to amend PRIN 3.1.8G specifically to confirm that for authorised persons the Principles do not apply should they conflict with the 2EMD.

Q15: Do you have any comments on the proposed policy on the use of the FSA logo?

It is important for the consumer to restrict the use of the FSA logo to appropriate fully regulated firms. eacg therefore supports the extension of the current policy permitting authorised electronic money issuers to use the logo but not small electronic money issuers nor incoming electronic money institutions.

Q16: Do you have any comments on the proposed deletion of the Electronic Money sourcebook and minor amendments or deletions to other Handbook material?

Clearly, following the introduction of the EMRs, the existing Electronic Money sourcebook will be out of date and should be deleted with effect from 30th April 2011. The various amendments to COBS and the consequential changes as listed in sections 6.9 and 6.10 appear sensible and accurate.

Q17: Do you agree with the transitional provision?

eacg believes that the transitional provisions are to be commended.

Although SELMIs will be required to re-register as small electronic money institutions, ELMIs can be grandfathered into the new regime as authorised electronic money institutions. 2EMD permits a transitional period ending 30th April 2012 for the former and 30th October 2011 for the latter which are deemed as appropriate.

ELMIs and SELMIs would no doubt anticipate meeting all aspects of the current regime until grandfathered or re-registered including regular report submission. The requirement for ELMIs and SELMIs to comply with the conduct of business section in the draft EMRs (part 5: regulations 38 to 45 inclusive) during the transitional period is sound. These will, of course, replace the relevant provisions in the Electronic Money sourcebook. Although time is now short, no difficulties are envisaged in meeting these requirements.

Q18: Do you think there should be any other transitional provisions?

NO: The transitional provisions are clear and transparent for those electronic money issuers wishing to continue in operation after 30th April 2011.

Q19: Do you have any comments on the cost benefit analysis?

The major cost for all electronic money issuers, as recognised in the CP text, will be the normal costs of compliance with the new EMRs. These figures have, of course, been expressed separately in the Regulatory Impact Assessment (RIA) completed by HM Treasury. The RIA identifies the main benefit accruing to large new entrants as lower capital requirements whilst the three main sources of ongoing costs are the minimum capital requirements for new entrant small issuers, the additional cost of capital and the new arrangements for redeeming and safeguarding customer funds. It is agreed that any further costs should be minimal especially if already meeting the requirements of the Electronic Money sourcebook.

The CBA appearing in CP10/25 will, of course, only cover the proposals in the CP. The primary benefit is rightly identified as the supervision and enforcement of the new regulations which will in turn help to deliver the benefits to the UK economy as identified by HM Treasury in the successful introduction of the 2EMD. A small benefit may accrue through the use of e-mail in replacement of the more complex GABRIEL system.

It is difficult to establish the likely number of players in the future marketplace. HM Treasury has identified 96 non-bank e-money issuers and 16 bank and building society issuers in the UK today. The FSA believes that post-2EMD there may be about 20 authorised electronic money institutions and 40 small electronic money institutions (from a current situation of 17 ELMIs and 71 SELMIs). Several commentators share this view as it is very difficult to gauge the enthusiasm of new entrants at least in the short term. The FSA's decision to express costs on a 'per issuer' basis in the CBA is therefore sound.

We welcome the inclusion of the costs provided by the EMA (Electronic Money Association) as their members represent a valid sample for the industry if, of course, accurate. The increase in costs for small electronic money issuers is noted and it is a pity that more figures for analysis were not forthcoming from the Post Office and National Savings.

If FOS currently receives some 400 complaints per annum about electronic money essentially under VJ then it does appear likely that far more complaints will be generated following the introduction of the new EMRs and market expansion. We note that the FSA is currently consulting on the structure of the levy for electronic money institutions and hopes to consult on the rate in February 2011.

Q20: Do you have any comments on the compatibility statement?

We believe that the compatibility statement is an accurate and fair statement relating to the FSA's responsibilities in the implementation of the 2EMD and as set out in the new EMRs. It appropriately outlines how the proposed rules and guidance in the revised Handbook will meet the statutory objectives of the FSA and also adhere to its stated principles of good regulation.