COMMISSION OF THE EUROPEAN COMMUNITIES

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Impact Assessment accompanying the
Draft Proposal for a
DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

amending Directive 2000/46/EC on the taking up, pursuit of and prudential supervision of the business of electronic money institutions
SUMMARY OF THE IMPACT ASSESSMENT

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1. INTRODUCTION

Directive 2000/46/EC on the taking up, pursuit of and prudential supervision of the business of electronic money institutions (hereby referred as 'the EMD')[1] was adopted in response to the emergence of new pre-paid electronic payment products, and was intended to create a clear legal framework designed to strengthen the Internal Market and stimulate competition whilst at the same time ensuring an adequate level of prudential supervision.

Electronic money is defined by the EMD, as 'monetary value as represented by a claim on the issuer which is: (i) stored on an electronic device; (ii) issued on receipt of funds of an amount not less in value than the monetary value issued; (iii) accepted as means of payment by undertakings other than the issuer'.

The EMD seeks to open the market for the issuance of E-money through the creation of Electronic Money Institutions (EMIs) regulated under a lighter prudential regime than that required of credit institutions.

2. PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

On the basis on the EMD's review clause (Article 11), the Commission launched, in January 2005, an evaluation exercise. Based on the evaluation study, the Commission adopted a Staff working document on the review of the E-Money Directive (EMD) in July 2006. The report concluded that there was a need to revise the current directive, some provisions of which seemed to have hindered the take-up of the e money market. The report also suggested awaiting the final adoption of the Payment Services Directive (PSD) before taking further action, to permit completion of the complex negotiations on the PSD.

In order to prepare the present impact assessment, multiple consultative initiatives were undertaken. This included regular discussions with Member States, the ECB, financial institutions, consumer organisations, mobile operators, notably through the existing consultative committees on retail payments: PSGEG[2] and PSMG[3] in 2007 and 2008. Next to this, a specific meeting with the e-money industry was held on 25 January 2008 and a specific bilateral meeting was held with the ECB on 30 April 2008. Finally, an inter-service working group was established in February 2008, with participation of the Secretariat-General and Competition DG, Information Society and Media DG, Economic and Financial Affairs DG, to discuss the impact assessment.

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[1] OJ L 275 of 27.10.2000, p. 39.

[2] The Payment Systems Government Experts Group (PSGEG) is a consultative body composed of government experts from Member States of the EEA, typically drawn from national finance ministries and national central banks as well as a representative from the European Central Bank members as observers, with expertise in the payments area with the objective of providing advice and guidance to the Commission.

[3] The Payment Systems Market Group (PSMG) is a consultative body composed of market experts, typically drawn from banks, corporates, retailers and associations representing interested stakeholders such as SMEs and consumers, with expertise in the payments area with the objective of providing advice and guidance to the Commission.

3. PROBLEM DEFINITION

The problems identified by the evaluation and the consultation process can be grouped in two main problem strands. The first problem strand refers to the **unclear definition of electronic money and the scope of the directive**, leading to legal uncertainty and hindering the development of the market. The second refers to the **inadequate legal framework**. This last point includes the prudential regime, the waivers and passporting regime as well as the application of anti money laundering rules to e-money services. This overall legal inconsistency will increase once the Payment Services Directive is implemented (by November 2009), since some provisions of the latter are incompatible with the EMD.

These problems have resulted in a **limited market uptake** for electronic money in Europe, in terms of volume of e-money issued and in terms of number of market participants, with e-money representing EUR 1 billion in comparison with 637 billion of cash in circulation as of August 2007.

3.1. The lack of legal certainty and the scope of the directive hampers market development

During the review process, stakeholders expressed concerns that the current directive lacks legal certainty due to an unclear definition of e-money and scope of the directive.

3.1.1. The definition of e-money is unclear

The definition of 'e-money' requires it to be 'stored on an electronic device'. This definition is therefore considered technically limited to one form of e-money (notably cards based electronic money) and does not encompass the various pre-paid products available in the market (e.g., 'server-based' e-money). The current definition also raises questions in cases where the value stored would be less than the amount actually paid to the issuer, disqualifying in principle such products from being defined as e-money.

3.1.2. The scope of the EMD prevents new market entrants

The application of the directive to mobile operators and issuers of electronic vouchers would have a huge impact on the number of market participants and on the amount of electronic money in circulation as they would be enabled to design new services. According to the stakeholders consulted, the current lack of clarity prevents the development of these two markets.

3.1.3. The activities of EMIs are too narrowly defined

The activities of electronic money institutions are restricted under Article 1(4) of the EMD to issuing electronic money and closely related services. This provision differs from the non-exclusivity approach of the PSD, where a payment institution can engage in non-payment services business (e.g. retailing or telecom activities). Under the EMD, 'hybrid institutions' such as telecom operators and retailers have to split up their business in different legal entities which can be costly and inefficient.

3.1.4. Redeemability

Article 3 of the EMD states that a bearer of electronic money may, during the period of validity, ask the issuer to redeem it at par value in coins and bank notes or by a transfer to an account free of charges other than those strictly necessary to carry out that operation. Redeemability was inserted in the EMD for consumer protection reasons, to ensure that customers can get at all times their money back. Redeemability appears to pose a problem for Mobile Network Operators (MNOs) and electronic vouchers' issuers. Mobile operators are unable to split 'ex ante' customers' prepaid funds for mobile services and electronic money.

3.2. An inconsistent legal framework

Although it is widely acknowledged that the EMD has provided non-banks with an opportunity to enter the e-money market-place, the review report showed that high capital requirements, as well as certain restrictions and requirements imposed by the EMD, have hindered the development of the e-money market. The adoption of the PSD, which is currently being transposed into national legislation, will increase the complexity and the inconsistency of the overall legal framework and eventually lead to an absence of level playing field between payment institutions and EMIs.

3.2.1. The prudential regime

Prudential requirements have as objective to ensure sound and prudent operations of electronic money institutions. The review process provided evidence that certain requirements are disproportionate to the risks posed by EMIs. This evidence is reinforced if the cumulative effects of the overall regime are considered. The problems on the prudential regime include:

- current **initial capital requirement of EUR 1 million** is deemed by a number of stakeholders to be too high and disproportionate with regard to the risk of the service. This high initial capital is an obstacle for smaller firms wishing to apply for an EMI license.

- The **2 % own funds requirement** does not in itself appear to have given rise to major difficulties for authorised EMIs, although its combination with other aspects of the EMD (e.g. initial capital, limitation of investments, restriction of activities) have led to complaints that the overall regime is excessive.

- The **limitations of investment**, under which EMIs are required to have investments which at least match their financial liabilities related to outstanding electronic money. Bank and credit card receivables are excluded from the list of eligible investments. Evidence showed that current limitations of investments leads for growing companies to more stringent capital requirements then those for credit institutions under the capital requirements directive.

3.2.2. Inconsistent implementation of some provisions

3.2.2.1. Inconsistent application of waivers

Under the EMD, Member States are allowed to waive some or all of the authorisation requirements for small EMIs in order to facilitate market entry and innovation by new players without subjecting them to the full rigours of the authorisation framework. This option has been applied inconsistently between Member States and four of them have not implemented the waiver at all. The current situation might lead to competitive distortions within national borders.

3.2.2.2. Passporting

The passporting regime allows EMIs to go cross border and conduct the same business in host Member States as they are entitled to conduct in their home Member State under the EMI licence, without additional hindrances. However, Article 2 of the EMD refers to certain articles in the CRD providing for the authorisation of branches in other Member States and setting out the scope of permitted activities. According to some stakeholders, additional requirements imposed in some Member States increase the complexity and eventually hinder EMIs to set up branches in other Member States.

3.2.2.3. Anti-Money Laundering Rules

The EMD contains no specific provisions covering anti-money laundering. However, Directive 2005/60/EC on anti money laundering(AML) does introduces a simplified customer due diligence regime which applies to e-money, From a consumer's point of view, these 'Know Your Customer' (KYC) requirements prove to be cumbersome and impractical. From a business point of view, these requirements, and the costs associated with addressing them, might pose a significant challenge to the business case for this type of services.

4. THE OBJECTIVES

The general objective of the review of the EMD is to promote the emergence of a true single market for electronic money services in Europe. Contribute to the design and implementation of new, innovative and secure electronic money services. Provide market access to new players and real and effective competition between all market participants, thereby generating significant benefits to the wider European economy.

In order to achieve this general objective, two operational objectives were defined: a clarification of the definition and scope of electronic money services and electronic money institutions and the assurance of consistency with the PSD, creating a true level playing field for all market participants. This would lead in the medium term to the achievement of the specific objectives which aim to enhance legal certainty for all service providers, to create a harmonised legal framework and to promote the development of new and innovative services.

5. THE POLICY OPTIONS AND THE POLICY INSTRUMENTS

A wide range of solutions have been considered to address the problems affecting e-money services and meet the objectives that have been defined. The two main problems, as mentioned in chapter three are caused by issues related to:

1. The definition of e-money and scope of the EMD (first problem strand)

2. The inadequacy of the legal framework (namely: prudential regime, waivers and anti-money laundering rules).

Based on an initial screening of the different policy options against the policy objectives the policy options have been grouped in concrete packages which are a selection of initiatives that can be taken. The following packages were evaluated:

- **Package 1: Keep the EMD as it is ('do nothing' approach)**

This is the so-called 'baseline scenario'. In this option there would be no legislative proposal

- **Package 2: Issue a guidance note on the scope and definition of electronic money**

Under this non-legally binding option a guidance note would be issued to clarify the current definition and scope of electronic money institutions.

- **Package 3: Align with PSD, applying the prudential regime of Payment Institutions to EMIs**

This option would mean the design a legal framework which is consistent with the PSD applying the prudential requirements of Payment Institutions to EMI. This could be implemented by amending the EMD or the PSD.

- **Package 4: Align with the PSD, with specific prudential regime for EMIs**

Package 4 is almost the same as Package 3 except from the specific prudential regime for EMIs. This could be implemented by amending the EMD or the PSD

- **Package 5: Repeal the EMD directive**

Under this package, the EMD directive would be repealed.

6. IMPACT OF THE PACKAGES

Based on the evaluation of the packages, we consider that an alignment with the PSD, as suggested in **Package 3** and **Package 4,** is the most appropriate way forward**.** Both packages are expected to have a positive impact on the uptake of the e-money market in terms of e-money in circulation (a potential increase up to EUR 10 billion) and in number of institutions (up to 120 EMIs)

The main advantages of Package 4 are the availability of a specific prudential regime commensurate with the risks posed by electronic money institutions and the maintenance of the existing reporting requirements for EMIs to ensure market monitoring and compliance with the prudential requirements. The disadvantage is a higher administrative burden, which remains however proportionate to its objective.

Package 3, applying the prudential requirements of payment institutions would have the advantage that it would lower the administrative burden as no reporting would be required. The main disadvantage is that this complicates market monitoring. In addition its prudential regime is indirectly linked to the risks of electronic money institutions by means of payment volume as electronic money is used to execute payment transactions.

Package 1, 'do nothing' or Package 2, 'guidance note' would maintain the complexity of the legal framework after the transposition of the PSD in 2009 and would hinder further market development. Package 5, 'repeal of the directive' would simplify the legal framework, however creating legal uncertainty and hindering the development of new electronic money services.

7. EVALUATION AND MONITORING

A first intermediate evaluation could be performed on the moment of the first review of the PSD, three years after its transposition. Second, no later then five years after implementation, the Commission services will present an evaluation report on the legislative initiative.

Thus, the forthcoming legislation will be subject to a complete evaluation in order to assess, among other things, how effective and efficient it has been in terms of achieving the objectives presented in this impact assessment and to decide whether new measures or amendments are needed. The Commission will also consider the integration of the Directive into the payment services directive.