

# ACI's 9<sup>th</sup> National Forum on Balancing Innovation with Consumer Protections in Emerging Payment Systems

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## Lessons Learned and Critical Regulatory Challenges in the International Emerging Payments Landscape:

*Assessing the Evolving Legal and Business Environments in Key Foreign Markets,  
Facilitating E-Commerce Abroad, Best Practices for Ensuring Compliance with Emerging  
Regulatory Schemes in the EU, Asia, and Latin America, and What the U.S. Market Can  
Glean from Foreign Markets*

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Wave Crest

Tweeting about this conference?

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# What is the Payment Services Directive?

- The Payment Services Directive (2007/64/EC) (PSD), which was adopted at European level in November 2007, harmonizes the regulatory regime for payment services across the EU. One of the European Commission's main aims for the legislation was to enable new types of PIs to compete with the banks in the provision of payment services. The Commission's reasoning was that the use of a banking license as a passport for access to payment systems was not justifiable, given that banking and payments are not necessarily synonymous and cover a wider range of differing risks.
- For the purposes of the PSD, payment services are services that allow consumers and businesses access to payment systems which process, clear or settle payment transactions. The PSD covers only those payment services which have an electronic component, such as credit cards, direct debits, direct credit and standing orders.
- The broad aim of the PSD is to generate a well-functioning, integrated and competitive single European market for payment services, where cross-border payments by credit card, debit card, electronic bank transfer, direct debit or any other means, are as cheap, secure and easy as national payments made within individual member states.
- The PSD also complements and supports the European payments industry's work to create the single euro payments area (SEPA), (that is, a pan-European infrastructure for payment schemes). The Commission considers that the PSD provides the necessary legal platform that the SEPA can be built upon.
- The PSD hosts an EU-wide licensing regime for certain large PIs. PIs are one of the six different categories of payment service provider that fall within the scope of the PSD.
- In general terms, PIs are entities providing payment services that are not licensed credit institutions (that is, banks or building societies) or e-money issuers. Money transfer companies, companies providing bill payment services, mobile phone operators and certain non-bank credit card issuers may be PIs, subject to the available exclusions and waivers from the PSD's requirements.

# PSD Licensing

The PSD licensing regime, which includes regulatory capital requirements, allows PIs to passport their services throughout Europe on the basis of a license obtained in any one member state. **The licensing provisions do not apply to:**

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**1. Smaller PIs** operating domestically below a specific threshold, who instead need to be registered under the PSD.

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**2. Agents and branches of the larger authorized PIs**, although both these agents and branches also need to be registered under the PSD.

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**3. Credit institutions and e-money issuers**, as these entities already require a license to carry on their activities and are able to passport their services under existing implemented directives.

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**4. Harmonized conduct of business rules that set out the rights and obligations for payment service providers and their customers** (known as users or end-users). These rules apply to all payment service providers, not just PIs. Most of the conduct of business rules only apply to intra-EU payment transactions (that is, transactions where payment service providers are located in the EU), where the transaction is denominated in the official currency of any of the member states.

# PSD Licensing Continued

## The key payment services activities that will be regulated are:

- Cash deposits and withdrawals
- Execution of payment transactions
- Credit transfers, including standing orders
- Direct debits, including one-off direct debits
- Payment card transactions
- Issuing payment instruments (e.g. debit cards) or acquiring payment transactions
- Money remittance
- Payments sent through the intermediary of a telecom, IT system or network operator

## List of activities excluded from scope:

- Cash only transactions (but any cash transaction involving movement to or from a payment account is caught)
- Checks and paper instruments
- Cash transportation (e.g. cash deliveries by commercial security companies)
- Payment transactions related to securities asset servicing
- Technical services including independent ATM deployers

# What is the E-Money Directive?

- **E-Money Directive (EMD)** aims to enable new, innovative and secure electronic money services, provide market access to new companies, and foster real and effective competition between all market participants. In the meantime the EU awaits the third E-Money Directive (3EMD). The first Consultation Paper was originally scheduled to be released in the first quarter of 2014.

# Second E-Money Key Terms and Definitions

- **E-Money:** E-money means electronically (including magnetically) stored monetary value as represented by a claim on the e-money issuer which (a) is issued on receipt of funds for the purpose of making payment transactions; (b) is accepted by a person other than the e-money issuer; and (c) is not excluded by regulation 3 of the UK Electronic Money Regulations 2009 (EMRs). The definition of e-money includes magnetically stored value. This extends the definition to include e-money held on a plastic card or an IT server.
- **Prohibition of interest:** E-money issuers are not allowed to grant interest or any other benefit related to the length of time e-money is held.
- **Authorization:** It creates a regulated category of "electronic money institution" (EMI) for certain types of e-money issuers other than banks and building societies. EMIs have their own prudential and conduct of business regime.
- **Prudential requirements:** The "own funds" requirements for EMIs include reducing the initial minimum capital requirement from EUR 1 million to EUR 350,000. This is to reduce the potential that such requirements might be a barrier to entry to this market.
- **Limited networks exemption:** It redefines the now repealed first Electronic Money Directive exemption for limited purpose e-money cards (such as single retailer cards, petrol cards, public transport cards, telephone cards and meal and other vouchers) and aligns it with the definition in the Payment Services Directive (PSD).

# Second E-Money Key Terms and Definitions

- **Safeguarding e-money:** Requirements for safeguarding customers' funds include that, if an EMI becomes insolvent, the e-money issued will be protected from other creditors' claims and can be repaid to customers. There is also a simple option to safeguard funds in secure, liquid low risk assets. This is the same as that applying to "payment institutions" (PIs) under the PSD.
- **Redeeming e-money:** Requirements for redeeming customers' funds. In particular, e-money issuers are not allowed to set a time limit on the e-money holder's right to redeem (although a proportionate fee can be charged for redemption in certain circumstances).
- **New activities:** The scope of activities that EMIs can undertake is expanded so that they can undertake mixed business activities. This means that they are able to carry out unrelated payment services and other unregulated business, and they are no longer restricted to issuing and administering e-money, or storing data.
- **Exemption for small EMIs:** 2EMD states that for small EMIs holding e-money not exceeding EUR 5 million are exempted from the requirement to be authorised and can instead apply to be registered as small EMIs. The EMD confirms that they do not qualify for an EU passport.

# Impact of E-Money On Emerging Payments Systems

There are three main ways of using e-money:

Prepaid Cards

Electronic prepaid accounts  
online use

Via an electronic device  
(mobile phone)

- The regulation of e-money is closely interlinked with the regulation of "payment services" and PIs, which are regulated under the PSD. The issuing of e-money is not itself a payment service but may entail the provision of payment services. For example, issuing a payment instrument is a payment service and e-money is likely to be issued on a payment instrument in order to make a payment transaction.
- Within new areas of regulated payments innovation such as the EU regime for issuing e-money, the UK under the FCA took the lead as the most supportive, pragmatic and adaptable regulatory environment. This regulatory stance has often been necessary to encourage operators to take advantage of the EU's intention to encourage alternative payment providers under the EMDs and the PSD. In many cases other EU Member States have not been so encouraging and difficulties with understanding the underlying EU law relating to, e.g., what is 'e-money' and what are 'payment accounts' in addition to difficulties in accessing payment systems and making use of passporting permissions have meant that the sector requires a constructive and supportive regulator.



# UK Payments Service Regulator (PSR) and the EU

PSR was created in April 2014 to regulate payment systems in the UK:

- It is a subsidiary of the Financial Conduct Authority (FCA) but is an independent economic regulator with its own governance and objectives. PSR expects to begin regulating payment systems from April 2015, in the meantime it is focused on carrying out its reviews and developing its policies, all of which have been or will be made publically available.
- In addition to the PSR's UK macro-regulatory position it will be interesting to see the extent to which it will become involved in working with the FCA on significant cross-border legal and regulatory uncertainties. Cross-border trade issues are macro-issues. The PSR's relationship with the European Banking Authority (EBA) and regulators in other jurisdictions will therefore be crucial to achieve macro-level objectives. There is also real need for a payment specialist regulator within the EU to take up the challenge of being a European advocate for emerging payments with Member States and to help the European Commission, Parliament and Council to structure payments laws and processes that meet stated objectives, are technologically neutral and take account of emerging innovations.



# Implementing policies and procedures to ensure compliance

All EMIs must comply with the legal requirements in place to deter and detect financial crime, including the legislation on money laundering and terrorism.

In the UK, when dealing with an application to become an EMI, the PSR (as mentioned above) and the FCA will review the applicant's policies and procedures to identify, manage, monitor and report any risks of financial crime to which the EMI may be exposed by the UK implemented legislation (Regulation 6(5)(b) EMRs).

# Cryptocurrencies

- Need for UK legislation (including the the PSR) to look at and identify the opportunities and risks relating to new currently unregulated payment networks and currencies.
- These new providers and solutions allow transfers of value using non-fiat currencies (virtual or crypto-currencies) and will often also involve mediation between virtual and fiat currencies.
  - Reviewing and pioneering the regulation of virtual currencies and encouraging their use and acceptance might lead to quicker and easier results to meet many of the PSR objectives rather than expending all its effort and time to try to move the attitudes of major market counterparties who will be loathe and slow to change their complex and established systems and processes.
- Currently the UK (and most of the EU) takes the view that virtual currencies do not constitute funds under either the PSD or the 2EMD, to date they are largely unregulated. However, given that the meaning of money ultimately derives from its acceptance and use it is only a matter of time before such virtual currencies are deemed to be recognized forms of money that require regulatory oversight and supervision. An EU member state has to take the lead on this issue to help these innovations flourish whilst protecting consumers from security breaches, fraud, pyramid sales schemes, insolvency etc. The smart players in the virtual currency sector are also looking for such a regulatory home



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# Facebook's impending e-money authorization in Ireland, and Google's in the UK



The Financial Times reports (February 2015) that Facebook is “weeks away” from gaining regulatory approval in Ireland for a service in which users can store money on the social network and transfer funds to one another. Facebook is waiting for the Irish authorities to approve its digital e-money transfer services, which will allow Facebookers to send money to each other and third parties using Messenger and WhatsApp. The e-money service would work throughout Europe, according to the report. Facebook is also looking to partner with several startups for international money transfers online.



Google has reiterated its commitment to expanding its mobile payments and wallet products, which have yet to be widely adopted by consumers. It is registered in the UK to issue e-money, in a process similar to the authorisation which Facebook is seeking in Ireland however there is no recent update.