

Electronic payment mechanisms I

by Stephen Mason

This two-part article considers the legal and regulatory issues relating to electronic payment mechanisms other than the usual forms of payment, such as cash, credit cards and debit cards.

INTRODUCTION

For trade to be effective, there must be a viable method of measuring value, and the ability to transfer value, by way of a medium of exchange. Historically, the concept of money has become the most popular means of exchanging worth. The instrument by which money is usually evident is in the form of currency. Currency, in turn, typically takes the form of cash, which is physically manifest as coin and promissory documents representing coin, such as bank notes. However, the methods by which money is transferred are not static, and different types of instrument can effect the transfer of value, including the cheque, credit cards and debit or charge cards.

The use of the internet as a medium for trade has posed a variety of challenges, one of which is the introduction of greater flexibility for exchanging money. Many organizations selling goods and services on-line use methods of payment that have found acceptance in the physical world, such as credit and debit or charge cards. However, not every item sold at a distance is amenable to being bought and sold using such instruments. There are two main reasons for this. First, goods or services can be valued by the trader at levels that do not permit the economic use of credit cards. By way of example, a publisher may wish to charge a viewer to obtain access to an on-line newspaper for a fixed period of time or for a specific number of articles. In the physical world, cash serves to effect the transfer of money for such a modest exchange, but it is more difficult to embody the exchange of low values of currency in the electronic environment. Second, even where the payment of goods or services by way of a credit card is proportionate, large numbers of people do not have credit cards.

Attempts have been made to provide solutions to resolve this problem. The aim of most payment mechanisms developed for use at a distance is to permit the transfer of money electronically at a reasonable cost, otherwise the solution can be more expensive to implement, and thereby defeat the aim.

ELECTRONIC PAYMENT SYSTEMS

Part of the reason for seeking alternative methods of making payment remotely, other than by the use of credit and debit cards, is to make it possible for payment to be made in very small denominations, otherwise known as micro payments. The attractiveness of using a credit card in particular to buy goods and services is manifest, but a credit card cannot be used to buy something that may be charged at a fraction of a pence. Hence the plethora of schemes that have been developed over the past ten years. The commercial payment systems generally fall into two categories for legal purposes, account-based and cash-based. Both methods are based on the evolution of the banking system (In relation to this matter, the author is indebted to the excellent discussion by Trystan Tether, "Payment Systems for E-Commerce" in Chris Reed, Ian Walden and Laura Edgar, editors, *Cross-Border Electronic Banking Challenges and Opportunities* (LLP, Second edition, 2000). The legal analysis outlined by Mr Tether is adopted in this text in relation to the various types of electronic money system available).

Account-based

In this instance, the person making the payment (Alice) deposits money or money's worth with a trusted third party. Alice makes a payment to the seller (Bob) by giving instructions to the trusted third party to hold the agreed value of her deposit for the benefit of Bob. Once the trusted third party acknowledges Alice's instruction and agrees to be bound by it, Bob can arrange for the value to be transferred to him physically, or he can leave it with the trusted third party for future use on his own behalf.

The structure of an account-based system

In outline, the account-based payment system will probably have the following attributes:

- Both parties will maintain an account with the operator of the system.
- The subscribing buyer (Alice) will provide details of her credit card to the operator of the system, authorizing

the operator to debit her credit card to make payments into her account with the operator as necessary.

- When Alice buys something from the subscribing seller (Bob), she gives an instruction to the operator of the system to debit her account and credit Bob's account. If Alice does not have sufficient credit to pay for the goods or services, the operator of the system will debit her credit card to ensure there are sufficient funds in her account to settle the payment in full.
- When the operator of the system receives instructions from Alice, it can credit and debit the respective accounts of Alice and Bob, and then confirm this to both subscribing parties. Bob can supply the goods or services in the knowledge that he has received payment.

An account-based system can have a number of benefits to an issuer, in that there is a negligible cost of transaction (in theory); the operator of the system is not liable to its subscribers, because the accounts are always in credit, and providing the operator does not provide credit to subscribers, it will not be liable for any connected lender liability (although this will not be effective against credit cards where the credit card issuer, upon the receipt of a complaint from a customer, raises a chargeback against the operator of the system); and on the assumption that no credit is given to subscribers of the system and the operator is not exposed to connected liability risk, the financial standing of individual subscribers will not be relevant.

Whilst there is great advantage in the possibility of providing for an effective micro payment environment that appears to reduce the risk to all parties, nevertheless the disadvantages may negate many of the advantages. Both the account-based and cash-based systems (see below) are "closed", in that only participants in the system can take part. As a result, both consumers and retailers have the option of subscribing to a number of differing schemes. It is highly probable that neither consumers nor retailers will wish to subscribe to more than one scheme. The retailer will not want to incur the expense of belonging to multiple schemes, and it is to be debated whether consumers will want to have money scattered around a number of providers.

It is also worth bearing in mind that a subscriber will be required to retain a credit balance in each of the systems to which they subscribe. Subscribers will not be able to obtain ready access to the credit balance, and if they are party to more than one system, the combined figure of deposits could be high enough to discourage being a member of more than one. In addition, where electronic money is stolen, it is not clear whether the innocent party is properly protected.

The operator may find itself involved in dealing with disputes relating to sub-standard goods or goods that have not been delivered. The costs of managing this may

increase operating costs to such an extent that the concept is not commercially viable.

The activity of holding money on behalf of a subscribing party could be construed as taking a deposit, in accordance with section 22(1) and Schedule 2(4) of the Financial Services and Markets Act 2000. This matter was discussed in the consultation exercise carried out by the Treasury. In the response to consultation (HM Treasury, *Implementation of the Electronic Money Directive: a response to consultation*, March 2002), the Treasury took the view, at paragraph 10, that account-based schemes do come within the meaning of electronic money.

The operator is subject to the Money Laundering Regulations 1993 (SI 1993 No 1933) and 2001 (SI 2001 No 3641), the provisions of which negate the assumption that an account-based system can be relatively inexpensive to set up and operate. For this reason, as well as the ability to track payments made electronically, such a system cannot be considered to have the attributes of anonymity. Any breach in security that enables a thief to steal money or cause money to be transferred without the authority of a subscribing party will undoubtedly fall on the operator.

Cash-based

This example also requires Alice to deposit money or money's worth with a trusted third party. In this case, the trusted third party gives Alice a certificate confirming the value of the deposit. Alice can then make a payment to Bob by transferring the certificate to Bob by whatever method required by the trusted third party.

The structure of a cash-based system

The basic building blocks of a cash-based system can be described as follows:

The customer (Alice) may be given, or might have to pay for, software or hardware (such as a smart card) or a combination of both software and hardware, which will permit her to obtain and store files that represent electronic money. Alice buys electronic money from the operator of the system, and the files are stored on the computer hard drive or within the chip on the smart card.

The operator maintains a float of the money used to purchase electronic money. The size of the float should be sufficient to ensure the total amount of electronic money issued can be redeemed at any one time.

Assume Alice decides to buy goods or services from Bob, who also supports the same electronic money protocol to which Alice subscribes. The two computers (or a computer and a smart card), exchange protocols to establish the authenticity of each, amongst other things. A transfer takes place by which Alice authorizes the transfer of sufficient electronic money to satisfy the price of the goods or services.

When Bob receives the transfer message, he can then send it to the operator of the system, who in turn will credit Bob with the value of the electronic money transferred from Alice. Alternatively, Bob can decide to use his electronic money in turn to pay for goods or services.

A cash-based system – some legal issues

Conceptually, electronic money may involve one of two types of relationship. The transfer between Alice and Bob could be construed as a record of a transaction to debit Alice's account and credit Bob's account. In this analysis, it is arguable that the Electronic Money Directive does not apply, because the process as described is one of taking money on deposit, permitting Alice to use her deposit at a date and time of her choosing. Further consideration should be given to the provisions of the Financial Services and Markets Act 2000. The meaning of deposits is set out in Schedule 2, Part I, section 22:

“Rights under any contract under which a sum of money (whether or not denominated in a currency) is paid on terms under which it will be repaid, with or without interest or a premium, and either on demand or at a time or in circumstances agreed by or on behalf of the person making the payment and the person receiving it.”

If this process is determined to be a certificate of deposit, then a cash-based scheme may be a regulated activity under the terms of Schedule 2 Part I. Alternatively, the transaction could be considered in the same way as a promissory note or a certificate of deposit, both of which are transferable and negotiable instruments.

The relevance of this enquiry relates to the theft of electronic money. If it is determined that the system operator holds the money on account, then where the holder (Alice) of electronic money has her electronic money files stolen, Alice retains the right to the payment she made to the system operator. Further, where another spends the electronic money, the operator of the system will be acting on the instructions of somebody other than Alice. The operator is not entitled to act on the instructions of somebody other than Alice, and will, therefore, be required to bear any loss. However, where the electronic money is a negotiable instrument, then the operator of the system is required to make a payment in relation to electronic money without liability to Alice, from whom the electronic money was stolen.

The costs of running the system can be minimal if there is no requirement to account for individual transactions, and the float of money can be used by the operator to balance the operating costs. Further, it may not cause the operator of the system to be liable for any connected lender liability, although the provisions of the Direct Financial Services Directive will apply (Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC

and 98/27/EC (OJ 9.10.02 L217/16)). Once the software is in place, it is possible for the system to be used by anybody, and the structure can, possibly, be used to provide for anonymity by selling disposable cards through shops, newsagents and similar outlets.

As with cash-based electronic money systems, it is conceivable that the disadvantages may be greater than the advantages to both consumers and retailers.

Where the cash-based system is used to buy goods or services, the buyer has to trust the seller to deliver the goods or provide the services. In the event a dispute occurs, as where the goods are not delivered or the quality is in dispute, the buyer (if a consumer) may have a range of rights that can be invoked against the seller, but will be in a difficult position to enforce any rights effectively. The operator is subject to the regulatory environment, including the provisions of the Money Laundering Regulations 1993 and 2001 (See Financial Services Authority Handbook Authorisation Manual, Appendix 3 “Guidance on the scope of the regulated activity of issuing e-money” for further guidance).

Where there is a breach in security of the operating system, two consequences may follow. First, the subscribing parties may obtain electronic money that is of no value. Second, the operator of the system may find that it redeems counterfeit electronic money, with the consequence that the float is reduced. If an attack is severe, it may undermine the solvency of the operator of the system.

ELECTRONIC MONEY

Definition

The Commission Recommendation of July 30, 1997 concerning transactions by electronic payment instruments and in particular the relationship between issuer and holder (Payments Recommendation (97/489/EC) (OJ 02/08/1997 L 208/52)) did not use the term “electronic money”, but referred to “electronic money instrument” and gave the following definition at article 2(c):

“means a reloadable payment instrument other than a remote access payment instrument, whether a stored-value card or a computer memory, on which value units are stored electronically, enabling its holder to effect transactions of the kind specified in Article 1 (1);”

The transactions can be effected by means of an “electronic payment instrument”, as defined in article 2(a) as “an instrument enabling its holder to effect transactions of the kind specified in Article 1 (1). This covers both remote access payment instruments and electronic money instruments.” The types of transaction covered in article 1(1) include the following:

“(a) transfers of funds, other than those ordered and executed by financial institutions, effected by means of an electronic payment instrument;

(b) cash withdrawals by means of an electronic payment instrument and the loading (and unloading) of an electronic money instrument, at devices such as cash dispensing machines and automated teller machines and at the premises of the issuer or an institution who is under contract to accept the payment instrument.”

A definition of electronic money is set out in the European Directive on the taking up, pursuit of and prudential supervision of the business of electronic money institutions (Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit of and prudential supervision of the business of electronic money institutions OJ 27.10.2000 L 275/39) (Electronic Money Directive). Recital 3 describes electronic money in terms of a metaphor, and suggests it is a substitute for money in the form of coins or promissory notes, such as bank notes:

“For the purposes of this Directive, electronic money can be considered an electronic surrogate for coins and bank notes, which is stored on an electronic device such as a chip card or computer memory and which is generally intended for the purpose of effecting electronic payments of limited amounts.”

This recital demonstrates the Electronic Money Directive is intended to give effect to the development of an electronic equivalent of cash. However, it should be noted that electronic money cannot be a substitute for coins or bank notes, because coins and bank notes are physical things in the physical world. If money is acceptable in electronic form, it will remain as currency, but not in the form of coins or bank notes. It is merely another form in which currency can be manifest.

The Electronic Money Directive provides a definition of electronic money in article 3(b), as follows:

“(b) ‘electronic money’ shall mean 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 elements of electronic money as provided in this definition are “monetary value as represented by a claim on the issuer”, which provides for electronic money to be a form of currency subject to a claim by an issuer.

The electronic money must be:

- “stored on an electronic device” which permits electronic money to be stored on a wide variety of devices, including mobile telephones, smart cards and computers.

- “issued on receipt of funds of an amount not less in value than the monetary value issued” which indicates that the funds issued must be of a specific value and cannot be less than the monetary value issued.
- “accepted as means of payment by undertakings other than the issuer” providing that some entity other than the issuer (“undertakings” appears to be used in this context as meaning “legal entity” – the meaning of which is open to interpretation) accepts the electronic money as a method of payment.

If the intention of the Electronic Money Directive was to provide for an electronic equivalent of cash, then it is possible to infer that electronic money should have the same attributes as cash, that is:

- anonymity of use (with the exception of bank notes, where the serial numbers may be used to identify a holder at a point in time);
- the ability of a recipient to re-use the cash immediately.

The Electronic Money Directive was implemented into law by means of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2002 (Statutory Instrument 2002 No 682). A definition of electronic money is inserted by Regulation 2, into article 3(1) of the principal Order (Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, Statutory Instrument 2002 No 544, as amended by The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2001, Statutory Instrument 2001 No. 3544). The definition incorporates much of the definition provided in the Electronic Money Directive, with two changes:

“‘electronic money’ means monetary value, as represented by a claim on the issuer, which is –

(a) stored on an electronic device;

(b) issued on receipt of funds; and

(c) accepted as a means of payment by persons other than the issuer;”.

It will be noted that item (b) of the requirement only refers to the electronic money being “issued on receipt of funds”. Those responsible at the Treasury considered the second limb of the requirement as set out in the Electronic Money Directive, namely the wording “of an amount not less in value than the monetary value issued” opened up the possibility of an issuer issuing electronic money at a discount, providing more value than the funds received. This, it was suggested, would mean electronic money issued at a discount would not come within the scope of the Electronic Money Directive, and would therefore fall outside the regulatory environment, and the Treasury would not be required to regulate electronic money issued in this way (HM Treasury, *Implementation of the Electronic Money Directive :a consultation document*, October 2001, para13). Further, the word “undertakings” has been rejected in favour of the more accurate “persons” in item

(c) (See also the Financial Services Authority *Handbook*, Electronic money, Chapter 4, “Limitations on activities”).

Electronic money can be considered a product, the cost of which is paid for before the value can be exchanged. It is not the same as credit provided by way of a credit card, because the customer must pay for the use of electronic money in advance in most instances. For this reason, the use of credit cards does not come within the definition of electronic money. However, where payment is made in exchange for electronic money by credit card, two contracts then come into existence: one for the sale of electronic money, and one for the credit provided by the credit card issuer (see Financial Services Authority *Handbook Authorisation Manual*, Appendix 3 ‘Guidance on the scope of the regulated activity of issuing e-money’ paragraph 3.3).

For a discussion about whether electronic money is or can be legal tender, see Robert C Effros, “Electronic Payment Systems. Legal Aspects” in Professor Dr Norbet Horn, editor, *Legal Issues in Electronic Banking*, (Kluwer Law International, 2002).

Redeeming electronic money

A debate ensued over the draft Electronic Money Directive as to whether electronic money was redeemable. The first proposal did not include a provision for the redeemability of electronic money. However, the European Central Bank provided a number of reasons in favour of the argument that electronic money should be redeemable (Opinion of the European Central Bank of January 18, 1999, para 19).

Electronic money liabilities should be redeemable at par value against the holders of electronic money because of monetary and payment systems policy, irrespective of the size of the electronic money schemes or the amount to be redeemed.

Monetary policy requires electronic money to be redeemable to:

- preserve the unit-of-account function of money,
- maintain price stability by avoiding the unconstrained issuance of electronic money, and
- safeguard both the controllability of liquidity conditions and the short-term interest rates set by the European Central Bank.

There must be an unconditional right to leave the relevant electronic money scheme at the discretion of the holder.

Redemption payments:

- Must be made either in legal tender or, with the consent of the electronic money holder, by way of banking channels by making an irrevocable payment

order to credit the electronic money holder’s bank account or an account of their choice.

- To be denominated in the same currency as the currency in which the relevant electronic money liability is denominated.
- To be made at the latest on the local business day following the day on which the request for redemption is received by the relevant issuer of electronic money.

Where technically possible, redemption of electronic money should be allowed after the expiry date of such electronic money or of such device on which the electronic money value is stored.

Disposable and re-loadable cards should also be redeemable.

In principle, redemption should be free of charge. Fees or commissions payable on redemption of electronic money must be a reasonable and fair estimate of the costs for the relevant electronic money issuer related to the redemption. If such fees or commissions are deemed acceptable, they should be clearly communicated to customers in advance.

A provision to this effect was subsequently included in the Electronic Money Directive. Article 3 provides for electronic money to be redeemed, that the conditions of redemption must be made clear, and any threshold for redemption is also to be stipulated:

“1. 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.

2. The contract between the issuer and the bearer shall clearly state the conditions of redemption.

3. The contract may stipulate a minimum threshold for redemption. The threshold may not exceed EUR 10.”

The practical issue is to encourage the use of money in electronic format. Although take-up has been poor, nevertheless it might be even more difficult to encourage the use of electronic money if it is not freely redeemable (see Professor Otmar Issing, “New Technologies in Payments – A Challenge to Monetary Policy”, Lecture given at the Center for Financial Studies, Frankfurt am Main, June 28, 2000, para 3.2.b, available in electronic format from <http://www.ecb.int>). Finally, it should be noted that when an issuer redeems electronic money, the act of redemption does not imply that the funds exchanged for electronic value are to be considered as deposits. Such funds do not constitute a deposit or other repayable fund if “... the funds received are immediately exchanged for electronic money” rather than being stored in an account (Article 2(3) – see also the Financial Services Authority *Handbook*, Electronic money, Chapter 6, “Redemption, information requirements and purse limits”).

THE REGULATORY REGIME

The Payments Recommendation

The Payments Recommendation (Commission Recommendation of July 30, 1997 concerning transactions by electronic payment instruments and in particular the relationship between issuer and holder (97/489/EC) (OJ 02/08/1997 L 208/52)) remains in place as a means of guidance in relation to electronic money. While it does not have the same effect as the Electronic Money Directive, nevertheless its provisions, mainly relating the obligations of the parties to a contract for electronic money, act to regulate liability between the parties, discussed in more detail below.

The Electronic Money Directive

By article 1(2), the Electronic Money Directive does not apply to the entities set out in article 2(3) of Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions (OJ 26.5.2000 L 126/1) (Banking Consolidation Directive). It only applies to electronic money institutions, which are defined in article 1(3)(a) as:

“an undertaking or any other legal person, other than a credit institution as defined in Article 1, point 1, first subparagraph (a) of Directive 2000/12/EC which issues means of payment in the form of electronic money;”

The aim in restricting the activities of electronic money institutions is to help control the stability of the financial system and the smooth operation of payment systems, as provided for in recital 14. Further, the business activities of electronic money institutions are restricted under article 1(5) of the Electronic Money Directive as follows:

“The business activities of electronic money institutions other than the issuing of electronic money shall be restricted to:

the provision of closely related financial and non-financial services such as the administering of electronic money by the performance of operational and other ancillary functions related to its issuance, and the issuing and administering of other means of payment but excluding the granting of any form of credit; and

the storing of data on the electronic device on behalf of other undertakings or public institutions.

Electronic money institutions shall not have any holdings in other undertakings except where these undertakings perform operational or other ancillary functions related to electronic money issued or distributed by the institution concerned.”

The aim is to distinguish between entities that offer deposit taking activities, and those that provide electronic money where the funds received are immediately exchanged for electronic money, as set out in recitals 7 and 8. Recital 9 makes it clear that electronic money must be redeemable to provide for bearer confidence, although redeemability in itself does not imply that the funds

received in exchange for electronic money are regarded as deposits or other repayable funds for the purposes of the Banking Consolidation Directive. Essentially, an electronic money institution is prohibited from granting any form of credit.

Capital requirements

Article 4(1) of the Electronic Money Directive requires issuers of electronic money to have an initial capital of not less than 1 million euro, and their own funds must not fall below this figure. The issuer is also required to have, at all times, their own funds that are equal to or above two per cent of “... the higher of the current amount or the average of the preceding six months’ total amount of their financial liabilities related to outstanding electronic money” (Article 4(2)). See also the Financial Services Authority *Handbook*, Electronic money, Chapter 2, “Initial and continuing own funds requirements”).

Requirement for authorization

The issuing of electronic money is a regulated activity under the provisions of the Financial Services and Markets Act 2000 (Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2002, Statutory Instrument 2002 No 682 regulation 4 inserting Chapter IIA, regulation 9B). The reason for making the issuing of electronic money a regulated activity was first, to prevent persons not authorized to do so (unless they have a waiver) from issuing electronic money, and second, to enable the Financial Services Authority to regulate the issuing of electronic money by making appropriate rules under section 138 of the Financial Services and Markets Act 2000 (HM Treasury, *Implementation of the Electronic Money Directive: a consultation document*, October 2001, paragraph 16).

Any entity wishing to issue electronic money is required, unless they have a waiver, to apply to the Financial Services Authority for authorization. Where an issuer of electronic money is established in the United Kingdom, or where they are established outside the European Union but carry out their business in the United Kingdom, they must apply for permission to carry on regulated activities under the provisions of Part IV of the Financial Services and Markets Act 2000. Where the applicant is an electronic money institution (ie they are not a bank), they are limited, in accordance with the provisions set out in the Electronic Money Directive as outlined above, to making an application for the issuing of electronic money. It is also necessary for a bank to apply for permission to issue electronic money.

Where an entity is established in other European Union Member States, and it carries on its activities in the United Kingdom, it will be required, under article 20 of the Banking Consolidation Directive, to go through a process of acceptance as part of the passport rights set out in Part

II, Schedule 3 to the Financial Services and Markets Act 2000. The passport rights also apply to entities that only issue electronic money, because the definition of credit institution in the Banking Consolidation Directive was amended to include an electronic money institution (Directive 2000/28/EC of the European Parliament and Council of 18 September 2000 amending Directive 2000/12/EC relating to the taking up and pursuit of the business of credit institutions (OJ 27.10.2000 L 275/37) Article 1(1)). Care should be taken to consult Chapter 2 of the Financial Services Authority *Authorisation Manual* to determine whether the entity is carrying on regulated activities in the United Kingdom.

Supervision by the Financial Services Authority

The Financial Services Authority supervises the issuers of electronic money by way of the *Authorisation Manual* and the *Handbook Relating to Electronic Money*. Further guidance is contemplated, the purpose of which is to help people with electronic payment schemes understand whether any of their proposals involve the issuing of electronic money, and to help those using a particular type of pre-paid electronic payments mechanism (such as air-time on mobile telephones, premium rate services, electronic travellers' cheques or trust arrangements) to understand the status of the mechanism under the Financial Services and Markets Act 2000. A consultation exercise was initiated that ended in May 2003. At the time of writing, consultation paper, CP172 *Electronic money: Perimeter guidance* remained current, although it will be superseded by a policy statement and definitive version of the new text for the *Handbook*.

Electronic money is not subject to the Financial Services Compensation Scheme (The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2002 Statutory Instrument 2002 No 682 Regulation 9J), although issuers of electronic money are subject to the Financial Ombudsman Scheme (Financial Services Authority, "The Regulation of Electronic Money Issuers Feedback on CP 117", page 33).

The Treasury decided to exclude electronic money issuers from the remit of the Financial Promotions Order. This means issuers of electronic money will be subject to the Advertising Standards Authority rules, although the Financial Services Authority have indicated that it will apply its principles for business and take action against an issuer if a firm's communications with its customers was so bad as to call into question the probity of the firm, its senior management or both (see "The Regulation of Electronic Money Issuers Feedback on CP 117" page 31).

Waiving the regulations

Under article 8 of the Electronic Money Directive, competent authorities in Member States have the authority to waive the application of some or all of the provisions of

the Directive and the application of the Banking Consolidation Directive, where the electronic money institution only operates within the territory of the Member State, for which see recital 15. The aim of the waiver is to permit those that issue electronic money in small quantities, or where a money issuer is located in a precise geographical site (such as within the confines of a university or company), to carry on their activities without requiring them to abide by the full rigour of the regulation. The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2002 (Statutory Instrument 2002 No 682), provides for the alternative regime that applies to issues of electronic money coming within the waiver. The criteria to obtain a certificate of waiver are set out in new regulation 9C (4):

"(a) A ["A" is the applicant] does not issue electronic money except on terms that the electronic device on which the monetary value is stored is subject to a maximum storage amount of not more than 150 euro; and

(b) A's total liabilities with respect to the issuing of electronic money do not (or will not) usually exceed 5 million euro and do not (or will not) ever exceed 6 million euro."

Further, the electronic money issued by the applicant can only be issued as a means of payment by, in accordance with regulation 9C(5)(c):

"(i) subsidiaries of A which perform operational or other ancillary functions related to electronic money issued or distributed by A; or

(ii) other members of the same group as A (other than subsidiaries of A)."

Where the above conditions are met, further limitations are imposed by the provisions of regulation 9C(6)(b);

"(b) electronic money issued by A is accepted as a means of payment, in the course of business, by not more than one hundred persons where –

those persons accept such electronic money only at locations within the same premises or limited local area; or

those persons have a close financial or business relationship with A, such as a common marketing or distribution scheme."

For the purposes of regulation 9C(6)(b)(i), the locations are to be treated as situated within the same premises or limited local area where they are situated within a shopping centre, airport, railway station, bus station, or campus of a university, polytechnic, college, school or similar educational establishment; or the geographical area does not exceed four square kilometres, in accordance with regulation 9C(7). Where a certificate is issued, the applicant is required to provide information regularly as required by regulation 9G (Financial Services Authority *Handbook*, Electronic money, Chapter 8, "Small e-money issuers").

It is to be noted that an electronic money issuer that obtains a waiver is subject to the Money Laundering Regulations 1993 and the Financial Services Authority Money Laundering Rules, because the activity of issuing electronic money comprises the “issuing and administering means of payment” within the meaning of item 5 of Annex I to the Banking Consolidation Directive. However, where an issuer obtains a waiver and is known as a “small e-money issuer”, customers do not have a claim under the Financial Services Compensation Scheme because the scheme only applies to claims in connection with regulated activities (Financial Services Authority *Handbook*, Electronic money, Chapter 8, “Small e-money issuers, para 8.3.1.4”). 

- The author wishes to thank Anne Crossfield, barrister, of Barristerweb The Internet Chambers, for her comments on the draft of this article.

Stephen Mason

www.stpaulschambers.com

The author is barrister and the author of *Electronic Signatures in Law* (LexisNexis Butterworths, 2003) and *E-mail and the internet at work: a concise guide to the legal issues* (Pario Communications Limited, 4th edn, 2004). Stephen specializes in advising organizations in relation to their e-risks.

© Stephen Mason, 2004