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ETNO Reflection Document on the European Commission Consultation Paper on the application of the E-money Directive to mobile operators

Executive Summary

The tentative conclusion that *“e-value stored on mobile phone pre-paid cards that is used to pay third party products and services is indeed likely to be e-money”* seriously concerns ETNO members, many of which have leading European mobile affiliates. Only 2-4% of the pre-paid financial volume is used for third party payment services. Applying E-money Directive regulation to the whole account and handling it through a subsidiary company would be disproportionate, very burdensome for undertakings whose core business is unrelated to the issuance of e-money, and would endanger the system’s current simplicity and user-friendliness.

ETNO wishes to see a list of criteria to determine which types of activity fall under the scope of the E-money Directive and recommends that the Directive be revised as soon as possible to take into account the evolution of technologies and businesses that will allow the development of new digital content and services.

As the representative of 41 major European telecom operators, ETNO welcomes the opportunity offered by the European Commission’s consultation paper to provide the Commission services with an overview of the impact of the E-money Directive (henceforth “the Directive”) on business activities of mobile operators. ETNO, as a trade association, does not intend to answer the specific questions raised in the consultation document, this will be done individually by its member companies, but instead aims to provide general comments on the issue which may prove useful to the Commission in the development of solutions to the problems identified.

The Commission’s tentative conclusion that *“the e-value stored on mobile phone pre-paid cards that is used to pay third party products and services is indeed likely to be e-money”* seriously concerns ETNO members, many of which have leading European mobile affiliates, given the impact that this may

have on the regulation of pre-paid services strongly linked to communication services provided by mobile operators.

ETNO's main concern is the impact that inadequate and disproportionate regulation of pre-paid mobile services might have on the incentives and ability of leading electronic communications providers to provide new digital content and services over mobile networks.

General remarks

ETNO believes that there is a lack of understanding of the business activities and business models of mobile operators based on pre-paid cards. The intention of the Directive vis-à-vis the mobile sector is being considered now as opposed to during its drafting process. The result is a discussion on the legal definitions, which does not fit the reality of the market or the initial purposes of the Directive of promoting consumer choice. Consequently one of ETNO's key recommendations is that the E-money Directive be revised as soon as possible to take into account the evolution of technologies and businesses.

The Directive can be seen to be the first financial services legislation to overlap with the electronic communications regulatory framework, the effect of this being the risk of suffocating the development of the emerging market for mobile payments and, by extension, content and services currently being rolled-out by mobile operators.

The regulations foreseen in the E-money Directive are not proportionate for the activities of undertakings whose core businesses are unrelated to the issuance of e-money, such as mobile services. Mobile operators are hybrid institutions where the core business is not the provision of payment services but rather the offering of services that require a payment mechanism. Moreover, regarding the background of a proposal on a new legal framework for payment in the internal market, the Commission should attend to keep consistency between this new legal framework and the possible review of the E-money Directive to certain mobile services in order not to over regulate mobile activities.

Impact of the Directive on mobile operators businesses

ETNO welcomes the Commission's recent attempts, through the Banking Advisory Committee (BAC) and its working group on the interpretation and application of the banking directive (GTIAD), to clarify the scope of the Directive with regards to mobile pre-paid accounts but fears that the tentative conclusion reached regarding the applicability of the Directive *"the e-value stored on mobile phone pre-paid cards that is used to pay third party products and services is indeed likely to be e-money"* is not satisfactory for mobile operators and the services they offer.

The Directive does not take into account "hybrid institutions" such as those offered by mobile operators pre-paid cards, which offer customers both mobile telephony services and mobile content services that may potentially

fall under the scope of the e-money requirements. The effect of this is over-regulation on mobile operators' activities, potentially regulating the whole pre-pay account when only a limited amount of the account (usually 2% - 4%) is being used for true payment services. Regulation of the entire pre-pay account (e.g.: through a subsidiary company) would be disproportionate and cause considerable problems for hybrid institutions such as mobile operators.

ETNO members strongly believe that the impact on hybrid institutions of the conclusion reached by the GTIAD should be fundamentally revisited by the Commission. ETNO wishes to stress that the means of payment constituted by mobile pre-paid cards are not accepted by any other party other than the mobile operators themselves (which are also the issuers). In this context, any reference to the relationship between the operator and the merchant is entirely irrelevant.

In the meantime, the establishment of a set of criteria, possibly in the form of a non-exhaustive list, to be used to determine whether certain activities fall under the scope of the Directive or not, could bring much needed clarity for mobile operators' activities. ETNO members understand that if a regulatory authority considers pre-paid premium services to be e-money then those obligations under financial regulation have to be applied proportionately to the actual risks involved.

Micropayments

The E-money Directive has proved to be an inappropriate tool to regulate micro-payments for digital goods and content delivered over networks because it does not appear to be proportionate. Mobile operators are focussing on micro-payments for mobile content (i.e. services delivered over a mobile network in the form of paid-data for consumption over a mobile device) and the amounts in question are relatively limited. Despite growth prospects, these are predicted to remain so in the foreseeable future. The current percentage of content in relation to average revenue per user (ARPU) in the year 2003 is 1.4%. It is estimated that this will grow to 4.5% by 2007. Therefore the current E-money Directive is disproportionate to the level of micropayments involved, and to the low consumer risk associated with such amounts.

The onerous rules and regulations under the E-money Directive regarding micropayments are both disproportionate and disincentivising for the mobile industry. The failure to find solutions to accommodate these new low value electronic transactions - which should be considered as emerging services - could well mean the withdrawal of existing services from the market and less choice for consumers, as a consequence of over-regulation. Therefore, the Directive should not apply to the emerging micropayment services for digital goods and content delivered over mobile networks.

“Premium rate services” offered by mobile operators

As mentioned previously, ETNO is seriously concerned about the outcome of recent discussions that appear to indicate that all pre-paid funds used for payments, including that for digital content offered via mobile operators, should be classified as E-money. For ETNO, the definition of e-money should not cover current pre-paid mobile services such as premium rate services for digital content. Mobile pre-pay customers pay for these services using the pre-paid value stored electronically in a centralised account on the mobile network, or on a SIM card issued by a mobile operator. This stored value can only be used by the customer with his/her mobile operator for mobile telecommunications services that include premium services. ETNO is not aware of any risks or benefits for consumers which would justify financial regulation of premium rate services.

Premium messaging services have experienced high growth and have been a huge success. This is the result of the preponderance of free market rules open to new players, thus allowing it to evolve without any regulatory interventions that may try to artificially modify its natural evolution.

The key to success of this market can be summarised as follows: commercial freedom, beneficial agreements for the various market players, who are paid for their services based on the value they provide, speed and flexibility. These conditions have made the success of these services possible. Therefore, it is necessary that they are not altered so that the market can continue to grow and new services can be developed. This should occur without imposing ex-ante regulations that seriously affect emerging markets and upset the existing balance between revenue and cost, and provide value for the various players, or defining business models, thus robbing the market of its own and unalienable responsibility.

The pre-paid premium rate services currently being marketed by mobile operators are undoubtedly pioneering services in the emerging market for mobile data services. Pre-payment options will also play a fundamental role in the success of new 3G digital content services. Should the final outcome of the interpretation of the Directive be that premium rate services are considered as e-money services, without modifying the obligations coming from such an interpretation, this would force mobile operators to stop offering them for pre-paid customers and to go through the costly and lengthy procedure of separating these services, possibly having to offer them via a different account and/or subsidiary. It is very likely that customers will not accept to deal with several separates accounts for mobile telephony and digital goods. This would sacrifice the market and the very reason why (simplicity and user friendliness) these services were developed for customers in the first place. In order to address this situation, the Commission will have to clarify which services are to be classified as e-money, and how waivers would apply.

Applicability of the E-money Directive on mobile operator's pre-paid activities

ETNO acknowledges that there may be circumstances when pre-paid mobile accounts, may fall under the scope of the E-money Directive. However, it is unlikely that any of these services will ever be able to fully

develop under the current, burdensome regulations. In particular the capital and funding requirements, the limitation of investments, the fund redeemability obligation, the need to create a separate entity to manage e-money accounts as well as the application of money laundering provisions, are burdensome conditions. The regulatory conditions to comply with the Directive are not proportional. A striking and important example is the money laundering regulation which was initially designed for dealers of high value goods. However, in the E-money Directive money laundering obligations are applied in an undifferentiated way to providers of micropayments (understood to be payments with a value less than 10 euros) as providers of macropayments.

Recommendations

Given the Commission's specific interest in receiving views from stakeholders on the impact of a supplementary legal framework, ETNO believes that the following measures should be enabled by national and EU regulatory authorities without delay:

- There should be no spill-over from financial regulation into other areas outside its scope, i.e. an **ex post monitoring mechanism** could ensure that only the alleged 'e-money' element of the mobile prepaid float would be regulated.
- Regulators should clearly aim to avoid onerous **regulatory obligations** where possible. In this context, mobile operators could satisfy the regulators' need to supervise financial flows and financial stability by reporting on 'e-money' floats maintained at an agreed level; this would be more proportionate than requiring operators to establish separate legal entities.
- **Redeemability** rules must be adapted to the inherent risks to consumers. "Hybrid institutions", such as mobile operators, which provide 'e-money' alongside their own communications services, could satisfy these obligations by allowing consumers to use their 'e-money' for communications services instead.
- Current **money laundering rules** applied to mobile are far from effective or proportionate. In particular, it should be noted that mobile operators do not offer person-to-person payments and this considerably reduces money laundering risks. Rather than registering and identifying individual prepay consumers, this check could be done with merchants who establish contractual relationships with operators. This would tackle money laundering risks in a more effective way.

Conclusion - proportionate and pragmatic ways forward

In light of the above, ETNO members believe that there is a clear need to review the E-money Directive in a technologically neutral manner with regard to its appropriateness and proportionality to the services offered through pre-paid accounts by hybrid institutions such as mobile operators. Clearly, the current regulatory requirements contained in the Directive are as disproportionate for mobile operators as for other e-money issuers. This inappropriateness is likely to continue to have a negative effect on the

development of mobile payment services, if the interpretation of the Directive does not fundamentally remedy existing problems. A thorough analysis of the characteristics and realities of developments in the market for mobile payment services should allow for an informed assessment of the risks involved and determine the most suitable and least intrusive measure to mitigate, if any, the risks identified.

The main reason for the success of mobile operator's services is their simplicity and user-friendliness. A key feature of this being that one does not have to determine in advance the purpose of pre-payment usage. Electronic communications' operators are committed to developing new digital content and services business models for mobile networks. This will require investments by mobile operators in upgrading existing content billing systems (in terms of flexibility, speed and security) to allow for the development of pricing strategies and payment models to best suit the demands of customers. It is therefore essential that the impact of any payment regulation does not put these developments into jeopardy. It is crucial that the services remain simple and easy to use at the consumer interface level. This is a fundamental requirement for any service to be accepted by consumers.

ETNO members are confident that practical long-term solutions can be devised with regulators and encourage financial regulators across the EU/EEA to engage with telecommunications regulators in order to better understand the sector-specific characteristics of the mobile sector. ETNO members hope that the points made in this contribution may provide a useful insight for the relevant Commission services into some of the broader concerns regarding the application of the E-money Directive to the activities of mobile operators and looks forward to seeing these concerns addressed in the Commission's future report on the application of the E-money Directives due to the Council by April 2005.