

# Summary of Responses to the Electronic Money Discussion Document

15th May 2007



Financial Supervision Commission Bannánte Oaseirys

## **SECTION I**

### **I. INTRODUCTION**

The Commission has been charged with the development of a regime to regulate electronic money (“e-money”) providers operating in or from the Island.

A Discussion Document, summarising the proposed approach to the regime and inviting comments, was issued by the Commission on 14 December 2006 with a deadline for responses of 2 February 2007.

There were a total of 13 responses received; the breakdown of the respondents was as follows:

<b>Respondent</b>	<b>Number</b>
IOM Government Departments	4
IOM E-money providers	3
Banks	2
UK Financial Services Authority	1
IOM IT firms	1
Isle of Man Institute of Chartered Accountants	1
Member of the public	1

In general, the responses were supportive of the proposed approach. The comments made were largely seeking to clarify issues at a lower level of detail, rather than objecting to the general principles outlined in the document.

The next step is to produce draft regulations for the approval of the Board of the Financial Supervision Commission. The draft regulations will be released for consultation in due course.

This document provides a summary of the responses to the questions included in the discussion document. Where appropriate, the Commission’s opinion follows those responses.

## **SECTION 2**

### **2. RESPONSES TO THE DISCUSSION DOCUMENT QUESTIONS**

#### **1. Do you believe a definition of e-money based upon the UK definition would be suitable for Isle of Man based e-money providers? In particular:-**

- **Do you think this covers all appropriate e-money products and services?**
- **Is there a danger that this definition might include products and services that should not be subject to these regulations?**

- “We believe that companies offering “intermediate wallet solutions / account based schemes”, who provide electronic money transfer services (but do not issue, at this point in time electronic money) should still be regulated under this proposal. For the purpose of this proposed regulation would the above model be included as in the UK FSA Perimeter Guidance Manual?”

- “There are not just "e-cards" and "e-wallets" to be considered, but also payments by means of mobile phones, web based or e-mail or text-linked transmission services etc.”

- “We consider that an exemption may need to apply to store cards or “points” cards where value can be earned in one store and redeemed for products and services elsewhere.”

- “Monetary value should be broad enough to include points or something that is not a currency unit and extend to where the person to whom the e-money is allocated has not paid funds (e.g. a bonus account).“

#### **Commission’s response**

*The Commission proposed replicating the UK definition as it is an established definition. If the UK definition is adopted, the intention is to follow the guidance issued by the FSA relating to account based schemes, thus including them within the regime.*

*The definition is intended to be technology neutral, so the device used to store, or facilitate the use of, electronic money will not affect the application of the regulations.*

*The views received differed on the appropriate scope of the regulations, with some favouring a broader definition that will include schemes which have similar properties to e-money solutions. The Commission is also aware of the EU’s forthcoming Payment Services Directive which may lead to a variation in the application of their existing Electronic Money Directive. The views received and the EU developments will be taken into account in settling on a definition of regulated activities.*

*In parallel to the development of the e-money regulations, the Commission is also considering the development of a suitable regime for Money Service Businesses (MSBs). Those offering electronic money transmission will be subject to the MSB regulations if their activities fall outside the scope of the e-money definition.*

## **2. Do you have any comments on the restrictions of activities applying to e-money providers?**

- “Credit would allow for flexibility regarding access to funds prior to cleared receipt.” (2 respondents made this comment)
- “We believe that there should be restrictions in order to prevent e-money providers becoming deposit takers or banks.”

### **Commission’s response**

*The Commission believes that relaxing the general prohibition on the offering of credit, to allow e-money operators to issue e-money prior to the clearance of a funding payment, would be appropriate. If credit is offered it must be funded from the e-money provider’s own funds and not clients’ money. In addition, a robust credit control process will be necessary. The other requirements, including the need to always hold assets equal to the value of e-money in issue, will still apply.*

## **3. Do you believe that e-money providers should be permitted to pay interest on outstanding e-money balances?**

- “It may be more commercially acceptable to allow interest to be applied provided that this would not cause an e-money issuer to be regulated as a bank.”
- “Yes, for interest also read bonus vouchers, points etc. This would be a potentially useful marketing tool but no obligation either way.”
- “In order to distinguish e-money from “deposits” we agree that interest should not be payable on outstanding e-money balances.”
- “Yes, provided that such a concession does not cause problems in terms of a licensed Isle of Man entity being able to operate in other jurisdictions.”

### **Commission’s response**

*Based on the responses received, the Commission is exploring the possibility of permitting e-money providers to offer interest on client balances. If interest payments are allowed, providers will be expected to treat all customers consistently, either offering interest payments to all or choosing not to offer interest.*

## **4. Do you foresee any problems with the application of the licensing requirements to the e-money operators?**

- “We feel that this should be applied in order to ensure that there is a 'level playing field' between e-money providers and other providers of payment provision.”
- “A balance will have to be struck in relation to outsourcing, between what an issuer may want to locate on the Isle of Man and what the FSC needs to be here for effective supervision.”

### Commission's response

*The Commission believes it is appropriate to apply the principles underlying the existing policies on licensing and outsourcing to e-money providers. However if, based on the nature of the business, e-money operators considered it essential to have a business structure that differs from more traditional financial institutions, consideration will be given to varying the requirements. Ensuring "mind and management" is on the Island will remain a key requirement.*

### 5. Are there expectations as to the anti-money laundering requirements which should be applied to e-money issuers? Would waivers of the type applied in the UK be suitable?

- "The approach for verifying customers should take into consideration the need to minimise barriers to the take up of these new products whilst addressing the risks of money laundering."
- "We are of the opinion that e-money providers should be subject to the standard AML requirements that apply to all other licensed entities."
- "Can we make the assumption, at this stage, that the revised AML requirements will reflect changes such as "electronic verification" which are currently included in the UK AML Guidance Notes?"
- "We would suggest that a more flexible approach to controls is appropriate, with more acceptance of alternative checks and evidence, and de minimis levels above which greater checks would be required."
- "We believe that anti-money laundering requirements should be specific to the e-money industry as is the case with online gambling."
- "The UK risk based approach is appropriate as is the ability to verify customer identity electronically."

### Commission's response

*E-money providers will be subject to the AML Code. However sector specific guidelines will be issued that reflect the circumstances applicable to the industry. These guidelines will take account of the risks arising from the non-face to face nature of the business, whilst acknowledging that traditional methods of verification may not be suitable particularly for low value transactions.*

### 6. Do you favour a regime where all customer balances are held in a segregated client account rather than "on balance sheet"?

- "On balance sheet providers should only be licenced banks."
- All other respondents that expressed an opinion favoured segregated client accounts for e-money providers (6 responses).

## Commission's response

*The Commission's favoured approach is for segregated client accounts. For licensed deposit takers offering e-money services, there may be freedom to take what would otherwise fall to be dealt with as client money 'on-balance sheet', although there are other factors, such as the applicability of the Depositors Compensation Scheme, which will need to be considered.*

### 7. What level of Minimum Net Tangible Assets do you believe would be appropriate for an e-money provider:

- a) holding balances in a segregated client account?
- b) holding balances on balance sheet?

- "Off Balance sheet should have the same capital requirements as other fiduciary providers."
- "Notwithstanding the on or off balance sheet debate, UK requirements are considered appropriate."
- "We do not consider that the number of employees should be a criteria for assessing the size of the company for capital adequacy, particularly where activities are outsourced. In addition, we consider that "turnover" should be defined for the purposes of capital adequacy assessment."
- "We would favour a minimum paid up Share Capital of EUR1,000,000 together with segregated client accounts."
- "We agree with the suggestion of a tiered approach based on size of the company."
- "I would say that the business should have working capital equal to a formula such as three months total running costs. If the cash deposits are protected then the formula applies to both large and small companies."

## Commission's response

*The Commission believes the minimum net tangible asset requirements for the segregated client account approach should have a base level in the region of the figures quoted in the discussion document (£75,000 to £175,000). Consideration is now being given to the specific levels to be applied and if and how these should vary based on the size of the operator.*

### 8. Do you foresee any difficulties with the ongoing liquidity requirement?

- "No don't foresee any issues with ongoing requirements, other than the ability to monitor on a daily basis"
- All other respondents that commented did not foresee problems with the liquidity requirements (3 responses).

**9. Do you have any views on the types of investments or on the approach to treasury management that should be permitted for management of client money?**

- “I think we should approach this by saying companies need to have 100% of client cash balances readily available and set a timeline for readily available.”
- “We believe the management of funds should involve the holding of low risk assets and should match the liquidity profile of client moneys.”
- “I would be reluctant to offer behavioural adjustments - if this is not a banking relationship, on demand should be on demand.”

**Commission’s response**

*The key requirements are that the provider can at all times cover the full amount of outstanding e-money in issue and meet all liabilities, arising from clients’ transactions and redemption requests, as they fall due. To ensure the requirements are met, the Commission will require the provider to hold either cash or a mix of cash and liquid, low-risk assets. For any non-cash holdings the issuer will have to demonstrate that the risk and liquidity profile is appropriate to satisfy all contractual responsibilities.*

**10. Are the proposed record keeping requirements likely to pose any problems for e-money providers?**

- “Where outsourcing arrangements are in place, this could mean that records are held off Island and the wording of the regulations need to take this into consideration.” (3 respondents raised similar comments)
- “The record keeping period is six years and this is in excess of the Anti-Money Laundering Code which requires records to be retained for five years.”
- “The record keeping requirements for e-money providers should follow the same requirements for other licensed entities.”
- “We think it is important to clarify whether “electronic” documents are included.”

**Commission’s response**

*The current Anti-Money Laundering Code requires that records “containing evidence of identification of applicants for business are kept on the Island, or alternatively, that a record be maintained on the Island which contains such information as would allow a copy of such evidence to be obtained”. This principle will be applied. The requirements relating to accounting records are also being considered.*

*The period quoted in the discussion document for the retention of AML records was incorrect; this should have stated 5 years – consistent with the AML Code.*

*Where documents are stored electronically the retention requirements will be the same as for paper records. Where there is reliance on electronic images of documents, the images will need to be created and stored in a way which ensures they have equivalent status to the original paper documents.*

**11. Is there any other data on which you feel e-money providers should be required to maintain records?**

- “I think we should encourage sharing of industry data such as problem accounts.”

**12. Do you have any comments on the proposed frequency and content of the reporting requirements?**

- “We would urge the Commission to ensure that breaches should be reportable on an immediate basis, rather than capturing these as part of the quarterly reporting requirement.”

- “We would be interested as to whether a standard report pack would be issued for completion.”

- “We consider that there should be a defined period for the preparation of audited accounts.”

**Commission’s response**

*The regulations will include a requirement to notify the Commission of material breaches as they arise.*

*The specific reporting requirements, including format and content, will be covered in the regulations and / or within associated guidance.*

*Consistent with other regulated entities, there will be a period of 4 months, from the annual Accounting Reporting Date, to provide the Commission with the audited accounts.*

**13. Is the proposed approach to system verification suitable? Is there an alternative approach that you feel is preferable?**

- “In our opinion, audit firms may not have the required experience and it may be cost prohibitive to resource this experience from elsewhere.”

- “With regards to audit we should allow audit by technical professionals with industry recognised security qualifications.”

- “The approach is acceptable although it must be acknowledged that ‘back office’ processes may be outsourced.”

- “I think it would be useful to provide some basic mission statement here like “the systems should be secure such that customer data is not lost should there be a systems failure of any sort and secure from access by any unauthorised sources”.”

**Commission’s response**

*The Commission believes that system verification is an important control and should apply to the end-to-end solution regardless of whether third parties are involved.*

*The intended approach is that the regulations will contain general principles on the need to prove system suitability, with associated guidance indicating how we would expect adherence with those principles to be demonstrated.*

*The Commission agrees that it is important that any independent person expected to verify compliance has the appropriate skills and can be employed directly by the e-money provider.*

#### **14. Do you have any comments to make in relation to the redeemability of e-money?**

- “Why is there a limit? For cash transfer businesses surely if you pay in you can get your money back at any time.”

- “We suggest that redemption is more accurately defined as it could be construed as money being used in the system, i.e. is money considered redeemed when it is provided back from a gambling company or spent with a retail operation or only when paid back to the client from the e money provider?”

#### **Commission’s response**

*The Commission expects the redemption arrangement to be covered in the contract between the provider and the client. The suggested minimum redemption requirements and the minimum period of validity are not intended to be guidelines on how schemes should be operated. Rather they set down limits preventing operators imposing more onerous conditions.*

*The use of redemption here refers to a client converting their e-money balance, or part of it, back to cash. It is not concerned with the transfer of e-money to, or receipt of e-money from, a third party.*