

# Electronic money: taking up, pursuit and prudential supervision of the business of electronic money institutions

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## **OPINION OF THE EUROPEAN CENTRAL BANK on a proposal for a Directive on the taking up, pursuit and prudential supervision of the business of electronic money institutions.**

On 30 October 2008, the European Central Bank (ECB) received a request from the Council of the European Union for an opinion on a proposal for a directive of the European Parliament and of the Council on the taking up, pursuit and prudential supervision of the business of electronic money institutions, amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC.

**General observations:** the objective of the proposed directive is to open the market for the issuance of electronic money by electronic money institutions (ELMIs), which are regulated under a lighter prudential regime than the one applicable to credit institutions. The ECB supports the review of Directive 2000/46/EC on the taking up, pursuit of and prudential supervision of the business of electronic money institutions, as this recognises that the Directive is not entirely in line with the current market expectations as regards the issuance of e-money. At the same time, the ECB has serious concerns regarding the proposal to change the legal definition of ELMIs from ‘credit institution’ to ‘financial institution’, as defined in Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions (recast). This may have wide-ranging consequences for the conduct of monetary policy. In the same vein, the proposed directive poses concerns from a supervisory perspective, as it lightens the supervisory regime for ELMIs while simultaneously broadening the scope of their activities.

**Specific observations:** the European Central bank makes the following observations:

**(1) Legal nature of ELMIs:** the ECB has serious concerns regarding the proposal to change the legal definition of ELMIs from ‘credit institution’ to ‘financial institution’, as defined in Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions (recast). The ECB notes that, in view of the type of activities which ELMIs will be allowed to undertake under the proposed directive, the legal nature of ELMIs would continue to be equivalent to that of credit institutions as defined in Directive 2006/48/EC - “**an undertaking whose business it is to receive deposits or other repayable funds from the public and to grant credits for its own account**”. This definition relates to the nature of the business transacted, not to the nature of the entity that transacts it. In this respect, it seems clear that irrespective of ELMIs ceasing to be credit institutions under the proposed directive and irrespective of its prohibition on ELMIs taking deposits or other repayable funds, they will de facto continue to take such deposits. More specifically, funds received may be kept for an indefinite period until the holder requests them to be redeemed and issuers of e-money may pay interest on the funds received. In addition, ELMIs will continue to fulfil the other criteria of the business of credit institutions. Therefore, from a legal point of view, it would seem that an ELMI, as defined in the proposed directive, would have features resembling those of credit institutions even more than today since deposit-taking activity remains unchanged and restricted granting of credit will be allowed in the future.

**(2) Monetary policy:** considerations from a monetary policy perspective strongly support that ELMIs should continue to be classified as credit institutions, contrary to the suggestion made in the proposed directive. In this respect, the ECB is of the view that the concerns relating to monetary policy clearly outweigh the rationale underlying the proposed directive to align the regulatory framework applicable to

ELMIs with that applicable to payment institutions as defined in Directive 2007/64/EC, which are not covered by the definition of credit institution.

At the same time, the ECB welcomes the fact that the proposed directive to a large extent maintains the redeemability requirements contained in Directive 2000/46/EC. Redeemability is a core issue from a central bank point of view. ELMIs must, therefore, be legally obliged to redeem e-money for central bank money at par value at the request of the holder of the e-money.

Moreover, the ECB notes that the proposed directive implies that the holder of e-money can request to be redeemed, at any moment, at 'the monetary value of the electronic money held'. The provision in question does not mirror the content of Directive 2000/46/EC according to which the holder can choose between being redeemed at par value in both coins and banknotes or by transfer to an account. For reasons of legal clarity and to ensure consistent transposition of the provision into the national legislation of the Member States, the ECB suggests amending the proposed directive accordingly to ensure that an e-money holder is free to choose their preferred method of redemption.

**(3) Supervisory framework:** the ECB highlights the following concerns:

- apart from the right of ELMIs and credit institutions to issue e-money, the distinction between ELMIs and payment institutions is unclear, which makes the assessment of risks and related safeguards a challenging task from a supervisory perspective;
- the proposed change in the definition of ELMIs would not reduce risks associated with their activities. By contrast, the impact assessment accompanying the proposed directive does not address the risks that may be associated with the broader range of activities that ELMIs are entitled to undertake;
- clear evidence of the alleged disproportion between safeguarding requirements and actual risks associated with ELMI activities is still missing. There is a clear need to further consider the potential risks associated with the new 'legal nature' of ELMIs to ensure their proper regulatory and supervisory treatment;
- the fairly restrictive nature of Directive 2000/46/EC in terms of the options that it leaves e-money issuers to make a profit through the issuance of e-money has been relaxed in the proposed directive. This proposed amendment may prove positive for the industry's future growth. However, the significant liquidity and default risks which an ELMI may face, if it is allowed to invest in any kind of assets, must be taken into account;
- the proposed directive raises the thresholds for identification and customer due diligence requirements in accordance with Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing. However, these thresholds do not correspond to the thresholds in Directive 2007/64/EC. A substantial increase of the current thresholds would facilitate anonymity in payment transactions and increase money laundering and financing of terrorism risks associated with the issuance of e-money, in particular through the acquisition of multiple prepaid cards.

**(4) Legal and technical comments:** the ECB highlights the need for clarification of Recital 5 of the proposed Directive in relation to "limited networks" and mobile phone operators' exemption from the scope of application. Moreover, the ECB recommends an amendment to the definition of e-money, specifying that any funds received can only be used for the sole purpose of electronic transfer of funds from the e-money holder to its payees.